

Equity Income Builder Strategy

3Q11

Market Review and Outlook

Just when you think you have seen it all, it gets crazier. During this past quarter, investors have gone through the gamut of emotions, as it began to dawn on observers that we never really came out of the recession. As companies reported good earnings in July, they also took note of the difficult business conditions. Many of them commented on the partisan bickering over the federal debt limit that was having a huge impact on already fragile consumers. The market began to drift lower on recession fears, but saved its worst decline for when the rating on U.S. Treasury obligations was downgraded.

We put out an interim memo on August 8th, discussing risk, the difference from past debacles and the likelihood that we were seeing peak pessimism. The selling climax of that Monday established a low for the overall stock market that, through this writing, has withstood several assaults, despite news flow that has been awful. Fear abounds regarding the debt of several European countries. That fear spreads to banks that might or might not be over-exposed to those bonds. Recently, China has shown signs of slowing growth, adding to the gloom about the economy.

Policy failures led to a renewed downturn during the Great Depression in 1937. We have discussed in earlier commentaries the dangers of policy mistakes as economies try to recover from the long unwinding of too much debt that had been built up during the prior couple of decades. While we understand that the United States has too much debt, we are dismayed by the calls for immediate federal debt reduction during this struggling attempt at an economic recovery. It is hard for us to understand the so-called wisdom of “cutting” our way to prosperity. Unfortunately, the decades old attempts at achievement of common goals by the people and our government have given way to a disregard or disdain for the hardships that too many are facing, through no fault of their own.

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Michael Clarfeld, CFA **Managing Director, Portfolio Manager**

- 11 years of investment industry experience
- BA in History from Duke University

Hersh Cohen **Managing Director, Senior Portfolio Manager**

- 42 years of investment industry experience
- PhD in Psychology from Tufts University
- BA from Western Reserve University

Peter Vanderlee, CFA **Managing Director, Portfolio Manager**

- 12 years of investment industry experience
- MBA from New York University, Leonard M. Stern School of Business
- MS in Math/Computer Science from the University of Technology, Eindhoven, Holland

Our biggest concern since 2008 has been from where jobs would come. Our inability to figure that out has been behind our forecast of continued economic weakness. Each time something is cut from the federal or local budgets, somebody's job is at risk. Bloated budgets need to be addressed, but only on a very long-term time horizon. Pro-growth policies seem to be constantly pushed into the background. Repatriation of foreign profits,

reform of the broken tax system, and approval of projects that would create jobs are among things that could help. Federal Reserve policies are designed to foster massive refinancing of home mortgages, which would also help. Regrettably, the Fed's low-rate policy has had a deleterious effect on those people dependent upon fixed income securities.

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With respect to financial markets, we have discussed ad nauseam how the ultra-low interest rates are forcing people and institutions to step out on the risk scale to try to capture more returns. At exactly the time when it seems necessary to add to stock holdings of quality companies with superior dividends, the volatility is scaring people away. When we think about protecting clients, we examine every possible consideration. As we look through our stock portfolios, we actually find it difficult to discern overpriced stocks that need to be sold. And that includes our belief that earnings estimates for 2012 are probably too high. Even adjusting for possible flat or declining earnings, most stocks are at levels that already factor in a good deal of wariness.

These are, as we state above, unprecedented times for the country. Interest rates, extreme partisan political fighting, and the unwinding of a debt bubble are things that can create havoc for savers and investors. We are doing our best to balance risks against the needs of clients. We continue to feel that equities of high-quality companies with good balance sheets, good business models and sound dividend practices, are the single best asset class, particularly if investors can look beyond the violent swings in both directions.

Strategy Highlights

In terms of absolute returns, none of the 10 industry sectors in the Fund's portfolio had positive returns for the second quarter. The consumer staples and health care sectors made marginally positive contributions to Fund returns for the quarter, while the financials, industrials and energy sectors were the leading detractors.

Relative to the benchmark Russell 3000 Value Index, both the Fund's overall stock selection and overall sector allocation contributed to performance for the third quarter. In particular, stock selection in the information technology (IT), energy, financials, industrials, consumer staples, health care, consumer discretionary and telecommunication services (telecom) sectors contributed to relative performance for the quarter, while selection in the utilities sector hurt it for the quarter. As for allocation, overweights to the consumer staples and utilities sector helped relative performance, as did an underweight in the financials sector and the Fund's cash position. An overweight in the materials sector and an underweight in the health care sector detracted from relative performance for the period.

Top contributors to Strategy performance during the third quarter included Kimberly-Clark Corp. in the consumer staples sector, Apple Inc. and Oracle Corp. in the IT sector, Bristol-Myers Squibb Co. in the health care sector and American Electric Power Co. in the utilities sector. The bottom contributors to performance included Total SA in the energy sector, JPMorgan Chase & Co. and MetLife Inc. in the financials sector, Xerox Corp. in the IT sector and 3M Co in the industrials sector.

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PORTFOLIO MANAGER COMMENTARY



Over the course of the quarter, we established new positions in a number of companies including those in Anheuser-Busch InBev N.V. ADS in the consumer staples sector, Eaton Corp. in the industrials sector, Qualcomm Inc. in the IT sector, Johnson Controls Inc. in the consumer discretionary sector and Westfield Group Australia in the financials sector.

We also closed a number of our existing positions, including those in U.S. Bancorp and Simon Property Group Inc. in the financials sector, Great Plains Energy Inc. in the utilities sector, Reed Elsevier PLC and Thomson Reuters Corp., both in the consumer discretionary sector, Linear Technology Corp. in the IT sector, Abbott Laboratories in the health care sector, SandRidge Mississippian Trust in the energy sector and BHP Billiton Ltd. ADS in the materials sector.

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Past performance is no guarantee of future results.

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