PORTFOLIO MANAGER COMMENTARY

CLEARBRIDGE ADVISORS
A LEGG MASON COMPANY

Institutional Aggressive Growth Strategy 4Q09

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Market Review

The U.S. equity market finished 2009 with its third straight quarterly advance as the S&P 500 Index (S&P 500) gained nearly 6% in the fourth quarter, while for 2009 it gained 23%, its best year since 2003. The market's recovery since the lows of the past spring was remarkable, with the S&P 500 gaining 65% from its 12-year low on March 9 through the end of the year. Perhaps more notable, however, was the fact that stocks closed the decade below where they began it, with the S&P 500 dropping 24% over the last 10 years for an average decline including dividends of 0.9% a year since 1999, the first decade of negative annualized returns for the S&P 500 since its inception in 1927.

In our prior commentaries this year, we wrote much in defense of equities and explained why we felt, using history as a guide, that the market levels seen in late 2008 and early 2009 could be "generational lows, off of which an advance could be dramatic and long-lasting." Last quarter, we gave the reasons why we expected to begin to see a shift in performance leadership from the more credit-sensitive parts of the market to higher-quality, secular growth companies. We stressed that, at that point in the cycle, we felt a premium should be placed on consistency and growth of earnings and cash flows, inexpensive valuation and balance sheet flexibility, all of which are hallmarks of our strategy.

Portfolio Highlights

In terms of absolute performance, the Strategy had positive returns in all seven of the 10 economic sectors in which it was invested during the fourth quarter. The greatest contributions to fourth-quarter performance came from the energy, information technology (IT) and consumer discretionary sectors, while the smallest contributions came from the health care, financials and materials sectors.

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Relative to the benchmark, the Strategy's overall stock selection contributed to performance while its overall sector allocation had a negative effect during the fourth quarter. In particular, stock selection in the energy and IT sectors made significant contributions to relative performance, with smaller contributions coming from stock selection in the materials, consumer discretionary sectors. However, stock selection in the health care sector and, to a lesser extent, the financials sector detracted from relative performance for the period.

In terms of sector allocation, the Strategy's overweight to the consumer discretionary sector and its underweights to the consumer staples, industrials and utilities sectors (it held no stocks in consumer staples or utilities during the period) helped relative performance for the quarter. Overweights to the health care and energy sectors and underweights to the IT and materials sectors detracted from relative performance for the quarter.

Leading individual contributors to Strategy performance for the fourth quarter included UnitedHealth Group Inc. and Forest Laboratories Inc. in the health care sector, SanDisk Corp. and Cree Inc. in the IT sector, and Cablevision Systems Corp. in the consumer discretionary sector. The bottom individual contributors to Strategy performance for the quarter included Weatherford International Ltd. in the energy sector, Genzyme Corp. and Amgen Inc. in the health care sector, Nokia Corp. (ADR) in the IT sector, as well as Fluor Corp. in industrials.

Market Outlook

As we enter a new year and decade, we remain constructive on the equity market and particularly our portfolio positioning. As growth managers, we feel stock selection is important given the current economic background of slow U.S. GDP growth, a choppy housing market and a consumer more inclined to save than spend. We believe companies that can grow on a sustainable basis in this environment are those which are innovative at their core, are fiscally disciplined, and in many cases are generating an increasing percentage of their revenues from emerging markets.

In no sector of our portfolio is innovation more a focal point than in our biotechnology holdings within the health care sector. Using our bottom-up, fundamental-driven process, we have identified what we think are leading-edge biotech firms developing novel methods to treat unmet medical needs. They are typically focused on treatment of diseases like cancer, Multiple Sclerosis and Alzheimer's, among others, for which there is no current cure. As the long-debated health care reform legislation nears a conclusion, the risk/reward relationship for this group appears favorable. It is our belief that sales of drugs that improve lives, make individuals healthier, keep them out of hospitals and avoid critical care, will continue to thrive. In addition, balance sheets of our holdings in the industry typically remain pristine, with lots of cash and high cash flow rates. Additionally, Biotech industry consolidation is a broad trend that we expect to continue, if not accelerate.

Within the IT sector, some of our best performing stocks in 2009 were those that were able to smartly invest throughout the cyclical downturn and improve their market positioning in preparation for the recovery of world economies. In this sector as well, companies that have continued to invest in new technologies have been rewarded. LEDs, flash memory, smaller and higher capacity hard disk drives are all examples of technologies within the sector where innovation has benefited shareholders. We continue to focus on those companies which we feel have both the necessary balance sheet strength and the technological prowess to enable their continued long-term growth.

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Finally, we remain firm believers in the growth prospects of energy sector companies that have been able to use science to identify new sources of hydrocarbons around the world, and energy-sector service companies whose technologies facilitate their extraction or streamline their production. We believe opportunity exists to invest in energy companies that have expanded their business in North America but also (and more importantly) in areas like Latin America, North/West Africa and parts of the Middle East and Asia that were previously undiscovered.

Over the last 10 years the equity markets have weathered, among other things, the collapse of the dot-com bubble, the attacks of 9/11, Hurricane Katrina, and most recently, the housing and credit-driven crisis. While we do not know what new challenges and opportunities the coming decade will bring, we feel confident that our investment discipline remains strong and believe our portfolio is well positioned to grow.