

Market Commentary

The S&P 500 Index continued on a tear last month, posting its best April showing since—you guessed it—1938. The S&P's two-month gain is its best since 1933. The market's advance since its intraday low of 666.79 on March 6, and closing low of 676.53 on March 9, has been broad-based and powerful. Through Wednesday, May 6, the S&P 500 is up +38.02% from its intraday low to its intraday high of 920.28, and a nearly as impressive +35.92% on a closing basis. The advance—while clearly a welcome change for the bulls—has been a bit of a problem for the bears and those sitting on the sidelines, since no correction, thus far, has lasted longer than two days.

TOTAL RETURNS

	April	YTD
S&P 500 Index	+9.57%	-2.49%
Dow Industrials	+7.56%	-5.86%
Nasdaq Composite Index	+12.40%	+9.26%
S&P MidCap 400 Index	+14.87%	+4.93%
Russell 2000 Index	+15.46%	-1.81%
Dow Jones US Total Market Index	+10.52%	-1.16%
S&P 100 Index	+7.81%	-4.96%
Russell 1000 Growth Index	+9.60%	+5.09%
Russell 1000 Value Index	+10.72%	-7.85%

Sources: Dow Jones, Russell®, NASDAQ® (via Bloomberg), S&P (via Bloomberg)

Veteran market strategist Steve Leuthold believes the market's powerful advance since early March is the first leg of a new cyclical bull market, rather than just a bear market rally. While acknowledging that there is no foolproof way to tell the difference, one strong indicator is the strength of the market's initial advance, as measured by the extent to which it rises above its 50-day moving average. In Leuthold Group's April monthly letter, strategist Doug Ramsey notes that the "S&P 500 closed +13.3% above its 50-day moving average on May 4, the highest reading since October 1982 (two months off the secular bear market low recorded in August 1982). For the readers looking for a "bear-killing" indicator, this may be the one. No S&P bear market rally has ever been able to achieve a momentum reading this high."

Market strategist Ned Davis also believes the market's recent advance has a different feel than prior bear market rallies since mid-2007. In a piece entitled "Trust the Thrusts," Davis notes that his research group identified a

number of breadth thrust buy signals in mid-March from a variety of work measuring price change, advances versus declines, and advancing volume versus declining volume. Based on this work, Davis has been predicting a "monster rally" in the market.

Another indication that we may be in the early stages of a new cyclical bull market is the stark change in market leadership that took place in April. After rewarding defensive behavior for the better part of two years, the market pulled the old "switcheroo" in April, as prior laggards, the financials, shot up +22.36% for the month, joined by consumer discretionary stocks (+18.64%), industrials (+17.85%), materials (+15.19%) and technology (+12.09), while traditionally defensive groups such as health care (-0.74%), utilities (+0.63%), consumer staples (+3.28%), telecom services (+3.56%) and energy (+4.85%) lagged badly. Again, quoting from Leuthold's April monthly, "the speed and severity of this rotation (though painful for some) is very bullish for the stock market outlook, because these rotations are always the most violent coming off bear market lows."

As impressive as the rally in the U.S. market has been, it is below average when compared to dollar-based gains overseas. As shown below, the S&P 500 bested only returns in Japan and Shanghai in April. The average monthly gain of 14.7% for the nine foreign markets listed below is more than 500 basis points better than the S&P 500's April return. Emerging markets—China, Russia, Korea and India—are the clear winners year-to-date, up an average of +26.5%, while the five developed markets are mirroring the S&P 500's decline, down an average of -2.9%, even including the +8.5% gain in Hong Kong's Hang Seng Index.

TOTAL RETURNS IN U.S. DOLLARS

	April	YTD
FTSE 100 Index (UK)	+12.13%	-1.18%
DAX Index (Germany)	+16.59%	-7.20%
CAC 40 Index (France)	+13.17%	-6.34%
MICEX Index (Russia)	+22.19%	+31.94%
NIKKEI 225 (Japan)	+9.36%	-8.12%
Hang Seng Index (HK)	+14.52%	+8.46%
Kospi Index (So. Korea)	+20.97%	+22.96%
Shanghai SE Comp. (China)	+4.59%	+36.16%
BSE Sensex 30 Index (India)	+18.82%	+14.83%

Source: Bloomberg

The extreme pessimism exhibited by investors in early March as measured by a number of sentiment indicators tracked by Ned Davis Research (NDR) also suggests that an important bottom may have been put in place. These include record lows in consumer confidence and analysts' expectations for earnings growth, as well as record cash levels. Davis notes that for the first time since they began tracking the data, the American Association of Individual Investors (AAII) Survey showed investors holding more cash than stocks. This finding is confirmatory of NDR's own research which showed money market fund assets to be a record 44% of the total market value of stocks in early March 2009.

Sentiment measures have improved somewhat off their lows, but investors appear to remain generally skeptical of the advance, if not outright negative, despite a better than +35% gain in the S&P 500. Mutual fund investors continued to give the market a thumbs-down in March, as net outflows from U.S. equity mutual funds rose to \$16.4 billion, a +16% increase from February's \$14.1 billion. Net flows out of the domestic equity mutual fund category have now been negative for the last nine months in a row. It will be interesting to see if flows remained negative in April, when that data becomes available.

Looking at the longer-term returns on stocks, it is not hard to see why investors are discouraged. Through the first quarter of 2009, the one-, three-, five- and 10-year annualized total returns of the S&P 500 are -38.3%, -13.2%, -4.8% and -3.0%, respectively. Over the corresponding time intervals, 10-year U.S. Treasuries have delivered annualized returns of +9.7%, +10.3%, +6.2% and +6.8%, respectively. The 980 basis-point annualized return differential (-3.0% vs. +6.8%) between the S&P 500 Index and the 10-year Treasury over the last 10 years is an all-time record since 1926. The extended period of poor stock market returns has severely shaken investors' confidence in the long-term outlook for equity investing. It will take a lot more than a two-month rally in stocks to convince many of them otherwise, in our judgment.

## Outlook

In our opinion, the pieces appear to be falling into place that will lead to a recovering economy and a durable market advance. As noted above, we are encouraged by the positive action of the stock market itself, since it is one of the most reliable leading indicators of economic activity. As also noted, market strength such as we have seen since early March is more typical of a new bull market than a bear market rally. We also take encouragement from the fact that as the broad averages made successive new lows in October and November 2008 and in March 2009, the number of individual stocks making new lows contracted sharply. This

is an important characteristic of market bottoms, as it indicates that more and more individual stocks are resisting further decline.

In addition to the market action itself, a growing number of signs (so-called "green shoots") are emerging that the economy may be stabilizing, setting the stage for a recovery beginning later this year or early next. We're not sure who originally coined the term "green shoots," but since Fed Chairman Ben Bernanke used it in a March 15, 2009 segment on *60 Minutes* as a metaphor for early signs of an incipient economic recovery, the phrase has enjoyed widespread usage. ISI Group has even taken up a global green shoots watch, with the latest count totaling 98 as of May 6. Numbers 95, 97 and 98 were upturns in the manufacturing and services PMIs in the U.S., Eurozone and Singapore, respectively. Number 96 was a sharp upturn in nominal retail sales in Australia. Without fully enumerating ISI's other 94 green shoots, we can say that they relate broadly to signs of stabilization in the housing market, an end to the sharp inventory liquidation cycle that slashed real GDP in 4Q 2008 and 1Q 2009, a slowing in the rate of job losses in the U.S., a rebound in consumer spending in 1Q 2009 from sharp declines late last year, a sextupling in refinancing activity brought about by a -1.75% drop to 4.8% in 30-year fixed-rate mortgages, a surge in junk and investment-grade bond issuance and improving credit spreads across a wide range of fixed-income markets.

Fed Chairman Bernanke echoed many of the same themes as ISI Group in his testimony before Congress's Joint Economic Committee on May 5, calling particular attention to signs of stabilization in the housing market, albeit at still depressed levels. Bernanke attributed the probable bottoming out of the housing market to the combined positive effects that falling home prices and falling mortgage rates have had on housing affordability, which has jumped to record levels recently, by several measures. Bernanke's current forecast is that the economy is in the process of bottoming and will turn up later this year. His forecast is conditioned on continuing improvement in the credit markets, which he sees as the most likely course of events. Importantly, Chairman Bernanke believes that "given the sizable margin of slack in resource utilization and diminished cost pressure from oil and other commodities, inflation is likely to move down some over the next year relative to its pace in 2008." If Bernanke's forecast is correct, and right or wrong, it comports reasonably well with our own, it would create a near ideal backdrop for an improving equity market, in our judgment.

If anything, we think it is possible that the economy may snap back much quicker than most now expect, at least initially. In our view, housing starts and auto sales—now both running well below replacement demand—are poised

for a sharp recovery. In addition, any recovery in industrial demand will likely trigger an inventory-rebuilding cycle, as inventories have been brought in line with a depressed level of sales over the last two quarters. While it now seems hard to imagine a robust economy, historically, sharp drops in economic activity have most typically been followed by sharp rebounds.

In thinking about how what we believe is an emerging bull market might evolve over the next year or so, and what a reasonable upside objective might be, we think it would be instructive to look back at the 2007-2009 bear market, which we believe had two distinct phases, before and after the events of September 2008. From October 2007 to early September 2008, the market, in our view, was undergoing a garden variety bear market, complete with the obligatory financial crisis—the implosion and subsequent “rescue” of Bear Stearns in March 2008—having declined a little over -22% from October 2007 to what then looked like its low in mid-July 2008. By the beginning of September 2008, it actually looked like the market and economy may have begun to recover.

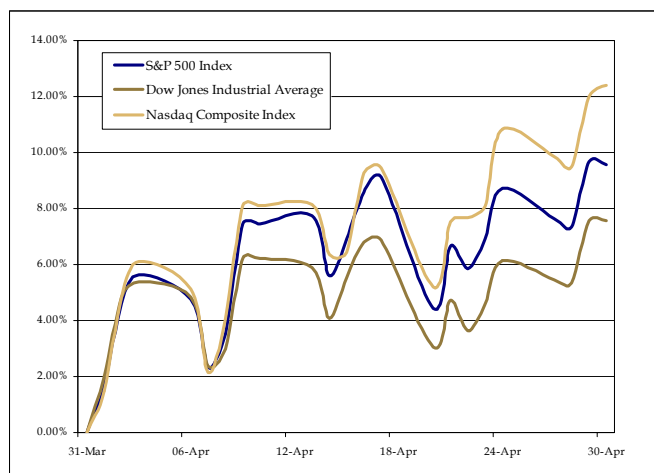
The events of September 2008—specifically the government seizure of Fannie Mae and Freddie Mac on Sunday, September 6, the bankruptcy of Lehman Brothers the following Sunday, and the takeover (take-under?) of AIG on Wednesday, September 17—caused the bear market to morph into a full-blown global financial meltdown, from which it has only recently (we trust) begun to recover. Because meltdowns such as we have recently experienced occur so infrequently, they are difficult for investors to properly assess, with the consequent risk that participants will underestimate the effects initially and, as conditions deteriorate beyond nearly everyone’s worst case assessment, overestimate them ultimately. We think that’s what happened this time, with market participants discounting an unduly high probability of another depression when the S&P 500 touched 667.

With fears of another depression fading, the financial system beginning to heal and hopes of recovery starting to emerge, we think a reasonable objective for the current advance is back to the pre-meltdown price levels that prevailed in September 2008, or roughly 1150 to 1250 on the S&P 500 Index. We won’t get there all at once, and we might not get there by year end 2009, but before this up move is over, we think we will get there, and possibly a good bit higher, depending on how things shake out. After a +35% move off the bottom, we wouldn’t be surprised to see a -10% to -15% correction at any time, but we seriously doubt that we are going back below 700 on the S&P 500.

As always, we thank you for your support and welcome your comments.

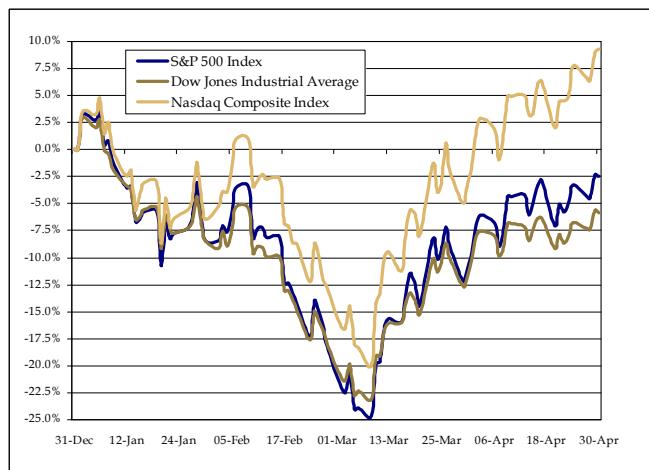
**David E. Nelson, CFA**  
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Major Indices April Performance



Sources: Dow Jones, NASDAQ® (via Bloomberg), S&P (via Bloomberg)

Major Indices 2009 Performance



Sources: Dow Jones, NASDAQ® (via Bloomberg), S&P (via Bloomberg)

Monthly U.S. Market Update (Total Returns)

Index Name	April	YTD
<i>Broad Market Indices</i>		
S&P 500	9.57	(2.49)
Dow Jones	7.56	(5.86)
Russell 1000	10.12	(1.39)
NASDAQ	12.40	9.26
Dow Jones US Total Market Index	10.52	(1.16)
Russell 2000	15.46	(1.81)
Russell 1000 Growth	9.60	5.09
Russell 1000 Value	10.72	(7.85)
<i>S&amp;P 500 Sector Indices</i>		
S&P 500 Consumer Discretionary	18.64	9.04
S&P 500 Consumer Staples	3.28	(7.61)
S&P 500 Energy	4.85	(7.29)
S&P 500 Financials	22.36	(12.88)
S&P 500 Health Care	(0.74)	(8.68)
S&P 500 Industrials	17.85	(6.75)
S&P 500 Information Technology	12.09	16.91
S&P 500 Materials	15.19	12.83
S&P 500 Telecomm Services	3.56	(3.82)
S&P 500 Utilities	0.63	(10.23)

Sources: Dow Jones, Russell®, NASDAQ® (via Bloomberg), S&P (via Bloomberg)

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