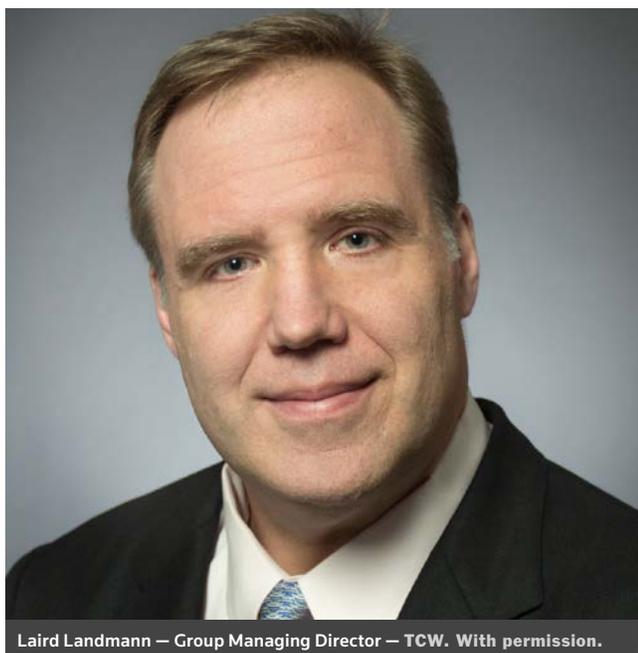




## LIPPER ALPHA INSIGHT

# Fund Manager Briefing: TCW Funds — MetWest Total Return Bond Fund

August 24, 2016



Laird Landmann — Group Managing Director — TCW. With permission.

TCW may not be a fund group overly familiar to European investors, despite forming in 1971. It does, however, enjoy considerable goodwill in the U.S. and the Middle East, especially following its acquisition of Metropolitan West Asset Management (MetWest) in 2010.

Today, TCW is looking to broaden its franchise into Europe, having launched a number of Luxembourg-based feeders into some of its successful U.S. fund range. "We own the second largest bond fund in the U.S., have a 20-year track record, and manage nearly \$200 billion of assets," states Laird Landmann. "We strongly believe our product suite is attractive to European-based investors."

## FUND PHILOSOPHY AND PROCESS

TCW has a long-established fundamental value-driven approach. This is underpinned by the belief of mean-reversion of securities following technical deviations and the identification of "persistent" structural inefficiencies of the bond market. These include rating anomalies, market segmentation, and policy-maker intervention.

**TCW Funds — MetWest Total Return Bond Fund** follows the same securities selection processes as all other TCW funds. It is a broad-based bond fund that contains nearly 500 holdings and is benchmarked to the Barclays U.S. Aggregate Bond Index, investing almost exclusively in U.S.-based issuance. It forms part of TCW's "core" fund offering investing predominantly in A-rated securities or higher and restricting high-yield content to a 20% maximum. It doesn't seek to take huge positions on duration, having only a one-year band either side of the benchmark.

Macro-economic analysis forms an integral part of the TCW process, and the group has four generalist portfolio managers who examine long-term economic outlook and interest rate positioning. However, this is undertaken to the extent of contextualizing the fair value of the securities formed from the fundamental analysis. "Humankind has a predilection to make sense out of chaos, but predicting macro events is unproductive," states Mr. Landmann. "It's an interesting narrative but doesn't return a lot of alpha."

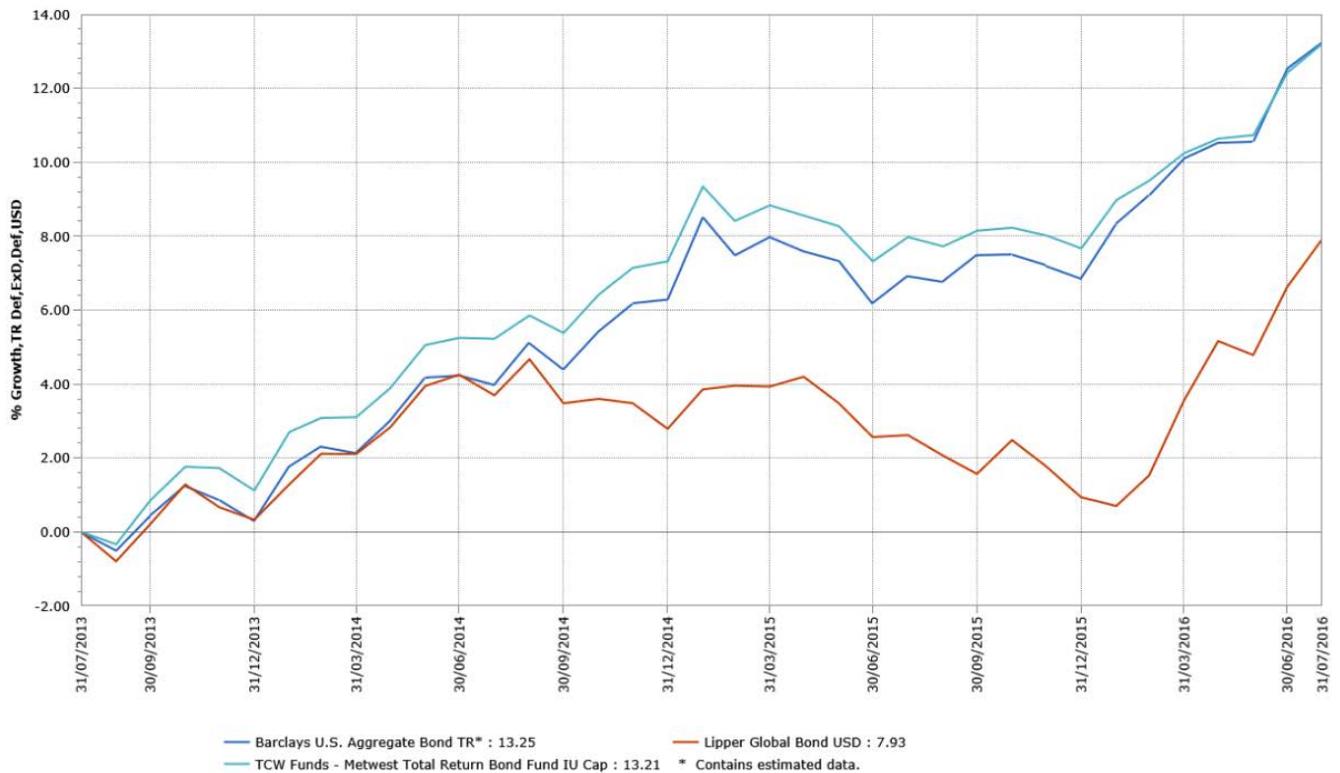
## CURRENT POSITIONING

The fund is currently defensively positioned, with the highest holdings (29%) in U.S. Treasuries and U.S. agencies (26%). This is on the basis that TCW believes the U.S. credit market to be late-cycle. "Companies have used debt to buy back stock or undertake M&A, not invest in capex," states Mr. Landmann. "This is not a healthy sign for the credit cycle. Leverage is rising, incomes are dropping, and risk is increasing in spread assets."

The agencies position is currently providing the yield-kicker to the fund and is an area where TCW sees some relative value. "Ratings agencies are giving some of these lines a bit of flack," says Mr. Landmann. "But you're getting government-backed assets at Libor plus 200." Mr. Landmann also likes non-agency mortgages. "These are deleveraging as homeowners pay down their mortgages. Even if house prices don't rise any further, you are sitting on high-quality mortgage pools."

Mr. Landmann also like U.S. banks, with his favored issuers currently being Bank of America, Citibank, and Wells Fargo.

## Exhibit 1. Three year performance of TCW Funds — MetWest Total Return Bond Fund v benchmark & peer group (to July 31, 2016 in USD)



Source: Thomson Reuters Lipper

On duration Mr. Landmann is also cautious: “The Fed is leading to a rate hike this year. We don’t think the level of real rates merits a substantial risk position to duration, so we are slightly short there.”

### KEEPING SOME POWDER DRY

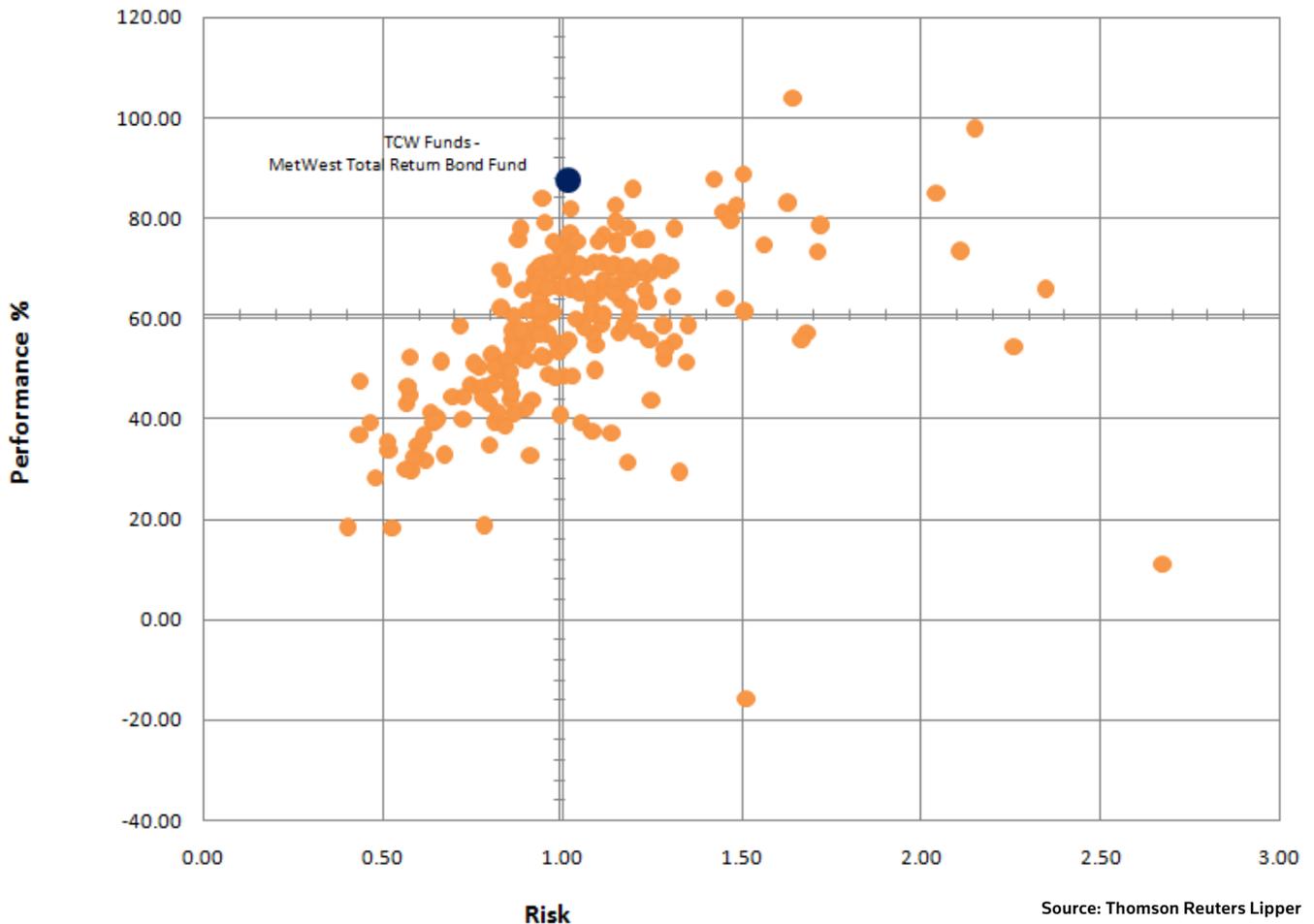
Mr. Landmann is looking to increase exposure to investment-grade credit, but he is not prepared to do so until valuations lower. “We are on a risk budget diet,” Mr. Landmann explains. “Investors have to diet now if they want to feast later.” TCW picked up a small amount of credit during the

market revaluations in February and March of this year, but Mr. Landmann considers a more material rotation toward risk to be most likely in the next 12-18 months.

### OUTLOOK

Despite overall caution with respect to valuations, TCW believes the U.S. bond market is in good health. Corporate issuance has been buoyant, with some \$88 billion of issuance in the first week of August 2016 globally, and substantial demand from non-U.S. institutions and clients turning to the U.S. for yield are providing support.

## Exhibit 2. Ten year risk/ return of TCW Funds – MetWest Total Return Bond Fund (to July 31, 2016 in USD)



With respect to the upcoming U.S. presidential election, Mr. Landmann sees both candidates likely to want to undertake fiscal stimulus, which would put a lower bound on U.S. interest rates. However, he believes a “wild card” for Donald Trump might be the desire to change the leadership of the Federal Reserve or issue “helicopter money,” which may unsettle the market.

### PERFORMANCE

The performance of the U.S. master version of this fund has a very strong risk-adjusted track record, scoring highly

across all Lipper Leader categories (see Exhibit 3, page 4); its I-share collecting a U.S. Lipper Fund Award in 2016. Over ten years **TCW Funds – MetWest Total Return Bond Fund** sits on the border of the favored “northwest” quadrant in its classification’s risk/return profile (see Exhibit 2, above).

The European version of this fund, identically managed but with its shorter performance history, has tracked its benchmark over the last three years in what Mr. Landmann describes as “one of the more challenging periods our style typically faces.” However, it has still done well in its peer Lipper Global-Bond USD category over three years, clearing

### Exhibit 3. Lipper Leaders Profile of TCW Funds – MetWest Total Return Bond Fund to July 2016 for U.S.)

| Lipper Rating As Of 31/08/2016 For United States |               |         |              |              |              |              |
|--|---------------|---------|--------------|--------------|--------------|--------------|
| Rating Type                                      | Country       | Date    | 3 years      | 5 years      | 10 years     | Overall      |
| Total Return                                     | United States | 08/2016 | 3<br>of 188  | 5<br>of 162  | 5<br>of 94   | 5<br>of 188  |
| Consistent Return                                | United States | 08/2016 | 3<br>of 188  | 5<br>of 162  | 5<br>of 94   | 5<br>of 188  |
| Preservation                                     | United States | 08/2016 | 4<br>of 5586 | 5<br>of 4670 | 5<br>of 3034 | 5<br>of 5586 |
| Tax Efficiency                                   | United States | 08/2016 | 4<br>of 188  | 3<br>of 162  | 2<br>of 94   | 3<br>of 188  |
| Expense  | United States | 08/2016 | 5<br>of 92   | 5<br>of 80   | 5<br>of 43   | 5<br>of 92   |

Source: Thomson Reuters Lipper

by over 5 percentage points in U.S.-dollar terms (see Exhibit 1, page 2 ).

#### CONCLUSION

TCW is a well-resourced and highly credible bond house and in the U.S. could be referred to as a “heavy hitter.” Although its reputation in Europe might not be well known, its pedigree will likely impress.

This is a fund for the more risk-averse and larger retail or institutional investor and certainly one disposed to U.S. securities. Mr. Landmann makes it clear that a move into the European market does not represent a move away from TCW’s core value proposition of expertise in U.S. debt.

Jake Moeller met with Laird Landmann, Group Managing Director & Co-Director of Fixed Income – TCW, on May 24, 2016, and August 17, 2016.

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| (%)                        | MWTIX<br>I Share | MWTRX<br>M Share | Benchmark <sup>1</sup>  | Expense Ratio (%)   | I Share | M Share |
|----------------------------|------------------|------------------|-------------------------|---|---------|---------|
| Quarter                    | 0.74             | 0.68             | 0.46                    | Gross   | 0.44    | 0.67    |
| Annualized 1 Year          | 4.82             | 4.48             | 5.19                    | Annual fund operating expenses as stated in the Prospectus dated July 29, 2016. |         |         |
| Annualized 3 Years         | 4.01             | 3.76             | 4.03                    |   |         |         |
| Annualized 5 Years         | 4.84             | 4.60             | 3.08                    |   |         |         |
| Annualized 10 Years        | 6.48             | 6.25             | 4.79                    |   |         |         |
| Annualized Since Inception | 6.54             | 6.65             | 5.42; 5.62 <sup>2</sup> |   |         |         |

The performance data presented represents past performance and is no guarantee of future results. Total returns include reinvestment of dividends and distributions. Current performance may be lower or higher than the performance data presented. Performance data current to the most recent month end is available on the Fund's website at TCW.com. Investment returns and principal value will fluctuate with market conditions. The value of an investment in the Fund, when redeemed, may be worth more or less than its original purchase cost. The index is not available for direct investment; therefore its performance does not reflect a reduction for fees or expenses incurred in managing a portfolio. The securities in the index may be substantially different from those in the Fund.

1 Bloomberg Barclays U.S. Aggregate Bond Index – A market capitalization-weighted index of investment-grade, fixed-rate debt issues, including government, corporate, asset-backed and mortgage-backed securities, with maturities of at least one year. The index is not available for direct investment; therefore its performance does not reflect a reduction for fees or expenses incurred in managing a portfolio. The securities in the index may be substantially different from those in the Fund.

2 The since inception return for the index reflects the inception date of the MetWest Class I, and Class M Share Funds, respectively. For period 3/31/00 – 9/30/16; 3/31/97 – 9/30/16.

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