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MUTUAL FUND PROFILE

What the Largest Active Bond Fund Is Buying Now

Move over, Bill Gross and Jeff Gundlach. Make way for Tad Rivelle, of MetWest Total Return Bond fund.

By Lewis Braham

While two fund titans—the erstwhile Pimco superstar Bill Gross and his rival, DoubleLine's Jeff Gundlach—have long vied for the title of bond king, a democratic insurgency is rising to prominence.

A self-effacing team of four managers—Stephen Kane, Laird Landmann, Tad Rivelle, and Bryan Whalen—now run the largest actively managed bond fund, the $78.6 billion Metropolitan West Total Return Bond (ticker: MWTRX). That compares with Pimco Total Return's (PTTAX) $74.2 billion; DoubleLine Total Return Bond's (DLTNX) $54.5 billion; and Gross' new charge, the $1.9 billion Janus Global Unconstrained Bond (JUCTX).

The MetWest team has quietly worked together without any celebrity managers for two decades.

If all of this seems irrelevant, consider: MetWest Total Return saw its largest historical inflows, $31.2 billion, in the seven months following Gross' blowup and departure from Pimco in September 2014. Also, the MetWest team stepped in to manage the TCW Total Return Bond Fund Class (TGMNX) after Gundlach's spectacular dismissal there, after which he founded DoubleLine in December 2009. Moreover, MetWest's three founding members—Landmann, Rivelle, and Kane—are all Pimco alums, and all three firms are within a short distance from one another in Southern California. They all fish from the same pool of bond analysts and traders.

Perhaps most important, MetWest has

Portfolio Managers (l to r) Bryan Whalen, Tad Rivelle, Laird Landmann, and Steve Kane manage MetWest Total Return Bond – now the largest active bond fund.

triumphed largely because of its expertise in mortgage-backed bonds and its savvy macro calls. The dual skill set has proved to be a winning formula. In the past 15 years, the fund has delivered a 5.7% annualized return, besting 93% of its peers, including Pimco Total Return's 5.2%. "We've had a Gold rating on this fund since we started issuing the [medal] ratings in 2011," says Karin Anderson, a Morningstar analyst who covers the fund. "We really like the team behind this fund."

MetWest's four primary managers are called "generalists" and devise the top-down macro themes and overall allocations for the fund. They interact with 65 other investment professionals, including 13 senior portfolio "specialists" who pick individual securities, as well as analysts and traders. Aside from performance, Anderson says, the stability and depth of MetWest's team are what lured Pimco investors after Gross left.

While macroeconomic analysis is essential to MetWest's investment process, the team isn't known for making bold macro

(over please)

MetWest Total Return Bond

	Total Returns[1] 1-Yr	5-Yr	10-Yr
MWTRX	0.8%	3.4%	5.6%
Bloomberg Barclays US Agg Bond Index	0.7	2.3	4.3

Credit Quality[2]	Fund %	Index
U.S. Treasury	28.9	44.1%
U.S. Agency	25.9	22.3
AAA Rated Credit	8.1	4.4
AA Rated Credit	5.1	4.8
A Rated Credit	15.4	10.7
BBB Rated Credit	9.8	13.8
BB & Below Credit	5.2	0
Average bond duration	5.6 years	6.0 years
SEC Yield [1]	1.89%	2.6%[3]

1. Performance and SEC Yield as of 3/29; 5- and 10-year performance annualized. 2. Allocations as of 2/28. 3. Yield on iShares Core U.S. Aggregate Bond ETF as indexes don't have SEC yields.

Sources: Metropolitan West; Morningstar; XTF.com

calls. "A lot of what we do as value investors is just picking up quarters and pennies in different markets," Rivelle says.

Right now, there isn't much loose change. "Since mid-2014 to the present, we've been gradually upgrading the portfolio and getting more defensive across the board with respect to credit risk," says Kane. The fund loaded up on both high-yield bonds and low-quality mortgage bonds, or nonagency bonds, in the years after the 2008 crash. Its weighting in debt rated below BB got as high as 20%—the maximum allowed for this fund—in March 2012. Today, that weighting is 5%. By 2014, "we came to the conclusion that we were entering the later stages of the credit/business cycle," Kane says.

One example of today's safer bets would be in utilities like Duke Energy (DUK) and Duquesne Light Holdings, since people pay their electric bills even during downturns. "We like first mortgage bonds of regulated utilities, which are effectively liens on assets, as opposed to unregulated utilities heavily involved in generation," says Landmann.

The team also piled into short-term bank bonds this January when an oversupply of issuance caused prices to fall. "The yields on one-year senior bank debt—JPMorgan (JPM), Bank of America (BAC), Citigroup (C)—were basically the same as debt out in the five-year area," says Whalen. "It's not the sexiest story, but we're in a fairly defensive posture."

More unusual value plays would be buying short-term Japanese bonds, which on the surface appear to pay negative yields. But because Japanese investors are willing to pay a premium for U.S. dollars, U.S. investors earn interest on the currency conversion. "That's a trade we've been in for a year to two years," Rivelle says. "We've been able to earn 1% to 2% on 30- to 90-day obligations with the only risk factor being that of Japanese sovereign debt"—the equivalent in Japan to U.S. Treasury bills.

Another under-the-radar investment is corporate bonds for nonprofit hospitals like New York Presbyterian Hospital. "These are bonds for local monopolies, many of them university teaching hospitals, that have not only good cash flow, but a lien on hospital buildings," says Landmann. "You're getting BBB-type bond yields for A-rated paper. Because they're not as well understood, these are areas where you can pick up yield without taking on additional credit risk."

THE FUND TAKES a conservative stance; its holdings are not that different from the Bloomberg Barclays US Aggregate Bond index from a credit-quality and bond-sector perspective, says Todd Rosenbluth, director of mutual fund research at CFRA. The defensive portfolio has caused the fund to trail its peers in the past three years by 0.11 percentage point.

While nonagency bonds aren't nearly as attractively valued as they once were, they still offer a better risk-reward payoff than high-yield bonds, Landmann says. Yet the asset class has shrunk as old securities have matured and new ones haven't been issued since the crash. "When the mortgage market blew up 10 years ago, the nonagency part was a $3 trillion market," Rivelle says. "Today that market's about $500 billion." That means the fund's holdings represent a much bigger segment of the total market.

Landmann says fund size isn't a problem: "Were we not to have grown, and this fund was, say, $35 billion, we would be positioned exactly the same as we are today."

MetWest Total Return Bond Fund Performance (MWTIX, MWTRX) | As of March 31, 2017

(%)	MWTIX I Share	MWTRX M Share	Benchmark[1]
Quarter	0.91	0.76	0.82
Annualized 1 Year	0.93	0.70	0.44
Annualized 5 Year	3.70	3.46	2.34
Annualized 10 Year	5.80	5.57	4.27
Annualized Since Inception[2]	6.23	6.38	5.12, 5.36

Expense Ratio (%)	I Share	M Share
Gross	0.44	0.67

Annual fund operating expenses as stated in the Prospectus dated July 29, 2016.

TCW Total Return Bond Fund Performance (TGLMX, TGMNX) | As of March 31, 2017

(%)	TGLMX I Share	TGMNX N Share	Benchmark[1]
Quarter	0.83	0.76	0.82
Annualized 1 Year	0.31	-0.07	0.44
Annualized 5 Year	3.97	3.66	2.34
Annualized 10 Year	6.32	6.01	4.27
Annualized Since Inception[3]	6.53	6.03	5.37; 4.95

Expense Ratio (%)	I Share	N Share
Gross	0.60	0.87
Net[4]	0.49	0.79

Annual fund operating expenses as stated in the Prospectus dated February 28, 2017.

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.

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 – 3/31/17; 3/31/97 – 3/31/17.

3 The annualized since inception return for the index reflects the inception date of the TCW Class I and Class N Share Funds, respectively. For periods 6/17/93 – 3/31/17; 3/1/99 – 3/31/17.

4 Effective February 28, 2017, the Advisor has contractually agreed to cap the expenses (excluding interest and acquired fund fees and expenses, if any) of the I share class of the Fund at 0.49% and the N share class of the Fund at 0.79% until March 1, 2018.

FUND RISKS

It is important to note that the Fund is not guaranteed by the U.S. Government. Fixed income investments entail interest rate risk, the risk of issuer default, issuer credit risk, and price volatility risk. Funds investing in bonds can lose their value as interest rates rise and an investor can lose principal. Mortgage-backed and other asset-backed securities often involve risks that are different from or more acute than risks associated with other types of debt instruments. MBS related to floating rate loans may exhibit greater price volatility than a fixed rate obligation of similar credit quality. With respect to non-agency MBS, there are no direct or indirect government or agency guarantees of payments in pools created by non-governmental issuers. Non-agency MBS are also not subject to the same underwriting requirements for the underlying mortgages that are applicable to those mortgage-related securities that have a government or government-sponsored entity guarantee.

INDEX DISCLOSURE

GENERAL DISCLOSURE

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