

Metropolitan West High Yield Bond M MWHYX

Morningstar's Take | 08-17-08 | by Paul Herbert, CFA

Metropolitan West High Yield Bond is taking its foot off of the brake pedal.

Those in charge of running this fund have been in a cautious mode going back a few years after the high-yield market rallied sharply in 2003 and 2004. They've moved up in quality and have also favored bank loans, to the tune of more than 20% of assets. They've also favored more-defensive sectors such as utilities and have taken short positions in certain retail, home building, and financials names. Broadly, this positioning held the fund back in 2006, as lower-quality fare soared, but it has helped the fund beat the pack in 2007 and so far in 2008.

The fund's bosses now think taking on a little more risk is warranted, though. The junk market is offering more yield (relative to Treasury bonds) than it has in years, and opportunities have arisen in investment-grade space. Securities backed by airplane leases have looked cheap to them lately, as investors nervous about the commercial airlines' woes have run for the exits. But the managers argue that demand isn't going to slow down, and there's money to be made if you focus on deals with newer planes and safer structures. The team also aims to capitalize on weakness by scooping up subordinated bonds of higher-rated money center banks. Not only do these securities offer compelling payouts relative to below-investment-grade paper, but the brass expects financials will recover ahead of other industries when the credit cycle turns upward.

There are risks to taking these steps, to be sure, but we aren't overly concerned that the fund is set up for a fall. The financials positions could suffer if the capital market's recovery is drawn out. But in all, the team has a lot of experience with the types of securities it has been acquiring, and its overall positioning, in terms of credit-rating and sector leanings, remains on the cautious side.

Plus, the fund's evergreen advantages in terms of research acumen, a small asset base, and low fees make it a winner.

Paul Herbert, CFA, is a senior fund analyst with Morningstar.com.

Morningstar Rating

★★★

Kudos

- The fund's expense ratio is now being capped at 0.80%.
- Metropolitan West has provided the fund with the resources to be successful.

Risks

- Like other high-yield bond funds, it is sure to be volatile at times.
- The fund's flexible approach can make it a bit unpredictable.

Strategy

Like other high-yield bond funds, this one invests heavily in bonds rated BB and below. Management attempts to limit the fund's downside risk by looking closely at asset value, cash flow, and seniority in evaluating specific issues. It also makes top-down adjustments based on its outlook for interest rates and the overall bond market. In 2003, for example, the fund took on a little more credit risk than its average high-yield peer. More recently, however, management has been more defensive, as evidenced by the fund's increasing stake in higher-quality shorter-term bonds.

Management

On March 6, 2006, Jamie Farnham replaced Mark Unferth as lead manager here. Farnham joined Metropolitan West as a credit analyst in 2002 and became its director of credit research in late 2004. Comanagers Gino Nucci, Tad Rivelle, David Lippman, Stephen Kane, and Laird Landmann also contribute here. The team is supported by a group of six analysts who follow different sectors of the market.

Inside Scoop

This high-yield bond fund's managers emphasize issuers with solid asset values and the ability to generate cash flow while keeping an eye on value. The fund won't appeal to those looking for benchmarklike exposure to the sector, as the advisor's edge is in issue selection.

Role in Portfolio

Supporting Player

Metropolitan West High Yield Bond M MWHYX

Year	Total Return (%)	+/-Category
YTD	-1.96	1.33
2008	—	—
2007	2.73	1.26
2006	8.74	-1.40
2005	3.28	0.69

Data through 08-31-08

Metropolitan West High Yield Bond Fund (M-Class) ★★ ★

3-Star Overall Morningstar Rating based on risk-adjusted returns as of 6/30/08 among 476 High Yield Bond Funds.

NET PERFORMANCE TOTAL RETURNS - As of June 30, 2008

	Q2 '08	YTD	1-year	Annualized			
				3-year	5-year	10-year	Since Inception
MWHYX (Inception: 09/30/2002) ¹	2.41%	-1.24%	-1.99%	4.20%	6.41%	-	10.62%
Lehman US Corp HY - 2% Issuer Cap ²	1.95%	-1.08%	-1.74%	4.48%	6.83%	-	10.25%
Lehman US Corp HY ²	1.76%	-1.31%	-2.26%	4.55%	6.92%	-	10.41%

The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. Performance data current to the most recent month-end may be obtained at www.mwamllc.com. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. The fund offers another class, the performance for which will vary due to fees and expenses. You should consider the investment objectives, risks, charges, and expenses of the Metropolitan West Funds carefully before investing. A prospectus with this and other information about the Funds may be obtained by calling (800) 241-4671 or you can download one at www.mwamllc.com. It should be read carefully before investing.

For MWHYX the total expense ratio is 1.05% and the net expense ratio is 0.80%. Expenses reflect a contractual agreement by the Adviser to reduce its fees and/or absorb expenses to limit the Fund's total annual operating expenses for the current fiscal year. The Adviser voluntarily extended the agreement for the current fiscal year, and expects to renew the contractual expense limitation each year in May. For more information about fees and expenses, please read the prospectus.

¹ Total return figures assume reinvestment of all distributions. Total returns reflect fee waivers in effect. Without fee waivers, returns would have been lower.

² The Lehman Brothers US Corporate High Yield Index is generally representative of corporate bonds rated below investment-grade and is an unmanaged index not available for direct investment. The 2% Issuer Cap is a component of the Lehman Brothers US Corporate High Yield Index. Inclusion is limited to 2% of the market value of the index. The securities in the Fund may differ substantially from those in the index. Unlike a mutual fund, the performance of an index assumes no taxes, transaction costs, management fees or other expenses.

Bond Funds have the same interest rate, yield and credit risks associated with the underlying bonds in the portfolio, all of which could reduce the Fund's value. As interest rates rise, the value of the Fund can decline and an investor can lose principal. High yield investments by the Fund in lower-rated and non-rated securities presents a greater risk of loss of principal and interest than higher-rated securities. The Fund may also not be suitable for all investors due to its use of sophisticated investment instruments such as derivatives.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five- and ten-year Morningstar Rating metrics. The Metropolitan West High Yield Bond Fund M-Class was rated 3 stars for the 3-year period and 3 stars for the 5-year period against 476 and 413 U.S.-Domiciled High Yield Bond Funds, respectively. Morningstar ratings are for the M share class only; other classes may have different performance characteristics. Past performance does not guarantee future results.

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