

Metropolitan West High Yield Bond M MWHYX

Analyst Report

by Paul Herbert, CFA

Morningstar's Take | 10-05-07

Metropolitan West High Yield Bond's cautious view has been paying off.

The bosses at Metropolitan West have been positioning the various funds in their stable rather conservatively throughout 2007. Broadly, they have had concerns about the health of the economy and bond valuations. The managers running this fund also don't like trends specific to corporate bonds such as higher debt loads and loose bondholder protections. They have been on the defensive, preferring higher-rated junk bonds and focusing on issuers in noncyclical areas such as cable, telecom, health care, and utilities. Bank loans, which feature higher-priority claims on assets than bonds do, took up 24% of the fund's assets lately.

This reined-in approach worked well lately. Troubles for lower-quality mortgage borrowers hit the bond market during the summer, and investors didn't spare the high-yield market. Like its category peers, this fund lost money during June and July. In part, its struggles were due to entities such as hedge funds and similar players dumping bank loans because they were easier to offload than bonds. But the abovementioned emphases and some good tactical moves, such as using derivatives to benefit from price declines in homebuilders' and retailers' bonds, helped the fund to top its peers. The fund's relative outperformance has buoyed its year-to-date gain, which ranks better than 62% of its peers'.

The managers remain skeptical about high yield's prospects. Valuations have improved since early in 2007, and the Federal Reserve has lowered interest rates, which has been known to help corporate bonds along. Still, the chiefs continue to brace for more tumult, selling off some of the fund's exposure to the automakers and swapping into bonds with better asset backing. The risk to this stance is that the fund would lag in a low-quality rally, as it did in 2006. Given the uncertainty around the economy, defaults, and valuations, we like this focus on protecting capital.

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Year	Total Return (%)	+/-Category
YTD	3.47	0.59
2007	—	—
2006	8.74	-1.40
2005	3.28	0.69
2004	9.26	-0.73

Data through 09-30-2007

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.

The fund recently lost an experienced manager.

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 Fund (M-Class) ★★★★★

4-Star Overall Morningstar Rating based on risk-adjusted returns as of 9/30/07 among 454 High Yield Bond Funds.

Net Performance Total Returns as of 9/30/07	Q3 '07	Year to Date	1-Year	ANNUALIZED			
				3-Year	5-Year	10-Year	Since Inception 9/30/2002
MWHYX ¹	-0.15%	3.38%	6.81%	6.71%	12.73%	-	12.73%
Lehman US Corp High Yield - 2% Issuer Cap ²	0.40%	3.36%	7.60%	7.14%	12.37%	-	12.37%
Lehman US Corp High Yield ²	0.33%	3.22%	7.55%	7.45%	12.65%	-	12.65%

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 4 stars for the 5-year period against 454 and 386 U.S.-Domiciled High Yield Bond Funds, respectively. Past performance does not guarantee future results. Morningstar Ratings are for the M share class only; other classes may have different performance characteristics.

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