

Metropolitan West Strategic Income M MWSTX

Analyst Report

by Scott Berry

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This intriguing young mutual fund may blaze a new path for bond investors.

Metropolitan West Strategic Income isn't a typical bond mutual fund. Though most bond funds look very much like the benchmark indexes they are measured against, this fund doesn't even have a benchmark index. The trouble with benchmarks is that if an index is suffering, the fund competing with the index is likely also suffering. This fund avoids that scenario by focusing on delivering positive absolute returns in all market environments—its stated goal is to outperform 90-day Treasury bills (a risk-free investment) by at least 2 percentage points.

Its portfolio looks nothing like a Treasury fund, though. The fund was created in part to take advantage of Metropolitan West's best ideas. And those best ideas can include strategies, such as interest-rate timing, arbitrage trading, and junk-bond investing, that plain-vanilla bond fund managers often avoid. The logic here is that those strategies combine to dampen the fund's overall volatility, while helping the fund limit market risk. For example, even if rising interest rates spell losses for the overall bond market, this fund still has an opportunity to deliver a positive return.

We've seen evidence of that in the fund's early results. When interest rates spiked in July 2003, for example, the fund gained 1.5%, while the average intermediate bond fund dropped 3.3%. The fund has hit a few bumps in the road, most notably in April 2004 and April 2005, but those losses weren't big—less than 1 percent. And since its inception in mid-2003, it has crushed the 90-day T-bill.

The fund doesn't look like any other bond fund, and it isn't priced like many either. The fund's basic management fee starts at 1.20%, but it can go up or down as much as 0.70% based on the fund's performance. That may seem a steep price to pay for a bond fund, but thus far, this fund has been worth the price of admission.

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Year	Total Return (%)	+/-Category
YTD	1.07	0.13
2005	—	—
2004	5.85	4.23
2003	—	—

Data through 06-30-2005

Morningstar Rating

Not Rated

Kudos

The fund boasts an experienced, proven management team.

Its early returns have been quite encouraging.

It has the potential to earn positive returns even when the bond market falters.

The fund will close to new investors when assets reach \$300 million.

Risks

The fund's unique approach could make it tough to slot in a portfolio.

Despite the fund's absolute-return mandate, it should not be confused with more conservative fund options.

Strategy

This fund follows a unique approach. Management looks to deliver positive absolute returns in all market environments by employing strategies such as interest-rate timing, arbitrage trading, and long-short trading. Those strategies help limit market risk and allow the fund an opportunity to deliver positive returns even when the bond market is suffering. The fund's stated goal is to outperform the 90-day T-bill by at least 2 percentage points each year. If it doesn't meet that goal, management trims its fee.

Management

The fund's management team of Laird Landmann, Stephen Kane, Tad Rivelle, and David Lippman bring lots of experience to the table here. Landmann, Kane, and Rivelle were founders of Metropolitan West, which opened its doors in 1996. Lippman joined the group in 2001. The team pulls the best ideas from Metropolitan West's managers and analysts, so it really is a team effort here.

Inside Scoop

This mutual fund employs hedge-fund-like strategies in an effort to deliver positive absolute returns in all market environments.

Role in Portfolio

Core

Metropolitan West Strategic Income Fund (M-Class) Net Performance Average Annual Total Returns as of 6/30/2005

	Q2 '05	1-Year	2-Year	Since Inception 6/30/03
MWSTX ¹	0.61%	4.57%	10.18%	10.18%
Merrill Lynch 3-Month UST + 200 bps ²	1.21%	4.20%	3.62%	3.61%

Yearly Performance

	2004	YTD 2005
MWSTX ¹	5.85%	1.07%
Merrill Lynch 3-Month UST + 200 bps ²	3.36%	2.30%

The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. Two-year and since inception returns are due in part to market conditions which might not be repeated in the future. 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.

This article must be preceded or accompanied by a prospectus for the Metropolitan West Strategic Income Fund. The prospectus describes the investment objectives, risks, charges, and expenses of the Metropolitan West Funds. Although the funds are no-load, other annual fees and expenses do apply as described in the prospectus.

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¹ Returns for the Fund are net of all charges and fees assuming reinvestment of dividends and capital gain distributions at net asset value. Returns for periods greater than one year are annualized. The Adviser has contractually agreed to reduce its fees and/or absorb expenses, and to pay a portion of the Fund's distribution expenses, to limit the Fund's total annual operating expense to 2.35% by limiting "Other Expenses" to 0.20% of the Fund's average daily net assets assuming the maximum management fee. Total returns reflect fee waivers in effect. Without fee waivers returns would have been lower. Total return figures assume reinvestment of all distributions.

² The Merrill Lynch 3-month Treasury Bill Index consists of U.S. Treasury Bills maturing in 90 days. The Adviser has selected the Index plus 200 basis points (2%) as the appropriate benchmark for performance comparison purposes. The indices discussed above are unmanaged indices that are not available for direct investment. Unlike a mutual fund, the performance of an index assumes no taxes, transaction costs, management fees, or other expenses. The securities that comprise the Index may differ substantially from those in the Fund's portfolio. Total return figures assume reinvestment of all distributions and are net of all charges.

The Strategic Income Fund uses sophisticated investment techniques, including the use of derivatives, and may not be suitable for all investors. Please see the prospectus for a complete discussion of the risks of investing in this fund.

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