

## Our Favorite Intermediate-Term Bond Funds

### Fund Spy

by Scott Berry, CFA

Most intermediate-term bond funds have weathered the market's recent storm quite well.

The subprime-housing meltdown has been felt far and wide, as banking stocks in the United States and overseas, asset-backed securities, nongovernment mortgage issues, and bonds with any hint of credit risk have come under pressure. However, with the exception of a handful of funds, the intermediate-term bond category has sidestepped most of the trouble. Some managers, such as the team at Metropolitan West Total Return Bond MWTRX and Bob Rodriguez at FPA New Income FPNIX, saw trouble coming, while others simply stuck with the government mortgages and high-quality bonds that typically populate their portfolios. Overall, the average fund in the group returned 2.56% for the year to date through Sept. 25, 2007.

Two of our eight intermediate-bond Analyst Picks have struggled, but the others have performed quite well. Fidelity Total Bond FTBFX and Western Asset Core WATFX, both of which own a slug of lower-quality bonds, have fallen off the pace. Meanwhile, Harbor Bond HABDX has made a strong recovery thanks in part to its aggressive interest-rate positioning, while FPA New Income has been rewarded for playing it safe on credit and rates. Those two funds have basically matched the year-to-date return of Metropolitan West Total Return, which has been a bit more measured in its moves than in years past.

Lower interest rates could mean continued good results for this group, but with bond prices already reflecting potential rate cuts, investors shouldn't set expectations too high.

#### Analyst Picks: Intermediate-Term Bond Category

	YTD Return (%)	3-Year Return (%)	5-Year Return (%)	Expense Ratio (%)
Dodge & Cox Income DODIX	2.99	3.76	4.57	0.44
Fidelity Total Bond FTBFX	2.18	3.67	—	0.45
FPA New Income FPNIX 1	4.11	3.73	4.66	0.62
Harbor Bond Instl HABDX	4.16	3.9	4.95	0.58
Metropolitan West Total Return Bond M MWTRX	3.82	5.27	7.41	0.65
TCW Total Return Bond I TGLMX	4.01	4.57	4.53	0.44
Vanguard Total Bond Market Index VBMFX	3.42	3.56	4.05	0.2
Western Asset Core Bond Institutional WATFX	1.56	3.61	5.2	0.47
<b>Intermediate-Term Bond Average</b>	<b>2.56</b>	<b>3.15</b>	<b>4.08</b>	<b>0.99</b>

<sup>1</sup> Fund has a front load.

<sup>2</sup> Closed to new investors.

Returns through 9/25/2007.

As of 9/30/2007, the Metropolitan West Total Return Bond Fund – M-Class 1-year return was 7.09%, 5-year return was 7.54%, and 10-year return was 6.65%. Returns are net of fees and annualized for the 5- and 10-year periods. Total expense ratio is 0.66%.

**The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. One year performance was due to conditions that may not be repeated in the future. Performance data current to the most recent month-end may be obtained at [www.mwamllc.com](http://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.**

## Our Favorite Intermediate-Term Bond Funds

### Fund spy (cont'd)

#### **Dodge & Cox Income** DODIX

This fund has booked several great years, including 2002, when its management team won Morningstar's Fixed-Income Manager of the Year award. The fund gets a lift from low expenses, proving that you don't have to pay big bucks for good, active management. It's not as cheap as Vanguard, but its expenses are among the lowest in the category. The fund's emphasis on government and high-quality corporate bonds has yielded consistently competitive results, and its low-turnover approach has minimized volatility.

#### **FPA New Income** FPNIX

This fund's management team, led by Bob Rodriguez, is one of the best in the business. It is more than willing to pile into unloved sectors of the bond market, often with impressive results. This fund sports an exceptional record of strong long-term returns with modest volatility.

#### **Harbor Bond** HABDX

Bill Gross, named Fixed-Income Manager of the Year in 1998 and 2000, has made this fund a star. Gross has made timely macroeconomic calls over the last few years that have driven this fund's returns. And although he shies away from most risky bets and sticks primarily to high-quality bonds, this fund has one of the best records in the intermediate-term bond category.

#### **Metropolitan West Total Return Bond** MWTRX

The team here sports some of the best brains in the industry, as well as a solid, deep bench of sector specialists. And although the fund isn't as cheap as Dodge & Cox Income or Vanguard Total Bond Market Index, its 0.65% expense ratio is quite reasonable. The fund's willingness to own large stakes in corporate bonds sometimes gives it a riskier profile than some competitors. The management team here won the Fixed-Income Manager of the Year award for 2005.

#### **TCW Galileo Total Return Bond** TGLMX

We've sometimes referred to this fund as a cat that thinks it's a dog. That's because it is ultimately a mortgage fund, but one that successfully competes with the more broadly constructed set of funds in this category. Despite occasionally lagging when mortgages fall behind, it has done a fantastic job over the years, producing excellent returns with more modest risk than many funds in this group. It also boasts a low hurdle for individual investors, as well as a very competitive expense ratio.

#### **Vanguard Total Bond Market Index** VBIMFX

This fund is not flashy, but it doesn't need to be. Its superlow expenses make it tough to beat over any extended period of time. It's a terrific choice for a core holding.

#### **Western Asset Core Bond** WATFX

While Southern California neighbor PIMCO grabs more of the bond world's attention, Western Asset Management deserves much recognition for the record it has assembled with its funds, including this offering. Over time, the Core fund has consistently outperformed peers and the Lehman Brothers Aggregate Bond Index thanks to superior credit selection as well as some crafty yield-curve, duration, and sector tilts. Low expenses and a deep and experienced research effort lend it considerable appeal. This team won the Fixed-Income Manager of the Year award for 2004.

#### **Fidelity Total Bond** FTBFX

This fund takes advantage of Fidelity's broad bond-market capabilities by owning small stakes in high-yield and emerging-markets debt. Those riskier areas of the market were arguably overpriced in early 2007, but we expect they will provide this fund extra yield and return over the long term.

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## Metropolitan West Total Return Bond Fund (M-Class) ★★★★★

5-Star Overall Morningstar Rating based on risk-adjusted returns as of 9/30/07 among 968 Intermediate-Term 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 3/31/1997
MWTRX <sup>1</sup>	3.07%	4.18%	7.09%	5.52%	7.54%	6.65%	7.08%
Lehman Aggregate <sup>2</sup>	2.85%	3.84%	5.13%	3.86%	4.13%	5.96%	6.37%
<i>Under/Outperformance</i>	<i>22 bps</i>	<i>34 bps</i>	<i>196 bps</i>	<i>166 bps</i>	<i>341 bps</i>	<i>69 bps</i>	<i>71 bps</i>

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For MWTRX the total expense ratio is 0.66% and the net expense ratio is 0.65%. 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.

<sup>1</sup> Total return figures assume reinvestment of all distributions. Total returns reflect fee waivers in effect. Without fee waivers returns would have been lower. For Class M, Rule 12b-1 fees were not charged until April 1, 2000.

<sup>2</sup> The Lehman Brothers Aggregate Index is an unmanaged index not available for direct investment. 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, high 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.

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 Total Return Bond Fund M-Class was rated 5 stars for the 3-year period, 5 stars for the 5-year period, and 5 stars for the 10-year period against 968, 819 and 407 U.S.-Domiciled Intermediate-Term Bond Funds respectively. Past performance is no guarantee of future results. Morningstar Rating is for the M share class only; other classes may have different performance characteristics.

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Fund Manager of the Year  
Fixed-Income