

## Product Focus

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### PIMCO's Approach to High Yield Bonds

High yield corporate bonds can be an attractive asset class for investors seeking higher risk and higher return potential relative to government or investment grade corporate bonds. However, managing risk is crucial to success in the high yield sector, where changes in the macroeconomic environment and market liquidity can have a substantial effect on returns. PIMCO's goal in managing high yield portfolios is to minimize these risks while attempting to generate consistent outperformance, which is why we take a conservative approach that encompasses macroeconomic analysis in addition to traditional credit analysis.

PIMCO's conservative approach to high yield investing emphasizes high credit quality while employing innovative techniques in an attempt to maximize return potential. Many high yield managers focus on yield, but we believe a total return approach that recognizes the effect of price as well as yield improves our ability to potentially add value while minimizing risk. PIMCO also leverages our global expertise in other fixed-income sectors, such as bank loans and emerging markets, in an attempt to add value through small, tactical positions. We aim to limit risk by diversifying among issuers and industries, relying on our in-house credit analysts to scrutinize every credit in our portfolios, and applying our own risk management analytics.

### Focus on High Quality

Credit quality varies widely within the high yield sector. PIMCO focuses on higher-quality bonds because we believe these securities offer the best risk-adjusted return potential in the high yield sector. Lower quality bonds may offer higher yields, but this may not always compensate for the increased risk of owning these securities. However, keep in mind that the credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio.

Normally, between half and two-thirds of a typical PIMCO high yield portfolio will be invested in stable, top-tier credits. Between 25% and 35% of the typical portfolio will be invested in attractively priced securities that are improving in credit quality. We also allocate up to 15% of a portfolio to short-term trading opportunities. These include credits that have declined significantly in price and appear set to recover. Small positions in select out-of-sector opportunities, such as emerging market securities or bank loans may also be included in this category.

In choosing individual positions, PIMCO focuses on companies with solid access to capital, a strong management team and industry position, conservative accounting practices and cash flows that are stable and visible. We have a strong preference for securities that are backed by real assets and have some level of seniority in the corporate capital structure.

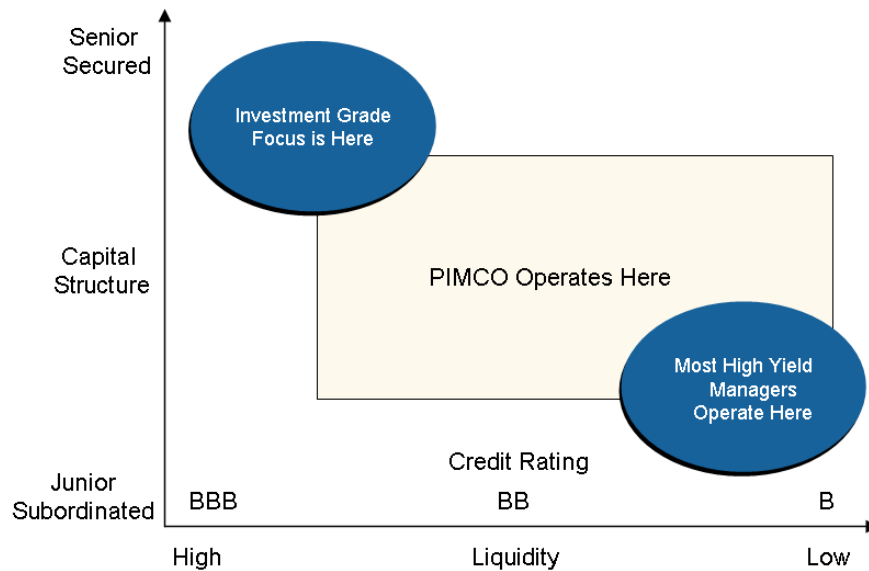
Our preference for top-quality high yield bonds puts us in a unique market niche, as shown in the chart below. We are willing to accept more potential risk than "cross-over"

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buyers (those that focus primarily on investment-grade corporate bonds but dip into high yield to enhance returns), but we typically assume less risk than many other high yield managers because we avoid lower-tier credits with weak credit fundamentals.

**PIMCO Operates in a Unique Market Niche**



Source: PIMCO

**An Innovative Investment Process**

PIMCO employs an innovative investment process in constructing high yield bond portfolios that takes full advantage of our depth and resources.

Our investment process begins with a top-down view of the major trends we expect to influence the financial markets and the economy over the next three to five years. This view is formulated annually at our firm-wide secular forums. To complement these long-term views, we also address trends we expect to shape the markets over the next six to 12 months at our quarterly cyclical forums.

The economic views formulated through this process are then factored into our proprietary in-house credit research. Rather than rely on the traditional credit rating agencies, PIMCO has developed an in-house team of global credit analysts that evaluate virtually every security in our portfolios. Our analysts examine the viability of high yield issuers under a wide range of economic scenarios in addition to PIMCO's baseline forecast. We believe this marriage of traditional balance sheet and cash flow analysis with top-down economic forecasting significantly enhances our ability to

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identify credits with the greatest potential for capital appreciation and the lowest degree of risk.

The macroeconomic insights PIMCO blends into our bottom-up credit analysis make our investment process unique in the high yield market, where many managers rely solely on credit research. We take this approach because PIMCO believes macroeconomic views are a critical aspect of the security selection process. Various economic scenarios will often favor one industry or company over another and a particularly effective method for adding potential value to a high yield portfolio is to locate credits with the potential for capital appreciation due to a favorable business climate. Similarly, PIMCO is able to de-emphasize sectors when economic fundamentals are unfavorable.

At PIMCO, we also apply our credit discipline and resources to explore opportunities in non-traditional sectors and complex security structures. For example, we may consider adding emerging market debt to high yield portfolios when our emerging markets specialists identify particularly attractive opportunities.

### **Importance of Risk Management and Controls**

High yield securities are subject to greater levels of credit and liquidity risk than many other securities. Choosing higher quality bonds, which tend to be more liquid than lower-tier securities, is therefore an important component of PIMCO's risk management process in the high yield sector.

PIMCO generally limits investment in an individual issuer to 5% and in a single industry to 15% of our high yield portfolios. Even though higher concentrations may enhance relative performance in the short run, broad diversification has been rewarding in the long run.

In addition to these investment controls, PIMCO employs proprietary risk management systems to help minimize the risks we take in the high yield sector.

### **Conclusion**

PIMCO's total return philosophy dictates that our first priority in high yield investing is to minimize risk while maximizing return potential for the level of risk that we do assume. To accomplish this, we utilize our extensive resources and the experience of our experts to analyze the high yield market from both a top-down and bottom-up perspective. We believe this approach improves our consistency in potentially enhancing high yield returns over the long-term.

### **Past Performance is no guarantee of future results**

High Yield portfolios may invest a portion of their net assets in lower-rated and non-rated convertible and other debt securities. This presents greater risk of loss of income and principal than higher-rated securities

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and are considered to be predominantly speculative with respect to the payment of interest and repayment of principal. An investment in high-yield securities generally involves greater risk to principal than an investment in higher-rated bonds.

There is no guarantee that these investment strategies will work under all market conditions and each investor should evaluate their ability to invest for a long-term especially during periods of downturn in the market. No representation is being made that any account, product, or strategy will or is likely to achieve profits, losses, or results similar to those shown.

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