

Product Focus

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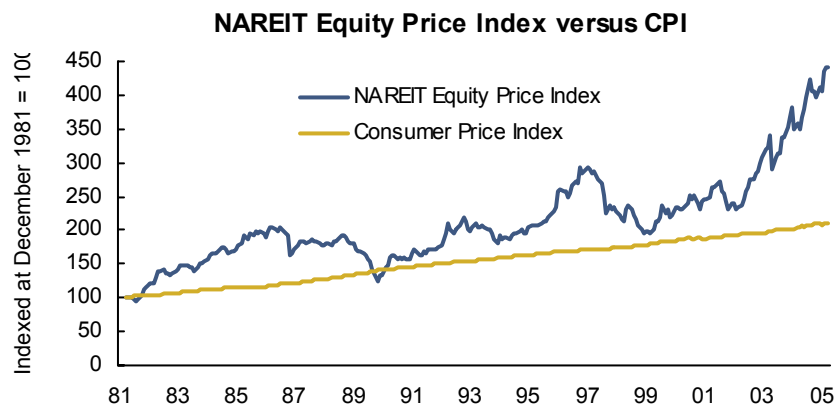
RealEstateRealReturn Strategy Offers More than an Inflation Hedge

Real estate can offer many benefits to investors concerned about the effect of inflation on their portfolio. First, real estate tends to rise along with prices in the overall economy and can thus provide an effective hedge against inflation. Second, real estate also has had very low return correlations with more traditional assets, including equities and bonds, which can improve portfolio diversification. Finally, real estate has historically provided steady and growing current income, providing a return cushion against a downturn in prices.

Investors can tap into the benefits of real estate investing through PIMCO's RealEstateRealReturn strategy. PIMCO's approach offers exposure to the performance of equity Real Estate Investment Trusts (REITs), which buy, operate and sell residential and commercial real estate.

The Benefits of Real Estate Exposure

Real estate has historically provided an effective hedge against inflation because, as inflation rises, the value of real estate usually increases. REITs, in particular, have shown a close link to inflation because they often invest in commercial properties that generate income through rents, which rise with inflation over time. As the chart below illustrates, the price performance of REITs has outpaced the rate of inflation, represented by the Consumer Price Index (CPI), over the past 24 years.



Sources: National Association of Real Estate Investment Trusts (NAREIT), PIMCO

Real estate has also demonstrated very low return correlations—which measure how closely movements in different types of securities are related—with more traditional asset classes. The low correlations stem largely from the fact that rising inflation tends to result in higher interest rates, which are not generally favorable for stocks because higher rates increase the cost of capital for companies. In fact, the correlation between total returns on REITs and equities has declined over time, as shown in the table below. Inflation and higher interest rates also tend to erode the value of fixed-income

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returns. Because real estate is not highly correlated with equities and bonds, it can help boost returns in an inflationary environment by diversifying the portfolio and lowering the volatility of returns.

Monthly Correlation of REIT Total Returns and Other Types of Investments

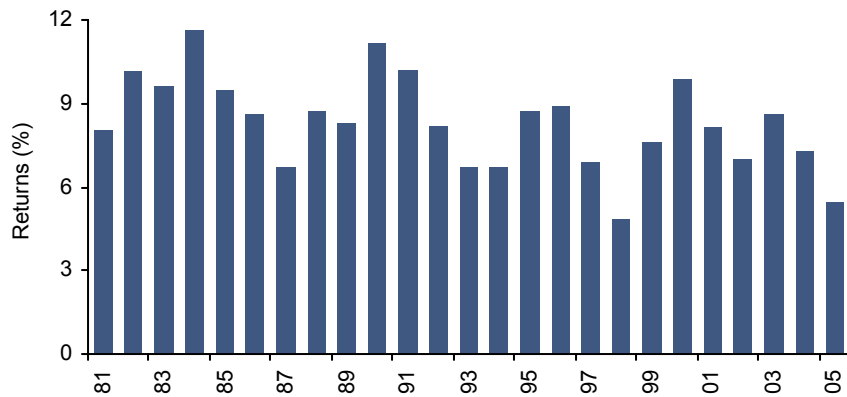
Based on Monthly Returns from 12/31/1977 through 3/31/2006	1978-1991	1992-2006
Large Stocks S&P 500 Index	0.68	0.28
Small Stocks Russell 2000 Index*	0.77	0.44
Long-term Bonds Lehman Treasury 20+ Year Index	0.24	0.05
International Stocks MSCI EAFE Index	0.34	0.26

Source: REITs – NAREIT Equity Index

* Russell 2000 Index data since 12/31/78

Finally, real estate can provide investors with income and the potential for growth in income. The chart below shows that REITs have produced income every year for more than 20 years—typically a healthy inflow of between 5% and 10%. During the period from 1981 through 2005, annual income has averaged 8.29%. This consistent income can help boost overall portfolio returns, especially when the performance of more traditional asset classes disappoints.

NAREIT Equity REIT Annual Income 1981 - 2005



Source: National Association of Real Estate Investment Trusts (NAREIT)

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PIMCO's Approach to Real Estate Investing

PIMCO's RealEstateRealReturn approach provides exposure to real estate by investing in REIT total return swap agreements. REITs often invest in commercial properties, such as apartments and offices, and the portfolio can therefore gain from increases in rents as well as property values, thus earning potentially greater returns in an inflationary environment.

PIMCO uses portfolio assets as collateral for the REIT total return swap agreements and typically invests these assets in inflation-linked fixed income securities, such as Treasury Inflation Protection Securities (TIPS). We aim to earn a higher return on these assets than the financing rate embedded in the swap agreements, thus enhancing the total return potential of the overall portfolio. In addition, the inflation-linked bonds can offer returns measured in real, rather than nominal, terms. Thus, the RealEstateRealReturn strategy offers a "double real"TM return investment, and seeks to provide real returns in the form of gains from the REIT exposure and consistent real return income from the inflation-indexed securities.

This approach capitalizes on two of PIMCO's core strengths: efficient management of derivatives positions and effective management of fixed-income securities. As one of the largest participants in the fixed income market, PIMCO has developed the resources, analytics and substantial experience to effectively manage positions in real return securities. PIMCO was an early leader in recognizing the value of inflation-indexed securities, and remains among the largest participants in the TIPS market.

Conclusion

Recognized as an effective hedge against inflation, real estate investments can also offer low correlations with more traditional assets and therefore help diversify a portfolio. Real estate, especially in the form of Real Estate Investment Trusts (REITs), has historically offered consistent income, which can help boost overall portfolio returns. PIMCO's RealEstateRealReturn can offer the benefits of real estate by investing in total return swap agreements on REITs, using portfolio assets as collateral. These portfolio assets are typically invested in inflation-indexed bonds with the aim of earning a higher return than the financing rate embedded in the swap agreements. RealEstateRealReturn thus provides a "double real"TM return investment, with potential real returns from the REIT index exposure and consistent real return income from the inflation-linked securities.

Past performance is no guarantee of future results. The charts above are not indicative of the past or future performance of any PIMCO product or strategy. This publication contains the current opinions of the manager and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Such opinions are subject to change without notice. The distribution of this publication is for informational purposes only. Information contained herein has been obtained from sources believed reliable, but not guaranteed.

Portfolios may use derivative instruments for hedging purposes or as part of the investment strategy. Use of these instruments may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk and the risk that a portfolio could not close out a position when it would be most advantageous to do so. Portfolios investing in derivatives could lose more than the principal amount invested. Real Estate-linked derivative instruments are subject to additional risks, such as loss to casualty or

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condemnation, and changes in supply and demand, interest rates, zoning laws, regulatory limitations on rents, property taxes and operating expenses. Investment in a real estate-linked derivative instrument that is linked to the value of a REIT is subject to additional risks such as poor performance by REIT manager, adverse changes to the tax laws or failure to qualify for tax-free pass-through of income.

Each sector of the bond market entails risk. The guarantee on Treasuries and Government Bonds is to the timely repayment of principal and interest, shares of a portfolio are not guaranteed. Mortgage-backed securities may be sensitive to interest rates. When interest rates rise, the value of fixed income securities generally declines and there is no assurance that private guarantors or insurers will meet their obligations. Investing in non-U.S. securities may entail risk due to non-U.S. economic and political developments which may be enhanced when investing in emerging markets. Inflation-indexed bonds issued by the U.S. Government, also known as TIPS, are fixed-income securities whose principal value is periodically adjusted according to the rate of inflation. Repayment upon maturity of the original principal as adjusted for inflation is guaranteed by the U.S. Government. Neither the current market value of inflation-indexed bonds nor the value a portfolio that invests in inflation-indexed bonds is guaranteed, and either or both may fluctuate. Diversification does not ensure against loss.

The Consumer Price Index is an unmanaged index representing the rate of inflation of the US consumer prices as determined by the US Department of Labor Statistics. The NAREIT Equity Price Index ("North American Real Estate Investment Trust Equity Index") includes REITs listed on the New York Stock Exchange, Nasdaq, and American Stock Exchange. The Standard & Poor's 500 Composite Index (S&P 500) is an unmanaged index of U.S. companies with market capitalizations in excess of \$4 billion. It is generally representative of the U.S. stock market. The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. The Lehman Brothers Treasury 20+ Year Index is the Treasury 20+ Year component of the U.S. Treasury Index. The U.S. Treasury Index represents public obligations of the U.S. Treasury with a remaining maturity of one year or more. The Morgan Stanley Capital International ("MSCI") Europe, Australasia, Far East Index ("EAFE") is an unmanaged index of over 900 companies, and is a generally accepted benchmark for major overseas markets.

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