

4Q

Allianz Global Investors Capital

High Yield

Fourth Quarter 2011 Commentary

Market Environment

Prices of high yield bonds rose in the quarter, and the high yield market ended a volatile year in solidly positive return territory. The Bank of America Merrill Lynch High Yield Master II Index returned 6.2% for the fourth quarter and 4.4% for 2011. By way of comparison, the high yield market outperformed the ten-year Treasury return of 1.2%, but underperformed the S&P 500's 11.8% result for the quarter.

After a rough third quarter, the market rebounded nicely to end the year. Fundamentally, from an issuer perspective, little has changed. Corporate balance sheets, earnings, access to capital and relative value all pointed to better returns in 4Q just as they did in 3Q. What is the difference? Clearly, the mood swings of the equity market have a significant impact on day-to-day high yield prices. In the fourth quarter, the mood was simply better, albeit still inconsistent day-to-day and month-to-month. It is feasible that the U.S. economy has shown more consistency in recent months. Economic stats have been better than expected, consumer spending has trended positively and even housing has shown signs of life. For high yield investors, these are important factors, but ultimately they should not warrant the day-to-day price fluctuations. Investors in high yield should be focused on the creditworthiness of the issuers. Ultimately, in the quarter, prices correctly reflected the lack of risk represented among high yield issuers.

Industry level performance was universally higher for the period, with the majority contributing an average price move of 5% or more. Leading industries for the quarter included Building Materials, Broadcasting and Containers.

Laggard industries included Transportation Ex Air/Rail, Airlines and Railroad. None of these industries has material weight in the benchmark.

New high yield issuance rebounded from a slower 3Q, although was still well below the \$90 billion average raised in 1Q and 2Q. Approximately \$38.2 billion were priced in the quarter. Refinancing activity still captured close to half of all new issuance proceeds, but acquisition financing / LBO was a growing share. Mutual fund flows jumped significantly versus the prior two quarters, with an approximate \$11.7 billion inflow. Year-to-date inflows equaled \$13.5 billion.

The ratio of upgrades to downgrades slipped in the quarter, with 68 upgrades and 79 downgrades. The upgrade to downgrade ratio was positive (3:2) for 2011. Defaults remained low in the fourth quarter. The list included some recognizable names, but still barely moved the needle on a total market percentage basis.

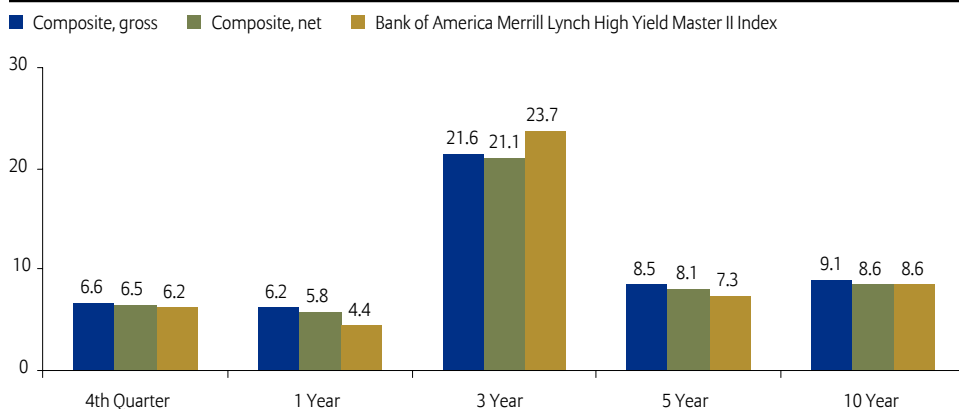
The trailing twelve-month (LTM) default rate ended the quarter at approximately 2.3% on an issuer-weighted basis. On a dollar-weighted basis, the LTM default rate was 1.76%.

These default numbers continued to be well below the 3-4% average for the past twenty-five years.

Portfolio Specifics

The attribution for the quarter can be viewed from a number of perspectives. The net result of the quarter was decidedly positive, but this was only after a significant upswing in October, a reprieve in November and finally, a rebound in December. In this environment, an all-weather design aided relative performance. The cornerstone of such a design is consistently identifying issuers that met or exceeded fundamental expectations. Also, to limit or eliminate exposure to issues that did not meet or exceed expectations. While industry exposure will be reviewed here, it is worth noting that several issuers in cyclical and basic materials industries did

Performance (%)



All data as of December 31, 2011 unless otherwise noted. Composite inception date: April 1, 1994. Performance of less than one year has not been annualized. Past performance is not indicative of future results. See additional disclosure at the end of this presentation. Source: Allianz Global Investors Capital.

High Yield

Portfolio Specifics (continued)

not meet expectations and lagged for the quarter and the year. These positions were reduced or sold from the portfolio throughout the year, but the positions that remained did not help.

An underweight in the lowest quality and distressed issuers also helped during the volatility. This group was especially susceptible to the day-to-day shocks in investor sentiment and the equity markets. The Treasury market did not have a material effect on any ratings category in the quarter.

Industry allocations that helped relative performance in the period included Energy, Transportation Ex Air/Rail and Automotive & Auto Parts. Energy issuers as a group continue to exceed expectations. Energy issuers led the new issue market, and several were first time to market. An emerging trend has been the domestic exploration and production of new areas within the U.S. Trucking was also a major contributor due to an increase in special purpose shipping and a general lift in demand. Auto sales have trended above expectations and production has increased.

Industry allocations that hurt relative performance during the period included Capital Goods, Building Materials and Metals/Mining. From an industry level perspective, every industry contributed positively to performance, but some less so.

Generally, materials-related issuers lagged in the quarter. Prices softened due to less certainty about the global economy, and the perception of demand for materials shifted.

Specific issues in Mining, Chemicals and Paper were lower in the quarter. Holdings demonstrating longer-term negative fundamental change were reduced or sold. Sells also included the standard calls, tenders and trims due to price.

Market Outlook

It is easy to have conviction in the positive outlook for high yield bonds, based on the clear trends in credit statistics. Leverage ratios and interest coverage ratios are near or better than levels seen in the past twenty years. Cash levels of investment grade issuers remain high, and acquisition activity is ongoing. Economic statistics have generally been improving in the U.S. Upgrades exceeded downgrades in 2011, providing third-party acknowledgement of balance sheet strength. Significant refinancing activity for the past three years has essentially eliminated amortization risk through 2013. The Fed and policymakers are in an accommodative stance and have communicated their commitment to remain that way. All of these factors combine to create an environment where defaults are low, and should stay low, for an extended period.

Spreads ended the month at approximately 723 over comparable Treasuries. The historical average spread is well inside of this level, specifically at this point in the credit cycle. This stage of the market cycle from a statistical perspective is best compared to the mid-1990s and mid-2000s—market environments which exhibited economic stability, low defaults and ample liquidity.

The high yield market has priced in a default rate forecast that is far higher than the current 1-2%. The yield generated by high yield issues relative to the risk associated with the asset class is clearly attractive.

Treasury rate moves have surprised investors the most in 2011. The weakness in the equity markets, federal intervention and global fears drove positive returns for Treasuries again in the quarter. If a rising rate forecast is included in an asset allocation strategy decision, an allocation to high yield is an obvious choice. Among fixed income alternatives, high yield bonds may be a contributor from both a diversification and relative performance perspective.

Nearly all strategists agree that the outlook for credit is constructive with minimal defaults for both 2012 and 2013. The combination of all the fundamental factors and the current excessive spread relative to risk leads to a forecast for 2012 of above coupon total return, 10% or greater.

We continue to build your portfolio one company at a time, by identifying companies which are opportunistically capitalizing on change. At Allianz Global Investors Capital, we recognize that the long-term driver of total return in a high yield portfolio is company fundamentals. Because fundamentals can only be discovered and monitored through rigorous credit analysis, which is the cornerstone of our approach, we will continue to apply our successful philosophy and process to managing change and information.

Allianz Global Investors Capital ("AGIC") was formed from the combination of three affiliates: NFI Investment Group ("NFI"), Nicholas-Applegate ("NACM"), and Oppenheimer Capital ("OpCap"). In July 2010, all employees of NACM and OpCap became employees of AGIC, and the transition of management of client assets from NACM and OpCap to AGIC Capital was initiated. AGIC provides oversight with respect to the investment management services provided by NFI, as well as non-investment functions including marketing, operations, technology, legal/compliance, and client service. AGIC and NFI are SEC registered investment advisers.

AGIC claims compliance with the Global Investment Performance Standards (GIPS). AGIC is an SEC registered investment adviser that provides investment management and advisory services primarily to separate accounts of institutional clients, and registered and unregistered investment funds. For GIPS purposes, the Firm is defined and held out to the public as the investment management and advisory services provided by AGIC and its SEC registered investment adviser subsidiary NFI Investment Group LLC; excluding (i) administrative and/or sub adviser oversight services, and (ii) separately managed account (wrap) services. The firm's list of composite descriptions, as well as information regarding the firm's policies for valuing investments, calculating performance, and preparing compliant presentations, are available upon request by contacting (619) 687-2800.

Past performance is not indicative of future results. The strategy may not achieve its desired results. Gross returns do not give effect to investment advisory fees, which would reduce such returns. All returns presented are calculated using U.S. dollars unless otherwise noted. Advisory fees are deducted periodically from the account and have an impact on performance. As an example, the effect of investment advisory fees on the total value of a portfolio assuming (a) \$1,000,000 investment, (b) portfolio return of 5% per year, and (c) 1.00% annual investment advisory fee would be \$10,268.81 in the first year, \$56,741.68 over five years, and \$129,160.05 over ten years. Actual fees charged may vary by portfolio due to various conditions, including account size. Investment advisory fees are described further in Form ADV Part 2A Brochure. Where "net of fee" performance is indicated, actual fees charged were used for performance calculations.

The asset and industry reports contained herein are unaudited. The summation of dollar values and percentages reported may not equal the total values, due to rounding discrepancies. Portfolio characteristics are derived using currently available data from independent research resources that are believed to be accurate. Estimates (est.) are preliminary and unaudited. Unless otherwise noted, AGIC is the source of illustrations, performance data, and characteristics.

References to specific securities and their characteristics are examples of securities held in the portfolio and are not intended to be, and should not be interpreted as an offer, solicitation or recommendation to purchase or sell any financial instrument, an indication that the purchase of such securities was or will be profitable, or representative of the composition or performance of the portfolio. "Representative Holdings" are as of the date indicated and are subject to change without notice. Holdings are selected based on size of positions, from a representative account. Representative account characteristics and partial lists of past recommendations do not reflect composite performance, which may be different. Additional information regarding account characteristics, and a complete list of all representative buys and sells for the last 12 months is available upon request. Portfolio and benchmark characteristics for this strategy are provided by FactSet, and calculated according to FactSet methodology.

This material contains the current opinions of the author, which are subject to change without notice. References to specific securities and their characteristics are examples of securities held in the portfolio and are not intended to be, and should not be interpreted as an offer, solicitation or recommendation to purchase or sell any financial instrument, or representative of the composition or performance of the portfolio. Statements concerning financial market trends are based on current market conditions, which will fluctuate. Forecasts are inherently limited and should not be relied upon as an indicator of future results. Unless otherwise noted, equity index performance is calculated with gross dividends reinvested and estimated tax withheld, and bond index performance include all payments to bondholders, if any. Indexes may not represent the investment style of the composite. Index calculations do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index. Currency conversions are provided by Russell Performance Universe and are based on monthly linked performance converted from U.S. dollar. Exchange rates are provided by the Federal Reserve Statistical Release as of month end.

The High Yield Composite (the "Composite") consists of accounts that invest primarily in below investment grade corporate securities as rated by Standard & Poor's or Moody's credit rating services. The Bank of America Merrill Lynch High Yield Master II index represents a broad set of High Yield issues. The Bank of America Merrill Lynch High Yield Master II Index captures the performance of below investment-grade debt issued by corporations domiciled in the United States or Canada. Bank of America Merrill Lynch uses a composite of Fitch Ratings, Moody's and Standard & Poor's credit ratings in selecting bonds for this index. The index is market weighted, and the representation of any single bond issuer is restricted to a maximum of 2% of the total index. Investment Risks: High yield bonds are either rated in the lowest category of investment grade or below-investment-grade. Below-investment-grade bonds have a higher default risk than investment grade bonds, are generally uncollateralized and subordinated to other outstanding debt of the issuer, and are considered predominantly speculative.