

DoubleLine™

Monthly Commentary

May 2010

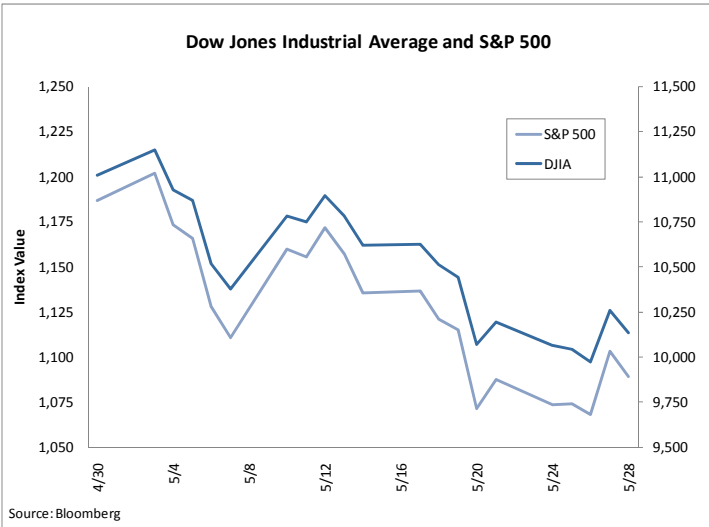


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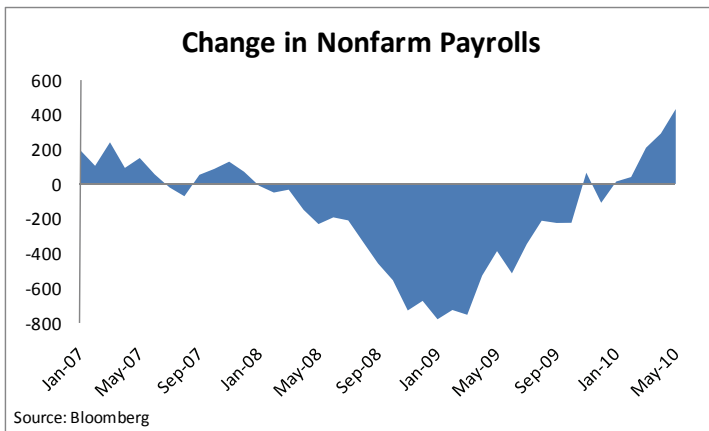


Overview

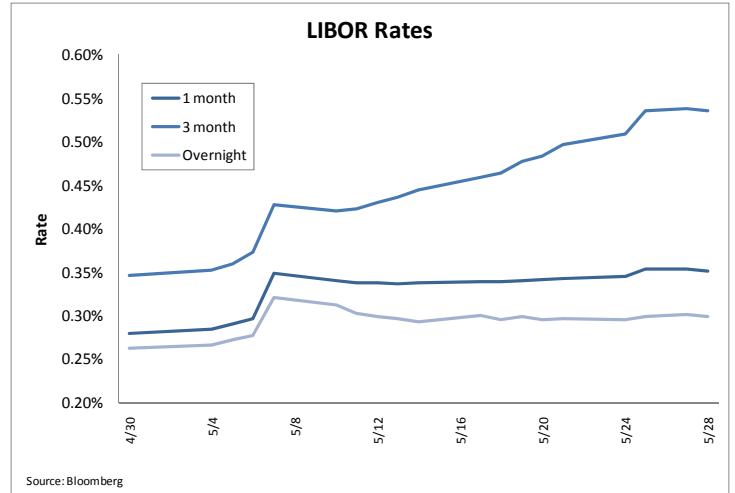
The major domestic equity indices posted massive losses in May, with the S&P 500 falling by 7.98%, and the Dow Jones Industrial Average down 7.54%.



The non-farm payroll report continued to rise due to Federal Census hiring, posting an increase of 431,000 jobs in May.



LIBOR rates continued to rise with relatively large increases during the month with the 1-month LIBOR rate up 7 bps, closing the month at a yield of 0.35%. The 3-month LIBOR rate rose 19 bps to 0.54%, while overnight rates rose 4 bps to 0.30%.



Emerging Markets

For the month, the Emerging Markets (EM) debt sectors posted negative returns ranging between -1.5% and -3.6%. The table below has the monthly and year to date returns for the external sovereign, corporate and local currency debt markets, represented by the JPMorgan Emerging Market Bond Index Global Diversified (EMBI), the JPMorgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI) and the JPMorgan Government Bond Index- Emerging Markets Broad Diversified (GBI-EM) respectively. The negative performance for the EMBI was driven primarily by the lower rated sovereign credits of Venezuela, Argentina and Jamaica. The returns were offset by the positive returns in China, Turkey, Panama and the Philippines.

	Tickers	Monthly Return	YTD Return	YTM	Spread	S&P Ratings
EMBI	JPGCCOMP	-1.50%	3.55%	6.57%	338	BB+
CEMBI	JBCDCOMP	-2.04%	4.29%	6.62%	393	BBB
GBI-EM	JGENBDUU	-3.62%	2.54%	6.48%	NA	A-

Source: Bloomberg

During the month, the Greece/EU debt crisis continued to plague the market. In addition, there were new negative developments that posed fresh challenges to the global growth picture. The following is a list of conflicts/negative news that developed

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during the month:

- North Korea/South Korea conflict
- Israel/Turkey/Gaza Strip conflict
- Inability by BP to stop oil spill in the Gulf of Mexico
- Continued rating deterioration of Eurozone countries
- Venezuela's new FX regime
- Statements by new Hungarian Ruling Party which compared Hungary's economic situation to Greece.

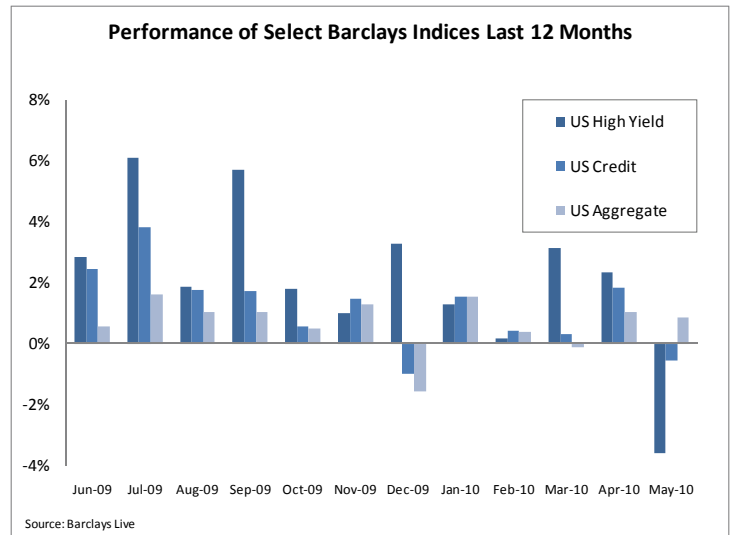
We believe that these issues added to the market sell-off during the month and could continue to create a drag on near-term performance for the global and emerging debt markets.

Against this volatile market backdrop, our investment strategy continues to focus on high quality credits for the strategy. We maintain an underweight position in the Central and Eastern European region and also maintain an underweight position to the lower rated sovereign credits. We still expect that the Central and Eastern European credits could suffer disproportionately due to contagion risk from the Greece/EU and now the Hungary debt situations.

Global Developed Credit

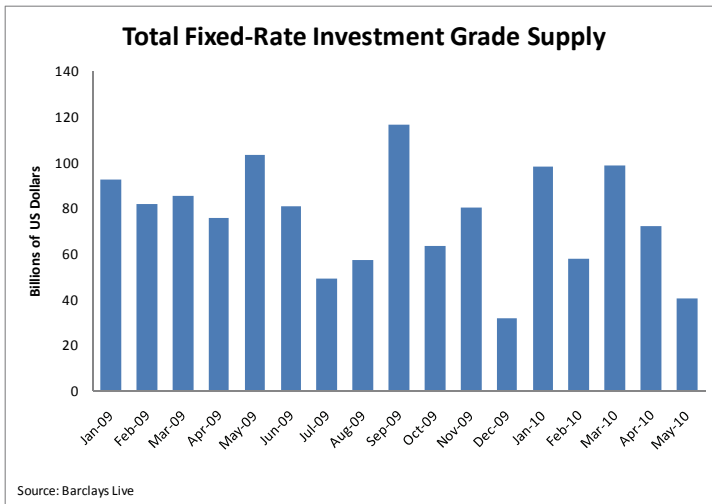
US credit markets underperformed in May, continuing the sell-off which began at the close of April. The investment grade credit market delivered its worst monthly performance since March 2009 and the high yield market ended May with the first negative monthly return for the asset class since February 2009, breaking a 14-month positive return streak. The Barclay's Capital US Credit Index underperformed duration-matched Treasuries by 237

basis points during May, returning -0.38%. The return of the Barclay's High Yield Index for May was -3.59%.



While all investment grade sectors experienced negative excess returns in May, sectors with the least negative returns included Supranationals (-37 bps), Aerospace/Defense (-60 bps), Healthcare (-67 bps) and Diversified Manufacturing (-76 bps). The worst performing sectors were primarily comprised of energy concerns including Oil Field Services (-564 bps), Refining (-551 bps) and Pipelines (-436 bps). In a contrast to the pattern of the market during most of 2010, debt rated in the lower tier of investment grade (Baa) underperformed higher-rated (single A or better) debt. Similarly, all sectors lost ground in the high yield market. The best-performing sectors in this environment included Airlines (-1.22%), Consumer Products (-1.54%) and Supermarkets (-2.06%). The worst-performing sectors were all financials and included both major components of the insurance sector: Life Insurance (-11.02%) and Property and Casualty Insurance (-10.73%). The Banking sector returned -7.13%. In line with the investment grade market, higher-quality securities outperformed during the month: B-rated issuers returned -2.92%, Ba-rated issuers returned -3.04% (primarily due to the concentration of financial issuers in this ratings

category) and Caa-rated paper returned -5.51%. Fixed-rate investment grade supply stood at \$40.4 billion in May – the second-lowest month of investment grade supply in more than a year.



New issuance declined substantially from the pace set in March and April in the high yield market. With only \$6.8 billion pricing in the month, May's total high yield issuance was the lowest since May 2005. Net of redemptions, May registered a total of -\$453 million; the first negative net supply month for high yield since March 2009.

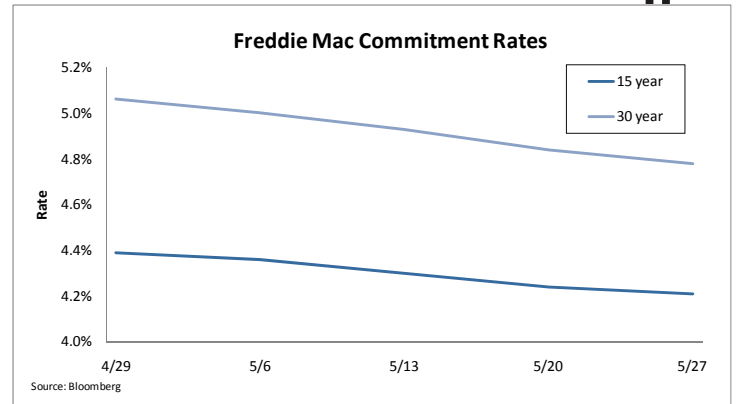
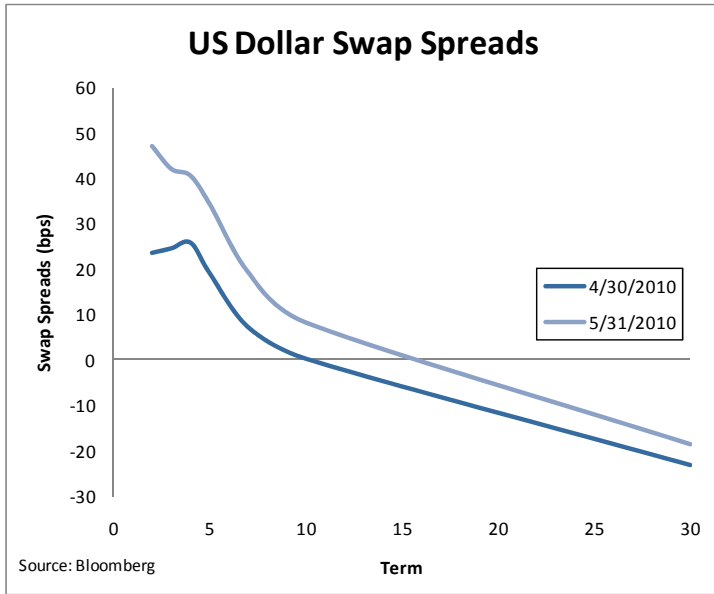
Spread widening among industrial credits largely reflected the rising cost of the to-date unsuccessful efforts by British Petroleum to stop the disastrous oil leak in the Gulf of Mexico following the explosion and sinking of the Deepwater Horizon oil rig. This spread widening was exacerbated by industry uncertainty following President Obama's comments surrounding the halting of drilling activities offshore. With regard to financials, the reform bill reconciliation process is set to begin soon in Congress and could add to the volatility in the markets near term. However, it is important to bear in mind that finalization of this bill could ultimately help bank credit spreads once the final version of reform legislation is unveiled, dispelling uncertainty regarding the outcome.

Renewed concerns of a double-dip recession in the U.S., along with the deteriorating economic situation in several European countries, continues to add a layer of uncertainty and concomitant fears of contagion, both far from constructive for credit spreads.

The complacency which has characterized credit investors thus far in 2010 continues to erode. We believe that prevailing market volatility poses challenges to the prospects for both credit-spread compression as well as market liquidity. DoubleLine continues to maintain a conservative posture toward global developed credit.

Agency Mortgage-Backed Securities

The U.S. MBS Agency market returned 1.12% in May, beating the Aggregate market, which posted a return of 0.84%. Within the Aggregate, the Treasuries posted the best results during the month, returning 1.71%, while Corporates posted the worse return, -0.55%. These numbers reflect a decrease in Treasury rates and a spread-widening in credit markets, as quantified by swap spreads. During the month, 2-year swap spreads widened from 24 to 47 basis points (bps), 5-year spreads widened from 19 to 34 bps, and 10-year swap spreads widened from 0 to 8 bps. In total, swap spreads widened from 10 to 20 bps across the curve.



The combination of declining Treasury rates and widening credit spreads typically hampers the mortgage market's ability to outperform; the market, however, performed relatively well over the month due to the relatively strong return of 1.12% for the Agency sector. The sector's positive performance continues to be supported by the existing conditions in the U.S. real estate market, including tighter lending standards, which constrains supply in this sector and limits fast prepayment speeds.

Prepayment speeds remained constant from April to May, in all sectors except for the FNMA 7% loans, which prepaid very quickly due to FNMA's three-month buyout program. We expect to see faster prepayments in FNMA 5% and 5.5% in June, as the buyout program comes to a close. Going forward, FNMA and FHLMC will continue to buy out loans that are more than 120 days delinquent; however, they will not be targeting specific coupons. The effect of the buyout programs on overall prepayments will depend on the course of the U.S. housing market in general. We expect the program to increase prepayment speeds for mortgages issued between 2005 and 2008 by 5-10 CPR, over the forthcoming months.

We continue to hold a neutral outlook on the mortgage market, as we monitor activity and supply levels. We continue to hold the belief that the Federal Reserve will not unwind its \$1.25 trillion position in a dramatic fashion, therefore keeping net supply levels fairly constant and limiting prepayment speeds, all to the benefit of the sector. However, we are concerned with the trading levels of 15- and 30-year mortgages, which are at all-time highs. Given the current levels, mortgages have negative convexity, which would be detrimental to performance during changing rate environments. That said, we do not expect the convexity issue to become a concern for an extended amount of time, and therefore we remain neutral on our outlook of the market.

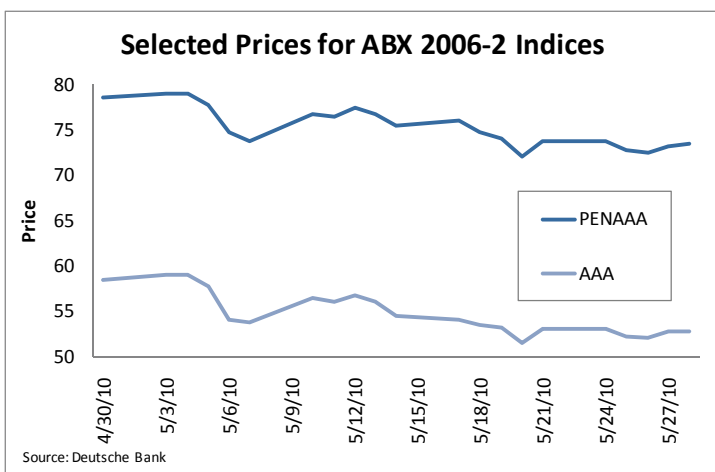
Non-Agency Mortgage-Backed Securities

As discussed in last month's commentary, the non-Agency market saw the launch of Primex, the first new non-Agency securitization away from the re-REMIC market since the meltdown in 2008. The Primex volume, despite some gains after inception, has waned in the last two weeks, likely due to a lack of sponsorship. In May, Primex (FRM-1) had a volatile month hitting a high of 110.5 and a low of 104, finally closing the month of May at 107, down three points from the end of April.

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Similar to the Primex movement, non-Agency prices fell as much as 3% on the month. May saw a number of bid lists, likely due to a larger number of collateralized debt obligation (CDO) liquidations as well as IO and inverse IO lists. Demand remains strong for this sector. Barring the type of high volatility action recently exhibited by the equity and sovereign debt markets, we anticipate this market to recover going forward.



Both foreclosures and delinquencies remain relatively stable, although there is some concern that the prime market may start to see an increase of “strategic defaults.” (A strategic default means a homeowner who can afford the monthly mortgage payment but chooses to stop paying, either walking away from the home or staying “for free” until eviction.) Strategic defaulters tend to be significantly underwater on their homes (LTV above 120%-130%). We are following this trend very closely as we believe it is one of the more dangerous and unpredictable phenomena affecting the mortgage market.

The Redwood securitization deal, which was previously mentioned in April’s commentary, received two opposing write-ups from nationally recognized ratings agencies Standards & Poor’s and Moody’s. S&P’s analysis concludes that the deal had exposure to a high geographic concentration, large loan sizes,

and a rather large portion of non-amortizing Interest only (IO) loans. Moody’s, however, disagreed with the S&P write-up, namely in the areas of subordination level and rating attribution. Regardless of the differing opinions, demand for the deal was very strong.

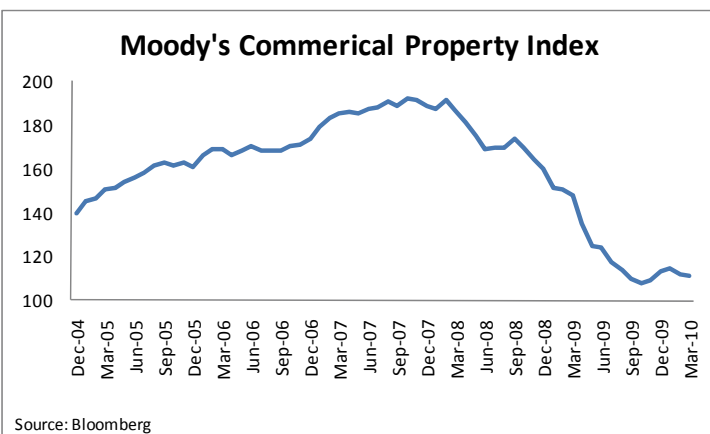
The SEC has recently implemented a rule (17g-5) which stands to have an effect on the new issue market. This new rule requires that any rating agency, having conflicts of interest involving the new issues must post all information received from the issuer, sponsor, or underwriter on a password protected Internet website. The posting process will allow other certified rating agencies to provide their feedback as well as give ratings. We believe that this development may add even more uncertainty to the new issue market.

Late in May, the U.S. Treasury announced an update to the HAMP program that allows for balance forgiveness on loans having a LTV over 115%. The balance forgiveness will be earned over three years (one third per year) as long as the borrower remains current. The maximum forgiveness only allows the balance to be reduced to 115%, leading us to believe that this update will not provide enough incentive or assistance to underwater borrowers. Indeed, lowering the LTV to 95%-100% would provide much more of an incentive for a borrower to stay in the home and remain current on payments. Our markets face an interesting summer with foreclosures slowing and the backlog of these properties hanging over the housing market. Most research indicates that a new foreclosure wave will start either late this year or early next. We continue to monitor this situation and will provide our clients with updates. In the interim, we continue to search for areas that are the most undervalued in which distressed case scenarios can be reasonably priced.

Commercial Mortgage-Backed and Asset-Backed Securities

Commercial mortgage-backed securities underperformed the index for the first time this year as ongoing concerns with the broader economy and sovereign debt halted the year-long rally. Bonds subordinate to super-senior suffered a sharp correction as investor concerns sparked a flight to quality. AM and AJ bonds took the largest hit. Investment grade CMBS posted a -1.67% return in May, underperforming the Barclays Aggregate by 251 bps while investment-grade corporates and ABS outperformed CMBS by 112 bps and 218 bps respectively. Despite this month's underperformance versus the Barclays Aggregate, CMBS is still up 10% year to date and has shown some resilience to price volatility, especially in a month where equity markets sold off, leaving the S&P down 7.98% for the month.

As expected, CMBS fundamentals continued to remain weak with the 30+ day delinquency rate rising 36bps in May to 8.03% from 7.67% in April; 60+ delinquencies rose 43bps to 7.02%. In addition, the latest Moody's Commercial Property Price Index measured a -0.5% price decline, marking the second consecutive month of falling prices following a brief three-month revival in commercial real estate values.



As of March, commercial property prices are down 42.1% from October 2007 peak levels. We note that

commercial real estate lending environments have shown signs of thawing, following effects of government-sponsored programs. However, there continues to be a disconnect between lenders and borrowers as both bank and balance sheet lenders have stringent lending guidelines which, in general, require low leverage, stable/high cash flowing properties, a trait that was largely absent during the pre-credit crisis period.

Given heightened volatility in broader markets and weakening credit fundamentals, our investment focus remains at the top of the capital structure as the added credit support and lower price volatility provides opportunities for a better risk-adjusted return versus other fixed income classes.

U.S. Government Securities

The U.S. Government market continued in May the trends that were established in April. Yields ratcheted lower, and the yield curve flattened modestly. The financial markets saw renewed "de-risking," as the euro zone experienced setbacks in efforts to deal with Greece and other troubled economies, fears emerged of slower growth in China, and the reality of tougher financial regulation in the U.S. descended on traders and investors. The two-year Treasury yield ended the month lower by 19 basis points and the 10-year Treasury yield was down nearly 40 bps.

Yield Curve

	4/30/2010	5/28/2010	Change
3 month	0.15	0.16	0.00
6 month	0.23	0.22	-0.01
1 year	0.38	0.32	-0.06
2 year	0.96	0.77	-0.19
3 year	1.48	1.23	-0.25
5 year	2.42	2.09	-0.32
10 year	3.65	3.29	-0.36
30 year	4.51	4.21	-0.30

Source: Bloomberg

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The Barclays Capital U.S. Government Index returned 1.53% in May. Treasuries returned 1.71%, leading all components of the Barclays Aggregate index, as well as outperforming high yield and U.S. dollar international and emerging markets debt. Agency issues returned 0.86%, with the shorter average duration of the Agency securities accounting for virtually all of the difference. Inflation-adjusted Treasuries lagged badly in May, returning -0.01%, following a CPI report showing inflation falling to multi-year lows.

Risk reduction will continue to drive flows in June, with flight-to-quality buying buoying U.S. Treasuries at the expense of equities, corporate debt and non-U.S. markets. We expect rates to remain low. We expect the yield curve to flatten regardless of the overall direction of rates. We have structured our U.S. Government investments accordingly, with the portfolio positioned to benefit from a flatter yield curve and stable agency spreads.

Disclaimer



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In preparing the client reports (and in managing the portfolios), DoubleLine and its vendors price separate account portfolio securities using various sources, including independent pricing services and fair value processes such as benchmarking.

To receive a complimentary copy of DoubleLine's current Form ADV Part II (which contains important additional disclosure information), a copy of the DoubleLine's proxy voting policies and procedures, or to obtain additional information on DoubleLine's proxy voting decisions, please contact DoubleLine's Client Services.

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DoubleLine seeks to maximize investment results consistent with our interpretation of client guidelines and investment mandates. While DoubleLine seeks to maximize returns for our clients consistent with guidelines, DoubleLine cannot guarantee that DoubleLine will outperform a client's specified benchmark. Additionally, the nature of portfolio diversification implies that certain holdings and sectors in a client's portfolio may be rising in price while others are falling; or, that some issues and sectors are outperforming while others are underperforming. Such out or underperformance can be the result of many factors, such as but not limited to duration/interest rate exposure, yield curve exposure, bond sector exposure, or news or rumors specific to a single name.

DoubleLine is an active manager and will adjust the composition of client's portfolios consistent with our investment team's judgment concerning market conditions and any particular security. The construction of DoubleLine portfolios may differ substantially (and possibly nearly completely) from the construction of any of a variety of bond market indices. As such, a DoubleLine portfolio has the potential to underperform or outperform a bond market index. Since markets can remain inefficiently priced for long periods, DoubleLine's performance is properly assessed over a full multi-year market cycle.

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