

DoubleLine®

Monthly Commentary

May 2011

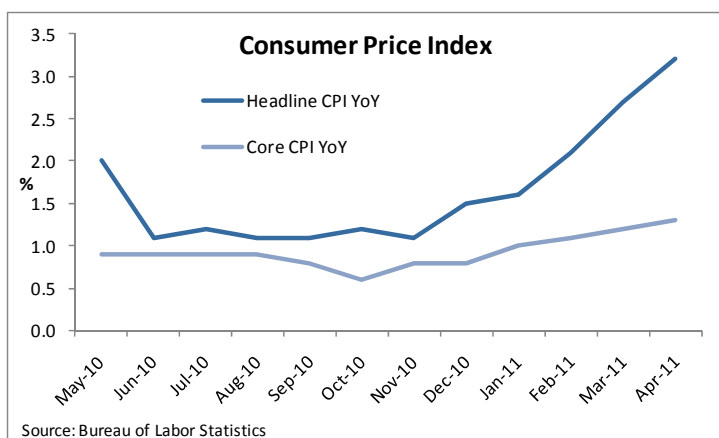


DoubleLine

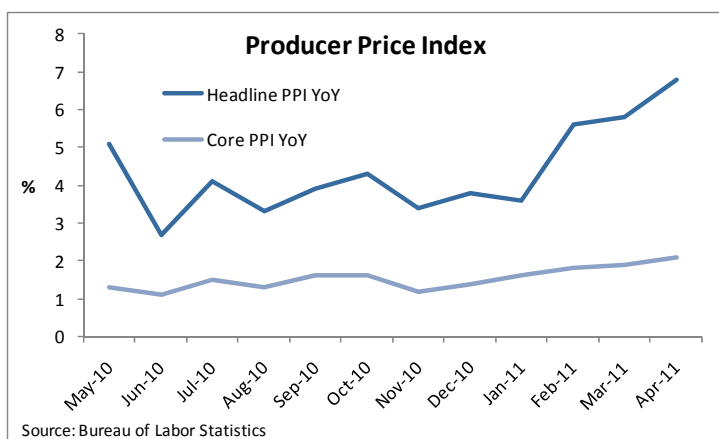
Overview

Nonfarm Payrolls increased 54k to 131,043k in May. Private Payrolls led the way with a gain of 83k to 108,916k while Government Payrolls dropped 29k.

The headline Consumer Price Index (CPI) rose 0.42% in April (+3.2% year-over-year (YoY)) led higher by a 2.2% increase in energy while food prices gained a modest 0.4%. Core CPI gained 0.19% month-over-month and 1.3% on the year, which is still well below the Federal Reserve's target of 2.0%.



The headline Producer Price Index (PPI) rose 0.8% in April (+6.8% YoY) on the back of rising energy prices (+2.5%) with food prices largely unchanged from prior month. Core PPI increased by 0.3% MoM and 2.1% YoY.



The Conference Board (CB) Leading Economic Indicators declined slightly, printing -0.3% in April versus +0.7% in March. On a yearly basis, the Index increased +5.0% in

April versus +5.2% in March. Six of 10 components underlying the Index were negative in April, a reversal on previous month where 60% of the components printed positive.

Existing Home Sales fell -0.8% to a 5.05 million annual rate. Sales fell 12.9% YoY and 37% of the sales were from distressed properties. First-time homebuyers represented 36% of the market versus 44% the year prior. Months' supply jumped +10.8% to 9.2 months while inventory rose 9.9% to 3.87 million units.

Pending Home Sales, which are based on sales of existing homes currently plagued by foreclosures, plummeted 11.6% in April over previous month and 12.9% over last year to an 81.9k annual rate. The drop was broad-based with only the Northeast seeing a gain of 1.7%. The South led declines with a drop of 17.2% MoM, the Midwest 10.4% and the West 8.9%.

Emerging Markets

In Emerging Markets Fixed Income, the three sectors of the markets – the external sovereign, corporate debt and local currency bonds, represented by the JP Morgan Emerging Markets Bond Index Global Diversified (EMBI), the JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI) and the JP Morgan Government Bond Index Emerging Markets Broad Diversified (GBI-EM) – posted mixed results for the month ending May 31, 2011.

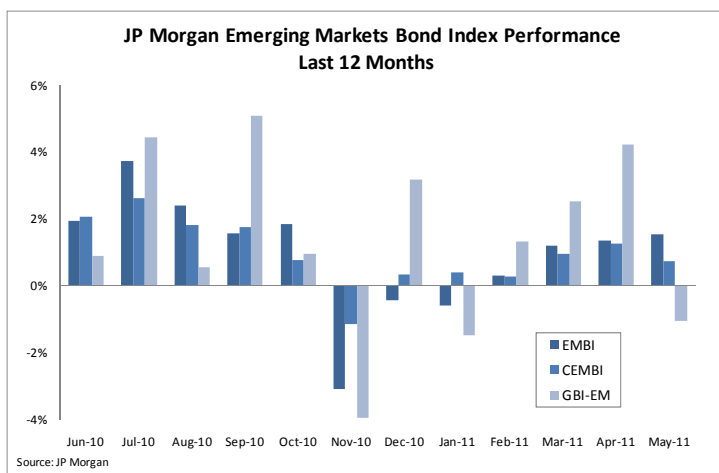
	Tickers	Monthly Return	YTD	YTM	Spread	S&P Ratings
EMBI	JPGCCOMP	1.53%	3.81%	5.86%	290	BBB-
CEMBI	JBCDCOMP	0.72%	3.60%	5.78%	330	BBB
GBI-EM	JGENBDUU	-1.07%	5.50%	6.69%	NA	A-

Source: JP Morgan

(Past performance is no guarantee of future results.)

For the month of May, external sovereign and corporate emerging markets (EM) debt benefited from a modest decline of 23 bps in the 10-year U.S. Treasury yield. The investment grade credits in both the EMBI and CEMBI outperformed their high yield counterparts for the month.

The monthly returns for the investment grade components of the EMBI and CEMBI for May were 2.14% and 1.21%, respectively. Geographically, the gains for the EMBI and CEMBI were broad based with Africa, the Middle East and Latin American credits leading returns. The EM government local currency bonds were the worst performer with a return of -1.07%, driven by currency weakness primarily in Europe and the Middle East/Africa, which posted returns of -3.45% and -2.16%, respectively.



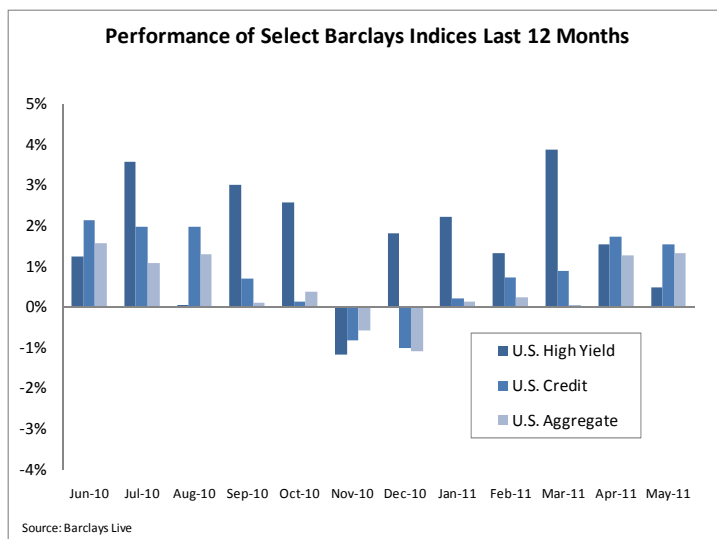
The month of May witnessed the reversal of the “risk on” EM debt trade that began at the end of March. The “risk off” trade for the month was driven predominantly by a string of weak economic data coming out of the U.S., and Standard & Poor’s placement of the U.S. AAA debt rating on negative outlook pending negotiations within the U.S. Congress to raise the debt ceiling. Additional pressure continued to come from European periphery headline risk. Investors are undecided on whether global markets are in a recovery mode or if they are in for a mid-cycle correction requiring further government stimulus, such as a “QE3”, and a further extension of low interest rates. As a result, EM spreads slowly widened 9 bps to the end of the month to 290 bps, versus April month-end.

We continue to expect EM countries and companies to benefit from rating upgrades during the next 12 months; however, EM valuations are likely to remain constrained by the global volatility. The new issue pipeline has picked up and is expected to remain robust over the medium-term, which should continue to provide select

opportunities to buy new credits, coming with new issue premiums or discounts to an existing yield curve for repeat issuers.

Global Developed Credit

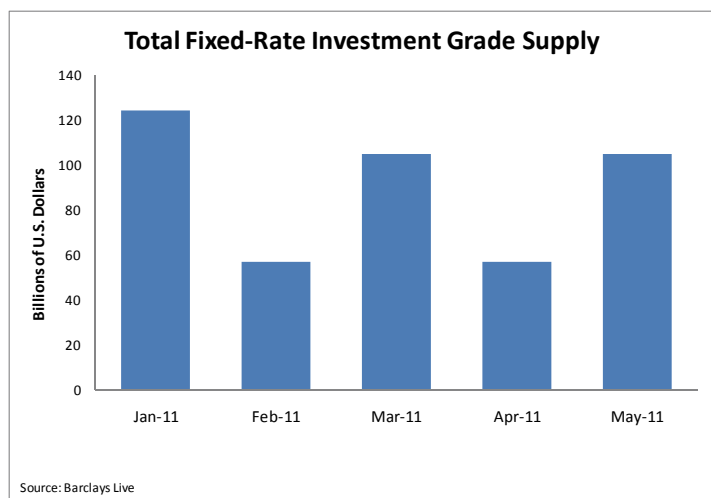
May marked the first month of credit market underperformance in 2011 with negative monthly excess returns posted for both investment grade and high yield. The Barclays Capital U.S. Credit Index underperformed duration-matched U.S. Treasuries by 27 bps for a total return of 1.53%. The Barclays Capital High Yield Index returned 49 bps for the month, underperforming U.S. Treasuries by 81 bps.



Risk assets generally declined during the month based on weak U.S. economic data as well as continuing concerns over the potential for a Greek debt restructuring. By month-end, it was reported that the European Commission, European Central Bank and International Monetary Fund had made significant progress with respect to fiscal reform and a privatization program. Conflicting news stories suggest, however, that Germany has backed off from a forced restructuring in conjunction with comments about Greece possibly leaving the eurozone.

Within the investment grade universe, the best-performing sectors included Foreign Local Government

(+80 bps); Lodging (+39 bps); Other Industrial (+9 bps); Natural Gas Distributors (+8 bps) and Supermarkets (+7 bps). Higher-rated credits outperformed lower rated and crossover credits. The worst-performing sectors were Life Insurance (-103 bps); Metals and Mining (-98 bps); Entertainment (-81 bps); Media Non-Cable (-77 bps) and Environmental (-61 bps). The best performers in the high yield space for the month were Pipelines (+1.95%); Retailers (+1.22%); Packaging (+1.17%); Airlines (+1.13%) and Property/Casualty Insurers (+1.12%). The worst high yield sectors for the month of May were Home Construction (-37 bps); Construction Machinery (-20 bps); Transportation Services (-19 bps); Independent Energy (-9 bps) and Other Industrial (-8 bps). Consistent with the performance in the investment grade market, higher beta credits underperformed in May in a reversal of the pattern of recent months.



Fixed-rate investment grade supply for May was \$105 billion, a significant increase from April's \$57 billion. As was the case in April, industrials were the most active issuers. High yield issuers priced \$42.8 billion in May, beating the previous monthly record of \$35.4 billion in March 2010. Year-to-date (YTD) high yield gross supply now stands at \$152 billion, nearly equal to the full year total for 2009. According to data published by Barclays Capital, two-thirds of proceeds have gone toward refinancing with 18% going toward mergers & acquisitions (M&A), 12% towards general corporate purposes (to include capital expenditures), and the remainder for other purposes.

With regard to the macroeconomic environment, those that are bullish would argue that recent economic data represents a temporary soft patch and that a rebound will ensue once the negative effects of higher gasoline prices and Japan-led supply disruptions normalize over the next few months. While this may be true, it is also true that this economic recovery is atypical and should be viewed as such. The fact that the U.S. is having one of the weakest post-war nominal recoveries in conjunction with an unusually strong post-recession rally in commodities is a reminder of the conflicting forces at work in this cycle which differentiate the recovery from recent predecessors. This further challenges an already difficult policy-making environment where the ability to call on further fiscal or monetary stimulus is constrained. With respect to the investment grade and high yield credit markets, DoubleLine continues to believe it is unlikely that credit quality improvement continues at the same pace relative to the start of the recovery and that opportunities for further spread compression have moderated. We continue to favor investment grade versus high yield credits.

Mortgage-Backed Securities

Washington, D.C. continues to influence our markets with the uncertainty of future regulations and the refusal to deal with the Government-Sponsored Enterprises (GSEs) and foreclosure issues.

Headlines were abundant in May with many trade groups trying to craft responses to the Dodd-Frank bill. The bill mandates both "skin-in-the-game" for new securitizations and GSE reforms. On May 23, Chairman of the Capital Markets and GSEs Subcommittee, Congressman Scott Garrett, announced seven bills to end the Fannie Mae/Freddie Mac bailout: Prevent Dividend Payment Decrease, Abolish Affordable Housing Trust Fund, Ensure an Exact GSE Replica is not Created, Require Disposition of Non-Mission Critical Assets, Set a Bailout Cap for the GSEs, Subject Fannie and Freddie to the Freedom of Information

Act (FOIA), and Prohibit Taxpayer Funding of GSE Employee Legal Fees.

In regard to skin-in-the-game, a number of congressmen, the same ones who were appalled by the lack of underwriting standards in the mortgage market previously, are now trying to reduce the amount of down payment needed to obtain a qualified residential mortgage (QRM) loan. To avoid having to hold skin-in-the-game on a securitization, you either had to use Agency securities or use loans that were considered the best possible credits available, also known as QRMs. This QRM designation was to be the platinum level of all loans. To get that designation, you had to have no less than 20% down, full documentation and at least six months of reserves in a cash account, amongst other qualifications. These congressmen are trying to ease the standard so that housing is more affordable. In our opinion, this is the wrong approach.

The comment period for the Dodd-Frank legislation has been extended to August 1, 2011 so we will monitor how the market reacts to this news. The fixed-rate prime/alt-A market, while suffering a small price decline, has reacted as we expected with almost little to no drop in price currently due to what we perceived as negative duration.

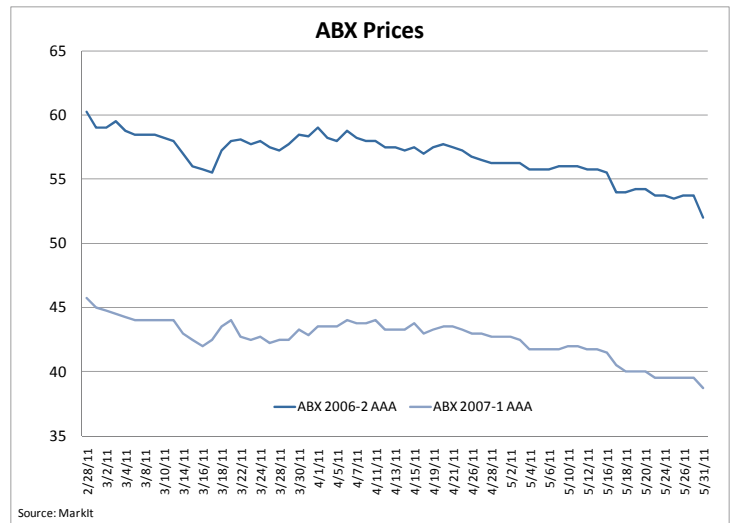
Conditional Prepayment Rates (CPR)			
2011	March	April	May
FNMA	15.2	13.2	12.8
FHLMC	14.4	12.9	12.2
GNMA	10.2	9.1	8.6
Mortgage Index	4/30/2011	5/31/2011	Change
Average Dollar Price	105.43	106.23	0.80
Duration	4.34	4.50	0.16
Index Returns	March 2011	April 2011	May 2011
Aggregate	0.06%	1.27%	1.31%
MBS	0.28%	1.10%	1.07%
Corporate	-0.13%	1.72%	1.44%
Treasury	-0.06%	1.15%	1.56%

Source: Bloomberg, eMBS, Barclays Capital, Deutsche Bank

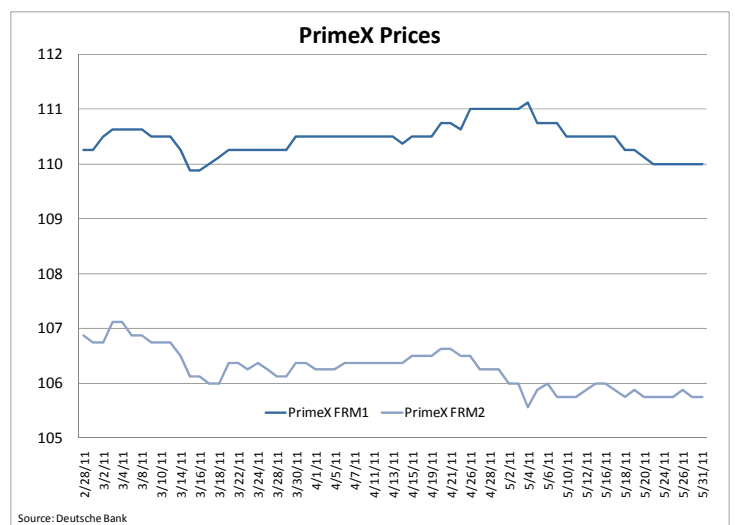
Non-Agency Mortgage-Backed Securities

Both the ABX 07-1 AAA and ABX 06-2 AAA Indices represent the subprime market. The ABX 07-1 AAA Index,

which closed both March and April at a price of 43, closed on May 31 at 38.5, a drop of 9.5% for the month. The ABX 06-2 AAA Index, which closed April at 57, closed on May 31 at 52.25, a drop of 8.3% for the month.



The PrimeX Fixed-Rate Mortgage (FRM) 1 Index closed at 110.25, a drop from 110.90, while the PrimeX FRM 2 Index closed at 105.50, a drop from 106.25. The PrimeX Indices certainly do not match the volatility of the ABX Indices. The PrimeX Indices track prime and alt-A fixed-rate product rather than floating rate bonds.



In our view, news of four Maiden Lane auctions of mostly subprime product, totaling well over \$8 billion, and headlines of double-dip home prices should put pressure

on the lowest credit security available, and in this case that is subprime. Add in the continuing saga of attorneys general suits, the Dodd-Frank legislative uncertainty and the European situation – specifically the Greek default issue – we have uncertainty which leads to lower prices for lower credits.

After calling a halt to the auction of Maiden Lane’s portfolios in May, the U.S. Treasury will sell over \$20 billion in product over the coming months. And as that headline was hitting, the European bank Dexia, announced the potential sale of nine billion more of non-Agency bonds.

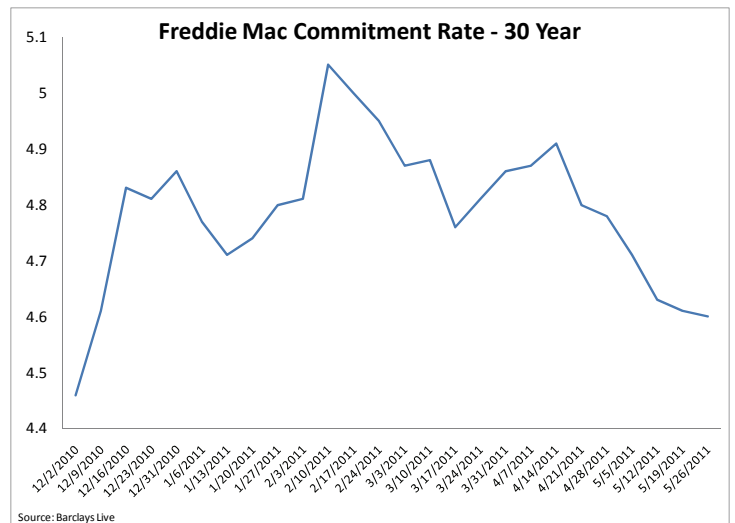
The lack of supply has been positive for the past year. Now that supply seems to be reappearing, especially in the subprime or floater sector, the market has been pushed lower as reflected in the ABX Indices.

PrimeX on the other hand has held up much better than the ABX. The rationale there is simply one of fixed coupon payments on higher balances that experience lower severities and had stronger underwriting criteria. In the prime/alt-A market, however, floaters and hybrid collateral have experienced slightly larger pricing declines than the pure fixed-rate product.

Agency Mortgage-Backed Securities

The Agency MBS¹ market underperformed the Corporate and Treasury components of the Barclays Capital U.S. Aggregate Bond Index for the month of May, primarily due to the fact that the MBS Index has a shorter duration than the other sectors. Within the mortgage sector, 30-year paper outperformed 15-year paper which is characteristic of a declining rate environment. The Ginnie Mae (GNMA) sector outperformed the Fannie Mae (FNMA) and Freddie Mac (FHLMC) sectors, as the GNMA prepayment speeds were lower than those of GSEs (FNMA and FHLMC). Given the high dollar price of mortgage securities, slower prepayments mean higher yields and the market will value those slower-paying pools more.

1. We are referring to the Barclays Capital U.S. MBS Index, which is made up of Agency MBS.



Prepayment speeds have drifted slightly lower over the past few months. During this period the 30-year commitment rate has gone from 5.00% to 4.55%. The economic incentive to refinance has increased, yet it is not being reflected in prepayments. At current levels, almost 70% of 30-year borrowers have economic incentive to refinance. The problem is that most of those borrowers are unable to refinance due to their financial condition and tighter underwriting standards. It will take a change in one of these two conditions to bring about a substantial change in prepayment speeds.

Commercial Mortgage-Backed Securities

CMBS markets ended the month significantly weaker across the capital structure following broader markets as weak economic prints coupled with anticipation for the QE2 finale sparked uncertainty for the first time in awhile. We saw generic last cash flow (LCF) super seniors widen out by 30-40 bps for the month of May with the bulk of the price action down in the mezzanine AAA super senior CMBS (AMs) and junior AAA CMBS (AJs) as these bonds were down about 3 to 7 points, respectively.

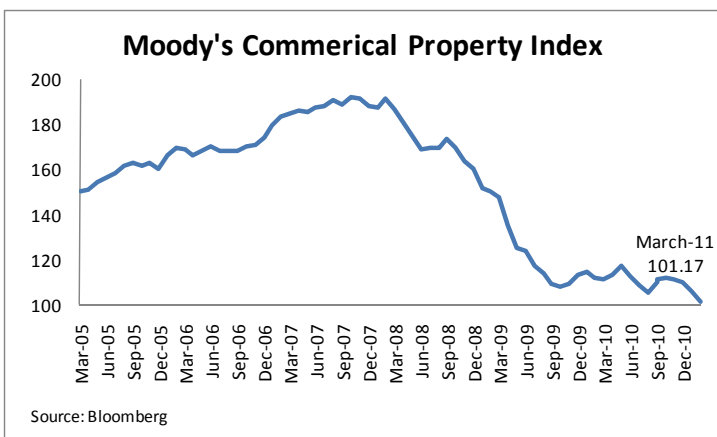
On the synthetic side of the equation, CMBX price movements were more pronounced as the Index provides a good hedge for dealer inventories which are heavy in

structured products as well as somewhat of a correlated macro bet against the market.

While prices were generically down for the month, the CMBS market did manage to push out \$2.9 billion of new issuance which priced relatively well given the circumstances. The 10-year LCF super seniors off the two new-issue deals priced at swaps + 110 bps and swaps + 125 bps, respectively.

The CMBS portion of the Barclays Capital U.S. Aggregate Bond Index returned 0.3%, underperforming the Index by 85 bps.

On the commercial real estate (CRE) fundamental side, delinquencies surprisingly reversed their recent up-trend declining 4 bps in May. For the month, the 30+ day delinquency rate declined 4 bps to 9.88%. On the valuation front, the latest Moody's/REAL Commercial Property Price Index (CPPI) showed a 4.2% decline for the month of March, equating to a 47% decline from October 2007 peak and 3.5% above the post-peak low recorded in August 2010.



Our investment focus remains on security selection as we continue to look for securities with a more “storied” basis as our ability to drill down to collateral/borrower level allows us to adequately assess risk. Looking forward, our outlook for the sector continues to remain cautious despite an improvement in the lending environment as a majority of loans that are able to obtain financing in new vintage CMBS are predominantly higher in quality from

seasoned transactions. Interest rate risk and unemployment continue to be large contributing factors for CRE fundamentals and without any real improvement in the unemployment picture, real recovery in the CRE sector will be limited.

U.S. Government Securities

U.S. Treasury yields moved lower in May, building on the rally that began in early April.

Yield Curve

	4/30/2011	5/31/2011	May Change
3 month	0.04	0.05	0.01
6 month	0.10	0.11	0.01
1 year	0.18	0.16	-0.03
2 year	0.60	0.47	-0.13
3 year	0.99	0.78	-0.21
5 year	1.97	1.70	-0.27
10 year	3.29	3.06	-0.23
30 year	4.40	4.22	-0.17

Source: Bloomberg

Treasury investors were focused on the steady stream of disappointing economic data and were undeterred by the approaching conclusion of QE2 and the prospect of debt limit-induced default by the U.S. Treasury. Ongoing turmoil surrounding the Greece debt drama helped maintain a flight-to-quality bid as well. The middle of the yield curve performed best in May as was the case in April. The 7-year U.S. Treasury was the best performing on-the-run, falling 28 bps in yield. The 10-year note ended the month at a yield of 3.06%, down from its YTD high of 3.74% in early February and its most recent peak of 3.59% in early April. The 2-year note ended the month at 0.47%, down 13 bps on the month and only 13 bps above its all-time low reached in November 2010.

The Barclays Capital U.S. Government Index returned 1.42% in May. The 30-year bond provided the highest return at 3.70% by virtue of its long duration and 19 bps drop in yield. Agency securities returned 0.76%, well behind the 1.56% return on U.S. Treasury issues and

underperforming Treasuries by 6 bps on a duration-adjusted basis. Inflation-indexed Treasuries lagged as the trend toward higher expected inflation rates dating back to August of 2010 reversed in May. The Barclays Capital U.S. Treasury Inflation-Protected Securities (TIPS) Index returned 0.31% in May.

Two long-standing themes in the posture of our government exposure are an overweight in the 5- to 10-year segment of the yield curve and an underweight in exposure to Agency securities. Those two themes were responsible for the favorable relative return in May, and should be reinforced in June. The overweight in intermediate-maturity issues is likely to creep higher, as the yields on short Treasuries have become decidedly unattractive. The allocation to Agency securities will move modestly lower as the supply of Agencies maturing within the period of unlimited Treasury support (through December 2012) trends lower and spreads contract.

Barclays U.S. Aggregate Bond Index

The Barclays US Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Barclays U.S. Credit Index

This index is the US Credit component of the US Government/Credit Index and consists of publically issued US corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered. The US Credit Index is the same as the former US Corporate Investment Grade Index.

Barclays U.S. Government Index

This index is the US Government component of the US Government/Credit Index and includes securities issued by the US Government, including treasuries and agencies. This includes public obligations of the US Treasury with a remaining maturity of one year or more and publically issued debt of US Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the US Government.

Barclays U.S. High Yield Index

This index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issuer from countries designated as emerging markets (e.g. Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeros, step-up coupon structures, 144-As and pay-in-kind (PIK, as of October 1, 2009) are also included.

JP Morgan Corporate Emerging Market Bond Index (CEMBI)

This index is a market capitalization weighted index consisting of US-denominated Emerging Market corporate bonds. It is a liquid global corporate benchmark representing Asia, Latin America, Europe and the Middle East/Africa.

JP Morgan Emerging Markets Bond Global Diversified Index (EMBI)

This index is uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by EMBI Global.

JP Morgan Government Bond Emerging Markets (GBI EM)

This index is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure.

Moody's REAL/Commercial Property Price Index (CPPI)

This index tracks fluctuations in value by measuring the sale price of specific properties that have been sold at different points in the real estate cycle.

PrimeX

The PrimeX index is a synthetic credit default swap (CDS) index which references non-Agency Prime residential mortgage-backed securities (RMBS). There are 20 prime RMBS deals referenced in each sub-index from 2005, 2006, and 2007.

S&P/Case-Shiller Home Price Indices

The Standard & Poor's (S&P) Case-Shiller Home Price Indices track changes in U.S. house prices using repeat sales pricing methodologies. The 20-City Composite Home Price Index is a value-weighted average of the 20 metropolitan area indices.

An investment cannot be made in an index.

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