DoubleLine®

Monthly Commentary

November 2011

DoubleLine

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Overview

November continued where October left off with a continued fall in both the headline Unemployment Rate and the broader Underemployment Rate, to 8.6% and 15.6%, respectively.

In addition, the 4-week moving average of Initial Jobless Claims continued to trend lower at 395,800. All this improving data, however, needs to be taken with a grain of salt. What needs to be highlighted in this case is that the 0.4% decrease in the headline rate was largely influenced by 315,000 Americans completely dropping out of the labor force. It is not clear, however, how much of this has to do with the aging Baby Boom generation and other demographic forces, and how much this has to do with true discouraged workers giving up on their job search.

November's Labor Force Participation Rate of 64% is the second lowest in the last twenty years. Further data regarding the state of American workers in November showed Average Hourly Earnings grew 1.8%, staying in what has essentially been a very tight year-over-year (YoY) range of 1.7-1.9% for the last twelve months. Average Weekly Hours Worked held steady in November at 34.3. The Institute of Supply Management (ISM) Manufacturing Index came in at 52.7 showing expansion for the 28th straight month, and the ISM Non-Manufacturing Index came in at 52.0 showing expansion for the 24th straight month.

The Economic Cycle Research Institute (ECRI) Weekly Leading Index Growth Rate was -7.80% for the week ending November 25 – a fall versus the week prior. This is the 15th consecutive week in negative territory for the ECRI. Combining the previously discussed labor data, the ISM data, and the ECRI's leading indicator still heavily in negative territory, we have a very mixed picture for the U.S. economy in November.

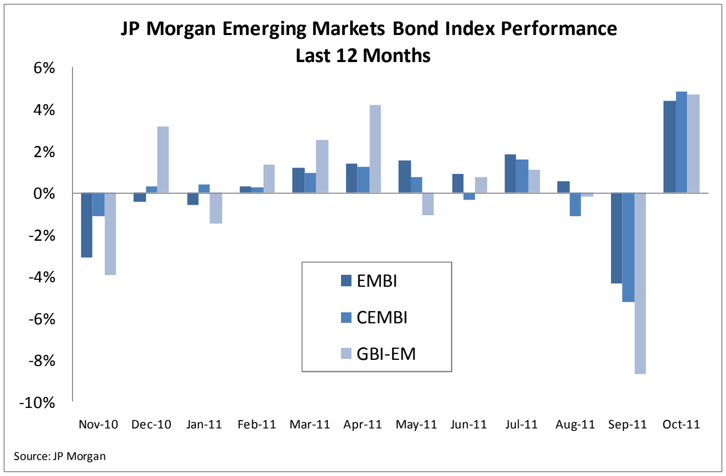
Emerging Markets

In Emerging Markets Fixed Income, the three sectors of the market – 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), respectively – posted negative returns for the month of November.

	Tickers	Monthly Return	Last 3 Months	YTD	YTM	Spread	S&P Ratings
EMBI	JPGCCOMP	-0.88%	-1.02%	6.15%	5.92%	396	BBB-
CEMBI	JBCDCOMP	-1.52%	-2.18%	1.46%	6.41%	470	BBB
GBI-EM	JGENBDUU	-3.35%	-7.56%	-0.90%	6.40%	NA	A-

Source: JP Morgan
(Past performance is no guarantee of future results.)

For the month of November, all three sectors of the market posted negative returns stemming from ongoing concerns with the European debt crisis and a potential China slow down which prompted another sell off in risk assets. Emerging markets (EM) external sovereign bonds were the best performing sector, returning -0.88% for the month. EM corporate bonds followed at -1.52% and EM local currency bonds were the worst performing sector at -3.35% as investors flocked to the perceived "safe haven" of the U.S. dollar. With ongoing fears of a global slowdown, high grade bonds outperformed high yield bonds in both the EM external sovereign and corporate indices. EM sovereign high grade bonds returned -0.60% versus -1.26% for its high yield sub index. EM corporate high grade bonds returned -0.98% versus -2.79% for its high yield sub index. Europe once again proved to be the main driver of volatility, and was the worst performing region in all three sectors of the market. The European sub index of the EM external sovereign and EM corporate index returned -2.38% and -3.19%, respectively. The European sub index of the EM local currency bond index returned -4.79%, driven by Poland and Hungary. Fear that European banks would slow down, or curtail lending to shore up their balance sheets, led to heightened capital flight for these countries.



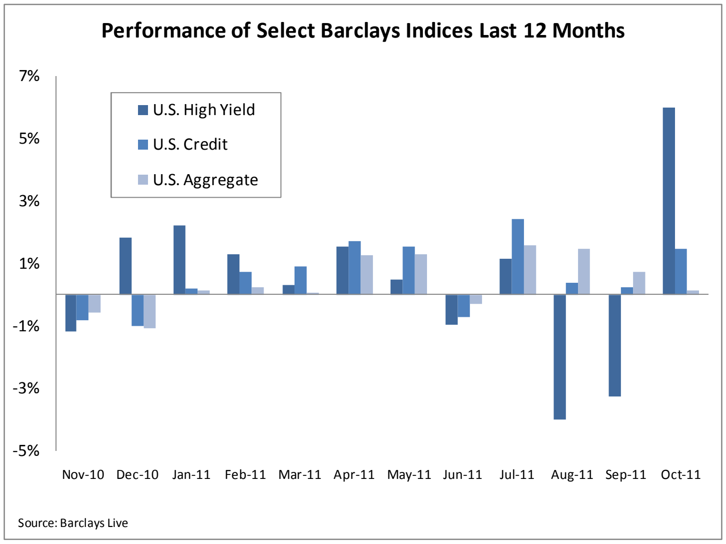
Another month, another round of "risk-on", "risk-off", with only a couple weeks between the Eurozone's recent announcement of its "Grand Plan" in late October, and the markets rejection of the plan. The "Grand Plan", which included: an increase in Greek debt haircuts, larger European Funding Stability Facility (EFSF) and a mandate for banks to raise capital levels; did little to keep the 5-year Italian and Spanish debt yields from peaking at unsustainable levels of 7.70% and 6.29%, respectively. EM spreads widened 52 bps from month end October to a peak of 422 bps on November 23, before regaining some ground, finishing 26 bps wider than the previous month. The market began to regain strength toward month-end as rumors out of Europe began to hint of new and more powerful measures being worked on, a new "Mega, Grand Plan", which could be announced sometime during summit meetings December 8-9. Also supporting market sentiment were the following points: 1) the hope that three new governments in Greece, Italy and Spain would be able to follow through on necessary, but unpopular austerity measures to ensure future ECB support for restructuring, aid tranches (Greece) and bond purchases (Italy, Spain); and 2) Western central banks, along with Japan, provided significant liquidity to their cash strapped banks through a 50 bps cut in the cost of their dollar swap lines. Not to be left out, China announced a 50 bps cut in its reserve requirement, presumably to provide liquidity to its own banking sector as European banks begin to deleverage. Further rate cuts around the world are anticipated in the coming weeks and months as global growth continues to be revised downward.

Away from politics, the markets provided mixed economic results in November. The European Commission lowered its 2012 GDP target for EU to 0.5%. We expect EM growth to be impacted, declining toward the 4.5-5.0% range. The Euro area PMI declined 0.9 pts to 45.7 in November, pointing to a trend for further contraction. Officials now believe the eurozone unemployment level could rise from 10.3% in October, to over 11.0% in 2012. Heavy austerity measures and bank deleveraging will only add pressure to these already weak economic statistics. China's PMI of 49.0 for the period was its first contraction since February 2009. Economic data out of the U.S. has been a little more promising, with the national unemployment rate down from 9.0% in October to 8.6% and headline payrolls up by 120,000 in November. In addition, the ISM manufacturing index rose 1.9 points to 52.7, showing improvement in new orders. Economic sentiment in the U.S. was helped by favorable sales data coming out of the Thanksgiving weekend. It is not yet clear whether the recent, favorable data from the U.S. will be the start of a trend or just a holiday shopping anomaly. Until the details of the new "Mega, Grand Plan" are specified and begin to be implemented the European sovereign debt and banking crisis will continue to dominate market sentiment going into 2012.

Credit fundamentals remain strong for EM countries and companies. We continue to expect EM countries and companies to benefit from rating upgrades, albeit at a slower pace, during the next 12 months on the back of these strong credit fundamentals. There were an estimated 35 sovereign upgrades this year, with an expected 22 next year, providing a solid base for additional corporate upgrades going forward. The new issue pipeline is expected to remain robust for the next couple of weeks, potentially providing some select opportunities to buy new credits, before shutting down for the holidays. EM valuations are expected to remain constrained by the global volatility; however, we continue to look for opportunities in these bouts of volatility.

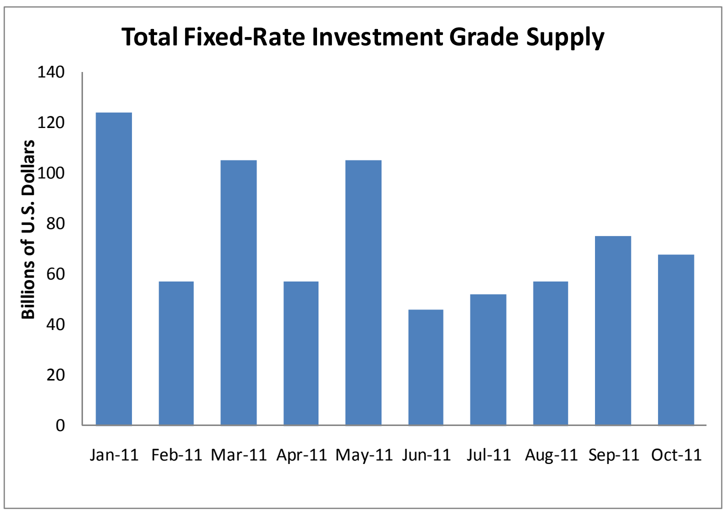
Global Developed Credit

November proved to be a dismal month for risk asset returns as credit spreads were hit hard. The month began with Greece's surprise referendum followed by a political crisis in Italy which eventually led to top-level Administration changes in two countries within two weeks. On the other side of the Atlantic the failure of the Super Committee to reach a deal on the U.S. budget proved disappointing to the markets. The Barclays Capital U.S. Credit Index ended November 38 bps wider and underperformed duration-matched Treasuries by 257 bps. Year-to-date (YTD) total returns in investment grade credit now stand at 6.29%. The high yield market, as measured by the Barclays Capital High Yield Index, reversed some of October's gains and was down 2.16% in November taking YTD total returns to 2.26%. Both the investment grade (-4.05%) and high yield (-4.42%) sectors are posting negative YTD excess returns.



Within the investment grade universe the best-performing sectors included Lodging (+75 bps); Non-Bank Financials (-26 bps); Other Industrials (-38 bps); Foreign/Local Government (-74 bps) and Airlines (-80 bps). The worst-performing sectors were Refining (-531 bps); Media/Cable (-476 bps); Brokerage (-453 bps); Life Insurers (-442 bps) and Oil Field Services (-429 bps). The best performers in the high yield space included Paper (+88 bps); Lodging (+55 bps); Diversified Manufacturing (+24 bps); Restaurants (+22 bps) and Non-Bank Financials (+20 bps). The worst performers in November were Wireless (-4.55%); Non-Captive Finance (-3.73%); Property/Casualty Insurers (-3.70%); Wirelines (-3.56%) and Airlines (-3.49%). In both the investment grade and high yield markets, higher beta credit underperformed higher rated issuers during the month.

Fixed-rate gross investment grade supply for November was $95.4 billion, up from the $76.9 billion in gross supply issued in October. Industrials comprised the bulk of the issuance at $59 billion. High yield issuers came to market with $22.5 billion in dollar-denominated bonds taking YTD issuance to $224 billion. November's default activity was the highest since November 2009 and the eighth largest monthly volume on record. There were six defaults totaling $9.6 billion in bonds in November following an upwardly revised three defaults in October which totaled $696 million. The defaults of Dynegy and General Maritime decreased the par value of the Barclays Capital High Yield Index by $4.1 billion. Other notable defaults included MF Global and AMR, the parent of American Airlines.



Seasonal factors and liquidity concerns are typically at the forefront during this time of year. Prior to the global financial crisis in 2008, the established pattern was for summer doldrums to give way to heightened activity in the form of a deluge of issuance between Labor Day and Thanksgiving. Spreads then tended to weaken as risk was shed across many trading desks ahead of a November 30 year-end. This set the stage for a rally in December as primary issuance faded and dealer books had a bid to bulk up their inventory levels in anticipation of a wave of demand in the New Year. Today's reality is more one of a limited risk-taking appetite in the face of highly volatile markets. Investors remain fearful that European politicians and regulators are simply not up to the task of negotiating the near-term liquidity crisis which has now spread beyond the periphery countries to the largest economies in the eurozone. As a result, seasonality has become a far less important factor in the corporate bond market as investors struggle with how to appropriately price the political dynamics which could lead to the low probability – but high severity – of a full-blown eurozone financial meltdown.

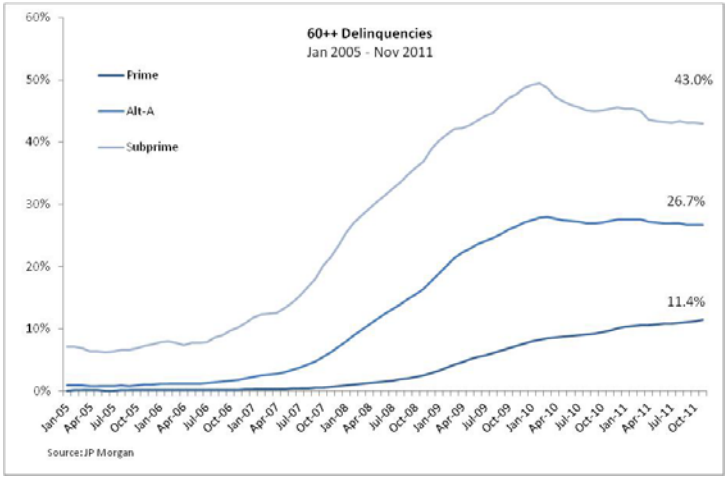
Mortgage-Backed Securities

On October 31, the investment firm of MF Global filed for bankruptcy protection. This action was caused by bets the firm made in the European Sovereign Debt market and was not due to mortgage exposure in non -Agency MBS, which was the catalyst for a majority of the problems the investment banks faced in 2008. There has been marginal weakening of non-Agency securities over the past few months but the bankruptcy can't be blamed on this issue alone. This bankruptcy will give the Volker Rule proponents an example to show why this rule is necessary. The Volker rule is scheduled to be implemented by July 2012. In its present state, this rule would prohibit "prop desks" at Wall Street firms and disincentivize these firms from making big positional bets. The result would be a market more similar to the municipal market and trading in the non-agency market would resemble the trading that occurred back in 2008 when dealers would not bid on securities and only took orders. We do not think the Volker Rule will be implemented in its present form as there will be many objections from Wall St. firms, both from the buy side and the sell side.

The Attorneys General lawsuit against the banks over mortgage loans continues with some changes. California, Delaware and New York have extracted themselves from the settlement talks as they feel the dollar figures are too low. On December 1, the Massachusetts AG came out with its own suit against five banks. This issue will be with us for the foreseeable future. One potential settlement point is an agreement by banks to modify mortgage loans in exchange for a smaller monetary settlement.

The future of the Government Sponsored Enterprises (GSEs) is another issue that comes and goes in national media. During November, Senator Corker (R, Tennessee) introduced legislation to "Responsibly Unwind Fannie and Freddie". The market assumes that any "responsible" action would be phased in over a number of years so as to not add further risk to an already fragile market. A separate proposal is the creation of a GSE-issued piece of debt whose cash flows would mirror that of a specific coupon cohort i.e. FNMA 4.5's. This piece of debt would have a non guaranteed first loss piece which would be privately held while protecting taxpayers from having to pay for the first percentages of losses that the cohort pool could expect. A proposal like this seems to appeal to both sides of the aisle in Washington, for different reasons. Given that 2012 is an election year we expect any decision on the future of the GSEs to be later rather than sooner.

Many mortgage analysts feel there is a need for a program to attract more investors capital to the housing market. Some of these plans center around an Own to Rent program (or the other way around depending on which way one looks at it). This plan would take the Real Estate Owned (REO) properties that the GSEs own and sell them into an investment vehicle. The GSEs would provide financing for the transaction. For a plan like this to go through and be



effective, certain roadblocks have to be passed. There would be a need for a mortgage company(s) to handle many aspects of the program. A transaction level would have to be established which would cause the GSEs to register a loss sooner and consequently go to Congress sooner for financial support. This program can also be viewed as helping investors (Wall Street) and—haven't we been down this road before? Perhaps it is no coincidence that the Wall Street solution provides benefits to Wall Street investors, and perhaps they should skip the middleman and go directly to the borrowers. This idea has support on Wall Street and as a result is, at a minimum, being discussed in Washington.

A report was released in November which showed what Wall Street expects in terms of QE III. On average, the firms polled believe that QE III will happen, probably in the second quarter of next year, that it would involve mortgage securities and the size would be approximately $545 billion. This increase in demand would be very good for the mortgage sector as a whole.

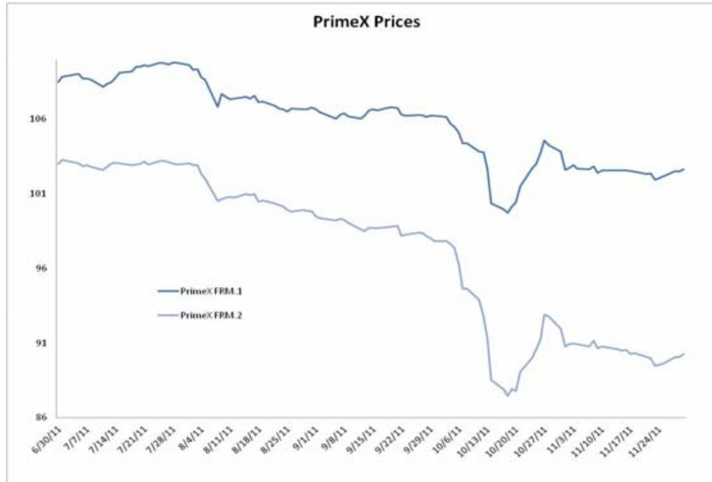
Non-Agency Mortgage-Backed Securities

In the non-Agency market, the ABX 7-1 AAA closed

October 30 at 35.25 and closed November 30 at 32.5. The ABX 06-2 AAA went from 43.75 to 41.08 for the same period, again showing weakness in a high volatility month.

The PrimeX Index had similar movement, with PrimeX Fixed-Rate Mortgage (FRM) 1 trading from 103.82 down to 102.625, and the FRM 2 trading from 91.96 down to 90.24 over the month.

Volume also was down from last month going from 14+ billion to 10 billion, but there were some large liquidations that were only seen by a few purchasers. These lists traded well for the better quality assets, but again showed weakness in the more severely credit challenged assets.



Current Face Traded	September 2011	October 2011
Total	14,517,135,343	10,314,158,023
Liquidation	4,382,764,408	1,803,088,666
BWIC	10,134,370,935	8,511,069,357

Source: Deutsche Bank; Bid Wanted In Competition (BWIC)

Conditional Prepayment Rates (CPR)

2011	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov
FNMA	19.4	15.2	15.2	13.2	12.8	15.0	15.2	17.3	22.6	24.8	24.8
FHLMC	21.0	17.4	14.4	12.9	12.2	14.2	14.9	17.0	22.3	25.9	25.8
GNMA	13.4	12.0	10.2	9.1	8.4	9.6	9.6	11.5	13.9	16.3	16.2

Source: eMBS

Mortgage Index	10/31/2011	11/30/2011	Change
Average Dollar P	107.30	107.22	-0.08
Duration	3.42	3.22	-0.20

source: Barclays Capital

Index Returns	Sept 2011	Oct 2011	Nov 2011
Aggregate	0.73%	0.11%	-0.87%
MBS	0.17%	0.00%	0.18%
Corporate	0.26%	1.79%	-1.96%
Treasury	1.75%	-0.82%	0.75%

ABX & PrimeX 3 month charts - source: Morgan Stanley
FHLMC Commitment Rate - source: Bloomberg

Agency Mortgage-Backed Securities

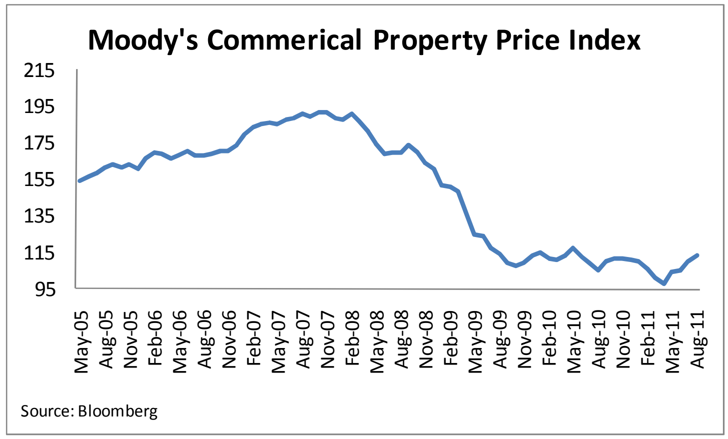
For the month of November, the mortgage market had a return of .18%. The Ginnie Mae (GNMA) sector returned .35% while the Fannie Mae (FNMA) sector returned -.14% and the Freddie Mac (FHLMC) sector returned -.02%. The GNMA sector had the best performance due to a better price return than the other sectors. There was not a lot of volatility during the month as the range of all mortgage pass-throughs was less than 5/8 point.

Prepayment speeds remained fairly constant in November. These speeds remain slower than they were last December when interest rates were 100 bps higher. We expect to see a slight increase in prepayments in the coming months as the Home Affordable Refinance Plan (HARP) 2.0 program becomes enacted.

Commercial Mortgage-Backed Securities

Performance in CMBS for the month of November was rather lackluster as on-going issues with Europe continue to weigh down on broader markets. As such, both cash CMBS and CMBX markets continue to trade on a technical basis with strong correlation to broader markets. There continues to be strong support for bonds at the senior portion of the CMBS capital structure with broader focus on seasoned short duration bonds as this part of the curve continues to be cheap relative to corporates and comparable spread products. For the month, the CMBS component of the Barclays Capital U.S. Aggregate Bond Index returned 0.33%, outperforming the broader index by 8 bps; YTD CMBS is up 4.64%.

On the commercial real estate (CRE) fundamental side, delinquency rates continue to remain flat to slightly up, due to a slow down in the pace of deterioration coupled with servicer loan modifications which effectively bring delinquent loans current for an indefinite period. For the month, the 30-day plus delinquency rate increased 4 bps in November to 9.91%. On the commercial property valuation side, the latest Moody's Commercial Property Price Index (CPPI) showed a slight decrease reflecting a 1.5% increase in September. This data point may be a bit skewed as transaction volume continues to remain low such that any large transaction may cause significant change in the index whether positive or negative.



Our investment focus for this sector remains largely the same with emphasis on security selection and focus in shorter duration assets including 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 slight improvement in lending environment as majority of loans that are able to obtain financing in new vintage CMBS are predominantly higher in quality off seasoned transactions. We'd also note that interest rate risk and unemployment continues to be a large contributing factor for commercial real estate fundamentals and without any real improvement in the unemployment picture, real recovery in the CRE sector will be limited.

U.S. Government Securities

November was a mirror image of October in the U.S. Treasury market, albeit with a reprieve from the elevated volatility experienced in October. The sovereign debt crisis in Europe was once again the main driver of returns, with a small assist from the Federal Reserve's "Operation Twist". Reversing October, Treasury yields generally fell and the yield curve flattened in November. The 2-year note yield rose 2 bps, while the 10-year note yield fell 5 bps, and the 30-year bond yield fell 8 bps. The 10-year note

Yield Curve

	9/30/2011	10/31/2011	October Change
3 month	0.02	-0.02	-0.04
6 month	0.05	0.04	-0.01
1 year	0.10	0.11	0.01
2 year	0.24	0.24	0.00
3 year	0.40	0.38	-0.02
5 year	0.95	0.96	0.01
10 year	1.92	2.11	0.19
30 year	2.91	3.13	0.22

Source: Bloomberg

yield traded in the 23 bps range in November compared to 64 bps in October.

The Barclays Capital U.S. Government Index returned 0.67% in November. Again in contrast to October, the strongest returns were posted by long maturity issues as the greater yield drop and longer duration combined to boost prices. Inflation-indexed Treasuries kept pace with conventional Treasuries, returning 0.77% in November on steady inflation expectations. Municipal debt also performed in line with Treasuries, as the Barclays Capital Municipal Bond Index returned 0.59% for the month.

The government portfolio returned 0.66% in October, virtually the same as the Barclays Capital U.S. Government Index. The portfolio maintained its posture from the end of October, staying closely in line with the broad market.

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