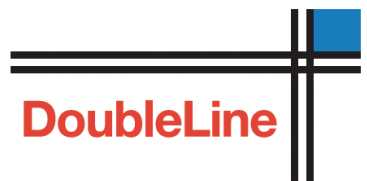


# Quarterly Commentary

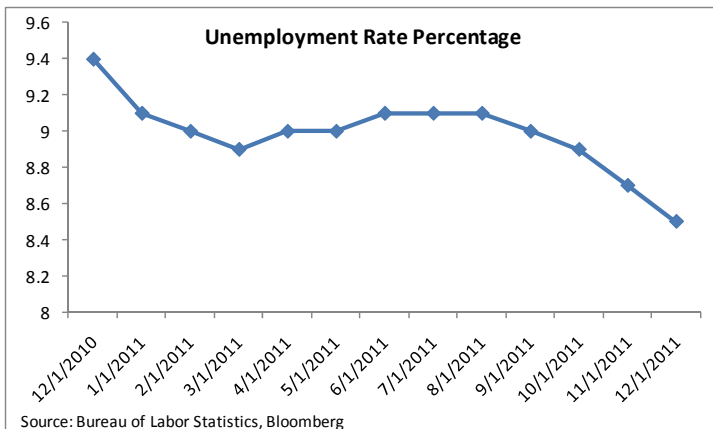
**Fourth Quarter 2011**



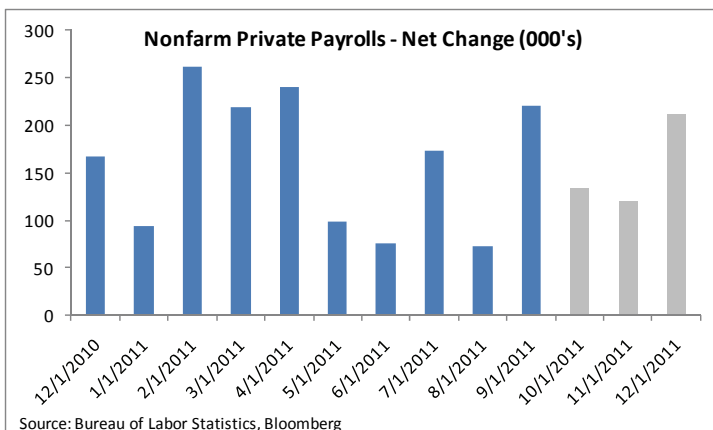
**DoubleLine**

## Overview

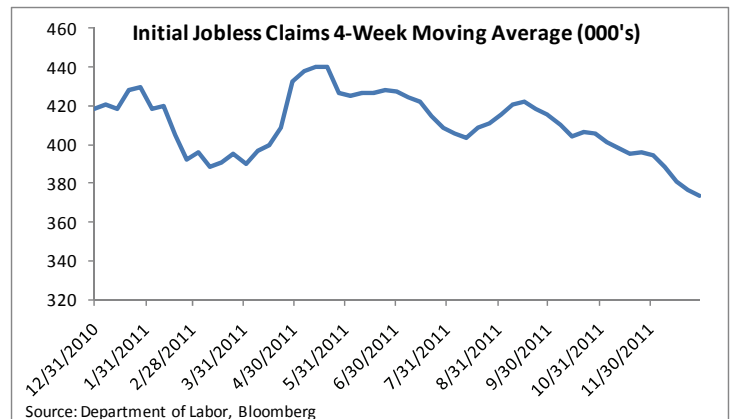
The fourth quarter of 2011 showed promising data for the economy as a whole, and employment in particular. December's unemployment rate stood at 8.5% which is a solid 40 basis points (bps) lower than at the beginning of the quarter.



While the labor force participation rate did revisit a 1981 seasonally-adjusted low of 64% in November and December, nonfarm employment expanded by 466,000 in the fourth quarter.



Initial jobless claims also hinted at a turnaround in the U.S. economy. The four-week moving average of initial claims ended the quarter well below the significant 400,000 mark – coming in at 373,000, capping eight straight weeks under 400,000.



The Institute of Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI) data implied continued growth in the manufacturing sector for each month of the fourth quarter. In fact, this Index has indicated growth for 29 consecutive months.

The Economic Cycle Research Institute (ECRI) Growth Index – a weekly composite of leading indicators – showed quite a contrary view of the economy in the quarter. It posted a negative reading for every week during this period. These negative readings from ECRI imply economic contraction in the near future.

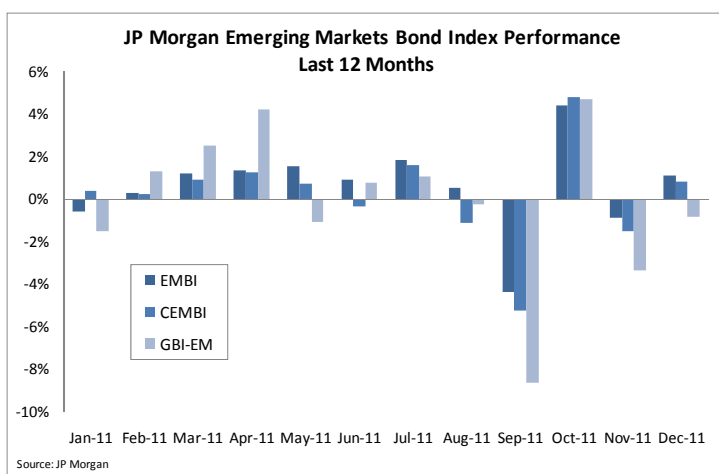
## Emerging Markets

All three sectors of the EMFI markets – the external sovereign, corporate debt and local currency bonds, represented by the JP Morgan Emerging Market 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 mixed returns for the month of December and throughout 2011.

	Tickers	Monthly Return	2011	YTM	Spread
EMBI	JPGCCOMP	1.13%	7.35%	5.84%	404
CEMBI	JBCDCOMP	0.84%	2.32%	6.33%	480
GBI-EM	JGENBDUU	-0.81%	-1.70%	6.45%	N/A

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

For the month of December, emerging markets (EM) sovereign bonds were the best performer with a return of 1.13%. Led by Latin America, all regions of the EM sovereign bond index posted positive returns, with the exception of Africa, which was down 0.13% over the month. December continued November's trend with the high grade sub-index outperforming its high yield counterpart. EM corporate bonds were the second best performer with a return of 0.84%. Regional returns were mixed as Latin America was the best performing region at 1.76% and Europe was the worst performing region posting -1.56% over the month. Similar to EM sovereigns, investment grade outperformed high yield. EM local currency bonds were the worst performer of the month, returning -0.81% as local currency markets were volatile. Hungary was the worst performing country for the month at -8.77%, followed by Russia at -4.02%.



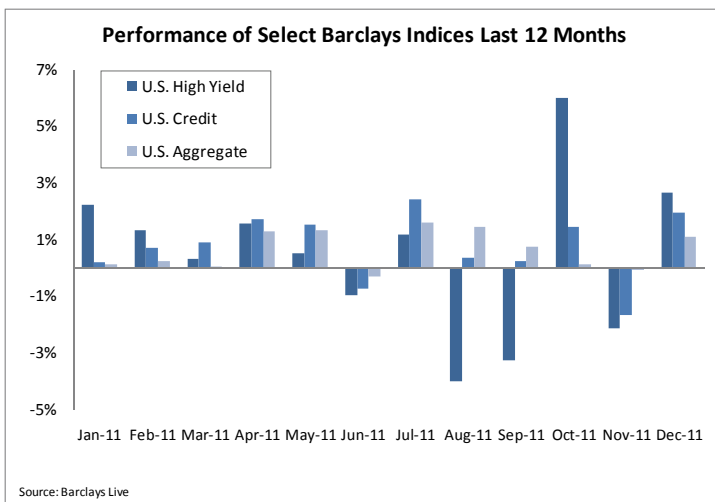
currency bonds being most affected, ending the 2011 year in the red at -1.70%. EM sovereign bonds were the most insulated, returning 7.35% for the year. EM corporates followed as the second best performer returning 2.32% for the year. Uncertainty arising from the global macro backdrop in Europe, Asia and the U.S., led investors to flock to the safe haven of U.S. treasuries.

During the month of December, U.S. Treasury yields fluctuated between 1.81-2.09%, as concerns surrounding the European debt and banking crisis remained the dominant issue. Late in the month, the European Central Bank (ECB) provided a massive liquidity injection of €489.2 billion in cheap funding to over 500 eurozone banks through its long-term refinancing program (3-year long-term refinancing operation (LTRO)). The market briefly rallied and then traded off as it appeared banks were likely to recycle the liquidity back to the ECB and not put it to work in the economy. Rating downgrades, or the threat of downgrades, uncertainty surrounding the effectiveness of Europe's most recent plan announced in early December, the magnitude of Europe's ongoing slowdown and the seasonal "risk-off" trade all contributed to year-end market weakness. Going forward market participants want to know whether favorable sales, consumer sentiment and improving job data out of the U.S. can be sustained, or if it is just seasonal strength waiting to slip away in the first quarter of 2012.

Over 2011, EM assets remained hostage to the European debt crisis that continued to unfold throughout the year. EM assets traded in sympathy with news flowing out of the eurozone, with EM local

## Global Developed Credit

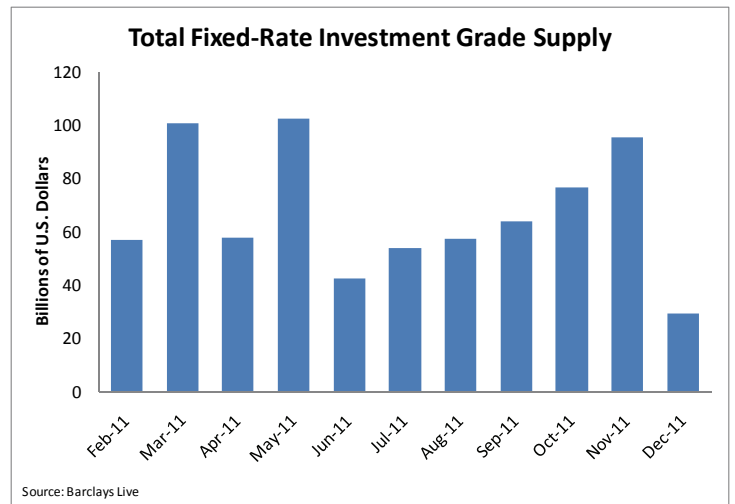
For the investment grade and high yield credit markets, 2011 proved to be a volatile year for corporate credit performance. Year-to-date (YTD), the total return of the Barclays Capital U.S. Credit Index was 8.35%, nearly matching its performance in 2010. The Barclays Capital U.S. Corporate High Yield Index returned 4.98%, materially below the 15.12% recorded for 2010. Excess returns for both investment grade and high yield corporate bonds were negative in 2011 as corporate credit was unable to rival the returns posted by U.S. Treasury securities.



Investment grade corporate spreads widened by 71 bps during the year and high yield spreads widened by 173 bps. Issuance in both the investment grade and high yield markets was active in 2011 but off from the levels posted in 2009 and 2010. Gross fixed-rate investment grade new issuance was \$858 billion, shy of the \$910 billion posted in 2010. The primary high yield market priced \$228 billion in 2011, the second highest total in history. High yield issuance in 2011 was primarily front-end loaded with record low all-in yields driving opportunistic issuance during the first half of the year to refinance upcoming maturities. From January through July 2011, \$185

# Quarterly Commentary

billion in high yield issuance was priced. The volatility in early August, however, shut down the market almost completely as just \$44 in new high yield priced during the final five months of the year.



Within the 2011 investment grade universe, the greatest excess returns were posted by Lodging (+246 bps); Foreign/Local Governments (+96 bps); Chemicals (+12 bps); Other Financials (+12 bps) and Transportation (-7 bps). The worst performing sectors were Life Insurance (-905 bps); Banking (-713 bps); Building Materials (-604 bps); Metals (-572 bps) and Non-Cable Media (-497 bps). Bonds rated single-A underperformed on the year due to the concentration of financial issuers within that rating category. High yield started off the year on a strong note, as the Federal Reserve's Large Scale Asset Purchase Program suppressed yield levels while also tamping down volatility. Investors seeking yield had little choice but to increase their risk exposure and, as a result, all-in yields in the high yield market fell to their lowest level in history reaching 6.60% in May 2011. As market participants became increasingly focused on Europe, volatility escalated and performance suffered. The top performing high yield sectors in 2011 were Supermarkets (+13.09%);

Pipelines (+10.17%); Pharmaceuticals (+10.07%); Cable-Media (+10.03%) and Entertainment (+9.19%). The worst performing sectors of 2011 were Transportation Services (-4.81%); Home Construction (-4.55%); Airlines (-3.93%); Wireless (-2.69%) and Banking (+0.14%). With respect to high yield default rate expectations, the 12-month trailing default rate fell to 1.99% in November 2011, the first figure below 2% since early 2008. Default activity picked up, however, in the fourth quarter and ratings migration momentum has decidedly swung downward, strongly suggesting that default rates may soon begin to rise.

We believe another year of global uncertainty awaits investors in 2012, driven not only by concerns in Europe but also by slowing domestic economic growth. In the fourth quarter of 2011, European Union (EU) leaders unveiled the fifth plan since May 2010 to address the sovereign debt problems in the region. The implementation of such a plan remains elusive and the immediate problems remain. Europe has approximately €1.1 trillion of EU government debt maturing in 2012, with half of that maturing in the first six months of 2012. Slowing European growth may be expected to impair U.S. exports and further cause the U.S. dollar to strengthen, thereby pressuring corporate profitability and corporate bond spreads. Added to that is a recent Bloomberg report highlighting the fact that U.S. corporate profit growth in 2011 was the lowest in 2 years. Structural domestic economic issues persist as we enter 2012 to include a stubbornly high unemployment rate, deflating home prices and huge state and local government budget gaps. Domestic economic concerns coupled with continuing problems in the eurozone will likely foster another year of low interest rates and heightened volatility in the capital markets.

## Mortgage-Backed Securities

There seem to be four major causes of the risk on/risk off trade during 2011. First, the European turmoil, which affected all markets, has impacted the non-Agency MBS market significantly due to that market's credit sensitivity. Additionally, there is no good estimate on how much some of these European banks hold in the non-Agency MBS space and how much they could be forced to sell. Even considering some of the more aggressive estimates of approximately 100 billion, we believe even that size could be absorbed going forward if the supply was not released all at once. It is our anticipation that the supply would be released on a more orderly basis.

Secondly, layer that turmoil with the new Basel 3 accords and the questions continue as to how much additional supply could be force sold into the market by those same banks. Basel 3 will increase the reserves in all these banks, and even though its full implementation does not begin until 2015, most European banks are already starting to implement these changes.

Third, throughout the year, the continuing decline in the value of housing has put pressure on the non-Agency market. Looking at the price action, for instance, of the PrimeX FRM 2 Index, starting at 105 on January 30 and ending at 90.25 on November 30, we see a clear indication of this housing price decline. Granted, some of the price decline in the PrimeX indices were in fact the realigning of the underlying bond prices with the overstated index prices, yet, as an example, when the GSEs start having calls with investors regarding "rent to own" solutions for their Real Estate-Owned (REO) portfolios, it isn't hard to see that the value of most American real estate still hasn't seen the bottom yet. This situation shows itself

in the high level of delinquency and severity prints which continue to persist, especially in the subprime sector, which has seen its severity and delinquency maintain the highest level versus the other sectors.

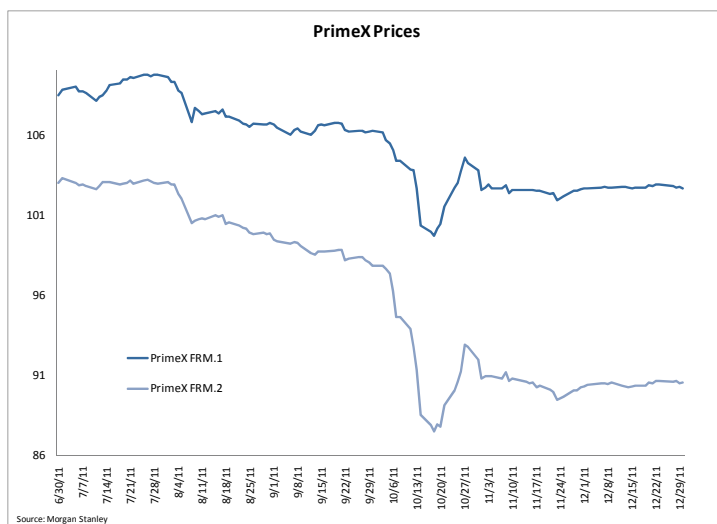
And finally, the potential introduction of the “Volker Rule”, a portion of the Dodd-Frank legislation passed by Congress in 2010, has had its potential unintended consequence on Wall Street. Non-Agency MBS positions have been reduced by over 50% and the street’s risk appetite cut back significantly. The result of this has been to remove a major price supporter in this space and allow prices to seek levels that investors are actually finding more compelling. Of course a reduction in liquidity is not the most sought after condition, but it can provide opportunistic situations to investors.

While there were lawsuits, congressional investigations, more attorneys general headlines, and even more legislation introduced in 2011, nothing really came to adjudication in terms of Washington significantly impacting the MBS markets. Only the Bank of America settlement with 22 institutional investors actually came to fruition in 2011, and even that settlement has been called into question by the likes of the FDIC and the Federal Home Loan Bank that has sought to intercede in the settlement. This settlement is now in the appeals court to determine which jurisdiction (state or federal) has the final say in the matter, which could extend the outcome for at least six months.

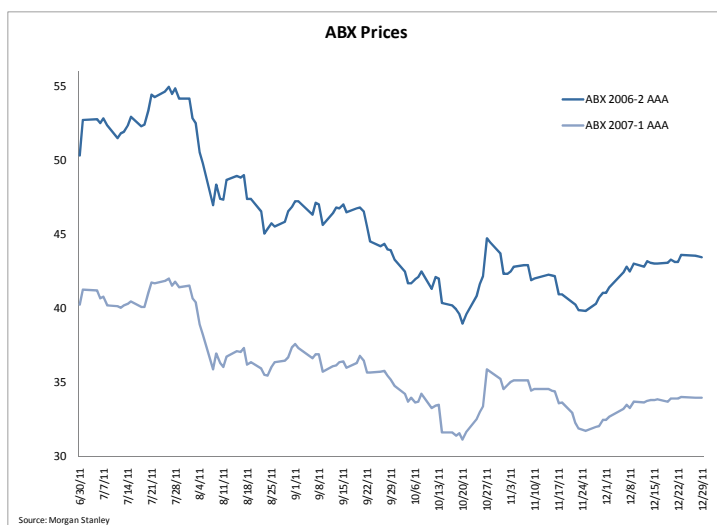
One substantial legislative process that found its way into the market, however, was the October FHFA announcement that provided an update to the Home Affordable Refinance Program (HARP) whose final guidelines were formally announced mid-November.

## Non-Agency MBS

The PrimeX Fixed-Rate Mortgage (FRM) 1 Index closed the year at 102.7 versus 102.62 in November, while the PrimeX FRM 2 Index closed 90.60 in December versus 90.24 in November.



The ABX 07-1 AAA Index closed 32.47 in December versus 32.50 in November, while the ABX 06-2 AAA Index closed 43.43 in December versus 41.25 in November.



These changes reflect the overall lethargy in the market in December. That same lack of activity is reflected in the volume of trades this month.

Current Face Traded		
	November 2011	December 2011
<b>Total</b>	7,687,794,455	5,764,610,704
<b>Liquidation</b>	888,900,072	1,655,335,657
<b>BWIC</b>	6,798,894,383	4,109,275,047

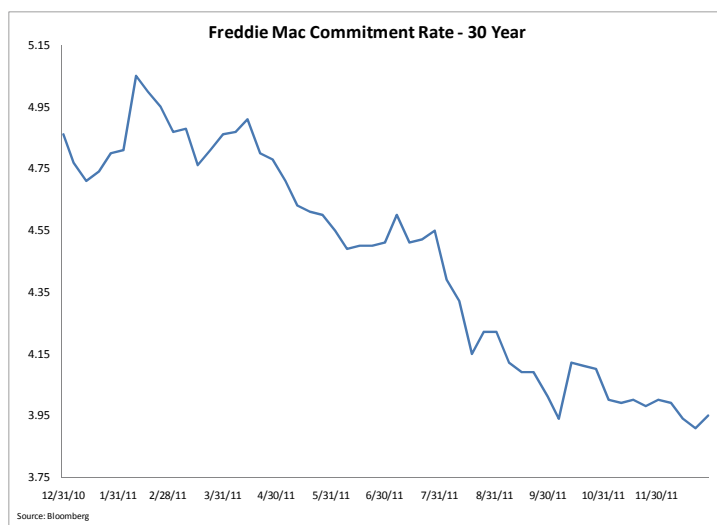
Source: Deutsche Bank; Bid Wanted In Competition (BWIC)

## Agency MBS

The Agency mortgage market returned 70 bps during the month of December, capping off an 88 bps return for the fourth quarter and a 6.23% return for the calendar year. The Barclays Capital MBS Index was the worst performer out of the major sectors of the Barclays Capital U.S. Aggregate Bond Index for the year, as the corporate subsector returned 8.15% and the Treasury subsector returned 9.81%. This underperformance is as expected given the fall in interest rates over the year since the Barclays Capital MBS Index has the lowest duration.

Prepayment speeds were relatively flat over the fourth quarter but were at the highest level for 2011.

National mortgage rates (as represented by the Freddie Mac Commitment Rate) are at the lowest level ever, however, prepayments are much slower than expected given this absolute level of rates. The early part of 2011 saw mortgage rates rising and the expected decrease in prepayments. As mortgage rates fell from their highs in February, prepayments only increased slightly. These conditions are due to a variety of factors, but most notably are the tightening of underwriting standards and the continued decline in housing prices. Most borrowers have an economic incentive to refinance but cannot afford to make these changes in underwriting standards and/or loan-to-value (LTV) ratios.



## Conditional Prepayment Rates (CPR)

2011	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FNMA	19.4	15.2	15.2	13.2	12.8	15.0	15.2	17.3	22.6	24.8	24.8	23.0
FHLMC	21.0	17.4	14.4	12.9	12.2	14.2	14.9	17.0	22.3	25.9	25.8	24.3
GNMA	13.4	12.0	10.2	9.1	8.4	9.6	9.6	11.5	13.9	16.3	16.2	16.3

## Barclays Capital U.S.

Mortgage Index	11/30/2011	12/30/2011	Change
Average Dollar Price	107.22	107.71	0.49
Duration	3.22	2.87	-0.35

## Barclays Capital

Index Returns	Oct. 2011	Nov. 2011	Dec. 2011
U.S. Aggregate	0.11%	-0.87%	1.10%
U.S. MBS	0.00%	0.18%	0.70%
U.S. Corporate	1.79%	-1.96%	2.14%
U.S. Treasury	-0.82%	0.75%	0.97%

source: Barclays Capital, eMBS

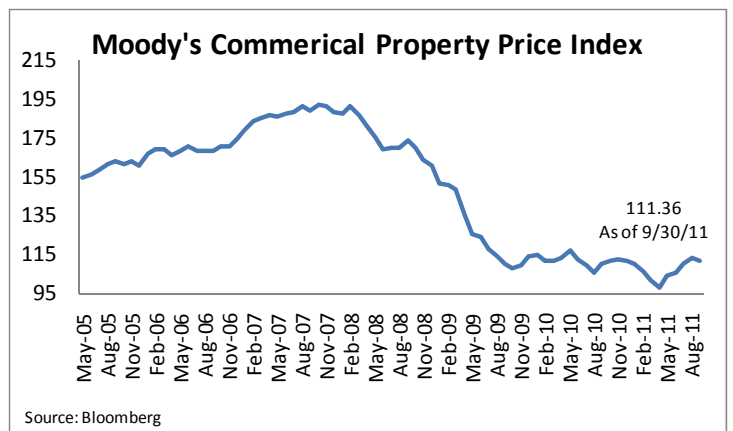
This dilemma is not lost on the U.S. government and there were multiple rumors throughout 2011 regarding a “Great Refi” plan to offer these historic rates to all mortgagees. What the market received instead was that in October, the Federal Housing Finance Authority (FHFA) announced changes to the Home Affordable Refinance Program (HARP) including eliminating the LTV cap of 125%. We expect this change will only lead to an increase in Agency MBS prepayments by a 5-10 Conditional Prepayment Rate (CPR) per year, spanning the next few years. We expect that if there is further weakening in the national housing market, then the government will intervene. This intervention could lead to higher prepayment speeds, especially in higher coupon securities.

## Commercial Mortgage-Backed Securities

The CMBS market experienced quite a tumultuous ride in 2011, a year where prices across the credit spectrum whipsawed alongside with macro markets and ultimately ended December with a fairly strong rally at the top of the capital stack. We continue to see tiering across deals in addition to a steepening credit curve as credit “cuspy” tranches, such as junior AAA CMBS (AJs) and below, continue to lag behind the outperformance in mezzanine AAA super senior CMBS (AMs) and last cash flow (LCF) super seniors. With that said, the market continues to chug along, albeit on a technical basis, as investors appear skittish on broader economic headlines. For December, CMBS returned 1.31% outperforming the Barclays Capital U.S. Aggregate Index by 94 bps equating to a 6.02% return for 2011.

On the commercial real estate (CRE) fundamental side, delinquency rates remained flat to slightly down

due to a slower pace of deterioration coupled with servicer loan modifications. There continues to be increasing trends of servicer loan modifications which effectively splits a loan into pieces: an A note pays interest and a B note does not pay interest and is effectively a hope note. We view these types of modifications as worrisome due to the fact that the hope notes are effectively a delayed write-down for the trust and in the interim may show lower cumulative losses on a deal level than what is occurring in reality. In December, 30-day plus delinquency rate decreased 16 bps to 9.68%. On the commercial property valuation side, the latest Moody’s Commercial Property Price Index (CPPI) showed a 1.4% decrease in September. This may be 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 an emphasis on security selection and in shorter duration assets. Unemployment continues to be a large contributing factor 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

In December, the government securities sector was similar to November with subdued volatility, punctuated by an occasional market-moving announcement from the eurozone, and a gradual downtrend in yields. Domestic economic data continued generally at low-end expectations. The Federal Reserve's so-called 'Operation Twist' went forward without causing any turmoil in the marketplace. The 10-year Treasury yield held in a 30 bps range, ending the month down 19 bps at 1.88%.

**Yield Curve**

	9/30/2011	12/30/2011	4Q 2011 Change
3 month	0.01	0.01	0.00
6 month	0.10	0.06	-0.04
1 year	0.18	0.10	-0.08
2 year	0.46	0.24	-0.22
3 year	0.80	0.35	-0.45
5 year	1.76	0.83	-0.93
10 year	3.16	1.88	-1.28
30 year	4.37	2.89	-1.48

Source: Bloomberg

The volatility during the fourth quarter was sharply lower compared to the third quarter of 2011. The 10-year Treasury yield moved only 5 bps over the quarter. The 5-year Treasury yield moved lower by 13 bps to 0.83% while the 30-year bond moved only 3 bps for the quarter ending at 2.89%.

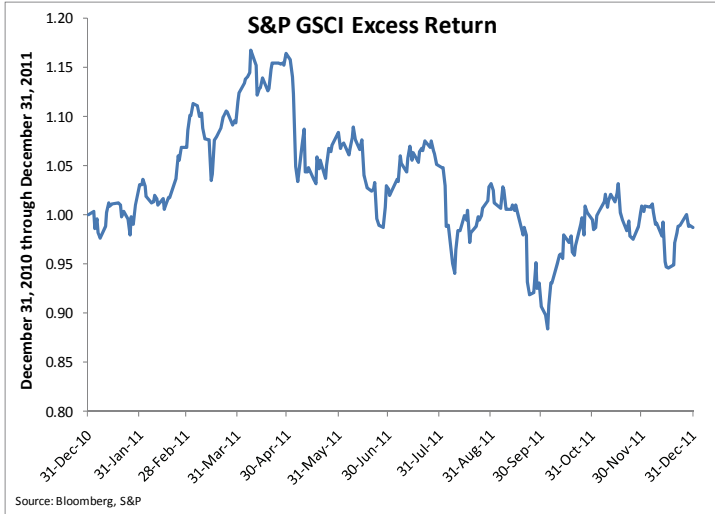
For December, 30-year Treasury bond returns were 3.75% according to Barclays Capital, while 5-year Treasury notes returned 0.77%. Treasury Inflation-Protected Securities (TIPS) lagged as inflation ticked higher, returning only 0.04%. The tax-exempt market, as represented by the Barclays Capital Municipal Bond Index, returned 1.90%. Municipal bonds remain cheap, with the higher absolute return from that sector attributable to its comparatively long duration.

For 2011, the Government market returned 9.02%, significantly higher than the consensus at the start of the year. The 30-year bond returned a stellar 35.6% according to Barclays Capital, while the 10-year note returned 17.18% for the year. The 2-year note returned 1.53%, which was somewhat respectable given that the 2-year yield was only 0.60% at the end of 2010.

Opportunities for profitable relative value trades declined during the fourth quarter. Sliding volatility and the Federal Reserve's buying drove this decline. In response, our government holdings shifted to more closely resemble the Index. Looking forward to 2012, we expect to favor the 7- to 10-year maturity range. These issues offer the best risk/return tradeoff and should benefit most if the Federal Reserve adopts an inflation-targeting or interest rate-targeting strategy.

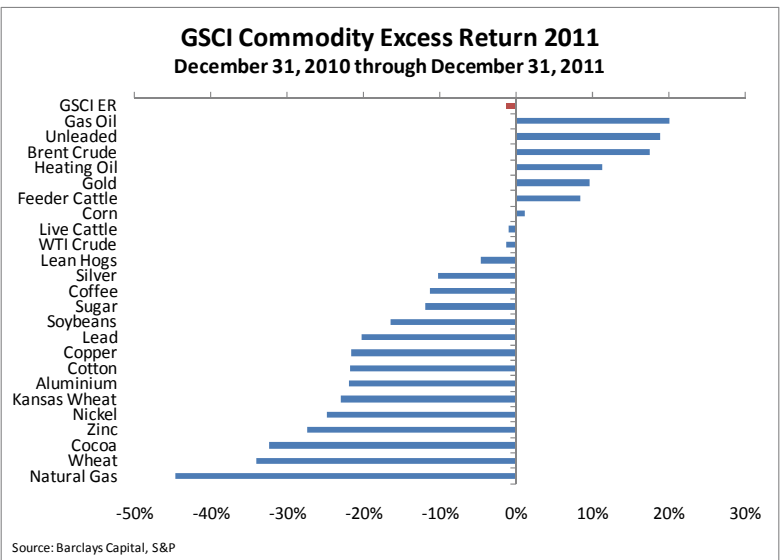
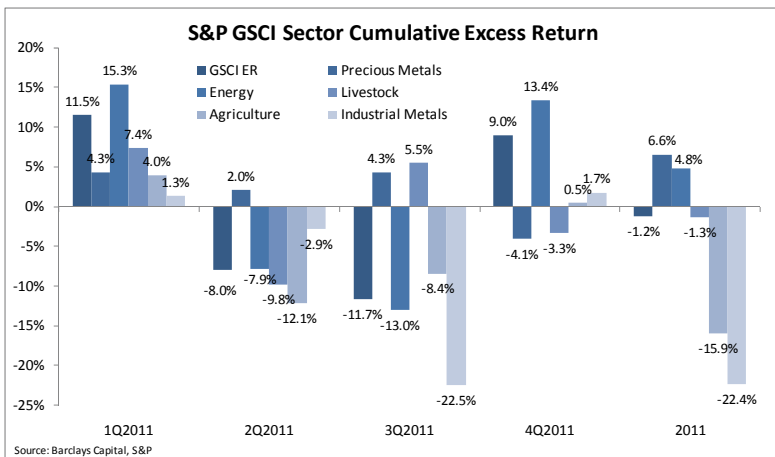
## Commodities

The Standard & Poor's Goldman Sachs Commodity Excess Return Index (SPGSCI ER) ended the year 1.2% lower than it began. Price volatility was rampant throughout 2011 as the commodity market digested the macroeconomic data attempting to forecast whether global growth would prevail amongst a backdrop of deleveraging and deflationary pressures. Fears of an economic slowdown in China; uncertainties surrounding the Arab Spring throughout the Middle East, including the death of Muammar Gaddafi; and increasing worry of a collapse of the European Union were persistent themes in 2011 and will likely continue through 2012.

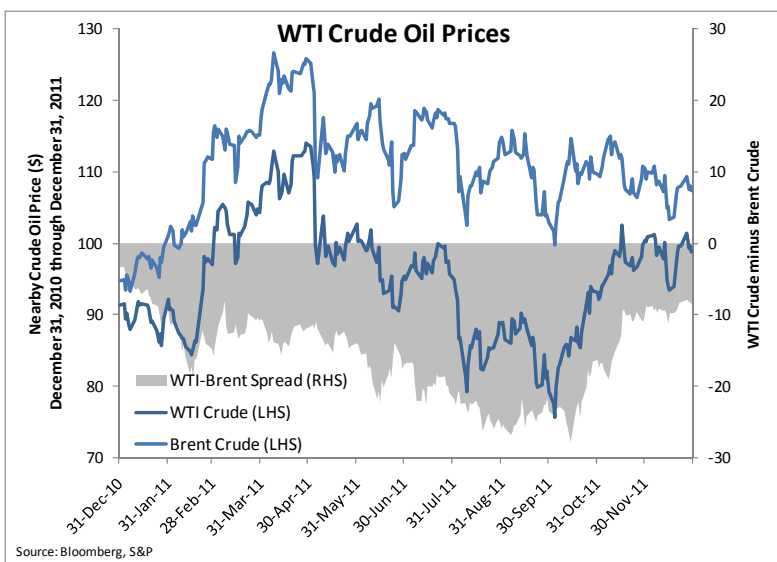


The year started off with a bang and amidst the U.S. Federal Reserve's second dose of quantitative easing (QEII), the first quarter ended with the SPGSCI ER up over 11.5% driven mainly by the energy sector. The second quarter was a reversal of the first with the market trying find a replacement growth catalyst after the U.S. Federal reserve announced at the end of April that they would halt the QEII program according to schedule on June 30, 2011. This set the backdrop for a third quarter that was dominated by negative headlines emanating from both the U.S. and Europe resulting in the SPGSCI ER losing more than 11.7%. The energy and industrial metals sectors drove the SPGSCI ER return significantly into positive territory for the fourth quarter, but not quite enough to erase the losses from the middle half of the year.

Only seven of the 24 commodities in the Index finished with a positive excess return for the year. Four of the seven were in the energy complex – gas oil, unleaded gasoline, Brent crude and heating oil – while gold, feeder cattle and corn were the remaining winners. All five of the industrial metals – aluminum, copper, nickel, lead and zinc – shed more than 20% during 2011 primarily driven by sharply negative performance in the third quarter. Agriculture was the second worst performing sector for the year with cocoa, cotton and wheat all losing more than 20% as well. The single worst performing commodity during 2011, dropping 44.6%, was natural gas as the supply glut in the U.S. continues to increase due to popularity of hydraulic fracturing and horizontal drilling without the accompanying increase on the demand side due to what had been an unseasonably warm start to winter. Low demand in November and December of 2011 has translated to record high natural gas storage levels. Even unusually cold temperatures in the remaining winter months would unlikely reduce the overhang in supply enough to reverse natural gas prices in early 2012.



On November 16, 2011 Enbridge announced the purchase of a 50% stake in the Seaway pipeline from Conocophillips and that it would reverse the flow of crude oil by up to 150,000 barrels per day immediately. The announcement sent WTI prices above \$100 and narrowed the WTI-Brent spread by over \$4 intraday. Instead of oil flowing from the Gulf Coast up to Cushing, Oklahoma where there was a bottleneck of supply, the reversal transports crude oil down to Gulf Coast refineries allowing the refineries to not have to pay the higher price of imported crude oil. The event further keeps Cushing, Oklahoma as a relevant delivery hub between Canada and the U.S.



By the middle of 2012 Enbridge expects to increase the daily volume to over 400,000 barrels. This should help bring the prices of the U.S. benchmark crude oil – WTI – in-line with the world’s benchmark – Brent. However, given that the Keystone XL pipeline is still under construction - and not expected to be functional until 2013 – WTI prices are expected to continue to remain at a discount to Brent prices throughout 2012.

## Global Equities

Global equity markets capped off a tumultuous year with mixed results as market volatility remained at the forefront. Ongoing concerns of European debt issues coupled with a potential slowdown in Asian economies continue to weigh down on investors’ expectations. As such, risk aversion for the quarter across some European and Asian markets appear to be the dominant theme with the exception of U.S. and Latin American markets which ended the year with an impressive fourth quarter rally.

Following a large sell off in U.S. equities during the third quarter 2011, all three major U.S. equity indices manage to post an impressive rally during the fourth quarter and into year end, with the Dow Jones Industrial up +14.66%, the NASDAQ composite up +11.52%, and the S&P 500 Index up +14.40%, leaving the S&P 500 Index effectively unchanged for 2011. Subsequently, global developed ex-U.S. equities (Europe, Australia, and Far East) as shown by the MSCI EAFE Index posted +5.16%, reflecting a positive performance for the quarter though still down -14.8% for the year.

On the emerging markets front, EM equities posted a +7.5% return, however still ended the year down -20.02% with continued concerns with regards to a broader economic slowdown, in particular Asian countries which are resource dependent on commodity-based nations such as Brazil.

**Important Information Regarding This Report**

Issue selection processes and tools illustrated throughout this presentation are samples and may be modified periodically. Such charts are not the only tools used by the investment teams, are extremely sophisticated, may not always produce the intended results and are not intended for use by non-professionals.

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To receive a complimentary copy of DoubleLine's current Form ADV (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 mandate. 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 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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