

Thematic Insights

An In-depth Look at Investment Opportunities



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Opportunity: Increasing Exposure to High Yield Fixed Income

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Highlights

LPL Financial Research recommends adjusting portfolio allocations to move from a risk aversion mode to the reintroduction of opportunistic exposure. One recent portfolio change was to increase allocation to the High Yield Fixed Income asset class. The main reasons why we became, and still are, optimistic toward High Yield include:

- Typically strong performers during economic recoveries
- The combination of inflows in High Yield mutual funds and a slowing new issue calendar
- High Yield spreads relative to U.S. Treasuries remain historically attractive
- Similar return characteristics to equities, but less risky

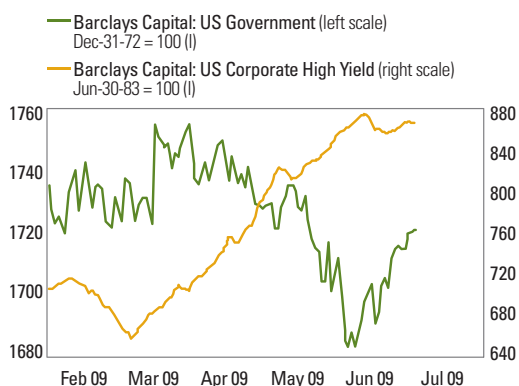
We believe that the current equity market rally reflects the strengthening economic backdrop and investors increasing appetite for risk. Our prognosis remains that the financial markets have reached their lowest levels of this bear market cycle and any retest will likely be relatively muted compared to the attractive opportunity for market gains.

With that as a backdrop, we believe the fixed income markets provide the best opportunities investors have had in several years. For most investors, bonds are viewed as the safety net that limits the downside effects of stocks, but at times aggressive fixed income strategies can potentially offer tremendous capital appreciation opportunities. Forced liquidations and illiquid conditions stemming from the global credit crunch led to the dramatic underperformance of High Yield since the middle of 2007 to the end of 2008. Specifically, when the credit markets froze in the second half of 2008 and investor concerns rose regarding the ability of companies to pay interest and repay the principal, yield spreads skyrocketed as investors required large premiums to remain invested in aggressive fixed income positions. These widening yield spreads caused the significant underperformance relative to more conservative bond sectors.

This year has been a different story as most credit sensitive sectors of fixed income markets have improved and still remain attractively valued. As the global economy improves and the credit markets heal, we expect yield spreads for aggressive fixed income strategies to fall (falling yields mean rising prices in bonds), representing attractive opportunities for investors.

The increase of High Yield exposure represents our continued plan of incrementally adding risk within our fixed income allocation as we become more confident in the economic backdrop. With this roadmap in mind, we initially reduced mortgage-backed exposure in favor of high-quality corporate bonds. Now we are taking this a step further and moving down the credit spectrum (in essence, taking on more risk for more expected return). While we do expect some near-term volatility in the asset class as investors sort through conflicting economic data, we continue to believe it remains an opportune time to increase High Yield exposure. Despite the nearly 31% jump in the Barclays U.S. Corporate High Yield index since the beginning of this year through July 2, we continue to believe opportunity remains in this asset class. In addition to many fundamental positives, historically, the High Yield asset class tends to outperform over extended time periods. Therefore, despite this year's strong performance in High Yield, as shown in the chart to the left, we recommend allocating to this attractive asset class if you have not done so already.

1 Relative Performance of High Yield to U.S. Government Securities



Source: Barclays Capital, Haver Analytics 07/07/09

OPPORTUNITIES IN HIGH YIELD FIXED INCOME

Style / Capitalization	Fundamentals	Technicals	Valuation	View			Bias	Active Manager Performance
				Negative	Neutral	Positive		
High Yield	●	●	●	■	■	■		-

Comment: Expected peak default rate (14%) in line with implied pricing; spreads wide at +1,040 bps.

● Negative ● Neutral ● Positive

Source: LPL Financial Research, Portfolio Compass Publication (07/01/09)

We expect spreads to tighten, subsequently benefiting performance, on the combination of declining default rate forecasts and further signs of economic improvement.

Fundamentally, there are numerous reasons why we remain optimistic on the outlook for the High Yield asset class:

- **Economic sensitivity** – High Yield fixed income is highly sensitive to the economy. Gradual improvement in economic data, along with upside corporate earnings surprises and company cost-cutting measures, should improve balance sheets, increasing the likelihood that issuers of High Yield securities will meet their debt obligations, benefiting performance.
- **Technical factors** – According to AMG data, year-to-date mutual fund inflows into the High Yield asset class totaled over \$17 billion through mid-June. This surge in inflows, along with a slowing in the High Yield new issue calendar, should provide a favorable supply/demand backdrop, supporting secondary issue pricing. Furthermore, we believe High Yield bonds may benefit as yield-seeking investors rotate from Investment Grade to High Yield during the second half of 2009.
- **Narrowing spreads** – High Yield was one of the hardest hit sectors during the credit crunch as 2008 generated by far the worst calendar year performance ever. According to Barclays data, High Yield spreads remain attractively priced at 10.2% over comparable U.S. Treasuries, narrower than the 11.1% peak of 2002 but still well above its 5.5% historical average. We expect spreads to tighten, subsequently benefiting performance, on the combination of declining default rate forecasts and further signs of economic improvement. The implied and forecast for default rates have been declining this year. At its peak in December of last year, the implied default rate priced in High Yield bonds was around 22% for the ensuing 12 month period. Moody’s has revised its forecasts for the peak default rate. Back in February, Moody’s had been predicting a default rate of 16.4% by the fourth quarter of this year. In May, they revised that number to 13.8%. At the end of May, actual default rates were just 9.2%. Recovery rates on defaulted issuers will help determine High Yield bond market performance going forward, but a low recovery rate is already being factored into current pricing. Despite the recent rally, the asset class remains attractively priced and we expect spreads to continue to tighten over the next several months.

2 High Yield Bond Spread
Yield Premium Above Treasuries



- **Similar return characteristics to equities, but less risky** – High Yield bonds are similar to equities in that they tend to be sensitive to the economy, but the income provided tends to make these securities less risky than stocks. As seen in the table below, volatility in High Yield is well below that of large cap and small caps equities, despite similar long-term returns. Offering sensitivity to the economy with less volatility than stocks also makes this asset class attractive right now.

RISK/RETURN FOR HIGH YIELD AND EQUITIES

	Fifteen-Year Return	Fifteen-Year Standard Deviation
Barclays Corporate High Yield Index	6.3%	9.5%
Russell 1000	7.1%	15.9%
Russell 2000	6.6%	20.1%

Source: Zephyr Analytics As of 7/94 - 6/09

High yield/junk bonds are not investment grade securities, involve substantial risks and generally should be part of the diversified portfolio of sophisticated investors.

Small-cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

We noted many reasons why the High Yield asset class remains an attractive investment. Keep in mind, however, that there are still risks that need to be considered. While default rates have come down, given their economic sensitivity, any setback in the economy could trigger higher default rates, hurting this asset class. In addition to rising defaults, another risk is poor liquidity as many firms that traded and held inventory of high-yield bonds have either closed or greatly reduced market participation. Poor liquidity can exacerbate any market sell-off. Lastly, while High Yield performance has been strong this year, we do expect the pace of corporate bond improvement to slow over the second half. Although many issuers are actively engaged in repairing balance sheets, much of the gains this year have come from better liquidity and investors taking advantage of overly cheap valuations. Further spread contraction will likely need to be accompanied by better underlying credit metrics. We believe this will occur, but more gradually than seen in the first half.

LPL Financial Research's ongoing strategy of repositioning our models from a risk aversion mode to the reintroduction of opportunistic risk led us to increase High Yield exposure last month. In addition to their favorable technical factors and yield spreads relative to comparable U.S. Treasuries, we believe this asset class greatly benefits from an improving economic environment. Despite the fact that the High Yield has performed well, we believe opportunity still exists in this asset class.

Implementing the Opportunity

To implement High Yield in the portfolio allocation, our top recommendation in this asset class is the Artio Global High Income Fund I (JHYIX). Keep in mind that every investor situation is different and there are many considerations you need to consider with your advisor before investing in a specific mutual fund.

ARTIO GLOBAL HIGH INCOME I PERFORMANCE (AS OF 6/30/09)

Fund Name	Ticker	QTD	YTD	1-Yr	3-Yrs	5-Yrs	Since Incep. (1/30/03)	Expense Ratio	Gross Exp. Ratio
Artio Global High Income I	JHYIX	21.88	28.85	-1.98	3.37	5.75	8.35	0.75	1.27
Barclays Corporate High Yield		23.07	30.43	-2.40	2.09	4.32	N/A	N/A	

Source: FactSet, Past performance is no guarantee of future results.

The performance data quoted represents past performance.

Past performance does not guarantee future results. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more than the performance information quoted. To obtain current month-end performance information, please visit www.artioglobal.com.

The performance quoted reflects the reinvestment of dividends and capital gains, is net of expenses and but does not reflect the maximum advisory fee of 3%. Such fee, if taken into consideration, will reduce the performance quoted above.

In managing this mutual fund, while focusing on delivering competitive risk-adjusted returns in the High Yield space, Artio adds value by combining a macroeconomic view with a rigorous, credit-driven investment process. Management can invest in a wide universe of high yielding securities: domestic high yield, local currency denominated emerging market government bonds and corporates, municipals, catastrophe bonds, preferred securities, distressed debt, bank loans, investment grade and convertibles. The team also has the ability to hedge currency risk within the portfolio.

There are many reasons why this fund is a strong choice to implement the High Yield investment opportunity, most notably its global mandate and current portfolio positioning:

- **Global Mandate** - By thinking and investing globally, management can take advantage of investment opportunities that other High Yield managers may miss due to a more constrained mandate. For example, during recent conversations with management, they noted that European, Latin American and Asian credit spreads tighten more than U.S. corporate spreads in improving economic conditions. As of May 27, 2009, the fund has roughly 20% of assets invested outside of the U.S.
- **Portfolio positioning** - Similar to our thesis, the investment team has become more optimistic toward worldwide credit markets and, as a consequence, has increased beta, or risk in the portfolio. They have raised beta by increasing exposure to CCC-rated securities and continuing their overweight toward economically sensitive sectors.

Keep in mind that every investor situation is different and there are many considerations you need to consider with your advisor before investing in a specific mutual fund.

By thinking and investing globally, management can take advantage of investment opportunities that other High Yield managers may miss due to a more constrained mandate.

As a result of the 2008 credit crisis, there have been many investment opportunities, not only in the domestic high yield space but also globally. LPL Financial Research feels that Artio Global High Income has a broader investment mandate and can take advantage of the global high yield markets that are providing more opportunities.

As always, please contact your financial advisor for more details on these asset allocation and mutual fund changes.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Investors should consider the investment objectives, risks, charges and expenses of the investment company carefully before investing. The prospectus contains this and other information about the investment company. You can obtain a prospectus from your financial representative. Read carefully before investing.

Investing in mutual funds involve risk, including possible loss of principal. Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

The Russell 1000 Index measures performance of 1000 large cap, US companies.

The Russell 2000 Index measures performance of 2000 small cap, US companies.

The Barclays U.S. Corporate High Yield Index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes Emerging Markets debt. The index was created in 1986, with index history backfilled to January 1, 1983. The U.S. Corporate HighYield Index is part of the U.S. Universal and Global High Yield Indices.

Beta measures a portfolio's volatility relative to its benchmark. A Beta greater than 1 suggests the portfolio has historically been more volatile than its benchmark. A Beta less than 1 suggests the portfolio has historically been less volatile than its benchmark.

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