DoubleLine Total Return Bond Fund Webcast Recap

Originally aired on March 12, 2019

About this Webcast Recap

On March 12, 2019, Chief Executive Officer Jeffrey Gundlach held a webcast discussing the DoubleLine Total Return Bond Fund (DBLTX/DLTNX).

This recap is not intended to represent a complete transcript of the webcast. It is not intended as solicitation to buy or sell securities. If you are interested in hearing more of Mr. Gundlach's views, please listen to the full version of this webcast on www.doublelinefunds.com on the **"Webcasts"** tab under **"Latest Webcast"**. You can use the **"Jump To"** feature to navigate to each slide.

DoubleLine Total Return Bond Fund – Performance

Month-End Returns February 28, 2019	Feb	YTD	Annualized 1-Year	3-Year	5-Year	Since Inception (4-6-2010 to 2-28-19)	1-Yr Std Deviation
I-share (DBLTX)	0.02%	0.61%	3.52%	2.23%	2.95%	5.81%	2.61%
N-share (DLTNX)	0.00%	0.56%	3.16%	1.97%	2.67%	5.54%	2.62%
Bloomberg Barclays U.S. Agg Index	-0.06%	1.00%	3.17%	1.69%	2.32%	3.22%	2.78%

Quarter-End Returns December 31, 2018	4Q2018	YTD	Annualized 1-Year	3-Year	5-Year	Since Inception (4-6-2010 to 12-31-18)
I-share (DBLTX)	1.75%	1.75%	1.75%	2.57%	3.34%	5.84%
N-share (DLTNX)	1.68%	1.49%	1.49%	2.28%	3.06%	5.58%
Bloomberg Barclays U.S. Agg Index	1.64%	0.01%	0.01%	2.06%	2.52%	3.16%

Gross Expense Ratio
I-share: 0.47%, N-share: 0.72%
Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month-end may be obtained by calling 213-633-8200 or by visiting www.doublelinefunds.com.

Slide #	Recap

8

Global Economic Momentum Heatmap

- In the first quarter of 2018, there was a narrative of synchronized global expansion.
- That is a contrast to where global economies are today. Now the narrative is a coordinated global slowdown, particularly outside the United States (U.S.).
  - Green indicates that the economic data changes are coming in above the 12-month moving average, while red indicates data changes are below the 12-month moving average.
- To start 2019, there is a lot of red on the screen, including the U.S. and the G-10. There are some places of emerging markets (EM) where data has not been as bad, such as Brazil, Mexico, Chile and Peru.
- Overall, global data has been flashing red, indicating a global synchronized slowdown.

DoubleLine Total Return Bond Fund Webcast Recap

Originally aired on March 12, 2019

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Slide # | **Recap**

9

Global Trade Volume

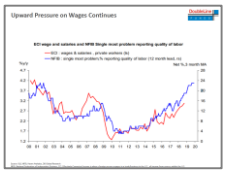
- The J.P. Morgan Global Manufacturing PMI hit a 33-month low, while Eurozone Manufacturing PMI fell below 50; registering its lowest reading in 68 months.
  - A reading below 50 indicates the economy is contracting.
- One of the drivers of a Eurozone slowdown has to do with global trade. Global trade volume year-over-year (YoY) is now negative.
  - The grey shaded areas represent a recession. Prior to the last two recessions, global trade volume was still positive YoY, and it was the global economic recessions that caused global trade to go lower.
  - The global economy is not currently in a recession, yet global trade YoY is negative.
- Mr. Gundlach believes it will be interesting to see just how badly global trade falls off if the current conditions sustain and we end up going into a global recession.

11

U.S. Conference Board Leading Economic Indicator & U.S. Economic Data Change

- The U.S. Conference Board Leading Economic Indicator (LEI) has fallen sharply, albeit from very high levels.
  - The LEI YoY was as high as 6.6 in September 2018, and has fallen to a reading of 3.5 in just four months.
- The red shaded areas indicate a recession. Going back to the 1960's, the U.S. has never had a recession without the leading economic indicators first going negative.
- The PMI New Orders data is weakening, and is starting to flash a cautionary yellow signal.
  - Although U.S. PMI and ISM New Orders data are still in the mid-50 range, the trend is starting to have the look of leading maybe a year or so before the last two recessions.
- Taken together, this doesn't worry Mr. Gundlach about an imminent recession, although the pattern is signaling a potential recession in 2020.
- The economic data change in the U.S. has been negative. Both soft data, which is sentiment driven, and hard data, which is statistically driven based on various indicators such as labor market, Capital Expenditure (CAPEX), etc., are now negative.
  - Soft data has been negative for over a year, while hard data turned negative recently.
- While the U.S. is not currently in a recession, Mr. Gundlach believes the U.S. stock market remains in a bear market, as the S&P 500 has not retraced its high of 2,930.75.

17



Upward Pressure on Wages Continues

- Right now the jobs market is tight, which has helped buoy consumer confidence.
- Wage growth has continued to gain momentum, as wages tend to follow the prediction of the National Federation of Independent Business (NFIB) line of companies reporting their single biggest issue is finding quality labor.
  - The NFIB line suggests higher wages over the next 12 months.
- The correlation between the NFIB and the Employment Cost Index (ECI) has been very strong. Based on current readings, it suggests that the ECI will go up to 4%, which Mr. Gundlach believes is a number that would change the psyche of investors about inflation.
- The Fed has stated 2% is no longer the ceiling on desired inflation. To Mr. Gundlach, that suggests even if inflation rises to 3%, the Fed might not be concerned, at least at first.

DoubleLine Total Return Bond Fund Webcast Recap

Originally aired on March 12, 2019

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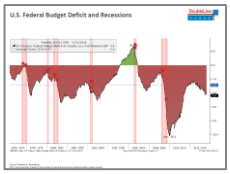
Slide # | **Recap**

19

U.S. Conference Board Consumer Expectations Less Current Situation

- Consumer confidence has rebounded with the stock market. Historically, consumer confidence starts to fall significantly prior to the front edge of a recession.
  - Mr. Gundlach believes we would need to see further weakness in consumer confidence to cause concern.
- One indicator that does look a little bit recessionary is looking at consumer expectation minus the current consumer situation.
  - This indicates consumers have had an increasingly rosy view of the present, but continue to maintain a pessimistic view of the future.
- One of the most important things to be watching is consumer confidence for the present situation. If it starts to drop, this chart will begin to display a distinctive recessionary look.
  - One indication current conditions may start to worsen is NFIB planned hiring, which has rolled over from a very high level. When this indicator starts to roll over, it tends to be a real trend change.
  - Another indicator that is looking troubling is retail sales, which somewhat ties into consumer confidence. The monthly reading from December printed -1.6%, which Mr. Gundlach believes is a pretty incredible non-annualized number. The U.S. hasn't had a reading even close to as bad as the December 2018 reading since the Global Financial Crisis.

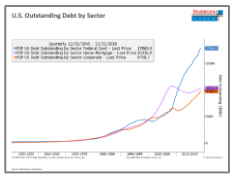
24



U.S. Federal Budget Deficit and Recessions

- The current Federal budget deficit as a percent of Nominal Gross Domestic Product (GDP) is -4.4%.
  - This is a level that has been historically associated with a U.S. recession or the aftermath of a recession.
  - With the U.S. economy growing at a 3.1% real rate, a 5.3% nominal rate, and an unemployment rate of 3.8%, things on the surface appear great. And yet, the U.S. has a recessionary type of budget deficit.
- The budget deficit for *fiscal 2018* was a little under $800 billion. However, the national debt increased by $1.27 trillion, fully 50% more than the official deficit.
  - This is due to off-balance sheet items such as military operations, natural disaster relief, and loans from Social Security.
- For the *calendar year 2018*, the national debt increased by $1.47 trillion, or roughly 7% of GDP.
  - A simplistic way to interpret this is if the U.S. hadn't grown its national debt, the economy wouldn't have experienced much growth at all.
- The total national debt now exceeds $22 trillion, which is a very big number and is higher than the U.S. GDP of roughly 19 trillion.

25



U.S. Outstanding Debt by Sector

- Mr. Gundlach believes debt broadly in the U.S. is at an alarming level.
  - Home mortgage debt has not grown since peaking prior to the housing crisis.
  - Corporate Debt has grown significantly over the past 10 years.
  - Treasury debt has ballooned the most since the Global Financial Crisis, and this doesn't include what the Fed owns.

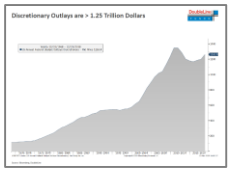
Slide #

Recap

- Putting all sectors together, this represents roughly 210% of GDP, up from 170% prior to the Global Financial Crisis – i.e. debt continues to pile up.
- This can be attributed to insufficient taxes or excessive spending.
  - The percentage of GDP that the U.S. is now receiving in federal taxation is roughly 16%, the lowest level since about 1950.
  - Simultaneously spending continues to increase, representing roughly 20% of GDP. This trend suggests an increasingly wider gap between tax receipts and government spending.

Discretionary Outlays & Entitlements and Mandatory Spending

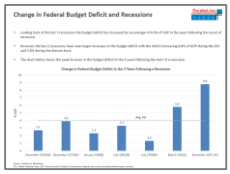
29



- This has been a lot of discussion around raising the top marginal tax rate in the U.S. as a way to increase federal tax revenue.
- Looking at data going back to 1935, taxes as a percentage of GDP have been relatively stable, while the top tax rate has gyrated significantly.
  - Something troubling has happened in the past 30 years, as the average tax revenue as percentage of GDP has come down while the top marginal tax rate has increased.
- This is due partly to discretionary spending, which currently is greater than $1.25 trillion.
- The other part is non-discretionary spending; entitlements and mandatory spending is over $2.5 trillion, double that of discretionary spending.
  - This means that two-thirds of the budget is automatic. And it has been rising extremely rapidly, a trend likely to persist with a compounding curve due to the demographics of the nation.
- As the national debt has exploded, the amount of people that care about the deficit has dropped – particularly for Republicans – fairly substantially.
  - Seven years ago, 82% of Republicans and 61% of Democrats said that deficit reduction was a priority.
  - Today, only 54% of Republicans and 44% of Democrats feel deficit reduction should be a priority.

Change in Federal Budget Deficit and Recessions

33



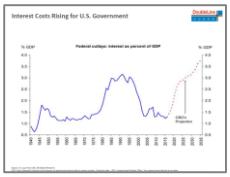
- Mr. Gundlach believes the national debt is much different than the official deficit in certain years. In most years, the national debt increase has exceeded official deficit.
  - Last year the U.S. had a massive increase in the national debt of $1.359 trillion.
  - During recessions, both the deficit as a percentage of GDP and the national debt increase, as there are fewer tax receipts due to higher unemployment and more people receiving benefits.
- The last two recessions it was an outsize increase in both.
  - 2001: the deficit increased three years later by 5.8% of GDP.
  - 2008: the deficit increased three years later by 8.8% of GDP.
  - The average during recessions going back to 1969 is 4.0% of GDP.
- Therefore, if the national debt is increasing by 7% of GDP and the average during a recession is 4%, this suggests that during the next recession it could go to 11% of GDP.

Slide # | **Recap**

- Absent any policy changes, Mr. Gundlach believes it will be higher than 11%, with the last two recessions averaging 6.8%.
- If we apply an 8% recession adjust to the Congressional Budget Office (CBO) budget forecast the deficit will grow to $2.6 trillion by 2020, roughly 13% of GDP.

- This is one reason why Mr. Gundlach believes that absent the Fed turning into the Bank of Japan (BOJ) or the European Central Bank (ECB) that long-term interest rates would have to go up during the next recession.

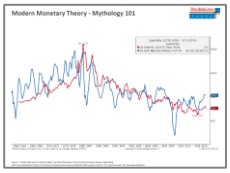
36



Interest Costs Rising for U.S. Government

- Rising interest costs are another sign of trouble for the U.S. Government. Interest costs as a percentage of GDP have been low for the past 15 years.
  - Based on the CBO's projection, interest cost are expected to explode higher.
  - Although short-term interest rates have been rising since 2015, interest costs have remained low due to the longer maturity of the bonds.
- However as bonds mature and rates increase, the CBO is projecting that interest as a percentage of GDP will go from 1.75% today to 3.0% by 2026.
  - This increase comes right out of the economy vis-à-vis reducing GDP by 1.75%.

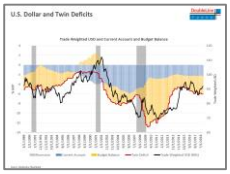
39



Modern Monetary Theory (MMT) – Mythology 101

- MMT at its most simplistic form states as long as nominal GDP is higher than the yield on the bond market, then it's okay to continue to borrow money – i.e. the economy is growing faster than the cost to borrow.
  - Mr. Gundlach believes this is a completely fallacious argument, as this doesn't account for:
    - The economy entering a recession
    - Interest rates increasing
    - The existing stock of debt

43



U.S. Dollar (USD) and Twin Deficits

- Trade balance is another problem for President Trump, as the trade deficit has expanded since Trump's inauguration.
- The twin deficit, which is the current account deficit plus the fiscal deficit, is highly correlated to moves in the USD.
  - When the twin deficits are expanding, the USD tends to weaken.
- The recent fiscal stimulus is pushing the deficit down. It's likely to continue to push this deficit even wider. If history holds true as a guide, it's likely this will put downward pressure on the USD.
  - This is one reason why Mr. Gundlach is long-term bearish on the USD.
- The USD also hit some important technical resistance, based on Fibonacci ratios.
- If the USD does continue to weaken, this should bode well for emerging markets (EM).
  - Interestingly in the fourth quarter of 2018, EM had outperformance in a big U.S. stock bear market, which is very rare as usually in a bear market EM is the worst place to be.
    - This was also without USD weakness, which suggests to Mr. Gundlach that there is underlying health for EM equities versus U.S. stocks.

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Slide # | **Recap**

Fed Dots vs. Market Expectations 2019 and 2020

45

- Another reason Mr. Gundlach believes the USD is going to weaken is that the Fed expectations for rate hikes are likely to capitulate.
  - In 2018, the bond market capitulated expectations, as the Fed followed through on four rate hikes.
  - For 2019, the bond market is pricing in zero rate hikes, while the Fed's dot plot is showing two hikes.
  - Looking out to 2020, the Fed's dot plots show an expected three rate hikes, while the bond market is pricing in half a rate cut.
- The longer-term expectations of how the Fed's rhetoric may change are very significant for the USD.
  - It's not necessarily driven by short-term Fed expectations of six months, but rather 12-24 months.
- Mr. Gundlach believes the at the Fed's next meeting, the dot plots may reveal a half of point hike for 2019 and two for 2020, signaling confidence in the economy in the intermediate term.
- Additionally, the Euro to USD tends to follow economic momentum. Based on how low the momentum for Europe is, Mr. Gundlach wouldn't be surprised if the momentum started to increase versus the U.S., which would suggest a higher Euro / lower USD.

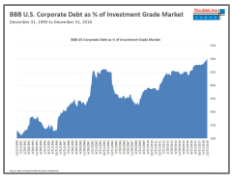
Primary Dealer U.S. Treasury Net Positions

51

- Primary dealer positions have exploded, as a lot of the auctions are being taken down by the primary dealers.
  - This shows a paucity in demand, broadly, and also leads Mr. Gundlach to wonder how much bigger dealers can actually get in terms of their Treasury net positions.
- The other problem is the bid cover ratios have been terrible in the bond auctions – i.e. there's not a lot of demand for U.S. bonds.
- Part of this is due to the lack of foreign demand, as borrowing costs for foreigners are higher than the yields on U.S. Treasuries (UST).
  - If a foreign investors were to buy the 10-year UST and hedge back to their domestic currency, investors would end up with a more negative yield than what is currently being offered in their domestic bond market.

BBB U.S. Corporate Debt as % of Investment Grade Market

54



- There has been a massive amount of BBB-rated corporate debt issued since the Global Financial Crisis
  - Fully half of the $6 trillion investment-grade universe carries a BBB rating, which is the lowest slice of investment-grade, up from one-third in 2009.
- A lot of these bonds are maturing:
  - 2020: $742 billion
  - 2021: $803 billion
    - Most of these maturing bonds will likely be re-borrowed longer term again, which means an even greater supply of long-term bonds.

Slide #

Recap

56

Downgrades Could be Significant Come Cycle Turn

- BBB-rated bonds are now two and a half times bigger than the entire high-yield bond market.
- Because BBB ratings are two notches from a junk rating, if they were to get downgraded the smaller high-yield bond market could have a hard time absorbing the new supply without sharp price discounts.
- According to Morgan Stanley, 45% of the investment-grade corporate bond market would be rated junk if evaluated by leverage ratios alone.
  - Company officials have acknowledged their debt ratios are too high and their idea is to address those ratios at some future date.
- If these companies don't address those debt levels or if there's a recession and they're not able to address those debt levels, there could be a significant portion of the investment-grade market being downgraded.
- In the fourth quarter of 2018, there were a significant amount of downgrades of A-rated bonds into BBB-rated.
  - Mr. Gundlach believes this could be a sign of things to come.

60

Duration: DBLTX vs. Barclays U.S. Aggregate Index

- The duration of the Bloomberg Barclays U.S. Aggregate Index (Agg) is currently the longest it's been over the past 10 years.
- The duration of DBLTX has been historically much lower than that of the Agg, and it continues to have a highly favorable pattern of being longer duration than the fund's average when the yields are higher on the 10-year and shorter duration than the fund's average when yields are lower – i.e. actively manipulating the duration of the fund with almost perfect consistency since the fund's inception has been accretive to high risk-adjusted returns.

Question and Answer

"Was Jerome Powell's appearance on *60 Minutes* a sign of something?"

- I think it was a little bit of an homage to Ben Bernanke, almost exactly 10 years after Ben Bernanke did it. But I think it's a sign that the Fed really wants to nail down with no uncertain terms their full-on U-turn that the December press conference was just a bad dream and it didn't really happen. Suddenly, the stock market went up to within about 3% of its October 3rd level. And now it seems to be wobbling a little bit more again. But that's on there as showmanship to show that the Fed is feeling good about things and is not going to completely take the punch bowl away.

"Do you feel your forecast of higher long-term interest rates is consistent with your forecast for slowing growth and credit disruption?"

- Exactly, yes. Because I think that the debt boom that is already underway will accelerate, and the yield curve will absolutely, positively steepen. And it will steepen substantially unless the Fed does something about it, which can't be ruled out given the 60 Minutes performance and the precedents being already set by the BOJ and the ECB.

Question and Answer (cont'd)

"What will equities do between now and year-end?"

- I think they'll go negative on a year-to-date basis, probably sometime during second quarter or early third quarter. I think the Fed will react to that. I think we will have a much more non-linear year. Last year was straight up, then straight down. This year I'm looking for more of zig-zag behavior. We've already had a pretty strong zig. I'm expecting before long a zag.

Definitions

Correlation - A statistical measurement of the relationship between two variables. Possible correlations range from +1 to -1. A zero correlation indicates that there is no relationship between the variables. A correlation of -1 indicates a perfect negative correlation and +1 indicates a perfect positive correlation.

Conference Board Leading Economic Indicator Index® (LEI) - The composite economic indexes are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components.

Investment Grade - Is a rating that indicates that a municipal or corporate bond has a relatively low risk of default.

Fibonacci Ratio - In technical analysis, a Fibonacci retracement is created by taking two extreme points (usually a major peak and trough) on a stock chart and dividing the vertical distance by the key Fibonacci ratios of 23.6%, 38.2%, 50%, 61.8% and 100%.

Employment Cost Index - Is a quarterly economic series detailing the changes in the costs of labor for businesses in the United States economy.

Hard Data - is defined as data in the form of numbers or graphs, as opposed to qualitative information.

Soft Data - based on qualitative information such as a rating, survey or poll.

ISM New Orders (ISM Manufacturing Index) – The PMI is a composite index that gives equal weighting to new orders, production, employment, supplier deliveries, and inventories. Each factor is seasonally adjusted.

Bloomberg Barclays US Aggregate Index – This 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. It is not possible to invest in an index.
Purchasing Managers' Index (PMI) – Is an indicator of the economic health of the manufacturing sector.
Price-to-Sales Ratio - Is a valuation metric for stocks. It is calculated by dividing the company's market cap by the revenue in the most recent year; or, equivalently, divide the per-share stock price by the per-share revenue.
Spread – Spread is the percentage point difference between yields of various classes of bonds compared to treasury bonds.
Standard Deviation - A measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Calculated by the square-root of the variance.
S&P 500 Index - S&P 500 Index is based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.
Yield Curve – A curve on a graph in which the yield of fixed-interest securities is plotted against the length of time they have to run to maturity.
Duration – Duration is a commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration.
G-10 - Is made up of eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the U.S.)

Credit Quality - Determined from the highest available credit rating from any Nationally Recognized Statistical Rating Agency (NRSRO", generally S&P, Moody's, or Fitch). DoubleLine chooses to display credit ratings using S&P's rating convention, although the rating itself might be sourced from another NRSRO. The firm evaluates a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when the rating agency has not issued a formal rating, the rating agency will classify the security as nonrated.