High-Yield Manager Gears for New Cycle

Payden High Income R		
Fund Facts		
Symbol	PYHRX	
Website	www.paydenfunds.com	
Address	Payden Funds, 333 South Grand Avenue, Los Angeles, CA 90071	
Tel. No.	800-572-9336	
Inception	12/30/97	
Portfolio		
Total Net Assets *		$326
Avg Mkt Cap ($ Weighted) *		---
Average Price/Earnings Ratio		---
Average Price/Book Ratio		---
Turnover Ratio		74%
Investment Information		
New Investment		Open
Min Initial Investment		$5,000
Min Subsequent Investment		$1,000
Min Initial IRA Investment		$2,000
Risk (Against Std Index - 3-yr Average)		
	PYHRX	Category Avg.
Alpha	-0.55	-4.67
Beta	-0.01	-0.01
Returns vs. Lipper HI Yld Bond Fd Index		
	PYHRX	Index
1 Year (Cum.)	6.03%	3.18%
3 Year (Ann.)	3.84%	-2.04%
5 Year (Ann.)	3.07%	-1.47%
Returns vs. Lehman Brothers Aggregate Bd		
	PYHRX	Index
1 Year (Cum.)	6.03%	11.69%
3 Year (Ann.)	3.84%	9.81%
5 Year (Ann.)	3.07%	7.51%
Fees and Expenses		
Max Sales Charge - Front		0.00%
Max Sales Charge - Deferred		0.00%
Redemption Fee		1.00%
Total Expense Ratio		0.52%
Portfolio Manager		
Management Team		---
* millions	Data through: 03/31/03	
Source: Company Documents; Lipper		

TICKER's Choice

The Payden High-Yield Bond Fund, headed by veteran credit analyst Kevin Akioka, has never experienced a default among securities held in the portfolio since inception. That attention to credit risk has delivered a performance, based on total return, that ranks the fund in the top 10% in its category for the past five years.

Q: In reviewing the description of the fund, 65% is geared toward the high quality issues from the high-yield market. Can you elaborate?

A: The basic strategy is we want to give investors high-yield market exposure, with the preservation of capital in mind. That takes us to this low risk end of the high-yield market. Basically, we call it the upper tier of the high-yield market. One of the challenges of high-yield is you have this whole universe of bonds that are anywhere from double B all the way down to triple C and single D. Our intent is to give the investor good, solid company exposure in that upper tier which is generally double B and single B kind of bonds.

Q: More than 75% of the portfolio is in B-rated debt. What do you look for in selecting which bonds to buy for the portfolio?

A: To distill it down, we do start from a top down viewpoint when we're looking at our high-yield funds. That is, obviously looking at the big macro picture, what's happening in the U.S., what's happening globally, what's happening across industries, either U.S. or globally, and really just getting a feel for the back drop of this high-yield market. Is it favorable or unfavorable? Once we settle in on a viewpoint, we start to slip into more of an industry selection mode. From an industry selection standpoint, you're asking the question of do I want weight gaming aggressively? Those kinds of decisions are made at that point after developing the macro picture. Once you settle in on what industries, you ask, what do I want to weight heavily and what do I want to under weight? What are the fundamentals? What are the trends? Do I like management or not? Once you get comfortable with an individual company, you're going to look at the valuation. When you're looking at the yield on the bond, you ask does that correspond to what your credit opinion is and are you getting paid a fair

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amount for a company that has a certain level of risk. We're very long term oriented. Once we dig into a company, its management and the business, we plan to hold onto that company for at least two or three quarters.

Q: Why do you focus so much on this sector of the high-yield market?

A: On a general basis, double Bs and single Bs are going to be our focus. I would also say that we're going to have a strategy that is going to perform over the full high-yield cycle. We've had single-digit returns over the last five years. Everybody is waiting for that 12% to 15% kind of year that never seems to happen. Because of our quality bias, meaning the upper tier, we're going to perform pretty well in that environment. As we get to the different part of the credit cycle, which is where we think we're heading, our challenge is to find these companies that have a little more yield and have a little more total return potential and put them into the portfolio without straying from our philosophy of capital preservation. That's the mode we're in or near right now.

Q: Are you saying that companies are paying more attention to their balance sheets and that this will work in favor of high-yield bonds?

A: Yes. It's something that started a while ago. It's the kind of fundamental that takes a long time to really start to show in the numbers. If you make a decision today to start to improve the balance sheet you can't go out tomorrow and sell assets and pay down debt. That obviously takes a long time. The other thing that's going on is you finally have shareholders that are starting to appreciate the value of a strong balance sheet. Once shareholders from the equity base start to say, "Hey, we need a good, solid balance sheet. Stop your share buybacks. Pay down some debt. Maybe even issue some equity," you'll begin seeing a slow and steady improvement in the balance sheet. You also have the high-yield markets much better disciplined about what kind of companies they're buying on a new issue basis. Going back to 1995 and 1997 where you had a market that was strong, frothy and overheated, anybody with a business plan and a decent idea could raise $100 million to $200 million. That has pretty much stopped now.

Q: What is your opinion of the credit rating agencies?

A: To preface it, I think they have a tough job. Their mandate is to have a view on credit risk, which is very different from having a view on the valuation of the company's bonds. People fall into the trap of confusing the two. I think the criticisms of the rating agencies might be somewhat misplaced in that everybody wants them to be able to call what the market price is going to be by assigning a rating that will reflect the market value of the bond. But they can't do that. The perspective that we place the rating agencies in is as a third party looking at a company, doing their work and assigning a letter rating, not more and not less than that. For us, it's part of the analysis that we go through, but we take every company, look at it individually, completely ignore what the rating is and try to come up with our own internal credit rating.

Q: In your research, which is fundamentally based, do you have an analyst team on which you rely?

A: We have six analysts who follow different industries. They each follow 20 to 30 companies. One of the unique aspects of our firm is we rely quite a bit on our investment grade research group in that you've had all these fallen angels that have been downgraded into the high-yield market. We use them as a resource. We use our equity analyst group as a resource as well. We have several people in the equity group looking at small cap and large cap stocks from the equity perspective. We're talking all the time, exchanging ideas, relying on each other for different angles. In this kind of market that we've seen over the past few years, where equity volatility has been high, balance sheet considerations are important for the equity side and an equity holder's perspective is important for the bond side. The need to work together closely has never been greater.

Q: Can you briefly describe the reasons why you decide to sell a bond?

A: Yes. A sell decision is reached when the fundamentals meaningfully change for a company, and when we readjust our internal credit rating and it no longer justifies the current price of the bond. That for us is a very disciplined process because it takes the emotion out of the equation and we're able to look at the fundamentals at face value. If that bond price has not responded or traded down a little, it's probably going to lead to a sale of that bond. If the bond has overshot on the downside, and we think the equation has changed a little bit and you've had this company deteriorate in credit quality but at the same time the bond

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price went down way too much, that's going to be a hold for us. A lot of people like to go in and trade it and buy it back at a lower price. We ground our decisions from a fundamental standpoint.

Q: The next issue involves equity capitalization. Where is the concentration?

A: High-yield, traditionally, has been more of a small cap from an equity perspective. You have market capitalizations anywhere from $500 million to maybe $2 or $3 billon on the high side. What's been happening lately with the companies getting downgraded to below investment grade is you're getting some substantially larger companies - Fortune 100 companies. You're getting a change from a small cap that now includes some of these larger companies.

Q: How do you hedge against a company defaulting on its debt?

A: We are not in that part of the market that is managing defaulted bonds and distressed bonds with the idea that they're going to emerge out of bankruptcy in a year-and-a-half. We just don't want to spend our time on that kind of analysis. We're fully aware that we're going to get into trouble. That's just the nature of the beast. But we tend to sell bonds before they get close to a high probability of default. Our portfolio has not experienced a default since inception, just for that philosophy.

Q: Is the fund seeing net inflows or net outflows?

A: We've seen some good net inflows since the beginning of the year. We started at $254 million, and now we're at $281 million. That's been a good, manageable inflow for us. It's reflecting the interest in the sector.

Q: The high-yield index bottomed at roughly the same time as the major U.S. stock market indexes. What is the outlook for the remainder of the year?

A: If we could hold our coupon at right around 9% to 9.5% and get a little bit in capital gains as yields come down, you could hit above 10% or 11%. That would be a pretty good year in the face of the past five years of basically single-digit returns. I still think to get a 9% or 10% yield on a security in a portfolio of good quality companies, while taking on less risk than equities, and in this kind of environment with concerns about growth, that high-yield is a good place to be. And, if you're worried about treasuries going up, we don't have the view that treasuries are going to rocket any time soon. But, if you're worried over the long term that treasury yields might trend up, high-yield is a lower correlated asset class and you have a cushion of yield to buffer against rising interest rates. ▮

Dave Jennings

"As we get to the different part of the credit cycle, our challenge is to find these companies that have a little more yield and have a little more total return potential."

About:

Kevin Akioka is a senior vice president at Payden & Rygel. He has been with the firm since 1995. As director of the firm's high yield corporate bond group, Mr. Akioka is responsible for the development and implementation of the firm's strategy in that sector. He also monitors the firm's credit-sensitive positions in the high yield sector. Prior to joining Payden & Rygel, Mr. Akioka was a corporate bond analyst at Merrill Lynch where he covered banks, brokerage firms and financial companies. Previously, he was an analyst at Salomon Smith Barney where his responsibilities included industry and credit analysis, M&A advisory, and developing credit-driven trading strategies for both high-yield and investment grade bonds/credits. A member of the Los Angeles Society of Financial Analysts (LASFA) and the Association of Investment Management and Research (AIMR), Mr. Akioka is a chartered financial analyst. He earned an MBA in finance from New York University. He received a B.S. in economics and psychology from the University of California, Irvine.

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