

TCW Balanced Managed Accounts

THIRD QUARTER 2018 | INFOFLASH

Philosophy: A strategy that invests in a diversified array of U.S. equity securities and investment grade U.S. bonds, seeking to outperform the benchmark through a combination of income and capital appreciation.

Key Issues

- U.S. equities marched higher in the third quarter as all three major indices finished the period in positive territory. The Dow Jones Industrial Average led the advance (+9.0%), followed by the S&P 500 (+7.7%) and the NASDAQ Composite (+7.4%). The U.S. equity market outperformed the rest of the world as the global synchronized equity markets of years past has thus far taken a breather YTD 2018. European markets remain challenged (Brexit, trade concerns, Italy).
- The third quarter began with solid economic news: June's nonfarm payrolls report of 213k job gains topped consensus with the employment rate of 4.0% and June's ISM print of 60.2 increased from May's 58.7. In late July, we learned U.S. GDP surged to a 4.1% QoQ annualized rate in 2Q18, marking the eighth consecutive quarter whereby U.S. GDP growth accelerated on a YoY basis. The S&P continued to shrug off trade headlines during September and the market continued its advance, thanks in part to continued positive economic data: jobless claims remain low, the September ISM came in with a reading of 59.8, and the Conference Board's Consumer Confidence Survey touched an 18 year high in September. Trade war concerns remained center stage as President Trump announced plans for additional tariffs on ~\$200b of imports from China (and China retaliated by announcing 5-10% tariffs on an additional \$60b of U.S. goods).
- Within the equities portion of the portfolio, including the contribution of sector allocation and security selection, our information technology and financials weightings hurt relative results most and our consumer discretionary and healthcare weightings most positively impacted performance during the third quarter. While we understand volatility is naturally uncomfortable in the near-term, as active stock pickers we believe it affords us the unique opportunity to increase our weightings in high-conviction holdings at lower prices. We are always mindful of our exposures and readily acknowledge the trickiness of this market cycle set-up, but we believe many of the broad secular themes to which we are exposed (e.g. cloud, digital transformation, mobile, e-commerce, digital payments) should continue to grow despite any Fed-policy induced confusion.
- With strong economic growth, a tight labor market, and inflation largely anchored around their target, it was not a surprise to the market that the Fed hiked rates 25 bps in September, the 8th so far this cycle, bringing the funds target range to 2.0% - 2.25%. The Fed's over-riding message continues to be one of gradual policy tightening. If anything, recent speeches by noted monetary doves Brainard and Evens have turned more hawkish, supporting the Fed's growing confidence in their efforts to hike three more times by the end of 2019.
- Within the fixed income marketplace, investment grade retraced lost ground this quarter, as spreads tightened in 17 bps to 106 bps and the sector outperformed Treasuries by nearly 170 bps. Meanwhile, high yield continued to be supported by strong investor demand, returning 2.5% in the quarter to bring year-to-date gains to 3.4% and spreads narrowed to 316 bps, close to their cyclical tights. Despite heightened downside risks such as emerging market turmoil, escalating trade tensions, and deteriorating fundamentals, domestic corporate credit has been largely resilient, with overall spreads only modestly wider for the year. Our allocation to corporate bonds is currently approximately 36% of the fixed income portion of the portfolio.

Top Five Equity Holdings

AS OF SEPTEMBER 30, 2018

Name	% of Portfolio
1. Amazon.com, Inc.	5.4
2. Visa Inc.	4.4
3. Alphabet, Inc.	4.0
4. Adobe Systems Incorporated	3.7
5. salesforce.com, inc.	3.5

Top Five Fixed Income Holdings

AS OF SEPTEMBER 30, 2018

Name	% of Portfolio
1. U.S. Treasury N/B 2.875%, 9/30/2023	6.7
2. U.S. Treasury Notes 1.125%, 7/31/2021	4.1
3. U.S. Treasury Notes 1.250%, 1/31/2020	3.1
4. U.S. Treasury N/B 2.875%, 5/15/2028	3.0
5. Boston Properties 3.850%, 2/1/2023	2.6

Source: TCW. Based on a managed account model portfolio. Portfolio characteristics and holdings are subject to change at any time. It should not be assumed that an investment in the securities listed was, or will be, profitable.

Note: TCW refers to this product as **Core Balanced**. The equity component of this **Balanced strategy** is **TCW Concentrated Core (Large Cap Growth)**.

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Representative Equity Buys and Sells

BUYS (Ticker; Sector)

Xylem Inc. (XYL; Industrials)

Xylem is a leading water infrastructure company that engages in the design, manufacture, and service of engineered solutions for the water industry. The company operates in three segments: water infrastructure, applied water and measurement/control solutions. We believe the company is benefitting from several secular tailwinds (regulatory, demographics, infrastructure needs) and over the last several years the company has been aggressively moving up the technology curve in the very fragmented water industry, providing a competitive advantage for the company. Xylem enjoys strong free-cash-flow generation (over 110% of net income) and we believe the company's business profile is more defensive than most industrials given stable end market demand, consistent utility replacement spend and its operational expenditure-reducing product suite. We do not believe the current stock price reflects the company's scale, breadth of products and secular tailwind in a large and growing end market.

IHS Markit Ltd. (INFO; Industrials)

IHS Markit is a leading information services business that provides critical information, analytics, and solutions to the transportation, resources and financial services industries. We believe the company's data sets are difficult to replicate and deeply embedded in the systems and workflows of its clients, providing INFO with ongoing pricing power. The company further enjoys meaningful leverage from its build it once, sell it many times business model. INFO's large subscription base drives recurring and consistent revenue growth, attractive and scalable margins, slightly negative working capital (clients generally pre-pay subscriptions) and high free-cash-flow margins. We believe the current stock price does not adequately reflect the company's long-term growth prospects.

SELLS (Ticker; Sector)

Starbucks Corporation (SBUX; Consumer Discretionary)

Starbucks operates a global chain of over 28,000 company-owned and licensed stores. The company, together with its subsidiaries, sells coffee, teas, blended beverages and food. When we first purchased shares over six years ago, we were attracted to the company's numerous growth opportunities including new product platforms, new distribution channels and geographic expansion (especially in China). Due to weakening fundamentals (compressing margins, global June comps of +1%, China's ~+3% comp marked the lowest in 34 quarters) as well as some senior executive changes (Howard Schultz stepping down as executive chairman, CFO Scott Maw retiring) we elected to sell our position and redeploy the proceeds into holdings we believe have more attractive risk/reward profiles.

Air Products and Chemicals, Inc. (APD; Materials)

Air Products and Chemicals produces industrial atmospheric and specialty gases and equipment worldwide. It offers products and services to a wide array of industries including manufacturing, energy, metals, chemicals and electronics. When we first purchased shares in APD we were attracted to the company's industry-leading returns on capital, strong balance sheet and our belief the company could grow in excess of industrial production. While an acceleration in the industrialized economy materialized, incremental margins remained challenged, leading the company to embark on what we believe to be riskier projects, particularly in China. We therefore elected to sell our shares and redeploy the assets into holdings with more attractive risk/reward profiles.

Source: TCW, and Bloomberg Barclays Inc.

Based on a managed account model portfolio. Portfolio characteristics and holdings are subject to change at any time. The investment strategy does not target any specific numbers or ranges for these characteristics. Accordingly, these characteristics can vary greatly. The estimates are forward-looking statements based on assumptions. This would include forward earnings estimates and growth rates, among other things, and all associated calculations, including projected price/earnings ratios. Actual results may vary materially from the estimates due to the numerous economic, financial and market conditions. There is no assurance that forecast estimates will be realized. The index is not available for direct investment; therefore its performance does not reflect a reduction for fees or expenses incurred in managing a portfolio. The securities in the index may be substantially different from those in the strategy.

Reflects up to the three largest buys (new buys) and up to the three largest sells (complete sells) for the quarter. There is no assurance that any securities discussed herein will remain in an account; be purchased in the portfolio at the time this report is received or that securities sold have not been repurchased. It should not be assumed that any of the securities transactions or holdings discussed were, or will prove to be, profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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Portfolio Profile

AS OF SEPTEMBER 30, 2018

Equities	TCW	Russell 1000® Growth Index
Number of Securities	33	542
Average Price/Earnings: Next 12 Months	30.0x	21.5x
PEG Ratio - Forward 1 Yr.	1.8x	1.6x
Price to Sales	6.1x	3.7x
Debt-to-Equity	1.0x	1.3x
Dividend Yield	0.4%	1.2%
Projected 3-5 yr. Revenue Growth	15.7%	10.3%
Projected 3-5 yr. EPS Growth	18.1%	14.0%
Market Capitalization (Billions)		
Average (\$ Wtd.)	\$229.2	\$319.3
Average (Eq. Wtd.)	\$136.7	\$37.2
Median	\$54.0	\$13.0

Fixed Income	TCW	Bloomberg Barclays Intermediate Gov't/Credit Index
Number of Securities	11	4,582
Wtd. Average Bond Rating	AA	AA
Wtd. Average Maturity	4.6	4.3
Effective Duration	4.2	3.9

Asset Allocation

AS OF SEPTEMBER 30, 2018

