Memo to: Clients

From: Howard Marks
Trust Company of the West

Re: First Quarter Performance

The mood swings of the securities markets resemble the movement of a pendulum. Although the midpoint of its arc best describes the location of the pendulum "on average," it actually spends very little of its time there. Instead, it is almost always swinging toward or away from the extremes of its arc. But whenever the pendulum is near either extreme, it is inevitable that it will move back toward the midpoint sooner or later. In fact, it is the movement toward an extreme itself that supplies the energy for the swing back.

Investment markets make the same pendulum-like swing:

- between euphoria and depression,
- between celebrating positive developments and obsessing over negatives, and thus
- between overpriced and underpriced.

This oscillation is one of the most dependable features of the investment world, and investor psychology seems to spend much more time at the extremes than it does at a "happy medium."

In late 1990, the securities markets were at a negative extreme as concerns about the economy and Iraq produced exaggerated risk aversion and thus drastic under-valuation of all securities considered to be of less than "gilt-edge" quality. The subsequent first quarter swing toward more reasonable valuations imparted to our portfolios some of the best quarterly performance in our history.

With investors worrying less about default rates and forced selling, our high yield bonds returned more than at any time since the second quarter of 1980. The rebirth of interest in smaller and second-tier stocks produced a quarterly return for our convertibles above any since the fourth quarter of 1982. Lastly, suspension of "end-of-the-world" thinking and an increased willingness to envision possible solutions caused our distressed-debt Special Credits portfolios to gain even more than either high yield bonds or convertibles.

It would be wonderful to be able to successfully predict the swings of the pendulum and always move in the appropriate direction, but this is certainly an unrealistic expectation. We consider it far more reasonable to try to (1) stay alert for occasions when a market has reached an extreme, (2) adjust our behavior slightly in response and, (3) most importantly, refuse to fall into line with the herd behavior which renders so many investors dead wrong at tops and bottoms.

The first quarter's swing back from the negative extreme has been rapid and impressive. No one can say whether it came too soon or went too far, and we are cautious that these dramatic results may have been realized without great improvement in the fundamental economy. However, we feel "fair" does a much better job of describing the prices which resulted than would "excessive." That is, the pendulum is closer to the midpoint at this time than to an extreme.

The bargains which were so readily available in the fourth quarter of 1990 are no longer there to the same extent, and we are not acting as if they were. And we certainly are not planning on a continuation of the first quarter's performance. Instead, from today's more reasonable prices, we consider our three areas to be poised for a continuation of their "normal" above-average risk-adjusted performance.

April 11, 1991

Legal Information and Disclosures

This memorandum expresses the views of the author as of the date indicated and such views are subject to change without notice. Oaktree has no duty or obligation to update the information contained herein. Further, Oaktree makes no representation, and it should not be assumed, that past investment performance is an indication of future results. Moreover, wherever there is the potential for profit there is also the possibility of loss.

This memorandum is being made available for educational purposes only and should not be used for any other purpose. The information contained herein does not constitute and should not be construed as an offering of advisory services or an offer to sell or solicitation to buy any securities or related financial instruments in any jurisdiction. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. Oaktree Capital Management, L.P. ("Oaktree") believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based.

This memorandum, including the information contained herein, may not be copied, reproduced, republished, or posted in whole or in part, in any form without the prior written consent of Oaktree.