

# NFJ Continues to Focus on Quality

An interview with NFJ Investment Group founder, managing director and portfolio manager Ben Fischer on the recent performance of Allianz NFJ Dividend Value Fund

**Allianz**   
Global Investors



Ben Fischer  
Portfolio Manager

NFJ Investment Group's investment philosophy is based on a well-supported observation: that dividend-paying, low P/E stocks have offered an impressive balance of risk and reward over extended periods of time. NFJ has remained true to this approach throughout its 20-year history, investing only in what it considers to be fundamentally sound companies with stronger value characteristics than a portfolio's benchmark.

**Q:** Ben, let's start with what is on everyone's mind: performance. How has the Fund fared vs. its benchmark and its peers year to date?

**A:** Through the end of April, the Fund has underperformed its benchmark, the Russell 1000 Value Index.

**Q:** Can you give us some details about why the Fund has underperformed so far this year?

**A:** Yes. There are really two distinct reasons why the Fund has underperformed recently.

The first has to do with stock selection, particularly stock selection within the financial sector. In fact, stock selection and industry allocation among financial stocks have accounted for the majority of relative underperformance we have experienced. On an absolute basis, financial names in the portfolio have underperformed financials in the benchmark. So that has been one part of the problem.

The second major reason has to do with recent underperformance of dividend-paying stocks in the Russell 1000 Value Index. Dividend-paying stocks within the index have underperformed

non-dividend payers in the index by almost 30% year to date. Digging a little deeper, it turns out that within this dividend-paying segment of the stock universe, the high-yielding names have fared the worst. That is precisely where NFJ typically positions itself.

**Q:** Given how financials have fared, how is the portfolio currently positioned in this sector?

**A:** Currently the portfolio is made up of about 17% financials, compared to the benchmark weight to financials, which would be about 22%. This is currently our largest underweight from a sector perspective. From an industry perspective, insurance, thrifts and mortgage finance names are our only overweights. All other industries in the financial sector are underweight or zero-weight.

**Q:** Why are you overweighting insurance but underweighting other areas of the financial sector?

**A:** Insurers as a group had been a defensive haven within financials during the first part of the credit crunch, but have since suffered disproportionately. NFJ remains invested in those names that we believe have the necessary capital and credit facilities available to make it through this downturn and those we believe should do well in an eventual equity market recovery.

**Q:** Why have the portfolio's financial stocks lagged the benchmark year to date?

**A:** Since the Dow Jones Industrial Average hit its low back on March 9, the index has climbed nearly 25%, and the aggregate performance of financials in the index has been over 60%—the best-performing sector since the bottom. Unfortunately, insurance and thrifts, which we have overweighted, have been the two worst-performing industries within the financial sector. In other words, the key drivers

## Dividend Payers Have Underperformed This Year

Dividend-paying stocks within the index have underperformed non-dividend payers in the index by almost 30% year to date.

Index	Total Return Dividend of Index	Dividend Payers	Non-Dividend Payers
Russell 1000	-4.83%	-7.89%	+11.27
Russell 1000 Value	-11.11%	-12.57%	+17.03
Russell 1000 Growth	+1.47%	-2.14%	+10.71

Source: Russell. Year-to-date performance as of 4/22/09. Past performance of the indexes is no guarantee of future results. Index returns are unmanaged. Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. One cannot invest directly in an index. The "dividend payers" and "non-dividend payers" are subsets of the same index listed in the left-most column.

of performance in the recent run-up were either underweighted or not represented in the portfolio.

**Q:** Why haven't the financials in the portfolio fully participated in the rally?

**A:** You need to remember that NFJ seeks to invest in low-priced stocks with attractive fundamentals. NFJ believes that many of the benchmark constituents that have driven recent index performance have not done so because of their fundamentals. In fact, many of the stocks that improved the most were those that declined most precipitously in 2008. Further, among financials, it is the very lowest quality stocks that have delivered the best performance since the market bottom on March 9. While we are not limited to investing in only high-quality names, our process does prevent us from owning the lowest quality names. This positioning has served our shareholders well in the past, and will do so over the long term.

**Q:** Your Morningstar rankings have been affected. Explain a bit about that.

**A:** Morningstar rankings can be useful, but must be understood in context. Growth has significantly outpaced value year to date. In that environment,

a deep value manager like us will likely underperform relative to its Morningstar peer group. Further, deep value funds like NFJ Dividend Value will lag traditional and relative value peers. In addition, given the way the rankings are weighted, one-year performance has a greater effect on longer-term rankings, so any performance lag over, say, four months, will have an unusually significant impact on three- and five-year rankings.

**Q:** Has the portfolio ever lagged its benchmark and Morningstar peers in the past?

**A:** Yes, in the late '90s, when growth outpaced value, the portfolio lagged both its benchmark and peer group. Again in 2003, when lower quality names outperformed, the fund lagged the benchmark and its peers. However, both of these periods were followed by periods of outperformance.

**Q:** What are you doing to protect your shareholders in this environment?

**A:** We are focusing intently on absolute yield. We are also focusing on the cushioning effect of dividends. To the latter point, though dividend cuts by many companies have been well publicized, among the Fund's holdings, raises have actually outnumbered cuts three to one. Only eight of 45 holdings have reduced payouts over the past year, and the median holding still pays more than it did one year ago.

We have also emphasized companies with no looming debt maturities or pension plan concerns. We have highlighted companies that have recently hiked their payouts, even in the midst of the current economic malaise, as NFJ views these companies as less likely to turn around and slash their dividends.

Further, in the future, dividends may become rarer, and company managements will probably think twice before instituting standard payout hikes unless they are certain that they can be maintained. Thus, going forward, increasing dividends may work even better as an indicator of quality and management confidence.

#### Allianz NFJ Dividend Value Portfolio Weightings vs. Benchmark Weightings

The portfolio is currently principally underweight in capital markets, commercial banks, consumer financials and diversified financial services.

As of 4/22/09	Portfolio Weight	Benchmark Weight	Overweight/Underweight
Capital markets	0.00	3.52	-3.52
Commercial banks	2.33	4.78	-2.45
Consumer financials	0.00	0.36	-0.36
Diversified financial services	2.52	5.32	-2.80
Insurance	6.93	5.15	+1.78
REITs	3.65	2.27	+1.38
Real estate mgmt. & development	0.00	0.06	-0.06
Thriffs & mortgage finance	1.92	0.47	+1.45

Source: NFJ. The composition of portfolio sectors is subject to change. Current and future holdings are subject to risk.

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The Russell 1000 Index is an unmanaged index that consists of the 1,000 largest companies in the Russell 3000 Index and represents approximately 90 percent of the total market capitalization of the Russell 3000 Index. It is highly correlated with the S&P 500 Index.

The Russell 1000 Growth Index is an unmanaged index that measures the performance of companies in the Russell 1000 Index considered to have a greater than average growth orientation.

The Russell 1000 Value Index is an unmanaged index that measures the performance of companies in the Russell 1000 Index considered to have a less than average growth orientation.

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