



TCW Investment Management Company Pinnacle American Mid Cap Growth Equity Fund First Quarter 2009

As we concluded the quarter, the question we heard asked and answered most by our peers was, “Is this rally for real?” Certainly, the market has come quite far quite quickly, with the S&P 500 Index up 18.1% from its March 9th low to the quarter’s end. Our benchmark was up 18.4% the same period. According to Barron’s, this was one of the fastest recoveries ever. Of course, on March 9, the S&P was about 55.1% off its 2007 highs (the Russell Midcap Growth index was down 56.7%) and the U.S equity markets had recorded, according to Stifel Nicolaus, their worst 10 year compound returns in the 172 years they analyzed.

Returning to the question du jour, we think it is unanswerable. Without a doubt, fundamental conditions remain very poor. S&P 500 Index earnings are now estimated by ISI to be \$45 for 2009, barely half their peak. In the credit markets, spreads remain unusually wide reflecting the lack of credit. There are glimmers of hope: Spreads are not as wide as they have been.

Regardless of what one thinks of government policy, the government and U.S. Federal Reserve have pumped trillions of dollars into the economy. Such a shot of adrenaline will most certainly have an impact. It is the magnitude and duration of such an impact that is in question, as well as the long-term outlook for the economy given the massive shift of power from the private economy to Washington, D.C.

Where we have more conviction is the three-year prospects for the individual companies in the portfolio. Unlike corporate America as a whole, our companies continue, on average, to grow. In the most recent three-months for which we have reported results, our average company grew revenues in the low-double-digit range. The rate is certainly not the 30%-plus rates we were seeing in 2005, 2006 and 2007 and may well go lower, but is commendable given the macroeconomic environment. Our portfolio companies are generally well-capitalized, with most having no material net debt on the balance sheet. Therefore, while the depth and duration of the recession is uncertain, we can have confidence in our companies’ abilities to take market share through the downturn and emerge on the other side. We have significant investments in insurance. This industry has seen massive destruction of capacity (capital), which should benefit our companies. We are already seeing pricing improve and lead activity growing rapidly. The amount of market share in play due to AIG’s problems alone is enticing for our companies. During the quarter, we purchased the first banks we have owned in two years. Like insurance, we are buying (at very attractive valuations) companies whose under-levered balance sheets should enable them to write new loans and attract deposits while their larger competitors are on (government-sponsored) life support.

During the period, the portfolio benefited from strong stock selection in Industrials sector. Good stock selection in the Financials, Energy and Consumer Staples sectors also helped. Partially offsetting this was weak stock selection in Consumer Discretionary.

The Pinnacle Program

We realize it has been a brutal twelve months for our investors and equity investors in general. We remain focused on the fact we own real businesses we expect to grow over the next three years. If they succeed in doing so, we have the prospect of delivering returns commensurate with that growth if multiples do not expand, and performance significantly higher than earnings growth if multiples expand from today's low levels.

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