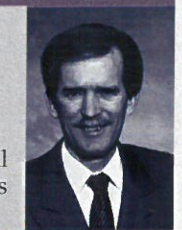
Bill
Gross



Investment Outlook

PIMCO

August 2000

Into the E-byss
(Bonds in a New Age Economy)

I used to explain to reporters when asked to describe the ideal bond manager, that he should be 1/3 economist, 1/3 mathematician, and 1/3 horse trader. It was a catchy answer, but at the time, almost 3/3 true. Bonds have a mathematical bent to them that stocks somehow manage to partially circumvent, and interest rates are no doubt highly correlated to movements in the real economy and the inflation or deflation that it produces. The horse trading aspect is a little bit harder to explain, especially for a long-term oriented bond manager such as PIMCO, but there are day trades like we see in stocks, and lifetime trades like some have in good marriages and invariably lots of trades in between. A good horse can last for quite a few years, as any good cowboy knows, so the trading or perhaps the strategizing is definitely a part of a great bond manager's psychological resume.

Over the past few years, however, I've come to believe that a bond superman should be divided into four, not three pieces. The advent of what PIMCO called Butler Creek in 1994, as well as, the demise of Long Term Capital Management in 1998, have taught me that structural, as well as strategic, economic, and quantitative inputs are critical to the successful management of bond portfolios. The final quarter then, that depends upon skills that can properly diversify a bond portfolio within the three-dimensional context of risk, reward and just as importantly – time – demands the skills of not just a mathematician, economist, and a long-term horse trader, but that of an architect as well.

I'd like to talk about that aspect of bond management but first I know you'd like to hear a little bit about the market itself and what I think lies ahead. For that, I'll put on my economist hat with a touch of bond math and strategizing to boot, but I'll return to puzzle making and blueprint reading because, as I've just suggested, there's value to be found in the architecture as well.

At PIMCO, as you know, the economics start at the very top but, as in mountain climbing there are legitimate questions as to how high is high. Too much elevation or too long of a time period can suffocate the bond manager in a perhaps futile quest for certainty – if only