PACIFIC FUNDS TRENDS

INVESTMENT IDEAS FOR TODAY'S PORTFOLIOS JUNE 2021

THE CASE FOR CORPORATE DEBT

Adding corporate debt to an investor's portfolio may provide higher levels of income, capital appreciation and a hedge against rising interest rates

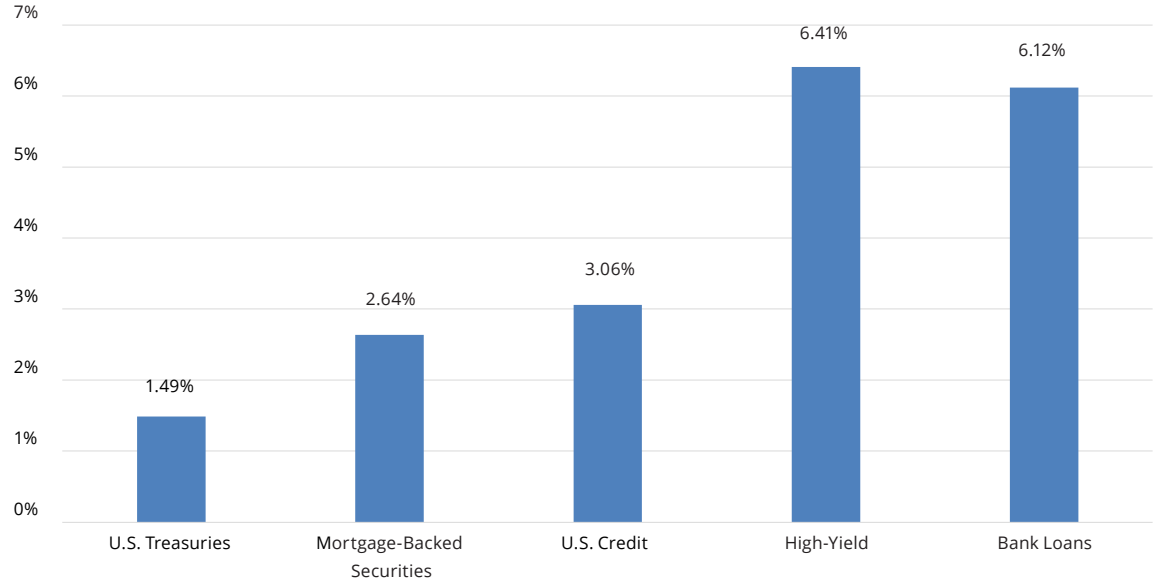
By Sam Masemer, CFA, CFP, Senior Client Portfolio Manager, and Craig Imamura, Product Strategist

Why consider corporate debt?

Higher level of income

Of the three main fixed-income asset classes—government securities, securitized debt, and corporate securities—corporate securities have historically provided the highest yield for a given maturity (Chart 1). Because the risk inherent in government securities and securitized debt is primarily composed of interest-rate risk, investors and their financial advisors may be overlooking the yield opportunities from having some corporate exposure in their portfolios. The additional credit spread achieved from corporate exposure represents the compensation for credit risk in corporate securities and provides an opportunity for investors and financial advisors to rethink their existing fixed-income allocations.

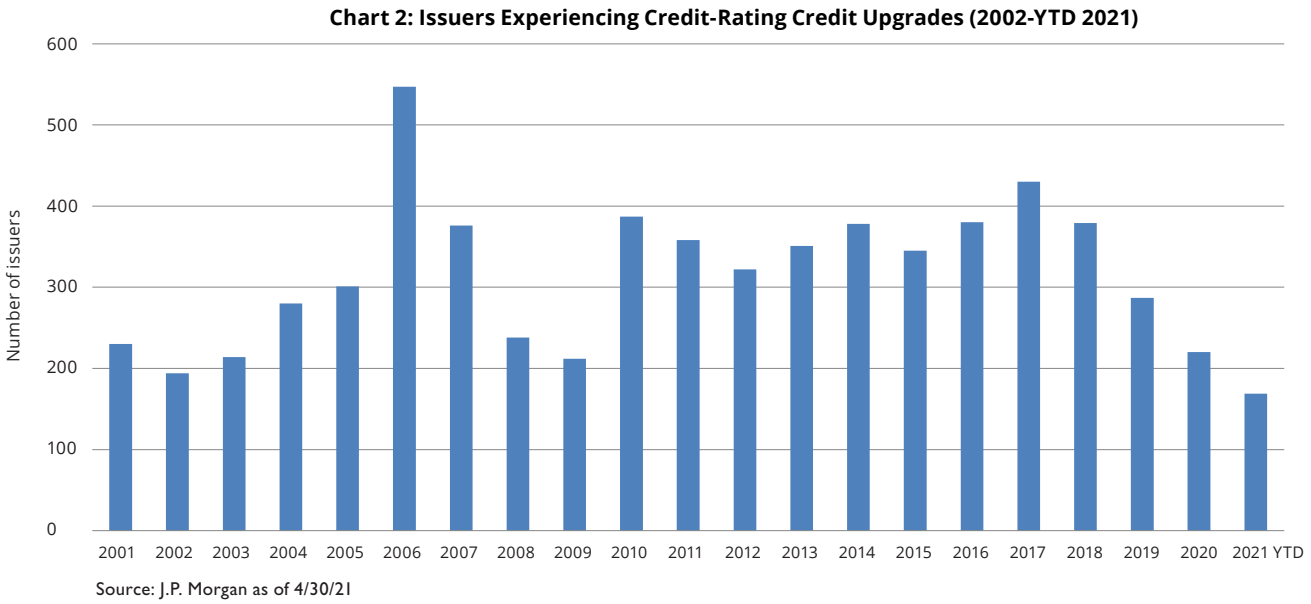
Chart 1: Average 10-Year Yield



Source: Morningstar, as of 3/31/21. U.S. Treasuries are represented by the Bloomberg Barclays U.S. Treasury Index, Mortgage-backed Securities are represented by the Bloomberg Barclays Mortgage-Backed Securities Index, U.S. Credit is represented by Bloomberg Barclays U.S. Credit Index, High Yield is represented by the Bloomberg Barclays U.S. Corporate High Yield Index and Bank Loans are represented by the Credit Suisse Leveraged Loan Index.

Potential for capital appreciation

Corporate bonds also provide the opportunity for capital appreciation related to a credit-rating upgrade. Because corporate bonds are rated based on the health of the issuing company's financial statements, the possibility exists for a credit-rating upgrade that does not exist for government securities or securitized debt. Chart 2 shows the number of issuers that experienced a credit-rating upgrade since 2001, including the five years from 2012 to 2016 that averaged more than 300 issuers upgraded each year.



Buffer for Rising-Rate Environments

In looking at three main corporate asset classes—investment grade, non-investment grade, and floating-rate loans—it is observed that the benchmark indexes representing these asset classes fared well during rising rate periods relative to the Bloomberg Barclays U.S. Aggregate Bond Index. Chart 3 shows the returns of these three asset classes relative to U.S. Treasuries in periods in which the 10-year U.S. Treasury rate rose more than 50 basis points (bps), trough to peak. When examining 17 such periods, investment grade corporates outperformed treasuries in 14 of 17 periods, while high-yield corporates outperformed U.S. Treasuries in 16 of 17 periods. Given their ability to adjust more frequently to increasing interest rates, bank loans were able to outperform treasuries in 17 of 17 periods by an average of 9.14% or 914 basis points. This data suggests that the additional credit spread achieved using corporate bonds provided compensation for shifting toward credit risk and away from interest-rate risk in a rising-rate environment.

Chart 3: Corporate Debt in Rising-Rate Environments

Period of Rate Increase	U.S. Treasuries	Outperformance of U.S. Credit over U.S. Treasuries	Bank Loans	Outperformance of Bank Loans over U.S. Treasuries
10/5/98 – 1/21/00	-3.82	0.93	6.53	10.35
11/7/01 – 4/1/02	-4.33	2.22	3.51	7.85
6/13/03 – 9/2/03	-6.25	0.63	1.77	8.02
3/22/04 – 6/14/04	-4.79	-0.13	0.92	5.70
6/27/05 – 6/27/06	-2.16	-0.44	6.12	8.29
3/17/08 – 6/13/08	-4.08	2.80	5.84	9.92
12/30/08 – 6/10/09	-6.92	10.68	31.83	38.75
11/30/09 – 4/5/10	-2.15	2.73	7.90	10.05
10/8/10 – 2/8/11	-4.64	1.15	5.19	9.82
9/22/11 – 10/27/11	-2.00	1.23	2.00	4.00
1/31/12 – 3/19/12	-2.29	1.75	1.36	3.65
7/24/12 – 9/14/12	-1.65	1.27	2.28	3.92
5/1/13 – 6/28/13	-2.79	-2.36	-0.43	2.36
10/23/13 – 12/31/13	-1.26	0.70	1.27	2.53
7/8/16 – 12/27/16	-5.43	1.79	5.02	10.45
9/8/17 – 11/9/18	-3.34	0.52	5.54	8.88
9/29/20 – 3/19/21	-5.25	2.84	5.52	10.76

Source: Morningstar, as of 3/31/21. U.S. Treasuries are represented by the Bloomberg Barclays U.S. Treasury Index, Mortgage-backed Securities are represented by the Bloomberg Barclays Mortgage-Backed Securities Index, U.S. Credit is represented by Bloomberg Barclays U.S. Credit Index, High Yield is represented by the Bloomberg Barclays U.S. Corporate High Yield Index and Bank Loans are represented by the S&P/LSTA Leveraged Loan Index.

Navigating This Environment with Pacific Funds

Predicting interest-rate directionality is among the most difficult tasks in capital markets. Corporate securities can provide opportunities for higher levels of income, capital appreciation and a help buffer against the effects of rising interest rates.

Pacific Funds offers fixed-income funds that are carefully constructed using a combination of investment-grade corporate bonds, high-yield corporate bonds, floating-rate loans, and short-term debt securities. The portfolio management team stays true to its strength as corporate-income specialists by researching individual securities and investing across the credit spectrum.

For more insights from Pacific Funds, visit

PacificFunds.com

Definitions

The **Bloomberg Barclays Mortgage-Backed Securities Index**, is a market value-weighted index composed of agency mortgage-backed pass-through securities of the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) with a minimum $150 million par amount outstanding and a weighted-average maturity of at least 1 year.

The **Bloomberg Barclays U.S. Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The **Bloomberg Barclays U.S. Corporate High Yield Index** covers the universe of fixed rate, non-investment-grade debt.

The **Bloomberg Barclays U.S. Credit Index** measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

The **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury

The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar denominated leveraged loan market.

The **S&P/LSTA Leveraged Loan Index** is designed to measure the performance of the U.S. leveraged loan market based upon market weightings, spreads, and interest payments.

About Principal Risks: All investing involves risks including the possible loss of the principal amount invested. There is no guarantee the Funds will achieve their investment goal. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. Bonds that are traded frequently and at high volumes may have stronger liquidity than bonds that trade less frequently. Corporate bonds are subject to issuer risk in that their value may decline for reasons directly related to the issuer of the security. Treasury notes are guaranteed by the U.S. government and thus they are considered to be safer than other asset classes. Not all U.S. government securities are checked or guaranteed by the U.S. government, and different government securities are subject to varying degrees of credit risk. Mortgage-related and other asset-backed securities are subject to certain rules affecting the housing market or the market for the assets underlying such securities. The Funds are subject to liquidity risk (the risk that an investment may be difficult to purchase, value, and sell particularly during adverse market conditions, because there is a limited market for the investment, or there are restrictions on resale) and credit risk (the risk an issuer may be unable or unwilling to meet its financial obligations, risking default). High-yield/high-risk bonds ("junk bonds") and floating rate loans (usually rated below investment grade) have greater risk of default than higher-rated securities/higher-quality bonds that may have a lower yield. The Funds are also subject to foreign-markets risk.

All share classes may not be available at all firms, and not all investors may be eligible for all share classes. Please see the prospectus for additional information about availability.

Pacific Life Insurance Company is the administrator for Pacific Funds. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.

Past performance does not guarantee future results. All investing involves risk, including the possible loss of the principal amount invested. ***It is not possible to invest in an index.***

You should consider a fund's investment goal, risks, charges, and expenses carefully before investing. The prospectus and/or the applicable summary prospectus contain this and other information about the Fund and are available from your financial advisor or PacificFunds.com. The prospectus and/or summary prospectus should be read carefully before investing.

Pacific Funds are distributed by **Pacific Select Distributors, LLC** (member FINRA & SIPC), a subsidiary of Pacific Life Insurance Company (Newport Beach, CA), and are available through licensed third parties. Pacific Funds refers to Pacific Funds Series Trust.

PF-20210510-0085

Mailing address:
P.O. Box 9768, Providence, RI 02940-9768
(800) 722-2333 • www.PacificFunds.com

PACIFIC FUNDS