PACIFIC FUNDS

PACIFIC FUNDS℠

ESG CORE BOND COMMENTARY

JUNE 30, 2021

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

Advisor Class		Class 1	
Ticker	**Fund Number**	**Ticker**	**Fund Number**
PLEDX	053	PLEBX	453

Market Overview

Interwoven focal points of 2021's second quarter have been the patient policy of the Federal Reserve, continued fiscal support, volatility within the Treasury market, and the specter of aggressive COVID-19 variants amid vaccine administration. As an indicator of monetary response, some Federal Open Market Committee (FOMC) members at the Federal Reserve's June meeting expressed greater certainty than before that the U.S. economy would soon be fully back on track, which may create a need for interest-rate hikes earlier than previously thought. However, Fed Charmain Jerome Powell was more dovish, noting the U.S. was not at the "substantial further progress" standard that would trigger policy normalization. That said, the tapering of monthly asset purchases (Treasuries and mortgage-backed securities) from $120 billion will most likely be a topic of discussion in future meetings. Additionally, the Fed "dot plot" moved expectations for possible interest-rate hikes from 2023 to 2022, but Chairman Powell urged restraint in reading too much into these projections, counseling that uncertainty will remain elevated over the next two years. The Fed also reiterated its transitory view on inflation and appears to be attempting to look through the associated price volatility (i.e. lumber, autos, and COVID-related re-opening sectors). From a fiscal and governmental perspective, over $5 trillion has been injected into the economy since March 2020 in an effort to provide broad-based support in overcoming impacts related to the pandemic. Expectations remain for additional support as we move further along in 2021. As an ancillary effect of supportive rhetoric and continued easing, the Treasury market saw steepening on the front end of the curve while experiencing material flattening on the back end. Lastly, the COVID-19 pandemic remains a material concern, both domestically and globally. While substantial progress has been made in the fight against the virus, the risk of COVID-19 variants affecting the economic and market rebound resides.

Continuing to expand upon the annualized 6.4% U.S. GDP growth rate in the first quarter, the GDPNow tracker of the Atlanta Federal Reserve estimates, as of July 1, 2021, the second quarter annualized U.S. GDP growth rate will be 8.6%. This is supported by data prints of both the ISM Services and Manufacturing reports (both in excess of 60) remaining entrenched in near-record territory in the second quarter (above 50 is an indicator of expansion). However, there are challenges that need be overcome for further record-breaking prints to be seen (including the hiring of qualified workers, resolution of bottlenecks in supply chains, and sourcing of materials). An additional possible looming headwind to projected domestic growth is the emergence (on a transitory or longer-term basis) of inflation. While the Fed has previously stated it will allow inflation to "run hot" and reach an average 2% inflation target over time, there are worries the economy's rebound from the pandemic, in conjunction with loose monetary and fiscal policy, may have spurred larger and more immediate inflation than expected with consumer prices rising in May by 5% from a year ago. May's increase in the Consumer Price Index was the largest since August 2008, when the reading rose 5.4%. The Core PCE Price Index, which excludes the often-volatile categories of food and energy, jumped 3.8% in May from the year before—the largest increase since June 1992. The labor force is a pivotal player in the re-emergence of a stronger domestic economy. According to the Bureau of Labor Statistics, the unemployment rate ended the second quarter at 5.9% down slightly from 6% in the first quarter and down from 6.7% to start 2021.

Building upon the supportive risk environment reflected by the S&P 500's 6.17% first quarter return, the index posted a resounding 8.55% return in the second quarter. While there were speedbumps along the way, risk remained largely in favor as markets banked on the continuation of fiscal support and the role of the Fed acting as a backstop to help dampen market volatility. The investment-grade market (represented by the Bloomberg Barclays U.S. Aggregated Bond Index) rebounded amid rate activity, returning 1.83% from -3.37%

seen in the first quarter. The high-yield market (represented by the Barclays Bloomberg U.S. Corporate High Yield Index) reflected investor appetite for risk, returning 2.74%. The short end of the yield curve, as represented by the two-year U.S. Treasury note, steepened by 9 basis points, ending the period at 25 basis points. Meanwhile, the long end of the curve, as represented by the 30-year U.S. Treasury bond, flattened significantly by 36 basis points, ending at 2.06%. The 10-year U.S. Treasury yield ended the quarter at 1.45%, lower by 29 basis points from the first quarter. Whatever the future holds for the rest of 2021, it is likely a near certainty that further transparent conversations will be a requirement to the stabilization of the complicated relationship between the Fed, the markets, and their participants.

Asset Class Overview

Total return on investment-grade bonds, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, was 1.83% in the second quarter, up from a challenged -3.37% in the first quarter. The year-to-date total return of the aggregate index is -1.60%. This semi-annual return marks the seventh worst start to a calendar year since 1976. While most of this negative impact was experienced in the first quarter, index duration has extended to reach levels never before seen. With a modified duration of over 6½, the index finds itself greater exposed to a rate shock than in each prior quarter. As Treasury rates widened 5 years and out over the quarter, the increased index duration acted as a positive contributor to total return. This is in sharp contrast to the events seen in first quarter. Index yield-to-worst fell by 11 basis points, ending at 1.50%.

Projections of support for the investment-grade asset class in the second half of 2021 include the surprise slowdown in total debt growth despite heavy bond issuance, increased EBITDA levels working to improve leverage and coverage ratios, and anticipation of an uptick in rising stars in 2021. Sectors with the strongest total return during the quarter included Other Industrial (6.84%), Other Utility (5.02%), Communications (4.57%), Energy (4.51%), and Transportation (4.50%). The most challenged sectors included Asset-Backed Securities Other (0.13%), Auto Backed (0.23%), Agency Fixed Rate (0.33%), Government Sponsored (0.46%), and Credit Card (0.59%). Reversing last quarter's performance, index returns by credit quality were all positive and favored the lowest quality tier. Investors sought the relative value and yield opportunities found within the deepest portion of the investment-grade market as BBB rated credits led the index higher, returning 3.71%, followed by A, AA, and AAA rated credits, returning 3.20%, 2.95%, and 1.17%, respectively. From quarter to quarter, spread levels widened by 1 basis points to end at 32 basis points. Additionally, the average index price increased to $106.24 from $105.16.

Lower-quality, higher-yielding bonds benefited from continued monetary and fiscal support and a lower-rate environment. This resulted in the Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index returning a strong 2.74% quarterly return, up from 0.86% in the first quarter. Spreads tightened by 42 basis points to end at 269 basis points—levels not seen since the first quarter of 2007. For context, the OAS of the index ended at 627 basis points in second quarter of 2020—over 350 basis points wider from the current level. Commodity and REITs-related sectors led the index higher over the period, including Oil Field Services (11.24%), Independent (7.03%), Midstream (4.17%), Life (3.74%), Office-REITs (3.72%), and Retail-REITs (3.53%). Index laggards included Pharmaceuticals (-1.03%), Tobacco (0.88%), Refining (1.07%), Electric (1.40%), Paper (1.40%), and Packaging (1.54%). In-line with risk appetite and support, quarterly returns by credit quality were mixed, but largely led by lower-rated credits with Ca-D rated issuers returning 12.48%, and CCC, BB, and B rated issuers returning 3.49%, 2.85%, and 2.16%, respectively. The average index price ending the period at $105.29, up from $104.11 at the start of the quarter. After remaining above 4% in prior quarter, the index yield-to-worst fell by 49 basis points to end the second quarter at 3.76%. This marks the lowest yield-to-worst of the index since 1992. However, J.P. Morgan has revised down its high-yield bond

Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest).

default-rate forecast for 2021 from 2% to 0.65% due to modest default activity year-to-date, negligible distressed volume, wide access to capital markets, and a robust global economic recovery. Notably, 2021's revised forecast would be the lowest default rate for high-yield bonds since 2007. Historically, the long-term average default rates for bonds has been 3.6%.

The floating-rate loan asset class, as measured by the Credit Suisse Leveraged Loan Index, remained in strong favor as it returned 1.44% in the second quarter, building off its 2.01% in the first quarter of 2021. On a year-to-date basis, the index has returned 3.48%. Many investors sought investments that have historically provide some shelter from a potential increase in rates while offering an attractive yield. Building upon strong retail flows into loan mutual funds and ETFs in the first quarter, retail loan investors continued to flock to the asset class in the second quarter and have invested over $19 billion year-to-date. Additionally, there have been net inflows into the loan asset class by retail investors in 24 of the past 25 weeks, according to Lipper. Per LCD, the U.S. CLO (collateralized loan obligations) market is running on all cylinders, having just recorded its busiest quarter on record. The second quarter produced $41.3 billion of new-issue volume, exceeding the record $39.8 billion set in the first quarter. Through June 30, 2021, the market printed $81 billion of new CLOs, the highest level for any comparable period in the CLO 2.0 era. The average price of the Credit Suisse Leveraged Loan Index increased to $97.96, up from $97.46 in the first quarter. Like its counterpart in high-yield fixed-rate bonds, lower-quality loans were well supported and outperformed higher-rated credits. The quarter saw BB, B, and CCC rated issuers return 0.77%, 1.45%, and 4.26%, respectively. Performing loans (above $90 price) returned 1.36%, while distressed loans (up to and including $90 price) returned 3.60%. Distressed loans within the index (trading less than $80) remain a shrinking and now miniscule portion of the index. Top-performing sectors included Metals/Minerals (3.46%), Energy (2.91%), Consumer Non-Durables (2.45%), Manufacturing (2.05%), and Gaming/Leisure (1.89%). The lowest returning sectors included Utility (-0.48%), Food & Tobacco (0.17%), Financials (1.08%), Media/Telecom (1.09%), and Food and Drug (1.20%). J.P. Morgan has revised down its loan default rate forecast for 2021 from 2% to 0.65% due to modest default activity year-to-date, negligible distressed volume, wide access to capital markets, and a robust global economic recovery. Notably, 2021's forecast would be the lowest default rate for loans since 2011. Historically, the long-term average default rates for loans has been 3.1%.

Fund Performance

Pacific Funds ESG Core Bond (Advisor Class) returned 1.93% versus the Bloomberg Barclays U.S. Aggregate Bond Index return of 1.83%.

Portfolio Review

The Pacific Funds ESG Core Bond's outperformance was driven primarily by its overweight exposure to investment-grade corporate bonds, which outperformed in the second quarter due to an improving economic backdrop. In an environment favoring spread income, the fund benefited from being overweight in investment-grade corporate bonds with 55% exposure versus the benchmark's 27% exposure. Meanwhile, the fund's underweight in U.S. mortgage-backed securities of 5% versus 28% for the benchmark also contributed to performance. Further, the fund's overweight exposure to BBB rated bonds was additive to relative performance as lower-tier investment-grade bonds outperformed. The fund's effective duration (5.57 years) was positioned underweight relative the benchmark with the fund's average (6.44 years). The fund's shorter duration overall detracted from relative performance during the period due to the decrease in nominal interest rates.

The fund benefited primarily from its overweight exposures to outperforming corporate bonds in the Banking, Technology, and Food & Beverage industries. Exposures to Morgan Stanley, Goldman Sachs, and PNC Bank in Banking; Broadcom and Citrix Systems in Technology; and Anheuser-Busch in Food & Beverage served as significant individual contributors. Conversely, the fund's underweight exposure to long-dated Treasuries did weigh on relative performance as interest rates declined.

The fund's ESG (environmental, social and governance) criteria continues to restrict investment in tobacco, controversial military weapons, and thermal coal, resulting

in the total exclusion of Tobacco, Defense, and Coal & Consumable Fuels industries. Other energy industries such as Natural Gas, Integrated, Refining, and Oil Field Services were entirely excluded, while the allocation to Midstream was minimal but nearly double that of the benchmark. Each of these industries outperformed the benchmark. The fund's exclusion of Integrated and Natural Gas slightly detracted from performance. The exclusion of Oil Field Services and Refining had null effect on performance. The overweight allocation to Midstream contributed slightly to performance.

Given the ESG construct of this fund, the relationship between financial performance and the ESG ratings of the fund's corporate bonds was also assessed, with a focus on Sustainalytics' ESG Risk Ratings (ranging from negligible to severe) and MSCI's ESG Quality Ratings (which rates companies as ESG leaders, average, laggards or worst-in-class). The fund's overweight exposure to companies with negligible, low, and medium ESG risk and null exposure to companies with severe ESG risk detracted from relative performance, while its underweight exposure to companies with high ESG risk contributed slightly to performance. The fund's overweight exposure to top ESG leaders and underweight exposure to ESG laggards had a slightly negative effect on relative performance. The fund's carbon intensity for the quarter was 61% less than that of the benchmark.

Manager Outlook

After posting one of the worst first quarters from a return standpoint in the past 40 years, investment-grade credit rebounded in the second quarter as both rates and credit spreads moved lower. The Barclay's U.S. Credit Index posted a positive 3.32% return for the second quarter. As rate volatility has been significant this year, spreads have only moved one way, lower. Investors continued to buy corporate bonds as the first quarter rate sell-off created an opportunity to own credit at higher-yielding levels. Spreads moved lower as a result, ending the second quarter 15 basis points lower from the start of the year. The interest-rate market will continue to be the story across the investment-grade landscape. It is yet to be seen whether economic growth and rising inflation levels can be sustained beyond 2021. The FOMC's interpretation of upcoming economic data and their meeting in Jackson Hole in August may give us a better picture as to how it sees the growth story playing out, including whether it needs to be as accommodative to risk markets as it has been since the outbreak of the pandemic.

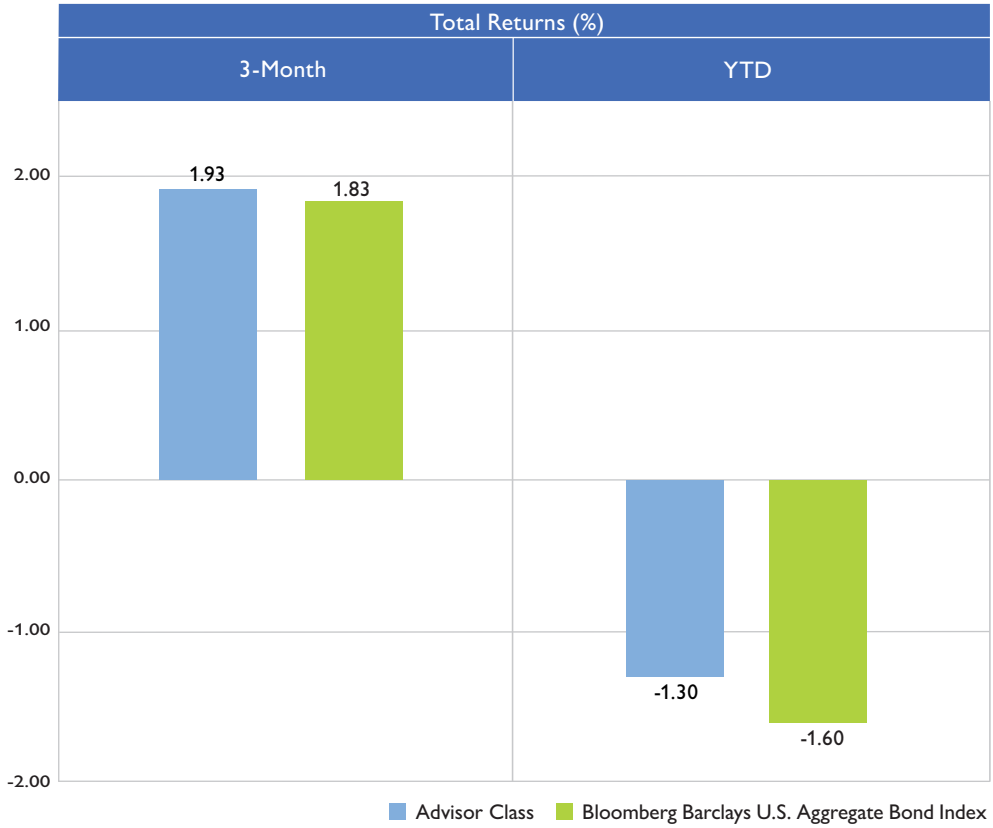
We still subscribe to a positive economic growth outlook. And we expect corporate fundamentals to continue to improve overall. Service sectors, particularly in the harder hit "COVID sectors," should see outsized demand improvements, allowing for a higher degree of pricing power and increased free-cash flows. Many of these sectors have been at risk for further downgrades. We are seeing this pressure ease with expectations for fallen angels in 2021 to be limited, along with an increasing pool of rising-star candidates. While overall credit valuations are at historical tights making us a little more cautious overall, we are still finding value in lower-rated credits in sectors that should see fundamental improvement with the broader economic rebound. These sectors include cyclical Industrials, Aircraft Leasing, Leisure/Lodging and Gaming.

We continue to see an increase in M&A (mergers and acquisitions) activity as cheap financing and wide-open capital markets are allowing companies to grow through consolidation. So far, the credit market reaction to these events has been muted. Generally, rating agencies have been fine with the increase in debt issuance and leverage, expecting greater scale to allow for rapid debt paydowns. The new-issue discounts from these newly created combinations can create attractive opportunities for us to invest in. But, as we have seen in the past, this activity can also lead to large idiosyncratic credit deterioration as synergies and debt-reduction plans disappoint. We remain cautious on the Technology and Healthcare sectors due to valuations and increasing M&A activity.

Our expectation is for continued rate volatility as the market anticipates changes in Fed policy. As we look to keep sensitivity to rate volatility lower across our strategies, we have increased exposure to selected sectors of high-quality consumer ABS in AAA CLOs given their credit diversification. We have also increased exposure to floating-rate loans as the fundamentals picture remains positive and expected default levels drop.

As the country (and world) emerges from the COVID-19 health and economic crisis, we hope our clients, co-workers, friends and family are able to do so safely and prosperously.

Advisor Class



Top-10 Holdings	Maturity	Weight (%)
US Treasury 0.375%	11/30/2025	5.43
US Treasury 0.125%	11/30/2022	4.79
US Treasury 0.875%	11/15/2030	4.17
Weir Group PLC 2.2%	5/13/2026	3.35
Santander Drive Auto Receivables Trust 2021-1 0.75%	3/15/2024	2.77
Morgan Stanley 3.772%	1/24/2028	2.10
Goldman Sachs Group, Inc. 3.814%	4/23/2028	2.08
Rayonier LP 2.75%	5/17/2031	2.07
Anheuse-Busch InBev Worldwide, Inc. 3.75%	7/15/2042	2.05
PSTAT 2021-1A	4/20/2029	1.85
Total		**30.66**

Net annual operating expenses for Advisor Class shares are 0.48% and total (gross annual) expenses are 0.85%. The Fund's annual operating expenses shown above are effective 12/14/20 through 7/31/22. Gross Expense Ratio reflects the total annual operating expenses paid by the Fund. **Net Expense Ratio** reflects waivers, reductions, reimbursements, and the limitation of certain "Other Expenses." Expense caps and/or fee waivers are reevaluated annually. There is no guarantee that the investment adviser will continue to cap expenses after the expiration date. Please see the current prospectus for detailed information.

Indexes are unmanaged and cannot be invested in directly. Further, they hold no cash and incur no expenses. All share classes may not be available at all firms and not all investors may be eligible for all share classes.

For performance data current to the most recent month-end, call Pacific Funds at (800) 722-2333 or go to PacificFunds.com/Performance. Performance data quoted represents past performance, which does not guarantee future results. Current performance may be lower or higher than the performance quoted. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than the original cost.

Definitions

One **basis point** equals 0.01%.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is composed of investment-grade U.S. government bonds, investment-grade corporate bonds, mortgage pass-through securities, and asset-backed securities, and is commonly used to track the performance of U.S. investment-grade bonds.

The **Bloomberg Barclays U.S. Corporate Bond Index** includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements.

The **Bloomberg Barclays U.S. Credit Index** measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets.

The **Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index** measures the performance of high-yield bonds with a 2% maximum allocation to any one issuer.

Consumer Price Index is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living.

Core PCE Price Index is defined as personal consumption expenditures (PCE) prices excluding food and energy prices. The core PCE price index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. senior secure-credit (leveraged-loan) market.

Duration is often used to measure a bond's or fund's sensitivity to interest rates. The longer a fund's duration, the more sensitive it is to interest-rate risk. The shorter a fund's duration, the less sensitive it is to interest-rate risk.

EBITDA, or Earnings Before Interest, Tax, Depreciation, and Amortization, is a measure of a company's profits before any of these net deductions are made.

Free cash flow measures a company's financial performance and shows the cash a company can produce after deducting operating expenses from its operating cash flow.

Option adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return.

The **S&P 500 index** is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the U.S. stock market.

About Principal Risks

All investing involves risks including the possible loss of the principal amount invested. Corporate bonds are subject to issuer risk in that their value may decline for reasons directly related to the issuer of the security. 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 Fund is 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 Fund is also subject to foreign-markets risk.

PF-20210511-0088

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

PACIFIC FUNDS