PACIFIC FUNDS

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ESG CORE BOND COMMENTARY

SEPTEMBER 30, 2021

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

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

Market Overview

The third quarter of 2021 was a mixed quarter as markets and a growing economy adjusted to a confluence of fiscal policy debates, slowing global growth forecasts, supply chain constraints, inflation, the Delta variant, and monetary policy adjustments.

Domestically, both sides of the political aisle in Washington D.C. continue to debate decisions pertaining to the debt ceiling, federal budget, infrastructure plans, and budget. These plans, if passed, may result in multi-trillions of dollars in overall stimulus to the economy.

Supply chain constraints are fueling inflation mixed with a declining growth forecast. Most surveys had supply-chain concerns normalizing in the first half of 2022. Now expectations are that normalization is not going to occur until the second half of 2022. The Atlanta Fed's GDPNow forecast entering the third quarter was 6%. By Sept. 1, it was down to 5%. And as of Oct. 5, that had dropped to just 1.3%. While the ISM Services and Manufacturing reports (both in excess of 60) remain in expansionary territory (above 50 is an indicator of expansion), both are citing a litany of warning signs as potential future challenges. Per the reports, tight labor markets, record-long material lead times, short-term shutdowns due to parts shortages, rising commodity prices, inflation, transportation issues, and logistical issues continue to cause capacity constraints. Given this, demand continues to expand despite rising inflation. The Consumer Price Index (CPI) in August supported the case that supply-chain disruptions and extraordinarily high demand fueled ongoing price pressures. CPI printed at 3.6% from one year ago. This is the highest reading since May 1991 and reflective of inflationary pressures that Federal Reserve Chair Jerome Powell called "frustrating."

While the Fed continues to hold the view that inflation is transitory and supply constraints will ease over the next year or so, there's been increased talk about the "stickiness" of inflation. Signals from Fed communications appear to have a more hawkish tilt and may signal a reduction the Fed's monthly bond purchases as soon as November. Nine of 18 U.S. central bank policymakers projected borrowing costs will need to rise in 2022. Per Chair Powell, the Fed may conclude its tapering process around the middle of 2022 so long as the recovery remains on track. It's notable that Chair Powell has made known there is a measurable difference in the criteria between tapering assets and increasing rates.

The domestic labor force remains a puzzle as the coexistence of record job openings (nearly 11 million in July) is coupled with high unemployment (5.2%), reflecting the struggle between employers and labor. Matching unemployed workers to job openings is a material strain within the labor market and is becoming more difficult now than in the early phase of the recovery due to the exhaustion of worker recalls and increasing skill gaps in particular occupations. It is possible that the recent expiration of expanded unemployment insurance benefits may impact wage and employment data going forward.

Additionally, the world continues to battle the COVID-19 pandemic via preventative measures and directives, advancements in therapeutics, localized lock-downs, and, especially, vaccinations. The Delta variant has proven to be highly transmissible, and concerns continue about new variants. As a result, global economies are unable to ramp up as quickly, resulting in more complexities with supply chains and travel.

In September, the S&P 500 Index reflected elements of inflation, slowing growth, reduced monetary support, global headwinds, and supply-chain bottlenecks, ending the month down 4.8%, breaking a 7-month positive streak. The S&P 500 remains positive, up approximately 16% year-to-date. The investment-grade market (represented by the Bloomberg Barclays US Aggregate Index) was nearly flat over the quarter, returning 0.05% and -1.55% year-to-date. The high-yield market (represented by the Bloomberg Barclays US Corporate High Yield Index) performed much better than the equity market over the third quarter, returning 0.89% (4.53% year-to-date). The short end of the yield curve, as represented by the two-year U.S. Treasury bond, steepened by 3 basis points,

ending the period at 28 basis points. Meanwhile, the long end of the curve, as represented by the 30-year U.S. Treasury bond, remained relatively consistent from the second quarter, steepening by only 2 basis points and ending at 2.08%. The 10-year U.S. Treasury yield ended the quarter at 1.52%, steeper by 7 basis points from the second quarter.

Asset Class Overview

Total return for investment-grade bonds (measured by the Bloomberg Barclays US Aggregate Bond Index) was 0.05% in third quarter (-1.55% year-to-date). The bulk of 2021's negative return was experienced in the first quarter. The index's modified duration of nearly 6 ¾ years is causing the index to be more sensitive to interest rate moves. U.S. Treasury yields generally shifted higher over the period, with the belly of the curve absorbing most of the shift higher. Index yields increased by 6 basis points, ending at 1.56%. While investment-grade bond issuance has been incredibly robust in 2021, the supply has been well received by the market. The domestic- and foreign-buyer base continues to be a supportive technical to the investment-grade market. Fundamentally, while debt issuance has increased, many company profiles are improving decreased leverage, increased coverage ratios, and higher EBITDA levels and profit margins. The market also reflected an increase in the upgrade/downgrade ratios as rising stars outpace fallen angels. Per FactSet, sectors with the strongest total return during the quarter included finance companies (0.51%), other financial (0.44%), local authority (0.32%), Real Estate Investment Trusts (REITs) (0.28%), and insurance (0.26%). The most challenged sectors included sovereign (-0.93%), technology (-0.17%), basic industry (-0.13%), agency CMBS (-0.12%), and communications (-0.08%). Index returns by credit quality were mixed as AAA, AA, A, and BBB rated credits returned 0.08%, 0.00%, -0.10%, and 0.04%, respectively. From quarter to quarter, spread levels widened by 1 basis points to end at 33 basis points. The average price of the index decreased from $106.24 to $105.50.

As a result of perceived headwinds translating into investor uncertainty, the Bloomberg Barclays US High-Yield 2% Issuer Capped Bond Index returned a more meager return of 0.89% in the third quarter versus the 2.74% second-quarter return. Nevertheless, the year-to-date total return for the index is 4.54%. Spreads widened over the quarter by 21 basis points to end at 290 basis points, indicating some weakness. In light of this slight widening, the index remains 337 basis points tighter than the end of the second quarter 2020. Per FactSet, energy (1.29%), banking (1.12%), Real Estate Investment Trusts (REITs) (1.09%), brokerage/asset managers (1.05%), and other financial (0.97%) were the top-performing sectors. Index laggards included natural gas (-3.48%), finance companies (0.38%), communications (0.45%), consumer cyclical (0.51%), and transportation (0.69%). Returns by credit quality were led by higher quality within the index as BB, B, CCC, and CC returned 1.10%, 0.61%, 0.75%, and 0.23%, respectively. The average index price moved lower from $105.29 to $104.59. The index yield-to-worst increased 20 basis points, ending the period at 3.96%. According to J.P. Morgan, high-yield bond default rates experienced further declines during the quarter. Including distressed exchanges, the U.S. high-yield bond decreased to 0.99% and is down 577 basis points year-to-date. This marks the lowest high-yield bond default rate since March 2014. If J.P. Morgan's year-end high-yield bond default projection of 0.65% proves accurate, it would be the lowest default rate for high-yield bonds since 2007. For reference,the long-term average default rates for high-yield bonds is 3.6%.

The floating-rate loan asset class (measured by the Credit Suisse Leveraged Loan Index) performed well in light of an uncertain rate environment. In the third quarter, the asset class returned 1.13% and is up 4.65% year-to-date. Investors sought to position themselves in an asset class that has historically performed well in a rising-rate environment, while compensating via an attractive yield. Year-to-date inflows for loan funds total $34.9 billion (+$8.5 billion in ETFs) following outflows in 2020 totaling $27 billion (including -$1.6 billion in ETFs). The loan-asset class has reported 37 inflows in the last 38 weeks, according to Lipper. Technical support remains record-breaking as the U.S. collateralized loan obligation (CLO) market is moving at breakneck pace with four of the five most active months on record in 2021. Year-to-date, net CLO issuance (ex-refi/reprice/re-issue) now totals $129 billion (up 113% year-over-year), which is 24% ahead of 2018's record trajectory. The average price of the CSLL Index increased to $98.42 from

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

$97.96 at the start of the quarter. Lower-quality loans outperformed higher-rated credits as the third quarter saw BB, B, and CCC rated issuers return 0.81%, 1.18%, and 2.82%, respectively. Performing loans (above $90 price) returned 1.06%, while distressed loans (up to and including $90 price) returned 3.58%. Distressed loans within the index (trading less than $80) continue to shrink and now represents less than 1% of the CSLL Index. Top-performing sectors for the quarter were metals/minerals (3.37%), energy (1.87%), utility (1.70%), consumer non-durables (1.46%), and transportation (1.21%). The lowest-returning sectors were the gaming/leisure (0.70%), food/tobacco (0.87%), food and drug (0.92%), aerospace (0.98%), and financial (0.98%). According to J.P. Morgan, leveraged-loan default rates experienced further declines over the quarter. Including distressed exchanges, the U.S. loan default rates decreased to 0.89% and is down 338 basis points year-to-date. This is the lowest loan default rate since February 2012. If J.P. Morgan's year end loan default projection of 0.65% proves accurate, it would be the lowest default rate for loans bonds since 2011. For reference, the long-term average default rate for loans is 3.1%.

Fund Performance

Pacific Funds ESG Core Bond (Advisor Class) returned -0.04% versus the Bloomberg Barclay US Aggregate Index return of 0.05%.

Portfolio Review

Pacific Funds ESG Core Bond fund's overweight exposure to BBB rated bonds of 44.87% versus the benchmark's 12.89% detracted from relative performance, as the fund had exposure to shorter maturity BBB corporates versus the benchmark. The fund's effective duration was positioned underweight relative to the benchmark with the fund's average being 5.49 years compared to the benchmark's 6.60 years. The fund's effective duration detracted from relative performance during the period due to the decrease in long-term nominal interest rates. In addition, the fund suffered primarily from its overweight exposure to investment-grade corporate bonds. In particular, the fund's overweight exposure to the banking sector names Bank of America, Morgan Stanley, Goldman Sachs, and Citigroup detracted from relative performance. Conversely, the fund's 1.92% exposure to high yield versus the benchmark's null exposure contributed to relative performance. In addition, the fund's null exposure to under-performing non-U.S. government and related securities contributed to relative performance.

The fund's ESG criteria continues to restrict investment in tobacco, controversial military weapons, and thermal coal, resulting in the total exclusion of tobacco, defense, and coal and 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 roughly double that of the benchmark. The exclusion of tobacco, defense, integrated, natural gas, oil field services and refining had limited effect on the fund's relative performance. The overweight allocation to midstream also had limited effect from performance.

Given the ESG mandate 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 medium and negligible ESG risk contributed to performance, while overweight exposure to companies with low risk detracted to performance. The fund's null exposure to companies with severe ESG risk slightly detracted from relative performance, while its underweight exposure to companies with high ESG risk did not affect performance. The fund's overweight exposure to ESG leaders had a positive effect on relative performance, while its exclusion of worst-in-class ESG performers had null effect on performance. At the close of the period, the fund's carbon intensity for the quarter was 44% less than that of the benchmark.

Manager Outlook

While interest-rate volatility has been significant this year, credit-spread volatility has not. At the end of the third quarter,

the 10-year Treasury yield ended Q3 almost 60 basis points higher than at the start of the year. Credit spreads, on the other hand, were 12 basis points lower, helping to offset some of the impact from higher rates. Going forward, investor eyes will be on the Federal Reserve and interest rates. As of now, it looks as though the Fed is set to formally announce asset-purchase tapering in the fourth quarter. However, the timing of interest-rates hikes remains uncertain and will be determined, in part, by whether the strong economic growth seen so far in 2021 will continue amid rising inflation.

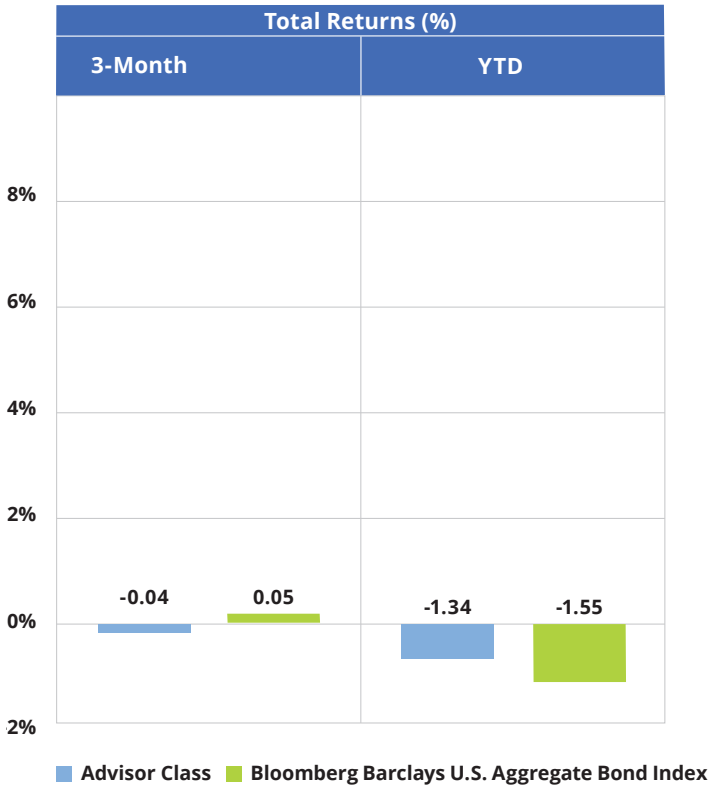
We expect corporate fundamentals will broadly continue to improve, along with a strong U.S. consumer market. However, rising commodity prices and supply-side bottlenecks, while potentially transitory, are limiting growth in certain parts of the economy. The supply of autos, certain technology and other consumer goods are becoming scarce as a result of raw material shortages. Many sectors have exhibited a degree of pricing power, allowing them to pass on these issues into a healthy broader economy. However, we are mindful that some sectors may struggle with the top line and margin impacts of limited supply.

With improving fundamentals, downgrades and fallen angels should be limited. However, intentional leveraging of the balance sheet is becoming a larger concern as relatively cheap funding costs and significant available liquidity may incentivize management teams to grow through mergers and acquisitions (or even succumb to a leveraged buyout. Other macro risks, such as the debt-ceiling, lower-than-expected fiscal policy, rising input costs, supply-side bottlenecks and the early stages of a less dovish Fed could impact corporate-spread valuations. And with investment-grade corporate spread levels near all-time lows, we are becoming more cautious.

We are still finding value in lower-rated credits in sectors that should see fundamental improvement with the broader economic rebound. We think certain sectors such as cyclical Industrials, aircraft leasing, leisure/lodging and domestic gaming will continue to benefit from the reopening trade. Other sectors will face tougher inflationary and supply-chain disruptions, including technology, some consumer products and certain retailers. We remain cautious on the technology and healthcare sectors due to valuations and increasing mergers and acquisitions activity.

The interest-rate picture, and hence the outlook for investment-grade returns for the remainder of the year remains quite uncertain, and we look to continue to limit the impact of rate volatility across our strategies. We like keeping exposure to selected sectors of high-quality consumer asset-backed securities (ABS) in AAA collateralized loan obligations (CLOs), given their credit diversification. We maintain exposure to floating-rate loans as the fundamental picture remains positive with near-zero default levels.

Advisor Class



Top-10 Holdings	Maturity	Weight (%)
US Treasury 0.375%	11/30/2025	5.34
US Treasury 0.125%	11/30/2022	4.71
US Treasury 0.875%	11/15/2030	4.11
Weir Group PLC 2.2%	5/13/2026	3.32
Santander Drive Auto Receivables Trust 2021-1 0.75%	3/15/2023	2.72
Goldman Sachs Group, Inc. 3.814%	4/23/2028	2.03
Morgan Stanley 3.772%	1/24/2028	2.02
Rayonier LP 2.75%	5/17/2031	2.00
Anheuser-Busch InBev Worldwide, Inc. 3.75%	7/15/2042	1.97
PSTAT 2021-4A	10/15/2029	1.81
Total		30.03

Net annual operating expenses for Advisor Class are 0.48% and total (gross annual) expenses are 0.85%. Returns reflect reinvestment of dividends and distributions. 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 US 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 US 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 US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market.

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

The **Consumer Price Index (CPI)** 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.

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.

Fallen angels refers to investment grade bonds that are given a reduced rating to "junk bond" due to a decline in the credit rating of the issuer.

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

Rising stars refers to a bond that is rated as a "junk bond" but could become investment grade because of improvements in the issuing company's credit quality.

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.

Yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

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.

This commentary represents the views of the portfolio managers at Pacific Asset Management LLC as of 9/30/21, and are presented for informational purposes only. These views should not be construed as investment advice, an endorsement of any security, mutual fund, sector or index, or to predict performance of any investment. Any forward-looking statements are not guaranteed. All material is compiled from sources believed to be reliable, but accuracy cannot be guaranteed. The opinions expressed herein are subject to change without notice as market and other conditions warrant. Sector names in this commentary are provided by the Fund's portfolio managers and could be different if provided by a third party.

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