PACIFIC FUNDS

PACIFIC FUNDS℠
STRATEGIC INCOME COMMENTARY

MARCH 31, 2022

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

Class A		Class C		Advisor Class	
Ticker	**Fund Number**	**Ticker**	**Fund Number**	**Ticker**	**Fund Number**
PLSTX	114	PLCNX	314	PLSFX	014

Market Overview

The "fog of war" has been used to describe the confusion, uncertainty, and unknown outcomes associated with an intense military battle. A version of this "fog" can be experienced in arenas, including today's markets. Opaqueness of geopolitical environments, health pandemics, central bank policy, and inflationary concerns need be navigated with fluidity and, tactical awareness through this volatility.

Globally, the war in the Ukraine will likely be a significant drag on growth worldwide. Per The Conference Board, "The deleterious effects will come from not just higher gasoline prices, but higher prices for food, metals, and intermediate inputs to manufacturing, and weaker GDP growth as consumers pull back spending." This, coupled with broken supply-chains, will likely fuel higher inflation prints. Global GDP estimates for 2022 and 2023 are now at 3.3% and 2.6%, respectively, both down from 5.9% in 2021. Given this backdrop, real economic growth slowed in the first quarter of 2022. The initial estimate of Q1 real U.S. GDP growth was -1.4%, down dramatically from the 7% for the previous quarter.

Stateside, both the ISM Services and Manufacturing indices have remained in expansionary territory, yet general trends warrant some concern. Month after month, respondents have continued to experience inventory and supply-chain constraints, higher input costs due to increased inflationary pressures, qualified-worker shortages, and the waterfall effect on pricing of fuel and various commodities directly related to the Ukrainian crisis. Despite pricing increases, demand has continued to outpace supply, and general activity has increased as most COVID-19-related restrictions have been lifted. However, inflation remains problematic with the Consumer Price Index's (CPI's) most recent print of 8.5% marking the fastest increase in over 40 years. That said, the Core Inflation Index (which measures prices, excluding more volatile food and energy costs) increased at a slower rate in March than it did in previous months, potentially indicating that the pace of inflation may be peaking. Notable was the difference in the pace of inflationary prints and the ability of prices to remain at elevated levels for some time. The argument for the former reaching peak pace over the latter may be easier to make now.

A key counter force to today's inflationary environment is the Federal Reserve. Historically, it has buffered periods of high inflation by increasing the federal funds rate, and this time has been no different. However, the pace and amount per hike combined with quantitative tightening may prove to be a very thin tightrope the Fed must balance or risk severe economic consequences. In March, the Fed increased the benchmark rate by 25 basis points to a range between 0.25% and 0.50%—the first hike in over three years.

Cementing the globalization of today's markets, several Fed officials have indicated they would have preferred a 50 basis points hike in March but for "great near-term uncertainty associated with Russia's invasion of Ukraine." Earlier this year, the Fed expected inflation to be reduced by spring as supply-chain bottlenecks improved, yet the war in Ukraine and recent COVID-related lockdowns in China appeared to have ended any expectation of near-term relief from a healing supply chain. "As we set policy, we will be looking to actual progress on these issues and not assuming significant near-term supply-side relief," Fed Chair Jerome Powell said. More aggressive rate hikes are also under consideration via 50-basis-points increments through the summer. Recent Federal Open Market Committee (FOMC) minutes noted that officials appeared close to finalizing a plan to shrink their asset portfolio, which nearly doubled in size over the past two years. Discussion of reducing assets at a considerably faster pace than last seen in 2019 may involve allowing up to $60 billion in Treasuries and $35 billion in mortgage-backed securities to mature each month. Chair Powell previously stated that the portfolio runoff may equate to an additional 25-basis-points rate increase. Suffice to say, the Fed is expected to move quickly and with purpose to combat inflation, while not stifling economic growth.

Accounting for the myriad of headwinds seen in the first three months of the year, the S&P 500 Index returned -4.61%. Rate pressures translated broadly across various fixed-income asset classes over the first quarter. The investment-grade market (represented by the Bloomberg US Aggregate Index) was strongly negative, returning -5.93%. The high-yield market (represented by the Bloomberg US Corporate High Yield 2% Issuer Cap Index) was not exempt from external pressures, resulting in a first quarter total return of -4.82%. The short end of the yield curve, as represented by the two-year U.S. Treasury bond, experienced material steepening, rising 155 basis points, ending the period at 228 basis points. Meanwhile, the long end of the curve, as represented by the 30-year U.S. Treasury bond, steepened but not as much as the short end of the curve, moving 54 basis points higher, ending at 2.44%. The 10-year U.S. Treasury yield ended the quarter 80 basis higher at 2.32%.

While markets attempt to navigate these roads, we would like to pause here and highlight that aside from the economic impacts associated with the Ukrainian invasion, it is the tragic humanitarian emergency that remains at the forefront. We hope for resolution and peace, and our thoughts are with those suffering.

Asset Class Overview

Total return for investment-grade bonds (measured by the Bloomberg US Aggregate Bond Index) was -5.93% in the first quarter. This return marks the third worst quarterly return in index history (exceeded only by two quarters in 1980). If the year were to end now, the return seen in the first quarter would double the worst calendar yearly performance of the index. Rate pressure and anticipation of further increases in rates worked strongly against the index and eroded total return. With a duration of 6.58 years, the index is increasingly susceptible to movement in rates. The 5-year Treasury note moved higher by 116 basis points along with the 7-year Treasury note moving higher by 96 basis points over the quarter. This move higher in rates was not buffered by spreads as they too moved wider by 5 basis points, ending at 41 basis points. Average price of the index also showed weakness in falling to $97.82 from $104.73 to start the year. However, given the inverse relationship between bond prices and yields, the yield-to-worst of the index moved substantially higher to 2.92% from 1.75%, surpassing the 2.83% yield-to-worst seen in 2011 and nearly reaching the 2.93% seen in March 2019. While the retail investor's appetite waned because of continued pressure, there was murmurs of interest in this space to capture attractive yields not seen in years. The foreign buyer support was mixed as of late as U.S. investment-grade yields seem to be looking attractive to the Japanese investor (even accounting for elevated hedging costs), while the European investor may be looking more at European investment-grade as having greater attractiveness than a year prior.

Investment-grade gross issuance recently surpassed the 2021 pace and now trails only 2020 for the heaviest amount of gross issuance ever on a year-to-date basis. On a net basis, first quarter issuance was the heaviest supply in a quarter since the second quarter of 2022 with accelerating retail outflows challenging demand. However, expectation is that issuance will slow more in April, hopefully righting the supply/demand imbalance. Per J.P. Morgan, a significant number of additional issuers are poised to ascend to investment grade on the back of economic growth. JPM forecasts $230 billion of debt to be upgraded from high yield to investment grade (rising stars) thru 2023. Specifically, the largest number of upgrades to BBB credits are anticipated in the energy, autos and utilities sectors.

The Bloomberg US High-Yield 2% Issuer Capped Bond Index returned -4.82 % in the first quarter. This quarterly return was the ninth worst quarterly return in index history (barely behind the third quarter of 2015's return of -4.86%). If the year were to end today, this would mark the four worst calendar year in index history. Thankfully, there remains nine months in 2022 to potentially improve this significant underperformance.

A hawkish Fed along with the Ukraine invasion resulted in sharply higher rates over the quarter, a spike in commodity prices, and overall lower prices for high-yield bonds and many risk-based assets. As a result of continued pressures, index spreads widened from 283 basis points to 326 basis points, along with yield-to-worst levels moving higher from 4.21% to

6.01%. Specifically, BB, B, and CCC rated bonds yielded 5.01%, 6.27%, and 9.06%, respectively at quarter end. Index duration ended the quarter at just shy of 4 years at 3.94 years, resulting in greater sensitivity to a move in interest rates than shorter dates credits. For the quarter, while returns were negative, lower quality outperformed higher quality as BBs, Bs, and CCCs returned -5.92%, -3.53%, -3.88%, respectively. Per FactSet, oil field services (3.05%), refining (2.93%), independent (-2.20%), tobacco (-2.33%), and leisure (-2.41%) were the top-performing sectors. Index laggards included wirelines (-11-92%), natural gas (-8.57%), food and beverage (-8.17%), banking (-7.28%), and consumer products (-6.87%).

Per JPM, high-yield capital markets produced their lightest volumes since March 2020 for a second consecutive month (February and March) as investors and issuers contended with a sharp increase in yields. Year-to-date, high-yield issuance has totaled $46.5 billion or $24.8 billion ex-refi, which is down from $158.8 billion (-71%) and $43.6 billion (-43%) over the same period a year ago. Additionally, per JPM, the U.S. high-yield bond default rate (including distressed exchanges) ended the quarter at 0.50%. JPM is forecasting a 2022 high-yield bond default rate of 0.75% and a 2023 default rate of 1.25%. Suffice to say, the low default-rate environment is expected to remain in place for some time.

The floating-rate loan asset class (measured by the Credit Suisse Leveraged Loan Index or CSLL Index) returned -0.10% in the first quarter. This marks the first negative quarterly return since the first quarter of 2020. However, the floating-rate loan asset class remains the standout within fixed income on a year-to-date basis. Investors continue to seek an asset class that has historically offered protection from a rising-rate environment coupled with a highly attractive yield. As measured by the 4-year effective yield, the asset class is offering investors a yield of 5.25%. Retail support remains in place and robust and is helping insulate the asset class from additional market-related degradation. Per JPM, on a year-to-date basis, 2022 inflows for loan funds totaled $18.7 billion ($2.1 billion ETF), which compares to inflows of $14.1 billion over the first three months last year and $46.5 billion ($10.0 billion ETF) in FY 2021. Notably, first quarter inflows were the second largest quarterly inflows on record, trailing only the $20.7 billion of inflows recorded in 3Q13.

Specific to collateralized loan obligations (CLOs), year-to-date 101 U.S. CLOs have priced totaling $50.3 billion ($31.2 billion ex-refinancing and $19.1 billion refinancing) compared with 234 U.S. CLOs totaling $106.3 billion for the same time period last year (-53% year-over-year). For context, in 2021, 920 U.S. CLOs priced for $421.1 billion ($183.7 billion ex-refinancing and $237.4 billion refinancing). The average price of the CSLL Index is lower by approximately $1 year-to-date, ending the quarter at $97.38. Returns by credit quality were mixed over the period as BB, B, and CCC rated issuers returned -0.08%, -0.01%, and -1.77%, respectively. Performing loans (over $90 price) strongly outperformed distressed loans (up to and including $90 price), returning 0.04% versus -5.25%. Top-performing sectors for the quarter were metals/minerals (0.90%), energy (0.68%), gaming/leisure (0.39%), aerospace (0.20%), and financial (0.17%). Meanwhile, the lowest quarterly returning sectors included retail (-0.88%), forest products/packaging (-0.56%), housing (-0.54%), chemicals (-0.48%) and food/tobacco (-0.36%). According to J.P. Morgan, leveraged-loan default rates (including distressed exchanges) ended the quarter at 0.86%. They are forecasting a 2022 loan-default rate of 0.75% and a 2023 default rate of 1.25%. Corporate health is anticipated to remain strong going forward, resulting in historically low-default expectations.

Fund Performance

Pacific Funds Strategic Income (Advisor Class) returned -4.14%, versus the Bloomberg US Aggregate Bond Index return of -5.93%.

Portfolio Review

The material shift higher in Treasury rates resulted in downward pressure across many fixed-income asset classes over the quarter. The Bloomberg US Corporate Investment Grade Index, the High Yield Bond 2% Issuer Cap Index, and the Credit Suisse Leveraged Loan Index returned -7.69%, -4.82%,

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.

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

and -0.10%, respectively. The fund's corporate-credit exposure totaled approximately 89.5%, allocated across investment-grade corporate bonds (32.7%), high-yield bonds (31.9%) and floating-rate bank loans (24.9%). High-yield and bank-loan allocations contributed to positive quarterly relative returns, while investment-grade corporate bonds detracted. The fund has maintained a lower-than-average exposure to rate-sensitive assets for some time. However, the sharp price action in fixed-rate securities provided opportunity to moderately increase the allocation to increasingly attractive higher quality high-yield and investment-grade corporate bonds during the quarter. On a sector basis, top contributors included electric utilities, pharmaceuticals, and integrated energy. Sectors detracting from fund performance included banking, diversified manufacturing, and automotive. Individual credit contributors included Lowe's Companies, Range Resources, and US LBM Holdings. Individual detractors included Verizon Communications, Boeing Company, Morgan Stanley. Equities detracted (1.6%), while collateralized loan obligation (CLO) holdings contributed (3.3%). Shorter-than-index duration of 3.67 years versus benchmark duration of 6.62 years was beneficial. The fund's average cash position was 4.85%.

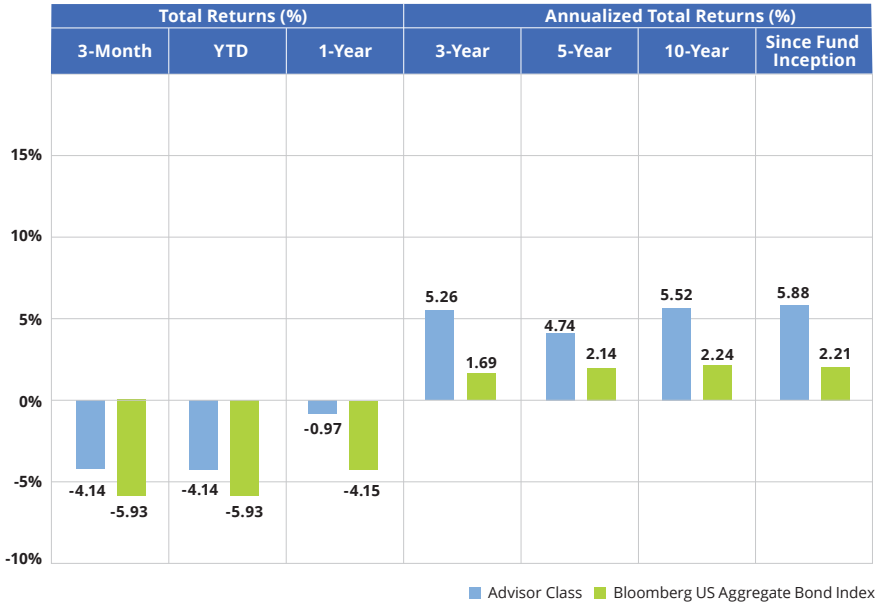
Manager Outlook

After a benign 2021 with limited volatility across most markets, 2022 has generated its share of market moving events. Conversations in the first part of the year were generally around what growth would look like if we were indeed exiting the COVID-restricted economy. This quickly transitioned to concerns about inflation and the Fed reaction, which contributed to significant increases in interest rates across the curve. A debate was being had around how quickly inflation could come down as we exited COVID-related disruptions, and then Russian invaded Ukraine. This furthered supply-chain disruptions, and any near-term hopes around softening inflation were put on hold.

On the positive side, the U.S. economy continues to show real GDP growth above trend despite growing headwinds. Savings for both the U.S. consumer and corporations remain elevated, and consumer willingness to finally get out and spend is strong. In our opinion, this keeps the risk of a recession in the second quarter at fairly low levels. The two big issues for the market in the near term seem to how quickly inflation will come down as 2022 progresses and whether the economy can handle the expectations of both rapidly increasing fed funds rates and quantitative tightening (QT). While we feel reasonably positive about both in the near term, we have larger concerns as we approach 2023.

For the time being, the rates curve has priced in a lot of Fed rate hikes over the next two years. While this seems appropriate, we do think the likelihood is growing that the Fed may have to go slower than what is forecast due to slowing growth and moderating inflation. We have been broadly cautious for some time on fixed-rate assets, high-yield and investment-grade bonds in strategic credit and had favored bank loans. In today's higher-rate environment, we now feel more comfortable extending duration and believe that intermediate- to long-duration credit has more merit in the portfolio than it has for quite some time. Inside of high yield, our growing preference is currently in higher-quality names (BB and B rated) as we are concerned that a slowing economy may start to challenge lower-rated companies. Rate volatility remains high, and valuations across credit have changed quickly so we will remain flexible in our allocations and continue to monitor the inflation and growth dynamics of the economy.

Advisor Class



Top-10 Holdings	Maturity	Weight (%)
Applied Systems, Inc.	9/19/2024	0.90
Boeing Company 5.04%	5/01/2027	0.82
SRS Distribution, Inc.	6/02/2028	0.78
Morgan Stanley 3.591%	7/22/2028	0.70
Celestial-Saturn Parent, Inc.	6/02/2028	0.68
Verizon Communications Inc. 2.55%	3/21/2031	0.67
Anheuser-Busch InBev World-wide, Inc. 4.75%	1/23/2029	0.64
Allied Universal Holdco LLC	5/12/2028	0.61
Labl, Inc.	10/29/2028	0.60
GLP Capital LP 5.3%	1/15/2029	0.60
Total		**7.00**

Net annual operating expenses for Advisor Class are 0.72% 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 8/1/21 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 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 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 US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market

The **Bloomberg 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 **Bloomberg US Treasury Index** includes public obligations of the U.S. Treasury with a remaining maturity of one year or more.

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.

The **ISM Manufacturing index** is also known as the Purchasing Managers' index (PMI) and is an indicator of the economic health of the manufacturing sector and is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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 3/31/22 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.

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 investment products.

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 professional 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.

Diversification does not assure a profit, nor does it protect against a loss in a declining market.

MFC0663-0322W
PF-20220516-0539

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

PACIFIC FUNDS