PACIFIC FUNDS

PACIFIC FUNDS℠
STRATEGIC INCOME COMMENTARY

SEPTEMBER 30, 2022

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

Class A		Class C		Class I-2	
Ticker	**Fund Number**	**Ticker**	**Fund Number**	**Ticker**	**Fund Number**
PLSTX	114	PLCNX	314	PLSFX	014

Market Overview

Amid the challenges of sustained inflation, broken supply chains, geopolitical conflict, slowing domestic growth, strained housing markets, and aggressive global central-bank action, historical index returns are being rewritten to the downside. The blunt response of the Federal Reserve (Fed) has confirmed its resolve to lower inflation via increasing rates, even at the risk of a recession and declining demand. As the Fed attempts to not repeat previous reactive policy responses over the last 50 years, it may be ignoring what the markets and numerous economic inputs have been indicating.

Real gross domestic product (GDP), as reported by the Bureau of Economic Analysis, declined for the second quarter of 2022 by 0.6%. This marks the second consecutive quarter of negative GDP prints. Real disposable income (personal income adjusted for taxes and inflation) decreased by 1.5%, along with the personal savings rate. With consumer spending accounting for nearly 70% of GDP, negative changes in consumer behavior are noteworthy. Furthermore, gross domestic purchase prices (the prices of goods and services purchased by U.S. residents) increased 8.5% in the third quarter. Additional economic headwinds include domestic home prices and new home starts battered by a historic increase in mortgage rates. Per the St. Louis Fed, the 30-year fixed-rate average mortgage in the U.S. at quarter-end was nearly 7%. The last time mortgage rates were over 7% was 20 years ago. While still above recessionary levels, both the Institute for Supply Management Manufacturing PMI and Services PMI contracted over the quarter, indicating potential headwinds on a granular level. Details within the monthly ISM reports reference headwinds, including managing employee headcount, navigating supply-chain disruptions, and pricing-power concerns. However, at this point, employment has remained broadly insulated. The national unemployment rate is 3.7%, but we are seeing limited wage growth pressure.

To squash elevated inflation, central banks have been responding in a coordinated fashion via increasing key interest rates. The Bank of England (BOE) recently raised its rate by 50 basis points to the highest level in 14 years. This marks the seventh straight rate move higher by the BOE as it tries to balance borrowing costs with rising food and energy prices. The European Central Bank (ECB) greeted markets with a 75-basis-point hike for the 19 countries that are Euro dependent, along with a commitment to continue on its rate tightening path. Not to be excluded, the Reserve Bank of Australia and the Bank of Canada both implemented robust increases over the quarter.

Stateside, the theme of elevated inflation fed by an imbalance between supply and demand, and supply-chain deterioration remained top of mind in several of Fed Chairman Jerome Powell's recent comments. Chair Powell has acknowledged that the Fed's goal of engineering a "soft landing" (where it would be able to slow growth and reduce the worst inflation in the last 40 years without triggering a recession) is becoming more unlikely. What is gravely concerning is that a blunt instrument is being used in hopes that its results are surgical. To this point, Chair Powell stated, "No one knows whether this process will lead to a recession or, if so, how significant that recession would be." "We have got to get inflation behind us," Chair Powell said. " … I wish there were a painless way to do that. There isn't." In September, the FOMC has performed its third straight 75-basis-point rate hike, leaving the short-term key rate at 3-3.25%—its highest level since 2008. Additional rate hikes have been projected over the remaining months of 2022 that may bring the year-end rate closer to 4.5% (100 basis points higher than the June projection for year-end levels) with further hikes expected in 2023. Notably, for the Fed to halt its rate advancement, Chair Powell said he would have to see "continued slow growth, a modest increase in unemployment, and clear evidence that inflation is moving toward the 2% target."

Markets continued to undergo a repricing through the previously mentioned challenges. Risk-based assets, as represented by the S&P 500 Index, returned -4.89% in the third quarter and -23.88% year-to-date. Fixed-income markets have continued to be battered by persistent rate volatility. The return of the investment-grade bond market (represented by

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the Bloomberg US Credit Index) was markedly negative for the quarter and year, returning -4.95% and -18.07%, respectively. The high-yield bond market (represented by the Bloomberg US Corporate High Yield 2% Issuer Cap Index) has performed better in the third quarter, returning -0.64% but -14.73% year-to-date. The short end of the yield curve (represented by the two-year U.S. Treasury bond) continued to steepen as the Fed increased rates, rising 120 basis points and ending the period at 4.12%. Meanwhile, the long end of the curve (represented by the 30-year U.S. Treasury bond) moved 59 basis points, ending at 3.73%. The 10-year U.S. Treasury yield ended the quarter 69 basis points higher, ending at 3.67%.

Asset Class Overview

Total return for investment-grade bonds (represented by the Bloomberg US Aggregate Bond Index (Agg) was -4.75% in the third quarter. This is the third consecutive negative quarterly return of the year. Year-to-date, the total return for the Agg is -14.61%, marking the worst year-to-date index return since its inception in 1976. For context, the next worst 9-month comparable period began in January 1981 and resulted in a total return of -3.91%. Aggressive Fed action has punished the mid and longer portions of the curve, and the anticipation of additional rate hikes will likely keep pressure applied through the end of 2022. Excess return of the index year-to-date of the Agg is -1.86%, demonstrating the immense impact of rate volatility. Yields on the 5-year Treasury note moved higher by 89 basis points, along with the 10-year Treasury yields moving higher by 69 basis points over the quarter. Year-to-date, the 5-year Treasury yield has increased by 264 basis points with the 10-year Treasury yields moved higher by 215 basis points. Meanwhile, index spreads widened only 7 basis points over the quarter and 32 basis points year-to-date, ending the third quarter at 68 basis points. As expected, price has moved lower amid an increase in yield. The index average price ended the quarter at $87.71, down from $92.63 in the second quarter. However, yield levels have increased nearly 300 basis points to 4.75% yield-to-worst—levels not seen since the end of 2008.

Investment-grade bond gross issuance year-to-date has totaled $1.02 trillion (down about 7% year-over-year). The pace of issuance has slowed compared to the beginning of the year, likely due to increased funding costs and associated clearing levels. Per J.P. Morgan, 2022 year-to-date has had the highest number of days when no issuers tapped the primary market of any year on record. As of end of the third quarter, 2022 has had 59 zero-issuance days. This is significantly higher than the third-quarter, year-to-date record of 45 days in 2015. Broadly speaking, index returns by credit quality were in line with each other over the third quarter; however, on a year-to-date basis, higher quality has continued to outperform lower quality as AAA rated credits returned -13.13%, followed by AA (-16.57%), A (-17.79%), and BBB (-19.29%).

The Bloomberg US High Yield 2% Issuer Capped Bond Index returned a tepid -0.64% in the third quarter. This follows previous first and second quarterly returns of -4.82% and -9.84%, respectively. The total return of the high-yield index year-to-date was -14.73%, marking the worst year-to-date return through nine months in the history of the index. The year-to-date return exceeds the comparable period seen in 2008 (-10.08%). On the positive, yields have increased to levels last seen in February 2016 (excluding pandemic-impacted April 2020) and, before that, October 2011 and November 2009. The yield-to-worst of the index ended the quarter at 9.69%, up from 8.91% the prior quarter and 4.21% to start 2022. Spreads actually tightened over the quarter by 16 basis points to end at 553 basis points. However, spread levels are 270 basis points wider from the start of the year at 382 basis points. Counter to previous quarters, lower quality outperformed higher quality credits over the quarter, as BB rated credits returned -0.72%, single Bs returned -0.66% and CCC rated bonds returned -0.42%. Additionally, BB, B, and CCC rated bonds yielded 7.78%, 10.23%, and 15.22%, respectively, at quarter-end. Index duration ended the quarter at 4.11 years.

Per J.P. Morgan, high-yield bond issuance in the third quarter was a benign $18.9 billion, resulting in the lightest amount since the first quarter of 2009. As such, high-yield gross, refi, and non-refi issuance year-to-date totals were only $90 billion, $44 billion, and $46 billion, respectively. As a comparable, the past decades' low for high-yield gross, refinancing, and non-refi issuance was in 2018 at $187.4 billion, $114.1 billion, and $73.3 billion, respectively. Additionally, per J.P. Morgan, the U.S. high-yield bond default rate (including distressed exchanges) ended the quarter at 1.57%, the highest level since June 2021. J.P. Morgan has forecasted a year-end 2022 high-yield bond default rate of 1.85% and a 2023 default rate of 2.25%, 50 basis points higher than prior forecasts.

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

The floating-rate loan asset class (represented by the Credit Suisse Leveraged Loan Index or CSLL Index) returned 1.19% in the third quarter. This reflects a strong reversal from the first and second quarterly returns of -0.10% and -4.35%, respectively. While not positive year-to-date, the CSLL Index has returned -3.31%, proving to be far more resilient than most fixed-income asset classes. To compare, U.S. credit and U.S. high-yield bonds have returned -18.07% and -14.73% year-to-date, respectively. And the 30-Year U.S. Treasury has returned over -30% -year-to-date.

Even amid waning retail demand, the potential for rate hedging and diversification that the asset class has historically provided has remained in place. Additionally, investors are now be greeted with a compelling yield offering. As measured by the 4-year effective yield, the CSLL Index currently offers investors a yield of 9.77%, with a coupon of nearly 7%. As investors weigh the impact and likelihood of a potential recession and slowing growth, the loan asset class has suffered significant retail outflows. This asset-class pressure has been countered by a lack of loan issuance and steady collateralized loan obligation (CLO) origination acting as technical supports. The value of assets under management at U.S. ETFs and mutual funds has fallen nearly $20 billion since May's global market selloff (per LCD and Lipper), resulting in a positive inflow of approximately $2 billion year-to-date. Per J.P. Morgan, institutional loan issuance in the third quarter was only $24 billion, the lowest since the first quarter of 2010. Institutional loan issuance year-to-date has totaled $204.9 billion or $145.1 billion ex-refi/repricing, which compares to $642.1 billion (-68%) and $276.4 billion year-to-end 2021 (-48%). Yet the CLO primary market has continued to function as a buoy, printing $105.1 billion year-to-date (down about 20% vs the record year of 2021). We believe the lack of issuance coupled with CLO origination will remain supportive of the asset class.

The average price of the CSLL Index ended the quarter at $91.60, only .06 cents above the year's low of $91.54 on July 6. For the quarter, higher-quality credits strongly outperformed lower quality with BB, B, and CCC rated issuers returning 2.29, 1.05%, and -1.62%, respectively. Performing loans (over $90 price) vastly outperformed distressed loans (up to and including $90 price), returning 1.62% versus -2.05%, respectively. Top-performing sectors for the quarter were food and drug (3.61%), aerospace (3.06%), utilities (2.93%), energy (2.92%), and housing (2.10%). Meanwhile, the worst quarterly returning sectors included metal/minerals (-3.19%), consumer durables (-1.22%), IT (-0.06%), chemicals (0.34%), and gaming/leisure (0.57%). According to J.P. Morgan, leveraged-loan default rates (including distressed exchanges) ended the quarter at 1.63%. J.P. Morgan has forecasted a 2022 year-end loan-default rate of 1.75% and a 2023 default rate of 2.75% (50 basis points higher than previous forecasts). While elevated, these projections indicate a lack of material stress in corporations at this time and are well below the longer-term average default rate of 3.10%.

Fund Performance

Pacific Funds Strategic Income (Class I-2) returned -1.90% versus the Bloomberg US Aggregate Bond Index return of -4.75%.

Portfolio Review

Fixed-rate fixed-income securities were pressured by rising rates. Treasuries with maturities between 10 and 20 years returned -8.66%. Investment-grade corporates (represented by the Bloomberg US Aggregate Bond Index) with maturities 10 years and out returned -8.65%. The fund's duration of 4.09 years remained well below index duration and was a significant positive factor in quarterly relative returns. Corporate-credit sector performance was mixed. The Bloomberg US Corporate Investment Grade Index, the High Yield Bond 2% Issuer Cap Index, and the Credit Suisse Leveraged Loan Index returned -5.06%, -0.64%, and 1.19%, respectively. The fund's corporate-credit exposure totaled approximately 93%, allocated across investment-grade corporate bonds (40.7%), high yield bonds (32.4%) and floating-rate bank loans (20.0%). Bank loan and high-yield bond allocations contributed to quarterly relative returns, while corporate bonds were a modest relative detractor. On a sector basis, relative-return contributors included electric

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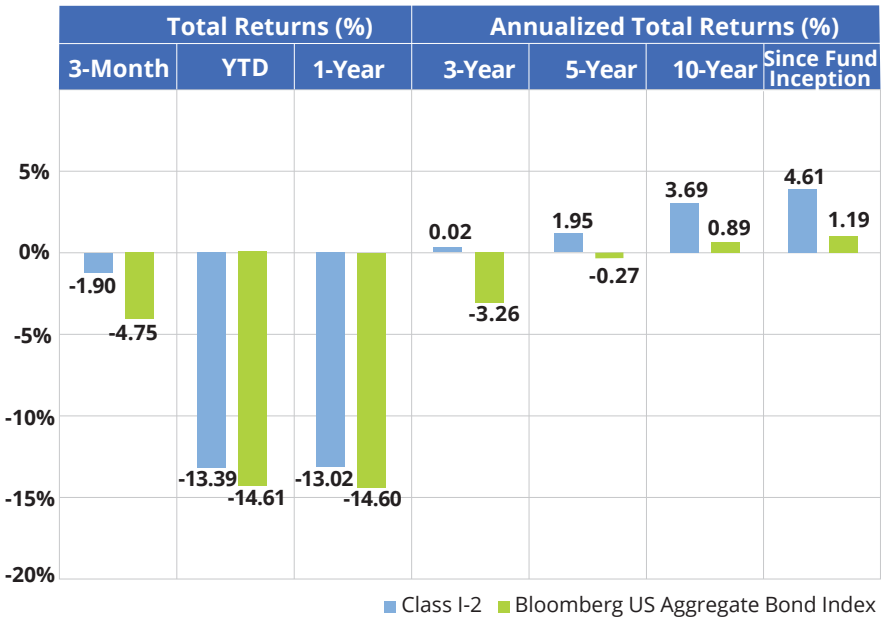
utilities, independent E&P, and packaging. Sectors detracting from relative performance included banking, retailers, and technology. Equities (.51%) and investment-grade collateralized loan obligations or CLOs (3.5%) contributed on a relative basis. The fund's average cash position was 2.79%.

Manager Outlook

The market saw meaningful gains early in the third quarter on the back of hopes for peak inflation and the slowing of Fed hikes. This rally quickly lost steam though, as inflation readings continued to come in higher than expectations and the projection of higher Fed hikes increased. Rates across the Treasury curve moved higher and market participant odds of an impending recession increased. Corporations in the U.S. are generally performing reasonably well, which seems to further the argument the Fed has more work to do in slowing the economy and inflation. As we have mentioned before, the longer inflation remains elevated, the narrower the path is to a soft landing. Given the elevated inflation prints as of late, it seems like more needs to go right at this point to keep a soft landing a possibility.

Rate-sensitive assets bore the brunt of the weakness in the third quarter, and, conversely, leverage loans continued to perform well due to their floating-rate nature. Spreads across credit markets have been rangebound in a zone that prices in a decent amount of downside but has more room to widen if we move towards a recessionary. Despite this, absolute yields across credit have moved to levels that we believe offer attractive entry points. If we head down a recessionary path, our expectation is inflation will moderate and some rate relief could be in store. Because of this, we continue to look to add higher-quality credit exposure, seeking companies that, in our opinion, can survive a downturn and believe this segment of the market is quite compelling.

Class I-2



Top-10 Holdings	Weight (%)
Applied Systems, Inc.	1.03
Boeing Company 5.04%	0.90
SRS Distribution, Inc.	0.86
Morgan Stanley 3.591%	0.74
Uber Technologies, Inc. 4.5%	0.73
Verizon Communications Inc. 2.55%	0.69
Anheuser-Busch InBev Worldwide, Inc. 4.75%	0.68
Labl, Inc.	0.65
Allied Universal Holdco LLC	0.65
UKG, Inc.	0.64
Total	**7.58**

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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.

Definitions

One **basis point** equals 0.01%.

The **Bloomberg 1–3 Year US Government/Credit Bond Index** is a performance benchmark of U.S. investment-grade government and corporate bonds with maturities of one to three years.

The **Bloomberg Asset-Backed Securities (ABS) Index** is the ABS component of the Bloomberg Barclays U.S. Aggregate Index that measures the performance of ABS with the following collateral types: credit and charge card, auto and utility loans. All securities have an average life of at least one year.

The **Bloomberg Short Treasury Total Return Index** is a performance benchmark of all U.S. Treasuries that have a remaining maturity between one and twelve months.

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 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 non-US agencies, sovereigns, supranationals and local authorities.

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 **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 Non-Manufacturing Purchasing Managers' Index (PMI)** (also known as the **ISM Services PMI**) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

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.

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

Investing involves risk. Principal loss is possible. 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 9/30/22 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.

Investors should consider a fund's investment goal, risk, charges and expenses carefully before investing. The prospectus contains this and other information about the fund and can be obtained at www.PacificFunds.com. It should be read carefully before investing.

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