PACIFIC FUNDS

PACIFIC FUNDS℠
HIGH INCOME COMMENTARY

DECEMBER 31, 2022

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

Class A		Class C		Class I-2	
Ticker	**Fund Number**	**Ticker**	**Fund Number**	**Ticker**	**Fund Number**
PLAHX	112	PLCHX	312	PLHYX	012

Market Overview

2022 dealt a year of challenges not seen in decades. Accelerating inflation in the front end of the year led to aggressive monetary policy responses across global central banks. Domestically, the Federal Reserve raised the target Fed Funds rate by over 400 bps through the year and transitioned from Quantitative Easing to Quantitative Tightening. As monetary policy tightened, domestic and global growth waned, elevating recessionary fears. Most risk assets had the worst calendar year returns since 2008. However, the most notable pain in 2022 was felt in the bond market, where the Bloomberg U.S. Aggregate Index lost over 13%, more than 4X the loss of the worst calendar year return, -2.92% during 1994, in index history. As we transition into 2023, investors remain uncertain on prospects of a hard or soft landing.

While third quarter real gross domestic product (GDP) was revised higher from 2.9% to 3.2%, indications of weakening fundamentals have emerged with greater frequency. After a 29-month period of consistent growth, the ISM Manufacturing Index contracted the last two months of 2022 to 48.4%. The index's report cites easing customer demand, skilled labor shortages, supply-chain issues, and uncertain economic forecasts that are causing delayed commitments for capital purchases. Likewise, December marked the sixth straight month of contraction for the US Services PMI. Additionally, the Conference Board Leading Economic Index (LEI) for the U.S. decreased by 1% in November following a decline October. The LEI is now down 3.7% over the six-month period (May to November 2022), a much steeper rate of decline than its 0.8% contraction over the previous six-month period (Nov. 2021 to May 2022).

The combination of a slowing savings rates, elevated costs of goods and services, increased usage of credit by consumers, declining home values, and lackluster market returns paints the picture of a worried consumer. Elevated cost pressures have been reflected in the personal savings rate (per BEA) moving to 2.4%, down from 4.7% in January 2022 and 20% in January 2021. As of year-end 2022, headline Consumer Price Index (CPI) resided at 7.1%, with the Core Personal Consumption Expenditures (PCE), the Fed's preferred inflation measure, at 4.7%. Both indicators were well above the Fed's targeted 2% inflation rate. A possible offset is that the labor market has remained tight, with unemployment holding at 3.7%. There has not been a formal recession in a century without deteriorating labor dynamics.

Inflation remains a key concern globally and has driven central banks to act strongly in both function and rhetoric. Federal Reserve officials appear unwavering in their fight against inflation. The 50bps rate hike in December ended a streak of four consecutive 75bps rate hikes, taking the target range for the fed funds rate to 4.25%-4.5%--its highest level in 15 years. The most recent FOMC meeting minutes revealed that while Fed Chair Powell indicated that there has been some progress in the battle against inflation, he saw only halting signs and expects rates to hold at higher levels even after the increases cease. The FOMC meeting minutes also stated, "Participants generally observed that a restrictive policy stance would need to be maintained until the incoming data provided confidence that inflation was on a sustained downward path to 2%, which was likely to take some time. … In view of the persistent and unacceptably high level of inflation, several participants commented that historical experience cautioned against prematurely loosening monetary policy." As a result, no FOMC members expect rate cuts in 2023. In conjunction with increasing rates, the Fed has been shrinking its balance sheet by enacting quantitative tightening (QT), allowing up to $95 billion in proceeds from maturing securities to roll off each month rather than be reinvested. In a program started mid-2022, the balance sheet has contracted by $364 billion to $8.6 trillion. As the rate of inflation remains well above the Fed's 2% target, the market has assumed additional rate hikes in early 2023, possibly elevating the fed funds rate north of 5%.

Across the pond, the European Central Bank (ECB) hiked rates again in December to 2% and stressed significant tightening remains ahead as it presented plans to drain cash from the financial system to further combat elevated inflation. Driven

largely by COVID, supply-chain disruption and elevated energy costs, European inflation has risen substantially, although there have been recent signs of peaking amid recessionary fears. Nevertheless, ECB President Christine Lagarde is forecasting, "another 50bps rise at our next meeting and possibly at the one after that, and possibly thereafter."

Despite a strong Q4, 2022 proved difficult for risk-based assets. For the fourth quarter, the S&P 500 returned 7.55%, yet had an overall dismal performance in 2022, returning -18.13%. Uncertainty within the rate market has wrecked havoc within fixed-income asset classes and duration was unfriendly to investors. The return of the investment-grade bond market (represented by the Bloomberg US Credit Index) was markedly positive for the quarter but negative for the year, returning 3.44% and -15.26%, respectively. The high-yield bond market (represented by the Bloomberg US Corporate High Yield 2% Issuer Cap Index) performed positively in the fourth quarter, returning 4.17% but closed -11.18% for the year. The 10-year U.S. Treasury yield moved 21bps higher over the quarter and 236bps over the year, ending at 3.88%.

Asset Class Overview

In a stunning reversal from the third quarter's negative return, the Bloomberg US High Yield 2% Issuer Capped Bond Index returned 4.17% in the fourth quarter. However, even the robust returns seen at year end could not overcome the annual total return, which ended at -11.18%. 2022 marked the second worst calendar-year return since the inception of the index, trailing only 2008 (-25.88%) and was nearly 2x the third worst calendar-year return (-5.79% in 2000). As monetary policy pressured duration-based assets, yields moved upward to compensate investors for additional risk. The index yield-to-worst moved 475bps higher over the year to end at 8.97%. Spreads moved 186bps wider to end at 470bps. Lower quality led the move down as BB rated credits returned -10.77%, single B rated bonds returned -10.26% and CCC rated bonds returned -16.29%. However, investors were incentivized by a dramatic increase in yields as BB, B, and CCC rated bonds yielded 7.23%, 9.22%, and 14.26%, respectively, at year end. Index duration ended the period at 3.88 years.

Per J.P. Morgan, high-yield bond issuance totaled $106.5 billion ($56.1 billion, excluding refi) in 2022, which was down 78% (71%, excluding refi) compared to 2021.J.P. Morgan is expecting the U.S. high-yield bond default rate (including distressed exchanges) to continue to march higher from the current level of 1.65% to 3% in 2023 and 3.25% in 2024 (this compares the long-term average default rate of 3.20%).

Fund Performance

Pacific Funds High Income (Class I-2) returned 5.41% versus the Bloomberg US High Yield 2% Issuer Capped Bond Index return of 4.17%.

Portfolio Review

The year finished on a positive note as investor sentiment turned more favorable and interest-rate impacts eased as the quarter progressed. High-yield returns by quality for BB, B, and CCC were 4.30%, 4.93%, and .51%, respectively. Option-adjusted spreads tightened by 84 basis points overall, led by B rated securities. Credit selection was the primary contributor to the fund's relative outperformance. On a sector basis, construction machinery, media and entertainment, and diversified manufacturing sectors contributed to relative returns. Gaming, pharmaceuticals, and healthcare sectors detracted. Notable individual credit contributors included Ahern Rentals, Titan Acquisition, and Allied Universal. OT Merger Corporation, CSC Holdings, and Legacy Lifepoint Health were among the individual credit detractors. The fund's allocation to CLOs (6.8%) and investment-grade corporate bonds (5.1%) contributed on a relative basis. Floating-rate bank loans (1.5%) posted positive absolute returns but detracted relative to the index. The fund's duration of 3.75 years was modestly shorter than index duration of 3.95 years. The average cash position during the quarter was 2.88%.

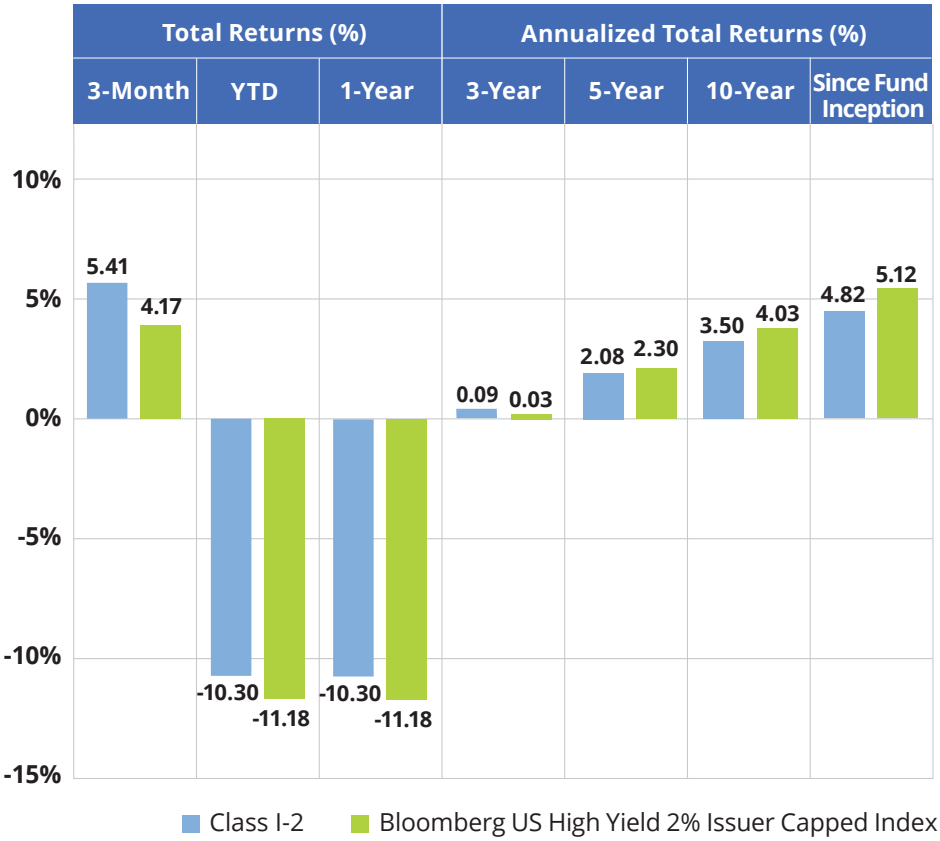
Past Performance is not indicative of future results. *Returns reflect reinvestment of dividends/distribution. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. Performance current to the most recent month end may be found at www.PacificFunds.com/performance or by calling 1-800-722-2333. The investment advisor has contractually agreed to limit certain expenses and reevaluates the annually. Please see the current prospectus for detailed information.*

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

Manager Outlook

While the high-yield market has remained volatile amid a period of significant uncertainty, we continue to view near 9% yield as attractive. It's likely to remain a bumpy ride, however, as the Federal Reserve looks to quickly quell inflation while keeping the economy from contracting too quickly. It's a difficult balancing act, and we expect the Fed to error on the side of overtightening to keep inflation from becoming too entrenched. For high yield, that is likely to drive an increase in default rates. Default rates have been well below historical levels for several years and we expect this increase to be moderate overall. Most importantly, we believe the market is compensating for those risks. Should the Federal Reserve induce a modest recession, we would expect interest rates to decline, and therefore, are shifting to taking on additional interest-rate risk. Despite macro concerns, the U.S. benefits from resilient employment, relatively high absolute savings amounts, and continued, albeit reduced, benefits from the substantial wealth creation that has occurred in the past couple of years. Importantly, for the fund, we view the underlying health of the companies as still sufficient to support their capital structures. Our investments remain focused on consumer-driven sectors that are likely to benefit from continued high spending and pent-up demand for services curtailed during the pandemic. We currently see value in select manufacturing, packaging, aerospace, and leisure companies.

Class I-2



Top-10 Holdings	Weight (%)
CCO Holdings LLC 4.75%	2.09
Ahern Rentals, Inc. 7.375%	1.86
Allied Universal Holdco LLC 9.75%	1.80
Standard Industries, Inc. 4.75%	1.76
Ford Motor Company 3.25%	1.75
CSC Holdings, LLC 6.5%	1.40
Colt Merger Sub, Inc. 8.125%	1.28
Cedar Fair, L.P. 5.25%	1.14
MAGNE 2021-29A	1.13
Bway Holding Co., Inc. 7.25%	1.11
Total	**15.30**

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Gross/Net annual operating expenses for Class I-2 are 0.87%/0.70%. Inception date 6/29/12.

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 Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market.

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

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.

Quantitative Easing (QE) is a monetary policy action whereby a central bank purchases predetermined amounts of government bonds or other financial assets in order to stimulate economic activity.

Quantitative Tightening (QT) (or quantitative hiking) is a contractionary monetary policy applied by a central bank to decrease the amount of liquidity within the economy.

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.

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

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