PACIFIC FUNDS

PACIFIC FUNDS℠

ULTRA SHORT INCOME COMMENTARY

DECEMBER 31, 2022

SUB-ADVISED BY PACIFIC ASSET MANAGEMENT LLC

Class I-2		Class I	
Ticker	**Fund Number**	**Ticker**	**Fund Number**
PLUDX	019	PLUIX	419

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

Short-duration investment-grade bonds (represented by the Bloomberg 1-3 Year US Government/Credit Bond Index) posted a stark reversal from 3Q by returning 0.89% in the fourth quarter. However, due to rate volatility, the index returned -3.69% for the year. The total return for 2022 was the worst calendar-year return for the index since its inception. In fact, the year's return was nearly 8x the previous worst return (-0.47% in 2021)! Corporate fundamentals, while softer, were not the driver of weakness seen in 2022; rather the primary factor was the rapid pace and magnitude of rate hikes. The Fed raised the federal funds rate by over 400bps (including a historic four consecutive hikes of 75bps each) with the most recent hike of 50bps coming in December. The result has been the highest borrowing costs seen since 2007, with market expectations of additional hikes in early 2023. As a result of aggressive monetary policy, the front end of the curve steepened. Quarter-over-quarter, the 3-month Treasury note moved 96 bps higher, the 2-year Treasury moved 29bps higher, and the 3-year Treasury moved 10bps higher. For the year, the 3-month Treasury note moved 436bps higher, the 2-year Treasury moved 368 higher, and the 3-year Treasury moved 325bps higher. The option-adjusted spread (OAS) ended the quarter/year at 18bps, wider by 8bps from the start of 2022. For the year, the Bloomberg 1–3 Year US Government/Credit Bond Index ended with an average price of $95.53, down from $101.52 to start the year. Conversely, in 2021, the yield-to-worst increased by 387bps, ending at 4.68%. Index duration moved slightly lower over the year to end at 1.86 years.

Fund Performance

Pacific Funds Ultra Short Income (Class I-2) returned 1.20% versus the Bloomberg Short Treasury Total Return Index return of 0.85%.

Portfolio Review

Three-month and 1-year Treasury yields increased by 109 and 68 basis points, respectively, during the quarter. Despite these rate pressures, short-duration corporate-credit spreads in the 1-3 year maturity range tightened by 15 basis points, reflecting a moderately more constructive investor sentiment. The fund's corporate-credit allocation totaled approximately 58.5% across investment-grade corporate bonds (54.3%) and floating-rate bank loans (4.2%). These allocations contributed to positive quarterly relative returns. On a sector basis, almost all sectors outperformed the Treasury benchmark in the fourth quarter, with banking, chemicals and lodging leading as the most notable positive return contributors. Cash was a slight drag to performance. The fund continues to maintain material exposure to banking (21.2%) and electric utility (7.32%) sectors, which offer stable fundamentals and attractive relative yields. Securitized asset exposure totaled approximately 24% allocated across senior CLO floating-rate securities (14.1%), fixed-rate auto ABS (7.4%) and student loan ABS (2.6%). The allocation to senior CLOs

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.*

was a positive return contributor. The fund's average duration of .54 years was slightly longer than index duration of .36 years. The fund held an average cash position of 5.85%.

Manager Outlook

Broadly speaking, corporate fundamentals have remained sound, even as costs (including borrowing costs) have risen and expectations for economic growth has slowed. If there is going to be a recession, most investment-grade borrowers will enter it with stronger profit margins, interest coverage and lower leverage than the prior one. As input cost pressures begin to ease, so too does potential pricing power. These dynamics will play out over the course of the 2023, leaving some companies to experience significant margin compression. How badly will the U.S. consumer pullback in the face of higher housing, food and energy costs will also likely be answered over the next 12 months. We think the odds of a recession in the coming year are high, but do not think overall corporate fundamentals will deteriorate dramatically. We are, however, concerned about more cyclical areas of the market as demand destruction occurs more quickly than expected in a contracting economy. The higher yields offered in the investment-grade corporate market will allow investors to be more selective in where to take risks.

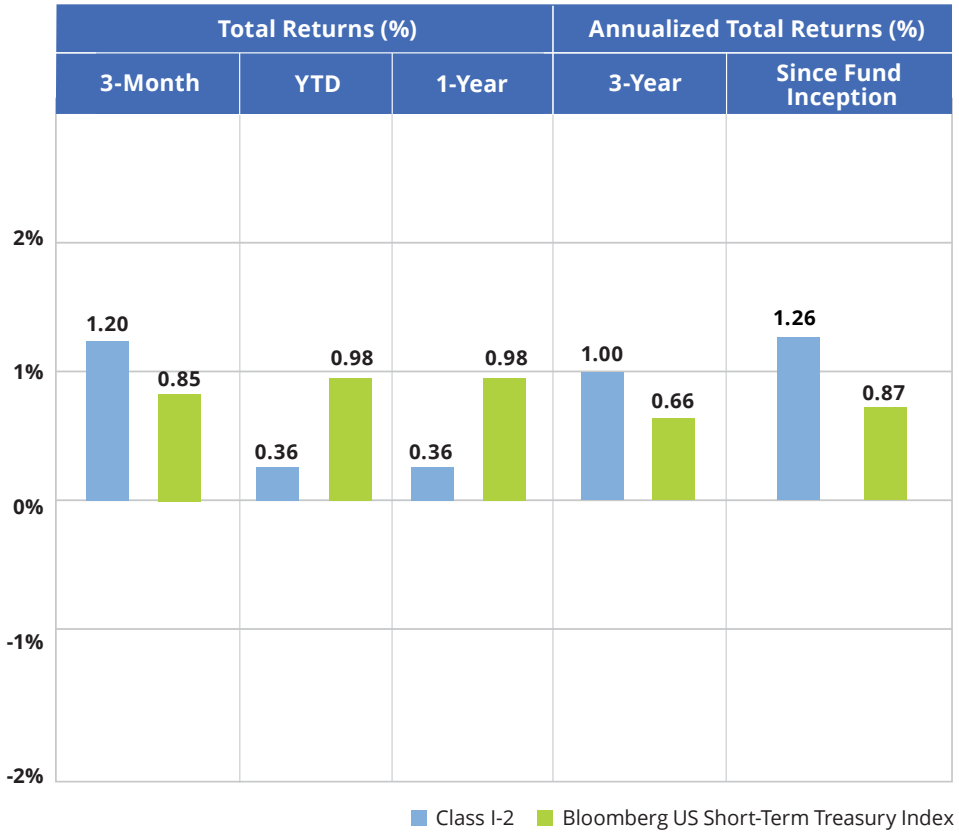
The technical picture for the investment-grade corporate-bond market that had been poor in 2022 seems to be turning a corner. Volatility has calmed as market expectations for further rates hikes have come down. Negative returns we saw for investment-grade corporates in 2022 have begun to turn positive. With the expectations for lower inflation, reduced Fed hikes and a better potential return profile, demand for corporate debt is improving. The supply side of the picture has also improved. We saw significant corporate-bond supply to start the year, and this has abated as borrowing costs (both interest rates and credit spreads) have risen significantly over the past year. We expect supply to pick up in the new year, improving liquidity and highlighting the attractive yields being offered by high-quality borrowers.

From a relative value standpoint, we believe investment-grade yields and dollar prices are at attractive levels. As for spread levels, we are starting to price in slower growth. The Bloomberg US Credit Index ended 2022 34 basis points wider, with lower-rated BBBs underperforming. At the end of the fourth quarter, the yield-to-worst and option-adjusted spreads (OAS) of the Bloomberg US Credit Index were 5.34% and 121 basis points, respectively, which were in the 99th and 90th percentiles over the past 10 years. While credit spreads are not fully pricing in a recession, they have become relatively more attractive over the course of 2022. The U.S. dollar price of the index sits below $90. Yield and price levels are creating cushion for any spread vulnerability that may occur in 2023, limiting fundamental credit risk.

We still think a lot of sectors have the ability to fundamentally perform well in 2023. We continue to focus on sectors that are still experiencing solid demand and/or pricing power, which includes airlines (EETCs), aircraft leasing, leisure/lodging and domestic gaming. Sectors such as food and beverage, pharmaceuticals, midstream and selected utilities have continued to perform well. We believe large U.S. banks should continue to be economically sound as strong balance sheets and improved net-interest margins offset weakening economic exposure. We remain cautious on European banks, given weaker balance sheets than U.S. counterparties and a weaker economic growth picture. We are also cautious against a weakening demand outlook for certain parts of the technology, chemicals, building products, consumer products and certain retail sectors.

It seems as if, with inflation finally showing signs of slowing down, the market is expecting the Fed to be closer to its rate-hike endgame. As the Fed's hawkish rhetoric and actions have caused significant volatility in rates and a weakness in risk assets, the likelihood of being at the end of this has caused increased stability and a bit of a risk rally to end the year. While we saw significant spread widening while experiencing decent earnings in 2022, we may get the opposite in 2023. Spreads may remain firm, despite a weakening earnings environment. We are broadly comfortable with IG credit risk (even in many BBB-rated areas of the market) and like to be a little longer in duration than we had been the past year. We are also starting to see more relative value in floating-rate assets as fixed yields begin to fall. While we are concerned about credit risk in lower-rated parts of our market, we think higher-quality leveraged loans can offer solid yield carry for limited credit risk. We also remain comfortable with certain ABS and AAA/AA CLOs due to their sound structures, limiting any fundamental deterioration.

Class I-2



Top-10 Holdings	Weight (%)
US Treasury 0.25%	2.80
US Treasury 0.125%	2.75
US Treasury 0.75%	2.72
US Treasury 1.5%	1.90
US Treasury 0.5%	1.87
US Treasury 0.25%	1.85
US Treasury 0.125%	1.84
US Treasury 0.125%	1.84
Mitsubishi UFJ Financial Group, Inc. 3.455%	1.81
JPMorgan Chase & Co.	1.58
Total	**20.95**

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Gross/Net annual operating expenses for Class I-2 are 0.66%/0.32%. Inception date 6/28/19.

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 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.

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.

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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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