

PIMCO Income Strategy Fund II
Form N-CSRS
April 01, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number 811-21601

PIMCO Income Strategy Fund II
(Exact name of registrant as specified in charter)

1345 Avenue of the Americas, New York, NY
(Address of principal executive offices)

10105
(Zip code)

Lawrence G. Altadonna - 1345 Avenue of the Americas, New York, New York 10105
(Name and address of agent for service)

Registrant's telephone number, including area code: 212-739-3371

Date of fiscal year July 31, 2010
end:

Date of reporting period: January 31, 2010

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-2001. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

ITEM 1. REPORT TO SHAREHOLDERS

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PIMCO Income Strategy/PIMCO Income Strategy II Funds Letter to Shareholders

March 15, 2010

Dear Shareholder:

Please find enclosed the semiannual report for PIMCO Income Strategy Fund and PIMCO Income Strategy Fund II (collectively, the Funds) for the fiscal six-month period ended January 31, 2010. On March 1, 2010, each Fund changed its name and rescinded its non-fundamental investment policy to, under normal market conditions, invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments. Each Fund now seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating and/or fixed-rate debt instruments.

Corporate credit securities provided solid returns during the six-month period as investors continued to gravitate toward riskier assets and away from lower-yielding government bonds. The Barclays Capital Investment Grade Credit Index, a measure of high quality corporate bond performance, returned 6.22% and the Barclays Capital U.S. High Yield Bond Index, a measure of below-investment-grade corporate bond performance, returned 15.78%. In contrast, government bonds, represented by the Barclays Capital Long Term Treasury Index, returned 0.92% for the period. The Barclays Capital U.S. Aggregate Index, a broad credit market measure of government and corporate securities, posted a return of 3.87%. Mortgage-backed securities, represented by the Barclays Capital Mortgage Index, returned 3.46%. Stocks also advanced for the six-month period as the Standard & Poor's 500 Index advanced 9.87%.

The Federal Reserve held the Federal Funds Rate, the key target rate on loans between member banks, to a historically low target range of 0.00% to 0.25% during the six-month period and pursued other initiatives designed to inject liquidity into the financial system. Under its policy of quantitative easing, the U.S. monetary authority purchased large amounts of securities (such as mortgage-backed securities and U.S. Treasuries) from commercial banks to encourage lending to consumers and businesses.

For specific information on the Funds and a review of their performance for the reporting period, please see the following pages. If you have any questions regarding the information provided, we encourage you to contact your financial advisor or call the Funds' shareholder servicing agent at (800) 254-5197. In addition, a wide range of information and resources is available on our website, www.allianzinvestors.com/closedendfunds.

Together with Allianz Global Investors Fund Management LLC, the Funds' investment manager, and Pacific Investment Management Company LLC (PIMCO), the Funds' sub-adviser, we thank you for investing with us.

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess
Chairman

Brian S. Shlissel
President & Chief Executive Officer

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PIMCO Income Strategy Fund Fund Insights/Performance & Statistics

January 31, 2010 (unaudited)

- For the fiscal six-month period ended January 31, 2010, PIMCO Income Strategy Fund returned 33.87% on net asset value (NAV) and 53.04% on market price.
- An emphasis on the banking and non-captive consumer and diversified sectors, which were among the top performing corporate industry categories during the period, contributed strongly to performance.
- Security selection in the insurance sector, where select life insurance companies posted outsized gains, was a significant benefit to performance.
- Minimal exposure to the gaming sector, which lagged the broader corporate market during the period, contributed to performance.
- Security selection in the consumer cyclical sector, where automotive related holdings outperformed alongside government sponsored campaigns, added to returns for the period.
- Below market weighting to the broadcasting sector, which benefited significantly from the overall stretch for higher yield during the period, detracted from performance.
- An emphasis on more defensive sectors and higher quality, including exposure to investment-grade holdings, negatively impacted performance given the rally in lower-quality credits during the six-month period.

Total Return(1):	Market Price	NAV
Six Month	53.04%	33.87%
1 Year	67.15%	77.85%
5 Year	0.92%	(0.08)%
Commencement of Operations (8/29/03) to 1/31/10	2.89%	1.40%

Market Price/NAV Performance:	Market Price/NAV:	
Commencement of Operations (8/29/03) to 1/31/10	Market Price	\$11.95
NAV	NAV	\$10.33
Market Price	Premium to NAV	15.68%
	Market Price Yield(2)	6.26%

(1) **Past performance is no guarantee of future results.** Total return is calculated by determining the percentage change in net asset value (NAV) or market price (as applicable) in the specified period. The calculation assumes that all income dividends and capital gain distributions if any, have been reinvested. Total return does not reflect broker commissions or sales charges. Total return for a period of less than one year is not annualized. Total return for a period of more than one year represents the average annual total return.

Performance at market price will differ from its results at NAV. Although market price returns typically reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Fund, market conditions, supply and demand for the Fund's shares, or changes in Fund dividends.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a onetime public offering and once issued, shares of closed-end funds are sold in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend payable to common shareholders (comprised of net investment income) payable to shareholders by the market price per common share at January 31, 2010.

PIMCO Income Strategy Fund II Fund Insights/Performance & Statistics

January 31, 2010 (unaudited)

- For the fiscal six-month period ended January 31, 2010, PIMCO Income Strategy Fund II returned 31.92% on NAV and 44.43% on market price.
- An emphasis on the banking and non-captive consumer and diversified sectors, which were among the top performing corporate industry categories during the period, contributed strongly to performance.
- Security selection in the insurance sector, where select life insurance companies posted outsized gains, was a significant benefit to performance.
- Minimal exposure to the gaming sector, which lagged the broader corporate market during the period, contributed to performance.
- Security selection in the consumer cyclical sector, where automotive related holdings outperformed alongside government sponsored campaigns, added to returns for the period.
- Below market weighting to the broadcasting sector, which benefited significantly from the overall stretch for higher yield during the period, detracted from performance.
- An emphasis on more defensive sectors and higher quality, including exposure to investment grade holdings, negatively impacted performance given the rally in lower-quality credits during the six-month period.

Total Return(1):	Market Price	NAV
Six Month	44.43%	31.92%
1 Year	77.22%	77.20%
5 Year	(1.63)%	(2.55)%
Commencement of Operations (10/29/04) to 1/31/10	(1.75)%	(2.31)%

Market Price/NAV Performance:		Market Price/NAV:	
Commencement of Operations (10/29/04) to 1/31/10	Market Price		\$9.87
	NAV		\$9.14
	Market Price	Premium to NAV	7.99%
		Market Price Yield(2)	7.07%

(1) **Past performance is no guarantee of future results.** Total return is calculated by determining the percentage change in net asset value (NAV) or market price (as applicable) in the specified period. The calculation assumes that all income dividends and capital gain distributions if any, have been reinvested. Total return does not reflect broker commissions or sales charges. Total return for a period of less than one year is not annualized. Total return for a period of more than one year represents the average annual total return.

Performance at market price will differ from its results at NAV. Although market price returns typically reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Fund, market conditions, supply and demand for the Fund's shares, or changes in Fund dividends.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a onetime public offering and once issued, shares of closed-end funds are sold in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend payable to common shareholders (comprised of net investment income) payable to shareholders by the market price per common share at January 31, 2010.

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PIMCO Income Strategy Fund Schedule of Investments

January 31, 2010 (unaudited)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
CORPORATE BONDS & NOTES 59.6%			
Apparel & Textiles 0.3%			
\$900	Hanesbrands, Inc., 3.831%, 12/15/14, FRN	B1/B+	\$859,500
Banking 15.9%			
1,200	Barclays Bank PLC (i), 7.375%, 12/15/11 (a) (d)	Baa2/BBB+	1,146,000
1,485	7.434%, 12/15/17 (a) (d)	Baa2/BBB+	1,421,888
£4,300	14.00%, 6/15/19	Baa2/BBB+	8,767,930
\$1,000	Den Norske Bank ASA, 7.729%, 6/29/11 (a) (d) (i)	A2/BBB	960,314
600	HBOS PLC, 6.75%, 5/21/18 (a) (d)	Ba1/BBB-	587,684
3,625	HSBC Capital Funding L.P., 9.547%, 6/30/10 (a) (d) (i)	A3/A-	3,697,500
10,000	Rabobank Nederland NV, 11.00%, 6/30/19 (a) (d) (i)	Aa2/AA-	12,817,270
7,200	Regions Financial Corp., 0.421%, 6/26/12, FRN (l)	Baa3/BBB	6,418,750
£31	Royal Bank of Scotland PLC, 4.556%, 4/6/11, VRN	NR/NR	46,520
\$6,260	Swedbank AB, 9.00%, 3/17/10 (a) (d) (i)	Ba1/BB	6,135,057
4,600	UBS Preferred Funding Trust I, 8.622%, 10/1/10 (i)	Baa3/BBB-	4,443,204
			46,442,117
Financial Services 31.3%			
3,900	American General Finance Corp., FRN, 0.504%, 12/15/11	B2/BB+	3,204,505
775	0.553%, 8/17/11	B2/BB+	659,386
£1,700	BAC Capital Trust VII, 5.25%, 8/10/35	Baa3/BB	1,893,235
\$4,900	Bank of America Corp., 8.125%, 5/15/18 (i)	Ba3/BB	4,658,430
1,400	Capital One Capital VI, 8.875%, 5/15/40	Baa2/BB	1,467,767
2,500	Chukchansi Economic Dev. Auth., 4.024%, 11/15/12, FRN (a) (d)	B3/B+	2,012,500
	CIT Group, Inc., 7.00%, 5/1/13	NR/NR	2,789,026
3,032	7.00%, 5/1/14	NR/NR	851,408
947	7.00%, 5/1/15	NR/NR	827,725
1,579	7.00%, 5/1/16	NR/NR	1,361,781
2,211	7.00%, 5/1/17	NR/NR	1,892,677
100	Citigroup Capital XXI, 8.30%, 12/21/77, (converts to FRN on 12/21/37)	Baa3/B+	93,500
2,500	Credit Agricole S.A., 6.637%, 5/31/17 (a) (d) (i)	Aa3/A-	2,190,625
	Ford Motor Credit Co. LLC, 3.001%, 1/13/12, FRN	B3/B-	9,699,063
10,250	7.25%, 10/25/11	B3/B-	2,227,779
2,200	GMAC, Inc., 6.00%, 12/15/11	Ca/B	489,090
500	6.875%, 9/15/11	Ca/B	1,422,493
1,425	6.875%, 8/28/12	Ca/B	1,603,974
1,625	7.25%, 3/2/11	Ca/B	2,615,584
2,600	7.50%, 12/31/13	Ca/B	5,127,510
5,102	ILFC E-Capital Trust I, 5.90%, 12/21/65, (converts to FRN on 12/21/10) (a) (b) (d) (m) (acquisition cost-\$3,473,750; purchased 11/10/09)	B3/BB	3,990,000
7,000			

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	International Lease Finance Corp.,		
650	4.75%, 1/13/12	B1/BB+	573,788
650	5.30%, 5/1/12	B1/BB+	568,492
650	5.35%, 3/1/12	B1/BB+	570,725
650	5.45%, 3/24/11	B1/BB+	613,284
2,111	5.625%, 9/20/13	B1/BB+	1,738,928
4,100	5.75%, 6/15/11	B1/BB+	3,844,627
2,947	6.625%, 11/15/13	B1/BB+	2,468,057

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PIMCO Income Strategy Fund Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
Financial Services (continued)			
\$1,500	Lehman Brothers Holdings, Inc., 7.50%, 5/11/38 (f)	WR/NR	\$450
11,100	National City Preferred Capital Trust I, 12.00%, 12/10/12 (i) (l)	Baa2/BBB	12,664,734
1,629	NB Capital Trust II, 7.83%, 12/15/26	Baa3/BB	1,551,623
9,650	SLM Corp., 0.479%, 10/25/11, FRN	Ba1/BBB-	8,903,669
4,250	Wells Fargo & Co., 7.98%, 3/15/18 (i)	Ba1/A-	4,313,750
2,550	Wells Fargo Capital XIII, 7.70%, 3/26/13 (i)	Ba1/A-	2,486,250
			91,376,435
Healthcare & Hospitals 1.2%			
3,300	HCA, Inc., 9.625%, 11/15/16, PIK	B2/BB-	3,506,250
Insurance 9.9%			
1,600	American International Group, Inc., 0.353%, 3/20/12, FRN (l)	A3/NR	1,418,310
5,900	0.361%, 10/18/11, FRN (l)	A3/A-	5,373,342
700	0.82%, 4/26/11, FRN	A3/A-	910,155
\$5,000	4.95%, 3/20/12	A3/NR	4,857,130
6,400	5.45%, 5/18/17	A3/A-	5,137,971
700	8.175%, 5/15/68, (converts to FRN on 5/15/38)	Ba2/BBB	476,000
4,400	8.25%, 8/15/18 (l)	A3/A-	4,045,413
£1,300	8.625%, 5/22/68, (converts to FRN on 5/22/18)	Ba2/BBB	1,406,106
\$800	AXA S.A., 6.463%, 12/14/18 (a) (d) (i)	Baa1/BBB+	637,000
2,300	Hartford Financial Services Group, Inc., 8.125%, 6/15/68, (converts to FRN on 6/15/18)	Ba1/BB+	2,282,750
2,440	Progressive Corp., 6.70%, 6/15/67, (converts to FRN on 6/15/17)	A2/A-	2,247,972
			28,792,149
Oil & Gas 0.2%			
600	SandRidge Energy, Inc., 8.00%, 6/1/18 (a) (d)	B3/B+	600,000
Paper/Paper Products 0.7%			
2,500	Verso Paper Holdings LLC, 4.031%, 8/1/14, FRN	B2/B-	2,062,500
Telecommunications 0.0%			
2,500	Hawaiian Telcom Communications, Inc., 8.765%, 5/1/13, FRN (b) (f)	WR/NR	71,875
Utilities 0.1%			
390	Dominion Resources, Inc., 6.30%, 9/30/66, (converts to FRN on 9/30/11) (l)	Baa3/BBB	362,838
Total Corporate Bonds & Notes (cost-\$158,671,428)			174,073,664
MORTGAGE-BACKED SECURITIES 17.2%			
1,100	Banc of America Commercial Mortgage, Inc., 5.451%, 1/15/49, CMO	Aaa/NR	992,271
3,163	Banc of America Funding Corp., 4.503%, 2/20/36, CMO, FRN	NR/AAA	2,754,302
1,400	Banc of America Mortgage Securities, Inc., 4.763%, 5/25/35, CMO, FRN	B3/NR	1,111,191
700	Bear Stearns Commercial Mortgage Securities, 5.70%, 6/11/50, CMO	NR/AA-	643,756
2,161	Chase Mortgage Finance Corp., CMO, 5.422%, 3/25/37, FRN	B3/NR	1,811,047

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1,200	6.00%, 7/25/37	NR/CCC	954,544
1,500	Citicorp Mortgage Securities, Inc., 6.00%, 6/25/36, CMO	Baa3/NR	1,314,280

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PIMCO Income Strategy Fund Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
\$1,500	Citigroup/Deutsche Bank Commercial Mortgage Trust, 5.322%, 12/11/49, CMO	Aaa/A-	\$1,353,546
	Commercial Mortgage Pass Through Certificates, CMO,		
1,900	5.306%, 12/10/46	Aaa/NR	1,719,383
6,550	5.816%, 12/10/49, VRN	Aaa/A	6,232,763
143	Countrywide Home Loan Mortgage Pass Through Trust, 3.401%, 2/20/35, CMO, VRN	A3/AA-	122,545
	Credit Suisse Mortgage Capital Certificates, CMO,		
800	6.00%, 2/25/37	NR/CCC	622,832
900	6.216%, 2/15/41, VRN	NR/AA	775,526
2,330	GS Mortgage Securities Corp. II, 5.56%, 11/10/39, CMO	Aaa/NR	2,163,533
520	GSR Mortgage Loan Trust, 5.50%, 5/25/36, CMO	NR/B	439,869
90	Harborview Mortgage Loan Trust, 5.033%, 7/19/35, CMO, VRN	Baa2/BBB+	64,848
4,600	JPMorgan Chase Commercial Mortgage Securities Corp., 5.44%, 6/12/47, CMO	Aaa/A+	4,318,182
2,657	JPMorgan Mortgage Trust, 5.00%, 3/25/37, CMO	NR/CCC	2,022,578
2,100	LB-UBS Commercial Mortgage Trust, 5.43%, 2/15/40, CMO, VRN	NR/A+	1,891,975
1,103	Mellon Residential Funding Corp., 0.583%, 11/15/31, CMO, FRN	Aaa/AAA	1,041,566
8,069	Morgan Stanley Capital I, 5.88%, 6/11/49, CMO, VRN	NR/BBB+	7,378,853
3,848	Suntrust Adjustable Rate Mortgage Loan Trust, 5.689%, 4/25/37, CMO, FRN	NR/CCC	3,079,786
394	WaMu Mortgage Pass Through Certificates, 5.921%, 9/25/36, CMO, VRN	NR/CCC	294,989
	Wells Fargo Mortgage Backed Securities Trust, CMO,		
6,274	5.587%, 7/25/36, FRN	NR/CCC	5,057,639
2,300	6.00%, 8/25/37	B1/NR	1,894,187
	Total Mortgage-Backed Securities (cost-\$45,446,055)		50,055,991

SENIOR LOANS (a) (c) 4.5%

Consumer Products 0.3%

1,000	National Mentor, Inc., 2.512%, 6/29/12 (b) (m) (acquisition cost-\$995,688; purchased 9/26/06)		905,000
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Diversified Manufacturing 0.7%

4,522	Grant Forest Products, 10.75%, 9/16/13 (b) (f) (m) (acquisition cost-\$4,539,385; purchased 3/16/07-7/2/09)		223,287
1,253	KION Group GmbH (b) (m), 2.481%, 12/20/14, Term B (acquisition cost-\$1,253,057; purchased 3/5/07-12/30/09)		968,613
1,253	2.731%, 12/20/15, Term C (acquisition cost-\$1,253,057; purchased 3/5/07-12/30/09)		968,613
			2,160,513

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Electronics	0.4%			
		982	Sensata Technologies, Inc., 2.728%, 4/27/13	1,209,582
Financial Services	1.3%			
		\$1,000	CIT Group, Inc., Term DD, 9.50%, 1/20/12 (e)	1,024,063
		1,000	13.00%, 1/20/12 (e)	1,024,063
		1,600	13.00%, 1/20/12 (b) (m) (acquisition cost-\$1,327,427; purchased 12/23/09)	1,638,501
				3,686,627

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PIMCO Income Strategy Fund Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
Multi-Media 1.0%			
	Seven Media Group, Term T		
AUD 660	5.73%, 12/28/12		\$533,812
AUD 2,766	6.058%, 2/7/13		2,237,058
			2,770,870
Paper/Paper Products 0.1%			
\$448	Verso Paper Holdings LLC (b) (m), 6.531%, 2/1/13 (acquisition cost-\$443,630; purchased 1/25/07-5/1/09)		229,600
41	7.281%, 2/1/13 (acquisition cost-\$40,370; purchased 1/25/07-11/03/09)		20,725
			250,325
Recreation 0.0%			
(h)	Cedar Fair L.P.,		
1	2.231%, 8/30/12		291
	4.231%, 8/30/14		1,162
			1,453
Telecommunications 0.7%			
2,589	Hawaiian Telcom Communications, Inc., 4.75%, 6/1/14, Term C (b) (f) (m) (acquisition cost-\$2,589,039; purchased 6/1/07-1/15/10)		2,174,793
			13,159,163
Total Senior Loans (cost-\$19,044,637)			
ASSET-BACKED SECURITIES 1.9%			
1,858	Asset Backed Funding Certificates, 0.451%, 5/25/37, FRN (a) (d)	Ba1/B-	1,555,071
12	Credit Suisse First Boston Mortgage Securities Corp., FRN, 0.931%, 7/25/32	Aaa/AAA	7,608
426	0.971%, 8/25/32	Aaa/AAA	313,624
1,881	Lake Country Mortgage Loan Trust, 0.691%, 12/25/32, FRN (a) (d)	Aaa/AAA	1,739,251
3,033	Popular ABS Mortgage Pass-Through Trust, 0.511%, 7/25/35, FRN	Aaa/AAA	1,926,051
			5,541,605
Total Asset-Backed Securities (cost-\$5,405,807)			
PREFERRED STOCK 0.9%			
Shares			
Financial Services 0.9%			
30	Richmond Cnty. Capital Corp., 3.501%, Ser. C, FRN (a) (b) (d) (m) (acquisition cost-\$3,068,307; purchased 3/04/04) (cost-\$3,068,307)	NR/NR	2,683,127
CONVERTIBLE PREFERRED STOCK 0.9%			
Financial Services 0.9%			
2,700	Wells Fargo & Co., 7.50%, 12/31/49, Ser. L (cost-\$1,869,885)	Ba1/A-	2,545,020

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PIMCO Income Strategy Fund Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
SHORT-TERM INVESTMENTS 15.0%			
Corporate Notes 12.8%			
Financial Services 8.4%			
\$4,800	American General Finance Corp., 0.307%, 3/2/10, FRN	B2/NR	\$4,754,640
900	4.875%, 5/15/10	B2/BB+	890,217
2,000	International Lease Finance Corp., 0.482%, 5/24/10, FRN	B1/BB+	1,960,814
1,350	4.875%, 9/1/10	B1/BB+	1,316,164
4,450	5.00%, 4/15/10	B1/BB+	4,420,901
650	5.125%, 11/1/10	B1/BB+	631,335
7,150	5.625%, 9/15/10 (l)	B1/BB+	6,969,019
3,600	SLM Corp., 0.34%, 3/15/10, FRN	Ba1/BBB-	3,589,132
			24,532,222
Insurance 4.4%			
10,000	American International Group, Inc., 0.321%, 9/27/10, FRN	A3/A-	9,522,310
1,500	4.70%, 10/1/10	A3/A-	1,494,714
1,300	Residential Reinsurance Ltd., FRN (a) (b) (d) (m), 7.506%, 6/7/10 (acquisition cost-\$1,300,000; purchased 5/16/07)	NR/BB	1,314,365
500	8.006%, 6/7/10 (acquisition cost-\$500,000; purchased 5/16/07)	NR/BB-	507,075
			12,838,464
			37,370,686
Total Corporate Notes (cost-\$35,362,992)			
U.S. Treasury Bills (j) 0.1%			
393	0.06%-0.25%, 2/18/10-3/4/10 (cost-\$392,995)		392,995
Repurchase Agreements 2.1%			
1,000	Barclays Capital, Inc., dated 1/29/10, 0.11%, due 2/1/10, proceeds \$1,000,009; collateralized by U.S. Treasury Inflation Index Notes, 3.50%, due 1/15/11, valued at \$1,029,851 including accrued interest		1,000,000
4,200	Deutsche Bank Securities, Inc., dated 1/29/10, 0.10%, due 2/1/10, proceeds \$4,200,035; collateralized by U.S. Treasury Bonds, 4.375%, due 11/15/39, valued at \$4,306,848 including accrued interest		4,200,000
918	State Street Bank & Trust Co., dated 1/29/10, 0.01%, due 2/1/10, proceeds \$918,001; collateralized by U.S. Treasury Bills, zero coupon, due 2/11/10, valued at \$940,000		918,000
			6,118,000
Total Repurchase Agreements (cost-\$6,118,000)			
Total Short-Term Investments (cost-\$41,873,987)			
Total Investments (cost-\$275,380,106) 100.0%			\$291,940,251

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PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
CORPORATE BONDS & NOTES 60.1%			
Banking 14.9%			
\$2,600	Barclays Bank PLC (i), 7.375%, 12/15/11 (a) (d)	Baa2/BBB+	\$2,483,000
3,000	7.434%, 12/15/17 (a) (d)	Baa2/BBB+	2,872,500
£8,600	14.00%, 6/15/19	Baa2/BBB+	17,535,862
\$2,000	Den Norske Bank ASA, 7.729%, 6/29/11 (a) (d) (i)	A2/BBB	1,920,628
1,400	HBOS PLC, 6.75%, 5/21/18 (a) (d)	Ba1/BBB-	1,371,262
12,175	HSBC Capital Funding L.P., 9.547%, 6/30/10 (a) (d) (i)	A3/A-	12,418,500
15,000	Rabobank Nederland NV, 11.00%, 6/30/19 (a) (d) (i)	Aa2/AA-	19,225,905
14,900	Regions Financial Corp., 0.421%, 6/26/12, FRN (l)	Baa3/BBB	13,283,246
£3,911	Royal Bank of Scotland PLC, 4.556%, 4/6/11, VRN	NR/NR	5,828,055
\$9,400	UBS Preferred Funding Trust I, 8.622%, 10/1/10 (i)	Baa3/BBB-	9,079,591
			86,018,549
Financial Services 32.8%			
8,415	AIG SunAmerica Global Financing VI, 6.30%, 5/10/11 (a) (d) (l)	A1/A+	8,425,603
8,450	American General Finance Corp., FRN, 0.504%, 12/15/11	B2/BB+	6,943,095
1,625	0.553%, 8/17/11	B2/BB+	1,382,582
£2,100	BAC Capital Trust VII, 5.25%, 8/10/35	Baa3/BB	2,338,702
\$10,100	Bank of America Corp., 8.125%, 5/15/18 (i)	Ba3/BB	9,602,070
2,900	Capital One Capital VI, 8.875%, 5/15/40	Baa2/BB	3,040,374
3,500	Chukchansi Economic Dev. Auth., 4.024%, 11/15/12, FRN (a) (d)	B3/B+	2,817,500
2,912	CIT Group, Inc., 7.00%, 5/1/13	NR/NR	2,678,951
1,068	7.00%, 5/1/14	NR/NR	959,736
1,068	7.00%, 5/1/15	NR/NR	933,039
1,780	7.00%, 5/1/16	NR/NR	1,535,046
2,491	7.00%, 5/1/17	NR/NR	2,133,493
200	Citigroup Capital XXI, 8.30%, 12/21/77, (converts to FRN on 12/21/37)	Baa3/B+	187,000
100	Citigroup, Inc., 6.50%, 8/19/13	A3/A	108,137
8,400	Ford Motor Credit Co. LLC, 3.001%, 1/13/12, FRN	B3/B-	7,948,500
7,000	7.25%, 10/25/11	B3/B-	7,088,389
3,300	7.80%, 6/1/12	B3/B-	3,347,900
3,000	GMAC, Inc., 2.456%, 12/1/14, FRN	Ca/B	2,527,500
5,500	6.00%, 12/15/11	Ca/B	5,379,990
3,000	6.75%, 12/1/14	Ca/B	2,917,584
3,575	6.875%, 9/15/11	Ca/B	3,568,712
3,375	6.875%, 8/28/12	Ca/B	3,331,331
11,000	ILFC E-Capital Trust II, 6.25%, 12/21/65, (converts to FRN on 12/21/15) (a) (b) (d) (m) (acquisition cost-\$5,582,500; purchased 9/22/09)	B3/BB	6,325,000
1,350	International Lease Finance Corp., 4.75%, 1/13/12	B1/BB+	1,191,712
1,350	5.30%, 5/1/12	B1/BB+	1,180,714

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1,350	5.35%, 3/1/12	B1/BB+	1,185,353
1,350	5.45%, 3/24/11	B1/BB+	1,273,743
4,950	5.625%, 9/20/13	B1/BB+	4,077,543
5,950	6.625%, 11/15/13	B1/BB+	4,983,012
15,900	JPMorgan Chase & Co., 7.90%, 4/30/18 (i)	Baa1/BBB+	16,339,444
2,500	Lehman Brothers Holdings, Inc., 7.50%, 5/11/38 (f)	WR/NR	750

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PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
Financial Services (continued)			
\$2,000	Mellon Capital IV, 6.244%, 6/20/12 (i)	A1/A-	\$1,760,000
22,600	National City Preferred Capital Trust I, 12.00%, 12/10/12 (i) (l)	Baa2/BBB	25,785,854
3,500	NB Capital Trust II, 7.83%, 12/15/26	Baa3/BB	3,333,750
19,350	SLM Corp., FRN, 0.479%, 10/25/11	Ba1/BBB-	17,853,471
10,000	1.967%, 9/15/15	Ba1/BBB-	7,748,500
6,750	Wells Fargo & Co., 7.98%, 3/15/18 (i)	Ba1/A-	6,851,250
9,900	Wells Fargo Capital XIII, 7.70%, 3/26/13 (i)	Ba1/A-	9,652,500
			188,737,830
Healthcare & Hospitals 1.2%			
6,700	HCA, Inc., 9.625%, 11/15/16, PIK	B2/BB-	7,118,750
Insurance 10.1%			
3,400	American International Group, Inc., 0.353%, 3/20/12, FRN (l)	A3/NR	3,013,909
12,600	0.361%, 10/18/11, FRN	A3/A-	11,475,273
2,800	0.82%, 4/26/11, FRN	A3/A-	3,640,619
\$3,200	4.95%, 3/20/12	A3/NR	3,108,563
13,600	5.45%, 5/18/17	A3/A-	10,918,189
1,450	8.175%, 5/15/68, (converts to FRN on 5/15/38)	Ba2/BBB	986,000
1,300	8.25%, 8/15/18	A3/A-	1,195,236
£2,400	8.625%, 5/22/68, (converts to FRN on 5/22/18)	Ba2/BBB	2,595,888
\$1,700	AXA S.A., 6.463%, 12/14/18 (a) (d) (i)	Baa1/BBB+	1,353,625
4,700	Hartford Financial Services Group, Inc., 8.125%, 6/15/68, (converts to FRN on 6/15/18)	Ba1/BB+	4,664,750
15,000	Metlife Capital Trust IV, 7.875%, 12/15/67, (converts to FRN on 12/15/37) (a) (d) (l)	Baa2/BBB	15,150,000
			58,102,052
Paper/Paper Products 1.1%			
7,500	Verso Paper Holdings LLC, 4.031%, 8/1/14, FRN	B2/B-	6,187,500
Telecommunications 0.0%			
8,750	Hawaiian Telcom Communications, Inc., 8.765%, 5/1/13, FRN (b) (f)	WR/NR	251,563
Total Corporate Bonds & Notes (cost-\$323,457,411)			346,416,244
MORTGAGE-BACKED SECURITIES 14.6%			
6,385	Banc of America Funding Corp., CMO, 4.485%, 2/20/36, FRN	NR/AAA	5,559,610
142	6.064%, 1/20/47, VRN	NR/CCC	101,268
1,450	Bear Stearns Commercial Mortgage Securities, 5.70%, 6/11/50, CMO	NR/AA-	1,333,496
4,506	Chase Mortgage Finance Corp., 5.422%, 3/25/37, CMO, FRN	B3/NR	3,777,326
8,226	Citigroup Commercial Mortgage Trust, 5.70%, 12/10/49, CMO, VRN	Aaa/AA	7,786,691
2,900	Citigroup/Deutsche Bank Commercial Mortgage Trust, 5.322%, 12/11/49, CMO	Aaa/A-	2,616,856
4,000	Commercial Mortgage Pass Through Certificates, CMO, 5.306%, 12/10/46	Aaa/NR	3,619,754
11,900	5.816%, 12/10/49, VRN	Aaa/A	11,323,645

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3,016	Countrywide Alternative Loan Trust, 5.75%, 12/25/36, CMO	NR/CC	2,079,885
1,900	Credit Suisse Mortgage Capital Certificates, 6.216%, 2/15/41, CMO, VRN	NR/AA	1,637,221

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PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
\$4,865	GS Mortgage Securities Corp. II, 5.56%, 11/10/39, CMO	Aaa/NR	\$4,517,420
11,987	GSR Mortgage Loan Trust, 4.551%, 11/25/35, CMO, FRN	NR/BBB+	10,451,403
5,769	JPMorgan Alternative Loan Trust, 5.894%, 5/25/36, CMO, VRN	NR/CCC	3,537,962
3,155	JPMorgan Chase Commercial Mortgage Securities Corp., 5.44%, 6/12/47, CMO	Aaa/A+	2,961,710
3,360	Morgan Stanley Capital I, CMO, VRN, 5.447%, 2/12/44	Aaa/A	3,087,114
2,800	5.88%, 6/11/49	NR/BBB+	2,560,514
92	Nomura Asset Acceptance Corp., 4.976%, 5/25/35, CMO	Baa3/B+	62,957
5,469	Residential Funding Mortgage Securities I, 6.25%, 8/25/36, CMO	B3/CCC	4,634,305
1,574	Sequoia Mortgage Trust, 0.929%, 5/20/34, CMO, FRN	A1/AAA	1,247,943
844	WaMu Mortgage Pass Through Certificates, 5.921%, 9/25/36, CMO, VRN	NR/CCC	632,119
12,759	Wells Fargo Mortgage Backed Securities Trust, 5.587%, 7/25/36, CMO, FRN	NR/CCC	10,283,247
Total Mortgage-Backed Securities (cost-\$74,473,980)			83,812,446
SENIOR LOANS (a) (c) 7.0%			
Chemicals 0.3%			
1,446	MacDermid, Inc., 2.64%, 4/12/14 (b) (m) (acquisition cost-\$1,902,195; purchased 9/12/07)		1,664,528
Consumer Products 0.5%			
\$3,000	National Mentor, Inc., 2.512%, 6/29/12 (b) (m) (acquisition cost-\$2,987,063; purchased 9/26/06)		2,715,000
Diversified Manufacturing 0.9%			
9,691	Grant Forest Products, 10.75%, 9/16/13 (b) (f) (m) (acquisition cost-\$9,727,571; purchased 3/16/07-7/2/09)		478,472
3,007	KION Group GmbH (b) (m), 2.481%, 12/20/14, Term B (acquisition cost-\$3,007,338; purchased 3/5/07-12/30/09)		2,324,672
3,007	2.731%, 12/20/15, Term C (acquisition cost-\$3,007,338; purchased 3/5/07-12/30/09)		2,324,672
Electronics 0.2%			
982	Sensata Technologies, Inc., 2.728%, 4/27/13		1,209,582
Financial Services 0.6%			
\$3,400	CIT Group, Inc., 13.00%, 1/20/12, Term DD (b) (m) (acquisition cost-\$3,526,473; purchased 12/23/09)		3,481,814
Hotels/Gaming 0.4%			
2,123	MotorCity Casino, 8.50%, 7/21/12, Term B (b) (m) (acquisition cost-\$2,011,441; purchased 10/5/09)		2,102,549
Manufacturing 0.5%			
1,586	Bombardier, Inc., Term B (b) (m), 3.02%, 6/26/13 (acquisition cost-\$1,586,111; purchased 6/26/06)		1,202,470
2,028	3.03%, 6/26/13 (acquisition cost-\$2,014,212; purchased 6/26/06-9/26/07)		1,537,336

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PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited) (continued)

	Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
Multi-Media 1.2%				
	AUD 1,706	Seven Media Group, Term T, 5.73%, 12/28/12		\$1,380,026
	AUD 7,150	6.058%, 2/7/13		5,783,304
				7,163,330
Printing/Publishing 0.9%				
	\$4,151	Tribune Co. (b) (f) (m), 5.00%, 6/4/24, Term X (acquisition cost-\$4,106,195; purchased 8/8/07-8/30/07)		2,532,194
	4,975	5.25%, 6/4/14, Term B (acquisition cost-\$3,836,238; purchased 6/24/08)		2,871,955
				5,404,149
Recreation 0.0%				
	1	Cedar Fair L.P., 2.231%, 8/30/12		676
	3	4.231%, 8/30/14		2,711
				3,387
Telecommunications 0.8%				
	5,749	Hawaiian Telcom Communications, Inc., 4.75%, 6/1/14, Term C (b) (f) (m) (acquisition cost-\$5,748,589; purchased 6/1/07-1/15/10)		4,828,814
Utilities 0.7%				
	4,950	Texas Competitive Electric Holdings Co. LLC, 3.731%, 10/10/14		4,014,428
	50	3.751%, 10/10/14		40,652
				4,055,080
				40,495,855
Total Senior Loans (cost-\$56,231,912)				
PREFERRED STOCK 2.3%				
Shares				
Automotive Products 0.0%				
	20,275	Dura Automotive Systems, Inc., 20.00% (b) (g) (k)	NR/NR	10,137
Insurance 2.3%				
	21,655	ABN AMRO North America Capital Funding Trust I, 6.968%, (converts to FRN on 9/15/10) (a) (d)	Ba3/BB	13,155,413
				13,165,550
Total Preferred Stock (cost-\$11,257,513)				
ASSET-BACKED SECURITIES 1.9%				
	Principal Amount (000s)			
	\$3,911	Asset Backed Funding Certificates, 0.451%, 5/25/37, FRN (a) (d)	Ba1/B-	3,273,834
	410	CIT Group Home Equity Loan Trust, 0.501%, 6/25/33, FRN	Aaa/AAA	330,053

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3,852	Lake Country Mortgage Loan Trust, 0.691%, 12/25/32, FRN (a) (d)	Aaa/AAA	3,561,323
6,159	Popular ABS Mortgage Pass-Through Trust, 0.511%, 7/25/35, FRN	Aaa/AAA	3,910,469
Total Asset-Backed Securities (cost-\$10,633,764)			11,075,679

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PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited) (continued)

Shares			Credit Rating (Moody s/S&P)	Value
CONVERTIBLE PREFERRED STOCK	0.5%			
Financial Services	0.5%			
	3,000	Wells Fargo & Co., 7.50%, 12/31/49, Ser. L (cost-\$2,077,650)	Bal/A-	\$2,827,800
COMMON STOCK	0.0%			
Automotive Products	0.0%			
	81,383	Dura Automotive Systems, Inc. (g) (k) (cost-\$1,317,433)		81,383
SHORT-TERM INVESTMENTS	13.6%			
	Principal Amount (000s)			
Corporate Notes	12.8%			
Financial Services	9.1%			
	\$14,200	American General Finance Corp., 0.307%, 3/2/10, FRN	B2/NR	14,065,810
	3,000	International Lease Finance Corp., 0.482%, 5/24/10, FRN	B1/BB+	2,941,221
	2,785	4.875%, 9/1/10	B1/BB+	2,715,197
	5,550	5.00%, 4/15/10	B1/BB+	5,513,709
	1,350	5.125%, 11/1/10	B1/BB+	1,311,233
	17,560	5.625%, 9/15/10 (l)	B1/BB+	17,115,521
	4,900	KeyCorp, 0.915%, 11/22/10, FRN	Baa1/BBB+	6,568,295
	\$500	Residential Capital LLC, 8.50%, 5/15/10	C/CCC+	498,750
	1,400	SLM Corp., 0.34%, 3/15/10, FRN	Bal/BBB-	1,395,774
				52,125,510
Insurance	3.7%			
	5,000	AIG Life Holdings U.S., Inc., 7.50%, 8/11/10	A3/A-	5,106,245
	10,000	American International Group, Inc., 0.321%, 9/27/10, FRN	A3/A-	9,522,310
	2,500	4.70%, 10/1/10	A3/A-	2,491,190
	3,000	Residential Reinsurance Ltd., FRN (a) (b) (d) (m), 7.506%, 6/7/10 (acquisition cost-\$3,000,000; purchased 5/16/07)	NR/BB	3,033,150
	1,200	8.006%, 6/7/10 (acquisition cost-\$1,200,000; purchased 5/16/07)	NR/BB-	1,216,980
				21,369,875
Total Corporate Notes (cost-\$70,368,322)				73,495,385
U.S. Treasury Bill (j)	0.0%			
	210	0.245%, 2/18/10 (cost-\$209,998)		209,998
Repurchase Agreements	0.8%			
	3,000	Barclays Capital, Inc., dated 1/29/10, 0.11%, due 2/1/10, proceeds \$3,000,027; collateralized by U.S. Treasury Inflation Index Notes, 3.50%, due 1/15/11, valued at \$3,088,256 including accrued interest		3,000,000

PIMCO Income Strategy Fund II Schedule of Investments

January 31, 2010 (unaudited) (continued)

Principal Amount (000s)		Value
Repurchase Agreements (continued)		
\$1,430	State Street Bank & Trust Co., dated 1/29/10, 0.01%, due 2/1/10, proceeds \$1,430,001; collateralized by U.S. Treasury Bills, zero coupon, due 2/11/10, valued at \$1,460,000	\$1,430,000
Total Repurchase Agreements (cost-\$4,430,000)		4,430,000
Total Short-Term Investments (cost-\$75,008,320)		78,135,383
Total Investments (cost-\$554,457,983) 100.0%		\$576,010,340

Notes to Schedules of Investments:

- (a) Private Placement Restricted as to resale and may not have a readily available market. Securities with an aggregate value of \$57,153,890 and \$139,100,078, representing 19.6% and 24.1% of total investments in Income Strategy and Income Strategy II, respectively.
- (b) Illiquid.
- (c) These securities generally pay interest at rates which are periodically pre-determined by reference to a base lending rate plus a premium. These base lending rates are generally either the lending rate offered by one or more major European banks, such as the LIBOR or the prime rate offered by one or more major United States banks, or the certificate of deposit rate. These securities are generally considered to be restricted as the Funds are ordinarily contractually obligated to receive approval from the Agent bank and/or borrower prior to disposition. Remaining maturities of senior loans may be less than the stated maturities shown as a result of contractual or optional payments by the borrower. Such prepayments cannot be predicted with certainty. The interest rate disclosed reflects the rate in effect on January 31, 2010.
- (d) 144A Exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, typically only to qualified institutional buyers. Unless otherwise indicated, these securities are not considered to be illiquid.
- (e) When-issued or delayed-delivery. To be settled/delivered after January 31, 2010.
- (f) In default.
- (g) Fair-Valued Securities with an aggregate value of \$91,520, representing less than 0.1% of total investments in Income Strategy II. See Note 1(a) in the Notes to Financial Statements.
- (h) Principal amount less than \$500.
- (i) Perpetual maturity. Maturity date shown is the first call date. Interest rate is fixed until the first call date and variable thereafter.
- (j) All or partial amount segregated as collateral for swaps.
- (k) Non-income producing.
- (l) All or partial amount segregated as collateral for reverse repurchase agreements.
- (m) Restricted. The aggregate acquisition cost of such securities is \$20,783,710 and \$53,243,264 for Income Strategy and Income Strategy II, respectively. The aggregate market value of \$15,623,699 and \$38,639,606 is approximately 5.4% and 6.7% of total investments in Income Strategy and Income Strategy II, respectively.

Glossary:

AUD	-	Australian Dollar
£	-	British Pound
CMO	-	Collateralized Mortgage Obligation
	-	Euro
FRN	-	Floating Rate Note. The interest rate disclosed reflects the rate in effect on January 31, 2010.
LIBOR	-	London Inter-Bank Offered Rate
NR	-	Not Rated
PIK	-	Payment-in-Kind
VRN	-	Variable Rate Note. Instruments whose interest rates change on specified date (such as a coupon date or interest payment date) and/or whose interest rates vary with changes in a designated base rate (such as the prime interest rate).

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WR - The interest rate disclosed reflects the rate in effect on January 31, 2010.
Withdrawn Rating

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PIMCO Income Strategy/PIMCO Income Strategy II Funds
Statements of Assets and Liabilities

January 31, 2010 (unaudited)

	Income Strategy	Income Strategy II
Assets:		
Investments, at value (cost-\$275,380,106 and \$554,457,983, respectively)	\$291,940,251	\$576,010,340
Cash (including foreign currency of \$0 and \$133,032 with a cost of \$0 and \$136,296, respectively)		133,303
Receivable for investments sold	15,207,424	45,044,816
Interest receivable	3,563,025	6,973,637
Unrealized appreciation of swaps	1,992,265	3,210,113
Deposits with brokers for futures contracts collateral	605,000	1,174,000
Unrealized appreciation of forward foreign currency contracts	347,627	1,093,594
Swap premiums paid	173,374	358,256
Prepaid expenses and other assets	35,929	25,306
Total Assets	313,864,895	634,023,365
Liabilities:		
Payable for reverse repurchase agreements	31,741,714	63,763,000
Payable for investments purchased	6,050,006	6,305,953
Payable to custodian for cash overdraft (including foreign currency due of \$2,243,621 and \$0 with a cost of \$2,262,181 and \$0, respectively)	2,237,487	
Swap premiums received	1,283,834	2,534,477
Dividends payable to common and preferred shareholders	1,156,723	2,532,748
Payable to brokers for cash collateral received	1,060,000	1,690,000
Investment management fees payable	185,462	370,454
Unrealized depreciation of forward foreign currency contracts	64,345	25,923
Unrealized depreciation of unfunded loan commitments	50,000	100,000
Payable for variation margin on futures contracts	16,667	65,497
Interest payable for reverse repurchase agreements	8,089	12,022
Unrealized depreciation of swaps	835	23,614
Accrued expenses and other liabilities	173,994	234,179
Total Liabilities	44,029,156	77,657,867
Preferred shares (\$0.00001 par value and \$25,000 liquidation preference per share applicable to an aggregate of 3,159 and 6,440 shares issued and outstanding, respectively)	78,975,000	161,000,000
Net Assets Applicable to Common Shareholders	\$190,860,739	\$395,365,498
Composition of Net Assets Applicable to Common Shareholders:		
Common Stock:		
Par value (\$0.00001 per share)	\$185	\$432
Paid-in-capital in excess of par	351,948,980	811,777,121
Undistributed net investment income	435,290	1,466,573
Accumulated net realized loss	(180,601,433)	(443,334,260)
Net unrealized appreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	19,077,717	25,455,632
Net Assets Applicable to Common Shareholders	\$190,860,739	\$395,365,498
Common Shares Issued and Outstanding	18,468,169	43,244,052
Net Asset Value Per Common Share	\$10.33	\$9.14

See accompanying Notes to Financial Statements. | 1.31.10 | PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Semi-Annual Report 15

PIMCO Income Strategy/PIMCO Income Strategy II Funds
Statements of Operations

Six Months ended January 31, 2010 (unaudited)

	Income Strategy	Income Strategy II
Investment Income:		
Interest	\$14,860,284	\$27,979,176
Dividends	149,315	869,027
Facility and other fee income	78,158	4,314
Total Investment Income	15,087,757	28,852,517
Expenses:		
Investment management fees	1,079,865	2,169,888
Custodian and accounting agent fees	89,356	117,732
Audit and tax services	74,768	75,204
Auction agent fees and commissions	67,137	131,654
Interest expense	61,221	87,566
Legal fees	49,476	82,556
Shareholder communications	39,684	81,154
Transfer agent fees	16,988	16,935
Trustees' fees and expenses	13,828	28,783
New York Stock Exchange listing fees	10,775	17,154
Insurance expense	4,567	8,935
Miscellaneous	4,730	4,619
Total expenses	1,512,395	2,822,180
Net Investment Income	13,575,362	26,030,337
Realized and Change in Unrealized Gain (Loss):		
Net realized gain (loss) on:		
Investments	4,685,630	160,753
Futures contracts	468,967	1,580,672
Swaps	2,338,791	6,013,060
Foreign currency transactions	37,094	(88,412)
Net change in unrealized appreciation/depreciation of:		
Investments	32,195,750	70,934,852
Futures contracts	429,650	248,650
Swaps	385,249	158,845
Unfunded loan commitments	129,166	258,332
Foreign currency transactions	57,750	1,080,603
Net realized and change in unrealized gain on investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	40,728,047	80,347,355
Net Increase in Net Assets Resulting from Investment Operations	54,303,409	106,377,692
Dividends on Preferred Shares from Net Investment Operations	(589,144)	(1,201,124)
Net Increase in Net Assets Applicable to Common Shareholders Resulting from Investment Operations	\$53,714,265	\$105,176,568

PIMCO Income Strategy Fund
Statements of Changes in Net Assets Applicable to Common Shareholders

	Six Months ended January 31, 2010 (unaudited)	Year ended July 31, 2009
Investment Operations:		
Net investment income	\$13,575,362	\$28,081,101
Net realized gain (loss) on investments, futures contracts, swaps and foreign currency transactions	7,530,482	(125,066,080)
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	33,197,565	18,780,180
Net increase (decrease) in net assets resulting from investment operations	54,303,409	(78,204,799)
Dividends on Preferred Shares from Net Investment Income		
Net increase (decrease) in net assets applicable to common shareholders resulting from investment operations	(589,144)	(3,784,254)
Dividends to Common Shareholders from Net Investment Income		
	(30,661,127)	(21,508,007)
Capital Share Transactions:		
Reinvestment of dividends	1,825,916	338,301
Total increase (decrease) in net assets applicable to common shareholders	24,879,054	(103,158,759)
Net Assets Applicable to Common Shareholders:		
Beginning of period	165,981,685	269,140,444
End of period (including undistributed net investment income of \$435,290 and \$18,110,199, respectively)	\$190,860,739	\$165,981,685
Common Shares Issued in Reinvestment of Dividends		
	160,413	41,974

See accompanying Notes to Financial Statements. | 1.31.10 | PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Semi-Annual Report 17

PIMCO Income Strategy Fund II**Statements of Changes in Net Assets Applicable to Common Shareholders** (continued)

	Six Months ended January 31, 2010 (unaudited)	Year ended July 31, 2009
Investment Operations:		
Net investment income	\$26,030,337	\$61,443,492
Net realized gain (loss) on investments, futures contracts, swaps and foreign currency transactions	7,666,073	(310,163,613)
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	72,681,282	36,741,535
Net increase (decrease) in net assets resulting from investment operations	106,377,692	(211,978,586)
Dividends on Preferred Shares from Net Investment Income		
Net increase (decrease) in net assets applicable to common shareholders resulting from investment operations	(1,201,124)	(8,434,704)
	105,176,568	(220,413,290)
Dividends to Common Shareholders from Net Investment Income		
	(55,262,454)	(43,472,525)
Capital Share Transactions:		
Reinvestment of dividends	3,502,120	1,203,410
Total increase (decrease) in net assets applicable to common shareholders	53,416,234	(262,682,405)
Net Assets Applicable to Common Shareholders:		
Beginning of period	341,949,264	604,631,669
End of period (including undistributed net investment income of \$1,466,573 and \$31,899,814, respectively)	\$395,365,498	\$341,949,264
Common Shares Issued in Reinvestment of Dividends		
	368,787	176,606

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PIMCO Income Strategy/PIMCO Income Strategy II Funds
Statements of Cash Flows

Six Months ended January 31, 2010 (unaudited)

	Income Strategy	Income Strategy II
Decrease in Cash from:		
Cash Flows provided by Operating Activities:		
Net increase in net assets resulting from investment operations	\$54,303,409	\$106,377,692
Adjustments to Reconcile Net Increase in Net Assets Resulting from Investment Operations to Net Cash provided by (used for) Operating Activities:		
Purchases of long-term investments	(106,780,505)	(220,393,141)
Proceeds from sales of long-term investments	122,903,878	234,946,159
Purchases (Sales) of short-term portfolio investments, net	(5,148,278)	7,717,737
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	(33,197,565)	(72,681,282)
Net realized gain on investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	(7,530,482)	(7,666,073)
Net amortization on investments	(7,536,318)	(13,486,466)
Increase in receivable for investments sold	(9,243,898)	(31,604,994)
Increase in interest receivable	(877,570)	(1,470,056)
Proceeds from futures contracts transactions	915,284	1,894,819
Increase in deposits with brokers for futures contracts collateral	(605,000)	(1,174,000)
Decrease in receivable from broker		94,272
(Increase) decrease in prepaid expenses and other assets	(18,900)	3,832
Decrease in payable for investments purchased	(1,806,870)	(17,819,298)
Increase in payable to brokers for cash collateral received	1,060,000	1,120,000
Decrease in payable to broker	(138,890)	
Periodic payments of swaps, net	1,395,501	4,061,531
Net cash provided by currency transactions	(396,132)	(604,112)
Increase in investment management fees payable	32,586	58,449
Increase in interest payable for reverse repurchase agreements	6,499	11,990
Decrease in accrued expenses and other liabilities	(72,620)	(55,414)
Net cash provided by (used for) operating activities	7,264,129	(10,668,355)
Cash Flows provided by (used for) Financing Activities:		
Increase in payable for reverse repurchase agreements	19,636,964	63,321,000
Cash dividends paid (excluding reinvestment of dividends of \$1,825,916 and \$3,502,120, respectively)	(29,476,257)	(53,085,118)
Increase in payable to custodian for cash overdraft	2,237,487	
Net cash provided by (used for) financing activities	(7,601,806)	10,235,882
Net decrease in cash	(337,677)	(432,473)
Cash at beginning of period	337,677	565,776
Cash at end of period	\$	\$133,303

Income Strategy and Income Strategy II paid \$54,303 and \$74,910, respectively, in cash for interest on reverse repurchase agreements.

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See accompanying Notes to Financial Statements. | 1.31.10 | PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Semi-Annual Report 19

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II
Notes to Financial Statements**

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies

PIMCO Income Strategy Fund (Income Strategy) and PIMCO Income Strategy Fund II (Income Strategy II), formerly known as PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund, respectively, collectively referred to as the Funds , were organized as Massachusetts business trusts on June 19, 2003 and June 30, 2004, respectively. Prior to commencing operations on August 29, 2003 and October 29, 2004, respectively, Income Strategy and Income Strategy II had no operations other than matters relating to their organization and registration as diversified, closed-end management investment companies registered under the Investment Company Act of 1940 and the rules and regulations there under, as amended. Allianz Global Investors Fund Management LLC (the Investment Manager), serves as the Funds Investment Manager and is an indirect, wholly-owned subsidiary of Allianz Global Investors of America L.P. (Allianz Global). Allianz Global is an indirect, wholly-owned subsidiary of Allianz SE, a publicly traded European insurance and financial services company. The Funds have an unlimited amount of \$0.00001 par value of common stock authorized.

Each Fund s investment objective is to seek high current income, consistent with the preservation of capital.

Effective March 1, 2010, each Fund changed its name and rescinded its non-fundamental investment policy to, under normal market conditions, invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments. Following these changes, each Fund will seek to achieve its investment objective by ordinarily investing in a diversified portfolio of floating and/or fixed-rate debt instruments. The ability of the issuers of the Funds investments to meet their obligations may be affected by economic developments in a specific industry.

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the Funds financial statements. Actual results could differ from those estimated.

In the normal course of business, the Funds enter into contracts that contain a variety of representations that provide general indemnifications. The Funds maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Funds that have not yet occurred.

The following is a summary of significant accounting policies consistently followed by the Funds:

(a) Valuation of Investments

Portfolio securities and other financial instruments for which market quotations are readily available are stated at market value. Market value is generally determined on the basis of last reported sales prices, or if no sales are reported, on the basis of quotes obtained from a quotation reporting system, established market makers, or independent pricing services.

Portfolio securities and other financial instruments for which market quotations are not readily available or for which a development/event occurs that may significantly impact the value of a security, are fair-valued, in good faith, pursuant to procedures established by the Board of Trustees, or persons acting at their discretion pursuant to procedures established by the Board of Trustees. The Funds' investments are valued daily using prices supplied by an independent pricing service or dealer quotations, or by using the last sale price on the exchange that is the primary market for such securities, or the mean between the last quoted bid and ask price for those securities for which the over-the-counter market is the primary market or for listed securities in which there were no sales. Independent pricing services use information provided by market makers or estimates of market values obtained from yield data relating to investments or securities with similar characteristics. Securities purchased on a when-issued or delayed-delivery basis are marked to market daily until settlement at the forward settlement date. Exchange-traded futures and options on futures are valued at the settlement price determined by the relevant exchange. Short-term securities maturing in 60 days or less are valued at amortized cost, if their original term to maturity was 60 days or less, or by amortizing their value on the 61st day prior to maturity, if the original term to maturity exceeded 60 days. Investments initially valued in currencies other than U.S. dollar are converted to the U.S. dollar using exchange rates obtained from pricing services. As a result, the net asset value (NAV) of each Fund's shares may be affected by changes in the value of currencies in relation to the U.S. dollar. The value of securities traded in markets outside the United States or denominated in currencies other than the U.S. dollar may be affected significantly on a day that the New York Stock Exchange (NYSE) is closed.

PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II
Notes to Financial Statements

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies (continued)

The prices used by the Funds to value securities may differ from the value that would be realized if the securities were sold and these differences could be material to the Funds' financial statements. Each Fund's NAV is normally determined as of the close of regular trading (normally, 4:00 p.m. Eastern time) on the NYSE on each day the NYSE is open for business.

(b) Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (*i.e.* the exit price) in an orderly transaction between market participants. The three levels of the fair value hierarchy are described below:

- Level 1 – quoted prices in active markets for identical investments that the Funds have the ability to access
- Level 2 – valuations based on other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.) or quotes from inactive exchanges
- Level 3 – valuations based on significant unobservable inputs (including the Funds' own assumptions in determining the fair value of investments)

An investment asset's or liability's level within the fair value hierarchy is based on the lowest level input, individually or in aggregate, that is significant to fair value measurement. The objective of fair value measurement remains the same even when there is a significant decrease in the volume and level of activity for an asset or liability and regardless of the valuation technique used.

The valuation techniques used by the Funds to measure fair value during the six months ended January 31, 2010 maximized the use of observable inputs and minimized the use of unobservable inputs. When fair-valuing securities, the Funds utilized multi-dimensional relational pricing model.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

A summary of the inputs used at January 31, 2010 in valuing each Fund's assets and liabilities is listed below:

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Income Strategy:

	Level 1 Quoted Prices	Level 2 Other Significant Observable Inputs	Level 3 Significant Unobservable Inputs	Value at 1/31/2010
Investments in Securities Assets				
Corporate Bonds & Notes:				
Insurance	\$2,282,750	\$26,509,399		\$28,792,149
All Other		145,281,515		145,281,515
Mortgaged-Backed Securities		50,055,991		50,055,991
Senior Loans		13,159,163		13,159,163
Asset-Backed Securities		5,541,605		5,541,605
Preferred Stock		2,683,127		2,683,127
Convertible Preferred Stock	2,545,020			2,545,020
Short-Term Investments		43,881,681		43,881,681
Total Investments in Securities Assets	\$4,827,770	\$287,112,481		\$291,940,251
Other Financial Instruments*	\$429,650	\$2,274,712		\$2,704,362
Total Investments	\$5,257,420	\$289,387,193		\$294,644,613

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PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II
Notes to Financial Statements

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies (continued)

Income Strategy II:

	Level 1 Quoted Prices	Level 2 Other Significant Observable Inputs	Level 3 Significant Unobservable Inputs	Value at 1/31/2010
Investments in Securities Assets				
Corporate Bonds & Notes:				
Insurance	\$4,664,750	\$53,437,302		\$58,102,052
All Other		288,314,192		288,314,192
Mortgaged-Backed Securities		83,812,446		83,812,446
Senior Loans		40,495,855		40,495,855
Preferred Stock:				
Automotive Products			\$10,137	10,137
Insurance		13,155,413		13,155,413
Asset-Backed Securities		11,075,679		11,075,679
Convertible Preferred Stock	2,827,800			2,827,800
Common Stock			81,383	81,383
Short-Term Investments		78,135,383		78,135,383
Total Investments in Securities Assets	\$7,492,550	\$568,426,270	\$91,520	\$576,010,340
Other Financial Instruments*	\$248,650	\$4,254,170		\$4,502,820
Total Investments	\$7,741,200	\$572,680,440	\$91,520	\$580,513,160

A roll forward of fair value measurements using significant unobservable inputs (Level 3) for the six months ended January 31, 2010, was as follows:

Income Strategy:

Beginning Balance 7/31/2009	Net Purchases (Sales) and Settlements	Accrued Discounts (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers in and/or out of Level 3	Ending Balance 1/31/2010

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Investments in Securities

Assets

Corporate

Bonds & Notes:

Insurance	\$6,810,437	\$1,114,628	\$1,597,245	\$(9,522,310)
Preferred Stock	1,191,803		1,491,324	(2,683,127)
Short-Term Investments	1,727,600		93,840	(1,821,440)

Total Investments in

Securities Assets	\$9,729,840	\$1,114,628	\$3,182,409	\$(14,026,877)
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Other Financial Instruments*	\$69,735		\$36,724	\$(106,459)
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Total Investments	\$9,799,575	\$1,114,628	\$3,219,133	\$(14,133,336)
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PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II
Notes to Financial Statements

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies (continued)

Income Strategy II:

	Beginning Balance 7/31/2009	Net Sales	Accrued Discounts (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers in and/or out of Level 3	Ending Balance 1/31/2010
Investments in Securities							
Assets							
Corporate							
Bonds & Notes:							
Insurance	\$6,810,437		\$1,114,628		\$1,597,245	\$(9,522,310)	
Preferred Stock:							
Automotive Products	10,137						\$10,137
Common Stock	81,383						81,383
Short-Term Investments	4,030,860				219,270	(4,250,130)	
Total Investments in Securities Assets	\$10,932,817		\$1,114,628		\$1,816,515	\$(13,772,440)	\$91,520
Other Financial Instruments*	\$48,716	\$21,019			\$36,724	\$(106,459)	
Total Investments	\$10,981,533	\$21,019	\$1,114,628		\$1,853,239	\$(13,878,899)	\$91,520

* Other Financial Instruments are derivative instruments not reflected in the Schedules of Investments, such as futures contracts, swap agreements and forward foreign currency contracts, which are valued at the unrealized appreciation (depreciation) of the instrument.

There was no net change in unrealized appreciation/depreciation of investments which the Funds held at January 31, 2010. Net realized gain (loss) and net change in unrealized appreciation/depreciation are reflected on the Statements of Operations.

In January 2010, the Financial Accounting Standards Board released ASU 2010-06, Improving Disclosures about Fair Value Measurements. ASU 2010-06 is effective for annual and interim reporting periods beginning after December 15, 2009. At this time Funds' management is in the process of reviewing ASU 2010-06 to determine future applicability.

(c) Investment Transactions and Investment Income

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Investment transactions are accounted for on the trade date. Securities purchased and sold on a when-issued or delayed-delivery basis may be settled a month or more after the trade date. Realized gains and losses on investments are determined on an identified cost basis. Interest income adjusted for the accretion of discount and amortization of premium is recorded on an accrual basis. Dividend income is recorded on the ex-dividend date. Facility fees and other fees (such as origination fees) received by the Funds are amortized as income over the expected term of the loan. Commitment fees received by the Funds relating to unfunded purchase commitments are recorded as other fee income upon receipt. Paydown gains and losses are netted and recorded as interest income on the Statements of Operations.

(d) Federal Income Taxes

The Funds intend to distribute all of their taxable income and to comply with the other requirements of the U.S. Internal Revenue Code of 1986, as amended, applicable to regulated investment companies. Accordingly, no provision for U.S. federal income taxes is required.

Accounting for uncertainty in income taxes establishes for all entities, including pass-through entities such as the Funds, a minimum threshold for financial statement recognition of the benefit of positions taken in filing tax returns (including whether an entity is taxable in a particular jurisdiction), and requires certain expanded tax disclosures. The Funds' management has determined that its evaluation has resulted in no material impact to the Funds' financial statements at January 31, 2010. The Funds' federal tax returns for the prior three fiscal years remain subject to examination by the Internal Revenue Service.

PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II

Notes to Financial Statements

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies (continued)

(e) Dividends and Distributions – Common Stock

The Funds declare dividends from net investment income monthly to common shareholders. Distributions of net realized capital gains, if any, are paid at least annually. The Funds record dividends and distributions to their shareholders on the ex-dividend date. The amount of dividends and distributions from net investment income and net realized capital gains are determined in accordance with federal income tax regulations, which may differ from generally accepted accounting principles. These book-tax differences are considered either temporary or permanent in nature. To the extent these differences are permanent in nature, such amounts are reclassified within the capital accounts based on their federal income tax treatment. Temporary differences do not require reclassification. To the extent dividends and/or distributions exceed current and accumulated earnings and profits for federal income tax purposes, they are reported as dividends and/or distributions of paid-in-capital in excess of par.

(f) Foreign Currency Translation

The Funds' accounting records are maintained in U.S. dollars as follows: (1) the foreign currency market value of investments and other assets and liabilities denominated in foreign currency are translated at the prevailing exchange rate at the end of the period; and (2) purchases and sales, income and expenses are translated at the prevailing exchange rate on the respective dates of such transactions. The resulting net foreign currency gain (loss) is included in the Statements of Operations for the Funds.

The Funds do not generally isolate that portion of the results of operations arising as a result of changes in the foreign currency exchange rates from the fluctuations arising from changes in the market prices of securities. Accordingly, such foreign currency gain (loss) is included in net realized and unrealized gain (loss) on investments. However, the Funds do isolate the effect of fluctuations in foreign currency exchange rates when determining the gain (loss) upon the sale or maturity of foreign currency denominated debt obligations pursuant to U.S. federal income tax regulations; such amount is categorized as foreign currency gain (loss) for both financial reporting and income tax reporting purposes.

(g) Senior Loans

The Funds purchase assignments of, and participations in, Senior Loans originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution (the Agent) for a lending syndicate of financial institutions (the Lender). When purchasing an assignment, the Funds succeed to all the rights and obligations under the loan agreement with the same rights and obligations as the assigning Lender. Assignments may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning Lender.

(h) Repurchase Agreements

The Funds enter into transactions with its custodian bank or securities brokerage firms whereby it purchases securities under agreements to resell such securities at an agreed upon price and date (repurchase agreements). The Funds, through their custodian, take possession of securities collateralizing the repurchase agreement. Such agreements are carried at the contract amount in the financial statements, which is considered to

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represent fair-value. Collateral pledged (the securities received), which consists primarily of U.S. government obligations and asset-backed securities, are held by the custodian bank until maturity of the repurchase agreement. Provisions of the repurchase agreements and the procedures adopted by the Funds require that the market value of the collateral, including accrued interest thereon, be sufficient in the event of default by the counterparty. If the counterparty defaults and the value of the collateral declines or if the counterparty enters an insolvency proceeding, realization of the collateral by the Funds may be delayed or limited.

(i) Reverse Repurchase Agreements

In a reverse repurchase agreement, the Funds sell securities to a bank or broker-dealer and agree to repurchase the securities at a mutually agreed upon date and price. Generally, the effect of such a transaction is that the Funds can recover and reinvest all or most of the cash invested in portfolio securities involved during the term of the reverse repurchase agreement and still be entitled to the returns associated with those portfolio securities. Such transactions are advantageous if the interest cost to the Funds of the reverse repurchase transaction is less than the returns it obtains on investments purchased with the cash. Unless the Funds cover their positions in reverse repurchase agreements (by segregating liquid assets at least equal in amount to the forward purchase commitment), their obligations under the agreements will be subject to the Funds' limitations on borrowings. Reverse repurchase agreements involve leverage risk and also the risk that the market value of the securities that the Funds are obligated to repurchase under the agreement may decline below the repurchase price. In the event the buyer of securities under

PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II

Notes to Financial Statements

January 31, 2010 (unaudited)

1. Organization and Significant Accounting Policies (continued)

a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Funds' use of the proceeds of the agreement may be restricted pending determination by the other party, or its trustee or receiver, whether to enforce the Funds' obligation to repurchase the securities.

(j) When-Issued/Delayed-Delivery Transactions

When-issued or delayed-delivery transactions involve a commitment to purchase or sell securities for a predetermined price or yield, with payment and delivery taking place beyond the customary settlement period. When delayed-delivery purchases are outstanding, the Funds will set aside and maintain until the settlement date in a designated account, liquid assets in an amount sufficient to meet the purchase price. When purchasing a security on a delayed-delivery basis, the Funds assume the rights and risks of ownership of the security, including the risk of price and yield fluctuations; consequently, such fluctuations are taken into account when determining the net asset value. The Funds may dispose of or renegotiate a delayed-delivery transaction after it is entered into, and may sell when-issued securities before they are delivered, which may result in a realized gain or loss. When a security is sold on a delayed-delivery basis, the Funds do not participate in future gains and losses with respect to the security.

(k) Mortgage-Related and Other Asset-Backed Securities

Investments in mortgage-related or other asset-backed securities include mortgage pass-through securities, collateralized mortgage obligations (CMOs), commercial mortgage-backed securities, mortgage dollar rolls, CMO residuals, stripped mortgage-backed securities (SMBSs) and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property. The value of some mortgage-related or asset backed securities may be particularly sensitive to changes in prevailing interest rates. Early repayment of principal on some mortgage-related securities may expose the Funds to a lower rate of return upon reinvestment of principal. The value of these securities may fluctuate in response to the market's perception of the creditworthiness of the issuers. The decline in liquidity and prices of these types of securities may have made it more difficult to determine fair market value. Additionally, although mortgages and mortgage related securities are generally supported by some form of government or private guarantee and/or insurance, there is no assurance that private guarantors or insurers will meet their obligations.

(l) Interest Expense

Interest expense relates primarily to the Funds' liability in connection with reverse repurchase agreements. Interest expense is recorded as it is incurred.

(m) Custody Credits on Cash Balances

The Funds benefit from an expense offset arrangement with their custodian bank, whereby uninvested cash balances earn credits which reduce monthly custodian and accounting agent expenses. Had these cash balances been invested in income-producing securities, they would have generated income for the Funds.

2. Principal Risk

In the normal course of business, the Funds trade financial instruments and enter into financial transactions where risk of potential loss exists due to, among other things, changes in the market (market risk) or failure of the other party to a transaction to perform (credit/counterparty risk). The Funds are exposed to various risks such as, but not limited to, interest rate, foreign currency and credit/counterparty risks.

Interest rate risk is the risk that fixed income securities will decline in value because of changes in interest rates. As nominal interest rates rise, the value of certain fixed income securities held by the Funds is likely to decrease. A nominal interest rate can be described as the sum of a real interest rate and an expected inflation rate. Fixed income securities with longer durations tend to be more sensitive to changes in interest rates, usually making them more volatile than securities with shorter durations. Duration is used primarily as a measure of the sensitivity of a fixed income security's market price to interest rate (*i.e.* yield) movements.

If the Funds invest directly in foreign currencies or in securities that trade in, and receive revenues in, foreign currencies, or in derivatives that provide exposure to foreign currencies, it will be subject to the risk that those currencies will decline in value relative to the U.S. dollar, or, in the case of hedging positions, that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including changes in interest rates, intervention (or the failure to intervene) by U.S. or foreign governments, central banks or supranational entities such as the International Monetary Fund, or by the imposition of currency controls or other political developments in the United States or abroad. As a result, the Funds' investments in foreign currency-denominated securities may reduce the returns of the Fund.

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2. Principal Risk (continued)

The Funds are subjected to elements of risk not typically associated with investments in the U.S., due to concentrated investments in specific industries or investments in foreign issuers located in a specific country or region. Such concentrations will subject the Funds to additional risks resulting from future political or economic conditions in such country or region and the possible imposition of adverse governmental laws of currency exchange restrictions affecting such country or region, which could cause the securities and their markets to be less liquid and prices more volatile than those of comparable U.S. companies.

The Funds are exposed to credit risk on parties with whom it trades and will also bear the risk of settlement default. The Funds seek to minimize concentrations of credit risk by undertaking transactions with a large number of customers and counterparties on recognized and reputable exchanges. The Funds could lose money if the issuer or guarantor of a fixed income security, or the counterparty to a derivatives contract, repurchase agreement or a loan of portfolio securities, is unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in credit ratings.

Similar to credit risk, the Funds are exposed to counterparty risk, or the risk that an institution or other entity with which the Funds have unsettled or open transactions will default. The potential loss to the Funds could exceed the value of the financial assets recorded in the Funds financial statements. Financial assets, which potentially expose the Funds to counterparty risk, consist principally of cash due from counterparties and investments. The Funds' sub-adviser, Pacific Investment Management Company LLC (the Sub-Adviser), an affiliate of the Investment Manager, seeks to minimize the Funds' counterparty risk by performing reviews of each counterparty. Generally, all delivery of securities sold is only made once the Funds have received payment. Payment is made on a purchase once the securities have been delivered by the counterparty. The trade will fail if either party fails to meet its obligation.

The Funds are party to International Swaps and Derivatives Association, Inc. Master Agreements (ISDA Master Agreements) with select counterparties that govern transactions, over-the-counter derivative and foreign exchange contracts, entered into by the Funds and those counterparties. The ISDA Master Agreements contain provisions for general obligations, representations, agreements, collateral and events of default or termination. Events of termination include conditions that may entitle counterparties to elect to terminate early and cause settlement of all outstanding transactions under the applicable ISDA Master Agreement. Any election to terminate early could be material to the financial statements of the Funds.

The considerations and factors surrounding the settlement of certain purchases and sales made on a delayed-delivery basis are governed by Master Securities Forward Transaction Agreements (Master Forward Agreements) between the Funds and select counterparties. The Master Forward Agreements maintain provisions for, among other things, initiation and confirmation, payment and transfer, events of default, termination, and maintenance of collateral.

The Funds are also a party to Master Repurchase Agreements (Master Repo Agreements) with select counterparties. The Master Repo Agreements maintain provision for, initiation, income payments, events of default, and maintenance of collateral.

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The credit risk associated with certain contracts may be reduced by master netting arrangements to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Funds' overall exposure to credit risk with respect to transactions subject to master netting arrangements can change substantially within a short period, as it is affected by each transaction subject to the arrangement.

On September 15, 2008, Lehman Brothers Holdings Inc. filed for protection under Chapter 11 of the United States Bankruptcy Code. On September 19, 2008, a proceeding under the Securities Investor Protection Act (SIPA) was commenced with respect to Lehman Brothers Inc., a broker-dealer. A trustee appointed under SIPA is administering the bankruptcy estate of Lehman Brothers Inc. Lehman Brothers International (Europe) was placed in administration under the UK Insolvency Act on September 15, 2008. Lehman Brothers Special Financing Inc. (LBSF) filed for protection under Chapter 11 of the United States Bankruptcy Code on October 3, 2008. In connection with these filings, the Lehman Brothers group of companies (collectively Lehman Brothers) will be reorganized and/or liquidated in an orderly fashion, subject to court approval. Each Lehman Brothers entity is a separate legal entity that is subject to its own bankruptcy proceeding.

The Funds had credit default swap agreements outstanding with LBSF entities as counterparty at the time the relevant Lehman Brothers entity filed for protection or was placed in administration. The credit default swap agreements associated with LBSF as counterparty were written down to their estimated recoverable values. A facilitated auction occurred on October 10, 2008 comprising multiple pre-approved brokerage agencies to determine the estimated

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Notes to Financial Statements

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2. Principal Risk (continued)

recovery rate for holdings and credit default swap agreements with Lehman Brothers Holdings Inc. as the referenced entity. These recovery rates, as well as the value of Senior Lehman bonds, were utilized in determining estimated recovery values for certain holdings. On September 23, 2009, LBSF returned all cash collateral to the Funds and the Funds paid all outstanding liabilities owed to LBSF. Losses for derivatives transactions associated with LBSF have been incorporated as net realized loss on the Statements of Operations of the Funds.

3. Financial Derivative Instruments

Disclosure about derivative instruments and hedging activities require qualitative disclosure regarding objectives and strategies for using derivatives, quantitative disclosure about fair value amounts of gains and losses on derivative instruments, and disclosure about credit-risk-related contingent features in derivative agreements. The disclosure requirements distinguish between derivatives which are accounted for as hedges and those that do not qualify for such accounting. Although the Funds sometimes use derivatives for hedging purposes, the Funds reflect derivatives at fair value and recognize changes in fair value through the Funds' Statements of Operations, and such derivatives do not qualify for hedge accounting treatment. Derivative notional amounts and values as of January 31, 2010, which are disclosed in the accompanying Notes to the Financial Statements, are indicative of the volume of the Funds' derivatives activities over the reporting period.

(a) Futures Contracts

The Funds use futures contracts to manage their exposure to the securities markets or the movements in interest rates and currency values. A futures contract is an agreement between two parties to buy and sell a financial instrument at a set price on a future date. Upon entering into such a contract, the Funds are required to pledge to the broker an amount of cash or securities equal to the minimum initial margin requirements of the exchange. Pursuant to the contracts, the Funds agree to receive from or pay to the broker an amount of cash or securities equal to the daily fluctuation in the value of the contracts. Such receipts or payments are known as variation margin and are recorded by the Funds as unrealized appreciation or depreciation. When the contracts are closed, the Funds record a realized gain or loss equal to the difference between the value of the contracts at the time they were opened and the value at the time they were closed. Any unrealized appreciation or depreciation recorded is simultaneously reversed. The use of futures transactions involves various risks, including the risk of an imperfect correlation in the movements in the price of futures contracts, interest rates and underlying hedging assets, and possible inability or unwillingness of counterparties to meet the terms of their contracts.

(b) Option Transactions

The Funds purchase and write (sell) put and call options on securities for hedging purposes, risk management purposes or otherwise as part of their investment strategies. The risk associated with purchasing an option is that the Funds pay a premium whether or not the option is exercised. Additionally, the Funds bear the risk of loss of premium and change in market value should the counterparty not perform under the contract. Put and call options purchased are accounted for in the same manner as portfolio securities. The cost of securities acquired through the exercise of call options is increased by the premiums paid. The proceeds from securities sold through the exercise of put options is decreased by the premiums paid.

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When an option is written, the premium received is recorded as an asset with an equal liability which is subsequently marked to market to reflect the market value of the option written. These liabilities are reflected as options written in the Funds' Statements of Assets and Liabilities. Premiums received from writing options which expire unexercised are recorded on the expiration date as a realized gain. The difference between the premium received and the amount paid on effecting a closing purchase transaction, including brokerage commissions, is also treated as a realized gain, or if the premium is less than the amount paid for the closing purchased transactions, as a realized loss. If a call option written is exercised, the premium is added to the proceeds from the sale of the underlying security in determining whether there has been a realized gain or loss. If a put option written is exercised, the premium reduces the cost basis of the security. In writing an option, the Funds bear the market risk of an unfavorable change in the price of the security underlying the written option. Exercise of a written option could result in the Funds purchasing a security at a price different from its current market value.

(c) Swap Agreements

Swap agreements are privately negotiated agreements between the Funds and a counterparty to exchange or swap investment cash flows, assets, foreign currencies or market-linked returns at specified, future intervals. The Funds enter into credit default, cross-currency, interest rate, total return, variance and other forms of swap agreements in

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3. Financial Derivative Instruments (continued)

order to manage its exposure to credit, currency and interest rate risk. In connection with these agreements, securities may be identified as collateral in accordance with the terms of the respective swap agreements to provide assets of value and recourse in the event of default or bankruptcy/insolvency.

Payments received or made at the beginning of the measurement period are reflected as such on the Funds' Statements of Assets and Liabilities and represent payments made or received upon entering into the swap agreement to compensate for differences between the stated terms of the swap agreement and prevailing market conditions (credit spreads, currency exchange rates, interest rates, and other relevant factors). These upfront payments are recorded