

PIMCO FLOATING RATE INCOME FUND

Form N-2/A

January 15, 2010

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As filed with the Securities and Exchange Commission on January 15, 2010

1933 Act File No. 333-

1940 Act File No. 811-21374

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM N-2**

(Check appropriate box or boxes)

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

**Pre-Effective Amendment No.**

**Post-Effective Amendment No.**

**and**

**REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940**

**Amendment No. 7**

# **PIMCO Floating Rate Income Fund**

(Exact Name of Registrant as Specified in Charter)

**1345 Avenue of the Americas**

**New York, New York 10105**

(Address of Principal Executive Offices)

(Number, Street, City, State, Zip Code)

**(212) 739-3222**

(Registrant's Telephone Number, including Area Code)

**Thomas J. Fuccillo, Esq.**

**c/o Allianz Global Investors Fund Management LLC**

**1345 Avenue of the Americas**

**New York, New York 10105**

(Name and Address (Number, Street, City, State, Zip Code) of Agent for Service)

*Copies of Communications to:*

**David C. Sullivan, Esq.**

**Ropes & Gray LLP**

**One International Place**

**Boston, Massachusetts 02110**

**Approximate Date of Proposed Public Offering:**

**As soon as practicable after the effective date of this Registration Statement.**

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box " .

## Edgar Filing: PIMCO FLOATING RATE INCOME FUND - Form N-2/A

It is proposed that this filing will become effective (check appropriate box):

when declared effective pursuant to section 8(c).

### Calculation of Registration Fee Under the Securities Act of 1933

| <b>Title of Securities<br/>Being Registered</b> | <b>Amount Being<br/>Registered</b> | <b>Proposed Maximum<br/>Offering Price per<br/>Unit</b> | <b>Proposed Maximum<br/>Aggregate<br/>Offering Price<sup>1</sup></b> | <b>Amount of<br/>Registration Fee</b> |
|---|------------------------------------|---|--|---------------------------------------|
| Common Shares, par value \$0.00001              | 88,810 Shares                      | \$11.26   | \$1,000,001  | \$71.30                               |

<sup>1</sup> Estimated solely for the purpose of calculating the registration fee as required by Rule 457(c) under the Securities Act of 1933, as amended, based upon the average of the high and low sales prices reported on the New York Stock Exchange consolidated reporting system of \$11.26 on January 12, 2010.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

PRELIMINARY PROSPECTUS  
[LOGO]

SUBJECT TO COMPLETION

January 15, 2010

**PIMCO [Income Strategy] Fund**

[ ] Common Shares

**Issuable Upon Exercise of Rights**

**[NOTE: On December 23, 2009, the Board of Trustees of the Fund approved a change of the Fund's name from PIMCO Floating Rate Income Fund to PIMCO Income Strategy Fund, a related rescission of the Fund's policy to normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in floating rate assets, and related changes to the Fund's investment strategies. These changes will take effect on March 1, 2010, following the provision of 60 days' written notice to shareholders in accordance with Rule 35d-1 under the Investment Company Act of 1940. This registration statement reflects the changes although they have not yet become effective. The Fund will request that the registration statement be declared effective on or after the effective date of the changes.]**

PIMCO [Income Strategy] Fund (the "Fund") is a diversified closed-end management investment company which was organized under the laws of The Commonwealth of Massachusetts on June 19, 2003. The Fund's investment objective is to seek high current income, consistent with the preservation of capital.

The Fund is issuing transferable rights ("Rights") to its common shareholders of record ("Record Date Shareholders") as of 5:00 p.m., Eastern time, on [ ] (the "Record Date"), entitling the holders of those Rights to subscribe for up to an aggregate of [ ] of the Fund's common shares of beneficial interest (the "Offer"). Record Date Shareholders will receive [ ] Right[s] for each outstanding whole common share held on the Record Date. The Rights entitle their holders to purchase [ ] new common share[s] for every [ ] Right[s] held ([ ]-for-[ ]). In addition, both Record Date Shareholders who fully exercise their Rights and holders of Rights acquired during the subscription period will be entitled to subscribe for additional common shares of the Fund that remain unsubscribed as a result of any unexercised Rights. This over-subscription privilege is subject to a number of limitations, and Record Date Shareholders will have the first priority right to subscribe for such additional shares.

The Fund's outstanding common shares are listed and trade on the New York Stock Exchange ("NYSE") under the symbol "PFL", as will the common shares offered for subscription in the Offer. The Rights are transferable and will be admitted for trading on the NYSE under the symbol [ ] throughout the term of the Offer, which may afford non-subscribing Record Date Shareholders the opportunity to sell their Rights for cash value. See "The offer" on page [ ] of this prospectus for a complete discussion of the terms of the Offer.

The subscription price (the "Subscription Price") will be determined based upon a formula equal to [ ]% of the average of the last reported sale prices of the Fund's common shares on the NYSE on the Expiration Date (as defined below) and the [ ] preceding trading days (the "Formula Price"). If, however, the Formula Price is less than [ ]% of the Fund's net asset value per common share on the Expiration Date, then the Subscription Price will be [ ]% of the Fund's net asset value per common share on that day. **The Offer will expire at 5:00 p.m., Eastern time, on [ ], unless extended as described in this prospectus.**

Because the Expiration Date of the subscription period will be [ ] (unless the Fund extends the subscription period), Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the common shares subscribed for pursuant to the primary subscription and, if eligible, any additional common shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of \$[ ] per common share and, except in limited circumstances, will not be able to rescind their subscription.

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The Fund's net asset value per common share at the close of business on [ ] (the last trading date prior to the date of this prospectus on which the Fund determined its net asset value) was \$[ ], and the last reported sale price of a common share of the Fund on the NYSE on that day was \$[ ].

Record Date Shareholders who do not fully exercise their Rights will, upon completion of the Offer, own a smaller proportional interest in the Fund than they owned prior to the Offer. In addition, because the Subscription Price per common share may be less than the then current net asset value per common share, the completion of the Offer will likely result in an immediate dilution of the net asset value per common share for all existing common shareholders. Such dilution is not currently determinable because it is not known how many common shares will be subscribed for, what the net asset value or market price of the common shares will be on the Expiration Date or what the Subscription Price will be. Such dilution could be substantial. If such dilution occurs, common shareholders will experience a decrease in the net asset value per common share held by them, irrespective of whether they exercise all or any portion of their Rights. The distribution to Record Date Shareholders of transferable Rights, which may themselves have intrinsic value, will afford such shareholders the potential of receiving cash payment upon the sale of the Rights, receipt of which may be viewed as partial compensation for the economic dilution of their interests. No assurance can be given that a market for the Rights will develop, or as to the value, if any, that the Rights will have. See The offer Investment Considerations.

If you have questions or need further information about the Offer, please write [ ], the Fund's information agent for the Offer, at [ ] or call [ ].

**Exercising your subscription rights and investing in the Fund's common shares involves a high degree of risk and may be considered speculative. Before exercising your subscription rights and investing in the Fund's common shares, you should read the discussion of the material risks of investing in the Fund, including the risks of leverage and of investing in below investment grade/high yield securities, in Principal risks of the Fund beginning on page [ ]. Certain of these risks are summarized in Prospectus summary Principal Risks of the Fund beginning on page [ ].**

You should read this prospectus, which contains important information about the Fund, before deciding whether to invest and retain it for future reference. A Statement of Additional Information, dated [ ], 2009, containing additional information about the Fund has been filed with the Securities and Exchange Commission (the Commission) and is incorporated by reference in its entirety into this prospectus. You can review the table of contents of the Statement of Additional Information on page [ ] of this prospectus. You may request a free copy of the Statement of Additional Information, request the Fund's most recent annual and semiannual reports, request information about the Fund and make shareholder inquiries by calling [ ] or by writing to the Fund at c/o Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105. You may also obtain a copy of the Statement of Additional Information (and other information regarding the Fund) from the Commission's Public Reference Room in Washington, D.C. by calling (202) 551-8090. The Commission charges a fee for copies. The Fund's most recent annual and semiannual reports are available, free of charge, on the Fund's website ([http://\[ \]](http://[ ])). You can obtain the same information, free of charge, from the Commission's web site (<http://www.sec.gov>).

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

|  | Per share | Total <sup>(1)</sup> |
|--|-----------|----------------------|
| Estimated subscription price <sup>(2)</sup>                    | \$ [ ]    | \$ [ ]               |
| Estimated sales load <sup>(2)(3)</sup>                         | \$ [ ]    | \$ [ ]               |
| Estimated offering expenses                                    | \$ [ ]    | \$ [ ]               |
| Estimated proceeds, after expenses, to the Fund <sup>(2)</sup> | \$ [ ]    | \$ [ ]               |

*(footnotes on inside front cover)*

**Table of Contents****[Name of Dealer Manager]**

The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The average portfolio duration of the Fund normally will be in a low to intermediate range (*i.e.*, zero to eight years). The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's Investors Service, Inc. (Moody's)) or below BBB- by either Standard & Poor's, a division of The McGraw-Hill Companies (S&P), or Fitch, Inc. (Fitch)) or that are unrated but judged by the Fund's sub-adviser, Pacific Investment Management Company LLC (PIMCO), to be of comparable quality, and also may invest without limit in investment grade securities. The Fund has the flexibility to allocate and re-allocate its assets in varying proportions among floating- and fixed-rate debt instruments as well as among investment grade and non-investment grade securities, and may choose to focus more heavily or exclusively on an asset class (*i.e.*, floating or fixed; investment grade or non-investment grade) at any time and from time to time based on PIMCO's assessment of relative values, market conditions and other factors. The Fund is actively managed in accordance with PIMCO's top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis, broad market diversification among industries and sectors and other risk management techniques. See Investment objective and policies Investment Strategies for further description of these and other investment management techniques used by PIMCO for the Fund. The Fund may invest in issuers of any credit quality (including bonds in the lowest ratings categories) if PIMCO determines that the particular obligation offers an attractive yield relative to its risk profile. **Debt securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. High yield securities are subject to greater risk of loss of principal and interest and may be less liquid than investment grade securities.** The Fund normally invests predominantly in U.S. dollar-denominated debt securities, which may include those issued by foreign corporations or supranational government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, and may invest up to 25% of its total assets in securities of issuers economically tied to emerging market countries. Various types of securities and other investments in which the Fund may invest are described under Investment objective and policies Portfolio Contents and Other Information in this prospectus. The Fund cannot assure you that it will achieve its investment objective.

The Fund's common shares do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

*(footnotes from front cover)*

- (1) Assumes that all Rights are exercised at the estimated Subscription Price.
- (2) Estimated on the basis of [ ]% of the last reported sale price of a common share of the Fund on the NYSE on [ ].
- (3) [ ] will act as dealer manager for the Offer (the Dealer Manager). The Fund has agreed to pay the Dealer Manager a fee for its financial advisory, marketing and soliciting services equal to [ ]% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights and the over-subscription privilege. The Dealer Manager will reallow to broker-dealers in the selling group to be formed and managed by the Dealer Manager selling fees equal to [ ]% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights as a result of their selling efforts. In addition, the Dealer Manager will reallow to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to [ ]% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of common shares held by each broker-dealer through The Depository Trust Company (DTC) on the Record Date. The fees and expenses of the Offer will be borne by the Fund and indirectly by all of its common shareholders, including those who do not exercise their Rights. The Fund and Allianz Global Investors Fund Management LLC, the Fund's investment manager, have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act of 1933, as amended.

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**You should rely only on the information contained or incorporated by reference in this prospectus. The Fund has not, and the Dealer Manager has not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The Fund is not, and the Dealer Manager is not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common shares.**

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**Prospectus summary**

This is only a summary. This summary may not contain all of the information that you should consider before investing in the Fund. You should review the more detailed information contained in this prospectus and in the Statement of Additional Information, especially the information set forth under the heading **Principal risks of the Fund**.

**The Fund**

PIMCO [Income Strategy] Fund is a diversified closed-end management investment company. The Fund commenced investment operations on August 29, 2003, following the initial public offering of its common shares. Throughout this prospectus, PIMCO [Income Strategy] Fund is referred to simply as the **Fund**. See **The Fund**.

**Purpose of the Offer**

The Board of Trustees of the Fund (the **Board**), Allianz Global Investors Fund Management LLC, the Fund's investment manager ( **AGIFM** or the **Investment Manager** ), and Pacific Investment Management Company LLC, the Fund's sub-adviser ( **PIMCO** or the **Sub-Adviser** ), have determined that it would be in the best interests of the Fund and its shareholders to increase the assets of the Fund, in order to more fully take advantage of current and prospective investment opportunities that may enable the Fund to increase overall investment yield on its investments, consistent with preservation of capital. The Board, the Investment Manager and the Sub-Adviser believe the current market environment offers the Fund compelling opportunities to deploy additional capital to take advantage of attractive investment opportunities and to enhance the Fund's future risk-adjusted returns by cost-efficiently altering investment allocations from bank loans to fixed rate instruments, more fully reflecting the investment opportunities available in the credit market. The Board, the Investment Manager and the Sub-Adviser also believe that increasing the Fund's assets available for investment may enable the Fund to enhance the Fund's market liquidity, increase the stability of future dividend distributions and reduce the Fund's expense ratio modestly, while achieving other net benefits to the Fund. The Board, the Investment Manager and the Sub-Adviser believe that the Offer is currently the most effective way to raise additional assets for the Fund while offering common shareholders the opportunity to buy additional common shares at a discounted price.

The Offer may not be successful. The completion of the Offer will likely result in an immediate dilution of the net asset value per common share for all existing common shareholders of the Fund, including those who fully exercise their rights. See **The offer Purpose of the Offer** on page [ ].

**Important Terms of the Offer**

The Fund is issuing transferable rights ( **Rights** ) to its common shareholders of record ( **Record Date Shareholders** ) as of 5:00 p.m., Eastern time, on [ ] (the **Record Date** ), entitling the holders of those Rights to subscribe for up to an aggregate of [ ] of the Fund's common shares (the **Shares** ) (the **Offer** ). Record Date Shareholders will receive [ ] Right[s] for each outstanding whole common share held on the Record Date. The Rights entitle their holders to purchase [ ] new common share[s] for every [ ] Right[s] held ([ ]-for-[ ]). Fractional Shares will not be issued upon the exercise of Rights; accordingly, Rights may be exercised only in integer multiples of [ ], except that any Record Date Shareholder who is issued fewer than [ ] Rights may subscribe, at the Subscription Price (defined below), for one full Share. Assuming the exercise of all Rights, the Offer will result in an approximately [ ]% increase in the Fund's common shares outstanding. The Offer is not contingent upon any number of Rights being exercised. The subscription period commences on [ ] and ends at 5:00 p.m., Eastern time, on [ ], unless otherwise extended (the **Expiration Date** ). See **The offer Important Terms of the Offer** on page [ ].



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The Fund expects to declare a monthly distribution in [ ]. Such distribution will not be payable with respect to Shares that are issued pursuant to the Offer after the record date for such dividend.

The Fund will bear the expenses of the Offer and all such expenses will be borne indirectly by the Fund's common shareholders. These expenses include, but are not limited to, the expenses of preparing and printing the prospectus for the Offer and the expenses of Fund counsel and the Fund's independent registered public accounting firm in connection with the Offer.

**Important Dates to Remember**

|  |             |
|--|-------------|
| Record Date:   | [ ]         |
| Subscription Period:   | [ ] to [ ]* |
| Confirmation Date of Over-Subscription Amounts:                  | [ ]*        |
| Final Date Rights Will Trade on NYSE:                            | [ ]*        |
| Expiration Date and Pricing Date:                                | [ ]*        |
| Payment for Shares Due or Notices of Guarantees of Delivery Due: | [ ]*        |
| Confirmation Mailed to Participants:                             | [ ]*        |
| Final Payment for Shares Due:                                    | [ ]*        |
| Delivery of Shares:  | [ ]*        |

\* See The offer Payment for Shares on page [ ].

Unless the Offer is extended.

**Subscription Price**

The subscription price for the Shares (the Subscription Price) will be determined based on a formula equal to [ ]% of the average of the last reported sale price of the Fund's common shares on the New York Stock Exchange (the NYSE) on the Expiration Date and the [ ] preceding trading days (the Formula Price). If, however, the Formula Price is less than [ ]% of the Fund's net asset value per common share on the Expiration Date, then the Subscription Price will be [ ]% of the Fund's net asset value per common share on that day. Because the Expiration Date of the subscription period will be [ ] (unless we extend the subscription period), Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the Shares subscribed for pursuant to the primary subscription and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of \$[ ] per Share and, except in limited circumstances, will not be able to rescind their subscription. See The offer The Subscription Price on page [ ].

**Over-Subscription Privilege**

Record Date Shareholders who exercise all the Rights issued to them (other than those Rights that cannot be exercised because they represent the right to acquire less than one Share) are entitled to subscribe for additional Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations and subject to allotment. If sufficient remaining Shares are available, all Record Date Shareholders over-subscription requests will be honored in full. In addition, any non-Record Date Shareholders who exercise Rights are entitled to subscribe for remaining Shares that are not otherwise subscribed for by Record Date Shareholders. If sufficient Shares are not available to honor all over-subscription requests, unsubscribed Shares will be allocated pro rata among those Record Date Shareholders who over-subscribe based on the number of common shares of the Fund they owned on the Record Date. Shares acquired pursuant to the over-subscription privilege are subject to certain limitations and to allocation. See The offer Over-Subscription Privilege on page [ ].

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**Sale and Transferability of Rights**

The Rights will be listed for trading on the NYSE under the symbol [ ] during the course of the Offer. Trading in the Rights on the NYSE may be conducted until the close of trading on the NYSE on the last business day prior to the Expiration Date. The Fund and [ ], the dealer manager of the Offer ( [ ] or the Dealer Manager ), will use their best efforts to ensure that an adequate trading market for the Rights will exist, although there can be no assurance that a market for the Rights will develop. Assuming a market exists for the Rights, the Rights may be purchased and sold through usual brokerage channels or sold through the Subscription Agent (defined below).

Record Date Shareholders who do not wish to exercise any of the Rights issued to them pursuant to the Offer may instruct the Subscription Agent to sell any unexercised Rights through or to the Dealer Manager. Subscription certificates representing the Rights to be sold through or to the Dealer Manager must be received by the Subscription Agent by 5:00 p.m., Eastern time, on [ ] (or, if the subscription period is extended, by 5:00 p.m., Eastern time, two business days prior to the extended Expiration Date).

Alternatively, the Rights evidenced by a subscription certificate may be transferred until the Expiration Date in whole or in part by endorsing the subscription certificate for transfer in accordance with the accompanying instructions. See The offer Sale and Transferability of Rights on page [ ].

**Method for Exercising Rights**

Rights are evidenced by subscription certificates that will be mailed to Record Date Shareholders (except as described below under Requirements for Foreign Shareholders ) or, if their common shares are held by Cede & Co. or any other depository or nominee, to Cede & Co. or such other depository or nominee. Rights may be exercised by filling in and signing the subscription certificate and mailing it in the envelope provided, or otherwise delivering the completed and signed subscription certificate to the Subscription Agent, together with payment at the estimated Subscription Price for the Shares. Completed subscription certificates and payments must be received by the Subscription Agent by 5:00 p.m., Eastern time, on the Expiration Date at the offices of the Subscription Agent. Rights also may be exercised by contacting your broker, banker or trust company, who can arrange, on your behalf, to guarantee delivery of payment and of a properly completed and executed subscription certificate. A fee may be charged for this service by your broker, banker or trust company. See The offer Method for Exercising Rights on page [ ] and The offer Payment for Shares on page [ ].

**Rights holders who have exercised their Rights will have no right to rescind their subscription after receipt of the completed subscription certificate together with payment for Shares by the Subscription Agent, except as described under The offer Notice of Net Asset Value Decline on page [ ].**

**Requirements for Foreign Shareholders**

Subscription certificates will not be mailed to Record Date Shareholders whose addresses are outside the United States (for these purposes, the United States includes the District of Columbia and the territories and possessions of the United States) ( Foreign Shareholders ). The Subscription Agent will send a letter via regular mail to Foreign Shareholders to notify them of the Offer. The Rights of Foreign Shareholders will be held by the Subscription Agent for their accounts until instructions are received to exercise the Rights. If instructions

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have not been received by 5:00 p.m., Eastern time, on [ ], three business days prior to the Expiration Date (or, if the subscription period is extended, on or before three business days prior to the extended Expiration Date), the Rights of Foreign Shareholders will be transferred by the Subscription Agent to the Dealer Manager, who will either purchase the Rights or use its best efforts to sell the Rights. The net proceeds, if any, from sale of those Rights by or to the Dealer Manager will be remitted to these Foreign Shareholders.

**Distribution Arrangements**

[ ] will act as Dealer Manager for this Offer. Under the terms and subject to the conditions contained in the Dealer Manager Agreement among the Dealer Manager, the Fund and the Investment Manager, the Dealer Manager will provide financial structuring services and marketing assistance in connection with the Offer and will solicit the exercise of Rights and participation in the over-subscription privilege. The Fund has agreed to pay the Dealer Manager a fee for its financial structuring, marketing and soliciting services equal to [ ]% of the aggregate Subscription Price for the Shares issued pursuant to the exercise of Rights and the over-subscription privilege. The fees paid to the Dealer Manager and other expenses of the Offer will be borne by the Fund and indirectly by all of its common shareholders, including those who do not exercise the Rights. The Dealer Manager will reallow a portion of its fees to other broker-dealers who have assisted in soliciting the exercise of Rights. The Fund and the Investment Manager have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act of 1933, as amended (the Securities Act ).

Prior to the expiration of the Offer, the Dealer Manager may independently offer for sale Shares it has acquired through purchasing and exercising the Rights, at prices it sets. Although the Dealer Manager may realize gains and losses in connection with purchases and sales of Shares, such offering of Shares is intended by the Dealer Manager to facilitate the Offer and any such gains or losses are not expected to be material to the Dealer Manager. The Dealer Manager's fee for its financial structuring, marketing and soliciting services is independent of any gains or losses that may be realized by the Dealer Manager through the purchase and exercise of the Rights and the sale of Shares. See Distribution Arrangements on page [ ].

**Investment Manager**

The Investment Manager serves as the investment manager of the Fund. Subject to the supervision of the Fund's Board, the Investment Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. The Investment Manager receives an annual fee, payable monthly, in an amount equal to 0.75% of the Fund's average weekly total managed assets. Total managed assets means the total assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). For purposes of calculating total managed assets, the liquidation preference of any preferred shares outstanding is not considered a liability. The Investment Manager is located at 1345 Avenue of the Americas, New York, New York 10105. Organized in 2000, the Investment Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. The Investment Manager is a wholly-owned indirect subsidiary of Allianz SE, a publicly-traded European insurance and financial services company. As of [ ], 2010, the Investment Manager and its investment management affiliates had approximately \$[ ] in assets under management.

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The Investment Manager has retained its affiliate, PIMCO, as a sub-adviser to manage the Fund's portfolio investments. See Sub-Adviser below.

**Sub-Adviser**

PIMCO serves as the Fund's sub-adviser responsible for managing the Fund's portfolio investments. Subject to the supervision of the Investment Manager, PIMCO has full investment discretion and makes all determinations with respect to the investment of the Fund's assets.

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to a number of open-end and closed-end investment companies. As of [ ], 2010, PIMCO had approximately \$[ ] in assets under management.

The Investment Manager (and not the Fund) pays a portion of the fees it receives to PIMCO in return for PIMCO's services.

**Subscription Agent**

The subscription agent for the Offer is [ ] (the Subscription Agent).

**Information Agent**

The information agent for the Offer is [ ] (the Information Agent). If you have questions or need further information about the Offer, please write the Information Agent at [ ] or call [ ].

**Listing**

The Fund's outstanding common shares are listed and trade on the NYSE under the trading or ticker symbol PFL, as will the Shares offered for subscription in the Offer. The Rights are transferable and will be listed for trading on the NYSE under the symbol [ ] during the course of the Offer.

**Use of Proceeds**

The net proceeds of the Offer will be invested in accordance with the Fund's investment objective and investment strategies set forth below. Assuming current market conditions, the Fund estimates that the net proceeds of the Offer will be substantially invested in accordance with its investment objective and investment strategies within [ ] to [ ] months of the completion of the Offer. Pending such investment, it is anticipated that the proceeds of the Offer will be invested in [short-term debt securities]. Following the completion of the Offer, the Fund may increase the Fund's leverage. See Use of leverage.

**Benefits to the Investment Manager and the Sub-Adviser**

The Investment Manager and the Sub-Adviser will benefit from the Offer because the investment management fee paid by the Fund to the Investment Manager and the subadvisory fee paid by the Investment Manager to the Sub-Adviser each are based on the Fund's average weekly total managed assets, meaning the total assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). It is not possible to state precisely the amount of additional compensation the Investment Manager and the Sub-Adviser will receive as a result of the Offer because it is not known how many Shares of the Fund will be subscribed for and because the proceeds of the Offer will be invested in additional portfolio securities which will fluctuate in value. However, assuming (i) all Rights are exercised, (ii) the Fund's average weekly net asset value during [ ] is \$[ ] per common share (the net asset value per common share on [ ]), (iii) the Subscription Price is \$[ ] per Share ([ ]% of the last reported sale price of the Fund's common shares on [ ]), and (iv) for purposes of this example, the Fund increases the amount of leverage outstanding while maintaining approximately the same percentage of total assets



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attributable to leverage, and after giving effect to Dealer Manager fees and other offering expenses, the Investment Manager and the Sub-Adviser would receive additional investment management fees and subadvisory fees of approximately \$[ ] and \$[ ], respectively, for the calendar year [ ], and would continue to receive additional investment management fees and subadvisory fees, respectively, as a result of the Offer, based on the Fund's average weekly total managed assets attributable to the Shares issued in the Offer, thereafter.

**Investment Objective**

The Fund's investment objective is to seek high current income, consistent with the preservation of capital. The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The average portfolio duration of the Fund normally will be in a low to intermediate range (*i.e.*, zero to eight years). The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's or below BBB- by either S&P or Fitch) or that are unrated but judged by PIMCO to be of comparable quality, and also may invest without limit in investment grade securities.

The Fund has the flexibility to allocate and to re-allocate its assets in varying proportions among floating- and fixed-rate debt instruments as well as among investment grade and non-investment grade securities, and may choose to focus more heavily or exclusively on an asset class (*i.e.*, floating or fixed; investment grade or non-investment grade) at any time and from time to time based on PIMCO's assessment of relative values, market conditions and other factors.

Various types of securities and other instruments in which the Fund may invest are described under "Portfolio contents" below. The Fund cannot assure you that it will achieve its investment objective.

**Investment Strategies**

The Fund is actively managed in accordance with PIMCO's top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis, broad market diversification among industries and sectors and other risk management techniques. In selecting investments for the Fund, PIMCO attempts to identify floating- and/or fixed-rate debt instruments that provide high current income through fundamental research, driven by independent credit analysis and proprietary analytical tools. Investment decisions are based primarily on PIMCO's assessment of the issuer's credit characteristics and the position of the particular security in the issuer's capital structure, in light of PIMCO's outlook for particular industries, the economy and the market generally. At the same time, PIMCO may use a variety of techniques, such as credit default swaps, designed to control risk and to minimize the Fund's exposure to issues that PIMCO believes are more likely to default or otherwise to depreciate in value over time and to detract from the Fund's overall return to investors. The Fund cannot assure you that such securities will ultimately continue to pay current income or be paid in full at maturity.

*Credit Quality.* The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade or that are unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. The Fund may invest in issuers of any credit quality (including debt securities in the lowest ratings categories and securities that are in default or the issuers of which are in bankruptcy) if PIMCO determines that the particular security offers an attractive yield relative

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to its risk profile. Debt securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and to repay principal, and are commonly referred to as high yield securities or junk bonds. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies. The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue.

*Independent Credit Analysis.* PIMCO relies heavily on its own analysis of the credit quality and risks associated with individual debt instruments considered for the Fund, rather than relying exclusively on rating agencies or third-party research. In the case of senior floating rate loans in which the Fund may invest (Senior Loans), PIMCO analyzes and takes into account the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral) in assessing their credit characteristics. PIMCO has a devoted team of professionals that conducts fundamental credit research and analysis of individual issuers, industries and sectors and uses proprietary analytical tools (such as computer databases and Web-based applications) to assess and to monitor credit risk. The Fund's portfolio manager utilizes this information in an attempt to manage credit risk and to identify issuers, industries or sectors that offer attractive yields relative to PIMCO's assessment of their credit characteristics. This aspect of PIMCO's capabilities is particularly important to the extent that the Fund focuses on Senior Loans and/or below investment grade securities. PIMCO's ability to analyze Senior Loans may be limited to the extent that the portfolio manager and analysts avoid the receipt of material, non-public information about the issuers of Senior Loans. See Principal risks of the Fund Confidential Information Access Risk.

*Duration.* The average portfolio duration of the Fund will normally be in a low to intermediate range (*i.e.*, zero to eight years), although it may be longer at any time and from time to time based on PIMCO's assessment of market conditions and other factors. PIMCO may utilize certain strategies, including investments in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund's portfolio, although there is no assurance that it will do so or that such strategies will be successful.

**Portfolio Contents**

The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The Fund may invest a substantial portion of its floating-rate assets in Senior Loans. Other floating rate debt instruments in which the Fund may invest include catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds and other debt securities, money market instruments and certain types of mortgage-backed and other asset-backed securities that pay interest at rates which adjust whenever a specified interest rate changes and/or reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund also considers floating rate assets to include 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. The Fund also may invest in a wide variety of fixed-rate debt securities, including corporate bonds, convertible securities and mortgage-backed and other asset-backed securities issued on a public or private basis. The Fund may make use of a variety of other

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instruments, including collateralized debt obligations, preferred shares, commercial paper, U.S. Government securities, zero-coupon and inflation-indexed bonds, real estate investment trusts (REITs), structured notes and other hybrid instruments and credit-linked trust certificates. Certain debt instruments, such as convertible bonds, also may include the right to participate in equity appreciation. The principal and/or interest rate on some debt instruments may be determined by reference to the performance of a benchmark asset or market, such as an index of securities, or the differential performance of two assets or markets, such as the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

The Fund may also hold common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The Fund may invest in securities that have not been registered for public sale, including securities eligible for purchase and sale pursuant to Rule 144A under the Securities Act of 1933 and other securities issued in private placements. The Fund may also invest in securities of other investment companies, including exchange-traded funds (ETFs). The Fund may invest in securities of companies with small market capitalizations.

As noted above, the Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade, and may also invest without limit in investment grade securities.

The Fund expects to invest predominantly in U.S. dollar-denominated debt securities, which may include those issued by foreign corporations or supra-national government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund may invest up to 25% of its total assets in securities of issuers economically tied to emerging market countries.

The Fund may utilize various derivative strategies involving the purchase or sale of credit default swaps, total return swaps and other swap agreements, call and put options (including options on futures contracts), futures and forward contracts, short sales and other derivative instruments for investment purposes, leveraging purposes or in an attempt to hedge against market, interest rate, currency and other risks in the portfolio. The Fund may also seek to obtain market exposure to the securities in which it invests by entering into a series of purchase and sales contracts.

The Fund may invest without limit in illiquid securities. Illiquidity is generally determined using the Securities and Exchange Commission's standard applicable to open-end investment companies (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

The Fund cannot change its investment objective without the approval (a) of the holders of a majority of the outstanding common shares and any preferred shares (including the Fund's currently outstanding auction market preferred shares (the Preferred Shares)) voting together as a single class, and (b) of the holders of a majority of the outstanding preferred shares (including the



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Preferred Shares) voting as a separate class. A majority of the outstanding shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

Upon PIMCO's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, the Fund may deviate from its investment objective and strategies and invest some or all of its total assets in investment grade debt securities, including high quality, short-term debt securities. The Fund may not achieve its investment objective when it does so.

**Use of Leverage**

The Fund has utilized leverage since shortly after it began investment operations, including through the issuance of Preferred Shares. As of [ ], 2010, the aggregate dollar amount (*i.e.*, liquidation preference) of the Fund's outstanding Preferred Shares was \$[ ] million, which then represented approximately [ ]% of the Fund's total assets (including assets attributable to the Preferred Shares). Information regarding the terms and features of the Preferred Shares is provided under "Description of capital structure" in this prospectus.

The Fund may also add leverage to its portfolio by utilizing reverse repurchase agreements, dollar rolls or other forms of borrowings, such as bank loans or commercial paper or other credit facilities (together "Borrowings"). As of [ ], 2010, the Fund had reverse repurchase agreements outstanding representing approximately [ ]% of the Fund's total assets (including the leverage obtained through the use of the instruments), such that the Fund's total leverage attributable in the aggregate to Preferred Shares and Borrowings then represented approximately [ ]% of the Fund's total assets.

The Fund may also enter into transactions other than those noted above that may give rise to a form of leverage including, among others, credit default swap contracts, futures and forward contracts and other derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions. Although it has no current intention to do so, the Fund may also determine to issue other preferred shares to add leverage to its portfolio.

Following completion of the Offer, the Fund may increase the amount of its leverage outstanding. The Trust may do so by engaging in additional Borrowings, including through the use of reverse repurchase agreements, in order to maintain the Fund's desired leverage ratio at that time, taking into account the additional assets raised through the issuance of Shares in the Offer. The Fund may also add leverage through the use of credit default swaps and other derivative transactions and/or the other techniques noted above. There is no assurance, however, that the Fund will determine to add leverage following the Offer, as the Fund intends to utilize leverage opportunistically and may choose to increase or decrease its use of leverage over time and from time to time based on PIMCO's assessment of the yield curve environment, interest rate trends, market conditions and other factors. In addition, if the Fund determines to add leverage following the Offer, it is not possible to predict with accuracy the precise amount of leverage that would be added, in part, because it is not possible to predict the number of Shares that ultimately will be subscribed for in the Offer.

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The Fund's net assets attributable to its Preferred Shares and the net proceeds the Fund obtains from Borrowings or other forms of leverage will be invested in accordance with the Fund's investment objective and policies as described in this prospectus. So long as the rate of return, net of applicable Fund expenses, on the debt obligations and other investments purchased by the Fund exceeds the dividend rates payable on the Preferred Shares together with the costs to the Fund of other forms of leverage it utilizes, the investment of the Fund's net assets attributable to leverage will generate more income than will be needed to pay the costs of the leverage. If so, the excess may be used to pay higher dividends to Common Shareholders than if the Fund were not so leveraged.

Regarding the expenses associated with the Fund's leverage, the terms of the Preferred Shares provide that they would ordinarily pay dividends at a rate set at auctions held every seven days, subject to a maximum applicable rate calculated as a function of the Preferred Shares' then-current rating and a reference interest rate. However, the weekly auctions for the Preferred Shares, as well as auctions for similar preferred shares of other closed-end funds across the U.S. industry, have failed since February 2008, and the dividend rates on the Preferred Shares since that time have been paid at the maximum applicable rate. The Fund expects that the Preferred Shares will continue to pay dividends at the maximum applicable rate for the foreseeable future and cannot predict whether or when the auction markets for the Preferred Shares may resume normal functioning. See "Principal risks of the Fund - Leverage Risk" and "Description of capital structure" for more information.

Leveraging is a speculative technique and there are special risks and costs involved. The Fund cannot assure you that its Preferred Shares and any Borrowings or other forms of leverage (such as the use of derivatives strategies) will result in a higher yield on your common shares. When leverage is used, the net asset value and market price of the common shares and the yield to Common Shareholders will be more volatile. See "Principal risks of the Fund - Leverage Risk." In addition, dividend, interest and other expenses borne by the Fund with respect to its Preferred Shares and any Borrowings or other forms of leverage are borne entirely by the Common Shareholders (and not by the holders of Preferred Shares) and result in a reduction of the net asset value of the common shares. In addition, because the fees received by the Investment Manager and by PIMCO are based on the total managed assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding), the Investment Manager and PIMCO have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of leverage (*e.g.*, reverse repurchase agreements and other Borrowings), which may create a conflict of interest between the Investment Manager and PIMCO, on the one hand, and the Common Shareholders, on the other hand.

Under the 1940 Act, the Fund is not permitted to issue preferred shares unless immediately after such issuance the value of the Fund's total net assets is at least 200% of the liquidation value of the outstanding Preferred Shares and the newly issued preferred shares plus the aggregate amount of any senior securities of the Fund representing indebtedness (*i.e.*, such liquidation value plus the aggregate amount of senior securities representing indebtedness may not exceed 50% of the Fund's total net assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on its common shares unless, at the time of such declaration, the value of the Fund's total net assets satisfies the above-referenced 200% coverage requirement.

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The 1940 Act also generally prohibits the Fund from engaging in most forms of leverage other than preferred shares (including through the use of reverse repurchase agreements, dollar rolls, bank loans, commercial paper or other credit facilities, credit default swap contracts and other derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions, to the extent that these instruments are not covered as described below) unless immediately after the issuance of the leverage the Fund has satisfied the asset coverage test with respect to senior securities representing indebtedness prescribed by the 1940 Act, *i.e.*, the value of the Fund's total assets less liabilities (other than the leverage and other senior securities) is at least 300% of the principal amount of such leverage (*i.e.*, effectively limiting the use of leverage through senior securities representing indebtedness to 33 1/3% of the Fund's total assets, including assets attributable to the leverage). The Fund is not permitted to declare any cash dividend or other distribution on common shares unless, at the time of such declaration, this 300% asset coverage test is satisfied. The Fund may (but is not required to) cover its commitments under these instruments by the segregation of liquid assets or by entering into offsetting transactions or owning positions covering its obligations. For instance, the Fund may cover its position in a reverse repurchase agreement by segregating liquid assets at least equal in amount to its forward purchase commitment. To the extent that certain of these instruments are so covered, they will not be considered senior securities under the 1940 Act and therefore will not be subject to the 300% asset coverage requirement otherwise applicable to forms of leverage (other than preferred shares) used by the Fund. However, these transactions, even if covered, may represent a form of economic leverage and create special risks. The use of these forms of additional leverage increases the volatility of the Fund's investment portfolio and could result in larger losses to Common Shareholders than if the strategies were not used. See *Principal risks of the Fund* **Leverage Risk**. Failure to maintain certain asset coverage requirements could result in an event of default under certain Borrowings that may be used by the Fund.

The Fund's ability to utilize leverage is also limited by asset coverage requirements and other guidelines imposed by rating agencies (currently Moody's and Fitch) that provide ratings for the Preferred Shares, which may be more restrictive than the limitations imposed by the 1940 Act noted above. See *Description of capital structure* for more information.

The Fund also may borrow money in order to repurchase its shares or as a temporary measure for extraordinary or emergency purposes, including for the payment of dividends or the settlement of securities transactions which otherwise might require untimely dispositions of portfolio securities held by the Fund.

**Principal Risks of the Fund**

The following is a summary of the principal risks associated with an investment in the Fund. Investors should also refer to *Principal risks of the Fund* in this prospectus and *Investment Objective and Policies* in the Statement of Additional Information for a more detailed explanation of these and other risks associated with investing in the Fund.

*Market Discount Risk.* As with any stock, the price of the Fund's common shares will fluctuate with market conditions and other factors. If common shares are sold, the price received may be more or less than the original investment. Net asset value will be reduced immediately following the Offer by a sales load and other expenses paid or reimbursed by the Fund. The common shares are designed for long-term investors and should not be treated as trading

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vehicles. Common shares of closed-end management investment companies frequently trade at a discount from their net asset value. The Fund's common shares may trade at a price that is less than the Subscription Price. This risk may be greater for investors who sell their shares relatively shortly after subscription.

*High Yield Risk.* In general, lower rated debt securities carry a greater degree of risk that the issuer will lose its ability to make interest and principal payments, which could have a negative effect on the net asset value of the Fund's common shares or common share dividends. The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's or below BBB- by either S&P or Fitch) or that are unrated but judged by PIMCO to be of comparable quality, including debt securities that are in default or the issuers of which are in bankruptcy. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. Securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. The prices of these lower grade bonds are generally more volatile and sensitive to actual or perceived negative developments, such as a decline in the issuer's revenues or revenues of underlying borrowers or a general economic downturn, than are the prices of higher grade securities. Bonds in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies.

The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy, which involve heightened risks. An economic downturn could severely affect the ability of highly leveraged issuers to service their debt obligations or to repay their obligations upon maturity. Lower-rated securities are generally less liquid than higher-rated securities, which may have an adverse effect on the Fund's ability to dispose of a particular security. For example, under adverse market or economic conditions, the secondary market for below investment grade securities could contract further, independent of any specific adverse changes in the condition of a particular issuer, and certain securities in the Fund's portfolio may become illiquid or less liquid. As a result, the Fund could find it more difficult to sell these securities or may be able to sell these securities only at prices lower than if such securities were widely traded. See Principal risks of the Fund Liquidity Risk.

The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue. In determining whether to retain or sell such a security, PIMCO may consider such factors as PIMCO's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other rating agencies. Analysis of creditworthiness may be more complex for issuers of high yield securities than for issuers of higher quality debt securities.

Although Senior Loans in which the Fund may invest will often be secured by collateral, there can be no assurance that liquidation of any such collateral would satisfy the borrower's obligation in the event of default or that such collateral could be readily liquidated. However, PIMCO believes that Senior Loans generally tend to have more favorable recovery rates than most other types of loans. In the event of bankruptcy of a borrower, the Fund could experience

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delays or limitations in its ability to realize the benefits of any collateral securing a Senior Loan. To the extent the Fund focuses on Senior Loans or other below investment grade debt obligations, PIMCO's capabilities in analyzing credit quality and associated risks are particularly important, and there can be no assurance that PIMCO will be successful in this regard. See "Investment objective and strategies" Portfolio Contents "High Yield Securities ( Junk Bonds )" for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

*Credit Risk.* Credit risk is the risk that one or more of the Fund's investments in debt securities or other instruments will decline in price, or fail to pay interest, liquidation value or principal when due, because the issuer of the obligation or the issuer of a reference security experiences an actual or perceived decline in its financial status. In addition to the credit risks associated with high yield securities, the Fund could also lose money if the issuer of other debt obligations, or the counterparty to a derivatives contract, repurchase agreement, loan of portfolio securities or other obligation, is, or is perceived to be, unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. The downgrade of a security may further decrease its value.

*Interest Rate Risk.* Generally, when market interest rates rise, the prices of debt obligations fall, and vice versa. Interest rate risk is the risk that debt obligations and other instruments in the Fund's portfolio will decline in value because of increases in market interest rates. This risk may be particularly acute because market interest rates are currently at historically low levels. The prices of long-term debt obligations generally fluctuate more than prices of short-term debt obligations as interest rates change. Because the Fund will normally have a low to intermediate average portfolio duration (*i.e.*, zero to eight years), the common share net asset value and market price per common share will tend to fluctuate more in response to changes in market interest rates than if the Fund invested mainly in short-term debt securities. During periods of rising interest rates, the average life of certain types of securities may be extended due to slower than expected payments. This may lock in a below market yield, increase the security's duration and reduce the security's value. In addition to directly affecting debt securities, rising interest rates may also have an adverse effect on the value of any equity securities held by the Fund. The Fund's use of leverage, as described below, will tend to increase common share interest rate risk. PIMCO may utilize certain strategies, including investments in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund's portfolio, although there is no assurance that it will do so or that such strategies will be successful.

Investments in floating rate debt instruments, although generally less sensitive to interest rate changes than longer duration fixed rate instruments, may nevertheless decline in value if their interest rates do not rise as much, or as quickly, as interest rates in general. Conversely, floating rate instruments will not generally increase in value if interest rates decline. Inverse floating rate debt securities may also exhibit greater price volatility than a fixed rate debt obligation with similar credit quality. To the extent the Fund holds floating rate instruments, a decrease (or, in the case of inverse floating rate securities, an increase) in market interest rates will adversely affect the income received from such securities and the net asset value of the common shares.

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*Distressed and Defaulted Securities Risk.* The Fund may invest in the debt securities of financially distressed issuers. Investments in the securities of financially distressed issuers involve substantial risks. These securities may present a substantial risk of default or may be in default at the time of investment. The Fund may incur additional expenses to the extent it is required to seek recovery upon a default in the payment of principal or interest on its portfolio holdings. In any reorganization or liquidation proceeding relating to an investment, the Fund may lose its entire investment or may be required to accept cash or securities with a value less than its original investment. Among the risks inherent in investments in a troubled issuer is the fact that it frequently may be difficult to obtain information as to the true financial condition of such issuer. PIMCO's judgments about the credit quality of the issuer and the relative value of its securities may prove to be wrong.

*Liquidity Risk.* The Fund may invest without limit in illiquid securities (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities may trade at a discount from comparable, more liquid investments, and may be subject to wide fluctuations in market value. Also, the Fund may not be able to dispose readily of illiquid securities when that would be beneficial at a favorable time or price or at prices approximating those at which the Fund currently values them. Further, the lack of an established secondary market for illiquid securities may make it more difficult to value such securities, which may negatively affect the price the Fund would receive upon disposition of such securities. The Senior Loans in which the Fund invests will likely not be registered with the Securities and Exchange Commission or any state securities commission and generally will not be listed on a national securities exchange. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

*Leverage Risk.* The Fund utilizes leverage on an ongoing basis for investment purposes, including through its outstanding Preferred Shares and also from time to time through the use of reverse repurchase agreements and other Borrowings. See [Use of leverage](#) for details.

Leverage creates several major types of risks for Common Shareholders, including:

the likelihood of greater volatility of net asset value and market price of common shares than a comparable portfolio without leverage;

the possibility either that common share dividends will fall if the costs of leverage rise, or that dividends paid on common shares will fluctuate because such costs vary over time; and

the effects of leverage in a declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the common shares.

In addition to using Preferred Shares and Borrowings, the Fund may also enter into other transactions that may give rise to a form of leverage including, among others, credit default swap contracts, futures and forward contracts and other derivatives transactions, loans of portfolio securities, short sales and when issued, delayed delivery and forward commitment transactions. The Fund's use of such transactions gives rise to associated leverage risks described herein, and

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may adversely affect the Fund's income and distributions. The Fund may manage some of its derivative positions by segregating an amount of cash or liquid securities equal to the face value or the market value, as applicable, of those positions. The Fund also may offset derivatives positions against one another or against other assets to manage effective market exposure resulting from derivatives in its portfolio. To the extent that any offsetting positions do not behave in relation to one another as expected, the Fund may perform as if it is leveraged through use of these derivative strategies. See "Use of leverage."

The Fund's use of leverage creates the opportunity for increased common share net income, but also creates special risks for Common Shareholders. There can be no assurance that the Fund's leveraging strategies will be successful. Leverage is a speculative technique that may expose the Fund to greater risk and increased costs. The net proceeds the Fund obtains from its use of leverage are invested in accordance with the Fund's investment objective and strategies as described in this prospectus. If the rate of return, net of applicable Fund expenses, on the investments purchased by the Fund exceeds the costs of such leverage to the Fund (including dividends, interest and other repayment obligations), then, all other things being equal, the use of such leverage by the Fund may allow the Fund to pay higher dividends to Common Shareholders than if the Fund were not so leveraged. If, however, the costs of leverage rise relative to the rate of return on the Fund's portfolio, the interest and other costs to the Fund of leverage could exceed the rate of return on the investments held by the Fund, thereby reducing the return to Common Shareholders. In such case, the Fund's ability to pay dividends and meet its asset coverage requirements on the Preferred Shares also would be reduced. Any decline in the net asset value of the Fund's investments could result in the Fund being in danger of failing to meet its asset coverage requirements or of losing its Aaa rating (in the case of Moody's) or AAA rating (in the case of Fitch) on the Preferred Shares. In an extreme case, the Fund's current investment income might not be sufficient to meet the dividend requirements on the Preferred Shares. In order to counteract such an event, the Fund might need to liquidate investments in order to fund a redemption of some or all of the Preferred Shares. Liquidation at times of adverse economic conditions may result in a capital loss to the Fund. The Preferred Shares have, and any Borrowings by the Fund or counterparties to the Fund's other leveraging transactions, if any, would have, seniority over the common shares.

Because the fees received by the Investment Manager and the Sub-Adviser are based on the total managed assets of the Fund (including any assets attributable to any Preferred Shares or other forms of leverage of the Fund that may be outstanding), the fees will be higher when leverage is utilized and the Investment Manager and the Sub-Adviser therefore have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of leverage (e.g., reverse repurchase agreements and other Borrowings), which may create a conflict of interest.

*Additional Risks Associated with the Fund's Preferred Shares.* [To be provided by amendment.]

*Issuer Risk.* The value of debt instruments may decline for a number of reasons that directly relate to the issuer, such as management performance, financial leverage and reduced demand for the issuer's goods and services, as well as the historical and prospective earnings of the issuer and the value of its assets.

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*Smaller Company Risk.* The general risks associated with debt instruments or equity securities are particularly pronounced for securities issued by companies with small market capitalizations. Small capitalization companies involve certain special risks. They are more likely than larger companies to have limited product lines, markets or financial resources, or to depend on a small, inexperienced management group. Securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. They may also have limited liquidity. These securities may therefore be more vulnerable to adverse developments than securities of larger companies, and the Fund may have difficulty purchasing or selling securities positions in smaller companies at prevailing market prices. Also, there may be less publicly available information about smaller companies or less market interest in their securities as compared to larger companies. Companies with medium-sized market capitalizations may have risks similar to those of smaller companies.

*Management Risk.* The Fund is subject to management risk because it is an actively managed portfolio. PIMCO and the portfolio manager will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these decisions will produce the desired results.

*Convertible Securities Risk.* Convertible securities generally offer lower interest or dividend yields than non-convertible debt securities of similar quality. The market values of convertible securities tend to decline as interest rates increase and, conversely, to increase as interest rates decline. However, a convertible security's market value tends to reflect the market price of the common stock of the issuing company when that stock price approaches or is greater than the convertible security's conversion price. The conversion price is defined as the predetermined price at which the convertible security could be exchanged for the associated stock. As the market price of the underlying common stock declines, the price of the convertible security tends to be influenced more by the yield of the convertible security. Thus, it may not decline in price to the same extent as the underlying common stock. In the event of a liquidation of the issuing company, holders of convertible securities would be paid before the company's common stockholders but after holders of any senior debt obligations of the company. Consequently, the issuer's convertible securities generally entail less risk than its common stock but more risk than its debt obligations.

The Fund may invest in synthetic convertible securities, which are created through a combination of separate securities that possess the two principal characteristics of a traditional convertible security; that is, an income-producing security ( income-producing component ) and the right to acquire an equity security ( convertible component ). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by purchasing warrants or options to buy common stock at a certain exercise price, or options on a stock index. The values of synthetic convertible securities will respond differently to market fluctuations than a traditional convertible security because a synthetic convertible is composed of two or more separate securities or instruments, each with its own market value. Synthetic convertible securities are also subject to the risks associated with derivatives. See Principal risks of the Fund Derivatives Risk. In addition, if the value of the underlying common stock or the level of the index involved in the convertible element falls below the strike price of the warrant or option, the warrant or option may lose all value.



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*Preferred Securities Risk.* In addition to equity securities risk (see *Principal risks of the Fund Equity Securities and Related Market Risk* ), credit risk (see *Principal risks of the Fund Credit Risk* ) and possibly high yield risk (see *Principal risks of the Fund High Yield Risk* ), investment in preferred stocks involves certain other risks. Certain preferred stocks contain provisions that allow an issuer under certain conditions to skip or defer distributions. If the Fund owns a preferred stock that is deferring its distribution, the Fund may be required to report income for tax purposes despite the fact that it is not receiving current income on this position. Preferred stocks often are subject to legal provisions that allow for redemption in the event of certain tax or legal changes or at the issuer's call. In the event of redemption, the Fund may not be able to reinvest the proceeds at comparable rates of return. Preferred stocks are subordinated to bonds and other debt securities in an issuer's capital structure in terms of priority for corporate income and liquidation payments, and therefore will be subject to greater credit risk than those debt securities. Preferred stocks may trade less frequently and in a more limited volume and may be subject to more abrupt or erratic price movements than many other securities, such as common stocks, corporate debt securities and U.S. Government securities.

*Foreign (Non-U.S.) Investment Risk.* The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers or supra-national government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund's investments in foreign issuers and in securities denominated in foreign currencies involve special risks.

For example, the value of these investments may decline in response to unfavorable political and legal developments, unreliable or untimely information or economic and financial instability. Foreign securities may experience more rapid and extreme changes in value than investments in securities of U.S. issuers. The securities markets of many foreign countries are relatively small, with a limited number of companies representing a small number of industries. Issuers of foreign securities are usually not subject to the same degree of regulation as U.S. issuers. Reporting, accounting and auditing standards of foreign countries differ, in some cases significantly, from U.S. standards. Also, nationalization, expropriation or other confiscation, currency blockage, political changes or diplomatic developments could adversely affect the Fund's investments in foreign securities. In the event of nationalization, expropriation or other confiscation, the Fund could lose its entire investment in foreign securities. To the extent that the Fund invests a significant portion of its assets in a particular foreign country or a concentrated geographic area (such as Europe or Asia), the Fund will generally have more exposure to regional economic risks associated with foreign investments. Also, adverse conditions in a certain region can adversely affect securities of other countries whose economies appear to be unrelated. The costs of investing in foreign countries frequently are higher than the costs of investing in the United States. Additionally, investments in securities of foreign issuers generally will be denominated in foreign currencies, subjecting the Fund to foreign currency risk. See *Principal risks of the Fund Foreign Currency Risk*.

*Emerging Markets Risk.* The Fund may invest up to 25% of its total assets in debt securities of issuers economically tied to emerging market countries. Foreign investment risk may be particularly high to the extent that the Fund

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invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers noted above, but to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in a lack of liquidity and in price volatility; (iii) certain national policies which may restrict the Fund's investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests and requirements that government approval be obtained prior to investment by foreign persons; (iv) certain national policies that may restrict the Fund's repatriation of investment income, capital or the proceeds of sales of securities, including temporary restrictions on foreign capital remittances; (v) the lack of uniform accounting and auditing standards; (vi) less publicly available financial and other information regarding issuers; (vii) potential difficulties in enforcing contractual obligations; and (viii) higher rates of inflation, higher interest rates and other economic concerns. The Fund may invest to a significant extent in emerging market securities that are issued in local currencies, subjecting the Fund to a greater amount of foreign currency risk. See *Principal risks of the Fund Foreign Currency Risk*. Also, investing in emerging market countries may entail purchases of securities of issuers that are insolvent, bankrupt, in default or otherwise of questionable ability to satisfy their payment obligations as they become due, subjecting the Fund to a greater amount of credit risk and/or high yield risk. See *Principal risks of the Fund Credit Risk* and *Principal Risks of the Fund High Yield Risk*.

*Foreign Currency Risk.* The Fund's common shares are priced in U.S. dollars and the distributions paid by the Fund to Common Shareholders are paid in U.S. dollars. However, a significant portion of the Fund's assets may at any time be denominated in foreign (non-U.S.) currencies and income received by the Fund from many foreign debt obligations will be paid in foreign currencies. The Fund may also invest in or gain exposure to foreign currencies themselves for investment or hedging purposes. The Fund's investments in or exposure to foreign currencies or in securities or instruments that trade, or receive revenues, in foreign currencies are subject to the risk that those currencies will decline in value relative to the U.S. dollar or, in the case of hedging positions (if utilized), 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 U.S. or abroad. These fluctuations may have a significant adverse effect on the value of the Fund's portfolio and/or the level of Fund distributions made to Common Shareholders. As noted above, the Fund may (but is not required to) attempt to hedge some of its exposure to foreign currencies in order to reduce the risk of loss due to fluctuations in currency exchange rates relative to the U.S. dollar. There is no assurance, however, that these hedging strategies will be available or will be used by the Fund or, if used, that they will be successful.

*Derivatives Risk.* Derivatives are financial contracts whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indexes). The Fund may invest in a variety of derivative instruments for hedging or risk management purposes or as part of its

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investment strategies, such as options contracts (including options on futures contracts), futures contracts, swap agreements (including total return and credit-default swaps) and short sales. The Fund may also have exposure to derivatives, such as interest rate or credit default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may use derivatives as a substitute for taking a position in an underlying debt instrument or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate or currency risk. The Fund also may use derivatives to add leverage to the portfolio. The Fund's use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks described elsewhere in this prospectus, such as liquidity risk, interest rate risk, issuer risk, credit risk, leveraging risk, counterparty risk, management risk and, if applicable, smaller company risk. They also involve the risk of mispricing or improper valuation, the risk of ambiguous documentation, and the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index. If the Fund invests in a derivative instrument, it could lose more than the principal amount invested. Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial. In addition, the Fund is subject to certain restrictions or limitations on its use of derivative strategies imposed by Moody's and Fitch (or any rating agency that may in the future rate the Preferred Shares) in connection with their ratings of the Fund's Preferred Shares. See Description of capital structure. The use of derivatives also may increase the amount of taxes payable by shareholders. In addition to the risks applicable to derivatives generally, credit default swaps involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty).

The Fund may invest in credit default swaps, total return swaps and other credit-related derivatives. These transactions generally provide for the transfer from one counterparty to another of certain credit risks and return characteristics inherent in the ownership of a financial asset. Such risks include the risk of default and insolvency of the issuer of such asset and the risk that the credit of the issuer or any underlying collateral will decline or that credit spreads for like assets will change (thus affecting the market value of the financial asset). The transfer of credit risk pursuant to a credit derivative may be complete or partial, and may be for the life of the related asset or for a shorter period. Credit derivatives may be used as a risk management tool for a pool of financial assets, providing the Fund with the opportunity to gain exposure to one or more reference assets without actually owning such assets in order, for example, to reduce a focused investment risk or to diversify its portfolio. In each credit derivative transaction that it is party to, the Fund assumes the credit risk of the counterparty. See Principal risks of the Fund Counterparty risk. Credit default swaps, total return swaps and other credit derivatives are a relatively recent development in the financial markets. Consequently, there are certain legal, tax and market uncertainties that present risks in entering into such total rate of return swaps and other credit derivatives. There is currently little or no case law or litigation characterizing total return swaps or other credit derivatives, interpreting their provisions, or characterizing their tax treatment. In addition, legislation (including financial reform legislation currently being considered in Congress), regulatory action and/or private initiatives may change

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the way credit default swaps and other instruments are used or regulated, possibly making their use less beneficial to the Fund or limiting the Fund's ability to use such instruments. Recent turmoil in the securities markets generally and among monoline insurers and other financial institutions in particular has increased the volatility and other risks associated with these instruments.

*Counterparty Risk.* The Fund will be subject to credit risk with respect to the counterparties to the derivative contracts and other instruments entered into by the Fund or held by special purpose or structured vehicles in which the Fund invests. In the event that the Fund enters into a derivative transaction with a counterparty that subsequently becomes insolvent or becomes the subject of a bankruptcy case, the derivative transaction may be terminated in accordance with its terms and the Fund's ability to realize its rights under the derivative instrument and its ability to distribute the proceeds could be adversely affected. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract in a bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

*Mortgage-Related and Asset-Backed Securities Risk.* The Fund may invest in a variety of mortgage-related securities, including commercial mortgage securities and other mortgage-backed instruments. The value of some mortgage-related securities, including commercial mortgage-backed securities and residential mortgage-backed securities, may be particularly sensitive to changes in prevailing interest rates. The yield and payment characteristics of mortgage-related securities differ from traditional debt securities. Interest and principal prepayments are made more frequently, usually monthly, over the life of the mortgage loans and principal generally may be prepaid at any time because the underlying mortgage loans generally may be prepaid at any time. Faster or slower prepayments than expected on underlying mortgage loans can dramatically alter the yield to maturity of a mortgage-related security, and early repayment of principal on some mortgage-related securities may expose the Fund to a lower rate of return upon reinvestment of principal.

Mortgage-related and other asset-backed securities often involve risks that are different from or more acute than risks associated with other types of debt instruments. For instance, these securities may be particularly sensitive to changes in prevailing interest rates. Rising interest rates tend to extend the duration of mortgage-related securities, making them more sensitive to changes in interest rates, and may reduce the market value of the securities. This is known as extension risk. In addition, mortgage-related securities are subject to prepayment risk—the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. For instance, the Fund may invest in stripped mortgage-backed securities for which one class receives all of the interest from the mortgage assets (the interest-only, or IO class), while the other class receives all of the principal (the principal-only, or PO class). The yield to maturity on an IO class is extremely sensitive to the rate of principal payments (including prepayments) on the underlying mortgage assets, and a rapid rate of principal payments may have a material adverse effect on the Fund's yield to maturity from these investments. The Fund's investments in other asset-backed securities are subject to risks similar to those associated with mortgage-backed securities, as well as additional risks associated with their structure and the

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nature of the assets underlying the security and the servicing of those assets. For instance, certain collateralized debt obligations in which the Fund may invest are backed by pools of high-risk, below investment grade debt securities and may involve substantial credit and other risks. Further, due to their often complicated structures, various mortgage-related and particularly asset-backed securities may be difficult to value and may constitute illiquid investments.

The value of mortgage-related securities may be substantially dependent on the servicing of the underlying asset pools, and are therefore subject to risks associated with the negligence by, or defalcation of, their servicers. Furthermore, debtors may be entitled to the protection of a number of state and federal consumer credit laws with respect to mortgage-related securities, which may give the debtor the right to avoid payment.

Investments in mortgage-related securities involve particularly high levels of risk under current market conditions. See Principal risks of the Fund Mortgage Market/Subprime Risk.

*Mortgage Market/Subprime Risk.* The residential and commercial mortgage markets in the United States have experienced substantial and in some cases unprecedented difficulties over the past few years that have adversely affected the performance, market value and liquidity of mortgage-related investments. Delinquencies and losses on U.S. residential mortgage loans (especially sub-prime, Alternative A-paper ( Alt-A ) and second-lien mortgage loans) generally have increased substantially during such period and may continue to increase, and the decline in or flattening of U.S. housing values that has been experienced in such period and that may continue to be experienced in many U.S. housing markets may exacerbate such delinquencies and losses. Borrowers with adjustable rate mortgage loans are more sensitive to changes in interest rates, which affect their monthly mortgage payments, and may be unable to secure replacement mortgages at comparably low interest rates or at all. Also, a number of U.S. residential mortgage loan originators have experienced serious financial difficulties or bankruptcy, and other such originators also may experience such difficulties or bankruptcy in the future. Owing largely to the foregoing, reduced investor demand for mortgage loans and mortgage-related securities, along with other general economic factors, have caused severely restricted liquidity in the secondary market for mortgage-related securities, and the Fund may invest without limitation in investments that are considered illiquid. It is possible that such limited liquidity in such secondary markets could continue or worsen and reduce the values of the Fund's investments, and there can be no guarantee that a liquid secondary market for such securities will redevelop. If the U.S. economy deteriorates further, the incidence of mortgage foreclosures may increase, which may adversely affect the value of any mortgage-related securities owned by the Fund. [The United States Congress and various government regulatory authorities have discussed the possibility of restructuring mortgages and imposing forbearance requirements on defaulted mortgages. Neither the Fund nor PIMCO can predict the form any such modifications, forbearance or related regulations might take or whether, if implemented, they will adversely affect the value of mortgage-related securities owned by the Fund.]

*Risk of Investing in REITs.* Like other mortgage-related securities, REITs are subject to interest rate risk and prepayment risk. Investing in REITs also involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A

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mortgage REIT may be affected by changes in interest rates and the ability of the issuers of its portfolio mortgages to repay their obligations. REITs are dependent upon the skills of their managers and are not diversified. REITs are generally dependent upon maintaining cash flows to repay borrowings and to make distributions to shareholders and are subject to the risk of default by lessees or borrowers. REITs whose underlying assets are concentrated in properties used by a particular industry are also subject to risks associated with such industry.

REITs may have limited financial resources, may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities. Historically, REITs have been more volatile in price than the larger capitalization stocks included in S&P 500 Composite Stock Index.

*Valuation Risk.* When market quotations are not readily available or are deemed to be unreliable, the Fund values its investments at fair value as determined in good faith pursuant to policies and procedures approved by the Board. See *Net asset value*. Fair value pricing may require subjective determinations about the value of a security or other asset. As a result, there can be no assurance that fair value pricing will result in adjustments to the prices of securities or other assets, or that fair value pricing will reflect actual market value, and it is possible that the fair value determined for a security or other asset will be materially different from quoted or published prices, from the prices used by others for the same security or other asset and/or from the value that actually could be or is realized upon the sale of that security or other asset.

*Focused Investment Risk.* Although the Fund has a policy not to concentrate investments in any particular industry, it may (consistent with that policy) invest up to 25% of its assets in any particular industry. To the extent that the Fund focuses its investments in a particular industry, the net asset value of the common shares will be more susceptible to events or factors affecting companies in that industry. These may include, but are not limited to, governmental regulation, inflation, rising interest rates, cost increases in raw materials, fuel and other operating expenses, technological innovations that may render existing products and equipment obsolete, competition from new entrants, high research and development costs, increased costs associated with compliance with environmental or other regulation and other economic, market, political or other developments specific to that industry. Also, the Fund may have greater risk to the extent that it invests a substantial portion of its assets in companies in related sectors, which may share common characteristics, are often subject to similar business risks and regulatory burdens, and whose securities may react similarly to the types of events and factors described above. The Fund will also be subject to focused investment risks to the extent that it invests a substantial portion of its assets in a particular country or geographic region. See *Principal risks of the Fund Foreign (Non-U.S.) Investment Risk*, *Principal risks of the Fund Emerging Markets Risk* and *Principal risks of the Fund Foreign Currency Risk*.

*Reinvestment Risk.* Reinvestment risk is the risk that income from the Fund's portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the portfolio's current earnings rate. For instance, during periods of declining interest rates, an issuer of debt obligations may exercise an option to redeem securities prior to maturity, forcing the Fund to invest in lower-yielding securities. A decline in income received by the Fund from its investments is

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likely to have a negative effect on the market price, net asset value and/or overall return of the Fund's common shares and to reduce asset coverage on the Preferred Shares.

*Inflation/Deflation Risk.* Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of payments at future dates. As inflation increases, the real value of the Fund's portfolio could decline. Deflation risk is the risk that prices throughout the economy decline over time. Deflation may have an adverse effect on the creditworthiness of issuers and may make issuer default more likely, which may result in a decline in the value of the Fund's portfolio.

*Confidential Information Access Risk.* In managing the fund, PIMCO normally will seek to avoid the receipt by portfolio managers and analysts of material, non-public information ( Confidential Information ) about the issuers of Senior Loans, other bank loans and related investments being considered for acquisition by the Fund or held in the Fund's portfolio. In many instances, issuers offer to furnish Confidential Information to prospective purchasers or holders of the issuer's loans. In circumstances when the PIMCO portfolio manager and analysts do not receive Confidential Information from these issuers, the Fund may be disadvantaged in comparison to other bank loan investors, including with respect to the price the Fund pays or receives when it buys or sells a bank loan. Further, in situations when the Fund is asked, for example, to grant consents, waivers or amendments with respect to bank loans, PIMCO's ability to assess the desirability of such consents, waivers and amendments may be compromised.

*Equity Securities and Related Market Risk.* The Fund may hold common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The market price of common stocks and other equity securities may go up or down, sometimes rapidly or unpredictably. Equity securities may decline in value due to factors affecting equity securities markets generally, particular industries represented in those markets, or the issuer itself. See Principal risks of the Fund Issuer Risk. The values of equity securities may decline due to general market conditions that are not specifically related to a particular company, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates or adverse investor sentiment generally. They may also decline due to factors which affect a particular industry or industries, such as labor shortages or increased production costs and competitive conditions within an industry. Debt securities are also subject to the market risks described above; however, equity securities generally have greater price volatility than bonds and other debt securities.

*Rule 144A Securities Risk.* Rule 144A permits certain qualified institutional buyers, such as the Fund, to trade in privately placed securities that have not been registered for sale under the Securities Act. Rule 144A securities may be deemed illiquid, although the Fund may determine that certain Rule 144A securities are liquid in accordance with procedures adopted by the Board.

*Other Investment Companies Risk.* The Fund may invest in securities of other open- or closed-end investment companies, including ETFs, to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act. As a shareholder in an investment company, the Fund will bear its ratable share of that investment company's

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expenses, and would remain subject to payment of the Fund's investment management fees with respect to the assets so invested. Common Shareholders would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. In addition, these other investment companies may utilize leverage, in which case an investment would subject the Fund to additional risks associated with leverage. See Principal risks of the Fund Leverage Risk.

*Risk of Regulatory Changes.* To the extent that legislation or state or federal bank or other regulators impose additional requirements or restrictions on the ability of certain financial institutions to make loans, particularly in connection with highly leveraged transactions, the availability of investments sought after by the Fund may be reduced. Further, such legislation or regulation could depress the market value of investments held by the Fund. Additionally, legislative, regulatory, or tax developments may affect the investment techniques available to PIMCO and each individual portfolio manager in connection with managing the Fund and may also adversely affect the ability of the Fund to achieve its investment objective.

*Market Disruption and Geopolitical Risk.* The wars with Iraq and Afghanistan, their aftermath and the occupations of Iraq and substantial military presence in Afghanistan are likely to have a substantial effect on the U.S. and world economies and securities markets. The nature, scope and duration of the wars and the potential costs of rebuilding infrastructure cannot be predicted with any certainty. Terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 closed some of the U.S. securities markets for a four-day period and similar future events cannot be ruled out. The war and occupation, terrorism and related geopolitical risks have led, and may in the future lead, to increased short-term market volatility and may have adverse long-term effects on U.S. and world economies and markets generally. Those events also could have an acute effect on individual issuers or related groups of issuers. These risks also could adversely affect individual issuers and securities markets, interest rates, secondary trading, ratings, credit risk, inflation, deflation and other factors relating to the Fund's investments and the market value and net asset value of the common shares.

**Certain Affiliations**

Certain broker-dealers may be considered to be affiliated persons of the Fund, the Investment Manager and/or PIMCO due to their possible affiliations with Allianz SE, the ultimate parent of the Investment Manager and PIMCO. Absent an exemption from the Securities and Exchange Commission or other regulatory relief, the Fund is generally precluded from effecting certain principal transactions with affiliated brokers, and its ability to purchase securities being underwritten by an affiliated broker or a syndicate including an affiliated broker, or to utilize affiliated brokers for agency transactions, is subject to restrictions. This could limit the Fund's ability to engage in securities transactions and take advantage of market opportunities.

**Anti-Takeover Provisions**

The Fund's Agreement and Declaration of Trust (the Declaration) includes provisions that could limit the ability of other entities or persons to acquire control of the Fund or to convert the Fund to open-end status. See Anti-takeover and other provisions in the Declaration of Trust. These provisions in the Declaration could have the effect of depriving the Common Shareholders of opportunities to sell their common shares at a premium over the then-current market price of the common shares or at net asset value.



**Table of Contents****Summary of Fund expenses**

The following table is intended to assist investors in understanding the fees and expenses (annualized) that an investor in common shares of the Fund would bear, directly or indirectly, as a result of the Offer being fully subscribed and the receipt of net proceeds from the Offer of approximately \$[ ] million. If the Fund issues fewer Shares in the Offer and the net proceeds to the Fund are less, all other things being equal, the expenses shown would increase. The table assumes that the Fund has Preferred Shares outstanding in an amount equal to [ ]% of the Fund's total assets (taking into account such outstanding Preferred Shares), which reflects the percentage of the Fund's total assets attributable to Preferred Shares as of [ ]. The table also assumes the use of leverage in the form of [reverse repurchase agreements] in an amount equal to [ ]% of the Fund's total assets (including the amounts of leverage obtained through the use of such instruments), which reflects the percentage of the Fund's assets attributable to reverse repurchase agreements as of [ ].

|  | <b>Percentage of<br/>Subscription Price</b>                               |
|--|---|
| <b>Shareholder Transaction Expenses</b>                          |   |
| Sales load   | [ ]%  |
| Offering expenses borne by Common Shareholders                   | [ ]%  |
| Dividend reinvestment and cash purchase plan fees                | None <sup>3</sup>   |
|  | <b>Percentage<br/>of Net Assets<br/>Attributable to<br/>Common Shares</b> |
| <b>Annual Expenses</b>   |   |
| Management fees <sup>4</sup>                                     | [ ]%  |
| Dividend expense on Preferred Shares <sup>5</sup>                | [ ]%  |
| Interest expense on [reverse repurchase agreements] <sup>6</sup> | [ ]%  |
| Other expenses <sup>7</sup>                                      | [ ]%  |
| [Acquired fund fees and expenses <sup>8</sup> ]                  | [ ]%  |
| <b>Total annual expenses</b>                                     | <b>[ ]%</b>   |

- The Dealer Manager will receive a fee for its financial structuring, marketing and soliciting services equal to [ ]% of the aggregate Subscription Price for Shares issued pursuant to the Offer. The Dealer Manager will reallow to broker-dealers in the selling group to be formed and managed by the Dealer Manager selling fees equal to [ ]% of the Subscription Price per Share for each Share issued pursuant to the Offer as a result of their selling efforts. In addition, the Dealer Manager will reallow to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to [ ]% of the Subscription Price per Share for each Share issued pursuant to the exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of Shares held by each broker-dealer through The Depository Trust Company ( DTC ) on the Record Date.*
- The fees and expenses of the Offer will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights.*
- You may pay brokerage charges if you direct the plan agent to sell your common shares held in a dividend reinvestment account. You also may pay a pro rata share of brokerage commissions incurred in connection with your market purchases pursuant to the Fund's dividend reinvestment plan. See Dividend reinvestment plan.*
- Management fees are charged to the Fund on the basis of total managed assets, but have been converted to a percentage of net assets attributable to common shares of the Fund for purposes of the fee table presentation as follows: management fees, assuming no leverage, divided by (one minus the percentage of the Fund's total assets attributable to outstanding Preferred Shares ( [ ]% of the Fund's total assets as of [ ])).*
- Assumes Preferred Shares outstanding in an amount equal to [ ]% of the Fund's total assets (taking into account such outstanding Preferred Shares) at an annual dividend cost to the Fund of [ ]%, which is based on PIMCO's assessment of current market conditions, and assumes the Fund will continue to pay Preferred Share dividends at the maximum applicable rate called for under the Fund's bylaws due to the ongoing failure of auctions for the Preferred Shares.*
- Assumes the use of leverage in the form of reverse repurchase agreements representing [ ]% of the Fund's total assets (including the amounts of leverage obtained through the use of such instruments) at an annual interest rate cost to the Fund of [ ]%, which is based on*

*PIMCO's assessment of current market conditions.*

7. *Other expenses are estimated for the Fund's current fiscal year.*

8. *[Footnote to be added by amendment, if applicable.]*

**EXAMPLE**

The following example illustrates the expenses that you would pay on a \$1,000 investment in common shares of the Fund (including the total sales load of \$[ ] and the other estimated costs of this Offer to be borne by the Common Shareholders of \$[ ]), assuming (1) that the Offer is fully subscribed and the Fund receives net proceeds from the

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Offer of approximately \$[ ], (2) that the Fund's current net assets do not increase or decrease, (3) that the Fund incurs total annual expenses of [ ]% of net assets attributable to common shares in years 1 through 10 (assuming outstanding Preferred Shares representing [ ]% of the Fund's total assets and reverse repurchase agreements utilized equal to [ ]% of the Fund's total assets) and (4) a 5% annual return:

|                         | 1 Year | 3 Years | 5 Years | 10 Years |
|-------------------------|--------|---------|---------|----------|
| Total expenses incurred | \$ [ ] | \$ [ ]  | \$ [ ]  | \$ [ ]   |

1. **The example above should not be considered a representation of future expenses. Actual expenses may be higher or lower than those shown.** The example assumes that the estimated Other expenses set forth in the Annual Expenses table are accurate and that all dividends and distributions are reinvested at net asset value. Actual expenses may be greater or less than those assumed. Moreover, the Fund's actual rate of return may be greater or less than the hypothetical 5% annual return shown in the example.

**Table of Contents****Financial highlights**

Except when noted, the information in this table is derived from the Fund's financial statements audited by [ ], whose report on such financial statements is contained in the Fund's [ ] Annual Report and incorporated by reference into the Statement of Additional Information.

[Financial highlights to be inserted by amendment.]

The following table sets forth certain unaudited information regarding the Fund's outstanding Preferred Shares as of the end of each of the Fund's fiscal years since inception.

| <b>Fiscal Year Ended</b> | <b>Total<br/>Amount<br/>Outstanding</b> | <b>Asset<br/>Coverage<br/>per<br/>Preferred Share<sup>1</sup></b> | <b>Involuntary<br/>Liquidating<br/>Preference<br/>per<br/>Preferred Share<sup>2</sup></b> | <b>Average<br/>Market<br/>Value per<br/>Preferred Share<sup>3</sup></b> |
|--------------------------|---|---|---|---|
| July 31, 2009            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |
| July 31, 2008            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |
| July 31, 2007            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |
| July 31, 2006            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |
| July 31, 2005            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |
| July 31, 2004            | \$ [ ]                                  | \$ [ ]  | \$ [ ]  | \$ [ ]  |

1. Asset Coverage per Preferred Share means the ratio that the value of the total assets of the Fund, less all liabilities and indebtedness not represented by Preferred Shares, bears to the aggregate of the involuntary liquidation preference of the Preferred Shares, expressed as a dollar amount per Preferred Shares.
2. Involuntary Liquidating Preference per Preferred Share means the amount to which a holder of Preferred Shares would be entitled upon the involuntary liquidation of the Fund in preference to the Common Shareholders, expressed as a dollar amount per Preferred Share.
3. [Footnote to be inserted by amendment.]

**Table of Contents****The offer****PURPOSE OF THE OFFER**

The Board, the Investment Manager and the Sub-Adviser have determined that it would be in the best interests of the Fund and its shareholders to increase the assets of the Fund, in order to more fully take advantage of current and prospective investment opportunities that may enable the Fund to increase overall investment yield on its investments, consistent with preservation of capital. The Board, the Investment Manager and the Sub-Adviser believe the current market environment offers the Fund compelling opportunities to deploy additional capital to take advantage of attractive investment opportunities and to enhance the Fund's future risk-adjusted returns by cost-efficiently altering investment allocations from bank loans to fixed rate instruments, more fully reflecting the investment opportunities available in the credit market. The Board, the Investment Manager and the Sub-Adviser also believe that increasing the Fund's assets available for investment may enable the Fund to enhance the Fund's market liquidity, increase the stability of future dividend distributions and reduce the Fund's expense ratio modestly, while achieving other net benefits to the Fund. The Board, the Investment Manager and the Sub-Adviser believe that the Offer is currently the most effective way to raise additional assets for the Fund while offering common shareholders the opportunity to buy additional common shares at a discounted price.

The Offer may not be successful. The completion of the Offer will likely result in an immediate dilution of the net asset value per common share for all existing Common Shareholders, including those who fully exercise their rights.

**IMPORTANT TERMS OF THE OFFER**

The Fund is issuing Rights to its Common Shareholders of record as of 5:00 p.m., Eastern time, on the Record Date, entitling the holders of those Rights to subscribe for up to an aggregate of [ ] Shares. Record Date Shareholders will receive [ ] Right[s] for each outstanding whole common share of the Fund held on the Record Date. The Rights entitle their holders to purchase [ ] new Share[s] for every [ ] Right[s] held ([ ]-for-[ ]). Fractional Shares will not be issued upon the exercise of Rights; accordingly, Rights may be exercised only in integer multiples of [ ], except that any Record Date Shareholder who is issued fewer than [ ] Rights may subscribe, at the Subscription Price (defined below), for one full Share. Assuming the exercise of all Rights, the Offer will result in an approximately [ ]% increase in the Fund's common shares outstanding.

Record Date Shareholders who exercise all the Rights issued to them (other than those Rights that cannot be exercised because they represent the right to acquire less than one Share) are entitled to subscribe for additional Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations and to allotment. Investors who are not Common Shareholders on the Record Date, but who otherwise acquire Rights to purchase Shares pursuant to the Offer, are not entitled to subscribe for any Shares pursuant to the over-subscription privilege. See **Over-Subscription Privilege** below. The distribution to Record Date Shareholders of transferable Rights may afford non-participating Record Date Shareholders the opportunity to sell their Rights for some cash value, receipt of which may be viewed as partial compensation for any economic dilution of their interests resulting from the Offer.

The subscription period commences on [ ] and ends at 5:00 p.m., Eastern time, on [ ], unless otherwise extended.

The Fund expects to declare a monthly distribution in [ ]. Such distribution will not be payable with respect to Shares that are issued pursuant to the Offer after the record date for such dividend.

For purposes of determining the maximum number of Shares a Rights holder may acquire pursuant to the Offer, broker-dealers, trust companies, banks or others whose shares are held of record by Cede & Co., the nominee for the Depository Trust Company ( DTC ), or by any other depository or nominee will be deemed to be the holders of the Rights that are held by Cede & Co. or such other depository or nominee on their behalf.

The Rights will be listed for trading on the NYSE under the symbol [ ] during the course of the Offer. Trading in the Rights on the NYSE may be conducted until the close of trading on the NYSE on the last business day prior to the Expiration Date. See **Sale and Transferability of Rights**. The Shares, once issued, will be listed on the NYSE under the symbol [ ]. The Rights will be evidenced by subscription certificates which will be mailed to Record Date Shareholders, except as discussed below under **Requirements for Foreign Shareholders**.

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Rights may be exercised by filling in and signing the subscription certificate and mailing it in the envelope provided, or otherwise delivering the completed and signed subscription certificate to the Subscription Agent, together with payment at the estimated Subscription Price for the Shares. For a discussion of the method by which Rights may be exercised and Shares may be paid for, see **Exercise of Rights** and **Payment for Shares**.

The Fund retained the Dealer Manager to provide the Fund with financial advisory, marketing and soliciting services relating to the Offer, including advice with respect to the structure, timing and terms of the Offer. In determining the structure of the Offer, the Board considered, among other things, using a fixed-pricing versus a variable pricing mechanism, the benefits and drawbacks of conducting a non-transferable versus a transferable rights offering, the anticipated effect on the Fund and its existing Common Shareholders if the Offer is not fully subscribed, the dilutive effects on the Fund and its existing Common Shareholder of the Offer and the experience of the Dealer Manager in conducting rights offerings. The Board also considered that the Investment Manager and the Sub-Adviser would benefit from the Offer because the investment management fee and the subadvisory fee are based on the Fund’s total managed assets, which would increase as a result of the Offer. See **Benefits to the Investment Manager and the Sub-Adviser** on page [ ].

**Important Dates to Remember**

|  |             |
|--|-------------|
| Record Date:   | [ ]         |
| Subscription Period:   | [ ] to [ ]* |
| Confirmation Date of Over-Subscription Amounts:                  | [ ]*        |
| Final Date Rights Will Trade on NYSE:                            | [ ]*        |
| Expiration Date and Pricing Date:                                | [ ]*        |
| Payment for Shares Due or Notices of Guarantees of Delivery Due: | [ ]*        |
| Confirmation Mailed to Participants:                             | [ ]*        |
| Final Payment for Shares Due:                                    | [ ]*        |
| Delivery of Shares:  | [ ]*        |

\* See **Payment for Shares**. .  
Unless the Offer is extended.

**SUBSCRIPTION PRICE**

The subscription price for the Shares (the **Subscription Price** ) will be determined based on a formula equal to [ ]% of the average of the last reported sale price of the Fund’s common shares on the New York Stock Exchange (the **NYSE** ) on the Expiration Date and the [ ] preceding trading days (the **Formula Price** ). If, however, the Formula Price is less than [ ]% of the net asset value per common share on the Expiration Date, then the Subscription Price will be [ ]% of the Fund’s net asset value per common share on the Expiration Date. In each case, net asset value will be calculated as of the close of trading on the NYSE.

Because the Expiration Date of the subscription period will be [ ] (unless the Fund extends the subscription period), Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the Shares subscribed for pursuant to the primary subscription and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of \$[ ] per Share. See **Payment for Shares**. A Rights holder will have no right to rescind his subscription after the Subscription Agent has received a completed subscription certificate together with payment for the Shares offered pursuant to the Offer[, except as provided under **Notice of Net Asset Value Decline**. ] The Fund does not have the right to withdraw the Rights or to cancel the Offer after the Rights have been distributed.

The net asset value per share of the Fund’s common shares at the close of business on [ ] (the last trading date prior to the date of this prospectus on which the Fund determined its net asset value) was \$[ ], and the last reported sale price of a Share on the NYSE on that day was \$[ ].

**OVER-SUBSCRIPTION PRIVILEGE**

Record Date Shareholders who exercise all the Rights issued to them (other than those Rights that cannot be exercised because they represent the right to acquire less than one Share) are entitled to subscribe for additional Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations and



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to allotment. If sufficient remaining Shares are available, all Record Date Shareholders' over-subscription requests will be honored in full. In addition, any non-Record Date Shareholders who exercise Rights are entitled to subscribe for remaining Shares that are not otherwise subscribed for by Record Date Shareholders. If sufficient Shares are not available to honor all over-subscription requests, unsubscribed Shares will be allocated pro rata among those Record Date Shareholders who over-subscribe based on the number of common shares of the Fund they owned on the Record Date. The allocation process may involve a series of allocations in order to ensure that the total number of Shares available for over-subscriptions is distributed on a pro rata basis.

Record Date Shareholders who are fully exercising their Rights during the subscription period should indicate, on the subscription certificate that they submit with respect to the exercise of the Rights issued to them, how many Shares they desire to acquire pursuant to the over-subscription privilege.

Banks, broker-dealers, trustees and other nominee holders of Rights will be required to certify to the Subscription Agent, before any over-subscription privilege may be exercised with respect to any particular beneficial owner, as to the aggregate number of Rights exercised during the subscription period and the number of Shares subscribed for pursuant to the over-subscription privilege by such beneficial owner, and that such beneficial owner's primary subscription was exercised in full. Nominee holder over-subscription forms will be distributed to banks, brokers, trustees and other nominee holders of Rights with the subscription certificates.

The Fund will not offer or sell any Shares that are not subscribed for during the subscription period or pursuant to the over-subscription privilege.

**SALE AND TRANSFERABILITY OF RIGHTS**

The Rights will be listed for trading on the NYSE under the symbol [ ] during the course of the Offer. Trading in the Rights on the NYSE may be conducted until the close of trading on the NYSE on the last business day prior to the Expiration Date. The Fund and the Dealer Manager will use their best efforts to ensure that an adequate trading market for the Rights will exist, although there can be no assurance that a market for the Rights will develop. Assuming a market exists for the Rights, the Rights may be purchased and sold through usual brokerage channels or sold through the Subscription Agent.

*Sales through the Subscription Agent and the Dealer Manager.* Record Date Shareholders who do not wish to exercise any of the Rights issued to them pursuant to the Offer may instruct the Subscription Agent to sell any unexercised Rights through or to the Dealer Manager. Subscription certificates representing the Rights to be sold through or to the Dealer Manager must be received by the Subscription Agent by 5:00 p.m., Eastern time, on [ ] (or, if the subscription period is extended, by 5:00 p.m., Eastern time, two business days prior to the extended Expiration Date). Upon the timely receipt by the Subscription Agent of appropriate instructions to sell Rights, the Subscription Agent will ask the Dealer Manager either to purchase them or to use its best efforts to complete their sale, and the Subscription Agent will remit the proceeds of the sale to the selling Rights holder. If the Rights are sold, sales of those Rights will be deemed to have been effected at the weighted average price received by the Dealer Manager on the day those Rights are sold. The sale price of any Rights sold to the Dealer Manager will be based upon the then-current market price for the Rights. The Dealer Manager will also attempt to sell all Rights that remain unclaimed as a result of subscription certificates being returned by the postal authorities to the Subscription Agent as undeliverable as of the [fourth] business day prior to the Expiration Date. The Subscription Agent will hold the proceeds from those sales for the benefit of those non-claiming shareholders until the proceeds are either claimed or revert to the Commonwealth of Massachusetts. There can be no assurance that the Dealer Manager will purchase or be able to complete the sale of any Rights, and neither the Fund nor the Dealer Manager have guaranteed any minimum sale price for the Rights. If a Record Date Shareholder does not utilize the services of the Subscription Agent and chooses to use another broker-dealer or other financial institution to sell Rights issued to that shareholder pursuant to the Offer, then the other broker-dealer or financial institution may charge a fee to sell the Rights.

*Other Transfers.* The Rights evidenced by a subscription certificate may be transferred in whole by endorsing the subscription certificate for transfer in accordance with the instructions accompanying the subscription certificate. A portion of the Rights evidenced by a single subscription certificate (but not fractional Rights) may be transferred by delivering to the Subscription Agent a subscription certificate properly endorsed for transfer, with instructions to register such portion of the Rights evidenced thereby in the name of the transferee and to issue a new subscription certificate to the transferee evidencing the transferred Rights. If this occurs, a new subscription certificate



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evidencing the balance of the Rights, if any, will be issued to the Record Date Shareholder or, if the Record Date Shareholder so instructs, to an additional transferee. The signature on the subscription certificate must correspond with the name as written upon the face of the subscription certificate in every particular, without alteration or enlargement, or any change. A signature guarantee must be provided by an eligible guarantor institution (as defined in Rule 17Ad-15 of the Securities Exchange Act of 1934 (the Exchange Act)), subject to the standards and procedures adopted by the Fund.

Record Date Shareholders wishing to transfer all or a portion of their Rights should allow at least [five] business days prior to the Expiration Date for: (i) the transfer instructions to be received and processed by the Subscription Agent; (ii) a new subscription certificate to be issued and transmitted to the transferee or transferees with respect to transferred Rights and to the transferor with respect to retained Rights, if any; and (iii) the Rights evidenced by the new subscription certificate to be exercised or sold by the recipients of the subscription certificate. Neither the Fund nor the Subscription Agent or the Dealer Manager shall have any liability to a transferee or transferor of Rights if subscription certificates are not received in time for exercise or sale prior to the Expiration Date.

Except for the fees charged by the Information Agent, the Subscription Agent and the Dealer Manager (which are expected to be paid from the proceeds of the Offer by the Fund), all commissions, fees and other expenses (including brokerage commissions and transfer taxes) incurred or charged in connection with the purchase, sale or transfer of Rights will be for the account of the transferor of the Rights, and none of these commissions, fees or expenses will be paid by the Fund, the Information Agent, the Subscription Agent or the Dealer Manager. Shareholders who wish to purchase, sell, exercise or transfer Rights through a broker, bank or other party should first inquire about any fees and expenses that the shareholder will incur in connection with the transactions.

The Fund anticipates that the Rights will be eligible for transfer through, and that the exercise of the primary subscription and the over-subscription may be effected through, the facilities of DTC or the Subscription Agent until 5:00 p.m., Eastern time, on the Expiration Date.

**METHOD FOR EXERCISING RIGHTS**

Rights are evidenced by subscription certificates that will be mailed to Record Date Shareholders (except as described under Requirements for Foreign Shareholders below) or, if a shareholder's shares are held by Cede & Co. or any other depository or nominee on their behalf, to Cede & Co. or the other depository or nominee. Rights may be exercised by completing and signing the subscription certificate and mailing it in the envelope provided, or otherwise delivering the completed and signed subscription certificate to the Subscription Agent, together with payment in full at the estimated Subscription Price for the Shares by the Expiration Date as described under Payment For Shares. Rights may also be exercised by contacting your broker, banker or trust company, which can arrange, on your behalf, to guarantee by the Expiration Date delivery of payment and of a properly completed and executed subscription certificate pursuant to a notice of guaranteed delivery by the close of business on the [third] business day after the Expiration Date. A fee may be charged for this service. Completed subscription certificates and payments must be received by the Subscription Agent by 5:00 p.m., Eastern time, on the Expiration Date (unless delivery of subscription certificate and payment is effected by means of a notice of guaranteed delivery as described below under Payment for Shares) at the offices of the Subscription Agent at the addresses set forth below under Subscription Agent. Fractional Shares will not be issued upon exercise of Rights.

*Shareholders Who are Record Owners.* Shareholders who are record owners can choose between either option set forth below under Payment For Shares. If time is of the essence, option (2) will permit delivery of the subscription certificate and payment after the Expiration Date.

*Investors Whose Shares are Held by a Nominee.* Shareholders whose shares are held by a nominee, such as a broker or trustee, must contact that nominee to exercise their Rights. In that case, the nominee will complete the subscription certificate on behalf of the investor and arrange for proper payment by one of the methods set forth below under Payment For Shares.

*Nominees.* Nominees, such as brokers, trustees or depositories for securities, who hold common shares of the Fund for the account of others should notify the respective beneficial owners of such shares as soon as possible to ascertain those beneficial owners' intentions and to obtain instructions with respect to the Rights. If the beneficial owner so instructs, the nominee should complete the subscription certificate and submit it to the Subscription Agent with the proper payment as described below under Payment For Shares.

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Banks, brokers, trustees and other nominee holders of Rights will be required to certify to the Subscription Agent, before any over-subscription privilege may be exercised with respect to any particular beneficial owner on the Record Date, as to the aggregate number of Rights exercised during the subscription period and the number of Shares subscribed for pursuant to the over-subscription privilege by the beneficial owner, and that the beneficial owner exercised all the Rights issued to it pursuant to the Offer.

### **REQUIREMENTS FOR FOREIGN SHAREHOLDERS**

Subscription certificates will not be mailed to Record Date Shareholders whose addresses are outside the United States (for these purposes, the United States includes the District of Columbia and the territories and possessions of the United States) ( Foreign Shareholders ). The Subscription Agent will send a letter via regular mail to Foreign Shareholders to notify them of the Offer. The Rights of Foreign Shareholders will be held by the Subscription Agent for their accounts until instructions are received to exercise the Rights. If instructions have not been received by 5:00 p.m., Eastern time, on [ ], [three] business days prior to the Expiration Date (or, if the subscription period is extended, on or before [three] business days prior to the extended Expiration Date), the Rights of Foreign Shareholders will be transferred by the Subscription Agent to the Dealer Manager, who will either purchase the Rights or use its best efforts to sell the Rights. The net proceeds, if any, from sale of those Rights by or to the Dealer Manager will be remitted to those Foreign Shareholders.

### **DISTRIBUTION ARRANGEMENTS**

[ ] will act as Dealer Manager for this Offer. Under the terms and subject to the conditions contained in the Dealer Manager Agreement among the Dealer Manager, the Fund and the Investment Manager, the Dealer Manager will provide financial structuring services and marketing assistance in connection with the Offer and will solicit the exercise of Rights and participation in the over-subscription privilege. The Fund has agreed to pay the Dealer Manager a fee for its financial structuring, marketing and soliciting services equal to [ ]% of the aggregate Subscription Price for the Shares issued pursuant to the exercise of Rights and the over-subscription privilege. The fees paid to the Dealer Manager and other expenses of the Offer will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise the Rights.

The Dealer Manager will reallocate a portion of its fees to other broker-dealers who have assisted in soliciting the exercise of Rights. The Dealer Manager will reallocate to broker-dealers included in the selling group to be formed and managed by the Dealer Manager selling fees equal to [ ]% of the Subscription Price per share for each Share issued pursuant to the Offer as a result of their selling efforts. In addition, the Dealer Manager will reallocate to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to [ ]% of the Subscription Price per share for each Share issued pursuant to exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of Shares held by each broker-dealer through DTC on the Record Date. Fees will be paid to the broker-dealer designated on the applicable portion of the subscription certificates or, in the absence of such designation, to the Dealer Manager.

The Fund and the Investment Manager have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act. The Dealer Manager Agreement also provides that the Dealer Manager will not be subject to any liability to the Fund in rendering the services contemplated by the Dealer Manager Agreement except for any act of bad faith, willful misconduct or gross negligence of the Dealer Manager or reckless disregard by the Dealer Manager of its obligations and duties under the Dealer Manager Agreement.

Prior to the expiration of the Offer, the Dealer Manager may independently offer for sale Shares it has acquired through purchasing and exercising the Rights, at prices it sets. Although the Dealer Manager may realize gains and losses in connection with purchases and sales of Shares, such offering of Shares is intended by the Dealer Manager to facilitate the Offer and any such gains or losses are not expected to be material to the Dealer Manager. The Dealer Manager's fee for its financial structuring, marketing and soliciting services is independent of any gains or losses that may be realized by the Dealer Manager through the purchase and exercise of the Rights and the sale of Shares.

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In the ordinary course of their businesses, the Dealer Manager and/or its affiliates may engage in investment banking or financial transactions with the Fund, the Investment Manager, the Sub-Adviser and their affiliates.

The principal business address of [ ] is [ ].

**SUBSCRIPTION AGENT**

[ ] is the Subscription Agent for the Offer. [The Subscription Agent will receive for its administrative, processing, invoicing and other services a fee estimated to be approximately \$[ ], plus reimbursement for all out-of-pocket expenses related to the Offer.] Questions regarding the subscription certificates should be directed by mail to [ ]. **Shareholders may also subscribe for the Offer by contacting their broker dealer, trust company, bank or other nominee.**

Completed subscription certificates must be sent together with proper payment of the estimated Subscription Price for all Shares subscribed for in the primary subscription and the over-subscription privilege (for Record Date Shareholders) to the Subscription Agent by one of the methods described below. Alternatively, shareholders may arrange for their financial institutions to send notices of guaranteed delivery by facsimile to DTC to be received by the Subscription Agent prior to 5:00 p.m., Eastern time, on the Expiration Date. Facsimiles should be confirmed by telephone at DTC. The Fund will accept only properly completed and executed subscription certificates actually received at any of the addresses listed below, prior to 5:00 p.m., Eastern time, on the Expiration Date or by the close of business on the [third] business day after the Expiration Date following timely receipt of a notice of guaranteed delivery. See **Payment for Shares** below.

| <b>Subscription Certificate Delivery Method</b>      | <b>Address/Number</b>   |
|--|---|
| Notice of Guaranteed Delivery:                       | Contact your broker-dealer, trust company, bank, or other nominee to notify the Fund of your intent to exercise the Rights. |
| First Class Mail Only: (No Overnight /Express Mail): | [ ]<br>Attn: [ ]<br>[ ]<br>[ ]  |
| Hand:  | [ ]<br>Attn: [ ]<br>[ ]<br>[ ]  |
| Express Mail or Overnight Courier:                   | [ ]<br>Attn: [ ]<br>[ ]<br>[ ]  |

**The Fund will honor only subscription certificates received by the Subscription Agent on or prior to the Expiration Date at one of the addresses listed above. Delivery to an address other than those listed above will not constitute good delivery.**

**INFORMATION AGENT**

The Information Agent for the Offer is [ ]. If you have questions or need further information about the Offer, please write the Information Agent at [ ] or call [ ]. Any questions or requests for assistance concerning the method of subscribing for Shares or additional copies of this prospectus or subscription certificates should be directed to the Information Agent. Shareholders may also contact their brokers or nominees for information with respect to the Offer.

The Information Agent will receive a fee estimated to be approximately \$[ ] for its services, plus reimbursement for all out-of-pocket expenses related to the Offer. The fees and expenses of the Information Agent are included in the fees and expenses of the Offer and therefore will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights.

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**EXPIRATION OF THE OFFER**

The Offer will expire at 5:00 p.m., Eastern time, on [ ], unless the Fund extends the Expiration Date. Rights will expire on the Expiration Date and may not be exercised after that date. If the Fund extends the Expiration Date, the Fund will make an announcement as promptly as practicable. This announcement will be issued no later than [ ], Eastern time, on the next business day following the previously scheduled Expiration Date. Without limiting the manner in which the Fund may choose to make this announcement, the Fund will not, unless otherwise required by law, have any obligation to publish, advertise or otherwise communicate this announcement other than by making a release to the Dow Jones News Service or any other means of public announcement as the Fund may deem proper.

**PAYMENT FOR SHARES**

Rights holders who wish to acquire Shares pursuant to the Offer may choose between the following methods of payment:

- (1) A Rights holder can send the subscription certificate together with payment for the Shares subscribed for during the subscription period and, if eligible, for any additional Shares subscribed for pursuant to the over-subscription privilege to the Subscription Agent based upon an estimated Subscription Price of \$[ ] per Share. Subscription will be accepted when payment, together with the executed subscription certificate, is received by the Subscription Agent at one of the addresses set forth above; the payment and subscription certificate must be received by the Subscription Agent by 5:00 p.m., Eastern time, on the Expiration Date. The Subscription Agent will deposit all checks received by it for the purchase of Shares into a segregated interest-bearing account of the Fund (the interest from which will belong to the Fund) pending proration and distribution of Shares. A payment pursuant to this method must be in U.S. dollars by money order or check drawn on a bank located in the United States, must be payable to PIMCO [Income Strategy] Fund and must accompany a properly completed and executed subscription certificate for such subscription to be accepted.
- (2) Alternatively, a subscription will be accepted by the Subscription Agent if, by 5:00 p.m., Eastern time, on the Expiration Date, the Subscription Agent has received a notice of guaranteed delivery by facsimile (teletype) or otherwise from a bank, a trust company or NYSE member guaranteeing delivery of (i) payment of the full Subscription Price for the Shares subscribed for during the subscription period and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege and (ii) a properly completed and executed subscription certificate. The Subscription Agent will not honor a notice of guaranteed delivery unless a properly completed and executed subscription certificate and full payment for the Shares at the estimated subscription price are received by the Subscription Agent by the close of business on the [third] business day after the Expiration Date.

On the confirmation date, which will be [five] business days following the Expiration Date, a confirmation will be sent by the Subscription Agent to each Rights holder exercising its Rights (or, if Shares are held by DTC or any other depository or nominee, to DTC and that other depository or nominee) showing (i) the number of Shares acquired during the subscription period, (ii) the number of Shares, if any, acquired pursuant to the over-subscription privilege, (iii) the per Share and total purchase price for the Shares and (iv) any additional amount payable to the Fund by the Rights holder or any excess to be refunded by the Fund to the Rights holder, in each case based on the Subscription Price as determined on the Expiration Date. If any Record Date Shareholder exercises its right to acquire Shares of the Fund pursuant to the over-subscription privilege, any excess payment which would otherwise be refunded to the Record Date Shareholder will be applied by the Fund toward payment for Shares acquired pursuant to exercise of the over-subscription privilege. Any additional payment required from a Rights holder must be received by the Subscription Agent within [ten] business days after the confirmation date ([ ], unless the Expiration Date is extended). Any excess payment to be refunded by the Fund to a Rights holder will be mailed by the Subscription Agent to such Rights holder as promptly as practicable. All payments by a Rights holder must be in U.S. dollars by money order or check drawn on a bank located in the United States and payable to PIMCO [Income Strategy Fund].

Whichever of the two methods described above is used, issuance and delivery of certificates for the Shares subscribed for are contingent upon actual payment for such Shares.

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**Rights holders who have exercised their Rights will have no right to rescind their subscription after receipt of the completed subscription certificate together with payment for Shares by the Subscription Agent, except as described under Notice of Net Asset Value Decline below.**

If a Rights holder who acquires Shares during the subscription period or pursuant to the over-subscription privilege (for Record Date Shareholders) does not make payment of any amounts due by the Expiration Date or the date payment is due under a notice of guaranteed delivery, the Fund reserves the right to take any or all of the following actions through all appropriate means: (i) find other Record Date Shareholders for the subscribed and unpaid for Shares; (ii) apply any payment actually received by the Fund toward the purchase of the greatest whole number of Shares that could be acquired by the Rights holder upon exercise of such Rights acquired during the subscription period or pursuant to the over-subscription privilege; and/or (iii) exercise any and all other rights or remedies to which the Fund may be entitled, including, without limitation, the right to set off against payments actually received by it with respect to such subscribed Shares.

The method of delivery of completed subscription certificates and payment of the Subscription Price to the Subscription Agent will be at the election and risk of exercising Rights holders, but if sent by mail it is recommended that such forms and payments be sent by registered mail, properly insured, with return receipt requested, and that a sufficient number of days be allowed to ensure delivery to the Subscription Agent and clearance of payment by 5:00 p.m., Eastern time, on the Expiration Date. Because uncertified personal checks may take at least five business days to clear, exercising Rights holders are strongly urged to pay, or arrange for payment, by means of certified or cashier's check or money order.

All questions concerning the timeliness, validity, form and eligibility of any exercise of Rights will be determined by the Fund, which determinations will be final and binding. The Fund, in its sole discretion, may waive any defect or irregularity, or permit a defect or irregularity to be corrected within such time as it may determine, or reject the purported exercise of any Right. Subscriptions will not be deemed to have been received or accepted until substantially all irregularities have been waived or cured within such time as the Fund determines in its sole discretion. The Fund will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription certificates or incur any liability for failure to give such notification.

**NOTICE OF NET ASSET VALUE DECLINE**

[The Fund has, pursuant to the Securities and Exchange Commission's regulatory requirements, undertaken to suspend the Offer until the Fund amends this prospectus if after [ ], the effective date of the Fund's Registration Statement, the Fund's net asset value declines more than 10% from the Fund's net asset value as of that date. In that event, the Expiration Date will be extended and the Fund will notify Record Date Shareholders of any such decline and permit Rights holders to cancel their exercise of Rights.]

**DELIVERY OF SHARES**

[Participants in the Fund's dividend reinvestment plan (the Plan) will have any Shares acquired pursuant to the Offer credited to their shareholder dividend reinvestment accounts in the Plan. Common Shareholders whose shares are held of record by DTC or by any other depository or nominee on their behalf or their broker-dealers' behalf will have any Shares acquired during the subscription period credited to the account of DTC or other depository or nominee.]

**U.S. FEDERAL INCOME TAX CONSEQUENCES**

The following is a general summary of the material U.S. federal income tax consequences of the Offer under the provisions of the Internal Revenue Code of 1986, as amended (the Code), Treasury regulations promulgated thereunder (Treasury regulations), and other applicable authority in effect as of the date of the prospectus that are generally applicable to Record Date Shareholders and other Rights holders who are United States persons within the meaning of the Code, and does not address any foreign, state, local or other tax consequences. These authorities may be changed, possibly with retroactive effect, or subject to new legislative, administrative or judicial action. Record Date Shareholders and other Rights holders should consult their tax advisors regarding the tax consequences, including U.S. federal, state, local, foreign or other tax consequences, relevant to their particular circumstances.

The Fund believes that the value of a Right will not be includible in the income of a Record Date Shareholder at the time the Right is issued, and the Fund will not report to the Internal Revenue Service (IRS) that a Record Date

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Shareholder has income as a result of the issuance of the Right; however, there is no guidance directly on point concerning certain aspects of this Offer. The remainder of this discussion assumes that the receipt of the Rights by Record Date Shareholders will not be a taxable event for U.S. federal income tax purposes.

The basis of a Right issued to a Record Date Shareholder will be zero, and the basis of the Share with respect to which the Right was issued (the old Share) will remain unchanged, except that the shareholder must allocate the basis of the old Share and the Right in proportion to their respective fair market values on the date of distribution if (i) either (a) the fair market value of the Right on the date of distribution is at least 15% of the fair market value of the old Share on that date, or (b) the shareholder affirmatively elects (in the manner set out in Treasury regulations) to allocate to the Right a portion of the basis of the old Share and (ii) the Right does not expire unexercised in the hands of the shareholder (*i.e.*, the shareholder either exercises or sells the Right following its issuance).

No loss will be recognized by a Record Date Shareholder if a Right distributed to such shareholder expires unexercised in the hands of such shareholder.

The basis of a Right purchased in the market will generally be its purchase price. If a Right that has been purchased in the market expires unexercised, the holder will recognize a loss equal to the basis of the Right.

Any gain or loss on the sale of a Right or, in the case of Rights purchased in the market, any loss from a Right that expires unexercised, will be a capital gain or loss if the Right is held as a capital asset (which in the case of Rights issued to Record Date Shareholders will depend on whether the old common share is held as a capital asset), and will be a long-term capital gain or loss if the holding period of the Right exceeds (or is deemed to exceed) one year. The deductibility of capital losses is subject to limitation. The holding period of a Right issued to a Record Date Shareholder will include the holding period of the old common share.

No gain or loss will be recognized by a shareholder upon the exercise of a Right, and the basis of any Share acquired upon exercise (the new Share) will equal the sum of the basis, if any, of the Right and the Subscription Price for the new Share. When a holder exercises a Right, the holder's holding period in the new Shares does not include the time during which the holder held the unexercised Right; the holding period for the new Share will begin no later than the date following the date of exercise of the Right.

## **EMPLOYEE PLAN CONSIDERATIONS**

Shareholders whose shares are in employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ( ERISA ) or Section 4975 of the Code (including corporate savings and 401(k) plans, Keogh or H.R. 10 plans of self-employed individuals and individual retirement accounts) (each, a Plan ) should be aware that additional contributions of cash to the Plan (other than rollover contributions or trustee-to-trustee transfers from other Plans) in order to exercise Rights would be treated as contributions to such Plan and, when taken together with contributions previously made, may result in, among other things, excise taxes for excess or nondeductible contributions. In the case of Plans qualified under Section 401(a) of the Code and certain other retirement plans, additional cash contributions could cause the maximum contribution limitations of Section 415 of the Code or other qualification rules to be violated. In addition, there may be other adverse tax and ERISA consequences if Rights are sold or transferred by a Plan.

ERISA contains fiduciary responsibility requirements, and ERISA and the Code contain prohibited transaction rules that may affect the exercise or transfer of Rights. Due to the complexity of these rules and the penalties for noncompliance, fiduciaries of Plans and other retirement plans should consult with their counsel and other advisers regarding the consequences of their exercise or transfer of Rights under ERISA and the Code.

## **BENEFITS TO THE INVESTMENT MANAGER AND THE SUBADVISER**

The Investment Manager and the Sub-Adviser will benefit from the Offer because the investment management fee paid by the Fund to the Investment Manager and the subadvisory fee paid by the Investment Manager to the Sub-Adviser are based on the Fund's average weekly total managed assets. It is not possible to state precisely the amount of additional compensation the Investment Manager and the Sub-Adviser will receive as a result of the Offer because it is not known how many Shares of the Fund will be subscribed for and because the proceeds of the Offer will be invested in additional portfolio securities which will fluctuate in value. However, assuming (i) all Rights are exercised, (ii) the Fund's average weekly net asset value during [ ] is \$[ ] per share (the net asset value per share

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on [ ] (iii) the Subscription Price is \$[ ] per share ([ ]% of the last reported sale price of the Fund's common shares on [ ]), and (iv) for purposes of this example, the Fund increases the amount of leverage outstanding while maintaining approximately the same percentage of total assets attributable to leverage, and after giving effect to Dealer Manager fees and other offering expenses, the Investment Manager and the Sub-Adviser would receive additional investment management fees and subadvisory fees of approximately \$[ ] and \$[ ], respectively, for the calendar year [ ], and would continue to receive additional investment management fees and subadvisory fees, respectively, as a result of the Offer, based on the Fund's average weekly total managed assets attributable to the Shares issued in the Offer, thereafter.

**INVESTMENT CONSIDERATIONS**

Upon completion of the Offer, Common Shareholders who do not exercise their Rights fully will own a smaller proportional interest in the Fund than would be the case if the Offer had not been made. In addition, because the Subscription Price per Share will be less than the Fund's net asset value per common share, the Offer will likely result in a dilution of the Fund's net asset value per common share for all Common Shareholders, irrespective of whether they exercise all or any portion of their Rights. Although it is not possible to state precisely the amount of such a decrease in value, because it is not known at this time what the Subscription Price will be, what the net asset value per common share will be at the Expiration Date or what proportion of Shares will be subscribed for, the dilution could be substantial. For example, assuming that all Rights are exercised, that the Fund's net asset value per common share on the Expiration Date is \$[ ] per common share (the net asset value per common share on [ ]), and that the Subscription Price is \$[ ] per Share ([ ]% of the last reported sale price of the Fund's common shares on [ ]), the Fund's net asset value per common share on this date would be reduced by approximately \$[ ] per common share, after giving effect to Dealer Manager fees and other offering expenses, estimated at \$[ ], payable by the Fund. Record Date Shareholders will experience a decrease in the net asset value per common share held by them, irrespective of whether they exercise all or any portion of their Rights. The distribution of transferable Rights, which may themselves have value, will afford non-participating shareholders the potential of receiving a cash payment upon the sale of the Rights, receipt of which may be viewed as partial compensation for the economic dilution of their interests, although there can be no assurance that a market for the Rights will develop.

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**Use of proceeds**

The net proceeds of the Offer will be invested in accordance with the Fund's investment objective and investment strategies set forth below. Assuming current market conditions, the Fund estimates that the net proceeds of the Offer will be substantially invested in accordance with its investment objective and investment strategies within [ ] to [ ] months of the completion of the Offer. Pending such investment, it is anticipated that the proceeds of the Offer will be invested in [short-term debt securities]. Following the completion of the Offer, the Fund may increase the Fund's leverage. See Use of leverage.



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**The Fund**

The Fund is a diversified closed-end management investment company. The Fund was organized as a Massachusetts business trust on June 19, 2003, pursuant to an Agreement and Declaration of Trust governed by the laws of The Commonwealth of Massachusetts. The Fund commenced investment operations on August 29, 2003, following the initial public offering of its common shares. The Fund's principal office is located at 1345 Avenue of the Americas, New York, New York 10105 and its telephone number is [ ].

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**Investment objective and policies**

**INVESTMENT OBJECTIVE**

The Fund's investment objective is to seek high current income, consistent with the preservation of capital. The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The average portfolio duration of the Fund normally will be in a low to intermediate range (*i.e.*, zero to eight years). The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's or below BBB- by either S&P or Fitch) or that are unrated but judged by PIMCO to be of comparable quality, and also may invest without limit in investment grade securities.

The Fund has the flexibility to allocate and to re-allocate its assets in varying proportions among floating- and fixed-rate debt instruments as well as among investment grade and non-investment grade securities, and may choose to focus more heavily or exclusively on an asset class (*i.e.*, floating or fixed; investment grade or non-investment grade) at any time and from time to time based on PIMCO's assessment of relative values, market conditions and other factors.

Various types of securities and other instruments in which the Fund may invest are described under "Portfolio contents" below. The Fund cannot assure you that it will achieve its investment objective.

**INVESTMENT STRATEGIES**

The Fund is actively managed in accordance with PIMCO's top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis, broad market diversification among industries and sectors and other risk management techniques. In selecting investments for the Fund, PIMCO attempts to identify floating- and/or fixed-rate debt instruments that provide high current income through fundamental research, driven by independent credit analysis and proprietary analytical tools. Investment decisions are based primarily on PIMCO's assessment of the issuer's credit characteristics and the position of the particular security in the issuer's capital structure, in light of PIMCO's outlook for particular industries, the economy and the market generally. At the same time, PIMCO may use a variety of techniques, such as credit default swaps, designed to control risk and to minimize the Fund's exposure to issues that PIMCO believes are more likely to default or otherwise to depreciate in value over time and to detract from the Fund's overall return to investors. The Fund cannot assure you that such securities will ultimately continue to pay current income or be paid in full at maturity.

*Credit Quality.* The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade or that are unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. The Fund may invest in issuers of any credit quality (including debt securities in the lowest ratings categories and securities that are in default or the issuers of which are in bankruptcy) if PIMCO determines that the particular security offers an attractive yield relative to its risk profile. Debt securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and to repay principal, and are commonly referred to as "high yield" securities or "junk bonds." Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies. The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue.

*Independent Credit Analysis.* PIMCO relies heavily on its own analysis of the credit quality and risks associated with individual debt instruments considered for the Fund, rather than relying exclusively on rating agencies or third-party research. In the case of Senior Loans, PIMCO analyzes and takes into account the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral) in assessing their credit characteristics. PIMCO has a devoted team of professionals that conducts fundamental credit research and analysis of individual issuers, industries and sectors and uses proprietary analytical tools (such as computer databases and Web-based applications) to assess and to monitor credit risk. The Fund's portfolio manager utilizes this information in an attempt to manage credit risk and to identify issuers, industries or

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sectors that offer attractive yields relative to PIMCO's assessment of their credit characteristics. This aspect of PIMCO's capabilities is particularly important to the extent that the Fund focuses on Senior Loans and/or below investment grade securities. PIMCO's ability to analyze Senior Loans may be limited to the extent that the portfolio manager and analysts avoid the receipt of material, non-public information about the issuers of Senior Loans. See "Principal risks of the Fund - Confidential Information Access Risk."

*Duration.* The average portfolio duration of the Fund will normally be in a low to intermediate range (*i.e.*, zero to eight years), although it may be longer at any time and from time to time based on PIMCO's assessment of market conditions and other factors. PIMCO may utilize certain strategies, including investments in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund's portfolio, although there is no assurance that it will do so or that such strategies will be successful.

Duration is a measure of the expected life of a debt security that is used to determine the sensitivity of the security's price to changes in interest rates. The longer a security's duration, the more sensitive it will be to changes in interest rates. For example, the market price of a bond with a duration of two years would be expected to decline 2% if interest rates were to rise 1%. Conversely, the market price of the same bond would be expected to increase 2% if interest rates were to fall 1%. The market price of a bond with a duration of four years would be expected to increase or decline twice as much as the market price of a bond with a two-year duration. The maturity of a security, another commonly used measure of price sensitivity, measures only the time until final payment is due, whereas duration takes into account the pattern of all payments of interest and principal on a security over time, including how these payments are affected by prepayments and by changes in interest rates, as well as the time until an interest rate on a security is reset (in the case of variable rate securities).

**Portfolio contents**

The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The Fund may invest a substantial portion of its floating-rate assets in Senior Loans. Other floating rate debt instruments in which the Fund may invest include catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds and other debt securities, money market instruments and certain types of mortgage-backed and other asset-backed securities that pay interest at rates which adjust whenever a specified interest rate changes and/or reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund also considers floating rate assets to include 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. The Fund also may invest in a wide variety of fixed-rate debt securities, including corporate bonds, convertible securities and mortgage-backed and other asset-backed securities issued on a public or private basis. The Fund may make use of a variety of other instruments, including collateralized debt obligations, preferred shares, commercial paper, U.S. Government securities, zero-coupon and inflation-indexed bonds, real estate investment trusts (REITs), structured notes and other hybrid instruments and credit-linked trust certificates. Certain debt instruments, such as convertible bonds, also may include the right to participate in equity appreciation. The principal and/or interest rate on some debt instruments may be determined by reference to the performance of a benchmark asset or market, such as an index of securities, or the differential performance of two assets or markets, such as the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

The Fund may also hold common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The Fund may invest in securities that have not been registered for public sale, including securities eligible for purchase and sale pursuant to Rule 144A under the Securities Act of 1933 and other securities issued in private placements. The Fund may also invest in securities of other investment companies, including exchange-traded funds (ETFs). The Fund may invest in securities of companies with small market capitalizations.

As noted above, the Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade, and may also invest without limit in investment grade securities.

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The Fund expects to invest predominantly in U.S. dollar-denominated debt securities, which may include those issued by foreign corporations or supra-national government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund may invest up to 25% of its total assets in securities of issuers economically tied to emerging market countries.

The Fund may utilize various derivative strategies involving the purchase or sale of credit default swaps, total return swaps and other swap agreements, call and put options (including options on futures contracts), futures and forward contracts, short sales and other derivative instruments for investment purposes, leveraging purposes or in an attempt to hedge against market, interest rate, currency and other risks in the portfolio. The Fund may also seek to obtain market exposure to the securities in which it invests by entering into a series of purchase and sales contracts.

The Fund may invest without limit in illiquid securities. Illiquidity is generally determined using the Securities and Exchange Commission's standard applicable to open-end investment companies (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

The Fund cannot change its investment objective without the approval (a) of the holders of a majority of the outstanding common shares and any preferred shares (including the Preferred Shares) voting together as a single class, and (b) of the holders of a majority of the outstanding preferred shares (including the Preferred Shares) voting as a separate class. A majority of the outstanding shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

Upon PIMCO's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, the Fund may deviate from its investment objective and strategies and invest some or all of its total assets in investment grade debt securities, including high quality, short-term debt securities. The Fund may not achieve its investment objective when it does so.

The following provides additional information regarding the types of securities and other instruments in which the Fund ordinarily invests. A more detailed discussion of these and other instruments and investment techniques that may be used by the Fund is provided under "Investment Objective and Policies" in the Statement of Additional Information.

**HIGH YIELD SECURITIES ( JUNK BONDS )**

The Fund may invest without limit in debt securities that are rated below investment grade (below Baa by Moody's or below BBB by either S&P or Fitch) or unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security, or unrated but judged by PIMCO to be of comparable quality. These securities are commonly referred to as high yield securities or junk bonds. Investments in high yield securities involve a greater degree of risk (in particular, a greater risk of default) than, and special risks in addition to the risks associated with, investments in investment grade debt obligations. While offering a greater potential opportunity for capital appreciation and higher yields, high yield securities typically entail greater potential price volatility and may be less liquid than higher-rated securities. High yield securities may be regarded as predominantly speculative with respect to the issuer's continuing ability to make timely principal and interest payments. They also may be more susceptible to real or perceived adverse economic and competitive industry conditions than higher-rated securities. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics.

The market values of high yield securities tend to reflect individual developments of the issuer to a greater extent than do higher-quality securities, which tend to react mainly to fluctuations in the general level of interest rates. In addition, lower-quality debt securities tend to be more sensitive to general economic conditions. Certain emerging market governments that issue high yield securities in which the Fund may invest are among the largest debtors to commercial banks, foreign governments and supranational organizations, such as the World Bank, and may not be able or willing to make principal and/or interest payments as they come due.

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Senior Loans generally tend to have more favorable recovery rates than most other types of loans. Although Senior Loans in which the Fund will invest will often be secured by collateral, there can be no assurance that liquidation of such collateral would satisfy the borrower's obligation in the event of default or that such collateral could be readily liquidated.

*Credit Ratings and Unrated Securities.* Rating agencies are private services that provide ratings of the credit quality of debt obligations. Appendix A to this prospectus describes the various ratings assigned to debt obligations by Moody's, S&P and Fitch. As noted in Appendix A, Moody's, S&P and Fitch may modify their ratings of securities to show relative standing within a rating category, with the addition of numerical modifiers (1, 2 or 3) in the case of Moody's, and with the addition of a plus (+) or minus (-) sign in the case of S&P and Fitch. The Fund may purchase a security, regardless of any rating modification, provided the security is rated at or above the Fund's minimum rating category. For example, the Fund may purchase a security rated Caa3 by Moody's, CCC- by S&P or CCC- by Fitch, provided that the Fund is permitted to purchase securities rated Caa/CCC. Ratings assigned by a rating agency are not absolute standards of credit quality and do not evaluate market risks. Rating agencies may fail to make timely changes in credit ratings and an issuer's current financial condition may be better or worse than a rating indicates. The Fund will not necessarily sell a security when its rating is reduced below its rating at the time of purchase. PIMCO does not rely solely on credit ratings, and develops its own analysis of issuer credit quality. The ratings of a debt security may change over time. Moody's, S&P and Fitch monitor and evaluate the ratings assigned to securities on an ongoing basis. As a result, debt instruments held by the Fund could receive a higher rating (which would tend to increase their value) or a lower rating (which would tend to decrease their value) during the period in which they are held.

The Fund may purchase unrated securities (which are not rated by a rating agency) if PIMCO determines that the securities are of comparable quality to rated securities that the Fund may purchase. Unrated securities may be less liquid than comparable rated securities and involve the risk that PIMCO may not accurately evaluate the security's comparative credit rating. Analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher-quality debt obligations. The Fund's success in achieving its investment objective may depend more heavily on PIMCO's credit analysis to the extent that the Fund invests in below investment grade quality and unrated securities.

**VARIABLE AND FLOATING RATE SECURITIES**

Variable and floating rate securities provide for a periodic adjustment in the interest rate paid on the obligations. The Fund may invest in floating rate debt instruments (floaters) and engage in credit spread trades. While floaters provide a certain degree of protection against rising interest rates, the Fund will participate in any decline in interest rates as well. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, where the value of the investment position is determined by changes in the difference between such prices or interest rates, as the case may be, of the respective securities. The Fund may also invest in inverse floating rate debt instruments (inverse floaters). An inverse floater may exhibit greater price volatility than a fixed rate obligation of similar credit quality.

**BANK LOANS**

The Fund may invest in fixed- and floating-rate loans issued by banks (including, among others, Senior Loans, delayed funding loans and revolving credit facilities). Loan interests may take the form of direct interests acquired during a primary distribution and may also take the form of assignments of, novations of or participations in a bank loan acquired in secondary markets.

As noted, the Fund may purchase assignments of bank loans from lenders. The purchaser of an assignment typically succeeds 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.

The Fund may also invest in participations in bank loans. Participations by the Fund in a lender's portion of a bank loan typically will result in the Fund having a contractual relationship only with such lender, not with the borrower. As a result, the Fund may have the right to receive payments of principal, interest and any fees to which it

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is entitled only from the lender selling the participation and only upon receipt by such lender of such payments from the borrower. In connection with purchasing participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement, nor any rights with respect to any funds acquired by other lenders through set-off against the borrower, and the Fund may not directly benefit from any collateral supporting the loan in which it has purchased the participation. As a result, the Fund may assume the credit risk of both the borrower and the lender selling the participation.

Among the types of bank loan investments that the Fund may make are interests in Senior Loans. Senior Loans typically pay interest at rates that are re-determined periodically on the basis of a floating base lending rate (such as the LIBOR Rate) plus a premium. Although Senior Loans are typically of below investment grade quality (*i.e.*, high yield securities), they tend to have more favorable recovery rates than other types of below investment grade quality debt obligations. Senior Loans generally (but not always) hold the most senior position in the capital structure of a borrower and are often secured with collateral. A Senior Loan is typically 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 (Lenders). The Agent typically administers and enforces the Senior Loan on behalf of the other Lenders in the syndicate. In addition, an institution, typically but not always the Agent, holds any collateral on behalf of the Lenders. A financial institution's employment as an Agent might be terminated in the event that it fails to observe a requisite standard of care or becomes insolvent. A successor Agent would generally be appointed to replace the terminated Agent, and assets held by the Agent under the loan agreement would likely remain available to holders of such indebtedness. However, if assets held by the Agent for the benefit of the Fund were determined to be subject to the claims of the Agent's general creditors, the Fund might incur certain costs and delays in realizing payment on a loan or loan participation and could suffer a loss of principal and/or interest. In situations involving other interposed financial institutions (*e.g.*, an insurance company or government agency) similar risks may arise.

Purchasers of Senior Loans and other forms of direct indebtedness depend primarily upon the creditworthiness of the corporate or other borrower for payment of principal and interest. If the Fund does not receive scheduled interest or principal payments on such indebtedness, the net asset value, market price and/or yield of the common shares could be adversely affected. Senior Loans that are fully secured may offer the Fund more protection than an unsecured loan in the event of non-payment of scheduled interest or principal. However, there is no assurance that the liquidation of any collateral from a secured Senior Loan would satisfy the borrower's obligation, or that such collateral could be liquidated. Also, the Fund may invest in Senior Loans that are unsecured.

Senior Loans may not be readily marketable and may be subject to restrictions on resale. In some cases, negotiations involved in disposing of indebtedness may require weeks to complete. Consequently, some indebtedness may be difficult or impossible to dispose of readily at what PIMCO believes to be a fair price.

Senior Loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the Senior Loan from free cash flow. The degree to which borrowers prepay Senior Loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among others. As such, prepayments cannot be predicted with accuracy. Upon a prepayment, either in part or in full, the actual outstanding debt on which the Fund derives interest income will be reduced. However, the Fund may receive both a prepayment penalty fee from the prepaying borrower and a facility fee upon the purchase of a new Senior Loan with the proceeds from the prepayment of the former. The effect of prepayments on the Fund's performance may be mitigated by the receipt of prepayment fees and the Fund's ability to reinvest prepayments in other Senior Loans that have similar or identical yields.

## **CORPORATE BONDS**

The Fund may invest in a wide variety of bonds of varying maturities issued by U.S. and foreign corporations and other business entities. Bonds are fixed or variable rate debt obligations, including bills, notes, debentures, money market instruments and similar instruments and securities. Bonds generally are used by corporations as well as governments and other issuers to borrow money from investors. The issuer pays the investor a fixed or variable rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are perpetual in that they have no maturity date.

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### **COMMERCIAL PAPER**

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The rate of return on commercial paper may be linked or indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

### **PREFERRED SECURITIES**

Preferred securities represent an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from liquidation of the company. Unlike common stocks, preferred stocks usually do not have voting rights. Preferred stocks in some instances are convertible into common stock. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in the company. Some preferred stocks offer a fixed rate of return with no maturity date. Because they never mature, these preferred stocks act like long-term bonds, can be more volatile than other types of preferred stocks and may have heightened sensitivity to changes in interest rates. Other preferred stocks have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction process, involving bids submitted by holders and prospective purchasers of such stocks. Although they are equity securities, preferred securities have certain characteristics of both debt securities and common stock. They are like debt securities in that their stated income is generally contractually fixed. They are like common stocks in that they do not have rights to precipitate bankruptcy proceedings or collection activities in the event of missed payments. Furthermore, preferred securities have many of the key characteristics of equity due to their subordinated position in an issuer's capital structure and because their quality and value are heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows. Because preferred securities represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt instruments to actual or perceived changes in a company's financial condition or prospects, or to fluctuations in the equity markets.

In order to be payable, dividends on preferred securities must be declared by the issuer's board of directors. In addition, distributions on preferred securities may be subject to deferral and thus may not be automatically payable. Income payments on some preferred securities are cumulative, causing dividends and distributions to accrue even if they are not declared by the board of directors of the issuer or otherwise made payable. Other preferred securities are non-cumulative, meaning that skipped dividends and distributions do not continue to accrue. There is no assurance that dividends on preferred securities in which the Fund invests will be declared or otherwise made payable.

Preferred securities have a liquidation value that generally equals their original purchase price at the date of issuance. The market values of preferred securities may be affected by favorable and unfavorable changes impacting the issuers' industries or sectors. They may also be affected by actual and anticipated changes or ambiguities in the tax status of the security and by actual and anticipated changes or ambiguities in tax laws, such as changes in corporate and individual income tax rates or the characterization of dividends as tax-advantaged. Many of the preferred securities in which the Fund may invest will not pay tax-advantaged dividends. See Tax matters. Because the claim on an issuer's earnings represented by preferred securities may become disproportionately large when interest rates fall below the rate payable on the securities or for other reasons, the issuer may redeem preferred securities, generally after an initial period of call protection in which the security is not redeemable. Thus, in declining interest rate environments in particular, the Fund's holdings of higher dividend-paying preferred securities may be reduced and the Fund may be unable to acquire securities paying comparable rates with the redemption proceeds.

### **CONVERTIBLE SECURITIES AND SYNTHETIC CONVERTIBLE SECURITIES**

The Fund may invest in convertible securities, which are debt securities that may be converted at either a stated price or stated rate into underlying shares of common stock. Convertible securities have general characteristics similar to both debt securities and equity securities. Although to a lesser extent than with debt obligations, the market value of convertible securities tends to decline as interest rates increase and, conversely, tends to increase as interest rates decline. In addition, because of the conversion feature, the market value of convertible securities tends to vary with fluctuations in the market value of the underlying common stocks and, therefore, also will react to variations in the general market for equity securities.

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Convertible securities are investments that provide for a stable stream of income with generally higher yields than common stocks. There can be no assurance of current income because the issuers of the convertible securities may default on their obligations. Convertible securities, however, generally offer lower interest or dividend yields than non-convertible debt securities of similar credit quality because of the potential for equity-related capital appreciation. A convertible security, in addition to providing current income, offers the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock.

The Fund may invest in synthetic convertible securities, which are created through a combination of separate securities that possess the two principal characteristics of a traditional convertible security, that is, an income-producing security ( income-producing component ) and the right to acquire an equity security ( convertible component ). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by purchasing warrants or options to buy common stock at a certain exercise price, or options on a stock index. The values of synthetic convertible securities will respond differently to market fluctuations than a traditional convertible security because a synthetic convertible is composed of two or more separate securities or instruments, each with its own market value. Synthetic convertible securities are also subject to the risks associated with derivatives. See Principal risks of the Fund Derivatives Risk. In addition, if the value of the underlying common stock or the level of the index involved in the convertible element falls below the strike price of the warrant or option, the warrant or option may lose all value.

### **BANK CAPITAL SECURITIES**

The Fund may invest in bank capital securities. Bank capital securities are issued by banks to help fulfill their regulatory capital requirements. There are three common types of bank capital: Lower Tier II, Upper Tier II and Tier I. Bank capital is generally, but not always, of investment grade quality. Upper Tier II securities are commonly thought of as hybrids of debt and preferred stock. Upper Tier II securities are often perpetual (with no maturity date), callable and have a cumulative interest deferral feature. This means that under certain conditions, the issuer bank can withhold payment of interest until a later date. However, such deferred interest payments generally earn interest. Tier I securities often take the form of trust preferred securities.

### **BANK OBLIGATIONS**

The Fund may invest in certain bank obligations, including certificates of deposit, bankers' acceptances, and fixed time deposits. Certificates of deposit are negotiable certificates issued against funds deposited in a commercial bank for a definite period of time and earning a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are accepted by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties which vary depending upon market conditions and the remaining maturity of the obligation.

### **ZERO-COUPON BONDS, STEP-UPS AND PAYMENT-IN-KIND SECURITIES**

Zero-coupon bonds pay interest only at maturity rather than at intervals during the life of the security. Like zero-coupon bonds, step up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security. Payment-in-kind securities ( PIKs ) are debt obligations that pay interest in the form of other debt obligations, instead of in cash. Each of these instruments is normally issued and traded at a deep discount from face value. Zero-coupon bonds, step-ups and PIKs allow an issuer to avoid or delay the need to generate cash to meet current interest payments and, as a result, may involve greater credit risk than bonds that pay interest currently or in cash. The Fund would be required to distribute the income on these instruments as it accrues, even though the Fund will not receive the income on a current basis or in cash. Thus, the Fund may have to sell other investments, including when it may not be advisable to do so, to make income distributions to its shareholders.

### **FOREIGN (NON-U.S.) INVESTMENTS**

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers or supranational government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including sovereign debt issued by foreign developed and emerging market





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governments and their respective sub-divisions, agencies or instrumentalities, government sponsored enterprises and supranational government entities. Supranational entities include international organizations that are organized or supported by one or more government entities to promote economic reconstruction or development and by international banking institutions and related governmental agencies. As a holder of sovereign debt, the Fund may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. In addition, there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. Investing in foreign securities involves special risks and considerations not typically associated with investing in U.S. securities. See Principal risks of the Fund Foreign (Non-U.S.) Investment Risk.

The Fund may invest in Brady Bonds, which are securities created through the exchange of existing commercial bank loans to sovereign entities for new obligations in connection with a debt restructuring. Investments in Brady Bonds may be viewed as speculative. Brady Bonds acquired by the Fund may be subject to restructuring arrangements or to requests for new credit, which may cause the Fund to realize a loss of interest or principal on any of its portfolio holdings.

The foreign securities in which the Fund may invest include Eurodollar obligations and Yankee Dollar obligations. Eurodollar obligations are U.S. dollar-denominated certificates of deposit and time deposits issued outside the U.S. capital markets by foreign branches of U.S. banks and by foreign banks. Yankee Dollar obligations are U.S. dollar-denominated obligations issued in the U.S. capital markets by foreign banks. Eurodollar and Yankee Dollar obligations are generally subject to the same risks that apply to domestic debt issues, notably credit risk, interest rate risk, market risk and liquidity risk. Additionally, Eurodollar (and to a limited extent, Yankee Dollar) obligations are subject to certain sovereign risks. One such risk is the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders. Other risks include adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of foreign withholding taxes; and the expropriation or nationalization of foreign issuers.

## **EMERGING MARKET SECURITIES**

The Fund may invest up to 25% of its total assets in the securities of issuers economically tied to emerging market countries. A security is considered to be economically tied to an emerging market country if the issuer or guarantor of the security is organized under the laws of the country or if the currency of settlement of the security is a currency of the emerging market country. PIMCO has broad discretion to identify countries that it considers to qualify as emerging securities markets. In making investments in emerging market securities, the Fund emphasizes countries with relatively low gross national product per capita and with the potential for rapid economic growth. Emerging market countries are generally located in Asia, Africa, the Middle East, Latin America and Eastern Europe. PIMCO will select emerging market country and currency composition based on its evaluation of relative interest rates, inflation rates, exchange rates, monetary and fiscal policies, trade and current account balances and any other specific factors it believes to be relevant.

Investments in emerging market securities involve a greater degree of risk than, and special risks in addition to the risks associated with, investments in domestic securities or in securities of foreign, developed countries. See Principal risks of the Fund Emerging Markets Risk.

## **FOREIGN CURRENCIES AND RELATED TRANSACTIONS**

The Fund's common shares are priced in U.S. dollars and the distributions paid by the Fund to Common Shareholders are paid in U.S. dollars. However, a significant portion of the Fund's assets may be denominated in foreign (non-U.S.) currencies and that income received by the Fund from many foreign debt obligations will be paid in foreign currencies. The Fund also may invest in or gain exposure to foreign currencies themselves for investment or hedging purposes. The Fund's investments in securities that trade in, or receive revenues in, foreign currencies will be subject to currency risk, which is the risk that fluctuations in the exchange rates between the U.S. dollar and foreign currencies may negatively affect any investment. See Principal risks of the Fund Foreign Currency Risk. The Fund may (but is not required to) hedge some or all of its exposure to foreign currencies through the use of derivative strategies. For instance, the Fund may enter into forward foreign currency exchange contracts, and may buy and sell foreign currency futures contracts and options on foreign currencies and foreign currency futures. A forward foreign currency exchange contract, which involves an obligation to purchase or sell a specific currency at a future date at a price set at the time of the contract, reduces the Fund's exposure to changes in the value of the

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currency it will deliver and increases its exposure to changes in the value of the currency it will receive for the duration of the contract. The effect on the value of the Fund is similar to selling securities denominated in one currency and purchasing securities denominated in another currency. Contracts to sell foreign currency would limit any potential gain which might be realized by the Fund if the value of the hedged currency increases. The Fund may enter into these contracts to hedge against foreign exchange risk arising from the Fund's investment or anticipated investment in securities denominated in foreign currencies. Suitable hedging transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in such transactions at any given time or from time to time when they would be beneficial. Although PIMCO has the flexibility to engage in such transactions for the Fund, it may determine not to do so or to do so only in unusual circumstances or market conditions. Also, these transactions may not be successful and may eliminate any chance for the Fund to benefit from favorable fluctuations in relevant foreign currencies.

The Fund may also use derivatives contracts for purposes of increasing exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one currency to another. To the extent that it does so, the Fund will be subject to the additional risk that the relative value of currencies will be different than anticipated by PIMCO.

Please see Investment Objective and Policies Foreign (Non-U.S.) Securities, Investment Objective and Policies Foreign Currency Transactions and Investment Objective and Policies Foreign Currency Exchange-Related Securities in the Statement of Additional Information for a more detailed description of the types of foreign investments and foreign currency transactions in which the Fund may invest and their related risks.

## **DERIVATIVES**

The Fund may, but is not required to, use a variety of derivative instruments for both investment and risk management purposes. The Fund also expects to use various derivatives transactions to add leverage to its portfolio. See Use of leverage. Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of an underlying asset, reference rate or index, and may relate to, among others, individual debt instruments, interest rates, currencies or currency exchange rates, commodities, and related indexes. Examples of derivative instruments that the Fund may use include options contracts, futures contracts, options on futures contracts and swap agreements. The Fund's use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investment directly in securities and other more traditional investments. See Principal risks of the Fund Derivatives Risk. Certain types of derivative instruments that the Fund may utilize are described elsewhere in this section, including those described under Certain Interest Rate Transactions, Credit Default Swaps and Structured Notes and Related Instruments. Please see Investment Objective and Policies Derivative Instruments in the Statement of Additional Information for additional information about these and other derivative instruments that the Fund may use and the risks associated with such instruments. There is no assurance that these derivative strategies will be available at any time or that PIMCO will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund may be subject to certain restrictions on its use of derivative strategies imposed by guidelines of one or more rating agencies that may issue ratings for the Preferred Shares.

## **CREDIT DEFAULT SWAPS**

The Fund may enter into credit default swap contracts for both investment and risk management purposes, as well as to add leverage to the Fund's portfolio. When used for hedging purposes, the Fund would be the buyer of a credit default swap contract. In that case, the Fund would be entitled to receive the par (or other agreed-upon) value of a referenced debt obligation from the counterparty to the contract in the event of a default by a third party, such as a U.S. or foreign issuer, on the debt obligation. In return, the Fund would pay to the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would have spent the stream of payments and received no benefit from the contract. When the Fund is the seller of a credit default swap contract, it receives the stream of payments but is obligated to pay upon default of the referenced debt obligation. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total assets, the Fund would be subject to investment exposure on the notional amount of the swap.

## **HYBRID INSTRUMENTS**

A hybrid instrument is a type of potentially high-risk derivative that combines a traditional stock, bond or commodity with an option or forward contract. Generally, the principal amount, amount payable upon maturity or redemption, or interest rate of a hybrid is tied (positively or negatively) to the price of some commodity, currency or

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securities index or another interest rate or some other economic factor (each a benchmark). The interest rate or (unlike most fixed income securities) the principal amount payable at maturity of a hybrid security may be increased or decreased, depending on changes in the value of the benchmark. An example of a hybrid could be a bond issued by an oil company that pays a small base level of interest with additional interest that accrues in correlation to the extent to which oil prices exceed a certain predetermined level. Such a hybrid instrument would be a combination of a bond and a call option on oil.

Hybrids can be used as an efficient means of pursuing a variety of investment goals, including currency hedging, duration management, and increased total return. Hybrids may not bear interest or pay dividends. The value of a hybrid or its interest rate may be a multiple of a benchmark and, as a result, may be leveraged and move (up or down) more steeply and rapidly than the benchmark. These benchmarks may be sensitive to economic and political events, such as commodity shortages and currency devaluations, which cannot be readily foreseen by the purchaser of a hybrid. Under certain conditions, the redemption value of a hybrid could be zero. Thus, an investment in a hybrid may entail significant market risks that are not associated with a similar investment in a traditional, U.S. dollar-denominated bond that has a fixed principal amount and pays a fixed rate or floating rate of interest. The purchase of hybrids also exposes a Fund to the credit risk of the issuer of the hybrids. These risks may cause significant fluctuations in the net asset value of the Fund.

Certain hybrid instruments may provide exposure to the commodities markets. These are derivative securities with one or more commodity-linked components that have payment features similar to commodity futures contracts, commodity options or similar instruments. Commodity-linked hybrid instruments may be either equity or debt securities, leveraged or unleveraged, and are considered hybrid instruments because they have both security and commodity-like characteristics. A portion of the value of these instruments may be derived from the value of a commodity, futures contract, index or other economic variable. The Funds will only invest in commodity-linked hybrid instruments that qualify under applicable rules of the Commodity Futures Trading Commission for an exemption from the provisions of the Commodity Exchange Act.

Certain issuers of structured products such as hybrid instruments may be deemed to be investment companies as defined in the 1940 Act. As a result, the Funds' investments in these products may be subject to limits applicable to investments in investment companies and may be subject to restrictions contained in the 1940 Act.

**STRUCTURED NOTES AND RELATED INSTRUMENTS**

The Fund may invest in structured notes and other related instruments, which are privately negotiated debt obligations in which the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate (an embedded index), such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Structured instruments may be issued by corporations, including banks, as well as by governmental agencies. Structured instruments frequently are assembled in the form of medium-term notes, but a variety of forms are available and may be used in particular circumstances. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards (but ordinarily not below zero) to reflect changes in the embedded index while the structured instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely, depending on a variety of factors, including the volatility of the embedded index and the effect of changes in the embedded index on principal and/or interest payments. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss.

PIMCO may use structured instruments for investment purposes and also for risk management purposes, such as to reduce the duration and interest rate sensitivity of the Fund's portfolio, and for leveraging purposes. While structured instruments may offer the potential for a favorable rate of return from time to time, they also entail certain risks. Structured instruments may be less liquid than other debt securities, and the price of structured instruments may be more volatile. In some cases, depending on the terms of the embedded index, a structured instrument may provide that the principal and/or interest payments may be adjusted below zero. Structured instruments also may involve significant credit risk and risk of default by the counterparty. Structured instruments may also be illiquid. Like other sophisticated strategies, the Fund's use of structured instruments may not work as intended. If the value of the embedded index changes in a manner other than that expected by PIMCO, principal and/or interest payments

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received on the structured instrument may be substantially less than expected. Also, if PIMCO uses structured instruments to reduce the duration of the Fund's portfolio, this may limit the Fund's return when having a longer duration would be beneficial (for instance, when interest rates decline).

**MORTGAGE-RELATED AND OTHER ASSET-BACKED SECURITIES**

The Fund may invest in mortgage-related or other asset-backed securities. Mortgage-related 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 Fund to a lower rate of return upon reinvestment of principal. When interest rates rise, the value of a mortgage-related security generally will decline; however, when interest rates are declining, the value of mortgage-related securities with prepayment features may not increase as much as other fixed income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of a mortgage-related security, and may shorten or extend the effective maturity of the security beyond what was anticipated at the time of purchase. If unanticipated rates of prepayment on underlying mortgages increase the effective maturity of a mortgage-related security, the volatility of the security can be expected to increase. The value of these securities may fluctuate in response to the market's perception of the creditworthiness of the issuers. 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. One type of SMBS has one class receiving all of the interest from the mortgage assets (the interest-only, or IO class), while the other class receives all of the principal (the principal-only, or PO class). The yield to maturity on an IO class is extremely sensitive to the rate of principal payments (including prepayments) on the underlying mortgage assets, and a rapid rate of principal payments may have a material adverse effect on the Fund's yield to maturity from these securities.

The Fund may also invest in collateralized debt obligations ( CDOs ), which include collateralized bond obligations ( CBOs ), collateralized loan obligations ( CLOs ) and other similarly structured securities. CBOs and CLOs are types of asset-backed securities. A CBO is a trust which is backed by a diversified pool of high-risk, below investment grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans.

Certain of the Fund's investments in mortgage-related securities may be backed by sub-prime mortgages, which are subject to certain special risks. See Principal risks of the Fund Mortgage Market/Subprime Risk.

The Fund may invest in other types of asset-backed securities that are offered in the marketplace, including Enhanced Equipment Trust Certificates ( EETCs ). Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. EETCs tend to be less liquid than bonds. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence of, or defalcation by, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that utilize the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets. The Fund may invest in other types of asset-backed securities that have been or will be offered to investors.

Please see Investment Objective and Policies Mortgage-Related and Other Asset-Backed Securities in the Statement of Additional Information and Principal risks of the Fund Mortgage-Related and Other Asset-Backed Securities Risk in this prospectus for a more detailed description of the types of mortgage-related and other asset-backed securities in which the Fund may invest and their related risks.

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**REAL ESTATE INVESTMENT TRUSTS (REITS)**

The Fund may invest in REITs. REITs primarily invest in income-producing real estate or real estate related loans or interests. REITs are generally classified as equity REITs, mortgage REITs or a combination of equity and mortgage REITs. Equity REITs invest the majority of their assets directly in real property and derive income primarily from the collection of rents. Equity REITs can also realize capital gains by selling properties that have appreciated in value. Mortgage REITs invest the majority of their assets in real estate mortgages and derive income from the collection of interest payments. REITs are not taxed on income distributed to shareholders provided they comply with the applicable requirements of the Internal Revenue Code of 1986, as amended. The Fund will indirectly bear its proportionate share of any management and other expenses paid by REITs in which it invests in addition to the expenses paid by the Fund. The Fund may invest in equity or debt securities issued by REITs. Debt securities issued by REITs are, for the most part, general and unsecured obligations and are subject to risks associated with REITs. Please see Investment Objective and Policies Real Estate Investment Trusts ( REITs ) in the Statement of Additional Information for a more detailed description of these instruments.

**DELAYED FUNDING LOANS AND REVOLVING CREDIT FACILITIES**

As noted above under Bank Loans, the Fund may enter into, or acquire participations in, delayed funding loans and revolving credit facilities, in which a bank or other lender agrees to make loans up to a maximum amount upon demand by the borrower during a specified term. These commitments may have the effect of requiring the Fund to increase its investment in a company at a time when it might not be desirable to do so (including at a time when the company's financial condition makes it unlikely that such amounts will be repaid). Delayed funding loans and revolving credit facilities are subject to credit, interest rate and liquidity risk and the risks of being a lender.

**CERTAIN INTEREST RATE TRANSACTIONS**

In order to reduce the interest rate risk inherent in the Fund's underlying investments and capital structure, the Fund may (but is not required to) enter into interest rate swap transactions. Interest rate swaps generally involve the Fund's agreement with the swap counterparty to pay a fixed rate payment in exchange for the counterparty paying the Fund a variable rate payment that is intended to approximate a variable rate payment obligation of the Fund (for example, a variable rate payment obligation on any preferred shares issued by the Fund). The payment obligation would be based on the notional amount of the swap. Other forms of interest rate swap agreements in which the Fund may invest include interest rate caps, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates exceed a specified rate, or cap; interest rate floors, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates fall below a specified rate, or floor; and interest rate collars, under which a party sells a cap and purchases a floor or vice versa in an attempt to protect itself against interest rate movements exceeding given minimum or maximum levels. The Fund may use interest rate swap transactions with the intent to reduce or eliminate the risk that an increase in short-term interest rates could pose for the performance of the common shares as a result of leverage, and also may use these instruments for other hedging or investment purposes. Any termination of an interest rate swap transaction could result in a termination payment by or to the Fund.

**REVERSE REPURCHASE AGREEMENTS AND DOLLAR ROLLS**

The Fund may use reverse repurchase agreements or dollar rolls in order to add leverage to the portfolio as a substitute for, or in addition to, leverage obtained through the Preferred Shares. Under a reverse repurchase agreement, the Fund would sell securities to a bank or broker dealer and agree to repurchase the securities at a mutually agreed future date and price. A dollar roll is similar to a reverse repurchase agreement except that the counterparty with which the Fund enters into a dollar roll transaction is not obligated to return the same securities as those originally sold by the Fund but only securities that are substantially identical. Generally, the effect of a reverse repurchase agreement or dollar roll transaction is that the Fund can recover and reinvest all or most of the cash invested in the portfolio securities involved during the term of the agreement and still be entitled to the returns associated with those portfolio securities thereby resulting in a transaction similar to a borrowing and giving rise to leverage for the Fund. In the event the buyer of securities under a reverse repurchase agreement or dollar roll files for bankruptcy or becomes insolvent, the Fund's use of the proceeds of the agreement may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

Unless the Fund covers its positions in reverse repurchase agreements or dollar rolls (by segregating liquid assets at least equal in amount to the forward purchase commitment), its obligations under such instruments will be subject to the Fund's limitations on borrowings.

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**Table of Contents****REPURCHASE AGREEMENTS**

The Fund may enter into repurchase agreements, in which the Fund purchases a security from a bank or broker-dealer and the bank or broker-dealer agrees to repurchase the security at the Fund's cost plus interest within a specified time. If the party agreeing to repurchase should default, the Fund will seek to sell the securities which it holds. This could involve transaction costs or delays in addition to a loss on the securities if their value should fall below their repurchase price. Repurchase agreements maturing in more than seven days are considered to be illiquid securities.

**U.S. GOVERNMENT SECURITIES**

The Fund may invest in U.S. Government securities, which are obligations of, or guaranteed by, the U.S. Government or its agencies, instrumentalities or government-sponsored enterprises. Some U.S. Government securities are supported by the full faith and credit of the United States; others are supported by the right of the issuer to borrow from the U.S. Treasury; others are supported by the discretionary authority of the U.S. Government to purchase the agency's obligations; and still others are supported only by the credit of the instrumentality. Although U.S. Government-sponsored enterprises may be chartered or sponsored by Congress, they are not funded by Congressional appropriations, and their securities are not issued by the U.S. Treasury or supported by the full faith and credit of the U.S. Government and involve increased credit risks. While some U.S. Government securities are guaranteed as to principal and interest, their market value is not guaranteed. Like other debt securities, U.S. Government securities are subject to interest rate risk and credit risk. The U.S. Government does not guarantee the net asset value or market value of the Fund's common shares.

**MUNICIPAL BONDS**

The Fund may invest in municipal bonds, which are generally issued by states and local governments and their agencies, authorities and other instrumentalities. Municipal bonds are subject to interest rate, credit and market risk. The ability of an issuer to make payments could be affected by litigation, legislation or other political events or the bankruptcy of the issuer. Lower rated municipal bonds are subject to greater credit and market risk than higher quality municipal bonds. The types of municipal bonds in which the Funds may invest include, without limitation, municipal lease obligations. The Fund may also invest in industrial development bonds, which are municipal bonds issued by a government agency on behalf of a private sector company and, in most cases, are not backed by the credit of the issuing municipality and may therefore involve more risk. The Funds may also invest in securities issued by entities whose underlying assets are municipal bonds.

The Fund may invest in Build America Bonds. Build America Bonds are tax credit bonds created by the American Recovery and Reinvestment Act of 2009, which authorized state and local governments to issue Build America Bonds as taxable bonds in 2009 and 2010, without volume limitations, to finance any capital expenditures for which such issuers could otherwise issue traditional tax-exempt bonds. State and local governments may receive a direct federal subsidy payment for a portion of their borrowing costs on Build America Bonds, and can elect to either take the federal subsidy or pass a tax credit along to bondholders. The Fund's investments in Build America Bonds will result in taxable income and the Fund may elect to pass through to shareholders the corresponding tax credits. The tax credits can generally be used to offset federal income taxes and the alternative minimum tax, but such credits are generally not refundable. Build America Bonds involve similar risks as municipal bonds, including credit and market risk. They are intended to assist state and local governments in financing capital projects at lower borrowing costs and are likely to attract a broader group of investors than tax-exempt municipal bonds.

**RESIDUAL INTEREST BONDS**

The Fund may invest in residual interest bonds (sometimes referred to as inverse floaters) (RIBs), which brokers create by depositing a municipal bond in a trust. The trust in turn issues a variable rate security and RIBs. The interest rate for the variable rate security is determined by an index or an auction process held approximately every 7 to 35 days, while the RIB holder receives the balance of the income from the underlying municipal bond less an auction fee. The market prices of RIBs may be highly sensitive to changes in market rates and may decrease significantly when market rates increase. In a transaction in which the Fund purchases a RIB from a trust, and the underlying municipal bond was held by the Fund prior to being deposited into the trust, the Fund treats the transaction as a secured borrowing for financial reporting purposes. As a result, the Fund will incur a non-cash interest expense with respect to interest paid by the trust on the variable rate securities, and will recognize additional interest income in an amount directly corresponding to the non-cash interest expense. Therefore, the Fund's net asset value per share and performance are not affected by the non-cash interest expense. This accounting treatment does not apply to RIBs acquired by the Fund when the Fund did not previously own the underlying municipal bond.

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### **WHEN ISSUED, DELAYED DELIVERY AND FORWARD COMMITMENT TRANSACTIONS**

The Fund may purchase securities which it is eligible to purchase on a when-issued basis, may purchase and sell such securities for delayed delivery and may make contracts to purchase such securities for a fixed price at a future date beyond normal settlement time (forward commitments). When-issued transactions, delayed delivery purchases and forward commitments involve a risk of loss if the value of the securities declines prior to the settlement date. The risk is in addition to the risk that the Fund's other assets will decline in value. Therefore, these transactions may result in a form of leverage and increase the Fund's overall investment exposure. Typically, no income accrues on securities the Fund has committed to purchase prior to the time delivery of the securities is made, although the Fund may earn income on securities it has segregated to cover these positions. When the Fund has sold a security on a when-issued, delayed delivery, or forward commitment basis, the Fund does not participate in future gains or losses with respect to the security. If the other party to a transaction fails to pay for the securities, the Fund could suffer a loss. Additionally, when selling a security on a when-issued, delayed delivery, or forward commitment basis without owning the security, the Fund will incur a loss if the security's price appreciates in value such that the security's price is above the agreed upon price on the settlement date.

### **INFLATION-INDEXED BONDS**

Inflation-indexed bonds (other than municipal inflation-indexed bonds and certain corporate inflation-indexed bonds, as discussed below) are fixed income securities whose principal value is periodically adjusted according to the rate of inflation. If the index measuring inflation falls, the principal value of inflation indexed bonds (other than municipal inflation indexed bonds and certain corporate inflation-indexed bonds) will be adjusted downward, and consequently the interest payable on these securities (calculated with respect to a smaller principal amount) will be reduced. Repayment of the original bond principal upon maturity (as adjusted for inflation) is guaranteed in the case of U.S. Treasury inflation-indexed bonds. For bonds that do not provide a similar guarantee, the adjusted principal value of the bond repaid at maturity may be less than the original principal. With regard to municipal inflation-indexed bonds and certain corporate inflation-indexed bonds, the inflation adjustment is reflected in the semi-annual coupon payment. As a result, the principal value of municipal inflation-indexed bonds and such corporate inflation-indexed bonds does not adjust according to the rate of inflation.

The value of inflation-indexed bonds is expected to change in response to changes in real interest rates. Real interest rates are tied to the relationship between nominal interest rates and the rate of inflation. If nominal interest rates increase at a faster rate than inflation, real interest rates may rise, leading to a decrease in value of inflation-indexed bonds. Any increase in the principal amount of an inflation-indexed bond will be considered taxable ordinary income, even though investors do not receive their principal until maturity. See Tax Matters.

### **EVENT-LINKED INSTRUMENTS**

The Fund may obtain event-linked exposure by investing in event-linked bonds or event-linked swaps or by implementing event-linked strategies. Event-linked exposure results in gains or losses that typically are contingent, or formulaically related to defined trigger events. Examples of trigger events include hurricanes, earthquakes, weather-related phenomena or statistics relating to such events. Some event-linked bonds are commonly referred to as catastrophe bonds. If a trigger event occurs, the Fund may lose a portion or its entire principal invested in the bond or notional amount on a swap. Event-linked exposure often provides for an extension of maturity to process and audit loss claims where a trigger event has, or possibly has, occurred. An extension of maturity may increase volatility. Event-linked exposure may also expose the Fund to certain unanticipated risks including credit risk, counterparty risk, adverse regulatory or jurisdictional interpretations and adverse tax consequences. Event-linked exposures may also be subject to liquidity risk.

### **CREDIT-LINKED TRUST CERTIFICATES**

The Fund may invest in credit-linked trust certificates, which are investments in a limited purpose trust or other vehicle formed under state law which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another debt securities market. Like an investment in a bond, investments in credit-linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust's receipt of payments from, and the trust's



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potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that the Fund would receive as an investor in the trust. The Fund's investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, counterparty risk, interest rate risk, leverage risk and management risk. It is expected that the trusts that issue credit-linked trust certificates will constitute private investment companies, exempt from registration under the 1940 Act. Therefore, the certificates will not be subject to applicable investment limitations and other regulation imposed by the 1940 Act (although the Fund will remain subject to such limitations and regulation, including with respect to its investments in the certificates). Although the trusts are typically private investment companies, they generally are not actively managed such as a hedge fund might be. It also is expected that the certificates will be exempt from registration under the Securities Act. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments. See Principal risks of the Fund Liquidity Risk. If market quotations are not readily available for the certificates, they will be valued by the Fund at fair value as determined by the Board or persons acting at its direction. See Net Asset Value. The Fund may lose its entire investment in a credit-linked trust certificate.

**COMMON STOCKS AND OTHER EQUITY SECURITIES**

The Fund may from time to time invest in or hold common stocks and other equity securities, including upon conversion of convertible securities held by the Fund or in connection with the restructuring of a debt security. For instance, in connection with the restructuring of a debt instrument, either outside of bankruptcy court or in the context of bankruptcy court proceedings, the Fund may determine or be required to accept equity securities in exchange for all or a portion of the instrument. Depending upon, among other things, PIMCO's evaluation of the potential value of such securities in relation to the price that could be obtained by the Fund at any given time upon sale thereof, the Fund may determine to hold these equity securities in its portfolio.

Although common stocks and other equity securities have historically generated higher average returns than debt securities over the long term, they also have experienced significantly more volatility in those returns and in certain years have significantly underperformed relative to debt securities. An adverse event, such as an unfavorable earnings report, may depress the value of a particular equity security held by the Fund. Also, prices of common stocks and other equity securities are sensitive to general movements in the equity markets and a decline in those markets may depress the prices of the equity securities held by the Fund. The prices of equity securities fluctuate for many different reasons, including changes in investors' perceptions of the financial condition of an issuer or the general condition of the relevant stock market or when political or economic events affecting the issuer occur. In addition, prices of equity securities may be particularly sensitive to rising interest rates, as the cost of capital rises and borrowing costs increase.

**OTHER INVESTMENT COMPANIES**

The Fund may invest in securities of other open- or closed-end investment companies, including exchange traded funds (ETFs), to the extent that such investments are consistent with the Fund's investment objective, strategies and policies and permissible under the 1940 Act. The Fund may invest in other investment companies to gain broad market or sector exposure, including during periods when it has large amounts of uninvested cash (such as the period shortly after the Fund receives the proceeds of the Offer) or when PIMCO believes share prices of other investment companies offer attractive values. The Fund may invest in investment companies that are advised by the Investment Manager, PIMCO or their affiliates to the extent permitted by applicable law and/or pursuant to exemptive relief from the Securities and Exchange Commission. As a shareholder in an investment company, the Fund will bear its ratable share of that investment company's expenses and would remain subject to payment of the Fund's management fees and other expenses with respect to assets so invested. Common Shareholders would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. The securities of other investment companies may be leveraged, in which case the net asset value and/or market value of the investment company's shares will be more volatile than unleveraged investments. See Principal risks of the Fund Leverage Risk.

**Table of Contents****SHORT SALES**

A short sale is a transaction in which the Fund sells an instrument that it does not own in anticipation that the market price will decline. The Fund may use short sales for investment purposes or for hedging and risk management purposes. When the Fund engages in a short sale, it must borrow the security sold short and deliver it to the counterparty. The Fund may have to pay a fee to borrow particular securities and would often be obligated to pay over any payments received on such borrowed securities. The Fund's obligation to replace the borrowed security will be secured by collateral deposited with the lender, which is usually a broker-dealer, and/or with the Fund's custodian. The Fund may not receive any payments (including interest) on its collateral. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may engage in so-called "naked" short sales where it does not own or have the immediate right to acquire the security sold short at no additional cost, in which case the Fund's losses theoretically could be unlimited. The Fund may also take short positions with respect to the performance of securities, indexes, interest rates, currencies and other assets or markets through the use of derivative instruments. If the price of the security sold short increases between the time of the short sale and the time that the Fund replaces the borrowed security, the Fund will incur a loss; conversely, if the price declines, the Fund will realize a capital gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. The successful use of short selling may be adversely affected by imperfect correlation between movements in the price of the security sold short and the securities being hedged. See Derivatives.

**LENDING OF PORTFOLIO SECURITIES**

For the purpose of achieving income, the Fund may lend its portfolio securities to brokers, dealers and other financial institutions provided a number of conditions are satisfied, including that the loan is fully collateralized. See Investment Objective and Policies Securities Loans in the Statement of Additional Information for details. When the Fund lends portfolio securities, its investment performance will continue to reflect changes in the value of the securities loaned although amounts received from the borrower will not be eligible to be treated as "qualified dividend income" eligible for favorable tax treatment. See Tax matters. The Fund will also receive a fee or interest on the collateral. Securities lending involves the risk of loss of rights in the collateral or delay in recovery of the collateral if the borrower fails to return the security loaned or becomes insolvent, or the risk of loss due to the investment performance of the collateral. The Fund may pay lending fees to the party arranging the loan.

Please see Investment Objective and Policies in the Statement of Additional Information for additional information regarding the investments of the Fund and their related risks.

**Use of leverage**

The Fund has utilized leverage since shortly after it began investment operations, including through the issuance of Preferred Shares. As of [ ], 2010, the aggregate dollar amount (*i.e.*, liquidation preference) of the Fund's outstanding Preferred Shares was \$[ ] million, which then represented approximately [ ]% of the Fund's total assets (including assets attributable to the Preferred Shares). Information regarding the terms and features of the Preferred Shares is provided under Description of capital structure in this prospectus.

The Fund may also add leverage to its portfolio by utilizing reverse repurchase agreements, dollar rolls or other Borrowings. As of [ ], 2010, the Fund had reverse repurchase agreements outstanding representing approximately [ ]% of the Fund's total assets (including the leverage obtained through the use of the instruments), such that the Fund's total leverage attributable in the aggregate to Preferred Shares and Borrowings then represented approximately [ ]% of the Fund's total assets.

The Fund may also enter into transactions other than those noted above that may give rise to a form of leverage including, among others, credit default swap contracts, futures and forward contracts and other derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions. Although it has no current intention to do so, the Fund may also determine to issue other preferred shares to add leverage to its portfolio.

Following completion of the Offer, the Fund may increase the amount of its leverage outstanding. The Trust may do so by engaging in additional Borrowings, including through the use of reverse repurchase agreements, in order to

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maintain the Fund's desired leverage ratio at that time, taking into account the additional assets raised through the issuance of Shares in the Offer. The Fund may also add leverage through the use of credit default swaps and other derivative transactions and/or the other techniques noted above. There is no assurance, however, that the Fund will determine to add leverage following the Offer, as the Fund intends to utilize leverage opportunistically and may choose to increase or decrease its use of leverage over time and from time to time based on PIMCO's assessment of the yield curve environment, interest rate trends, market conditions and other factors. In addition, if the Fund determines to add leverage following the Offer, it is not possible to predict with accuracy the precise amount of leverage that would be added, in part, because it is not possible to predict the number of Shares that ultimately will be subscribed for in the Offer.

The Fund's net assets attributable to its Preferred Shares and the net proceeds the Fund obtains from Borrowings or other forms of leverage will be invested in accordance with the Fund's investment objective and policies as described in this prospectus. So long as the rate of return, net of applicable Fund expenses, on the debt obligations and other investments purchased by the Fund exceeds the dividend rates payable on the Preferred Shares together with the costs to the Fund of other forms of leverage it utilizes, the investment of the Fund's net assets attributable to leverage will generate more income than will be needed to pay the costs of the leverage. If so, the excess may be used to pay higher dividends to Common Shareholders than if the Fund were not so leveraged.

Regarding the expenses associated with the Fund's leverage, the terms of the Preferred Shares provide that they would ordinarily pay dividends at a rate set at auctions held every seven days, subject to a maximum applicable rate calculated as a function of the Preferred Shares' then-current rating and a reference interest rate. However, the weekly auctions for the Preferred Shares, as well as auctions for similar preferred shares of other closed-end funds across the U.S. industry, have failed since February 2008, and the dividend rates on the Preferred Shares since that time have been paid at the maximum applicable rate. The Fund expects that the Preferred Shares will continue to pay dividends at the maximum applicable rate for the foreseeable future and cannot predict whether or when the auction markets for the Preferred Shares may resume normal functioning. See "Principal risks of the Fund - Leverage Risk" and "Description of capital structure" for more information.

Leveraging is a speculative technique and there are special risks and costs involved. The Fund cannot assure you that its Preferred Shares and any Borrowings or other forms of leverage (such as the use of derivatives strategies) will result in a higher yield on your common shares. When leverage is used, the net asset value and market price of the common shares and the yield to Common Shareholders will be more volatile. See "Principal risks of the Fund - Leverage Risk." In addition, dividend, interest and other expenses borne by the Fund with respect to its Preferred Shares and any Borrowings or other forms of leverage are borne entirely by the Common Shareholders (and not by the holders of Preferred Shares) and result in a reduction of the net asset value of the common shares. In addition, because the fees received by the Investment Manager and by PIMCO are based on the total managed assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding), the Investment Manager and PIMCO have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of leverage (e.g., reverse repurchase agreements and other Borrowings), which may create a conflict of interest between the Investment Manager and PIMCO, on the one hand, and the Common Shareholders, on the other hand.

Under the 1940 Act, the Fund is not permitted to issue preferred shares unless immediately after such issuance the value of the Fund's total net assets is at least 200% of the liquidation value of the outstanding Preferred Shares and the newly issued preferred shares plus the aggregate amount of any senior securities of the Fund representing indebtedness (i.e., such liquidation value plus the aggregate amount of senior securities representing indebtedness may not exceed 50% of the Fund's total net assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on its common shares unless, at the time of such declaration, the value of the Fund's total net assets satisfies the above-referenced 200% coverage requirement.

The 1940 Act also generally prohibits the Fund from engaging in most forms of leverage other than preferred shares (including through the use of reverse repurchase agreements, dollar rolls, bank loans, commercial paper or other credit facilities, credit default swap contracts and other derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions, to the extent that these instruments are not covered as described below) unless immediately after the issuance of the leverage the Fund has satisfied the asset coverage test with respect to senior securities representing indebtedness prescribed by the 1940 Act, i.e., the

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value of the Fund's total assets less liabilities (other than the leverage and other senior securities) is at least 300% of the principal amount of such leverage (*i.e.*, effectively limiting the use of leverage through senior securities representing indebtedness to 33 1/3% of the Fund's total assets, including assets attributable to the leverage). The Fund is not permitted to declare any cash dividend or other distribution on common shares unless, at the time of such declaration, this 300% asset coverage test is satisfied. The Fund may (but is not required to) cover its commitments under these instruments by the segregation of liquid assets or by entering into offsetting transactions or owning positions covering its obligations. For instance, the Fund may cover its position in a reverse repurchase agreement by segregating liquid assets at least equal in amount to its forward purchase commitment. To the extent that certain of these instruments are so covered, they will not be considered senior securities under the 1940 Act and therefore will not be subject to the 300% asset coverage requirement otherwise applicable to forms of leverage (other than preferred shares) used by the Fund. However, these transactions, even if covered, may represent a form of economic leverage and create special risks. The use of these forms of additional leverage increases the volatility of the Fund's investment portfolio and could result in larger losses to Common Shareholders than if the strategies were not used. See Principal risks of the Fund Leverage Risk. Failure to maintain certain asset coverage requirements could result in an event of default under certain Borrowings that may be used by the Fund.

The Fund's ability to utilize leverage is also limited by asset coverage requirements and other guidelines imposed by rating agencies (currently Moody's and Fitch) that provide ratings for the Preferred Shares, which may be more restrictive than the limitations imposed by the 1940 Act noted above. See Description of capital structure for more information.

The Fund also may borrow money in order to repurchase its shares or as a temporary measure for extraordinary or emergency purposes, including for the payment of dividends or the settlement of securities transactions which otherwise might require untimely dispositions of portfolio securities held by the Fund.

**EFFECTS OF LEVERAGE**

Assuming that the Preferred Shares and Borrowings used by the Fund will represent approximately [ ]% of the Fund's total assets after the Expiration Date and pay dividends or incur interest expense at a combined average annual rate of [ ]% (based on Preferred Share dividend rates and market interest rates as of the date of this prospectus), the income generated by the Fund's portfolio (net of expenses) would have to exceed [ ]% in order to cover such dividend payments or interest expense. Of course, these numbers are merely estimates, used for illustration. Actual Preferred Share dividend rates and interest expenses on Borrowings used by the Fund, if any, will vary.

The following table is furnished in response to requirements of the Securities and Exchange Commission. It is designed to illustrate the effect of leverage on common share total return, assuming investment portfolio total returns (consisting of income and changes in the value of investments held in the Fund's portfolio) of -10%, -5%, 0%, 5% and 10%. These assumed investment portfolio returns are hypothetical figures and are not necessarily indicative of the investment portfolio returns experienced or expected to be experienced by the Fund. The table further assumes the Fund has Preferred Shares outstanding and is utilizing Borrowings representing approximately [ ]% of the Fund's total assets and a combined average Preferred Share dividend rate and interest expense of [ ]%.

| Assumed Return on Portfolio (Net of Expenses) | (10.00)% | (5.00)% | 0%   | 5%   | 10%  |
|---|----------|---------|------|------|------|
| Corresponding Return to Common Shareholders   | [ ]%     | [ ]%    | [ ]% | [ ]% | [ ]% |

Common share total return is composed of two elements—the common share dividends paid by the Fund (the amount of which is largely determined by the net investment income of the Fund after paying dividends on Preferred Shares and expenses on other forms of leverage) and gains or losses on the value of the securities and other instruments the Fund owns. As required by Securities and Exchange Commission rules, the table assumes that the Fund is more likely to suffer capital losses than to enjoy capital appreciation. For example, to assume a total return of 0%, the Fund must assume that the interest it receives on its investments is entirely offset by losses in the value of those investments.

Any benefits of additional leverage used by the Fund following the Offer cannot be fully achieved until the proceeds resulting from the use of leverage have been received by the Fund and invested in accordance with the Fund's investment objective and policies. As noted above, the Fund's willingness to use additional leverage, and the extent to which leverage is used at any time, will depend on many factors, including PIMCO's assessment of the yield curve environment, interest rate trends, market conditions and other factors.

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**Principal risks of the Fund**

The net asset value of the common shares will fluctuate with and be affected by, among other things, the following principal risks of the Fund: market discount risk, high yield risk, credit risk, interest rate risk, distressed and defaulted securities risk, liquidity risk, leverage risk, issuer risk, smaller company risk, management risk, foreign (non-U.S.) investment risk, emerging markets risk, foreign currency risk, derivatives risk, counterparty risk, mortgage-related and asset-backed securities risk, mortgage market/subprime risk, risk of investing in REITs, reinvestment risk, inflation/deflation risk, confidential information access risk, risk of regulatory changes and market disruption and geopolitical risk. These and other risks are summarized below.

**MARKET DISCOUNT RISK**

As with any stock, the price of the Fund's common shares will fluctuate with market conditions and other factors. If common shares are sold, the price received may be more or less than the original investment. Net asset value will be reduced immediately following the subscription by a sales load and other expenses paid or reimbursed by the Fund. The common shares are designed for long-term investors and should not be treated as trading vehicles. Common shares of closed-end management investment companies frequently trade at a discount from their net asset value. The Fund's common shares may trade at a price that is less than the Subscription Price. This risk may be greater for investors who sell their shares relatively shortly after subscription.

**HIGH YIELD RISK**

In general, lower rated debt securities carry a greater degree of risk that the issuer will lose its ability to make interest and principal payments, which could have a negative effect on the net asset value of the Fund's common shares or common share dividends. The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's or below BBB- by either S&P or Fitch) or that are unrated but judged by PIMCO to be of comparable quality, including debt securities that are in default or the issuers of which are in bankruptcy. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. Securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. The prices of these lower grade bonds are generally more volatile and sensitive to actual or perceived negative developments, such as a decline in the issuer's revenues or revenues of underlying borrowers or a general economic downturn, than are the prices of higher grade securities. Bonds in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies.

The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy, which involve heightened risks. An economic downturn could severely affect the ability of highly leveraged issuers to service their debt obligations or to repay their obligations upon maturity. Lower-rated securities are generally less liquid than higher-rated securities, which may have an adverse effect on the Fund's ability to dispose of a particular security. For example, under adverse market or economic conditions, the secondary market for below investment grade securities could contract further, independent of any specific adverse changes in the condition of a particular issuer, and certain securities in the Fund's portfolio may become illiquid or less liquid. As a result, the Fund could find it more difficult to sell these securities or may be able to sell these securities only at prices lower than if such securities were widely traded. See Principal risks of the Fund Liquidity Risk.

The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue. In determining whether to retain or sell such a security, PIMCO may consider such factors as PIMCO's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other rating agencies. Analysis of creditworthiness may be more complex for issuers of high yield securities than for issuers of higher quality debt securities. To the extent the Fund focuses on below investment grade debt obligations, PIMCO's capabilities in

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analyzing credit quality and associated risks are particularly important, and there can be no assurance that PIMCO will be successful in this regard. See Investment objective and policies Portfolio Contents High Yield Securities ( Junk Bonds ) for additional information.

Although Senior Loans in which the Fund may invest will often be secured by collateral, there can be no assurance that liquidation of any such collateral would satisfy the borrower's obligation in the event of default or that such collateral could be readily liquidated. However, PIMCO believes that Senior Loans generally tend to have more favorable recovery rates than most other types of loans. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations in its ability to realize the benefits of any collateral securing a Senior Loan. To the extent the Fund focuses on Senior Loans or other below investment grade debt obligations, PIMCO's capabilities in analyzing credit quality and associated risks are particularly important, and there can be no assurance that PIMCO will be successful in this regard. See Investment objective and strategies Portfolio Contents High Yield Securities ( Junk Bonds ) for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

### **CREDIT RISK**

Credit risk is the risk that one or more of the Fund's investments in debt securities or other instruments will decline in price, or fail to pay interest, liquidation value or principal when due, because the issuer of the obligation or the issuer of a reference security experiences an actual or perceived decline in its financial status. In addition to the credit risks associated with high yield securities, the Fund could also lose money if the issuer of other debt obligations, or the counterparty to a derivatives contract, repurchase agreement, loan of portfolio securities or other obligation, is, or is perceived to be, unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. The downgrade of a security may further decrease its value.

### **INTEREST RATE RISK**

Generally, when market interest rates rise, the prices of debt obligations fall, and vice versa. Interest rate risk is the risk that debt obligations and other instruments in the Fund's portfolio will decline in value because of increases in market interest rates. The prices of long-term debt obligations generally fluctuate more than prices of short-term debt obligations as interest rates change. Because the Fund will normally have a low to intermediate average portfolio duration (*i.e.*, zero to eight years), the common share net asset value and market price per common share will tend to fluctuate more in response to changes in market interest rates than if the Fund invested mainly in short-term debt securities. During periods of rising interest rates, the average life of certain types of securities may be extended due to slower than expected payments. This may lock in a below market yield, increase the security's duration and reduce the security's value. In addition to directly affecting debt securities, rising interest rates may also have an adverse effect on the value of any equity securities held by the Fund. The Fund's use of leverage, as described below, will tend to increase common share interest rate risk. PIMCO may utilize certain strategies, including investments in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund's portfolio, although there is no assurance that it will do so or that such strategies will be successful.

Investments in floating rate debt instruments, although generally less sensitive to interest rate changes than longer duration fixed rate instruments, may nevertheless decline in value if their interest rates do not rise as much, or as quickly, as interest rates in general. Conversely, floating rate instruments will not generally increase in value if interest rates decline. Inverse floating rate debt securities may also exhibit greater price volatility than a fixed rate debt obligation with similar credit quality. To the extent the Fund holds floating rate instruments, a decrease (or, in the case of inverse floating rate securities, an increase) in market interest rates will adversely affect the income received from such securities and the net asset value of the common shares.

### **DISTRESSED AND DEFAULTED SECURITIES RISK**

The Fund may invest in the debt securities of financially distressed issuers. Investments in the securities of financially distressed issuers involve substantial risks. These securities may present a substantial risk of default or may be in default at the time of investment. The Fund may incur additional expenses to the extent it is required to seek recovery upon a default in the payment of principal or interest on its portfolio holdings. In any reorganization or liquidation proceeding relating to an investment, the Fund may lose its entire investment or may be required to accept cash or securities with a value less than its original investment. Among the risks inherent in investments in a troubled issuer is the fact that it frequently may be difficult to obtain information as to the true financial condition of such issuer. PIMCO's judgments about the credit quality of the issuer and the relative value of its securities may prove to be wrong.

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**LIQUIDITY RISK**

The Fund may invest without limit in illiquid securities (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities may trade at a discount from comparable, more liquid investments, and may be subject to wide fluctuations in market value. Also, the Fund may not be able to dispose readily of illiquid securities when that would be beneficial at a favorable time or price or at prices approximating those at which the Fund currently values them. Further, the lack of an established secondary market for illiquid securities may make it more difficult to value such securities, which may negatively affect the price the Fund would receive upon disposition of such securities. The Senior Loans in which the Fund invests will likely not be registered with the Securities and Exchange Commission or any state securities commission and generally will not be listed on a national securities exchange. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

**LEVERAGE RISK**

The Fund utilizes leverage on an ongoing basis for investment purposes, including through its outstanding Preferred Shares and also from time to time through the use of reverse repurchase agreements and other Borrowings. See "Use of leverage" for details.

Leverage creates several major types of risks for Common Shareholders, including:

the likelihood of greater volatility of net asset value and market price of common shares than a comparable portfolio without leverage;

the possibility either that common share dividends will fall if the costs of leverage rise, or that dividends paid on common shares will fluctuate because such costs vary over time; and

the effects of leverage in a declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the common shares.

In addition to using Preferred Shares and Borrowings, the Fund may also enter into other transactions that may give rise to a form of leverage including, among others, credit default swap contracts, futures and forward contracts and other derivatives transactions, loans of portfolio securities, short sales and when issued, delayed delivery and forward commitment transactions. The Fund's use of such transactions gives rise to associated leverage risks described herein, and may adversely affect the Fund's income and distributions. The Fund may manage some of its derivative positions by segregating an amount of cash or liquid securities equal to the face value or the market value, as applicable, of those positions. The Fund also may offset derivatives positions against one another or against other assets to manage effective market exposure resulting from derivatives in its portfolio. To the extent that any offsetting positions do not behave in relation to one another as expected, the Fund may perform as if it is leveraged through use of these derivative strategies.

The Fund's use of leverage creates the opportunity for increased common share net income, but also creates special risks for Common Shareholders. There can be no assurance that the Fund's leveraging strategies will be successful. Leverage is a speculative technique that may expose the Fund to greater risk and increased costs. The net proceeds the Fund obtains from its use of leverage are invested in accordance with the Fund's investment objective and strategies as described in this prospectus. If the rate of return, net of applicable Fund expenses, on the investments purchased by the Fund exceeds the costs of such leverage to the Fund (including dividends, interest and other repayment obligations), then, all other things being equal, the use of such leverage by the Fund may allow the Fund to pay higher dividends to Common Shareholders than if the Fund were not so leveraged. If, however, the costs of leverage rise relative to the rate of return on the Fund's portfolio, the interest and other costs to the Fund of leverage could exceed the rate of return on the investments held by the Fund, thereby reducing the return to Common Shareholders. In such case, the Fund's ability to pay dividends and meet its asset coverage requirements on the Preferred Shares also would be reduced. Any decline in the net asset value of the Fund's investments could result in

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the Fund being in danger of failing to meet its asset coverage requirements or of losing its Aaa rating (in the case of Moody's) or AAA rating (in the case of Fitch) on the Preferred Shares. In an extreme case, the Fund's current investment income might not be sufficient to meet the dividend requirements on the Preferred Shares. In order to counteract such an event, the Fund might need to liquidate investments in order to fund a redemption of some or all of the Preferred Shares. Liquidation at times of adverse economic conditions may result in a capital loss to the Fund. The Preferred Shares have, and any Borrowings by the Fund or counterparties to the Fund's other leveraging transactions, if any, would have, seniority over the common shares.

Because the fees received by the Investment Manager and the Sub-Adviser are based on the total managed assets of the Fund (including any assets attributable to any Preferred Shares or other forms of leverage of the Fund that may be outstanding), the fees will be higher when leverage is utilized and the Investment Manager and the Sub-Adviser therefore have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of leverage (e.g., reverse repurchase agreements and other Borrowings), which may create a conflict of interest.

## **ISSUER RISK**

The value of debt instruments may decline for a number of reasons that directly relate to the issuer, such as management performance, financial leverage and reduced demand for the issuer's goods and services, as well as the historical and prospective earnings of the issuer and the value of its assets.

## **SMALLER COMPANY RISK**

The general risks associated with debt instruments or equity securities are particularly pronounced for securities issued by companies with small market capitalizations. Small capitalization companies involve certain special risks. They are more likely than larger companies to have limited product lines, markets or financial resources, or to depend on a small, inexperienced management group. Securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. They may also have limited liquidity. These securities may therefore be more vulnerable to adverse developments than securities of larger companies, and the Fund may have difficulty purchasing or selling securities positions in smaller companies at prevailing market prices. Also, there may be less publicly available information about smaller companies or less market interest in their securities as compared to larger companies. Companies with medium-sized market capitalizations may have risks similar to those of smaller companies.

## **MANAGEMENT RISK**

The Fund is subject to management risk because it is an actively managed portfolio. PIMCO and the portfolio manager will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these decisions will produce the desired results.

## **CONVERTIBLE SECURITIES RISK**

Convertible securities generally offer lower interest or dividend yields than non-convertible debt securities of similar quality. The market values of convertible securities tend to decline as interest rates increase and, conversely, to increase as interest rates decline. However, a convertible security's market value tends to reflect the market price of the common stock of the issuing company when that stock price approaches or is greater than the convertible security's conversion price. The conversion price is defined as the predetermined price at which the convertible security could be exchanged for the associated stock. As the market price of the underlying common stock declines, the price of the convertible security tends to be influenced more by the yield of the convertible security. Thus, it may not decline in price to the same extent as the underlying common stock. In the event of a liquidation of the issuing company, holders of convertible securities would be paid before the company's common stockholders but after holders of any senior debt obligations of the company. Consequently, the issuer's convertible securities generally entail less risk than its common stock but more risk than its debt obligations.

The Fund may invest in synthetic convertible securities, which are created through a combination of separate securities that possess the two principal characteristics of a traditional convertible security; that is, an income-producing security (income-producing component) and the right to acquire an equity security (convertible component). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by purchasing warrants or options to buy common stock at a certain exercise price, or options on a stock index. The values of synthetic convertible securities will respond differently to market fluctuations than a traditional convertible





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security because a synthetic convertible is composed of two or more separate securities or instruments, each with its own market value. Synthetic convertible securities are also subject to the risks associated with derivatives. See *Principal risks of the Fund Derivatives Risk*. In addition, if the value of the underlying common stock or the level of the index involved in the convertible element falls below the strike price of the warrant or option, the warrant or option may lose all value.

### **PREFERRED SECURITIES RISK**

In addition to equity securities risk (see *Principal risks of the Fund Equity Securities and Related Market Risk*), credit risk (see *Principal risks of the Fund Credit Risk*) and possibly high yield risk (see *Principal risks of the Fund High Yield Risk*), investment in preferred stocks involves certain other risks. Certain preferred stocks contain provisions that allow an issuer under certain conditions to skip or defer distributions. If the Fund owns a preferred stock that is deferring its distribution, the Fund may be required to report income for tax purposes despite the fact that it is not receiving current income on this position. Preferred stocks often are subject to legal provisions that allow for redemption in the event of certain tax or legal changes or at the issuer's call. In the event of redemption, the Fund may not be able to reinvest the proceeds at comparable rates of return. Preferred stocks are subordinated to bonds and other debt securities in an issuer's capital structure in terms of priority for corporate income and liquidation payments, and therefore will be subject to greater credit risk than those debt securities. Preferred stocks may trade less frequently and in a more limited volume and may be subject to more abrupt or erratic price movements than many other securities, such as common stocks, corporate debt securities and U.S. Government securities.

### **FOREIGN (NON-U.S.) INVESTMENT RISK**

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers or supra-national government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund's investments in foreign issuers and in securities denominated in foreign currencies involve special risks.

For example, the value of these investments may decline in response to unfavorable political and legal developments, unreliable or untimely information or economic and financial instability. Foreign securities may experience more rapid and extreme changes in value than investments in securities of U.S. issuers. The securities markets of many foreign countries are relatively small, with a limited number of companies representing a small number of industries. Issuers of foreign securities are usually not subject to the same degree of regulation as U.S. issuers. Reporting, accounting and auditing standards of foreign countries differ, in some cases significantly, from U.S. standards. Also, nationalization, expropriation or other confiscation, currency blockage, political changes or diplomatic developments could adversely affect the Fund's investments in foreign securities. In the event of nationalization, expropriation or other confiscation, the Fund could lose its entire investment in foreign securities. To the extent that the Fund invests a significant portion of its assets in a particular foreign country or a concentrated geographic area (such as Europe or Asia), the Fund will generally have more exposure to regional economic risks associated with foreign investments. Also, adverse conditions in a certain region can adversely affect securities of other countries whose economies appear to be unrelated. The costs of investing in foreign countries frequently are higher than the costs of investing in the United States. Additionally, investments in securities of foreign issuers generally will be denominated in foreign currencies, subjecting the Fund to foreign currency risk. See *Principal risks of the Fund Foreign Currency Risk*.

### **EMERGING MARKETS RISK**

The Fund may invest up to 25% of its total assets in debt securities of issuers economically tied to emerging market countries. Foreign investment risk may be particularly high to the extent that the Fund invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers noted above, but to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in a lack of liquidity and in price volatility; (iii) certain national policies which may restrict the Fund's investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests and requirements that government approval be obtained prior to investment by foreign persons; (iv) certain national policies that may restrict the Fund's

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repatriation of investment income, capital or the proceeds of sales of securities, including temporary restrictions on foreign capital remittances; (v) the lack of uniform accounting and auditing standards; (vi) less publicly available financial and other information regarding issuers; (vii) potential difficulties in enforcing contractual obligations; and (viii) higher rates of inflation, higher interest rates and other economic concerns. The Fund may invest to a significant extent in emerging market securities that are issued in local currencies, subjecting the Fund to a greater amount of foreign currency risk. See Principal risks of the Fund Foreign Currency Risk. Also, investing in emerging market countries may entail purchases of securities of issuers that are insolvent, bankrupt, in default or otherwise of questionable ability to satisfy their payment obligations as they become due, subjecting the Fund to a greater amount of credit risk and/or high yield risk. See Principal risks of the Fund Credit Risk and Principal Risks of the Fund High Yield Risk.

**FOREIGN CURRENCY RISK**

The Fund's common shares are priced in U.S. dollars and the distributions paid by the Fund to Common Shareholders are paid in U.S. dollars. However, a significant portion of the Fund's assets may at any time be denominated in foreign (non-U.S.) currencies and income received by the Fund from many foreign debt obligations will be paid in foreign currencies. The Fund may also invest in or gain exposure to foreign currencies themselves for investment or hedging purposes. The Fund's investments in or exposure to foreign currencies or in securities or instruments that trade, or receive revenues, in foreign currencies are subject to the risk that those currencies will decline in value relative to the U.S. dollar or, in the case of hedging positions (if utilized), 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 U.S. or abroad. These fluctuations may have a significant adverse effect on the value of the Fund's portfolio and/or the level of Fund distributions made to Common Shareholders. As noted above, the Fund may (but is not required to) attempt to hedge some of its exposure to foreign currencies in order to reduce the risk of loss due to fluctuations in currency exchange rates relative to the U.S. dollar. There is no assurance, however, that these hedging strategies will be available or will be used by the Fund or, if used, that they will be successful.

**DERIVATIVES RISK**

Derivatives are financial contracts whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indexes). The Fund may invest in a variety of derivative instruments for hedging or risk management purposes or as part of its investment strategies, such as options contracts (including options on futures contracts), futures contracts, swap agreements (including total return and credit-default swaps) and short sales. The Fund may also have exposure to derivatives, such as interest rate or credit default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may use derivatives as a substitute for taking a position in an underlying debt instrument or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate or currency risk. The Fund also may use derivatives to add leverage to the portfolio. The Fund's use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks described elsewhere in this prospectus, such as liquidity risk, interest rate risk, issuer risk, credit risk, leveraging risk, counterparty risk, management risk and, if applicable, smaller company risk. They also involve the risk of mispricing or improper valuation, the risk of ambiguous documentation, and the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index. If the Fund invests in a derivative instrument, it could lose more than the principal amount invested. Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial. In addition, the Fund is subject to certain restrictions or limitations on its use of derivative strategies imposed by Moody's and Fitch (or any rating agency that may in the future rate the Preferred Shares) in connection with their ratings of the Fund's Preferred Shares. See Description of capital structure. The use of derivatives also may increase the amount of taxes payable by shareholders. In addition to the risks applicable to derivatives generally, credit default swaps involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty).

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The Fund may invest in credit default swaps, total return swaps and other credit-related derivatives. These transactions generally provide for the transfer from one counterparty to another of certain credit risks and return characteristics inherent in the ownership of a financial asset. Such risks include the risk of default and insolvency of the issuer of such asset and the risk that the credit of the issuer or any underlying collateral will decline or that credit spreads for like assets will change (thus affecting the market value of the financial asset). The transfer of credit risk pursuant to a credit derivative may be complete or partial, and may be for the life of the related asset or for a shorter period. Credit derivatives may be used as a risk management tool for a pool of financial assets, providing the Fund with the opportunity to gain exposure to one or more reference assets without actually owning such assets in order, for example, to reduce a focused investment risk or to diversify its portfolio. In each credit derivative transaction that it is party to, the Fund assumes the credit risk of the counterparty. See **Principal risks of the Fund Counterparty risk.** Credit default swaps, total return swaps and other credit derivatives are a relatively recent development in the financial markets. Consequently, there are certain legal, tax and market uncertainties that present risks in entering into such total rate of return swaps and other credit derivatives. There is currently little or no case law or litigation characterizing total return swaps or other credit derivatives, interpreting their provisions, or characterizing their tax treatment. In addition, legislation (including financial reform legislation currently being considered in Congress), regulatory action and/or private initiatives may change the way credit default swaps and other instruments are used or regulated, possibly making their use less beneficial to the Fund or limiting the Fund's ability to use such instruments. Recent turmoil in the securities markets generally and among monoline insurers and other financial institutions in particular has increased the volatility and other risks associated with these instruments.

**COUNTERPARTY RISK**

The Fund will be subject to credit risk with respect to the counterparties to the derivative contracts and other instruments entered into by the Fund or held by special purpose or structured vehicles in which the Fund invests. In the event that the Fund enters into a derivative transaction with a counterparty that subsequently becomes insolvent or becomes the subject of a bankruptcy case, the derivative transaction may be terminated in accordance with its terms and the Fund's ability to realize its rights under the derivative instrument and its ability to distribute the proceeds could be adversely affected. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract in a bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

**MORTGAGE-RELATED AND ASSET-BACKED SECURITIES RISK**

The Fund may invest in a variety of mortgage-related securities, including commercial mortgage securities and other mortgage-backed instruments. The value of some mortgage-related securities, including commercial mortgage-backed securities and residential mortgage-backed securities, may be particularly sensitive to changes in prevailing interest rates. The yield and payment characteristics of mortgage-related securities differ from traditional debt securities. Interest and principal prepayments are made more frequently, usually monthly, over the life of the mortgage loans and principal generally may be prepaid at any time because the underlying mortgage loans generally may be prepaid at any time. Faster or slower prepayments than expected on underlying mortgage loans can dramatically alter the yield to maturity of a mortgage-related security, and early repayment of principal on some mortgage-related securities may expose the Fund to a lower rate of return upon reinvestment of principal.

Mortgage-related and other asset-backed securities often involve risks that are different from or more acute than risks associated with other types of debt instruments. For instance, these securities may be particularly sensitive to changes in prevailing interest rates. Rising interest rates tend to extend the duration of mortgage-related securities, making them more sensitive to changes in interest rates, and may reduce the market value of the securities. This is known as extension risk. In addition, mortgage-related securities are subject to prepayment risk—the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. For instance, the Fund may invest in stripped mortgage-backed securities for which one class receives all of the interest from the mortgage assets (the interest-only, or IO class), while the other class receives all of the principal (the principal-only, or PO class). The yield to maturity on an IO class is extremely sensitive to the rate of principal payments (including prepayments) on the underlying mortgage assets, and a rapid rate of principal payments may have a material adverse effect on the Fund's yield to maturity from these investments. The Fund's investments in other asset-backed securities are subject to risks similar to those associated with mortgage-backed securities, as well as additional risks associated with their structure and the nature of the assets underlying the security and the

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servicing of those assets. For instance, certain collateralized debt obligations in which the Fund may invest are backed by pools of high-risk, below investment grade debt securities and may involve substantial credit and other risks. Further, due to their often complicated structures, various mortgage-related and particularly asset-backed securities may be difficult to value and may constitute illiquid investments.

The value of mortgage-related securities may be substantially dependent on the servicing of the underlying asset pools, and are therefore subject to risks associated with the negligence by, or defalcation of, their servicers. Furthermore, debtors may be entitled to the protection of a number of state and federal consumer credit laws with respect to mortgage-related securities, which may give the debtor the right to avoid payment.

Investments in mortgage-related securities involve particularly high levels of risk under current market conditions. See **Principal risks of the Fund Mortgage Market/Subprime Risk**.

## **MORTGAGE MARKET/SUBPRIME RISK**

The residential and commercial mortgage markets in the United States have experienced substantial and in some cases unprecedented difficulties over the past few years that have adversely affected the performance, market value and liquidity of mortgage-related investments. Delinquencies and losses on U.S. residential mortgage loans (especially sub-prime, Alternative A-paper ( Alt-A ) and second-lien mortgage loans) generally have increased substantially during such period and may continue to increase, and the decline in or flattening of U.S. housing values that has been experienced in such period and that may continue to be experienced in many U.S. housing markets may exacerbate such delinquencies and losses. Borrowers with adjustable rate mortgage loans are more sensitive to changes in interest rates, which affect their monthly mortgage payments, and may be unable to secure replacement mortgages at comparably low interest rates or at all. Also, a number of U.S. residential mortgage loan originators have experienced serious financial difficulties or bankruptcy, and other such originators also may experience such difficulties or bankruptcy in the future. Owing largely to the foregoing, reduced investor demand for mortgage loans and mortgage-related securities, along with other general economic factors, have caused severely restricted liquidity in the secondary market for mortgage-related securities, and the Fund may invest without limitation in investments that are considered illiquid. It is possible that such limited liquidity in such secondary markets could continue or worsen and reduce the values of the Fund's investments, and there can be no guarantee that a liquid secondary market for such securities will redevelop. If the U.S. economy deteriorates further, the incidence of mortgage foreclosures may increase, which may adversely affect the value of any mortgage-related securities owned by the Fund. [The United States Congress and various government regulatory authorities have discussed the possibility of restructuring mortgages and imposing forbearance requirements on defaulted mortgages. Neither the Fund nor PIMCO can predict the form any such modifications, forbearance or related regulations might take or whether, if implemented, they will adversely affect the value of mortgage-related securities owned by the Fund.]

## **RISK OF INVESTING IN REITS**

Like other mortgage-related securities, REITs are subject to interest rate risk and prepayment risk. Investing in REITs also involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by changes in interest rates and the ability of the issuers of its portfolio mortgages to repay their obligations. REITs are dependent upon the skills of their managers and are not diversified. REITs are generally dependent upon maintaining cash flows to repay borrowings and to make distributions to shareholders and are subject to the risk of default by lessees or borrowers. REITs whose underlying assets are concentrated in properties used by a particular industry are also subject to risks associated with such industry.

REITs may have limited financial resources, may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities. Historically, REITs have been more volatile in price than the larger capitalization stocks included in S&P 500 Composite Stock Index.

## **VALUATION RISK**

When market quotations are not readily available or are deemed to be unreliable, the Fund values its investments at fair value as determined in good faith pursuant to policies and procedures approved by the Board. See **Net asset value**. Fair value pricing may require subjective determinations about the value of a security or other asset. As a result, there can be no assurance that fair value pricing will result in adjustments to the prices of securities or other

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assets, or that fair value pricing will reflect actual market value, and it is possible that the fair value determined for a security or other asset will be materially different from quoted or published prices, from the prices used by others for the same security or other asset and/or from the value that actually could be or is realized upon the sale of that security or other asset.

### **FOCUSED INVESTMENT RISK**

Although the Fund has a policy not to concentrate investments in any particular industry, it may (consistent with that policy) invest up to 25% of its assets in any particular industry. To the extent that the Fund focuses its investments in a particular industry, the net asset value of the common shares will be more susceptible to events or factors affecting companies in that industry. These may include, but are not limited to, governmental regulation, inflation, rising interest rates, cost increases in raw materials, fuel and other operating expenses, technological innovations that may render existing products and equipment obsolete, competition from new entrants, high research and development costs, increased costs associated with compliance with environmental or other regulation and other economic, market, political or other developments specific to that industry. Also, the Fund may have greater risk to the extent that it invests a substantial portion of its assets in companies in related sectors, which may share common characteristics, are often subject to similar business risks and regulatory burdens, and whose securities may react similarly to the types of events and factors described above. The Fund will also be subject to focused investment risks to the extent that it invests a substantial portion of its assets in a particular country or geographic region. See [Principal risks of the Fund Foreign \(Non-U.S.\) Investment Risk](#), [Principal risks of the Fund Emerging Markets Risk](#) and [Principal risks of the Fund Foreign Currency Risk](#).

### **REINVESTMENT RISK**

Reinvestment risk is the risk that income from the Fund's portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the portfolio's current earnings rate. For instance, during periods of declining interest rates, an issuer of debt obligations may exercise an option to redeem securities prior to maturity, forcing the Fund to invest in lower-yielding securities. A decline in income received by the Fund from its investments is likely to have a negative effect on the market price, net asset value and/or overall return of the Fund's common shares and to reduce asset coverage on the Preferred Shares.

### **INFLATION/DEFLATION RISK**

Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of payments at future dates. As inflation increases, the real value of the Fund's portfolio could decline. Deflation risk is the risk that prices throughout the economy decline over time. Deflation may have an adverse effect on the creditworthiness of issuers and may make issuer default more likely, which may result in a decline in the value of the Fund's portfolio.

### **CONFIDENTIAL INFORMATION ACCESS RISK**

In managing the fund, PIMCO normally will seek to avoid the receipt by portfolio managers and analysts of material, non-public information ( Confidential Information ) about the issuers of Senior Loans, other bank loans and related investments being considered for acquisition by the Fund or held in the Fund's portfolio. In many instances, issuers offer to furnish Confidential Information to prospective purchasers or holders of the issuer's loans. In circumstances when the PIMCO portfolio manager and analysts do not receive Confidential Information from these issuers, the Fund may be disadvantaged in comparison to other bank loan investors, including with respect to the price the Fund pays or receives when it buys or sells a bank loan. Further, in situations when the Fund is asked, for example, to grant consents, waivers or amendments with respect to bank loans, PIMCO's ability to assess the desirability of such consents, waivers and amendments may be compromised.

### **EQUITY SECURITIES AND RELATED MARKET RISK**

The Fund may hold common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The market price of common stocks and other equity securities may go up or down, sometimes rapidly or unpredictably. Equity securities may decline in value due to factors affecting equity securities markets generally, particular industries represented in those markets, or the issuer itself. See [Principal risks of the Fund Issuer Risk](#). The values of equity securities may decline due to general market conditions that are not specifically related to a particular company, such as real or perceived adverse economic conditions, changes in the general outlook for

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corporate earnings, changes in interest or currency rates or adverse investor sentiment generally. They may also decline due to factors which affect a particular industry or industries, such as labor shortages or increased production costs and competitive conditions within an industry. Debt securities are also subject to the market risks described above; however, equity securities generally have greater price volatility than bonds and other debt securities.

### **RULE 144A SECURITIES RISK**

Rule 144A permits certain qualified institutional buyers, such as the Fund, to trade in privately placed securities that have not been registered for sale under the Securities Act. Rule 144A securities may be deemed illiquid, although the Fund may determine that certain Rule 144A securities are liquid in accordance with procedures adopted by the Board.

### **OTHER INVESTMENT COMPANIES RISK**

The Fund may invest in securities of other open- or closed-end investment companies, including ETFs, to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act. As a shareholder in an investment company, the Fund will bear its ratable share of that investment company's expenses, and would remain subject to payment of the Fund's investment management fees with respect to the assets so invested. Common Shareholders would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. In addition, these other investment companies may utilize leverage, in which case an investment would subject the Fund to additional risks associated with leverage. See Principal risks of the Fund Leverage Risk.

### **RISK OF REGULATORY CHANGES**

To the extent that legislation or state or federal bank or other regulators impose additional requirements or restrictions on the ability of certain financial institutions to make loans, particularly in connection with highly leveraged transactions, the availability of investments sought after by the Fund may be reduced. Further, such legislation or regulation could depress the market value of investments held by the Fund. Additionally, legislative, regulatory, or tax developments may affect the investment techniques available to PIMCO and each individual portfolio manager in connection with managing the Fund and may also adversely affect the ability of the Fund to achieve its investment objective.

### **MARKET DISRUPTION AND GEOPOLITICAL RISK**

The wars with Iraq and Afghanistan, their aftermath and the occupation of Iraq and substantial military presence in Afghanistan are likely to have a substantial effect on the U.S. and world economies and securities markets. The nature, scope and duration of the wars and the potential costs of rebuilding infrastructure cannot be predicted with any certainty. Terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 closed some of the U.S. securities markets for a four-day period and similar future events cannot be ruled out. The war and occupation, terrorism and related geopolitical risks have led, and may in the future lead, to increased short-term market volatility and may have adverse long-term effects on U.S. and world economies and markets generally. Those events also could have an acute effect on individual issuers or related groups of issuers. These risks also could adversely affect individual issuers and securities markets, interest rates, secondary trading, ratings, credit risk, inflation, deflation and other factors relating to the Fund's investments and the market value and net asset value of the common shares.

### **CERTAIN AFFILIATIONS**

Certain broker-dealers may be considered to be affiliated persons of the Fund, the Investment Manager and/or PIMCO due to their possible affiliations with Allianz SE, the ultimate parent of the Investment Manager and PIMCO. Absent an exemption from the Securities and Exchange Commission or other regulatory relief, the Fund is generally precluded from effecting certain principal transactions with affiliated brokers, and its ability to purchase securities being underwritten by an affiliated broker or a syndicate including an affiliated broker, or to utilize affiliated brokers for agency transactions, is subject to restrictions. This could limit the Fund's ability to engage in securities transactions and take advantage of market opportunities.

### **ANTI-TAKEOVER PROVISIONS**

The Fund's Declaration includes provisions that could limit the ability of other entities or persons to acquire control of the Fund or to convert the Fund to open-end status. See Anti-takeover and other provisions in the Declaration of Trust. These provisions in the Declaration could have the effect of depriving the Common Shareholders of opportunities to sell their common shares at a premium over the then-current market price of the common shares or at net asset value.





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**How the Fund manages risk**

**INVESTMENT LIMITATIONS**

The Fund has adopted certain investment limitations designed to limit investment risk and to maintain portfolio diversification. These limitations (two of which are listed below) are fundamental and may not be changed without the approval of the holders of a majority of the outstanding common shares and Preferred Shares voting together as a single class, and the approval of the holders of a majority of the Preferred Shares voting as a separate class. The Fund may not:

concentrate its investments in a particular industry, as that term is used in the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time; or

with respect to 75% of the Fund's total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities of other investment companies, if, as a result, (i) more than 5% of the Fund's total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer.

The Fund would be deemed to concentrate its investments in a particular industry if it invested more than 25% of its total assets in that industry. The Fund's industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities). The Fund interprets its industry concentration policy to apply to direct investments in the securities of issuers in a particular industry, as defined by the Fund. For purposes of this restriction, a foreign government is considered to be an industry. Currency positions are not considered to be an investment in a foreign government for industry concentration purposes. Mortgage-backed securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities are not subject to the Fund's industry concentration restrictions, by virtue of the exclusion from that test available to all U.S. Government securities. Similarly, municipal bonds issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies and authorities are not subject to the Fund's industry concentration restrictions. In the case of privately issued mortgage-related securities, or any asset-backed securities, the Fund takes the position that such securities do not represent interests in any particular industry or group of industries.

The Fund is subject to additional guidelines in order to obtain and maintain ratings on the Preferred Shares of Aaa from Moody's and AAA from Fitch and may become subject to additional guidelines in the future. See Description of capital structure in this Prospectus and Investment Objective and Policies and Investment Restrictions in the SAI for information about these guidelines and a complete list of the fundamental investment policies of the Fund.

**HEDGING AND RELATED STRATEGIES**

The Fund may (but is not required to) use various investment strategies designed to limit the risk of price fluctuations of its portfolio securities and to preserve capital. For instance, the Fund may purchase credit default swap contracts for the purpose of hedging the Fund's exposure to certain issuers and, thereby, decreasing its exposure to credit risk, and it may invest in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund's portfolio and, thereby, decreasing the Fund's exposure to interest rate risk. See Investment objective and policies Credit Default Swaps, Investment objective and policies Structured Notes and Related Instruments and Investment objective and policies Certain Interest Rate Transactions in this prospectus. The Fund may also (but is not required to) seek to hedge some or all of its exposure to foreign currencies, including through the use of derivative strategies, to protect against future fluctuations in foreign currencies in relation to the U.S. dollar. See Investment objective and policies Foreign Currencies and Related Transactions. Other hedging strategies that the Fund may use include: financial futures contracts; short sales; other types of swap agreements or options thereon; options on financial

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futures; and options based on either an index or individual debt securities whose prices, PIMCO believes, correlate with the prices of the Fund's investments. Income earned by the Fund from its foreign currency hedging activities, if any, will generally give rise to ordinary income that, to the extent not offset by losses from such activities, will be distributed to shareholders and taxable at ordinary income rates. Income earned by the Fund from its other hedging activities will be treated as capital gain and, if not offset by net realized capital losses, will be distributed to shareholders in taxable distributions. See Tax matters. There is no assurance that these hedging strategies will be available at any time or that PIMCO will determine to use them for the Fund or, if used, that the strategies will be successful. PIMCO may determine not to engage in hedging strategies or to do so only in unusual circumstances or market conditions. In addition, the Fund is subject to certain restrictions on its use of hedging strategies imposed by guidelines of Fitch and/or Moody's with respect to their ratings on the Preferred Shares.

**Management of the Fund**

**TRUSTEES AND OFFICERS**

The Board is responsible for the management of the Fund, including supervision of the duties performed by the Investment Manager and PIMCO. There are currently [ ] Trustees of the Fund, [ ] of whom [is/are] treated by the Fund as an interested person (as defined in the 1940 Act). The names and business addresses of the Trustees and officers of the Fund and their principal occupations and other affiliations during the past five years are set forth under Management of the Fund in the SAI.

**INVESTMENT MANAGER**

The Investment Manager serves as the investment manager of the Fund. Subject to the supervision of the Board, the Investment Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. The Investment Manager is located at 1345 Avenue of the Americas, New York, New York 10105.

Organized in 2000, the Investment Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. The Investment Manager is a wholly-owned indirect subsidiary of Allianz SE, a publicly-traded European insurance and financial services company. As of [ ], the Investment Manager and its investment management affiliates had approximately \$[ ] in assets under management.

The Investment Manager has retained its affiliate, PIMCO, as a sub-adviser to manage the Fund's portfolio investments. See Sub-Adviser below. The Investment Manager may retain affiliates to provide various administrative and other services required by the Fund.

**SUBADVISER**

PIMCO, an affiliate of the Investment Manager, serves as the sub-adviser for the Fund, pursuant to a portfolio management agreement between the Investment Manager and PIMCO. Subject to this agreement and to the supervision of the Investment Manager, PIMCO has full investment discretion and makes all determinations with respect to the investment of the Fund's assets.

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to a number of open-end and closed-end investment companies. As of [ ], PIMCO had approximately \$[ ] in assets under management.

The Investment Manager (and not the Fund) will pay a portion of the fees it receives under the Investment Management Agreement to PIMCO in return for PIMCO's services. The fee is paid monthly at the annual rate of 0.55% of the Fund's average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced by the amount of all fees, if any, payable by the Investment Manager to the underwriters of the Fund's initial public offering of common shares for such month (such that the Investment Manager retains from its investment management fee, on an annual basis, .05% of the Fund's average weekly total managed assets, after having paid PIMCO and such underwriters).

The following individual has primary responsibility for the day-to-day portfolio management of the Fund.

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| <b>Portfolio Manager</b> | <b>Since</b>  | <b>Title</b>   | <b>Recent Professional Experience</b>  |
|--------------------------|---------------|--|--|
| William H. Gross         | December 2009 | Managing Director and Co-Chief Investment Officer of PIMCO | Managing Director, Co-Chief Investment Officer and a founding partner of PIMCO. Mr. Gross has been associated with PIMCO since 1971. |

The Statement of Additional Information provides additional information about portfolio manager compensation, other accounts managed by the portfolio manager and the portfolio manager's ownership of securities in the Fund.

**INVESTMENT MANAGEMENT AGREEMENT**

Pursuant to an investment management agreement between the Investment Manager and the Fund (the "Investment Management Agreement"), the Fund has agreed to pay the Investment Manager an annual fee, payable monthly, in an amount equal to 0.75% of the Fund's average weekly total managed assets, for the services and facilities it provides. Total managed assets means the total assets of the Fund (including any assets attributable to any Preferred Shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). For purposes of calculating total managed assets, the liquidation preference of any Preferred Shares outstanding is not considered a liability.

In addition to the fees of the Investment Manager, the Fund pays all other costs and expenses of its operations, including compensation of its trustees (other than those affiliated with the Investment Manager), custodial expenses, shareholder servicing expenses, transfer agency, sub-transfer agency and dividend disbursing expenses, legal fees, expenses of independent auditors, expenses of preparing, printing and distributing prospectuses, shareholder reports, notices, proxy statements and reports to governmental agencies, and taxes, if any.

Because the fees received by the Investment Manager and PIMCO are based on the total managed assets of the Fund (including any assets attributable to any Preferred Shares or other forms of leverage of the Fund that may be outstanding), the fees will be higher when leverage is utilized and the Investment Manager and PIMCO therefore have a financial incentive for the Fund to utilize leverage, which may create a conflict of interest between the Investment Manager and PIMCO, on the one hand, and the Fund's Common Shareholders, on the other hand.

**REGULATORY AND LITIGATION MATTERS**

In June and September 2004, the Investment Manager and certain of its affiliates (including PEA Capital LLC ("PEA"), Allianz Global Investors Distributors LLC and Allianz Global), agreed to settle, without admitting or denying the allegations, claims brought by the Securities and Exchange Commission and the New Jersey Attorney General alleging violations of federal and state securities laws with respect to certain open-end funds for which the Investment Manager serves as investment adviser. The settlements related to an alleged market timing arrangement in certain open-end funds formerly sub-advised by PEA. The Investment Manager and its affiliates agreed to pay a total of \$68 million to settle the claims. In addition to monetary payments, the settling parties agreed to undertake certain corporate governance, compliance and disclosure reforms related to market timing, and consented to cease and desist orders and censures. Subsequent to these events, PEA deregistered as an investment adviser and dissolved. None of the settlements alleged that any inappropriate activity took place with respect to the Funds.

Since February 2004, the Investment Manager and certain of its affiliates and their employees have been named as defendants in a number of pending lawsuits concerning market timing which allege the same or similar conduct underlying the regulatory settlements discussed above. The market timing lawsuits have been consolidated in a multi-district litigation proceeding in the U.S. District Court for the District of Maryland. Any potential resolution of these matters may include, but not be limited to judgments or settlements for damages against the Investment Manager or its affiliates or related injunctions.

In addition, the Sub-Adviser is the subject of a lawsuit in the Northern District of Illinois Eastern Division in which the complaint alleges that plaintiffs each purchased and sold a 10-year Treasury note futures contract and suffered damages from an alleged shortage when the Sub-Adviser held both physical and futures positions in 10-year Treasury notes for its client accounts. In July 2007, the court granted class certification of a class consisting of those persons who purchased futures contracts to offset short positions between May 9, 2005 and June 30, 2005. The Sub-Adviser currently believes that the complaint is without merit and the Sub-Adviser intends to vigorously defend against this action.

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The Investment Manager and the Sub-Adviser believe that these matters are not likely to have a material adverse effect on the Funds or on their ability to perform their respective investment advisory activities relating to the Funds.

The foregoing speaks only as of the date of this prospectus. While there may be additional litigation or regulatory developments in connection with the matters discussed above, the foregoing disclosure of litigation and regulatory matters will be updated only if those developments are material.

### **Net asset value**

The net asset value per share ( NAV ) of the Fund's common shares is determined by dividing the total value of the Fund's portfolio investments and other assets, less any liabilities, by the total number of shares outstanding. Fund shares are valued as of a particular time (the Valuation Time ) on each day ( Business Day ) that the New York Stock Exchange is open for trading. The Valuation Time is ordinarily at the close of regular trading on the New York Stock Exchange (normally 4:00 p.m., Eastern time) (the NYSE Close ). In unusual circumstances, the Board may determine that the Valuation Time shall be as of 4:00 p.m., Eastern time, notwithstanding an earlier, unscheduled close or halt of trading on the New York Stock Exchange.

For purposes of calculating NAV, the Fund's investments for which market quotations are readily available are valued at market value. Market values for various types of securities and other instruments are determined on the basis of closing prices or last sales prices on an exchange or other market, or based on quotes or other market information obtained from quotation reporting systems, established market makers or pricing services. Short-term investments having a maturity of 60 days or less are generally valued at amortized cost.

If market quotations are not readily available (including in cases where available market quotations are deemed to be unreliable), the Fund's investments will be valued at fair value as determined in good faith pursuant to policies and procedures approved by the Board. Fair value pricing may require subjective determinations about the value of a security or other asset, and fair values used to determine the Fund's NAV may differ from quoted or published prices, or from prices that are used by others, for the same investments. Also, the use of fair value pricing may not always result in adjustments to the prices of securities or other assets held by the Fund.

The Fund may determine that market quotations are not readily available due to events relating to a single issuer (e.g., corporate actions or announcements) or events relating to multiple issuers (e.g., governmental actions or natural disasters). The Fund may determine the fair value of investments based on information provided by pricing services and other third-party vendors, which may recommend fair value prices or adjustments with reference to other securities, indices or assets. In considering whether fair value pricing is required and in determining fair values, the Fund may, among other things, consider significant events (which may be considered to include changes in the value of U.S. securities or securities indices) that occur after the close of the relevant market and before the Valuation Time. The Fund may use modeling tools provided by third-party vendors to determine fair values of certain non-U.S. securities.

For purposes of calculating NAV, the Fund normally uses pricing data for domestic equity securities received shortly after the NYSE Close and does not normally take into account trading, clearances or settlements that take place after the NYSE Close. Domestic fixed income and non-U.S. securities are normally priced using data reflecting the earlier closing of the principal markets for those securities, subject to possible fair value adjustments. Information that becomes known to the Fund or its agents after NAV has been calculated on a particular day will not generally be used to retroactively adjust the price of a security or NAV determined earlier that day.

Investments initially valued in currencies other than the U.S. dollar are converted to U.S. dollars using exchange rates obtained from pricing services. As a result, NAV of the Fund's shares may be affected by changes in the value of currencies in relation to the U.S. dollar. The value of investments 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 is closed. The calculation of the Fund's NAV may not take place contemporaneously with the determination of the prices of non-U.S. securities used in NAV calculations.

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In unusual circumstances, instead of valuing securities in the usual manner, the Fund may value securities at fair value as determined in good faith by the Board, generally based upon recommendations provided by the Investment Manager or PIMCO. Fair valuation also may be required due to material events that occur after the close of the relevant market but prior to the NYSE Close.

**Distributions**

The Fund intends to make regular monthly cash distributions to Common Shareholders at rates which may vary based upon the performance of the Fund and income accrual. Distributions can be made only from net investment income after paying any accrued dividends to holders of Preferred Shares. The dividend rate that the Fund pays on its common shares will depend on a number of factors, including variable rates of interest which may be received on the Fund's portfolio, the level of dividends payable on the Preferred Shares and the expenses of any other leveraging transactions utilized by the Fund. Because some or all of the debt instruments held by the Fund may be floating rate assets, the amount of the Fund's monthly distributions to Common Shareholders may vary over time with fluctuations in market interest rates. The net income of the Fund consists of all income paid or accrued on portfolio assets less all expenses of the Fund. Expenses of the Fund are accrued each day. Over time, substantially all the net investment income of the Fund will be distributed. At least annually, the Fund also intends to distribute to Common Shareholders their pro rata shares of any available net capital gains. Although it does not now intend to do so, the Board may change the Fund's dividend policy and the amount or timing of the distributions based on a number of factors, including the amount of the Fund's undistributed net investment income and historical and projected investment income and the amount of the expenses and dividend rates on any outstanding Preferred Shares.

To permit the Fund to maintain a more stable relationship between its monthly distributions and the variable rates of interest it may receive on its investment portfolio, the Fund may initially distribute less than the entire amount of net investment income earned in a particular period. The undistributed net investment income would be available to supplement future distributions. As a result, the distributions paid by the Fund for any particular monthly period may be more or less than the amount of net investment income actually earned by the Fund during the period. Undistributed net investment income will be added to the Fund's net asset value and, correspondingly, distributions from undistributed net investment income will be deducted from the Fund's net asset value. Unless Common Shareholders elect to receive distributions in cash, all distributions to Common Shareholders will be automatically reinvested in additional common shares under the Fund's Dividend Reinvestment Plan.

**Dividend reinvestment plan**

[Pursuant to the Fund's Dividend Reinvestment Plan (the Plan), all Common Shareholders whose shares are registered in their own names will have all dividends, including any capital gain dividends, reinvested automatically in additional common shares by PNC Global Investment Servicing Inc., as agent for the Common Shareholders (the Plan Agent), unless the shareholder elects to receive cash. An election to receive cash may be revoked or reinstated at the option of the shareholder. In the case of record shareholders such as banks, brokers or other nominees that hold common shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of common shares certified from time to time by the record shareholder as representing the total amount registered in such shareholder's name and held for the account of beneficial owners who are to participate in the Plan. Shareholders whose shares are held in the name of a bank, broker or nominee should contact the bank, broker or nominee for details. Such shareholders may not be able to transfer their shares to another bank or broker and continue to participate in the Plan. All distributions to investors who elect not to participate in the Plan (or whose broker or nominee elects not to participate on the investor's behalf) will be paid in cash by check mailed, in the case of direct shareholders, to the record holder by PNC Global Investment Servicing Inc., as the Fund's dividend disbursement agent.

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Unless you elect (or your broker or nominee elects) not to participate in the Plan, the number of common shares you will receive will be determined as follows:

- (1) If on the payment date the net asset value of the common shares is equal to or less than the market price per Common Share plus estimated brokerage commissions that would be incurred upon the purchase of common shares on the open market, the Fund will issue new shares at the greater of (i) the net asset value per Common Share on the payment date or (ii) 95% of the market price per Common Share on the payment date; or
- (2) If on the payment date the net asset value of the common shares is greater than the market price per Common Share plus estimated brokerage commissions that would be incurred upon the purchase of common shares on the open market, the Plan Agent will receive the dividend or distribution in cash and will purchase common shares in the open market, on the New York Stock Exchange or elsewhere, for the participants' accounts. It is possible that the market price for the common shares may increase before the Plan Agent has completed its purchases. Therefore, the average purchase price per share paid by the Plan Agent may exceed the market price on the payment date, resulting in the purchase of fewer shares than if the dividend or distribution had been paid in common shares issued by the Fund. The Plan Agent will use all dividends and distributions received in cash to purchase common shares in the open market on or shortly after the payment date, but in no event later than the ex-dividend date for the next distribution. Interest will not be paid on any uninvested cash payments.

You may withdraw from the Plan at any time by giving written notice to the Plan Agent. If you withdraw or the Plan is terminated, you will receive shares for each whole share in your account under the Plan and you will receive a cash payment for any fraction of a share in your account. If you wish, the Plan Agent will sell your shares and send you the proceeds, minus brokerage commissions.

The Plan Agent maintains all shareholders' accounts in the Plan and gives written confirmation of all transactions in the accounts, including information you may need for tax records. The Plan Agent will also furnish each person who buys common shares with written instructions detailing the procedures for electing not to participate in the Plan and to instead receive distributions in cash. Common shares in your account will be held by the Plan Agent in non-certificated form. Any proxy you receive will include all common shares you have received under the Plan.

There is no brokerage charge for reinvestment of your dividends or distributions in common shares. However, all participants will pay a pro rata share of brokerage commissions incurred by the Plan Agent when it makes open market purchases.

Automatically reinvested dividends and distributions are taxed in the same manner as cash dividends and distributions. See Tax matters.

The Fund and the Plan Agent reserve the right to amend or terminate the Plan. There is no direct service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. Additional information about the Plan may be obtained from PNC Global Investment Servicing Inc., P.O. Box 43027, Providence, Rhode Island 02940-3027, telephone number (800) 331-1710.]

**Description of capital structure**

The Fund is an unincorporated voluntary association with transferable shares of beneficial interest (commonly referred to as a Massachusetts business trust) established under the laws of The Commonwealth of Massachusetts by the Declaration. The Declaration provides that the Trustees of the Fund may authorize separate classes of shares of beneficial interest. The Trustees have authorized an unlimited number of common shares of beneficial interest and preferred shares of beneficial interest. Preferred shares (such as the Preferred Shares) may be issued in one or more series, with such par value and with such rights as determined by the Board, by action of the Board without the approval of the Common Shareholders. The following table shows, for each class of authorized securities of the Fund, the amount of (i) shares authorized and (ii) shares outstanding, each as of [ ].

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| <b>Title of Class</b> | <b>Amount Authorized</b> | <b>Amount Outstanding</b> |
|-----------------------|--------------------------|---------------------------|
| Common Shares         | Unlimited                | [ ]                       |
| Preferred Shares      |                          |                           |
| Series T              | 2,800                    | 1,053                     |
| Series W              | 2,800                    | 1,053                     |
| Series TH             | 2,800                    | 1,053                     |

Common Shareholders are entitled to share equally in dividends declared by the Board payable to Common Shareholders and in the net assets of the Fund available for distribution to Common Shareholders after payment of the preferential amounts payable to holders of Preferred Shares and any other outstanding preferred shares of beneficial interest. Neither Common Shareholders nor holders of preferred shares (including the Preferred Shares) have preemptive or conversion rights or have the right to cause the Fund to redeem their shares. Upon liquidation of the Fund, after paying or adequately providing for the payment of all liabilities of the Fund and the liquidation preference with respect to any outstanding preferred shares (including the Preferred Shares), and upon receipt of such releases, indemnities and refunding agreements as they deem necessary for their protection, the Trustees may distribute the remaining assets of the Fund among the Fund's Common Shareholders.

Shareholders of each class are entitled to one vote for each share held. Common Shareholders will vote with the holders of any outstanding Preferred Shares or other preferred shares on each matter submitted to a vote of holders of common shares, except as otherwise provided by the Declaration, the Fund's amended and restated bylaws (the Amended Bylaws), or applicable law. Except as otherwise provided by the Declaration, the Amended Bylaws or applicable law, holders of Preferred Shares are (voting as a separate class) entitled to elect two trustees, and the remaining trustees are elected by Common Shareholders and holders of Preferred Shares, voting as a single class.

So long as any Preferred Shares or any other preferred shares are outstanding, holders of common shares will not be entitled to receive any dividends of or other distributions from the Fund, unless at the time of such declaration, (1) all accrued dividends on the Preferred Shares and any other preferred shares of beneficial interest or accrued interest on borrowings (if any) have been paid and (2) the value of the Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all liabilities and indebtedness of the Fund not represented by senior securities, is at least 300% of the aggregate amount of senior securities representing indebtedness and at least 200% of the aggregate amount of senior securities representing indebtedness plus the aggregate liquidation value of the outstanding preferred shares (expected to equal the aggregate original purchase price of the outstanding preferred shares plus the redemption premium, if any, together with any accrued and unpaid dividends thereon, whether or not earned or declared and on a cumulative basis). In addition to the requirements of the 1940 Act, the Fund is required to comply with other asset coverage requirements as a condition of the Fund maintaining an Aaa or AAA rating of the Preferred Shares from Moody's and Fitch, respectively.

The Fund will send unaudited reports at least semi-annually and audited financial statements annually to all of its shareholders.

The common shares of the Fund commenced trading on the NYSE on August 29, 2003. As of the close of trading on the NYSE on [ ], the net asset value per common share was \$[ ], and the closing price per common share on the NYSE was \$[ ].

The Declaration authorizes the issuance of an unlimited number of Preferred Shares. The Preferred Shares were issued in three series, with a par value of \$0.00001 and rights determined by action of the Board without the approval of the Common Shareholders.

The terms of the Preferred Shares provide that they would ordinarily pay dividends at a rate set at auctions held every seven days, subject to a maximum applicable rate calculated as a function of the Preferred Shares' then-current rating and a reference interest rate. However, the weekly auctions for the Preferred Shares, as well as auctions for similar preferred shares of other closed-end funds across the U.S. industry, have failed since February 2008, and the dividend rates on the Preferred Shares since that time have been paid at the maximum applicable rate. The Fund expects that the Preferred Shares will continue to pay dividends at the maximum applicable rate for the foreseeable future and cannot predict whether or when the auction markets for the Preferred Shares may resume normal functioning.

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As used in this prospectus, unless otherwise noted, the Fund's net assets include assets of the Fund attributable to any outstanding Preferred Shares, with no deduction for the liquidation preference of the Preferred Shares. Solely for financial reporting purposes, however, the Fund is required to exclude the liquidation preference of Preferred Shares from net assets, so long as the Preferred Shares have redemption features that are not solely within the control of the Fund. For all regulatory and tax purposes, the Fund's Preferred Shares will be treated as stock (rather than indebtedness).

### **DISTRIBUTION PREFERENCE**

The Preferred Shares have complete priority over the common shares as to distribution of assets.

### **LIQUIDATION PREFERENCE**

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Fund, holders of Preferred Shares will be entitled to receive a preferential liquidating distribution (expected to equal the original purchase price per share plus accumulated and unpaid dividends thereon, whether or not earned or declared) before any distribution of assets is made to the Common Shareholders.

### **VOTING RIGHTS**

Except as otherwise provided in the Declaration or the Fund's Bylaws or otherwise required by applicable law, holders of Preferred Shares will vote together with Common Shareholders as a single class.

Holders of Preferred Shares, voting as a separate class, will also be entitled to elect two of the Fund's Trustees. The remaining Trustees will be elected by Common Shareholders and holders of Preferred Shares, voting together as a single class. In the unlikely event that two full years of accrued dividends are unpaid on the Preferred Shares, the holders of all outstanding Preferred Shares, voting as a separate class, will be entitled to elect a majority of the Fund's Trustees until all dividends in arrears have been paid or declared and set apart for payment.

### **REDEMPTION, PURCHASE AND SALE OF PREFERRED SHARES**

[To be inserted by amendment.]

### **OTHER ISSUES RELATING TO PREFERRED SHARES**

Under the 1940 Act, the Fund is permitted to have outstanding more than one series of preferred shares of beneficial interest as long as no single series has priority over another series as to the distribution of assets of the Fund or the payment of dividends. Neither Common Shareholders nor holders of Preferred Shares have pre-emptive rights to purchase any Preferred Shares or any other preferred shares that might be issued.

### **Market and net asset value information**

The Fund's common shares are listed on the NYSE under the trading or ticker symbol PFL. The Fund's common shares commenced trading on the NYSE in August 2003. The Fund cannot predict whether its common shares will trade in the future at a premium or discount to net asset value. Issuance of additional common shares pursuant to the Offer may have an adverse effect on prices in the secondary market for the Fund's common shares by increasing the number of shares available, which may put downward pressure on the market price for the common shares. Record Date Shareholders who do not fully exercise their Rights will, upon completion of the Offer, own a smaller proportional interest in the Fund than they owned prior to the Offer. In addition, because the Subscription Price per common share may be less than the then current net asset value per common share, the completion of the Offer will likely result in an immediate dilution of the net asset value per common share for all existing Common Shareholders. Such dilution is not currently determinable because it is not known how many common shares will be subscribed for, what the net asset value or market price of the common shares will be on the Expiration Date or what the Subscription Price will be. Such dilution could be substantial. If such dilution occurs, Common Shareholders will experience a decrease in the net asset value per common share held by them, irrespective of whether they exercise all or any portion of their Rights.

The following table sets forth, for each of the periods indicated, the high and low closing market prices of the Fund's common shares on the NYSE, the high and low net asset value per share and the high and low premium/discount to net asset value per share. See Net asset value for information as to how the Fund's net asset value is determined.





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| Quarter                     | Common Share<br>Market price |        | Common Share<br>Net asset value |        | Premium (discount) as<br>a % of net asset value |      |
|-----------------------------|------------------------------|--------|---------------------------------|--------|---|------|
|                             | High                         | Low    | High                            | Low    | High  | Low  |
| Quarter ended Oct. 31, 2007 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Jan. 31, 2008 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Apr. 30, 2008 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Jul. 31, 2008 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Oct. 31, 2008 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Jan. 31, 2009 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Apr. 30, 2009 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Jul. 31, 2009 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Oct. 31, 2009 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |
| Quarter ended Jan. 31, 2010 | \$ [ ]                       | \$ [ ] | \$ [ ]                          | \$ [ ] | [ ]%  | [ ]% |

**Anti-takeover provisions in the agreement and declaration of trust**

The Declaration and the Amended Bylaws include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to convert the Fund to open-end status. The Fund's Trustees are divided into three classes. At each annual meeting of shareholders, the term of one class expires and each Trustee elected to that class holds office for a term of three years. The classification of the Board in this manner could delay for an additional year the replacement of a majority of the Board. In addition, the Declaration provides that a Trustee may be removed only for cause and only (i) by action of at least seventy-five percent (75%) of the outstanding shares of the classes or series of shares entitled to vote for the election of such Trustee, or (ii) by at least seventy-five percent (75%) of the remaining Trustees.

As described below, the Declaration grants special approval rights with respect to certain matters to members of the Board who qualify as

Continuing Trustees, which term means a Trustee who either (i) has been a member of the Board for a period of at least thirty-six months (or since the commencement of the Fund's operations, if less than thirty-six months) or (ii) was nominated to serve as a member of the Board by a majority of the Continuing Trustees then members of the Board.

The Declaration requires the affirmative vote or consent of at least seventy-five percent (75%) of the Board and holders of at least seventy-five percent (75%) of the Fund's shares (including common and preferred shares of beneficial interest) to authorize certain Fund transactions not in the ordinary course of business, including a merger or consolidation, issuance or transfer by the Fund of the Fund's shares (except as may be pursuant to a public offering, the Fund's dividend reinvestment plan or upon exercise of any stock subscription rights), a sale, transfer or other disposition of Fund assets, or any shareholder proposal regarding specific investment decisions, unless the transaction is authorized by both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees (in which case no shareholder authorization would be required by the Declaration, but may be required in certain cases under the 1940 Act). The Declaration also requires the affirmative vote or consent of holders of at least seventy-five percent (75%) of each class of the Fund's shares entitled to vote on the matter to authorize a conversion of the Fund from a closed-end to an open-end investment company, unless the conversion is authorized by both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees (in which case shareholders would have only the minimum voting rights required by the 1940 Act with respect to the conversion). Also, the Declaration provides that the Fund may be terminated at any time by vote or consent of at least seventy-five percent (75%) of the Fund's shares or, alternatively, by vote or consent of both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees. See Anti-Takeover and Other Provisions in the Declaration of Trust in the SAI for a more detailed summary of these provisions.

The Trustees may from time to time grant other voting rights to shareholders with respect to these and other matters in the Fund's Amended Bylaws, certain of which are required by the 1940 Act. For example, the Amended Bylaws grant holders of Preferred Shares and any other preferred shares special voting rights with respect to certain matters described in the preceding paragraph.

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The overall effect of these provisions is to render more difficult the accomplishment of a merger or the assumption of control by a third party. These provisions also provide, however, the advantage of potentially requiring persons seeking control of the Fund to negotiate with its management regarding the price to be paid and facilitating the continuity of the Fund's investment objective and policies. The provisions of the Declaration and Amended Bylaws described above could have the effect of discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. The Board of the Fund has considered the foregoing anti-takeover provisions and concluded that they are in the best interests of the Fund and its shareholders.

The foregoing is intended only as a summary and is qualified in its entirety by reference to the full text of the Declaration and the Amended Bylaws, both of which are on file with the Securities and Exchange Commission.

Under Massachusetts law, shareholders could, in certain circumstances, be held personally liable for the obligations of the Fund. However, the Declaration contains an express disclaimer of shareholder liability for debts or obligations of the Fund and requires that notice of such limited liability be given in each agreement, obligation or instrument entered into or executed by the Fund or the Trustees. The Declaration further provides for indemnification out of the assets and property of the Fund for all loss and expense of any shareholder held personally liable for the obligations of the Fund. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which the Fund would be unable to meet its obligations. The Fund believes that the likelihood of such circumstances is remote.

**Repurchase of common shares; conversion to open-end fund**

The Fund is a closed-end investment company and as such holders of its common shares do not have the right to cause the Fund to redeem their shares. Instead, the common shares trade in the open market at a price that is a function of several factors, including dividend levels, net asset value, call protection, portfolio credit quality, relative demand for and supply of such shares in the market, general market and economic conditions, conditions affecting individual issuers and other factors. Shares of a closed-end investment company may frequently trade at prices lower than net asset value. The Fund's Board regularly monitors the relationship between the market price and net asset value of the common shares. If the common shares were to trade at a substantial discount to net asset value for an extended period of time, the Board may consider the repurchase of its common shares on the open market or in private transactions, the making of a tender offer for such shares, or the conversion of the Fund to an open-end investment company. The Fund cannot assure you that its Board will decide to take or propose any of these actions, or that share repurchases or tender offers will actually reduce market discount.

If the Fund were to convert to an open-end company, it would be required to redeem all Preferred Shares and other preferred shares then outstanding (requiring in turn that it liquidate a portion of its investment portfolio), and the common shares would no longer be listed on the NYSE. In contrast to a closed-end investment company, shareholders of an open-end investment company may require the company to redeem their shares at any time (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less any redemption charge that is in effect at the time of redemption. In addition, if the Fund were to convert to an open-end company, it would not be able to invest more than 15% of its net assets in illiquid securities, which likely would necessitate a substantial repositioning of the Fund's investment portfolio, which may in turn generate substantial transaction costs, which would be borne by Common Shareholders.

Before deciding whether to take any action to convert the Fund to an open-end investment company, the Board would consider all relevant factors, including the extent and duration of the discount, the liquidity of the Fund's portfolio, the impact of any action that might be taken on the Fund or its shareholders, and market considerations. Based on these considerations, even if the Fund's common shares should trade at a discount, the Board may determine that, in the interest of the Fund and its shareholders, no action should be taken. See the Statement of Additional Information under "Repurchase of Common Shares; Conversion to Open-End Fund" for a further discussion of possible action to reduce or to eliminate such discount to net asset value.

**Table of Contents****Tax matters****Federal Income Tax Matters**

The following discussion of federal income tax matters is based on the advice of Ropes & Gray, LLP, counsel to the Fund, and is a general summary of some of the important U.S. federal income tax considerations affecting the Fund and its Common Shareholders that are United States persons within the meaning of the Code, and does not address any state, local, foreign or other tax consequences. It reflects provisions of the Code, existing Treasury regulations, rulings published by the Internal Revenue Service (the IRS), and other applicable authority, as of the date of this prospectus. These authorities may be changed, possibly with retroactive effect, or subject to new legislative, administrative or judicial interpretations. This summary does not purport to be a complete description of the U.S. federal income tax considerations applicable to an investment in common shares of the Fund. For example, we have not described certain tax considerations that may be relevant to certain types of holders subject to special treatment under the U.S. federal income tax laws, including shareholders subject to the U.S. federal alternative minimum tax, insurance companies, tax-exempt organizations, pension plans and trusts, RICs, dealers in securities, shareholders holding Fund shares through tax-advantaged accounts (such as 401(k) plans or IRAs), financial institutions, and shareholders holding common shares as part of a hedge, straddle, or conversion transaction. This summary assumes that investors hold common shares as capital assets (within the meaning of the Code). Your investment in the Fund may have other tax implications. Please consult your tax advisor about U.S. federal, state, local, foreign or other tax laws applicable to you, as tax matters are very complex and the tax consequences to an investor of an investment in the Fund's common shares will depend on the facts of his, her or its particular situation. For more information, including a summary of certain tax consequences of investing in common shares of the Fund for non-U.S. persons, see the Statement of Additional Information.

The Fund has elected to be treated as a regulated investment company (a RIC) under Subchapter M of the Code and intends each year to qualify and to be eligible to be treated as such. If the Fund so qualifies and satisfies certain distribution requirements, the Fund will not be subject to federal income tax on income distributed in a timely manner to its shareholders in the form of dividends or capital gain distributions.

To satisfy the distribution requirement applicable to RICs, amounts paid as dividends by the Fund to its shareholders, including holders of its Preferred Shares, must qualify for the dividends-paid deduction. In certain circumstances, the IRS could take the position that dividends paid on the Preferred Shares constitute preferential dividends under Section 562(c) of the Code, and thus do not qualify for the dividends-paid deduction. The Fund believes this position, if asserted, would be unlikely to prevail.

If at any time when Preferred Shares are outstanding the Fund does not meet applicable asset coverage requirements, it will be required to suspend distributions to Common Shareholders until the requisite asset coverage is restored. Any such suspension may cause the Fund to pay a 4% excise tax (imposed on RICs that fail to distribute for a given calendar year, generally, at least 98% of their net investment income and capital gain net income) and U.S. federal income tax on undistributed income or gains, and may, in certain circumstances, prevent the Fund from qualifying for treatment as RIC. The Fund may redeem or purchase Preferred Shares in an effort to comply with the distribution requirement applicable to RICs and to avoid income and excise taxes. The Fund may have to dispose of portfolio securities to generate cash for such redemptions, which may result in transaction expenses and gain at the Fund level and in further distributions to Common Shareholders.

Subject to the considerations discussed immediately above, the Fund intends to distribute at least annually to its Common Shareholders all or substantially all of its investment company taxable income (as that term is defined in the Code without regard to the deduction for dividends paid generally, taxable ordinary income and the excess, if any, of net short-term capital gains over net long-term capital losses), its net tax-exempt interest (if any), and its net capital gain (that is, the excess of net long-term capital gains over net short-term capital losses). If the Fund does retain any investment company taxable income, it will be subject to tax at regular corporate rates on the amount retained. If the Fund does retain any net capital gain, it will be subject to tax at regular corporate rates on the amount retained, but may designate the retained amount as undistributed capital gains in a notice to its shareholders who would then, in turn, be (i) required to include in income for U.S. federal income tax purposes, as long-term capital gain, their shares of such undistributed amount, and (ii) entitled to credit their proportionate shares of the tax

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paid by the Fund on such undistributed amount against their U.S. federal income tax liabilities, if any, and to claim refunds on a properly-filed U.S. tax return to the extent the credit exceeds such liabilities. If the Fund makes this designation, for federal income tax purposes, the tax basis of the shares owned by a shareholder of the Fund would be increased by an amount equal under current law to the difference between the amount of undistributed capital gains included in the shareholder's gross income under clause (i) of the preceding sentence and the tax deemed paid by the shareholder under clause (ii) of the preceding sentence. The Fund is not required to, and there can be no assurance the Fund will, make this designation if it retains all or a portion of its net capital gain in a taxable year. To the extent that the Fund retains any net capital gain, it may be required to liquidate portfolio securities that it might otherwise have continued to hold (possibly at times or prices when it might not be advantageous to do so) in order to generate the cash to pay the tax on the amount retained.

For federal income tax purposes, distributions of investment income are generally taxable to shareholders as ordinary income. Taxes on distributions of capital gains are determined by how long the Fund owned the investments that generated such capital gains, rather than how long a shareholder has owned his or her shares. Distributions of gains from the sale of investments that the Fund owned for more than one year and that are properly designated by the Fund as capital gain dividends will generally be taxable to shareholders as long-term capital gains. Distributions of gains from the sale of investments that the Fund owned for one year or less will generally be taxable to shareholders as ordinary income. Distributions in excess of the Fund's current and accumulated earnings and profits are treated as returns of capital to the extent of the shareholder's basis in its shares and thereafter as capital gain. A return of capital is not taxable, but it reduces a shareholder's tax basis in its shares, thus reducing any loss or increasing any gain on a subsequent taxable disposition by the shareholder of its shares. Where one or more such distributions occur in any taxable year of the Fund, the available earnings and profits will be allocated first to the distributions made to the holders of Preferred Shares, and only thereafter to distributions made to holders of common shares. As a result, the holders of Preferred Shares will receive a disproportionate share of the distributions treated as dividends, and the holders of the common shares will receive a disproportionate share of the distributions treated as a return of capital.

Distributions are taxable to a shareholder whether the shareholder receives them in cash or reinvests them in additional common shares through the Fund's Dividend Reinvestment Plan. Distributions are taxable to a shareholder even if they are paid from income or gains earned by the Fund before a shareholder's investment (and thus were reflected in the price the shareholder paid). Shareholders will be notified annually as to the U.S. federal tax status of Fund distributions.

Any gain resulting from the sale or exchange of common shares generally will be taxable as capital gain.

For taxable years beginning before January 1, 2011, distributions of investment income designated by the Fund as derived from qualified dividend income will be taxed in the hands of individuals at the rates applicable to long-term capital gain, provided holding period and other requirements are met at both the shareholder and Fund level. See the Statement of Additional Information for a description of these requirements. It is currently unclear whether Congress will extend, change or eliminate this provision to or for tax years beginning on or after January 1, 2011. Fund dividends representing distributions from interest income and short-term capital gains cannot be designated as qualified dividend income and will not qualify for the reduced rates. Therefore, the Fund does not expect a significant portion of Fund distributions to be derived from qualified dividend income.

Long-term capital gain rates applicable to individuals have been temporarily reduced in general, to 15% with a 0% rate applying to taxpayers in the 10% and 15% brackets for taxable years beginning before January 1, 2011. It is currently unclear whether Congress will extend, change or eliminate this special rate to or for tax years beginning on or after January 1, 2011.

Generally, the Fund's transactions in derivative instruments (*e.g.*, options, structured notes, futures contracts, swap agreements and forward contracts), as well as any of its other hedging, short sale or similar transactions may be subject to one or more special tax rules (*e.g.*, notional principal contract, mark-to-market, constructive sale, straddle, wash sale and short sale rules), the effect of which may be, among other things, to accelerate the recognition of income to the Fund, to defer losses to the Fund, to cause adjustments in the holding periods of the Fund's securities, to convert lower taxed long-term capital gains or qualified dividend income into higher taxed short-term capital gains or ordinary income and to convert short-term capital losses into long-term capital losses. These rules, therefore, could affect the amount, timing and/or character of distributions to shareholders of the Fund.

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Some of the debt obligations with a fixed maturity date of more than one year from the date of issuance (and all zero-coupon debt obligations with a fixed maturity date of more than one year from the date of issuance) that are acquired by the Fund will be treated as debt obligations that are issued originally at a discount. Generally, the amount of the original issue discount (OID) is treated as interest income and is included in the Fund's income (and thus required to be distributed) over the term of the debt security, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt security. In addition, payment-in-kind securities will give rise to income which is required to be distributed and is taxable even though the Fund holding the security receives no interest payment in cash on the security during the year.

Some debt obligations with a fixed maturity date of more than one year from the date of issuance that are acquired by the Fund in the secondary market may be treated as having market discount. Very generally, market discount is the excess of the stated redemption price of a debt obligation over the purchase price of such obligation. Generally, any gain recognized on the disposition of, and any partial payment of principal on, a debt security having market discount is treated as ordinary income to the extent the gain, or principal payment, does not exceed the accrued market discount on such debt security. Alternatively, the Fund may elect to accrue market discount currently, in which case the Fund will be required to include the accrued market discount in the Fund's income (as ordinary income) and thus distribute it over the term of the debt security, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt security. The rate at which the market discount accrues, and thus is included in the Fund's income, will depend upon which of the permitted accrual methods the Fund elects.

If the Fund holds the foregoing kinds of securities, it may be required to pay out as an income distribution each year an amount which is greater than the total amount of cash interest the Fund actually received. As a result, the Fund could be required at times to liquidate other investments (including at potentially disadvantageous times or prices) in order to satisfy its distribution requirements and/or to avoid incurring Fund-level U.S. federal income or excise taxes.

Investments in debt obligations that are at risk of or in default present special tax issues for the Fund. Tax rules are not entirely clear about issues such as whether or to what extent the Fund should recognize market discount on a debt obligation, when the Fund may cease to accrue interest, OID or market discount, when and to what extent the Fund may take deductions for bad debts or worthless securities and how the Fund should allocate payments received on obligations in default between principal and income. These and other related issues will be addressed by the Fund when, as and if it invests in such securities, in order to seek to ensure that it distributes sufficient income to preserve its status as a RIC and does not become subject to U.S. federal income or excise tax.

The Fund's transactions in foreign currencies, foreign currency-denominated debt obligations and certain foreign currency options, futures contracts and forward contracts (and similar instruments) may give rise to ordinary income or loss to the extent such income or loss results from fluctuations in the value of the foreign currency concerned. Such ordinary income treatment may accelerate the Fund's distributions to shareholders and increase the distributions taxed to shareholders as ordinary income. Losses from such positions may lead to a return of capital to Fund shareholders.

Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries, in which case, the Fund's yield on the securities giving rise to such income would be decreased. Tax treaties between certain countries and the U.S. may reduce or eliminate such taxes. If more than 50% of the Fund's assets at its year end consist of the securities of foreign corporations, the Fund may elect to permit shareholders to claim a credit or deduction on their income tax returns for their pro rata portion of qualified taxes paid by the Fund to foreign countries in respect of foreign securities the Fund has held for at least the minimum period specified in the Code. See the Statement of Additional Information for additional requirements to obtain such credits. The Fund does not expect that it will be eligible to make this special election.

Under current law, the backup withholding rate is 28% for amounts paid through 2010 and will be 31% for amounts paid after December 31, 2010, unless Congress enacts tax legislation providing otherwise. The Fund may be

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required to apply backup withholding to taxable distributions or redemption proceeds payable to a shareholder including, for example, distributions paid to any individual shareholder who fails to properly furnish the Fund with a correct taxpayer identification number, who has under-reported dividend or interest income, or who fails to certify to the Fund that he or she is not subject to such withholding. Please see the Statement of Additional Information for additional information about backup withholding.

This section relates only to the U.S. federal income tax consequences of investing in common shares of the Fund; the consequences under other tax laws may differ. You should consult your tax advisor as to the possible application of foreign, state, local or other income tax laws to Fund dividends and capital distributions as well as possible estate tax consequences to foreign shareholders. Please see **Tax Matters** in the Statement of Additional Information for additional information regarding the tax aspects of investing in common shares of the Fund.

**Custodian and transfer agent**

The custodian of the assets of the Fund is State Street Bank and Trust Co., 801 Pennsylvania Avenue, Kansas City, Missouri 64105. The custodian performs custodial and fund accounting services.

PNC Global Investment Servicing, P.O. Box 43027, Providence, Rhode Island 02940, serves as the Fund's transfer agent, registrar, dividend paying agent and redemption agent for its common shares.

**Legal opinions**

Certain legal matters in connection with the common shares will be passed upon for the Fund by Ropes & Gray LLP, Boston Massachusetts, and certain other legal matters will be passed on for the Dealer Manager by [ ], [ ].

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**Appendix A**

**DESCRIPTION OF SECURITIES RATINGS**

The Fund's investments may range in quality from securities rated in the lowest category to securities rated in the highest category (as rated by Moody's, S&P or Fitch or, if unrated, determined by PIMCO to be of comparable quality). The percentage of the Fund's assets invested in securities in a particular rating category will vary. The following terms are generally used to describe the credit quality of fixed income securities:

High Quality Debt Securities are those rated in one of the two highest rating categories (the highest category for commercial paper) or, if unrated, deemed comparable by PIMCO.

Investment Grade Debt Securities are those rated in one of the four highest rating categories or, if unrated deemed comparable by PIMCO.

Below Investment Grade, High Yield Securities ( Junk Bonds ) are those rated lower than Baa by Moody's or BBB by S&P or Fitch and comparable securities. They are considered predominantly speculative with respect to the issuer's ability to repay principal and interest.

The following is a description of Moody's, S&P's and Fitch's rating categories applicable to fixed income securities.

**Moody's Long-Term Ratings: Bonds and Preferred Stock**

Aaa: Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as gilt edge. Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

Aa: Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present that make the long-term risks appear somewhat larger than with Aaa securities.

A: Bonds which are rated A possess many favorable investment attributes and are to be considered as uppermedium-grade obligations. Factors giving security to principal and interest are considered adequate but elements may be present that suggest a susceptibility to impairment sometime in the future.

Baa: Bonds which are rated Baa are considered as medium-grade obligations (*i.e.*, they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

Ba: Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well assured.

Often the protection of interest and principal payments may be very moderate and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B: Bonds which are rated B generally lack characteristics of a desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

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Caa: Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca: Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C: Bonds which are rated C are the lowest rated class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

Moody's applies numerical modifiers, 1, 2, and 3 in each generic rating classified from Aa through Caa in its corporate bond rating system. The modifier 1 indicates that the security ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates that the issue ranks in the lower end of its generic rating category.

## **Corporate Short-Term Debt Ratings**

Moody's short-term debt ratings are opinions of the ability of issuers to repay punctually senior debt obligations which have an original maturity not exceeding one year. Obligations relying upon support mechanisms such as letters of credit and bonds of indemnity are excluded unless explicitly rated.

Moody's employs the following three designations, all judged to be investment grade, to indicate the relative repayment ability of rated issuers:

PRIME-1: Issuers rated Prime-1 (or supporting institutions) have a superior ability for repayment of senior short-term debt obligations. Prime-1 repayment ability will often be evidenced by many of the following characteristics: leading market positions in well-established industries; high rates of return on funds employed; conservative capitalization structure with moderate reliance on debt and ample asset protection; broad margins in earnings coverage of fixed financial charges and high internal cash generation; and well-established access to a range of financial markets and assured sources of alternate liquidity.

PRIME-2: Issuers rated Prime-2 (or supporting institutions) have a strong ability for repayment of senior short-term debt obligations. This will normally be evidenced by many of the characteristics cited above but to a lesser degree. Earnings trends and coverage ratios, while sound, may be more subject to variation. Capitalization characteristics, while still appropriate, may be more affected by external conditions. Ample alternate liquidity is maintained.

PRIME-3: Issuers rated Prime-3 (or supporting institutions) have an acceptable ability for repayment of senior short-term obligations. The effect of industry characteristics and market compositions may be more pronounced. Variability in earnings and profitability may result in changes in the level of debt protection measurements and may require relatively high financial leverage. Adequate alternate liquidity is maintained.

NOT PRIME: Issuers rated Not Prime do not fall within any of the Prime rating categories.

## **Short-Term Municipal Bond Ratings**

There are three rating categories for short-term municipal bonds that define an investment grade situation, which are listed below. In the case of variable rate demand obligations (VRDOs), a two-component rating is assigned. The first element represents an evaluation of the degree of risk associated with scheduled principal and interest payments, and the other represents an evaluation of the degree of risk associated with the demand feature. The short-term rating assigned to the demand feature of VRDOs is designated as VMIG. When either the long- or short-term aspect of a VRDO is not rated, that piece is designated NR, *e.g.*, Aaa/NR or NR/VMIG 1. MIG ratings terminate at the retirement of the obligation while VMIG rating expiration will be a function of each issuer's specific structural or credit features.

MIG 1/VMIG 1: This designation denotes superior quality. There is present strong protection by established cash flows, superior liquidity support or demonstrated broad-based access to the market for refinancing.

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MIG 2/VMIG 2: This designation denotes strong quality. Margins of protection are ample although not so large as in the preceding group.

MIG 3/VMIG 3: This designation denotes acceptable quality. All security elements are accounted for but there is lacking the undeniable strength of the preceding grades. Liquidity and cash flow protection may be narrow and market access for refinancing is likely to be less well established.

SG: This designation denotes speculative quality. Debt instruments in this category lack margins of protection.

## **Standard & Poor's Ratings Services**

### **Corporate and Municipal Bond Ratings**

#### **Investment Grade**

AAA: Debt rated AAA has the highest rating assigned by S&P. Capacity to pay interest and repay principal is extremely strong.

AA: Debt rated AA has a very strong capacity to pay interest and repay principal and differs from the highest rated issues only in small degree.

A: Debt rated A has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.

BBB: Debt rated BBB is regarded as having an adequate capacity to pay interest and repay principal. Whereas it normally exhibits adequate protection parameters, adverse economic conditions, or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for debt in this category than in higher-rated categories.

#### **Speculative Grade**

Debt rated BB, B, CCC, CC, and C is regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal. BB indicates the least degree of speculation and C the highest. While such debt will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major exposures to adverse conditions.

BB: Debt rated BB has less near-term vulnerability to default than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to inadequate capacity to meet timely interest and principal payments. The BB rating category is also used for debt subordinated to senior debt that is assigned an actual or implied BBB- rating.

B: Debt rated B has a greater vulnerability to default but currently has the capacity to meet interest payments and principal repayments. Adverse business, financial, or economic conditions will likely impair capacity or willingness to pay interest and repay principal. The B rating category is also used for debt subordinated to senior debt that is assigned an actual or implied BB or BB- rating.

CCC: Debt rated CCC has a currently identifiable vulnerability to default and is dependent upon favorable business, financial, and economic conditions to meet timely payment of interest and repayment of principal. In the event of adverse business, financial or economic conditions, it is not likely to have the capacity to pay interest and repay principal. The CCC rating category is also used for debt subordinated to senior debt that is assigned an actual or implied B or B- rating.

CC: The rating CC is typically applied to debt subordinated to senior debt that is assigned an actual or implied CCC rating.

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C: The rating C is typically applied to debt subordinated to senior debt that is assigned an actual or implied CCC debt rating. The C rating may be used to cover a situation where a bankruptcy petition has been filed, but debt service payments are continued.

CI: The rating CI is reserved for income bonds on which no interest is being paid.

D: Debt rated D is in payment default. The D rating category is used when interest payments or principal payments are not made on the date due even if the applicable grace period has not expired, unless S&P believes that such payments will be made during such grace period. The D rating will also be used upon the filing of a bankruptcy petition if debt service payments are jeopardized.

Plus (+) or Minus (-): The ratings from AA to CCC may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

Provisional ratings: The letter p indicates that the rating is provisional. A provisional rating assumes the successful completion of the project being financed by the debt being rated and indicates that payment of debt service requirements is largely or entirely dependent upon the successful and timely completion of the project. This rating, however, while addressing credit quality subsequent to completion of the project, makes no comment on the likelihood of, or the risk of default upon failure of, such completion. The investor should exercise his own judgment with respect to such likelihood and risk.

r: The r is attached to highlight derivative, hybrid, and certain other obligations that S&P believes may experience high volatility or high variability in expected returns due to non-credit risks. Examples of such obligations are: securities whose principal or interest return is indexed to equities, commodities, or currencies; certain swaps and options; and interest only and principal only mortgage securities.

The absence of an r symbol should not be taken as an indication that an obligation will exhibit no volatility or variability in total return.

N.R.: Not rated.

Debt obligations of issuers outside the United States and its territories are rated on the same basis as domestic corporate and municipal issues. The ratings measure the creditworthiness of the obligor but do not take into account currency exchange and related uncertainties.

## **Commercial Paper Rating Definitions**

An S&P commercial paper rating is a current assessment of the likelihood of timely payment of debt having an original maturity of no more than 365 days. Ratings are graded into several categories, ranging from A for the highest quality obligations to D for the lowest. These categories are as follows:

A-1: This highest category indicates that the degree of safety regarding timely payment is strong. Those issues determined to possess extremely strong safety characteristics are denoted with a plus sign (+) designation.

A-2: Capacity for timely payment on issues with this designation is satisfactory. However, the relative degree of safety is not as high as for issues designated A-1.

A-3: Issues carrying this designation have adequate capacity for timely payment. They are, however, more vulnerable to the adverse effects of changes in circumstances than obligations carrying the higher designations.

B: Issues rated B are regarded as having only speculative capacity for timely payment.

C: This rating is assigned to short-term debt obligations with a doubtful capacity for payment.

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D: Debt rated D is in payment default. The D rating category is used when interest payments or principal payments are not made on the date due, even if the applicable grace period has not expired, unless S&P believes that such payments will be made during such grace period.

A commercial paper rating is not a recommendation to purchase, sell or hold a security inasmuch as it does not comment as to market price or suitability for a particular investor. The ratings are based on current information furnished to S&P by the issuer or obtained from other sources it considers reliable. S&P does not perform an audit in connection with any rating and may, on occasion, rely on unaudited financial information. The ratings may be changed, suspended, or withdrawn as a result of changes in or unavailability of such information.

### **Fitch, Inc.**

A brief description of the applicable Fitch ratings symbols and meanings (as published by Fitch) follows:

#### ***Long-Term Credit Ratings***

##### ***Investment Grade***

AAA: Highest credit quality. AAA ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very high credit quality. AA ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High credit quality. A ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

BBB: Good credit quality. BBB ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category.

##### ***Speculative Grade***

BB: Speculative. BB ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B: Highly speculative. B ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.

CCC, CC, C: High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. A CC rating indicates that default of some kind appears probable. C ratings signal imminent default.

DDD, DD, D: Default. The ratings of obligations in this category are based on their prospects for achieving partial or full recovery in a reorganization or liquidation of the obligor. While expected recovery values are highly speculative and cannot be estimated with any precision, the following serve as general guidelines. DDD obligations have the highest potential for recovery, around 90%-100% of outstanding amounts and accrued interest. DD indicates potential recoveries in the range of 50%-90%, and D the lowest recovery potential, *i.e.*, below 50%. Entities rated in this category have defaulted on some or all of their obligations. Entities rated DDD have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Entities rated DD and D are generally undergoing a formal reorganization or liquidation process; those rated DD are likely to satisfy a higher portion of their outstanding obligations, while entities rated D have a poor prospect for repaying all obligations.

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### ***Short-Term Credit Ratings***

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for U.S. public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

F1: Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added + to denote any exceptionally strong credit feature.

F2: Good credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3: Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

B: Speculative. Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.

C: High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favorable business and economic environment.

D: Default. Denotes actual or imminent payment default.

+ or - may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the AAA long-term rating category, to categories below CCC, or to short-term ratings other than F1.

NR indicates that Fitch does not rate the issuer or issue in question.

Withdrawn: A rating is withdrawn when Fitch deems the amount of information available to be inadequate for rating purposes, or when an obligation matures, is called, or refinanced.

Rating Watch: Ratings are placed on Rating Watch to notify investors that there is a reasonable probability of a rating change and the likely direction of such change. These are designated as Positive, indicating a potential upgrade, Negative, for a potential downgrade, or Evolving, if ratings may be raised, lowered or maintained. Rating Watch is typically resolved over a relatively short period.

A Rating Outlook indicates the direction a rating is likely to move over a one to two year period. Outlooks may be positive, stable, or negative. A positive or negative Rating Outlook does not imply a rating change is inevitable. Similarly, companies whose outlooks are stable could be downgraded before an outlook moves to positive or negative if circumstances warrant such an action. Occasionally, Fitch may be unable to identify the fundamental trend. In these cases, the Rating Outlook may be described as evolving.

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**PIMCO [Income Strategy] Fund**

**Common Shares**

**PROSPECTUS**

[ ]

[ ], 2010

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**The information in this Statement of Additional Information is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Statement of Additional Information is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to Completion Dated January 15, 2010**

**PIMCO INCOME STRATEGY FUND**

**Statement of Additional Information**

**[ ], 2010**

PIMCO [Income Strategy] Fund (the Fund) is a diversified, closed-end management investment company. Allianz Global Investors Fund Management LLC (the Investment Manager) serves as investment manager to the Fund, and has retained Pacific Investment Management Co. LLC (PIMCO or the Sub-Adviser) to serve as sub-adviser to the Fund.

This Statement of Additional Information relating to the offering of rights to subscribe for common shares of the Fund (the Offer) is not a prospectus, and should be read in conjunction with the Fund's prospectus dated [ ], 2010 (the Prospectus). This Statement of Additional Information does not include all information that a prospectus investor should consider before investing in the Fund, and investors should obtain and read the Prospectus prior to investing in the Fund. A copy of the Prospectus may be obtained without charge by calling [(877) 819-2224]. You may also obtain a copy of the Prospectus on the Web site of the Securities and Exchange Commission (the SEC) at <http://www.sec.gov>. Capitalized terms used but not defined in this Statement of Additional Information have the meanings ascribed to them in the Prospectus.



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**THE FUND**

The Fund was organized as a Massachusetts business trust on June 19, 2003 under the name PIMCO Floating Rate Income Fund. On [ ], 2010, the Fund's name was changed to [PIMCO [Income Strategy] Fund] in connection with certain changes to its investment policies. Prior to commencing operations on August 29, 2003, the Fund had no operations other than matters relating to its organization and registration as a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act").

**USE OF PROCEEDS**

The net proceeds of the Offer will be invested in accordance with the Fund's investment objective and investment strategies as set forth in the Prospectus. Assuming current market conditions, the Fund estimates that the net proceeds of the Offer will be substantially invested in accordance with its investment objective and investment strategies within [ ] to [ ] months of the completion of the Offer. Pending such investment, it is anticipated that the proceeds of the Offer will be invested in [short-term debt securities]. Following completion of the Offer, the Fund may increase the Fund's leverage. See "Use of leverage" in the Prospectus.

**INVESTMENT OBJECTIVE AND POLICIES**

The investment objective and general investment policies of the Fund are described in the Prospectus. Additional information concerning the characteristics of certain of the Fund's investments is set forth below.

**High Yield Securities ( Junk Bonds )**

The Fund may invest without limit in debt instruments that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's Investors Service, Inc. ("Moody's"), below BBB- by either Standard & Poor's, a division of the McGraw Hill Companies ("S&P"), or Fitch, Inc. ("Fitch Ratings")), or unrated but judged by PIMCO to be of comparable quality. These securities are sometimes referred to as "high yield" securities or "junk bonds." The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality.

Some of the Senior Loans in which the Fund may invest will be high yield securities. See "Senior Loans."

Investments in high yield securities generally provide greater income and increased opportunity for capital appreciation than investments in higher quality securities, but they also typically entail greater price volatility and principal and income risk, including the possibility of issuer default and bankruptcy. High yield securities are regarded as predominantly speculative with respect to the issuer's continuing ability to meet principal and interest payments. Debt securities in the

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lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies. In addition, analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher quality securities.

High yield securities may be more susceptible to real or perceived adverse economic and competitive industry conditions than investment grade securities. A projection of an economic downturn or of a period of rising interest rates, for example, could cause a decline in high yield security prices because the advent of a recession could lessen the ability of an issuer to make principal and interest payments on its debt obligations. If an issuer of high yield securities defaults, in addition to risking non-payment of all or a portion of interest and principal, the Fund may incur additional expenses to seek recovery. The market prices of high yield securities structured as zero-coupon, step-up or payment-in-kind securities will normally be affected to a greater extent by interest rate changes, and therefore tend to be more volatile than the prices of securities that pay interest currently and in cash.

The secondary market on which high yield securities are traded may be less liquid than the market for investment grade securities. Less liquidity in the secondary trading market could adversely affect the price at which the Fund could sell a high yield security, and could adversely affect the net asset value of the shares. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may decrease the values and liquidity of high yield securities, especially in a thinly-traded market. When secondary markets for high yield securities are less liquid than the market for investment grade securities, it may be more difficult to value the lower rated securities because such valuation may require more research, and elements of judgment may play a greater role in the valuation because there is less reliable, objective data available. During periods of thin trading in these markets, the spread between bid and asked prices is likely to increase significantly and the Fund may have greater difficulty selling its portfolio securities. The Fund will be more dependent on PIMCO's research and analysis when investing in high yield securities. PIMCO seeks to minimize the risks of investing through in-depth credit analysis and attention to current developments in interest rates and market conditions.

A general description of the ratings of securities by Moody's, S&P and Fitch Ratings is set forth in Appendix A to the Prospectus. The ratings of Moody's, S&P, and Fitch Ratings represent their opinions as to the quality of the securities they rate. It should be emphasized, however, that ratings are general and are not absolute standards of quality. Consequently, debt obligations with the same maturity, coupon and rating may have different yields while obligations with the same maturity and coupon with different ratings may have the same yield. For these reasons, the use of credit ratings as the sole method of evaluating high yield securities can involve certain risks. For example, credit ratings evaluate the safety of principal and interest payments, not the market value risk of high yield securities. Also, credit rating agencies may fail to change credit ratings in a timely fashion to reflect events since the security was last rated. PIMCO does not rely solely on credit ratings when selecting securities for the Fund, and develops its own independent analysis of issuer credit quality.

The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue. In determining whether to retain or

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sell such a security, PIMCO may consider such factors as PIMCO's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other rating agencies. However, analysis of creditworthiness may be more complex for issuers of Senior Loans and other high yield securities than for issuers of higher quality debt securities.

### **Floating Rate Debt Instruments**

The Fund may invest in floating rate debt instruments, including senior floating rate loans ( Senior Loans ) (described in more detail below). Floating rate debt instruments are debt instruments that pay interest at rates that adjust whenever a specified interest rate changes, float at a fixed margin above a generally recognized base lending rate and/or reset or are redetermined (*e.g.*, pursuant to an auction) on specified dates (such as the last day of a month or calendar quarter). These floating rate debt instruments may include, in addition to Senior Loans, instruments such as catastrophe bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities. Due to their floating rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt instrument is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed-rate debt instrument, although the value of a floating rate instrument may nonetheless decline as interest rates rise and due to other factors, such as changes in credit quality.

### **Senior Loans**

The Fund may invest in Senior Loans. Senior Loans include senior floating rate loans and institutionally traded senior floating rate debt obligations issued by asset-backed pools and other issues, and interests therein. Loan interests generally take the form of direct interests acquired during a primary distribution and may also take the form of assignments of, novations of, or participations in a Senior Loan acquired in secondary markets. Loan interests may be acquired from U.S. or non-U.S. commercial banks, insurance companies, finance companies or other financial institutions who have made loans or are members of a lending syndicate or from other holders of loan interests.

Senior Loans typically pay interest at rates which are re-determined periodically on the basis of a floating base lending rate (such as the London Inter-Bank Offered Rate, LIBOR ) plus a premium. Although Senior Loans are typically of below investment grade quality, they tend to have more favorable recovery rates than other types of below investment grade quality debt obligations. Senior Loans generally (but not always) hold the most senior position in the capital structure of a borrower and are often secured with collateral. A Senior Loan is typically originated, negotiated and structured by a U.S. or non-U.S. commercial bank, insurance company, finance company or other financial institution (the Agent ) for a lending syndicate of financial institutions ( Lenders ). The Agent typically administers and enforces the Senior Loan on behalf of the other Lenders in the syndicate. In addition, an institution, typically but not always the Agent, holds any collateral on behalf of the Lenders.

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The Fund may purchase assignments and participations in commercial loans, as well as debtor-in-possession loans. Such indebtedness may be secured or unsecured. Loan participations typically represent direct participations in a loan to a corporate borrower, and generally are offered by banks or other financial institutions or lending syndicates. The Fund may participate in such syndications, or can buy part of a loan, becoming a part lender. When purchasing loan participations, the Fund assumes the credit risk associated with the corporate or other borrower and may assume the credit risk associated with an interposed bank or other financial intermediary. The participation interests in which the Fund intends to invest may not be rated by any nationally recognized rating service.

Unless, under the terms of the loan or other indebtedness (such as may be the case in an assignment), the Fund has direct recourse against the borrower, the Fund may have to rely on the Agent or other financial intermediary to apply appropriate credit remedies against a borrower.

Purchasers of loans and other forms of direct indebtedness depend primarily upon the creditworthiness of the corporate or other borrower for payment of principal and interest. If the Fund does not receive scheduled interest or principal payments on such indebtedness, the Fund's share price and yield could be adversely affected. Senior Loans that are fully secured offer the Fund more protection than an unsecured loan in the event of non-payment of scheduled interest or principal. However, there is no assurance that the liquidation of collateral from a secured Senior Loan would satisfy the borrower's obligation, or that such collateral could be liquidated.

The Fund may invest in loan participations with credit quality comparable to that of many issuers of its other debt securities investments. Indebtedness of companies whose creditworthiness is poor involves substantially greater risks, and may be highly speculative.

Some companies may never pay off their indebtedness, or may pay only a small fraction of the amount owed. Consequently, when investing in indebtedness of companies with poor credit, the Fund bears a substantial risk of losing the entire amount invested.

Loans and other types of direct indebtedness may not be readily marketable and may be subject to restrictions on resale. In some cases, negotiations involved in disposing of indebtedness may require weeks to complete. Consequently, some indebtedness may be difficult or impossible to dispose of readily at what PIMCO believes to be a fair price. In addition, valuation of illiquid indebtedness involves a greater degree of judgment in determining the Fund's net asset value than if that value were based on available market quotations. At the same time, many loan interests are actively traded among certain financial institutions and considered to be liquid. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions. Investments in loan participations are considered to be debt obligations for purposes of the Fund's investment restriction relating to the lending of funds or assets.

Investments in loans through a direct assignment of the financial institution's interests with respect to the loan may involve additional risks to the Fund. For example, if a loan is foreclosed, the Fund could become part owner of any collateral, and would bear the costs and liabilities associated with owning and disposing of the collateral. In addition, it is conceivable that, under

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emerging legal theories of lender liability, the Fund could be held liable as co-lender. It is unclear whether loans and other forms of direct indebtedness offer securities law protections against fraud and misrepresentation. In the absence of definitive regulatory guidance, the Fund relies on PIMCO's research in an attempt to avoid situations where fraud or misrepresentations could adversely affect the Fund.

From time to time, PIMCO and its affiliates may borrow money from various banks in connection with their business activities. Such banks may also sell Senior Loans to or acquire them from the Fund or may be intermediate participants with respect to Senior Loans in which the Fund owns interests. Such banks may also act as Agents for Senior Loans held by the Fund.

*Lending Fees.* In the process of buying, selling and holding Senior Loans, the Fund may receive and/or pay certain fees. These fees are in addition to interest payments received and may include facility fees, commitment fees, commissions and prepayment penalty fees. When the Fund buys a Senior Loan it may receive a facility fee and when it sells a Senior Loan it may pay a facility fee. On an ongoing basis, the Fund may receive a commitment fee based on the undrawn portion of the underlying line of credit portion of the Senior Loan. In certain circumstances, the Fund may receive a prepayment penalty fee upon the prepayment of a Senior Loan by a borrower. Other fees received by the Fund may include covenant waiver fees and covenant modification fees.

*Borrower Covenants.* A borrower under a Senior Loan typically must comply with various restrictive covenants contained in a loan agreement or note purchase agreement between the borrower and the Lender or lending syndicate (the "Loan Agreement"). Such covenants, in addition to requiring the scheduled payment of interest and principal, may include restrictions on dividend payments and other distributions to stockholders, provisions requiring the borrower to maintain specific minimum financial ratios and limits on total debt. In addition, the Loan Agreement may contain a covenant requiring the borrower to prepay the Senior Loan with any free cash flow. Free cash flow is generally defined as net cash flow after scheduled debt service payments and permitted capital expenditures, and includes the proceeds from asset dispositions or sales of securities. A breach of a covenant which is not waived by the Agent, or by the lenders directly, as the case may be, is normally an event of acceleration; *i.e.*, the Agent, or the lenders directly, as the case may be, has the right to call the outstanding Senior Loan. The typical practice of an Agent or a Lender in relying exclusively or primarily on reports from the borrower may involve a risk of fraud by the borrower. In the case of a Senior Loan in the form of a participation, the agreement between the buyer and seller may limit the rights of the holder of a Senior Loan to vote on certain changes which may be made to the Loan Agreement, such as waiving a breach of a covenant. However, the holder of the participation will, in almost all cases, have the right to vote on certain fundamental issues such as changes in principal amount, payment dates and interest rate.

*Administration of Loans.* In a typical Senior Loan, the Agent administers the terms of the Loan Agreement. In such cases, the Agent is normally responsible for the collection of principal and interest payments from the borrower and the apportionment of these payments to the credit of all institutions which are parties to the Loan Agreement. The Fund will generally rely upon the Agent or an intermediate participant to receive and forward to the Fund its portion of the

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principal and interest payments on the Senior Loan. Furthermore, unless under the terms of a participation agreement the Fund has direct recourse against the borrower, the Fund will rely on the Agent and the other members of the lending syndicate to use appropriate credit remedies against the borrower. The Agent is typically responsible for monitoring compliance with covenants contained in the Loan Agreement based upon reports prepared by the borrower. The seller of the Senior Loan usually does, but is often not obligated to, notify holders of Senior Loans of any failures of compliance. The Agent may monitor the value of the collateral, if any, and if the value of such collateral declines, may accelerate the Senior Loan, may give the borrower an opportunity to provide additional collateral or may seek other protection for the benefit of the participants in the Senior Loan. The Agent is compensated by the borrower for providing these services under a Loan Agreement, and such compensation may include special fees paid upon structuring and funding the Senior Loan and other fees paid on a continuing basis. With respect to Senior Loans for which the Agent does not perform such administrative and enforcement functions, PIMCO will perform such tasks on behalf of the Fund, although a collateral bank will typically hold any collateral on behalf of the Fund and the other lenders pursuant to the applicable Loan Agreement.

A financial institution's appointment as Agent may usually be terminated in the event that it fails to observe the requisite standard of care or becomes insolvent, enters Federal Deposit Insurance Corporation ( FDIC ) receivership, or, if not FDIC insured, enters into bankruptcy proceedings. A successor Agent would generally be appointed to replace the terminated Agent, and assets held by the Agent under the Loan Agreement should remain available to holders of Senior Loans. However, if assets held by the Agent for the benefit of the Fund were determined to be subject to the claims of the Agent's general creditors, the Fund might incur certain costs and delays in realizing payment on a Senior Loan, or suffer a loss of principal and/or interest. In situations involving other intermediate participants similar risks may arise.

*Prepayments.* Senior Loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the Senior Loan from free cash flow, as defined above. The degree to which borrowers prepay Senior Loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among others. As such, prepayments cannot be predicted with accuracy. Upon a prepayment, either in part or in full, the actual outstanding debt on which the Fund derives interest income will be reduced. However, the Fund may receive both a prepayment penalty fee from the prepaying borrower and a facility fee upon the purchase of a new Senior Loan with the proceeds from the prepayment of the former. Prepayments generally will not materially affect the Fund's performance because the Fund should be able to reinvest prepayments in other Senior Loans that have similar or identical yields and because receipt of such fees may mitigate any adverse impact on the Fund's yield.

*Bridge Financings.* The Fund may acquire interests in Senior Loans which are designed to provide temporary or bridge financing to a borrower pending the sale of identified assets or the arrangement of longer-term loans or the issuance and sale of debt obligations. The Fund may also invest in Senior Loans of borrowers who have obtained bridge loans from other parties. A borrower's use of bridge loans involves a risk that the borrower may be unable to locate permanent financing to replace the bridge loan, which may impair the borrower's perceived creditworthiness.

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*Secured Senior Loans.* To the extent that the collateral, if any, securing a Senior Loan consists of the stock of the borrower's subsidiaries or other affiliates, the Fund will be subject to the risk that this stock will decline in value. Such a decline, whether as a result of bankruptcy proceedings or otherwise, could cause the Senior Loan to be undercollateralized or unsecured. In most credit agreements there is no formal requirement to pledge additional collateral. In addition, the Fund may invest in Senior Loans guaranteed by, or fully secured by assets of, shareholders or owners, even if the Senior Loans are not otherwise collateralized by assets of the borrower. There may be temporary periods when the principal asset held by a borrower is the stock of a related company, which may not legally be pledged to secure a secured Senior Loan. On occasions when such stock cannot be pledged, the secured Senior Loan will be temporarily unsecured until the stock can be pledged or is exchanged for or replaced by other assets, which will be pledged as security for such Senior Loan. However, the borrower's ability to dispose of such securities, other than in connection with such pledge or replacement, will be strictly limited for the protection of the holders of secured Senior Loans.

If a borrower becomes involved in bankruptcy proceedings, a court may invalidate the Fund's security interest in any loan collateral or subordinate the Fund's rights under a secured Senior Loan to the interests of the borrower's unsecured creditors. Such action by a court could be based, for example, on a fraudulent conveyance claim to the effect that the borrower did not receive fair consideration for granting the security interest in the loan collateral to the Fund. For secured Senior Loans made in connection with a highly leveraged transaction, consideration for granting a security interest may be deemed inadequate if the proceeds of such loan were not received or retained by the borrower, but were instead paid to other persons, such as shareholders of the borrower, in an amount which left the borrower insolvent or without sufficient working capital. There are also other events, such as the failure to perfect a security interest due to faulty documentation or faulty official filings, which could lead to the invalidation of the Fund's security interest in any loan collateral. If the Fund's security interest in loan collateral is invalidated or a secured Senior Loan is subordinated to other debt of a borrower in bankruptcy or other proceedings, it is unlikely that the Fund would be able to recover the full amount of the principal and interest due on the secured Senior Loan.

The Fund may also invest in Senior Loans that are not secured by collateral or otherwise.

## **Distressed Securities**

Securities in which the Fund invests may be subject to significant risk of an issuer's inability to meet principal and interest payments on the obligations and also may be subject to price volatility due to such factors as market perception of the creditworthiness of an issuer and general market liquidity. If PIMCO's evaluation of the anticipated outcome of an investment situation should prove incorrect, such Fund investments could experience a loss.



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### **Bonds**

The Fund may invest in a variety of bonds and related debt obligations of varying maturities issued by U.S. and non-U.S. corporations, banks and other business entities. Bonds include bills, notes, debentures, money market instruments and similar instruments and securities, and are generally used by corporations and other issuers to borrow money from investors for such purposes as working capital or capital expenditures. The issuer pays the investor a variable or fixed rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are perpetual in that they have no maturity date.

The Fund's investments in bonds are often subject to a number of risks described in the Prospectus and/or elaborated upon elsewhere in this section of the Statement of Additional Information, including credit risk, high yield risk, interest rate risk, issuer risk, foreign (non-U.S.) investment risk, inflation risk, liquidity risk, smaller company risk and management risk.

### **Event-Linked Bonds**

The Fund may invest in event-linked bonds. Event-linked bonds, which are sometimes referred to as catastrophe bonds, are debt obligations for which the return of principal and payment of interest is contingent on the non-occurrence of a specific trigger event, such as a hurricane or an earthquake. They may be issued by government agencies, insurance companies, reinsurers, special purpose corporations or other on-shore or off-shore entities. If a trigger event causes losses exceeding a specific amount in the geographic region and time period specified in a bond, the Fund may lose a portion or all of its principal invested in the bond. If no trigger event occurs, the Fund will recover its principal plus interest. For some event-linked bonds, the trigger event or losses may be based on company-wide losses, index-portfolio losses, industry indexes or readings of scientific instruments rather than specified actual losses. Often event-linked bonds provide for extensions of maturity that are mandatory, or optional at the discretion of the issuer, in order to process and audit loss claims in those cases when a trigger event has, or possibly has, occurred. In addition to the specified trigger events, event-linked bonds may also expose the Fund to certain unanticipated risks including but not limited to issuer (credit) default, adverse regulatory or jurisdictional interpretations and adverse tax consequences.

Event-linked bonds are a relatively new type of financial instrument. As such, there is no significant trading history for many of these securities, and there can be no assurance that a liquid market in these bonds will develop. Lack of a liquid market may impose the risk of higher transaction costs and the possibility that the Fund may be forced to liquidate positions when it would not be advantageous to do so. Event-linked bonds are typically rated.

### **Inflation-Indexed Bonds**

The Fund may invest in inflation-indexed bonds, which are debt obligations whose value is periodically adjusted according to the rate of inflation. Two structures are common. The U.S. Treasury and some other issuers utilize a structure that accrues inflation into the principal value of the bond. Many other issuers pay out the Consumer Price Index accruals as part of a semiannual coupon.

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Inflation-indexed bonds issued by the U.S. Treasury have maturities of approximately five, ten or thirty years, although it is possible that securities with other maturities will be issued in the future. The U.S. Treasury securities pay interest on a semi-annual basis equal to a fixed percentage of the inflation-adjusted principal amount. For example, if the Fund purchased an inflation-indexed bond with a par value of \$1,000 and a 3% real rate of return coupon (payable 1.5% semi-annually), and the rate of inflation over the first six months was 1%, the mid-year par value of the bond would be \$1,010 and the first semi-annual interest payment would be \$15.15 (\$1,010 times 1.5%). If inflation during the second half of the year resulted in the whole year's inflation equaling 3%, the end-of-year par value of the bond would be \$1,030 and the second semi-annual interest payment would be \$15.45 (\$1,030 times 1.5%).

If the periodic adjustment rate measuring inflation falls, the principal value of inflation-indexed bonds will be adjusted downward, and consequently the interest payable on these securities (calculated with respect to a smaller principal amount) will be reduced. Repayment of the original bond principal upon maturity (as adjusted for inflation) is guaranteed in the case of U.S. Treasury inflation-indexed bonds, even during a period of deflation. However, the current market value of the bonds is not guaranteed and will fluctuate. The Fund may also invest in other inflation-related bonds which may or may not provide a similar guarantee. If a guarantee of principal is not provided, the adjusted principal value of the bond repaid at maturity may be less than the original principal amount.

The value of inflation-indexed bonds is expected to change in response to changes in real interest rates. Real interest rates in turn are tied to the relationship between nominal interest rates and the rate of inflation. Therefore, if the rate of inflation rises at a faster rate than nominal interest rates, real interest rates might decline, leading to an increase in value of inflation-indexed bonds. In contrast, if nominal interest rates increase at a faster rate than inflation, real interest rates might rise, leading to a decrease in value of inflation-indexed bonds.

While these securities are expected to provide protection from long-term inflationary trends, short-term increases in inflation may lead to a decline in value. If interest rates rise due to reasons other than inflation (for example, due to changes in currency exchange rates), investors in these securities may not be protected to the extent that the increase is not reflected in the bond's inflation measure.

The periodic adjustment of U.S. inflation-indexed bonds is tied to the Consumer Price Index for Urban Consumers (CPI-U), which is calculated monthly by the U.S. Bureau of Labor Statistics. The CPI-U is a measurement of changes in the cost of living, made up of components such as housing, food, transportation and energy. Inflation-indexed bonds issued by a non-U.S. government are generally adjusted to reflect a comparable inflation index calculated by that government. There can be no assurance that the CPI-U or any non-U.S. inflation index will accurately measure the real rate of inflation in the prices of goods and services. Moreover, there can be no assurance that the rate of inflation in a non-U.S. country will be correlated to the rate of inflation in the United States.

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For federal income tax purposes, any increase in the principal amount of an inflation-indexed bond will be original issue discount which is taxable as ordinary income in the year accrued, even though investors do not receive their principal, including any increases thereto, until maturity. See Tax Matters Original Issue Discount and Payment-in-Kind Securities.

### **Mortgage-Related and Other Asset-Backed Securities**

The Fund may invest in mortgage-related securities, and may also invest in other asset-backed securities (whether or not related to mortgage loans) that are offered to investors currently or in the future. Mortgage-related securities are interests in pools of residential or commercial mortgage loans, including mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and others. Pools of mortgage loans are assembled as securities for sale to investors by various governmental, government-related and private organizations. The value of some mortgage-related or asset-backed securities in which the Fund invests may be particularly sensitive to changes in prevailing interest rates, and, like other debt securities, the ability of the Fund to successfully utilize these instruments may depend in part upon the ability of PIMCO to forecast certain macro-economic factors correctly. See Mortgage Pass-Through Securities below. Certain debt obligations are also secured with collateral consisting of mortgage-related securities. See Collateralized Mortgage Obligations ( CMOs ) below.

The mortgage-related securities in which the Fund may invest may pay variable or fixed rates of interest.

Through investments in mortgage-related securities, including those that are issued by private issuers, the Fund may have some exposure to subprime loans as well as to the mortgage and credit markets generally. Private issuers include commercial banks, savings associations, mortgage companies, investment banking firms, finance companies and special purpose finance entities (called special purpose vehicles or SPVs) and other entities that acquire and package mortgage loans for resale as mortgage-related securities.

In addition, mortgage-related securities that are issued by private issuers are not subject to the underwriting requirements for the underlying mortgages that are applicable to those mortgage-related securities that have a government or government-sponsored entity guarantee. As a result, the mortgage loans underlying private mortgage-related securities may, and frequently do, have less favorable collateral, credit risk or other underwriting characteristics than government or government-sponsored mortgage-related securities and have wider variances in a number of terms including interest rate, term, size, purpose and borrower characteristics. Privately issued pools more frequently include second mortgages, high loan-to-value mortgages and manufactured housing loans. The coupon rates and maturities of the underlying mortgage loans in a private-label mortgage-related securities pool may vary to a greater extent than those included in a government guaranteed pool, and the pool may include subprime mortgage loans. Subprime loans refer to loans made to borrowers with weakened credit histories or with a lower capacity to make timely payments on their loans. For these reasons, the loans underlying these securities have had in many cases higher default rates than those loans that meet government underwriting requirements.

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The risk of non-payment is greater for mortgage-related securities that are backed by mortgage pools that contain subprime loans, but a level of risk exists for all loans. Market factors adversely affecting mortgage loan repayments may include a general economic downturn, high unemployment, a general slowdown in the real estate market, a drop in the market prices of real estate, or an increase in interest rates resulting in higher mortgage payments by holders of adjustable rate mortgages.

*Mortgage Pass-Through Securities.* Mortgage pass-through securities are securities representing interests in pools of mortgage loans secured by residential or commercial real property. Interests in pools of mortgage-related securities differ from other forms of debt obligations, which normally provide for periodic payment of interest in fixed or variable amounts with principal payments at maturity or specified call dates. Instead, these securities provide a monthly payment which consists of both interest and principal payments. In effect, these payments are a pass-through of the monthly payments made by the individual borrowers on their residential or commercial mortgage loans, net of any fees paid to the issuer or guarantor of such securities. Additional payments are caused by repayments of principal resulting from the sale of the underlying property, refinancing or foreclosure, net of fees or costs which may be incurred. Some mortgage-related securities (such as securities issued by the Government National Mortgage Association (GNMA)) are described as modified pass-through. These securities entitle the holder to receive all interest and principal payments owed on the mortgage pool, net of certain fees, at the scheduled payment dates regardless of whether or not the mortgagor actually makes the payment.

The rate of prepayments on underlying mortgages will affect the price and volatility of a mortgage-related security, and may have the effect of shortening or extending the effective duration of the security relative to what was anticipated at the time of purchase. Early repayment of principal on some mortgage-related securities (arising from prepayments of principal due to the sale of the underlying property, refinancing, or foreclosure, net of fees and costs which may be incurred) may expose the Fund to a lower rate of return upon reinvestment of principal. Also, if a security subject to prepayment has been purchased at a premium, the value of the premium would be lost in the event of prepayment. Like other fixed-rate debt obligations, when interest rates rise, the value of a fixed-rate mortgage-related security generally will decline; however, when interest rates are declining, the value of fixed-rate mortgage-related securities with prepayment features may not increase as much as other debt obligations. Adjustable rate mortgage-related and other asset-backed securities are also subject to some interest rate risk. For example, because interest rates on most adjustable rate mortgage- and other asset-backed securities only reset periodically (e.g., monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuations in the market value of these securities, including declines in value as interest rates rise. In addition, to the extent that unanticipated rates of prepayment on underlying mortgages increase the effective maturity of a mortgage-related security, the volatility of such security can be expected to increase.

The residential mortgage market in the United States recently has experienced difficulties that may adversely affect the performance and market value of certain of the Fund's mortgage-related investments. Delinquencies and losses on residential mortgage loans (especially subprime and

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second-lien mortgage loans) generally have increased recently and may continue to increase, and a decline in or flattening of housing values (as has recently been experienced and may continue to be experienced in many housing markets) may exacerbate such delinquencies and losses. Borrowers with adjustable rate mortgage loans are more sensitive to changes in interest rates, which affect their monthly mortgage payments, and may be unable to secure replacement mortgages at comparably low interest rates. Also, a number of residential mortgage loan originators have recently experienced serious financial difficulties or bankruptcy. Owing largely to the foregoing, reduced investor demand for mortgage loans and mortgage-related securities and increased investor yield requirements have caused limited liquidity in the secondary market for mortgage-related securities, which can adversely affect the market value of mortgage-related securities. It is possible that such limited liquidity in such secondary markets could continue or worsen.

Payment of principal and interest on some mortgage pass-through securities (but not the market value of the securities themselves) may be guaranteed by the full faith and credit of the U.S. Government (in the case of securities guaranteed by GNMA) or guaranteed by agencies or instrumentalities of the U.S. Government (in the case of securities guaranteed by the Federal National Mortgage Association ( FNMA ) or the Federal Home Loan Mortgage Corporation ( FHLMC ). The principal governmental guarantor of mortgage-related securities is GNMA. GNMA is a wholly-owned U.S. Government corporation within the Department of Housing and Urban Development. GNMA is authorized to guarantee, with the full faith and credit of the U.S. Government, the timely payment of principal and interest on securities issued by institutions approved by GNMA (such as savings and loan institutions, commercial banks and mortgage bankers) and backed by pools of mortgages insured by the Federal Housing Administration (the FHA ), or guaranteed by the Department of Veterans Affairs (the VA ).

Government-related guarantors (*i.e.*, not backed by the full faith and credit of the U.S. Government) include the FNMA and the FHLMC. FNMA was, until recently, a government-sponsored corporation owned entirely by private stockholders and subject to general regulation by the Department of Housing and Urban Development and the Office of Federal Housing Enterprise Oversight. As described below under U.S. Government Securities, FNMA is now under conservatorship by the FHFA. FNMA primarily purchases conventional (*i.e.*, not insured or guaranteed by any government agency) residential mortgages from a list of approved seller/servicers, which includes state and federally chartered savings and loan associations, mutual savings banks, commercial banks, and credit unions and mortgage bankers, although it may purchase other types of mortgages as well. Pass-through securities issued by FNMA are guaranteed as to timely payment of principal and interest by FNMA but are not backed by the full faith and credit of the U.S. Government. Instead, they are supported only by the discretionary authority of the U.S. Government to purchase the agency's obligations.

FHLMC was created by Congress in 1970 for the purpose of increasing the availability of mortgage credit for residential housing. It was, until recently, a government-sponsored corporation formerly owned by the twelve Federal Home Loan Banks and then owned entirely by private stockholders. As described above under Government Securities, FHLMC is now under in conservatorship by the FHFA. FHLMC issues Participation Certificates ( PCs ) which represent interests in conventional mortgages from FHLMC's national portfolio. FHLMC

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guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. Government. Instead, they are supported only by the discretionary authority of the U.S. Government to purchase the agency's obligations.

Commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers also create pass-through pools of conventional residential mortgage loans. Such issuers may, in addition, be the originators and/or servicers of the underlying mortgage loans as well as the guarantors of the mortgage-related securities. Pools created by such non-governmental issuers generally offer a higher rate of interest than government and government-related pools because there are no direct or indirect government or agency guarantees of payments in such pools. However, timely payment of interest and principal of these pools may be supported by various forms of insurance or guarantees, including individual loan, title, pool and hazard insurance and letters of credit. The insurance and guarantees are issued by governmental entities, private insurers and the mortgage poolers. There can be no assurance that the private insurers or guarantors can meet their obligations under the insurance policies or guarantee arrangements. Securities issued by certain private organizations may not be readily marketable.

Mortgage-related securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities, are not subject to the Fund's industry concentration restriction (see *Investment Restrictions*) by virtue of the exclusion from that restriction available to all U.S. Government securities. In the case of privately issued mortgage-related securities, the Fund takes the position that mortgage-related securities do not represent interests in any particular industry or group of industries. The assets underlying such securities may be represented by a portfolio of first lien residential mortgages (including both whole mortgage loans and mortgage participation interests) or portfolios of mortgage pass-through securities issued or guaranteed by GNMA, FNMA or FHLMC. Mortgage loans underlying a mortgage-related security may in turn be insured or guaranteed by the FHA or the VA. In the case of private issue mortgage-related securities whose underlying assets are neither U.S. Government securities nor U.S. Government insured mortgages, to the extent that real properties securing such assets may be located in the same geographical region, the security may be subject to a greater risk of default than other comparable securities in the event of adverse economic, political or business developments that may affect such region and, ultimately, the ability of residential homeowners to make payments of principal and interest on the underlying mortgages.

*Collateralized Mortgage Obligations (CMOs)*. A CMO is a hybrid between a mortgage-backed bond and a mortgage pass-through security. Similar to a bond, interest and prepaid principal is paid, in most cases, semi-annually or on a monthly basis. CMOs may be collateralized by whole mortgage loans, but are more typically collateralized by portfolios of mortgage pass-through securities guaranteed by GNMA, FHLMC, or FNMA, and their income streams.

CMOs are structured into multiple classes, often referred to as tranches, with each class bearing a different stated maturity and entitled to a different schedule for payments of principal and interest, including prepayments. Actual maturity and average life will depend upon the prepayment experience of the collateral. CMOs provide for a modified form of call protection

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through a de facto breakdown of the underlying pool of mortgages according to how quickly the loans are repaid. Monthly payment of principal received from the pool of underlying mortgages, including prepayments, is first returned to investors holding the shortest maturity class. Investors holding the longer maturity classes receive principal only after the first class has been retired. An investor is partially guarded against a sooner than desired return of principal because of the sequential payments.

In a typical CMO transaction, a corporation ( issuer ) issues multiple series ( e.g., A, B, C, Z ) of CMO bonds ( the Bonds ). Proceeds of the Bond offering are used to purchase mortgages or mortgage pass-through certificates ( the Collateral ). The Collateral is pledged to a third party trustee as security for the Bonds. Principal and interest payments from the Collateral are used to pay principal on the Bonds in the order A, B, C, Z. The Series A, B and C Bonds all bear current interest. Interest on the Series Z Bond is accrued and added to principal and a like amount is paid as principal on the Series A, B or C Bond currently being paid off. When the Series A, B and C Bonds are paid in full, interest and principal on the Series Z Bond begin to be paid currently. With some CMOs, the issuer serves as a conduit to allow loan originators ( primarily builders or savings and loan associations ) to borrow against their loan portfolios. CMOs may be less liquid and may exhibit greater price volatility than other types of mortgage- or asset-backed securities.

CMOs that are issued or guaranteed by the U.S. Government or by any of its agencies or instrumentalities will be considered U.S. Government securities by the Fund, while other CMOs, even if collateralized by U.S. Government securities, will have the same status as other privately issued securities for purposes of applying the Fund's diversification tests.

*FHLMC Collateralized Mortgage Obligations.* FHLMC CMOs are debt obligations of FHLMC issued in multiple classes having different maturity dates which are secured by the pledge of a pool of conventional mortgage loans purchased by FHLMC. Payments of principal and interest on the CMOs are made semi-annually, as opposed to monthly. The amount of principal payable on each semi-annual payment date is determined in accordance with FHLMC's mandatory sinking fund schedule, which in turn, is equal to approximately 100% of FHA prepayment experience applied to the mortgage collateral pool. All sinking fund payments in the CMOs are allocated to the retirement of the individual classes of bonds in the order of their stated maturities. Payments of principal on the mortgage loans in the collateral pool in excess of the amount of FHLMC's minimum sinking fund obligation for any payment date are paid to the holders of the CMOs as additional sinking fund payments. Because of the pass-through nature of all principal payments received on the collateral pool in excess of FHLMC's minimum sinking fund requirement, the rate at which principal of the CMOs is actually repaid is likely to be such that each class of bonds will be retired in advance of its scheduled maturity date.

If collection of principal ( including prepayments ) on the mortgage loans during any semi-annual payment period is not sufficient to meet FHLMC's minimum sinking fund obligation on the next sinking fund payment date, FHLMC agrees to make up the deficiency from its general funds.

Criteria for the mortgage loans in the pool backing the FHLMC CMOs are identical to those of FHLMC PCs. FHLMC has the right to substitute collateral in the event of delinquencies and/or defaults.

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*Commercial Mortgage-Backed Securities.* Commercial mortgage-backed securities include securities that reflect an interest in, and are secured by, mortgage loans on commercial real property. The market for commercial mortgage-backed securities developed more recently and in terms of total outstanding principal amount of issues is relatively small compared to the market for residential single-family mortgage-backed securities. Many of the risks of investing in commercial mortgage-backed securities reflect the risks of investing in the real estate securing the underlying mortgage loans. These risks reflect the effects of local and other economic conditions on real estate markets, the ability of tenants to make loan payments, and the ability of a property to attract and retain tenants. Commercial mortgage-backed securities may be less liquid and exhibit greater price volatility than other types of mortgage- or asset-backed securities.

*CMO Residuals.* CMO residuals are mortgage securities issued by agencies or instrumentalities of the U.S. Government or by private originators of, or investors in, mortgage loans, including savings and loan associations, homebuilders, mortgage banks, commercial banks, investment banks and special purpose entities of the foregoing.

The cash flow generated by the mortgage assets underlying a series of CMOs is applied first to make required payments of principal and interest on the CMOs and second to pay the related administrative expenses of the issuer. The residual in a CMO structure generally represents the interest in any excess cash flow remaining after making the foregoing payments. Each payment of such excess cash flow to a holder of the related CMO residual represents income and/or a return of capital. The amount of residual cash flow resulting from a CMO will depend on, among other things, the characteristics of the mortgage assets, the coupon rate of each class of CMO, prevailing interest rates, the amount of administrative expenses and the prepayment experience on the mortgage assets. In particular, the yield to maturity on CMO residuals is extremely sensitive to prepayments on the related underlying mortgage assets. In addition, if a series of a CMO includes a class that bears interest at an adjustable rate, the yield to maturity on the related CMO residual will also be extremely sensitive to changes in the level of the index upon which interest rate adjustments are based. The Fund may fail to recoup some or all of its initial investment in a CMO residual.

CMO residuals are generally purchased and sold by institutional investors through several investment banking firms acting as brokers or dealers. The CMO residual market has developed fairly recently and CMO residuals currently may not have the liquidity of other more established securities trading in other markets. CMO residuals may, or pursuant to an exemption therefrom, may not, have been registered under the Securities Act of 1933, as amended (the "1933 Act"). CMO residuals, whether or not registered under the 1933 Act, may be subject to certain restrictions on transferability, and may be deemed illiquid. As used in this Statement of Additional Information, the term CMO residual does not include residual interests in real estate mortgage investment conduits.

*Adjustable Rate Mortgage Backed Securities.* Adjustable rate mortgage-backed securities ( "ARMBSs" ) have interest rates that reset at periodic intervals. Acquiring ARMBSs permits the Fund to participate in increases in prevailing current interest rates through periodic adjustments in the coupons of mortgages underlying the pool on which ARMBSs are based. Such ARMBSs



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generally have higher current yield and lower price fluctuations than is the case with more traditional fixed income debt securities of comparable rating and maturity. In addition, when prepayments of principal are made on the underlying mortgages during periods of rising interest rates, the Fund can reinvest the proceeds of such prepayments at rates higher than those at which they were previously invested. Mortgages underlying most ARMBSs, however, have limits on the allowable annual or lifetime increases that can be made in the interest rate that the mortgagor pays. Therefore, if current interest rates rise above such limits over the period of the limitation, the Fund if holding an ARMBS does not benefit from further increases in interest rates. Moreover, when interest rates are in excess of coupon rates (*i.e.*, the rates being paid by mortgagors) of the mortgages, ARMBSs behave more like fixed income securities and less like adjustable rate securities and are subject to the risks associated with fixed income securities. In addition, during periods of rising interest rates, increases in the coupon rate of adjustable rate mortgages generally lag current market interest rates slightly, thereby creating the potential for capital depreciation on such securities.

*Other Mortgage-Related Securities.* Other mortgage-related securities include securities other than those described above that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property, including CMO residuals and stripped mortgage-backed securities. Other mortgage-related securities may be equity or debt securities issued by agencies or instrumentalities of the U.S. Government or by private originators of, or investors in, mortgage loans, including savings and loan associations, homebuilders, mortgage banks, commercial banks, investment banks, partnerships, trusts and special purpose entities of the foregoing.

*Asset-Backed Securities.* The Fund may invest in, or have exposure to, asset-backed securities, which are securities that represent a participation in, or are secured by and payable from, a stream of payments generated by particular assets, most often a pool or pools of similar assets (*e.g.*, trade receivables). The credit quality of these securities depends primarily upon the quality of the underlying assets and the level of credit support and/or enhancement provided.

The underlying assets (*e.g.*, loans) are subject to prepayments which shorten the securities' weighted average maturity and may lower their return. If the credit support or enhancement is exhausted, losses or delays in payment may result if the required payments of principal and interest are not made. The value of these securities also may change because of changes in the market's perception of the creditworthiness of the servicing agent for the pool, the originator of the pool, or the financial institution or trust providing the credit support or enhancement. Typically, there is no perfected security interest in the collateral that relates to the financial assets that support asset-backed securities. Asset-backed securities have many of the same characteristics and risks as the mortgage backed securities described above.

The Fund may purchase or have exposure to commercial paper, including asset-backed commercial paper ( ABCP ), that is issued by structured investment vehicles or other conduits. These conduits may be sponsored by mortgage companies, investment banking firms, finance companies, hedge funds, private equity firms and special purpose finance entities. ABCP typically refers to a short-term debt security, the payment of which is supported by cash flows from underlying assets, or one or more liquidity or credit support providers, or both. Assets

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backing ABCP include credit card, car loan and other consumer receivables and home or commercial mortgages, including subprime mortgages. The repayment of ABCP issued by a conduit depends primarily on the cash collections received from the conduit's underlying asset portfolio and the conduit's ability to issue new ABCP. Therefore, there could be losses to the Fund if investing in ABCP in the event of credit or market value deterioration in the conduit's underlying portfolio, mismatches in the timing of the cash flows of the underlying asset interests and the repayment obligations of maturing ABCP, or the conduit's inability to issue new ABCP. To protect investors from these risks, ABCP programs may be structured with various protections, such as credit enhancement, liquidity support, and commercial paper stop-issuance and wind-down triggers. However there can be no guarantee that these protections will be sufficient to prevent losses to investors in ABCP. Some ABCP programs provide for an extension of the maturity date of the ABCP if, on the related maturity date, the conduit is unable to access sufficient liquidity through the issue of additional ABCP. This may delay the sale of the underlying collateral and the Fund may incur a loss if the value of the collateral deteriorates during the extension period. Alternatively, if collateral for ABCP deteriorates in value, the collateral may be required to be sold at inopportune times or at prices insufficient to repay the principal and interest on the ABCP. ABCP programs may provide for the issuance of subordinated notes as an additional form of credit enhancement. The subordinated notes are typically of a lower credit quality and have a higher risk of default. To the extent the Fund purchases these subordinated notes, it will have a higher likelihood of loss than investors in the senior notes.

*Collateralized Debt Obligations.* The Fund may invest in Collateralized Debt Obligations ( CDOs ), which include collateralized bond obligations ( CBOs ), collateralized loan obligations ( CLOs ) and other similarly structured securities. CBOs and CLOs are types of asset-backed securities. A CBO is a trust which is backed by a diversified pool of high risk, below investment grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and non-U.S. senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans. CDOs may charge management fees and administrative expenses.

For both CBOs and CLOs, the cash flows from the trust are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the residual or equity tranche which bears the bulk of defaults from the bonds or loans in the trust and serves to protect the other, more senior tranches from default in all but the most severe circumstances. Since it is partially protected from defaults, a senior tranche from a CBO trust or CLO trust typically has higher ratings and lower yields than underlying securities, and can be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, downgrades of the underlying collateral by rating agencies, forced liquidation of the collateral pool due to a failure of coverage tests, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults, as well as aversion to CBO or CLO securities as a class. Interest on certain tranches of a CDO may be paid in kind or deferred and capitalized (paid in the form of obligations of the same type rather than cash), which involves continued exposure to default risk with respect to such payments.

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The risks of an investment in a CDO depend largely on the type of the collateral securities and the class of the CDO in which the Fund invests. Normally, CBOs, CLOs and other CDOs are privately offered and sold, and thus, are not registered under the securities laws. As a result, investments in CDOs may be characterized by the Fund as illiquid securities; however, an active dealer market may exist for CDOs allowing a CDO to qualify for Rule 144A transactions. In addition to the normal risks associated with debt instruments discussed elsewhere in this Statement of Additional Information and the Prospectus (*e.g.*, interest rate risk and default risk), CDOs carry additional risks that include, but are not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the risk that the collateral may default or decline in value or be downgraded, if rated by a nationally recognized statistical rating organization (NRSRO); (iii) the Fund may invest in tranches of CDOs that are subordinate to other tranches; (iv) the structure and complexity of the transaction and the legal documents could lead to disputes among investors regarding the characterization of proceeds; (v) the investment return achieved by the Fund could be significantly different than those predicted by financial models; (vi) the lack of a readily available secondary market for CDOs; (vii) risk of forced fire sale liquidation due to technical defaults such as coverage test failures; and (viii) the CDO's manager may perform poorly.

*Other Asset-Backed Securities.* Other asset-backed securities (unrelated to mortgage loans) will be offered to investors in the future and may be purchased by the Fund. Several types of asset-backed securities have already been offered to investors, including Enhanced Equipment Trust Certificates (EETCs) and Certificates for Automobile Receivables (CARSM).

Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. Airline EETCs generally have credit enhancement in the form of over-collateralization and cross-subordination (*i.e.*, multiple tranches and multiple aircraft as collateral). They also generally have a dedicated liquidity facility provided by a third-party insurer to insure that coupon payments are made on a timely basis until collateral is liquidated in the event of a default by the lessor of the collateral. Aircraft EETCs issued by registered U.S. carriers also benefit from a special section of the U.S. Bankruptcy Code, which allows the aircraft to be sold by the trust holding the collateral to repay note holders without participating in bankruptcy proceedings. EETCs tend to be less liquid than bonds.

CARS<sup>SM</sup> represent undivided fractional interests in a trust whose assets consist of a pool of motor vehicle retail installment sales contracts and security interests in the vehicles securing the contracts. Payments of principal and interest on CARS<sup>SM</sup> are passed through monthly to certificate holders, and are guaranteed up to certain amounts and for a certain time period by a letter of credit issued by a financial institution unaffiliated with the trustee or originator of the trust. An investor's return on CARS<sup>SM</sup> may be affected by early prepayment of principal on the underlying vehicle sales contracts. If the letter of credit is exhausted, the trust may be prevented from realizing the full amount due on a sales contract because of state law requirements and restrictions relating to foreclosure sales of vehicles and the obtaining of deficiency judgments following such sales or because of depreciation, damage or loss of a vehicle, the application of federal and state bankruptcy and insolvency laws, or other factors. As a result, certificate holders may experience delays in payments or losses if the letter of credit is exhausted.

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Consistent with the Fund's investment objective and policies, PIMCO also may invest in other types of asset-backed securities. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence by, or defalcation of, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that utilize the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

Investors should note that Congress from time to time may consider actions that would limit or remove the explicit or implicit guarantee of the payment of principal and/or interest on many types of asset-backed securities. Any such action would likely adversely impact the value of such securities.

### **Real Estate Investment Trusts ( REITs )**

REITs are pooled investment vehicles that invest primarily in income-producing real estate or real estate related loans or interests. REITs are generally classified as equity REITs, mortgage REITs or a combination of equity and mortgage REITs. Equity REITs invest the majority of their assets directly in real property and derive income primarily from the collection of rents. Equity REITs can also realize capital gains by selling properties that have appreciated in value. Mortgage REITs invest the majority of their assets in real estate mortgages and derive income from the collection of interest payments. REITs are not taxed on income distributed to shareholders provided they comply with the applicable requirements of the Internal Revenue Code of 1986, as amended (the Code). The Fund will indirectly bear its proportionate share of any management and other expenses paid by REITs in which it invests in addition to the expenses paid by the Fund. The Fund may invest in debt or equity securities issued by REITs. Debt securities issued by REITs are, for the most part, general and unsecured obligations and are subject to risks associated with REITs.

Investing in REITs involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by changes in interest rates and the ability of the issuers of its portfolio mortgages to repay their obligations. REITs are dependent upon the skills of their managers and are not diversified. REITs are generally dependent upon maintaining cash flows to repay borrowings and to make distributions to shareholders and are subject to the risk of default by lessees or borrowers. REITs whose underlying assets are concentrated in properties used by a particular industry, such as health care, are also subject to risks associated with such industry.

REITs (especially fixed-rate mortgage REITs) are also subject to interest rate risks that apply generally to mortgage-related securities and other debt instruments, as described above.

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REITs may have limited financial resources, may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities. Historically REITs have been more volatile in price than the larger capitalization stocks included in the Standard & Poor's 500 Composite Stock Index.

### **Bank Capital Securities and Obligations**

The Fund may invest in bank capital securities. Bank capital securities are issued by banks to help fulfill their regulatory capital requirements. There are three common types of bank capital: Lower Tier II, Upper Tier II and Tier I. Bank capital is generally, but not always, of investment grade quality. Upper Tier II securities are commonly thought of as hybrids of debt and preferred stock. Upper Tier II securities are often perpetual (with no maturity date), callable and have a cumulative interest deferral feature. This means that under certain conditions, the issuer bank can withhold payment of interest until a later date. However, such deferred interest payments generally earn interest. Tier I securities often take the form of trust preferred securities.

The Fund may also invest in other bank obligations including certificates of deposit, bankers' acceptances and fixed time deposits. Certificates of deposit are negotiable certificates that are issued against funds deposited in a commercial bank for a definite period of time and that earn a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are accepted by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties which vary depending upon market conditions and the remaining maturity of the obligation. There are generally no contractual restrictions on the right to transfer a beneficial interest in a fixed time deposit to a third party, although there is generally no market for such deposits. The Fund may also hold funds on deposit with its custodian bank in an interest-bearing account for temporary purposes.

Subject to the Fund's limitation on concentration of no more than 25% of its total assets in the securities of issuers in a particular industry, the Fund may invest without limit in U.S. dollar-denominated obligations of non-U.S. banks and may invest up to 25% of its total assets in non-U.S. bank obligations denominated in non-U.S. currencies, and a maximum of 25% of the Fund's total assets may be invested in securities of issuers economically tied to emerging market countries. Obligations of non-U.S. banks involve certain risks associated with investing in non-U.S. securities described under "Non-U.S. Securities" below. Non-U.S. banks are not generally subject to examination by any U.S. Government agency or instrumentality.

### **Delayed Funding Loans and Revolving Credit Facilities**

The Fund may enter into, or acquire participations in, delayed funding loans and revolving credit facilities. Delayed funding loans and revolving credit facilities are borrowing arrangements in which the lender agrees to make loans up to a maximum amount upon demand by the borrower during a specified term. A revolving credit facility differs from a delayed funding loan in that as

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the borrower repays the loan, an amount equal to the repayment may be borrowed again during the term of the revolving credit facility. Delayed funding loans and revolving credit facilities usually provide for floating or variable rates of interest. These commitments may have the effect of requiring the Fund to increase its investment in a company at a time when it might not otherwise be desirable to do so (including a time when the company's financial condition makes it unlikely that such amounts will be repaid).

The Fund may invest in delayed funding loans and revolving credit facilities with credit quality comparable to that of issuers of its securities investments. Delayed funding loans and revolving credit facilities may be subject to restrictions on transfer, and only limited opportunities may exist to resell such instruments. As a result, the Fund may be unable to sell such investments at an opportune time or may have to resell them at less than fair market value. Delayed funding loans and revolving credit facilities are considered to be debt obligations for the purposes of the Fund's investment restriction relating to the lending of funds or assets by the Fund.

## **Commercial Paper**

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The Fund may invest in commercial paper of any credit quality consistent with the Fund's investment objective and policies, including unrated commercial paper for which PIMCO has made a credit quality assessment. See Appendix A to the Prospectus for a description of the ratings assigned by Moody's, S&P and Fitch Ratings to commercial paper. The rate of return on commercial paper may be linked or indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

## **U.S. Government Securities**

U.S. Government securities are obligations of, or guaranteed by, the U.S. Government, its agencies or instrumentalities. The U.S. Government does not guarantee the net asset value of the Fund's shares. Some U.S. Government securities, such as Treasury bills, notes and bonds, and securities guaranteed by the GNMA, are supported by the full faith and credit of the United States; others, such as those of the Federal Home Loan Banks, are supported by the right of the issuer to borrow from the U.S. Treasury; others, such as those of the FNMA, are supported by the discretionary authority of the U.S. Government to purchase the agency's obligations; and still others, such as those of the Student Loan Marketing Association, are supported only by the credit of the instrumentality.

Although U.S. Government-sponsored enterprises such as the Federal Home Loan Banks, Federal Home Loan Mortgage Corporation ( FHLMC ) and FNMA may be chartered or sponsored by Congress, they are not funded by Congressional appropriation and their securities are not issued by the U.S. Treasury or supported by the full faith and credit of the U.S. Government and include increased credit risks. Until recently, FNMA and FHLMC were government-sponsored enterprises owned entirely by private stockholders. The value of these entities' stock fell sharply in 2008 due to concerns that the entities did not have sufficient capital to offset losses. In mid-2008, the U.S. Treasury was authorized to increase the size of home loans

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that FNMA and FHLMC could purchase in certain residential areas and, until 2009, to lend FNMA and FHLMC emergency funds and to purchase the entities' stock. More recently, in September 2008, the U.S. Treasury announced that FNMA and FHLMC had been placed in conservatorship by the Federal Housing Finance Agency ( FHFA ), a newly created independent regulator. As the conservator, FHFA succeeded to all rights, titles, powers and privileges of FNMA and FHLMC and of any stockholder, officer or director of FNMA and FHLMC with respect to FNMA and FHLMC and the assets of FNMA and FHLMC. FHFA selected a new chief executive officer and chairman of the board of directors for each of FNMA and FHLMC.

In addition to placing FNMA and FHLMC in conservatorship, the U.S. Treasury announced three additional steps that it intended to take with respect to both companies. First, the U.S. Treasury entered into Preferred Stock Purchase Agreements ( PSPAs ) under which, if the FHFA determines that FNMA's or FHLMC's liabilities have exceeded its assets under generally accepted accounting principles, the U.S. Treasury will contribute cash capital to the entity in an amount equal to the difference between liabilities and assets. The PSPAs are designed to provide protection to the senior and subordinated debt and the mortgage-backed securities issued by FNMA and FHLMC. Second, the U.S. Treasury established a new secured-lending credit facility. Third, the U.S. Treasury initiated a temporary program to purchase FNMA and FHLMC mortgage-backed securities. FNMA and FHLMC are continuing to operate as going concerns while in conservatorship and each remains liable for all of its obligations, including its guaranty obligations, associated with its mortgage-backed securities. The liquidity backstop and PSPAs [are] both intended to enhance each of FNMA's and FHLMC's ability to meet its obligations, however, no assurance can be given that the U.S. Treasury initiatives discussed above with respect to the debt and mortgage-backed securities issued by FNMA and FHLMC [will be] successful.

Under the Federal Housing Finance Regulatory Reform Act of 2008 (the Reform Act ), which was included as part of the Housing and Economic Recovery Act of 2008, FHFA, as conservator or receiver, has the power to repudiate any contract entered into by FNMA or FHLMC prior to FHFA's appointment as conservator or receiver, as applicable, if FHFA determines, in its sole discretion, that performance of the contract is burdensome and that repudiation of the contract promotes the orderly administration of FNMA's or FHLMC's affairs. The Reform Act requires FHFA to exercise its right to repudiate any contract within a reasonable period of time after its appointment as conservator or receiver. FHFA, in its capacity as conservator, has indicated that it has no intention to repudiate the guaranty obligations of FNMA or FHLMC because FHFA views repudiation as incompatible with the goals of the conservatorship. However, in the event that FHFA, as conservator or if it is later appointed as receiver for FNMA or FHLMC, were to repudiate any such guaranty obligation, the conservatorship or receivership estate, as applicable, would be liable for actual direct compensatory damages in accordance with the provisions of the Reform Act. Any such liability could be satisfied only to the extent of FNMA's or FHLMC's assets available therefore.

In the event of repudiation, the payments of interest to holders of FNMA or FHLMC mortgage-backed securities would be reduced if payments on the mortgage loans represented in the mortgage loan groups related to such mortgage-backed securities are not made by the borrowers or advanced by the servicer. Any actual direct compensatory damages for repudiating these

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guaranty obligations may not be sufficient to offset any shortfalls experienced by such mortgage-backed security holders. Further, in its capacity as conservator or receiver, FHFA has the right to transfer or sell any asset or liability of FNMA or FHLMC without any approval, assignment or consent. Although FHFA has stated that it has no present intention to do so, if FHFA, as conservator or receiver, were to transfer any such guaranty obligation to another party, holders of FNMA or FHLMC mortgage-backed securities would have to rely on that party for satisfaction of the guaranty obligation and would be exposed to the credit risk of that party.

In addition, certain rights provided to holders of mortgage-backed securities issued by FNMA and FHLMC under the operative documents related to such securities may not be enforced against FHFA, or enforcement of such rights may be delayed, during the conservatorship or any future receivership. The operative documents for FNMA and FHLMC mortgage-backed securities may provide (or with respect to securities issued prior to the date of the appointment of the conservator may have provided) that upon the occurrence of an event of default on the part of FNMA or FHLMC, in its capacity as guarantor, which includes the appointment of a conservator or receiver, holders of such mortgage-backed securities have the right to replace FNMA or FHLMC as trustee if the requisite percentage of mortgage-backed securities holders consent. The Reform Act prevents mortgage-backed security holders from enforcing such rights if the event of default arises solely because a conservator or receiver has been appointed. The Reform Act also provides that no person may exercise any right or power to terminate, accelerate or declare an event of default under certain contracts to which FNMA or FHLMC is a party, or obtain possession of or exercise control over any property of FNMA or FHLMC, or affect any contractual rights of FNMA or FHLMC, without the approval of FHFA, as conservator or receiver, for a period of 45 or 90 days following the appointment of FHFA as conservator or receiver, respectively.

U.S. Government securities include securities that have no coupons, or have been stripped of their unmatured interest coupons, individual interest coupons from such securities that trade separately, and evidences of receipt of such securities. Such securities may pay no cash income, and are purchased at a deep discount from their value at maturity. See [Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities](#). Custodial receipts issued in connection with so-called trademark zero-coupon securities, such as CATs and TIGRs, are not issued by the U.S. Treasury, and are therefore not U.S. Government securities, although the underlying bond represented by such receipt is a debt obligation of the U.S. Treasury. Other zero-coupon Treasury securities (*e.g.*, STRIPs and CUBEs) are direct obligations of the U.S. Government.

## **Preferred Stock**

Preferred stock represents an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from a liquidation of the company. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in that company. The Fund may invest in preferred stocks that pay variable or fixed rates of return. The value of a company's preferred stock may fall as a result of factors relating directly to that company's products or services. A preferred stock's value may also fall because of factors affecting not just



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the company, but companies in the same industry or in a number of different industries, such as increases in production costs. The value of preferred stock may also be affected by changes in financial markets that are relatively unrelated to the company or its industry, such as changes in interest rates or currency exchange rates. In addition, a company's preferred stock generally pays dividends only after the company makes required payments to holders of its bonds and other debt. For this reason, the value of the preferred stock will usually react more strongly than bonds and other debt to actual or perceived changes in the company's financial condition or prospects. Preferred stocks of smaller companies may be more vulnerable to adverse developments than those of larger companies.

*Adjustable Rate and Auction Preferred Stocks.* Typically, the dividend rate on an adjustable rate preferred stock is determined prospectively each quarter by applying an adjustment formula established at the time of issuance of the stock. Although adjustment formulas vary among issues, they typically involve a fixed premium or discount relative to rates on specified debt securities issued by the U.S. Treasury. Typically, an adjustment formula will provide for a fixed premium or discount adjustment relative to the highest base yield of three specified U.S. Treasury securities: the 90-day Treasury bill, the 10-year Treasury note and the 20-year Treasury bond. The premium or discount adjustment to be added to or subtracted from this highest U.S. Treasury base rate yield is fixed at the time of issue and cannot be changed without the approval of the holders of the stock. The dividend rate on other preferred stocks in which the Fund may invest, commonly known as auction preferred stocks, is adjusted at intervals that may be more frequent than quarterly, such as every 49 days, based on bids submitted by holders and prospective purchasers of such stocks and may be subject to stated maximum and minimum dividend rates. The issues of most adjustable rate and auction preferred stocks currently outstanding are perpetual, but are redeemable after a specified date at the option of the issuer. Certain issues supported by the credit of a high-rated financial institution provide for mandatory redemption prior to expiration of the credit arrangement. No redemption can occur if full cumulative dividends are not paid. Although the dividend rates on adjustable and auction preferred stocks are generally adjusted or reset frequently, the market values of these preferred stocks may still fluctuate in response to changes in interest rates. Market values of adjustable preferred stocks also may substantially fluctuate if interest rates increase or decrease once the maximum or minimum dividend rate for a particular stock is approached.

*Fixed Rate Preferred Stocks.* Some fixed rate preferred stocks in which the Fund may invest, known as perpetual preferred stocks, offer a fixed return with no maturity date. Because they never mature, perpetual preferred stocks act like long-term bonds, can be more volatile than other types of preferred stocks that have a maturity date and may have heightened sensitivity to changes in interest rates. The Fund may also invest in sinking fund preferred stocks. These preferred stocks also offer a fixed return, but have a maturity date and are retired or redeemed on a predetermined schedule. The shorter duration of sinking fund preferred stocks makes them perform somewhat like intermediate-term bonds and they typically have lower yields than perpetual preferred stocks.

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### **Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities**

Zero-coupon securities are debt obligations that do not entitle the holder to any periodic payments of interest either for the entire life of the obligation or for an initial period after the issuance of the obligations. Like zero-coupon bonds, step-up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security.

Payment-in-kind securities (PIKs) pay dividends or interest in the form of additional securities of the issuer, rather than in cash. Each of these instruments is typically issued and traded at a deep discount from its face amount. The amount of the discount varies depending on such factors as the time remaining until maturity of the securities, prevailing interest rates, the liquidity of the security and the perceived credit quality of the issuer. The market prices of zero-coupon bonds, step-ups and PIKs generally are more volatile than the market prices of debt instruments that pay interest currently and in cash and are likely to respond to changes in interest rates to a greater degree than do other types of securities having similar maturities and credit quality.

In order to satisfy a requirement for qualification as a regulated investment company under the Code, an investment company, such as the Fund, must distribute each year at least 90% of its net investment income, including the original issue discount accrued on zero-coupon bonds, step-ups and PIKs. Because the Fund will not, on a current basis, receive cash payments from the issuer of these securities in respect of any accrued original issue discount, in some years the Fund may have to distribute cash obtained from selling other portfolio holdings of the Fund. In some circumstances, such sales might be necessary in order to satisfy cash distribution requirements even though investment considerations might otherwise make it undesirable for the Fund to sell securities at such time. Under many market conditions, investments in zero-coupon bonds, step-ups and PIKs may be illiquid, making it difficult for the Fund to dispose of them or determine their current value.

### **Convertible Securities and Synthetic Convertible Securities**

Convertible securities are generally bonds, debentures, notes, preferred stocks or other securities or investments that may be converted or exchanged (by the holder or by the issuer) into shares of the underlying common stock (or cash or securities of equivalent value) at a stated exchange ratio or predetermined price (the conversion price). A convertible security is designed to provide current income and also the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock. A convertible security may be called for redemption or conversion by the issuer after a particular date and under certain circumstances (including a specified price) established upon issue. If a convertible security held by the Fund is called for redemption or conversion, the Fund could be required to tender it for redemption, convert it into the underlying common stock, or sell it to a third party, which may have an adverse effect on the Fund's ability to achieve its investment objectives. Convertible securities have general characteristics similar to both debt and equity securities.

A convertible security generally entitles the holder to receive interest paid or accrued until the convertible security matures or is redeemed, converted or exchanged. Convertible securities rank

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senior to common stock in a corporation's capital structure and, therefore, generally entail less risk than the corporation's common stock, although the extent to which such risk is reduced depends in large measure upon the degree to which the convertible security sells above its value as a debt obligation. Before conversion, convertible securities have characteristics similar to non-convertible debt obligations and are designed to provide for a stable stream of income with generally higher yields than common stocks. However, there can be no assurance of current income because the issuers of the convertible securities may default on their obligations. Convertible securities are subordinate in rank to any senior debt obligations of the issuer, and, therefore, an issuer's convertible securities entail more risk than its debt obligations. Moreover, convertible securities are often rated below investment grade or not rated because they fall below debt obligations and just above common equity in order of preference or priority on an issuer's balance sheet.

Convertible securities generally offer lower interest or dividend yields than non-convertible debt securities of similar credit quality because of the potential for capital appreciation. The common stock underlying convertible securities may be issued by a different entity than the issuer of the convertible securities.

The value of convertible securities is influenced by both the yield of non-convertible securities of comparable issuers and by the value of the underlying common stock. The value of a convertible security viewed without regard to its conversion feature (*i.e.*, strictly on the basis of its yield) is sometimes referred to as its investment value. The investment value of the convertible security typically will fluctuate based on the credit quality of the issuer and will fluctuate inversely with changes in prevailing interest rates. However, at the same time, the convertible security will be influenced by its conversion value, which is the market value of the underlying common stock that would be obtained if the convertible security were converted. Conversion value fluctuates directly with the price of the underlying common stock, and will therefore be subject to risks relating to the activities of the issuer and/or general market and economic conditions. Depending upon the relationship of the conversion price to the market value of the underlying security, a convertible security may trade more like an equity security than a debt instrument.

If, because of a low price of the common stock, the conversion value is substantially below the investment value of the convertible security, the price of the convertible security is governed principally by its investment value. Generally, if the conversion value of a convertible security increases to a point that approximates or exceeds its investment value, the value of the security will be principally influenced by its conversion value. A convertible security will sell at a premium over its conversion value to the extent investors place value on the right to acquire the underlying common stock while holding an income-producing security.

To the extent consistent with its other investment policies, the Fund may also create a synthetic convertible security by combining separate securities that possess the two principal characteristics of a traditional convertible security, *i.e.*, an income-producing security (income-producing element) and the right to acquire an equity security (convertible element). The income-producing element is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible element is achieved by investing in warrants or options to buy common stock at a certain

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exercise price, or options on a stock index. Unlike a traditional convertible security, which is a single security having a unitary market value, a synthetic convertible comprises two or more separate securities, each with its own market value. Therefore, the market value of a synthetic convertible security is the sum of the values of its income-producing element and its convertible element. For this reason, the values of a synthetic convertible security and a traditional convertible security may respond differently to market fluctuations.

A holder of a synthetic convertible security faces the risk of a decline in the price of the security or the level of the index or security involved in the convertible element, causing a decline in the value of the call option or warrant purchased to create the synthetic convertible security. Should the price of the stock fall below the exercise price and remain there throughout the exercise period, the entire amount paid for the call option or warrant would be lost. Because a synthetic convertible security includes the income-producing element as well, the holder of a synthetic convertible security also faces the risk that interest rates will rise, causing a decline in the value of the income-producing element.

The Fund may also purchase synthetic convertible securities created by other parties, including convertible structured notes. Convertible structured notes are income-producing debentures linked to equity, and are typically issued by investment banks. Convertible structured notes have the attributes of a convertible security; however, the investment bank that issued the convertible note, rather than the issuer of the underlying common stock into which the note is convertible, assumes the credit risk associated with the investment.

## **Municipal Bonds**

The Fund may invest in municipal bonds which pay interest that, in the opinion of bond counsel to the issuer (or on the basis of other authority believed by PIMCO to be reliable), is exempt from federal income taxes ( municipal bonds ), although dividends that the Fund pays that are attributable to such interest will not be tax-exempt to shareholders of the Fund.

Municipal bonds share the attributes of debt obligations in general, but are generally issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies or authorities. The municipal bonds that the Fund may purchase include general obligation bonds and limited obligation bonds (or revenue bonds), including industrial development bonds issued pursuant to former federal tax law. General obligation bonds are obligations involving the credit of an issuer possessing taxing power and are payable from such issuer's general revenues and not from any particular source. Limited obligation bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise or other specific revenue source. Tax-exempt private activity bonds and industrial development bonds generally are also revenue bonds and thus are not payable from the issuer's general revenues. The credit and quality of private activity bonds and industrial development bonds are usually related to the credit of the user of the facilities. Payment of interest on and repayment of principal of such bonds is the responsibility of the user (and/or any guarantor).

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Municipal bonds are subject to credit and market risk. Generally, prices of higher quality issues tend to fluctuate less with changes in market interest rates than prices of lower quality issues and prices of longer maturity issues tend to fluctuate more than prices of shorter maturity issues. Prices and yields on municipal bonds are dependent on a variety of factors, including general money-market conditions, the financial condition of the issuer, general conditions of the municipal bond market, the size of a particular offering, the maturity of the obligation and the rating of the issue. A number of these factors, including the ratings of particular issues, are subject to change from time to time. Information about the financial condition of an issuer of municipal bonds may not be as extensive as that which is made available by corporations whose securities are publicly traded. Obligations of issuers of municipal bonds are subject to the provisions of bankruptcy, insolvency and other laws, such as the Federal Bankruptcy Reform Act of 1978, affecting the rights and remedies of creditors. Congress or state legislatures may seek to extend the time for payment of principal or interest, or both, or to impose other constraints upon enforcement of such obligations. There is also the possibility that as a result of litigation or other conditions, the power or ability of issuers to meet their obligations for the payment of interest and principal on their municipal bonds may be materially affected or their obligations may be found to be invalid or unenforceable.

The Fund may also invest in residual interest municipal bonds ( RIBS ) whose interest rates bear an inverse relationship to the interest rate on another security or the value of an index. RIBS are created by dividing the income stream provided by the underlying bonds to create two securities, one short-term and one long-term. The interest rate on the short-term component is reset by an index or auction process normally every seven to 35 days. After income is paid on the short-term securities at current rates, the residual income from the underlying bond(s) goes to the long-term securities. Therefore, rising short-term interest rates result in lower income for the longer-term portion, and vice versa. The longer-term bonds can be very volatile and may be less liquid than other municipal bonds of comparable maturity. An investment in RIBS typically will involve greater risk than an investment in a fixed rate bond. Because increases in the interest rate on the other security or index reduce the residual interest paid on a RIB, the value of a RIB is generally more volatile than that of a fixed rate bond. RIBS have interest rate adjustment formulas that generally reduce or, in the extreme, eliminate the interest paid to the Fund when short-term interest rates rise, and increase the interest paid to the Fund when short-term interest rates fall. RIBS have varying degrees of liquidity that approximate the liquidity of the underlying bond(s), and the market price for these securities is volatile. These securities generally will underperform the market of fixed rate bonds in a rising interest rate environment, but tend to outperform the market of fixed rate bonds when interest rates decline or remain relatively stable. Although volatile, RIBS typically offer the potential for yields exceeding the yields available on fixed rate bonds with comparable credit quality, coupon, call provisions and maturity. The Fund may also invest in RIBS for the purpose of increasing the Fund's leverage. Should short-term and long-term interest rates rise, the combination of the Fund's investment in RIBS and its use of other forms of leverage (including through the issuance of preferred shares or the use of other derivative instruments) likely will adversely affect the Fund's net asset value per share and income, distributions and total returns to shareholders. Trusts in which RIBS may be held could be terminated, in which case the residual bond holder would take possession of the underlying bond(s) on an unleveraged basis.

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The Fund may invest in Build America Bonds. Build America Bonds are tax credit bonds created by the American Recovery and Reinvestment Act of 2009, which authorizes state and local governments to issue Build America Bonds as taxable bonds in 2009 and 2010, without volume limitations, to finance any capital expenditures for which such issuers could otherwise issue traditional tax-exempt bonds. State and local governments may receive a direct federal subsidy payment for a portion of their borrowing costs on Build America Bonds equal to 35% of the total coupon interest paid to investors. The state or local government issuer can elect to either take the federal subsidy or pass the 35% tax credit along to bondholders. Investments in Build America Bonds will result in taxable income and the Fund may elect to pass through to shareholders the corresponding tax credits. The tax credits can generally be used to offset federal income taxes and the alternative minimum tax, but such credits are generally not refundable. Build America Bonds involve similar risks as municipal bonds, including credit and market risk. They are intended to assist state and local governments in financing capital projects at lower borrowing costs and are likely to attract a broader group of investors than tax-exempt municipal bonds. For example, taxable funds, including the Fund, may choose to invest in Build America Bonds.

**Non-U.S. Securities**

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of corporate and other non-U. S. issuers, including obligations of non-U.S. banks (see Bank Obligations above), non-U.S. governments or their subdivisions, agencies and instrumentalities, international agencies and supra-national government entities. The Fund may invest up to 25% of its total assets in securities denominated in currencies other than the U.S. dollar.

The non-U.S. securities in which the Fund may invest include Eurodollar obligations and Yankee Dollar obligations. Eurodollar obligations are U.S. dollar-denominated certificates of deposit and time deposits issued outside the U.S. capital markets by non-U.S. branches of U.S. banks and by non-U.S. banks. Yankee Dollar obligations are U.S. dollar-denominated obligations issued in the U.S. capital markets by non-U.S. banks. Eurodollar and Yankee Dollar obligations are generally subject to the same risks that apply to domestic debt issues, notably credit risk, market risk and liquidity risk. Additionally, Eurodollar (and to a limited extent, Yankee Dollar) obligations are subject to certain sovereign risks. One such risk is the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders. Other risks include adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of non-U.S. withholding taxes; and the expropriation or nationalization of non-U.S. issuers.

The Fund may invest in American Depositary Receipts ( ADRs ), European Depositary Receipts ( EDRs ) or Global Depositary Receipts ( GDRs ). ADRs are U.S. dollar-denominated receipts issued generally by domestic banks and represent the deposit with the bank of a security of a non-U.S. issuer. EDRs are foreign currency-denominated receipts similar to ADRs and are issued and traded in Europe, and are publicly traded on exchanges or over-the-counter in the United States. GDRs may be offered privately in the United States and also trade in public or private markets in other countries. ADRs, EDRs and GDRs may be issued as sponsored or unsponsored programs. In sponsored programs, an issuer has made arrangements to have its securities trade in the form of ADRs, EDRs or GDRs. In unsponsored programs, the issuer may

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not be directly involved in the creation of the program. Although regulatory requirements with respect to sponsored and unsponsored programs are generally similar, in some cases it may be easier to obtain financial information from an issuer that has participated in the creation of a sponsored program.

The Fund may invest in Brady Bonds. Brady Bonds are securities created through the exchange of existing commercial bank loans to sovereign entities for new obligations in connection with debt restructurings under a debt restructuring plan introduced by former U.S. Secretary of the Treasury, Nicholas F. Brady (the Brady Plan). Brady Plan debt restructurings have been implemented in a number of countries, including: Argentina, Bolivia, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Jordan, Mexico, Niger, Nigeria, Panama, Peru, the Philippines, Poland, Uruguay and Venezuela.

Brady Bonds may be collateralized or uncollateralized, are issued in various currencies (primarily the U.S. dollar) and are actively traded in the over-the-counter secondary market. Brady Bonds are not considered to be U.S. Government securities. U.S. dollar-denominated, collateralized Brady Bonds, which may be fixed rate par bonds or floating rate discount bonds, are generally collateralized in full as to principal by U.S. Treasury zero-coupon bonds having the same maturity as the Brady Bonds. Interest payments on these Brady Bonds generally are collateralized on a one-year or longer rolling-forward basis by cash or securities in an amount that, in the case of fixed rate bonds, is equal to at least one year of interest payments or, in the case of floating rate bonds, initially is equal to at least one year's interest payments based on the applicable interest rate at that time and is adjusted at regular intervals thereafter. Certain Brady Bonds are entitled to value recovery payments in certain circumstances, which in effect constitute supplemental interest payments but generally are not collateralized. Brady Bonds are often viewed as having three or four valuation components: (i) the collateralized repayment of principal at final maturity; (ii) the collateralized interest payments; (iii) the uncollateralized interest payments; and (iv) any uncollateralized repayment of principal at maturity (the uncollateralized amounts constitute the residual risk).

Most Mexican Brady Bonds issued to date have principal repayments at final maturity fully collateralized by U.S. Treasury zero-coupon bonds (or comparable collateral denominated in other currencies) and interest coupon payments collateralized on an 18-month rolling-forward basis by funds held in escrow by an agent for the bondholders. A significant portion of the Venezuelan Brady Bonds and the Argentine Brady Bonds issued to date have repayments at final maturity collateralized by U.S. Treasury zero-coupon bonds (or comparable collateral denominated in other currencies) and/or interest coupon payments collateralized on a 14-month (for Venezuela) or 12-month (for Argentina) rolling-forward basis by securities held by the Federal Reserve Bank of New York as collateral agent.

Brady Bonds involve various risk factors including residual risk and the history of defaults with respect to commercial bank loans by public and private entities of countries issuing Brady Bonds. There can be no assurance that Brady Bonds in which the Fund may invest will not be subject to restructuring arrangements or to requests for new credit, which may cause the Fund to suffer a loss of interest or principal on any of its holdings.

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Investing in the securities of non-U.S. issuers involves special risks and considerations not typically associated with investing in U.S. companies. These include: differences in accounting; auditing and financial reporting standards; generally higher commission rates on non-U.S. portfolio transactions; the possibility of expropriation or confiscatory taxation; adverse changes in investment or exchange control regulations (which may include suspension of the ability to transfer currency from a country); political instability which can affect U.S. investments in non-U.S. countries; and potential restrictions on the flow of international capital. In addition, non-U.S. securities and dividends and interest payable on those securities may be subject to non-U.S. taxes, including taxes withheld from payments on those securities. Non-U.S. securities often trade with less frequency and volume than domestic securities and therefore may exhibit greater price volatility. Changes in foreign exchange rates will affect the value of those securities which are denominated or quoted in currencies other than the U.S. dollar. The currencies of non-U.S. countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the Fund.

*Emerging Market Securities.* The Fund may invest up to 25% of its total assets in securities of issuers economically tied to emerging market countries. PIMCO generally considers an instrument to be economically tied to an emerging market country if the issuer or guarantor is a government of an emerging market country (or any political subdivision, agency, authority or instrumentality of such government), if the issuer or guarantor is organized under the laws of an emerging market country, or if the currency of settlement of the security is a currency of an emerging market country. With respect to derivative instruments, PIMCO generally considers such instruments to be economically tied to emerging market countries if the underlying assets are currencies of emerging market countries (or baskets or indexes of such currencies), or instruments or securities that are issued or guaranteed by governments of emerging market countries or by entities organized under the laws of emerging market countries. PIMCO has broad discretion to identify countries that it considers to qualify as emerging markets. In exercising such discretion, PIMCO generally will consider a country to be an emerging market country if it is classified as an emerging or developing economy by any supranational organization such as the World Bank or the United Nations, or related entities, or if the country is considered an emerging market country for purposes of constructing emerging markets indices.

Investment risk may be particularly high to the extent that the Fund invests in instruments economically tied to emerging market countries. These securities may present market, credit, currency, liquidity, legal, political and other risks different from, or greater than, the risks of investing in developed countries. The Fund may invest in emerging markets that may be in the process of opening to trans-national investment, which may increase these risks. Risks particular to emerging market countries include, but are not limited to, the following risks:

General Emerging Market Risk. The securities markets of countries in which the Fund may invest may be relatively small, with a limited number of companies representing a small number of industries. Additionally, issuers in countries in which the Fund may invest may not be subject to a high degree of regulation and the financial institutions with which the Fund may trade may not possess the same degree of financial sophistication, creditworthiness or resources as those in developed markets. Furthermore, the legal



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infrastructure and accounting, auditing and reporting standards in certain countries in which the Fund may invest may not provide the same degree of investor protection or information to investors as would generally apply in major securities markets.

Nationalization, expropriation or confiscatory taxation, currency blockage, political changes or diplomatic developments could adversely affect the Fund's investments in a foreign country. In the event of nationalization, expropriation or other confiscation, the Fund could lose its entire investment in that country. Adverse conditions in a certain region can adversely affect securities of other countries whose economies appear to be unrelated. To the extent that the Fund invests a significant portion of assets in a concentrated geographic area, the Fund will generally have more exposure to regional economic risks associated with those investments.

**Restrictions on Foreign Investment.** A number of emerging securities markets restrict foreign investment to varying degrees. Furthermore, repatriation of investment income, capital and the proceeds of sales by foreign investors may require governmental registration and/or approval in some countries. While the Fund will only invest in markets where these restrictions are considered acceptable, new or additional repatriation or other restrictions might be imposed subsequent to the Fund's investment. If such restrictions were to be imposed subsequent to the Fund's investment in the securities markets of a particular country, the Fund's response might include, among other things, applying to the appropriate authorities for a waiver of the restrictions or engaging in transactions in other markets designed to offset the risks of decline in that country. Such restrictions will be considered in relation to the Fund's liquidity needs and all other acceptable positive and negative factors. Some emerging markets limit foreign investment, which may decrease returns relative to domestic investors. The Fund may seek exceptions to those restrictions. If those restrictions are present and cannot be avoided by the Fund, the Fund's returns may be lower.

**Settlement Risks.** Settlement systems in emerging markets may be less well organized than in developed markets. Supervisory authorities may also be unable to apply standards comparable with those in developed markets. Thus there may be risks that settlement may be delayed and that cash or securities belonging to the Fund may be in jeopardy because of failures of or defects in the systems. In particular, market practice may require that payment be made prior to receipt of the security which is being purchased or that delivery of a security must be made before payment is received. In such cases, default by a broker or bank through whom the relevant transaction is effected might result in a loss being suffered by the Fund. The Fund will seek, where possible, to use counterparties whose financial status is such that this risk is reduced. However, there can be no certainty that the Fund will be successful in eliminating or reducing this risk, particularly as counterparties operating in developing countries frequently lack the substance, capitalization and/or financial resources of those in developed countries.

There may also be a danger that, because of uncertainties in the operation of settlement systems in individual markets, competing claims may arise in respect of securities held by or to be transferred to the Fund. Furthermore, compensation schemes may be non-existent, limited or inadequate to meet the Fund's claims in any of these events.

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**Counterparty Risk.** Trading in the securities of developing markets presents additional credit and financial risks. The Fund may have limited access to, or there may be a limited number of, potential counterparties that trade in the securities of emerging market issuers. Governmental regulations may restrict potential counterparties to certain financial institutions located or operating in the particular emerging market. Potential counterparties may not possess, adopt or implement creditworthiness standards, financial reporting standards or legal and contractual protections similar to those in developed markets. Currency hedging techniques may not be available or may be limited. The Fund may not be able to reduce or mitigate risks related to trading with emerging market counterparties. The Fund will seek, where possible, to use counterparties whose financial status is such that the risk of default is reduced, but the risk of losses resulting from default is still possible.

**Government in the Private Sector.** Government involvement in the private sector varies in degree among the emerging markets in which the Fund invests. Such involvement may, in some cases, include government ownership of companies in certain sectors, wage and price controls or imposition of trade barriers and other protectionist measures. With respect to any developing country, there is no guarantee that some future economic or political crisis will not lead to price controls, forced mergers of companies, expropriation, or creation of government monopolies, to the possible detriment of the Fund's investment in that country.

**Litigation.** The Fund may encounter substantial difficulties in obtaining and enforcing judgments against individuals and companies located in certain developing countries. It may be difficult or impossible to obtain or enforce legislation or remedies against governments, their agencies and sponsored entities.

**Fraudulent Securities.** It is possible, particularly in markets in developing countries, that purported securities in which the Fund invests may subsequently be found to be fraudulent and as a consequence the Fund could suffer losses.

**Taxation.** The local taxation of income and capital gains accruing to non-residents varies among developing countries and, in some cases, is comparatively high. In addition, developing countries typically have less well-defined tax laws and procedures and such laws may permit retroactive taxation so that the Fund could in the future become subject to local tax liabilities that had not been anticipated in conducting its investment activities or valuing its assets. The Fund will seek to reduce these risks by careful management of assets. However, there can be no assurance that these efforts will be successful.

**Political Risks/Risks of Conflicts.** Recently, various countries have seen significant internal conflicts and in some cases, civil wars may have had an adverse impact on the securities markets of the countries concerned. In addition, the occurrence of new disturbances due to acts of war or other political developments cannot be excluded.

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Apparently stable systems may experience periods of disruption or improbable reversals of policy. Nationalization, expropriation or confiscatory taxation, currency blockage, political changes, government regulation, political, regulatory or social instability or uncertainty or diplomatic developments could adversely affect the Fund's investments. The transformation from a centrally planned, socialist economy to a more market oriented economy has also resulted in many economic and social disruptions and distortions. Moreover, there can be no assurance that the economic, regulatory and political initiatives necessary to achieve and sustain such a transformation will continue or, if such initiatives continue and are sustained, that they will be successful or that such initiatives will continue to benefit foreign (or non-national) investors. Certain instruments, such as inflation index instruments, may depend upon measures compiled by governments (or entities under their influence) which are also the obligors.

*Sovereign Debt.* The Fund may invest in sovereign debt issued by non-U.S. developed and emerging market governments and their respective sub-divisions, agencies or instrumentalities, government sponsored enterprises and supra-national government entities. Supra-national entities include international organizations that are organized or supported by one or more government entities to promote economic reconstruction or development and by international banking institutions and related governmental agencies. Investment in sovereign debt can involve a high degree of risk. The governmental entity that controls the repayment of sovereign debt may not be able or willing to repay the principal and/or interest when due in accordance with the terms of the debt. A governmental entity's willingness or ability to repay principal and interest due in a timely manner may be affected by, among other factors, its cash flow situation, the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the governmental entity's policy toward the International Monetary Fund, and the political constraints to which a governmental entity may be subject. Governmental entities may also depend on expected disbursements from non-U.S. governments, multilateral agencies and others to reduce principal and interest arrearages on their debt. The commitment on the part of these governments, agencies and others to make such disbursements may be conditioned on a governmental entity's implementation of economic reforms and/or economic performance and the timely service of such debtor's obligations. Failure to implement such reforms, achieve such levels of economic performance or repay principal or interest when due may result in the cancellation of such third parties' commitments to lend funds to the governmental entity, which may further impair such debtor's ability or willingness to service its debts in a timely manner. Consequently, governmental entities may default on their sovereign debt. Holders of sovereign debt (including the Fund) may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. There is no bankruptcy proceeding by which sovereign debt on which governmental entities have defaulted may be collected in whole or in part.

The Fund's investments in foreign currency-denominated debt obligations and hedging activities will likely produce a difference between its book income and its taxable income. This difference may cause a portion of the Fund's income distributions to constitute returns of capital for tax purposes or require the Fund to make distributions exceeding book income to qualify as a regulated investment company for federal income tax purposes.

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### **Foreign Currency Transactions**

Subject to the limitations discussed above and in the Prospectus, the Fund also may purchase and sell foreign currency options and foreign currency futures contracts and related options (see *Derivative Instruments* below), and may engage in foreign currency transactions either on a spot (cash) basis at the rate prevailing in the currency exchange market at the time or through forward foreign currency exchange contracts ( *forwards* ) with terms generally of less than one year. The Fund may (but is not required to) engage in these transactions in order to protect against uncertainty in the level of future foreign exchange rates in the purchase and sale of securities. The Fund may also use foreign currency options and foreign currency forward contracts to increase exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one country to another. Suitable currency hedging transactions may not be available in all circumstances and PIMCO may decide not to use hedging transactions that are available.

A forward foreign currency exchange contract involves an obligation to purchase or sell a specific currency at a future date, which may be any fixed number of days from the date of the contract agreed upon by the parties, at a price set at the time of the contract. These contracts may be bought or sold to protect the Fund against a possible loss resulting from an adverse change in the relationship between foreign currencies and the U.S. dollar or to increase exposure to a particular foreign currency. Although forwards are intended to minimize the risk of loss due to a decline in the value of the hedged currencies, at the same time, they tend to limit any potential gain which might result should the value of such currencies increase. Forwards will be used primarily to adjust the foreign exchange exposure of the Fund with a view to protecting the outlook, and the Fund might be expected to enter into such contracts under the following circumstances:

*Lock In.* When PIMCO desires to lock in the U.S. dollar price on the purchase or sale of a security denominated in a foreign currency.

*Cross Hedge.* If a particular currency is expected to decrease against another currency, the Fund may sell the currency expected to decrease and purchase a currency that is expected to increase against the currency sold in an amount approximately equal to some or all of the Fund's portfolio holdings denominated in the currency sold.

*Direct Hedge.* If PIMCO wants to eliminate substantially all of the risk of owning a particular currency, and/or if PIMCO believes that the Fund can benefit from price appreciation in a given country's debt obligations but does not want to hold the currency, it may employ a direct hedge back into the U.S. dollar. In either case, the Fund would enter into a forward contract to sell the currency in which a portfolio security is denominated and purchase U.S. dollars at an exchange rate established at the time it initiated a contract. The cost of the direct hedge transaction may offset most, if not all, of the yield advantage offered by the non-U.S. security, but the Fund would hope to benefit from an increase (if any) in the value of the debt obligation.

*Proxy Hedge.* PIMCO might choose to use a proxy hedge, which may be less costly than a direct hedge. In this case, the Fund, having purchased a security, will sell a currency whose value is

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believed to be closely linked to the currency in which the security is denominated. Interest rates prevailing in the country whose currency was sold would be expected to be close to those in the United States and lower than those of securities denominated in the currency of the original holding. This type of hedging entails greater risk than a direct hedge because it is dependent on a stable relationship between the two currencies paired as proxies and the relationships can be very unstable at times.

*Costs of Hedging.* When the Fund purchases a non-U.S. bond with a higher interest rate than is available on U.S. bonds of a similar maturity, the additional yield on the non-U.S. bond could be substantially reduced or lost if the Fund were to enter into a direct hedge by selling the foreign currency and purchasing the U.S. dollar. This is what is known as the cost of hedging. Proxy hedging attempts to reduce this cost through an indirect hedge back to the U.S. dollar.

It is important to note that hedging costs are treated as capital transactions and are not, therefore, deducted from the Fund's dividend distribution and are not reflected in its yield.

*Tax Consequences of Hedging.* Under applicable tax law, the Fund's hedging activities may result in the application of, among other rules, the mark-to-market and straddle provisions of the Code. These provisions could affect the amount, timing and/or character of distributions to Fund shareholders. See Tax Matters.

Among the risks of utilizing foreign currencies and related transactions is the risk that the relative value of currencies will be different than anticipated by PIMCO. The Fund will segregate assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees to cover forward currency contracts entered into for non-hedging purposes.

## **Foreign Currency Exchange-Related Securities**

*Foreign Currency Warrants.* Foreign currency warrants, such as Currency Exchange Warrants<sup>SM</sup> (CEW<sup>SM</sup>), are warrants that entitle their holders to receive from their issuer an amount of cash (generally, for warrants issued in the United States, in U.S. dollars) that is calculated pursuant to a predetermined formula and based on the exchange rate between a specified foreign currency and the U.S. dollar as of the exercise date of the warrant. Foreign currency warrants generally are exercisable upon their issuance and expire as of a specific date and time. Foreign currency warrants have been issued in connection with U.S. dollar-denominated debt offerings by major issuers in an attempt to reduce the foreign currency exchange risk that, from the point of view of the prospective purchasers of the securities, is inherent in the international debt obligation marketplace. Foreign currency warrants may attempt to reduce the foreign exchange risk assumed by purchasers of a security by, for example, providing for a supplement payment in the event that the U.S. dollar depreciates against the value of a major foreign currency such as the Japanese yen. The formula used to determine the amount payable upon exercise of a foreign currency warrant may make the warrant worthless unless the applicable foreign currency exchange rate moves in a particular direction (*e.g.*, unless the U.S. dollar appreciates or depreciates against the particular foreign currency to which the warrant is linked or indexed). Foreign currency warrants are severable from the debt obligations with which they may be offered, and may be listed on exchanges. Foreign currency warrants may be exercisable only in

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certain minimum amounts, and an investor wishing to exercise warrants who possesses less than the minimum number required for exercise may be required either to sell the warrants or to purchase additional warrants, thereby incurring additional transaction costs. In the case of any exercise of warrants, there may be a time delay between the time a holder of warrants gives instructions to exercise and the time the exchange rate relating to exercise is determined, during which time the exchange rate could change significantly, thereby affecting both the market and cash settlement values of the warrants being exercised. The expiration date of the warrants may be accelerated if the warrants should be delisted from an exchange or if their trading should be suspended permanently, which would result in the loss of any remaining time values of the warrants (*i.e.*, the difference between the current market value and the exercise value of the warrants), and, if the warrants were out-of-the-money, in a total loss of the purchase price of the warrants. Warrants are generally unsecured obligations of their issuers and are not standardized foreign currency options issued by the Options Clearing Corporation ( OCC ). Unlike foreign currency options issued by the OCC, the terms of foreign exchange warrants generally will not be amended in the event of government or regulatory actions affecting exchange rates or in the event of the imposition of other regulatory controls affecting the international currency markets. The initial public offering price of foreign currency warrants is generally considerably in excess of the price that a commercial user of foreign currencies might pay in the interbank market for a comparable option involving significantly larger amounts of foreign currencies. Foreign currency warrants are subject to significant foreign exchange risk, including risks arising from complex political or economic factors.

*Principal Exchange Rate Linked Securities.* Principal exchange rate linked securities ( PERLS<sup>M</sup> ) are debt obligations the principal on which is payable at maturity in an amount that may vary based on the exchange rate between the U.S. dollar and a particular foreign currency at or about that time. The return on standard principal exchange rate linked securities is enhanced if the foreign currency to which the security is linked appreciates against the U.S. dollar, and is adversely affected by increases in the foreign exchange value of the U.S. dollar; reverse principal exchange rate linked securities are like standard securities, except that their return is enhanced by increases in the value of the U.S. dollar and adversely impacted by increases in the value of foreign currency. Interest payments on the securities are generally made in U.S. dollars at rates that reflect the degree of foreign currency risk assumed or given up by the purchaser of the notes (*i.e.*, at relatively higher interest rates if the purchaser has assumed some of the foreign exchange risk, or relatively lower interest rates if the issuer has assumed some of the foreign exchange risk, based on the expectations of the current market). Principal exchange rate linked securities may in limited cases be subject to acceleration of maturity (generally, not without the consent of the holders of the securities), which may have an adverse impact on the value of the principal payment to be made at maturity.

*Performance Indexed Paper.* Performance indexed paper ( PIPS<sup>M</sup> ) is U.S. dollar-denominated commercial paper the yield of which is linked to certain foreign exchange rate movements. The yield to the investor on performance indexed paper is established at maturity as a function of spot exchange rates between the U.S. dollar and a designated currency as of or about that time (generally, the index maturity two days prior to maturity). The yield to the investor will be within a range stipulated at the time of purchase of the obligation, generally with a guaranteed minimum rate of return that is below, and a potential maximum rate of return that is above, market yields

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on U.S. dollar-denominated commercial paper, with both the minimum and maximum rates of return on the investment corresponding to the minimum and maximum values of the spot exchange rate two business days prior to maturity.

### **Derivative Instruments**

The Fund may, but is not required to, use a variety of derivative instruments for hedging or risk management purposes or as part of its investment strategies.

Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of an underlying asset, reference rate or index, and may relate to individual debt instruments, interest rates, currencies or currency exchange rates, commodities or related indexes. The Fund may use derivatives to gain exposure to floating rate or high yield securities and other securities in which the Fund may invest (including pending investment of the proceeds of this offering). Examples of derivative instruments that the Fund may use include, but are not limited to, options contracts, futures contracts, options on futures contracts, swap agreements (including total return and credit default swaps) and short sales. The Fund may also engage in credit spread trades. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, where the value of the investment position is determined by changes in the difference between such prices or interest rates, as the case may be, of the respective securities. The Fund may also have exposure to derivatives, such as interest rate or credit-default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may also use derivatives to add leverage to the portfolio. If other types of financial instruments, including other types of options, futures contracts or futures options are traded in the future, the Fund may also use those instruments, provided that their use is consistent with the Fund's investment objective and policies.

Like the other investments of the Fund, the ability of the Fund to successfully utilize derivative instruments may depend in part upon the ability of PIMCO to assess the issuer's credit characteristics and other macro-economic factors correctly. If PIMCO incorrectly forecasts such factors and has taken positions in derivative instruments contrary to prevailing market trends, the Fund could lose money.

The Fund might not employ any of the strategies described below, and no assurance can be given that any strategy used will succeed. If PIMCO incorrectly forecasts market values or other economic factors in utilizing a derivatives strategy for the Fund, the Fund might have been in a better position if it had not entered into the transaction at all. Also, suitable derivative transactions may not be available in all circumstances. The use of these strategies involves certain special risks, including a possible imperfect correlation, or even no correlation, between price movements of derivative instruments and price movements of related investments. While some strategies involving derivative instruments can reduce the risk of loss, they can also reduce the opportunity for gain or even result in losses by offsetting favorable price movements in related investments or otherwise, due to the possible inability of the Fund to purchase or sell a portfolio security at a time that otherwise would be favorable or the possible need to sell a portfolio security at a disadvantageous time because the Fund is required to maintain asset

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coverage or offsetting positions in connection with transactions in derivative instruments, and the possible inability of the Fund to close out or to liquidate its derivatives positions. Income earned by the Fund from many derivative strategies will be treated as capital gain and, if not offset by net realized capital loss, will be distributed to shareholders in taxable distributions.

*Options on Securities, Swap Agreements and Indexes.* The Fund may purchase and sell put and call options on securities, swap agreements or indexes in standardized contracts traded on domestic or other securities exchanges, boards of trade, or similar entities, or quoted on NASDAQ or on an over-the-counter market, and agreements, sometimes called cash puts, which may accompany the purchase of a new issue of debt obligations from a dealer.

An option on a security (or an index) is a contract that gives the holder of the option, in return for a premium, the right to buy from (in the case of a call) or sell to (in the case of a put) the writer of the option the security underlying the option (or the cash value of the index) at a specified exercise price at any time during the term of the option. The writer of an option on a security has the obligation upon exercise of the option to deliver the underlying security upon payment of the exercise price or to pay the exercise price upon delivery of the underlying security. Upon exercise, the writer of an option on an index is obligated to pay the difference between the cash value of the index and the exercise price multiplied by the specified multiplier for the index option. (An index is designed to reflect features of a particular securities market, a specific group of financial instruments or securities, or certain economic indicators.)

The Fund may (but is not required to) cover its obligations when it writes call options or put options. In the case of a call option on a debt obligation or other security, the option is covered if the Fund owns the security underlying the call or has an absolute and immediate right to acquire that security without additional cash consideration (or, if additional cash consideration is required, cash or other assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in such amount are segregated by its custodian) upon conversion or exchange of other securities held by the Fund.

A call option on a security is also covered if the Fund does not hold the underlying security or have the right to acquire it, but the Fund segregates assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees in an amount equal to the contract value of the position (minus any collateral deposited with a broker-dealer), on a mark-to-market basis (a so-called naked call option).

For a call option on an index, the option is covered if the Fund maintains with its custodian assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in an amount equal to the contract value of the index. A call option is also covered if the Fund holds a call on the same index or security as the call written where the exercise price of the call held is (i) equal to or less than the exercise price of the call written, or (ii) greater than the exercise price of the call written, provided the difference is maintained by the Fund in segregated assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. A put option on a security or an index is covered if the Fund segregates assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees equal to the exercise price. A put option is also covered if



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the Fund holds a put on the same security or index as the put written where the exercise price of the put held is (i) equal to or greater than the exercise price of the put written, or (ii) less than the exercise price of the put written, provided the difference is maintained by the Fund in segregated assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. Obligations under written call and put options so covered will not be construed to be senior securities for purposes of the Fund's investment restrictions concerning senior securities and borrowings.

If an option written by the Fund expires unexercised, the Fund realizes on the expiration date a capital gain equal to the premium the Fund received at the time the option was written. If an option purchased by the Fund expires unexercised, the Fund realizes a capital loss equal to the premium paid. Prior to the earlier of exercise or expiration, an exchange-traded option may be closed out by an offsetting purchase or sale of an option of the same series (type, exchange, underlying security or index, exercise price, and expiration). There can be no assurance, however, that a closing purchase or sale transaction can be effected when the Fund desires.

The Fund may sell put or call options it has previously purchased, which could result in a net gain or loss depending on whether the amount realized on the sale is more or less than the premium and other transaction costs paid on the put or call option which is sold. Prior to exercise or expiration, an option may be closed out by an offsetting purchase or sale of an option of the same series. The Fund will realize a capital gain from a closing purchase transaction if the cost of the closing option is less than the premium received from writing the option, or, if it is more, the Fund will realize a capital loss. If the premium received from a closing sale transaction is more than the premium paid to purchase the option, the Fund will realize a capital gain or, if it is less, the Fund will realize a capital loss. The principal factors affecting the market value of a put or a call option include supply and demand, interest rates, the current market price of the underlying security or index in relation to the exercise price of the option, the volatility of the underlying security or index and the time remaining until the expiration date.

The premium paid for a put or call option purchased by the Fund is an asset of the Fund. The premium received for an option written by the Fund is recorded as a deferred credit. The value of an option purchased or written is marked to market daily and is valued at the closing price on the exchange on which it is traded or, if not traded on an exchange or no closing price is available, at the mean between the last bid and asked prices.

The Fund may write straddles (covered or uncovered) consisting of a combination of a call and a put written on the same underlying security. A straddle will be covered when sufficient assets are deposited to meet the Fund's immediate obligations. The Fund may use the same liquid assets to cover both the call and put options where the exercise price of the call and put are the same, or the exercise price of the call is higher than that of the put. In such cases, the Fund will also segregate liquid assets equivalent to the amount, if any, by which the put is in the money.

*Risks Associated with Options on Securities and Indexes.* There are several risks associated with transactions in options on securities and on indexes. For example, there are significant differences between the securities and options markets that could result in an imperfect correlation between these markets, causing a given transaction not to achieve the intended result.

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A decision as to whether, when and how to use options involves the exercise of skill and judgment, and even a well-conceived transaction may be unsuccessful because of market behavior or unexpected events.

During the option period, the covered call writer has, in return for the premium on the option, given up the opportunity to profit from a price increase in the underlying security above the exercise price, but, as long as its obligation as a writer continues, has retained the risk of loss should the price of the underlying security decline. The writer of an option has no control over the time when it may be required to fulfill its obligation as a writer of the option. Once an option writer has received an exercise notice, it cannot effect a closing purchase transaction in order to terminate its obligation under the option and must deliver the underlying security at the exercise price. If a put or call option purchased by the Fund is not sold when it has remaining value, and if the market price of the underlying security remains equal to or greater than the exercise price (in the case of a put), or remains less than or equal to the exercise price (in the case of a call), the Fund will lose its entire investment in the option. Also, where a put or call option on a particular security is purchased to hedge against price movements in a related security, the price of the put or call option may move more or less than the price of the related security.

There can be no assurance that a liquid market will exist when the Fund seeks to close out an option position. If the Fund were unable to close out an option that it had purchased on a security or index, it would have to exercise the option in order to realize any profit or the option may expire worthless. If the Fund were unable to close out a call option that it had written on a security held in its portfolio, it would not be able to sell the underlying security unless the option expired without exercise. As the writer of a call option on an individual security held in its portfolio, the Fund forgoes, during the option's life, the opportunity to profit from increases in the market value of the security or index position covering the call option above the sum of the premium and the exercise price of the call.

If trading were suspended in an option purchased by the Fund, the Fund would not be able to close out the option. If restrictions on exercise were imposed, the Fund might be unable to exercise an option it has purchased. Except to the extent that a call option on an index written by the Fund is covered by an option on the same index purchased by the Fund, movements in the index may result in a loss to the Fund; however, such losses may be mitigated by changes in the value of the Fund's securities during the period the option was outstanding.

*Foreign Currency Options.* The Fund may buy or sell put and call options on foreign currencies for investment purposes or as a hedge against changes in the value of the U.S. dollar (or another currency) in relation to a foreign currency in which the Fund's securities may be denominated. The Fund may buy or sell put and call options on foreign currencies either on exchanges or in the over-the-counter market. A put option on a foreign currency gives the purchaser of the option the right to sell a foreign currency at the exercise price until the option expires. A call option on a foreign currency gives the purchaser of the option the right to purchase the currency at the exercise price until the option expires. Currency options traded on U.S. or other exchanges may be subject to position limits which may limit the ability of the Fund to reduce foreign currency risk using such options.

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*Futures Contracts and Options on Futures Contracts.* The Fund may invest in futures contracts and options thereon ( futures options ), including interest rates, securities indexes, debt obligations (to the extent they are available) and U.S. Government and agency securities, as well as purchase put and call options on such futures contracts.

Generally, a futures contract provides for the future sale by one party and purchase by another party of a specified quantity of the security or other financial instrument at a specified price and time. A futures contract on an index is an agreement pursuant to which two parties agree to take or make delivery of an amount of cash equal to the difference between the value of the index at the close of the last trading day of the contract and the price at which the index contract was originally written. Although the value of an index might be a function of the value of certain specified securities, physical delivery of these securities is not always made. A public market exists in futures contracts covering a number of indexes as well as financial instruments, including, without limitation: U.S. Treasury bonds; U.S. Treasury notes; GNMA Certificates; three-month U.S. Treasury bills; 90-day commercial paper; bank certificates of deposit; Eurodollar certificates of deposit; the Australian dollar; the Canadian dollar; the British pound; the Japanese yen; the Swiss franc; the Mexican peso; and certain multinational currencies, such as the euro. It is expected that other futures contracts will be developed and traded in the future.

The Fund may purchase and write call and put futures options. Futures options possess many of the same characteristics as options on securities and indexes (discussed above). A futures option gives the holder the right, in return for the premium paid, to assume a long position (call) or short position (put) in a futures contract at a specified exercise price at any time during the period of the option. Upon exercise of a call option, the holder acquires a long position in the futures contract and the writer is assigned the opposite short position. In the case of a put option, the opposite is true.

The Fund may enter into futures contracts and futures options that are standardized and traded on a U.S. or other exchange, board of trade, or similar entity, or quoted on an automated quotation system, and the Fund may also enter into OTC options on futures contracts.

When a purchase or sale of a futures contract is made by the Fund, the Fund is required to deposit with its custodian (or broker, if legally permitted) a specified amount of assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees ( initial margin ). The margin required for a futures contract is set by the exchange on which the contract is traded and may be modified during the term of the contract. The initial margin is in the nature of a performance bond or good faith deposit on the futures contract that is returned to the Fund upon termination of the contract, assuming all contractual obligations have been satisfied. The Fund expects to earn taxable interest income on its initial margin deposits. A futures contract held by the Fund is valued daily at the official settlement price of the exchange on which it is traded. Each day the Fund pays or receives cash, called variation margin, equal to the daily change in value of the futures contract. This process is known as marking to market. Variation margin does not represent a borrowing or loan by the Fund but is instead a settlement between the Fund and the broker of the amount one would owe the other if the futures contract expired. In computing daily net asset value, the Fund will mark to market its open futures positions.

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The Fund is also required to deposit and maintain margin with respect to put and call options on futures contracts written by it. Such margin deposits will vary depending on the nature of the underlying futures contract (and the related initial margin requirements), the current market value of the option, and other futures positions held by the Fund.

Although some futures contracts call for making or taking delivery of the underlying securities, generally these obligations are closed out prior to delivery by offsetting purchases or sales of matching futures contracts (involving the same exchange, underlying security or index, and delivery month). If an offsetting purchase price is less than the original sale price, the Fund realizes a capital gain, or if it is more, the Fund realizes a capital loss. Conversely, if an offsetting sale price is more than the original purchase price, the Fund realizes a capital gain, or if it is less, the Fund realizes a capital loss. The transaction costs must also be included in these calculations.

The Fund may write straddles (covered or uncovered) consisting of a call and a put written on the same underlying futures contract. A straddle will be covered when sufficient assets are deposited to meet the Fund's immediate obligations. The Fund may use the same liquid assets to cover both the call and put options where the exercise price of the call and put are the same, or the exercise price of the call is higher than that of the put. In such cases, the Fund will also segregate liquid assets equivalent to the amount, if any, by which the put is in the money.

The Fund is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Commodity Exchange Act (the "CEA"), and, therefore, such person is not subject to registration or regulation as a pool operator under the CEA.

*Limitations on Use of Futures and Futures Options.* When purchasing a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that, when added to the amounts deposited with a futures commission merchant as margin, are equal to the market value of the futures contract. Alternatively, the Fund may cover its position by purchasing a put option on the same futures contract with a strike price as high as or higher than the price of the contract held by the Fund.

When selling a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that are equal to the market value of the instruments underlying the contract. Alternatively, the Fund may cover its position by owning the instruments underlying the contract (or, in the case of an index futures contract, a portfolio with a volatility substantially similar to that of the index on which the futures contract is based), or by holding a call option permitting the Fund to purchase the same futures contract at a price no higher than the price of the contract written by the Fund (or at a higher price if the difference is maintained in liquid assets with the Fund's custodian).

When selling a call option on a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with

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procedures established by the Board of Trustees, that, when added to the amounts deposited with a futures commission merchant as margin, equal the total market value of the futures contract underlying the call option. Alternatively, the Fund may cover its position by entering into a long position in the same futures contract at a price no higher than the strike price of the call option, by owning the instruments underlying the futures contract, or by holding a separate call option permitting the Fund to purchase the same futures contract at a price not higher than the strike price of the call option sold by the Fund, or by taking other offsetting positions.

When selling a put option on a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that equal the purchase price of the futures contract, less any margin on deposit. Alternatively, the Fund may cover the position either by entering into a short position in the same futures contract, or by owning a separate put option permitting it to sell the same futures contract so long as the strike price of the purchased put option is the same as or higher than the strike price of the put option sold by the Fund, or by taking other offsetting positions.

To the extent that securities with maturities greater than one year are used to segregate assets to cover the Fund's obligations under futures contracts and related options, such use will not eliminate the leverage risk arising from such use, which may tend to exaggerate the effect on net asset value of any increase or decrease in the market value of the Fund's portfolio, and may require liquidation of portfolio positions when it is not advantageous to do so.

The requirements for qualification as a regulated investment company also may limit the extent to which the Fund may enter into futures, futures options or forward contracts. See Tax Matters.

*Risks Associated with Futures and Futures Options.* There are several risks associated with the use of futures contracts and futures options. A purchase or sale of a futures contract may result in losses in excess of the amount invested in the futures contract. There can be no guarantee that there will be a correlation between price movements in the hedging vehicle and in the Fund securities being hedged. In addition, there are significant differences between the securities and futures markets that could result in an imperfect correlation between the markets, causing a given hedge not to achieve its objective. The degree of imperfection of correlation depends on circumstances such as variations in speculative market demand for futures and futures options on securities, including technical influences in futures trading and futures options, and differences between the financial instruments being hedged and the instruments underlying the standard contracts available for trading in such respects as interest rate levels, maturities, and creditworthiness of issuers. A decision as to whether, when and how to hedge involves the exercise of skill and judgment, and even a well-conceived hedge may be unsuccessful to some degree because of market behavior or unexpected interest rate trends.

Futures contracts on U.S. Government securities historically have reacted to an increase or decrease in interest rates in a manner similar to that in which the underlying U.S. Government securities reacted. To the extent, however, that the Fund enters into such futures contracts, the value of such futures will not vary in direct proportion to the value of the Fund's holdings of debt

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obligations. Thus, the anticipated spread between the price of the futures contract and the hedged security may be distorted due to differences in the nature of the markets. The spread also may be distorted by differences in initial and variation margin requirements, the liquidity of such markets and the participation of speculators in such markets.

Futures exchanges may limit the amount of fluctuation permitted in certain futures contract prices during a single trading day. The daily limit establishes the maximum amount that the price of a futures contract may vary either up or down from the previous day's settlement price at the end of the current trading session. Once the daily limit has been reached in a futures contract subject to the limit, no more trades may be made on that day at a price beyond that limit. The daily limit governs only price movements during a particular trading day and therefore does not limit potential losses because the limit may work to prevent the liquidation of unfavorable positions. For example, futures prices have occasionally moved to the daily limit for several consecutive trading days with little or no trading, thereby preventing prompt liquidation of positions and subjecting some holders of futures contracts to substantial losses.

There can be no assurance that a liquid market will exist at a time when the Fund seeks to close out a futures contract or a futures option position, and the Fund would remain obligated to meet margin requirements until the position is closed. In addition, many of the contracts discussed above are relatively new instruments without a significant trading history. As a result, there can be no assurance that an active secondary market will develop or continue to exist.

*Additional Risks of Options on Securities, Futures Contracts, Options on Futures Contracts and Forward Currency Exchange Contracts and Options Thereon.* Options on securities or indexes, futures contracts, options on futures contracts, and options on currencies may be traded on foreign exchanges. Such transactions may not be regulated as effectively as similar transactions in the United States, may not involve a clearing mechanism and related guarantees, and are subject to the risk of governmental actions affecting trading in, or the prices of, non-U.S. securities. Some foreign exchanges may be principal markets so that no common clearing facility exists and a trader may look only to the broker for performance of the contract. The value of such positions also could be adversely affected by (i) other complex non-U.S. political, legal and economic factors, (ii) lesser availability than in the United States of data on which to make trading decisions, (iii) delays in the Fund's ability to act upon economic events occurring in non-U.S. markets during non-business hours in the United States, (iv) the imposition of different exercise and settlement terms and procedures and margin requirements than in the United States and (v) lesser trading volume. In addition, unless the Fund hedges against fluctuations in the exchange rate between the U.S. dollar and the currencies in which trading is done on non-U.S. exchanges, any profits that the Fund might realize in trading could be eliminated by adverse changes in the exchange rate, or the Fund could suffer losses as a result of those changes. The Fund's use of such instruments may cause the Fund to realize higher amounts of short-term capital gains (generally taxed to shareholders at ordinary income tax rates) than if the Fund had not used such instruments.

*Swap Agreements.* The Fund may enter into total return swap agreements, credit default swap agreements and other swap agreements made with respect to interest rates, currencies, indexes of securities and other assets or measures of risk or return. These transactions are entered into in an

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attempt to obtain a particular return when it is considered desirable to do so, possibly at a lower cost to the Fund than if the Fund had invested directly in an instrument that yielded that desired return.

Swap agreements are two-party contracts entered into primarily by institutional investors for periods ranging from a few weeks to more than one year. Swap agreements are individually negotiated and structured to include exposure to a variety of types of investments or market factors. In a standard swap transaction, two parties agree to exchange the returns (or differentials in rates of return) earned or realized on particular predetermined investments or instruments, which may be adjusted for an interest factor. The gross returns to be exchanged or swapped between the parties are generally calculated with respect to a notional amount, *i.e.*, the return on or increase in value of a particular dollar amount invested at a particular interest rate or in a basket of securities representing a particular index.

Forms of swap agreements include interest rate caps, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates exceed a specified rate, or cap; interest rate floors, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates fall below a specified rate, or floor; and interest rate collars, under which a party sells a cap and purchases a floor or vice versa in an attempt to protect itself against interest rate movements exceeding given minimum or maximum levels. The Fund may use interest rate caps, floors and collars to a substantial degree in connection with its leveraging strategies. See Certain Interest Rate Transactions below and Portfolio Contents Certain Interest Rate Transactions in the Prospectus.

The Fund may also enter into options on swap agreements (swaptions). A swaption is a contract that gives a counterparty the right (but not the obligation) to enter into a new swap agreement or to shorten, extend, cancel or otherwise modify an existing swap agreement, at some designated future time on specified terms. The Fund may write (sell) and purchase put and call swaptions.

Most swap agreements entered into by the Fund would calculate the obligations of the parties to the agreement on a net basis. Consequently, the Fund's current obligations (or rights) under a swap agreement will generally be equal only to the net amount to be paid or received under the agreement based on the relative values of the positions held by each party to the agreement (the net amount). The Fund's current obligations under a swap agreement will be accrued daily (offset against any amounts owed to the Fund). The Fund may (but is not required to) cover any accrued but unpaid net amounts owed to a swap counterparty through the segregation of assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. Obligations under swap agreements so covered will not be construed to be senior securities for purposes of the Fund's investment restriction concerning senior securities and borrowings.

Whether the Fund's use of swap agreements or swaptions will be successful in furthering its investment objective will depend on PIMCO's ability to predict correctly whether certain types of investments are likely to produce greater returns than other investments. Because they are two-party contracts and because they may have terms of greater than seven days, swap

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agreements may be considered to be illiquid. Moreover, the Fund bears the risk of loss of the amount expected to be received under a swap agreement in the event of the default or bankruptcy of a swap agreement counterparty. The swaps market is a relatively new market and is largely unregulated. It is possible that developments in the swaps market, including potential government regulation, could adversely affect the Fund's ability to terminate existing swap agreements or to realize amounts to be received under such agreements.

Depending on the terms of the particular option agreement, the Fund will generally incur a greater degree of risk when it writes a swaption than it will incur when it purchases a swaption. When the Fund purchases a swaption, it risks losing only the amount of the premium it has paid should it decide to let the option expire unexercised. However, when the Fund writes a swaption, upon exercise of the option the Fund will become obligated according to the terms of the underlying agreement.

Certain swap agreements are exempt from most provisions of the CEA and, therefore, are not regulated as futures or commodity option transactions under the CEA.

### **Credit Default Swaps**

The Fund may enter into credit default swap contracts for both investment and risk management purposes. As the seller in a credit default swap contract, the Fund would be required to pay the par (or other agreed-upon) value of a referenced debt obligation to the counterparty in the event of a default by a third party, such as a U.S. or non-U.S. issuer, on the debt obligation. In return, the Fund would receive from the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would keep the stream of payments and would have no payment obligations. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total net assets, the Fund would be subject to investment exposure on the notional amount of the swap.

The Fund may also purchase credit default swap contracts in order to hedge against the risk of default of debt securities held in its portfolio, in which case the Fund would function as the counterparty referenced in the preceding paragraph. This would involve the risk that the investment may expire worthless and would generate income only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial instability). It would also involve credit risk - that the seller may fail to satisfy its payment obligations to the Fund in the event of a default.

### **Credit-Linked Trust Certificates**

The Fund may invest in credit-linked trust certificates, which are investments in a limited purpose trust or other vehicle formed under state law which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another fixed income market. For instance, the Fund may invest in credit-linked trust certificates as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income-producing securities are not available, including during the period when the net proceeds of this offering and any future offering are being invested.



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Like an investment in a bond, investments in these credit-linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust's receipt of payments from, and the trust's potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that the Fund would receive as an investor in the trust. Please see "Investment Objective and Policies - Credit Default Swaps" in this Statement of Additional Information for additional information about credit default swaps. The Fund's investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, counterparty risk, interest rate risk, leverage risk and management risk. It is expected that the trusts which issue credit-linked trust certificates will constitute private investment companies, exempt from registration under the 1940 Act. Therefore, the certificates will be subject to the risks described under "Other Investment Companies" below, and will not be subject to applicable investment limitations and other regulation imposed by the 1940 Act (although the Fund will remain subject to such limitations and regulation, including with respect to its investments in the certificates). Although the trusts are typically private investment companies, they are generally not actively managed such as a hedge fund might be. It is also expected that the certificates will be exempt from registration under the 1933 Act. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments. See "Principal Risks of the Fund - Liquidity Risk" in the Prospectus. If market quotations are not readily available for the certificates, they will be valued by the Fund at fair value as determined by the Board of Trustees or persons acting at its direction. See "Net asset value" in the Prospectus.

**Structured Notes and Other Hybrid Instruments**

The Fund may invest in structured notes, which are privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate, such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Depending on the terms of the note, the Fund may forgo all or part of the interest and principal that would be payable on a comparable conventional note. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage which will serve to magnify the potential for gain and the risk of loss. The Fund may use structured notes to add leverage to the portfolio and for investment as well as risk management purposes. Like other sophisticated strategies, the Fund's use of structured notes may not work as intended.

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The Fund may invest in other types of hybrid instruments which combine the characteristics of securities, futures, and options. For example, the principal amount or interest rate of a hybrid could be tied (positively or negatively) to the price of some commodity, currency or securities index or another interest rate (each a benchmark). The interest rate or (unlike most debt obligations) the principal amount payable at maturity of a hybrid security may be increased or decreased, depending on changes in the value of the benchmark. Hybrids can be used as an efficient means of pursuing a variety of investment goals, including duration management and increased total return. Hybrids may not bear interest or pay dividends. The value of a hybrid or its interest rate may be a multiple of a benchmark and, as a result, may be leveraged and move (up or down) more steeply and rapidly than the benchmark. These benchmarks may be sensitive to economic and political events that cannot be readily foreseen by the purchaser of a hybrid. Under certain conditions, the redemption value of a hybrid could be zero. Thus, an investment in a hybrid may entail significant market risks that are not associated with a similar investment in a traditional, U.S. dollar-denominated bond that has a fixed principal amount and pays a floating rate or fixed rate of interest. The purchase of hybrids also exposes the Fund to the credit risk of the issuer of the hybrids. These risks may cause significant fluctuations in the net asset value of the Fund.

Certain issuers of structured products such as hybrid instruments may be deemed to be investment companies as defined in the 1940 Act. As a result, the Fund's investments in these products may be subject to limits applicable to investments in investment companies and may be subject to restrictions contained in the 1940 Act.

## **Reverse Repurchase Agreements**

The Fund may enter into reverse repurchase agreements and economically similar transactions in order to add leverage to the portfolio or for hedging or cash management purposes. A reverse repurchase agreement involves the sale of a portfolio-eligible security by the Fund, coupled with its agreement to repurchase the instrument at a specified time and price. Under a reverse repurchase agreement, the Fund continues to receive any principal and interest payments on the underlying security during the term of the agreement. Reverse repurchase agreements involve leverage risk and the risk that the market value of securities retained by the Fund may decline below the repurchase price of the securities sold by the Fund which it is obligated to repurchase. The Fund may (but is not required to) segregate assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, equal (on a daily mark-to-market basis) to its obligations under reverse repurchase agreements. To the extent that positions in reverse repurchase agreements are not so covered, such transactions would be subject to the Fund's limitations on borrowings, which would, among other things, restrict the aggregate of such transactions (plus any other borrowings) to one-third of the Fund's total assets.

The Fund also may effect simultaneous purchase and sale transactions that are known as sale-buybacks. A sale-buyback is similar to a reverse repurchase agreement, except that in a sale-buyback, the counterparty who purchases the security is entitled to receive any principal or interest payments made on the underlying security pending settlement of the Fund's repurchase of the underlying security.

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### **Mortgage Dollar Rolls**

A mortgage dollar roll is similar to a reverse repurchase agreement in certain respects. In a dollar roll transaction, the Fund sells a mortgage-related security, such as a security issued by GNMA, to a dealer and simultaneously agrees to repurchase a similar security (but not the same security) in the future at a pre-determined price. A dollar roll can be viewed, like a reverse repurchase agreement, as a collateralized borrowing in which the Fund pledges a mortgage-related security to a dealer to obtain cash. However, unlike reverse repurchase agreements, the dealer with which the Fund enters into a dollar roll transaction is not obligated to return the same securities as those originally sold by the Fund, but only securities which are substantially identical. To be considered substantially identical, the securities returned to the Fund generally must: (1) be collateralized by the same types of underlying mortgages; (2) be issued by the same agency and be part of the same program; (3) have a similar original stated maturity; (4) have identical net coupon rates; (5) have similar market yields (and therefore price); and (6) satisfy good delivery requirements, meaning that the aggregate principal amounts of the securities delivered and received back must be within 2.5% of the initial amount delivered.

As with reverse repurchase agreements, to the extent that positions in dollar roll agreements are not covered by segregated liquid assets at least equal to the amount of any forward purchase commitment, such transactions would be subject to the Fund's restrictions on borrowings. Furthermore, because dollar roll transactions may be for terms ranging between one and six months, dollar roll transactions may be deemed illiquid.

### **Repurchase Agreements**

The Fund may enter into repurchase agreements with domestic commercial banks or registered broker/dealers. A repurchase agreement is a contract under which the Fund would acquire a security for a relatively short period (usually not more than one week) subject to the obligation of the seller to repurchase and the Fund to resell such security at a fixed time and price (representing the Fund's cost plus interest). In the case of repurchase agreements with broker-dealers, the value of the underlying securities (or collateral) will be at least equal at all times to the total amount of the repurchase obligation, including the interest factor. The Fund bears a risk of loss in the event that the other party to a repurchase agreement defaults on its obligations and the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities. This risk includes the risk of procedural costs or delays in addition to a loss on the securities if their value should fall below their repurchase price. PIMCO will monitor the creditworthiness of the counterparties.

### **When-Issued, Delayed Delivery and Forward Commitment Transactions**

The Fund may purchase or sell securities on a when-issued, delayed delivery, or forward commitment basis. When such purchases are outstanding, the Fund will segregate until the settlement date assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in an amount sufficient to meet the purchase price. Typically, no income accrues on securities the Fund has committed to purchase prior to the time delivery of the securities is made, although the Fund may earn income on securities it has segregated.

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When purchasing a security on a when-issued, delayed delivery, or forward commitment basis, the Fund assumes the rights and risks of ownership of the security, including the risk of price and yield fluctuations, and takes such fluctuations into account when determining its net asset value. Because the Fund is not required to pay for the security until the delivery date, these risks are in addition to the risks associated with the Fund's other investments. If the other party to a transaction fails to deliver the securities, the Fund could miss a favorable price or yield opportunity. If the Fund remains substantially fully invested at a time when when-issued, delayed delivery, or forward commitment purchases are outstanding, the purchases may result in a form of leverage.

When the Fund has sold a security on a when-issued, delayed delivery, or forward commitment basis, the Fund does not participate in future gains or losses with respect to the security. If the other party to a transaction fails to pay for the securities, the Fund could suffer a loss. Additionally, when selling a security on a when-issued, delayed delivery, or forward commitment basis without owning the security, the Fund will incur a loss if the security's price appreciates in value such that the security's price is above the agreed upon price on the settlement date.

The Fund may dispose of or renegotiate a transaction after it is entered into, and may sell when-issued, delayed delivery or forward commitment securities before the settlement date, which may result in a capital gain or loss. There is no percentage limitation on the extent to which the Fund may purchase or sell securities on a when-issued, delayed delivery, or forward commitment basis.

## **Borrowing**

The Fund may borrow money to the extent permitted under the 1940 Act as interpreted, modified or otherwise permitted by regulatory authority having jurisdiction, from time to time. The Fund may from time to time borrow money to add leverage to the portfolio. The Fund may also borrow money for temporary administrative purposes.

Under the 1940 Act, the Fund is not permitted to issue preferred shares unless immediately after such issuance the value of the Fund's total net assets is at least 200% of the liquidation value of the Fund's currently outstanding auction market preferred shares (the Preferred Shares) and the newly issued preferred shares plus the aggregate amount of any senior securities of the Fund representing indebtedness (*i.e.*, such liquidation value plus the aggregate amount of senior securities representing indebtedness may not exceed 50% of the Fund's total net assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on its common shares unless, at the time of such declaration, the value of the Fund's total net assets satisfies the above-referenced 200% coverage requirement.

The 1940 Act also generally prohibits the Fund from engaging in most forms of leverage other than preferred shares (including through the use of reverse repurchase agreements, dollar rolls, bank loans, commercial paper or other credit facilities, credit default swap contracts and other

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derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions, to the extent that these instruments are not covered as described below) unless immediately after the issuance of the leverage the Fund has satisfied the asset coverage test with respect to senior securities representing indebtedness prescribed by the 1940 Act, *i.e.*, the value of the Fund's total assets less liabilities (other than the leverage and other senior securities) is at least 300% of the principal amount of such leverage (*i.e.*, effectively limiting the use of leverage through senior securities representing indebtedness to 33 1/3% of the Fund's total assets, including assets attributable to the leverage). The Fund is not permitted to declare any cash dividend or other distribution on common shares unless, at the time of such declaration, this 300% asset coverage test is satisfied. The Fund may (but is not required to) cover its commitments under these instruments by the segregation of liquid assets or by entering into offsetting transactions or owning positions covering its obligations. For instance, the Fund may cover its position in a reverse repurchase agreement by segregating liquid assets at least equal in amount to its forward purchase commitment. To the extent that certain of these instruments are so covered, they will not be considered senior securities under the 1940 Act and therefore will not be subject to the 300% asset coverage requirement otherwise applicable to forms of leverage (other than preferred shares) used by the Fund. However, these transactions, even if covered, may represent a form of economic leverage and create special risks. The use of these forms of additional leverage increases the volatility of the Fund's investment portfolio and could result in larger losses to Common Shareholders than if the strategies were not used. Failure to maintain certain asset coverage requirements could result in an event of default under certain Borrowings that may be used by the Fund. As discussed further under Description of Shares Auction Market Preferred Shares, failure to maintain certain asset coverage requirements could result in an event of default and entitle the holders of Preferred Shares (the Preferred Shareholders) and holders of any other senior securities of the Fund to elect a majority of the Trustees of the Fund.

The Fund may also enter into transactions other than those noted above that may give rise to a form of leverage including, among others, credit default swap contracts, futures and forward contracts and other derivative transactions, loans of portfolio securities, short sales and when-issued, delayed delivery and forward commitment transactions. Although it has no current intention to do so, the Fund may also determine to issue other preferred shares to add leverage to its portfolio. See Principal risks of the Fund Leverage Risk in the Prospectus.

As described above, the Fund will, under certain circumstances, cover its commitment under these instruments by the segregation of assets determined to be liquid by PIMCO in accordance with procedures adopted by the Trustees, equal in value to the amount of the Fund's commitment, or by entering into offsetting transactions or owning positions covering its obligations. In such cases, the instruments will not be considered senior securities under the 1940 Act for purposes of the asset coverage requirements otherwise applicable to borrowings by the Fund or the Fund's issuance of Preferred Shares. Borrowing will tend to exaggerate the effect on net asset value of any increase or decrease in the market value of the Fund's portfolio. Money borrowed will be subject to interest costs which may or may not be recovered by appreciation of the securities purchased. The Fund also may be required to maintain minimum average balances in connection with such borrowing or to pay a commitment or other fee to maintain a line of credit; either of these requirements would increase the cost of borrowing over the stated interest rate.

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### **Short Sales**

The Fund may make short sales of securities as part of its overall portfolio management strategies involving the use of derivative instruments and to offset potential declines in long positions in similar securities. A short sale is a transaction in which the Fund sells a security it does not own in anticipation that the market price of that security will decline.

When the Fund makes a short sale, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The Fund may have to pay a fee to borrow particular securities and is often obligated to pay over any accrued interest and dividends on such borrowed securities.

If the price of the security sold short increases between the time of the short sale and the time that the Fund replaces the borrowed security, the Fund will incur a loss; conversely, if the price declines, the Fund will realize a capital gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. The successful use of short selling may be adversely affected by imperfect correlation between movements in the price of the security sold short and the securities being hedged.

To the extent the Fund engages in short sales, it will provide collateral to the broker-dealer and (except in the case of short sales against the box) will maintain additional asset coverage in the form of segregated or earmarked assets that PIMCO determines to be liquid in accordance with procedures established by the Board of Trustees and that is equal to the current market value of the securities sold short, or will ensure that such positions are covered by offsetting positions, until the Fund replaces the borrowed security. A short sale is against the box to the extent that the Fund contemporaneously owns, or has the right to obtain at no added cost, securities identical to those sold short. The Fund will engage in short selling to the extent permitted by the federal securities laws and rules and interpretations thereunder. To the extent the Fund engages in short selling in foreign (non-U.S.) jurisdictions, the Fund will do so to the extent permitted by the laws and regulations of such jurisdiction.

### **Illiquid Securities**

The Fund may invest without limit in illiquid securities (determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, that is, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities are considered to include, among other things, written over-the-counter options, securities or other liquid assets being used as cover for such options, repurchase agreements with maturities in excess of seven days, certain loan participation interests, fixed time deposits which are not subject to prepayment or provide for withdrawal penalties upon prepayment (other than overnight deposits), and other securities whose disposition is restricted under the federal

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securities laws (other than securities issued pursuant to Rule 144A under the 1933 Act and certain commercial paper that PIMCO has determined to be liquid under procedures approved by the Board of Trustees). PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

Illiquid securities may include privately placed securities, which are sold directly to a small number of investors, usually institutions. Unlike public offerings, such securities are not registered under the federal securities laws. Although certain of these securities may be readily sold, others may be illiquid, and their sale may involve substantial delays and additional costs.

### **Portfolio Trading and Turnover Rate**

Portfolio trading may be undertaken to accomplish the investment objective of the Fund. In addition, a security may be sold and another of comparable quality purchased at approximately the same time to take advantage of what PIMCO believes to be a temporary price disparity between the two securities. Temporary price disparities between two comparable securities may result from supply and demand imbalances where, for example, a temporary oversupply of certain bonds may cause a temporarily low price for such bonds, as compared with other bonds of like quality and characteristics. The Fund may also engage in short-term trading consistent with its investment objective. Securities may be sold in anticipation of a market decline or purchased in anticipation of a market rise and later sold, or to recognize a gain.

A change in the securities held by the Fund is known as portfolio turnover. PIMCO manages the Fund without regard generally to restrictions on portfolio turnover. The use of certain derivative instruments with relatively short maturities may tend to exaggerate the portfolio turnover rate for the Fund. Trading in debt obligations does not generally involve the payment of brokerage commissions, but does involve indirect transaction costs. The use of futures contracts may involve the payment of commissions to futures commission merchants. High portfolio turnover (*e.g.*, greater than 100%) involves correspondingly greater expenses to the Fund, including brokerage commissions or dealer mark-ups and other transaction costs on the sale of securities and reinvestments in other securities. The higher the rate of portfolio turnover of the Fund, the higher these transaction costs borne by the Fund generally will be. Transactions in the Fund's portfolio securities may result in realization of taxable capital gains (including short-term capital gains, distributions of which are generally taxed to shareholders at ordinary income tax rates). The trading costs and tax effects associated with portfolio turnover may adversely affect the Fund's performance.

The portfolio turnover rate of the Fund is calculated by dividing (a) the lesser of purchases or sales of portfolio securities for the particular fiscal year by (b) the monthly average of the value of the portfolio securities owned by the Fund during the particular fiscal year. In calculating the rate of portfolio turnover, there is excluded from both (a) and (b) all securities, including options, whose maturities or expiration dates at the time of acquisition were one year or less.

For the fiscal year ended July 31, 2008, the Fund's portfolio turnover rate was 31%. For the fiscal year ended July 31, 2009, the Fund's portfolio turnover rate was 98%. This increase was a result of [ ].

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### **Warrants to Purchase Securities**

The Fund may invest in warrants to purchase debt securities. Debt obligations with warrants attached to purchase equity securities have many characteristics of convertible bonds and their prices may, to some degree, reflect the performance of the underlying stock. Debt obligations also may be issued with warrants attached to purchase additional debt securities at the same coupon rate. A decline in interest rates would permit the Fund to buy additional bonds at the favorable rate or to sell the warrants at a profit. If interest rates rise, the warrants would generally expire with no value.

### **Other Investment Companies**

The Fund may invest in securities of open- or closed-end investment companies, including exchange-traded funds ( ETFs ), to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act.

In general, under the 1940 Act, an investment company such as the Fund may not (i) own more than 3% of the outstanding voting securities of any one registered investment company, (ii) invest more than 5% of its total assets in the securities of any single registered investment company or (iii) invest more than 10% of its total assets in securities of other registered investment companies.

The Fund may invest in other investment companies either during periods when it has large amounts of uninvested cash, such as the period shortly after the Fund receives the proceeds of an offering, during periods when there is a shortage of attractive variable rate and other debt instruments available in the market, or when PIMCO believes share prices of other investment companies offer attractive values. The Fund may invest in investment companies that are advised by PIMCO or its affiliates to the extent permitted by applicable law and/or pursuant to exemptive relief from the SEC.

As a shareholder in an investment company, the Fund will bear its ratable share of that investment company's expenses and would remain subject to payment of the Fund's management fees with respect to assets so invested. Holders of the Common Shares would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. PIMCO will take expenses into account when evaluating the investment merits of an investment in an investment company relative to available debt instruments. In addition, the securities of other investment companies may also be leveraged and will therefore be subject to the same leverage risks described in the Prospectus and herein. As described in the Prospectus in the section entitled "Principal Risks of the Fund - Leverage Risk," the net asset value and market value of leveraged shares will be more volatile and the yield to shareholders will tend to fluctuate more than the yield generated by unleveraged shares.



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### **Securities Loans**

Subject to the Fund's Investment Restrictions listed below, the Fund may make secured loans of its portfolio securities to brokers, dealers and other financial institutions amounting to no more than one-third of its total assets. The risks in lending portfolio securities, as with other extensions of credit, consist of possible delay in recovery of the securities or possible loss of rights in the collateral should the borrower fail financially. However, such loans will be made only to broker-dealers that are believed by PIMCO to be of relatively high credit standing. Securities loans are made to broker-dealers pursuant to agreements requiring that loans be continuously secured by collateral consisting of U.S. Government securities, cash or cash equivalents (negotiable certificates of deposit, bankers' acceptances or letters of credit) maintained on a daily mark-to-market basis in an amount at least equal at all times to the market value of the securities lent. The borrower pays to the Fund, as the lender, an amount equal to any dividends or interest received on the securities lent. The Fund may invest only the cash collateral received in interest-bearing, short-term securities or receive a fee from the borrower. In the case of cash collateral, the Fund typically pays a rebate to the lender. Although voting rights or rights to consent with respect to the loaned securities pass to the borrower, the Fund, as the lender, retains the right to call the loans and obtain the return of the securities loaned at any time on reasonable notice, and it will do so in order that the securities may be voted by the Fund if the holders of such securities are asked to vote upon or consent to matters materially affecting the investment. The Fund may also call such loans in order to sell the securities involved. When engaged in securities lending, the Fund's performance will continue to reflect changes in the value of the securities loaned and will also reflect the receipt of either interest, through investment of cash collateral by the Fund in permissible investments, or a fee, if the collateral is U.S. Government securities.

### **Participation on Creditors Committees**

The Fund may from time to time participate on committees formed by creditors to negotiate with the management of financially troubled issuers of securities held by the Fund. Such participation may subject the Fund to expenses such as legal fees and may make the Fund an insider of the issuer for purposes of the federal securities laws, and therefore may restrict the Fund's ability to trade in or acquire additional positions in a particular security when it might otherwise desire to do so. Participation by the Fund on such committees also may expose the Fund to potential liabilities under the federal bankruptcy laws or other laws governing the rights of creditors and debtors. The Fund would participate on such committees only when PIMCO believes that such participation is necessary or desirable to enforce the Fund's rights as a creditor or to protect the value of securities held by the Fund.

### **Short-Term Investments / Temporary Defensive Strategies**

Upon PIMCO's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, including the period during which the net proceeds of the offering are being invested, the Fund may invest up to 100% of its net assets in investment grade debt securities, including high quality, short-term debt instruments, credit-linked trust certificates and/or index futures contracts or similar derivative instruments. Such investments may prevent the Fund from achieving its investment objective.

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### **Government Intervention in Financial Markets**

Recent instability in the financial markets has led the U.S. Government to take a number of unprecedented actions designed to support certain financial institutions and segments of the financial markets that have experienced extreme volatility, and in some cases a lack of liquidity. Federal, state, and other governments, their regulatory agencies, or self regulatory organizations may take actions that affect the regulation of the instruments in which the Fund invests, or the issuers of such instruments, in ways that are unforeseeable. Legislation or regulation may also change the way in which the Fund itself is regulated. Such legislation or regulation could limit or preclude the Fund's ability to achieve its investment objective.

Governments or their agencies may also acquire distressed assets from financial institutions and acquire ownership interests in those institutions. The implications of government ownership and disposition of these assets are unclear, and such a program may have positive or negative effects on the liquidity, valuation and performance of the Fund's portfolio holdings. Furthermore, volatile financial markets can expose the Fund to greater market and liquidity risk and potential difficulty in valuing portfolio instruments held by the Fund. The Fund has established procedures to assess the liquidity of portfolio holdings and to value instruments for which market prices may not be readily available. PIMCO will monitor developments and seek to manage the Fund in a manner consistent with achieving the Fund's investment objective, but there can be no assurance that it will be successful in doing so.

### **INVESTMENT RESTRICTIONS**

Except as described below, the Fund, as a fundamental policy, may not, without the approval of the holders of a majority of the outstanding Common Shares and any outstanding preferred shares of beneficial interest (including Preferred Shares) voting together as a single class, and of the holders of a majority of any outstanding preferred shares of beneficial interest (including Preferred Shares) voting as a separate class:

- (1) Concentrate its investments in a particular industry, as that term is used in the 1940 Act, and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
- (2) With respect to 75% of the Fund's total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities issued by other investment companies, if, as a result, (i) more than 5% of the Fund's total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer.
- (3) Purchase or sell real estate, although it may purchase securities secured by real estate or interests therein, or securities issued by companies which invest in real estate, or interests therein.

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- (4) Purchase or sell commodities or commodities contracts or oil, gas or mineral programs. This restriction shall not prohibit the Fund, subject to restrictions described in the Prospectus and elsewhere in this Statement of Additional Information, from purchasing, selling or entering into futures contracts, options on futures contracts, forward contracts, or any interest rate, securities-related or other hedging instrument, including swap agreements and other derivative instruments, subject to compliance with any applicable provisions of the federal securities or commodities laws.
- (5) Borrow money or issue any senior security, except to the extent permitted under the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
- (6) Make loans, except to the extent permitted under the 1940 Act, and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
- (7) Act as an underwriter of securities of other issuers, except to the extent that in connection with the disposition of portfolio securities, it may be deemed to be an underwriter under the federal securities laws.

Currently, under the 1940 Act, the Fund generally is not permitted to engage in borrowings unless immediately after a borrowing the value of the Fund's total assets less liabilities (other than the borrowing) is at least 300% of the principal amount of such borrowing (*i.e.*, such principal amount may not exceed 33 1/3% of the Fund's total assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on Common Shares unless, at the time of such declaration, the value of the Fund's total assets, less liabilities other than the borrowing, is at least 300% of such principal amount.

Currently, under the 1940 Act, the Fund may generally not lend money or property to any person, directly or indirectly, if such person controls or is under common control with the Fund, except for a loan from the Fund to a company which owns all of the outstanding securities of the Fund, except directors' and qualifying shares.

For purposes of the foregoing, majority of the outstanding, when used with respect to particular shares of the Fund (whether voting together as a single class or voting as separate classes), means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of such shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

Unless otherwise indicated, all limitations applicable to the Fund's investments (as stated above and elsewhere in this Statement of Additional Information) apply only at the time a transaction is entered into. Any subsequent change in a rating assigned by any rating service to a security (or, if unrated, deemed by PIMCO to be of comparable quality), or change in the percentage of the Fund's total assets invested in certain securities or other instruments, or change in the average maturity or duration of the Fund's investment portfolio, resulting from market fluctuations or

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other changes in the Fund's total assets, will not require the Fund to dispose of an investment until PIMCO determines that it is practicable to sell or close out the investment without undue market or tax consequences to the Fund. In the event that rating agencies assign different ratings to the same security, PIMCO will determine which rating it believes best reflects the security's quality and risk at that time, which may be the higher of the several assigned ratings.

Under the 1940 Act, a senior security does not include any promissory note or evidence of indebtedness where such loan is for temporary purposes only and in an amount not exceeding 5% of the value of the total assets of the issuer at the time the loan is made. A loan is presumed to be for temporary purposes if it is repaid within sixty days and is not extended or renewed.

The Fund would be deemed to concentrate its investments in a particular industry if it invested more than 25% of its total assets in that industry. The Fund's industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities). The Fund interprets its industry concentration policy to apply to direct investments in the securities of issuers in a particular industry, as defined by the Fund. For purposes of this restriction, a foreign government is considered to be an industry. Currency positions are not considered to be an investment in a foreign government for industry concentration purposes. Mortgage-backed securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities are not subject to the Fund's industry concentration restrictions, by virtue of the exclusion from that test available to all U.S. Government securities. Similarly, municipal bonds issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies and authorities are not subject to the Fund's industry concentration restrictions. In the case of privately issued mortgage-related securities, or any asset-backed securities, the Fund takes the position that such securities do not represent interests in any particular industry or group of industries.

To the extent the Fund covers its commitment under a reverse repurchase agreement, credit default swap or other derivative instrument by the segregation of assets determined by PIMCO to be liquid in accordance with procedures adopted by the Trustees, equal in value to the amount of the Fund's commitment, such instrument will not be considered a senior security for purposes of the asset coverage requirements otherwise applicable to borrowings by the Fund or the Fund's issuance of Preferred Shares.

The Fund interprets its policies with respect to borrowing and lending to permit such activities as may be lawful for the Fund, to the full extent permitted by the 1940 Act or by exemption from the provisions thereof pursuant to exemptive order of the SEC.

The Fund is subject to additional guidelines in order to obtain and maintain ratings on the Preferred Shares of Aaa from Moody's and AAA from Fitch and may become subject to additional guidelines in the future.

**Table of Contents****MANAGEMENT OF THE FUND****Trustees and Officers**

The business of the Fund is managed under the direction of the Fund's Board of Trustees. Subject to the provisions of the Fund's Amended and Restated Agreement and Declaration of Trust (the Declaration), its Third Amended and Restated Bylaws (the Bylaws) and Massachusetts law, the Trustees have all powers necessary and convenient to carry out this responsibility, including the election and removal of the Fund's officers. The Trustees and officers of the Fund, their ages, the position they hold with the Fund, their term of office and length of time served, a description of their principal occupations during the past five years, the number of portfolios in the fund complex (as defined in SEC regulations) that the Trustee oversees and any other directorships held by the Trustee are listed in the two tables immediately following. Except as shown, each Trustee's and officer's principal occupation and business experience for the last five years have been with the employer(s) indicated, although in some cases the Trustee may have held different positions with such employer(s). Unless otherwise indicated, the business address of the persons listed below is c/o Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105.

**Independent Trustees<sup>(1)</sup>**

| Name,             |   |                                  |  | Number of              |                                      |
|-------------------|---|----------------------------------|--|------------------------|--------------------------------------|
| Address and       |   | Term of Office                   | Principal Occupation(s)  | Portfolios             | Other                                |
| Date of Birth     | Position(s) Held                        | and Length of                    | During the Past 5 Years  | in Fund                | Directorships                        |
|                   | with the Fund                           | Time Served                      |  | Complex <sup>(2)</sup> | Held by Trustee                      |
| Paul Belica       | Trustee                                 | Since inception<br>(August 2003) | Retired. Formerly Director, Student Loan Finance Corp., Education Loans, Inc., Goal Funding, Inc., Goal Funding II, Inc. and Surety Loan Fund, Inc.; and formerly, Manager of Stratigos Fund LLC, Whistler Fund LLC, Xanthus Fund LLC & Wynstone Fund LLC. | 49                     | None.                                |
| Robert E. Connor  | Trustee                                 | Since inception<br>(August 2003) | Corporate Affairs Consultant. Formerly, Senior Vice President, Corporate Office, Smith Barney Inc.   | 49                     | None.                                |
| James A. Jacobson | Trustee                                 | Since<br>December 2009           | Retired. Formerly, Vice Chairman, Managing Director, Spear, Leeds & Kellogg Specialists, LLC, specialist firm on NYSE (2003-2008).   | 44                     | Trustee, Alpine Mutual Fund complex. |
| Hans W. Kertess   | Trustee and<br>Chairman of the<br>Board | Since inception<br>(August 2003) | President, H. Kertess & Co., a financial advisory company; formerly, Managing Director, Royal Bank of Canada Capital Markets.  | 49                     | None.                                |

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| Name,                             |                                |  | Principal Occupation(s)   | Number of Portfolios in Fund Complex <sup>(2)</sup> | Other Directorships Held by Trustee |
|-----------------------------------|--------------------------------|--|---|---|-------------------------------------|
| Address and Date of Birth         | Position(s) Held with the Fund | Term of Office and Length of Time Served | During the Past 5 Years   | Overseen by Trustee                                 |                                     |
| William B. Ogden, IV<br>1/11/1945 | Trustee                        | Since September 2006                     | Asset Management Industry Consultant. Formerly, Managing Director, Investment Banking Division of Citigroup Global Markets Inc. | 49  | None.                               |
| R. Peter Sullivan III             | Trustee                        | Since September 2004                     | Retired. Formerly, Managing Partner, Bear Wagner Specialists LLC, specialist firm on the New York Stock Exchange.               | 49  | None.                               |

**Interested Trustee<sup>(3)</sup>**

| Name,                     |                                |  | Principal Occupation(s)   | Number of Portfolios in Fund Complex <sup>(2)</sup> | Other Directorships Held by Trustee |
|---------------------------|--------------------------------|--|---|---|-------------------------------------|
| Address and Date of Birth | Position(s) Held with the Fund | Term of Office and Length of Time Served | During the Past 5 Years   | Overseen by Trustee                                 |                                     |
| John C. Maney<br>8/3/1959 | Trustee                        | Since December 2006                      | Management Board of Allianz Global Investors Fund Management LLC; Management Board and Managing Director of Allianz Global Investors of America L.P. since January 2005 and also Chief Operating Officer of Allianz Global Investors of America L.P. since November 2006. | 78  | None.                               |

(1) Independent Trustees are those Trustees who are not interested persons (as defined in Section 2(a)(19) of the 1940 Act).

(2) The term Fund Complex as used herein includes the Fund and the following registered investment companies: each series of Allianz Funds, each series of Allianz Funds Multi-Strategy Trust, each series of PIMCO Funds, each series of Nicholas-Applegate Institutional Funds, PIMCO Global Advisors (Ireland) Limited, PIMCO Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund, PIMCO California Municipal Income Fund II, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund, PIMCO New York Municipal Income Fund II, PIMCO New York Municipal Income Fund III, PIMCO Corporate Income Fund, PIMCO Corporate Opportunity Fund, PIMCO High Income Fund, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO [Income Strategy] Fund II, NFJ Dividend, Interest and Premium Strategy Fund, Nicholas-Applegate International and Premium Strategy Fund, PIMCO Global StocksPLUS & Income Fund, Nicholas-Applegate Equity & Convertible Income Fund, Nicholas-Applegate Global Equity & Convertible Income Fund, PIMCO Income Opportunity Fund, PCM Fund Inc., PIMCO Strategic Global Government Fund Inc., each series of Premier VIT, PIMCO Private Account Portfolio Series, each series of Allianz Global Investors Managed Accounts Trust, each series of OCC Cash Reserves, Inc., each series of OCC Accumulation Trust, each series of USAllianz Variable Insurance Products Trust and registered investment companies advised by RCM Capital Management LLC and Nicholas-Applegate Capital Management LLC.

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- (3) An Interested Trustee is a Trustee who is an interested person (as defined above) of the Fund. Mr. Maney is an interested person of the Fund due to his affiliation with Allianz Global Investors of America L.P. In addition to Mr. Maney's positions set forth in the table above, he holds the following positions with affiliated persons: Management Board, Managing Director and Chief Operating Officer of Allianz Global Investors of America L.P., Allianz Global Investors of America LLC and Allianz-Pac Life Partners LLC; Member Board of Directors and Chief Operating Officer of Allianz Global Investors of America Holdings Inc. and Oppenheimer Group, Inc.; Managing Director and Chief Operating Officer of Allianz Global Investors NY Holdings LLC; Management Board and Managing Director of Allianz Global Investors U.S. Holding LLC; Managing Director and Chief Operating Officer of Allianz Hedge Fund Partners Holding L.P. and Allianz Global Investors U.S. Retail LLC; Member Board of Directors and Managing Director of Allianz Global Investors Advertising Agency Inc.; Compensation Committee of NFJ Investment Group LLC; Management Board of Allianz Global Investors Fund Management LLC, Allianz Global Investors Managed Partners LLC, Nicholas-Applegate Holdings LLC and OpCap Advisors LLC; Member Board of Directors and Chief Operating Officer of PIMCO Global Advisors (Resources) Limited; Executive Vice President of PIMCO Japan Ltd.; Chief Operating Officer of Allianz Global Investors U.S. Holding II LLC; and Member and Chairman Board of Directors, President and Chief Operating Officer of PFP Holdings, Inc.

In accordance with the Fund's staggered board (see Anti-Takeover and Other Provisions in the Declaration of Trust ), the Common Shareholders of the Fund elect Trustees to fill the vacancies of Trustees whose terms expire at each annual meeting of Common Shareholders. So long as any Preferred Shares or any other preferred shares of beneficial interest are outstanding Preferred Shareholders and holders of any other preferred shares outstanding, voting as a separate class, will elect two Trustees and the remaining Trustees will be elected by Common Shareholders and Preferred Shareholders and holders of any other preferred shares outstanding, voting together as a single class. Preferred Shareholders and holders of any other preferred shares outstanding are entitled to elect a majority of the Fund's Trustees under certain circumstances.

**Officers**

| <b>Name, Address and Date of Birth</b> | <b>Position(s) Held with the Fund</b>                 | <b>Term of Office and Length of Time Served</b> | <b>Principal Occupation(s) During the Past 5 Years</b>  |
|--|---|---|---|
| Brian S. Shlissel<br>11/14/1964        | President & Chief Executive Officer                   | Since inception<br>(August 2003)                | Executive Vice President, Director of Fund Administration, Allianz Global Investors Fund Management LLC; President and Chief Executive Officer of [ ] funds in the Fund Complex; Treasurer, Principal Financial and Accounting Officer of [ ] funds in the Fund Complex and The Korea Fund, Inc. Formerly, Director of [ ] funds in the Fund Complex (2002-2008). |
| Lawrence G. Altadonna<br>3/10/1966     | Treasurer, Principal Financial and Accounting Officer | Since inception<br>(August 2003)                | Senior Vice President, Allianz Global Investors Fund Management LLC; Treasurer, Principal Financial and Accounting Officer of [ ] funds in the Fund Complex; Assistant Treasurer of [ ] funds in the Fund Complex and The Korea Fund, Inc.  |

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| <b>Name, Address and Date of Birth</b>  | <b>Position(s) Held with the Fund</b>             | <b>Term of Office and Length of Time Served</b> | <b>Principal Occupation(s) During the Past 5 Years</b>  |
|---|---|---|---|
| Thomas J. Fuccillo<br>3/22/1968   | Vice President, Secretary and Chief Legal Officer | Since December 2004                             | Executive Vice President, Chief Legal Officer and Secretary of Allianz Global Investors Fund Management LLC and Allianz Global Investors Solutions LLC; Executive Vice President of Allianz Global Investors of America L.P.; Vice President, Secretary and Chief Legal Officer of [ ] funds in the Fund Complex; Secretary and Chief Legal Officer of The Korea Fund, Inc. Formerly, Vice President and Associate General Counsel, Neuberger Berman, LLC, 1991-2004. |
| Youse Guia<br>680 Newport Center Drive Suite 250<br>Newport Beach, CA 92660<br>9/3/1972 | Chief Compliance Officer                          | Since October 2004                              | Senior Vice President and Chief Compliance Officer of Allianz Global Investors of America L.P.; Chief Compliance Officer of [ ] funds in the Fund Complex and The Korea Fund, Inc. Formerly, Vice President, Group Compliance Manager, Allianz Global Investors of America L.P., 2002-2004.   |
| Scott Whisten<br>3/13/1971  | Assistant Treasurer                               | Since January 2007                              | Vice President, Allianz Global Investors Fund Management LLC; Assistant Treasurer of [ ] funds in the Fund Complex. Formerly, Accounting Manager, Prudential Investments, 2000-2005.  |
| Richard J. Cochran<br>1/23/1961   | Assistant Treasurer                               | Since May 2008                                  | Vice President, Allianz Global Investors Fund Management LLC; Assistant Treasurer of [ ] funds in the Fund Complex; formerly, Tax manager, Teachers Insurance Annuity Association/College Retirement Equity Fund (TIAA-CREF) (2002-2008).   |
| Kathleen A. Chapman<br>11/11/1954   | Assistant Secretary                               | Since December 2006                             | Assistant Secretary of [ ] funds in the Fund Complex. Formerly, Manager Individual Investor Group Advisory Law, Morgan Stanley (2004-2005); Paralegal and Assistant Corporate Secretary, Prudential Financial, Inc. (formerly American Skandia, Inc.) (1996-2004).  |
| Lagan Srivastava  | Assistant Secretary                               | Since December 2006                             | Assistant Secretary of [ ] funds in the Fund Complex and The Korea Fund, Inc. Formerly, Research Assistant, Dechert LLP, 2004-2005; Research Assistant, Swidler Berlin Shereff Friedman LLP, 2002-2004.   |

**Additional Information About Board Leadership Structure and Trustee Qualifications**

[To be inserted by amendment]

**Committees of the Board of Trustees**

**Audit Oversight Committee.** The Audit Oversight Committee provides oversight with respect to the internal and external accounting and auditing procedures of the Fund and, among other things, considers the selection of independent public accountants for the Fund and the scope of the audit, approves all audit and permitted non-audit services proposed to be performed by those auditors on behalf of the Fund and certain affiliates, including the Investment Manager and



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PIMCO, and the possible effect of those services on the independence of those auditors. Messrs. Belica, Connor, Jacobson, Kertess, Ogden and Sullivan, each of whom is an Independent Trustee, serve on this committee. During the fiscal year ended July 31, 2009 the Audit Oversight Committee met [ ] times.

**Nominating Committee.** The Nominating Committee is responsible for reviewing and recommending qualified candidates to the Board in the event that a position is vacated or created. The Nominating Committee will review and consider nominees recommended by shareholders to serve as Trustee, provided any such recommendation is submitted in writing to the Fund, c/o Thomas J. Fuccillo, Secretary, at the address of the principal executive offices of the Fund. The Nominating Committee has full discretion to reject nominees recommended by shareholders, and there is no assurance that any such person so recommended and considered by a committee will be nominated for election to the Board. Messrs. Belica, Connor, Jacobson, Kertess, Ogden and Sullivan, each of whom is an Independent Trustee, serve on this committee. During the fiscal year ended July 31, 2009 the Nominating Committee met [ ] times.

**Valuation Committee.** The Valuation Committee reviews procedures for the valuation of securities and periodically reviews information from the Investment Manager and PIMCO regarding fair value and liquidity determination made pursuant to the Board-approved procedures, and makes related recommendations to the full Board and assists the full Board in resolving particular valuation matters. Messrs. Belica, Connor, Jacobson, Kertess, Ogden and Sullivan, each of whom is an Independent Trustee, serve on this committee. During the fiscal year ended July 31, 2009 the Valuation Committee met [ ] times.

**Compensation Committee.** The Compensation Committee periodically reviews and sets compensation payable to the Trustees of the Fund who are not directors, officers, partners or employees of the Investment Manager, PIMCO or any entity controlling, controlled by or under common control with the Investment Manager or PIMCO. Messrs. Belica, Connor, Jacobson, Kertess, Ogden and Sullivan, each of whom is an Independent Trustee, serve on this committee. During the fiscal year ended July 31, 2009 the Compensation Committee met [ ] times.

**Securities Ownership**

For each Trustee, the following table discloses the dollar range of equity securities beneficially owned by the Trustee in the Fund and, on an aggregate basis, in any registered investment companies overseen by the Trustee within the Fund's family of investment companies as of December 31, 2009:

| Name of Trustee             | Aggregate Dollar Range of Equity Securities in |   |
|-----------------------------|--|---|
|                             | Dollar Range of Equity Securities in the Fund  | All Registered Investment Companies Overseen by Trustee in Family of Investment Companies |
| <b>Independent Trustees</b> |  |   |
| Paul Belica                 | [ ]  | [ ]   |
| Robert E. Connor            | [ ]  | [ ]   |
| James A. Jacobson           | [ ]  | [ ]   |
| Hans W. Kertess             | [ ]  | [ ]   |
| William B. Ogden, IV        | [ ]  | [ ]   |
| R. Peter Sullivan III       | [ ]  | [ ]   |
| <b>Interested Trustee</b>   |  |   |
| John C. Maney               | [ ]  | [ ]   |

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\* The term "Family of Investment Companies" as used herein includes the Fund and the following registered investment companies: each series of Allianz Funds, each series of PIMCO Funds, each series of Allianz Funds Multi-Strategy Trust, PIMCO Global Advisors (Ireland) Limited, PIMCO Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund, PIMCO California Municipal Income Fund II, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund, PIMCO New York Municipal Income Fund II, PIMCO New York Municipal Income Fund III, PIMCO Corporate Income Fund, PIMCO Corporate Opportunity Fund, PIMCO High Income Fund, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO [Income Strategy] Fund II, NFJ Dividend, Interest and Premium Strategy Fund, Nicholas-Applegate International and Premium Strategy Fund, PIMCO Global StocksPLUS & Income Fund, Nicholas-Applegate Equity & Convertible Income Fund, Nicholas-Applegate Global Equity & Convertible Income Fund, PCM Fund Inc., PIMCO Income Opportunity Fund, each series of Premier VIT, PIMCO Strategic Global Government Fund, Inc., each series of PIMCO Funds: Global Investors Series plc, each series of PIMCO Private Account Portfolio Series and each series of Allianz Global Investors Managed Accounts Trust. [Description of Trustee Share Ownership Policy to be added by amendment.]

For Independent Trustees and their immediate family members, the following table provides information regarding each class of securities owned beneficially in an investment adviser or principal underwriter of the Fund, or a person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund as of December 31, 2009:

| Name of Owners<br>and Relations to |         |         |                |  | Value of Securities | Percent of Class |
|------------------------------------|---------|---------|----------------|--|---------------------|------------------|
| Name of Trustee                    | Trustee | Company | Title of Class |  |                     |                  |
| Paul Belica                        | [None.] |         |                |  |                     |                  |
| Robert E. Connor                   | [None.] |         |                |  |                     |                  |
| James A. Jacobson                  | [None.] |         |                |  |                     |                  |
| Hans W. Kertess                    | [None.] |         |                |  |                     |                  |
| William B. Ogden, IV               | [None.] |         |                |  |                     |                  |
| R. Peter Sullivan III              | [None.] |         |                |  |                     |                  |

[As of December 31, 2009, the Fund's officers and Trustees as a group owned less than 1% of the outstanding Common Shares.]

As of [ ], the following persons owned of record the number of shares of the noted class as set forth below, representing the indicated percentage of such class as of such date. Many of these shares are believed to be held only as nominee. To the knowledge of the Fund, no other person owned of record or beneficially 5% or more of any class of the Fund's outstanding equity securities on such date.

| Shareholder | Class | Number of Shares | Percentage of Class |
|-------------|-------|------------------|---------------------|
| [ ]         | [ ]   | [ ]              | [ ]                 |

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**Compensation**

Each of the Independent Trustees also serves as a trustee of NFJ Dividend, Interest & Premium Strategy Fund, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, Nicholas-Applegate Equity & Convertible Income Fund, Nicholas-Applegate Global Equity & Convertible Income Fund, Nicholas-Applegate International & Premium Strategy Fund, PCM Fund, Inc., PIMCO California Municipal Income, PIMCO California Municipal Income Fund II, PIMCO California Municipal Income Fund III, PIMCO Corporate Income Fund, PIMCO Corporate Opportunity Fund, PIMCO Floating Rate Strategy Fund, PIMCO Global StocksPLUS & Income Fund, PIMCO High Income Fund, PIMCO Income Opportunity Fund, PIMCO Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO New York Municipal Income Fund, PIMCO New York Municipal Income Fund II, PIMCO New York Municipal Income Fund III, and PIMCO Strategic Global Government Fund, each a closed-end fund for which the Investment Manager serves as investment manager and affiliates of the Investment Manager serve as sub-advisers (together, the Allianz Closed-End Funds ) and certain other open-end investment companies for which the Investment Manager serves as investment manager and administrator and affiliates of the Investment Manager serve as investment sub-advisers (together with the Allianz Closed-End Funds, the Allianz Managed Funds ). As indicated below, certain of the officers of the Fund are affiliated with the Investment Manager.

[Each of the Allianz Managed Funds are expected to hold joint meetings of their Boards of Trustees whenever possible. Each Trustee, other than any Trustee who is a director, officer, partner or employee of the Investment Manager, PIMCO, or any entity controlling, controlled by or under common control with the Investment Manager or PIMCO or receives annual compensation of \$[ ], which is payable quarterly. The Independent Chairman of the Boards receives an additional \$[ ] per year, payable quarterly. An Audit Oversight Committee Chairman annually receives an additional \$[ ], payable quarterly. Trustees will also be reimbursed for meeting-related expenses.

Each Trustee's compensation and other costs of joint meetings will be allocated pro rata among the Allianz Managed Funds for which such Trustee serves as Trustee based on the complexity of issues relating to each such Fund and relative time spent by the Trustees in addressing them, and secondarily, on each such Fund's relative net assets (including assets attributable to any outstanding preferred shares issued by an Allianz Closed-End Fund).

Trustees do not currently receive any pension or retirement benefits from the Fund or the Fund Complex.]

The following table provides information concerning the compensation paid to the Trustees for the fiscal year ended July 31, 2009. For the calendar year ended December 31, 2009, the Trustees received the compensation set forth in the table below for serving as trustees of the Fund and other funds in the same Fund Complex as the Fund. Each officer and each Trustee who is a director, officer, partner, member or employee of the Investment Manager or the Sub-Adviser, or of any entity controlling, controlled by or under common control with the Investment Manager or the Sub-Adviser including any Interested Trustee, serves without any compensation from the Fund.

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| Name of Trustee       | Aggregate             | Total Compensation from the Fund and |
|-----------------------|-----------------------|--------------------------------------|
|                       | Compensation from the | Fund Complex Paid to                 |
|                       | Fund for Fiscal       | Trustees for                         |
|                       | Year                  | Calendar Year-Ended                  |
|                       | Ended                 | December 31, 2009 <sup>(1)</sup>     |
|                       | July 31, 2009         |                                      |
| Paul Belica           | \$ 7,464              | \$ [ ]                               |
| Robert E. Connor      | \$ 6,554              | \$ [ ]                               |
| James A. Jacobson(2)  | \$ 0                  | \$ [ ]                               |
| Hans W. Kertess       | \$ 8,089              | \$ [ ]                               |
| William B. Ogden, IV  | \$ 6,554              | \$ [ ]                               |
| R. Peter Sullivan III | \$ 6,554              | \$ [ ]                               |
| Diana L. Taylor(3)    | \$ 6,554              | \$ [ ]                               |

- (1) In addition to the AGIFM Closed-End Funds, during the Fund's most recently completed fiscal year, the Trustees (except as noted) served as Trustees of two open-end investment companies (each consisting of separate investment portfolios) advised by the Investment Manager. These investment companies are considered to be in the same Fund Complex as the Fund.
- (2) Mr. Jacobson's appointment as a Trustee of the Fund was not effective until December 14, 2008. Mr. Jacobson serves as a Trustee to only one of the two open-end investment companies (each consisting of separate investment portfolios) advised by the Investment Manager, mentioned above.
- (3) Ms. Taylor resigned as Trustee on September 10, 2009. Until September 10, 2009, Ms. Taylor served as a Trustee to only one of the two open-end investment companies (each consisting of separate investment portfolios) advised by the Investment Manager, mentioned above.

**Codes of Ethics**

The Fund, the Investment Manager and PIMCO have each adopted a separate code of ethics governing personal trading activities of, as applicable, all Trustees and officers of the Fund, and directors, officers and employees of the Investment Manager and PIMCO, who, in connection with their regular functions, play a role in the recommendation of any purchase or sale of a security by the Fund or obtain information pertaining to such purchase or sale or who have the power to influence the management or policies of the Fund, the Investment Manager or PIMCO, as applicable. Such persons are prohibited from effecting certain transactions, allowed to effect certain exempt transactions (including with respect to securities that may be purchased or held by the Fund), and are required to preclear certain security transactions with the applicable compliance officer or his designee and to report certain transactions on a regular basis. The Fund, the Investment Manager and PIMCO have each developed procedures for administration of their respective codes. Text-only versions of the codes of ethics can be viewed online or downloaded from the EDGAR Database on the SEC's internet Web site at [www.sec.gov](http://www.sec.gov). You may also review and copy those documents by visiting the SEC's Public Reference Room in Washington, DC, information on the operation of which may be obtained by calling 1-800-551-8090. Copies may be obtained, after paying a duplicating fee, by electronic request to [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, Washington, DC 20549-0102.

**Table of Contents****INVESTMENT MANAGER AND SUB-ADVISER****Investment Manager**

Allianz Global Investors Fund Management LLC (the Investment Manager) serves as investment manager to the Fund pursuant to an investment management agreement (the Investment Management Agreement) between it and the Fund. The Investment Manager is a wholly-owned indirect subsidiary of Allianz Global Investors of America L.P. (Allianz). Allianz was organized as a limited partnership under Delaware law in 1987. Allianz's sole general partner is Allianz-Pacliffe Partners LLC. Allianz-Pacliffe Partners LLC is a Delaware limited liability company whose sole member is Allianz Global Investors U.S. Holding LLC, a Delaware limited liability company. The sole member of Allianz Global Investors U.S. Holding LLC is Allianz Global Investors of America LLC. Allianz Global Investors of America LLC has two members, Allianz of America, Inc. (Allianz of America), a Delaware corporation that owns a 99.9% non-managing interest, and Allianz Global Investors of America Holdings Inc., a Delaware corporation that owns a 0.01% managing interest. Allianz of America is a wholly-owned subsidiary of Allianz SE. Allianz Global Investors of America Holdings Inc. is a wholly-owned subsidiary of Allianz Global Investors Aktiengesellschaft, which is a wholly-owned indirect subsidiary of Allianz SE. Allianz SE indirectly holds a controlling interest in Allianz. Allianz SE is a European-based, multinational insurance and financial services holding company. The address for Allianz, Allianz-Pacliffe Partners LLC, Allianz Global Investors U.S. Holding LLC, Allianz Global Investors of America LLC and Allianz Global Investors of America Holdings Inc. is 680 Newport Center Drive, Suite 250, Newport Beach, California 92660. The address for Allianz Global Investors Aktiengesellschaft is Nymphenburger Strasse 112-116, 80636 Munich, Germany. Allianz SE's address is Koeniginstrasse 28, D-80802, Munich, Germany.

The general partner of Allianz has substantially delegated its management and control of Allianz to an Executive Committee.

The Investment Manager is located at 1345 Avenue of the Americas, New York, NY 10105. The Investment Manager and its investment management affiliates had approximately \$[ ] of assets under management as of [ ].

As of [ ], no shareholder holding 5% or more of the share capital was reported to Allianz SE. Certain broker-dealers that might be controlled by or affiliated with entities owned by the Investment Manager and its affiliates, either directly or indirectly, may be considered to be affiliated persons of the Investment Manager and its affiliates. (Broker-dealer affiliates of such significant institutional shareholders are sometimes referred to herein as Affiliated Brokers). Absent an SEC exemption or other regulatory relief, the Fund is generally precluded from effecting principal transactions with the Affiliated Brokers, and its ability to purchase securities being underwritten by an Affiliated Broker or a syndicate including an Affiliated Broker is subject to restrictions. Similarly, the Fund's ability to utilize the Affiliated Brokers for agency transactions is subject to the restrictions of Rule 17e-1 under the 1940 Act.

The Investment Manager, subject to the supervision of the Board of Trustees, is responsible for managing, either directly or through others selected by the Investment Manager, the investments of the Fund. The Investment Manager also furnishes to the Board of Trustees periodic reports on the investment performance of the Fund. As more fully discussed below, the Investment Manager has retained its affiliate, PIMCO, to serve as the Fund's sub-adviser.

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### **Investment Management Agreement**

Under the terms of the Investment Management Agreement, subject to such policies as the Trustees of the Fund may determine, the Investment Manager, at its expense, will furnish continuously an investment program for the Fund and will make investment decisions on behalf of the Fund and place all orders for the purchase and sale of portfolio securities subject always to the Fund's investment objective, policies and restrictions; provided that, so long as PIMCO serves as the sub-adviser for the Fund, the Investment Manager's obligation under the Investment Management Agreement with respect to the Fund is, subject always to the control of the Trustees, to determine and review with PIMCO the investment policies of the Fund.

Subject to the control of the Trustees, the Investment Manager also manages, supervises and conducts the other affairs and business of the Fund, furnishes office space and equipment, provides bookkeeping and certain clerical services (excluding determination of the net asset value of the Fund, shareholder accounting services and the accounting services for the Fund) and pays all salaries, fees and expenses of officers and Trustees of the Fund who are affiliated with the Investment Manager. As indicated under Portfolio Transactions Brokerage and Research Services, the Fund's portfolio transactions may be placed with broker-dealers which furnish the Investment Manager and PIMCO, without cost, certain research, statistical and quotation services of value to them or their respective affiliates in advising the Fund or their other clients. In so doing, the Fund may incur greater brokerage commissions and other transactions costs than it might otherwise pay.

Pursuant to the Investment Management Agreement, the Fund has agreed to pay the Investment Manager an annual management fee, payable on a monthly basis, at the annual rate of 0.75% of the Fund's average weekly total managed assets for the services and facilities it provides. Total managed assets means the total assets of the Fund (including any assets attributable to preferred shares or other forms of leverage that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). All fees and expenses are accrued daily and deducted before payment of dividends to investors.

Except as otherwise described in the Prospectus, the Fund pays, in addition to the investment management fee described above, all expenses not assumed by the Investment Manager, including, without limitation, fees and expenses of Trustees who are not interested persons of the Investment Manager or the Fund, interest charges, taxes, brokerage commissions, expenses of issue of shares, fees and expenses of registering and qualifying the Fund and its classes of shares for distribution under federal and state laws and regulations, charges of custodians, auditing and legal expenses, expenses of determining net asset value of the Fund, reports to shareholders, expenses of meetings of shareholders, expenses of printing and mailing prospectuses, proxy statements and proxies to existing shareholders, and its proportionate share of insurance premiums and professional association dues or assessments. The Fund is also responsible for such nonrecurring expenses as may arise, including litigation in which the Fund may be a party, and other expenses as determined by the Trustees. The Fund may have an obligation to indemnify its officers and Trustees with respect to such litigation.

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Under the Investment Management Agreement the Fund paid the Investment Manager a total of \$[ ] for the fiscal year ended July 31, 2009, \$[ ] for the fiscal year ended July 31, 2008, and \$[ ] for the fiscal year ended July 31, 2007.

### **Sub-Adviser**

PIMCO, an affiliate of the Investment Manager, serves as sub-adviser for the Fund pursuant to a portfolio management agreement (the Sub-Advisory Agreement ) between PIMCO and the Investment Manager. Originally organized in 1971, reorganized as a Delaware general partnership in 1994 and reorganized as a Delaware limited liability company in 2000, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to mutual funds. PIMCO is a majority owned subsidiary of Allianz Global Investors of America L.P. ( Allianz Global Investors ) with a minority interest held by PIMCO Partners, LLC, a California limited liability company. PIMCO Partners, LLC is owned by the current managing directors and executive management of PIMCO. Through various holding company structures, Allianz Global Investors is majority owned by Allianz SE.

### **Portfolio Management Agreement**

Under the Portfolio Management Agreement, subject always to the control of the Trustees and the supervision of the Investment Manager, PIMCO's obligation is to furnish continuously an investment program for the Fund, to make investment decisions on behalf of the Fund and to place all orders for the purchase and sale of portfolio securities and all other investments for the Fund.

The Investment Manager (and not the Fund) pays a portion of the fees it receives under the Investment Management Agreement to PIMCO in return for PIMCO's services. The fee is paid monthly at the annual rate of 0.55% of the Fund's average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced by the amount, if any, of all fees payable by the Investment Manager to the underwriters of the Fund's initial public offering of common shares for such month (such that the Investment Manager retains from its investment management fee, on an annual basis, .05% of the Fund's average weekly total managed assets, after having paid PIMCO and such underwriters).

Under the Sub-Advisory Agreement the Investment Manager paid PIMCO a total of \$[ ] for the fiscal year ended July 31, 2009, \$[ ] for the fiscal year ended July 31, 2008, and \$[ ] for the fiscal year ended July 31, 2007.

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. PIMCO had approximately \$[ ] of assets under management as of [ ].

**Table of Contents****Certain Terms of the Investment Management and Sub-Advisory Agreements**

The Investment Management Agreement and the Sub-Advisory Agreement were each approved by the Trustees of the Fund (including all of the Trustees who are not interested persons of the Investment Manager or PIMCO). By their terms the Investment Management Agreement and Sub-Advisory Agreement each continued in force with respect to the Fund for an initial two year period, and continue in force from year to year thereafter, but only so long as their continuance is approved at least annually by (i) vote, cast in person at a meeting called for that purpose, of a majority of those Trustees who are not interested persons of the Investment Manager, PIMCO or the Fund, and (ii) the majority vote of either the full Board of Trustees or the vote of a majority of the outstanding shares of all classes of the Fund. Each of the Investment Management Agreement and Sub-Advisory Agreement automatically terminates on assignment. The Investment Management Agreement may be terminated on not less than 60 days notice by the Investment Manager to the Fund or by the Fund to the Investment Manager. The Sub-Advisory Agreement may be terminated on not less than 60 days notice by the Investment Manager to PIMCO or by PIMCO to the Investment Manager, or by the Fund at any time by notice to the Investment Manager and PIMCO.

The Investment Management Agreement and the Sub-Advisory Agreement each provide that the Investment Manager or PIMCO, as applicable, shall not be subject to any liability in connection with the performance of its services thereunder in the absence of willful misfeasance, bad faith, gross negligence or reckless disregard of its obligations and duties.

**Individual Portfolio Managers**

William H. Gross, as portfolio manager, is responsible for the day-to-day management of the Fund. The table below provides information about Mr. Gross.

**Other Accounts Managed.** Mr. Gross also manages the other registered investment companies, other pooled investment vehicles and/or other accounts indicated below. The following table identifies, as of July 31, 2009: (i) the number of registered investment companies, pooled investment vehicles and other accounts managed by the portfolio manager; and (ii) the total assets of such companies, vehicles and accounts, and the number and total assets of such companies, vehicles and accounts with respect to which the advisory fee is based on performance.

|                                  | Total Assets<br>of All<br>Accounts (in<br>\$Millions) | Number of<br>Accounts Paying<br>a Performance<br>Fee | Total Assets of<br>Accounts Paying a<br>Performance Fee<br>(in \$Millions) |
|----------------------------------|---|--|--|
| <i>William H. Gross</i>          |   |  |  |
| Registered Investment Companies  | [ ]   | [ ]  | [ ]  |
| Other Pooled Investment Vehicles | [ ]   | [ ]  | [ ]  |
| Other Accounts                   | [ ]   | [ ]  | [ ]  |



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### **Conflicts of Interest**

From time to time, potential conflicts of interest may arise between the portfolio manager's management of the investments of the Fund, on the one hand, and the management of other accounts, on the other. The other accounts might have similar investment objectives or strategies as the Fund, track the same index the Fund tracks or otherwise hold, purchase, or sell securities that are eligible to be held, purchased or sold by the Fund. The other accounts might also have different investment objectives or strategies than the Fund.

*Knowledge and Timing of Portfolio Trades.* A potential conflict of interest may arise as a result of the portfolio manager's day-to-day management of the Fund. Because of his position with the Fund, the portfolio manager knows the size, timing and possible market impact of the Fund's trades. It is theoretically possible that the portfolio manager could use this information to the advantage of other accounts he manages and to the possible detriment of the Fund.

*Investment Opportunities.* A potential conflict of interest may arise as a result of the portfolio manager's management of a number of accounts with varying investment guidelines. Often, an investment opportunity may be suitable for both the Fund and other accounts managed by the portfolio manager, but may not be available in sufficient quantities for both the Fund and the other accounts to participate fully. Similarly, there may be limited opportunity to sell an investment held by the Fund and another account. PIMCO has adopted policies and procedures reasonably designed to allocate investment opportunities on a fair and equitable basis over time.

Under PIMCO's allocation procedures, investment opportunities are allocated among various investment strategies based on individual account investment guidelines and PIMCO's investment outlook. PIMCO has also adopted additional procedures to complement the general trade allocation policy that are designed to address potential conflicts of interest due to the side-by-side management of the Fund and certain pooled investment vehicles, including investment opportunity allocation issues.

*Performance Fees.* The portfolio manager may advise certain accounts with respect to which the advisory fee is based entirely or partially on performance. Performance fee arrangements may create a conflict of interest for the portfolio manager in that the portfolio manager may have an incentive to allocate the investment opportunities that he believes might be the most profitable to such other accounts instead of allocating them to the Fund. PIMCO has adopted policies and procedures reasonably designed to allocate investment opportunities between the Fund and such other accounts on a fair and equitable basis over time.

### **Portfolio Manager Compensation**

[To be inserted by amendment.]

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**Securities Ownership**

The following table discloses the dollar range of equity securities beneficially owned by the portfolio manager of the Fund. The information is as of July 31, 2009.

| <b>Portfolio Manager</b> | <b>Dollar Range of Equity Securities</b> |
|--------------------------|--|
| William H. Gross         | [ ]                                      |

**Proxy Voting Policies**

The Fund and its Board of Trustees have delegated to the Investment Manager, and the Investment Manager has in turn delegated to PIMCO, responsibility for voting any proxies relating to portfolio securities held by the Fund in accordance with PIMCO's proxy voting policies and procedures. A description of the proxy voting policies and procedures to be followed by PIMCO on behalf of the Fund, including procedures to be used when a vote represents a conflict of interest, is attached hereto as Appendix A ( Description of Proxy Voting Policies and Procedures ).

Information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available is available without charge, upon request, by calling [ ], or on the SEC's Web site at <http://www.sec.gov>.

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**Table of Contents****PORTFOLIO TRANSACTIONS****Investment Decisions and Portfolio Transactions**

Investment decisions for the Fund and for the other investment advisory clients of the Investment Manager and PIMCO are made with a view to achieving their respective investment objectives. Investment decisions are the product of many factors in addition to basic suitability for the particular client involved (including the Fund). Some securities considered for investments by the Fund may also be appropriate for other clients served by the Investment Manager and PIMCO. Thus, a particular security may be bought or sold for certain clients even though it could have been bought or sold for other clients at the same time including accounts in which the Investment Manager, PIMCO, their officers or their employees may have a financial interest. If a purchase or sale of securities consistent with the investment policies of the Fund and one or more of these clients served by the Investment Manager or PIMCO is considered at or about the same time, transactions in such securities will be allocated among the Fund and clients in a manner deemed fair and reasonable by the Investment Manager or PIMCO, as applicable. The Investment Manager or PIMCO may acquire on behalf of its clients (including the Fund) securities or other financial instruments providing exposure to different aspects of the capital and debt structure of an issuer, including without limitation those that relate to senior and junior/subordinate obligations of such issuer. In certain circumstances, the interests of those clients exposed to one portion of the issuer's capital and debt structure may diverge from those clients exposed to a different portion of the issuer's capital and debt structure. The Investment Manager or PIMCO may advise some clients or take actions for them in their best interests with respect to their exposures to an issuer's capital and debt structure that may diverge from the interests of other clients with different exposures to the same issuer's capital and debt structure.

The Investment Manager or PIMCO may aggregate orders for the Fund with simultaneous transactions entered into on behalf of its other clients when, in its reasonable judgment, aggregation may result in an overall economic benefit to the Fund and the other clients in terms of pricing, brokerage commissions or other expenses. When feasible, PIMCO allocates trades prior to execution. When pre-execution allocation is not feasible, PIMCO promptly allocates trades following established and objective procedures. Allocations generally are made at or about the time of execution and before the end of the trading day. As a result, one account may receive a price for a particular transaction that is different from the price received by another account for a similar transaction on the same day. In general, trades are allocated among portfolio managers on a pro rata basis (to the extent a portfolio manager decides to participate fully in the trade), for further allocation by each portfolio manager among that manager's eligible accounts. In allocating trades among accounts, portfolio managers generally consider a number of factors, including, but not limited to, each account's deviation (in terms of risk exposure and/or performance characteristics) from a relevant model portfolio, each account's investment objectives, restrictions and guidelines, its risk exposure, its available cash, and its existing holdings of similar securities. Once trades are allocated, they may be reallocated only in unusual circumstances due to recognition of specific account restrictions. In some cases, the Investment Manager or PIMCO may sell a security on behalf of a client, including the Fund, to a broker-dealer that thereafter may be purchased for the accounts of one or more other clients, including the Fund, from that or another broker-dealer. The Investment Manager and PIMCO have adopted procedures they believe are reasonably designed to obtain the best execution for the transactions by each account.

A particular security may be bought for one or more clients when one or more clients are selling the security. In some instances, one client may sell a particular security to another client. It also sometimes happens that two or more clients simultaneously purchase or sell the same security, in which event each day's transactions in such security are, insofar as possible, averaged as to price and allocated between such clients in a manner which the Investment Manager or PIMCO believes is equitable to each and in accordance with the amount being purchased or sold by each. There may be circumstances when purchases or sales of portfolio securities for one or more clients will have an adverse effect on other clients.

**Brokerage and Research Services**

There is generally no stated commission in the case of debt securities, which are traded in the over-the-counter markets, but the price paid by the Fund usually includes an undisclosed dealer commission or mark-up. In underwritten offerings, the price paid by the Fund includes a disclosed, fixed commission or discount retained by the underwriter or dealer. Transactions on U.S. stock exchanges and other agency transactions involve the payment by the Fund of negotiated brokerage commissions. Such commissions vary among different brokers. Also, a particular broker may charge different commissions according to such factors as the difficulty and size of the transaction. Transactions in foreign securities generally involve the payment of fixed brokerage commissions, which are generally higher than those in the United States.

Subject to the supervision of the Investment Manager, PIMCO places all orders for the purchase and sale of portfolio securities, options, futures contracts and other instruments for the Fund and buys and sells such securities, options, futures contracts and other instruments for the Fund through a substantial number of brokers and dealers. In so doing, PIMCO uses its best efforts to obtain for the Fund the most favorable price and execution available, except to the extent it may be permitted to pay higher brokerage commissions as described below. In seeking the most favorable price and execution, PIMCO, having in mind the Fund's best interests, considers all factors it deems relevant, including, by way of illustration, price, the size of the transaction, the



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nature of the market for the security, the amount of the commission, the timing of the transaction taking into account market prices and trends, the reputation, experience and financial stability of the broker-dealer involved and the quality of service rendered by the broker-dealer in other transactions. Changes in the aggregate amount of brokerage commissions paid by the Fund from year-to-year may be attributable to the volume of portfolio transactions effected by the Fund, the types of instruments in which the Fund invests, or the rates negotiated by PIMCO on behalf of the Fund.

The Fund paid brokerage commissions of \$[ ] for the fiscal year ended July 31, 2009, \$[ ] for the fiscal year ended July 31, 2008 and \$[ ] for the fiscal year ended July 31, 2007.

Subject to the supervision of the Investment Manager, PIMCO places orders for the purchase and sale of portfolio investments for the Fund's account with brokers or dealers selected by it in its discretion. In effecting purchases and sales of portfolio securities for the account of the Fund, PIMCO will seek the best price and execution of the Fund's orders. In doing so, the Fund may pay higher commission rates than the lowest available when PIMCO believes it is reasonable to do so in light of the value of the brokerage and research services provided by the broker effecting the transaction, as discussed below.

It has for many years been a common practice in the investment advisory business for advisers of investment companies and other institutional investors to receive research services from broker-dealers which execute portfolio transactions for the clients of such advisers. Consistent with this practice, PIMCO may receive research services from many broker-dealers with which PIMCO places the Fund's portfolio transactions. PIMCO may also receive research or research credits from brokers which are generated from underwriting commissions when purchasing new issues of debt securities or other assets for the Fund. These services, which in some cases may also be purchased for cash, include such matters as general economic and security market reviews, industry and company reviews, evaluations of securities and recommendations as to the purchase and sale of securities. Some of these services are of value to PIMCO in advising various of its clients (including the Fund), although not all of these services are necessarily useful and of value in managing the Fund. Neither the management fee paid by the Fund to the Investment Manager nor the Sub-Advisory fee paid by the Investment Manager to PIMCO is reduced because PIMCO and its affiliates receive such services.

As permitted by Section 28(e) of the Securities Exchange Act of 1934, PIMCO may cause the Fund to pay a broker-dealer which provides brokerage and research services (as defined in such Act) to PIMCO an amount of disclosed commission for effecting a securities transaction for the Fund in excess of the commission which another broker-dealer would have charged for effecting that transaction.

As noted above, PIMCO may purchase new issues of securities for the Fund in underwritten fixed price offerings. In these situations, the underwriter or selling group member may provide PIMCO with research in addition to selling the securities (at the fixed public offering price) to the Fund or other advisory clients. Because the offerings are conducted at a fixed price, the ability to obtain research from a broker-dealer in this situation provides knowledge that may benefit the Fund, other PIMCO clients, and PIMCO without incurring additional costs. These arrangements may not fall within the safe harbor of Section 28(e) because the broker-dealer is considered to be acting in a principal capacity in underwritten transactions. However, the FINRA has adopted rules expressly permitting broker-dealers to provide bona fide research to

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advisers in connection with fixed price offerings under certain circumstances. As a general matter in these situations, the underwriter or selling group member will provide research credits at a rate that is higher than that which is available for secondary market transactions.

PIMCO may place orders for the purchase and sale of exchange-listed portfolio securities with a broker-dealer that is an affiliate of the Investment Manager or PIMCO where, in the judgment of the Investment Manager or PIMCO, such firm will be able to obtain a price and execution at least as favorable as other qualified broker-dealers. Pursuant to rules of the SEC, a broker-dealer that is an affiliate of the Investment Manager or PIMCO may receive and retain compensation for effecting portfolio transactions for the Fund on a securities exchange if the commissions paid to such an affiliated broker-dealer by the Fund on exchange transactions do not exceed usual and customary brokerage commissions. The rules define usual and customary commissions to include amounts which are reasonable and fair compared to the commission, fee or other remuneration received or to be received by other brokers in connection with comparable transactions involving similar securities being purchased or sold on a securities exchange during a comparable period of time. As required by applicable SEC rules, the Board of Trustees has adopted procedures which are reasonably designed to provide that any commissions, fees or other remuneration paid to an affiliated broker are consistent with the foregoing standards.

Since the securities in which the Fund invests consist primarily of fixed income securities, which are generally not subject to stated brokerage commissions, as described above, its investments in securities subject to stated commissions generally constitute a small percentage of the aggregate dollar amount of its transactions.

[The Fund did not pay any commissions to affiliated brokers during the fiscal years ended July 31, 2009, July 31, 2008, and July 31, 2007].

References to PIMCO in this section would apply equally to the Investment Manager if the Investment Manager were to assume portfolio management responsibilities for the Fund and place orders for the purchase and sale of the Fund's portfolio investments.

**Holdings of Securities of the Fund's Regular Brokers and Dealers**

The following table lists the regular brokers or dealers of the Fund whose securities the Fund acquired during the fiscal year ended July 31, 2009, as well as the Fund's holdings in such brokers or dealers as of July 31, 2009.

| Broker or Dealer | Value of Securities Held by the Fund as of July 31, 2009 |
|------------------|--|
| [ ]              | [ ]  |

**DISTRIBUTIONS**

See Distributions in the Prospectus for information relating to distributions made to Fund shareholders.

For tax purposes, the Fund is currently required to allocate net capital gain and other taxable income, if any, between and among Common Shares, the Series T Preferred Shares, the Series W Preferred Shares and the Series TH Preferred Shares in proportion to total distributions paid to each class for the year in which such net capital gain or other taxable income is realized.

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While any Preferred Shares are outstanding, the Fund may not declare any cash dividend or other distribution on its Common Shares unless at the time of such declaration (1) all accumulated dividends on the Preferred Shares have been paid and (2) the net asset value of the Fund's portfolio (determined after deducting the amount of such dividend or other distribution) is at least 200% of the liquidation value of any outstanding Preferred Shares. In addition to delaying or preventing the payment of dividends to holders of Common Shares, these limitations could cause the Fund to incur income and excise tax and, under certain circumstances, impair the ability of the Fund to maintain its qualification for taxation as a regulated investment company. See Tax Matters.

**DESCRIPTION OF SHARES**

**Common Shares**

The Declaration authorizes the issuance of an unlimited number of Common Shares. The Common Shares currently outstanding have been issued with a par value of \$0.00001 per share. All Common Shares of the Fund have equal rights as to the payment of dividends and the distribution of assets upon liquidation of the Fund. The Common Shares currently outstanding have been fully paid and, subject to matters discussed in Anti-takeover and other provisions in the Declaration of Trust Shareholder Liability below, non-assessable, and will have no pre-emptive or conversion rights or rights to cumulative voting. At any time when the Fund's Preferred Shares or any other preferred shares of beneficial interest are outstanding, Common Shareholders will not be entitled to receive any distributions from the Fund unless all accrued dividends on Preferred Shares and any other preferred shares of beneficial interest have been paid, and unless asset coverage (as defined in the 1940 Act) with respect to Preferred Shares and any other preferred shares of beneficial interest would be at least 200% after giving effect to such distributions. See Auction Market Preferred Shares below and Description of Capital Structure in the Prospectus.

The Common Shares are listed on the New York Stock Exchange. The Fund intends to hold annual meetings of shareholders so long as the Common Shares are listed on a national securities exchange and such meetings are required as a condition to such listing.

Shares of closed-end investment companies may frequently trade at prices lower than net asset value. Shares of closed-end investment companies have during some periods traded at prices higher than net asset value and during other periods traded at prices lower than net asset value. There can be no assurance that Common Shares or shares of other similar funds will trade at a price higher than net asset value in the future. Net asset value will be reduced immediately following the offer by a sales load and other expenses paid or reimbursed by the Fund. Net asset value generally increases when interest rates decline, and decreases when interest rates rise, and these changes are likely to be greater in the case of a fund, such as the Fund, having a leveraged capital structure. Whether investors will realize gains or losses upon the sale of Common Shares will not depend upon the Fund's net asset value but will depend entirely upon whether the market price of the Common Shares at the time of sale is above or below the original purchase price for such Common Shares. Since the market price of the Fund's Common Shares will be determined by factors beyond the control of the Fund, the Fund cannot predict whether the Common Shares will trade at, below, or above net

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asset value or at, below or above the initial public offering price. Accordingly, the Common Shares are designed primarily for long-term investors, and investors in the Common Shares should not view the Fund as a vehicle for trading purposes. See [Repurchase of Common Shares](#); [Conversion to Open-End Fund](#).

### **Auction Market Preferred Shares**

The Declaration authorizes the Fund to issue an unlimited number of preferred shares. Any such preferred shares may be issued in one or more classes or series, with such par value and rights as determined by the Board of Trustees of the Fund, by action of the Board of Trustees without the approval of the Common Shareholders.

The Fund has issued Auction Market Preferred Shares (as previously defined, Preferred Shares ) in three series, of which the noted amounts remain outstanding: Series T ([ ] shares), Series W ([ ] shares) and Series TH ([ ] shares), with each share having a liquidation preference of \$25,000. The terms of the Preferred Shares provide that they would ordinarily pay dividends at a rate set at auctions held every seven days, subject to a maximum applicable rate calculated as a function of the Preferred Shares then-current rating and a reference interest rate. However, the weekly auctions for the Preferred Shares, as well as auctions for similar preferred shares of other closed-end funds across the U.S. industry, have failed since February 2008, and the dividend rates on the Preferred Shares since that time have been paid at the maximum applicable rate. The Fund expects that the Preferred Shares will continue to pay dividends at the maximum applicable rate for the foreseeable future and cannot predict whether or when the auction markets for the Preferred Shares may resume normal functioning.

As used in this Statement of Additional Information, unless otherwise noted, the Fund's net assets include assets of the Fund attributable to any outstanding preferred shares, including Preferred Shares, with no deduction for the liquidation preference of the preferred shares. Solely for financial reporting purposes, however, the Fund is required to exclude the liquidation preference of any preferred shares from net assets, so long as such preferred shares have redemption features that are not solely within the control of the Fund. For all regulatory and tax purposes, the Fund's preferred shares will be treated as stock (rather than indebtedness).

*Limited Issuance of Preferred Shares.* Under the 1940 Act, the Fund could issue preferred shares with an aggregate liquidation value of up to one-half of the value of the Fund's total net assets, measured immediately after issuance of the preferred shares. As of the date of this Statement of Additional Information, Preferred Shares with an aggregate liquidation preference of \$[ ] remain outstanding. Liquidation preference means the original purchase price of the shares being liquidated plus any accrued and unpaid dividends. The Fund is not permitted to declare any cash dividend or other distribution on its Common Shares unless the aggregate liquidation value of any preferred shares, including the Preferred Shares, is less than one-half of the value of the Fund's total net assets (determined after deducting the amount of such dividend or distribution) immediately after the distribution. Failure to maintain asset coverage requirements could result in an event of default and entitle the holders of the Preferred Shares and holders of any other senior securities of the Fund to elect a majority of the Trustees of the Fund. To the extent that the Fund has outstanding any senior securities representing indebtedness (such as through the use



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of reverse repurchase agreements or derivative instruments that constitute senior securities), the aggregate amount of such senior securities representing indebtedness will be added to the total liquidation value of any outstanding preferred shares for purposes of these asset coverage requirements.

*Distribution Preference.* Any preferred shares issued by the Fund (including the Preferred Shares) have complete priority over the Common Shares as to distribution of assets.

*Liquidation Preference.* In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Fund, preferred shareholders (including holders of Preferred Shares) will be entitled to receive a preferential liquidating distribution (expected to equal the original purchase price per share plus accumulated and unpaid dividends thereon, whether or not earned or declared) before any distribution of assets is made to holders of Common Shares. After payment of the full amount of the liquidating distribution to which they are entitled, preferred shareholders would not be entitled to any further participation in any distribution of assets by the Fund. A consolidation or merger of the Fund with or into any Massachusetts business trust or corporation or a sale of all or substantially all of the assets of the Fund shall not be deemed to be a liquidation, dissolution or winding up of the Fund.

*Voting Rights.* In connection with any issuance of preferred shares (including the Preferred Shares), the Fund must comply with Section 18(i) of the 1940 Act which requires, among other things, that preferred shares be voting shares. Except as otherwise provided in the Declaration or the Fund's Bylaws or otherwise required by applicable law, preferred shareholders vote together with Common Shareholders as a single class.

In connection with the election of the Fund's Trustees, preferred shareholders, voting as a separate class, are entitled to elect two of the Fund's Trustees (at any shareholder meeting at which such trustees are standing for election under the staggered board structure), and the remaining Trustees would be elected by Common Shareholders and preferred shareholders, voting together as a single class. In addition, if at any time dividends on any outstanding preferred shares are unpaid in an amount equal to two full years' dividends thereon, the holders of all outstanding preferred shares, voting as a separate class, would be entitled to elect a majority of the Fund's Trustees until all dividends in arrears had been paid or declared and set apart for payment.

The affirmative vote of the holders of a majority of any outstanding preferred shares of the Fund (including the Preferred Shares), voting as a separate class, is required to approve any action requiring a vote of security holders under Section 13(a) of the 1940 Act including, among other things, changes in the Fund's investment objective, the conversion of the Fund from a closed-end to an open-end company, or changes in the investment restrictions described as fundamental policies under Investment Restrictions. The class or series vote of preferred shareholders described above would in each case be in addition to any separate vote of the requisite percentage of Common Shares and preferred shares necessary to authorize the action in question.

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**ANTI-TAKEOVER AND OTHER PROVISIONS IN THE DECLARATION OF TRUST**

**Shareholder Liability**

Under Massachusetts law, shareholders could, under certain circumstances, be held personally liable for the obligations of the Fund. However, the Declaration contains an express disclaimer of shareholder liability for acts or obligations of the Fund and requires that notice of such disclaimer be given in each agreement, obligation or instrument entered into or executed by the Fund or the Trustees. The Declaration also provides for indemnification out of the Fund's property for all loss and expense of any shareholder held personally liable on account of being or having been a shareholder. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which such disclaimer is inoperative or the Fund is unable to meet its obligations, and thus should be considered remote.

**Anti-Takeover Provisions**

As described below, the Declaration includes provisions that could have the effect of limiting the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Trustees, and could have the effect of depriving shareholders of opportunities to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund.

The Fund's Trustees are divided into three classes (Class I, Class II and Class III), having initial terms of one, two and three years, respectively. At each annual meeting of shareholders, the term of one class will expire and each Trustee elected to that class will hold office for a term of three years. The classification of the Board of Trustees in this manner could delay for an additional year the replacement of a majority of the Board of Trustees. In addition, the Declaration provides that a Trustee may be removed only for cause and only (i) by action of at least seventy-five percent (75%) of the outstanding shares of the classes or series of shares entitled to vote for the election of such Trustee, or (ii) by at least seventy-five percent (75%) of the remaining Trustees. Except as provided in the next paragraph, the affirmative vote or consent of at least seventy-five percent (75%) of the Board of Trustees and at least seventy-five percent (75%) of the shares of the Fund outstanding and entitled to vote thereon are required to authorize any of the following transactions (each a "Material Transaction"): (1) a merger, consolidation or share exchange of the Fund or any series or class of shares of the Fund with or into any other person or company, or of any such person or company with or into the Fund or any such series or class of shares; (2) the issuance or transfer by the Fund or any series or class of shares (in one or a series of transactions in any twelve-month period) of any securities of the Fund or such series or class to any other person or entity for cash, securities or other property (or combination thereof) having an aggregate fair market value of \$1,000,000 or more, excluding sales of securities of the Fund or such series or class in connection with a public offering, issuances of securities of the Fund or such series or class pursuant to a dividend reinvestment plan adopted by the Fund and issuances of securities of the Fund or such series or class upon the exercise of any stock subscription rights distributed by the Fund; or (3) a sale, lease, exchange, mortgage, pledge, transfer or other disposition by the Fund or any series or class of shares (in one or a series of transactions in any twelve-month period) to or with any person of any assets of the Fund or such series or class.

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having an aggregate fair market value of \$1,000,000 or more, except for transactions in securities effected by the Fund or such series or class in the ordinary course of its business. The same affirmative votes are required with respect to any shareholder proposal as to specific investment decisions made or to be made with respect to the Fund's assets or the assets of any series or class of shares of the Fund. Notwithstanding the approval requirements specified in the preceding paragraph, the Declaration requires no vote or consent of the Fund's shareholders to authorize a Material Transaction if the transaction is approved by a vote of both a majority of the Board of Trustees and seventy-five percent (75%) of the Continuing Trustees (as defined below), so long as all other conditions and requirements, if any, provided for in the Fund's Bylaws and applicable law (including any shareholder voting rights under the 1940 Act) have been satisfied. In addition, the Declaration provides that the Fund may be terminated at any time by vote or consent of at least seventy-five percent (75%) of the Fund's shares or, alternatively, by vote or consent of both a majority of the Board of Trustees and seventy-five percent (75%) of the Continuing Trustees (as defined below). In certain circumstances, the Declaration also imposes shareholder voting requirements that are more demanding than those required under the 1940 Act in order to authorize a conversion of the Fund from a closed-end to an open-end investment company. See *Repurchase of Common Shares; Conversion to Open-End Fund* below. As noted, the voting provisions described above could have the effect of depriving Common Shareholders of an opportunity to sell their Common Shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. In the view of the Fund's Board of Trustees, however, these provisions offer several possible advantages, including: (1) requiring persons seeking control of the Fund to negotiate with its management regarding the price to be paid for the amount of Common Shares required to obtain control; (2) promoting continuity and stability; and (3) enhancing the Fund's ability to pursue long-term strategies that are consistent with its investment objective and management policies. The Board of Trustees has determined that the voting requirements described above, which are generally greater than the minimum requirements under the 1940 Act, are in the best interests of the Fund's Common Shareholders generally. A Continuing Trustee, as used in the discussion above, is any member of the Fund's Board of Trustees who either (i) has been a member of the Board for a period of at least thirty-six months (or since the commencement of the Fund's operations, if less than thirty-six months) or (ii) was nominated to serve as a member of the Board of Trustees by a majority of the Continuing Trustees then members of the Board. The foregoing is intended only as a summary and is qualified in its entirety by reference to the full text of the Declaration and the Fund's Bylaws, both of which have been filed as exhibits to the Fund's registration statement on file with the SEC.

**Liability of Trustees**

The Declaration provides that the obligations of the Fund are not binding upon the Trustees of the Fund individually, but only upon the assets and property of the Fund, and that the Trustees shall not be liable for errors of judgment or mistakes of fact or law. Nothing in the Declaration, however, protects a Trustee against any liability to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

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**REPURCHASE OF COMMON SHARES; CONVERSION TO OPEN-END FUND**

The Fund is a closed-end investment company and as such its shareholders will not have the right to cause the Fund to redeem their shares. Instead, the Fund's Common Shares will trade in the open market at a price that will be a function of several factors, including dividend levels (which are in turn affected by changes in the rates of interest on the Fund's investments and expenses), net asset value, call protection, price, relative demand for and supply of such shares in the market, general market and economic conditions and other factors. Shares of a closed-end investment company may frequently trade at prices lower than net asset value. The Fund's Board of Trustees regularly monitors the relationship between the market price and net asset value of the Common Shares. If the Common Shares were to trade at a substantial discount to net asset value for an extended period of time, the Board may consider the repurchase of its Common Shares on the open market or in private transactions, or the making of a tender offer for such shares. There can be no assurance, however, that the Board of Trustees will decide to take or propose any of these actions, or that share repurchases or tender offers, if undertaken, will reduce market discount. The Fund has no present intention to repurchase its Common Shares and would do so only in the circumstances described in this section.

Notwithstanding the foregoing, at any time when the Fund's Preferred Shares are outstanding, the Fund may not purchase, redeem or otherwise acquire any of its Common Shares unless (1) all accrued dividends on Preferred Shares have been paid and (2) at the time of such purchase, redemption or acquisition, the net asset value of the Fund's portfolio (determined after deducting the acquisition price of the Common Shares) is at least 200% of the liquidation value of the outstanding Preferred Shares (expected to equal the original purchase price per share plus any accrued and unpaid dividends thereon).

Subject to its investment limitations, the Fund may borrow to finance the repurchase of shares or to make a tender offer. Interest on any borrowings to finance share repurchase transactions or the accumulation of cash by the Fund in anticipation of share repurchases or tenders will reduce the Fund's net income. Any share repurchase, tender offer or borrowing that might be approved by the Board of Trustees would have to comply with the Securities Exchange Act of 1934, as amended, and the 1940 Act and the rules and regulations thereunder.

The Fund's Board of Trustees may also from time to time consider submitting to the holders of the shares of beneficial interest of the Fund a proposal to convert the Fund to an open-end investment company. In determining whether to exercise its sole discretion to submit this issue to shareholders, the Board of Trustees would consider all factors then relevant, including the relationship of the market price of the Common Shares to net asset value, the extent to which the Fund's capital structure is leveraged and the possibility of re-leveraging, the spread, if any, between the yields on securities in the Fund's portfolio and interest and dividend charges on Preferred Shares issued by the Fund and general market and economic conditions.

The Declaration requires the affirmative vote or consent of holders of at least seventy-five percent (75%) of each class of the Fund's shares entitled to vote on the matter to authorize a conversion of the Fund from a closed-end to an open-end investment company, unless the conversion is authorized by both a majority of the Board of Trustees and seventy-five percent

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(75%) of the Continuing Trustees (as defined above under Anti-Takeover and Other Provisions in the Declaration of Trust Anti-Takeover Provisions ). This seventy-five percent (75%) shareholder approval requirement is higher than is required under the 1940 Act. In the event that a conversion is approved by the Trustees and the Continuing Trustees as described above, the minimum shareholder vote required under the 1940 Act would be necessary to authorize the conversion. Currently, the 1940 Act would require approval of the holders of a majority of the outstanding Common Shares and, if issued, Preferred Shares voting together as a single class, and the holders of a majority of the outstanding Preferred Shares voting as a separate class, in order to authorize a conversion.

If the Fund converted to an open-end company, it would be required to redeem all Preferred Shares then outstanding (requiring in turn that it liquidate a portion of its investment portfolio), and the Fund's Common Shares likely would no longer be listed on the New York Stock Exchange. In addition, if the Fund were to convert to an open-end company, it would not be able to invest more than 15% of its net assets in illiquid securities, which likely would necessitate a substantial repositioning of the Fund's investment portfolio, which may in turn generate substantial transaction costs, which would be borne by Common Shareholders. Shareholders of an open-end investment company may require the company to redeem their shares on any business day (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less such redemption charge, if any, as might be in effect at the time of redemption. In order to avoid maintaining large cash positions or liquidating favorable investments to meet redemptions, open-end companies typically engage in a continuous offering of their shares. Open-end companies are thus subject to periodic asset in-flows and out-flows that can complicate portfolio management.

The repurchase by the Fund of its shares at prices below net asset value will result in an increase in the net asset value of those shares that remain outstanding. However, there can be no assurance that share repurchases or tenders at or below net asset value will result in the Fund's shares trading at a price equal to their net asset value. Nevertheless, the fact that the Fund's shares may be the subject of repurchase or tender offers at net asset value from time to time, or that the Fund may be converted to an open-end company, may reduce any spread between market price and net asset value that might otherwise exist.

In addition, a purchase by the Fund of its Common Shares will decrease the Fund's total assets. This would likely have the effect of increasing the Fund's expense ratio. Any purchase by the Fund of its Common Shares at a time when Preferred Shares or other forms of leverage are outstanding will increase the leverage applicable to the outstanding Common Shares then remaining. See the Prospectus under Principal risks of the Fund Leverage Risk.

Before deciding whether to take any action if the Fund's Common Shares trade below net asset value, the Board of Trustees would consider all relevant factors, including the extent and duration of the discount, the liquidity of the Fund's portfolio, the impact of any action that might be taken on the Fund or its shareholders and market considerations. Based on these considerations, even if the Fund's shares should trade at a discount, the Board of Trustees may determine that, in the interest of the Fund and its shareholders, no action should be taken.

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**Table of Contents****TAX MATTERS**

The following discussion of U.S. federal income tax consequences of an investment in Common Shares of the Fund is based on the Code, U.S. Treasury regulations promulgated thereunder, and other applicable authority, as of the date of this Statement of Additional Information. These authorities may be changed, possibly with retroactive effect, or subject to new legislative, administrative, or judicial interpretation. The following discussion is only a summary of some of the important U.S. federal tax considerations generally applicable to investments in Common Shares of the Fund and does not constitute tax advice. This summary does not purport to be a complete description of the U.S. federal income tax considerations applicable to an investment in Common Shares of the Fund. There may be other U.S. federal income tax consequences applicable to particular shareholders. For example, except as otherwise specifically noted herein, we have not described certain tax considerations that may be relevant to certain types of holders subject to special treatment under the U.S. federal income tax laws, including shareholders subject to the U.S. federal alternative minimum tax, insurance companies, tax-exempt organizations, pension plans and trusts, regulated investment companies, dealers in securities, shareholders holding Common Shares through tax-advantaged accounts (such as 401(k) plans or individual retirement accounts), financial institutions, shareholders holding Common Shares as part of a hedge, straddle, or conversion transaction, entities that are not organized under the laws of the United States or a political subdivision thereof, and persons who are neither citizens nor residents of the United States. This summary assumes that investors hold Common Shares as capital assets (within the meaning of the Code). Shareholders should consult their own tax advisors regarding their particular situation and the possible application of U.S. federal, state, local, foreign or other tax laws.

The Fund has elected to be treated as a regulated investment company under Subchapter M of the Code and intends each year to qualify and to be eligible to be treated as such. In order to qualify for the special tax treatment accorded regulated investment companies and their shareholders, the Fund must, among other things:

- (a) derive at least 90% of its gross income for each taxable year from (i) dividends, interest, payments with respect to certain securities loans, and gains from the sale or other disposition of stock, securities or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies, or (ii) income from qualified publicly traded partnerships (as defined below);
- (b) diversify its holdings so that, at the end of each quarter of the Fund's taxable year, (i) at least 50% of the value of the Fund's total assets is represented by cash and cash items, U.S. Government securities, securities of other regulated investment companies, and other securities limited in respect of any one issuer to a value not greater than 5% of the value of the Fund's total assets and not more than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the value of the Fund's total assets is invested (x) in the securities (other than those of the U.S. Government or other regulated investment companies) of any one issuer or of two or more issuers which the

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Fund controls and which are engaged in the same, similar, or related trades or businesses, or (y) in the securities of one or more qualified publicly traded partnerships (as defined below); and

- (c) distribute with respect to each taxable year at least 90% of the sum of its investment company taxable income (as that term is defined in the Code without regard to the deduction for dividends paid- generally taxable ordinary income and the excess, if any, of net short-term capital gains over net long-term capital losses) and net tax-exempt interest income, for such year.

In general, for purposes of the 90% gross income requirement described in (a)(i) above, income derived from a partnership will be treated as qualifying income only to the extent such income is attributable to items of income of the partnership which would be qualifying income if realized by the regulated investment company. However, 100% of the net income derived from an interest in a qualified publicly traded partnership (defined as a partnership (i) interests in which are traded on an established securities market or readily tradable on a secondary market or the substantial equivalent thereof, (ii) that derives at least 90% of its income from passive sources defined in Code section 7704(d), and (iii) that derives less than 90% of its income from the qualifying income described in paragraph (a)(i) above) will be treated as qualifying income. In addition, although in general the passive loss rules of the Code do not apply to regulated investment companies, such rules do apply to a regulated investment company with respect to items attributable to an interest in a qualified publicly traded partnership. Further, for the purposes of paragraph (b) above: (i) the term outstanding voting securities of such issuer will include the equity securities of a qualified publicly traded partnership, and (ii) in the case of the Fund's investment in loan participations, the Fund will treat both the intermediary and the issuer of the underlying loan as an issuer.

If the Fund were to fail to qualify as a regulated investment company accorded special tax treatment in any taxable year, the Fund would be subject to federal income tax on its taxable income at corporate rates, and all distributions from current and accumulated earnings and profits, including any distributions of net tax-exempt income and net long-term capital gains, would be taxable to shareholders as dividend income. Some portions of such distributions may be eligible for the dividends received deduction in the case of corporate shareholders and to be treated as qualified dividend income in the case of individuals. In addition, the Fund could be required to recognize unrealized gains, pay substantial taxes and interest and make substantial distributions before requalifying as a regulated investment company that is accorded special tax treatment.

## **Distributions**

As a regulated investment company, the Fund generally will not be subject to federal income tax on its investment company taxable income (as that term is defined in the Code generally, taxable ordinary income and the excess, if any, of net short-term capital gains over net long-term capital losses) and net capital gain (that is, the excess of net long-term capital gains over net short-term capital losses), if any, that it distributes to shareholders on a timely basis. The Fund intends to distribute to its shareholders, at least annually, all or substantially all of its investment

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company taxable income (computed without regard to the dividends paid deduction) and net capital gains. If the Fund does retain any investment company taxable income, it will be subject to tax at regular corporate rates on the amount retained. If the Fund does retain any net capital gain, it will be subject to tax at regular corporate rates on the amount retained, but may designate the retained amount as undistributed capital gains in a notice to its shareholders who would then, in turn, be (i) required to include in income for federal income tax purposes, as long-term capital gain, their shares of such undistributed amount, and (ii) entitled to credit their proportionate shares of the tax paid by the Fund on such undistributed amount against their U.S. federal income tax liabilities, if any, and to claim refunds on a properly-filed U.S. tax return to the extent the credit exceeds such liabilities. If the Fund makes this designation, for federal income tax purposes, the tax basis of the shares owned by a shareholder of the Fund would be increased by an amount equal under current law to the difference between the amount of undistributed capital gains included in the shareholder's gross income under clause (i) of the preceding sentence and the tax deemed paid by the shareholder under clause (ii) of the preceding sentence. The Fund is not required to, and there can be no assurance the Fund will, make this designation if it retains all or a portion of its net capital gain in a taxable year. To the extent that the Fund retains any net capital gain, it may be required to liquidate portfolio securities that it might otherwise have continued to hold (including when it might not be advantageous to do so) in order to generate the cash to pay the tax on the amount retained.

Amounts not distributed by the Fund on a timely basis in accordance with calendar year distribution requirements are subject to a nondeductible 4% excise tax. To avoid the excise tax, the Fund must distribute during each calendar year an amount at least equal to the sum of (1) 98% of its ordinary income (not taking into account any capital gains or losses) for the calendar year, (2) 98% of its capital gains in excess of its capital losses (and adjusted for certain ordinary losses) for the twelve-month period ending on October 31 of the calendar year or later if the Fund is permitted to elect and so elects, and (3) all ordinary income and capital gains for previous years that were not distributed during such years. For these purposes, the Fund will be treated as having distributed any amount for which it is subject to federal income tax. The Fund intends generally to make distributions sufficient to avoid the imposition of the excise tax, although there can be no assurance it will be able to do so. It may determine to pay the excise tax in a year to the extent it is deemed to be in the best interest of the Fund (*e.g.*, if the excise tax is *de minimis*).

A distribution will be treated as paid on December 31 of the calendar year if it is declared by the Fund in October, November or December of that year to shareholders of record on a date in such a month and paid by the Fund during January of the following year. Such distributions will be taxable to shareholders in the calendar year in which the distributions are declared, rather than the calendar year in which the distributions are received.

Distributions are taxable whether shareholders receive them in cash or reinvest them in additional Common Shares through the Dividend Reinvestment Plan. A shareholder whose distributions are reinvested in Common Shares under the Dividend Reinvestment Plan generally will be treated as having received a dividend equal to either (i) if shares are trading at or above net asset value, the fair market value of the new Common Shares issued to the shareholder or (ii) if shares are trading below net asset value, the amount of cash allocated to the shareholder for the purchase of additional Common Shares on its behalf in the open market.



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Distributions received by tax-exempt shareholders generally will not be subject to federal income tax to the extent permitted under applicable tax law.

For federal income tax purposes, distributions of investment income generally are taxable as ordinary income. Taxes on distributions of capital gains are determined by how long the Fund owned (and is treated for federal income tax purposes as having owned) the investments that generated them, rather than how long a shareholder has owned his or her shares. Distributions of net capital gains from the sale of investments that the Fund owned for more than one year and that are properly designated by the Fund as capital gain dividends ( Capital Gain Dividends ) will generally be taxable to shareholders as long-term capital gains. Distributions of gains from the sale of investments that the Fund owned for one year or less will generally be taxable to shareholders as ordinary income.

The ultimate tax characterization of the Fund's distributions made in a taxable year cannot be determined finally until after the end of that taxable year. As a result, there is a possibility that the Fund may make total distributions during a taxable year in an amount that exceeds the net investment income and net capital gains of the Fund with respect to that year, in which case the excess generally will be treated as a return of capital, which will be tax-free to the holders of the shares, up to the amount of the shareholder's adjusted tax basis in the applicable shares, with any amounts exceeding such basis treated as gain from the sale of such shares. See additional discussion below regarding the effect of distributions constituting returns of capital on Common Shareholders.

To the extent the Fund makes distributions of capital gains in excess of the Fund's net capital gains for the taxable year (as reduced by any available capital loss carryforwards from prior taxable years), as the Fund may elect to do, and the distributions are supported by the Fund's current earnings and profits (realized income and gain of the current year), the distributions will be taxable as ordinary dividend distributions, even though distributed excess amounts would not have been subject to tax if retained by the Fund. Moreover, in such cases the capital loss carryforwards that will remain available for future years are reduced by the excess of current-year capital gains over current-year capital losses.

For taxable years beginning before January 1, 2011, qualified dividend income received by an individual will be taxed at the rates applicable to long-term capital gain. It is currently unclear whether Congress will extend, change or eliminate this provision to or for tax years beginning on or after January 1, 2011. In order for some portion of the dividends received by the Fund shareholder to be qualified dividend income, the Fund must meet holding period and other requirements with respect to some portion of the dividend-paying stocks in its portfolio and the shareholder must meet holding period and other requirements with respect to the Fund's shares. A dividend will not be treated as qualified dividend income (at either the Fund or shareholder level) (1) if the dividend is received with respect to any share of stock held for fewer than 61 days during the 121-day period beginning on the date which is 60 days before the date on which such share becomes ex-dividend with respect to such dividend (or, in the case of certain

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preferred stock, 91 days during the 181-day period beginning 90 days before such date), (2) to the extent that the recipient is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property, (3) if the recipient elects to have the dividend income treated as investment income for purposes of the rules relating to the limitation on the deductibility of investment-related interest, or (4) if the dividend is received from a non-U.S. corporation that is (a) not eligible for the benefits of a comprehensive income tax treaty with the United States (with the exception of dividends paid on stock of such a non-U.S. corporation readily tradable on an established securities market in the United States) or (b) treated as a passive foreign investment company. If the Fund receives dividends from an underlying fund that qualifies as a regulated investment company, and the underlying fund designates such dividends as qualified dividend income, then the Fund may, in turn, designate a portion of its distributions as qualified dividend income as well, provided the Fund meets the holding period and other requirements with respect to shares of the underlying fund. The Fund does not expect a significant portion of Fund distributions to be derived from qualified dividend income.

Long-term capital gain rates applicable to most individual shareholders have been temporarily reduced in general, to 15% with a 0% rate applying to taxpayers in the 10% and 15% ordinary income tax rate brackets for taxable years beginning before January 1, 2011. It is currently unclear whether Congress will extend, change or eliminate this special rate to or for tax years beginning on or after January 1, 2011.

In general, dividends of net investment income received by corporate shareholders of the Fund will qualify for the 70% dividends received deduction generally available to corporations to the extent of the amount of eligible dividends received by the Fund from domestic corporations for the taxable year. A dividend received by the Fund will not be treated as a dividend eligible for the dividends-received deduction (1) if it has been received with respect to any share of stock that the Fund has held for less than 46 days (91 days in the case of certain preferred stock) during the 91-day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend (during the 181-day period beginning 90 days before such date in the case of certain preferred stock) or (2) to the extent that the Fund is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. Moreover, the dividends received deduction may be disallowed or reduced (1) if the corporate shareholder fails to satisfy the foregoing requirements with respect to its shares of the Fund or (2) by application of various provisions of the Code (for instance, the dividends-received deduction is reduced in the case of a dividend received on debt-financed portfolio stock (generally, stock acquired with borrowed funds)). The Fund generally does not expect a significant portion of its distributions to be eligible for the dividends received deduction.

The Internal Revenue Service ( IRS ) currently requires that a regulated investment company that has two or more classes of stock allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains) based upon the percentage of total dividends distributed to each class for the tax year. Accordingly, the Fund intends each year to allocate Capital Gain Dividends between and among its Common Shares, Series T Preferred Shares, Series W Preferred Shares and Series TH Preferred Shares in proportion to the total

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dividends paid to each class with respect to such tax year. Dividends qualifying and not qualifying for (a) treatment as qualified dividend income and (b) the dividends received deduction, if any, will similarly be allocated between and among any such classes.

Existing authorities do not specifically address whether dividends that are paid following the close of a taxable year, but that are treated for tax purposes as derived from the income of such prior taxable year, are treated as dividends paid during such prior taxable year for purposes of determining each class' proportionate share of a particular type of income. Existing authorities also do not specifically address the allocation of taxable income among the dividends paid to holders of a class of shares during or with respect to a taxable year. It is possible that the IRS could disagree with the Fund's position concerning the treatment of dividends paid after the close of a taxable year or with the Fund's method of allocation, in which case the IRS could attempt to recharacterize a portion of the dividends paid to the holders of Preferred Shares. If the IRS were to prevail with respect to any such attempted recharacterization, holders of Preferred Shares could be subject to additional tax on amounts so recharacterized and the Fund could be subject to federal income and excise tax.

If the Fund makes a distribution to a shareholder in excess of the Fund's current and accumulated earnings and profits (including earnings and profits arising from tax-exempt income) in any taxable year, the excess distribution will be treated as a return of capital to the extent of such shareholder's tax basis in its shares, and thereafter as capital gain. A return of capital is not taxable, but it reduces a shareholder's tax basis in its shares, thus reducing any loss or increasing any gain on a subsequent taxable disposition by the shareholder of its shares. Where one or more such distributions occur in any taxable year of the Fund, the available earnings and profits will be allocated, first, to the distributions made to the holders of Preferred Shares, and only thereafter to distributions made to holders of Common Shares. As a result, the holders of Preferred Shares will receive a disproportionate share of the distributions treated as dividends, and the holders of the Common Shares will receive a disproportionate share of the distributions treated as a return of capital.

Dividends and distributions on the Fund's shares are generally subject to federal income tax as described herein to the extent they do not exceed the Fund's realized income and gains, even though such dividends and distributions may economically represent a return of a particular shareholder's investment. Such distributions are likely to occur in respect of shares purchased at a time when the Fund's net asset value reflects unrealized gains or income or gains that are realized but not yet distributed. Such realized income and gains may be required to be distributed even when the Fund's net asset value also reflects unrealized losses.

**Sales, Exchanges or Redemptions of Shares.**

The sale, exchange or redemption of shares of the Fund may give rise to a gain or loss. In general, any gain or loss realized upon a taxable disposition of shares will be treated as long-term capital gain or loss if the shares have been held for more than 12 months. Otherwise, the gain or loss on the taxable disposition of shares will be treated as short-term capital gain or loss. However, any loss realized upon a taxable disposition of shares held for six months or less will be treated as long-term, rather than short-term, to the extent of any long-term capital gain

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distributions received (or deemed received) by the shareholder with respect to those shares. All or a portion of any loss realized upon a taxable disposition of shares will be disallowed if other substantially identical shares of the Fund are purchased (whether through the automatic reinvestment of dividends or otherwise) within 30 days before or after the disposition. In such a case, the basis of the newly purchased shares will be adjusted to reflect the disallowed loss.

From time to time the Fund may make a tender offer for its Common Shares. Shareholders who tender all Common Shares held, or considered to be held, by them and do not hold (directly or by attribution under certain attribution rules of the Code) any other Fund shares (namely, Preferred Shares) will be treated as having sold their shares and generally will realize a capital gain or loss. If a shareholder tenders fewer than all of its Common Shares, or continues to hold (directly or by attribution) other Fund shares (Preferred Shares), such shareholder may be treated as having received a taxable dividend upon the tender of its Common Shares. In such a case, there is a remote risk that non-tendering shareholders will be treated as having received taxable distributions from the Fund. To the extent that the Fund recognizes net gains on the liquidation of portfolio securities to meet such tenders of Common Shares, the Fund will be required to make additional distributions to its Common Shareholders.

### **Original Issue Discount and Payment-in-Kind Securities**

Some of the debt obligations (with a fixed maturity date of more than one year from the date of issuance) that may be acquired by the Fund may be (and all zero-coupon debt obligations acquired by the Fund will be) treated as debt obligations that are issued originally at a discount. Generally, the amount of the original issue discount (OID) is treated as interest income and is included in the Fund's income (and thus is required to be distributed) over the term of the debt security, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt obligation. Increases in the principal amount of an inflation-indexed bond will generally be treated as OID. Some of the debt obligations (with a fixed maturity date of more than one year from the date of issuance) that are acquired by the Fund in the secondary market may be treated as having market discount. Very generally, market discount is the excess of the stated redemption price of a debt obligation over the purchase price of such obligation. Generally, any gain recognized on the disposition of, and any partial payment of principal on, a debt obligation having market discount is treated as ordinary income to the extent the gain, or principal payment, does not exceed the accrued market discount on such debt obligation. Alternatively, the Fund may elect to accrue market discount currently, in which case the Fund will be required to include the accrued market discount in the Fund's income (as ordinary income) and thus distribute it over the term of the debt obligation, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt obligation. The rate at which the market discount accrues, and thus is included in the Fund's income, will depend upon which of the permitted accrual methods the Fund elects.

Some debt obligations (with a fixed maturity date of one year or less from the date of issuance) that are acquired by the Fund may be treated as having acquisition discount, or OID in the case of certain types of debt obligations. Generally, the Fund will be required to include the acquisition discount, or OID, in income over the term of the debt obligation, even though

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payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt obligation. The Fund may make one or more of the elections applicable to debt obligations having acquisition discount, or OID, which could affect the character and timing of recognition of income.

In addition, pay-in-kind securities will, and commodity-linked notes may, give rise to income which is required to be distributed and is taxable even though the Fund holding the security receives no interest payment in cash on the security during the year.

By reason of holding such securities, the Fund may be required to pay out as an income distribution each year an amount which is greater than the total amount of cash interest the Fund actually received. Such distributions may be made from the cash assets of the Fund or by liquidation of portfolio securities, if necessary (including when it is not advantageous to do so). The Fund may realize gains or losses from such liquidations. In the event the Fund realizes net capital gains from such transactions, its shareholders may receive a larger capital gain distribution, if any, than they would in the absence of such transactions.

## **Higher-Risk Securities**

To the extent such investments are permissible for the Fund, the Fund may invest in debt obligations that are in the lowest rating categories or are unrated, including debt obligations of issuers not currently paying interest or who are in default. Investments in debt obligations that are at risk of or in default present special tax issues for the Fund. Federal income tax rules are not entirely clear about issues such as when the Fund may cease to accrue interest, OID or market discount, when and to what extent deductions may be taken for bad debts or worthless securities and how payments received on obligations in default should be allocated between principal and income. These and other related issues will be addressed by the Fund when, as and if it invests in such securities, in order to seek to ensure that it distributes sufficient income to preserve its status as a regulated investment company and does not become subject to federal income or excise tax.

## **Issuer Deductibility of Interest**

A portion of the interest paid or accrued on certain high yield discount obligations owned by the Fund may not be deductible (and thus, may affect the cash flow of) the issuer. If a portion of the interest paid or accrued on certain high yield discount obligations is not deductible, that portion will be treated as a dividend for purposes of the corporate dividends received deduction. In such cases, if the issuer of the high yield discount obligations is a domestic corporation, dividend payments by the Fund may be eligible for the dividends received deduction to the extent of the deemed dividend portion of such accrued interest.

## **Certain Investments in REITs**

The Fund may invest in REITs. Such investments in REIT equity securities may require the Fund to accrue and to distribute income not yet received. To generate sufficient cash to make the requisite distributions, the Fund may be required to sell securities in its portfolio (including when

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it is not advantageous to do so) that it otherwise would have continued to hold. The Fund's investments in REIT equity securities may at other times result in the Fund's receipt of cash in excess of the REIT's earnings; if the Fund distributes such amounts, such distribution could constitute a return of capital to Fund shareholders for federal income tax purposes. Dividends received by the Fund from a REIT generally will not constitute qualified dividend income.

The Fund may invest directly or indirectly in real estate mortgage investment conduits ( REMICs ) (including by investing in residual interests in CMOs with respect to which an election to be treated as a REMIC is in effect) or equity interests in taxable mortgage pools ( TMPs ). Under a notice issued by the IRS in October 2006 and Treasury Regulations that have yet to be issued but may apply retroactively, a portion of a regulated investment company's income (including income allocated to the Fund from a REIT or other pass-through entity) that is attributable to a residual interest in a REMIC or an equity interest in a TMP referred to in the Code as an excess inclusion will be subject to U.S. federal income tax in all events. This notice also provides, and the regulations are expected to provide, that excess inclusion income of a regulated investment company, such as the Fund, will be allocated to shareholders of the regulated investment company in proportion to the dividends received by such shareholders, with the same consequences as if the shareholders held the related interest directly. As a result, a Fund investing in such interests may not be a suitable investment for charitable remainder trusts, as noted below.

In general, excess inclusion income allocated to shareholders (i) cannot be offset by net operating losses (subject to a limited exception for certain thrift institutions), (ii) in the case of a non-U.S. shareholder, will not qualify for any reduction in U.S. federal withholding tax (discussed below), and (iii) will constitute unrelated business taxable income ( UBTI ) to entities (including a qualified pension plan, an individual retirement account, a 401(k) plan, a Keogh plan or other tax-exempt entity) subject to tax on unrelated business income, thereby potentially requiring such an entity that is allocated excess inclusion income, and otherwise might not be required to file a tax return, to file a tax return and pay tax on such income. Additionally a tax-exempt shareholder will recognize UBTI by virtue of its investment in the Fund if shares in the Fund constitute debt-financed property in the hands of the tax-exempt shareholder within the meaning of section 514(b) of the Code.

Under legislation enacted in December 2006, if a charitable remainder trust ( CRT ), as defined in Section 664 of the Code, realizes any UBTI for a taxable year, a 100% excise tax is imposed on such UBTI. Under IRS guidance issued in October 2006, a CRT will not recognize UBTI solely as a result of investing in a regulated investment company that recognizes excess inclusion income. Rather, if at any time during any taxable year a CRT (or one of certain other tax-exempt shareholders, such as the United States, a state or political subdivision, or an agency or instrumentality thereof, and certain energy cooperatives) is a record holder of a share in a regulated investment company that recognizes excess inclusion income, then the regulated investment company will be subject to a tax on that portion of its excess inclusion income for the taxable year that is allocable to such shareholders at the highest federal corporate income tax rate. The extent to which this IRS guidance remains applicable in light of the December 2006 legislation is unclear. To the extent permitted under the 1940 Act, the Fund may elect to specially allocate any such tax to the applicable CRT, or other shareholder, and thus reduce such

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shareholder's distributions for the year by the amount of the tax that relates to such shareholder's interest in the Fund. The Fund has not yet determined whether such an election will be made. CRTs are urged to consult their tax advisors concerning the consequences of investing in the Fund.

**Options, Futures, Forward Contracts and Swap Agreements**

The federal income tax treatment of the Fund's options activity will vary based on the nature and the subject of the options. In general, option premiums from the Fund's option writing activity are not immediately included in the income of the Fund when received. Instead, in the case of certain options (including options on single stocks, options on certain narrow-based indexes and options not listed on certain exchanges) the premiums are recognized when the option contract expires, the option is exercised by the holder, or the Fund transfers or otherwise terminates the option. If an option written by the Fund with respect to individual stocks is exercised and the Fund sells or delivers the underlying stock, the Fund generally will recognize capital gain or loss equal to (a) the sum of the strike price and the option premium received by the Fund minus (b) the Fund's adjusted tax basis in the stock. Such gain or loss generally will be short-term or long-term depending upon the holding period of the underlying stock. The gain or loss with respect to any termination of the Fund's obligation under such an option other than through the exercise of the option and related sale or delivery of the underlying stock will be short-term capital gain or loss. Thus, if an option written by the Fund expires unexercised, the Fund generally will recognize short-term capital gain equal to the premium received.

Certain options that are listed on a qualified board of exchange (listed options) written or purchased by the Fund (including options on futures contracts, broad-based equity indices and debt securities) as well as certain futures contracts will be governed by section 1256 of the Code (section 1256 contracts). Gains or losses on section 1256 contracts generally are considered 60% long-term and 40% short-term capital gains or losses (<sup>60</sup>/<sub>40</sub>), although certain foreign currency gains and losses from such contracts may be treated as ordinary in character. Also, section 1256 contracts held by the Fund at the end of each taxable year (and, for purposes of the nondeductible 4% excise tax, on certain other dates as prescribed under the Code) are marked to market with the result that unrealized gains or losses are treated as though they were realized and the resulting gain or loss is treated as ordinary or <sup>60</sup>/<sub>40</sub> gain or loss, as applicable. Almost no options listed on non-U.S. exchanges will meet the requirements for section 1256 treatment.

Certain covered call-writing activities of the Fund, if any, may trigger the federal income tax straddle rules of section 1092 of the Code, requiring that losses be deferred and holding periods be terminated on offsetting positions in options and stocks deemed to constitute substantially similar or related property. Options that are not deep in the money may give rise to qualified covered calls, which generally are not subject to the straddle rules; the holding period on stock underlying qualified covered calls that are in the money although not deep in the money will be suspended while such calls are outstanding. Thus, the straddle rules and the rules governing qualified covered calls could cause gains that would otherwise constitute long-term capital gains to be treated as short-term capital gains, and distributions that would otherwise constitute qualified dividend income to fail to satisfy the holding period requirements and therefore to be taxed as ordinary income.

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More generally, to the extent such investments are permissible for the Fund, the Fund's transactions in options, futures contracts, swap agreements, hedging transactions, forward contracts, straddles and foreign currencies will be subject to special tax rules (including notional principal contract, mark-to-market, constructive sale, straddle, wash sale and short sale rules), the effect of which may be, among other things, to accelerate the recognition of income to the Fund, to defer losses to the Fund, to cause adjustments in the holding periods of the Fund's securities, to convert lower taxed long-term capital gains or qualified dividend income into higher taxed short-term capital gains or ordinary income and to convert short-term capital losses into long-term capital losses. These rules, therefore, could affect the amount, timing and/or character of distributions to shareholders. In particular, the straddle rules require that certain losses be deferred, and the holding period for positions governed by these rules generally will not begin until after the offsetting position is no longer outstanding.

The special tax rules that apply to certain of the Fund's activities and investments, including certain of its options-writing activities, if any, investments in futures contracts and hedging activities (including its transactions, if any, in non-U.S. currencies or in certain non-U.S. currency-denominated instruments) are likely to produce a difference between its book income and its taxable income. Among other things, these special rules can affect the treatment of capital gain or loss as long-term or short-term and may result in ordinary income rather than capital gain. The application of these special rules may also affect the timing, amount and/or character of distributions made by the Fund. If the Fund's book income exceeds its taxable income, the distribution (if any) of such excess will be treated as (i) a dividend to the extent of the Fund's remaining current and accumulated earnings and profits, (ii) thereafter as a return of capital to the extent of the recipient's adjusted tax basis in the shares and (iii) thereafter as gain from the sale or exchange of a capital asset. If the Fund's book income is less than its taxable income, the Fund could be required to make distributions exceeding book income to qualify as a regulated investment company that is accorded special tax treatment.

## **Foreign Currency Transactions**

The Fund's transactions in foreign currencies, foreign currency-denominated debt obligations and certain foreign currency options, futures contracts and forward contracts (and similar instruments) may give rise to ordinary income or loss to the extent such income or loss results from fluctuations in the value of the foreign currency concerned. Such ordinary income treatment may accelerate the Fund's distributions to shareholders and increase the distributions taxed to shareholders as ordinary income. Losses from such positions may lead to a return of capital to Fund shareholders.

## **Non-U.S. Taxation**

Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries. Tax treaties between certain countries and the United States may reduce or eliminate such taxes. In addition, the Fund's investments in non-U.S. securities or foreign currencies may increase or accelerate the Fund's recognition of ordinary income and may affect the timing, amount and/or characterization of the Fund's distributions.



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If more than 50% of the Fund's assets at its year end consists of the securities of non-U.S. corporations, the Fund may elect to permit shareholders to claim a credit or deduction on their income tax returns for their pro rata portion of qualified taxes paid by the Fund to non-U.S. countries in respect of non-U.S. securities the Fund has held for at least the minimum period specified in the Code. In such a case, shareholders will include in gross income from non-U.S. sources their pro rata shares of such taxes. A shareholder's ability to claim a non-U.S. tax credit or deduction in respect of non-U.S. taxes paid by the Fund may be subject to certain limitations imposed by the Code, as a result of which the shareholder might not get a full credit or deduction for the amount of such taxes. Shareholders who do not itemize on their federal income tax returns may claim a credit (but no deduction) for such non-U.S. taxes. The Fund does not expect to be eligible to pass through non-U.S. tax credits or deductions to its shareholders.

**Non-U.S. Shareholders**

In general, Capital Gain Dividends are not subject to withholding of U.S. federal income tax. In general, dividends other than Capital Gain Dividends paid by the Fund to a shareholder that is not a United States person within the meaning of the Code (such shareholder, a non-U.S. person or a non-U.S. shareholder) are subject to withholding of federal income tax at a rate of 30% (or lower applicable treaty rate) even if they are funded by income or gains (such as portfolio interest, short-term capital gains, or non-U.S.-source dividend and interest income) that, if paid to a non-U.S. person directly, would not be subject to withholding. However, effective for taxable years of the Fund beginning before January 1, 2010 (and for taxable years beginning before January 1, 2011 if pending legislation discussed below is enacted), the Fund is not required to withhold any amounts with respect to (i) properly designated distributions (other than distributions to a non-U.S. person (w) that has not provided a satisfactory statement that the beneficial owner is not a United States person, (x) to the extent that the dividend is attributable to certain interest on an obligation if the non-U.S. person is the issuer or is a 10% shareholder of the issuer, (y) that is within certain non-U.S. countries that have inadequate information exchange with the United States, or (z) to the extent the dividend is attributable to interest paid by a person that is a related person of the non-U.S. person and the non-U.S. person is a controlled foreign corporation) from U.S. source interest income that, in general, would not be subject to federal income tax if earned directly by an individual non-U.S. person, and (ii) properly designated distributions (other than distributions to an individual non-U.S. person who is present in the United States for a period or periods aggregating 183 days or more during the year of the distribution or distributions subject to special rules regarding the disposition of U.S. real property interests, as described below) of net short-term capital gains in excess of net long-term capital losses. Pending legislation would extend the exemption from withholding for interest-related distributions and short-term capital gain distributions for one year. It is unclear at this time whether the legislation will be enacted and, if enacted, what the terms of the extension will be.

In the case of shares held through an intermediary, the intermediary may withhold even if the Fund makes a designation with respect to a payment. Non-U.S. shareholders should contact their intermediaries regarding the application of these rules to their accounts.

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Special rules would apply if the Fund were either a U.S. real property holding corporation (USRPHC) or would be a USRPHC but for the operation of certain exceptions to the definition thereof. Very generally, a USRPHC is a domestic corporation that holds USRPIs the fair market value of which equals or exceeds 50% of the sum of the fair market values of the corporation's USRPIs, interests in real property located outside the United States, and other assets. USRPIs are generally defined as any interest in U.S. real property and any interest (other than solely as a creditor) in a USRPHC or former USRPHC.

If the Fund were a USRPHC or would be a USRPHC but for the exceptions referred to above, any distributions by the Fund to a non-U.S. shareholder attributable to gains realized by the Fund on the disposition of USRPIs or to distributions received by the Fund from a lower-tier RIC or REIT that the Fund is required to treat as USRPI gain in its hands generally would be subject to U.S. tax withholding. In addition, such distributions could result in the non-U.S. shareholder being required to file a U.S. tax return and pay tax on the distributions at regular U.S. federal income tax rates. The consequences to a non-U.S. shareholder, including the rate of such withholding and character of such distributions (e.g., as ordinary income or USRPI gain), would vary depending upon the extent of the non-U.S. shareholder's current and past ownership of the Fund. On and after January 1, 2010, this look-through USRPI treatment for distributions by the Fund, if it were either a USRPHC or would be a USRPHC but for the operation of the exceptions referred to above, to non-U.S. shareholders would apply only to those distributions that, in turn, are attributable to distributions received by the Fund from a lower-tier REIT that the Fund is required to treat as USRPI gain in its hands. Pending legislation proposes to extend the look-through provisions applicable before January 1, 2010 described above for one additional year, i.e., to distributions made on or after January 1, 2010 but before January 1, 2011. However, as of the date of this Statement of Additional Information, it is unclear whether such legislation will be enacted and, if enacted, what the terms of the extension will be.

In addition, if the Fund were a USRPHC or former USRPHC, a greater-than-5% non-U.S. shareholder generally would be required to file a U.S. tax return in connection with the sale of its Fund shares, and pay related taxes due on any gain realized on the sale. Moreover, if the Fund were a USRPHC or former USRPHC, it could be required to withhold on amounts distributed to a greater-than-5% non-U.S. shareholder to the extent such amounts are in excess of the Fund's current and accumulated earnings and profits for the applicable taxable year.

The Fund generally does not expect that it will be a USRPHC or would be a USRPHC but for the operation of certain of the special exceptions referred to above.

In order to qualify for any exemptions from withholding described above or for lower withholding tax rates under income tax treaties, or to establish an exemption from backup withholding, a non-U.S. shareholder must comply with special certification and filing requirements relating to its non-U.S. status (including, in general, furnishing an IRS Form W-8BEN or substitute form). Non-U.S. shareholders should consult their tax advisors in this regard.

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Under federal tax law, a beneficial holder of shares who is a non-U.S. shareholder generally is not subject to federal income tax on gains (and is not allowed a deduction for losses) realized on the sale of shares of the Fund or on Capital Gain Dividends unless (i) such gain or dividend is effectively connected with the conduct of a trade or business carried on by such holder within the United States, (ii) in the case of an individual holder, the holder is present in the United States for a period or periods aggregating 183 days or more during the year of the sale or capital gain dividend and certain other conditions are met, or (iii) the special rules relating to gain attributable to the sale or exchange of USRPIs apply to the non-U.S. shareholder's sale of Common Shares or to the Capital Gain Dividend the non-U.S. shareholder received (as described above).

If a beneficial holder who is a non-U.S. person has a trade or business in the United States, and the dividends are effectively connected with the conduct by the beneficial holder of a trade or business in the United States, the dividend will be subject to federal net income taxation at regular income tax rates. If a non-U.S. person is eligible for the benefits of a tax treaty, any effectively connected income or gain will generally be subject to federal income tax on a net basis only if it is attributable to a permanent establishment maintained by such person in the United States.

A beneficial holder of shares who is a non-U.S. person may be subject to state and local tax and to the federal estate tax in addition to the federal tax on income referred to above.

## **Backup Withholding**

The Fund may be required to withhold and to remit to the U.S. Treasury a percentage of the taxable dividends and other distributions paid to and proceeds of share sales, exchanges, or redemptions made by any individual shareholder who fails to properly furnish the Fund with a correct taxpayer identification number (TIN), who has under-reported dividends or interest income, or who fails to certify to the Fund that he or she is not subject to such withholding. The backup withholding tax rate is 28% for amounts paid through December 31, 2010. The backup withholding tax rate will be 31% for amounts paid after December 31, 2010, unless Congress enacts tax legislation providing otherwise. Corporate shareholders and certain other shareholders specified in the Code generally are exempt from such backup withholding. Backup withholding is not an additional tax. Any amounts withheld may be credited against the shareholder's federal income tax liability, provided the appropriate information is furnished to the Internal Revenue Service.

In order for a non-U.S. investor to qualify for exemption from the backup withholding tax rates, the non-U.S. investor may be required to comply with special certification and filing requirements. Non-U.S. investors in the Fund should consult their tax advisors in this regard. Backup withholding is not an additional tax. Any amounts withheld may be credited against the shareholder's U.S. federal income tax liability, provided the appropriate information is furnished to the IRS.

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### **Tax Shelter Reporting Regulations**

Under U.S. Treasury regulations, if a shareholder recognizes a loss with respect to the Fund's shares of \$2 million or more for an individual shareholder or \$10 million or more for a corporate shareholder, the shareholder must file with the Internal Revenue Service a disclosure statement on Form 8886. Direct shareholders of portfolio securities are in many cases excepted from this reporting requirement, but under current guidance, shareholders of a regulated investment company are not excepted. Future guidance may extend the current exception from this reporting requirement to shareholders of most or all regulated investment companies. The fact that a loss is reportable under these regulations does not affect the legal determination of whether the taxpayer's treatment of the loss is proper. Shareholders should consult their tax advisors to determine the applicability of these regulations in light of their individual circumstances.

### **Shares Purchased Through Tax-Qualified Plans**

Special tax rules apply to investments through defined contribution plans and other tax-qualified plans. Shareholders should consult their tax advisors to determine the suitability of shares of the Fund as an investment through such plans and the precise effect of an investment on their particular tax situation.

### **Other Taxation**

Distributions also may be subject to additional state, local and non-U.S. taxes, depending on each shareholder's particular situation. Under the laws of various states, distributions of investment company taxable income generally are taxable to shareholders even though all or a substantial portion of such distributions may be derived from interest on certain federal obligations which, if the interest were received directly by a resident of such state, would be exempt from such state's income tax (qualifying federal obligations). However, some states may exempt all or a portion of such distributions from income tax to the extent the shareholder is able to establish that the distribution is derived from qualifying federal obligations. Moreover, for state income tax purposes, interest on some federal obligations generally is not exempt from taxation, whether received directly by a shareholder or through distributions of investment company taxable income (for example, interest on FNMA Certificates and GNMA Certificates). The Fund will provide information annually to shareholders indicating the amount and percentage of its dividend distribution which is attributable to interest on federal obligations, and will indicate to the extent possible from what types of federal obligations such dividends are derived. The Fund is organized as a Massachusetts business trust. Under current law, so long as the Fund qualifies for the federal income tax treatment described above, it is believed that the Fund will not be liable for any income or franchise tax imposed by Massachusetts. Shareholders, in any event, are advised to consult their own tax advisors with respect to the particular tax consequences to them of an investment in the Fund.

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**PERFORMANCE RELATED AND COMPARATIVE INFORMATION**

The Fund may quote certain performance-related information and may compare certain aspects of its portfolio and structure to other substantially similar closed-end funds as categorized by Lipper, Inc. ( Lipper ), Morningstar Inc. or other independent services. Comparison of the Fund to an alternative investment should be made with consideration of differences in features and expected performance. The Fund may obtain data from sources or reporting services, such as Bloomberg Financial and Lipper, that the Fund believes to be generally accurate.

The Fund, in its advertisements, may refer to pending legislation from time to time and the possible impact of such legislation on investors, investment strategy and related matters. At any time in the future, yields and total return may be higher or lower than past yields and there can be no assurance that any historical results will continue.

Past performance is not indicative of future results. At the time Common Shareholders sell their shares, they may be worth more or less than their original investment.

**CUSTODIAN, TRANSFER AGENT AND DIVIDEND DISBURSEMENT AGENT**

State Street Bank and Trust Co., 801 Pennsylvania Avenue, Kansas City, Missouri 64105, serves as custodian for assets of the Fund. The custodian performs custodial and fund accounting services.

PNC Global Investment Servicing Inc., P.O. Box 43027, Providence, RI 02940, serves as the transfer agent, registrar and dividend disbursement agent for the Common Shares, as well as agent for the Dividend Reinvestment Plan relating to the Common Shares.

Deutsche Bank Trust Company Americas, 280 Park Avenue, 9th Floor, New York, New York 10017, serves as auction agent, transfer agent, registrar, dividend paying agent and redemption agent for the Preferred Shares.

**INDEPENDENT REGISTERED PUBLIC ACCOUNTANT**

[ ], [ ] serves as independent auditors for the Fund. [ ] provides audit services, tax return preparation and assistance and consultation in connection with review of SEC filings to the Fund.

**COUNSEL**

Ropes & Gray LLP, One International Place, Boston, Massachusetts 02110, passes upon certain legal matters in connection with shares offered by the Fund, and also acts as counsel to the Fund.

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**REGISTRATION STATEMENT**

A Registration Statement on Form N-2, including any amendments thereto (the "Registration Statement"), relating to the shares of the Fund offered hereby, has been filed by the Fund with the SEC, Washington, D.C. The Prospectus and this Statement of Additional Information are parts of, but do not contain all of the information set forth in, the Registration Statement, including any exhibits and schedules thereto. For further information with respect to the Fund and the shares offered or to be offered hereby, reference is made to the Fund's Registration Statement. Statements contained in the Prospectus and this Statement of Additional Information as to the contents of any contract or other document referred to are not necessarily complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement, each such statement being qualified in all respects by such reference. Copies of the Registration Statement may be inspected without charge at the SEC's principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the SEC upon the payment of certain fees prescribed by the SEC.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

[To be added]

**FINANCIAL STATEMENTS**

The Fund's financial statements appearing in the Fund's annual shareholder report for the period ended July 31, 2009 are incorporated by reference in this Statement of Additional Information (File No. 811-21374) and have been so incorporated in reliance upon the report of [ ], independent registered public accounting firm for the Fund. The annual shareholder report is available upon request and without charge by writing to the Fund at 1345 Avenue of the Americas, New York, New York 10105.

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**Appendix A**

**Description of Proxy Voting Policy and Procedures**

***Pacific Investment Management Company LLC ( PIMCO )***

PIMCO has adopted written proxy voting policies and procedures ( Proxy Policy ) as required by Rule 206(4)-6 under the Advisers Act. The Proxy Policy has been adopted by the Fund as the policies and procedures that PIMCO will use when voting proxies on behalf of the Fund. Recognizing that proxy voting is a rare event in the realm of fixed income investing and is typically limited to solicitation of consent to changes in features of debt securities, the Proxy Policy also applies to any voting rights and/or consent rights of PIMCO, on behalf of the Fund, with respect to debt securities, including but not limited to, plans of reorganization, and waivers and consents under applicable indentures.

The Proxy Policy is designed and implemented in a manner reasonably expected to ensure that voting and consent rights are exercised in the best interests of the Fund and its shareholders. Each proxy is voted on a case-by-case basis taking into consideration any relevant contractual obligations as well as other relevant facts and circumstances at the time of the vote. In general, PIMCO reviews and considers corporate governance issues related to proxy matters and generally supports proposals that foster good corporate governance practices. PIMCO may vote proxies as recommended by management on routine matters related to the operation of the issuer and on matters not expected to have a significant economic impact on the issuer and/or its shareholders.

PIMCO will supervise and periodically review its proxy voting activities and implementation of the Proxy Policy. PIMCO will review each proxy to determine whether there may be a material conflict between PIMCO and the Fund. If no conflict exists, the proxy will be forwarded to the appropriate portfolio manager for consideration. If a conflict does exist, PIMCO will seek to resolve any such conflict in accordance with the Proxy Policy. PIMCO seeks to resolve any material conflicts of interest by voting in good faith in the best interest of the Funds. If a material conflict of interest should arise, PIMCO will seek to resolve such conflict in the Fund's best interest by pursuing any one of the following courses of action: (i) convening a committee to assess and resolve the conflict; (ii) voting in accordance with the instructions of the Board of Trustees; (iii) voting in accordance with the recommendation of an independent third-party service provider; (iv) suggesting to the Board of Trustees that the Fund engage another party to determine how the proxy should be voted; (v) delegating the vote to a third-party service provider; or (vi) voting in accordance with the factors discussed in the Proxy Policy.

Information about how the Funds voted proxies relating to portfolio securities held during the most recent twelve month period ended June 30th is available no later than the following August 31st without charge, upon request, by calling the Fund at 1-866-746-2606, on the Fund's website at <http://www.pimco-funds.com> and on the SEC's website at <http://www.sec.gov>.

Copies of the written Proxy Policy and the factors that PIMCO may consider in determining how to vote proxies for the Fund are available by calling the Fund at 1-866-746-2606, on the Fund's website at <http://www.pimco-funds.com> and on the Distributor's website at <http://www.allianzinvestors.com>.

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**PART C OTHER INFORMATION**

**Item 25: Financial Statements and Exhibits**

1. Financial Statements:

**Included in Part A:**

Financial Highlights for each of year ended July 31 since inception.

**Incorporated into Part B by reference to Registrant's most recent Certified Shareholder Report on Form N-CSR, dated July 31, 2009 (File No. 811-21374):**

Schedule of Investments as of July 31, 2009

Statement of Assets and Liabilities as of July 31, 2009

Statement of Operations for the year ended July 31, 2009

Statements of Changes in Net Assets for the two years ended July 31, 2009 and July 31, 2008

Statement of Cash Flows for the year ended July 31, 2009

Notes to Financial Statements

Report of Independent Registered Public Accounting Firm dated September 25, 2009

2. Exhibits:

(a)(1) Agreement and Declaration of Trust dated June 19, 2003. (1)

(a)(2) Amended and Restated Agreement and Declaration of Trust dated August 14, 2003. (2)

(b)(1) Bylaws of Registrant dated June 19, 2003. (1)

(b)(2) Amended and Restated Bylaws of the Registrant, dated August 14, 2003. (2)

(b)(3) Second Amended and Restated Bylaws of the Registrant, dated October 28, 2003. (4)

(b)(4) Amendment to Second Amended and Restated Bylaws of the Registrant, dated June 15, 2005. (5)

(b)(5) Third Amended and Restated Bylaws of the Registrant, dated December 11, 2008. (6)

(c) None.

(d)(1) Article III (Shares) and Article V (Shareholders' Voting Powers and Meetings) of the Amended and Restated Agreement and Declaration of Trust. (2)

(d)(2) Article 10 (Shareholders' Voting Powers and Meetings) of the Third Amended and Restated Bylaws. (6)

(d)(3) Form of Share Certificate of the Common Shares. (2)

(d)(4) Specimen certificate representing the Registrant's Auction Preferred Shares of beneficial interest. (3)



(d)(5) Form of subscription certificate for rights offering.

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- (e) Terms and Conditions of the Dividend Reinvestment Plan. (2)
- (f) None.
- (g)(1) Investment Management Agreement between Registrant and Allianz Global Investors Fund Management LLC. (2)
- (g)(2) Form of Portfolio Management Agreement between Allianz Global Investors Fund Management LLC and Pacific Investment Management Company LLC. (2)
- (h)(1) Form of Dealer Manager Agreement To be filed by pre-effective amendment.
- (i) None.
- (j) Form of Custodian and Investment Accounting Agreement between Registrant and State Street Bank and Trust Company. (2)
- (k)(1) Transfer Agency Services Agreement between Registrant and PNC Global Investment Servicing Inc. (2)
- (k)(2) Organizational and Offering Expenses Reimbursement Agreement between Registrant and Allianz Global Investors Fund Management LLC. (2)
- (k)(3) Auction Agency Agreement between the Registrant and the Auction Agent as to the Registrant's Preferred Shares. (3)
- (k)(4) Broker-Dealer Agreement as to the Registrant's Preferred Shares. (3)
- (k)(5) Depository Trust Company Representations letter as to the Registrant's Preferred Shares. (3)
- (k)(6) Form of Subscription Agent Agreement To be filed by pre-effective amendment.
- (k)(7) Form of Information Agent Agreement To be filed by pre-effective amendment.
- (l) Opinion and consent of Ropes & Gray LLP To be filed by pre-effective amendment.
- (m) None.
- (n) Consent of Registrant's independent registered public accounting firm To be filed by pre-effective amendment.
- (o) None.
- (p) Subscription Agreement of Allianz Global Investors of America L.P. dated August 19, 2003. (2)
- (q) None.
- (r)(1) Code of Ethics of Registrant dated August 14, 2003. (2)
- (r)(2) Code of Ethics of Allianz Global Investors Fund Management LLC dated February 9, 2009. (7)
- (r)(3) Code of Ethics of Pacific Investment Management Company LLC dated May 1 2009. (7)
- (s) Powers of Attorney for Paul Belica, Robert E. Connor, James A. Jacobson, Hans W. Kertess, John C. Maney and William B. Ogden, IV Filed herewith.

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- (1) Incorporated by reference to the Registrant's Initial Registration Statement on Form N-2 relating to its common shares of beneficial interest, File No. 333-106334, filed on June 20, 2003.
- (2) Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Initial Registration Statement on Form N-2 relating to its common shares of beneficial interest, File No. 333-106334, filed on August 25, 2003.
- (3) Incorporated by reference to Pre-Effective Amendment No.1 to the Registrant's Registration Statement on Form N-2 relating to its preferred shares of beneficial interest, File No. 333-108475, filed on October 24, 2003.
- (4) Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Initial Registration Statement on Form N-2 relating to its preferred shares of beneficial interest, File No. 333-108475, filed on October 29, 2003.
- (5) Incorporated by reference to the Registrant's Annual Report filed on Form NSAR-B, File No. 811-21374, filed on September 29, 2005.
- (6) Incorporated by reference to the Registrant's Semi-Annual Report filed on Form NSAR-A, File No. 811-21374, filed on March 27, 2009.
- (7) Incorporated by reference to Post-Effective Amendment No. 157 of PIMCO Funds, File No. 33-12113, filed on June 8, 2009.

**Item 26: Marketing Arrangements**

[To be filed by pre-effective amendment.]

**Item 27: Other Expenses of Issuance and Distribution**

|  |          |
|--|----------|
| Securities and Exchange Commission Fees            | \$ *     |
| Financial Industry Regulatory Authority, Inc. Fees | *        |
| Underwriters' partial reimbursement                | *        |
| Printing and engraving expenses                    | *        |
| Legal fees   | *        |
| New York Stock Exchange fees                       | *        |
| Accounting expenses                                | *        |
| Transfer Agent fees                                | *        |
| Marketing expenses                                 | *        |
| Miscellaneous expenses                             | *        |
| <b>Total</b>                                       | <b>*</b> |

\* Estimated expenses. [To be completed by pre-effective amendment.]

**Item 28: Persons Controlled by or under Common Control with Registrant**

Not applicable.

**Item 29: Number of Holders of Securities**

At , 2010

| Title of Class                        | Number of Record Holders                      |
|---------------------------------------|---|
| Preferred Shares, par value \$0.00001 | [To be completed by pre-effective amendment.] |
| Common Shares, par value \$0.00001    |   |

[To be completed by pre-effective amendment.]

**Table of Contents****Item 30: Indemnification**

Reference is made to Article VIII, Sections 1 through 4, of the Registrant's Amended and Restated Agreement and Declaration of Trust, which is incorporated by reference herein.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended (the "Act"), may be permitted to trustees, officers and controlling persons of the Registrant by the Registrant pursuant to the Trust's Amended and Restated Agreement and Declaration of Trust, its Amended and Restated Bylaws or otherwise, the Registrant is aware that in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Act and, therefore, is unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by trustees, officers or controlling persons of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such trustees, officers or controlling persons in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

**Item 31: Business and Other Connections of Investment Adviser**

Descriptions of the business of Allianz Global Investors Fund Management LLC, the Registrant's investment manager, and Pacific Investment Management Company LLC, the Registrant's sub-adviser, are set forth under the captions "Investment Manager" and "Sub-Adviser" under "Management of the Fund" in both the Prospectus and Statement of Additional Information forming part of this Registration Statement. The following sets forth business and other connections of each director and executive officer (and persons performing similar functions) of Allianz Global Investors Fund Management LLC and Pacific Investment Management Company LLC.

**Allianz Global Investors Fund Management LLC**

1345 Avenue of the Americas

New York, NY 10105

| <b>Name</b>          | <b>Position with AGIFM</b>                                   | <b>Other Connections</b>  |
|----------------------|--|---|
| E. Blake Moore, Jr.  | Chairman<br><br>Management Board and Chief Executive Officer | Chief Executive Officer of Allianz Global Investors Solutions LLC and Management Board of OpCap Advisors LLC.   |
| Udo Frank            | Management Board   | Managing Director, Chief Executive Officer, Chairman of the Board, Executive Committee and Board Manager of RCM Capital Management LLC; Managing Director, Chairman of the Board, Chief Executive Officer, Executive Committee and Member Board of Managers of RCM U.S. Holdings LLC. |
| Barbara Claussen     | Management Board   | Member-Management Board, Managing Director, Chief Operating Officer and Executive Committee of NFJ Investment Group LLC; Management Board of Allianz Global Investors Management Partners LLC.  |
| Marna C. Whittington | Management Board   | Managing Director, Chief Executive Officer, Executive Committee of Nicholas-Applegate Capital Management LLC; Managing Director and Chief Executive Officer of Nicholas-Applegate Securities LLC; Member-Management Board, Managing Director and CEO of AGI Management Partners LLC.  |
| John C. Maney        | Management Board   | Management Board, Managing Director and Chief Operating Officer of Allianz Global Investors of America  |

LLC, Allianz Global Investors of America L.P., and Allianz-PacLife Partners LLC; Member, Board of Directors and Managing Director of Allianz Global Investors Advertising Agency Inc.; Managing Director and Chief Operating Officer of Allianz Global

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| Name                  | Position with AGIFM   | Other Connections  |
|-----------------------|---|--|
| Michael J. Puntoriero | Chief Financial Officer                                     | <p>Investors NY Holdings LLC; Management Board and Managing Director of Allianz Global Investors U.S. Holding LLC; Managing Director and Chief Operating Officer of Allianz Global Investors U.S. Retail LLC; Managing Director and Chief Operating Officer of Allianz Hedge Fund Partners Holding L.P.; Director and Chief Operating Officer of PIMCO Global Advisors (Resources) Limited; Management Board of Nicholas-Applegate Holdings LLC, Allianz Global Investors Management Partners LLC and OpCap Advisors LLC; Board of Directors and Chief Operating Officer of Oppenheimer Group, Inc. and Allianz Global Investors of America Holdings Inc.; Compensation Committee of NFJ Investment Group LLC; Executive Vice President of PIMCO Japan Ltd. Chief Operating Officer of Allianz Global Investors U.S. Holding II LLC; Director, President and Chief Operating Officer of PFP Holdings, Inc.</p> <p>Chief Financial Officer of Allianz Global Investors of America Holdings Inc., Allianz Global Investors Managed Accounts LLC, Allianz Global Investors Solutions LLC, Allianz Global Investors U.S. Holding LLC, Allianz Global Investors U.S. Holding II LLC; Allianz Global Investors Hedge Fund Partners Holding L.P., NFJ Investment Group LLC, Nicholas-Applegate Capital Management LLC, Nicholas-Applegate Holdings LLC, OpCap Advisors LLC, Oppenheimer Capital LLC, Oppenheimer Group, Inc., Pacific Investment Management Company LLC, PFP Holdings Inc., PIMCO Australia Pty Ltd., PIMCO Canada Holding LLC, PIMCO Canada Management Inc., PIMCO Canada Corp., PIMCO Europe Limited, PIMCO Global Advisors LLC, PIMCO Japan Ltd., StocksPLUS Management Inc.; Managing Director and Chief Financial Officer of Allianz Global Investors Advertising Agency Inc., Allianz Global Investors of America LLC, Allianz Global Investors of America L.P., Allianz Global Investors Management Partners LLC, Allianz Global Investors U.S. Retail LLC, Allianz-PacLife Partners LLC, Allianz Global Investors NY Holdings LLC; Director and Chief Financial Officer of PIMCO Global Advisors (Resources) Limited. Managing Director of Allianz Global Investors Distributors LLC.</p> |
| Brian S. Shlissel     | Executive Vice President                                    | Executive Vice President of OpCap Advisors LLC.  |
| Larry G. Altadonna    | Senior Vice President                                       | Senior Vice President of OpCap Advisors LLC.   |
| Thomas J. Fuccillo    | Executive Vice President, Chief Legal Officer and Secretary | Executive Vice President of Allianz Global Investors of America L.P.   |
| Vinh T. Nguyen        | Senior Vice President and Treasurer                         | <p>Senior Vice President and Treasurer of Allianz Global Investors Advertising Agency Inc., Allianz Global Investors of America LLC, Allianz Global Investors of America L.P., Allianz Global Investors of America Holdings Inc., Allianz Global Investors Distributors LLC, Allianz Global Investors Managed Accounts LLC, Allianz Global Investors Management Partners LLC, Allianz Global Investors NY Holdings LLC, Allianz Global Investors Solutions LLC, Allianz Global Investors U.S. Retail LLC, Allianz Global</p>   |

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| Name               | Position with AGIFM                                | Other Connections   |
|--------------------|--|---|
| Colleen Martin     | Senior Vice President and Controller               | <p>Investors U.S. Holding LLC, Allianz Hedge Fund Partners Holding L.P., Allianz-PacLife Partners LLC, NFJ Investment Group LLC, Nicholas-Applegate Capital Management LLC, Nicholas-Applegate Holdings LLC, OpCap Advisors LLC, Oppenheimer Capital LLC, Oppenheimer Group, Inc., Pacific Investment Management Company LLC, PFP Holdings Inc., PIMCO Canada Holding LLC, PIMCO Canada Management Inc., PIMCO Global Advisors LLC, and PIMCO Global Advisors (Resources) Limited; Vice President and Controller of PIMCO Australia Pty Ltd, PIMCO Europe Limited, and PIMCO Japan Ltd.; and Treasurer of Allianz Global Investors U.S. Holding II LLC.</p> <p>Senior Vice President and Controller of Allianz Global Investors Advertising Agency Inc., Allianz Global Investors of America LLC, Allianz Global Investors of America L.P., Allianz Global Investors of America Holdings Inc., Allianz Global Investors Managed Accounts LLC, Allianz Global Investors Management Partners LLC, Allianz Global Investors NY Holdings LLC, Allianz Global Investors Solutions LLC, Allianz Global Investors U.S. Holding LLC, Allianz Global Investors U.S. Retail LLC, Allianz Hedge Fund Partners Holding L.P., Allianz-PacLife Partners LLC, NFJ Investment Group LLC, Nicholas-Applegate Capital Management LLC, Nicholas-Applegate Holdings LLC, OpCap Advisors LLC, Oppenheimer Capital LLC, Oppenheimer Group Inc., PFP Holdings Inc., PIMCO Canada Holding LLC, PIMCO Canada Management Inc., PIMCO Global Advisors LLC, PIMCO Global Advisors (Resources) Limited; and Stocks Plus Management Inc.; Chief Financial Officer, Financial Operations Principal, Senior Vice President and Controller of Allianz Global Investors Distributors LLC; and Chief Financial Officer and Financial Operations Controller of Nicholas-Applegate Securities LLC; and Controller of Allianz Global Investors U.S. Holding II LLC.</p> |
| Albert A. Pisano   | Senior Vice President and Chief Compliance Officer | Senior Vice President of Allianz Global Investors of America L.P.   |
| Kellie E. Davidson | Assistant Secretary                                | <p>Assistant Secretary of Allianz Global Investors Advertising Agency Inc., Allianz Global Investors of America LLC, Allianz Global Investors of America L.P., Allianz Global Investors of America Holdings Inc., Allianz Global Investors Distributors LLC, Allianz Global Investors Managed Accounts LLC, Allianz Global Investors NY Holdings LLC, Allianz Global Investors Solutions LLC, Allianz Global Investors U.S. Holding II LLC, Allianz Global Investors U.S. Retail LLC, Allianz Hedge Fund Partners Holding L.P., Allianz-PacLife Partners LLC, NFJ Investment Group LLC, Nicholas-Applegate Capital Management LLC, Nicholas-Applegate Holdings LLC, OpCap Advisors LLC, Oppenheimer Capital LLC, Oppenheimer Group, Inc., PFP Holdings Inc., PIMCO Canada Holding LLC, PIMCO Canada Management Inc., PIMCO Global Advisors LLC, and PIMCO Global Advisors (Resources) Limited; and Secretary of Allianz Global Investors Management Partners LLC.</p>   |



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| <b>Name</b>           | <b>Position with AGIFM</b> | <b>Other Connections</b>                        |
|-----------------------|----------------------------|---|
| Richard J. Lavery     | Vice President             | Vice President of OpCap Advisors LLC.           |
| Orhan Dzemaili        | Vice President             | None.   |
| Lydia Lawrence        | Assistant Vice President   | None.   |
| Manuel Madero         | Assistant Vice President   | Assistant Vice President of OpCap Advisors LLC. |
| Pamela M. Wooster     | Senior Vice President      | None.   |
| Richard Cochran       | Vice President             | None.   |
| Sophie Wang           | Vice President             | None.   |
| Scott Whisten         | Vice President             | None.   |
| Daisy S. Ramraj-Singh | Assistant Vice President   | None.   |

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| <b>Name</b>                  | <b>Position with PIMCO</b>  | <b>Other Connections</b>                 |
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Gupta, Sachin

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Hyman, Daniel Herbert  
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| Nicholls, Steven B.         | Senior Vice President, PIMCO  |  |
| Nieves, Roger O.            | Senior Vice President, PIMCO  |  |
| Nojima, Sachiko             | Vice President, PIMCO   |  |
| Norris, John F.             | Vice President, PIMCO   |  |
| Nunziata, Cristina          | Vice President, PIMCO   |  |
| O'Connell, Gillian          | Senior Vice President, PIMCO  |  |
| Okamura, Shigeki            | Senior Vice President, PIMCO  |  |
| Okuma, Sachiko              | Vice President, PIMCO   |  |
| Okun, Eric A.               | Executive Vice President, PIMCO   |  |
| Olazabal, Joshua A.         | Vice President, PIMCO   |  |
| Oliva, Jennifer L.          | Vice President, PIMCO   |  |
| Ollenburger, Loren P.       | Vice President, PIMCO   |  |
| Ong, Arthur Y.D.            | Executive Vice President, PIMCO;<br>Secretary, StocksPLUS<br>Management, Inc.; Secretary,<br>PIMCO Canada Corp. |  |
| Ongaro, Douglas J.          | Executive Vice President, PIMCO   |  |
| Osborne, Simon Timothy      | Senior Vice President, PIMCO  |  |
| Osses, Guillermo Ariel      | Executive Vice President, PIMCO   |  |
| Otterbein, Marie S.         | Vice President, PIMCO   |  |
| Otterbein, Thomas J.        | Managing Director, PIMCO  |  |
| Ozeki, Koyo                 | Executive Vice President, PIMCO   |  |
| Padmanabhan, Lalantika      | Vice President, PIMCO   |  |
| Pagani, Lorenzo P.          | Senior Vice President, PIMCO  |  |
| Parikh, Bijal Y.            | Vice President, PIMCO   |  |
| Parikh, Saumil H.           | Executive Vice President, PIMCO   |  |
| Park, Jung                  | Executive Vice President, PIMCO   | formerly Senior Managing Director, Bear Stearns Asia Limited |
| Pascutti, Michael J.        | Executive Vice President, PIMCO   | Formerly Founding Partner, Sandelman Partners                |

Paulson, Bradley W.

Executive Vice President, PIMCO;  
Director, Vice President and  
Secretary, PIMCO Europe Ltd.;  
Director, PIMCO Asia Pte Ltd.;

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|                             |   |  |
|-----------------------------|---|--|
|                             | Director, Vice President and Assistant Secretary, PIMCO Australia Pty Ltd.; Vice President and Secretary, PIMCO Japan Ltd.; Director, PIMCO Asia Limited (Hong Kong); and Assistant Secretary, PIMCO Canada Corp. |  |
| Pejavar, Sheila M.          | Vice President, PIMCO   |  |
| Perez, Iohan                | Vice President, PIMCO   |  |
| Perez, Keith                | Senior Vice President, PIMCO  |  |
| Philipp, Elizabeth M.       | Executive Vice President, PIMCO   |  |
| Phillipson, Daniel          | Senior Vice President, PIMCO  |  |
| Pimentel, Rudolph           | Senior Vice President, PIMCO  |  |
| Pittman, David J.           | Senior Vice President, PIMCO  |  |
| Pont, Nicholas J.           | Vice President, PIMCO   |  |
| Porterfield, Mark J.        | Executive Vice President, PIMCO   |  |
| Posch, Brigitte             | Executive Vice President, PIMCO   | formerly Managing Director, Deutsche Bank                    |
| Pothalingam, Ketishwaran S. | Senior Vice President, PIMCO  | formerly Credit Fund Manager, Threadneedle Asset Management  |
| Potthof, Axel               | Senior Vice President, PIMCO  |  |
| Powers, William C.          | Managing Director, PIMCO  |  |
| Price, Rosamond J.          | Vice President, PIMCO   |  |
| Pricer, Jesse L.            | Vice President, PIMCO   |  |
| Putnicki, Matthew S.        | Vice President, PIMCO   |  |
| Putyatin, Vladyslav         | Senior Vice President, PIMCO  | formerly Director, Deutsche Bank AG                          |
| Qiao, Yi                    | Vice President, PIMCO   |  |
| Qiu, Ying                   | Vice President, PIMCO   | formerly Portfolio Manager, ING Investment Management        |
| Qu, Wendong                 | Senior Vice President, PIMCO  |  |
| Rahari, Pierre-Yves         | Vice President, PIMCO   |  |
| Rahman, Lupin               | Vice President, PIMCO   | Formerly, Policy Development and Review Economist, Sri Lanka |
| Ratner, Joshua D.           | Vice President, PIMCO. Assistant Secretary, PIMCO Funds, PIMCO Variable Insurance Trust and ETF Trust   |  |
| Ravano, Emanuele            | Managing Director, PIMCO  |  |
| Reimer, Danelle J.          | Vice President, PIMCO   |  |
| Reimer, Ronald M.           | Senior Vice President, PIMCO  |  |
| Reisz, Paul W.              | Senior Vice President, PIMCO  |  |
| Repoulis, Yiannis           | Senior Vice President, PIMCO  |  |
| Rice, Thomas Edmund         | Senior Vice President, PIMCO  |  |

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|                     |                                 |  |
|---------------------|---------------------------------|--|
| Riendeau, Kevin     | Vice President, PIMCO           | formerly, Vice President, Morgan Stanley |
| Rodosky, Stephen A. | Executive Vice President, PIMCO |  |
| Rogers, William A.  | Vice President, PIMCO           |  |
| Rollins, Melody     | Senior Vice President, PIMCO    |  |
| Romano, Mark A.     | Senior Vice President, PIMCO    |  |

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|-------------------------|----------------------------------|---|
| Rowe, Cathy T.          | Vice President, PIMCO            |   |
| Rudolph, Lynn           | Vice President, PIMCO            |   |
| Ruebesam, Roland        | Vice President, PIMCO            |   |
| Ruthen, Seth R.         | Executive Vice President, PIMCO  |   |
| Sakane, Yoshiyuki       | Vice President, PIMCO            |   |
| Salastekar, Deepa A.    | Vice President, PIMCO            | formerly Managing Director, Bear, Stearns & Co., Inc.   |
| Sargent, Jeffrey M.     | Executive Vice President, PIMCO. |   |
| Schaus, Stacy Leigh     | Senior Vice President, PIMCO     |   |
| Schneider, Gero         | Vice President, PIMCO            |   |
| Schneider, Jerome M.    | Executive Vice President, PIMCO  | Formerly Senior Managing Director, Bear, Stearns & Co., Inc.                                    |
| Schneider, Patrick      | Vice President, PIMCO            |   |
| Schuetz, Patricia Ann   | Vice President, PIMCO            |   |
| Schulist, Stephen O.    | Senior Vice President, PIMCO     |   |
| Schultes, Adrian O.     | Vice President, PIMCO            |   |
| Schwab, Gerlinde        | Vice President, PIMCO            |   |
| Schwab, Stephen D.      | Vice President, PIMCO            | Formerly, Vice President, Fidelity Investments  |
| Schwetz, Myckola        | Senior Vice President, PIMCO     |   |
| Scibisz, Iwona E.       | Vice President, PIMCO            |   |
| Scorah, Ian             | Vice President, PIMCO            |   |
| Seidner, Marc P.        | Executive Vice President, PIMCO  | formerly Managing Director, Domestic Fixed Income Portfolio Manager, Harvard Management Company |
| Sejima, Toru            | Senior Vice President, PIMCO     |   |
| Seksaria, Rahul M.      | Vice President, PIMCO            |   |
| Senne, Verena           | Senior Vice President, PIMCO     |   |
| Serafino Jr., George P. | Vice President, PIMCO            |   |
| Sesay, Therenah         | Vice President, PIMCO            |   |
| Shah, Sapna K.          | Vice President, PIMCO            |   |
| Shaw, Matthew D.        | Senior Vice President, PIMCO     |   |
| Sheehy, Erica H.        | Vice President, PIMCO            |   |
| Shepherd, Julie M.      | Vice President, PIMCO            |   |
| Shiroyama, Taro         | Vice President, PIMCO            |   |
| Short, Jonathan D.      | Executive Vice President, PIMCO  |   |
| Simon, W Scott          | Managing Director, PIMCO         |   |
| Singal, Alka            | Vice President, PIMCO            |   |
| Skobtsov, Ivan          | Senior Vice President, PIMCO     |   |
| Smith, Kenton Todd      | Senior Vice President, PIMCO     | formerly Vice President, First Horizon  |
| Somersan-Coqui, Aylin   | Vice President, PIMCO            |   |
| Sonner, Michael         | Senior Vice President, PIMCO     |   |

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|                         |                                 |
|-------------------------|---------------------------------|
| Soto, Alyssa Michele    | Vice President, PIMCO           |
| Spajic, Luke            | Executive Vice President, PIMCO |
| Spalding, Scott M.      | Senior Vice President, PIMCO    |
| Spandri, Tobias         | Vice President, PIMCO           |
| Spicijaric, Jennifer N. | Vice President, PIMCO           |
| Springer, Jeffrey       | Senior Vice President, PIMCO    |



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|---------------------------|---|--|
| Stack, Candice E.         | Senior Vice President, PIMCO  |  |
| Stancil, Thomas A.        | Vice President, PIMCO   | Formerly Partner, Ashland Partners & Co., LLP                                    |
| Staub, Christian M.       | Senior Vice President, PIMCO;<br>Director, President, and Chief<br>Compliance Officer, PIMCO<br>(Switzerland) LLC |  |
| Stauffer, Christina       | Vice President, PIMCO   |  |
| Steele, Scott Patrick     | Senior Vice President, PIMCO  | formerly Chief Investment Officer, BMO Mutual Funds                              |
| Steiner, Jason R.         | Vice President, PIMCO   | Formerly Consultant, Centerline Capital Group.                                   |
| Stracke, Thibault C.      | Executive Vice President, PIMCO   | formerly, Senior Credit Strategist, CreditSights                                 |
| Strauch, Joel Edward      | Senior Vice President, PIMCO  |  |
| Stravato, Richard         | Vice President, PIMCO   |  |
| Streiff, Thomas F.        | Executive Vice President, PIMCO   | formerly Managing Director, UBS Investment Bank                                  |
| Strelow, Peter G          | Executive Vice President, PIMCO   |  |
| Struc, Alexandru          | Vice President, PIMCO   |  |
| Sun, Hao                  | Vice President, PIMCO   |  |
| Suo, Yuanyuan             | Vice President, PIMCO   |  |
| Suskind, Donald W.        | Vice President, PIMCO; Vice<br>President, StocksPLUS<br>Management Inc. and Vice<br>President, PIMCO ETF Trust    |  |
| Taborsky, Mark A.         | Executive Vice President, PIMCO   | formerly Managing Director of External Management, Harvard<br>Management Company |
| Takano, Makoto            | Managing Director, PIMCO;<br>Director and President, PIMCO<br>Japan Ltd.  |  |
| Takeuchi, Ichiro          | Vice President, PIMCO   |  |
| Takizuka, Hikaru          | Vice President, PIMCO   |  |
| Tam Joe                   | Vice President, PIMCO   |  |
| Tamura, Maiko             | Vice President, PIMCO   | formerly Manager, AIG Japan Capital Investment Co., Ltd.                         |
| Tarman, Daniel            | Executive Vice President, PIMCO   |  |
| Telish, Christine M.      | Vice President, PIMCO   |  |
| Terry, Michael A.         | Vice President, PIMCO   | Formerly Vice President, Morgan Stanley  |
| Tersin, Dominique         | Vice President, PIMCO   |  |
| Theodore, Kyle J.         | Senior Vice President, PIMCO  |  |
| Thompson, Michael Frazier | Senior Vice President, PIMCO  |  |
| Thurston, Powell C.       | Senior Vice President, PIMCO  |  |
| To, Steven P.             | Vice President, PIMCO   |  |
| Toloui-Tehrani, Ramin     | Executive Vice President, PIMCO   |  |
| Tomlinson, Brian          | Vice President, PIMCO   |  |
| Tournier, Eve             | Executive Vice President, PIMCO   | formerly Managing Director, Deutsche Bank AG                                     |

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|-----------------------------------|---|--|
| Traber, Eva-Maria                 | Vice President, PIMCO   |  |
| Tran, Loc K.                      | Vice President, PIMCO   |  |
| Tredwell, Alonzo S.               | Vice President, PIMCO   |  |
| Trevithick, Natalie               | Senior Vice President, PIMCO  |  |
| Trovato, Michael J.               | Vice President, PIMCO   |  |
| Tsubota, Shiro                    | Senior Vice President, PIMCO  |  |
| Tyson, Richard E.                 | Executive Vice President, PIMCO   |  |
| Tzemach, Y. Gayle                 | Vice President, PIMCO   |  |
| Upadhyay, Nishant                 | Vice President, PIMCO   |  |
| Vallarta-Jordal, Maria-Theresa F. | Senior Vice President, PIMCO  |  |
| Vames, Steven                     | Vice President, PIMCO   |  |
| van Akkeren, Marco                | Senior Vice President, PIMCO  | formerly Vice President, Goldman Sachs & Co. |
| van Bezooijen, Jeroen             | Senior Vice President, PIMCO  | formerly, Executive Director, Goldman Sachs  |
| van De Zilver, Peter A.           | Vice President, PIMCO   |  |
| van Heel, Marc                    | Executive Vice President, PIMCO   |  |
| van Zoelen, Henk Jan              | Senior Vice President, PIMCO  |  |
| Veit, Konstantin                  | Vice President, PIMCO   |  |
| Velasco, Christine Ann            | Vice President, PIMCO   |  |
| Velicer, Erik A.                  | Vice President, PIMCO   |  |
| Viana, David                      | Senior Vice President, PIMCO  |  |
| von der Linden, Greg              | Vice President, PIMCO   |  |
| Walenbergh, Mark                  | Vice President, PIMCO   |  |
| Walker, Trent W.                  | Senior Vice President, PIMCO.<br>Assistant Treasurer of PIMCO<br>Funds, PIMCO Variable Insurance<br>Trust and ETF Trust. Vice<br>President, StocksPLUS<br>Management Inc. |  |
| Walsh, Lauren R.                  | Vice President, PIMCO   |  |
| Walther, Kasten                   | Vice President, PIMCO   |  |
| Ward, Jim                         | Executive Vice President, PIMCO;<br>Senior Vice President, PIMCO<br>Europe Ltd. And PIMCO Japan<br>Ltd.; Vice President, PIMCO<br>Australia Pty Ltd.                      |  |
| Warner IV, Hansford B.            | Vice President, PIMCO   |  |
| Watchorn, Michael                 | Senior Vice President, PIMCO  |  |
| Watford, Charles                  | Vice President, PIMCO   |  |
| Weil, Richard M.                  | Managing Director, PIMCO;<br>Trustee and Senior Vice President,<br>PIMCO Funds, PIMCO Variable<br>Insurance Trust and PIMCO ETF   |  |

Trust; Director, Senior Vice  
President and Assistant Secretary,  
PIMCO Japan Ltd and PIMCO Asia  
Limited (Hong Kong).

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|                             |  |  |
|-----------------------------|--|--|
| Weinberger, Michele Deborah | Vice President, PIMCO  | formerly Vice President, Goldman Sachs Asset Mgmt                        |
| Wendler IV, Paul F.         | Vice President, PIMCO  |  |
| Werber, Keith A.            | Vice President, PIMCO  | formerly, Vice President, Countrywide Securities Corporation             |
| White, Timothy C.           | Senior Vice President, PIMCO   |  |
| Whitewolf, Lance E.         | Vice President, PIMCO  |  |
| Whitton, Bransby M.         | Senior Vice President, PIMCO;<br>Director, PIMCO Asia Pte Ltd.         |  |
| Wild, Christian             | Senior Vice President, PIMCO   |  |
| Wildermuth, Paul T.         | Vice President, PIMCO  |  |
| Williams III, Charles A     | Vice President, PIMCO  |  |
| Williams, Jason A.          | Vice President, PIMCO  |  |
| Wilner, Mitchell W.         | Senior Vice President, PIMCO   |  |
| Wilson, John F.             | Executive Vice President, PIMCO;<br>Director, PIMCO Australia Pty Ltd. |  |
| Wilson, Susan L.            | Executive Vice President, PIMCO  |  |
| Winters, Kevin M.           | Vice President, PIMCO  |  |
| Witt, Frank                 | Executive Vice President, PIMCO  |  |
| Wittkop, Andrew T.          | Vice President, PIMCO  |  |
| Wolf, Gregory S.            | Vice President, PIMCO  |  |
| Wong, Tammy Nguyen          | Vice President, PIMCO  |  |
| Wood, George H.             | Executive Vice President, PIMCO  |  |
| Worah, Mihir P.             | Executive Vice President, PIMCO  |  |
| Xu, Jianghua                | Vice President, PIMCO  |  |
| Yamamoto, Shinichi          | Senior Vice President, PIMCO   |  |
| Yang, Jing                  | Vice President, PIMCO  |  |
| Yasnov, Vadim I.            | Vice President, PIMCO  |  |
| Yildiz, Sadettin            | Vice President, PIMCO  |  |
| Yip, Jonathan               | Vice President, PIMCO  |  |
| Yip, Paul S.                | Vice President, PIMCO  | formerly Principal Database Admin/Architect, Yahoo, Inc.                 |
| Yoon, Kenneth G.            | Vice President, PIMCO  |  |
| Young, Robert O.            | Executive Vice President, PIMCO  | formerly Managing Director, Global Capital Markets                       |
| Yu, Anna W.                 | Vice President, PIMCO  |  |
| Yu, Cheng-Yuan              | Executive Vice President, PIMCO  |  |
| Yu, Walter                  | Vice President, PIMCO  |  |
| Zerner, Mary                | Vice President, PIMCO  | formerly Senior Vice President, Lazard Asset Management Limited - London |
| Zhu, Changhong              | Managing Director, PIMCO   |  |

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**Item 32: Location of Accounts and Records**

The account books and other documents required to be maintained by the Registrant pursuant to Section 31(a) of the Investment Company Act of 1940 and the rules thereunder will be maintained at the offices of Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105, Pacific Investment Management Company LLC, 840 Newport Center Drive, Suite 300, Newport Beach, California 92660, State Street Bank and Trust Company, 801 Pennsylvania Avenue, Kansas City, Missouri 64105, and/or PNC Global Servicing Inc., 400 Bellevue Parkway, Wilmington, Delaware 19809.

**Item 33: Management Services**

Not applicable.

**Item 34: Undertakings**

1. Registrant undertakes to suspend the offering of its Common Shares until it amends the prospectus filed herewith if (1) subsequent to the effective date of its registration statement, the net asset value declines more than 10 percent from its net asset value as of the effective date of the registration statement, or (2) the net asset value increases to an amount greater than its net proceeds as stated in the prospectus.
2. Not applicable.
3. Not applicable.
4. Not applicable.
5. The Registrant undertakes that:
  - a. For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in the form of prospectus filed by the Registrant under Rule 497(h) under the Securities Act of 1933 shall be deemed to be part of this registration statement as of the time it was declared effective; and
  - b. For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of the securities at that time shall be deemed to be the initial bona fide offering thereof.
6. The Registrant undertakes to send by first class mail or other means designed to ensure equally prompt delivery, within two business days of receipt of a written or oral request, any Statement of Additional Information.

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**NOTICE**

A copy of the Agreement and Declaration of Trust of the Registrant, together with all amendments thereto, is on file with the Secretary of The Commonwealth of Massachusetts, and notice is hereby given that this instrument is executed on behalf of the Registrant by any trustee or officer of the Registrant as a trustee or officer, as applicable, and not individually, and that the obligations of or arising out of this instrument are not binding upon any of the trustees of the Registrant or shareholders of the Registrant individually, but are binding only upon the assets and property of the Registrant.

**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933 and the Investment Company Act of 1940, the Registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, and the State of New York, on the 15th day of January, 2010.

PIMCO FLOATING RATE INCOME FUND

By: /s/ BRIAN S. SHLISSEL  
 Name: **Brian S. Shlissel**  
 Title: **President and Chief Executive Officer**

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the date indicated.

| Name  | Capacity   | Date             |
|---|--|------------------|
| /s/ BRIAN S. SHLISSEL<br><b>Brian S. Shlissel</b>         | President and Chief Executive Officer                    | January 15, 2010 |
| /s/ LAWRENCE G. ALTADONNA<br><b>Lawrence G. Altadonna</b> | Treasurer and Principal Financial and Accounting Officer | January 15, 2010 |
| PAUL BELICA*<br><b>Paul Belica</b>                        | Trustee  | January 15, 2010 |
| ROBERT E. CONNOR*<br><b>Robert E. Connor</b>              | Trustee  | January 15, 2010 |
| JAMES A. JACOBSON*<br><b>James A. Jacobson</b>            | Trustee  | January 15, 2010 |
| HANS W. KERTESS*<br><b>Hans W. Kertess</b>                | Trustee  | January 15, 2010 |
| JOHN C. MANEY*<br><b>John C. Maney</b>                    | Trustee  | January 15, 2010 |
| WILLIAM B. OGDEN, IV*<br><b>William B. Ogden, IV</b>      | Trustee  | January 15, 2010 |
| <b>R. Peter Sullivan, III</b>                             | Trustee  |                  |

\* By: /s/ BRIAN S. SHLISSEL  
Brian S. Shlissel  
Attorney-In-Fact  
Date: January 15, 2010

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**INDEX TO EXHIBITS**

| <b>Exhibit</b> | <b>Exhibit Name</b>  |
|----------------|--|
| (s)            | Powers of Attorney for Paul Belica, Robert E. Connor, James A. Jacobson, Hans W. Kertess, John C. Maney and William B. Ogden, IV |