

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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM N-CSR**

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

Investment Company Act file number 811-21601

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

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

10105  
(Zip code)

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

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

Date of fiscal year July 31, 2010  
end:

Date of reporting period: January 31, 2010

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

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

ITEM 1. REPORT TO SHAREHOLDERS

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

March 15, 2010

Dear Shareholder:

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 On March 1, 2010, each Fund changed its name and rescinded its non-fundamental investment policy to, under normal market conditions, invest at least 80% of its net assets (plus any borrowings for investment purposes)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

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

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

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

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

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess  
*Chairman*

Brian S. Shlissel  
*President & Chief Executive Officer*

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**PIMCO Income Strategy Fund Fund Insights/Performance & Statistics**

January 31, 2010 (unaudited)

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

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

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

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

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

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

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

**PIMCO Income Strategy Fund II Fund Insights/Performance & Statistics**

January 31, 2010 (unaudited)

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

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

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



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

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

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

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

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**PIMCO Income Strategy Fund Schedule of Investments**

January 31, 2010 (unaudited)

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

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

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**PIMCO Income Strategy Fund Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

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

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**PIMCO Income Strategy Fund Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

**SENIOR LOANS (a) (c) 4.5%**

**Consumer Products 0.3%**

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

**Diversified Manufacturing 0.7%**

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

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

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**PIMCO Income Strategy Fund Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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





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**PIMCO Income Strategy Fund Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

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**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited)

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

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

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**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

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

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**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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





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**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

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

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**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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



**PIMCO Income Strategy Fund II Schedule of Investments**

January 31, 2010 (unaudited) (continued)

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

**Notes to Schedules of Investments:**

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

**Glossary:**

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

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

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

January 31, 2010 (unaudited)

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

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





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

Six Months ended January 31, 2010 (unaudited)

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

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

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

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

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

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

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

Six Months ended January 31, 2010 (unaudited)

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

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

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

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

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies**

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

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

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

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

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

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

**(a) Valuation of Investments**

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

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

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

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies** (continued)

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

**(b) Fair Value Measurements**

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

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

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

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

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

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



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Income Strategy:

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

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

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies** (continued)

Income Strategy II:

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

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

Income Strategy:

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

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**Investments in Securities**

**Assets**

Corporate

Bonds & Notes:

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

**Total Investments in**

|                          |             |             |             |                |
|--------------------------|-------------|-------------|-------------|----------------|
| <b>Securities Assets</b> | \$9,729,840 | \$1,114,628 | \$3,182,409 | \$(14,026,877) |
|--------------------------|-------------|-------------|-------------|----------------|

|                                     |          |  |          |             |
|-------------------------------------|----------|--|----------|-------------|
| <b>Other Financial Instruments*</b> | \$69,735 |  | \$36,724 | \$(106,459) |
|-------------------------------------|----------|--|----------|-------------|

|                          |             |             |             |                |
|--------------------------|-------------|-------------|-------------|----------------|
| <b>Total Investments</b> | \$9,799,575 | \$1,114,628 | \$3,219,133 | \$(14,133,336) |
|--------------------------|-------------|-------------|-------------|----------------|

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

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies** (continued)

Income Strategy II:

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

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

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

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

**(c) Investment Transactions and Investment Income**

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

### **(d) Federal Income Taxes**

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

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies** (continued)

**(e) Dividends and Distributions – Common Stock**

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

**(f) Foreign Currency Translation**

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

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

**(g) Senior Loans**

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

**(h) Repurchase Agreements**

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

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

### **(i) Reverse Repurchase Agreements**

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**1. Organization and Significant Accounting Policies** (continued)

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

**(j) When-Issued/Delayed-Delivery Transactions**

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

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

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

**(l) Interest Expense**

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

**(m) Custody Credits on Cash Balances**

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



## 2. Principal Risk

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

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

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**2. Principal Risk** (continued)

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

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

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

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

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

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

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

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

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**2. Principal Risk** (continued)

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

**3. Financial Derivative Instruments**

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

**(a) Futures Contracts**

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

**(b) Option Transactions**

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

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

### **(c) Swap Agreements**

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**3. Financial Derivative Instruments** (continued)

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

Payments received or made at the beginning of the measurement period are reflected as such on the Funds' Statements of Assets and Liabilities and represent payments made or received upon entering into the swap agreement to compensate for differences between the stated terms of the swap agreement and prevailing market conditions (credit spreads, currency exchange rates, interest rates, and other relevant factors). These upfront payments are recorded as realized gains or losses on the Funds' Statements of Operations upon termination or maturity of the swap. A liquidation payment received or made at the termination of the swap is recorded as realized gain or loss on the Funds' Statements of Operations. Net periodic payments received or paid by the Funds are included as part of realized gains or losses on the Funds' Statements of Operations.

Entering into these agreements involves, to varying degrees, elements of credit, legal, market and documentation risk in excess of the amounts recognized on the Funds' Statements of Assets and Liabilities. Such risks include the possibility that there will be no liquid market for these agreements, that the counterparties to the agreements may default on their obligation to perform or disagree as to the meaning of contractual terms in the agreements and that there may be unfavorable changes in interest rates.

**Credit Default Swap Agreements** Credit default swap agreements involve one party (referred to as the buyer of protection) making a stream of payments to another party (the seller of protection) in exchange for the right to receive a specified return in the event of a default or other credit event for the referenced entity, obligation or index. As sellers of protection on credit default swap agreements, the Funds will generally receive from the buyer of protection a fixed rate of income throughout the term of the swap provided that there is no credit event. As sellers, the Funds would effectively add leverage to their portfolios because, in addition to their total net assets, the Funds would be subject to investment exposure on the notional amount of the swap.

If a Fund is a seller of protection and a credit event occurs, as defined under the terms of that particular swap agreement, a Fund will either (i) pay to the buyer of protection an amount equal to the notional amount of the swap and take delivery of the referenced obligation, other deliverable obligations or underlying securities comprising the referenced index or (ii) pay a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation or underlying securities comprising the referenced index. If a Fund is a buyer of protection and a credit event occurs, as defined under the terms of that particular swap agreement, a Fund will either (i) receive from the seller of protection an amount equal to the notional amount of the swap and deliver the referenced obligation, other deliverable obligations or underlying securities comprising the referenced index or (ii) receive a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation or underlying securities comprising the referenced index. Recovery values are assumed by market makers considering either industry standard recovery rates or entity specific factors and considerations until a credit event occurs. If a credit event has occurred, the recovery value is determined by a facilitated auction whereby a minimum number of allowable broker bids, together with a specified valuation method, are used to calculate the settlement value.

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Credit default swap agreements on corporate issues or sovereign issues of an emerging country involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a default or other credit event. If a credit event occurs and cash settlement is not elected, a variety of other deliverable obligations may be delivered in lieu of the specific referenced obligation. The ability to deliver other obligations may result in a cheapest-to-deliver option (the buyer of protection's right to choose the deliverable obligation with the lowest value following a credit event). The Funds use credit default swaps on corporate issues or sovereign issues of an emerging country to provide a measure of protection against defaults of the issuers (i.e., to reduce risk where the Funds own or have exposure to the referenced obligation) or to take an active long or short position with respect to the likelihood of a particular issuer's default.

Credit default swap agreements on asset-backed securities involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a default or other credit events. Unlike credit default swaps on corporate issues or sovereign issues of an emerging country, deliverable obligations in most instances would be limited to the specific referenced obligation as performance for asset-backed securities can vary across deals. Prepayments, principal paydowns, and other writedown or loss events on the underlying mortgage loans

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**3. Financial Derivative Instruments (continued)**

will reduce the outstanding principal balance of the referenced obligation. These reductions may be temporary or permanent as defined under the terms of the swap agreement and the notional amount for the swap agreement will be adjusted by corresponding amounts. The Funds use credit default swaps on asset-backed securities to provide a measure of protection against defaults of the referenced obligation or to take an active long or short position with respect to the likelihood of a particular referenced obligation's default.

Credit default swap agreements on credit indices involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a write-down, principal shortfall, interest shortfall or default of all or part of the referenced entities comprising the credit index. A credit index is a list of a basket of credit instruments or exposures designed to be representative of some part of the credit market as a whole. These indices are made up of reference credits that are judged by a poll of dealers to be the most liquid entities in the credit default swap market based on the sector of the index. Components of the indices may include, but are not limited to, investment grade securities, high yield securities, asset backed securities, emerging markets, and/or various credit ratings within each sector. Credit indices are traded using credit default swaps with standardized terms including a fixed spread and standard maturity dates. An index credit default swap references all the names in the index, and if there is a default, the credit event is settled based on that name's weight in the index, or in the case of a tranching index credit default swap, the credit event is settled based on the name's weight in the index that falls within the tranche for which the Fund bears exposure. The composition of the indices changes periodically, usually every six months, and for most indices, each name has an equal weight in the index. The Funds use credit default swaps on credit indices to hedge a portfolio of credit default swaps or bonds with a credit default swap on indices which is less expensive than it would be to buy many credit default swaps to achieve a similar effect. Credit-default swaps on indices are benchmarks for protecting investors owning bonds against default, and traders use them to speculate on changes in credit quality.

Implied credit spreads, represented in absolute terms, utilized in determining the market value of credit default swap agreements on corporate issues or sovereign issues of an emerging country as of period end are disclosed in section 5(b) of the Notes to Financial Statements and serve as an indicator of the current status of the payment/performance risk and represent the likelihood or risk of default for the credit derivative. The implied credit spread of a particular referenced entity reflects the cost of buying/selling protection and may include upfront payments required to be made to enter into the agreement. For credit default swap agreements on asset-backed securities and credit indices, the quoted market prices and resulting values serve as the indicator of the current status of the payment/performance risk. Wider credit spreads and increasing market values, in absolute terms when compared to the notional amount of the swap, represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement.

The maximum potential amount of future payments (undiscounted) that the Funds as sellers of protection could be required to make under a credit default swap agreement would be an amount equal to the notional amount of the agreement. Notional amounts of all credit default swap agreements outstanding as of January 31, 2010 for which the Funds are sellers of protection are disclosed in section 5(b) of the Notes to Financial Statements. These potential amounts would be partially offset by any recovery values of the respective referenced obligations, upfront payments received upon entering into the agreement, or net amounts received from the settlement of buy protection credit default swap agreements entered into by the Funds for the same referenced entity or entities.

**Interest Rate Swap Agreements** Interest rate swap agreements involve the exchange by the Funds with a counterparty of their respective commitments to pay or receive interest, e.g., an exchange of floating rate payments for fixed rate payments, with respect to the notional amount of principal. Certain forms of interest rate swap agreements may include: (i) interest rate caps, under which, in return for a premium, one party



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agrees to make payments to the other to the extent that interest rates exceed a specified rate, or cap, (ii) 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, (iii) 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, (iv) callable interest rate swaps, under which the counterparty may terminate the swap transaction in whole at zero cost by a predetermined date and time prior to the maturity date, (v) spreadlocks, which allow the interest rate swap users to lock in the forward differential (or spread) between the interest rate swap rate and a specified benchmark, or (vi) basis swap, under which two parties can exchange variable interest rates based on different money markets.

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

January 31, 2010 (unaudited)

**3. Financial Derivative Instruments** (continued)**(d) Forward Foreign Currency Contracts**

A forward foreign currency contract is an agreement between two parties to buy and sell a currency at a set exchange rate on a future date. The Funds enter into forward foreign currency contracts for the purpose of hedging against foreign currency risk arising from the investment or anticipated investment in securities denominated in foreign currencies. The Funds also enter into these contracts for purposes of increasing exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one country to another. The market value of a forward foreign currency contract fluctuates with changes in foreign currency exchange rates. All commitments are marked to market daily at the applicable exchange rates and any resulting unrealized appreciation or depreciation is recorded. Realized gains or losses are recorded at the time the forward contract matures or by delivery of the currency. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. In addition, these contracts may involve market risk in excess of the unrealized gain (loss) reflected in the Funds' Statements of Assets and Liabilities.

**Fair Value of Derivative Instruments at January 31, 2010**

The following is a summary of the fair valuation of the Funds' derivative instruments categorized by risk exposure.

The effect of derivative instruments on the Funds' Statements of Assets and Liabilities at January 31, 2010:

Income Strategy:

| Location  | Interest<br>Rate Contracts | Credit<br>Contracts | Foreign<br>Exchange<br>Contracts | Total       |
|---|----------------------------|---------------------|----------------------------------|-------------|
| <b>Asset Derivatives:</b>                                     |                            |                     |                                  |             |
| Unrealized appreciation of swaps                              |                            | \$1,992,265         |                                  | \$1,992,265 |
| Unrealized appreciation of forward foreign currency contracts |                            |                     | \$347,627                        | 347,627     |
| <b>Total Asset Derivatives</b>                                |                            | \$1,992,265         | \$347,627                        | \$2,339,892 |
| <b>Liability Derivatives:</b>                                 |                            |                     |                                  |             |
| Unrealized depreciation of swaps                              |                            | \$(835)             |                                  | \$(835)     |
| Payable for variation margin on futures contracts*            | \$(16,667)                 |                     |                                  | (16,667)    |
| Unrealized depreciation of forward foreign currency contracts |                            |                     | \$(64,345)                       | (64,345)    |
| <b>Total Liability Derivatives</b>                            | \$(16,667)                 | \$(835)             | \$(64,345)                       | \$(81,847)  |

Income Strategy II:

| Location | Total |
|----------|-------|
|----------|-------|

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|   | Interest<br>Rate Contracts | Credit<br>Contracts | Foreign<br>Exchange<br>Contracts |             |
|---|----------------------------|---------------------|----------------------------------|-------------|
| <b>Asset Derivatives:</b>                                     |                            |                     |                                  |             |
| Unrealized appreciation of swaps                              |                            | \$3,210,113         |                                  | \$3,210,113 |
| Unrealized appreciation of forward foreign currency contracts |                            |                     | \$1,093,594                      | 1,093,594   |
| <b>Total Asset Derivatives</b>                                |                            | \$3,210,113         | \$1,093,594                      | \$4,303,707 |
| <b>Liability Derivatives:</b>                                 |                            |                     |                                  |             |
| Unrealized depreciation of swaps                              |                            | \$(23,614)          |                                  | \$(23,614)  |
| Payable for variation margin on futures contracts*            | \$(65,497)                 |                     |                                  | (65,497)    |
| Unrealized depreciation of forward foreign currency contracts |                            |                     | \$(25,923)                       | (25,923)    |
| <b>Total Liability Derivatives</b>                            | \$(65,497)                 | \$(23,614)          | \$(25,923)                       | \$(115,034) |

\* Included in the unrealized appreciation of \$429,650 and \$248,650 on futures contracts of Income Strategy and Income Strategy II, respectively, as reported in section 5(a) of the Notes to Financial Statements.

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

January 31, 2010 (unaudited)

**3. Financial Derivative Instruments (continued)**

The effect of derivative instruments on the Funds' Statements of Operations for the six months ended January 31, 2010:

Income Strategy:

| Location   | Interest<br>Rate Contracts | Credit<br>Contracts | Foreign<br>Exchange<br>Contracts | Total       |
|--|----------------------------|---------------------|----------------------------------|-------------|
| <b>Net Realized Gain (Loss) on:</b>                              |                            |                     |                                  |             |
| Futures contracts  | \$468,967                  |                     |                                  | \$468,967   |
| Swaps  |                            | \$2,338,791         |                                  | 2,338,791   |
| Foreign currency transactions                                    |                            |                     | \$(25,549)                       | (25,549)    |
| <b>Total Net Realized Gain (Loss)</b>                            | \$468,967                  | \$2,338,791         | \$(25,549)                       | \$2,782,209 |
| <b>Net Change in Unrealized Appreciation/ Depreciation of:</b>   |                            |                     |                                  |             |
| Futures contracts  | \$429,650                  |                     |                                  | \$429,650   |
| Swaps  |                            | \$385,249           |                                  | 385,249     |
| Foreign currency transactions                                    |                            |                     | \$490,976                        | 490,976     |
| <b>Total Net Change in Unrealized Appreciation/ Depreciation</b> | \$429,650                  | \$385,249           | \$490,976                        | \$1,305,875 |

Income Strategy II:

| Location   | Interest<br>Rate Contracts | Credit<br>Contracts | Foreign<br>Exchange<br>Contracts | Total       |
|--|----------------------------|---------------------|----------------------------------|-------------|
| <b>Net Realized Gain (Loss) on:</b>                              |                            |                     |                                  |             |
| Futures contracts  | \$1,580,672                |                     |                                  | \$1,580,672 |
| Swaps  |                            | \$6,013,060         |                                  | 6,013,060   |
| Foreign currency transactions                                    |                            |                     | \$(354,636)                      | (354,636)   |
| <b>Total Net Realized Gain (Loss)</b>                            | \$1,580,672                | \$6,013,060         | \$(354,636)                      | \$7,239,096 |
| <b>Net Change in Unrealized Appreciation/ Depreciation of:</b>   |                            |                     |                                  |             |
| Futures contracts  | \$248,650                  |                     |                                  | \$248,650   |
| Swaps  |                            | \$158,845           |                                  | 158,845     |
| Foreign currency transactions                                    |                            |                     | \$1,596,302                      | 1,596,302   |
| <b>Total Net Change in Unrealized Appreciation/ Depreciation</b> | \$248,650                  | \$158,845           | \$1,596,302                      | \$2,003,797 |

**4. Investment Manager/Sub-Adviser**

Each Fund has an Investment Management Agreement (each an "Agreement") with the Investment Manager. Subject to the supervision of the Funds' Board of Trustees, the Investment Manager is responsible for managing, either directly or through others selected by it, the Funds' investment activities, business affairs and administrative matters. Pursuant to each Agreement, the Investment Manager receives an annual fee,

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payable monthly, at an annual rate of 0.75% of each Fund's average weekly total managed assets. Total managed assets refer to the total assets of each Fund (including assets attributable to any Preferred Shares or other forms of leverage that may be outstanding minus accrued liabilities (other than liabilities representing leverage)).

The Investment Manager has retained the Sub-Adviser to manage the Funds' investments. Subject to the supervision of the Investment Manager, the Sub-Adviser is responsible for making all of the Funds' investment decisions. The Investment Manager, and not the Funds, pays a portion of the fees it receives as Investment Manager to the Sub-Adviser in return for its services.

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**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Notes to Financial Statements**

January 31, 2010 (unaudited)

**5. Investments in Securities**

Purchases and sales of investments, other than short-term securities for the six months ended January 31, 2010, were:

|                               | U.S. Government Obligations |             | All Other     |               |
|-------------------------------|-----------------------------|-------------|---------------|---------------|
|                               | Purchases                   | Sales       | Purchases     | Sales         |
| PIMCO Income Strategy Fund    | \$840,902                   | \$1,962,904 | \$105,939,603 | \$121,080,236 |
| PIMCO Income Strategy Fund II | 273,853                     | 3,970,162   | 220,119,288   | 231,576,042   |

(a) Futures contracts outstanding at January 31, 2010:

Income Strategy:

| Type                                | Contracts | Market Value (000s) | Expiration Date | Unrealized Appreciation |
|-------------------------------------|-----------|---------------------|-----------------|-------------------------|
| Long: Financial Futures Euro 90 day | 405       | \$100,840           | 6/14/10         | \$429,650               |

Income Strategy II:

| Type                                | Contracts | Market Value (000s) | Expiration Date | Unrealized Appreciation |
|-------------------------------------|-----------|---------------------|-----------------|-------------------------|
| Long: Financial Futures Euro 90 day | 279       | \$69,468            | 6/14/10         | \$248,650               |

Income Strategy and Income Strategy II pledged cash collateral of \$605,000 and \$1,174,000, respectively, for futures contracts.

(b) Credit default swap agreements:

Buy protection swap agreements outstanding at January 31, 2010 (1):

Income Strategy:

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| Swap Counterparty/Referenced Debt Issuer               | Notional Amount Payable on Default (000s) (4) | Credit Spread (3) | Termination Date | Payments Made | Market Value (5)     | Upfront Premiums Paid(Received) | Unrealized Appreciation (Depreciation) |
|--|---|-------------------|------------------|---------------|----------------------|---------------------------------|--|
| Barclays Bank:<br>Dow Jones CDX<br>HY-13 5-Year Index  | \$13,068                                      | 5.62%             | 12/20/14         | (5.00)%       | \$243,379            | \$49,005                        | \$194,374                              |
| Deutsche Bank:<br>Dow Jones CDX<br>HY-13 5-Year Index  | 6,633   | 5.62%             | 12/20/14         | (5.00)%       | 123,534              | 124,369                         | (835)                                  |
| Morgan Stanley:<br>Dow Jones CDX<br>HY-13 5-Year Index | 6,534   | 5.62%             | 12/20/14         | (5.00)%       | 121,689<br>\$488,602 | (4,084)<br>\$169,290            | 125,773<br>\$319,312                   |

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

January 31, 2010 (unaudited)

**5. Investments in Securities** (continued)Income Strategy II:

| Swap Counterparty/Referenced Debt Issuer               | Notional Amount Payable on Default (000s) (4) | Credit Spread (3) | Termination Date | Payments Made | Market Value (5)       | Upfront Premiums Paid(Received) | Unrealized Appreciation (Depreciation) |
|--|---|-------------------|------------------|---------------|------------------------|---------------------------------|--|
| Barclays Bank:<br>Dow Jones CDX<br>HY-13 5-Year Index  | \$27,225                                      | 5.62%             | 12/20/14         | (5.00)%       | \$507,040              | \$102,094                       | \$404,946                              |
| Deutsche Bank:<br>Dow Jones CDX<br>HY-13 5-Year Index  | 13,662  | 5.62%             | 12/20/14         | (5.00)%       | 254,441                | 256,162                         | (1,721)                                |
| Morgan Stanley:<br>Dow Jones CDX<br>HY-13 5-Year Index | 13,563  | 5.62%             | 12/20/14         | (5.00)%       | 252,598<br>\$1,014,079 | (8,477)<br>\$349,779            | 261,075<br>\$664,300                   |

Sell protection swap agreements outstanding at January 31, 2010 (2):

Income Strategy:

| Swap Counterparty/Referenced Debt Issuer | Notional Amount Payable on Default (000s) (4) | Credit Spread (3) | Termination Date | Payments Received | Market Value (5) | Upfront Premiums (Received) | Unrealized Appreciation |
|--|---|-------------------|------------------|-------------------|------------------|-----------------------------|-------------------------|
| BNP Paribas:<br>General Electric         | \$800   | 1.99%             | 12/20/13         | 4.60%             | \$79,320         |                             | \$79,320                |
| General Electric                         | 800   | 1.99%             | 12/20/13         | 4.70%             | 82,292           |                             | 82,292                  |
| Citigroup:<br>Chrysler Financial         | 1,000   | 5.82%             | 6/20/13          | 5.00%             | (13,541)         | \$(120,000)                 | 106,459                 |
| General Electric                         | 2,000   | 1.99%             | 12/20/13         | 4.65%             | 202,016          |                             | 202,016                 |
| SLM                                      | 3,300   | 5.11%             | 12/20/13         | 5.00%             | 6,995            | (406,250)                   | 413,245                 |
| Deutsche Bank:<br>SLM                    | 2,550   | 5.11%             | 12/20/13         | 5.00%             | 5,405            | (357,000)                   | 362,405                 |
| Goldman Sachs:<br>HCA                    | 1,500   | 2.54%             | 9/20/13          | 3.00%             | 26,917           |                             | 26,917                  |
| Merrill Lynch:                           |   |                   |                  |                   |                  |                             |                         |



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|                 |       |       |          |       |           |               |             |
|-----------------|-------|-------|----------|-------|-----------|---------------|-------------|
| SLM             | 1,575 | 5.11% | 12/20/13 | 5.00% | 3,338     | (220,500)     | 223,838     |
| Morgan Stanley: |       |       |          |       |           |               |             |
| SLM             | 1,600 | 5.17% | 3/20/14  | 5.00% | (374)     | (176,000)     | 175,626     |
|                 |       |       |          |       | \$392,368 | \$(1,279,750) | \$1,672,118 |

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

January 31, 2010 (unaudited)

**5. Investments in Securities** (continued)Income Strategy II:

| Swap Counterparty/Referenced Debt Issuer | Notional Amount Payable on Default (000s) (4) | Credit Spread (3) | Termination Date | Payments Received | Market Value (5) | Upfront Premiums (Received) | Unrealized Appreciation (Depreciation) |
|--|---|-------------------|------------------|-------------------|------------------|-----------------------------|--|
| Citigroup:                               |   |                   |                  |                   |                  |                             |  |
| Chrysler Financial                       | \$1,000                                       | 5.82%             | 6/20/13          | 5.00%             | \$(13,541)       | \$(120,000)                 | \$106,459                              |
| SLM                                      | 6,550   | 5.11%             | 12/20/13         | 5.00%             | 13,883           | (807,000)                   | 820,883                                |
| Deutsche Bank:                           |   |                   |                  |                   |                  |                             |  |
| Ford Motor                               | 1,000   | 3.29%             | 6/20/12          | 2.17%             | (21,893)         |                             | (21,893)                               |
| SLM                                      | 5,400   | 5.11%             | 12/20/13         | 5.00%             | 11,446           | (756,000)                   | 767,446                                |
| Merrill Lynch:                           |   |                   |                  |                   |                  |                             |  |
| SLM                                      | 3,350   | 5.11%             | 12/20/13         | 5.00%             | 7,100            | (469,000)                   | 476,100                                |
| Morgan Stanley:                          |   |                   |                  |                   |                  |                             |  |
| SLM                                      | 3,400   | 5.17%             | 3/20/14          | 5.00%             | (796)            | (374,000)                   | 373,204                                |
|  |   |                   |                  |                   | \$(3,801)        | \$(2,526,000)               | \$2,522,199                            |

- (1) If the Funds are buyers of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the Funds will either (i) receive from the seller of protection an amount equal to the notional amount of the swap and deliver the referenced obligation or underlying securities comprising the referenced index or (ii) receive a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation or underlying securities comprising the referenced index.
- (2) If the Funds are sellers of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the Funds will either (i) pay to the buyer of protection an amount equal to the notional amount of the swap and take delivery of the referenced obligation or underlying securities comprising the referenced index or (ii) pay a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation or underlying securities comprising the referenced index.
- (3) Implied credit spreads, represented in absolute terms, utilized in determining the market value of credit default swap agreements as of year end serve as an indicator of the current status of the payment/performance risk and represent the likelihood or risk of default for the credit derivative. The implied credit spread of a particular referenced entity reflects the cost of buying/selling protection and may include upfront payments required to be made to enter into the agreement. Wider credit spreads represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement.
- (4) The maximum potential amount the Funds could be required to make as sellers of credit protection or receive as buyers of credit protection if a credit event occurs as defined under the terms of that particular swap agreement.
- (5) The quoted market prices and resulting values for credit default swap agreements serve as an indicator of the status at January 31, 2010 of the payment/performance risk and represent the likelihood of an expected liability (or profit) for the credit derivative should the notional amount of the swap agreement been closed/sold as of the period end. Increasing market values, in absolute terms when compared to the notional amount of the swap, represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement.

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

January 31, 2010 (unaudited)

**5. Investments in Securities** (continued)

(c) Forward foreign currency contracts outstanding at January 31, 2010:

Income Strategy:

|   | Counterparty           | U.S. \$<br>Value on<br>Origination<br>Date | U.S. \$ Value<br>January 31, 2010 | Unrealized<br>Appreciation<br>(Depreciation) |
|---|------------------------|--|-----------------------------------|--|
| <u>Purchased:</u>                               |                        |  |                                   |  |
| 1,400,000 British Pound<br>settling 3/25/10     | Goldman Sachs          | \$2,289,353                                | \$2,242,525                       | \$(46,828)                                   |
| 145,000 Euro settling 4/26/10                   | JPMorgan Chase         | 205,358                                    | 201,499                           | (3,859)                                      |
| <u>Sold:</u>                                    |                        |  |                                   |  |
| 2,115,813 Australian Dollar<br>settling 2/26/10 | Royal Bank of Scotland | 1,933,900                                  | 1,875,924                         | 57,976                                       |
| 240,000 British Pound<br>settling 3/25/10       | Deutsche Bank          | 384,653                                    | 384,433                           | 220  |
| 25,000 British Pound<br>settling 3/25/10        | Goldman Sachs          | 40,805                                     | 40,045                            | 760  |
| 10,054,000 British Pound<br>settling 3/25/10    | UBS                    | 16,090,874                                 | 16,104,532                        | (13,658)                                     |
| 6,211,000 Euro settling 3/23/10                 | JPMorgan Chase         | 8,920,611                                  | 8,631,940                         | 288,671                                      |
|   |                        |  |                                   | \$283,282                                    |

Income Strategy II:

|   | Counterparty           | U.S. \$<br>Value on<br>Origination<br>Date | U.S. \$ Value<br>January 31, 2010 | Unrealized<br>Appreciation<br>(Depreciation) |
|---|------------------------|--|-----------------------------------|--|
| <u>Sold:</u>                                    |                        |  |                                   |  |
| 7,942,000 Australian Dollar<br>settling 2/26/10 | Royal Bank of Scotland | \$7,259,163                                | \$7,041,541                       | \$217,622                                    |
| 261,000 British Pound<br>settling 3/25/10       | Citigroup              | 421,310                                    | 418,071                           | 3,239  |
| 464,000 British Pound<br>settling 3/25/10       | Deutsche Bank          | 743,662                                    | 743,237                           | 425  |

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|  |                |            |            |             |
|--|----------------|------------|------------|-------------|
| 50,000 British Pound<br>settling 3/25/10     | Goldman Sachs  | 81,610     | 80,090     | 1,520       |
| 19,083,000 British Pound<br>settling 3/25/10 | UBS            | 30,541,292 | 30,567,215 | (25,923)    |
| 15,151,000 Euro settling 3/23/10             | JPMorgan Chase | 21,760,775 | 21,056,597 | 704,178     |
| 6,261,000 Euro settling 4/26/10              | JPMorgan Chase | 8,867,204  | 8,700,594  | 166,610     |
|  |                |            |            | \$1,067,671 |

Income Strategy and Income Strategy II received \$1,060,000 and \$1,370,000, respectively, in cash as collateral for derivative contracts. Cash collateral received may be invested in accordance with the Funds' investment strategy.

(d) Open reverse repurchase agreements at January 31, 2010 were:

Income Strategy:

| Counterparty    | Rate  | Trade Date | Maturity Date | Principal & Interest | Principal    |
|-----------------|-------|------------|---------------|----------------------|--------------|
| Bank of America | 0.55% | 1/8/10     | 2/10/10       | \$332,446            | \$332,324    |
|                 | 0.55% | 1/13/10    | 2/11/10       | 4,021,557            | 4,020,390    |
| Barclays Bank   | 0.55% | 1/20/10    | 2/18/10       | 6,681,225            | 6,680,000    |
|                 | 0.65% | 1/8/10     | 2/10/10       | 8,598,724            | 8,595,000    |
| Morgan Stanley  | 0.55% | 1/22/10    | 2/22/10       | 12,115,851           | 12,114,000   |
|                 |       |            |               |                      | \$31,741,714 |

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

January 31, 2010 (unaudited)

**5. Investments in Securities** (continued)

Income Strategy II:

| Counterparty               | Rate  | Trade Date | Maturity Date | Principal & Interest | Principal    |
|----------------------------|-------|------------|---------------|----------------------|--------------|
| Barclays Bank              | 0.55% | 1/14/10    | 2/17/10       | \$2,879,792          | \$2,879,000  |
|                            | 0.55% | 1/19/10    | 2/1/10        | 1,239,246            | 1,239,000    |
|                            | 0.55% | 1/27/10    | 2/24/10       | 4,106,314            | 4,106,000    |
|                            | 0.55% | 1/28/10    | 2/26/10       | 2,899,177            | 2,899,000    |
| Credit Suisse First Boston | 0.55% | 1/12/10    | 2/12/10       | 16,049,902           | 16,045,000   |
| Morgan Stanley             | 0.55% | 1/22/10    | 2/22/10       | 36,600,591           | 36,595,000   |
|                            |       |            |               |                      | \$63,763,000 |

The weighted average daily balance of reverse repurchase agreements outstanding during the six months ended January 31, 2010 for Income Strategy and Income Strategy II were \$18,356,276 and \$29,807,482, respectively, at a weighted average interest rate of 0.65% and 0.60%, respectively. The total market value of underlying collateral (refer to the Schedules of Investments for positions segregated as collateral for reverse repurchase agreements) for open reverse repurchase agreements at January 31, 2010 were \$33,373,118 and \$67,722,217, respectively.

Income Strategy received \$250,000 in principal value of U.S. government agency securities as collateral for reverse repurchase agreements outstanding. Income Strategy II received \$320,000 in cash as collateral for reverse repurchase agreements outstanding. Cash collateral received may be invested in accordance with Funds' investment strategy. Collateral received as securities cannot be pledged.

(e) At January 31, 2010, the Funds had the following unfunded loan commitments which could be extended at the option of the borrower:

| Borrower      | Income Strategy | Income Strategy II |
|---------------|-----------------|--------------------|
| Eastman Kodak | \$1,250,000     | \$2,500,000        |

**6. Income Tax Information**

Net investment income and net realized gains differ for federal income tax and financial statement purposes primarily due to the treatment of amounts received under swap agreements. For the six months ended January 31, 2010, Income Strategy and Income Strategy II received \$762,761 and \$1,660,907, respectively, from swap agreements which are treated as net realized gain for financial statement purposes and as net income for federal income tax purposes.

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The cost basis of investments is substantially the same for both federal income tax and financial reporting purposes. Gross unrealized appreciation and gross unrealized depreciation of investments at January 31, 2010 were:

|                    | Cost of<br>Investments | Gross<br>Unrealized<br>Appreciation | Gross<br>Unrealized<br>Depreciation | Net<br>Unrealized<br>Appreciation |
|--------------------|------------------------|-------------------------------------|-------------------------------------|-----------------------------------|
| Income Strategy    | \$275,380,106          | \$28,275,958                        | \$(11,715,813)                      | \$16,560,145                      |
| Income Strategy II | 554,457,983            | 55,883,663                          | (34,331,306)                        | 21,552,357                        |

### 7. Auction-Rate Preferred Shares

Income Strategy has 1,053 shares of Preferred Shares Series T, 1,053 shares of Preferred Shares Series W, 1,053 shares of Preferred Shares Series TH, each with a liquidation preference of \$25,000 per share plus any accumulated, unpaid dividends.

Income Strategy II has 1,288 shares of Preferred Shares Series M, 1,288 shares of Preferred Shares Series T, 1,288 shares of Preferred Shares Series W, 1,288 shares of Preferred Shares Series TH, and 1,288 shares of Preferred Shares Series F outstanding, each with a liquidation preference of \$25,000 per share plus any accumulated, unpaid dividends.

Dividends are accumulated daily at an annual rate (typically re-set every seven days) through auction procedures. Distributions of net realized capital gains, if any, are paid annually.

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

January 31, 2010 (unaudited)

**7. Auction-Rate Preferred Shares (continued)**

For the six months ended January 31, 2010, the annualized dividend rates ranged from:

|                            | High   | Low    | At January 31, 2010 |
|----------------------------|--------|--------|---------------------|
| <u>Income Strategy:</u>    |        |        |                     |
| Series T                   | 1.513% | 1.458% | 1.459%              |
| Series W                   | 1.511% | 1.458% | 1.459%              |
| Series TH                  | 1.512% | 1.458% | 1.459%              |
| <u>Income Strategy II:</u> |        |        |                     |
| Series M                   | 1.513% | 1.458% | 1.459%              |
| Series T                   | 1.513% | 1.458% | 1.459%              |
| Series W                   | 1.511% | 1.458% | 1.459%              |
| Series TH                  | 1.512% | 1.458% | 1.459%              |
| Series F                   | 1.511% | 1.456% | 1.456%              |

The Funds are subject to certain limitations and restrictions while Preferred Shares are outstanding. Failure to comply with these limitations and restrictions could preclude the Funds from declaring any dividends or distributions to common shareholders or repurchasing common shares and/or could trigger the mandatory redemption of Preferred Shares at their liquidation preference.

Preferred shareholders, who are entitled to one vote per share, generally vote together with the common shareholders but vote separately as a class to elect two Trustees and on any matters affecting the rights of the Preferred Shares.

Since mid-February 2008, holders of auction-rate preferred shares ( ARPS ) issued by the Funds have been directly impacted by an unprecedented lack of liquidity, which has similarly affected ARPS holders in many of the nation's closed-end funds. Since then, regularly scheduled auctions for ARPS issued by the Funds have consistently failed because of insufficient demand (bids to buy shares) to meet the supply (shares offered for sale) at each auction. In a failed auction, ARPS holders cannot sell all, and may not be able to sell any, of their shares tendered for sale. While repeated auction failures have affected the liquidity for ARPS, they do not constitute a default or automatically alter the credit quality of the ARPS, and ARPS holders have continued to receive dividends at the defined maximum rate, the higher of the 7-day USD London Inter-Bank Offered Rate ( LIBOR ) multiplied by 125% or the 7-day USD LIBOR plus 1.25% (which is a function of short-term interest rates and typically higher than the rate that would have otherwise been set through a successful auction). If the Funds' ARPS auctions continue to fail and the maximum rate payable on the ARPS rises as a result of changes in short-term interest rates, returns for the Funds' common shareholders could be adversely affected.

**8. Legal Proceedings**

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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 Investors of America, L.P.), agreed to settle, without admitting or denying the allegations, claims brought by the Securities and Exchange Commission ( SEC ) 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



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

January 31, 2010 (unaudited)

**8. Legal Proceedings** (continued)

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.

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.

**9. Subsequent Events**

On February 1, 2010, the following dividends were declared to common shareholders payable March 1, 2010 to shareholders of record on February 11, 2010:

|                    |                            |
|--------------------|----------------------------|
| Income Strategy    | \$0.06235 per common share |
| Income Strategy II | \$0.05819 per common share |

On March 1, 2010, the following dividends were declared to common shareholders payable March 30, 2010 to shareholders of record on March 11, 2010:

|                    |                            |
|--------------------|----------------------------|
| Income Strategy    | \$0.06235 per common share |
| Income Strategy II | \$0.05819 per common share |

Effective March 1, 2010, each Fund adopted amended and restated by-laws ( By-laws ) that incorporate substantially revised and updated ratings criteria (the New Fitch Criteria ) issued by Fitch, Inc. ( Fitch ) applicable to each Fund s outstanding auction rate preferred shares ( Preferred Shares ). The New Fitch Criteria includes two separate Preferred Shares asset coverage tests which differ from the single test previously applicable to Fitch s ratings. Other key components of the New Fitch Criteria as cited by Fitch include, among others, updated asset discount

## Edgar Filing: PIMCO Income Strategy Fund II - Form N-CSRS

factors, changes to issuer and industry concentration thresholds and guidelines, and inclusion of certain leverage and derivatives when calculating the Fitch asset coverage tests. The New Fitch Criteria is available on the Fitch website ([www.fitchratings.com](http://www.fitchratings.com)) and is incorporated by reference into each Fund's By-laws. Furthermore, as announced in press release dated March 12, 2010, Fitch has reaffirmed the AAA rating it assigned to each Fund's Preferred Shares.

On March 11, 2010 each Fund announced that its Board of Trustees approved the terms of a transferable rights offering of additional common shares of the Fund. Generally, pursuant to each Fund's rights offering, the Fund will issue to its common shareholders of record on March 24, 2010 one transferable right for each full common share held, and rights holders will be able to purchase one new common share for every three (3) rights held at a discounted price to the then current market value of the common shares. Each Fund's subscription period will begin on March 24, 2010 and end on April 23, 2010, unless extended. The specific terms and conditions of each Fund's rights offering, which are subject to change, are set forth in its registration statement relating to the offering, which is on file with the Securities and Exchange Commission.

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**PIMCO Income Strategy Fund Financial Highlights**

For a share of common stock outstanding throughout each period:

|  | Six Months<br>ended<br>January 31,<br>2010<br>(unaudited) | 2009      | 2008      | Year ended July 31,<br>2007 | 2006      | 2005      |
|--|---|-----------|-----------|-----------------------------|-----------|-----------|
| Net asset value, beginning of period   | \$9.07  | \$14.73   | \$17.38   | \$19.14                     | \$19.51   | \$19.38   |
| <b>Investment Operations:</b>  |   |           |           |                             |           |           |
| Net investment income  | 0.73  | 1.54      | 1.81      | 2.13                        | 1.91      | 1.36      |
| Net realized and change in unrealized gain (loss) on investments, futures contracts, options written, swaps, unfunded loan commitments and foreign currency transactions | 2.23  | (5.81)    | (2.08)    | (1.29)                      | (0.14)    | 0.39      |
| Total from investment operations   | 2.96  | (4.27)    | (0.27)    | 0.84                        | 1.77      | 1.75      |
| <b>Dividends and Distributions on Preferred Shares from:</b>   |   |           |           |                             |           |           |
| Net investment income  | (0.03)  | (0.21)    | (0.54)    | (0.59)                      | (0.48)    | (0.29)    |
| Net realized gains   |   |           |           | (0.00)                      |           |           |
| Total dividends and distributions on preferred shares  | (0.03)  | (0.21)    | (0.54)    | (0.59)                      | (0.48)    | (0.29)    |
| Net increase (decrease) in net assets applicable to common shareholders resulting from investment operations   | 2.93  | (4.48)    | (0.81)    | 0.25                        | 1.29      | 1.46      |
| <b>Dividends and Distributions to Common Shareholders from:</b>  |   |           |           |                             |           |           |
| Net investment income  | (1.67)  | (1.18)    | (1.54)    | (1.77)                      | (1.63)    | (1.19)    |
| Net realized gains   |   |           | (0.30)    | (0.24)                      | (0.03)    | (0.14)    |
| Total dividends and distributions to common shareholders   | (1.67)  | (1.18)    | (1.84)    | (2.01)                      | (1.66)    | (1.33)    |
| Net asset value, end of period   | \$10.33   | \$9.07    | \$14.73   | \$17.38                     | \$19.14   | \$19.51   |
| Market price, end of period  | \$11.95   | \$8.98    | \$13.98   | \$17.88                     | \$20.02   | \$18.75   |
| <b>Total Investment Return (1)</b>   | 53.04%  | (25.78)%  | (12.26)%  | (0.93)%                     | 16.53%    | (2.05)%   |
| <b>RATIOS/SUPPLEMENTAL DATA:</b>   |   |           |           |                             |           |           |
| Net assets applicable to common shareholders, end of period (000s)   | \$190,861   | \$165,982 | \$269,140 | \$316,289                   | \$345,750 | \$351,708 |
| Ratio of expenses to average net assets, including interest expense (2)(4)   | 1.59%(5)  | 2.31%(3)  | 1.68%(3)  | 1.68%(3)                    | 1.53%(3)  | 1.52%(3)  |
| Ratio of expenses to average net assets, excluding interest expense (2)  | 1.52%(5)  | 2.20%(3)  | 1.67%(3)  | 1.55%(3)                    | 1.53%(3)  | 1.52%(3)  |
| Ratio of net investment income to average net assets (2)   | 14.26%(5)   | 17.31%    | 11.18%    | 11.14%                      | 9.91%     | 6.93%     |
| Preferred shares asset coverage per share  | \$85,408  | \$77,538  | \$57,030  | \$62,622                    | \$66,133  | \$66,856  |
| Portfolio turnover   | 43%   | 98%       | 31%       | 62%                         | 64%       | 83%       |

Less than \$0.005 per share.

- (1) Total investment return is calculated assuming a purchase of common stock at the current market price on the first day and a sale of share of common stock at the current market price on the last day of each period reported. Dividends and distributions are assumed, for purposes of this calculation, to be reinvested at prices obtained under the Fund's dividend reinvestment plan. Total investment return does not reflect brokerage commissions or sales charges. Total investment return for a period of less than one year is not annualized.
- (2)

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Calculated on the basis of income and expenses applicable to both common and preferred shares relative to the average net assets of common shareholders.

- (3) Inclusive of expenses offset by custody credits earned on cash balances at the custodian bank. (See note 1(m) in Notes to Financial Statements).
- (4) Interest expense primarily relates to investments in reverse repurchase agreement transactions.
- (5) Annualized.

**See accompanying Notes to Financial Statements.** | 1.31.10 | PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Semi-Annual Report **39**

**PIMCO Income Strategy Fund II Financial Highlights**

For a share of common stock outstanding throughout each period:

|  | Six Months<br>ended<br>January 31,<br>2010<br>(unaudited) | 2009                 | Year ended July 31,<br>2008 | 2007                 | Eleven months<br>ended<br>July 31, 2006 | For the period<br>October 29,<br>2004*<br>through<br>August 31, 2005 |
|--|---|----------------------|-----------------------------|----------------------|---|--|
| Net asset value, beginning of period   | \$7.98  | \$14.16              | \$16.76                     | \$18.76              | \$18.98                                 | \$19.10**  |
| <b>Investment Operations:</b>  |   |                      |                             |                      |   |  |
| Net investment income  | 0.61  | 1.44                 | 1.81                        | 2.06                 | 1.64                                    | 0.88   |
| Net realized and change in unrealized gain (loss) on investments, futures contracts, options written, swaps, unfunded loan commitments and foreign currency transactions | 1.87  | (6.40)               | (2.37)                      | (1.34)               |   | 0.31   |
| Total from investment operations   | 2.48  | (4.96)               | (0.56)                      | 0.72                 | 1.64                                    | 1.19   |
| <b>Dividends and Distributions on Preferred Shares from:</b>   |   |                      |                             |                      |   |  |
| Net investment income  | (0.03)  | (0.20)               | (0.52)                      | (0.58)               | (0.45)                                  | (0.24)   |
| Net realized gains   |   |                      |                             | (0.00)               |   |  |
| Total dividends and distributions on preferred shares  | (0.03)  | (0.20)               | (0.52)                      | (0.58)               | (0.45)                                  | (0.24)   |
| Net increase (decrease) in net assets applicable to common shareholders resulting from investment operations   | 2.45  | (5.16)               | (1.08)                      | 0.14                 | 1.19                                    | 0.95   |
| <b>Dividends and Distributions to Common Shareholders from:</b>  |   |                      |                             |                      |   |  |
| Net investment income  | (1.29)  | (1.02)               | (1.51)                      | (1.72)               | (1.41)                                  | (0.91)   |
| Net realized gains   |   |                      |                             | (0.42)               |   |  |
| Return of capital  |   |                      | (0.01)                      |                      |   |  |
| Total dividends and distributions to common shareholders   | (1.29)  | (1.02)               | (1.52)                      | (2.14)               | (1.41)                                  | (0.91)   |
| <b>Capital Share Transactions:</b>   |   |                      |                             |                      |   |  |
| Common stock offering costs charged to paid-in capital in excess of par  |   |                      |                             |                      |   | (0.03)   |
| Preferred shares offering costs/ underwriting discounts charged to paid-in capital in excess of par  |   |                      |                             |                      |   | (0.13)   |
| Total capital share transactions   |   |                      |                             |                      |   | (0.16)   |
| Net asset value, end of period   | \$9.14  | \$7.98               | \$14.16                     | \$16.76              | \$18.76                                 | \$18.98  |
| Market price, end of period  | \$9.87  | \$7.78               | \$12.80                     | \$17.28              | \$18.87                                 | \$18.21  |
| <b>Total Investment Return (1)</b>   | 44.43%  | (29.85)%             | (18.08)%                    | 2.73%                | 11.77%                                  | (4.39)%  |
| <b>RATIOS/SUPPLEMENTAL DATA:</b>   |   |                      |                             |                      |   |  |
| Net assets applicable to common shareholders, end of period (000s)   | \$395,365   | \$341,949            | \$604,632                   | \$712,152            | \$782,371                               | \$789,094  |
| Ratio of expenses to average net assets, including interest expense (2)(4)   | 1.45%(5)<br>1.41%(5)                                      | 2.08%(3)<br>1.96%(3) | 1.60%(3)<br>1.60%(3)        | 1.48%(3)<br>1.48%(3) | 1.47%(3)(5)<br>1.47%(3)(5)              | 1.35%(3)(5)<br>1.35%(3)(5)   |

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|   |           |          |          |          |          |          |
|---|-----------|----------|----------|----------|----------|----------|
| Ratio of expenses to average net assets, excluding interest expense (2) |           |          |          |          |          |          |
| Ratio of net investment income to average net assets (2)                | 13.38%(5) | 17.84%   | 11.59%   | 11.03%   | 9.51%(5) | 5.57%(5) |
| Preferred shares asset coverage per share                               | \$86,380  | \$78,091 | \$56,481 | \$62,069 | \$65,722 | \$66,084 |
| Portfolio turnover  | 44%       | 96%      | 29%      | 65%      | 60%      | 47%      |

\* Commencement of operations.

\*\* Initial public offering price of \$20.00 per share less underwriting discount of \$0.90 per share.

Fiscal year-end changed from August 31 to July 31.

Amount less than \$0.005 per share.

- (1) Total investment return is calculated assuming a purchase of common stock at the current market price on the first day and a sale of share of common stock at the current market price on the last day of each period reported. Dividends and distributions are assumed, for purposes of this calculation, to be reinvested at prices obtained under the Fund's dividend reinvestment plan. Total investment return does not reflect brokerage commissions or sales charges. Total investment return for a period of less than one year is not annualized.
- (2) Calculated on the basis of income and expenses applicable to both common and preferred shares relative to the average net assets of common shareholders.
- (3) Inclusive of expenses offset by custody credits earned on cash balances at the custodian bank. (See note 1(m) in Notes to Financial Statements).
- (4) Interest expense primarily relates to investments in reverse repurchase agreement transactions.
- (5) Annualized.

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

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II  
 Joint Annual Shareholder Meeting Results/Changes to the Funds Board of Trustees/  
 Proxy Voting Policies & Procedures/Change in Portfolio Manager (unaudited)**

**Joint Annual Shareholder Meeting Results:**

The Funds held their joint annual meeting of shareholders on December 16, 2009. Common/Preferred shareholders voted as indicated below:

Income Strategy:

|  | Affirmative | Withheld<br>Authority |
|--|-------------|-----------------------|
| Election of R. Peter Sullivan, III Class III to serve until 2012 | 16,502,991  | 394,495               |
| Election of John C. Maney Class III to serve until 2012          | 16,486,153  | 411,333               |

Messr. Paul Belica, Robert E. Connor\*, Hans W. Kertess, James A. Jacobson and William B. Ogden, IV continue to serve as Trustees of Income Strategy.

Income Strategy II:

|   | Affirmative | Withheld<br>Authority |
|---|-------------|-----------------------|
| Election of R. Peter Sullivan, III Class II to serve until 2012 | 36,283,414  | 996,035               |

Messr. Paul Belica, Robert E. Connor\*, Hans W. Kertess, William B. Ogden, IV, James A. Jacobson and John C. Maney continue to serve as Trustees of Income Strategy II.

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\* Preferred Shares Trustee  
 Interested Trustee

**Changes to the Funds Board of Trustees:**

Diana L. Taylor resigned as Trustee of the Funds on September 10, 2009.

On December 14, 2009, the Funds Board of Trustees appointed James A. Jacobson as a Trustee.

**Proxy Voting Policies & Procedures:**

A description of the policies and procedures that the Funds have adopted to determine how to vote proxies relating to portfolio securities and information about how the Funds voted proxies relating to portfolio securities held during the most recent twelve month period ended June 30 is available (i) without charge, upon request, by calling the Funds' shareholder servicing agent at (800) 254-5197; (ii) on the Funds' website at [www.allianzinvestors.com/closedendfunds](http://www.allianzinvestors.com/closedendfunds); and (iii) on the Securities and Exchange Commission website at [www.sec.gov](http://www.sec.gov)

**Change in Portfolio Manager:**

Effective December 15, 2009, Mr. William H. Gross assumed primary responsibility for the day-to-day portfolio management of the Funds. Mr. Gross founded PIMCO more than 38 years ago and is a managing director and co-Chief Investment Officer of the company. He has 40 years of investment experience and holds an MBA from the Anderson School of Management at the University of California, Los Angeles. He received his undergraduate degree from Duke University.



**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**

**Changes to Fund Names and Investment Policies** (unaudited)

Effective March 1, 2010, each Fund changed its name and rescinded its non-fundamental investment policy to, under normal market conditions, invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments. Each Fund now seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating and/or fixed-rate debt instruments.

The new names for PIMCO Floating Rate Income Fund (PFL) and PIMCO Floating Rate Strategy Fund (PFN) are PIMCO Income Strategy Fund and PIMCO Income Strategy Fund II, respectively. The New York Stock Exchange ticker symbols for the Funds' common shares (PFL and PFN) remain the same.

Under their new names and policies, the Funds have flexibility to allocate and re-allocate 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 either asset class or rating quality at any time, based on assessments of relative values, market conditions and other factors made by the Sub-Adviser.

Effective December 28, 2009, the investment policies and guidelines of the Funds were also revised as follows:

*Below Investment Grade Securities:* The policies of PFL and PFN, each of which may invest without limit in below investment grade securities, have been revised such that each Fund may not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or below by each ratings agency rating the security, or unrated but judged by PIMCO to be of comparable quality. Each of the Funds previously observed a limit of 10% of their total assets in CCC+/Caa1 or lower securities. The Funds may also invest without limit in investment grade securities.

The Funds 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 the Sub-Adviser 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 Funds' credit quality policies apply only at the time a security is purchased, and the Funds are not required to dispose of a security in the event that a rating agency or the Sub-Adviser downgrades its assessment of the credit characteristics of a particular issue.

*Duration:* In addition, the prior guideline observed by the Funds of normally having a low average portfolio duration (zero to three years) has been revised such that the average portfolio duration of each Fund will normally be in a low to intermediate range (zero to eight years), although it may be longer at any time based on the Sub-Adviser's assessment of market conditions and other factors. The Sub-Adviser 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 Funds' portfolios, 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. Generally, the longer a security's duration, the more sensitive it will be to changes in interest rates. i.e., the prices of debt obligations typically fall when market interest rates rise.

*Emerging Market Securities:* Each Fund may now invest up to 25% of its total assets in securities of issuers economically tied to emerging market countries. This reflects an increase in each Fund's previous maximum investment limit in emerging market securities of 10% of total assets.

Foreign investment risk may be particularly high to the extent that the Funds invest in emerging market securities. These securities may present market, credit, currency, liquidity, legal, political and other risks different from, and greater than, the risks of investing in developed foreign countries, including (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 lack of liquidity and in price volatility; and (iii) certain national policies which may restrict a Fund's investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests.

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**Board of Trustees**

Hans W. Kertess  
Chairman of the Board of Trustees  
Paul Belica  
Robert E. Connor  
James A. Jacobson  
John C. Maney  
William B. Ogden, IV  
R. Peter Sullivan III

**Fund Officers**

Brian S. Shlissel  
President & Chief Executive Officer  
Lawrence G. Altadonna  
Treasurer, Principal Financial & Accounting Officer  
Thomas J. Fuccillo  
Vice President, Secretary & Chief Legal Officer  
Scott Whisten  
Assistant Treasurer  
Richard J. Cochran  
Assistant Treasurer  
Youse E. Guia  
Chief Compliance Officer  
Kathleen A. Chapman  
Assistant Secretary  
Lagan Srivastava  
Assistant Secretary

**Investment Manager**

Allianz Global Investors Fund Management LLC  
1345 Avenue of the Americas  
New York, NY 10105

**Sub-Adviser**

Pacific Investment Management Company LLC  
840 Newport Center Drive  
Newport Beach, CA 92660

**Custodian & Accounting Agent**

State Street Bank & Trust Co.  
801 Pennsylvania Avenue  
Kansas City, MO 64105-1307

**Transfer Agent, Dividend Paying Agent and Registrar**

PNC Global Investment Servicing  
P.O.Box 43027  
Providence, RI 02940-3027

**Independent Registered Public Accounting Firm**

PricewaterhouseCoopers LLP  
300 Madison Avenue  
New York, NY 10017

**Legal Counsel**

Ropes & Gray LLP  
One International Place  
Boston, MA 02110-2624

*This report, including the financial information herein, is transmitted to the shareholders of PIMCO Income Strategy Fund and PIMCO Income Strategy Fund II for their information. It is not a prospectus, circular or representation intended for use in the purchase of shares of the Funds or any securities mentioned in this report.*

*The financial information included herein is taken from the records of the Funds without examination by an independent registered public accounting firm, who did not express an opinion herein.*

*Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940, as amended, that from time to time the Funds may purchase shares of their common stock in the open market.*

*The Funds file their complete schedules of portfolio holdings with the Securities and Exchange Commission ( SEC ) for the first and third quarters of their fiscal year on Form N-Q. The Funds' Form N-Qs are available on the SEC's website at [www.sec.gov](http://www.sec.gov) and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information on the operation of the Public Reference Room may be obtained by calling (800) SEC-0330. The information on Form N-Q is also available on the Funds' website at [www.allianzinvestors.com/closedendfunds](http://www.allianzinvestors.com/closedendfunds).*

*Information on the Funds are available at [www.allianzinvestors.com/closedendfunds](http://www.allianzinvestors.com/closedendfunds) or by calling the Funds' shareholder servicing agent at (800) 254-5197.*

Receive this report electronically and eliminate paper mailings.

To enroll, go to **[www.allianzinvestors.com/edelivery](http://www.allianzinvestors.com/edelivery)**.

ITEM 2. CODE OF ETHICS

Not required in this filing.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT

Not required in this filing.

ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Not required in this filing

ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANT

Not required in this filing

ITEM 6. SCHEDULE OF INVESTMENTS

Schedule of Investments is included as part of the Report to Shareholders filed under Item 1 of this form.

ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES

Not required in this filing

ITEM 8. PORTFOLIO MANAGERS OF CLOSED-END MANAGEMENT INVESTMENT COMPANIES



Not required in this filing

ITEM 9. PURCHASES OF EQUITY SECURITIES BY CLOSED-END MANAGEMENT INVESTMENT COMPANY AND AFFILIATED COMPANIES

None

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ITEM 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There have been no material changes to the procedures by which shareholders may recommend nominees to the Fund's Board of Trustees since the Fund last provided disclosure in response to this item.

ITEM 11. CONTROLS AND PROCEDURES

(a) The registrant's President and Chief Executive Officer and Treasurer, Principal Financial & Accounting Officer have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-2(c) under the Act (17 CFR 270.30a-3(c))), as amended are effective based on their evaluation of these controls and procedures as of a date within 90 days of the filing date of this document.

(b) There were no significant changes in the registrant's internal controls (over financial reporting as defined in Rule 30a-3(d) under the Act (17 CFR 270.30a-3(d))) that occurred during the second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's control over financial reporting.

ITEM 12. EXHIBITS

(a) Exhibit 99.302 Cert. - Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(b) Exhibit 99.906 Cert. - Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(Registrant)

PIMCO Income Strategy Fund II

By */s/ Brian S. Shlissel*  
President & Chief Executive Officer

Date April 1, 2010

By */s/ Lawrence G. Altadonna*  
Treasurer, Principal Financial & Accounting Officer

Date April 1, 2010

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By */s/ Brian S. Shlissel*  
President & Chief Executive Officer

Date April 1, 2010

By */s/ Lawrence G. Altadonna*  
Treasurer, Principal Financial & Accounting Officer

Date April 1, 2010

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