PIMCO

4Q15

Putting Markets in Perspective

A company of Allianz

PIMCO's Forums: *Reading the Road*

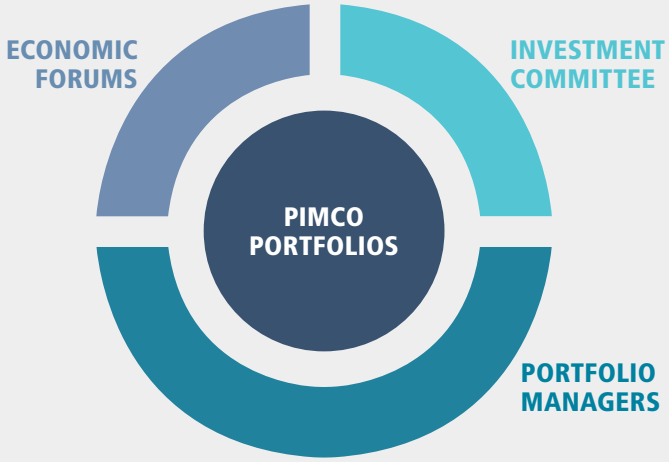
PIMCO's economic forums help provide a framework for how we position our clients' portfolios. Our annual Secular Forum looks over a three-to-five-year horizon. Three times a year, we also hold Cyclical Forums to test and refine our macroeconomic thinking against current facts on the ground, reconciling likely events in the next six to twelve months with our longer-term forecast.

These cyclical "check-ins" are key to our process. If our secular outlook tells us which direction the freeway is headed, then our cyclical outlook reads more immediate conditions so we know which lane to drive in, how fast to go and what the drivers around us are doing.

INVESTMENT PROCESS

Process

PIMCO's time-tested process combines our top-down global outlook with extensive bottom-up security analysis and risk management capabilities.



ECONOMIC FORUMS

Four times a year (at the annual Secular Forum and three Cyclical Forums), our investment professionals around the world gather to identify the trends that will drive the global economy and markets. This macro-economic outlook informs all PIMCO portfolios.

INVESTMENT COMMITTEE

The Investment Committee (IC) meets two hours each day to distill our outlook and current events into specific investment themes and risk factor targets.

PORTFOLIO MANAGERS

Portfolio managers are responsible for day-to-day strategy execution, leveraging our scores of sector and regional specialists.

Table of Contents

Our baseline view for global economic prospects over the next 12 months remains broadly unchanged since last quarter – with global growth in the range of 2.5–3.0% and global inflation at 2.0–2.5%.

However, we see significant and, in some cases, widening divergences among the world's major economies – and somewhat higher macro and market risks due to the diminishing returns of unconventional monetary policy and also the volatility stemming from developments in China.

In major developed markets, such as the U.S., eurozone, U.K. and Japan, we expect an uptick in the pace of growth. Conversely, China's growth prospects are deteriorating. And other major emerging economies, like Russia and Brazil, are in recession with uncertain prospects for a near-term recovery. Additionally, more than 40 central banks have eased monetary policy this year, and the odds are high for additional easing in Europe, China and Japan. As for the Federal Reserve, we believe a rate hike cycle will commence sometime over the next 12 months, but the pace of liftoff is likely to be even more gradual than we previously expected.

Putting Markets in Perspective is designed to provide some direction for today's multi-speed marketplace. It presents, in a concise format, PIMCO's latest thinking on key themes driving the economies and markets, practical applications for investors and specific solutions to consider.

For additional *Putting Markets in Perspective* resources, visit pimco.com/puttingmarketsinperspective

PIMCO continues to forecast global growth of 2.5–3.0% and global inflation of 2.0–2.5%.

WHAT THESE CHARTS SHOW

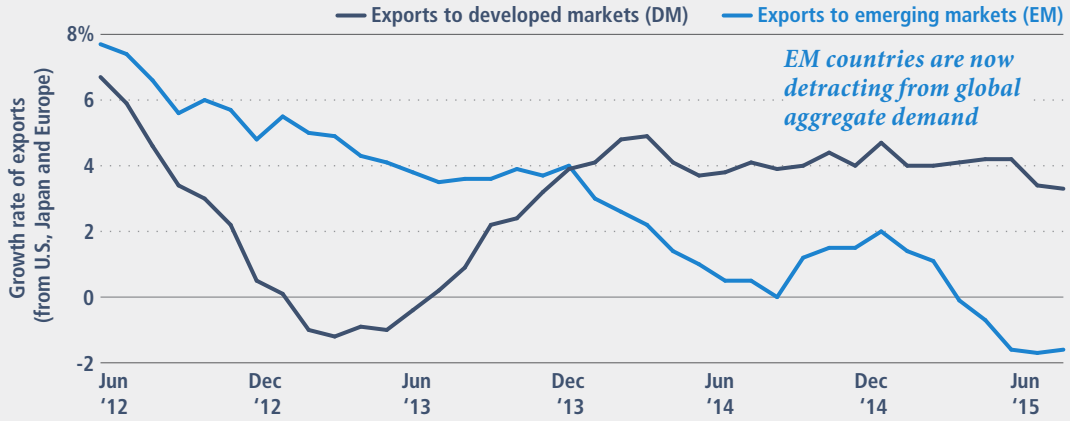
Weakness in aggregate demand growth remains a headwind for the global economy, so it is important to understand which of the world's economies are increasing their demand for the world's goods and services. As the top chart shows, for several years, the exports from some of the world's primary producers (U.S., Japan and Europe) to the emerging world (light blue line) had been growing at a faster rate than those to the developed world (dark blue line). More recently, exports to developed markets (DM) have been growing more rapidly than to emerging markets (EM). In other words, far from being an engine of global growth, EM countries have actually become a drag on global aggregate demand. The bottom chart shows that PIMCO continues to expect EM countries to expand at a quicker pace than developed ones, but the growth differential has narrowed as growth rates in EM have slowed. Moreover, divergences in growth within the EM world continue to bear watching: India and Mexico are growing, for instance, while Brazil and Russia remain in recession.

WHAT IT MEANS FOR INVESTORS

Investors are facing a shifting environment, with widening divergences between the world's economies. We believe investors should favor an actively managed portfolio that includes strategies with a broad opportunity set and a flexible mandate to meet the challenges of changing economic, policy and market conditions.

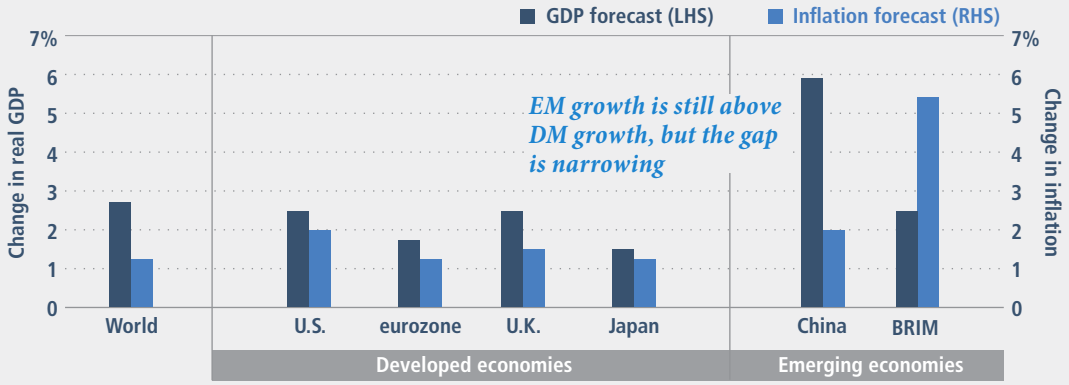
ECONOMY: **GLOBAL**

Sources of aggregate demand growth are shifting



Source: Haver, Morgan Stanley Research. Data as of 31 July 2015. Growth rate is six-month rolling average of year-over-year change in exports.

PIMCO's outlook for the global economy remains broadly unchanged



Source: PIMCO. Forecast is for four quarters ending Q3 2016. World is a weighted average sum of countries listed in chart above. BRIM is Brazil, Russia, India and Mexico.

PIMCO is forecasting solid growth in the U.S. (2.25–2.75%) and a modest pickup in inflation (1.75–2.25%) over the next four quarters.

WHAT THESE CHARTS SHOW

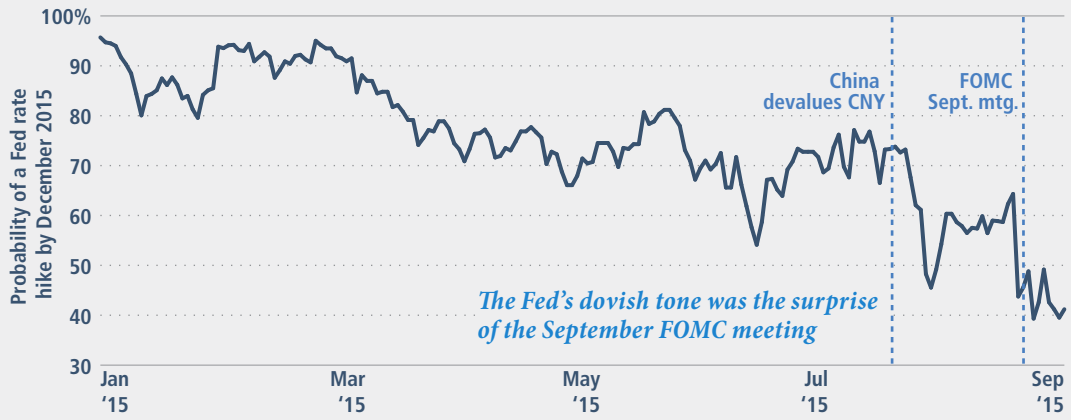
With the Fed on the verge of the first rate increase in a decade, markets remain intently focused on the expected path of monetary policy. The first chart, which shows the market's estimate of the likelihood that the Fed will have begun hiking by the end of the year, highlights the challenge of predicting the Fed's actions. While expectations faltered following China's currency devaluation, it was the Fed's dovish tone at the September Federal Open Market Committee meeting that caused expectations to fall dramatically. One reason for the uncertainty is highlighted in the second chart: since 2008, no country has successfully and sustainably moved off the lower-bound. In PIMCO's view, the Fed will likely lift off in the next 12 months, but the nature of the tightening cycle will be more important than its start date. We expect the Fed to normalize rates gradually and end at a lower neutral rate than we have seen in past cycles.

WHAT IT MEANS FOR INVESTORS

Once the rate hike cycle begins, the yield curve will not necessarily move uniformly, as Fed monetary policy usually has the largest impact at the front end. Investors will need to consider the risk/return characteristics of spots along the curve to find attractive opportunities. In addition, investors may want to consider allocations to non-U.S. fixed income, as other countries may be at different stages in the monetary policy cycle.

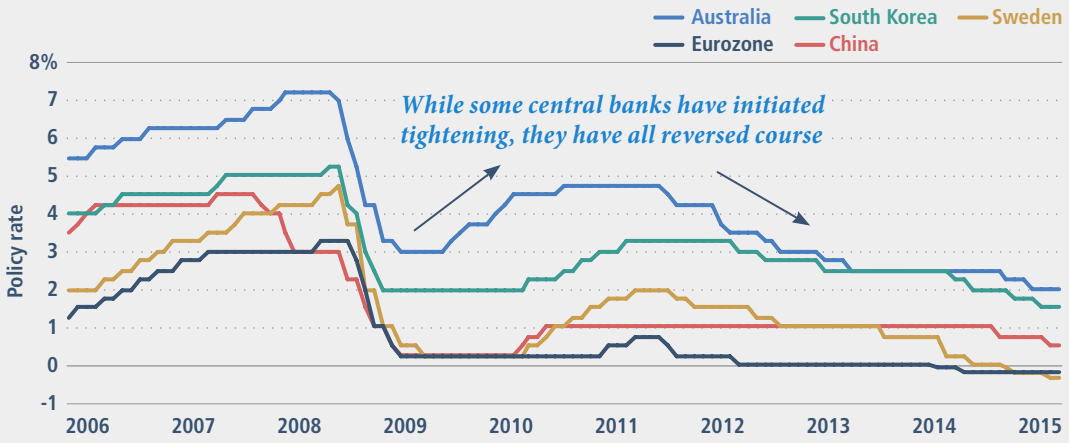
ECONOMY: **U.S.**

Market expectations for a rate hike fell sharply



Source: Bloomberg. Data as of 30 September 2015.

Getting off zero ain't easy



Source: Bloomberg. Data as of 30 September 2015.

PIMCO is forecasting a modest increase in eurozone economic growth (1.5–2.0%) and inflation (1.0–1.5%) over the next 12 months.

WHAT THESE CHARTS SHOW

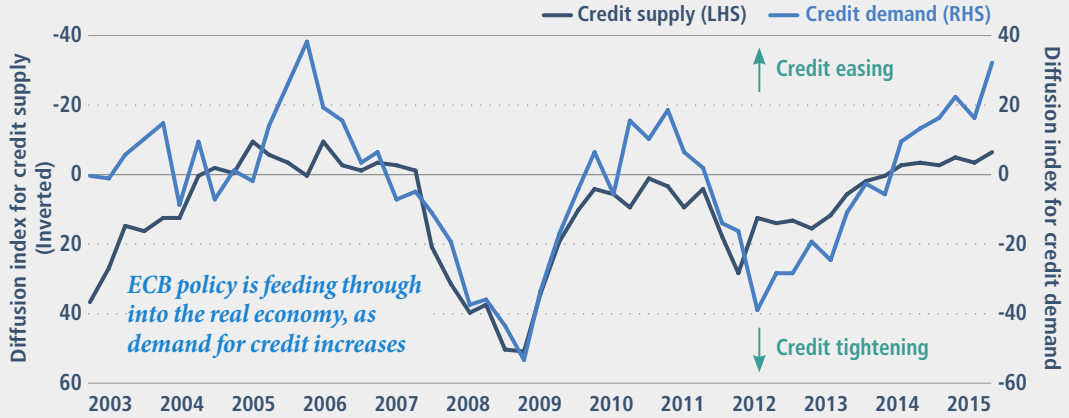
Several factors are converging to modestly boost growth prospects in the eurozone. First, ECB policy is starting to have an impact on credit creation. The top chart tracks change in the sentiment of eurozone banks' willingness to lend and the market's interest in borrowing. Although the ECB can't force banks to increase lending, by using its QE program to push interest rates down, it encourages them to do so in search of profits. The increase in their willingness to supply credit (dark blue line) suggests banks are responding. Similarly, companies and households are responding to lower rates with increasing interest in borrowing (light blue line). Secondly, fiscal policy is no longer holding economic growth back (bottom chart). For the last several years fiscal austerity has been the mantra among eurozone governments eager to put the sovereign debt crisis behind them. While this austerity has been effective, it has been a drag on overall growth. With fiscal policy remaining more or less unchanged recently, this headwind is set to dissipate.

WHAT IT MEANS FOR INVESTORS

While the forecast for the eurozone is improving, the region is still offering only moderate prospects for growth. In addition, the difference between core and periphery country growth is decreasing. Investment in this environment will require in-depth and experienced research at the country, market and security level. PIMCO is, however, favorable on select opportunities in Europe, including intermediate maturity debt and spreads in some countries (including Italy and Spain), and prefers European equities over U.S. equities.

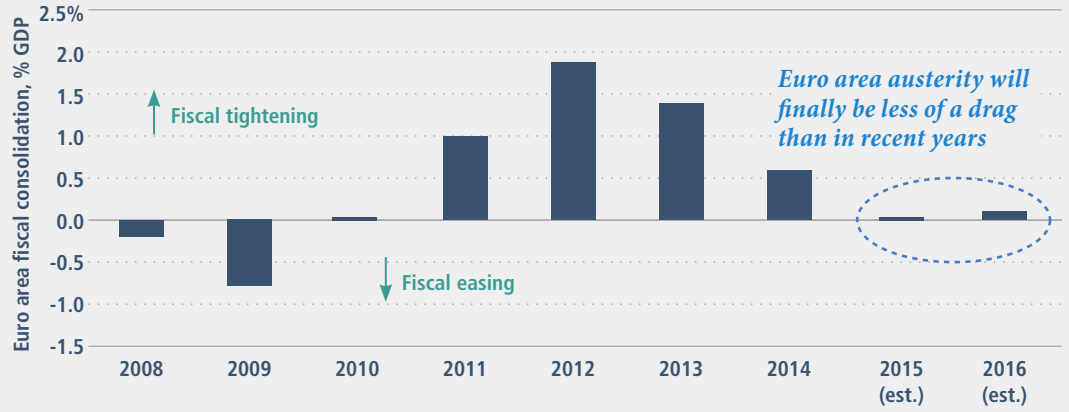
ECONOMY: **EUROPE**

Borrowers are taking advantage of easier credit conditions



Source: PIMCO, ECB. Data as of 31 August 2015. Credit supply and credit demand is measured by the Diffusion Index, which tracks 3-month trailing change in the sentiment of 120 Euro area banks on willingness to lend and the markets' interest in borrowing.

Addition by the elimination of subtraction



Source: PIMCO, Eurostat, European Commission, IMF, National Governments, Bloomberg. Data as of 31 August 2015.

Chinese currency shift comes at an inopportune time as the rest of EM faces domestic and global challenges.

WHAT THESE CHARTS SHOW

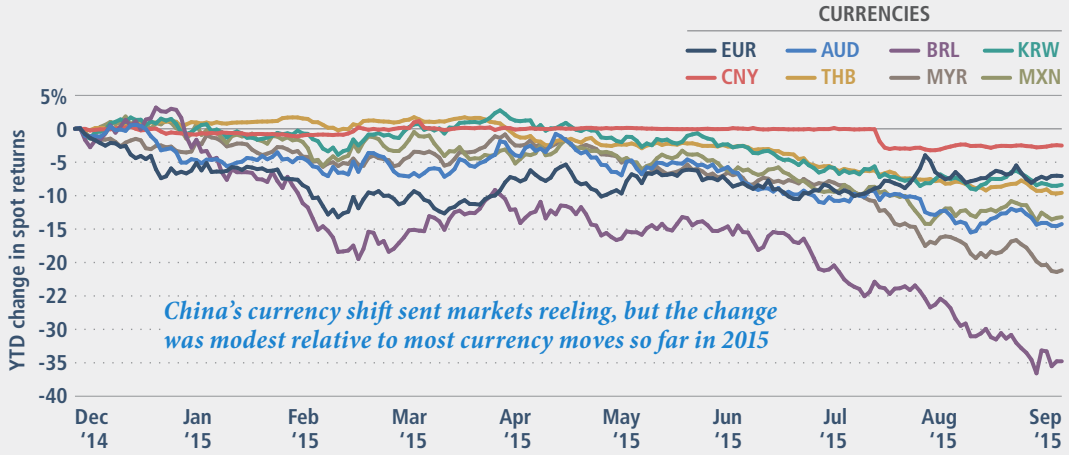
As the world's second largest economy, China plays an outsized role in determining the outlook for emerging markets (EM). As evidence, consider the market turmoil that followed China's currency devaluation in August. While the shift in the yuan (CNY) sent financial markets reeling, as the first chart shows, it was actually modest relative to the persistent weakening of many currencies so far in 2015. So why the strong reaction to China's move? First, the stability of the yuan has long served as an anchor for EM countries, so the devaluation carries additional impact. Perhaps more importantly, many saw the devaluation as an acknowledgment by Chinese policymakers that the country's growth was slowing at a faster rate than official GDP statistics reported. The second chart shows China's officially reported GDP (light blue line) versus PIMCO's calculated estimate of China's actual GDP (dark blue line), and suggests that "real" growth has actually been slowing for quite some time. To the extent the devaluation signals China's willingness to use fiscal, monetary and regulatory tools to avoid a hard landing, it could be a good sign, but for now it is yet another challenge to other EM economies.

WHAT IT MEANS FOR INVESTORS

Emerging market assets are likely to continue to face internal and external pressure, leading PIMCO to forecast GDP growth in China of 5.5–6.5% and in BRIM (Brazil, Russia, India, Mexico) of 2.0–3.0% over the next 12 months. The key for investors in this environment will be to evaluate EM as a diverse opportunity set, rather than as a homogeneous asset class.

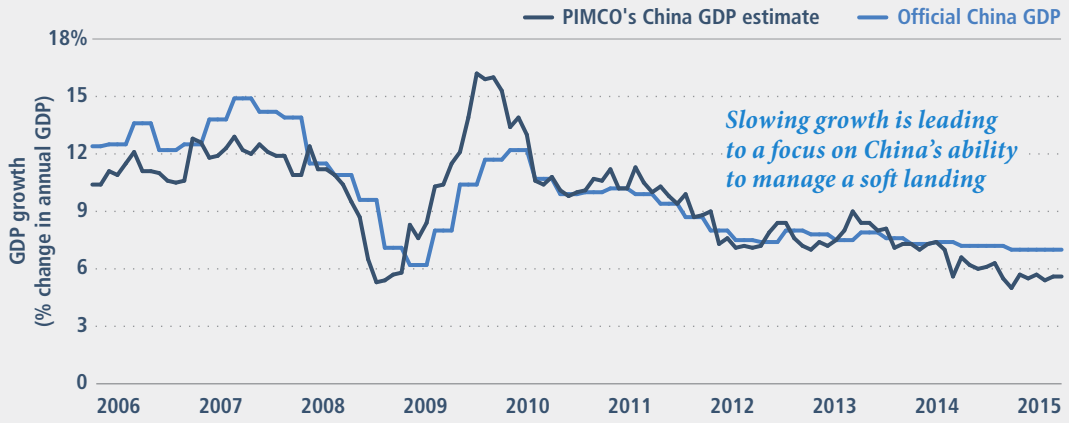
ECONOMY: **EMERGING MARKETS**

China's devaluation was small in size but large in impact



Source: Bloomberg. Data as of 30 September 2015.

Regardless of what the "real" number is, China is slowing



Source: PIMCO, Bloomberg. Data as of 30 September 2015. PIMCO's China GDP estimate uses a monthly weighted average of underlying economic indicators such as bank loans, railway, electricity production, and others.

The macroeconomic backdrop remains supportive of positive equity returns over the long term, and PIMCO sees opportunity in value stocks.

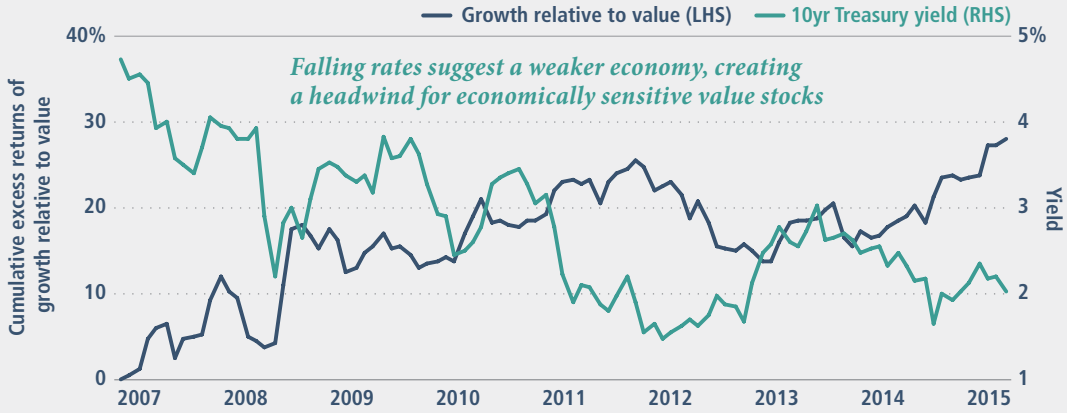
WHAT THESE CHARTS SHOW

As the first chart shows, growth stocks have been outperforming value stocks over the last few years. This outperformance is related to the Fed's easing program over the same period (seen in falling 10-year Treasury yields). What is the connection between style performance and rates? First, falling rates suggest a weaker economy, so more cyclical and economically-sensitive value stocks face a headwind. Second, lower policy rates mean lower discount rates, so the future earnings of growth companies are more valuable today. These years of outperformance have increased the valuation gap between growth and value, as seen in the second chart. At these levels value stocks offer an attractive valuation discount. When the Fed ultimately starts to raise rates, it will be a signal that the economy is strengthening. This, combined with valuations, could serve as the catalyst for mean reversion in style performance.

WHAT IT MEANS FOR INVESTORS

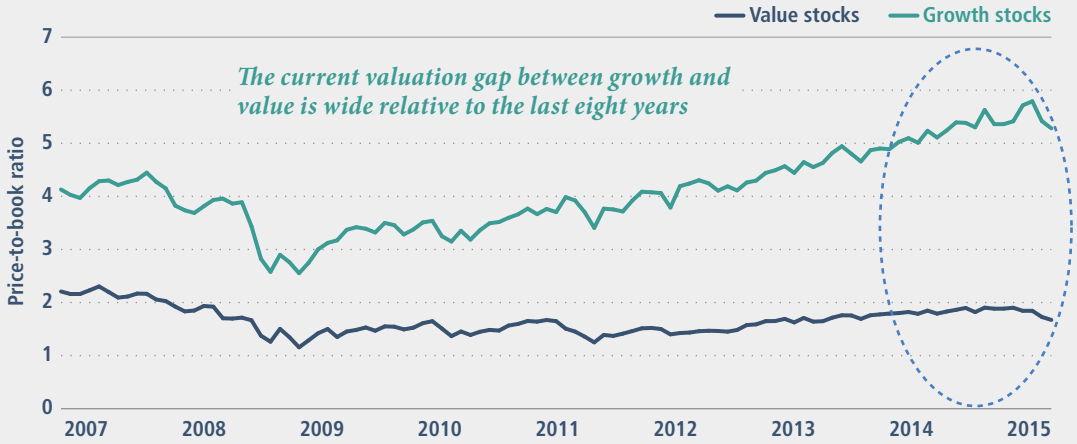
Continued economic expansion and rising rates may support value stocks more than growth stocks. Forward-looking equity investors may want to consider increasing allocations to value stocks given current valuations.

Lower rates have supported the outperformance of growth versus value



Source: Bloomberg. Data from July 2007 to 30 September 2015. Russell 1000 Growth and Value indices were used to represent growth and value.

Value stocks are trading at a significant discount to growth stocks



Source: Bloomberg. Data from July 2007 to 30 September 2015. Russell 1000 Growth and Value indices were used to represent growth and value.

Given our forecast for gradually increasing inflation, PIMCO considers TIPS attractive at current valuations.

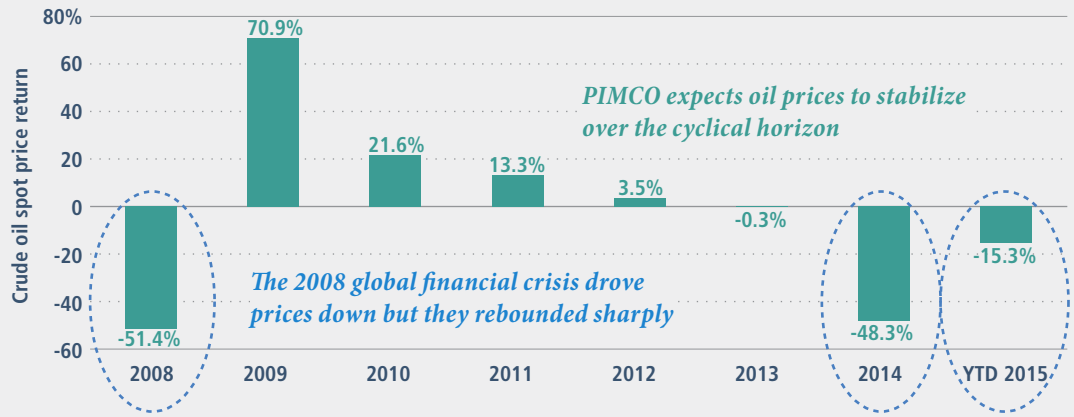
WHAT THESE CHARTS SHOW

Fluctuations in oil prices (seen in the first chart) have played a significant role in supporting or hindering the world's economies and financial markets. This has been especially evident recently as growth in U.S. shale production has created a supply glut that has pressured oil prices significantly lower. Going forward, PIMCO expects supply and demand dynamics to come into better balance, which should stabilize prices over the cyclical horizon. In PIMCO's view, the turmoil in oil and other commodity markets may have created dislocations (and opportunities) in related asset classes, including Treasury Inflation-Protected Securities (TIPS). The second chart shows that the market's expectation for inflation, according to the Fed's preferred measure of long-term inflation expectations, has declined dramatically alongside the fall in energy prices. While transitory energy price fluctuations do not usually have a big impact on longer-term expectations, the breakeven level has dipped to near all-time lows and is now well below the Fed's inflation target.

WHAT IT MEANS FOR INVESTORS

Given our view that U.S. inflation will likely trend upwards toward the Fed's target over the near-term, PIMCO considers TIPS attractive at current valuations, offering investors valuable inflation protection.

Oil prices have continued to grind lower in 2015



Source: Bloomberg, Data as of 30 September 2015.

Inflation expectations have fallen with commodity markets

Source: Bloomberg. Data as of 30 September 2015. Long-term inflation expectations are proxied by 5y5y forward breakeven inflation, as calculated by the Federal Reserve. Fed's target = 2% PCE + historical average CPI wedge of +0.4% (Treasury Inflation-Protected Securities pricing is based off headline CPI).

PIMCO continues to see opportunity in the credit market, given our outlook for modest economic growth, low defaults and current valuations.

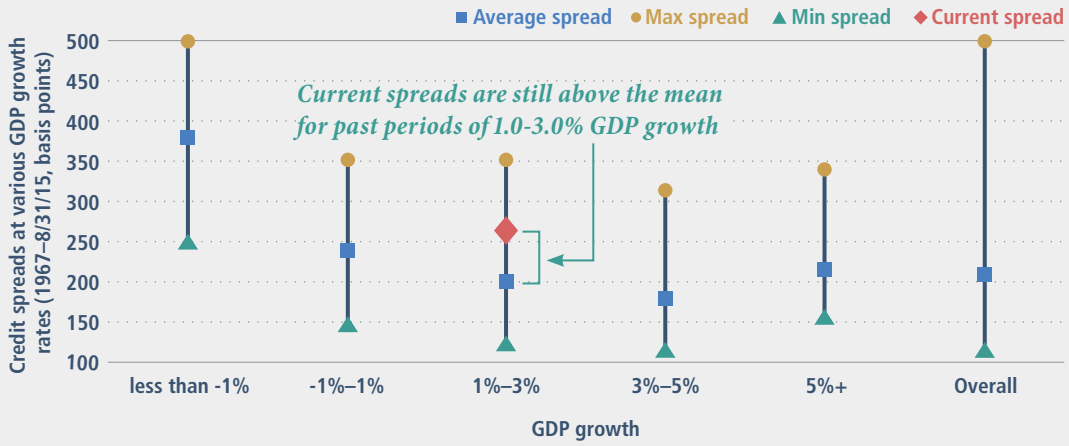
WHAT THESE CHARTS SHOW

Recent events (China devaluation, Fed postponing rate hike) have led to some increased uncertainty in the economic outlook, but investors may be adequately compensated for credit risk at current prices. The first chart argues for this case, providing historical ranges and averages for credit spreads (the difference between the yield of credit securities and the yield of comparable maturity Treasuries) in periods of different GDP growth. Historically, when U.S. GDP growth has averaged 1.0–3.0% (which is consistent with PIMCO's forecast of 2.25% to 2.75%), the average spread for BBB-rated long-term corporate bonds (blue square) was 200 basis points. The current spread (red diamond) is over 250 basis points, suggesting current levels may be attractive relative to historical averages. In addition, the starts of rate hiking cycles by the Federal Reserve have usually led to tighter corporate spreads. As the second chart demonstrates, spreads for long-term BBB-rated bonds have tightened 30 basis points across the average six-month period following the beginning of major Fed rate hike cycles since 1972.

WHAT IT MEANS FOR INVESTORS

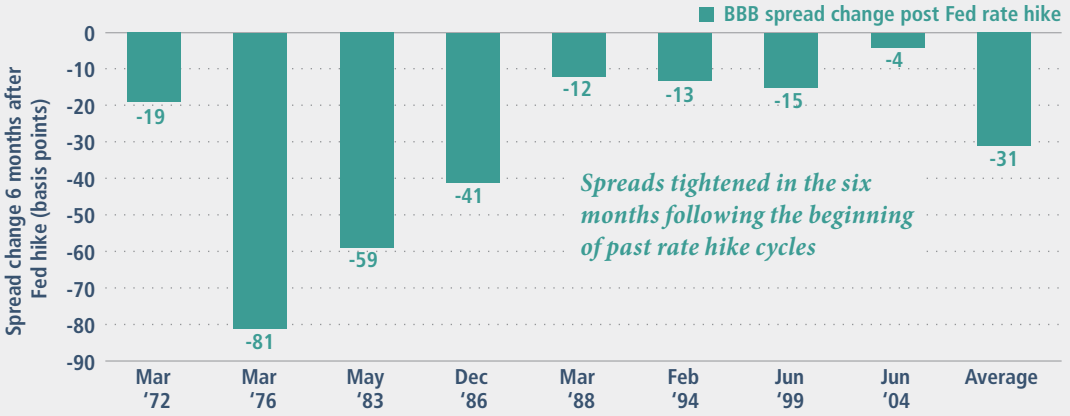
Investors may want to consider an allocation to corporate credit given attractive current valuations and the historical performance of credit spreads when tightening cycles by the Fed commence. Active management and independent credit research should help investors navigate the changing – and likely challenging – environment ahead.

Forecasted U.S. economic growth supports credit valuations



Source: Federal Reserve Board, Bureau of Economic Analysis, Haver. Data is from 1967 – 31 August 2015.

Spreads have tightened in previous rate hike cycles



Source: Bank of America. Data as of 31 August 2015.

While widening spreads have created income opportunities, increased economic and market uncertainty will likely drive up volatility.

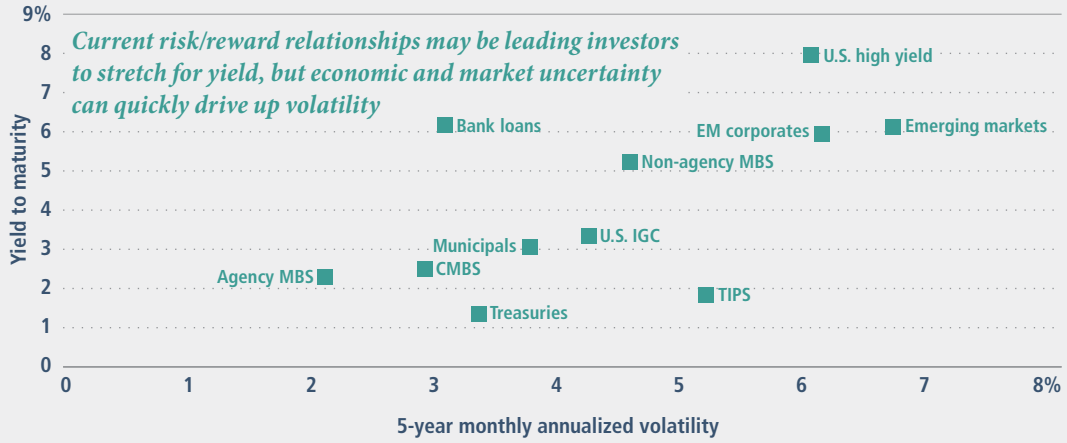
WHAT THESE CHARTS SHOW

Income investors continue to face difficult choices as they seek a stable stream of income. As the first chart shows, traditional sources of income (Treasuries, Agency MBS, Municipals) are offering very little yield, leading many investors to consider higher-risk securities, such as U.S. high yield and emerging market sovereigns and corporates. But, the current economic and market uncertainty can increase the potential for market volatility going forward, meaning income-seeking investors may be taking on more risk than they realize. One way to hedge this risk is to pair higher-yielding, higher-risk securities with securities that continue to perform well even in an economic slowdown. For example, while the U.S. is poised to hike rates, the Australian central bank has been cutting rates to counteract the slowdown in Australian exports to China (second chart). Given that the Australian government debt is AAA-rated and yields more than U.S. Treasuries, these high-quality bonds can be a valuable addition to a diversified income portfolio.

WHAT IT MEANS FOR INVESTORS

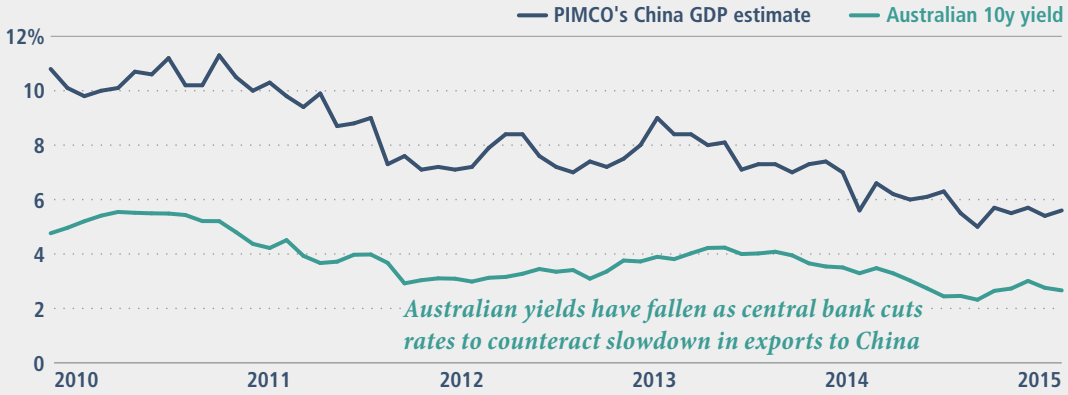
A diversified approach to generating income will be especially valuable in today's environment, combining higher-quality sectors to maintain liquidity and price stability with exposure to riskier sectors that offer the potential for higher income. Identifying these opportunities will likely require an active manager with the flexibility to access a global opportunity set.

Uncertainty and volatility are linked



Source: Barclays, Credit Suisse, JPMorgan. Data as of 30 September 2015. Refer to appendix for additional index information.

Non-U.S. debt may offer an attractive source of income



Source: PIMCO, Bloomberg. Data as of 30 September 2015. The PIMCO estimate of China GDP uses a monthly weighted average of underlying economic indicators such as bank loans, railway, electricity production and others.

Key topics	*PIMCO's outlook*	*Implications*
Global economy	Growth of 2.5–3.0% should continue over the next 12 months	Maintain a broad opportunity set and a flexible mandate to meet challenges of changing conditions
U.S. economy	Fed will likely start rate hikes in the next 12 months, with 2.25–2.75% growth to continue	The yield curve will not necessarily move uniformly, so investors will need to pick spots that offer favorable risk/return characteristics
Europe economy	Modest increase in eurozone economic growth to 1.5–2.0% over next 12 months	Be selective in country, market and security selection during period of modest growth and shifting conditions
EM economies	Internal and external pressure will challenge growth in China and BRIM	Evaluate EM as a diverse opportunity set, favoring active managers who can analyze the myriad strengths, susceptibilities and value propositions across opportunities
Equities	Macroeconomic backdrop remains supportive of positive equity returns over the long-term	Rising rates and valuation discounts should support value over growth
TIPS	TIPS are attractive at current valuations	Prepare for inflation through an actively managed TIPS allocation
Credit	Continue to see attractive opportunities in credit market	Prioritize active management and independent research to navigate changing environment and monitor liquidity
Income	Increased economic and market uncertainty raise the potential for market volatility going forward	Adopt a diversified approach to generating income

For investors seeking	*Consider*	*Class A, C, D, P, R, Inst., Admin.*
Global diversification	PIMCO Foreign Bond Fund (U.S. Dollar-Hedged) PIMCO Global Advantage® Strategy Bond Fund	PFOAX / PFOCX / PFODX / PFBPX / PFRRX / PFORX / PFRAX PGSAX / PAFCX / PGSDX / PGBPX / PSBRX / PSAIX / –
Core bond holding	PIMCO Total Return Fund PIMCO Total Return Active Exchange-Traded Fund	PTTAX / PTTCX / PTTDX / PTTPX / PTRRX / PTTRX / PTRAX BOND
Emerging market exposure	PIMCO Emerging Markets Full Spectrum Bond Fund	PFSSX / PFSCX / PFSYX / PFSPX / – / PFSIX / –
Equity exposure	PIMCO StocksPLUS® International Fund (U.S. Dollar-Hedged) PIMCO EqS Long/Short Fund	PIPAX / PIPCX / PIPDX / PIUHX / – / PISIX / – PMHAX / PMHCX / PMHDX / PMHBX / – / PMHIX / –
Inflation protection	PIMCO Real Return Fund PIMCO Real Return Limited Duration Fund	PRTNX / PRTCX / PRRDX / PRLPX / PRRRX / PRRIX / PARRX – / – / PPDRX / PPPRX / PPIRX / – / –
Credit exposure	PIMCO High Yield Spectrum Fund PIMCO Investment Grade Corporate Bond Fund	PHSAX / PHSCX / PHSDX / PHSPX / – / PHSIX / – PBDAX / PBDCX / PBDDX / PBDPX / – / PIGIX / PGCAX
Income allocation	PIMCO Income Fund PIMCO Diversified Income Fund	PONAX / PONCX / PONDX / PONPX / PONRX / PIMIX / PIINX PDVAX / PDICX / PDVDX / PDVPX / – / PDIIX / PDAAX

Investors should consider the investment objectives, risks, charges and expenses of the funds carefully before investing. This and other information is contained in the fund's prospectus and summary prospectus, if available, which may be obtained by contacting your investment professional or PIMCO representative or by visiting pimco.com or pimcoetfs.com. Please read them carefully before you invest or send money.

The minimum initial investment for institutional, administrative and P class shares is $1 million; however, it may be modified for certain financial intermediaries who submit trades on behalf of eligible investors.

A word about risk

Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk and liquidity risk. The value of most bonds and bond strategies is impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Sovereign securities** are generally backed by the issuing government. Obligations of U.S. government agencies and authorities are supported by varying degrees, but are generally not backed by the full faith of the U.S. government. Portfolios that invest in such securities are not guaranteed and will fluctuate in value. **Currency rates** may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **Management risk** is the risk that the investment techniques and risk analyses applied by PIMCO will not produce the desired results, and that certain policies or developments may affect the investment techniques available to PIMCO in connection with managing the strategy. **Derivatives** may involve certain costs and risks, such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

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On page 11: Municipals are represented by Barclays Municipal Bond Index, TIPS are represented by Barclays U.S. TIPS Index, Agency MBS are represented by Barclays Fixed Rate MBS Index, Treasuries are represented by Barclays U.S. Treasuries Index, U.S. High Yield is represented by Barclays U.S. High Yield Index, Bank Loans are represented by Credit Suisse Leveraged Loan Index, CMBS are represented by Barclays Investment Grade CMBS Index, Emerging Markets are represented by JPMorgan EMBI Global Diversified Index, U.S. IGC is represented by Barclays U.S. Corporate Index, EM Corporates are represented by JPMorgan CEMBI Diversified Index, Non-Agency MBS are represented by PIMCO estimates and iBoxx Non-Agency MBS Index.

The Gross Domestic Product (GDP) is a measure of output from U.S. factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. The S&P 500 Index is an unmanaged market index generally considered representative of the stock market as a whole. The index focuses on the Large-Cap segment of the U.S. equities market. It is not possible to invest directly in an unmanaged index.

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