PACIFIC FUNDS

PACIFIC FUNDS℠

SHORT DURATION INCOME COMMENTARY

MANAGED BY PACIFIC ASSET MANAGEMENT

SEPTEMBER 30, 2019

Class A		Class C		Advisor Class	
Ticker	Fund Number	Ticker	Fund Number	Ticker	Fund Number
PLADX	113	PLCSX	313	PLDSX	013

Fund Performance

In the third quarter, Pacific Funds Short Duration Income (Advisor Class) ("the Fund") returned 0.98% versus the Bloomberg Barclays 1–3 Year U.S. Government/Credit Bond Index return of 0.69%.

Market Overview

Cracks in one of the longest economic expansions in history became more visible during the third quarter. Slowing global growth, continued unstable trade policy, and increasing concern about corporate profit growth are leading to lower yields, with investors migrating to low-risk assets. Despite the U.S. posting the longest economic expansion on record, areas of concern have emerged. The Institute for Supply Management (ISM®) Manufacturing Purchasing Manager Index reading dropped to 47.8 (a number below 50 indicates contraction), the lowest number since June 2009. Additionally, the ISM Non-Manufacturing Index contracted during the quarter causing worry within the Services sector, which constitutes a far larger percentage of the economy than the Manufacturing sector.

Additional concerns mounted within U.S. corporations as FactSet, a provider of financial data and analytics, is projecting estimated earnings decline for the S&P 500® index of –4.1% for the fourth quarter. If –4.1% is the actual result, it will mark the first time the index has reported three straight quarters of year-over-year earnings declines since fourth-quarter 2015 through second-quarter 2016. The second-largest economy in the world, China, is now expanding at the slowest economic pace since the early 1990s. With the weakest industrial output growth since 2002, waning retail sales, a declining labor market, and the unknown potential effects of U.S. trade policy, China employed accommodative stimuli in hopes of growth potential. Slowing global growth is being reflected, in part, by the near $17 trillion in negative-yielding assets. Germany, the Netherlands, and Switzerland reflect a yield curve that is entirely negative. These large economies are joined by the economies of France and Japan, which are offering negative-yielding 10-year debt.

Global central bank activity remained in full force as more than 30 central banks have cut interest rates in 2019 with the hopes of counteracting slowing economic growth and trade concerns. During the quarter, the Federal Reserve (Fed) eased for the second time this year, lowering the federal funds rate range an additional 25 basis points to 1.75%–2.00% (one basis point equals 0.01%). Further dovish action by the Fed included announcing the conclusion of the balance-sheet reduction program two months earlier than anticipated. Market expectations are for one to two more rate cuts in 2019 followed by additional cuts in 2020. Overseas, the European Central Bank reignited stimulus once again by reducing rates and promising to buy additional bonds and financial assets as it seeks to support the waning European economy. China attempted to confront slowing growth by injecting billions into its financial system and further reducing the reserve requirement ratio by 0.5 percentage points. It has become clear that global central banks will act to uplift flagging economies; what is unclear is if this will be enough.

Accommodative Fed activity and increased allocations to fixed income translated to overall lower yields. Ten-year U.S. Treasury yields moved lower by 32 basis points during the quarter, ending at 1.68%. The move lower in rates resulted in an inversion of the U.S. Treasury curve (10-year versus 3-month) lasting almost the entire third quarter. The short end of the yield curve, as represented by the two-year U.S. Treasury note, decreased by 24 basis points ending at 1.88%; while the long end of the curve, as represented by the 30-year U.S. Treasury bond, decreased by 40 basis points, ending at 2.12%. Of note, the 30-year U.S. Treasury bond closed at its historic low during the quarter at 1.94%.

Short-duration investment-grade bonds, as measured by the Bloomberg Barclays 1–3 Year U.S. Government/Credit Bond Index, returned 0.69% for the third quarter. Year-to-date, the total return of the index is 3.42%. Credit remains in favor as demonstrated once again by the credit portion of the index

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outperforming the government portion, with returns of 0.93% and 0.59%, respectively. The increase in volatility and global uncertainty led many investors to seek lower-risk assets. With U.S. Treasury yields declining across the curve, some investors sought marginally higher yields and relative stability offered via front-end corporate-credit assets. Inflows continued during the quarter into the short-duration asset class and remain robust on a year-to-date basis. The Bloomberg Barclays 1–3 Year U.S. Government/Credit Bond Index ended the quarter with a yield to worst of 1.81%, down 14 basis points from the end of second-quarter 2019. The price of the index continued its move higher as the short-term index captured increasing interest, settling at $101.02, up from $100.89 at the end of second-quarter 2019.

Investment-grade bonds, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, returned 2.27%. While this is the lowest quarterly return thus far in 2019, it represents the third strongest quarterly return since first-quarter 2016. The year-to-date return is now 8.52%, reflecting the strongest total return for the first nine months of a calendar year in more than a decade. Credit continued to outperform, and duration remains in favor as central banks continue to reduce rates. The sectors with the strongest total returns included Other Industrial, Natural Gas, Other Utility, and Electric returning 7.42%, 5.13%, 4.97%, and 4.40%, respectively. While still positive, sectors that lagged the most included Residential Mortgages, Auto, Credit Card, and Government Sponsored returning 0.72%, 0.81%, 1.02%, and 10.04%, respectively. Continuing from the prior quarter's theme of lower credit quality outperforming higher credit quality, the index was led by BBB rated credits returning 3.26%, followed by A, AA, and AAA rated credits returning 2.92%, 2.62%, and 1.97%, respectively. From a spread perspective, the Bloomberg Barclays U.S. Aggregate Bond Index traded in a range during the quarter of roughly 10 basis points, but index option-adjusted spread (OAS) ended at 46 basis points—exactly where it started at the beginning of the third quarter. The index yield to worst closed the third quarter at 2.26%, down from 2.49% in the second-quarter 2019, with an average price of $106.24, up from $104.70 in the second-quarter 2019.

The Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index provided a below-coupon return of 1.33% for the quarter. Even with a muted total return for the third quarter, the year-to-date return of 11.41% represents the strongest total return for the first nine months of a calendar year since 2016. OAS were volatile, reflecting market uncertainty, as they widened by 67 basis points in the first part of the quarter, only to tighten by nearly the same amount by the end of it. Index OAS levels ended at 373 basis points, three basis points tighter than where they began the quarter at 376 basis points. The sectors with the strongest total return included Life Insurance, P&C Insurance, Wireless, and Banking, returning 8.07%, 4.64%, 4.01%, and 3.80%, respectively. The worst performing sectors for the quarter included Oil Field Services, Independent, Pharmaceuticals, and Tobacco, returning –10.73%, –5.68%, –2.44%, and –1.45%, respectively. Returns across the high-yield spectrum were led by higher-quality credits as BB rated issues returned 2.03%, B rated issues returned 1.65%, and CCC rated issues returned –1.76%. The Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index average price increased to $99.79, slightly up from $99.46. The yield to maturity ended the quarter at 6.26%, down seven basis points; and the yield to worst navigated its way lower, ending at 5.65% versus 5.87% at the end of the prior quarter. For context, the index yield to worst has tightened 231 basis points year-to-date. According to J.P. Morgan, the par-weighted U.S. high-yield default rate ended the quarter at 2.52%, reflecting an increase of 106 basis points during the past three months. Notably, default activity has been higher due largely to the Energy sector. The par-weighted U.S. high-yield default rate excluding Energy and including distressed exchanges is a moderate 1.21%. For context, the long-term average default rate for high yield is 3.46% based on annual default rates back to 1980.

The floating-rate loan asset class (as measured by the Credit Suisse Leveraged Loan Index) returned 0.92% for the third quarter. Additionally, the total return of the index year-to-date of 6.39% represents the strongest first nine months of a calendar year since 2016. While there remains downward pressure on the asset class generated from global economic slowing, an accommodative Fed via lower rates, and retail outflows, the asset class continues to provide a strong yield offering and a positive total return. The technical issuance of collateralized loan obligations (CLOs) remains healthy, but not quite as strong as the record setting $130 billion in 2018. Currently, the pace of CLO issuance is $90 billion, down from $100.9 billion in the same period of 2018, but it marks the

Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest).

third-highest reading for any comparable period. With retail outflows consistent in 2019, CLOs continue to gain market share of the asset class, representing 72% of the market base with loan mutual funds representing 15%. There was a significant bifurcation in performance during the quarter between performing and distressed issuers. Performing loans (above a $90 price) returned 1.42%, while distressed loans (up to and including a $90 price) returned –6.71%. Additionally, issue/facility sizes greater than $1 billion returned 1.11%, while issuers below $300 million returned 0.70%. Consistent with the high-yield bond universe during the quarter, higher-rated credits outperformed lower-rated credits with BB, B, and CCC rated issuers returning 1.57%, 0.87%, and –1.25%, respectively. The top-performing sectors included Housing, Aerospace, Financial, and Food and Drug, returning 2.02%, 2.01%, 1.97%, and 1.87%, respectively. Conversely, the weakest sectors included Metals/Minerals, Energy, Retail, and Manufacturing returning –4.15%, –3.94%, –0.20%, and 0.56%, respectively. According to J.P. Morgan, the par-weighted loan default rate ended September at 1.42%. This reflects a decrease of 30 basis points year-to-date and 35 basis points from one year prior. For context, the long-term average loan default rate is 3.07% based on annual default rates since 1998.

Portfolio Review

The Fund outperformed the Bloomberg Barclays 1–3 Year U.S. Government/Credit Bond Index for the third quarter due primarily to its overweight of credit-based assets and credit selection. Credit spreads of short-term investment-grade bonds tightened in the quarter. The flattened yield curve led to longer-end credits providing limited term-risk premium, while front-end credits offered attractive relative value. Short investment-grade bonds benefited from an accommodative Fed and strong investor demand. The Fund's credit overweight significantly contributed to overall performance. Additionally, the Fund's allocation to bank loans was positive to performance during the quarter. Securitized asset exposure remained constant at 21% and we continue to see relative value attractiveness in asset-backed securities (ABS) compared to corporates that have experienced recent spread tightening. Given the possibility of additional Fed rate cuts, the Fund swapped some of its shorter-dated maturity ABS to extend toward intermediate-maturity offerings. During the quarter, the Fund increased its AAA rated credit exposure and reduced its AA and A rated credit exposure. Duration was slightly increased, ending the quarter at 1.68 years. The Fund maintained its average A credit-quality rating.

Manager Outlook

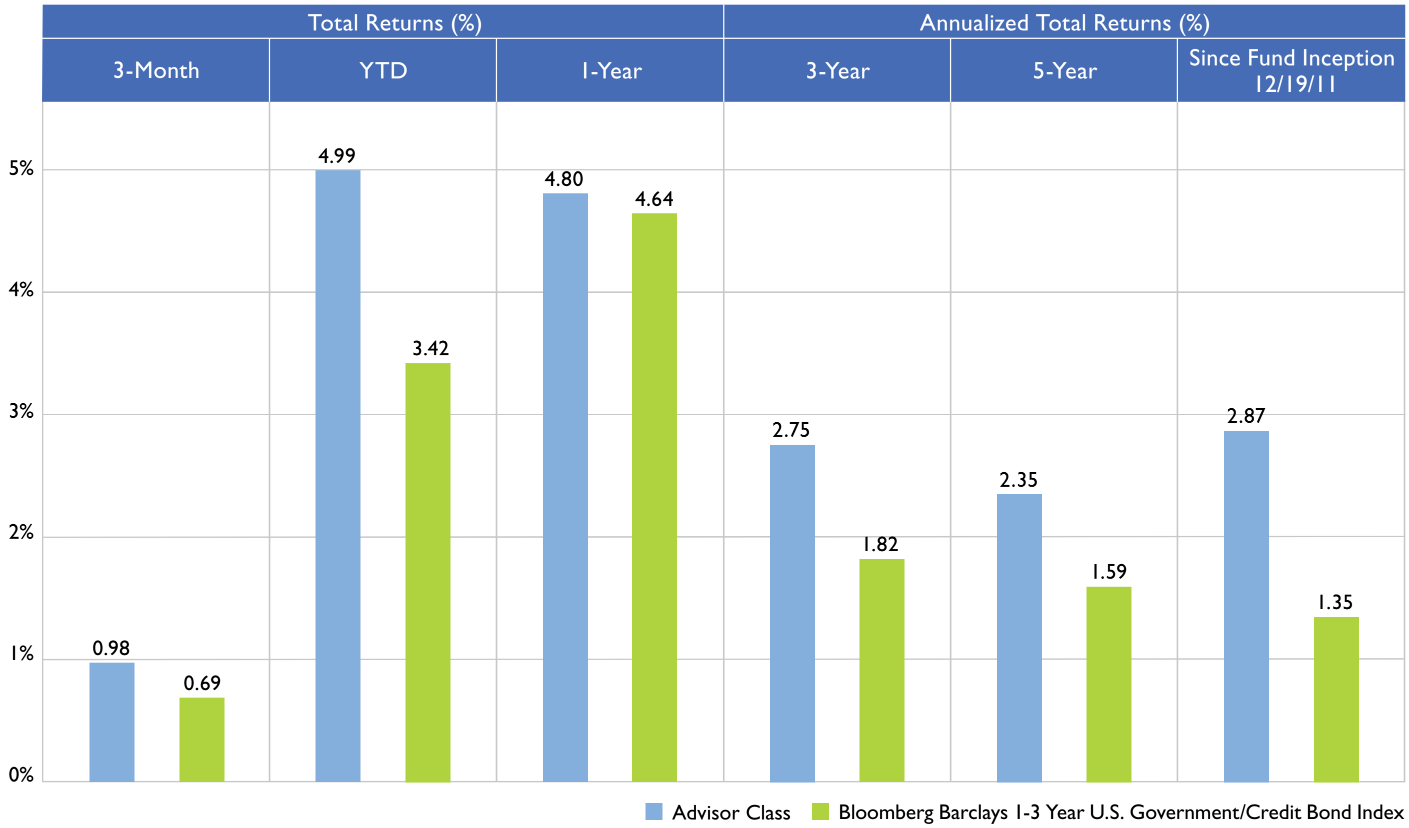
Investment-grade corporate credit provided relatively strong returns in the third quarter. However, this was primarily due to lower interest rates, as corporate spreads moved sideways during the course of the quarter. Slowing global macro data points and another cut in the federal funds rate by the Fed, created momentum for interest rates to move lower. These factors also created a positive technical backdrop for higher-quality credit as sovereign rates around the globe offer very little yield.

While stable corporate fundamentals and a positive technical environment currently exist, we are seeing trade-war casualties emerge. A slowdown in global trade and growth is being felt in many countries and across many sectors. While waiting for a trade deal to be negotiated, U.S.-centric businesses have been somewhat insulated thus far. Whether or not a lower interest-rate environment can keep them from feeling the impact of slowing global growth remains to be seen.

Overall, we look to take a more defensive stance heading into year-end. Despite supportive central banks around the globe, odds of a recession increase the longer global trade relations remain fractured. Thus, from an asset-allocation perspective, we continue to find value in government bonds and certain securitized asset-deal structures that allow us to diversify away from overvalued areas of the corporate market. The front end of the yield curve remains inverted, while the long end of the curve is rather flat but is at risk of inverting. Thus, higher-quality floating-rate bonds and loans look attractive as Treasury yields have sunk. Within corporates, the spread tightening seen year-to-date leaves us focused on higher-quality, defensive credits that are more U.S. domestically focused, such as those found in the Utility, REITs, and Telecommunications sectors. Slowing growth has left us more cautious on cyclical sectors that are being impacted more directly such as Chemicals, Automotive, and Metals & Mining areas within the Technology space.

While 2019 has seen many large corporate issuers refocus on improving the balance sheet, the lower interest-rate environment has created incentive in some sectors (for example, Pharmaceuticals and Technology) to turn toward mergers and acquisitions for potential growth.

Advisor Class



Net annual operating expenses for Advisor Class shares are 0.50% and total (gross annual) expenses are 0.78%. The Fund's annual operating expenses shown above are effective 8/1/19 through 7/31/20. Gross Expense Ratio reflects the total annual operating expenses paid by the Fund. **Net Expense Ratio** reflects waivers, reductions, reimbursements, and the limitation of certain "Other Expenses." Expense caps and/or fee waivers are reevaluated annually. There is no guarantee that the investment adviser will continue to cap expenses after the expiration date. Please see the current prospectus for detailed information.

Indexes are unmanaged and cannot be invested in directly. Further, they hold no cash and incur no expenses. All share classes may not be available at all firms and not all investors may be eligible for all share classes.

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Definitions

The **Bloomberg Barclays 1–3 Year U.S. Government/Credit Bond Index** is a performance benchmark of U.S. investment-grade government and corporate bonds with maturities of one to three years.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is composed of investment-grade U.S. government bonds, investment-grade corporate bonds, mortgage pass-through securities, and asset-backed securities, and is commonly used to track the performance of U.S. investment-grade bonds.

The **Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index** measures the performance of high-yield bonds with a 2% maximum allocation to any one issuer.

The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. senior secure-credit (leveraged-loan) market.

Duration is often used to measure a bond's or fund's sensitivity to interest rates. The longer a fund's duration, the more sensitive it is to interest-rate risk. The shorter a fund's duration, the less sensitive it is to interest-rate risk.

The **Institute for Supply Management Non-Manufacturing Index** surveys more than 400 non-manufacturing firms' purchasing and supply executives within 60 sectors across the U.S. The data is used to help monitor economic conditions such as output and inflation.

The **Institute for Supply Management Purchasing Managers Index** surveys senior executives at over 400 companies on five areas: new orders, inventory levels, production, supplier deliveries, and employment. The data is used as an indicator of economic health for manufacturing and service sectors.

The **S&P 500 index** is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the U.S. stock market.

The **yield curve** is a graph showing the term structure of interest rates by plotting the yield of fixed-interest securities against maturity.

Yield to maturity is the anticipated rate of return on a bond assuming it will be held until its maturity date (the specific period of time until final payment (principal and any applicable interest) is due) and not called.

Yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

About Principal Risks

All investing involves risks including the possible loss of the principal amount invested. Corporate bonds are subject to issue risk in that their value may decline for reasons directly related to the issuer of the security. Not all U.S. government securities are checked or guaranteed by the U.S. government, and different government securities are subject to varying degrees of credit risk. Mortgage-related and other asset-backed securities are subject to certain rules affecting the housing market or the market for the assets underlying such securities. The Fund is subject to liquidity risk (the risk that an investment may be difficult to purchase, value, and sell particularly during adverse market conditions, because there is a limited market for the investment, or there are restrictions on resale) and credit risk (the risk an issuer may be unable or unwilling to meet its financial obligations, risking default). High-yield/high-risk bonds ("junk bonds") and floating-rate loans (usually rated below investment grade) have greater risk of default than higher-rated securities/higher-quality bonds that may have a lower yield. The Fund is also subject to foreign-markets risk.

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