

PIMCO INCOME STRATEGY FUND

Form N-CSRS

March 31, 2015

Table of Contents

**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: 811-21374

**PIMCO Income Strategy Fund**

**(Exact name of registrant as specified in charter)**

**1633 Broadway, New York, NY 10019**

**(Address of principal executive offices)**

**William G. Galipeau**

**Treasurer, Principal Financial & Accounting Officer**

**650 Newport Center Drive**

**Newport Beach, CA 92660**

**(Name and address of agent for service)**

Copies to:

**David C. Sullivan**

**Ropes & Gray LLP**

**Prudential Tower**

**800 Boylston Street**

**Boston, MA 02199**

Registrant's telephone number, including area code: (844) 337-4626

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Date of fiscal year end: July 31

Date of reporting period: January 31, 2015

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, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

**Table of Contents**

**Item 1. Reports to Shareholders.**

The following is a copy of the report transmitted to shareholders pursuant to Rule 30e-1 under the Investment Company Act of 1940, as amended (the 1940 Act ) (17 CFR 270.30e-1).

**Table of Contents**

Your Global Investment Authority

**PIMCO Closed-End Funds**

# Semiannual Report

*January 31, 2015*

PIMCO Income Strategy Fund

PIMCO Income Strategy Fund II



## **Table of Contents**

### **Letter from the Chairman of the Board & President**

Dear Shareholder:

As previously announced on September 26, 2014, prior to the close of the reporting period, William Bill Gross, PIMCO's former chief investment officer (CIO) and co-founder, resigned from the firm. PIMCO's managing directors then elected Daniel Ivascyn to serve as group chief investment officer (Group CIO). In addition, PIMCO appointed Andrew Balls, CIO Global Fixed Income; Mark Kiesel, CIO Global Credit; Virginie Maisonneuve, CIO Global Equities; Scott Mather, CIO U.S. Core Strategies; and Mihir Worah, CIO Real Return and Asset Allocation. On November 3, 2014, PIMCO announced that Marc Seidner returned to the firm effective November 12, 2014 in a new role as CIO Non-traditional Strategies and the head of Portfolio Management in its New York office. Under this leadership structure, Andrew and Mihir have additional managerial responsibilities for PIMCO's Portfolio Management group and trade floor activities globally. Andrew oversees portfolio management and trade floor activities in Europe and Asia-Pacific, while Mihir oversees portfolio management and trade floor activities in the U.S.

Douglas Hodge, PIMCO's chief executive officer, and Jay Jacobs, PIMCO's president, continue to serve as the firm's senior executive leadership team, spearheading PIMCO's business strategy, client service and the firm's operations.

These appointments are a further evolution of the structure that PIMCO established earlier in 2014, reflecting PIMCO's belief that the best approach for its clients and the firm is an investment leadership team of seasoned, highly-skilled investors overseeing all areas of PIMCO's investment activities.

During his 43 years of service at PIMCO, Mr. Gross made great contributions to building the firm and delivering value to PIMCO's clients. Over this period, PIMCO developed into a global asset manager, expanding beyond core fixed income, and now employs over 2,400 professionals across 13 offices, including more than 250 portfolio managers. Mr. Gross was also responsible for starting PIMCO's robust investment process, with a focus on long-term macroeconomic views and bottom-up security selection—a process that is well institutionalized and will continue into PIMCO's future.

For the six-month reporting period ended January 31, 2015

The U.S. economy expanded at a solid pace during the reporting period. Looking back, gross domestic product (GDP), the value of goods and services produced in the country, the broadest measure of economic activity and the principal indicator of economic performance, expanded at a 4.6% annual pace during the second quarter of 2014. The economy then gathered further momentum, with GDP expanding at a 5.0% annual pace during the third quarter—its strongest growth rate since the third quarter of 2003. According to the Commerce Department's second estimate released on

## **2 PIMCO CLOSED-END FUNDS**

## **Table of Contents**

February 27, 2015, GDP expanded at an annual pace of 2.2% during the fourth quarter of 2014.

The Federal Reserve (the Fed) began tapering its monthly asset purchase program in January 2014. At each of its next seven meetings, the Fed announced that it would further taper its asset purchases. Following its meeting in October 2014, the Fed announced that it had concluded its asset purchases. However, the Fed again indicated that it would not raise interest rates in the near future. Finally, at its meeting in January 2015, the Fed stated, "Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy. However, if incoming information indicates faster progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated."

## **Outlook**

PIMCO expects global growth to accelerate in 2015, from approximately 2.50% (year over year) in 2014 to 2.75% in 2015. The majority of this improvement, in PIMCO's view, will come from supply-driven declines in oil prices serving as a fundamental positive for a majority of global economies, as well as consumer spending. Furthermore, PIMCO expects declining oil prices to have a clear impact on global inflation readings. In most developed economies, PIMCO believes headline inflation will likely go into negative readings in the early part of 2015, only to bounce back toward positive core inflation readings as we head into late 2015 and early 2016. Against this backdrop, the firm's baseline expectation remains for the Fed to raise interest rates sometime between June and September of 2015. This view is widely embedded in market prices and expectations of economic divergence between the U.S. and other major developed market economies in 2015.

In the following pages of this PIMCO Closed-End Funds Semiannual Report, please find specific details regarding investment performance and a discussion of factors that most affected the Funds' performance over the six-month reporting period ended January 31, 2015.

Thank you for investing with us. We value your trust and will continue to work diligently to meet your investment needs. If you have questions regarding any of your PIMCO Closed-End Funds investments, please contact your financial advisor or call the Funds' shareholder servicing agent at (844) 33-PIMCO or (844) 337-4626. We also invite you to visit our website at [pimco.com/investments](http://pimco.com/investments) to learn more about our views and global thought leadership.

**Table of Contents**

**Letter from the Chairman of the Board & President (Cont.)**

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess  
Chairman of the Board of Trustees

Peter G. Strelow  
President/Principal Executive Officer

**4 PIMCO CLOSED-END FUNDS**



## **Table of Contents**

### **Important Information About the Funds**

We believe that bond funds have an important role to play in a well-diversified investment portfolio. It is important to note, however, that in an environment where interest rates trend upward, rising rates would negatively impact the performance of most bond funds, and fixed-income securities held by a Fund are likely to decrease in value. A number of factors can cause interest rates to rise (e.g., central bank monetary policies, inflation rates, general economic conditions, etc.). Accordingly, changes in interest rates can be sudden, and there is no guarantee that Fund Management will anticipate such movement.

As of the date of this report, interest rates in the U.S. are at or near historically low levels. As such, bond funds may currently face an increased exposure to the risks associated with rising interest rates. This is especially true since the Federal Reserve Board has concluded its quantitative easing program. Further, while the U.S. bond market has steadily grown over the past three decades, dealer inventories of corporate bonds have remained relatively stagnant. As a result, there has been a significant reduction in the ability of dealers to make markets in corporate bonds. All of the factors mentioned above, individually or collectively, could lead to increased volatility and/or lower liquidity in the fixed income markets, which could result in increased losses to a Fund. Bond funds and individual bonds with a longer duration (a measure of the sensitivity of a security's price to changes in interest rates) tend to be more sensitive to changes in interest rates, usually making them more volatile than securities or funds with shorter durations. In addition, in the current low interest rate environment, the market price of the Funds' common shares may be particularly sensitive to changes in interest rates or the perception that there will be a change in interest rates.

The use of derivatives may subject the Funds to greater volatility than investments in traditional securities. The Funds may use derivative instruments for hedging purposes or as part of an investment strategy. Use of these instruments may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, call risk, credit risk, management risk and the risk that a Fund could not close out a position when it would be most advantageous to do so. Certain derivative transactions may have a leveraging effect on a Fund. For example, a small investment in a derivative instrument may have a significant impact on a Fund's exposure to interest rates, currency exchange rates or other investments. As a result, a relatively small price movement in a derivative instrument may cause an immediate and substantial loss or gain, which translates into heightened volatility in a Fund's net asset value. A Fund may engage in such transactions regardless of whether the Fund owns the asset, instrument or components of the index underlying a derivative instrument. A Fund may invest a significant portion of its assets in these types of instruments. If it does, a Fund's investment exposure could far exceed the value of its portfolio securities and its investment performance could be primarily dependent upon securities it does not directly own.

For purposes of applying a Fund's investment policies and restrictions, swap agreements are generally valued by the Fund at market value. In the case of a credit default swap, however, in applying certain of a Fund's investment policies and restrictions the Fund will value the credit default swap at its notional value or its full exposure value (i.e., the sum of the notional amount for the contract plus the market value), but may value the credit default swap at market value for purposes of applying certain of the Fund's other investment policies and restrictions. For example, a Fund may value credit default swaps at full exposure value for purposes of the Fund's credit quality guidelines (if any) because such value reflects the Fund's actual economic exposure during the term of the credit default swap agreement. In this context, both the notional amount and the market value may be positive or negative depending on whether a Fund is selling or buying protection through the credit

## **Table of Contents**

### **Important Information About the Funds (Cont.)**

default swap. The manner in which certain securities or other instruments are valued by a Fund for purposes of applying investment policies and restrictions may differ from the manner in which those investments are valued by other types of investors.

A Fund's use of leverage creates the opportunity for increased income for the Fund's common shareholders, but also creates special risks. Leverage is a speculative technique that may expose a Fund to greater risk and increased costs. If shorter-term interest rates rise relative to the rate of return on a Fund's portfolio, the interest and other costs to the Fund of leverage could exceed the rate of return on the debt obligations and other investments held by the Fund, thereby reducing return to the Fund's common shareholders. In addition, fees and expenses of any form of leverage used by a Fund will be borne entirely by its common shareholders (and not by preferred shareholders, if any) and will reduce the investment return of the Fund's common shares. There can be no assurance that a Fund's use of leverage will result in a higher yield on its common shares, and it may result in losses. Leverage creates several major types of risks for a Fund's common shareholders, including: (1) the likelihood of greater volatility of net asset value and market price of the Fund's common shares, and of the investment return to the Fund's common shareholders, than a comparable portfolio without leverage; (2) the possibility either that the Fund's common share dividends will fall if the interest and other costs of leverage rise, or that dividends paid on the Fund's common shares will fluctuate because such costs vary over time; and (3) the effects of leverage in a declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the Fund's common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the Fund's common shares.

A Fund's investments in and exposure to foreign securities involve special risks. For example, the value of these investments may decline in response to unfavorable political and legal developments, unreliable or untimely information or economic and financial instability. Foreign securities may experience more rapid and extreme changes in value than investments in securities of U.S. issuers. The securities markets of certain foreign countries are relatively small, with a limited number of companies representing a small number of industries. Issuers of foreign securities are usually not subject to the same degree of regulation as U.S. issuers. Reporting, accounting, auditing and custody standards of foreign countries differ, in some cases significantly, from U.S. standards. Also, nationalization, expropriation or other confiscation, currency blockage, political changes or diplomatic developments could adversely affect a Fund's investments in foreign securities. In the event of nationalization, expropriation or other confiscation, a Fund could lose its entire investment in foreign securities. Risks associated with investing in foreign securities may be increased when a Fund invests in emerging markets. For example, if a Fund invests in emerging market debt, it may face increased exposure to interest rate, liquidity, volatility, and redemption risk due to the specific economic, political, geographical, or legal background of the emerging market.

Investments in loans are generally subject to risks similar to those of investments in other types of debt obligations, including, among others, credit risk, interest rate risk, variable and floating rate securities risk, and, as applicable, risks associated with mortgage-related securities. In addition, in many cases loans are subject to the risks associated with below-investment grade securities. In the case of a loan participation or assignment, a Fund generally has no right to enforce compliance with the terms of the loan agreement with the borrower. As a result, a Fund may be subject to the credit risk of both the borrower and the lender that is selling the loan agreement. In the event of the insolvency of the lender selling a loan participation, a Fund may be treated as a general creditor of the lender and may not

## **6 PIMCO CLOSED-END FUNDS**

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**Table of Contents**

benefit from any set-off between the lender and the borrower. The Funds may be subject to heightened or additional risks and potential liabilities and costs by investing in mezzanine and other subordinated loans or acting as an originator of loans, including those arising under bankruptcy, fraudulent conveyance, equitable subordination, lender liability, environmental and other laws and regulations, and risks and costs associated with debt servicing and taking foreclosure actions associated with the loans. To the extent that a Fund originates a loan, it may be responsible for all or a substantial portion of the expenses associated with initiating the loan, irrespective of whether the loan transaction is ultimately consummated or closed. This may include significant legal and due diligence expenses, which will be indirectly borne by a Fund and its shareholders.

Mortgage-related and other asset-backed securities often involve risks that are different from or more acute than risks associated with other types of debt instruments. Generally, rising interest rates tend to extend the duration of fixed rate mortgage-related securities, making them more sensitive to

changes in interest rates. As a result, in a period of rising interest rates, if a Fund holds mortgage-related securities, it may experience additional volatility since individual mortgage holders are less likely to exercise prepayment options, thereby putting additional downward pressure on the value of these securities and potentially causing the Fund to lose money. This is known as extension risk. Mortgage-backed securities can be highly sensitive to rising interest rates, such that even small movements can cause an investing Fund to lose value. Mortgage-backed securities, and in particular those not backed by a government guarantee, are subject to credit risk. In addition, adjustable and fixed rate mortgage-related securities are subject to prepayment risk. When interest rates decline, borrowers may pay off their mortgages sooner than expected. This can reduce the returns of the Funds because the Funds may have to reinvest that money at the lower prevailing interest rates. The Funds' investments in other asset-backed securities are subject to risks similar to those associated with mortgage-related securities, as well as additional risks associated with the nature of the assets and the servicing of those assets. Payment of principal and interest on asset-backed securities may be largely dependent upon the cash flows generated by the assets backing the securities, and asset-backed securities may not have the benefit of any security interest in the related assets.

High-yield bonds (commonly referred to as junk bonds) typically have a lower credit rating than other bonds. Lower-rated bonds generally involve a greater risk to principal than higher-rated bonds. Further, markets for lower-rated bonds are typically less liquid than for higher-rated bonds, and public information is usually less abundant in such markets. Thus, high yield investments increase the chance that a Fund will lose money on its investment. The Funds may hold defaulted securities that may involve special considerations including bankruptcy proceedings, other regulatory and legal restrictions affecting the Funds' ability to trade, and the availability of prices from independent pricing services or dealer quotations. Defaulted securities are often illiquid and may not be actively traded. Sale of securities in bankrupt companies at an acceptable price may be difficult and differences compared to the value of the securities used by the Funds could be material.

The Funds may invest in securities and instruments that are economically tied to Russia. Investments in Russia are subject to political, economic, legal, market and currency risks, as well as the risk of economic sanctions imposed by the United States and/or other countries. Such sanctions which may impact companies in many sectors, including energy, financial services and defense, among others may negatively impact a Fund's performance and/or ability to achieve its investment objective. For example, certain transactions may be prohibited and/or existing investments may become illiquid (e.g., in the event that transacting in certain existing investments is prohibited).

**Table of Contents**

**Important Information About the Funds (Cont.)**

The common shares of the Funds trade on the New York Stock Exchange. As with any stock, the price of a Fund's common shares will fluctuate with market conditions and other factors. If you sell your common shares of a Fund, the price received may be more or less than your original investment. Shares of closed-end management investment companies frequently trade at a discount from their net asset value. The common shares of a Fund may trade at a price that is less than the initial offering price and/or the net asset value of such shares.

The Funds may be subject to various risks in addition to those described above. Some of these risks may include, but are not limited to, the following: asset allocation risk, credit risk, stressed securities risk, distressed and defaulted securities risk, corporate bond risk, market risk, issuer risk, liquidity risk, equity securities and related market risk, mortgage-related and other asset-backed securities risk, extension risk, prepayment risk, privately issued mortgage-related securities risk, mortgage market/subprime risk, foreign (non-U.S.) investment risk, emerging markets risk, currency risk, redenomination risk, non-diversification risk, management risk, municipal bond risk, inflation-indexed security risk, senior debt risk, loans, participations and assignments risk, reinvestment risk, real estate risk, U.S. Government securities risk, foreign (non-U.S.) government securities risk, valuation risk, segregation and cover risk, focused investment risk, credit default swaps risk, event-linked securities risk, counterparty risk, preferred securities risk, confidential information access risk, other investment companies risk, private placements risk, inflation/deflation risk, regulatory risk, tax risk, recent economic conditions risk, market disruptions and geopolitical risk, potential conflicts of interest involving allocation of investment opportunities, repurchase agreements risk, securities lending risk, zero-coupon bond and payment-in-kind securities risk, portfolio turnover risk, smaller company risk, short sale risk and convertible securities risk. A description of certain of these risks is available in the Notes to Financial Statements of this Report.

The geographical classification of foreign securities in this report are classified by the country of incorporation of a holding. In certain instances, a security's country of incorporation may be different from its country of economic exposure.

On each individual Fund Summary page in this Shareholder Report the Common Share Average Annual Total Return table and Common Share Cumulative Returns (if applicable) measure performance assuming that all dividend and capital gain distributions were reinvested. Total return is calculated by determining the percentage change in NAV or market price (as applicable) in the specified period. Returns do not reflect the deduction of taxes that a shareholder would pay on Fund distributions. Total return for a period of more than one year represents the average annual total return. Performance at market price will differ from results at NAV. Although market price returns tend to reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about a Fund, market conditions, supply and demand for the Fund's shares, or changes in the Fund's dividends. Performance shown is net of fees and expenses.

The following table discloses the commencement of operations of each Fund:

Fund Name	Commencement of Operations
PIMCO Income Strategy Fund	08/29/03
PIMCO Income Strategy Fund II	10/29/04

**8 PIMCO CLOSED-END FUNDS**

**Table of Contents**

An investment in a Fund is not a deposit of a bank and is not guaranteed or insured by the Federal Deposit Insurance Corporation or any other government agency. It is possible to lose money on investments in the Funds.

PIMCO has adopted written proxy voting policies and procedures ( Proxy Policy ) as required by Rule 206(4)-6 under the Investment Advisers Act of 1940. The Proxy Policy has been adopted by the Funds as the policies and procedures that PIMCO will use when voting proxies on behalf of the Funds. A description of the policies and procedures that PIMCO uses to vote proxies relating to portfolio securities of each Fund, and information about how each Fund voted proxies relating to portfolio securities held during the most recent twelve-month period ended June 30, are available without charge, upon request, by calling the Funds at (844) 33-PIMCO (844-337-4626), on the Funds website at [www.pimco.com/investments](http://www.pimco.com/investments), and on the Securities and Exchange Commission's ( SEC ) website at <http://www.sec.gov>.

Each Fund files a complete schedule of its portfolio holdings with the SEC for the first and third quarters of its fiscal year on Form N-Q. A copy of each Fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C., and is available without charge, upon request by calling the Funds at (844) 33-PIMCO (844-337-4626) and on the Funds website at [www.pimco.com/investments](http://www.pimco.com/investments). Updated portfolio holdings information about a Fund will be available at [www.pimco.com/investments](http://www.pimco.com/investments) approximately 15 calendar days after such Fund's most recent fiscal quarter end, and will remain accessible until such Fund files a Form N-Q or a shareholder report for the period which includes the date of the information. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

**Table of Contents**

**PIMCO Income Strategy Fund**

Symbol on NYSE - **PFL**

Allocation Breakdown

Corporate Bonds & Notes	43.4%
Mortgage-Backed Securities	16.9%
U.S. Government Agencies	12.0%
Short-Term Instruments	9.5%
Asset-Backed Securities	7.2%
Municipal Bonds & Notes	5.7%
Other	5.3%

% of Investments, at value as of 01/31/15  
Fund Information (as of January 31, 2015)<sup>(1)</sup>

Market Price	\$11.75
NAV	\$11.28
Premium/Discount	4.17%
Market Price Distribution Yield <sup>(2)</sup>	9.19%
NAV Distribution Yield <sup>(2)</sup>	9.57%
Regulatory Leverage Ratio <sup>(3)</sup>	27.18%

Average Annual Total Return for the period ended January 31, 2015

	6 Month*	1 Year	5 Year	10 Year	Commencement of Operations (08/29/2003)
Market Price	4.95%	12.89%	10.26%	5.49%	6.05%
NAV	-1.70% <sup>(4)</sup>	5.50%	12.80%	6.16%	6.24%

All Fund returns are net of fees and expenses.

\*Cumulative return

- (1) Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and the principal value of an investment will fluctuate. Total return, market price, NAV, market price distribution yield, and NAV distribution yield will fluctuate with changes in market conditions. For performance current to the most recent month-end, visit [www.pimco.com](http://www.pimco.com) or call (844) 33-PIMCO.
- (2) Distribution yields are not performance and are calculated by annualizing the most recent distribution rate per share and dividing by the NAV or Market Price, as applicable, as of the reported date. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the Fund. Because the distribution rate may include a ROC, it should not be confused with yield or income. If the Fund estimates that a portion of its distribution may be comprised of amounts from sources other than net investment income, the Fund will notify shareholders of the estimated composition of such distribution through a Section 19 Notice. Please refer to the most recent Section 19 Notice, if applicable, for additional information regarding the composition of distributions. Please visit [www.pimco.com](http://www.pimco.com) for most recent Section 19 Notice, if applicable. Final determination of a distribution's tax character will be made on Form 1099 DIV sent to shareholders each January.
- (3) Represents regulatory leverage outstanding, as a percentage of total managed assets. Regulatory leverage may include preferred shares, tender option bond transactions, reverse repurchase agreements, and other borrowings (collectively Leverage). Total managed assets refer to total assets (including assets attributable to Leverage that may be outstanding) minus accrued liabilities (other than liabilities representing Leverage).
- (4) Included in the total investment return at net asset value is the impact of the repurchase by the Fund of a portion of its Auction-Rate Preferred Shares ( ARPS ) which were tendered at 90% of the ARPS per share liquidation preference. Had this transaction not occurred, the total return at net asset value would have been lower by 0.92%. See Note 12 in the Notes to Financial Statements.

**10 PIMCO CLOSED-END FUNDS**

## **Table of Contents**

### Portfolio Insights

- » PIMCO Income Strategy Fund's primary investment objective is to seek high current income, consistent with the preservation of capital.
  
- » The fixed income market was volatile at times during the reporting period, as investor sentiment was impacted by conflicting economic data from the U.S. vs. the rest of the world, changing expectations regarding future monetary policies and a number of geopolitical issues. All told, longer-term U.S. Treasury yields declined during the six-month period, with the yield on the benchmark 10-year Treasury bond falling from 2.58% to 1.68%.
  
- » Exposure to select U.S. dollar-denominated Russian quasi-sovereign and corporate bonds detracted from returns, as Russian debt experienced an indiscriminate selloff due in part to geopolitical tensions with Ukraine, European Union/U.S. sanctions and falling oil prices.
  
- » Exposure to investment grade-rated energy credits detracted from returns as the sector was negatively impacted by a steep selloff in oil prices.
  
- » Exposure to high yield corporate bonds also detracted from performance, as the sector sold off during the reporting period, although high coupon income helped offset some of this impact.
  
- » The Fund's overall exposure to U.S. interest rate risk contributed to performance as rates declined during the reporting period; however, strategies that generally benefit when long-maturity interest rates rise offset some of these gains.

**Table of Contents**

**PIMCO Income Strategy Fund II**

Symbol on NYSE - **PFN**

Allocation Breakdown

Corporate Bonds & Notes	40.1%
Mortgage-Backed Securities	23.6%
Short-Term Instruments	8.8%
U.S. Government Agencies	8.3%
Municipal Bonds & Notes	7.7%
Asset-Backed Securities	5.5%
Other	6.0%

% of Investments, at value as of 01/31/15

Fund Information (as of January 31, 2015)<sup>(1)</sup>

Market Price	\$10.27
NAV	\$10.11
Premium/(Discount) to NAV	1.58%
Market Price Distribution Yield <sup>(2)</sup>	9.35%
NAV Distribution Yield <sup>(2)</sup>	9.50%
Regulatory Leverage Ratio <sup>(3)</sup>	23.33%

Average Annual Total Return for the period ended January 31, 2015

	6 Month*	1 Year	5 Year	10 Year	Commencement of Operations (10/29/2004)
Market Price	3.94%	11.68%	11.56%	4.77%	4.54%
NAV	-1.37% <sup>(4)</sup>	6.75%	13.02%	4.95%	4.89%

All Fund returns are net of fees and expenses.

\*Cumulative return

- (1) Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and the principal value of an investment will fluctuate. Total return, market price, NAV, market price distribution yield, and NAV distribution yield will fluctuate with changes in market conditions. For performance current to the most recent month-end, visit [www.pimco.com](http://www.pimco.com) or call (844) 33-PIMCO.
- (2) Distribution yields are not performance and are calculated by annualizing the most recent distribution rate per share and dividing by the NAV or Market Price, as applicable, as of the reported date. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the Fund. Because the distribution rate may include a ROC, it should not be confused with yield or income. If the Fund estimates that a portion of its distribution may be comprised of amounts from sources other than net investment income, the Fund will notify shareholders of the estimated composition of such distribution through a Section 19 Notice. Please refer to the most recent Section 19 Notice, if applicable, for additional information regarding the composition of distributions. Please visit [www.pimco.com](http://www.pimco.com) for most recent Section 19 Notice, if applicable. Final determination of a distribution's tax character will be made on Form 1099 DIV sent to shareholders each January.
- (3) Represents regulatory leverage outstanding, as a percentage of total managed assets. Regulatory leverage may include preferred shares, tender option bond transactions, reverse repurchase agreements, and other borrowings (collectively "Leverage"). Total managed assets refer to total assets (including assets attributable to Leverage that may be outstanding) minus accrued liabilities (other than liabilities representing Leverage).
- (4) Included in the total investment return at net asset value is the impact of the repurchase by the Fund of a portion of its Auction-Rate Preferred Shares ( "ARPS" ) which were tendered at 90% of the ARPS' per share liquidation preference. Had this transaction not occurred, the total return at net asset value would have been lower by 1.09%. See Note 12 in the Notes to Financial Statements.

**12 PIMCO CLOSED-END FUNDS**



**Table of Contents**

Portfolio Insights

- » PIMCO Income Strategy Fund II's primary investment objective is to seek high current income, consistent with the preservation of capital.
  
- » The fixed income market was volatile at times during the reporting period, as investor sentiment was impacted by conflicting economic data from the U.S. vs. the rest of the world, changing expectations regarding future monetary policies and a number of geopolitical issues. All told, longer-term U.S. Treasury yields declined during the six-month period, with the yield on the benchmark 10-year Treasury bond falling from 2.58% to 1.68%.
  
- » Exposure to select U.S. dollar-denominated Russian quasi-sovereign and corporate bonds detracted from returns, as Russian debt experienced an indiscriminate selloff due in part to geopolitical tensions with Ukraine, European Union/U.S. sanctions and falling oil prices.
  
- » Exposure to investment grade-rated energy credits detracted from returns as the sector was negatively impacted by a steep selloff in oil prices.
  
- » Allocations to collateralized mortgage obligations and non-agency MBS were negative for performance.
  
- » Exposure to high yield corporate bonds also detracted from performance, as the sector sold off during the reporting period, although high coupon income helped offset some of this impact.
  
- » The Fund's overall exposure to U.S. interest rate risk contributed to performance as rates declined during the reporting period; however, strategies that generally benefit when long-maturity interest rates rise offset some of these gains.

**Table of Contents****Financial Highlights**

Selected Per Common Share Data for the Year or Period Ended:	Net Asset Value Beginning of Year or Period	Net Investment Income (a)	Net Realized/ Unrealized Gain (Loss)	Total Income (Loss) from Investment Operations	Distributions on Preferred Shares from Net Investment Income	Net Increase (Decrease) in Net Assets Applicable		Total Distributions to Common Shareholders
						Distributions to Common Shareholders Resulting from Investment Operations	Distributions to Common Shareholders from Net Investment Income	
<b>PIMCO Income Strategy Fund</b>								
01/31/2015+	\$ 12.15	\$ 0.43	\$ (0.71)	\$ (0.28)	\$ (0.02)	\$ (0.30)	\$ (0.68)	\$ (0.68)
07/31/2014	11.70	0.79	0.78	1.57	(0.04)	1.53	(1.08)	(1.08)
07/31/2013	11.35	0.92	0.87	1.79	(0.04)	1.75	(1.40)	(1.40)
07/31/2012	11.39	1.16	(0.04)	1.12	(0.05)	1.07	(1.11)	(1.11)
07/31/2011	10.62	1.24	0.79	2.03	(0.05)	1.98	(1.21)	(1.21)
07/31/2010	9.07	1.38	2.72	4.10	(0.06)	4.04	(2.06)	(2.06)
<b>PIMCO Income Strategy Fund II</b>								
01/31/2015+	\$ 10.88	\$ 0.36	\$ (0.60)	\$ (0.24)	\$ (0.02)	\$ (0.26)	\$ (0.63)	\$ (0.63)
07/31/2014	10.29	0.72	0.87	1.59	(0.04)	1.55	(0.96)	(0.96)
07/31/2013	10.23	0.88	0.68	1.56	(0.04)	1.52	(1.46)	(1.46)
07/31/2012	10.04	1.03	0.03	1.06	(0.04)	1.02	(0.83)	(0.83)
07/31/2011	9.29	1.03	0.73	1.76	(0.04)	1.72	(0.97)	(0.97)
07/31/2010	7.98	1.18	2.20	3.38	(0.05)	3.33	(1.64)	(1.64)

+ Unaudited

\* Annualized

(a) Per share amounts based on average number of common shares outstanding during the year or period.

(b) See Note 12 in the Notes to Financial Statements.

(c) Total investment return is calculated assuming a purchase of a common share at the market price on the first day and a sale of a common share at the market price on the last day of each year reported. Dividends and distributions, if any, 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 in connection with the purchase or sale of Fund shares.

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

(e) Interest expense primarily relates to participation in reverse repurchase agreement transactions.

**Table of Contents**

Dilution to net asset value, resulting from rights offering	Increase resulting from tender and repurchase of Auction-Rate Preferred Shares	Net Asset Value End of Year or Period	Market Price End of Year or Period	Total Investment Return (c)	Net Assets Applicable to Common Share holders End of Year or Period (000s)	Ratio of Expenses to Average Net Assets (d)(e)	Ratio of Expenses to Average Net Assets Excluding Interest Expense (d)	Ratio of Net Investment Income to Average Net Assets (d)	Preferred Shares Asset Coverage Per Share	Portfolio Turn over Rate
\$	\$ 0.11 <sup>(b)</sup>	\$ 11.28	\$ 11.75	4.95%	\$ 285,082	1.11%*	1.06%*	5.86%*	\$ 163,975	34%
		12.15	11.87	9.95	306,475	1.19	1.18	6.71	122,004	113
		11.70	11.83	5.69	294,017	1.24	1.21	7.59	118,058	63
		11.35	11.52	12.02	283,285	1.85	1.65	10.93	114,654	23
		11.39	12.39	19.67	282,691	1.51	1.41	11.00	114,474	44
(0.43)		10.62	11.50	52.70	262,060	1.47	1.43	13.44	107,946	115
\$	\$ 0.12 <sup>(b)</sup>	\$ 10.11	\$ 10.27	3.94%	\$ 597,453	1.01%*	0.98%*	5.52%*	\$ 186,531	31%
		10.88	10.50	12.39	642,119	1.14	1.14	6.79	124,695	119
		10.29	10.24	6.80	605,843	1.16	1.14	8.20	119,060	71
		10.23	10.96	16.33	597,683	1.48	1.37	10.87	117,792	17
		10.04	10.27	12.53	584,351	1.24	1.21	10.34	115,720	42
(0.38)		9.29	10.05	52.97	537,342	1.42	1.37	13.08	108,425	87

SEMIANNUAL REPORT JANUARY 31, 2015 15

**Table of Contents****Statements of Assets and Liabilities**

	PIMCO Income	PIMCO
(Amounts in thousands, except per share amounts)	Strategy Fund	Income Strategy Fund II
<b>Assets:</b>		
<i>Investments, at value</i>		
Investments in securities*	\$ 390,999	\$ 781,782
<i>Financial Derivative Instruments</i>		
Exchange-traded or centrally cleared	2,464	5,301
Over the counter	4,021	10,954
Cash	44	1
Deposits with counterparty	2,081	7,464
Foreign currency, at value	3,659	3,346
Receivable for investments sold	364	763
Interest and dividends receivable	4,137	7,420
Other assets	13	21
	407,782	817,052
<b>Liabilities:</b>		
<i>Borrowings &amp; Other Financing Transactions</i>		
Payable for reverse repurchase agreements	\$ 55,132	\$ 89,306
<i>Financial Derivative Instruments</i>		
Exchange-traded or centrally cleared	2,806	6,771
Over the counter	4,341	9,708
Payable for investments purchased	4,702	9,799
Deposits from counterparty	1,630	5,800
Distributions payable to common shareholders	2,273	4,722
Dividends payable to preferred shareholders	8	18
Accrued management fees	283	536
Other liabilities	250	489
	71,425	127,149
<b>Preferred Shares (\$0.00001 par value and \$25,000 liquidation preference per share applicable to an aggregate of 2,051 issued and 3,698 shares issued and outstanding, respectively)</b>	51,275	92,450
<b>Net Assets Applicable to Common Shareholders</b>	\$ 285,082	\$ 597,453

**Table of Contents**

January 31, 2015 (Unaudited)

	<b>PIMCO Income</b>	<b>PIMCO Income</b>
	<b>Strategy Fund</b>	<b>Strategy Fund II</b>
(Amounts in thousands, except per share amounts)		
<b>Composition of Net Assets Applicable to Common Shareholders:</b>		
Common Shares:		
Par value (\$0.00001 per share)	\$ 0	\$ 1
Paid in capital	419,214	950,395
(Overdistributed) net investment income	(8,357)	(25,954)
Accumulated undistributed net realized (loss)	(140,229)	(343,955)
Net unrealized appreciation	14,454	16,966
	\$ 285,082	\$ 597,453
<b>Common Shares Issued and Outstanding</b>	<b>25,277</b>	<b>59,075</b>
<b>Net Asset Value Per Common Share</b>	<b>\$ 11.28</b>	<b>\$ 10.11</b>
<b>Cost of Investments in securities</b>	<b>\$ 382,974</b>	<b>\$ 764,626</b>
<b>Cost of Foreign Currency Held</b>	<b>\$ 373</b>	<b>\$ 782</b>
<b>Cost or Premiums of Financial Derivative Instruments, net</b>	<b>\$ (1,082)</b>	<b>\$ (2,261)</b>
* Includes repurchase agreements of:	\$ 27,951	\$ 45,758

A zero balance may reflect actual amounts rounding to less than one thousand.

**Table of Contents****Statements of Operations**

Six Months Ended January 31, 2015 (Unaudited)

	<b>PIMCO</b>	
	<b>PIMCO</b>	<b>Income</b>
(Amounts in thousands)	<b>Income</b>	<b>Strategy Fund II</b>
	<b>Strategy Fund</b>	
<b>Investment Income:</b>		
Interest	\$ 12,347	\$ 23,471
Dividends	641	1,713
Total Income	12,988	25,184
<b>Expenses:</b>		
Management fees	1,659	3,213
Auction agent fees and commissions	77	146
Trustee fees and related expenses	93	100
Interest expense	10	40
Auction rate preferred shares related expenses	182	359
Operating expenses pre-transition <sup>(a)</sup>		
Custodian and accounting agent	18	23
Audit and tax services	12	12
Shareholder communications	7	10
New York Stock Exchange listing	3	6
Transfer agent	2	2
Legal	6	8
Insurance	1	2
Other expenses	0	1
Total Expenses	2,070	3,922
<b>Net Investment Income</b>	<b>10,918</b>	<b>21,262</b>
<b>Net Realized Gain (Loss):</b>		
Investments in securities	1,712	7,604
Exchange-traded or centrally cleared financial derivative instruments	(17,183)	(29,478)
Over the counter financial derivative instruments	6,036	22,846
Foreign currency	136	221
Net Realized Gain (Loss)	(9,299)	1,193
<b>Net Change in Unrealized Appreciation (Depreciation):</b>		
Investments in securities	(11,569)	(18,500)
Exchange-traded or centrally cleared financial derivative instruments	643	(13,085)
Over the counter financial derivative instruments	2,117	(4,340)
Foreign currency assets and liabilities	(78)	(203)
Net Change in Unrealized (Depreciation)	(8,887)	(36,128)
Net (Loss)	(18,186)	(34,935)
<b>Net (Decrease) in Net Assets Resulting from Investment Operations</b>	<b>(7,268)</b>	<b>(13,673)</b>
<b>Distributions on Preferred Shares from Net Investment Income</b>	<b>(458)</b>	<b>(896)</b>
<b>Net (Decrease) in Net Assets Applicable to Common Shareholders Resulting from Investment Operations</b>	<b>\$ (7,726)</b>	<b>\$ (14,569)</b>

A zero balance may reflect actual amounts rounding to less than one thousand.

<sup>(a)</sup> These expenses were incurred by the Fund prior to the close of business on September 5, 2014. Subsequent to the close of business on September 5, 2014, any such operating expenses are borne by PIMCO.



**Table of Contents****Statements of Changes in Net Assets**

(Amounts in thousands)	PIMCO		PIMCO	
	Income Strategy Fund		Income Strategy Fund II	
	Six Months Ended January 31, 2015 (Unaudited)	Year Ended July 31, 2014	Six Months Ended January 31, 2015 (Unaudited)	Year Ended July 31, 2014
<b>Increase (Decrease) in Net Assets from:</b>				
<b>Operations:</b>				
Net investment income	\$ 10,918	\$ 19,940	\$ 21,262	\$ 42,061
Net realized gain (loss)	(9,299)	14,120	1,193	35,833
Net change in unrealized appreciation (depreciation)	(8,887)	5,796	(36,128)	15,693
Net increase (decrease) resulting from operations	(7,268)	39,856	(13,673)	93,587
Distributions on Preferred Shares from Net Investment Income	(458)	(1,090)	(896)	(2,217)
Net increase (decrease) in net assets applicable to common shareholders resulting from operations	(7,726)	38,766	(14,569)	91,370
<b>Distributions to Common Shareholders from Net Investment Income</b>	<b>(17,174)</b>	<b>(27,203)</b>	<b>(37,469)</b>	<b>(56,598)</b>
<b>Preferred Share Transactions:</b>				
Net Increase resulting from tender and repurchase of Auction-Rate Preferred Shares***	2,770	0	6,855	0
<b>Common Share Transactions**:</b>				
Issued as reinvestment of distributions	737	895	517	1,504
Net increase resulting from common share transactions	3,507	895	7,372	1,504
<b>Total Increase (Decrease) in Net Assets</b>	<b>(21,393)</b>	<b>12,458</b>	<b>(44,666)</b>	<b>36,276</b>
<b>Net Assets Applicable to Common Shareholders:</b>				
Beginning of period	306,475	294,017	642,119	605,843
End of period*	\$ 285,082	\$ 306,475	\$ 597,453	\$ 642,119
* Including undistributed net investment income of:	\$ (8,357)	\$ (1,643)	\$ (25,954)	\$ (8,851)
<b>** Common Share Transactions:</b>				
Shares issued as reinvestment of distributions	63	76	51	143

A zero balance may reflect actual amounts rounding to less than one thousand.

\*\*\* See Note 12 in the Notes to Financial Statements.



**Table of Contents****Schedule of Investments PIMCO Income Strategy Fund**

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
<b>INVESTMENTS IN SECURITIES 137.2%</b>		
<b>BANK LOAN OBLIGATIONS 0.8%</b>		
<b>Clear Channel Communications, Inc.</b>		
6.921% due 01/30/2019	\$ 400	\$ 374
<b>Tibco Software, Inc.</b>		
6.500% due 12/04/2020	1,804	1,768
<b>Total Bank Loan Obligations</b>		<b>2,142</b>
<b>(Cost \$2,093)</b>		
<b>CORPORATE BONDS &amp; NOTES 59.6%</b>		
<b>BANKING &amp; FINANCE 33.0%</b>		
<b>AIG Life Holdings, Inc.</b>		
8.125% due 03/15/2046	2,000	2,760
<b>American International Group, Inc.</b>		
6.250% due 03/15/2087 (g)	7,500	8,651
8.175% due 05/15/2068 (g)	693	953
<b>Army Hawaii Family Housing Trust Certificates</b>		
5.524% due 06/15/2050	3,400	4,040
<b>Banco Popular Espanol S.A.</b>		
11.500% due 10/10/2018 (e)	EUR 1,500	1,975
<b>Banco Santander S.A.</b>		
6.250% due 09/11/2021 (e)	800	898
<b>Barclays Bank PLC</b>		
14.000% due 06/15/2019 (e)	GBP 6,300	12,858
<b>BGC Partners, Inc.</b>		
5.375% due 12/09/2019	\$ 3,040	2,987
<b>Cooperatieve Centrale Raiffeisen-Boerenleenbank BA</b>		
8.400% due 06/29/2017 (e)	300	333
<b>Credit Agricole S.A.</b>		
6.500% due 06/23/2021 (e)	EUR 200	236
7.500% due 06/23/2026 (e)	GBP 1,600	2,401
7.875% due 01/23/2024 (e)	\$ 1,000	1,037
<b>Greystar Real Estate Partners LLC</b>		
8.250% due 12/01/2022	1,130	1,178
<b>GSPA Monetization Trust</b>		
6.422% due 10/09/2029	2,415	2,812
<b>Jefferies Finance LLC</b>		
6.875% due 04/15/2022	4,000	3,630
<b>LBG Capital PLC</b>		
7.375% due 03/12/2020	EUR 200	241
8.500% due 12/17/2021 (e)	\$ 2,000	2,131
9.125% due 07/15/2020	GBP 1,134	1,751
<b>Lloyds Bank PLC</b>		
12.000% due 12/16/2024 (e)	\$ 400	573
<b>Lloyds Banking Group PLC</b>		
7.625% due 06/27/2023 (e)	GBP 3,600	5,490
<b>Millennium Offshore Services Superholdings LLC</b>		
9.500% due 02/15/2018	\$ 2,100	1,901

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	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
<b>Navient Corp.</b>		
5.500% due 01/15/2019	\$ 7,900	\$ 8,192
<b>Novo Banco S.A.</b>		
2.625% due 05/08/2017	EUR 100	110
4.750% due 01/15/2018	400	462
5.000% due 04/04/2019	101	116
5.000% due 04/23/2019	311	361
5.000% due 05/14/2019	206	239
5.000% due 05/21/2019	115	133
5.000% due 05/23/2019	115	133
5.875% due 11/09/2015	900	1,041
<b>OneMain Financial Holdings, Inc.</b>		
7.250% due 12/15/2021	\$ 3,026	3,139
<b>Rio Oil Finance Trust</b>		
6.250% due 07/06/2024 (g)	8,200	7,558
<b>Royal Bank of Scotland Group PLC</b>		
7.648% due 09/30/2031 (e)	1,550	1,860
<b>Russian Agricultural Bank OJSC Via RSHB Capital S.A.</b>		
5.298% due 12/27/2017	1,500	1,262
6.299% due 05/15/2017	2,600	2,315
<b>Sberbank of Russia Via SB Capital S.A.</b>		
5.717% due 06/16/2021	3,000	2,496
<b>Towergate Finance PLC</b>		
8.500% due 02/15/2018	GBP 600	804
<b>Vnesheconombank Via VEB Finance PLC</b>		
5.942% due 11/21/2023	\$ 1,500	1,010
6.902% due 07/09/2020	5,100	3,862
		93,929

**INDUSTRIALS 16.2%**

<b>Altice S.A.</b>		
6.250% due 02/15/2025 (b)	EUR 1,700	1,921
7.625% due 02/15/2025 (b)	\$ 1,970	1,970
<b>Anadarko Petroleum Corp.</b>		
7.000% due 11/15/2027	1,600	1,853
<b>Boxer Parent Co., Inc. (9.000% Cash or 9.750% PIK)</b>		
9.000% due 10/15/2019 (c)	1,400	1,148
<b>Caesars Entertainment Operating Co., Inc.</b>		
9.000% due 02/15/2020 ^	3,800	2,850
<b>Continental Airlines Pass-Through Trust</b>		
9.798% due 10/01/2022	1,087	1,206
<b>Forbes Energy Services Ltd.</b>		
9.000% due 06/15/2019	612	376
<b>Ford Motor Co.</b>		
7.700% due 05/15/2097 (g)	9,030	12,535
<b>Gulfport Energy Corp.</b>		
7.750% due 11/01/2020	300	299
<b>Hema Bondco BV</b>		
6.250% due 06/15/2019	EUR 100	94
<b>Intrepid Aviation Group Holdings LLC</b>		
6.875% due 02/15/2019	\$ 960	936

**Table of Contents**

(Unaudited)

January 31, 2015

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
<b>Perstorp Holding AB</b>		
8.750% due 05/15/2017	\$ 1,100	\$ 1,092
9.000% due 05/15/2017	EUR 400	461
<b>Pertamina Persero PT</b>		
6.450% due 05/30/2044	\$ 7,600	8,322
<b>Petrobras International Finance Co. S.A.</b>		
7.875% due 03/15/2019 (g)	3,200	3,193
<b>Quiksilver, Inc.</b>		
7.875% due 08/01/2018 (g)	1,000	910
<b>QVC, Inc.</b>		
4.850% due 04/01/2024	200	213
<b>Scientific Games International, Inc.</b>		
10.000% due 12/01/2022	2,000	1,845
<b>Sequa Corp.</b>		
7.000% due 12/15/2017	1,544	1,378
<b>UAL Pass-Through Trust</b>		
10.400% due 05/01/2018	510	565
<b>Westmoreland Coal Co.</b>		
8.750% due 01/01/2022	3,026	3,003
		46,170
<b>UTILITIES 10.4%</b>		
<b>Bruce Mansfield Unit Pass-Through Trust</b>		
6.850% due 06/01/2034	1,138	1,243
<b>Dynegy Finance, Inc.</b>		
6.750% due 11/01/2019	450	463
7.375% due 11/01/2022	430	445
7.625% due 11/01/2024	55	57
<b>Gazprom Neft OAO Via GPN Capital S.A.</b>		
4.375% due 09/19/2022	3,000	2,154
6.000% due 11/27/2023	7,000	5,285
<b>Illinois Power Generating Co.</b>		
6.300% due 04/01/2020	1,420	1,193
7.000% due 04/15/2018	800	720
7.950% due 06/01/2032	200	171
<b>Northwestern Bell Telephone</b>		
7.750% due 05/01/2030	7,000	7,954
<b>Red Oak Power LLC</b>		
9.200% due 11/30/2029	5,000	5,500
<b>Rosneft Finance S.A.</b>		
6.625% due 03/20/2017	1,900	1,786
7.500% due 07/18/2016	2,600	2,545
7.875% due 03/13/2018	200	186
		29,702
<b>Total Corporate Bonds &amp; Notes</b> (Cost \$168,917)		<b>169,801</b>

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	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
<b>MUNICIPAL BONDS &amp; NOTES 7.8%</b>		
<b>CALIFORNIA 1.7%</b>		
<b>Riverside County, California Redevelopment Successor Agency Tax Allocation Bonds, Series 2010</b>		
7.500% due 10/01/2030	\$ 600	\$ 678
<b>Stockton Public Financing Authority, California Revenue Bonds, (BABs), Series 2009</b>		
7.942% due 10/01/2038	3,600	4,128
		4,806
<b>ILLINOIS 2.6%</b>		
<b>Chicago, Illinois General Obligation Bonds, (BABs), Series 2010</b>		
7.517% due 01/01/2040	6,000	7,495
<b>NEBRASKA 2.7%</b>		
<b>Public Power Generation Agency, Nebraska Revenue Bonds, (BABs), Series 2009</b>		
7.242% due 01/01/2041	6,400	7,814
<b>NEW JERSEY 0.1%</b>		
<b>Tobacco Settlement Financing Corp., New Jersey Revenue Bonds, Series 2007</b>		
5.000% due 06/01/2041	200	161
<b>VIRGINIA 0.1%</b>		
<b>Tobacco Settlement Financing Corp., Virginia Revenue Bonds, Series 2007</b>		
6.706% due 06/01/2046	395	302
<b>WEST VIRGINIA 0.6%</b>		
<b>Tobacco Settlement Finance Authority, West Virginia Revenue Bonds, Series 2007</b>		
7.467% due 06/01/2047	1,995	1,717
<b>Total Municipal Bonds &amp; Notes</b>		
<b>(Cost \$19,307)</b>		<b>22,295</b>
<b>U.S. GOVERNMENT AGENCIES 16.4%</b>		
<b>Fannie Mae</b>		
3.500% due 12/25/2032 - 01/25/2043 (a)	1,760	233
4.000% due 11/25/2042 - 01/25/2043 (a)	9,437	1,257
5.197% due 12/25/2042	506	508
5.982% due 11/25/2042 - 02/25/2043 (a)	21,041	4,305
6.432% due 04/25/2041 (a)	6,398	801

See Accompanying Notes

SEMIANNUAL REPORT

JANUARY 31, 2015 21

**Table of Contents****Schedule of Investments PIMCO Income Strategy Fund (Cont.)**

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
9.764% due 06/25/2043	\$ 4,144	\$ 4,577
11.818% due 06/25/2043 (g)	4,402	5,105
14.492% due 12/25/2040	132	213
<b>Fannie Mae Strips</b>		
3.500% due 02/25/2043 (a)	31,654	5,468
<b>Freddie Mac</b>		
2.500% due 10/15/2027 - 01/15/2028 (a)(g)	109,290	9,601
9.661% due 11/15/2040	576	612
11.548% due 08/15/2043	1,953	2,106
11.689% due 03/15/2044 (g)	11,450	11,984
<b>Total U.S. Government Agencies (Cost \$50,053)</b>		<b>46,770</b>

**MORTGAGE-BACKED SECURITIES 23.2%**

<b>Banc of America Alternative Loan Trust</b>		
6.000% due 01/25/2036 ^	92	79
<b>Banc of America Funding Trust</b>		
6.000% due 08/25/2036 ^	3,155	3,104
6.000% due 03/25/2037 ^	1,776	1,534
6.000% due 08/25/2037 ^	2,846	2,511
<b>BCAP LLC Trust</b>		
5.255% due 03/26/2037	855	292
17.351% due 06/26/2036	217	64
<b>Bear Stearns ALT-A Trust</b>		
2.641% due 09/25/2035 ^	652	529
2.952% due 11/25/2036	341	236
<b>Bear Stearns Mortgage Funding Trust</b>		
7.000% due 08/25/2036	1,108	1,036
<b>Chase Mortgage Finance Trust</b>		
2.426% due 12/25/2035 ^	9	8
6.000% due 02/25/2037 ^	892	777
6.000% due 07/25/2037 ^	569	501
6.250% due 10/25/2036 ^	1,643	1,467
<b>Citicorp Mortgage Securities Trust</b>		
5.500% due 04/25/2037	109	112
<b>Countrywide Alternative Loan Resecuritization Trust</b>		
6.000% due 05/25/2036 ^	2,233	1,949
6.000% due 08/25/2037 ^	923	723
<b>Countrywide Alternative Loan Trust</b>		
5.500% due 03/25/2035	298	278
5.500% due 12/25/2035 ^	3,542	3,112
5.500% due 03/25/2036 ^	135	116
5.652% due 04/25/2036 ^	1,106	863
5.750% due 01/25/2035	349	357
6.000% due 02/25/2035	322	346
6.000% due 08/25/2036 ^	168	152
6.000% due 04/25/2037 ^	1,062	889
6.250% due 11/25/2036 ^	662	628
6.250% due 12/25/2036 ^	1,435	1,202

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	420 PRINCIPAL AMOUNT (000S)	322 MARKET VALUE (000S)
6.500% due 08/25/2036 ^		
<b>Countrywide Home Loan Mortgage Pass-Through Trust</b>		
2.449% due 02/20/2035	\$ 65	\$ 64
5.500% due 10/25/2035 ^	1,199	1,121
5.750% due 03/25/2037 ^	557	510
6.000% due 05/25/2036 ^	1,273	1,183
6.000% due 02/25/2037 ^	457	438
6.000% due 03/25/2037 ^	628	570
6.000% due 04/25/2037 ^	116	110
6.250% due 09/25/2036 ^	664	618
<b>Credit Suisse Mortgage Capital Mortgage-Backed Trust</b>		
6.000% due 02/25/2037 ^	363	328
6.750% due 08/25/2036 ^	1,215	965
<b>GSR Mortgage Loan Trust</b>		
5.500% due 05/25/2036 ^	135	125
6.000% due 02/25/2036	4,499	3,967
<b>HarborView Mortgage Loan Trust</b>		
0.888% due 01/19/2035	325	292
2.604% due 07/19/2035	54	49
<b>IndyMac Mortgage Loan Trust</b>		
6.500% due 07/25/2037 ^	2,019	1,393
<b>JPMorgan Alternative Loan Trust</b>		
2.518% due 03/25/2037 ^	1,570	1,234
2.627% due 03/25/2036 ^	1,733	1,389
6.310% due 08/25/2036	1,193	966
<b>JPMorgan Mortgage Trust</b>		
2.493% due 01/25/2037 ^	525	469
2.571% due 02/25/2036 ^	518	464
5.000% due 03/25/2037 ^	975	905
5.750% due 01/25/2036 ^	82	77
6.000% due 08/25/2037 ^	232	212
<b>Merrill Lynch Mortgage Investors Trust</b>		
2.787% due 03/25/2036 ^	1,508	1,038
<b>New Century Alternative Mortgage Loan Trust</b>		
6.173% due 07/25/2036 ^	3,549	2,438
<b>Residential Accredited Loans, Inc. Trust</b>		
6.000% due 06/25/2036 ^	955	794
<b>Residential Asset Securitization Trust</b>		
5.750% due 02/25/2036 ^	965	811
6.000% due 09/25/2036 ^	407	287
6.000% due 03/25/2037 ^	658	477
6.000% due 05/25/2037 ^	1,415	1,259
6.000% due 07/25/2037 ^	993	739
6.250% due 09/25/2037 ^	1,682	1,217
<b>Residential Funding Mortgage Securities, Inc. Trust</b>		
3.662% due 08/25/2036 ^	1,763	1,544
6.000% due 09/25/2036 ^	233	214
6.000% due 01/25/2037 ^	587	541
6.000% due 06/25/2037 ^	3,075	2,717
<b>Structured Adjustable Rate Mortgage Loan Trust</b>		
2.405% due 11/25/2036 ^	1,584	1,298
4.843% due 03/25/2037 ^	614	454

**Table of Contents**

(Unaudited)

January 31, 2015

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
4.847% due 05/25/2036 ^	\$ 1,774	\$ 1,384
5.025% due 01/25/2036 ^	1,334	1,009
5.337% due 07/25/2036 ^	578	496
<b>Suntrust Adjustable Rate Mortgage Loan Trust</b>		
2.569% due 02/25/2037 ^	281	244
2.736% due 04/25/2037 ^	1,791	1,522
<b>Thornburg Mortgage Securities Trust</b>		
1.418% due 06/25/2047 ^	51	46
<b>WaMu Mortgage Pass-Through Certificates Trust</b>		
2.171% due 12/25/2046	491	459
2.233% due 09/25/2036 ^	210	189
4.434% due 02/25/2037 ^	595	545
6.047% due 10/25/2036 ^	825	700
<b>Washington Mutual Mortgage Pass-Through Certificates Trust</b>		
6.500% due 08/25/2034	772	804
<b>Wells Fargo Mortgage-Backed Securities Trust</b>		
2.610% due 07/25/2036 ^	324	307
2.612% due 07/25/2036 ^	1,143	1,108
5.750% due 03/25/2037 ^	373	362
6.000% due 06/25/2037 ^	213	216
6.000% due 07/25/2037 ^	320	317
<b>Total Mortgage-Backed Securities</b> (Cost \$60,547)		<b>66,172</b>
<b>ASSET-BACKED SECURITIES 9.8%</b>		
<b>Bear Stearns Asset-Backed Securities Trust</b>		
6.500% due 10/25/2036	256	214
<b>Countrywide Asset-Backed Certificates</b>		
0.728% due 12/25/2035	3,500	3,266
5.224% due 08/25/2035	3,000	2,837
<b>GSAA Home Equity Trust</b>		
5.772% due 11/25/2036 ^	7,753	4,665
6.295% due 06/25/2036 ^	914	553
<b>JPMorgan Mortgage Acquisition Trust</b>		
0.490% due 04/25/2036	6,000	4,099
<b>Lehman XS Trust</b>		
5.425% due 06/24/2046	3,510	2,740
<b>MASTR Asset-Backed Securities Trust</b>		
5.233% due 11/25/2035	324	330
<b>Mid-State Trust</b>		
6.340% due 10/15/2036	703	743
<b>Morgan Stanley ABS Capital, Inc. Trust</b>		
0.458% due 01/25/2036	4,300	3,860
1.158% due 06/25/2035	500	452
<b>Morgan Stanley Mortgage Loan Trust</b>		
6.250% due 07/25/2047 ^	518	397
<b>Securitized Asset-Backed Receivables LLC Trust</b>		
0.308% due 05/25/2036	6,790	3,850
		<b>28,006</b>

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Total Asset-Backed Securities  
(Cost \$27,059)

		PRINCIPAL AMOUNT (000S)		MARKET VALUE (000S)
<b>SOVEREIGN ISSUES 0.5%</b>				
<b>Republic of Greece Government Bond</b>				
3.800% due 08/08/2017	JPY	201,000	\$	1,282
<b>Total Sovereign Issues</b> (Cost \$1,354)				<b>1,282</b>

SHARES

**PREFERRED SECURITIES 6.1%**

**BANKING & FINANCE 4.5%**

<b>Farm Credit Bank of Texas</b>				
10.000% due 12/15/2020 (e)		6,000		7,524
<b>GMAC Capital Trust</b>				
8.125% due 02/15/2040		207,100		5,447
				12,971

**UTILITIES 1.6%**

<b>Entergy Texas, Inc.</b>				
5.625% due 06/01/2064		171,600		4,539

<b>Total Preferred Securities</b> (Cost \$16,623)				<b>17,510</b>
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PRINCIPAL  
AMOUNT  
(000S)

**SHORT-TERM INSTRUMENTS 13.0%**

<b>REPURCHASE AGREEMENTS (f) 9.8%</b>				<b>27,951</b>
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**SHORT-TERM NOTES 0.2%**

<b>Fannie Mae</b>				
0.086% due 04/22/2015	\$	300		300
<b>Freddie Mac</b>				
0.132% due 05/13/2015		300		300
				600

**U.S. TREASURY BILLS 3.0%**

0.049% due 03/26/2015 - 05/21/2015 (d)(i)(k)		8,471		8,470
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<b>Total Short-Term Instruments</b> (Cost \$37,021)				<b>37,021</b>
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<b>Total Investments in Securities</b> (Cost \$382,974)				<b>390,999</b>
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<b>Total Investments 137.2%</b> (Cost \$382,974)				<b>\$ 390,999</b>
<b>Financial Derivative Instruments (h)(j) (0.2%)</b>				<b>(662)</b>



(Cost or Premiums, net \$(1,082))

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SEMIANNUAL REPORT

JANUARY 31, 2015 23

**Table of Contents**

**Schedule of Investments PIMCO Income Strategy Fund (Cont.)**

	MARKET VALUE (000S)
Preferred Shares, at Liquidation Value (18.0%)	\$ (51,275)
Other Assets and Liabilities, net (19.0%)	(53,980)
 Net Assets Applicable to Common Shareholders 100.0%	 \$ 285,082

**NOTES TO SCHEDULE OF INVESTMENTS (AMOUNTS IN THOUSANDS\*):**

- \* A zero balance may reflect actual amounts rounding to less than one thousand.
- ^ Security is in default.
- (a) Interest only security.
- (b) When-issued security.
- (c) Payment in-kind bond security.
- (d) Coupon represents a weighted average yield to maturity.
- (e) Perpetual maturity; date shown, if applicable, represents next contractual call date.

**BORROWINGS AND OTHER FINANCING TRANSACTIONS**

**(f) REPURCHASE AGREEMENTS:**

Counterparty	Lending Rate	Settlement Date	Maturity Date	Principal Amount	Collateralized By	Collateral Received, at Value	Repurchase Agreements, at Value	Repurchase Agreement Proceeds to be Received <sup>(1)</sup>
MSC	0.120%	01/30/2015	02/02/2015	\$ 15,800	U.S. Treasury Bonds 3.750% due 11/15/2043	\$ (16,194)	\$ 15,800	\$ 15,800
SAL	0.110%	01/30/2015	02/02/2015	11,100	U.S. Treasury Notes 2.375% due 08/15/2024	(11,355)	11,100	11,100
SSB	0.000%	01/30/2015	02/02/2015	1,051	Fannie Mae 2.260% due 10/17/2022	(1,075)	1,051	1,051
<b>Total Repurchase Agreements</b>						<b>\$ (28,624)</b>	<b>\$ 27,951</b>	<b>\$ 27,951</b>

<sup>(1)</sup> Includes accrued interest.

**REVERSE REPURCHASE AGREEMENTS:**

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Counterparty	Borrowing Rate	Borrowing Date	Maturity Date	Amount Borrowed <sup>(2)</sup>	Payable for Reverse Repurchase Agreements
BCY	(7.000%)	12/29/2014	12/26/2016	\$ (892)	\$ (886)
BPG	0.400%	01/08/2015	02/09/2015	(11,762)	(11,765)
RDR	0.590%	11/05/2014	02/05/2015	(10,919)	(10,935)
	0.590%	11/10/2014	02/03/2015	(12,711)	(12,728)
UBS	0.430%	01/12/2015	02/12/2015	(7,660)	(7,662)
	0.480%	01/12/2015	02/12/2015	(3,150)	(3,151)
	0.480%	01/23/2015	04/23/2015	(8,004)	(8,005)
<b>Total Reverse Repurchase Agreements</b>					<b>\$ (55,132)</b>

<sup>(2)</sup> The average amount of borrowings outstanding during the period ended January 31, 2015 was \$33,460 at a weighted average interest rate of 0.490%.

**Table of Contents**

(Unaudited)

January 31, 2015

**BORROWINGS AND OTHER FINANCING TRANSACTIONS SUMMARY**

The following is a summary by counterparty of the market value of Borrowings and Other Financing Transactions and collateral (received)/pledged as of January 31, 2015:

(g) Securities with an aggregate market value of \$59,978 and cash of \$1,032 have been pledged as collateral under the terms of the following master agreements as of January 31, 2015.

Counterparty	Repurchase Agreement Proceeds to be Received	Payable for Reverse Repurchase Agreements	Payable for Sale-Buyback Transactions	Payable for Short Sales	Total Borrowings and Other Financing Transactions	Collateral (Received)/Pledged	Net Exposure <sup>(3)</sup>
Global/Master Repurchase Agreement							
BCY	\$ 0	\$ (886)	\$ 0	\$ 0	\$ (886)	\$ 910	\$ 24
BPG	0	(11,765)	0	0	(11,765)	12,534	769
MSC	15,800	0	0	0	15,800	(16,194)	(394)
RDR	0	(23,663)	0	0	(23,663)	27,723	4,060
SAL	11,100	0	0	0	11,100	(11,355)	(255)
SSB	1,051	0	0	0	1,051	(1,075)	(24)
UBS	0	(18,818)	0	0	(18,818)	19,843	1,025
<b>Total Borrowings and Other Financing Transactions</b>	<b>\$ 27,951</b>	<b>\$ (55,132)</b>	<b>\$ 0</b>	<b>\$ 0</b>			

<sup>(3)</sup> Net Exposure represents the net receivable/(payable) that would be due from/to the counterparty in the event of default. Exposure from borrowings and other financing transactions can only be netted across transactions governed under the same master agreement with the same legal entity. See Note 7, Principal Risks, in the Notes to Financial Statements for more information regarding master netting arrangements.

**(h) FINANCIAL DERIVATIVE INSTRUMENTS: EXCHANGE-TRADED OR CENTRALLY CLEARED****SWAP AGREEMENTS:****INTEREST RATE SWAPS**

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Pay/Receive	Floating Rate	Floating Rate Index	Fixed Rate	Maturity Date	Notional Amount	Market Value	Unrealized Appreciation/ (Depreciation)	Variation Margin	
								Asset	Liability
Pay	3-Month	USD-LIBOR	1.900%	06/18/2019	\$ 35,800	\$ 1,054	\$ 905	\$ 119	\$ 0
Pay	3-Month	USD-LIBOR	2.000%	06/18/2019	99,400	3,367	2,021	331	0
Pay	3-Month	USD-LIBOR	2.250%	12/17/2019	20,800	955	529	81	0
Receive	3-Month	USD-LIBOR	3.750%	09/17/2043	94,600	(31,287)	(24,459)	0	(1,639)
Pay	3-Month	USD-LIBOR	3.500%	06/19/2044	107,000	32,653	36,143	1,845	0
Receive	3-Month	USD-LIBOR	3.250%	06/17/2045	68,400	(16,277)	(9,511)	0	(1,167)
Pay	6-Month	AUD-BBR-BBSW	3.000%	12/17/2019	AUD 6,200	122	29	41	0
Pay	6-Month	AUD-BBR-BBSW	3.500%	06/17/2025	3,900	191	94	47	0
						\$ (9,222)	\$ 5,751	\$ 2,464	\$ (2,806)
<b>Total Swap Agreements</b>						<b>\$ (9,222)</b>	<b>\$ 5,751</b>	<b>\$ 2,464</b>	<b>\$ (2,806)</b>

See Accompanying Notes

SEMIANNUAL REPORT

JANUARY 31, 2015 25

**Table of Contents**

Schedule of Investments PIMCO Income Strategy Fund (Cont.)

**FINANCIAL DERIVATIVE INSTRUMENTS: EXCHANGE-TRADED OR CENTRALLY CLEARED SUMMARY**

The following is a summary of the market value and variation margin of Exchange-Traded or Centrally Cleared Financial Derivative Instruments as of January 31, 2015:

(i) Securities with an aggregate market value of \$6,966 and cash of \$2,627 have been pledged as collateral for exchange-traded and centrally cleared financial derivative instruments as of January 31, 2015. See Note 7, Principal Risks, in the Notes to Financial Statements for more information regarding master netting arrangements.

	Financial Derivative Assets				Financial Derivative Liabilities			
	Market Value		Variation Margin		Market Value		Variation Margin	
	Purchased	Options Futures	Asset Swap	Agreements	Written	Options Futures	Liability Swap	Agreements
<b>Total Exchange-Traded or Centrally Cleared</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 2,464</b>	<b>\$ 2,464</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ (2,806)</b>	<b>\$ (2,806)</b>

**(j) FINANCIAL DERIVATIVE INSTRUMENTS: OVER THE COUNTER**

**FORWARD FOREIGN CURRENCY CONTRACTS:**

Counterparty	Settlement Month	Currency to be Delivered		Currency to be Received		Unrealized Appreciation/ (Depreciation)	
		Asset	Liability	Asset	Liability	Asset	Liability
BOA	02/2015	BRL	22,084	\$	8,525	\$ 295	\$ 0
	02/2015	GBP	15,994		24,987	896	0
	02/2015	\$	8,295	BRL	22,084	0	(65)
	02/2015		1,370	JPY	162,200	12	0
	03/2015	EUR	50	\$	57	0	0
	03/2015	JPY	162,200		1,370	0	(12)
	03/2015	\$	8,462	BRL	22,084	0	(296)
	04/2015	BRL	958	\$	357	6	0
	06/2015	EUR	9		12	2	0
	07/2015	BRL	868		314	4	0
	06/2016	EUR	26		36	6	0
	06/2016	\$	1	EUR	1	0	0
BPS	02/2015	BRL	37,333	\$	14,387	473	0
	02/2015	\$	14,023	BRL	37,333	0	(109)

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	03/2015		14,281		37,333	0	(476)
	06/2015	EUR	4	\$	5	1	0
BRC	06/2015		5		7	1	0
	06/2016		5		7	1	0
CBK	02/2015		1,430		1,753	137	0
	03/2015	GBP	211		317	0	(1)
	03/2015	JPY	10,119		86	0	0
	06/2015	EUR	5		7	1	0
	06/2015	\$	45	EUR	34	0	(6)
DUB	02/2015	AUD	71	\$	57	2	0
	02/2015	BRL	2,046		769	6	0
	02/2015	EUR	49		57	1	0
	02/2015	\$	774	BRL	2,046	0	(11)
	03/2015	GBP	38	\$	58	1	0
	07/2015	BRL	19,884		7,329	229	0
	06/2016	EUR	3		4	1	0

26 PIMCO CLOSED-END FUNDS

See Accompanying Notes

**Table of Contents**

(Unaudited)

January 31, 2015

Counterparty	Settlement Month	Currency to be Delivered		Currency to be Received		Unrealized Appreciation/ (Depreciation)			
						Asset	Liability		
FBF	04/2015	EUR	4,173	\$	5,658	\$	939	\$	0
	06/2015		7		10		2		0
	07/2015	BRL	19,774		7,244		183		0
GLM	02/2015		526		202		6		0
	02/2015	EUR	97		115		5		0
	02/2015	\$	198	BRL	526		0		(2)
	02/2015		221	EUR	191		0		(6)
	06/2015		9		7		0		(1)