PIMCO INCOME STRATEGY FUND
Form 497
March 23, 2010
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PROSPECTUS

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March 22, 2010

PIMCO Income Strategy Fund

(formerly, PIMCO Floating Rate Income Fund)

6,173,000 Common Shares

Issuable Upon Exercise of Rights to Subscribe for Such Shares

PIMCO Income Strategy Fund (formerly, PIMCO Floating Rate Income Fund, the Fund) is a diversified closed-end management investment company. The Fund s investment objective is to seek high current income, consistent with the preservation of capital.

The Fund is issuing transferable rights (Rights) to its common shareholders of record (Record Date Shareholders) as of 5:00 p.m., Eastern time, on March 24, 2010 (the Record Date), entitling the holders of those Rights to subscribe for up to an aggregate of 6,173,000 of the Fund s common shares of beneficial interest (the Offer). Record Date Shareholders will receive one Right for each outstanding whole common share held on the Record Date. The Rights entitle their holders to purchase one new common share for every three Rights held (1-for-3). Any Record Date Shareholder who is issued fewer than three Rights may subscribe for one full common share in the Offer. In addition, Record Date Shareholders who fully exercise their Rights (other than those Rights that cannot be exercised because they represent the right to acquire less than one common share) will be entitled to subscribe for additional common shares of the Fund that remain unsubscribed as a result of any unexercised Rights. This over-subscription privilege is subject to a number of limitations and subject to allotment.

The subscription price (the Subscription Price) will be determined based upon a formula equal to 90% of the average of the last reported sale prices of the Fund s common shares on the New York Stock Exchange (NYSE) on the Expiration Date (as defined below) and on each of the four preceding trading days (the Formula Price). If, however, the Formula Price is less than 80% of the Fund s net asset value per common share on the Expiration Date, then the Subscription Price will be 80% of the Fund s net asset value per common share on that day. **The Offer will expire at 5:00 p.m., Eastern time, on April 23, 2010, unless extended as described in this prospectus (the Expiration Date).**

Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the common shares subscribed for pursuant to the primary subscription and, if eligible, any additional common shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of $10.77 per common share and, except in limited circumstances, will not be able to rescind their subscription.

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

(continued on following page)

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

	Per share	Total(1)
Estimated subscription price(2)	$ 10.77	$ 66,483,210
Estimated sales load(2)(3)	$ 0.38	$ 2,326,912
Estimated offering expenses	$ 0.08	$ 500,000
Estimated proceeds, after expenses, to the Fund(2)	$ 10.31	$ 63,656,298

(footnotes on inside front cover)

UBS Investment Bank

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(footnotes from front cover)

(1) Assumes that all Rights are exercised at the estimated Subscription Price.

(2) Estimated on the basis of 90% of the last reported sale price of a common share of the Fund on the NYSE on March 19, 2010.

(3) UBS Securities LLC will act as dealer manager for the Offer (the Dealer Manager). The Fund has agreed to pay the Dealer Manager a fee for its financial structuring and soliciting services equal to 3.50% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights and the over-subscription privilege. The Dealer Manager will reallow to broker-dealers in the selling group to be formed and managed by the Dealer Manager selling fees equal to 2.50% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights as a result of their selling efforts. In addition, the Dealer Manager will reallow to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to 0.50% of the Subscription Price per common share for each common share issued pursuant to the exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of common shares held by each broker-dealer through The Depository Trust Company (DTC) on the Record Date. The fees and expenses of the Offer, including the Dealer Manager fee, will be borne by the Fund and indirectly by all of its common shareholders, including those who do not exercise their Rights. The Fund and Allianz Global Investors Fund Management LLC, the Fund s investment manager, have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act of 1933, as amended.

(continued from previous page)

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

The Fund s outstanding common shares are listed and trade on the NYSE under the symbol PFL, as will the common shares offered for subscription in the Offer. The Rights are transferable and will be admitted for trading on the NYSE under the symbol PFL.RT throughout the term of the Offer. See The Offer for a complete discussion of the terms of the Offer.

If you have questions or need further information about the Offer, please write The Altman Group, the Fund s information agent for the Offer, at 60 East 42nd Street, Suite 916, New York, NY 10165 or call (866) 207-3647.

The Fund seeks to achieve its investment objective by ordinarily investing in a diversified portfolio of floating- and/or fixed-rate debt instruments. The average portfolio duration of the Fund normally will be in a low to intermediate range (*i.e.*, zero to eight years). The Fund may invest without limit in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody s Investors Service, Inc. or below BBB- by either Standard & Poor s, a division of The McGraw-Hill

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

You should read this prospectus, which contains important information about the Fund, before deciding whether to invest and retain it for future reference. A Statement of Additional Information, dated March 22, 2010, containing additional information about the Fund has been filed with the Securities and Exchange Commission (the Commission) and is incorporated by reference in its entirety into this prospectus. You can review the table of contents of the Statement of Additional Information on page 109 of this prospectus. You may request a free copy of the Statement of Additional Information, request the Fund s most recent annual and semiannual reports, request information about the Fund and make shareholder inquiries by calling (800) 254-5197 or by writing to the Fund at c/o Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105. You may also obtain a copy of the Statement of Additional Information (and other information regarding the Fund) from the Commission s Public Reference Room in Washington, D.C. by calling (202) 551-8090. The Commission charges a fee for copies. The Fund s most recent annual and semiannual reports are available, free of charge, on the Fund s website (http://www.allianzinvestors.com). You can obtain the same information, free of charge, from the Commission s web site (http://www.sec.gov).

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

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

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Prospectus summary

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

THE FUND

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

PURPOSE OF THE OFFER

The Board of Trustees of the Fund (the Board), Allianz Global Investors Fund Management LLC, the Fund s investment manager (AGIFM or the Investment Manager), and Pacific Investment Management Company LLC, the Fund s sub-adviser (PIMCO or the Sub-Adviser), have determined that it would be in the best interests of the Fund and its shareholders to increase the assets of the Fund, in order to more fully take advantage of current and prospective investment opportunities that reflect the Sub-Adviser s views regarding the credit markets. Consistent with the changes to the Fund s name and investment policies and guidelines that became effective on March 1, 2010 (see The Fund), the Board, the Investment Manager and the Sub-Adviser believe that there are more attractive opportunities in fixed-rate securities. By increasing assets through the Offer (as defined below), the Fund believes that it will be able to cost-efficiently shift a larger portion of the Fund s investment allocations from floating-rate assets (including floating-rate loans) to fixed-rate instruments, achieve greater portfolio diversification with respect to industries and issuers currently represented in the portfolio (including as an alternative to possibly selling existing holdings that have appreciated in value) and potentially enhance risk-adjusted returns, in pursuit of its investment objective of seeking high current income, consistent with the preservation of capital. The Offer is also intended to enhance the market liquidity of the Fund s common shares, reduce the Fund s expense ratio modestly (not taking into account interest expense) and provide holders of the Fund s common shares (Common Shareholders) with the opportunity to buy additional common shares at a discounted price to then-current market value.

The Offer may not be successful. The completion of the Offer may result in an immediate dilution of the net asset value per common share for all existing Common Shareholders of the Fund, including those who fully exercise their Rights (as defined below). See The Offer Purpose of the Offer.

IMPORTANT TERMS OF THE OFFER

The Fund is issuing transferable rights (Rights) to its Common Shareholders of record (Record Date Shareholders) as of 5:00 p.m., Eastern time, on March 24, 2010 (the Record Date), entitling the holders of those Rights to subscribe for up to an aggregate of 6,173,000 of the Fund s common shares (the Shares) (the Offer). Record Date Shareholders will receive one Right for each

outstanding whole common share held on the Record Date. The Rights entitle their holders to purchase one Share for every three Rights held (1-for-3). Fractional Shares will not be issued upon the exercise of Rights; accordingly, Rights may be exercised only in integer multiples of three, except that any Record

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Date Shareholder who is issued fewer than three Rights may subscribe, at the Subscription Price (defined below), for one full Share. Assuming the exercise of all Rights, the Offer will result in an approximately 33 1/3% increase in the Fund s common shares outstanding. The Offer is not contingent upon any number of Rights being exercised. The subscription period commences on March 24, 2010 and ends at 5:00 p.m., Eastern time, on April 23, 2010, unless otherwise extended (the Expiration Date). See The Offer Important Terms of the Offer.

The Fund expects to declare a monthly common share dividend in April 2010. Such dividend will not be payable with respect to Shares that are issued pursuant to the Offer after the record date for such dividend.

The Fund will bear the expenses of the Offer and all such expenses will be borne indirectly by the Fund s Common Shareholders, including those who do not exercise their Rights. These expenses include, but are not limited to, the dealer manager fee and the reimbursement of dealer manager expenses, the expenses of preparing, printing and mailing the prospectus and Rights subscription materials for the Offer and the expenses of Fund counsel and the Fund s independent registered public accounting firm in connection with the Offer.

IMPORTANT DATES TO REMEMBER

Record Date:	March 24, 2010
Subscription Period:	March 24, 2010 to April 23, 2010*
Final Date Rights Will Trade on NYSE:	April 22, 2010*
Expiration Date and Pricing Date:	April 23, 2010*
Payment for Shares or Notice of Guarantees of Delivery Due:	April 23, 2010*
Payment for Guarantees of Delivery Due:	April 28, 2010*
Confirmation Mailed to Participants:	May 5, 2010*
Final Payment for Shares Due:	May 19, 2010*

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

SUBSCRIPTION PRICE

The subscription price for the Shares (the Subscription Price) will be determined based on a formula equal to 90% of the average of the last reported sale prices of the Fund s common shares on the New York Stock Exchange (the NYSE) on the Expiration Date and on each of the four preceding trading days (the Formula Price). If, however, the Formula Price is less than 80% of the Fund s net asset value per common share on the Expiration Date, then the Subscription Price will be 80% of the Fund s net asset value per common share on that day. Because the Expiration Date of the subscription period will be April 23, 2010 (unless the subscription period is extended), Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the Shares subscribed for pursuant to the primary subscription and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of $10.77 per Share and, except in limited circumstances, will not be able to rescind their subscription. See The Offer Subscription Price.

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OVER-SUBSCRIPTION PRIVILEGE

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

SALE AND TRANSFERABILITY OF RIGHTS

The Rights will be admitted for trading on the NYSE under the symbol PFL.RT during the course of the Offer. Trading in the Rights on the NYSE may be conducted until the close of trading on the NYSE on the last business day prior to the Expiration Date. The Fund will use its best efforts to ensure that an adequate trading market for the Rights will exist, although there can be no assurance that a market for the Rights will develop. Assuming a market exists for the Rights, the Rights may be purchased and sold through usual brokerage channels or sold through the Subscription Agent (defined on page 5).

Record Date Shareholders who do not wish to exercise any of the Rights issued to them pursuant to the Offer may instruct the Subscription Agent to sell any unexercised Rights through or to the Dealer Manager (as defined on the next page). Subscription certificates representing the Rights to be sold through or to the Dealer Manager must be received by the Subscription Agent by 5:00 p.m., Eastern time, on April 21, 2010 (or, if the subscription period is extended, by 5:00 p.m., Eastern time, on the second business day prior to the extended Expiration Date).

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

METHOD FOR EXERCISING RIGHTS

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

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

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REQUIREMENTS FOR FOREIGN SHAREHOLDERS

Subscription certificates will not be mailed to Record Date Shareholders whose addresses are outside the United States (for these purposes, the United States includes the District of Columbia and the territories and possessions of the United States) (Foreign Shareholders). The Subscription Agent will send a letter via regular mail to Foreign Shareholders to notify them of the Offer. The Rights of Foreign Shareholders will be held by the Subscription Agent for their accounts until instructions are received to exercise the Rights. If instructions have not been received by 5:00 p.m., Eastern time, on April 20, 2010, three business days prior to the Expiration Date (or, if the subscription period is extended, on or before the third business day prior to the extended Expiration Date), the Rights of Foreign Shareholders will be transferred by the Subscription Agent to the Dealer Manager, who will either purchase the Rights or use its best efforts to sell the Rights. The net proceeds, if any, from the sale of those Rights by or to the Dealer Manager will be remitted to these Foreign Shareholders.

DISTRIBUTION ARRANGEMENTS

UBS Securities LLC (UBS or the Dealer Manager) will act as Dealer Manager for this Offer. Under the terms and subject to the conditions contained in the Dealer Manager Agreement among the Dealer Manager, the Fund and the Investment Manager, the Dealer Manager will provide financial structuring services in connection with the Offer and will solicit the exercise of Rights and participation in the over-subscription privilege. The Fund has agreed to pay the Dealer Manager a fee for its financial structuring and soliciting services equal to 3.50% of the aggregate Subscription Price for the Shares issued pursuant to the exercise of Rights and the over-subscription privilege. The fees paid to the Dealer Manager and other expenses of the Offer will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights. The Dealer Manager will reallow a portion of its fees to other broker-dealers who have assisted in soliciting the exercise of Rights. The Fund and the Investment Manager have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act of 1933, as amended (the Securities Act).

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

INVESTMENT MANAGER

The Investment Manager serves as the investment manager of the Fund. Subject to the supervision of the Fund s Board of Trustees (the Board), the Investment Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund s business affairs and other administrative matters. The Investment Manager receives an annual fee, payable monthly, in an amount equal to 0.75% of the Fund s average weekly total managed assets. Total managed assets means the total assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). For purposes of calculating total managed assets, the liquidation preference of any preferred shares outstanding is not considered a liability. The Investment Manager is located at 1345 Avenue of the Americas, New York, New York 10105. Organized in 2000, the

Investment Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. The Investment Manager is a wholly-owned indirect subsidiary of Allianz SE, a publicly-traded European insurance and financial services company. As of December 31, 2009, the Investment Manager and its investment management affiliates had approximately $1.7 trillion in assets under management.

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

SUB-ADVISER

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

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to a number of open-end and closed-end investment companies. As of December 31, 2009, PIMCO had approximately $1 trillion in assets under management.

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

SUBSCRIPTION AGENT

The subscription agent for the Offer is The Colbent Corporation (the Subscription Agent).

INFORMATION AGENT

The information agent for the Offer is The Altman Group (the Information Agent). If you have questions or need further information about the Offer, please write the Information Agent at 60 East 42nd Street, Suite 916, New York, NY 10165 or call (866) 207-3647.

LISTING

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

USE OF PROCEEDS

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

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BENEFITS TO THE INVESTMENT MANAGER AND THE SUB-ADVISER

The Investment Manager and the Sub-Adviser will benefit from the Offer, in part, because the investment management fee paid by the Fund to the Investment Manager and the subadvisory fee paid by the Investment Manager to the Sub-Adviser each are based on the Fund s average weekly total managed assets, meaning the total assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). It is not possible to state precisely the amount of additional compensation the Investment Manager and the Sub-Adviser will receive as a result of the Offer because it is not known how many Shares of the Fund will be subscribed for and because the proceeds of the Offer will be invested in additional portfolio securities which will fluctuate in value. However, assuming (i) all Rights are exercised, (ii) the Fund s average weekly net asset value during the twelve-month period beginning May 1, 2010 is $10.74 per common share (the net asset value per common share on March 19, 2010) (iii) the Subscription Price is $10.77 per Share (90% of the last reported sale price of the Fund s common shares on March 19, 2010), and (iv) for purposes of this example, the Fund increases the amount of leverage it has outstanding (through the use of reverse repurchase agreements) while maintaining approximately the same percentage of total assets attributable to leverage, and after giving effect to the Dealer Manager fee and other estimated offering expenses, the Investment Manager and the Sub-Adviser would receive additional investment management fees and subadvisory fees of approximately $168,052 and $462,145, respectively, for the twelve-month period beginning May 1, 2010, and would continue to receive additional investment management fees (after payment of the subadvisory fees) and subadvisory fees, respectively, as a result of the Offer, based on the Fund s average weekly total managed assets attributable to the Shares issued in the Offer and related additional leverage, thereafter.

INVESTMENT OBJECTIVE

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

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

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

INVESTMENT STRATEGIES

The Fund is actively managed in accordance with PIMCO s top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis and risk management techniques. In selecting investments for the Fund, PIMCO attempts to identify floating- and/or fixed-rate debt instruments that provide high current income through fundamental research, driven by independent credit analysis and proprietary analytical tools. Investment decisions are based

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primarily on PIMCO s assessment of the issuer s credit characteristics and the position of the particular security in the issuer s capital structure, in light of PIMCO s outlook for particular industries, the economy and the market generally. At the same time, PIMCO may use a variety of techniques, such as credit default swaps, designed to control risk and to minimize the Fund s exposure to issues that PIMCO believes are more likely to default or otherwise to depreciate in value over time and to detract from the Fund s overall return to investors. The Fund cannot assure you that such securities will ultimately continue to pay current income or be paid in full at maturity.

Credit quality

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

Independent credit analysis

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

Duration

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

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

The Fund may also hold up to 20% of its total assets in common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The Fund may invest in securities that have not been registered for public sale, including securities eligible for purchase and sale pursuant to Rule 144A under the Securities Act and other securities issued in private placements. The Fund may also invest in securities of other investment companies, including exchange-traded funds (ETFs). The Fund may invest in securities of companies with small market capitalizations.

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

The Fund has a policy not to concentrate investments in any particular industry, but may (consistent with that policy) invest up to 25% of its assets in any particular industry, and may invest a substantial portion of its assets in companies in related sectors, such as those in the banking or financial services sectors, which may share common characteristics and are often subject to similar business risks and regulatory burdens.

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

The Fund may utilize various derivative strategies involving the purchase or sale of credit default swaps, total return swaps and other swap agreements, call and put options (including options on futures contracts), futures and forward contracts, short sales and other derivative instruments for investment

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purposes, leveraging purposes or in an attempt to hedge against market, interest rate, currency and other risks in the portfolio. The Fund may also seek to obtain market exposure to the securities in which it invests by entering into a series of purchase and sale contracts.

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

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

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

USE OF LEVERAGE

The Fund has utilized leverage since shortly after it began investment operations, including through the issuance of Preferred Shares. As of February 28, 2010, the aggregate dollar amount (*i.e.*, liquidation preference) of the Fund s outstanding Preferred Shares was $78,975,000, which then represented approximately 27% of the Fund s total assets (including assets attributable to the Preferred Shares). Information regarding the terms and features of the Preferred Shares is provided under Description of capital structure in this prospectus.

Following completion of the Offer, the Fund currently intends to add leverage to its portfolio by utilizing reverse repurchase agreements, dollar rolls or other forms of borrowings, such as bank loans or commercial paper or other credit facilities (together Borrowings) in order to maintain approximately the total amount of leverage (as a percentage of the Fund s total assets) that the Fund currently maintains. As of February 28, 2010, the Fund had reverse repurchase agreements outstanding representing approximately 5% of the Fund s total assets (including the leverage obtained through the use of the instruments), such that the Fund s total leverage attributable in the aggregate to Preferred Shares and Borrowings then represented approximately 32% of the Fund s total assets (including assets attributable to the Preferred Shares and the leverage obtained through such instruments).

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

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

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

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

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

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

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

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

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

PRINCIPAL RISKS OF THE FUND

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

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Market discount risk

As with any stock, the price of the Fund s common shares will fluctuate with market conditions and other factors. If common shares are sold, the price received may be more or less than the original investment. Net asset value of the Fund s common shares will be reduced immediately following the Offer by expenses paid or reimbursed by the Fund in connection with the Offer. The completion of the Offer may result in an immediate dilution of the net asset value per common share for all existing Common Shareholders, including those who fully exercise their Rights. The common shares are designed for long-term investors and should not be treated as trading vehicles. Common shares of closed-end management investment companies frequently trade at a discount from their net asset value. The Fund s common shares may trade at a price that is less than the Subscription Price for Shares issued pursuant to the Offer. This risk may be greater for investors who sell their Shares relatively shortly after completion of the Offer.

Market risk

The market price of securities owned by the Fund may go up or down, sometimes rapidly or unpredictably. Securities may decline in value due to factors affecting securities markets generally or particular industries represented in the securities markets. The value of a security may decline due to general market conditions that are not specifically related to a particular company, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates or adverse investor sentiment generally. They may also decline due to factors that affect a particular industry or industries, such as labor shortages or increased production costs and competitive conditions within an industry. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

High yield risk

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

The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy, which involve heightened risks. See Principal risks of the Fund Distressed and Defaulted Securities Risk.

An economic downturn could severely affect the ability of issuers (particularly those that are highly leveraged) to service their debt obligations or to repay their obligations upon maturity. Lower-rated securities are generally less liquid than higher-rated securities, which may have an adverse effect on the Fund s ability to dispose of a particular security. For example, under adverse market or economic

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conditions, the secondary market for below investment grade securities could contract further, independent of any specific adverse changes in the condition of a particular issuer, and certain securities in the Fund s portfolio may become illiquid or less liquid. As a result, the Fund could find it more difficult to sell these securities or may be able to sell these securities only at prices lower than if such securities were widely traded. See Principal risks of the Fund Liquidity Risk.

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

Although Floating-Rate Loans in which the Fund may invest will often be secured by collateral, there can be no assurance that liquidation of any such collateral would satisfy the borrower s obligation in the event of default or that such collateral could be readily liquidated. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations in its ability to realize the benefits of any collateral securing a Floating-Rate Loan. To the extent the Fund focuses on Floating-Rate Loans or other below investment grade debt obligations, PIMCO s capabilities in analyzing credit quality and associated risks will be particularly important, and there can be no assurance that PIMCO will be successful in this regard. See Portfolio contents High Yield Securities (Junk Bonds) for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

Distressed and defaulted securities risk

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

Credit risk

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

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Interest rate risk

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

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

Liquidity risk

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

Leverage risk

The Fund utilizes leverage on an ongoing basis for investment purposes, including through its outstanding Preferred Shares and also from time to time through the use of reverse repurchase agreements and other Borrowings and through other transactions noted below. As noted under Use of leverage, the Fund currently intends to add leverage to its portfolio following completion of the Offer in order to maintain approximately the total amount of leverage (as a percentage of the Fund s total assets) that the Fund currently maintains. See Use of leverage for details.

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

- the likelihood of greater volatility of net asset value and market price of common shares than a comparable portfolio without leverage;
- the possibility either that common share dividends will fall if the costs of leverage rise, or that dividends paid on common shares will fluctuate because such costs vary over time; and
- the effects of leverage in a declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the common shares.

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

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

Because the fees received by the Investment Manager and by the Sub-Adviser are based on the total managed assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding), the Investment Manager and the Sub-Adviser have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of

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leverage (*e.g.*, reverse repurchase agreements and other Borrowings), which may create a conflict of interest between the Investment Manager and the Sub-Adviser, on the one hand, and the Common Shareholders, on the other hand.

Additional risks associated with the Fund s Preferred Shares

Although the Fund s Preferred Shares ordinarily would pay dividends at rates set at periodic auctions, the weekly auctions for the Preferred Shares (and auctions for similar preferred shares across the U.S.) have failed since February 2008. The dividend rates on the Preferred Shares since that time have been paid, and the Fund expects that they will continue to be paid for the foreseeable future, at the maximum applicable rate, which is calculated using a reference interest rate. An increase in market interest rates generally, therefore, could increase substantially the dividend rate required to be paid by the Fund to the holders of Preferred Shares, which would reduce the Fund s net income available for distribution to Common Shareholders. It is possible that a substantial rise in market interest rates could make the Fund s continued use of Preferred Shares for leverage purposes less attractive than such use is currently considered to be. In such case, the Fund may elect to redeem some or all of the Preferred Shares outstanding, which may require it to dispose of investments at inopportune times and to incur losses on such dispositions. Such dispositions may adversely affect the Fund s investment performance generally, and the resultant loss of leverage may materially and adversely affect the Fund s investment returns to Common Shareholders.

The Preferred Shares have complete priority over the common shares as to distribution of assets, and in the event that limited funds are available for distribution to shareholders, it is possible that all of such funds would be paid to holders of Preferred Shares to the exclusion of Common Shareholders.

The Fund is subject to certain asset coverage tests associated with the rating agencies that rate the Preferred Shares currently Fitch and Moody s. Failure by the Fund to maintain the asset coverages (or to cure such failure in a timely manner) may require the Fund to redeem Preferred Shares. See Description of capital structure. Failure to satisfy ratings agency asset coverage tests or other guidelines could also result in ratings agencies downgrading their then-current ratings on the Preferred Shares, which, among other consequences, could result in the Fund paying higher dividends on the Preferred Shares, which would reduce income available for distribution to the Common Shareholders and otherwise detract from the Fund s investment performance. Moreover, the rating agency guidelines impose restrictions or limitations on the Fund s use of certain financial instruments or investment techniques that the Fund might otherwise utilize in order to achieve its investment objective, which may adversely affect the Fund s investment performance. The New Fitch Criteria (as defined in Description of capital structure) and related asset coverage requirements in various respects impose more stringent and limiting standards than the guidelines to which the Fund previously was subject. In this regard, the New Fitch Criteria may cause the Fund to invest in higher-quality assets, use derivatives transactions and related leverage to a lesser extent, maintain higher balances of highly liquid assets and otherwise to invest the Fund s assets differently than it otherwise would prefer, all or any of which could negatively affect the Fund s investment performance, yield to Common Shareholders and common share net asset value and/or market price. Rating agency guidelines may be modified by the rating agencies in the future and, if adopted by the Fund, such modifications may make such guidelines substantially more restrictive, which could further negatively affect the Fund s investment performance.

Issuer risk

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

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Smaller company risk

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

Management risk

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

Convertible securities risk

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

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

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Preferred securities risk

In addition to equity securities risk (see Principal risks of the Fund Equity Securities and Related Market Risk), credit risk (see Principal risks of the Fund Credit Risk) and possibly high yield risk (see Principal risks of the Fund High Yield Risk), investment in preferred stocks involves certain other risks. Certain preferred stocks contain provisions that allow an issuer under certain conditions to skip or defer distributions.

Preferred stocks often are subject to legal provisions that allow for redemption in the event of certain tax or legal changes or at the issuer s call. In the event of redemption, the Fund may not be able to reinvest the proceeds at comparable rates of return. Preferred stocks are subordinated to bonds and other debt securities in an issuer s capital structure in terms of priority for corporate income and liquidation payments, and therefore will be subject to greater credit risk than those debt securities. Preferred stocks may trade less frequently and in a more limited volume and may be subject to more abrupt or erratic price movements than many other securities, such as common stocks, corporate debt securities and U.S. Government securities.

If the Fund owns a preferred stock that is deferring its distribution, the Fund may be required to include the amount of the deferred distribution in its taxable income for tax purposes despite the fact that it does not currently receive such amount. In order to receive the special treatment accorded to regulated investment companies (RICs) and their shareholders under the Internal Revenue Code of 1986, as amended (the Code) and to avoid U.S. federal income and/or excise taxes at the Fund level, the Fund may be required to distribute this income to shareholders in the tax year in which the income is recognized (without a corresponding receipt of cash). Therefore, the Fund may be required to pay out as an income distribution in any such tax year an amount greater than the total amount of cash income the Fund actually received, and to sell portfolio securities, including at potentially disadvantageous times or prices, to obtain cash needed for these income distributions.

Foreign (non-U.S.) investment risk

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

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

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in securities of foreign issuers generally will be denominated in foreign currencies, subjecting the Fund to foreign currency risk. See Principal risks of the Fund Foreign Currency Risk.

Emerging markets risk

The Fund may invest up to 25% of its total assets in securities that are economically tied to emerging market countries. Foreign investment risk may be particularly high to the extent that the Fund invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers noted above, but to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation and nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in a lack of liquidity and in price volatility; (iii) certain national policies which may restrict the Fund s investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests and requirements that government approval be obtained prior to investment by foreign persons; (iv) certain national policies that may restrict the Fund s repatriation of investment income, capital or the proceeds of sales of securities, including temporary restrictions on foreign capital remittances; (v) the lack of uniform accounting and auditing standards; (vi) less publicly available financial and other information regarding issuers; (vii) potential difficulties in enforcing contractual obligations; and (viii) higher rates of inflation, higher interest rates and other economic concerns. The Fund may invest to a significant extent in emerging market securities that are issued in local currencies, subjecting the Fund to a greater degree of foreign currency risk. See Principal risks of the Fund Foreign Currency Risk. Also, investing in emerging market countries may entail purchases of securities of issuers that are insolvent, bankrupt, in default or otherwise of questionable ability to satisfy their payment obligations as they become due, subjecting the Fund to a greater amount of credit risk and/or high yield risk. See Principal risks of the Fund Credit Risk and Principal Risks of the Fund High Yield Risk.

Foreign currency risk

The Fund s common shares are priced in U.S. dollars and the distributions paid by the Fund to Common Shareholders are paid in U.S. dollars. However, a significant portion of the Fund s assets may at any time be denominated in foreign (non-U.S.) currencies and income received by the Fund from many foreign debt obligations will be paid in foreign currencies. The Fund may also invest in or gain exposure to foreign currencies themselves for investment or hedging purposes. The Fund s investments in or exposure to foreign currencies or in securities or instruments that trade, or receive revenues, in foreign currencies are subject to the risk that those currencies will decline in value relative to the U.S. dollar or, in the case of hedging positions (if utilized), that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including changes in interest rates, intervention (or the failure to intervene) by U.S. or foreign governments, central banks or supranational entities such as the International Monetary Fund, or the imposition of currency controls or other political developments in the U.S. or abroad. These fluctuations may have a significant adverse effect on the value of the Fund s portfolio and/or the level of Fund distributions made to Common Shareholders. As noted above, the Fund may (but is not required to) attempt to hedge some of its exposure to foreign currencies in order to reduce the risk of loss due to fluctuations in currency exchange rates relative to the U.S. dollar. There is no assurance, however, that these hedging strategies will be available or will be used by the Fund or, if used, that they will be successful.

Derivatives risk

Derivatives are financial contracts whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indexes). The Fund may invest in a variety of

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

Counterparty risk

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

Mortgage-related and asset-backed securities risk

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

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

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

Investments in mortgage-related securities may involve particularly high levels of risk under current market conditions. See Principal risks of the Fund Mortgage Market/Subprime Risk. See also Principal Risks of the Fund Recent Economic Conditions Risk/Impacts on Banking and Financial Services Sectors.

Mortgage market/subprime risk

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

Government entity risk

As noted, the Fund may invest in mortgage-related and other debt securities issued or guaranteed by certain U.S. government agencies, instrumentalities and sponsored enterprises. Some U.S. Government securities, such as U.S. Treasury bills, notes and bonds, and securities guaranteed by the Government National Mortgage Association (GNMA), are supported by the full faith and credit of the United States; others, such as those of the Federal Home Loan Banks or the Federal Home Loan Mortgage Corporation (FHLMC), are supported by the right of the issuer to borrow from the U.S. Treasury; others, such as those of the Federal National Mortgage Association (FNMA), are supported by the discretionary authority of the U.S. Government to purchase the agency s obligations; and still others, such as those of the Student Loan Marketing Association, are supported only by the credit of the instrumentality. Although U.S. Government-sponsored enterprises, such as the Federal Home Loan Banks, FHLMC, FNMA and the Student Loan Marketing Association may be chartered or sponsored by Congress, they are not funded by Congressional appropriations, and their securities are not issued by the U.S. Treasury or supported by the full faith and credit of the U.S. Government and involve increased

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credit risks. Certain governmental entities, including FNMA and FHLMC, have been subject to regulatory scrutiny regarding their accounting policies and practices and other concerns that may result in legislation, changes in regulatory oversight and/or other consequences that could adversely affect the credit quality, availability or investment character of securities issued by these entities. See Investment Objective and Policies Mortgage-Related and Other Asset-Backed Securities in the Statement of Additional Information.

Risk of investing in REITs

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

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

Valuation risk

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

Focused investment risk

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

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the extent that it invests a substantial portion of its assets in a particular country or geographic region. See Principal risks of the Fund Foreign (Non-U.S.) Investment Risk, Principal risks of the Fund Emerging Markets Risk and Principal risks of the Fund Foreign Currency Risk.

Reinvestment risk

Reinvestment risk is the risk that income from the Fund s portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the portfolio s current earnings rate. For instance, during periods of declining interest rates, an issuer of debt obligations may exercise an option to redeem securities prior to maturity, forcing the Fund to invest in lower-yielding securities. The Fund also may choose to sell higher yielding portfolio securities and to purchase lower yielding securities to achieve greater portfolio diversification, because the portfolio manager believes the current holdings are overvalued or for other investment-related reasons. A decline in income received by the Fund from its investments is likely to have a negative effect on the market price, net asset value and/or overall return of the Fund s common shares.

Short sale risk

The Fund may use short sales for investment and risk management purposes, including when PIMCO anticipates that the market price of securities will decline or will underperform relative to other securities held in the Fund s portfolio. Short sales are transactions in which the Fund sells a security or other instrument (such as an option, forward, futures or other derivative contract) that it does not own. Short exposure with respect to securities or market segments may also be achieved through the use of derivative instruments, such as futures on indices or swaps on individual securities. When the Fund engages in a short sale on a security, it must borrow the security sold short and deliver it to the counterparty. The Fund will ordinarily have to pay a fee or premium to borrow particular securities and be obligated to repay the lender of the security any dividends or interest that accrue on the security during the period of the loan. The amount of any gain from a short sale will be decreased, and the amount of any loss increased, by the amount of the premium, dividends, interest or expenses the Fund pays in connection with the short sale. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may, to the extent permitted by law, engage in short sales where it does not own or have the right to acquire the security (or basket of securities) sold short at no additional cost. The Fund s loss on a short sale could theoretically be unlimited in a case in which the Fund is unable, for whatever reason, to close out its short position. The use by the Fund of short sales in combination with long positions in its portfolio in an attempt to improve performance may not be successful and may result in greater losses or lower positive returns than if the Fund held only long positions. It is possible that the Fund s long positions will decline in value at the same time that the value of the securities underlying its short positions increase, thereby increasing potential losses to the Fund. In addition, the Fund s short selling strategies may limit its ability to fully benefit from increases in the relevant securities markets. Short selling also involves a form of financial leverage that may exaggerate any losses realized by the Fund. See Principal risks of the Fund Leverage Risk. Also, there is the risk that the counterparty to a short sale may fail to honor its contractual terms, causing a loss to the Fund. See Principal risks of the Fund Counterparty Risk. To the extent the Fund seeks to obtain some or all of its short exposure by using derivative instruments instead of engaging directly in short sales on individual securities, it will be subject to many of the foregoing risks, as well as to those described under Principal Risks of the Fund Derivatives Risk.

Inflation/deflation risk

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

Confidential information access risk

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

Equity securities and related market risk

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

Rule 144A securities risk

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

Other investment companies risk

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

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Risk of regulatory changes

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

Market disruption and geopolitical risk

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

Recent economic conditions risk/impacts on banking and financial services sectors

The debt and equity capital markets in the United States have been negatively affected by significant write-offs in the banking and financial services sectors relating to subprime mortgages and the re-pricing of credit risk in the broadly syndicated market, among other things. These events, along with the deterioration of the housing market, the failure of banking and other major financial institutions and the resulting United States federal government actions have led to worsening general economic conditions, which have materially and adversely affected the broader financial and credit markets and have reduced the availability of debt and equity capital for the market as a whole and financial firms in particular. These developments may increase the volatility of the value of securities owned by the Fund, particularly those of companies in the banking and financial services sectors, and also may make it more difficult for the Fund to accurately value securities or to sell securities on a timely basis. These developments have adversely affected the broader economy, and may continue to do so, which in turn may adversely affect the ability of issuers of securities owned by the Fund to make payments of principal and interest when due, lead to lower credit ratings and increase defaults. Such developments could, in turn, reduce the value of securities owned by the Fund and adversely affect the net asset value and/or market value of the Fund s common shares. In addition, the prolonged continuation or further deterioration of current market conditions could adversely affect the Fund s portfolio.

The recent instability in the financial markets discussed above has led the U.S. government to take a number of unprecedented actions designed to support certain banking and other financial institutions and segments of the financial markets that have experienced extreme volatility, and in some cases a lack of liquidity. Federal, state and other governments and their regulatory agencies or self-regulatory organizations may take actions that affect the regulation of the instruments in which the Fund invests, or the issuers of such instruments, in ways that are unforeseeable. Governments or their agencies may also acquire distressed assets from financial institutions and acquire ownership interests in those institutions.

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The implications of government ownership and disposition of these assets are unclear, and such a program may have positive or negative effects on the liquidity, valuation and performance of the Fund s portfolio holdings and common shares.

Legislation or regulation may also change the way in which the Fund itself is regulated. Such legislation or regulation could limit or preclude the Fund s ability to achieve its investment objective.

CERTAIN AFFILIATIONS

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

ANTI-TAKEOVER PROVISIONS

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

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Summary of Fund expenses

The following table is intended to assist investors in understanding the fees and expenses (annualized) that an investor in common shares of the Fund would bear, directly or indirectly, as a result of the Offer being fully subscribed and the receipt of net proceeds from the Offer of approximately $63 million. If the Fund issues fewer Shares in the Offer and the net proceeds to the Fund are less, all other things being equal, the total annual expenses shown would increase. The table assumes that the Fund has Preferred Shares outstanding in an amount equal to 22% of the Fund s total assets (taking into account such outstanding Preferred Shares), which reflects the percentage of the Fund s total assets that would be represented by Preferred Shares, taking into account the additional assets to be raised in the Offer as estimated above, and based on the amount of Preferred Shares outstanding as of February 28, 2010. The table also assumes the use of additional leverage in the form of reverse repurchase agreements in an amount equal to 10% of the Fund s total assets (including the amounts of leverage obtained through the use of such instruments), also taking into account the additional assets to be raised in the Offer, as estimated above. The table assumes the use of leverage attributable to a combination of Preferred Shares and reverse repurchase agreements following the Offer in an amount equal to 32% of the Fund s total assets (taking into account such Preferred Shares and amounts attributable to such reverse repurchase agreements), which reflects approximately the percentage of the Fund s total assets attributable to such leverage (although in different proportions as between Preferred Shares and reverse repurchase agreements) as of February 28, 2010. The extent of the Fund s assets attributable to leverage following the Offer, and the Fund s associated expenses, are likely to vary (perhaps significantly) from these assumptions.

Shareholder transaction expenses	
Sales load (as a percentage of Subscription Price)	3.50%(1)
Offering expenses borne by Common Shareholders (as a percentage of Subscription Price)	0.75%(2)
Dividend reinvestment and cash purchase plan fees	None(3)

	Percentage of Net Assets Attributable to Common Shares
Annual expenses	
Management fees(4)	1.08%
Dividend expense on Preferred Shares(5)	0.45%
Interest expense on reverse repurchase agreements(6)	0.09%
Other expenses(7)	0.28%
Total annual expenses	1.90%

(1) The Dealer Manager will receive a fee for its financial structuring and soliciting services equal to 3.50% of the aggregate Subscription Price for Shares issued pursuant to the Offer. The Dealer Manager will reallow to broker-dealers in the selling group to be formed and managed by the Dealer Manager selling fees equal to 2.50% of the Subscription Price per Share for each Share issued pursuant to the Offer as a result of their selling efforts. In addition, the Dealer Manager will reallow to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to 0.50% of the Subscription Price per Share for each Share issued pursuant to the exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of Shares held by each broker-dealer through The Depository Trust Company (DTC) on the Record Date.

(2) The fees and expenses of the Offer will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights.

(3) You may pay brokerage charges if you direct the plan agent to sell your common shares held in a dividend reinvestment account. You also may pay a pro rata share of brokerage commissions incurred in connection with your market purchases pursuant to the Fund s dividend reinvestment plan. See Dividend reinvestment plan.

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(4) Management fees are charged to the Fund on the basis of total managed assets, but have been converted to a percentage of net assets attributable to common shares of the Fund for purposes of the presentation in the table above as follows: management fees, assuming no leverage attributable to Preferred Shares or Borrowings, divided by (one minus the percentage of the Fund s total assets estimated to be attributable to outstanding Preferred Shares and reverse repurchase agreements following the Offer (32% of the Fund s total assets, based on amounts of leverage outstanding as of February 28, 2010)).

(5) Assumes Preferred Shares outstanding in an amount equal to 22% of the Fund s total assets following the Offer (taking into account such outstanding Preferred Shares) at an annual dividend cost to the Fund of 1.48%, and assumes the Fund will continue to pay Preferred Share dividends at the maximum applicable rate called for under the Fund s Bylaws due to the ongoing failure of auctions for the Preferred Shares. The actual dividend rate paid on the Preferred Shares will vary over time in accordance with variations in market interest rates.

(6) Assumes the use of leverage in the form of reverse repurchase agreements representing 10% of the Fund s total assets following the Offer (including the amounts of leverage obtained through the use of such instruments) at an annual interest rate cost to the Fund of 0.65%. The actual amount of interest expense borne by the Fund will vary over time in accordance with the level of the Fund s use of reverse repurchase agreements and/or other Borrowings and variations in market interest rates. Interest expense is required to be treated as an expense of the Fund for accounting purposes. Any associated income or gains (or losses) realized from leverage obtained through such instruments is not reflected in the Annual expenses table above, but would be reflected in the Fund s performance results.

(7) Other expenses are estimated for the Fund s current fiscal year ending July 31, 2010.

EXAMPLE

The following example illustrates the expenses that you would pay on a $1,000 investment in common shares of the Fund (including the total sales load of $35 and the other estimated costs of this Offer to be borne by the Common Shareholders of $7.50), assuming (1) that the Fund s net assets following the Offer do not increase or decrease, (2) that the Fund incurs total annual expenses of 1.90% of net assets attributable to common shares in years 1 through 10 (assuming outstanding Preferred Shares representing 22% of the Fund s total assets and reverse repurchase agreements utilized equal to 10% of the Fund s total assets) and (3) a 5% annual return(1):

	1 Year	3 Years	5 Years	10 Years
Total expenses incurred	$ 61	$ 100	$ 141	$ 255

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

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Financial highlights

The information in the table below for the fiscal years ended July 31, 2005, 2006, 2007, 2008 and 2009 is derived from the Fund s financial statements for the fiscal year ended July 31, 2009 audited by PricewaterhouseCoopers, LLP, whose report on such financial statements is contained in the Fund s July 31, 2009 Annual Report and is incorporated by reference into the Statement of Additional Information. The information shown for the fiscal period ended July 31, 2004 is derived from the Fund s financial statements for the fiscal year ended July 31, 2008 audited by PricewaterhouseCoopers LLP, whose report on such financial statements is contained in the Fund s July 31, 2008 Annual Report and is incorporated by reference into the Statement of Additional Information. The information shown for the six months ended January 31, 2010 is unaudited.

	Six Months Ended January 31,				Year ended July 31,		For the Period August 29, 2003* through July 31,
	2010	2009	2008	2007	2006	2005	2004
	(unaudited)						
Net asset value, beginning of period	$ 9.07	$ 14.73	$ 17.38	$ 19.14	$ 19.51	$ 19.38	$ 19.35**
Investment Operations:							
Net investment income	0.73	1.54	1.81	2.13	1.91	1.36	0.71
Net realized and change in unrealized gain (loss) on investments, futures contracts, options written, swaps, unfunded loan commitments and foreign currency transactions	2.23	(5.81)	(2.08)	(1.29)	(0.14)	0.39	0.39
Total from investment operations	2.96	(4.27)	(0.27)	0.84	1.77	1.75	1.10
Dividends and Distributions on Preferred Shares from:							
Net investment income	(0.03)	(0.21)	(0.54)	(0.59)	(0.48)	(0.29)	(0.11)
Net realized gains				(0.00)			
Total dividends and distributions on preferred shares	(0.03)	(0.21)	(0.54)	(0.59)	(0.48)	(0.29)	(0.11)
Net increase (decrease) in net assets applicable to common shareholders resulting from investment operations	2.93	(4.48)	(0.81)	0.25	1.29	1.46	0.99
Dividends and Distributions to Common Shareholders from:							
Net investment income	(1.67)	(1.18)	(1.54)	(1.77)	(1.63)	(1.19)	(0.78)
Net realized gains			(0.30)	(0.24)	(0.03)	(0.14)	
Total dividends and distributions to common shareholders	(1.67)	(1.18)	(1.84)	(2.01)	(1.66)	(1.33)	(0.78)

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	Six Months Ended January 31, 2010 (unaudited)	2009	2008	2007	Year ended July 31, 2006	2005	For the Period August 29, 2003* through July 31, 2004
Capital Share Transactions:							
Common stock offering costs charged to paid-in capital in excess of par							(0.04)
Preferred shares offering costs/underwriting discount charged to paid-in capital in excess of par							(0.14)
Total capital share transactions							(0.18)
Net asset value, end of period	$ 10.33	$ 9.07	$ 14.73	$ 17.38	$ 19.14	$ 19.51	$ 19.38
Market price, end of period	$ 11.95	$ 8.98	$ 13.98	$ 17.88	$ 20.02	$ 18.75	$ 20.47
Total Investment Return(1)	53.04%	(25.78)%	(12.26)%	(0.93)%	16.53%	(2.05)%	6.55%
Ratios/Supplemental Data:							
Net assets applicable to common shareholders, end of period (000)	$ 190,861	$ 165,982	$ 269,140	$ 316,289	$ 345,750	$ 351,708	$ 346,749
Ratio of expenses to average net assets, including interest expense(2)(4)	1.59%(5)	2.31%(3)	1.68%(3)	1.68%(3)	1.53%(3)	1.52%(3)	1.36%(3)(5)
Ratio of expenses to average net assets, excluding interest expense(2)	1.52%(5)	2.20%(3)	1.67%(3)	1.55%(3)	1.53%(3)	1.52%(3)	1.36%(3)(5)
Ratio of net investment income to average net assets(2)	14.26%(5)	17.31%	11.18%	11.14%	9.91%	6.93%	4.04%(5)
Preferred shares asset coverage per share	$ 85,408	$ 77,538	$ 57,030	$ 62,622	$ 66,133	$ 66,856	$ 66,274
Portfolio turnover	43%	98%	31%	62%	64%	83%	94%

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* Commencement of operations.

** Initial public offering of $20.00 per share less underwriting discount of $0.65 per share.

Amount less than $0.005 per share.

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

(2) Calculated on the basis of income and expenses applicable to both common shares and Preferred Shares relative to the average net assets attributable to common shares.

(3) Inclusive of expenses offset by custody credits earned on cash balances at the custodian bank. (See note 1(k) in the Notes to Financial Statements in the Fund s July 31, 2009 Annual Report to Shareholders).

(4) Interest expense primarily relates to investments in reverse repurchase agreement transactions.

(5) Annualized.

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

Fiscal Year Ended	Total Amount Outstanding	Asset Coverage per Preferred Share(1)	Involuntary Liquidating Preference per Preferred Share(2)	Average Market Value per Preferred Share(3)
July 31, 2009	$78,975,000	$77,538	$25,000	N/A
July 31, 2008	$210,000,000	$57,030	$25,000	N/A
July 31, 2007	$210,000,000	$62,622	$25,000	N/A
July 31, 2006	$210,000,000	$66,133	$25,000	N/A
July 31, 2005	$210,000,000	$66,856	$25,000	N/A
July 31, 2004(4)	$210,000,000	$66,274	$25,000	N/A

(1) Asset Coverage per Preferred Share means the ratio that the value of the total assets of the Fund, less all liabilities and indebtedness not represented by Preferred Shares, bears to the aggregate of the involuntary liquidation preference of the Preferred Shares, expressed as a dollar amount per Preferred Share.

(2) Involuntary Liquidating Preference per Preferred Share means the amount to which a holder of Preferred Shares would be entitled upon the involuntary liquidation of the Fund in preference to the Common Shareholders, expressed as a dollar amount per Preferred Share.

(3) The Preferred Shares have no readily ascertainable market value. As discussed herein under Use of leverage, auctions for the Preferred Shares have failed since February 2008, there is currently no active trading market for the Preferred Shares and the Fund is not able to reliably estimate what their value would be in a third-party market sale.

(4) Information in this row is for the period from August 29, 2003 through July 31, 2004.

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PURPOSE OF THE OFFER

The Board of Trustees of the Fund (the Board), Allianz Global Investors Fund Management LLC, the Fund s investment manager (AGIFM or the Investment Manager), and Pacific Investment Management Company LLC, the Fund s sub-adviser (PIMCO or the Sub-Adviser), have determined that it would be in the best interests of the Fund and its shareholders to increase the assets of the Fund, in order to more fully take advantage of current and prospective investment opportunities that reflect PIMCO s views regarding the credit markets. Consistent with the changes to the Fund s name and investment policies and guidelines that became effective on March 1, 2010 (see The Fund), the Board, the Investment Manager and the Sub-Adviser believe that there are more attractive opportunities in fixed-rate securities. By increasing assets through the Offer (as defined below), the Fund believes that it will be able to cost-efficiently shift a larger portion of the Fund s investment allocations from floating-rate assets (including floating-rate loans) to fixed-rate instruments, achieve greater portfolio diversification with respect to industries and issuers currently represented in the portfolio (including as an alternative to possibly selling existing holdings that have appreciated in value) and potentially enhance risk-adjusted returns, in pursuit of its investment objective of seeking high current income, consistent with the preservation of capital. The Offer is also intended to enhance the market liquidity of the Fund s common shares, reduce the Fund s expense ratio modestly (not taking into account interest expense) and provide holders of the Fund s common shares (Common Shareholders) with the opportunity to buy additional common shares at a discounted price to then-current market value.

The Offer may not be successful. The completion of the Offer may result in an immediate dilution of the net asset value per common share for all existing Common Shareholders, including those who fully exercise their Rights (as defined below).

IMPORTANT TERMS OF THE OFFER

The Fund is issuing transferable rights (Rights) to its Common Shareholders of record (Record Date Shareholders) as of 5:00 p.m., Eastern time, on March 24, 2010 (the Record Date), entitling the holders of those Rights to subscribe for up to an aggregate of 6,173,000 of the Fund s common shares (the Shares) (the Offer). Record Date Shareholders will receive one Right for each outstanding whole common share of the Fund held on the Record Date. The Rights entitle their holders to purchase one Share for every three Rights held (1-for-3). Fractional Shares will not be issued upon the exercise of Rights; accordingly, Rights may be exercised only in integer multiples of three, except that any Record Date Shareholder who is issued fewer than three Rights may subscribe, at the Subscription Price (as defined on page 34), for one full Share. Assuming the exercise of all Rights, the Offer will result in an approximately 33 $^{1}/3$% increase in the Fund s common shares outstanding.

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

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The Offer

The subscription period commences on March 24, 2010 and ends at 5:00 p.m., Eastern time, on April 23, 2010, unless otherwise extended (the Expiration Date).

The Fund expects to declare a monthly dividend in April 2010. Such dividend will not be payable with respect to Shares that are issued pursuant to the Offer after the record date for such dividend.

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

The Rights are transferable and will be admitted for trading on the New York Stock Exchange (NYSE) under the symbol PFL.RT during the course of the Offer. Trading in the Rights on the NYSE may be conducted until the close of trading on the NYSE on the last business day prior to the Expiration Date. See Sale and Transferability of Rights. The Shares, once issued, will be listed on the NYSE under the symbol PFL. The Rights will be evidenced by subscription certificates which will be mailed to Record Date Shareholders, except as discussed below under Requirements for Foreign Shareholders.

Rights may be exercised by filling in and signing the subscription certificate and mailing it in the envelope provided, or otherwise delivering the completed and signed subscription certificate to The Colbent Corporation, the subscription agent for the offer (the Subscription Agent) together with payment at the estimated Subscription Price for the Shares subscribed for. For a discussion of the method by which Rights may be exercised and Shares may be paid for, see Method for Exercising Rights and Payment for Shares.

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

IMPORTANT DATES TO REMEMBER

Record Date:	March 24, 2010
Subscription Period:	March 24, 2010 through April 23, 2010*
Final Date Rights Will Trade on NYSE:	April 22, 2010*
Expiration Date and Pricing Date:	April 23, 2010*
Payment for Shares Due or Notices of Guarantees of Delivery Due:	April 23, 2010*
Payment for Guarantees of Delivery Due:	April 28, 2010*
Confirmation Mailed to Participants:	May 5, 2010*
Final Payment for Shares Due:	May 19, 2010*

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

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The Offer

SUBSCRIPTION PRICE

The subscription price for the Shares (the Subscription Price) will be determined based on a formula equal to 90% of the average of the last reported sale prices of the Fund s common shares on the NYSE on the Expiration Date and on each of the four preceding trading days (the Formula Price). If, however, the Formula Price is less than 80% of the net asset value per common share on the Expiration Date, then the Subscription Price will be 80% of the Fund s net asset value per common share on the Expiration Date. In each case, net asset value will be calculated as of the close of trading on the NYSE on the applicable day.

Because the Expiration Date of the subscription period will be April 23, 2010 (unless the subscription period is extended), Rights holders may not know the Subscription Price at the time of exercise and will be required initially to pay for both the Shares subscribed for pursuant to the primary subscription and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege at the estimated Subscription Price of $10.77 per Share. See Payment for Shares. A Rights holder will have no right to rescind his subscription after the Subscription Agent has received a completed subscription certificate together with payment for the Shares subscribed for, except as provided under Notice of Net Asset Value Decline. The Fund does not have the right to withdraw the Rights or to cancel the Offer after the Rights have been distributed.

The net asset value per share of the Fund s common shares at the close of business on March 19, 2010 (the last trading date prior to the date of this prospectus on which the Fund determined its net asset value) was $10.74, and the last reported sale price of a common share on the NYSE on that day was $11.97.

OVER-SUBSCRIPTION PRIVILEGE

Record Date Shareholders who exercise all the Rights issued to them (other than those Rights that cannot be exercised because they represent the right to acquire less than one Share) are entitled to subscribe for additional Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations and subject to allotment. If sufficient remaining Shares are available following the primary subscription, all Record Date Shareholders over-subscription requests will be honored in full. Investors who are not Record Date Shareholders, but who otherwise acquire Rights pursuant to the Offer, are not entitled to subscribe for any Shares pursuant to the over-subscription privilege. If sufficient Shares are not available to honor all over-subscription requests, unsubscribed Shares will be allocated pro rata among those Record Date Shareholders who over-subscribe based on the number of common shares of the Fund they owned on the Record Date. The allocation process may involve a series of allocations in order to ensure that the total number of Shares available for over-subscriptions is distributed on a pro rata basis.

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

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

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

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The Fund has been advised that one or more of the officers or employees of the Sub-Adviser may exercise all of the Rights initially issued to them and may request additional Shares pursuant to the over-subscription privilege. An exercise of the over-subscription privilege by such persons will increase their proportionate voting power and share of the Fund s assets.

SALE AND TRANSFERABILITY OF RIGHTS

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

Sales through the Subscription Agent and the Dealer Manager

Record Date Shareholders who do not wish to exercise any of the Rights issued to them pursuant to the Offer may instruct the Subscription Agent to sell any unexercised Rights through or to the Dealer Manager. Subscription certificates representing the Rights to be sold through or to the Dealer Manager must be received by the Subscription Agent by 5:00 p.m., Eastern time, on April 21, 2010 (or, if the subscription period is extended, by 5:00 p.m., Eastern time, on the second business day prior to the extended Expiration Date). Upon the timely receipt by the Subscription Agent of appropriate instructions to sell Rights, the Subscription Agent will ask the Dealer Manager either to purchase them or to use its best efforts to complete their sale, and the Subscription Agent will remit the proceeds of the sale to the selling Rights holder. If the Rights are sold, sales of those Rights will be deemed to have been effected at the weighted average price received by the Dealer Manager on the day those Rights are sold. The sale price of any Rights sold to the Dealer Manager will be based upon the then-current market price for the Rights. The Dealer Manager will also attempt to sell all Rights that remain unclaimed as a result of subscription certificates being returned by the postal authorities to the Subscription Agent as undeliverable as of the fourth business day prior to the Expiration Date. The Subscription Agent will hold the proceeds from those sales for the benefit of those non-claiming Common Shareholders until the proceeds are either claimed or revert to The Commonwealth of Massachusetts. There can be no assurance that the Dealer Manager will purchase or be able to complete the sale of any Rights, and neither the Fund nor the Dealer Manager have guaranteed any minimum sale price for the Rights. If a Record Date Shareholder does not utilize the services of the Subscription Agent and chooses to use another broker-dealer or other financial institution to sell Rights issued to that shareholder pursuant to the Offer, then the other broker-dealer or financial institution may charge a fee to sell the Rights.

Other transfers

The Rights evidenced by a subscription certificate may be transferred in whole by endorsing the subscription certificate for transfer in accordance with the instructions accompanying the subscription certificate. A portion of the Rights evidenced by a single subscription certificate (but not fractional Rights) may be transferred by delivering to the Subscription Agent a subscription certificate properly endorsed for transfer, with instructions to register such portion of the Rights evidenced thereby in the name of the transferee and to issue a new subscription certificate to the transferee evidencing the transferred Rights. If this occurs, a new subscription certificate evidencing the balance of the Rights, if any, will be issued to the Record Date Shareholder or, if the Record Date Shareholder so instructs, to an additional transferee. The signature on the subscription certificate must correspond with the name as written upon the face of the subscription certificate in every particular, without alteration or

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enlargement or any other change. A signature guarantee must be provided by an eligible guarantor institution (as defined in Rule 17Ad-15 of the Securities Exchange Act of 1934).

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

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

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

METHOD FOR EXERCISING RIGHTS

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

Shareholders who are record owners

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

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Investors whose common shares are held by a nominee

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

Nominees

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

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

REQUIREMENTS FOR FOREIGN SHAREHOLDERS

Subscription certificates will not be mailed to Record Date Shareholders whose addresses are outside the United States (for these purposes, the United States includes the District of Columbia and the territories and possessions of the United States) (Foreign Shareholders). The Subscription Agent will send a letter via regular mail to Foreign Shareholders to notify them of the Offer. The Rights of Foreign Shareholders will be held by the Subscription Agent for their accounts until instructions are received to exercise the Rights. If instructions have not been received by 5:00 p.m., Eastern time, on April 20, 2010, three business days prior to the Expiration Date (or, if the subscription period is extended, on or before the third business day prior to the extended Expiration Date), the Rights of Foreign Shareholders will be transferred by the Subscription Agent to the Dealer Manager, who will either purchase the Rights or use its best efforts to sell the Rights. The net proceeds, if any, from the sale of those Rights by or to the Dealer Manager will be remitted to those Foreign Shareholders.

DISTRIBUTION ARRANGEMENTS

UBS Securities LLC will act as Dealer Manager for this Offer. Under the terms and subject to the conditions contained in the Dealer Manager Agreement among the Dealer Manager, the Fund and the Investment Manager, the Dealer Manager will provide financial structuring services in connection with the Offer and will solicit the exercise of Rights and participation in the over-subscription privilege. The Fund has agreed to pay the Dealer Manager a fee for its financial structuring and soliciting services equal to 3.50% of the aggregate Subscription Price for the Shares issued pursuant to the exercise of Rights and the over-subscription privilege. The fees paid to the Dealer Manager and other expenses of the Offer will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights.

The Dealer Manager will reallow a portion of its fees to other broker-dealers who have assisted in soliciting the exercise of Rights. The Dealer Manager will reallow to broker-dealers included in the selling group to be formed and managed by the Dealer Manager selling fees equal to 2.50% of the Subscription Price per share for each Share issued pursuant to the Offer as a result of their selling efforts.

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In addition, the Dealer Manager will reallow to other broker-dealers that have executed and delivered a soliciting dealer agreement and have solicited the exercise of Rights solicitation fees equal to 0.50% of the Subscription Price per Share for each Share issued pursuant to exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of Shares held by each broker-dealer through DTC on the Record Date. Fees will be paid to the broker-dealer designated on the applicable portion of each subscription certificate or, in the absence of such designation, to the Dealer Manager.

In addition to the fees noted above, the Fund also has agreed to reimburse the Dealer Manager for its reasonable expenses incurred in connection with its activities under the Dealer Manager Agreement in an amount up to $100,000.

The Fund and the Investment Manager have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act of 1933, as amended (the Securities Act). The Dealer Manager Agreement also provides that the Dealer Manager will not be subject to any liability to the Fund in rendering the services contemplated by the Dealer Manager Agreement except for any act of bad faith, willful misconduct or gross negligence of the Dealer Manager or reckless disregard by the Dealer Manager of its obligations and duties under the Dealer Manager Agreement.

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

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

The principal business address of UBS Securities LLC is 299 Park Avenue, New York, New York 10171.

SUBSCRIPTION AGENT

The Colbent Corporation is the Subscription Agent for the Offer. The Subscription Agent will receive for its administrative, processing, invoicing and other services a fee estimated to be approximately $22,500, plus reimbursement for all out-of-pocket expenses related to the Offer. The fees and expenses of the Subscription Agent are included in the fees and expenses of the Offer and therefore will be borne by the Fund and indirectly by all Common Shareholders, including those who do not exercise their Rights. Questions regarding the subscription certificates should be directed by mail to The Colbent Corporation, Rights Offering, Attn: Corporate Actions, P.O. Box 859208, Braintree, MA 02185-9208. **Shareholders may also subscribe for the Offer by contacting their broker dealer, trust company, bank or other nominee.**

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

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business on the third business day after the Expiration Date following timely receipt of a notice of guaranteed delivery. See Payment for Shares.

Subscription Certificate Delivery Method	Address/Number
Notice of Guaranteed Delivery:	Contact your broker-dealer, trust company, bank or other nominee to notify the Fund of your intent to exercise the Rights.
First Class Mail Only (No Express Mail or Overnight Courier):	The Colbent Corporation Rights Offering Attn: Corporate Actions P.O. Box 859208 Braintree, MA 02185-9208
Hand:	The Colbent Corporation Rights Offering Attn: Corporate Actions 161 Bay State Road Braintree, MA 02184
Express Mail or Overnight Courier:	The Colbent Corporation Rights Offering Attn: Corporate Actions 161 Bay State Road Braintree, MA 02184

The Fund will honor only subscription certificates received by the Subscription Agent prior to 5:00 p.m., Eastern time, on the Expiration Date at one of the addresses listed above. Delivery to an address other than those listed above will not constitute good delivery.

INFORMATION AGENT

The Information Agent for the Offer is The Altman Group. If you have questions or need further information about the Offer, please write the Information Agent at 60 East 42nd Street, Suite 916, New York, NY 10165 or call (866) 207-3647. Any questions or requests for assistance concerning the method of subscribing for Shares or additional copies of this prospectus or subscription certificates should be directed to the Information Agent. Shareholders may also contact their brokers or nominees for information with respect to the Offer.

The Information Agent will receive a fee estimated to be approximately $7,500 for its services, plus reimbursement for all out-of-pocket expenses related to the Offer. The fees and expenses of the Information Agent are included in the fees and expenses of the Offer and therefore will be borne by the Fund and indirectly by all of its Common Shareholders, including those who do not exercise their Rights.

EXPIRATION OF THE OFFER

The Offer will expire at 5:00 p.m., Eastern time, on April 23, 2010, unless the Fund extends the subscription period. Rights will expire on the Expiration Date and may not be exercised after that date. If the Fund extends the subscription period, the Fund will make an announcement as promptly as practicable. This announcement will be issued no later than 9:00 a.m., Eastern time, on the next business day following the previously scheduled Expiration Date. Without limiting the manner in which the Fund may choose to make this announcement, the Fund will not, unless otherwise required by law, have any obligation to publish, advertise or otherwise communicate this announcement other than by making a

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release to the Dow Jones News Service or any other means of public announcement as the Fund may deem proper.

PAYMENT FOR SHARES

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

(1) A Rights holder can send the properly completed and executed subscription certificate together with payment for the Shares subscribed for during the subscription period and, if eligible, for any additional Shares subscribed for pursuant to the over-subscription privilege to the Subscription Agent based upon an estimated Subscription Price of $10.77 per Share. A subscription will be accepted when payment, together with the executed subscription certificate, is received by the Subscription Agent at one of the addresses set forth under Subscription Agent; the payment and the properly completed and executed subscription certificate must be received by the Subscription Agent by 5:00 p.m., Eastern time, on the Expiration Date. The Subscription Agent will deposit all checks received by it for the purchase of Shares into a segregated interest-bearing account of the Fund (the interest from which will belong to the Fund) pending proration and distribution of Shares. A payment pursuant to this method must be in U.S. dollars by money order or check drawn on a bank located in the United States, must be payable to PIMCO Income Strategy Fund and must accompany a properly completed and executed subscription certificate for such subscription to be accepted.

(2) Alternatively, a subscription will be accepted by the Subscription Agent if, by 5:00 p.m., Eastern time, on the Expiration Date, the Subscription Agent has received a notice of guaranteed delivery by facsimile (telecopy) or otherwise from a bank, a trust company or an NYSE member guaranteeing delivery of (i) payment of the full Subscription Price for the Shares subscribed for during the subscription period and, if eligible, any additional Shares subscribed for pursuant to the over-subscription privilege and (ii) a properly completed and executed subscription certificate. The Subscription Agent will not honor a notice of guaranteed delivery unless a properly completed and executed subscription certificate and full payment for the Shares at the estimated Subscription Price are received by the Subscription Agent by the close of business on the third business day after the Expiration Date.

On the confirmation date, which will be eight business days following the Expiration Date, a confirmation will be sent by the Subscription Agent to each Rights holder exercising its Rights (or, if a Rights holder s common shares are held by DTC or any other depository or nominee, to DTC and/or that other depository or nominee) showing (i) the number of Shares acquired during the subscription period, (ii) the number of Shares, if any, acquired pursuant to the over-subscription privilege, (iii) the per Share and total purchase price for the Shares and (iv) any additional amount payable to the Fund by the Rights holder or any excess to be refunded by the Fund to the Rights holder, in each case based on the Subscription Price as determined on the Expiration Date. Any additional payment required from a Rights holder must be received by the Subscription Agent within ten business days after the confirmation date (May 19, 2010, unless the subscription period is extended). Any excess payment to be refunded by the Fund to a Rights holder will be mailed by the Subscription Agent to such Rights holder as promptly as practicable. All payments by a Rights holder must be in U.S. dollars by money order or check drawn on a bank located in the United States and payable to PIMCO Income Strategy Fund.

Whichever of the two methods described above is used, issuance and delivery of the Shares subscribed for are contingent upon actual payment for such Shares. No certificates will be issued or delivered with respect to Shares issued and sold in the Offer.

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

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

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

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

NOTICE OF NET ASSET VALUE DECLINE

The Fund has, pursuant to the Securities and Exchange Commission s regulatory requirements, undertaken to suspend the Offer until the Fund amends this prospectus if, after March 18, 2010, the effective date of the Fund s Registration Statement, the Fund s net asset value declines more than 10% from the Fund s net asset value as of that date. In that event, the Expiration Date will be extended and the Fund will notify Record Date Shareholders of any such decline and permit Rights holders to cancel their exercise of Rights.

DELIVERY OF SHARES

Participants in the Fund s dividend reinvestment plan (the Plan) will have any Shares acquired pursuant to the Offer credited to their shareholder dividend reinvestment accounts in the Plan. Common Shareholders whose shares are held of record by DTC or by any other depository or nominee on their behalf or their broker-dealers behalf will have any Shares acquired during the subscription period credited to the account of DTC or other depository or nominee. No certificates will be issued or delivered with respect to Shares issued and sold in the Offer.

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U.S. FEDERAL INCOME TAX CONSEQUENCES

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

The Fund believes that the value of a Right will not be includible in the income of a Record Date Shareholder at the time the Right is issued, and the Fund will not report to the Internal Revenue Service (IRS) that a Record Date Shareholder has income as a result of the issuance of the Right; however, there is no guidance directly on point concerning certain aspects of the Offer. The remainder of this discussion assumes that the receipt of the Rights by Record Date Shareholders will not be a taxable event for U.S. federal income tax purposes.

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

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

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

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

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

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EMPLOYEE PLAN CONSIDERATIONS

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

Plans also should be aware that if they borrow in order to finance their exercise of Rights, they may become subject to the tax on unrelated business taxable income (UBTI) under Section 511 of the Code. If any portion of an individual retirement account (IRA) is used as security for a loan, the portion so used also is treated as distributed to the IRA depositor.

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

BENEFITS TO THE INVESTMENT MANAGER AND THE SUB-ADVISER

The Investment Manager and the Sub-Adviser will benefit from the Offer, in part, because the investment management fee paid by the Fund to the Investment Manager and the subadvisory fee paid by the Investment Manager to the Sub-Adviser are based on the Fund s average weekly total managed assets. It is not possible to state precisely the amount of additional compensation the Investment Manager and the Sub-Adviser will receive as a result of the Offer because it is not known how many Shares of the Fund will be subscribed for and because the proceeds of the Offer will be invested in additional portfolio securities which will fluctuate in value. However, assuming (i) all Rights are exercised, (ii) the Fund s average weekly net asset value during the twelve-month period beginning May 1, 2010 is $10.74 per common share (the net asset value per common share on March 19, 2010) (iii) the Subscription Price is $10.77 per Share (90% of the last reported sale price of the Fund s common shares on March 19, 2010), and (iv) for purposes of this example, the Fund increases the amount of leverage outstanding (through the use of reverse repurchase agreements) while maintaining approximately the same percentage of total assets attributable to leverage, and after giving effect to Dealer Manager fee and other estimated offering expenses, the Investment Manager and the Sub-Adviser would receive additional investment management fees (after payment of the subadvisory fees) and subadvisory fees of approximately $168,052 and $462,145, respectively, for the twelve-month period beginning May 1, 2010, and would continue to receive additional investment management fees and subadvisory fees, respectively, as a result of the Offer, based on the Fund s average weekly total managed assets attributable to the Shares issued in the Offer and related additional leverage, thereafter.

INVESTMENT CONSIDERATIONS AND DILUTION

Upon completion of the Offer, Common Shareholders who do not exercise their Rights fully will own a smaller proportional interest in the Fund than would be the case if the Offer had not been made. In addition, because the Subscription Price per Share is likely to be less than the Fund s net asset value per common share, the Offer will likely result in a dilution of the Fund s net asset value per common share

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for all Common Shareholders, irrespective of whether they exercise all or any portion of their Rights. Although it is not possible to state precisely the amount of such a decrease in value, because it is not known at this time what the Subscription Price will be, what the net asset value per common share will be on the Expiration Date or what proportion of Shares will be subscribed for, the dilution could be substantial. For example, assuming that all Rights are exercised, that the Fund s net asset value on the Expiration Date is $10.74 per common share (the net asset value per common share on March 19, 2010), and that the Subscription Price is $10.77 per Share (90% of the last reported sale price of the Fund s common shares on March 19, 2010), the Fund s net asset value per common share on this date would be reduced by approximately $0.11 per common share, after giving effect to the estimated Dealer Manager fee of $2,826,912 and to other estimated offering expenses of $500,000, each payable by the Fund. Record Date Shareholders will experience a decrease in the net asset value per common share held by them, irrespective of whether they exercise all or any portion of their Rights. The distribution of transferable Rights, which may themselves have value, will afford non-participating Common Shareholders the potential of receiving a cash payment upon the sale of the Rights, receipt of which may be viewed as partial compensation for the economic dilution of their interests, although there can be no assurance that a market for the Rights will develop.

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Use of proceeds

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

The Fund

The Fund is a diversified closed-end management investment company. The Fund was organized as a Massachusetts business trust on June 19, 2003, pursuant to an Agreement and Declaration of Trust governed by the laws of The Commonwealth of Massachusetts. The Fund commenced investment operations on August 29, 2003, following the initial public offering of its common shares. The Fund s principal office is located at 1345 Avenue of the Americas, New York, New York 10105 and its telephone number is (800) 254-5197.

Effective March 1, 2010, the Fund changed its name from PIMCO Floating Rate Income Fund to its current name, PIMCO Income Strategy Fund, and rescinded its prior policy to normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in floating-rate assets. The Fund also recently revised various of its investment guidelines and strategies (including those relating to average portfolio duration, investments in below investment grade securities and exposure to emerging market securities) to those reflected in this prospectus. In this regard, the Fund s investments and performance results under its new policies, guidelines and strategies are likely to differ, and perhaps substantially, from those it has made and achieved in the past.

Investment objective and policies

INVESTMENT OBJECTIVE

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

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

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

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Investment objective and policies

INVESTMENT STRATEGIES

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

Credit quality

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

Independent credit analysis

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

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Investment objective and policies

Duration

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

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

Portfolio contents

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

The Fund may also hold up to 20% of its total assets in common stocks and other equity securities from time to time, including those it has received through the conversion of a convertible security held by the Fund or in connection with the restructuring of a debt security. The Fund may invest in securities that have not been registered for public sale, including securities eligible for purchase and sale pursuant to Rule 144A under the Securities Act and other securities issued in private placements. The Fund may also invest in securities of other investment companies, including exchange-traded funds (ETFs). The Fund may invest in securities of companies with small market capitalizations.

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

The Fund has a policy not to concentrate investments in any particular industry, but may (consistent with that policy) invest up to 25% of its assets in any particular industry, and may invest a substantial portion of its assets in companies in related sectors, such as those in the banking or financial services sectors, which may share common characteristics and are often subject to similar business risks and regulatory burdens.

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

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

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

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

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

The following provides information regarding certain types of securities and other instruments in which the Fund ordinarily may invest. Additional information regarding these and other instruments and investment techniques that may be used by the Fund is provided under Investment Objective and Policies in the Statement of Additional Information.

HIGH YIELD SECURITIES (JUNK BONDS)

The Fund may invest without limit in debt securities that are rated below investment grade (below Baa by Moody s or below BBB by either S&P or Fitch) or unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 20% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. Below investment grade securities are commonly referred to as

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Portfolio contents

high yield securities or junk bonds. High yield securities involve a greater degree of risk (in particular, a greater risk of default) than, and special risks in addition to the risks associated with, investment grade debt obligations. While offering a greater potential opportunity for capital appreciation and higher yields, high yield securities typically entail greater potential price volatility and may be less liquid than higher-rated securities. High yield securities may be regarded as predominantly speculative with respect to the issuer s continuing ability to make timely principal and interest payments. They also may be more susceptible to real or perceived adverse economic and competitive industry conditions than higher-rated securities. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain ratings agencies.

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

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

Credit ratings and unrated securities

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

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

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VARIABLE- AND FLOATING-RATE SECURITIES

Variable- and floating-rate instruments are instruments that pay interest at rates that adjust whenever a specified interest rate changes and/or that reset on predetermined dates (such as the last day of a month or calendar quarter). In addition to Floating-Rate Loans, variable- and floating-rate instruments may include, without limitation, instruments such as catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities. Due to their variable- or floating-rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a variable- or floating-rate instrument is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed-rate instrument, although the value of a variable- or floating-rate instrument may nonetheless decline as interest rates rise and due to other factors, such as changes in credit quality.

The Fund also may engage in credit spread trades. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, in which the value of the investment position is determined by changes in the difference between the prices or interest rates, as the case may be, of the respective securities. The Fund may also invest in inverse floating-rate debt instruments (inverse floaters). An inverse floater may exhibit greater price volatility than a fixed-rate obligation of similar credit quality.

FLOATING-RATE AND OTHER BANK LOANS

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

As noted, the Fund may purchase assignments of bank loans from lenders. The purchaser of an assignment typically succeeds to all the rights and obligations under the loan agreement with the same rights and obligations as the assigning lender. Assignments may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning lender.

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

The Floating-Rate Loans in which the Fund may invest typically pay interest at rates that are re-determined periodically on the basis of a floating base lending rate (such as LIBOR) plus a premium. Although Floating-Rate Loans are typically of below investment grade quality (*i.e.*, high yield securities), they tend to have more favorable recovery rates than other types of below investment grade quality debt obligations. Floating-Rate Loans may hold a senior position in the capital structure of a borrower and are often secured with collateral. A Floating-Rate Loan is typically originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other

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financial institution (the Agent) for a lending syndicate of financial institutions (Lenders). The Agent typically administers and enforces the Floating-Rate Loan on behalf of the other Lenders in the syndicate. In addition, an institution, typically but not always the Agent, holds any collateral on behalf of the Lenders. A financial institution s employment as an Agent might be terminated in the event that it fails to observe a requisite standard of care or becomes insolvent. A successor Agent would generally be appointed to replace the terminated Agent, and assets held by the Agent under the loan agreement would likely remain available to holders of such indebtedness. However, if assets held by the Agent for the benefit of the Fund were determined to be subject to the claims of the Agent s general creditors, the Fund might incur certain costs and delays in realizing payment on a loan or loan participation and could suffer a loss of principal and/or interest. In situations involving other interposed financial institutions (*e.g.*, an insurance company or government agency) similar risks may arise.

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

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

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

DELAYED FUNDING LOANS AND REVOLVING CREDIT FACILITIES

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

BANK CAPITAL SECURITIES AND BANK OBLIGATIONS

The Fund may invest in bank capital securities. Bank capital securities are issued by banks to help fulfill their regulatory capital requirements. There are three common types of bank capital: Lower Tier II,

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Upper Tier II and Tier I. Bank capital is generally, but not always, of investment grade quality. Upper Tier II securities are commonly thought of as hybrids of debt and preferred stock. Upper Tier II securities are often perpetual (with no maturity date), callable and have a cumulative interest deferral feature. This means that under certain conditions, the issuer bank can withhold payment of interest until a later date. However, such deferred interest payments generally earn interest. Tier I securities often take the form of trust preferred securities.

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

BONDS

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

COMMERCIAL PAPER

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

PREFERRED SECURITIES

Preferred securities represent an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from liquidation of the company. Unlike common stocks, preferred stocks usually do not have voting rights. Preferred stocks in some instances are convertible into common stock. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company s common stock, and thus also represent an ownership interest in the company. Some preferred stocks offer a fixed rate of return with no maturity date. Because they never mature, these preferred stocks act like long-term bonds, can be more volatile than other types of preferred stocks and may have heightened sensitivity to changes in interest rates. Other preferred stocks have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction process, involving bids submitted by holders and prospective purchasers of such stocks. Although they are equity securities, preferred securities have certain characteristics of both debt securities and common stock. They are like debt

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securities in that their stated income is generally contractually fixed. They are like common stocks in that they do not have rights to precipitate bankruptcy proceedings or collection activities in the event of missed payments. Furthermore, preferred securities have many of the key characteristics of equity due to their subordinated position in an issuer s capital structure and because their quality and value are heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows. Because preferred securities represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt instruments to actual or perceived changes in a company s financial condition or prospects, or to fluctuations in the equity markets.

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

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

CONVERTIBLE SECURITIES AND SYNTHETIC CONVERTIBLE SECURITIES

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

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

The Fund may invest in synthetic convertible securities, which are created through a combination of separate securities that possess the two principal characteristics of a traditional convertible security, that

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is, an income-producing security (income-producing component) and the right to acquire an equity security (convertible component). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by purchasing warrants or options to buy common stock at a certain exercise price, or options on a stock index. The Fund may also purchase synthetic securities created by other parties, typically investment banks, including convertible structured notes. The income-producing and convertible components of a synthetic convertible security may be issued separately by different issuers and at different times. The values of synthetic convertible securities will respond differently to market fluctuations than a traditional convertible security because a synthetic convertible is composed of two or more separate securities or instruments, each with its own market value. Synthetic convertible securities are also subject to the risks associated with derivatives. See Principal risks of the Fund Derivatives Risk. In addition, if the value of the underlying common stock or the level of the index involved in the convertible element falls below the strike price of the warrant or option, the warrant or option may lose all value.

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

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

FOREIGN (NON-U.S.) INVESTMENTS

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers or supranational government agencies. The Fund may invest up to 25% of its total assets in securities denominated in foreign currencies, including sovereign debt issued by foreign developed and emerging market governments and their respective sub-divisions, agencies or instrumentalities, government sponsored enterprises and supranational government entities. Supranational entities include international organizations that are organized or supported by one or more government entities to promote economic reconstruction or development and by international banking institutions and related governmental agencies. As a holder of sovereign debt, the Fund may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. In addition, there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. Investing in foreign securities involves special risks and considerations not typically associated with investing in U.S. securities. See Principal risks of the Fund Foreign (Non-U.S.) Investment Risk.

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

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

EMERGING MARKET SECURITIES

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

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

FOREIGN CURRENCIES AND RELATED TRANSACTIONS

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

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denominated in foreign currencies. Suitable hedging transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in such transactions at any given time or from time to time when they would be beneficial. Although PIMCO has the flexibility to engage in such transactions for the Fund, it may determine not to do so or to do so only in unusual circumstances or market conditions. Also, these transactions may not be successful and may eliminate any chance for the Fund to benefit from favorable fluctuations in relevant foreign currencies.

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

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

DERIVATIVES

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

CREDIT DEFAULT SWAPS

The Fund may enter into credit default swaps for both investment and risk management purposes, as well as to add leverage to the Fund s portfolio. A credit default swap may have as reference obligations one or more securities that are not currently held by the Fund. The protection buyer in a credit default swap is generally obligated to pay the protection seller an upfront or a periodic stream of payments over the term of the contract provided that no credit event, such as a default, on a reference obligation has occurred. If a credit event occurs, the seller generally must pay the buyer the par value (full notional value) of the swap in exchange for an equal face amount of deliverable obligations of the reference entity described in the swap, or the seller may be required to deliver the related net cash amount, if the swap is cash settled. The Fund may be either the buyer or seller in the transaction. If the

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Fund is a buyer and no credit event occurs, the Fund may recover nothing if the swap is held through its termination date. However, if a credit event occurs, the buyer generally may elect to receive the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity whose value may have significantly decreased. As a seller, the Fund generally receives an upfront payment or a fixed rate of income throughout the term of the swap provided that there is no credit event. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total net assets, the Fund would be subject to investment exposure on the notional amount of the swap.

The spread of a credit default swap is the annual amount the protection buyer must pay the protection seller over the length of the contract, expressed as a percentage of the notional amount. When spreads rise, market perceived credit risk rises and when spreads fall, market perceived credit risk falls. Wider credit spreads and decreasing market values, when compared to the notional amount of the swap, represent a deterioration of the referenced entity s credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement. For credit default swaps on asset-backed securities and credit indices, the quoted market prices and resulting values, as well as the annual payment rate, serve as an indication of the current status of the payment/performance risk.

Credit default swaps involve greater risks than if the Fund had invested in the reference obligation directly since, in addition to general market risks, credit default swaps are subject to illiquidity risk, counterparty risk and credit risk. The Fund will enter into credit default swaps only with counterparties that meet certain standards of creditworthiness. A buyer generally also will lose its investment and recover nothing should no credit event occur and the swap is held to its termination date. If a credit event were to occur, the value of any deliverable obligation received by the seller, coupled with the upfront or periodic payments previously received, may be less than the full notional value it pays to the buyer, resulting in a loss of value to the seller. The Fund s obligations under a credit default swap will be accrued daily (offset against any amounts owing to the Fund). In connection with credit default swaps in which the Fund is the buyer, the Fund will segregate or earmark cash or liquid assets, or enter into certain offsetting positions, with a value at least equal to the Fund s exposure (any accrued but unpaid net amounts owed by the Fund to any counterparty), on a marked-to-market basis. In connection with credit default swaps in which the Fund is the seller, the Fund will segregate or earmark cash or liquid assets, or enter into offsetting positions, with a value at least equal to the full notional amount of the swap (minus any amounts owed to the Fund). Such segregation or earmarking will ensure that the Fund has assets available to satisfy its obligations with respect to the transaction and will limit any potential leveraging of the Fund s portfolio. Such segregation or earmarking will not limit the Fund s exposure to loss.

HYBRID INSTRUMENTS

A hybrid instrument is a type of potentially high-risk derivative that combines a traditional stock, bond or commodity with an option or forward contract. Generally, the principal amount, amount payable upon maturity or redemption, or interest rate of a hybrid is tied (positively or negatively) to the price of some commodity, currency or securities index or another interest rate or some other economic factor (each a benchmark). The interest rate or (unlike most fixed income securities) the principal amount payable at maturity of a hybrid security may be increased or decreased, depending on changes in the value of the benchmark. An example of a hybrid could be a bond issued by an oil company that pays a small base level of interest with additional interest that accrues in correlation to the extent to which oil prices exceed a certain predetermined level. Such a hybrid instrument would be a combination of a bond and a call option on oil.

Hybrids can be used as an efficient means of pursuing a variety of investment goals, including currency hedging, duration management and increased total return. Hybrids may not bear interest or pay

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

Certain hybrid instruments may provide exposure to the commodities markets. These are derivative securities with one or more commodity-linked components that have payment features similar to commodity futures contracts, commodity options or similar instruments. Commodity-linked hybrid instruments may be either equity or debt securities, leveraged or unleveraged, and are considered hybrid instruments because they have both security and commodity-like characteristics. A portion of the value of these instruments may be derived from the value of a commodity, futures contract, index or other economic variable.

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

STRUCTURED NOTES AND RELATED INSTRUMENTS

The Fund may invest in structured notes and other related instruments, which are privately negotiated debt obligations in which the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate (an embedded index), such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Structured instruments may be issued by corporations, including banks, as well as by governmental agencies. Structured instruments frequently are assembled in the form of medium-term notes, but a variety of forms are available and may be used in particular circumstances. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards to reflect changes in the embedded index while the structured instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely, depending on a variety of factors, including the volatility of the embedded index and the effect of changes in the embedded index on principal and/or interest payments. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss.

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

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embedded index changes in a manner other than that expected by PIMCO, principal and/or interest payments received on the structured instrument may be substantially less than expected. Also, if PIMCO uses structured instruments to reduce the duration of the Fund s portfolio, this may limit the Fund s return when having a longer duration would be beneficial (for instance, when interest rates decline).

MORTGAGE-RELATED AND OTHER ASSET-BACKED SECURITIES

The Fund may invest in mortgage-related or other asset-backed securities. Mortgage-related securities include mortgage pass-through securities, collateralized mortgage obligations (CMOs), commercial mortgage-backed securities (CMBSs), mortgage dollar rolls, CMO residuals, adjustable rate mortgage-backed securities (ARMBSs), stripped mortgage-backed securities (SMBSs) and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property.

Mortgage pass-through securities

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

The rate of pre-payments on underlying mortgages will affect the price and volatility of a mortgage-related security, and may have the effect of shortening or extending the effective duration of the security relative to what was anticipated at the time of purchase. To the extent that unanticipated rates of prepayment on underlying mortgages increase the effective duration of a mortgage-related security, the volatility of such security can be expected to increase. The residential mortgage market in the United States recently has experienced difficulties that may adversely affect the performance and market value of mortgage-related investments. Delinquencies and losses on residential mortgage loans (especially subprime and second-lien mortgage loans) generally have increased recently and may continue to increase, and a decline in or flattening of housing values (as has recently been experienced and may continue to be experienced in many housing markets) may exacerbate such delinquencies and losses. Borrowers with adjustable-rate mortgage loans are more sensitive to changes in interest rates, which affect their monthly mortgage payments, and may be unable to secure replacement mortgages at comparably low interest rates. Also, a number of residential mortgage loan originators have recently experienced serious financial difficulties or bankruptcy. Owing largely to the foregoing, reduced investor demand for mortgage loans and mortgage-related securities and increased investor yield requirements have caused limited liquidity in the secondary market for mortgage-related securities, which can adversely affect the market value of mortgage-related securities. It is possible that such limited liquidity in such secondary markets could continue or worsen.

The principal governmental guarantor of mortgage-related securities is GNMA. GNMA is a wholly owned U.S. Government corporation within the Department of Housing and Urban Development. GNMA is authorized to guarantee, with the full faith and credit of the U.S. Government, the timely payment of principal and interest on securities issued by institutions approved by GNMA (such as

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savings and loan institutions, commercial banks and mortgage bankers) and backed by pools of mortgages insured by the Federal Housing Administration (the FHA), or guaranteed by the Department of Veterans Affairs (the VA). Government-related guarantors (*i.e.*, not backed by the full faith and credit of the U.S. Government) include the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). FNMA is a government-sponsored corporation the common stock of which is owned entirely by private stockholders. FNMA purchases conventional (*i.e.*, not insured or guaranteed by any government agency) residential mortgages from a list of approved seller/servicers which include state and federally chartered savings and loan associations, mutual savings banks, commercial banks and credit unions and mortgage bankers. Pass-through securities issued by FNMA are guaranteed as to timely payment of principal and interest by FNMA, but are not backed by the full faith and credit of the U.S. Government. FHLMC was created by Congress in 1970 for the purpose of increasing the availability of mortgage credit for residential housing. It is a government-sponsored corporation formerly owned by the twelve Federal Home Loan Banks but the common stock of which is now owned entirely by private stockholders. FHLMC issues Participation Certificates (PCs), which are pass-through securities, each representing an undivided interest in a pool of residential mortgages. FHLMC guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. Government.

On September 6, 2008, the Federal Housing Finance Agency (FHFA) placed FNMA and FHLMC into conservatorship. As the conservator, FHFA succeeded to all rights, titles, powers and privileges of FNMA and FHLMC and of any stockholder, officer or director of FNMA and FHLMC with respect to FNMA and FHLMC and the assets of FNMA and FHLMC. FNMA and FHLMC continue to operate as going concerns while in conservatorship, and each remains liable for all of its obligations, including its guaranty obligations, associated with its mortgage-backed securities. For more information regarding the mechanics and effects of such conservatorships, see Investment Objective and Policies Mortgage-Related and Other Asset-Backed Securities in the Statement of Additional Information.

Commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers also create pass-through pools of conventional residential mortgage loans. Such issuers may be the originators and/or servicers of the underlying mortgage loans as well as the guarantors of the mortgage-related securities. Pools created by such non-governmental issuers generally offer a higher rate of interest than government and government-related pools because there are no direct or indirect government or agency guarantees of payments in the former pools. However, timely payment of interest and principal of these pools may be supported by various forms of insurance or guarantees, including individual loan, title, pool and hazard insurance and letters of credit, which may be issued by governmental entities or private insurers. Such insurance and guarantees and the creditworthiness of the issuers thereof will be considered in determining whether a mortgage-related security meets the Fund s investment quality standards. There can be no assurance that the private insurers or guarantors can meet their obligations under the insurance policies or guarantee arrangements. The Fund may buy mortgage-related securities without insurance or guarantees if, through an examination of the loan experience and practices of the originators/servicers and poolers, PIMCO determines that the securities meet the Fund s quality standards. Securities issued by certain private organizations may not be readily marketable.

Collateralized mortgage obligations

A CMO is a debt obligation of a legal entity that is collateralized by mortgages and divided into classes. Similar to a bond, interest and prepaid principal is paid, in most cases, on a monthly basis. CMOs may be collateralized by whole mortgage loans or private mortgage bonds, but are more typically collateralized by portfolios of mortgage pass-through securities guaranteed by GNMA, FHLMC or

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FNMA and their income streams. CMOs are structured into multiple classes, often referred to as tranches, with each class bearing a different stated maturity and entitled to a different schedule for payments of principal and interest, including prepayments. Actual maturity and average life will depend upon the pre-payment experience of the collateral. In the case of certain CMOs (known as sequential pay CMOs), payments of principal received from the pool of underlying mortgages, including prepayments, are applied to the classes of CMOs in the order of their respective final distribution dates. Thus, no payment of principal will be made to any class of sequential pay CMOs until all other classes having an earlier final distribution date have been paid in full. CMOs may be less liquid and may exhibit greater price volatility than other types of mortgage- or asset-backed securities.

Commercial mortgage-backed securities

CMBSs include securities that reflect an interest in, and are secured by, mortgage loans on commercial real property. Many of the risks of investing in commercial mortgage-backed securities reflect the risks of investing in the real estate securing the underlying mortgage loans. These risks reflect the effects of local and other economic conditions on real estate markets, the ability of tenants to make loan payments and the ability of a property to attract and retain tenants. Commercial mortgage-backed securities may be less liquid and exhibit greater price volatility than other types of mortgage- or asset-backed securities.

Mortgage dollar rolls

A mortgage dollar roll is similar to a reverse repurchase agreement in certain respects. In a dollar roll transaction, the Fund sells a mortgage-related security to a dealer and simultaneously agrees to repurchase a similar security (but not the same security) in the future at a predetermined price. A dollar roll can be viewed, like a reverse repurchase agreement, as a collateralized borrowing in which the Fund pledges a mortgage-related security to a dealer to obtain cash. However, unlike reverse repurchase agreements, the dealer with which the Fund enters into a dollar roll transaction is not obligated to return the same securities as those originally sold by the Fund, but only securities which are substantially identical. To be considered substantially identical, the securities returned to the Fund generally must: (1) be collateralized by the same types of underlying mortgages; (2) be issued by the same agency and be part of the same program; (3) have a similar original stated maturity; (4) have identical net coupon rates; (5) have similar market yields (and therefore price); and (6) satisfy good delivery requirements, meaning that the aggregate principal amounts of the securities delivered and received back must be within 2.5% of the initial amount delivered.

CMO residuals

CMO residuals are mortgage securities issued by agencies or instrumentalities of the U.S. Government or by private originators of, or investors in, mortgage loans, including savings and loan associations, homebuilders, mortgage banks, commercial banks, investment banks and special purpose entities of the foregoing. The cash flow generated by the mortgage assets underlying a series of a CMO is applied first to make required payments of principal and interest on the CMO and second to pay the related administrative expenses and any management fee of the issuer. The residual in a CMO structure generally represents the interest in any excess cash flow remaining after making the foregoing payments. Each payment of such excess cash flow to a holder of the related CMO residual represents income and/or a return of capital. The amount of residual cash flow resulting from a CMO will depend on, among other things, the characteristics of the mortgage assets, the coupon rate of each class of CMO, prevailing interest rates, the amount of administrative expenses and the prepayment experience on the mortgage assets. In particular, the yield to maturity on CMO residuals is extremely sensitive to prepayments on the related underlying mortgage assets, in the same manner as an interest-only (IO) class of stripped mortgage-backed securities (described below). In addition, if a series of a CMO includes a class that

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bears interest at an adjustable rate, the yield to maturity on the related CMO residual will also be extremely sensitive to changes in the level of the index upon which interest rate adjustments are based. As described below with respect to stripped mortgage-backed securities, in certain circumstances the Fund may fail to recoup fully its initial investment in a CMO residual. CMO residuals are generally purchased and sold by institutional investors through several investment banking firms acting as brokers or dealers. CMO residuals may, or pursuant to an exemption therefrom, may not, have been registered under the Securities Act. CMO residuals, whether or not registered under the Securities Act, may be subject to certain restrictions on transferability.

Adjustable rate mortgage-backed securities

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

Stripped mortgage-backed securities

SMBSs are derivative multi-class mortgage securities. SMBSs may be issued by agencies or instrumentalities of the U.S. Government, or by private originators of, or investors in, mortgage loans, including savings and loan associations, mortgage banks, commercial banks, investment banks and special purpose entities of the foregoing. SMBSs are usually structured with two classes that receive different proportions of the interest and principal distributions on a pool of mortgage assets. A common type of SMBS will have one class receiving some of the interest and most of the principal from the mortgage assets, while the other class will receive most of the interest and the remainder of the principal. In the most extreme case, one class will receive all of the interest (the IO class), while the other class will receive all of the principal (the principal-only or PO class). The yield to maturity on an IO class is extremely sensitive to the rate of principal payments (including prepayments) on the related underlying mortgage assets, and a rapid rate of principal payments may have a material adverse effect on the Fund s yield to maturity from these securities. If the underlying mortgage assets experience greater than anticipated prepayments of principal, the Fund may fail to recoup some or all of its initial investment in these securities even if the security is in one of the highest rating categories.

Collateralized debt obligations

The Fund may invest in collateralized debt obligations (CDOs), which include collateralized bond obligations (CBOs), collateralized loan obligations (CLOs) and other similarly structured securities.

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CBOs and CLOs are types of asset-backed securities. A CBO is a trust which is backed by a diversified pool of high risk, below investment grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans. CDOs may charge management fees and administrative expenses. For both CBOs and CLOs, the cash flows from the trust are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the equity tranche which bears the bulk of defaults from the bonds or loans in the trust and serves to protect the other, more senior tranches from default in all but the most severe circumstances. Since it is partially protected from defaults, a senior tranche from a CBO trust or CLO trust typically has higher ratings and lower yields than the underlying securities, and can be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults and aversion to CBO or CLO securities as a class. The risks of an investment in a CDO depend largely on the type of the collateral securities and the class of the CDO in which the Fund invests. Normally, CBOs, CLOs and other CDOs are privately offered and sold, and thus are not registered under the securities laws. As a result, investments in CDOs may be characterized by the Fund as illiquid securities; however, an active dealer market may exist for CDOs allowing a CDO to qualify under Rule 144A under the Securities Act. In addition to the normal risks associated with fixed income securities discussed elsewhere in this prospectus and in the Statement of Additional Information (*e.g.*, interest rate risk and default risk), CDOs carry additional risks including, but not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the quality of the collateral may decline in value or default; (iii) the Fund may invest in CDOs that are subordinate to other classes; and (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results.

Asset-backed securities

Asset-backed securities (ABS) are bonds backed by pools of loans or other receivables. ABS are created from many types of assets, including auto loans, credit card receivables, home equity loans and student loans. ABS are issued through special purpose vehicles that are bankruptcy remote from the issuer of the collateral. The credit quality of an ABS transaction depends on the performance of the underlying assets. To protect ABS investors from the possibility that some borrowers could miss payments or even default on their loans, ABS include various forms of credit enhancement. Some ABS, particularly home equity loan ABS, are subject to interest rate risk and prepayment risk. A change in interest can affect the pace of payments on the underlying loans, which in turn affects total return on the securities. ABS also carry credit or default risk. If many borrowers on the underlying loans default, losses could exceed the credit enhancement level and result in losses to investors in an ABS. Finally, ABS have structure risk due to a unique characteristic known as early amortization, or early payout, risk. Built into the structure of most ABS are triggers for early payout, designed to protect investors from losses. These triggers are unique to each transaction and can include: a big rise in defaults on the underlying loans, a sharp drop in the credit enhancement level or even the bankruptcy of the originator. Once early amortization begins, all incoming loan payments are used to pay investors as quickly as possible.

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

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REAL ESTATE INVESTMENT TRUSTS (REITS)

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

CERTAIN INTEREST RATE TRANSACTIONS

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

REVERSE REPURCHASE AGREEMENTS AND DOLLAR ROLLS

The Fund may use reverse repurchase agreements or dollar rolls in order to add leverage to its portfolio in addition to (or as a substitute for) leverage obtained through the Preferred Shares. Under a reverse repurchase agreement, the Fund would sell securities to a bank or broker dealer and agree to repurchase the securities at a mutually agreed future date and price. A dollar roll is similar to a reverse repurchase agreement except that the counterparty with which the Fund enters into a dollar roll transaction is not obligated to return the same securities as those originally sold by the Fund but only securities that are substantially identical. See Mortgage-Related and Other Asset-Backed Securities Mortgage dollar rolls. Generally, the effect of a reverse repurchase agreement or dollar roll transaction is that the Fund can recover and reinvest all or most of the cash invested in the portfolio securities involved during the term of the agreement and still be entitled to the returns associated with those portfolio securities, thereby resulting in a transaction similar to a borrowing and giving rise to leverage for the Fund. The Fund will incur interest expense as a cost of utilizing reverse repurchase agreements and dollar rolls. In the event the buyer of securities under a reverse repurchase agreement or dollar roll files for bankruptcy

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or becomes insolvent, the Fund s use of the proceeds of the agreement may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund s obligation to repurchase the securities.

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

REPURCHASE AGREEMENTS

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

U.S. GOVERNMENT SECURITIES

U.S. Government securities are obligations of and, in certain cases, guaranteed by, the U.S. Government, its agencies or instrumentalities. The U.S. Government does not guarantee the net asset value of the Funds shares. Some U.S. Government securities, such as Treasury bills, notes and bonds, and securities guaranteed by GNMA, are supported by the full faith and credit of the United States; others, such as those of the Federal Home Loan Banks, are supported by the right of the issuer to borrow from the U.S. Department of the Treasury (the U.S. Treasury); others, such as those of FNMA, are supported by the discretionary authority of the U.S. Government to purchase the agency s obligations; and still others, such as those of the Student Loan Marketing Association, are supported only by the credit of the instrumentality. U.S. Government securities may include zero coupon securities, which do not distribute interest on a current basis and tend to be subject to greater risk than interest-paying securities of similar maturities.

MUNICIPAL BONDS

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

The Fund may invest in pre-refunded municipal bonds. Pre-refunded municipal bonds are tax-exempt bonds that have been refunded to a call date prior to the final maturity of principal, or, in the case of

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pre-refunded municipal bonds commonly referred to as escrowed-to-maturity bonds, to the final maturity of principal, and remain outstanding in the municipal market. The payment of principal and interest of the pre-refunded municipal bonds held by the Fund is funded from securities in a designated escrow account that holds U.S. Treasury securities or other obligations of the U.S. Government (including its agencies and instrumentalities (Agency Securities)). While still tax-exempt, pre-refunded municipal bonds usually will bear an AAA/Aaa rating (if a re-rating has been requested and paid for) because they are backed by U.S. Treasury securities or Agency Securities. Because the payment of principal and interest is generated from securities held in an escrow account established by the municipality and an independent escrow agent, the pledge of the municipality has been fulfilled and the original pledge of revenue by the municipality is no longer in place. The escrow account securities pledged to pay the principal and interest of the pre-refunded municipal bond do not guarantee the price movement of the bond before maturity. Issuers of municipal bonds refund in advance of maturity the outstanding higher cost debt and issue new, lower cost debt, placing the proceeds of the lower cost issuance into an escrow account to pre-refund the older, higher cost debt. Investment in pre-refunded municipal bonds held by the Fund may subject the Fund to interest rate risk and market risk. In addition, while a secondary market exists for pre-refunded municipal bonds, if the Fund sells pre-refunded municipal bonds prior to maturity, the price received may be more or less than the original cost, depending on market conditions at the time of sale.

The Fund may invest in Build America Bonds, which are taxable municipal bonds with federal subsidies for a portion of the issuer s borrowing costs. Build America Bonds offer an alternative form of financing to the state and local governments whose primary means for accessing the capital markets has been through the issuance of tax-exempt municipal bonds. Build America Bonds are issued through the Build America Bond program, which was created as part of the American Recovery and Reinvestment Act of 2009 (the Act). The objective of the program is to reduce the borrowing costs of state and local governments. Pursuant to the Act, issuers can elect to receive the federal subsidies on Build America Bonds in one of two forms: (i) direct payments from the U.S. Treasury and the IRS to the issuer over the life of the bond in an amount generally equal to 35% (or 45% in the case of Recovery Zone Economic Development Bonds) of the total coupon interest payable by the issuer to its bondholders or (ii) a federal tax credit, which is passed along directly to bondholders, generally in an amount equal to 35% of the total coupon interest payable by the issuer to the bondholders. Issuance of Build America Bonds will cease on December 31, 2010 unless the relevant provisions of the Act are extended. In the event that the Build America Bond program is not extended, the Build America Bonds outstanding at such time will continue to be eligible for the federal interest rate subsidy, which continues for the life of the Build America Bonds.

The Fund may invest in municipal lease obligations. A lease is not a full faith and credit obligation of the issuer and is usually backed only by the borrowing government s unsecured pledge to make annual appropriations for lease payments. There have been challenges to the legality of lease financing in numerous states, and, from time to time, certain municipalities have considered not appropriating money for lease payments. In deciding whether to purchase a lease obligation, the Fund will assess the financial condition of the borrower, the merits of the project, the level of public support for the project and the legislative history of lease financing in the state. These securities may be less readily marketable than other municipal securities.

Some longer-term municipal bonds give the investor the right to put or sell the security at par (face value) within a specified number of days following the investor s request usually one to seven days.

This demand feature enhances a security s liquidity by shortening its effective maturity and enables it to trade at a price equal to or very close to par. If a demand feature terminates prior to being exercised, the Fund would hold the longer-term security, which could experience substantially more volatility.

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The Fund may invest in municipal warrants, which are essentially call options on municipal bonds. In exchange for a premium, municipal warrants give the purchaser the right, but not the obligation, to purchase a municipal bond in the future. The Fund may purchase a warrant to lock in forward supply in an environment in which the current issuance of bonds is sharply reduced. Like options, warrants may expire worthless and may have reduced liquidity.

The Fund may invest in municipal bonds with credit enhancements such as letters of credit, municipal bond insurance and standby bond purchase agreements (SBPAs). Letters of credit are issued by a third party, usually a bank, to enhance liquidity and to ensure repayment of principal and any accrued interest if the underlying municipal bond should default. Municipal bond insurance, which is usually purchased by the bond issuer from a private, nongovernmental insurance company, provides an unconditional and irrevocable guarantee that the insured bond s principal and interest will be paid when due. Insurance does not guarantee the price of the bond. The credit rating of an insured bond reflects the credit rating of the insurer, based on its claims-paying ability. The obligation of a municipal bond insurance company to pay a claim extends over the life of each insured bond. Although defaults on insured municipal bonds have been low to date and municipal bond insurers have met their claims, there is no assurance that this will continue. A higher-than expected default rate could strain the insurer s loss reserves and adversely affect its ability to pay claims to bondholders. Because a significant portion of insured municipal bonds that have been issued and are outstanding is insured by a small number of insurance companies, not all of which have the highest credit rating, an event involving one or more of these insurance companies, such as a credit rating downgrade, could have a significant adverse effect on the value of the municipal bonds insured by such insurance company or companies and on the municipal bond markets as a whole. An SBPA is a liquidity facility provided to pay the purchase price of bonds that cannot be re-marketed. The obligation of the liquidity provider (usually a bank) is only to advance funds to purchase tendered bonds that cannot be re-marketed and does not cover principal or interest under any other circumstances. The liquidity provider s obligations under the SBPA are usually subject to numerous conditions, including the continued creditworthiness of the underlying borrower.

RESIDUAL INTEREST BONDS

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

WHEN ISSUED, DELAYED DELIVERY AND FORWARD COMMITMENT TRANSACTIONS

The Fund may purchase securities that it is eligible to purchase on a when-issued basis, may purchase and sell such securities for delayed delivery and may make contracts to purchase such securities for a fixed price at a future date beyond normal settlement time (forward commitments). When-issued transactions, delayed delivery purchases and forward commitments involve a risk of loss if the value of

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

INFLATION-INDEXED BONDS

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

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

EVENT-LINKED INSTRUMENTS

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

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CREDIT-LINKED TRUST CERTIFICATES

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

COMMON STOCKS AND OTHER EQUITY SECURITIES

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

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

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OTHER INVESTMENT COMPANIES

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

SHORT SALES

A short sale is a transaction in which the Fund sells an instrument that it does not own in anticipation that the market price will decline. The Fund may use short sales for investment purposes or for hedging and risk management purposes. The Fund may also take short positions with respect to the performance of securities, indexes, interest rates, currencies and other assets or markets through the use of derivative or forward instruments. When the Fund engages in a short sale of a security, it must borrow the security sold short and deliver it to the counterparty. The Fund may have to pay a fee to borrow particular securities and would often be obligated to pay over any payments received on such borrowed securities. The Fund s obligation to replace the borrowed security will be secured by collateral deposited with the lender, which is usually a broker-dealer, and/or with the Fund s custodian. The Fund may not receive any payments (including interest) on its collateral. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may engage in so-called naked short sales when it does not own or have the immediate right to acquire the security sold short at no additional cost, in which case the Fund s losses theoretically could be unlimited. If the price of the security sold short increases between the time of the short sale and the time that the Fund replaces the borrowed security, the Fund will incur a loss; conversely, if the price declines, the Fund will realize a gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. The successful use of short selling may be adversely affected by imperfect correlation between movements in the price of the security sold short and securities being hedged if the short sale is being used for hedging purposes. See Derivatives. The Fund may engage in short selling to the extent permitted by the 1940 Act and the rules and interpretations thereunder and other federal securities laws. If the Fund engages in short selling in foreign (non-U.S.) jurisdictions, the Fund will do so only to the extent permitted by the laws and regulations of such jurisdiction.

LENDING OF PORTFOLIO SECURITIES

For the purpose of achieving income, the Fund may lend its portfolio securities to brokers, dealers or other financial institutions provided a number of conditions are satisfied, including that the loan is fully collateralized. See Investment Objective and Policies Securities Loans in the Statement of Additional Information for details. When the Fund lends portfolio securities, its investment performance will continue to reflect changes in the value of the securities loaned. The Fund will also receive a fee or interest on the collateral. Securities lending involves the risk of loss of rights in the collateral or delay in

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recovery of the collateral if the borrower fails to return the security loaned or becomes insolvent, or the risk of loss due to the investment performance of the collateral. The Fund may pay lending fees to the party arranging the loan.

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

PORTFOLIO TURNOVER

The length of time the Fund has held a particular security is not generally a consideration in investment decisions. A change in the securities held by the Fund is known as portfolio turnover. The Fund may engage in frequent and active trading of portfolio securities to achieve its investment objective, particularly during periods of volatile market movements. High portfolio turnover (*e.g.,* over 100%) involves correspondingly greater expenses to the Fund, including brokerage commissions or dealer mark-ups and other transaction costs on the sale of securities and reinvestments in other securities. Such sales may also result in realization of taxable capital gains, including short-term capital gains (which are generally taxed at ordinary income tax rates). The trading costs and tax effects associated with portfolio turnover may adversely affect a Fund s performance. Please see Financial highlights for the Fund s historic portfolio turnover rates.

Use of leverage

The Fund has utilized leverage since shortly after it began investment operations, including through the issuance of Preferred Shares. As of February 28, 2010, the aggregate dollar amount (*i.e.*, liquidation preference) of the Fund s outstanding Preferred Shares was $78,975,000, which then represented approximately 27% of the Fund s total assets (including assets attributable to the Preferred Shares). Information regarding the terms and features of the Preferred Shares is provided under Description of capital structure in this prospectus.

Following completion of the Offer, the Fund currently intends to add leverage to its portfolio by utilizing reverse repurchase agreements, dollar rolls or other forms of borrowings, such as bank loans or commercial paper or other credit facilities (collectively, Borrowings) in order to maintain approximately the total amount of leverage (as a percentage of the Fund s total assets) that the Fund currently maintains. As of February 28, 2010, the Fund had reverse repurchase agreements outstanding representing approximately 5% of the Fund s total assets (including the leverage obtained through the use of the instruments), such that the Fund s total leverage attributable in the aggregate to Preferred Shares and Borrowings then represented approximately 32% of the Fund s total assets (including assets attributable to the Preferred Shares and the leverage obtained through such instruments).

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

Following completion of the Offer, the Fund currently intends to increase the amount of its leverage outstanding. The Fund intends to do so by engaging in additional Borrowings, including through the use of reverse repurchase agreements, in order to maintain the Fund s desired leverage ratio at that time, taking into account the additional assets raised through the issuance of Shares in the Offer. The Fund may also add leverage through the use of credit default swaps and other derivative transactions and/or the other techniques noted above. There is no assurance, however, that the Fund will determine to add

Use of leverage

leverage following the Offer, as the Fund intends to utilize leverage opportunistically and may choose to increase or decrease its use of leverage over time and from time to time based on PIMCO s assessment of the yield curve environment, interest rate trends, market conditions and other factors. In addition, if the Fund determines to add leverage following the Offer, it is not possible to predict with accuracy the precise amount of leverage that would be added, in part, because it is not possible to predict the number of Shares that ultimately will be subscribed for in the Offer.

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

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

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

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

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Use of leverage

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

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

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

EFFECTS OF LEVERAGE

Assuming that the Preferred Shares and Borrowings used by the Fund will represent approximately 32% of the Fund s total assets after the Expiration Date and that the portion of the Fund attributable to Preferred Shares and Borrowings will pay dividends or incur interest expense at a combined average annual rate of 1.23% (based on Preferred Share dividend rates and market interest rates as of the date of this prospectus), the income generated by the Fund s portfolio (net of expenses) would have to exceed 0.39% in order to cover such dividend payments and interest expense. Of course, these numbers are merely estimates, used for illustration. The amount of leverage used by the Fund as well as actual Preferred Share dividend rates and interest expenses on Borrowings used by the Fund, if any, will vary.

The following table is furnished in response to requirements of the Securities and Exchange Commission. It is designed to illustrate the effect of leverage on common share total return, assuming investment portfolio total returns (consisting of income and changes in the value of investments held in the Fund s portfolio) of -10%, -5%, 0%, 5% and 10%. These assumed investment portfolio returns are hypothetical figures and are not necessarily indicative of the investment portfolio returns experienced or

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Use of leverage

expected to be experienced by the Fund. The table further assumes the Fund has Preferred Shares outstanding and is utilizing Borrowings representing, collectively, approximately 32% of the Fund s total assets and that the portion of the Fund attributable to Preferred Shares and Borrowings pays a combined average Preferred Share dividend rate and interest expense of 1.23%.

Assumed Return on Portfolio (Net of Expenses)	(10.00)%	(5.00)%	0%	5%	10%
Corresponding Return to Common Shareholders	(15.28)%	(7.93)%	(0.58)%	6.77%	14.13%

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

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

Principal risks of the Fund

The net asset value of the common shares will fluctuate with and be affected by, among other things, the following principal risks of the Fund: market discount risk, market risk, high yield risk, distressed and defaulted securities risk, credit risk, interest rate risk, liquidity risk, leverage risk, additional risks associated with the Fund s Preferred Shares, issuer risk, smaller company risk, management risk, convertible securities risk, preferred securities risk, foreign (non-U.S.) investment risk, emerging markets risk, foreign currency risk, derivatives risk, counterparty risk, mortgage-related and asset-backed securities risk, mortgage market/subprime risk, government entity risk, risk of investing in REITs, valuation risk, focused investment risk, reinvestment risk, short sale risk, inflation/deflation risk, confidential information access risk, equity securities and related market risk, Rule 144A securities risk, other investment companies risk, risk of regulatory changes, market disruption and geopolitical risk and recent economic conditions risk/impacts on banking and financial services sectors. These and other risks are summarized below.

MARKET DISCOUNT RISK

As with any stock, the price of the Fund s common shares will fluctuate with market conditions and other factors. If common shares are sold, the price received may be more or less than the original investment. Net asset value of the Fund s common shares will be reduced immediately following the Offer by expenses paid or reimbursed by the Fund in connection with the Offer. The completion of the Offer may result in an immediate dilution of the net asset value per common shares for all existing Common Shareholders, including those who fully exercise their Rights. The common shares are designed for long-term investors and should not be treated as trading vehicles. Common shares of closed-end management investment companies frequently trade at a discount from their net asset value. The Fund s common shares may trade at a price that is less than the Subscription Price for Shares issued pursuant to the Offer. This risk may be greater for investors who sell their Shares relatively shortly after completion of the Offer.

Principal risks of the Fund

MARKET RISK

The market price of securities owned by the Fund may go up or down, sometimes rapidly or unpredictably. Securities may decline in value due to factors affecting securities markets generally or particular industries represented in the securities markets. The value of a security may decline due to general market conditions that are not specifically related to a particular company, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates or adverse investor sentiment generally. They may also decline due to factors that affect a particular industry or industries, such as labor shortages or increased production costs and competitive conditions within an industry. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

HIGH YIELD RISK

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

The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy, which involve heightened risks. See Distressed and Defaulted Securities Risk.

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

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

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Principal risks of the Fund

Although Floating-Rate Loans in which the Fund may invest will often be secured by collateral, there can be no assurance that liquidation of any such collateral would satisfy the borrower s obligation in the event of default or that such collateral could be readily liquidated. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations in its ability to realize the benefits of any collateral securing a Floating-Rate Loan. To the extent the Fund focuses on Floating-Rate Loans or other below investment grade debt obligations, PIMCO s capabilities in analyzing credit quality and associated risks will be particularly important, and there can be no assurance that PIMCO will be successful in this regard. See Portfolio contents High Yield Securities (Junk Bonds) for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

DISTRESSED AND DEFAULTED SECURITIES RISK

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

CREDIT RISK

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

INTEREST RATE RISK

Generally, when market interest rates rise, the prices of debt obligations fall, and vice versa. Interest rate risk is the risk that debt obligations and other instruments in the Fund s portfolio will decline in value because of increases in market interest rates. This risk may be particularly acute because market interest rates are currently at historically low levels. The prices of long-term debt obligations generally fluctuate more than prices of short-term debt obligations as interest rates change. Because the Fund will normally have a low to intermediate average portfolio duration (*i.e.*, zero to eight years), the common share net asset value and market price per common share will tend to fluctuate more in response to changes in market interest rates than if the Fund invested mainly in short-term debt securities. During periods of rising interest rates, the average life of certain types of securities may be extended due to slower than expected payments. This may lock in a below market yield, increase the security s duration and reduce the security s value. In addition to directly affecting debt securities, rising interest rates may also have an adverse effect on the value of any equity securities held by the Fund. The Fund s use of leverage, as described below, will tend to increase common share interest rate risk. PIMCO may utilize certain

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Principal risks of the Fund

strategies, including investments in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions, for the purpose of reducing the interest rate sensitivity of the Fund s portfolio, although there is no assurance that it will do so or that such strategies will be successful.

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

LIQUIDITY RISK

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

LEVERAGE RISK

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

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

- the likelihood of greater volatility of net asset value and market price of common shares than a comparable portfolio without leverage;
- the possibility either that common share dividends will fall if the costs of leverage rise, or that dividends paid on common shares will fluctuate because such costs vary over time; and
- the effects of leverage in a declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the common shares.

In addition to using Preferred Shares and Borrowings, the Fund may also enter into other transactions that may give rise to a form of leverage including, among others, credit default swaps, futures and forward contracts and other derivatives transactions, loans of portfolio securities, short sales and when issued, delayed delivery and forward commitment transactions. The Fund s use of such transactions gives rise to associated leverage risks described herein, and may adversely affect the Fund s income and distributions. The Fund may manage some of its derivative positions by segregating an amount of cash or liquid securities equal to the face value or the market value, as applicable, of those positions. The Fund

Principal risks of the Fund

also may offset derivatives positions against one another or against other assets to manage effective market exposure resulting from derivatives in its portfolio. To the extent that any offsetting positions do not behave in relation to one another as expected, the Fund may perform as if it is leveraged through use of these derivative strategies. See Use of leverage.

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

Because the fees received by the Investment Manager and by the Sub-Adviser are based on the total managed assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding), the Investment Manager and the Sub-Adviser have a financial incentive for the Fund to have Preferred Shares outstanding and to use certain other forms of leverage (*e.g.*, reverse repurchase agreements and other Borrowings), which may create a conflict of interest between the Investment Manager and the Sub-Adviser, on the one hand, and the Common Shareholders, on the other hand.

ADDITIONAL RISKS ASSOCIATED WITH THE FUND S PREFERRED SHARES

Although the Fund s Preferred Shares ordinarily would pay dividends at rates set at periodic auctions, the weekly auctions for the Preferred Shares (and auctions for similar preferred shares across the U.S.) have failed since February 2008. The dividend rates on the Preferred Shares since that time have been paid, and the Fund expects that they will continue to be paid for the foreseeable future, at the maximum applicable rate, which is calculated using a reference interest rate. An increase in market interest rates generally, therefore, could increase substantially the dividend rate required to be paid by the Fund to the holders of Preferred Shares, which would reduce the Fund s net income available for distribution to Common Shareholders. It is possible that a substantial rise in market interest rates could make the Fund s continued use of Preferred Shares for leverage purposes less attractive than such use is currently considered to be. In such case, the Fund may elect to redeem some or all of the Preferred Shares outstanding, which may require it to dispose of investments at inopportune times and to incur losses on such dispositions. Such dispositions may adversely affect the Fund s investment performance generally, and the resultant loss of leverage may materially and adversely affect the Fund s investment returns to Common Shareholders.

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Principal risks of the Fund

The Preferred Shares have complete priority over the common shares as to distribution of assets, and in the event that limited funds are available for distribution to shareholders, it is possible that all of such funds would be paid to holders of Preferred Shares to the exclusion of Common Shareholders.

The Fund is subject to certain asset coverage tests associated with the rating agencies that rate the Preferred Shares currently Fitch and Moody s. Failure by the Fund to maintain the asset coverages (or to cure such failure in a timely manner) may require the Fund to redeem Preferred Shares. See Description of capital structure. Failure to satisfy ratings agency asset coverage tests or other guidelines could also result in ratings agencies downgrading their then-current ratings on the Preferred Shares, which, among other consequences, could result in the Fund paying higher dividends on the Preferred Shares, which could reduce income available for distribution to the Common Shareholders and otherwise detract from the Fund s investment performance. Moreover, the rating agency guidelines impose restrictions or limitations on the Fund s use of certain financial instruments or investment techniques that the Fund might otherwise utilize in order to achieve its investment objective, which may adversely affect the Fund s investment performance. The New Fitch Criteria (as defined in Description of capital structure) and related asset coverage requirements in various respects impose more stringent and limiting standards than the guidelines to which the Fund previously was subject. In this regard, the New Fitch Criteria may cause the Fund to invest in higher-quality assets, use derivatives transactions and related leverage to a lesser extent, maintain higher balances of highly liquid assets and otherwise invest the Fund s assets differently than it otherwise would prefer, all or any of which could negatively affect the Fund s investment performance, yield to Common Shareholders and common share net asset value and/or market price. Rating agency guidelines may be modified by the rating agencies in the future and, if adopted by the Fund, such modifications may make such guidelines substantially more restrictive, which could further negatively affect the Fund s investment performance.

ISSUER RISK

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

SMALLER COMPANY RISK

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

MANAGEMENT RISK

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

Principal risks of the Fund

CONVERTIBLE SECURITIES RISK

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

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

PREFERRED SECURITIES RISK

In addition to equity securities risk (see Equity Securities and Related Market Risk), credit risk (see Credit Risk) and possibly high yield risk (see High Yield Risk), investment in preferred stocks involves certain other risks. Certain preferred stocks contain provisions that allow an issuer under certain conditions to skip or defer distributions. If the Fund owns a preferred stock that is deferring its distribution, the Fund may be required to include the amount of the deferred distribution in its taxable income for tax purposes despite the fact that it does not currently receive such amount. In order to receive the special treatment accorded to regulated investment companies (RICs) and their shareholders under the Internal Revenue Code of 1986, as amended (the Code) and to avoid U.S. federal income and/or excise taxes at the Fund level, the Fund may be required to distribute this income to shareholders in the tax year in which the income is recognized (without a corresponding receipt of cash). Therefore, the Fund may be required to pay out as an income distribution in any such tax year an amount greater than the total amount of cash income the Fund actually received, and to sell portfolio securities, including at potentially disadvantageous times or prices, to obtain cash needed for these income distributions. Preferred stocks often are subject to legal provisions that allow for redemption in the event of certain tax or legal changes or at the issuer s call. In the event of redemption, the Fund may not be able to reinvest the proceeds at comparable rates of return. Preferred stocks are subordinated to bonds and other debt securities in an issuer s capital structure in terms of priority for corporate income and liquidation payments, and therefore will be subject to greater credit risk than those debt securities. Preferred stocks may trade less frequently and in a more limited volume and may be subject to more

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Principal risks of the Fund

abrupt or erratic price movements than many other securities, such as common stocks, corporate debt securities and U.S. Government securities.

FOREIGN (NON-U.S.) INVESTMENT RISK

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

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

EMERGING MARKETS RISK

The Fund may invest up to 25% of its total assets in securities that are economically tied to emerging market countries. Foreign investment risk may be particularly high to the extent that the Fund invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers noted above, but to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation and nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in a lack of liquidity and in price volatility; (iii) certain national policies which may restrict the Fund s investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests and requirements that government approval be obtained prior to investment by foreign persons; (iv) certain national policies that may restrict the Fund s repatriation of investment income, capital or the proceeds of sales of securities, including temporary restrictions on foreign capital remittances; (v) the lack of uniform accounting and auditing standards; (vi) less publicly available financial and other information regarding issuers; (vii) potential difficulties in enforcing contractual obligations; and (viii) higher rates of inflation, higher interest rates and other economic concerns. The Fund may invest to a significant extent in emerging market securities that are issued in local currencies, subjecting the Fund to a greater degree of foreign currency risk. See Foreign Currency Risk. Also, investing in emerging market countries may entail purchases of securities of issuers that are insolvent, bankrupt, in default or otherwise of questionable ability to satisfy their payment obligations as they become due, subjecting the Fund to a greater amount of credit risk and/or high yield risk. See Credit Risk and High Yield Risk.

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Principal risks of the Fund

FOREIGN CURRENCY RISK

The Fund s common shares are priced in U.S. dollars and the distributions paid by the Fund to Common Shareholders are paid in U.S. dollars. However, a significant portion of the Fund s assets may at any time be denominated in foreign (non-U.S.) currencies and income received by the Fund from many foreign debt obligations will be paid in foreign currencies. The Fund may also invest in or gain exposure to foreign currencies themselves for investment or hedging purposes. The Fund s investments in or exposure to foreign currencies or in securities or instruments that trade, or receive revenues, in foreign currencies are subject to the risk that those currencies will decline in value relative to the U.S. dollar or, in the case of hedging positions (if utilized), that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including changes in interest rates, intervention (or the failure to intervene) by U.S. or foreign governments, central banks or supranational entities such as the International Monetary Fund, or the imposition of currency controls or other political developments in the U.S. or abroad. These fluctuations may have a significant adverse effect on the value of the Fund s portfolio and/or the level of Fund distributions made to Common Shareholders. As noted above, the Fund may (but is not required to) attempt to hedge some of its exposure to foreign currencies in order to reduce the risk of loss due to fluctuations in currency exchange rates relative to the U.S. dollar. There is no assurance, however, that these hedging strategies will be available or will be used by the Fund or, if used, that they will be successful.

DERIVATIVES RISK

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

COUNTERPARTY RISK

The Fund will be subject to credit risk with respect to the counterparties to the derivative contracts and other instruments entered into by the Fund or held by special purpose or structured vehicles in which the

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Principal risks of the Fund

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

MORTGAGE-RELATED AND ASSET-BACKED SECURITIES RISK

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

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

MORTGAGE MARKET/SUBPRIME RISK

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

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Principal risks of the Fund

GOVERNMENT ENTITY RISK

As noted, the Fund may invest in mortgage-related and other debt securities issued or guaranteed by certain U.S. government agencies, instrumentalities and sponsored enterprises. Some U.S. Government securities, such as Treasury bills, notes and bonds, and securities guaranteed by GNMA, are supported by the full faith and credit of the United States; others, such as those of the Federal Home Loan Banks or FHLMC, are supported by the right of the issuer to borrow from the U.S. Treasury; others, such as those of FNMA, are supported by the discretionary authority of the U.S. Government to purchase the agency s obligations; and still others, such as those of the Student Loan Marketing Association, are supported only by the credit of the instrumentality. Although U.S. Government-sponsored enterprises, such as the Federal Home Loan Banks, FHLMC, FNMA and the Student Loan Marketing Association may be chartered or sponsored by Congress, they are not funded by Congressional appropriations, and their securities are not issued by the U.S. Treasury or supported by the full faith and credit of the U.S. Government and involve increased credit risks. Certain governmental entities, including FNMA and FHLMC, have been subject to regulatory scrutiny regarding their accounting policies and practices and other concerns that may result in legislation, changes in regulatory oversight and/or other consequences that could adversely affect the credit quality, availability or investment character of securities issued by these entities. See Investment Objective and Policies Mortgage-Related and Other Asset-Backed Securities in the Statement of Additional Information.

RISK OF INVESTING IN REITS

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

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

VALUATION RISK

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

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FOCUSED INVESTMENT RISK

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

REINVESTMENT RISK

Reinvestment risk is the risk that income from the Fund s portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the portfolio s current earnings rate. For instance, during periods of declining interest rates, an issuer of debt obligations may exercise an option to redeem securities prior to maturity, forcing the Fund to invest in lower-yielding securities. The Fund also may choose to sell higher yielding portfolio securities and to purchase lower yielding securities to achieve greater portfolio diversification, because the portfolio manager believes the current holdings are overvalued or for other investment-related reasons. A decline in income received by the Fund from its investments is likely to have a negative effect on the market price, net asset value and/or overall return of the Fund s common shares.

SHORT SALE RISK

The Fund may use short sales for investment and risk management purposes, including when PIMCO anticipates that the market price of securities will decline or will underperform relative to other securities held in the Fund s portfolio. Short sales are transactions in which the Fund sells a security or other instrument (such as an option, forward, futures or other derivative contract) that it does not own. Short exposure with respect to securities or market segments may also be achieved through the use of derivative instruments, such as futures on indices or swaps on individual securities. When the Fund engages in a short sale on a security, it must borrow the security sold short and deliver it to the counterparty. The Fund will ordinarily have to pay a fee or premium to borrow particular securities and be obligated to repay the lender of the security any dividends or interest that accrue on the security during the period of the loan. The amount of any gain from a short sale will be decreased, and the amount of any loss increased, by the amount of the premium, dividends, interest or expenses the Fund pays in connection with the short sale. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may, to the extent permitted by law, engage in short sales where it does not own or have the right to acquire the security (or basket of securities) sold short at no additional cost. The Fund s loss on a short sale could theoretically be unlimited in a case in which the Fund is unable, for whatever reason, to close out its short position. The use by the Fund of short sales in combination with long positions in its portfolio in an attempt to improve performance may not be successful and may result in greater losses or lower positive returns than if the Fund held only long positions. It is possible that the

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Fund s long positions will decline in value at the same time that the value of the securities underlying its short positions increase, thereby increasing potential losses to the Fund. In addition, the Fund s short selling strategies may limit its ability to fully benefit from increases in the relevant securities markets. Short selling also involves a form of financial leverage that may exaggerate any losses realized by the Fund. See Leverage Risk. Also, there is the risk that the counterparty to a short sale may fail to honor its contractual terms, causing a loss to the Fund. See Counterparty Risk. To the extent the Fund seeks to obtain some or all of its short exposure by using derivative instruments instead of engaging directly in short sales on individual securities, it will be subject to many of the foregoing risks, as well as to those described under Derivatives Risk.

INFLATION/DEFLATION RISK

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

CONFIDENTIAL INFORMATION ACCESS RISK

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

EQUITY SECURITIES AND RELATED MARKET RISK

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

RULE 144A SECURITIES RISK

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

Principal risks of the Fund

OTHER INVESTMENT COMPANIES RISK

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

RISK OF REGULATORY CHANGES

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

MARKET DISRUPTION AND GEOPOLITICAL RISK

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

RECENT ECONOMIC CONDITIONS RISK/IMPACTS ON BANKING AND FINANCIAL SERVICES SECTORS

The debt and equity capital markets in the United States have been negatively affected by significant write-offs in the banking and financial services sectors relating to subprime mortgages and the repricing of credit risk in the broadly syndicated market, among other things. These events, along with the deterioration of the housing market, the failure of banking and other major financial institutions and the resulting United States federal government actions have led to worsening general economic conditions, which have materially and adversely affected the broader financial and credit markets and have reduced the availability of debt and equity capital for the market as a whole and financial firms in particular. These developments may increase the volatility of the value of securities owned by the Fund, particularly those of companies in the banking and financial services sectors, and also may make it more difficult for the Fund to accurately value securities or to sell securities on a timely basis. These developments have adversely affected the broader economy, and may continue to do so, which in turn may adversely affect the ability of issuers of securities owned by the Fund to make payments of principal and interest when due, lead to lower credit ratings and increase defaults. Such developments could, in turn, reduce the value

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Principal risks of the Fund

of securities owned by the Fund and adversely affect the net asset value of the Fund. In addition, the prolonged continuation or further deterioration of current market conditions could adversely affect the Fund s portfolio.

The recent instability in the financial markets discussed above has led the U.S. government to take a number of unprecedented actions designed to support certain banking and other financial institutions and segments of the financial markets that have experienced extreme volatility, and in some cases a lack of liquidity. Federal, state and other governments and their regulatory agencies or self-regulatory organizations may take actions that affect the regulation of the instruments in which the Fund invests, or the issuers of such instruments, in ways that are unforeseeable. Governments or their agencies may also acquire distressed assets from financial institutions and acquire ownership interests in those institutions. The implications of government ownership and disposition of these assets are unclear, and such a program may have positive or negative effects on the liquidity, valuation and performance of the Fund s portfolio holdings.

Legislation or regulation may also change the way in which the Fund itself is regulated. Such legislation or regulation could limit or preclude the Fund s ability to achieve its investment objective.

CERTAIN AFFILIATIONS

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

ANTI-TAKEOVER PROVISIONS

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

How the Fund manages risk

INVESTMENT LIMITATIONS

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

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

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How the Fund manages risk

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

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

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

HEDGING AND RELATED STRATEGIES

The Fund may (but is not required to) use various investment strategies designed to limit the risk of price fluctuations of its portfolio securities and to preserve capital. For instance, the Fund may purchase credit default swaps for the purpose of hedging the Fund s credit exposure to certain issuers and, thereby, decreasing its exposure to credit risk, and it may invest in structured notes or interest rate futures contracts or swap, cap, floor or collar transactions for the purpose of reducing the interest rate sensitivity of the Fund s portfolio and, thereby, decreasing the Fund s exposure to interest rate risk. See Portfolio contents Credit Default Swaps, Portfolio contents Structured Notes and Related Instruments and Portfolio contents Certain Interest Rate Transactions in this prospectus. The Fund may also (but is not required to) seek to hedge some or all of its exposure to foreign currencies, including through the use of derivative strategies, to protect against future fluctuations in foreign currencies in relation to the U.S. dollar. See Portfolio contents Foreign Currencies and Related Transactions. Other hedging strategies that the Fund may use include: financial futures contracts; short sales; other types of swap agreements or options thereon; options on financial futures; and options based on either an index or individual debt securities whose prices, PIMCO believes, correlate with the prices of the Fund s investments. Income earned by the Fund from its hedging and related transactions may be subject to one or more special U.S. federal income tax rules that can affect the amount, timing and/or character of distributions to shareholders. For instance, income earned by the Fund from its foreign currency hedging activities, if any, may give rise to ordinary income that, to the extent not offset by losses from such activities, will be distributed to shareholders and taxable at ordinary income rates. Therefore, these foreign currency hedging activities can increase the amount of distributions taxable to shareholders as ordinary income. See Tax matters. There is no assurance that these hedging strategies will be available at any time or that PIMCO will determine to use them for the Fund or, if used, that the strategies will be successful. PIMCO may determine not to engage in hedging strategies or to do so only in unusual circumstances or market conditions. In addition, the Fund is subject to certain restrictions on its use of hedging strategies imposed by guidelines of Fitch and/or Moody s with respect to their ratings on the Preferred Shares.

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Management of the Fund

TRUSTEES AND OFFICERS

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

INVESTMENT MANAGER

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

Organized in 2000, the Investment Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. The Investment Manager is a wholly-owned indirect subsidiary of Allianz SE, a publicly-traded European insurance and financial services company. As of December 31, 2009, the Investment Manager and its investment management affiliates had approximately $1.7 trillion in assets under management.

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

SUB-ADVISER

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

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to a number of open-end and closed-end investment companies. As of December 31, 2009, PIMCO had approximately $1 trillion in assets under management.

The Investment Manager (and not the Fund) pays a portion of the fees it receives under the Investment Management Agreement (as defined below) to PIMCO in return for PIMCO s services. The fee is paid monthly at the annual rate of 0.55% of the Fund s average weekly total managed assets.

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

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

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

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Management of the Fund

INVESTMENT MANAGEMENT AGREEMENT

Pursuant to an investment management agreement between the Investment Manager and the Fund (the Investment Management Agreement), the Fund has agreed to pay the Investment Manager an annual fee, payable monthly, in an amount equal to 0.75% of the Fund s average weekly total managed assets, for the services and facilities it provides. Total managed assets means the total assets of the Fund (including any assets attributable to any preferred shares or other forms of leverage of the Fund that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). For purposes of calculating total managed assets, the liquidation preference of any Preferred Shares outstanding is not considered a liability. With respect to any reverse repurchase agreement or similar transaction, total managed assets include any proceeds from the sale of an asset of the Fund to a counterparty in such a transaction, in addition to the value of the underlying asset as of the relevant measuring date.

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

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

A discussion regarding the basis for the Board s continuation of the Fund s Investment Management Agreement and Portfolio Management Agreement is available in the Fund s annual report to shareholders for the fiscal year ended July 31, 2009.

REGULATORY AND LITIGATION MATTERS

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

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

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Management of the Fund

PIMCO and PIMCO Funds, a series of mutual funds managed by PIMCO, are the subject of a lawsuit in the Northern District of Illinois Eastern Division, in which the complaint alleges that the plaintiffs each purchased and sold a 10-year Treasury note futures contract and suffered damages from an alleged shortage when PIMCO held both physical and futures positions in 10-year Treasury notes for its client accounts in violation of the federal Commodity Exchange Act provisions on market manipulation. In July 2007, the District Court granted class certification of a class consisting of those persons who purchased futures contracts to offset short positions between May 9, 2005 and June 30, 2005. PIMCO believes the complaint is without merit and PIMCO and PIMCO Funds intend to vigorously defend against this action. The outcome of this action cannot be predicted at this time.

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

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

Net asset value

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

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

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

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

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Net asset value

indices) that occur after the close of the relevant market and before the Valuation Time. The Fund may use modeling tools provided by third-party vendors to determine fair values of certain non-U.S. securities.

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

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

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

Distributions

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

To permit the Fund to maintain a more stable relationship between its monthly distributions and the variable rates of interest it may receive on its investment portfolio, the Fund may initially distribute less than the entire amount of net investment income earned in a particular period. The undistributed net investment income would be available to supplement future distributions. As a result, the distributions paid by the Fund for any particular monthly period may be more or less than the amount of net investment income actually earned by the Fund during the period. Undistributed net investment income will be added to the Fund s net asset value and, correspondingly, distributions from undistributed net

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Distributions

investment income will be deducted from the Fund s net asset value. Unless Common Shareholders elect to receive distributions in cash, all distributions to Common Shareholders will be automatically reinvested in additional common shares under the Fund s Dividend Reinvestment Plan.

Dividend reinvestment plan

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

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

(1) If on the payment date the net asset value of the common shares is equal to or less than the market price per common share plus estimated brokerage commissions that would be incurred upon the purchase of common shares on the open market, the Fund will issue new common shares at the greater of (i) the net asset value per common share on the payment date or (ii) 95% of the market price per common share on the payment date; or

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

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

The Plan Agent maintains all shareholders accounts in the Plan and gives written confirmation of all transactions in the accounts, including information you may need for tax records. The Plan Agent will

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Dividend reinvestment plan

also furnish each person who buys common shares with written instructions detailing the procedures for electing not to participate in the Plan and to instead receive distributions in cash. Common shares in your account will be held by the Plan Agent in non-certificated form. Any proxy you receive will include all common shares you have received under the Plan.

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

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

The Fund and the Plan Agent reserve the right to amend or terminate the Plan. There is no direct service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. Additional information about the Plan may be obtained from PNC Global Investment Servicing Inc., P.O. Box 43027, Providence, Rhode Island 02940-3027, telephone number (800) 254-5197.

Description of capital structure

The following is a brief description of the capital structure of the Fund. This description does not purport to be complete and is subject to and qualified in its entirety by reference to the Declaration and the Fund s Bylaws, as amended and restated through the date hereof (the Bylaws). The Declaration and Bylaws are each exhibits to the registration statement of which this prospectus is a part.

The Fund is an unincorporated voluntary association with transferable shares of beneficial interest (commonly referred to as a Massachusetts business trust) established under the laws of The Commonwealth of Massachusetts by the Declaration. The Declaration provides that the Trustees of the Fund may authorize separate classes of shares of beneficial interest. Preferred shares (such as the Preferred Shares) may be issued in one or more series, with such par value and with such rights as determined by the Board, by action of the Board without the approval of the Common Shareholders. The following table shows, for each class of authorized securities of the Fund, the amount of (i) shares authorized and (ii) shares outstanding, each as of February 28, 2010.

Title of Class	Amount Authorized	Amount Outstanding
Common Shares	Unlimited	18,474,036
Preferred Shares		
Series T	2,800	1,053
Series W	2,800	1,053
Series TH	2,800	1,053

The common shares of the Fund commenced trading on the NYSE on August 29, 2003 under the trading or ticker symbol PFL. As of the close of trading on the NYSE on March 19, 2010, the net asset value per common share was $10.74, and the closing price per common share on the NYSE was $11.97.

Common Shareholders are entitled to share equally in dividends declared by the Board payable to Common Shareholders and in the net assets of the Fund available for distribution to Common Shareholders after payment of the preferential amounts payable to holders of Preferred Shares and any other outstanding preferred shares of beneficial interest. See Preferred Share Dividends below. Neither Common Shareholders nor holders of preferred shares (including the Preferred Shares) have preemptive or conversion rights or have the right to cause the Fund to redeem their shares. Upon liquidation of the Fund, after paying or adequately providing for the payment of all liabilities of the Fund

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Description of capital structure

and the liquidation preference with respect to any outstanding preferred shares (including the Preferred Shares), and upon receipt of such releases, indemnities and refunding agreements as they deem necessary for their protection, the Trustees may distribute the remaining assets of the Fund among the Fund s Common Shareholders. See Liquidation Preference below.

For so long as any Preferred Shares are outstanding, the Fund generally may not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of additional common shares or rights to purchase common shares or other shares ranking junior to the Preferred Shares as to dividends or upon liquidation) in respect of common shares or any other shares of the Fund ranking junior to or on a parity with the Preferred Shares as to dividends or upon liquidation, or call for redemption, redeem, purchase or otherwise acquire for consideration any common shares or any other such junior shares (except by conversion into or exchange for shares of beneficial interest of the Fund ranking junior to Preferred Shares as to dividends and upon liquidation) or any such parity shares (except by conversion into or exchange for shares of beneficial interest of the Fund ranking junior to or on a parity with Preferred Shares as to dividends and upon liquidation), unless and only if: (i) immediately after such transaction, the Fund would satisfy both Moody s Ratings Agency Preferred Shares Asset Coverage and Fitch Ratings Agency Preferred Shares Asset Coverage, and 1940 Act Preferred Shares Asset Coverage would be satisfied (each as defined and described under Rating Agency Guidelines and Asset Coverage); (ii) full cumulative dividends on the Preferred Shares due on or prior to the date of the transaction have been declared and paid or shall have been declared and sufficient funds for the payment thereof deposited with the auction agent for the Preferred Shares; and (iii) the Fund has redeemed the full number of Preferred Shares required to be redeemed by any provision for mandatory redemption contained in the Bylaws. See Preferred Shares Redemption. The Fund expects that similar restrictions would apply to any other classes of preferred shares that the Fund might choose to issue in the future. In addition, if the Fund has outstanding any senior security representing indebtedness, the 1940 Act prohibits the Fund from declaring any dividend or distribution on the Fund s common shares (other than a dividend or distribution paid in shares of additional common shares) unless such senior securities representing indebtedness have, at the time of the declaration, asset coverage of at least 300% after deducting the amount of such dividend or distribution. See Use of leverage.

Shareholders of each class are entitled to one vote for each share held. Common Shareholders will vote with the holders of any outstanding Preferred Shares or other preferred shares as a single class on each matter submitted to a vote of holders of common shares, except as otherwise provided by the Declaration, the Bylaws or applicable law. Except as otherwise provided by the Declaration, the Bylaws or applicable law, holders of Preferred Shares, voting as a separate class, are entitled to elect two of the Fund s Trustees. The remaining Trustees will be elected by Common Shareholders and holders of Preferred Shares, voting together as a single class. In the unlikely event that two full years of accrued dividends are unpaid on the Preferred Shares, the holders of all outstanding Preferred Shares, voting as a separate class, will be entitled to elect a majority of the Fund s Trustees until all dividends in arrears have been paid or declared and set apart for payment.

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

ADDITIONAL INFORMATION REGARDING THE PREFERRED SHARES

The Fund initially issued Preferred Shares in three series (Series T, Series W and Series TH) in October 2003, in the amount of 2,800 shares per series. The Preferred Shares have a par value of $0.00001 and liquidation value of $25,000 per share. The Preferred Shares have various rights determined by action of the Board without the approval of Common Shareholders, most of which are specified in Article 11 of the Bylaws. The Fund voluntarily redeemed a total of 1,747 shares of each series of its outstanding

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Description of capital structure

Preferred Shares in December 2008 and March and April 2009, such that the Fund currently has a total of 3,159 Preferred Shares outstanding (1,053 shares per series), with a total liquidation value of $78,975,000.

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

PREFERRED SHARE DIVIDENDS

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

As noted, the maximum applicable rate for each series of Preferred Shares depends on the credit ratings assigned to such shares (currently by Fitch and Moody s) and on the duration of the rate period. The maximum applicable rate for any regular rate period (*i.e.*, any rate period other than a non-payment period) will be the higher of the applicable percentage of the reference rate, or the applicable spread plus the reference rate. The reference rate is the applicable LIBOR Rate (as defined below) (for a rate period of fewer than 365 days) or the Treasury Index Rate (as defined below) (for a rate period of 365 days or more). The applicable percentage and applicable spread for any regular rate period will generally be determined based on the credit ratings assigned to the Preferred Shares by Fitch and Moody s on the auction date for such period (as set forth in the table below).

Moody s Credit Rating	Fitch Credit Rating	Applicable Percentage	Applicable Spread
Aaa	AAA	125%	125 bps
Aa3 to Aa1	AA- to AA+	150%	150 bps
A3 to A1	A- to A+	200%	200 bps
Baa3 to Baa1	BBB- to BBB+	250%	250 bps
Ba1 and below	BB+ and below	300%	300 bps

For these purposes, the LIBOR Rate is the applicable London Inter-Bank Offered Rate for deposits in U.S. dollars for the period most closely approximating the applicable rate period for a series of Preferred Shares (ordinarily 7 days), and the Treasury Index Rate is the average yield to maturity for certain U.S. Treasury securities having substantially the same length to maturity as the applicable rate period for a series of Preferred Shares.

RATING AGENCY GUIDELINES AND ASSET COVERAGE

The Fund is required to satisfy various asset maintenance requirements with respect to its Preferred Shares under the terms of the Bylaws, which are summarized below.

1940 Act Preferred Shares Asset Coverage

The Fund is required under the Bylaws to maintain, with respect to the Preferred Shares, as of the last business day of each month in which any Preferred Shares are outstanding, 1940 Act Preferred Shares

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Asset Coverage (as defined on the next page) of at least 200% with respect to senior securities that are equity securities, including the Preferred Shares. If the Fund fails to maintain 1940 Act Preferred Shares Asset Coverage and such failure is not cured as of the last business day of the following month (the 1940 Act Cure Date), the Fund will be required under certain circumstances to redeem certain of the Preferred Shares. See Preferred Shares Redemption.

The 1940 Act Preferred Shares Asset Coverage with respect to the Fund s currently outstanding Preferred Shares is equal to the following ratio, which as of February 28, 2010 was as follows:

Value of the Fund s total assets less all liabilities and indebtedness not represented by senior securities	=	343%
Senior securities representing indebtedness plus liquidation value of the Preferred Shares		

Ratings Agency Preferred Shares Asset Coverage

In connection with the Fund s receipt of ratings of Aaa from Moody s and AAA from Fitch with respect to the Preferred Shares, the Fund is required under the Bylaws to satisfy separate asset coverage tests specific to each rating agency (with respect to each ratings agency, Ratings Agency Preferred Shares Asset Coverage).

Moody s Ratings Agency Preferred Shares Asset Coverage

Satisfaction of Moody s Ratings Agency Preferred Shares Asset Coverage generally requires the Fund to have eligible assets having in the aggregate a discounted value equal to or in excess of a Preferred Shares Basic Maintenance Amount. Generally, the Preferred Shares Basic Maintenance Amount includes the sum of (a) the aggregate liquidation preference of the Fund s preferred shares then outstanding (including the Preferred Shares) and (b) certain accrued and projected payment obligations of the Fund, including without limitation any accrued and projected dividends on its preferred shares then outstanding (including the Preferred Shares).

Article 11 of the Bylaws includes Moody s-specific guidelines for calculating discounted value for purposes of determining whether the Moody s Ratings Agency Preferred Shares Asset Coverage test is satisfied. These guidelines specify discount factors that the Fund must apply to various types of securities in its portfolio for purposes of calculating whether the discounted value of the Fund s eligible assets is at least equal to the Preferred Shares Basic Maintenance Amount (with the level of discount generally becoming greater as the credit quality of a security becomes lower). In addition, under the Moody s guidelines, certain types of securities (including securities in which the Fund may otherwise invest) are not eligible for inclusion in the calculation of the discounted value of the Fund s portfolio. Such ineligible securities may include, for example, certain privately placed debt securities (other than Rule 144A securities) and debt securities of certain non-U.S. issuers. The Moody s guidelines for calculating discounted value do not impose any limitations on the percentage of the Fund s assets that may be invested in ineligible assets, and the amount of ineligible assets included in the Fund s portfolio at any time may vary depending upon the rating, diversification and other characteristics of the Moody s eligible assets included in the portfolio.

Fitch Ratings Agency Preferred Shares Asset Coverage

Until recently, the ratings agency asset coverage criteria relating to Fitch s ratings of the Preferred Shares were substantially similar in structure to the Moody s-related requirements summarized above. Like the Moody s requirements, the Fitch asset coverage requirements were premised on the Fund having eligible assets with an aggregate discounted value equal to or in excess of the Preferred Shares Basic Maintenance

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Amount. The asset coverage requirements of the two ratings agencies differed in that each rating agency had different guidelines for calculating discounted value and for determining whether a particular asset was an eligible asset for these purposes.

Effective March 1, 2010, the Fund s Board adopted amended and restated Bylaws which incorporate substantially revised and updated Preferred Shares ratings criteria issued by Fitch with respect to its ratings on debt and preferred stock issued by closed-end investment companies (the New Fitch Criteria). The New Fitch Criteria are attached as Exhibit 1 to the Bylaws and are incorporated therein by reference.

Generally, the New Fitch Criteria include two separate asset coverage tests which differ from the single Preferred Shares Basic Maintenance Amount test currently applicable to Moody s ratings of the Preferred Shares and previously to Fitch s ratings. Under the New Fitch Criteria, the Fund must satisfy both a Fitch Total Overcollateralization Test (Fitch Total OC) and a Fitch Net Overcollateralization Test (Fitch Net OC), in each case to be consistent with a AAA rating from Fitch, to satisfy Fitch Ratings Agency Preferred Shares Asset Coverage.

The New Fitch Criteria define Fitch Total OC and Fitch Net OC as follows:

$$\text{Fitch Total OC} = \frac{\text{Total Net Discounted Assets at MV*}}{\text{Fitch Rated Liability + Other Liabilities Pari Passu and Senior to Rated Liability}}$$

* Total net discounted assets at market value (MV) equal total portfolio assets at MV and accrued income, including assets held as collateral for other Fund liabilities, less current liabilities that settle in 10 days that are not part of a rolling leverage strategy (such as to-be-announced (TBA) securities, futures and forwards, among others), then discounted pursuant to the Fitch discount factors specified in the New Fitch Criteria.

$$\text{Fitch Net OC} = \frac{\text{Available Net Discounted Assets*}}{\text{Fitch Rated Liability + Other Liabilities That Are Pari Passu}}$$

* Available net discounted assets equals total portfolio assets at MV and accrued income minus all assets that are either held as collateral for other Fund liabilities and/or subject to a first claim of a senior liability in the capital structure minus current liabilities that settle in 10 days that are not part of a rolling leverage strategy (such as TBA security rolls, futures and forwards, among others), then discounted pursuant to the Fitch discount factors specified in the New Fitch Criteria.

Under the Bylaws, Fitch Ratings Agency Preferred Shares Asset Coverage is satisfied if, as of a particular date or time, the Fund has sufficient asset coverage with respect to the Preferred Shares such that the Fund satisfies both the (i) Fitch Total OC test and the (ii) Fitch Net OC test as of such date or time. The Fitch Total OC test and the Fitch Net OC test are satisfied if the Fund has Fitch Total OC or Fitch Net OC, as the case may be, in excess of one-hundred percent (100%) pursuant to the applicable formula above.

Other key components of the New Fitch Criteria as cited by Fitch include, among others, updated asset discount factors (used in part to calculate Fitch Total OC and Fitch Net OC), changes to issuer and industry diversification and concentration thresholds and guidelines and inclusion of leverage and derivatives when calculating asset coverage for purposes of determining Fitch Ratings Agency Preferred Shares Asset Coverage.

In the event the Fund does not timely cure a failure to maintain (a) Moody s Ratings Agency Preferred Shares Asset Coverage or Fitch Ratings Agency Preferred Shares Asset Coverage (as applicable) or (b) 1940 Act Preferred Shares Asset Coverage, in each case in accordance with the requirements of the rating agency or agencies then rating the Preferred Shares, the Fund will be required to redeem Preferred Shares as described under Preferred Shares Redemption Mandatory redemption.

In addition to the requirements described above, the rating agency guidelines impose restrictions or limitations on the Fund s use of certain financial instruments or investment techniques that the Fund might otherwise utilize in order to obtain and maintain a rating from Moody s and Fitch on the Preferred

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Shares. It is not currently anticipated that these guidelines will materially impede PIMCO from managing the Fund s portfolio in accordance with the Fund s investment objective and policies. However, it should be noted that the New Fitch Criteria and related asset coverage requirements to which the Fund recently became subject are different in material respects from the Fitch-related asset coverage requirements to which the Fund was subject prior to March 1, 2010, and in various respects impose more stringent and limiting standards than the prior Fitch guidelines and/or the Moody s guidelines summarized above. In this regard, the New Fitch Criteria may cause the Fund to invest in higher-quality assets, use derivatives transactions and related leverage to a lesser extent, maintain higher balances of highly liquid assets and otherwise invest the Fund s assets differently than it has in the past under the prior Fitch guidelines, which could negatively affect the Fund s investment performance, yield to Common Shareholders and common share NAV and/or market price.

The Fund may, but is not required to, adopt any modifications to the guidelines that may be established by Moody s and/or Fitch with respect to their ratings of the Preferred Shares. Failure to adopt any such modifications, however, may result in a reduction in the ratings described above or a withdrawal of ratings altogether. In addition, any rating agency providing a rating for the Preferred Shares may, at any time, change or withdraw any such rating. The Board may, without shareholder approval, amend, alter or repeal various definitions and related provisions that have been adopted by the Fund pursuant to the rating agency guidelines in the event the Fund receives written confirmation from Moody s or Fitch (or any substitute rating agency) that any such amendment, alteration or repeal would not impair the rating then assigned by the rating agency to the Preferred Shares.

The ratings of the Preferred Shares are based on current information furnished to Moody s and Fitch by the Fund, the Investment Manager and/or the Sub-Adviser or information obtained from other sources. The ratings may be changed, suspended or withdrawn as a result of changes in, or the unavailability of, such information. The Fund s common shares have not been rated by a nationally recognized statistical rating organization. A rating agency s guidelines will apply to the Preferred Shares only so long as the rating agency is rating the shares. The Fund pays certain fees to Moody s and Fitch for rating the Preferred Shares.

The foregoing description of the rating agency guidelines and asset coverage requirements applicable to the Preferred Shares is intended only as a summary and is qualified in its entirety by reference to the actual terms of Article 11 and other relevant provisions of the Bylaws and Exhibit 1 thereto (which includes the New Fitch Criteria).

LIQUIDATION PREFERENCE

Subject to the rights of holders of any series or class or classes of shares ranking on a parity with Preferred Shares with respect to the distribution of assets upon liquidation of the Fund, upon a liquidation of the Fund (whether voluntary or involuntary), the holders of Preferred Shares then outstanding would be entitled to receive and to be paid, out of the assets of the Fund available for distribution to its shareholders, before any payment or distribution would be made on the Fund s common shares or any other class of shares of the Fund ranking junior in right of payment upon liquidation to the Preferred Shares, an amount equal to the liquidation preference with respect to such Preferred Shares ($25,000 per share), plus an amount equal to all dividends thereon (whether or not earned or declared by the Fund, but excluding the interest thereon) accumulated but unpaid to (but not including) the date of final distribution in same-day funds in connection with the liquidation of the Fund. If such assets of the Fund are insufficient to make the full liquidation payment on outstanding Preferred Shares and liquidation payments on any other outstanding class or series of preferred shares of the Fund ranking on parity with the Preferred Shares as to payment upon liquidation, then such assets will be

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distributed among the holders of Preferred Shares and the holders of shares of such other class or series ratably in proportion to the respective preferential amounts to which they are entitled. After the payment to the holders of Preferred Shares of the full preferential amounts provided for as described herein, the holders of Preferred Shares as such would have no right or claim to any of the remaining assets of the Fund. For these purposes, a liquidation of the Fund does not include the sale of all or any portion of the assets of the Fund or the merger, consolidation or statutory share exchange of the Fund into or with any trust or other entity.

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

PREFERRED SHARES REDEMPTION

Mandatory redemption

As noted above, the Fund is required under the Bylaws to maintain (a) both Moody s Ratings Agency Preferred Shares Asset Coverage and Fitch Ratings Agency Preferred Shares Asset Coverage and (b) 1940 Act Preferred Shares Asset Coverage. Eligible portfolio securities for the purposes of (a) above will be determined from time to time by the rating agency then rating the then outstanding Preferred Shares. If the Fund fails to maintain such asset coverage amounts and does not timely cure such failure in accordance with the Bylaws, the Fund would be required to redeem all or a portion of the Preferred Shares. This mandatory redemption would take place on a date that the Board specifies out of legally available funds in accordance with the Declaration, the Bylaws and applicable law, at the redemption price of $25,000 per share, plus accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption. In determining the number of Preferred Shares required to be redeemed in accordance with the foregoing, the Fund would redeem the lesser of (a) the minimum number of Preferred Shares necessary to satisfy the applicable Ratings Agency Preferred Shares Asset Coverage or 1940 Act Preferred Shares Asset Coverage, as the case may be, and (b) the maximum number of Preferred Shares and any other preferred shares of the Fund subject to redemption or retirement that can be redeemed out of funds expected to be legally available therefor at the time of redemption, and in any case will redeem such Preferred Shares pro rata among the Preferred Shares and any other preferred shares of the Fund subject to redemption or retirement. The mandatory redemption will be limited to the number of Preferred Shares and any other preferred shares necessary to restore the required Ratings Agency Preferred Shares Asset Coverage or 1940 Act Preferred Shares Asset Coverage, as the case may be.

Optional redemption

To the extent permitted under the 1940 Act and under Massachusetts law, upon giving notice of redemption, as provided below, the Fund, at its option, may redeem Preferred Shares, in whole or in part, out of funds legally available therefore, at the Optional Redemption Price (as defined below) per share on any dividend payment date, provided that no Preferred Shares may be redeemed at the option of the Fund during (a) the initial rate period with respect to the Preferred Shares or (b) a non-call period to which such shares are subject. Optional Redemption Price means $25,000 per Preferred Share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption plus the applicable redemption premium, if any. The Fund has

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the authority to redeem Preferred Shares for any reason and may redeem all or part of the outstanding Preferred Shares if it anticipates that the Fund s leveraged capital structure will result, for a significant period of time, in a lower rate of return to Common Shareholders than that obtainable if the common shares were not so leveraged.

Although the Preferred Shares are subject to redemption under certain circumstances as described above, unlike the shares of an open-end mutual fund, the Preferred Shares may not be redeemed at a shareholder s option at NAV or otherwise.

Market and net asset value information

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

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

	Common share market price		**Common share net asset value**		**Premium (discount) as a % of net asset value**	
Quarter	**High**	**Low**	**High**	**Low**	**High**	**Low**
Quarter ended Oct. 31, 2007	$ 18.59	$ 16.03	$ 18.04	$ 17.32	4.78%	-4.29%
Quarter ended Jan. 31, 2008	$ 17.30	$ 15.62	$ 17.85	$ 15.87	3.78%	-9.92%
Quarter ended Apr. 30, 2008	$ 16.54	$ 13.76	$ 15.57	$ 14.21	8.41%	-2.68%
Quarter ended Jul. 31, 2008	$ 16.93	$ 13.00	$ 15.60	$ 14.64	5.43%	-7.61%
Quarter ended Oct. 31, 2008	$ 14.21	$ 7.37	$ 14.69	$ 9.20	-4.02%	-27.03%
Quarter ended Jan. 31, 2009	$ 10.23	$ 5.26	$ 9.26	$ 6.97	29.12%	-28.88%
Quarter ended Apr. 30, 2009	$ 8.58	$ 3.89	$ 7.04	$ 4.89	20.03%	-11.04%
Quarter ended Jul. 31, 2009	$ 8.98	$ 6.49	$ 9.07	$ 6.81	-0.99%	-8.70%
Quarter ended Oct. 31, 2009	$ 12.05	$ 9.22	$ 10.81	$ 9.16	15.55%	0.66%
Quarter ended Jan. 31, 2010	$ 12.83	$ 10.75	$ 11.14	$ 9.80	24.56%	3.17%

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Anti-takeover provisions in the Agreement and Declaration of Trust

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

As described below, the Declaration grants special approval rights with respect to certain matters to members of the Board who qualify as Continuing Trustees, which term means Trustees who either (i) have been members of the Board for a period of at least thirty-six months (or since the commencement of the Fund s operations, if less than thirty-six months) or (ii) were nominated to serve as members of the Board by a majority of the Continuing Trustees then members of the Board.

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

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

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

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Anti-takeover provisions in the Agreement and Declaration of Trust

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

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

Repurchase of common shares; conversion to open-end fund

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

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

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

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U.S. FEDERAL INCOME TAX MATTERS

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

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

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

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

Subject to the considerations discussed immediately above, the Fund intends to distribute at least annually to its Common Shareholders all or substantially all of its investment company taxable income,

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without regard to the deduction for dividends paid (generally defined in the Code as taxable ordinary income and the excess, if any, of net short-term capital gains over net long-term capital losses), its net tax-exempt interest (if any) and its net capital gain (that is, the excess of net long-term capital gains over net short-term capital losses). Any taxable income, including any net capital gain retained by the Fund, will be subject to tax at the Fund level at regular corporate rates. In the case of net capital gain, the Fund is permitted to designate the retained amount as undistributed capital gains in a notice to its shareholders who would then, in turn, be (i) required to include in income for U.S. federal income tax purposes, as long-term capital gain, their shares of such undistributed amount, and (ii) entitled to credit their proportionate shares of the tax paid by the Fund on such undistributed amount against their U.S. federal income tax liabilities, if any, and to claim refunds on a properly-filed U.S. tax return to the extent the credit exceeds such liabilities. If the Fund makes this designation, for U.S. federal income tax purposes, the tax basis of the shares owned by a shareholder of the Fund would be increased by an amount equal under current law to the difference between the amount of undistributed capital gains included in the shareholder s gross income under clause (i) of the preceding sentence and the tax deemed paid by the shareholder under clause (ii) of the preceding sentence. The Fund is not required to, and there can be no assurance the Fund will, make this designation if it retains all or a portion of its net capital gain in a taxable year. To the extent that the Fund retains any net capital gain, it may be required to liquidate portfolio securities that it might otherwise have continued to hold (possibly at times or prices when it might not be advantageous to do so) in order to generate the cash to pay the tax on the amount retained.

For U.S. federal income tax purposes, distributions of net investment company taxable income are generally taxable to shareholders as ordinary income. Taxes on distributions of net capital gain are determined by how long the Fund owned the investments that generated such capital gain, rather than how long a shareholder has owned his or her shares. In general, the Fund will recognize long-term capital gain or loss on investments it has owned for more than one year, and short-term capital gain or loss on investments it has owned for one year or less. Therefore, distributions of net long-term capital gains (as reduced by any net short-term capital losses) that are properly designated by the Fund as capital gain dividends generally are taxable to shareholders as long-term capital gains. Long-term capital gain rates applicable to individuals have been temporarily reduced in general, to 15% with a 0% rate applying to taxpayers in the 10% and 15% brackets for taxable years beginning before January 1, 2011. It is currently unclear whether Congress will extend, change or eliminate this special rate to tax years beginning on or after January 1, 2011. Distributions of net short-term capital gains (as reduced by any net long-term capital losses) are generally taxable to shareholders as ordinary income.

Distributions in excess of the Fund s current and accumulated earnings and profits are treated as returns of capital to the extent of the shareholder s basis in its shares and thereafter as capital gain. A return of capital is not taxable, but it reduces a shareholder s tax basis in its shares, thus reducing any loss or increasing any gain on a subsequent taxable disposition by the shareholder of its shares. When one or more such distributions occur in any taxable year of the Fund, the available earnings and profits will be allocated first to the distributions made to the holders of Preferred Shares, and only thereafter to distributions made to Common Shareholders. As a result, in such a case, the holders of Preferred Shares will receive a disproportionate share of the distributions treated as dividends, and the Common Shareholders will receive a disproportionate share of the distributions treated as a return of capital.

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

Tax matters

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

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

From time to time, a substantial portion of the Fund s investments in loans and other debt obligations could be treated as having market discount and/or original issue discount (OID) for U.S. federal income tax purposes, which, in some cases, could be significant and could cause the Fund to recognize income in respect of these investments before, or without receiving, cash representing such income. If so, the Fund could be required to pay out as an income distribution each year an amount which is greater than the total amount of cash interest the Fund actually received. As a result, the Fund could be required at times to, among other things, liquidate other investments (including at potentially disadvantageous times or prices) in order to satisfy its distribution requirements and/or to avoid incurring Fund-level U.S. federal income or excise taxes. If the Fund liquidates portfolio securities to raise cash, the Fund may realize gain or loss on such liquidations; in the event the Fund realizes net long-term or short-term capital gains from such liquidation transactions, its shareholders may receive larger capital gain or ordinary dividends, respectively, than they would in the absence of such transactions.

The interest paid on municipal bonds is generally exempt from U.S. federal income tax. However, because the Fund does not expect to be eligible to pay exempt-interest dividends to its shareholders under the Code, any distribution received by Fund shareholders that is attributable to the interest received by the Fund on its municipal bond holdings is taxable to shareholders. In addition, any gains realized by the Fund on the sale or exchange of municipal bonds generally are taxable to shareholders when distributed to them by the Fund.

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

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

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Tax matters

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

Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries, in which case the Fund s yield on the securities giving rise to such income would be decreased. Tax treaties between certain countries and the United States may reduce or eliminate such taxes. If more than 50% of the Fund s assets at its year end consist of the securities of foreign corporations, the Fund may elect to permit shareholders to claim a credit or deduction on their income tax returns for their pro rata portion of qualified taxes paid by the Fund to foreign countries in respect of foreign securities the Fund has held for at least the minimum period specified in the Code. See the Statement of Additional Information for additional requirements to obtain such credits.

Under current law, the backup withholding rate is 28% for amounts paid through 2010 and will be 31% for amounts paid after December 31, 2010, unless Congress enacts tax legislation providing otherwise. The Fund may be required to apply backup withholding to taxable distributions or redemption proceeds payable to a shareholder including, for example, distributions paid to any individual shareholder who fails to properly furnish the Fund with a correct taxpayer identification number, who has under-reported dividend or interest income or who fails to certify to the Fund that he or she is not subject to such withholding. Please see the Statement of Additional Information for additional information about backup withholding.

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

Custodian and transfer agent

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

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

Independent registered public accounting firm

PricewaterhouseCoopers LLP, 300 Madison Avenue, New York, New York 10017, serves as independent registered public accounting firm for the Fund. PricewaterhouseCoopers LLP provides audit services, tax and other audit related services to the Fund.

Legal opinions

Certain legal matters in connection with the common shares will be passed upon for the Fund by Ropes & Gray LLP, Boston Massachusetts, and certain other legal matters will be passed on for the Dealer Manager by Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, Illinois.

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Appendix A Description of securities ratings

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

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

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

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

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

MOODY S LONG-TERM RATINGS

Bonds and preferred stock

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

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

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

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

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

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

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Appendix A Description of securities ratings

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

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

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

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

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

Corporate short-term debt ratings

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

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

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

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

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

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

Short-term municipal bond ratings

There are three rating categories for short-term municipal bonds that define an investment grade situation, which are listed below. In the case of variable-rate demand obligations (VRDOs), a two-component rating is assigned. The first element represents an evaluation of the degree of risk associated with scheduled principal and interest payments, and the other represents an evaluation of the degree of risk associated with the demand feature. The short-term rating assigned to the demand feature of VRDOs is designated as

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Appendix A Description of securities ratings

VMIG. When either the long- or short-term aspect of a VRDO is not rated, that piece is designated NR, *e.g.*, Aaa/NR or NR/VMIG 1. MIG ratings terminate at the retirement of the obligation while VMIG rating expiration will be a function of each issue s specific structural or credit features.

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

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

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

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

STANDARD & POOR S RATINGS SERVICES

Corporate and municipal bond ratings

Long-term issue credit ratings

Issue credit ratings are based, in varying degrees, on the following considerations:

- Likelihood of payment capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;

- Nature of and provisions of the obligation;

- Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors rights.

Issue ratings are an assessment of default risk, but may incorporate an assessment of relative seniority or ultimate recovery in the event of default. Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation may apply when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.)

Investment grade

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

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

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

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

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Appendix A Description of securities ratings

Speculative grade

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

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

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

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

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

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

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

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

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

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

N.R.: Not rated.

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

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Commercial paper rating definitions

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

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

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

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

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

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

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

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

Active qualifiers (currently applied and/or outstanding)

i: This subscript is used for issues in which the credit factors, terms, or both, that determine the likelihood of receipt of payment of interest are different from the credit factors, terms or both that determine the likelihood of receipt of principal on the obligation. The i subscript indicates that the rating addresses the interest portion of the obligation only. The i subscript will always be used in conjunction with the p subscript, which addresses likelihood of receipt of principal. For example, a rated obligation could be assigned ratings of AAAp NRi indicating that the principal portion is rated AAA and the interest portion of the obligation is not rated.

L: Ratings qualified with L apply only to amounts invested up to federal deposit insurance limits.

P: This subscript is used for issues in which the credit factors, the terms, or both, that determine the likelihood of receipt of payment of principal are different from the credit factors, terms or both that determine the likelihood of receipt of interest on the obligation. The p subscript indicates that the rating addresses the principal portion of the obligation only. The p subscript will always be used in conjunction with the i subscript, which addresses likelihood of receipt of interest. For example, a rated obligation could be assigned ratings of AAAp NRi indicating that the principal portion is rated AAA and the interest portion of the obligation is not rated.

pi: Ratings with a pi subscript are based on an analysis of an issuer s published financial information, as well as additional information in the public domain. They do not, however, reflect in-depth meetings with an issuer s management and are therefore based on less comprehensive information than ratings

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Appendix A Description of securities ratings

without a pi subscript. Ratings with a pi subscript are reviewed annually based on a new year s financial statements, but may be reviewed on an interim basis if a major event occurs that may affect the issuer s credit quality.

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

Preliminary: Preliminary ratings are assigned to issues, including financial programs, in the following circumstances.

Preliminary ratings may be assigned to obligations, most commonly structured and project finance issues, pending receipt of final documentation and legal opinions. Assignment of a final rating is conditional on the receipt and approval by Standard & Poor s of appropriate documentation. Changes in the information provided to Standard & Poor s could result in the assignment of a different rating. In addition, Standard & Poor s reserves the right not to issue a final rating.

Preliminary ratings are assigned to Rule 415 Shelf Registrations. As specific issues, with defined terms, are offered from the master registration, a final rating may be assigned to them in accordance with Standard & Poor s policies. The final rating may differ from the preliminary rating.

t: This symbol indicates termination structures that are designed to honor their contracts to full maturity or, should certain events occur, to terminate and cash settle all their contracts before their final maturity date.

Unsolicited: Unsolicited ratings are those credit ratings assigned at the initiative of Standard & Poor s and not at the request of the issuer or its agents.

Inactive qualifiers (no longer applied or outstanding)

*: This symbol indicated continuance of the ratings is contingent upon Standard & Poor s receipt of an executed copy of the escrow agreement or closing documentation confirming investments and cash flows. Discontinued use in August 1998.

c: This qualifier was used to provide additional information to investors that the bank may terminate its obligation to purchase tendered bonds if the long-term credit rating of the issuer is below an investment-grade level and/or the issuer s bonds are deemed taxable. Discontinued use in January 2001.

q: A q subscript indicates that the rating is based solely on quantitative analysis of publicly available information. Discontinued use in April 2001.

r: The r modifier was assigned to securities containing extraordinary risks, particularly market risks, that are not covered in the credit rating. The absence of an r modifier should not be taken as an indication that an obligation will not exhibit extraordinary non-credit related risks. Standard & Poor s discontinued the use of the r modifier for most obligations in June 2000 and for the balance of obligations (mainly structured finance transactions) in November 2002.

Local Currency and Foreign Currency Risks: Country risk considerations are a standard part of Standard & Poor s analysis for credit ratings on any issuer or issue. Currency of repayment is a key factor in this analysis. An obligor s capacity to repay foreign currency obligations may be lower than its capacity to repay obligations in its local currency due to the sovereign government s own relatively lower capacity to repay external versus domestic debt. These sovereign risk considerations are incorporated in

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Appendix A Description of securities ratings

the debt ratings assigned to specific issues. Foreign currency issuer ratings are also distinguished from local currency issuer ratings to identify those instances where sovereign risks make them different for the same issuer.

FITCH, INC.

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

Long-term credit ratings

Investment grade

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

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

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

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

Speculative grade

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

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

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

DDD, DD, D: Default. The ratings of obligations in this category are based on their prospects for achieving partial or full recovery in a reorganization or liquidation of the obligor. While expected recovery values are highly speculative and cannot be estimated with any precision, the following serve as general guidelines. DDD obligations have the highest potential for recovery, around 90%-100% of outstanding amounts and accrued interest. DD indicates potential recoveries in the range of

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50%-90%, and D the lowest recovery potential, *i.e.*, below 50%. Entities rated in this category have defaulted on some or all of their obligations. Entities rated DDD have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Entities rated DD and D are generally undergoing a formal reorganization or liquidation process; those rated DD are likely to satisfy a higher portion of their outstanding obligations, while entities rated D have a poor prospect for repaying all obligations.

Recovery ratings

Recovery ratings are assigned to selected individual securities and obligations. These currently are published for most individual obligations of corporate issuers with IDRs in the B rating category and below, and for selected structured finance obligations in low speculative grade.

Among the factors that affect recovery rates for securities are the collateral, the seniority relative to other obligations in the capital structure (where appropriate), and the expected value of the company or underlying collateral in distress.

The recovery rating scale is based upon the expected relative recovery characteristics of an obligation upon the curing of a default, emergence from insolvency or following the liquidation or termination of the obligor or its associated collateral. For structured finance, recovery ratings are designed to estimate recoveries on a forwardlooking basis while taking into account the time value of money.

Recovery ratings are an ordinal scale and do not attempt to precisely predict a given level of recovery. As a guideline in developing the rating assessments, the agency employs broad theoretical recovery bands in its ratings approach based on historical averages, but actual recoveries for a given security may deviate materially from historical averages.

RR1: *Outstanding recovery prospects given default*. RR1 rated securities have characteristics consistent with securities historically recovering 91%-100% of current principal and related interest.

RR2: *Superior recovery prospects given default. RR2 rated securities have characteristics consistent with securities historically recovering 71%-90% of current principal and related interest.*

RR3: *Good recovery prospects given default.* RR3 rated securities have characteristics consistent with securities historically recovering 51%-70% of current principal and related interest. Prospectus A-5

RR4: *Average recovery prospects given default.* RR4 rated securities have characteristics consistent with securities historically recovering 31%-50% of current principal and related interest.

RR5: *Below average recovery prospects given default.* RR5 rated securities have characteristics consistent with securities historically recovering 11%-30% of current principal and related interest.

RR6: *Poor recovery prospects given default.* RR6 rated securities have characteristics consistent with securities historically recovering 0%-10% of current principal and related interest.

Short-term credit ratings

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

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

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

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

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

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

D: Default. Denotes actual or imminent payment default.

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

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

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

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

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

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PIMCO INCOME STRATEGY FUND

(formerly, PIMCO Floating Rate Income Fund)

Statement of Additional Information

March 22, 2010

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

This Statement of Additional Information relating to the offering of transferable rights to subscribe for common shares of the Fund (the Offer) is not a prospectus, and should be read in conjunction with the Fund s prospectus dated March 22, 2010 (the Prospectus). This Statement of Additional Information does not include all information that a prospective investor should consider before investing in the Fund, and investors should obtain and read the Prospectus prior to investing in the Fund. A copy of the Prospectus may be obtained without charge by calling the Information Agent at (866) 207-3647. You may also obtain a copy of the Prospectus on the Web site of the Securities and Exchange Commission (the SEC) at http://www.sec.gov. Capitalized terms used but not defined in this Statement of Additional Information have the meanings ascribed to them in the Prospectus.

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THE FUND

The Fund was organized as a Massachusetts business trust on June 19, 2003 under the name PIMCO Floating Rate Income Fund. Effective March 1, 2010, the Fund changed its name from PIMCO Floating Rate Income Fund to its current name, PIMCO Income Strategy Fund, and rescinded its prior policy to normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in floating rate assets. The Fund also recently revised various of its investment guidelines and strategies (including those relating to average portfolio duration, investments in below investment grade securities and exposure to emerging market securities) to those reflected in the Prospectus. Prior to commencing operations on August 29, 2003, the Fund had no operations other than matters relating to its organization and registration as a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the 1940 Act).

USE OF PROCEEDS

The net proceeds of the Offer will be invested in accordance with the Fund s investment objective and investment strategies as set forth in the Prospectus. Assuming current market conditions, the Fund estimates that the net proceeds of the Offer will be substantially invested in accordance with its investment objective and investment strategies within one to three months of the completion of the Offer. Pending such investment, it is anticipated that the proceeds of the Offer will be invested in short-term debt securities. Following completion of the Offer, the Fund currently intends to add leverage to its portfolio in order to maintain approximately the total amount of leverage (as a percentage of the Fund s total assets) that the Fund currently maintains. See Use of leverage in the Prospectus.

INVESTMENT OBJECTIVE AND POLICIES

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

High Yield Securities (Junk Bonds)

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

Some of the floating rate loans (Floating Rate Loans) in which the Fund may invest will be high yield securities. See Floating Rate Loans.

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Investments in high yield securities generally provide greater income and increased opportunity for capital appreciation than investments in higher quality securities, but they also typically entail greater price volatility and principal and income risk, including the possibility of issuer default and bankruptcy. High yield securities are regarded as predominantly speculative with respect to the issuer s continuing ability to meet principal and interest payments. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies. In addition, analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher quality securities.

High yield securities may be more susceptible to real or perceived adverse economic and competitive industry conditions than investment grade securities. A projection of an economic downturn or of a period of rising interest rates, for example, could cause a decline in high yield security prices because the advent of a recession could lessen the ability of an issuer to make principal and interest payments on its debt obligations. If an issuer of high yield securities defaults, in addition to risking non-payment of all or a portion of interest and principal, the Fund may incur additional expenses to seek recovery. The market prices of high yield securities structured as zero-coupon, step-up or payment-in-kind securities will normally be affected to a greater extent by interest rate changes, and therefore tend to be more volatile than the prices of securities that pay interest currently and in cash. PIMCO seeks to reduce these risks through prudent diversification with respect to industries and issuers, independent and fundamental credit analysis and an emphasis on top-down macroeconomic analysis focused on the developments of structural changes in both the economy and financial markets.

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

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

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

Floating Rate Debt Instruments

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

Floating Rate Loans

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

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

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

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

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

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

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

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

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indebtedness involves a greater degree of judgment in determining the Fund s net asset value than if that value were based on available market quotations. At the same time, many loan interests are actively traded among certain financial institutions and considered to be liquid. PIMCO will determine the liquidity of the Fund s investments by reference to market conditions and contractual provisions. Investments in loan participations are considered to be debt obligations for purposes of the Fund s investment restriction relating to the lending of funds or assets.

Investments in loans through a direct assignment of the financial institution s interests with respect to the loan may involve additional risks to the Fund. For example, if a loan is foreclosed, the Fund could become part owner of any collateral, and would bear the costs and liabilities associated with owning and disposing of the collateral. In addition, it is conceivable that, under emerging legal theories of lender liability, the Fund could be held liable as co-lender. It is unclear whether loans and other forms of direct indebtedness offer securities law protections against fraud and misrepresentation. In the absence of definitive regulatory guidance, the Fund relies on PIMCO s research in an attempt to avoid situations where fraud or misrepresentations could adversely affect the Fund.

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

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

Borrower Covenants. A borrower under a Floating Rate Loan typically must comply with various restrictive covenants contained in a loan agreement or note purchase agreement between the borrower and the Lender or lending syndicate (the Loan Agreement). Such covenants, in addition to requiring the scheduled payment of interest and principal, may include restrictions on dividend payments and other distributions to stockholders, provisions requiring the borrower to maintain specific minimum financial ratios and limits on total debt. In addition, the Loan Agreement may contain a covenant requiring the borrower to prepay the Floating Rate Loan with any free cash flow. Free cash flow is generally defined as net cash flow after scheduled debt service payments and permitted capital expenditures, and includes the proceeds from asset dispositions or sales of securities. A breach of a covenant which is not waived by the Agent, or by the lenders directly, as the case may be, is normally an event of acceleration; *i.e.*, the Agent, or the lenders directly, as the case may be, has the right to call the outstanding Floating Rate Loan. The typical practice of an Agent or a Lender in relying exclusively or primarily on reports from the borrower

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may involve a risk of fraud by the borrower. In the case of a Floating Rate Loan in the form of a participation, the agreement between the buyer and seller may limit the rights of the holder of a Floating Rate Loan to vote on certain changes which may be made to the Loan Agreement, such as waiving a breach of a covenant. However, the holder of the participation will, in almost all cases, have the right to vote on certain fundamental issues such as changes in principal amount, payment dates and interest rate.

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

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

Prepayments. Floating Rate Loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the Floating Rate Loan from free cash flow, as defined above. The degree to which borrowers prepay Floating Rate Loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among others. As such, prepayments cannot be predicted with accuracy. Upon a prepayment, either in part or in full, the