

PIMCO INCOME STRATEGY FUND  
Form N-CSR/A  
October 04, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM N-CSR**

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

Investment Company Act file number 811-21374

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

1633 Broadway, New York, New York  
(Address of principal executive offices)

10019  
(Zip code)

Lawrence G. Altadonna -1633 Broadway, New York, New York 10019  
(Name and address of agent for service)

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

Date of fiscal year July 31, 2011  
end:

Date of reporting period: July 31, 2011

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

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

Item 1. Report to Shareholders



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Dear Shareholder:

This letter focuses on the twelve-month fiscal period ended July 31, 2011. However, it is important to note the significant volatility that has impacted U.S. financial markets since the end of the reporting period. This volatility has been sparked by a variety of economic and geopolitical challenges in both the United States and abroad. Ongoing U.S. government budget battles and the downgrading of its credit rating, fiscal concerns in Europe, and data indicating that the U.S. and global economies are slowing down have all contributed significantly to the recent market downturn.

Hans W. Kertess

*Chairman*

Brian S. Shlissel

*President & CEO*

### **Twelve Month Period in Review through July 31, 2011**

For the twelve-month fiscal period ended July 31, 2011:

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- PIMCO Income Strategy Fund rose 19.46% on net asset value ( NAV ) and 19.67% on market price.
- PIMCO Income Strategy Fund II advanced 19.12% on NAV and 12.53% on market price.

The Barclays Capital U.S. Credit Index, a measure of high quality corporate bond performance, returned 6.70% and the Barclays Capital U.S. High Yield Bond Index, a measure of below investment-grade corporate bond performance, returned 12.95% during the reporting period. Government bonds, as represented by the Barclays Capital Long Term Treasury Index, rose 3.04%. The Barclays Capital U.S. Aggregate Bond Index, a broad credit market measure of government and corporate securities, posted a 4.44% return, and mortgage-backed securities, reflected by the Barclays Capital Mortgage Index, rose 3.88%. As for stocks, the Standard & Poor's 500 Index advanced 19.65% during the fiscal twelve month period.

At the start of the fiscal year, Gross Domestic Product ( GDP ), the value of goods and services produced in the country, the broadest measure of economic activity and the principal indicator of economic performance, was growing at an annualized rate of 2.5%. GDP fell to 2.3% between October and December 2010 and 0.4% between January and March of 2011. It perked up to an annualized rate of 1.3% between April and June 2011.

As the economy struggled, U.S. Treasury prices jumped, sending yields plummeting. After reaching 3.75% in February 2011, the benchmark 10-year Treasury yielded just 2.82% at the end of the fiscal period.

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The slowdown took steam out of corporate bonds, particularly in the higher-yielding ( junk bond ) sector. Corporate profits remained robust, but concerns grew that skittish consumers would reduce spending, jeopardizing future earnings.

The economic weakness prompted the Federal Reserve (the Fed ) to indicate that it would keep interest rates low through 2013. Policymakers have also hinted of additional stimulus measures.

### **The Road Ahead**

The recent market volatility reflects ongoing concerns about the health of the U.S. economy. Key measures such as unemployment and housing remain troubled, and consumer confidence has fallen to levels not seen since 1982.

There are reasons to be hopeful, however, as GDP accelerated between April and June. In addition, there were 3.1 million job openings in May. The Fed is maintaining a low interest rate environment and U.S. companies, holding record amounts of cash, appear healthy. We maintain our view that the U.S. rebound now entering its third year will continue.

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

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

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess  
Chairman

Brian S. Shlissel  
President & CEO

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

July 31, 2011 (unaudited)

For the 12 months ended July 31, 2011, PIMCO Income Strategy Fund returned 19.46% on net asset value ( NAV ) and 19.67% on market price.

For the 12 months ended July 31, 2011, PIMCO Income Strategy Fund II returned 19.12% on NAV and 12.53% on market price.

The unmanaged Barclays Capital U.S. Aggregate Bond Index and Barclays Capital U.S. Credit Index returned 4.44% and 6.70%, respectively, during the reporting period.

While the U.S. fixed income market generated a positive return during the reporting period, there were periods of heightened volatility due to shifting expectations for the economy and periodic flights to quality. Early in the period, there were concerns that the economic recovery was losing momentum and the U.S. may fall back into recession. Beginning in the fourth quarter of 2010, expectations improved and inflationary concerns emerged. Despite a number of geopolitical challenges, the ongoing European sovereign debt crisis and the devastating earthquake in Japan, most spread sectors (non-U.S. Treasuries) outperformed equal-duration Treasuries through the end of April 2011. However, over the last three months of the period, the economy decelerated and investor risk appetite was replaced with risk aversion. Further impacting investor sentiment were concerns regarding the raising of the debt ceiling and the potential for a downgrade of U.S. government securities. Against this backdrop, Treasury yields moved lower and nearly every spread sector lagged equal-duration Treasuries. All told, during the 12 months ended July 31, 2011, both short- and long-term Treasury yields declined and the yield curve steepened.

Sector exposures largely enhanced the Funds' performance

During the reporting period, the Funds significantly outperformed the broad U.S. fixed income market (as measured by the Barclays Capital U.S. Aggregate Bond Index) as well as the U.S. credit market (as measured by the Barclays Capital U.S. Credit Index).

Overall, the Funds' sector exposures within the corporate bond market were beneficial for performance. An emphasis on the life insurance sector, which materially outpaced the broad market, benefited returns. An overweighting to non-captive consumer finance bonds was a strong contributor to performance, as these issues substantially outperformed the overall credit market. An emphasis on banks was rewarded, as recapitalization efforts increased. However, a portion of these gains were given back toward the end of the reporting period as sovereign debt tensions increased and negatively impacted the financial sector. Select exposure to Build America Bonds, a part of the Obama administration's economic stimulus package, which subsidized taxable municipal securities in an effort to attract investors, added to performance, as these municipal issues generally outperformed the broader market. Finally, having an exposure to certain speculative-grade corporate bonds enhanced the Funds' results, as these securities outperformed their higher quality counterparts.

Underweight exposure to technology detracted from results as this sector rallied and outperformed the overall credit market. An underweighting to the metals and mining sector was also not rewarded, as this sector benefited from increasing metal prices. Elsewhere, the Funds' exposure to the European banking sector detracted from performance as select issuers were adversely impacted by sovereign credit concerns.

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

July 31, 2011 (unaudited)

**Total Return<sup>(1)</sup>:**

	<b>Market Price</b>	<b>NAV</b>
1 Year	19.67%	19.46%
5 Year	3.35%	3.01%
Commencement of Operations (8/29/03) to 7/31/11	4.65%	4.27%

**Market Price/NAV Performance:**

Commencement of Operations (8/29/03) to 7/31/11

**Market Price/NAV:**

Market Price	\$12.39
NAV	\$11.39
Premium to NAV	8.78%
Market Price Yield <sup>(2)</sup>	7.26%

Market Price

NAV

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

July 31, 2011 (unaudited)

<b>Total Return(1):</b>	<b>Market Price</b>	<b>NAV</b>
1 Year	12.53%	19.12%
5 Year	0.32%	0.06%
Commencement of Operations (10/29/04) to 7/31/11	1.23%	1.61%

<b>Market Price/NAV Performance:</b>	<b>Market Price/NAV:</b>	
Commencement of Operations (10/29/04) to 7/31/11	Market Price	\$10.27
	NAV	\$10.04
Market Price	Premium to NAV	2.29%
NAV	Market Price Yield(2)	7.59%

**Portfolio Composition**

(as a % of total investments)

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

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

An investment in the Funds involves risk, including the loss of principal. Total return, market price, market price yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end

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funds, unlike open-end funds, are not continuously offered. There is a one time public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

(2) Market Price Yield is determined by dividing the annualized current monthly per common share dividend (comprised of net investment income) payable to common shareholders by the market price per common share at July 31, 2011.

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>CORPORATE BONDS &amp; NOTES 58.8%</b>			
<b>Airlines 5.1%</b>			
\$900	American Airlines, Inc., 10.50%, 10/15/12	B2/B	\$949,500
3,774	American Airlines Pass Through Trust, 9.73%, 9/29/14	Caa2/CCC+	3,697,932
1,861	10.18%, 1/2/13	Caa1/CCC+	1,861,294
14,637	United Air Lines Pass Through Trust, 10.40%, 5/1/18 (j)	Baa2/BBB+	16,484,010
			22,992,736
<b>Banking 8.3%</b>			
2,600	AgFirst Farm Credit Bank, 7.30%, 8/29/11 (a) (b) (d) (g) (k) (acquisition cost-\$2,225,000; purchased 2/26/10-4/15/10)	NR/A	2,611,448
1,200	Barclays Bank PLC (g), 7.375%, 12/15/11 (a) (d)	Baa2/A-	1,212,000
1,885	7.434%, 12/15/17 (a) (d) (j)	Baa2/A-	1,899,137
£7,800	14.00%, 6/15/19	Baa2/A-	15,588,042
3,000	Cooperatieve Centrale Raiffeisen-Boerenleenbank BA, 6.875%, 3/19/20	NR/NR	4,306,689
\$4,400	11.00%, 6/30/19 (a) (d) (g) (j)	A2/AA-	5,637,355
600	HBOS PLC, 6.75%, 5/21/18 (a) (d)	Baa3/BBB	602,413
800	Regions Financial Corp., 7.375%, 12/10/37	B1/BB	763,470
1,500	7.75%, 9/15/24	B1/BB	1,484,257
£2,000	Santander Issuances S.A. Unipersonal, 7.30%, 7/27/19, (converts to FRN on 9/27/14)	Aa3/AA-	3,346,801
			37,451,612
<b>Chemicals 0.5%</b>			
\$1,861	Lyondell Chemical Co., 8.00%, 11/1/17 (a) (d)	Ba1/BB+	2,112,235
<b>Consumer Products 0.2%</b>			
800	Reynolds Group Issuer, Inc., 9.00%, 4/15/19 (a) (d)	Caa1/B-	800,000
<b>Energy 0.2%</b>			
1,100	Dynegy Roseton/Danskammer Pass Through Trust, 7.67%, 11/8/16, Ser. B	Ca/CC	852,500
<b>Financial Services 24.3%</b>			
304	Ally Financial, Inc., 5.90%, 1/15/19	B1/B+	285,225
156	5.90%, 10/15/19	B1/B+	143,441
55	6.00%, 2/15/19	B1/B+	51,666
90	6.00%, 3/15/19	B1/B+	84,768
8	6.00%, 4/15/19	B1/B+	7,500
325	6.00%, 9/15/19	B1/B+	302,831

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95	6.05%, 8/15/19	B1/B+	88,680
413	6.05%, 10/15/19	B1/B+	383,703
31	6.125%, 10/15/19	B1/B+	28,943
1,208	6.15%, 8/15/19	B1/B+	1,135,739
1,371	6.25%, 2/15/16	B1/B+	1,347,165
25	6.25%, 1/15/19	B1/B+	23,950
120	6.30%, 8/15/19	B1/B+	113,902
1,168	6.35%, 2/15/16	B1/B+	1,152,136
285	6.35%, 4/15/16	B1/B+	279,269
216	6.40%, 3/15/16	B1/B+	215,973

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Financial Services (continued)</b>			
\$360	6.40%, 11/15/19	B1/B+	\$342,443
1,357	6.50%, 2/15/16	B1/B+	1,346,265
20	6.50%, 9/15/16	B1/B+	19,669
442	6.50%, 10/15/16	B1/B+	434,892
170	6.50%, 12/15/18	B1/B+	165,262
22	6.50%, 5/15/19	B1/B+	21,190
358	6.55%, 12/15/19	B1/B+	344,146
14	6.60%, 5/15/18	B1/B+	13,996
51	6.65%, 6/15/18	B1/B+	51,129
60	6.70%, 6/15/18	B1/B+	60,152
329	6.75%, 4/15/13	B1/B+	329,327
3	6.75%, 8/15/16	B1/B+	2,979
13	6.75%, 6/15/17	B1/B+	13,010
89	6.75%, 5/15/19	B1/B+	86,985
10	6.75%, 6/15/19	B1/B+	9,737
205	6.80%, 9/15/16	B1/B+	203,965
3	6.80%, 10/15/18	B1/B+	3,001
938	6.85%, 4/15/16	B1/B+	936,212
30	6.85%, 5/15/18	B1/B+	29,991
336	6.875%, 8/15/16	B1/B+	334,982
5	6.875%, 7/15/18	B1/B+	5,004
140	6.90%, 6/15/17	B1/B+	140,384
32	6.90%, 8/15/18	B1/B+	31,845
151	6.95%, 6/15/17	B1/B+	151,439
25	7.00%, 12/15/16	B1/B+	25,003
27	7.00%, 6/15/17	B1/B+	27,083
130	7.00%, 7/15/17	B1/B+	130,506
367	7.00%, 2/15/18	B1/B+	367,257
12	7.00%, 3/15/18	B1/B+	11,999
155	7.00%, 8/15/18	B1/B+	154,999
5	7.00%, 9/15/18	B1/B+	4,984
42	7.05%, 3/15/18	B1/B+	42,000
39	7.05%, 4/15/18	B1/B+	39,003
3,812	7.10%, 9/15/12	B1/B+	3,804,875
100	7.125%, 8/15/12	B1/B+	99,882
160	7.125%, 10/15/17	B1/B+	160,351
40	7.15%, 3/15/25	B1/B+	39,447
75	7.20%, 10/15/17	B1/B+	74,217
288	7.25%, 6/15/16	B1/B+	288,310
293	7.25%, 9/15/17	B1/B+	289,880
10	7.25%, 4/15/18	B1/B+	10,026
10	7.25%, 8/15/18	B1/B+	10,002
328	7.25%, 9/15/18	B1/B+	327,992
25	7.30%, 1/15/18	B1/B+	25,063
396	7.35%, 4/15/18	B1/B+	397,545
57	7.50%, 6/15/16	B1/B+	57,314
45	7.55%, 5/15/16	B1/B+	45,210



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47	7.75%, 10/15/17	B1/B+	47,137
110	8.125%, 11/15/17	B1/B+	110,372
110	9.00%, 7/15/20	B1/B+	111,647
£1,700	BAC Capital Trust VII, 5.25%, 8/10/35	Baa3/BB+	2,148,660
\$1,400	Capital One Capital VI, 8.875%, 5/15/40	Baa3/BB	1,470,909

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Financial Services</b> (continued)			
	CIT Group, Inc.,		
\$528	7.00%, 5/1/14	B2/B+	\$532,919
1,157	7.00%, 5/1/15	B2/B+	1,162,383
1,579	7.00%, 5/1/16	B2/B+	1,584,798
2,210	7.00%, 5/1/17	B2/B+	2,218,715
2,500	Citigroup Capital XXI, 8.30%, 12/21/77, (converts to FRN on 12/21/37)	Ba1/BB+	2,575,000
	Credit Agricole S.A. (g),		
2,500	6.637%, 5/31/17 (a) (d) (j)	A3/BBB+	2,150,000
£1,000	8.125%, 10/26/19	A3/BBB+	1,608,622
\$4,600	Ford Motor Credit Co. LLC, 8.125%, 1/15/20 (j)	Ba2/BB-	5,476,562
7,000	ILFC E-Capital Trust I, 5.74%, 12/21/65, FRN (a) (d)	B3/BB	5,886,930
	LBG Capital No.1 PLC,		
500	6.439%, 5/23/20	Ba3/BB	607,090
200	7.375%, 3/12/20	Ba3/BB	258,786
£300	7.588%, 5/12/20	Ba3/BB	443,192
£4,800	7.867%, 12/17/19	Ba3/BB	7,130,464
£700	7.869%, 8/25/20	Ba3/BB	1,051,924
\$2,500	7.875%, 11/1/20 (a) (d)	Ba3/BB	2,368,750
1,400	8.00%, 6/15/20 (a) (d) (g)	NR/BB-	1,302,000
2,000	8.50%, 12/17/21 (a) (d) (g)	NR/BB-	1,790,000
£900	11.04%, 3/19/20	Ba3/BB	1,564,098
	LBG Capital No.2 PLC,		
£534	9.125%, 7/15/20	Ba2/BB+	850,677
£2,500	11.25%, 9/14/23	Ba2/BB+	4,349,846
\$1,500	Lehman Brothers Holdings, Inc., 7.50%, 5/11/38 (e)	WR/NR	1,650
1,629	NB Capital Trust II, 7.83%, 12/15/26	Baa3/BB+	1,661,580
5,000	PNC Financial Services Group, Inc., 6.75%, 8/1/21 (g)	Baa3/BBB	5,007,660
3,700	Royal Bank of Scotland Group PLC, 7.648%, 9/30/31 (g) SLM Corp.,	Ba2/BB	3,209,750
400	6.25%, 1/25/16	Ba1/BBB-	419,261
12,200	8.00%, 3/25/20 (j)	Ba1/BBB-	13,392,306
6,400	8.45%, 6/15/18 (j)	Ba1/BBB-	7,166,925
2,168	SMFG Preferred Capital USD 3 Ltd., 9.50%, 7/25/18 (a) (d) (g)	Ba1/BBB+	2,596,180
	Springleaf Finance Corp.,		
900	3.25%, 1/16/13	B3/B	1,224,274
\$8,200	6.50%, 9/15/17	B3/B	7,503,000
1,800	Wells Fargo Capital XV, 9.75%, 9/26/13 (g) (j)	Baa3/A-	1,914,750
			110,054,661
<b>Insurance 12.2%</b>			
10,000	American General Capital II, 8.50%, 7/1/30 (j)	Baa2/BBB-	11,050,000
1,600	American General Institutional Capital A, 7.57%, 12/1/45 (a) (d)	Baa2/BBB-	1,684,000
2,000	American General Institutional Capital B, 8.125%, 3/15/46 (a) (d)	Baa2/BBB-	2,170,000

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	American International Group, Inc.,		
2,800	4.875%, 3/15/67, (converts to FRN on 3/15/17)	Baa2/BBB	3,198,538
\$4,000	6.25%, 3/15/87, (converts to FRN on 3/15/37) (j)	Baa2/BBB	3,630,000
MXN 8,000	7.98%, 6/15/17	Baa1/A-	621,308
1,900	8.00%, 5/22/68, (converts to FRN on 5/22/18) (a) (d)	Baa2/BBB	2,702,808
\$8,200	8.175%, 5/15/68, (converts to FRN on 5/15/38)	Baa2/BBB	8,968,750
4,400	8.25%, 8/15/18 (j)	Baa1/A-	5,231,050
£1,300	8.625%, 5/22/68, (converts to FRN on 5/22/18)	Baa2/BBB	2,181,899

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Insurance (continued)</b>			
\$2,200	Dai-ichi Life Insurance Co., Ltd., 7.25%, 7/25/21 (a) (d) (g) (j)	A3/BBB+	\$2,326,990
2,300	Hartford Financial Services Group, Inc., 8.125%, 6/15/68, (converts to FRN on 6/15/18)	Ba1/BB+	2,466,750
2,000	Metlife Capital Trust IV, 7.875%, 12/15/67, (converts to FRN on 12/15/37) (a) (d)	Baa2/BBB	2,200,554
3,300	MetLife Capital Trust X, 9.25%, 4/8/68, (converts to FRN on 4/8/38) (a) (d) (j)	Baa2/BBB	4,108,500
2,440	Progressive Corp., 6.70%, 6/15/67, (converts to FRN on 6/15/17) (j)	A2/A-	2,522,338
			55,063,485
<b>Oil &amp; Gas 2.6%</b>			
5,000	NGPL PipeCo LLC (a) (d), 7.119%, 12/15/17	Ba2/BB+	5,698,300
5,000	7.768%, 12/15/37 (j)	Ba2/BB+	5,456,590
600	SandRidge Energy, Inc., 8.00%, 6/1/18 (a) (d)	B3/B	639,000
			11,793,890
<b>Paper &amp; Forest Products 2.4%</b>			
10,000	Weyerhaeuser Co., 7.375%, 3/15/32 (j)	Ba1/BBB-	10,767,360
<b>Telecommunications 2.4%</b>			
11,000	CenturyLink, Inc., 7.60%, 9/15/39 (j)	Baa3/BB	11,109,978
<b>Utilities 0.6%</b>			
1,900	AES Andres Dominicana Ltd., 9.50%, 11/12/20 (a) (d)	NR/B-	2,035,850
390	Dominion Resources, Inc., 6.30%, 9/30/66, (converts to FRN on 9/30/11)	Baa3/BBB	379,875
400	PPL Capital Funding, Inc., 6.70%, 3/30/67, (converts to FRN on 3/30/17)	Ba1/BB+	394,657
			2,810,382
Total Corporate Bonds & Notes (cost-\$241,957,648)			265,808,839
<b>MUNICIPAL BONDS 22.2%</b>			
<b>California 7.6%</b>			
9,200	Alameda Cnty. Joint Powers Auth. Rev., 7.046%, 12/1/44, Ser. A	A1/AA	9,980,252
3,000	Fresno Cnty. Rev., zero coupon, 8/15/24, Ser. A (FGIC-NPFGC)	WR/AA-	1,308,270
900	Long Beach Redev. Agcy., Tax Allocation, 8.36%, 8/1/40	NR/BBB+	939,222
7,600	Los Angeles Cnty. Public Works Financing Auth. Rev., 7.618%, 8/1/40	A1/A+	8,454,696
2,375	Marysville Public Financing Auth., CP, 6.15%, 10/1/36	NR/A-	1,981,344
1,100		A2/NR	1,231,901

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	Oakland Unified School Dist., Alameda Cnty., GO, 9.50%, 8/1/34		
600	Riverside Cnty. Redev. Agcy., Tax Allocation, 7.50%, 10/1/30, Ser. A-T	A3/A-	604,248
1,000	Riverside Rev., 7.605%, 10/1/40	NR/AA-	1,222,580
1,000	San Luis Obispo Cnty. Rev., zero coupon, 9/1/27, Ser. C (NPFGC)	Baa1/AA-	320,200
400	San Marcos Unified School Dist., GO, zero coupon, 8/1/32	Aa2/AA-	101,708
4,000	State Public Works Board Rev., 7.804%, 3/1/35, Ser. B-2	Aa3/BBB+	4,179,120
3,600	Stockton Public Financing Auth. Rev., 7.942%, 10/1/38, Ser. B	NR/A	3,777,984
			34,101,525

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)			Credit Rating (Moody s/S&P)*	Value
<b>Colorado 1.0%</b>				
\$4,000	Denver Public Schools, CP, 7.017%, 12/15/37, Ser. B	Aa3/A+	\$4,586,840	
<b>District of Columbia 3.4%</b>				
15,000	Metropolitan Airports Auth. Rev., 7.462%, 10/1/46	Baa1/BBB+	15,379,950	
<b>Nevada 2.4%</b>				
10,000	Las Vegas Valley Water Dist., GO, 7.263%, 6/1/34	Aa2/AA+	10,765,700	
<b>New Jersey 0.5%</b>				
	Middlesex Cnty. Improvement Auth. Rev. (AGM-GTD),			
1,935	zero coupon, 10/1/22	Aa3/NR	979,923	
2,455	zero coupon, 10/1/23	Aa3/NR	1,158,735	
			2,138,658	
<b>Ohio 4.6%</b>				
16,000	American Municipal Power-Ohio, Inc. Rev., Comb Hydroelectric Projects, 8.084%, 2/15/50, Ser. B	A3/A	20,892,960	
<b>Pennsylvania 0.1%</b>				
1,000	Philadelphia Auth. for Industrial Dev. Rev., zero coupon, 4/15/26, Ser. B (AMBAC)	A2/BBB	347,560	
<b>Texas 2.6%</b>				
1,900	Dallas Convention Center Hotel Dev. Corp. Rev., 7.088%, 1/1/42	A1/A+	2,051,639	
9,000	North Texas Tollway Auth. Rev., 8.91%, 2/1/30	Baa3/NR	9,857,610	
			11,909,249	
Total Municipal Bonds (cost-\$91,123,197)				100,122,442
<b>MORTGAGE-BACKED SECURITIES 11.3%</b>				
162	Banc of America Alternative Loan Trust, 6.00%, 1/25/36, CMO	Caa2/NR	112,164	
3,100	Banc of America Funding Corp., 6.00%, 3/25/37, CMO BCAP LLC Trust, CMO, VRN (a) (d) (f),	Caa2/CCC	2,277,582	
1,200	5.835%, 3/26/37	NR/NR	104,292	
1,000	10.322%, 6/25/36	NR/NR	122,311	
402	Bear Stearns Alt-A Trust, 4.516%, 11/25/36, CMO, VRN	Caa3/CCC	231,630	
1,581	Chase Mortgage Finance Corp., CMO, 2.526%, 3/25/37, FRN	Caa2/NR	1,229,780	
41	2.935%, 12/25/35, FRN	NR/CC	39,891	
1,600	6.00%, 2/25/37	Caa2/CCC	1,260,641	
1,200	6.00%, 7/25/37	NR/CCC	993,215	
2,500	6.25%, 10/25/36	Caa1/CCC	2,121,464	
449	Citicorp Mortgage Securities, Inc., 5.50%, 4/25/37, CMO	Caa1/NR	399,426	
	Countrywide Alternative Loan Trust, CMO,			

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212	5.50%, 3/25/36	Caa3/NR	147,886
4,029	6.00%, 5/25/36	Ca/NR	2,541,583
2,963	6.045%, 4/25/36, VRN	Ca/CCC	1,891,885
1,280	6.25%, 11/25/36	Caa3/NR	997,240
669	6.50%, 8/25/36	Ca/CC	392,662
	Countrywide Home Loan Mortgage Pass Through Trust, CMO,		
117	2.786%, 2/20/35, VRN	Caa1/BB	94,723
1,414	5.50%, 10/25/35	Caa1/NR	1,350,445
1,360	5.75%, 3/25/37	NR/CCC	1,171,375
937	6.00%, 5/25/36	NR/CC	814,872

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
\$900	6.00%, 2/25/37	NR/CC	\$751,162
312	6.00%, 4/25/37	NR/CCC	287,478
1,457	6.25%, 9/25/36	B3/NR	1,179,393
675	Credit Suisse Mortgage Capital Certificates, 6.00%, 2/25/37, CMO	NR/CCC	576,840
	GSR Mortgage Loan Trust, CMO,		
328	5.50%, 5/25/36	NR/CCC	283,125
7,396	6.00%, 2/25/36	NR/CCC	6,516,142
77	Harborview Mortgage Loan Trust, 2.774%, 7/19/35, CMO, VRN	Caa3/CCC	57,369
	JPMorgan Mortgage Trust, CMO,		
2,021	5.00%, 3/25/37	NR/CCC	1,628,959
893	5.561%, 1/25/37, VRN	Caa2/NR	693,153
480	6.00%, 8/25/37	NR/CCC	428,016
	Residential Asset Securitization Trust, CMO,		
1,412	5.75%, 2/25/36	Caa3/D	972,534
561	6.00%, 9/25/36	Ca/D	314,274
1,466	6.00%, 7/25/37	NR/CCC	1,065,475
	Residential Funding Mortgage Securities I, CMO,		
528	6.00%, 9/25/36	Caa1/CC	475,366
1,200	6.00%, 1/25/37	Caa2/NR	1,029,164
6,192	6.00%, 6/25/37	NR/D	4,993,390
	Suntrust Adjustable Rate Mortgage Loan Trust, CMO, FRN,		
3,572	5.533%, 4/25/37	NR/CCC	2,742,837
550	5.824%, 2/25/37	NR/CCC	392,775
	WaMu Mortgage Pass Through Certificates, CMO,		
1,000	5.653%, 2/25/37, FRN	NR/CCC	843,159
310	5.833%, 9/25/36, VRN	NR/CCC	230,211
	Wells Fargo Mortgage-Backed Securities Trust, CMO,		
5,309	2.734%, 7/25/36, FRN	NR/CC	4,424,733
577	2.743%, 7/25/36, FRN	NR/CC	448,661
303	2.77%, 4/25/36, VRN	NR/CC	254,207
909	5.75%, 3/25/37	Caa2/NR	795,881
538	6.00%, 6/25/37	Caa1/NR	506,477
700	6.00%, 7/25/37	B3/CCC	668,139
Total Mortgage-Backed Securities (cost-\$49,449,899)			50,853,987
Shares			
<b>PREFERRED STOCK 3.8%</b>			
<b>Banking 1.1%</b>			
90,200	CoBank Acb, 11.00%, 7/1/13, Ser. C (a) (b) (d) (g) (k) (l) (acquisition cost-\$4,973,200; purchased 8/31/10-2/1/11)	NR/A	4,916,631
<b>Financial Services 0.9%</b>			
100,000	Ally Financial, Inc., 8.50%, 5/15/16, Ser. A (g) (l)	Caa1/CCC	2,462,000
60,000	Citigroup Capital XIII, 7.875%, 10/30/15 (l)	Ba1/BB+	1,624,200
			4,086,200



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<b>Real Estate Investment Trust</b>	<b>1.8%</b>			
6,800		Sovereign Real Estate Investment Trust, 12.00%, 5/16/20		
		(a) (d) (g)	Baa2/BBB+	8,046,950
Total Preferred Stock (cost-\$16,746,700)				17,049,781

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**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Shares			Credit Rating (Moody s/S&P)*	Value
<b>CONVERTIBLE PREFERRED STOCK 1.8%</b>				
<b>Financial Services 0.6%</b>				
	2,700	Wells Fargo & Co., 7.50%, 3/15/13, Ser. L (g)	Baa3/A-	\$2,866,590
<b>Utilities 1.2%</b>				
	98,000	PPL Corp., 9.50%, 7/1/13	NR/NR	5,496,820
Total Convertible Preferred Stock (cost-\$7,163,145)				8,363,410
Principal Amount (000s)				
<b>SENIOR LOANS (a) (c) 0.9%</b>				
<b>Financial Services 0.3%</b>				
	\$1,244	CIT Group, Inc., 6.25%, 8/11/15, Term 3		1,249,707
<b>Multi-Media 0.6%</b>				
	AUD 2,246	Seven Media Group, Term T1, 6.855%, 12/28/12		2,378,729
	AUD 563	6.902%, 12/28/12		596,408
Total Senior Loans (cost-\$3,538,003)				2,975,137
				4,224,844
<b>ASSET-BACKED SECURITIES 0.7%</b>				
	\$1,352	Asset-Backed Funding Certificates, 0.407%, 5/25/37, FRN (a) (d)	B3/B-	1,141,291
	1,125	GSAA Trust, 6.295%, 6/25/36	Caa3/CCC	649,818
	883	MASTR Asset-Backed Securities Trust, 5.233%, 11/25/35	A1/BBB	781,785
	772	Morgan Stanley Mortgage Loan Trust, 6.25%, 7/25/47	Caa2/CCC	610,642
Total Asset-Backed Securities (cost-\$2,983,576)				3,183,536
Shares				
<b>MUTUAL FUNDS 0.0%</b>				
	1,540	BlackRock MuniYield Quality Fund II, Inc.		17,895
	3,836	BlackRock MuniYield Quality Fund III, Inc.		46,684
Total Mutual Funds (cost-\$66,897)				64,579
Principal Amount (000s)				
<b>SHORT-TERM INVESTMENTS 0.5%</b>				
<b>U.S. Treasury Obligations (h) (m) 0.1%</b>				
	\$570	U.S. Treasury Bills, 0.015%, 9/1/11 (cost-\$569,993)		569,993



**PIMCO Income Strategy Fund Schedule of Investments**

July 31, 2011 (continued)

Principal Amount (000s)		Value
<b>Repurchase Agreements</b>	<b>0.4%</b>	
\$800	Barclays Capital, Inc., dated 7/29/11, 0.15%, due 8/1/11, proceeds \$800,010; collateralized by U.S. Treasury Inflation Index Notes, 3.00%, 7/15/12, valued at \$816,453 including accrued interest	\$800,000
848	State Street Bank & Trust Co., dated 7/29/11, 0.01%, due 8/1/11, proceeds \$848,001; collateralized by U.S. Treasury Notes, 3.125%, due 4/30/17, valued at \$866,270 including accrued interest	848,000
Total Repurchase Agreements (cost-\$1,648,000)		1,648,000
Total Short-Term Investments (cost-\$2,217,993)		2,217,993
<b>Total Investments</b> (cost-\$415,247,058) <b>100.0%</b>		<b>\$451,889,411</b>

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

July 31, 2011

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>CORPORATE BONDS &amp; NOTES 54.3%</b>			
<b>Airlines 1.5%</b>			
	American Airlines Pass Through Trust,		
\$7,686	9.73%, 9/29/14	Caa2/CCC+	\$7,532,276
3,834	10.18%, 1/2/13	Caa1/CCC+	3,833,993
889	United Air Lines Pass Through Trust, 10.40%, 5/1/18	Baa2/BBB+	1,001,616
			12,367,885
<b>Banking 8.5%</b>			
5,500	AgFirst Farm Credit Bank, 7.30%, 8/29/11		
	(a) (b) (d) (g) (k) (acquisition cost-\$4,709,000;	NR/A	5,524,216
	purchased 2/26/10-4/15/10)		
£13,600	Barclays Bank PLC, 14.00%, 6/15/19 (g)	Baa2/A-	27,179,150
\$ 6,700	BBVA Bancomer S.A., 7.25%, 4/22/20 (a) (d)	A3/NR	7,143,875
	Cooperatieve Centrale Raiffeisen-Boerenleenbank BA,		
16,000	6.875%, 3/19/20	NR/NR	22,969,008
\$1,400	HBOS PLC, 6.75%, 5/21/18 (a) (d) (j)	Baa3/BBB	1,405,631
2,400	Intesa Sanpaolo SpA, 8.375%, 10/14/19 (g)	Baa2/BBB+	3,241,645
\$1,675	Regions Financial Corp., 7.375%, 12/10/37	B1/BB	1,598,514
	Santander Finance Preferred S.A. Unipersonal, 11.30%,		
£ 800	7/27/14 (g)	Baa2/A-	1,383,743
			70,445,782
<b>Chemicals 0.5%</b>			
\$3,887	Lyondell Chemical Co., 8.00%, 11/1/17 (a) (d)	Ba1/BB+	4,411,745
<b>Consumer Products 0.2%</b>			
1,700	Reynolds Group Issuer, Inc., 9.00%, 4/15/19 (a) (d)	Caa1/B-	1,700,000
<b>Energy 1.4%</b>			
9,943	AES Red Oak LLC, 8.54%, 11/30/19	B2/BB-	10,240,834
	Dynegy Roseton/Danskammer Pass Through Trust,		
2,300	7.67%, 11/8/16, Ser. B	Ca/CC	1,782,500
			12,023,334
<b>Financial Services 23.8%</b>			
1,800	AGFC Capital Trust I, 6.00%, 1/15/67, (converts to FRN		
	on 1/15/17) (a) (d)	Caa2/CCC-	1,215,000
	Ally Financial, Inc.,		
416	5.25%, 1/15/14	B1/B+	410,352
315	5.35%, 1/15/14	B1/B+	311,432
130	5.70%, 6/15/13	B1/B+	128,885
561	5.75%, 1/15/14	B1/B+	559,698
565	5.90%, 1/15/19	B1/B+	530,106
3	5.90%, 2/15/19	B1/B+	2,801
585	6.00%, 12/15/13	B1/B+	585,271
1,437	6.00%, 2/15/19	B1/B+	1,350,776
119	6.00%, 3/15/19	B1/B+	112,022
9	6.00%, 9/15/19	B1/B+	8,386
486	6.10%, 9/15/19	B1/B+	455,816
159	6.125%, 10/15/19	B1/B+	148,448
394	6.15%, 8/15/19	B1/B+	370,431
454	6.15%, 10/15/19	B1/B+	426,270
675	6.20%, 4/15/19	B1/B+	640,910

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500	6.25%, 12/15/18	B1/B+	479,077
47	6.25%, 7/15/19	B1/B+	44,432

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody's/S&P)*	Value
<b>Financial Services</b> (continued)			
\$7	6.35%, 4/15/16	B1/B+	\$6,859
792	6.35%, 10/15/16	B1/B+	774,264
303	6.35%, 4/15/19	B1/B+	290,346
1,142	6.35%, 7/15/19	B1/B+	1,086,404
463	6.375%, 1/15/14	B1/B+	463,674
249	6.50%, 9/15/16	B1/B+	244,873
608	6.50%, 10/15/16	B1/B+	598,223
5	6.50%, 6/15/18	B1/B+	5,004
449	6.50%, 11/15/18	B1/B+	437,982
190	6.50%, 12/15/18	B1/B+	184,688
15	6.50%, 5/15/19	B1/B+	14,448
208	6.60%, 8/15/16	B1/B+	205,402
864	6.60%, 5/15/18	B1/B+	863,733
100	6.60%, 6/15/19	B1/B+	96,514
132	6.65%, 10/15/18	B1/B+	131,971
190	6.70%, 5/15/14	B1/B+	190,403
256	6.70%, 6/15/18	B1/B+	256,475
335	6.70%, 12/15/19	B1/B+	325,051
160	6.75%, 9/15/12	B1/B+	159,112
844	6.75%, 10/15/12	B1/B+	843,254
555	6.75%, 6/15/14	B1/B+	556,572
215	6.75%, 8/15/16	B1/B+	213,348
1,136	6.75%, 11/15/16	B1/B+	1,129,338
210	6.75%, 6/15/17	B1/B+	210,164
831	6.75%, 7/15/18	B1/B+	832,963
3	6.75%, 9/15/18	B1/B+	2,952
612	6.75%, 10/15/18	B1/B+	607,387
107	6.75%, 11/15/18	B1/B+	107,008
27	6.75%, 5/15/19	B1/B+	26,390
92	6.80%, 9/15/16	B1/B+	91,536
12	6.80%, 9/15/18	B1/B+	11,998
207	6.85%, 4/15/16	B1/B+	206,605
7	6.875%, 7/15/18	B1/B+	7,005
319	6.90%, 7/15/18	B1/B+	319,951
326	6.90%, 8/15/18	B1/B+	324,424
135	6.95%, 6/15/17	B1/B+	135,393
201	7.00%, 8/15/16	B1/B+	201,060
1,729	7.00%, 11/15/16	B1/B+	1,728,872
580	7.00%, 12/15/16	B1/B+	580,075
1,729	7.00%, 1/15/17	B1/B+	1,729,797
601	7.00%, 2/15/17	B1/B+	601,459
1,087	7.00%, 6/15/17	B1/B+	1,090,343
1,073	7.00%, 7/15/17	B1/B+	1,077,177
43	7.00%, 2/15/18	B1/B+	43,030
506	7.00%, 3/15/18	B1/B+	505,974
15	7.00%, 5/15/18	B1/B+	15,001
400	7.00%, 9/15/18	B1/B+	398,741
134	7.00%, 6/15/22	B1/B+	131,613
2,035	7.00%, 11/15/24	B1/B+	2,012,273
325	7.05%, 3/15/18	B1/B+	325,000

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4	7.05%, 4/15/18	B1/B+	4,000
837	7.10%, 9/15/12	B1/B+	835,036

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Financial Services</b> (continued)			
\$28	7.15%, 11/15/12	B1/B+	\$28,032
6	7.15%, 9/15/18	B1/B+	5,999
477	7.20%, 10/15/17	B1/B+	472,019
339	7.25%, 8/15/12	B1/B+	339,975
1,998	7.25%, 12/15/12	B1/B+	2,001,858
55	7.25%, 6/15/16	B1/B+	55,059
653	7.25%, 9/15/17	B1/B+	646,104
329	7.25%, 1/15/18	B1/B+	332,191
255	7.25%, 4/15/18	B1/B+	255,661
39	7.30%, 12/15/17	B1/B+	38,452
503	7.30%, 1/15/18	B1/B+	504,263
165	7.35%, 1/15/17	B1/B+	166,385
58	7.35%, 4/15/18	B1/B+	58,226
25	7.375%, 11/15/16	B1/B+	25,083
55	7.375%, 4/15/18	B1/B+	55,218
166	7.40%, 12/15/17	B1/B+	166,431
1,828	7.50%, 11/15/16	B1/B+	1,828,486
15	7.50%, 8/15/17	B1/B+	15,166
559	7.50%, 11/15/17	B1/B+	560,488
290	7.50%, 12/15/17	B1/B+	290,786
40	8.00%, 3/15/17	B1/B+	40,110
3	8.125%, 11/15/17	B1/B+	3,010
25	8.20%, 3/15/17	B1/B+	25,075
24	8.40%, 8/15/15	B1/B+	24,387
224	9.00%, 7/15/20	B1/B+	227,354
3,200	American General Finance Corp., 4.125%, 11/29/13	B3/B	4,301,883
£2,100	BAC Capital Trust VII, 5.25%, 8/10/35	Baa3/BB+	2,654,227
\$10,100	Bank of America Corp., 8.125%, 5/15/18 (g) (j)	Ba3/BB+	10,414,716
2,900	Capital One Capital VI, 8.875%, 5/15/40 (j)	Baa3/BB	3,046,882
	CIT Group, Inc.,		
596	7.00%, 5/1/14	B2/B+	600,725
1,068	7.00%, 5/1/15	B2/B+	1,073,195
2,129	7.00%, 5/1/16	B2/B+	2,136,537
2,492	7.00%, 5/1/17	B2/B+	2,501,015
3,200	Citigroup Capital XXI, 8.30%, 12/21/77, (converts to FRN on 12/21/37)	Ba1/BB+	3,296,000
£2,000	Credit Agricole S.A., 8.125%, 10/26/19 (g)	A3/BBB+	3,217,244
\$11,000	ILFC E-Capital Trust II, 6.25%, 12/21/65, (converts to FRN on 12/21/15) (a) (d)	B3/BB	9,460,000
	LBG Capital No.1 PLC,		
500	6.439%, 5/23/20	Ba3/BB	607,090
500	7.375%, 3/12/20	Ba3/BB	646,964
£300	7.588%, 5/12/20	Ba3/BB	443,192
£10,200	7.867%, 12/17/19	Ba3/BB	15,152,236
£1,000	7.869%, 8/25/20	Ba3/BB	1,502,749
\$4,500	7.875%, 11/1/20 (a) (d)	Ba3/BB	4,263,750
£4,700	11.04%, 3/19/20	Ba3/BB	8,168,067
	LBG Capital No.2 PLC,		
8,900	8.875%, 2/7/20	Ba2/BB+	12,596,578

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£300	12.75%, 8/10/20	Ba2/BB+	551,528
1,100	15.00%, 12/21/19	Ba2/BB+	2,102,184
\$2,500	Lehman Brothers Holdings, Inc., 7.50%, 5/11/38 (e)	WR/NR	2,750

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Financial Services</b> (continued)			
\$22,600	National City Preferred Capital Trust I, 12.00%, 12/10/12 (g) (j)	Baa3/BBB	\$24,741,169
3,500	NB Capital Trust II, 7.83%, 12/15/26	Baa3/BB+	3,570,000
5,965	NSG Holdings LLC, 7.75%, 12/15/25 (a) (d)	Ba2/BB	5,935,175
5,000	SLM Corp., 5.625%, 8/1/33 (j)	Ba1/BBB-	4,394,860
10,700	8.00%, 3/25/20 (j)	Ba1/BBB-	11,745,711
1,700	8.45%, 6/15/18	Ba1/BBB-	1,903,714
11,800	Springleaf Finance Corp., 6.50%, 9/15/17	B3/B	10,797,000
6,750	Wells Fargo & Co., 7.98%, 3/15/18 (g)	Baa3/A-	7,264,688
			198,278,925
<b>Insurance 17.3%</b>			
3,000	American General Institutional Capital A, 7.57%, 12/1/45 (a) (d)	Baa2/BBB-	3,157,500
10,000	American General Institutional Capital B, 8.125%, 3/15/46 (a) (d) (j)	Baa2/BBB-	10,850,000
17,600	American International Group, Inc., 4.875%, 3/15/67, (converts to FRN on 3/15/17)	Baa2/BBB	20,105,095
£5,000	5.75%, 3/15/67, (converts to FRN on 3/15/17)	Baa2/BBB	6,729,950
\$1,900	6.25%, 3/15/87, (converts to FRN on 3/15/37)	Baa2/BBB	1,724,250
MXN16,000	7.98%, 6/15/17	Baa1/A-	1,242,616
11,800	8.00%, 5/22/68, (converts to FRN on 5/22/18) (a) (d)	Baa2/BBB	16,785,857
\$27,750	8.175%, 5/15/68, (converts to FRN on 5/15/38) (j)	Baa2/BBB	30,351,562
£14,100	8.625%, 5/22/68, (converts to FRN on 5/22/18)	Baa2/BBB	23,665,213
\$1,700	AXA S.A., 6.463%, 12/14/18 (a) (d) (g) (j)	Baa1/BBB	1,428,000
6,500	Dai-ichi Life Insurance Co., Ltd., 7.25%, 7/25/21 (a) (d) (g) (j)	A3/BBB+	6,875,200
4,700	Hartford Financial Services Group, Inc., 8.125%, 6/15/68, (converts to FRN on 6/15/18)	Ba1/BB+	5,040,750
15,000	Metlife Capital Trust IV, 7.875%, 12/15/67, (converts to FRN on 12/15/37) (a) (d) (j)	Baa2/BBB	16,504,155
			144,460,148
<b>Telecommunications 0.0%</b>			
200	Sprint Capital Corp., 8.75%, 3/15/32	B1/BB-	217,500
<b>Utilities 1.1%</b>			
3,900	AES Andres Dominicana Ltd., 9.50%, 11/12/20 (a) (d)	NR/B-	4,178,850
4,500	Ameren Energy Generating Co., 7.95%, 6/1/32	Ba1/BBB-	4,566,789
			8,745,639
Total Corporate Bonds & Notes (cost-\$393,139,183)			452,650,958
<b>MUNICIPAL BONDS 20.5%</b>			
<b>California 10.5%</b>			
13,100	Alameda Cnty. Joint Powers Auth. Rev., 7.046%, 12/1/44, Ser. A	A1/AA	14,211,011

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1,650	City & Cnty. of San Francisco Redev. Agcy., Tax Allocation, 8.406%, 8/1/39	A1/A	1,766,341
3,000	La Quinta Financing Auth., Tax Allocation, 8.07%, 9/1/36, Ser. A	NR/A	3,049,740
4,000	Long Beach Redev. Agcy., Tax Allocation, 8.11%, 8/1/30	NR/BBB+	4,136,400
10,800	Los Angeles Cnty. Public Works Financing Auth. Rev., 7.618%, 8/1/40	A1/A+	12,014,568

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>California (continued)</b>			
\$20,000	Northern California Power Agcy. Rev., 7.311%, 6/1/40	A3/A-	\$21,510,000
1,200	Riverside Cnty. Redev. Agcy., Tax Allocation, 7.50%, 10/1/30, Ser. A-T	A3/A-	1,208,496
10,000	Riverside Community College Dist., GO, 7.021%, 8/1/40, Ser. D-1	Aa2/AA	10,254,900
1,355	San Bernardino Cnty. Redev. Agcy., Tax Allocation, 8.50%, 9/1/40	NR/BBB	1,353,388
2,100	San Luis Obispo Cnty. Rev., zero coupon, 9/1/27, Ser. C (NPFGC)	Baa1/AA-	672,420
9,200	State Public Works Board Rev., 7.804%, 3/1/35, Ser. B-2	Aa3/BBB+	9,611,976
7,500	Stockton Public Financing Auth. Rev., 7.942%, 10/1/38, Ser. B	NR/A	7,870,800
			87,660,040
<b>Colorado 0.7%</b>			
5,000	Denver Public Schools, CP, 7.017%, 12/15/37, Ser. B	Aa3/A+	5,733,550
<b>District of Columbia 1.6%</b>			
13,000	Metropolitan Airports Auth. Rev., 7.462%, 10/1/46	Baa1/BBB+	13,329,290
<b>Illinois 0.7%</b>			
5,500	State, GO, 6.63%, 2/1/35	A1/A+	5,756,355
<b>Nevada 3.0%</b>			
22,700	Las Vegas Valley Water Dist., GO, 7.263%, 6/1/34	Aa2/AA+	24,438,139
<b>Ohio 2.0%</b>			
13,000	American Municipal Power-Ohio, Inc. Rev., Comb Hydroelectric Projects, 8.084%, 2/15/50, Ser. B	A3/A	16,975,530
<b>Texas 2.0%</b>			
4,000	Dallas Convention Center Hotel Dev. Corp. Rev., 7.088%, 1/1/42	A1/A+	4,319,240
11,500	North Texas Tollway Auth. Rev., 8.91%, 2/1/30	Baa3/NR	12,595,835
			16,915,075
Total Municipal Bonds (cost-\$160,119,214)			170,807,979
<b>MORTGAGE-BACKED SECURITIES 12.4%</b>			
377	Banc of America Alternative Loan Trust, 6.00%, 1/25/36, CMO	Caa2/NR	261,717
115	Banc of America Funding Corp., CMO, 5.766%, 1/20/47, VRN	NR/CCC	80,660
14,600	6.00%, 3/25/37	Caa2/CCC	10,726,678
2,209	BCAP LLC Trust, CMO, VRN (a) (d) (f), 2.788%, 5/26/36 (b) (k) (acquisition cost-\$45,096; purchased 6/15/11)	NR/NR	44,810
2,500	5.835%, 3/26/37	NR/NR	217,275
3,627	9.00%, 5/25/37	NR/NR	569,950
2,000	10.322%, 6/25/36	NR/NR	244,623
653	Bear Stearns Alt-A Trust, 4.516%, 11/25/36, CMO, VRN	Caa3/CCC	376,399
3,298	Chase Mortgage Finance Corp., CMO, 2.526%, 3/25/37, FRN	Caa2/NR	2,564,970
82	2.935%, 12/25/35, FRN	NR/CC	79,783
2,310	5.50%, 5/25/36	B3/NR	2,145,772



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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
\$898	Citicorp Mortgage Securities, Inc., CMO, 5.50%, 4/25/37	Caa1/NR	\$798,852
7,117	6.00%, 9/25/37	B3/NR	7,008,556
2,470	Countrywide Alternative Loan Trust, CMO, 5.50%, 1/25/36	Caa3/CCC	1,768,324
345	5.50%, 3/25/36	Caa3/NR	240,314
2,145	5.75%, 12/25/36	NR/CC	1,406,088
8,273	6.00%, 5/25/36	Ca/NR	5,218,975
1,608	6.00%, 4/25/37	NR/CC	1,069,320
6,112	6.045%, 4/25/36, VRN	Ca/CCC	3,902,994
2,631	6.25%, 11/25/36	Caa3/NR	2,049,881
1,338	6.50%, 8/25/36	Ca/CC	785,323
	Countrywide Home Loan Mortgage Pass Through Trust, CMO,		
2,845	5.75%, 3/25/37	NR/CCC	2,449,239
1,902	6.00%, 5/25/36	NR/CC	1,654,437
1,800	6.00%, 2/25/37	NR/CC	1,502,323
7,700	6.00%, 3/25/37	NR/CCC	6,414,204
2,996	6.25%, 9/25/36	B3/NR	2,424,309
3,742	First Horizon Asset Securities, Inc., 2.796%, 11/25/35, CMO, FRN	NR/CC	2,974,654
4,754	JPMorgan Alternative Loan Trust, 2.739%, 5/25/36, CMO, VRN	NR/CCC	2,801,022
	JPMorgan Mortgage Trust, CMO,		
1,654	5.334%, 10/25/35, VRN	B2/NR	1,597,588
840	6.00%, 8/25/37	NR/CCC	749,027
333	6.50%, 9/25/35	NR/CCC	337,001
1,992	MASTR Asset Securitization Trust, 6.50%, 11/25/37, CMO	NR/CCC	1,677,408
83	Nomura Asset Acceptance Corp., 4.976%, 5/25/35, CMO	Caa2/CCC	75,091
	Residential Asset Securitization Trust, CMO,		
2,921	5.75%, 2/25/36	Caa3/D	2,011,200
1,122	6.00%, 9/25/36	Ca/D	628,548
3,115	6.00%, 7/25/37	NR/CCC	2,264,134
	Residential Funding Mortgage Securities I, CMO,		
6,255	5.425%, 9/25/35, VRN	Caa2/CCC	5,061,390
12,714	6.00%, 6/25/37	NR/D	10,253,603
2,749	6.25%, 8/25/36	Caa1/CCC	2,280,781
1,101	Suntrust Adjustable Rate Mortgage Loan Trust, 5.824%, 2/25/37, CMO, FRN	NR/CCC	785,551
	WaMu Mortgage Pass Through Certificates, CMO,		
2,000	5.653%, 2/25/37, FRN	NR/CCC	1,686,318
664	5.833%, 9/25/36, VRN	NR/CCC	493,308
	Wells Fargo Mortgage-Backed Securities Trust, CMO,		
10,801	2.734%, 7/25/36, FRN	NR/CC	9,002,659
1,207	2.743%, 7/25/36, FRN	NR/CC	938,109
605	2.77%, 4/25/36, VRN	NR/CC	508,415

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	1,818	5.75%, 3/25/37	Caa2/NR	1,591,763
Total Mortgage-Backed Securities (cost-\$101,130,754)				103,723,346

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

July 31, 2011 (continued)

Shares			Credit Rating (Moody's/S&P)*	Value
<b>PREFERRED STOCK 5.3%</b>				
<b>Automotive Products 0.0%</b>				
20,275	Dura Automotive Systems, Inc., 20.00% (b) (f) (i)		NR/NR	\$10,137
<b>Banking 2.6%</b>				
397,300	CoBank Acb, 11.00%, 7/1/13, Ser. C (a) (b) (d) (g) (k) (l) (acquisition cost-\$21,899,400; purchased 2/26/10-3/23/11)		NR/A	21,656,071
<b>Financial Services 2.3%</b>				
248,000	Ally Financial, Inc., 7.30%, 3/9/31		B1/B+	5,803,200
240,000	Citigroup Capital XIII, 7.875%, 10/30/15 (l)		Ba1/BB+	6,496,800
5,000	Farm Credit Bank, 10.00%, 12/15/20, Ser. 1 (g)		A3/NR	5,739,063
40,000	GMAC Capital Trust I, 8.125%, 2/15/16, Ser. 2 (l)		B3/CCC	1,023,700
				19,062,763
<b>Real Estate Investment Trust 0.4%</b>				
3,000	Sovereign Real Estate Investment Trust, 12.00%, 5/16/20 (a) (d) (g)		Baa2/BBB+	3,550,125
Total Preferred Stock (cost-\$45,583,520)				44,279,096
<b>CONVERTIBLE PREFERRED STOCK 3.6%</b>				
<b>Financial Services 0.4%</b>				
3,000	Wells Fargo & Co., 7.50%, 3/15/13, Ser. L (g)		Baa3/A-	3,185,100
<b>Utilities 3.2%</b>				
104,000	PPL Corp., 8.75%, 5/1/14		NR/NR	5,578,560
374,000	9.50%, 7/1/13		NR/NR	20,977,660
				26,556,220
Total Convertible Preferred Stock (cost-\$27,405,180)				29,741,320
Principal Amount (000s)				
<b>SENIOR LOANS (a) (c) 1.7%</b>				
<b>Financial Services 0.4%</b>				
\$1,174	CIT Group, Inc., 6.25%, 8/11/15, Term 3			1,180,277
2,115	International Lease Finance Corp., 7.00%, 3/17/16, Term B2			2,130,495
				3,310,772
<b>Multi-Media 0.9%</b>				
AUD 5,807	Seven Media Group, Term T1, 6.855%, 12/28/12			6,149,556
AUD 1,456	6.902%, 12/28/12			1,541,850
				7,691,406
<b>Utilities 0.4%</b>				
\$2,309	Texas Competitive Electric Holdings Co. LLC, 4.686%, 10/10/17			1,727,372
2,450	4.768%, 10/10/17			1,832,958
				3,560,330

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Total Senior Loans (cost-\$13,252,611)

14,562,508

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody's/S&P)*	Value
<b>ASSET-BACKED SECURITIES 1.2%</b>			
	Asset-Backed Funding Certificates, 0.407%, 5/25/37, FRN		
\$2,847	(a) (d)	B3/B-	\$2,402,717
2,344	GSAA Trust, 6.295%, 6/25/36	Caa3/CCC	1,353,787
	Indymac Residential Asset-Backed Trust, 0.347%, 7/25/37,		
6,578	FRN	Caa3/CCC	3,328,771
1,803	MASTR Asset-Backed Securities Trust, 5.233%, 11/25/35	A1/BBB	1,596,145
1,543	Morgan Stanley Mortgage Loan Trust, 6.25%, 7/25/47	Caa2/CCC	1,221,285
Total Asset-Backed Securities (cost-\$10,396,790)			9,902,705
Shares			
<b>MUTUAL FUNDS 0.0%</b>			
3,160	BlackRock MuniYield Quality Fund II, Inc.		36,719
7,920	BlackRock MuniYield Quality Fund III, Inc.		96,387
Total Mutual Funds (cost-\$137,887)			133,106
<b>COMMON STOCK 0.0%</b>			
<b>Automotive Products 0.0%</b>			
81,383	Dura Automotive Systems, Inc. (b) (f) (i) (cost-\$1,317,433)		813
Principal Amount (000s)			
<b>SHORT-TERM INVESTMENTS 1.0%</b>			
<b>U.S. Treasury Obligations (h) (m) 0.6%</b>			
\$5,000	U.S. Treasury Bills, 0.023%-0.077%, 8/18/11-9/1/11 (cost-\$4,999,859)		4,999,859
<b>Corporate Notes 0.2%</b>			
<b>Financial Services 0.2%</b>			
	Ally Financial, Inc.,		
30	1.931%, 10/17/11, FRN	B1/B+	29,968
25	1.951%, 9/15/11, FRN	B1/B+	25,002
81	1.981%, 8/15/11, FRN	B1/B+	81,117
360	2.031%, 8/15/11, FRN	B1/B+	360,526
250	2.031%, 11/15/11, FRN	B1/B+	249,460
33	2.081%, 11/15/11, FRN	B1/B+	32,933
38	2.131%, 11/15/11, FRN	B1/B+	37,929
100	2.181%, 11/15/11, FRN	B1/B+	99,826
155	2.251%, 12/15/11, FRN	B1/B+	154,626
30	2.801%, 3/15/12, FRN	B1/B+	29,848
256	6.50%, 7/15/12	B1/B+	254,275
45	6.60%, 6/15/12	B1/B+	44,747
76	6.625%, 10/15/11	B1/B+	76,175

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Total Corporate Notes (cost-\$1,462,007)

1,476,432

PIMCO Income Strategy Fund

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

July 31, 2011 (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)*	Value
<b>Repurchase Agreements</b>	<b>0.2%</b>		
\$400	Barclays Capital, Inc., dated 7/29/11, 0.15%, due 8/1/11, proceeds \$400,005; collateralized by U.S. Treasury Inflation Index Notes, 3.00%, 7/15/12, valued at \$408,226 including accrued interest		\$400,000
1,218	State Street Bank & Trust Co., dated 7/29/11, 0.01%, due 8/1/11, proceeds \$1,218,001; collateralized by U.S. Treasury Notes, 1.75%, due 5/31/16, valued at \$1,242,886 including accrued interest		1,218,000
Total Repurchase Agreements (cost-\$1,618,000)			1,618,000
Total Short-Term Investments (cost-\$8,079,866)			8,094,291
<b>Total Investments</b> (cost-\$760,562,438) <b>100.0%</b>			<b>\$833,896,122</b>

**PIMCO Income Strategy Fund /PIMCO Income Strategy Fund II**  
**Notes to Schedules of Investments**

July 31, 2011 (continued)

- \* Unaudited.
- (a) Private Placement Restricted as to resale and may not have a readily available market. Securities with an aggregate value of \$78,547,359 and \$144,087,033 representing 17.4% and 17.3% of total investments in Income Strategy and Income Strategy II, respectively.
- (b) Illiquid.
- (c) These securities generally pay interest at rates which are periodically pre-determined by reference to a base lending rate plus a premium. These base lending rates are generally either the lending rate offered by one or more major European banks, such as the LIBOR or the prime rate offered by one or more major United States banks, or the certificate of deposit rate. These securities are generally considered to be restricted as the Funds are ordinarily contractually obligated to receive approval from the Agent bank and/or borrower prior to disposition. Remaining maturities of senior loans may be less than the stated maturities shown as a result of contractual or optional payments by the borrower. Such prepayments cannot be predicted with certainty. The interest rate disclosed reflects the rate in effect on July 31, 2011.
- (d) 144A Exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, typically only to qualified institutional buyers. Unless otherwise indicated, these securities are not considered to be illiquid.
- (e) In default.
- (f) Fair-Valued Securities with an aggregate value of \$226,603 and \$1,087,608, representing 0.1% and 0.1% of total investments in Income Strategy and Income Strategy II, respectively. See Note 1(a) and Note 1(b) in the Notes to Financial Statements.
- (g) Perpetual maturity. The date shown is the next call date. On Corporate Bonds & Notes, the interest rate is fixed until the first call date and variable thereafter.
- (h) All or partial amount segregated for the benefit of the counterparty as collateral for derivatives.
- (i) Non-income producing.
- (j) All or partial amount segregated for the benefit of the counterparty as collateral for reverse repurchase agreements.
- (k) Restricted. The aggregate acquisition cost of such securities is \$7,198,200 and \$26,653,496 for Income Strategy and Income Strategy II, respectively. The aggregate market value is \$7,528,079 and \$27,225,097, representing 1.7% and 3.3% of total investments in Income Strategy and Income Strategy II, respectively.
- (l) Dividend rate is fixed until the first call date and variable thereafter.
- (m) Rates reflect the effective yields at purchase date.

**Glossary:**

AGM	-	insured by Assured Guaranty Municipal Corp.
AMBAC	-	insured by American Municipal Bond Assurance Corp.
AUD	-	Australian Dollar
£	-	British Pound
CMO	-	Collateralized Mortgage Obligation
CP	-	Certificates of Participation
	-	Euro
FGIC	-	insured by Financial Guaranty Insurance Co.
FRN	-	Floating Rate Note. The interest rate disclosed reflects the rate in effect on July 31, 2011.
GO	-	General Obligation Bond
GTD	-	Guaranteed
LIBOR	-	London Inter-Bank Offered Rate
MXN	-	Mexican Peso
NPFGC	-	insured by National Public Finance Guarantee Corp.
NR	-	Not Rated
VRN	-	Variable Rate Note. Instruments whose interest rates change on a specified date (such as a coupon date or interest payment date) and/or whose interest rates vary with changes in a designated base rate (such as

the prime interest rate). The interest rate disclosed reflects the rate in effect on July 31, 2011.

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Withdrawn Rating

PIMCO Income Strategy Fund

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

July 31, 2011

	Income Strategy	Income Strategy II
<b>Assets:</b>		
Investments, at value (cost-\$415,247,058 and \$760,562,438, respectively)	\$451,889,411	\$833,896,122
Cash (including foreign currency at value of \$22,092 and \$154,185 with a cost of \$21,199 and \$151,338, respectively)	3,547,448	10,196,455
Interest and dividends receivable	7,950,635	13,741,358
Deposits with brokers for futures contracts collateral	548,000	841,000
Unrealized appreciation of swaps	215,101	330,592
Receivable for variation margin on futures contracts	93,275	223,988
Unrealized appreciation of forward foreign currency contracts	45,620	169,812
Prepaid expenses	30,584	60,968
Total Assets	464,320,074	859,460,295
<b>Liabilities:</b>		
Payable for reverse repurchase agreements	96,361,093	103,792,225
Dividends payable to common and preferred shareholders	1,874,416	3,814,046
Payable for investments purchased	1,237,834	
Unrealized depreciation of forward foreign currency contracts	1,068,022	3,465,593
Unrealized depreciation of swaps	947,127	1,351,798
Swap premiums received	525,488	823,823
Investment management fees payable	289,095	531,079
Payable to brokers for cash collateral received	100,000	
Interest payable for reverse repurchase agreements	22,222	9,724
Payable to broker		42,340
Accrued expenses	229,042	278,421
Total Liabilities	102,654,339	114,109,049
<b>Preferred Shares (\$0.00001 par value and \$25,000 liquidation preference per share applicable to an aggregate of 3,159 and 6,440 shares issued and outstanding, respectively)</b>	78,975,000	161,000,000
<b>Net Assets Applicable to Common Shareholders</b>	<b>\$282,690,735</b>	<b>\$584,351,246</b>
<b>Composition of Net Assets Applicable to Common Shareholders:</b>		
Common Shares:		
Par value (\$0.00001 per share)	\$248	\$582
Paid-in-capital in excess of par	411,178,843	934,419,652
Undistributed net investment income	4,998,713	6,957,156
Accumulated net realized loss	(168,962,601)	(426,975,174)
Net unrealized appreciation of investments, futures contracts, swaps and foreign currency transactions	35,475,532	69,949,030
<b>Net Assets Applicable to Common Shareholders</b>	<b>\$282,690,735</b>	<b>\$584,351,246</b>
Common Shares Issued and Outstanding	24,829,508	58,199,229
<b>Net Asset Value Per Common Share</b>	<b>\$11.39</b>	<b>\$10.04</b>



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

Year ended July 31, 2011

	Income Strategy	Income Strategy II
<b>Investment Income:</b>		
Interest	\$33,168,399	\$61,675,617
Dividends	1,668,127	5,171,083
Facility and other fee income	68,677	242,834
Total Investment Income	34,905,203	67,089,534
<b>Expenses:</b>		
Investment management fees	3,104,398	5,883,242
Interest expense	288,779	192,231
Legal fees	176,575	160,280
Custodian and accounting agent fees	165,133	249,237
Auction agent fees and commissions	137,678	273,257
Audit and tax services	110,933	114,609
Shareholder communications	109,496	144,841
Trustees' fees and expenses	35,549	69,145
Transfer agent fees	30,620	30,815
New York Stock Exchange listing fees	22,259	42,380
Insurance expense	9,545	18,702
Miscellaneous	24,326	27,311
Total Expenses	4,215,291	7,206,050
<b>Net Investment Income</b>	<b>30,689,912</b>	<b>59,883,484</b>
<b>Realized and Change in Unrealized Gain (Loss):</b>		
Net realized gain (loss) on:		
Investments	13,691,493	37,571,372
Futures contracts	56,379	110,582
Swaps	(4,243,167)	(6,662,116)
Foreign currency transactions	(3,121,305)	(11,827,720)
Net change in unrealized appreciation/depreciation of:		
Investments	13,743,321	23,528,546
Futures contracts	577,182	890,772
Swaps	(1,382,914)	(2,297,212)
Unfunded loan commitments	25,625	51,250
Foreign currency transactions	51,358	562,814
Net realized and change in unrealized gain on investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	19,397,972	41,928,288
<b>Net Increase in Net Assets Resulting from Investment Operations</b>	<b>50,087,884</b>	<b>101,811,772</b>
<b>Dividends on Preferred Shares from Net Investment Income</b>	<b>(1,166,363)</b>	<b>(2,379,363)</b>
<b>Net Increase in Net Assets Applicable to Common Shareholders Resulting from Investment Operations</b>	<b>\$48,921,521</b>	<b>\$99,432,409</b>

PIMCO Income Strategy Fund

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

	Year ended July 31,	
	2011	2010
<b>Investment Operations:</b>		
Net investment income	\$30,689,912	\$27,707,207
Net realized gain on investments, futures contracts, swaps and foreign currency transactions	6,383,400	12,662,734
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	13,014,572	36,580,808
Net increase in net assets resulting from investment operations	50,087,884	76,950,749
<b>Dividends on Preferred Shares from Net Investment Income</b>	(1,166,363)	(1,184,659)
Net increase in net assets applicable to common shareholders resulting from investment operations	48,921,521	75,766,090
<b>Dividends to Common Shareholders from Net Investment Income</b>	(29,956,842)	(39,077,561)
<b>Common Share Transactions:</b>		
Net proceeds from rights offering (See Note 8)		57,647,677
Offering costs charged to paid-in-capital in excess of par (See Note 8)		(537,741)
Reinvestment of dividends	1,666,381	2,279,525
Net increase in net assets from common share transactions	1,666,381	59,389,461
Total increase in net assets applicable to common shareholders	20,631,060	96,077,990
<b>Net Assets Applicable to Common Shareholders:</b>		
Beginning of year	262,059,675	165,981,685
End of year (including undistributed net investment income of \$4,998,713 and \$6,672,703, respectively)	\$282,690,735	\$262,059,675
<b>Common Shares Issued:</b>		
Issued in rights offering (see Note 8)		6,173,000
Issued in reinvestment of dividends	146,096	202,656
Net increase	146,096	6,375,656

PIMCO Income Strategy Fund

See accompanying Notes to Financial Statements. | 7.31.11 | PIMCO Income Strategy Fund II Annual Report 27

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

	Year ended July 31,	
	2011	2010
<b>Investment Operations:</b>		
Net investment income	\$59,883,484	\$55,300,404
Net realized gain (loss) on investments, futures contracts, swaps and foreign currency transactions	19,192,118	(848,527)
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions	22,736,170	94,438,510
Net increase in net assets resulting from investment operations	101,811,772	148,890,387
<b>Dividends on Preferred Shares from Net Investment Income</b>	(2,379,363)	(2,413,554)
Net increase in net assets applicable to common shareholders resulting from investment operations	99,432,409	146,476,833
<b>Dividends to Common Shareholders from Net Investment Income</b>	(56,277,446)	(73,374,027)
<b>Common Share Transactions:</b>		
Net proceeds from rights offering (See Note 8)		118,231,945
Offering costs charged to paid-in-capital in excess of par (See Note 8)		(603,331)
Reinvestment of dividends	3,854,345	4,661,254
Net increase in net assets from common share transactions	3,854,345	122,289,868
Total increase in net assets applicable to common shareholders	47,009,308	195,392,674
<b>Net Assets Applicable to Common Shareholders:</b>		
Beginning of year	537,341,938	341,949,264
End of year (including undistributed net investment income of \$6,957,156 and \$13,526,981, respectively)	\$584,351,246	\$537,341,938
<b>Common Shares Issued:</b>		
Issued in rights offering (see Note 8)		14,444,000
Issued in reinvestment of dividends	385,713	494,251
Net increase	385,713	14,938,251

PIMCO Income Strategy Fund

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**PIMCO Income Strategy Fund**  
**Statement of Cash Flows**

Year ended July 31, 2011

<b>Increase in Cash from:</b>		
<b>Cash Flows used for Operating Activities:</b>		
Net increase in net assets resulting from investment operations		\$50,087,884
<b>Adjustments to Reconcile Net Increase in Net Assets Resulting from Investment Operations to Net Cash used for Operating Activities:</b>		
Purchases of long-term investments		(239,379,486)
Proceeds from sales of long-term investments		174,290,710
Proceeds from sales of short-term portfolio investments, net		13,319,930
Net change in unrealized appreciation/depreciation of investments, futures contracts, swaps, unfunded loan commitments and foreign currency transactions		(13,014,572)
Net realized gain on investments, futures contracts, swaps, and foreign currency transactions		(6,383,400)
Net amortization on investments		(1,590,773)
Decrease in receivable for investments sold		9,036,417
Increase in interest and dividends receivable		(2,777,414)
Proceeds from futures contracts transactions		540,286
Increase in deposits with brokers for futures contracts collateral		(548,000)
Increase in prepaid expenses		(131)
Decrease in payable for investments purchased		(5,702,556)
Decrease in payable to brokers for cash collateral received		(470,000)
Periodic and termination payments of swaps, net		(4,575,429)
Net cash used for foreign currency transactions		(3,138,450)
Increase in investment management fees payable		63,199
Increase in interest payable for reverse repurchase agreements		11,569
Increase in accrued expenses		9,566
<b>Net cash used for operating activities*</b>		<b>(30,220,650)</b>
<b>Cash Flows provided by Financing Activities:</b>		
Increase in payable for reverse repurchase agreements		62,909,524
Cash dividends paid (excluding reinvestment of dividends of \$1,666,381)		(29,443,763)
<b>Net cash provided by financing activities</b>		<b>33,465,761</b>
<b>Net increase in cash</b>		<b>3,245,111</b>
<b>Cash at beginning of year</b>		<b>302,337</b>
<b>Cash at end of year</b>		<b>\$3,547,448</b>

Statement of Cash Flows not required for Income Strategy II.

\* Included in operating expenses is cash paid of \$277,238 by Income Strategy for interest expense primarily in connection with participation in reverse repurchase agreement transactions.



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

July 31, 2011

**1. Organization and Significant Accounting Policies**

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

Each Fund s investment objective is to seek high current income, consistent with the preservation of capital. There is no guarantee that the Funds will meet their stated objectives.

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

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

In April 2011, the Financial Accounting Standards Board ( FASB ) issued an Accounting Standards Update ( ASU ) related to the accounting for repurchase agreements and similar agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The ASU modifies the criteria for determining effective control of transferred assets and as a result certain agreements may be accounted for as secured borrowings. The ASU is effective prospectively for new transfers and existing transactions that are modified in the first interim or annual period beginning on or after December 15, 2011. Fund management is evaluating the implications of this change.

In May 2011, FASB issued an ASU to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with Generally Accepted Accounting Principles ( GAAP ) and International Financial Reporting Standards ( IFRSs ). FASB concluded that the amendments in this ASU will improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with GAAP and IFRSs. The ASU is effective prospectively for interim or annual periods beginning on or after December 15, 2011. Fund management is evaluating the implications of this change.

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

**(a) Valuation of Investments**

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

Portfolio securities and other financial instruments for which market quotations are not readily available, or for which a development/event occurs that may significantly impact the value of a security, are fair-valued, in good faith, pursuant to procedures established by the Board of Trustees, or persons acting at their discretion pursuant to procedures established by the Board of Trustees, including certain fixed income securities which may be valued with reference to securities whose prices are more readily available. The Funds' investments are valued daily using prices supplied by an independent pricing service or dealer quotations, or by using the last sale price on the exchange that is the primary market for such securities, or the mean between the last quoted bid and ask price. Independent pricing services use information provided by market makers or estimates of market values obtained from yield data relating to investments or securities with similar characteristics. Exchange traded futures are valued at the settlement price determined by the relevant exchange. Short-term securities maturing in 60 days or less are valued at amortized cost, if their original term to maturity was 60 days or less, or by amortizing their value on the 61st day prior to maturity, if the original term to maturity exceeded 60 days. Investments initially valued in currencies other than the U.S. dollar are converted to the U.S. dollar using exchange rates obtained from pricing services. As a result, the net asset value ( NAV ) of each Fund s

PIMCO Income Strategy Fund

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

July 31, 2011

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

shares may be affected by changes in the value of currencies in relation to the U.S. dollar. The value of securities traded in markets outside the United States or denominated in currencies other than the U.S. dollar may be affected significantly on a day that the New York Stock Exchange ( NYSE ) is closed.

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

**(b) Fair Value Measurements**

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

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

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

The valuation techniques used by the Funds to measure fair value during the year ended July 31, 2011 maximized the use of observable inputs and minimized the use of unobservable inputs. When fair-valuing securities, the Funds utilized multi-dimensional relational pricing models and option adjusted spread pricing techniques.

The inputs or methodology used for valuing securities is not necessarily an indication of the risk associated with investing in those securities. The following are certain inputs and techniques that the Funds generally use to evaluate how to classify each major category of assets and liabilities for Level 2 and Level 3, in accordance with GAAP.

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Equity Securities (Common and Preferred Stock) Equity securities traded in inactive markets and certain foreign equity securities are valued using inputs which include broker-dealer quotes, recently executed transactions adjusted for changes in the benchmark index, or evaluated price quotes received from independent pricing services that take into account the integrity of the market sector and issuer, the individual characteristics of the security, and information received from broker-dealers and other market sources pertaining to the issuer or security. To the extent that these inputs are observable, the values of equity securities are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

U.S. Treasury Obligations U.S. Treasury obligations are valued by independent pricing services based on pricing models that evaluate the mean between the most recently quoted bid and ask price. The models also take into consideration data received from active market makers and broker-dealers, yield curves, and the spread over comparable U.S. Treasury issues. The spreads change daily in response to market conditions and are generally obtained from the new issue market and broker-dealer sources. To the extent that these inputs are observable, the values of U.S. Treasury obligations are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Government Sponsored Enterprise and Mortgage-Backed Securities Government sponsored enterprise and mortgage-backed securities are valued by independent pricing services using pricing models based on inputs that include issuer type, coupon, cash flows, mortgage prepayment projection tables and Adjustable Rate Mortgage evaluations that incorporate index data, periodic and life caps, the next coupon reset date, and the convertibility of the bond. To the extent that these inputs are observable, the values of government sponsored enterprise and mortgage-backed securities are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Municipal Bonds Municipal bonds are valued by independent pricing services based on pricing models that take into account, among other factors, information received from market makers and broker-dealers, current trades, bid-

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

July 31, 2011

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

want lists, offerings, market movements, the callability of the bond, state of issuance, benchmark yield curves, and bond insurance. To the extent that these inputs are observable, the values of municipal bonds are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Corporate Bonds & Notes Corporate bonds and notes are generally comprised of two main categories: investment grade bonds and high yield bonds. Investment grade bonds are valued by independent pricing services using various inputs and techniques, which include broker-dealer quotations, live trading levels, recently executed transactions in securities of the issuer or comparable issuers, and option adjusted spread models that include base curve and spread curve inputs. Adjustments to individual bonds can be applied to recognize trading differences compared to other bonds issued by the same issuer. High yield bonds are valued by independent pricing services based primarily on broker-dealer quotations from relevant market makers and recently executed transactions in securities of the issuer or comparable issuers. The broker-dealer quotations received are supported by credit analysis of the issuer that takes into consideration credit quality assessments, daily trading activity, and the activity of the underlying equities, listed bonds and sector-specific trends. To the extent that these inputs are observable, the values of corporate bonds and notes are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Asset-Backed Securities and Collateralized Mortgage Obligations Asset-backed securities and collateralized mortgage obligations are valued by independent pricing services using pricing models based on a security's average life volatility. The models also take into account tranche characteristics such as coupon average life, collateral types, ratings, the issuer and tranche type, underlying collateral and performance of the collateral, and discount margin for certain floating rate issues. To the extent that these inputs are observable, the values of asset-backed securities and collateralized mortgage obligations are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Forward Foreign Currency Contracts Forward foreign currency contracts are valued by independent pricing services using various inputs and techniques, which include broker-dealer quotations, actual trading information and foreign currency exchange rates gathered from leading market makers and foreign currency exchange trading centers throughout the world. To the extent that these inputs are observable, the values of forward foreign currency contracts are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Interest Rate Swaps Interest rate swaps are valued by independent pricing services using pricing models that are based on real-time intraday snapshots of relevant interest rate curves that are built using the most actively traded securities for a given maturity. The pricing models also incorporate cash and money market rates. In addition, market data pertaining to interest rate swaps is monitored regularly to ensure that interest rates are properly depicting the current market rate. To the extent that these inputs are observable, the values of interest rate swaps are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

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Credit Default Swaps Credit default swaps are valued by independent pricing services using pricing models that take into account, among other factors, information received from market makers and broker-dealers, default probabilities from index specific credit spread curves, recovery rates, and cash flows. To the extent that these inputs are observable, the values of credit default swaps are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Senior Loans Senior Loans are valued by independent pricing services based on the average of quoted prices received from multiple dealers or valued relative to other benchmark securities when broker-dealer quotes are unavailable. To the extent that these inputs are observable, the values of Senior Loans are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

The Funds' policy is to recognize transfers between levels at the end of the reporting period.

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

July 31, 2011

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

A summary of the inputs used at July 31, 2011 in valuing Income Strategy assets and liabilities is listed below:

	Level 1 Quoted Prices	Level 2 Other Significant Observable Inputs	Level 3 Significant Unobservable Inputs	Value at 7/31/11
<b>Investments in Securities Assets</b>				
Corporate Bonds & Notes:				
Airlines		\$949,500	\$22,043,236	\$22,992,736
Energy			852,500	852,500
All Other		241,963,603		241,963,603
Municipal Bonds		100,122,442		100,122,442
Mortgage-Backed Securities		50,627,384	226,603	50,853,987
Preferred Stock:				
Financial Services	\$4,086,200			4,086,200
All Other		12,963,581		12,963,581
Convertible Preferred Stock	8,363,410			8,363,410
Senior Loans		4,224,844		4,224,844
Asset-Backed Securities		3,183,536		3,183,536
Mutual Funds	64,579			64,579
Short-Term Investments		2,217,993		2,217,993
<b>Total Investments in Securities Assets</b>	<b>\$12,514,189</b>	<b>\$416,252,883</b>	<b>\$23,122,339</b>	<b>\$451,889,411</b>
<b>Other Financial Instruments* Assets</b>				
Credit Contracts		\$55,003		\$55,003
Foreign Exchange Contracts		45,620		45,620
Interest Rate Contracts	\$577,182	160,098		737,280
<b>Total Other Financial Instruments* Assets</b>	<b>\$577,182</b>	<b>\$260,721</b>		<b>\$837,903</b>
<b>Other Financial Instruments* Liabilities</b>				
Foreign Exchange Contracts		\$(1,068,022)		\$(1,068,022)
Interest Rate Contracts		(947,127)		(947,127)
<b>Total Other Financial Instruments* Liabilities</b>		<b>\$(2,015,149)</b>		<b>\$(2,015,149)</b>
<b>Total Investments</b>	<b>\$13,091,371</b>	<b>\$414,498,455</b>	<b>\$23,122,339</b>	<b>\$450,712,165</b>

There were no significant transfers between Levels 1 and 2 during the year ended July 31, 2011.

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A roll forward of fair value measurements using significant unobservable inputs (Level 3) for Income Strategy for the year ended July 31, 2011, was as follows:

	Beginning Balance 7/31/10	Net Purchases (Sales) and Settlements	Accrued Discounts (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers into Level 3**	Transfers out of Level 3	Ending Balance 7/31/11
<b>Investments in Securities</b>								
Corporate Bonds & Notes:								
Airlines	\$17,101,920	\$(1,052,994)	\$(132,599)	\$(91,810)	\$659,493	\$5,559,226		\$22,043,236
Energy						852,500		852,500
Mortgage-Backed Securities	6,534,423	(6,896,977)	15,930	863,320	(290,093)			226,603
<b>Total Investments</b>	\$23,636,343	\$(7,949,971)	\$(116,669)	\$771,510	\$369,400	\$6,411,726		\$23,122,339

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

July 31, 2011

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

A summary of the inputs used at July 31, 2011 in valuing Income Strategy II assets and liabilities is listed below:

	Level 1 Quoted Prices	Level 2 Other Significant Observable Inputs	Level 3 Significant Unobservable Inputs	Value at 7/31/11
<b>Investments in Securities Assets</b>				
Corporate Bonds & Notes:				
Airlines			\$12,367,885	\$12,367,885
Energy		\$10,240,834	1,782,500	12,023,334
All Other		428,259,739		428,259,739
Municipal Bonds		170,807,979		170,807,979
Mortgage-Backed Securities		102,646,688	1,076,658	103,723,346
Preferred Stock:				
Automotive Products			10,137	10,137
Financial Services	\$12,300,000	6,762,763		19,062,763
All Other		25,206,196		25,206,196
Convertible Preferred Stock	29,741,320			29,741,320
Senior Loans		14,562,508		14,562,508
Asset-Backed Securities		9,902,705		9,902,705
Mutual Funds	133,106			133,106
Common Stock			813	813
Short-Term Investments		8,094,291		8,094,291
<b>Total Investments in Securities Assets</b>	<b>\$42,174,426</b>	<b>\$776,483,703</b>	<b>\$15,237,993</b>	<b>\$833,896,122</b>
<b>Other Financial Instruments* Assets</b>				
Foreign Exchange Contracts		\$169,812		\$169,812
Interest Rate Contracts	\$890,772	330,592		1,221,364
<b>Total Other Financial Instruments* Assets</b>	<b>\$890,772</b>	<b>\$500,404</b>		<b>\$1,391,176</b>
<b>Other Financial Instruments* Liabilities</b>				
Foreign Exchange Contracts		\$(3,465,593)		\$(3,465,593)
Interest Rate Contracts		(1,351,798)		(1,351,798)
<b>Total Other Financial Instruments* Liabilities</b>		<b>\$(4,817,391)</b>		<b>\$(4,817,391)</b>
<b>Total Investments</b>	<b>\$43,065,198</b>	<b>\$772,166,716</b>	<b>\$15,237,993</b>	<b>\$830,469,907</b>

There were no significant transfers between Levels 1 and 2 during the year ended July 31, 2011.

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

July 31, 2011

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

A roll forward of fair value measurements using significant unobservable inputs (Level 3) for Income Strategy II for the year ended July 31, 2011, was as follows:

	Beginning Balance 7/31/10	Net Purchases (Sales) and Settlements	Accrued Discounts (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers into Level 3**	Transfers out of Level 3	Ending Balance 7/31/11
<b>Investments in Securities</b>								
Corporate Bonds & Notes:								
Airlines	\$1,039,163	\$(63,983)	\$(8,126)	\$(5,625)	\$40,188	\$11,366,268		\$12,367,885
Energy						1,782,500		1,782,500
Mortgage-Backed Securities		1,082,222	34,472		(40,036)			1,076,658
Preferred Stock:								
Automotive Products	10,137							10,137
Common Stock	813							813
<b>Total Investments</b>	<b>\$1,050,113</b>	<b>\$1,018,239</b>	<b>\$26,346</b>	<b>\$(5,625)</b>	<b>\$152</b>	<b>\$13,148,768</b>		<b>\$15,237,993</b>

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

\*\* Transferred out of Level 2 into Level 3 because sufficient observable inputs were not available.

The net change in unrealized appreciation/depreciation of Level 3 investments and other financial instruments, which Income Strategy and Income Strategy II held at July 31, 2011 was \$807,499 and \$318,180, respectively. Net realized gain (loss) and net change in unrealized appreciation/depreciation are reflected on the Statements of Operations.

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

Investment transactions are accounted for on the trade date. Securities purchased and sold on a when-issued or delayed-delivery basis may be settled a month or more after the trade date. Realized gains and losses on investments are determined on an identified cost basis. Interest income adjusted for the accretion of discount and amortization of premiums is recorded on an accrual basis. Discounts or premiums on debt securities purchased are accreted or amortized, respectively, to interest income over the lives of the respective securities. Dividend income is recorded on the ex-dividend date. Facility fees and other fees (such as origination fees) received after settlement date are amortized as income over the expected term of the senior loan. Facility fees and other fees received after settlement date relating to senior loans and commitment fees received

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relating to unfunded purchase commitments are recorded as other fee income upon receipt. Paydown gains and losses are netted and recorded as interest income of the Statements of Operations.

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

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

Accounting for uncertainty in income taxes establishes for all entities, including pass-through entities such as the Funds, a minimum threshold for financial statement recognition of the benefit of positions taken in filing tax returns (including whether an entity is taxable in a particular jurisdiction), and requires certain expanded tax disclosures. The Funds' management has determined that its evaluation has resulted in no material impact to the Funds' financial statements at July 31, 2011. The Funds' federal tax returns for the prior three years remain subject to examination by the Internal Revenue Service.

### **(e) Dividends and Distributions – Common Shares**

The Funds declare dividends from net investment income monthly to common shareholders. Distributions of net realized capital gains, if any, are paid at least annually. The Funds record dividends and distributions to their respective shareholders on the ex-dividend date. The amount of dividends and distributions from net investment income and net

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

realized capital gains are determined in accordance with federal income tax regulations, which may differ from GAAP. These book-tax differences are considered either temporary or permanent in nature. To the extent these differences are permanent in nature, such amounts are reclassified within the capital accounts based on their federal income tax treatment. Temporary differences do not require reclassification. To the extent dividends and/or distributions exceed current and accumulated earnings and profits for federal income tax purposes, they are reported as dividends and/or distributions to shareholders from return of capital.

**(f) Foreign Currency Translation**

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

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

**(g) Repurchase Agreements**

The Funds enter into transactions with their custodian bank or securities brokerage firms whereby they purchase securities under agreements to resell such securities at an agreed upon price and date (repurchase agreements). The Funds, through their custodian, take possession of securities collateralizing the repurchase agreement. Such agreements are carried at the contract amount in the financial statements, which is considered to represent fair-value. Collateral pledged (the securities received), which consists primarily of U.S. government obligations and asset-backed securities, is held by the custodian bank for the benefit of the Funds until maturity of the repurchase agreement. Provisions of the repurchase agreements and the procedures adopted by the Funds require that the market value of the collateral, including accrued interest thereon, be sufficient in the event of default by the counterparty. If the counterparty defaults and the value of the collateral declines or if the counterparty enters an insolvency proceeding, realization of the collateral by the Funds may be delayed or limited.

**(h) Reverse Repurchase Agreements**

In a reverse repurchase agreement, the Funds sell securities to a bank or broker-dealer and agree to repurchase the securities at a mutually agreed upon date and price. Generally, the effect of such a transaction is that the Funds can recover and reinvest all or most of the cash invested in portfolio securities involved during the term of the reverse repurchase agreement and still be entitled to the returns associated with those portfolio securities. Such transactions are advantageous if the interest cost to the Funds of the reverse repurchase transaction is less than the

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returns it obtains on investments purchased with the cash. To the extent a Fund does not cover its positions in reverse repurchase agreements (by segregating liquid assets at least equal in amount to the forward purchase commitment), the Fund's uncovered obligations under the agreements will be subject to the Fund's limitations on borrowings. Reverse repurchase agreements involve leverage risk and also the risk that the market value of the securities that the Funds are obligated to repurchase under the agreement may decline below the repurchase price. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Funds' use of the proceeds of the agreement may be restricted pending determination by the other party, or their trustee or receiver, whether to enforce the Funds' obligation to repurchase the securities.

### (i) Mortgage-Related and Other Asset-Backed Securities

Investments in mortgage-related or other asset-backed securities include mortgage pass-through securities, collateralized mortgage obligations (CMOs), commercial mortgage-backed securities, mortgage dollar rolls, CMO residuals, stripped mortgage-backed securities (SMBSs) and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property. The value of some mortgage-related or asset-backed securities may be particularly sensitive to changes in prevailing interest rates. Early repayment of principal on some mortgage-related securities may expose the Funds to a lower rate of return upon reinvestment of

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

principal. The value of these securities may fluctuate in response to the market's perception of the creditworthiness of the issuers. The decline in liquidity and prices of these types of securities may make it more difficult to determine fair market value. Additionally, although mortgages and mortgage-related securities are generally supported by some form of government or private guarantee and/or insurance, there is no assurance that private guarantors or insurers will meet their obligations.

**(j) Restricted Securities**

The Fund is permitted to invest in securities that are subject to legal or contractual restrictions on resale. These securities generally may be resold in transactions exempt from registration or to the public if the securities are registered. Disposal of these securities may involve time-consuming negotiations and expenses, and prompt sale at an acceptable price may be difficult.

**(k) Interest Expense**

Interest expense primarily relates to the Funds' participation in reverse repurchase agreement transactions. Interest expense is recorded as incurred.

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

The Funds benefit from an expense offset arrangement with their custodian bank, whereby uninvested cash balances may earn credits that reduce monthly custodian and accounting agent expenses. Had these cash balances been invested in income-producing securities, they would have generated income for the Funds. Cash overdraft charges, if any, are included in custodian and accounting agent fees.

**(m) Senior Loans**

The Funds purchase assignments of, and participations in, Senior Loans originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution (the "Agent") for a lending syndicate of financial institutions (the "Lender"). When purchasing an assignment, the Funds succeed to all the rights and obligations under the loan agreement with the same rights and obligations as the assigning Lender. Assignments may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning Lender. The Funds may also enter into unfunded loan commitments, which are contractual obligations for future funding. Unfunded loan commitments may include revolving credit facilities, which may obligate the Funds to supply additional cash to the borrower on demand. Unfunded loan commitments represent a future obligation in full, even though a percentage of the principal amounts will never be utilized by the borrower.

## 2. Principal Risks

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

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

Variable and floating rate securities generally are less sensitive to interest rate changes but may decline in value if their interest rates do not rise as much, or as quickly, as interest rates in general. Conversely, floating rate securities will not generally increase in value if interest rates decline. Inverse floating rate securities may decrease in value if interest rates increase. Inverse floating rate securities may also exhibit greater price volatility than a fixed rate obligation with similar credit quality. When the Funds hold variable or floating rate securities, 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 NAV of the Funds' shares.

**PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II**  
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**2. Principal Risks** (continued)

Mortgage-related and other asset-backed securities often involve risks that are different from or more acute than risks associated with other types of debt instruments. Generally, rising interest rates tend to extend the duration of fixed rate mortgage-related securities, making them more sensitive to changes in interest rates. As a result, in a period of rising interest rates, if the Funds hold mortgage-related securities, they may exhibit additional volatility. This is known as extension risk. In addition, adjustable and fixed rate mortgage-related securities are subject to prepayment risk. When interest rates decline, borrowers may pay off their mortgages sooner than expected. This can reduce the returns of the Funds because the Funds may have to reinvest that money at the lower prevailing interest rates. The Funds' investments in other asset-backed securities are subject to risks similar to those associated with mortgage-related securities, as well as additional risks associated with the nature of the assets and the servicing of those assets.

The Funds are exposed to credit risk, which is the risk of losing money if the issuer or guarantor of a fixed income security is unable or unwilling, or is perceived (whether by market participants, rating agencies, pricing services or otherwise) as unable or unwilling, to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in credit ratings.

To the extent the Funds directly invest in foreign currencies or in securities that trade in, and receive revenues in, foreign currencies, or in derivatives that provide exposure to foreign currencies, they will be subject to the risk that those currencies will decline in value relative to the U.S. dollar, or, in the case of hedging positions, that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including economic growth, inflation, 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 United States or abroad. As a result, the Funds' investments in foreign currency-denominated securities may reduce the returns of the Funds.

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

The market values of equity securities, such as common and preferred stock, or equity-related investments, such as futures and options, may decline due to general market conditions which 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. 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. Equity securities and equity-related investments generally have greater market price volatility than fixed income securities.

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

Leverage will cause the value of the Funds' shares to be more volatile than if the Funds did not use leverage. This is because leverage tends to exaggerate the effect of any increase or decrease in the value of the Funds' portfolio securities. The Funds may engage in transactions (such as reverse repurchase agreements) or purchase instruments that give rise to forms of leverage. In addition, to the extent the Funds employ leverage, interest costs may not be recovered by any appreciation of the securities purchased with the leverage proceeds and could exceed the Funds' investment returns, resulting in greater losses.

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**2. Principal Risks** (continued)

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

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

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

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

The Funds had credit default swap agreements and securities outstanding with Lehman Brothers entities as issuer, referenced entity, counterparty or guarantor at the time the relevant Lehman Brothers entity filed for protection or was placed in administration. The balance shown under payable to broker on the Statement of Assets and Liabilities for Income Strategy II represents the amount due to Lehman Brothers International (Europe).

**3. Financial Derivative Instruments**

Disclosure about derivatives and hedging activities requires qualitative disclosure regarding objectives and strategies for using derivatives, quantitative disclosure about fair value amounts of gains and losses on derivatives, and disclosure about credit-risk-related contingent features in derivative agreements. The disclosure requirements distinguish between derivatives, which are accounted for as hedges , and those that do not qualify for such accounting. Although the Funds sometimes use derivatives for hedging purposes, the Funds reflect derivatives at fair value and recognize changes in fair value through the Funds' Statements of Operations, and such derivatives do not qualify for hedge accounting treatment.

**(a) Futures Contracts**

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

**(b) Swap Agreements**

Swap agreements are privately negotiated agreements between the Funds and a counterparty to exchange or swap investment cash flows, assets, foreign currencies or market-linked returns at specified, future intervals. The Funds enter into credit default, cross-currency, interest rate, total return, variance and other forms of swap agreements in order to manage their exposure to credit, currency and interest rate risk. In connection with these agreements, securities may be identified as collateral in accordance with the terms of the respective swap agreements to provide assets of value and recourse in the event of default or bankruptcy/insolvency.

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

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

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

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

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

Credit default swap agreements on corporate or sovereign issues involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a default or other credit event. If a credit event occurs and cash settlement is not elected, a variety of other deliverable obligations may be delivered in lieu of the specific referenced obligation. The ability to deliver other obligations may result in a cheapest-to-deliver option (the buyer of protection's right to choose the deliverable obligation with the lowest value following a credit event). The Funds use credit default swaps on corporate or sovereign issues to provide a measure of protection against defaults of the issuers

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(i.e., to reduce risk where the Funds own or have exposure to the referenced obligation) or to take an active long or short position with respect to the likelihood of a particular issuer's default.

Credit default swap agreements on asset-backed securities involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a default or other credit event. Unlike credit default swaps on corporate or sovereign issues deliverable obligations in most instances would be limited to the specific referenced obligation as performance for asset-backed securities can vary across deals. Prepayments, principal paydowns, and other writedown or loss events on the underlying mortgage loans will reduce the outstanding principal balance of the referenced obligation. These reductions may be temporary or permanent as defined under the terms of the swap agreement and the notional amount for the swap agreement will be adjusted by corresponding amounts. The Funds use credit default swaps on asset-backed securities to provide a measure of protection against defaults of the referenced obligation or to take an active long or short position with respect to the likelihood of a particular referenced obligation's default.

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July 31, 2011

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

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

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

The maximum potential amount of future payments (undiscounted) that the Funds as sellers of protection could be required to make under a credit default swap agreement would be an amount equal to the notional amount of the agreement. Notional amounts of all credit default swap agreements outstanding as of July 31, 2011 for which the Funds are sellers of protection are disclosed later in the Notes to Financial Statements (see 5(b)). These potential amounts would be partially offset by any recovery values of the respective referenced obligations, upfront payments received upon entering into the agreement, or net amounts received from the settlement of buy protection credit default swap agreements entered into by the Funds for the same referenced entity or entities.

**Interest Rate Swap Agreements** Interest rate swap agreements involve the exchange by the Funds with a counterparty of their respective commitments to pay or receive interest, e.g., an exchange of floating rate payments for fixed rate payments, with respect to the notional amount of principal. Certain forms of interest rate swap agreements may include: (i) interest rate caps, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates exceed a specified rate, or "cap", (ii) interest rate floors, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates fall below a specified rate, or "floor", (iii) interest rate collars, under which a party sells a cap and purchases a floor or vice versa in an attempt to protect itself against interest rate movements exceeding given minimum or maximum levels, (iv) callable interest rate swaps, under which the counterparty may terminate the swap transaction in whole at zero cost by a predetermined date and time prior to the maturity date, (v) spreadlocks, which allow the interest rate swap users to lock in the forward differential (or spread) between the interest rate swap rate and a specified benchmark, or (vi) basis swaps, under

which two parties can exchange variable interest rates based on different money markets.

**(c) Forward Foreign Currency Contracts**

A forward foreign currency contract is an agreement between two parties to buy and sell a currency at a set exchange rate on a future date. The Funds enter into forward foreign currency contracts for the purpose of hedging against foreign currency risk arising from the investment or anticipated investment in securities denominated in foreign currencies. The Funds also enter into these contracts for purposes of increasing exposure to a foreign currency or shifting exposure to foreign currency fluctuations from one country to another. The market value of a forward foreign currency contract fluctuates with changes in foreign currency exchange rates. All commitments are marked to market daily at the

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

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

applicable exchange rates and any resulting unrealized appreciation or depreciation is recorded. Realized gains or losses are recorded at the time the forward contract matures or by delivery of the currency. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. In addition, these contracts may involve market price risk in excess of the unrealized appreciation (depreciation) reflected in the Funds Statements of Assets and Liabilities.

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

The effect of derivatives on the Statements of Assets and Liabilities at July 31, 2011:

Income Strategy:

Location	Interest Rate Contracts	Credit Contracts	Foreign Exchange Contracts	Total
<b>Asset derivatives:</b>				
Unrealized appreciation of swaps	\$160,098	\$55,003		\$215,101
Receivable for variation margin on futures contracts*	93,275			93,275
Unrealized appreciation of forward foreign currency contracts			\$45,620	45,620
<b>Total asset derivatives</b>	<b>\$253,373</b>	<b>\$55,003</b>	<b>\$45,620</b>	<b>\$353,996</b>
<b>Liability derivatives:</b>				
Unrealized depreciation of swaps	\$(947,127)			\$(947,127)
Unrealized depreciation of forward foreign currency contracts			\$(1,068,022)	(1,068,022)
<b>Total liability derivatives</b>	<b>\$(947,127)</b>		<b>\$(1,068,022)</b>	<b>\$(2,015,149)</b>

\* Included in the unrealized appreciation of \$577,182 on futures contracts, as reported in section 5(a) of the Notes to Financial Statements.

Income Strategy II:

Location	Interest Rate Contracts	Credit Contracts	Foreign Exchange Contracts	Total
<b>Asset derivatives:</b>				
Unrealized appreciation of swaps	\$330,592			\$330,592
Receivable for variation margin on futures contracts*	223,988			223,988

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Unrealized appreciation of forward foreign currency contracts		\$169,812	169,812
<b>Total asset derivatives</b>	\$554,580	\$169,812	\$724,392
<b>Liability derivatives:</b>			
Unrealized depreciation of swaps	\$(1,351,798)		\$(1,351,798)
Unrealized depreciation of forward foreign currency contracts		\$(3,465,593)	(3,465,593)
<b>Total liability derivatives</b>	\$(1,351,798)	\$(3,465,593)	\$(4,817,391)

\* Included in the unrealized appreciation of \$890,772 on futures contracts, as reported in section 5(a) of the Notes to Financial Statements.

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

July 31, 2011

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

The effect of derivatives on the Statements of Operations for the year ended July 31, 2011:

Income Strategy:

Location	Interest Rate Contracts	Credit Contracts	Foreign Exchange Contracts	Total
<b>Net realized gain (loss) on:</b>				
Futures contracts	\$56,379			\$56,379
Swaps	(7,935,635)	\$3,692,468		(4,243,167)
Foreign currency transactions (forward foreign currency contracts)			\$(3,653,930)	(3,653,930)
<b>Total net realized gain (loss)</b>	<b>\$(7,879,256)</b>	<b>\$3,692,468</b>	<b>\$(3,653,930)</b>	<b>\$(7,840,718)</b>
<b>Net change in unrealized appreciation/depreciation of:</b>				
Futures contracts	\$577,182			\$577,182
Swaps	(787,029)	\$(595,885)		(1,382,914)
Foreign currency transactions (forward foreign currency contracts)			\$68,502	68,502
<b>Total net change in unrealized appreciation/depreciation</b>	<b>\$(209,847)</b>	<b>\$(595,885)</b>	<b>\$68,502</b>	<b>\$(737,230)</b>

Income Strategy II:

Location	Interest Rate Contracts	Credit Contracts	Foreign Exchange Contracts	Total
<b>Net realized gain (loss) on:</b>				
Futures contracts	\$110,582			\$110,582
Swaps	(16,208,878)	\$9,546,762		(6,662,116)
Foreign currency transactions (forward foreign currency contracts)			\$(13,041,826)	(13,041,826)
<b>Total net realized gain (loss)</b>	<b>\$(16,098,296)</b>	<b>\$9,546,762</b>	<b>\$(13,041,826)</b>	<b>\$(19,593,360)</b>
<b>Net change in unrealized appreciation/depreciation of:</b>				
Futures contracts	\$890,772			\$890,772
Swaps	(1,021,206)	\$(1,276,006)		(2,297,212)
Foreign currency transactions (forward foreign currency contracts)			\$605,465	605,465
<b>Total net change in unrealized appreciation/depreciation</b>	<b>\$(130,434)</b>	<b>\$(1,276,006)</b>	<b>\$605,465</b>	<b>\$(800,975)</b>



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

July 31, 2011

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

The average volume (measured at each fiscal quarter-end) of derivative activity during the year ended July 31, 2011:

	Futures Contracts (1)	Forward Foreign Currency Contracts (2)	Credit Default Swap Agreements (3)	Interest Rate Swap Agreements (3)
	Long	Purchased	Sold	Sell
Income Strategy	249	\$3,697,271	\$56,287,572	\$26,400
Income Strategy II	454	10,860,099	180,184,106	57,800
				85,360

(1) Number of contracts

(2) U.S. \$ value on origination date

(3) Notional amount (in thousands)

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

Each Fund has an Investment Management Agreement (each an Agreement) with the Investment Manager. Subject to the supervision of the Funds' Board of Trustees, the Investment Manager is responsible for managing, either directly or through others selected by it, the Funds' investment activities, business affairs and administrative matters. Pursuant to each Agreement, the Investment Manager receives an annual fee, payable monthly, at an annual rate of 0.75% of each Fund's average weekly total managed assets. Total managed assets refer to the total assets of each Fund (including assets attributable to any Preferred Shares or other forms of leverage that may be outstanding) minus accrued liabilities (other than liabilities representing leverage).

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

**5. Investments in Securities**

Purchases and sales of investments, other than short-term securities for the year ended July 31, 2011:

	Purchases	Sales
Income Strategy	\$239,379,486	\$177,348,044
Income Strategy II	367,219,101	320,958,396

(a) Futures contracts outstanding at July 31, 2011:

Income Strategy:

Type			Contracts	Market Value (000s)	Expiration Date	Unrealized Appreciation
Long:	Financial Futures Euro	90 day	178	\$44,262	3/19/12	\$128,462
	Financial Futures Euro	90 day	243	60,404	6/18/12	227,115
	Financial Futures Euro	90 day	101	25,091	9/17/12	37,702
	Financial Futures Euro	90 day	101	25,067	12/17/12	73,052
	Financial Futures Euro	90 day	101	25,040	3/18/13	104,615
	Financial Futures Euro	90 day	11	2,723	6/17/13	6,236
						\$577,182

PIMCO Income Strategy Fund

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

July 31, 2011

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

Income Strategy II:

Type			Contracts	Market Value (000s)	Expiration Date	Unrealized Appreciation
Long:	Financial Futures Euro	90 day	355	\$88,275	3/19/12	\$257,375
	Financial Futures Euro	90 day	285	70,844	6/18/12	13,763
	Financial Futures Euro	90 day	285	70,801	9/17/12	106,388
	Financial Futures Euro	90 day	285	70,733	12/17/12	206,138
	Financial Futures Euro	90 day	285	70,659	3/18/13	295,200
	Financial Futures Euro	90 day	21	5,199	6/17/13	11,908
						\$890,772

At July 31, 2011, Income Strategy and Income Strategy II pledged cash collateral of \$548,000 and \$841,000, respectively, for futures contracts.

(b) Credit default swap agreements:

Sell protection swap agreements outstanding at July 31, 2011 (1):

Income Strategy:

Swap Counterparty/ Referenced Debt Issuer	Notional Amount (000s) (3)	Credit Spread (2)*	Termination Date	Payments Received	Market Value (4)	Upfront Premiums Received	Unrealized Appreciation
Goldman Sachs: HCA	\$1,500	1.40%	9/20/13	3.00 %	\$55,003		\$55,003

\* Unaudited.

(1) If the Funds are sellers of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the Funds will either (i) pay to the buyer of protection an amount equal to the notional amount of the swap and take delivery of the referenced obligation or underlying securities comprising the referenced index or (ii) pay a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation or underlying securities comprising the referenced index.

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- (2) Implied credit spreads, represented in absolute terms, utilized in determining the market value of credit default swap agreements as of year end serve as an indicator of the current status of the payment/performance risk and represent the likelihood or risk of default for the credit derivative. The implied credit spread of a particular referenced entity reflects the cost of buying/selling protection and may include upfront payments required to be made to enter into the agreement. Wider credit spreads represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement.*
- (3) This represents the maximum potential amount the Fund could be required to make available as a seller of credit protection or receive as a buyer of credit protection if a credit event occurs as defined under the terms of that particular swap agreement.*
- (4) The quoted market prices and resulting values for credit default swap agreements serve as an indicator of the status at July 31, 2011 of the payment/performance risk and represent the likelihood of an expected liability (or profit) for the credit derivative should the notional amount of the swap agreement been closed/sold as of the period end. Increasing market values, in absolute terms when compared to the notional amount of the swap, represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement.*

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

July 31, 2011

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

(c) Interest rate swap agreements outstanding at July 31, 2011:

<u>Income Strategy:</u>				Rate Type			
Swap Counterparty	Notional Amount (000s)	Termination Date	Payments Made	Payments Received 3-Month	Market Value	Upfront Premiums Received	Unrealized Appreciation (Depreciation)
JPMorgan Chase	\$76,300	12/21/41	4.00% Federal Funds Overnight Rate	USD-LIBOR	\$(1,356,858)	\$(409,731)	\$(947,127)
Royal Bank of Scotland	77,000	9/19/13		0.50%	44,341 \$(1,312,517)	(115,757) \$(525,488)	160,098 \$(787,029)

<u>Income Strategy II:</u>				Rate Type			
Swap Counterparty	Notional Amount (000s)	Termination Date	Payments Made	Payments Received 3-Month	Market Value	Upfront Premiums Received	Unrealized Appreciation (Depreciation)
JPMorgan Chase	\$108,900	12/21/41	4.00% Federal Funds Overnight Rate	USD-LIBOR	\$(1,936,591)	\$(584,793)	\$(1,351,798)
Royal Bank of Scotland	159,000	9/19/13		0.50%	91,562 \$(1,845,029)	(239,030) \$(823,823)	330,592 \$(1,021,206)

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LIBOR London Inter-Bank Offered Rate

PIMCO Income Strategy Fund

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

July 31, 2011

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

(d) Forward foreign currency contracts outstanding at July 31, 2011:

Income Strategy:

	Counterparty	U.S.\$ Value on Origination Date	U.S.\$Value July 31, 2011	Unrealized Appreciation (Depreciation)
<u>Purchased:</u>				
186,100 Brazilian Real settling 9/2/11	Bank of America	\$100,000	\$119,043	\$19,043
41,570 Brazilian Real settling 8/2/11	Barclays Bank	25,998	26,805	807
100,000 British Pound settling 8/2/11	Bank of America	163,349	164,145	796
7,095,112 Chinese Yuan Renminbi settling 2/13/12	Deutsche Bank	1,095,347	1,106,186	10,839
323,000 Mexican Peso settling 11/18/11	Deutsche Bank	27,466	27,251	(215)
60,000 Mexican Peso settling 11/18/11	Morgan Stanley	5,025	5,062	37
760,150 South African Rand settling 9/13/11	Barclays Bank	100,000	113,047	13,047
<u>Sold:</u>				
2,788,000 Australian Dollar settling 8/31/11	Bank of America	3,038,933	3,052,122	(13,189)
41,570 Brazilian Real settling 9/2/11	Barclays Bank	25,833	26,591	(758)
41,570 Brazilian Real settling 8/2/11	UBS	25,714	26,805	(1,091)
100,000 British Pound settling 9/13/11	Bank of America	163,269	164,073	(804)
100,000 British Pound settling 9/13/11	Barclays Bank	163,214	164,073	(859)
100,000 British Pound settling 8/2/11	Credit Suisse First Boston	163,908	164,145	(237)
24,090,000 British Pound settling 8/9/11	JPMorgan Chase	38,848,136	39,539,731	(691,595)
1,151,000 British Pound settling 9/13/11	Royal Bank of Scotland	1,856,540	1,888,483	(31,943)
6,975,000 Chinese Yuan Renminbi settling 9/14/11	JPMorgan Chase	1,075,559	1,083,100	(7,541)
861,000 Euro settling 10/19/11	Citigroup	1,235,886	1,234,835	1,051
4,018,000 Euro settling 10/19/11	Credit Suisse First Boston	5,610,133	5,762,561	(152,428)
4,019,000 Euro settling 10/19/11	Morgan Stanley	5,600,476	5,763,995	(163,519)
683,681 South African Rand settling 10/28/11	HSBC Bank	97,165	101,008	(3,843)
				\$(1,022,402)



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

July 31, 2011

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

Income Strategy II:

	Counterparty	U.S.\$ Value on Origination Date	U.S.\$Value July 31, 2011	Unrealized Appreciation (Depreciation)
<u>Purchased:</u>				
372,200 Brazilian Real settling 9/2/11	Bank of America	\$200,000	\$238,086	\$38,086
408,946 Brazilian Real settling 8/2/11	Barclays Bank	255,751	263,691	7,940
185,950 Brazilian Real settling 9/2/11	Morgan Stanley	100,000	118,947	18,947
300,000 British Pound settling 8/2/11	Bank of America	490,047	492,435	2,388
14,519,138 Chinese Yuan Renminbi settling 2/13/12	Deutsche Bank	2,241,318	2,263,652	22,334
627,000 Euro settling 8/25/11	Citigroup	906,785	900,489	(6,296)
4,103,000 Euro settling 8/25/11	HSBC Bank	5,876,481	5,892,675	16,194
1,497,000 Euro settling 8/25/11	Royal Bank of Canada	2,179,460	2,149,972	(29,488)
4,058,000 Indian Rupee settling 8/12/11	Barclays Bank	86,487	91,663	5,176
600,000 Indian Rupee settling 8/12/11	Deutsche Bank	12,834	13,553	719
4,658,000 Indian Rupee settling 7/12/12	JPMorgan Chase	100,215	100,180	(35)
646,000 Mexican Peso settling 11/18/11	Deutsche Bank	54,932	54,503	(429)
130,000 Mexican Peso settling 11/18/11	Morgan Stanley	11,013	10,968	(45)
1,520,300 South African Rand settling 9/13/11	Barclays Bank	200,000	226,094	26,094
759,900 South African Rand settling 9/13/11	Morgan Stanley	100,000	113,010	13,010
<u>Sold:</u>				
7,146,000 Australian Dollar settling 8/31/11	Bank of America	7,789,240	7,822,978	(33,738)
408,946 Brazilian Real settling 9/2/11	Barclays Bank	254,130	261,592	(7,462)
408,946 Brazilian Real settling 8/2/11	UBS	252,966	263,691	(10,725)
300,000 British Pound settling 9/13/11	Bank of America	489,807	492,220	(2,413)
200,000 British Pound settling 8/2/11	Barclays Bank	327,816	328,290	(474)
9,000 British Pound settling 9/13/11	Barclays Bank	14,690	14,767	(77)
100,000 British Pound settling 8/2/11	Credit Suisse First Boston	163,908	164,145	(237)
54,974,000 British Pound settling 8/9/11	JPMorgan Chase	88,652,447	90,230,684	(1,578,237)
1,700,000 British Pound settling 9/13/11	Royal Bank of Scotland	2,742,066	2,789,245	(47,179)
14,273,000 Chinese Yuan Renminbi settling 9/14/11	JPMorgan Chase	2,200,925	2,216,356	(15,431)
61,977,000 Euro settling 8/25/11	Citigroup	87,294,047	89,010,556	(1,716,509)
3,047,000 Euro settling 9/22/11	Citigroup	4,368,271	4,373,046	(4,775)

PIMCO Income Strategy Fund



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

July 31, 2011

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

Income Strategy II:

	Counterparty	U.S.\$ Value on Origination Date	U.S.\$Value July 31, 2011	Unrealized Appreciation (Depreciation)
1,800,000 Euro settling 8/25/11	Royal Bank of Scotland	\$2,604,060	\$2,585,136	\$18,924
4,658,000 Indian Rupee settling 8/12/11	JPMorgan Chase	104,721	105,216	(495)
2,054,362 South African Rand settling 10/28/11	HSBC Bank	291,966	303,514	(11,548)
				\$(3,295,781)

At July 31, 2011, Income Strategy held \$100,000 in cash as collateral for derivatives. Cash collateral held may be invested in accordance with the Funds' investment strategies.

(e) Open reverse repurchase agreements at July 31, 2011:

Income Strategy:

Counterparty	Rate	Trade Date	Maturity Date	Principal & Interest	Principal
Bank of America	0.45%	7/22/11	8/22/11	\$2,240,373	\$2,240,093
Barclays Bank	0.45%	7/12/11	8/12/11	7,981,995	7,980,000
	0.45%	7/15/11	8/12/11	900,191	900,000
	0.45%	7/25/11	8/25/11	7,064,618	7,064,000
	0.45%	7/26/11	8/26/11	4,068,305	4,068,000
	0.45%	7/27/11	8/29/11	1,834,115	1,834,000
	0.60%	6/28/11	8/1/11	3,938,230	3,936,000
	0.60%	7/22/11	8/22/11	5,852,975	5,852,000
	0.65%	7/18/11	8/17/11	14,735,724	14,732,000
Credit Suisse First Boston	0.40%	7/28/11	8/29/11	594,026	594,000
Deutsche Bank	0.38%	6/30/11	8/1/11	1,822,616	1,822,000
	0.38%	7/7/11	8/8/11	6,153,624	6,152,000
	0.38%	7/11/11	8/10/11	3,219,714	3,219,000
	0.38%	7/26/11	8/26/11	485,031	485,000
	0.60%	6/30/11	8/1/11	4,810,564	4,808,000
	0.60%	7/7/11	8/8/11	5,876,448	5,874,000
	0.60%	7/22/11	8/22/11	12,196,032	12,194,000

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	0.60%	7/28/11	8/30/11	5,054,337	5,054,000
Greenwich Capital Markets	0.40%	6/30/11	8/1/11	1,578,561	1,578,000
	0.40%	7/11/11	8/10/11	2,627,613	2,627,000
UBS	0.40%	7/26/11	8/24/11	3,348,223	3,348,000
					\$96,361,093

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

July 31, 2011

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

Counterparty	Rate	Trade Date	Maturity Date	Principal & Interest	Principal
Barclays Bank	(1.00)%	3/3/11	3/3/13	\$1,417,255	\$1,423,225
	0.45%	7/12/11	8/12/11	1,050,263	1,050,000
	0.45%	7/25/11	8/25/11	6,275,549	6,275,000
	0.45%	7/28/11	8/30/11	2,705,135	2,705,000
	0.60%	6/28/11	8/1/11	5,463,094	5,460,000
	0.60%	7/18/11	8/17/11	25,865,034	25,859,000
Credit Suisse First Boston	0.60%	7/25/11	8/24/11	5,656,660	5,656,000
	0.60%	7/25/11	8/24/11	10,027,170	10,026,000
Deutsche Bank	0.38%	7/28/11	8/29/11	34,283,447	34,282,000
	0.60%	7/7/11	8/8/11	4,067,694	4,066,000
	0.60%	7/22/11	8/22/11	2,757,460	2,757,000
Greenwich Capital Markets	0.40%	7/28/11	8/30/11	4,233,188	4,233,000
					\$103,792,225

The weighted average daily balance of reverse repurchase agreements outstanding during the year ended July 31, 2011 for Income Strategy and Income Strategy II was \$56,827,147 and \$46,032,113, respectively, at a weighted average interest rate of 0.50% and 0.42%, respectively. The total market value of underlying collateral (refer to the Schedules of Investments for positions segregated for the benefit of the counterparty as collateral for reverse repurchase agreements) for open reverse repurchase agreements at July 31, 2011 was \$102,385,670 and \$109,251,735, for Income Strategy and Income Strategy II, respectively.

At July 31, 2011, Income Strategy and Income Strategy II held \$580,000 and \$375,000, respectively, in principal value of U.S. Treasury Obligations as collateral for open reverse repurchase agreements. Securities held as collateral will not be pledged and are not reflected in the Schedules of Investments.

**6. Income Tax Information**

The tax character of dividends paid by the Funds was as follows:

Year ended	Year ended
July 31, 2011	July 31, 2010

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	Ordinary Income Distributions (1)	Ordinary Income Distributions (1)
Income Strategy	\$31,123,205	\$40,262,220
Income Strategy II	58,656,809	75,787,581

(1) Includes short-term capital gains, if any.

PIMCO Income Strategy Fund

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