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April 2010

# ETF Investment Solutions Series

ISSUES ■ EDUCATION ■ SOLUTIONS

*The PIMCO ETF Investment Solution Series offers insight into the challenges investors face and provides an educational framework for implementing potential solutions using PIMCO's suite of ETF investment strategies.*

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## *Active Municipal Bond Investing with PIMCO ETFs*

**Product Highlights: MUNI and SMMU**

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## Active Municipal Bond Investing with PIMCO ETFs

### ISSUE

#### Tax Advantaged Investing Is Increasingly Important Amid a Challenging Municipal Credit Environment

- Tax advantaged investing is becoming ever more important for individuals as state and federal governments look to raise tax rates to cover revenue shortfalls. At the same time, the municipal bond investment environment has become more challenging with deteriorated credit quality and sharply reduced liquidity.
- We expect this challenging credit environment to persist. The economic crisis has simultaneously hit state and local governments' three major revenue sources: income, sales and property taxes. This triple whammy has led to severe revenue contractions and deteriorating credit for many states and municipalities, including credit rating downgrades in the hardest hit areas.
- Liquidity is also severely diminished: Several major broker dealers' Municipal desks merged into smaller desks during the consolidation precipitated by the crisis; many municipal hedge funds that were active players in the market deleveraged or went out of business; and insurance companies that were historically important players in the municipal bond market turned their focus instead to cleaning up their balance sheets and raising liquidity. This has most likely permanently altered the liquidity profile in the market leading to a persistent and significant liquidity premium.

### EDUCATION

#### The Importance of Active Management: The Rebirth of Municipal Credit Analysis

- Greater volatility and wider credit dispersion may increase the opportunities for skilled active managers in the municipal bond space.
- Historically, the municipal market was fairly homogeneous with more than 50% of the bonds insured by third-party wrappers (monoline insurers) that had AAA ratings<sup>1</sup>. There was little value to add through bottom up credit screening. Now, many of these insurers are out of business

or downgraded (See the following table). This means the credit quality of most municipal bonds is now almost based entirely on the fundamental credit quality of the issuer, raising the bar for bottom up credit analysis.

- As of December 2009, less than 9% of the municipal bonds in the market were insured<sup>1</sup>, which also calls into question the benefits of investing in funds based on bond indexes, particularly insured indexes that rely passively on ratings to determine the bonds represented in the index. Robust active credit management can provide superior credit screening by continuously monitoring the underlying credit fundamentals of each security and issuer.

#### Municipal Bond Insurer Ratings

	Moody's	S&P	Fitch
Ambac Assurance Corp	Caa2	CC	No Rating
Assurance Guaranty Corp and subsidiary Assured Guaranty Municipal Corp (formerly Financial Security Assurance, FSA)	Aa3	AAA	AA-
Berkshire Hathaway Assurance Corp. (BHAC)	Aa1	AA+	No Rating
Financial Guaranty Insurance Co. (FGIC)	B1	BB	No Rating
National Public Finance Guarantee Corp. (formerly MBIA Insurance Corp of Illinois)	Baa1	A	No Rating

Source: Raymond James, February 10, 2010

- In addition to credit selection, active management allows for top down sector allocation and duration management within the municipal market. With active management there is no forced buying and selling when the indexes rebalance, the fund can be optimized for liquidity and managed with an aim to avoid capital gains.

#### Active and Indexed Municipal Bond ETF Characteristics

	Active Municipal Bond ETFs	Indexed Municipal Bond ETFs
Credit Screening	Yes	No
Duration Management/ Curve Positioning	Yes	No
Forced Transactions (buys or sells) when Indexes Rebalance	No	Yes
Liquidity Optimized	Yes	Yes
Managed for Capital Gains Tax Efficiency	Yes	Yes

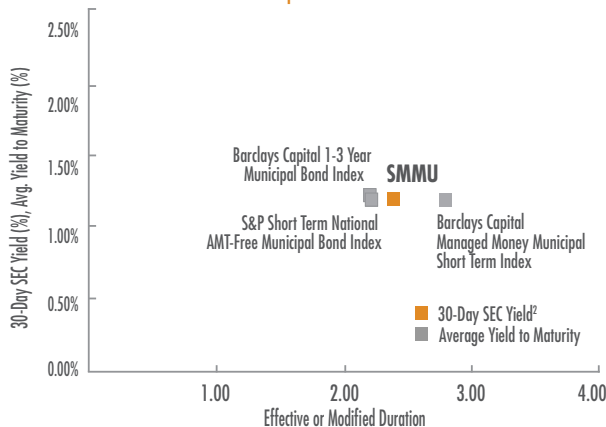
## Product Highlights: MUNI and SMMU

### A PIMCO SOLUTION

#### PIMCO's Active Municipal ETFs Provide Investors Access to Institutional Quality Credit Analysis and a Professional Trading Platform

- Pimco's active municipal bond management focuses on high quality issuers with strong credit fundamentals and utilizes the same portfolio managers, trade execution and investment acumen that supports all of PIMCO's Municipal Bond products.
- PIMCO prefers essential service revenue bonds as well as bonds backed by a dedicated revenue source, and is avoiding General Obligation bonds, particularly in distressed areas.
- Focusing on the short and intermediate part of the curve, MUNI, the PIMCO Intermediate Municipal Bond Strategy Fund duration is in the three to eight year range, while SMMU, the PIMCO Short Term Municipal Bond Strategy Fund, is a short duration portfolio that is positioned defensively for a rising rate environment. Both Funds are nationally diversified and do not intend to invest in AMT-free bonds.

#### Yields and Durations for Short Term Municipal ETFs and Indexes



The average yield to maturity is stated for the indexes listed because 30-day SEC yield is not calculated for indexes.

- Active Municipal ETFs are designed to provide enhanced price transparency and liquidity over most traditional mutual funds in this increasingly illiquid market: The secondary market for the ETF is exchange traded with continuous real-time pricing, and the ETF can be created or redeemed in the primary market by authorized participants in securities or in cash utilizing PIMCO's institutional trade execution and liquidity on the underlying bonds.

Performance (Total Returns)	Since Inception as of 3/31/2010	Since Inception as of 12/31/2009
<b>MUNI</b> (Inception date 11/30/2009)		
NAV	0.40	-0.39
Market Price	0.40	-0.31

Performance (Total Returns)	Since Inception as of 3/31/2010
<b>SMMU</b> (Inception date 2/1/2010)	
NAV	-0.22
Market Price	-0.22

Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and principal value will fluctuate, so that Fund shares may be worth more or less than their original cost when sold or redeemed. Performance data current to the most recent month-end is available at [www.pimcoetfs.com](http://www.pimcoetfs.com) or by calling 888-400-4ETF.

Operating Expenses	
<b>MUNI</b>	Total expenses include the 0.35% management fee plus 0.13% of estimated organizational expenses for the Fund's first fiscal year. Expense reductions totaling 0.13% include a contractual agreement by PIMCO until October 31, 2010 to waive a portion of its management fees equal to 0.13% of average daily net assets.
Management Fee 0.35%	
Total Annual Operating Expenses 0.48%	
Net Annual Operating Expenses 0.35%	
<b>SMMU</b>	Total expenses include the 0.35% management fee plus 0.20% of estimated organizational expenses for the Fund's first fiscal year. Expense reductions totaling 0.20% include a contractual agreement by PIMCO until October 31, 2011 to waive a portion of its management fees equal to 0.20% of average daily net assets.
Management Fee 0.35%	
Total Annual Operating Expenses 0.55%	
Net Annual Operating Expenses 0.35%	

## Currently Available PIMCO ETFs

Actively Managed ETFs	
MINT	PIMCO Enhanced Short Maturity Strategy Fund
MUNI	PIMCO Intermediate Municipal Bond Strategy
SMMU	PIMCO Short Term Municipal Bond Strategy Fund
Indexed ETFs	
TUZ	PIMCO 1-3 Year U.S. Treasury Index Fund
FIVZ	PIMCO 3-7 Year U.S. Treasury Index Fund
TENZ	PIMCO 7-15 Year U.S. Treasury Index Fund
ZROZ	PIMCO 25+ Year Zero Coupon U.S. Treasury Index Fund
STPZ	PIMCO 1-5 Year U.S. TIPS Index Fund
LTPZ	PIMCO 15+ Year U.S. TIPS Index Fund
TIPZ	PIMCO Broad U.S. TIPS Index Fund

*Investors should consider the investment objectives, risks, charges and expenses of the funds carefully before investing. This and other information are contained in the Fund's prospectus, which may be obtained by contacting your PIMCO representative. Please read the prospectus carefully before you invest or send money.*

<sup>1</sup> Raymond James, Feb 10, 2010

<sup>2</sup> The SEC Yield is a standardized annual yield based on the most recent 30 day period. It is calculated in accordance with current Securities and Exchange Commission regulations and is subject to change. The performance figures presented reflect the total return performance and reflect changes in share price and reinvestment of dividend and capital gain distributions. All periods longer than one year are annualized. The SEC Yield is a standardized annual yield based on the most recent 30 day period. It is calculated in accordance with current Securities and Exchange Commission regulations and is subject to change.

Investing in the bond market is subject to certain risks including the risk that fixed income securities will decline in value because of changes in interest rates; the risk that fund shares could trade at prices other than the net asset value; and the risk that the manager's investment decisions might not produce the desired results. Income from municipal bonds may be subject to state and local taxes and at times the alternative minimum tax. Please consult your tax and/or legal counsel for specific tax questions and concerns. Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. Please refer to the Fund's prospectus for a complete list of applicable risks.

Exchange Traded Funds ("ETF") are afforded certain exemptions from the Investment Company Act. The exemptions allow, among other things, for individual shares to trade on the secondary market. Individual shares cannot be directly purchased from or redeemed by the ETF. Purchases and redemptions directly with ETFs are only accomplished through creation unit aggregations or "baskets" of shares. Shares of an ETF are bought and sold at market price (not NAV). Brokerage commissions will reduce returns. Investment policies, management fees and other information can be found in the individual ETF's prospectus.

The value of most bond funds and fixed income securities are impacted by changes in interest rates. Bonds and bond funds with longer durations tend to be more sensitive and more volatile than securities with shorter durations; bond prices generally fall as interest rates rise.

ETFs are subject to secondary market trading risks. Shares of an ETF will be listed for trading on an exchange, however, there can be no guarantee that an active trading market for such shares will develop or continue. There can be no guarantee that an ETF's exchange listing or ability to trade its shares will continue or remain unchanged. Shares of an ETF may trade on an exchange at prices at, above or below their most recent NAV. The per share NAV of an ETF is calculated at the end of each business day, and fluctuates with changes in the market value of the Fund's holdings. The trading prices of an ETF's shares fluctuate continuously throughout the trading day based on market supply and demand, which may not correlate to NAV. The trading prices of an ETF's shares may differ significantly from NAV during periods of market volatility, which may, among other factors, lead to the Fund's shares trading at a premium or discount to NAV.

Duration is the measure of a bond's price sensitivity to interest rates and is expressed in years. The credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio. The Quality ratings of individual issues/issuers are provided to indicate the credit worthiness of such issues/issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody's, and Fitch respectively.

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