PIMCO

March 2017

BOND and LDUR ETFs: Evolving to Meet the Changing Needs of ETF Investors

Q&A

On May 8,[1] PIMCO will be evolving its exchange-traded fund (ETF) offerings to better align with the changing needs of ETF investors. We will be enhancing our Total Return Active Exchange-Traded Fund (BOND) and Low Duration Active Exchange-Traded Fund (LDUR) to address investors' growing desire for income in an environment characterized by low rates and low return expectations. To build on the success of our active core bond solutions, which also include MINT – the largest active ETF in the U.S., managed by Jerome Schneider – we will be updating the BOND and LDUR management teams to provide continuity and expertise across the risk/return spectrum while aligning manager skill sets with the updated strategies.

Here we address some questions you may have about these enhancements, with insight from members of the funds' new or expanded portfolio management teams about how the changes will address ETF investor objectives. David Braun, Jerome Schneider and Dan Hyman will co-manage BOND, while Braun, Schneider and Hozef Arif will co-manage LDUR.

David Braun is a managing director and head of PIMCO's U.S. financial institutions portfolio management team. David is a U.S. core bond specialist and also brings extensive expertise in managing tax-aware, income-focused portfolios to his role as a co-manager of both BOND and LDUR.

Jerome Schneider, a managing director and current portfolio manager on LDUR as well as MINT, brings deep portfolio management experience along with an established track record, for which he won the Morningstar Fixed-Income Fund Manager of the Year award in 2015 in recognition of his management of the PIMCO Short-Term Fund. He will co-manage both BOND and LDUR.

Daniel Hyman, a managing director and co-head of PIMCO's agency mortgage portfolio management team, will bring additional mortgage expertise to BOND, offering detailed insight into a sector with attractive potential for income generation. He is currently the lead portfolio manager on PIMCO's Ginnie Mae and Mortgage Opportunities Strategies and serves as a member of PIMCO's Executive Committee.

Hozef Arif, an executive vice president, credit specialist and co-manager of several PIMCO credit funds, will contribute his experience with global corporate credit portfolios to the LDUR team's increased emphasis on corporate credit as part of its effort to increase and maintain a fairly consistent level of dividend income.

Q: What changes is PIMCO making to the BOND and LDUR ETFs?

Schneider: Broadly speaking, we're evolving our fixed income ETF offering to better align with ETF investors' changing objectives. More specifically, we're making changes to our fund guidelines in an effort to address investors' growing demand for income by seeking to increase distribution yields while maintaining a fairly consistent level of dividend income. We will also look to manage year-end capital gains distributions. Our investment style will be more strategic or long-term in nature, with less emphasis on short-term, more tactical trading strategies.

For BOND, these shifts in objectives will mean investing in a broad array of fixed income sectors and utilizing income efficient implementation strategies, and less focus on foreign exchange (FX), which can create distribution volatility. LDUR will continue to be a strategy for short-term asset management, extending out the risk/return spectrum from MINT (PIMCO Enhanced Short Maturity Active Exchange-Traded Fund), while similarly reducing its focus on FX and increasing its emphasis on corporate credit. As a reflection of these changes we will be updating the funds' names, changing BOND's official name to PIMCO Active Bond Exchange-Traded Fund and LDUR's to PIMCO Enhanced Low Duration Active Exchange-Traded Fund. The fund tickers will remain the same.

Q: Given both funds' strong historical performance, why is PIMCO making these changes now?

Braun: It's true that BOND and LDUR have celebrated some key milestones this year: Both strategies have earned 5-star Morningstar overall ratings[2] in their respective categories; LDUR hit the three-year mark in January, and BOND celebrated its five-year anniversary in February. And the management teams for both funds produced attractive returns despite a challenging environment in recent years. But the ETF market is changing, and as the leader in active ETFs, we know that our strategies need to adapt to meet our clients' evolving needs. Our clients today are increasingly looking for income, and we've put together portfolio management teams that we think are best positioned to help those clients achieve their objectives.

Q: Can you tell us more about your team-oriented approach to actively managing these funds?

Braun: The BOND and LDUR ETFs will be jointly managed, and each team member brings a unique background and set of skills to the day-to-day strategy execution of these ETFs. Our teams were carefully selected to provide complementary skill sets, and given that each of us has a history of working with the specialists in our area of expertise, our team structure also provides strong links between the specialist desks for these portfolios.

We believe the success of each of our strategies benefits from PIMCO's time-tested, team-oriented investment process. Our cyclical and secular forum processes bring together portfolio managers like ourselves and other investment professionals from around the globe to formulate top-down themes, while generalists and specialists work together on a daily basis to build portfolios from the bottom up. So in a very real way, the funds also leverage investment ideas from PIMCO's global team of 230+ portfolio managers and 50+ credit analysts,[3] which span every facet of public and private credit markets.

Our active strategies may provide certain advantages over passive ETFs: In a New Neutral reality of "lower for longer" interest rates, achieving attractive risk-adjusted income while preserving purchasing power has become increasingly important for many investors. And actively managed ETFs like BOND and LDUR that can invest in securities outside a given index are able to seek to take advantage of dislocations in the market and exploit targeted opportunities to potentially enhance distribution yield. At the same time, our active, risk-focused approach helps to limit volatility while still seeking to take advantage of pockets of value throughout the fixed income markets. In an environment where exposure to interest rates is a major source of volatility for many portfolios, active management may also help mitigate that risk and potentially produce better risk-adjusted returns.

Q: What current macro outlook is PIMCO expecting as it positions its BOND and LDUR strategies?

Schneider: As discussed in our 2017 Asset Allocation Outlook, we expect a highly uncertain investment environment this year against a backdrop of four important transitions: a handoff from monetary-led to fiscal-led policy, a transition from globalization to de-globalization, China's currency regime shift and a pivot from disinflation to reflation. In short, we believe the likelihood of extreme events or tail risks (to both the downside and the upside) is much greater than it was last year.

In the U.S., our baseline for 2017 is that GDP grows at an above-trend pace, with headline Consumer Price Index (CPI) inflation continuing to converge with core inflation and the Federal Reserve raising interest rates two or three times during the year (with risks to the upside). But our conviction in any given scenario is lower due to a host of uncertainties. Trump administration policies, for example, could include a combination of deregulation and tax reform that unleashes productivity-boosting investment and in turn sustained higher growth rates and corporate profits. But on the flip side, trade wars, tariffs and geopolitical conflicts could depress growth and even tip the economy into a recession. Against this backdrop, actively allocating risk will continue to be a key focus for our BOND and LDUR funds as they evolve to better align with ETF investor objectives.

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[1]For BOND, we expect the changes to the strategies' guidelines and management teams to become effective on 8 May 2017 or when applicable regulatory relief approval is received, whichever occurs later. For LDUR, we expect the changes to the strategies' guidelines and management teams to become effective on 8 May 2017.

[2]Morningstar Rating as of 28 February 2017. PIMCO Total Return Active ETF (BOND): Overall rating for the intermediate-term bond category: Fund ratings are out of 5 Stars: Overall 5 Stars (854 funds rated); 3 Yrs. 5 Stars (854 funds rated); 5 Yrs. 5 Stars (754 funds rated). PIMCO Low Duration Active ETF (LDUR): Overall rating for the short-term bond category: Fund ratings are out of 5 Stars: Overall 5 Stars (451 funds rated); 3 Yrs. 5 Stars (451 funds rated). The Morningstar RatingTM for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Morningstar, Inc.® 2017. All rights reserved. The information contained herein; (1) is proprietary to Morningstar and/or its affiliates; (2) may not be copied or distributed; (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

[3]As of 31 December 2016.

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.

A word about risk:

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. Investments may be worth more or less than the original cost when redeemed. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Investing in f**oreign denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Mortgage and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market's perception of issuer creditworthiness; while generally supported by some form of government or private guarantee there is no assurance that private guarantors will meet their obligations. **High-yield, lower-rated, securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Diversification** does not ensure against loss.

Management risk is the risk that the investment techniques and risk analyses applied by PIMCO will not produce the desired results, and that certain policies or developments may affect the investment techniques available to PIMCO in connection with managing the strategy. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. Investors should consult their investment professional prior to making an investment decision.

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.

Premiums (when market price is above NAV) or discounts (when market price is below NAV) reflect the differences (expressed as a percentage) between the NAV and the Market Price of the Fund on a given day, generally at the time the NAV is calculated. A discount or premium could be significant. Data in chart format displaying the frequency distribution of discounts and premiums of the Market Price against the NAV can be found for each Fund at www.pimcoetfs.com.

The Morningstar Fixed-Income Fund Manager of the Year award (2015) awarded to Jerome Schneider and Team is based on the strength of the manager, performance, strategy and firm's stewardship. Morningstar Awards 2015©. Morningstar, Inc. All Rights Reserved.

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CMR2017-0307-254461