PIMCO

Your Global Investment Authority

STAY THE COURSE

Even as bond markets change, the reasons to invest remain constant.

For long-term savers, rising rates are nothing to fear.

Most investors are familiar with the bond "seesaw" showing the inverse relationship between bond prices and rates: When one rises, the other falls. But the reality is more nuanced.

While short-term market fluctuations are never comfortable, investors focusing on their long-term goals should not fear rising rates.

Here are four reasons why.

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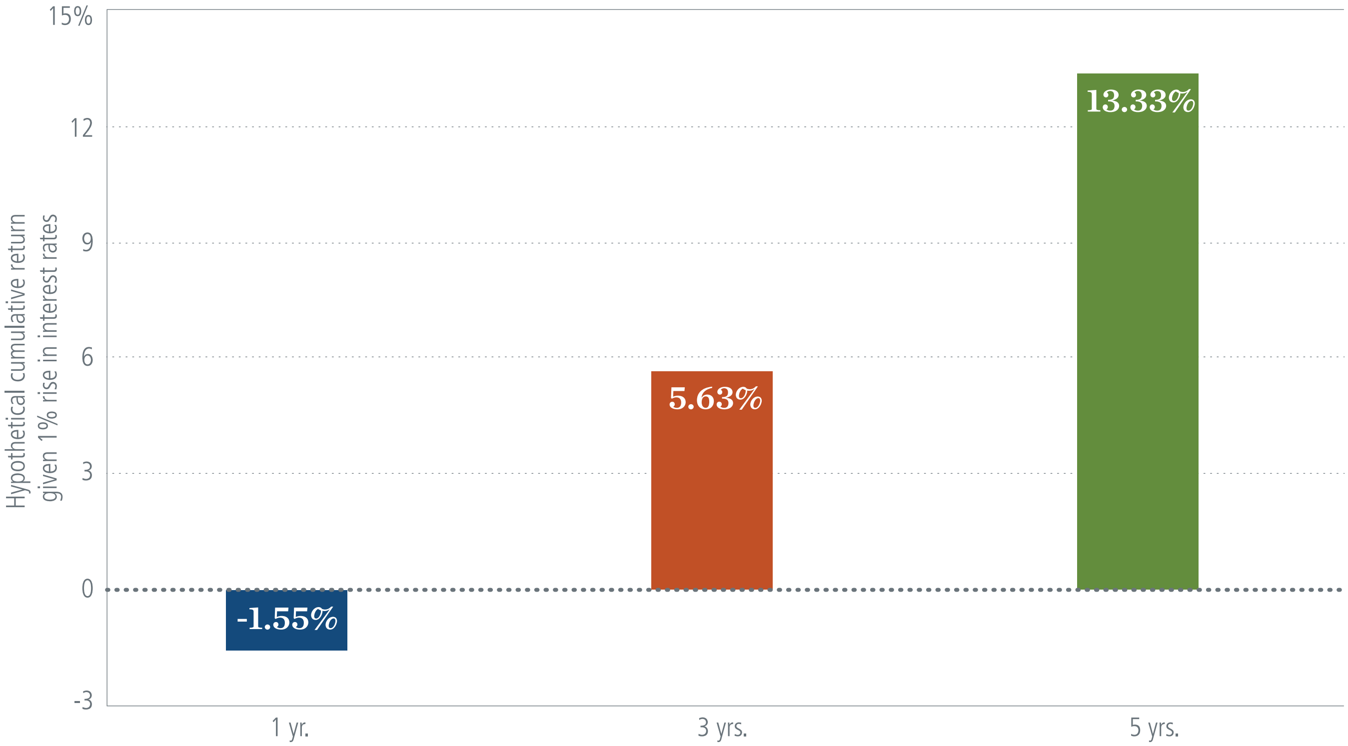
Rising rates build income

Because interest income is the primary driver of bond returns, the ability to reinvest into a gradually rising rate environment can help build long-term growth. Remember that a bond is a loan to a debt issuer such as a government, agency or company. When rates rise, new bonds pay a higher coupon, increasing what you as a lender receive. In contrast, equity investors would fare less well, as increased borrowing costs would reduce profits.

An increase in a bond portfolio's income also helps to offset the negative impact on its price – often quite quickly, as the chart below shows. Over time, rising income should actually provide a return advantage. It's important to note that while a money market instrument would provide a positive (if minimal) return, it would soon lag behind bonds, especially if the Federal Reserve holds its policy rate at zero through 2015, as many believe it will.

THE UPSIDE OF RISING RATES



Hypothetical example for illustrative purposes only

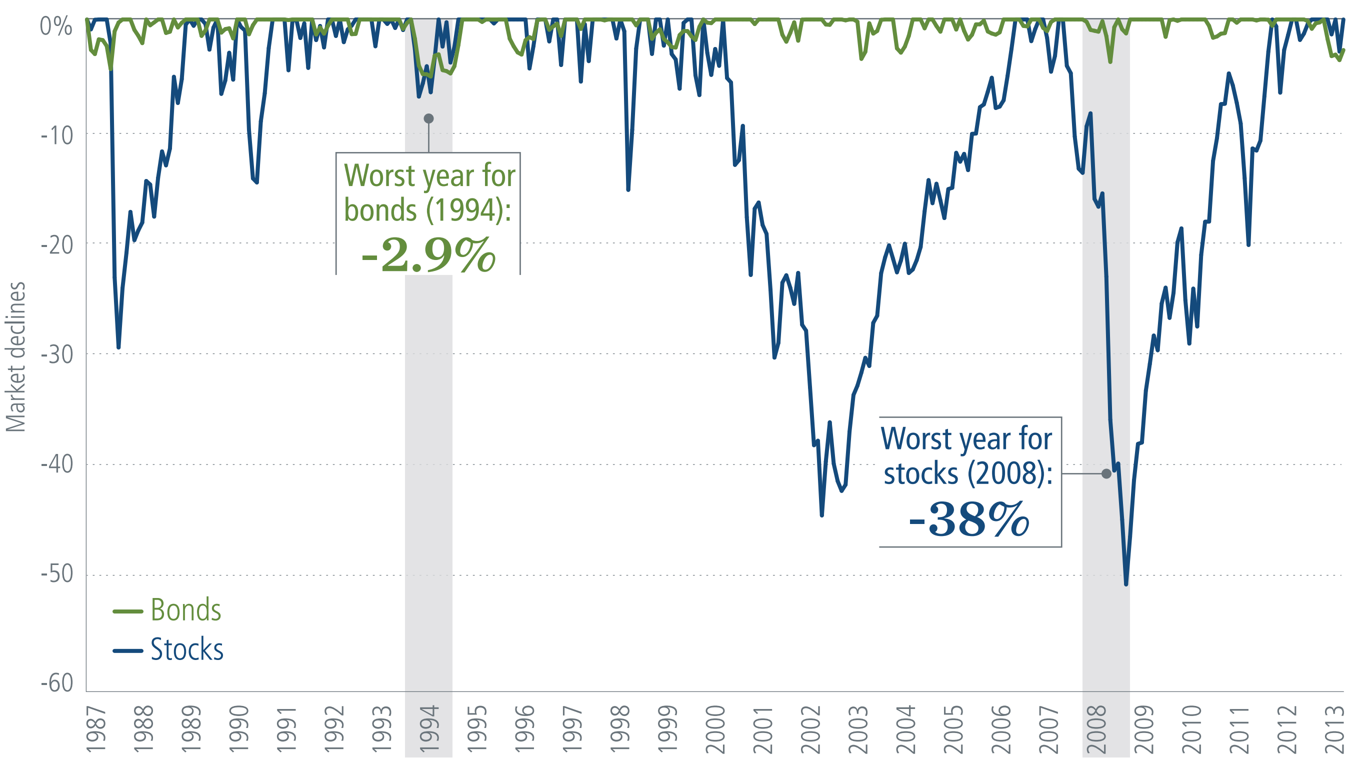
Source: Barclays, as of 30 September 2013. The chart shows the performance of the Barclays U.S. Aggregate Index while assuming a rate rise of 1%, that occurs on day one and remains constant over the time periods depicted.

Lower volatility helps preserve capital

Market declines are never easy, but they can be a good reminder of why investors have looked to fixed income to anchor their portfolios. Bonds have historically provided capital preservation, income and growth, and low-to-negative correlations to equities – essential goals for many of us.

Bonds, particularly core bonds, have also been less volatile than stocks, making an extreme market shock highly unlikely. As the chart below shows, bond declines have been dramatically less severe and quicker to recover.

A VAST DIFFERENCE IN 'WORST-CASE' SCENARIOS



Performance quoted represents past performance. **Past performance is not a guarantee or a reliable indicator of future results.**

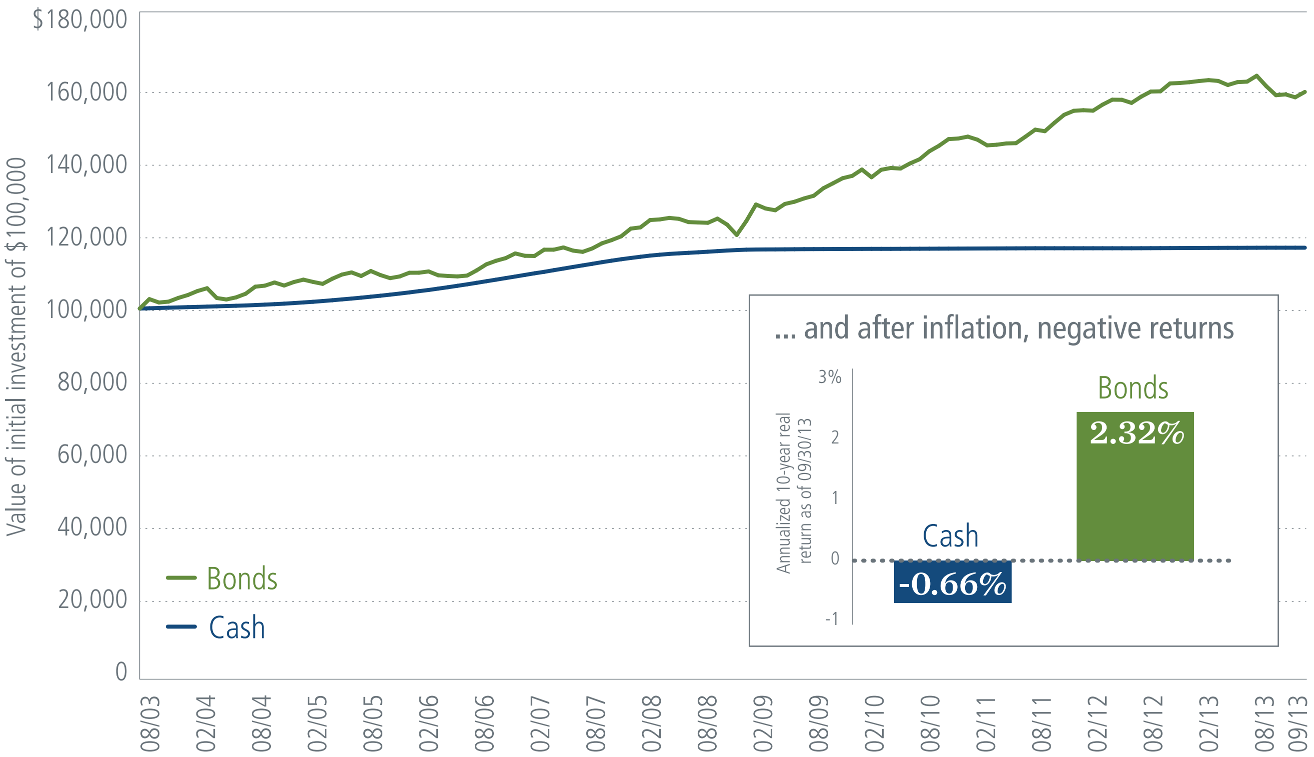
Source: Zephyr. Chart shows U.S. stock and bond declines beginning March 1987 and ending September 2013. Stocks are represented by the S&P 500 Index, bonds by the Barclays U.S. Aggregate Index. Worst years are calendar years.

Cash ‘safety’ comes at a price

Investors concerned about bond volatility may be tempted to exit the market until prices stabilize. While a positive return from cash or money markets may be reassuring, it’s important to recognize that there are costs. Cash instruments currently yield close to zero, a level unlikely to change as long as the Federal Reserve keeps its target rate at zero. And after accounting for inflation, they provide a negative return. That’s a high price to pay for perceived safety.

Bonds almost always generate a higher rate of return than cash or money markets, and though their prices may fluctuate, the compounding effect should work to your long-term advantage, as the chart below shows.

A SMOOTH BUT FLAT RIDE FROM CASH ...



Hypothetical example for illustrative purposes only.

Source: U.S. bonds – Barclays U.S. Aggregate Index; cash – Citigroup 3-Month Treasury Bill Index. Chart shows growth of $100,000 from 31 August 2003 to 30 September 2013. Inset chart shows annualized 10-year real return from 30 September 2003 to 30 September 2013. Cash is represented by the Citigroup 3-month Treasury Bill Index. Core bonds represented by the Barclays U.S. Aggregate Index. Inflation-adjusted returns are based on the Consumer Price Index (Bureau of Labor Statistics).

Experts have access to a diverse toolset

News about the bond market tends to focus on U.S. Treasuries, which are the most sensitive to changing rates. In reality, the "market of bonds" is exceedingly diverse and global, encompassing corporate and high yield bonds, mortgage-backed securities, floating rate issuers, emerging market bonds and others. Each sector or asset class responds differently to economic and market trends. Some, such as floating rate or high yield bonds, tend to do well in a rising rate environment.

Although a market event may temporarily depress prices across the board, a skilled bond fund manager can diversify a portfolio in an effort to defend against threats to capital while also seeking to capture a range of growth opportunities.

COMBATING RATE INCREASES IN THE MARKET OF BONDS

Rate hike period (basis points)	U.S. Treasuries	MBS	Credit	Munis	High yield	Emerging markets	Senior floating rate
03/29/88 to 02/24/89 (325)	3.92%	5.27%	5.21%	7.44%	n/a	n/a	n/a
02/04/94 to 02/01/95 (300)	-2.69%	-0.49%	-3.93%	-3.56%	-1.74%	-21.70%	n/a
06/30/99 to 05/16/00 (175)	3.27%	2.27%	0.10%	-0.16%	-2.27%	14.92%	n/a
06/30/04 to 06/29/06 (425)	5.41%	6.80%	5.85%	9.30%	14.88%	25.44%	12.38%

Past performance is not a guarantee or a reliable indicator of future results. The performance data above is not representative of the performance of any PIMCO product.

Source: BofA Merrill Lynch U.S. Treasury Master Index; Barclays U.S. Agency Fixed Rate MBS Index; Barclays U.S. Credit Index; Barclays Municipal Index; Barclays U.S. High Yield 1% Issuer Cap Index; JP Morgan EMBI Global Index (measures external debt); Credit Suisse Institutional Leveraged Loan Index. The high yield, EM and senior floating rate indexes did not exist during the periods marked n/a.

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A word about risk: Investing in the **bond market** is subject to certain risks, including market, interest rate, issuer, credit and inflation risk; investments may be worth more or less than the original cost when redeemed. Investing in **foreign-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. **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. **Diversification** does not ensure against loss.

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

The BofA Merrill Lynch U.S. Treasury Index tracks the performance of U.S.-dollar-denominated sovereign debt publicly issued by the U.S. government in its domestic market. Qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of $1 billion.

The Barclays U.S. Agency Index includes native currency agency debentures (Fannie Mae, Freddie Mac and Federal Home Loan Bank), and includes both callable and non-callable agency securities issued by U.S. government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. government.

Barclays U.S. Credit Index is an unmanaged index comprising of publicly issued U.S. corporate and specified non-U.S. debentures and secured notes that meet the specified maturity, liquidity and quality requirements. To qualify, bonds must be Securities and Exchange Commission (SEC)-registered.

The Barclays Municipal Bond Index consists of a broad selection of investment grade general obligation and revenue bonds with maturities ranging from one year to 30 years. It is an unmanaged index representative of the tax-exempt bond market. The index is made up of all investment grade municipal bonds issued after 12/31/90 that have a remaining maturity of at least one year.

The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable and dollar-denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis.

The S&P 500 Index is an unmanaged market index generally considered representative of the stock market as a whole. The index focuses on the large-cap segment of the U.S. equities market.

The JPMorgan Emerging Markets Bond Index Global is an unmanaged index that tracks the total return of U.S.-dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady Bonds, loans, Eurobonds and local market instruments.

The Barclays High Yield Index is an unmanaged market-weighted index including only SEC-registered and 144(a) securities with fixed (non-variable) coupons. All bonds must have an outstanding principal of $100 million or greater, a remaining maturity of at least one year, a rating of below investment grade and a U.S. dollar denomination.

The Credit Suisse Institutional Leveraged Loan Index is a subindex of the Credit Suisse Leveraged Loan Index and is designed to more closely reflect the investment criteria of institutional investors by sampling a lower volatility component of the market. The index is formed by excluding the following facilities from the Credit Suisse Leveraged Loan Index: facility types TL and TLa, facilities priced at 90 or lower at the beginning of the month and facilities rated CC, C or Default. The Credit Suisse Leveraged Loan Index is designed to mirror the investable universe of the U.S.-dollar denominated leveraged loan market.

It is not possible to invest directly in an unmanaged index.

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