

PCM FUND, INC.  
Form N-CSRS  
August 27, 2012  
Table of Contents

**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: 811-07816

**PCM Fund, Inc.**

(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 end: December 31, 2012

Date of reporting period: June 30, 2012

**Table of Contents**

ITEM 1. REPORT TO SHAREHOLDERS

# Semi-Annual Report

June 30, 2012

PCM Fund, Inc.

Table of Contents

## Contents

<u>Letter to Stockholders</u>	2 3
<u>Fund Insights</u>	4
<u>Performance &amp; Statistics</u>	5
<u>Schedule of Investments</u>	6 14
<u>Statement of Assets and Liabilities</u>	15
<u>Statement of Operations</u>	16
<u>Statement of Changes in Net Assets</u>	17
<u>Statement of Cash Flows</u>	18
<u>Notes to Financial Statements</u>	19 32
<u>Financial Highlights</u>	33
<u>Changes in Investment Policies/Proxy Voting Policies &amp; Procedures</u>	34 35
<u>Matters Relating to the Directors - Consideration of the Investment Management &amp; Portfolio Management Agreements</u>	36 38

## **Table of Contents**

Hans W. Kertess

*Chairman*

Brian S. Shlissel

*President & CEO*

Dear Stockholders:

The U.S. economy slowed during the fiscal six-month reporting period ended June 30, 2012. Growth was held back by a variety of economic and geopolitical factors including increasing gasoline prices and a tepid labor market. Abroad, Europe's deepening sovereign debt crisis also contributed to the slowdown. The increase in corporate earnings since the recession have also appeared to level off, although, U.S. stocks reached their highest levels since early 2008.

### **The Six Months in Review**

For the fiscal six-month period ended June 30, 2012, the PCM Fund returned 13.52% on net asset value ( NAV ) and 8.05% on market price. The U.S. Treasury market, as measured by the Barclays U.S. Treasury Index, gained 1.08% and the Barclays Mortgage Index, a broad measure of mortgage bond performance, rose 1.67%. The Barclays U.S. Aggregate Index, a broad measure of government and corporate bond performance, advanced 2.37%, while the Barclays U.S. Credit Index, a measure of corporate bond performance, increased 4.55%.

At the beginning of the fiscal period, U.S. 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 expanding at an annual pace of 3.0%. This growth, the strongest since the second quarter of 2010, declined to 1.9% annually during the first quarter of 2012. Economic data released indicated that the second quarter of 2012 would be similarly anemic.

U.S. consumers, responsible for approximately two-thirds of U.S. economic activity, remained cautious during the period as gasoline prices rose sharply before easing as the period ended. The housing market continued to struggle during the first quarter of 2012, with the Standard & Poor's/Case-Shiller Home Price Index dropping to a new low. Robust hiring experienced at the start of the year also eased, with the economy adding fewer than 100,000 jobs as the reporting period drew to a close. Slight progress was demonstrated during the six month period as the unemployment rate declined from 8.3% to 8.2%.

## **Table of Contents**

U.S. Treasury bond prices rose during the period, as investors perceived the asset class as a safe haven. The benchmark 10-year government bond yield reached historic lows, dropping to as low as 1.47%, and stood at 1.67% at the end of the period.

Market and economic uncertainty contributed to the Federal Reserve's (the Fed's) revelation that it would continue to maintain its closely watched Fed Funds rate

in the 0.0% to 0.25% range through late 2014. In testimony to Congress, Fed Chairman Ben Bernanke indicated that the Fed is prepared to take action to protect the U.S. economy and financial system.

## **Outlook**

There is considerable uncertainty regarding future levels of federal taxes and spending. A series of tax cuts are scheduled to expire on December 31, 2012 and major spending reductions are planned to

begin in January 2013. The possibility of higher taxes, reduced spending, or both, would likely have an adverse impact on the U.S. economy in 2013.

Abroad, the European Union's (E.U.) deepening sovereign debt crisis has had significant ramifications on this side of the Atlantic as the U.S. currently sends approximately 20% of its exports to the E.U. The economic slowdown seen in China also contributed to U.S. economic strains.

For specific information on the Fund and its 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 Fund's stockholder servicing agent at (800) 254-5197. In addition, a wide range of information and resources are available on our Web site, [www.allianzinvestors.com/closedendfunds](http://www.allianzinvestors.com/closedendfunds).

Together with Allianz Global Investors Fund Management LLC, the Fund's investment manager, and Pacific Investment Management Company LLC (PIMCO), the Fund's 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

Receive this report electronically and eliminate paper mailings. To enroll, go to [www.allianzinvestors.com/edelivery](http://www.allianzinvestors.com/edelivery).



---

**Table of Contents**

**PCM Fund, Inc. Fund Insights**

June 30, 2012 (unaudited)

For the fiscal six-month period ended June 30, 2012, PCM returned 13.52% on net asset value ( NAV ) and 8.05% on market price, outperforming the unmanaged Barclays CMBS Investment Grade Index<sup>1</sup> (the benchmark index ), which returned 4.35% during the reporting period.

The U.S. fixed income market experienced periods of volatility during the reporting period, but ultimately generated positive returns amid shifting expectations for the U.S. economy. As the reporting period began, fears of a double-dip recession appeared to be receding as certain economic data was better than expected. This largely continued throughout the first quarter of 2012, as unemployment moved lower and consumer spending accelerated. During this time, both short- and long-term Treasury yields generally rose and most spread sectors (non-U.S. Treasuries) outperformed equal duration Treasuries. Investor sentiment reversed course in April and May 2012 due to fears of contagion from the European sovereign debt crisis and concerns that the U.S. economy may be hitting a soft patch. This triggered increased risk aversion and falling Treasury yields. Spread sectors then rallied in June due to signs of eurozone progress and expectations of additional quantitative easing by the Federal Reserve Board. All told, during the six-months ended June 30, 2012, short-term Treasury yields were relatively flat, long-term Treasury yields declined and the yield curve flattened.

During the reporting period, higher quality, lower yielding securities generally underperformed lower rated, higher yielding investments. For instance, the overall U.S. fixed income market (as measured by the Barclays U.S. Aggregate Index) rose 2.37%, while the Commercial Mortgage-Backed Securities ( CMBS ) market, as measured by the benchmark index, advanced 4.35%. Within the CMBS market, lower rated securities outperformed higher rated investments, as fixed-rate BBB CMBS returned 7.14%, compared to 3.31% for fixed-rate AAA CMBS.

**Spread sector exposures generally produced positive results**

The Fund's exposure to the banking sector contributed to performance as this sector outperformed the market during the six-months ended June 30, 2012. The sector was supported by robust fundamentals and strong overall investor demand. Further enhancing performance was the Fund's allocation to non-agency mortgage-backed securities as the sector benefited from periods of strong risk appetite, positive supply/demand technicals and an improved housing market outlook.

Detracting from performance was the Fund's allocation to super-senior CMBS as CMBS positioned high in the capital structure underperformed the lower rated (less senior) portion of the CMBS capital structure.

<sup>1</sup> The Barclays CMBS Investment Grade Index is an index designed to mirror commercial mortgage backed securities ( CMBS ) of investment grade quality (Baa3/BBB-/BBB- or above) using Moody's, S&P, and Fitch respectively, with maturity of at least one year.

**Table of Contents****PCM Fund, Inc. Performance & Statistics**

June 30, 2012 (unaudited)

Total Return <sup>(1)</sup> :	Market Price	NAV
Six Month	8.05%	13.52%
1 Year	8.00%	11.24%
5 Year	13.40%	11.00%
10 Year	7.98%	9.06%
Commencement of Operations (9/2/93) to 6/30/12	8.56%	8.78%

Market Price/NAV Performance:

Commencement of Operations (9/2/93) to 6/30/12

Market Price/NAV:

Market Price	\$11.12
NAV	\$10.26
Premium to NAV	8.38%
Market Price Yield <sup>(2)</sup>	8.63%
Leverage Ratio <sup>(3)</sup>	45.59%

Moody's Rating

(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 and capital gain 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 less than one year is not annualized. 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 Fund, market conditions, supply and demand for the Fund's shares, or changes in Fund dividends.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market 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 funds, unlike open-end funds, are not continuously offered. There is a onetime public offering and once issued, shares of closed-end funds are sold in the open market through a stock exchange. NAV is equal to total assets less total liabilities divided by the number of shares outstanding. Holdings are subject to change daily.



## Edgar Filing: PCM FUND, INC. - Form N-CSRS

(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend (comprised of net investment income) payable to stockholders by the market price per share at June 30, 2012.

(3) Represents Reverse Repurchase Agreements ( Leverage ) that are outstanding, as a percentage of total managed assets. Total managed assets refer to total assets (including assets attributable to Leverage) minus accrued liabilities (other than liabilities representing Leverage).

6.30.12 PCM Fund, Inc. Semi-Annual Report 5

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited)

Principal Amount (000s)		Value
<b>MORTGAGE-BACKED SECURITIES 130.9%</b>		
\$552	Adjustable Rate Mortgage Trust, 2.842%, 1/25/36, CMO (f) Banc of America Alternative Loan Trust, CMO,	\$312,765
10	6.25%, 1/25/37	55
736	6.403%, 4/25/37 (f) Banc of America Funding Corp., CMO,	512,146
1,027	2.816%, 12/20/34 (f)	738,641
370	5.631%, 3/20/36 (f)	287,355
1,026	7.00%, 10/25/37	613,285
1,500	Banc of America Large Loan, Inc., 0.712%, 3/15/22, CMO (a)(c)(f)	1,455,779
2,000	Banc of America Merrill Lynch Commercial Mortgage, Inc., 5.414%, 9/10/47, CMO Banc of America Mortgage Securities, Inc., CMO (f),	2,221,671
764	2.678%, 6/20/31	732,802
857	2.793%, 11/25/34	784,110
581	2.891%, 6/25/35 BCAP LLC Trust, CMO (a)(c)(f),	520,842
87	0.445%, 7/26/36	20,790
150	5.033%, 3/26/36	134,598
1,000	BCRR Trust, 5.858%, 7/17/40, CMO (a)(c)(f)(i) Bear Stearns Adjustable Rate Mortgage Trust, CMO (f),	1,019,594
443	3.125%, 5/25/34	406,904
2,000	3.189%, 10/25/35 Bear Stearns Alt-A Trust, CMO (f),	1,602,290
87	2.751%, 5/25/36	37,514
1,271	2.828%, 11/25/36	680,332
114	2.884%, 1/25/47	59,849
622	2.986%, 5/25/36	299,959
374	3.547%, 9/25/34	324,705
1,689	4.394%, 8/25/36	932,456
290	4.92%, 7/25/35	199,572
682	5.543%, 8/25/36	400,264
202	Bear Stearns Asset-Backed Securities Trust, 5.50%, 12/25/35, CMO Bear Stearns Commercial Mortgage Securities, CMO,	174,297
3,000	5.694%, 6/11/50 (f)(i)	3,476,650
1,300	5.714%, 3/13/40 (a)(c)(f)	1,195,176
2,000	5.906%, 6/11/40 (f)(i)	2,298,873
1,000	5.983%, 5/11/39 (a)(c)(f)	1,004,335
524	6.50%, 2/15/32 (b)	27,105
1,383	CBA Commercial Small Balance Commercial Mortgage, 5.54%, 1/25/39, CMO (a)(c)	721,455
770	Chase Mortgage Finance Corp., 6.00%, 3/25/37, CMO Citigroup Commercial Mortgage Trust, CMO (f),	629,449
101,930	0.241%, 5/15/43, IO (a)(c)	930,215
2,500	5.889%, 12/10/49 (i) Citigroup Mortgage Loan Trust, Inc., CMO (f),	2,904,095
549	2.749%, 8/25/35	394,801
658	4.782%, 9/25/35	519,976
666	5.183%, 11/25/36	464,114

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
\$4,012	Citigroup/Deutsche Bank Commercial Mortgage Trust, 5.322%, 12/11/49, CMO (i)	\$4,476,024
179	Citimortgage Alternative Loan Trust, 5.50%, 4/25/22, CMO	175,630
3,000	Commercial Capital Access One, Inc., 7.853%, 11/15/28, CMO (a)(c)(f)	2,210,914
	Commercial Mortgage Pass Through Certificates, CMO (a)(c),	
2,500	5.605%, 6/9/28	2,561,938
690	6.106%, 7/10/46 (f)	664,344
1,500	6.586%, 7/16/34 (i)	1,622,956
1,500	7.007%, 7/16/34 (f)	1,697,669
	Countrywide Alternative Loan Trust, CMO,	
1,631	0.425%, 6/25/47 (f)(i)	880,087
3,921	0.454%, 7/20/46 (f)(i)	1,465,373
508	0.525%, 2/25/37 (f)	273,068
373	0.535%, 2/25/36 (f)	136,098
4,292	1.147%, 12/25/35 (f)(i)	2,448,172
332	6.00%, 11/25/35	163,403
	Countrywide Home Loan Mortgage Pass Through Trust, CMO,	
388	0.565%, 3/25/35 (f)	197,897
41	2.595%, 2/20/36 (f)	30,193
359	2.744%, 9/20/36 (f)	179,562
1,433	5.533%, 9/25/47 (f)(i)	947,504
1,004	6.00%, 5/25/37	808,099
	Credit Suisse First Boston Mortgage Securities Corp., CMO,	
16,439	1.433%, 12/15/35, IO (a)(c)(f)	37,809
134	7.00%, 2/25/33	145,473
1,705	7.46%, 1/17/35 (f)(i)	1,736,418
	Credit Suisse Mortgage Capital Certificates, CMO,	
1,000	5.467%, 7/18/16 (a)(c)(f)	1,011,496
5,000	5.467%, 9/15/39 (i)	5,556,535
416	5.896%, 4/25/36	262,519
326	6.50%, 5/25/36	178,651
1,925	CW Capital Cobalt Ltd., 5.223%, 8/15/48, CMO (i)	2,135,407
3,132	FFCA Secured Lending Corp., 1.081%, 9/18/27, CMO, IO (a)(c)(f)	129,944
341	First Horizon Alternative Mortgage Securities, 2.592%, 8/25/35, CMO (f)	60,841
269	First Horizon Asset Securities, Inc., 2.625%, 4/25/35, CMO (f)	262,390
15,679	FREMF Mortgage Trust, 0.10%, 5/25/20, CMO, IO (e)(f)	87,919
157	G-Force LLC, 5.158%, 12/25/39, CMO (a)(c)	155,334
	GMAC Commercial Mortgage Securities, Inc., CMO (a)(c),	
725	5.539%, 4/10/40 (f)	734,211
1,720	6.50%, 5/15/35	1,783,128
1,500	7.111%, 5/15/30 (d)(f)	260,551
1,500	8.531%, 9/15/35 (f)	1,490,255
	Greenwich Capital Commercial Funding Corp., CMO,	
1,500	5.419%, 1/5/36 (a)(c)(f)	1,515,824
2,000	5.444%, 3/10/39 (i)	2,227,322
	GS Mortgage Securities Corp. II, CMO,	
17,948	1.69%, 8/10/43, IO (a)(c)(f)	1,502,387
6,500	2.633%, 5/10/45, IO (b)(f)	990,311
2,710	4.805%, 3/6/20 (a)(c)(f)	2,711,257

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
\$5,750	5.56%, 11/10/39 (i)	\$6,566,986
1,670	6.136%, 8/10/43 (a)(c)(f)	1,616,560
	Harborview Mortgage Loan Trust, CMO (f),	
104	0.433%, 1/19/38	63,009
1,450	0.493%, 1/19/36	772,339
851	5.595%, 6/19/36	537,204
929	Indymac INDA Mortgage Loan Trust, 3.307%, 6/25/37, CMO (f)	701,959
	Indymac Index Mortgage Loan Trust, CMO (f),	
234	1.045%, 11/25/34	147,228
359	5.194%, 5/25/36	174,224
	JPMorgan Chase Commercial Mortgage Securities Corp., CMO,	
61,000	0.573%, 2/15/46, IO (a)(c)(f)	2,006,138
8,064	1.305%, 3/12/39, IO (a)(c)(f)	57,822
4,100	5.708%, 3/18/51 (a)(c)(f)(i)	4,058,660
1,195	5.794%, 2/12/51 (f)	1,389,805
1,400	5.924%, 2/12/49 (f)	1,593,869
700	6.135%, 7/12/37 (a)(c)	702,259
1,150	6.179%, 2/15/51 (f)	1,223,709
	JPMorgan Mortgage Trust, CMO (f),	
420	2.88%, 7/25/35	402,884
21	4.97%, 10/25/35	21,160
	LB Commercial Conduit Mortgage Trust, CMO,	
520	5.60%, 10/15/35 (a)(c)	564,306
950	6.109%, 7/15/44 (f)	1,101,661
1,278	LB-UBS Commercial Mortgage Trust, 5.347%, 11/15/38, CMO (i)	1,446,465
	Lehman Mortgage Trust, CMO,	
1,333	6.00%, 5/25/37	1,169,519
612	6.457%, 4/25/36 (f)	593,849
1,529	Luminent Mortgage Trust, 0.415%, 12/25/36, CMO (f)	894,886
1,746	MASTR Asset Securitization Trust, 6.00%, 6/25/36, CMO (f)	1,439,240
1,500	Merrill Lynch Mortgage Investors, Inc., 7.008%, 12/15/30, CMO (f)	1,568,174
	Merrill Lynch/Countrywide Commercial Mortgage Trust, CMO (i),	
1,500	5.485%, 3/12/51 (f)	1,639,627
2,300	5.70%, 9/12/49	2,535,584
	MLCC Mortgage Investors, Inc., CMO (f),	
557	0.455%, 7/25/30	465,700
428	0.575%, 11/25/29	370,432
148	2.501%, 11/25/35	125,228
540	2.663%, 11/25/35	448,238
	Morgan Stanley Capital I, Inc., CMO,	
70,123	0.447%, 11/12/49, IO (a)(c)(f)	820,050
2,000	5.447%, 2/12/44 (f)(i)	2,274,113
315	5.692%, 4/15/49 (f)	348,074
558	5.809%, 12/12/49	648,749
4,000	6.01%, 11/15/30 (a)(c)(i)	3,968,108
1,177	Morgan Stanley Dean Witter Capital I, 6.50%, 11/15/36, CMO (a)(c)	1,179,005
	Morgan Stanley Mortgage Loan Trust, CMO,	
722	3.090%, 1/25/35 (f)	55,702
891	6.00%, 8/25/37	792,767

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
\$1,200	Morgan Stanley Reremic Trust, zero coupon, 7/17/56, CMO, PO (a)(c)	\$1,044,000
	Ocwen Residential MBS Corp., CMO (a)(c)(f),	
23	6.753%, 6/25/39 (d)	119
692	7.00%, 10/25/40 (e)	58,731
	RALI Trust, CMO,	
248	0.425%, 6/25/46 (f)	84,367
784	3.923%, 1/25/36 (f)	447,257
613	6.00%, 8/25/35	517,496
627	6.50%, 9/25/37	369,780
	RBSCF Trust, CMO (a)(c)(f),	
1,000	5.223%, 8/16/48	1,001,121
1,000	5.331%, 2/16/44	1,023,481
1,000	5.336%, 5/16/47 (i)	1,036,396
2,744	6.068%, 2/17/51 (i)	2,613,191
697	Regal Trust IV, 2.64%, 9/29/31, CMO (a)(c)(f)	616,671
484	Residential Asset Securitization Trust, 6.00%, 3/25/37, CMO	311,880
870	RFMSI Trust, 6.00%, 6/25/36, CMO	716,599
	RMF Commercial Mortgage Pass Through Certificates, CMO (a)(c),	
135	7.471%, 1/15/19	135,612
265	9.35%, 1/15/19 (f)	264,110
	Structured Adjustable Rate Mortgage Loan Trust, CMO (f),	
969	5.214%, 11/25/36	802,253
1,224	5.334%, 4/25/36	816,527
500	5.399%, 9/25/36	332,524
795	5.435%, 1/25/36	543,570
1,581	Structured Asset Mortgage Investments, Inc., 0.455%, 8/25/36, CMO (f)	873,380
323	Structured Asset Securities Corp., 5.00%, 5/25/35, CMO	326,604
325	TBW Mortgage-Backed Pass Through Certificates, 6.00%, 7/25/36, CMO	161,809
1,500	TIAA Retail Commercial Trust, 5.77%, 6/19/33, CMO (a)(c)	1,555,969
	Wachovia Bank Commercial Mortgage Trust, CMO,	
32,414	1.08%, 10/15/41, IO (a)(c)(f)	563,790
2,500	5.188%, 2/15/41 (a)(c)(f)(i)	2,362,760
1,000	5.509%, 4/15/47	1,098,753
5,044	5.605%, 2/15/35 (a)(c)(f)(i)	5,012,896
1,825	6.097%, 2/15/51 (f)(i)	2,036,112
1,000	WaMu Commercial Mortgage Securities Trust, 6.303%, 3/23/45, CMO (a)(c)(f)	754,169
976	WaMu Mortgage Pass Through Certificates, 2.655%, 12/25/36, CMO (f)(i)	673,572
3,385	Washington Mutual Alternative Mortgage Pass Through Certificates,	
	6.50%, 8/25/36, CMO	1,921,058
180	Wells Fargo Alternative Loan Trust, 5.50%, 7/25/22, CMO	170,725
900	Wells Fargo Mortgage-Backed Securities Trust, 5.662%, 10/25/36, CMO (f)	801,426
	WF-RBS Commercial Mortgage Trust, CMO, IO (a)(c)(f),	
2,273	1.042%, 6/15/44	92,489
31,582	1.346%, 2/15/44 (i)	1,665,670
<b>Total Mortgage-Backed Securities (cost-\$142,886,153)</b>		<b>154,245,891</b>

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
<b>CORPORATE BONDS &amp; NOTES 29.5%</b>		
<b>Airlines 2.5%</b>		
\$305	Northwest Airlines, Inc., 1.217%, 11/20/15, (MBIA) (f)(i)	\$293,550
	United Air Lines Pass Through Trust (i),	
779	6.636%, 1/2/24	814,304
835	9.75%, 7/15/18	949,683
728	10.40%, 5/1/18	830,916
		2,888,453
<b>Banking 4.0%</b>		
2,200	Discover Bank, 7.00%, 4/15/20 (i)	2,566,018
2,000	Regions Financial Corp., 7.75%, 11/10/14 (i)	2,165,000
		4,731,018
<b>Construction &amp; Engineering 0.9%</b>		
1,111	Alion Science and Technology Corp., 12.00%, 11/1/14, PIK (i)	1,047,117
<b>Diversified Manufacturing 0.5%</b>		
900	Colt Defense LLC, 8.75%, 11/15/17 (i)	563,625
<b>Energy 0.8%</b>		
950	Consol Energy, Inc., 8.00%, 4/1/17 (i)	990,375
<b>Financial Services 10.6%</b>		
	Ally Financial, Inc.,	
10	5.90%, 1/15/19	9,187
20	6.00%, 2/15/19	18,549
106	6.00%, 3/15/19	98,555
30	6.15%, 3/15/16	28,723
20	6.30%, 8/15/19	18,804
16	6.50%, 10/15/16	15,457
23	6.65%, 6/15/18	22,175
25	6.70%, 6/15/18	23,885
19	6.75%, 8/15/16	18,646
12	6.75%, 6/15/17	11,612
18	6.75%, 9/15/18	17,256
35	6.75%, 10/15/18	33,661
2	6.80%, 10/15/18	1,920
12	6.85%, 4/15/16	11,736
174	6.90%, 8/15/18	169,384
30	7.00%, 6/15/17	28,809
3	7.00%, 2/15/18	2,915
100	7.00%, 3/15/18	97,495
5	7.00%, 5/15/18	4,840
55	7.00%, 8/15/18	53,649
14	7.05%, 3/15/18	13,395
32	7.05%, 4/15/18	31,002
6	7.15%, 9/15/18	5,854
60	7.20%, 10/15/17	58,841
5	7.25%, 9/15/17	4,891

Edgar Filing: PCM FUND, INC. - Form N-CSRS

38 7.25%, 4/15/18

37,375

60 7.25%, 8/15/18

58,154

10 PCM Fund, Inc. Semi-Annual Report 6.30.12

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
<b>Financial Services (continued)</b>		
\$30	7.25%, 9/15/18	\$29,475
195	7.30%, 12/15/17	189,700
102	7.30%, 1/15/18	99,284
76	7.35%, 4/15/18	74,987
20	7.375%, 11/15/16	19,614
36	7.40%, 12/15/17	34,853
14	7.50%, 8/15/17	13,694
12	7.50%, 11/15/17	11,654
8	7.75%, 10/15/17	7,891
19	8.00%, 10/15/17	18,792
18	8.00%, 11/15/17	17,709
5	8.20%, 3/15/17	4,998
322	9.00%, 7/15/20	322,176
1,000	Cantor Fitzgerald L.P., 7.875%, 10/15/19 (a)(c)(i)	1,001,179
800	CIT Group, Inc., 5.25%, 4/1/14 (a)(c)(i)	832,000
1,000	Citigroup Capital XXI, 8.30%, 12/21/77, (converts to FRN on 12/21/37) (i)	1,005,000
	Ford Motor Credit Co. LLC (i),	
1,000	6.625%, 8/15/17	1,139,224
500	8.00%, 12/15/16	592,854
1,600	International Lease Finance Corp., 7.125%, 9/1/18 (a)(c)(i)	1,772,000
1,200	Morgan Stanley, 0.947%, 10/15/15 (f)(i)	1,069,872
	SLM Corp. (i),	
1,000	8.00%, 3/25/20	1,100,000
1,100	8.45%, 6/15/18	1,237,500
1,000	Stone Street Trust, 5.902%, 12/15/15 (a)(c)(i)	1,023,921
		12,515,147
<b>Hotels/Gaming 1.0%</b>		
1,100	MGM Resorts International, 9.00%, 3/15/20 (i)	1,226,500
<b>Insurance 2.9%</b>		
	American International Group, Inc. (i),	
500	5.45%, 5/18/17	544,193
1,350	6.25%, 5/1/36	1,569,167
1,100	6.40%, 12/15/20	1,247,516
		3,360,876
<b>Oil &amp; Gas 0.2%</b>		
285	Global Geophysical Services, Inc., 10.50%, 5/1/17 (i)	272,888
<b>Paper/Paper Products 1.0%</b>		
1,000	Weyerhaeuser Co., 7.375%, 3/15/32 (i)	1,121,054
<b>Real Estate Investment Trust 1.9%</b>		
2,000	SL Green Realty Corp., 7.75%, 3/15/20 (i)	2,286,408
<b>Retail 2.6%</b>		
	CVS Pass Through Trust (i),	
1,655	5.88%, 1/10/28	1,818,537



Edgar Filing: PCM FUND, INC. - Form N-CSRS

953 7.507%, 1/10/32 (a)(c)

1,187,328

3,005,865

6.30.12 PCM Fund, Inc. Semi-Annual Report 11

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
<b>Utilities</b>	<b>0.6%</b>	
\$250	Dynegy Holdings, Inc., 7.125%, 5/15/18 (d)	\$168,750
500	Energy Future Holdings Corp., 10.00%, 1/15/20 (i)	536,250
		705,000
Total Corporate Bonds & Notes (cost-\$30,933,357)		34,714,326

<b>ASSET-BACKED SECURITIES</b>		<b>8.7%</b>	
181	Advanta Business Card Master Trust, 0.494%, 6/20/14 (b)(f)		172,468
97	Ameriquest Mortgage Securities, Inc., 5.87%, 2/25/33 (f)		6,686
154	Asset-Backed Securities Corp. Home Equity, 2.994%, 6/21/29 (f)		32,016
448	Associates Manufactured Housing Pass Through Certificates, 7.15%, 3/15/28 (f)		449,993
515	Bayview Financial Acquisition Trust, 0.525%, 12/28/36 (f)		376,944
	Bear Stearns Asset-Backed Securities Trust (f),		
88	0.625%, 6/25/36		69,366
959	3.183%, 7/25/36		651,305
1,298	Bombardier Capital Mortgage Securitization Corp., 7.83%, 6/15/30 (f)		714,546
762	Denver Arena Trust, 6.94%, 11/15/19 (a)(c)		781,267
777	EMC Mortgage Loan Trust, 0.895%, 2/25/41 (a)(c)(f)		650,520
303	GE Mortgage Services LLC, 6.705%, 4/25/29 (f)		274,139
199	GSAA Trust, 0.515%, 6/25/35 (f)		175,008
6,250	Indymac Residential Asset Backed Trust, 0.485%, 4/25/47 (f)(i)		2,264,734
56	Keystone Owner Trust, 9.00%, 1/25/29 (a)(c)		54,271
709	Lehman XS Trust, 5.42%, 11/25/35		672,941
2,455	Merrill Lynch First Franklin Mortgage Loan Trust, 0.485%, 5/25/37 (f)		1,047,158
630	Merrill Lynch Mortgage Investors, Inc., 0.745%, 6/25/36 (f)		340,791
797	Oakwood Mortgage Investors, Inc., 6.89%, 11/15/32 (f)		245,632
85	RAMP Trust, 0.615%, 9/25/32 (f)		55,652
66	Southern Pacific Secured Asset Corp., 0.585%, 7/25/29 (f)		50,674
68	Structured Asset Investment Loan Trust, 4.745%, 10/25/33 (f)		7,343
1,000	UCFC Manufactured Housing Contract, 7.90%, 1/15/28 (f)		1,010,406
1,856	UPS Capital Business Credit, 3.489%, 4/15/26 (b)(f)		112,289
Total Asset-Backed Securities (cost-\$11,682,967)			10,216,149

<b>U.S. GOVERNMENT AGENCY SECURITIES</b>		<b>2.0%</b>	
	Freddie Mac, CMO, IO (f),		
3,150	0.837%, 1/25/21		128,521
10,500	3.615%, 6/25/46		2,223,078

Total U.S. Government Agency Securities (cost-\$2,374,622) 2,351,599

<b>MUNICIPAL BONDS</b>		<b>1.6%</b>	
<b>Arkansas</b>		<b>0.7%</b>	
795	Little Rock Municipal Property Owners Multipurpose Improvement Dist. No. 10, Special Tax, Capital Improvement Projects, 7.20%, 3/1/32, Ser. B		791,693

**Virginia** 0.3%

Edgar Filing: PCM FUND, INC. - Form N-CSRS

355 Lexington Industrial Dev. Auth. Rev., 8.00%, 1/1/15, Ser. C

354,734

---

12 PCM Fund, Inc. Semi-Annual Report 6.30.12

**Table of Contents****PCM Fund, Inc. Schedule of Investments**

June 30, 2012 (unaudited) (continued)

Principal Amount (000s)		Value
<b>West Virginia 0.6%</b>		
\$930	Tobacco Settlement Finance Auth. Rev., 7.467%, 6/1/47, Ser. A	\$701,210
Total Municipal Bonds (cost-\$2,016,395)		1,847,637
Shares		
<b>COMMON STOCK 0.0%</b>		
<b>Oil, Gas &amp; Consumable Fuels 0.0%</b>		
1,294	SemGroup Corp., Class A (h) (cost-\$33,638)	41,309
Units		
<b>WARRANTS 0.0%</b>		
<b>Construction &amp; Engineering</b>		
1,100	Alion Science and Technology Corp., expires 11/1/14 (a)(c)(h)	11
<b>Oil, Gas &amp; Consumable Fuels 0.0%</b>		
1,362	SemGroup Corp., expires 11/30/14 (h)	12,325
Total Warrants (cost-\$6,139)		12,336
Principal Amount (000s)		
<b>SHORT-TERM INVESTMENTS 9.0%</b>		
<b>U.S. Treasury Obligations (g)(j) 4.9%</b>		
\$5,791	U.S. Treasury Bills, 0.13%, 8/23/12 (cost-\$5,789,911)	5,789,911
<b>Repurchase Agreements 2.2%</b>		
2,100	JPMorgan Securities, Inc., dated 6/29/12, 0.20%, due 7/2/12, proceeds \$2,100,035; collateralized by U.S. Treasury Notes, 1.125%, due 12/15/12, valued at \$2,145,456 including accrued interest	2,100,000
500	Morgan Stanley & Co., dated 6/29/12, 0.20%, due 7/2/12, proceeds \$500,008; collateralized by U.S. Treasury Bonds, 6.125%, due 11/15/27, valued at \$510,249 including accrued interest	500,000
Total Repurchase Agreements (cost-\$2,600,000)		2,600,000
<b>Corporate Notes 1.8%</b>		
<b>Financial Services 0.1%</b>		
100	Ally Financial, Inc., 7.125%, 8/15/12	99,994
<b>Insurance 1.7%</b>		
2,000	American International Group, Inc., 4.25%, 5/15/13 (i)	2,042,014
Total Corporate Notes (cost-\$1,937,214)		2,142,008

Edgar Filing: PCM FUND, INC. - Form N-CSRS

<b>Municipal Bonds</b>	<b>0.1%</b>		
<b>Iowa</b>	<b>0.1%</b>		
		55 Dickinson Cnty. Rev., Spirit Lake, 7.75%, 12/1/12, Ser. B (cost-\$55,000)	55,781
<b>Total Short-Term Investments (cost-\$10,382,125)</b>			<b>10,587,700</b>
<b>Total Investments (cost-\$200,315,396)</b>			<b>214,016,947</b>
<b>Liabilities in excess of other assets (81.7%)</b>			<b>(96,217,785)</b>
<b>Net Assets</b>			<b>100%</b>
			\$117,799,162

**Table of Contents**

**PCM Fund, Inc. Notes to Schedule of Investments**

June 30, 2012 (unaudited) (continued)

- (a) Private Placement Restricted as to resale and may not have a readily available market. Securities with an aggregate value of \$68,648,539, representing 58.3% of net assets.
- (b) Illiquid.
- (c) 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.
- (d) In default.
- (e) Fair-Valued Securities with an aggregate value of \$146,650, representing 0.1% of net assets. See Note 1(a) and Note 1(b) in the Notes to Financial Statements.
- (f) Variable or Floating Rate Security Securities with an interest rate that changes periodically. The interest rate disclosed reflects the rate in effect on June 30, 2012.
- (g) All or partial amount segregated for the benefit of the counterparty as collateral for derivatives.
- (h) Non-income producing.
- (i) All or partial amount transferred for the benefit of the counterparty as collateral for reverse repurchase agreements.
- (j) Rates reflect the effective yields at purchase date.

**Glossary:**

CMO	-	Collateralized Mortgage Obligation
FRN	-	Floating Rate Note
IO	-	Interest Only
MBIA	-	insured by Municipal Bond Investors Assurance
MBS	-	Mortgage-Backed Securities
PIK	-	Payment-in-Kind
PO	-	Principal Only

**14** PCM Fund, Inc. Semi-Annual Report 6.30.12 **See accompanying Notes to Financial Statements**

**Table of Contents****PCM Fund, Inc. Statement of Assets and Liabilities**

June 30, 2012 (unaudited)

<b>Assets:</b>	
Investments, at value (cost-\$200,315,396)	\$214,016,947
Cash	96,140
Unsettled reverse repurchase agreements	7,308,000
Interest receivable	1,478,498
Unrealized appreciation of OTC swaps	643,858
Swap premiums paid	146,950
Receivable from broker	15,017
Receivable for terminated swaps	11
Prepaid expenses	12,882
<b>Total Assets</b>	<b>223,718,303</b>
<b>Liabilities:</b>	
Payable for reverse repurchase agreements	98,701,000
Swap premiums received	5,871,755
Dividends payable to stockholders	918,919
Investment management fees payable	141,124
Interest payable for reverse repurchase agreements	110,528
Unrealized depreciation of OTC swaps	70,974
Payable for terminated swaps	8,166
Accrued expenses	96,675
<b>Total Liabilities</b>	<b>105,919,141</b>
<b>Net Assets</b>	<b>\$117,799,162</b>
<b>Composition of Net Assets:</b>	
Common Stock:	
Par value (\$0.001 per share, applicable to 11,486,496 shares issued and outstanding)	\$11,486
Paid-in-capital in excess of par	147,238,089
Undistributed net investment income	987,453
Accumulated net realized loss	(44,712,301)
Net unrealized appreciation of investments and swaps	14,274,435
<b>Net Assets</b>	<b>\$117,799,162</b>
<b>Net Asset Value Per Share</b>	<b>\$10.26</b>

See accompanying Notes to Financial Statements 6.30.12 PCM Fund, Inc. Semi-Annual Report 15

**Table of Contents****PCM Fund, Inc. Statement of Operations**

Six months ended June 30, 2012 (unaudited)

<b>Investment Income:</b>	
Interest	\$7,637,188
<b>Expenses:</b>	
Investment management fees	847,849
Interest expense	516,206
Audit and tax services	32,970
Stockholder communications	32,129
Custodian and accounting agent fees	25,869
Transfer agent fees	18,162
Legal fees	14,425
New York Stock Exchange listing fees	8,471
Directors' fees and expenses	5,857
Insurance expense	2,506
Miscellaneous	7,872
Total Expenses	1,512,316
<b>Net Investment Income</b>	<b>6,124,872</b>
<b>Realized and Change in Unrealized Gain (Loss):</b>	
Net realized gain (loss) on:	
Investments	(553,184)
Swaps	278,150
Net change in unrealized appreciation/depreciation of:	
Investments	7,772,198
Swaps	745,836
Net realized and change in unrealized gain on investments and swaps	8,243,000
<b>Net Increase in Net Assets Resulting from Investment Operations</b>	<b>\$14,367,872</b>

16 PCM Fund, Inc. Semi-Annual Report 6.30.12 See accompanying Notes to Financial Statements



**Table of Contents****PCM Fund, Inc. Statement of Changes in Net Assets**

	Six Months ended June 30, 2012 (unaudited)	Year ended December 31, 2011
<b>Investment Operations:</b>		
Net investment income	\$6,124,872	\$12,966,180
Net realized gain (loss) on investments and swaps	(275,034)	690,814
Net change in unrealized appreciation/depreciation of investments and swaps	8,518,034	(6,017,074)
Net increase in net assets resulting from investment operations	14,367,872	7,639,920
<b>Dividends to Stockholders from Net investment income</b>	(5,511,286)	(12,153,003)
<b>Capital Share Transactions:</b>		
Reinvestment of dividends	132,282	303,054
Total increase (decrease) in net assets	8,988,868	(4,210,029)
<b>Net Assets:</b>		
Beginning of period	108,810,294	113,020,323
End of period (including undistributed net investment income of \$987,453 and \$373,867, respectively)	\$117,799,162	\$108,810,294
<b>Shares issued in reinvestment of dividends</b>	12,659	29,412

See accompanying Notes to Financial Statements 6.30.12 PCM Fund, Inc. Semi-Annual Report 17

**Table of Contents****PCM Fund, Inc. Statement of Cash Flows**

Six months ended June 30, 2012 (unaudited)

**Increase in Cash from:****Cash Flows provided by Operating Activities:**

Net increase in net assets resulting from investment operations \$14,367,872

**Adjustments to reconcile net increase in net assets resulting from investment operations to net cash provided by operating activities:**

Purchases of long-term investments (16,049,217)

Proceeds from sales of long-term investments 13,941,629

Sales of short-term portfolio investments, net 617,464

Net change in unrealized appreciation/depreciation of investments and swaps (8,518,034)

Net realized loss on investments and swaps 275,034

Net amortization premium on investments (506,121)

Decrease in receivable for investments sold 70,000

Increase in unsettled reverse repurchase agreements 412,000

Increase in interest receivable (36,748)

Increase in prepaid expenses (10,376)

Increase in periodic and termination payments of swaps 5,782,866

Increase in investment management fees payable 874

Decrease in interest payable for reverse repurchase agreements (3,754)

Decrease in accrued expenses (23,386)

**Net cash provided by operating activities\*** 10,320,103**Cash Flows used for Financing Activities:**

Decrease in payable for reverse repurchase agreements (3,700,000)

Cash dividends paid (excluding reinvestment of dividends of \$132,282) (6,525,376)

**Net cash used for financing activities** (10,225,376)**Net increase in cash** 94,727**Cash at beginning of period** 1,413**Cash at end of period** \$96,140

\* Included in operating expenses is cash paid by the Fund for interest primarily related to participation in reverse repurchase agreement transactions of \$519,960.

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

**1. Organization and Significant Accounting Policies**

PCM Fund, Inc. (the Fund) commenced operations on September 2, 1993. The Fund is registered under the Investment Company Act of 1940, as amended, as a non-diversified, closed-end management investment company organized as a Maryland corporation. Allianz Global Investors Fund Management LLC (the Investment Manager) serves as the Fund's investment manager and is an indirect, wholly-owned subsidiary of Allianz Asset Management of America L.P. (AAM). AAM is an indirect, wholly-owned subsidiary of Allianz SE, a publicly traded European insurance and financial services company. The Fund has the authority to issue 300 million shares of \$0.001 par value common stock.

The Fund's primary investment objective is to achieve high current income. Capital gain from the disposition of investments is a secondary objective of the Fund. There can be no assurance that the Fund will meet its 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 the Fund's financial statements. Actual results could differ from those estimates.

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

In December 2011, the FASB issued ASU No. 2011-11, "Disclosures About Offsetting Assets and Liabilities," which requires enhanced disclosures that will enable users to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial and derivative instruments. The amendments are effective for fiscal years beginning on or after January 1, 2013. Fund management is currently evaluating the effect that the guidance may have on its financial statements.

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

**(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. The Fund's 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.

The Board of Directors has adopted methods for valuing portfolio securities and other financial derivative instruments in circumstances where market quotes are not readily available, and has delegated the responsibility for applying the valuation methods to the Investment Manager and Pacific Investment Management

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

Company LLC ( the Sub-Adviser ), an affiliate of the Investment Manager. The Valuation Committee has been established by the Board to oversee the implementation of the Fund s valuation methods and to make fair value determinations on behalf of the Board as instructed. The Sub-Adviser monitors the continual appropriateness of methods applied and determines if adjustments should be made in light of market changes, events affecting the issuer, or other factors. If the Sub-Adviser determines that a valuation method may no longer be appropriate, another valuation method may be selected, or the Valuation Committee will be convened to consider the matter and take any appropriate action in accordance with procedures set forth by the Board. The Board shall review the appropriateness of the valuation methods and these methods may be amended or supplemented from time to time by the Valuation Committee.

Benchmark pricing procedures are used as the basis for setting the base price of a fixed-income security and for subsequently adjusting the price proportionally to market value changes of a pre-determined security deemed to be

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

comparable in duration, generally a U.S. Treasury or sovereign note based on country of issuance. The base price may be a broker-dealer quote, transaction price, or an internal value as derived by analysis of market data. The base price of the security may be reset on a periodic basis based on the availability of market data and procedures approved by the Valuation Committee. The validity of the fair value is reviewed by the Sub-Adviser on a periodic basis and may be amended as the availability of market data indicates a material change.

If third party evaluated vendor pricing is neither available nor deemed to be reliable of fair value, the Sub-Adviser may elect to obtain market quotations ( broker quotes ) directly from a broker-dealer.

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.

The prices used by the Fund 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 Fund's financial statements. The Fund's net asset value ( NAV ) is normally determined as of the close of regular trading (normally, 4:00 p.m. Eastern time) on the New York Stock Exchange ( 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 Fund has the ability to access

Level 2 valuations based on other significant observable inputs, which may include, but are not limited to, quoted prices for similar assets or liabilities, interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates) or other market corroborated inputs.

Level 3 valuations based on significant unobservable inputs (including the Sub-Adviser's or Valuation Committee's own assumptions and single source broker quotes in determining the fair value of investments)

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 Fund generally uses to evaluate how to classify each major category of assets and liabilities for Level 2 and Level 3, in accordance with GAAP:

**Equity Securities (Common and Preferred Stock)** Equity securities traded in inactive markets 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.

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

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.

20 PCM Fund, Inc. Semi-Annual Report 6.30.12

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

**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-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 & 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 & 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.

**Credit Default Swaps** OTC 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 OTC credit default swaps are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

**Table of Contents****PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

A summary of the inputs used at June 30, 2012 in valuing the Fund's assets and liabilities is listed below (refer to the Schedule of Investments and Note 5(a) for more detailed information on Investments in Securities and Other Financial Instruments):

	Level 1 Quoted Prices	Level 2 Other Significant Observable Inputs	Level 3 Significant Unobservable Inputs	Value at 6/30/12
<b>Investments in Securities</b> <b>Assets</b>				
Mortgage-Backed Securities		\$ 152,899,907	\$ 1,345,984	\$ 154,245,891
Corporate Bonds & Notes:				
Airlines			2,888,453	2,888,453
All Other		31,825,873		31,825,873
Asset-Backed Securities		10,216,149		10,216,149
U.S. Government Agency Securities		2,351,599		2,351,599
Municipal Bonds		1,847,637		1,847,637
Common Stock	\$ 41,309			41,309
Warrants		12,325	11	12,336
Short-Term Investments		10,587,700		10,587,700
<b>Total Investments in Securities</b> <b>Assets</b>	\$ 41,309	\$ 209,741,190	\$ 4,234,448	\$ 214,016,947
<b>Other Financial Instruments*</b> <b>Assets</b>				
Credit Contracts		\$ 643,858		\$ 643,858
<b>Other Financial Instruments*</b> <b>Liabilities</b>				
Credit Contracts		\$ (70,974)		\$ (70,974)
<b>Total Investments</b>	\$ 41,309	\$ 210,314,074	\$ 4,234,448	\$ 214,589,831

The valuation techniques used by the Fund to measure fair value during the six months ended June 30, 2012 maximized the use of observable inputs and minimized the use of unobservable inputs.

The Fund's policy is to recognize transfers between levels at the end of the reporting period. 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. Assets categorized as Level 1 or 2 as of period end may have been transferred between Levels 1 and 2 since the prior period due to changes in the valuation method utilized in valuing the investments.

For the six-months ended June 30, 2012, there were no transfers between Level 1 and Level 2.





**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

A roll forward of fair value measurements using significant unobservable inputs (Level 3) for the six months ended June 30, 2012, was as follows:

	Beginning Balance 12/31/11	Purchases	Sales	Accrued Discounts (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers into Level 3	Transfers out of Level 3**	Ending Balance 6/30/12
<b>Investments in Securities Assets</b>									
Mortgage-Backed Securities	\$ 1,460,808	\$ 37,240	\$ (425,590)	\$ 13,647	\$ 208,906	\$ 71,882		\$ (20,909)	\$ 1,345,984
Corporate Bonds & Notes:									
Airlines	2,941,661		(174,552)	7,304	5,748	108,292			2,888,453
Warrants		11							11
<b>Total Investments</b>	<b>\$ 4,402,469</b>	<b>\$ 37,251</b>	<b>\$ (600,142)</b>	<b>\$ 20,951</b>	<b>\$ 214,654</b>	<b>\$ 180,174</b>		<b>\$ (20,909)</b>	<b>\$ 4,234,448</b>

\* Other financial instruments are swap agreements not reflected in the Schedule of Investments, which are valued at the unrealized appreciation (depreciation) of the instrument.

\*\* Transferred out of Level 3 into Level 2 because independent prices became available.

The net change in unrealized appreciation/depreciation of Level 3 investments which the Fund held at June 30, 2012, was \$132,399.

Net realized gain (loss) and net change in unrealized appreciation/depreciation are reflected on the Statement of Operations.

The following table presents additional information about valuation techniques and inputs used for investments that were measured at fair value and categorized as Level 3 at June 30, 2012:

Investments in Securities Assets	Ending Balance at 6/30/12	Valuation Technique Used	Unobservable Inputs	Range of Input values
Mortgage-Backed Securities	\$ 1,199,334	Third-Party pricing vendor	Broker quotes	\$87.00-\$99.00
Mortgage-Backed Securities	87,919	Benchmark pricing	Broker quote	\$0.56
Mortgage-Backed Securities	58,731	Benchmark pricing	Security price reset	\$8.50
Corporate Bonds & Notes: Airlines	2,888,453	Third-Party pricing vendor	Broker quotes	\$96.25-\$114.13
Warrants	11	Portfolio manager recommendation	Price	\$0.01

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

**Total Investments** \$ 4,234,448

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

Investment transactions are accounted for on 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. Paydown gains and losses are netted and recorded as interest income on the Statement of Operations.

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

The Fund intends to distribute all of its 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 Fund, a minimum threshold for financial statement recognition of the benefit of positions taken in filing tax returns

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

(including whether an entity is taxable in a particular jurisdiction), and requires certain expanded tax disclosures. The Fund's management has determined that its evaluation has resulted in no material impact to the Fund's financial statements at June 30, 2012. The Fund's federal tax returns for the prior three years remain subject to examination by the Internal Revenue Service.

**(e) Dividends and Distributions**

The Fund declares dividends from net investment income to stockholders monthly. Distributions of net realized capital gains, if any, are paid at least annually. The Fund records dividends and distributions on the ex-dividend date. The amount of dividends from net investment income and distributions from net realized capital gains is 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 stockholders from return of capital.

**(f) Repurchase Agreements**

The Fund enters into transactions with its custodian bank or securities brokerage firms whereby it purchases securities under agreements to resell such securities at an agreed upon price and date ( repurchase agreements ). The Fund, through its custodian, takes 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 Fund until maturity of the repurchase agreement. Provisions of the repurchase agreements and the procedures adopted by the Fund 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 Fund may be delayed or limited.

**(g) Reverse Repurchase Agreements**

In a reverse repurchase agreement, the Fund sells securities to a bank or broker-dealer and agrees to repurchase the securities at a mutually agreed upon date and price. Generally, the effect of such a transaction is that the Fund 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 Fund of the reverse repurchase transaction is less than the returns it obtains on investments purchased with the cash. To the extent the Fund does not cover its positions in reverse repurchase agreements (by transferring 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 Fund is 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 Fund's use of the proceeds of the agreement may be restricted pending determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

**(h) 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

Fund to a lower rate of return upon

**24** PCM Fund, Inc. Semi-Annual Report 6.30.12

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

reinvestment of 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.

**(i) U.S. Government Agencies or Government-Sponsored Enterprises**

Securities issued by U.S. Government agencies or government-sponsored enterprises may not be guaranteed by the U.S. Treasury. The Government National Mortgage Association (GNMA or Ginnie Mae), a wholly-owned U.S. Government corporation, is authorized to guarantee, with the full faith and credit of the U.S. Government, the timely payment of principal and interest on securities issued by institutions approved by GNMA and backed by pools of mortgages insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs. Government-related guarantors not backed by the full faith and credit of the U.S. Government include the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). Pass-through securities issued by FNMA are guaranteed as to timely payment of principal and interest by FNMA, but are not backed by the full faith and credit of the U.S. Government. FHLMC guarantees the timely payment of interest and ultimate collection of principal, but its participation certificates are not backed by the full faith and credit of the U.S. Government.

**(j) Interest Expense**

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

**2. Principal Risks**

In the normal course of business, the Fund trades financial instruments and enters 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 Fund is also exposed to other risks such as, but not limited to, interest rate, credit and leverage 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 Fund is 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 Fund holds 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 Fund's shares.

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

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 Fund holds mortgage-related securities, it 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 Fund because the Fund may have to reinvest that money at the lower prevailing

## **Table of Contents**

### **PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

#### **2. Principal Risks (continued)**

interest rates. The Fund's 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 Fund is 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.

The market values of securities 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.

The Fund is exposed to counterparty risk, or the risk that an institution or other entity with which the Fund has unsettled or open transactions will default. The potential loss to the Fund could exceed the value of the financial assets recorded in the Fund's financial statements. Financial assets, which potentially expose the Fund to counterparty risk, consist principally of cash due from counterparties and investments. The Fund's Sub-Adviser seeks to minimize the Fund's 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 Fund has 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.

The Fund is exposed to risks associated with leverage. Leverage may cause the value of the Fund's stock to be more volatile than if the Fund did not use leverage. This is because leverage tends to exaggerate the effect of any increase or decrease in the value of the Fund's portfolio securities. The Fund engages in transactions or purchases instruments that give rise to forms of leverage. Obligations to settle reverse repurchase agreements may be detrimental to the Fund's performance. In addition, to the extent the Fund employs leverage, interest costs may not be recovered by any appreciation of the securities purchased with the leverage proceeds and could exceed the Fund's investment returns, resulting in greater losses.

The Fund is party to International Swaps and Derivatives Association, Inc. Master Agreements ( ISDA Master Agreements ) with select counterparties that govern transactions and over-the-counter derivatives entered into by the Fund 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 Fund.

The Fund is 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.



## Edgar Filing: PCM FUND, INC. - Form N-CSRS

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 Fund's 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.

26 PCM Fund, Inc. Semi-Annual Report 6.30.12

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

**2. Principal Risks (continued)**

The Fund had security transactions outstanding with Lehman Brothers entities as counterparty at the time the relevant Lehman Brothers entity filed for protection or was placed in administration. The security transactions associated with Lehman Brothers, Inc. ( SLH ) as counterparty were written down to their estimated recoverable values. Adjustments to anticipated losses for security transactions associated with SLH have been incorporated as net realized gain (loss) on the Fund's Statement of Operations. The remaining balances due from SLH are included in receivable from broker on the Fund's Statement of Assets and Liabilities. The estimated recoverable value of receivables is determined by an independent broker quote.

**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 Fund sometimes uses derivatives for hedging purposes, the Fund reflects derivatives at fair value and recognizes changes in fair value through the Fund's Statement of Operations, and such derivatives do not qualify for hedge accounting treatment.

**(a) Swap Agreements**

Swap agreements are bilaterally negotiated agreements between the Fund and a counterparty to exchange or swap investment cash flows, assets, foreign currencies or market-linked returns at specified, future intervals. Swap agreements are privately negotiated in the over-the-counter market ( OTC swaps ) and may be executed in a multilateral or other trade facility platform, such as a registered commodities exchange ( centrally cleared swaps ). The Fund enters into credit default, cross-currency, interest rate, total return, variance and other forms of swap agreements in order to manage its exposure to credit, currency and interest rate risk. In connection with these agreements, securities may be identified as collateral or margin 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.

OTC swap payments received or made at the beginning of the measurement period are reflected as such on the Fund's Statement 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 Fund's Statement 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 Fund's Statement of Operations. Net periodic payments received or paid by the Fund are included as part of realized gains or losses on the Fund's Statement of Operations. Changes in market value, if any, are reflected as a component of net changes in unrealized appreciation/depreciation on the Fund's Statement of Operations. Daily changes in valuation of centrally cleared swaps, if any, are recorded as a receivable or payable for variation margin on centrally cleared swaps on the Fund's Statement of Assets and Liabilities.

Entering into these agreements involves, to varying degrees, elements of credit, legal, market and documentation risk in excess of the amounts recognized on the Fund's Statement 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.

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

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 a seller of protection on credit default swap agreements, the Fund 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 the

6.30.12 PCM Fund, Inc. Semi-Annual Report 27

---

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

seller, the Fund would effectively add leverage to its investment portfolio because, in addition to its total net assets, the Fund would be subject to investment exposure on the notional amount of the swap.

If the Fund is a seller of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the 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 Fund is a buyer of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the 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 issues or sovereign issues of an emerging market country 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 Fund uses credit default swaps on corporate issues or sovereign issues of an emerging market country to provide a measure of protection against defaults of the issuers (*i.e.*, to reduce risk where the Fund owns or has 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 events. Unlike credit default swaps on corporate issues or sovereign issues of an emerging market country, 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 Fund uses 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.

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



**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

within the tranche for which the Fund bears 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 Fund uses 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 issues or sovereign issues of an emerging market country as of period end are disclosed later in the Notes to Financial Statements (see 5(a)) 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 Fund as a seller 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 June 30, 2012 for which the Fund is the seller of protection are disclosed later in the Notes to Financial Statements (see 5(a)). 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 Fund for the same referenced entity or entities.

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

The effect of derivatives on the Statement of Assets and Liabilities at June 30, 2012:

Location	Credit Contracts
<b>Asset derivatives:</b>	
Unrealized appreciation of swaps	\$ 643,858
<b>Liability derivatives:</b>	
Unrealized depreciation of swaps	\$ (70,974)

The effect of derivatives on the Statement of Operations for the six months ended June 30, 2012:

## Edgar Filing: PCM FUND, INC. - Form N-CSRS

Location	Credit Contracts
<b>Net realized gain on:</b>	
Swaps	\$ 278,150
<b>Net change in unrealized appreciation/depreciation of:</b>	
Swaps	\$ 745,836

The average volume (measured at each fiscal quarter-end) of derivative activity for sell protection on credit default swap agreements was approximately \$116,117,000 in Notional Amounts during the six months ended June 30, 2012.

**Table of Contents**

**PCM Fund, Inc. Notes to Financial Statements**

June 30, 2012 (unaudited)

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

The Fund has an Investment Management Agreement (the Agreement) with the Investment Manager. Subject to the supervision of the Fund's Board of Directors, the Investment Manager is responsible for managing, either directly or through others selected by it, the Fund's investment activities, business affairs and administrative matters. Pursuant to the Agreement, the Investment Manager receives an annual fee, payable monthly, at an annual rate of 0.80% of the Fund's average daily total managed assets. Total managed assets refers to the total assets of the Fund (including assets attributable to any reverse repurchase agreements and borrowings) minus accrued liabilities (other than liabilities representing reverse repurchase agreements and borrowings).

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

**5. Investments in Securities**

For the six months ended June 30, 2012, purchases and sales of investments, other than short-term securities and U.S. government obligations, were \$16,049,217 and \$6,699,940, respectively.

(a) OTC credit default swap agreements outstanding at June 30, 2012:

Sell protection swap agreements: