

PIMCO Income Strategy Fund II
Form N-CSRS
March 31, 2014

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 811-21601

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

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

10019
(Zip code)

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

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

Date of fiscal year July 31, 2014
end:

Date of reporting period: January 31, 2014

Item 1. Report to Shareholders

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Letter to Shareholders

Dear Shareholder:

The US economy expanded throughout the fiscal six-month reporting period ended January 31, 2014. Bond yields moved modestly higher as the Federal Reserve (the Fed) adjusted its monetary policy, while stocks posted solid gains.

For the six-month reporting period ended January 31, 2014:

- PIMCO Income Strategy Fund returned 6.05% on net asset value (NAV) and 2.13% on market price.
- PIMCO Income Strategy Fund II returned 7.06% on NAV and 4.61% on market price.

During the reporting period, Barclays US Credit Index, a measure of high quality corporate bond performance, rose 2.63%; the Barclays US High Yield Bond Index, a measure of below investment-grade corporate bond performance, returned 4.70%; and government bonds, represented by the Barclays Intermediate-Term Treasury Index, gained 0.67%. The Barclays US Aggregate Bond Index, a broad credit market measure of government and corporate securities, increased 1.78% and mortgage-backed securities, reflected by the Barclays Fixed Rate Mortgage Backed Securities Index, rose 2.29%. As for stocks, the Standard & Poor's 500 Index advanced 6.85% during the fiscal six-month period ended January 31, 2014.

During the reporting period, US economic growth accelerated. Gross domestic product (GDP), the value of goods and services produced in the country, the broadest measure of US economic activity and the principal indicator of economic performance, grew at an annual pace of 2.5% during the second quarter of 2013. The US Commerce Department reported third quarter 2013 GDP growth at 4.1%, the highest growth since the fourth quarter of 2011. This improvement was partially due to an increase in private inventory investment and decelerating imports. According to the US Commerce Department, fourth quarter 2013 GDP growth expanded at a 2.4% annual pace.

The Fed maintained an accommodative monetary policy during the reporting period. However, at its meeting in December 2013, the Fed announced that it would begin tapering its asset purchase program beginning in January 2014, from \$85 billion to \$75 billion. The Fed also reiterated that tapering does not signify that the Fed would raise interest rates anytime soon,

indicating, it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6.5%.

Receive this report electronically and eliminate paper mailings.

Outlook

The US was highly resilient and appeared to overcome the headwinds associated with higher taxes, the sequestration, a partial federal government shutdown and rising interest rates. Barring unanticipated strengthening of US labor markets and accelerating inflation, we expect the central bank to take a measured approach to the reduction of purchases in 2014. Tapering of asset purchases, as well as concerns about global growth, ongoing geopolitical issues and dysfunction in Washington DC, will likely contribute to increased market volatility.

To enroll, visit:
us.allianzgi.com/edelivery.

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

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

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess
Chairman

Julian Sluyters
President & CEO

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Fund Insights

PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II

January 31, 2014 (unaudited)

For the six-months ended January 31, 2014, PIMCO Income Strategy Fund returned 6.05% on net asset value (NAV) and 2.13% on market price. For the six-months ended January 31, 2014, PIMCO Income Strategy Fund II returned 7.06% on NAV and 4.61% on market price.

The unmanaged Barclays US Aggregate Bond Index and Barclays US Credit Index returned 1.78% and 2.63%, respectively, during the reporting period. The US fixed income market experienced periods of elevated volatility during the six-month reporting period ended January 31, 2014. This was triggered by a number of factors, including mixed economic data, Fed tapering, geopolitical issues and the 16 day partial federal government shutdown. All told, both short- and long-term Treasury yields rose and the yield curve steepened during the reporting period. That being said, Treasury yields fell from their peak toward the end of the period. This occurred as investor risk aversion increased due to concerns about China's economy and several sharply declining emerging market currencies. The benchmark 10-year Treasury bond began the fiscal period yielding 2.60% and ended the period at 2.67%.

The US credit market was also volatile at times, but it outperformed the overall bond market. The credit market was dragged down during periods of rising interest rates. However this was offset by overall positive fundamentals, generally solid corporate profits, low defaults and solid demand from investors looking to generate incremental yield in the low interest rate environment.

Sector exposures produce largely enhance the Funds' performance

During the reporting period, PIMCO Income Strategy and PIMCO Income Strategy II (the Funds) outperformed the broad US fixed income market (as measured by the Barclays US Aggregate Bond Index) as well as the US credit market (as measured by the Barclays US Credit Index) at NAV.

An allocation to high yield bonds helped the Funds' results, as the sector outperformed the broad credit market during the reporting period. The Funds' overweighting to the Financial sector was beneficial as it was supported by improving earnings. Security selection within the Telecommunications sector contributed to performance. An allocation to non-agency mortgage-backed securities was positive for performance, as these bonds benefited from continued improvements in the US housing market. Opportunistically gaining exposure to select emerging market external bonds during the third and fourth quarters of 2013 was additive for the Funds' performance, as their spreads tightened following the May/June sell-off.

On the downside, a tactical allocation to Brazilian local rates detracted from the Funds' performance, as rates continued rising due to expectations for higher inflation within the country.

Performance & Statistics

PIMCO Income Strategy Fund

January 31, 2014 (unaudited)

| Total Return(1) | Market Price | NAV |
|---|---------------------|------------|
| Six Month | 2.13% | 6.05% |
| 1 Year | -4.80% | 5.69% |
| 5 Year | 19.26% | 25.22% |
| 10 Year | 5.43% | 6.38% |
| Commencement of Operations (8/29/03) to 1/31/14 | 5.42% | 6.31% |

| Market Price/NAV Performance | | Market Price/NAV | |
|---|--|-------------------------|---------|
| Commencement of Operations (8/29/03) to 1/31/14 | | Market Price | \$11.53 |
| NAV | | NAV | \$11.84 |
| Market Price | | Discount to NAV | -2.62% |
| | | Market Price Yield(2) | 6.59% |
| | | Leverage Ratio(3) | 21.89% |

(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 dividends and 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 and includes the effect of any expense reductions. 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 the Fund's dividends.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market price yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a one time public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

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(2) Market Price Yield is determined by dividing the annualized current monthly dividend per common share (comprised of net investment income) by the market price per common share at January 31, 2014.

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

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Performance & Statistics

PIMCO Income Strategy Fund II

January 31, 2014 (unaudited)

| Total Return(1) | Market Price | NAV |
|--|---------------------|------------|
| Six Month | 4.61% | 7.06% |
| 1 Year | -2.75% | 8.20% |
| 5 Year | 22.38% | 25.07% |
| Commencement of Operations (10/29/04) to 1/31/14 | 3.79% | 4.69% |

Market Price/NAV Performance

Commencement of Operations (10/29/04) to 1/31/14

Market Price/NAV

| | |
|-----------------------|---------|
| Market Price | \$10.22 |
| NAV | \$10.52 |
| Discount to NAV | -2.85% |
| Market Price Yield(2) | 5.20% |
| Leverage Ratio(3) | 20.61% |

NAV
Market Price

(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 dividends and 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 and includes the effect of any expense reductions. 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 the Fund's dividends.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market price yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a one time public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

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(2) Market Price Yield is determined by dividing the annualized current monthly dividend per common share (comprised of net investment income) by the market price per common share at January 31, 2014.

(3) Represents Preferred Shares outstanding (Leverage), as a percentage of total managed assets. Total managed assets refer to total assets (including assets attributable to Leverage) minus liabilities (other than liabilities representing Leverage).

Schedule of Investments

PIMCO Income Strategy Fund

January 31, 2014 (unaudited)

| Principal Amount (000s) | | | Value |
|--|--|--|-------------|
| Corporate Bonds & Notes 25.8% | | | |
| Airlines 1.8% | | | |
| | | American Airlines Pass-Through Trust (d), | |
| \$3,614 | | 9.73%, 9/29/14 | \$2,710,726 |
| 1,861 | | 10.18%, 1/2/13 (e) | 2,043,753 |
| 1,228 | | Continental Airlines Pass-Through Trust, 9.798%, 10/1/22 | 1,387,988 |
| 740 | | United Air Lines Pass-Through Trust, 10.40%, 5/1/18 | 839,980 |
| | | | 6,982,447 |
| Auto Manufacturers 3.7% | | | |
| 12,700 | | Ford Motor Co., 7.70%, 5/15/97 | 14,431,962 |
| Banking 11.0% | | | |
| £6,300 | | Barclays Bank PLC, 14.00%, 6/15/19 (f) | 13,877,793 |
| \$800 | | Citigroup, Inc., 6.125%, 8/25/36 | 861,778 |
| | | LBG Capital No. 1 PLC, | |
| 200 | | 7.375%, 3/12/20 | 289,256 |
| £300 | | 7.588%, 5/12/20 | 527,691 |
| 4,800 | | 7.867%, 12/17/19 | 8,443,064 |
| 2,400 | | 7.869%, 8/25/20 | 4,247,113 |
| \$2,000 | | 8.50%, 12/17/21 (a)(c)(f) | 2,141,916 |
| £900 | | 11.04%, 3/19/20 | 1,719,929 |
| | | LBG Capital No. 2 PLC, | |
| 534 | | 9.125%, 7/15/20 | 960,780 |
| 2,200 | | 11.25%, 9/14/23 | 4,235,012 |
| \$1,550 | | Royal Bank of Scotland Group PLC, 7.648%, 9/30/31 (f) | 1,652,688 |
| £2,000 | | Santander Issuances S.A. Unipersonal, 7.30%, 7/27/19 (converts to FRN on 9/27/14) | 3,386,431 |