

PIMCO INCOME STRATEGY FUND
Form N-CSR
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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 811-21374

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

1345 Avenue of the Americas, New York, NY
(Address of principal executive offices)

10105
(Zip code)

Lawrence G. Altadonna - 1345 Avenue of the Americas, New York, New York 10105
(Name and address of agent for service)

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

Date of fiscal year July 31, 2010
end:

Date of reporting period: July 31, 2010

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-2001. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

ITEM 1. REPORT TO SHAREHOLDERS

July 31, 2010

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Dear Shareholder:

The fiscal year ended July 31, 2010, was a tale of two markets. The first eight months were characterized by cautious optimism, as the U.S. economy grew, stocks posted sharp gains and investors fled low-yielding U.S. Treasury bonds for riskier, and higher-yielding, corporate securities. But fear and uncertainty returned during the last four months of the reporting period, sending stocks tumbling, and causing many bond investors to flee right back to the perceived safe haven of Treasuries. As demand for U.S. Treasuries surged, prices on the benchmark 10-year Treasury bond rose, moving yields (which move in the opposite direction) below 3%.

Tracing economic growth helps tell the story. In the last three months of 2009, the U.S. economy, as measured by gross domestic product (GDP), grew at an annual rate of 5.0% due in part to government stimulus programs. Between January and March of this year, GDP grew, but at a slower pace 3.7%. This deceleration continued between April and June, with the economy expanding at a rate of 2.4%.

This clear trend has been a matter of growing concern for the Federal Reserve (the Fed). Policymakers indicated in late June that it could take up to six years for the U.S. economy to return to what they considered normal. It was also mentioned that new stimulus measures may be necessary if conditions were to worsen appreciably. Officials hinted of one possible remedy: the Fed could resume buying U.S. Treasury bonds to bolster the economy. This would be a reversal of an earlier policy to unwind such investments as the economy recovered.

The Fed also stated that it would keep interest rates low. The closely-watched Federal Funds Rate the interest rate banks charge to lend federal funds to other banks, usually on an overnight basis remained in the 0.0% to 0.25% range, while the discount-rate the interest rate charged to banks for direct loans stayed at 0.75%, though this rate was increased in February from 0.50%.

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Twelve Months in Review

For the fiscal year ended July 31, 2010:

- PIMCO Income Strategy Fund returned 42.75% on net asset value (NAV) and 52.70% on market price.
- PIMCO Income Strategy Fund II returned 39.47% on NAV and 52.97% on market price.

In contrast, the Barclays Capital Credit Investment Grade Index, a measure of high quality corporate bond performance, returned 23.83% and the Barclays Capital U.S. High Yield Bond Index, a measure of below-investment-grade corporate bond performance, returned 23.74%. Government bonds, as represented by the Barclays Capital Long Term Treasury Index, gained 11.44% for the fiscal period.

The Barclays Capital U.S. Aggregate Index, a broad credit market measure of government and corporate securities, posted a return of 8.91%. Mortgage-backed securities, as reflected by the Barclays Capital Mortgage Index, advanced 7.68%. As for stocks, the Standard & Poor's 500 Index rose 13.84% during the fiscal year.

Positioned to Face Today's Challenges

The slowing U.S. economy, and the see-saw performance in the financial markets are unmistakable signs that the road ahead is likely to be bumpy. Talk of a double-dip recession, once discounted, is being taken more seriously, as is the specter of deflation — when prices of goods and services fall. On the surface, falling prices may sound like a good thing. However, wages can fall as well, as can demand for those goods and services, setting off a potentially harmful spiral. All of this suggests that caution is warranted. Even so, and despite these gloomy possibilities, another scenario is possible: the U.S. economy may sidestep another recession — defined as two consecutive quarters of negative economic growth — and trudge ahead at a lower-than-historic growth rate.

That is our near-term perspective. It may be a good time to look at the long-term perspective as well. For all its travails, all of the ups and downs, the fears and uncertainty we mentioned earlier — the U.S. economy has proven to be resilient over many market cycles and many years.

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During April, the Funds completed rights offerings which were over-subscribed. Net proceeds of the rights offerings aggregated \$57.6 million and \$118.2 million for PIMCO Income Strategy and PIMCO Income Strategy II, respectively. The Funds' Board of Trustees, Investment Manager and Sub-Adviser believe that in offering additional shares, both Funds will be able to take better advantage of current and future investment opportunities.

For specific information on the Funds and a review of their performance for the reporting period, please refer to 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, www.allianzinvestors.com/closedendfunds.

Receive this report electronically and eliminate paper mailings. To enroll, go to www.allianzinvestors.com/edelivery.

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

Brian S. Shlissel
President & CEO

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PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Fund Insights/Performance & Statistics

July 31, 2010 (unaudited)

- For the fiscal year ended July 31, 2010, PIMCO Income Strategy Fund returned 42.75% on NAV and 52.70% on market price.
- For the fiscal year ended July 31, 2010, PIMCO Income Strategy Fund II returned 39.47% on NAV and 52.97% on market price.
- An emphasis on the banking sector was a strong contributor to the Funds' performance, as recapitalization efforts benefited securities within this sector during the reporting period.
- A larger-than-market weighting in the insurance sector, which significantly outperformed the broader credit market, benefited returns.
- Security selection in the insurance sector, where life insurance securities materially outpaced the broader category, benefited the Funds' performance.
- Security selection was also strong in the transportation sector, where airline securities outperformed.
- Exposure to health care, which underperformed alongside other more defensive sectors amid generally elevated risk appetites, was negative for the Funds' performance.
- Tactical exposure to mortgage-backed holdings, which could not keep pace with the rallying corporate market, also detracted from returns.
- Exposure to speculative-grade corporate credits, which outperformed their higher quality counterparts, was positive for performance.

Income Strategy:

Total Return(1):	Market Price	NAV
1 Year	52.70%	42.75%
5 Year	2.80%	0.75%
Commencement of Operations (8/29/03) to 7/31/10	2.64%	2.25%

Market Price/NAV Performance:	Market Price/NAV:	
Commencement of Operations (8/29/03) to 7/31/10	Market Price	\$11.50
NAV	NAV	\$10.62
Market Price	Premium to NAV	8.29%
	Market Price Yield(2)	7.83%

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PIMCO Income Strategy Fund/PIMCO Income Strategy Fund II Fund Insights/Performance & Statistics

July 31, 2010 (unaudited) (continued)

Income Strategy II:

Total Return(1):	Market Price	NAV
1 Year	52.97%	39.47%
5 Year	0.64%	(2.08)%
Commencement of Operations (10/29/04) to 7/31/10	(0.62)%	(1.16)%

Market Price/NAV Performance:

Commencement of Operations (10/29/04) to 7/31/10
 NAV
 Market Price

Market Price/NAV:

Market Price	\$10.05
NAV	\$9.29
Premium to NAV	8.18%
Market Price Yield(2)	7.76%

(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. Total return for a period of more than one year represents the average annual total return.

Performance at market price will differ from its 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 Funds, market conditions, supply and demand for the Funds' shares, or changes in the Funds' dividends.

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An investment in the Funds 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 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.

(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend (comprised of net investment income) payable to common shareholders by the market price per common share at July 31, 2010.

PIMCO Income Strategy Fund Schedule of Investments								
July 31, 2010								
Principal Amount (000s)					Credit Rating (Moody s/S&P)*			Value
CORPORATE BONDS & NOTES 68.4%								
Airlines 7.0%								
\$900		American Airlines, Inc., 10.50%, 10/15/12 (a) (d)			B2/B			\$963,000
		American Airlines Pass Through Trust,						
4,319		9.73%, 9/29/14			Caa2/CCC+			3,865,699
3,948		10.18%, 1/2/13			Caa1/CCC+			3,938,472
15,690		United Air Lines Pass Through Trust, 10.40%, 5/1/18			Ba1/BBB			17,101,920
								25,869,091
Banking 10.2%								
2,600		AgFirst Farm Credit Bank, 7.30%, 8/30/10 (a) (b) (d) (g) (k) (acquisition cost-\$2,225,000; purchased 2/26/10-4/15/10)			NR/A			2,271,217