

NICHOLAS APPLGATE CONVERTIBLE & INCOME FUND II
Form N-CSR
May 06, 2009

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 811-21338

Nicholas-Applegate Convertible & Income Fund II
(Exact name of registrant as specified in charter)

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

New York 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 end: February 28, 2009

Date of reporting period: February 28, 2009

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, 450 Fifth Street, NW, Washington, DC 20549 0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

ITEM 1. REPORT TO SHAREHOLDERS

Nicholas-Applegate Convertible & Income Fund

Nicholas-Applegate Convertible & Income Fund II

Annual Report
February 28, 2009

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Nicholas-Applegate Convertible & Income Funds Letter to Shareholders

April 15, 2009

Dear Shareholder:

Please find enclosed the annual reports for the Nicholas-Applegate Convertible & Income Fund and Nicholas-Applegate Convertible & Income Fund II (collectively, the Funds) for the fiscal year ended February 28, 2009.

Corporate securities, including convertible bonds and U.S. stocks, fell sharply during the period as tight credit conditions and global economic slowing prompted investors to favor the relative safety of government bonds. In this environment, the Merrill Lynch All-Convertible Index declined 35.69% and the S&P 500 Index dropped 43.32%. The Barclays Global U.S. Treasury Bond Index rose 5.91% for the 12-month period.

Please refer to the following pages for more information on the Funds. 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) 331-1710. You will also find a wide range of information and resources on our Web site, www.allianzinvestors.com/closedendfunds.

Together with Allianz Global Investors Fund Management LLC, the Funds investment manager, and Nicholas-Applegate Capital Management LLC, the Funds sub-adviser, we thank you for investing with us.

We remain dedicated to serving your financial needs.

Sincerely,

Hans W. Kertess
Chairman

Brian S. Shlissel
President & Chief Executive Officer
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Nicholas-Applegate Convertible & Income Fund
Nicholas-Applegate Convertible & Income Fund II
Fund Insights

February 28, 2009 (unaudited)

For the fiscal 12-month period ended February 28, 2009, Nicholas-Applegate Convertible & Income Fund decreased 55.03% on net asset value and 61.55% on market price.

For the fiscal 12-month period ended February 28, 2009, Nicholas-Applegate Convertible & Income II Fund decreased 58.55% on net asset value and 63.34% on market price.

History books will be written to describe the past year. The simple conclusion was the equity, convertible and debt markets experienced one of the most rapid sell-offs of all time. Investors began 2008 with many questions about different economic scenarios and how the operating performance of issuers would fare. Those generic concerns paled in comparison to the shocking events of 2008.

Most will trace the beginning of the decline to mortgage delinquencies and falling housing prices. The housing downturn led to rapid quality and price declines in collateralized mortgage obligations (CMOs). Price declines in the CMO market led to price declines in all collateralized debt and loan obligations (CDOs, CLOs) which, in turn, cut off demand for loans.

Historically, convertibles have offered downside protection versus equities. During the fiscal year, however, the convertible universe performed roughly in line with the S&P 500 and NASDAQ. While the larger financial sector weighted in the Merrill Lynch All Convertible Index partially explained the convertible performance, rapidly widening corporate bond spreads explained the balance.

All industries posted negative returns during the fiscal year for both equities and convertibles. Consumer discretionary underperformance was the most severe of any industry in the market for the fiscal period. Materials, industrials and energy industries also underperformed as the economic data worsened. The best-performing industries were consumer staples and healthcare. These industries performed well because of favorable operating performance as well as an expected flight to quality.

The high-yield market ended 2008 on a positive note, with a record monthly gain in December. However, the final weeks' positive price move did not make up for the sharp price declines experienced during the fiscal period. For 2008, the high-yield market was down 26.4%, according to the Merrill Lynch High Yield Master II Index, a greater decline than any year in history.

Remarkably, with all of the financial chaos and headlines, the fundamentals of the majority of issuers in the high-yield market did not decline as rapidly as in previous cycles. The default rate ended 2008 at 2.25% according to JPMorgan. The average spread in the Merrill Lynch High Yield Master II Index ended the year at more than 1,800 basis points over comparable duration Treasuries. Spreads did eclipse 2,300 basis points in mid-December. In the last cycle (1990-1991), when spreads peaked near 1,200 basis points, the default rate was in excess of 10%. Defaults, or the expectation of imminent default, are the primary driver of spreads. Therefore, technical pressure and fear had a far greater impact on spreads than the relative credit deterioration.

What seemed like an endless sell-off through mid-December sharply reversed during the last weeks of 2008 and was stable for the first couple of months in 2009. The Funds outperformed in both of the record-setting down months of October and November. The Funds' high quality high yield holdings and avoidance of distressed issues helped during the tumultuous markets. As important to outperforming in poor market conditions, the Funds performed equally well in the record-setting rally in late December.

There were many negative high yield contributors during the fiscal period. Retail, Auto Supply and Chemical issuers all underperformed. Operational performance was lower than expectations and the outlook was tempered for these issuers. All of the issues were considered to be oversold and will continue to be monitored.

Concurrent with the collapsing markets, the VIX (ticker symbol for the Chicago Board Options Volatility Index) first peaked in October and then re-peaked in November at an incredulous level of 80.8. These never-before-seen volatility levels were double previous historic highs. In fact, the average volatility during the past three months was 35.7, outpacing historic averages since initial recordings.

The rapid equity market correction and record spreads and yields experienced will be discussed for a long time. We have reviewed the catalysts for this downfall. But, ultimately, investors lost confidence in the equity and debt markets, and those sellers brought more sellers through forced liquidations (from leverage triggers or withdrawals) or through sheer panic.

Nicholas-Applegate Convertible & Income Fund

Nicholas-Applegate Convertible & Income Fund II

Fund Insights

February 28, 2009 (unaudited)

Have the lows been reached? The answer is more difficult when looking at equities, but relatively easy when looking at corporate defaults. The high-yield market reached nearly double prior-cycle trough spreads without a significant increase in defaults. In this case, we believe the credit markets are oversold. Should there be a credit rally we expect convertibles and high yield issues to participate.

The duration of the economic downturn is still not clear. Corporate earnings have been poor and economic statistics are weak and are not likely to rebound in the short-term. Many eyes are watching the Obama administration. How many more TARP (Troubled Assets Relief Program) and other bailout programs will combine with economic stimulus plans to attempt to foster growth? From an investor's standpoint, it will be just as prudent to focus on credit metrics as well as on corporate profits.

Performance has been volatile as investors balance the uncertain outlook for the economy, corporate profits, and equity valuations versus prior cycles. The delevering of the market continued into early 2009, and it is unclear when the process will end. The tug of war between the deteriorating global economy and the massive and expanding global policy response package continued at the end of the fiscal period.

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Nicholas-Applegate Convertible & Income Fund Performance & Statistics

February 28, 2009 (unaudited)

Total Return ⁽¹⁾:	Market Price	Net Asset Value (NAV)
1 year	(61.55)%	(55.03)%
5 year	(13.46)%	(10.95)%
Commencement of Operations (3/31/03) to 2/28/09	(8.87)%	(5.62)%

Market Price/NAV Performance:

Commencement of Operations (3/31/03) to 2/28/09

n Market Price

n NAV

Market Price/NAV:

Market Price	\$	4.05
NAV	\$	4.80
Discount to NAV		(15.63)%
Market Price Yield ⁽²⁾		26.67%

Moody's Ratings
(as a % of total investments)

(1) **Past performance is no guarantee of future results.** Returns are calculated by determining the percentage change in net asset value or market share price (as applicable) in the period covered. The calculation assumes that all of the Fund's income dividends and capital gain distributions 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.

The Fund's 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 Fund, market conditions, supply and demand for the Fund's shares, or changes in Fund distributions.

An investment in the Fund involves risk, including the loss of principal. Total return, market price, market yield and net asset value will fluctuate with changes in market conditions. This data is provided for information 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. Net asset value 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 payable to common shareholders by the market price per common share at February 28, 2009.

Nicholas-Applegate Convertible & Income Fund II Performance & Statistics

February 28, 2009 (unaudited)

Total Return ⁽¹⁾:	Market Price	Net Asset Value (NAV)
1 year	(63.34)%	(58.55)%
5 year	(14.74)%	(12.37)%
Commencement of Operations (7/31/03) to 2/28/09	(12.04)%	(8.98)%

Market Price/NAV Performance:

Commencement of Operations (7/31/03) to 2/28/09

☐ Market Price

☐ NAV

Market Price/NAV:

Market Price	\$	3.73
NAV	\$	4.39
Discount to NAV		(15.03%)
Market Price Yield ⁽²⁾		27.35%

Moody's Ratings (as a % of total investments)

(1) **Past performance is no guarantee of future results.** Returns are calculated by determining the percentage change in net asset value or market share price (as applicable) in the period covered. The calculation assumes that all of the Fund's income dividends and capital gain distributions 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.

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(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend payable to common shareholders by the market price per common share at February 28, 2009.

Nicholas-Applegate Convertible & Income Fund Schedule of Investments

February 28, 2009

Principal Amount (000)		Credit Rating (Moody s/S&P)*	Value
CORPORATE BONDS & NOTES 45.3%			
Advertising 1.0%			
\$11,450	Affinion Group, Inc., 11.50%, 10/15/15	B3/B-	\$ 7,328,000
Aerospace/Defense 0.2%			
1,730	BE Aerospace, Inc., 8.50%, 7/1/18	Ba3/BB+	1,384,000
Apparel 2.0%			
12,295	Levi Strauss & Co., 9.75%, 1/15/15	B2/B+	10,266,324
5,340	Oxford Industries, Inc., 8.875%, 6/1/11	B2/B+	3,978,300
			14,244,624
Automotive 1.9%			
8,545	Accuride Corp., 8.50%, 2/1/15	Caa2/CCC	2,606,225
14,195	Exide Technologies, 10.50%, 3/15/13, Ser. B	B3/B-	8,446,025
7,490	General Motors Corp., 8.375%, 7/15/33	C/C	1,029,875
9,818	Tenneco, Inc., 8.625%, 11/15/14	Caa2/CCC	1,423,610
			13,505,735
Chemicals 0.3%			
4,890	Momentive Performance Materials, Inc. 9.75%, 12/1/14	B3/B-	1,882,650
Commercial Services 1.8%			
13,665	Cenveo Corp., 7.875%, 12/1/13	B3/B	7,857,375

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11,810	Hertz Corp., 10.50%, 1/1/16	B2/B	4,487,800
			12,345,175
Computers 0.4%			
10,325	Unisys Corp., 8.00%, 10/15/12	Caa1/B	2,529,625
Electric 0.6%			
7,475	Energy Future Holdings Corp., 10.875%, 11/1/17	B3/B-	4,298,125
Electronics 1.3%			
12,170	Stoneridge, Inc., 11.50%, 5/1/12	B2/B+	8,884,100
Financial Services 4.4%			
12,725	AMR Holdings Co., 10.00%, 2/15/15	B1/B	12,852,250
	Ford Motor Credit Co.,		
10,795	7.00%, 10/1/13	Caa1/CCC+	5,321,255
8,080	9.875%, 8/10/11	Caa1/CCC+	4,698,964
6,456	GMAC LLC, 6.75%, 12/1/14 (a) (b)	NR/CCC	3,138,003
10,090	KAR Holdings, Inc., 8.75%, 5/1/14	B3/CCC+	4,540,500
			30,550,972
Hand/Machine Tools 0.4%			
3,430	Baldor Electric Co., 8.625%, 2/15/17	B3/B	2,735,425
Healthcare 3.8%			
7,275	Alliance Imaging, Inc., 7.25%, 12/15/12	B3/B	6,838,500
8,515	Hanger Orthopedic Group, Inc., 10.25%, 6/1/14	Caa1/CCC+	8,515,000
8,065	HCA, Inc., 9.25%, 11/15/16	B2/BB-	7,399,637
3,585	Health Net, Inc., 6.375%, 6/1/17	Ba3/BB	2,419,875
1,350	Psychiatric Solutions, Inc., 7.75%, 7/15/15	B3/B-	1,191,375

26,364,387

Holding Company-Diversified 0.3%

2,000	Kansas City Southern Railway, 13.00%, 12/15/13	B2/BB-	2,115,000
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Nicholas-Applegate Convertible & Income Fund Schedule of Investments

February 28, 2009

Principal Amount (000)		Credit Rating (Moody s/S&P)*	Value
Home Furnishings 1.1%			
\$ 10,090	Jarden Corp., 7.50%, 5/1/17	B3/B	\$ 7,920,650
Hotels/Gaming 0.4%			
2,385	Mandalay Resort Group, Inc., 2.275%, 3/21/33, FRN (e) (g)	Caa2/CCC	2,575,929
Manufacturing 2.0%			
13,610	Harland Clarke Holdings Corp., 9.50%, 5/15/15	Caa1/B-	6,192,550
2,155	Park-Ohio Industries, Inc., 8.375%, 11/15/14	B3/B-	894,325
9,710	Polypore, Inc., 8.75%, 5/15/12	B3/B-	7,233,950
			14,320,825
Metals & Mining 0.4%			
12,735	RathGibson, Inc., 11.25%, 2/15/14	Caa2/B	2,865,375
Multi-Media 1.0%			
8,330	Mediacom LLC, 9.50%, 1/15/13	B3/B-	7,288,750
Office Furnishings 0.5%			
4,835	Interface Inc., 9.50%, 2/1/14	B3/B-	