

PIMCO MUNICIPAL INCOME FUND III

Form N-CSRS

May 30, 2014

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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 811-21187

PIMCO Municipal Income Fund III

(Exact name of registrant as specified in charter)

1633 Broadway, New York, New York 10019

(Address of principal executive offices) (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: September 30, 2014

Date of reporting period: March 31, 2014

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Item 1. REPORT TO SHAREHOLDERS

PIMCO Municipal Income Fund III

PIMCO California Municipal Income Fund III

PIMCO New York Municipal Income Fund III

Semi-Annual Report

March 31, 2014

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Letter from the Chairman of the Board &

President

Hans W. Kertess

Chairman

Julian Sluyters

President & CEO

Dear Shareholder:

After a weak first half of the reporting period, municipal bonds rallied and produced solid results during the fiscal six months ended March 31, 2014. US Treasury yields fluctuated but ultimately moved higher as the US economy continued to expand and the Federal Reserve (the Fed) clarified its timeline for asset purchase tapering. Investor demand for municipal securities strengthened due to improving fundamentals and attractive valuations.

Six-Month Period in Review

For the six-month fiscal period ended March 31, 2014, PIMCO Municipal Income III returned 10.24% on net asset value (NAV) and 10.46% on market price.

For the six-month fiscal period ended March 31, 2014, PIMCO California Municipal Income III returned 9.05% on NAV and 10.74% on market price.

For the six-month fiscal period ended March 31, 2014, PIMCO New York Municipal Income III returned 7.54% on NAV and 3.16% on market price.

The Barclays Municipal Bond Index gained 3.65% while the broad taxable bond market, as represented by the Barclays US Aggregate Bond Index, returned 1.70% during the reporting period.

The US economy continued to grow during the reporting period, albeit at a less robust pace. According to the US Commerce Department, 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, expanded at a 2.6% annual pace during the fourth quarter. Moderating growth was attributed to a number of factors, including a deceleration in private inventory investment, declining federal government spending and less residential fixed

investments.

The Fed maintained an accommodative monetary policy during the reporting period. The central bank did, however, announce that it would begin tapering its monthly asset purchase program beginning in January 2014 during its December 2013 meeting. At its meetings in both January and March 2014, the Fed announced that it would further taper its asset purchases. However, the Fed repeated that it would not raise interest rates in the near future, saying in March that it expected to maintain the current target range for the federal funds rate for a considerable time

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after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2% longer-run goal.

Outlook

The US economy has been resilient and we believe has overcome the headwinds associated with higher taxes, rising interest rates and severe winter weather. We continue to expect US economic growth will be above-trend in 2014 due, in part, to the fact that fiscal policy

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will be less of a drag than it was last year.

While we are prepared for the Fed to start raising benchmark interest rates in 2015, we think policymakers will remain behind the curve on monetary normalization. Several factors support this view, including: the modest pace of the labor recovery, the lack of inflation pressure, the need to support the deleveraging process, the risk of a bond market crash if rates were to normalize too quickly, and constrained fiscal policy and political pressure.

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 of the Board of Trustees

Julian Sluyters
President & Chief Executive Officer

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Fund Insights

PIMCO Municipal Income Funds III

March 31, 2014 (unaudited)

For the six-month fiscal period ended March 31, 2014, PIMCO Municipal Income III (Municipal III) returned 10.24% on net asset value (NAV) and 10.46% on market price.

For the six-month fiscal period ended March 31, 2014, PIMCO California Municipal Income III (California Municipal III) returned 9.05% on NAV and 10.74% on market price.

For the six-month fiscal period ended March 31, 2014, PIMCO New York Municipal Income III (New York Municipal III) returned 7.54% on NAV and 3.16% on market price.

The municipal bond market overcame a challenging start and generated positive results during the six-month reporting period ended March 31, 2014. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), was relatively flat for the first half of the reporting period, as it returned 0.32%. Impacting the municipal market were rising interest rates, as well as generally weak demand given concerns over the city of Detroit's bankruptcy filing and credit issues in Puerto Rico. However, the municipal bond market then strengthened and gained 3.32% over the second half of the reporting period. This turnaround was due to several factors, including improving fundamentals, attractive valuations and falling interest rates. In addition, investor demand improved, while new municipal supply fell sharply over the first three months of 2014. All told, the Index gained 3.65% during the six-month reporting period. In

comparison, the overall taxable fixed income market, as measured by the Barclays US Aggregate Bond Index, gained 1.70%.

Overweight duration relative to the Index contributed to the performance of all three Funds as municipal yields declined during the six-months ended March 31, 2014. All three Funds' overweighting to the Health Care sector was rewarded as it outperformed the Index. Municipal III's and New York Municipal III's overweighting to the Industrial Revenue sector was beneficial for results as it outperformed the Index. Municipal III's and California Municipal III's overweighting to the Revenue-Backed sector contributed to results as it outperformed the Index. New York Municipal III's and California Municipal III's overweighting to Tobacco sector was beneficial as it outperformed the Index.

Municipal III's and California Municipal III's underweighting to the Transportation and Lease-Backed sectors detracted from performance as they outperformed the Index. Municipal III's underweighting to the Education sector was a negative for results given its outperformance versus the Index. New York Municipal III's overweighting to the Special Tax sector detracted from results given its underperformance versus the Index. New York Municipal III's underweighting to the Water and Sewer sector was a negative for results due to its outperformance versus the Index.

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PIMCO Municipal Income Fund III

March 31, 2014 (unaudited)

Total Return⁽¹⁾:	Market Price	NAV
Six Month	10.46%	10.24%
1 Year	-2.54%	-0.58%
5 Year	13.65%	14.61%
10 Year	4.57%	4.08%
Commencement of Operations (10/31/02) to 3/31/14	4.62%	4.48%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/14

Market Price/NAV:

Market Price	\$11.07
NAV	\$10.11
Premium to NAV	9.50%
Market Price Yield ⁽²⁾	6.28%
Leverage Ratio ⁽³⁾	39.80%

Moody's Rating

(as a % of total investments)

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PIMCO California Municipal Income Fund III

March 31, 2014 (unaudited)

Total Return⁽¹⁾:	Market Price	NAV
Six Month	10.74%	9.05%
1 Year	-2.87%	0.23%
5 Year	13.64%	13.83%
10 Year	3.57%	3.25%
Commencement of Operations (10/31/02) to 3/31/14	3.43%	3.53%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/14

Market Price/NAV:

Market Price	\$9.97
NAV	\$9.53
Premium to NAV	4.62%
Market Price Yield ⁽²⁾	7.22%
Leverage Ratio ⁽³⁾	43.00%

Moody's Rating

(as a % of total investments)

Table of Contents**Performance & Statistics**

PIMCO New York Municipal Income Fund III

March 31, 2014 (unaudited)

Total Return⁽¹⁾:	Market Price	NAV
Six Month	3.16%	7.54%
1 Year	-2.06%	-0.30%
5 Year	10.73%	10.19%
10 Year	1.87%	1.46%
Commencement of Operations (10/31/02) to 3/31/14	2.23%	2.20%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/14

Market Price/NAV:

Market Price	\$9.25
NAV	\$8.82
Premium to NAV	4.88%
Market Price Yield ⁽²⁾	6.81%
Leverage Ratio ⁽³⁾	42.57%

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 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. 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 Funds, market conditions, supply and demand for each Fund's shares, or changes in each Fund's dividends.

An investment in each 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.

(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 March 31, 2014.

(3) Represents Floating Rate Notes issued in tender option bond transactions and Preferred Shares 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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PIMCO Municipal Income Fund III

March 31, 2014 (unaudited)

Principal Amount (000s)		Value
Municipal Bonds & Notes 93.4%		
Alabama 9.5%		
\$500	Birmingham Special Care Facs. Financing Auth. Rev., Childrens Hospital, 6.00%, 6/1/39 (AGC)	\$559,780
9,000	Birmingham-Baptist Medical Centers Special Care Facs. Financing Auth. Rev., Baptist Health Systems, Inc., 5.00%, 11/15/30, Ser. A	9,009,180
53,000	Jefferson Cnty. Sewer Rev., zero coupon, 10/1/50, Ser. F (i)	27,878,530
12,000	6.50%, 10/1/53, Ser. D	12,434,040
1,000	State Docks Department Rev., 6.00%, 10/1/40	1,121,290
		51,002,820
Arizona 6.7%		
1,250	Health Facs. Auth. Rev., Banner Health, 5.00%, 1/1/35, Ser. A	1,282,062
900	Banner Health, 5.50%, 1/1/38, Ser. D	954,162
2,250	Beatitudes Campus Project, 5.20%, 10/1/37	1,916,887
13,000	Pima Cnty. Industrial Dev. Auth. Rev., 5.00%, 9/1/39 (h)	13,244,270
750	Tucson Electric Power Co., 5.25%, 10/1/40, Ser. A	769,478
5,000	Salt River Project Agricultural Improvement & Power Dist. Rev., 5.00%, 1/1/39, Ser. A (h)	5,331,750
11,600	Salt Verde Financial Corp. Rev., 5.00%, 12/1/37	12,281,384
		35,779,993
California 19.1%		
1,500	Bay Area Toll Auth. Rev., San Francisco Bay Area, 5.00%, 10/1/29	1,636,065
500	5.00%, 4/1/34, Ser. F-1	536,600
3,260	5.00%, 10/1/42	3,414,426
12,000	5.25%, 4/1/53, Ser. S-4	12,741,720
2,630	Golden State Tobacco Securitization Corp. Rev., Ser. A-1, 4.50%, 6/1/27	2,278,632
3,600	5.125%, 6/1/47	2,665,080
11,120	5.75%, 6/1/47	8,999,861
2,500	Health Facs. Financing Auth. Rev., Catholic Healthcare West, 6.00%, 7/1/39, Ser. A	2,765,375
600	Sutter Health, 5.00%, 11/15/42, Ser. A (IBC-NPFGC)	613,992
4,390	Sutter Health, 5.00%, 8/15/52, Ser. A	4,545,845

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1,500	Sutter Health, 6.00%, 8/15/42, Ser. B	1,710,450
3,350	Indian Wells Redev. Agcy., Tax Allocation, Whitewater Project, 4.75%, 9/1/34, Ser. A (AMBAC)	3,105,952
130	Los Angeles Unified School Dist., GO, 5.00%, 7/1/30, Ser. E (AMBAC)	136,997
2,000	M-S-R Energy Auth. Rev., 6.50%, 11/1/39, Ser. B	2,525,420
1,445	Municipal Finance Auth. Rev., Azusa Pacific Univ. Project, 7.75%, 4/1/31, Ser. B	1,623,645
1,250	Palomar Pomerado Health, CP, 6.75%, 11/1/39	1,292,013
1,600	San Marcos Unified School Dist., GO, 5.00%, 8/1/38, Ser. A State, GO,	1,679,920
5,000	5.00%, 6/1/37	5,282,200
5,300	5.00%, 12/1/37	5,643,864
1,350	5.25%, 3/1/38	1,454,544

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PIMCO Municipal Income Fund III

March 31, 2014 (unaudited) (continued)

Principal Amount (000s)		Value
	California (continued)	
\$ 1,300	5.25%, 11/1/40	\$1,435,811
3,200	5.50%, 3/1/40	3,546,176
2,500	5.75%, 4/1/31	2,891,975
5,000	6.00%, 4/1/38	5,738,400
	Statewide Communities Dev. Auth. Rev.,	
1,000	American Baptist Homes West, 6.25%, 10/1/39	1,044,770
	California Baptist Univ., 5.75%, 11/1/17, Ser. B (a)(b)(d)(j)	
1,635	(acquisition cost-\$1,635,000; purchased 6/22/07)	1,783,507
2,580	Methodist Hospital Project, 6.625%, 8/1/29 (FHA)	3,039,988
9,200	Methodist Hospital Project, 6.75%, 2/1/38 (FHA)	10,802,364
3,000	Trinity Health, 5.00%, 12/1/41	3,119,760
6,200	Tobacco Securitization Auth. of Southern California Rev., 5.00%, 6/1/37, Ser. A-1	4,741,512
		102,796,864
	Colorado 0.7%	
	Health Facs. Auth. Rev., Ser. A,	
500	Evangelical Lutheran, 6.125%, 6/1/38 (Pre-refunded @ \$100, 6/1/14) (c)	504,810
2,000	Sisters of Charity of Leavenworth Health System, 5.00%, 1/1/40	2,062,240
500	Public Auth. for Colorado Energy Rev., 6.50%, 11/15/38	633,870
	Regional Transportation Dist. Rev., Denver Transportation Partners, 6.00%,	
500	1/15/34	529,395
		3,730,315
	Connecticut 0.3%	
	Harbor Point Infrastructure Improvement Dist., Tax Allocation, 7.875%, 4/1/39,	
1,250	Ser. A	1,396,488
	District of Columbia 2.1%	
10,000	Water & Sewer Auth. Rev., 5.50%, 10/1/39, Ser. A (h)	11,057,100
	Florida 3.2%	
3,480	Brevard Cnty. Health Facs. Auth. Rev., Health First, Inc. Project, 5.00%, 4/1/34	3,518,767
500	Broward Cnty. Airport System Rev., 5.375%, 10/1/29, Ser. O	552,275
4,500	Broward Cnty. Water & Sewer Utility Rev., 5.25%, 10/1/34, Ser. A (h)	5,008,815
3,000	Cape Coral Water & Sewer Rev., 5.00%, 10/1/41 (AGM)	3,125,520
350	Dev. Finance Corp. Rev., Renaissance Charter School, 6.50%, 6/15/21, Ser. A	364,634
4,200	State Board of Education, GO, 5.00%, 6/1/38, Ser. D (h)	4,551,204