Quarterly Portfolio Update

Pioneer Funds – Global Multi-Asset Target Income
29 December 2017

ASSET-CLASS COMMENTARY

Market Review

Politics and central bank policy continued to impact asset performance in Q4 against a backdrop of robust global macroeconomic data. Earlier in the quarter, markets climbed higher, shrugging off tensions between U.S. and Korea, disruption from the results of the Catalonia independence referendum and German elections..

Investor sentiment rebounded in the latter half of the quarter in anticipation of the passage of tax reforms in the U.S. The $1.5 trillion tax bill to cut corporate and personal taxes was eventually approved by the U.S. Senate in late December, providing a boost to domestic equity markets. Progress on Brexit discussions also helped global markets, as the UK agreed to pay a £40bn "divorce bill" to the EU. Other news included the widely expected rate hike by the Fed in December, which was the third hike in 2017. Although the Fed indicated 3 hikes for 2018, notably, the closely watched "dot plot" took a more dovish tilt for 2019.

Equities outperformed in Q4 amidst buoyant market sentiment. U.S. was in the lead (S&P +6.1%) with returns driven by the Technology sector, while Europe (Eurostoxx 50 -2.5%) suffered due to a strong Euro and political uncertainty. Despite a stronger Yen, Japanese markets (Nikkei +11.8%) benefited from strong earnings results and renewed investor appetite. Emerging Markets ("EM") were strong performers (MSCI[1] EM +7.3%) supported by a weaker U.S. Dollar, strong global economic growth and accommodative central banks.

Within fixed income, a notable flattening of the yield curve was observed across most Developed Market ("DM") sovereign bonds, particularly in the U.S., where short yields rose in anticipation of future rate hikes while long yields remained stable and even fell in some markets as investors lowered their expectations for long-term growth. 2-year bond yields in the U.S. and Germany rose by +40bps and +6bps respectively while 10 year maturities were +7bps higher in the U.S. but fell by -4bps in Germany.

Emerging and credit markets outperformed their sovereign counterparts and returned positively in Q4. However, they experienced some volatility as spreads widened in the first half of November due to spikes in underlying bond yields. The sell-off was short lived as a result of strong macro and corporate fundamentals as well as inflows from opportunistic yield seeking investors.

In currency markets, uncertainty over the sustainability of domestic economic growth and clarity on tax reforms weighed on the U.S. Dollar in Q4. It lost ground versus the Euro (-1.6%) and Sterling (-0.8%), both of which were supported by resilient domestic macro data despite geopolitical uncertainty. EM currencies were also significant winners, with the exception of Latin American currencies such as the Brazilian Real (-4.7%) which suffered from uncertainty surrounding the upcoming presidential elections. The U.S. Dollar also stabilised against the Yen (+0.2%) and commodity related currencies such as Australian Dollar (+0.4%) in Q4. The latter was under pressure from a bearish outlook on Australian interest rates due to disappointing inflation data.

Commodity markets were the strongest performers in Q4 benefiting from a weak U.S Dollar and an improving global growth outlook. Oil (West Texas Intermediate +16.9%) rallied amidst compliance by OPEC and non-OPEC members to production cuts and supply disruptions resulting from corruption crack-downs in the Middle East and the Kurdish independence referendum. Precious metals (Gold +1.8%) saw muted gains due to risk-on market backdrop while industrial metals bounced back in December to end the quarter strongly. Nickel (+22.0%) and Copper (+12.0%) were the best performers against the positive macro backdrop, helped by aggressive Chinese demand.

Portfolio Review

The Portfolio performed positively in Q4 with gains led by the Macro Strategy and a smaller upside from Selection Strategies. Macro Hedging was a negative contributor while Satellites were small detractors. In terms of asset classes, gains were contributed

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Amundi ASSET MANAGEMENT

primarily by equities. Currencies, credit, rates and liquid real asset strategies also added positively while EM bonds generated losses.

Equity exposures were successful primarily due to directional exposure led by Japan and U.S. followed by Selection, where positioning in the U.S. was the main contributor. In terms of sectors, high beta sectors such as Information Technology, Consumer Discretionary and Financials were the top contributors. Macro Hedging, especially volatility reduction strategies in Japan and U.S, unsurprisingly detracted. Satellites, which include relative value and asymmetric reflationary focused strategies, posted a negative performance.

Within fixed income, rates strategies gained due to an overall negative stance on duration versus the strategic asset allocation target. Duration hedges in the U.S. and short positioning in short-dated core Eurozone benefited as yields trended higher. Within spread strategies, corporate bonds gained, especially the exposure to Investment Grade ("IG") where we maintain a positive tilt versus High Yield ("HY"). Among detractors were hedges on duration in Europe and credit. Performance across relative value yield curve Satellite strategies was loss generating.

Currency trading returned positively, led by Satellites including short Australian Dollar versus Euro and long Canadian Dollar versus Australian Dollar. Within the Macro Strategy, a reduced exposure to the U.S. Dollar in favour of the Euro also benefited. Among negative contributors was the long positioning in EM currencies such as Turkish Lira and South African Rand versus the U.S. Dollar.

In Q4, income was generated primarily from bond coupons, followed by equity dividends and option writing premiums. Although option writing was muted for most of the quarter, we sold put options aiming to build exposure to high dividend sectors such as Healthcare and Materials. Meanwhile, we sold call options on select U.S. and European Financials. In the U.S, we were tactical on the Technology sectors writing calls and puts on select names.

Asset Allocation (Macro Strategy and Satellite Strategy)

Bond yields continue to remain at depressed levels and, in our view, do not reflect the synchronised global growth recovery and monetary policy normalisation which is underway. Although there are some divergences between central bank policies, markets appear to remain too complacent in assessing their policies in our view especially if inflation should surprise on the upside prompting a more aggressive policy action.

We hold a negative stance on Portfolio duration primarily on short-dated maturities in core Europe and U.S, where valuations appear most stretched and most susceptible to rising rates. We are more constructive on Eurozone peripherals given their attractive carry over core bonds and support through ECB purchases. The recent re-rating of some countries such as Italy and Portugal is also a positive factor.

We also maintain some inflation-linked strategies, which are expected to benefit from a gradual pick-up in inflation as central banks scale back on their monetary stimulus programmes. Upward pressure on commodity prices from rising global demand and tighter labour markets may also be a driver of inflation in 2018. We also hold limited exposure to relative value yield curve strategies, for instance a Swedish 2-10 Year flattener expected to benefit from a potential policy shift by the Swedish Central Bank.

On spread strategies, we hold a positive outlook on EM debt (primarily hard currency). We note that spreads have been under pressure more recently, given Venezuela's sovereign debt default and tensions in North Korea and the Middle East. We believe that contagion should be mitigated, helped by improving fundamentals at both macro and corporate level as reflected in current account surpluses and healthy margins. Moving into 2018, we expect spreads to widen further due to headwinds from rising U.S. interest rates. However, given the divergence between economies we prefer to remain selective and focused on quality, maintaining a preference to EMs with stronger fiscal positions, credible reform agendas and relatively attractive valuations.

We remain constructive on credit due to improving corporate fundamentals and a positive macro backdrop, which may continue to attract flows from yield seeking investors despite stretched valuations. However, a synchronised normalisation of central bank policies is expected to reduce liquidity, thus resulting in wider spreads particularly in the most crowded sectors. Hence, we maintain hedges on spread duration and remain selective through a focus on quality and liquidity. In our view, credit spreads in the U.S. appear more stretched than Europe for both IG and HY sectors. European credits offer attractive risk adjusted returns given the support from ECB's corporate purchase programme and lower levels of leverage relative to the U.S. Hence, our positioning remains biased to European IG.

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We believe, the macro backdrop of consolidating growth and subdued inflation should benefit equities more than credit, especially HY. The positive economic momentum should be supportive for a continued pick-up in global earnings growth and a re-start in capital expenditure. However, we acknowledge that the equity market has had a strong run in 2017 while investor complacency has remained high, making the market susceptible to spikes in volatility. Hence, from an asset allocation perspective, we prefer to reduce equity risk exposure through hedges. We maintain volatility management strategies across equity markets while from a selection perspective, we remain more focused on idiosyncratic opportunities through a selective positioning in countries and sectors.

In terms of regions, we prefer Europe, Japan and select EMs due to attractive fundamentals and relative valuations. European and EM companies can offer higher earnings growth prospects fuelled by higher margins from improved productivity rather than by share buybacks. Japanese companies should benefit from a weak Yen and the Bank of Japan's (BOJ's) equity purchase programme. In the U.S, we seek idiosyncratic opportunities which may benefit from the reflationary boost from the tax bill.

On currencies, we hold a reduced exposure to the U.S. Dollar in favour of the Euro, which we believe will benefit from a solid recovery in the Eurozone and a less accommodative ECB. We remain short on Sterling versus the U.S. Dollar and Euro due to continued political uncertainty in the UK and short Australian Dollar versus the Euro. The former has been under pressure recently due to a bearish outlook on Australian interest due to inflation undershooting central bank and market expectations. We maintain a limited long EM exposure (Indian Rupee, Turkish Lira) versus U.S. Dollar.

To seek risk diversification[2] and benefit from a reflationary scenario, we maintain several relative value and asymmetric equity strategies within Satellites. For instance, to increase the reflationary bias in the Portfolio, we hold a long positioning in U.S. Financials vs U.S. Utilities. We also hold a commodity basket, consisting of energy, agricultural, precious and base metals to diversify risk further. Finally, we are exposed to an income-generating fund with a reflationary focus. Its objective is to generate income expected to grow with global inflation by investing in real economy sectors such as infrastructure, agriculture, REITs, etc.

Macro Hedging

We maintain partial hedges on duration (in U.S. and Europe), spread duration (European IG and EM sovereign) and equity (via option spread strategies on U.S, Europe, Japan and EM) to hedge against global geopolitical uncertainty. We also maintain volatility management strategies on European rates aiming to benefit from a pick-up in volatility.

Security Selection

In terms of equity sectors, we hold a tilt to pro-cyclical sectors where earnings growth has been encouraging such as Financials, Consumer Discretionary and Energy balanced across Europe and U.S. primarily. On the other hand, we hold limited exposure to bond-proxy sectors such as Telecommunications and Utilities, which may suffer in an environment of rising yields.

Within credit, we hold a majority of our exposure in the crossover area (BBB+ to BB ratings). Lower default expectations amid improving fundamentals makes positioning attractive despite tight spreads. We maintain a tilt to European IG and selective Lower Tier 2 and AT1 credits, which are preferable for their carry and relatively attractive valuations. We took profit on select so-called "rising stars", which gained on rating upgrades into IG and were selectively adding names, which came under pressure lately.

Outlook

A backdrop of consolidating global growth, subdued inflation and gradually normalising central bank monetary policies should, in our view, drive a smooth transition from a reflationary phase into a late phase of the market cycle. An anticipated revival in reflationary fiscal policies, global trade and capex activity can also provide further support to markets, particularly equities in 2018.

On the other hand, cross-asset valuations appear stretched and investor complacency remains high despite persistent geopolitical risks. An unexpected pick-up in inflationary pressures prompting aggressive policy action from central banks could cause volatility to spike suddenly, especially in rates markets. Against this backdrop, we expect directional opportunities to be less appealing and rotations across assets, sectors and styles to be in flavour in 2018.

We are positioned in risk assets with a bias to equities over credit but remain active in our asset allocation for the aforementioned reasons. We focus on being relatively positioned at country, sector and security level to seek pockets of value. On a positive note, global corporate earnings results have been encouraging in 2017 with companies revising up their

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earnings forecasts. Based on our projections, we expect global EPS growth to consolidate around 10% on average.

In 2017, we have already decreased risk exposure by reducing exposure to the most crowded areas of the market, such as momentum driven trades and lower quality credit, which in our view is susceptible to heightened liquidity risks from a sudden reversal in investor flows. We also maintain hedges through option strategies but also through low correlated assets such as gold to mitigate potential losses in case of a market correction.

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[2]Diversification does not guarantee a profit or protect against a loss

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