LIQUID ALTERNATIVES

Pioneer Funds – Absolute Return European Equity

True Market Neutrality Complemented by Diversification of Manager Risk

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Pioneer Funds – Absolute Return European Equity:
True Market Neutrality Complemented by Diversification of Manager Risk

Today's environment of lower returns and higher volatility has led investors to seek alternative uncorrelated sources of return for their portfolios. In this context, Pioneer Funds – Absolute Return European Equity (the Portfolio) is a "pure alpha" Portfolio, which seeks market neutrality by focusing on alpha and eliminating beta.

This product not only seeks to isolate alpha for investors, but also seeks to address the two dominant concerns we hear from absolute return investors; 1) Increased Manager Risk and 2) Drawdown Risk.

INCREASED MANAGER RISK → SOLUTION: Dilute this risk through multiple Alpha Sources

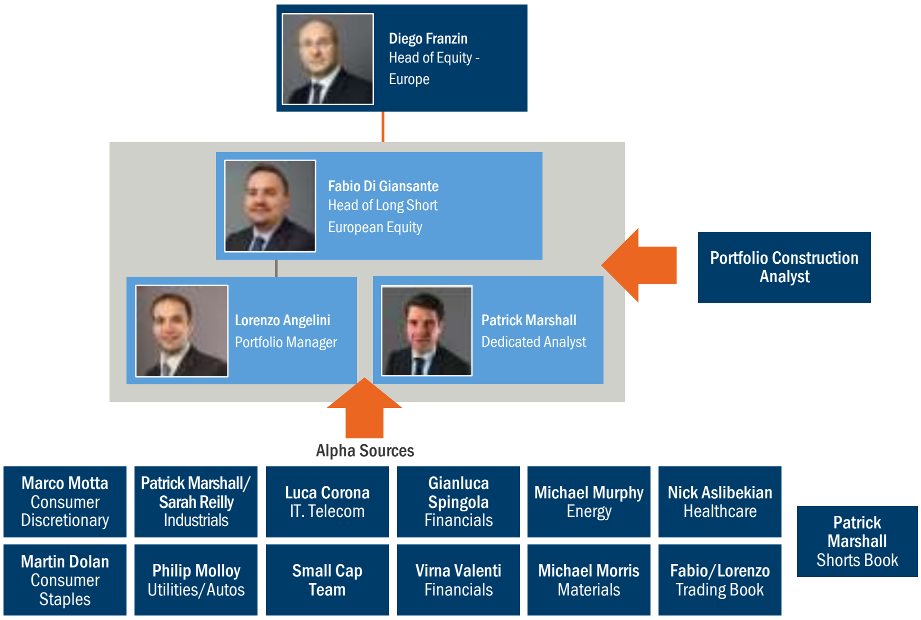
DRAWDOWN RISK → SOLUTION: Aims to protect the Alpha through multiple layers of Drawdown Management

1. Addressing Manager Risk:
   A key risk for investors in Absolute Return is that by eliminating beta, you can immediately increase your manager risk; that is - the sole delivery of returns is now from manager skill and their ability to deliver consistent alpha generation. Typically, in a market neutral or in fact long/short product, the teams consists of a small group of people, covering the entire universe and seeking to deliver independent alpha in all market environments. We have taken steps to address this concern for investors. In our Portfolio, we dilute that perceived higher manager risk (without diluting potential return) by having 13 alpha sleeves and (including small cap) 18 risk takers.

2. Addressing Drawdown Risk:
   The second concern for Absolute Return investors is the risk of drawdown. Investors fret that, not only will a manager fail to deliver returns, but will deliver negative returns. We have sought to mitigate some of this risk through a multi-layered risk management framework, working closely with the Portfolio Construction team. Risk management is applied at different levels of the Portfolio – single stock, alpha sleeve level and total portfolio level – with the ultimate goal of containing drawdown.

Investment Process

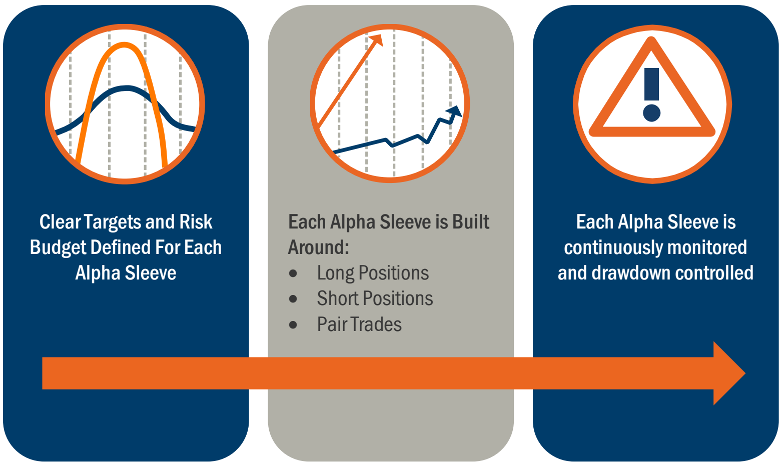
The investment process is built on the proven integrated approach of the European Equity team.



Source: Pioneer Investments as at September 2016.

As is consistent with the overall Pioneer Investments' European Equity investment process, the investment approach is bottom-up and research driven, in which each participant plays an active role. We believe focusing on stock selection, both long and short, is the key to long-term outperformance. Three groups of specialists work together as an integrated team to create ideas and build the Portfolio – Portfolio Managers, Sector Analysts and the Portfolio Construction team.

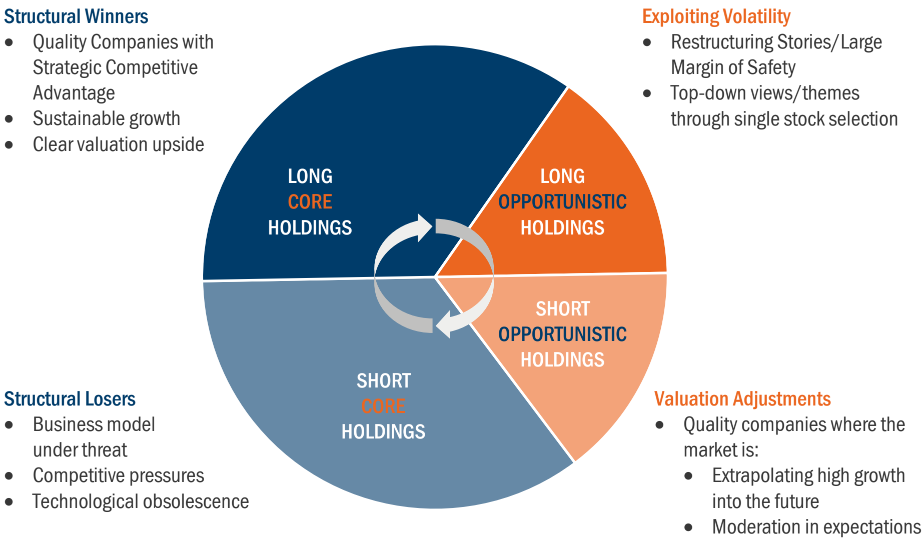
3 Step Process in Which Every Team Member Influences Performance



The Portfolio is constructed by creating alpha sleeves, which are focused on each sector in the European equity universe. Each Alpha Sleeve is allocated clear performance targets and risk budgets, and the Sector Analyst works with the Portfolio Managers to construct a sector portfolio or alpha sleeve that can consist of absolute long positions, absolute short positions and pair trades with the definitive aim of generating alpha and eliminating beta (or market direction). Additional alpha sleeves, such as an allocation to Small-Cap are also adopted, seeking further uncorrelated sources of alpha and to achieve greater diversification[1] of alpha sources. The Portfolio does not have a benchmark, but seeks to deliver returns in excess of Eonia +5-6%, gross of fees, over a rolling three-year period[2]. The Portfolio Construction team monitor the risk and performance, as well as any drawdown in an alpha sleeve. Any drawdown will result in an automatic meeting with the team, which allows the team to discuss immediately and take action to try to prevent the drawdown of an individual alpha sleeve becoming a performance issue for the rest of the Portfolio.

Investment Framework for Building a Long/Short Portfolio

By focusing on the fundamentals of companies within the universe, the investment team seek to generate both long and short ideas. Building on their existing proven stock-picking capability, the investment team have sought to create a framework for defining core and opportunistic investment ideas – both long and short.



Part of the aim of a market neutral portfolio is to eliminate beta and any thematic skew. That said, there are a number of identifiable trends in the Portfolio, which are borne out of our continued focus on idiosyncratic investment cases. Although the Portfolio is divided into 13 alpha sleeves (which exhibit low correlation to each other), some commonality in approach exists. Across the entire Portfolio, ideas typically fall into three different categories, with each built around a shared view of fundamental medium-term investing.

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[1] Diversification does not ensure profit or protect against loss.
[2] The performance target can be exceeded or undershot and should not be construed as an assurance or guarantee.

Core holdings tend to be Structural Winners within their market.

Long Positions – Structural Winners and Restructuring Stories

On the long side, Core holdings tend to be Structural Winners within their market and characterised by three specific criteria:

- Quality
- Growth
- Valuation

Firstly, we look for companies (which by virtue of their defendable competitive advantage and the quality of the management team) have the ability to deliver outperformance over the medium to long-term. Secondly, we want companies to be targeting and have the ability to deliver mid to high single-digit growth. Finally, we focus on the valuation of the company. In particular, we focus on return on capital employed in an attempt to ascertain whether the company's ability to create value is under-priced by the market.

Restructuring Stories have formed a large part of the opportunistic element.

Opportunistic holdings are more short term in nature and seek to exploit a theme in the market, which the investment team believe has been mispriced. As a result, these holdings make up a smaller percentage of the Portfolio and have a shorter investment horizon. Therefore, unlike the core holdings (for which the three criteria above need to be satisfied), we typically insist on just two for the opportunistic holdings. For example, in 2015 and 2016, Restructuring Stories have formed a large part of the opportunistic element. Recognising that valuations are fuller, we are actively seeking investment cases whereby management action can unlock value for investors, through focusing on costs reduction or other self-help initiatives internally.

Disruption forms the cornerstone of absolute short positions.

Short Positions

Disruption forms the cornerstone of absolute short positions. This can come in many forms: new technologies and changes in consumer tastes may be distorting the competitive landscape. We recognise that new technologies in every sector could change the way business is conducted at a rapid pace. Barriers to entry (which were once in place), will be distorted by new entrants, existing companies that may feel the threat of new forms of distribution (online) and substitute products. This will permanently change the earnings power of some companies who are currently market leaders. Core short positions will be most exposed to this more structural shift. Some simple examples are:

- How will online shopping affect traditional retailers?
- How will new technologies impact existing products?

Similar to our absolute long positions, these investment cases require an investment of time to identify the business models that are under threat, and ultimately patience. Our experience has taught us that we are typically a number of quarters ahead of the market when selecting these investment cases. These companies are not short-term trades, but high conviction positions, which we believe can deliver meaningful alpha over the medium term.

Pair Trades

Pair trades are only placed in the Portfolio where we believe companies to be natural or pure peers. Typically, these represent peers in the same sector, where the business model is similar but the strategy or execution of the business is different and has therefore, created a gap in terms of valuation. Pair trades are usually a mean reversion play and represent an efficient manner to hedge systematic risk in the Portfolio.

Positioning and Performance in 2016

Fundamentals have not been the dominant driver of returns in 2016, impeding the market neutral category in general from delivering positive returns. That said, we have suffered less than others during this period. Looking back, we can identify the key drivers in 2016 as follows:

1. Stock Selection – what has worked

   Despite delivering a negative return YTD, this disguises somewhat the positive returns that have been generated in the Portfolio. Seven of the thirteen alpha sleeves are in positive territory, albeit some more than others. This has highlighted the ability of the team to generate alpha, even in market conditions such as those experienced this year. Of particular note, given their performance are the alpha sleeves in Consumer Discretionary, Information Technology and Banks.

   Consumer Discretionary and IT have both generated alpha across both long and short positions.

   Consumer Discretionary has delivered alpha in all two components of the alpha sleeve: Absolute longs, absolute shorts. For example, on the long side, WPP (the international advertising firm and a structural winner in its market) has continued to deliver strong organic growth and margin expansion pushing the share price higher. This has been complemented by a short position in a U.K. retailer, which we believe will face some headwinds due to the migration of customers towards online competitors. This position was closed earlier in the year after good performance and we recently re-opened as we believe further downside exists.

   Similarly, in Information Technology, we have generated alpha across multiple components of the sleeve. Long positions, like ASML, have been standout performers. The company is a clear leader in its space and continues to report robust results with both EBIT and EPS growth ahead of expectations. In addition, considerable performance came from an absolute short position in a payment solutions company. The investment case is predicated on slowing growth and greater competition in growth markets was confirmed after the company warned in Q2. We took profits on half of the position, believing further downside exists but also managing risk in the position.

   Concentrating our efforts on pair trades due to the volatility of the Banking Sector.

   Finally, given the volatility of the Banking sector this year, we decided to concentrate most of our efforts on pair trades. We believe this was a way to exploit the opportunities that come with higher volatility without exposing the Portfolio to the indiscriminate selling and subsequent rebounds that the sector has experienced this year. Two pair trades in particular, one in Italy and one in Spain, delivered the majority of this performance.

2. Managing the Gross Exposure

   The number of external events in the marketplace this year, whether economic or more commonly political, have led the Portfolio Management team to be more cognisant than normal of the level of gross exposure we are running in the Portfolio. While our main aim at all times is alpha generation (given the absolute return nature of the Portfolio), capital preservation must remain a focus to meet investors needs and protect the longer-term performance of the Portfolio. As a result, the decision was taken (on more than one occasion this year) to reduce the gross, believing it was the best method to contain drawdown during periods of extreme volatility. For example, in the days leading up to Brexit, the decision was taken to reduce the gross back towards 100%, believing this would insulate the Portfolio somewhat in the event of a surge in volatility. This choice led to more contained drawdown in the days following Brexit (c.70bps). In fact, we quickly gained performance back as markets settled, indicating that we were not exposed to either side of the Brexit result. We found this result pleasing, given the focus on eliminating beta and any underlying skew that was demonstrated, in what was a completely unexpected outcome.

That said, while we are content with the containment of drawdown in the Portfolio this year (in line with our process), reducing the gross also reduces the alpha potential of the Portfolio in the short term. This is something we are comfortable with for only short periods of time.

3. Stock Selection – what has not worked

   Not all positions have delivered for the Portfolio this year. While this is in line with our expectations, two short positions have caused a greater drag on performance than anticipated and jointly account for 200bps of negative performance. These are investment cases that have been re-visited on a number of occasions this year, and in truth, where our conviction over the medium-term remains strong.

   The market tested our conviction again in early October, and at this point, we decided to take greater action. The short in Materials was covered in the Portfolio, as ultimately we had no visibility on when new capacity (the primary driver of the investment case) would come on stream, increasing pricing pressure.

   Reluctantly we have also closed the short position in Consumer Staples. We have evidence that the key disruptor in their market has intentions to increase its presence and we believe the investment case will play out, but unfortunately, in the short-term at least, the position could cause further performance issues. Therefore, we have closed it and will seek, another entry point when the catalysts are cleaner.

   We recognize in hindsight that we should have taken a more pragmatic approach and reduced the positions to limit continued drag at an earlier point, even though it may have limited the upside somewhat.

Outlook

Looking forward, we believe the market will remain as problematic as it has been to date this year, with market rotations and volatility leaving less of a focus on fundamentals as a near-term driver of returns. Taking a more medium-term view, we believe fundamentals will again start to drive returns for equity investors and that focusing on these three areas will allow us to identify sources of alpha to deliver absolute returns for our investors. Over the medium term, we have faith in our ability to deliver on our mandate of uncorrelated absolute returns with low levels of volatility.

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Date of First Use: 17 November 2016