View from the 20th Floor

Pioneer Funds – Absolute Return Multi-Strategy
31 October 2017

MULTI-STRATEGY COMMENTARY

"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing"

– Chuck Prince, Citigroup CEO & Chairman, 2007

PERSPECTIVE

Have you ever wondered what the connection is between Wile E. Coyote (the cartoon character that was forever chasing Road Runner in the *Looney Tunes* series of cartoons) and the American economics professor Hyman Minsky? In our ongoing attempts to "inform, educate and amuse" our readers about the team's thoughts and positioning we'll explain the amusing link later in this month's newsletter, but first we'll cover the "inform and educate" part.

Fixed Income fulfils four key roles

Historically, fixed income securities have fulfilled four important roles in an investment portfolio – they provide an income stream (via coupon payments); they provide an element of capital stability (an investor receives a bond's principal at maturity); they are traditionally a very liquid instrument (especially government bonds); and finally, bonds are often seen as providing diversification to equities, and thus can lower the volatility of a balanced portfolio. This is because bonds have generally moved in the opposite direction (or had a negative correlation) with equities, and movements in bond prices tend to be much less volatile than those of equity prices.

QE programmes may have changed the reaction functions of fixed income and equities

Over the last three years, the Absolute Return Multi-Asset team's exposure to equities, credit risk, duration, and FX exposure has been quite dynamic. On average, we have balanced our "risky" asset exposure (equities, and to a lesser extent, credit) by maintaining a long duration and long U.S. Dollar exposure. The rationale behind this positioning was that any sell-off in risky assets would lead to a "flight to quality" into sovereign bonds and the U.S. Dollar, both of which are seen as "safe-haven" assets in times of turmoil and/or volatility. However, in recent years the actions of global central banks and their bond-buying programmes meant that this negative correlation between the price action in risky assets and bonds has almost completely turned around, and fixed income now tends to be positively correlated with risky assets.
Good economic news is taken as a sign that less monetary stimulus is needed, which is bad for bonds. However a rise in bond yields will pressure equity valuations, so equity markets may also react unfavourably to good economic news. On the contrary, bad economic news prolongs the Quantitative Easing programmes, and keeps bond yields lower, which also supports equity valuations. Based on our internal analysis and empirical observations, we increasingly suspect that fixed income (and particularly developed markets sovereign bonds) will be a source of risk in the near future, rather than a source of diversification and dampening volatility.

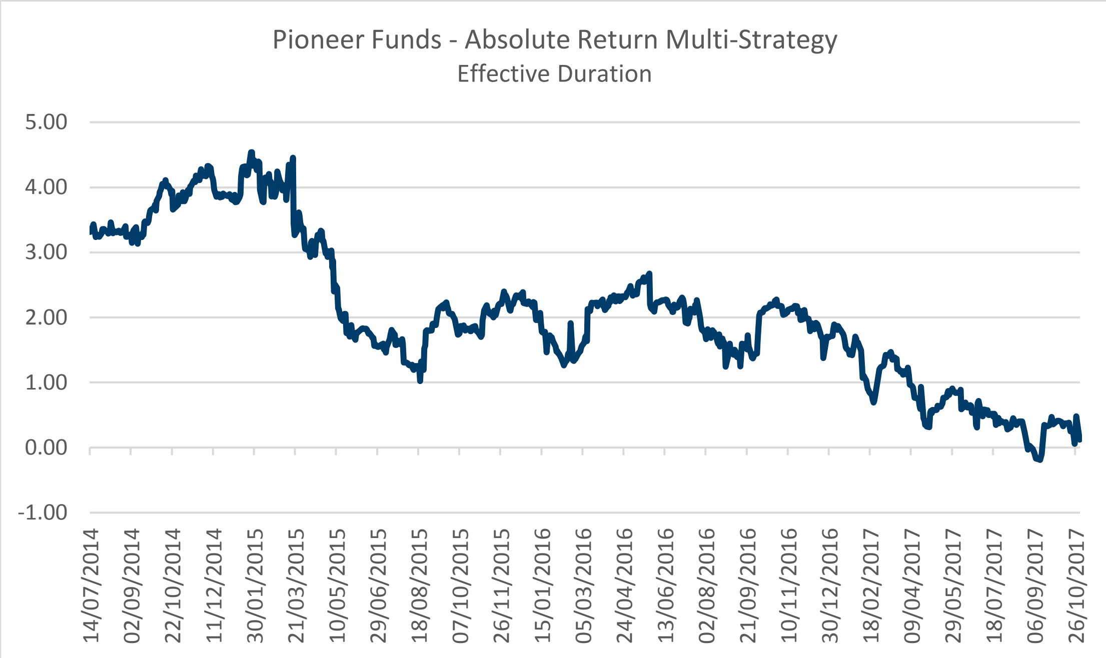
Over the past two years, many investors have called the end of the 30-year bull market in bonds. Investors have suggested many reasons for the long-lasting low-yield environment, with the "secular stagnation" argument (originally put forward by economist Alvin Hansen in the 1930's) being dusted down and brought back to the public's attention by Larry Summers. In this view, the economies of the industrial world suffer from an imbalance; caused by an increasing propensity to save, and a decreasing propensity to invest. Excessive savings act as a drag on demand, reducing growth and inflation, and ultimately, real interest rates.

We believe there is a real risk of a cyclical pick-up in inflation, in which case central banks will, to paraphrase Warren Buffet, be caught swimming naked when the tide goes out.

Amundi ASSET MANAGEMENT

Fixed Income is increasingly becoming a source of risk

If our view is right, global central banks will be forced to increase rates more rapidly than markets are currently discounting, with all the negative consequences that this entails. So for this reason, we do not rely on duration as a diversifier, but rather we see it as a potential source of risk as opposed to a source of risk mitigation. In recent months, our overall duration exposure has tactically fluctuated around zero, and we currently see little reason to expect a change in this stance over coming months.



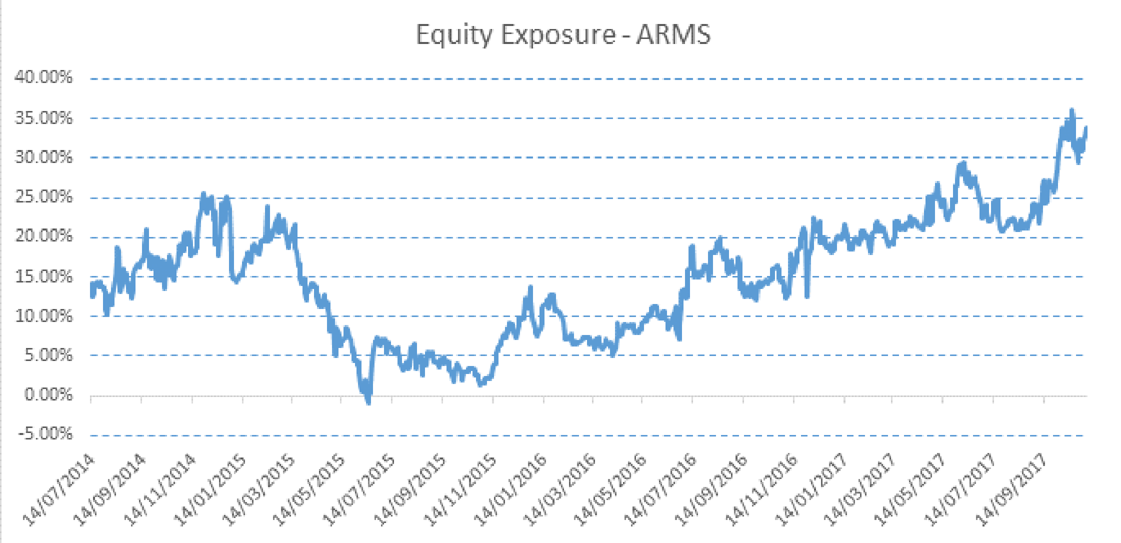
Likewise with our U.S. Dollar exposure, which so far in 2017 has not worked well as a diversifying asset. We continue to believe that it may act as a source of diversification in the case of “tail events”, such as an Emerging Markets (EM) correction. As such, our overweight U.S. Dollar exposure also acts as a natural hedge against our overweight EM equity and credit positions. However, we have reduced our long U.S. Dollar position below 10%, and we plan to keep it structurally lower than in the past.

Credit is another class where we worry about valuations. We think that the risks to the credit markets are asymmetric in terms of return profiles. The more that credit spreads compress, the lower the potential returns can be, whilst the higher the potential drawdown if yields rise and/or spreads widen. For an Absolute Return Portfolio this is a vitally important point, as we are always trying to minimise drawdowns.

Finally, that leads us to Equities, which is now our preferred asset class. Given the low levels of implied volatility, we have been able to reduce our direct investment in cash equities and substitute it with option exposure. In doing so, we have managed to incorporate a significant degree of convexity in our Portfolio. Last month, we wrote that the low level of overall equity market volatility masked larger underlying sectoral volatility, and this option exposure also compensates for the lower level of diversification based on these low correlations.

We remain comfortable with our current equity weighting

Overall, we are currently running a different asset allocation stance when compared to the last three years. However, for all the reasons explained above, we remain comfortable running equity exposure just above 30% (in delta-adjusted notional terms), and a very low (sometimes negative) duration stance.



Hyman Minsky's theory that stability leads to instability

So back to our connection between Wile E. Coyote and Hyman Minsky. Minsky explained how apparent stability in the economy and financial markets can lead to speculative investment bubbles, which subsequently burst and cause the economy to contract. He identified 3 types of borrowers that contribute to the accumulation of insolvent debt – (a) Hedge Borrower, who can cover both interest and principal payments from current cash flows; (b) Speculative Borrower, who can only service interest payments from current cash flows, and has to regularly refinance the principal; and (c) Ponzi Borrower, who is relying on the price of the asset appreciating sufficiently to allow refinancing of the debt. But if the asset price stops appreciating (or even depreciates), then the Ponzi borrower defaults and this causes lenders to become more circumspect. This in turn affects the ability of the Speculative Borrower to refinance his principal (even if he can cover interest payments). Finally, the collapse of Speculative Borrowers causes the financial system to seize up, and even the Hedge Borrower is unable to find anyone to lend to him. So when Ponzi Borrowers are the dominant form of borrowers or investors, it usually signals trouble for a financial system. And what allows Ponzi Borrowers to flourish? Benign financial markets, with plentiful credit and appreciating asset prices.

"Minsky Moment"

A "Minsky Moment" is a sudden collapse in asset values, which occurs because long periods of prosperity and ever-increasing asset values lead to increasing speculation using borrowed money. The term was famously used by then-PIMCO economist Paul McCulley, to explain the Russian Financial Crisis of 1998 and was widely used to describe the sub-prime debt crisis that contributed to the Global Financial Crisis of 2008. Another way to think of a "Minsky Moment" is to think of Wile E. Coyote, who in pursuit of his nemesis Road Runner, would run off a cliff and hang in mid-air for a second or two - feet furiously peddling, before plunging downwards as gravity eventually won out.

To confirm, we are not predicting another global crisis or anything like that; however, we did notice recently that the Chinese Central Bank governor warned that the country faced a possible "Minsky Moment", as a result of excessive debt and speculative investment. The extraordinarily low levels of volatility seen in today's markets might also be considered to be a candidate for experiencing a "Minsky Moment".

We remain cautious

We use the "Minsky Moment" reference to once again reinforce our message that in overall terms, we continue to adopt a cautious approach, believing that many markets and asset classes are fully valued. The levels of risk we are running in the Portfolio remain low compared to historic averages. Our position is that we will resist the temptation to increase carry exposure in our Portfolio, as our absolute return approach means that protection of our clients' capital is

	a priority. We will do this by focusing on managing Portfolio risk, while opportunistically seeking returns.
PERFORMANCE	
Good month for Equities	Equities enjoyed a positive month, helped by the news of continued good economic momentum, low inflation, and signals from central banks that the road to normalisation of monetary policy should be long and slow. Earnings per share and dividend growth mostly met or exceeded expectations, with bell-weather stocks like Caterpillar (often seen as a proxy for global economic conditions) reporting strong growth across all market segments. Central banks were again at the forefront of investors' minds, whether it was discussing who the new U.S. Federal Reserve Chairperson is likely to be, or whether the ECB will taper more quickly or more slowly than the market expects. As always, geopolitical concerns appeared to cause much discussion amongst investors (especially as the Catalan situation developed) but didn't actually lead to much reduction of positions, or any flight to safety. The S&P500 returned 2.33% during October, with earnings growth the main driver of performance. The S&P has now seen a positive total return for all 10 months so far this year, the first time that this has happened in the last 90 years. GDP numbers were strong, but the monthly payroll numbers exhibited some effects from Hurricane Irma and Storm Brian, although average hourly earnings did hint at some strengthening in wage pressures. At various stages throughout the month, certain candidates became favourite for the role of replacing Janet Yellen as U.S. Federal Reserve Chairperson, but towards month-end opinion seemed to focus on Jerome Powell. Powell is considered to represent a continuation of existing Fed policies, and unlikely to surprise markets. Likewise in Europe, where the Euro Stoxx 50 advanced 2.27%, against the back-drop of strong economic growth. Q3 2017 Eurozone GDP was reported at an annualised rate of 2.5%, the strongest growth rate since Q1 2011. With inflation surprising to the downside (again), it was hardly a surprise that the ECB signalled a "recalibration" of their bond-buying programme, cutting monthly purchases from the current €60bn to €30bn starting in January 2018, but extending the programme to September 2018. The Japanese Topix Index put in the best performance of the major markets, rising over 5% as incumbent Prime Minister Abe was returning to power in national elections. This signals a likely extension of "Abenomics", which the market views favourably and should lead to a weaker Japanese Yen - again good for the export part of the index. Emerging Markets equities, as measured by the MSCI EM Index, again performed well, rising by 3.51% in USD terms. The projected slow pace of U.S. rate hikes is helping sentiment in the EM regions.
Bond Markets mixed	Bond markets had a topsy-turvy month, with yields rising during the first half of the month before falling back again to finish the month broadly unchanged. Market-specific factors were the main drivers of the major markets – U.S. 10-year yields rose 5bps in October to 2.38%, as expectations of a tax package grew; whilst 10-year German yields actually fell 10bps to 0.36%, as the ECB's bond buying programme was extended for longer than expected. Despite higher inflation prints and a strong hint that U.K. rates will rise by 25bps in November, U.K. 10-year yields fell 3bps to 1.33%. In EMs, the JP Morgan Emerging Markets Bond Index was almost unchanged throughout October, finishing the month 0.1% lower.
Credit performed well	Investment-Grade credit performed strongly during October, with the Euro Investment Grade iTraxx Main index falling 7bps to 50bps, approaching levels not seen since the start of the Global Financial Crisis in early 2008. Top-performing sectors were Insurance, Automotive, and Wirelines; whilst the underperforming sectors were Finance Companies, Pharmaceuticals, and Construction Machinery. High yield kept pace with Investment Grade, and the iTraxx Crossover Index of High Yield credit fell 28bps to 224bps.

U.S. Dollar had a good month

Most Commodities had a strong month with the CRB Index rising 2.4%, mainly driven by a continued strong rebound in the oil price. West Texas Intermediate finished October up 5.2%, and has now risen over 8% in the last 3 months. As seen in previous months, Brent outperformed - rising 7.8%, and being up 16.8% over the last 3 months. Copper sustained its recent strong run and rose 6% in October, and is now up 23.4% year-to-date as strong Chinese demand boosts prices.

Finally, the Dollar managed to break its recent run of losses and appreciated during October. The Dollar Index (a trade-weighted basket of currencies against the U.S. Dollar) rose 1.59% during the month, whilst other crosses also reflected U.S. Dollar strength. The EUR/USD rate moved from 1.1815 to 1.1645, whilst the USD/JPY rate moved from 112.50 to 113.65. The Euro lost a bit of ground against the British Pound, which was supported by the likelihood of higher interest rates; whilst the Swiss Franc was probably the biggest loser of the major currencies, reversing some of its out-performance during September. EM currencies gave back some of their recent gains, with the JP Morgan Emerging Markets Currency Index falling 1.9% in October. We noted last month that many investors are underweight the Euro, and that this could support the Euro. Recent data showing a positive current account balance averaging €30bn per month may also act as a long-term support for the currency.

Figure 3
Market Performance in October 2017

Equities	Return (%)	Fixed Income	Return (%)
MSCI World Index - Daily, TR, Net USD	1.89%	JPM GBI EMU 3-5 Years - Local	0.40%
S&P 500 TR Index	2.33%	JPM GBI EMU 5-7 Years - Local	0.80%
EURO STOXX 50 NR Index	2.27%	JPM Emerging Markets Bond Index	-0.13%
FTSE 100 TR Index	1.82%	**Fixed Income - Corporate**	**Spread**
DAX TR Index	3.12%	iTraxx Europe Main Generic 5yr	-6.6bps
FTSE MIB NR Index	0.43%	iTraxx Europe Xover Generic 5yr	-28bps
Topix NR Index	5.45%	**FX**	**Return (%)**
MSCI Emerging Markets - Daily, TR, Net USD	3.51%	EUR/USD Spot	-1.42%
Commodities	**Return (%)**	EUR/GBP Spot	-0.60%
TR/CC CRB (Commodity Futures Index)	2.44%	EUR/JPY Spot	-0.44%
Oil - West Texas	5.24%	EUR/CHF Spot	1.55%
Oil – Brent	7.80%	US Dollar Index Spot	1.59%
Gold Spot	-0.71%	JPM EM Currency Index	-1.90%
Copper Spot	5.98%		

Source: Bloomberg as at 31 October 2017.

The Portfolio delivered a positive return in October 2017

Figure 4
Portfolio performance to 31 October 2017

	October	YTD
Pioneer Funds – Absolute Return Multi-Strategy - "A" Class	0.70%	1.89%

Source: Amundi Asset Management as at 31 October 2017, Class A EUR ND net of fees.

Monthly Performance Summary

Figure 5

Strategy Performance

Strategy Group	31/10/2017	30/09/2017	31/08/2017	31/07/2017
Macro	0.73%	0.70%	0.43%	0.23%
Macro – Hedging	-0.08%	-0.16%	-0.12%	-0.16%
Satellite – Comm & Inflat	0.01%	0.13%	-0.05%	0.01%
Satellite – Equity	0.18%	-0.03%	0.21%	0.24%
Satellite – FI	0.04%	0.23%	-0.11%	-0.10%
Satellite – FX	-0.12%	-0.03%	0.12%	0.09%
Satellite – Quant Models	-0.02%	-0.08%	0.04%	-0.04%
Satellite – Spread	0.02%	-0.09%	0.01%	0.08%
Selection – Spread	0.04%	-0.03%	-0.02%	0.10%
Grand Total	0.80%	0.64%	0.53%	0.45%

Source: Amundi Asset Management. Data as at 31 October 2017. Data is sourced internally and quoted gross of fees.

October Performance Contribution

- The **Macro Strategy** delivered the bulk of the outperformance in October 2017, with our **Thematic Equity** strategies performing strongly - generating 53bps of return. Given the strong reporting season in the Technology space, and with Tech having been the best sector contributor on all the market indices, it's no surprise that our **Internet of Things** basket did particularly well in the month. This is a basket of technology leaders linked to the Internet of Things - primarily in the U.S, Japan and South-East Asia (Taiwan, South Korea & China). Another two of our **Thematic Equity** strategies, **Robotics** (a selection of stocks operating in the Robotics & Automation fields, and a long/short position in U.S. versus European industrials via futures) and **Japanese Reflation** (a basket of Japanese and Chinese banks, and futures on the Japanese banking sector) also made strong contributions.

- Within the Satellites space, the best performing strategies were: **Trading ST2** (+10bps), which contains long trading positions in the Taiwanese market via futures, and on the Dow Jones Industrial Average via call options; **U.S. Opportunities** (+7bps), a selection of U.S. stocks hedged against the broader U.S. market; and **U.S. / European Sectors** (+3bps), a strategy of sector-based relative value plays, implemented by futures. This strategy currently features a long U.S. Financials, Energy, Technology and Industrials vs short U.S. Staples, Utilities and Real Estate; which in essence, is a wager on higher rates, strong fundamentals and momentum for Tech stocks, and a tactical rebound in Energy.

- On the downside, our **Satellite – FX** strategy was the largest overall contributor to negative performance, driven by our **long EM Currencies strategy**. With the U.S. Dollar recovering somewhat, and a sell-off in U.S. bond yields early in October - EM currencies were under some pressure.

- Another significant drag on performance was our **Macro Hedging** pillar; as equity, bond, and FX volatility remain muted. Within the Macro Hedging pillar, it was our **Equity Volatility hedge** that underperformed the most, followed by our **Investment Grade iTraxx Main** position, where we are hedging against a widening in credit spreads. We view the Macro Hedging pillar similar to an "insurance policy" for which we pay a premium. We expect that this Investment Pillar should help to protect the Portfolio during periods of market turbulence.

Best Performing Strategies in October

Figure 6
Best Performing Strategies

Five Best Performing Strategies		
Investment Pillar	**Theme**	**Performance**
Macro Strategy	Internet of Things	0.22%
Macro Strategy	Robotics	0.15%
Macro Strategy	U.S. Equity	0.12%
Satellite – Equity	Trading ST2	0.10%
Macro Strategy	Japanese Reflation	0.10%

Source: Amundi Asset Management. Data as at 31 October 2017. Performance shown gross of fees.

Worst Performing Strategies in October

Figure 7
Worst Performing Strategies

Five Worst Performing Strategies		
Investment Pillar	**Theme**	**Performance**
Satellite – High Yield	Overlay	-0.11%
Macro Strategy	Japanese Equity	-0.09%
Satellite – Relative Value	EM Currencies	-0.07%
Satellite - Curve	EUR Duration	-0.07%
Macro Strategy	Equity Risk Premia	-0.07%

Source: Amundi Asset Management. Data as at 31 October 2017. Performance shown gross of fees.

Long-Term Performance

Figure 8
Portfolio Performance

As at 31 October 2017	1 Month (%)	3 Months (%)	YTD (%)	1 Year (%)	3 Years p.a. (%)	5 Years p.a. (%)	260 Day Vol. (%)	Sharpe Ratio (3Yr)
Pioneer Funds – Absolute Return Multi-Strategy "A" Class	0.70%	1.58%	1.89%	2.40%	2.37%	2.93%	3.32%	1.04

Source: Amundi Asset Management as at 31 October 2017, Class A EUR ND net of fees

Risk Profile

Figure 9
Portfolio Risk

Risk Profile: Pioneer Funds – Absolute Return Multi-Strategy

	31/10/2017	**30/09/2017**	**31/08/2017**	**31/07/2017**	**30/06/2017**
Portfolio VaR:	**3.02%**	**2.84%**	**2.27%**	**2.25%**	**2.11%**
Sum of Standalone risk:	10.84%	10.58%	9,38%	9.62%	9.92%
Diversification benefit*:	7.82%	7.74%	7.11%	7.37%	7.81%

Source: Amundi Asset Management. Data as at 31 October 2017.
* Diversification does not guarantee a profit or protect against a loss.

Summary Asset Allocation

Figure 10
Portfolio Asset Allocation (market value %)

Asset Class	Market Value (%)
Equities	**25.4%**
Fixed Income	**61.1%**
Government Bonds	13.5%
Corporate Bonds	45.0%
Commodities	**4.5%**
Real Estate	**0.5%**
Forex	**-0.6%**
Cash	**9.1%**

Source: Amundi Asset Management. Data as at 31 October 2017.

REVIEW & OUTLOOK

Despite a cautious approach, equity exposure remains high

Equity exposure at the end of October has remained quite elevated when compared to historical levels, at 25% (approximately the same as it was at the end of September). However, the potential exposure may be higher due to our decision to exploit convexity in the Portfolio using optionality. Overall, delta-adjusted equity exposure was as high as 36% during the month, but decreased to around 30% (delta-adjusted) when some of those options expired at month-end, and were replaced with more Out-of-The-Money (OTM) strikes that have a lower delta.

With volatility remaining very low (especially on the upside), we have used this opportunity to buy call options. In addition, with the skew being very rich, we sold some puts and used the premium proceeds to buy a significantly larger number of calls. The current equity exposure of the Portfolio may go up to above 40% in rising markets, but on the downside it goes to 10% rapidly.

Geographically we increased our exposure to Japan (mainly due to a favourable election result for Mr. Abe, which signals a continuation of "Abenomics" and a low interest rate environment, both of which should be positive for Japanese equities) and the U.S. (based on good earning numbers and continued decent economic momentum, while risk adjusted valuations are not expensive and the weaker U.S. Dollar could act as a tailwind), but slightly reduced our European exposure.

Thematic exposure has remained high

As we mentioned last month in the newsletter, Thematic exposure has been increased to above 10% of the Net Asset Value – we feel this pro-growth environment is particularly favourable for long term stories, and removes some of the idiosyncratic risk involved with individual sectors.
On the sector side, we made the following small changes during the month:

- Increased exposure in Energy through both stocks and futures (largest increase was in the U.S.);
- Increased exposure in Financials across regions, mainly through futures;
- Industrials exposure marginally decreased - geographically we increased in the U.S., and decreased in Europe;
- Materials exposure increased across regions, mainly in Europe through stocks and futures;
- Discretionary and Utilities decreased, primarily in the U.S. and Europe (mainly through futures).

Duration of fixed income portfolios remains low

Our fixed income Portfolio continues to run very low levels of duration, as we believe that global bond yields will push higher against a backdrop of better growth - increasing inflation and removal of accommodative monetary policy settings by central banks. The Portfolio duration fluctuated around the zero level and finished the month at 0.12. We are still long on the U.S. curve, (currently 0.14 year duration) but lower than at end-September; and remain neutral on the Euro curve. We retain a bearish bias in the U.K. in light of Brexit and an expected rate increase in November, and currently at -0.24yr short duration. We are also short duration in Japan, where we feel that the Bank of Japan's attempts at yield curve control may be abandoned, leading to a

	rise in Japanese government bond yields. Our views on inflation are unchanged, and in fact, have been reinforced by movement in commodity prices; therefore we have not changed any of our inflation basket positions.
Spread Duration exposure remains low as well	Likewise with our Spread duration, risk is also low. This reflects the team's view that corporate credit valuations are stretched and vulnerable to the removal of the ECB's Quantitative Easing measures. During October, the spread duration of the Portfolio remained fairly steady, finishing the month at 0.35 year. In the Investment Grade space, we are long at approximately 0.5 year, slightly down on end-September's level of 0.6 year. Existing names are diversified in both U.S. Dollars and Euros - with some Floating Rate Notes, and some exposure in the 5-7 year area of the curve. We are somewhat negative on High Yield; we have kept our existing positions, but have increased our hedges to end up with an overall -0.3 year duration. In the EMs we are net long about 0.15 year, but as with our High Yield exposure, we have hedged some of our cash EM exposure (long about 0.40 year) by buying protection - using the Itraxx Crossover index (-0.25 year).
Reduced our long U.S. Dollar position	On the FX and Commodity side, we have again modestly reduced our long U.S. Dollar exposure, acknowledging that it hasn't acted as the diversifier that we thought it would, but also happy to keep the exposure as a hedge against our overweight EM positioning. We are also modestly overweight the Turkish Lira, Japanese Yen, Indonesian Rupiah, Indian Rupee, Swedish Krona and Russian Rouble. As in previous months, we continue to favour a strategy of running long EM FX positions to benefit from the positive carry in the higher yielding currencies, which can often amount to 7%-8% differential against the U.S. Dollar. Against that, we remain short the Omani Rial, Swiss Franc, Taiwanese Dollar and Hungarian Florint.
	In Commodities, we remain long Gold (but more as a hedge against market turmoil and/or geopolitical risk, rather than having a positive view on the metal) and Oil (we expect that the market should rebalance over the rest of 2017 and into 2018, providing some support for the oil price), and some of the industrial metals such as aluminium, platinum and silver. Our Commodity exposure increased marginally to 4.5% by end-October. We are keeping our long volatility positions and hedging structures, as extremely low volatility across the various asset classes belies excessive market complacency vis-à-vis geopolitical risks (e.g. Trump, Brexit). Hence, our Portfolio features ample hedging structures, though preserving a positive carry. In order to minimise the cost of hedging (realised volatility is still lower than implied volatility), we are looking to exploit volatility term structures and skews, such as calendar spreads.
Continue to try and protect the Portfolio	In summary, we maintain our views and are relatively more favourable towards equities versus fixed income on a risk-adjusted basis. We are maintaining a shorter investment horizon; focusing on Satellite Strategies to generate alpha; utilising optionality to protect the Portfolio from "fat tails"; and attempting to take advantage of mispriced opportunities.

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