Monthly Portfolio Update

Pioneer Funds –Strategic Income
31 July 2017

EQUITY

COMMENTARY

Market Review

Fixed income and equity markets enjoyed strong performance over the month in the wake of solid global economic growth, which has contributed to robust quarterly earnings, as well as a benign inflation outlook and relatively less hawkish rhetoric among central bankers. Both Europe and China surprised to the upside: French and German PMIs remained strong and Germany's IFO Business Climate Index reached record levels; China reported second quarter GDP at 6.9%, higher than the 6.8% expectation. U.S. second quarter GDP was solid at 2.6%, and the ISM manufacturing survey held at high levels. CPI reported inflation fell to 1.6%, prompting Yellen to acknowledge a broadening softness of inflation. Most U.S. Treasuries yields fell modestly, although the 30-year yield rose on a slight increase in breakevens.The 10-year Treasury fell from 2.30% to 2.29%. Agency MBS rebounded in July from their June underperformance, delivering strong excess returns of 0.24%, benefiting from low interest rate volatility and greater comfort with the Fed's transparency vis-a-vis the fall timing of the balance sheet taper program. U.S. Investment Grade (IG) corporates continued to grind tighter, with a 0.60% excess return, enjoying strong overseas demand for U.S. Dollar assets and solid profits. The average IG option-adjusted spread now stands near record post-crisis lows, despite higher corporate leverage. High yield returned 1.15%, for a 0.86% excess return, as Energy and Basic Materials sectors rallied on strong global growth and a more positive outlook for oil prices. The U.S. Dollar continued its decline, and was down 2.5%, for a year to date decline of 9.2%, reflecting stronger global growth and lower expectations of U.S fiscal stimulus.

Portfolio Review

The Portfolio outperformed the 0.50%, return of its benchmark, the Bloomberg Barclays U.S. Universal Index, in July.

The Portfolio benefitted primarily from sector allocation, with security selection, relative credit quality, and currency allocation also contributing to performance. Yield curve and duration positioning detracted from performance over the month.

Positive

Portfolio returns benefitted from sector allocation, specifically the 26% underweight to nominal U.S. Treasuries and the 2% allocation to convertibles.

The Portfolio was also helped by security selection within Financials, as subordinated positions of banks continued their strong performance, as well as within Industrials.

The Portfolio benefited from the lower relative credit quality of its holdings.

The proxy currency hedge which is long the Norwegian/Sweden currency and short the Euro contributed to performance as the Norwegian Krone outperformed.

Negative

The barbelled yield curve position detracted from performance, as the yield curve steepened; in particular, the underweight to the 5-year key rate duration and overweight to the 30-year key rate duration hurt performance.

The relative short duration position of approximately 1 year hurt performance, due primarily to the negative carry effect.

Outlook

The U.S. economy may deliver over 2% growth in gross domestic product (GDP) in 2017. While the benefits of Donald Trump's proposed policies of lower taxes and higher infrastructure spending should be realised more in 2018 than in 2017, solid employment may continue to support consumption and the housing market. GDP growth may strengthen through

2017, buoyed by stronger corporate profits that are benefitting from improved global growth, easy financial conditions and lower regulation.
We believe that the markets continue to be "behind the curve" in their views on the appropriate level of interest rates. Although Chairperson Yellen has been less hawkish, and acknowledged concerns about softer inflation, the Fed appears ready to begin balance sheet tapering in the fall. In addition, the Federal Open Market Committee (FOMC) governors have recently focused on rate normalisation as a means to avoid creating asset bubbles.

The U.S. Dollar could depreciate modestly in the near-term, as yield differentials between the U.S. and developed markets narrow. Improving global growth may drive more central banks, including the ECB, to consider withdrawal from quantitative easing policies. In addition, Trump's preference for a lower U.S. Dollar, combined with the three openings on the FOMC, and the potential for more expensive trade, may put a brake on Dollar appreciation.

The Portfolio continues to be positioned for rising interest rates, and a solid economy. It has not made significant changes to its positioning over the past month:

Overweight to credit, underweight to U.S. Treasuries. Most U.S. government debt is unattractive, while credit sectors may benefit from stronger growth, lower taxes, and less regulation.

The Portfolio holds a 1.1-year relative short duration position compared to its benchmark. We believe the market may be behind the curve, given solid GDP growth, little slack in the labour market, and an average 1.5% to 2% inflation over the rest of the year.

We hold long-duration Treasury Inflation Protected Securities (TIPS), and believe the recent decline in breakevens does not accurately reflect the longer-term potential for 2% inflation.

The Portfolio holds a neutral weight in agency MBS, but including the exposure to non-agency MBS, remains significantly overweight to RMBS. We hold this overweight to RMBS because we believe that MBS offer attractive value relative, particularly in comparison to investment grade corporate credit. Fundamentals for the Housing sector remain strong, given improving employment, the recent decline in longer-term rates, and attractive home price affordability.

We believe that non-agency MBS offer attractive value relative to agency MBS, based on long-term price spreads. In particular, CMO 2.0 new issues (issued in 2012 and later), offer very attractive relative value vs. agency MBS. This new issuance represents jumbo prime MBS, of pristine credit quality; indeed we view them as a proxy for agency MBS. The characteristics and performance of CMO 2.0 paper have been exceptional. We do not believe the credit differential between this non-agency segment and agency MBS justifies the current price spread difference of over 1%.

The Portfolio remains underweight to IG corporates, but continues to hold a significant overweight to high yield corporates. Tighter spreads and higher leverage is counterbalanced by strong fundamentals. We have been seeking to add subordinated exposures in European banks, however, given their attractive relative value vs. U.S. banking issues.

Within corporates, we hold an overweight to Financials. We have increased exposure to European banks, and reduced U.S. bank exposure, based on more attractive relative value and the positive outlook for GDP growth in the Eurozone. More generally, we believe the Banking and Insurance sectors offer attractive relative value. While spreads are modestly lower than the broad corporate benchmarks, Financials offer lower event risk of share repurchases or credit impairment due to M&A activity. Banks are currently focused on improving capital ratios to meet regulatory requirements. Banks should also benefit from rising global yields and steepening yield curves.

We continue to hold an overweight to the energy midstream sub-sector, a sector that shows relatively less sensitivity to oil price volatility. We expect continued spread tightening in the space, which remains one of the wider-trading subsectors in IG. While OPEC's extension of production cuts should help offset increased production from U.S. shale producers, we are watching the supply/demand balance carefully.

We believe that the U.S. Dollar could depreciate modestly in 2017, and have recently added select emerging market currency exposures.
The Portfolio includes certain emerging markets exposures, with a preference for countries undertaking important structural reforms, such as India, Indonesia, and Argentina. Emerging Markets are benefitting from the stronger global growth and increased domestic demand.

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