Monthly Portfolio Update

Pioneer Funds – Strategic Income
31 August 2017

EQUITY COMMENTARY

Market Review

Markets delivered mixed performance amid strong global growth, increased geopolitical risk posed by North Korea, and lower confidence in the Trump administration. Global growth surprised to the upside, with annualised second quarter GDP at 2.2% for Europe, the highest level since 2011, at 4% for Japan, and at 6.9% for China. U.S. second quarter growth was upward adjusted to 3.0% at month-end, as employment remained strong and inflation, contained. Yet concerns about stretched market valuations, high new issuance in U.S. credit markets, and geopolitical and U.S. political risk, kept many markets in check. 10-year U.S. Treasury yields fell from 2.29% to 2.12%, as volatility increased in the wake of North Korea's missile and nuclear tests, inflation remained quiescent, and Yellen and Draghi avoided any comments on current monetary policy at the Jackson Hole central bank gathering.

In addition, the upcoming September 30 expiration of the debt ceiling extension may have pushed investors into Treasuries as a more secure trade. This decline in the 10-year yield reduced the 2's-10's spread to 79 bps. Agency MBS underperformed Treasuries, posting a -0.12% excess return, with conventional mortgages outperforming Ginnie Maes, and 30-year mortgages outperformed 15 year mortgages. In addition, lower coupon outperformed higher coupon, as prepayment fears subsided. CMBS and ABS bucked the trend, outperforming for the month; CMBS benefitted from low new issuance during the month. Both Investment Grade (IG) and High Yield (HY) corporates significantly underperformed Treasuries, as investors backed away from low spreads and large new issue calendars. Investment Grade (IG) corporates suffered a -0.62% excess return, led down by Industrials, while HY was down -0.03%, for a -0.70% excess return. Emerging Markets (EM) enjoyed strong demand, buoyed by strong growth in China. EM sovereigns returned 1.9%, while corporates returned 1.0%, with HY outperforming IG issues. The U.S. Dollar fell modestly against a broad range of currencies; the Euro was up 0.57% and the Yen was up 0.25%, vs the U.S. Dollar over the month.

Portfolio Review

The Portfolio underperformed the 0.86% return of its benchmark, the Bloomberg Barclays U.S. Universal Index. The Portfolio was hurt primarily by its relative short duration position, as rates rallied.

Positive:

- The barbelled yield curve positioning contributed to performance, as the yield curve flattened over the month. In particular, the underweight to the 2-year key rate duration helped performance.
- The lower relative credit quality of the portfolios holdings and currency effect contributed modestly to performance.

Negative

- The relative short duration position of approximately 1.3 years hurt performance, as the 10-year Treasury yield fell 0.17% to 2.12%.

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 market continues to be "behind the curve" in their views on the appropriate level of interest rates; the market has priced in only a 32% probability of a December rate increase. We believe the FOMC may initiate the balance sheet taper in September, and may raise rates in December, as well as at least twice in 2018, based on continued strength in GDP and employment, and declining slack in the labour market. In addition, the Fed has focused on financial stability as a "third" mandate; raising rates could help inhibit the formation of asset bubbles. The U.S. Dollar may depreciate 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 soon to be four openings on the FOMC, and the potential for more expensive trade, may put a brake on U.S. Dollar appreciation.

The Portfolio continues to be positioned for rising interest rates, and a solid economy. It increased its relative short duration position, as expectations for a rate hike declined, and rates fell over the 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 1.3-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 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.

The Portfolio remains underweight to IG corporates, but continues to hold an overweight to high yield corporates. Tighter spreads and higher leverage is counterbalanced by strong fundamentals.

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 investment grade. 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 2018, and have recently added select EM currency exposures.

The Portfolio includes certain EM exposures, with a preference for countries undertaking important structural reforms, such as India, Indonesia, and Argentina. EM are benefitting from the stronger global growth and increased domestic demand.

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