Monthly Portfolio Update

Pioneer Funds – Strategic Income

31 October 2017

Bond COMMENTARY

Market Review

Stronger U.S. and global growth bolstered strong global corporate earnings, driving credit market spreads to post-crisis lows during the month. Third quarter U.S. GDP surprised to the upside at 3.0%, following the 3.1% second quarter level. Investors were further encouraged by the Senate's passage of a budget paving the way for corporate (and individual) tax cuts, if not tax reform. Europe also continued to enjoy strong GDP growth. Ongoing contained inflation led the ECB to meet consensus expectations, extending its monthly QE purchase program, but at a reduced $30 billion level.

U.S. Treasury yields moved higher on the back of stronger U.S. GDP growth, and the yield curve flattened. The 2-year yield rose by 0.12% to 1.60%, while the 10-year yield rose 0.05% to 2.38%. Agency MBS slightly outperformed Treasuries, with conventional and lower coupon mortgages outperforming. CMBS, often more correlated with High Yield (HY) markets, enjoyed strong outperformance, delivering 0.54% excess returns. ABS rallied as well, with esoteric ABS spreads narrowing by 5 to 10 basis points. Despite a monthly October record $130 billion issuance, Investment Grade (IG) corporate delivered 0.52% excess returns, as spreads tightened to the lowest levels since 2007, buoyed by yield-hungry global investors. The ECB's implication that it would maintain corporate bond purchases, while tapering sovereign bond purchases, further supported credit spreads.

HY performed in line with IG, with a total return of 0.39% and an excess return of 0.48%. With respect to floating rate sectors, bank loans outperformed HY, delivering 0.60% return, benefiting from limited new issuance and strong CLO demand. Catastrophe bonds retraced some of their September underperformance, returning 1.75% for the month. Emerging Market (EM) debt underperformed over the month, with sovereigns returning -0.13%, and corporates 0.34%, in response to the 1.7% rally in the U.S. Dollar broad market index. The U.S. Dollar rose on greater economic optimism and on expectations of a tax cut.

Portfolio Review

The Portfolio overperformed the Bloomberg Barclays U.S. Universal Index (Benchmark).

The Portfolio returns benefited primarily from sector allocation, security selection and yield curve positioning over the month.

Positive:

- Sector allocation was the primary contributor to performance, benefiting from the 29% underweight to U.S. nominal Treasuries and the 11% exposure to bank loans[1].
- Portfolio returns were also helped by security selection within Industrials. Industrials benefited from strong performance among select Energy issues, as oil prices rose 7% over the month.
- The portfolio was aided by duration and yield curve positioning. As the yield curve flattened, the barbelled yield curve position contributed to performance, particularly the underweights to the 2- and 5-year and overweight to the 30-year key rate durations. The relative short duration position of 1.15 years modestly contributed as rates rose.

Negative:

- The Portfolio returns were impacted by non-U.S. Dollar exposures, as the U.S. Dollar rallied over the month. In particular, the 1.0% Mexican Peso and proxy hedge of the long Sweden and Norway/short Euro underperformed.

[1] Pioneer Funds – Strategic Income may gain exposure to bank loans only indirectly through derivatives.

Amundi ASSET MANAGEMENT

Outlook

The team remains constructive regarding both U.S. and global GDP growth. In our view, within the U.S., solid employment should continue to support consumption and the housing market, while the economy may also continue to benefit from higher corporate profits, reflecting improved global growth, easy financial conditions and lower regulation. The prospect for tax cuts has also increased, this may further bolster corporate profits and the economy in 2018.

While the market has now priced in higher expectations for a 2017 December rate increase, the market has priced in a 1.69% Fed Funds rate by the end of 2018, well below the median level of the FOMC projections of 2.13%. We believe the market continues to be “behind the curve” in their views on the appropriate level of interest rates. Despite the Fed’s concern about relatively low inflation, we believe they are likely to proceed with their planned rate increases.

While the U.S. Dollar appreciated in September and October, and may appreciate in the near term, we believe it may come under pressure in the longer-term, as yield differentials between the U.S. and Developed Markets (DM) narrow. Improving global growth may drive more Central Banks, including the ECB, to begin raising rates, possibly by the fourth quarter of 2018, after the end of its extended purchase programme. In addition, U.S. President Donald Trump’s preference for a lower U.S. Dollar, the nomination of the less hawkish candidate Jerome Powell as the chairman of the Fed, and the outcome of trade negotiations, may put a brake on U.S. Dollar appreciation.

Positioning

	Pioneer Strategic Income Fund	Amundi Pioneer Strategic Income
Cash	5.04	1.13
Treas/Agency	5.03	4.06
Municipal	0.45	
Agency MBS	23.66	29.61
Non-Agency MBS	10.24	11.46
CMBS	3.14	3.83
ABS	2.47	2.88
US IG Corporate	12.1	18.12
Intl IG	7.22	4.62
EM. Sov IG	5.65	2.11
EM. Corp IG	3.51	1.23
Bank Loan	7.75	10.17
Catastrophe Bonds	2.9	
US HY	7.39	10.63
Intl HY	2.01	0.34
Convertible/Pref	1.62	1.4
CDX/CDS IG (notional value)	-3.01	0.97
CDX/CDS HY (notional value)	0.38	0.62
Total Non-Investment Grade including derivatives	28.24	25.08

Source: AmundiPioneer, Bloomberg Barclays POINT as at 31/10/2017

As previously stated, we may be limited to investment in HY and EM, in certain structured securities, as well as subordinated bank securities, which require minimum denomination sizes.

The Portfolio continues to be positioned for rising interest rates, and a solid economy. It continued to reduce its relative short duration position over the month, as yields rose and the market priced in a higher likelihood of a December rate increase. We also modestly reduced risk, in light of extended valuations within corporates and EM.

- Overweight to diverse credit sectors, underweight to U.S. Treasuries. In our view, ,most U.S. government debt is unattractive, while credit sectors may benefit from stronger growth, lower taxes, and less regulation.

- The Portfolio holds a 1.06-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 lower inflation levels implied in TIPS does not accurately reflect the longer-term potential for 2% inflation.

- The Portfolio holds a neutral weight in agency MBS; including the exposure to non-agency MBS, the Portfolio remains significantly overweight to RMBS. We believe agency MBS currently offer fair value, but are more attractive relative to fixed income IG corporates, the spreads of which stand at post-crisis lows. In addition, fundamentals for the Housing sector remain strong, given improving employment, low mortgage rates and attractive home price affordability.

- The Portfolio holds underweight in IG and an overweight in HY corporates, but has reduced credit risk as valuations have become extended. Strong fundamentals, strong economic growth and the prospects for corporate tax cuts are counterbalanced by stretched valuations. Total IG corporate spreads stand at post-crisis lows, and reflect lower quality and overall longer duration relative to their historical levels. Reviewing intermediate 1-10 year IG corporate option-adjusted spreads by quality tier (we look at intermediate term, so that spreads are more comparable to agency MBS spreads, which currently stand at 21 bps), these extended valuations become more evident:

Intermediate Investment Grade Corporate Spreads				
	AAA	AA	A	BB
31/10/2017	29.8	37.4	56.2	94.8
20-year average	68.1	94.5	130.5	191.0
20-year minimum	24.6	36.9	50.9	76.4

Source: AmundiPioneer, Bloomberg Barclays POINT as at 31/10/2017

We continue to find select opportunities within IG, particularly within Financials and Energy, and believe we can continue to potentially add value through security selection, given our core competency in corporate credit.

- We believe the valuation picture may be more nuanced within the HY market. While spreads are low at 351 bps, they remain well above their 2007 tights of 241 bps, although we believe further spread compression could be more limited in this market by total yield. Again, we believe, the fundamental outlook for the HY markets appears positive, with strong economic growth, higher energy prices, and the prospect for tax cuts, although the proposed interest deduction limit could impact more highly levered companies. In light of extended valuations, the Portfolio has reduced and upgraded the quality of its HY exposure, but remains modestly overweight to the market, given the greater opportunity to add excess returns from sector as well as security selection.

- Within corporates, we hold an overweight to Financials. We have benefited from increased exposure to European banks, based on more attractive relative value in subordinated structures 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 can 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, in our opinion.

- 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 appreciate in the near term, and have limited our non-U.S. Dollar exposures as a result.

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

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