Monthly Portfolio Update

Pioneer Funds – Global Multi-Asset Target Income
31 October 2017

ASSET-CLASS

COMMENTARY

Market Review

In October, markets shrugged off geopolitical tensions between U.S. and Korea, as well as the disruption resulting from the Catalonian independence referendum. Risk assets continued to outperform amidst generally resilient global macro data with progress on U.S. tax reforms provided a further boost.

Bond yields remained volatile, falling during periods of uncertainty, but settling higher by the end of the month given the higher probability of a December rate hike by the Fed. 10-year U.S. Treasury yields ended the month +5bp higher, although shorter maturities increased by more, given the positive developments on tax reforms. Meanwhile, 10-year maturities in the Eurozone (proxy Germany) ended lower by -10bps as a result of the continued expansionary policies of the ECB. As had been expected, during their October meeting the ECB announced a gradual tapering of asset purchases, although surprising the markets in terms of the size and timing of purchases.

Emerging Market (“EM”) sovereign bonds were notably weaker given higher U.S. bond yields and a stronger U.S. Dollar. Credit markets, by comparison, were resilient, supported by continued investor flows. Amidst a risk-on backdrop, the higher beta Global High Yield (“HY”) outperformed Global Investment Grade (“IG”) (+0.4% and +0.0% respectively in U.S. Dollars using the Bloomberg Barclays Global Indices as proxy).

Equities outperformed fixed income markets given positive investor sentiment. EMs were clear winners (MSCI EM +3.5%) boosted by a strong improvement in corporate fundamentals. Asian equity markets such as Korea, Hong Kong and India posted in excess of 5% gains in local currency terms. Developed Markets (“DM”) also experienced a strong rally (MSCI World +2.2%) with U.S. markets once again supported by the Technology sector (S&P 500 +2.2%, S&P 500 Technology +7.7%) but also strong Q3 earnings results. European equity markets (Eurostoxx 50 +2.2% in Euros) were weighed down by political uncertainty stemming from the Catalonian referendum, but rallied in the last week of the month post dovish ECB announcements. Japanese markets (Nikkei +8.1%) were one of the best performing equity markets, supported by a depreciating currency and a market friendly election result.

Currency markets continued to be driven by market expectations on Central Bank policy and political noise. The U.S. Dollar continued to gain ground, given the positive macro and corporate backdrop in the U.S. as well the more hawkish stance of the Fed. This impacted commodity-sensitive currencies such as Canadian Dollar (-3.3%), Brazilian Real (-3.4%) and South African Rand (-4.2%) as investors continued to reverse short positioning on the U.S. Dollar. Meanwhile, a more dovish ECB and Bank of Japan (“BOJ”) resulted in a depreciation in the Euro (-1.5%) and Japanese Yen (-1.0%). Political risk also impacted the Euro and the UK Sterling (-0.8%) although the latter found some support from likely rate hikes by the Bank of England (“BoE”) in early November.

Commodity markets were among the strongest performers particularly due to oil markets. West Texas Intermediate gained +5.2% amidst adverse U.S. weather conditions and political upheaval in oil supplying regions of Iraq. However, rising U.S. inventories and oversupply concerns kept rallies in check. Industrial metals also enjoyed good returns (Nickel +17%, Copper +6.0%) due to robust demand amidst strong macro data especially from China. Gold prices were volatile (-0.7%) falling post the easing of global geopolitical tensions.

Portfolio Review

The Portfolio added positive results in October with gains from the Macro Strategy offsetting losses from Selection and Macro Hedging. Satellite strategies were small negative contributors. In terms of asset classes, gains were contributed by equities followed by spread (credit and EM bonds) while currency strategies and rates strategies were small detractors.

Equity exposures were successful, primarily due to long directional exposure led by Japan. Macro Hedging, including volatility strategies in Japan and

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Europe, unsurprisingly detracted. Selection was the main detractor as a result of positioning in Europe followed by U.S. and EM but option writing helped offset some losses. In terms of sectors, defensive sectors such as Healthcare were the worst performers, while Information Technology and Financials in the U.S. were the strongest. Satellite strategies, which include relative value and asymmetric reflationary focused strategies, posted a mixed performance.

Within Fixed Income, rates strategies were slightly down, due to an overall negative stance on duration versus the target income strategic asset allocation. Short duration positions in short-dated core Eurozone rates and duration hedges in Europe suffered as yields trended lower. Inflation-linked strategies in the U.S. also generated losses but these were almost offset by gains from Japanese inflation-linked strategies. Meanwhile, directional exposure to corporate debt (IG and HY) helped, amidst continued spread compression while EM bonds were relatively less successful. Performance across relative value yield curve and Selection Strategies was mixed.

Currency trading was a detractor, primarily due to a tactical reduction of the U.S. Dollar versus Euro. Long positioning in EM currencies (Turkish Lira and South African Rand for instance) versus U.S. Dollar also added to losses. Positive contributors included relative value strategies for instance within EMs (long Indian Rupee versus Singapore Dollar).

In October, income was generated from bond coupons, followed by equity dividends, while option writing was limited. We have written call and put options (November maturities) on stocks in diverse sectors.

Asset Allocation (Macro Strategy and Satellite Strategy)

Inflation remains subdued but we expect this to rise from current levels, given stronger global macroeconomic momentum (supported by potential fiscal stimulus) and tighter labour markets especially in the U.S. The positive macro backdrop has caused Central Banks in DMs to turn more hawkish, at least on scaling back asset purchases. In our view, markets have not fully priced in the upside risks to rates from Central Banks' normalisation policies. Therefore, we prefer to hold a cautious outlook on rates and keep overall Portfolio duration low.

We hold a negative duration stance on U.S. and core European rates, particularly on short maturities, where valuations are extremely stretched in our view. We expect short rates should be impacted most aggressively by a possible re-pricing in yields. Although we have reduced exposure to peripheral rates in previous months due to continued political uncertainty, we hold an overall positive stance given the attractive carry, especially from longer maturities. We maintain some inflation-linked strategies, which are expected to benefit from a gradual pick-up in inflation as Central Banks scale back on their monetary stimulus programmes. We also hold limited exposure to relative value yield curve strategies, for instance a Swedish 2-10 Year flattener expected to benefit from a potential policy shift by the Swedish Central Bank in our view.

On spread strategies, we continue to favour EM debt, particularly from an income perspective, but expect to reduce positioning during the quarter. Although the macroeconomic momentum remains positive for EMs, spreads are tight in our view. We remain selective and focused on quality given the divergence between economies, holding a preference to EMs with stronger fiscal positions.

Although, improved corporate fundamentals and cheap financing conditions support a positioning in credit, we prefer a cautious approach and expect to reduce spread duration through hedges in Europe primarily (through CDS indices). Despite the yield pick-up over government bonds, which has kept investor demand buoyant, valuations across corporate sectors appear stretched and the room for further spread compression is limited, in our view. We expect corporate spreads to widen if volatility spikes due to global geopolitical uncertainties, which may impact the HY sector more adversely than IG.

In the U.S, a late phase in the credit cycle, higher leverage levels and tightening financial conditions do not provide an attractive risk-return trade-off for HY sectors, in our view. Moreover, we believe that volatility in oil prices may also impact the sector potentially resulting in defaults if investor outflows accelerate abruptly. In Europe, the technical backdrop for HY has improved lately, but new issuance spreads have reached pre-crisis lows. Given this backdrop, we prefer to maintain a more selective approach through high quality and more liquid names. We also hold hedges on HY in U.S. and Europe and prefer European Equities compared to credits.

We remain constructive on equities, particularly from an income perspective due to resilient macroeconomic and earnings momentum across DMs and EMs. We believe a crowded investor positioning makes our long positioning vulnerable to spikes in volatility from rising geopolitical risks. Therefore, we prefer the use of asymmetric pay-off structures such as through option strategies whose aim may be to provide upside participation while limiting the downside.

In terms of regions, Europe remains our favoured market, thanks to its improving macro momentum, low inflation and supportive ECB policies. We also hold a positive outlook on Japanese equities, given attractive valuations and the economy's apparent transitioning towards a more balanced growth driven by consumption and capital expenditure. U.S. equity markets appear expensive, although strong quarterly earnings results, and a boost from potential fiscal policies, could support a further rally. On EMs, we remain constructive due to improving global growth and corporate fundamentals, benign financial conditions and relatively cheap valuations. However, selectivity on countries and sectors remains key amidst less accommodative monetary policies.

On currencies, we continue to hold a reduced exposure to the U.S. Dollar in favour of the Euro, while also maintaining some long EM exposure (Indian Rupee, Brazilian Real, South African Rand and Turkish Lira). We remain short on the Australian Dollar versus Euro and Canadian Dollar due to more dovish expectations from the Australian Central Bank. We re-iterate the short Sterling versus U.S. Dollar and Euro positioning due to continued political uncertainty in the UK.

To seek risk diversification and benefit from a reflationary scenario, we maintain several relative value and asymmetric equity strategies within Satellites. For instance, to increase the reflationary bias in the Portfolio, we hold a long positioning in U.S. Energy vs U.S. Utilities. We also hold a commodity basket, consisting of Energy, Agricultural, Precious and Base Metals to diversify risk further. Finally, we believe may be exposed to an income-generating fund with a reflationary focus. Its objective could be to generate income expected to grow with global inflation by investing in real economy sectors such as Infrastructure, Agriculture, REITs, etc.

Macro Hedging

We maintain partial hedges on duration (via put options on bond futures in U.S. and Europe), spread duration (via HY CDS index in Europe) and equity (via option spread strategies on U.S, Europe, Japan and EM) to hedge against global geopolitical uncertainty. We also maintain volatility reduction strategies on European rates aiming to benefit from a pick-up in volatility.

Security Selection

We hold a balanced exposure to equities and credit for income generation purposes. In terms of equity sectors, we hold a tilt to pro-cyclical sectors such as Financials and Industrials where earnings growth has been encouraging but also through select Information Technology and Healthcare names.

Within credit, we hold a majority of our exposure in the crossover area (BBB+ to BB ratings). Lower default expectations amid improving fundamentals makes selective positioning still attractive in our view. We maintain a tilt to European IG where Industrial Hybrids and Lower Tier 2 as well as selective AT1 credits are preferable for their carry and relatively attractive valuations. We also took profit on select so-called "rising stars", which gained on rating upgrades into IG.

Outlook

Risk assets have shrugged off the uncertainty created by global geopolitical tensions, focusing instead on improving market fundamentals. Global growth, although low, -is picking up along with a recovery in global trade while inflation remains subdued. Corporate earnings results are encouraging and companies are revising up their earnings forecasts.

While we believe that the backdrop remains constructive for a bias to equities over bonds, we acknowledge that we appear to be transitioning into a late phase of the market cycle. Valuations across several equity and credit markets appear rich from a historical perspective. Volatility, meanwhile, remains low by historical standards and could potentially spike if Central Banks turn more aggressive in the normalisation of their monetary policies or from an escalation of geopolitical tensions. A sudden rise in volatility could cause a reversal in investor positioning and hence a sell-off across risk assets.

Against this backdrop, although we hold a constructive outlook on equities, we prefer to remain cautiously positioned through hedges and asymmetric exposures to mitigate potential downside volatility. We are positive on corporate debt from a fundamental perspective but prefer to remain selective given tight spreads. Given favourable macro conditions, the Fed has turned more hawkish resulting in a re-pricing in bond yields in October. A rate hike now appears imminent with markets having priced in an 85% probability of an increase in December. Hence, we maintain a cautious stance on duration.

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