Monthly Portfolio Update

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

ASSET-CLASS COMMENTARY

Market Review

A pick-up in global geopolitical tensions, most notably between the U.S. and North Korea, weighed on asset performance in August, although strong macro and corporate earnings data provided some support. Inconclusive debates on raising the debt ceiling by the U.S. Congress to avoid a government shutdown exacerbated market uncertainty, as did the destruction caused by the hurricane in southern U.S. states. Investor fear gauges such as the VIX - which represents the implied volatility of the S&P, spiked intra-month before abating towards the end of the month, aided by the possibility of U.S. tax reforms by the Trump administration.

Amidst heightened uncertainty, investors rushed into perceived safe havens. This led to a compression in bond yields, particularly for longer maturities, thus resulting in flatter yield curves. The probability of a rate hike by the U.S. Federal Reserve ("Fed") in December receded amidst weak inflation data, however a reduction in bond purchases is still expected in September.

Fixed income markets were beneficiaries against this backdrop. In the U.S., 2 year and 10 year Treasury bond yields ended the month down by -2bps and -18bps respectively. Bond yields in core European markets registered a similar fall, while moves in peripheral European markets were less aggressive. Emerging Market sovereign ("EM") yields also ended the month tighter, this was helped by a pullback in the U.S. Dollar. Lower bond yields also supported a positive performance from corporate bond sectors, with Global Investment Grade ("IG") unsurprisingly outperforming Global High Yield ("HY") (+1.0% and +0.3% respectively using the Bloomberg Barclays Global Indices as proxy).

Equity markets mostly underperformed bond markets given the risk-off market backdrop, although resilient macro and corporate earnings data helped mitigate the downside. Developed Markets ("DM") (MSCI World -0.1%) ended slightly down while EMs (MSCI EM +2.0%) were winners amidst improved domestic backdrop and upbeat macro data. Stronger domestic currencies on the other hand proved to be headwinds for DMs across Europe (Eurostoxx 50 -0.8%) and Japan (Nikkei -1.4%).
Falling expectations for a rate hike by the Fed in December and uncertainty induced by President Trump, led to a further weakness in the U.S. Dollar. While the currency appears to have stabilised relative to previous months, weakness against EM currencies was notable. The strongest DM currencies were Euro (+0.6%) and Yen (+0.3%), the latter gaining in August due to its safe haven status. Meanwhile, persistent uncertainty over Brexit resulted in a significant pull-back in the U.K. Sterling (-2.2%).

Commodity markets posted a mixed performance, with weakness in primarily agricultural commodities counterbalanced by strength in industrial and precious metals. Gold (+4.1%) was supported by the risk-off market backdrop, while base metals such as Copper (+6.7%) and Iron Ore (+10.9%) were helped by rebounding Chinese macro data. Meanwhile, in Energy markets, the hurricane in the U.S. put a dampener on West Texas Intermediate prices (-5.9%), although falling inventories in the U.S. provided some support earlier in the month.

Portfolio Review

The Portfolio added positively in August, with gains from the Macro Strategy offsetting losses from Selection and Macro Hedging; while Satellites were small positive contributors. In terms of asset classes, gains came from spread (credit and EM bonds) and currency strategies, while losses were posted by rates and equities.

Equity exposures were unsuccessful, primarily due to long directional exposure to Europe through equity futures within the Macro Strategy. Within Satellites, small losses were contributed by some relative value and asymmetric reflationary focused strategies. U.S. equity selection also generated some losses, along with option writing (short puts on stocks) in the U.S. Equity hedges helped offset some losses, mainly due to the volatility strategies which gained amidst a spike in intra-month volatility.

Amundi ASSET MANAGEMENT

Within fixed income, gains came from long exposure in the Macro Strategy to spread strategies (led by IG and hard currency EM debt) primarily, but also rates were offset partially by losses from short duration positions in short-dated core Eurozone rates and duration hedges in Europe, US and EMs. Inflation-linked and relative value yield curve trades were detractors; while within Selection, gains from IG were offset by rates strategies.

Currency trading was a strong positive contributor, primarily due to positioning in Satellites where long exposure to EM currencies (Turkish Lira and South African Rand versus U.S. Dollar for instance) helped. Another profitable trade was the short position on New Zealand Dollar versus U.S. Dollar, with the former suffering from uncertainty surrounding domestic political elections in September. Short U.K. Sterling versus U.S. Dollar and Euro also proved to be effective in generating gains.

In August, income was generated from equity dividends, followed by bond coupons; while option writing was very limited.

Asset Allocation (Macro Strategy and Satellite Strategy)

A continuation of earnings growth, supported by positive global economic momentum, confirms our preference for equity markets. We do not see value in most DM government bond markets, and maintain a low duration relative to our strategic income target. However, the resurgence of geopolitical risks, and resulting investor flight to quality - has resulted in an increase in duration in August (~2.3 years). As we expect the normalisation in Central Bank policies to slow down further, we have increased exposure to U.S. rates, and reduced hedges more aggressively in core Eurozone rates. We have also reduced exposure to peripheral rates through Italy, as a result of potential political risks. We maintain some 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.

On spread strategies we continue to favour EM debt, particularly from an income perspective, and especially against a backdrop of a gradual normalisation in policy and weakness in the U.S. Dollar. Spreads are tight in absolute terms from our perspective, but the macroeconomic momentum remains positive for EMs. We expect continued improvement in corporate earnings and credit fundamentals, yet remain selective and focused on quality - given the divergence between economies. We favour EMs with stronger fiscal positions, and more insulated from U.S. trade policies. We have become more cautious on corporate debt, and maintain hedges on spread duration. Despite the yield pick-up over government bonds and improved macroeconomic and corporate fundamentals, valuations across corporate sectors appears stretched. We expect spreads to widen amidst the higher volatility, this is a result of the geopolitical uncertainties and U.S. political issues, which should hurt the HY sector more 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 Europe, the technical backdrop (outflows, net issuance) for HY has not been supportive, but spread widening in August has prompted a slight increase in Portfolio spread duration.

We remain constructive on equities, particularly from an income perspective, due to robust macroeconomic and earnings momentum across developed and emerging markets. Positive investor flows also provide support, but a crowded investor positioning makes our long positioning vulnerable to spikes in volatility from the rising geopolitical risks. Therefore, we have increased hedges further in August.

Despite the recent appreciation of the Euro, Europe remains our favoured equity market, thanks to its pro-cyclical nature and positive inflows. We believe that any adverse impact on earnings from currency appreciation will be contained by resilient European domestic demand, a mild recovery in global trade, high corporate margins and a moderate steepening of the yield curve. We prefer to remain cautious due to political risks and have reduced overall exposure via futures primarily, but also options on European indices. We also hold volatility reduction trades in Europe (also in U.S.) through spread option strategies.

We hold a positive outlook on Japanese equities. Inflation appears to be trending higher, and the economy is moving towards a more balanced growth that is driven by consumption and capital expenditure. Fundamentally, it also remains one of the cheapest markets, particularly relative to the U.S.
Unattractive valuations coupled with a more mature phase in the market cycle, results in a more cautious and selective stance on the U.S. equity market. We also remain constructive on EMs, which remain significantly undervalued relative to DMs. Positive global macro momentum should provide further upside to earnings growth in our view. Our favourite macro plays are in Asia, where we hold cyclical markets such as South Korea - for its potential for strong earnings growth, as well as corporate governance improvements.

From a currencies perspective, we 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 reiterate 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, through sector and single security exposures (long call options on U.S. Energy stocks, versus for instance). In August, we have implemented a commodity exposure basket, (consisting of energy, agricultural, precious and base metals) seeking to diversify* risk further. We continue to hold exposure to an income-generating fund with a reflationary focus. The specialist fund holds exposure to real economy sectors such as infrastructure, agriculture, REITs, etc., whose income and returns are expected to grow with global inflationary trends.

Macro Hedging

We maintain partial hedges on duration (via put options on bond futures in U.S. and Europe), spread duration (via CDS indices and options on CDS indices across U.S., Europe and EMs) and equity (Europe, U.S., Japan and EMs) to hedge against global geopolitical uncertainty. We also maintain volatility strategies, aiming to benefit from a pick-up in volatility - for instance on rates.

Security Selection

We hold a balanced exposure to equities and credit for income generation purposes. We remain constructive on equities, holding a slight bias to Europe for its more resilient earnings outlook and higher dividend potential. In terms of sectors, we hold a tilt to cyclical sectors such as Financials, Industrials and Energy where earnings growth has been encouraging, but also to Information Technology and Healthcare.

Within credit, we hold a majority of our exposure in the crossover area (BBB+ to BB ratings). We maintain a tilt to European IG, where Industrial Hybrids and Lower Tier 2 credits are preferable for their carry and relatively attractive valuations. We also hold some exposure to European HY, as rating upgrades and lower default expectations amid improving fundamentals, makes selective positioning attractive in our view.

Outlook

Geopolitical tensions are back in play, weighing on equity market performance despite stronger macro and corporate fundamentals. Data and business surveys continue to point to global expansion, driven by domestic demand in most economies. Meanwhile, the subdued global inflation outlook is prompting Central Banks to hold back from any aggressive moves on interest rates and balance sheet normalisation.

We acknowledge that cyclical momentum in the U.S. may have faded somewhat due to delays in the implementation of the fiscal stimulus package from the Trump administration, which dampens the reflationary outlook for risk assets. However, there are no signs of an imminent recession, even though we appear to be approaching a more mature phase of the business cycle.
Europe, meanwhile, is enjoying strong and widespread growth which has surprised on the upside. If the appreciation of the Euro remains limited, as we believe, it should not derail positive economic and earnings momentum.

We prefer to remain selectively and cautiously positioned, particularly given the low levels of asset volatility, which may be indicative of investor complacency. A resurgence in geopolitical risks could result in significant sell-offs, and therefore we continue to hedge risk exposures with the objective to manage downside volatility.

Important Information

*Diversification does not guarantee a profit or protect against a loss.

Unless otherwise stated all information contained in this document is from Amundi Asset Management and is as at 31 August 2017.

Pioneer Funds – Global Multi-Asset Target Income is a sub-fund (the "Sub-Fund") of Pioneer Funds (the "Fund"), a fonds commun de placement with several separate sub-funds established under the laws of the Grand Duchy of Luxembourg.

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