Monthly Portfolio Update

Pioneer Funds – U.S. Fundamental Growth

31 July 2017

EQUITY COMMENTARY

Market Review

U.S. equities posted solid returns in the month, with the S&P 500 returning 2.1%.

Growth continued to outperform value as investors continued to favour secular over cyclical growth in a slow growth economic environment. The Russell 1000 Growth Index returned 2.7% vs. 1.3% for the Russell 1000 Value Index.

Within the growth universe, high valuation growth stocks such as Facebook (+12%), Netflix (+22%), and NVIDIA (+12%) continued to outperform the broader index. More reasonably valued, large-capitalisation Technology stocks such as Alphabet (+2%) and Apple (+3%) performed in line with the index.
From a sector perspective, Technology (+5%) performed well as did Financial stocks (+4%) due to positive earnings reports in the sector. Consumer Staples (-1%) and Materials (0%) were the worst performing sectors.

Portfolio Review

As we indicated in the last quarterly commentary, we take a conservative approach to investing in large-capitalisation stocks. We believe the benefits of this approach can be seen in the Portfolio's long-term capital appreciation, downside risk management – especially evident during difficult markets – and lower volatility versus its benchmark. While our conservative approach has historically worked particularly well when markets decline, it can sometimes result in the Portfolio not keeping pace when markets advance swiftly, as was the case for growth stocks over the first half of 2017. This is especially true when returns are driven as they were in July by a limited number of highly valued stocks, many of which the Portfolio does not own due to valuation concerns.

With this as a backdrop, the Portfolio underperformed the 2.7% return of its index, the Russell 1000 Growth, in July.

The underperformance was due almost entirely to two factors:

1. An underweight in technology stocks, which have become increasingly expensive in our view. In particular, the Portfolio did not own Facebook, Netflix and NVIDIA. In total, these three stocks detracted .5% from performance relative to the benchmark in the month.

2. A decline in some of our consumer holdings (CVS, Home Depot, Ross Stores, and Starbucks) due to concerns related to competition and growth. In total, these stocks cost the Portfolio 0.4% in relative performance.

Both sector allocation and stock selection detracted from performance in the month. Sector allocation was negative due to the overweight in the Consumer sectors, which underperformed for the reasons mentioned above, and due to the underweight in the Technology sector, which outperformed as investors rewarded stocks with high growth.

Individual detractors from performance included Medtronic, a medical devices company, which declined after management indicated growth would be lower than expected due to supply issues in the diabetes business and an IT disruption that negatively impacted sales. We believe these are short-term issues that do not impact the longer-term investment case for the stock. Another detractor, home improvement retailer Home Depot, fell after Amazon announced it would sell Kenmore appliances, which prompted concerns that Amazon would continue to expand into the home improvement category. We believe the move is an act of desperation by Sears and does not alter our investment case for Home Depot. Leading coffee retailer, Starbucks, also declined despite reporting inline quarterly results after indicating that comparable store sales would likely come in below expectations in the coming quarter. We believe after meeting with the CEO in our offices that the growth investments the company is making in online ordering and the high end of the coffee business can pay off and lead to steady, sustainable growth over time.

Stocks that contributed to performance in July included Mastercard, a financial transaction processing company, which rose after reporting strong quarterly results. The stock continues to be one of the largest actively weighted positions in the Portfolio given our conviction in the company's prospects as the shift towards a cashless society continues. Leading defense contractor Raytheon was another contributor, performing well after reporting slightly better than expected quarterly earnings and a positive outlook for bookings given increased defense spending in many parts of the world. Finally, Vertex Pharmaceuticals, a leader in cystic fibrosis, rose after reporting positive clinical trial results for a cystic fibrosis product and strong quarterly earnings.

Trading Activity

The Portfolio added no new positions in the month and sold one stock, Reynolds American, which was acquired by British American Tobacco.

Outlook

While our outlook for global economic growth remains positive, there are significant risks to this outlook, including a tightening of monetary policy by the Federal Reserve, uncertainty relating to U.S. public policies on trade and immigration, and geopolitical risks such as North Korea. For this reason, we continue to favour secular over cyclical growth.

With respect to the equity markets, we remain cautious given that valuations are high by historical standards.In particular, we believe a number of cyclical stocks - especially in the Industrials sector - have performed well in anticipation of higher economic growth in the U.S., which may not occur if Congress fails to enact policies that stimulate economic growth. We also believe the highly valued technology-oriented stocks that have driven the equity markets higher this year could be vulnerable in a market correction. For this reason, we continue to underweight the Technology sector in general and those stocks in particular.

Consistent with our conservative approach to investing and high quality focus, the Portfolio remains overweight in the Healthcare and Consumer sectors. Healthcare stocks are attractive in our view given reasonable valuations, secular growth due to demographics, high returns on capital, and little prospect of a significant change to the healthcare landscape under the new Administration due to political gridlock in Washington, DC. We also remain optimistic about our consumer holdings despite their recent decline given the strength of their business models and their longer-term growth prospects.

While the Portfolio has lagged the benchmark as the markets have moved higher, this performance is consistent with our expectation of how the Portfolio would perform in sharply rising markets driven by stocks with high valuations. We believe the Portfolio's defensive positioning could allow it to capture most of the upside potential if markets continue to rise while providing downside risk management when the markets turn.

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