

# Monthly Portfolio Update

## Pioneer Funds – U.S. Fundamental Growth

### 31 October 2017

EQUITY

COMMENTARY

## Market Review

U.S. equities posted their twelfth consecutive month of positive returns in October, with the S&P 500 returning 2.3%. Growth stocks, once again, outperformed value stocks as investors rewarded secular growth over cyclical growth. The Russell 1000 Growth Index returned 3.9% vs. 0.7% for the Russell 1000 Value Index.

Eight of the eleven sectors in the growth index posted positive results for the month, led by Information Technology (+8%) and Materials (+4%). Utilities (-2%) and Telecommunication services (-2%) were the worst performing sectors.

## Portfolio Review

The Portfolio underperformed its benchmark (the Russell 1000 Growth Index).

Underperformance for the month was largely due to stock selection in the Healthcare and Consumer sectors. Sector allocation was also modestly negative, due primarily to the overweight in defensive sectors such as Consumer Staples and Healthcare, both of which underperformed the Index in a risk-on, low volatility market environment. An overweight in Financials also detracted from results.

Stock selection in the Consumer and Healthcare sectors was the biggest detractor to performance year to date. Sector allocation was also negative year to date due to the overweight in Consumer Staples, Energy, Financials, and Healthcare, as well as a slight underweight in the Technology sector.

Detractors to performance for the month included CVS Health, Allergan, and Celgene. CVS Health, a pharmacy chain and integrated health care provider, fell due to concerns that Amazon would enter the pharmaceutical business and also due to reports that CVS Health may purchase Aetna, which we believe could be a good strategic decision, but also financially cumbersome given the purchase price. The stock is

under review as we assess the potential impact of a deal. Allergan, a specialty pharmaceutical company, declined after a judge ruled that the patents on the company's lead dry eye product, Restasis, are invalid. We believe that, while the product is a meaningful contributor to overall sales (9%), the stock appears to have overreacted to the news given solid double digit growth from Botox (12% growth in the quarter) and pipeline products that should help return the company to a steady growth path after the patent losses are absorbed next year. Celgene, a biopharmaceutical company, fell after reporting lower than expected quarterly results related to Otezla for the treatment of psoriasis. We had significantly reduced our position in the stock due to patent related concerns before the company reported its results. We have since sold the remainder of the position.

Contributors to performance included Adobe Systems, PayPal Holdings, and Microsoft. Adobe Systems, a software company focused on digital content production and marketing, rose after reporting better than expected quarterly results. PayPal Holdings, a leader in digital payments, also performed well after reporting strong quarterly results. Microsoft, the leading software company, outperformed consensus earnings estimates for the quarter due to continued growth in cloud computing. This caused the stock to move higher.

## Trading Activity

The Portfolio added two new holdings and also exited two positions during the month of October. We added CDW and Alexion Pharmaceuticals while selling our holdings in Amazon.com and Celgene.

CDW provides information technology solutions to business, government, education and healthcare customers in North America and the UK. We believe the company's unique and proven business model is more durable and has greater scale than investors perceive. Due to the company's low overall market penetration, we believe that they have ample opportunity to redeploy capital at excellent returns. In addition, any corporate tax reform should be a

significant tailwind for the company. Alexion Pharmaceuticals is a biopharmaceutical company that has developed successful drugs for treatment of several rare diseases. We believe that Alexion's core product, Soliris, could be approved for use in additional indications resulting in higher revenues and higher returns on capital while the stock trades at an attractive valuation.

We sold Amazon.com after concluding that their profitability could come under pressure due the acquisition of Whole Foods and the potential investment in pharmaceuticals. We also sold long time holding, Celgene, which is a biopharmaceutical company that focuses on cancer. Recently we became concerned about the possibility that potential generic competitors to their number one product, Revlimid, could enter the market sooner than anticipated, therefore we sold the stock.

## Outlook

Despite a recovery in earnings growth, we are cautious in our outlook for equities given high valuations. Though tax cuts and other pro-growth government policies may further boost growth, there are significant factors that could undermine growth including the potential for the Fed to raise interest rates more aggressively if inflation increases, possible negative repercussions from restrictive immigration, trade policies, and geopolitical issues.

The Portfolio remains conservatively positioned with an overweight in the Healthcare sector, as we believe a major change to the way drugs are priced is unlikely and Healthcare stock valuations are reasonable in our view. The Portfolio is also overweight the Financials sector due to the recent addition of Charles Schwab and a greater position size in Marsh McLennan.

While growth stocks have performed well this year, much of the performance has come from a small set of highly valued growth stocks, which we believe could be vulnerable when the market corrects. Volatility has been exceptionally low over the last few months but this may change if geopolitical concerns escalate or inflationary pressure builds, leading to further tightening of monetary policy.

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