Quarterly Portfolio Update

Pioneer Funds – Global Subordinated Bond
29 September 2017

BOND COMMENTARY

Market Overview

The month of September was dominated by three major themes: Economics, Politics, and Central Banks' communications. Bond yields experienced continued volatility throughout the month, driven in large by geo-political tensions, economic data and the impact of the hurricanes in the U.S.. The major Central Banks (CB) of the world – the U.S. Federal Reserve (the Fed), the European Central Bank (the ECB) and the Bank of England (BoE) all did their best to clarify their intentions regarding policy normalisation, and the message was clear - markets should prepare for a less accommodative Monetary Policy heading into 2018. Equities had a good month and corporate credit spreads, despite tight valuations, closed the month relatively unchanged.

In aggregate, core bond yields displayed divergent performance during September across the major markets. The German 10-year yield opened the month at 0.36%, and closed at 0.46% on the back of ongoing robust growth data in Europe and positive risk sentiment. The U.S. 10-year yield also closed the month up at 2.33% versus 2.12% at the end of August, following indications by the U.S. Fed that it would start unwinding its Balance Sheet and would continue to raise U.S. interest rates. In the UK, the 10-year bond yield closed at 1.36%, versus 1.03% at the end of August, following the BoE's indications that a rate hike at its next meeting was imminent.

The tone of the economic data released in the U.S. during September was mixed. The economy continued to suffer somewhat in the aftermath of Hurricanes Harvey and Irma, with the extent of the damages reflected in poor industrial output and retail sales numbers, and a downward revision of Consumer Confidence numbers between July and August. Nevertheless, consumer prices increased 0.3% in August (partly due to higher gasoline prices resulting from the Hurricanes) and August's Inflation numbers reached a seven-month high of 1.9% (versus 1.7% in July). September inflation print is expected to peak before negative energy base effect push it lower during the rest of Q4 and Q1 2018. Despite falling short of its 2.0% inflation target, at its September meeting the Federal Open Monetary Committee (FOMC) pressed ahead with its balance sheet normalisation and indicated it is likely to hike again at the December meeting.

It was a robust month for Eurozone growth. Strong economic releases, a growing labour market, continued domestic demand and healthier global backdrop were the main drivers of the strengthening economy. Core inflation for August was stable at 1.3%, mirroring July's print, but headline inflation of 1.5% was still below the ECB's target of "close to 2%". In terms of economic growth, a revised estimate of seasonally adjusted Eurozone GDP showed an increase of 0.6% in Q2 compared to Q1. A combination of the improving labour market, expansionary monetary policy and domestic demand have been supportive of growth. The European Commission's Economic Sentiment Indicator for September jumped to highest level in more than a decade, reaching 113.0.

Despite no significant changes to monetary policy settings during the month, communications by the major CBs caused some movement in bond yields. The BoE's Monetary Policy Committee (MPC) left interest rates unchanged at its September meeting (with a majority of 7-2 in favour of maintaining the current 0.25% rate), but signalled a rate hike was probable ahead of its November meeting. The ECB did not offer much detail about tapering of its bond-buying programme, but suggested that a decision regarding the process will be made before its next meeting and details will be communicated at the October and December meetings. Finally in the U.S., the FOMC confirmed at its September meeting that it would begin shrinking its $3 trillion balance sheet in October. It also suggested via the "Dot Plot" that it expects one more rate hike in 2017.

Subordinated Debt Review

Subordinated bonds enjoyed a good month of September.

According to Bank of America Merrill Lynch (Bloomberg, at end of September) corporate hybrids were up nearly 1%, outperforming Cocos (+0.5%) and pref shares (+0.25%). Subordinated bonds benefit from an environment where investors are still chasing yield while supply is limited.

In corporate hybrids, the universe has been shrinking this month with the tender offer from RWE for a variety of existing subordinated bonds. In AT1, many of the bonds issued this month were from small issuers (Grenke, Jyske, NIBC). Issuers now have to create long call date bonds that have an appealing coupon to attract the yield buyers. We don't like those structures which have low back-end and a lot of duration risk.

The market absorbed without difficulty the massive Postal savings bank of China issue (7.25bn USD) and recent new issues are quite resilient despite rates going up (Westpac nc10, Jyske nc10, ABN nc10) or the geography (Santander).

While spreads are currently quite tight, they are still the highest in Fixed-Income and offers the best value in our opinion.

Portfolio Review

Performance

In terms of performance, the strongest contributors during the month were our allocations to Subordintated Financial and Additional Tier 1 (AT1) bonds.

Within Subordinated Financials, our bond selection in the Lower Tier 2 and Insurance Spaces performed well during September. We make reference to our holdings in Unicredit and Rabobank in LT2. Within the Insurance Space, our holding in Delta Lloyd were a strong contributor to performance during the month. We find insurance subordinated bonds particularly interesting due to their strong capital positions and attractive spreads compared to other financial sectors.

Within our AT1 bucket, we make particular reference to our holdings in Erste Bank, AIB and Barclays (in the HY Space) and Rabobank, Swedbank and Danskebank (in the IG Space)- all of which added to performance during the month.

Our bond selection in the Corporate Hybrid space also performed well in September. We make particular reference to our holdings in the Real Estate and Basic Industry sectors, namely the bonds we chose to hold in German Real Estate issuer Aroundtown, and French Chemicals manufacturer Solvay Finance. We view the corporate hybrid universe as an attractive asset class that has further potential to outperform, in our opinion.

Positioning

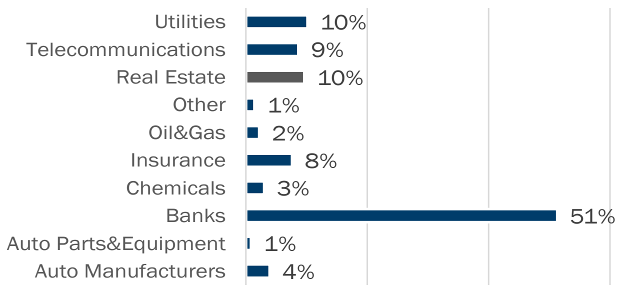
We maintain our OW in financials and keep a low cash balance which reflects our confidence in the outlook for the market in the short term. We nonetheless aim to concentrate the portfolio in our preferred structures as a way of making it more defensive.

At September month-end, the Portfolio has a duration position of 4 years, a spread duration of 4.31 years and a Yield-to-Maturity of 5.07%. The Yield to worst is lower at 3.45%.

The cash position is c.1.00% - as mentioned above, this is in the low end of our target of high-single digit cash levels. The Portfolio Managers employ this low cash levels to retain flexibility in managing client flows without significantly altering positions and to avail of market opportunities – primary offerings or price volatility, whenever they arise.

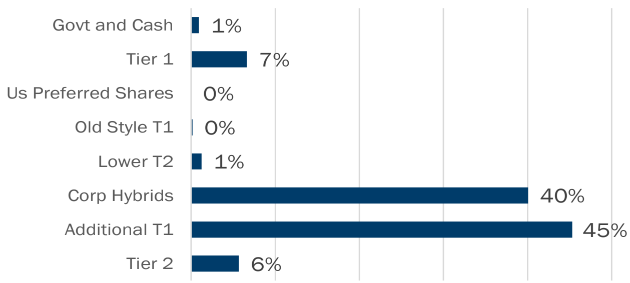
Consistent with our other Investment Grade Credit portfolios, our preference within this asset class is for solid issuers, with a strong credit profile, a proven creditor friendly attitude (both in terms of financial discipline and track-record of calling bonds) as well as with attractive bond structures, in terms of both coupon reset after the call date (which incentivises the issuer to call the bond) and loss of equity credit (this being very important for Corporate Hybrids).

Breakdown By Sector (Ex-Cash)



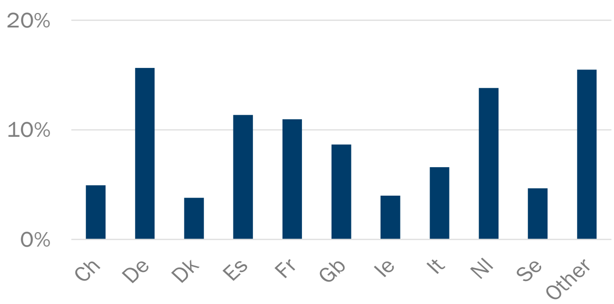
Source: Amundi Asset Management. Data as at 29 September 2017

Breakdown By Subordination Type (Ex-Cash)



Source: Amundi Asset Management. Data as at 29 September 2017

Top 10 Countries (Ex-Cash)



Source: Amundi Asset Management. Data as at 29 September 2017

Outlook

In our opinion, the outlook for the remainder of 2017 should be dependent on CBs' outlooks and actions, with a potential greater impact from geopolitical events. Throughout 2017, CBs globally have, for various reasons, indicated a desire to normalise monetary policy settings despite a lack of pick-up in inflation. We believe that generally they will continue to remain accommodative but will continue the process of normalising monetary policy.

In the U.S., the Fed continues to suggest they favour another rate hike in 2017 and another three hikes in 2018 but markets appear unwilling to fully price this in. As well as potential rate hikes, the Fed has also signalled the start of its Balance Sheet normalisation process. In terms of economic growth, we expect GDP growth to stabilize in the U.S. at around 2% or slightly higher, and as the unemployment rate continues to fall, the Fed will grow increasingly concerned about the outlook for inflation. We believe, tax reform has returned to the fore and should a reform package be passed, it could provide a significant boost to growth and inflation expectations, which the market is not discounting and in turn could help the Fed deliver more tightening than is currently priced. In Europe, we maintain our view that the theme of positive Eurozone growth momentum and reflation should continue, particularly given the strength of actual growth levels seen this year. Most forecasters now expect overall Euro-area GDP to be in excess of 2% by year end and risks for 2018 forecasts are to the upside. In terms of monetary policy, the ECB has recently become more vocal in preparing the market for a normalisation of its unconventional policy, starting in early 2018. We believe, the ECB are likely to signal their next move before year end but markets remain divided on the speed and length of the tapering process. A shorter and/ or a more aggressive taper could cause bond yields to spike higher whereas a longer and more gradual taper could see yields rising gently over the course of 2018, in our opinion.

In European politics, Mrs. Angela Merkel will most likely form the next government in Germany but as part of a rainbow (Jamaica) coalition. This may result in positive fiscal impulse in Germany (which the market does not price) but also ultimately a less EU/ Euro friendly approach despite French President Emmanuel Macron's desire for greater integration between both countries. Italian elections now look likely to be pushed out into Spring 2018, and the market may focus on Italian political risk more as we approach year end. Overall, we continue to believe there is more of a shift towards fiscal expansion in Europe, which will support upward pressure on bond yields. Given this outlook, and the subtle shift in global CB reaction functions, we continue to favour a short duration stance.

In the UK, the fractures and splits within the Government are increasingly apparent, and the UK's negotiation position on many aspects related to Brexit appears unclear. Despite this, UK growth has not collapsed as many had feared, although it has slowed considerably. We believe, questions still remain as to how long Prime Minister Theresa May can remain as Prime Minister and whether new elections may be necessary in the next 12-18 months. In turn, this has weakened the UK's negotiating stance with Europe over Brexit terms, with the UK having already moderated their stance. We still believe that negotiations are unlikely to be completed within the two-year time frame, and a two-year extension period is now being widely discussed. The political uncertainty could be mirrored by monetary policy uncertainty. At its September meeting, the BoE's Monetary Policy Committee voted 7-2 in favour of keeping the current monetary policy settings unchanged but signalled that a rate hike at the November meeting would be likely. We believe, this uncertainty, coupled with higher inflation, suggests that UK bond yields can also move higher into 2018.

In Credit, despite tight valuations, we remain constructive on European Investment grade credit heading into Q4. The traditional September pick up in primary issuance has been well digested, with the ongoing technical support of CSPP buying in place for now together with ongoing fund inflows into IG, encouraged by the strong YTD returns from the asset class. Credit fundamentals also remain supportive, in our opinion, with the recent pick up in Eurozone economic growth feeding through to higher operating earnings, which combined with low funding costs, has been supportive for debt protection measures. Nonetheless, idiosyncratic risk from shareholder friendly measures such as M&A is clearly on the rise in Europe, with stock selection key at this later stage in the credit cycle. We reiterate that there remains a broad range of potential known and unknown triggers for an increase in overall market volatility, in our opinion, particularly where geopolitical risks (e.g. North Korea, Brexit) and CB policies are concerned. At current compressed valuations, we believe there is a declining reward for less liquid, off-benchmark positions across the IG credit universe. In terms of our positioning, we remain Underweight in our cash positioning but long DTS through our preference for selected subordinated bonds of investment grade issuers both in financials and non-financials, combined with an Underweight positioning in European investment grade senior debt, which offers in our view less attractive risk-reward, especially as CSPP tapering may become more of a market focus in the coming months. In terms of sector preferences, we see value in Real Estate, Industrials and Insurance, and select Subordinated Financials, as fundamentals should in our opinion continue to strengthen while these bonds still offer some yield-pick up versus other segments of the Credit market.

Important Information

Date of First Use: 25 October 2017.

Doc ID: 286587

Amundi
ASSET MANAGEMENT