# Quarterly Portfolio Update

*Pioneer Funds – Global Subordinated Bond*
*29 December 2017*

BOND COMMENTARY

## Market Overview

As has been the case many times this year, the fourth quarter of 2017 was dominated by two major themes: Economics and Politics.

In the US, President Trump's €1.5 trillion tax reform bill was finally approved and passed in December, making it the President's first major legislative victory since assuming office. Both sides of the US Congress, the Senate and the House of Representatives, agreed to cut the US corporate tax rate by 14%, from 35% to 21%. In response to the vote, both the US and German 10-year government bond yield sold off more than 10bps as investors expect the cuts to further fuel economic growth and inflation. In the week following the vote, the US 10-year rate rose from 2.37% to a 6-month high of 2.49% and the German 10-year rate jumped from 0.30% to 0.42%. President Trump is expected to sign the bill into law early in January 2018.

In European politics, it was a relatively muted quarter, unsettled more than anything else by the political instability in Spain. Following its declaration of independence in October (and the subsequent dissolution of the local parliament), a parliamentary election was held in Catalonia on the 21st December 2017. The election saw a marginal but absolute majority win for the region's three major pro-independence parties (who won 70 out of 135 seats). The result underlines how Catalan society is split almost evenly between pro and anti-independence sides. Following the election, Spanish bonds underperformed slightly into year end, although the impact was limited and investor focus began to shift to the Italian elections in March 2018 . At month end the yield on the 10-year Spanish bond closed at 1.56%.

In Central Bank (CB) news, the US Federal Reserve raised short-term interest rates in December - its third rate hike in 2017. The widely expected 0.25% increase had been priced in by the market given the strengthening US economy and its positive outlook for 2018. Out of Europe, the only notable CB update during the quarter took place in October with the announcement that the ECB's monthly purchases would remain at €60 bln per month until January 2018, and then at €30 bln per month until September 2018. President Mario Draghi's announcement and subsequent remark that the very accomodative QE programme would remain in place for "as long as needed", were both perceived as dovish by the market.

On the economic front, the momentum of the previous months' continued throughout Q4 with very positive releases in both the Eurozone and US. In December, data releases were good on almost all accounts. Out of the US, non-farm payrolls surprised to the upside with 228,000 new jobs being added during the month of November. The unemployment rate remained unchanged from the previous month at 4.1%, its lowest level in 17-years, and retail sales were up 0.8% on the month. In Europe, complete data showed that Eurozone GDP for Q3 increased by 0.6% on the quarter. Industrial production was up 0.2% in October, having dropped by 0.5% in September, and Composite Purchasing Managers' Index jumped from 57.5 in November to a near seven-year high of 58 in December. Despite the positive releases, Core Inflation continued to disappoint in the US (falling to 1.7% in November) and remained subdued in the Eurozone (staying static at 1.1% between October and November).

## Subordinated Debt Review

Following a strong October and November, December was a particularly quiet month in the Hybrid space.

The lack of momentum was resultant from very few new issuances (year-end lull). We continue to see limited issuance forecast for the coming months, however we maintain our positive view on this asset class amidst a friendly macroeconomic environment, and the attractive premium it offers - particularly when compared to senior debt. Our view for the asset class in 2018 is that while potential returns will be lower than 2017 (following the large rally), it is still one of the best places to be invested, in fixed-income.

In terms of timing, we expect a proportion of spread widening to materialise in the second half of next year, as potential tapering of the CSPP impacts valuations. The impact of "mega mergers" on the hybrid market is something we will be watchful of. December saw the acquisition of Australia's Westfield Corp by Paris based company Unibail (Europe's largest commercial landlord), which should lead to hybrid issuance in the coming months.

# Portfolio Review

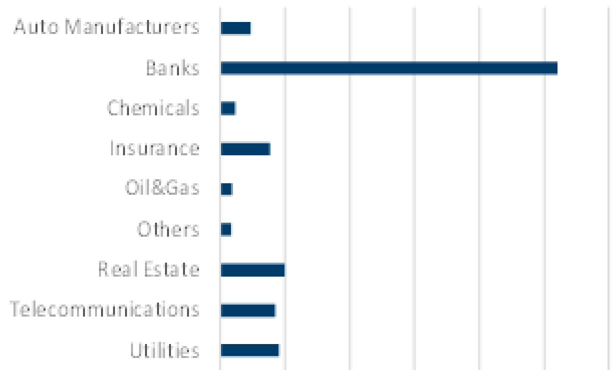
## Performance

The Portfolio had a positive performance during the quarter, returning 2.03% (net of fees).

## Positioning

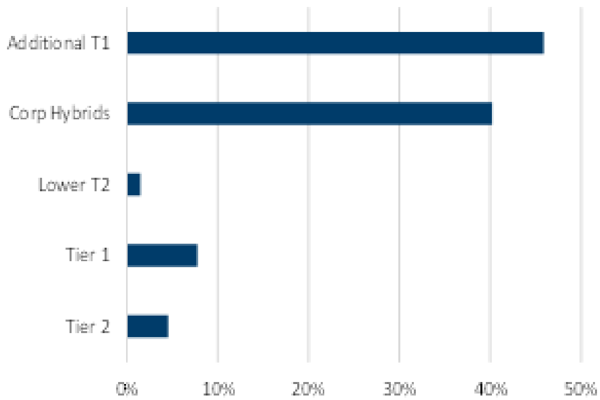
Our asset allocation at end December was mostly unchanged from October and November:

**Breakdown By Sector (Ex-Cash)**



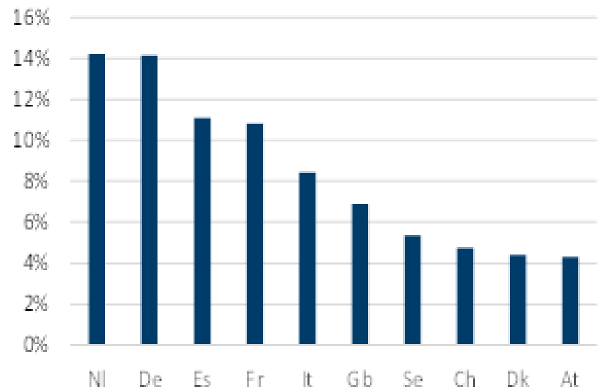

Source: Amundi Asset Management, end December 2017

**Breakdown By Subordination Type (Ex-Cash)**




Source: Amundi Asset Management, end December 2017

**Top 10 Countries (Ex-Cash)**




Source: Amundi Asset Management, end December 2017

# Outlook

We believe that the growth outlook remains strong, both globally and within the eurozone. The market outlook as we enter 2018 will be driven by the response of CBs to this positive growth backdrop and the inflation outlook, which so far has remained subdued. Current global CB policy remains extremely accommodative, however, in our view, both the Fed and the ECB are likely to continue to gradually remove accommodation this year. We believe market volatility could come from a series of inflation surprises that challenge the market's expectations for monetary policy, or from geopolitical events - as was the case in 2017.

In the U.S., market pricing for 2018 and 2019 continues to diverge substantially from the Fed's expectations, therefore a U.S. economy that remains on track could force further repricing of Fed Funds rate expectations. The recent progress on U.S. tax reform, which was passed in December, will likely provide a modest boost to U.S. growth. That said, political risk around Trump's presidency has also increased - as Special Counsel Mueller's investigation progresses, so the impact of the reform might be less significant than anticipated.

In Europe, growth remains strong and above trend - supported by the ECB's extended bond purchasing programme and negative rates. Political risk in Spain had been somewhat contained ahead of the Catalan elections - but we are mindful of potential future uncertainties for the country in the event of a win for pro-independence parties. In Italy, recent polls show no surprises, and continue to point to a grand coalition as being the most likely outcome of March's elections. ECB policy is expected to remain extremely accommodative throughout 2018 - although based on December's ECB Minutes, there is growing debate from the governing council about how to communicate the adjustments to their policy, and how to frame the link between their inflation target and asset purchases. This issue around ECB forward guidance may result in some volatility from Q2 onwards if the debate intensifies against a backdrop of above trend growth, and a pickup in core inflation. In the U.K., the BOE delivered a dovish hike earlier this year; and the focus now is on the Brexit negotiations, and the difficult political position of Prime Minister May.

In Credit, we remain constructive on European investment grade credit as we enter 2018. While valuations are tight in spread terms, there is still value in IG credit given the technical support from the CSPP and the strong fundamentals in Europe. Fundamentals remain very supportive, 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.

## Important Information



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