

Capturing the “Potential” in European Small-and Mid-Caps

FOCUS

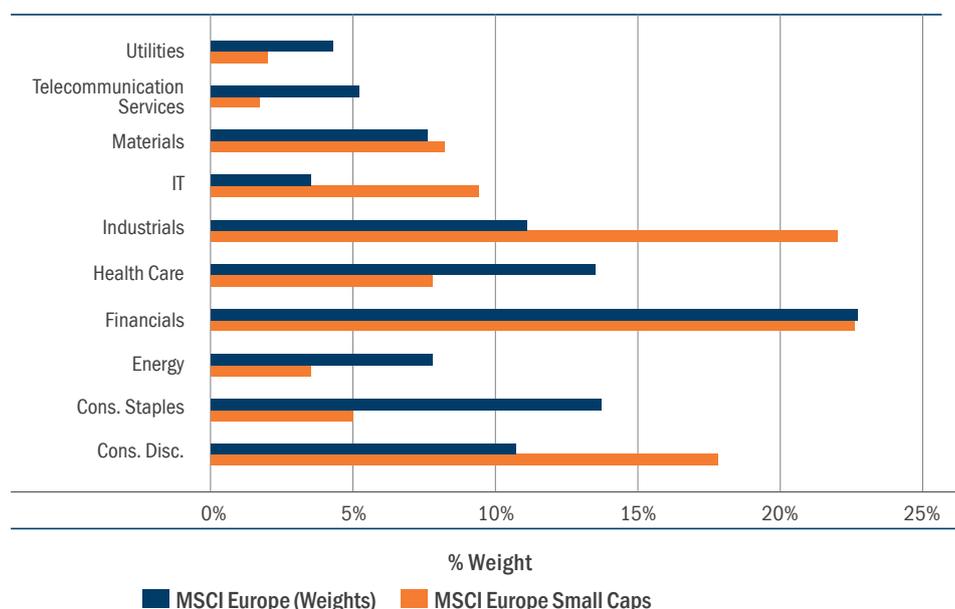
Despite the recent bouts of volatility, we enter 2015 with an air of cautious optimism. We retain our view there are a number of reasons to be optimistic regarding the asset class including greater ECB commitment, a supportive FX rate and earnings growth appearing to return.

Risk appetite appears to be on the rise and flows into Equities have increased fuelled by the recent developments from the ECB and should continue into the coming months. We believe European Equities are ideally positioned to benefit from the return of growth in Europe and Small-and Mid- Caps, in our view, represent an ideal way to play this theme.

In the following piece, we provide seven reasons to consider investing in the asset class and show why we believe our five-star, Morningstar rated Pioneer Funds – European Potential may be an ideal way to play this theme.

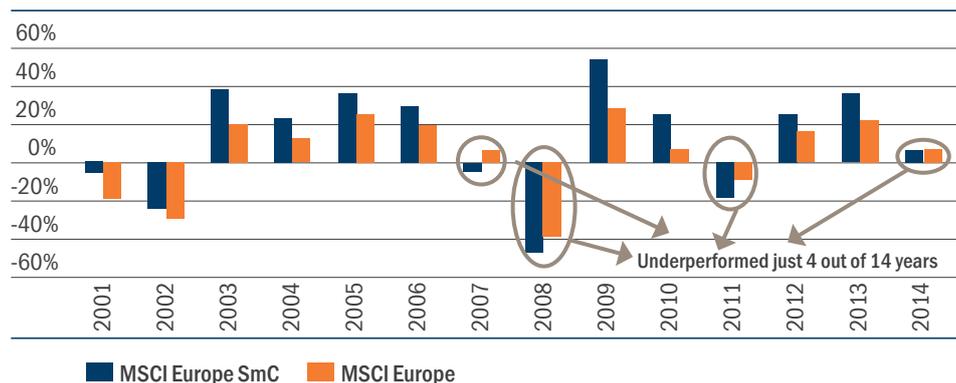
1 Cyclical in Nature

European Small- and Mid-Caps have a more cyclical bias than the European Equity market as a whole. The weight of sectors such as Industrials, Cyclical Consumer Goods and Technology is higher compared to the overall Equity market, granting a larger exposure to a recovery or an acceleration of the economic cycle.



2 Not Just High(er) Beta

European Small- and Mid-Caps’ performance in a rising Equity market is higher than the overall market: over the past 14 years, European Small- and Mid-Caps only underperformed for 4 years, in conjunction with negative equity market performance. These few periods of underperformance coincided with aggressive equity market sell-offs which were triggered by very strong risk-off sentiment, for example in 2008. In 2001 and 2002, despite negative market performance, we saw Small-and-Mid Caps outperforming the broader equity market.



Source: Factset data as at 31 December 2014.

3 (More) Solid Capital Structure (than you Might Think)

European Small-and Mid-Caps have repaired their balance sheets over the past few years and can now boast a net cash position (according to JPM Research, 37.3% of the companies in the asset class), and a Net Debt/EBITDA ratio of 1.2 compared to 1.4x for the larger Capitalisation companies.

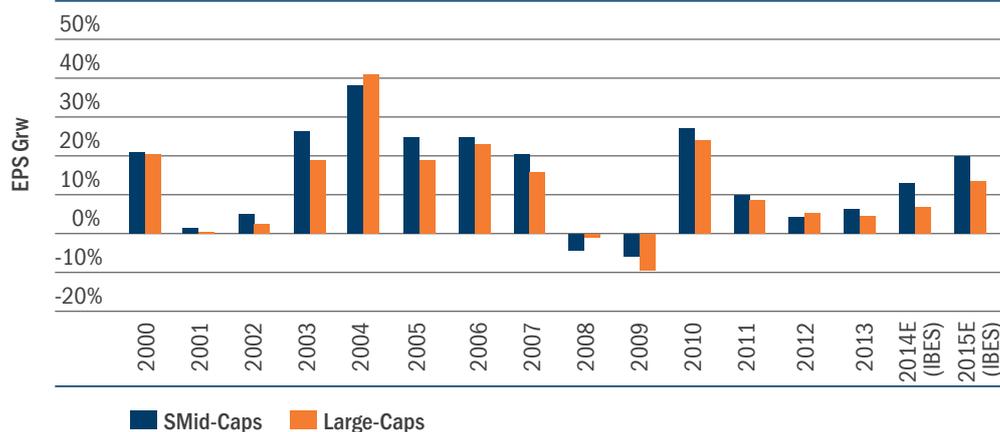
	Large Caps		Small- Mid- Caps	
	Global	W Europe	Global	W Europe
Net Debt/EBITDA	1.4x	1.4x	1.0x	1.2x
Hist Net Debt/EBITDA	1.2x	1.3x	1.1x	1.2x
% of Co's with Net Cash	28.3%	21.5%	44.3%	37.3%
% of Co's with Net Debt	71.7%	78.5%	55.7%	62.7%

Source: JPM Research as at 31 December 2014.

4 Attractive Earnings Growth

Using IBES estimates (an average of the estimates published by brokerage houses and equity analysts), European Small and Mid-Caps sales are expected to grow by 6.6% in 2015, which should allow them to translate their high operating leverage into earnings that are expected to grow by 19.8% in 2015, further emphasising the appeal of the asset class for investors looking for growth exposure. While expectations appear to us quite bullish we think earnings growth will support prices and valuations.

EPS Growth for Pan-European EQs - Equal Wtd Avgs Ex-outliers (1990-Present)



Source: Datastream, Factset, Bloomberg and JP Morgan Calculations as at 31 December 2014.

5 Diamonds in the Rough

Despite easier access to information, a strong interest from investors and brokerage houses, and a buoyant IPO market, European Small- and Mid-Caps continue to remain a market where more than 60% of the companies are covered by less than 5 analysts. This compares to c. 14% of the universe which is covered by more than 10 analysts. This leaves room for active managers supported by dedicated equity analysts to find stocks which are not yet in the spotlight and to buy early into new “future leaders”.

6 M&A – Not a Threat but Rather the Potential Icing on the Cake

M&A was a theme in 2013 and 2014. Small-and Mid-Caps are often leaders in their respective markets, have very knowledgeable and motivated management teams and are able to withstand acquisition debt when integrated into a larger company because of their healthy capital structure, nimble asset base and high operational leverage. While we have not yet seen any signs of releveraging in Europe, we argue that Small-and Mid-Caps could represent a natural target for acquisitions.

Why Consider Pioneer Funds – European Potential?

*5 star rated by Morningstar**

One of the largest funds within the Morningstar Mid-Cap Equity category

Has achieved a downside capture ratio that is better than many of our peers within the Morningstar category across multiple time periods

1

Pioneer Funds – European Potential is **one of only 6 funds** in its Morningstar category awarded the coveted **5 star** rating by Morningstar, which is awarded based on risk-adjusted returns (after fees) versus its Morningstar peer group, and is based on the performance recorded over the past 10, 5, 3, 2 and 1 years.

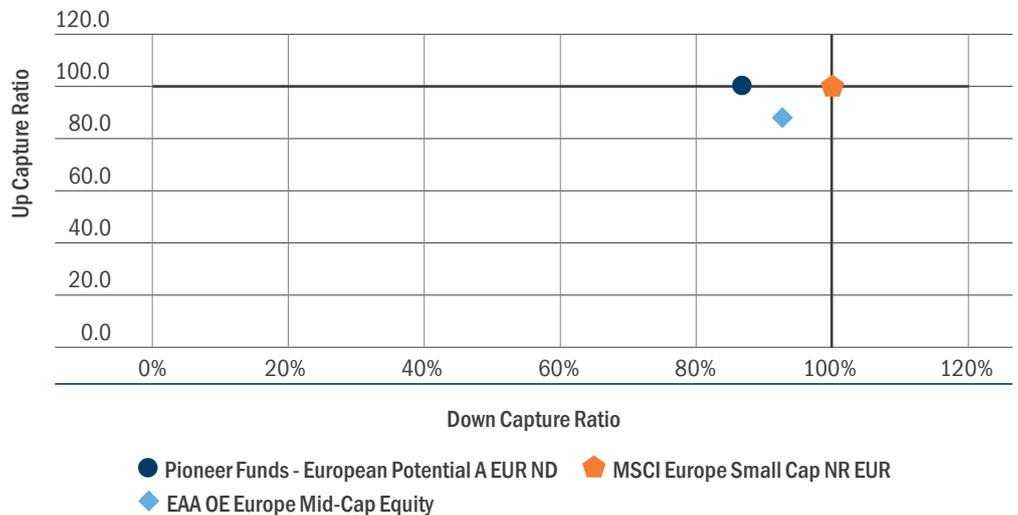
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Pioneer Funds – European Potential, as of December 2014, was one of the largest funds within the Morningstar Mid-Cap Equity category and recorded the largest inflows over the past 12 months.

3

Asymmetric Upside/Downside Capture Ratio: It is not good enough to offer excess performance with low volatility. Due to our fundamental stock picking and our proprietary portfolio construction and risk management techniques, we have also **achieved a downside capture ratio that is better than many of our peers across multiple time periods.** (in other words, historically, we have outperformed our Morningstar peer group in a negative market).

Upside-Downside Capture (1 January 2011 - 31 January 2015**)



Peer Group (1-100%): None - None Currency: Euro Source Data: Monthly Return

Source: Morningstar as of 31 December 2014 for Pioneer Funds – European Potential A-Class in Euro versus Europe Mid-Cap Peers from 01 January 2011 to 31 January 2015. **Past performance does not guarantee and is not indicative of future results.** Copyright © 2015 Morningstar UK Limited. All Rights Reserved. The information contained herein: (1) may not be copied or distributed; and (2) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

*as at 31 December 2014

**Time period reflects Portfolio management team's tenure

*Our investment process:
Commitment, Consistency
and Control*

4

Our investment process is simple yet articulated – we can explain it using the words Commitment, Consistency and Control – our “**Three Cs**”

- a. Commitment – to active portfolio management, as well as to bottom-up investing.
- b. Consistency – of (i) has delivered strong risk-adjusted performance relative to our Morningstar peer group (ii) investment team (more than 13 years investing in this asset class in Pioneer Investments) and (iii) approach to the asset class (fundamental stock-picking)
- c. Control – our dedicated portfolio construction team allows us to identify and therefore manage both implicit and explicit risks.

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