# Focus on: Pioneer Funds – European Equity Target Income

*European Equity Portfolio with an Enhanced Income Approach*

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***Exposure to equities with enhanced risk/return profile***

## Pioneer Funds – European Equity Target Income

- → Enhanced Income: Investment in a basket of high-yielding equities with the added potential benefit of income from a covered call-overwriting strategy
- → Reduced Volatility: Focus on dividend yield and use of covered call-overwriting can reduce the overall volatility of the portfolio
- → Equity Market Exposure: Can provide investors with exposure to some equity market returns

The last decade has been characterised by periods of extreme volatility in light of unprecedented economic events. The steps taken by the major central banks of the world to promote growth against the backdrop of a global economic crisis has pushed bond yields to historical lows. As a result, we believe investors are now looking outside traditional sources to increase the income of their portfolios, while recognising that other asset classes may carry higher levels of risk. Our solution has been to create a product which aims to address both these issues - targeting higher income levels from equity at lower levels of volatility. In addition, as forecasts for global growth over the coming years remain relatively muted, it is our expectation that we have witnessed a shift as investors continue to seek equity market returns, but look to use their allocation of risk in a more effective way.

Pioneer Funds - European Equity Target Income ('EETI') seeks to address all these concerns by combining the capabilities of the European equity team with the expertise of the in-house derivatives team. The aim is to provide investors with the prospect of income and capital growth from European equity markets, while aiming to reduce the risk profile of the portfolio. This product is designed for both investors seeking an income and investors seeking exposure to equity markets with the aim of reduced volatility.

## Investment Approach

| High Dividends | Option Overlay |
|---|---|
| Portfolio of 50 to 70 European High Dividend Stocks | Selling short-dated call options primarily on selective stocks held in the portfolio |
| Income from "dividends" | Income from "option premium earned" |

Potential Regular Income Distribution



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The investment process on EETI utilises Pioneer Investments' proven bottom-up fundamental investment process.

The European Equity market can be an excellent source of income with dividend yields that have been typically been in the region of 4%. EETI exploits this by investing in a basket of high-yielding equities with the aim of providing investors with an income source and exposure to equity market returns. As a starting point and to identify suitable stocks for inclusion in the portfolio, a quantitative screening process is used which identifies stocks with the following attributes:

- Attractive Dividend Yield
- Potential for Dividend Growth
- Dividend Stability
- Cash Coverage

This screen is purely to reduce the investment universe to a more manageable size. Typically, we screen for stocks with a market capitalisation of €1 billion or over and look for companies, which have not only paid an attractive dividend yield, but we believe also have the ability to maintain and possibly grow that yield. Approximately 200 stocks pass the screening process. The Portfolio Manager then works with Pioneer Investments' career analysts to decide which stocks may be suitable for inclusion in the portfolio. Each analyst specialises in a particular sector and thus can provide invaluable insights into both the sector and chosen company.

A key differentiating factor of this portfolio from traditional dividend portfolios is that having two income streams allows for greater flexibility when constructing the portfolio. As there is an additional income stream, the Portfolio Managers do not need to rely so heavily on the highest-yielding parts of the market, which often may offer little or no upside. As a result, the Portfolio Manager works closely with the team of analysts to identify companies that we view offer, not only a sustainable dividend, but also have the potential for upside from a valuation perspective. As a result, the portfolio is more balanced in terms of sector and country weightings than traditional dividend portfolios allowing investors broader equity market participation.

Once the portfolio has been constructed, the Lead Portfolio Manager works with the derivatives specialist, who in turn aims to enhance this income stream through a technique called covered-call overwriting. This involves writing call options on the certain stocks in the portfolio potentially increasing the income in the portfolio through the premiums received from these options.

## What is Covered Call-Overwriting?

Covered call-overwriting involves selling an option to a third party on a stock already held in the portfolio. This gives the buyer the option to buy shares from the seller at a pre-agreed price on a future date. The option seller receives an upfront fee or "premium" for writing the call option.

Our option-writing process is a team-based fundamental process. We begin by screening the stocks already held in the portfolio based on a number of metrics including valuation, volatility and any potential upcoming events such as a dividend payment. This provides our derivative specialists with an idea of which stocks are most suitable for option-writing at any point in time. The derivatives specialist then proposes different opportunities to the Portfolio Manager. The Portfolio Manager, in turn, uses his fundamental knowledge of each stock and may decide he



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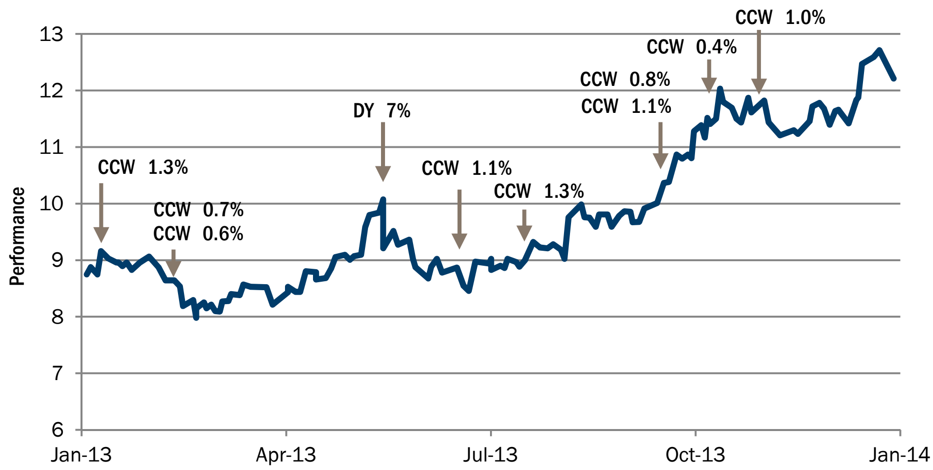
does not want to write options on particular stocks because he is aware of an upcoming event or potential catalyst that might cause the share price to move higher. In addition, our derivative specialists typically aim to write 105-110% out-of-the-money (OTM) calls, whereby the option's strike price is higher than the market price, giving less probability of the stock being called away. This team approach means each participant is using their skills and knowledge to further reduce the risk of stocks being called away with the objective of generating additional income, while reducing any negative impact of the option overlay on the potential for market participation. As a result, we have generated the required additional income by writing calls on an average of just 10-15% of the portfolio's holdings. This fundamental approach is a key differentiator versus any systematic overlay, which aims to optimise income, but gives little thought to the risk attached. In our opinion, option writing should always be an enhancement in the portfolio. Hence, the reason we target approx. 2/3 of income from dividends and 1/3 from options.  Although increasing the amount of options we write could deliver higher income, we believe the risks do not outweigh the reward and favour our more prudent approach to enhancing the income of the portfolio.

### Covered Call-Writing in Practice



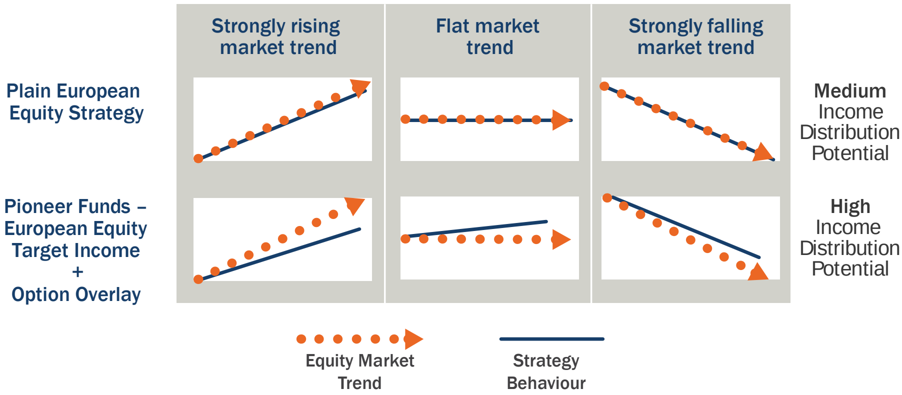

Source: Bloomberg,  December 2013, Gross Calculation of yields. Past performance is no guarantee of future results.

The portfolio is actively managed and information may not be representative of current or future holdings.  References to individual stocks should not be taken as an investment recommendations to buy or sell a particular stock.

In the example above, the portfolio buys a German based telecommunications company with a high dividend yield. Over the one year period, the team took the opportunity to write a number of options on the stock to generate additional income, while continuing to benefit from the share price appreciation.

# Providing Returns in a Variety of Market Scenarios

**Dividend Yield + Option Overlay**
**May Outperform the Broad Equity Market in Different Market Scenarios**




The portfolio seeks to provide returns to investors in a variety of market scenarios. In a flat or bear market, covered call-overwriting can improve a portfolio's risk/return profile by providing additional up-front returns to the portfolio. As the fund receives premiums up-front the potential for capital appreciation may be capped in strongly rising markets. Even in a bull market, covered call-overwriting can improve the overall risk/return profile of a portfolio, provided the call over-writer is adequately compensated for the magnitude and frequency of market rallies.

Unsurprisingly, given the stocks held in the portfolio and also the reduction in volatility in the portfolio from the option overlay, the portfolios have tended to outperform during falling markets. This lower downside capture also contributes to the longer-term performance potential of the product. As a result, we believe investors who do not require an income but are seeking equity market exposure with lower volatility may find this product attractive.

**Reasons to Invest:**

- Income*: Target yield set at the beginning of each year.
- Bridge to Equities: Provides investors with some exposure to equity markets
- Reduced Volatility: All portfolios have demonstrated lower volatility versus respective markets
- Semi-Annual Distributions: A semi-annual distributing unit class is available to our investors

* Expected income target can be exceeded or undershot and should not be construed as an assurance or guarantee

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Unless otherwise stated all information contained in this document is from Pioneer Investments and is as at 20 June 2014.

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