Monthly Portfolio Update

*Amundi Funds II – Pioneer Strategic Income**

31 May 2018

BOND COMMENTARY

Market Review

Volatility returned to markets over the month, driven primarily by politics. President Trump's hard-line policy on exiting the Iran nuclear deal, and his reversal on tariffs, renewing demands for steel and aluminum tariffs against U.S. allies, contributed to unsettled markets. But Italy took centre stage in the second half of the month with populist victories in its elections, reminding investors of deep divisions between core and peripheral countries in Europe and of the fragility of the Euro. Finally, investor concerns rose about certain Emerging Market (EM) countries with high external indebtedness, on concerns of rising U.S. rates and a strong U.S. Dollar, reduced Dollar liquidity, trade wars and high oil prices. Oil prices, however, fell from their $72 highs to $67, as OPEC and Russia hinted they would increase production.

U.S. Treasuries and German Bund prices rallied as safe haven assets. In the middle of the month, the U.S. 10-year Treasury breached 3.1% on a 26% increase in S&P 500 corporate profits, a rebound in retail sales, and better than expected U.S. GDP growth. 10-year yields then plummeted to a low of 2.82% on 29 May, recovering to 2.90% by month end, as investor fears about trade wars and the potential exit of Italy from the Euro took hold. In addition, public comments of FOMC members were generally more dovish than expected.

Most credit markets underperformed Treasuries over the month. Agency MBS delivered -0.05% excess returns, as rate volatility rose. CMBS and ABS enjoyed better performance, delivering returns in line with Treasuries. Investment Grade (IG) corporates suffered the worst underperformance, with excess returns of -0.45% and year-to-date excess returns of -1.18%. Year-to-date total returns for IG corporates stand at -2.7%. While Financials as a whole held in better than other Industrials and Utilities over the month, European banking paper sold-off sharply. High Yield (HY) corporates modestly underperformed IG corporates, posting a -0.65% excess return over the month, but have significantly outperformed IG on a year-to-date basis, with a -0.25% total return and 0.38% excess return. Certain non-IG EM sold-off sharply; while IG sovereigns lost -0.41%, non-IG sovereigns lost -3.12%. Within corporates, IG EM were down modestly by -0.10%, compared to -1.44% for HY corporates. The broad U.S. Dollar Index rose 2.1% over the month; the Yen rose 0.5%, as a risk-off trade, while the U.S. Dollar rose 3.3% vs. the Euro.

Portfolio Review

The Portfolio underperformed the 0.55% return of its benchmark, the Bloomberg Barclays U.S. Universal Index, in May.

Duration positioning, sector allocation and currency all detracted from performance over the month.

Positive:
There were no significant contributors to performance.
Negative:

- The relative short duration position of 1.56 years detracted significantly from performance, as yields fell over the month. The relative short duration position within the U.S. and net short position in the German Bunds/Bobls both underperformed, as the Italian crisis drove a flight to quality in both regions.
- Sector allocation also hurt performance, due primarily to the 31% underweight to U.S. Treasuries and the 3.6% allocation to TIPS. 30-year TIPS underperformed, as breakevens, which indicate inflation expectations, fell from 2.19% to 2.08%.
- Non-Dollar exposures fell as the U.S. Dollar rose, reflecting underperformance of the long positions in certain European currencies, as well as in the Uruguayan Peso.

Outlook & Positioning

We believe U.S. GDP growth may accelerate to almost 3% over the year, benefitting from significant tax cuts, deregulation and stronger fixed investment spending. Solid employment and income growth may continue to support consumption and the housing market. Higher corporate profits, benefitting from strong global growth, tax cuts, and the 100% expensing of fixed investment, may also support increased fixed investment.

Globally, we believe the Eurozone and Japan may also grow above their potential GDP, benefitting from still supportive monetary policy. Eurozone growth may be lower than that achieved in 2017, as exports may suffer from the lagged effects of a stronger Euro. In addition, political risk has risen in Europe, with more populist governments in Italy and Spain representing a significant risk for the Euro. While China's growth may moderate in light of its goals to rein in credit growth, we believe a modest decline in China's growth will not disrupt overall Asia or global GDP growth.

Global growth may moderate, however, in the face of Trump's more aggressive protectionist trade policy. While the U.S. and China are currently negotiating trade imbalances, Trump has been aggressive against U.S. allies.

We continue to believe that inflation may surprise to the upside on a number of fronts in 2018 and that the FOMC may be behind the curve in raising rates. Nascent signs of wage growth acceleration, service inflation, tighter labour markets in key industries such as homebuilding, higher import prices resulting from tariffs, and more restrictive immigration policies may contribute to higher price levels in the coming year. In addition, producer price indices are already increasing, on the heels of higher oil and metals prices. Fiscal stimulus, including the tax cuts and higher spending from the budget has the potential to further fuel inflation.

The Portfolio continues to be positioned for rising interest rates and a solid economy. It holds the following positions:
Overweight to diverse credit sectors, underweight to U.S. Treasuries. Most U.S. government debt is unattractive, while credit sectors may benefit from stronger growth, lower taxes, and less regulation.

The Portfolio holds a relative short duration position compared to its benchmark. We have reduced our relative short duration position, however, to -1.5 years, with -0.9 years within the U.S. and -0.6 years to the German Bund/Bobl, as the Fed seems to have struck a more moderate tone on the speed of its rate increases. Nonetheless, we believe the market may be behind the curve, given solid GDP growth, and little slack in the labour market. At 1.8%, core PCE is near the Fed's year-end target. With the unemployment rate at 3.8%, we anticipate that continued wage inflation will help drive core PCE to higher levels through the year.

We hold long-duration TIPS, which can help protect the Portfolio should inflation surprise to the upside. We believe inflation expectations could overshoot; in addition, these levels remain below long-term averages.

The Portfolio holds an Index weight in agency MBS; including the 12% in non-agency MBS, it continues to remain significantly overweight to the RMBS sector. Fundamentals within the housing market remain positive, spurred by strong GDP growth and employment, and still affordable mortgage rates. In addition, we believe that agency MBS offer investors reasonable value at current spreads. While certain investors are concerned about the increased net supply of approximately $400 billion forecast for 2018, we believe that the market has already priced in this forecast (which we witnessed earlier in 2017 when the Fed first announced the taper plan). The Federal Open Market Committee has been fully transparent in setting forth its tapering programme with respect to both U.S. Treasuries and agency MBS. Moreover, agency MBS already extended duration in the fourth quarter of 2016, in response to higher rates, and we do not foresee significant extension risk going forward. High quality non-agency RMBS remain attractive, with pristine credit metrics and trade approximately 1.25 points behind agency MBS, translating into a spread pickup of 25 bps vs. agency MBS.

We believe structured securities including ABS and CMBS generally offer more attractive relative value than corporates, and find attractive opportunities within non-Index ABS issues.

The Portfolio holds a near Index weight in IG corporates, with an overweight to U.S. IG and an underweight to non-US IG. The Portfolio also continues to hold an overweight to HY corporates. Spreads in broad IG corporates now stand near fair value; but these spreads reflect lower average quality and overall longer duration relative to their historical levels. Leverage in IG corporates is significantly higher than in the past, with 23% of the market trading at greater than 4X leverage, compared to 11% five years ago. Tighter spreads and higher leverage is counterbalanced by strong fundamentals. We continue to believe, however, that corporates face greater downside risk than agency MBS, in a higher volatility environment that may result from a negative outcome on trade policy, an unexpected change in central bank policies or from an unexpected slowdown in global growth.

Within corporates, we continue to hold an overweight to Financials in banks, insurance and REITS. We had reduced the bank overweight, including European exposures, coming into 2018, based on valuations. We continue to believe the banking, insurance and REITS offer attractive relative value and may perform well, despite a rising rate environment. While spreads are modestly lower than the broad corporate benchmarks, Financials offer lower event risk of share repurchases or credit impairment due to M&A activity. Banks are currently focused on improving capital ratios to meet regulatory requirements. Banks should also benefit from rising global yields and steepening yield curves.

We continue to hold an overweight to the Energy midstream sub-sector, a sector that shows relatively less sensitivity to oil price volatility. We expect continued spread tightening in the space, which remains one of the wider-trading subsectors in IG. The mid-stream space is benefitting from increased production, and is building new pipelines to transport that production to market. While Saudi Arabia and Russia have indicated plans to increase production, we believe that, with Venezuela's reduced production, oil prices may be range-bound.

The Portfolio includes certain EM exposures. We had reduced EM exposures over the past year based on extended valuations. Over the past month, we further reduced certain sovereign and supranational exposures, related to countries more vulnerable to oil price increases and with greater external debt, on increased risks we see facing certain EM. We continue to believe certain EM are benefitting from stronger global growth and increased domestic demand.

We believe the U.S. Dollar may be range-bound going forward, or may modestly appreciate in the shorter term should Eurozone growth disappoint. Given the higher volatility associated with currencies, we have significantly reduced our EM currency exposure.

Important Information

On the 16 February 2018, Pioneer Funds was renamed Amundi Funds II. Prior to 16 February 2018 the name of the sub-fund was with the prefix "Pioneer Funds".

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Date of publication: 12 June 2018.
Document ID: 524646

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