Liquid Alternatives:

A Panacea for Goal-Based Investors?

May 2017

Today's investment landscape is vastly different to previous cycles. As we approach the latter years of a bull market in both equities and bonds, investors now find themselves in a situation where valuations on traditional asset classes appear stretched. At the same time, traditional correlation patterns are breaking down and the frequency of extreme events is rising – all of which could, in our opinion, increase the likelihood that investors' investment goals may not be met. Our belief is that this change will be long-lasting and the traditional 60% bond/ 40% equity investment framework will no longer be resilient or flexible enough for this environment.

Investors will likely be required to re-evaluate and enhance redundant asset allocation techniques through:

1. The inclusion of alternative sources of return
2. Migrating to more **innovative portfolio construction techniques**, which have the potential to cope with new and increasing risks in a period of lower returns

Use of Liquid Alternatives can Support the Rise of Goal-Based Investing

In our view, investors will need to be more disciplined in terms of identifying their desired investment outcome before structuring their portfolio – ***Goal-Based Investing.*** Investors should become more benchmark-agnostic and focus on how their investment goals can be achieved. In this context, we believe investors should consider the enhancement that alternative sources of return (or liquid alternatives) can provide to portfolios.

Similar to equities and bonds, where different geographies or grades exhibit different return and risk expectations, Liquid Alternatives come in a variety of forms – using different asset classes and diverse strategies in their bid to achieve defined goals. With this in mind, we believe an investor's consideration of Liquid Alternatives should match their individual investments goals.

What are the Main Challenges Facing Investors Today?

While each investor is unique, we believe there are three dominant investor requirements in the current market environment and here we consider each of these challenges and demonstrate the role that different Liquid Alternative strategies can play in overcoming them:

How to Manage?

INSUFFICIENT RETURNS ✔ | DRAWDOWN ✔ | VOLATILITY ✔

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The Challenge: Insufficient Returns

Consensus opinion suggests that future returns are likely to be lower across all asset classes, meaning investors' ability to meet their liabilities will be pressured going forward. If an investor's primary goal is 'return-orientated', rather than seeking to optimise returns through a higher allocation to riskier assets (such as equities), we believe Liquid Alternatives can offer a potential solution without raising the portfolio's overall risk/return profile.

Liquid Alternatives have the potential to capture 'new alpha' – the return of financial assets driven by a relatively small number of independent factors: equity market return, interest rate return, and spread return, etc – that can act as a driver of returns independent to those from traditional asset classes.

However, Liquid Alternative strategies can vary in terms of how they arrive at their end goal, so it is important that investors should focus on what their total return goals are and what level of risk they are willing to take to achieve that. The chart below shows a selection of Liquid Alternative strategies based on their achieved annualised risk and return:

Sample Risk/Return Metrics for Different Liquid Alternatives

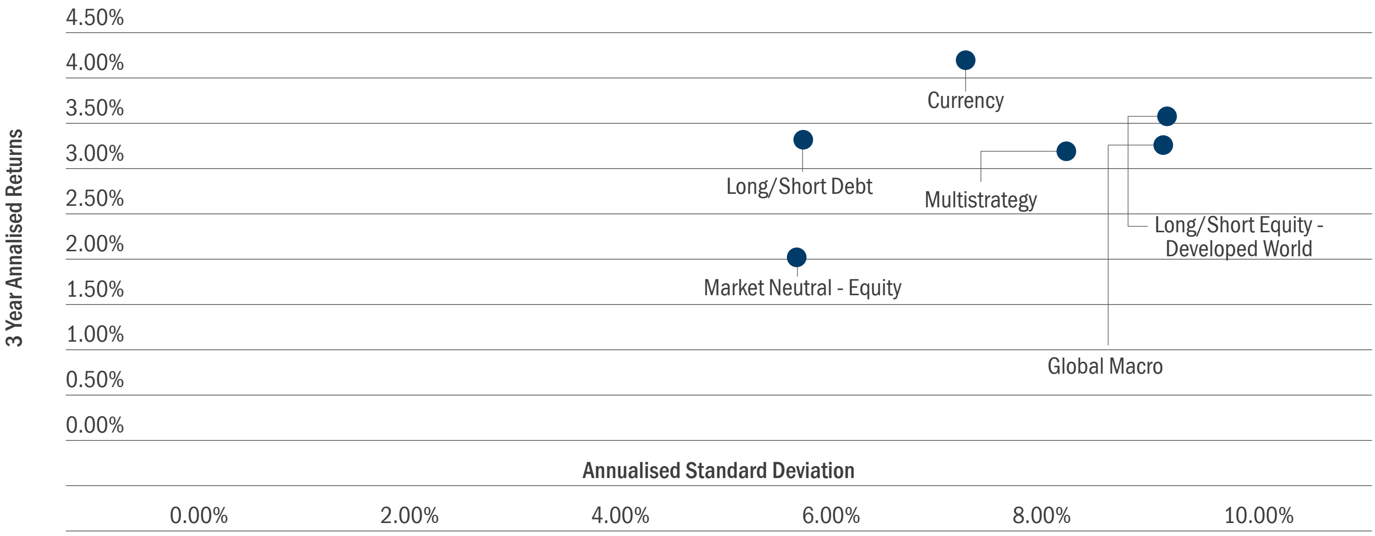


Figure 2: Sample Risk/Return Metrics for different portfolios showing alternative currency funds over a 3 year period (from March 2014 to March 2017) had the highest return. Based on Morningstar categories. Illustrative purposes only. Past Performance does not guarantee a profit or protect against a loss.

If maximising investment returns is truly the key focus, we believe the investor should acknowledge that a higher appetite for risk is needed to achieve that goal.

Our solution:

As shown on the above sample risk/return metrics, a Liquid Alternative currency strategy has the potential to deliver the highest return characteristics and, therefore has the potential to enhance the return profile of a traditional 60/40 portfolio.

Our ***Pioneer Funds – Absolute Return Currencies*** seeks to deliver strong risk-adjusted returns by taking advantage of opportunities in the world's most efficient and liquid market – currencies. It has an unconstrained approach to currency selection, and only takes positions in those the team believes offer the best risk-reward. Combined with a robust drawdown management process, this offers an opportunity to deliver positive returns.

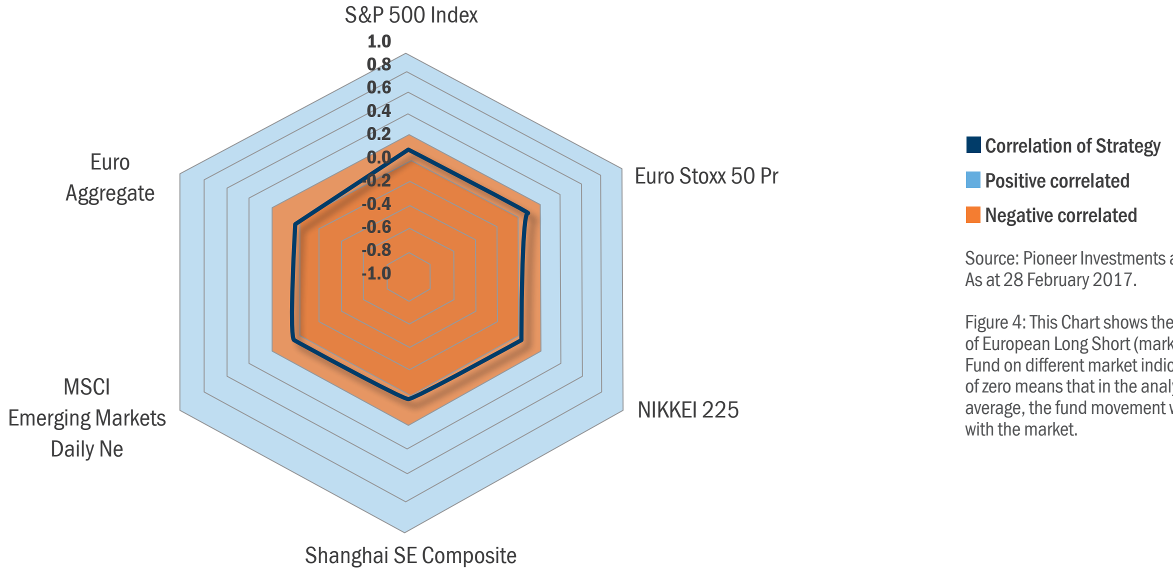
The Challenge: Drawdown Containment

Almost every asset class experienced a sharp drawdown at some point during 2016 and for investors with limited ability to absorb drawdowns, a traditionally diversified portfolio may not offer adequate protection. Investors seeking to limit drawdowns, while retaining the potential for returns, we believe, should pursue a Liquid Alternative strategy that has limited directionality and a typically lower drawdown profile.

Our solution:

Market neutral equity strategies seek to eliminate beta and, as a result, are characterised by a very low correlation to traditional asset classes, whilst still offering alpha potential.

Pioneer Funds – Absolute Return European Equity Typically Exhibits Low Correlation with all Asset Classes



Source: Pioneer Investments and Bloomberg. As at 28 February 2017.

Figure 4: This Chart shows the low correlation of European Long Short (market neutral) Equity Fund on different market indices. A Correlation of zero means that in the analysed period, on average, the fund movement was not correlated with the market.

Our ***Pioneer Funds – Absolute Return European Equity*** seeks to generate positive absolute performance in all market conditions. To achieve this, a two-pillar approach is applied. Firstly, our proven European equity research capabilities are utilised to identify the most compelling investment cases on both the long and short side. Secondly, Portfolio Construction techniques are embedded in the process to help mitigate drawdown risk and ensure a balanced portfolio.

The Challenge: Volatility

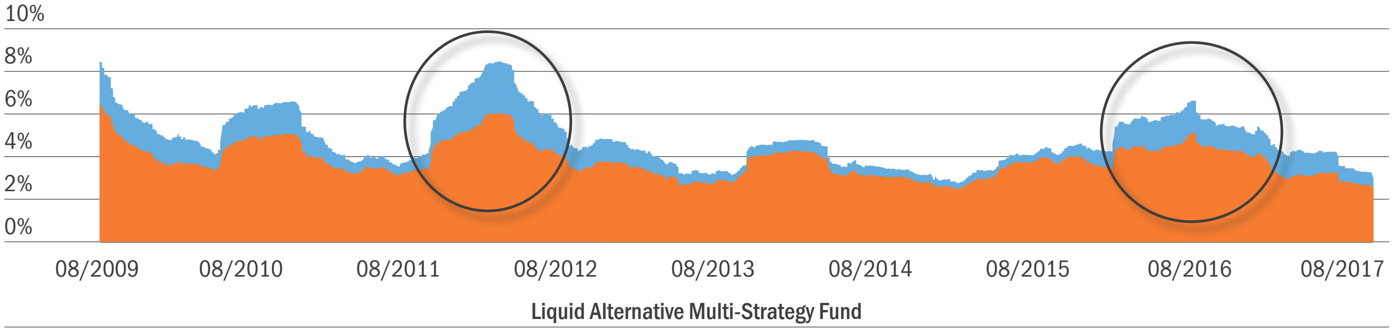
The occurrence of volatility events have been high in recent years and investors face an ever-growing task of how they manage their exposure to this volatility – Liquid Alternatives can provide some level of protection by potentially offering a 'smoothed' return.

Our solution:

Multi-Strategy portfolios which combine directional and non-directional positions can provide a way to have good exposure to market premia while seeking to reduce portfolio volatility. The chart overleaf shows how the inclusion of a Multi-Strategy Liquid Alternative strategy to a traditional 60/40 portfolio can act as a volatility dampener while still allowing the portfolio to actively participate in fund performance.

Our ***Pioneer Funds – Absolute Return Multi-Strategy*** seeks to pursue stable returns in an era of low bond yields and rising market volatility. The team target alternative return streams with low correlation with equity and bonds, while disciplined drawdown management aims to mitigate capital losses.

Realised Volatility of a 60/40 Portfolio with and without Pioneer Funds – Absolute Return Multi-Strategy

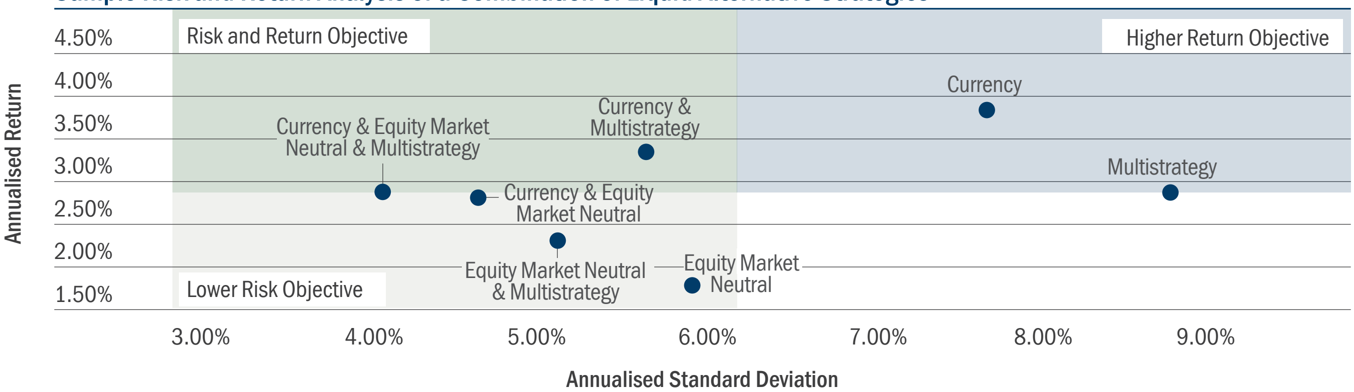


Source: Pioneer Investments and Bloomberg. As at 28 February 2017.
Figure 8: Liquid alternatives mixed in a fund allow a reduction of volatility, but unlike simple deleveraging, they reduced volatility when the volatility spikes. Potentially reducing volatility when you need it the most. For illustrative purposes only. 60/40 Portfolio refers to a Portfolio made up of 60% Bloomberg Barclays Global Aggregate Bond TR Hedge EUR Index and 40% MSCI World TR Euro Index. Neither index is available for direct investment, so the portfolio impact shown is purely hypothetical and not indicative of any actual performance results. The Liquid Alt Portfolio included in the analysis is liquid alternative multi strategy fund.

Multiple Goals? Combine Liquid Alternative Solutions to Address Multiple Issues

In reality investors may have more than one goal. We believe adding a combination of different Liquid Alternative strategies could be helpful in addressing these goals.

Sample Risk and Return Analysis of a Combination of Liquid Alternative Strategies



Currency: Pioneer Funds – Absolute Return Currencies
Multistrategy: Pioneer Funds – Absolute Return Multi-Strategy
Equity Market Neutral: Pioneer Funds – Absolute Return European Equity

Source: Pioneer Investments and Bloomberg. As at 28 February 2017. For illustrative purposes only. The grid shows the risk and return analysis of a combination of sample liquid alternatives strategies.

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