Monthly Portfolio Update

Pioneer SICAV – Absolute Return Bond

28 February 2017

Pioneer SICAV – Absolute Return Bond is a feeder fund of and invests 100% of its assets to buy units in Pioneer Funds – Absolute Return Bond (the "Portfolio"). The following commentary therefore reflects the investment strategy and process including holdings of the Portfolio.

Overview

This month, the Portfolio had a negative absolute return on a net basis.

February was another month dominated by political events, with economic data coming a close second in terms of influencing market price movements. Two main political themes grabbed the market's attention – whether U.S. President Donald Trump would be able to enact his election campaign promises, and how the French Presidential election would pan out. In the case of the former, markets began to suspect that it would be both harder and longer for Trump to make all the changes he promised. If this does indeed turn out to be the case, it would lead to a downgrading of U.S. growth and inflation expectations for 2017. Indeed, some of the price action we saw during February suggested that some of the "Trump reflation" trades were being unwound. U.S. 10-year bond yields fell from 2.45% at the start of the month to finish the month at 2.35%. The U.S. yield curve also flattened during the month, meaning longer-dated securities outperformed. Economic data was generally ok in the U.S., with continued strong growth in employment and a sharp uptick in inflation from 2.1% in December to 2.5% in January.

In Europe the focus was squarely on the French Presidential campaign. Last month Mr. Benoit Hamon emerged as the surprise Socialist candidate for the national elections at the end of March. In February the centre-right Conservative candidate and frontrunner Mr Francois Fillon was rocked by a scandal concerning payments made to his wife. That allowed the centrist candidate Emmanuel Macron to suddenly become the media's favourite, but he is relatively untested in the political arena and lacks the backing of a big party. All the time, the National Front's Marine Le Pen continues to poll well. Her pledge to call for a referendum on France's membership of the EU spooked markets, and briefly saw the spread between 10-year French and German government bonds blow out to nearly 80bps, having traded as low as 40bps in mid-December. It also had knock-on effects on other peripheral European markets such as Italy where 10-year spreads against German Bunds briefly touched 200bps, a level not seen since early 2014. Economic data in Europe continued to point to an economy that has started the year on a strong footing. Indeed the Euro-area Composite Purchasing Managers' Index (PMI) for February rose to 56.0 from a previous level of 54.4, whilst headline inflation rose to 1.8% in January from 1.1% in December, although core inflation was unchanged at 0.9% year-on-year. As in the U.S., bond yields rallied with the 10-year German Bund yield falling from its end-January level of 0.44% to finish February at 0.20%. Generally the curve shape was unchanged during the month.

The Bank of England acknowledged that the effects of the Brexit vote had little effect so far on the UK economy, and raised their growth forecasts for 2017 from 1.4% to 2%. They revised their inflation forecasts slightly lower, but importantly revised their forecast for the neutral level of unemployment from 5% to 4.5%, thus acknowledging that there still remains some degree of spare capacity in the UK economy. UK bonds benefitted from these revisions and the 10-year yield fell from 1.40% at end-January to 1.15% at end-February.

Having struggled in January, the U.S. Dollar recovered some of its poise in February, with the Dollar Index moving from 99.50 at end-January to 101.00 at end-February. The U.S. Dollar appreciated from 1.08 to 1.06 against the Euro as the chances of a March U.S. Federal Reserve rate hike rose to almost 50%. In keeping with the global rally in bond yields, most Emerging Market (EM) currencies performed well during February and made good gains against the U.S. Dollar.

Market Review

Prices/Other Indices	Feb-17	Dec-16	Sep-16
Gold Spot (USD$)	1248	1152	1318
Oil - West Texas (USD$)	54.00	53.72	48.24

VIX (Euro)	12.92	14.04	13.29

Source: Bloomberg as at 28 February 2017.

Government Bond Yields	2 Year			5 Year			10 Year			30 Year		
(%)	Feb-17	Dec-16	Sep-16	Feb-17	Dec-16	Sep-16	Feb-17	Dec-16	Sep-16	Feb17	Dec16	Sep-16
U.S.	1.26	1.19	0.77	1.93	1.93	1.15	2.39	2.45	1.60	3.00	3.07	2.32
Germany	-0.90	-0.77	-0.69	-0.57	-0.53	-0.58	0.21	0.21	-0.12	0.99	0.94	0.45
UK	0.10	0.08	0.10	0.55	0.49	0.22	1.15	1.24	0.75	1.74	1.88	1.49
Japan	-0.26	-0.18	-0.29	-0.14	-0.09	-0.25	0.06	0.03	-0.09	0.81	0.58	0.46
Ireland							0.89	0.75	0.33			
Spain							1.66	1.38	0.88			
Italy							2.09	1.99	1.19			

Source: Bloomberg as at 28 February 2017.

Currencies	Feb-17	Dec-16	Sep-16
Euro/USD	1.06	1.05	1.12
Euro/GB Sterling	0.854	0.854	0.87
Euro/Yen	119	123	114
USD/Yen	113	117	101
GBP/USD	1.24	1.23	1.30

Source: Bloomberg as at 28 February 2017.

CDS Indices (Euro Unhedged)	Feb-17	Dec-16	Sep-16
iTraxx Europe Crossover	291.4	287.8	338.31
iTraxx Europe Main	72.8	72.35	72.59

Source: Bloomberg as at 28 February 2017.

Credit Indices (Unhedged, YTD returns %)	Feb-17	Dec-16	Sep-16
Bank of America Merrill Lynch Euro Large Cap Corporate (Euro)	0.59%	4.78%	6.13%
Barclays Global High Yield (USD$)	3.12%	14.27%	14.49%

Source: Bank of America Merrill Lynch, Bar Cap as at 28 February 2017.

Portfolio Review

Risk Positioning

During February, following close co-ordination between the Portfolio Management and Portfolio Construction teams, we made the decision to introduce a new alpha strategy called "Macro Hedging". The purpose of this sleeve is to allow us to hedge excessive duration or weighted correlation risk within portfolios or strategies. More details can be found in a separate note issued at the start of March 2017.

In terms of overall duration profile, the Portfolio ended the month with a duration of -1.86 years. The majority of the underweight duration stance comes from short positions in the Inflation, Interest Rates $ Bloc and Interest Rates Japan alpha sleeves, with other contributions from the Interest Rate Scandi and Interest Rates U.S. sleeves.

The credit spread duration of -0.07 is mainly due to some short positions in the European Itraxx Main credit index and the U.S. CDX credit index in our Credit Spread Duration Macro alpha sleeve.

Top 2 Performing Alpha Sleeves

ITREND EUR: Our model switched to a long duration stance at the end of January, and that signal was reinforced by mid-month, when we increased the size of our long position. Therefore we were able to benefit from the global rally in bond yields, with 10-year German Bund yields dropping from 0.45% at the start of February to 0.20% by month-end. This helped the ITREND alpha sleeve make a positive contribution to overall performance this month.

Trend Forex: The counterpart to our ITREND rates alpha sleeve, this sleeve uses the same methodology but in the FX markets to predict price movements across a range of currencies. In February, the models started the month giving a long U.S. Dollar signal, and these positions benefitted from the appreciation of the U.S. Dollar. By month-end, the signal has switched to a short U.S. Dollar bias, and overall this alpha sleeve made a marginal positive contribution to overall Portfolio performance.

Bottom 3 Performing Alpha Sleeves

Relative Value: This alpha sleeve suffered from a long 10-year France vs Short 5-year Germany (duration adjusted) position when French spreads blew out on political worries. We had implemented this position when spreads started widening, and even though we think the spread between Germany and France is currently too wide, we have closed the position. Another position expecting semi-core European 30-year to outperform 5-year 5-year EUR swaps (duration-adjusted) underperformed in the general widening of non-core European spreads. Overall this was the worst-performing alpha sleeve during the month.

Interest Rates $ Bloc: This alpha sleeve suffered from a position that was expecting higher New Zealand Dollar 5-year yields, but the decision of the Reserve Bank of New Zealand to leave rates unchanged caused a sharp drop in bond yields, as the market had been expecting higher rates. Two other positions (a short duration 3-year Australian futures position and a short duration 10-year Canadian futures) also both detracted from performance as global bond markets rallied.

Interest Rates EUR: Another alpha sleeve that was affected by the global rally in bond markets in February. We had implemented a short duration position in 10-year German Bund futures in anticipation of higher bond yields, but this did not work and the position detracted from overall performance.

Outlook

We have, for the past couple of months, expressed the view that the primary driver of markets in 2017 could be geo-political events and, to a lesser extent, central banks. Markets may vacillate between believing that U.S. President Trump can enact many of his election promises (in which case bond yields should rise) and believing that many of the promises won't be enacted until later in 2017 (taking upward pressure off bond yields). Much has already been priced into markets in terms of the reflationary benefits of Trump's promises, leading to higher bond yields and steeper yield curves, as well as increased inflation expectations. In general we feel that Trump's policies could support the reflationary theme evident in markets since his election, and should continue to drive the trends mentioned above in bond and FX markets. We also believe that the market may be too sanguine about the path of the Fed Funds rate in 2018, with expectations currently being that the Fed's dot plan is too aggressive. Should the U.S. economy, which is already running at close to full employment, receive a significant boost to growth from Trump's policies, we believe wage pressures could emerge. This in turn could force the Fed into a tighter pace of tightening than currently envisaged.

Our view that the reflationary theme across Europe should continue into the first half of 2017, largely driven by a strong finish to 2016 in growth terms, base effects and the rise in oil price, has been vindicated by the data in the first two months of the year. Combining this with bond valuations, which we feel are still expensive by historical standards, leads us to favour a short duration bias to Euro nominal yields and Euro real yields. We expect to maintain this general bias throughout 2017, but increased political uncertainty in Europe during 2017 makes it difficult for us to predict with clarity the exact path of bond yields over the course of the year. National elections are scheduled to be held in the Netherlands, France, Germany and possibly Italy in 2017 and although established pro-European parties appear to be the likely winners in all countries, there are significant risks in each country that an anti-European party may poll better than expected. This is a key reason why we feel there may be more of a shift towards fiscal expansion in Europe, even if it happens via stealth means such as budget deficit slippages. Another factor that will have to be taken into account is the ECB's proposed reduction in their Public Sector Purchase Programme, scheduled to fall from a current monthly pace of €80bn to €60bn in March 2017. In turn, this may put further upward pressure on bond yields, especially if the strong inflation and economic numbers put pressure on the ECB to accelerate the reduction of their Purchase Programme.

In the UK, the domestic economy continues to hold up quite well, although there are some signs of slowing growth on the fringes. Much of the strength in recent months has been driven by the consumer and a rise in consumer debt. But recent data shows a slowing in consumer lending and with real wages being squeezed hard by higher inflation, we have our doubts that this consumer-driven strength will last. From a markets perspective, we continue to believe that a steeper UK yield curve is warranted, as a larger inflation premium is incorporated into longer-dated bonds. In late 2016, the Chancellor announced net borrowing is to increase over the next five years, funded by new T-Bill and gilt issuance, another factor that could push yields higher.

Given our view that global bond yields should experience upward pressure during early 2017, we anticipate that the Bank of Japan's (BOJ) plan to target price-based policy stimulus (namely anchoring the 10-year yield around 0% yield) could come under pressure. The increased yield differential between Japanese government bonds and other markets (particularly U.S. Treasuries) could cause the Yen to depreciate, but we still believe the BOJ's actions might have limited success in pushing inflation towards the target level of 2%.

Heading into 1Q17, we remain constructive on European Investment Grade Credit overall, continuing to view value in segments of the market.

There are also reasons for a more cautious stance from rising political and macro risks in our view, whether it be from the large calendar of elections in Europe in the coming months (leading to fears of more populist outcomes), Brexit or rising protectionist fears from the U.S. which may weigh on EM-exposed names in particular.

Recent moves in the currency markets have been difficult to decipher, and driven by movements in yield differentials and real yield differentials in particular. We believe that many investors finished 2016 with a long U.S. Dollar bias, and that performance in the first two months of 2017 is reflective of some reduction in those positions. Once we feel that positioning is more balanced, we would look to implement long U.S. Dollar positions again, especially against currencies which would be regarded as "higher-yielding" or "carry" currencies. In the event of a "risk-off" move in markets, we would expect this positioning to benefit.

Important Information

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