

Recovery: Where Next?

*Pioneer Funds – Global Trends
September 2009*

Equity

The Recovery Theme

Our strategy is to seek out themes that we believe will be influential in the economy of today and tomorrow. We have an unconstrained approach to investing, only backing stocks where we have a high conviction in the business case. The number of themes within the Portfolio will vary and often our holdings could be categorised under more than one area.

In 2009, we made one big strategic change to the Portfolio, which was influenced by the credit crunch and its effects on markets, economies, investor sentiment and valuations. In late February and early March 2009, we shifted from the more defensive stance that we adopted in the third and fourth quarters, and decisively backed Recovery situations that were, at this time, being shunned by investors as too risky.

To us, the Recovery theme is a focus on companies with decent business models where financing for the next three years or so is already secure. If when taking a pessimistic, almost worst-case, view on sales and profitability we still find upside then in effect any recovery prospects are in the stock as a free option. We want to acquire these 'free options', as we will see a stabilisation and eventually a recovery in the economy.

We decisively backed this new theme by rotating a significant percentage of the Portfolio. The initial basket of investments had a consumer bias but there are also some industrials. The names we purchased at the time included Abercrombie & Fitch, BASF, Carnival, Honda, Holcim, Intercontinental Hotels, Ladbrokes, Marks & Spencer, Marriott, Michelin, Rolls Royce and United Technologies.

Given the poor economic outlook at in the first quarter of the year, our expectation was that the returns from these stocks would initially be driven by a change in risk premia from very high levels to something lower rather than by a pick-up in fundamentals.

We also identified another theme called Equity Reloaded although, in reality, this was more of a short-term play (per investment not necessarily as a theme) and could be classified as sub-set of Recovery. This opportunity was in companies that were out of favour due to financial

concerns, but where recapitalisations or new financing agreements, would alleviate any worries. With these complications out of the way, investors will be able to focus attention on the quality of the business and the attractive valuation. These ideas could just have been called Recovery, but we decided on a new theme as it was a specific-type of recovery opportunity.

At the time, we purchased positions in British Land, Lafarge and Wolseley. However, as we subsequently experienced, prices of these types of stocks can rally very quickly and we sold Lafarge and Wolseley, and significantly reduced our holding in British Land. For example, shares in British Land rallied by around 50% in just over one month since our initial investment.

The Future

Despite the fact that we have sold many names within the Recovery theme, we have since bought fresh ideas with recovery potential, albeit, from a slightly different perspective than the deeply unloved stocks that were cheap mainly due to sky-high risk-aversion levels earlier in the year. Recovery remains an important driver for future returns.

We only currently have two Equity Reloaded investments, although one of these is a new name, Elan, which we purchased in July. We are still keeping Equity Reloaded as a current theme although, as mentioned, it needs to be viewed alongside Recovery. Most Equity Reloaded names will eventually be sold or move over into other themes like Recovery when the financing issues are resolved.

Recovery is our most significant area of investment, with around 41% of the NAV as at the end of August. Our current investments in this area are quite varied and span consumer areas (Staples and Discretionary), along with Financials, Industrials, IT, Materials and Utilities.

We envisage that the Recovery theme could last for a while longer, at least the rest of the year. Markets have come a long way in a short time but the economic and market recovery is likely to be protracted over several years, rather than the more normal V-shaped movement, although a large part of the mean reversion in many share prices may have occurred. You could argue that out-of-favour

companies at any time and for whatever reason have recovery potential. This has certainly been the case in 2009. Our mindset will be focused on spotting the best opportunities in any area at any stage in the cycle. Even if 'Recovery' as a major theme only has a limited lifespan due to valuation anomalies disappearing, it will always be an important concept in stock picking.

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