

An Opportunity for Investors in Corporate Bonds

May 2009



Fixed Income

Corporate Bonds Poised to Outperform over the Medium Term

Sentiment improves for Corporate Bonds

We believe corporate bonds are an attractive investment opportunity. Patient investors stand to benefit from a favourable environment for corporate bonds. Over the next two to three years, we anticipate that credit markets will provide solid investment returns.

There are a number of reasons for our view:

- Investment Grade corporate bonds are cheap on a historical basis. Indiscriminate selling across credit markets has created selective investment opportunities.
- Corporate Bonds and the economy will benefit from the policies implemented by governments and central banks. Monetary and fiscal measures implemented by central banks and governments will ensure the global economy does not enter into a long and deep recession.
- It is unlikely that corporate default rates will increase to levels that are currently priced in to the market.

Corporate Bonds are Cheap and Offer Very Good Yields for investors

Fear has been the key driver of the widening in corporate bond spreads

Credit markets froze as banks became reluctant to lend to each other. They did not know how many bad loans could be on their counterparty's balance sheets. Lack of credit - to banks, companies and individuals - brought with it the threat of recession, job losses, bankruptcies, repossessions and a rise in living costs.

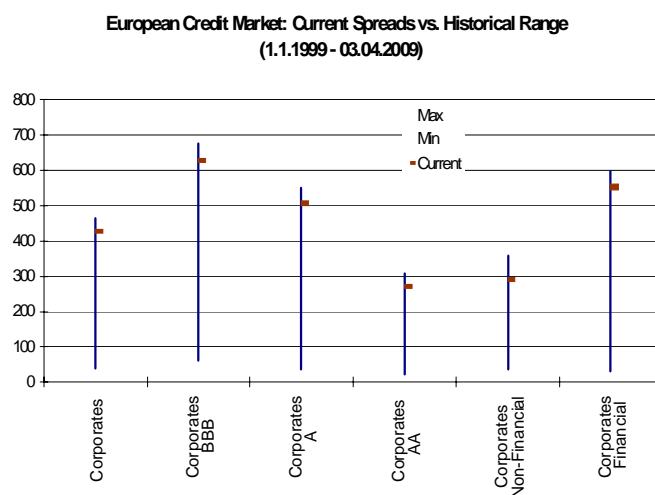
Put simply, there are currently more sellers of credit risk than buyers

After several years of borrowing money to invest in assets including corporate bonds, investors are now quickly selling investments. The threat of another large institution filing for bankruptcy resulted in heavy losses in corporate bond markets due to a crisis of confidence. This has triggered a rotation away from riskier assets, causing corporate bond spreads to move to new all-time wide levels. Investors are hoarding cash while selling anything with risk, including high-quality Investment Grade corporate bonds.

The falls in corporate bond markets have been magnified by other factors

Actual and potential fund withdrawals are forcing managers of borrowed money to sell assets into a market with limited liquidity. As a result, corporate bond prices have fallen markedly causing corporate bond spreads to widen.

European Credit spreads are trading at near all-time wides



Source: Merrill Lynch, Bloomberg, as at 03.04.2009

The option-adjusted spread¹ for EMU Investment Grade corporate bonds has widened to a historical level of 433 basis

¹ Source: Merrill Lynch EMU Corporates, Large Cap Index. Pioneer Investments. 31.03.09.

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points. This level is almost six standard deviations higher than the average of this decade. The result of the widening in spreads means that corporate bonds now offer very attractive yields for investors over government bonds.

Corporate Bond Holders will Benefit from Government Guarantees

Global policy has taken aim at “unfreezing” credit markets

Governments and central banks have responded with an unprecedented global policy package.

Government actions have generally consisted of steps to:

1. Increase protection for retail deposits;
2. Guarantee various types of wholesale lending; and
3. Strengthen the capital position of banks.

In addition, monetary policy has become more accommodative and fiscal policy has become stimulatory. The combination of these policies should help unfreeze credit markets.

Steps are underway to restore normality to credit markets



Patient investors in corporate bonds stand to benefit from these policy actions

In terms of sectors, banks are the big winners. We believe that the vast majority of outstanding bank debt will benefit from support from governments. Patient investors can now feel far more comfortable holding bank-issued paper on a long-term basis.

Globally, since the onset of the crisis, the major banking institutions have announced around US\$1341.7 billion² of sub-prime related write-downs. Reflecting these developments, some of the major banks have sought sizeable capital injections in the order of US\$1110.3 billion, primarily from governments. These equity injections have returned capital ratios to above their pre-crisis levels.

More recently, spreads for high-quality financial corporate bonds have stabilised. Credit Default Swap³ premia on commercial banks in the United States, Europe and the United Kingdom have narrowed noticeably. Conversely, CDS premia on government debt has increased, suggesting investors view government debt as a riskier investment than previously. This is largely the result of the unprecedented actions undertaken by governments and central banks to support the financial system.

We believe the outlook for non-financials is positive

The recent sell-off in corporate bond markets has produced some very good buying opportunities for patient investors. It is our view that non-financial companies with good visibility in terms of revenues and cash-flows are likely to see the value of their bonds increase over the medium term. Non-financials have not borrowed to the extent they have in past recessions. In addition, many have medium-term finance facilities in place.

Implied Default Rates are Unlikely to Occur, Meaning Credit has been Oversold

Default rates are very low by historical standards

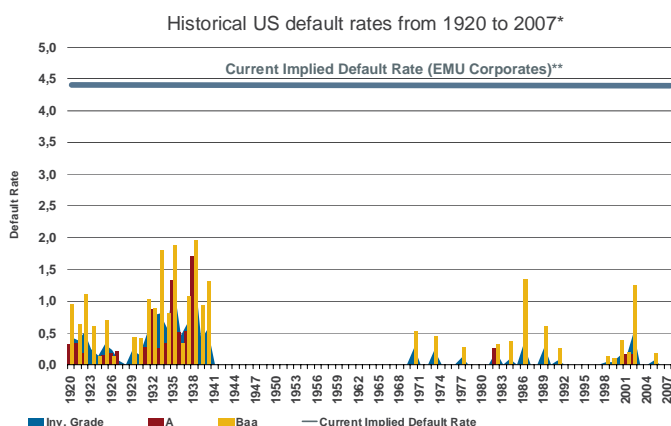
The deterioration in investment grade corporate bond spreads suggests a corporate default rate⁴ of around 4.4% (as of December 2007). To put this in perspective, default rates in the 1930s Depression period rose to 1.6% and the historic average is 0.1%. As outlined above, the policy response from governments and Central Banks has been very different to that seen in the Depression. Although we acknowledge that default rates are likely to increase from current levels, we do not expect them to reach the levels that the market is currently pricing in.

² Source: Bloomberg; Pioneer Investments

³ A CDS is a derivative instrument which allows investors to speculate on changes in an entity's credit quality

⁴ Source: Moody's Investor Services. December 2007.

Implied default rates are very pessimistic

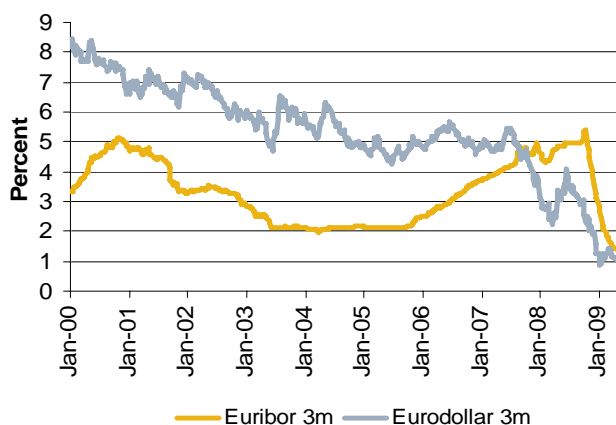


Source: Moody's, as at 31.12.2007. Data refers to US historical default rate.
 ** Source: Merrill Lynch, Pioneer Investments, as at 08.04.2009. All rates given can be exceeded or undershot and should not be construed as an assurance or guarantee. The application and results of the analysis will depend upon the particular circumstances involved, which may change at any time based on market and other conditions. There can be no assurances that countries, markets or sectors will perform as expected.

Evidence is accumulating that credit conditions are already improving

Indicators of credit market conditions are improving. Uncertainty and lack of confidence in credit have led to the current credit crunch. The heightened uncertainty that occurred during the credit crunch can be seen in the increase in 3-month Euribor and Eurodollar rates.

There are early signs that credit markets are unfreezing



Source: Bloomberg as at 24.04.09

The fall in the respective rates suggests to us that banks are lending to each other again, after credit dried up in August 2007 when losses from subprime mortgages left financial institutions with securities and financial contracts they couldn't value. Credit markets froze when Lehman filed for the biggest bankruptcy in history on 15 September 2008.

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Outlook

Short-term market volatility expected

We expect that difficult market conditions for corporate bonds will persist in the coming months. Liquidity in the secondary market remains low, though we are seeing increasing appetite for risk in the primary market. We are, for the very first time, faced with a global financial crisis and ensuing global recession. While the number of defaults remains relatively contained among investment-grade corporate bonds, we expect that the number of downgrades and default rates will rise as bank lending stalls and economic activity declines. Though credit spreads could stabilise in 2009, we do not expect to see a sustained rally in corporate bonds before we see signs of a stabilisation of the US housing market and the global financial sector.

Spreads already discounting a very negative outlook

Credit spreads across all asset classes are well outside historic averages. They are already discounting a severe recession and a sharp rise in default rates. We believe that implied default rates look extreme in a historical context and are unlikely to occur.

The market is pricing in an unprecedented surge in corporate bond defaults

	EMU IG Corporate
Implied default rate	4.40%
Highest default rate in US during the Great Depression*	1.60%
Assumptions	
Corporate Bond Yield	6.68%
Swap rate (4 year)	2.60%
Spread over swap rate	4.08%
Required return after default over government bonds (Risk premium)**	1.00%
Recovery rate***	30%
Spread (adj. for risk premium)	3.08%

¹ Source: Merrill Lynch, Moody's, Pioneer Investments (as at 06.04.2009). IG: Investment Grade. * 1938. Highest default rate for companies rated Baa was 1.97% also recorded in 1938. Data refers to the US historical default rate. (Source: Moody's). ** We believe today's IG bond investors is seeking an approximate 100 basis point risk premium - or return after default - over government bond (i.e. if the implied default rate materialise, the investor will still earn the risk premium of 100 basis points over government bonds). Historically the risk premium for holding European corporate bonds has been around 50 basis points. ***Note the standard recovery rate in the market is 40%. All rates given can be exceeded or undershot and should not be construed as an assurance or guarantee. The application and results of the analysis will depend upon the particular circumstances involved, which may change at any time based on market and other conditions. There can be no assurances that countries, markets or sectors will perform as expected.

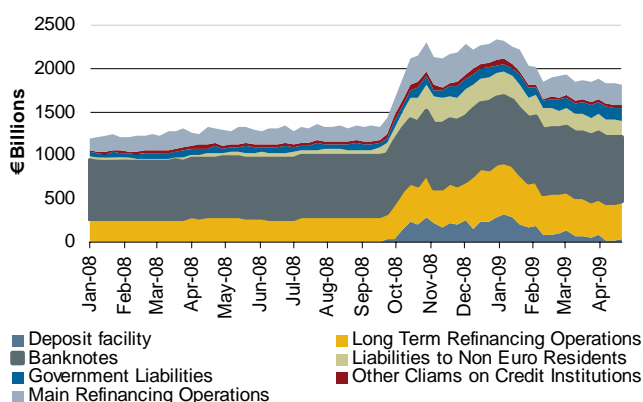
For example, spreads on European investment-grade corporate bonds with a maturity of between one and three years, currently imply a default rate of around 4.4% annually.

Historically, the default rate on US investment-grade bonds has not been above 2.0%, as recorded in 1938.

Financials are supported

We believe that financial debt is supported by unprecedented policy responses. Financial bonds offer investors a substantial yield over equivalent government bonds - especially in an environment of lower central bank rates, deteriorating public finances and increased government issuance. We expect that financial spreads will remain volatile in the short-term but there is some excellent value in the market over the medium-term, particularly for subordinated debt issued by large financials with diversified and clear revenue streams.

The ECB has been aggressive in expanding its balance sheet – mainly by expanding its money market operations



Source: Bloomberg as at 24.04.09

Non-financials generally in better shape versus past recessions

Looking at non-financials, they are not as leveraged as was the case in recent recessions. Companies have reacted quickly to cut costs and dividends and halt share buy-back programs to preserve cash. We have recently seen evidence that companies with good business models and solid earnings streams have access to funding, while many companies have refinancing facilities in place over the medium term. In addition, central banks are focused on providing companies with continued access to credit. Large and strategically important industries are likely to be the recipients of unprecedented fiscal stimulus to support future economic growth. As a result, we do not anticipate that default rates will reach the highs currently implied in credit spreads.

Attractive opportunity for the patient investor

We believe that in these market conditions, a strategy of holding selected investment-grade securities to expiry and receiving the very good yields on offer should produce superior Portfolio returns. We believe that current market

yields are compelling and offer sufficient compensation for a rise in default rates. In addition, heavily discounted bond prices provide some downside protection against short-term market volatility, while offering significant upside potential. Overall, we believe that spreads near all-time wides and high current income present a very attractive opportunity for the patient investor.

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