

Pioneer Funds – European Potential

Strong Track Record Rewarded by New AA S&P Rating

January 2009

European Equity

Pioneer Funds– European Potential has recently been awarded an AA rating by Standard & Poor's, adding further accolades to a Portfolio that is already rated with four stars by Morningstar.¹ The Portfolio has performed extremely well over the past five years to the end of December 2008, returning 40% and outperforming its benchmark by 58%.² It is also considerably ahead of the sector average. Christian Zimmermann, Portfolio Manager, gives us his views on the main drivers for the strong performance, the distinguishing features of his investment approach, and explains why he is positive on the long-term prospects for the market.

What are the distinguishing features of the European Potential investment approach?

Pioneer Funds – European Potential is a small- and mid-cap Portfolio, investing in companies with good momentum, cheap valuations and strong growth potential. Our investment approach, which is a mix of quantitative and fundamental analysis with a flexible capability, distinguishes us from many other small-cap strategies.

The first part of our investment process is to screen companies with a quantitative model that we have developed in-house, to highlight stocks that are attractive based on a range of price-momentum indicators and key valuation metrics such as price-to-earnings, price-to-sales and price-to-book ratios. Over 1,100 individual securities are screened, giving us a list of potential Portfolio candidates to analyse further. This multi-factor screening process is updated on a weekly basis.

Our process changed in 2004 from being purely quantitative, to include a second stage: a qualitative fundamental overlay to help us identify attractively valued companies on a consistent basis. We evaluate companies' existing and anticipated order backlogs as compared with the industry, assess current news flow, expected cash-flows and earnings trends. The results of our fundamental analysis lead to our buy and sell decisions.

A key part of our philosophy is that we are not benchmark led in our investment approach. The benchmark, whilst providing us with a large set of investment opportunities, does not represent our entire investment universe. We seek to invest in stocks with low valuations and good price momentum which leads to an active and concentrated portfolio based on attractive opportunities rather than benchmark-led requirements. We have the flexibility to buy very small-cap stocks worth less than €50 million, and we can participate in block trades to capitalise on the most promising investment opportunities. Over the past six months, the Portfolio has invested, on average, 38% in off-benchmark stocks. Currently around 30% of the Portfolio is invested in non-index stocks. We have no preconceptions about investing a certain amount outside of the index; it is merely a result of where we see the most attractive opportunities at any given time.

What are the reasons behind the strong performance over the past five years?

The drivers of performance are mainly derived from stock-selection decisions. We screen the European small-cap investment universe on a weekly basis using a variety of valuation metrics and momentum indicators. As mentioned, we retain the flexibility to invest in off-benchmark holdings to capitalise on the most promising investment opportunities. Our relatively high exposure to large caps has reflected this opportunistic element of the strategy and, indeed, some of the main contributors to performance recently have been our off-benchmark bets, such as positions in automobile manufacturer Volkswagen, and fertiliser producer K+S. Our recent bias towards industrials and materials has also been particularly beneficial, although it is worth noting that sector weightings are purely a consequence of stock selection. Also, our use of cash in down markets has helped mitigate some risk associated with the small-cap environment and contributed to relative performance.

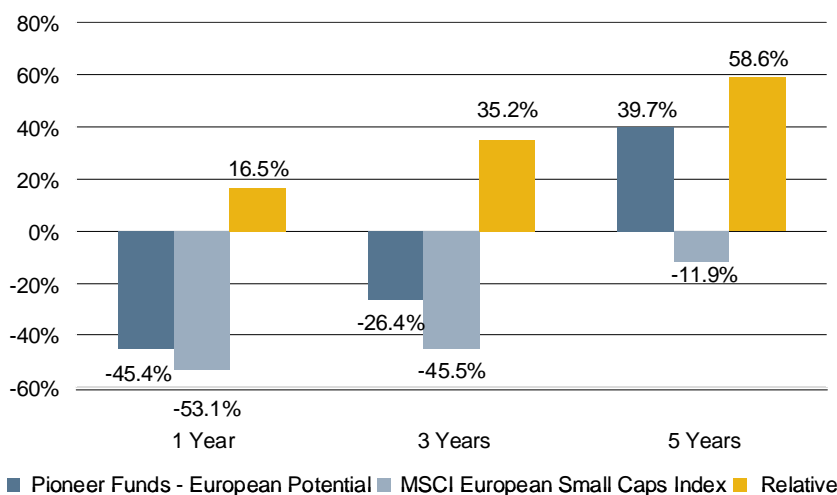
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Source: Pioneer Investments, 31 December 2008. Until 30 March 2007, the performance disclosed above is that of the Actinvest EuropaPotenzial Class C. Since 30 March 2007 (cumulative) performance disclosed above refers to Class A EUR non-distributing units only of the Sub-Fund, and is based upon NAV net of fees. Benchmark is the MSCI Europe Small Cap Index.

Can you describe the best and worst situations the fund has gone through over the past few years? In which market situations does your strategy perform particularly well?

The strategy performs best in steadily appreciating markets and benefits from consistent trends in the market. However, we believe, and the performance track record confirms, that the strategy has outperformed in all market conditions.

2005 was the best year for Portfolio performance, both on an absolute and relative basis. At that time we took advantage of market conditions in Scandinavia by investing heavily in building stocks and other cyclical companies. In May/June 2006 and May/June 2007, we increased the percentage of cash (to around 20%) to mitigate risk associated with small caps in this environment. During the first half of 2008, in a market environment where commodity prices were staying higher for longer, we benefited by holding companies within the materials and capital goods sectors. We also recently added to our exposure to Germany and are currently overweight, taking advantage of the relative cheapness of the German market.

What are the main risks in managing a small-cap equities portfolio? How do you manage the sources of risk within the Portfolio?

Risk management is a critical aspect of Pioneer Investments' approach to investing in small- and mid-cap markets. Given the inherent volatility of this asset class, much emphasis is placed upon risk control in both Portfolio construction and Portfolio management. Therefore, the Portfolio is managed not only to maximise return but also to minimise volatility. As well as monitoring the tracking error, we place particular emphasis on managing risk on an absolute basis. Indeed, we have designed a dynamic stop-loss system embedded in the investment process in order to mitigate the downside risk to stock selection.

This aims to ensure an attractive risk/return profile for investors. Opportunities are seized actively, and risks are monitored continuously with the help of our stop-loss system. In this context, both return (relative and absolute) are key considerations. The key risks we have identified are liquidity issues and individual stock risk. Our stop-loss system ensures that individual stock risk is monitored continuously. Additionally we have identified the risk that the demand for the small-cap niche may deteriorate and that market volatility will disproportionately impact the small-cap asset class. We pay particular attention to monitoring global financial developments and taking appropriate steps within the portfolio. Our flexibility to invest in large caps and to hold a large percentage of cash in downturns also helps mitigate these risks.

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What is your outlook for European small-cap equities?

While we expect market volatility to continue and remain cautious on the economic outlook, we have welcomed decisions by various central banks to cut interest rates and increase liquidity in the wholesale markets. Indeed, the EU leaders' commitment not to let any key financial institutions fail in their respective countries has been positive for the market. While the outlook for small-cap equities remains less certain, we believe that valuations are at extremely attractive levels and that, selectively, there will be major beneficiaries of the recent shake out. Additionally, some of the negatives which we have seen are beginning to look more positive for the market such as falling oil prices, decreasing interest rates and inflationary expectations coming down. Within the small-cap space we believe that M&A activity will pick up and we will see more large-cap companies buying small caps. An additional positive for the asset class is that smaller companies are less dependent on currency movements. We continue to monitor developing events in the global financial markets. As already mentioned, our focus remains on the management of risk within the Portfolio, and taking appropriate steps to actively manage risks as they arise. We believe that our time-tested strategy enables us to perform well in most markets, and the Portfolio is well placed for when market conditions begin to normalise.

Important Information

Unless otherwise stated all information contained in this document is from Pioneer Investments and is as at 9 January 2009.

1. Morningstar rating is as at 31 December 2008 and refers to Class A Non-Distributing units in Euro.
2. Until 30 March 2007, the performance disclosed above is that of the Actinvest EuropaPotenzial Class C. Since 30 March 2007 (cumulative) performance disclosed above refers to Class A units only of the Sub-Fund, and is based upon NAV net of fees. Benchmark is the MSCI Europe Small Cap Index.

Pioneer Funds – European Potential is a sub-fund (the "Sub-Fund") of Pioneer Funds (the "Fund"), a fonds commun de placement with several separate sub-funds established under the laws of the Grand Duchy of Luxembourg. This Sub-Fund was created to absorb another fund offered by Pioneer Investments, Actinvest EuropaPotenzial on the 30 March 2007. Until 30 March 2007, the performance disclosed above is that of the Actinvest EuropaPotenzial Class C. Since 30 March 2007 performance disclosed above refers to Class A units only of Pioneer Funds – European Potential, Although the Actinvest EuropaPotenzial has an investment policy and management process similar to that of the Sub-Fund there can be no assurance that performance data of Actinvest EuropaPotenzial are representative of the future performance of the Sub-Fund.

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