INVESTMENTS

Quarterly Portfolio Update

Pioneer Funds – Emerging Europe and Mediterranean Equity
30 December 2011

Equity

Review

The Portfolio was up by 1.37% (Class A, non-distributing, EUR units) over the quarter, behind its benchmark, the MSCI Emerging Markets Europe & Middle East 10/40 Index, which returned 2.78%. We slightly outperformed the benchmark over the past six months (-21.2% vs. -21.32%).

Markets Remain Hostage to Eurozone News Flow

Despite a flat/slightly negative December and the fact that investors were very nervous of risk, equities, developed and developing, made decent returns in the fourth quarter. Markets remained hostage to news flow and developments in the eurozone and, to a lesser degree, worries over global growth. Most of the negativity occurred at the end of October and through November: MF global collapsed, the Greek Prime Minister called for a vote of confidence on his regime and a referendum on the new aid package, Italian 10-year yields broke through 6% (and hit a low of 7.26% on 25 November). These events caused pessimism about a solution to European debt problems.

A tough stance from the EU against Greece led to the resignation of Prime Minister Papandreou and the appointment of ex ECB vice president Lucas Papademos. In Italy, Berlusconi became the second eurozone PM to resign in November (he was replaced by ex EU commissioner Mario Monti). The fact that Greece and Italy are now being run by technocrats should be seen as a positive with regard to implementing austerity measures. Spain was the third European country to see a new leader: following an election victory by the conservative Popular Party, Mariano Rajoy took over as prime minister.

On a more positive note, economic data generally surprised on the upside, especially in the US. Although US Q3 GDP was revised down to 1.5% (annualised), several analysts have been upgrading fourth-quarter expectations. There was better US data on jobs, house sales, consumer spending, employment, manufacturing and business activity (Chicago PMI). Additionally, the unemployment rate fell to 8.6%, a 2.5-year low and there were upward revisions for non-farm payrolls in September and October.

One of the key positive developments over the quarter, that led to a big rally at the end of November, was co-ordinated action from six central banks (US, EU, UK, Canada, Japan and Switzerland) to cut the cost of US-dollar funding via swaps by 50 bps (to US$ OIS + 50 bps). With the growing danger of a liquidity crisis, this type of co-ordinated action is key to reducing pressures in the Banking sector and boosting confidence. However, while this will help short-term pressures, focus will soon move back to the fundamentals of the European debt problems.

Emerging Europe Underperforms in 2011 and Q4

The MSCI EM Europe & Middle East Index was down by 18.6% (capital return) in local currency during 2011 but a much worse -25.3% in US dollars, due to weak currencies in the region, particularly the Turkish lira. Developed markets outperformed all emerging-market regions (-7.6% in local and US dollars). Emerging Europe declined more than Asia (-16.2% in local currency), Latin America (-12.9%) and the wider EMEA (11.8%). This means that equities in emerging markets and particularly emerging Europe ended the year at compelling valuations.

Over the fourth quarter, the MSCI EM Europe & Middle East Index returned 1.6% (capital return, local currencies), trailing Asia (3.5%), global EM (4.1%), developed markets (7.3%) and Latin America (8.3%). Of the main markets in emerging Europe, Turkey was by far the weakest, with the ISE National 100 falling by 14.1%, not helped by speculation about the health of Prime Minister Erdogan; Poland (-1.8%) and the Czech Republic (-2.4%) also underperformed, while Hungary's 7.6% gain would have been wiped out for most investors due to currency weakness. Russia slightly outperformed (Micex 2.6%), especially London-listed depository receipts (6.8% in US$ and 3.3% in euros).

Currencies: US-Dollar Continues to Advance

It was a tale of two halves (well almost) for the US dollar in 2011. After a very weak start, it bottomed out in early May (-7.7% ytd), traded slightly up through the summer and then enjoyed a strong rally from September as risk-aversion spiked. Over the year, the US Dollar Index was up by 1.5%, with a 2.1% gain in the fourth quarter (2.3% in December). The greenback appreciated against all currencies in Eastern Europe, where the Turkish lira was the weakest global currency (-18.9% and -12.2% against the

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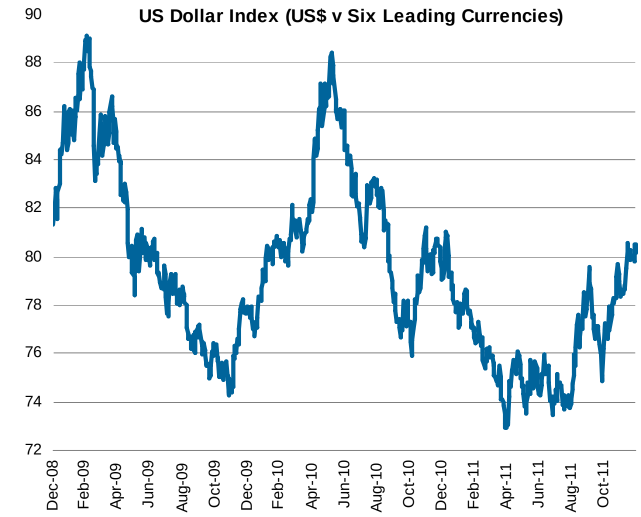
US$ and euro respectively). The Hungarian forint and Polish zloty lost around 14% against the greenback.

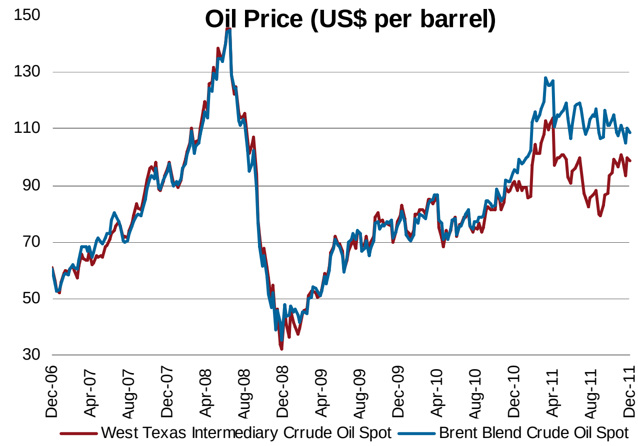
Over the fourth quarter, the weakest global EM currency, by some margin, was the Hungarian forint (-6.9% and -9.9% against the euro and US dollar respectively). The forint dropped 7% against the US dollar in December alone as investors became concerned about changes to the constitution, including the independence of the central bank, and S&P downgraded the country's debt to junk status (BBB- to BB+). The Russian ruble appreciated by 0.35% against the US dollar over the fourth quarter despite a 4.5% fall in December. Russian assets suffered in the first half of December due to worries over protests against allegations of fraud in the Duma elections. There were also concerns that if the protests turned violent it could negatively influence the WTO Council vote on Russian membership – there was no violence and Russia was accepted in to the World Trade Organisation.



Source: Bloomberg, daily data, 31 December 2008 – 30 December 2011

Commodities Advance but Gold Declines

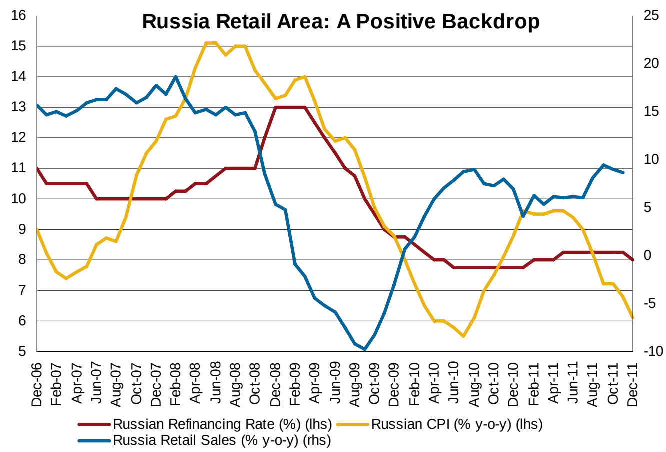
Commodities were generally higher over the fourth quarter, with the notable exceptions of gold (-3.7% to US$1,564) and sugar (-7.9%). The Thomson Reuters/Jefferies CRB Index was up by 2.4%, although the S&P GSCI TR CME Index, another broad measure, advanced by 9%. By far the best returns were from West Texas Oil (24.8%), which closed the price differential with European Brent (2.3%) to around US$10 from almost US$30 in September.



Source: Bloomberg, weekly data, 29 December 2006 – 30 December 2011

Russia: Positive Momentum in Consumer Area

There was a continuation of the trend of positive macro data in Russia in the fourth quarter, including a 25 bps cut in interest rates to 8% in December. Unlike the majority of other countries, Russia's income is exceeding its expenditure. As at the end of November, the budget surplus was around 3.2% of GDP (US$46bn) and it is likely to stay positive for the full year despite an expected pre-election increase in spending in December. A weak ruble and resilient oil prices have both helped budget revenues.



Source: Bloomberg, monthly data, Dec2006 – Nov/Dec 2011

Retail sales remained strong in October and December (9% and 8.6% y-o-y), well above the average this year. Unemployment was 6.3% in November and has been steady at between 6% and 6.5% since May. Inflation in December was down to 6.1% (y-o-y), a 17-month low, which should result in a similar figure for 2011 as a whole, which would be the best ever result in modern Russia (food inflation was 5.3% y-o-y in December, down from 13%-15% in the first half of the year). Real wages were up 7.1% (y-o-y) in November and real disposable income has

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remained in positive (y-o-y) territory since June, with the past three months each seeing at least 1% (m-o-m) improvements.

Unlike many other countries, growth accelerated in Russia in the third quarter. The initial estimate of third-quarter GDP was 4.8% (y-o-y), up from 3.4% in Q2. There is also a chance that this figure will be revised higher. The economics Ministry is predicting 4.1% growth in 2011 but we believe that this is too low and could be between 4.5% and 5%. Growth should stay relatively strong in 2012, at around 4%.

Russia Nears WTO Entry

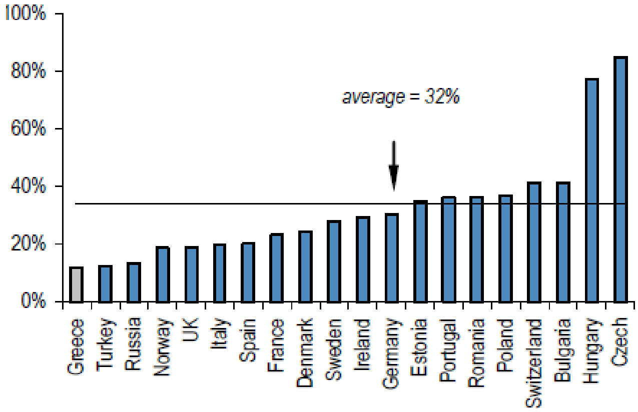
Following an agreement with Georgia, the WTO Council approved Russia's membership of the WTO in mid December. The deal needs to be ratified in the Russian parliament in early 2012. Following this, Russia will notify the WTO that ratification is complete and it would then officially become a WTO member 30 days later, probably sometime towards the middle of the year. Russia is the largest economy and the only one of the G20 not in the WTO. In order to gain entry to the WTO, Russia has had to agree to various measures that should make trade and foreign investment more transparent, including fewer price controls, reduced regulation and licensing, and lower market-access barriers. The obligations of membership may prompt the government to pursue a more active reform agenda. It is clear that the Russian people are also seeking change, as highlighted by the large-scale protests about election fraud in the Duma elections in December. While the immediate economic benefits of WTO membership may be limited, it should give a positive boost to Russia's economy over the medium term.

Russia and Turkey – Low Trade with Eurozone – Unlike Hungary and the Czech Republic

The bulk of our investments are in Russia and Turkey, with underweight positions in Poland, the Czech Republic and Hungary, especially to Banks and Materials stocks. With low absolute and relative trade with the eurozone and buoyant domestic economies, Russia and Turkey should be relatively isolated from eurozone weakness compared to Hungary and the Czech Republic.

Total trade with Euro area as percentage of GDP, 2010

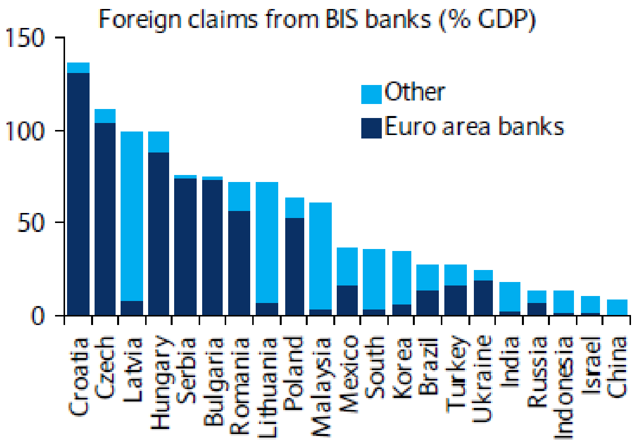
Exports plus imports to the Euro area as percentage of national GDP



Source: JPM, FX Markets Weekly, 4 November 2011

Russia and Turkey – Relatively Low Financing from the Eurozone – Unlike the Czech Republic, Hungary & Poland

We have been particularly wary of banks in Eastern Europe, which are now also likely to be affected by lower liquidity as major European banks delever due to falling values of eurozone debt. It is estimated that Western European banks may reduce their balance sheets by around €2.5 trillion. As well as suffering from asset sales by eurozone banks, Eastern Europe could be affected by a lack of cross-border funding as a high percentage of the banks have European parents. According to Morgan Stanley, "Twelve of the 16 major European banks in central and Eastern Europe, representing about 78 percent of these banking assets, either had a capital shortfall in the recent 9 percent test or are recipients of state aid". In contrast, under 20% of the banking system in Russia is controlled by foreign-owned banks.



Source: BarCap Research – Euro Area Bank Deleveraging, 22 Nov 2011

Performance Analysis

On a country perspective, the underperformance was primarily due to Russia, although holding cash was also a negative. We added value in Hungary due to not owning OTP Bank, which added 12 bps to relative returns. Poland was the main positive: not owning mining company KGHM, which declined by 16.4% in the fourth quarter, gave us 34 bps; we also made money through a big underweight in Telekom Polska and our holding in non-index Eurocash, a cash and carry retailer.

In Russia, we lost ground due to a large underweight in MTS, which rallied by over 23%, plus our overweights in X5 (retailer), Power Machines (producer of power-plant equipment) and Pharmstandard (pharmaceuticals), a big underweight in Uralkali (potash producer) and no holding in Tatneft (oil producer, refiner and retailer). Partially offsetting these losses, we added value through an overweight in Transneft (monopoly provider of pipeline oil transportation) and our holdings in non-index Etalon (property developer) and Eurasia Drilling (oilfield services), all of which rallied by between 35% and 55%.

On a sector perspective, we underperformed in seven out of the ten sectors. Utilities, Telecoms and Consumer Staples were the main negatives, but we added value in Materials, Financials and Energy.

Portfolio Strategy

We remain cautious overall, due to the uncertain short-term outlook. On a country perspective, Russia (65.72% vs. 61.75%) is our only meaningful overweight, along with small positions in some non-index markets (Egypt, Lebanon, Israel and Austria). Conversely, our key underweight is Poland (12.17% vs. 16.18%), followed by Turkey (12.03 vs. 14.66%), Hungary (1.49% vs. 3.40%) and the Czech Republic (2.44% vs. 4.02%).

The main strategic direction over the fourth quarter was to boost exposure to Russia, which we view as being the market least affected by the eurozone troubles - it has large foreign currency reserves, low levels of debt and experience in dealing with the crises of 2008. We also reduced exposure to Turkey and added to Poland.

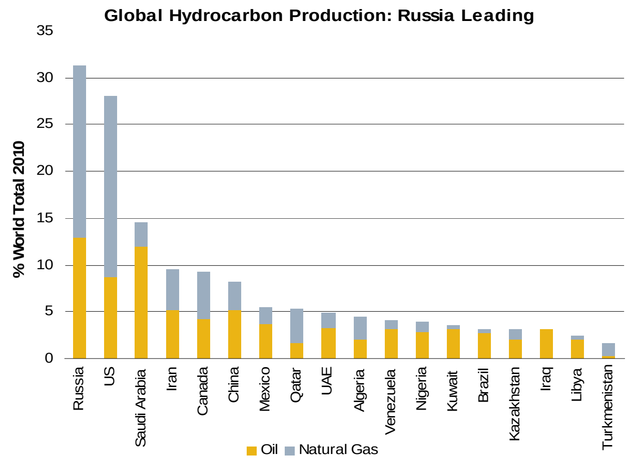
We purchased two new holdings during the quarter: Telekom Polska, a Polish fixed-line and mobile-telecom provider, and Erste Bank, which is based in Austria but operates in the Czech Republic, the Slovak Republic, Hungary and Croatia. We also added to our Russian holdings in MTS (mobile telecom), X5 (supermarkets) and Mostotrest (transport infrastructure construction), plus Polish companies PKO Bank Polski and PGN (electricity generator). Conversely, we sold Emlak Konut Gayrimenkul, a Turkish property developer, and Global Ports (container and oil-products terminal ports). In Turkey, we trimmed positions in Tofas Turk Otomobil, Tupras Turkiye Petrol Rafine, Garanti Bank, Akbank, Isbank, BIM and Arcelik. In Russia, we cut exposure to VTB, Norilsk Nickel and Synergy. We also reduced our holdings in PZU, PGE and Warsaw Stock Exchange (Poland) and GB Auto (Egypt).

Sector Positioning

On a sector perspective, our key overweights are Energy (502 bps), Industrials (481 bps) and Consumer Staples (386 bps). We are underweight in Materials (-780 bps), Telecoms (-621 bps) and Financials (-321 bps), although less so than the previous quarter. We also added to Energy, which is now our largest overweight. Conversely, we trimmed exposure to Industrials, Consumer Staples, Consumer Discretionary and Utilities.

Russia

Russia's total foreign debt (circa 30% of GDP) is very low compared to most countries and is covered by its FX reserves (circa US$500bn). Additionally, the budget should show a surplus in 2011. Our main focus is on the Consumer, Industrial and Energy sectors. Relatively strong oil prices should benefit Russia more than most other countries as it has the world's largest hydrocarbon reserves and is the leading producer of oil and gas.



Source: BP Statistical Review of World Energy, June 2011

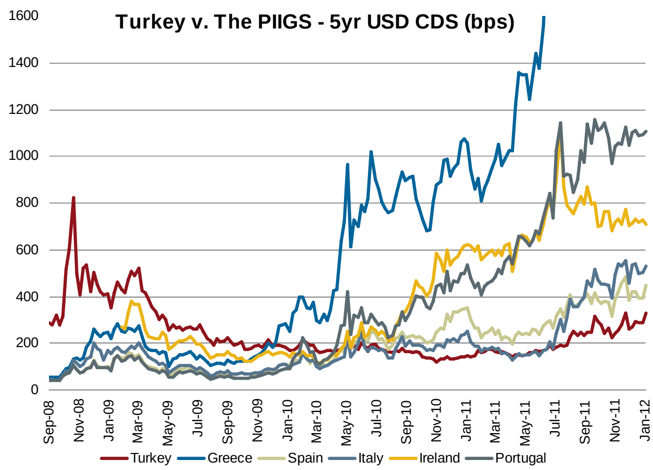
The Consumer areas are recovering from a weak first half of 2011 as inflation is falling, incomes and pensions are rising, especially in the state sector ahead of the presidential elections, and unemployment remains low.

We remain underweight in Financials and Materials. Russia has very limited exposure to Greece and other peripheral European economies, low external financing needs, a current-account surplus and a big pot of reserves, which means it should be a relative safe haven if contagion in the eurozone stays elevated or even increases. Indeed, Russia was ranked as the least vulnerable emerging-market country to increased eurozone contagion in Citi's Contagion Index (July 2011).

Turkey

Turkey has become a much more attractive market over the past few years and is a country with very exciting medium- and long-term prospects. We have been overweight most of the time since December 2008, especially to consumption, although we recently moved underweight. Turkey is looking more vulnerable and volatile on a short-term perspective as the Central Bank is struggling to manage a large current-account deficit caused by very strong economic growth. There is also an increased risk of a hard landing in 2012 that is still not properly reflected in equity valuations. Our focus in Turkey remains on Industrial, Energy and Consumer companies; we are underweight in Banks.

We are still very positive on Turkey over the medium and long term. Turkish credit-default swaps improved dramatically from the high levels in the early days of the credit crisis, as have the other countries in the region. They have risen from the record low of 118 bps on 4 November 2010, due to geopolitical risk in the Mediterranean region and the European debt crisis, but still look positive on a relative basis. This highlights the economic progress made by Turkey over the last few years and the changing perceptions of risk between emerging and developed nations, especially the so-called PIIGS (Portugal, Italy, Ireland, Greece and Spain).



Source: Bloomberg, weekly data, 5 September 2008 – 6 January 2011

Opportunities Across the MENA Region

We view the opportunity set as being all of Emerging Europe, and the Middle East and North Africa (MENA). Egypt is a key market for the future, but currently we only have a few small positions, as we have been cautious about building too much exposure until there is better visibility about politics post-President Mubarak. We bought into two Lebanese banks in November 2010. Other potential areas of interest are the United Arab Emirates (UAE) and Qatar, both of which are possible contenders for promotion from 'frontier' to the 'emerging' index series – MSCI did not upgrade these countries in June but said that it will conduct a special review at year-end. Qatar has the world's third-largest gas reserves (after Russia and Iran) and we are interested to see if there are attractive opportunities in this sector to diversify our Energy exposure outside of Russia. At present, we feel that it is too early to allocate more money to the MENA region, but we are monitoring the geopolitical situation and potential opportunities.

The region has huge potential, but it is not homogenous. Each country is at a different phase of growth and investment. The Gulf States in particular have strong economic fundamentals. The North African economies will benefit from increased economic ties with Europe and the development of the proposed 'Mediterranean Union'. Overall, the region benefits from strong demographic trends and an emerging middle class. After decades of underinvestment, the region has lined up more than US$100 billion worth of projects in the infrastructure space. Both transport and utility-related infrastructure sectors require significant investment and should continue to deliver growth once the political unrest subsides. Qatar, Saudi Arabia, UAE and Kuwait are likely to be the major drivers behind this spend. Despite the recent turmoil in Tunisia, Egypt and Libya, further spill-over is unlikely to hamper economic growth in the larger economies.

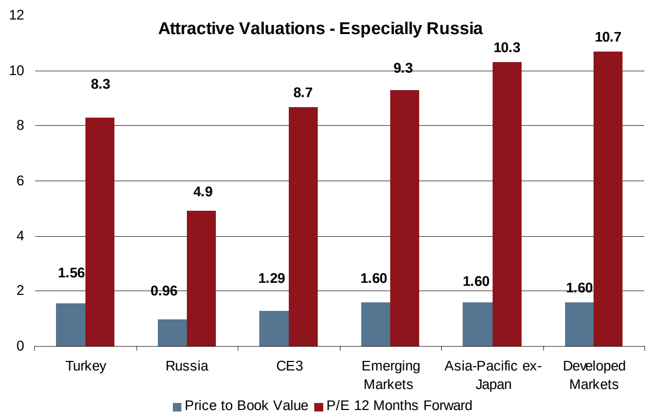
Outlook

The short-term outlook is uncertain given the exogenous threats, principally the major debt and structural problems in Europe, but also slowing global growth, high unemployment in Europe/US and political tensions in the Middle East and North Africa. Our longer-term outlook is for a sub-par global recovery and consequently low global interest rates and a weak US dollar. This should be a favourable environment for emerging European equities, as their economies are less export-oriented than many other countries, with growth driven more by domestic consumption and investment. In addition, free-floating currencies give governments and central banks more fiscal and monetary options to deal with adverse economic conditions.

There are several potential catalysts that could help equity markets and economies, such as the likely upgrade of Turkish foreign debt to investment-grade status (local debt is now investment grade), and tax reform for the Oil and Gas sector in Russia. We see the era of excessive capital flows as slowly passing. Thus, in not so distant future countries will have to compete for capital by creating a stable and predictable economic environment. In this respect, the recent setbacks of reform-oriented politicians in Russia and the unconventional policies of the Turkish Central Bank could backfire. However, we believe that the strong fiscal standing of both countries will differentiate them from the fiscally troubled, low-growth developed world.

We can, however, expect counter trades in the US dollar and periods of rising risk aversion because of events such as the debt crises in Europe, US job creation and global growth concerns. We try to hedge these risks by being underweight in the Materials sector, which will be hurt by a stronger US dollar, and avoiding bank exposure in economies prone to credit problems, such as Ukraine, Kazakhstan, the Baltic countries and Hungary.

Russian equities are trading at a significant discount to other emerging-market countries on most measures, with a 12-month forward PE of 4.93 as at 15 December. This compares to 9.3 for emerging markets in general and 10.7 for developed markets. Predicting 18 months forward, Russia is on 4.89 times earnings. For comparison to its own history, the five-year average PE for Russia is 9.99 (five-year high 20.9).



Source: Pioneer Investments/MSCI, data as at 15 December 2011

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