

Monthly Portfolio Update

Pioneer Funds – Emerging Europe and Mediterranean Equity
26 February 2010

Equity

Review

The Portfolio was down by 3.0% (Class A, non-distributing, EUR units) over the month, slightly behind its benchmark, the MSCI Emerging Markets Europe & Middle East 10/40 Index, which returned -2.8%.

Emerging Europe & Middle East underperformed other emerging-market regions and developed markets last month. In terms of individual markets, Turkey was easily the weakest market, due to increased political tensions, but Russia also underperformed.

Political Tensions Increase in Turkey

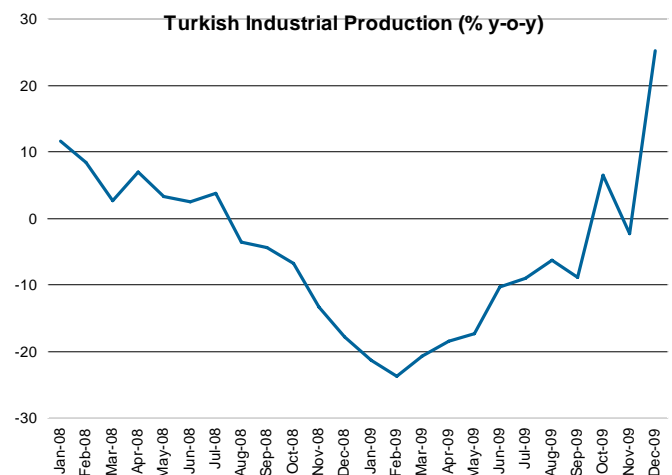
Despite all its attractions, there are still worries in Turkey over political tensions between the secular establishment, led by the army, and the ruling AK Party. The latest news in a long-running saga saw 40 military officers arrested over claims of attempting to overthrow the government in the so-called “sledgehammer” plot, which dates back to 2003. There are already many other people, including journalists, academics and military officers, still on trial for the similar, and possibly linked, Ergenekon conspiracy from 2008. President Abdullah Gul tried to defuse tensions by holding meetings with General Ilker Basburg, the head of the army.

These events occurred near the end of the month, but they negatively affected the equity market (ISE National 100 Index was down 9%) and dented investor confidence. However, we do not expect the situation to escalate too far and, thus, do not see it being a major risk. We remain significantly overweight Turkey at the moment.

Turkey: Economy Still Looks Attractive & Stocks Cheap

Interest rates remained at a record low of 6.5% in February, for a fourth consecutive month, despite inflation continuing to pick up: CPI hit 8.19% y-o-y in January, a 12-month high. Consumer confidence, while still subdued, was up in January for the second consecutive month and unemployment in the three months to December 2009 was 13.1% (from 13% the previous month), which was a smaller rise than expected. Unemployment in Turkey has remained relatively stable over the past year (12.6% in the same period in 2008), compared to many other countries that have experienced big increases. There was also a big

surge in industrial production, which was up 25% in December 2009 (y-o-y), although this was flattered by the weak figures last year.



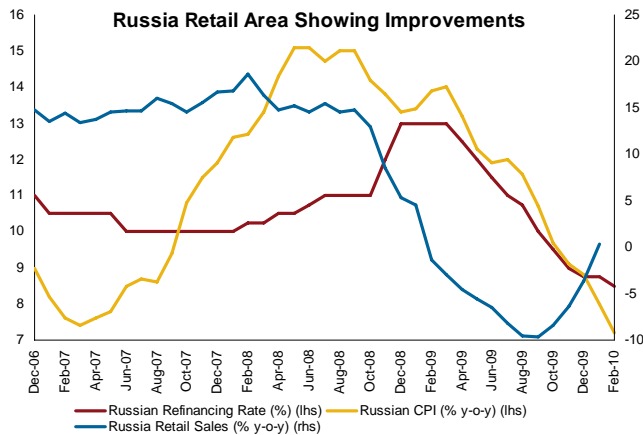
Source: Bloomberg, monthly data, January 2008 – December 2009

In an affirmation of positive economics progress, Standard & Poor's lifted the rating on Turkey's sovereign debt to BB (with a positive outlook), which is only two notches below investment grade. The reasons for the upgrade were cited as reduced government debt, which is estimated at 43% of GDP for 2009, compared to 67% in 2003, and a “solid” banking system. Interestingly, Turkey's debt situation already passes Maastricht criteria of being under 60%. The government has pledged to implement long-term targets for the deficit and borrowing, which could result in the country receiving investment-grade status in the next couple of years. Moody's upgraded Turkey to the same level as Standard & Poor's last month; Fitch is the most positive, moving its rating on the country to one level below investment grade in December 2009.

Russia: Retail Sales Rise for First Time in 12 Months

Following on from a record contraction of 7.9% last year, it is likely that the Russian economy is now growing. Retail sales rose slightly (0.3%) in January, for the first time in a year, and the trend has been good since bottoming out in September 2009. Consumer price inflation also continued to fall (to 8% in January and 7.2% in February), as it has every month since hitting 14% last March. With inflation falling, the central bank is especially keen on bolstering the domestic economy, which remains weak, albeit improving,

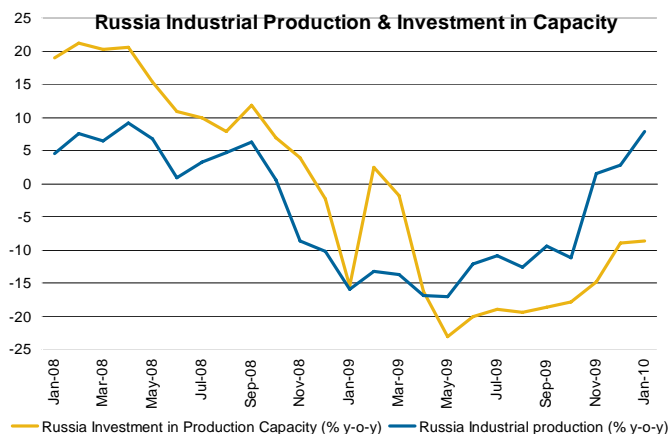
through monetary-policy loosening: in February, the eleventh cut in interest rates since last April and the first this year takes the refinancing rate down to 8.5%.



Source: Bloomberg, monthly data, December 2006 – February 2010 (January 2010 for retail sales)

Unemployment jumped in January to 9.2%, giving the central bank further incentive for continued easing in order to promote bank lending and encourage businesses to hire. Encouragingly, disposable income has been growing strongly since last August which, combined with lower interest rates, should give retail sales added momentum despite the uptick in unemployment.

As the world’s biggest energy exporter, Russian energy companies were given a boost last month by a big jump in oil prices. Investment in production capacity and industrial production has also been rapidly improving over the past four months.



Source: Bloomberg, monthly data, January 2008 – January 2010

Both factors are positives, not only for the economy, but also for our overweight position in the Energy sector, although due to slow progress on tax reforms for oil companies and a stronger US dollar, we are less bullish

over short-term prospects. The Russian economy is highly leveraged to oil prices, which explains why it substantially lagged other BRIC countries in the downturn. But, if oil prices stay stronger for longer, the Russian economy and energy companies could surprise on the upside. At the end of February, Russia’s Finance Minister Alexei Kudrin said that the budget deficit could be less than seven percent of GDP in 2010, which is an improvement on forecasts from earlier in the month. Russia’s budget figures for this year are calculated based on an average oil price of US\$58 a barrel (US\$60 for 2011). Kudrin now thinks that oil could average US\$65 this year. Even this may be too conservative as, apart from four days in September, Urals crude has been above this level since 20 July 2009.

Performance Analysis

Country Performance

On a country perspective, the key negatives were Israel and Turkey. These losses were partially balanced by good returns in Russia. We also added value in Hungary, Kazakhstan, Poland and Ukraine.

Stock selection was a positive in Israel (despite being underweight Teva), but this was far outweighed by being significantly underweight the strongest market. It was a similar story in Turkey: selection was neutral but our large overweight in the weakest market was a negative. Outperformance in Russia was driven by strong stock selection, principally underweight positions in Sberbank and Gazprom, and our overweight holdings in CTC Media, X5, Sollers, Siloviye Mashiny and Polymetal.

Sector Performance

On a sector level, we outperformed in five out of 10 areas, with the main positives being Consumer Staples, Financials and Utilities. The key negative was Healthcare (underweight Teva). We also lost ground in Materials, due to an underweight allocation, and Telecoms (underweight MTS).

Portfolio Strategy

On a country perspective, our main overweights are Turkey and Russia. By far our largest underweight is Israel, followed by Hungary and Poland. The main change in February was to reduce our overweight in Russia and add a bit more to Israel, where we remain substantially underweight.

In Russia, we continued to reduce exposure to the Energy and Materials sectors by trimming positions in Gazprom,

Lukoil, Rosneft, Surgutneftegas, Petropavlovsk and Norilsk Nickel. The rationale for our less positive, but still overweight, stance on the Energy sector is twofold. Firstly, planned taxation changes for oil companies are a positive, but there is reduced visibility on the timing of these changes; a stronger US dollar is a further headwind. Secondly, the long-term outlook for gas prices has deteriorated. We also took some profits on mobile-telecom stocks, Vimpelcom and MTS, due to lower growth expectations. We are still keen on the opportunities in the consumer space in Russia.

In terms of Portfolio activity, we added a new position in Bezeq Israeli Telecom and sold out of Sistema, a Russian holding company. Bezeq is attractive due to its defensive qualities, a strong dividend yield of around 9% and improving cash flows.

We continued to take profits in Ukrainian chicken-producer MHP. Conversely, we added to our holdings in Turkish Energy companies, Tupras-Turkiye Petrol Rafine and Petrol Ofisi, Teva (Israeli pharmaceuticals) and CAT Oil (Austrian registered oilfield services focused on Russia and Kazakhstan).

On a sector perspective, our key overweights are Consumer Staples, Consumer Discretionary, Industrials and Energy. Financials, Materials and Healthcare are the biggest underweights. Overall positioning was relatively unchanged in February, although we did reduce Industrials, Energy, Materials and Telecoms, with increases to Consumer Staples and Healthcare.

Outlook

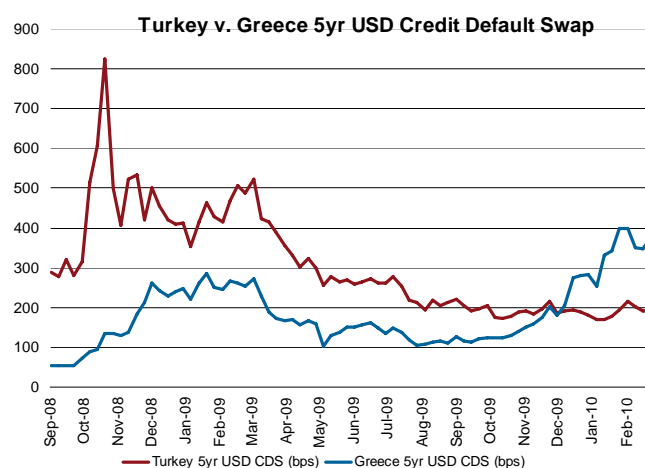
Over the short term, there is the potential for the US dollar to extend the rally that began in December and a correction (fall) in commodity prices. This will favour Turkey, Israel and Poland. Our longer-term outlook is of weak global recovery and consequently low global interest rates, and a weak US dollar. This will be a favourable environment for emerging European equities. We can, however, expect occasional counter trades in the US dollar and the reoccurrence of risk aversion because of credit events, such as the recent crises in Dubai and Greece. We try to hedge these risks by being underweight in the Materials sector, which will be hurt by a stronger US dollar, and by avoiding bank exposure in economies prone to credit problems such as Ukraine, Kazakhstan, Russia, Baltic countries and Hungary.

Turkey has become a more attractive market overall and we have been increasing exposure since going overweight

in December 2008, especially to Banks and other consumer-focused areas. We believe that Banks will have much higher returns on equity and lending growth than people expect for an extended period. Turkish interest rates are at record lows and the rates that banks charge clients have become more affordable, which should lead to volume growth without a significant deterioration in margins. Our other investments are mainly in consumer-focused areas such as cars, petrol and white goods.

Increased political tensions in Turkey have negatively affected sentiment, but we still remain positive on the market and do not expect things to escalate much further. Paradoxically, political tensions between the ruling AK Party and the secular establishment have had a positive effect as they give the AK Party a strong incentive to align the country with the EU and continue with economic reforms. Maintaining economic growth will be a key priority for the AK Party and we anticipate news of a financing agreement with the IMF to be announced in the future. Such financing will prevent the crowding out of the private sector that has so far not profited from record-low interest rates as banks directed their assets towards Treasuries.

Despite the lack of agreement with the IMF, Turkish credit-default swaps are now substantially lower than Greece, a member of the eurozone, highlighting the economic progress made by Turkey over the last few years. This was further confirmed recently by a several upgrades from credit-rating agencies.

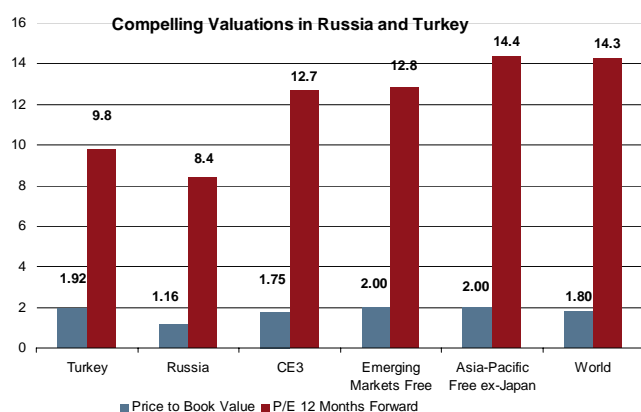


Source: Bloomberg, weekly data, 5 September 2008 – 26 February 2010

In Russia, we are positioned to benefit from planned changes in taxation rules for oil companies from revenue to profit-based measures, although uncertainty over the timing of these changes has meant we are less bullish short term. Currently these changes only benefit companies

producing oil offshore and in East Siberia, such as Rosneft and Surgutneftegas. Further changes in Russian tax rules are needed if the government production and revenue targets are to be reached. These changes would boost the valuations of companies, such as Lukoil, and would jump-start capital expenditure in the Oil-Services sector, which is another favoured area of investment (CAT Oil, TMK). We are underweight the Financials and Materials sectors in Russia.

Russia has been the weakest of the big emerging markets in terms of economic decline (GDP -7.9% in 2009). However, we see signs of economic recovery. Additionally, Russian equities are trading at a significant discount to other emerging-market countries on most measures. For instance, Russia was trading on 12-month forward PE of 8.4 as at 18 February. This compares to 12.8 for emerging markets in general and 14.3 for developed markets. Predicting 18 months forward, Russia is on 6.9 times earnings. For comparison to its own history, the five-year average PE for Russia is 12.2 (five-year high 20.9).



Source: Pioneer Investments/MSCI, data as at 18 February 2010

The long-term trends for our region remain very positive, although there could be some short-term profit taking due to uncertainties over the global outlook after an extremely strong rally over the past ten months.

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Date of First Use 11 March 2010.