

Monthly Portfolio Update

Pioneer Funds – Emerging Markets Equity

26 February 2010

Equity

Review

The Portfolio was up by 2.52% (Class A, non-distributing, EUR units) over the month, ahead its benchmark, the MSCI Emerging Markets Index, which returned 2.21%.

Markets

Emerging markets (-0.3% in local currency terms) underperformed developed markets (1.8%) for the second successive month in a volatile period dominated by increased risk aversion and investor caution. Over the year to date, emerging equities are down 4.7% compared to -3% for developed markets. Returns are better in US dollars and better still in euros due to strong emerging-market currencies. Latin America (Latam) was the strongest emerging region (1.3%) and EMEA the weakest (-2.3%); Asia was slightly down (-0.1%).

In terms of individual markets, the clear losers were Turkey, due to increased political tensions, and Russia, which was weak despite strong commodities, especially oil.

Macro

In a month of mixed global data and indicators, and generally increased risk aversion, emerging markets seemed to exhibit continued economic strength. China raised its reserve ratios for banks in an effort to contain bubbles. It is a similar story in several other Asian countries, where tightening is firmly on the agenda over the coming months. The strength of the Indian economy was reinforced by finance minister Pranab Mukherjee, who predicted that GDP should hit 8.7% in the coming fiscal year starting in April, although inflation needs to be controlled and the budget deficit (6.9% of GDP) reduced. Maintaining growth in Asia and other emerging regions is not a problem, unlike many developed markets, which goes to show that economic decoupling is a reality.

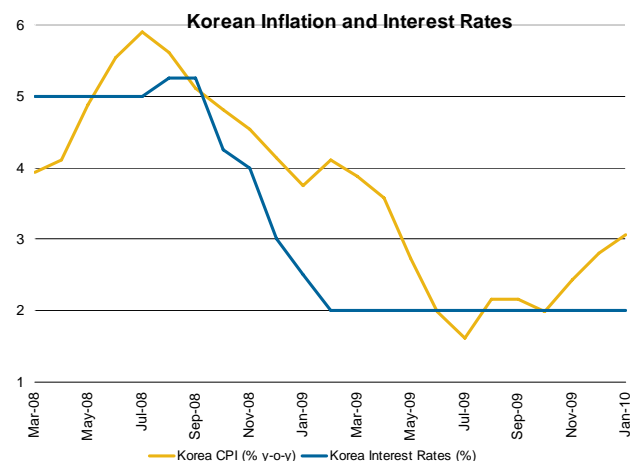
China: Banks' Reserve Ratios Raised Again

Following up on January's increase in banks' capital requirements, the first move since June 2008, the Chinese central bank increased reserve ratios by a further 50 bps in February. The tightening measure was applied despite consumer price inflation falling in January and coming in lower than expected. This is a further indication that China

is keen to avoid bubbles following record credit growth in January (19% of this year's RMB7,500bn target).

Korean Strength: Exit Strategy Imminent

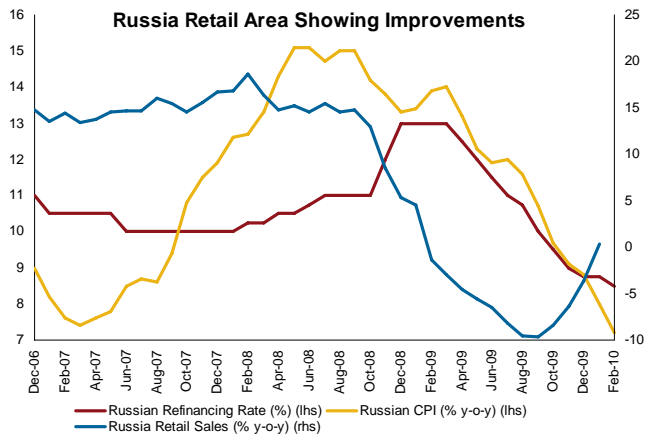
Inflation is continuing to rise in Korea, making it more likely that monetary policy will soon be tightened. CPI advanced to 3.1% (y-o-y) in January, having nearly doubled in the past six months since bottoming out in July 2009, whereas interest rates have been at their lows for a year. The country avoided recession, with a single, but large, 5.1% (q-o-q) contraction in Q4 2008. Since then, growth has picked up, particularly in the second and third quarters of last year. We steadily increased our allocation to Korea through 2009, although we moved slightly underweight again in February after taking profits on some stocks that were starting to look reasonably fully valued.



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

Russia: Retail Sales Rise for First Time in 12 Months

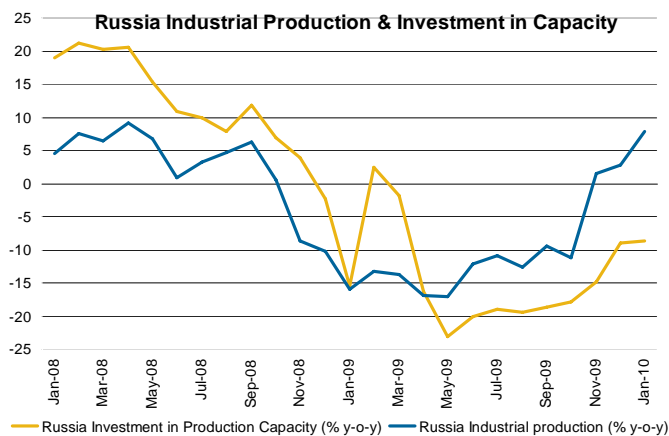
Following on from a record contraction of 7.9% last year, it is likely that the Russian economy is now growing. Retail sales rose slightly (0.3%) in January, for the first time in a year, and the trend has been good since bottoming out in September 2009. Consumer price inflation also continued to fall (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

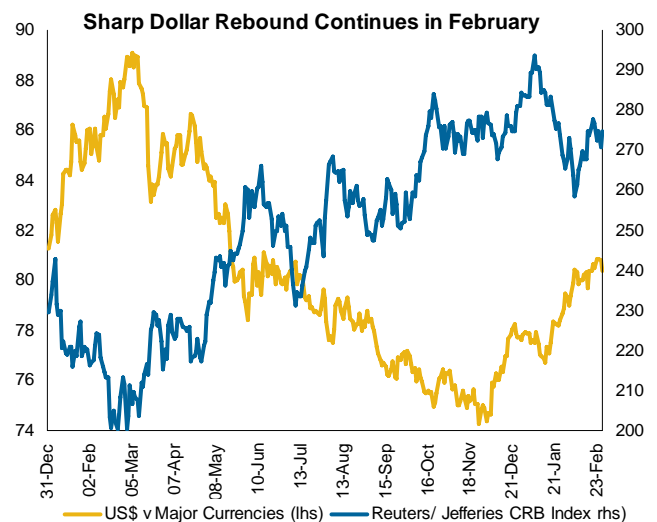
Both factors are positives, not only for the economy, but also for our overweight position in the Energy sector, although due to slow progress on tax reforms for oil companies and a stronger US dollar, we are less bullish over short-term prospects. The Russian economy is highly leveraged to oil prices, which explains why it substantially lagged other BRIC countries in the downturn. However, 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 7% 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.

Commodities and Currencies

Commodities were very strong in February, apart from sugar, which was down 17.5%. This trend was an almost mirror image of last month. The Reuters/Jefferies CRB and S&P GSCI Industrial Metals Indices returned 3.5% and 5.6% respectively; copper (6.6%) and oil (9.3%) were particularly strong.

The US dollar continued to gain against most developed currencies, as it has for the last three months, but was generally weaker against emerging currencies, particularly the Brazilian real, Mexican peso and Russian ruble.



Source: Bloomberg, daily data, 31 December 2008 – 26 February 2010

Performance Analysis

Summary

Over the month, we added value mostly through selection, although allocation was also a positive. Currency factors were a negative due to continued euro weakness. In terms of regions, we added value in Asia and Latam but lost ground in EMEA. Our two North American mining stocks

also helped relative performance, with double-digit returns during February.

Asia Performance

The main positives were China and India, although we also outperformed in Indonesia and Taiwan. The other four markets were small negatives, the main one being Korea.

In China, outperformance was driven by selection, particularly Dongfeng Motor, China Pacific Insurance, China Shipping Development and ZTE. Stock selection was also the main positive in India: Hero Honda had the best returns but all of our holdings contributed to outperformance except Reliance Industries, which was neutral. In Taiwan, an underweight allocation was the main contributor to relative performance, but selection was also positive. In Indonesia, Indocement and Astra outperformed. Underperformance in Korea was due to selection (what we did not own).

Latin America Performance

The key positives in Latam were stock selection in Brazil and Mexico. In Brazil we benefited by small amounts from several holdings, the main ones being Vale, MRV Engenharia, Lojas Renner, Cyrela Brazil Realty and Banco Brasil. All four of our holdings in Mexico outperformed, particularly Grupo Mexico and Banorte.

EMEA Performance

The main positive in EMEA was stock selection in South Africa, particularly Kumba Iron Ore and Aspen. The key negatives were overweight allocations to Russia and Turkey, which were weak, and selection in Israel (no Teva and our holding in Israel Chemicals). Stock selection was a positive in Russia and Turkey.

Sector Performance

On a sector perspective, we outperformed in five out of the ten sectors, with the key positives being Consumer Staples (allocation), Financials (allocation and selection) and Utilities (selection). Conversely, the main negatives were Healthcare (allocation and selection) and Materials (allocation and currency).

Portfolio Strategy

We maintain a mix of cyclical and more cautious investments as 2010 is likely to see lower returns but continued volatility. On a country perspective, our main overweights are Russia, Indonesia and Argentina, with the key underweights being Taiwan, Malaysia, Chile, Thailand, South Africa and Poland.

There were no major changes in February. Cash was up by around 300 bps due to a combination of inflows and some profit taking, but this was a temporary position. We are consciously looking to add weight to India and China, both of which are underweight now but are looking increasingly attractive on a macro perspective. In other moves, we added to Indonesia, but reduced exposure to Russia, Korea, Mexico and Taiwan, mainly due to stock-specific reasons.

India Looking More Attractive

The budget in India at the end of February looked to be a positive. The country will boost spending on infrastructure, reduce income tax and increase excise duty by less than expected, which should be good for oil and the Auto sector. The new government is becoming more aggressive and decisive about putting the economy on a clearer growth path. Economic growth is accelerating and the budget deficit is predicted to shrink next year. We slightly reduced our underweight in India by adding to our holding in Hero Honda Motors.

Looking to Boost China Exposure

Our China weighting was relatively unchanged over the month: we purchased a new position in China Telecom but this was offset by selling out of China Petroleum. China Telecom is the country's largest fixed-line telecom company: the outlook for profitability is improving faster than China Mobile and it is cheaper, with good growth in the broadband and mobile business.

Indonesia: New Ideas for Long-Term Favourite

Indonesia has long been one of our favourite markets and we initiated two new holdings this month: Adaro Energy and Bank Mandiri. Adaro is the second-largest thermal coal producer in Indonesia, but we believe it is better placed to grow faster than its peers and double production in five years or less. It has high-quality infrastructure, sizeable reserves of good-quality coal, low capital expenditure and high demand from export markets, particularly China, India and Korea, should ensure strong cash-flow generation. There is also the possibility of a tie up with BHP, which could prove a near-term catalyst. We diversified our Financials exposure in Indonesia with a new position in Bank Mandiri, which looks slightly cheaper than Bank Rakyat. We slightly trimmed our holding in Indocement, which was a star performer in 2009, rallying over 240% in euro terms.

Korea: Reduced to Small Underweight After Profit Taking

In Korea, we reduced overall exposure due to trimming holdings in Samsung Electronics, LG Display, LG Household & Health Care and Hyundai Mobis, but we added a new position in Hynix Semiconductor. Hynix is

cheap, with a 2010 forward PE (price-to-earnings) ratio of under 8x and a PB (price-to-book) of under 2x. We forecast return on equity moving from negative to 31% as tight supply in the DRAM market should result in higher selling prices and enable the company to reduce debt. The third quarter is likely to see a strong rebound but we believe that the second quarter, which is traditionally weak, could surprise on the upside. Additionally, KEB is selling its stake, which should be a short-term positive for the share price.

Sector Positioning

On a sector basis, our main overweight positions are Consumer Discretionary and Materials. Our biggest underweights are Utilities, Telecoms and Industrials. There were no big sector changes last month: we added to Telecoms and slightly increased Consumer Discretionary, but reduced exposure to Materials, Consumer Staples, Financials and Energy.

Outlook

We remain reasonably bullish on the outlook for emerging markets and have a cyclical bias in the Portfolio. However, we are cognisant of the risks as there are likely to be pullbacks ahead and, therefore, we need to keep a balance in the Portfolio between quality names exposed to growth and those companies that are more stable and offer downside protection. Overall, we feel that the rally is more likely to continue than reverse following a couple of weak months both on an absolute and relative basis. We are unlikely to see the levels of returns over the next six months that we have seen since the strong rebound started last March, but further volatility is to be expected.

There are still many powerful reasons why emerging equity markets can move higher, such as strong liquidity, faster economic growth, better government finances, higher reserves and earnings upgrades. There should also be favourable year-on-year earnings numbers through the first quarter, due to poor results twelve months prior.

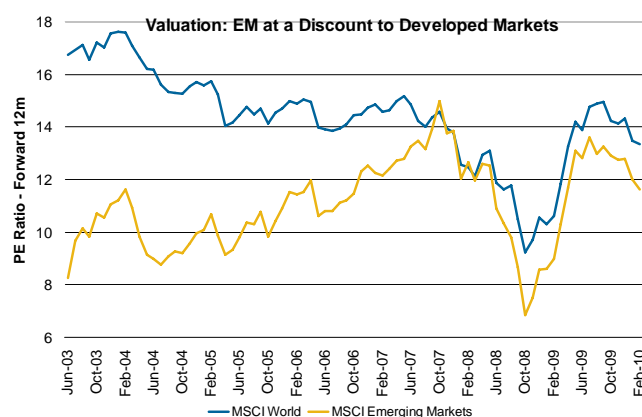
We have to be aware of potential pitfalls and we will closely monitor factors such as US dollar strength, inflation and signs of monetary tightening, which could be a negative if rates are raised too early or by too much. The only country where we see the prospect of lower interest rates is Russia, because industrial production is so weak and 2009 was the worst year for its economy in 15 years (GDP -7.9%). Conversely, strong growth in other countries means that inflation is a growing risk. There are also exogenous factors, mainly in developed countries, such as the debt problems in Greece and other European countries.

A stronger US dollar is not necessarily a negative. If the US dollar strengthens due to stronger growth, it could be a positive for exporters and even some commodity stocks, with the effects of stronger growth compensating for US dollar strength, which will increase prices. Nevertheless, it would be more serious if risk aversion falls and investors seek the US dollar as a safe haven.

China is growing faster than expected in many areas and this is having a knock-on effect not only in Asia but globally. Strong data from China in areas like GDP and manufacturing, and better news on exports and imports, point to further improvements to come. Also, we are reasonably confident in China's ability to balance inflation and growth, with controlled and sensible changes. The market is often spooked when China starts to tighten, but it outperformed in February despite further increases to banks' reserve ratios. Therefore, it looks likely that the scares over tightening have now diminished.

If the trend of better-than-expected earnings announcements continues, and it certainly appears more likely than not, this will be a further positive and may tempt more of the 'big wall of cash' that is waiting on the sidelines, back into the equity markets. Investors are probably too cautiously positioned and will, as a secular trend, need to rebalance more of their money to emerging markets in the years ahead.

Valuations have certainly become more expensive since late 2008 but they have been falling again since last September and are by no means expensive on relative or historical measures. Additionally, positive earnings surprises can move markets higher without expanding earnings multiples and the discount to developed markets has widened again in recent months.



Source: Bloomberg, monthly data, June 2003 – February 2010

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