INVESTMENTS

Quarterly Portfolio Update

Pioneer Funds – Euro Aggregate Bond
30 December 2011

Bond

Macro Review

European Bonds end the year on a High

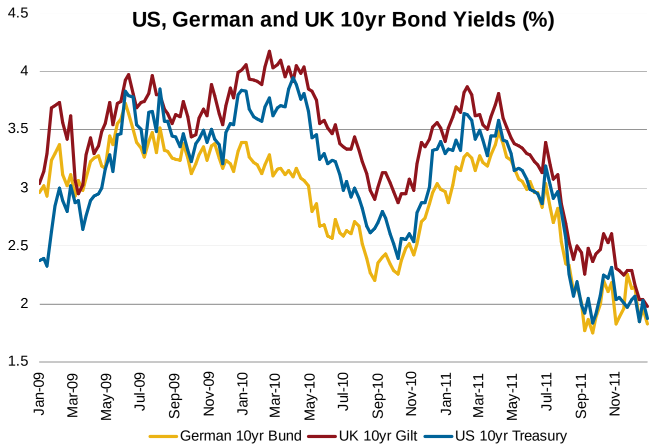
The main developments in the markets occurred early in the month as the EU Summit on the 8/9 December led to eurozone nations agreeing to further integration. Around the same time, the ECB announced it was cutting its main interest rate to 1% and extending a 3 year LTRO to banks. European fixed income markets reacted overwhelmingly positive to all these news items and thus created a positive environment for our risk-on position.

Yields Hit Euro-era Records in Italy, Spain and Portugal

Yields on government debt from the GIIPS countries spiked to record levels in the fourth quarter. Italian generic 10-year yields spiked from 5.5% at the start of the quarter to a high of 7.24% on 25 November; they subsequently fell back below 5.9% in early December on ECB buying but ended the year at 7.03%. Portuguese bond yields increased by 243 bps during the quarter (10.93% to 13.36%), hitting a high of 14% at the end of November. Spanish yields actually fell slightly during the period (5.13% to 5.09%) but also hit a record of 6.7% on 25 November, although the government had to pay 6.98% on a new auction of 10-year paper.

US, German and UK Government Bond Yields Fall

Yields on US and German yields fell slightly (4-6 bps) over the period due to their safe-haven status, although UK Gilts rallied more sharply, with yields falling by 45 bps to end the year at 1.98%, only slightly above Germany and the US. However, there was a brief divergence between Bunds and Treasuries in late November, with Bunds moving more in line with riskier paper as a German auction of 10-year paper was short of bids, with the weakest demand since 1998.



Source: Bloomberg, weekly data, 2 January 2009 – 30 December 2011

CDS Insurance Costs Hit Highs

Most countries such as Italy, Spain, Turkey, Russia, France, Germany and the UK saw CDS costs reach new highs in this cycle. Ireland and Portugal are still down from the mid-July peaks. Over the quarter, insurance costs fell in Portugal, Germany, Turkey and, particularly, Russia, which has seen strong macro data in recent months. France saw the biggest increase in CDS costs.

CDS Prices (bps)

	End Sep	Q4 Peak	End Dec
Italy	470	570	503
Spain	382	491	393
Portugal	1110	1123	1092
Ireland	700	781	726
Turkey	294	321	287
Russia	309	338	275
Germany	112	119	103
France	187	250	222
UK	94	105	98

Source: Bloomberg. Data as at 30 December 2011.

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Portfolio Analysis

Pioneer Funds - Euro Aggregate Bond ended the year on a strong note and locked in another successful calendar year. Pioneer Funds – Euro Aggregate Bond (Class A, non-distributing, EUR units) outperformed its benchmark, the BarCap Euro Aggregate Index, by 0.22% over the month, returning 3.37% in absolute terms. Over the year, the Portfolio outperformed its benchmark by 0.97%, returning 4.21% in absolute terms.

The Portfolio performance has two major drivers; the first part replicates the benchmark and the second part uses relative value strategies managed by specialists within the confines of our risk budgeting framework. The performance contribution can be assessed on the back of these alpha drivers.

Over the year, we sourced a large proportion of our extra performance from our duration position, sovereign exposure and exposure to Subordinated Financials. The primary negative contributors to performance were our long credit position in Tier1 financials and relative value trades on the BTP curve.

As we expected, our positioning delivered strong positive returns on both an absolute and relative basis in December. The main developments in the markets occurred early in the month as the EU Summit on the 8/9 December led to eurozone nations agreeing to further integration. Around the same time, the ECB announced it was cutting its main interest rate to 1% and extending a 3 year LTRO to banks. European fixed income markets reacted overwhelmingly positive to all these news items and thus created a positive environment for our risk-on position.

Sovereign Exposure

In terms of country positioning, we took a long position on Italy and Spain in September through the use of CDS as well as cash bonds. We took this position as part of our overall sovereign spreads strategy, which has been a key performance driver across our funds over the past two years.

As a consequence, our peripheral positioning is now as follows:

- No direct exposure to Greece. We have had no direct exposure to Greece in our Portfolio since the end of 2009. The solution from October’s EU summit effectively represents a redistribution of Greek debt to other European sovereigns and bondholders. We remain concerned about Greek debt levels in the long run.
- A relative long position on Italy and Spain. The reason for this is that we feel valuations on Italian and Spanish bonds have now reached a sufficiently attractive level to warrant a long position. Our view on Italy is that it can survive this crisis. The majority of Italy's borrowing is done domestically and they have finally begun implementing some credible austerity measures. The primary risk to Italy's situation is political through the possibility of poor decision-making at the government level. We feel the government in Spain are taking strong pro-active measures to restructure their economy. This position paid off in October.
- We remain neutral on Ireland and Portugal.

The reason we make use of CDS as well as cash bonds is that it enables us to achieve our sovereign exposure in a liquid manner.

Overall, we believe the EU is gradually moving in the right direction. If the situation continues to improve we may consider taking a long position on some other European peripheral nations (not Greece) in the not-to-distant future.

Financials and Non-Financials Exposure

Following a difficult month in November, we cut some of our credit exposure as part of our drawdown management strategy. We retain our faith in our credit positioning though and this was a key performance driver in December.

Financials' exposure to peripheral sovereign debt, funding concerns and increased levels of regulation has led to a lot of sector-specific nervousness in the market. We believe that sovereign concerns will continue to weigh on the sector in the near-term, but feel that these concerns are somewhat overblown. The Greek restructuring was manageable and - whilst this is not our base case - we consider similar moves on Irish and Portuguese debt would be manageable. A possible restructuring of Spanish and Italian debt would be of greater concern though, but again this is not our base case scenario. We think funding concerns for the sector are overstated – especially given how proactive the ECB has been on this issue. Headline risks remain very high for the sector, but European banks are far better capitalised than in 2008 with improved funding positions, greater transparency and proactive policy-making. In our Portfolio, our focus is on high quality names with little peripheral exposure and high levels of capitalisation. Examples include HSBC, Standard Chartered and various Nordic Banks.

In cyclicals, we have seen some underperformance from key names. We have largely avoided this through being underweight Building Materials and having no direct exposure to Steel or Mining. However, even factoring in a lower growth environment, the widening now looks over-done in many instances. This is creating potential opportunities that we will look to capitalise on.

Overall, we have a long position on credit (sub-financials and senior financials and Tier 1 bonds).

Duration Exposure

We are short duration. We think German rates are too low and they benefited from a safe heaven status. We expect this situation to fade soon and the spread between German rates and those of other eurozone countries to tighten.

Outlook

In the second half of 2011, the eurozone bond market experienced something akin to a slow bank run. In order to bring this to a halt we need either a lender of last resort (the ECB) or a fiscal lender of last resort (Germany) to restore markets' faith in the eurozone.

The recent EU Summit took us another step closer to fiscal federalism and tighter controls on the national budgets of eurozone nations. The ECB is acting as a lender of last resort through its Securities Markets Programme (SMP) and this has helped bring in yields on Italian and Spanish bonds. In the medium run, we feel a treaty that entrenches fiscal federalism and tighter control of national budgets is imperative. Rather than going through the arduous process of amending existing legislation, we think a new treaty to be ratified by the 17 eurozone nations is the neatest solution.

In the present environment however, you are paid well to take a risk-on position. As such, we will maintain our current trading themes of taking exposure to Spain and Italy and overweighting credit in our Portfolio.

Important Information

Unless otherwise stated all information contained in this document is from Pioneer Investments and is as at 30 December 2011.

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