

Monthly Portfolio Update

Pioneer Funds – Global Trends

26 February 2010

Equity

Review

The Portfolio was up by 2.6% (Class A, non-distributing, EUR units) over the month, slightly underperforming its benchmark, the MSCI World Index, which returned 3.29%.

Markets

Developed equity markets (-3.7% in local currency terms) outperformed emerging markets (-4.5%) during a month when risk aversion remained elevated. Equities bounced from 9 February, following consistent falls since mid January, but it seemed more of a value trade after the sell-off than renewed confidence. Indeed, risk aversion levels increased again in the latter part of the month on weaker-than-expected data that further highlighted a lacklustre consumer.

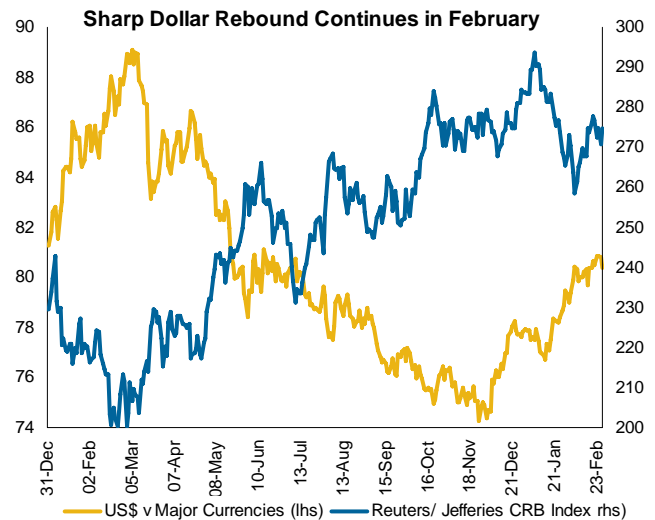
Macro

Central banks started easing off the gas and began implementing, or at least signposting, exit strategies despite still mixed data, especially on the consumer front, ongoing sovereign-debt worries and waning growth momentum. Data was a bit weak towards the end of the month, especially US consumer confidence and German business sentiment (Ifo).

Commodity and Currency Volatility

Commodities were 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, the notable exception being the Japanese yen, which remains strong, especially year-to-date, despite the new finance minister's desire for a weaker currency. The US dollar rally has now lasted three months, during which time it is up against most currencies outside of Asia except the Australian dollar, Canadian dollar and Mexican peso. During those three months, the biggest gain (10.1%) has been against the euro. Apart from the yen, the strongest major currencies over the month were the Brazilian real, Canadian dollar, Mexican peso and Russian ruble.



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

Government Debt in the Spotlight

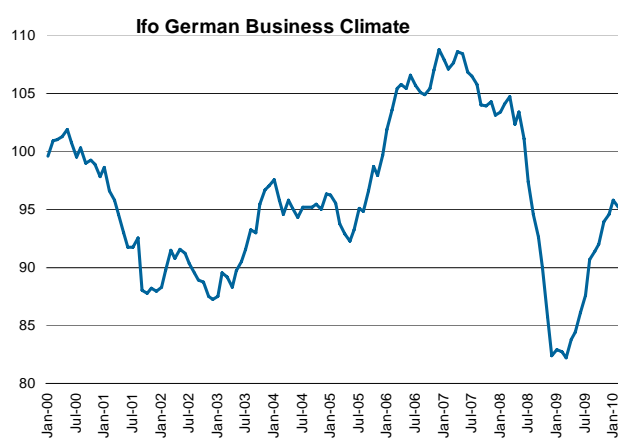
Soaring budget deficits, caused by stimulus packages, have led to governments issuing large quantities of bonds. This has pushed up sovereign debt to uncomfortable levels and sparked crises in Dubai and Greece, and could lead to further funding problems for other countries if the appetite for new paper wanes. This issue was starkly highlighted in February when the US announced that foreign holdings of US debt fell by a record US\$53bn in December 2009, largely due to a second month of net reductions from China. If falling foreign demand for sovereign bonds becomes a trend, it could push up borrowing costs for governments at a time when they are trying to reverse record budget deficits.

Greece: Europe May Help

Problems in Greece dominated news flow in Europe and especially in relation to the euro. EU leaders announced that they would be willing to help Greece but gave no details. However, the news was badly received and at a subsequent meeting, a harsher tone was evident, putting the pressure back on Greece to implement additional measures to reduce its budget deficit. There were further comments by various leaders and it looks likely that Greece will receive some help, but details are yet to be sorted. However, any assistance is likely to come with tough conditions.

European Recovery Stalls

At the same time that Greece has prompted an uptick in risk aversion, recovery prospects in Europe are also waning. Economic growth in the eurozone was an anaemic and lower-than-expected 0.1% (q-o-q) in the fourth quarter of 2009, down from 0.4% in Q3. The figure for the full year was -4%. The French economy remained strong (0.6%), with Germany flat and Italy (-0.2%) and Spain (-0.1%) contracting. Indeed, Spain is the last major economy still in recession, which has so far lasted seven quarters. Towards the end of the month, the Ifo reading of German business sentiment surprisingly fell for the first time since last March when it bottomed at the same time as equity markets.



Source: Bloomberg, monthly data, January 2000 – February 2010

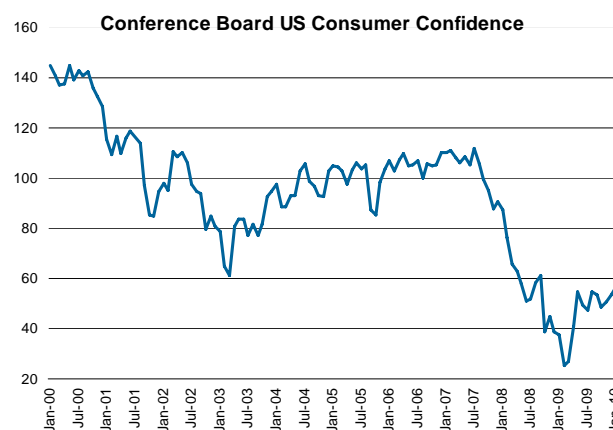
US: Fed Raises Discount Rate; Consumer Confidence Down

The US central bank made the first, but largely symbolic, step in normalising monetary policy and exiting the emergency measures implemented in the face of the financial crisis. The increase of 25 bps takes the discount rate to 0.75%, with a reduction in the term from a maximum 28 days to overnight. This is the start of the Federal Reserve’s (Fed) efforts to reduce excess liquidity and encourage banks to seek short-term funding elsewhere. The Fed emphasised that the changes are technical in nature, stating that they “are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy, which remains about as it was at the January meeting”. In other words, it does not expect an increase in the Fed Funds rate in the near term, probably not in the first half of the year.

US Consumer Confidence Disappointingly Weak

Investors reacted negatively to news that the Conference Board’s Consumer Confidence Index was much weaker than expected: the reading of 46 was a 10-month low and

significantly down from 56.5 in January. This highlights reduced optimism about recovery prospects and worries over jobs. There was also disappointing news on existing US home sales, which fell for the second successive month. Expectations were for an increase on the December 2009 level, although the extension of the tax credit has made it difficult to rationalise short-term trends.



Source: Bloomberg, monthly data, January 2000 – February 2010

Despite the concerns, the month finished on a high (with markets rising) as Q4 economic growth was revised higher to 5.9% (annualised). However, the higher number was down to increased manufacturing output, and the contribution from consumer spending was actually lower than first thought. This further highlights a recovery that is business rather than consumer-led, which backs up our cautious stance.

Despite the overall improvement in the economy, recovery is not balanced and interest rates are likely to stay low for longer than previously thought in the hope of reviving consumer confidence and spending. High unemployment remains an obstacle, probably more to do with the psychological impact on the circa 90% employed rather than the contribution of those out of work. In an effort to promote jobs, the Senate approved a fresh US\$15bn package of tax breaks for companies hiring unemployed people.

China: Banks’ Reserve-Ratio Requirements Increased 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).

UK: Rising Inflation, Weak Consumer

February data in the UK showed rising inflation, stronger-than-expected manufacturing figures but very weak retail sales. Consumer inflation hit 3.5% (annual) in January, its highest level since November 2008 and above the top of the target range, thus forcing the governor of the Bank of England (BoE) to write a letter of explanation to the chancellor; inflation has been rising strongly since hitting a five-year low of 1.1% last September. The figures were buoyed by VAT returning to 17.5% and the BoE governor said that the rise was temporary. It is unlikely that interest rates will be raised in response to higher prices, especially as the BoE called a halt on further quantitative easing after having spent its allocated £200bn.

Worse-than-expected January retail sales (-1.8% m-o-m) further highlighted the weak nature of the recovery and the likelihood that monetary policy will stay loose until there is evidence of a stronger consumer. There was also some positive news: UK manufacturing was up by 0.9% (m-o-m) in December 2009, ahead of expectations, and Q4 GDP was revised higher to 0.3% (q-o-q) from the initial estimate of 0.1%.

Performance Analysis

On a sector basis, we outperformed in three out of the 10 areas, Consumer Discretionary, Consumer Staples and Telecoms. The main negatives were Industrials and Energy, while Healthcare, Financials and Materials also detracted.

On the positive side, the key contributors to outperformance in Consumer Discretionary were off-benchmark positions in Gafisa (+14.1%), a Brazilian homebuilder, and Anhanguera Educacional Participacoes, a Brazilian education company (+10%). Our holdings in Interpublic, Home Depot and Comcast, which we added during the month, also added to performance. Interpublic rallied 15.7% over the month following the company's announcement that it would improve profitability in 2010 due to an expected recovery in marketing expenditures.

In Consumer Staples, we benefited from our holdings in the Food, Beverage & Tobacco sub-sector, with a good performance from our off-benchmark positions in salmon-farmer Cermaq (+16%) and sugar producer Cosan, which is recovering from a poor performance in January. Within Food & Staples Retailing, Familymart also contributed to relative performance.

Underperformance in Industrials was caused by what we did not own within Capital Goods. Our holding in Ryanair was the biggest single detractor within the sector. The other main negative was Energy, where underperformance was mainly driven by our holding in US refiner Valero, which fell 6.7%, as demand is still subdued in the US Refining sector.

In Healthcare, the biggest single detractor was Athenahealth, which offers web-based physician billing, practice management and EHR solutions. This more than offset the positive contributions from our holdings in Mindray Medical International and Universal Health Services, which both gained over 10% in February. Our holdings within Pharmaceuticals, Biotechnology & Life Sciences also detracted.

Portfolio Strategy

We have positioned the Portfolio more appropriately for our expectations of lower market returns and a more discerning stock-specific environment. Our overriding high-level strategy is to have a barbell approach to quality. We are looking for stocks that can either 'defy gravity' and are not reliant on GDP growth to deliver over the short and medium term, or cheap, safe and predictable companies with high dividends and low valuations.

Many high-quality market-leading companies have been left behind in the rally, which is creating opportunities across different areas of the market, such as Telecoms, IT and Consumer Staples. This focus is the one side of our barbell approach. Within the other camp, we see high-growth opportunities that can be categorised under several different themes. Over the next couple of years or so, growth will be a scarce commodity and companies that can deliver should attract increased premiums.

Current Themes

- Cheap, Defensive and Predictable Quality
- Home Entertainment
- Emerging Markets, with a Focus on Structural Social Improvements
- Consumer-led Broadband Consumption
- Healthcare
- Special Situations

Changes in February

Over the month, we purchased five new holdings, with a corresponding number of sales.

Within the defensive side of our barbell strategy, we purchased Kraft Foods and Southern Company, a leading US energy producer, and sold Home Depot.

Kraft Foods is a cheap, mega-cap, US-based consumer-staples company. Kraft had been facing structural disadvantages, but the purchase of Cadbury creates meaningful revenue synergies and increases its earnings potential significantly. This value-enhancing deal broadens its product range and, more importantly, enables Kraft to increase its scale in Europe as well as to accelerate top-line growth in emerging markets.

Within Utilities, we are positioning our exposure more defensively. We sold International Power, a UK-based international power provider, and Questar, a US gas services company, and purchased a new position in Southern Company.

Southern is a solid US-regulated electric utility that offers a dividend yield of around 5.5% and has grown its dividends by around 4.5% over the last five years. The US administration recently announced its plans to build new nuclear power plants, the first ones in the US in more than 30 years. Two new power plants are to be constructed by Southern, which is a major positive for the company.

On the other side of the barbell, we bought Capcom, Comcast and Renault, and sold Honda and Universal Health Services.

Within our Home Entertainment theme, Capcom and Comcast were bought based on their compelling valuations. Capcom is a cheap video-game developer, with a major focus on Japan. The company targets core gamers, a sub-sector of gaming that is completely cycle independent. In 2009, volumes and profits in the video-game sector fell sharply, largely due to ‘casual’, non-core gamers that emerged in 2008 and reduced spending in 2009 due to the financial crisis. Core gamers, by contrast, increased their purchases during the period. Within the gaming sector in Japan, there are very few pure-play gaming opportunities as most businesses are part of conglomerates that focus on the arcade business. While Capcom has a legacy arcade business, it is a smaller part of its overall activities, but still provides the company with useful cash flow.

Comcast, a communication company and provider of cable services, has been underperforming for years due to acquisition fears and lacking content. Its latest deal to take control of NBC Universal makes the company a major media player. This acquisition was cheap and well structured and should allow Comcast to become a leader in

the development and distribution of multiplatform ‘anytime, anywhere’ media. Although the stock decreased further in value after the acquisition announcement, due to fears that the deal would lead to a dividend cut, the company maintained its dividend. We see significant value in the stock as the deal was transformational, strategic and well structured.

Within Healthcare, we sold Universal Health due to concerns about the new US healthcare bill and increased our position in McKesson. We also added to our position in Mindray Medical, which is part of our Emerging Markets theme.

Within the Special Situation theme, we sold Honda and bought Renault. The French company underperformed significantly this year, but we now feel it offers compelling value. Renault is a significant shareholder in Nissan. The market value of Renault is only roughly equivalent to the value of its stake in Nissan. Therefore, the market is distributing a zero value to the rest of its business. Renault also indicated that a sale of its 20% stake in truck maker Volvo could be a possibility in the future, which would reduce debt and further enhance the company’s value. Additionally, both companies have some innovative electric vehicles, which are due to go into production in the next few years and could represent a potential future growth driver.

Outlook

There have been clear signs recently that the market is finding some resistance levels. Returns have been relatively flat over the past four or five months and markets are down so far this year. The unprecedented rally since March has pushed equities from being clearly cheap to being fairly valued or, in some cases, a bit expensive. There are many headwinds facing consumers, governments and companies, which are going to impact on most areas. While we acknowledge that good progress has been made on the economic front, much of this is due to government fiscal and monetary stimuli. Despite some concerns about inflation, we believe that policymakers’ key priorities will be to keep momentum behind growth. This may store up problems for the future, but that is clearly a secondary issue now in most countries, with some exceptions in Asia. Interest rates have started to rise in some countries but we feel that the US, Europe and probably China, will keep monetary policy relatively loose.

We believe that the most likely and definitely most favourable outcome over the short and possibly medium term is for markets to trade within a range. This would

stop bubbles forming, and allow governments and consumers to retrench and repair balance sheets, while growth stays positive but sub-par.

We are market neutral with regards to beta and do not want to predict the direction of markets. We prefer to find companies that we believe can deliver in the expected low-growth environment with probably more muted overall market returns. Making money is going to be harder, especially compared to the previous year. One key factor will be to back quality businesses that can take market share from weaker competitors, whether they are low or high growth.

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