

# Quarterly Portfolio Update

*Pioneer Funds – Japanese Equity*

*31 December 2009*

Equity

The Portfolio was down by -1.73% (Class A, non-distributing, EUR units) over the quarter, slightly underperforming its benchmark, the MSCI Japan Index, which returned -1.00%. Factors that negatively impacted returns over the quarter included stock selection in Diversified Financials, where holdings such as Jafco underperformed, and allocation (overweight) and selection in Technology Hardware, such as NEC. We benefited from an overweight position in steel producers including Nippon Steel and JFE, and underweight exposure to land-transportation companies such as Keio and Central Railway.

Japanese equities performed in-line with global markets over the quarter in local-currency terms, but a weaker yen reduced returns for euro and US dollar investors. However, this disguised some big volatility, partly driven by currency factors. Japanese markets underperformed through October and November due to currency strength but rallied significantly in December as the yen fell heavily after hitting a 14-year-high against the US dollar (86.4) on the last day of November. Indeed, in local-currency terms, only Turkey beat the Nikkei's 12.8% surge in December.

Japanese exporters saw further improvements in earnings, driven by shipments in Asia and the weaker currency in December. Banks continued to underperform as investors feared that they may need fresh capital, while domestic-related stocks such as retailers also underperformed due to deflation worries.

The Portfolio is positioned to benefit from a cyclical recovery driven by Japanese companies with high market share and strong technological expertise. Over the quarter, we reduced our exposure to the Materials sector, which we believe has priced in earnings recovery, and added to the Capital Goods and Consumer sectors, which should further benefit from consumption growth in China.

We sold stocks with high potential of needing to raise capital, including Mizuho Bank and Sumitomo Mitsui Financial Group. Conversely, we increased exposure to Asahi Brewery, which is gaining market share in the fast-growing beer market in China, and Nippon Electric Glass, that should benefit from the growth of LCD TV across Asia. There were clear signs of consolidation in the market over recent months, with investors becoming more

discerning about how much growth is already priced in to different stocks. We want to increase our positions in companies that can continue to grow earnings and increase market share over the medium term. We are also keen to find companies with leading brands and technology that are also deriving an increasing amount of their earnings from fast-growing emerging economies.

The recovery in exports and industrial production is not showing signs of any slowdown yet, although overseas consumption will have to maintain its momentum for the recovery to be sustainable. The Bank of Japan is likely to make further incremental changes in liquidity provisions to prevent the yen from strengthening significantly against the US dollar. A strengthening yen will erode the earnings of exporters that have been the key driver for this recovery.

The Democratic Party of Japan's initiatives to stimulate domestic consumption are unlikely to have a material impact on the earnings of companies focused on the domestic economy as unemployment remains high and total wages continue to shrink. We believe that a key area of growth will come from Japanese companies that are global leaders in environmentally friendly technologies, which is likely to be a growing secular theme.

Over the next quarter, the direction of the yen will continue to influence earnings forecasts for Japanese exporters. Companies with high debt/equity ratios are still likely to engage in dilutive capital raising. We continue to favour low P/B (price to book) companies with strong balance sheets that can invest for future earnings growth. After the slew of capital raising settles down in early 2010, we expect the market to refocus on companies that are able to increase market share in overseas economies and continue to improve cost management. As long as the Bank of Japan makes an effort to maintain the yen at around Y90/USD, the recovery in exporters' earnings could lead to more capital spending and halt the rise in unemployment. If this happens, we could see a more meaningful economic recovery that will support a rise in the Japanese stockmarket.

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