

# Monthly Portfolio Update

Pioneer Funds – Top Global Players

26 February 2010

Equity

## Review

The Portfolio was up by 2.54% (Class A, non-distributing, EUR units) over the month, 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.

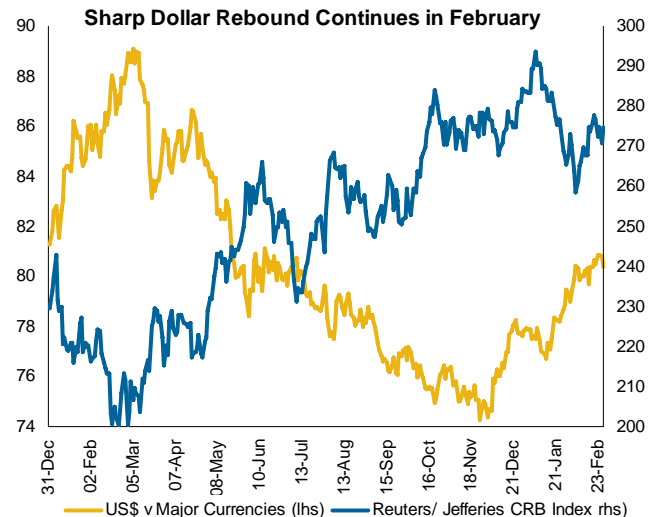
### Macro

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

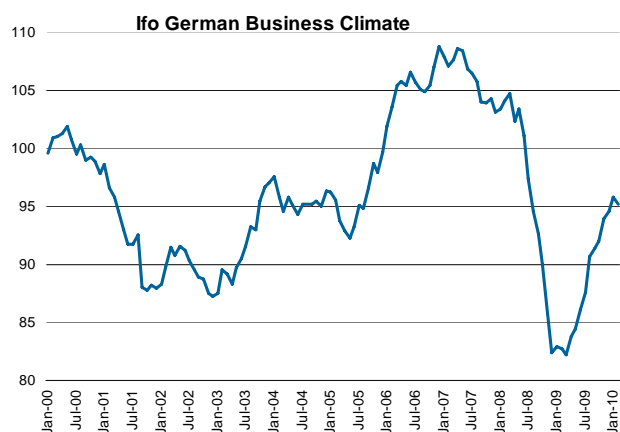
Soaring budget deficits, caused by stimulus packages, have led to governments issuing large quantities of bonds. This has pushed up sovereign debt to uncomfortable levels and sparked crises in Dubai and Greece, and could lead to further funding problems for other countries if the appetite for new paper 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

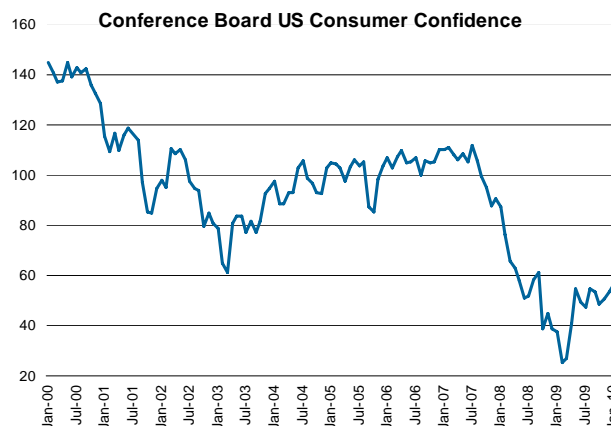
### US: Fed Raises Discount Rate

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 2009 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, ahead of expectations, and Q4 GDP was revised higher to 0.3% (q-o-q) from the initial estimate of 0.1%.

## Performance Analysis

Out of the ten sectors in the benchmark, we outperformed in four and were neutral in Utilities. Our best relative returns came from IT and Consumer Discretionary. Conversely, Financials, Industrials and Health Care were the main negatives.

In IT, all of our holdings except the new position in CSR made positive contributions towards relative performance. The main drivers of outperformance were our Technology Hardware stocks, particularly Hewlett-Packard, Cisco, Dell and Canon. In Consumer Discretionary, the star performer was GAP, which rallied 14.8%, compared to 6.1% for the Retailing sub-sector, on strong fourth-quarter results, improved guidance for 2011 and an 18% increase in its full-year dividend.

The key detractors in Financials were Societe Generale (poor results) and Lazard (results: top line good but costs were higher), with a smaller negative from Wells Fargo. This was partially offset by the outperformance from our holding in Morgan Stanley, which rebounded following a weak January. Industrials was weak due to poor performances from Finmeccanica and Thales, although this was partially balanced by a 13% gain for Flowserve. Fourth-quarter results from Thales showed a weaker-than-expected order book, which may mean restructuring takes

longer. The main drag in Health Care was our large position in Pfizer, which slightly underperformed on results that showed higher-than-expected integration costs from the Wyeth purchase.

Outside of the above areas, our holdings in Apache, Newmont Mining and Agrium performed well. Conversely, Akzo Nobel was a key underperformer, falling 13.6% compared to a 4.4% rise for the Materials sector. The market was concerned about the level of unfunded liabilities in its pension fund, although we believe it was an overreaction and more an accounting issue that will balance itself out in the future.

## Portfolio Strategy

We keep a diversified Portfolio, with investments in all ten sectors, as we look to add value more in stock selection. Consequently, our active sector positions are reasonably constrained. Our biggest overweights are IT, Consumer Staples and Health Care, while Financials, Utilities and Industrials are the main underweights.

Positioning was relatively unchanged in February. We slightly decreased our overweights in IT and Consumer Staples, increased our underweight in Financials and reduced the underweights in Consumer Discretionary and Utilities. Cash was also slightly higher at the end of February at around 4%.

One of our key themes for the year ahead is to focus on increasing the Portfolio's dividend yield. On average, dividend yield makes up a substantial portion, around 50%, of overall returns from equities over the long term. Last year, dividends contributed a much smaller percentage (nearer 10%) of overall returns. This situation should revert more towards the mean, which means that dividend income should be more in demand, especially in a period of more subdued lower-growth markets.

Over the month, we made two switches that were valuation driven. We sold out of Bank of America and Dell, and bought new positions in JPMorgan Chase and CSR. We also added to our existing holdings in International Power, Sanofi-Aventis, Wells Fargo and Bank of New York. Conversely, we reduced our holdings in companies including Keycorp, Societe Generale, Morgan Stanley, Flowserve, Hewlett-Packard, Cisco and Repsol.

JPMorgan is one of the largest Diversified Financials companies in America, with a market value of US\$165bn (as at 4 March); it has operations in areas including investment banking; asset management; private banking;

card services; commercial banking; treasury and home finance. The company has strong market positions in many of its businesses, good management and a solid balance sheet. It should also see further benefits from the acquisitions of Washington Mutual and Bear Stearns during the crisis. JPMorgan had a similar value to Bank of America but the former is a higher-quality business.

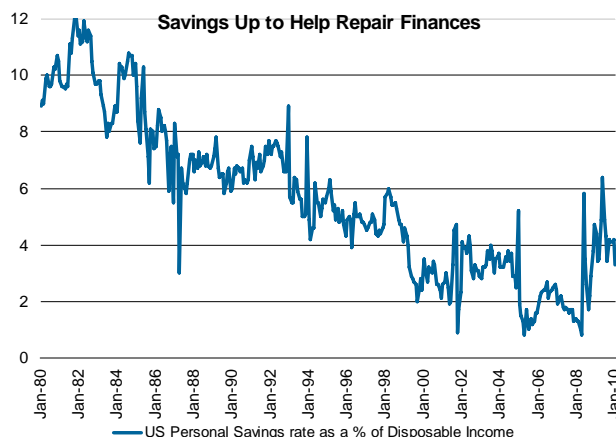
We took advantage of a rebound in Dell's share price and sold out in favour of CSR, a mid-cap UK-based technology company. CSR designs multifunction connectivity and location platforms, such as Bluetooth, GPS and Wi-Fi chips that are used extensively in mobile consumer devices such as phones, navigation systems, headsets, computers and cameras. CSR is the market leader in Bluetooth design and has partnerships with many top electronics companies that utilise this technology. The market for its products is growing strongly and finding new uses, such as TVs. CSR is on an attractive valuation considering its growth potential and quality.

## Outlook

In general, we still have a defensive bias. The problem that caused the financial crisis was excess leverage, which has yet to be cured. We believe that the market has gone up too far too fast and we are still more concerned with downside protection than chasing cyclicity. However, we also want to be able to participate if the market rally resumes, so we are exposed to a mixture of growth drivers.

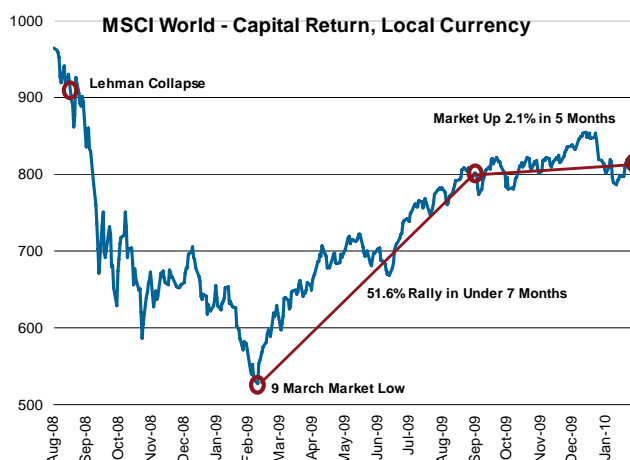
We are in a normalisation-of-margins phase driven by cost reductions, but end demand is still subdued. The third quarter of 2009 saw generally strong corporate results. This trend has been maintained in the fourth-quarter results so far released, especially on a comparative basis against weak periods last year. There has been some top-line growth coming through but it has certainly not been strong and is going to be difficult to find, in general, through 2010.

Liquidity and improving economic data caused the market rebound but leverage and its knock-on effects (indebtedness, tax increases, slower growth, higher unemployment, higher savings etc.) will be a continuing headwind through this year. Additionally, there is still spare capacity utilisation in most industries. A key reason why we like IT companies is that spare capacity can be reduced quickly due to technological innovations and the rapid pace of change.



Source: Bloomberg, monthly data, January 1980 – January 2010

We have turned the corner but there is a danger that people are losing sight of the hurdles that lie ahead just because we have passed the trough of a very serious downturn. Indeed, there seems to have been a change in investors' behaviour and sentiment over the past few months: optimism and market rallies have been far more balanced with caution and sell-offs. Markets have been pretty flat since October 2009 due to the sell-off this year, so it seems we have been in the consolidation phase that we were expecting for some time. Fundamentals and stock picking will become increasingly important going forward.



Source: Bloomberg, daily data, 31 December 2008 – 8 February 2010

Indeed, to emphasise our point that 2010 could be much more suited to stock picking rather than themes or trends, Citi Global Equity Strategist (published on 16 December) highlighted some interesting points about the rally in 2009. In the initial stages of the bounce, between 9 March and 9 June, markets (DJ Stoxx Large Cap) were led by very narrow leadership, with the top decile massively outperforming: the spread between top and bottom decile was 130%. This shows that very bombed-out stocks that suffered most in the sell-off were in demand as risk

premiums dropped. The second phase since 9 June saw the spread almost disappear, with only a 6% difference between top and bottom decile. We believe that the next phase in markets should be more stock specific, with investors being more discerning between the quality of companies. This should result in a greater performance differential between winners than in recent months, but not to the extent that we witnessed in the early stages of the rally.

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