

Quarterly Portfolio Update

Pioneer Funds – Euro Curve 7-10year
31 March 2009



Fixed Income

The EMU (European Economic and Monetary Union) government bond market was characterised by large inter market volatility in Q1 2009 as sovereign spreads widened to levels not seen since the euro was launched in January 1999. This process which had started in the second half of 2008 (and was highly correlated to the overall widening in credit spreads) accelerated at the start of 2009 as the idiosyncratic risk of each country came into play. Greece, Spain, Portugal and Ireland were all downgraded, and Austria, with its large exposure to Eastern Europe, came under much pressure. The widening was particularly pronounced in the 10-year sector. Spreads, however, did narrow towards the end of the quarter as commitments from individual governments and the IMF bail-out towards Eastern Europe allayed market fears of an EMU break up.

Outside of the movement in sovereign spreads, EMU government bonds endured a mixed quarter with large intra day swings being nullified over the quarter. The other main feature was a significant curve steepening, with shorter maturities delivering a positive return (aided by a further 125 bps easing from the European Central Bank (ECB)) but longer-dated bonds ending the quarter in negative territory (weighed down by concerns over rising government deficits and as a result of a rising term premium).

Outperformance came from being overweight core EMU bond markets (Germany and France) versus the rest of the benchmark, the JP Morgan EMU Bond 7-10years Index. As noted above, the spread widening was the most pronounced feature of the market over the quarter, especially in the 10-year sector. In addition, the Portfolio had a long duration position in the UK, which contributed +7.5 bps to performance. However, this was offset by a long duration position in Europe in March, which lost -2 bps, a short EURUSD FX position (-3 bps) and a Long US Short Europe duration position (-3 bps). Our 5% credit component in the Portfolio contributed positively (+10 bps).

The strategy of the Portfolio is to generate performance of between 50 bps – 70 bps in excess of the benchmark, using no more than 100 bps of tracking error (ex ante). This is

managed within a quantitative investment process where all our investment decisions have a quantitative underpinning.

Our quantitative duration models had relatively weak signals in Q1 2009, potentially indicating a turning point in the interest rate environment. This is not so surprising given the fiscal stimulus that will hit the global economy in the next couple of quarters. However, with the ECB still likely to cut interest rates to below 1% in Q2, we believe that the interest rate environment should remain favourable towards government bonds.

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