

Quarterly Portfolio Update

Pioneer S.F. – Euro Inflation Linked

30 June 2010

Bond

Review

The second quarter of 2010 was characterised by high levels of volatility in both the equity and bond markets. By the time the dust settled, European corporate and government bond indices lost some ground and the MSCI Europe Index dropped 11.2% in euro terms over the period. In addition to this, the euro dropped 9.4% and 14.3% in value against the US dollar and Japanese yen respectively.

The G20 summit took place in June. The key conclusion from the summit is that advanced G20 economies will aim to halve their budget deficits by 2013 and start to stabilise their debt-to-output ratios by 2016. G20 leaders agreed that nations can move at their own pace in the deficit reduction efforts and pledged to fulfil existing stimulus plans. This was a compromise decision between the US position and that of some European leaders, and was perceived by some economists as being a weak agreement.

In light of the pressure on the euro and the burgeoning sovereign debt crisis, on 10 May the EU and the IMF agreed on a €750 billion safety package for eurozone countries as part of a three-year aid plan. Later that week, the European Central Bank (ECB) announced its Securities Market Programme, which enables the ECB to intervene in public and private debt markets "to ensure depth and liquidity in those market segments which are dysfunctional".

The trend towards austerity and fiscal tightening continued in May as Spain and Portugal agreed to implement additional spending cuts to bring down their budget deficits more quickly. Spain plans to cut its budget deficit to 9.3% of GDP this year, from 11.2% in 2009, and to 6.5% in 2011. It had previously committed to lower the budget deficit to 9.8% of GDP this year. Portugal plans to cut its budget deficit to 7.3% of GDP this year, compared with an earlier target of 8.3%. Last year's budget deficit was 9.4% of GDP.

Against this background, a number of sovereign debt issues took place in the eurozone in May with mixed success. Spain, for example, had to scale back a projected

issue of €8 billion to €6.44 billion in light of limited investor appetite.

Throughout April, bond market headlines were dominated by Greece. On 23 April, Greek Prime Minister George Papandreou formally requested the activation of the aid package that was arranged between the Greek government, the European Union and the IMF. The immediate priority of the aid package was to help Greece meet €9 billion worth of debt repayments on 19 May, now that borrowing on the open market has become prohibitively expensive for Greece. Shortly after this announcement, S&P Ratings Services lowered its ratings on Greek debt from BB+ to BBB-, thus assigning Greece junk status. Portugal's rating was also cut two steps to A- as contagion from Greece's debt crisis spread through the euro region. Credit-default swaps on Greek debt jumped 104 basis points to a record 814 basis points on 27 April.

Performance Analysis

Pioneer S.F. – Euro Inflation Linked (Class A non-distributing, EUR units) underperformed the benchmark, the BofA ML Euro Government Inflation Linked Index, by 1.18% over the second quarter of 2010, returning -0.6% overall. On a year-to-date basis, the Portfolio has outperformed the benchmark by 0.70%, returning 0.64% overall. The Portfolio's investment process is built on a three-stage framework, namely fundamentals, technicals and valuations. Pioneer Investments' views on these three pillars is built based on a combination of top-down and bottom-up factors, including qualitative and quantitative analysis, portfolio manager and specialist insights and a macro view from our asset allocation strategists.

Over the quarter, positive performance contributions came from a number of factors. The primary positive contributions came from the fact we had no Greek inflation-linked bonds, relative value trades and our overall country exposure.

Negative contributions came as a result of the flight to quality that took place over the quarter, as many investors switched their exposure from linkers to nominals. Liquidity issues in the market further widened the spread

and peripheral linkers, such as Greek and Italian inflation-linked bonds, underperformed.

Outlook

On 1 July, the European Central Bank's 12-month Long Term Refinancing Operation (LTRO) will expire. Over the past 12 months, this operation has added €442 billion in market liquidity and enabled European banks, and Spanish Banks in particular, to gain access to liquidity they were unable to access on the open market. Despite persistent lobbying from Spanish banks, the ECB has decided not to extend the 12-month LTRO and is instead offering banks the option of rolling into a 3-month facility, or into an even shorter 6-day facility. The auction for these short-term loan offers came out on 30 June and €132 billion worth of debt rolled over into the 3-month facility, which was perceived by the market as being a relatively low amount.

We do not foresee any significant liquidity issues for banks over the short term (as those banks that need to can roll into the 3-month LTRO programme which is unlimited in size). The take-up of the 3-month facility was lower than expected (which was a small positive), but we believe that the reliance of a minority of weaker institutions on the ECB is now greater than ever. Therefore, we believe that funding may well remain a challenge for certain institutions over the coming 12-18 months. Accordingly, we have been trying to concentrate our bank holdings in names, which have good access to wholesale and/or deposit rich balance sheets. Our rather pragmatic view of the issues which the sector faces (including increasing regulation, potential windfall taxes and most importantly question marks over economic recovery) means that we are focusing on better capitalised banks with more defensive balance sheets. We have very limited exposure to banks in Ireland, Greece and Spain and we are also taking a conservative approach towards UK and German banks.

In Europe, we expect the focus to remain on sovereign risk for the foreseeable future. Governments will continue the current trend of tightening fiscal policies and curbing spending in order to both rein in spiralling budget deficits and appease the increasingly risk-averse financial markets. We expect the support packages announced by the EU, IMF and ECB over the month to benefit PIIGS sovereign and corporate spreads in the long run as spreads will begin to converge relative to their German counterparts.

One of the primary risks of the support packages is that the monetisation of fiscal deficits has potential long-term inflationary implications.

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