Monthly Portfolio Update

Pioneer Funds – Absolute Return European Equity
31 January 2018

Equity

COMMENTARY

Market Review

The European equity market began 2018 on the same positive trajectory as we saw during the final weeks of 2017. In January, the broad European equity market added over 1.5% led higher by some of the more cyclical areas. The Eurozone market outperformed, adding over 3%. At sector level, Financials and Consumer Discretionary were the best performing, while Real Estate, Utilities, and Consumer Staples lagged.

Perhaps the most prominent event during the month was the January meeting of the ECB. While Draghi remained quite neutral in his tone, and continued to stress that the ECB would maintain its supportive monetary policy, his comments caused quite an aggressive and somewhat surprising market reaction. Investors appeared to view his comments as being more hawkish than anticipated and, as a result, we saw a sharp move higher in bond yields and Euro strength, as equity markets gave back some of the strong performance we saw during the start of the month. While volatility remains at very suppressed levels compared to historical averages, we did note an uptick in January. This served as a reminder to investors that the market can be susceptible to short-term swings. For us, the underlying fundamentals supporting the European economy remain firmly in place. Economic data released during the month continued to point to solid growth across the Eurozone, with PMI's remaining at very encouraging levels.

We have long been of the view that earnings growth will be the primary catalyst for the market to move higher from here. January marks the beginning of the Q4 2017 earnings season for European companies. While only a small percentage have reported at this point, the positive earnings momentum that we have seen in recent quarters appears to be continuing. With current valuations becoming fuller, the ongoing evidence of earnings growth is key. We continue to believe that the underlying conditions within the European economy provide a fertile environment for companies to deliver, and developments in January have helped to reinforce this view.

Portfolio Review

The Portfolio delivered a negative return in January in what was quite a challenging month for market neutral portfolios. In general, the past 12/18 months have seen very low volatilities across markets, with correlations high and dispersion low. This is a particularly difficult environment for disciplined portfolios such as this as the temptation is to generate alpha through directional bets rather than idiosyncratic investment cases.

In January, the Portfolio had a positive contribution from Autos, Information Technology, and Insurance. In contrast, Healthcare, Consumer Discretionary and Telecommunication Services detracted.

Within the Autos alpha sleeve it was an absolute long position in UK-listed auto-component and aerospace company GKN which was the primary driver of the strong performance. During the month, Melrose Industries (an investment company specialised in the acquisition and improvement of manufacturing businesses) made a bid for GKN which caused quite an aggressive move higher in the share price. We remain holders at this point as we await further details of the proposed deal, and monitor the potential for a more attractive offer.

Healthcare cost the Portfolio some performance in January. At stock level, our long position in pharmaceutical company Shire detracted following the release of a business update. From our perspective, the new 2020 revenue guidance of between 17-18 billion U.S. Dollar should be seen as quite supportive, albeit lower than the 20 billion previously stated. Sentiment towards the name remains very weak as investors appear concerned about the potential for pricing pressure coming through the U.S. – especially related to the haemophilia business. Against this backdrop, any marginal negativity can weigh on the stock, as we saw in January. More positively, our long position in Italian-listed hearing aid distributor Amplifon performed well as the underlying market conditions

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for the company began to show some more positive signs.

In Information Technology, a short position in a German software company allowed the Portfolio to gain ground. In January, the company issued a more cautious outlook statement saying that margins would be at the lower end of consensus expectations in 2018. Given the highly rated nature of the stock, any incremental bad news could cause significant volatility in the name.

Consumer Discretionary cost the Portfolio some performance in January. A pair trade between a long position in online fashion retailer Asos and a short position in an online peer detracted. The short side of the pair was subject to an unforeseen bid which caused a move higher in the share price. Recognising that the potential for further newsflow around M&A activity could cause further positive share price movements we felt it prudent to close the pair trade.

Within Insurance, an absolute short position in Nordic insurer was a rewarding position. During the month, the company issued a set of disappointing Q4 numbers which missed consensus expectations. Specifically, weakness in underwriting volumes in the key motor division weighed on the share price. For us, the valuation remains full and we maintain our short view on the name.

Finally, in Telecommunication Services, our long position in Dutch-listed KPN detracted. At the end of the month, the company issued a set of somewhat disappointing Q4 numbers which caused some weakness in the name. We maintain our positon at this point.

Gross leverage stands at 125%, while net exposure is -4.7%. The long short ratio at 35/33, with 40% of gross in pair trades.

Outlook

As we enter 2018, we maintain our constructive outlook for European equity markets. 2017 was a year for the cyclicals, with the more economically sensitive areas of the market driving the rally. Market movements in January saw a continuation of this trend, as economic data and investor sentiment remained on a strong footing. One sector which somewhat lagged in 2017 was Financials, however with the move higher in interest rates which we saw in January, Financial names were the obvious winner. While we continue to remain cautiously optimistic on our outlook for sector, we are cognisant of regulatory demands and therefore we remain very selective in our holdings. In keeping with the theme of higher interest rates, much newsflow was centred on the continued strength of the Euro, and the subsequent impact on corporate profitability. For us, the stronger Euro is a result of the improved fundamentals, and while another significant move higher would be a clear headwind, we do not see the current level as a threat to our current outlook.

Within our Portfolios, we remain cognisant of the potential for market rotations, and therefore, as we did throughout 2017, we see the need for balance. We continue to focus on idiosyncratic investment cases which offer us the potential for reliable and sustainable earnings over the medium term.

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