# Monthly Portfolio Update

*Pioneer Funds – U.S. High Yield*

*31 January 2018*

BOND COMMENTARY

## Market Review

The primary U.S. High Yield ("HY") benchmark, the ICE Bank of America Merrill Lynch U.S. High Yield Index, returned 0.64% for the month. The majority of this positive return occurred during the first week of the year, as investors grew optimistic around the impact of the new tax bill on corporate earnings. Over the last two weeks of the month, a continued rise in U.S. Treasury yields, coupled with some HY market outflows (mostly on Retail side), has slightly weighed on pricing.

Sectors which outperformed in January included Retail, Energy and Telecom, all of which correspond to a "risk on" environment. In a similar vein, lower-rated credits outperformed for the month. Month-to-date BB, B, and CCC-rated bonds are returning 0.26%, 1.03%, and 2.10%, respectively.

The strong performance to start the year in the HY market is in part due to rising the stock market, improved oil pricing, tax optimism and a good start to the earnings season.

## Performance Review

The Portfolio performed in line with its benchmark, the ICE Bank of America Merrill Lynch U.S. High Yield Index, during the month.

The largest contributor to relative performance was our allocation selection. The allocation to convertible bonds outperformed HY corporates during the month. The Portfolio benefited from allocations to Technology & Electronics, Healthcare and Services. Individual convertible bonds that contributed to this outperformance included On Semiconductor Corporation and Medicines Company. Emergent BioSolutions (a convertible bond that converted to equity in late December) was a significant outperformer due to renewal of a government vaccine contract and M&A speculation.

Security selection within corporate bonds was a negative contributor. Negative selection within Energy, Healthcare and Basis Industries were only slightly offset by positive relative performance within Telecommunications and Banking.

The natural underweight to CCC's, given our higher quality bias, was also a detractor to relative performance. CCC rated bonds outperformed higher quality bonds, by returning 2.10% during the month.

## Portfolio Positioning

We continue to remain overweight the Healthcare sector through our allocation to both corporate bonds and convertible bonds. The sector may be poised to benefit from further capital appreciation in 2018. We had been overweight to Homebuilders in 2017, but have recently reduced some exposure, as the sector had a strong year. We remain underweight to the Retail sector which continues to struggle and, historically, is a sector that has exhibited low recovery rates in a restructuring.

The Portfolio maintains a higher quality bias, and as such remains under-weight "CCC and below" rated buckets relative to the benchmark.

We continue the practice of seeking diversification[1] and relative value by carrying out-of-index exposures, including via convertibles and insurance-linked bonds. Despite recent events, we remain constructive on insurance-linked bonds as they are uncorrelated with the financial markets, which in the long-term, provides diversification benefits and can help enhance the risk-return profile of the Portfolio.

## Outlook

The default rate for HY bonds remains well below historical averages, and we maintain a constructive outlook with respect to the U.S. economy and overall corporate credit fundamentals. Strong earnings and a record pace of debt refinancing has enabled an extension of the credit cycle, in our opinion.

That said, valuations are high across risk assets and the current economic cycle is likely closer to its end



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than its beginning. As a result, we are seeking to be cautious in assuming risk within HY and generally are moving up in quality with new purchases.

We believe the Fed is expected to continue to gradually hike rates and the tapering of its bond portfolio should inevitably lead to some tightening of credit conditions. That said, HY may be less interest rate sensitive than other fixed-income segments.

We have been evaluating the impact of tax reform on various sectors and companies and repositioning our holdings accordingly. Overall, lower tax rates should have a positive impact on HY as an asset class. However, the scaling back of interest deductibility could negatively affect the more leveraged issuers. Looking ahead, any movement in Washington on an infrastructure bill has the potential to boost market sentiment.

We view the overall composition of the HY market as healthy, with an improving quality profile across a range of industries. While HY valuations are somewhat extended, we believe overall conditions remain supportive of the asset class.

### Important Information

[1]Diversification does not guarantee a profit or protect against a loss.



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