Quarterly Portfolio Update

*Amundi Funds II – Euroland Equity**
28 September 2018

EQUITY
COMMENTARY

Market Review

September is typically a more active month for equity markets as investors return from summer vacations and position their portfolios for the final months of the year. This year, the overall European equity market added marginal gains of 0.5% for the month, taking Q3 gains to over 1%. Looking at Q3, Healthcare and Energy were among the top performing areas, while Real Estate and Telecommunication Services lagged.

While headline performance figures in Q3 were far from exciting, they mask what has been quite a volatile period for the asset class. Newsflow has been dominated by ongoing concerns about the potential impact of an escalation of a “trade war” between the US and some of its biggest trading partners including Europe and China. While global growth figures released have been robust, trending around the 4% level, investors are clearly beginning to grow increasingly anxious should President Trump’s protectionist policies dampen this positive trajectory. Adding to this, the economic crisis in Turkey grabbed headlines as the Turkish lira dropped to fresh lows against the USD. Investors’ jitters were felt most within Financials, given the exposure of certain European banks to the domestic Turkish market. Closer to home, in September, we saw a resurgence of Italian political uncertainty as the government scramble to enact budget legislation which meets the demands of the EU in terms of the permissible deficit. While no clear outcome is visible at this point, the market is beginning to demand a higher risk premium for holding Italian assets – a reflection of the heightened uncertainty.

That said, it was not all bad news. We have long been of the view that the key catalyst for the European market to push higher from these levels is earnings growth. Looking at the most recent Q2 earnings season, we remain encouraged by the underlying performance of European corporates, and we continue to see EPS growth for 2018 in the region of 9% which we believe should be a key support. Our view remains that the best way to navigate these potentially more volatile market conditions is by focusing on compelling idiosyncratic investment cases that we believe have the ability to deliver on EPS over the medium-term.

Portfolio Review

Over the third quarter of 2018 the Portfolio underperformed its benchmark, the MSCI EMU. At sector level, the Portfolio had a positive contribution from Consumer Staples and Consumer Discretionary, while some of our holdings within Financials and Industrials detracted.

The Portfolio gained some performance within Consumer Staples. Our holdings the Irish-listed ingredients company Kerry Group performed strongly. During the quarter, the company reported very solid underlying first-half results which pointed to good results from both the Taste & Nutrition business, and the Consumer Foods business. These results help to underpin our investment case, highlighting that the changing trends in terms of consumer consumption have allowed Kerry to carve out a market leading position in food solutions. In addition, our holding our holding of dairy and water company Danone performed quite strongly. The company reported a set of solid underlying H1 results. Despite the headwinds from the consumer boycott in Morocco and the strikes in Brazil, the company delivered a 7.9% rise in H1 profit, helped by strong cost control across the group which was well-received by investors.

Financials cost the Portfolio some performance, the sector came under increased pressure in the wake of the Turkish crisis. Given the exposure of some European banks to Turkey (generally through subsidiaries) these names were hardest hit. Our holdings in BBVA, BNP Paribas and ING were all negatively impacted by this uncertainty. BBVA being the most exposed (c. 15% earnings), but the scale of its presence in the region is still relatively small in a group context and they have been taking management actions to mitigate fall-out. Fundamentally, we feel BBVA is in a strong positon to cope with the macro-shock.

*Prior to 16 February 2018, Pioneer Funds – Euroland Equity

Consumer Discretionary was a source of positive returns. At stock level, our holding of international cruise operator Carnival performed well. At the end of the month, the company reported a set of encouraging quarterly results which came in ahead of both consensus expectations and the company's own guidance. The company reported net revenue yield growth of 2.9% during the quarter, and increased its FY net revenue yield guidance to 3% which for us points to solid performance in the underlying business. In addition, our holding of automaker Volkswagen delivered strong performance. During August the company reported a strong set of Q2 results, comfortably exceeding expectations, with solid performance across divisions. Management affirmed its full year guidance which was well received, especially given the ongoing regulatory changes within the auto industry.

The portfolio lost ground within Industrials. Of our holdings, the low-fare passenger airline Ryanair was the main detractor. Ryanair quarterly numbers were in-line with consensus. However, the main negative for the earnings was the softer yield guidance for the next three months. This has been moved lower to recognise the impact of strikes and disruption on revenue yields. When passengers are affected by disruptions, the airline tends to reallocate more of its late purchase seats to disrupted passengers rather than being able to sell these potentially lucrative seats. This reduces late booking yields, dragging down the overall pricing. This, combined with on-going news of strike action, created negative sentiment towards the name over the quarter.

Healthcare cost the Portfolio some performance in the third quarter. At stock level, our holding of Bayer has underperformed in the wake of the initial unfavourable ruling by a U.S. court concerning compensation to a claim that one of the key products has been the cause of cancer. We reduced our holding, while reviewing our investment case. We believe that the share price reaction has been too strong and we currently remain holders of the stock. More positively, our holding of biotech company Lonza continued to perform well. In September, the company's management held a CMD whereby the message was one of confidence with a good growth profile being signalled through 2022.

Finally, within Telecommunication Services, our holding of the integrated telecommunications operator Deutsche performed well. In August the company released a robust Q2 results with EBITDA a small beat on expectations, combined with news that its U.S. deal with Spirt is not experiencing a high level of resistance from regulators, created some positive sentiment towards the name.

Sector Allocation	Portfolio Weight	Benchmark Weight	Delta
Energy	7.30%	6.16%	1.15%
Materials	6.04%	9.06%	-3.02%
Industrials	20.06%	14.55%	5.51%
Consumer Discretionary	14.59%	13.96%	0.63%
Consumer Staples	9.46%	9.93%	-0.46%
Health Care	11.40%	8.33%	3.07%
Financials	14.75%	18.16%	-3.41%
Information Technology	7.77%	9.18%	-1.40%
Telecommunication Services	6.19%	3.58%	2.61%
Utilities	1.91%	5.16%	-3.25%

Source: Amundi Asset Management as at 28 September 2018.

Portfolio Strategy

In our view, bottom-up stock selection is a key driver of Portfolio performance and excess return. We seek to invest in high-quality, undervalued companies with strong fundamentals.

The majority of positions we hold are long-term 'Core' holdings. These companies are characterised by high quality, attractive valuations and strong growth potential, with a medium-term investment horizon.

The remainder of our Portfolio is built using an unconstrained 'Opportunistic' approach, giving us the opportunity to take advantage of different market trends; and enabling us to invest across the market cap spectrum, looking beyond the benchmark for attractive investment opportunities.

Sector Allocation	Portfolio Weight	Benchmark Weight	Delta
DEUTSCHE TELEKOM	4.22%	1.16%	3.06%
CRH PLC	3.61%	0.59%	3.02%
PRUDENTIAL	2.88%	0.00%	2.88%
SIEMENS	4.84%	2.11%	2.73%
BNP PARIBAS	4.18%	1.48%	2.70%
TECHNIPFMC	2.68%	0.00%	2.68%
DANONE	3.67%	1.03%	2.65%
ROYAL DUTCH SHELL	2.61%	0.00%	2.61%
SAINT-GOBAIN	3.01%	0.46%	2.55%
CAP GEMINI SA	2.97%	0.43%	2.53%

Source: Amundi Asset Management as at 28 September 2018.

Outlook

The third quarter of 2018 has provided investors with fresh challenges. A combination of geopolitical unrest in Turkey coupled with ongoing newsflow surrounding the potential impact of a "trade war", and the more uncertain political backdrop in Italy have certainly weighed on sentiment towards the asset class. While these are of course overhangs in the near-term, we continue to believe that the fundamental pillars supporting European equities are largely intact. Economic data coming out of the Eurozone has shown a stabilisation, with PMI numbers remaining firmly in expansionary territory.

Our view remains that GDP growth for the Eurozone should be in the region of 2% in 2018 with a weaker euro a clear tailwind as we move towards the end of the year. Turning to earnings, which for us remains the key catalyst for the market to move higher, we can take some solace from the most recent Q2 reporting season which showed European companies continued to deliver – most notably in terms of revenue growth. We believe that this positive EPS momentum alongside the cooler valuations in the market should act as a support going forward. As fundamental bottom up stock pickers with a medium-term view, we continue to monitor the current situation, seeking to take advantage of valuation opportunities should they arise in the wake of bouts of short-term volatility.

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