Quarterly Portfolio Update

*Amundi Funds II – European Potential**
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, with global growth 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. Investor’s 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 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 Europe Small Cap. At sector level, the Portfolio had a positive contribution from Telecommunications Services and Financials. In contrast, Consumer Discretionary and Healthcare detracted.

Telecommunications Services was a source of positive performance over the quarter. Of our holdings, the Swiss telecommunication services and equipment provider Sunrise Communications was a standout performer. It had a strong set of Q2 results that came in ahead of expectations on earnings and raised its FY2018 guidance by 1%. In addition, our holding of towers company Cellnex performed well following the release of first half results, which saw solid underlying operational and financial performance. The management confirmed that they are on track to meet full year guidance that was an additional support for the share price.

Within Consumer Discretionary, our holding of auto-component maker Faurecia detracted. During the quarter the company reported a strong set of first half results with good revenue growth coming through. On top of this, management raised its 2018 guidance for sales growth, operating profit margin, and EPS targets. Despite this, the market appeared to focus more on the macro dynamics facing the industry with a combination of a changing regulatory environment for the auto makers and continued newsflow surrounding trade tariffs weighing on sentiment. Our holding in the French leisure vehicle and recreation equipment company Trigano underperformed, driven by an analyst de-rating. We think the market reaction was overdone and are comfortable with our holding, as we still see some growth potential in the recreation equipment market.

*Prior to 16 February 2018, Pioneer Funds – European Potential

We gained some performance within Financials. Of our holdings, the Dutch listed insurance company ASR Nederland continued to perform well. The company reported a strong set of results, with operating profit and capital generation ahead of consensus. These numbers help underpin our investment case and keep the positive momentum towards the share price. During the month, 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) and the further political uncertainty in Italy. The negative sentiment towards the sector impacted many of the names we do not own. The one name we do own, Fineco, reported Q2 results that were better consensus and contributed positively to performance as a result.

Healthcare cost the portfolio some performance in the third quarter. Our holding of the UK listed provider of health services UDG Healthcare underperformed. The group flagged that it experienced a challenging quarter with operating profit below the same quarter last year, the weaknesses due to phasing out of contracts and fewer new business opportunities. This news created negative sentiment towards the name. We continued to hold the name as we feel UDG balance sheet remains strong allowing it potential to execute further strategic acquisitions to complement its existing platforms. In addition, our holding Recordati detracted as the news of the agreement to sell a stake in the company to CVC capital for a somewhat disappointing valuation continued to weigh on sentiment towards the name over the period.

Our holding of the global technology company Logitech continued to perform strongly. The company reported better that expected Q2 results that were ahead of consensus on growth. It upgraded its growth guidance again this year, as a result of good numbers coming from video collaboration and online gaming. Also, following the release of good H1 results, our holding in the French software services company Alten performed well during the month. Good results combined with an indication of some further acquisitions outside of France helped create a tailwind to performance.

We lost some performance within Real Estate. Of our holdings the Spanish based REIT Merlin Properties underperformed. Merlin had a muted set of Q2. numbers with only 2.0% rental growth in H1, slowing down from 2.7% reported for 2017, which had a negative impact the share price. In addition, our holing in the French real estate developer Nexity detracted on the back of H1 results that missed market expectations. We will continue like the name as Nexity has a strong order book and good growth opportunities.

In the Industrials sector, Saab performed well during over the period. Q2 results were a bit lacklustre (it is a seasonally lumpy business), however, the company confirmed its FY guidance helped by a strong order intake. This, combined with the news in September that Saab, in partnership with Boeing, won a big contact for the US Air Force, were clear tailwinds for the share price during the quarter.

Finally, within Energy, our holding of international energy services company Wood group was a positive contributor to performance. At the end of August, the company reported a good set of half year 2018 results with performance at the upper end of their guidance range. In addition, they communicated that the Integration from their recent M&A activity is ahead of schedule and that they are increasing their three year cost synergy target. This positive newsflow was a clear support to the share price in Q3.

Sector Allocation	**Portfolio Weight**	**Bench mark Weight**	**Delta**
Energy	5.45%	3.88%	1.57%
Materials	8.03%	7.58%	0.44%
Industrials	29.15%	22.44%	6.72%
Consumer Discretionary	10.21%	14.19%	-3.98%
Consumer Staples	1.63%	4.85%	-3.22%
Health Care	7.80%	8.62%	-0.81%
Financials	12.75%	14.68%	-1.93%
Information Technology	9.44%	10.01%	-0.56%
Telecommunicati on Services	6.13%	1.80%	4.33%
Utilities	1.38%	2.29%	-0.91%
Real Estate	8.02%	9.67%	-1.65%

Source: Amundi Asset Management as at 28 September 2018
Benchmark: MSCI Europe Small Cap

Sector Allocation	Portfolio Weight	Benchmark Weight	Delta
AMPLIFON	3.16%	0.13%	3.04%
JOHN WOOD GROUP	2.83%	0.00%	2.83%
VALMET OYJ	3.03%	0.20%	2.82%
CHRISTIAN HANSEN	2.79%	0.00%	2.79%
SAAB AB	3.02%	0.23%	2.78%
CELLNEX TELECOM	3.03%	0.28%	2.74%
ALTEN LTD	2.94%	0.21%	2.72%
SUNRISE	2.92%	0.22%	2.70%
LOGITECH	3.04%	0.50%	2.54%
ASR NEDERLAND	3.03%	0.50%	2.53%

Source: Amundi Asset Management as at 28 September 2018.
Benchmark: MSCI Europe Small Cap

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 team, 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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