Monthly Portfolio Update

*Amundi Funds II – Pioneer Strategic Income**
31 July 2018

BOND COMMENTARY

Market Review

Strong earnings growth and robust U.S. economic activity overcame trade concerns during the month, spurring a rally in U.S. credit and equity markets. Strong demand and tax cuts contributed to earnings growth of approximately 24% among S&P 500 firms, with an estimated 80% reporting positive earnings surprises for the second quarter. Second quarter U.S. GDP came in at a strong 4.1%, with consumption, net trade, and non-residential investment making solid contributions; inventories detracted from GDP, suggesting that higher inventories may contribute to growth going forward. Employment continued to make gains, averaging 211,000 over the past three months, while inflation, particularly wage inflation, remained contained. Trade tensions between the U.S. and China rose, as President Trump ratcheted up his threats at month-end to raise tariffs to 25% on $200 billion of Chinese imports. Trade relations with the Eurozone eased, however, as the two announced, in a thinly veiled reference to China, their common concern about unfair trade practices and intellectual property theft, and a goal to reduce tariffs on non-auto related goods. Europe also may commit to purchase more soybeans and LNG from the U.S., helping blunt the impact of China's higher tariffs. Globally, markets also rallied, as risk was embraced; Emerging Markets enjoyed the most significant rally.

Treasury rates rose across the curve, responding to stronger GDP growth. In addition, longer Treasury yields jumped on Trump's criticism of the Fed's plan for continued rate increases, as well as from rumours that the BOJ was contemplating tightening policy, perhaps through targeting a positive higher 10-year yield. The 2-year Treasury yield rose from 2.53% to 2.67% for a -0.04% return, while the 10-year and 30-year Treasury yields rose respectively from 2.85% to 2.96%, and from 2.98% to 3.08%, returning -0.71% and -1.65%. Inflation expectations remained stable. Agency MBS outperformed Treasuries, with a 0.20% excess return and -0.11% absolute return, benefiting from continued low volatility and relatively stable mortgage rates over the past three months. Investment grade corporates bounced back in dramatic fashion, delivering a 0.83% return for a 1.33% excess return, as the option-adjusted spread narrowed from 126 bps to 109 bps. Strong earnings, as well as improving technicals in the form of lower supply, reduced dealer inventories, and stronger international demand buoyed the market. High yield corporates returned 1.12% for an excess return of 1.36%, as spreads narrowed from 371 bps to 346 bps. The market also benefited from solid earnings and a favourable outlook for the U.S. economy, amid limited supply. USD emerging markets rallied from their sell-off, with sovereigns returning 1.92% and corporates returning 1.45%. The Dollar sustained a modest loss over the month, down -0.56%, and returned 0.99% vs. the Yen and lost 0.06% vs. the Euro. The Mexican Peso rose 6.8% against the Dollar, benefiting from the rally in Emerging Markets.

Portfolio Review

The Portfolio outperformed it's benchmark, the Bloomberg Barclays U.S. Universal Index, for the month. Year-to-date, the Portfolio underperformed it's benchmark.

July Attribution: Duration positioning, sector allocation and currency were the primary contributors to performance.

Positive:

- The relative short duration position of 1.4 years compared to the benchmark contributed to performance as rates rose across the curve. The barbelled yield curve position had a relatively neutral effect on performance.
- Sector allocation made a significant contribution to performance, as credit outperformed over the month. In particular, the 31% underweight to U.S. Treasuries and the 4% overweight to Industrials, which includes emerging market corporates, outperformed.
- Non-Dollar currency contributed to performance, as the Dollar fell against many currencies. The 3.3% exposure to the

Swedish Krona (part of a proxy hedge of long SEK/NOK, short EUR) outperformed, as did the 0.4% in the Mexican Peso.
- The lower relative quality of the Portfolio's holdings in Agencies, Industrials and Financials also outperformed.

Negative:
- Security selection detracted modestly from performance

Outlook & Positioning

We continue to believe U.S. GDP growth may accelerate to almost 3% over the year, benefiting from significant tax cuts, deregulation and stronger fixed investment spending. Solid employment and income growth may continue to support consumption and the housing market. Higher corporate profits, benefiting from solid global growth, tax cuts, and the 100% expensing of fixed investment, may also support increased fixed investment.

Globally, we believe the Eurozone and Japan may also grow above their potential GDP, benefiting from still supportive monetary policy. Eurozone growth may be lower than that achieved in 2017, as exports may suffer from the lagged effects of a stronger Euro. In addition, political risk has risen in Europe, with more populist governments in Italy and Spain representing a significant risk for the Euro. Recent monetary and fiscal stimulus may help stabilize China's growth levels for the remainder of the year, which may offset the negative impact of U.S. tariffs, and China's earlier tightening of credit.

Global growth may suffer from Trump's more aggressive protectionist trade policy. While U.S. and European tensions have moderated, Trump's proposed higher tariffs on Chinese imports could have a negative impact on China, and by extension, on its Asian trade partners, as well as on select commodity-dependent emerging market economies.

We continue to believe that inflation may surprise to the upside and that the FOMC may be behind the curve in raising rates. Wage growth acceleration, service inflation, tighter labour markets in key industries such as homebuilding, higher import prices resulting from tariffs, and more restrictive immigration policies may contribute to higher price levels in the coming year. In addition, producer price indices are already increasing, on the heels of higher oil and metals prices. Fiscal stimulus, including the tax cuts and higher spending from the budget has the potential to further fuel inflation.

The Portfolio continues to be positioned for rising interest rates and a solid economy. The Portfolio holds the following positions:
- While the Portfolio holds an overweight to diverse credit sectors, and an underweight to U.S. Treasuries, we have moderated this positioning and have reduced credit risk and increased portfolio liquidity over the past few months. While we believe credit sectors may continue to benefit from stronger growth, lower taxes, and less regulation, we also believe downside risks have increased, particularly in light of their stretched valuations. Credit sectors may face increased risks over a range of economic outcomes. Should U.S. growth continue to strengthen and global growth remain strong, credit assets, the spreads of which are well below long-term averages, could face downside risks from rising interest rates and tightening global financial conditions. Should China's growth falter significantly, partly as a result of increased trade wars, credit assets could also sell off. As U.S. rates have risen, we have begun to add short-term Treasuries to our Portfolio, as relative value has improved and as we have reduced credit risk in the Portfolio.
- The Portfolio maintains as relative short duration position of 1.4 years compared to the Portfolio's benchmark. We believe the market may be behind the curve, given solid GDP growth, and little slack in the labour market. At 1.9%, core PCE is close to the Fed's inflation target. With the unemployment at 3.9%, below the FOMC's estimated NAIRU level, we anticipate that continued wage inflation will help drive core PCE to higher levels through the year.
- We hold long-duration TIPS, which can help protect the Portfolio should inflation surprise to the upside. We believe inflation expectations could overshoot; in addition, these levels remain below long-term averages.
- The Portfolio holds a near index weight in agency MBS. Including the 13% in non-agency MBS, the Portfolio remains significantly overweight to the RMBS sector. Fundamentals within the housing market remain positive, spurred by strong GDP growth and employment, and still affordable mortgage rates. In addition, we believe that agency MBS offer investors reasonable value at current spreads. While certain investors are

concerned about the increased net supply of approximately $400 billion forecast for 2018, we believe that the market has already priced in this forecast. The Federal Open Market Committee has been fully transparent in setting forth its tapering program with respect to both U.S. Treasuries and agency MBS. As such, reinvestments by the FOMC in agency MBS may end before the end of the year. In addition, we believe that agency MBS represent a more defensive sector with less downside risk, in the less credit-friendly environment that we may be facing going forward.

- The Portfolio holds a below index weight in investment grade corporates, having reduced exposure by over 3% over the month. The Portfolio holds an overweight in high yield corporates, a more U.S-centric sector and modestly reduce that exposure over the month. Investment grade corporate spreads now stand at 109 bps, well below long term averages. In addition, these spreads reflect lower average quality and overall longer duration relative to their historical levels. Leverage in investment grade corporates is significantly higher than in the past, with 23% of the total market value of the sector at greater than 4X leverage, compared to 11% five years ago. Finally, we believe issuance to fund M&A transactions will continue over the year, with the potential to further increase leverage in the investment grade sector. While we continue to believe that the corporate sector will enjoy relatively strong fundamentals, due to the continuing benefit of lower taxes, less regulation and strong U.S. growth, our concerns about aggressive financial policy have led to our reduction of risk in this sector. In addition, corporates face greater downside risk than agency MBS, in a higher volatility environment that may result from a negative outcome on trade policy, an unexpected change in central bank policies or from an unexpected slowdown in global growth.
- We have carefully positioned ourselves within the corporate sector, to avoid exposure to sectors most vulnerable to M&A risk and higher leverage, including technology; we also hold an underweight to telecom and media that are more highly leveraged and face technological risk. We currently hold an overweight to insurance, REITS and banks. We continue to believe banking, insurance and REITS offer attractive relative value and may perform well, despite a rising rate environment. While spreads are modestly lower than the broad corporate benchmarks, financials offer lower event risk of share repurchases or credit impairment due to M&A activity. Banks currently have very strong capital ratios, well in excess of regulatory requirements.
- We continue to hold an overweight to the Energy midstream sub-sector, a sector that shows relatively less sensitivity to oil price volatility. We expect continued spread tightening in the space, which remains one of the wider-trading subsectors in investment grade. The mid-stream space is benefiting from increased production, and is building new pipelines to transport that production to market. A key point on our midstream exposure is that the sector is still undergoing significant deleveraging from both debt reduction and growing EBITDA, which underpins our decision to have a significant overweight to the sector. While Saudi Arabia and Russia have indicated plans to increase production, we believe that, with the world still in supply deficit, and with Venezuela's reduced production, oil prices may have an upward bias.
- The Portfolio includes certain emerging markets exposures. We had reduced emerging market exposures over the past year, based on extended valuations. Over the past month, we modestly reduced exposures, given increased risks Emerging Markets face from trade tensions and a higher Dollar. We continue to believe certain Emerging Markets are benefiting from strong global growth and increased domestic demand.
- We believe the Dollar may be range-bound going forward, or may modestly appreciate in the shorter term should Eurozone growth disappoint. Given the higher volatility associated with currencies, we hold low emerging market currency exposures relative to historical levels. We added a Mexican Peso position June, but have pared back that position as the Peso rallied 6.8% over the month.

Important Information

On the 16 February 2018, Pioneer Funds was renamed Amundi Funds II. Prior to 16 February 2018 the name of the sub-fund was with the prefix "Pioneer Funds".

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