Quarterly Portfolio Update

*Amundi Funds II – Pioneer U.S. Dollar Aggregate Bond**

29 June 2018

BOND COMMENTARY

Market Review

While volatility pulled back from the high levels seen in the first quarter, in the second quarter markets continued to suffer from heightened volatility relative to the very low levels of 2017. Concerns about trade wars took centre stage, as President Trump stepped up the aggressive pursuit of tariffs against allies and adversaries alike. In late May, fears that the new populist Italian government threatened the status quo of the Euro and European Union rose , but abated as a new government was formed and officials toned down their anti-Euro rhetoric. Finally, the unexpected appreciation of the U.S. Dollar, which rose 5.7% from its mid-April low, as well as a continued rise in oil prices, which have climbed 23% year to date, including a 14% increase in the second quarter, contributed to a sell-off in Emerging Markets (EM), particularly in countries with significant U.S. Dollar debt.

The U.S. Dollar appreciated in part due to a more hawkish FOMC, counterbalanced by a more dovish ECB. Citing continued strong GDP, employment growth and rising inflation, the FOMC raised rates in both of their March and June meetings, and brought forward projected rate increases, to include two more increases in 2018. They also, however, adopt a symmetric view around their inflation target in June, indicating they would not necessarily take a more aggressive approach to increasing rates, should future inflation exceed target levels for a short time.

Treasury rates rose over the quarter and in June, led by short-term rates. While Treasury prices enjoyed a short-lived rally at the end of May, driven by a flight to quality on the Italian crisis, they quickly shed their gains and yields rose modestly into the end of June. The 2-year US Treasury yield rose from 2.27% to 2.53% over the quarter. The yield curve flattened, as the 10-year US Treasury yield rose from 2.74% to 2.85%, after peaking at 3.11% in mid-May; 30-year US Treasury yields remained relatively unchanged over the period, ending at 2.98%. Inflation expectations rose from 2.04% to 2.13% over the quarter.

Investment grade corporates delivered their worst semi-annual return since 2013, as they continued to sustain losses over the quarter and the month. Structured sectors and high yield assets generally outperformed Treasuries over the quarter and month. Investment grade corporates returned negative absolute and relative returns (vs. Treasuries) of approximately 1% over the quarter, and spreads widened from 109 bps to 123 bps in the wake of multiple factors: higher rates, trade fears, lower non-U.S. investor demand (who balked at increased currency hedging costs), the sales of corporates from repatriated offshore cash portfolios, deteriorating credit quality and high issuance due to increased M&A transactions. Agency MBS outperformed, delivering a 0.15% excess return, as rate volatility declined from the first quarter and the housing market continued to be strong, despite increasing rates and rising home prices. CMBS were flat to Treasuries, while ABS delivered 0.17% excess returns. High yield corporates enjoyed positive total and excess returns over both the quarter and the month, benefiting from their U.S.-focus, their higher yield and low default outlook. Over the quarter, they delivered positive total and excess returns of approximately 1%, as spreads remained almost unchanged, ending the period at 371 bps.

Portfolio Review

Second Quarter Attribution: The Portfolio delivered near-benchmark Bloomberg Barclays U.S. Aggregate Index) returns on a net basis, with modest contributions from the lower relative quality of its holdings, security selection and yield curve positioning, partly offset by slight underperformance of duration positioning and sector allocation.

Positive:

- The Portfolio benefited from the lower relative quality of its holdings within industrials and CMBS, particularly from the overweight to high yield industrials issues, as high yield outperformed investment grade corporates.

For Professional Clients Only

*Prior to 16 February 2018, Pioneer Funds – U.S. Dollar Aggregate Bond

Marketing Material

Amundi ASSET MANAGEMENT

- Security selection benefited modestly from exposure to USD-denominated foreign government-related issues, as well as agency MBS positioning.
- The barbelled yield curve position contributed, benefiting from the underweight to the 2-year and overweight to the 30-year key rate duration.

Negative:

- The relative short duration position of approximately 0.8 years slightly detracted, due to the negative carry associated with the position.
- Portfolio returns were hurt by sector allocation. The negative impact of the 36% underweight to U.S. Treasuries and of the 9% overweight to corporates was not fully offset by the benefit of the 3.9% TIPs exposure, the 14% allocation to CMOs and the 6% overweight to ABS.

Outlook

We believe U.S. GDP growth could 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 strong 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 have the potential to grow above their GDP, benefiting from still supportive monetary policy. Eurozone growth could 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. While China's growth may moderate in light of its goals in order to rein in credit growth, we believe a modest decline in China's growth should not disrupt overall Asia or global GDP growth.

Global growth may moderate, however, in the face of Trump's more aggressive protectionist trade policy. While the U.S. and China are currently negotiating trade imbalances, Trump has been aggressive against U.S. allies.

We continue to believe that inflation may surprise to the upside on a number of fronts in 2018 and that the FOMC may be behind the curve in raising rates. Nascent signs of 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, holding the following positions:

- Overweight to diverse credit sectors, underweight to U.S. Treasuries. In our view, most U.S. government debt appears unattractive, while credit sectors may benefit from stronger growth, lower taxes, and less regulation.
- The Portfolio holds a relative short duration position of 0.5 years compared to its benchmark. We continued to believe the market may be behind the curve, given solid GDP growth, and little slack in the labour market. At 2.0%, core PCE has reached the Fed's inflation target. With the unemployment at 4.0%, well 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 we believe could help protect the portfolio, should inflation surprise to the upside. In our view, inflation expectations are likely to overshoot; in addition, these levels remain below long-term averages.

- The Portfolio holds an underweight in agency MBS; including the 13% in non-agency MBS, and remains significantly overweight to the RMBS sector. Exposure to both agency and non-agency MBS has been reduced over the quarter, based on less attractive relative value.
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  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 could 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 (which we witnessed earlier in 2017 when the Fed first announced the taper plan). The FOMC has been fully transparent in setting forth its tapering programme with respect to both U.S. Treasuries and agency MBS. Moreover, agency MBS already extended duration in the fourth quarter of 2016, in response to higher rates, and we do not foresee significant extension risk going forward. High quality non-agency RMBS remain reasonably attractive, with pristine credit metrics and trade approximately 1.375 points behind agency MBS, translating into a spread pickup of 26-28 bps vs. agency MBS.

- We believe structured securities, including ABS and CMBS generally, offer more attractive relative value than corporates. In addition, consumer and housing-related ABS issued after the financial crisis offer better credit protection for the same ratings, while we have witnessed more lenient treatment by the rating agencies with respect to investment grade corporate ratings.
- The Portfolio holds an index weight in investment grade corporates, having reduced exposure by approximately 5% over the quarter. The Portfolio has maintained its overweight to High Yield corporates, a more U.S-centric sector. While spreads in broad Investment Grade corporates have widened recently, these spreads reflect lower average quality and overall longer duration relative to their historical levels. In addition, leverage in Investment Grade corporates is significantly higher than in the past, with 23% of the market trading at greater than 4X leverage, compared to 11% five years ago. Finally, we believe issuance to fund M&A transactions should continue over the year, with the potential to further increase leverage in the investment grade sector. We continue to believe, however, that the corporate sector will enjoy relatively strong fundamentals, due to the continuing benefit of lower taxes, less regulation and strong U.S. growth. However, in our view corporates can 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 and Pharma; we also have avoided the Media and Telecom space as we believe this to be more highly leveraged and could face technological risk. We continue to hold an overweight to Financials in Banks, Insurance and REITS. We had reduced the Bank overweight, including European exposures, coming into 2018, based on valuations. We continue to believe the Banking, Insurance and REITS can potentially 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 are currently focused on improving capital ratios to meet regulatory requirements. We also expect that Banks should also benefit from rising global yields and steepening yield curves.
- 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. While Saudi Arabia and Russia have indicated plans to increase production, we believe that, with Venezuela's reduced production, oil prices may be range-bound.

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