Quarterly Portfolio Update

*Amundi Funds II – Pioneer Flexible Opportunities**
29 June 2018

BOND COMMENTARY

Market Review & Outlook

Although the present economic cycle may turn out to be second-longest (perhaps even the longest) in history: the state of the U.S. economy remains surrounded by scepticism. Mainstream economists and market strategists alike continue to comment on an absence of corporate investment activity. Is this conclusion being grounded via supporting data? Both Nominal and Real Non-residential Private Fixed Investment as a percentage of Real GDP continue to trend higher. Moreover, capex, according to the Institute for Supply Management, is set to accelerate. Yet, retail-oriented inflationary metrics remain extremely subdued. While the coming months may produce a slight escalation to said levels on account of the base effect, what really matters is corporate pricing power, which has been weak for years. This may finally be starting to change, as evidenced by the Suppliers' Deliveries component of the ISM, however more time is required to establish conviction.

In the absence of taking price, the Corporate Developed World has successfully maintained its margins through steadfast control of unit labour costs. In fact, both the current expansion the previous one, have been very unusual in that increases in labour productivity have contributed outsized gains to overall GDP growth. This is not about to unwind, and upward pressure on capacity utilization sets the stage for further profitability growth through the course of Q3 and Q4.

Good for stocks, but what about bonds?
The rate of inflation combined with the productivity of capital are generally considered to be enemy number one for fixed-income and, accordingly inflation-adjusted yields are expected to rise when conditions improve. With a real yield on the 10 Year U.S. Treasury Note of 55 basis points, this constitutes the highest reading on record since Q1 of 2010 (57 basis points). Should the market witness an additional slight increase, the inflation-adjusted yield would have reverted back to pre-great financial crisis levels. But, our intention here is not to suggest that current conditions represent an attractive point of entry. Many institutional investors still show a penchant for long-dated securities, however valuations must be placed in context. The yield on treasury notes remains very close to secular lows. Inflation-adjusted 10 Year U.S. Treasury yields are failing to properly reflect industrial activity trends captured by ISM New Orders. Lastly, investors, thirsty for return, are underwriting rising levels of risk to the tune of inappropriate remuneration when considering the yield gap belying junk bonds. In short, our view is that the yield curve has flattened as a consequence of the above mentioned factors, versus indication/confirmation that the economy is flirting with recession. Indeed, all underlying macroeconomic data supports this assertion.

The problem is not contained within the fixed-income market, for the stock market in recent years has also been increasingly viewed as a branch of the bond market. Nothing could be farther from the truth. The S&P 500 is selling at a 5.3% earnings yield on 4-quarter trailing earnings per share (EPS); at 6.2% on forward EPS; and at 3.5% on the last 10 years average EPS. The cost of capital is significantly greater than the current cost of debt, and free cash flow yield of U.S. stocks remains either equal to, or greater than, present bond yields. Accordingly, Corporate America is withdrawing equity, and the S&P divisor has reverted back to the level (post-GFC bank stock-issuance notwithstanding) it was at 19 years ago.

In Europe and Japan, capital structure optimization has failed to follow suit, which explains our bias for U.S. stocks despite their relative expense.

To summarize, our orientation remains equivalent to that communicated back at the end of Q1:

1) Stocks versus bonds
    a. Stock exposure broadly diversified between the U.S., other Developed Markets (i.e. Western Europe & Japan), and the Emerging Markets (primarily concentrated in China)
    b. Fixed Income at ~8% of NAV with 85% of this outside the U.S. Largest exposures to

For Professional Investors
*Prior to 16 February 2018, Pioneer Funds – Flexible Opportunities

Amundi ASSET MANAGEMENT

Marketing Material

foreign sovereign entities, but all USD denominated so as to mitigate currency risk.

2) Major themes remain intact
   a. Largest exposures to Aerospace & Defence,
   b. “Dividend aristocrats” and “Buyback Achievers”
   c. To a smaller scale, Hotels & Leisure
   d. U.S. Healthcare
   e. European Insurance
   f. European and Singaporean Real Estate
   g. European, Emerging Markets, and Japanese Banks. This exposure is structural in nature, as we expect the fundamentals to benefit from multi-year tailwinds.

Fundamentals suggests a patient approach is warranted to navigating this present environment. Negative headlines surrounding trade conflict and policy uncertainty caused notable downward pressure during the month of June, however we do not believe the reported actions taken to date are sufficient to signal the end of this cycle. It will be important to monitor whether positions are softened either entering, or immediately following the midterm elections, as failure to reach agreements with major trading partners will ultimately damage capital formation.

Performance

The Portfolio underperformed its benchmark, the BBgBarc US Trsy Inflat 1-10Yr. We continue to have a long-term view with its top-down positioning.

Performance was negative during the period, a strong U.S. Dollar amidst heightened trade war rhetoric and questions about potential damages as a consequence of a trade war between the U.S. and Europe and China caused several markets to sell off particularly in Emerging Markets. For example, equities in China were down over -8% (adjusted for USD), Japan was down -2.5% and Europe was down -0.7%. However, despite the turbulence globally U.S. stocks closed up returning 0.6%, and our U.S. equity exposure did outperform during the period on a relative basis however this was not enough to offset other negative factors that affected the Portfolio.

Furthermore, several end markets in commodities where we have exposure to steel and metallurgical coal were also affected as commodity complexes sold -off during the month over concerns surrounding future demand due to the potential for a trade war. As a result, performance for the period was largely driven by exposures to equities, and particularly from our exposures to Emerging Markets.

As we move through 2018, no material alterations have been made to the Portfolio and its positioning. We continue to maintain a globally diversified asset allocation by owning assets across both the U.S. and foreign markets. We recognize that exogenous events can and will occur and, as a result, we have the flexibility to shift our allocations as conditions evolve.

Asset allocation at the end of the second quarter continues to be heavily biased toward equities, representing approximately 74% of the Portfolio. Within our equity exposure, approximately 27% was held in North American equities, 28% in other developed economies (ex U.S.), and 18% was in the Emerging Markets. For the Fixed Income sleeve, which represented approximately 13%, approximately 8% was exposed to Investment Grade and 2% to High Yield. At quarter end, we had approximately 15% in cash.

Stocks remain our favoured asset class, with a preference for Aerospace and Defence, Dividend Aristocrats, Buyback Achievers, Healthcare (excluding the Pharma Sub-sector), and Real Estate (at a limited number of locations). The overall economic data has continued to be strong as new order activity and business/consumer optimism all the pieces are in place for global expansion to continue. As the expansion continues the volatility of profitability continues to decline, and that valuations are arguably cheap in the face of accelerating earnings. Given current market conditions and volatility throughout the global sphere we continue to maintain some systematic hedges on markets in China, Europe and in the U.S. to address some of this volatility.

Our view is that market volatility will likely continue, but we expect that our overall allocations will not change. Aside from the market noise, the fundamentals for a global market recovery and growth in the domestic economy remain intact. As we observe economic data we see exceptionally strong new order activity and PMI activity on both services and manufacturing remain in healthy expansion territory. Also recently elevated unit labour costs have abated on a productivity adjusted basis suggesting companies are not feeling pressures on their cost structures which means marginal are defensible and valuations should continue to expand. These factors lead us to maintain our overweight to

equities and remain invested in the asset classes we have had in place over the last several months.

Derivatives instruments are utilized within the strategy to:
a) effect tactical hedges against existing positions (such as currency, geographic or asset-type specific systematic risk, etc.), or
b) express a particular viewpoint on an economy or asset class without committing capital via cash security purchases.
Regardless of the investment premise, Portfolio Management is uncomfortable with underwriting/absorbing any semblance of tail risk, as we do not believe our clients, as an investors, are appropriately compensated for doing so. This means that all strategies are effectively bounded. Security selection operates via a relative value framework that is identical in concept to management of the rest of the Portfolio.

All of the above mentioned portfolio allocation, investment decisions and positioning reflect our understanding of the current economic climate. With that said, uncertainty persists with respect to how potential changes within major trade relationships, plus geopolitical tension could influence fundamentals and undermine growth. Portfolio Management remains acutely focused on whether these external considerations have the potential impact our core outlook, and thus our orientation and asset allocation.

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