Monthly Portfolio Update

*Amundi Funds II – Global Multi-Asset Target Income**

31 July 2018

MULTI-ASSET

COMMENTARY

Market Review

July was a busy month with political uncertainly in Germany and the UK, Chinese Renminbi weakness, ongoing trade tariff skirmishes and some re-calibration of the Bank of Japan's Yield Curve Control programme as some of the more notable events in the month. Despite the risky backdrop, surprisingly, the overall effect was generally positive for most asset classes. Equity markets and bond yields rose, credit outperformed sovereigns, commodities struggled and the U.S. Dollar was generally flat but the Euro appreciated.

The MSCI World Equity Index was up +3.1% (in USD terms) with the U.S. S&P 500 in the lead at +3.7% against a backdrop of good macro and corporate earnings data. In Europe, political concerns still dominated the markets, although by month-end, attention was swinging back to a slowdown in economic data. As had been signalled by the recent Purchasing Mangers' Indices, European Q2 GDP was lower than expected (+0.3% vs expected +0.4%), whilst headline inflation ticked higher to 2.1%, above the ECB's target of "close to, but below 2%". Despite this uncertainty, European equity markets performed well with the Eurostoxx 50 up +3.8% and German DAX in the lead at +4.1%. A weaker Yen and changing stance of the Bank of Japan did not provide a big boost to the Japanese stock markets – the Topix rose +1.3% whilst the Nikkei 225 was up +1.1%.

Emerging Markets (EM) equities, (as measured by the MSCI EM Index) rose +1.7% mainly driven by a bounce in EM Latam markets (+9.1%, with Argentina gaining +12.5%) and strong performance from EM Europe (+4.2%). Meanwhile, EM Asia was only barely positive at +0.1% despite strong performance from Thailand (SET +6.7%) and India Sensex (+6.2%). Weakness in Korea (KOSPI -1.3%) and Hong Kong (Hang Seng -1.3%) dragged the Index down.

Within fixed income markets, most sovereign bond yields were higher as markets generally took note of higher inflation prints and the changing monetary policy stance of central banks. U.S. 10-year Treasury yields rose by 10bps to 2.96%, whilst the yield spread between the U.S. 2-year and the 10-year yields narrowed to 29bps. In Europe the 10-year German Bund yield rose from 0.30% to 0.44%, whilst the gap between 2-year and 10-year German yields is 102bps – a stark contrast to the U.S. Italian government bonds staged a small recovery and managed to out-perform their equivalent German counterparts. The Bank of Japan tweaked their bond-buying programme at month-end by allowing the 10-year government bond to fluctuate in a +/- 20bps range around 0%, as opposed to the previous range of +/-10bps.

Investment-Grade credit had a good month with spreads tightening across the spectrum and outperforming government bonds. The broad Bloomberg Barclays Euro Aggregate Corporate Index generated positive returns of +0.3%, whilst the Bloomberg Barclays U.S. Corporate Index was positive to the tune of +0.8%. High Yield markets outperformed with Euro High Yield and U.S. High Yield rising +1.3% and 1.1% respectively.

Within currency markets, the US Dollar Index (a trade-weighted basket of currencies against the U.S. Dollar) rose a modest +0.1% with notable gains versus the Japanese Yen (+1.0%) and British Pound, (+0.6%) while performance versus the Euro was flat. EM currencies finished the month stronger with the JP Morgan Emerging Markets Currency Index rising 1.0% in July owing to gains versus most Asian and Latin American currencies. A notable exception was the Chinese Renminbi which fell -3.0% against the U.S. Dollar.

Commodities had a poor month, with the CRB Index falling -2.9%. West Texas Intermediate fell -7.3% in July, whilst Brent fell -7%. Among industrial metals, Nickel and Copper fell -6.0% and -5.2% amidst trade tariff related concerns while Gold was down -2.3%.

Portfolio Review

The performance of the Portfolio was positive in July as risk assets trended higher on the back of strong corporate financial results in Q2. Concerns on a further escalation of the trade dispute softened the positive mood somewhat and triggered volatile market

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*Prior to 16 February 2018, Pioneer Funds – Global Multi-Asset Target Income.

Amundi ASSET MANAGEMENT

moves. However, a meeting between Trump and Juncker towards the end of the month brought some relief and supported export-oriented European assets. Nevertheless, political uncertainty remains elevated in a maturing financial cycle. In this environment, we seek to reduce exposure to risk assets to neutral levels and maintain hedges in place to protect the Portfolio from a risk-off scenario.

While Macro Strategy was positive, Satellites were neutral and Macro Hedging and Selection Strategies detracted from returns. With respect to asset classes, exposure to global equities was positive in July as equities advanced in all regions. Interest rate exposure was supportive as well with EM bonds being one of the key performance drivers as the market rebounded after a sell-off earlier this year. Also, our position in corporate bonds – both IG and HY - added to performance as spreads tightened over the month in all major regions.

Within the equity sector, our exposure to equities in Europe, the U.S, Japan as well as EMs added to returns as these markets all posted monthly gains, despite continuing risks for global trade. Equity selection was broadly neutral for the month. Within satellite equity strategies, a strategy on asymmetric global equity volatility added to returns, while other sector strategies (i.e. long the U.S. energy sector vs. REITS) were largely neutral for July performance.

Within fixed income, exposure to EMs was a major positive return contributor in July as the sector benefitted from tightening spreads on the back of a stabilising U.S. Dollar. Interest rate exposure in Industrial countries slightly detracted from returns overall as yields trended higher. As such, duration exposure in the U.S, the UK and peripheral Europe was negative, whereas a short position in German rates helped to partially offset the losses. Exposure to inflation in the U.S, Europe and Japan helped performance as well as inflation expectations as measured by 5Y5Y Inflation Swaps trended higher. Our position in Investment Grade and High Yield Credit was positive as spreads fell over the month and the sectors posted attractive excess returns over government bonds. The overweight position to subordinated financials was positive as well as the sector outperformed within credit markets. Satellite strategies in fixed income were slightly positive as duration strategies in New Zealand and Sweden added to returns. Our curve steepening position in the U.S. slightly detracted as the curve continued to flatten.

Within FX markets, our overweight positions in the Japanese Yen vs. the USD and the EUR were negative for performance. An underweight of the U.S. Dollar vs. a basket of EM currencies was positive as they recovered from some of their losses earlier this year. Satellite FX strategies detracted from returns over the month. Exposure to Real Assets added to performance, while our allocation to gold was negative as the gold price dropped further.

Asset Allocation (Macro Strategy and Satellite Strategy)

While our central scenario remains a continuation of global growth with slightly higher inflation, we also acknowledge an increase in geopolitical risks. In light of the escalating global trade dispute, we have tactically reduced exposure to risky assets. As we are in the midst of a mature economic cycle, we focus on markets with stronger earnings prospects.

Fundamental data in the U.S. remained supportive, underpinned by a strong Q2 reporting season. In the Portfolio, we place a higher emphasis on U.S. equities as they continue to benefit from expansive fiscal policies and we expect them to be more resilient in an escalating trade dispute. In Europe, we are a bit more cautious as sentiment indicators have softened over the previous months due to trade concerns. We believe a focus on quality and value is warranted in this environment. In Japan, we have tactically reduced our equity exposure compared to our allocation earlier this year. With respect to EM, we remain cautious and selective for the moment. Although the market has sold off recently, we expect some earnings downward revisions in the coming months. China is discounting an escalation of the trade war with the U.S, however, fundamentals remain robust and the People’s Bank of China has been stimulating the economy in an attempt to offset the negative effects from trade. The weakening Yuan has also been supportive for the Chinese economy. As such, we maintain our constrictive view on China versus the overall EM index given more attractive valuations.

On fixed income, we further added to duration, but still keep an overall reduced Portfolio duration. We increased our rates exposure in Europe, where the ECB might support bonds with longer maturities. Also in the US, where 10-year yields around the 3%-level are increasingly attractive, we increased our duration position. In Italy, yields have remained broadly stable in July after the political turmoil around the government formation previously. We maintain cautious until there is more clarity on the government’s plans with respect to budget discussions in autumn. In Japan we continue to maintain a negative duration exposure as the BoJ has

increased the bandwidth around the 0% target rate for 10-year JGBs to +/- 20 basis points and we expect rates to drift higher. We maintain our positioning for higher break-even rates in Europe, Japan and the U.S, where we anticipate an increase in price dynamics. Although the U.S. curve between 2 and 10 year maturities has flattened considerably over the past months, we maintain our curve steepening strategy, as we expect some inflation premia to be discounted in longer maturities. EM bonds posted strong gains in July as spreads recovered from the peak they reached in June. Although the asset class remains appealing for carry reasons we have decided to slightly reduce exposure over the coming months. We continue to focus on selective countries in Latin America, Africa, Asia and Eastern Europe.

In the IG corporate sector, we are becoming slightly more cautious as we expect higher spread volatility ahead. In the U.S, credits are still supported by the positive cyclical momentum, but funding conditions have considerably tightened. We have a preference for European credits, where balance sheets remain solid, the credit cycle is younger than in the U.S. and credits enjoy continued support from the ECB's CSPP. In terms of sector allocation, we maintain an overweight to Financials, which could benefit from improved fundamentals amidst higher interest rates and better asset quality. Moreover, deregulation could increase profitability especially for U.S. banks. We keep an underweight position in Subordinated Non-Financials due to stretched valuations limited excess return potential.

We also have become less constructive on High Yield ("HY") and have reduced our overall exposure – both in Europe and the U.S. In the U.S, a rising oil price and low default rates have been supportive for the sector so far this year, but high leverage levels and tightening financing conditions warrant a more defensive stance and a strong focus on security selection. We also have implemented hedging strategies on U.S. High Yield.

In the current late cycle environment combined with unpredictable political dynamics, we place a higher emphasis on uncorrelated, market-neutral Satellite Strategies. For example, we have a long position in Russell 2000 vs. a short position in Nasdaq as smaller, domestic corporations should be less affected by the trade dispute. Reflecting the political risks in Europe, we implemented a spread widening strategy between German Bunds and Italian BTPs. We also keep our long position in the European Banking sector vs. the MSCI Europe, seeking to participate in a rebound of the banking sector as we expect solid growth in Q3 and Q4 after the soft patch in Q2.

In terms of currencies, we keep our short U.S. Dollar position vs. a basket of EM - predominantly Asian - currencies with strong current account balances. We maintain the long JPY position vs. the U.S. Dollar due to its safe heaven character in case of a more volatile market environment. Scandinavian currencies like Swedish and Norwegian Kronor should benefit from strengthening macroeconomic conditions. In Australia, we have implemented a short AUD position on the back of a weaker outlook for the real estate sector.

Macro Hedging

We have put hedges in place on spread duration for U.S. High Yield bonds and have a implemented a hedge on U.S. equity exposure via put options. In addition, we maintain positions to mitigate equity volatility and reduce downside risk from tail events in Europe, the U.S, Japan and EMs. We also maintain volatility management strategies on U.S. High Yield bonds via CDS Index options, which should benefit from a pick-up in spread volatility.

Security Selection

Generally, we seek to improve overall credit quality in the portfolio by putting a higher emphasis on Investment Grade vs. High Yield. In the current environment, we prefer European issuers and maintain a tilt to Subordinated Financials, which are preferable for their carry and relatively attractive valuations. We also maintain selective positions in the crossover area (BBB to BB ratings) as it still offers attractive risk-return characteristics.

In terms of equities, we are in favour of sectors such as Financials and Energy, where earnings may benefit from rising rates and higher oil prices. We also hold some exposure to bond-proxy sectors such as Healthcare and Consumer Staples, which offer the prospects of sustainable dividend yields

During the last quarter, we wrote options on single stocks with an average notional of c. 3.2% of the fund's assets. For example, we wrote options on European banks, car manufacturers and chemical producers.

Outlook

Our central scenario is still for a continuation of global growth and inflation trending mildly higher. So far, there has been a very limited impact on global growth

from the announced trade tariffs, and, indeed, the U.S. may actually benefit slightly due to import substitution. However, if a serious escalation were to occur, global trade and financial markets would be hit and no markets would be immune from the effects. We expect the U.S. to be the most resilient area, particularly supported by fiscal expansion. Europe is also expected to grow above trend. However, the main risks are still to the downside and the higher probability attached to the negative scenario could prevent risky assets from showing strong upside trends.

In this environment, we believe investors should maintain low directional risk exposure given the backdrop of rising risks. We focus not only on the structural risks related to possible central bank policy mistakes or to the cycle downturn, but new geopolitical risks due to tariff rhetoric or political changes in Europe (Italy, Spain, Germany) as well as specific idiosyncratic stories in EMs could become concerns for investors. Hedging strategies have been implemented therefore to protect portfolios from risk-off situations.

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