Quarterly Portfolio Update

*Amundi Funds II – Emerging Markets Bond**

29 June 2018

Bond

COMMENTARY

Market Review

So far 2018 has proved an eventful period for financial assets. Over the last six months, we have compiled a long list of individual surprises which appear to be more than coincidental. When viewed alongside the decoupling of growth paths, tightening U.S. financial conditions and re-pricing of risky assets, we would appear to have all the hallmarks of a slow-motion credit crunch. However, while the U.S. data may be holding up, the rest of the world appears to be doing less well, as evident from recent PMIs. In China, policy has become more accommodating in response to the tighter financial conditions, and we note that CNY rates appear to be falling towards their USD equivalents. The Eurozone has cooled off somewhat, leading to a reassessment of the outlook for policy normalisation and a cut to our bond yield forecasts.

We see three developments primarily impacting the global economic outlook. First, tighter U.S. financial conditions, rising bond yields and a stronger U.S. Dollar. Second, sustained upward movement in the oil price, recently augmented by the re-imposing of U.S. sanctions on Iran. Third, trade war rhetoric, which may have the potential to inflict the most damage on the global economy. Going forward, we think the bigger threat facing EM assets may progressively come from trade and less from U.S. monetary policy considerations.

Across markets, the tension between global growth optimism and local funding stress continues to drive huge divergences in performance. As activity data like global composite PMI improve for a second-consecutive month, global equities have reached their highest level since February, while a handful of markets and styles (NASDAQ, Russell, Momentum & Growth stocks) touched new all-time highs. Base metals have also approached new 2018 highs, confirming Chinese industrial production momentum. Stresses are local and, like the early stages of the Asian Crisis 20 years ago, or the EMU Crisis 8 years ago, are sources of intermittent volatility for U.S. Equity and Credit markets. Emerging Markets (EM) currencies, as a bloc, have fallen to 18-month lows, while EM Sovereign and Corporate plus Italian government spreads are widening again towards this year's highs. Oil is down 5% to 10% (WTI and Brent, respectively) from its late-May highs as OPEC-Russia consider a supply increase at their June 23 summit.

Within this sovereign turbulence, oil market developments have probably been overlooked despite their materiality. Since late May, some cartel members have floated the idea of a supply increase to prevent Brent prices from moving sustainably above $80/bbl and damaging demand, partly out of self-interest and partly on U.S. request.

Portfolio Review

The Portfolio and the benchmark[1] have both registered negative returns in June and YTD.

At the Portfolio level, key performance drivers YTD have been: duration exposure, which we are running 0.7 years short (vs benchmark) and 0.6 years shorter spread duration (vs benchmark); allocation to High Yield; EM FX which generated alpha. We lost some performance on sovereign and credit selection and USD/EUR currency pair. Throughout the year, we have been running a significant cash buffer which fluctuated between 7% and 10%; as of end June this was standing at 7.4%.

Coming into H2; we continue holding our highest exposure in EMEA, where we believe that the Oil story should support the likes of Nigeria and Oman.

[1] JPM EMBI Global Diversified 95%, JPM Cash 1 Mnth Euro 5%

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* Prior to 16 February 2018, Pioneer Funds - Emerging Markets Bond

We are slightly overweight in Latin America as Brazil continues to be our highest single country overweight; and are underweight in Asia as markets offer unappealing valuations.

In terms of sectors, our highest conviction and overweight are in Banking, Energy and Basic Industry which are financed with an underweight in sovereign exposure.

In terms of returns, at the country level, it was in Nigeria, Qatar and Kazakhstan where commodity cycles prove supportive for hard currency bonds. We saw performance lagging the benchmark in Argentina, Turkey and Russia. In Argentina it was the run against the currency triggered by higher U.S. rates and exacerbated situation around current account deficit and the lack of clarity in monetary policy. In Turkey we had a negative surprise on the inflation front as the election campaign geared towards the erosion of institutions, coupled with President Erdogan's comments on central bank independence and rates levels (which markets hardly digested) put Turkish assets under selling pressure. In Russia, early April U.S. sanctions triggered currency depreciation and brought clouds over economic recovery that country is much in need of after the 2014-2017 financial recession. At the Sector level we outperformed Banking, Basic Industry and Consumer goods, while our underweight in Services and Healthcare came at a small cost.

Latest USD strengthening and idiosyncratic developments in some EM countries have led to a sharp depreciation of EM currencies that erased all of the YTD gains in EM local markets, which were, until recently, the most resilient subcomponent of the EM asset class. Our allocation to Local Currency (LC) bonds have been influenced by those developments and we have been further reducing our exposure to LC assets. An antidote for stress may be on the way, but will likely require more time and policy adjustments. In Latin America, Mexico's real rates are already above average, but clarity on NAFTA and elections would be required to reduce the Peso's risk premium. Brazil has low real rates by historical standards, but high ones for a country running a balanced current account. Also Argentina has delivered higher real rates, secured external funds and committed to fiscal tightening. In EMEA, Turkey has also lifted real rates, but not announced fiscal adjustment.

We are of a view that recent market sell-offs equally penalized weaker sovereigns (of which some run serious fiscal imbalances), and credit space which is doing what we expect them to do (deleveraging and running strong balance sheets). In our view, this series of very sharp market moves, which pushed yields higher and spreads wider, now offer pockets of value opportunities which we plan to play tactically.

Outlook

As volatilities remain high, we believe market participants will likely stay on the side-lines in the short-term. However, with the rising relative values of EM assets, especially for LC and sovereign bonds, we think the recent weakness is more likely to reverse than deteriorate further.

The unpredictable policy environment prompts us to become even more selective about which parts of EM to own. Should we experience contained EM political risks and a continuation of positive data prints, EM fixed income could be set for a rebound. Looking further out into the year end, we are of the view that if the global growth remains in place and election cycle doesn't disappoint, our full year targets of low single digit returns for both EMD and EM credit (in USD) could remain in place.

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