



Climbing the Wall of Worry: U.S. Economic and Market Outlook

September 21, 2015

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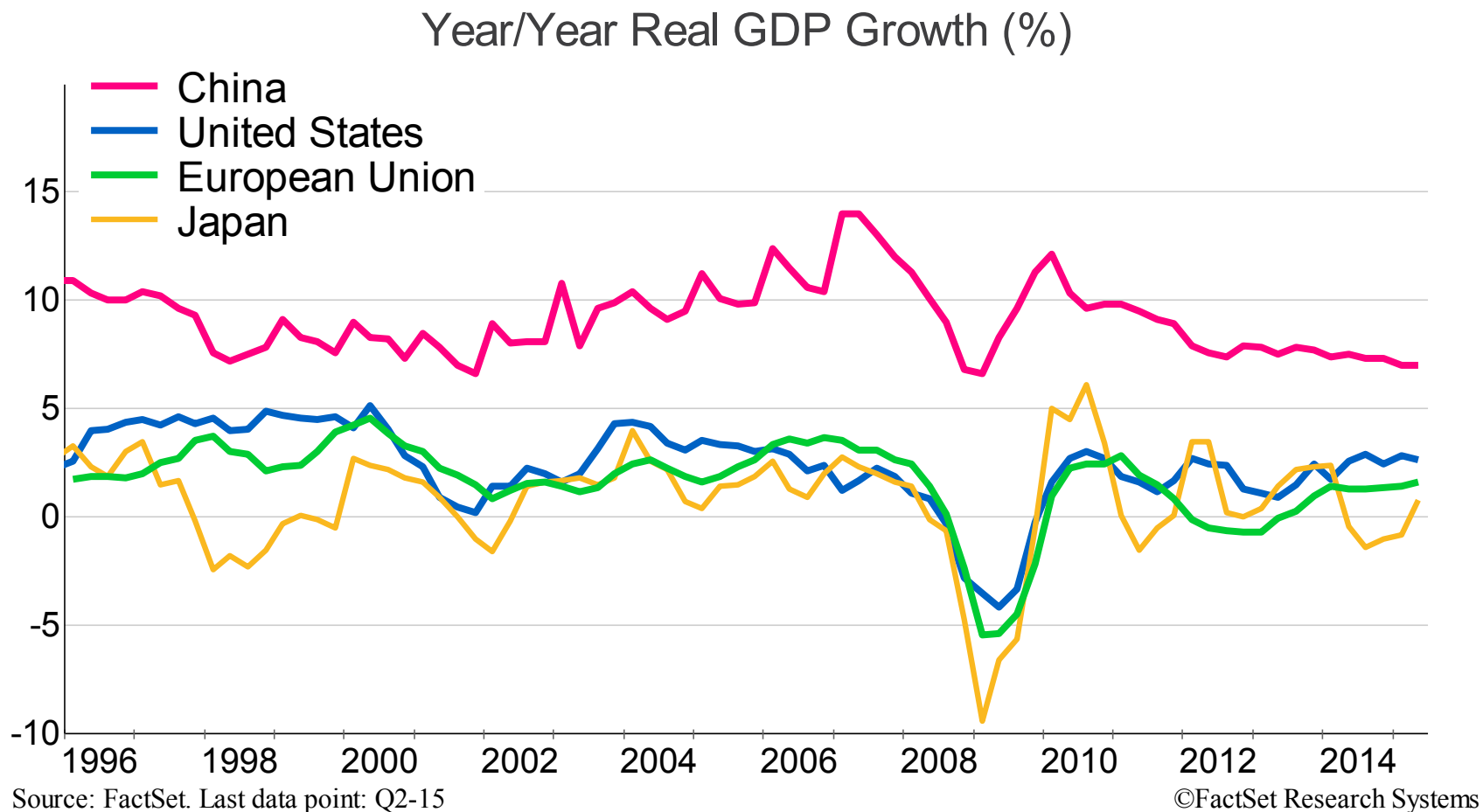
Agenda

- Overview and global context
- U.S. economic outlook: recession risks?
- Labor market conditions and consumer spending outlook
- Business investment, trade, and fiscal policy outlook
- Focus: oil prices and their impact
- Inflation: sources and outlook
- Monetary policy outlook
- Asset prices: where is the relative value?

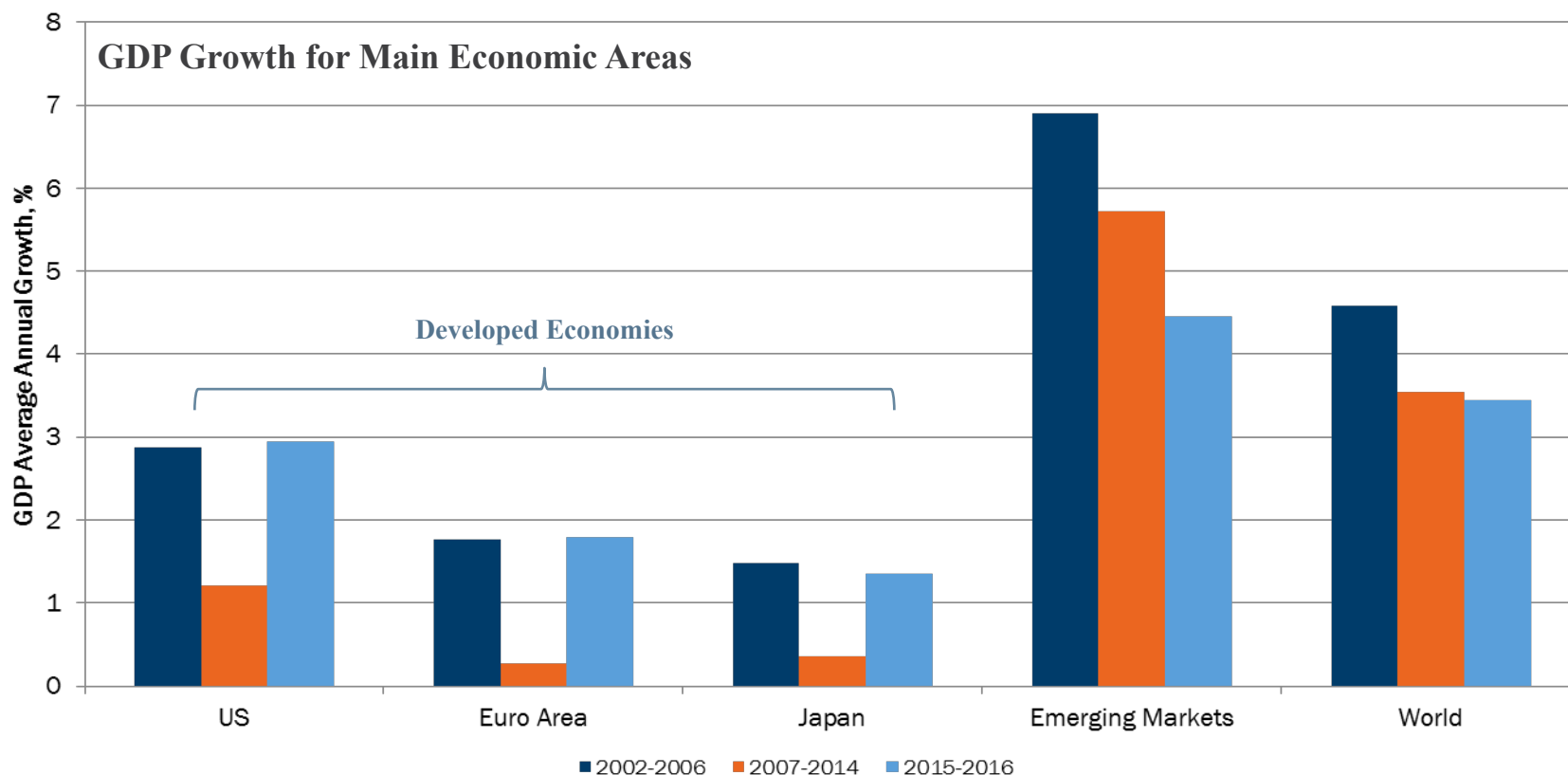
Looking Forward at 2016: Solid U.S. Economic Growth is Expected

- We expect somewhat better, but still modest growth of approximately 2.75% to 3.0% over the next year in the U.S. led by consumption, the housing sector and improved government spending.
- Easy global monetary policies may continue to support growth. Europe may enjoy higher-than-expected growth from the ECB stimulus, lower Euro and lower oil prices.
- Corporations are currently enjoying strong margins and balance sheets. They may continue to benefit from improving U.S. growth and a stabilized global economic climate, although they may begin to experience margin pressures from wage increases. Shareholder-friendly activity remains a risk in many industrial sectors.
- Many Emerging Market countries may suffer from the sell-off in commodities, lower growth in China and from high levels of U.S. dollar-denominated debt.
- The greatest risks to our forecast are a faster “normalization” of monetary policy and interest rates in the U.S., disappointing growth in China and global geo-political uncertainties.

The Global Economic Backdrop is Mixed



Improving Global Economic Outlook, Driven by Developed Countries



» Global growth mainly supported by Developed Market outlook, where domestic conditions are getting traction. The long term picture is still fragile, due to structural factors such as the debt deleveraging, low productivity, inequalities.

Source: 2015-2016 data for US, Japan, Euro Area and World GDP are Pioneer Investments estimates, as of September 2, 2015. All the remaining data are from the IMF World Economic Outlook as of July 2015 Update. EM represents emerging markets.

EU: Domestic Conditions Are Improving, Risks Come From Abroad



ECONOMIC CONDITIONS

Poor ———— ● ———— Good

- **Growth:** weak Q2 GDP data, but underlying figures are better than at first glance. Spain and Italy are doing better than expected. Risks and threats come from abroad.
- **Economic Trend:** inflation will increase towards year end but low commodity prices and the slack in the economy will prevent any jump.
- **Financial Conditions:** loose credit standards in a less risky environment, loans extended to Non Financial Corporations turned positive again.
- **Economic Policies:** fiscal policy no longer a drag on growth. The Greek saga could help in changing the approach to policy.

EU



STABILITY CONDITIONS



Poor ———— ● ———— Good

- **Demographics:** aging population is a threat to long term equilibrium. Now the issue is to find a common and reasonable policy to deal with immigration and refugees.
- **Social:** improving economic conditions should help lessen social tensions.
- **Politics:** general elections in Greece, Portugal and Spain will have a huge “European” content. On the immigration issue, debate with UK will be not easy.
- **Economic health:** ECB is favoring deleveraging, public sector is reducing the debt service burden.

Source: Pioneer Investments. Data available as of September 1, 2015.

Japan: Fiscal Measures Before Monetary Measures



ECONOMIC CONDITIONS

Poor —●— Good

- **Growth:** Q2 2015 GDP negative. Households Consumption declined by 3.0% QoQ Ann. According to our model the blip will prove to be temporary.
- **Inflation:** The inflation path has slightly moderated. It's expected to mildly increase starting from Q3 2015. Far from the BoJ's target in the forecasting horizon.
- **Financial Conditions:** The BoJ will certify the outlook deterioration by October 2015. If the weakness proves temporary as expected, no further intervention by the BoJ in the near term.
- **Economic Policies:** fiscal measures more likely than monetary measures.

Japan



STABILITY CONDITIONS



Poor —●— Good

- The focus of the current Diet (extended by 90 days till the end of September) is to pass the Security and Defence Bill.
- The election of the new LDP President occurred in September. Consensus expects an easy go for Abe.
- The focus of reforms process has been confirmed as investment revitalization and productivity increases in order to lift the potential rate of growth.
- The TPP (Trans-Pacific Partnership) Hawaii round in July has so far proved disappointing. The signing of the deal is more and more urgent given lagging Global Trade backdrop.

Source: Pioneer Investments. Data as of September 1, 2015.

China: Slowdown, Not Hard Landing



ECONOMIC CONDITIONS

Poor Good

- Economic activity cooled in early Q3 after temporary strength in Q2, with **weakness particularly in state sector**.
- Nonetheless, key downside risks show **further signs of easing**, with recent property sales stabilisation helping new starts bottom out.
- **Broad price pressures remain relatively low**, which should allow policy stance to stay supportive in H2.
- **Credit growth seems to be stabilising** at least in the short term, although the current pace of credit expansion is still not sustainable.

China



STABILITY CONDITIONS



Poor Good

- **Economic structure** is improving further with private sector and consumption holding up relatively well.
- **Reforms continue**, with new efforts to facilitate Renminbi (RMB) inclusion in IMF's SDR (Special Drawing Rights) basket. This includes easing controls on reference rates of RMB.
- That said, the resulting sudden **RMB depreciation** has caused worries about a larger competitiveness devaluation, which seems still unlikely.
- **A shift to more market friendly measures** in managing equity markets may help restore onshore stock markets.

Source: Pioneer Investments. Data as of September 1, 2015.

US: A Strong Labor Market Stimulates Consumption and Residential Investments



ECONOMIC CONDITIONS

Poor ————— Good

- **Growth:** growth more widespread and robust: residential investment and consumption are the main engines.
- **Economic Trend:** labor market data continue to be good, sustaining domestic demand. Also capital good orders (and hence investments) are growing. Inflation is low everywhere, due to commodities.
- **Financial Conditions:** recent market turmoil dampened the picture a bit, with corporate spreads rising; otherwise financial conditions are generally good..
- **Economic Policies:** fiscal policy no longer a drag on growth. Fed will start normalizing monetary policy gradually.

US



STABILITY CONDITIONS



Poor ————— Good

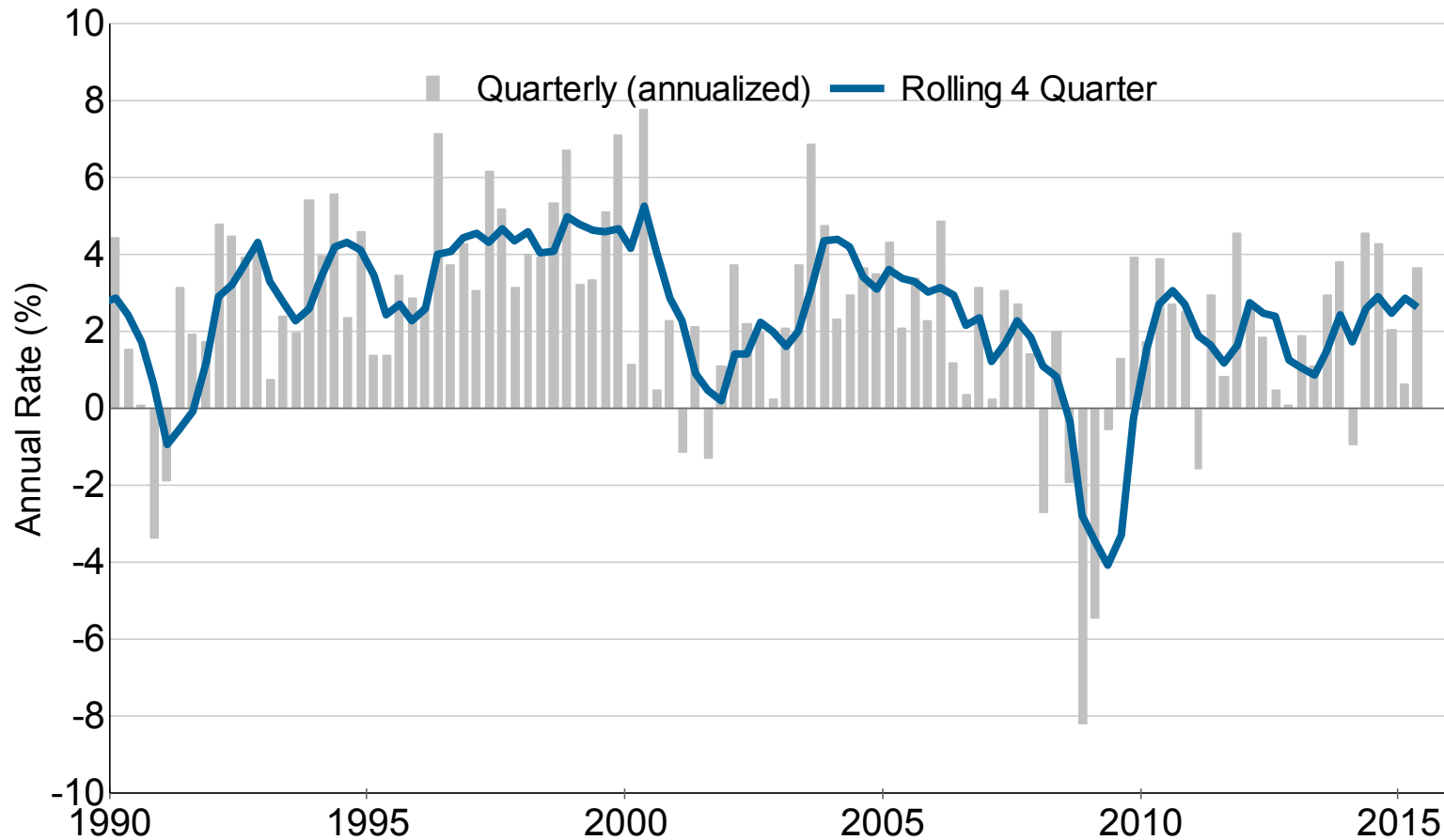
- **Demographics:** labor force participation rate should not pose risks to improvement in unemployment rate
- **Social:** improving labor market conditions and wages should start benefiting lower & middle income households (though income inequality remains an issue globally)
- **Politics:** strong partisanship continues
- **Economic Health:** Stronger internal demand should insure against external shocks.

Source: Pioneer Investments. Data available as of October 1, 2015.

We Expect 2.5-3.0% US Real GDP Growth in 2015

...Modestly higher than in 2009-2013

Annualized Growth of U.S. Real Gross Domestic Product



Source: FactSet. Last data point: Q2-15

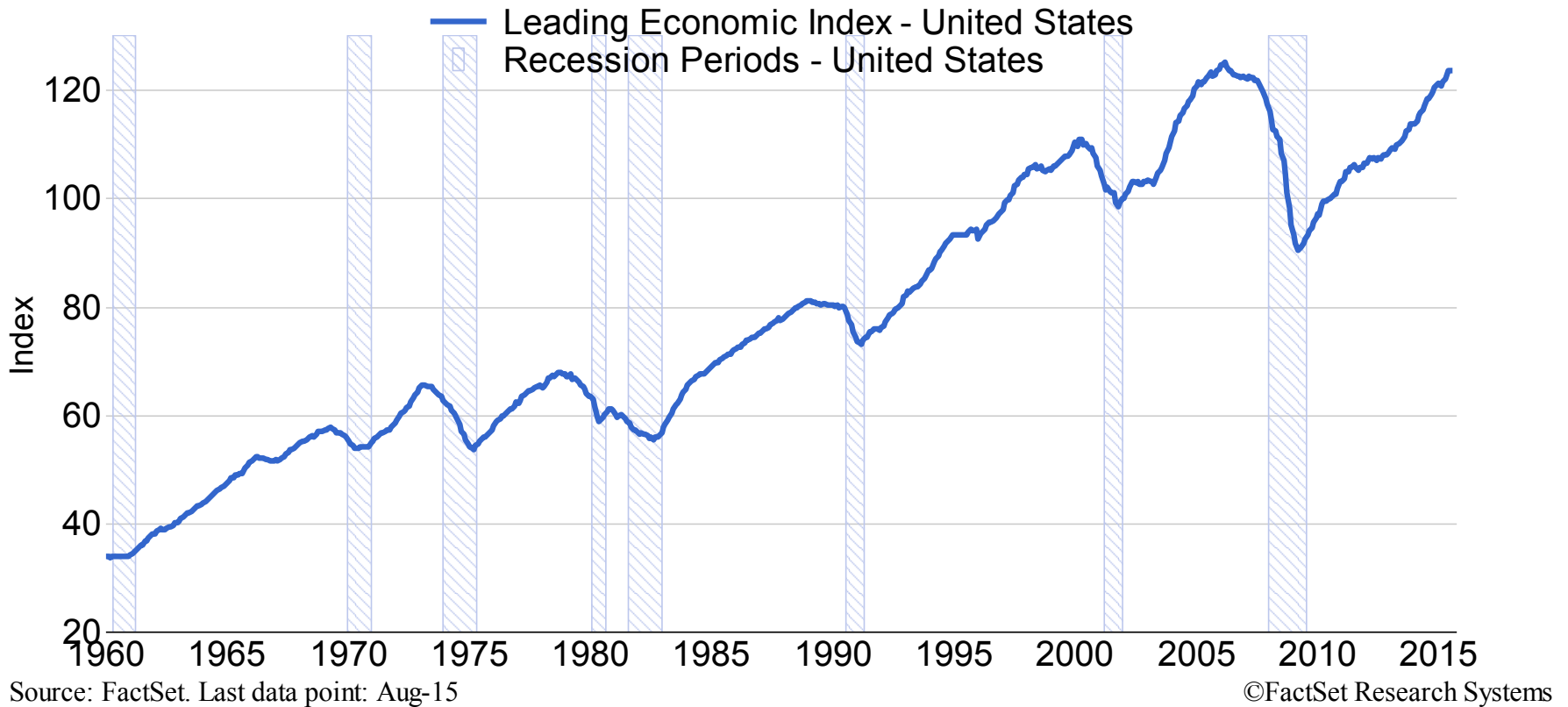
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There is no guarantee that forecasts discussed will be realized.

The Index of Leading Economic Indicators Is (Still) Rising

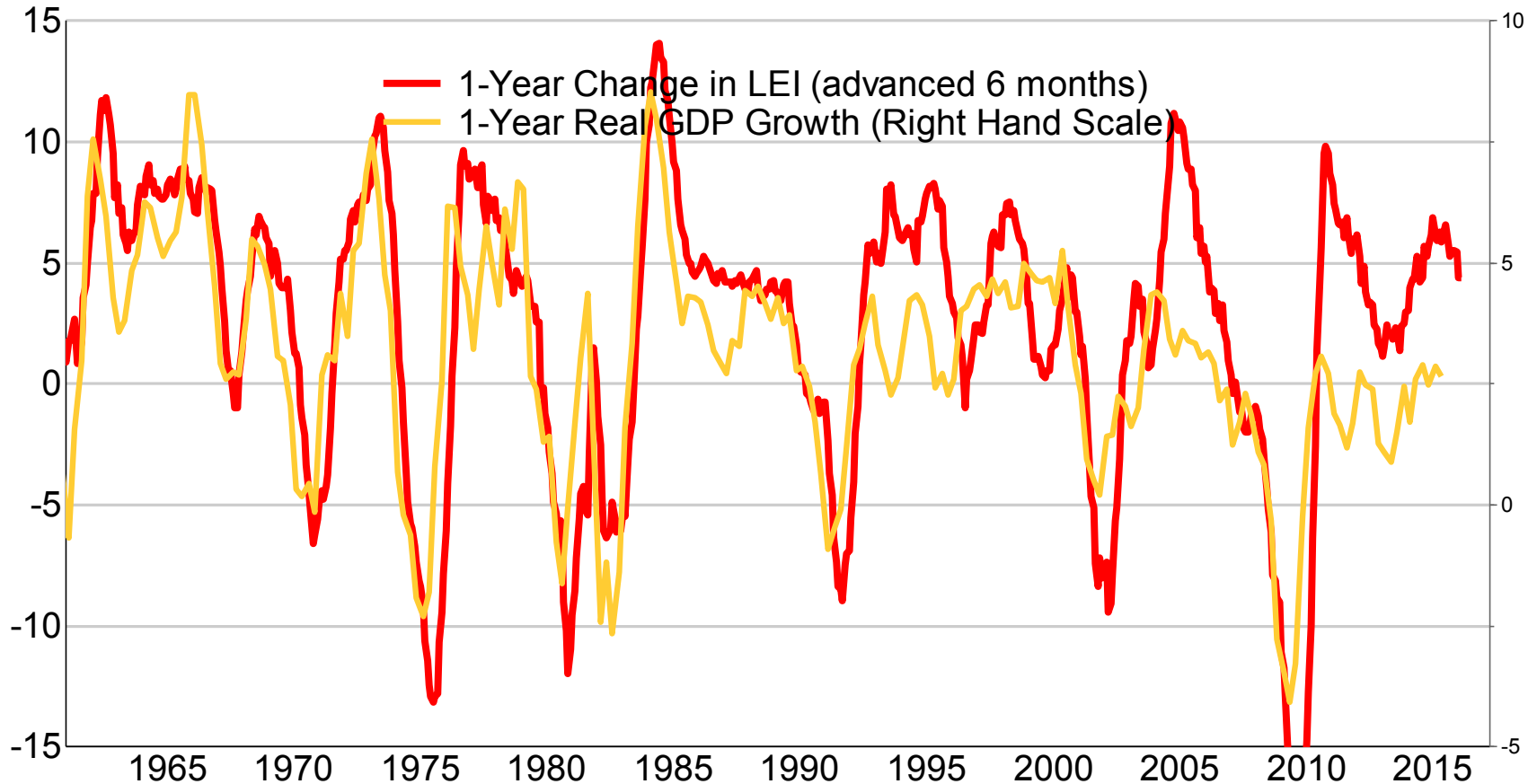
The rate of increase is consistent with continuing GDP growth

U.S. Index of Leading Economic Indicators



...Suggesting That GDP Growth Should Continue

U.S. Leading Economic Indicators and Real GDP Growth



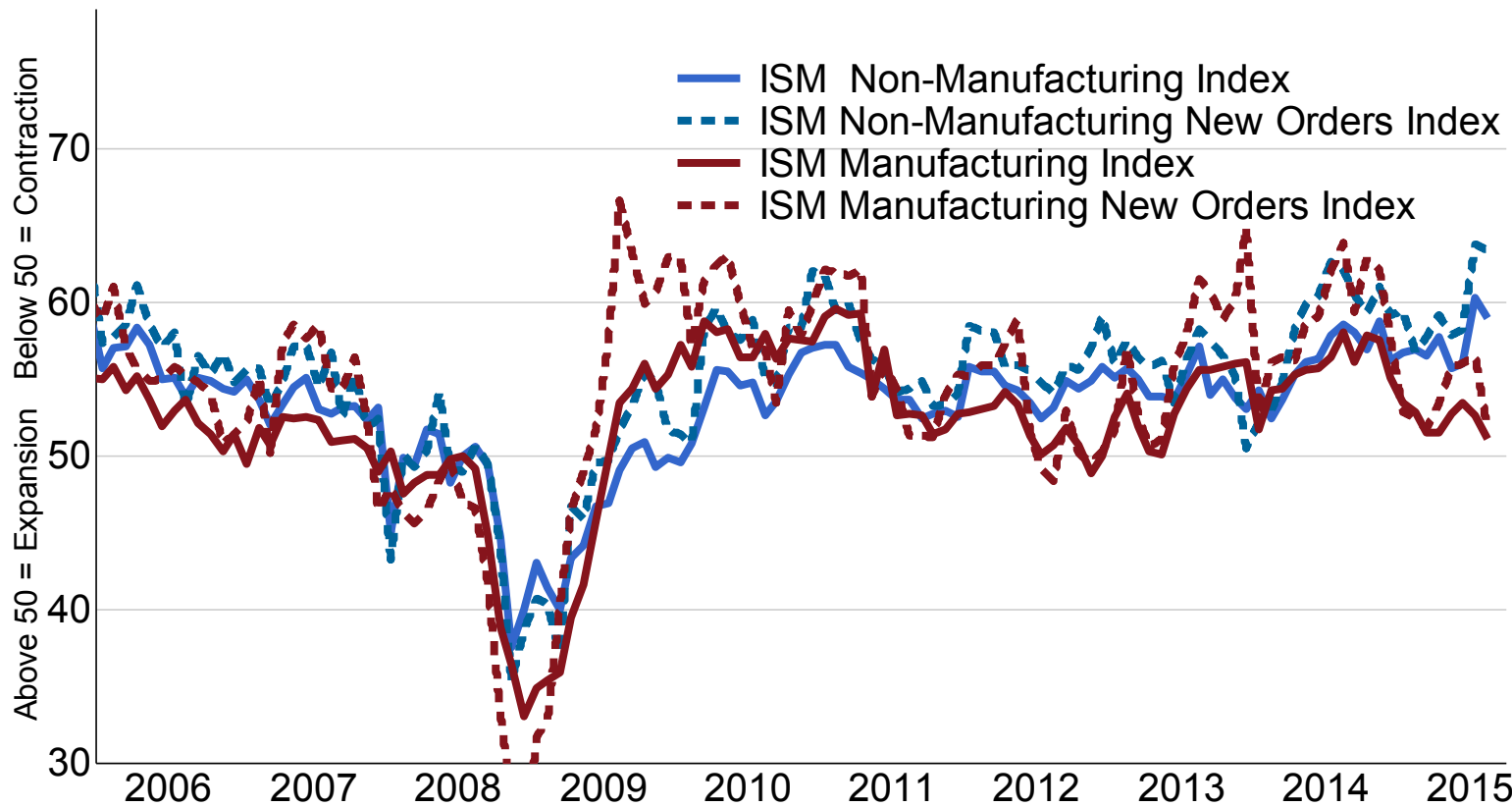
Source: FactSet. Last data point: Q2-15

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The ISM Indexes are Still Signaling Growth

Services is stronger than Manufacturing

ISM Indexes



Source: FactSet. Last data point: Aug-15

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Recent Economic Data Has Been Weaker Than Expected

Citicorp Economic Surprise Index



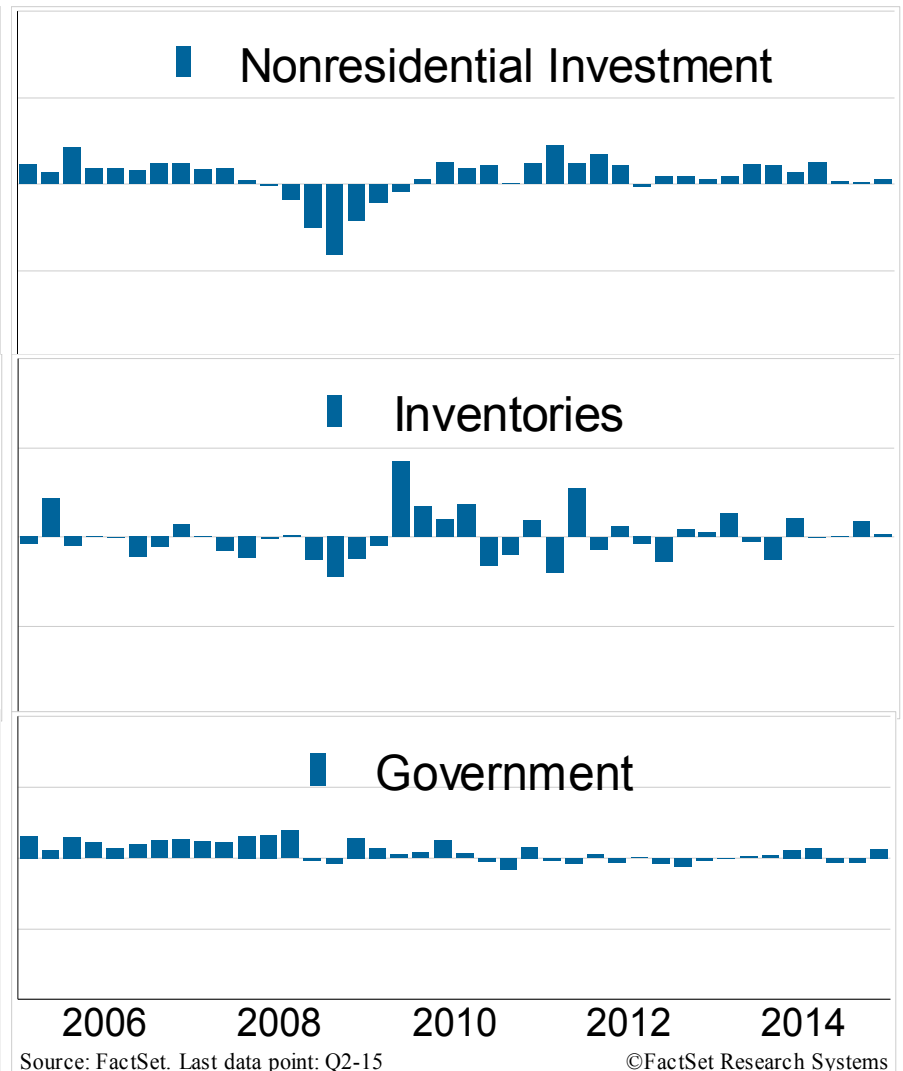
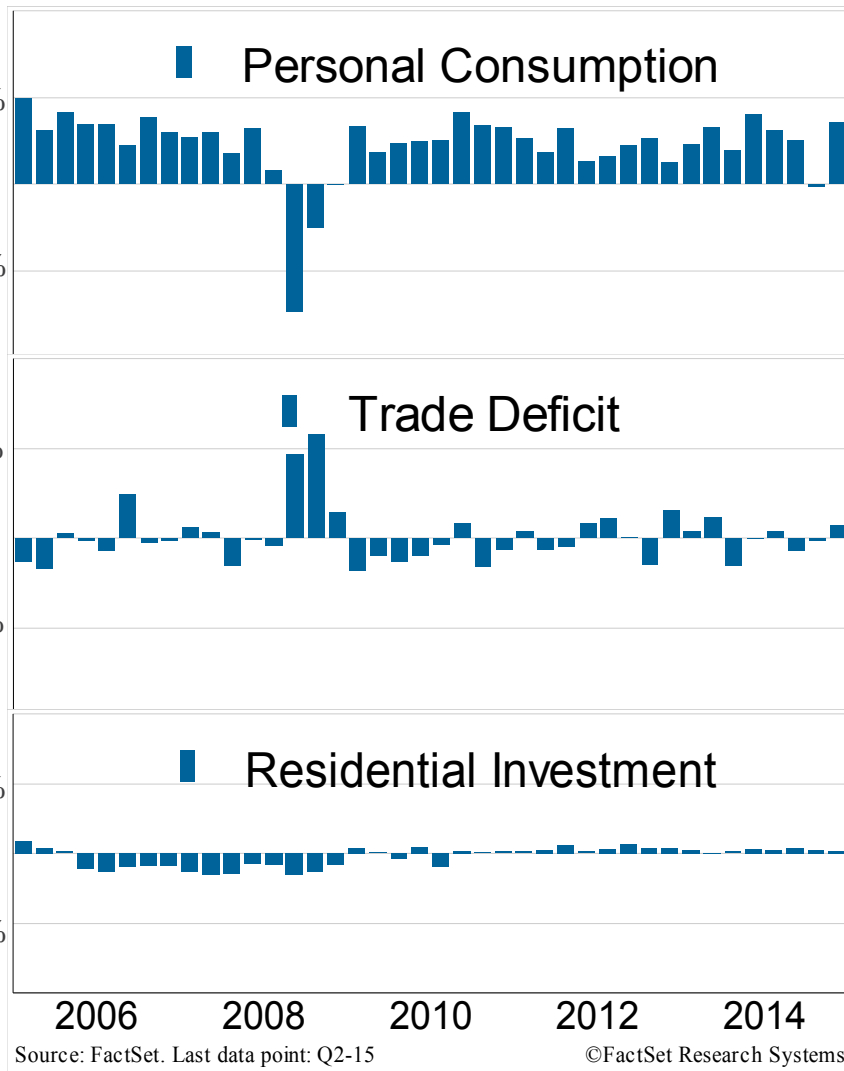
Source: FactSet. Last data point: 18-SEP-15

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The Fundamentals Remain Supportive of U.S. Growth

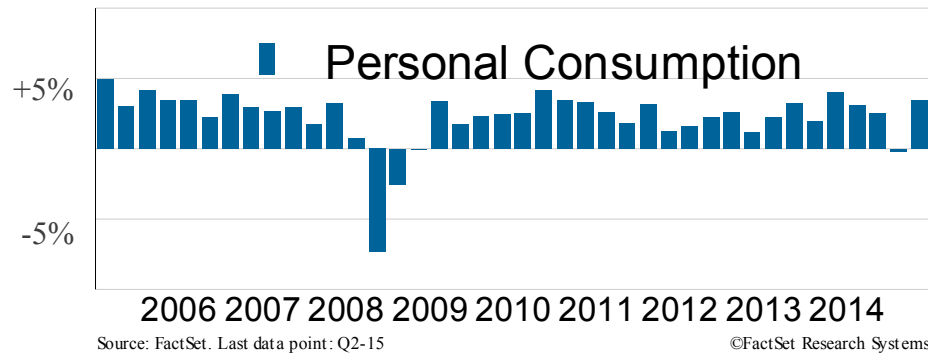
- A strong job market is increasing disposable income; consumer debt burdens are modest.
- Homebuilding has increased to roughly 1 million units/year and auto sales at 16-17 million vehicles/year. In both cases, underlying supply/demand fundamentals are supportive: no decline is anticipated.
- Business capital spending has been modest, but should rise along with the capacity utilization rate. Inventories had been well-contained until recently, but are a concern.
- Government fiscal austerity, a drag on growth over the past few years, is now contributing to growth & expected to do so for the next 2 years.
- Lower energy prices and higher domestic energy production are shrinking the trade deficit...and supporting domestic manufacturing and consumers.

Quarterly Contribution to Annualized U.S. GDP Growth by Sector



We Expect Consumer Spending To Strengthen in 2015

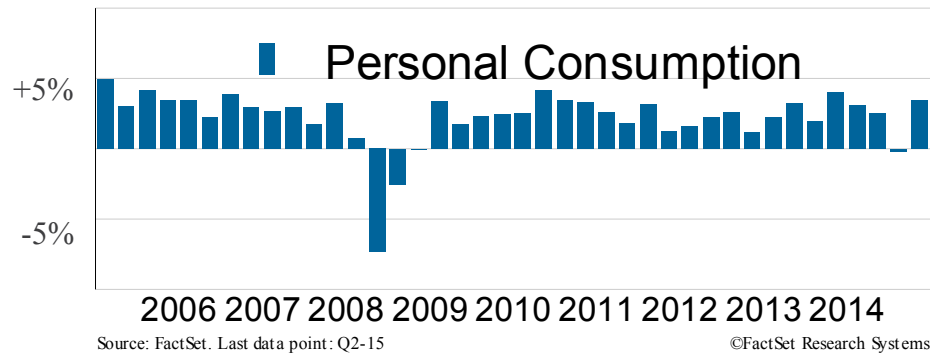
Supported by rising employment, incomes, confidence, and borrowing



- Stronger labor market conditions should result in rising incomes.
- Consumer balance sheets are relatively healthy—able to bear increasing debt, thanks to a high savings rate and deleveraging.
- Rising confidence should result in a lower savings rate, more use of debt.

We Expect Consumer Spending To Strengthen in 2015

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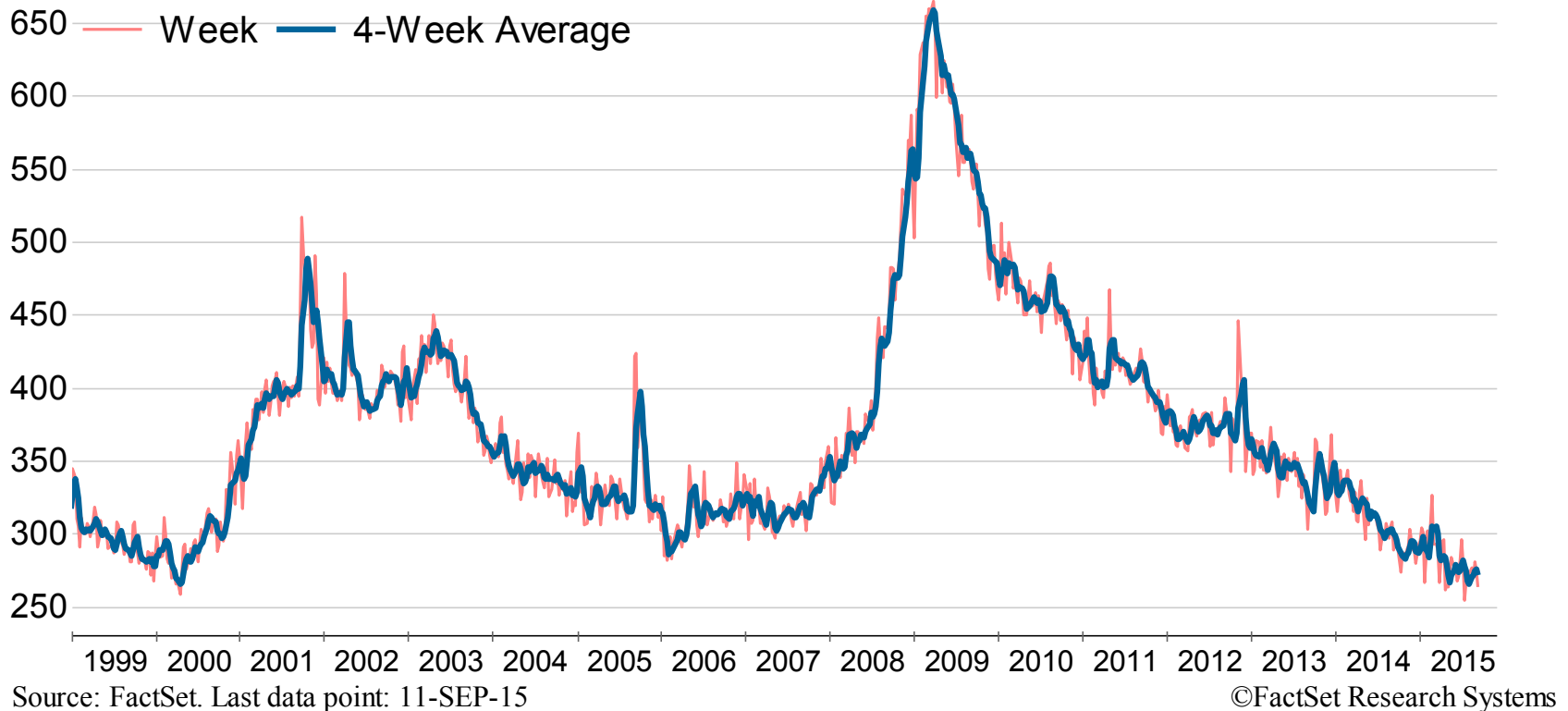


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Initial Unemployment Claims Are Remarkably Low

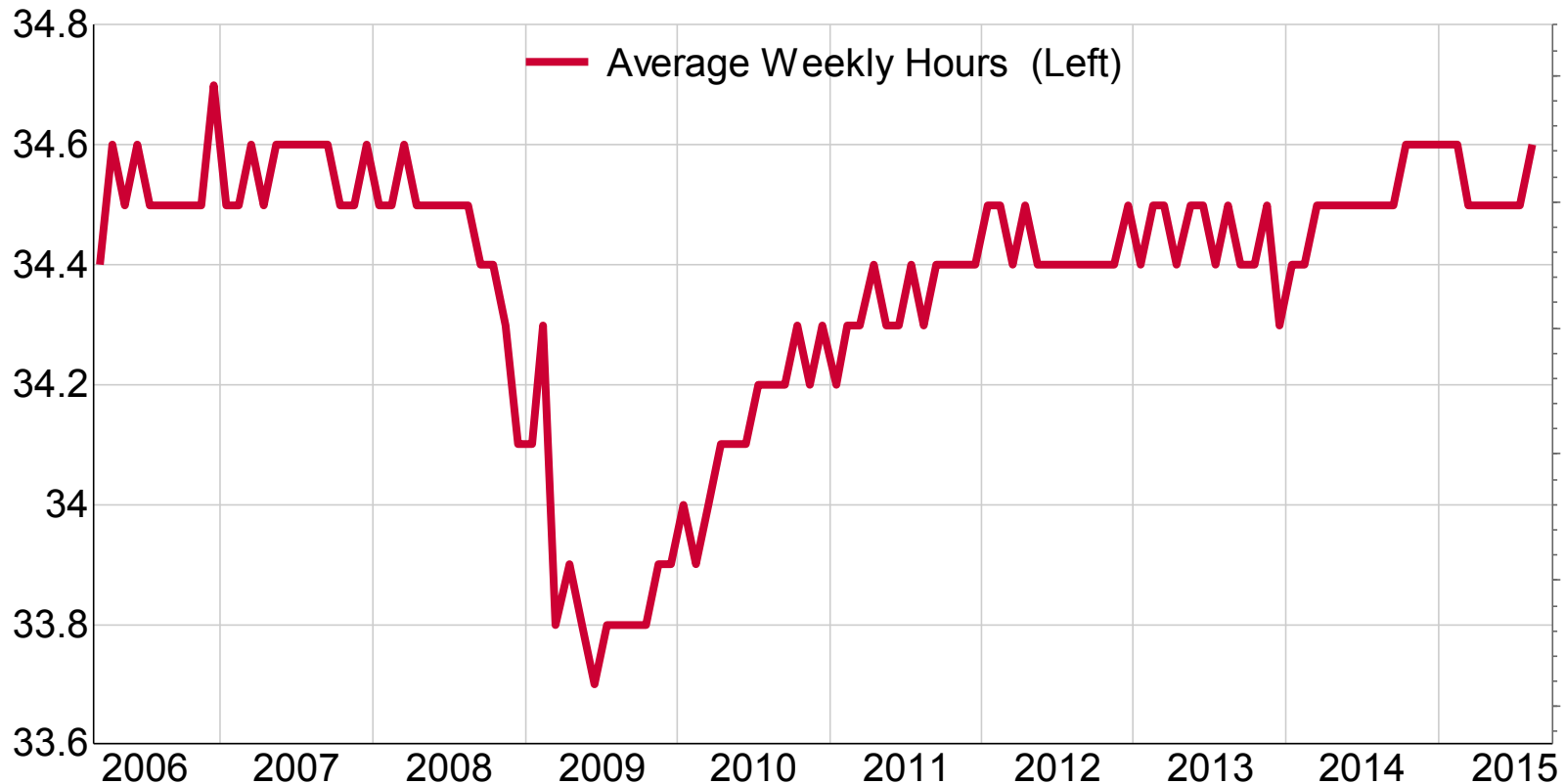
Suggesting that business conditions are still broadly improving

U.S. Initial Unemployment Claims (000)



The Work Week is Near Cycle Highs—The Demand for Labor is Strong

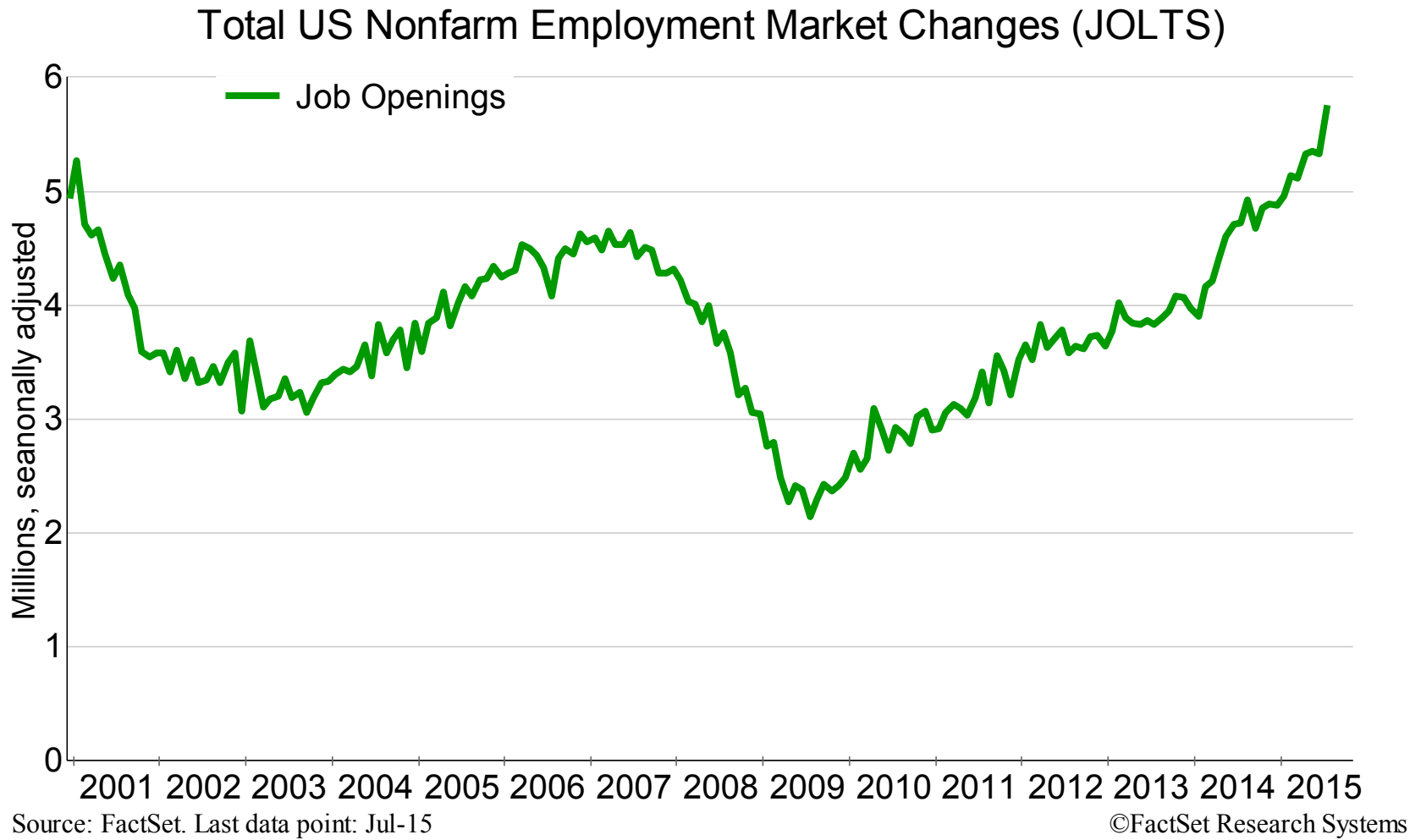
Hours Worked: All Private Sector Employees



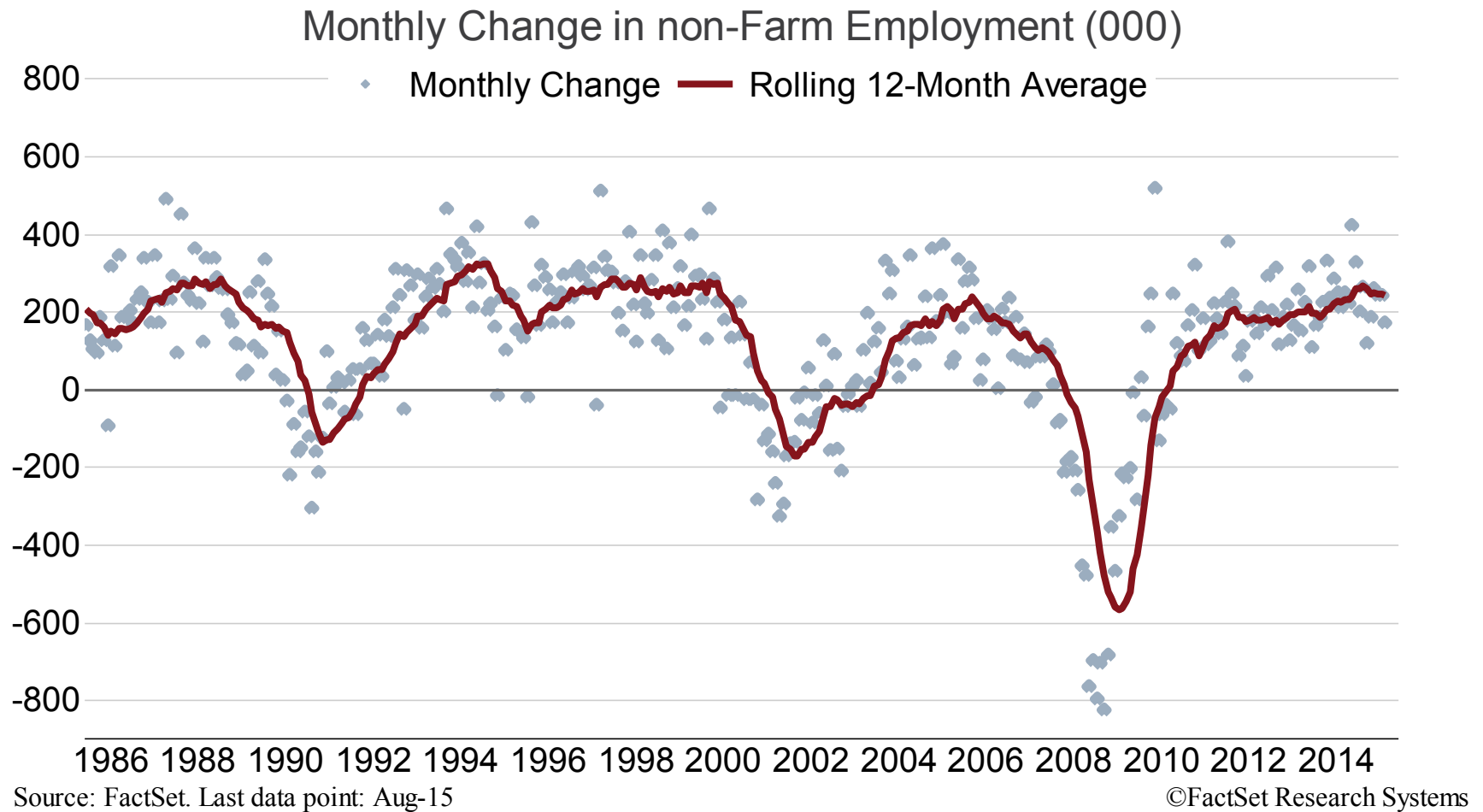
Source: FactSet. Last data point: Aug-15

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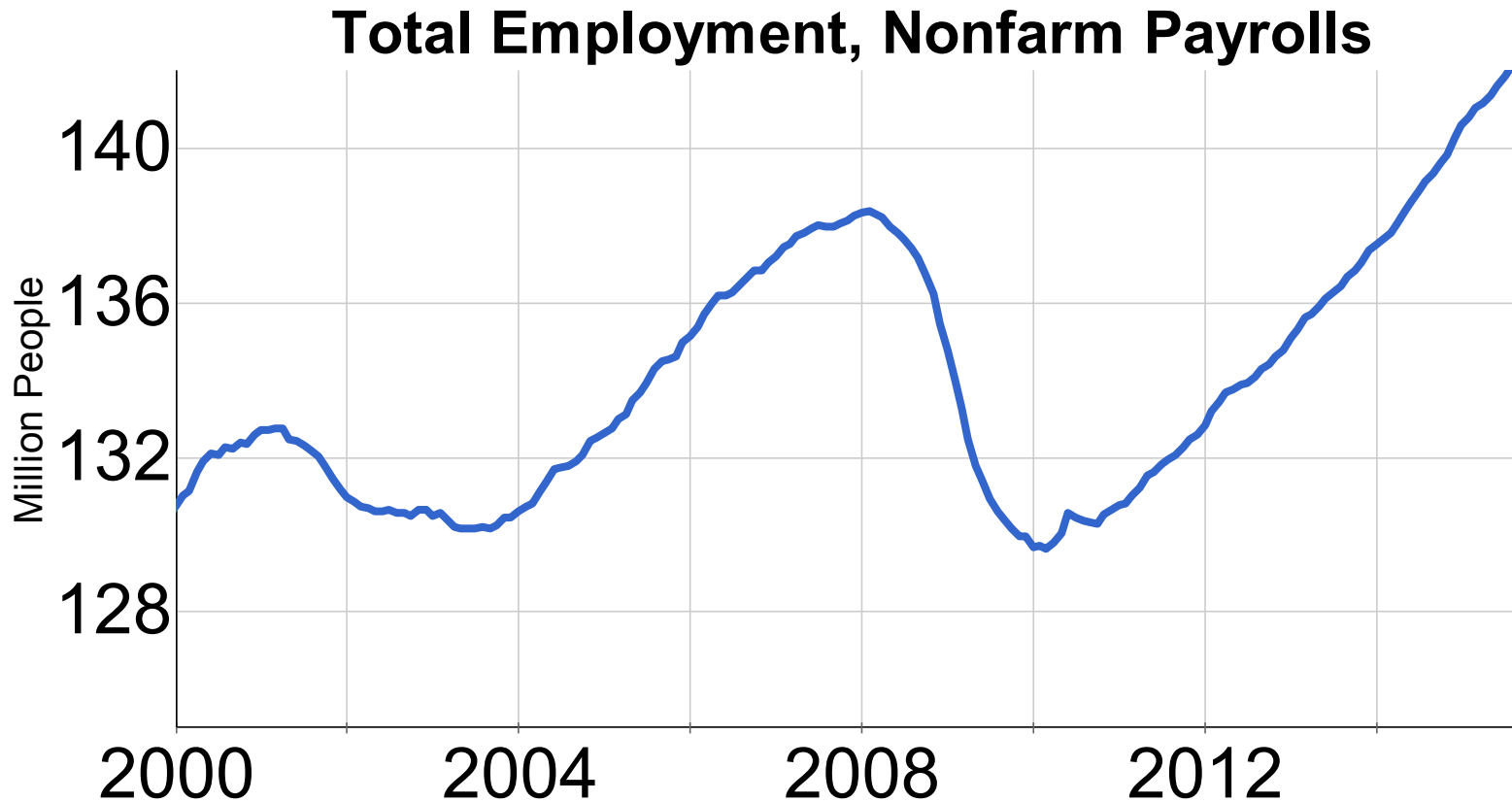
Job Openings Are at New Cycle Highs



Employment Growth Has Been Accelerating



Total Employment Has Never Been Higher



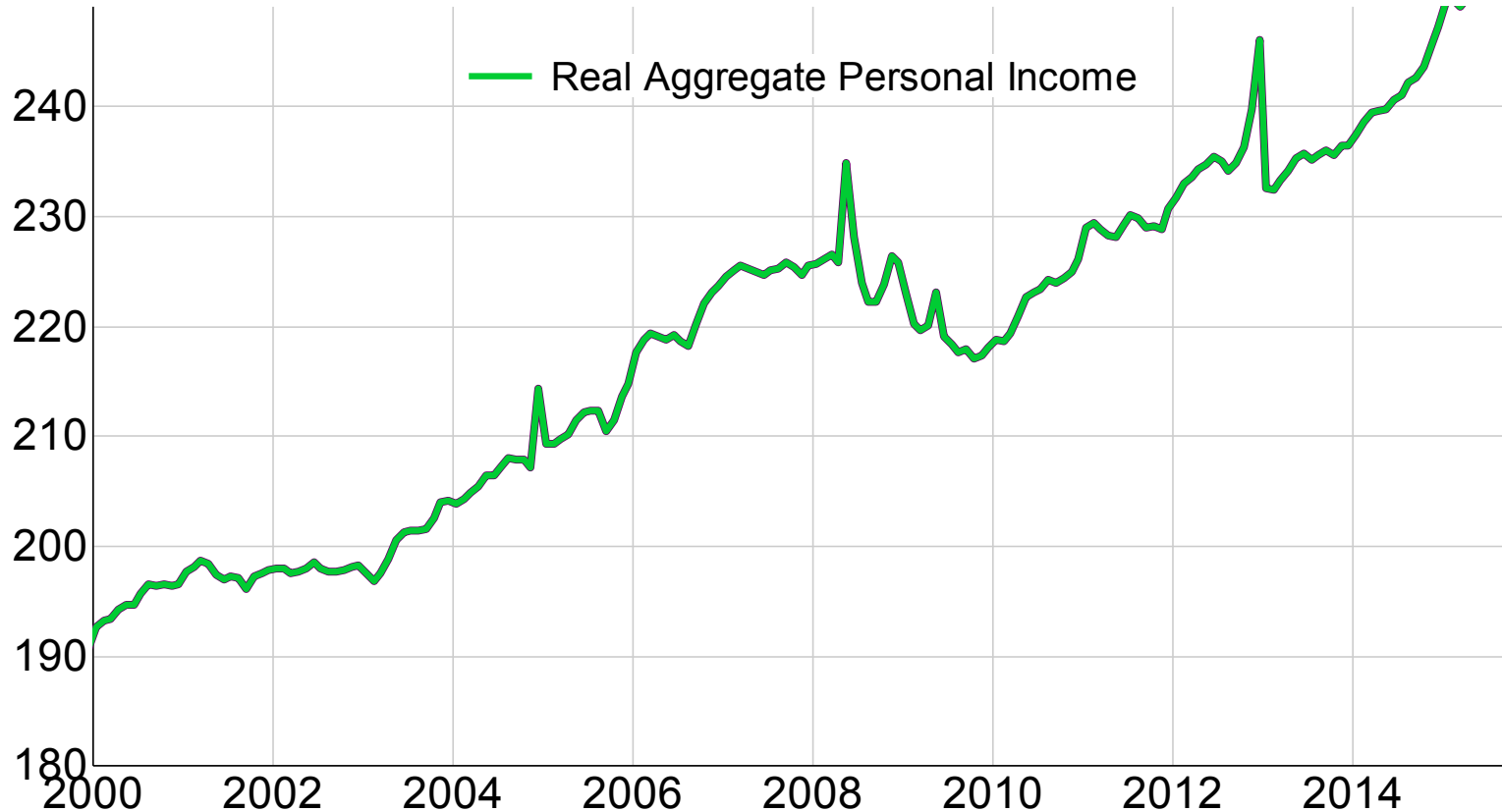
Source: FactSet. Last data point: Aug-15

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Aggregate Consumer Spending Power Has Never Been Higher

Real Personal Income

Indexed to 100 at 12/31/1975

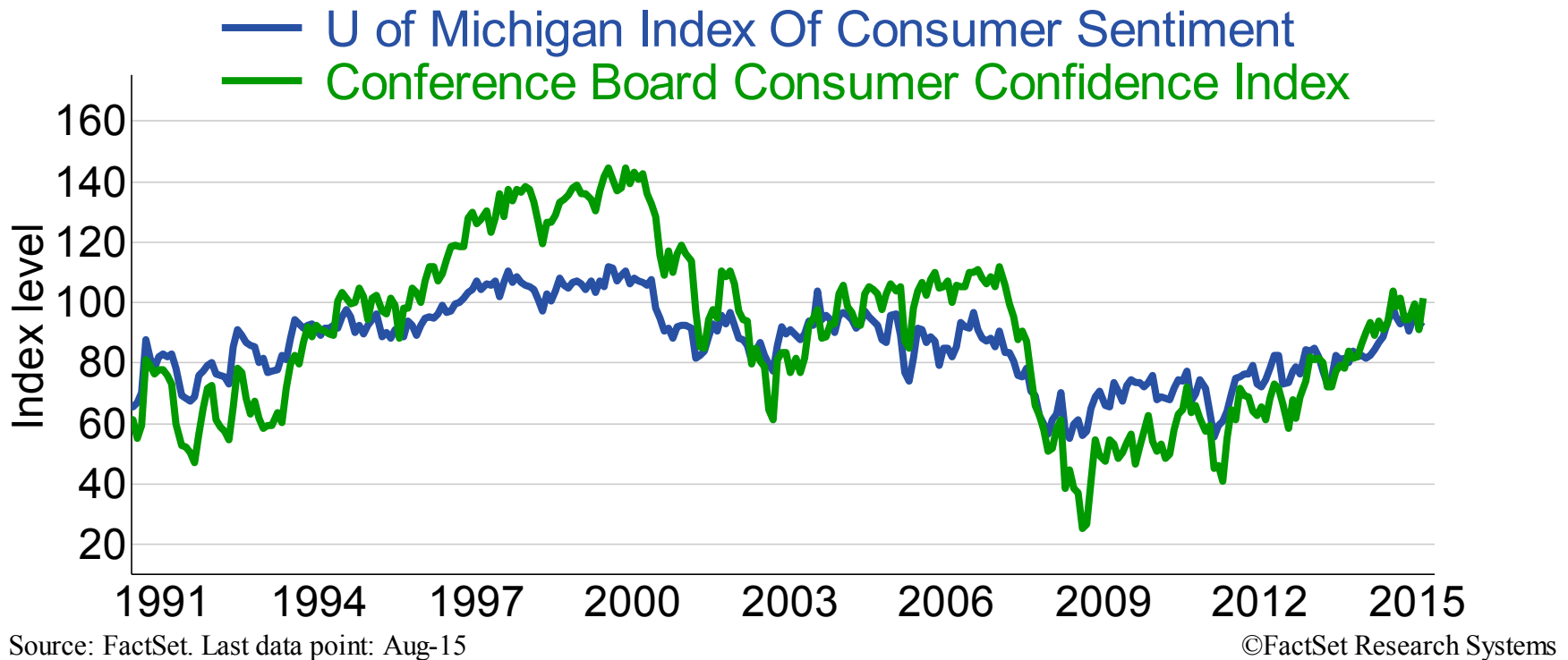


Source: FactSet. Last data point: Q3-15

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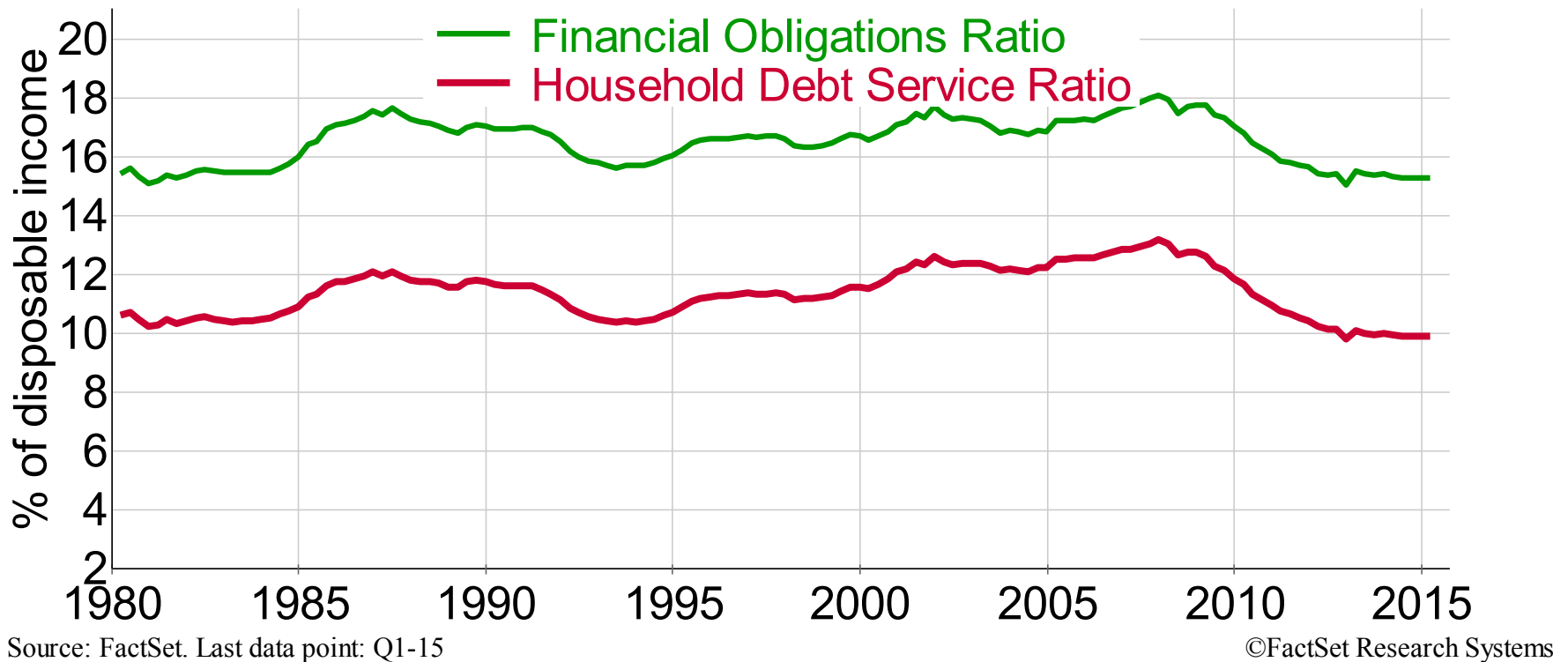
Consumer Confidence Continues to Rise

Consumer Confidence



Consumers are Able to Service Additional Debt

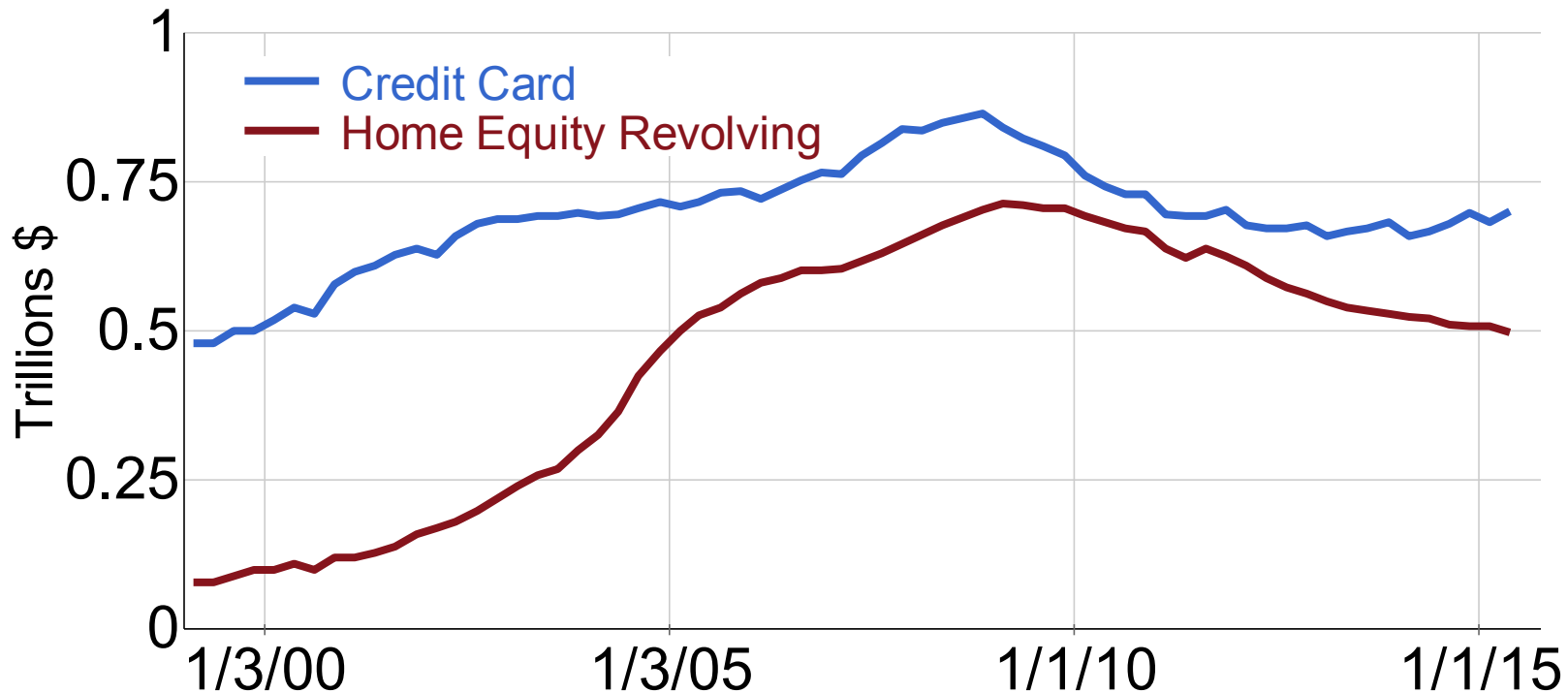
Household Debt Service and Financial Obligations Ratios



Consumers Remain Reluctant to Borrow to Fund Consumption

They have cut back their use of revolving debt

Household Credit Card and HELOC Debt



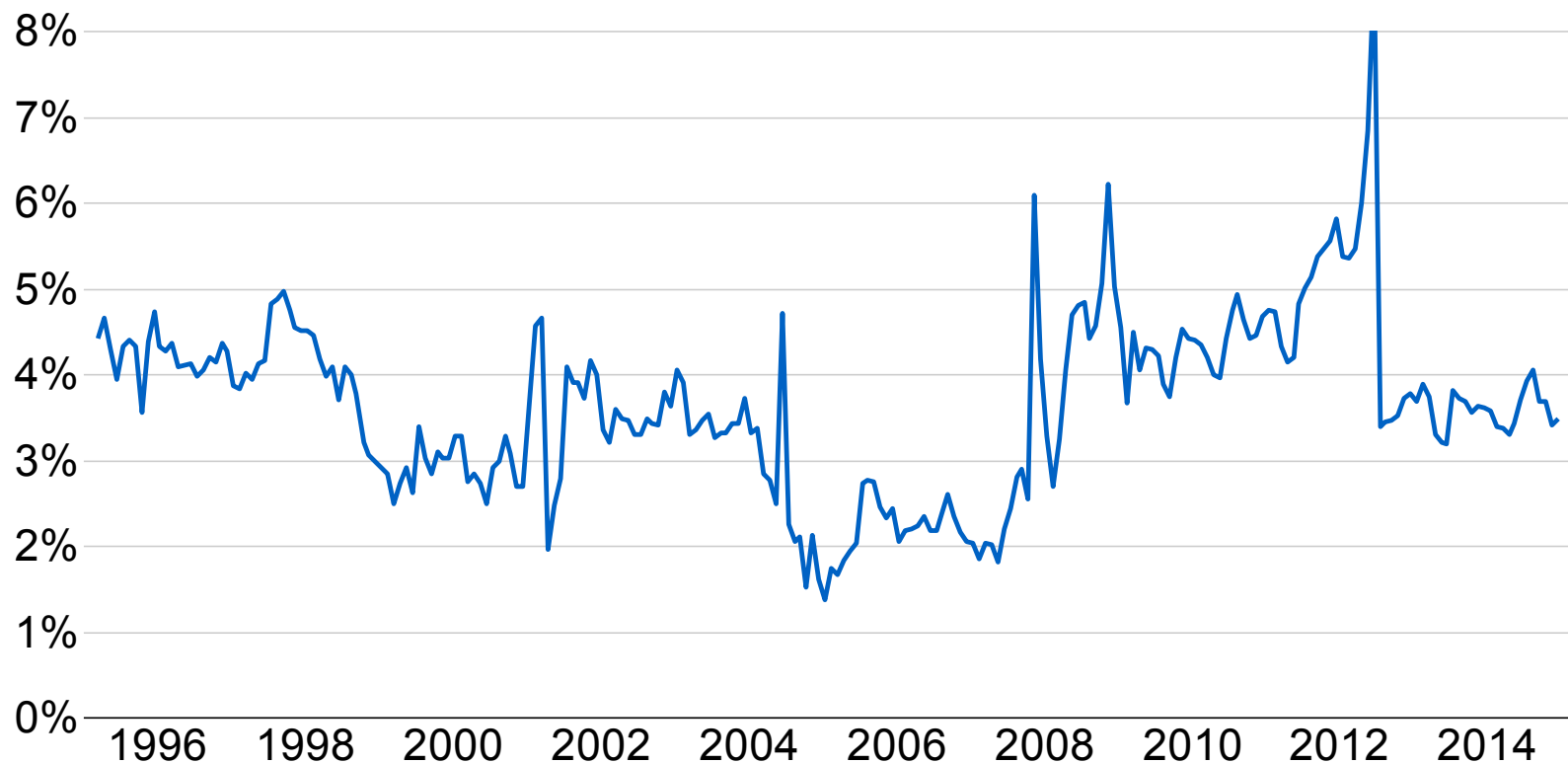
Source: FactSet. Last data point: Q2-15

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Consumers Remain Cautious, are Saving More

Higher savings reduce reported current GDP . . . But a longer-term positive

Personal Savings/GDP

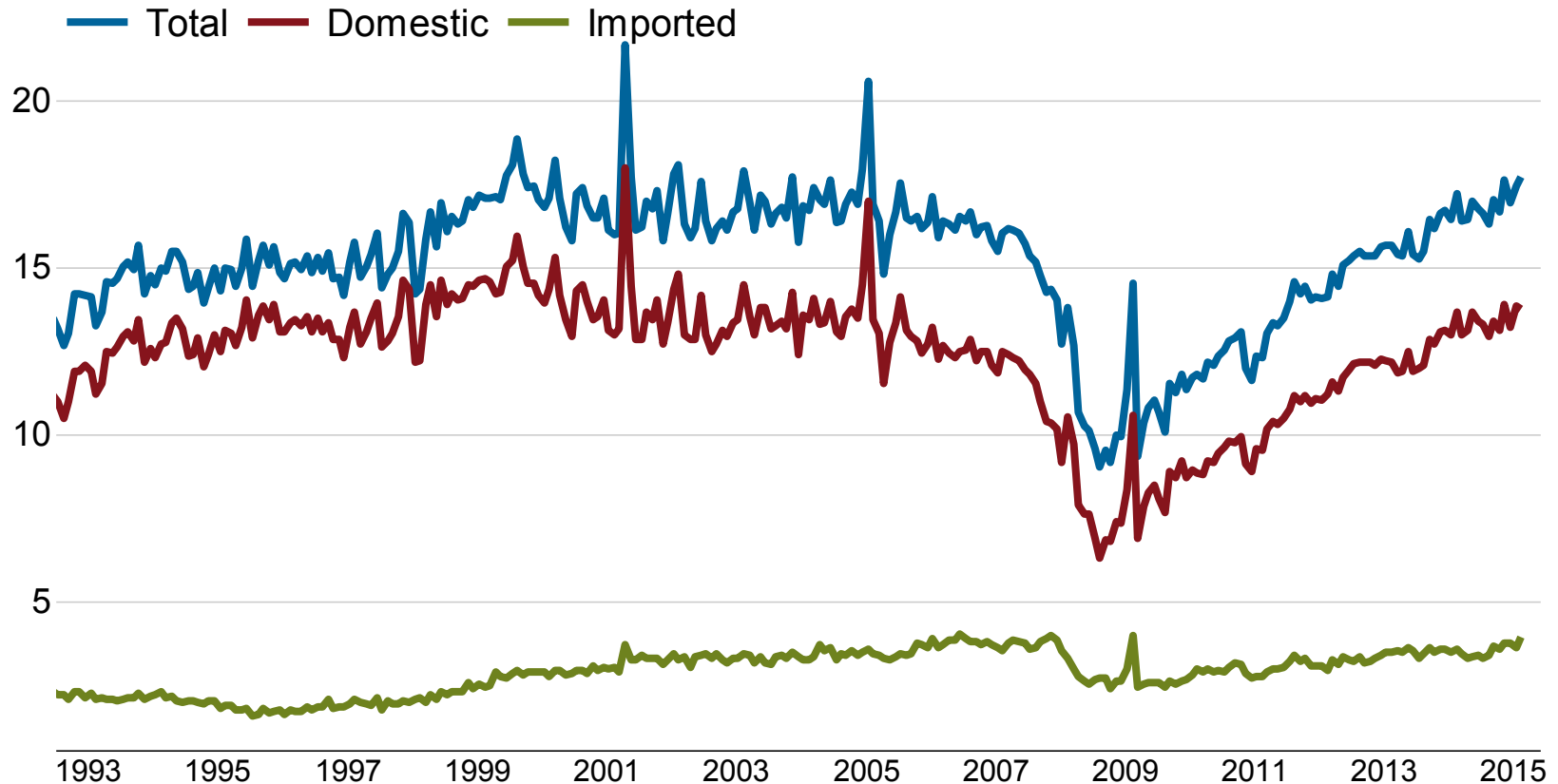


Source: FactSet. Last data point: Q3-15

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We Expect Auto Sales to Remain Strong

U.S. New Light Vehicle Sales (Millions units/year)



Source: FactSet. Last data point: Aug-15

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Lower Gasoline Prices Free Up Consumer Spending Power

U.S. Average Retail Gasoline Price



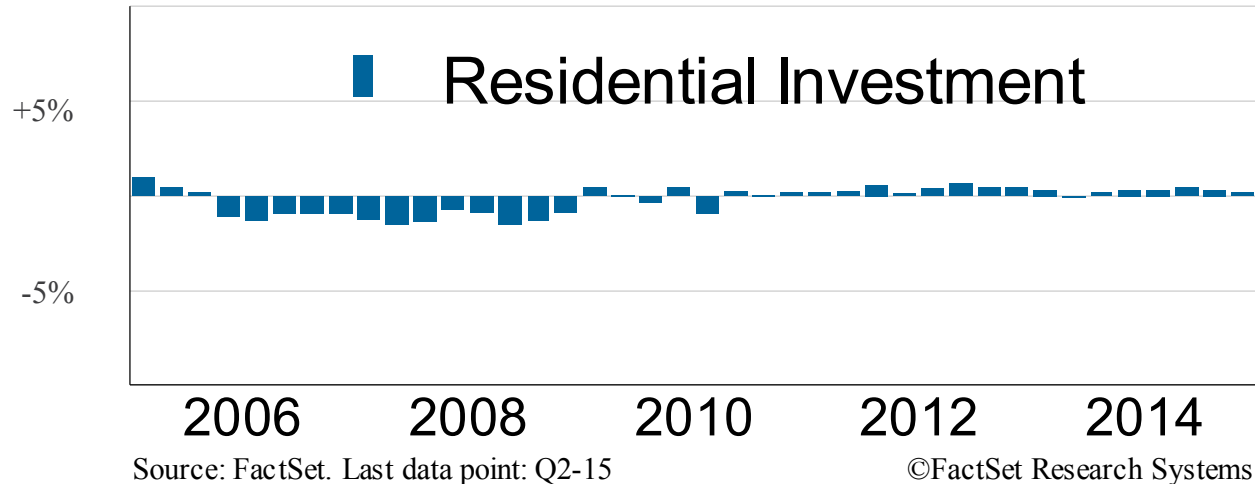
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We Expect Residential Investment To Contribute to 2015 Growth

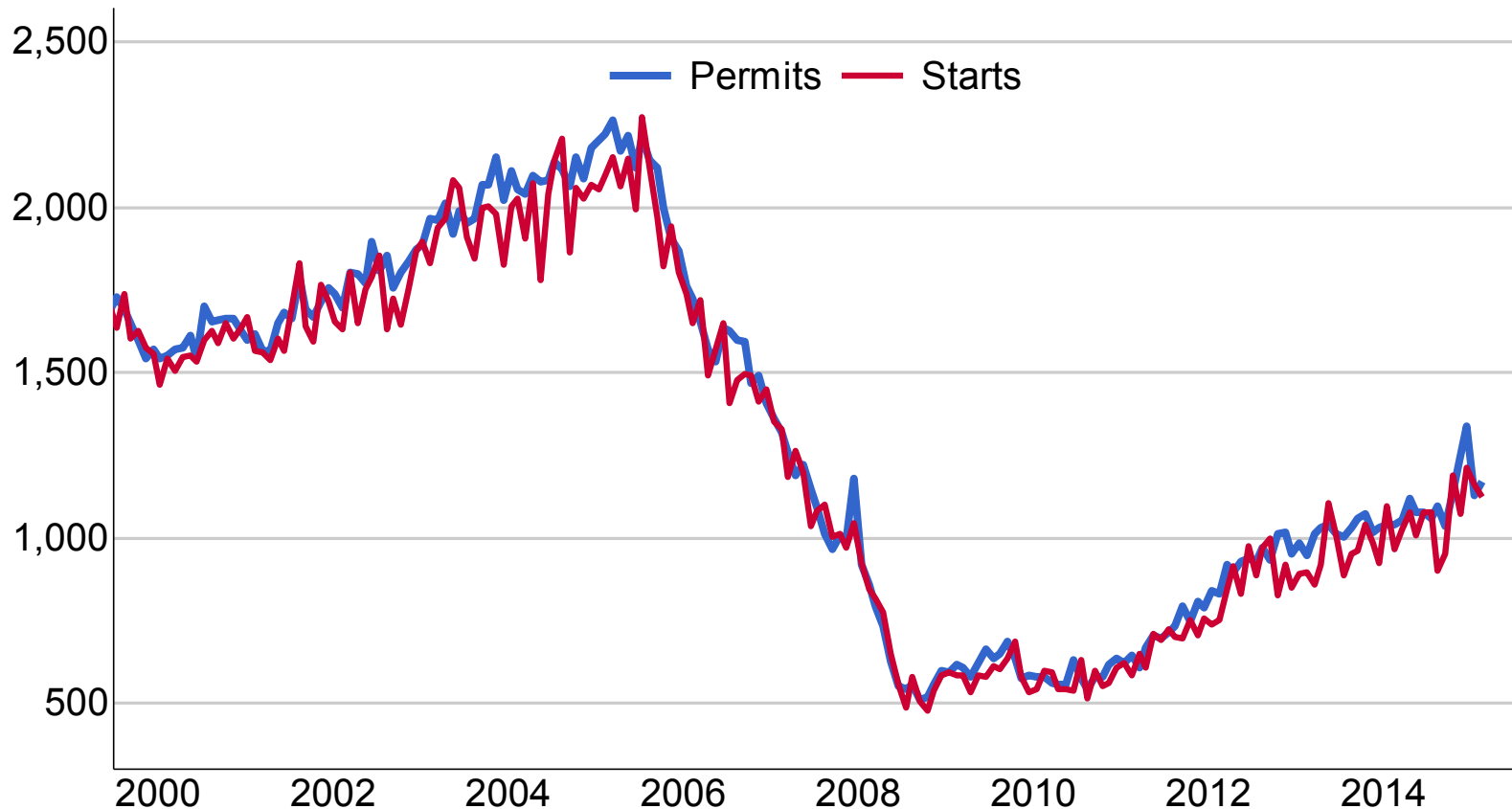
Demographics and affordability are supportive

- Residential investment leveled off last year, not materially contributing to economic growth.
- We expect a somewhat faster pace of homebuilding in 2015, along with more remodeling spending.



We Expect Residential Investment (Homebuilding) to Increase

U.S. Monthly Housing Permits and Starts (000)

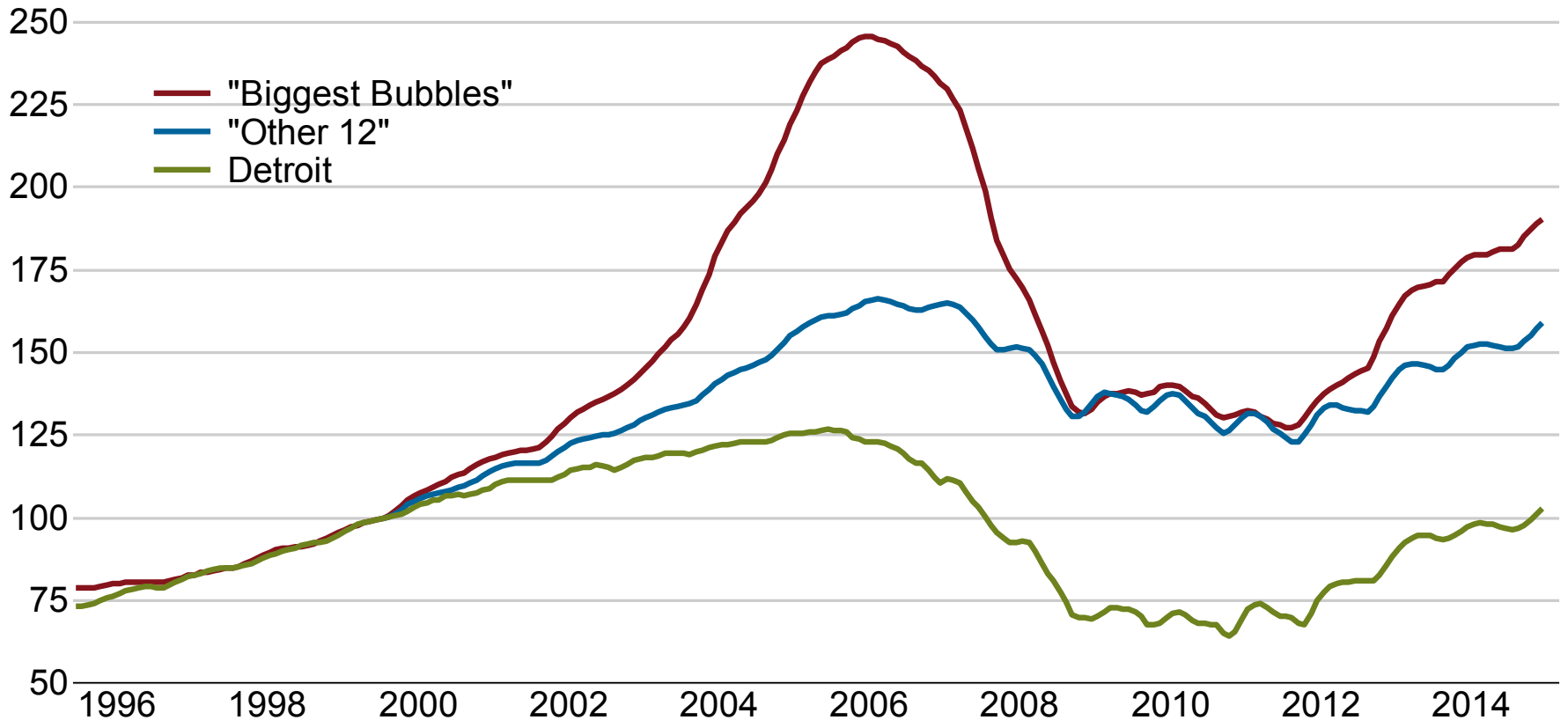


Source: FactSet. Last data point: Aug-15

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Home Prices Appreciation Continues, But Has Been Slowing

Case-Shiller Home Price Index - Three Subsets
(Indexed to 12/31/1999)



Source: FactSet. Last data point: Jun-15

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The Trade Deficit is Subject to Conflicting Forces

We expect the overall impact on 2015 GDP growth to be limited



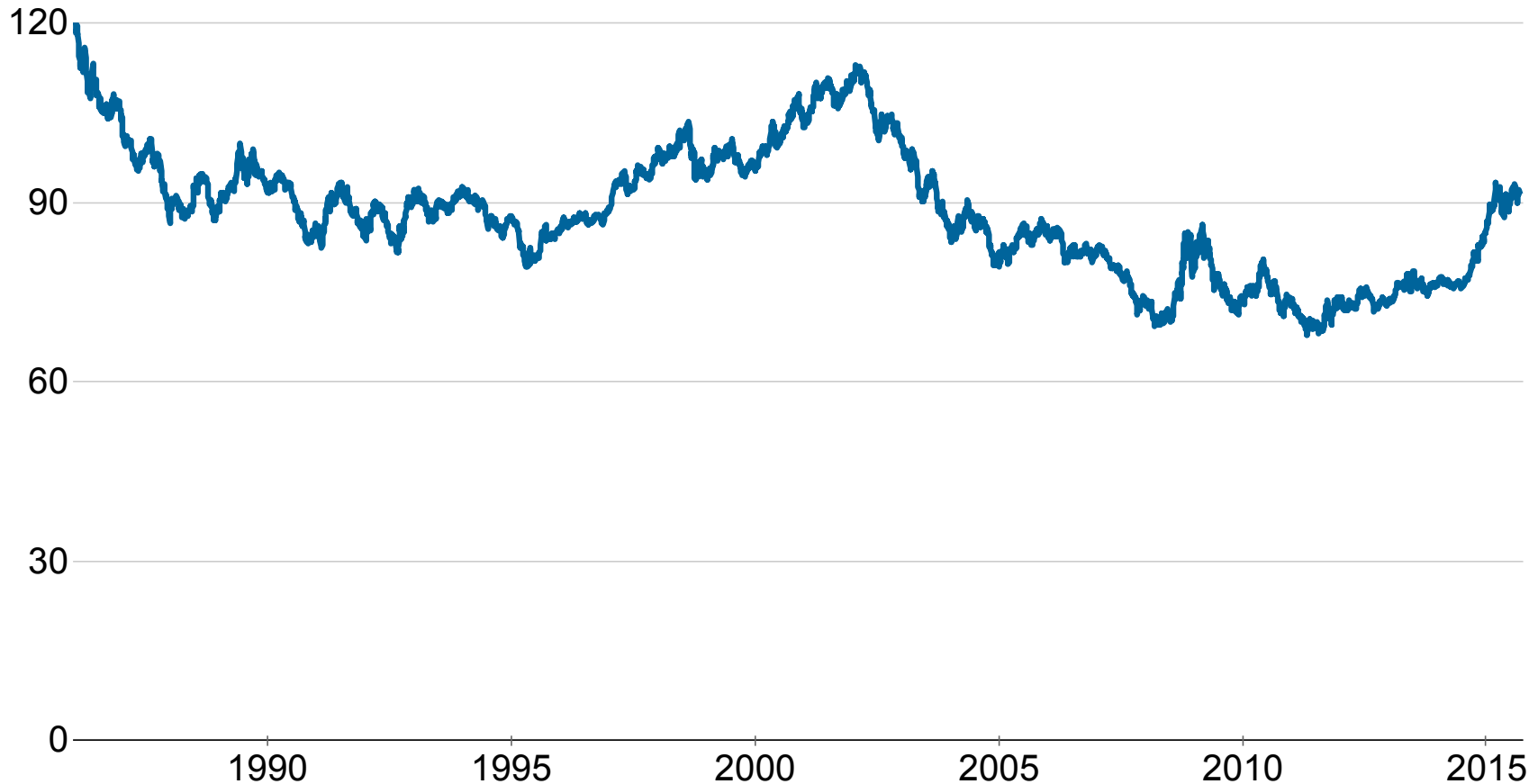
Source: FactSet. Last data point: Q2-15

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- The stronger dollar is expected to, in the short run, cause domestic employers to lose market share to foreign competitors, slowing U.S. growth.
- Rising domestic oil production is dramatically reducing the energy trade deficit.
- The West Coast port slowdowns may be distorting the data.

Despite Recent Appreciation, the U.S. Dollar is not “Too High” for the U.S. Economy

Trade-Weighted Value of the U.S. Dollar



Source: FactSet. Last data point: 11-SEP-15

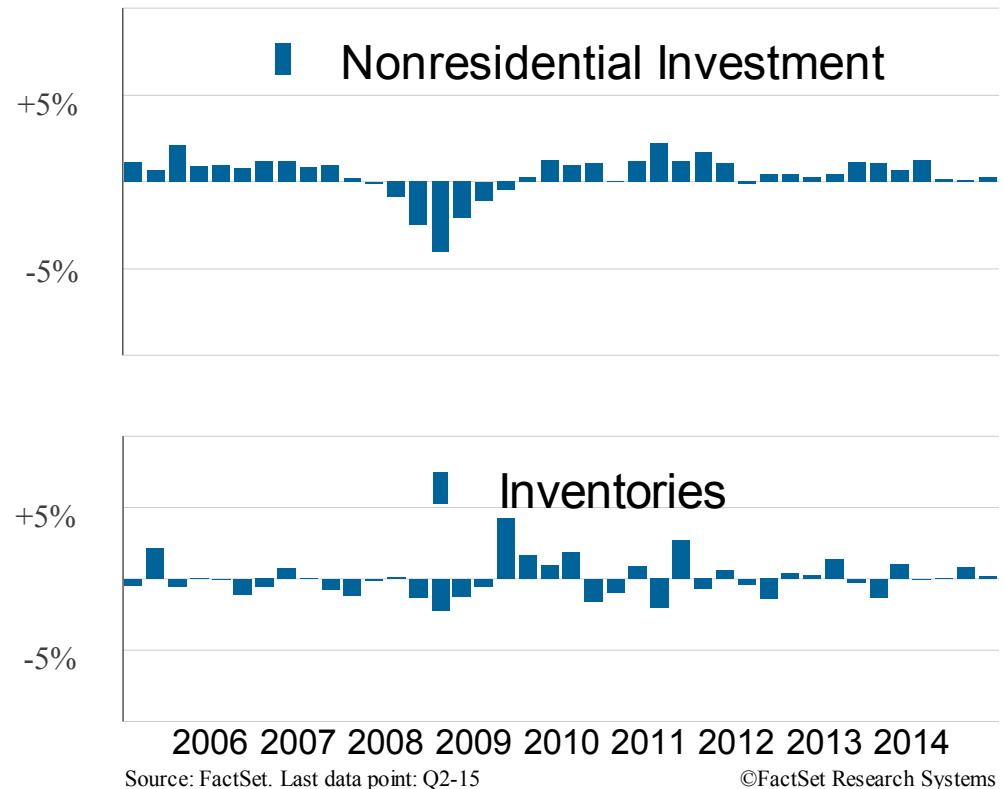
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There is no guarantee that forecasts discussed will be realized.

Business Capital Spending is Likely to be a Modest Contributor

Demand is not strong enough justify expansion

- Business capital spending has been restrained, held down by risk aversion and low capacity utilization.
- Inventories are mean-reverting over time...in the short run, the recent build-up of inventories is a concern.



Capacity Utilization Remains Below 80%

Below levels which typically spark a rise in capital spending

U.S Capacity Utilization

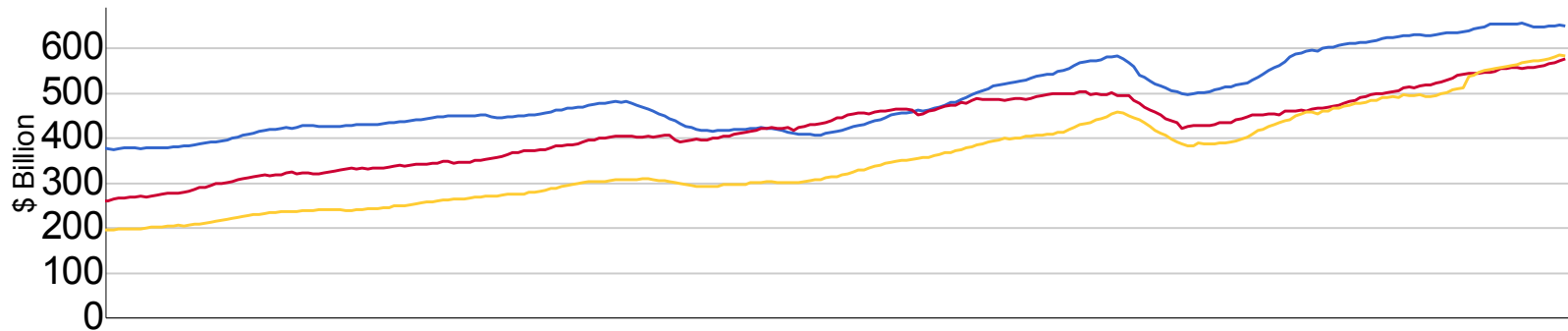


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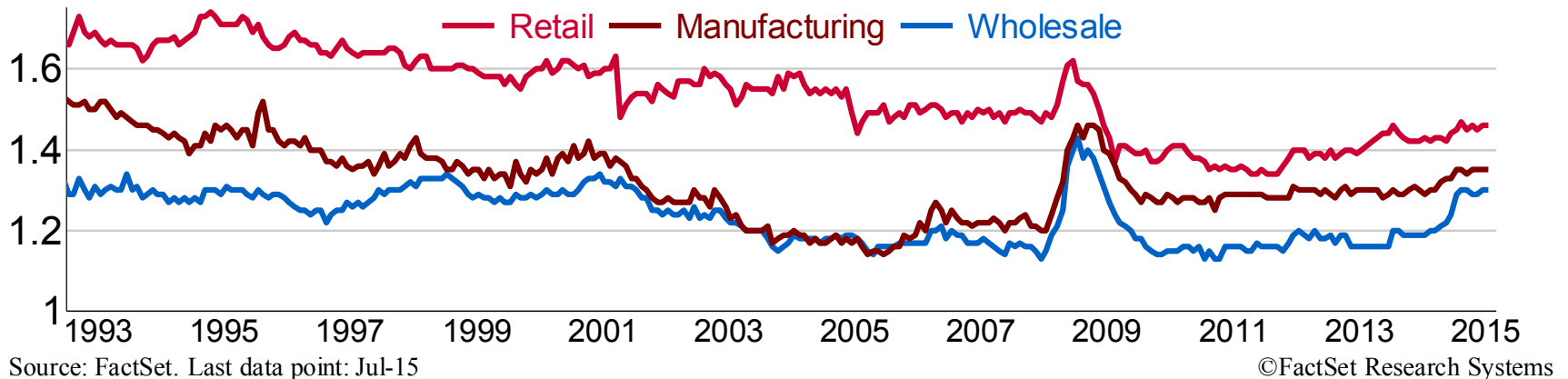
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Inventory/Sales Ratios Are Sounding a Warning Signal

Inventories



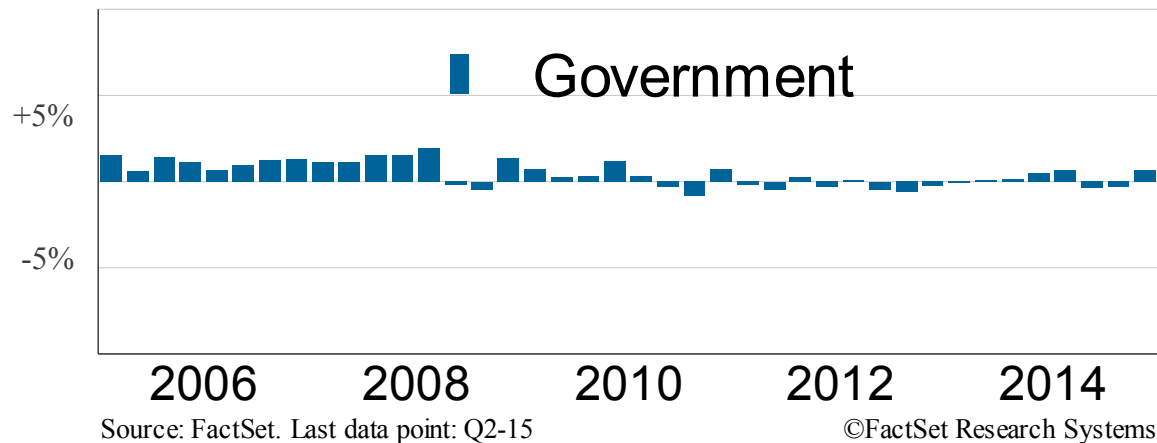
Inventory/Sales Ratio



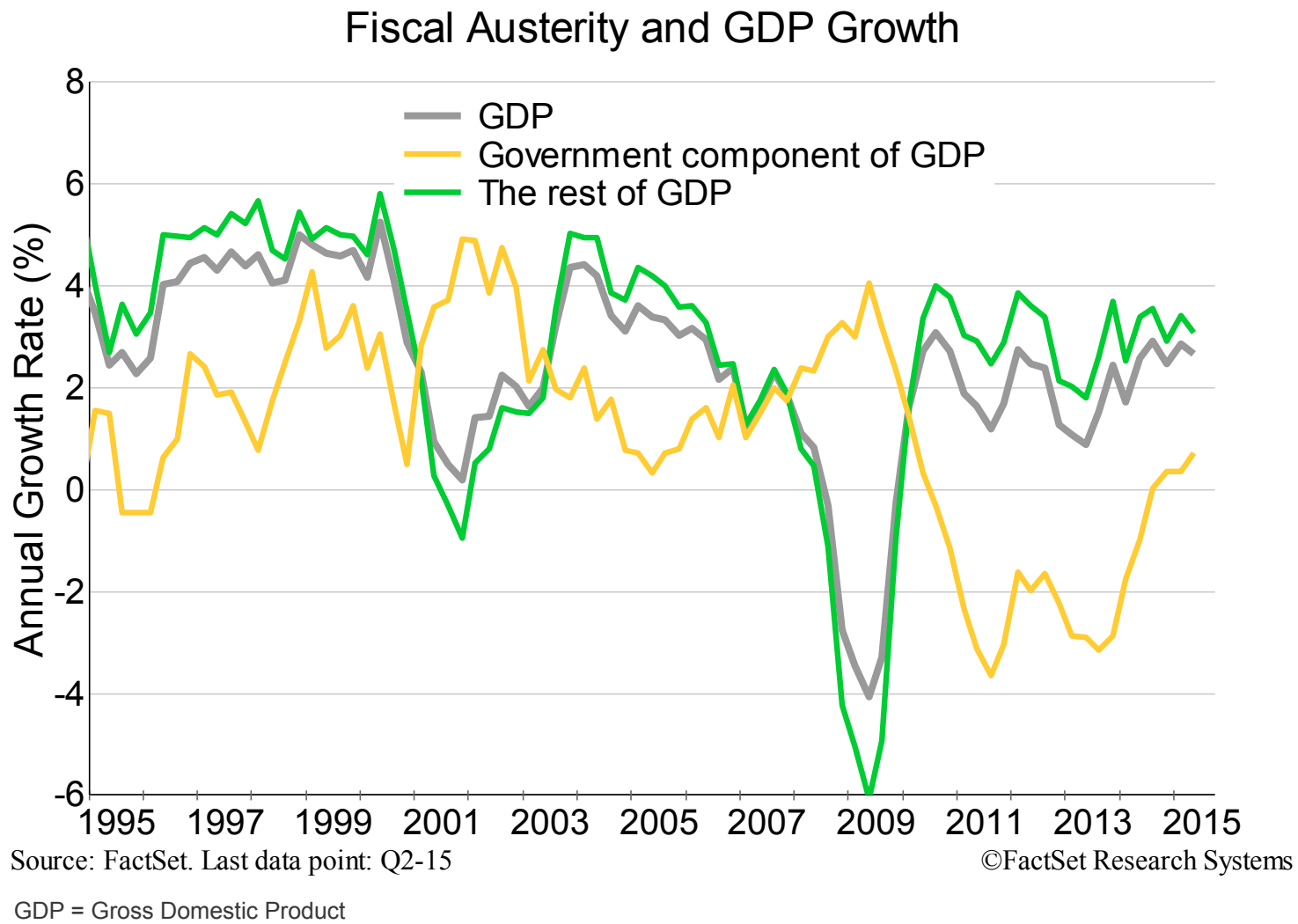
Fiscal Policy is Expected to Contribute to 2015 Growth

Austerity is not the watchword in 2015-2016.

- The sequesters and debt ceiling will be worked around...
- There are big open questions (e.g. ACA) and long term problems (e.g. Medicare), but the near-term trajectory is GDP-supportive.



The Drag from Fiscal Austerity is Gone



We Expect Solid U.S. Economic Growth in 2015

Recession risks appear low unless there is an external shock

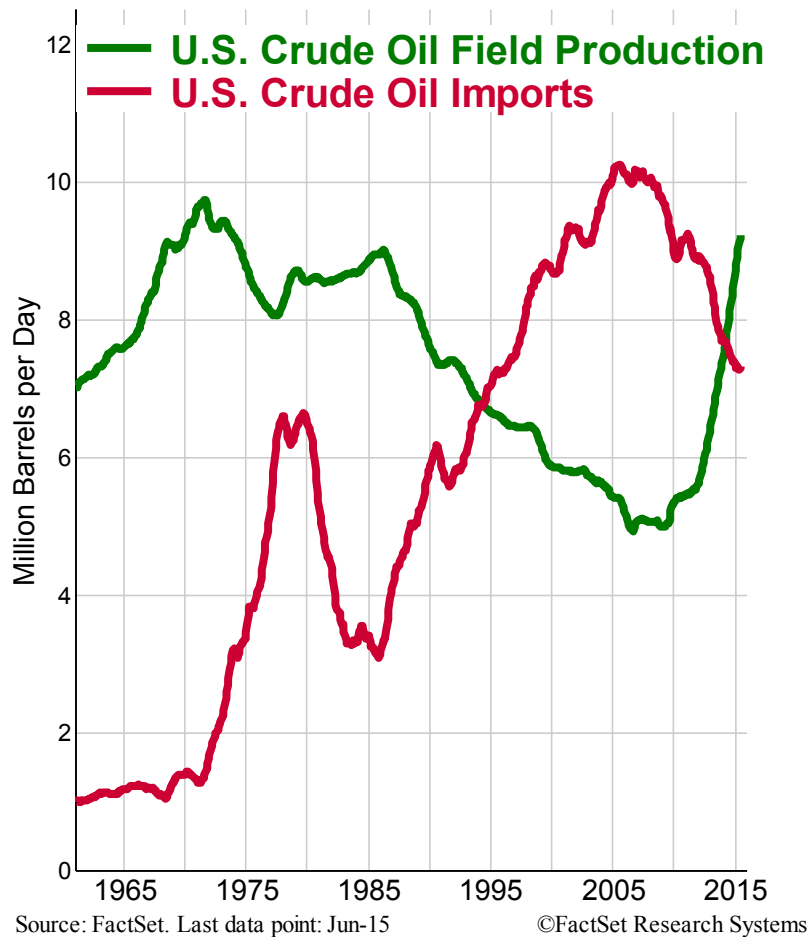
- Employment is rising...so are job openings...layoffs are falling.
- Consumer spending power is rising...consumer debt is low.
- Homebuilding and business capital spending are expected to be incrementally positive for growth.
- Fiscal policy is shifting from austerity to expansionary.
- While manufacturing is showing softness, it is only 13% of U.S. GDP.
- The strong dollar and weak growth in other countries is a headwind to growth but is unlikely to cause a U.S. recession.
- Falling energy prices are more a tailwind than headwind for the U.S. economy.

On Balance, Lower Oil Prices are a Positive for the U.S. Economy

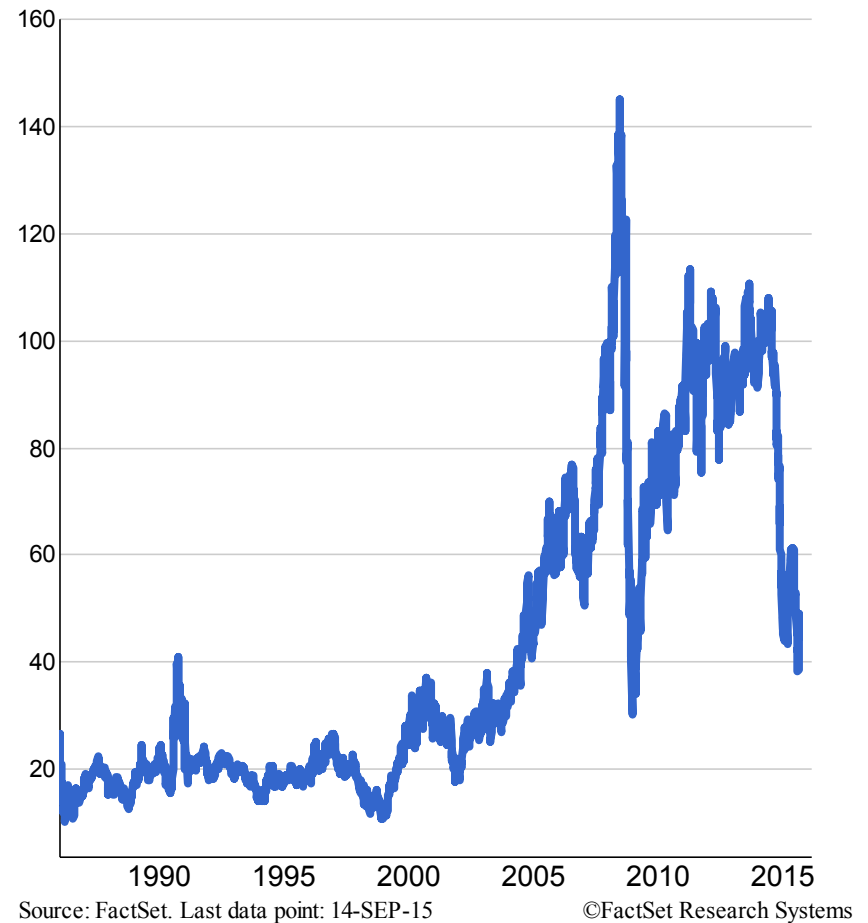
- Lower oil prices have a larger impact on corporate profits than on the real economy.
- Employment in drilling is very small relative to the size of the economy.
- Lower energy costs reduce costs for most businesses.
- Lower energy costs free up consumer spending power to purchase other goods and services.

Oil Prices Have Collapsed as Production has Outrun Demand

U.S. Crude Oil Production and Imports

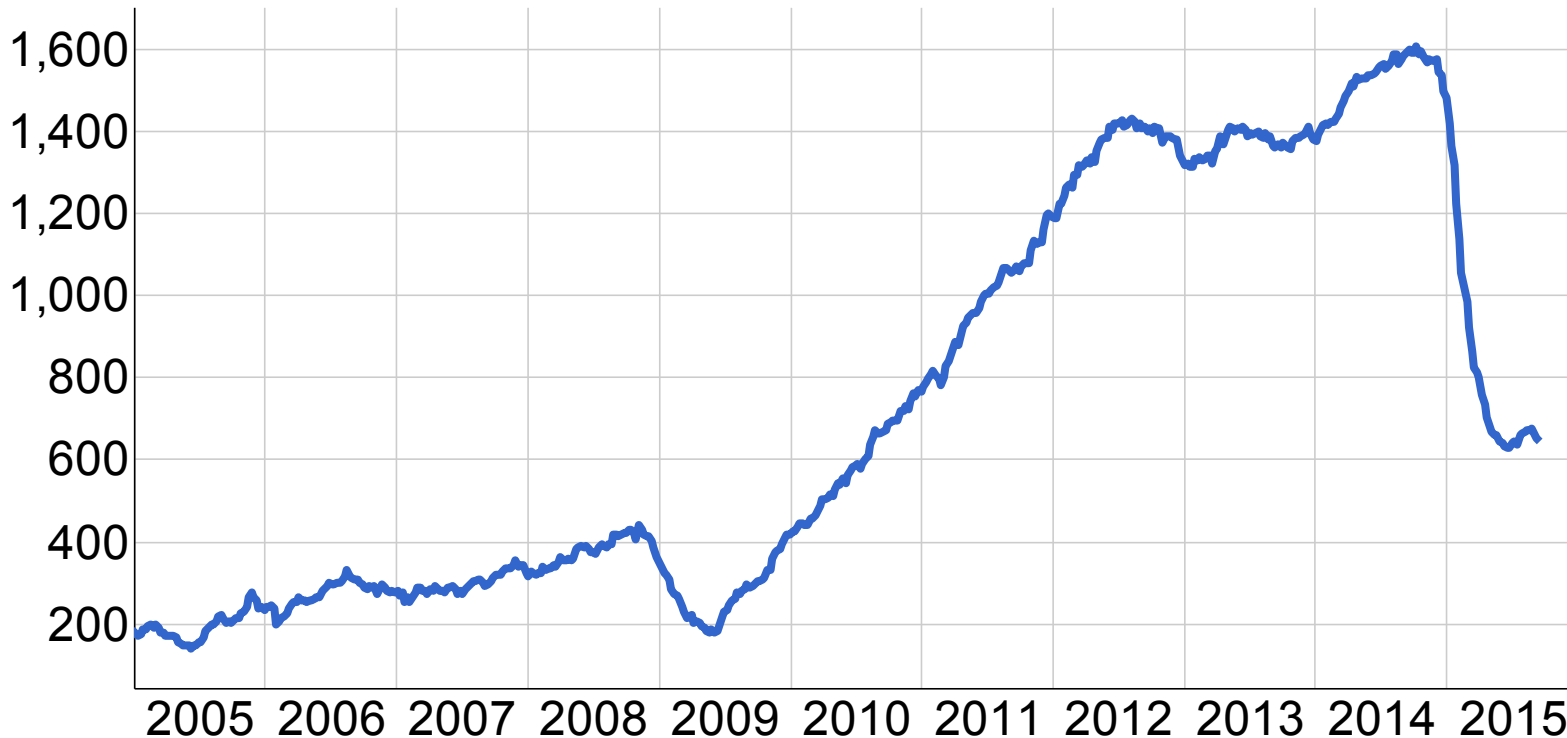


WTI Oil



The U.S. Rig Count Has Declined Rapidly

Baker-Hughes US Oil Rotary Rig Count

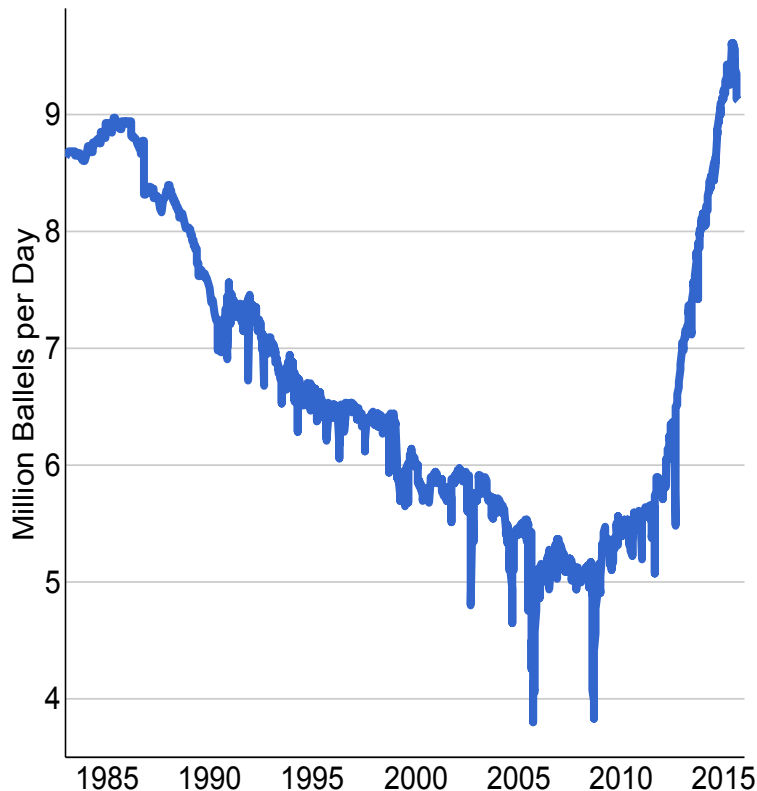


Source: FactSet. Last data point: 18-SEP-15

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...But Production and Inventory Growth Have Not Yet Reversed

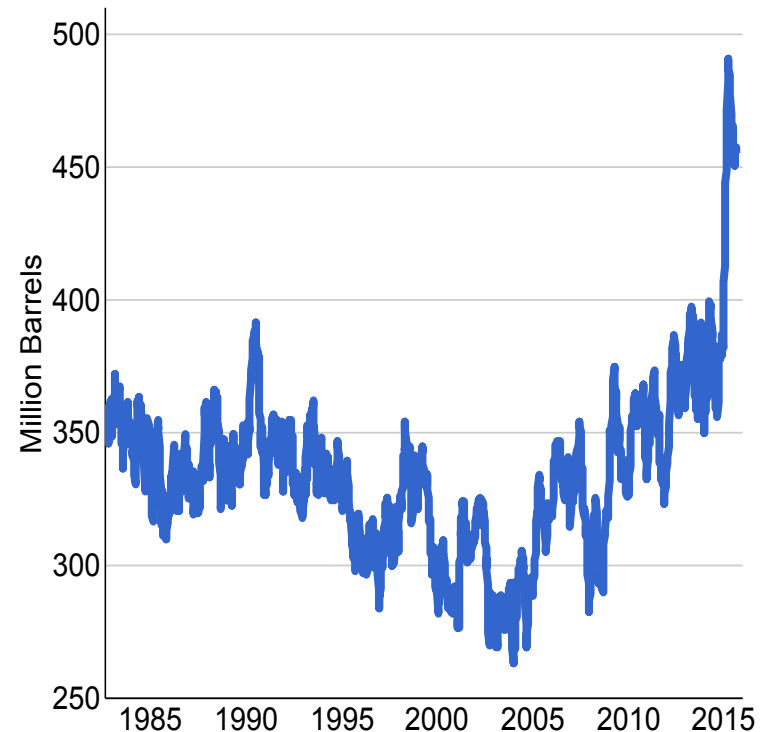
U.S. Crude Oil Production



Source: FactSet. Last data point: 11-SEP-15

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U.S. Crude Oil Inventories (excluding SPDR)

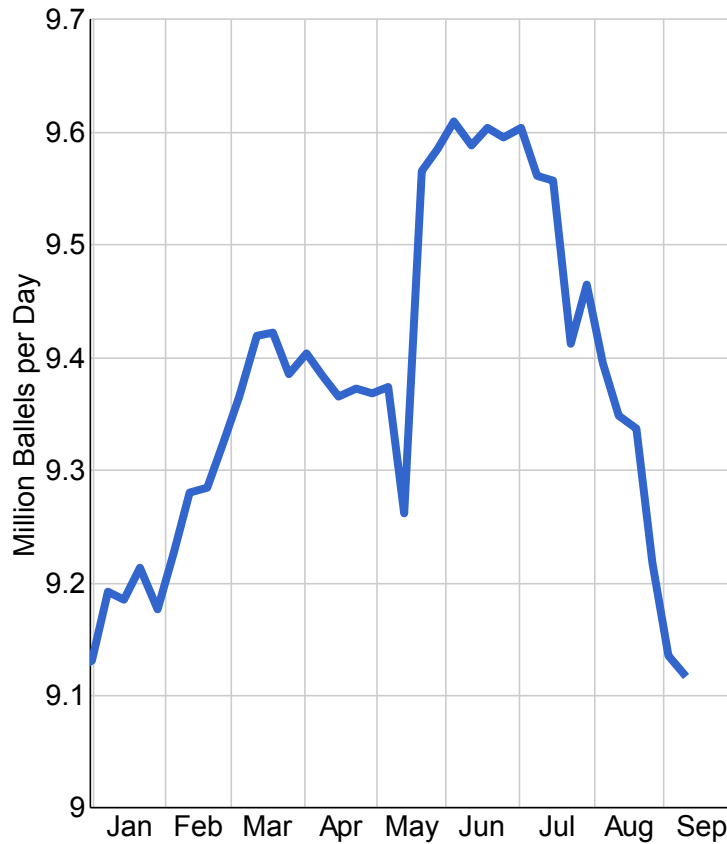


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A Closer Look at Production and Inventory Levels in 2015

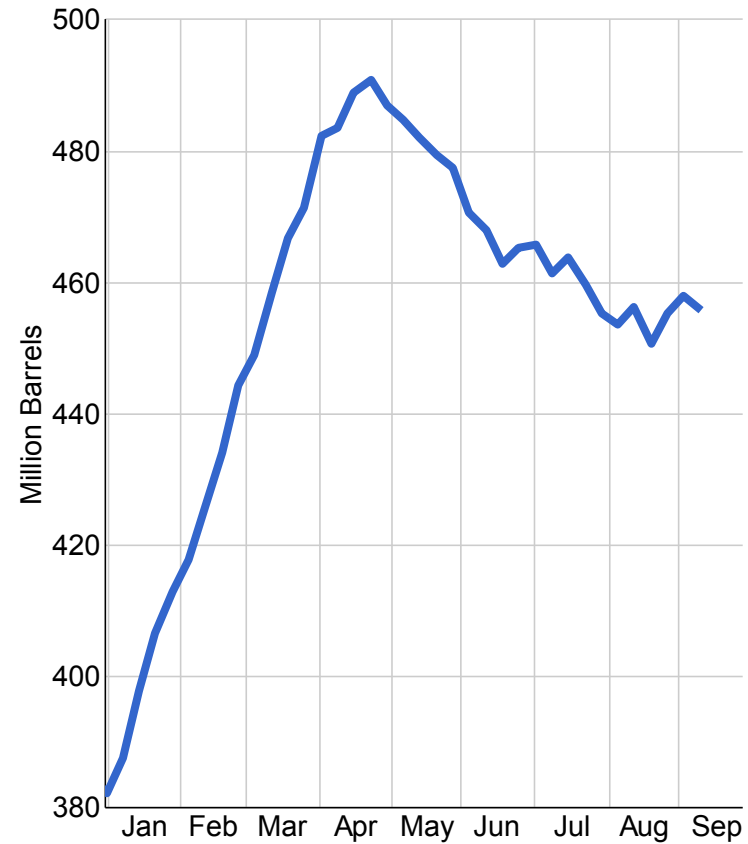
U.S. Crude Oil Production



Source: FactSet. Last data point: 11-SEP-15

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U.S. Crude Oil Inventories

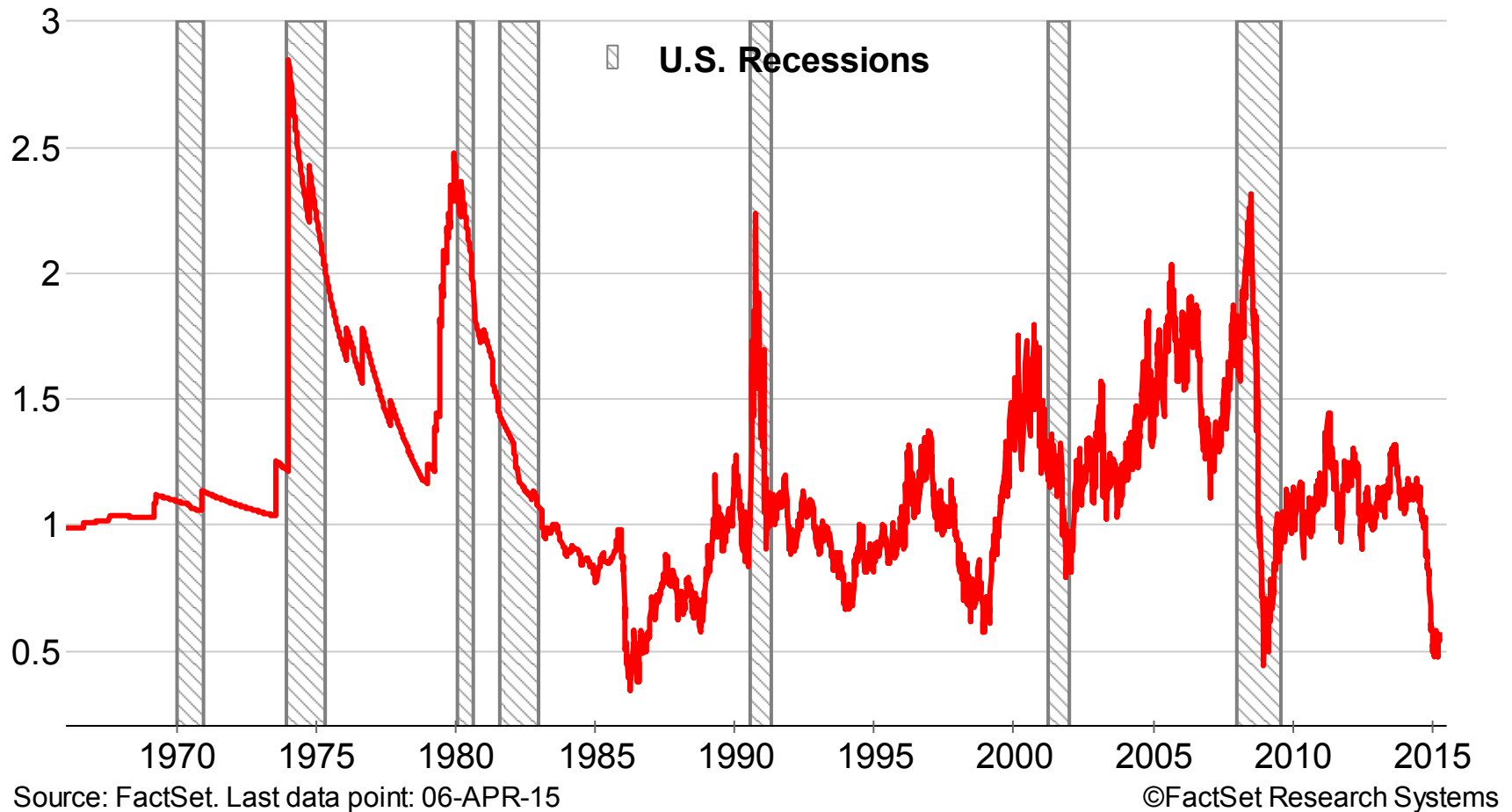


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Sudden Increases in Oil Prices Cause Recessions...Declines Don't

Oil (WTI) divided by Trailing 5-Year Average

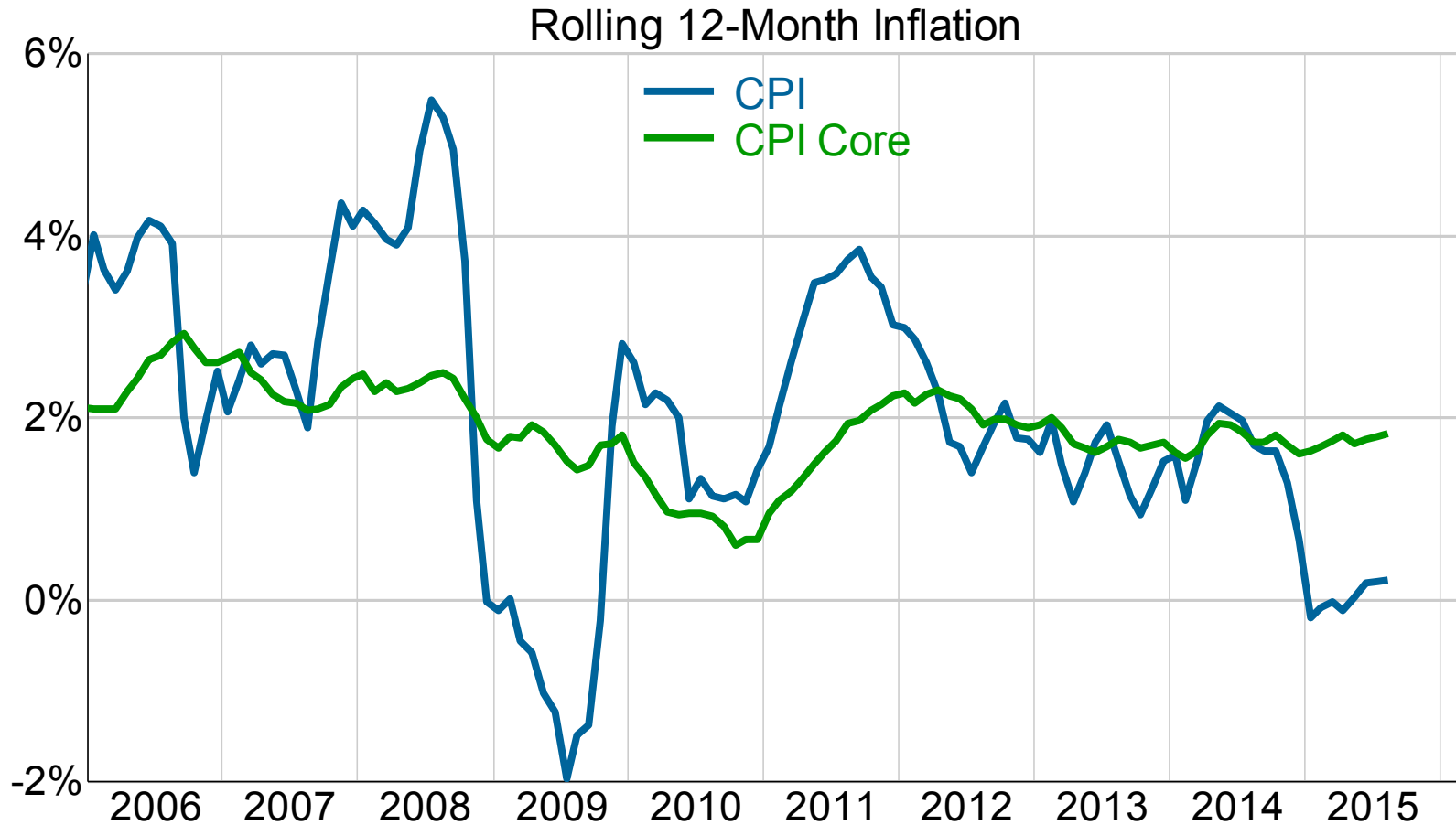


Inflation is Low...but Cyclical

- Lower oil prices have a large, but transient, negative impact on headline inflation.
- A rising dollar reduces inflation.
- Shelter costs rise with rents, interest rates, and home prices.
- Labor is the largest cost for many businesses. As the economy approaches full employment, rising labor costs (the classic wage-price spiral) should put upward pressure on core inflation.

Headline Inflation has Been Pulled Down by Energy Prices

Core CPI Remains Close To But Below 2%



Source: FactSet. Last data point: Aug-15

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How Long Can the Expansion Last?

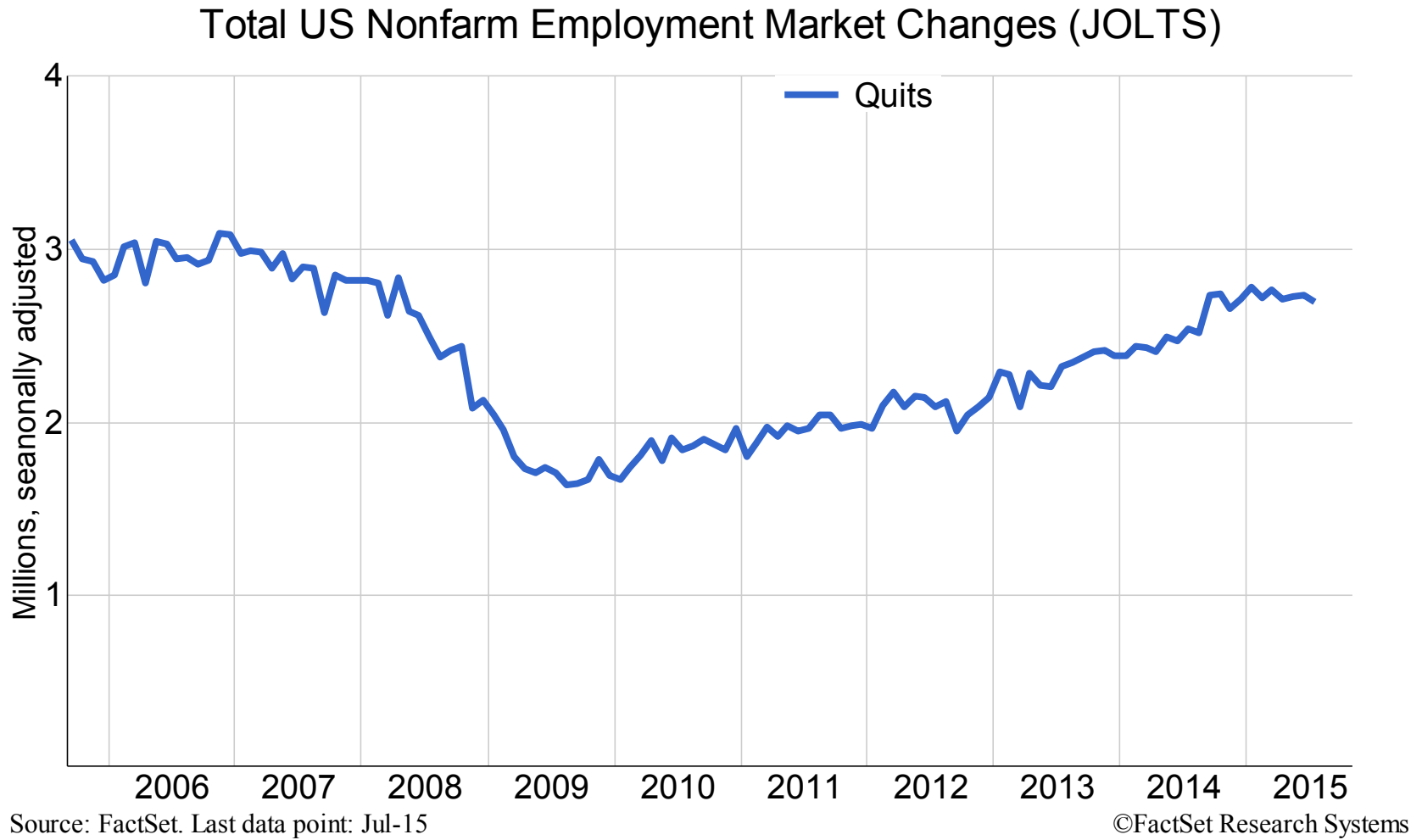
What is Full Employment? When Will We Get There?

U.S. Unemployment Rate



Source: FactSet. Last data point: Jun-2014.

A Rising Quit Rate Suggests Diminishing Labor Market Slack

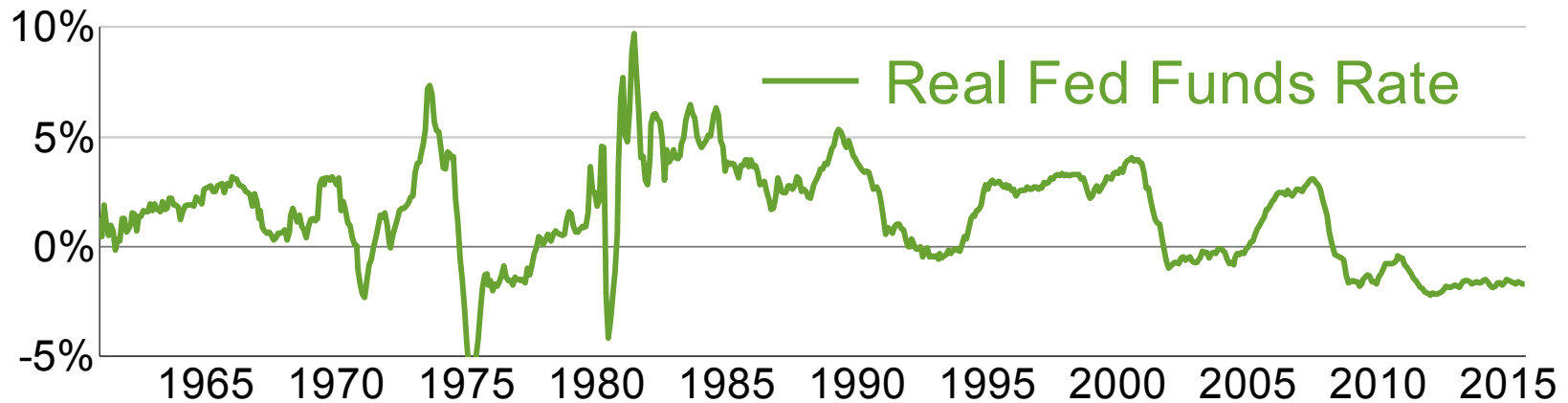
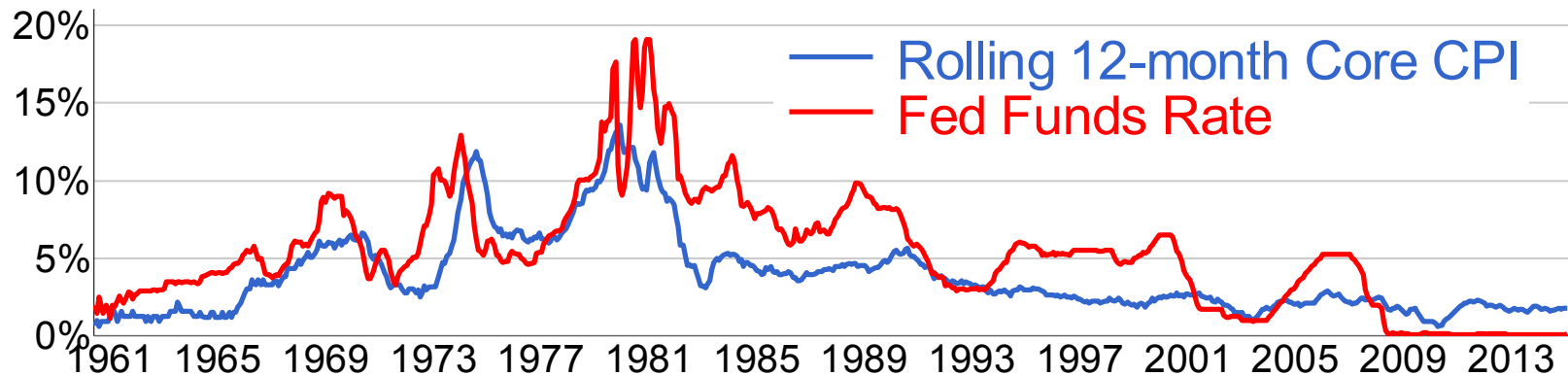


Monetary Policy Outlook

- U.S. interest rates, in both nominal and inflation-adjusted terms remain very low.
- The U.S. Federal Reserve has removed some policy accommodation (QE), but has not yet started to normalize interest rates.
 - We expect the Fed to begin raising short-term rates this year.
- The European Central Bank and Bank of Japan are actively pursuing balance sheet expansion (QE)

U.S. Monetary Policy Remains Very Accommodative

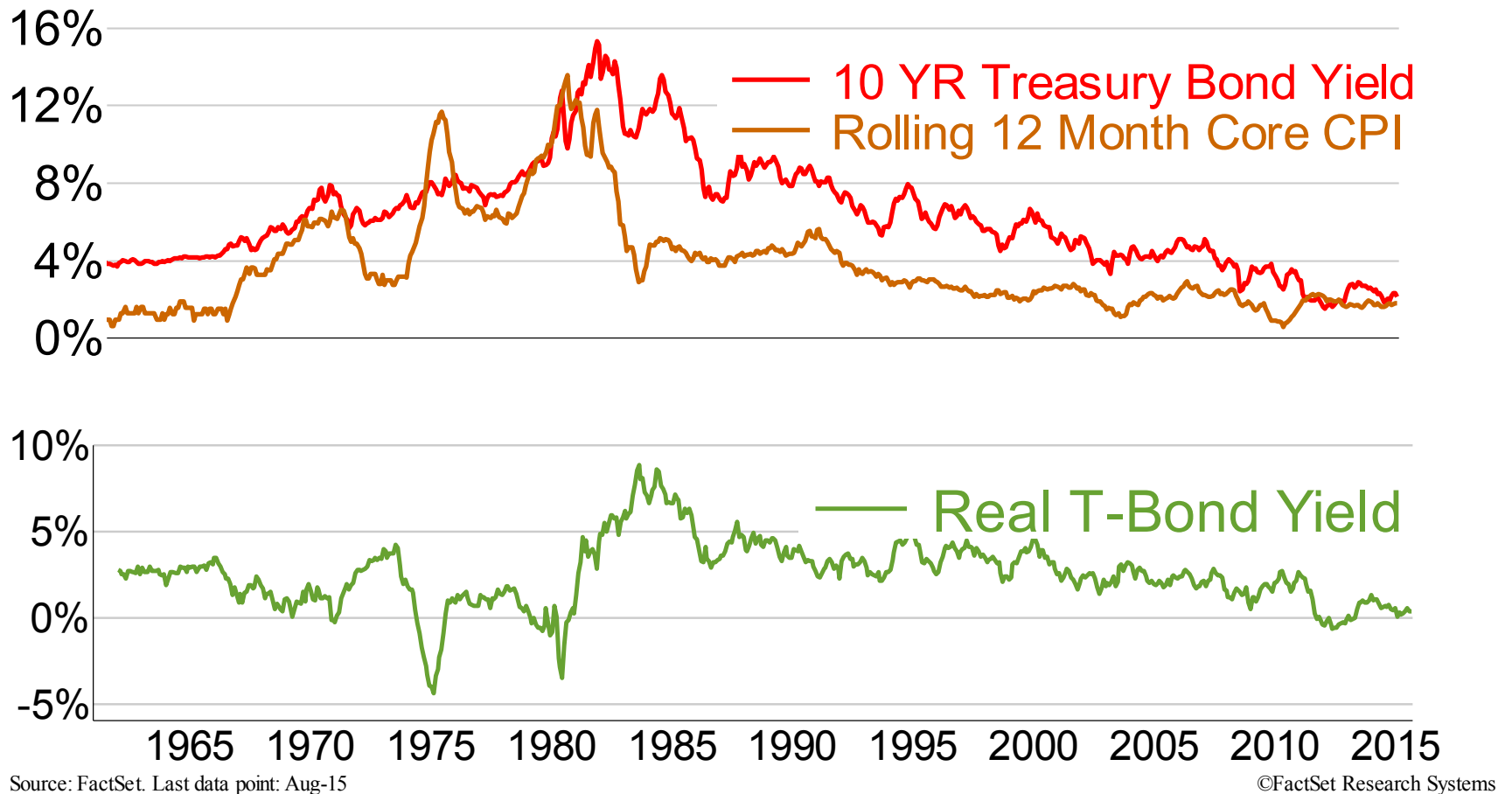
The fed funds rate will probably remain below inflation for several more years



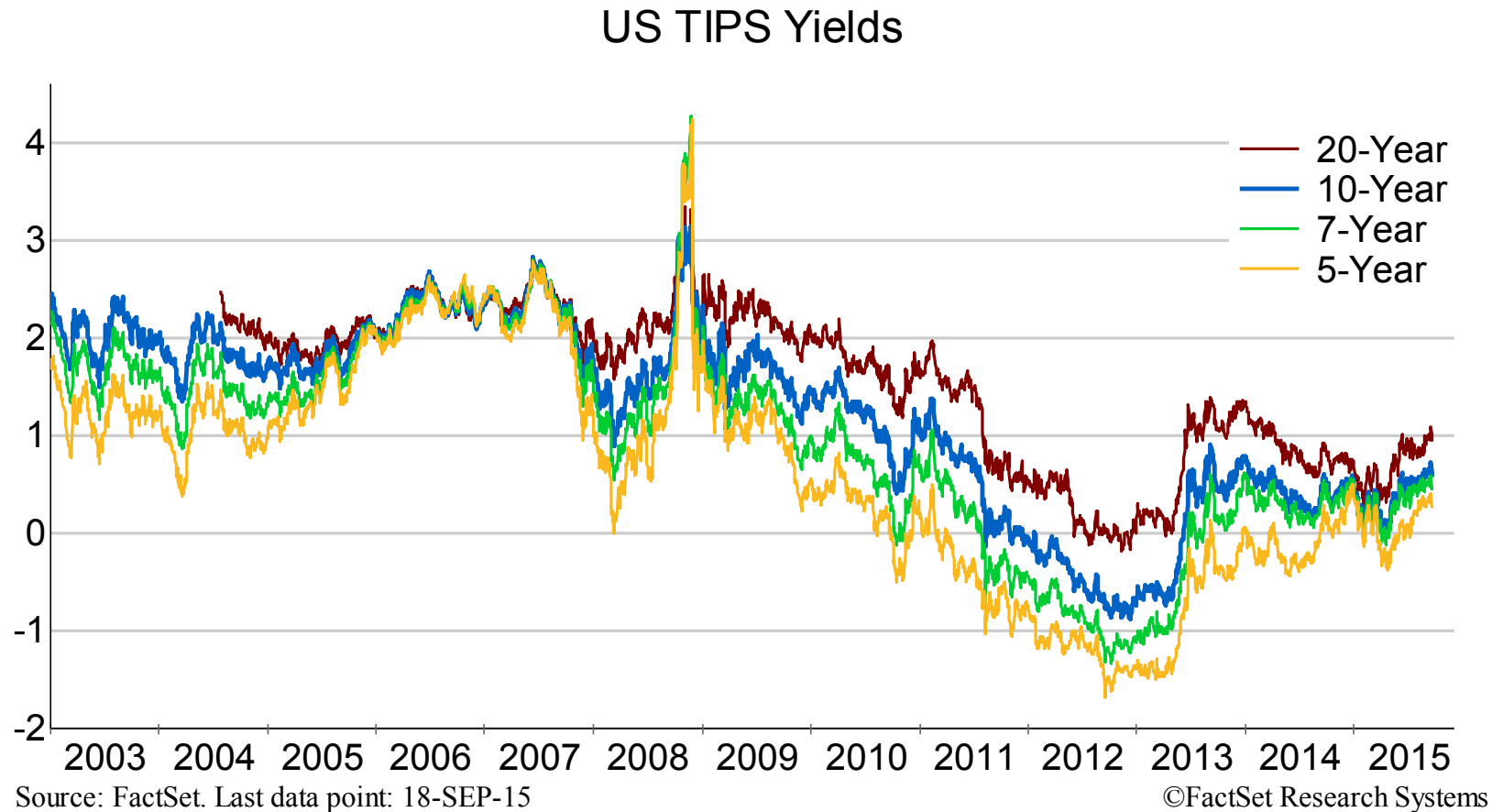
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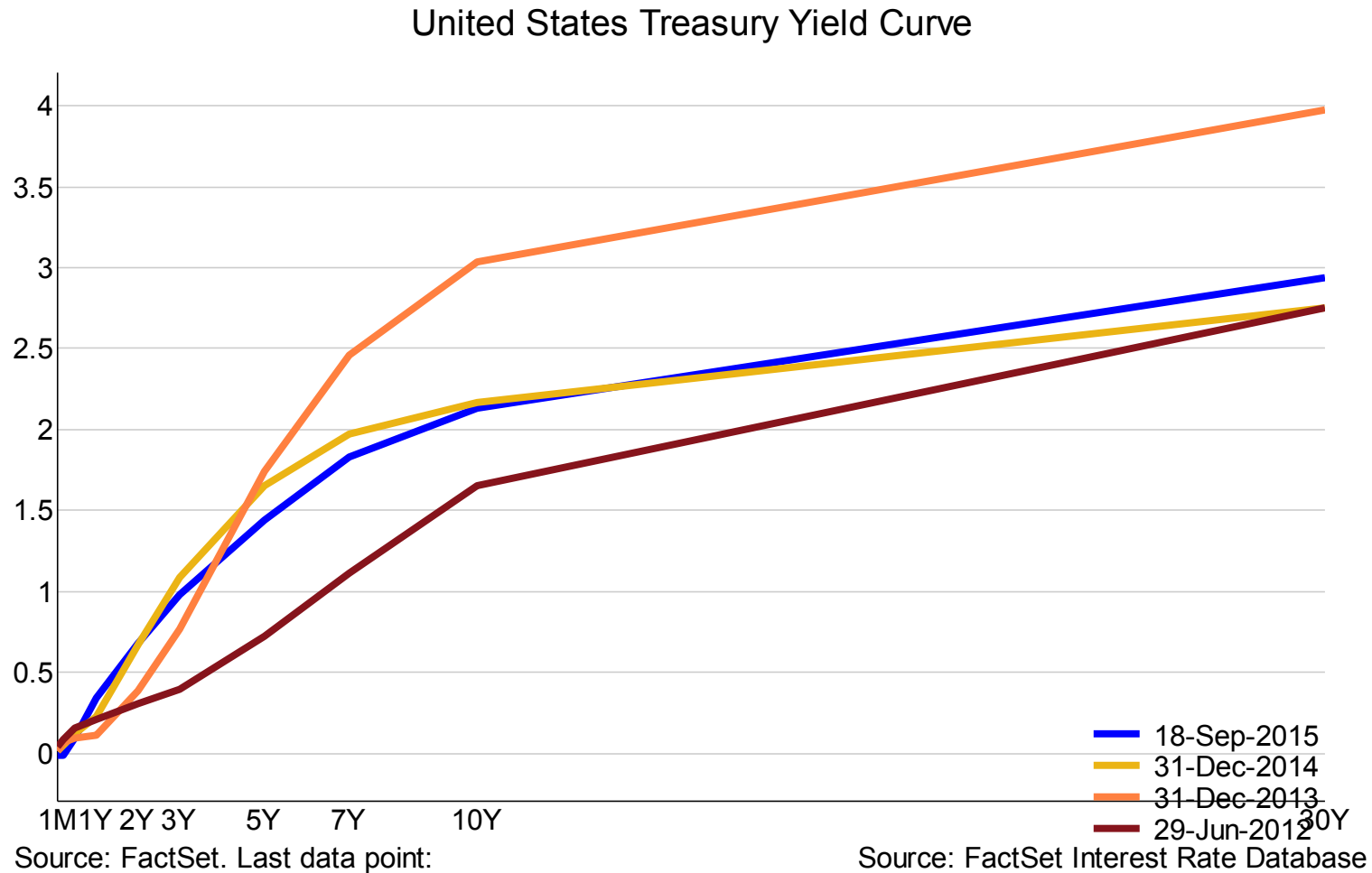
Nominal and Real Treasury Yields Are Still Near Historic Lows



U.S. TIPS Yields Remain Below Historical Average Levels

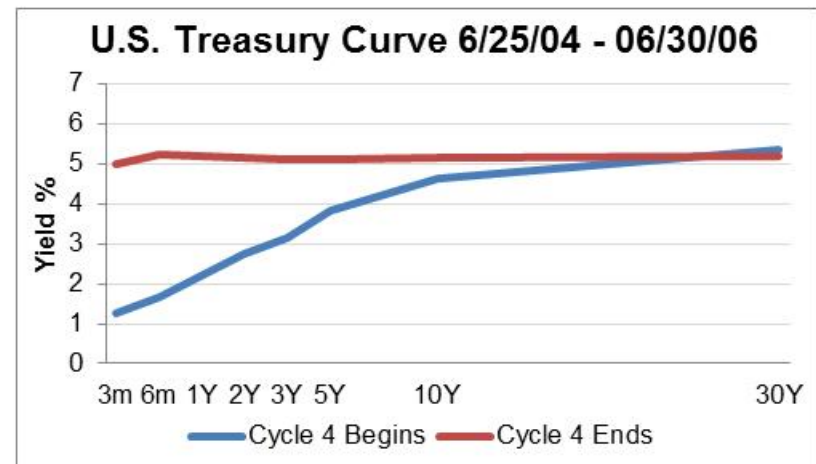
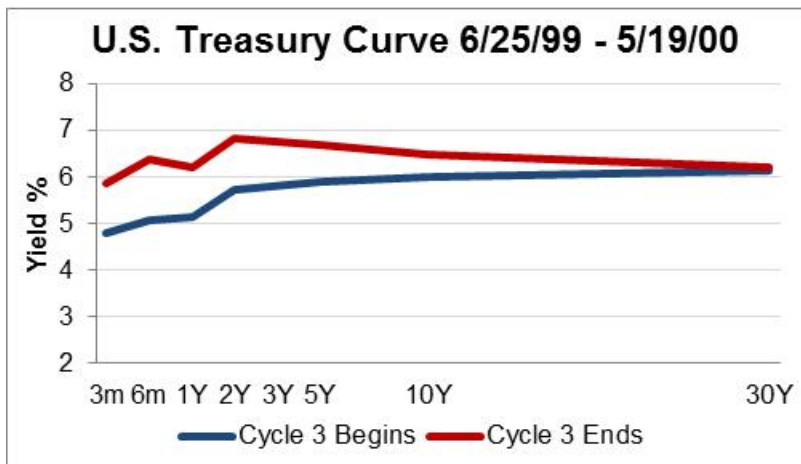
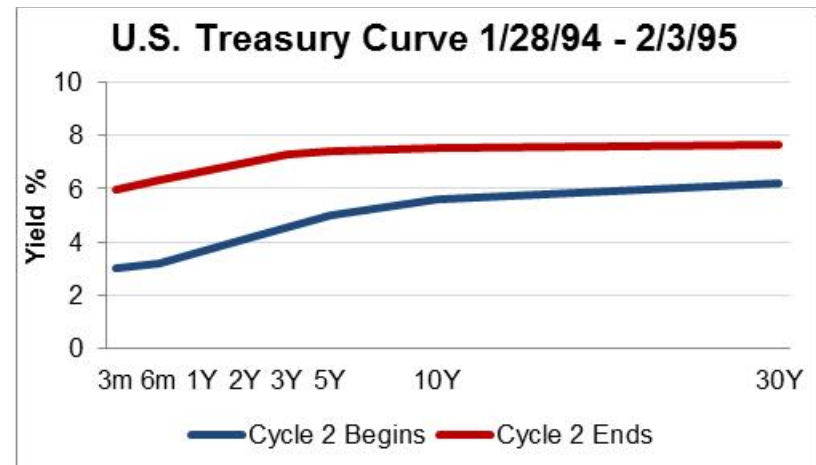
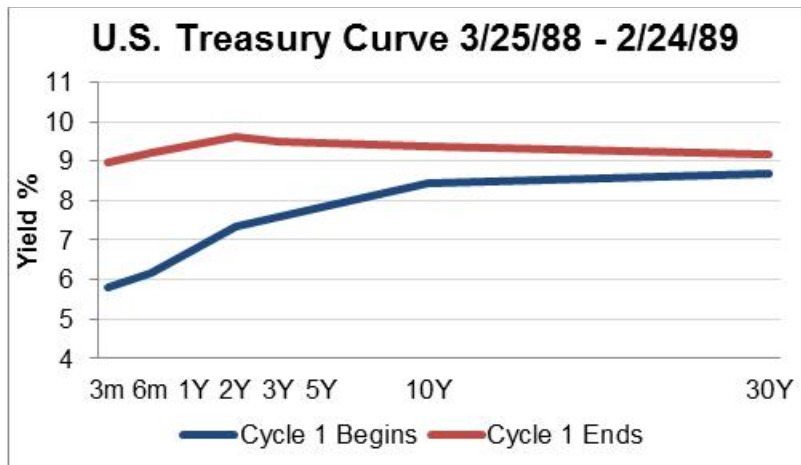


U.S. Treasury Yield Curve



Treasury Yield Curves in Previous Fed Tightening Cycles

Beware the belly of the curve



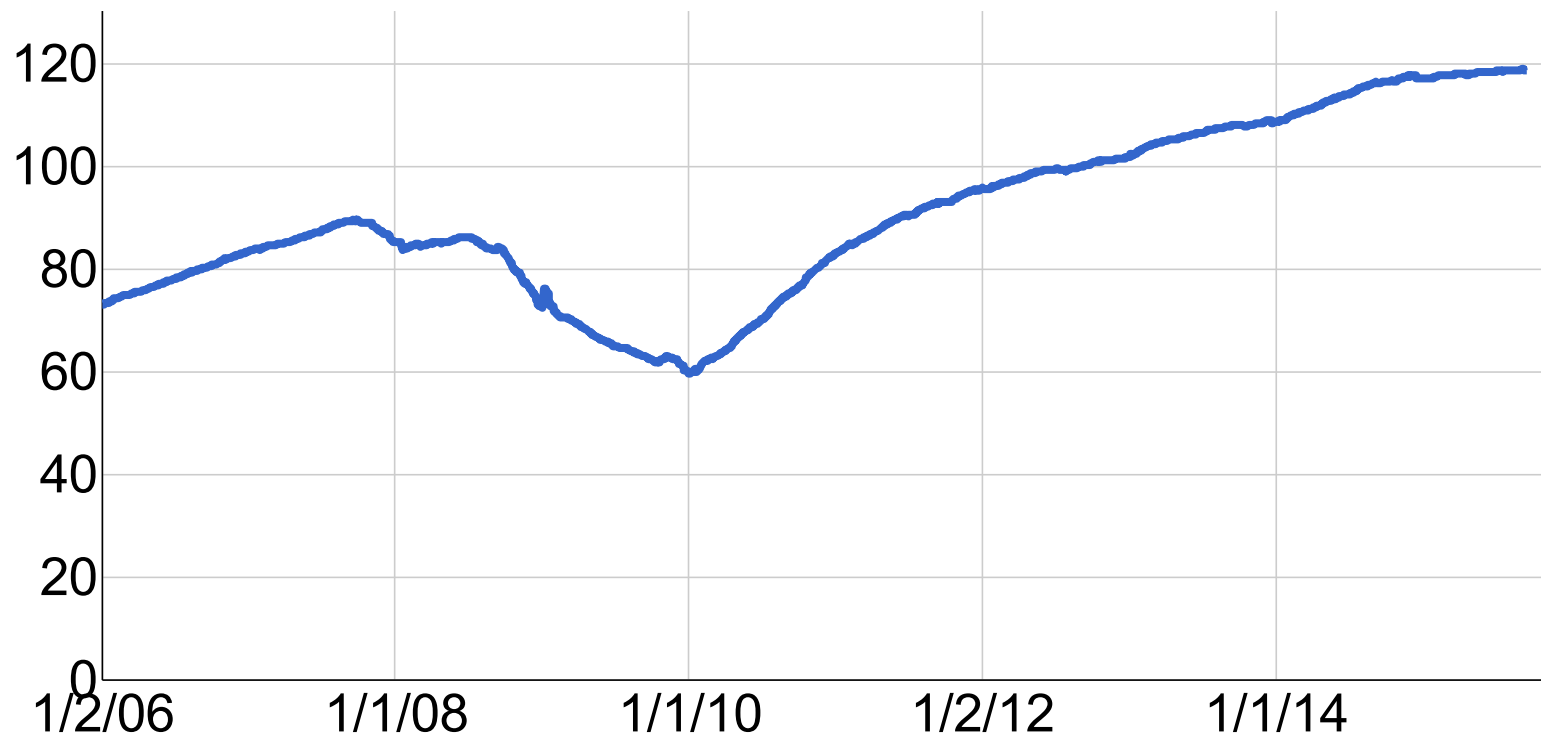
Source: Bloomberg- dates as above

There is no guarantee that forecasts discussed will be realized.

Corporate Earnings are Strong, but Growth has Paused/Stalled

The energy sector and FX effects are the largest detractors

S&P 500 Trailing 12-Month Earnings Per Share

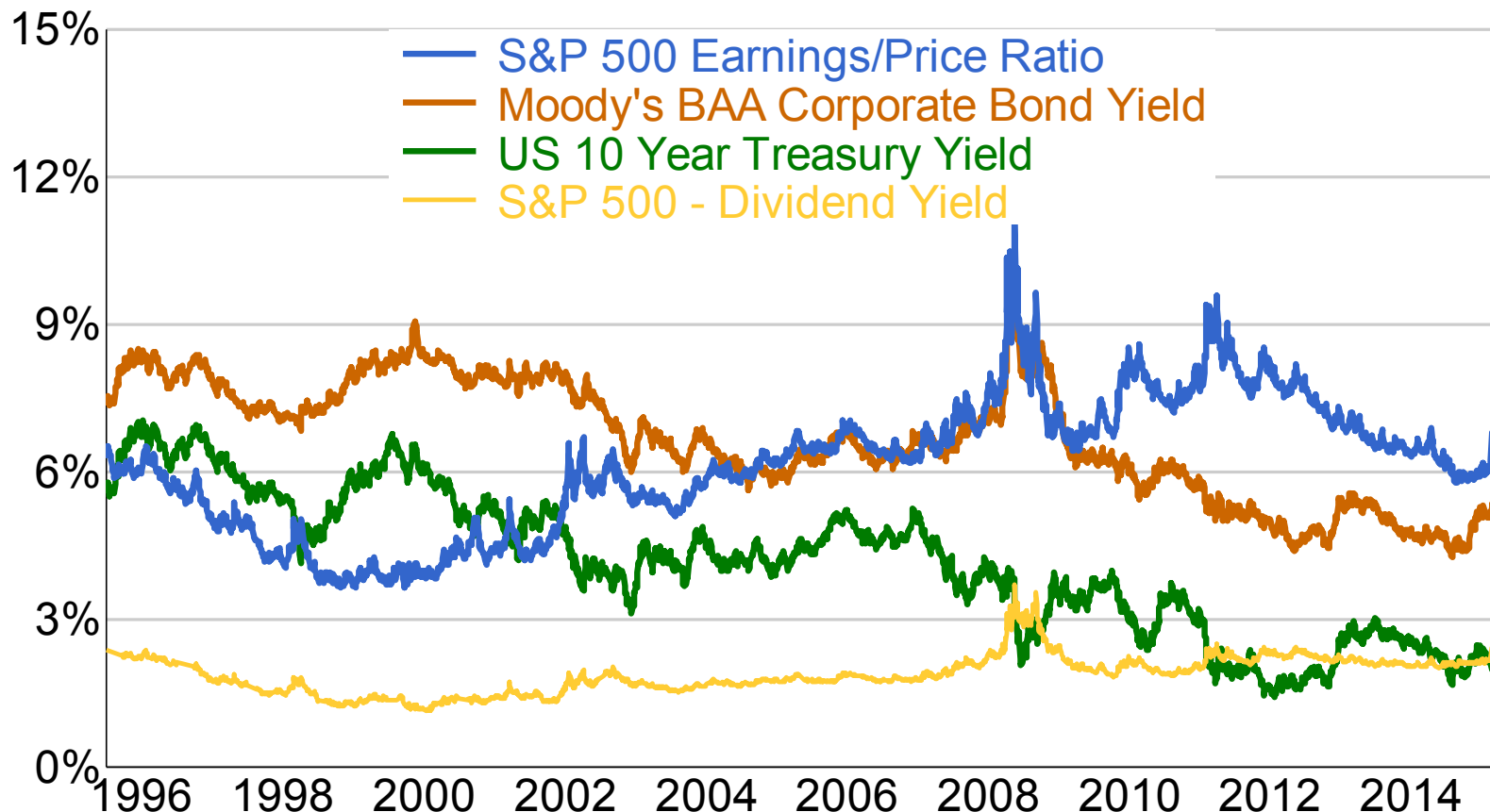


Source: FactSet. Last data point: 18-SEP-15

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Equity Valuations, While not Cheap in Absolute Terms, Remain Attractive Relative to Bonds

U.S. Capital Market Valuations

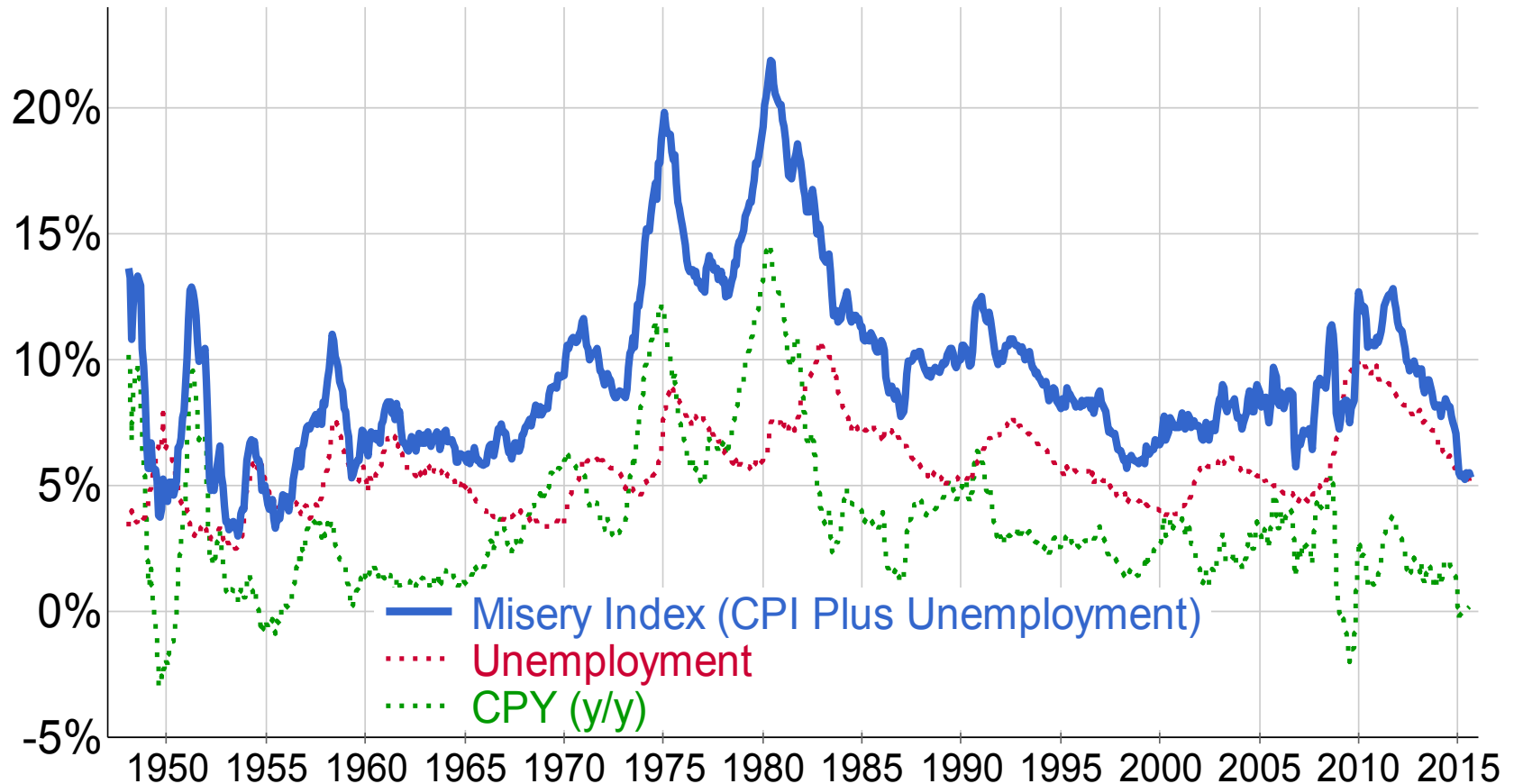


Source: FactSet. Last data point: 17-SEP-15

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The “Misery” Index is at a 55-Year Low

Both unemployment and inflation are low



Source: FactSet. Last data point: Aug-15

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Important Information

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Pioneer Investments
60 State Street
Boston, Massachusetts 02109
us.pioneerinvestments.com
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