PIONEER INVESTMENTS

Pioneer Diversified High Income Trust (HNW) & Pioneer High Income Trust (PHT) Conference Call Transcript

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4:00 pm EST

Tony Clarizio: Good afternoon everyone and thank you for taking the time to join us for today's conference call. We will be discussing Pioneer High Income Trust which trades under the New York Stock Exchange symbol PHT and Pioneer Diversified High Income Trust which trades under the American Stock Exchange symbol HNW. My name is Tony Clarizio and I'm a Senior Product Manager here at Pioneer.

Before we begin I'd like to remind you that this call will include statements that contain forward-looking information. Such statements are necessarily subject to risks and uncertainties some of which are significant in scope and by their very nature beyond the control of the Fund and its investment advisor, Pioneer Investment Management, Inc. There can be no assurance that such statements will prove to be accurate and actual results and future events could differ in material fashion from those anticipated in such statements. Historical results are not necessarily indicative of future performance.

With that said, this call will be available for replay for one week by dialing 800-642-1687 and you will need the ID number for access which is 36228509. We will also be posting a transcript of this call to our Web site at www.pioneerinvestments.com.

We are pleased today to be joined by Andrew Feltus, Portfolio Manager of PHT. Andrew is also one of the co-Portfolio Managers of HNW. And we also have with us Jon Sharkey, the Portfolio Manager who is responsible for managing the bank loan a security sleeve of HNW. Andrew is going to give us an update on PHT. Then we'll move on to HNW with both Andrew and Jon updating us on the Global High Yield, Catastrophe Bond and Bank Loan Asset Class components.

We will save Q&A for the end once the speakers have completed their remarks. But before I turn it over to Andrew I'd like to introduce Gabe Altbach, Director of Product Management who will make a statement on the auction rate securities market in general and in particular with respect to Pioneer's Closed-End Funds.

Gabe Altbach: Tony, thank you and good afternoon everyone. We always appreciate you folks taking the time to join us on these calls. Typically Pioneer holds calls like this for each of our closed-end funds on a quarterly basis open to both investors and financial advisors. On these calls we generally focus on the performance both of the underlying portfolio of securities in which our funds invest, i.e., the NAV of our funds, but also on the performance of the stock prices of our funds and the relationship between those two numbers, that being the premium and our discount.

However all this relates typically just to the common shares rather than the preferred shares as there is usually very little to report with respect to the auction rate preferred that many closed-end funds issue. That as all of us know has changed. Due to widespread distress in many corners of the fixed income market auction rate securities began to experience a wave of severe supply and demand imbalances specifically with regard to the auction rate preferred shares issued by many closed-end funds.

The result of this has been at least twofold. First, many preferred share investors have been unable to sell their positions. Second, when an auction does not clear due to the absence of sufficient buying demand the interest rates that preferred shares pay their investors reset to a maximum rate as outlined in each fund's offering documents.

With respect to the auction rate preferred shares issued by five of Pioneer's six closed-end funds (HNW as you all probably know was leveraged via a line of credit, not via auction rate preferred shares), I would like to emphasize that this is a liquidity, not a credit issue in that our funds continue to have asset coverage ratios of 250% or higher. In fact four of the five funds have coverage ratios of greater than 300% or more.

As you know the 40 Act requires that closed-end mutual funds have coverage ratios of at least 200%. However we very much appreciate the fact that the more pressing issue to many of our preferred share investors and their financial advisors is the absence of liquidity stemming from the absence of buyers at auction as well as the decision on the part of underwriting broker-dealers to not serve as buyers of last resort.

Please know that all of us at Pioneer Investments up to the very highest echelons of the firm are focused on resolving this issue while balancing the interests of all constituents, common and preferred shareholders alike. To that end we have had and are having discussions with many industry participants as to the state of the auction rates preferred shares marketplace as well as regarding potential changes to this market that might result in improved liquidity for preferred shareholders while maintaining the potential benefits of leverage within the closed-end fund structure.

At this point it is too early to state with any kind of certainty when a sense of calmness and rationality may return to the auction rate preferred shares market or when potential changes might be implemented. Such changes include the development of a secondary market, making auction rate preferred shares eligible for investment by money market mutual funds or even the transitioning to an alternative form of leverage on the part of closed-end funds.

Once again we along with all industry participants are focused on the situation. That said we'd be happy to take any questions on this at the end of our Portfolio Managers' comments. And thanks as always for your partnership and support. With that I'd like to turn the call over to Andy Feltus who will provide an update on Pioneer High Income Trust. Andy.

Andrew Feltus: Thanks Gabe. The last time we spoke was last August and that's when the credit markets were really taking their first leg down. At the time High Income Trust was trading at a very deep discount, actually a double-digit discount. We were actually very concerned with this but after our conference call those of you who purchased or who were already owners have seen a substantial jump up in the value there and the market seems to be doing a much better job of pricing our product at this point.

Currently we're trading at 3%, a little bit over 3% premium and we feel that this actually reflects the stability of the dividend that we have been able to deliver to you as well as the good performance. To put it in perspective if you had bought on the IPO you've averaged 12.3% annually since the life of the Fund, substantially outperforming both the other high yield closed-end funds as well as the high yield index. So thank you for your support. We appreciate that you listened and responded likewise.

The number one issue that we have always had – well there's a lot of issues but the one that we always go back to is that dividend. There's been three factors that really drive that dividend; what we pay for our cost of leverage, what we reinvest our current portfolio at and then what we've built up as a backup. And I'm happy to say that on all three of these issues we're stronger today than we were back in August.

The funding cost is the one that most people are most concerned with. We have issued auction rate preferred securities that we use to provide leverage. And in general the auction sets the rate but as you know many of these auctions have been failing as of late; when that occurs you do have a penalty rate - a maximum level where yields will rise. That said, it relative to lie where the London Interbank Rate which is the standard for money market transactions.

And because that rate has been falling as the Fed has cut rates we have seen our actual costs of our preferred shares actually fall. And so that is making us easier to service that dividend. Likewise our unpaid distributions continue to be very strong and we don't anticipate any changes in the dividend in the near future.

The best news is sort of a good news, bad news scenario. We talked about eight months ago. The issue was that a lot of the bonds that we had invested in were now maturing or being called away from us and we were being forced to invest at much lower rates. Given the crisis going on in the credit markets we're now investing at much higher rates and hopefully that will allow us to hold that for much longer.

Now the overall market I think is one of the things that is on the forefront of everyone's mind. And it has been a very tough market with spreads backing

up almost 500 basis points from where they were last summer. This is – the speed is unprecedented. But what really amazes us is how much spreads have widened without seeing any deterioration in the underlying fundamentals.

For the year of 2007 the default rate actually came in under 1%. That's the lowest rate we've seen since 1982. It's a phenomenal low level. Rates have creeped up marginally after January but we're currently running at a 1.1% default level. Usually the high yield market anticipates a rise in default but we've never seen such a gap between yields and where defaults rate currently are. We haven't had a default in any of our portfolios in the last 2-1/2 years, knock on wood. We are a high yield fund so we do take our risks but we do have a very strong track record in that and the market seems to back that up.

Likewise, the other factor that goes into there is earnings. We have not seen declines in earnings for the overall market. Once again to see this backup of such an extreme amount without seeing any deterioration in underlying earnings is also unprecedented. And so at current levels, the high yield market is something that we have been really getting very positively disposed to.

I think the one caveat that you have to take is that the problems aren't in the high yield market. We're not the bad guys here. We are the innocent bystander. The real issue is in the banks. The banks and the mortgage markets – that is forcing the writedowns as a result of bad lending whether it's the sub-prime or it's to the bank loan market etc. - has really constrained the banks. And so we see constant withdrawals, liquidity from various parts of the market.

And we're constantly surprised at what that's affecting. Who thought that the muni market and the auction rate preferred market would be ultimately

damaged by this but the longer this goes on the worse we've seen it. And that's really what's driven the dislocation in the high yield markets.

And likewise until the banks can really get their act together, and that's going to consist of admitting everything they've done wrong and writing down their assets to appropriate levels and also rebuilding their capital which will be a process of time, of rebuilding their profits as the yield curve steepens.

I think that's going to go on for at least another couple of months. Once the market gets comfortable that those issues have been addressed we'll start looking beyond that and focusing on fundamentals. And that's going to be a much better environment for high yield. Currently in our funds that have flexibility we are looking to add high yield exposure.

The silver lining in this cloud for our shareholders is that we are now investing at much higher rates. So while a year ago we were investing at rates 8%, sometimes 9% and 9-1/2% if we were lucky, we're now reinvesting at 11%. And as I mentioned before that's going to go a long way to basically helping us reload the Fund like when we originally bought the Fund and were able to invest at very high rates. We're in effect doing the same thing today and that's going to prove the sustainability of the dividend going forward. So we are cautiously optimistic. There's going to be more volatility but there's an opportunity.

So let's move on to HNW. I think this is a product that the market has not appreciated nearly as much which is really kind of ironic given that it was designed to hold up in a variety of environments and while the returns are not stellar the performance has basically delivered as we expected.

If you remember this is really a three-legged stool. One leg is our Global High Yield. Our second leg is a higher quality, the loan market. And the third leg is the CAT bonds. These are the event-linked Catastrophe Bonds.

The CAT Bonds have performed phenomenally. Actually every single one we own is either at where we bought it or at a higher rate which means that you've earned a very high level of interest. We had a very good hurricane season which did improve the performance. But we've seen an increased demand for these from a variety of different sources whether it's new hedge funds or other mutual funds. We've actually seen some tightening in the spreads – still an attractive market, still a great diversifier – but it's really allowed us to perform quite well.

And if I look at net asset value over the life of the Fund we're down slightly, .33 basis points. That strong performance is really reflective of how the CAT bonds have offset. The markets have been tougher - the loan market and the global high yield market.

To put it in perspective at market price the Fund is almost down 12-1/2% and we're trading at a 7.6% discount. Now almost everything I said about the High Income Trust Fund can also be said of the Global High Yield portion of this portfolio. But yet the market doesn't really appreciate that. While the discount has come in substantially since last year it is still trading at a discount relative to our competitors. Actually I believe personally this is a great opportunity if you look at the SEC filings you'd see that I purchased shares myself back in December. So it does offer a very attractive yield, over 11.8% and trading the assets at a discount.

Let me mention - and I'll talk a little bit about the yield. When we bought the Fund we initially invested but when we went to actually raise the leverage

which is necessary to sustain the yield the auction rate preferred market had already shut down to new entrants and was already a little shaky. The good news is we didn't give up. We continue to pursue alternatives. And if any of you saw the recent Press Release we have actually entered a loan agreement that will provide our leverage.

This is slightly more expensive than the auction rate preferred market but actually if we had issued auction rate preferreds we'd probably be at the penalty rate today which would be more expensive than what we're currently borrowing. What's exceptionally good news about that is that given the market is backed up we're going to be able to put that money to work at much higher rates than we originally expected. We're pretty happy with where the portfolio is. We're pretty happy with where we're going to invest the additional money over the next three months. The strategy is not going to change. That's going to be 25% in the event-linked market, roughly about 40% in the global high yield market and the remainder being in the loan market.

I talked about how we see that - the attractiveness of the high yield market but I'm going to have Jonathan Sharkey who's one of the other portfolio managers and leads our loan effort here at Pioneer talk a little bit about what he sees going on in the loan market.

Jonathan Sharkey: Thanks Andy. Well just a small quick update -- I know you're going to have some questions overall. But the bank loan market has taken it on the chin harder than any of the other asset classes. And that's primarily been driven by Libor rates coming down. The Fed Funds' Libor has historically neared Fed Funds rate give or take 10 or 12 basis points. And the Fed Funds steep cuts in the early part of this year drove Libor eventually down and that caused bank loans to be less attractive for crossover bonds and hedge funds.

As a result that put significant technical pressure on bank loans and caused the secondary prices to drop off significantly. So just for context in November the index was down -1.4%. December was at .3%. But in January when we really started to see the effects of the Fed funds cuts January's returns were down -3% and month to date February was down -4%. So what you're seeing is basically January and February are going to be two of the worst months in bank loan history.

Bank loans got down on February 7 to its lowest price ever at 86-1/4. It's popped up recently. We've had a little bit of a rally in the market which is a positive. But, you know, we view the bank loans as a huge opportunistic value at this point. The kind of the spreads is Libor plus 400 on bank loans. But historically bank loans refinance in three years so people usually look at it as a three-year maturity and that's Libor plus 600.

Just for context that would equate - based off of historical default rates and recovery rates that would equate to north of a 12% default rate. So context - today the default rate in bank loans are 1-1/2%. Historically they've averaged 3% in the worse time ever. In '01 they were 8%.

So you're getting hugely compensated for a spread that's greater than any kind of implied future default rate. In fact for '08 Altman, who is an expert of defaults has a 4.6% expected default rate for '08 and Moody's has 4.8%. So if you look at it as an implied 12% default rate then we're only going to have a 4-1/2 or so percent default rate, then bank loans look very attractive.

So one final point, Andy had touched about the new money that's coming into the funds. The beauty of that is we can be bank loans. And again I had mentioned that bank loans are now around 90 cents on the dollar. So we can

buy bank loans at highly attractive prices. And the other part is there are some new issues that are coming out and they're coming out with much tighter credit structures with Libor floors and higher current yields. And so we can opportunistically play in those.

So despite having negative performance from the bank loan sleeve of the funds we do feel that it's a great opportunity to be buying those assets.

Tony Clarizio: Thank you very much. Thank you Andy, Jon and Gabe for your earlier comments on the option rate market. With that Operator why don't we queue up some questions for any one of these gentlemen here on any one of these topics.

Caller #1: Hi. That was a glowing report and very welcome in this – the way these closed-end funds have been acting. What I wanted to ask you – the high yield debt instruments that are held by the funds – on – from the PHT at least – are they subject to adjustment or are the rates fixed? In other words does Libor or other rates play any part in setting the rate high or low during the term of the loan?

Andrew Feltus: Most of the bonds are fixed rates. They do contain call features though it's not a real issue these days. But we do have some floating rate issues and we do have some loan exposure but those are under 10% of the portfolio.

Caller #1: May I ask you one other question? Do you mark to market or mark to model?

Andrew Feltus: No, when you see the NAV that's reported and the paper – actually you can get it online every single day if you want…That's a market provided by a completely independent pricing source. Actually all of the administration is

done by (Princeton) here. We're not even involved in any of that. We simply manage the portfolio and hope they price it where we think it's valued.

Caller #1: Understood, but I mean these are marked to model because there are no ready markets for these instruments.

Andrew Feltus: No, the high yield market and the loan market while, you know, they're not as liquid as the stock market they haven't shut down completely. These are not like the auction rate preferreds where they're at Par. There are active markets and that's not to say that every single bond is priced accurate but on average the overall NAV properly reflects the price of the Fund.

Caller #2: Good afternoon. Thank you for the call. I just wanted to clarify something. I understood earlier in the call you said that about 35% of HNW was loans. But I thought I might have heard a few minutes ago that it was 10% loans, or maybe that was not HNW that you were referring to.

Andrew Feltus: That High Income Trust is about 10% in floating rate high yield bonds and loans. Actually the loan portion to be very precise is 2.6%, about 6-1/2% in floating rates high yield bonds.

Caller #2: Great. Could you speak a little bit about how – I know that loans are paying high rates right now despite short term rates having gone down but could you speak a little bit about how that loan exposure could affect the earnings of that Fund going forward here?

Gabe Altbach: Well to the extent that Libor drops down any further that would have some effect on the portfolio. We're thinking that a lot of that has been adjusted in with the downfall that we had in January and February when Libor rates when down. So we're hoping that the market has already built in those additional

Libor rates dropping so we won't have that much capital depreciation on the principal of – meaning the prices going down lower on the bank loans.

But absent of that being able to reinvest the new money coming in at much higher Libor rates, that should help the Fund overall.

Andrew Feltus: You'll remember that we now do have liabilities at our floating rate too and so that offsets some of the movement and given that we're investing at much wider spreads it more than makes up for whatever we've lost as far as the Libor at this point.

Caller #2: And you mean that the credit facility we now have in place is itself Libor based so our cost of borrowing would drop even if the earnings dropped…

Andrew Feltus: That's right. You bring up a good point that these markets are now trading at 80 to 85 cents on the dollar, the high yield market as well. To put that in perspective that's as bad as it was back in the heart of the last recession for the high yield market and we've never seen that before in the loan market and then there's two things that take away from that.

First of all that's – we believe it's an attractive opportunity. But it also allows us to reinvest at higher rates which not only increases the yield in our earnings but also creates capital losses to offset our – hopefully our future wins. And that's going to help us do a more effective way of managing the tax liability while providing a good total return investment.

Caller #2: All right. Could you address just generally what the period over which you'd be investing the new money, how long that might last?

Andrew Feltus: Yeah I'd say that's – hopefully in the next 60 days we'll be fully invested. It might be less. It might be more. We take it one day at a time.

Jonathan Sharkey: We had purposely held off a little bit on the bank loans because every day bank loan prices were going down and we wanted to make sure that we felt that we were, you know, at some leveling off period which we have in the last week. So we're starting to weigh in on the bank loans right now.

Andrew Feltus: The tone of all our markets has improved in the last week or two.

Caller #3: Good afternoon. I had a general question. These floating rate loans, for instance – PHT is all floating rate. How bad is that relative to putting more money in at higher rates? PHT is all floating rates and I'm getting nervous. If the floating rates are coming down will the new rates for new purchases compensate for the difference?

Andrew Feltus: Yeah, that fund is actually run by Highland Capital as a sub-advisor. So Gabe will have to get back to you on that.

Gabe Altbach: We just held a conference call for investors on PHD a couple of weeks ago now, the end of January I believe. And the transcript of that call is posted to pioneerinvestments.com, our public Web site. They may very well have covered that issue. In fact I think I did hear that a question like that had come up at least in broad terms.

Jonathan Sharkey: But in theory any new dollar (in) meaning, say a company refinances and pay down its bank loan and historically on average bank loans have paid off, you know, every three years. So you can almost obviously look at 1/3 of the portfolio getting paid out in one year from now. All that new money can get redeployed at much higher credit spreads than what the existing loans were

booked at before. So even though Libor is going down some of that is going to be compensated by significantly higher credit premiums just based off of what's been going on in the market.

Andrew Feltus: And at the same time PHT is leveraged via the traditional auction rate preferred mechanism and that too is a short term benchmark - Libor-based type of borrowing. So as the Fed cuts rates and Libor declines so does the cost of borrowing for that portfolio, somewhat offsetting the decline in the earnings stream.

Caller #3: Thank you very much. I have a little more confidence now.

Andrew Feltus: Great.

Tony Clarizio: For those of you who want to listen to this call on replay the number is 800-642-1687. You will need the ID to do that. That number is 36228509. March 5 at 4 o'clock Eastern Time we are going to have another Closed-End Conference Call on two of our tax-exempt Closed-End Funds, namely MAV and MHI. There will be a press release out on that. Check our Web site for more details. We're going to end this call now. I'd like to thank our speakers, Gabe Altbach, Andy Feltus and John Sharkey. And more importantly I'd like to thank you all for participating. I know it's a busy time out there and I thank you for your attention. Have a great night.

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