Pioneer Short Term Income Fund

Annual Report

8/31/05

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PORTFOLIO MANAGEMENT DISCUSSION 8/31/05

In the following interview, Richard Schlanger, the Fund's portfolio manager, discusses the factors that influenced performance for the annual period ended August 31, 2005.

Q: Can you describe the market environment for fixed-income investors over the Fund's fiscal year?

A: The economy continued to show solid growth over the period, although there have been concerns that employment gains have not been on a par with those in previous recoveries. Given a backdrop of economic expansion, the Federal Reserve followed through on the "measured" approach to raising short-term interest rates that it had initiated in June of 2004. This approval took the form of eight separate hikes of one-quarter percentage point in the benchmark Fed funds rate (the interbank overnight lending rate) totaling two percentage points (200 basis points) over the Fund's fiscal year.

Despite the Fed's less accommodative stance with respect to short-term rates, long-term interest rates were relatively stable and even fell over the last 12 months. The development confounded no less an analyst than Fed Chairman Greenspan, who referred to it as a "conundrum" in widely cited remarks. By contrast, shorter-term bonds naturally experienced yield increases – and corresponding price declines – given the Fed's tightening over the period. Yields on shorter-maturity issues rose substantially, with six-month and two-year Treasuries experiencing yield increases of nearly two and one and a half percentage points, respectively. By contrast, long-term interest rates ended the period slightly below where they began, with the 10-year Treasury yield falling slightly. The result was a very substantial flattening of the yield curve over the 12 months. In fact, at the end of August, the yield advantage provided by 10-year versus two-year Treasuries was less than one-quarter percentage point.

Q: How did the Fund perform in this environment?

A: The Fund's total return from August 31, 2004, through August 31, 2005, was a positive 1.31%, versus 1.39% for the unmanaged benchmark index. The Fund's SEC yield as of August 31, 2005, was 3.26%. The total return and SEC yield numbers are for Class A shares, do not include the impact of any sales charge paid, and reflect a temporary expense limitation that was in effect through August 31, 2005. Without the limitation, the yield would have been 3.09%.

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The performance data quoted represents past performance, which is no guarantee of future results. Investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost.

The Fund's modest total return for the year primarily reflects the difficult environment for short-term bonds, as yields increased and prices fell generally among these issues. We have the ability within the Fund's overall maturity guidelines to invest a portion of assets in longer-term issues. However, we generally maintained a cautious approach to allocating portfolio assets across maturities during the period, in view of ongoing high federal budget deficits and the uncertainties created by rising oil prices and the conflict in Iraq. This was reflected in our emphasis on issues with maturities under two years, which limited returns somewhat as longer-term issues outperformed.

In allocating Fund assets among government, mortgage-backed, corporate, and high-yield issues we focused on the relative value offered by each sector at a particular time. It was our view that corporate issues and other sectors were trading at rich levels after a period of strong performance. As a result, we did not seek to emphasize these areas of the market, which generally performed well relative to Treasuries over the fiscal year. One of the most significant events during the period was the downgrading of GM and Ford to high-yield or "junk" status by the rating agencies. While we held both in the Fund, our exposure was lighter than that of our benchmark and peer group, which helped our relative returns. We maintained a small position in high-yield issues throughout the period, which helped performance.

Q: What is your assessment of the current climate for fixed-income investing?

A: We have been keeping a close watch on a number of factors with the potential to lead to higher overall interest rate levels and corresponding downward pressure on bond prices. The factors include a global economy that continues to display solid growth, which should support expansion in employment over time and could put some upward pressure on inflation and interest rates. In addition, while oil prices may ease somewhat going forward, they are not likely to recede to the $30 to $40 a barrel range that we

saw as recently as a year ago, and that may yet impact the overall rate of inflation in a substantial way. The lack of meaningful progress in reducing the U.S. budget deficit may also push up interest rates over time.

At the end of the Fund's reporting period, Hurricane Katrina devastated much of the Gulf Coast. While the broad economic impact of the tragedy will initially be to dampen growth, the rebuilding effort required will be massive, with monetary estimates currently ranging as high as $200 billion. There is no obvious source of funds with which to pay for this effort, and thus we expect the situation to add another level of strain to the already imposing task of reducing the deficit. In addition, while we think it is likely that the Fed is nearing the end of its current tightening cycle, the incremental economic stimulus we anticipate in 2006 in the wake of Katrina complicates this outlook to a degree.

Q: How is the Fund positioned?

A: The Fund is somewhat conservatively positioned from the perspective of sensitivity to changes in interest rates. At the end of August, the Fund's weighted average maturity was 1.71 years, well under the Fund's maximum of three years. Moreover, among our purchases of shorter maturity issues, we have emphasized bonds trading at a discount to face value. As those bonds mature and principal is repaid, an additional element of support to the Fund's net asset value may result, regardless of the direction of short-term rates.

Average quality of the Fund's portfolio is currently a high "AA." U.S. Treasury and agency issues totaled about 48% of assets at period end. We continue to maintain broad exposure to the major areas of the bond market, while seeking to benefit from weighting more heavily those sectors that we believe could provide better relative value. Currently, the yield advantage provided by corporate bonds and other credit-sensitive sectors versus Treasuries is quite narrow. For instance, high-quality corporate securities offer only about 20 basis points (or 0.20 percentage points) of additional yield versus Treasuries of comparable maturity. At the end of August, our weighting in corporate bonds accounted for about 25% of Fund assets, well under our anticipated upper limit. In addition, given the Fed's history of erring on the side of bringing about a recession before ending a tightening cycle, we are closely scrutinizing prospective corporate holdings on the basis of credit quality.

A little more than one-quarter of the Fund's assets is invested in mortgage pass-through securities, down from approximately 40% at the beginning of the period. This allocation reflects some caution on our part with respect to the outlook for the housing market. Our holdings among pass throughs are focused on "balloon" mortgages, which have shorter maturities and, thus, less exposure to any future increase in long-term rates. We also are emphasizing collateralized mortgage obligations, which have more reliable cash flow than most other pass-through securities and, as a result, are not as vulnerable to the impact of changes in market interest rate levels. (By contrast, many mortgage-backed securities experience a reduced rate of prepayment on their underlying obligations when rates rise, increasing their duration – a measure of a bond's price sensitivity to changes in interest rates – and corresponding interest rate sensitivity.)

Going forward, we will continue to seek to provide a high level of current income while maintaining a relatively stable share price. We believe our focus on quality and on reducing the impact of interest rate changes on the Fund's share price makes it an attractive option for investors seeking to maintain fixed-income exposure in an uncertain environment.

When interest rates rise, the prices of fixed-income securities in the Fund will generally fall. Conversely, when interest rates fall, the prices of fixed-income securities in the Fund will generally rise. Investments in the Fund are subject to possible loss due to the financial failure of underlying securities and their inability to meet their debt obligations. Prepayment risk is the chance that mortgage-backed bonds will be paid off early if falling interest rates prompt homeowners to refinance their mortgages. Forced to reinvest the unanticipated proceeds at lower interest rates, the Fund would experience a decline in income and lose the opportunity for additional price appreciation associated with falling interest rates. Investing in foreign and/or emerging markets securities involves risks relating to interest rates, currency exchange rates, economic, and political conditions. At times, the Fund may focus its investments in a limited number of related industries and sectors, making it more susceptible to adverse economic, political or regulatory developments affecting those industries and sectors than a portfolio that invests more broadly and, as a result, may experience greater market fluctuation.