Janus Henderson INVESTORS

UK PORTFOLIO TRENDS AND OPPORTUNITIES FOR 2021

Portfolio Construction and Strategy

Janus Henderson's Portfolio Construction and Strategy Team (PCS) performs customised analyses on investment portfolios, providing differentiated, data-driven diagnostics. From a diverse universe of thousands of model portfolios emerge trends, themes and potential opportunities in portfolio construction. In the following update, Adam Hetts, Global Head of Portfolio Construction and Strategy, and Sabrina Geppert, Senior Portfolio Strategist, examine portfolio trends and opportunities for UK investors in 2021.

Investors across the globe today are grappling with a range of challenges, from the COVID-19 economic rebuild and ongoing threats of further outbreaks and lockdowns, to record levels of fiscal and monetary stimulus driving down yields and interest rates. However, while each of our individual clients has their own financial goals and challenges to overcome, the language of risk management is universal, and is integral to the efficient management of portfolios over the long term.

Portfolio trends & themes

Looking at the global landscape for 2021, several similar portfolio trends and themes are found regardless of where in the world investors are based. The challenge, therefore, is to identify which local trends and themes are profound. Just because the same risk-based principles apply across regions does not mean that the same principles are the most important in each region. We believe the key is to use global insights and learn from investors in different regions, but to apply these lessons through the lens of local-market challenges and financial goals.

Four key considerations

Focusing on the UK IFA market for 2021, we believe there are four key considerations for investors, which have the potential to improve the efficiency and returns of their portfolios. We have found each of these to be prevalent in a range of portfolios of UK-based investors, often to the detriment of overall performance.

1. UK EQUITY HOME BIAS
2. GLOBAL EQUITY THAT ISN'T GLOBALISING
3. THE EXCESS RISK HIDDEN IN ALLOCATION FUNDS
4. UNDIVERSIFIED FIXED INCOME

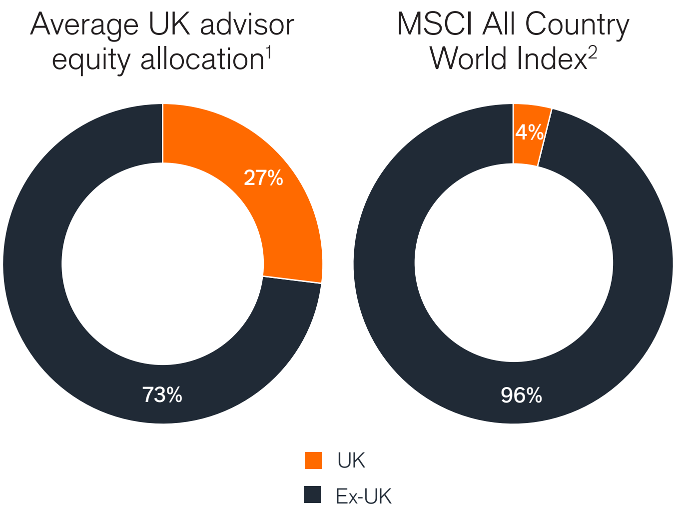
For Promotional Purposes. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

1. UK equity home bias

It is a universal phenomenon to have a myopic focus on your immediate surroundings. Unsurprisingly, UK investors typically favour local domestic equities. Too much local loyalty, however, can arguably work against one's long-term portfolio goals.

Although UK equities are only approximately 4% of the market capitalisation of global equities (measured by the MSCI All Country World Index), our proprietary database of UK IFA portfolios shows the average weight to UK equities is approximately 27%, as shown in the charts below:

Average UK advisor equity allocation vs. MSCI All Country World Index (ACWI)



[1] Average UK advisor public equity allocation in 2020 based on data shared with the Portfolio Construction & Strategy (PCS) Team by UK IFA clients.

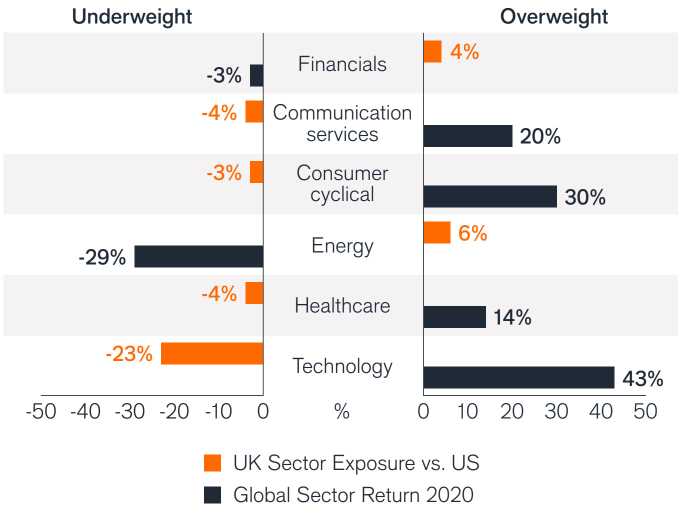
[2] MSCI All Country World Index Market Values as of 31 December 2020.

Source: Morningstar, PCS Team.

While there is no single statistic to determine the success of an investment, we have identified two alarming metrics that highlight the potential harm that a focus on UK equities can cause to UK investors' portfolios:

i. In isolation: a drastic discrepancy in the Sharpe Ratio versus the rest of the world, especially the US. The US has a notably higher exposure to the technology sector, which outperformed the rest of the market over the calendar year 2020. For UK equities, a concentration in cyclical sectors, such as energy, coupled with an overweight to financials, and the prolonged uncertainty around Brexit, led to underperformance versus US and global equities over the periods shown in the following chart, and less confidence in the economic growth of the UK market.

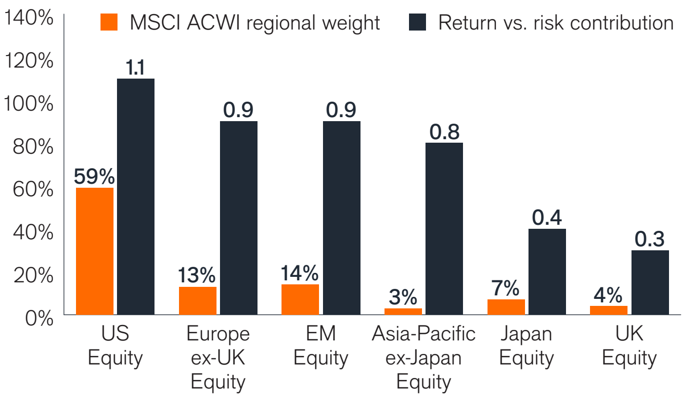
Relative UK vs. US sector exposure and global sector returns



FTSE All-Share (UK all-cap) sector exposures versus FTSE US all-cap sector exposures as of 31 December 2020. Morningstar Global Sector Indices Returns (GBP) as of 31 December 2020. Source: Morningstar, PCS Team.

ii. In context of a broader portfolio: accounting for cross correlations with the rest of the portfolio, over the prior five years, UK equities tended to contribute the most portfolio risk relative to portfolio return, compared to other regions, as shown in the chart below:

Global market capitalisation weights and return vs. risk contribution



MSCI ACWI market capitalisations as of 31 December 2020. Return in GBP. Source: Morningstar, PCS Team.

Home bias is a universal phenomenon for good reason. Investors are more likely to stay invested in familiar companies and, frankly, simply staying invested can often be more important than a high Sharpe Ratio. We believe the answer to home bias is not as simple as an 'optimisation' that would be undigestible to many investors because it would often cut out 20% or more of most portfolios' UK equity weight. Instead, we prefer to compare a client's model portfolio to both traditional benchmark weights as well as our proprietary Industry Portraits. This helps to offer a global perspective, based on the former, while at the same time not taking on 'maverick risk' i.e. not veering too far from the peer investor UK equity weights portrayed in the latter.

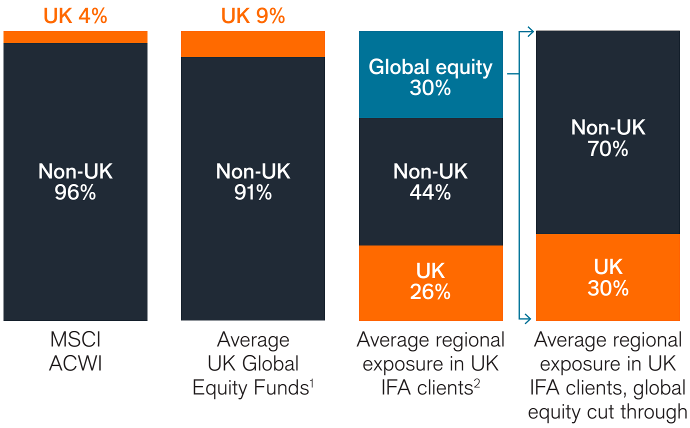
2. Global equity that isn't globalising

While we typically see UK investors continue to tilt their portfolios towards their home market, global strategies are popular as a balancing mechanism. Within our UK client portfolios on the PCS Team, we saw an average weight of 18% in global equity funds over 2020 by UK IFA clients.

By adding global exposure to their portfolio, our clients can seek to broaden diversification and lower the idiosyncratic risk of a single country. Therefore, we must look behind the curtain of global equities to see if they are indeed globally diversifying. We examine the regional allocation of a globally diversified equity index versus our clients' top five global equity funds, by assets under management (AUM). Surprisingly, we find that the allocation to the UK market in global equities is significantly larger than the UK's global market capitalisation weight.

UK exposure: MSCI ACWI vs. Average advisors top five global equity funds

Global equity funds split into regional exposures



MSCI ACWI market capitalisations as of 31 December 2020. Average UK advisor global equity allocation in 2020 based on data shared with the PCS Team by UK IFA clients. Source: Morningstar, PCS Team.

[1] Regional exposures of the 5 largest global equity funds (by AUM) in our UK advisors portfolios, based on data shared with the PCS Team by UK IFA clients.

[2] Average UK advisor global equity allocation in 2020, based on data shared with the PCS Team by UK IFA clients.

We believe that global equity funds have very limited ability to truly balance a portfolio with an existing UK overweight. In client projects where we utilise our proprietary holdings and returns-based analytics, we often find that once we cut through the actual holdings in a global equity allocation, the overall portfolio actually has a higher UK equity weight than the already high starting point investors are aware of.

3. The excess risk hidden in allocation funds

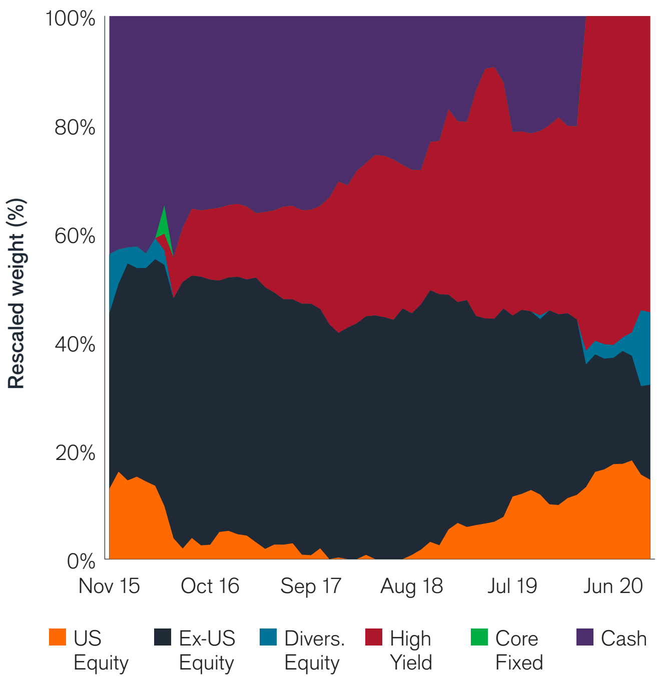
Multi-asset allocation strategies are a popular tool within our UK IFA client portfolios, with an average portfolio weighting of 8% – larger than the average weighting to US or emerging markets equities, for example. The myriad advantages to using multi-asset allocation strategies within a portfolio – diversification, outsourcing timing decisions – must be balanced against their opaque nature and, occasionally, the addition of unintended risk to the portfolio.

The ubiquity of these strategies in the UK, combined with their potential to invest across the entire risk spectrum, from low-risk sovereign bonds up to high-risk emerging equities, means that a "moderate" portfolio overly reliant on 'moderate allocation' strategies might often result in unpleasant surprises caused by large pockets of hidden risk.

Our Portfolio Construction and Strategy Team has designed a variety of proprietary analytics to help our clients cut through potentially opaque strategies and understand their propensity to add risk to the broader portfolio.

For example, the style analysis chart below is based on one of the five largest funds by AUM in the Morningstar Moderate Allocation category and is examined with our proprietary three-year rolling risk factor decomposition. The high yield factor (red) moves from 0% at the beginning of 2016 to about 50% of the fund's factor exposure in 2020. Meanwhile the cash factor moves from nearly 50% to 0%. That is a stunning change in risk profile:

Factor Contribution over a 3-year Rolling Window (2015-2020)[1]



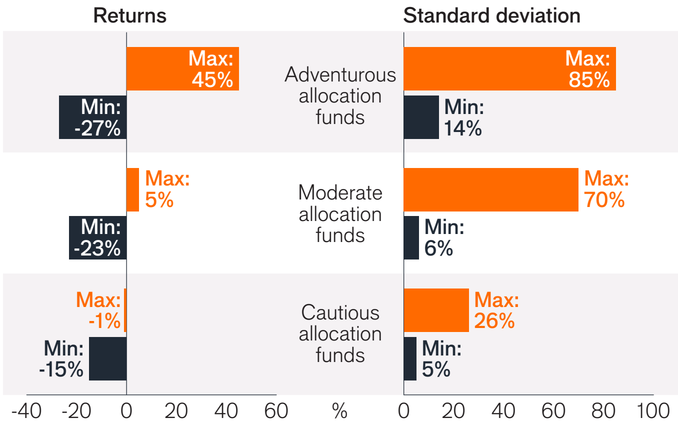
[1] Factor contribution from a Balanced Fund in the top 5 largest AUM within the Morningstar GBP Moderate Allocation category, as of 31 December 2020 for illustrative purposes. Month end data from November 2015 to October 2020.

Source: Morningstar, PCS Team.

Occasional spikes in certain risky asset classes, such as high yield or diversifying equity, can cause unwelcome surprises in the broader portfolio. Allocation funds within the same risk category may show certain biases in different directions, leading to a wide variety of potential results. For example, the extreme volatility of March 2020 created huge ranges of results in returns and standard deviations within seemingly homogenous categories:

Don't judge an allocation book by its cover:

March 2020 average returns and standard deviations for Morningstar Adventurous, Moderate, and Cautious Allocation categories



Performance based on daily fund returns (GBP) in March 2020. Standard deviation in March 2020 annualised. Past performance is no guarantee of future results.

Source: Morningstar, PCS Team.

Multi-asset allocation strategies are an invaluable tool in the portfolio construction process, although it is paramount to not just judge a 'moderate' book by its cover. We believe that it is important to deeply analyse individual holdings and historical biases, and undertake implementation with the understanding that not all asset allocation strategies are created equal.

4. Undiversified fixed income

Since the Global Financial Crisis, traditional lines in fixed income investing have been blurred by low rates, large price swings, high duration risks and a proliferation of new strategies. It makes perfect sense, then, that across our client base, fixed income is likely the most polarising topic of analysis and conversation.

It is not uncommon that we finish one consultation with a client determined to remove all sovereign bonds from their portfolio, only to then move onto the next consultation with a client determined to add sovereign bonds in order to increase downside protection. We think there has been too much focus on finding a single solution, when the best solution is probably that it is a mix – and that mix depends on an investor's goals.

We believe clients are best served with a multi-faceted, goals-based approach. Even in the face of today's low rate environment, core fixed income's role is as essential as ever. Core bond allocations are strategic allocations intended to provide the potential for mitigating losses during a crisis. However, the post-COVID environment will require forward-looking investors to pursue a new level of due diligence across multiple destinations of capital within their fixed income allocation.

We are taking a goals-based approach to fixed income where we consolidate the breadth of fixed income instruments into three distinct objectives: Defend, Diversify and Increase Income. Below we outline how Defend, Diversify and Increase Income can be defined by their respective goals, personalities and criteria.

We offer this powerful framework to help organise the huge universe of fixed income managers and, importantly, help our clients implement this framework through our customised fixed income portfolio analytics.

DEFEND
Risk-managing, core fixed income

Goal: Seeks to provide the potential for mitigating losses during a market downturn

Personality: Low volatility, low correlation to traditional equities, high-quality, high-interst rate sensitivity; composed of primarily investment grade securities

Criteria: Allocates to currency-hedged, global developed market credit, securitized or government debt

DIVERSIFY
Move beyond traditional benchmarks

Goal: Dynamically combine some elements of potential loss mitigation with higher income potential

Personality: Go-anywhere approaches combining elements from Defend and Increase Income categories, more risk-aware than approaches in the Increase Income category

Criteria: Allocates across the quality spectrum with higher alpha targets than benchmark-constrained portfolios. May include ability to short. Common strategy names include terms like 'strategic income,' 'multi-sector' and 'unconstrained'

INCREASE INCOME
High income opportunities

Goal: Highest return and income potential via exposure to equity-like fixed income on a global scale

Personality: High volatility, high correlation to traditional equities

Criteria: Benchmark-constrained, long-only exposure typically to below-investment grade and/or lower in the capital structure, or investment emerging markets

Introducing our Portfolio Construction and Strategy Team

Are you concerned about your clients' portfolios in uncertain markets? Our Portfolio Construction and Strategy (PCS) Team provides support through detailed analysis aimed at helping your clients stay on track towards their investment goals. The service offered is objective – providing a whole-of market view, not focused on Janus Henderson products. It is bespoke to your requirements as the team customises portfolio diagnostics and reports to meet your needs and support conversations you have with clients. The service is complimentary and we would be delighted to discuss in more detail the service the PCS Team can offer.

Adam Hetts, CFA
Global Head of Portfolio Construction and Strategy

Adam Hetts is Global Head of Portfolio Construction and Strategy at Janus Henderson Investors. In this role, he leads the Portfolio Construction and Strategy Team that is focused on delivering actionable investment strategy and thought leadership to help clients in all aspects of the investment management process. From 2011 until joining Janus in 2017, he was vice president, senior portfolio strategist with Goldman Sachs Asset Management in New York, leading efforts in the US and Asia Pacific regions. Prior to that, Adam worked with Goldman Sachs Principal Strategies, a proprietary hedge fund, and as a corporate strategist within Goldman Sachs Asset Management. Earlier in his career, he was a consultant with The Law and Economic Consulting Group in Washington, D.C.

Adam earned his bachelor of science degree in finance with a concentration in accounting from Pennsylvania State University. He holds the Chartered Financial Analyst designation and FINRA Series 24, 7, and 63 securities licenses. He has 16 years of financial industry experience.

Sabrina Geppert
Senior Portfolio Strategist

Sabrina Geppert is a Senior Portfolio Strategist at Janus Henderson Investors, a role she has held since 2020. She is a member of the Portfolio Construction and Strategy Team focused on delivering actionable investment strategy and thought leadership to help clients in all aspects of the investment management process. Prior to joining the firm, Sabrina was at Goldman Sachs in London where she was an executive director in the investment strategy group since 2015, advising clients across EMEA on portfolio strategy.

Sabrina earned an undergraduate degree in socioeconomics from Friedrich-Alexander University – Erlangen-Nuremberg and a MSc in statistics from Ludwig-Maximilians University – Munich. She has 6 years of financial industry experience.

Sharpe ratio: This measures a portfolio's risk-adjusted performance by quantifying its excess return (as measured by returns above the risk-free rate) per unit of realised risk. A high Sharpe ratio indicates a better risk-adjusted return. The ratio is designed to measure how far a portfolio's return can be attributed to fund manager skill as opposed to excessive risk taking. **Cyclical stocks:** Companies that sell discretionary consumer items, such as cars, or industries highly sensitive to changes in the economy, such as miners. The prices of equities and bonds issued by cyclical companies tend to be strongly affected by ups and downs in the overall economy, when compared to non-cyclical companies. **Monetary policy:** The policies of a central bank, aimed at influencing the level of inflation and growth in an economy. It includes controlling interest rates and the supply of money. Monetary stimulus refers to a central bank increasing the supply of money and lowering borrowing costs. Monetary tightening refers to central bank activity aimed at curbing inflation and slowing down growth in the economy by raising interest rates and reducing the supply of money. **Fiscal policy:** Government policy relating to setting tax rates and spending levels. It is separate from monetary policy, which is typically set by a central bank. Fiscal austerity refers to raising taxes and/or cutting spending in an attempt to reduce government debt. Fiscal expansion (or 'stimulus') refers to an increase in government spending and/or a reduction in taxes.

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