

SHIFTING GEARS: ROUTES TO SUCCESS

ACTIVATING A GOALS-BASED FIXED INCOME STRATEGY

Portfolio Construction and Strategy

For financial professionals, fixed income allocations can have profound consequences for their entire portfolio. In this decade alone, investors have faced several market scenarios, beginning with low interest rates and benign spreads, moving to illiquidity and wide spreads, which then turned into high inflation, higher correlations, and higher interest rate volatility. All of these market scenarios conspired to negatively impact traditional core, duration-sensitive fixed income (e.g. Aggregate Bond), which in 2022 experienced one of its worst drawdowns in history. However, investors would be wise to reframe expectations for what is ahead, instead of focusing on what is in the rearview mirror. Yields across all fixed income sectors have reset at levels not seen since before the Global Financial Crisis. We believe that a more diversified fixed income allocation can offer investors the ability to achieve greater total return for less risk, allowing it to firmly reassert itself as a ballast within portfolios.

Mapping the right route

Moving into an environment of higher starting yields, we often hear questions from clients such as, “Does longer duration still make sense?” or “Why should I own anything besides money markets?” We think there has been too much focus on what’s worked, when the best solution is taking a step back and considering a long-term strategic mix focused on an investor’s goals:

A Goals-Based Approach

- ▶ Adopt a forward-looking mindset
- ▶ Reduce the universe of fixed income strategies into four distinct objectives
- ▶ Allocate across these objectives according to one’s goals



An extra gear

Sometimes small distinctions can make a real difference. We have evolved our framework to include a fourth objective that respects the gradation between seeking to preserve capital and a defensive approach that tolerates more risk. These modifications should help investors in mapping the right route.

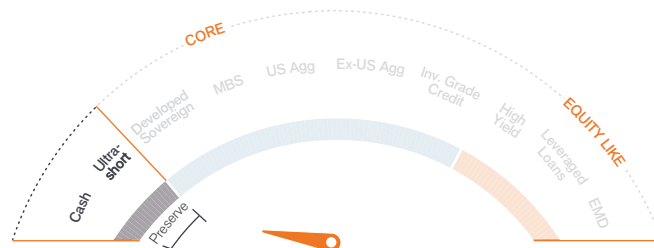
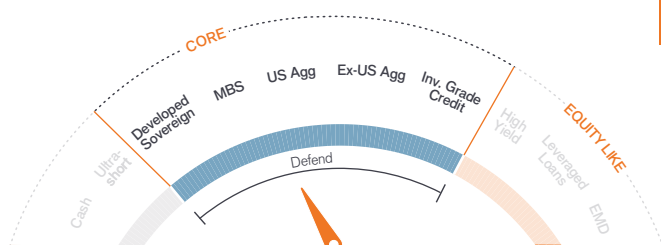
Breaking Down our Four Fixed Income Objectives

Consolidating the breadth of fixed income instruments into four objectives can seem challenging to those not yet familiar with our framework. Below, we outline how Preserve, Defend, Diversify and Increase Income can be defined by their respective goals, personalities, and criteria.



Preserve: Protect capital

- **Goal:** Preserve principal and provide liquidity
- **Personality:** Limited duration and low volatility, generally the most liquid portion of an entire portfolio
- **Criteria:** Cash and cash-like instruments with high credit quality and little duration risk, with intention of capital preservation over capital appreciation



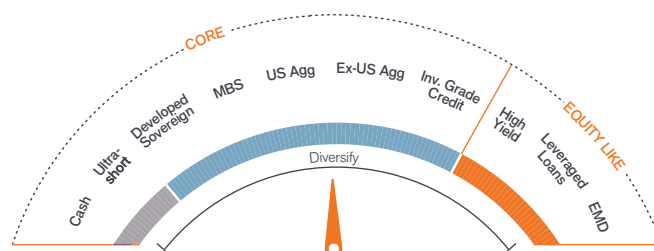
Defend: Ballast, core fixed income

- **Goal:** Seeks to be a ballast against equity volatility during a market drawdown
- **Personality:** Low correlation to traditional equities, high quality, high interest rate sensitivity, composed primarily of investment-grade securities
- **Criteria:** Allocates to currency-hedged, global developed market credit, securitised or sovereign debt



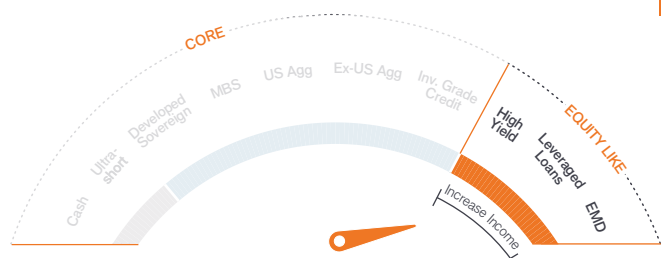
Diversify: Move beyond traditional benchmarks

- **Goal:** Dynamically combine some elements of equity ballast with higher income potential
- **Personality:** Go-anywhere approaches combining elements from Preserve, 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:** Aims for the highest total return within fixed income by seeking high income opportunities and potential capital appreciation to achieve equity-like return 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 to emerging markets



Implementation: No Single Destination

We believe clients are best served with a multi-faceted, goals-based approach. In a shifting interest rate environment, core fixed income's role is as essential as ever: offering a potential diversifier to equities during a crisis. However, the current environment requires forward-looking investors to be increasingly diligent when determining where to allocate capital within fixed income.



Preserve | Protect capital

- **New Consideration:** With a potential new era marked by higher interest rates, shorter duration assets can provide insulation while also providing compelling yields
- **New Roadmap:** Look past traditional money markets for opportunities with less reinvestment risk and diversifying income



Defend | Ballast, core fixed income

- **New Consideration:** Core fixed income allocations are reasserting their correlation benefits to equities while also providing yields higher than the past decade, however not all core bonds are created equal
- **New Roadmap:** Dig deeper into the defensive toolkit; understand new opportunities and trade-offs within securitised, investment-grade corporates and intermediate sovereign bonds



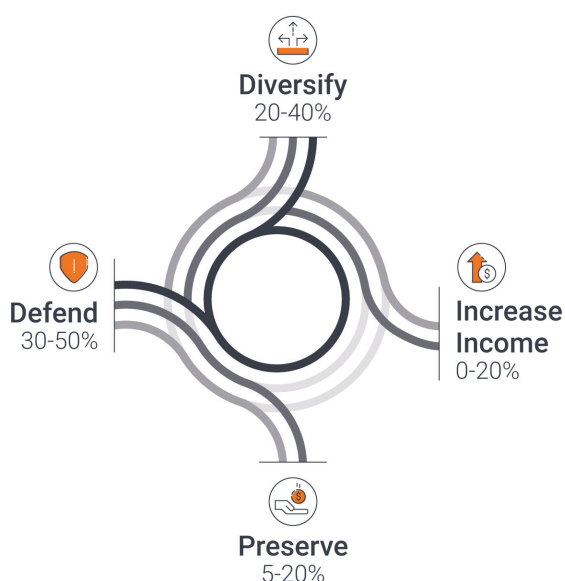
Diversify | Move beyond traditional benchmarks

- **New Consideration:** Volatility has exposed gaps and concentrations in fixed income allocations. Flexibility alone does not necessarily diversify interest rate or credit risk without a thorough understanding of asset correlations
- **New Roadmap:** Diversifying strategies are dynamic tools that can "re-risk" core fixed income overweights and/or "de-risk" overly aggressive fixed income allocations. We believe investors need to focus on managers who are truly dynamic and can help to avoid unintended risk



Increase Income | High income opportunities

- **New Consideration:** A recovering market has created opportunities for the riskiest – and highest-returning – fixed income markets but tight spread levels/richer valuations increase vulnerability in any market correction
- **New Roadmap:** High yields do not guarantee positive prospective returns, but investors need to pay heed to opportunities. Security-selection expertise, a nimble approach and a strong stomach are necessary ingredients to navigate dislocations in these markets



We still believe a large amount of a fixed income portfolio should stay in high-quality fixed income across the Preserve and Defend goals, but savvy investors need to strongly consider the balance of duration and sector allocations within the core.

Outside of the core, we believe allocations to the Diversify and Increase Income goals will depend upon both risk tolerance and current opportunities in the market. Managers within the Diversify goal have the potential to be more strategic and long term given their ability to flexibly allocate across sectors and/or duration. Allocations to Increase Income managers may require more tailoring to current market dynamics.

This powerful framework helps organise the huge universe of fixed income managers and, most importantly, conveys a clear, forward-looking approach to fixed income for clients.

About Janus Henderson's Portfolio Construction and Strategy Team

The PCS team performs customised analyses on investment portfolios, providing differentiated, data-driven diagnostics. From a diverse universe of thousands of models emerge trends, themes and potential opportunities in portfolio construction that we believe will be interesting and beneficial to any investor.

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