

Janus Henderson Absolute Return Income Fund

January 2020

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For professional investors only

Fund manager names: Nick Maroutsos and Jason England

Investment Environment

Global bond markets rallied during the month, largely the consequence of growing uncertainty about how the coronavirus outbreak may impact global growth. Yields on "safe-haven" US Treasuries slid, with that of the 10-year note falling roughly 40 basis points (bps) to close the month at 1.51%. Investment-grade corporate credits delivered positive returns, mostly on the back of lower interest rates on their risk-free benchmarks. High-yield corporates were flat for the period, as the tailwind of lower rates was offset by widening credit spreads late in the period.

Performance Summary

The fund outperformed its benchmark, the FTSE 3-month US Treasury Bill Index.

Portfolio Discussion

Positive returns were largely driven by the fund's cash-based core of corporate credits with both carry from these securities and their interest-rate component contributing. In addition to seeking to generate positive returns via its core of investment-grade corporate bonds, the fund can also opportunistically seek to generate excess returns in currency markets. For the month, the fund's bearish positions on the euro contributed to performance. Detracting from performance in January were positions in government bonds that had been utilised to hedge overall portfolio duration. In this instance, positions were initiated with the aim of reducing the fund's risk from a rise in interest rates, which did not occur given the Coronavirus outbreak.

We expect to maintain a higher level of portfolio risk despite recent market volatility, believing that rates may remain low and corporate profitability may continue to be solid. We expect to maintain Australian and US duration in the 0.50 to 1.00 range for a total portfolio duration of 1.50 years. This is a longer duration position than we have historically taken, but it is informed by our views of scant inflation prospects, continuing global tensions and global central banks remaining in easing mode.

Manager Outlook

We expect the fixed income environment in 2020 to be similar to what we experienced in 2019 in that the predominant trend will be one of growing policy accommodation by central banks. A notable exception is the uncertain trajectory of the Federal Reserve (Fed). While we expect the Fed to ultimately resume lowering, it has hinted that after three cuts, it is willing to pause until economic conditions merit action. In this sense, the Fed's policy normalisation programme that commenced in 2015 paid dividends as it afforded the bank sufficient dry powder to react in an economic downturn. Other central banks are not so fortunate and will likely have to rely upon non-traditional measures to support their fragile economies.

We believe that inaction was likely the Fed's playbook for this past year, but the market forced its hand as concerns about weakening global growth festered. Some of these concerns have not left us. While inroads have been made in breaking the US-China trade impasse, a tenable resolution that could reignite the languishing manufacturing sector and soft trade flows is far from certain. Much of the optimism priced into riskier asset classes as we closed out 2019 reflected a "better-case" trade scenario. The high valuations of both corporate credits and equities could quickly reverse should the two countries retreat to a more protectionist stance.

In Europe, even after Brexit became official, the divorce between the UK and the European Union continues to hang over markets as the final structure of the post-Brexit relationship has yet to be determined. Also lingering are questions about whether the European Central Bank's latest increase of asset purchases will move the needle for economic growth, especially if governments remain hesitant to implement fiscal stimulus. A new risk is the policy uncertainty thrust upon markets by the US election cycle. Sectors ranging from health care and energy to technology and financials may all be impacted by the proposals of leading presidential contenders.

Fed policy, itself, is a risk that merits close attention. We believe that lower nominal interest rates are a secular trend, and one from which the US is not exempt. Ultimately, we expect the Fed will re-engage in rate cuts, but their timing represents a risk to markets. We don't foresee a "doom" scenario as we don't think a near-term recession is on the cards. In the wake of the Fed's "not-quite-dovish" October statement, futures markets have backed off their expectations for 2020 rate cuts, but they still price in more than what Fed officials estimate.

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Should the Fed stick to its guns and the yield curve steepen more than it already has, we could foresee repricing across a range of risk assets.

Despite our view that a strong US consumer and accommodative policy by central banks will likely stave off global recession, the lack of clarity on this cocktail of risks means that investors should expect higher levels of bond market volatility. One place where this volatility may manifest itself is the longer end of the US Treasuries curve. Tight spreads may mean that the upside of US corporate credits is limited as well. Other markets appear better positioned as their monetary authorities are firmly in the easing camp and their corporate sector may not be as richly priced as comparable US issuers.

Source: Janus Henderson Investors, as at 31 January 2020

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Please note that as of 30 September 2018, Jason England also manages the fund. With effect from 30 November 2018, the benchmark changed from 3-Month LIBOR to FTSE 3-Month US Treasury Bill Index