COMMENTARY

Janus Henderson Balanced Fund

Q4 2019

For promotional purposes
For professional investors only

Fund manager names: Marc Pinto, CFA, Jeremiah Buckley, CFA, Mayur Saigal, Michael Keough

Performance

The fund seeks to provide more consistent returns over time by allocating across the spectrum of fixed income and equity securities. It returned (I US dollar accumulation share class) 5.2% compared with a 5.0% return for the Balanced Index, which is an internally calculated, hypothetical combination of unmanaged indices that combines the total returns from the S&P 500® Index (55%) and the Bloomberg Barclays U.S. Aggregate Bond Index (45%). The S&P 500 Index returned 9.1% during the same time period, while the Bloomberg Barclays US Aggregate Bond Index returned 0.2%.

Investment Environment

Large-cap equities generated strong gains, with growth equities - especially high-growth names - outperforming value stocks. The relatively strong US economy, benign interest rate environment and late-period progress in US-China trade relations provided a positive backdrop for US equities.

Continued strength in employment and wage growth supported consumer confidence and spending. Companies generally reported healthy earnings growth, although those with exposure to industrial production continued to experience weakness. The Federal Reserve (Fed) remained accommodative, cutting its benchmark federal funds rate for the third time this year, but signalled plans for a pause to allow the cuts to work through the economy before taking further action.

Rising rates held fixed income to nominal gains. The US Treasury yield curve steepened with the benchmark 10-year bond yield closing December at 1.92%, up from 1.66% in September. But corporate credit performed well, with high yield bonds outperforming investment grade bonds.

Performance Discussion

Compared to the Balanced Index the fund has an overweight position to equities, with roughly 62% allocated to stocks, 38% to fixed income and a small portion in cash. While we maintained a relatively bullish stance, we took advantage of the strong performance in equities to modestly decrease our equity position near the end of the period. We determined it prudent to reduce risk exposure by trimming some higher-beta holdings that were trading at or near peak valuations. Nevertheless, we believe that the risk/reward trade-off between stocks and bonds currently favours stocks, with the dividend yield on the S&P 500 Index attractive relative to that of longer-term Treasury notes. Although not that attractive on an absolute basis, US equities remain reasonably valued and within historical ranges. Going forward, the fund's equity weighting will continue to be dynamic, based on market conditions and the investment opportunities our teams identify across asset classes.

The fund's equity holdings underperformed the S&P 500 Index. While our emphasis on relatively less-volatile stocks lagged the broader market, some of our larger positions also faced idiosyncratic challenges. For example, Boeing was the top equity detractor. The Federal Aviation Administration's diligence in reinstating the 737 MAX aircraft resulted in concerns over potential negative cash flow, as it is still awaiting approval. We continue to hold the position as robust air traffic is supportive of a growing fleet and orders for the 737 MAX remain intact.

McDonald's also detracted. An unexpected CEO change negatively impacted the stock and while the company reported strong sales and earnings results its operating leverage disappointed. We maintained our position, believing the company's investment into its business, including its digital customer experience, will ultimately be accretive.

Apple led the fund's absolute contributors. Optimism around the rollout of 5G and the company's 2020 product line-up supported the stock. Apple's higher-margin accessory business, which includes the Apple Watch and AirPods, continues to grow, and its services business has helped create a recurring revenue stream that makes the company less dependent on the phone replacement cycle.

Microsoft was another contributor. The company had solid quarterly results as demand for its (SaaS) products, including the Azure cloud platform and subscription-based Office 365, remains healthy. Further, Microsoft won a sizeable government contract for Azure during the period. The company's consistent revenue growth is commendable for a company of its size, and we admire the consistency with which it returns capital to shareholders.

Janus Henderson Balanced Fund

The Fund's fixed income holdings outperformed the Bloomberg Barclays US Aggregate Bond Index. We maintained a constructive view on credit markets, believing they would be supported by the more accommodative Fed, a healthy consumer and favourable financial conditions. Our overweight position in investment-grade corporate credit, particularly in the lowest-ratings tier of the segment, contributed significantly to relative outperformance, as did our out-of-index exposure to high yield.

At the industry level, security selection and a focus on companies that prioritise sound fundamentals and deleveraging their balance sheets boosted returns in technology and health care. Our overweight position in semiconductor manufacturer Broadcom benefited from a shift in the company's long-standing financial policy in which management demonstrated its commitment to maintaining investment-grade ratings and paying down debt. In the health insurance sector we added exposure to Centene, a leading player in the Managed Medicaid and Affordable Care Act (ACA) exchange markets. While rated investment grade by Standard & Poor's (S&P), we expect the crossover issuer to be upgraded by Moody's in the near to medium term. Positive momentum in the company's new issue boosted performance.

While there were no material detractors from relative results, a position in Newell Brands, the makers of Rubbermaid, modestly detracted after a ratings downgrade by S&P. We exited our position, though we were pleased with performance of the bonds for the calendar year. Our modest cash position also held back results. Cash is not a strategy within the fund but is a residual of our bottom-up investment process.

Outlook

US equity markets have remained resilient despite the backdrop of fading global economic growth, seesawing trade tensions and uncertainties surrounding the 2020 US presidential election. Solid corporate results and the return of money to shareholders continue to buoy the market, and the consumer remains on relatively strong footing, with increasing wage growth and a healthy labour market supporting consumer confidence and spending. In our view, the outlook for accommodative interest rates and slower but constructive earnings growth coupled with consumer strength make many equity valuations defendable, with potential for upside. Further, with suppressed Treasury yields and corporate yields over Treasuries near their tightest levels of this credit cycle, we intend to maintain our equity overweight position.

Still, the macroeconomic situation points to short-term bumps along the road in 2020, and we fully expect US-China trade tensions and the presidential election to generate volatility, with the market responding positively or negatively depending on the tenor of the latest news. While progress appears to have been made on the trade front, until there is a definitive resolution, the negotiations will overhang markets and threaten to disrupt supply chains, and we remain mindful of our exposure to those companies in the cross fire.

Within equities, we prefer to focus on powerful secular themes that we believe will remain in place for an extended period of time, including the shift to cloud services and greater adoption of Software as a Service (SaaS) solutions, a worldwide increase in the use of e-payments and the growth of global travel and leisure activity. We continue to look for companies that stand to benefit from these trends and those that exhibit quality earnings growth and generate excess free cash flow to reinvest in their businesses and return value to shareholders. We believe these firms can perform well through a variety of market cycles and economic conditions.

Within fixed income, we remain positive, but our outlook for returns is subdued in comparison to 2019. Corporate credit, in aggregate, should find support from a stabilising US economy. However, given the relative tightness in corporate bond spreads, we are biased toward higher-quality, cash flow-generative business models and issuers that are focused on balance sheet improvement. We expect consumer strength to remain a bright spot and, as we seek to diversify the portfolio's credit risk, we believe asset and mortgage-backed securities will offer attractive opportunities in 2020. Across fixed income sectors, we remain committed to astute security selection as we strive to deliver strong risk-adjusted returns.

Source: Janus Henderson Investors, as at 31 December 2019

Janus Henderson Balanced Fund

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Benelux
Janus Henderson Investors
Tel: +31 20 675 0146
Fax: +31 20 675 7197
Email: info.nederlands@janushenderson.com

France/Monaco/Geneva
Janus Henderson Investors
Tel: +33 1 53 05 41 30
Fax: +33 1 44 51 94 22
Email: info.europe.francophone@janushenderson.com

Germany/Austria
Janus Henderson Investors
Tel: +49 69 86 003 0
Fax: +49 69 86 003 355
Email: info.germany@janushenderson.com

Dubai
Janus Henderson Investors
Tel: +9714 401 9565
Fax: +9714 401 9564
Email: JanusHenderson-MEACA@janushenderson.com

Hong Kong
Janus Henderson Investors
Tel: +852 2905 5188
Fax: +852 2905 5138
Email: marketing.asia@janushenderson.com

Italy
Janus Henderson Investors
Tel: +39 02 72 14 731
Fax: +39 02 72 14 7350
Email: info.italy@janushenderson.com

Latin America
Janus Henderson Investors
Tel: +44 20 7818 6458
Fax: +44 20 7818 7458
Email: sales.support@janushenderson.com

Nordics
Janus Henderson Investors
United Kingdom
Tel: +44 20 7818 4397
Fax: +44 20 7818 1819
Email: sales.support@janushenderson.com

Singapore
Janus Henderson Investors
Tel: +65 6836 3900
Fax: +65 6221 0039
Email: marketing.asia@janushenderson.com

Spain/Portugal/Andorra
Janus Henderson Investors
Tel: +34 91 562 6172
Fax: +34 91 564 6225
Email: info.iberia@janushenderson.com

Switzerland (Germanic)
Janus Henderson Investors
Tel: +41 43 888 6262
Fax: +41 43 888 6263
Email: info.switzerland@janushenderson.com

United Kingdom
Janus Henderson Investors
Tel: +44 20 7818 1818
Fax: +44 20 7818 1819
Email: sales.support@janushenderson.com

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Janus Henderson Balanced Fund

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