COMMENTARY

Janus Henderson High Yield Fund

December 2019

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For professional investors only

Fund manager names: Seth Meyer CFA and Brent Olson

Investment Environment

US high-yield bonds posted positive returns in December. Investor appetite for risk increased as the US and China reached an initial trade agreement, and positive employment and consumer spending data pointed to continued resilience in the US economy. As economic conditions appeared to stabilise, the Federal Reserve (Fed) signalled a likely pause in additional stimulus following three rate cuts in 2019. The US Treasury yield curve steepened over the month, with the yield on the 5-year note closing December at 1.69%, up from 1.63% in November.

Portfolio Attribution

The fund (I US dollar accumulation share class) returned 2.0% while the Bloomberg Barclays US Corporate High Yield Bond Index returned 2.0%.

While our out-of-index allocation to bank loans generated positive returns, it weighed on relative performance as the asset class failed to keep pace with high-yield corporate credit. The fund's modest cash balance also held back results during the risk-on environment. Cash is not used as a strategy within the fund, but is a residual of our bottom-up security selection process. At the sector level, security selection in wireline communications and oil field services detracted. A lower-rated investment-grade position in General Electric also proved to be a drag on returns.

Our modest allocation to equity and equity-like securities benefited relative performance given the outperformance of relatively riskier investments. A convertible position in Change Healthcare was a top individual contributor. Security selection in technology and midstream energy aided results. In midstream, the fund had an overweight position to NGL Energy Partners, which was also among the largest individual contributors as the energy sector recovered from distressed levels reached during the summer and fall.

Market Outlook & Investment Approach

A precarious stability is priced into markets as optimism about economic growth is balanced against fears of further weakness. With headwinds in the form of trade and the US presidential election still unresolved, we believe it prudent to be more conservative about the US economic outlook. Even still, it is difficult to be outright bearish on corporate credit, because a growth rate wobbling around 1.5% to 2% may not fuel strong growth in equity markets, but it is sufficient to support many corporate capital structures. Further, the search for yield remains a global theme that should continue to benefit corporate bonds, and high yield in particular. December's aggressive rally in the lowest tiers of high yield is evidence of this demand insofar as there was not a commensurate turnaround in company fundamentals to justify such a sharp rally.

With the high-yield market likely to remain suspended between concerns about US economic weakness and expensive valuations on the one hand, and demand for yield on the other, we do not anticipate significant spread tightening or widening in 2020. In the fund, we are working to strike a balance between holdings with the potential for high total return and those with more stable prices and steady income. We will continue to look across company capital structures for attractive risk/reward, investing in more senior bank loans for income opportunities and in equity-like positions to gain exposure to the market without buying troubled credits.

At the sector level, we are closely monitoring those likely to experience election volatility, such as health care and pharmaceuticals. We continue to seek means to capitalise on consumer strength in sectors such as gaming. As always, we favour companies where free cash flow is positive and management is focused on deleveraging as we to seek to temper the downside risks associated with the high-yield asset class.

Source: Janus Henderson Investors, as at 31 December 2019

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