COMMENTARY

Janus Henderson High Yield Fund

Q4 2019

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Fund manager names: Seth Meyer CFA and Brent Olson

Investment Environment

Fixed income markets broadly became more confident of a soft landing for the US economy as the US Federal Reserve (Fed) continued with accommodation. The Fed lowered its policy rate for the third time in 2019 and purchased Treasury bills to help stabilise the short-term borrowing market. International trade disputes remained a source of volatility, but markets were encouraged by December's news that a phase one trade deal with China was likely. The yield on the 5-year Treasury note was relatively range-bound, closing the quarter at 1.69%, up from 1.54% in September. High-yield valuations rose with spreads (yields over Treasuries) tightening roughly 37 basis points as investors favoured riskier asset classes.

Portfolio Attribution

The fund (I US dollar accumulation share class) returned 2.9% compared with a 2.6% return from the Bloomberg Barclays US Corporate High Yield Bond Index.

Relative outperformance was driven by security selection, though asset allocation decisions added to performance on balance. Amid the risk-on mindset, our modest equity and equity-like positions proved particularly beneficial.

Security selection was strong across multiple industries, including technology, gaming, and metals and mining. At the individual issuer level, medical solutions company Avantor performed well based on the market's expectation that it will refinance parts of its higher cost capital structure. In metals and mining, security selection and our overweight allocation aided results. Issuer First Quantum Minerals performed well on speculation that involvement of a new strategic partner could result in a spin-off of or joint venture in one of its emerging market operations. Copper prices also recovered towards the end of the period as the likelihood of a trade deal increased, supporting the sector. We took the opportunity to reduce exposure now that the sector appears to be pricing in too strong an outlook for GDP growth in our view.

In an attempt to replicate exposure to the lowest tiers of high yield while avoiding troubled, illiquid credits, we rely on our in-depth research to analyse the entire capital structure of companies we know and like. When we identify discrepancies between rich bond valuations and other areas of the capital structure, we are willing to take small equity positions in our highest-conviction names. One such position in Ardagh Group, one of the world's largest metal and glass packaging companies, contributed positively to relative results, benefiting as investors reacted favourably to the company's refinancing of its capital structure.

Positioning in the independent energy sector detracted, with issuers including Extraction Oil and Gas and Chesapeake Energy struggling early in the period as lower-quality, higher-beta energy names were largely avoided by the market. We exited both positions prior to December's fierce rally in lower-quality bonds, which further weighed on performance.

A position in Sinclair Broadcast Group's Diamond Sports, which was formed when the company acquired the regional sports networks of 21st Century Fox, also detracted. We trimmed our position, sharing the concerns of other investors that contractual stumbles with the DISH Network raised the risks in the company's negotiations with Comcast.

The fund's cash position further hindered results as the market rallied, but the effect diminished as our cash level dropped over the quarter. Cash is not used as a strategy in the fund but is a residual of our bottom-up, fundamental approach.

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.

Janus Henderson High Yield Fund

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 profiles, 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

Janus Henderson High Yield Fund

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Janus Henderson High Yield Fund

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