



MARKET GPS

EQUITY PERSPECTIVES

JUNE 2021

Featuring the latest quarterly insights from our investment teams:

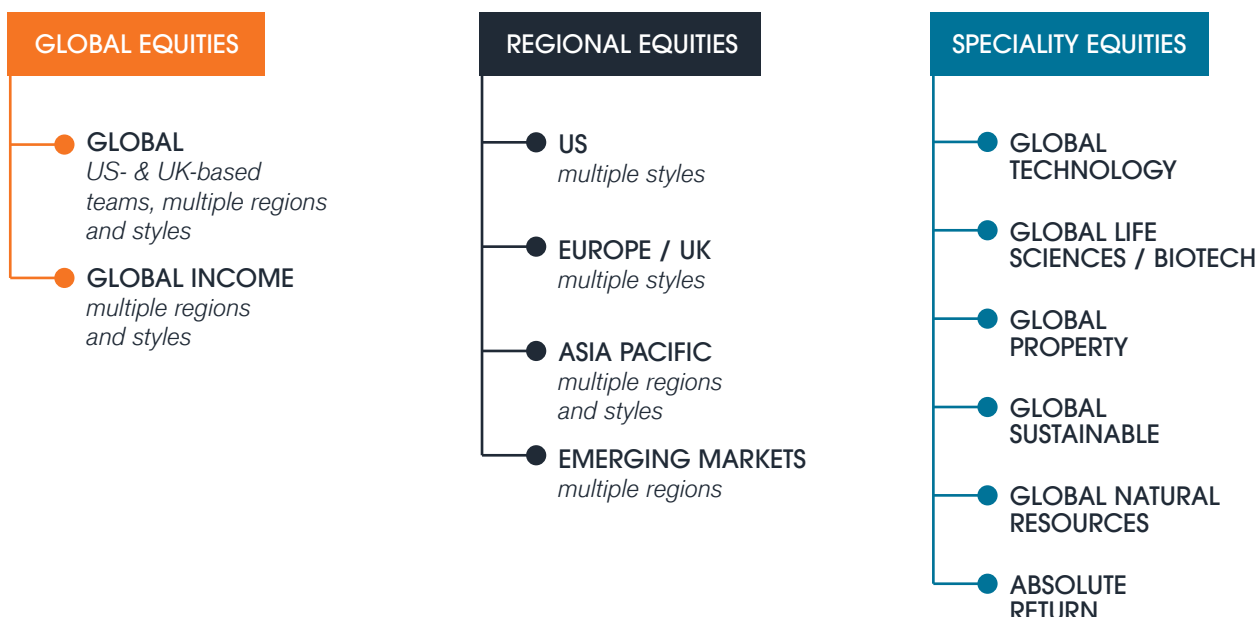
- ▶ A unique recovery: the handoffs commence
- ▶ 'Renewable, electric, digital': the Fourth Industrial Revolution
- ▶ Location, location, location: considerations for a 'listed' approach to commercial real estate
- ▶ Consumer revenge - the next stage of the recovery in Europe

OUR EQUITY CAPABILITIES

Janus Henderson provides an active approach to equity investing. The equities platform is shaped by the belief that fundamental research is the foundation for delivering long-term, market-leading risk-adjusted returns. Independent thought and unique viewpoints are central to this approach and result in portfolios that are meaningfully different to an index. Each team expresses their individual, high-conviction ideas through processes that have evolved to suit their specific areas of the market and within robust risk control frameworks.

While operating with independence, the equities teams benefit from collaboration and shared research that provide a source of portfolio ideas. The culture encourages intellectual challenge and stimulating debate to test – and ultimately strengthen – investment thinking. The success of ideas is measured by overall client outcomes with the aim to deliver consistent, long-term risk-adjusted excess returns over benchmarks and peers regardless of the investment landscape. This effort is supported by award-winning, proprietary portfolio construction technology and a cultural emphasis on the client promise.

The equity teams, led by Co-Heads of Equities Alex Crooke and George Maris, include 162 investment professionals, responsible for US\$224.9bn in assets under management¹. The teams include those with a global perspective, those with a regional focus – US, Europe, Asia Pacific and Emerging Markets – and those invested in specialist sectors. A range of growth, value and absolute return styles are employed.



¹ Source: Janus Henderson, as at 31 March 2021.

A UNIQUE RECOVERY: THE HANDOFFS COMMENCE



Matt Peron

Director of Equities Research Matt Peron explains why this year's equities' gains are built on a positive earnings outlook for both cyclical and secular stocks.

Key takeaways

- » Earnings growth is taking the handoff from rising valuations as economic reopenings lead to more business and consumer activity.
- » Economic growth will likely be iterative as certain sectors and geographies appear set to benefit at different stages of the early-cycle recovery.
- » A wave of stimulus programs means investors must keep a watchful eye on inflationary pressure.

While the equities rally since the pandemic low has been largely uninterrupted, its leadership has undergone a marked transition. In 2020, stocks rebounded on the strength of the stay-at-home stocks that allowed societies to work, learn and shop remotely. Overlapping this group were the mega-cap internet platforms and cloud computing companies aligned with what are considered to be durable, secular-growth themes. In a world of rapid economic contraction, investors were willing to pay a premium for the rare growth story.

This year, optimism surrounding a broader economic reopening has placed more cyclically oriented stocks at the rally's forefront. In contrast to late 2020 when vaccines were on the cusp of approval, improving earnings – rather than hope – are now driving markets. Consequently, leadership has rotated toward beaten-down market segments that are expected to perform well during an economic recovery. Year-to-date returns for value stocks have more than doubled those of growth, and small caps are starting to place distance between themselves and large caps.

Although this rotation largely follows the market-cycle playbook, 2020 was no ordinary recession and investors should be mindful that the recovery may unfold in an atypical manner. A favorable interpretation is that economic disruptions caused by natural phenomena are typically short-lived. A broadening economic recovery, however, may mask the large-scale disruptions to business models caused by shifting consumer behavior and an acceleration in the transition toward a digital economy that occurred during the pandemic. At the same time, unprecedented levels of monetary and fiscal intervention have been

unleashed. The ultimate impact of these developments on certain segments of the market and the economy are far from certain.

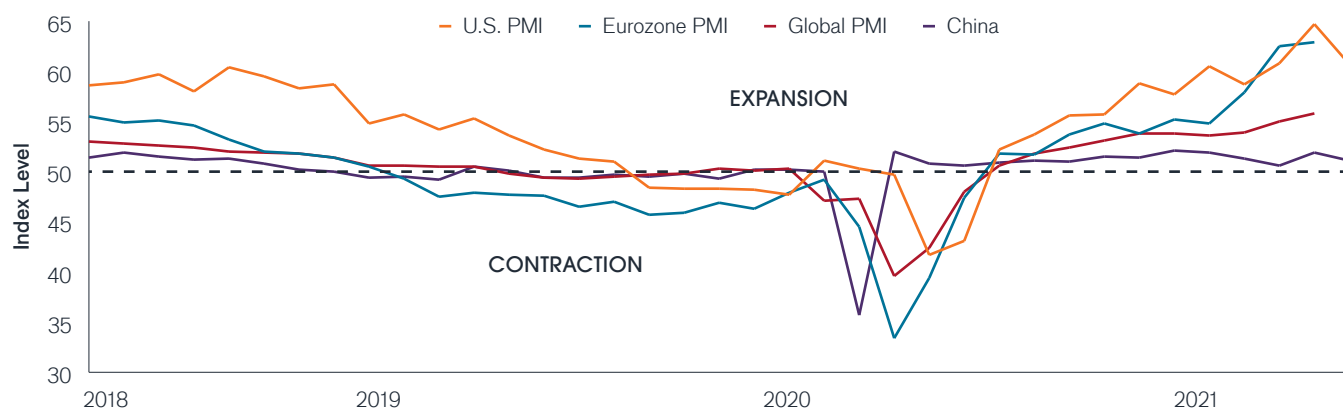
An improving economic backdrop may tempt investors to believe it is smooth sailing for stocks. And while we share the sanguine view on near-term earnings, we believe one cannot simply “buy the market.” This is because market dynamics are bound to shift, and add to that any number of risks – from policy error to inflation and liquidity-driven market dislocations – that could result in a quick withdrawal of support for rally participants that do not possess the strategy or financial strength to deliver earnings growth over the entire business cycle.

Still early innings

Economic recoveries tend to mirror the trajectory of their downdraft. Unlike the Global Financial Crisis (GFC), this appears the case with the emergence from the COVID-19 pandemic. Driving this are considerable vaccination efforts that have allowed an increasing number of countries to reopen their economies. Global gross domestic product (GDP) is now expected to reach 5.8% this year and, as evidenced in Figure 1, regional purchasing manager indices (PMIs) indicate that a “V-shaped” recovery is underway. Owing to the nature of this recession, all geographies contracted together. The recovery, on the other hand, is shaping up to be asynchronous and iterative.

Soon after last year's stay-at-home orders were administered, the global economy received a lifeline as China's central government unleashed a wave of stimulus via its favored policy lever: construction spending. Once

Figure 1: Global PMIs indicate “V-shaped” recovery



Source: Bloomberg, as of 14 May 2021.

“The American shopper ... is positioned to take the handoff from China and propel the next stage of global recovery.”

the country gained sounder economic footing, and mindful of the threat excess leverage may pose, it adopted a less accommodative stance. By this time, however, signs were emerging that the U.S. was beginning to see the light at the end of the tunnel. Given the substantial role that U.S. consumption plays in global economic growth, the American shopper – buttressed by high savings rates and stimulus checks – is positioned to take the handoff from China and propel the next stage of global recovery.

With vaccination rates climbing in key regions such as the UK – and more recently continental Europe – sources of growth, in our view, should become more dispersed as 2021 progresses. India and Brazil, however, are only now experiencing their most recent waves, and vaccination efforts will be pivotal in tamping down on outbreaks and placing these economies on sounder economic footing.

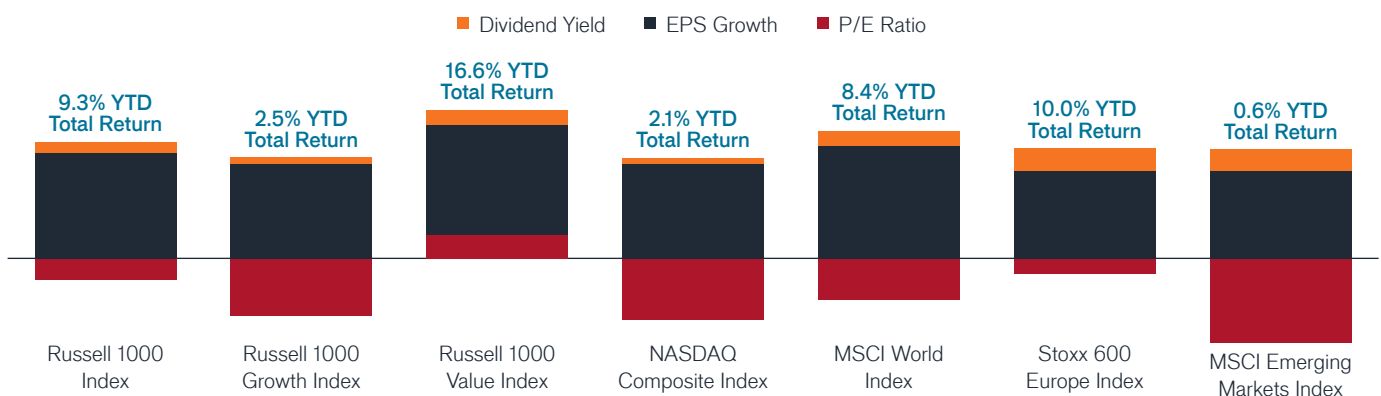
Building a foundation

Equities' gains in 2020 were largely a story of multiple expansion as investors bid up the price for growth-oriented, mega-cap stocks. This year, it is rising earnings growth expectations fueling market advancement (see Figure 2). Equities' earlier re-rating as vaccination research gained

momentum has continued as the global economy records concrete progress. In the past three months, through 13 May, aggregate earnings for the MSCI World Index have been upgraded by over 7%. Importantly, the greatest improvement has been registered by cyclical sectors, including energy, materials, financials and communications. While the latter category was also a driver of the 2020 rally, its repeat appearance has less to do with its exposure to secular growth than to internet platforms' dominant position in online ad spending, which is primed to rise as corporations fight for consumers' attention.

The market has taken notice as these four sectors have been among the best-performing components of the MSCI World Index through late-May. Anticipation of rising demand for industrial inputs has propelled commodity-related sectors, while financials benefited from the early-year yield curve steepening, which bodes well for lenders' operating margins. Historically defensive sectors have, thus far, fallen behind. Among these is the tech sector, which in 2020 assumed the peculiar mantle of “defensive growth,” meaning that at the depths of the crisis, investors gravitated toward the fortress balance sheets and defensible strategic positions of mega-cap sector members.

Figure 2: Earnings growth expectations fueling market advancement



Source: Bloomberg, as of 13 May 2021.

Priming the pump

As COVID mandates are eased in the U.S. and other regions make progress on vaccinations, we expect the economic recovery to broaden. The next stage will likely be driven by consumers eager to re-engage in travel and social activity. Until then, factories scrambling to procure inputs as they ramp up capacity should contribute to growth. This is easier said than done given how the slashing of industrial orders in 2020 disrupted supply chains across a range of industries, with the persistent shortage of semiconductor chips being the highest-profile example. Steps to reestablish these links should fuel early-cycle recovery, albeit with possible hiccups as setbacks could lead to impediments to growth and transitory inflation.

Once industrial capacity rises and consumers open their wallets, purchases have to get settled. While banks stand to benefit from steeper yield curves associated with economic growth, rising transaction volumes should support increasingly prominent financial technology companies, chiefly payment processors. After accelerating during the pandemic, digital transactions, in our view, are likely not going away as consumers and small businesses experienced the ease and efficiency of online payments.

Other activities adopted during the pandemic are also likely to maintain momentum. While e-commerce has been de rigueur for years among digital natives, other demographics – especially the elderly – were won over during lockdowns. Whether with payments or online shopping, individuals and entities are unlikely to return to a less efficient way of conducting business.

Another category may not maintain its pandemic-level of activity but will likely remain part of the economic fabric. Hybrid work and learning models as well as certain online social interactions are not going away. A new equilibrium between the “old” and the “new” must be established. Case in point: A surprise winner during the pandemic was online dating as singles were stuck at home. As in-person contact reemerges, we expect some – but not all – digital engagement to abate.

Lastly, some pandemic-era activities are bound to decline. Video games for example, cannot expand in perpetuity as there are a finite number of hours in the day. As people grow more comfortable with other pursuits, online games will find it difficult to match 2020 levels. Still, this category is better off than the host of businesses that likely will not fully recover due to pandemic-induced behavioral changes. We expect travel and social activities to rise, but for those where there are suitable digital alternatives, their path forward appears challenged.

A unique recovery brings unique risks

Nearly every early recovery enjoys the support of accommodative policy. Consequently, each cycle is at risk of policy error. To be sure, we believe that the driver of the current recovery is a favorable earnings backdrop but given the magnitude of government intervention in the global economy, the scope of unforeseen outcomes, in our view, has widened.

On one hand is the adage that the death knell of every cycle is tighter monetary policy. Markets got a remedial course in this during 2013's taper tantrum, when the Federal Reserve (Fed) hinted at culling its balance sheet. The opposite risk is central banks doing too little, thus creating conditions for accelerating inflation. Given the Fed's firm rhetoric on maintaining an accommodative stance over the midterm, inflation may be the risk meriting greater attention. Simmering concerns about higher prices were likely behind this winter's rise in Treasury yields.

While some inflation is a welcome sign of an improving economy and enables companies to raise wages and pass along higher prices, difficult-to-control inflation would diminish the present value of all riskier assets – not just corporate bonds. Furthermore, aggressive rate hikes, as central banks play catch-up, would fulfill the prophecy of restrictive policy being an expansion's executioner.

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Thus far, the Fed seems circumspect in the uptick in mid- to long-dated Treasury yields. It likely views this as a “push-forward” of year-end rates. And while yields have stabilized, any additional growth-restricting upward move would, in our view, be met by more accommodative initiatives.

Massive fiscal and monetary stimulus not only risk distorting the pricing mechanism in the real economy by introducing inflationary pressure, they may also directly affect financial markets. The combination of liquidity and low rates has sent investors scrambling for yield. Often, they deploy leverage to magnify returns. While we view a market dislocation as a low-percentage scenario, it is not zero, and given the post-GFC market structure, a quick removal of liquidity could have unforeseen consequences as investors de-lever and sell what they can.

It goes back to earnings

In such a scenario, selling could be indiscriminate. But once the dust settles, the stocks that would prove most resilient are likely those supported by earnings growth rather than beneficiaries of the sugar high of excess liquidity. Earnings growth has been particularly strong in energy, materials, financials and communications of late, as shown in Figure 3.

Similarly, should interest rates rise too quickly and the recovery stall, the companies that stand to weather the storm best are those capable of delivering earnings growth over the full business cycle, highlighted by themes

Figure 3: Earnings growth key to resiliency

	YTD Total Return	3-Month Change in Full-Year EPS Estimate
MSCI World Index	9.5%	7.4%
Communications	13.3%	11.1%
Consumer Discretionary	5.5%	3.7%
Consumer Staples	5.4%	-0.9%
Energy	26.0%	45.2%
Financials	22.7%	11.4%
Health Care	5.6%	1.7%
Industrials	12.8%	4.1%
Technology	1.4%	6.7%
Materials	15.8%	17.1%
Real Estate	10.9%	4.3%
Utilities	2.7%	-0.8%

Source: Bloomberg, as of 14 May 2021.

associated with an increasingly digital global economy. But as our base-case for the remainder of 2021 is for a broadening recovery, we believe investors would be well served by balancing their secular exposure with higher-quality names whose earnings should receive a multi-quarter boost in rising economic activity.

Glossary

Cyclically oriented: Companies that sell discretionary consumer items, such as cars, or industries highly sensitive to changes in the economy, such as miners. The prices of equities and bonds issued by cyclical companies tend to be strongly affected by ups and downs in the overall economy, when compared to non-cyclical companies.

Earnings per share (EPS): The portion of a company's profit attributable to each share in the company. It is one of the most popular ways for investors to assess a company's profitability.

Multiple expansion: The expansion of a stock's price to earnings ratio based on investor willingness to place more value on the company's earnings.

Price to earnings (P/E) ratio: A popular ratio used to value a company's shares. It is calculated by dividing the current share price by its earnings per share. In general, a high P/E ratio indicates that investors expect strong earnings growth in the future, although a (temporary) collapse in earnings can also lead to a high P/E ratio.

'RENEWABLE, ELECTRIC, DIGITAL': THE FOURTH INDUSTRIAL REVOLUTION



Hamish Chamberlayne

Portfolio Manager and Head of Global Sustainable Equities Hamish Chamberlayne explores the changes ahead as we enter a decade of transformation and explains the importance of digitalisation, electrification and decarbonisation.

Key takeaways

- » The fossil fuel economy is a highly complex and interdependent system. Detangling the web of carbon-emitting processes is no easy feat.
- » Much greater global political harmony on the climate agenda means the stars are aligning for what we believe will be a globally synchronised investment boom into clean technologies.
- » Digitalisation, electrification and decarbonisation (the 'DED nexus') are powerful agents of positive change for societal and environmental sustainability goals.

For nearly 30 years we have recognised the link between sustainability and innovation, and today we believe we are entering a decade of transformational change. The transition to a low carbon economy is finally accelerating. We view decarbonisation as a generational investment trend that will have a profound impact on almost every sector of the economy.

What does low carbon investing mean?

Low carbon investing is much more than simply investing in renewable energy companies and removing fossil fuels from a portfolio. For the last 250 years, since the beginning of the Industrial Revolution, humankind has made tremendous progress using a fossil fuel-driven economic growth engine. Unfortunately, tremendous industrial progress has not come without its consequences. The world today relies heavily on the use of carbon-emitting processes in everyday life, such that it would be hard to live without them. In essence, the fossil economy has been woven into our global economic system.

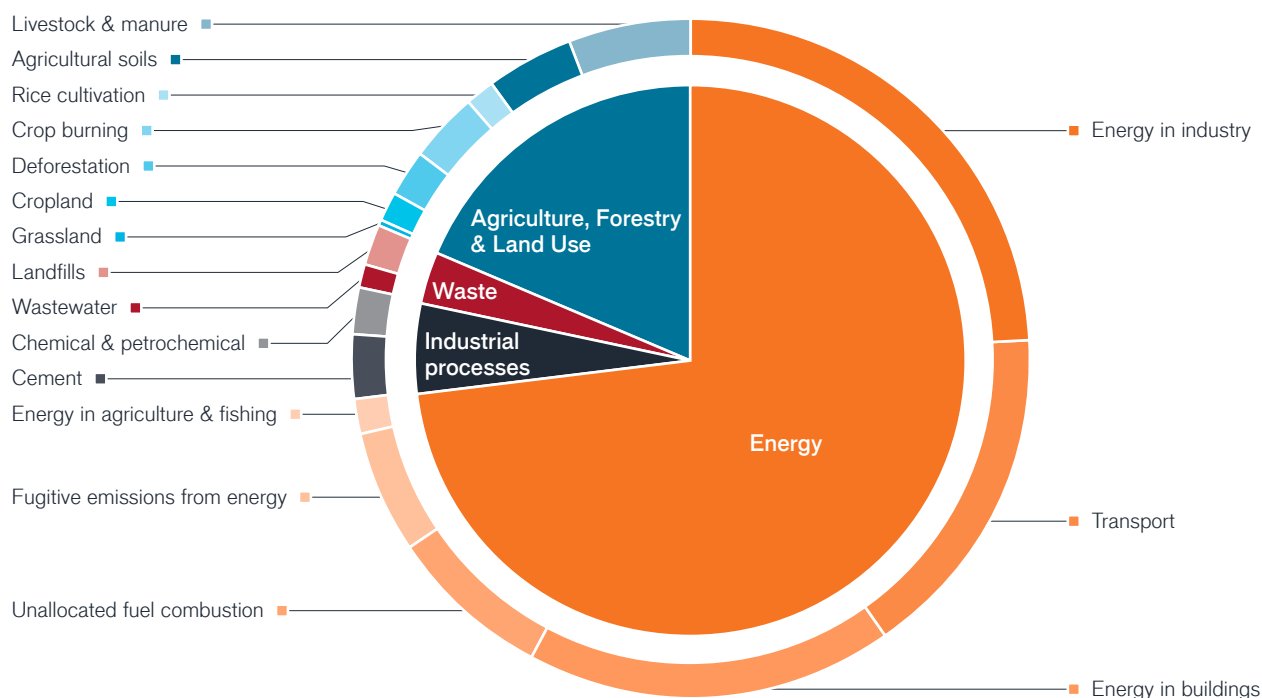
Greenhouse gas emissions are produced across almost all industries. The largest emitters include transportation, electricity, power generation, industry, commercial and

residential buildings, and agriculture. However, it is important to consider that the fossil fuel economy is a highly complex and interdependent system, as shown in Figure 1. Within each sector are various sub sectors and industries with differing levels of fossil fuel-driven economic activity. Detangling the web of carbon-emitting processes is no easy feat.

Synchronised investment boom into clean technologies

This year, the world's most influential governments have made ambitious commitments to tackle climate change head on. In April 2021, 40 world leaders convened virtually to address the climate crisis at the Leaders Summit on Climate. The White House stated its aim to reduce US emissions by 50% to 52% by 2030 based on 2005 levels and China premier Xi Jinping announced intentions to phase out coal use from 2026. Meanwhile, the UK government announced the world's most ambitious climate change target – to cut emissions by 78% by 2035 compared to 1990 levels. The UK's sixth carbon budget is set to include international aviation and shipping emissions and would bring the UK more than three-quarters of the way to net zero by 2050. Today, we are pleased to see much greater

Figure 1: Global greenhouse gas emissions by sector



Source: Climate Watch, The World Resources Institute, 2020. Global greenhouse gas emissions data from 2016 (latest available).

In April 2021, 40 world leaders convened virtually to address the climate crisis at the Leaders Summit on Climate.

Emission Reduction Plans



US PLANS TO REDUCE EMISSIONS BY 50% TO 52% BY 2030 BASED ON 2005 LEVELS



CHINA PLANS TO PHASE OUT COAL USE FROM 2026



UK PLANS TO CUT EMISSIONS BY 78% BY 2035 COMPARED TO 1990 LEVELS

“Today, we are pleased to see much greater global political harmony on the climate agenda. The stars are aligning for what we believe will be a globally synchronised investment boom into clean technologies.”

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So, what do these climate commitments mean for the fossil fuel economy? In order to align with the 1.5°C climate limit, we will need multiple solutions to address the multiple sectors and industries involved. Countries must increase electricity share of the primary energy mix from 20% to 50% over the next few decades. The US has set out material provisions to electrify a portion of the school bus fleet, retrofit buildings to higher environmental standards, reduce the use of coal and gas generation, and invest in the country's electric and renewable energy infrastructure. The UK, meanwhile, has banned the sale of diesel and petrol cars by 2030 and announced a £20m funding pot for electric vehicles.

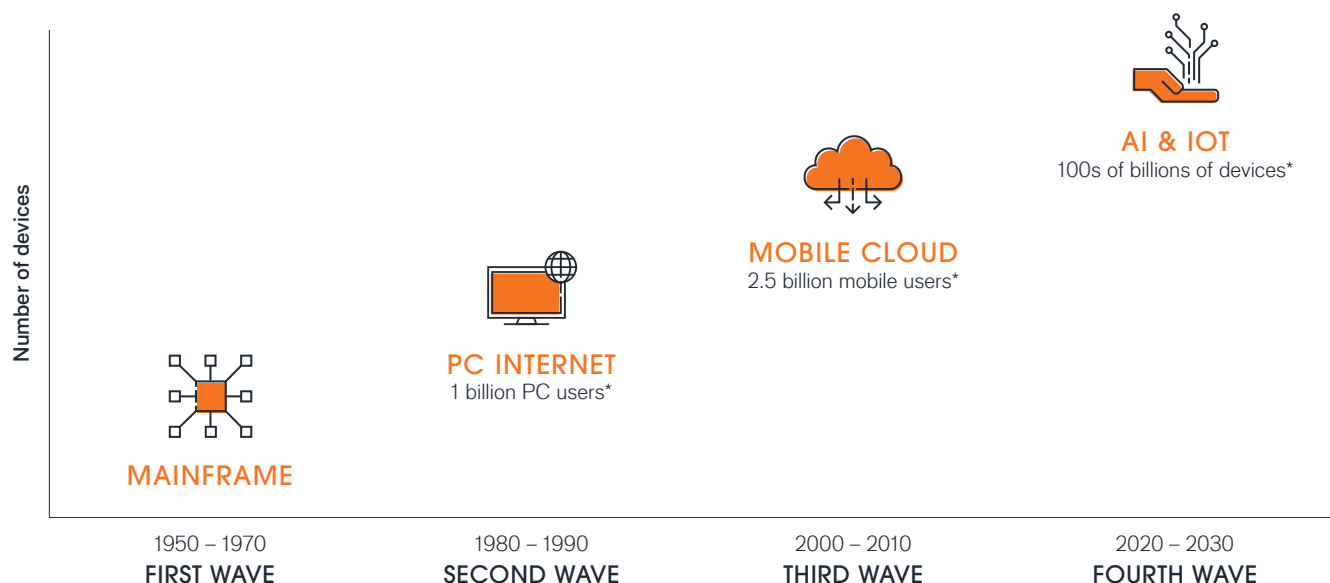
A decade of transformational change

Electrification of the global automotive fleet is one area that we are particularly excited about. As battery and computing technology continue to improve and associated costs decrease, we expect to see mass production and adoption of electric vehicles. This is often referred to as the S-curve. When plotted on a chart, the S-curve illustrates the innovation of a technology from its slow early beginnings as it is developed, to an acceleration phase as it matures and, finally, to its stabilisation over time. The electrification of vehicles is just one example of this. We believe we are standing at the beginning of a decade of transformational change that will induce multiple S-curves across many different industries.

At the heart of this change is electrification. Picture a light-emitting diode (LED) bulb, which emits light through a process called electroluminescence. In contrast to the traditional incandescent bulb, which emits light through the heating of a small metal filament, LEDs pass electrical currents through semiconducting material in order to emit photons. This same photon emitting process can be used to transmit data. LiFi, similar to WiFi, is a wireless communication technology which utilises the LED process to transmit data from one object to another.

While the details of LiFi might be fascinating, the key takeaway is that the electrification and digitalisation are intrinsically linked. As electrification continues to develop, everything will become 'smart' and connected, blurring the lines between sectors and industries. Over the next decade, we anticipate the inception of multiple S-curves as technology improves and connectivity progresses.

Figure 2: The Fourth Industrial Revolution: merging industrial and technological economies



Source: Janus Henderson Investors, 2021. *Citi Research, as at 31 December 2016. Note: AI = artificial intelligence, IOT = Internet of Things.

Traditional analogue products will make way for the new era of cloud computing and the Industrial Internet of Things. This shift has already started happening in smart cars, smart watches and even smart fridges. We consider this to be the Fourth Industrial Revolution (see Figure 2).

The Fourth Industrial Revolution is enabling us to move from a 'fossil analog' economy towards a 'renewable electric digital' economy. It is at the heart of decarbonisation and the transition to a low carbon economy. We refer to the

trio of digitalisation, electrification and decarbonisation (DED) as the 'DED nexus'. These dynamics are impacting every sector and every corner of the global economy. We highlight the importance of considering the implications of these changes on portfolios. The DED nexus has been accelerated by the events of last year and we believe that, combined, they are powerful agents of positive change with regards to both societal and environmental sustainability goals.

LOCATION, LOCATION, LOCATION: CONSIDERATIONS FOR A 'LISTED' APPROACH TO COMMERCIAL REAL ESTATE



Guy Barnard



Tim Gibson



Greg Kuhl

Investing in listed companies is an increasingly popular route to gaining exposure to commercial real estate. Portfolio managers Guy Barnard, Tim Gibson and Greg Kuhl explore the key considerations.

Key takeaways

- » The wide dispersions in stock and sector performance within listed real estate create opportunities. An active approach to selecting concentrated groups of companies to suit target outcomes is key within this diverse opportunity set.
- » Specialist valuation techniques and expertise on the trends reshaping the real estate landscape are important lenses through which to view opportunities.
- » As with many asset classes, environmental, social and governance (ESG) factors are key to future performance. This is particularly the case within listed real estate where integration within portfolios requires expert judgement and subjectivity.

“There are three criteria that matter in property: location, location, location.” While the true origins of this well-known phrase may be uncertain (first seen in print in a 1926 Chicago Tribune real estate advertisement)¹, its veracity has proved timeless. It is well accepted that physical location is a primary determinant of real estate investing.

Beyond “location” and certain other factors, there are also key considerations around allocating capital within real estate. Capital can be deployed into private market real estate via direct ownership of buildings or through various types of private-equity real estate vehicles. Investors can also choose listed real estate equities (landlord companies quoted on a stock exchange that derive income from the ownership, trading, and development of income-producing real estate assets). Within listed real estate allocations, whether to take a passive (buying an index of listed real estate companies) or active (investing in a more selective portfolio) approach is another important decision. As more and more investors consider the listed real estate option, it is timely to explore key considerations within this relatively young and growing asset class.

Asset class considerations

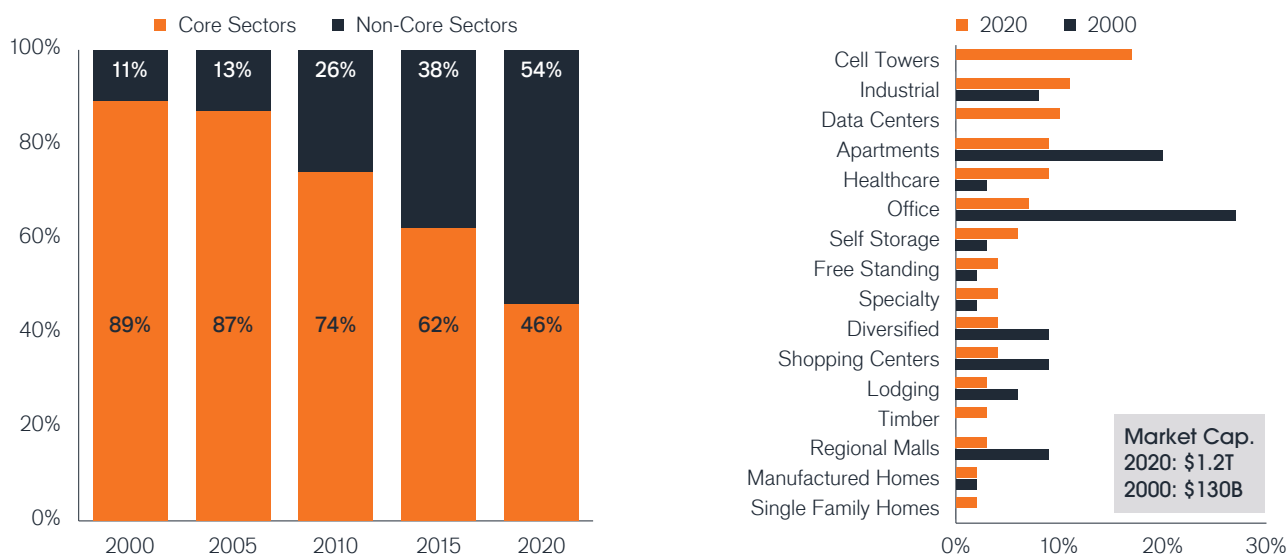
It is important to look at the many parts that make up the whole. The listed real estate asset class is comprised of hundreds of companies owning thousands of physical assets across dozens of property types around the world. Each of these variables comes with its own set of supply

and demand characteristics, some of which are much more favourable to landlords than others. Listed real estate companies are vehicles with significant scale and their management teams can opportunistically raise and deploy capital as they see fit. They often specialise in a single property type and employ highly experienced senior management teams with relevant expertise in private real estate and public equities.

Commercial real estate is categorised between the “core” property sectors of retail, office, multifamily, and industrial, and “non-core” real estate. “Non-core” has seen significant growth in the last 20 years (see Figure 1) and broadens the range of property types available for investment significantly. Examples include single-tenant retail buildings, experiential real estate assets, cell phone towers, data centres, singlefamily rental homes, self-storage, laboratory space, manufactured home communities, and health care real estate.

“Non-core” properties have outperformed “core” over the long term,² although past performance is not a guide to future performance. The operational intensity and granular nature (i.e. fewer, extremely high-value single properties) of many non-core property types mean portfolios can take years, if not decades, to assemble and require a significant depth of expertise to manage. These types of businesses are very difficult to replicate and are uniquely suited to the long-term investment horizon and continuous access to capital afforded by public equity markets.

Figure 1: Listed US real estate: an evolving asset class (% of index)



Source: NAREIT, as at 31 December 2020. Data depicts the FTSE Nareit All Equity REITs Index, which is a free-float adjusted, market capitalisation-weighted index that includes all tax qualified US REITs listed in the NYSE, AMEX, and Nasdaq National Market.

Key themes

This is an asset class that provides interesting and evolving risks and opportunities. We believe there are currently three considerations that should be top of mind when analysing the opportunity set.

1. Active or passive?

It is possible to invest in listed real estate passively by buying an appropriate index. Or to invest in an actively managed portfolio of listed real estate companies. We believe the latter approach is more appropriate with, in our view, a digitization asset class requiring specific knowledge and a high degree of selectivity.

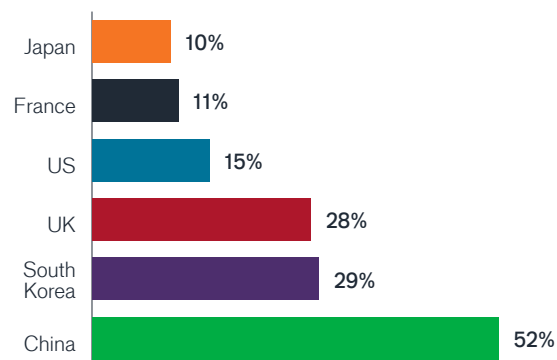
Listed real estate offers a large universe of investments from which active managers can select focused groups of companies to suit certain target outcomes. This selectivity is, in our view, essential given the disparate nature of the asset class and the importance of valuation analysis. Listed real estate companies own tangible assets that can be valued using either traditional equity valuation tools (earnings multiples, discounted cash flows, dividend growth models), or private market valuation techniques (observation of comparable sales, Internal Rate of Return forecasts). This dual approach can provide active real estate managers with an important insight into intrinsic value. Skilled managers can use this informed perspective in conjunction with the daily liquidity of stocks to take advantage of potential mispricing in the market. This is particularly important given the wide dispersions in stock and sector performance that exist (see Figure 2).

2. A shifting landscape

What has worked in the past (property types that are heavily represented in indices) may not be what works in the future. An example of an ongoing trend with disruption potential is demographics; this is leading to a shift in preferred housing options for baby boomers and millennials. Another is the digitization of nearly everything; this is leading to a growing percentage of commerce occurring online, driving exponential growth in data traffic and consumption, and having an impact on where people choose to live and work (see Figure 3).

Figure 3: Growth in eCommerce: a key trend impacting real estate

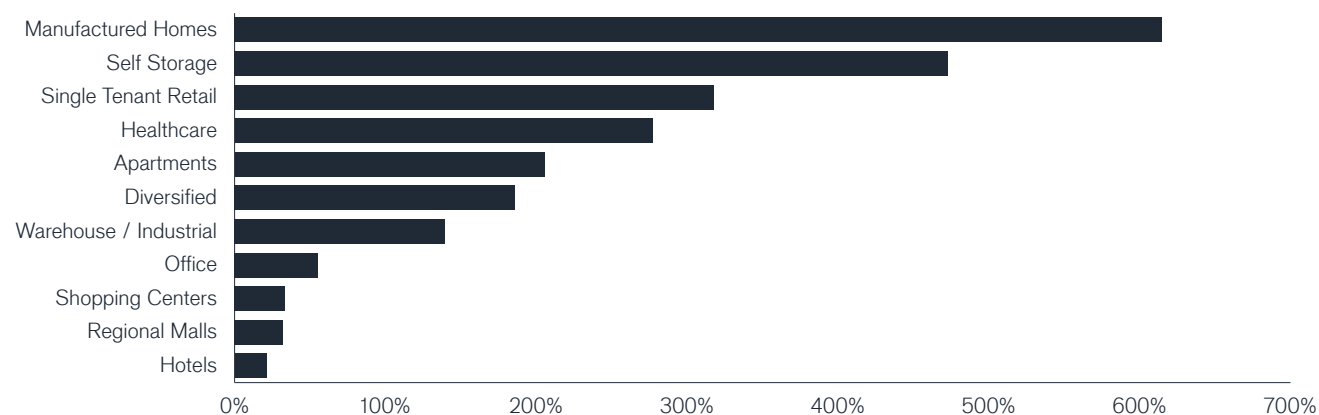
Ecommerce sales penetration (2021 estimates):
plenty of headroom for developed countries



Source: eMarketer, as at end Q2 2020 Census Bureau, Prologis.

Figure 2: Not all property types are created equal

15-year cumulative total return by US real estate property type



Source: Bloomberg Real Estate Property Type Indices. Cumulative total returns from 31 March 2006 to 31 March 2021. Past performance is not a guide to future performance. Each property type noted above denotes a digitization n-weighted sub-index of the Bloomberg REIT Index (BBREIT), which is a digitization n-weighted index of Real Estate Investment Trusts having a market digitization n of \$15 million or greater. The BBREIT index was developed with a base value of 100 as of 31 December 1993.

These trends may mean that some of the core property types, notably office and retail, are facing more challenges than ever, while other types of property like warehouses, cell phone towers, and owners of specialty housing are benefiting from tailwinds. It is also important to consider less mainstream asset types that may not yet be included in benchmark indices. Applying an approach that allows the identification of, and access to, these new and growing property types is key to real estate investing.

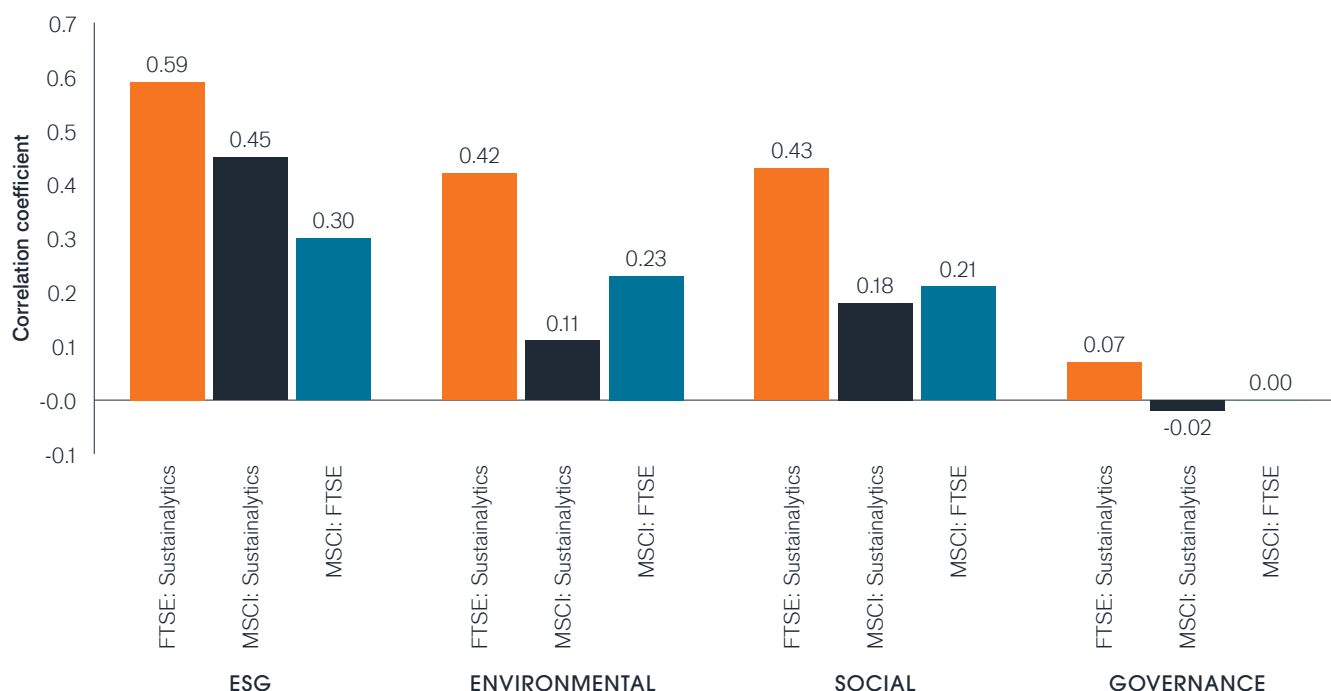
3. ESG can't be automated

Effective integration of environmental, social and governance (ESG) factors into real estate portfolio construction requires judgement and subjectivity. There are many third-party providers attempting to quantitatively score real estate companies on ESG metrics. The near complete lack of agreement across these providers around which metrics to measure and whether a particular company is "good" or "bad" on a particular ESG pillar is a challenge (see Figure 4). In our view, this is another key supporting argument for taking an active approach where selectivity can be applied.

“We believe that benchmark investing is akin to driving using the rearview mirror. There are dynamic trends reshaping how we live our lives and it is important to shape listed real estate portfolios around a vision of the future.”

Figure 4: ESG scoring data can vary widely

Pairwise correlation between ESG rating services' ranking of individual companies



Source: Credit Suisse Global Investment Returns Yearbook 2020. ESG scoring data from MSCI, FTSE Russell and Sustainalytics, computations and analysis by Dimson, Marsh and Staunton. Correlation measures how far the movements of two variables match each other in their direction. If variables have a correlation of +1, then they move in the same direction. If they have a correlation of -1, they move in opposite directions while 0.00 implies no relationship. Pairwise correlation identifies groups of highly correlated features and keeps ones to improve predictability of the relationship.

ESG analysis is unlikely to ever be as clear cut as analysing a balance sheet given significant challenges in the comparison of companies operating in disparate industries. Within the real estate sector, a meaningful comparison of ESG principles across listed companies requires a depth of knowledge regarding the company's property portfolio, its capital allocation, its management team's incentives, and the oversight of its board of directors. The selection of specific real estate ESG criteria also needs to consider the vast operational differences that exist between various property types and markets. Within a specialist sector such as real estate, every company has unique considerations to evaluate and there is no standard set of reporting metrics. All of this means portfolio construction that includes a rational consideration of ESG is likely to remain a challenge unless approached actively. In our view, if approached in the right way based on sound judgement, the integration of ESG into portfolio construction can lead to meaningfully better performance.

In summary, we believe that 'location, location, location' remains a truism in real estate investing, stemming from the fact that location is often the only aspect of a property that cannot be changed. There are, however, meaningful ways to change one's investment approach to the asset class and listed real estate is a fast-developing route to capturing the diverse and exciting opportunities available.

¹ Source: The New York Times Magazine, 'Location, Location, Location', 26 June 2009.

² Source: Bloomberg Real Estate Property Type Indices. Cumulative total returns from 31 March 2006 to 31 March 2021. Past performance is not a guide to future performance.

Glossary

Discounted cash flow: a valuation method used to estimate the value of an investment based on its expected future cash flows.

Earnings multiples: a valuation metric used to compare the relative costliness of stocks of similar companies. The price-to-earnings (P/E) ratio, calculated as price per share/earnings per share is a commonly used measure.

Experiential real estate: real estate focused on entertainment, leisure, sports, culture, and other types of experiences that are not easily replicated virtually.

Internal rate of return: measures the annual rate of growth an investment is expected to generate.

Manufactured home communities: active adult early retirement communities where tenants buy a pre-fabricated house and pay site rent to the landlord.

Multifamily: a single building accommodating more than one family living separately. For example, a duplex with two dwellings within a single building, to homes or small apartment buildings with multiple units.

CONSUMER REVENGE – THE NEXT STAGE OF THE RECOVERY IN EUROPE



John Bennett

Is pent-up consumer demand the key to unlocking value in Europe? In this article, John Bennett, Director of European Equities, considers some of the meaningful trends he believes could drive positive momentum in the region.

Key takeaways

- » As we progress towards a post-pandemic world, the next stage of the recovery is likely to be led by consumers armed with record-high savings.
- » Political instability (including Brexit) and COVID-19 have left European equities out of favour. As these headwinds pass, the valuation gap between Europe and the US appears extreme.
- » We expect the unprecedented synchronised fiscal and monetary response to COVID-19 to lead to an inflationary environment which warrants consideration of a greater allocation to Europe.

While Europe has faced renewed COVID-related restrictions over the past few months, we are now seeing significant progress in the vaccination campaign. Having witnessed a profound 'V-shape' recovery in the industrial economy, it is our view that the next 'V-shape' will be led by consumers. The risk of potential virus mutations demands vigilance, but we believe the direction of travel – back to some semblance of social and economic normality – is clear. It is merely the speed of travel that remains uncertain.

The reopening play

As we progress towards this post-pandemic world, many consumers have accumulated record-high savings due to limited consumption opportunities during lockdown and supportive furlough measures. The term 'revenge spending' has been coined to express the fervour of the unleashed consumer. The US, UK and Israel – with the most advanced vaccination programmes – offer glimpses of the consumer revival: clothing, cosmetics, holidays, homeware, eating and drinking all feature on wish lists. We anticipate this will be replicated in Europe as the vaccine programme catches up.

We expect consumer finances to remain supportive: US payrolls have surprised positively and are on track to return to pre-pandemic levels by the end of 2021 if job creation continues at the same pace. Economic growth in the UK is expected to reach over 6% in 2021, with additional government spending aimed at supporting employment. In the European Union (EU), aside from the measures undertaken by individual countries, financial assistance of up to €100bn has been made available to

help preserve jobs under the SURE¹ instrument, in the form of loans to member states. European Central Bank policy has been correspondingly accommodative, with the relaxation of the Stability and Growth Pact to help governments support their economies through the pandemic, as well as a raft of country-specific and other regional measures implemented in 2020 (Figure 1):

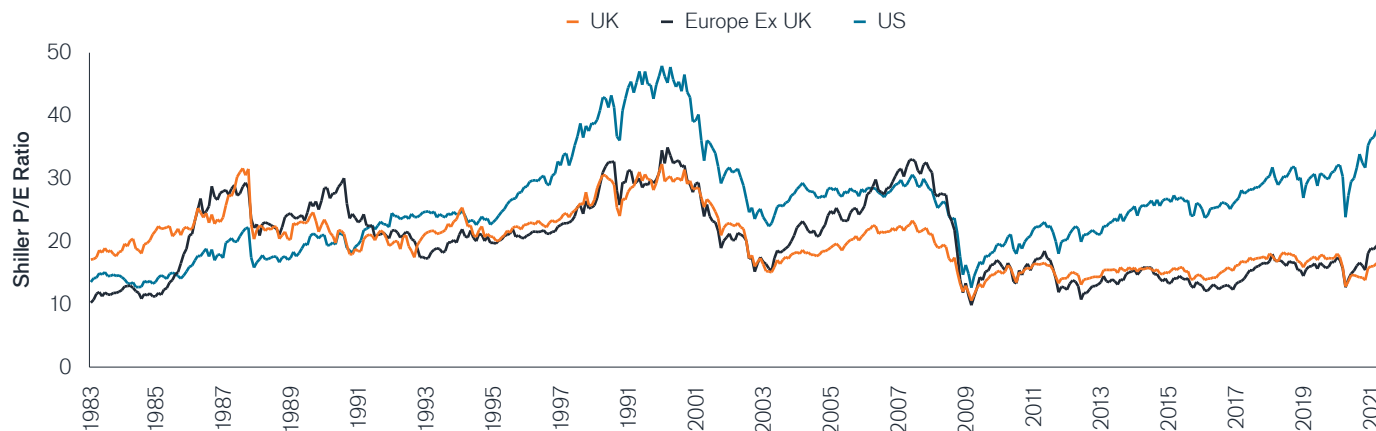
Figure 1: Fiscal support announced in 2020

	Fiscal stimulus	% 2019 GDP
EU Recovery Fund	€750bn	4.40%
France	€270-300bn	11.50%
Germany	€236bn	6.90%
Italy	€25bn	1.40%
Sweden	SEK 300bn	6.10%
Spain	€17bn	1.40%
Norway	NOK 100bn	3.40%

Source: Janus Henderson, JPMorgan, as at 30 November 2020.

Political instability, including Brexit, and the impact of COVID-19 have limited the appeal of European equities to investors. As these headwinds pass, the valuation gap between Europe and the US begins to look unjustified (Figure 2). On a fundamental level we are encouraged by many of the recent corporate earnings releases in Europe comfortably 'beating' analysts' expectations.

Figure 2: The valuation gap between Europe and US is at extreme levels



Source: Janus Henderson Investors, Refinitiv Datastream, from 1 February 1983 to 1 May 2021. Past performance is not a guide to future performance. Shiller P/E Ratio = a price-to-earnings ratio adjusted to take into account the cyclical nature of markets.

Risk and reward

The beneficiaries of 'stay at home' trends, such as video conferencing and food delivery, technology and Software as a Service (SaaS), have until recently been afforded ever-higher multiples of future earnings by the market, with share prices reflecting heightened expectations. COVID-19 further fuelled the decade-long outperformance of the 'growth' factor in stock markets, which has tended to favour the more technology-heavy US market over Europe. Conversely, due to the often-binary nature of the market, many high-quality businesses have been penalised, with earnings multiples (share prices) implying run-off or disruption. Amidst its abundance of 'old economy' sectors, such as steel, agriculture and manufacturing, trading on optically cheap valuations, the European market has been blessed with some global champions.

The automotive industry offers up a perfect illustration of this dichotomy: Tesla, a US-listed electric vehicle 'disruptor', is seemingly priced for global domination. In Europe, longstanding premium auto brands like Mercedes-Benz and BMW are priced as hapless victims of the looming transition to electric vehicles. At such extreme valuation disparities, a small change in market perception can have significant share price implications.

Is inflation finally making a comeback? If so, Europe stands to benefit

US equities have led Europe for the past decade, aided by the US market's greater abundance of 'growth' stocks which benefit from low interest rates. We believe the unprecedented synchronised fiscal and monetary response to COVID-19 offers the best prospect for a return of inflation since the global financial crisis. If inflation proves to be more than the US Federal Reserve's 'transitory' base case, a change in market regime is likely; one which, in our view, broadly favours a rebalancing towards 'value' at the expense of 'growth' and by extension, towards Europe and away from the US.

Glossary

Growth investing: Growth investors search for companies they believe can grow their earnings at an above-average rate compared to the rest of the market, with a consequent increase in share price.

'Old economy' sectors/stocks: Those companies/sectors with their foundations in the era of industrialisation, commonly large, well-established businesses where there is a limit to what innovation can do to improve processes (e.g. steel, agriculture, manufacturing).

Price to earnings (P/E) ratio: A popular ratio used to value a company's shares. It is calculated by dividing the current share price by its earnings per share. In general, a high P/E ratio indicates that investors expect strong earnings growth in the future.

Value investing: Value investors search for companies that they believe are undervalued by the market, and therefore expect their share price to increase over time.

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