COMMENTARY

Janus Henderson Continental European Fund

Quarter 4 2019

Fund Manager Name: John Bennett

Macro backdrop

An exceptionally strong year for European stocks has ended. History suggests that it is likely to be followed by another positive year, though with more volatility and overall much lower general stock market returns. Often it is when things go from deterioration to 'less bad' and stabilisation that the greatest market gains are realised, but when things go from stabilisation to 'better', equities have often already anticipated part of the improvement.

This chimes with our top-down view of the world. We were proven right over the second half of 2019 in our bullish and pro-cyclical view as the macro data stopped deteriorating and, over the last few months, showed nascent signs of improvement. This coincided with bearish investor positioning in equity markets and record valuation gaps between growth and value stocks. For the New Year though, global money creation trends suggest economic momentum is likely to remain weak over the first quarter, with a chance to revive from the second quarter. Further monetary pick-up is needed, in particular from China, to confirm the stronger recovery scenario which is now beginning to get priced into stocks. Inventory de-stocking across many cyclical sectors - a point we belaboured regularly over the last year - has largely completed and, eventually, the re-stocking effects will kick in and contribute positively to GDP growth. However, the longer lead time capital expenditure and employment cycles remain fragile. The politicisation of global trade has impacted the psyche of management teams and it seems this may well remain an overhang, reining in animal spirits apropos business investments. After all, a phase one trade deal between the US and China is still not signed and phase two negotiations may very well get trapped in the run-up to the US presidential election. Stocks are no longer as attractively valued as they were in 2019 when many cyclicals were priced for recession. The fear of missing out has lately forced more investor participation in the stock market rally.

Fund performance and activity

The fund rose by 6.5% over the quarter compared with a rise of 5.3% in the benchmark index, MSCI Europe ex UK, bringing the overall 2019 return to 28.7% versus an index return of 27.1%. The standout performer over the quarter was semiconductor holding STMicroelectronics as it continued its strong year-to-date run following sector optimism as well as the company's specific 2020 growth prospects. Among the positive contributors Kion, the largest manufacturer of industrial trucks in Europe and a global leader in automation technology, reported solid results. Encouragingly, order strength was not just in warehouse automation but forklift trucks on account of the company's often-ignored defensive nature. Almost half of forklift truck segment sales are from services that have exhibited stable growth even in recessions. Other strong performers in the fund included Finnish pulp and paper manufacturer UPM-Kymmene. Pulp markets are in the process of working off excess inventories and UPM has the only sizeable new pulp mill in the global capacity expansion pipeline. Entry barriers are very high, and this mill alone could lead to greater than 30% earnings growth by 2023. German automotive, defence and electronics group Rheinmetall lagged and we booked some profit on the position.

Activity over the quarter included the introduction of French pharmaceutical firm Sanofi, where we are encouraged by much-needed management change. Following a meeting with its management team we established a holding in Swedish construction and mining machinery manufacturer Epiroc as we believe its commodities exposure mix remains attractive and its exposure to underground has high growth potential from automation and electrification. In addition, internal efficiency measures should drive return to peak margins.

In the Nordic region we disposed of Finnish engineer Wartsila due to poor prospects, switching the proceeds into Swedish industrial Sandvik. The latter is trading at meaningful discount to the capital goods sector despite continuing improved resilience to the cycle and we believe the stock should re-rate to quality cap goods levels. We also booked profit on German chemical name BASF due to concerns over full-year 2020 guidance, returning to semiconductor name Infineon Technologies for its cyclical upside and clearer view on inventory cycle than exists at BASF. Due to lower conviction we disposed of Finnish oil refiner Neste as we believe that raw material price increases are unlikely to be fully passed on to customers. A consensual and richly valued long position, there are emerging questions on earnings growth next year. On the sell side we also disposed of Pernod Ricard and Ericsson following disappointing performance.

Outlook/strategy

From the macro environment described above, the upcoming year may well lend itself to our strategy which remains focused on a portfolio of bottom-up, well-researched stock ideas, reasonably balanced across sectors and factors, avoiding strong tilts, be they factor or style.

Source: Janus Henderson Investors, as at 31 December 2019

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For further information on the Luxembourg-domiciled Janus Henderson fund range please contact your local sales office or visit our website: www.janushenderson.com.

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