COMMENTARY

Janus Henderson Horizon Pan European Alpha Fund

Quarter 4 2019

Fund Managers Names: John Bennett & Robert Schramm-Fuchs

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 returned 6.6 % over the quarter (euro retail class, net of fees), bringing the overall 2019 return to 9.9%.

Good bottom-up stock picking and sector positions in the industrials, materials and information technology sectors benefited the fund over the quarter.

On the long side semiconductor name STMicroelectronics was the highest contributor to alpha as it continued its strong year-to-date run following sector optimism as well as the company's specific 2020 growth prospects. Other strong performers included the fund's largest position, building materials manufacturer LafargeHolcim. 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 their often-ignored defensive nature. Almost half of forklift truck segment sales are from services that have exhibited stable growth even in recessions. Finally, the fund benefited from its holding in 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. There were no significant detractors on the long book. Similarly, contributors and detractors on the short book were negligible.

Activity of note on the long book included the introduction of Swedish industrial Sandvik. The latter is trading at a 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 took a position in number one cocoa and chocolate company globally Barry Callebaut, which exhibits a higher growth profile than its staples customers and has room for profit margin expansion. The balance sheet offers good room for accretive merger and acquisition (M&A). Our purchase of Volvo followed a meeting which encouraged us on the prospects for the bottoming of the truck cycle, as well as the potential for structural improvement. In the UK we added DIY group Kingfisher. While the 'big box' DIY concept is under pressure in both its major markets - the UK and France - the new management team has an opportunity to extract value from its bloated inventory position, freehold assets, renegotiation of its leasehold liabilities and repairing the substantial self-harm inflicted in France through the failed project management plan under the previous management. 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. A bid for stock provided the opportunity to sell our holding in TI Fluids, the latter a reduction in exposure to the challenged auto sector. Finally, we took profit on our holdings in Novartis and BASF and disposed of Pernod Ricard and Ericsson following disappointing performance.

Our short book continues to be concentrated on stocks with high corporate leverage, bad capital allocation track records and richly valued defensives, where we see significant earnings disappointment potential. It is focused primarily on communication services, energy and real estate names.

In terms of overall positioning our exposures stood at approximately 70% net and 116% gross respectively at the end of the quarter.

Outlook/strategy

Pleasingly, the alpha delivered in the final quarter of 2019 generated returns above what the net exposure would have suggested. Naturally, our aim is to replicate the 2019 return and especially that of the second half. From the macro environment described in the paragraph above, the upcoming year should lend itself to our Pan European Alpha long-short strategy. It is centred around a portfolio of bottom-up, well-researched long and short stock ideas, reasonably balanced across sectors and factors, avoiding strong tilts, be they factor or style. Overlaying this is our options hedging strategy, designed to offer a protective net during more pronounced market pullbacks and spikes in volatility. We will continue to trim the number of stock-specific lines, especially in the long book, to focus even more on our highest conviction ideas and enable sharper risk management. At the time of writing we have 71 stock-specific long and short positions, but a gradual move to the low 60's is our direction of travel.

Source: Janus Henderson Investors, as at 31 December 2019

Janus Henderson Horizon Pan European Alpha Fund

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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