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The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

2018: Structural disinflation vs cyclical inflation?

KNOWLEDGE. SHARED

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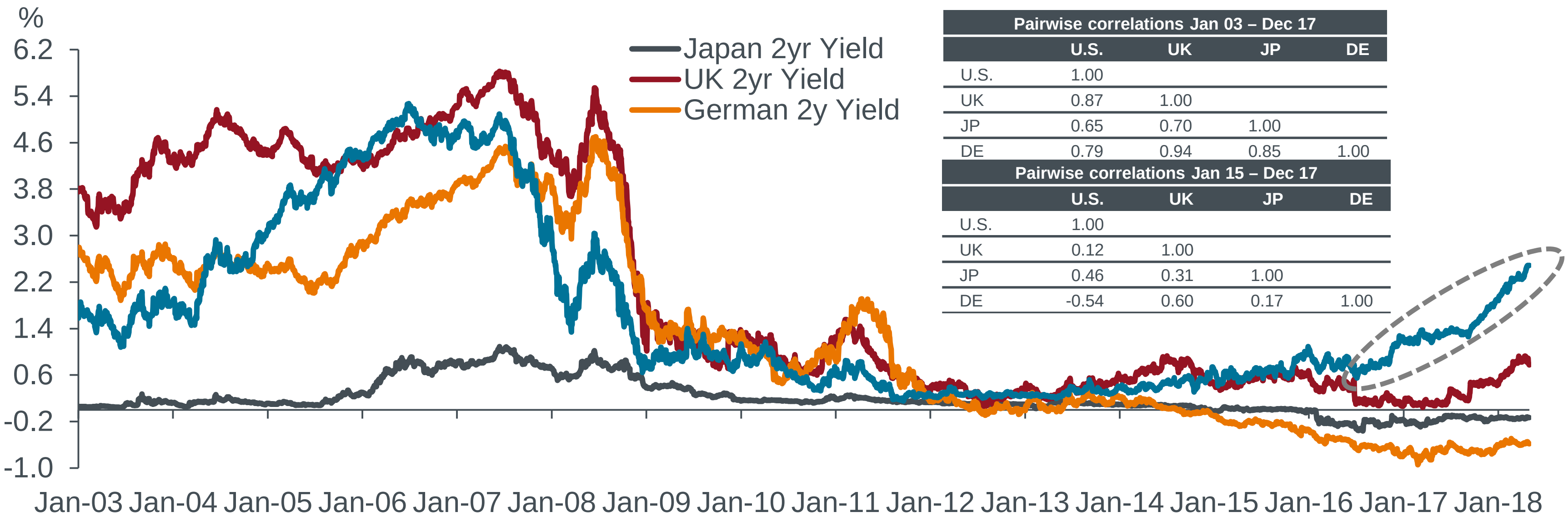
INVESTORS

Diverging developed bond markets



Pairwise correlations Jan 03 – Dec 17				
	U.S.	UK	JP	DE
U.S.	1.00			
UK	0.87	1.00		
JP	0.65	0.70	1.00	
DE	0.79	0.94	0.85	1.00

Pairwise correlations Jan 15 – Dec 17				
	U.S.	UK	JP	DE
U.S.	1.00			
UK	0.12	1.00		
JP	0.46	0.31	1.00	
DE	-0.54	0.60	0.17	1.00

Source: Janus Henderson Investors desk estimates, Bloomberg, as at 30 April 2018

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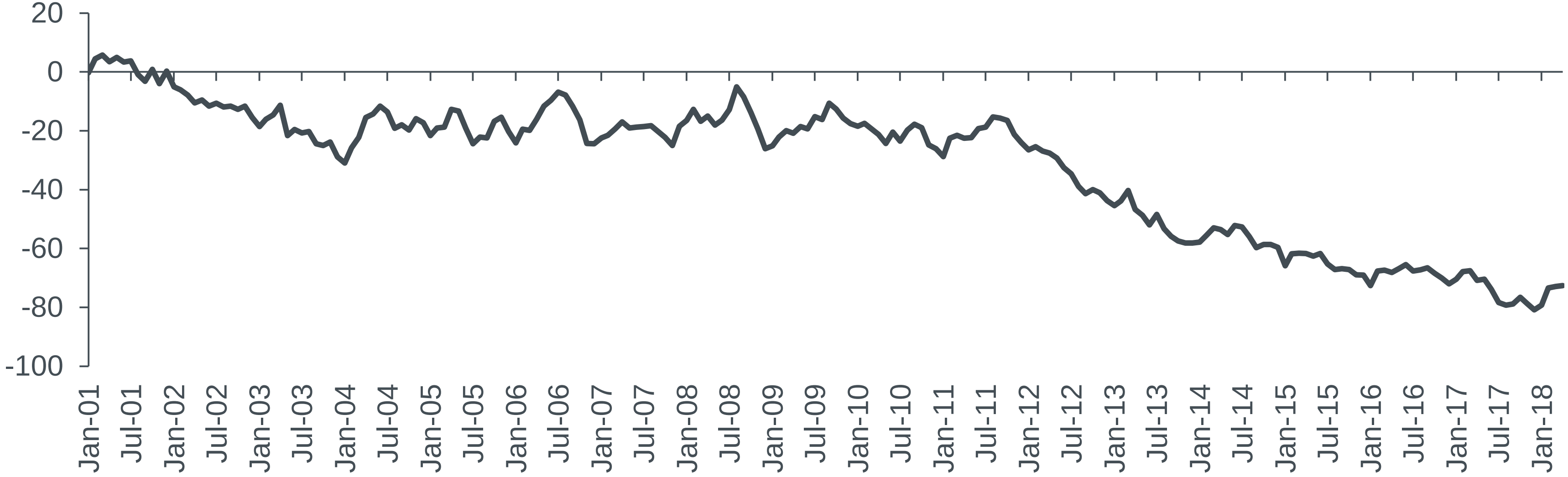
Diverging inflation profiles

Core CPI surprises: 6m rolling sums

Source: RBS, as at 10 May 2018

Some context needed… US inflation has surprised consistently on the downside

HSBC US Inflation Surprise Index, cumulative



Source: Bloomberg, as at 30 April 2018

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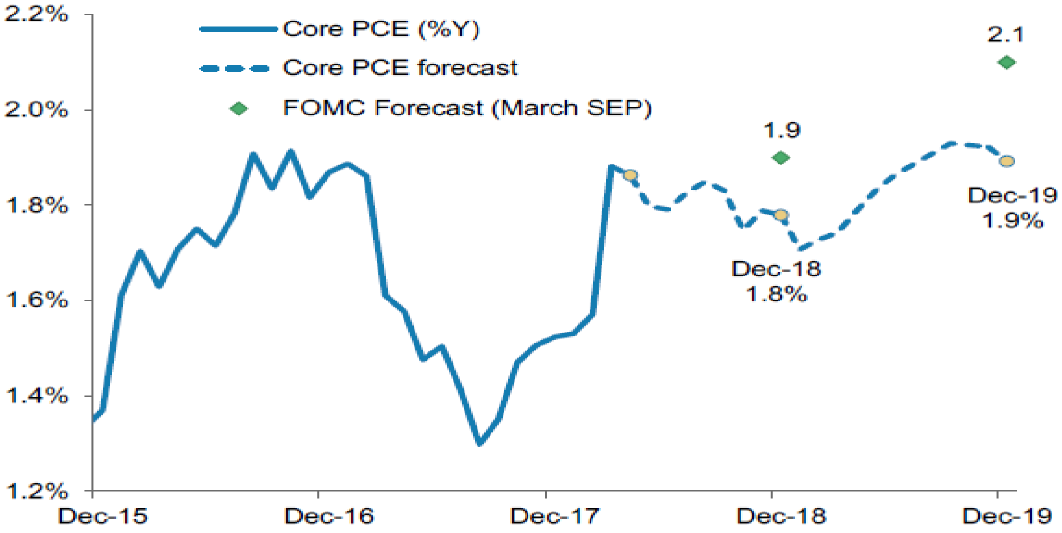
2018 above target core inflation for a few months…

US Core PCE inflation and economist forecasts



Source: Morgan Stanley, as at 30 April 2018

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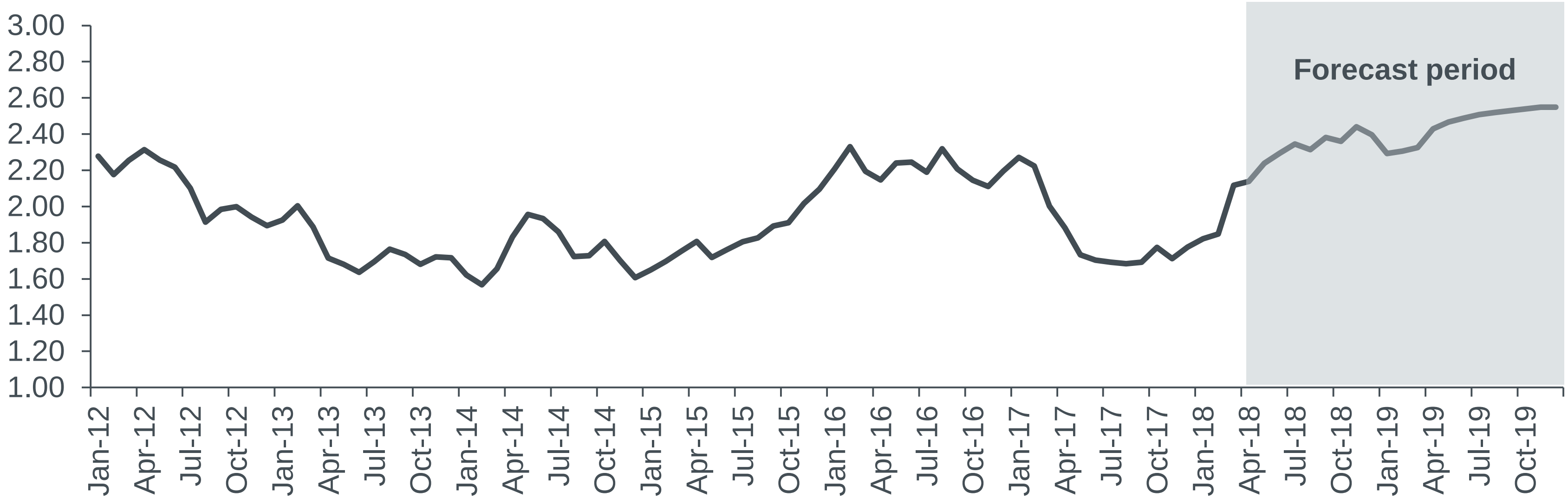
Core CPI accelerating faster

US Core CPI inflation and economist forecasts



Source: JP Morgan, as at 30 April 2018

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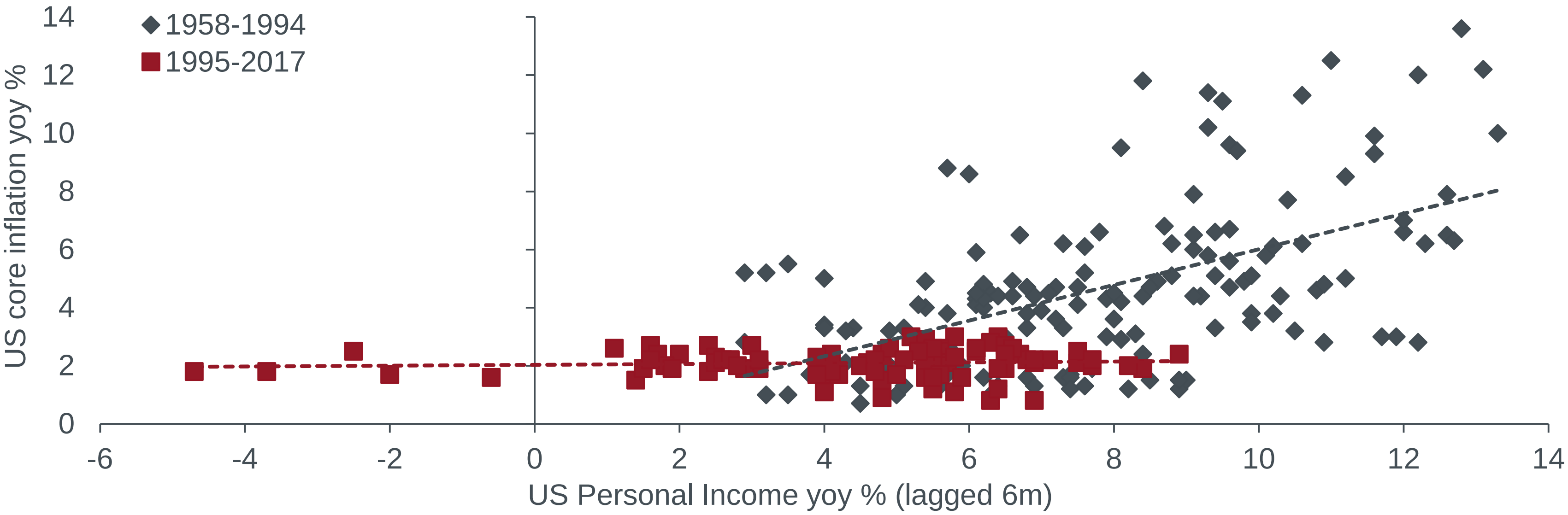
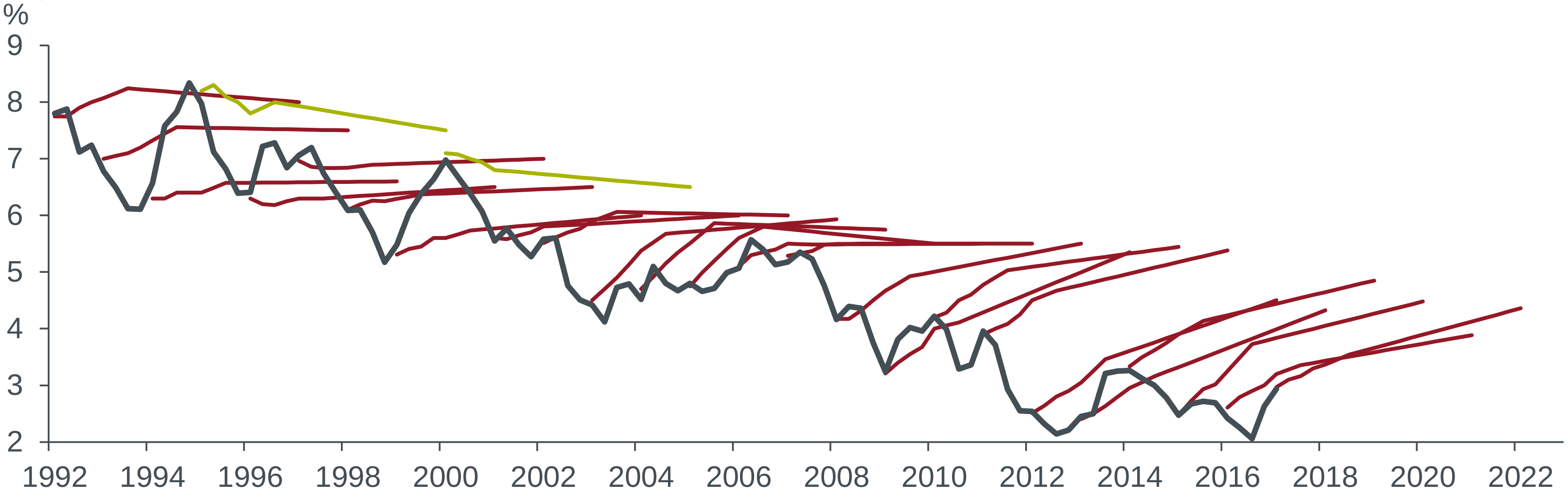
Changes in income do not seem to affect inflation since the mid-90s



Source: Bloomberg, Oxford Economics as at 31 March 2018

Playing into a persistent forecast that government bond yields will rise

10-year US Treasury rate and historical economist forecasts



Source: Philadelphia Fed Survey of Professional Forecasters, as at June 2017

Forecasters have called for lower bond yields in only two of the last 26 years

Thoughts on US bond market – classically late cycle

“You have to be patient. Wait until the market comes to you. It’s contrary to human nature to sit there all day and do nothing”

- **Charlie Munger**

Elsewhere, central banks are struggling to follow the Federal Reserve in a traditional hiking cycle…

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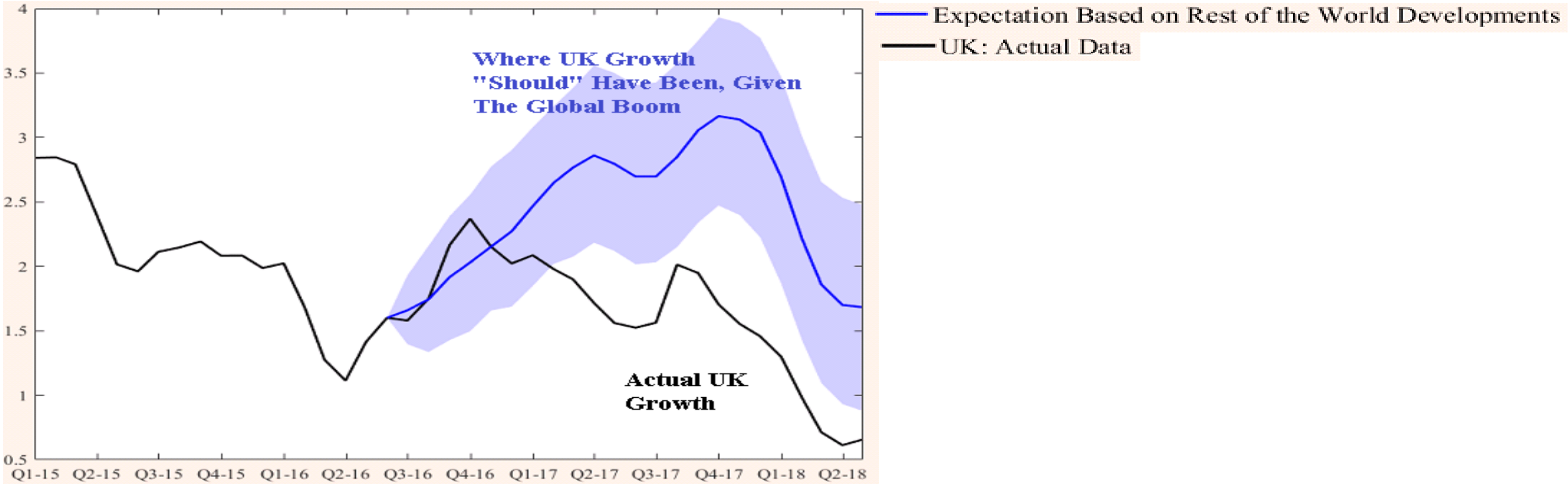
The UK counterfactual

UK GDP growth YoY & fan projection



Source: Gavyn Davies, Fulcrum Asset management & Financial Times, 14 May 2018

UK…

Squeezed consumers, Brexit, structural decline of the high street

From: [redacted]
Sent: 23 March 2018 12:44
To: [redacted]
Subject: Future of physical retail (according to NEXT) - MUST READ

Hi [redacted]

NEXT, the fashion retailer, made some fascinating revelations about its store portfolio in today's full year results.
It's an amazing read and we distil the key points and REIT impact in the link below. I would recommend reading in the current M&A environment.

Headlines here (but the attachment has some eye-opening charts!)

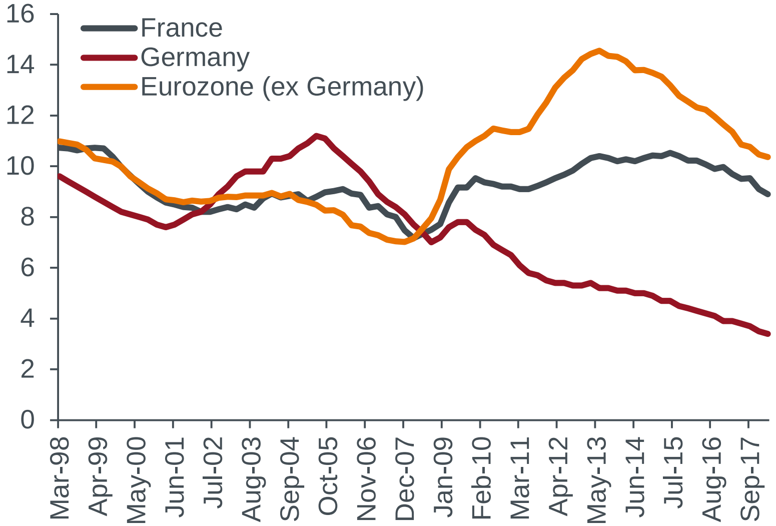
- Store LfL sales growth of -9.1% in 2017/18, guidance for -8.5% in 2018/19e
- Store margins reduced from 15.3% to 12.7% in 2017/18, guidance for c.10% in 2018/19e
- Channel shift to online is margin dilutive on flat sales
- Lease renewals expected to achieve 22% rent reductions in 2018/19
- New leases being signed on five year terms with c.19% incentives
- Stress test suggests stores become cashflow negative in 2022

LINK TO THE FULL SUMMARY (INC. SOME GREAT CHARTS): NEXT email 2018-03-23.pdf

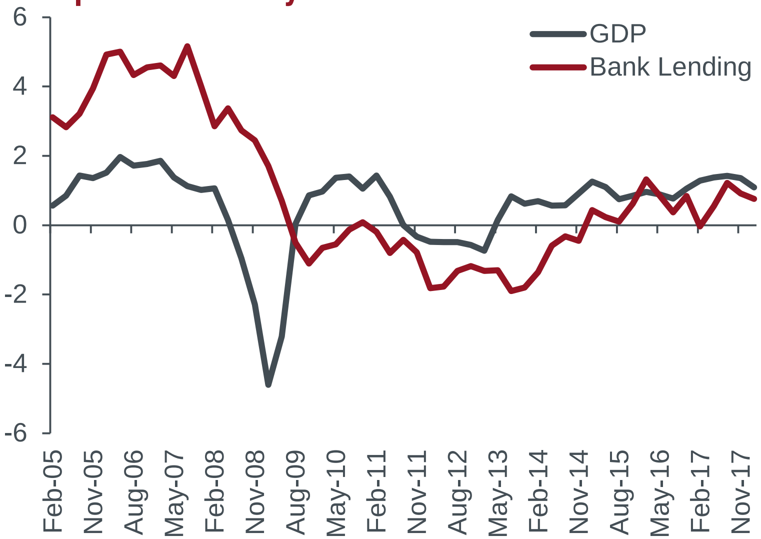
Source: Exane, as at 23 March 2018

Europe – underwhelming domestic demand

European unemployment rate



European monetary trends



Source: Bloomberg and DataStream, as at 31 March 2018

No rate hikes

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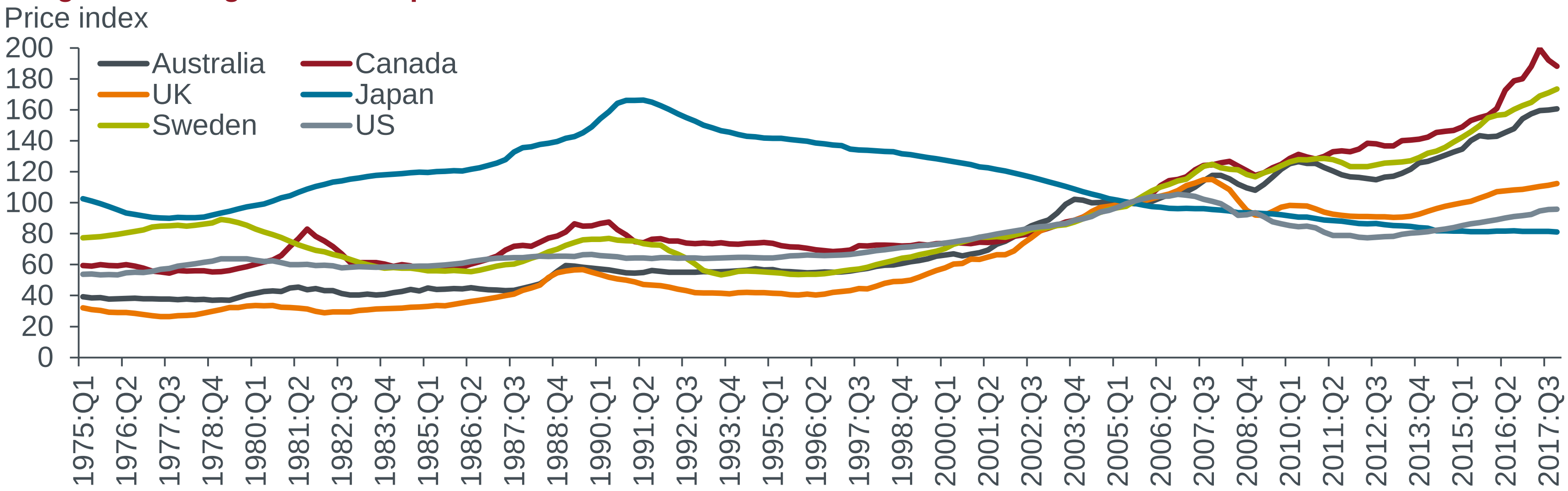
Vulnerabilities building in some economies

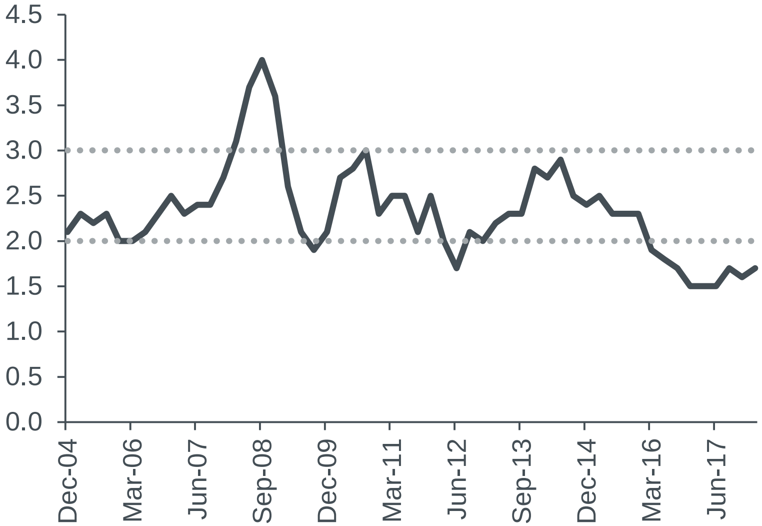
Long term changes in house price for selected economies



Source: Federal Reserve of Dallas, as at April 2018

Australia – no inflation, weak consumer, housing market boom & banking scandal

Australian core CPI YoY%



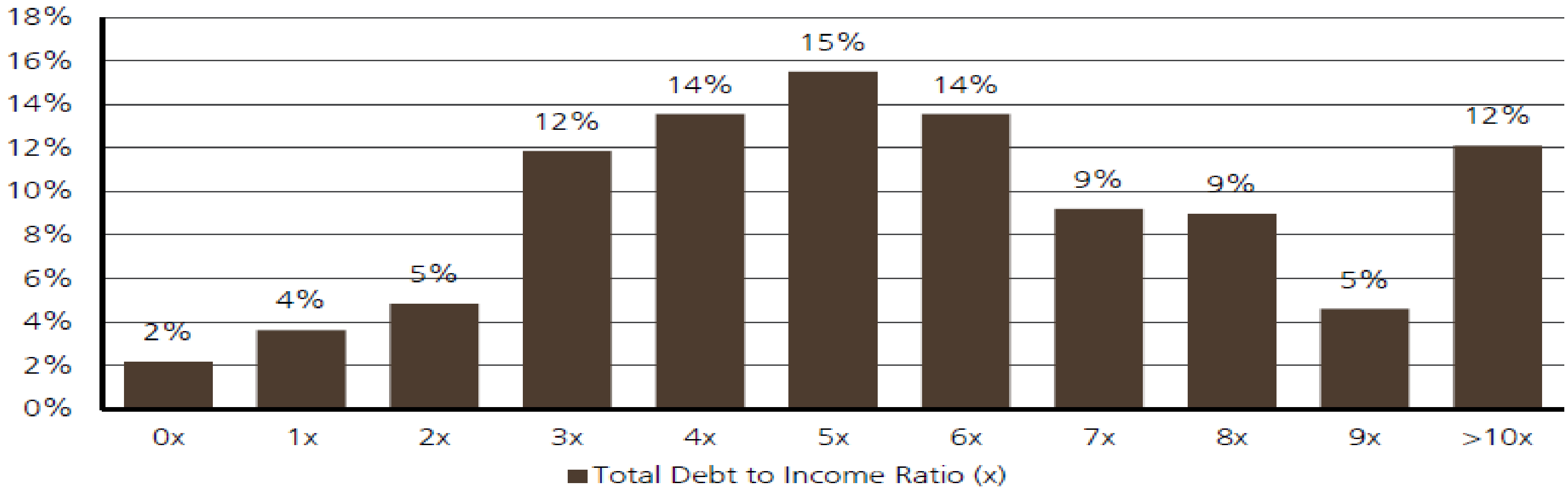
Australian hourly pay YoY%

Source: Bloomberg, as at 31 March 2018

No rate hikes

Royal commission into the banking sector – Credit crunch coming?

Royal Commission 'Targeted Review' of Westpac mortgage lending



Source: Royal Commission into Baking Misconduct, PQC, UBS estimates

Endemic "liar loans" & high risk mortgage lending

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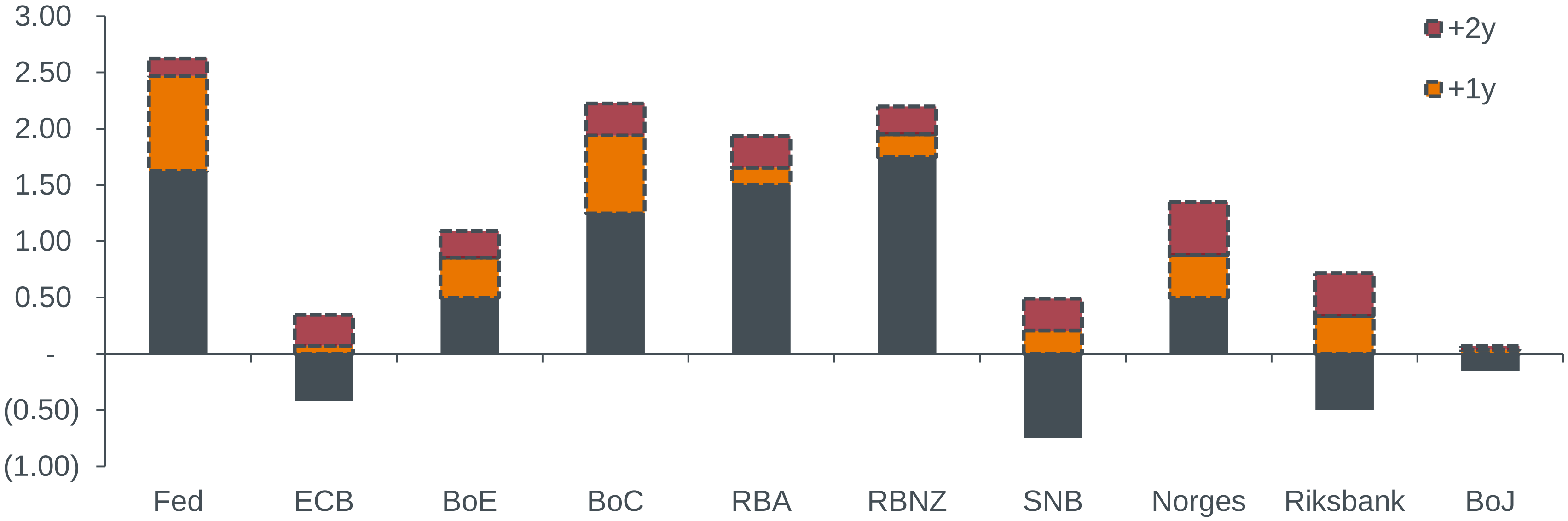
What's priced in

Market implied central bank expectations, as at 14 June 2018



Source: Bloomberg and Morgan Stanley, as at 14 June 2018

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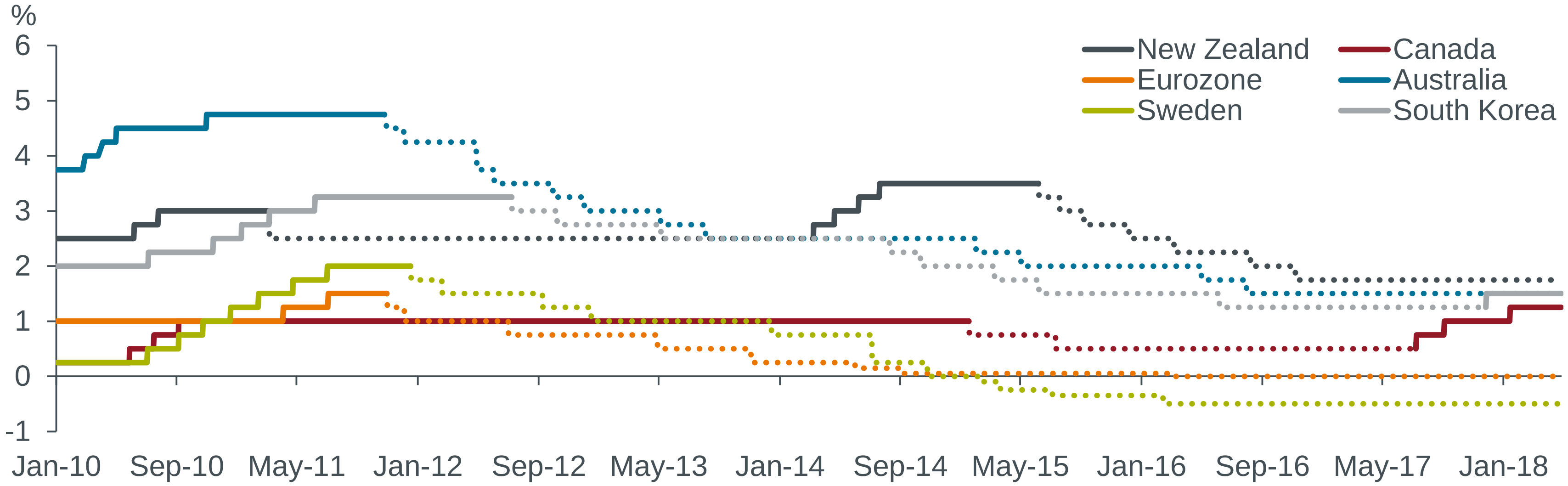
Interesting parallels 2010-2011

Previous developed market attempts to raise rates have not been successful

Interest rate paths of hiking economies



Source: Bloomberg, as at 30 April 2018

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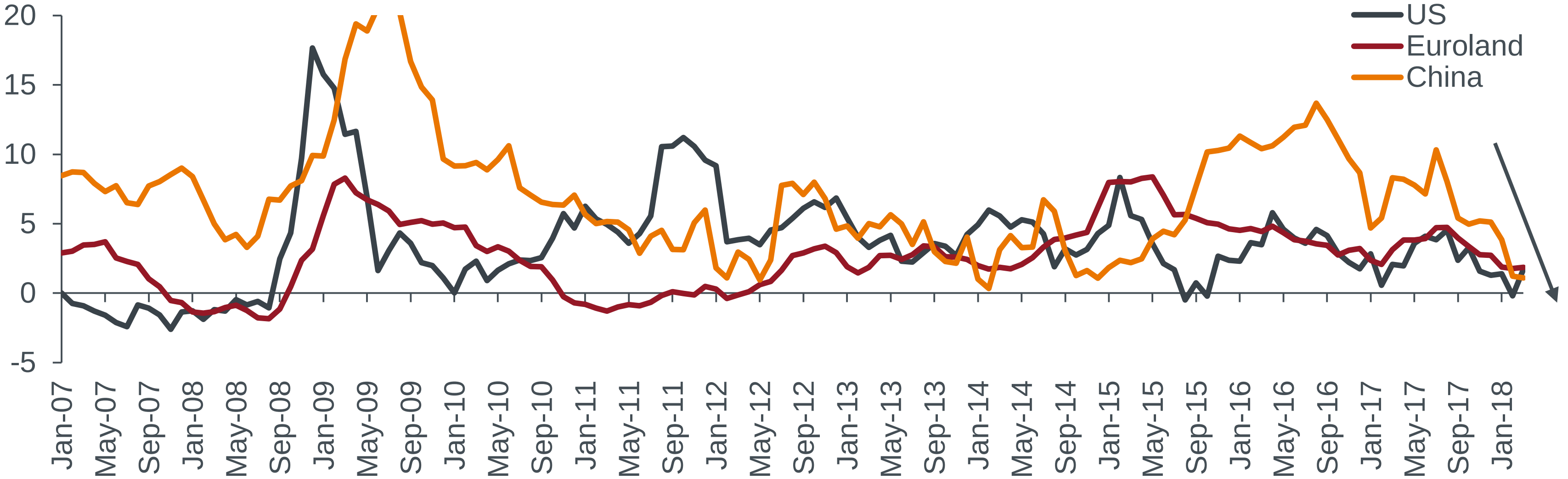
Bigger picture – Q1 a blip or are the monetarists right?

Real narrow money growth YoY%

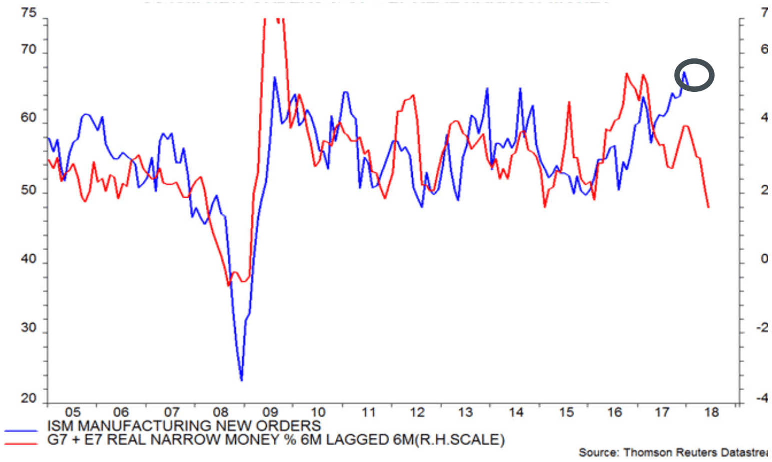


Source: DataStream, as at 31 May 2018

LEIs have turned now… but not yet coincident indicators

South Korean exports & global EPS

Global monetary impulse & US ISM new orders



Source: Bloomberg and DataStream, as at 31 May 2018

Expressing the divergence theme in 2018 thus far:

- Divergent economic growth
- Low inflation ex US

Tactical longs = Aus, Can, Sw, UK, Bunds

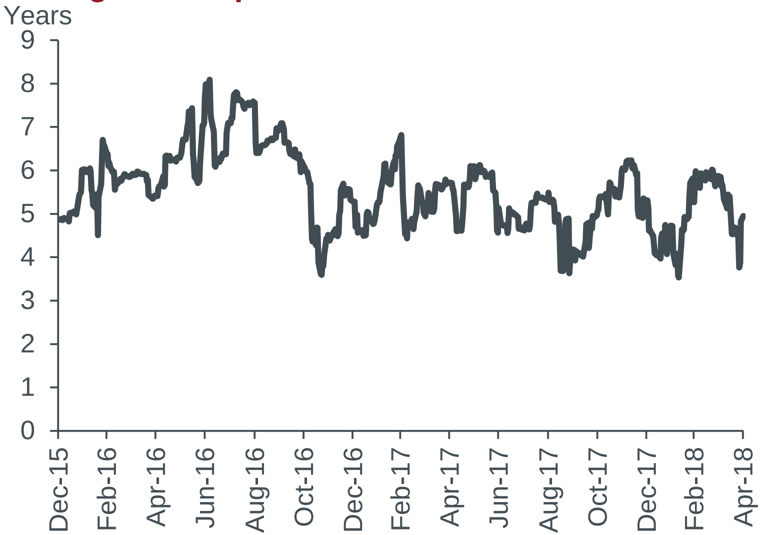
- Patience required waiting for the bigger “turn”.. Could be 2018 if monetarists are correct
- Interest rate divergence also presents a stronger USD case
  - Long USD vs € & AUD in mid-late April

Active duration management

- Opportunities around duration management are often driven by the ***emotion of investors*** rather than actual changes in inflation or growth regimes
- Tactical duration management allows us to profit from these opportunities
- Bond managers should not fear duration

Strategic Bond performance	2016	2017	2018*
Government bonds	59.7	20.5	8.9
Long interest rate futures	16.9	18.9	8.8
Short interest rate futures	19.8	4.2	15.1
Total	**96.4**	**43.6**	**32.8**

Strategic Bond portfolio duration since 2016



Source: Janus Henderson Investors, as at 30 April 2018
Note: * Desk estimates, for April
Past performance is not a guide to future performance

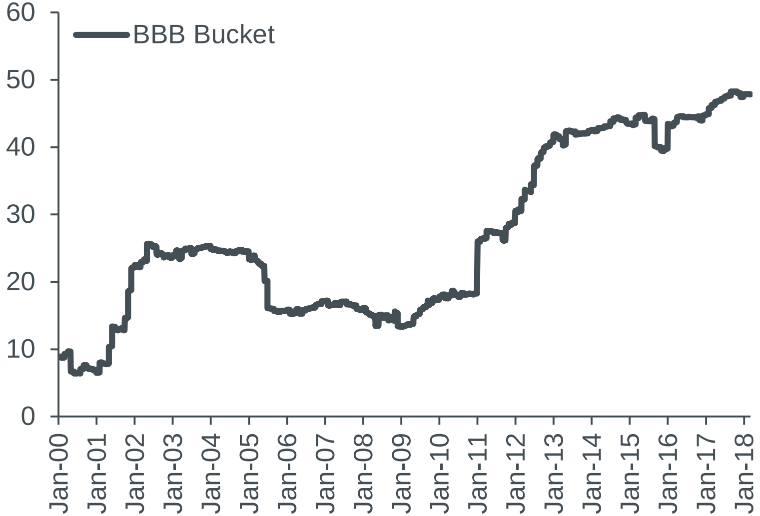
Contrast to the short duration group think among many bond managers

Credit markets

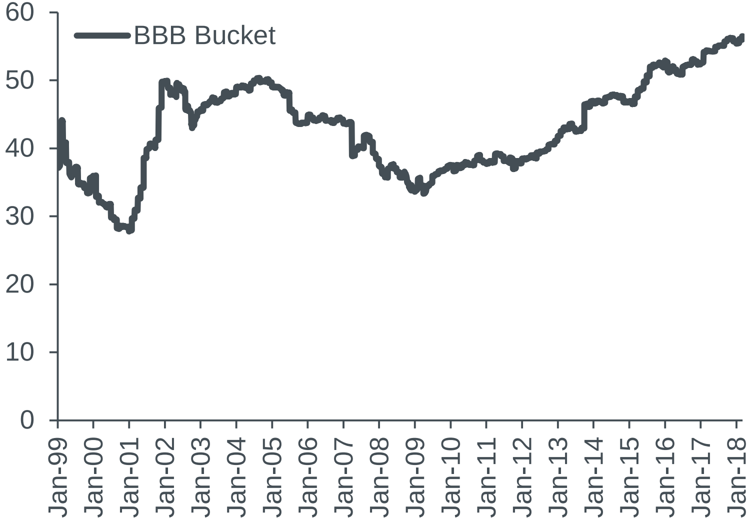
- Not a source of cross asset volatility this year
- Investment grade & loan markets continue to see quality of issuance erode at a rapid pace
- Hard to see a cyclical default inflection point (distressed ratio still low)
- But structurally most high yield companies are stories of decline

Credit – late cycle environment

European IG Index rating weights



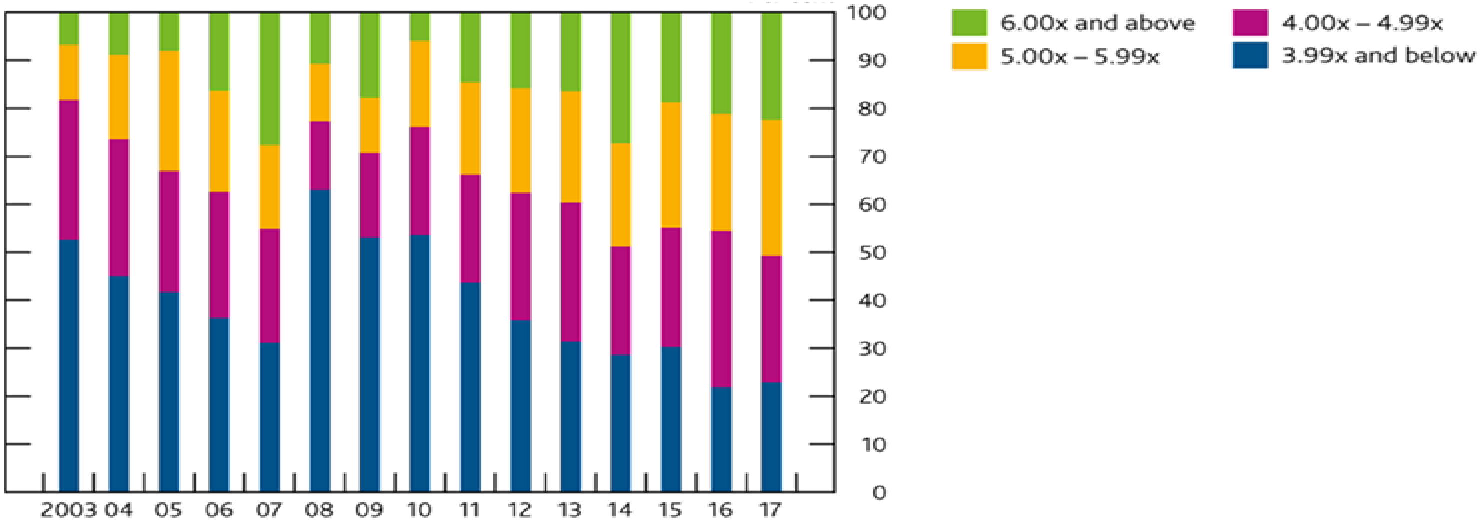
US IG Index rating weights



Source: Credit Suisse, as at 31 May 2018

Loans to highly indebted firms have increased

Global leveraged loan issuance to large corporates by debt to earnings ratio



Source: Bank of England, as at April 2018

Structural decline – pursued businesses

Car Rentals

Advertising

Funerals

Retail

Tobacco

US Hospitals

Utilities

Commercial Real Estate

US Beer

Restaurants

Cable & Cord Cutting

Autos

Fund Management

Drug Pricing

Consumer Brands

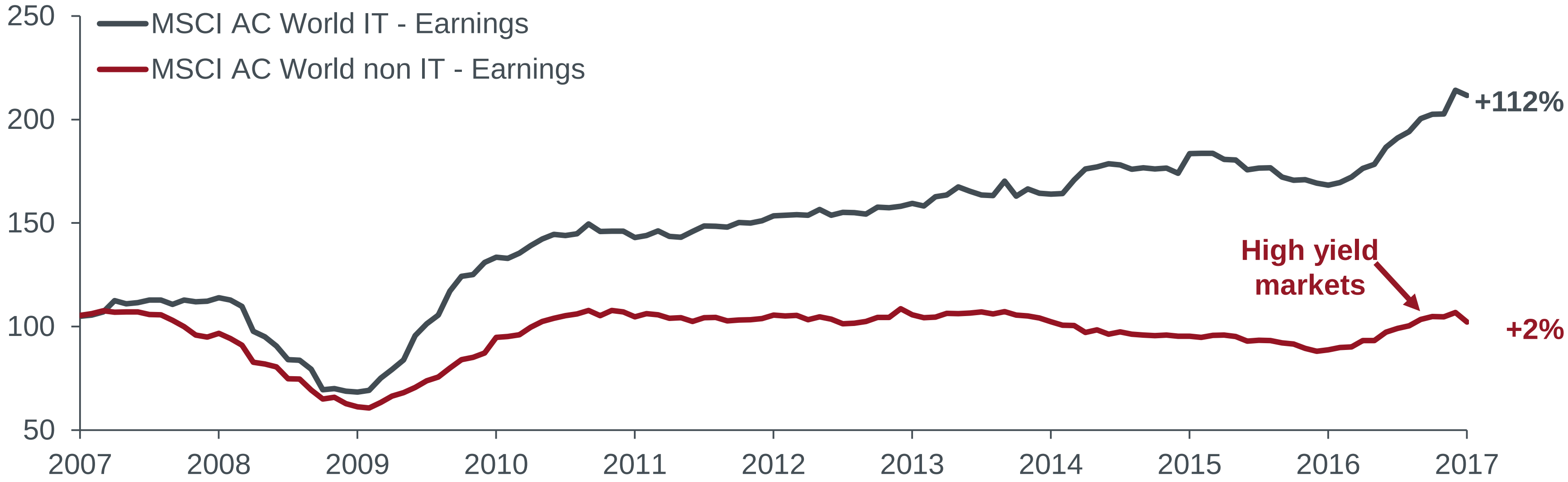
Restaurants

Where we are comfortable (for now..)

- Data Centres
- Document Storage
- Payment Processors
- Packaging
- New Technology

Technology outperformance driven by superior earnings growth

Technology sector earnings vs non-technology



Source: Bernstein, as at 31 December 2017
Note: Based on trailing earnings. Rebased to 100 at 30 September 2007.

Nearly all of the growth in the last decade has come from IT

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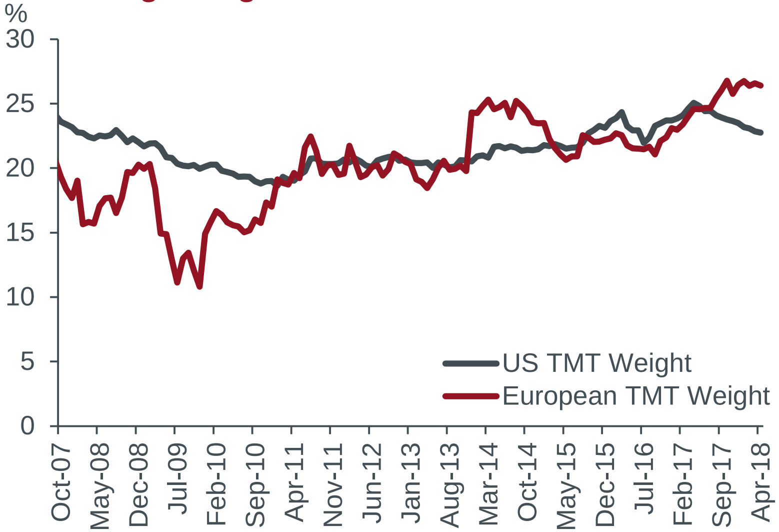
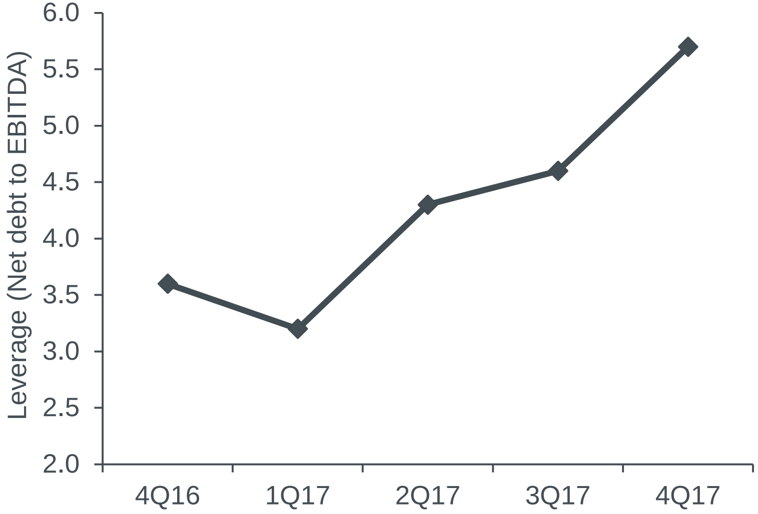
Potential threat to the high yield market..

Percentage weight of Indices



Leverage trends of US telecommunications firms



Source: Credit Suisse, Creditsights & FactSet, as at May 2018

Summary

- Uncertainty & divergence in rate hiking far higher than in “normal” business cycles

- Finding government bond markets where we can “hide” (short ends) & tactically trade (10y)

- Patience in the US bond market

- Fate of credit markets determined by;
  - Pace of disruption in TMT sectors
  - Whether the monetarist economists are right

Appendix

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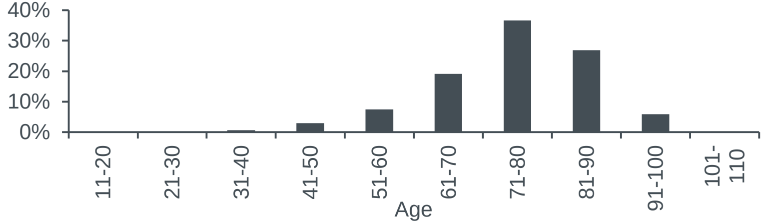
Managing for an output

Total return funds	Size	Distributions	Distribution yield (I Inc share class)	Underlying yield (I Inc share class)
Janus Henderson Strategic Bond Fund	£2.1bn	Quarterly	3.2%	2.6%
Income funds				
Janus Henderson Preference & Bond Fund	£807m	Quarterly	3.9%	3.3%
Janus Henderson Fixed Interest Monthly Income Fund	£844m	Monthly	4.6%	4.0%
Janus Henderson Diversified Income Ltd	£175m	Quarterly	5.1%	-

Age distribution of Fixed Interest Monthly Income Fund investors*

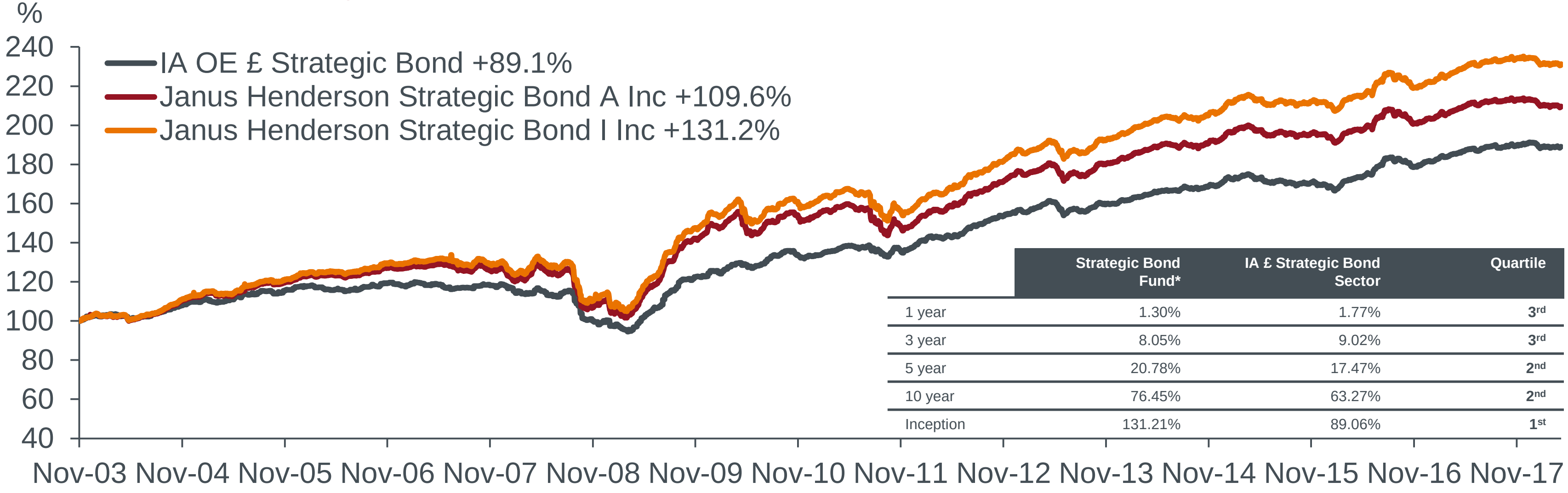


Source: Janus Henderson Investors & BNP, as at 30 April 2018
Note: * Sample size of Fixed Interest Monthly Income Fund represented 35% of investors as at 31 March 2016

- We are **client-focused**
- The underlying investor is skewed to **retirement age** – they do not want a manager wasting income on option strategies, energy bonds and African sovereigns trying to chase outsized returns
- We remain fixated on large-cap firms with a reason to exist offering **solid yields**
- **Client communication** is important, follow us on Twitter; **John & Jenna @StrategicBond** for latest desk thoughts

Janus Henderson Strategic Bond Fund

Janus Henderson Strategic Bond Fund performance since inception in November 2003



	Strategic Bond Fund*	IA £ Strategic Bond Sector	Quartile
1 year	1.30%	1.77%	**3rd**
3 year	8.05%	9.02%	**3rd**
5 year	20.78%	17.47%	**2nd**
10 year	76.45%	63.27%	**2nd**
Inception	131.21%	89.06%	**1st**

Source: Morningstar, as at 30 April 2018

Note: All performance presented net of fees. Based on cumulative GBP midday pricing, nav-nav, net income reinvested.

Past performance is not a guide to future performance

* Janus Henderson Strategic Bond Fund, I Inc share Class, as at 30 April 2018. Yield may vary and is not guaranteed.

3.2% distribution yield*

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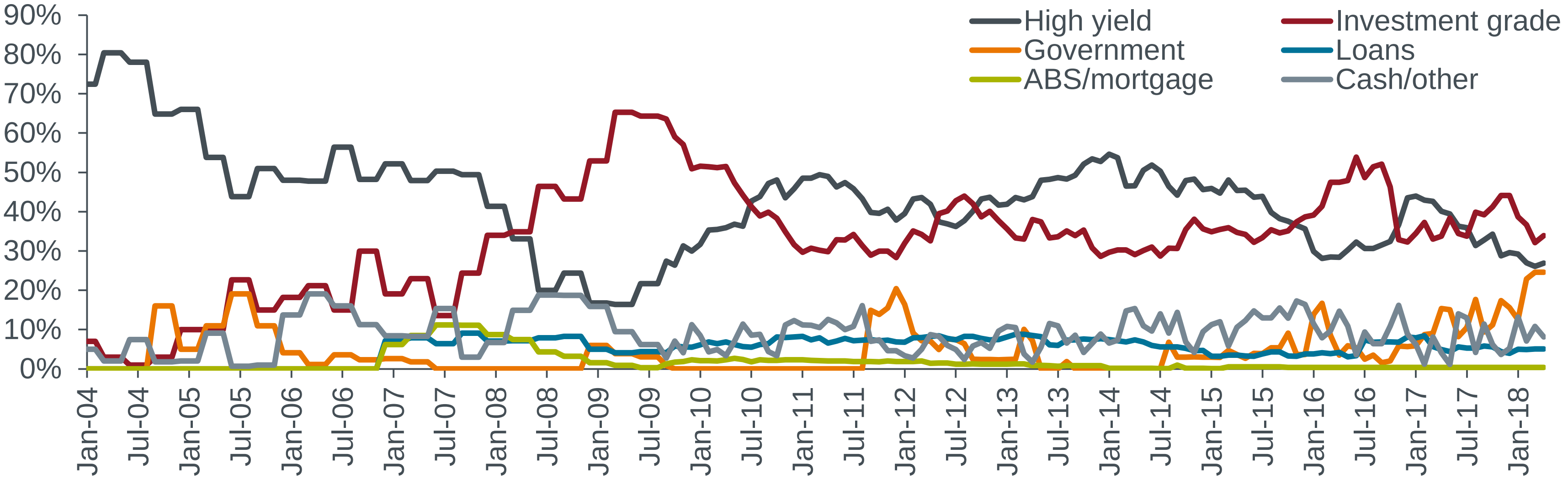
Janus Henderson Strategic Bond Fund

Janus Henderson Strategic Bond Fund asset allocation through time

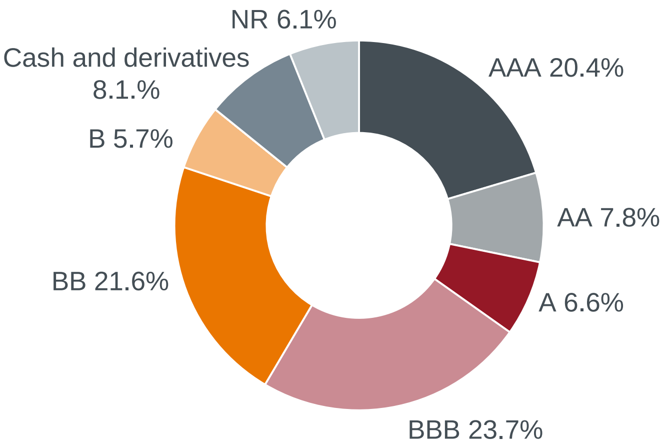


Source: Janus Henderson Investors, desk classifications, as at 30 April 2018
Note: Quarterly data points up to September 2009, monthly data points thereafter

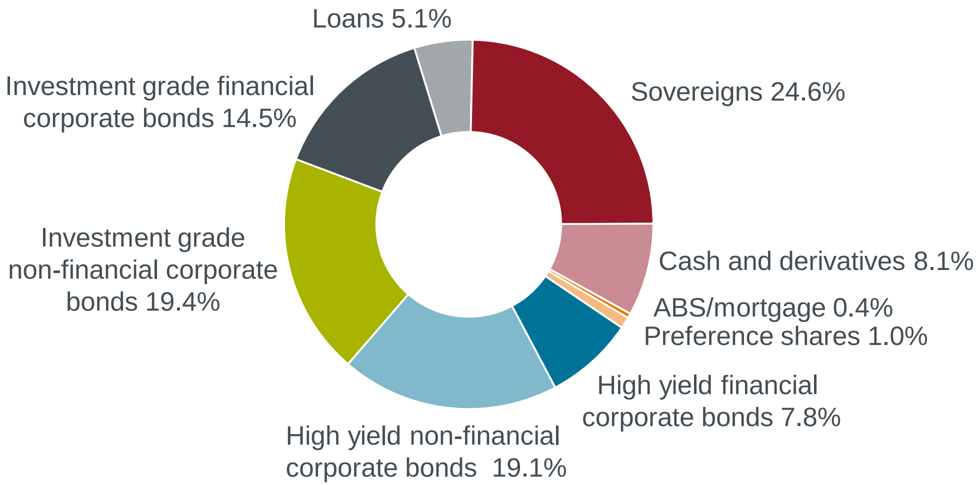
Janus Henderson Strategic Bond Fund

Portfolio composition

Credit breakdown



Asset allocation



Source: Janus Henderson Investors, desk classifications, as at 30 April 2018
Note: Totals may not add up to 100 due to rounding

Janus Henderson Investors
201 Bishopsgate, London EC2M 3AE
Tel: 020 7818 1818 Fax: 020 7818 1819

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