Straight Talk:
MID-YEAR OUTLOOK

Investment insights from the experts at Janus Capital Group

JANUS CAPITAL Group

ABOUT JANUS CAPITAL GROUP

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OFFICES WORLDWIDE

On the ground where our clients live and work, we have an in-depth understanding of local markets and investor needs to complement our global perspective.

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INVESTMENT PROFESSIONALS

Our seasoned team of investment experts brings deep knowledge and experience to help us deliver on our commitment to provide better outcomes for clients.

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INVESTMENT STRATEGIES

Actively managed equity, fixed income, alternative and multi-asset class strategies are designed to help clients in any type of market, with the goal of delivering strong risk-adjusted returns over time.

INTRODUCTION

As we head into the second half of 2015, investors face continued volatility. There is uncertainty surrounding U.S. interest rates, the direction of equity markets and a sluggish global economy.

But there's an upside too.

Opportunities across asset classes exist, and our portfolio managers see strong secular growth trends that may not need an economic tailwind to thrive.

In our Mid-Year Outlook, investment experts from Janus, INTECH and Perkins share insights and recommended strategies to help you navigate the months ahead.

MEET OUR EXPERTS

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Chief Investment Strategist

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Janus Global Allocation Funds

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Portfolio Manager
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Portfolio Manager
Janus Global Life Sciences Fund

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Portfolio Manager
Janus Contrarian Fund

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Chief Investment Officer, Fixed Income | Portfolio Manager
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Janus Flexible Bond Fund
Janus Global Bond Fund
Janus High-Yield Fund
Janus Real Return Fund
Janus Short-Term Bond Fund
Perkins Value Plus Income Fund

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Perkins International Fund

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Head of Global Rates | Portfolio Manager
Janus Global Bond Fund

BILL GROSS

Portfolio Manager
Janus Global Unconstrained Bond Fund


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2015: THE YEAR OF VOLATILITY CONTINUES

Heading into the year, many of our investment experts dubbed 2015 the year of volatility. That theme has been evident in both fixed income and currency markets, and there are plenty of indicators that equity markets are headed for a bumpier ride. With markets in flux, consideration of downside risk is taking on increasing importance.

VOLATILE TIMES AHEAD

While fixed income markets have been volatile in 2015, equity markets have been relatively calm. However, there is no shortage of geopolitical and macroeconomic question marks that could spark equity market volatility in the days ahead.

AN ECONOMIC SLOWDOWN IN CHINA

TURBULENCE IN OIL PRICES

GEOPOLITICAL INSTABILITY IN THE MIDEAST AND RUSSIA

STRUGGLE TO STIMULATE ECONOMIC GROWTH IN EUROPE AND JAPAN

Myron S. Scholes, Ph.D.

BRACE FOR AFTERSHOCKS

"I believe the current monetary experiment conducted by the world's central banks will ultimately play itself out in one of two ways. Either record levels of fiscal and monetary stimulus jump-start the global economy into a real recovery, or sustainable growth never materializes and fiscal imbalances become so great it takes major economies years to work out of a debt overhang. This is the great question facing investors and economists, and the back-and-forth signs we see lending confirmation to either potential scenario will act like shifting tectonic plates in financial markets, whose aftershocks will affect asset returns."

SOMETIMES NOT LOSING IS A WIN

"Recovering from a financial crisis takes much longer than a typical economic crisis because the entire economy must deleverage. This is why economic growth remains tepid, despite years of low interest rates and massive government stimulus efforts. Until we can return to a more normalized market environment of 2% to 3% economic growth and interest rates that are closer to historical norms, we would expect heightened volatility. Winning will largely be defined by not losing in the next two to three years."

Enrique Chang

Nick Cherney, CFA

WHAT NOW? STAY IN THE MARKET

"There are a significant number of people that have a heightened concern about an equity correction. Does that mean it is inevitable? No. But it does mean that whatever that fundamental catalyst is that will trigger a correction has a higher chance of materializing. You have a sideways equity market, increased volatility and investor flows, which have shifted dramatically from selling volatility to buying insurance against volatility. These factors may point to an upcoming correction, but it's no reason to leave the market. One: you will miss out on interim gains, and two: you won't know the best time to get back in."

78% of volatility ETP assets are invested long in volatility.

This is the highest level of long exposure to volatility exchange traded products (ETPs) since 2013. Increased long exposure indicates the market expects more equity market volatility ahead.

As of 4/30/15.

STAY DYNAMIC TO NAVIGATE CHANGE

"Investors don't have to accept market volatility standing still. Having a process in place to recognize, and adapt to, a changing volatility environment can help reduce risk within a portfolio at times when investors need it most. A dynamic approach can also play an important role in managing volatility, as what was defensive in previous volatile environments may not be defensive in the next one. The recent sharp change in the beta of energy stocks highlights how quickly the behavior of a subset of equities can change."

Adrian Banner, Ph.D.

Ashwin Alankar, Ph.D.

HEIGHTENED TAIL RISK AHEAD

"Over the last several years, retail and institutional investors were underexposed to equities. As equity markets kept rising, investors were looking for any dip to step back in. This made equities uncannily resilient to market shocks. We're finally seeing indications that people are no longer as underexposed. This doesn't mean a correction is imminent, but with fewer investors on the sidelines waiting to buy equities on the dip and provide liquidity to the market, a pullback in equities could be far less gentle today. We're entering a period where tail risk is heightened."

PORTFOLIO CONSIDERATIONS

Given the difficulty of timing markets, don't exit an asset class based on volatility. Instead, **consider equity strategies that seek to participate in equity markets' upside but reduce drawdown risk.**

Ask whether the strategies utilized by a client **have a plan for handling volatility.**

Examine portfolio needs to **make sure clients have the appropriate time horizon to hold on to less-liquid assets through volatile periods.**

POCKETS OF GROWTH IN A LOW-GROWTH ENVIRONMENT

In just about every corner of the world, economic growth remains sluggish. Where does one find growth in such a low-growth environment? Look to those companies and countries that are playing the hand they've been dealt. In response to tepid economic growth, savvier corporate boards are getting resourceful and creating shareholder value. Some national governments are also responding, enacting reforms to make their countries' business climate more dynamic. Our portfolio managers also see strong secular growth trends that may not need an economic tailwind to thrive.

Carmel Wellso

STRUCTURAL REFORMS A GAME CHANGER FOR SOME COUNTRIES

"Global growth is slow, but I believe there are some great opportunities in equity markets, many of them coming as a direct or indirect result of the slowdown. There are a number of international companies becoming more competitive on a global basis due to a falling currency. In response to the economic slowdown, some governments are also making structural reforms that will dramatically reshape the business climate within their country. Some of the most encouraging structural changes are coming in India, Italy and Japan. The changes taking place in these countries are making a number of stocks attractive that have never been viewed favorably in my 20-year history as an investor."

WHEN THE GOING GETS TOUGH, THE TOUGH GET GOING

A slow-growth global economy has ushered in an era of change for some countries.

SEEKING OUTLIERS & INNOVATION

"Tepid economic growth might translate into a slower growth rate for the average company, but the disparity of individual company growth rates has never been wider. The key is to focus on the outliers, not the average. A great deal of innovation and disruption is taking place today. Biotech and pharmaceutical companies are seeing more productivity from research. Life science tools are also evolving. In the technology sector, electronic devices that connect to the world around us are proliferating. Data and analytics are becoming increasingly important to business operations. Companies tied to these themes have long-term growth opportunities regardless of the economic environment."

Brian Demain, CFA

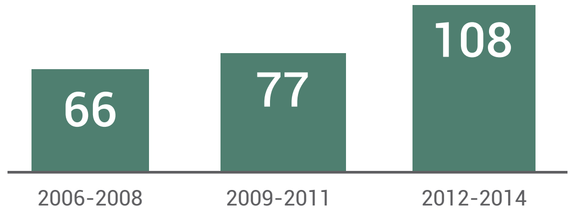
Andy Acker, CFA

HEALTH CARE SECTOR ALIVE AND WELL

“Gaining a better understanding of the genetic causes of disease has been a significant catalyst for innovation in the health care sector, but this only marks the beginning of medical advancement. An improved ability to manipulate genetic material and harness the power of the immune system to destroy cancer cells is rapidly expanding doctors’ arsenal to fight disease. We believe the acceleration of innovation within the sector could offer some of the best secular growth opportunities in today’s markets.”

FDA DRUG APPROVALS ARE ON THE RISE

Innovation in the health care sector is accelerating, leading to an increase in new therapies coming to market.



Source: Washington Analysis, FDA.

Daniel Kozlowski, CFA

BOARDS ARE ON THEIR TOES

“In the absence of easier revenue growth opportunities that come when the economy is humming, there’s continued pressure on corporate boards to make changes that will create shareholder value. We’ve already seen many boards respond to slow growth by making dramatic changes, whether it’s a change in management, spinning off a noncore business or making acquisitions to consolidate an industry.

If growth remains slow, we’ll see more changes. There is an important dynamic to watch going forward, however. Slow growth and increased shareholder activism have put boards on their toes, causing companies to enact change quickly before decisions are made for them. As these changes become more commonplace, investors will need to isolate truly transformative changes from purely cosmetic ones. A sound knowledge of a management team’s history and the competitive dynamics within an industry can help.”

PORTFOLIO CONSIDERATIONS

Use active global equity strategies to **seek those companies poised to benefit most from a changing business climate in their home country.**

Look for companies undergoing significant positive change, but be selective. Some changes will be cosmetic in nature, and not bold enough to reshape a poor-performing business.

Focusing on some of the more compelling secular growth drivers can lead to outsized returns in a slow-growth environment.

Consider an allocation to sectors such as health care, **where innovation is creating one of the best growth opportunities in today's markets.**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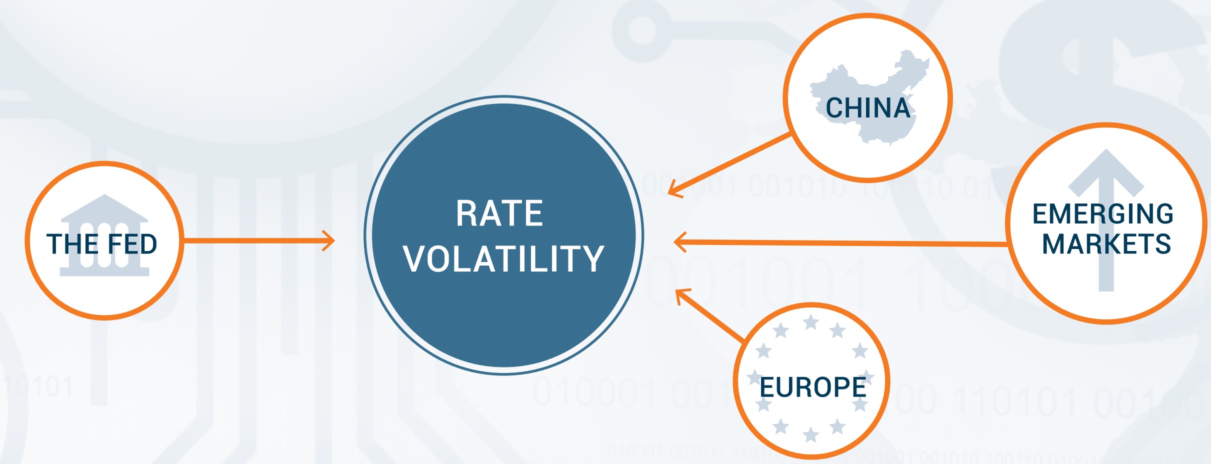
RATE RISK: OPPORTUNITIES ON A TIGHTROPE

After two years of the market anxiously awaiting a rate hike by the Federal Reserve (Fed), a rate hike has yet to materialize. Now, many investors have become complacent about U.S. rates remaining lower for longer. To the complacent, we say: Watch out. While there are forces that may keep U.S. rates from catapulting higher, rates are being impacted by far more than Fed policy, and this could keep rates volatile. We believe that the U.S. rate environment calls for defensive positioning, not complacency.

RATES ARE BEING IMPACTED BY MORE THAN JUST THE FED

While the market anticipates the Fed will initiate interest rate hikes in the near future, it may be overlooking other factors that could influence rate levels all along the yield curve.



Gibson Smith

FED CLARITY DOESN'T MEAN LESS VOLATILITY

"The world is out of balance. Not just because of rate differentials, but growth differentials. That's creating disruption and volatility. There is an uneven growth environment that is occurring among China, emerging markets generally, the U.S., Europe and Japan.

Amid all of this, clarity about a Fed rate hike won't necessarily result in less rate volatility. We like to think that the Fed is being transparent, telling us what they are going to do, but the reality is, rate volatility is determined by more than the Fed. The Fed doesn't control what is happening in China or what's happening in emerging markets or what's happening in Europe. Because of this, I think it's important to be defensive and active around rate positioning rather than taking outsized bets on whether rates will go up or down."

TAKE AIM

"It's time to be even more selective about equities, given valuations. One thing that worries me is whether today's stock prices will still make sense in the context of interest rates three years from now, when central bank policies may have changed. Today's central bank policies are very extreme and may not endure. That's one thing that keeps me wanting to be very wary of the current prices in markets, and to be cautious about investing in sectors that have been dependent on low rates."

Gregory Kolb, CFA

WHAT WAS BAD COULD BE GOOD AGAIN

Christopher Diaz, CFA

"From my standpoint, if we don't see U.S. economic data strengthen to some meaningful level, you may not see a rate hike at all in 2015. In general, the rate hike anticipation has created a significant rally in the U.S. dollar. Amid weaker data, the rate hike expectation has been pushed out, and the upward momentum of the U.S. dollar has slowed.

In response to all of this, the biggest beneficiaries versus the U.S. dollar have been the higher-beta emerging market currencies. Thus, if there is no rate hike amid weaker U.S. data, we could find ourselves back in a situation where the central banks around the world are easing and the Fed is not going to tighten, so the riskier currencies, which were bad, are now good again."

25%

By mid-March, the U.S. Dollar Index (DXY) had risen 25.3% over the preceeding 12 months.

This is the highest 12-month increase for the basket of six currencies in 30 years.

*Based on a basket of developed market currencies. As of 4/2015.

IT'S ALL RELATIVE

Bill Gross

"What's the new neutral policy rate, what's the Nominal GDP growth rate, what's the yield of a 10-year Treasury, Bund, Gilt or JGB? An explorer looking for these answers, however, should not necessarily be setting sail to find *absolute* values, but *relative* values. The "*relative*" narrows the universe significantly under the assumption that "*relative*" growth rates in the developed world and "*relative*" new neutrals should be more amenable to mean reversion than *absolute* values. Although influenced by slow crawling demographic differences, productivity and therefore nominal growth rates in developed countries are more likely to mean revert to one another, than to an *absolute* historical means."

PORTFOLIO CONSIDERATIONS

Construct defensive fixed income portfolios and incorporate a greater amount of diversification rather than counting on Treasury yields remaining low.

Invest in stocks of companies whose earnings prospects **are not dependent upon low interest rates.**

Focus on returns among global fixed income instruments relative to each other rather than expecting rates of specific asset classes to revert to historical averages.

Janus Capital Group has a breadth of insights and strategies to help guide clients through 2015 and beyond. Talk to your Janus representative or visit us online at janus.com/advisor for additional insights.

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Follow us on Twitter for up-to-the-minute market and investment insights. Twitter.com/JanusCapital

Past performance is no guarantee of future results.

Investing involves market risk. Investment return and value will fluctuate, and it is possible to lose money by investing. There is no assurance that the investment process will consistently lead to successful investing.

Statements in this piece that reflect projections or expectations of future financial or economic performance of a mutual fund or strategy and of the markets in general and statements of a fund's plans and objectives for future operations are forward-looking statements. Actual results or events may differ materially from those projected, estimated, assumed or anticipated in any such forward-looking statements. Important factors that could result in such differences, in addition to the other factors noted with such forward-looking statements, include general economic conditions such as inflation, recession and interest rates.

Investment return and value will fluctuate in response to issuer, political, market and economic developments, which can affect a single issuer, issuers within an industry, economic sector or geographic region, or the market as a whole.

When valuations fall and market and economic conditions change it is possible for both actively and passively managed investments to lose value.

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