December 2017

Janus Henderson
—KNOWLEDGE. SHARED—

Portfolio Manager View:
Darrell Watters, Mayur Saigal and Mike Keough

Incremental Return Opportunities for Credit in 2018

Portfolio Managers from Janus Henderson's U.S. Fundamental Fixed Income Team share why they expect the lower-for-longer rates environment, U.S. tax reform and disruption themes to present opportunities for credit investing in 2018.

What lessons have you learned from 2017?

It was highlighted that even as central banks become less accommodative, their dovish approaches can continue to suppress rates. The Federal Reserve (Fed) has emphasized tapering without the tantrum, diligently telegraphing its plans to gradually normalize its balance sheet. Additionally, the premise of the "Fed put" — its willingness to reverse course if warranted — has capped U.S. Treasury yields, even as it raises interest rates. Similarly, the European Central Bank plans to reduce asset purchases, but is prepared to extend the length of its quantitative easing program. And despite the Bank of England's recent rate hike, its proposed path of future hikes remains dovish. These cautious methods are sustaining range-bound yields.

What are the key themes likely to shape the markets in which you invest in 2018 and how is this likely to impact portfolio positioning?

Lower for Longer: The nomination of Jerome Powell as the next Fed chair portends that the Fed will maintain its measured approach to raising interest rates and a gradual balance sheet unwind. Further, the Fed's willingness to step back in, should economic conditions deteriorate, suggests that any monetary tightening in 2018 will minimally impact Treasurys. Lower-for-longer yields in Europe will continue to foster demand for U.S. rates, further limiting upward movement in Treasury yields. Within our core portfolios, we intend to maintain duration in line with that of the benchmark, although we will tactically adjust duration as opportunities to add value present themselves.

As central banks seek to taper without the tantrum, range-bound rates and low volatility should continue to drive investors' reach for yield and demand for other fixed income asset classes, including corporate credit.

U.S. Tax Reform: We are actively seeking opportunities in entities poised to benefit from a tax overhaul. If passed, reform features including a drop in the corporate tax rate, the allowance for immediate expensing of capital expenditures and incentives for companies to repatriate capital would bolster corporate credit. These would likely boost free cash flow and marginally reduce the need for corporate debt issuance. The resulting reprieve from elevated issuance should push valuations higher in this yield-starved environment. Limitations on interest deductibility could, however, have negative implications for highly levered, capital-intensive businesses.

Disruption: A wide range of industries are experiencing disruption, which is pressuring profit pools and forcing management teams into action. Many issuers are making acquisitions to diversify their business models and increase scale. Amazon, in particular, is disrupting multiple sectors including technology, retail, supermarkets, media and potentially, health care. The "Amazon effect" of lower prices is even disrupting inflation. The proliferation of digital streaming

Darrell Watters
Head of U.S. Fundamental Fixed Income

Mayur Saigal
Head of Fundamental Fixed Income Risk

Mike Keough
Portfolio Manager

services is another disruptor, impeding subscriber growth for cable and video providers and forcing many investment-grade media companies to consolidate. In energy, increasing efficiencies in the extraction of shale oil and gas are pressuring issuers to develop strategies that can succeed amid lower energy prices. We are evaluating these and other disruptions, and digging into company fundamentals to identify which issuers are prepared to adapt and which we are better off avoiding.

Where do you currently see the risks within your asset class and where are the most compelling opportunities?

Strong risk market returns in 2017 have stretched valuations across most spread products. However, if policymakers can successfully pivot to a gradual normalization of monetary policy and an increase in fiscal stimulus, we believe credit will continue to provide incremental return opportunities. The key will be balancing offense with capital preservation, as additional returns are likely to come from carry rather than the spread tightening of recent years.

Investment-grade and crossover issuers that stand to benefit from constructive earnings trends and aspects of tax reform, including technology issuers likely to benefit from the repatriation of capital, are particularly attractive. Security selection will be critical. However, successfully navigating structural industry changes will also require avoiding issuers susceptible to disruption risks. The necessary evolution of business strategy to combat disruption will likely result in sustained debt-funded consolidation activity. While we seek to avoid the downside prior to consolidation, entities committed to deleveraging post-transaction often offer strong risk-adjusted opportunities.

For more information, please visit **janushenderson.com.**

Janus Henderson
—KNOWLEDGE. SHARED—

The views presented are as of the date published. They are for information purposes only and should not be used or construed as an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell or hold any security, investment strategy or market sector. No forecasts can be guaranteed. Opinions and examples are meant as an illustration of broader themes, are not an indication of trading intent, and are subject to change at any time due to changes in market or economic conditions. There is no guarantee that the information supplied is accurate, complete, or timely, nor are there any warranties with regards to the results obtained from its use. It is not intended to indicate or imply that any illustration/example mentioned is now or was ever held in any portfolio.

Past performance is no guarantee of future results. Investing involves risk, including the possible loss of principal and fluctuation of value.

Fixed income securities are subject to interest rate, inflation, credit and default risk. The bond market is volatile. As interest rates rise, bond prices usually fall, and vice versa. The return of principal is not guaranteed, and prices may decline if an issuer fails to make timely payments or its credit strength weakens.

Quantitative Easing (QE) is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market.

Duration measures a bond price's sensitivity to changes in interest rates. The longer a bond's duration, the higher its sensitivity to changes in interest rates and vice versa.

Janus Henderson is a trademark of Janus Henderson Investors. © Janus Henderson Investors. The name Janus Henderson Investors includes HGI Group Limited, Henderson Global Investors (Brand Management) Sarl and Janus International Holding LLC.

C-1217-14165 06-15-18 666-15-414094 12-17