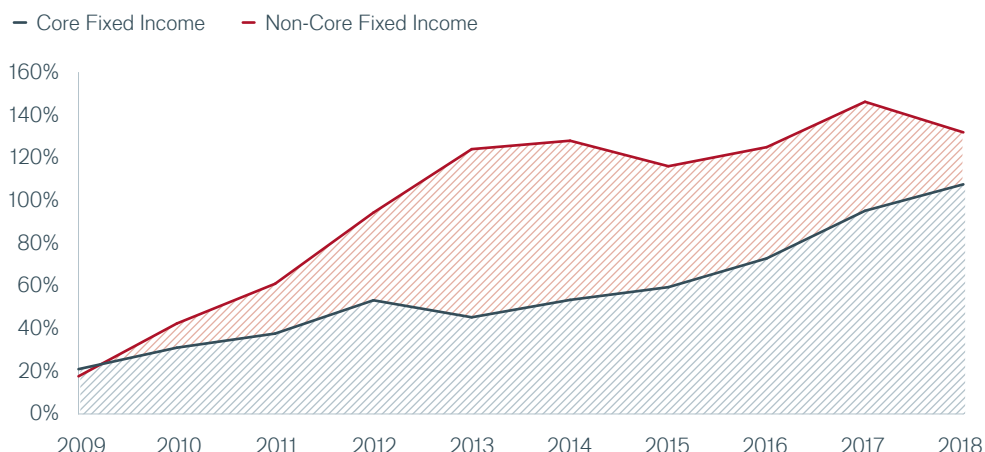


Shifting Gears

Moving to a Goals-Based Fixed Income Strategy

For traditional fixed income investors, much of the last 30 years have been nirvana; the 1980s began with double-digit interest rates that have steadily fallen, creating large amounts of bond return and income as well as crisis management along the way. Instead of investors paying a premium for portfolio crisis management, traditional fixed income paid investors that premium. Risk management came at so little cost and was so profitable to own that many investors essentially “over-insured” their portfolios. Going forward, we’re at a crossroads where high-quality, traditional fixed income will always be a crucial bedrock for investment portfolios, but this “insurance” might become more expensive. It’s no wonder, then, that most investors are revisiting their fixed income allocations.

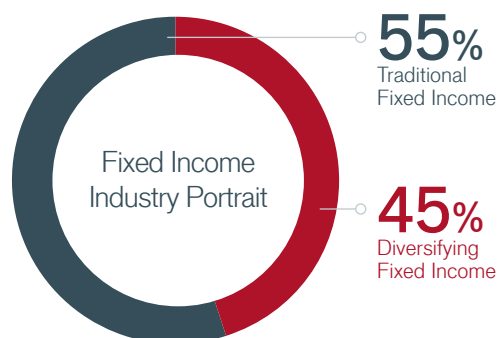
Non-Core Fixed Income vs. Core Fixed Income 2009 – 2018 Cumulative Flows, as a Percent of 2009 AUM



Source: Morningstar.

Across our consultations with thousands of advisors, we have seen this industry trend manifest in advisor portfolio asset allocations. To focus on fixed income diversification and other prominent industry trends, we track average allocations across the thousands of advisor models on which we’ve run analyses. Using our proprietary “Industry Portraits,” we’ve found that nearly half of the average advisor’s portfolio has been diversified outside of the core.

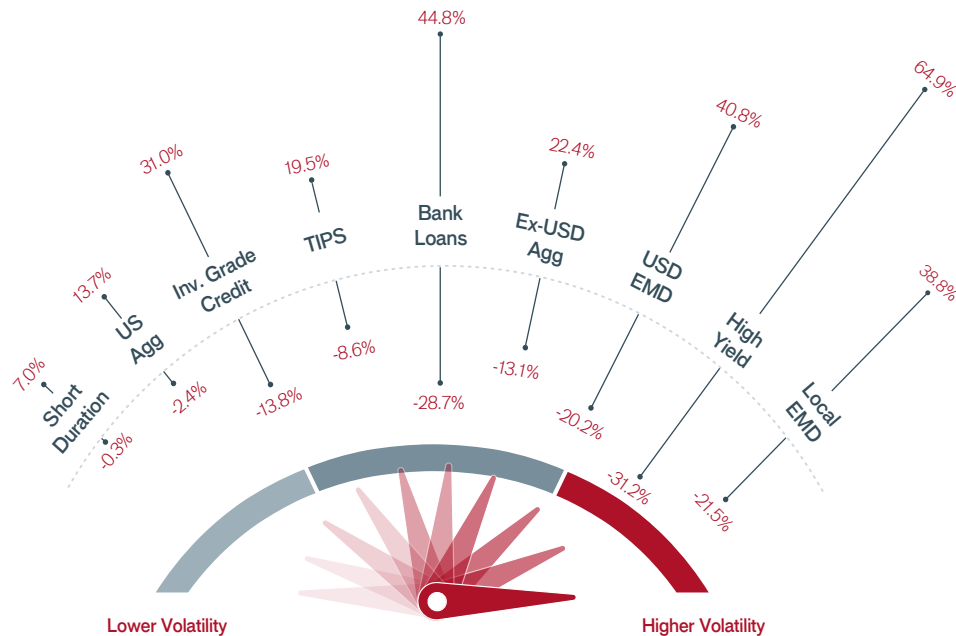
Fixed Income Allocations Have Shifted



Nearly half of the average advisor’s portfolio has been diversified outside of the core.

Farewell to an Old Era, Hello to New

This level of diversification isn't surprising, because ever since the Global Financial Crisis traditional lines in fixed income investing have been blurred by large price swings, high duration risks and a proliferation of new strategies. This environment has turned fixed income from what has traditionally been a fairly straightforward asset class – one that seeks to provide downside protection and income – into one that investors may find disorienting:



A Disorienting Environment*

- ▶ Double-digit dispersions among major fixed income asset classes
- ▶ Ranked from lowest 10-year volatility to highest
- ▶ Figures represent best and worst 12-month returns

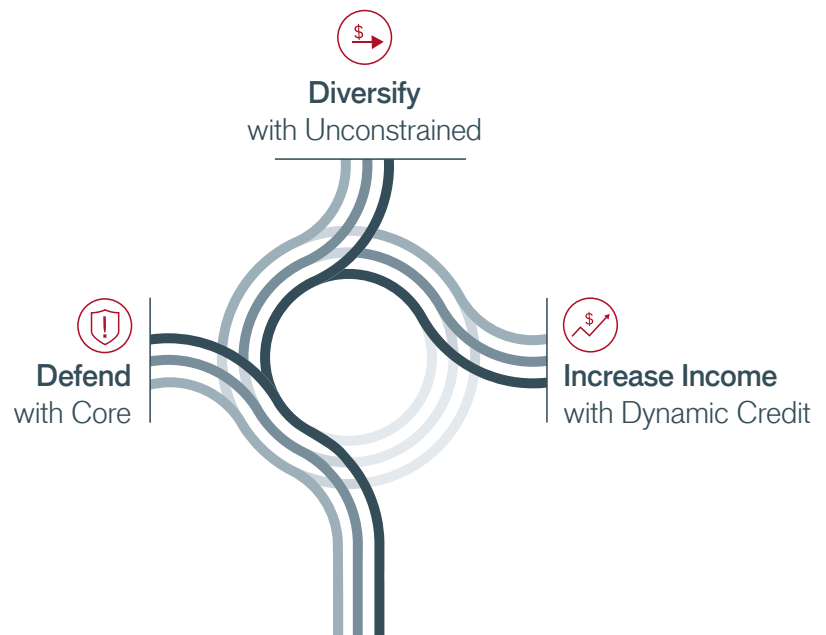
*Calculated using 12-month rolling windows with 1-month step over 10 years trailing through 6/30/19. Categories represented by corresponding indices from Bloomberg Barclays, JPMorgan and Credit Suisse.

New Era, New Framework

This disorienting environment has created a slew of new questions, such as: "Is high yield the new risk manager, since it might perform better than Treasuries if rates rise?" or "Even with rates near historical lows, are Treasuries still the best risk manager?" We think there has been too much focus on finding a single solution when the best solution is probably that it's a mix – and that mix depends on an investor's goals:

A Goals-Based Approach

- ▶ Janus Henderson's proprietary forward-looking approach
- ▶ Reduce the universe of fixed income managers into three distinct objectives
- ▶ Allocate across these objectives according to one's goals



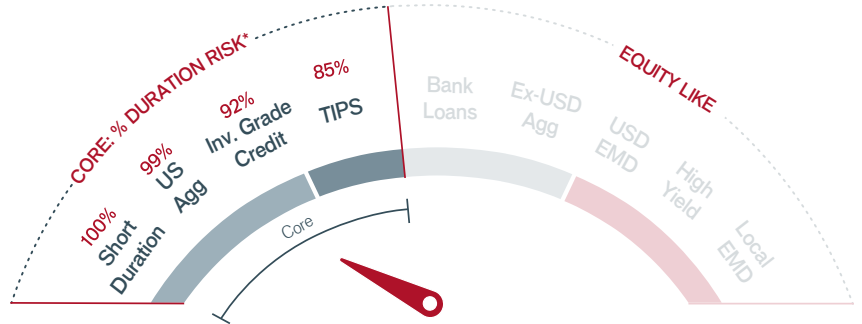
Breaking Down Our Three Fixed Income Objectives

Consolidating the breadth of fixed income instruments into three objectives can be confounding. Below, we outline how Core, Unconstrained and Dynamic Credit can be defined by their respective goals, personalities and criteria.

Defend with Core

What makes Core “Core”

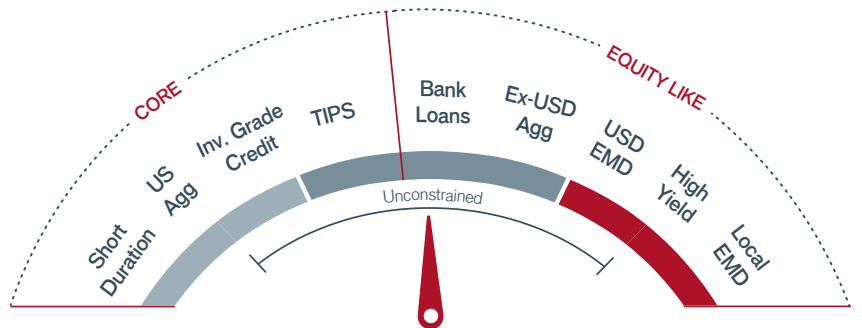
- **Goal:** Seeks to provide capital preservation during a market downturn
- **Personality:** Lowest volatility fixed income, high interest rate sensitivity
- **Criteria:** Currency-hedged, global developed government debt



Diversify with Unconstrained

Screening for Unconstrained

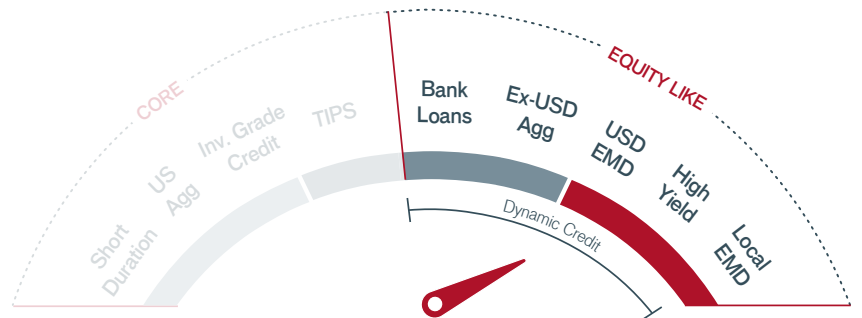
- **Goal:** Potential to perform during rising rates and/or widening spreads
- **Personality:** Generally lower volatility than high yield and higher than core
- **Criteria:** Low correlation to other fixed income, long and short across all global fixed income sectors



Increase Income with Dynamic Credit

Find Risk-Adjusted Income

- **Goal:** Broad exposure to equity-like fixed income on a global scale
- **Personality:** Potentially similar income and return as equity-like fixed income benchmarks with lower risk
- **Criteria:** Dynamic and global credit and government exposure, primarily long only



*To analyze the extent to which duration drives the overall risk of each major core fixed income asset class, we look to Janus Henderson's proprietary risk management software, Quantum. As illustrated in the above graphic, Quantum shows that the vast majority of each core asset classes' risk budget is driven by duration, as of August 2019.

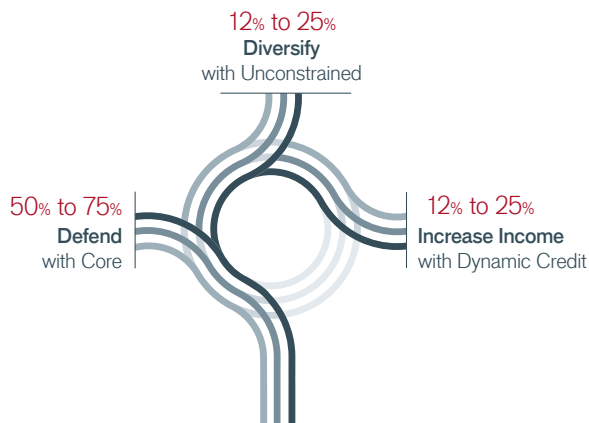
Duration measures a bond price's sensitivity to changes in interest rates. The longer a bond's duration, the higher its sensitivity to changes in interest rates and vice versa. Equity-like fixed income vehicles are investments that may be less susceptible to changes in interest rates or other factors than traditional fixed income. They are higher risk than traditional fixed income, without necessarily the same returns as a true equity investment.

Implementation: The Majority Stays in Core

When it comes to fixed income, there is no single solution to solve every client's needs; we believe clients are much better served with a goals-based approach. As we partner with thousands of advisors on a customized basis to help them solve for their clients' needs, we can distill our experience into these general allocation size ranges across the three fixed income objectives in our framework.

As discussed in our previous research (see: **Forecast Your Clients' Needs, Not the Rates Market**), even in the face of today's low rate environment, core fixed income's role is as essential as ever: clients rely on their core bond allocations for capital preservation during a crisis. In other words, core fixed income is the primary tool to make a moderate portfolio truly "moderate." Therefore, the majority (50%-75%) of most fixed income portfolios should stay in the core.

Outside of the core, we advocate allocations to both unconstrained and dynamic credit strategies. Each has its own benefits and costs in different market environments, and advisors are best served by having a balanced exposure to each and managing their clients' expectations based on strictly defining the managers deployed for each objective, as per the prior section of this article.



Reframing Fixed Income Portfolios

This powerful framework helps organize the huge universe of fixed income managers and, most importantly, conveys a clear, forward-looking approach to fixed income for clients. You can read more about our approach to goals-based fixed income portfolio design at: janushenderson.com/reframing-fixed-income.

About Janus Henderson's Portfolio Construction and Strategy Team

The PCS Team performs customized analyses on advisor portfolios, providing differentiated, data-driven diagnostics. From a diverse universe of thousands of models emerge trends, themes and potential opportunities in portfolio construction that we believe will be interesting and beneficial to any investor.

Engage with Us

Get the most from your business and your life. Our experts offer one-on-one consultations, keynote speeches, industry presentations and client-facing seminars. Contact your Janus Henderson sales director at **800.668.0434** or experience us online at janushenderson.com for more information.

For more information, please visit janushenderson.com.

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Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.

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FOR MORE INFORMATION CONTACT JANUS HENDERSON INVESTORS
151 Detroit Street, Denver, CO 80206 | janushenderson.com