Janus Henderson INVESTORS

Diversified Alternatives Fund

John Fujiwara
Portfolio Manager

Ashwin Alankar, Ph.D.
Portfolio Manager

Investment Environment

Cooling growth expectations, elevated trade rhetoric and a disconnect between central banks and the market on the future trajectory of interest rates all weighed heavily on riskier assets, including high-yield bonds and equities, during the period, with only a few traditionally safer asset classes, such as U.S. Treasuries, notching gains. Stocks sold off early as investors interpreted comments by Federal Reserve (Fed) Chairman Jerome Powell that the central bank would continue its rate-hike path. By the time Mr. Powell hedged his remarks, investors had moved onto other concerns, namely weaker global growth. Late in the period, the Fed's decision to raise rates a ninth time since 2015 was overshadowed by the bank's forecasts still exceeding that of the market. This led to the pronounced late-period sell-off.

High-yield corporate credits followed stocks' lead, with spreads between securities and their underlying risk-free benchmarks, widening considerably. Spreads on investment-grade corporates came under less pressure, resulting in returns on these issuers being roughly flat, aided by falling yields on benchmark Treasuries. After briefly rising to above 3.2%, the yield on 10-year U.S. Treasuries plummeted to the lowest levels since January 2018.

The U.S. dollar rose for much of the period, but gave back some gains late. Commodities tied to the business cycle suffered. Crude oil had the added challenge of potential excess supply going into a softer economic patch. An exception was natural gas, which saw a mid-period spike as an early start to winter exposed low inventory levels. Commodity gains were largely concentrated in agricultural products.

Performance Discussion

The Fund underperformed its primary benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, and its secondary benchmark, LIBOR + 3%, during the quarter. Over time, the Fund seeks to provide positive absolute returns and offer true diversification with low correlation to stocks and bonds by investing in a portfolio of risk premia strategies.

Risk premia strategies endured a difficult year in 2018 as many were caught on the back foot during February's volatility and had difficulty recovering. Our strategy is designed to minimize correlations to both stocks and bonds, and dampen volatility by attempting to distribute risk weights evenly across 11 risk premia. This approach worked well for much of the year, but volatility reached such levels during the fourth quarter that many risk premia delivered negative returns. Much of our underperformance was attributable to the nature of the previous equity rally, and more can be explained by fundamental factors within specific commodities markets.

Highlights

- The Fund underperformed its benchmarks during the quarter.
- Weighing most on performance were the Fund's equity momentum and equity-size risk premia.
- We believe that managing volatility levels and correlations will be paramount for risk premia strategies in navigating turbulent markets.

Two of the leading individual detractors were the equity momentum and equity-size risk premia. After an early-period sell-off, stocks remained range-bound for much of October and November as investors sought additional insight on the direction of the global economy. This lack of a pronounced trend did not enable the equity momentum strategy to contribute to performance as an established trajectory is necessary for returns to be generated. Later, initial reports out of the Group of 20 summit in Argentina hinted at a resolution in the U.S.-China trade spat. This ignited a push upward in stocks, sending a signal to our model to position itself for a rally. When the news on trade negotiations proved overly optimistic, markets quickly reversed and slid precipitously over the remainder of the period, leading to losses in the equity momentum strategy.

The equity-size risk premium weighed on performance as rising volatility caused investors to shed what they considered the riskiest portions of their portfolios, including smaller-cap stocks. This behavior runs counter to the tendency upon which this premium strategy is based: smaller-cap stocks outperforming large caps over time. We believe that this downdraft was more of a knee-jerk reaction rather than being fundamentally driven. We, therefore, would not be surprised if the small-cap underperformance subsides once portfolio underweights to small companies become meaningful.

The commodities roll yield risk premium also detracted. This strategy is aimed at capitalizing on the price differentials that tend to exist between shorter-dated and deferred futures contracts. These differences can generate excess returns, but the strategy's structure does expose it to supply shocks. This is what occurred during the period, when a combination of inventory shortages and a fierce start to the winter led to a substantial spike in natural gas prices. While this resulted in a loss, the strategy's risk-management protocol reduced the leverage to this risk premium, potentially mitigating additional losses.

The leading contributor was the equity emerging risk premium. Declines in emerging market (EM) stocks were dwarfed by their developed market peers, enabling the strategy, which seeks to capture the potential return of EM equities outperforming their developed market peers, to generate positive returns. Similarly, the equity value strategy delivered positive returns as value stocks fell less than companies with richer multiples. In both cases, EM and value stocks lagged developed market and growth stocks, respectively, during 2018's mid-year rally and when investor sentiment turned, the leaders quickly became the laggards.

Also contributing was the rates momentum strategy as, after initially rising, U.S. Treasuries aggressively rallied over the remainder of the period.

For detailed performance information, please visit janushenderson.com/performance.

Outlook

The market events of the past quarter, in our view, are likely the consequence of liquidity being drained from the system as global central banks shift from quantitative easing to quantitative tightening. The risk premia upon which the strategy is based have been evident in markets for decades. The distortions caused by highly accommodative monetary policy – and now its reversal – have sent shock waves through financial markets, thus impacting the historical relationships underlying many of these risk premia.

We do not believe this will last. Over time we expect these relationships to reestablish themselves. Over the near term, however, elevated volatility and the high amount of leverage in the system may result in additional idiosyncratic movements. Therefore, we believe risk premia strategies that emphasize dampening volatility across the portfolio and within each component are better positioned to weather any additional storms.

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

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Discussion is based on the performance of Class I Shares.

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Risk premia contribution is based on a model portfolio, and may differ from actual contribution. It is internally calculated and is gross of trading costs, fees and expenses. Risk premia contribution is intended to demonstrate the impact of each risk premia strategy within the portfolio.

Performance may be affected by risks that include those associated with non-diversification, portfolio turnover, short sales, potential conflicts of interest, foreign and emerging markets, initial public offerings (IPOs), high-yield and high-risk securities, undervalued, overlooked and smaller capitalization companies, real estate related securities including Real Estate Investment Trusts (REITs), derivatives, and commodity-linked investments. Each product has different risks. Please see the prospectus for more information about risks, holdings and other details.

There is a risk that the Fund's investments will correlate with stocks and bonds to a greater degree than anticipated, and the investment process may not achieve the desired results. The Fund may underperform during up markets and be negatively affected in down markets. Diversification does not assure a profit or eliminate the risk of loss.

Derivatives can be highly volatile and more sensitive to changes in economic or market conditions than other investments. This could result in losses that exceed the original investment and may be magnified by leverage.

There are special risks associated with selling securities short. Stocks sold short have the potential risk of unlimited losses.

Commodities, commodity-linked notes, foreign securities and investments through a nonregistered subsidiary provide exposure to special risks, including greater volatility and loss of interest and principal, and may not be appropriate for all investors. Commodities are speculative and may fluctuate widely based on a variety of factors, including market movements, economic events and supply and demand disruptions.

Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

LIBOR (London Interbank Offered Rate) is a short-term interest rate that banks offer one another and generally represents current cash rates.

Index performance does not reflect the expenses of managing a portfolio as an index is unmanaged and not available for direct investment.

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