Strategic Income Fund

December 31, 2018

Quarterly update and outlook

Overview

The fourth quarter was pivotal for bond markets. The scenario we have patiently positioned for is coming and we feel vindicated in our late-cycle views, accepting it begun later in the year than envisaged. The fall of 2018, in some ways, was the perfect storm for credit; investment grade and high yield underperformed, while developed world sovereign bonds rallied. The concoction of late-cycle factors caused a tightening in financial conditions and affected risk assets. To get a sense of the magnitude of the fourth quarter's move it's worth looking at the range in U.S.10-year yields. In early October, 10-year U.S. Treasuries hit 3.26% (having started the year at 2.4%) and by December 31, yields ended at 2.68%. Needless to say, credit spreads (the difference in yield between two different bonds that are the same in all aspects except for the credit rating) widened aggressively as equities sold off.

There has been an inherent contradiction between bond and equity markets. If this was a regime break to higher growth and inflation, cyclical equities would be expected to start outperforming. This did not happen and, in fact, defensive equity sectors such as utilities and health care ("bond proxies") outperformed. Moreover, the break higher in bond yields was entirely in real yields, arguably driven up by tighter real rates (not higher, sustainable growth). Inflation expectation barely moved, not the narrative that was making the rounds on social media.

Fund performance and positioning

Fund performance was strong during the period on both an absolute and relative basis. We remain long of sovereign interest rate risk, diversified across a number of countries, including Australia. The housing data and economic news flow continues to deteriorate in Australia, justifying our positioning. We feel the two-year reflation trade is definitely fading while some of the longer-term secular factors of low growth and inflation are reasserting themselves. We had been reducing the credit in the Fund since August 2017 given the "late-cycle" environment and that helped minimize losses from credit during the reporting period, albeit we still had exposure. Fortunately we had added more duration and interest rate risk such that the NAV of the Fund rallied in the fourth quarter.

Outlook

The slowing global economy has certainly gotten the attention of the Federal Reserve. We believe the circularity of tightening credit conditions will continue. A lot of damage has been done in equity and credit valuations, and the liquidity of credit markets is now disappearing. We are positioned long of developed world sovereign bond risk and are fairly light in credit interest rate sensitivity, having significantly reduced the latter. We hope and expect 3.26% will be the top for 10-year Treasuries this cycle.

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Asset class allocation	
Investment-grade corporates	36.22%
Government bonds	33.85%
High-yield corporates	13.76%
Cash	13.57%
Bank loans	2.51%
CMBS	0.25%

Regional allocation	
U.S.	44.20%
Australia	14.52%
Cash	13.57%
Europe	11.44%
UK	9.53%
Canada	6.74%

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Past performance is no guarantee of future results. Call 800.668.0434 or visit janushenderson.com/performance for current month-end performance.

Discussion is based on the performance of the Fund's Class I Shares.

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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.

High-yield or "junk" bonds involve a greater risk of default and price volatility and can experience sudden and sharp price swings.

Foreign securities are subject to additional risks including currency fluctuations, political and economic uncertainty, increased volatility, lower liquidity and differing financial and information reporting standards, all of which are magnified in emerging markets.

Bloomberg Barclays Global Aggregate Credit Index measures the credit sector of the global investment grade fixed-rate bond market, including corporate, government and agency securities. 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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