



JANUS CAPITAL®
Group



JANUS
MARKET GPS™
2017

INSIGHTS FROM THE EXPERTS AT JANUS CAPITAL GROUP



**CHINA'S
TRANSITION**
An Update



INFLATION
Caution Ahead



LOW GROWTH
Finally Coming
to an End?



ENERGY
Are Oil Prices
Set to Rise?



THE INNOVATORS
Not Limited to Tech
and Health Care

2017

A YEAR OF CHANGE

JANUARY 2017

As 2017 gets underway, the landscape for investors and financial markets is shifting. Stable energy prices, renewed optimism about the U.S. economy and ongoing innovation suggest that new opportunities lie ahead. Meanwhile, for the first time in years, inflation appears to be rising, while China, once the engine of the global economy, grapples with slower growth.

Here, the investment professionals at Janus Capital Group share insights on these trends, which we believe will be key considerations for investors in 2017. As China transitions to a more modest growth trajectory, we assess whether the world can continue to rely upon Beijing for growth and examine the risks posed by China's reliance on massive credit expansion to fuel this growth. In the January 2016 Market GPS™, the Janus Asset Allocation Team put forth the nonconsensus view that the market was underestimating the risk of inflation. This year, we explore the risks posed by rising prices and how investors should position themselves in an inflationary environment.

We also look at whether post-election fiscal stimulus can pave the way for higher interest rates. Already, oil prices are moving higher and we examine what that means for beleaguered energy companies. Lastly, we turn our attention to the innovators. While health care and technology remain at the forefront of new ideas, we see innovation in other sectors as fertile ground for exciting investment ideas.

We invite you to explore these discussions, as our investment experts discern the changing landscape and provide guidance for the year ahead.

ABOUT JANUS

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OFFICES
WORLDWIDE

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PROFESSIONALS

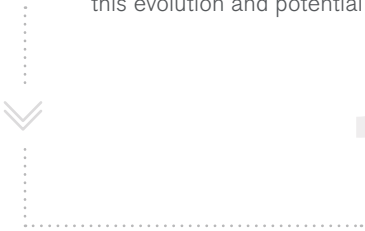
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CHINA

China's transition from a manufacturing and export-led economy to consumption-led growth remains in its early stages. Janus' investment professionals examine this evolution and potential obstacles in its path.



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INFLATION

Our Asset Allocation team's proprietary model signals that the long period of price stability may be on the cusp of coming to an end. We examine these signals, as well as their global scope, with input from Janus' Fundamental Fixed Income team.

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LOW GROWTH

Will subdued economic growth continue? Following the presidential election, outcome distributions in Janus' options-based risk model underwent a significant shift, alluding to a possible upside breakout for the U.S. economy.



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ENERGY

Crude oil prices recovered during the first half of 2016 and have since been range-bound. We believe prices could go even higher in 2017. Learn what's behind our forecast, and what may derail a further rebound in crude oil prices.

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THE INNOVATORS

New ideas are commonly associated with the technology and health care sectors. Janus' investment professionals discuss how innovation is the engine of growth in these reliable areas, as well as other sectors of the economy.





CHINA

GROWING PAINS

Since the 2008 global financial crisis, China's commitment to deliver both monetary and fiscal stimulus in the domestic economy has been the growth engine of the global economy. However, the country amassed a significant amount of debt in the process. Without a pickup in growth elsewhere around the globe, we are concerned that the sustainability of this debt-fueled model will erode and present challenges going forward.

China's growth is already slowing as the country pivots from a manufacturing-based economy to one driven by consumption. While we believe the transition to consumption remains on track, albeit relatively early in the process, we expect that the search for levers to boost growth will mean continued volatility in 2017. Yet, our recent visits to China convince us that growth is unlikely to collapse overnight, and that the world's second-largest economy presents some attractive investment opportunities.

THE TRIANGLE AT THE HEART OF THE STRUGGLE

The core of the issue is China's ongoing policy conundrum, says Equity Research Analyst Barrington Pitt Miller. The country has targeted economic growth of 6.5% to 7% annually for the next five years, while also striving to maintain full employment and reduce leverage. Social stability is of paramount concern for the central government, meaning that a reduction of the growth target is highly unlikely in Mr. Pitt Miller's view; less growth would employ fewer people and could

potentially lead to unrest. In recent years, growth – and therefore employment – has been sustained through credit and fiscal stimulus. Mr. Pitt Miller sees a fundamental disconnect between the central government’s gross domestic product (GDP) ambition and its leverage rhetoric. China cannot slow leverage and achieve the current GDP target without help from the rest of the world through economic growth.

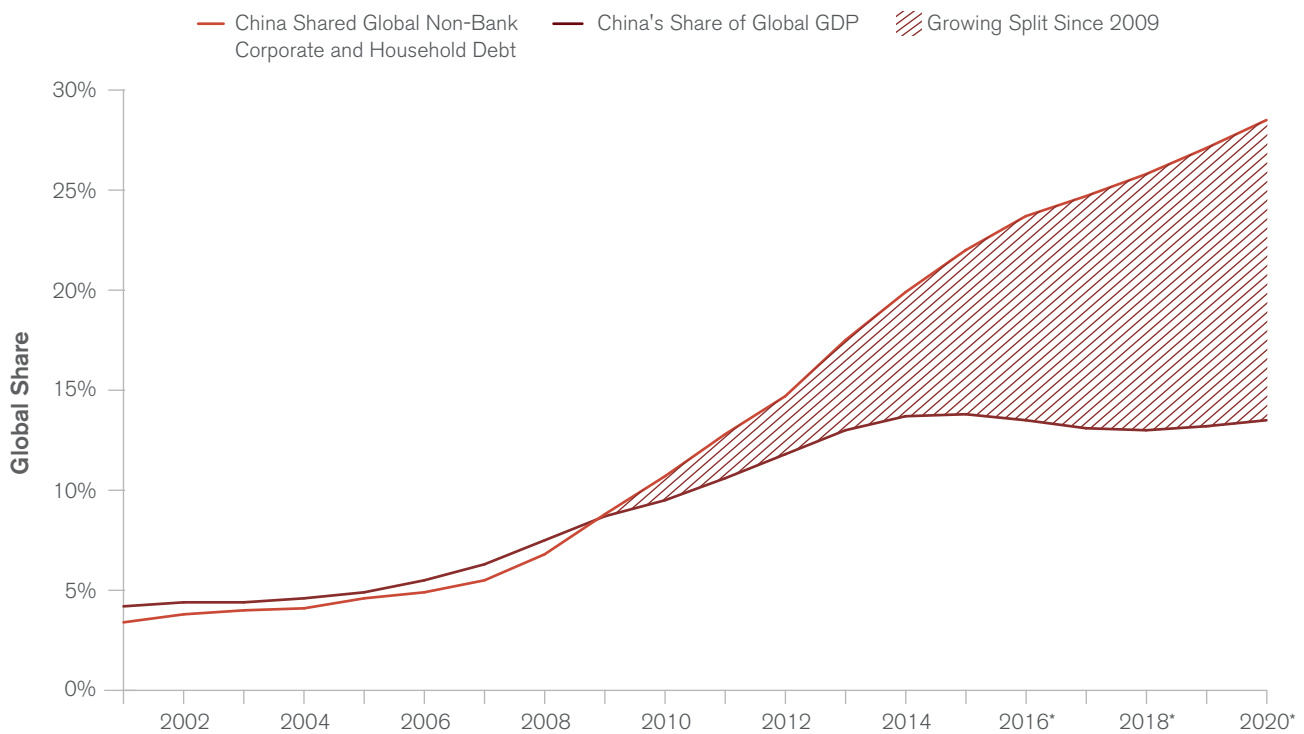
Fundamental Fixed Income Analyst David Spilsted agrees that policy makers are pursuing a set of conflicting goals and is concerned that the circular nature of this policy environment will emphasize growth, to the detriment of true structural reform. Mr. Spilsted notes that while talk of faster and deeper reform continues, at the first sign of deceleration, the government’s typical reaction is to turn on the credit spigot.

» **THERE IS A FUNDAMENTAL DISCONNECT BETWEEN THE CENTRAL GOVERNMENT’S GDP AMBITION AND ITS LEVERAGE RHETORIC. UNTIL THE ECONOMY TRANSITIONS SUFFICIENTLY, CHINA CANNOT SLOW LEVERAGE AND ACHIEVE THE CURRENT GDP TARGET. THOSE TWO OBJECTIVES CANNOT COEXIST.**



Barrington Pitt Miller
Equity Research Analyst

CHINA’S SHARE OF GLOBAL GDP AND GLOBAL NON-BANK CORPORATE AND HOUSEHOLD DEBT



*Estimated
Source: Bank for International Settlements, Janus Capital Group

WHAT DOES THIS MEAN? <

While it is known that China’s share of global GDP has risen to more than 13%, what is less well known is that much of that growth has been fueled by rapidly expanding private sector credit.

NON-BANK CORPORATE AND HOUSEHOLD DEBT TO GDP

China's reliance on non-bank credit has gone from trailing developed markets to far exceeding them.



STATE-OWNED ENTERPRISES UNDERSCORE CHINA'S EFFICIENCY CHALLENGE

We saw evidence of this credit injection in early 2016, and the primary recipients of the stimulus, per usual, were State Owned Enterprises (SOEs). This is problematic because these government-owned corporations, which dominate China's industrial sector, have historically operated with massive inefficiencies, and their underlying mission of maintaining employment has resulted in overproduction. Yet, as the central government simultaneously promotes capacity cuts and mandates municipalities to contribute to GDP

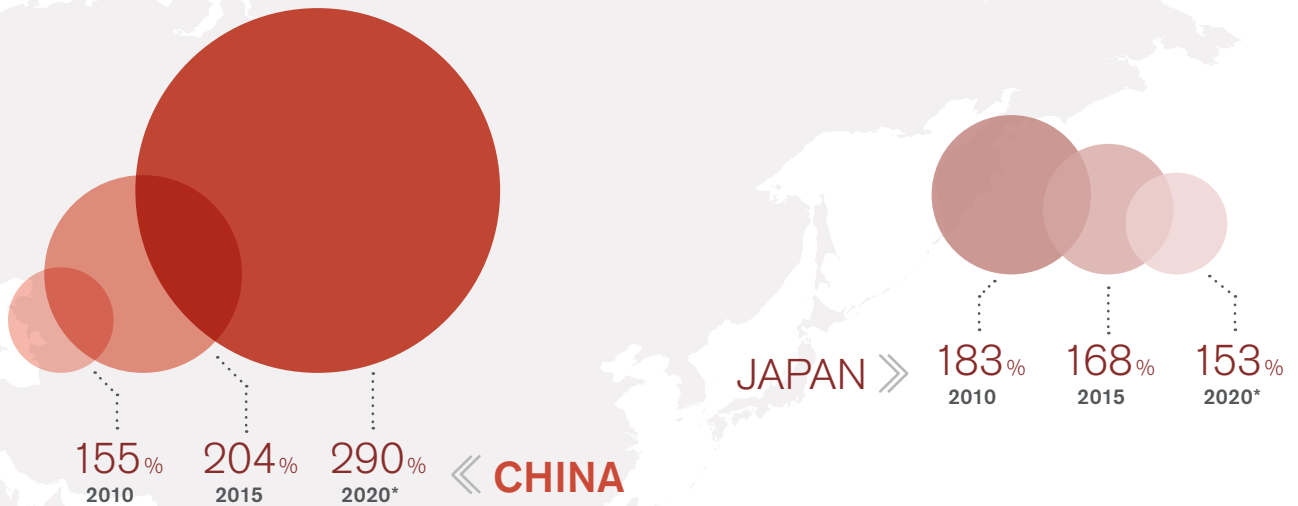
growth, local authorities often turn to their largest employers, which are typically SOEs. Local officials have had little problem finding credit to keep the inefficient entities operating and their constituencies employed.

Acknowledging the overcapacity issue, China's four state-owned banks have been directed to reduce leverage, and are in fact slowing loan growth. Unfortunately, credit expansion in other channels, including municipal bonds and the policy banks, is filling the void. Using credit to prop up the SOEs may fuel the economy in the near term, but the leverage needed to support these inefficient organizations will at some point become unsustainable.

Supporting unproductive legacy enterprises only prolongs the country's transition to a consumption-led economy.

Until the government concedes to slower growth, Mr. Spilsted points out, the headwinds presented by supporting the old economy will keep the transition from moving full steam ahead.

China holds its regular National Congress in 2017 and President Xi Jinping will insist/demand that the economy move along smoothly until then. Given party pressures, administrators at all levels will want to be seen contributing to growth. Ultimately, according to Mr. Spilsted, party politics are everywhere in China and while it will be just reinforcing the façade, it will be a powerful motivator. The event, however, could present Mr. Xi with an opportune moment to reevaluate growth and assert a lower growth target.



*Estimated
Source: Bank for International Settlements, Janus Capital Group

CHINA'S ECONOMIC TRANSITION CONTINUES: MINDFUL OF THE NEED FOR STABILITY

While we believe the economic transition is in its early phase, the ambition to switch the economy is undeniably clear and ongoing, says Mr. Pitt Miller. China wants a more self-sustainable, consumer-led economy; they do not wish to rely on external consumers for growth in the model of postwar Germany or Japan. Nonetheless, evolving the world's second-largest economy is a massive undertaking. Portfolio Manager Guy Scott, CFA, notes that it took the U.S. 40 to 50 years to make a similar transition. China is moving much more rapidly,

and perhaps faster than most realize. E-commerce has severely diminished the importance of physical storefronts. The Internet, in combination with advanced manufacturing technologies, will accelerate China's transition, as it skips past the era of brick and mortar based consumption and straight to e-commerce. Now, it's a matter of the old economy versus the new economy, says Mr. Scott. How fast can the new economy grow, and can the old economy be stabilized? Key to stabilization efforts will be how Beijing manages the employment consequences of this change.

SOEs largely remain a drag on growth, but stabilization is underway via government-led reform initiatives. To mitigate overcapacity, for example, the government shuttered underperforming

mills and mines, and substantially lowered the number of average working days in the coal industry. We've also seen an increase in the approval of mergers and layoffs. Domestically, these

CONTINUED ON PAGE 10

» CHINA DOES NOT HAVE TO FOLLOW THE PATH OF THE WEST. COMING ALONG LATER, THEY ARE ABLE TO USE THE NEW ECONOMY TO TRANSITION FASTER AND BYPASS THE COSTLY STEPS THAT HAD TO BE TAKEN IN THE WEST.



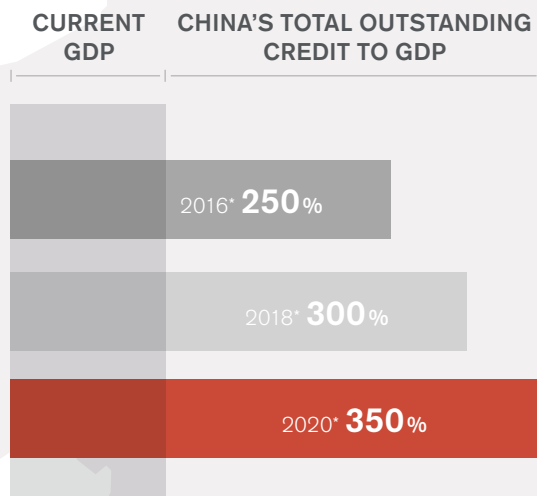
Garth Yettick, CFA
Equity Research Analyst

CREDIT EXPANSION IN CHINA

If left unchecked, China's credit growth poses an enormous risk to the domestic economy, and could have broader implications for global growth.

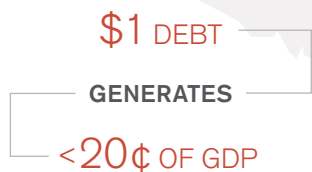
CHINA'S TOTAL OUTSTANDING CREDIT TO GDP

China's total credit outstanding stands at an estimated 250% of GDP. On current GDP growth estimates, the future looks worse:

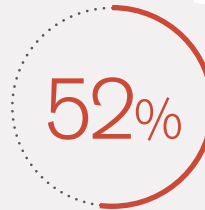


However, Janus' models suggest a scenario in which stronger U.S. economic growth could help limit credit to GDP to about 300% in 2020.

Incremental credit expansion's positive impact on the economy is diminishing.



FROM 2008 TO 2015, CHINA ACCOUNTED FOR



of global bank credit growth to the non-bank sector (in USD), as defined by the Bank for International Settlements.

THE BANKING SYSTEM IS NOT GENERATING SUFFICIENT PROFITS

Even when accounting for overstated earnings, the big four banks generate about one-quarter of the required retained profits necessary to sustain the pace of credit growth needed to meet China's current GDP targets of about 6.5% to 7%.

REQUIRED RETAINED PROFITS TO SUSTAIN PACE OF CREDIT GROWTH



CURRENT RETAINED PROFITS ARE ONLY ABOUT 25% OF WHAT'S REQUIRED TO SUSTAIN CREDIT GROWTH

✓ TAKEAWAY

Over time, this will push the financing needs to elsewhere in the system, such as municipal bonds and policy bank lending.

CHINESE MUNICIPAL BOND ISSUANCE

The country's muni bond issuance accounts for approximately \$1.5 trillion of the \$4.5 trillion of credit extended in China since early 2015.



Regional, city and policy banks are buying these liquid securities, which are valuable repo collateral for interbank liquidity transactions, in addition to amassing substantial shadow banking products on their balance sheets.

The four major state-owned banks are slowing loan growth and reducing risk relative to the overall system, but loan growth remains astounding.



Bank credit at the big four banks totals \$6.3 trillion, a number Mr. Pitt Miller expects to be closing in on \$9 trillion by 2020. While the big four banks are shifting their focus to the new economy, the rest of the bank sector, led by policy banks, continues to support the unproductive sectors of the economy.

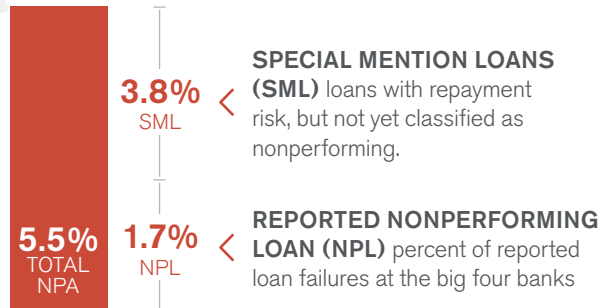
✓ TAKEAWAY

The unproductive SOE sector still accounts for a large share of outstanding loans.

A NONPERFORMING ASSET PROBLEM

Combined, nonperforming assets (NPAs) total more than 5.5%, which means the required loan loss reserve of 160% covers less than 50% of NPAs.

If bad loans go unrecognized, banks do not have to provision for them, nor do they have to write them off, which enables the banks to continue "growing," albeit still holding nonperforming loans. Unfortunately, this causes a heavy drag on net interest income and margins. Authorities have recently issued debt-to-equity swap guidelines, which could relieve pressure on balance sheets, but the effort will become unsustainable if bad loans continue to grow commensurate with leverage over time.

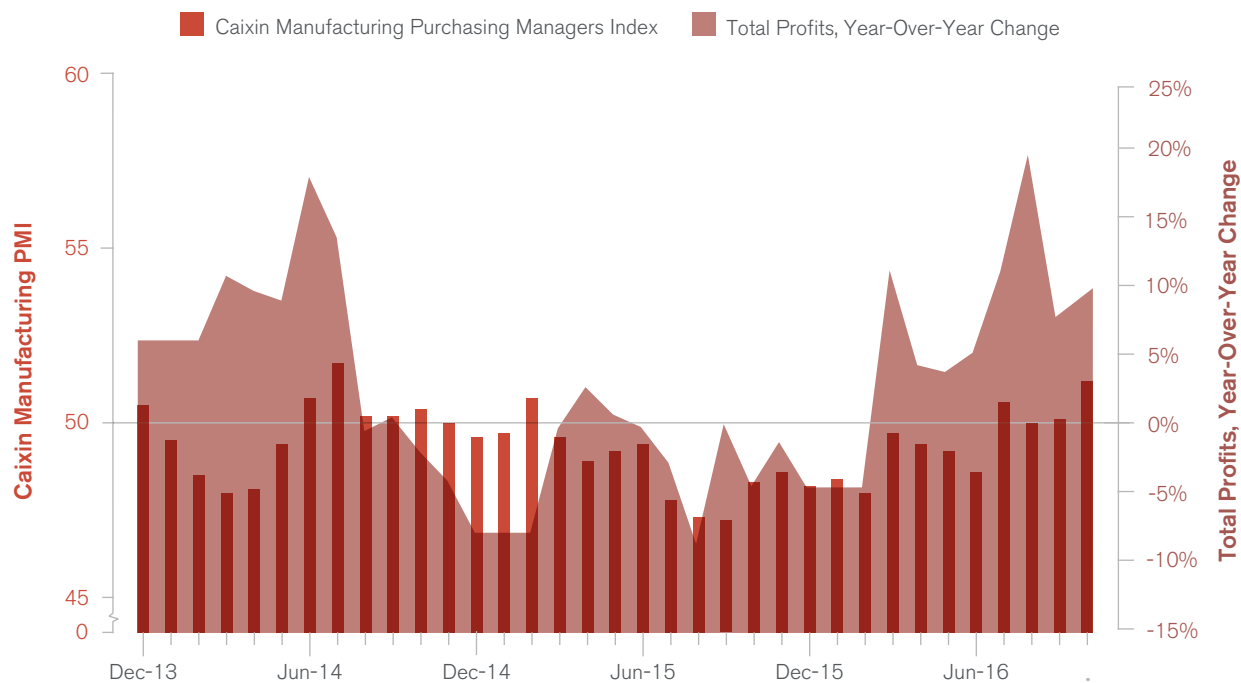


For now, the fact that the banking system is domestically funded makes a near-term liquidity event unlikely. Both sides of the balance sheet are owned internally, so there is no mark-to-market pressure.

If the government does not recognize that GDP growth has to slow, the debt stock will continue to climb and the country's ability to service it will become questionable, especially as the foreign exchange reserve buffer declines. As a result, the risk to the currency via the banking system will grow.

*Estimated
Source: Janus Capital Group, Bank for International Settlements, Company Reports

CHINESE CORPORATE PROFITS RISE AS INDUSTRY INSTILLS DISCIPLINE



Source: Bloomberg, Markit

WHAT DOES THIS MEAN? <

The reduction of overcapacity in key industries has led to a more rational marketplace and increased pricing power for the healthiest firms.

» IN GENERAL, WE'VE SEEN CONSISTENT FEAR THAT THE ECONOMY WILL SLOW DOWN DRAMATICALLY, AND THAT THERE WILL BE A HARD LANDING. INSTEAD, THINGS HAVE BEEN PRETTY GOOD, LED BY THE CONSUMER IN TRANSITION.



Garth Yettick, CFA
Equity Research Analyst

CONTINUED FROM PAGE 7

reforms have dramatically increased profitability for a number of SOEs, and the coal and steel industries have benefited, as evidenced by climbing prices of the respective commodities. Reducing investment in construction and imposing property-market controls also speak to the government's commitment to rein in credit growth. We see positive side effects from anti-corruption efforts as well, including the funneling of capital into productive areas of the economy, versus into unproductive sectors. Mr. Scott confirms that investment into low-return projects is now a flag for potential corruption, particularly in industrials and

oil and gas, and is attracting the attention of anti-graft government officials.

We believe these reform initiatives are linked to the recent uptick in the Producer Price Index (PPI) (see chart on page 14). China's September PPI data turned positive for the first time in nearly five years, and October saw a 1.2% rise in the price of manufactured goods. Following years of deflationary pressure, companies are regaining pricing power as inflation creeps in, which is positive for both capital expenditure and the bottom line. Nominal growth acceleration may also afford more room for a lower real GDP target.

MIDDLE CLASS DESIRES AND THE CHALLENGES OF TECHNOLOGY AND GLOBALIZATION

The “new” consumption-driven economy already represents approximately 40% of GDP and contributes approximately 70% to GDP growth. The emergence of the middle class has arrived with considerable momentum, and they want better goods.

We’ve seen tremendous demand for quality products, notes Portfolio Manager George Maris, CFA, as well as a strong desire for experiences: investment opportunities are arising in travel, video games, Internet and e-commerce. We particularly like the e-commerce space, including online to offline commerce (O to O). We expect e-commerce as a portion of China’s GDP to increase from about 6% now to roughly 15% or more by 2025.

The country’s environmental challenges also merit close attention, says Equity Analyst Garth Yettick, and we are closely monitoring the potential for government incentives on the purchase of eco-friendly products.

Yet, employment struggles in the new economy bring the policy triangle back to the forefront. Heavy industry typically employs more people than technology, notes Mr. Pitt Miller, and as people lose jobs, spending power declines and GDP growth becomes challenged. As the country explores high-skill manufacturing, increased use of robotics and automation is likely, and may aid China’s efforts to overcome the demographic reality of a shrinking workforce.

Alternatively, other Janus investment professionals believe the shift could ultimately benefit the employment rate in the long run, because many services require labor-intensive work, as opposed to the machine-driven processes of heavy industry. Regardless, China will need to confront the need for retraining and re-employment of its workforce.

Of additional concern on the road to transition are the yet-to-be-determined policies of U.S. President-elect Donald Trump. Pro-growth, fiscal stimulus initiatives in the U.S. would be beneficial to China, but this benefit could easily be nullified by the imposition of tariffs. Additionally, U.S. (and by extension European) rhetoric about Chinese currency manipulation may also heat up as the yuan depreciates due to slower economic growth and near-term capital flight.

The threat of tariffs will push China closer to the rest of Asia, says Mr. Spilsted, and Asia will be eager to reciprocate. A notion, Mr. Maris remarks, to which the U.S. should be wary,

because China’s injection of capital into the region has already supplanted U.S. influence there. Intra-region trading will benefit the Chinese economy, and we expect the intra-Asia trade lane to remain the fastest-growing trade lane over the next decade.

In the interim, to effectively transition its economy, China must grapple with its burgeoning debt and continue cutting capacity in nonproductive arenas. If successful, our equity analysts believe that China, and Asia in general, will continue to be sources of global growth for some time, and that consumer-demand in emerging Asia will be a promising area for investment. ●

» IN DEVELOPED MARKETS, COMPANIES HAVE TO CREATE DEMAND. IN EMERGING MARKETS COMPANIES HAVE TO CREATE ENOUGH SUPPLY TO MEET THE DEMAND.



George Maris, CFA
Equity Portfolio Manager

INVESTOR IMPLICATIONS

CHINA’S CREDIT BUBBLE IS NOT TO BE TAKEN LIGHTLY; however, it does not pose an immediate threat. In our estimate, the economy can be controlled internally for three to five more years.

INVESTORS SHOULD BE PREPARED FOR CYCLICALITY IN CHINA’S GROWTH CYCLE. The fits and starts in the country’s transition to a consumption-driven economy are likely to continue. Yet growth is unlikely to collapse overnight.

GENUINE EFFICIENCY GAINS ARE TAKING HOLD IN THE OLD INDUSTRY, increasing productivity and supporting pricing which may provide a tailwind for global commodity prices. Assuming China continues to grow, it is likely that the downside to commodities has largely played out.

THE NEW ECONOMY IS BEING PROPELLED BY THE CONSUMER, and we believe companies can benefit from where growth in China is heading.



INFLATION

IT'S BACK?

The U.S. and much of the developed world have witnessed a sustained period of stubbornly low price pressures. The Janus Asset Allocation and Fundamental Fixed Income teams believe this pastoral period of price pressures is likely to change. We are already seeing early signs of inflation, and we expect continued upward pressure on prices. Janus' investment professionals are monitoring inflationary signals and actively adjusting our portfolios to account for these shifting expectations.

COMMODITY PRICES AND WAGE PRESSURES ARE RISING

Contributing to rising prices is the general uptick in commodities pricing and the recent stabilization of the energy sector, (see Energy on page 20). The energy sector's deflationary impact on the economy for the last two years is coming to an end as the price of crude oil comes off a decade-plus low. However, this is not just a temporary commodity shock, says Chief Investment Strategist Myron Scholes, Ph.D. This is more pervasive; asset classes across the market are signaling that inflation is here and on the rise.

A key reason for this is the return of wage growth throughout the U.S. economy, says Fundamental Fixed Income Portfolio Manager Chris Diaz, CFA. Today's low unemployment rate infers a tight labor market, especially for skilled workers. As a result, companies are paying higher wages to obtain the skills they need, yet productivity has generally been weak. October's 2.8% year-over-year increase in average hourly earnings was the largest increase since 2009. Should the trend persist, wages will continue to contribute to the inflation story throughout 2017 and perhaps the years ahead.

» THIS IS NOT JUST A TEMPORARY COMMODITY SHOCK. ASSET CLASSES ACROSS THE MARKET ARE SIGNALING THAT INFLATION IS HERE AND ON THE RISE.



Myron Scholes, Ph.D.
Chief Investment Strategist

FISCAL STIMULUS IN THE OFFING?

Also supporting inflation expectations is the prospect of U.S. fiscal stimulus. Global Head of Fundamental Fixed Income Risk Management Mayur Saigal notes that while inflation expectations began changing after June's Brexit vote, they have been significantly amplified in the wake of the 2016 U.S. presidential election. Infrastructure spending, tax cuts and deregulation – all of which would help stimulate the economy – now look more likely with Republicans in control of the White House and both houses of Congress. Global Head of Asset Allocation Ashwin Alankar, Ph.D., agrees, noting that while uncertainty remains over the specific

» WE SEE INFLATIONARY FORCES DESPITE A STRONGER U.S. DOLLAR. INFLATION WILL BE IGNITED BY DOMESTIC SPENDING. WE EXPECT THE CONSUMER WILL START TO SPEND AND A LITTLE PICK-UP IN THE VELOCITY OF MONEY WILL PUT THE TREMENDOUS SUPPLY OF MONEY TO USE.



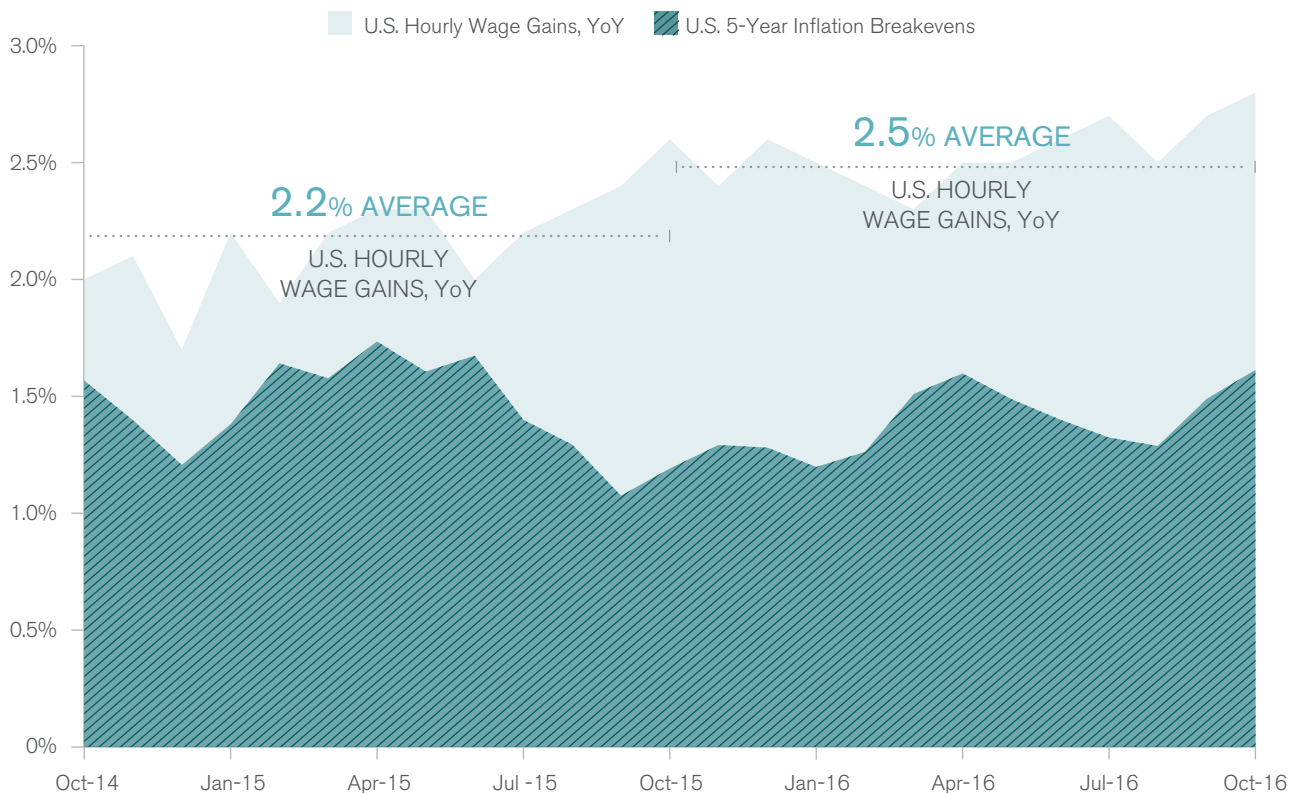
Ashwin Alankar, Ph.D.
Portfolio Manager, Global Head of Asset Allocation and Risk Management

policy agenda, markets indicate a Trump presidency will be inflationary. That assumption weighed on U.S. Treasuries following the election as yields climbed. Mr. Saigal says Treasury yields could face even more upside if economic growth and inflation continue to push up yields in 2017. Additionally, we are seeing inflationary forces, despite a stronger dollar, says Dr. Alankar, and the options markets signal

continued U.S. dollar strength. Rather than importing inflation, the fear of future expenses will motivate current spending, leaving the U.S. consumer as the driver of upward price pressures. An increase in the velocity of the massive U.S. money supply will also translate to inflation. The global economy could benefit as well, says Dr. Alankar, as other countries import inflation through a stronger dollar.

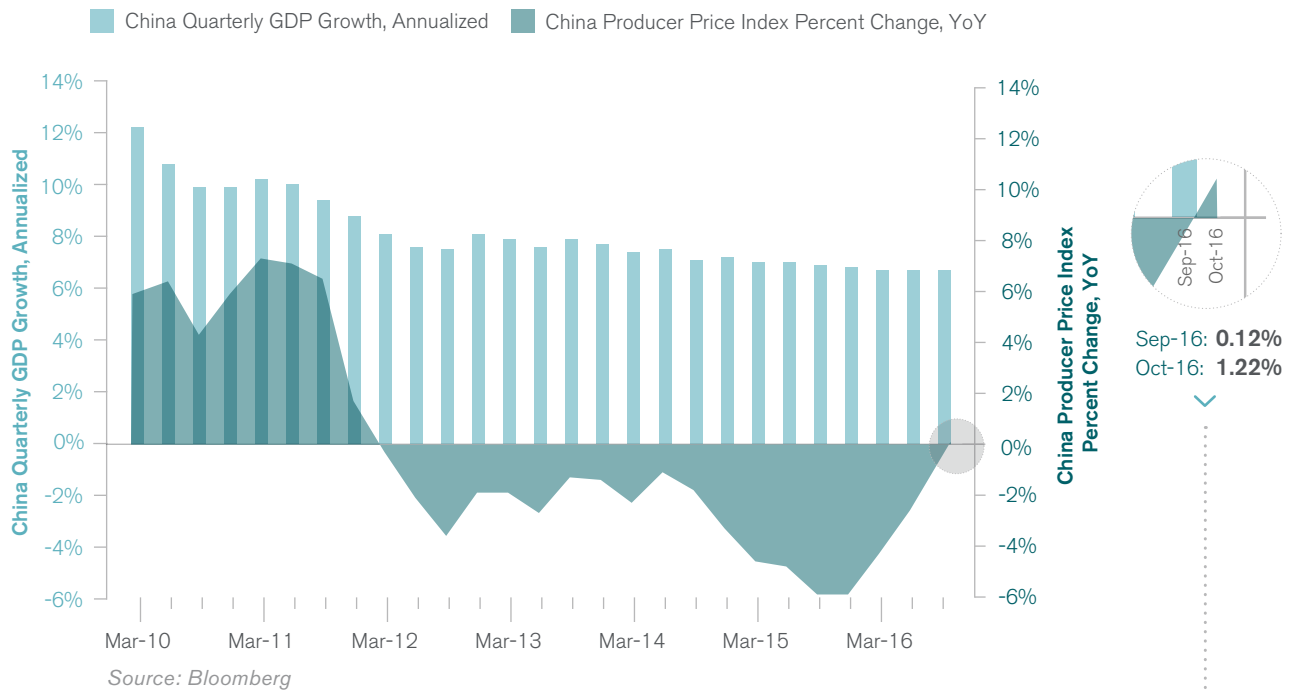
U.S. WAGES AND INFLATION BREAKEVENS ARE RISING

Wages – a key source of inflation in service-based economies – averaged more than 2.5% year over year in 2016. That upward pressure, along with post-election stimulus expectations, caused the TIPS market to raise its inflation expectations.



Source: Bureau of Labor Statistics, Bloomberg

CHINA'S PRODUCER PRICE INDEX TURNS POSITIVE



WHAT DOES THIS MEAN? <

Increasing input costs for Chinese producers may signal that Beijing's role as a disinflationary force for the global economy is over, which may provide a tailwind for developed market central bankers trying to reflate their economies.

INFLATIONARY RISKS ARE NOT LIMITED TO THE U.S., BUT ARE NOT WIDESPREAD

Another potential impetus for global inflation is China. Low wages and excess capacity have contributed to Beijing becoming a source of disinflationary pressures and one of the primary reasons that the goods component of inflation has remained depressed. However, as the country works to stabilize its old industrial economy and transition to a consumption-led model, deflationary forces emanating from China may be abating. After 54 months of downward price pressure, China's Producer Price Index (PPI) turned positive in September, and increased 1.2% in October.

Equity Research Analyst Garth Yettick, CFA, notes that companies, particularly within technology manufacturing, are clearly experiencing wage inflation and are actively seeking cheaper labor both domestically and abroad in countries like Vietnam. Mr. Diaz notes that an increase in production input costs may not translate through to consumer prices, but the uptick in PPI could be a sign that China may no longer be relied on to export deflation around the world. Portfolio Manager Ryan Myerberg,

however, cautions that China is not out of the woods yet. Dependent on post-election trade terms from the U.S., and potential policy responses from Beijing, China could still deliver a shock to global confidence and act as a tail-risk event from a deflationary standpoint.

Inflation will be present in the UK, but due to idiosyncratic events, rather than economics, says Mr. Myerberg. Brexit concerns caused a massive depreciation in sterling, which has fallen roughly 16%

» THE U.S. INFLATION PICTURE SEEMS CLEAR, AS DOES THAT OF THE UK. EUROPE, HOWEVER, IS MORE CHALLENGING. ANY INFLATION BOOST CAN EASILY BE OFFSET BY INFLATION HEADWINDS.



Ryan Myerberg
Fundamental Fixed Income Portfolio Manager

against the U.S. dollar since June's vote. A devaluation of that magnitude should bring a pop in inflation next year, as the pass-through effect from the currency typically takes six to 18 months.

In Europe, the story is a bit more muddled. Any inflation boost from the U.S. and China could easily be offset by headwinds, including the negative effects of Brexit and the general political uncertainties plaguing the region, says Mr. Myerberg. While the European Central Bank (ECB) has recently extended its quantitative easing program, scheduled cutbacks or a move to stop its asset purchase program at the end of 2017 could also act as a brake on inflationary pressures.

In the southern periphery of Europe, high unemployment rates present additional challenges for upward price pressure, even in economies with improved growth outlooks, such as Spain. Additionally, if U.S. trade policies turn toward tariffs and protectionism, the chance of inflation being exported will be significantly reduced.

With these risks in mind, Mr. Myerberg anticipates headline inflation in Europe to be within the ECB's expectations of 1% to 1.5%, with core measures staying stubbornly low, and risks tilted to the downside. One possible catalyst for an upturn in inflation, in Mr. Myerberg's view, would be a loosening of the fiscal constraint in the region and a corresponding increase in government spending.

INFLATION MAY LEAD TO NORMALIZED INTEREST RATES IN THE U.S.

In the U.S., our investment professionals believe the Federal Reserve (Fed) will embrace inflation in order to normalize rates. Fiscal stimulus would help extend today's aging business cycle and reduce fears of a recession, says Mr. Saigal. The Fed, in turn, would finally have an opportunity to raise its benchmark rate. Dr. Alankar says the options market already is signaling that the Fed must raise rates to replenish its toolkit. If fiscal

» **WHAT WE SEE FROM THE OPTIONS MARKET IS THAT THE OBJECTIVE OF FISCAL POLICY IS TO ACT AS A BRAKE, PREVENTING THE ECONOMY FROM SLIPPING INTO RECESSION. IN THIS SENSE, IT REPLACES THE FED'S SO-CALLED PUT OPTION, AS THE BATON PASSES FROM MONETARY POLICY TO FISCAL STIMULUS.**



Ashwin Alankar, Ph.D.

Portfolio Manager, Global Head of Asset Allocation and Risk Management

policy spurs growth – effectively taking the baton from monetary policy – the Fed could hike rates faster than most market participants expect.

Janus' proprietary asset allocation model was designed to provide insight into which asset classes and sectors are best positioned to weather environments such as this. From the middle of 2016, the model began pointing to real assets as the most attractive investment opportunity. Inflationary concerns are likely the reason our model views much of the commodities complex as attractive. The one exception is energy. This may be the result of investors' lack of conviction that foreign producers will be able to maintain the coordination necessary to stem supply.

The model has identified heightened interest rate risk and suggests caution is warranted in holding duration, while inflation-protected bonds look appealing. The Fundamental Fixed Income Team agrees that actively managing duration will be crucial as new U.S. policies become clear and stresses the importance of being nimble enough to adjust yield curve positioning.

There is no indication of a serious downside risk to equities, says Dr. Alankar, suggesting that growth will remain positive. The model is not forecasting stagflation. Even if the real economy grows slowly, notes Dr. Scholes, you can still have mild inflation. This is not '70s-style inflation, agrees Mr. Saigal, but more of a normalization of deflationary forces that were in place until late 2016. ●

INVESTOR IMPLICATIONS

INVESTORS SHOULD BE MINDFUL of the inflationary pressures building in the U.S. economy.

U.S. INFLATIONARY FORCES COULD SPREAD upward price pressures abroad.

EXPOSURE TO REAL ASSETS, including commodities and TIPS, should prove beneficial in an inflationary environment.

BE NIMBLE AND ADJUST DURATION EXPOSURE AND YIELD CURVE POSITIONING as U.S. policies become clear.

ACTIVE MANAGERS MAINTAIN THE ABILITY TO ADJUST PORTFOLIOS as rate and inflation expectations arise.



LOW GROWTH

AN END IN SIGHT?

Subpar economic growth has humbled investors for the past several years. While the recovery has been shallow, it has been long. Investors are now searching for clues on whether growth continues or stalls. Addressing this question, the Janus Asset Allocation Team uses its proprietary options-based model: A powerful tool that aggregates the convictions of a broad array of investors to help determine the greatest causes of concern and opportunities for investment. As discussed in our article on inflation (see page 12), the model indicates that inflation is at the forefront of our concerns. Ashwin Alankar, Ph.D., Global Head of Asset Allocation and Risk Management, states, "The options market is telling us that the risk to interest rates and bonds is elevated as inflationary pressures rise."

"At the same time," Dr. Alankar continues, "Our model indicates meaningful upside potential for equities." This more sanguine view toward stocks accelerated after the U.S. presidential election, as the model's distributions of possible outcomes shifted considerably, inferring that economic growth should not only remain positive but also may break out of its subdued post-crisis range. In fact, Dr. Alankar believes that "The heightened focus on a left tail (downside) risk event in 2017 may very well result in missing a right tail event."

POST-ELECTION FISCAL STIMULUS A CATALYST FOR EQUITIES?

Dr. Alankar and Myron Scholes, Ph.D., Chief Investment Strategist, believe that for economic growth to remain buoyant as the Fed initiates inflation-fighting rate hikes, there must be a catalyst. That catalyst will likely be fiscal stimulus along with other pro-growth agenda items of the Trump administration.

Illustrating this point is the bullish view the options market has toward infrastructure stocks. However, our asset allocation model most favors financials at this juncture. We believe this is due to the distortions created by artificially low interest rates. In an uncertain growth environment, cyclicals – including financials – should typically be avoided.

However, the reach for yield resulted in the traditional safety net of an equities portfolio – stable, dividend-paying companies such as utilities and oil majors – becoming a source of risk while beaten down cyclical sectors now represent a safe harbor. Dr. Scholes states that this trend is counter to our belief that equities should be priced on growth and bond prices determined on yield. Consumer stocks also stand to benefit, as fiscal stimulus tends to have a more direct impact on American workers by putting cash into their wallets either through lower taxes or infrastructure-related employment.

BUT FIXED INCOME MAY LAG AS RATES NORMALIZE

This stimulus-driven growth is more positive for equities given corporate spreads are already trading close to eight year lows. Mayur Saigal, Global Head of Fixed Income Risk Management, notes that much of the increase in nominal rates on U.S. Treasuries, between the short-lived flight to safety after June's Brexit referendum and just prior to the U.S. election, was largely due to increasing inflation expectations while real yields remain unchanged. Post-election, real yields have started to normalize but still have room to go higher.

Mr. Saigal also points out that the rapid steepening of the yield curve since the U.S. presidential election reflects increasing confidence that the economy may break out of its post-crisis rut. Thus far, the markets believe that the new administration will mute its anti-trade impulses and instead undertake business-friendly, pro-growth and reflationary initiatives. Should such growth take hold – while inflation continues its march upward and the Fed normalizes policy – Mr. Saigal sees plenty of room for nominal yields to rise. Such a move would likely be most pronounced toward the longer end of the yield curve. Over time, nominal yields for the 10-year Treasury should converge to nominal GDP.

For more than two years Janus' Fundamental Fixed Income Team believed that the U.S. was in the latter stages of a credit cycle. Such periods are marked by increased shareholder-friendly activity often financed by leveraging balance sheets at the expense of bondholders. With the prospect of rising operating earnings, the elevated leverage that has kept bond investors up at night becomes more manageable. As Mr. Saigal frames it, "if we had been in the latter innings of a credit cycle, the game just got extended to extra innings."

Longer term, Mr. Saigal believes that bond investors must remain vigilant of other factors, including increasing deficits, unfavorable demographics, a lack of savings and lower productivity. These latter three are partly behind the steady downward revision in the Fed's projection of the terminal – or natural – interest rate. This measure is the Fed's estimate of the long-term level of interest rates needed to allow GDP to reach its potential without stoking inflation.

In the wake of the crisis, quantitative easing programs and forward guidance from the Fed lowered term premiums, credit premiums and real yields, a situation aggravated by aggressive global central bank policy after 2014. A return to U.S.-driven global growth should, in his view, reprice global bond markets.

» COMPANIES THAT HAVE GROWTH LOOK MORE ATTRACTIVE AT THIS STAGE. THEY ARE REINVESTING IN THEIR BUSINESSES, AND ALTHOUGH THEY MAY NOT PAY AS HIGH A DIVIDEND, OVER THE LONG TERM I BELIEVE YOU'LL GET MORE CASH OUT OF THEM. FURTHERMORE, TRUE GROWTH COMPANIES ARE NOT THAT MUCH MORE EXPENSIVE.

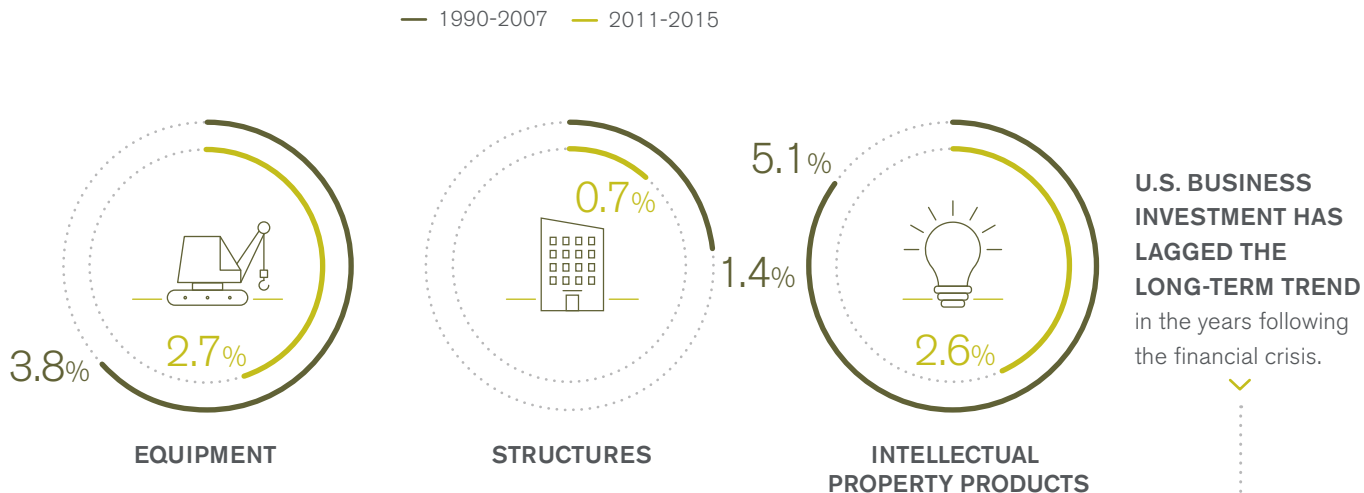


Carmel Wellso

Director of Research, Portfolio Manager

U.S. BUSINESS INVESTMENT AND PRODUCTIVITY GAINS

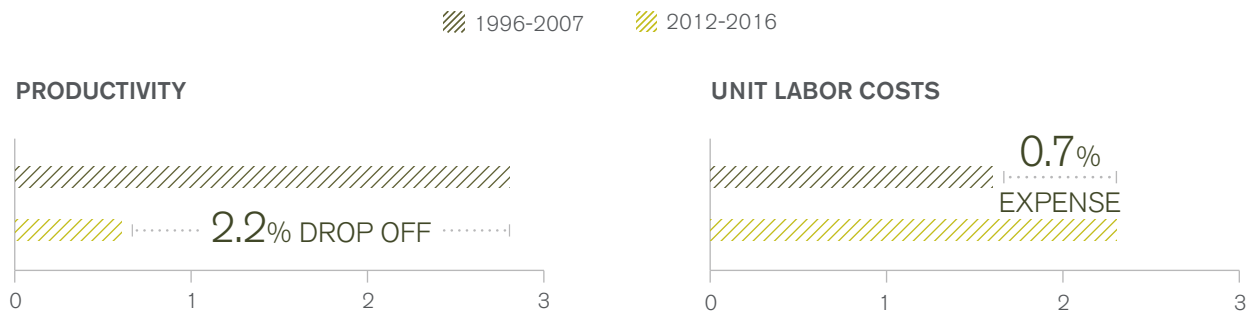
Annual growth rates across major fixed asset categories trail their pre-crisis average.



Source: Bureau of Labor Statistics, Bloomberg

WHAT DOES THIS MEAN? <

Without investment, productivity declines and labor costs rise. This may lead to higher inflation, as entrants to the workforce are less productive.



Source: Bureau of Economic Analysis

» WE SEE LOWER GROWTH NOT ONLY CREATING OPPORTUNITY FOR GROWTH STOCKS, BUT ALSO VALUE. THE DISPERSION OF PERFORMANCE AMONG VALUE STOCKS ENABLES DISCIPLINED INVESTORS TO PURCHASE QUALITY COMPANIES WHEN THEY GO ON SALE.



Tom Reynolds
Portfolio Manager, Perkins Investment Management

AS THE LOW RATE ENVIRONMENT WANES, INVESTMENT MODELS ADJUST

Carmel Wellso, Director of Research, shares Dr. Alankar's view that the low-rate environment in some countries is nearing an end. She cites authorities' growing concerns of potentially hazardous asset bubbles and the continued pressure low rates put on bank profitability. Despite ebbing monetary policy support, Ms. Wellso remains optimistic. She believes few asset classes can match the current risk/reward profile of stocks. In fact, she sees as much as a 20% upside to stocks, should equity risk premia normalize.

Equity investors will also need to rely upon a playbook much different than what has proven successful of late. Ms. Wellso believes that the trend in share buybacks has peaked. Dividends, in many cases, exceed free cash flow. "Some of these companies are becoming declining annuities," states Ms. Wellso. "If you are already paying out 100% of free cash flow and not reinvesting in the business, then over time, the returns that support dividends are going to decline. I don't think that's sustainable." Rather than taking a short-term view and favoring bond proxies, Ms. Wellso favors growth companies and believes that investors will eventually reach a similar conclusion.

We, however, expect the trend of companies seeking growth through consolidation to continue. Even with measured rate hikes, financing costs will remain at levels where most merger and acquisition deals are accretive. Consolidation should be buttressed by companies continuing to purchase cheaply valued competitors, integrating them into existing platforms and quickly reaping the benefits of a larger earnings base priced on the acquirers' higher multiple.

Ms. Wellso also believes that slow growth means that investors need to seek growth where they can find it. Secular growth stories such as cloud computing and novel therapies in health care remain areas of interest, see Innovation on page 23. Given their smaller base, small-cap companies merit scrutiny as well, especially given that their historical premium to large caps has contracted considerably.

While we expect the risks of recession and runaway inflation to be low, risks remain. This is usually the case when a regime change is imminent; in this case, the regime is changing from an unnaturally low-rate environment to a more normalized one. Foremost in Dr. Alankar's mind is the market's underappreciation of the possible cadence of rate hikes. "The market does not fully acknowledge that the Fed is in a precarious position. It needs

to replenish its toolkit; we are likely to see the Fed transform from a dove to a hawk in 2017 – this is the hidden risk that will catch most market participants off guard." Officials acknowledge that rates must reach a level that allows them to act should a tipping point occur. He points to growing geopolitical risks, a consumer slowdown or a pullback in housing prices, and Mr. Trump's stimulus plan failing to pass Congress as possible sources of economic weakness.

Janus Portfolio Manager Bill Gross, however, is a bit more subdued in his forecast for 2017 Fed tightening. "I see 35 to 40 bps for the entire year, so maybe one or two hikes. I think that goes along with the conservatism and dovishness of [Fed Chairwoman] Janet Yellen." He argues that the Fed will be wary of the high amount of leverage and structural headwinds in the global financial system as they raise rates. ●

» **WE VIEW 2017 AS A STEP ALONG THE ROAD TO NORMALIZATION. THE FED WANTS TO ERR ON THE SIDE OF MORE INFLATION AND WILL NOT BE SO AGGRESSIVE AS TO SEND US INTO RECESSION. ASSETS THAT BENEFIT FROM INFLATION WILL BE BETTER INVESTMENTS AT THIS JUNCTURE.**



Myron Scholes, Ph.D.
Chief Investment Strategist

INVESTOR IMPLICATIONS

CONSIDER AVOIDING BOND PROXIES. Instead seek growth companies, as we believe the market will soon rediscover the value of growth.

CONSIDER SHORTER-DATED CREDIT as the long-end of the yield curve will likely experience a steeper sell-off as rates rise.

AS RATES TRAVEL THE PATH TOWARD NORMALIZATION, active security selection will have a much greater chance of adding value, as companies will be judged on their execution rather than yields.



ENERGY

A BALANCING ACT

Since cratering at the start of 2016, crude oil prices rebounded during the first half of the year and have since been range-bound between \$40 and \$60 dollars a barrel. We believe prices could potentially go even higher in 2017 should OPEC and other large oil-producing countries follow through on promises to curtail production during the year. As such, Equity Research Analyst Noah Barrett, CFA, notes that the mood of the industry is now more positive. We appreciate that the surviving companies have withstood a challenging environment and now have a credible plan for coping with low prices. We also are closely monitoring catalysts that we feel will drive prices higher in coming years, especially within the supply/demand dynamic, with an eye on those producers we believe will benefit most when demand for oil finally exceeds supply.

OIL GLUT CAPS PRICES

The supply/demand dynamic remained tilted in favor of supply during 2016, as persistent oversupply and elevated inventory levels put downward pressure on oil prices. As prices rebounded from their early 2016 lows, global producers responded with incremental supply, effectively capping oil prices. OPEC's unwillingness, until late last year, to curtail production also contributed to the supply/demand imbalance. Moreover, although the cartel and other non-OPEC countries committed to reduce production, it remains to be seen whether the planned cuts will occur. Equity Research Analyst Kris Kelley, CFA, believes that this general lack of discipline within the cartel warrants concern.

Another source of apprehension for Mr. Kelley is investors' willingness to continue providing financing to oil companies without any demonstrated return on their invested capital. Justin Tugman, CFA, Portfolio Manager at Perkins Investment Management, explains that despite the number of companies that have gone bankrupt, many after participating in equity offerings prior to the bankruptcy, a significant number of private equity investors remain willing to fund equity stakes. Indeed, the bankruptcies, particularly within the exploration

» THERE'S NO DISCIPLINE AT ALL. INVESTORS HAVE GIVEN THEM AN AMPLE AMOUNT OF LIQUIDITY TO GO OUT AND BURN MORE CASH WITHOUT EVER GETTING AN APPROPRIATE RETURN ON CAPITAL.



Kris Kelley, CFA
Equity Research Analyst

and production (E&P) segment, have not culled as many undesirable management teams as he would like; many, if not all, of the proceedings have been workouts that simply leave the existing management teams to run a recapitalized company with less leverage on the balance sheet.

Despite the general lack of discipline, Fundamental Fixed Income Portfolio Manager Seth Meyer, CFA, recognizes companies that have cut capacity, streamlined their business and shored up their balance sheets via asset sales. Janus' investment professionals feel these companies, particularly the ones with quality assets and long production runways, have a better shot at surviving various crude oil pricing scenarios and

» **THE MARKET HAS CONTINUED TO REWARD COMPANIES THAT GROW PRODUCTION AS OPPOSED TO THOSE THAT FOCUS MORE ON CAPITAL DISCIPLINE. WE HAVEN'T CLEANED OUT A LOT OF BAD ACTORS IN THE INDUSTRY.**

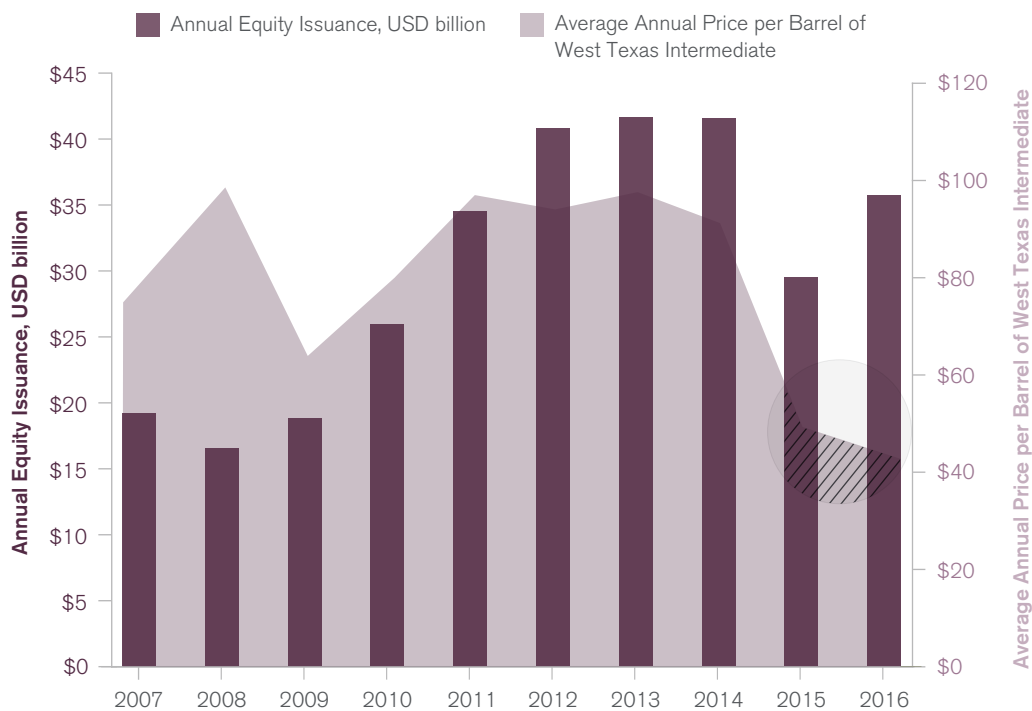


Justin Tugman, CFA
Portfolio Manager,
Perkins Investment Management

present strong investment opportunities. Mr. Tugman is also identifying what he believes are higher-quality companies, i.e., firms that don't have excess leverage on their balance sheets, and still have quality assets and management teams that are effective capital allocators. While it may be difficult to find such opportunities within the energy sector,

he explains that the sector's weakness led many investors to paint associated sectors, such as industrials, with the same broad brush. As a result, many otherwise strong companies with reasonable valuations have been unfairly sold off by the market, creating opportunities in these energy-related sectors for the savvy investor.

U.S. ENERGY SECTOR STOCK ISSUANCE REMAINS HIGH



Source: Bloomberg



THE ISSUANCE OF ENERGY STOCKS REBOUNDED IN 2016, as oil prices stabilized albeit at lower levels.

WHAT DOES THIS MEAN? <

Investors' appetites for growth have enabled companies to drill more, delaying the rebalancing of the market.

STRONGER DEMAND POINTS TO EVENTUAL UPSIDE BREAKOUT FOR CRUDE PRICES

Fundamental Fixed Income Global Analyst Jason Groom stresses that the sector faces growing demand, a naturally declining production base, and a lack of capital expenditure (capex) investment. Stubbornly low crude oil prices strain profitability and leave companies hesitant to initiate projects that require hefty capex, such as offshore drilling projects. If weak capital spending continues, Mr. Groom forecasts a gap of 20 million barrels per day (bpd) or more in the next 10 years.

While U.S. shale is the main short-term growth driver, it likely can only meet 5 to 10 million bpd of demand. Deepwater drilling can close the entire gap, and there is also the potential to find new sources of supply – such as international shale. Mr. Groom believes the anticipated gap between supply and demand should, over time, exert upward pressure on crude oil prices.

Mr. Groom also considers the potential impacts of a Trump presidency on the sector, which he believes could help push the price of crude oil higher. Since the U.S. is the largest consumer of oil, a pro-growth stimulus package from Mr. Trump may boost demand; additionally, the potential for aggressive foreign policy actions from Mr. Trump could lead to some supply disruption. That may outweigh the supply impact of any additional opening of federal lands to fracking. ●

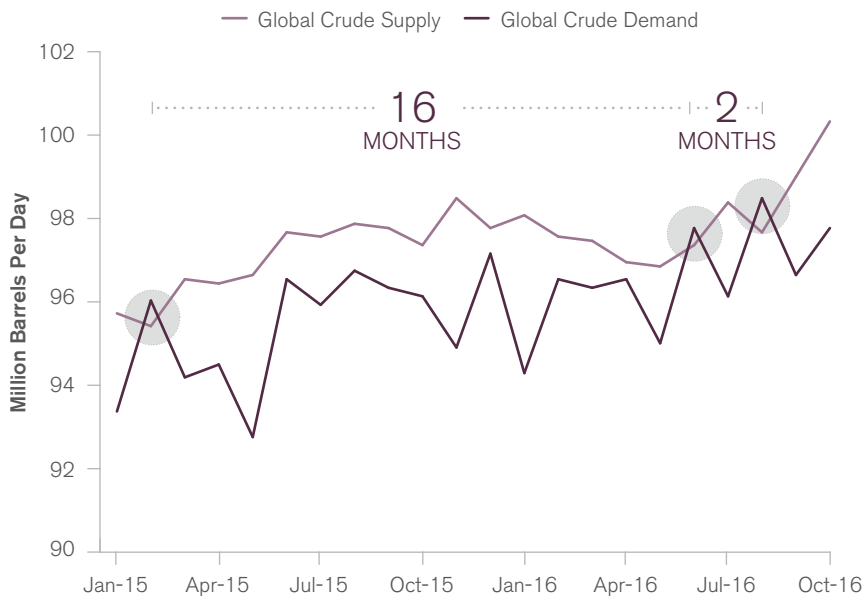
» **MANY BIG DEEPWATER PROJECTS HAVEN'T BEEN SANCTIONED, INCREASING THE PROBABILITY OF A MEANINGFUL SUPPLY GAP BY THE END OF THE DECADE.**



Noah Barrett, CFA
Equity Research Analyst

GLOBAL CRUDE SUPPLY AND DEMAND

The extended trend of supply outstripping demand has mitigated of late.



Source: Energy Intelligence Group, Bloomberg

WHAT DOES THIS MEAN? <

The continuation of this trend, along with OPEC's late 2016 announced production cuts, stands to push the crude market back into balance during 2017.

INVESTOR IMPLICATIONS

THE INVESTOR MUST DISCERN WHICH COMPANIES ARE GROWING WITHIN THEIR MEANS, and which are overspending and overproducing at risk to themselves. If oil prices decline again, some undisciplined upstream companies may get hurt.

WHILE RANGE-BOUND IN THE NEAR TERM, crude could even be pushed higher before 2019 if we get a shock to the system, such as a sustained OPEC production cut, unplanned supply outage or other exogenous event.

AN IMPENDING SUPPLY/DEMAND IMBALANCE PRESENTS OPPORTUNITIES for companies with exposure to higher cost sources of supply.

THERE MAY BE ATTRACTIVE COMPANIES IN ENERGY-RELATED SECTORS, such as industrials, that have been unfairly impacted by weakness in the energy sector.



THE INNOVATORS

We believe investors will soon rediscover that growth matters, especially should broad economic expansion remain elusive. Nowhere do we see greater prospects for growth than in innovative companies. "Innovation has never been faster, nor has the pace of disruption been more rapid," says Brinton Johns, Portfolio Manager. "Every company is a technology company, whether it realizes it or not."

Innovation is not limited to technology companies. Janus' portfolio managers and research analysts see innovation as a key differentiator across multiple sectors. So while we have long favored leading tech, biotech and medical device firms, we also see examples of industrial and consumer companies adopting game-changing technologies and processes. Here, we highlight four areas where we see some of the most compelling opportunities for 2017 and beyond.

A SMARTER INTERNET AND SMARTER MACHINES

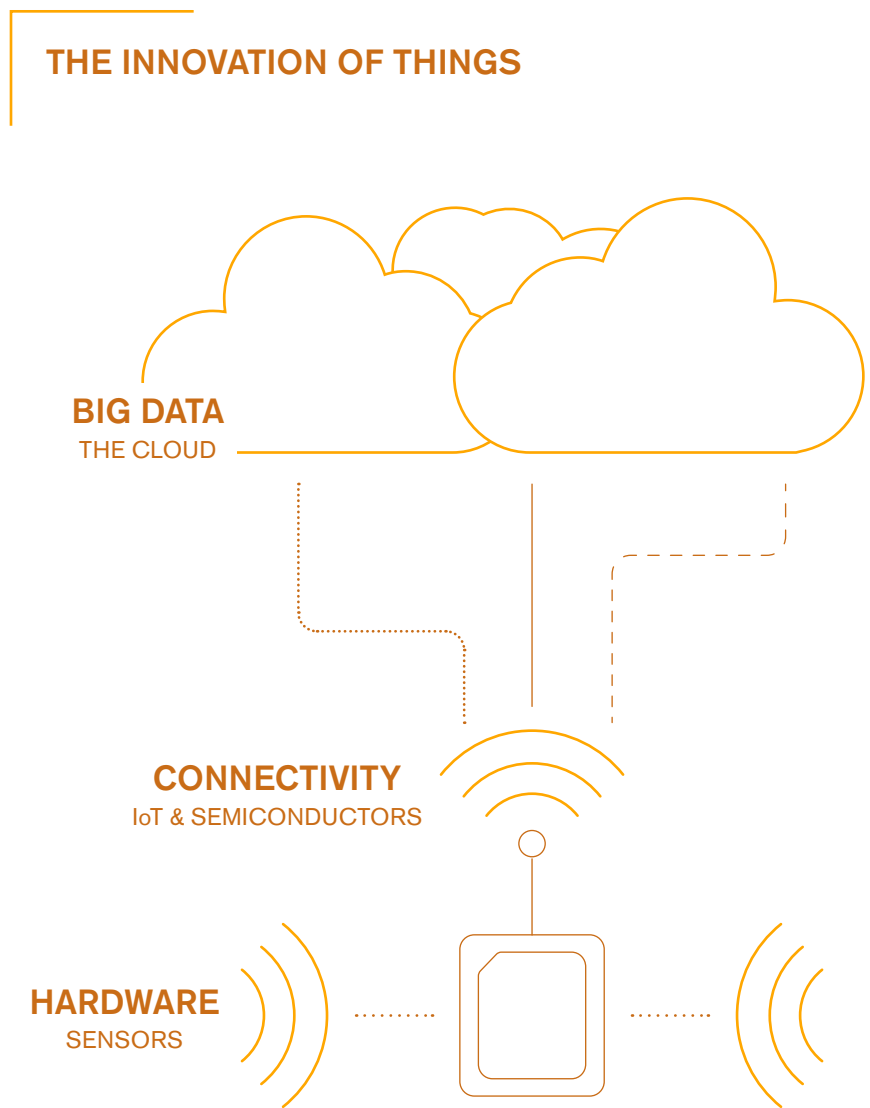
The Janus global technology team believes the transition to mobile and the cloud marks a seismic shift in the sector. Yet, they view these developments as a means to an end, providing the architecture for a range of novel applications. Much of this activity centers on the so-called Internet of Things (IoT), where everyday objects are connected to the Internet. Equity Portfolio Manager Brad Slingerland,

CFA, believes the current convergence of connectivity, data collection and computing power will lead to what he calls “the Internet of *Intelligent* Things.” At that stage programs using industry-specific algorithms will be able to teach themselves, i.e., “learn” as they process data, making it possible to identify relationships and achieve solutions far beyond the scope of human programmers.

Machine learning’s potential was on display when, in 2016, Alphabet reduced power consumption at its data centers by 15% using these types of algorithms. Equity Portfolio Manager Denny Fish, expects that rapidly evolving concepts, including machine vision and superior language capabilities, will speed the development of artificial intelligence. Also in the mix is so-called augmented reality, which will enable programmers to place digitally generated objects into the real world. Such capabilities, in our view, will have profound implications for industrial and medical device companies, among others, in the design of new products.

SELF-DRIVING CARS AND INTUITIVE FACTORY FLOORS

The importance of technology and innovation becomes increasingly evident in industrials. Equity Research Analyst David Chung, CFA, highlights recent advances in automobiles. “A year ago, people thought of advanced driving assisted systems, or ADAS, as incremental safety features, such as an alert when drivers inadvertently drift between lanes on the highway or automatic emergency braking. Developments since then have reframed it as a step toward autonomous-driving vehicles,” he says. Mr. Chung notes that features such as cameras, sensors, radar and laser-based light detection and ranging (LIDAR) combined with enhanced software capabilities, are pushing



autos along the self-driving spectrum. “We are starting to see companies lay down specific timelines for technology, progressing from Level 1 – some driver assistance – to Levels 4 and 5, which are completely autonomous,” he says.

Mr. Chung is also excited about IoT applications within industrial companies. He believes that the sharing of data across machines on a factory floor will help managers better monitor operations, plan for downtime, order replacement parts before a forced shutdown and ultimately improve productivity. “At its core, it is machines being able to talk,” he says. “What’s resonating with people is the magnitude of the opportunity.”

Mr. Chung believes industrial IoT is in its formative phase. The industry is now laying the groundwork and major players are exploring ways in which they can integrate IoT into their processes and products. Some companies are even seeking to establish an industry-wide platform with common standards that would facilitate more rapid and broader adoption.

Further down the road, Mr. Chung sees promise in additive manufacturing. This concept can be viewed as the next iteration of 3-D printing. Whereas the focus had been on creating prototypes and smaller objects, newer processes are allowing for the integration of more

» I THINK THE INDUSTRIAL INTERNET IS STILL IN ITS EARLY DAYS, BUT I AM CONFIDENT IN THE PROSPECTS FOR SELF-DRIVING AUTOS. IT IS JUST A MATTER OF WHEN.



David Chung, CFA
Equity Research Analyst

complex materials to create more intricate products. Mr. Chung cites GE's production of turboprop engines as one example. When GE switched to additive manufacturing, the number of parts required to make the engine plummeted from more than 850 to only 15. Such developments will revolutionize supply chains, dramatically reduce design lead time and ultimately create higher quality products more efficiently.

MEANINGFUL GAINS IN EXTENDING LIFE

Rapid advancements also continue in health care. In recent years, we have seen a surge in approvals by the Food and Drug Administration (FDA) for novel therapies addressing unmet medical needs.

Equity Portfolio Manager Andy Acker, CFA, believes the next wave of innovation will come from combination therapies, which often involve recently approved biomedicines. Already the combination of Bristol-Myers Squibb's Opdivo and Yervoy has led to a meaningful improvement in survival rates for patients with metastatic melanoma, an advanced form of skin cancer. Over the next two years, we expect the FDA to approve combination therapies for other illnesses, including lung cancer. Says Mr. Acker, "The reason why this is so important is that there is the opportunity to develop long-term functional cures in previously incurable cancers."

Innovation is not limited to biomedicines. Advances in medical devices improve the treatment of major conditions, such as diabetes and heart disease. We

eventually expect the introduction of a continuous glucose monitor will help the roughly 70% of Type 1 diabetics and a rising number of Type 2 patients to better manage their blood sugar levels. The benefits to the individual and the health care system as a whole are significant given that roughly one-quarter of the U.S. population is either a Type 2 diabetic or has impaired glucose tolerance, meaning they are at elevated risk of developing the disease.

The miniaturization of devices and communication capabilities seen in other sectors also plays a role in medical innovation. Within the next few years, we believe that monitoring devices for diabetes will become more functional, not just for withholding insulin dosage but also proactively dispensing insulin when a hypoglycemic event is detected. As algorithms, sensors and communications improve, researchers may ultimately achieve a closed system that effectively functions as an artificial pancreas.

Within cardiovascular care, companies continue to build upon past successes. Using catheterization to deliver stents to problem arteries led to transcatheter aortic valve replacements (TAVR). Currently, the industry is working on addressing a larger unmet medical need: transcatheter mitral valve replacement, or TMVR, in which another type of heart valve is replaced. "Poorly functioning aortic valves are a threat to many elderly patients. The mitral valve, however, is more often in need of repair," says Ethan Lovell, Equity co-Portfolio Manager of the Janus Global Life Sciences strategy. He sees TMVR as a much larger market than TAVR, thus benefiting a greater number of patients.

LIFE SCIENCES: GROWING MARKET FOR NEW IDEAS

DIABETES IS A GROWING GLOBAL CHALLENGE

108 MILLION AS OF 1980 **vs** 422 MILLION AS OF 2014

390%
INCREASE

IN THE LAST 34 YEARS

U.S. POPULATION AFFECTED

1 IN 11
PEOPLE

ARE DIABETES PATIENTS

UNFORTUNATE RESULT

5.2
MILLION

DEATHS ANNUALLY RELATED TO DIABETES

Source: World Health Organization

PUTTING THE CONSUMER FIRST

Innovation not only occurs in labs, but also within the mindset of corporate managers. The advent of e-commerce has upended many business models within the consumer sector. Yet some management teams are taking to heart the motto, “through adversity comes opportunity.” As such, the Janus consumer sector team is identifying companies that are leveraging new technologies to meet continuously shifting consumer demands.

The proliferation of choices and platforms has decidedly increased the bargaining power of consumers. “As business models shift toward digital platforms, the companies that will be most successful in the battle for online purchases are those that have a consumer-first focus, with the two core tenets being value and transparency,” states Equity Research

Analyst Josh Cummings, CFA. Rather than asking the question, ‘Is it profitable to sell this product online?’ adept management teams now place primacy on the question: ‘Do customers want to purchase this over the Internet?’” These questions will become all the more relevant as e-commerce gains traction across a broader range of goods and services. Only those companies that are built to deliver real value for the customer will thrive.

Another risk to retailers is what Equity Research Analyst Greg Kuczynski, CFA, calls the “infinite shelf.” Consumers can now go online and search for any product. Consequently, even businesses that proactively developed an online presence must fight to retain customer loyalty.

The rapid speed at which companies are forced to build e-commerce capabilities speaks to this shift in the balance of power. Digital-only models such as Amazon, unencumbered by the fixed costs associated with stores, are pushing

deeper into products and services once thought immune. For example, not long ago it was believed that consumers would never choose to purchase groceries online, says Equity Research Analyst Tom Roller, CFA. But in 2007, the e-tailer launched AmazonFresh, which today sells more than 500,000 grocery items with same-day and early morning delivery in select areas of the country.

The consumer sector also stands to benefit from innovation in less obvious ways. A key example is the efficiencies gained by the eventual adoption of driverless technology. With commute times commanding a significant portion of the average American’s workweek, the possibility of reapportioning those unproductive hours to other endeavors – including online shopping and, yes, working – could result in a boost to economic activity. Our investment team even foresees a time when restaurant waitstaff become superfluous and online purchases become even more seamless. ●

INVESTOR IMPLICATIONS

THE ONLY CONSTANT IS CHANGE: Technology investors must attempt to identify which novel technologies and applications will result in the large-cap companies of tomorrow.

FOCUS ON INNOVATION, NOT THE CYCLE: Investors need to ignore the industrial sector’s normal cyclical and instead seek out trends that will determine the landscape three to five years down the road.

HEALTH CARE INVESTORS SHOULD CONCENTRATE ON ACTIVE MANAGERS WHO INVEST IN FIRMS IDENTIFYING ORIGINAL THERAPIES that are sufficiently differentiated from the current standard of care to merit coverage by government programs and insurance providers.

AS THE “NEW NORMAL” OF SLOWER ECONOMIC GROWTH CONTINUES, investors must rediscover the benefits of innovative, secular growth stories rather than filling portfolios with low-growth bond proxies.



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FOR MORE INFORMATION CONTACT JANUS

151 Detroit Street, Denver, CO 80206 / 800.668.0434 / www.janus.com

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