Janus Henderson
INVESTORS

Portfolio Construction and Strategy

THE REOPENING TRADE GOES INTERNATIONAL

The global economy is reopening, and equity markets are taking notice. As COVID-19 vaccinations continue rolling out globally, equity market leadership transitioned to what one would typically expect in an early recovery. When seeking to optimize their exposure to the next leg of the reopening theme, investors should factor in both geographic and sector considerations. Co-Head of Equities – Americas and Portfolio Manager George Maris and Global Head of Portfolio Construction and Strategy Adam Hetts discuss the transition underway in equities markets and explain why it is an opportune time for U.S.-based investors to reconsider the size of their international equities allocation relative to domestic stocks.

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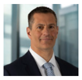
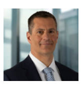
Global Head of Portfolio Construction and Strategy

GEORGE, WHERE ARE WE IN THE MARKET'S RESPONSE TO ECONOMIC REOPENING?



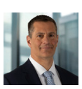
The reopening of the global economy from the depths of the COVID-19 lockdowns was uneven but progress is being made. The inflection point was the approval of the first coronavirus vaccines late last year. While the global rollout is bumpy, the speed at which many parts of the world vaccinated material portions of their population is impressive. Given their forward-looking nature, equity markets anticipated the impact of these steps – a move reflected in the recent broadening of stock gains. Still, the uneven rollout of vaccinations means many equity market segments continue to be weighed down by the challenges posed by the pandemic. As progress is made, however, we expect many of the stocks that have underperformed due to suppressed business activity will ultimately reflect an improving economic backdrop as global vaccination rates increase.

WHAT DO YOU SEE AS SOME OF THE MOST OVERLOOKED OPPORTUNITIES IN EQUITIES RIGHT NOW?



While they recently gained traction, international stocks, in my view, remain underappreciated by U.S. investors, especially as these regions are on a path to return to a more normal course of activity. Several powerful themes exist outside the U.S., as do many innovative companies. The pandemic taught management teams everywhere the imperative of operating with the highest level of efficiency and of integrating digital strategies into every aspect of their business. These actions are allowing companies to navigate the current environment and should also yield benefits over the long term.

SO IN THAT RESPECT, THE TAILWINDS YOU SEE FOR INTERNATIONAL EQUITIES ARE BEING DRIVEN BY MORE THAN JUST THE EMERGENCE FROM THE PANDEMIC?

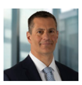


Absolutely. Although much attention is given to the level of innovation emanating from the U.S., the environment abroad is becoming increasingly conducive to fostering cutting-edge technologies and novel business models. As we've seen in the U.S., such developments can lead to accelerated growth and investment returns for the companies leading the charge. These developments, along with favorable demographics in many regions, should help fuel global economic growth. Many of these advancements are the fruits of entrepreneurial ventures in technology, health care, consumer discretionary, fintech and other sectors. The democratization of demand driven by digitization – as exemplified by the explosion of mobile computing – puts services into the hands of consumers across the world that would have been unimaginable a decade ago. Innovation and entrepreneurship are allowing emerging markets to skip an entire generation of infrastructure buildout in applications such as communications and payments.

ADAM, BASED ON YOUR EXAMINATION OF CLIENT PORTFOLIO ALLOCATIONS, DO YOU AGREE WITH GEORGE THAT INTERNATIONAL EQUITIES ARE OVERLOOKED?

Very much so, and the Janus Henderson Portfolio Construction and Strategy (PCS) team's database of advisor portfolios bears that out. We've long noted international stocks are underrepresented in U.S.-based portfolios relative to those regions' share of global GDP and market capitalization. Consequently, U.S. investors are typically underexposed to several compelling international markets and companies. Given this home-country bias, the staggered reopening of the global economy post-pandemic and recent performance differentials, we believe U.S. investors are at risk of not fully participating in the next stage of global economic reopening.

GEORGE, THERE IS A LOT OF TALK ABOUT THE ROTATION FROM GROWTH EQUITIES TOWARD VALUE, AND SINCE OCTOBER OF LAST YEAR, GAINS OF VALUE STOCKS EASILY OUTPACED THOSE OF GROWTH. IS WHAT WE ARE EXPERIENCING THE MARKET'S RESPONSE TO A CLASSIC EARLY-CYCLE RECOVERY?



That is a popular narrative, but I do not think the standard growth/value construct captures what is occurring. The crisis was caused by a unique, exogenous threat and the response by governments and the private sector was equally unique. The latter is especially true when we examine how businesses and households adjusted behaviors and leveraged technology to ride out the pandemic. Consequently, the economic recovery is reflecting these behavioral changes and the market's reaction may not fit a standard early-recovery template.

ADAM, DO YOU CONCUR THAT SOMETHING OTHER THAN A ROTATION TOWARD VALUE IS OCCURRING AND IF SO, HOW WOULD YOU DEFINE IT?

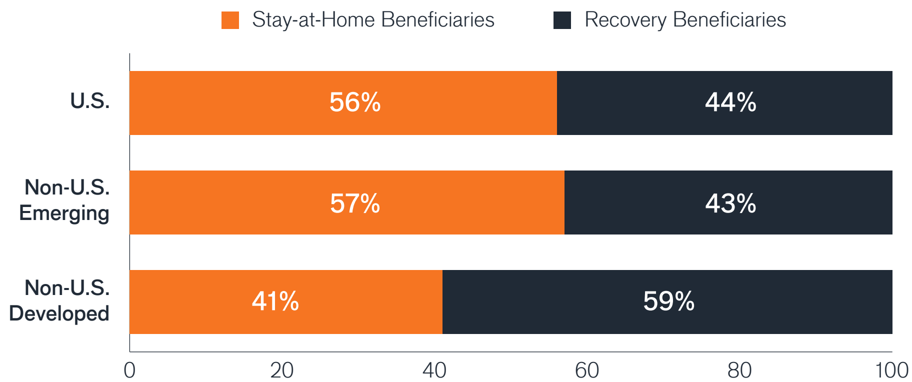
Rather than applying the abstract categorization of style investing, I believe a more apt classification for stocks is "stay-at-home beneficiaries" versus "recovery beneficiaries." In examining returns across industries, the PCS team has identified certain categories whose trajectories were greatly impacted by the approval of vaccines. Prior to that development, the stay-at-home stocks that allowed us to work, shop and socialize remotely were the big beneficiaries for much of 2020. Once approvals were imminent, however, those stocks cooled fairly quickly as investors increased exposure to companies that stood to benefit from broader economic reopening. Granted, there is overlap between these "recovery beneficiaries" and traditional early-cycle value stocks, the value rotation, in my view, is not the full story.

Note: The Stay-at-Home and Recovery categories are based on stocks within the MSCI ACWI Index that performed in a similar manner both prior to and after the announcement of the first COVID-19 vaccines. The former category is comprised of stocks that performed well through much of 2020 and were leveraged to social-distancing and remote work activities. The latter category includes a broader universe of stocks that tended to perform better as large-scale vaccination efforts commenced and stay-at-home mandates were lifted.

Q YOU MENTIONED U.S.-BASED EQUITY PORTFOLIOS OFTEN BEING UNDER-ALLOCATED TO INTERNATIONAL MARKETS; HOW DOES THE RECENT TRANSITION OF MARKET LEADERSHIP TOWARD "RECOVERY" STOCKS IMPACT THIS?

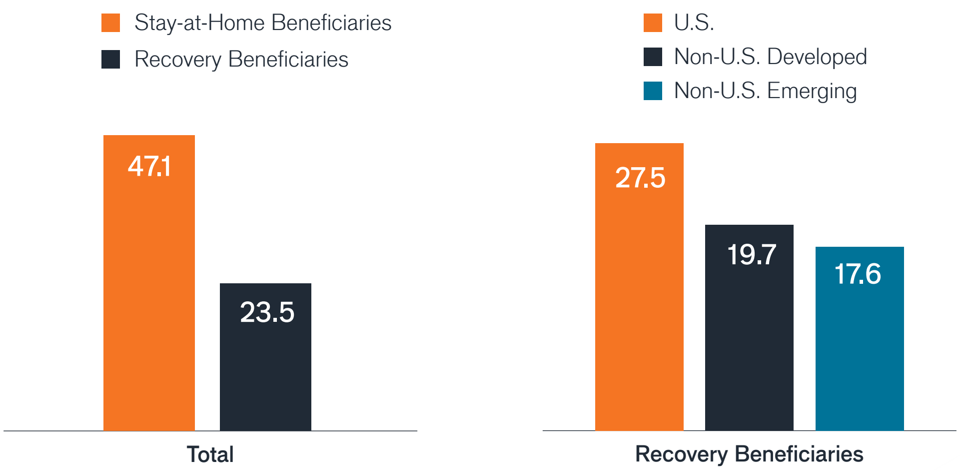
It exacerbates it. Many of the "stay-at-home beneficiaries" were Internet and cloud computing companies domiciled in the U.S. That explains much of last year's outperformance by U.S. equities. "Recovery beneficiaries," on the other hand, are more prevalent in other developed markets and even have a greater representation in emerging markets than they do in the U.S.

Exhibit 1: "Recovery Beneficiary" stocks more common outside the U.S.



Source: Janus Henderson Portfolio Construction and Strategy Group, FactSet, as of 28 May, 2021.

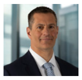
Exhibit 2: Forward price/earnings multiples lower for "recovery beneficiaries," and within that category, lower ex U.S.



Source: Janus Henderson Portfolio Construction and Strategy Group, FactSet, as of 28 May, 2021.

Furthermore, many of these regions' vaccination efforts lag the U.S., meaning it's earlier in the reopening trade for several countries. It will surprise no one that the "stay-at-home beneficiaries" included highly valued U.S. technology and Internet companies. In aggregate, "recovery" stocks tend to have lower valuations given their greater sensitivity to the economic cycle. It's worth noting, however, that both international developed and emerging market recovery stocks carry cheaper valuations than their U.S. peers. As these countries achieve certain vaccination and reopening milestones, we'd expect investors to take note of these valuation differentials and earnings multiples to eventually converge.

GEORGE, HOW HAS SECURITY SELECTION IN THE STRATEGIES YOU MANAGE EVOLVED SINCE THE INITIAL ROTATION THAT BEGAN IN NOVEMBER?



We are still focused on the metrics we think are the best indicators of a company's success over the long term, namely the ability to generate – and grow – free cash flow. Given the progress made with vaccinations, several industries stand to benefit from increased economic activity. Energy and banking companies, for example, should benefit from heightened activity as economic activity ramps up. Conversely, some of those firms that helped us cope with being stuck at home may witness a reduction in demand as economic activity recovers. In periods of economic transition, especially when staggered, we think security selection – and avoidance – is paramount.

AND HOW DOES GEOGRAPHY FIT INTO THE EQUATION, BOTH DURING THE RECOVERY PERIOD AND OVER A LONGER TIME HORIZON?

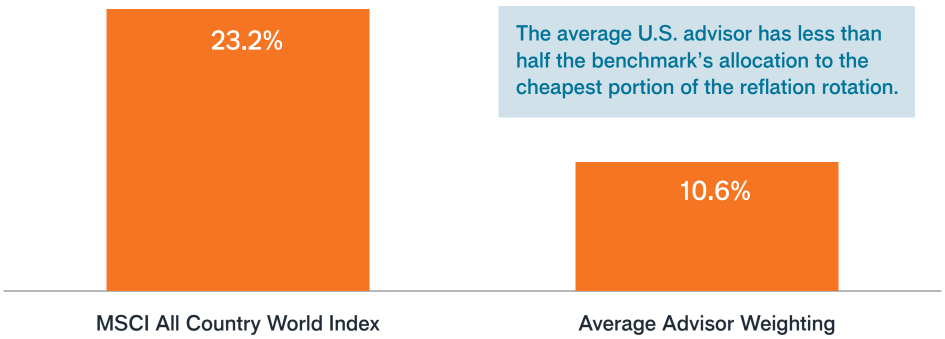
Even more than usual, we think it is necessary to point out the opportunities available in international equities. Developed markets outside the U.S. are still home to many high-quality companies capable of compounding free cash flows. While some of these regions fit into the recovery beneficiary or reopening bucket, these areas are also home to many highly innovative companies. Similarly, many emerging market companies are moving into value-added industries and are catering to an increasingly sophisticated middle class.

Investors must also be aware of the potential for a rising ubiquity of regulations on the corporate sector. Implicit is the lessening of what is often argued is the advantage U.S. companies enjoy by being domiciled in a business-friendly regulatory environment. The same holds true with taxation. Should global tax rate policies converge, especially in areas like corporate tax rates and capital gains, another purported benefit of investing in U.S. stocks would diminish. Proposed changes to U.S. tax and regulatory policy could increase the relative attractiveness of international stocks already operating under more onerous policy regimes.

Q ADAM, IN YOUR CLIENT PORTFOLIO CONSULTATIONS, HOW ARE YOU SUMMARIZING ALL OF THIS INFORMATION INTO ACTIONABLE NEXT STEPS?

Geographic diversification, in our view, is a sound strategy regardless of the economic regime, but given the larger representation of "recovery" stocks in international markets, it may presently make tactical sense as well when seeking to capture the next stage of global economic reopening. Given the aforementioned home country bias in our database of client portfolios, the typical U.S.-based investor is vastly under-allocated to the "recovery beneficiaries" we've discussed.

Exhibit 3: Weighting of "recovery beneficiaries" in average U.S. advisor portfolio compared to global equities benchmark



Source: Janus Henderson Portfolio Construction and Strategy Group, FactSet, as of 28 May, 2021.

Compared to traditional benchmark weights, these investor portfolios are potentially under-allocated by more the 50% to where we see some of the most important global equity opportunities. As investors revisit their global equity allocations, next steps might involve rebalancing in a way that can alleviate these drastic underweights.

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