



MARKET GPS

EQUITY PERSPECTIVES

SEPTEMBER 2021

Featuring the latest quarterly insights from our investment teams:

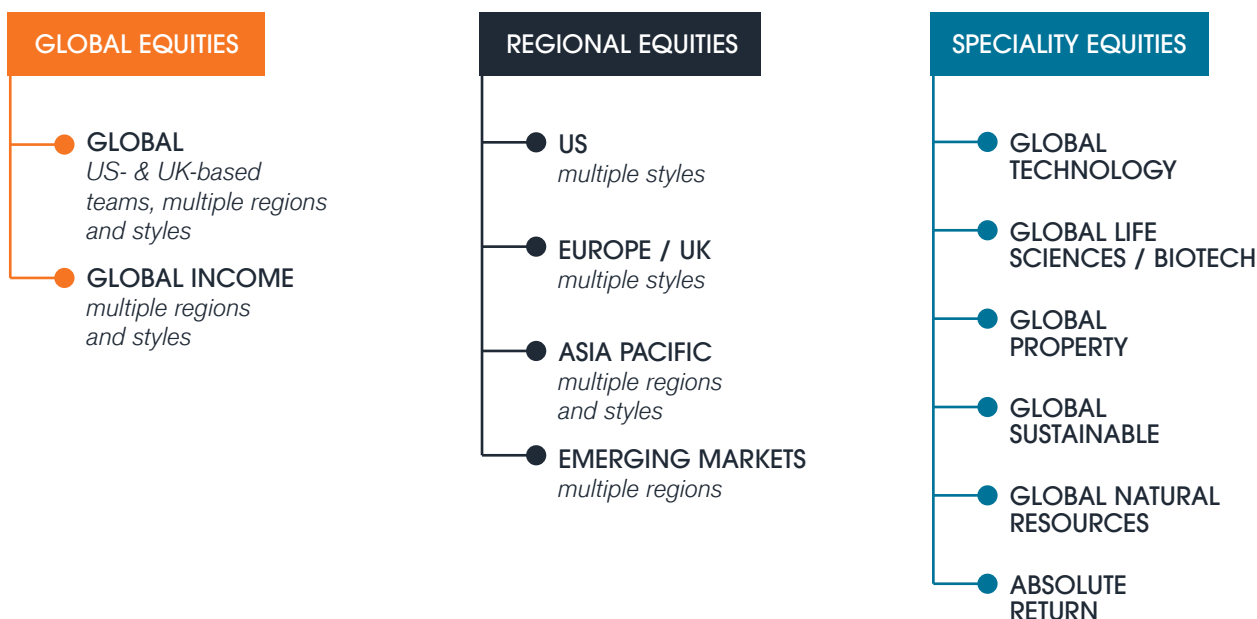
- ▶ ESG and women - product design matters
- ▶ The importance of diversifying U.S. equities through an uneven recovery
- ▶ Natural resources: paving the way towards net zero
- ▶ Emerging Markets: near-term uncertainty matched by long-term opportunity

OUR EQUITY CAPABILITIES

Janus Henderson provides an active approach to equity investing. The equities platform is shaped by the belief that fundamental research is the foundation for delivering long-term, market-leading risk-adjusted returns. Independent thought and unique viewpoints are central to this approach and result in portfolios that are meaningfully different to an index. Each team expresses their individual, high-conviction ideas through processes that have evolved to suit their specific areas of the market and within robust risk control frameworks.

While operating with independence, the equities teams benefit from collaboration and shared research that provide a source of portfolio ideas. The culture encourages intellectual challenge and stimulating debate to test – and ultimately strengthen – investment thinking. The success of ideas is measured by overall client outcomes with the aim to deliver consistent, long-term risk-adjusted excess returns over benchmarks and peers regardless of the investment landscape. This effort is supported by award-winning, proprietary portfolio construction technology and a cultural emphasis on the client promise.

The equity teams, led by Co-Heads of Equities Alex Crooke and George Maris, include 160 investment professionals, responsible for US\$240.1bn in assets under management¹. The teams include those with a global perspective, those with a regional focus – US, Europe, Asia Pacific and Emerging Markets – and those invested in specialist sectors. A range of growth, value and absolute return styles are employed.



¹ Source: Janus Henderson, as at 30 June 2021.

ESG AND WOMEN – PRODUCT DESIGN MATTERS



Amarachi Seery

Many businesses have fallen short of the requirements that make a gender-neutral product genuinely inclusive for women. Amarachi Seery, Sustainability Analyst, discusses why it makes good investment sense to design for inclusivity.

Key takeaways

- » Despite owning 75% of discretionary consumer spend, many products and services are not designed to cater to the needs of women and there are even instances where design flaws can be dangerous.
- » Athleisure company Nike recognised the negative impact surrounding lack of diversity in the workplace and has since boosted sales of its women's apparel by hiring talented and diverse staff who have made its products more inclusive for all.
- » The team believe strongly that as awareness of gender inclusive design increases, companies will need to adapt to avoid being outcompeted by those with a genuine understanding of gender requirements.

We all agree that women should be considered as part of the environmental, social and governance (ESG) analysis of a company. There are very good reasons to do this, the obvious one being that they make up half of the population. When women are considered as an ESG factor, it is often from an operational perspective. Qualitative metrics – such as percentage of women on the board, percentage of women in senior management and percentage of women employed – commonly make up the reported ESG metrics for determining how ‘woman friendly’ a company is. In addition to these, qualitative metrics such as company culture and controversies are considered. This is good practice because the way in which a company treats its female employees can often be indicative of the presence of other potentially damaging systemic cultural issues. This led me to start thinking about whether these operational factors should be the only aspect that we consider.

In 2009, Harvard Business noted the growing economic power of women. While this report was produced some time ago, it provides a good baseline and highlights that women determine the majority of household spending decisions (see chart 1). A number of studies since have pointed to the trend of increasing income and spending in females. One study by Frost & Sullivan highlighted a \$4 trillion increase in global female income over two years, while Boston Consulting Group anticipates that by 2028, women will own 75% of the discretionary consumer spend.^{1,2} Yet, consistently the needs of women are not designed into products and services.

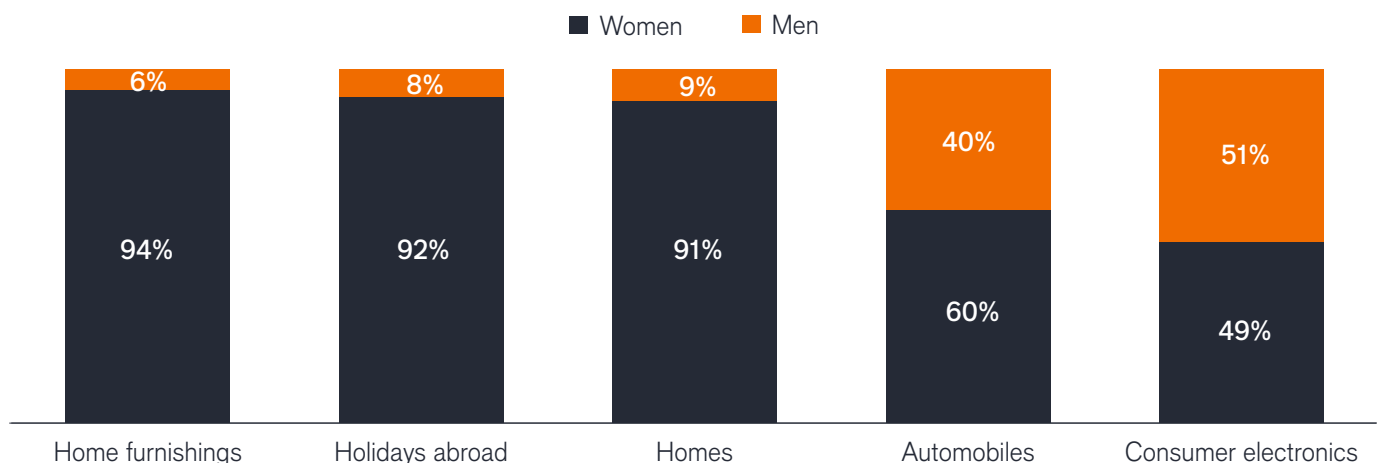
The McKinsey Global Institute found that truly empowering women in the economy could add as much as £12 trillion to GDP by 2025.³ If it wasn't already, the case for the economic empowerment of women is clear.

When it comes to products specifically designed for women, efforts have at times fallen short. In the past we have seen companies make products pink in a poor attempt to attract female buyers. Unsurprisingly, this did not address the concerns and needs of female consumers, and in some cases these products are more expensive than their non-pink counterparts. In her book *Invisible Women: Exposing Data Bias in a World Designed for Men*, Caroline Criado Perez exposes design that fails to accommodate the needs of women, which can, in some instances, be life-threatening.

Dismissive design practices can be dangerous

Criado Perez uses the example of automobiles, a product that should be designed to be gender-neutral. She makes the point that even though men are more likely to be involved in a car crash, women are 47% more likely to be seriously injured, 71% more likely to be moderately injured and 17% more likely to die. One of the main reasons for this is that car safety is designed from the perspective of the male driver, with there being no requirement in the European Union (EU) to use an anthropometrically correct female crash-test dummy for the five tests that a car must pass before being allowed onto the market.⁴ The US

Chart 1: Women determine the majority of spending decisions



Source: Harvard Business Review, *The Female Economy*, 2009

“When it comes to products specifically designed for women, efforts have at times fallen short.”

regulations are not much better, with the standard female test dummy representative of the 5th percentile of women in the US, at 4 foot 11 and 108 pounds.⁵

I have personal experience of safety not being designed from the female perspective. I used to work on construction sites, where the safety coat, high-visibility vest, safety shoes and gloves were ill fitting because they were designed for men. Often my cumbersome personal protective equipment (PPE) would snag on scaffolding and climbing rigs because it was too baggy, the result of not being provided with PPE that would accommodate a female body. Another female colleague of mine took to wearing multiple pairs of thick socks because they did not make safety boots in her size.

And then I had a moment that changed the way looked at gender from an ESG perspective. I was in an engagement meeting with a company that we were conducting research on. The company had brought samples of the shoes it made, and I asked the CEO and Investor Relations team what I thought would be a simple question “did you bring any of your women’s shoes to look at?” The CEO’s face dropped as he and his team had not factored for a woman being present or even for anyone to be interested

in seeing the womenswear at all. I started to reflect on my experiences and the fact that there are so many companies that now understand that products and services should be designed to be inclusive. These companies were taking market share from traditional incumbents. Yet still, how can inclusive design become the norm when it is estimated that 78% of the UK’s design workforce is male?⁶ I wanted to understand whether my experiences echoed with my female colleagues and I felt the best place to start was athleisure.

Case study: Nike

Nike, one of the world’s largest suppliers of shoes and clothing, has stated its mission to bring inspiration and innovation to every athlete in the world. In the past we had shared concerns around the shortcomings of the company’s diversity. Specifically, we believed that the dearth of female representation in senior positions within Nike was leading the company to lose market share in the women’s sportswear and athleisure market. Since then, the company has elevated its Employee Relations function, focusing on hiring those that specialise in Human Resources, Employee Relations, and Legal and,

“I started to reflect on my experiences and the fact that there are so many companies that now understand that products and services should be designed to be inclusive.”

as a result, there has been an increase in Vice Presidents (VPs) that are female and/or are from underrepresented groups. We now consider Nike to be an independent centre of excellence with regards to its diverse staff. The company has also strengthened its code of conduct and increased its employee engagement and visibility with an annual employee engagement survey. The company has also put all employees through unconscious bias training and expanded its manager awareness training.

As a result of this diversity, Nike has increased marketing and innovation for women, making sizing more inclusive and creating more storytelling and digital connections through social media. Heidi O'Neill, President of Nike Direct, has been key in promoting investing in women's wear, fit and design. The company is looking at ways to be more thoughtful about how it speaks to women and has seen an increase in female engagement, especially with yoga wear and its yoga line. At the time of writing, the company has seen an increase in revenues from women's apparel and has sighted its focus on marketing and design as reasons for this.

This is just one example of how gender diversity can add value to a company. Many other studies have indicated that a more diverse leadership team is positively

correlated to innovation. Despite this, women are less likely than men to be in senior roles within design. We believe there is one simple way to reduce the data gap between innovators and consumers: by making the consumers the innovators. Just five years ago, a study by the Design Council found that in the UK only 17% of design managers and 14% of designers at a supervisory level were female.⁶

We believe that putting talented women in design roles can unleash a wealth of untapped potential, helping to promote alternative thinking and make businesses more cognisant of the needs of women. Without the advocates in leadership and design teams, this voice can easily be lost amid other conversations in design. Company engagement is a fundamental way in which we can hold companies to account while also looking to improve shareholder returns. On the topic of gender, we are beginning to expand our focus on whether products produced are gender inclusive as well as considering the roles held by women within the business. We believe strongly that as awareness of gender inclusive design increases, companies will need to adapt to avoid being outcompeted by those with a genuine understanding of gender requirements.

¹ Frost & Sullivan Global Mega Trends to 2030, March 2020

² Boston Consulting Group

³ McKinsey Global Institute, The Power of Parity: How Advancing Women's Equality can add \$12 Trillion to Global Growth, September 2015

⁴ Invisible Women: Exposing data bias in a world designed for men, Caroline Criado Perez, 2020

⁵ United States Department of Transportation National Highway Traffic Safety Administration

⁶ Design Council, Design Economy, 2018

THE IMPORTANCE OF DIVERSIFYING U.S. EQUITIES THROUGH AN UNEVEN RECOVERY



Nick Schommer

Given fluctuating markets and changing leadership as the economic recovery progresses, Portfolio Manager Nick Schommer discusses how it may be prudent to sharpen the focus on sources of risk and return within one's portfolio and seek to ensure these are not overly correlated.

Key takeaways

- » The recovery to date has been highlighted by distinct swings in leadership – between value and growth, smaller- and larger-capitalizations and cyclical and secular growth stocks.
- » Given fluctuating markets and changing leadership it may now be prudent to sharpen the focus on sources of risk and return within one's portfolio and seek to ensure these are not overly correlated.
- » A portfolio not dependent on specific market capitalizations, styles or sectors, but rather, focused on quality business models, may benefit from uncorrelated sources of risk and return with the potential to perform across multiple market scenarios.

In our view, the shifting nature of the COVID economic recovery has brought into focus the potential value of owning diversifying equity assets. A blend of holdings that do not look like the S&P 500® Index, are not dependent on specific market capitalizations, styles or sectors, but rather exhibiting the attributes of durable business models with the potential to perform in different market scenarios, may prove beneficial at this stage in the cycle.

The COVID Recovery has been Swift, but Uneven

While COVID initially created a severe economic contraction – akin to a natural disaster – we believed for some time that a health care solution to the pandemic would enable a similarly swift rebound. As the vaccination effort has steadily progressed in the U.S., consumers eager to re-engage with the physical economy have released substantial pent-up demand, and GDP growth has accelerated significantly. Powerful fiscal and monetary stimulus, strong capital market performance and a robust housing market have likewise positioned both individuals and corporations to reinforce an already widening economic recovery. Recently, though, the Delta variant has raised fears of slowing consumer demand. At the same time, supply chain bottlenecks and raw material and labor shortages have stoked inflation concerns and the potential for stormier weather ahead from an interest rate and economic data standpoint.

So, we have witnessed an ongoing push-pull in markets, and the recovery to date has been highlighted by distinct swings in leadership – between value and growth, smaller- and larger-capitalizations and cyclical and secular growth stocks. At the end of last year and earlier this year, cyclical, more value-oriented stocks assumed market leadership. These were companies positioned to benefit from a reopening and a normalization of the economy in industries like travel where consumers directed pent-up demand and savings. Cyclical companies – which tend to have a greater degree of operating leverage and perform better during periods of higher GDP growth – in general, rebounded strongly as the market gained confidence in a v-shaped recovery.

Diversifying Away from Big Tech

This is a stark reversal of the theme that saw the digital economy continue to thrive while the physical economy stalled at the onset of the pandemic, when a handful of large technology companies benefitted directly from the COVID environment. As with any crisis, the pandemic created a set of economic challenges that exposed weakness in certain business models and created opportunity for others. As businesses and consumers became increasingly dependent on – and comfortable with – digital technology during widespread lockdowns, big tech companies' prominence in the economy grew.

As it stood in August, the information technology and communication services sectors made up 39% of the

Chart 1: S&P 500 Index – sector weightings (%)



Source: Bloomberg, as of 8/16/21.

Chart 2: S&P 500 Index

Top Holdings	Weight (%)
Apple, Inc.	5.91
Microsoft	5.65
Amazon.com, Inc.	4.06
Alphabet, Inc.	3.99
Facebook, Inc.	2.29

Source: Bloomberg, as of 6/30/21.

S&P 500 Index (as of 8/16/21). Out of eleven economic sectors, information technology alone was larger than six sectors combined (energy, utilities, materials, real estate, consumer staples and industrials). What's more, the largest five stocks represented nearly 22% of the index, a level of concentration not seen even in the 2000 dot-com bubble (as of 6/30/21).

Many investors' primary exposure to U.S. equities is associated with the S&P 500 Index, which represents approximately 80% of the total value of the U.S. market.¹ However, as illustrated above, the S&P 500 has become – perhaps unwittingly to many – an index increasingly concentrated in a handful of large-cap technology stocks

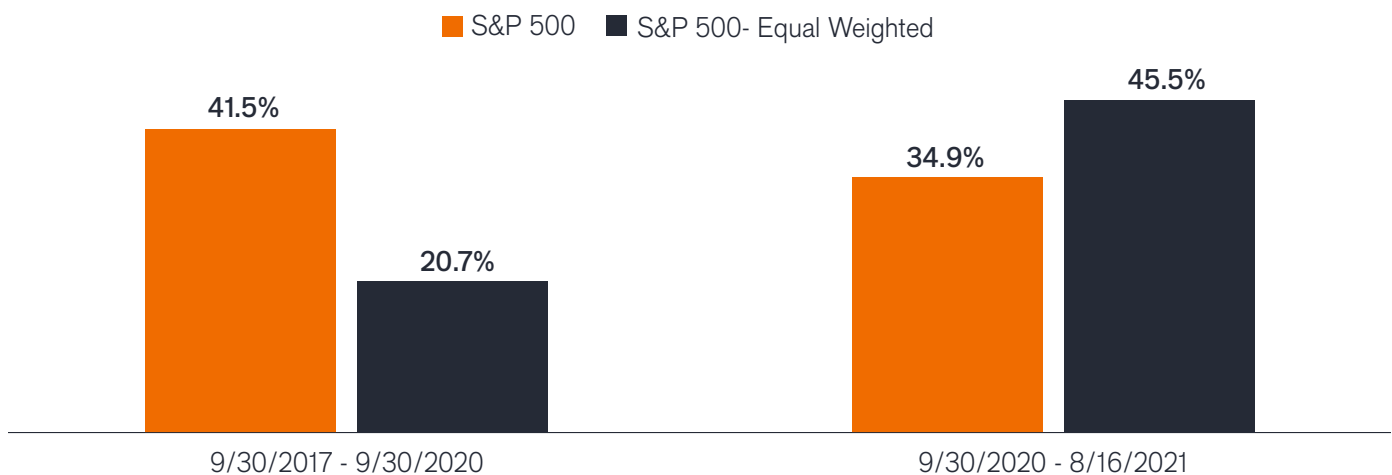
– a development that is certainly not without risk. This is not to say these stocks are not worth owning or bad companies. On the contrary, they have seen strong growth in recent years. As illustrated in the table below, over the trailing three years through to the end of September 2020, the S&P 500 (which is market capitalization weighted, giving greater influence to the largest stocks) outperformed the equal-weighted S&P 500, due largely to the strong performance of the mega-cap tech stocks. But, particularly as the economic recovery has broadened, we have witnessed a substantial leadership change, as illustrated in the period since September last year during which the equal weighted index has significantly outperformed.

Given the fluctuating nature of the recovery, this demonstrates to us the potential benefits of owning diversifying equities in other market sectors or wholly outside of the highly tech-concentrated S&P 500.

Differentiation by Redefining Value

To be clear, we do not advocate looking different from an index just for the sake of being different, nor do we suggest trying to time which market segment will be the next to outperform. Rather, taking an independent and thoughtful approach may lead investors to attractive opportunities that can provide diversified sources of return.

Chart 3: Index returns (%)



Source: Bloomberg, as of 8/16/21.

For instance, we believe that investors can uncover value in the market not by focusing on traditional measures, like price-to-book and price-to-earnings ratios, but by identifying companies with durable business models that have the ability to create value independent of macroeconomic conditions or market trends. This can be the case when the market misunderstands the potential profitability of a business or its growth capacity. There may also be opportunity in undervalued businesses where, over time, the market becomes willing to pay more for that business after company, industry or market events have created short-term dislocations in value.

Thus, it is our belief that by building a knowledge base of specific companies, one can assemble holdings with different sources of value and the ability to move independently to potentially create uncorrelated sources of risk and return. Likewise, we think it is particularly important in this environment to better understand changes to company business models and differences in pre- and post-COVID financials to home in on investment opportunities.

Deeper Analysis Required

We also think analysis that extends beyond the norm is particularly important in periods such as this. One such example that we believe can be extremely valuable for fundamental research – but that is rarely applied in equity management – is a knowledge of a company's entire capital structure: both its bonds and its equity.

This analysis can be critical in identifying an inflection point in a company's financial lifecycle. For example, when a company deleverages, at a certain level, equity

investors may begin to see real returns in the form of stock buybacks and gain more confidence in that company's ability to invest for future growth. Additionally, with more highly levered businesses, there tend to be a greater proportion of hedge fund investors, who often have shorter investment time frames and are more comfortable with the increased volatility that high leverage entails. Again, as a company deleverages and strengthens its balance sheet, more cash can be given to shareholders, and a new base of equity investors may become potential investors in that company, opening up the potential for a keen observer to arbitrage these different investor bases' appetites for leverage and risk. Thus, while fixed income investors tend to focus on the appeal of a company's bonds and equity investors study the value of its stock, at the end of the day, the ability to analyze the total capital structure can offer an advantage.

Navigating an Unpredictable Recovery

Thus far, we have seen fluctuation in the markets and changing leadership as the economic recovery progresses. We expect this to continue and it may therefore be prudent to sharpen the focus on sources of risk and return within one's portfolio and seek to ensure these are not overly correlated. This could be through holding stocks of different market cap and sectors, or bringing in companies with diverse sources of value, uncovered through differentiated research. With more twists and turns likely ahead, a portfolio that is less dependent on the economic cycle and that avoids unintended concentration risks may well be welcome.

¹ Source: S&P Dow Jones Indices, as of 7/31/21.

S&P 500® Index reflects U.S. large-cap equity performance and represents broad U.S. equity market performance.

Equity securities are subject to risks including market risk. Returns will fluctuate in response to issuer, political and economic developments.

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

Value stocks can continue to be undervalued by the market for long periods of time and may not appreciate to the extent expected.

Smaller capitalization securities may be less stable and more susceptible to adverse developments, and may be more volatile and less liquid than larger capitalization securities.

Growth stocks are subject to increased risk of loss and price volatility and may not realize their perceived growth potential.

Please consider the charges, risks, expenses and investment objectives carefully before investing. Please see a prospectus or, if available, a summary prospectus containing this and other information. Read it carefully before you invest or send money.

The fund is classified as "nondiversified", meaning it has the ability to take larger positions in a smaller number of issuers than a "diversified" fund. Nondiversified funds may experience greater price volatility.

Janus Henderson Distributors

Technology industries can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants, and general economic conditions. A concentrated investment in a single industry could be more volatile than the performance of less concentrated investments and the market as a whole.

Price-to-Earnings (P/E) Ratio measures share price compared to earnings per share for a stock or stocks in a portfolio.

Price-to-Book (P/B) Ratio measures share price compared to book value per share for a stock or stocks in a portfolio.

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.

NATURAL RESOURCES: PAVING THE WAY TOWARDS NET ZERO



Tal Lomitzer

Portfolio manager Tal Lomitzer discusses the key role natural resources play in combatting climate change and the exciting opportunities for investors.

Key takeaways

- » Global decarbonisation is creating an investment cycle across a wide range of natural resource sectors.
- » The energy, metals & mining and agriculture sectors are facilitating net zero via key secular themes such as energy transition and sustainable mobility and agri-business. lenses through which to view opportunities.
- » We believe an active approach is best suited to identifying resource companies that are reducing their carbon footprint, or contributing to decarbonisation, and driving what appears to be an attractive outlook for the sector in the years to come.

In the fight against global climate change, more than 120 countries have pledged to reach net zero carbon emissions by around 2050, complemented by more than 100 regional governments, 800 cities and companies.¹ This represents a huge and wide commitment towards net zero, with the aim of achieving a balance between the greenhouse gases (GHG) put into the atmosphere and those taken out, the most significant being carbon dioxide. In effect, dramatic action is required before 2030 in order to achieve those pledges, and some countries are even beginning to bring forward their net zero deadlines.

Natural resources are a requisite for decarbonisation

Many trillions of dollars will need to be invested, not only significantly increasing the demand and price for those natural resources that enable decarbonisation but, very importantly, also presenting opportunities for investors in the myriad enablers required to achieve net zero. Among others, this includes the building out of renewable infrastructure, production of more environmentally friendly blue and green hydrogen, acceleration of recycling rates to reduce energy consumption and hence emissions, smart farming, sustainable proteins, and the application of innovative science.

While certain areas of the natural resources sector, such as metals production, are far from carbon neutral, they are critical to facilitating large scale aggregated carbon reductions. When judged relative to the decarbonisation that metals enable, all emissions directly and indirectly related to metals may potentially be negative through to 2050. There are limitations in the measurement of downstream emissions (related to production, processing, and transportation), such as the lack of and inaccuracy of

data, as well as differing and evolving definitions and standards. This means existing assessment methods are crude, however experienced natural resource investment teams should have the capability and sufficient knowledge of companies to redefine how carbon is measured throughout the supply chain.

Wind, solar, electric mobility, and energy storage are the biggest contributors to carbon reduction. There are also, however, significant roles to be played for waste to be converted into energy, sustainable packaging, biofuels, alternative protein, reforestation and leveraging technology via smart farming.

Hard to decarbonise sectors like cement or fertiliser production will most likely turn to abatement (reduction/ending of usage) through carbon capture utilisation and storage (CCUS) where emissions are captured and then stored in the ground, or potentially used to produce precursors such as pure alcohol for several industrial processes. The know-how to do this lies in the hands of energy services companies which have historically managed oil and gas projects. The infrastructure to transport carbon dioxide and hydrogen will also be needed. Using carbon to produce nanotubes is also being discussed; these can be mixed into concrete to increase strength, reducing the amount of concrete for the same applications.

A global challenge presenting exciting investment opportunities

We believe some of the most compelling investment opportunities lie in the energy, metals & mining and agriculture sectors.

“Many trillions of dollars will need to be invested, not only significantly increasing the demand and price for those natural resources that enable decarbonisation but, very importantly, also presenting opportunities for investors in the myriad enablers required to achieve net zero.”

Energy transition

Clean energy currently makes up 15% of total energy consumed. It is forecast that this needs to increase to more than 55%² among signatory countries to the Paris Agreement to have a chance of managing greenhouse gas emissions to a level that achieves climate neutrality by mid-century.

Investment bank UBS estimates around US\$140 trillion of cumulative investment is needed by 2050 to decarbonise just the world's energy supply (see Chart 1). This will require large quantities of basic resources like steel, aluminium, copper, nickel and lithium. Considering that the amount of steel required to develop one megawatt of offshore wind or concentrated solar is three to four times higher than that in traditional coal fired, gas or nuclear power plants, the potential demand for these resources is staggering.

As renewables generation grows, fossil fuels need to be significantly reduced from around 80% of the current energy mix to roughly half by 2050 if the world is to meet the minimum Paris Agreement target of 2 degrees warming.³ This poses a significant headwind for current producers of hydrocarbons and explains why most of the large oil companies are pivoting towards renewables and looking to become energy businesses rather than oil businesses.

Meanwhile, the increasing growth of renewable electricity enables the manufacture of electrolysis-produced zero-carbon green hydrogen, which is produced by splitting water into hydrogen and oxygen. This has huge potential to

decarbonise steel production by replacing coking coal and may feature in the decarbonisation of heavy transportation such as lorries, airplanes and ships.

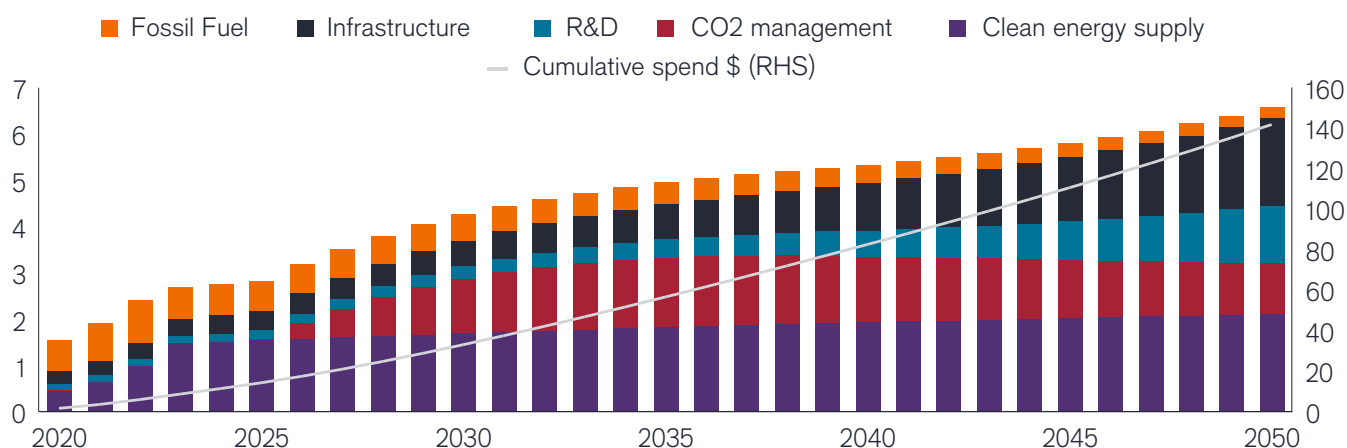
During the California Gold Rush of the 1840s and 1850s, prospectors needed to buy a pick and a shovel to mine for gold. While prospectors would not be guaranteed to find gold, the companies that sold the tools were making money. Within energy, the most attractive opportunities may be found in companies that are selling the 'picks and shovels' to facilitate the production and development of renewable energy. In our view, fewer opportunities are to be found in the utility companies running the projects and facing falling returns from increasing competition and new capital flows.

As an example within wind energy, we see strong potential in manufacturers of wind turbines and blades; copper cable that will connect offshore energy projects to the grid; energy services companies that provide ocean bed surveys; and the ship builders needed to construct offshore wind farms. We believe these are all companies that stand to benefit from the rising growth and demand for renewables.

Metals and mining, sustainable mobility and renewables

While good progress has been made in the adoption and manufacture of electric vehicles (EV), sustainable mobility needs to develop further; electric car sales need to grow from 3 million in 2020 to 56 million in 2030 to make a meaningful impact.⁴

Chart 1: Annual investment needed to decarbonise energy supply



Source: UBS Equity Research Q-Series: Energy Transition: How will \$140tn of investment be allocated across the energy supply chain? 25 March 2021. © UBS 2021. All rights reserved. Reproduced with permission. May not be forwarded or otherwise distributed.

The amount of copper used in a battery electric vehicle is five to ten times higher than that used in a conventional combustion engine vehicle. The dominant battery chemistry uses nickel-cobalt-aluminium, iron-phosphate, and nickel-manganese-cobalt. All of these metals are going to see significant increases in demand with EV growth, and indeed we have seen their prices soar based on increasing pressure on the raw material supply chain. Total demand for copper by clean energy technologies is expected to see a three-fold increase by 2040.⁵

Aside from EVs, copper is in high demand as a key component used in renewable energy systems. Being a highly efficient conductor of electricity and heat, copper is required in the generation of hydro, solar, thermal, and wind energy.

Nickel used in lithium ion batteries could double in scale over that period. Meanwhile, Fitch Solutions forecasts EV sales will drive lithium consumption growth by around seven-fold through to 2030.

Agriculture – sustainable agri-business

Decarbonisation is not limited to energy, metals and mining. Turning our attention to the agriculture space, by 2050 the UN predicts that almost ten billion people will be living on this planet. That means more food needs to be produced in the next 40 years than we have harvested in the last 8,000 years.

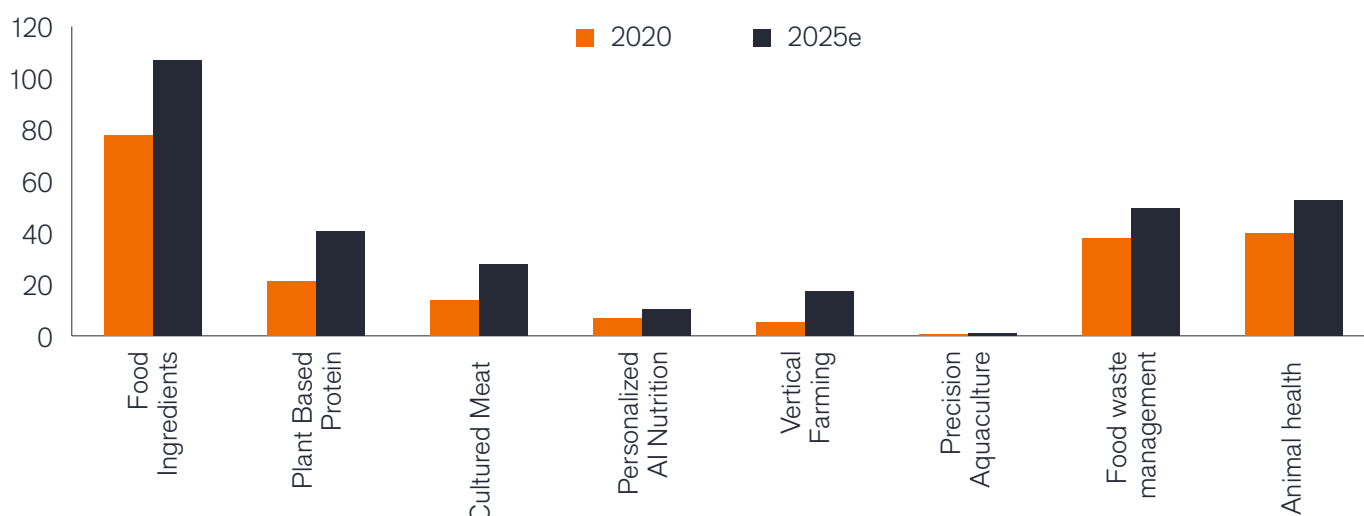
At present, about a third of agricultural produce is wasted annually, a strong reason why more efficient farming and distribution of food are badly needed. We also need to consider changing the type of food that we consume. Plant-based or lab-grown 'meat' uses 90% less water, land and emissions than conventional livestock farming.⁶ This plays into the hands of large agricultural companies and producers, which are investing significantly in some cases to grow their plant-based nutrition businesses. The following chart provides an illustration of the significant opportunities within agriculture.

Within agriculture, there are also opportunities to invest in large natural assets such as forests, which are increasingly recognised as carbon sinks that can absorb large amounts of carbon dioxide from Earth's atmosphere. Another opportunity is in providers of renewable construction materials to replace those that have a high-carbon content. Examples include replacing cement with wood, swapping out plastic packaging for paper products or utilising pulp in the manufacture of bioplastics and biofuels.

Challenges

The pathway towards net zero does come with risks to both the ultimate goal of achieving a climate neutral world as well as to the companies involved in this Herculean effort. Moreover, time is very much of the essence. There is a concern that materials could be sourced from countries

Chart 2: The future food market opportunity (US\$bn)



Source: BofA Global Research based on various sources: Markets and Markets, Global Market Insights, Grand View Research.

with low environmental standards and poor labour practices. The rate at which the world requires new renewable energy is so high that there may be a risk it cannot be achieved within the time span expected. Will renewable energy projects be able to source the required funding, will specifications be met, will there be maintenance issues? Developing countries that are facing food shortages will not be able to modify their eating behaviour as quickly as developed populations. Lower energy costs in recent years have led to increasing energy consumption, while the switch to clean energy may not be as cost efficient as anticipated. The multiple cogs in the wheel to address climate change need to work in tandem, be it regulation, government policy, technology, socially responsible corporates, investors or end consumers.

Natural resources, as an enabler of decarbonisation, is a sector facing a challenging and unmapped path with compelling opportunities along the way. From an investment perspective, we believe an active approach is

warranted here to identify and engage with resource companies. Those that adhere to sustainable practices are, in our view, more likely to be well positioned for the future and have greater potential to deliver attractive returns to investors.

Conclusion

Through the process of decarbonisation, company engagement and supplier requirements, many natural resource companies are actively seeking to reduce their carbon footprint and are focusing their efforts towards this end goal. Those that can do this well are likely to be rewarded by investors. While there are obstacles along the way, a multi-decade runway lies ahead – meaning the outlook for natural resources and the potential to change the world for the better appears as exciting as it has ever been.

¹ The Energy & Climate Intelligence Unit and Oxford Net Zero, March 2021: Taking stock: a global assessment of net zero targets.

² UBS Equity Research, 25 March 2021, Q-Series: Energy transition: how will \$140tn of investment be allocated across the energy supply chain.

³ S&P Global Platt Analytics, 23 June 2020.

⁴ International Energy Association (IEA), May 2021: Net zero by 2050.

⁵ International Energy Association (IEA), May 2021: The role of critical minerals in clean energy transitions.

⁶ BofA Global Research; 7 April 2020: We can't keep (m)eating like this – future food primer.

EMERGING MARKETS: NEAR-TERM UNCERTAINTY MATCHED WITH LONG-TERM OPPORTUNITY



Daniel J. Graña



Matthew Culley

While the pandemic has increased near-term risk, the rise of innovative and value-added industries should place the future trajectory of emerging markets on more stable footing, Daniel Graña and Matt Culley argue.

Key takeaways

- » Disparate responses to the global pandemic are resulting in varying near-term outlooks for emerging market (EM) countries.
- » Increasingly, the legacy EM drivers of offshoring and economic convergence are being eclipsed by innovation.
- » Despite changes to tech sector regulations in China, we believe authorities continue to recognize the role that tech companies play in increasing efficiencies and providing needed services.

Over the course of 2021, emerging markets (EM) – similar to all countries – have had the trajectory of their economies and financial markets dictated, to a degree, by developments in the COVID-19 pandemic. Anticipation of increasing economic activity pushed EM equities benchmarks to record highs in February. Later, the spread of the Delta variant and the threat of renewed curtailment of commerce exerted downward pressure on the asset class. For reasons explained below, these public health developments should serve as a reminder that EM equities are not monolithic; EM countries' unique responses to the pandemic will likely be an important determinant in their near-term economic progression and ability to generate attractive returns for investors.

More recently, an important segment of the asset class – China technology – has come under pressure due to a shifting regulatory landscape. While the situation merits monitoring, we recognize what hasn't changed, which is the innovation being carried out by a host of Chinese companies as they leverage technology to drive productivity gains across the broader economy and, in several instances, create entirely new industries.

Shifting Drivers

We believe that future advancement of EM economies will be driven by innovative, private companies seeking to address the unique needs of these regions' consumers and business customers. The growing role of innovation in many EM economies is owed to the greater economic stability brought about by years of outsourcing and

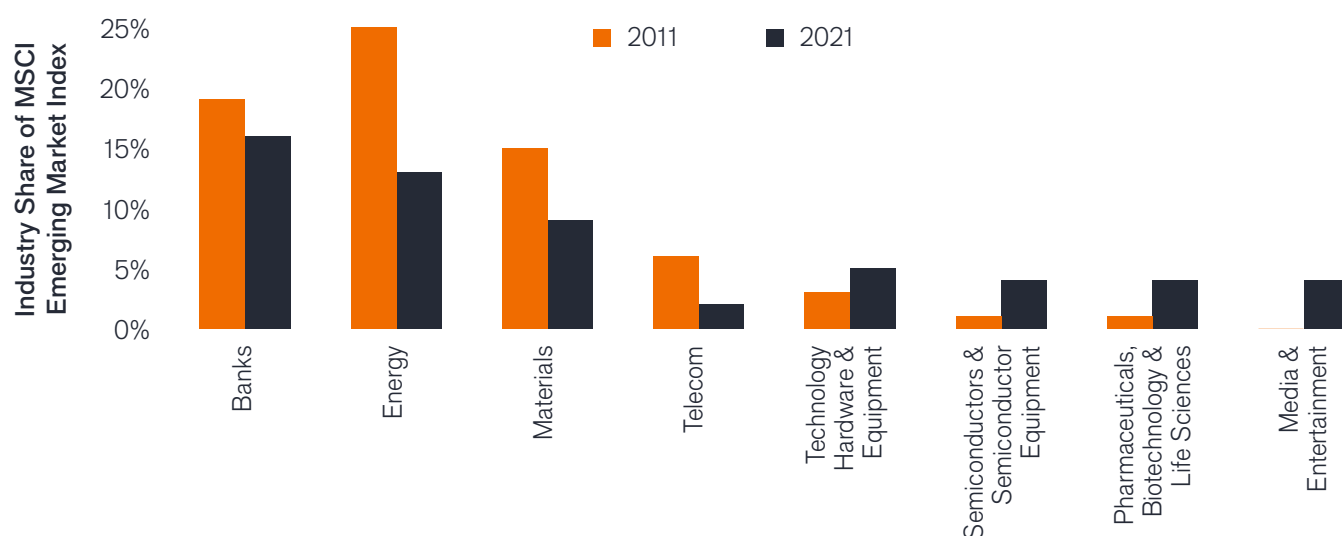
convergence-led growth across the EM landscape. With clear policy support, we are now witnessing the establishment of what are rapidly becoming essential industries and the ascent of digitally native, middle-class consumers. As seen in Chart 1, industries most closely associated with innovation and a digital economy have seen their share of the MSCI Emerging Market Index¹ grow considerably over the past decade at the expense of banking and commodities, which long dominated EM economies.

Economic decoupling between China and the U.S. is gaining traction, and the role played by global trade in powering economic growth is likely to diminish. Similarly, state-owned enterprises (SOE) that often lag the private sector in efficiency and can be called on to perform acts of "national service," such as what we witnessed in several EMs during the pandemic, are likely to play a smaller role in delivering marginal economic growth. Given these developments, actively managing exposure to legacy exporters and SOEs – including avoiding certain securities all together – will likely be an important tool for managers seeking to maximize returns and managing risk in EM equities going forward. That this third "innovation" pillar is gaining momentum as a long-term source of returns is an exciting development for the asset class.

A Playbook for Navigating a Complex Landscape

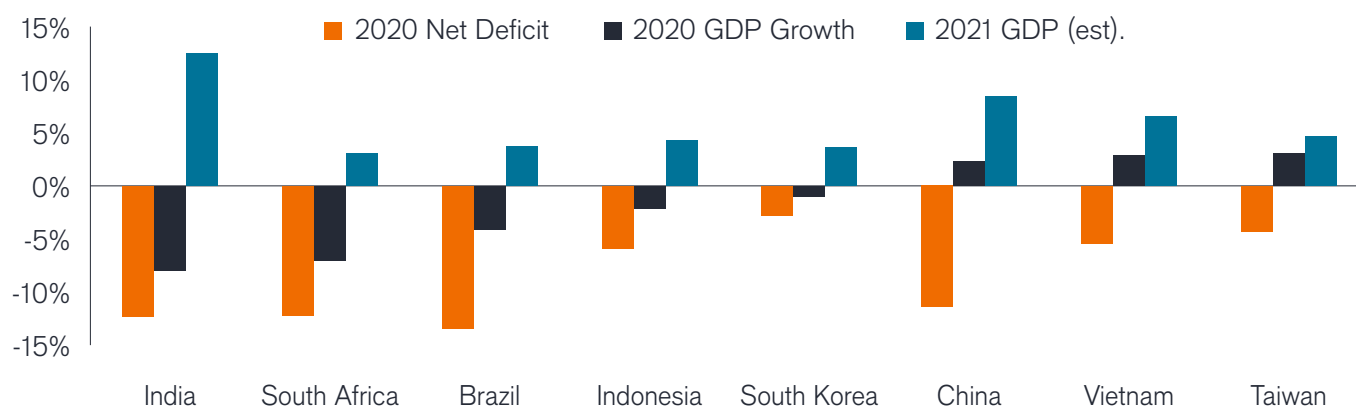
While we believe the private sector holds the keys to

Chart 1: Innovative industries have gained market share in emerging markets



Source: Bloomberg, Janus Henderson Investors. Industry weightings as of 19 August 2011 and 19 August 2021.

Chart 2: Weaker fiscal positions often align with deeper 2020 recessions



Source: IMF World Economic Outlook Database, April 2021.

EMs' future prosperity, other factors are at play as well. Policy casts a long shadow in countries still creating sound economic structures and regulatory frameworks, and corporate governance – especially with respect to minority shareholders' rights – is an issue that often requires close examination. Given this, we think EM investors should be guided by a multi-lens approach that considers company fundamentals, corporate and political governance and the direction of macroeconomic policy.

Looking forward, within the macro context, we see reasons for optimism as the availability of COVID-19 vaccines and other therapeutics may help address the pandemic and should then lead to a broadening of investment opportunities. At the same time, we see divergence in how individual countries are dealing with the crisis. While some governments have been proactive in distributing vaccines and addressing outbreaks, others have struggled with logistics, new variants and reduced vaccine efficacy.

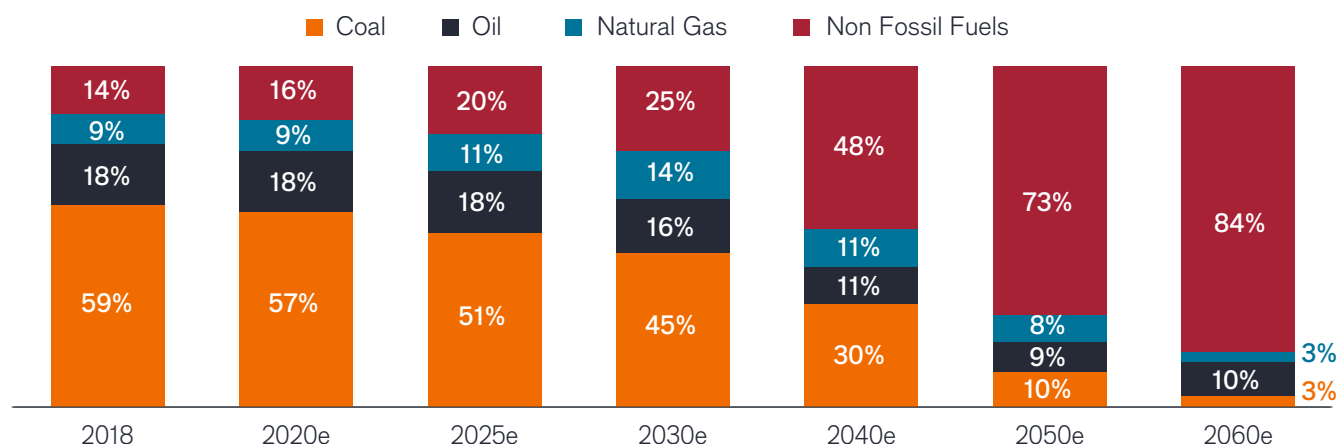
We believe these challenges could create a wide-ranging spectrum of trajectories for different countries. Those that succeed in combating the pandemic may return more quickly to their pre-2020 economic path. Countries that are slow to roll out vaccines or address uncontrolled viral spread may face longer-term health, economic and fiscal

repercussions. India, in particular, has been hard hit by the virus, and as seen in Chart 2, its weak fiscal position limits the government's ability to support the economy. On the other hand, the north Asia countries of China, Taiwan and South Korea have made more progress in addressing the pandemic. Nonetheless, we caution that the health care crisis is far from over, and new variants and additional waves of the virus remain sources of near-term uncertainty both for the global economy and for many EMs and their fiscal conditions.

An Eye Toward the Future

What makes this a compelling time within EM investments is the degree to which these regions – especially heavyweight China – find themselves on the cutting edge of global trends. One trend we continue to follow is the long-term move toward decarbonization. President Xi Jinping has laid out ambitious plans for China to reach carbon neutrality by 2060. As illustrated in Chart 3, crucial to achieving this objective is the phasing out coal-fired electricity generation. This aggressive timeline will necessitate significant investments in renewable energy and electric vehicles. By many measures, China is at the forefront of developing novel technologies related to decarbonization and deploying them at scale.

Chart 3: China's decarbonization programme focuses on replacing coal with renewables



Source: China National Bureau of Statistics, Tsinghua University, JPMorgan. All periods except 2018 are estimates. Data as of 30 April 2021.

The revolution occurring in the energy and automotive industries is having knock-on effects across the global economy. Essential to the drive toward decarbonization is the extraction of metals – among them copper – to help power a battery- and renewable-centric economy. We believe the demand for copper and other essential metals will rise considerably over the coming years, benefiting several EM countries with sizable mineral deposits.

We continue to see opportunity in China's technology sector, especially companies tied to the digitization of its economy as this aligns with broad government objectives of increasing productivity and economic growth and helping to mitigate rising social inequalities. Recent developments with respect to more stringent regulation merit close observation, but we believe the central government recognizes the important role played by the tech sector in creating needed services and wringing out efficiencies in the economy. Staying on the right side of these economic and social policy objectives, in our view, will be key to investment returns.

While garnering less attention than technology and energy, EM companies are increasingly contributing to health care innovation. In China as well as other EM countries, the biotech industry finds itself on the right

side of official policy as it develops novel therapies to meet patient needs and lower costs. These developments are important in both countries with aging demographics and regions that historically haven't had access to adequate health care.

Tailwinds, Yes, but a Hand on Rudder still Needed

As with other regions, we believe the economic and social upheaval brought on by the COVID-19 pandemic has accelerated many existing trends, including the digitization of the global economy. In this respect, the opportunity to gain access to value-added technologies and intellectual property within EM economies has never been greater. But given the challenges certain countries face in containing the pandemic while also managing tenuous fiscal positions, risks remain. This potentially divergent path of EM countries means that as the global economy emerges from the pandemic, investors will be tested to identify the most durable trends and innovative companies while also recognizing which countries and industries face secular headwinds and should thus be avoided.

¹ MSCI Emerging Markets IndexSM reflects the equity market performance of emerging markets.

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