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Janus Henderson Multi Strategy – Overview

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A world in flux merits increased communication. This series outlines the way we see the world, provides our ongoing view on the shifting opportunity-set for our seven overarching strategies, and addresses any issues where outcomes have disappointed. As with any multi strategy process, the positioning and return achieved by the team is a reflection of many inputs and approaches. Here, the views are my own, but I will attempt to provide a distillation of the expert and diverse views across the team.

Operating environment:

It is time to say it – this cannot go on. Cold War 2 has raged quietly like a smoldering fire. We can all smell it, but it is never quite clear where the fire will burst into the open. Worse, it feels like so many wish to pour gasoline on the embers. Russia, China and now the Middle East – there seems no way that the US military (starved of real resources since the Obama administration) can handle three fronts simultaneously. Is this coordinated or coincidental? We shall soon find out. 'Once is happenstance. Twice is coincidence. Three times is enemy action.' (Ian Fleming).

America, meanwhile, has never been more dysfunctional – homelessness not seen since the 1930s and a Gini Index[i] that screams the demise of reason and democratic principles. Can America handle this degree of stress, both internal and external? It is this outlook that gives us sleepless nights in navigating buoyant equity markets.

The US Strategic Petroleum Reserve was tapped just before the mid-term elections for political expedience and leaves the US close to its congressionally mandated minimum reserve level. Fracking and pipelines continue to be blocked by politics, nuclear energy has been without investment for decades, solar energy is reliant entirely on one non-friendly supplier, and the economy is running above long-term capacity. Monopoly and monopsony are both deeply embedded across almost all industries and are now accompanied by a resurgence in union activity. A President on the picket line is certainly new and a long way from the 1970s income policies we remember in seemingly similar circumstances. Inflation may have found a floor nearer to 3.5% than 2%. So, are higher nominal rates or a greater focus on the US Federal Reserve's (Fed) balance sheet reduction policy the way forward?

Fiscal deficits are of a scale not seen since WW2. This is even before we have a recession, a 'hot' war with open military confrontation, or higher financing costs begin to be fully reflected in the numbers. This should ring alarm bells – are there no limits to financing? Is crowding out another part of my economics education that no longer applies (rational expectations was the first to die)? The curve has bear steepened as expected, but what now?

Retail investors have crowded into short-term bonds at rates most had assumed they would never see again. Real 10-year rates (nominal less inflation) now approach 2.5%, perhaps reflecting an elevated risk premia across the economy. I fear the plurality never simultaneously makes the right decision. Either reinvestment risk rears its head and rates rally dramatically and unexpectedly. Or inflation stays persistently above target and leaves the Fed with a conundrum between higher nominal rates, which will create an uncomfortable spiral of higher deficits (through higher funding costs), or bond market repression, pushing real rates back into negative territory and inevitably stoking further inflationary pressure.

The banking industry stress has been hidden by Fed action following the demise of Silicon Valley Bank, but it is still very real. I believe the credit creation process, especially in regional banks (also see Bank of America's balance sheet), is inhibiting banks' ability to generate any meaningful loan growth and explains the rapid slowdown in money growth. Only a rapid reduction in long rates will reinvigorate this process.

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The Case-Shiller Housing Index[ii] suggests there has been little change in house prices across the US. But it is my contention that this is entirely a reflection of a market in disequilibrium, with sellers unwilling to release locked-up cheap financing and ever fewer buyers (believing prices will eventually reflect much higher mortgage costs). I am watching Airbnb data closely for leading signs of distress in one of the frothiest parts of the housing market. If rates stay high, a price reset is eventually inevitable in residential real estate. If I am right, this has the potential to materially affect economic activity and Fed policy. A Goldilocks or stagflation scenario would remain the most obvious outcome looking six months forward.

Strategy implications:

The great news is multi strategy investing is not all about one guy and his view. Strategies that previously underperformed in Q2 have performed much better in Q3. I see opportunity and risk everywhere. An uptick in activity, higher risk premia and carry across a range of markets allow our nimble investing style and a focus on the left tail to flourish, leading to a stronger multi strategy outlook in our view. We have added risk to a number of strategies in Q3 and have adjusted the protection balance. Too much protection is (and has been) painful when mis-calibrated but it is far less painful than having too little when it is needed.

Stay safe and invest with an open mind.

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[i] The Gini index measures the extent to which the distribution of income or consumption among individuals or households within an economy deviates from a perfectly equal distribution. The Gini rating for the US is currently meaningfully higher than other western countries, indicating greater inequality.

[ii] The Case-Shiller Housing Index tracks monthly changes in the value of single-family homes in the US.

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