COMMENTARY

Janus Henderson Horizon US Growth Fund

Q3 2019

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For professional investors only

Fund manager names: Derek J. Pawlak and W. Scott Priebe

Overview

While the market backdrop has been anything but encouraging over the past quarter, the performance of the major market indices essentially ended the quarter nearly flat. There was certainly volatility fuelled by the erratic nature of the US-China trade discussions, an ominous cloud of headlines surrounding the US administration, and a slowing economy. In retrospect, we shouldn't be entirely surprised with the decelerating economic growth rates we are witnessing, as the markets are typically forward looking and the correction in the fourth quarter of 2018 portended the slowdown. In fact, this is the third such slow down (2015/16, 2011/12) since the commencement of this expansionary period, which is now the longest in modern history. Soft periods should not be feared but rather welcomed, as it is healthy to remove some of the excess which builds during bull markets.

Performance and activity

The fund returned 0.7% versus 1.0% for the Russell Midcap Growth Index.

At the sector level the greatest contributors were materials and processing, financial services and health care. Tyler Technologies, Trex Company and Edwards Life Sciences were the greatest individual contributors. Shares of Tyler Technologies were up 21.5% during the quarter and the company has been a strong performer all year. Recently the company signed two very large subscription agreements which will increase the mix of subscription business but be a short-term negative for revenue growth. Trex was the second best performer this quarter but earnings came in a bit mixed while revenue was on the high end of the range for the second quarter, margins were compressed due to higher costs related to increasing capacity and raw material. Going forward, the company will be focused on expanding production to more accurately meet demand, and with the $200 million investment in a new facility and enhancements of the existing one, total capacity will grow 70%. Edwards Life Sciences reported second quarter results which exceeded expectations. The beat was driven by strong global TAVR (transcatheter aortic valve replacement) sales and as a result management is now guiding toward the top end of its range for second half of the year revenue growth.

The greatest detractors were producer durables, consumer discretionary and technology. At the stock level the greatest detractors were Abiomed, Ulta Beauty and Grand Canyon Education. Shares of Abiomed were down 31.7% during the quarter and it was the second quarter in a row in which the company missed revenue expectations. Management cut the 2020 outlook and continues to work through execution related issues; until the company is able to reaccelerate growth and the newly hired sales staff fully ramps up the company will continue to trade at a depressed multiple. Ulta Beauty shares were down 27.7% due to a fairly lacklustre second quarter report and significant guidance revision given what management sees as industry headwinds in the cosmetics category. The company noted the makeup category recently turned negative and has become increasingly volatile; management believes the lack of newness and innovation has impacted growth but the issue should be short-term in nature as the company works with brand partners to bring new innovative cosmetics products to the market. Grand Canyon Education reported earnings-per-share (EPS) solidly above expectations but the weakness can be explained by the negative sentiment surrounding the space, specifically fears around potential risks around for-profit education if the Democrats were to take over the White House.

Church & Dwight Co was added to the fund this quarter. The company develops, manufactures, and distributes household, personal care and specialty products. Fortive Corp was sold during the period to make room for a higher conviction idea.

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Outlook

The S&P 500 Index has generated a positive return 14 of the last 17 years, and while we are experiencing the longest bull market in modern history we feel the markets are set up well for 2020. During an election year one should expect for rhetoric to be extreme on both sides of the aisle. However, elections do not create economic growth but rather it is driven by population growth and enhanced productivity. In this respect, the United States is in an enviable position as the domestic working age population will grow 13% from 2019-2050 versus declining rates for most developed peers. China for example is expected to see its population shrink by 20% over this time frame. Concurrent with the election noise and trade wars is the credit cycle, which still appears robust. We feel it will be challenging for the Federal Reserve (Fed) to meaningfully raise rates beyond our developed counterparts, who essentially act as an anchor to our rates, which will be supportive for companies who wish to take on additional leverage for merger and acquisition (M&A), stock buybacks or simply term out existing debt at more palatable rates.

Source: Janus Henderson Investors, as at 30 September 2019

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