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Janus Henderson
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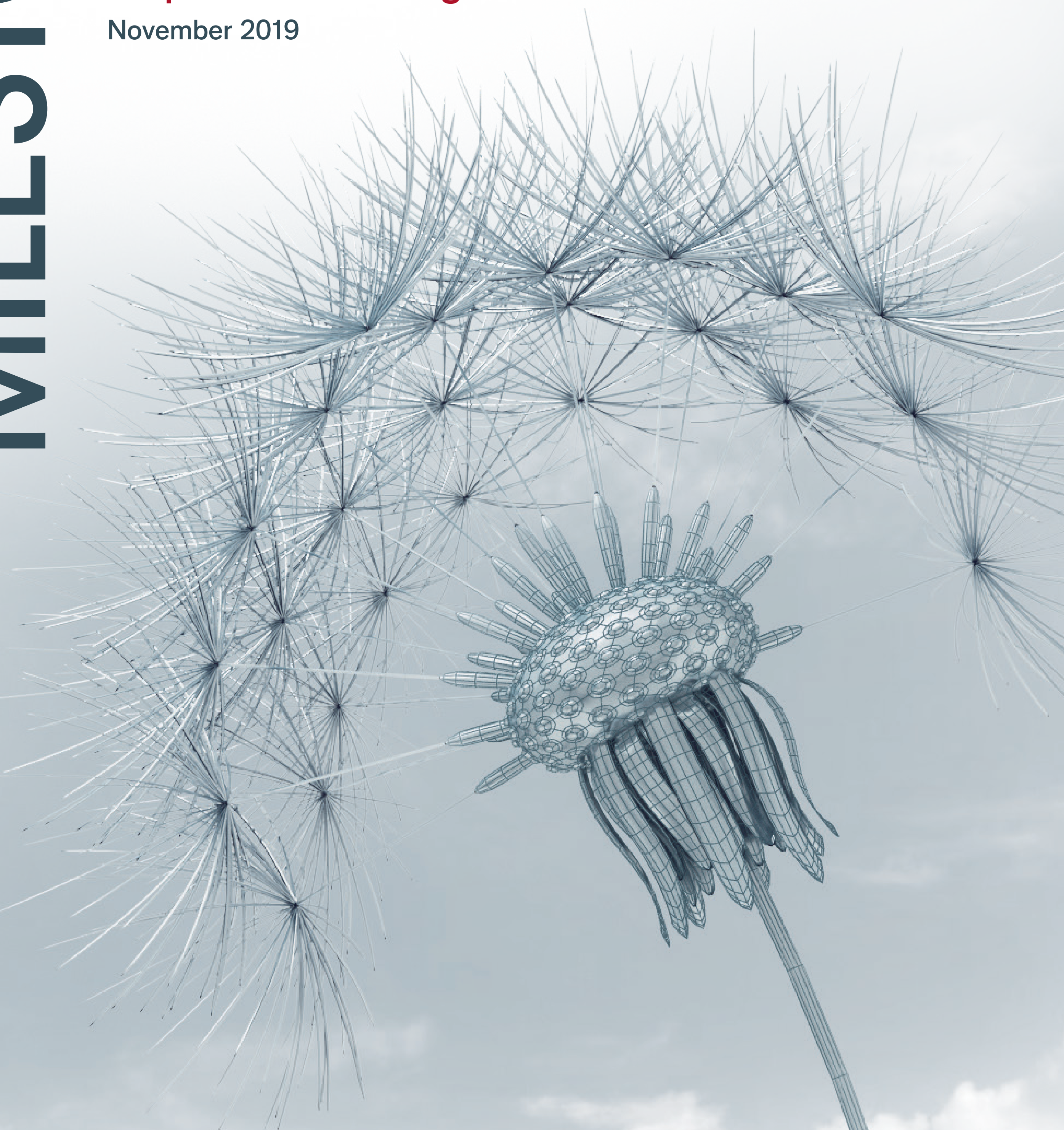
Multi-Asset Credit Fund:
7-up and still fizzing

November 2019



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MULTI-ASSET CREDIT FUND: 7-UP AND STILL FIZZING

With the fund currently celebrating its seventh anniversary, members of the Secured Credit Team and co-managers of the fund, Colin Fleury, Head of Secured Credit and David Milward, Head of Loans, share their lessons learnt from managing the fund over the past seven years and how that will help them manage through a somewhat uncertain future. The managers expand on their views through seven questions covering seven years (and beyond) with Norbert Fullerton, Head of Institutional Client Strategy, EMEA.

The Multi-Asset Credit (MAC) Fund was launched seven years ago focusing on an opportunity in Europe. How has it evolved over this period?

Colin Fleury: The fund continues to have a European focus, even though we have a deep, global pool of analysts and are allowed to have up to 40% of our investments outside of Europe. There are a number of reasons for this:

- current valuations are typically more expensive for equivalent risk profile investments outside of Europe
- currency hedging costs are high in some geographies
- Europe has a higher volume of senior secured high yield issuance
- some securitisation regulations restrict US investment and,
- our belief that the European loan market's technical conditions are more stable, given limited retail fund involvement.

While these factors will continue to limit our appetite for US investments in the near term, we would not be surprised to see the allocation move into the 20-30% range during periods when, from a valuation perspective, opportunities become more compelling.

What is the key to your success in managing the fund?

Colin: David and I have worked together at the firm for over 12 years, providing a strong foundation to build a breadth of knowledge around how we manage the fund. However, we believe the success of the strategy is down to the strength of our team more than an over-reliance on any one key individual. When assessing top-down portfolio positioning we draw on insights from a dedicated MAC Strategy Group made up of senior investment professionals in London and Denver. Bottom-up ideas come from our global credit research resources.

The MAC Fund currently focuses on three asset classes. How do you see this evolving over time into new asset classes or markets?

David Milward: We always remain on the lookout for attractive opportunities that meet the risk and liquidity profile of the fund and its preference for senior and secured investments. However, we do not feel constrained by the current focus on three asset classes. In fact, we believe maintaining a relatively straightforward investment style is one of the ways we can distinguish ourselves within an increasingly broad universe of MAC funds.

Colin: When we launched the fund we gave ourselves flexibility to invest up to 20% in 'other' investments away from the three core assets but we have not yet felt the need to utilise it. The most obvious area that we may consider in the future is investment grade corporate bonds, if through the credit cycle they cheapen to attractive entry levels, but for the present we remain happy with asset-backed securities (ABS) as our lower risk and return investment grade portion of the portfolio.

The return target for the MAC Fund is Libor+5% per annum, gross over a market cycle. How will you aim to achieve this over the next seven years?

Colin: The fund has delivered close to its target since inception. However, we do not seek to position the portfolio to deliver this target in all market conditions. We believe that we should respond appropriately to market environments, the returns available at any one time and our corresponding appetite for risk. This has always been our message to clients. We are also very conscious of the length of this credit cycle and the suppressive impact of central bank actions.

Currently, we think that there will be better times to add yield into the portfolio, although there is a risk that the 'lower for longer' interest rate environment may continue for some time yet. Our clients want us to use the flexibility that the fund offers to manage the risk profile of the portfolio sensibly and deliver a good risk-adjusted return, rather than be wedded to delivering the return target every year. We believe this is one of the reasons why we tend to compare favourably against MAC peers, in terms of the volatility of returns or drawdown in more difficult markets such as Q4 2018.

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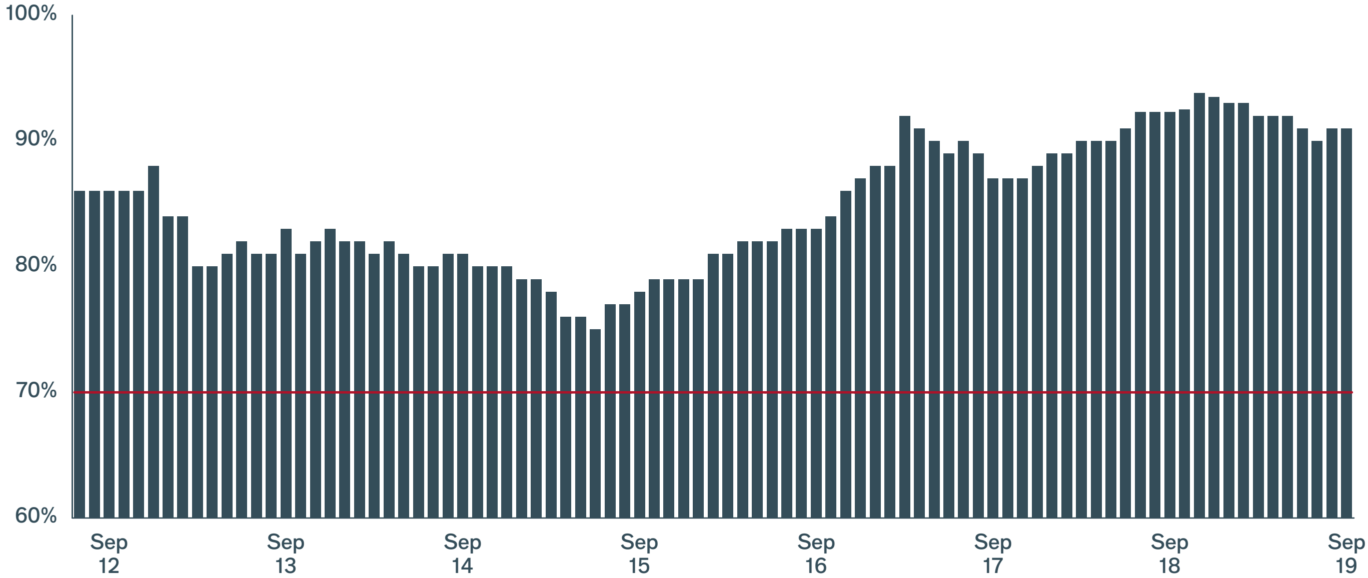
Multi-Asset Credit portfolio – percentage of senior ranking positions over time



Source: Janus Henderson Investors, as at 30 September 2019

In periods of stress, how do you manage risk in order to preserve capital and/or meet liquidity needs?

David: We take a medium-term investment view with a focus on minimising portfolio defaults while deriving the majority of the target return from income. However, we do not seek to hedge out market volatility and as such always emphasise that while the realised volatility since inception has been less than 2% per annum, we still guide to a 4-7% range as we advised at launch. Hence, investors should not be surprised by any volatile periods and would hopefully ride them through with us, benefiting from the opportunities that maybe revealed.

Beyond this, there are a number of ways we mitigate capital and liquidity risks. Capital protection is rooted in good credit selection and enhanced by construction of a diverse portfolio (our largest position size today is around 1%) with a preference for senior and secured investments. We also use the broad opportunity set available to adjust the credit rating mix and spread duration (sensitivity to movements in credit spreads).

Colin: In addition, liquidity is managed through the types of investments we make. For example, in the loan market, we only participate in larger syndicated transactions with a number of other institutional investors and broad dealer trading activity. Liquidity also benefits from the portfolio diversity referenced above. Fund dealing is conducted monthly, requiring a minimum 20 business days' notice of redemption. This allows both orderly trading and assessment of the associated transaction costs, to ensure remaining investors are protected through an appropriate dilution adjustment.

What are the macro or micro challenges that you are currently facing and how do you intend to mitigate them?

David: We face a dilemma between an ageing credit (and broader market) cycle and a central banking community that has convinced many market participants of their ability and desire to protect the market from any significant downturn. This has supressed broad market volatility but also the prospective returns available across risk asset markets. The fundamental picture is then further confused by political uncertainty such as trade wars and Brexit.

This leaves us with a cautious bias implemented in a number of ways. One illustration in the chart (above) shows how the senior ranking portion of the portfolio has increased over time. Given the depth and breadth of the spectrum of assets available to us and the fact that the fund is not constrained by a benchmark, we are able to build a portfolio that reflects this reality and can implement it in a number of ways, both from the top-down and the bottom-up.

Colin: It is also important to look closely at the risk makeup within different areas of the portfolio. For example, the current percentage of UK risk in the portfolio is in the mid-20s; this may appear high but around 40% of this risk is in ABS with an average rating of AA and a maturity of around two years. The balance represents a very broad mix of companies, many of which are large international businesses incorporated in the UK. Instead of trying to decipher the uncertain political landscape since the summer of 2016, we focus on the quality of a business and its ability to persist through a market cycle; including market stresses caused by say a hard Brexit, a recession or some other global macro shock.

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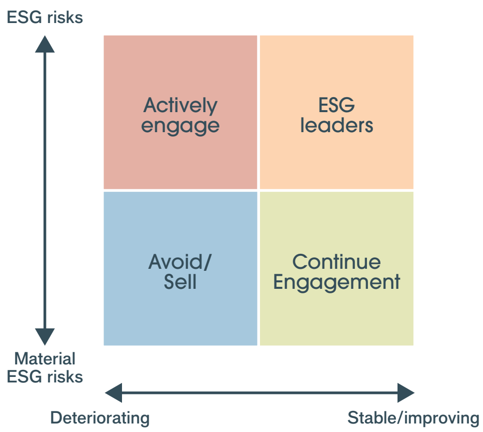
How do you take ESG risk factors into account when carrying out stock selection?

David: Environmental, social and governance (ESG) risk factors are integrated into our fundamental research process. When formulating our ESG assessment of an issuer (or issue), we typically ask three key questions:

1. What ESG risks are material to the issuer and are they taking steps to mitigate them?
2. What is the ESG profile of the issuer?
3. Is the ESG profile improving or deteriorating?



Key criteria for formulating our ESG assessment

Where we judge a company to have material ESG risks and think that they are on a deteriorating trend, we will divest and/or avoid the issuer, overriding our overall credit recommendation.

This approach appears most appropriate for the loans and high yield bonds that we hold. However, for ABS, we use the same materiality and ESG profile framework and use it to assess not just the issuer, but also the servicer and the underlying collateral, as well as examining the originators' motivation for the transaction, making sure that there is an appropriate alignment of risk.

For example, ESG considerations played an important role in an ABS issue we were recently analysing. We had concerns over the underwriting, servicing practices and long-term market commitment of the originator of a residential mortgage-backed portfolio and decided not to participate. The originator has since ceased underwriting new mortgages. While the securitisation issued should not be fundamentally impacted by this given the standard structural protections in place, it creates a level of noise that we are glad not to be exposed to.

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