COMMENTARY

Janus Henderson Horizon US Growth Fund

Q4 2019

Fund Managers Names: Derek J. Pawlak & W. Scott Priebe

Macro backdrop

2019 turned out to be a surprisingly vibrant year for equities considering emerging fears of a sharp global economic slowdown, the continuing (at times escalating) trade dispute between the US and China, lacklustre auto sales/housing starts, and fears that rising labour costs would combine to pressure both margins and profitability. This somewhat dire forecast proved to be false, and indeed as we flip the calendar to another year there are signs the economy could actually accelerate through 2020. However, assessing the appreciation potential for US equities in 2020 after the 30% plus returns across domestic growth equities in 2019 is clearly a difficult task. But if history is any guide, the average return following a strong 20% return year is 11%, and 83% of those observations are positive. Given our economic outlook we feel optimistic that 2020 will see a continuation of this bull market.

While the fourth quarter market performance was strong and broad-based, it was mainly driven by lower quality factors. This low quality bias was especially apparent when comparing the stock level performance based on S&P Quality Ratings, and C and D-rated companies were up 17.3% versus 4.1% for A+ rated companies. Overall, high quality companies (those rated B+ or better) returned 5.8% versus 10.4% for low quality (those rated B or below).

Fund performance and activity

The fund* returned 7.5% versus 7.7% for the Russell 3000 Growth Index.

At the sector level the greatest detractors were health care, technology and consumer staples which detracted 1.4%, 1.1% and 0.2% respectively. At the stock level the greatest detractors were Church & Dwight, Ecolab and Grand Canyon Education which all detracted 0.1%. Shares in Church & Dwight were weak after the company posted a lacklustre quarter where revenue was reported in-line and where earnings beat but the underlying fundamentals were weaker than expected. The company posted 3% organic revenue growth, but this was driven by increasing prices rather than greater volume. Ecolab shares were down just over 2% during the period and quarterly earnings were mixed; earnings came in just ahead of expectations but revenue missed. Grand Canyon reported a strong quarter with a beat on revenue and earnings per share (EPS) and management raised 2019 guidance. Unfortunately, its shares were down because the DOE notified the company that it will not be recognised as a not-for-profit; this was unexpected as the IRS will recognise it as a non-for-profit, in addition to state and local authorities. However, investors fear this could taint the brand and make marketing more difficult for the company.

Contributing to performance at the sector level were financial services and consumer discretionary at 0.3% and 0.1% respectively. At the stock level the greatest contributors were Paycom Software, Adobe and Microsoft, up 1.0%, 0.7% and 0.5% respectively. Paycom once again reported another beat and raise in the quarter; the company grew revenue 31% year-on-year and drove strong EBITDA and EPS growth as well. The company raised 2019 guidance beyond the third quarter beat and continues to make investments in new offices and driving customer engagement which in turn drives higher client retention. Adobe posted strong quarterly results with revenue and earnings coming in ahead of expectations. Microsoft reported extremely strong results with earnings and revenue surprising to the upside and while nearly every segment saw strength, strong cloud results drove the beat.

Outlook/strategy

To say we closed out the decade on a high note from a market perspective is an understatement. We began the decade emerging from the worst bear market since the Great Depression and concluded the decade at all-time highs, even amid a backdrop of a host economic and political challenges. The question on many investors' minds is what will the forthcoming decade bring with respect to investment returns. History would show a decade which produces a double-digit annualised return does not necessary imply the following decade's performance will be challenged. From a risk perspective, corporate debt and non-bank debt balances continue to grow and should a problem manifest in one of these areas then liquidity may become an issue. This risk is heightened by the immense inflows into ETFs, where Vanguard, State Street and BlackRock rank in the top ten holders of nearly every company - owning in many cases 20-30% of the shares outstanding aggregately. Should the market face disruptions and equity investors simultaneously hit the sell button, we fear the door may not be wide enough for all investors to exit, potentially creating a liquidity-driven panic. However, given the backdrop of new trade agreements, lower corporate taxes, US energy independence, strong demographics both in terms of population growth (relative to the rest of the developed world) and consumption driven by the largest transfer of wealth in history (as children of boomers receive inheritance), we remain constructive on the US markets looking forward.

Source: Janus Henderson Investors, as at 31 December 2019

* Gross of fees - gross of 5% initial sales charge. Calculated on a bid to bid basis, with gross income reinvested in USD.

Note: Reference to any specific company or stock is for information purposes only and should not be construed as a recommendation to buy or sell the same.

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