4Q16 PORTFOLIO COMMENTARY

# Janus Short-Term Bond Fund

JANUS®

## Investment Environment

Early in the quarter, positive economic data bolstered sentiment around the overall state of the U.S. economy. This caused investors to coalesce around the expectation that the Federal Reserve (Fed) would raise interest rates by the end of the year, and triggered a move upward in Treasury yields. The election of Donald Trump to the U.S. presidency in November added optimism of pro-growth fiscal policies and increased inflation expectations to the already strengthening economic picture. Rates continued to climb, while risk assets, including corporate credit, rallied over the prospect of growth – trends that continued through quarter end.

On December 14, the Fed announced a widely expected 25 basis point increase to the target federal funds rate, and a projection of three additional hikes in 2017. The yields on the 5- and 10-year Treasury notes bore the brunt of the impact of the Fed's projections, although rates across the U.S. yield curve rose considerably during the quarter. The yield on the 2-year note ended December at 1.19%, up from 0.76% at the end of September.

Investment-grade and high-yield corporate credit spreads continued to grind tighter, driven by the incoming administration's proposals for an easing regulatory landscape coupled with tax reform and other pro-business initiatives.

## Performance Discussion

The Fund outperformed its benchmark, the Bloomberg Barclays 1-3 Year U.S. Government/Credit Index, during the fourth quarter.

Throughout the quarter, we continued to take advantage of price dislocations in what we believe to be issuers with higher quality business models and strong spread carry – a measure of excess income generated by the Fund's corporate credit holdings. We increased emphasis on securities and sectors that could benefit from potential changes in fiscal policy. Yet our conservative bias and focus on the front end of the curve remained intact. We shifted our positioning near quarter end in an attempt to protect capital amidst rising rates and higher inflation. An actively tightening Fed in combination with rising inflationary pressures led us to reduce our duration exposure from U.S. Treasurys, and we modestly increased our exposure to bank loans. In our view, loans – which benefit from a senior position in the capital structure and can offer protection in a rising-rate environment – will offer stable and attractive risk-adjusted opportunities in the coming year.

Our out-of-index allocation to high-yield corporate credit was the leading contributor to relative results. Investment-grade corporate credit also contributed as spread carry and our overweight allocation proved beneficial. Outperformance was concentrated in the lowest tier of investment-grade ratings and the highest tier of high yield, both of which saw spread tightening on the prospect of economic growth leading to improved fundamentals.

Further supporting performance was our off-benchmark allocation to bank loans. The floating rate nature of the instruments aided results as short-term interest rates ticked higher. The Fund also benefited from the generally higher yields on the instruments.

**Portfolio Manager:**
**Darrell Watters**

**Portfolio Manager:**
**Mayur Saigal**

## Executive Summary

- The Fund outperformed its benchmark during the fourth quarter.
- Our positioning in high-yield corporate credit was the leading contributor to relative performance.
- We expect that investor optimism in conjunction with a stronger dollar and relatively higher oil prices will continue to propel rates upward across the yield curve in the coming year.

Our out-of-index allocation to asset-backed securities (ABS) was also additive to relative returns. Some of our subprime auto securities benefited from spread tightening during the quarter. We view ABS as opportunistic investments, seeking those where our analysts can form a constructive fundamental view on the underlying assets.

At the corporate credit sector level, banking, wireline communications and lodging were the leading contributors to relative performance. Outperformance in banking was due to our overweight allocation. The sector benefited from a long-awaited steepening yield curve and Mr. Trump's plans for a more relaxed regulatory environment.

Yield curve positioning in wireline communications, including a duration underweight in AT&T, also aided returns. The announcement of AT&T's acquisition of media company Time Warner resulted in general spread widening in the name as investors expect the merger will come with a large debt issuance and a credit downgrade. The telecommunications company was among our leading individual corporate credit contributors as the news had minimal impact on the front-end paper we own.

Within lodging, outperformance was driven largely by yield curve positioning, including bank loan exposure to Hilton. The company also benefited from its improving earnings profile after spinning out the time share portion of its business. We appreciate management's focus on pursuing an investment-grade rating.

Specific asset classes, credit sectors and individual issuers weighed minimally on performance during the quarter. However, Equifax was the largest individual corporate detractor from relative results as our duration positioning in the consumer credit reporting agency was negatively impacted by rates rising in the belly of the curve.

For detailed performance information or to download a Fact Sheet, please visit www.janus.com/funds

## Outlook

Investor sentiment has changed dramatically with the election of Mr. Trump. The pro-business initiatives his administration has proposed have already generated a more positive outlook for the U.S. economy and triggered increased growth and inflation expectations. In our view, this optimism in conjunction with a stronger dollar and relatively higher oil prices will continue to propel rates upward across the yield curve in the coming year. We anticipate a steeper curve, with the front end moving on Fed projections and the long end rising further on increased inflationary expectations. The Fed's forecast for three interest rate hikes in 2017 is in line with our expectations, although we believe more hikes could be warranted in a reflationary environment. As a result, we will continue to actively manage duration and yield curve positioning, with the expectation of maintaining duration below that of the benchmark.

New fiscal policies for tax reform, industry deregulation and infrastructure spending, if properly implemented, should drive increased growth and inflation in the U.S., enabling the recent earnings recession to shift toward improving corporate fundamentals in 2017. Organic growth prospects and the accompanying rise in operating earnings would allow companies to grow into their capital structures, reversing the recent trend of increasing leverage. For the past two years we've seen accommodative monetary policy prolong the latter stages of a credit cycle, and we believe the results of the U.S. election may have just further extended the cycle. Global demand for U.S. corporate credit – due to its comparatively higher yields versus other global fixed income asset classes – also contributes to our modestly improved outlook.

Market moves in the coming year will largely be determined by the success of Mr. Trump's policy execution, in our view, and we will closely monitor the difference between rhetoric and implementation, as well as the transition from policy intentions to growth. Our analysts are conducting in-depth, bottom-up research to identify issuers with higher quality business models and strong fundamentals, particularly in sectors that may benefit from a change in economic policy. Fiscal stimulus should spur improved fundamentals in the industrial and consumer sectors. Reduced regulation should prove advantageous for financials – a sector also set to benefit from a steepening yield curve. Pharmaceuticals and technology companies may benefit from the repatriation of foreign capital, which could reduce bond issuance from these sectors and improve the technical backdrop. Hospital cash flows could improve if Mr. Trump succeeds in dropping the corporate tax rate, and while hospitals will be impacted by a potential revocation of the Affordable Care Act (ACA), we believe the market is overreacting given the societal need for hospital services, leaving these asset-rich entities at attractive valuations.

With growth prospects on the horizon, we are taking a selectively opportunistic approach to U.S. corporate credit, yet we remain mindful of tighter spread levels after tightening in 2016. We are also closely watching the ability for corporate spreads to hold near current levels in a rising-rate environment.

Our focus remains on issuers with higher quality business models, ample liquidity, strong free-cash-flow generation potential and commitment to a sound balance sheet. We continue to seek issuers that provide greater spread carry than the index. In this extended cycle, the importance of security avoidance remains a central aspect of our investment process. We intend to maintain a conservative bias, reflecting our commitment to deliver capital preservation and strong risk-adjusted returns for our clients.

## Top Relative Contributing and Detracting Issuers Held for the Quarter Ended 12/31/16

| Top Contributors | Average Weight (%) | Relative Contribution (%) | Top Detractors | Average Weight (%) | Relative Contribution (%) |
|---|---|---|---|---|---|
| Santander Drive Auto Receivabl | 2.75 | 0.02 | Equifax Inc | 0.76 | -0.02 |
| Hilton Worldwide Finance | 1.05 | 0.02 | CIT Group Inc | 2.32 | -0.02 |
| Morgan Stanley | 1.80 | 0.02 | Charter Communications (CCO Holdings, LLC) | 1.57 | -0.01 |
| AT&T Inc | 2.16 | 0.01 | Penske Truck Leasing Co Lp | 0.76 | -0.01 |
| Allergan, Plc | 2.13 | 0.01 | Total System Services Inc | 0.62 | -0.01 |

The holdings identified in this table, in compliance with Janus policy, do not represent all of the securities purchased, held or sold during the period. To obtain a list showing every holding as a percentage of the portfolio at the end of the most recent publicly available disclosure period, contact 877.33JANUS (52687) or visit janus.com/advisor/mutual-funds.

Relative contribution is the difference between the issuer's contribution to the portfolio's performance versus that issuer's contribution to the benchmark's performance. It reflects how the portfolio's holdings impacted return relative to the benchmark. Cash and issuers not held in the portfolio are excluded.

**Please consider the charges, risks, expenses and investment objectives carefully before investing. For a prospectus or, if available, a summary prospectus containing this and other information, please call Janus at 877.33JANUS (52687) or download the file from janus.com/info. Read it carefully before you invest or send money.**

Past performance is no guarantee of future results. Call 877.33JANUS (52687) or visit janus.com/advisor/mutual-funds for current month-end performance.

Discussion is based on performance of the Fund's "parent" share class (typically that with the longest history).

As of 12/31/16 the top ten portfolio holdings of Janus Short-Term Bond Fund are: United States Treasury Note/Bond (2.82%), Wells Fargo Bank NA (2.23%), BellSouth LLC (2.22%), United States Treasury Bill (2.22%), United States Treasury Bill (2.22%), United States Treasury Note/Bond (2.10%), United States Treasury Note/Bond (1.91%), CIT Group Inc (1.83%), United States Treasury Bill (1.62%) and Anheuser-Busch InBev Finance Inc (1.42%). There are no assurances that any Janus portfolio currently holds these securities or other securities mentioned in this commentary.

The opinions are as of 12/31/16 and are subject to change at any time due to changes in market or economic conditions. Janus may have a business relationship with certain entities discussed. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

For fixed income portfolios, relative contribution is calculated by rolling up securities by issuer and comparing the daily returns for securities in the portfolio relative to those in the index. Relative contribution is based on returns gross of advisory fees, and may differ from actual performance.

**A Fund's performance may be affected by risks that include those associated with nondiversification, non-investment grade debt securities, high-yield/high-risk securities, undervalued or overlooked companies, investments in specific industries or countries and potential conflicts of interest. Additional risks to a Fund may also include, but are not limited to, those associated with investing in foreign securities, emerging markets, initial public offerings, real estate investment trusts (REITs), derivatives, short sales, commodity-linked investments and companies with relatively small market capitalizations. Each Fund has different risks. Please see a Janus prospectus for more information about risks, Fund holdings and other details.**

**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.**

**Foreign securities are subject to additional risks including currency fluctuations, political and economic uncertainty, increased volatility, lower liquidity and differing financial and information reporting standards, all of which are magnified in emerging markets.**

**High-yield/high-risk bonds, also known as "junk" bonds, involve a greater risk of default and price volatility than U.S. Government and other high quality bonds. High-yield/high-risk bonds can experience sudden and sharp price swings which will affect net asset value.**

**Bloomberg Barclays 1-3 Year U.S. Government/Credit Index** measures Treasuries, government-related issues and corporates with maturity between 1-3 years.

A Fund's portfolio may differ significantly from the securities held in an index. An index is unmanaged and not available for direct investment; therefore its performance does not reflect the expenses associated with the active management of an actual portfolio.

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