




**JANUS CAPITAL**<sup>®</sup>  
Group



**Winter 2017 Ski Report:**  
**JANUS EQUITY OUTLOOK**  
Equities Play the Trump Card

We're happy to be away from the consensus views of crowds. And on winter weekends, we're happier yet to be in the heart of ski country. In our regular equity outlook, we combine investing and skiing to map the current market terrain. Like a ski day, markets offer a mixture of riskier paths and easier ones. We'll point out the positive and negative themes driving equities, and tips to navigating those themes more effectively.



Green runs signal easier paths, but watch for crowds and stay away from the pack.



The blue runs highlight issues that are less dangerous, but not without pitfalls. These are attractive runs but proceed with care.



Black runs are themes that present key risks to equity markets. Be careful and alert before proceeding.

# Equity Outlook

We start with our usual three equity outlook scenarios: The green runs represent our most optimistic case and the easiest path forward for stocks. The most likely and more moderate outlook is reflected in the blue runs. The worst-case and most difficult scenario for equities is represented by the black runs.

With a new administration heading to the White House, our best-case “green runs” scenario calls for a stronger U.S. economy, improved confidence and the return of risk-taking to the equity market. In turn, active stock picking becomes especially important, as stocks are driven more by corporate fundamentals and less by the return of cash to shareholders and other financial engineering.

In our more moderate “blue runs” scenario, political risks continue, especially in Europe, where several countries will hold key elections in 2017. The U.S. economy improves, but stocks – having already priced in reforms that are not yet guaranteed – could experience some bumps. In addition, rising interest rates help boost bank profits but weigh on certain high-yielding equities.

And in our worst-case “black runs” scenario, volatility rises under Donald J. Trump, who in his unofficial role as “Commander in Tweet” causes short-term sell-offs. Populism in both the U.S. and in Europe gains momentum, leading to anti-growth measures, such as trade tariffs and restrictive immigration policies. In addition, an increasingly strong dollar impairs U.S. exports and thwarts the positive effects of growth-oriented reforms.

As usual, we see the blue runs as the most likely scenario, followed by the green and then the black runs. At the end of 2016, the market seemed to embrace the best-case outlook, with stocks rallying to new highs. But with so much change on the way for the new year, we remain cautiously optimistic and dedicated to focusing on what matters most: corporate fundamentals.





# The Green Runs

Green runs signal easier paths. But watch for crowds and stay away from the pack.

- > **Flight to safety ends**

Defensive stocks sell off and risk-taking returns to the market

- > **The economic outlook improves**

A new administration and Federal Reserve (Fed) rate hike boost confidence

- > **Mergers and acquisitions (M&A) continue**

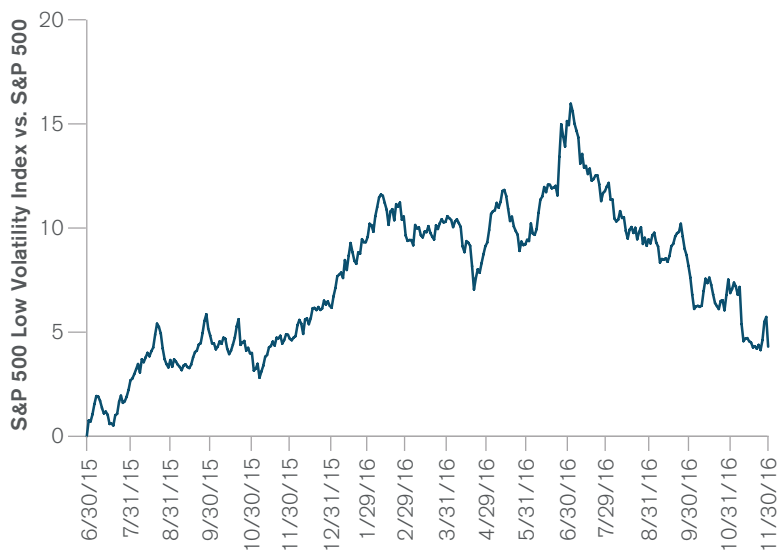
A good time to own growth stocks

# Flight to Safety Ends

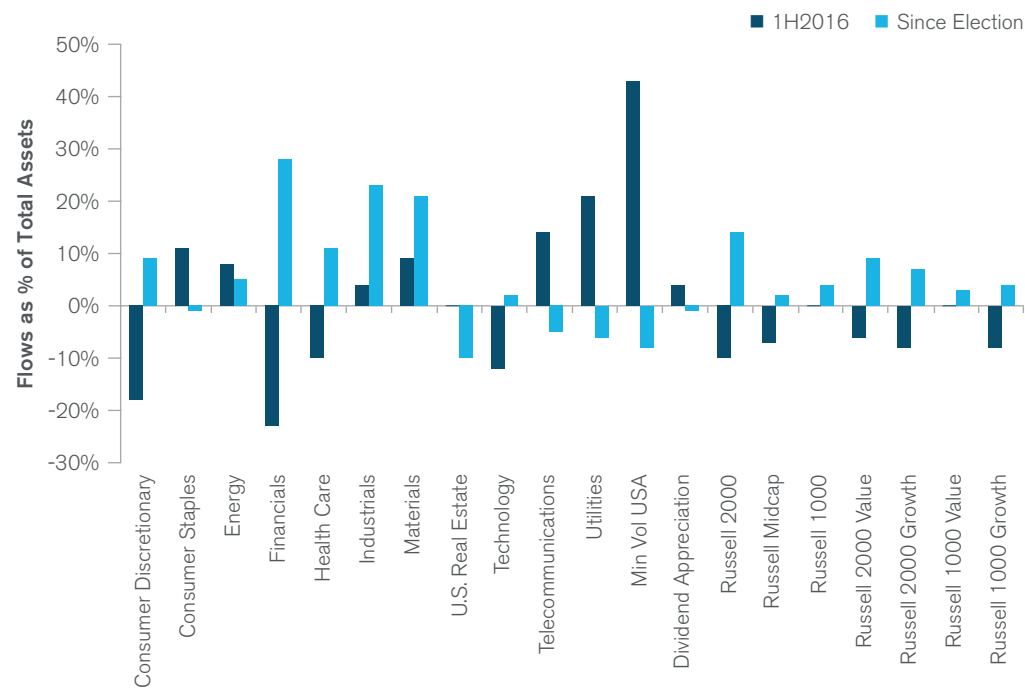
## Risk-taking returns to the market

- > Low-volatility stocks begin to underperform
- > ETF flows show a renewed appetite for risk
- > The market's equity outlook has changed – and it's good

### Low Volatility Stocks vs. S&P 500

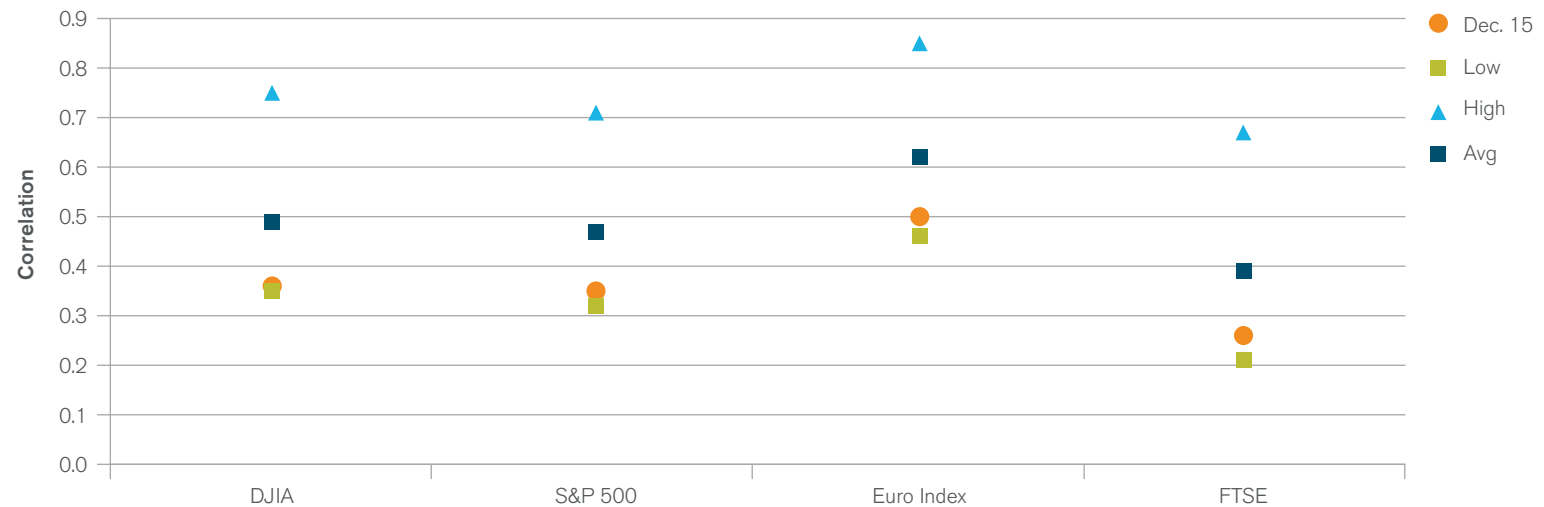


### ETF Flows as a % of Total Assets



# Ski Tip: Focus on Fundamentals

## Stock Correlations Within Indices



## The Way Down

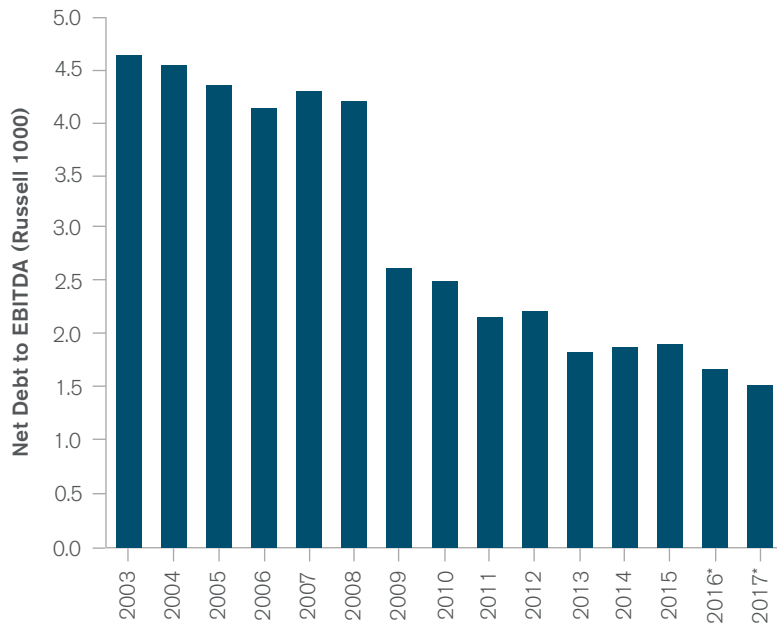
- > Active stock-picking will matter more as macroeconomic risks diminish and stocks are propelled by corporate fundamentals. Factors such as volatility, momentum and yield no longer dominate returns.

# The Economic Outlook Improves

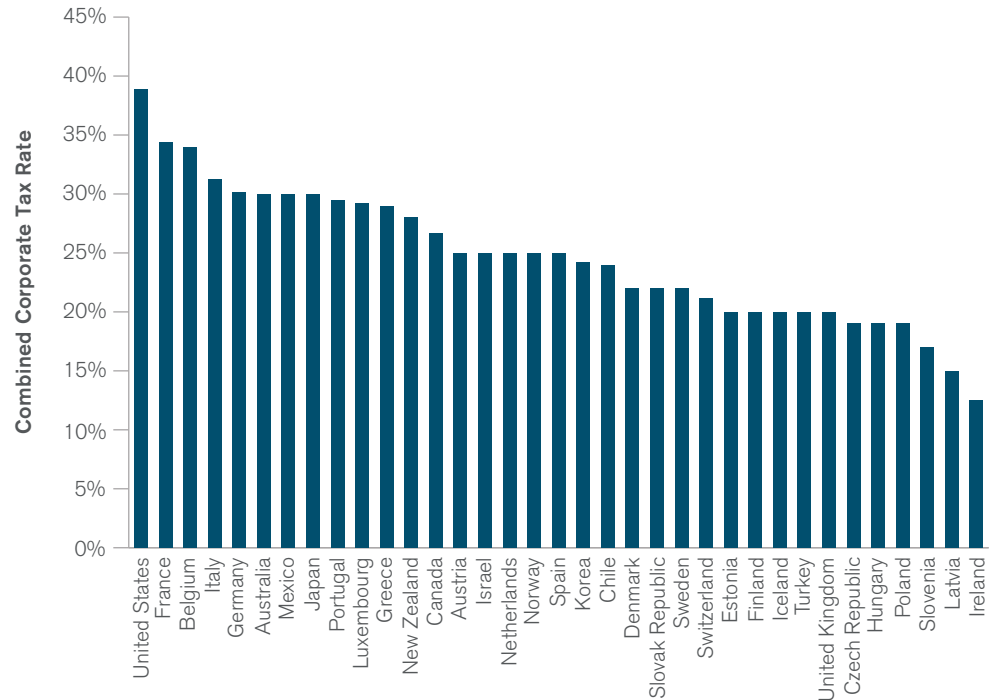
## A new administration and Fed rate hike boost confidence

- > Markets have shrugged off the political shocks of Brexit, Trump and Italy, showing confidence in corporate fundamentals
- > Businesses will grow by investing in capital goods, not through financial engineering
- > The Fed's outlook has turned positive and corporate tax rates could fall under the new administration

### Corporate Leverage



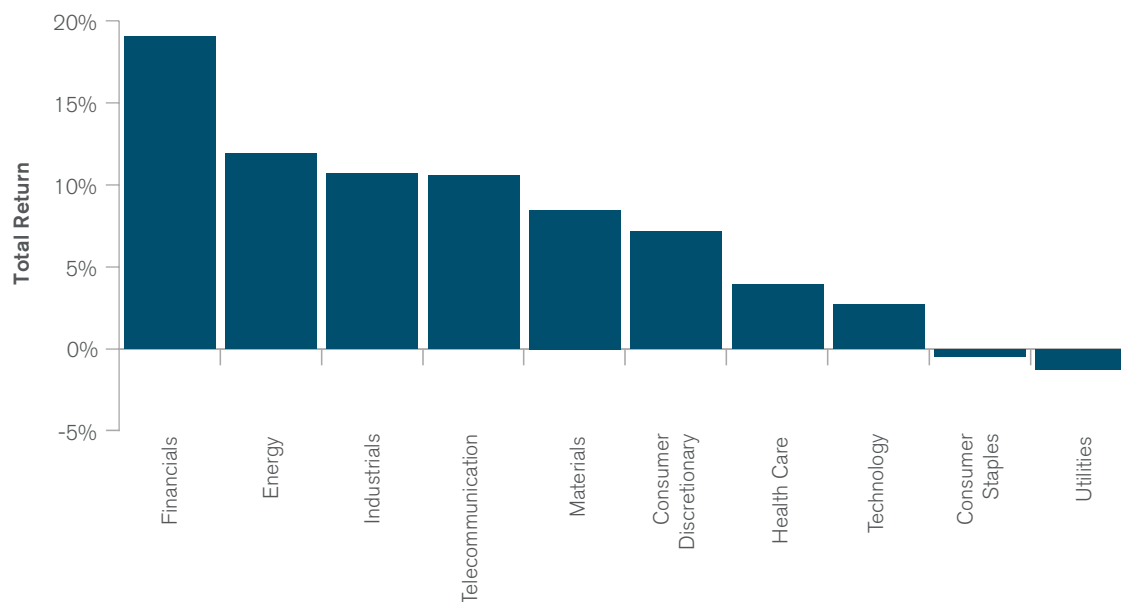
### Corporate Tax Rates By Country



\*Estimate. Source: Janus, Bloomberg, Organisation for Economic Co-operation and Development (OECD)

# Ski Tip: Avoid Chasing Sectors

S&P 500 Sector Returns Since 11/1/16



## The Way Down

- > The initial market reaction is now behind us. Pay attention to company fundamentals and be mindful that ETF flows can accentuate broad market moves.



# M&A Continues

## A good time to own growth stocks

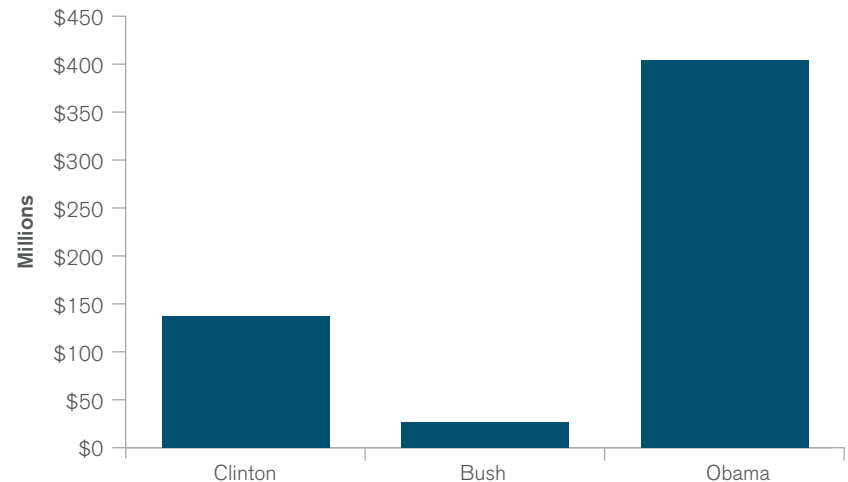
- > Lower regulatory hurdles and increased corporate spending will fuel M&A activity
- > Growing companies make for good acquisitions
- > Buy growth, not turnarounds

### Failed M&A Activity

2011-2016

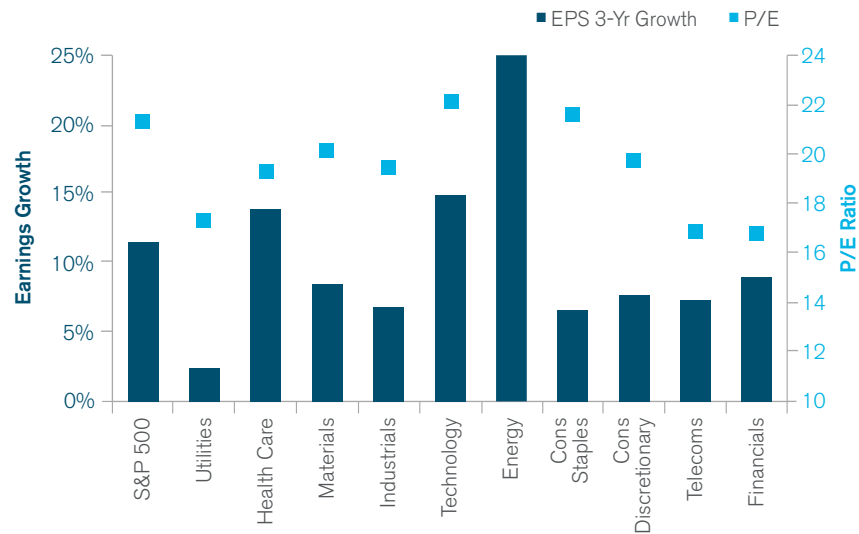
Buyer	Target	Deal Value \$million	Year
Pfizer	Allergan	160	2016
Comcast	Time Warner	71	2015
AbbVie	Shire	55	2014
AT&T	T-Mobile	39	2011
Halliburton	Baker Hughes	25	2016
NASDAQ	NYSE	11	2011
Staples	Office Depot	6	2016

### Value of Blocked Deals



# Ski Tip: Ignore Financial Engineering

Earnings Growth and P/E by S&P 500 Sector



## The Way Down

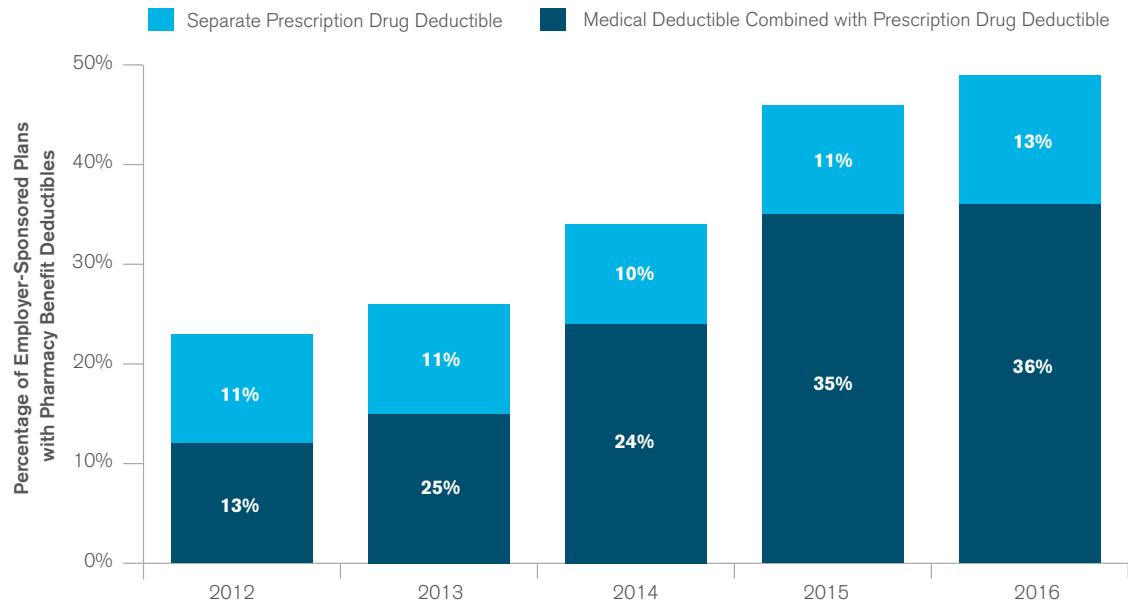
- > Focus more on business operations. Based on current multiples and earnings growth estimates, equities look attractive, even with higher interest rates.

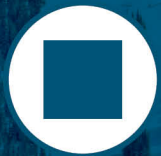
# Health Care

New regulations and rising costs will emphasize the importance of stock picking

## Patients Shouldering More Drug Costs

Percentage of employer-sponsored health care plans with combined or separate prescription drug deductibles, by year





# The Blue Runs

The blue runs highlight issues that are less dangerous, but not without pitfalls. These are attractive runs but proceed with care.

- > **Financials rebound**  
But competition for deposits limits the benefit of a steeper yield curve
- > **Europe recovers**  
Corporate balance sheets have improved but political risk remains
- > **Yields rise**  
A stronger economy means challenges for yield-driven investors

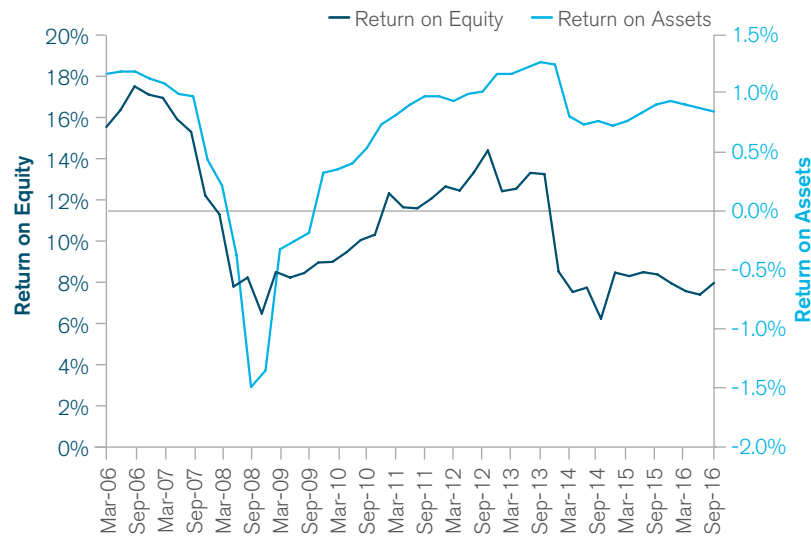
# Financials Rebound

## Competition for deposits limits the benefits of a steeper yield curve

- > The Dodd-Frank Act is not going away, but regulatory pressures are likely to hit a plateau
- > Higher rates help bank profits, but competition for cash deposits could weigh on net interest margins
- > As the economy improves, capital expenditure could fuel demand for bank loans

### U.S. Bank Profitability

(MSCI U.S. Banks Index)



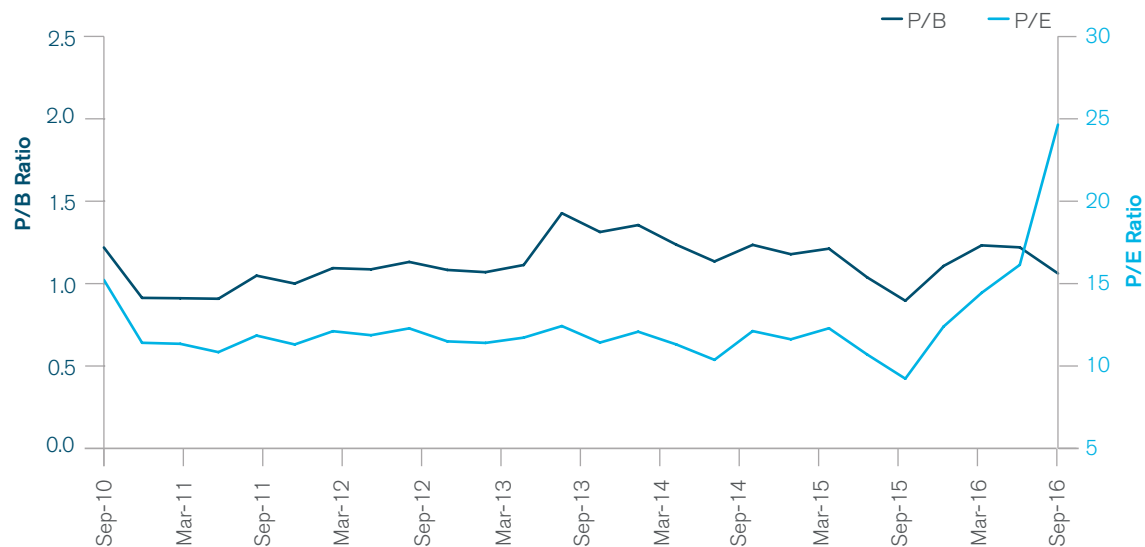
### Yield Curve Steepness





# Ski Tip: Focus on Valuation

## U.S. Bank Valuation (MSCI U.S. Banks Index)



## The Way Down

- > Multiples for financials now assume that net interest margins and return on equity (ROE) will climb in 2017. The multiples also assume additional Fed rate hikes over the next 12 months. All are plausible but not guaranteed.

# Europe Recovers

## Corporate balance sheets have improved but political risks remain

- > Corporations are healthy operationally and consumer confidence has improved
- > Still, Brexit details are unknown and populist sentiment could sway key elections in 2017
- > A weak euro and aggressive European Central Bank (ECB) helps, but how will the market react when easy-money policies are scaled back?

### European Operating Margins

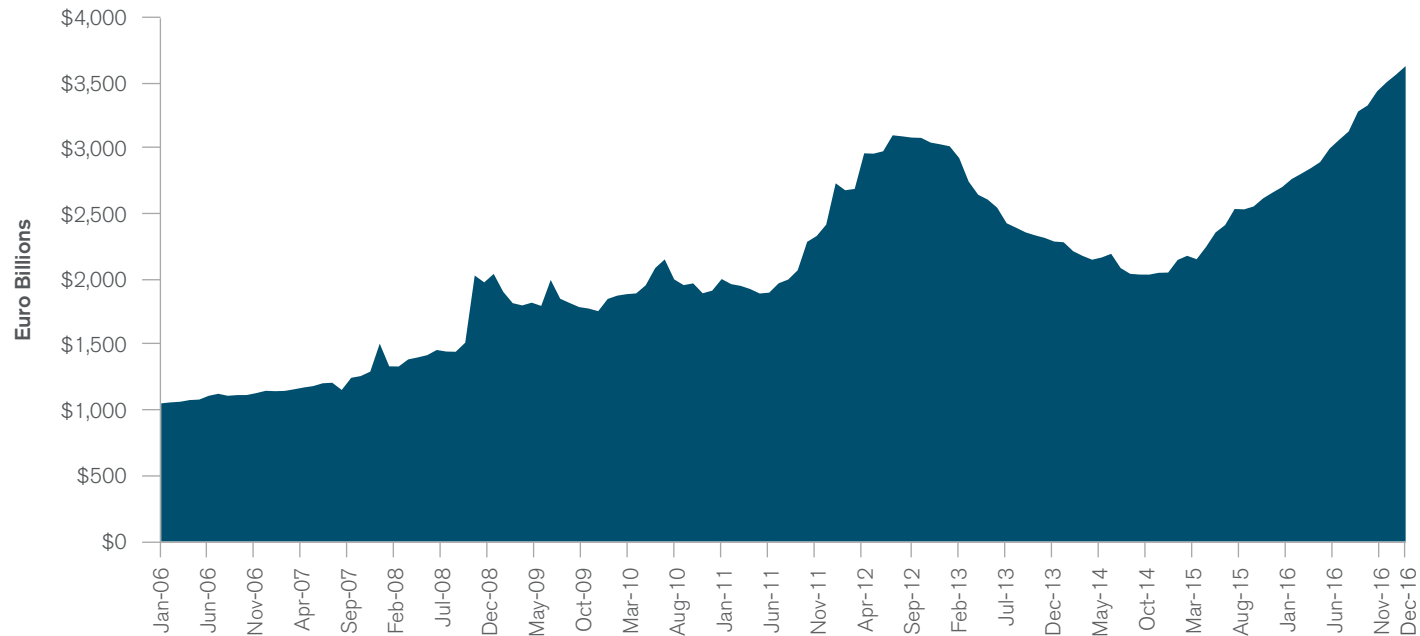


### Eurozone Consumer Confidence



# Ski Tip: Consider Key Growth Metrics

ECB Balance Sheet



## The Way Down

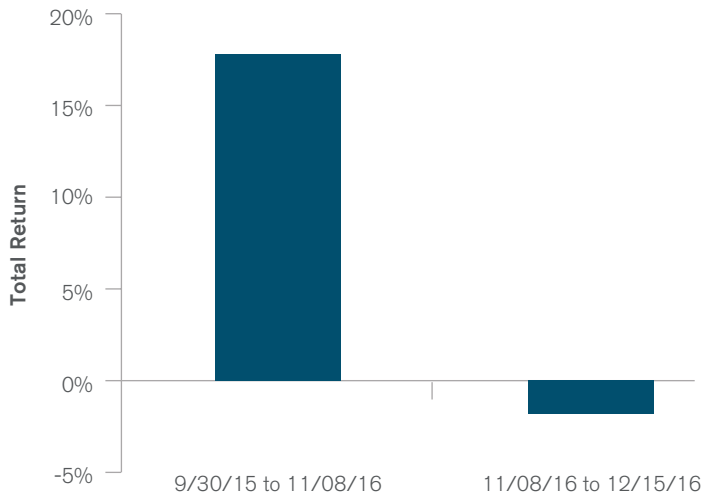
- > Key metrics include increased business investment, rising exports (thanks to a weak euro) and faster inflation. If these lead to higher interest rates, the European economy and financial sector benefit.

# Yields Rise

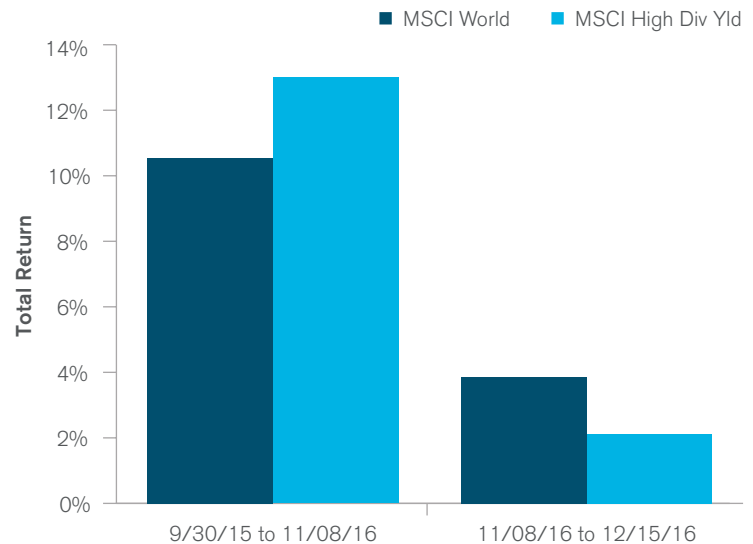
## A stronger economy means challenges for yield-driven investors

- > The yield trade in equities is over. Now what?
- > The Fed is signaling a stronger economy and markets are pivoting
- > Not all yield is bad. Some high-yielding sectors can grow with more economic activity

### S&P 500 Utilities Sector Performance

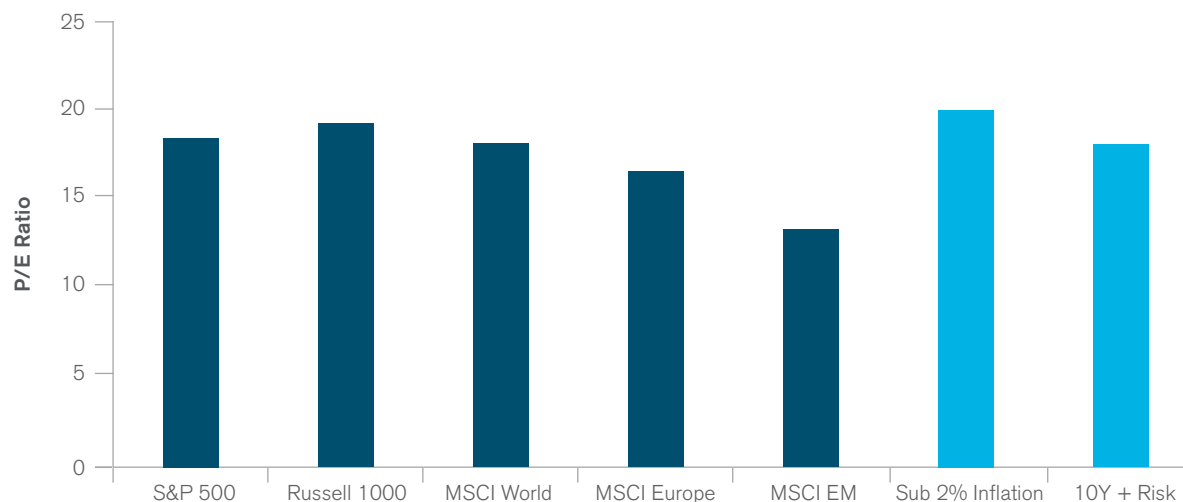


### MSCI Index Performance



# Ski Tip: Look for Yield with Growth Opportunities

P/E Ratios for Major Indices



## The Way Down

- > Earnings growth can offset rising rates, especially if risk premiums fall. Some yield plays could surprise, such as master limited partnerships (MLPs) and real estate investment trusts (REITs), which benefit from higher oil prices or improved economic activity.

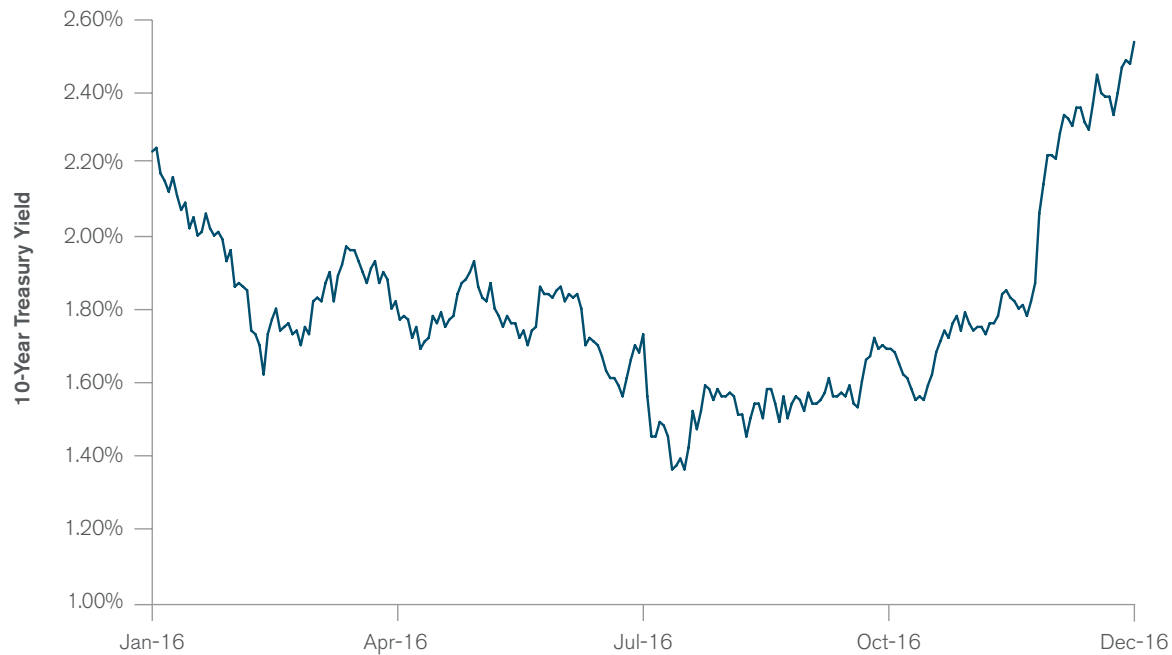


# Financials

## New opportunities and risks

### Rates Go Higher

Daily 10-Year U.S. Treasury Yield, YTD





# The Black Runs

Black runs are themes that present key risks to equity markets. Be careful and alert before proceeding.

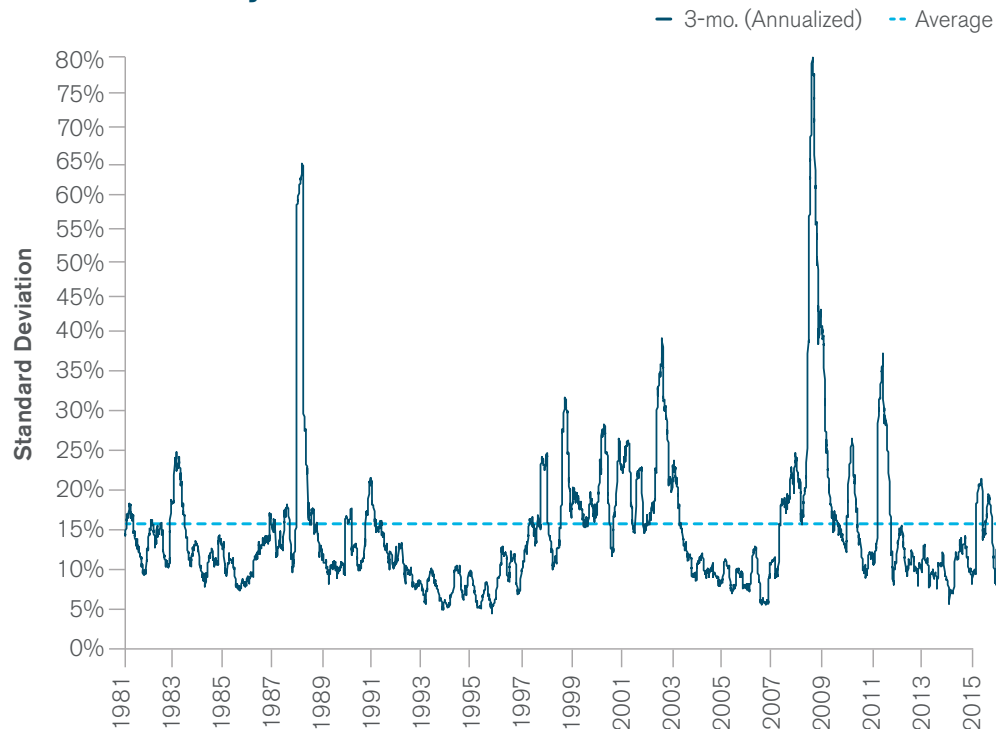
- > **Market noise escalates**  
Volatility under Donald J. Trump, the “Commander in Tweet”
- > **The dollar rises**  
The challenge of an increasingly strong greenback
- > **Populism**  
Not popular with every sector

# Market Noise Escalates

## Volatility under the “Commander in Tweet”

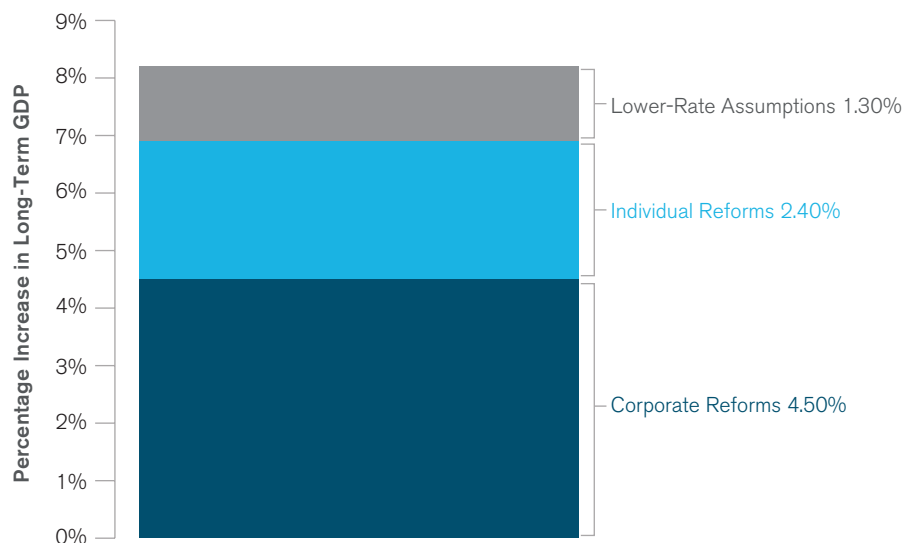
- > Expect volatile days as markets react to uncertain policies
- > Pro-business minds could prevail
- > Volatility remains moderate, which is good for stocks if correlations are low

### S&P 500 Volatility



# Ski Tip: Consider Risks to Growth

## Impact of Projected Tax Reforms on GDP



## The Way Down

- > Equity returns now depend on stock selection, not sector positioning. The Trump administration will likely have a pro-growth agenda, but the market is overlooking the long-term risk of rising U.S. federal debt, which could grow with lower corporate tax rates and increased federal spending.

# The Dollar Rises

## The challenge of an increasingly strong greenback

- > Expect the dollar to continue rising. But a strong dollar eventually could get in the way of Trump administration policies
- > Trade barriers and inflation fears could undermine currency policy
- > China's currency policy in 2017 is important, but Brexit and Europe's path matter, too

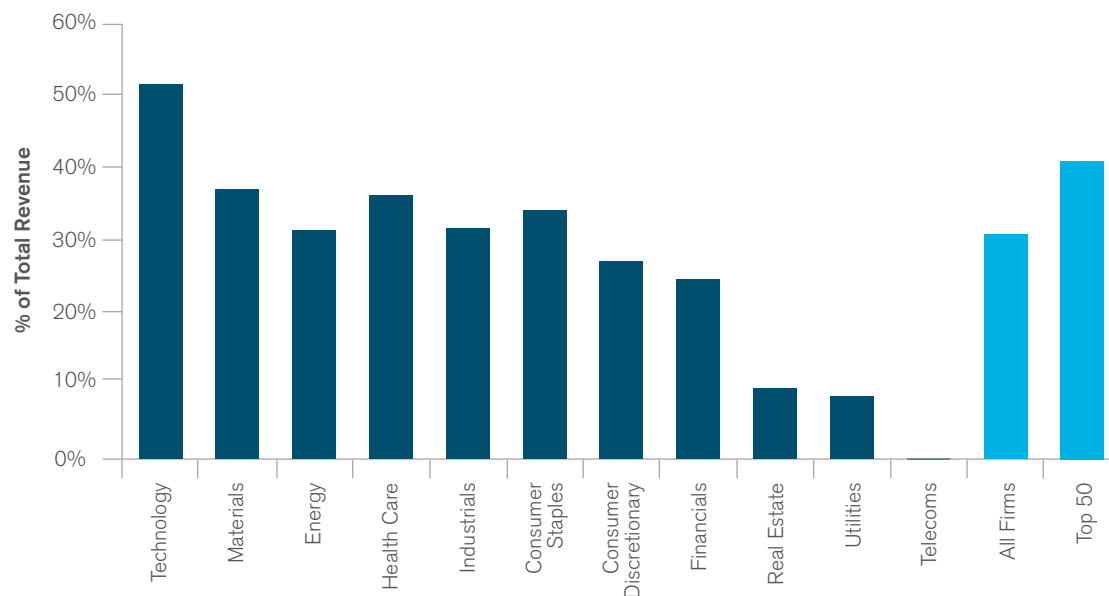
**A Rising Dollar**





# Ski Tip: Look Beyond the Headlines

Foreign Revenues in S&P 500



## The Way Down

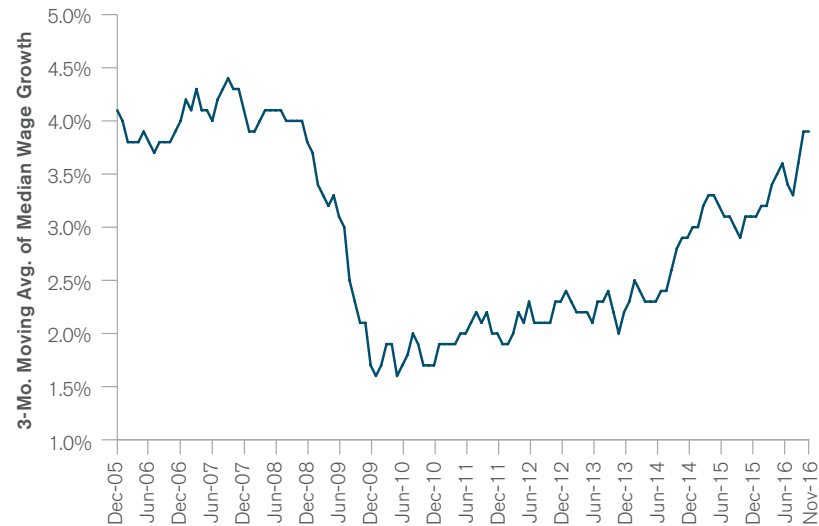
- > Technology has the highest foreign-revenue exposure, but the sector – along with other exporters – could benefit from earnings repatriation. Also, remember cost structures. What is lost in accounting translation may not hurt long-term competitive positioning.

# Populism

## Not popular with every sector

- > Although good for workers, rising wages cut into operating margins
- > Tax reform could hurt companies that import goods or services for resale in the U.S.
- > Lower-margin businesses with high labor costs would feel the biggest impact

### Wage Growth



# Ski Tip: Rising Costs Could Be a Headwind

## The Impact of Potential Tax Reform on Imported Goods

	Current Tax Code 100% U.S.-sourced COGS 35% tax rate	As Proposed 100% U.S.-sourced COGS 20% tax rate	As Proposed 100% imported COGS 20% tax rate
Sales	\$1,000	\$1,000	\$1,000
COGS	(\$600)	(\$600)	(\$600)
Gross Profit	\$400	\$400	\$400
Gross Margin Rate	40%	40%	40%
SG&A	\$200	\$200	\$200
Taxable Income	\$200	\$200	\$800
Taxes	\$70	\$40	\$160
Rate	35%	20%	20%
Net Income	\$130	\$160	\$40
Shares	\$100	\$100	\$100
EPS	\$1.30	\$1.60	\$0.40

## The Way Down

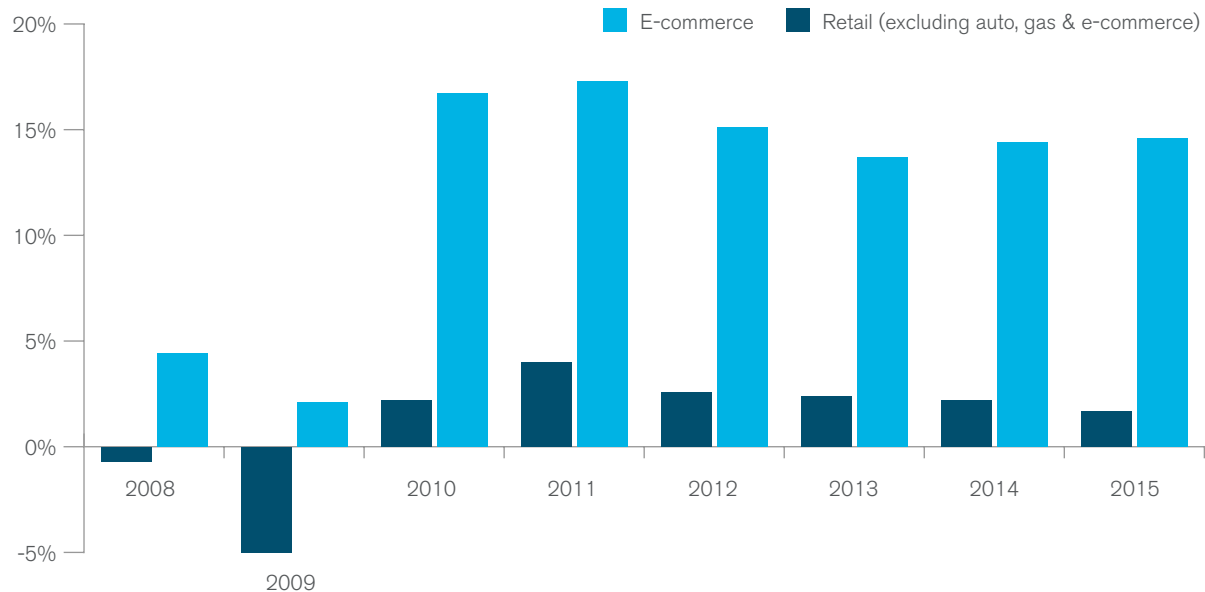
- > Wage pressure may create inflation, which could help equities. But companies with high wage costs would suffer. In addition, tax reform targeting imported goods would offset the benefit of lower corporate tax rates for some firms.

# Consumer Discretionary

Despite potential headwinds, e-commerce remains an area of growth

## More Shopping Online

Sales growth online vs. at traditional retailers



# Disclosures

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Past performance is no guarantee of future results.

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S&P 500<sup>®</sup> Index measures broad U.S. equity performance.

Russell 1000<sup>®</sup> Index measures the performance of the 1,000 largest companies in the Russell 3000<sup>®</sup> Index.

Russell 3000<sup>®</sup> Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.

Russell 2000<sup>®</sup> Index is an index that measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> Index.

Russell 1000<sup>®</sup> Growth Index measures the performance of those Russell 1000<sup>®</sup> companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000<sup>®</sup> Value Index measures the performance of those Russell 1000<sup>®</sup> companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI U.S. Banks Index is a market cap-weighted index, measuring the price appreciation of stocks in the Banks industry group.

MSCI World Index<sup>SM</sup> is a market capitalization weighted index composed of companies representative of the market structure of Developed Market countries in North America, Europe and the Asia/Pacific Region. The index includes reinvestment of dividends, net of foreign withholding taxes.

MSCI All Country World Index<sup>SM</sup> is an unmanaged, free float-adjusted market capitalization weighted index composed of stocks of companies located in countries throughout the world. It is designed to measure equity market performance in global developed and emerging markets. The index includes reinvestment of dividends, net of foreign withholding taxes.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. It consists of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI EAFE<sup>®</sup> (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization weighted index designed to measure developed market equity performance. The MSCI EAFE<sup>®</sup> Index is composed of companies representative of the market structure of developed market countries. The index includes reinvestment of dividends, net of foreign withholding taxes.

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DJIA: Dow Jones Industrial Average, a price-weighted average of 30 U.S. stocks

Euro Index: MSCI Euro Index, a benchmark of large-cap, developed-markets stocks in the European Economic and Monetary Union

FTSE: Financial Times Stock Exchange 100 Index, a benchmark of the 100 largest companies by market cap on the London Stock Exchange

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