1Q17 PORTFOLIO COMMENTARY

# Janus Growth and Income Fund

JANUS®

## Investment Environment

U.S. stocks continued their strong run well into the first quarter. Optimism was premised on the belief that the Trump administration would champion a series of pro-growth reforms. Economic data lent support to the notion of a strengthening U.S. economy. Even prior to any legislation being passed, gains in nonfarm payrolls accelerated and average hourly wages registered the highest year-over-year increase since 2009. A key U.S. manufacturing survey also achieved a recent high. This favorable environment was a key factor in allowing the Federal Reserve (Fed) to raise interest rates by a quarter of a percentage point at its March meeting. After peaking in early March, however, many key U.S. indices slid over the remainder of the period. The Trump administration's failure to pass a replacement for the Affordable Care Act raised concerns that other anticipated reforms would not be successful.

## Performance Discussion

The Fund underperformed its S&P 500 Index benchmark during the quarter. We seek to provide our clients with both growth of capital and quarterly income. As part of that investment mandate, we focus much of our research efforts on identifying large, well-established companies that should be in a position to grow free cash flow and continue increasing their dividend over longer time horizons. We think investing in companies that pay out the majority of their free cash flow in dividends and have the ability to grow their dividends over time will drive better risk-adjusted performance over the long term.

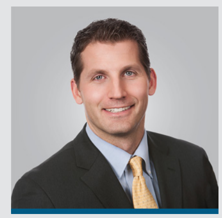
L Brands was the leading detractor amid continued weakness in apparel retailers. Investors have also been skittish as L Brands restructures its Victoria's Secret business, which has included leadership changes, the exit from swimwear/non-core apparel, and promotional strategy repositioning. Management has also seen margin pressure as a result of investing in sport apparel. The general weakness in mall traffic weighed on the stock, especially given the weakness in the fourth quarter holiday season. Although we continue to appreciate the company's roughly 5% dividend yield, we are closely monitoring the future of mall retailers as a whole.

Chevron was also among the leading detractors. The integrated oil and gas giant was negatively impacted as oil prices fell during the quarter. Escalating U.S. shale production, coupled with news that countries are not complying with OPEC's agreement to reduce supply, knocked the price of crude below $50 per barrel late in the quarter. However, we continue to appreciate Chevron's enviable position in the Permian Basin (spanning part of Texas and New Mexico) compared with other integrated oil and gas peers.

Kroger, a national grocery-store chain, also weighed on returns during the quarter. Given the company's fixed cost base, the stock suffered from the continued decline in food prices. Although Kroger continues to gain market share from its competitors, the gains have slowed amid increased competition. We think the capital investments that Kroger is making in both new and existing stores will eventually lead to higher free cash flow per share. However, we are concerned about the challenging environment and are closely monitoring the stock.

While the aforementioned stocks weighed on performance, we were pleased by the results of other companies in the portfolio. Apple was the leading contributor as iPhone sales stabilized during the quarter. This has lent to considerable optimism for the launch


**Portfolio Manager:**
**Marc Pinto, CFA**


**Portfolio Manager:**
**Jeremiah Buckley, CFA**


## Executive Summary

- Economic data lent support to the notion of a strengthening U.S. economy, which was a key factor in allowing the Fed to raise interest rates at its March meeting.
- The Fund underperformed its benchmark during the period.
- Despite concerns about President Trump's ability to carry out the anticipated tax and regulatory reforms, we remain optimistic that some pro-business changes can be made.

of Apple's 10-year anniversary product later this year. The continued growth of their high margin services business further aided the stock's performance. This business line is growing into a material portion of company profits and is more stable than product-based revenues that depend on innovation cycles. Investors also identified Apple as a beneficiary of potential tax reform that would enable multinationals to repatriate cash to the U.S. under less punitive rates. This could allow them to invest further in the business through merger and acquisition (M&A) activity, or return additional cash to shareholders. We appreciate that the company continues to return cash to its shareholders in the form of dividend increases and share buybacks.

Boeing was another top contributor. The airplane manufacturer rose after reporting stronger-than-expected fourth quarter earnings. Additionally, global air traffic continues to grow, which means more wear and tear on jets and, as a result, the faster replacement of planes – providing a favorable backdrop for the company's commercial airline business. We like Boeing's ability to generate free cash flow – which management often returns to shareholders, and appreciate the recent dividend increase.

CSX Corp. was another large contributor to performance. The stock was up after an announcement that a new CEO with a history of improving operations at railroad companies was taking the helm at the company. We had long believed that CSX's operating underperformance relative to other railroad companies made it rife for improvement, and believe better results will follow the new leadership. As CSX focuses on improving its service and reliability to customers, we believe it will continue to drive more shippers to use the railway instead of trucking services.

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

## Outlook

We continue to believe that U.S. stocks are well positioned, notwithstanding historically high valuations. Although the recent failure of the repeal and replacement of the Affordable Care Act has raised concerns about President Trump's ability to carry out the anticipated tax and regulatory reforms, we remain optimistic that some pro-business changes can be made.

Given the possibility of future volatility, we remain focused on finding companies that can continue to grow earnings and free cash flow over the long term. Although rising rates may weigh on high-yielding stocks, we believe investor demand for income will remain strong and that focusing on companies with growing dividends will help offset any multiple contraction. Therefore, we continue to favor firms that can both deliver high current income that is strongly supported by free-cash-flow generation and grow organically in most economic environments – which will enable them to raise these dividends over time.

## Top Contributors and Detractors for the Quarter Ended 3/31/17

| Top Contributors | Ending Weight (%) | Contribution (%) | Top Detractors | Ending Weight (%) | Contribution (%) |
|---|---|---|---|---|---|
| Apple Inc | 3.45 | 0.72 | L Brands Inc | 0.69 | -0.28 |
| Boeing Co | 3.35 | 0.45 | Chevron Corp | 2.19 | -0.20 |
| CSX Corp | 1.77 | 0.43 | Kroger Co | 1.13 | -0.20 |
| Hasbro Inc | 1.36 | 0.32 | Verizon Communications Inc | 1.66 | -0.14 |
| Eli Lilly & Co | 2.12 | 0.29 | TD Ameritrade Holding Corp | 0.99 | -0.12 |

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.

## Top Contributors

**Apple:** One of the world's largest mobile device and computer makers, Apple has been the beneficiary of incremental sales opportunities and increased penetration in new geographies, mobile service providers and product categories.

**Boeing:** The Boeing Company is the largest manufacturer of commercial jet aircraft in the world. The company also builds military aircraft and provides support services to both commercial airlines and the U.S. military. We believe Boeing could have the opportunity to grow its domestic and foreign defense businesses, particularly if the new U.S. administration is willing to increase defense spending. Growth in commercial air travel globally should lead to strong demand for its commercial airplanes, as will the increasingly efficient and reliable planes being produced through Boeing's innovation pipeline. Boeing also continues to make progress on lowering the production costs of the 787 aircraft. The cost reductions have led to higher free cash flow, which enabled the company to increase its dividend and repurchase shares.

**CSX Corp.:** The company provides traditional rail services and the transport of intermodal containers across the eastern U.S. We believe internal management changes will drive significant operational improvement at CSX relative to its peer group. Carload volumes are expected to stabilize in 2017 and beyond as headwinds including coal and other commodity groups stabilize while intermodal growth accelerates. We believe the operational leverage continues to be underappreciated by the market as cost efficiencies will allow CSX to realize industry leading incremental margins.

**Hasbro Bradley Inc.:** Hasbro provides children's toys, games, interactive software and infant products through a portfolio of industry leading brands that include Nerf, Magic: The Gathering, Monopoly, and Transformers. Hasbro is also the go-to partner for designing and manufacturing toys for the leading entertainment properties like Star Wars, Disney Princess, and Marvel. Hasbro has been at the industry forefront in leveraging the growing impact of these global media properties and linking with consumers digitally to increase their brand's appeal. Hasbro has also been very disciplined about managing their costs and finding efficiencies in their supply chain, which has led to growing free cash flow which has been returned to shareholders through increasing dividends and share repurchases.

**Eli Lilly:** Pharmaceutical giant Eli Lilly has ramped up research and development (R&D) spending in recent years

## Top Detractors

**L Brands:** We believe the retailer's two largest brands, Victoria's Secret and Bath & Body Works, are uniquely advantaged because of their strong brand equity, dominant market share and proprietary sourcing. While a slowdown in mall traffic has weighed on results recently, L Brand's direct channel sales are rising. We also believe the company's investments in store remodels and new product lines – particularly sports apparel and beauty products – as well as its recent expansion into China, will help drive future growth.

**Chevron:** We believe the integrated energy company will improve its production growth when its Wheatstone liquid natural gas (LNG) project comes on-stream, adding to the Gorgon LNG project, which launched in 2016. Both projects are in western Australia. Chevron also expects to moderate its capital spending in 2017, thus improving the company's free cash flow. The firm's earnings are primarily leveraged to oil and international natural gas prices, which could rise if OPEC carries out expected production cuts. Finally, we appreciate the company's relatively high dividend yield.

**Kroger:** The company operates supermarkets and convenience stores in the U.S., and manufactures and processes some of the foods that its supermarkets sell. As a best-in-class retailer, they continue to gain market share with private label brand expansions, their loyalty program and sophisticated data analytics. We also believe that capital investments Kroger is making in new and existing stores will lead to higher free cash flow per share over the next couple of years.

**Verizon Communications:** Verizon Communications Inc. is an integrated telecommunications company that provides wireline voice and data services, wireless services and Internet services. We believe Verizon will benefit from the growing consumer consumption of data as more communication and media viewing is done on mobile devices. In our view, its industry leading network quality will enable Verizon to gain share. The company continues to add more wireless services to both commercial and consumer customers organically and through acquisitions that should help keep churn costs low over time. The business continues to generate significant amounts of free cash flow with most of it returned to shareholders in dividends.

**TD Ameritrade:** We believe the online broker is a best-in-class asset gatherer. We also like that TD Ameritrade has outsourced banking operations, which, in our opinion, allows the broker to run a capital-light business model that helps generate free cash flow in excess of net income and deliver attractive returns. Going forward, we believe TD Ameritrade

**Top Contributors** (continued)

and, as a result, is building a broad suite of new products. The failure of its Alzheimer's drug in a major clinical trial was a disappointment, but Eli Lilly has a pipeline of treatments for many other major medical conditions, including cancer, heart disease and diabetes. In addition, we appreciate the stock's healthy dividend yield.

**Top Detractors** (continued)

will benefit from the dual tailwinds of retiring baby boomers moving assets from defined contribution plans to rollover IRAs and younger investors preferring to do financial planning online.

**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 the performance of Class I Shares.

As of 3/31/17 the top ten portfolio holdings of Janus Growth and Income Fund are: Altria Group Inc (3.75%), Microsoft Corp (3.68%), Apple Inc (3.45%), Boeing Co (3.34%), Texas Instruments Inc (2.73%), TE Connectivity Ltd (2.68%), McDonald's Corp (2.66%), CME Group Inc (2.61%), US Bancorp (2.48%) and LyondellBasell Industries NV (2.40%). There are no assurances that any Janus portfolio currently holds these securities or other securities mentioned in this commentary.

The opinions are as of 3/31/17 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.

Security contribution to performance is measured by using an algorithm that multiplies the daily performance of each security with the previous day's ending weight in the portfolio and is gross of advisory fees. Fixed income securities and certain equity securities, such as private placements and some share classes of equity securities, are excluded.

**Performance may be affected by risks that include those associated with non-diversification, portfolio turnover, short sales, potential conflicts of interest, foreign and emerging markets, initial public offerings (IPOs), high-yield and high-risk securities, undervalued, overlooked and smaller capitalization companies, real estate related securities including Real Estate Investment Trusts (REITs), derivatives, and commodity-linked investments. Each product has different risks. Please see the prospectus for more information about risks, holdings and other details.**

**S&P 500® Index** reflects U.S. large-cap equity performance and represents broad U.S. equity market performance.

Index performance does not reflect the expenses of managing a portfolio as an index is unmanaged and not available for direct investment.



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