Targeting Firms in Transition

Equities remain an important component of many portfolios. However, when much of the market moves as a herd and stocks become more richly valued, thus limiting opportunities, — investors need to pick their spots. Therefore, taking a contrarian viewpoint may become more valuable. We spoke with Dan Kozlowski, CFA, portfolio manager of the Janus Contrarian Fund, about his active investment approach and why it works.

What is contrarian investing?

KOZLOWSKI: It’s a philosophical approach based on avoiding the consensus view on markets and during the stock selection process. Given the stock markets’ role as a discounting mechanism, the investment view du jour is often outdated, representing crowded, or played out investment situations. “When it’s in the papers,” as they say, “it’s in the prices.” We, on the other hand, look for non-consensus investment ideas that are less understood and have evolving change factors at hand.

What is a change factor?

KOZLOWSKI: It’s a major transition that could greatly improve the performance of a company. We research three different kinds of change. The first is company-specific, resulting from a management change, spinoffs or other situations that change the strategic direction of a company. The second is industry change. Usually, this is driven by consolidation of a formerly over-competitive industry. As consolidation occurs, pricing power is often conferred on the survivors. The third is sentiment change. For instance a company is maligned, often because it made a serious mistake or is under incredible pressure. But a small lift in perception can take valuation from extremely undervalued to equilibrium.

If we see overlapping change factors, then there’s a multiplicity effect, and that may inform us to take a more sizable position.

Isn’t focusing on companies in flux risky?

KOZLOWSKI: We look at companies for which we believe the valuation is attractive before the positive change factor is applied. If at the end of the day the change catalyst doesn’t work favorably, we’re not paying for the upside, so we expect to roughly break even on the investment. When predicting future cash flows and their impact on valuation, we do scenario analysis. We aim to buy at a price level that is at or even below our worst-case valuation scenario which also helps us to manage downside risk.

For example, we attempt to reduce risk using change factor investing by focusing on well-funded businesses that were underperforming with their former management teams, but are executing new management teams. Our view is that the new management has more flexibility to transition successfully if it starts with a good balance sheet.

We’re similar to value investors in that we look for undervalued companies. But value investors generally buy at a low valuation and just hope things get better. We like to invest when true change is occurring that could catalyze high performance.

“We believe that investing when true change is occurring could catalyze high performance.”

Dan Kozlowski, CFA
Portfolio Manager
How does the Fund reflect the Janus investment approach?

KOZLOWSKI: First is our reliance on fundamental research. I believe that when considerable change is occurring, fundamental research is most valuable.

Second is our use of the Janus analyst teams. For me, it’s a two-way street. I bring change factor ideas to the analysts and leverage their industry expertise to help me understand and ultimately determine the probability of a change factor going in our favor. In return, I ask the analysts to bring me ideas about companies that are early into major transitions so that I can be early to those potential opportunities.

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How would Janus Contrarian Fund fit into an investor’s portfolio?

KOZLOWSKI: A portfolio like this is designed to perform differently than other products in the marketplace. It should also perform differently than other Janus funds. We attempt to never hold more than five positions in Janus Contrarian Fund that are within the top 20 firm wide holdings.

What areas of the economy do you anticipate a positive outlook for 2015?

KOZLOWSKI: The U.S. economy steadily improved in 2014, but we believe a stronger U.S. consumer could reawaken economic growth in 2015. We believe that the employment picture is improving, and lower oil prices should translate into more disposable income for almost every American. While we are not dependent on the economy, the current macroeconomic environment has nevertheless created investment opportunities for our Fund. At a broad level, the slow growth economy of the past five years has forced many companies to make the kind of significant changes we typically look for. With little-to-no economic growth at their backs, boards and management teams have been forced to take a closer look at their businesses and create their own growth. As this happens, we’ve seen more companies undergoing the types of transformational changes we invest around, and we believe we’ll continue to see more of those changes next year. Going forward, we would expect to see an uptick in spin-offs and would also expect to see more corporate boards getting active in changing management teams when a management team is underperforming. Sinking oil prices are also creating new opportunities. We are spending more time reviewing energy companies to see if depressed valuations provide opportunities. We are also spending incrementally more time looking for contrarian opportunities among companies that have strong ties to consumer spending, and also among industrial companies that benefit from cheaper input costs as oil prices fall.

PORTFOLIO MANAGER BIO

Dan Kozlowski, CFA | Portfolio Manager

Prior to managing Janus Contrarian Fund, Mr. Kozlowski was with Janus from 2000-2008 as an equity research analyst and portfolio manager. Throughout his investment career, he founded and managed a privately offered investment vehicle, as well as a start-up venture. Prior to that, he worked at Arthur Andersen LLP and Ariel Capital Management. He has 16 years of financial industry experience.

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This Fund is designed for long-term investors who can accept the special risks associated with value investing.