STRAIGHT TALK ON 2015

Investment insights from the experts at Janus Capital Group

JANUS CAPITAL Group

ABOUT JANUS CAPITAL GROUP

20
OFFICES WORLDWIDE

On the ground where our clients live and work, we have an in-depth understanding of local markets and investor needs to complement our global perspective.

120
INVESTMENT PROFESSIONALS

Our seasoned team of investment experts brings deep knowledge and experience to help us deliver on our commitment to provide better outcomes for clients.

108
INVESTMENT STRATEGIES

Actively managed equity, fixed income, alternative and multi-asset class strategies are designed to help clients in any type of market, with the goal of delivering strong risk-adjusted returns over time.

Investors face a complex investment landscape in 2015. There is market uncertainty about global growth, monetary policies and the direction of U.S. interest rates – all of which point to greater volatility ahead.

In the following pages, investment experts from Janus, INTECH, Perkins and VelocityShares weigh in on the major themes we expect to shape 2015. Just as there's no one-size-fits-all strategy for today's investors, a single point of view about today's complex investment landscape seems inadequate.

We hope these insights give you a more complete view to help guide your clients through the year ahead.

MEET OUR EXPERTS

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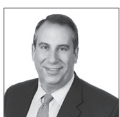

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2015: THE YEAR OF VOLATILITY

Central banks are in the midst of the biggest monetary experiment in the history of modern economics. China is changing the engine that drives its growth. Geopolitical unrest is evident. Among all the lurking uncertainties of 2015, there is one predominant consensus in which all of our investment experts agree – **greater volatility lies ahead.**

GLOBAL FACTORS DRIVING VOLATILITY

INSTABILITY OF FISCAL PROCESSES

END OF QUANTITATIVE EASING

FALTERING EUROPEAN ECONOMIES

TENSIONS BETWEEN UKRAINE AND RUSSIA

CHINA'S GROWTH SLOWING

MYRON SCHOLES, Ph.D.

THE YEAR OF VOLATILITY

I think 2015 will be the year of volatility. There is a lot of uncertainty all around the world. In the U.S., there is uncertainty about whether the Federal Reserve will continue to keep rates low in the face of increasing evidence the economy is improving. Europe is teetering on the brink of deflation, and individual countries in the region differ on how to stimulate the economy. There is increasing instability in the Middle East. China and India are trying to make fundamental shifts in what drives their economy and there will be bumps along the way.

If there are going to be more shocks, now would be the time to avoid over-reaching for the highest returns. With greater volatility, investors should gravitate to more liquid investments and consider increasing reserves at the margins. I would suggest paying up for liquidity at this juncture, even if it means taking a slightly lower return on those investments. Now would also be the time for investors to consider their illiquid holdings and confirm they have the appropriate time horizon to hold those investments through a volatile period. At a broad level, I would advocate greater diversification across assets, with the realization that if a shock occurs, a number of investments that looked unrelated before are going to look much more related during the volatility.

DYNAMICALLY ADJUST TO VOLATILITY IN THE MARKET

There are a lot of potentially destabilizing factors in the market today which indicate the possibility of more volatility. If volatility spikes up, then a portfolio that may have seemed fairly innocuous in terms of its risk level can quickly become quite risky. A lot of investment managers lost control of their portfolios during the 2008-09 crisis when volatility increased so rapidly that the portfolios weren't able to adjust quickly enough. A real question for any investment strategy next year will be whether it can dynamically adjust to the volatility that's observed in the market, and reduce portfolio volatility more aggressively as necessary. Investors can benefit from such an investment process that adjusts to put a greater focus on risk reduction when there's more observed market risk.

ADRIAN BANNER, Ph.D.

ENRIQUE CHANG

THE RUBBER BAND IS BEING STRETCHED TIGHTER

When volatility has spiked up over the last two or three years, it's been a dramatic spike, not a gradual increase. When we see big jumps like this, it means the rubber band is being stretched tighter, so when volatility moves, it moves quickly. These big jumps are a sign that there is pressure building in financial markets that will likely cause higher levels of volatility in the future. Higher volatility has historically been challenging for riskier assets. Investors should take a close look at the holdings in their portfolios, ranking investments from most exposed to risky assets to the least exposed, and consider shedding off some holdings with the highest risk profiles.

HISTORY'S LARGEST ECONOMIC EXPERIMENT

The one word that describes the current economic state is experimentation. We are running history's largest economic experiment with central banks all over the world injecting unprecedented amounts of liquidity over the last few years. We don't know how this experiment will end, but we do know that gross imbalances have been created, which amplify the risk of tail events. Managers and investors cannot afford to ignore tail risks and the possibility that these risks materialize.

ASHWIN ALANKAR, Ph.D.

NICK CHERNEY, CFA

SPIKES SIGNAL EMOTIONAL STATE OF THE MARKET

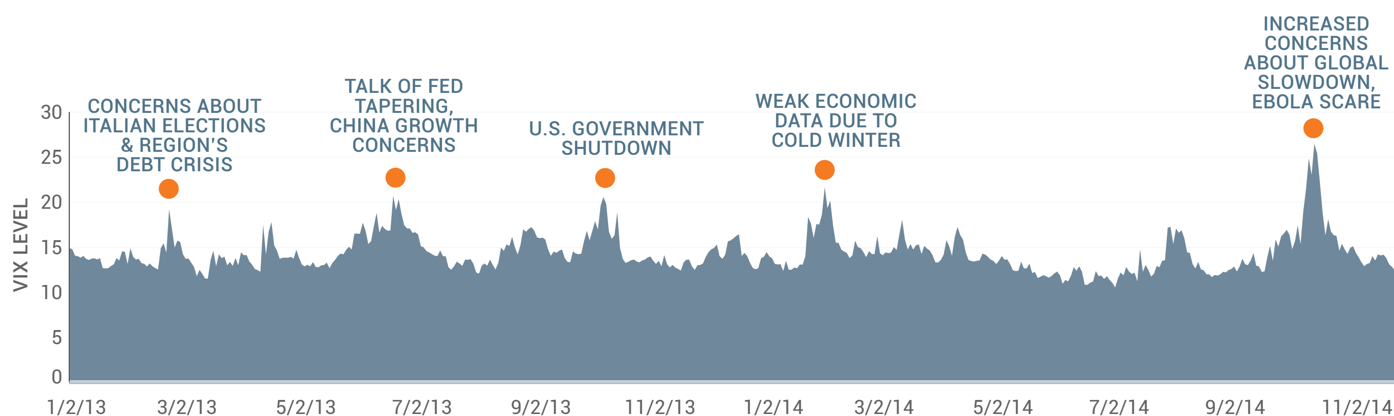
We have been in a regime of low volatility with intermittent spikes that have been very emotional in nature. We have been seeing these spikes accelerate, like the one on October 15, and it signals the really emotional state of the market. The CBOE Volatility Index (VIX) is indicating that the market is fragile, and any catalyst – whether it's Federal Reserve news or geopolitical – can cause a significant market reaction.

We expect volatility to continue to spike higher and more quickly with each one of these corrections until ultimately, we see a more substantial correction. Consequently, we also expect the cost of hedging to keep going up.

The Chicago Board of Options Exchange (CBOE) Volatility Index (VIX) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 Index options and is a widely used measure of market risk and is often referred to as the "investor fear" gauge.

CBOE VOLATILITY INDEX (VIX)

The VIX represents the "fear" in the market. Here is a chronological timeline showing the volatile spikes in the market and major events that correlate to those large spikes.



SOURCE: JANUS/BLOOMBERG. AS OF 11/30/14.

MARC PINTO, CFA

MORE VOLATILITY THE NEW NORMAL

I expect volatility to continue in equity markets. We are already seeing individual stocks move more dramatically than they would have five years ago, given the same set of circumstances. In my view, this is due to a structural shift on Wall Street. Regulatory changes affecting the amount of capital that broker dealers are required to hold has made it more difficult for Wall Street firms to be the buffer between buyer and seller. With fewer market makers doing the job they used to do, I think more volatility is the new normal.

PORTFOLIO CONSIDERATIONS

Evaluate the riskiness of portfolio holdings, and **consider reducing exposure to investment products with the highest risk profiles.**

Increase diversification across asset classes as a way to help mitigate downside risk during a market shock.

Assess any illiquid assets and confirm you have an appropriate time horizon to hold these assets through volatile periods.

Consider investment products that have an ingrained investment process that dynamically responds to spikes in volatility with the goal of quickly reducing risk.

U.S. TO STAND TALL AMID STUNTED GLOBAL GROWTH

It's easy to be pessimistic about the world's economic prospects. Japan, Brazil and Russia are all in recession. China, the global growth engine, is slowing and the eurozone is fending off deflation. Yet, our experts believe there is good reason to be optimistic that the **U.S. economy could hold on to its momentum,** while attempts by countries to boost growth and reengineer their economies could prevail.

PROJECTED GDP GROWTH FOR MAJOR ECONOMIES IN 2015

	REAL GDP GROWTH 2014*	REAL GDP GROWTH 2015*	Change
U.S.	2.3%	3.0%	+0.7
EUROZONE	0.8%	1.1%	+0.3
JAPAN	0.3%	1.0%	+0.7
UK	3.0%	2.6%	-0.4
CANADA	2.4%	2.5%	+0.1
AUSTRALIA	2.8%	2.6%	-0.2
CHINA	7.4%	7.0%	-0.4
RUSSIA	0.5%	-1.2%	-1.65

REAL GDP GROWTH 2014*
REAL GDP GROWTH 2015*
OVERALL INCREASE
OVERALL DECREASE
PERCENTAGE INCREASE
PERCENTAGE DECREASE

* Projections, which are a composite of contributing forecasters to Bloomberg.

SOURCE: BLOOMBERG.

GIBSON SMITH

BACK TO BASICS WITH FOCUS ON DOWNSIDE

Overall, my outlook for the global economy is a little more positive than others' right now. The concerns around rising rates have grown into a consensus view that rates are going to be range bound or lower for longer. The risk of a higher rate environment in the U.S. in 2015 is real, albeit a significant move is unlikely. The bond market will start to discount a stable U.S. economy and recovery to a greater extent moving forward, and I think the wild card is if Europe and Japan do better.

The divergence of U.S. growth versus the eurozone and Japan has spurred Treasury volatility. We have entered a low-return environment in fixed income. Investors may be tempted to take on excessive risk to get big returns. Don't do it. In a fixed income market where there is a risk of higher rates amid elevated volatility, a back to basics approach with a focus on downside risk is prudent.

INVESTORS MAY BE MISSING THE BIG PICTURE ON CHINA

While global growth forecasts for 2015 remain subdued, expectations are for the U.S. to build upon 2014's gains. As rising GDP leads to improved sales, companies with fixed operating costs should register expanding profit margins. This, along with lower energy prices putting more dollars in consumers' pockets, is supportive of U.S. stocks. Yes, equities have become more fairly valued, but in comparison to bonds, cash or real estate, they remain a compelling asset class.

Steady U.S. growth will also provide support to exporting nations such as Japan, Germany and China. Of these, the latter is among the most interesting. For China to be trading at a substantial discount to European market multiples, while recording 7% or even 6.5% real growth, seems like an attractive opportunity. Many investors are missing the big picture. For those who have a longer-term view and can withstand some short-term volatility, I expect exposure to this country to pay off over the medium to long term.

GEORGE MARIS, CFA

DISINFLATIONARY BOOM

ASHWIN ALANKAR, Ph.D.

Growth in the rest of the world is slow, but the U.S. is experiencing a "disinflationary boom," meaning economic growth is healthy and there is little threat of inflation. This is the perfect type of economic growth. There are two ways an economy can grow: One is for inflationary pressures to build, so prices go up simply due to inflation. This looks like economic growth, but it's fake growth. It's just inflation. The second is what we're seeing today – growth through productivity. This is the ideal type of economic growth because companies can grow cash flows and earnings without worrying about the uncertainties of inflation, and having to hedge that inflation with higher prices – in this case, all companies can gain from the growth. Conversely, in an inflationary growth scenario only companies that can pass inflation along to consumers benefit.

A closer dissection of nominal interest rates gives further credence to the belief U.S. growth is poised to increase. Many view current low nominal interest rates (the sum of real interest rates and inflation) in the U.S. as a sign that future economic growth will be slow. Focusing on this headline number is misleading. Investors should instead focus on the real interest rate, which is a true sign of growth expectations. Real interest rates have steadily risen higher over the last six months. Nominal interest rates are only low because inflation has been benign, but again, this is an ideal environment for growth – it is organic growth. Equities have typically performed best when inflation is low and real rates are higher.

BILL GROSS

ECONOMIC GROWTH NO MAGIC ELIXIR

Asset prices depend significantly on economic growth, and that isn't good news for investors in 2015. Aside from the United States, the growth outlook for developed countries and many emerging ones is subpar. Do not look, therefore, for economic growth to be the magic elixir for 2015. Almost all economies are facing structural headwinds such as aging demographics, technological advances which depress job growth, and importantly, still highly levered private and public balance sheets. Many economies in Euroland, Japan, Brazil and elsewhere will struggle to avoid recession. With the potential for greater market volatility, investors should be flexible and consider more liquid securities. Fixed income with shorter maturities is one starting place.

43% of revenues for companies in MSCI Europe Index are coming from Europe.

WAHID CHAMMAS

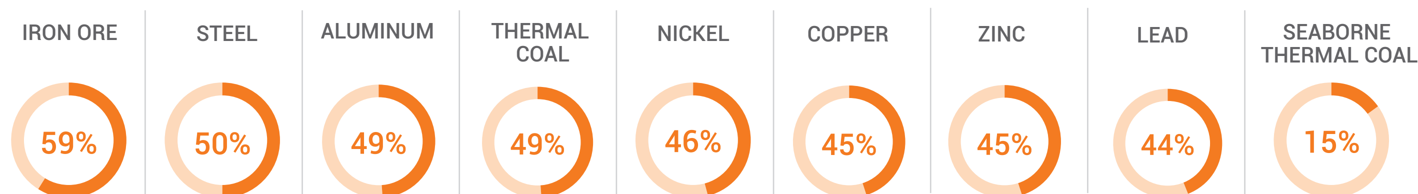
EUROPEAN EQUITIES: ARBITRAGE OPPORTUNITY

The headwinds facing Europe, including austerity, deleveraging and relatively tight monetary policy, are well documented. But investors must draw the distinction between the ailing European economy and its companies, many of which generate only a portion of their revenue from the region. Current valuations for globally-focused European equities are exceptionally cheap and trading as though they are dependent upon a single, inward-looking and underperforming economy.

I believe European equities today represent an arbitrage opportunity of a lifetime simply because of their address. By filtering out the macro noise, investors stand to gain by owning European companies that are creating value globally, and that will benefit from rising exports and an improved domestic cost structure.

CHINA'S SHARE OF GLOBAL COMMODITIES CONSUMPTION

China has become a significant consumer of global commodities. With its growth slowing, so too will its demand for these commodities, which has far-reaching implications – both positive and negative.



SOURCE: JANUS.

WHEN CHINA SNEEZES, EMERGING MARKETS CATCH A COLD

China's future growth rate continues to be a concern, especially in a world where it is taken as fact that "when China sneezes, emerging markets catch a cold." China has become the world's largest consumer of commodities, so as its growth slows, so too does its demand for industrial inputs. While this scenario portends adverse consequences for commodities-exporting countries, emerging markets that rely upon raw materials imports stand to gain. And with food and energy prices coming down, consumers will experience a windfall. We are honing in on companies that will benefit from either lower commodity input costs or heightened consumer demand.

GUY SCOTT, CFA

CHRISTOPHER DIAZ, CFA

ECB WILL DO WHATEVER IT TAKES

The eurozone's economy will be challenged next year. But, we expect areas of fixed income investment in the eurozone to remain attractive, with the region itself avoiding recession. Real GDP growth in the eurozone could be 1% or less, but the European Central Bank is showing it will take whatever monetary stimulus measures it needs to boost growth and stop the region's disinflation. Plus, structural reforms and corporate restructuring are still in their earlier stages, so sovereign and credit opportunities could emerge.

We would avoid Japan as we are not optimistic that the country's proposed structural reforms will take place to the degree that they need to. That, on top of Japan's increasing amount of massive government debt, makes fixed income investment in the country less attractive.

PORTFOLIO CONSIDERATIONS

Maintain an allocation to U.S. equities, which have typically performed well when inflation is low amid steady economic growth.

Consider globally-focused European equities and select European corporate credit. Many companies there are still in the early stages of restructuring.

With prices of commodities declining, **look for companies that benefit from either lower commodity input costs or heightened consumer demand** (thanks to lower gasoline prices).

Given the expectation of greater volatility, **downside risk should be a key focus.** Avoiding the blowups will be as important to returns in 2015 as the home runs.

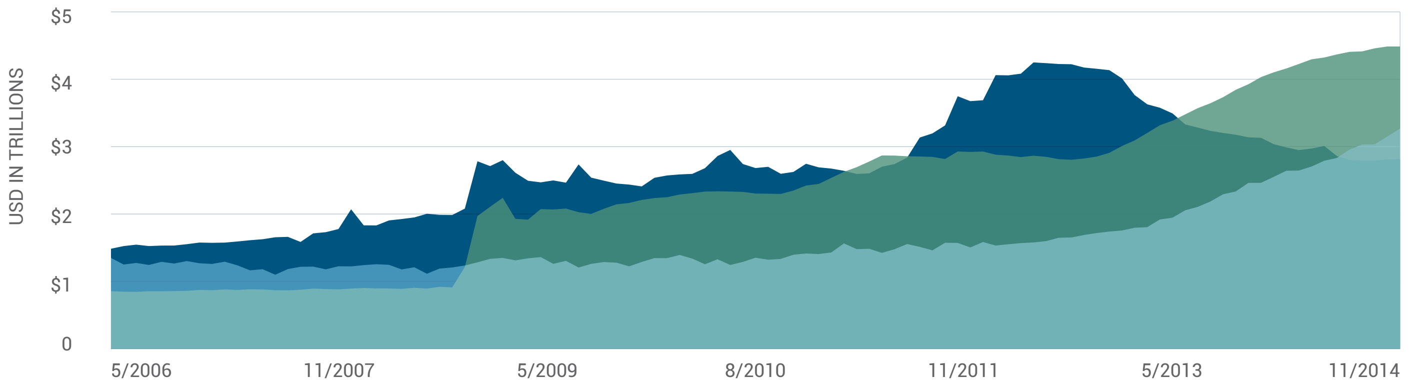
CENTRAL BANK DIVERGENCE: A GIFT IN DISGUISE

The world's major central banks are headed in separate directions, and that will have important consequences for investors. The Federal Reserve (Fed) is expected to hike rates in 2015, while several major central banks abroad are either expected to maintain loose policy, or like the European Central Bank (ECB), loosen policy even further. While loose policy has been priced into the markets to a degree, this **"central bank divergence" may be a gift in disguise.**

CENTRAL BANK ASSETS IN U.S. DOLLARS

The European Central Bank (ECB) is indeed behind the curve in terms of monetary stimulus, and it is likely that the balance sheets of both the ECB and Bank of Japan (BOJ) will grow further. ECB President Mario Draghi has indicated that the ECB is set to do more to combat falling inflation in 2015.

FED ECB BOJ



SOURCE: JANUS/BLOOMBERG.

BILL GROSS

MONETARY POTION REQUIRED

If markets are to move higher and spreads remain tight, the potion of monetary policy will be required. That potion will remain on the table in 2015. While the U.S. Fed has concluded its QE program, the ECB and BOJ are committed to print money and elevate asset prices for the foreseeable future.

Interest rates in almost all developed countries will remain near the zero bound, as well. With the U.S. dollar strengthening and oil prices declining, it is hard to see even the Fed raising short rates until late in 2015, if at all.

Such easy monetary policies, while near-term supportive of asset prices, have risks of capital market and real economy distortion. With much of the benefit from loose monetary policies already priced into the markets, a more conservative investment approach may be warranted by maintaining some cash balances. Be prepared for low returns in almost all asset categories.

CHRISTOPHER DIAZ, CFA

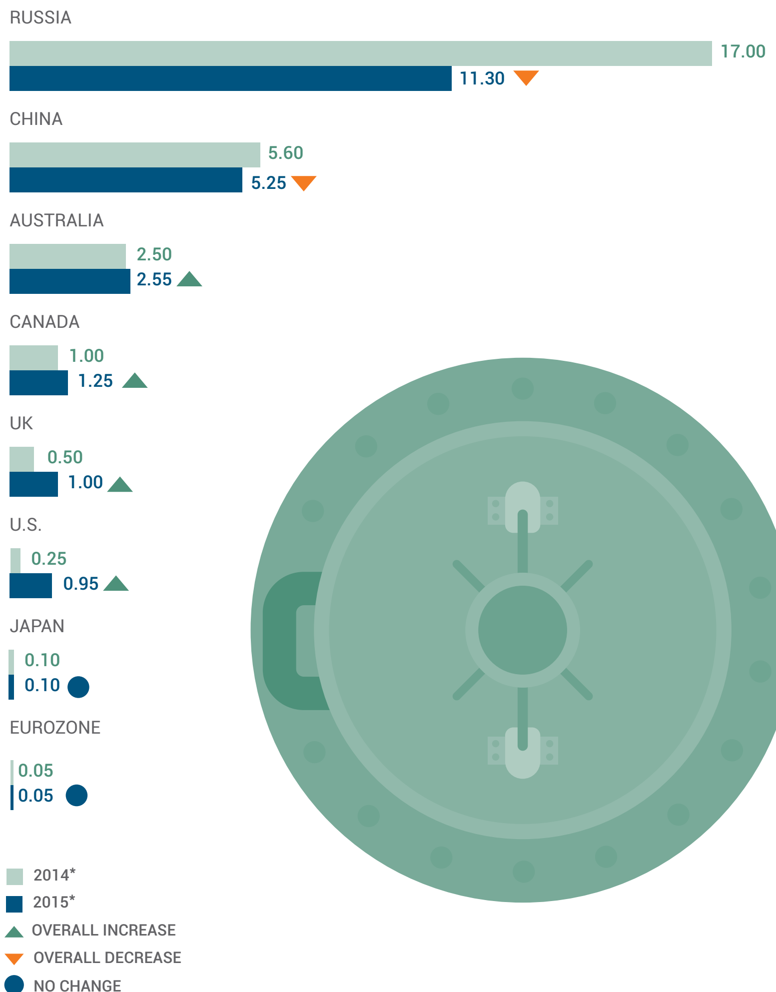
CONSIDER CURRENCY PROTECTION FOR INTERNATIONAL INVESTMENTS

I expect the U.S. dollar will remain strong versus the currencies of the major U.S. trading partners in 2015. This means it's worth considering having some currency protection for international investments, and hedging investments denominated in euros or yen, back into U.S. dollars.

Divergence in the growth trajectories between the U.S. on the one side, and the eurozone and Japan on the other, is what has led to central bank policy divergence. We expect rate hikes by the Federal Reserve in 2015, while the ECB could launch a quantitative easing program in the first half that includes eurozone sovereign purchases. Anticipation of the ECB's QE could create buying opportunities in certain eurozone sovereigns.

Historically, a withdrawal of liquidity by Fed rate hikes has increased volatility in emerging markets, and I expect 2015 to be no different if central bank divergence plays out. Major EM countries already look vulnerable with Russia and Brazil in recessions, so Fed action only increases EM downside risk and demands even greater selectivity.

CENTRAL BANK LENDING RATES OF MAJOR ECONOMIES



*Projections, which are a composite of contributing forecasters to Bloomberg.

SOURCE: BLOOMBERG.

PUSH AND PULL

The risk is greater for U.S. rates to move higher than lower, yet a sustainable move higher in U.S. rates won't be a sharp rise upward either. This could create range bound action.

There is plenty of push and pull in the market. The U.S. recovery has been moderate, and yet the U.S. labor market and personal consumption have been strong enough and sustained enough to set the stage for the Fed to raise rates in 2015. The higher short-term rates will likely be met with greater volatility in the currency markets.

Given loose monetary policy will remain in place in most of the major markets around the world, lower rates globally will facilitate the need for yield in the marketplace, and I think that will be a theme for the next few years. Solid risk-adjusted returns may be found in corporate credit, particularly in select crossover names with ratings just beneath investment grade in high yield. This includes companies that may have dropped in credit ratings at one point, but now have solid management and improving fundamentals, which may not be reflected in the price.

GIBSON SMITH

ASHWIN ALANKAR, Ph.D.

A GIFT IN DISGUISE

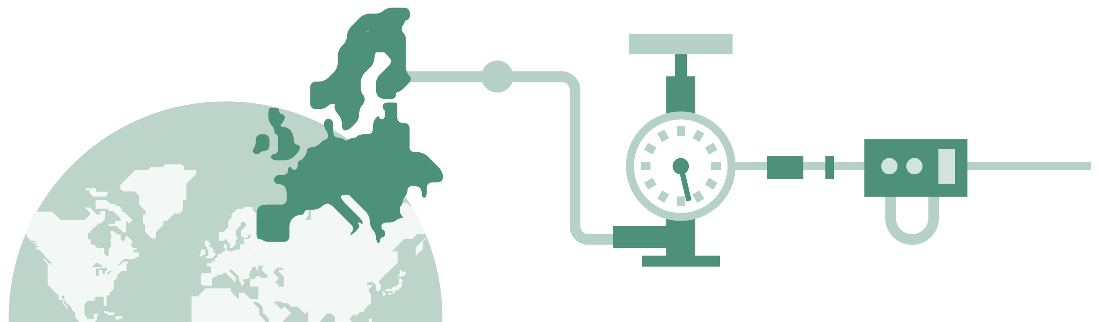
The divergence in monetary policies is a gift in disguise. If all the central banks around the world were thinking about withdrawing stimulus at the same time it would risk a liquidity crunch. A hard to beat scenario is for the major central banks to inject liquidity and stimulus in a coordinated fashion, but to turn off the spigots one at a time. And this is how the story has unfolded. Reining in liquidity simultaneously could lead to a liquidity crisis and risk a global recession. Uncertainty and fear could ensue because the market wouldn't know if central banks were ending accommodative policies prematurely. The ideal scenario toward renormalization is for the U.S. to step away from easy monetary policies first, followed by Europe or Japan.

A GAME OF COMPETITIVE DEVALUATION

We've already seen Japan reduce the yen vis-à-vis the U.S. dollar from the high 80s to 117, with a goal of depreciating further. Europe is at real risk of sliding into deflation and will have to have a competitive devaluation of the euro. Competitive devaluations can be very bad if they become a zero sum game where everyone is trying to depreciate. I think the competitive devaluation problem is another uncertainty that will create volatility next year.

MYRON SCHOLES, Ph.D.

Europe is at real risk of sliding into deflation and will have to have a competitive devaluation of the euro.



PORTFOLIO CONSIDERATIONS

Central bank divergence may keep the U.S. dollar strong against major currencies, so **consider having some currency protection for international investments** by hedging investments denominated in depreciating currencies back into U.S. dollars.

With fixed income yields low, seek to take advantage of the "crossover high yield" area of corporate credit, i.e., the credit just one notch below investment grade. This area comprises companies that are working toward a rating upgrade to investment grade, so investors get the potential for higher yield in a "rising star" that is transforming its balance sheet.

Greater selectivity in emerging markets will be key in 2015 given the downside risks. Historically, monetary tightening by the Fed has boosted volatility of emerging markets.

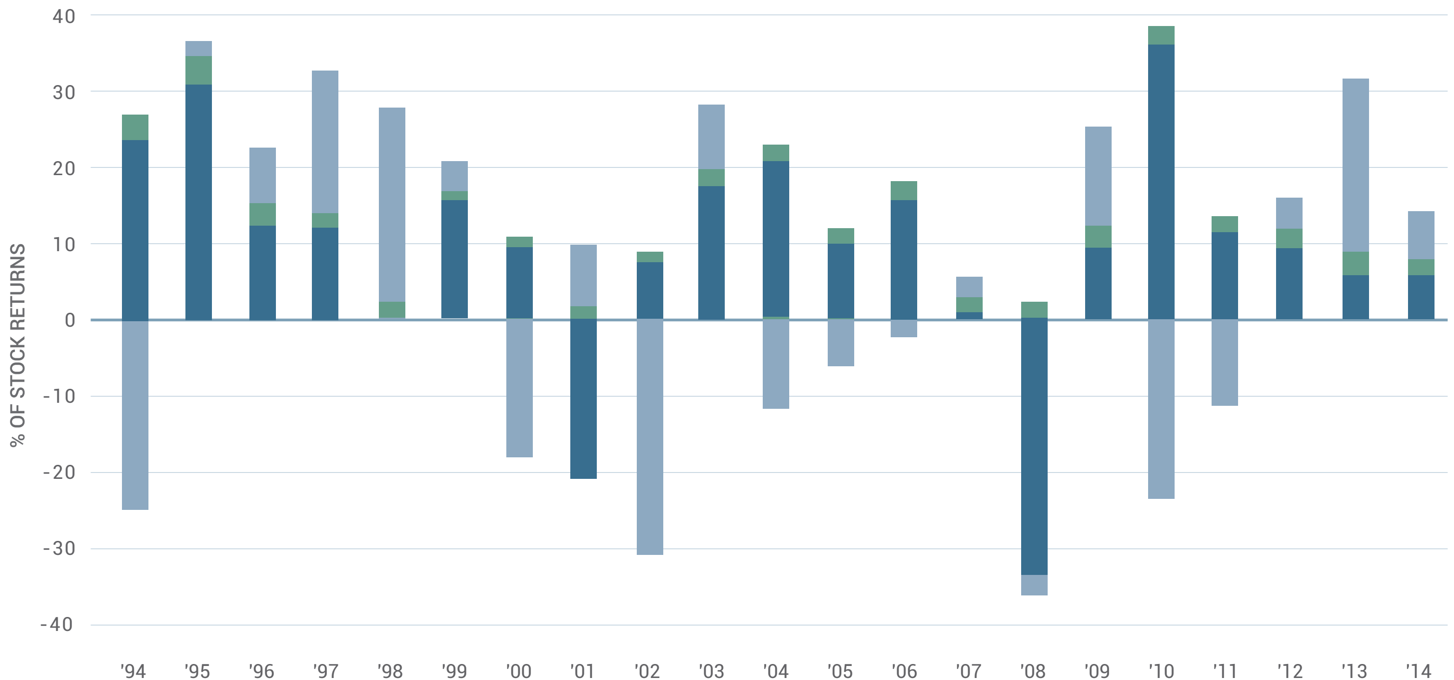
SHARPEN YOUR PENCIL: THE FOCUS RETURNS TO FUNDAMENTALS

A sea change is underway in equity markets. Coming off historically low multiples after the financial crisis, multiple expansion was a rising tide lifting all boats. In a broad and undiscerning rally, fundamentals were easy to ignore. The same could be said about fixed income markets, given the multi-year rally and that valuations remain rich overall. **Bottom line: Fundamentals are about to matter a great deal again** – for equity and fixed income investors alike.

DRIVERS OF STOCK RETURNS FOR S&P 500

After nearly two years of multiple expansion driving stock returns, we expect earnings growth to drive returns going forward. Said another way, stock selection will be more important as fundamentals return to the driver's seat.

CHANGE P/E
YIELD
CHANGE EPS



SOURCE: JANUS/BLOOMBERG. AS OF 11/30/14.

ENRIQUE CHANG

FUNDAMENTALS TO START DRIVING PERFORMANCE AGAIN

Over the last four years, the average investor has been less focused on fundamentals and more focused on beta. This was due largely to low rates playing such a large role in driving the performance of various asset classes. The result has been a big divergence between GDP growth and earnings growth on one hand, and stock performance on another. Exactly when it happens is hard to predict, but in the next year or two, I would expect company-specific fundamentals to start driving performance again. We've already seen that reversal take place with small-cap stocks, where higher-quality stocks have begun to perform much better. I would expect that trend to carry over across the market cap spectrum.

SECURITY BY SECURITY; AVOID BLOWUPS

In the fixed income market, there has been some air let out of valuations, particularly in short-duration high yield. However, following a multi-year rally in the fixed income market, valuations still remain rich overall. So, investors need to take a security by security approach, with close attention paid to downside risk. This is true especially because lower rates and tight spreads have lured companies into re-levering their balance sheets. We have seen this amid increased shareholder-friendly activity where companies have engaged in large debt offerings to pay for corporate acquisitions and share repurchases. These activities put bondholders at risk due to increased leverage. Investors can have an edge in this market by avoiding the blowups as much as they can by finding the bargains.

GIBSON SMITH

FINDING COMPANIES POSITIONED TO STEADILY GROW EARNINGS

In a low-growth economic environment, steadier, higher-quality companies typically outperform. Many "excessive growth" stocks with higher multiples often start to underperform, because without strong economic growth, it's harder to achieve the earnings growth needed to justify their higher valuations. At the other end of the spectrum, deep value stocks also typically underperform in a low-growth environment because they lack long-term growth or face structural challenges. We are focused on identifying stocks of steadier companies that can grow at a solid clip regardless of the economic environment, because they have their own secular growth drivers. Finding these companies that are positioned to steadily grow earnings requires a deep understanding of the underlying business, so fundamental research is key.

CARMEL WELLSO

GREGORY KOLB, CFA

GLOBAL BLUE CHIPS: TIME IS ON OUR SIDE

Given the risks to growth globally, one big area that we like is the global blue chips – large-cap companies that are of the highest quality, domiciled in either the United States or Europe. One example would be Oracle, in technology. For staples, Procter & Gamble, and in health care GlaxoSmithKlein. With global blue chips you are not just buying earning streams that are less economically sensitive, like in a health care company, but you are buying a company with a competitive position strong enough to navigate challenging macro environments.

Global blue chips share a number of strong characteristics, one being very well capitalized balance sheets, another being stable, consistent earning streams that can weather changes to the economic backdrop, and a third is management teams who have good capital allocation pedigrees. Given a two-, three-, four-year window, the value of these businesses is likely to be higher than it is today. Time is on our side with them.

DIVIDEND GROWERS MEETING NEEDS OF YIELD-HUNGRY INVESTORS

Given the potential of a rising rate environment, we are focused on finding companies that have the potential to grow free cash flow and keep growing their dividend. In recent periods where the market feared a potential hike in interest rates, such stocks held up much better than those with a static dividend payment. In a rising rate environment, stocks that can grow their dividends are in a unique position to meet the needs of yield-hungry investors who will need to see an increase in dividends to offset the erosion of principal.

MARC PINTO, CFA

LOW-QUALITY RUN APPEARS EXTENDED

Low-quality stocks have generally outperformed since the 2008-09 crisis, but we are starting to see a reversal of that trend with low-quality stocks breaking down and high-quality stocks showing strength. There are reasons to believe this reversal could continue.

ALL CAP HIGH/LOW QUALITY RELATIVE STRENGTH RATIO

HIGH QUALITY / LOW QUALITY STOCKS RELATIVE STRENGTH RATIO

500
400
300
200
100

HIGH QUALITY OUTPERFORMS
LOW QUALITY OUTPERFORMS
CYCLICAL LOW
HIGH QUALITY OUTPERFORMS
LOW QUALITY OUTPERFORMS
CYCLICAL LOW
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LOW QUALITY OUTPERFORMS

'85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14

SOURCE: (RELATIVE STRENGTH RATIO) THE LEUTHOLD GROUP. AS OF 11/28/14.

Leuthold assigns a quality rank to the largest 1500 stocks in their coverage universe based on average rank of trailing 5 year ROE, debt/assets ratio, and sales and earnings trends. The top quintile is the high quality basket and the bottom quintile is the low quality basket. The high quality/low quality ratio is a ratio that compares the monthly returns of the high quality and low quality baskets (returns are cumulative with dividends and other earnings reinvested), multiplied by 100. The ratio began at 100 at its inception (12/85).

PORTFOLIO CONSIDERATIONS

Consider exposure to higher-quality stocks that can steadily grow earnings, even in a low-growth economic environment. These stocks tend to do better in volatile markets.

Avoid stocks that require high economic growth to justify their lofty valuations.

Look for stocks of companies that have the potential to grow free cash flow and grow their dividend as a means to obtain more yield in a rising rate environment.

A defensive posture in fixed income is prudent in this environment. An actively managed approach focused on risk management and security selection can help preserve capital in a difficult market.

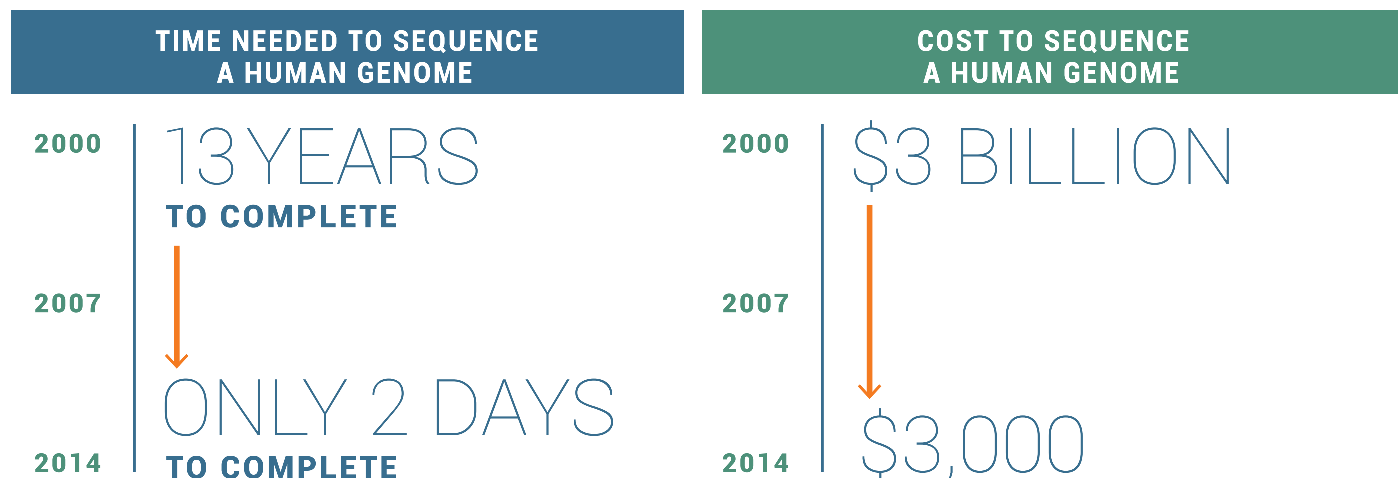
GROWTH IN A HAYSTACK: AREAS OF OPPORTUNITY

While 2015 poses risks, markets are not void of opportunity. Corporate boards are more engaged and active than ever, effecting positive change. Productivity enhancements and lower raw material costs can aid further margin expansion. Advancements in genetic research are rewriting the outcomes for patients suffering from many diseases.

Look carefully, and growth can be found.

HEALTH CARE INNOVATION:
TIME AND COST OF SEQUENCING A HUMAN GENOME

DNA sequencing used to take decades and billions of dollars. Now it takes a couple days and a few thousand dollars.



NEW HEALTH CARE THERAPIES

NOW TREATING	Hepatitis C, multiple sclerosis, leukemia, prostate cancer
ON THE HORIZON	Cystic fibrosis, immunotherapies for cancer, gene therapy, Alzheimer's disease

ANDY ACKER, CFA

DRIVERS OF HEALTH CARE GAINS REMAIN INTACT

The fundamental backdrop for the health care sector has never been stronger, and drivers of recent gains remain intact. Dramatic advances in human genome sequencing and the aging baby boomer population are two massive tailwinds driving growth.

Yet the health care landscape for investors is likely to be more challenging in 2015 due to current valuations, especially among a number of richly-priced early-stage firms, and also an IPO pipeline packed with unproven companies capitalizing on elevated investor appetite. While I don't expect the extreme outperformance of the sector to continue, I do see solid return potential. Health care stocks are prone to extreme outcomes; for instance, for every 10 therapies that go into clinical testing, generally only one is approved and makes it to market. This is why deep fundamental research is critical to differentiate between the sector's few winners and numerous losers.

DANIEL R. KOZLOWSKI, CFA

CHANGE RE-CHARTING COURSE OF COMPANIES

Without the tailwind of strong economic growth at their backs, corporate boards have been forced to get creative and to create shareholder value. This means more spin-offs of businesses that aren't a central focus of a company, more changes in management teams, and more merger and acquisition activity to consolidate poorly performing industries.

Such changes can re-chart the course of a company. A business that is spun off, for instance, gets to control its own destiny for the first time. A consolidated industry creates more favorable competitive dynamics for the remaining participants. As such dramatic changes take place, improving market sentiment around the repositioned company can cause a substantial re-rating of its stock. With markets more fairly valued today, it is hard to envision a catalyst that will dramatically lift all stocks. In such an environment, I believe finding those isolated instances where a material change can drive a valuation re-rating of a stock can lead to outsized returns.

U.S. REMAINS MAIN SOURCE OF INNOVATION

U.S. economic growth has been fueled by productivity gains, and I think those gains can continue. Productivity gains are driven from new technology and innovation. I think the U.S. remains the main source of the world's innovation because its education system is still one of the best in the entire world. Another reason I expect more innovation from the U.S. is because we're seeing better allocation of our labor capital coming out of the financial crisis in 2008. Before the crisis, many of our greatest statisticians, mathematicians and engineers were all going to Wall Street. Now we're seeing more of that intellectual capital working in Silicon Valley, or with other startups.

ASHWIN ALANKAR, Ph.D.

GUY SCOTT, CFA

DECLINING FOOD AND GAS PRICES ARE A BOON FOR CONSUMERS

As commodity prices fall, U.S. and European companies that are large buyers of raw materials and have pricing power stand to benefit from expanding margins. In this environment, consumer discretionary stocks should also do well as declining food and gasoline prices are a boon for consumers. This could be especially beneficial for European consumer companies as the region has struggled to spur aggregate demand.

M&A activity in Europe, which is at record lows, should pick up as companies make deals to improve their competitive position. With top-line growth subpar, we are looking for companies with strong balance sheets and the ability to generate free cash flow that can help fund acquisitions. These companies can take advantage of fertile conditions, especially as many potential targets on the continent presently trade below replacement costs.

HEIGHTENED M&A A BOOST TO THE MARKET

Given the outlook for slow economic global growth, I think that M&A activity will continue to be strong in 2015. Companies are no longer seeing high single digit, or double-digit kind of organic growth. It's 5% or less in a lot of cases, so companies are starting to look for mergers and acquisitions as a way to enhance growth. Heightened M&A could certainly continue in health care but I see it happening across industries next year, which should be a boost to the market.

TOM PERKINS

DECLINING ENERGY COSTS BENEFITING CONSUMERS AND COMPANIES

The ripple effect of declining energy costs is great for consumers and possibly even greater for some industries that will benefit from lower input costs.

According to Wal-Mart management, every penny per gallon decline in gas prices (annualized) translates into a billion dollars of incremental consumer spending. Each driver will spend about 75 cents to $1 less per mile per year, which is roughly $1,000 on the top end. That equates to $83 per car per month, and there are roughly 2 cars per house. Extrapolating this to the 110+ million households equates to over $200 billion.

RESTAURANTS

RETAILERS

AIRLINES

TRANSPORTERS

TIRE MANUFACTURERS

DECLINING OIL PRICES A MEANINGFUL BENEFIT TO SOME COMPANIES

There are still many opportunities for companies to control expenses or enhance productivity, which will create margin expansion and earnings growth. One of the biggest opportunities on the expense-cutting front is with companies where oil, or oil-based products, are a high input cost. I'm investing in a number of companies that should see their cost bases shrink significantly due directly, or indirectly, to cheaper oil. Examples include anything from transportation companies, where fuel is a high input cost, to companies that use a lot of plastic or oil-based resin. Oil prices were a meaningful detriment to these companies' earnings on the way up, and we expect it to be a meaningful benefit on the way down.

MARC PINTO, CFA

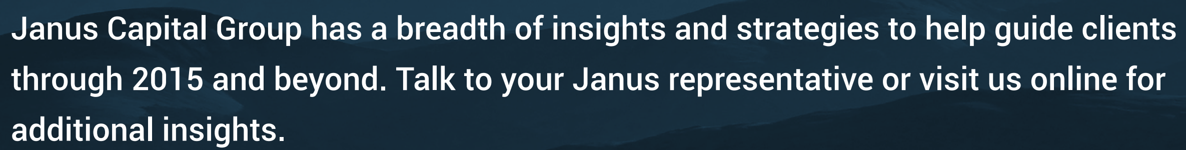
PORTFOLIO CONSIDERATIONS

Consider an allocation to the health care sector to take advantage of rapid innovation in the biotech and pharmaceutical industries. However, fundamental analysis is critical to identify the winners and avoid the numerous losers.

Slower economic growth creates a ripe environment to **invest in companies undergoing dramatic changes that can re-chart their destinies.** Look for companies where significant, positive changes are underway.

Increasing M&A activity in the U.S. and Europe will provide a boost to the market. Investors can benefit from the trend by having insight into which businesses or industries are likely to be tomorrow's acquisition targets.

Declining food and gasoline prices are a boon to consumers. **Consider consumer discretionary stocks and other companies that will benefit from margin expansion** through productivity gains or cheaper raw materials.



Janus Capital Group has a breadth of insights and strategies to help guide clients through 2015 and beyond. Talk to your Janus representative or visit us online for additional insights.

JANUS CAPITAL Group

Past performance is no guarantee of future results.

Investing involves market risk. Investment return and value will fluctuate, and it is possible to lose money by investing. There is no assurance that the investment process will consistently lead to successful investing.

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When valuations fall and market and economic conditions change it is possible for both actively and passively managed investments to lose value.

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