MARKET PERSPECTIVES SERIES

JANUS

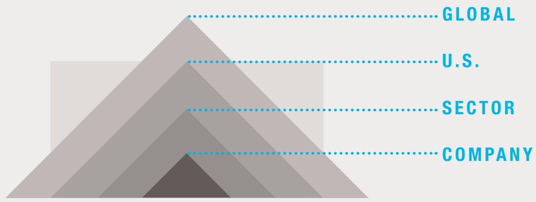
4Q: Defiance

Growth in spite of a global slowdown.

COMPANY-INFORMED MACRO PERSPECTIVES FROM THE JANUS FIXED INCOME TEAM

4Q 2014

A JANUS CAPITAL Group Company



Janus Company-Informed Macro Perspective

Fundamental credit research has been at the core of the Janus fixed income process for over 25 years. Not only does in-depth company research anchor our fixed income investment process, it also serves as the foundation for our macroeconomic views. While most macroeconomic forecasts originate from government data, we start at the bottom, aggregating individual company data from our fundamental credit research to arrive at a company-informed macro view at the firm, sector, U.S. and global levels. We believe this approach differentiates us from our peers and other macroeconomic data providers.

Each quarter, our fixed income team shares its company-informed outlook on key macroeconomic indicators and how that insight is applied in Janus' fixed income portfolios.

The opinions expressed are those of the authors as of September 2014 and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

4Q: Defiance

The U.S. recovery has defied slowing global growth. The recovery continues at a moderate but steady pace, with companies reporting strong demand and in some cases, even higher labor costs. Yet, U.S. interest rates have equally defied expectations by remaining at historically low levels, presenting a seductive but risky opportunity for investors.

Even as the Federal Reserve (Fed) prepares to exit loose monetary policy, there are powerful forces keeping rates low. It's easy to be seduced into thinking rates will remain low for the long term. There are investors who have placed large interest-rate bets on the "lower for longer" rate assumption. This creates significant risk of capital loss, in our view, as we believe interest-rate risk is the largest risk facing fixed income investors today.

In the face of increased risk taking, we are sticking to our principles of capital preservation and risk-adjusted returns. We are doing this by taking a balanced but defensive approach to interest-rate sensitivity that may allow investors to participate in the upside but protects them on the downside. Our company-informed macro view helps shape our defensive posture. For example, in this report's Company View we discuss pockets of wage pressure in various industries due to increased demand, labor constraints and minimum wage hikes. While U.S. inflation is contained for now, higher labor costs and demand threaten to change that, providing further impetus for Fed tightening.

Moreover, U.S. consumers are feeling confident enough to take on debt to buy big-ticket items. Companies are reporting brisk sales for cars and household appliances thanks to consumer credit expansion, as we discuss in our Sector View. Steady hiring by companies also bodes well for consumer spending, generally. All told, economic momentum is creating a tightening spring beneath rates. With the Fed shifting its rate outlook upward for 2015, there is real risk this spring could push rates higher, underscoring the importance of balanced and defensive investing.

The spring underneath U.S. rates may be hard to appreciate as rates here have been contained partly by yield-hungry foreign investors. The decline in European sovereign yields has been much steeper than in Treasurys. The European Central Bank (ECB) is becoming increasingly aggressive about monetary stimulus to head off eurozone deflation and a faltering recovery. The ECB's measures have created "irrational pricing" with some two-year European sovereigns carrying negative yields. Any rise in U.S. Treasury yields makes them all the more attractive to foreign buyers, especially those whose local currency is depreciating versus the U.S. dollar.

This dynamic may keep U.S. rates range bound for the time being. In turn, investors may continue to embrace greater risk by going down in credit quality and by extending duration. High yielding emerging market (EM) debt is also in vogue, but here too, we are being selective. EM markets, which have depended on the Fed's loose monetary policy and China's growth, are looking particularly vulnerable. In fact, we believe concerns about China's growth may only increase. Thus, we are paying close attention to local EM currency markets for early hints of concern.

With the economies in Europe and Japan continuing to struggle as well, it can seem like the U.S. is going it alone. But, as we discuss in the Global View, the UK's recovery remains intact and could precede the U.S. in raising rates, another reason to remain balanced in one's rate outlook and to be positioned accordingly. We still see exciting investment opportunities in fixed income as the U.S. defies the global growth trend and the rest of the world repairs itself. But, we intend to take advantage of them strictly within the confines of our key tenets of seeking risk-adjusted returns and capital preservation. We believe resisting the lure of greater risk will serve our clients well in the end.

Gibson Smith
Chief Investment Officer, Fixed Income

THE COMPANY VIEW

Pockets of wage pressure

company-informed macro

- The Federal Reserve (Fed) is focused on wage pressure as a key metric of labor market strength.
- Recent minimum wage increases and a shortage of skilled labor have boosted wages in several industries.
- Energy, restaurant and construction companies are reporting higher labor costs.

Defying a trend

A key metric of the labor market's strength is wage growth. Fed chair Janet Yellen has made it clear that she would like to see greater wage growth before the Fed raises rates. While income gains are hardly broad-based nationally, companies from a variety of industries are still citing higher labor costs. Restaurant-chain giant **McDonald's** said it expects "significant pressure" on profit margins due to "higher labor expenses partly as the result of minimum wage increases in several states."

State-level minimum wage increases are gathering momentum across the nation. Wage pressure would be more pronounced at restaurant chains from **Starbucks** to **Chipotle** were it not for scheduling software, which keeps worker hours to the very minimum needed. It's unclear how effective the software may be in managing wage pressure long term. When store managers at hamburger chain **Red Robin** didn't precisely abide by the software, the chain's labor expenses hit profit margins.

Meanwhile, shortages of skilled workers ranging from oil rig operators to garbage truck drivers to carpenters means higher wages being paid by energy companies, waste management firms and homebuilders. Oil producer **PDC Energy** says "Labor costs have been growing across all services; drilling, completion and production operations." **Masco Corp.**, installer of home building material, and homebuilders **Ryland Group** and **Lennar** continue to pay up to attract enough subcontractors. While the Fed doesn't see widespread wage pressure yet, a foundation for it is forming.

Construction firm KBR says wages and per diems are moving up quickly in the Gulf Coast.

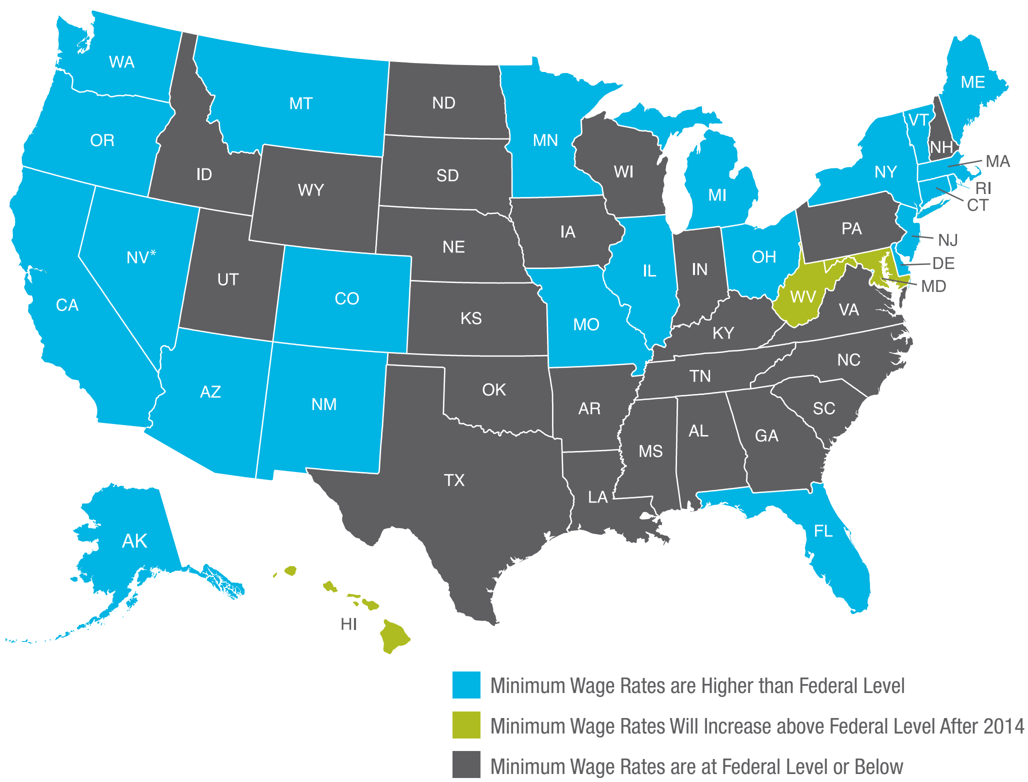
Chevron Corp CEO John Watson says oil at $100/barrel pays for the oil output that $20/barrel did years ago partly because of labor costs.

Building parts supplier Universal Forest Products sees a shortage of skilled labor impacting its business more than weather-related issues.

MINIMUM WAGES BY STATE

More Than 20 States Have Set a Minimum Wage Above the Federal Government's $7.25/hour

Light blue states (and D.C.) have wages above the $7.25/hour minimum wage. Green state wages will rise above the federal level in 2015.



Source: U.S. Dept. of Labor and National Conference of State Legislatures.
*Nevada has the same federal rate of $7.25/hour if paid with health benefits.

KEY IMPLICATIONS

- **Minimum wage increases at the state level are spreading, and that may help fuel Federal Reserve hawkishness.**
- **Higher wages typically lead to greater consumer spending, which grows the economy.**
- **Technology, such as work scheduling software, has helped contain wage pressures, but it has its limits.**

Borrowing is back

- Borrowing to purchase big-ticket items, like home appliances, is on the rise.
- Auto lending has surged, with subprime showing noteworthy expansion.
- Loosening credit conditions will spur economic growth.

Durables given credit

The consumer durables sector is getting a shot in the arm amid loosening credit conditions. Our company research shows that consumers are borrowing to buy cars and home appliances. Credit creation gives the U.S. recovery deeper roots as it spurs growth and reflects consumer confidence.

Home Depot says purchases of big-ticket items have fueled demand for its private label credit card, with consumer approval rates steadily rising in the single digits, and the average credit line now at $5,800. Appliance retailer **HHGregg** says purchases with its private label credit card have grown to almost 40% of its business due to increasing credit demand from customers. At the same time, both **Whirlpool** and **Electrolux**, the dominant players in the home appliance market, reported record earnings for their North American operations, specifically the U.S.

Meanwhile, consumer demand for auto financing has only gathered momentum, leading to the best sales growth at **Ford**, **Chrysler** and **GM** in years. **Ally Financial**, the second largest auto lender, expects feverish demand to continue after it recently reported its second highest quarterly originations in its history. **Capital One** has taken advantage of the hot demand and has been a big market share winner in auto lending. **JPMorgan Chase** notes the increasingly competitive market has resulted in aggressive expansion into subprime lending by some. While this has sparked concern by regulators and economists alike, loosening credit is allowing for greater participation in the U.S. recovery.

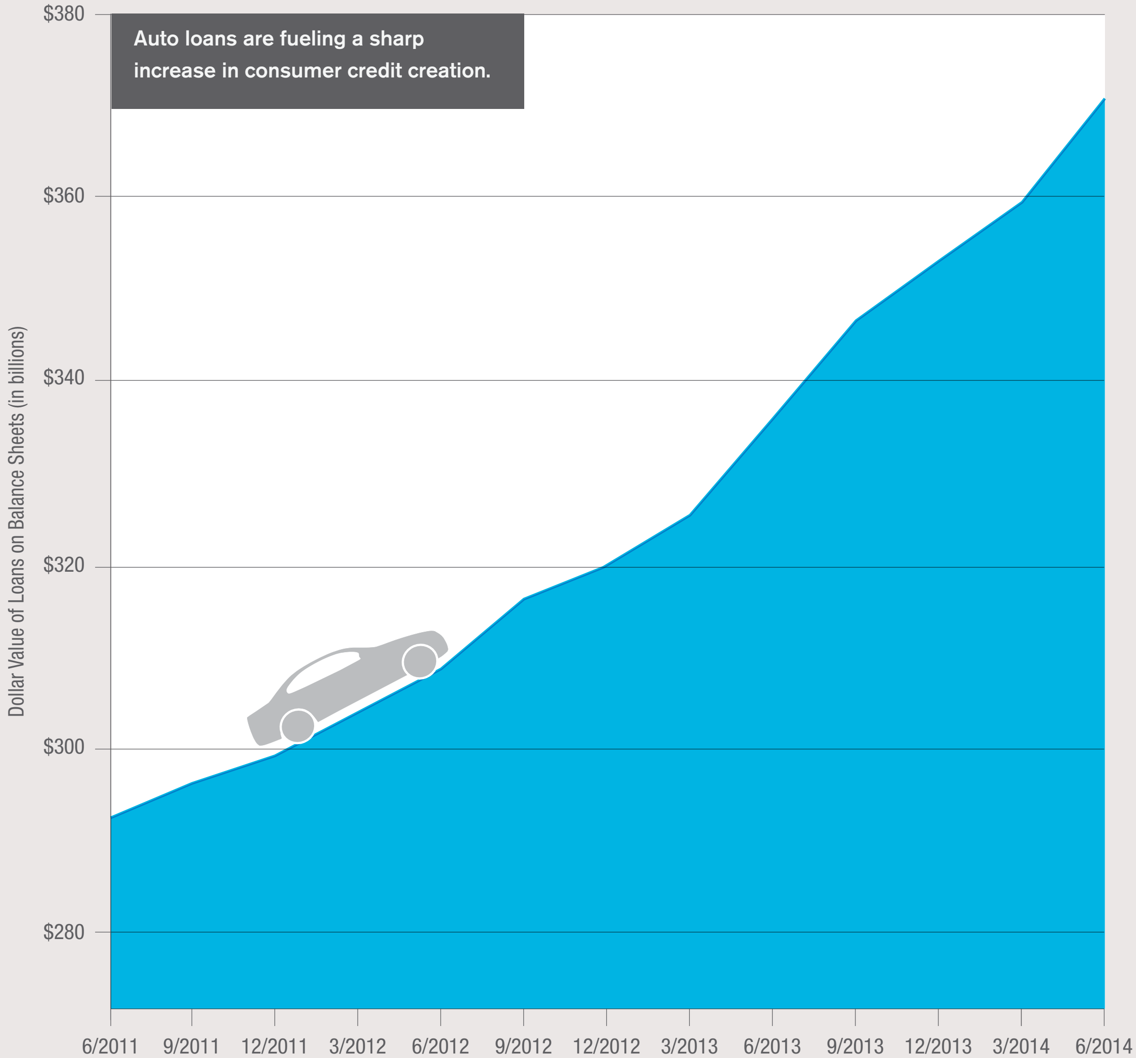
HHGregg says customers are "really interested in credit," so it's expanding its credit offerings.

Bank of America is seeing rising momentum in credit spending and growing card balances.

Home appliance store Conn's has hired more people in its credit division to meet borrowing demand.

AUTO LOANS ON BALANCE SHEETS OF FDIC-BACKED LENDERS

A Record Number of Consumers are Borrowing to Purchase a Car



Source: Bloomberg, FDIC.

KEY IMPLICATIONS

- **Demand for credit to buy consumer durables is solid evidence of loosening credit conditions.**
- **While consumer credit expansion will spur U.S. economic growth, an increase in subprime lending has created concern about a lending bubble.**
- **Increased borrowing and lending is a sign of consumer and business confidence that may help fuel continued spending.**

Defiant growth

- We expect U.S. gross domestic product (GDP) growth to end the year around 2% in the face of ebbing growth abroad.
- A solid labor market could keep consumer spending steady; business spending is rising.
- Core inflation should remain around the Fed's target of 2% if commodity prices remain tame.

Shouldering global growth

The U.S. economy is defiant. America's growth has survived a severe winter slowdown and the economic travails of its major trading partners. For now, one of the only other G7 economies in good shape is the UK. Sometimes it feels like U.S. growth is going it alone. Yet, based on what we're hearing from companies, we believe the U.S. can achieve 3% GDP growth for the second half of 2014, ending the year with 2% growth overall.

The recovery's health pivots on the labor market, both in hiring and wages. Supermarket giant **Kroger** is hiring for 20,000 permanent positions while **Fastenal** is boosting headcount by mid-teen percentages, so senior staff will have more time for sales. Corporate hiring is reflected in solid nonfarm payroll growth of 215,000 a month on average for 2014. While wages are holding steady nationally, we've discussed how there are pockets of rising wages in the labor market. That's a promising signal given consumer spending is 70% of gross domestic product.

Now, business spending on products and services is perking up after being diverted to acquisitions in 2014's first half. The increase is being seen across industries from food processing, like **Tyson Foods**, to construction, like **Vulcan Materials**. Spending is being balanced somewhat by tame commodity prices, and we expect core inflation to remain contained around the Fed's 2% target. This will allow the Fed to raise rates incrementally starting in 2015's second half, especially as the U.S. shoulders much of the world's growth on its own.

Wal-Mart is seeing modest deflation in some consumer products.

Domino's Pizza is beginning to spend at a faster pace on production and distribution projects.

After recently hiring 2,500 people in California for a new fulfillment center, Amazon is extending its hiring spree.

U.S. MACROSCAN			
	FACTOR	TREND	OUTLOOK
CONSUMER			
	▸ Housing is improving in the second half of 2014. New and existing home sales are turning around and the S&P/Case-Shiller Home Price Index is up 6.8% year over year (YoY). ▸ The Conference Board's consumer confidence index has reached multi-year highs. ▸ Nonfarm payroll job growth is now averaging 226K in 2014, with the unemployment rate down to 5.9%.	↑	▸ We expect consumer spending to extend its solid trend into year-end amid steady job creation, increased net worth and stable savings. ▸ We expect housing to recover in year-end from the beginning of the year softness. ▸ Current job growth will keep the unemployment rate within the Fed's 5.2% to 6% natural rate of employment into year-end.
BUSINESS			
	▸ The pace of business capital expenditure is starting to recover (now up 9.7% YoY within the GDP report), but is still slower to recover than we expected. ▸ The Institute for Supply Management (ISM) manufacturing index for September printed at 56.6, near its high levels.	↑	▸ We expect full-year GDP growth to be 2% in 2014, but we have the second half at a 3% pace. ▸ The business spending recovery should continue, in our view. While 2014's M&A activity has dampened business spending, we believe demand will help bring capital expenditures back to pre-crisis levels.
INFLATION			
	▸ Inflation remains within a normalizing trend. The core Consumer Price Index (CPI) printed 1.7% YoY while the core personal consumption expenditures (PCE) price index recovered to 1.5% YoY. ▸ Commodity prices remain tame. Oil is trending around $90/barrel and gold is around $1,200/ounce.	↔	▸ We expect year-over-year core CPI for 2014 to be around the Fed's 2% target, compared with 1.7% in 2013. ▸ We don't see inflation having a material impact on consumer spending. Consumers should benefit from generally tame commodity prices. We are starting to see pockets of inflation, but it's within the price "normalization" trend.
FISCAL & MONETARY POLICY			
	▸ A continuing resolution was passed to extend government funding levels through December 11; this gives Washington time to get through the November 4 elections. ▸ The debt ceiling was raised until March 15, 2015. ▸ The Federal Reserve (Fed) has continued to taper its quantitative-easing (QE) program and to prepare the market for an exit from loose monetary policy.	↑	▸ Elections November 4 will determine leadership in the Senate. Budgets from Congress are due in February and the debt ceiling will need to be addressed in March 2015. ▸ The Fed will conclude tapering in October. We still expect the initial Fed rate hike in mid-2015 and that monetary tightening will be gradual.

Source: Janus.

KEY IMPLICATIONS

- **Steady jobs growth and tame inflation supports a gradual rate hike trajectory by the Fed starting in mid-2015.**
- **Manufacturing activity and consumer spending puts U.S. growth on track for 3% in the second half of 2014 and full-year growth at around 2%.**
- **The momentum of the U.S. recovery points to continued moderate growth as monetary stimulus disappears.**

Central bank divergence

- The UK may raise rates before the U.S., while Europe and Japan maintain their loose monetary policies.
- UK's rate hikes could be as early as 1Q 2015 as the economy gathers momentum.
- The Bank of England (BOE) is expected to raise rates incrementally to protect UK growth.

Defiance creates divergence

The UK economy, like the U.S., has defied the slowing growth of some of its G7 trading partners. Company reports signal that the UK's strong economic growth will continue. Now, diverging G7 growth is culminating in central bank policy divergence. The UK is set to be first out of the gate to hike rates, with the U.S. a close second, while loose monetary policies in Europe and Japan aren't expected to change anytime soon.

As BOE officials debate whether to hike rates as early as 1Q 2015 or before then, the UK's **Lloyds Banking Group** says it's experiencing rapid and accelerating growth in consumer loans to the tune of 16% year to date. Strong UK consumer confidence is translating straight to discretionary spending, and high-end coffee chains like **Starbucks** and Whitbread Plc's **Costa Coffee** are reporting that UK sales are trouncing its sales in continental Europe. Consumer spending is being supported by steady job growth, with the UK unemployment rate heading toward 6%.

French hotel group Accor says its UK business improved strongly in the second quarter, and it expects the trend to continue.

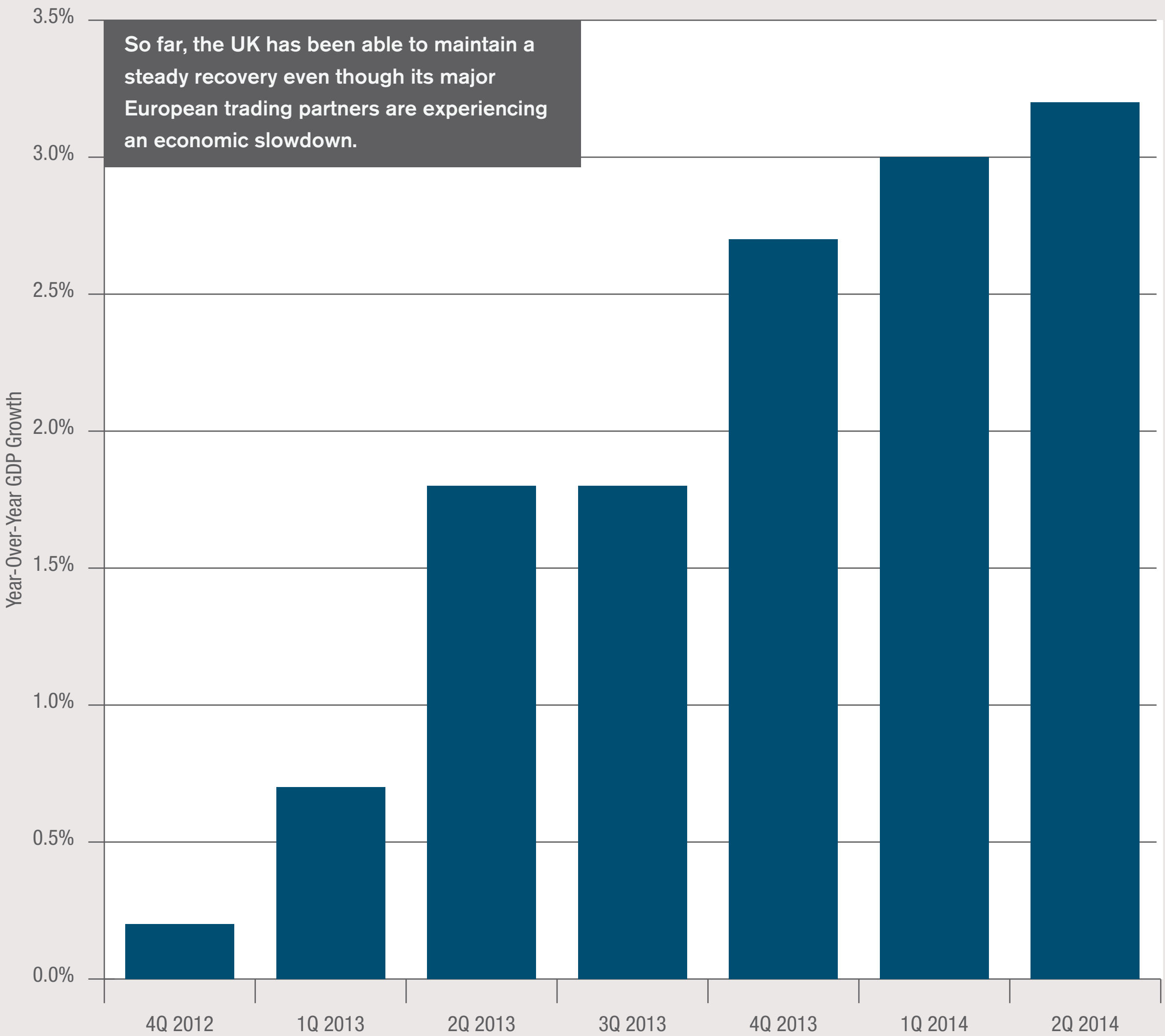
Already the UK's largest bank, **HSBC Holdings**, is anticipating that rate hikes will make holding cash at the bank more attractive. Yet, BOE officials appear very aware that UK growth must defy a weaker global economy. Expectations are for a cautious rate hike regime. Still, robust company prospects in the UK are a reminder that the growth chasm within the G7 could soon widen into a monetary one.

UPS is doubling the capacity of its Southampton, UK, facility to meet demand.

Scotts Miracle-Gro noted its business momentum is being partly driven by double-digit sales growth in the UK.

UK YEAR-OVER-YEAR GDP GROWTH SINCE END OF 2012

Consumer Spending is Driving UK GDP Growth



Source: Bloomberg. As of 6/30/14.

KEY IMPLICATIONS

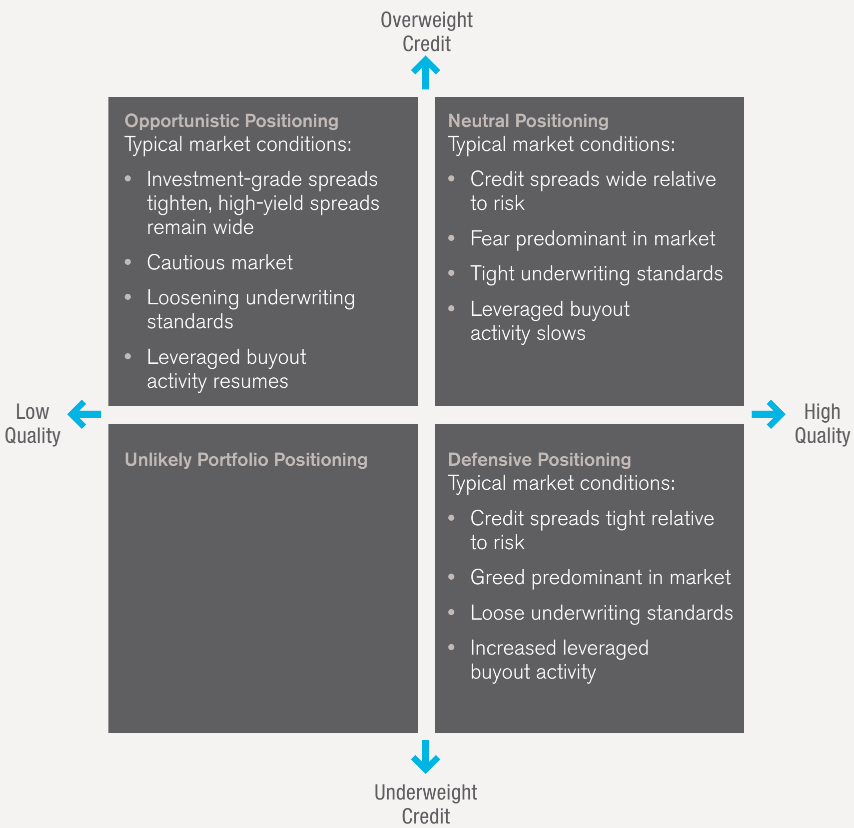
- **Once the BOE raises rates, higher rates on UK gilts versus eurozone sovereigns could make gilts more attractive.**
- **A tighter monetary policy typically strengthens a currency, so the British pound could strengthen versus the euro and yen.**
- **The UK's rate hikes may be very incremental in order to protect its economy in the face of weak global growth.**

ROADMAP TO JANUS FIXED INCOME POSITIONING

Near-term credit neutral, interest rate neutral to defensive

Janus fixed income portfolios are overweight credit (as of 9/30/14), with a neutral-to-defensive stance on interest rate exposure.

PORTFOLIO POSITIONING SUMMARY



Sector Allocation

- We remain constructive on corporate credit in general. While our credit weighting remains fairly similar to last quarter, we continue to trim richly valued positions. Moreover, given relatively high valuations in general we remain especially selective. Our continued overweight reflects our view of the relative attractiveness of credit versus interest rate-sensitive securities, such as Treasurys.
- We maintained our credit duration while tactically increasing our duration contribution from Treasurys. This positioning enables us to be opportunistically neutral to defensive along the yield curve given the interest rate environment.
- Among securitized products, we slightly increased our exposure to agency mortgage-backed securities (MBS). We continue to believe the shrinking MBS supply and steady demand will keep spread levels tight. We are biased toward higher-coupon securities due to their lower volatility and because the Federal Reserve is ending its purchasing of lower-coupon MBS. In commercial mortgage-backed securities, we cut exposure slightly due to material early debt repayments.
- We maintain little exposure to bank loans as we think better risk-adjusted returns can be found in high-yield bonds.

- We remain cautious on emerging market (EM) debt. We believe that plans by the U.S. to tighten monetary policy and a slowdown in China's growth will create heightened volatility in EM markets. Still, we remain cognizant that there may be potential opportunities in select countries.
- We believe some peripheral European sovereigns are attractive as fundamentals slowly turn in these countries and the European Central Bank implements aggressive stimulus.

Credit Spreads

- Thus far, the pace of shareholder-friendly activity remains unabated in 2014 with more share buybacks, dividend increases and additional mergers and acquisitions. We expect it to remain high as economic activity gains momentum in the latter half of the year.
- Some caution is warranted with credit. Both investment-grade and high-yield spreads are relatively tight, even after some widening in high-yield spreads during the summer. Current spread levels express a very bullish view in the credit markets, in spite of the increased shareholder-friendly activity. We believe it's important not to stretch for yield in this environment.

- We are concentrated in the front end of the curve on the higher quality credits, where we are finding good risk-adjusted opportunities that can generate some additional income above that of the benchmark. Our long-end exposure is more selective, reflecting our long-term view of rates.
- We believe security avoidance will be just as important as security selection going forward. Amid rising valuations, increased shareholder-friendly activity can quickly create more risk than reward with individual issuers. These are the type of issuers we seek to avoid.

Duration*

- Duration contribution from U.S. Treasurys, and sovereigns where applicable, remains less than that of the indices overall, consistent with our concerns around interest rate volatility. We still maintain certain short-duration Treasury positions for liquidity.

** Duration measures a bond price's sensitivity to changes in interest rates. The longer a bond's duration, the higher its sensitivity to interest rates, all else being equal.*

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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.

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.

The Consumer Price Index (CPI) represents changes in prices of all goods and services purchased for consumption by urban households. The core CPI represents changes in prices of all goods, excluding volatile food and energy prices.

Case-Shiller Home Price Indices are constant-quality house price indexes for the United States. There are multiple Case-Shiller home price indexes: a national home price index, a 20-city composite index, a 10-city composite index and 20 individual metro area indexes.

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