2Q 2015

GLOBAL
OUTLOOK

JANUS CAPITAL Group

Sobering Times

Growth prospects seen through a cautious lens

FUNDAMENTAL-INFORMED MACRO VIEWS FROM JANUS FIXED INCOME

Fundamental-Informed Macro Views

Fundamental, independent research has been at the core of the Janus Fixed Income process for over 25 years. While many competitors rely on government statistics to form a top-down view, we focus first on company, issuer and security level fundamentals. We believe this approach differentiates us from our peers and other macroeconomic data providers. Our comprehensive, bottom-up view drives decision making at the macro level, enabling us to make informed sector and risk allocation decisions.

Each quarter we share our global outlook and provide insights on emerging investment opportunities and risks.

ABOUT JANUS FIXED INCOME

- **Over 25 years of experience focused on risk-adjusted returns and capital preservation**
- **Integrated fixed income and equity research**
- **Quantum Global: proprietary investment research and risk management system**
- **Highly collaborative, non-siloed team based in Denver and London**
- **34 fixed income investment professionals**
- **$33.6 billion in assets under management as of 3/31/2015**

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GIBSON SMITH
CIO, FIXED INCOME
& PORTFOLIO MANAGER

Are We Headed for a Hangover?

It's late, and the punch bowl is half full.

With central banks around the globe still in accommodative mode, the threat that the Federal Reserve (Fed) will pull away the punch bowl sets up the markets for some real disruption. Until then, let the party continue.

Many investors have been drinking from the punch bowl. The punch leads them to believe that interest rates are still heading lower, will remain low for a long time, and that corporate spreads will follow suit. They've convinced themselves of a never ending fixed income rally.

Most of us know the effects of drinking too much, and the impact it has on decision making. **Before casting judgment, however, drinking this "Lower for Longer" punch can be hard to resist. After several rounds, you may end up calling the drink "Lower Forever." Just look at the ingredients:**

First, inflation remains contained globally, with some countries still in jeopardy of disinflation. The deleveraging cycle post the Great Recession continues to play out. In addition, the decline in oil prices, and in commodity prices more generally, have fueled a new round of concern. Then, add in the strong U.S. dollar, which makes imports to the U.S. cheaper and U.S. exports more expensive. This potentially hurts U.S. growth and further strengthens the lower for longer view.

More pungent is the stubborn economic slowdown abroad, not just in Europe but in China, which may be of greater importance. But, what really makes this cocktail stand apart? The powerful and unprecedented scale of monetary stimulus by central banks around the world that has sent rates plunging internationally.

A round of low yields for everyone

At this point, several developed market rates are far lower than the yield on the 10-year U.S. Treasury, which is hovering around 2%. The yield on the 10-year German bund is at around 40 basis points while some European rates are negative. If you like, you can pay the Swiss government 20 basis points per year to own their seven-year debt. This only encourages foreign investors to buy higher-yielding Treasurys, which in turn, keeps those yields lower.

Feeling dizzy?

No wonder. The "Lower for Longer" punch is flowing and the decision making in fixed income is becoming more and more blurred, with investors overly complacent about potential downside risks.

Why stop consuming? The market is flush with easy money that is being pumped by central banks around the globe, and there is no indication that it's going to stop any time soon. Fight it at your own peril as you might miss out on a few basis points of performance, and those few basis points could make or break your year from a competitive performance standpoint. We hear, "Don't be left behind in the fun." But, how much fun is it really?

Too much punch leads to complacency and risks

We see that lower for longer complacency is not only building in the sovereign bond markets, but also in the risk segments of fixed income. The central banks – monetary bartenders, really – allow investors to feel okay about continuing to take on risk even as corporate spreads remain historically tight. The commercial mortgage backed securities (CMBS) market has totally recovered from the lows of the financial crisis, and you can hardly see daylight between the yields of unsecured agency debt and 10-year Treasurys. Investors have been drinking the punch far too long.

With all the optimism about spreads tightening even further and rates heading lower, you would think that companies would hold off issuing debt until rates declined more. But, these sober patrons see opportunity, especially in debt with longer maturities. They're showing up in force to meet the insatiable drunken demand for even the anemic yield they're offering. Given the great deal these companies are getting, it makes them generous enough to issue the securities at a discount to thank the buyers for inviting themselves to their party.

We can hear the issuing company's leadership loudly saying: "Congratulations. You are one of the new owners of long duration, low coupon debt that holds paltry return potential. Thank you for your support." In other words, bonds with plenty of interest-rate sensitivity and downside risk that will be hard to sell if need be. Thank you for joining us. Have more punch.

The complacent get stuck holding the bag

This drinking analogy hopefully drives home the point around the complacency in the market today. We all know people that can drink all night and keep the party going. But, they can also overstay their welcome. **I don't know when the party is going to end, and this party could rage on for some time, but I know for sure that the band has stopped playing and we have turned to the jukebox for our musical enjoyment.**

Let's consider more facts.

It is always helpful to pull up a graph of the yield on the 10-year U.S. Treasury going back to 2007. Let's remember in that time that rates have had several periods of roughly 100 basis point moves in relatively short time frames. Five have been lower and three have been higher. Over the past eight years, 10-year Treasury yields have rallied from just over 5% to just beneath 2%. Getting the 100 basis point moves right, in either direction, can be key to investment success. But don't be wrong today as the outcome can cost you big in an already low return environment.

We've already seen this in the "taper tantrum" in 2013. We saw it at the end of 2014 in risk assets when owners of long-duration credit wanted to sell in order to stem losses. Given the credit market's low liquidity, especially in long-duration corporate debt, these investors were stuck holding the bag.

Restraint is needed to see the opportunities

I believe certain spread securities (those that are priced off Treasurys) can still be a solid investment for the extra yield and potential return. But, as I mentioned, the drinks are flowing and spreads are already tight. Year-to-date corporate debt issuance is up about 10% (and it's only gathering momentum) and CMBS issuance is up more than 35%.

Be selective. If we learned anything in the last four to five significant fixed income market corrections, it is that those pesky credit blowups become very costly. We also know that when there is a need and desire for more yield/return, investors go down in quality and extend duration to achieve their goals. This strategy can work for a while, but when the music stops and the lights get turned back on, you may realize you are dancing alone.

It is a time for caution, and to be actively defensive with investing. The Barclays U.S. Aggregate Bond Index doesn't give you that, in my view. It gives you a lot of long-end Treasury-weighted duration, interest-rate sensitivity and potential volatility.

I hate saving the best for last, but the real story that exemplifies investor complacency is that so many are turning a blind eye to the lack of trading liquidity in the fixed income markets. Many investors have been handed warnings about this by the Fed, and now, the International Monetary Fund. But, they would prefer to dance and drink than read.

Gibson Smith
CIO, Fixed Income & Portfolio Manager

COMPANY-INFORMED MACRO VIEW

Where's the Spending?

As gasoline prices tumbled in 2014, there was much talk that less money spent on gasoline would boost spending on more discretionary purchases. After three consecutive months of declines, retail sales rose in March (month over month) only to fall back to posting no growth in April. Indeed, it is not clear how strong the retail sales recovery will be. While some companies are now uncertain about how much lower gasoline prices will be a benefit, others are providing reasons to believe that spending should still see some uptick as 2015 progresses.

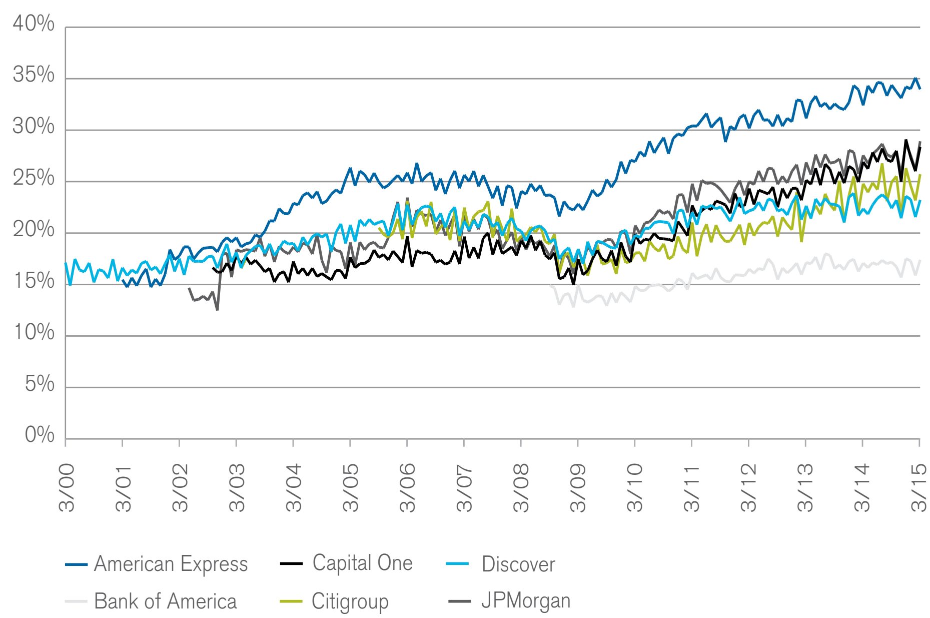
Credit card issuer **Capital One Financial** says the sharpest drop in gasoline prices has only been in the last several months, so it's still too early for the impact of lower gasoline prices to translate into consumer spending growth. **MasterCard** says its cardholders are waiting to see whether lower gasoline price trends stick before splurging. Yet, the Energy Information Administration estimates that Americans spend 4% of their pre-tax income on gasoline, so what are consumers doing with this extra cash?

Visa estimates that 50% of the extra cash their cardholders have in their wallet is being stashed in savings, while 25% of it is being used to pay down debt. That is leaving only 25% for discretionary expenditures. Part of the caution may stem from the fact that lower gasoline prices affect lower- and middle-income workers the most, so they also have the most to lose if gasoline prices suddenly turn upward.

KEY TAKEAWAYS

- Retail sales have been lackluster as consumers have yet to be confident that savings on gasoline are here to stay.
- While companies are cautious about how much lower gasoline prices ultimately will boost consumer spending, the pace of retail sales could gather momentum as current and expected wage hikes are also added to the mix.
- Retail sales are slow now, but the larger threat to the traditional retail model is e-commerce, and we would favor companies that have solid online capabilities or are more insulated from e-commerce taking their market share.

Savings on gasoline are also being channeled into debt payment



The above graph shows the average percentage of credit card balances paid each month by credit card issuer. Monthly payments on credit card balances have been on the rise since the financial crisis, reflecting more prudent debt management by credit card customers by and large. Lower gasoline prices are helping to contribute to this trend as people use some of the savings to pay down a greater amount of their monthly balance.

Source: Credit card issuers and Janney Capital Markets.

Discount retailer **Family Dollar** says gasoline prices may eventually provide impetus for its customers to spend more, but thus far, other macro factors like lackluster wage growth have kept them from spending. Despite the unemployment rate dropping to the Federal Reserve's targeted range in February, wage growth has lagged that of past labor market recoveries.

But, consumers that live on hourly wages are beginning to see some respite. That may create enough tailwind for spending to pick up. First, at the start of 2015, minimum wage increases came into effect in more than 20 states. These state-level hourly wage hikes have been met with an increasing number of major retailers like **Wal-Mart**, **TJX Companies** and restaurant chains like **Panera Bread** and **Cheesecake Factory** boosting wages for their workers. The impact of an hourly wage increase is far reaching. According to the Bureau of Labor Statistics, more than 3.3 million Americans live at or below minimum wage.

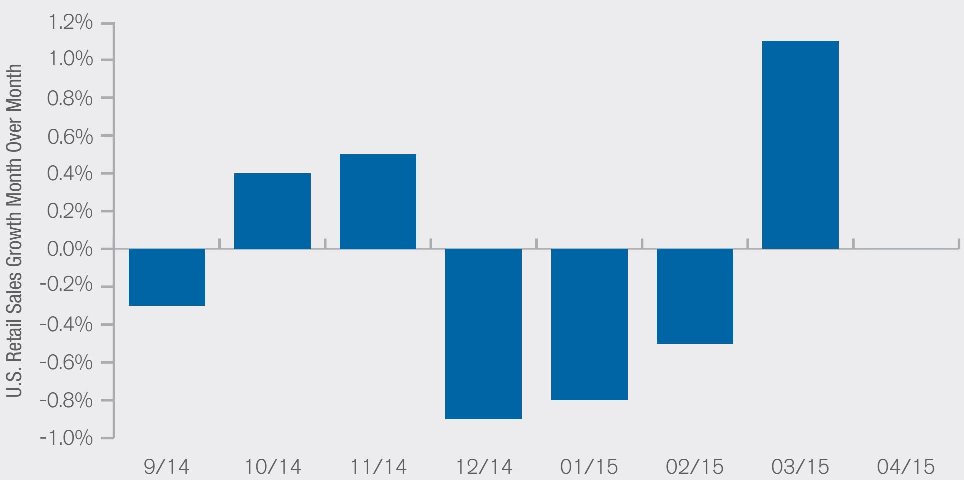
Provided the uptrend in wages continues and gasoline prices remain lower, we could start to see a related boost in consumer spending in the second quarter, which is why we still see the U.S. GDP growing at 2.75% this year as spending finally catches and growth is lifted in the second quarter through year-end.

Discover Financial Services says credit card purchases were generally not as robust as expected for the card industry generally, and it cited an increase in the personal savings rate as a possibility.

Amid speculation that debt is being paid at the expense of retail sales, student loan company **Navient** says the Class of 2014 is showing the best loan payment performance of any graduating class.

Companies cautious about a retail sales rebound

While retail sales rebounded in March (month over month), there was no growth in April retail sales. Some companies say that extra cash from lower gasoline prices is also finding its way into personal savings and debt repayment rather than at the cash register.



Source: Bloomberg.

KEY TAKEAWAYS

- Agency MBS tend to underperform in volatile Treasury rate markets such as the one we are in, and given their historically tight spreads, generic MBS may not compensate investors for downside risk, in our view.
- We still believe there are opportunities in MBS, particularly those securities that we believe are more prepayment resistant.
- The securitized market also holds opportunities in the CMBS market, such as the pre-crisis issued CMBS with underlying assets that are deleveraging.

Tug-of-War

The market for mortgage-backed securities (MBS) issued by government agencies like Fannie Mae and Freddie Mac is in a tug-of-war of excellent technicals but terrible fundamentals.

Technically, agency MBS is in good shape due to the low expected supply combined with high demand from the Federal Reserve (Fed) money managers and banks. We only expect about $100 billion of new net supply in 2015, up from 2014, but still not much of a dent considering the total mortgage market is $5.3 trillion. The Fed owns about a third of the mortgage market, and while they are no longer adding to their MBS portfolio, they are also not letting it roll off. This means that whatever principal prepays monthly from their mortgage book, the Fed is using that cash flow to buy new mortgages.

Agency MBS issuance (billions)

2015*	2014	2013	2012	2011	2010
100	66	237	29	26	-148

*estimated.

Source: BofA Merrill Lynch.

Additionally, money managers came into the year at very low weights of MBS versus the Barclays U.S. MBS Index. Given the hunger for yield and low Treasury rates, money managers have been adding MBS. Banks need to add MBS to meet new regulatory guidelines. This has left MBS spreads historically tight. While there are select opportunities, we don't believe the asset class in a generic sense compensates the investor for the risks it holds.

Agency MBS 30-year current coupon spread versus U.S. Treasury curve

The yield difference between agency MBS and the U.S. Treasury curve has tightened.

Source: Bloomberg.

Fundamentally, the agency MBS market is in difficult shape due to the higher levels of rate volatility, mainly driven by uncertainty around the timing of the Fed's anticipated rate hike. Mortgages tend to underperform in volatile rate environments, especially if new rate lows are reached, leading to higher prepayments and more cash flow uncertainty for the investor. This is exactly the environment we are encountering.

Where is one to invest? We favor agency MBS that we believe has a stable, more prepayment-resistant profile in volatile markets. For example, based on our bottom-up, fundamental approach to MBS, we have found low loan-to-value mortgages in the Midwest attractive. We believe these mortgages are low enough to make it unlikely for the owners to refinance. We also cast a wide net in searching for solid, risk-adjusted returns. Certain Portuguese MBS are attractive, in our view. We believe these securities have the potential to track the gains of Portuguese sovereigns amid the European Central Bank's sovereign bond-buying program.

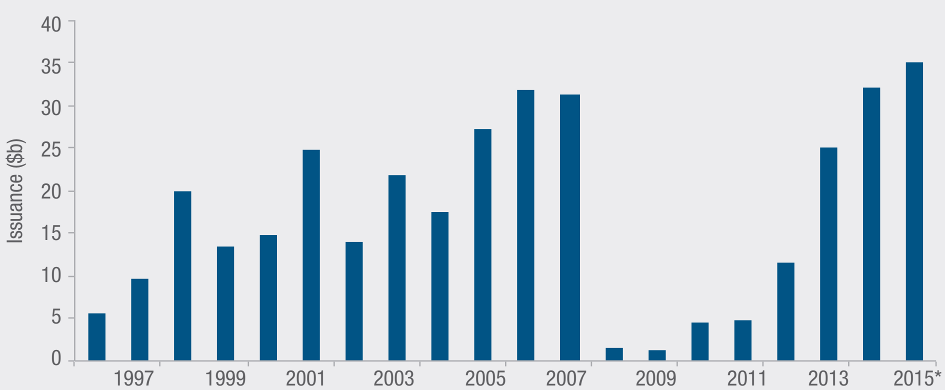
Finding attractive opportunities in the commercial mortgage-back securities (CMBS) market is also challenging now that the market is fully recovered from the 2008 financial crisis. So far in 2015, CMBS issuance is up more than 35%.

However, opportunities are there. For example, CMBS issued pre-crisis has been attractive amid the deleveraging of underlying commercial real estate assets.

While CMBS can be a diversified pool of assets from different borrowers, we tend to favor new issues that represent single assets from single borrowers as information on assets and deal terms tend to be more transparent and have less leverage, in our view.

Single asset/single borrower CMBS issuance

Single asset/single borrower CMBS issuance is fully recovered from the 2008 crisis and has taken off.



*estimated.

Source: BofA Merrill Lynch Global Research, Intex.

U.S.
OUTLOOK

KEY TAKEAWAYS

- We believe a rate hike by the Fed at its September meeting is a possibility.
- U.S. economic growth could gather pace as the year progresses.
- Domestic economic growth should be supportive for companies with large U.S. economic exposure as well as their corporate debt.

Gathering Pace

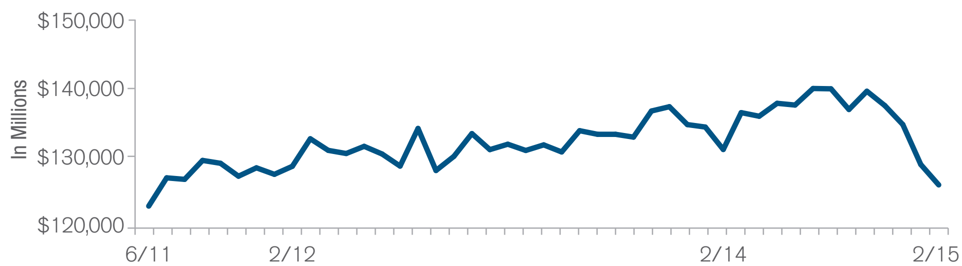
We expect U.S. economic growth to gather momentum in 2015, giving the Federal Reserve (Fed) cover to begin hiking rates, albeit cautiously, late in the year.

The jury is still out as to the extent to which lower energy prices will boost U.S. consumer spending. However, companies ranging from **Eastman Chemical** to major discount retailers like **Wal-Mart** and **Target** are optimistic that there will be some uptick in spending. **Starwood Hotels** says the combination of low oil prices and low interest rates could maintain the U.S. recovery for some time to come.

Any projections about the U.S. economy, given its size and complexity, must be dynamic, especially as it is tied to an even larger and fast changing global market. Indeed, U.S. growth has its challenges as well. For example, the upward tear of the U.S. dollar against most other currencies curbed exports in early 2015 and cut first quarter GDP growth.

First quarter GDP reflected weaker exports

A strong U.S. dollar has made U.S. exports more expensive for those abroad. U.S. exports of goods in February were the lowest since June 2011.



Source: U.S. Census Bureau.

At this juncture, it is unclear how much more exports will continue to weaken as the U.S. dollar's fast rise may have accounted for the stronger U.S. economy as well as the Fed's anticipated rate hikes. The Fed has moderated the amount it expects to raise rates in 2015, while the market itself has become more skeptical that a rate hike will occur this year.

Fed funds interest rate probability

The below table represents the current Fed benchmark rate as 0.25. Based on fed funds futures contracts as of April 30, the market is placing higher probabilities that the Fed will hike rates in either December 2015 or later.

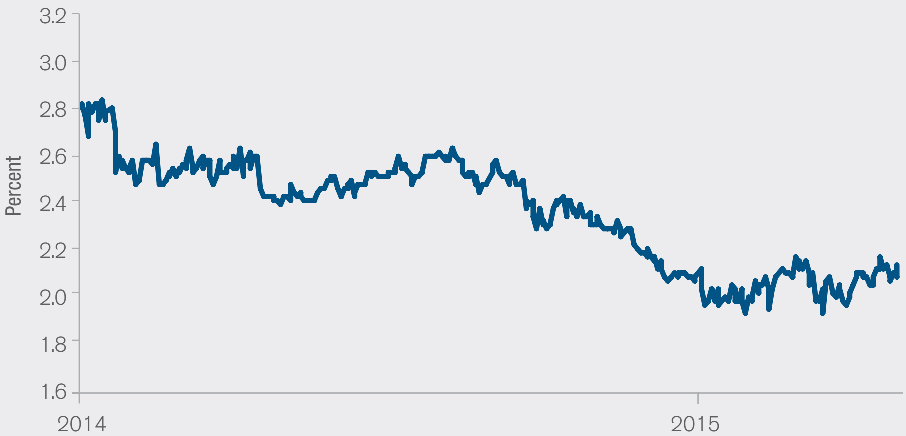
	Interest Rates					
Meeting Date	0	0.25	0.5	0.75	1	1.25
6/17/15	38.0%	62.0%				
7/29/15	35.0%	60.1%	5.0%			
9/17/15	23.1%	51.5%	23.7%	1.7%		
10/28/15	19.4%	47.0%	28.2%	5.2%	0.3%	
12/16/15	10.9%	34.8%	36.4%	15.3%	2.4%	0.1%
1/27/16	8.5%	29.6%	36.1%	20.0%	5.3%	0.6%

Source: Bloomberg.

In keeping with fed fund futures, the market also had been signaling a disinflationary environment through a decline in the 5-year, 5-year forward inflation rate. However, we believe there are glimmers that this indicator is bottoming, reflecting a bottoming in core inflation government data. As of March, year-over-year growth in core CPI, which excludes energy and food, was at 1.8%. It is moving toward the Fed's 2% target and playing out the Fed's thesis that depressed inflation is transitory. We believe that a September rate hike remains a possibility.

U.S. inflation may be tepid, but it appears to have bottomed

The 5-year, 5-year forward inflation rate appears to have stabilized after signaling disinflation.



Source: FRED. As of 04/30/15.

We see the overall trend of core inflation combined with a healthy labor market giving the Fed the confidence it needs to tighten monetary policy further. Mindful that companies (i.e., those doing the hiring) are themselves optimistic about U.S. growth, we expect the unemployment rate to end 2015 between 5.2% and 5.5%. Moderate wage growth also may help stabilize inflation. There is evidence that minimum wages are headed higher, with a variety of restaurants and retailers announcing pay increases on top of legislated minimum wage increases at the state level.

We also take note of companies like truck maker **PACCAR** and recruiting firm **Manpower** that expect that central bank stimulus abroad along with lower energy prices will create the beginnings of a global economic recovery. Demand for U.S. goods and services could increase as 2015 unfolds. That along with steady job and wage growth could help the U.S. achieve GDP growth of 2.75% in 2015, in our view.

Our Outlook for 2015

EUROZONE

GDP	1.2%. While Europe remains very early in its recovery and there are encouraging signs of growth, we expect low oil prices to help. For now, there is still high unemployment, low inflation and imbalances between core eurozone countries (like Germany) and weaker peripherals (like Greece). Greater economic stability may emerge in 2015.
Unemployment Rate	Will decline to 11.2%
Inflation	Will end the year at 0.3%
Monetary Policy	The European Central Bank (ECB) launched a quantitative easing (QE) program in the first half of 2015 to help combat disinflation. The program started mid-March.
Fiscal Policy	Austerity policies will continue to moderate, leading to less fiscal drag on the economy.

UK

GDP	2.5%. The UK will benefit from improving growth and unemployment as well as normalizing inflation and stabilization in Europe.
Unemployment Rate	Will decline to 5.5%
Inflation	Will end the year at 1.3%
Monetary Policy	The Bank of England (BOE) will maintain a loose policy until inflation recovers. Inflation has been softening on the back of lower energy prices and an appreciating currency, so we don't expect the BOE to boost rates until the end of 2015 at the earliest.
Fiscal Policy	The UK has reformed its tax regime to boost its coffers and stimulate the economy. It introduced a 25% tax on corporate profits moved outside the UK. That's expected to raise £1 billion over five years. A yawning fiscal gap requires continued budgetary discipline.

JAPAN

GDP	1.1%. Abenomics will continue to be both a growth driver and source of uncertainty.
Unemployment Rate	Will hold near 3.5%
Inflation	Will grow 1.3%, from 2014, excluding the effect of 2014's consumption tax increase. Lower oil prices should keep inflation beneath the Bank of Japan's (BOJ) target.
Monetary Policy	The BOJ is expected to engage in even more quantitative and qualitative easing to lift flagging growth and inflation.
Fiscal Policy	A consumption tax increase for 2015 was postponed to spur growth, which was derailed in 2014 by a consumption tax. Abenomics must deliver on structural reform to provide a foundation for long-term growth.

CANADA

GDP 2.5%. Canada will benefit from U.S. growth, but low commodity prices may affect its commodity export-driven economy.

Unemployment Rate Will decline to 6.4%

Inflation Will hold near 2%

Monetary Policy The Bank of Canada is biased to further rate cuts as growth slows on oil production cuts and inflation remains muted, also on oil prices. Their next move will be determined by the Federal Reserve (Fed).

Fiscal Policy Canada's fiscal policy remains mildly stimulative to support growth but will not deteriorate to where it impacts the overall picture. The deficit will trend back to neutral in 2015/16 as the growth path follows the U.S. improvement.

EMERGING MARKETS

GDP The economic slowdown in China, Brazil and Russia will continue, but there is potential for developed markets to improve enough to offset this for global GDP.

Inflation Lower commodity prices combined with a benign growth outlook will help keep inflation tame.

Monetary Policy The combination of a weak growth outlook and benign inflation will enable EM monetary policies (overall) to remain neutral with an easing bias. The Fed's communications and actions will remain a primary concern for EM countries.

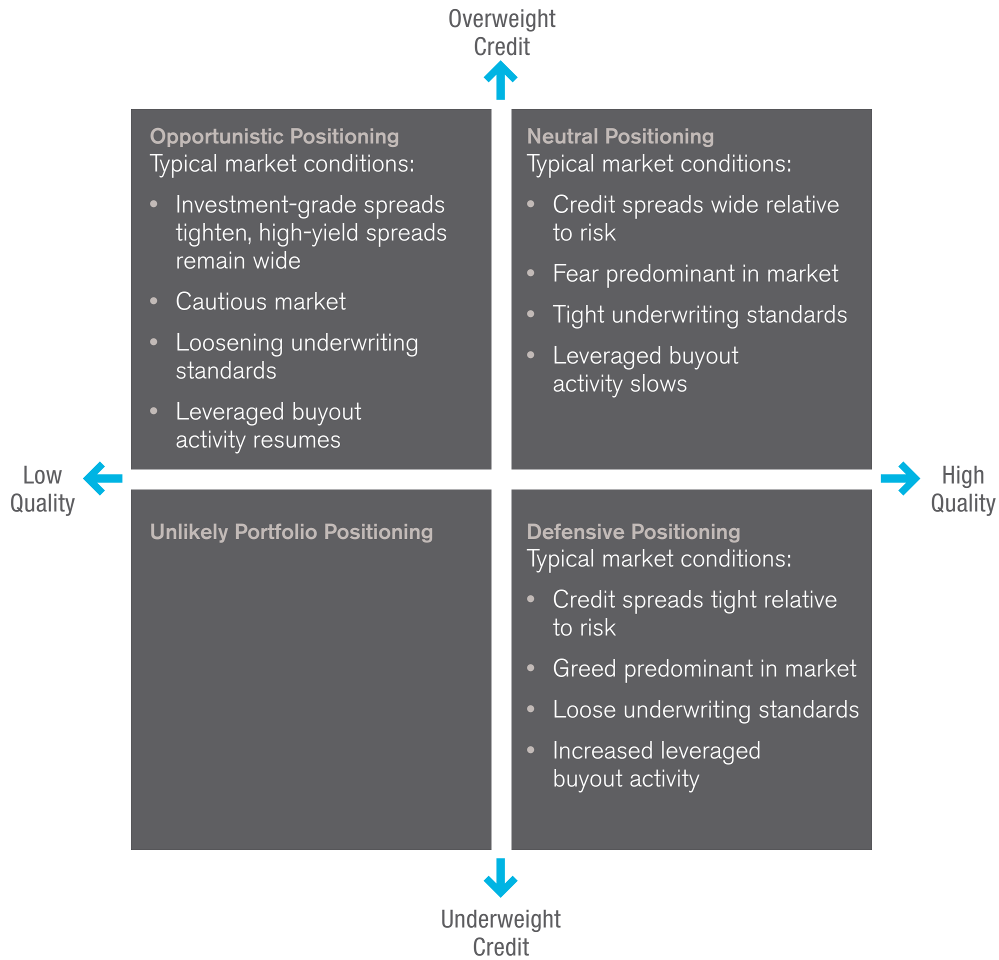
Fiscal & Current Account Balances As the Fed moves closer to or actually raises rates, EM current account balances will be a market focus. While many EM countries have made needed budget cuts, others have held back due to economic or political restraints.

China China remains a key determinant for EM countries due to its influence on the prices of commodities produced by them. China has begun to ease monetary policy to boost its flagging growth, and it has more tools in its arsenal.

Moving from neutral towards defensive positioning

Janus fixed income's multi-sector portfolios have been positioned with the goal of reduced credit exposure, but the exposure remains slightly above index weight. We are actively managing duration risk with a focus on capital preservation (as of 4/30/15).

PORTFOLIO POSITIONING SUMMARY



Sector Allocation

- We remain constructive on corporate credit in general. We continue to trim richly valued positions. As risk/reward profiles continue to decline, we have been reducing this overweight across the board. Our slight overweight relative to the index 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 have decreased our exposure to agency mortgage-backed securities. 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 potentially less volatility. However, given MBS outperformance over 2014 and the fears of prepayment speeds increasing given the rally in rates, we reduced the weighting. We continue to see early debt repayments in commercial mortgage-backed securities, which reduces our exposure to the asset class.
- We maintain little exposure to bank loans as we think better risk-adjusted returns can be found in high-yield bonds.
- We remain underweight to emerging market sovereign debt, and we have further decreased our exposure. We believe that diverging central bank policies globally and a slowdown in China's growth will create heightened volatility in EM markets. Additionally, the recent dislocations in the currency markets and the dramatic fall in oil prices have increased our pessimism for EM. 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

- The pace of shareholder-friendly activity remains unabated, with more share buybacks, dividend increases and additional merger and acquisition activity. We expect it to remain high as economic activity gains momentum 2015.
- Some caution is warranted with credit. Both investment-grade and high-yield spreads are relatively tight, even after some widening in both arenas since the summer, especially in oil-related credit spreads. We believe it's important not to stretch for yield as we continue further into the later stages of the credit bull market.
- We believe security avoidance will be just as important as security selection in 2015. We are in the very late stages of the recent credit bull market amid uncertainty about the direction of rates and increased shareholder-friendly activity. Risk/reward on specific credits can change rapidly. These are the type of issuers we seek to avoid.

Duration*

- Interest rate curve positioning is a primary focus as we get closer to potential Fed interest rate hikes. There was a substantial flattening of the yield curve in 2014 as inflation fears have remained muted. There will be a wide variety of factors to consider in 2015 that will impact the yield, including Fed timing, U.S. economic momentum, Japanese currency devaluation, and more ECB stimulus.
- We are taking a particularly active stance toward duration contribution from U.S. Treasurys and sovereigns where applicable with an eye toward defensive positioning versus the benchmark.

** 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.*

JANUS CONTRIBUTORS

CIO, FIXED INCOME
Gibson Smith

PORTFOLIO MANAGER
Darrell Watters

HEAD OF GLOBAL RATES & PORTFOLIO MANAGER
Chris Diaz, CFA

GLOBAL RESEARCH ANALYST
Lindsay Bernum

GLOBAL RESEARCH ANALYST
David Spilsted

GLOBAL HEAD OF SECURITIZED PRODUCTS & PORTFOLIO MANAGER
John Kerschner

GLOBAL RESEARCH ANALYST
Jason Brooks

GLOBAL RESEARCH ANALYST
Rachel Young

PORTFOLIO MANAGER & GLOBAL RESEARCH ANALYST
Ryan Myerberg

PORTFOLIO RISK ANALYST
Aspen Large

PORTFOLIO MANAGER & GLOBAL RESEARCH ANALYST
Seth Meyer, CFA

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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.

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FOR MORE INFORMATION CONTACT JANUS

151 Detroit Street, Denver, CO 80206 I 800.668.0434 I www.janus.com

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