WINTER 2017

GLOBAL
SECTOR VIEWS

JANUS CAPITAL®
Group

Global Sector Views Report

A sector-by-sector outlook from the Janus Equity Team

For four decades, fundamental, bottom-up research has been at the core of the Janus investment process. Our deep team of analysts covers approximately 1,500 stocks around the globe. Each takes a do-it-yourself, unconstrained approach to research. We believe this differentiates us from our peers and drives results for our clients and the investors they serve.

Every quarter, our six global sector teams share their bottom-up perspective on key themes in the equity markets and how those themes impact their sectors and areas of coverage.

TABLE OF CONTENTS

> Energy + Utilities 4

> Financials 6

> Technology 8

> Consumer 10

> Health Care 12

> Industrials + Materials 14

The opinions are those of the authors as of December 2016 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.

Big Risk Factors Give Way to Company Fundamentals

Markets in 2016 were nothing if not resilient. The election of Donald J. Trump, the United Kingdom's decision to leave the European Union ("Brexit"), European politics, Federal Reserve (Fed) rate policy, and other issues fueled, rather than stalled, a rally. Many observers, including us, feared short-term disruptions from these issues, in particular from Brexit and Mr. Trump's election. Although we felt that fundamentals ultimately would win out and that markets would recover, the speed of the bounce-back was surprising. With each event, the short term went from days to hours to minutes.

As we head into 2017, macroeconomic themes and big risk factors no longer dominate. The main driver now is company-specific details, not the big picture. And for most companies, those details are positive. Pure defensive investments and yield plays have lost their luster, and rightfully so. We believe the Fed's decision in December to increase its benchmark rate will continue to prod investors out of bond proxies and into growth stocks, a transition that started shortly after the Brexit vote. The shift means growth companies with attractive valuations and sustainable business models will be, in our opinion, most attractive in the coming years. Our analysts continue to find these types of stocks across sectors.

For equities, our best-case scenario calls for a stronger U.S. economy, improved confidence and the return of risk-taking. In turn, active stock selection becomes especially important, as stocks are driven more by corporate fundamentals and less by macroeconomic forces. We also hope to see greater business investment to match a decently healthy consumer. Companies have been reluctant to invest, but greater confidence and perhaps fears of higher rates might propel firms to use their strong balance sheets for more than share buybacks and dividends. An improved tax policy, including lower corporate tax rates and the ability to repatriate overseas profits efficiently, also should make projects more attractive. We hope this confidence spills into Europe, which could deliver surprisingly faster growth in 2017, thanks to a weak euro and strong U.S. economy.

When fundamentals matter, it becomes increasingly important to ignore index weights and to be an active investor. We anticipate a reversal of the strong relative performance of major indices versus active managers in the coming quarters. In such an environment, sector observations and ultimately our stock analysis matter more. In the following pages, you will get an insight into our outlook for key sectors. In each, opportunities and challenges exist, but we think the market will begin to sort out these issues based more on corporate fundamentals and less on momentum, volatility, yield and other factors that until now have dominated market sentiment.

Rest assured, we have not been swept away by Trump-mania. We understand that political risks continue, especially in Europe, where several countries will hold key elections in 2017. China is still going through an uncertain economic transition. The equity rally could sputter if the progress of reform in the U.S. is slower than the market expects or if issues arise outside the U.S. In the U.S., for example, the financial sector soared after the election on the expectation of higher rates and lower regulation. Today, many bank stocks are pricing in a series of additional Fed rate moves and the ability of companies to improve their return on equity significantly. We may see that recovery, but the risk remains that banks now are structurally less profitable than they were before the financial crisis.

Of course, "Commander in Tweet" Trump can cause short-term sell-offs with just 140 characters. His policies and the rise of populism both in the U.S. and in Europe could lead to anti-growth measures, such as trade wars and restrictive immigration policies. In addition, an increasingly strong dollar benefits Europe and China but could impair U.S. exports and thwart the positive effects of growth-oriented reforms. In the end, however, we expect a highly pro-business administration that will be good for equity markets.

The post-Trump rally has been impressive, and that momentum could cool in the short term. We have discussed the return to active investing for several quarters. Today we believe we are solidly in the middle of this new long-term trend. In bursts of excitement, such as the days after November 8, investor flows move from markets to sectors and then to companies. We saw this pattern. Most indices soared but with a divergence among sectors. Financials ETFs, for example, rallied and pulled in record amounts of money. We are in the company picking stage now, we believe.

Carmel Wellso
Director of Research

Adam Schor, CFA
Director of Global Equity Strategies

ENERGY + UTILITIES

We think the decision by OPEC and non-OPEC countries to meaningfully reduce production in 2017 will bring the oil market into balance.

Opportunities & Trends

> **We think the decision by OPEC and non-OPEC countries to meaningfully reduce production in 2017 will bring the oil market into balance over the next year.** As a result, crude prices likely will range from $50 to $70 a barrel in the near term, with the potential to trade even higher.

> **The industry responded to lower oil prices by aggressively cutting equipment and capital expenditure (capex), as well as other costs.** Many companies now have strategies in place to navigate a world in which crude trades around $50 a barrel. If oil prices rise beyond that, company earnings will rebound.

> **The energy industry may benefit from looser regulations.** The Trump administration favors energy independence and that could result in fewer regulations, a net positive for the energy industry.

Risks & Headwinds

> **Production cuts may not be honored.** OPEC cannot enforce quotas. Plus, if the price of oil starts to rise, certain non-OPEC countries could be tempted to step in and fill the gap. That would effectively keep a lid on oil prices.

> **Inefficient operators also could be a drag on oil prices.** Among U.S. shale operators, not all companies are exercising financial discipline. As a result, even without a reasonable return on investment, some operators could be willing to ramp up drilling and add to supply.

> **Higher crude prices benefit oil field services companies, but the market is still very competitive.** Many firms in this segment are operating at or below breakeven margins, which is unsustainable. Favorable financing has provided a lifeline for some companies, but exploration and production (E&P) activity must ramp up in order for service providers' prospects to improve.

Investment Implications

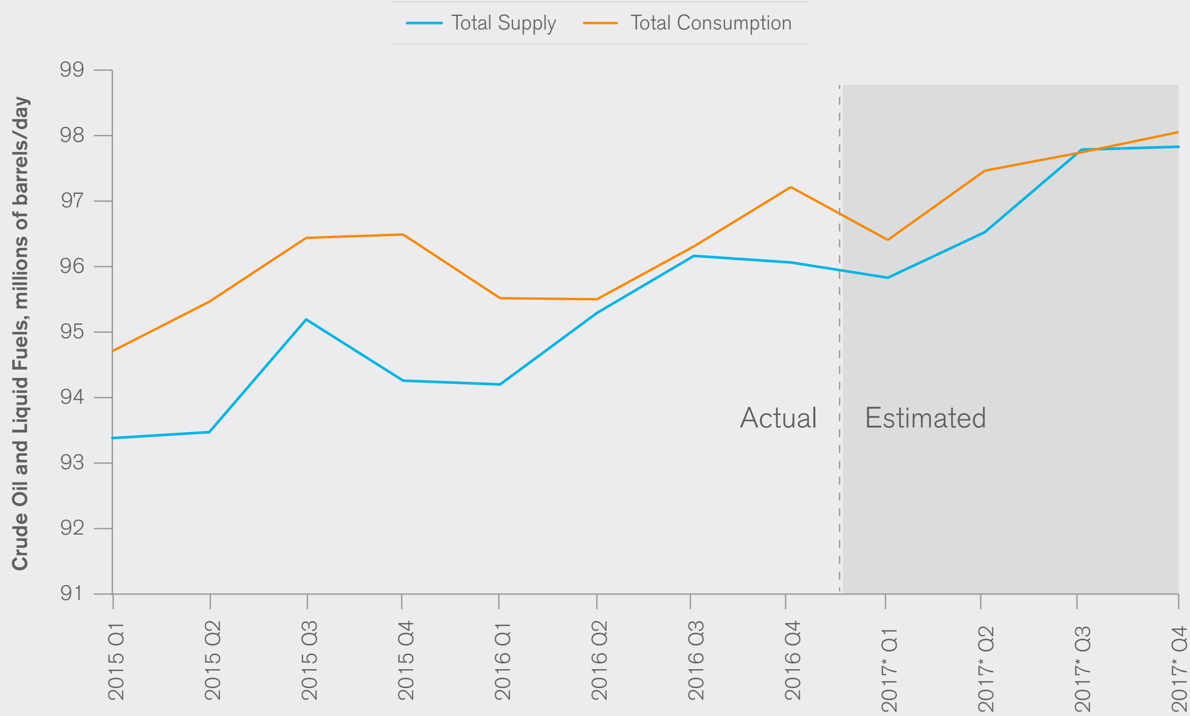
> **As equilibrium returns to North American markets, we view larger service companies as advantaged over smaller peers.** These companies had the financial strength to maintain capex during the downturn, which now makes them able to deliver products and services expeditiously and meet the needs of upstream companies.

> **We favor E&P companies over integrated majors.** The defensive nature of integrated energy companies makes them less likely to benefit from rising oil prices.

> **Midstream operators appear well positioned in the current environment.** Should U.S. shale ramp up production as a result of higher oil prices, midstream operators will benefit from higher volumes.

Coming Into Balance

Supply and demand for international crude oil and liquid fuels, millions of barrels/day



The supply/demand imbalance is forecast to narrow.

*Estimated

Source: Energy Information Administration

FINANCIALS

We like banks that will benefit from rate hikes but also have revenue streams that could see accelerating growth.

Opportunities & Trends

> **Banks, along with other financial intermediation companies, are well positioned to benefit from Federal Reserve (Fed) rate hikes.** The extended period of low interest rates has weighed on bank earnings. That headwind could become a tailwind if the Fed continues increasing its benchmark rate in 2017.

> **The private sector could benefit from lower corporate tax rates and less regulation under President-elect Trump, helping drive capital spending and faster economic growth.** All of that likely would boost banks' earnings growth in the years ahead.

> **Providers of data, analytics and technology services to financial companies are an increasingly attractive area of growth.** Demand for these services is rooted in a wide variety of functions, including trading execution, index construction, risk management, payments and loyalty programs.

Risks & Headwinds

> **The outlook for the U.S. economy has grown more positive but depends, in part, on still-unknown government policies.** In addition, given weak economic growth in Europe and Japan, the European Central Bank (ECB) and Bank of Japan (BOJ) will likely be slower to increase their respective benchmark rates, though forward interest rates and stock prices could anticipate U.S.-led rate normalization.

> **Post-Brexit, it will take time to establish a passport framework for UK-based financial companies with operations focused in the European Union (EU).** The political implications of a "hard" or "soft" Brexit arrangement remain uncertain. More broadly, populist political risks across continental Europe remain a key consideration in 2017, with elections looming in Germany, France, the Netherlands and potentially Italy.

> **China's GDP growth targets are increasingly dependent on unproductive credit expansion.** We estimate credit-to-GDP will exceed 300% within a few years, raising concerns over China's debt sustainability, especially since banks are not generating sufficient capital organically and foreign-exchange reserves are shrinking. That could put downward pressure on the country's currency, the renminbi.

Investment Implications

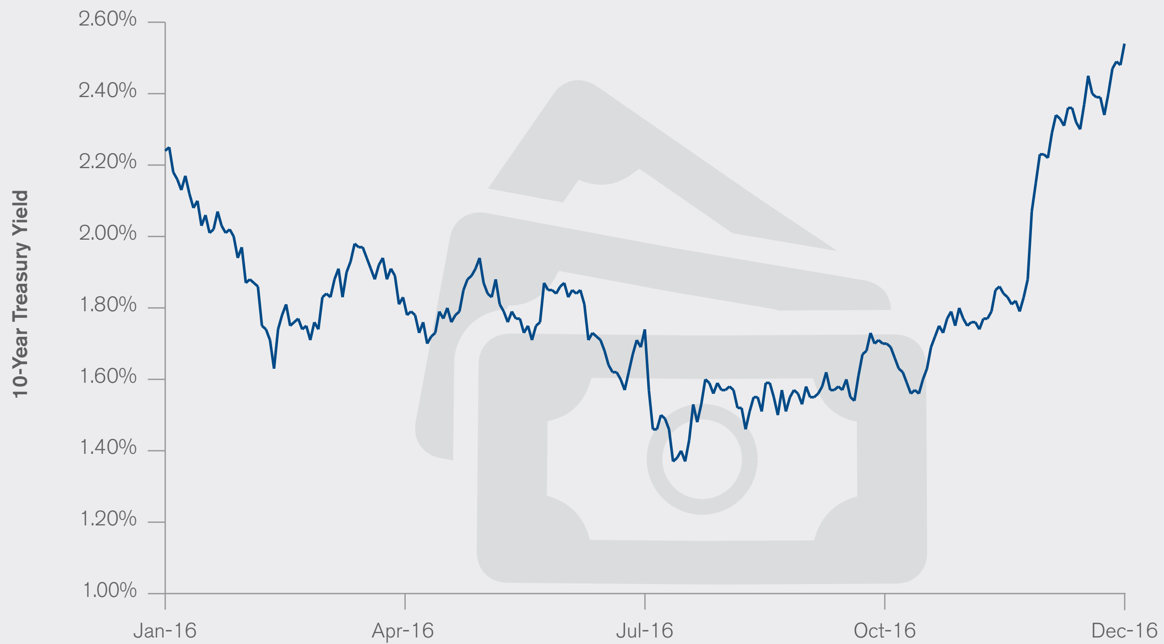
> **We like banks that will benefit from rate hikes but also have strong management teams, high or improving returns, and revenue streams that could see accelerating growth.** Examples of these revenue streams include fees from wealth management, payments, investment banking and trading.

> **We continue to like financial stocks exposed to structural growth opportunities.** Asian insurers are well positioned to potentially benefit from the region's rising middle class and the desire of consumers in those countries to protect newfound wealth.

> **Similarly, the ongoing transition to electronic payments, in our view, remains one of the most attractive areas in financials.** The winners in this space will have advantaged business models that will continue to offer clients value-enhancing products throughout the business cycle.

Rates Turn Higher

Daily 10-Year U.S. Treasury Yield, YTD



Rising yields could help boost bank profits.

Source: U.S. Department of Treasury

TECHNOLOGY

Self-driving automobiles and other new end markets are providing sources of growth for semiconductors.

Opportunities & Trends

> **The transition to the cloud is accelerating.** Companies are increasingly moving workloads from physical servers to the cloud, adopting programs such as Software as a Service (SaaS) and Infrastructure as a Service (IaaS). That has resulted in impressive growth rates for industry leaders, including Salesforce.com and Amazon Web Services. The same dynamic, however, has placed legacy software and hardware companies under increasing pressure.

> **Semiconductors have new opportunities for growth.** Virtual and augmented reality, the Internet of Things (IoT), and self-driving automobiles, among other new technologies, require sophisticated chips. These end markets are providing new sources of growth for semiconductors.

> **Machine learning continues to drive investors' appetites for IoT.** We expect every business sector to develop IoT applications that "learn" as data are processed and achieve solutions far beyond the scope of human programmers. These solutions can improve productivity and efficiencies for companies, making the technology highly valuable.

Risks & Headwinds

> **The regulatory environment could be changing.** Growing signs of political unrest around the world widen the potential outcomes for increased regulatory scrutiny of technology companies. Areas of focus could be trade, jobs and the Internet.

> **Automation will likely create as many new job opportunities as it will eliminate.** New technologies can benefit society as a whole (for example, safer transportation as a result of self-driving vehicles), but they can also displace workers (e.g., long-haul drivers). Sentiment could turn against the largest technology companies driving these innovations.

> **The risks to legacy technology companies are underappreciated.** Investors continue to hold shares of legacy companies due to the stocks' attractive dividend yields and still-dominant positions in market benchmarks. Yet, investors often do not understand the risks to underlying business models. This is especially true for software companies that were slow in adopting SaaS and hardware firms that overlooked the threat of the cloud.

Investment Implications

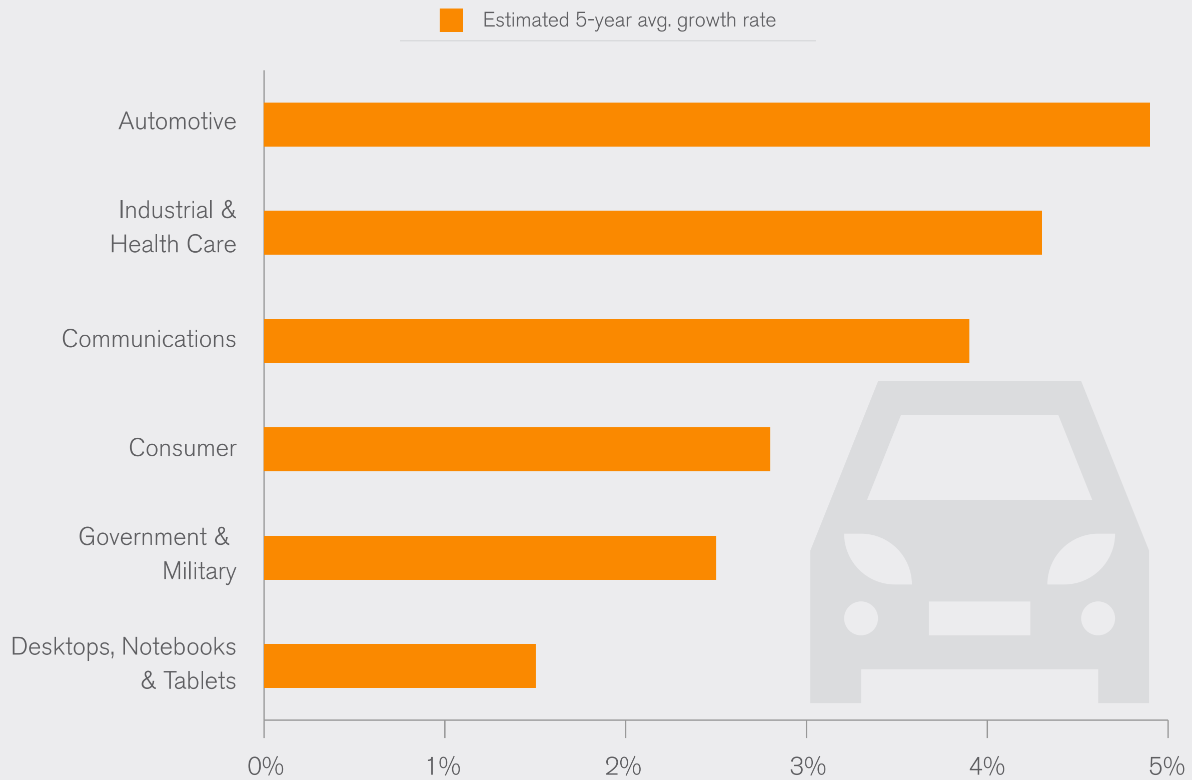
> **We continue to avoid larger legacy companies whose existing business models we seriously question.** Volatility in the early part of 2016 enabled us to reposition our portfolios toward higher-growth names that we prefer.

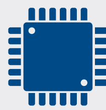
> **We see opportunity in segments of the semiconductor industry.** While smartphones garner headlines, other segments have more attractive growth trajectories, as they are earlier in the life cycle of software adoption.

> **While we expect our growth technology investments to achieve commanding positions over the next several years, the stock market is also trading at all-time highs.** We are tilting our portfolios toward stocks that we believe are more resilient to downside risk.

Growing Demand for Semiconductors

Estimated demand growth for integrated circuits by end use, 2015-2020





The auto industry is expected to be a major source of demand for semiconductors through 2020.

Source: IC Insights

CONSUMER

E-commerce continues to upend traditional business models.

Opportunities & Trends

> **While the retail industry has a number of secular challenges to contend with, we are encouraged by companies' proactive initiatives.** Astute management teams are taking these challenges head-on by aligning inventories to match tempered sales growth, tightly managing expenses and working to improve digital marketing to more effectively target customers.

> **E-commerce continues to upend traditional business models, but some companies are leveraging new technologies to meet shifting consumer demands.** Mobile order and pay, as well as buy online/pick up in store, are helping brick-and-mortar retailers continue to drive sales and stay relevant.

Risks & Headwinds

> **We see a growing disconnect between macroeconomic data and what we hear from companies on the health of the consumer.** Government data indicate a healthy consumer, given today's low unemployment rate and improving wage growth. However, from the industry's point of view, retail trends are lackluster.

> **E-commerce is now encroaching on stores that sell consumer staples.** In December, for example, Amazon rolled out a brick-and-mortar grocery store in Seattle where customers can shop in person but pay digitally – no waiting in checkout lines.

> **In addition to a decline in the number of consumers dining out, restaurants face other hurdles.** Those hurdles include rising labor costs and a competitive market with low barriers to entry.

> **Potential tax reforms could raise costs for certain retailers.** House Speaker Paul Ryan has called for the passage of a so-called destination-based corporate tax system, which would be a negative for retailers that sell imported goods in the U.S. Although the passage of such reform is far from certain, it is something we will be watching closely under a Republican administration.

Investment Implications

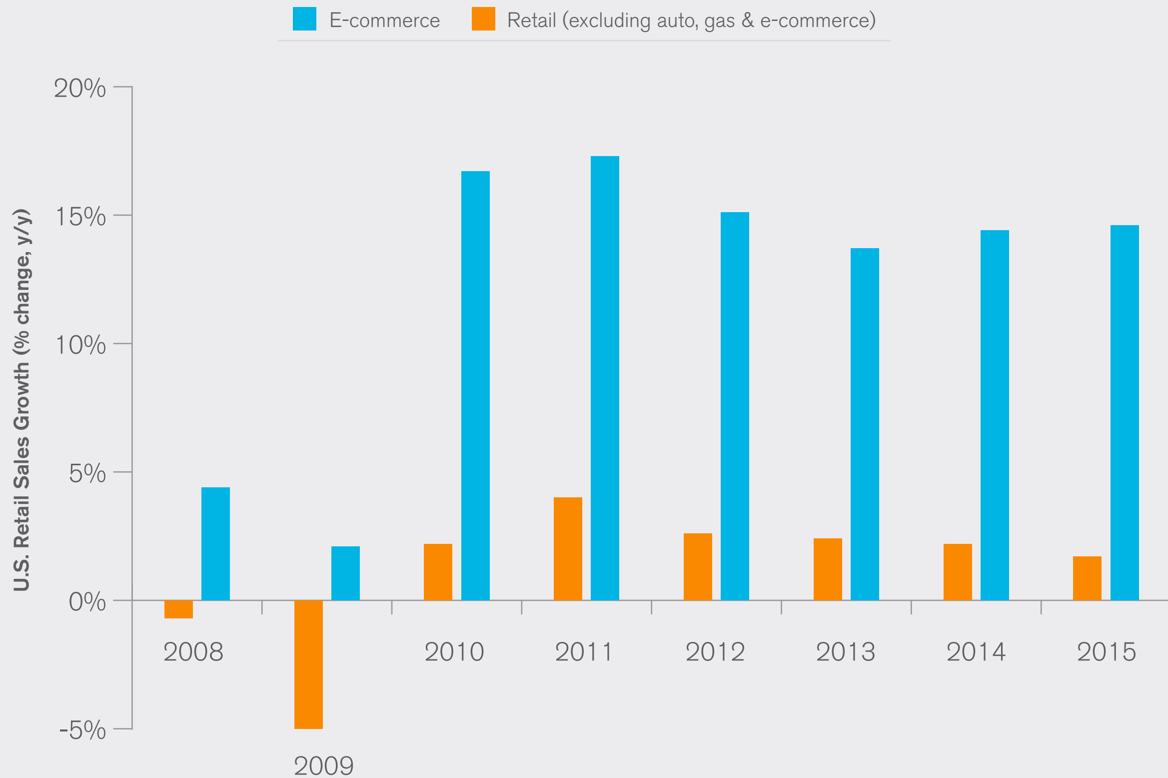
> **We prefer consumer discretionary companies that are less impacted by the migration toward online and mobile sales.** Many of the companies we hold sell products that require a consultative sale or are too large to ship.

> **We also like distributors of food products, whose customers include hospitals, universities and sports arenas.** Distributors have durable business models and operate in a highly fragmented market, creating opportunities to make acquisitions and grow market share.

> **Within consumer staples, we see significant opportunities in reduced-harm nicotine products.** E-cigarette growth has re-accelerated in the U.S., and heat-not-burn is gaining traction in Japanese and European test markets. Improved next-generation technology is increasing the conversion rate from traditional combustible cigarettes.

More Shopping Online

Sales growth online vs. at traditional retailers



Consumers increasingly prefer to shop online rather than in brick-and-mortar stores.

Source: Janus Capital, U.S. Census Bureau

HEALTH CARE

We expect that insurers will continue to act as a headwind to drug pricing.

Opportunities & Trends

> **The results of November's U.S. presidential election potentially impact much of the sector.** U.S.-focused health care firms should benefit from a lower tax burden, which could materially raise long-term earnings. Companies with large foreign subsidiaries – and earnings trapped overseas – may be poised to repatriate cash under more favorable conditions. Access to this capital could fuel additional industry consolidation.

> **Even prior to the election, deal activity picked up, driven in part by compelling valuations.** Low stock prices translated into significant premiums in recent deals, a trend we expect to continue. Biotechnology and medical technology companies, in particular, commanded attractive prices.

> **Pharmaceutical companies continually had to readjust their portfolios to accommodate an increasing focus on value, not just safety and efficacy.** As a consequence, we're witnessing a high and sustained level of licensing activity, with a focus on areas such as oncology, immunology and rare diseases. We believe this portfolio rationalization process will help bolster the biotech sector, giving companies the opportunity to pursue non-dilutive financing alternatives.

> **Food & Drug Administration (FDA) approvals remained robust in recent years, and illustrate companies' commitment to deliver growth through innovation.** Quicker approvals are the hallmark of the increased efficacy of many new treatments and their ability to address high, unmet medical needs.

Risks & Headwinds

> **The potential for change represented in the election's outcome brings with it near-term uncertainty.** While much of the campaign's rhetoric centered on "repealing and replacing" the Affordable Care Act (ACA), we believe the Trump administration will move slowly on the replacement phase, allowing sufficient time for transition. Health exchange subsidies, for example, may continue for a period, and congressional leaders have signaled their intent to alter the mechanics of Medicaid expansion, rather than repealing it.

> **The recent backlash against drug prices, along with consolidation among payers, represents an impediment to what drug companies can charge.** While Republican control of Congress may lead to less government pressure on drug pricing, we expect that insurers will continue to act as a headwind to pricing. Unless new drugs demonstrate important benefits for patients and value for the system, coverage may be more restrictive.

Investment Implications

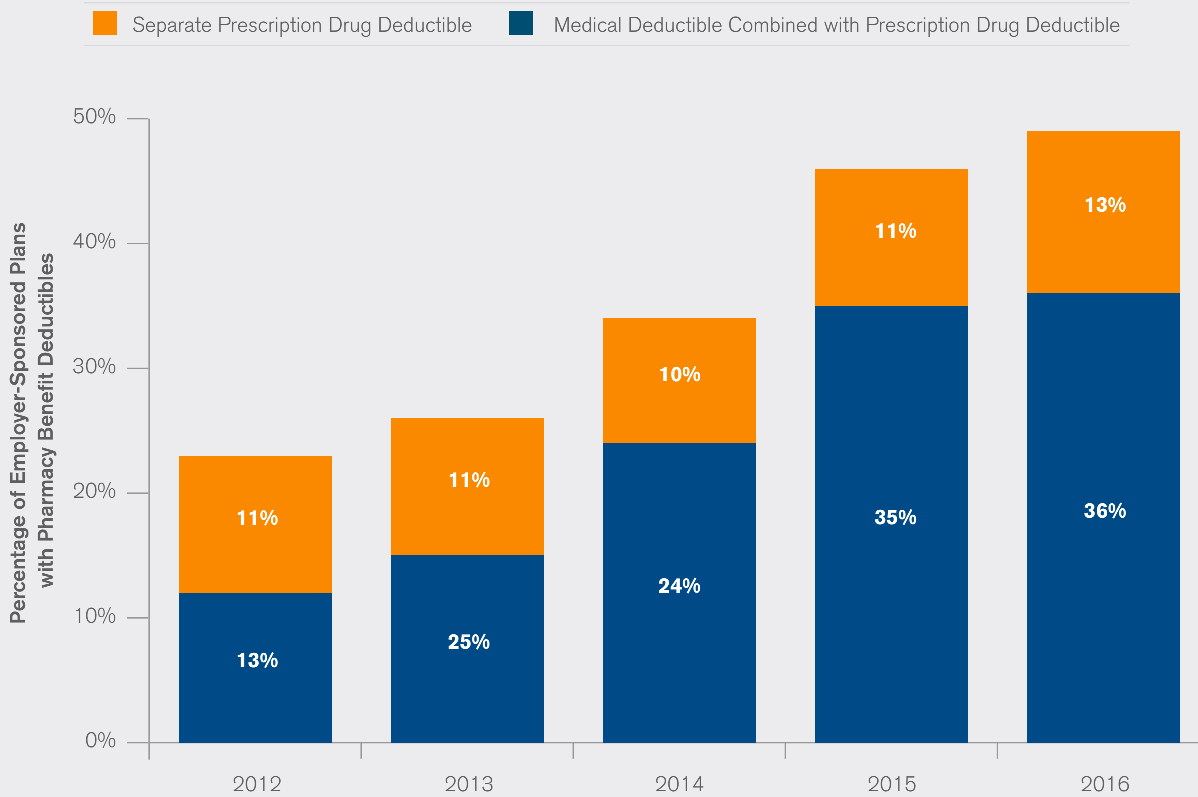
> **The transition from fee-for-service to value-based payments should continue and presents a sea change for the sector.** We expect these reforms will create a climate where true innovation in health care delivery is possible. Companies that create the most efficient products and services stand to be the largest beneficiaries.

> **We remain cautious on select specialty pharmaceutical companies, recognizing that recent challenges have yet to fully dissipate.** Debt-driven merger and acquisition activity has resulted in leveraged balance sheets. At the same time, external pressure has dented a business model reliant upon sizable price increases.

> **How reforms unfold will determine whether managed care companies can benefit from offering flexible plans to customers seeking a wider array of coverage options.** Should tax reform ignite repatriation of foreign earnings, innovative biotechnology companies that address high, unmet medical needs could become desirable acquisition targets.

Patients Shouldering More Drug Costs

Percentage of employer-sponsored health care plans with combined or separate prescription drug deductibles, by year



The number of combined medical/drug deductible plans has nearly tripled since 2012.

Source: Pembroke Consulting, PWC

INDUSTRIALS + MATERIALS

A growth agenda should improve the earnings backdrop for a range of industrial companies.

Opportunities & Trends

> **Shorter-cycle industrial companies are likely the immediate beneficiaries of November's U.S. election.** We expect the incoming administration to focus on infrastructure projects to catalyze growth, and that such initiatives can garner bipartisan support. More broadly, a growth agenda should improve the earnings backdrop for industrial companies, including those whose end market is tied to the U.S. consumer.

> **The possibility of heightened geopolitical risk and more hawkish foreign policy may improve the outlook for defense contractors.** Companies providing equipment to hydrocarbon producers could gain from increased domestic energy output. Lower nominal corporate tax rates would benefit the entire sector by stimulating greater capital expenditures and investment.

> **Lowering barriers to the repatriation of foreign earnings may fuel a wave of domestic consolidation.** Companies are eager to identify synergistic opportunities in potential targets. The recent sale of Harmon to Samsung illustrates our view that technology companies recognize the auto industry as an area ripe for expansion. Rising interest rates may also pull forward any deals management teams may be considering.

Risks & Headwinds

> **The results of November's election, along with other hints of global populism, raise questions about many countries' commitment to the current trade-based economic order.** We are concerned that future laws may tamp down on the rate of global integration, but we believe the current footprint in global supply chains is likely safe.

> **We remain mindful of China's economic trajectory.** There are signs that the recently pressured industrial sector has stabilized. Auto sales have been strong, and key purchasing managers indices have returned to expansionary territory. Longer term we believe that China has likely reached an inflection point in urbanization, and as incremental growth shifts toward consumption, the economy may exhibit greater cyclicality.

> **Industrials remain exposed to a challenged energy sector, although not to the degree that some investors fear.** Still, we are mindful of recent developments, including OPEC's announcement to curtail production. It remains to be seen whether the cartel has the discipline to instill compliance. If the agreement is effective, more stable prices may help management teams make investment decisions. Our optimistic view is not limited to downstream players, but also to firms providing products and services to exploration and production companies.

> **Currency continues to be a factor for many multinationals' prospects.** We are monitoring the impact of the U.S. dollar's relationship with the euro, British pound and Chinese renminbi. Given the composition of U.S. exports, we consider a weakening renminbi as less of a threat than we do a lower euro. Europe is a large market for U.S. large-cap multinationals, and a weaker pound and euro could weigh on U.S. sales in the region.

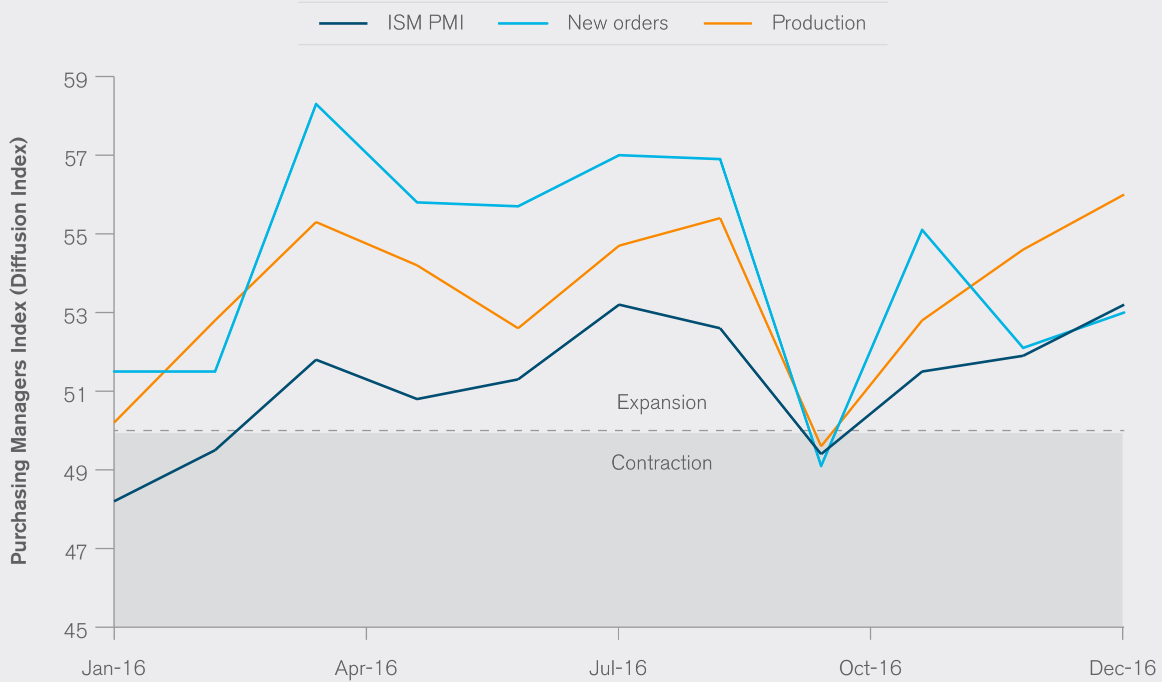
Investment Implications

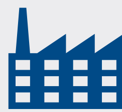
> **We continue to focus on company-specific drivers of value, such as management teams with a record of superior capital allocation.** These factors tend to determine outperformance regardless of the economic environment. Rather than be consumed by investing around the business cycle, we believe long-term returns will be driven by identifying the most innovative industrial companies.

> **We opportunistically invest in companies that have been able to demonstrate a marked turnaround and improvement in operations.** Acquisitive companies may have additional resources to consummate deals should a wave of repatriated foreign earnings come ashore.

Manufacturing Rebounds

Monthly changes in the Institute for Supply Management's purchasing managers index (ISM PMI) and key components, YTD





The manufacturing sector has strengthened in recent months, led by increased production and new orders.

Source: Institute for Supply Management, Bloomberg

GUIDING PRINCIPLES OF JANUS RESEARCH

- Invest with our clients' interests first.
- Develop a deep understanding of the companies we research.
- Employ a strong valuation discipline focused on quality growth.
- Develop independent and differentiated views on our companies, supported by in-depth primary research.
- Spend as much time thinking about what could go wrong as about what could go right.
- Take a long-term view.
- Seek to anticipate change, don't just analyze it.
- Attract the best and brightest analysts in the business, and foster an environment in which they can succeed on behalf of our investors.

JANUS GLOBAL EQUITY SECTOR TEAM LEADERS

CONSUMER
Josh Cummings, CFA

ENERGY + UTILITIES
Noah Barrett, CFA

ENERGY + UTILITIES
Kris Kelley, CFA

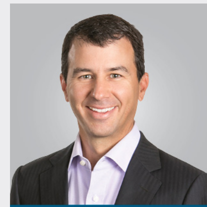
FINANCIALS
John Jordan

HEALTH CARE
Andy Acker, CFA

HEALTH CARE
Ethan Lovell

INDUSTRIALS + MATERIALS
David Chung, CFA

TECHNOLOGY
Denny Fish



TECHNOLOGY
Brinton Johns

JANUS CAPITAL® Group

The views presented are as of the date published. They are for information purposes only and should not be used or construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security or market sector. No forecasts can be guaranteed. The opinions and examples are meant as an illustration of broader themes, are not an indication of trading intent, and are subject to change at any time due to changes in market or economic conditions. There is no guarantee that the information supplied is accurate, complete, or timely, nor are there any warranties with regards to the results obtained from its use. It is not intended to indicate or imply in any manner that any illustration/example mentioned is now or was ever held in any Janus portfolio, or that current or past results are indicative of future profitability or expectations. As with all investments, there are inherent risks to be considered.

In preparing this document, Janus has relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.

This material may not be reproduced in whole or in part in any form, or referred to in any other publication, without express written permission.

Janus is a registered trademark of Janus International Holding LLC. © Janus International Holding LLC.

Janus Capital Group Inc. is a global asset manager offering individual investors and institutional clients complementary asset management disciplines. Janus Capital Management LLC, Perkins Investment Management LLC and INTECH Investment Management LLC serve as investment advisers. Perkins and INTECH are subsidiaries of Janus Capital Group Inc.

Janus Distributors LLC 151 Detroit St. Denver, CO 80206

FOR MORE INFORMATION CONTACT JANUS

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

C-0117-6227 1-30-18

188-15-14919 01-17