SPRING 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.

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The opinions are those of the authors as of February 2017 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.

Show Time

The Trump Show is just beginning, but so far the markets are giving it two thumbs up. We think the surge in indices reflects not only the benefits that the new president likely will bring to the U.S. economy but also the economy's underlying strength. Federal Reserve (Fed) Chair Janet Yellen reported to Congress in February that the economy was healthy and business sentiment was improving, a view our analysts are hearing in our company meetings. Outside the U.S., conditions are better, too.

For all its special effects, Donald Trump's presidency marks the beginning of a few important transitions. For the first time in many years, we have a decidedly pro-business administration that's promising lower corporate tax rates and less regulation. Companies, as a result, are starting to feel more positive about capital investment and expansion. That could mean corporate activity will return to being the driver of economic growth, not central bank policy and financial engineering. In that scenario, we believe the era of macro- and defensive-driven investing will finally give way to a period where active investing and stock selection thrive.

Already, we're seeing hints of that transition. Low-volatility stocks, for example, have started to underperform. Such performance makes sense: Less-risky assets tend to lag in a rising market. But until June 2016, low-volatility stocks had beaten the broad market for the previous five years. The performance upended the traditional trade-off of risk and reward and required a suspension of disbelief, something we were never willing to do.

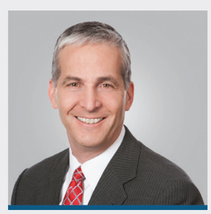
If the U.S economy improves, Europe also stands to benefit. Demand for the continent's exports could grow, for one, especially if the euro remains weak (making European exports more affordable for consumers overseas). Firms also have cut costs, suggesting many European companies will be levered to an economic recovery. But this transition won't come easy: This year, several nations will hold key national elections, while the UK will begin to negotiate the terms of its exit, or Brexit, from the European Union (EU). Like a horror movie villain, the Greek debt issue won't go away. The European Central Bank (ECB) also has to find a way to unwind its bond holdings without stalling an economic recovery, a difficult task (and one that the Fed must also undertake in the U.S.).

We think markets can overcome these plot twists, but the uncertainty will bring volatility. Currency fluctuations, tax reform and other still-undecided policies could add to that uncertainty. Not all stocks will be affected equally, in our opinion. To that end, in the following pages, we address sector trends that we think will be important for finding stocks that are long-term winners.

True, equity indices have hit record levels, but we'd argue that valuations do not seem extreme. Today's average forward price-to-earnings (P/E) ratio of 18 or so for large-cap U.S. stocks may look a bit toppy, but it is not out of line in a low-rate environment. Plus, our fixed income team expects a flattening yield curve, suggesting that even if the Fed raises short-term rates, the long-term rates that matter more for stock valuations won't spike. Correlations also are down sharply, giving stocks that have not participated in the rally an opportunity to break from the pack and revalue. In addition, we may see earnings growth estimates be adjusted upward in the coming months after several years of Wall Street having to revise its forecasts lower. When we study consensus estimates, we find that analysts are just as likely to be too pessimistic as they are optimistic. We may see that pessimism be corrected as the year progresses.

Optimism vs. pessimism brings us back to Trump. The risk is that markets expect too much of him or that he tweets us into a policy or trade war that saps economic confidence. We think, however, that his pro-business instincts ultimately will win out and that his actions will outweigh his words. We also think that corporate confidence, once ignited, will take more than 140 characters to extinguish. Thus, while the plot may wander and the characters may confound us at times, we think the story goes on.

Stay tuned.



Adam Schor, CFA
Director of Global Equity Strategies

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We think crude oil prices will range from $50 to $70 a barrel in the near term.

Opportunities & Trends

- **We think the decision by the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries to meaningfully reduce production in the first half of this year has started to bring the oil market back into balance.** 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, earnings and cash flow will rebound, soon followed by more production.
- **The new administration has already been a positive for the oil and gas industry**, as they've fast-tracked pipeline projects, which will help alleviate bottlenecks that exist between supply and demand centers. We expect this to be a continuous theme over the next four years.

Risks & Headwinds

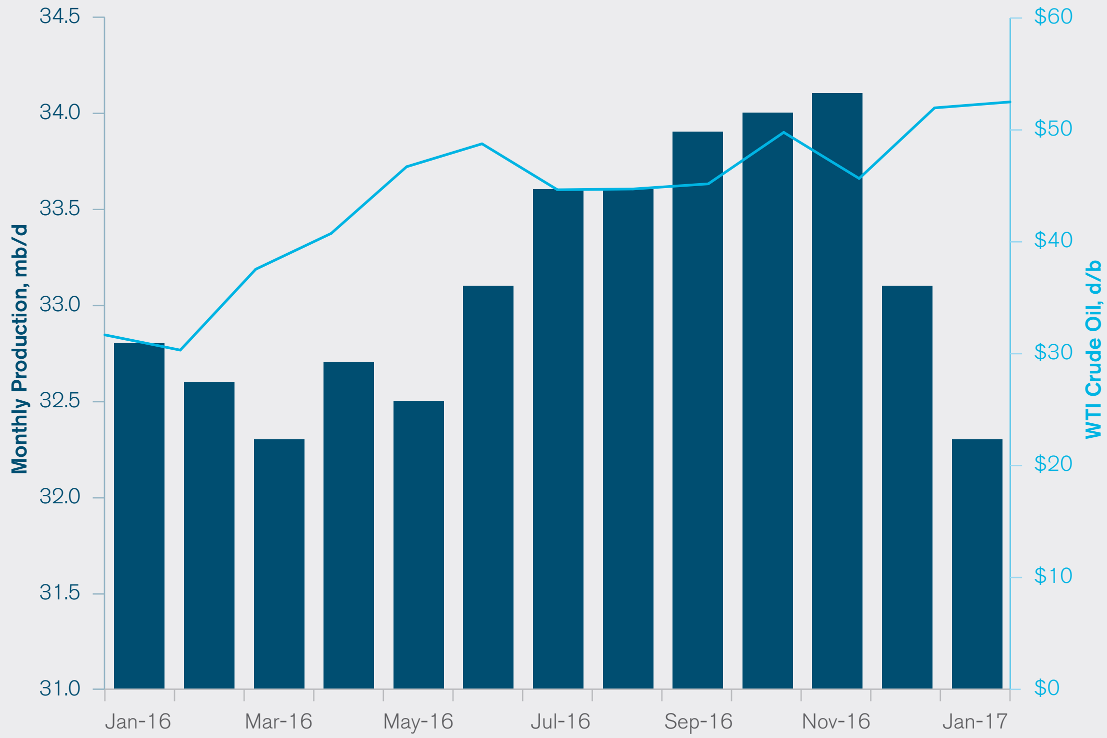
- **Production cuts may not be honored.** OPEC cannot enforce quotas and cartel members have a history of cheating on production cuts. Plus, if the price of oil starts to rise, certain non-OPEC countries could be tempted to step in and fill the gap. That would effectively keep a lid on oil prices.
- **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 believe large service companies have an advantage 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.

The Oil Spigot Tightens

Total OPEC Crude Oil Production



OPEC is making good on its pledge to cut supply for the first half of 2017, but it's unclear how long the discipline will last.

Source: Bloomberg, U.S. Energy Information Administration. Data as of 1/31/17.
Notes: Oil prices are an unweighted average of daily prices per month.

FINANCIALS

Deregulation and interest rate hikes could help boost bank earnings.

Opportunities & Trends

> **Regulatory rollbacks, if carried out by the Trump administration, could ease capital constraints on banks and encourage lending.** That, in turn, would boost banks' earnings growth. Capital reserve requirements overseas could also be watered down, which would be materially beneficial for European and Japanese banks.

> **A number of firms are well positioned to benefit from Federal Reserve (Fed) rate hikes.** The extended period of low interest rates has weighed on banks and other financial intermediaries. That headwind could become a tailwind if the Fed raises its benchmark rate in 2017, as expected.

> **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

> **Populist political risks across continental Europe remain a key consideration, with elections looming this year in France, Germany, the Netherlands and potentially Italy.** Meanwhile, in the UK, Prime Minister Theresa May has signaled her preference for a "hard" Brexit, but the details of such an arrangement are far from certain. It also will take time to establish a passport framework for UK-based financial companies with operations focused in the European Union (EU).

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

> **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 (despite the government's recently ramped-up efforts to stem capital outflows). That could put downward pressure on the country's currency, the yuan.

Investment Implications

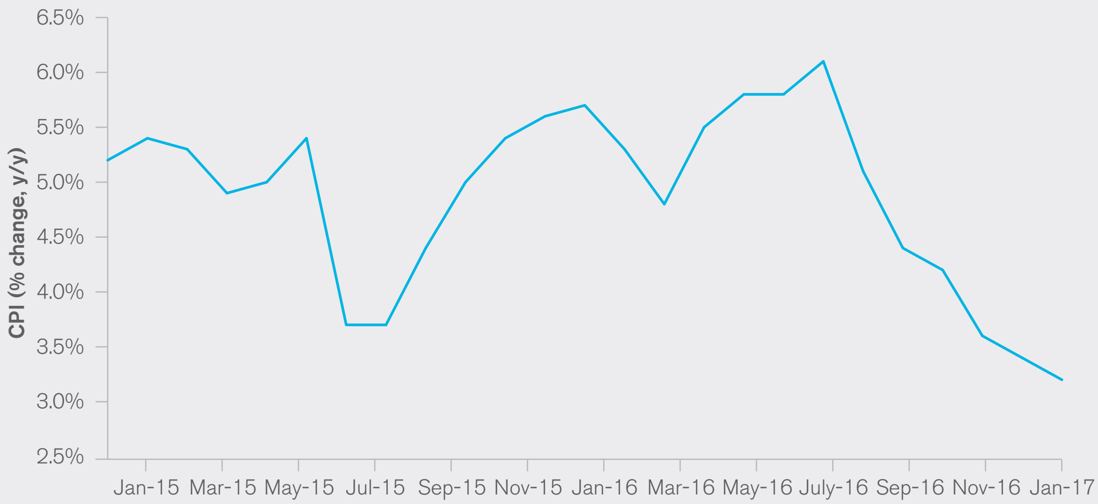
> **We like banks that will benefit from rate hikes but also have strong management teams, high or improving returns, and revenue streams that could see accelerating growth.** Examples of these revenue streams include fees from wealth management, payments, investment banking and trading.

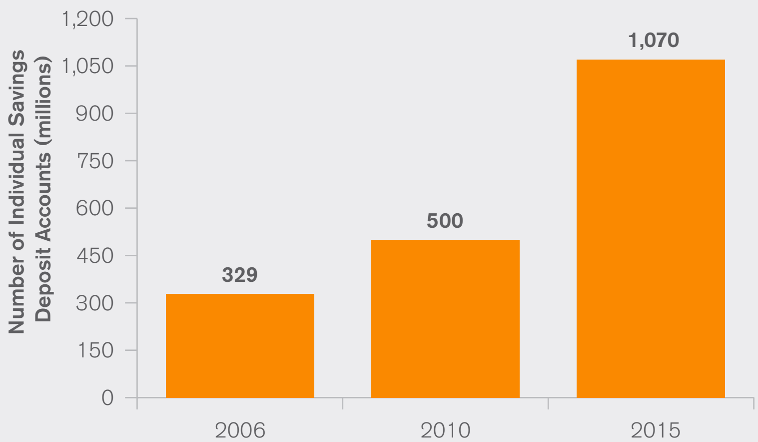
> **We continue to like financial stocks exposed to structural growth opportunities.** Asian insurers are well positioned to potentially benefit from the region's rising middle class and the desire of consumers in those countries to protect newfound wealth. Meanwhile, in India, deepening financial penetration and well-contained inflation underpin our constructive stance on financials in that country.

> **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.

India's Stable Economy

Combined Consumer Price Index (CPI) and Financial Inclusion, India





Low inflation and consumers' increasing access to bank services has made India's financials sector look attractive.

Source: Bloomberg, Reserve Bank of India. Data as of 1/31/2017

TECHNOLOGY

Virtual and augmented reality, IoT, and self-driving automobiles are new areas of growth.

Opportunities & Trends

> **The transition to the cloud is accelerating.** Companies are increasingly moving workloads from physical servers to the cloud and deploying programs such as Software as a Service (SaaS). That has resulted in impressive growth rates for industry leaders. 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 large numbers of new solutions. So, despite slowdowns in smartphones, tablets and PCs, industries such as health care, industrials and energy – early in their adoption of advanced technology – will drive growth for semiconductors.

> **Along with IoT, artificial intelligence (AI) and machine learning are creating opportunities to push high-performance computing out across networks to myriad connected devices.** This combination of AI and increasingly connected devices will also help the semiconductor market grow.

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 them.** 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 and hardware companies that overlooked the threat of the cloud.

Investment Implications

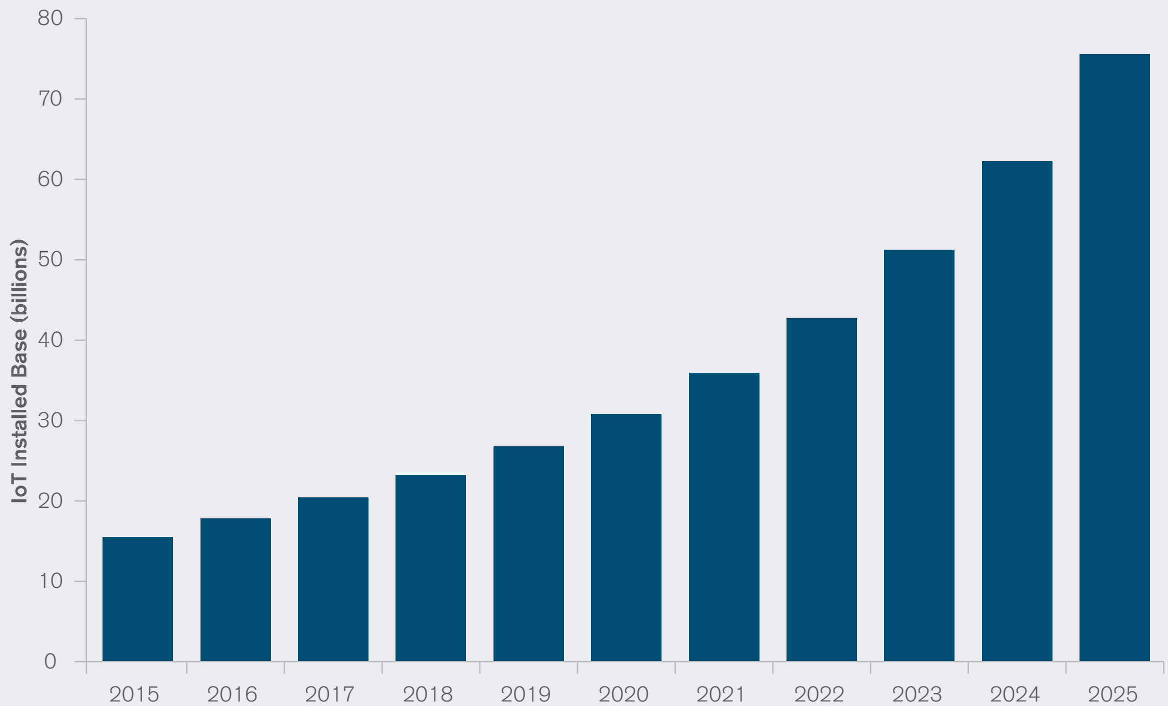
> **We continue to avoid larger legacy companies whose existing business models we seriously question.** Volatility in 2016 enabled us to reposition our portfolios toward higher-growth names that we prefer.

> **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.

> **Although 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.** Therefore, as always, we are constructing the portfolio with an eye toward balancing what we call resilient and optional companies, those that can adapt to changing market conditions and have the potential to deliver a significant payoff as a result of new investments.

The Rise of the Internet of Things (IoT)

Number of Devices Connected to the Internet Worldwide, Estimated



IoT is expected to be a dominant trend for years to come.

Source: IHS Technology

CONSUMER

The consumer sector is becoming increasingly bifurcated between winners and losers.

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 slower 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 retain sales and stay relevant.

Risks & Headwinds

> **Consumer spending trends remain stable, but the sector is becoming increasingly bifurcated between winners and losers**, as consumers allocate more discretionary dollars to experiences and services rather than goods, and to e-commerce rather than physical stores.

> **E-commerce is now encroaching on stores that sell consumer staples.** Last year, 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.

> **Traffic at many restaurants has been weak**, due in part to falling grocery prices, which makes it more affordable for consumers to dine at home. In addition, restaurants face other hurdles, such as rising labor costs and a competitive market with low barriers to entry.

> **Potential tax reform 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

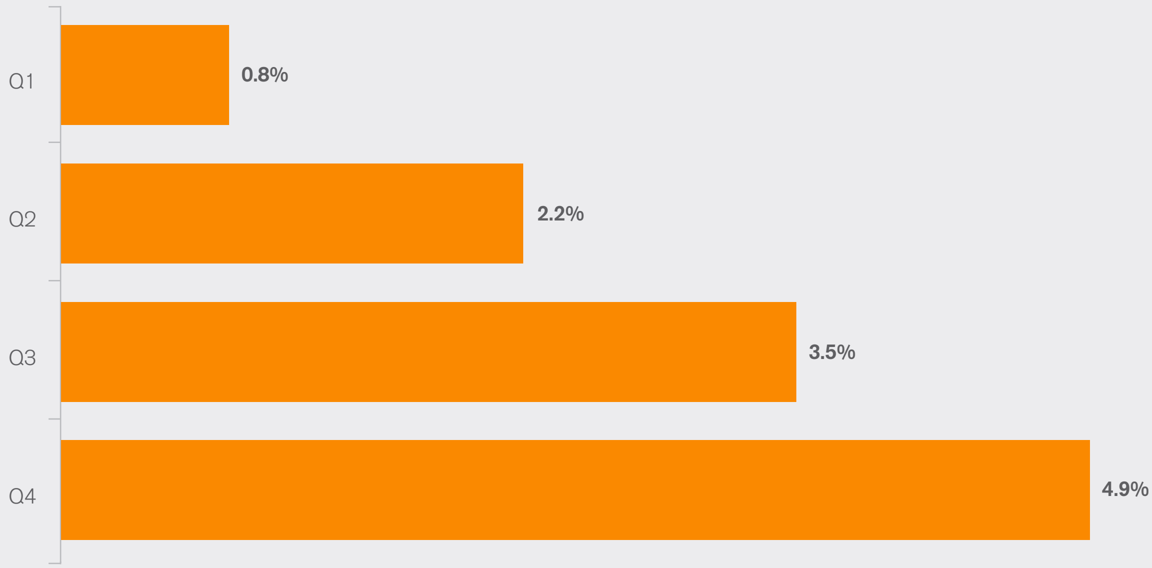
> **We prefer consumer discretionary companies that are less impacted by the migration toward online and mobile sales.** Many of the companies we hold sell products that require a consultative sale or are too large to ship.

> **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.

Heat-Not-Burn Products Take Off

Market Share of Marlboro HeatSticks in Japan, 2016



Reduced-harm nicotine products are growing in popularity overseas.

Sources: Philip Morris International, Tobacco Institute of Japan

Notes: Market share for HeatSticks is defined as the total sales volume for HeatSticks as a percentage of the total estimated sales volume for cigarettes andHeatSticks.

HEALTH CARE

The transition from fee-for-service to value-based payments should continue in health care.

Opportunities & Trends

> **Donald Trump's presidency will potentially impact much of the sector. U.S.-focused health care firms could benefit from a lower tax burden, which would materially raise long-term earnings.** Companies with large foreign subsidiaries – and earnings trapped overseas – may be poised to repatriate cash under more favorable conditions and fuel additional industry consolidation.

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

> **Pharmaceutical companies are readjusting 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 and maximize the value of their portfolios.

> **Food and Drug Administration (FDA) approvals have been robust in recent years and illustrate companies' commitment to deliver growth through innovation.** Quicker approvals are a hallmark of the increased efficacy of many new therapies and their ability to address high unmet medical needs, or serious medical conditions with few if any effective treatments.

Risks & Headwinds

> **The new administration has created near-term uncertainty.** Although campaign rhetoric centered on "repealing and replacing" the Affordable Care Act (ACA), we believe Congress 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 repeal it.

> **The recent backlash against drug prices, along with the adoption of higher deductible plans, represents an impediment to what drug companies can charge.** Even if a Republican-controlled Congress leads to new ways of improving affordability, we expect that payers will continue to push back on drug price inflation. Unless new drugs demonstrate both 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 to 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.** Debt-driven merger and acquisition (M&A) 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 benefit from offering flexible plans to customers seeking a wider array of coverage options.** We remain optimistic that we are entering a sustained period of deregulation in this regard.

> **Should tax reform ignite repatriation of foreign earnings**, innovative biotechnology companies that address high unmet medical needs could become desirable acquisition targets.

What's Next for Health Care

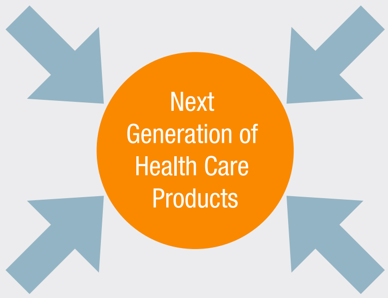
Major Trends Shaping the Pharmaceutical and Medical Technology Industries

Unsolved Medical Needs

Unmet medical needs spur innovation.

Global Health Care Consumption

Chronic diseases, along with emerging markets' rising middle class, drive demand for medical care.



Explosion of Information

A proliferation of data and tools helps improve outcomes and reduce costs.

Cost Containment

Rising health care consumption makes cost reduction imperative.

Cost containment and unmet medical needs are areas of growth for pharmaceutical and medtech companies.

Source: L.E.K. Consulting

INDUSTRIALS + MATERIALS

Faster economic growth will improve the earnings backdrop for industrials.

Opportunities & Trends

> **Shorter-cycle industrial companies are likely the immediate beneficiaries of Trump administration policies.** We expect the White House to focus on infrastructure projects, which could garner bipartisan support. That, plus other growth initiatives, 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 expenditure (capex).

> **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. 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 the Organization of the Petroleum Exporting Countries' (OPEC) cut in production this year. 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 (E&P) companies

> **Currency continues to be a factor for many multinationals' prospects.** We are monitoring the impact of the dollar's exchange rate with the euro, British pound and Chinese yuan. Given the composition of U.S. exports, we consider a weakening yuan 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.

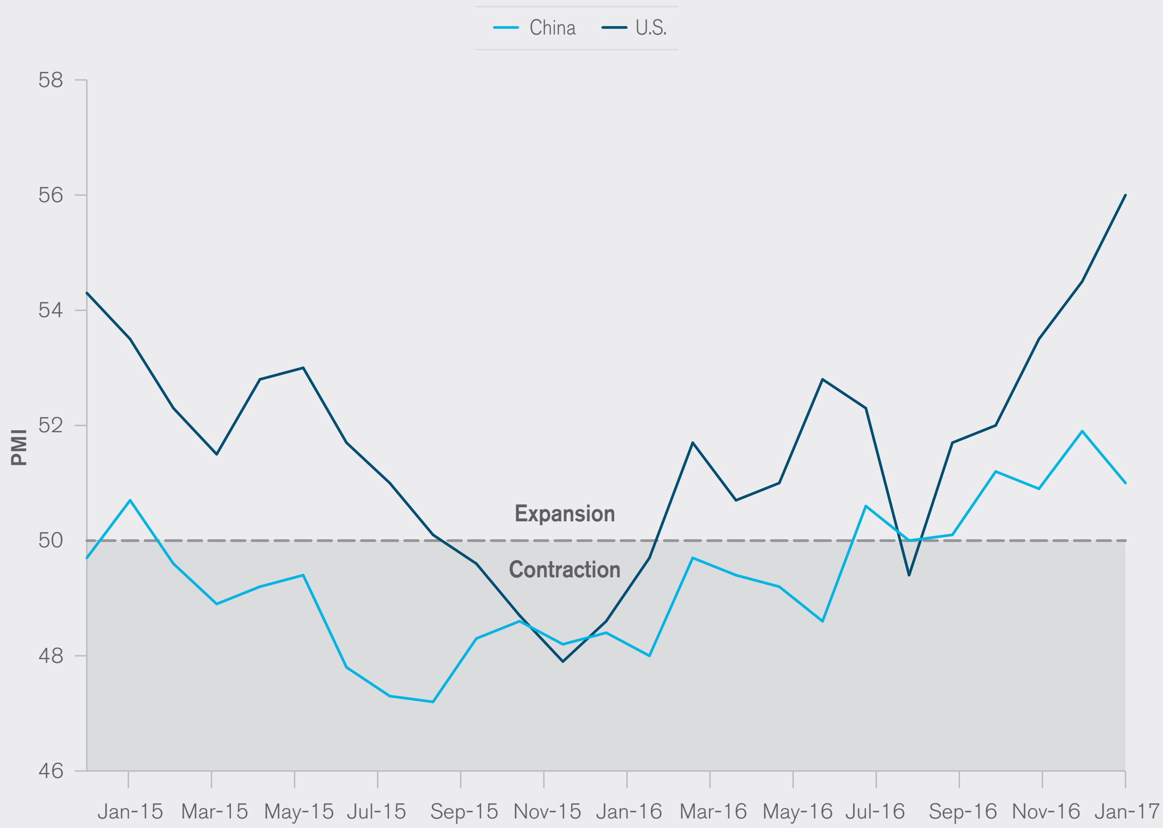
Investment Implications

> **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 Expands

China Caixin Manufacturing Purchasing Managers' Index (PMI) and Institute for Supply Management PMI, Monthly



Both China's and the U.S.'s manufacturing sectors are in expansionary territory.

Source: Bloomberg. Data as of 1/31/2017

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.

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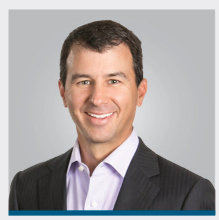

TECHNOLOGY
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