COMMENTARY

Janus Henderson Horizon Pan European Alpha Fund

Q2 2019

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Overview

European equities continued to confound a pessimistic consensus in the second quarter. On a global basis, more market cap was lost in May than in December 2018 when European markets had their worst month since the global growth scare in the first quarter of 2016. In contrast, June was one of the strongest Junes on record for equity markets.

We remain much more optimistic than the seemingly vast majority of our peers and are not chasing the 'global recession' trades. It is not easy to hold a bullish view in the face of ever-worsening headline data, but aside from very cautious investor positioning there are a number of factors that give us conviction.

Firstly, global real money growth continues slowly to improve after bottoming in October/November 2018, suggesting a third quarter 2019 low in industrial output momentum. Euroland money growth trends are beginning to encourage.

Second, despite lower overall purchasing managers' index (PMI) readings, the global new orders versus inventories series expanded its recovery further in June. A lot of the current macroeconomic softness seems to be caused by de-stocking, which can only run for so long. As before, for further clues we turn to the semiconductor sector due to its early cycle nature. Here, the year-on-year monthly shipment decline rate is now no longer worsening and companies are starting to report book-to-bill ratios in excess of 1.0x again.

Moreover, we are now entering a phase when comparable figures from the prior year are getting a lot easier. For instance, monthly China autos sales, Japan machine tool orders and South Korean exports are soon beginning to annualise negative change rates. In the face of normalised inventories it is harder to see things getting incrementally worse from here. We remain convinced our business is about the rate of change, and often things becoming less negative produces some of the best share price returns. Historic analysis on US markets suggests that the share prices of the industrial sector underperform the market in the 12 months prior to yield curve inversion, but outperform in both the three months and 12 months following the inversion because the risk of a recession has been discounted.

Lastly, we continue to believe that policy aggression will beget policy panic, as the new US-China trade truce already seems to indicate. On China's side, sharply rising domestic banking stress and a slowing economy, potentially leading to more political dissatisfaction – see Hong Kong – are putting pressure on the government. In case of the US, unemployment is now rising in key swing states and labour market perception by consumers is turning even more sharply. Voter perception of tariffs is also turning more negative and businesses are slowing investments and becoming more vocal in their displeasure about supply chain disruptions.

Performance and activity

The fund delivered 0.5% over the quarter (euro retail class, net of fees) bringing the year-to-date return to 2.7%.

On the long book we continue to rely on our high conviction ideas in the autos, healthcare, industrials, materials and semiconductor sectors to express our top-down views described above. At a stock level German information technology stock SAP was the top performer, boosted by recent equity market strength and accommodative central banks. Its shares also reacted positively to the announcement that activist investor, Elliott, had taken a stake in the company. Swedish telecom operator Tele2 was another positive contributor as the company made further progress slimming down the group following good first quarter results. We had success with German automotive, defence and electronics group Rheinmetall as the defence outlook remains solid. There were no significant detractors.

During the quarter key activity included the addition of AB-Inbev, BASF, Dometic, Kion, Lanxess, SBM Offshore and Siemens. We also topped up our weighting in the fund's largest long position, LafargeHolcim. We reversed track on Sandvik as the share price pulled back hard on short cycle concerns and weakening metals prices. Similarly, we changed direction on STMicroelectronics following a meeting with its management team.

We further concentrated our number of holdings in the fund. On the sell side we pretty much completed the exit from our position in banks given the structurally challenged business models by disposing of our holdings in

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Bankinter and DNB. In the healthcare sector we sold Bayer following a US court ruling against the company in its glyphosate-based weedkiller case. Finally, we took profit on long positions in Puma, Hugo Boss and Logitech and used periods of strength to take profit on our long-standing holding of Smurfit Kappa.

Our short book continues to be focused on stocks with high corporate leverage, bad capital allocation track records and richly valued defensives where we see significant earnings disappointment potential.

As always, the hedge book via options remains in place to offer protection in case of sharp market drawdowns, especially with binary event risk from trade negotiations or wider war in the Middle East.

In terms of overall positioning at the mid-year point our exposures stood at approximately 67% net and 130% gross respectively.

Outlook

We continue to overlay our bottom-up stock picks with the options hedging strategy to be prepared, if and when set-backs or external shocks hit.

Source: Janus Henderson Investors, as at 30 June 2019.

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