

Janus Henderson Pan European Fund

August 2019

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Fund manager names: John Bennett

Overview

August proved to be very volatile, but at the time of writing pretty much all of the month's losses have been recouped by markets that continue to benefit from increasingly light and bearish investor positioning. We still think it is right to look through the poor macroeconomic data and focus on money creation which troughed in the fourth quarter of last year and has since been on a moderate recovery, in particular in the eurozone. Barring further political escalations, this should lay the grounds for a trough in purchasing managers' indices (PMIs) this quarter if the historic precedence of around nine months lead time holds. An industrial capital expenditure recession is already advanced and industrial goods de-stocking seems to be rapidly underway. The key question now is whether those weaknesses will spill over to employment and consumer spending. It may be well into 2020 before GDP growth troughs.

Should spill-over to the consumer happen, markets will probably shift from a risk-off to a phase of complete risk-aversion. Since PMI's peaked around 18 months ago, the equity markets are basically flat. In past instances, periods of risk-aversion with sub-50 PMI readings came with changed equity market leadership. Growth typically loses its leadership, and is replaced by ultra-defensive names. At the same time, the risk-reward of picking up beaten down cyclical stocks dramatically improves with PMI and PMI new order readings in the 40s, which is where we are now.

We have to admit having been too early this year in turning more positive on select cyclical stocks with strong idiosyncratic stories, but in our view it is now too late to sell those stocks, as valuations appear to already price in a recession. Upside surprise potential for certain such stocks is particularly pronounced and could come from Chinese monetary and fiscal stimulus, European fiscal stimulus, the end of aggressive de-stocking and, last but not least, from a potential (temporary) reversal in sovereign yields due to stretched positioning. We take encouragement from now stabilised semiconductor memory, and pulp, paper and packaging spot prices following long periods of decline.

Performance and activity

The fund fell by 1.3% over the month compared with a fall of 1.5% in the benchmark index.

Consumer staples was one of the few positive sectors in Europe in August and sector constituent Carlsberg was the fund's best individual performer over the month as it reported robust first-half results and raised its 2019 guidance. In the same sector we used weakness in Tesco's share price to establish a position. While dependent on a somewhat more benign competitive environment in UK food retail than has been the case over the last decade, the strategic narrative at Tesco – a focus on earnings, capital discipline and cash flow – is fundamentally appealing and its management incentive plans look well aligned. This provides reassurance on the likelihood of realising the 8%+ consensus free cash flow yield that Tesco trades on. We also topped up our holding in Pernod Ricard, attracted by its long track record of profitability, scope for margin improvement and attractive valuation.

Amid a weak energy sector and an overhang of lower oil prices SBM Offshore lagged despite reporting good second quarter results raising full year guidance. Dometic, a Swedish manufacturer of equipment fitted to recreational vehicles (RV) and boats, detracted as current cyclical trends in RV are weak. We maintain a position.

Activity over the month included the rebalancing of our telecoms sector position. Following a meeting with its management we introduced Dutch carrier KPN. The company has, in our view, a realistic chance of escaping the deflationary spiral troubling the overall industry and of delivering its mid-single digit per annum free cash flow growth ambition. Hence, we expect it to trade at a material premium to the overall sector. Other rebalancing included the reduction of our holding in Swedish telecom company Ericsson following disappointing performance. Also on sell side we completed our exit from global leader in braking systems Knorr-Bremse and disposed of our holding in Royal Dutch Shell.

Outlook

We continue to abstain from the European banks sector which has historically performed worst in risk-off and risk-aversion environments. As ever, our emphasis remains on stock selection based on bottom-up analysis.

Source: Janus Henderson Investors, as at 31 August 2019

Janus Henderson Pan European Fund

For further information on the Luxembourg-domiciled Janus Henderson fund range please contact your local sales office or visit our website: www.janushenderson.com.

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