

AUSTRALIAN FIXED INTEREST FUND

As at December 2020

Fund objective

The Fund seeks to achieve a total return after fees that exceeds the total return of the Benchmark, over rolling three-year periods.

Investment approach

The Fund is an actively managed portfolio of high quality interest bearing securities that seeks to provide a high level of capital protection. The Manager's investment approach is fundamentally driven and seeks to take advantage of situations where market pricing has become misaligned with economic and investment fundamentals. The Manager seeks to add value to the benchmark using a combination of active strategies including duration and yield curve management, sector allocation and security selection.

Benchmark

Bloomberg AusBond Composite 0+ Yr Index

Risk profile

Medium

Suggested timeframe

3 years

Inception date

31 August 1994

Fund size

\$642.4 million

Minimum investment

\$25,000

Management cost (%)

0.47 p.a.

Buy/sell spread (%)

0.00/0.08[^]

Distribution frequency

Quarterly

ARSN code

087 719 739

APIR code

IOF0046AU

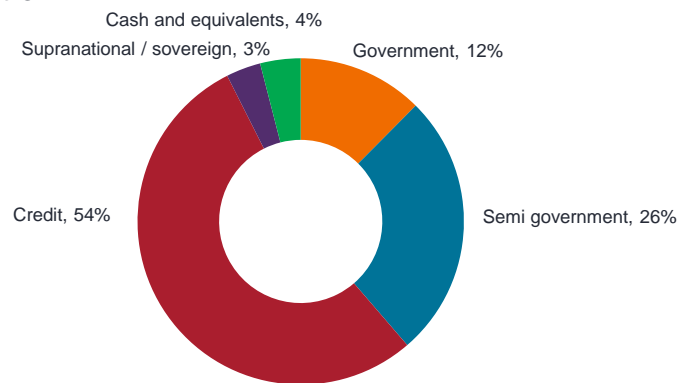
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Performance	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	Since inception (% p.a.)
Fund (gross)	-0.04	0.89	2.68	7.55	6.26	5.30	6.29	7.49
Fund (net)	-0.08	0.78	2.46	6.97	5.74	4.80	5.78	6.92
Benchmark	-0.27	-0.10	0.92	4.48	5.42	4.56	5.59	6.67
Excess return*	0.19	0.88	1.54	2.49	0.32	0.24	0.19	0.25

*Excess return is measured against net performance.
Gross return is Gross of Management costs and Sell Spread.
Past performance is not a reliable indicator of future performance.

Sector allocation



Rounding accounts for small +/- from 100%.

Credit rating distribution (%)



Portfolio characteristics

Estimated Weighted Average Yield to Maturity (EWAYTM) ¹	1.17
Benchmark EWAYTM	0.69

¹ Estimated Weighted Average Yield to Maturity is a measure of the average annual yield of all securities in the Fund.

Modified duration	Years
Fund	6.86
Benchmark	6.07
Active Position	0.79

Benchmark duration is as at month end and therefore does not include rebalancing.

[^] For more information and most up to date buy/sell spread information visit www.janushenderson.com/en-au/investor/buy-sell-spreads

AUSTRALIAN FIXED INTEREST FUND

(continued)

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Head of Australian Fixed Interest
Jay Sivapalan

Fund performance

The Janus Henderson Australian Fixed Interest Fund (Fund) returned -0.08% (net) and -0.04% (gross). The Fund outperformed the Bloomberg AusBond Composite 0+ Yr Index (Benchmark) by 0.19% (net) in December, which fell -0.27% on the month. Further, it continued its string of outperformance across all periods beating the Benchmark net of fees by 0.88% over the quarter, 2.49% over the year, and 0.25% since inception.

Notwithstanding the steepening of the yield curve in December, active intra-month management in rates assisted performance versus the Benchmark. As Europe and the US began distributing the vaccine over the month and markets looked through the current COVID-19 wave, yields remained in a higher range creating opportunities to actively manage duration.

Semi-government bond performance was down in the month. The rise in rates on the long end, together with a ratings downgrade on NSW and Vic from S&P, offset the coupon income. Last month, the Fund actively trimmed its exposure to semi's taking profit given the downgrade potential as well as supply uncertainty from the Victorian and NSW budget announcements and used the proceeds to buy supra national bonds, thus reducing the negative impact on the Fund in December.

Inflation-linked bonds outperformed in December and were a strong contributor to overall performance. The positive outlook by markets from the commencement of the vaccine distribution in the US and Europe lifted inflation expectations and buoyed pricing of these securities. We took advantage of cheap inflation protection offered earlier in the year as inflation expectations were at their lows, and our perseverance with these bond positions has been rewarded.

Credit had another good month in December. The spread tightening on corporate IG credit and global high yield was a decent contributor for performance in the month. Recent adding of cyclical names benefitted the Fund as the vaccine draws near in Australia. The Fund continues to maintain a high allocation to recession-proof sleep-at-night industries to balance out the cyclical issuers (major airports, toll roads, large diversified lowly geared property trusts) which will perform well in a post-vaccine world.

Reflecting on the year

Despite earlier market volatility and some drawdown in bond markets in March, overall, fixed interest investors had a good return this year with the Bloomberg AusBond Composite 0+ Yr Index delivering 4.48%, while cash averaged 0.37%. With the cash rate falling to an all-time low of 0.10% and bond yields dropping below 1%, returns have mostly come from capital movements. 2020 created a once-in-a-decade opportunity for active investors to outperform should they have acted on the many dislocations available throughout the year. The Fund benefitted by capitalising on these unprecedented times. Successful strategies included:

- active duration management (e.g. long and active curve positions, such as a flattening bias),
- holding sizable positions in inflation-linked bonds when the world didn't believe inflation would return,
- overweight positions in risk-free / low-risk assets, such as semi government bonds (even with the ratings downgrades), and
- taking advantage of wide spreads in recession-proof credits. This was nuanced from initially navigating the downturn in the face of poor trading and liquidity conditions, to later participating in the recovery.

The Fund returned 6.97% (net) over the year, outperforming its Benchmark by 2.49%. A successful year for active management and a performance we feel has rewarded our loyal investors and one we are very proud of.

AUSTRALIAN FIXED INTEREST FUND

(continued)

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Market moves

Bond markets ended 2020 on a slightly softer tone having delivered a strong result over the calendar year for investors.

Despite ongoing COVID-19 outbreaks, the commencement of vaccination programs and another round of fiscal easing in the United States helped buoy investor sentiment. Risk asset including equity markets had another strong month, while credit markets remained firm. Expectations for a post-vaccine global rebound and burgeoning sovereign debt supply saw yield curves steepen and inflation expectations lift.

Yields at the shorter end of the yield curve remained anchored as the Reserve Bank of Australia (RBA) reaffirmed its 0.10% cash and three-year government bond yield target. The three-year government bond drifted up to 0.14% before central bank action saw it end the month at 0.11%, in line with the target.

Longer-dated government bond yields rose, mimicking offshore moves as growth expectations were revised up, US fiscal policy eased and the US Federal Reserve (Fed) and RBA didn't increase their current QE programs. After lifting to as high as 1.04%, the Australian 10-year government bond ended the month 7 basis points (bps) higher at 97bps. The 30-year government bond finished 6bps higher at 1.96%.

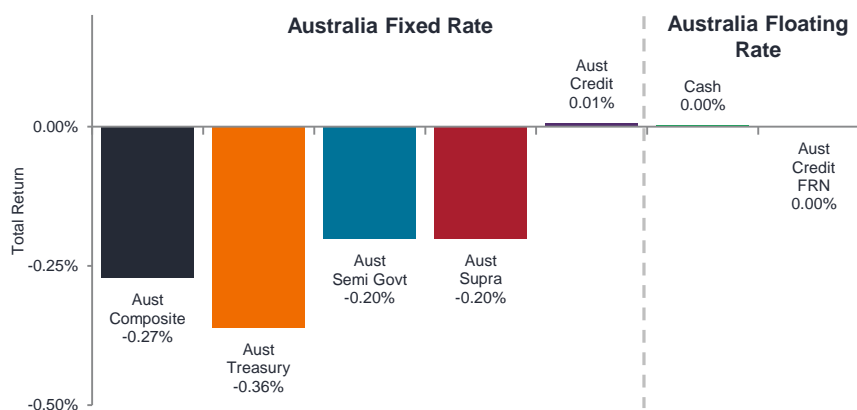
Money market rates adjusted to RBA policy moves, flush liquidity conditions and forward guidance for an extended period of highly accommodative policy. Three-month bank bills ended the month 4bps lower at 2bps, while six-month bank bills ended 4bps lower at 2.5bps.

The environment remained supportive for credit assets, with spreads on corporate investment grade bonds tightening 5bps during the month to finish 12bps tighter over 2020. Bank floating rate note (FRN) spreads underperformed as spreads widened 4bps from very low levels on profit taking after a very strong year. Over the year, however, FRN spreads tightened 29bps thanks largely due to the RBA's Term Funding Facility supporting bank liquidity.

Despite the pandemic escalating again in the northern hemisphere, higher yielding markets outperformed, with spreads tightening 37bps, continuing the strong momentum from the prior month. The improving market environment in the December quarter helped global high yield spreads claw their way back to finish only 35bps wider over 2020 after starting the year at very tight levels.

The Australian bond market, as measured by the Bloomberg AusBond Composite 0+ Yr Index, ended December 0.27% lower but was up 4.48% over the year.

Bond market returns



Source: Bloomberg AusBond Indices
Period of 1 December 2020 – 31 December 2020

AUSTRALIAN FIXED INTEREST FUND

(continued)

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It appears aggressive fiscal and monetary measures have limited the damage caused by public health measures and helped boost business and consumer confidence.

Market review

Economic growth surged more than expected in the September quarter, with real output lifting by 3.3%. This move followed the significant lock-down related 7% plunge in the June quarter. Partial demand indicators pointed to strong momentum over the December quarter, with strong gains in business conditions and business and consumer confidence. Anecdotal reports suggest that retail spending was strong over the Christmas period.

Labour market outcomes were also better than expected with the number of jobs lifting by 90,000 in November, building on the previous month's 180,000 gain. The unemployment rate edged down to 6.8% from 7%, while the participation rate lifted to 66.1%, a level not seen since January 2020.

Issuers remained active in the domestic primary market in the early part of the month before market liquidity slowed into the holiday season. The market saw strong demand for higher credit quality spreads, with Western Sydney University, University of Wollongong and SMHL RMBS (ME Bank) pricing 10-15bps tighter than initial price guidance, while NBN Co. managed to come back to the market for the second time in as many months and Macquarie Bank issued \$1.45bn of a five-year FRN. Industrial property exposure continued to be highly sought after by investors due to the relative lack of impact from the pandemic and a rare issuer, Goodman Australia Industrial Fund, raised \$400 million but left a further \$1.3 billion of demand from investors unfilled.

Market outlook

It appears aggressive fiscal and monetary measures have limited the damage caused by public health measures and helped boost business and consumer confidence. Growth and labour market outcomes at the end of 2020 were stronger than forecast six months ago and mid-year hopes for an effective vaccine were replaced by the commencement of vaccination programs, although these programs are expected to take years to complete.

While the Australian economy is recovering, the latest COVID-19 outbreaks in Sydney and Melbourne and simmering trade tensions with China are reminders that we are not completely out of the woods yet.

We still look for the Australian economy to rebound by around 5% over 2021, though the latest outbreaks and reintroduction of state border controls have increased downside risks. While a 5% growth rate looks very high, we don't expect the economy to reach end of 2019 levels until late 2021. This means that the economy will have built up considerable slack and this will continue to show up in an elevated unemployment rate, low rate of wages growth and inflation rate below the RBA's 2% to 3% target band.

With the cash rate now at 0.10% and the RBA reluctant to move into a negative rate regime, further easing, if needed, is likely to come in quantitative form. For example, the RBA could choose to increase the amount or extend the duration of its November 2020 program to buy government and semi-government bonds to the tune of \$100 billion over six months.

A key takeaway for investors is that the low risk-free interest rate regime will persist for at least the next couple of years and drive ongoing demand for income-producing assets. The preconditions for a shift in accommodative policy remain 'outcome' based. Fiscal policy will move from accommodation to consolidation only when the unemployment rate falls below 6%.

Monetary conditions will only normalise (first tightening in a new cycle) when actual inflation is sustainably in the 2% to 3% RBA target band and the labour market is at full employment. We do not see these outcomes being achieved over the next couple of years.

While vaccine euphoria has led markets to price in better growth prospects, we see the current steepness in the Australian yield curve where the 10-year government bond is around ten times the cash rate, as providing investors more than adequate compensation for term risk. Nearer term inflation risks are low, with the stronger currency acting as a break on both activity and inflation.

Despite ever-present solvency risks, we expect spread sectors to be shored up by the outlook for an extended period of low yields on government securities, unprecedented levels of central bank support for both sovereign and non-sovereign debt markets and investor demand for income.

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(continued)

The steepness in the curve and subsequent roll down benefits make it still worthwhile to hold a long position.

Investment strategy

Our north stars for investing are:

- Zero to ultra-low risk-free rates
- Inflation protection when its cheap
- Income bid (spread sectors, including credit)
- Invest with a recession mindset – avoid default heavy areas
- Aim to participate in any cyclical growth uplift

The following is a summary of the key strategies in the Fund (at the time of writing):

Interest rates:

The steepness in the curve and subsequent roll down benefits make it still worthwhile to hold a long position. Bond buying by the RBA will keep yields out to 10 years suppressed. With the cash rate anchored at 0.10%, yield curve control and active RBA buying of bonds each week, yields will be capped on the upside even as the vaccine rolls out abroad and comes closer to our shores. We see excessive curve steepening as buying opportunities and we will actively take advantage of these periods as was evident in previous months.

The pricing in of higher inflation by markets rewarded our overweight position in inflation-linked bonds in the Fund. These securities were purchased cheaply as a hedge against rising inflation. We will look to trim this position and take profit at these higher levels.

Sector allocation:

Semi-government bonds: An overweight position on these low risk assets have been a strong contributor to performance throughout 2020. Just prior to the ratings downgrade we trimmed some of our holdings on NSW and Vic. Now that the downgrade risk has been resolved, the RBA's bond buying of semi-government bonds will keep these securities well bid. We will monitor pricing and may look to add exposure again noting that AA rated semi-government bonds do offer good relative value to sovereign bonds.

Investment grade credit: The Fund is poised to balance a robust portfolio that can continue to ride through the impact of COVID-19 downturns, whilst participating in the recovery. We will monitor how the vaccine rollout will occur versus policy support in key economies, such as the US and UK. How Australia navigates geo-political tensions with China (noting we are wary of sectors that are most exposed) and tolerates near term interruptions of COVID-19 outbreaks and state closures will be key to a solid economic recovery.

Generally, in credit, we prefer fixed rate bonds over floating rate, as we take advantage of the steeper curve and the pick-up to the low rates of floating rate securities which are set against the Bank Bill Swap Rate (BBSW). We are comfortable with the reward for risk premium that the longer maturities offer.

Important information

A new Product Disclosure Statement and Additional Information Guide for the Fund dated 30 September 2020 is available at www.janushenderson.com/australia.

Past performance is not a reliable indicator of future performance. Performance source: Morningstar, Janus Henderson. Performance figures are calculated using the exit price net of fees and assume distributions are reinvested. The Gross performance methodology was updated at the end of March 2020 to reflect the Gross return to be Gross of Management costs and Sell Spread. Due to rounding the figures in the holdings, breakdowns may not add up to 100%. The information in this monthly report was prepared by Janus Henderson Investors (Australia) Funds Management Limited ABN 43 164 177 244, AFS Licence 444268 and should not be considered a recommendation to purchase, sell or hold any particular security. Securities and sectors mentioned in this monthly report are presented to illustrate companies and sectors in which the Fund has invested. Holdings are subject to change daily. This monthly report contains general information only and does not take account of your individual objectives, financial situation or needs. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested. None of Janus Henderson Investors (Australia) Funds Management Limited nor any of the Janus Henderson group entities nor their respective related bodies corporate, associates, affiliates, officers, employees, agents or any other person are, to the extent permitted by law, responsible for any loss or damage suffered as a result of any reliance by any reader or prospective investor. You should consider the current PDS, available at www.janushenderson.com/australia, before making a decision about the Fund. Dollar figures shown are in Australian Dollars (AUD), unless otherwise stated.