

AUSTRALIAN FIXED INTEREST FUND

As at February 2021

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

\$630.2 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

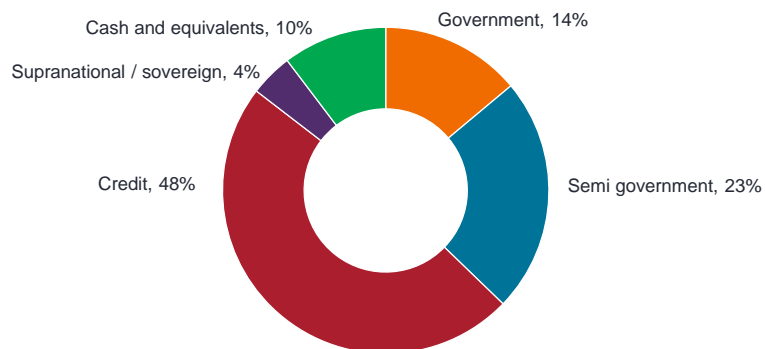
ASX mFund

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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)	-4.00	-4.49	-2.48	-0.42	4.61	3.93	5.63	7.26
Fund (net)	-4.03	-4.60	-2.70	-0.95	4.10	3.43	5.13	6.69
Benchmark	-3.58	-4.25	-3.05	-2.80	3.99	3.25	5.02	6.47
Excess return*	-0.45	-0.35	0.35	1.85	0.11	0.18	0.11	0.22

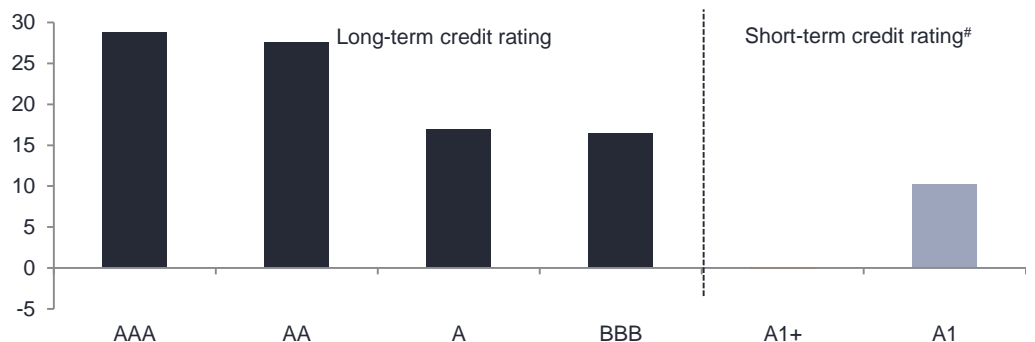
*Excess return is measured against net performance.
Gross return is Gross of Management costs and Sell Spread.
Past performance is not a reliable indicator of future performance.

Sector allocation



Rounding accounts for small +/- from 100%.

Credit rating distribution (%)



Portfolio characteristics

Estimated Weighted Average Yield to Maturity (EWAYTM) ¹	1.60
Benchmark EWAYTM	1.18

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	6.64
Benchmark	5.77
Active Position	0.87

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.janus Henderson.com/en-au/investor/buy-sell-spreads

AUSTRALIAN FIXED INTEREST FUND

(continued)



Head of Australian Fixed Interest
Jay Sivapalan

Fund performance

The Janus Henderson Australian Fixed Interest Fund (Fund) underperformed the Bloomberg AusBond Composite 0+ Yr Index (Benchmark) in February by 45 basis points (net), returning -4.0% (gross) and -4.03% (net). Whilst this month's underperformance is not ideal, February's result needs to be assessed in the context of the largest monthly drawdown in the bond market since 1983. This month comes on the back of a string of rising bond yields, with the Benchmark having had four months of negative returns with November (-0.11%), December (-0.27%), January (-0.42%) and February (-3.58%) with a cumulative -4.35%. The Fund has outperformed the Benchmark over this four month period.

On the rates side over February, the Fund was adversely impacted in absolute terms by sharply rising bond yields and a dramatic steepening in the yield curve. Our 'fair value' process indicated that markets (longer-term bond yields) had begun overshooting and as such we had commenced adding interest rate risk (duration) relative to the Benchmark. It is always difficult to pick turning points as bond markets overshoot, but our process favours getting set early in order to have the largest active position when markets turn as trying to reposition after this has occurred is rarely successful. Despite some tactical duration management intra-month cushioning the impact, the sheer magnitude of lift in bond yields adversely impacted returns. Offsetting to some extent was the Fund's exposure to inflation linked bonds (inflation protection) as inflation expectations lifted.

Sector allocation overall delivered muted results, with various assets such as semi-government bonds and higher quality credit closing the month broadly flat despite giving up earlier gains towards the end of the month.

Semi government bond spreads also showed resilience over the month given favourable demand and supply dynamics. The RBA announced \$100bn in Quantitative Easing, but left the market awaiting clarification on the purchasing split between government and semi-government bonds. Improved State budgets have also seen the expected new supply of issuance fall. Some slight selling pressure in the shorter dated semi government bonds was said to be mainly due to profit taking from foreign investors as spreads reached tights and the currency appreciated. Notwithstanding, the stable spread was not enough to offset the mark down from the higher rates.

Market moves

The reflation trade gathered momentum over the month and bond markets sold-off sharply in February. Given the rapid pace of the vaccine rollout offshore and the commencement locally, markets responded to the idea that the global economic recovery will be strong as lockdowns end and inflation is expected to lift higher. Cash rate expectations in the out years lifted and rose above 3% cash rate for Australia in 2028-2030). This was buoyed by a backdrop of expansionary monetary and fiscal policies, with markets challenging central banks on whether they'll stay the course with forward guidance and yield curve control (YCC) over the next three years. Credit markets were relatively stable considering the tightening of financial conditions in the rates market. The Australian bond market had its largest negative monthly drawdown since 1983, with the Bloomberg AusBond Composite 0+ Yr Index ending February 3.58% lower.

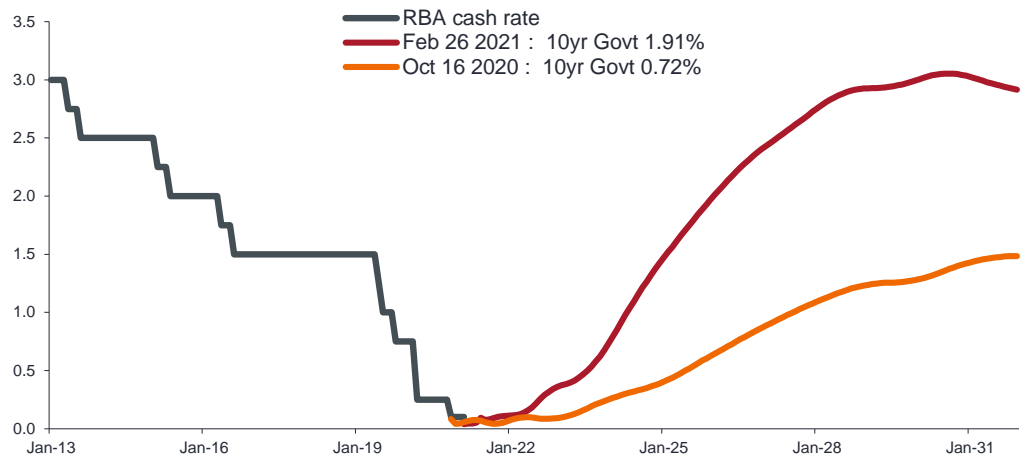
In combination with the negative return in January, this wipes out 80% of the Index's 2020 returns. The ingredients for a bond market sell-off, such as the one we're witnessing, has been building for some time due to historically low bond yields (influenced by Quantitative Easing programs) and elevated levels of interest rate risk (duration).

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(continued)

Yields at the shorter end of the yield curve drifted higher than the Reserve Bank of Australia's (RBA) 0.10% cash rate and three-year government bond yield target.

Australian implied OIS forward 1m cash rate (%)



Source: Janus Henderson Investors, Bloomberg, monthly to February 2021, spot 26 February 2021

Yields at the shorter end of the yield curve drifted higher than the Reserve Bank of Australia's (RBA) 0.10% cash rate and three-year government bond yield target. The three-year government bond edged up to 0.127% before ending the month at 0.117%.

Longer-dated government bond yields lifted to their highest level in two years, with fears that policy makers have over-stimulated. The Biden administration's US\$1.9 trillion COVID-19 relief bill awaiting to be passed by the senate comes at a time when the private sector is rebounding and the labour market is recovering. Dovish central bank commentary by the US Federal Reserve (Fed) and RBA did little to ease the falling bond market. The 10-year Australian government bond yield ended the month 79 basis points (bps) higher at 1.92%. The 30-year Australian government bond finished 77bps higher at 2.91%. Money market rates remained very low given the 0.10% official cash rate and RBA forward guidance for an extended period of highly accommodative policy. Three-month bank bills ended the month higher at 3bps, while six-month bank bills rose 0.5bps to 2bps.

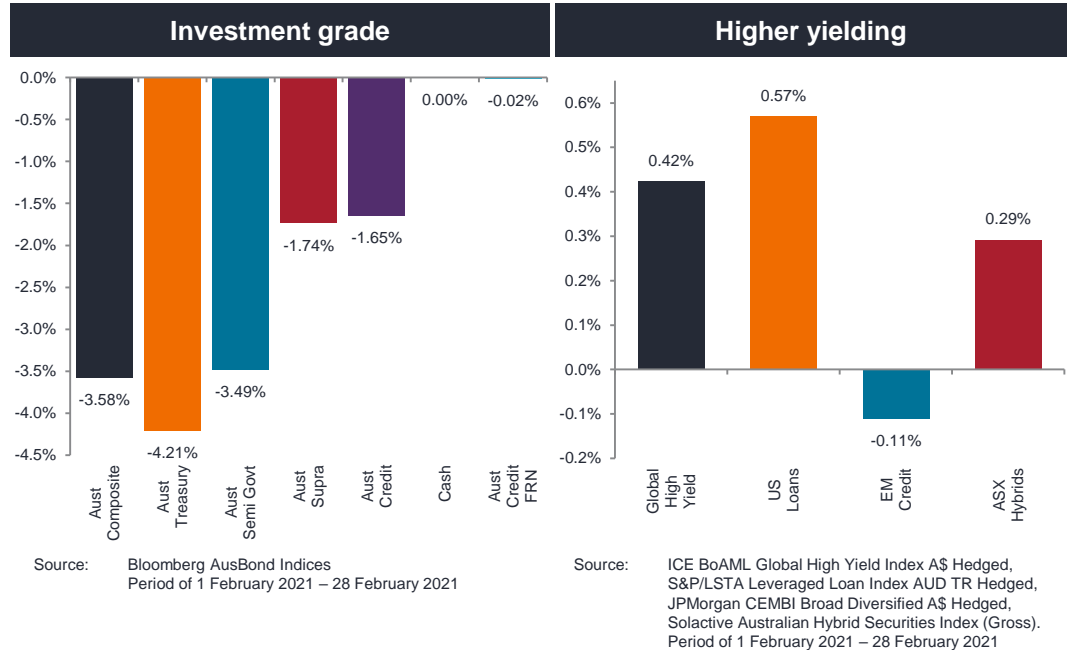
Credit markets continued their string of positive returns above government equivalents in February, with Australian and global credit markets finishing the month tighter in spread. Floating rate notes (FRN) outperformed fixed coupon bonds as the negative return contribution from the sharp rise in bond yields more than offset the positive contribution from income and credit spread compression. Spreads on Australian investment grade credit tightened 4bps due to outperformance in A and BBB rated sectors, which showed some resilience during the recent reporting season. Bank FRN spreads were wider by 2bps, unable to sustain their very tight levels as liquidity conditions became more challenging late in the month.

Higher yielding spread sectors like bank hybrids and subordinated notes returned between 0.2-0.5% as a reasonable level of income remains in high demand, with term deposit rates remaining very low and banks still reporting very high levels of liquidity and capital. The iTraxx Australia Index was unchanged on the month. After tightening 6bps to 57, the Index weakened to finish back at 63 during the more volatile final week.

AUSTRALIAN FIXED INTEREST FUND

(continued)

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Market review

New business capital expenditure rose by 3% in the December quarter to \$29.4 billion, beating expectations of a 1% rise. Business investment on equipment, plant and machinery grew by 5.7%, indicating that the Federal government's business investment incentives may be having an impact. This is on top of the previous significant rise in residential building approvals.

Following the fall in the unemployment rate in the December quarter from 7.4% to 6.4%, domestic wages surprised to the upside, with a 0.6% rise. This exceeded expectations by double, pushing the annual wage growth rate up to 1.4%. Most of this was in the private sector as labour shortages were reported and many businesses lifted short-term wage reductions back to pre-pandemic levels.

Iron ore prices continued their upward trajectory over the month. While China still accounts for 50-60% of iron ore demand, growing demand has picked up outside of China. This fuelled the recovery story for the Australian economy, given the benefit to the budget from stronger corporate tax revenues, notwithstanding the negative impact from the stronger Australian dollar.

Primary issuance picked up in February, with a number of issuers attempting to capitalise on the tight spread environment post reporting. In local financials, we saw Suncorp-Metway issue a five-year deal at a margin of 45bps, while Macquarie was active in capital notes issuing a Group hybrid at 290bps and a US dollar Bank Tier 2. Offshore banks were also active, with BNP, UBS and Svenska Handelsbanken all coming to the Australian dollar market. Charter Hall Long WALE REIT, with their inaugural bond deal was the long awaited first corporate issuer of the year which saw strong demand for both seven- and 10-year bonds issued at margins of 95bps and 115bps respectively. The book was three times oversubscribed for the \$500 million of bonds available.

Market outlook

We see 2021 as a reopening year, as the vaccine programs continue to roll out, lockdowns become obsolete or less frequent and policy settings remain supportive. Cheap money will likely have a large effect on asset prices, as already demonstrated by the rise in the domestic housing market. Building approvals have risen sharply and this trend is set to continue. This has a multiplier effect as industries of design, planning, raw materials and furnishings benefit.

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With the pick-up in economic activity comes a narrowing of spare capacity in the labour market.

With the pick-up in economic activity comes a narrowing of spare capacity in the labour market. Adding to this is the build-up in household savings from government handouts, lockdowns, inability to travel overseas and cautionary savings. As the pressure valve is released on pent up savings, this is likely to give a sugar hit to discretionary goods and services, with figures already showing a lift in credit card spending on restaurants and cafés. Spending will likely discriminate, as businesses reliant on offshore tourism will continue to struggle. We look for the economy to lift by 5% this year, which should see the economy return to the same size it was at the end of 2019. Of course, risks around the effectiveness of vaccines against COVID-19 mutations and the vaccine's rollout remain.

The global and domestic yield curve (cash – 10-year spread) has steepened since late 2020 as markets factored in a cyclical rebound and greater tolerance by central banks for inflation to run higher. The violent sell-off in bond markets (yields materially higher) in February has markets pricing in an earlier return to the RBA tightening monetary policy than the 2024 conditional commitment. Bond yields rose despite the asset purchase programs and dovish rhetoric from central banks.

The broad macro-economic environment is positive for risk assets. A synchronised global growth recovery and fiscal and monetary policies that concur on “whatever it takes” should be supportive for credit. Corporates are in good health as liquidity buffers and debt tenors are extended and earnings recover. Notwithstanding, market dynamics are weakening. Rising bond yields have tightened financial conditions and valuations, and while still attractive to risk-free are now less compelling.

Markets on the other hand have moved swiftly to pricing these expectations in and have perhaps gone too far in the near term. Whilst we do expect inflation, cash rates, bond yields to normalise over the next 5 to 10 years, in our assessment it is premature for all of this to be priced in now. Especially against the policy settings central banks have committed to in the near term. The global and domestic yield curve (cash - 10year spread) has steepened since late 2020 as markets factored in a cyclical rebound and greater tolerance by central banks for inflation to run higher. The violent selloff in bond markets (yields materially higher) in February has markets pricing in an earlier return to the RBA tightening monetary policy than the 2024 conditional commitment. Bond yields rose despite the asset purchase programmes and dovish rhetoric from central banks.

While a higher rate regime and steeper curve is somewhat expected given the improved outlook, we are mindful that the markets may have got ahead of themselves. A tightening of monetary conditions through the higher yields and currency strength should act as a drag on growth and require the RBA to keep monetary conditions accommodative. An expansion/extension of its quantitative easing program may be warranted to support medium-term growth prospects and support lower yields.

All of the action thus far has been in rates markets, but the possibility is it may lead into credit markets; a potential taper tantrum style sell-off. The conditions are fast brewing for this to occur if central banks do not intervene in a coordinated fashion. Our assessment is that the combination of sharply higher risk-free yields and high risk asset valuations (including relatively tight credit spreads) will struggle to co-exist in the very near-term. One will likely have to give way to the other.

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(continued)

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Investment Strategy

In terms of strategy, the pendulum again is fast changing from a recent heavy capital preservation focus to now enhancing returns especially through interest rate strategies. Historically, when yield curves are very steep, the subsequent move in bond yields are either sideways or down (due to overshooting) as most of the tightening cycle had already been priced in.

As a manager that incorporates rates (duration, curve, relative value) strategies, while we will have some underperformance as all of the action has been in rates during February, we expect the real show will be in March should risk assets falter. Whilst we will also be impacted if this occurs, our relative position may be smaller after the recent actions we've taken. Our focus continues to be on capital preservation strategies and protecting the Fund from a breakout in inflation and credit weakness. While the underperformance in February is not ideal, we expect some better returns moving forward as the whole term structure (yields) lifts.

Interest rates:

We see value in the elevated rates and will continue to gradually buy into the weakening bond market (rising yields) in nominal bonds. While buying duration early will bring some near-term drawdown in returns, but we expect this to reverse as the market stabilises. We note the challenge of picking turning points, but our focus is on averaging in as yields lift, with the view of having the largest active position at the turning point whenever that occurs. We suspect this episode might offer both higher income, roll down and potential capital gains from risk-free assets. We have taken some profit on inflation protection, whilst maintaining an allocation should inflation expectations breakout on the upside.

Sector allocation:

Semi-government bonds: We more than halved our position in semi-government bonds throughout February, preferring to take on duration risk via government bonds. The outlook is now more positive for this sector, with the RBA flexing its buying power to curb the bond market sell-off. A show of continued support by the central bank was necessary to alleviate the potential for semi-spreads to move wider.

Investment grade credit: We have been trimming credit exposure to spread sectors at or near peak valuation valuations, including adding some credit protection through CDS contracts. The Fund continues to be exposed to credit markets (for good reason), but a reduction at this juncture allows some room for risk taking should markets become unstable and good buying opportunities present.

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.