



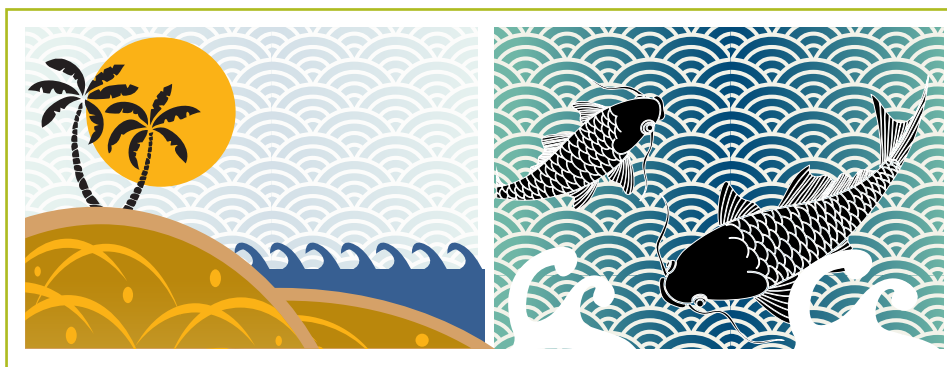
JANUS CAPITAL  
Group

# Investment Outlook

from Bill Gross

November 2014

## The Trouble with Porosity and Prosperity



"We're all one thing, Lieutenant. That's what I've come to realize. Like cells in a body. 'Cept we can't see the body. The way fish can't see the ocean. And so we envy each other. Hurt each other. Hate each other. How silly is that? A heart cell hating a lung cell?"

– "Cassie" in the novel *The Three*

---

I am a philosophical nomad disguised in Western clothing, a wondering drifter, masquerading in a suit near a California beach. Sand forms the foundation of my being and its porosity is at once my greatest strength and deepest wound. I have become after 70 years, a man who believes that no belief is sacred. I have ideals and moral standards, but I believe them specific to me. Had I inherited your body and ego, "I" could just as clearly have assumed "yours." If so, I wonder, if values are relative, then what are mortals to make of them, and what would a judging God make of us? If a collective humanity is to be rooted in sandy loam, spreading its ideological seeds through howling winds only to root in mutant form at different places and different times, can we judge an individual life?

Decades and indeed centuries have taught us that both inflation and deflation are the enemies of stability and growth, but knowing which one is just around the corner can be difficult.

---

I despair that my only answer is “not easily.” The conclusion at its logical end makes us all innocent and equal. We are born innocent, falter, but no matter, we remain mostly innocent. My problem, however, is that if there are no absolute standards, it may minimize life’s value. Concrete, as opposed to porous sand, provides a firmer foundation for judgment, but sand I suspect is the soil into which we are insecurely grounded. All one thing, masquerading as ourselves.

The global economy and its financial markets are insecurely grounded as well. Decades and indeed centuries have taught us that both inflation and deflation are the enemies of stability and growth, but knowing which one is just around the corner can be difficult. Before the advent of central banks in the early 20th century, prices were just as likely to go up as down. A bountiful harvest or supply shock miracle could sink prices just as easily as the discovery of gold and silver in the New World could raise them. Even after the miraculous “discovery” of the modern central banks printing press, a miscue or fat fingered mistake by one of the “wise men” could lead to depression and accompany deflation. The world of the 1930s and the more recent lost decades of Japan give testament. Prices change – and while they usually go up these days, sometimes they do not. We are at such a moment of uncertainty.

That one or the other should be favored, is a fascinating debate. Currently, almost all central bankers have a targeted level of inflation that approaches 2%. Some even argue for higher levels now that deflationary demons approach in peripheral Euroland. They argue that the 2% level is sort of like a firebreak. Once inflation approaches zero, goes their theory, the deflationary firestorm is difficult to stop. With interest rates at zero and quantitative easing approaching potential political maximums, there is little water left to pour on the flames. Best then to keep inflation at a reasonable 2% so that the zero hour never comes. They have a point, but then how to explain to the average 30-year-old citizen that if so, his/her retirement dollar will only be worth half as much come 65, and if inflation averages 3%, it will only be worth a third. Actually, a 30-year-old citizen of the 1970s (yours truly), has experienced a 75% depreciation of his purchasing power. The cost of a firebreak can be expensive insurance.

And why, goes the argument, are lower prices so bad? Didn’t Wal-Mart get famous by featuring everyday low prices, and what’s so bad about 3-buck-a-gallon gas at the pump? More dollars in consumer pocketbooks suggests more spending, stronger growth rates and ultimately more jobs. Jim Grant, one of the most gifted financial historians of our day, has long argued that economies did just fine during bouts of deflation in the 18th and 19th centuries – in fact, in many cases, they did better. America in the 1880s was a period of good deflation with output rising by 2% to 3% from 1873 to 1893. Two percent targeted inflation, he would argue, is the “con” of central bankers who know nothing better than to create money during a financial crisis and then to keep creating it during the inevitable recovery. Grant has a point. If that is their job, then indeed they have been good at it.

But Grant must know, I suspect, that our modern finance based economy is not your 19th century Oldsmobile, if there had been one. "That indeed is the problem," he might counter. In fact, Grant has even written a book supporting that thesis titled *"The Trouble with Prosperity."* Prosperity has created inflation and excess, he would argue. My problem though (getting back to the introductory quote's reference to a heart cell as opposed to the lung cell) is that much of our 21st century economy has been planted in the sandy loam of finance as opposed to the concrete foundation of investment and innovation. Stopping the printing press sounds like a great solution to the depreciation of our purchasing power but today's printing is simply something that the global finance based economy cannot live without. Going home again, to paraphrase Thomas Wolfe, is something you just can't do. Modern economies have grown used to inflationary sand and cannot grow in the concrete based economy that Grant eulogizes in his magnificently written histories.

Why not? Simple math, I suppose. Our 2014 U.S. Oldsmobile requires 4% nominal growth just to keep it running, and Euroland economies need at least 3%. Having created outstanding official and shadow banking credit of nearly \$100 trillion with an average imbedded interest rate of 4% to 5%, the Fed presses must crank out new credit (nominal growth) of approximately the same 4% to 5% just to pay the interest rate tab. That of course wasn't the case in Grant's 19th century version – there was very little debt to service. But now at 500% to 600% of GDP (shadow debt included), it's a Sisyphean struggle just to stay above water. Inflation, in other words – or in simple math – is required to pay for prior inflation. Deflation is no longer acceptable.

Such is the dilemma facing central bankers (and supposedly fiscal authorities) in 2014 and beyond: How to create inflation. They've made a damn fine attempt at it – have they not? Four trillion dollars in the U.S., two trillion U.S. dollar equivalents in Japan, and a trillion U.S. dollars coming from the ECB's Draghi in the eurozone. Not working like it used to, the trillions seem to seep through the sandy loam of investment and innovation straight into the cement mixer of the marketplace. Prices go up, but not the right prices. Alibaba's stock goes from \$68 on opening day to \$92 in the first minute, but wages simply sit there for years on end. One economy (the financial one) thrives while the other economy (the real one) withers.

Perhaps sooner rather than later, investors must recognize that modern day inflation, while a necessary condition for survival, is not a sufficient condition for increasing wealth at a rate necessary to satisfy future liabilities associated with education, health care, and a satisfactory retirement. The real economy needs money printing, yes, but money spending more so, and that must come from the fiscal side – from the dreaded government side – where deficits are anathema and balanced budgets are increasingly in vogue. Until then, Grant's deflation remains a growing possibility – not the kind that creates prosperity but the kind that's the trouble for prosperity.

-William H. Gross

... deflation remains a growing possibility – not the kind that creates prosperity but the kind that's the trouble for prosperity.

## About Janus Fixed Income

Janus has been helping fixed income investors reach their financial goals for more than 25 years. Our team of investment experts is committed to delivering the stability our clients expect, with an unwavering focus on risk-adjusted returns and capital preservation. Today, we serve investors across a variety of markets by offering a diverse suite of fixed income strategies with highly complementary and distinctly separate investment approaches: a bottom-up, fundamental process led by CIO Gibson Smith, and a top-down, global macro process managed by Bill Gross.

Issued in Europe by Janus Capital International Limited, authorised and regulated by the U.K. Financial Conduct Authority and by the Dubai Financial Services Authority as a Representative Office and also issued by Janus Capital (Switzerland) LLC, authorised and regulated in Switzerland by FINMA.

Issued in: (a) Taiwan R.O.C by Janus Capital Taiwan Limited, licensed and regulated by the Financial Supervisory Commission R.O.C., (b) Hong Kong and Australia by Janus Capital Asia Limited (ARBN 122 997 317), which is incorporated in Hong Kong, is exempt from the requirement to hold an Australian financial services licence and is licensed and regulated by the Securities and Futures Commission of Hong Kong under Hong Kong laws which differ from Australian laws, and (c) Singapore by Janus Capital Singapore Pte. Limited (Company Registration No. 200617443N), holder of a capital markets services licence issued by the Monetary Authority of Singapore to conduct the regulated activities of fund management and dealing in securities.

In Australia, for wholesale client use only; In Taiwan R.O.C and the PRC, only available to select targeted institutional investors. In Singapore, only available to accredited and institutional investors as defined under section 4A of the Securities and Futures Act (Cap.289), and may not otherwise be distributed in Singapore.

The information contained in this document has not been submitted to or approved by the China Securities Regulatory Commission or any other governmental authorities in China. Janus Capital Group and its subsidiaries are not licensed or approved to publicly offer investment products or provide investment advisory services in the PRC. This document and the information contained in it is only available to select targeted institutional investors in the PRC. Not for public distribution or use in the PRC.

This document does not constitute investment advice or an offer to sell, buy or a recommendation for securities, other than pursuant to an agreement in compliance with applicable laws, rules and regulations. Janus Capital Group and its subsidiaries are not responsible for any unlawful distribution of this document to any third parties, in whole or in part, or for information reconstructed from this presentation and do not guarantee that the information supplied is accurate, complete, or timely, or make any warranties with regards to the results obtained from its use. As with all investments, there are inherent risks that each individual should address.

The distribution of this document or the information contained in it may be restricted by law and may not be used in any jurisdiction or any circumstances in which its use would be unlawful. Should the intermediary wish to pass on this document or the information contained in it to any third party, it is the responsibility of the intermediary to investigate the extent to which this is permissible under relevant law, and to comply with all such law.

This presentation does not constitute a public offer of securities in the Sultanate of Oman, as contemplated by the Commercial Companies Law of Oman (Royal Decree No. 4/74) or the Capital Market Law of Oman (Royal Decree No. 80/98), or an offer to sell or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman, as contemplated by Article 6 of the Executive Regulations to the Capital Market Law (issued by Ministerial Decision No. 4/2001).

Additionally, this document is not intended to lead to the making of any contract within the territory of the Sultanate of Oman.

The Capital Market Authority and the Central Bank of Oman take no responsibility for the accuracy of the statements and information contained in this presentation or for the performance of strategy nor shall they have any liability to any person for damage or loss resulting from reliance on any statement or information contained herein.

THE CENTRAL BANK OF BAHRAIN AND THE BAHRAIN STOCK EXCHANGE ASSUME NO RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THE STATEMENTS AND INFORMATION CONTAINED IN THIS DOCUMENT AND EXPRESSLY DISCLAIM ANY LIABILITY WHATSOEVER FOR ANY LOSS HOWSOEVER ARISING FROM RELIANCE UPON THE WHOLE OR ANY PART OF THE CONTENTS OF THIS DOCUMENT.

Past performance is not a guarantee of future results. There is no assurance that the investment process will consistently lead to successful investing.

The opinions are those of the authors 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.

Statements in the brief that reflect projections or expectations of future financial or economic performance of a strategy, or of markets in general, and statements of any Janus strategies' plans and objectives for future operations are forward-looking statements. Actual results or events may differ materially from those projected, estimated, assumed or anticipated in any such forward-looking statement. Important factors that could result in such differences, in addition to the other factors noted with forward-looking statements, include general economic conditions such as inflation, recession and interest rates.

FOR INSTITUTIONAL USE, AUTHORISED PERSONS AND WHOLESALE CLIENT ONLY. NOT FOR PUBLIC VIEWING OR DISTRIBUTION.

AMG-1114(8)0115 EAPM Inst