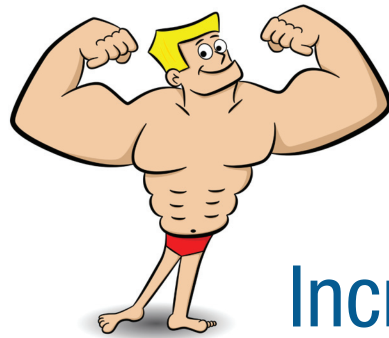
JANUS CAPITAL® Group

Investment Outlook

from Bill Gross

February 2016



Increasingly Addled

Long ago and far away in the adolescent cauldron known as Los Altos High School, I attended a senior U.S. history class with a man-child named Delos Roman. He was appropriately christened it seems, because his body resembled that of Zeus, the God of Thunder, and at 6'4"/230 pounds, he rumbled down the football sidelines like a Mack truck on a downhill mountain road. If you were a defensive corner, you didn't want any part of him, nor did you after the 3:00PM Springtime bell, when "fight" became the rallying cry between Delos and any would-be challenger in the school parking lot. Fate, it seems, had predestined him to be a tough guy. His size didn't necessarily mean he lacked intellect, but it emphasized brawn over brains and he went with his strong suit like many of us did. Homecoming queens, high scoring SAT nerds, chess club leaders, debate champions, even those with less attractive physical and IQ characteristics seemed primarily guided by how they came out of the oven, not by who they might become – if uninfluenced by their genetic makeups. That was not to discount free will (I now understand), but Nietzsche was never required reading back then and four years was too short a time to really judge the measure of a boy or a girl in blossom. "Mirror, mirror on the wall" seemed a better lead indicator than Nietzsche's "Superman".

I was reminded of Delos when the phone rang at my office several months ago and my assistant said there was a Mr. Roman on the line. He had had a hard life, he said, and wanted to know how to invest the $50,000 he had received from his mother's will. He spoke softly and was almost inaudible, "I've been in and out of trouble all my life", he murmured, "beginning in junior high when I was tough enough to beat up high school seniors." His story had a ring of the famous Marlon Brando soliloquy in On the Waterfront. "I could've been somebody", he said in so many words, "but I was too big for my own good."

Well, Mr. Roman was just one example in hundreds of the Los Altos class of '62, many molded by inbred physical and intellectual characteristics that had guided their destinies. But perhaps, I wondered if some of those with a plain vanilla wrapper or an average IQ might in some ways have been better off than the 800 SAT genius or

the prettiest girl in the class. Maybe that left them free to determine their own direction, to develop a multitude of skills that then led to a more successful outcome than that of Delos Roman. Bob Dylan once wrote that "I got nothin' Ma – to live up to." He did of course – strange little guy with the raspy voice. But Dylan's and Roman's lives might just be a lesson for discouraged parents to stay optimistic. If your child isn't at the head of the class or captain of the volleyball team, a free-will outcome, as opposed to predestination, may be just around their corner.

"Stability leads to instability" was Minsky's mantra, but it still inevitably begged the big question of "when?"

Some readers might think that there are some autobiographical traces in the above, and I suppose there are. I was "different". While at 71 it is hard to remember details from a half century past, as recently as 2007, I was the subject of a few revealing comments from a now retired Governor during a Fed meeting chaired by Ben Bernanke. I had been highly critical for several years of the potential housing bubble and the Fed's neglect of same, which caused the Governor to criticize my written Investment Outlooks and label me as an "odd duck" and "increasingly addled". Following much laughter, the Governor asked that the remarks be stricken from the minutes, which prompted another Governor to say "and replaced by what?" More laughter, but PIMCO and a few others it turns out had the last hoo-hah. The housing bubble and the Fed's neglect of it was recognized early on by PIMCO's Paul McCulley, an economist/investor who should belong in someone's Hall of Fame. McCulley introduced me and PIMCO to Hyman Minsky and his personal characterization of the upcoming "Minsky Moment", a phenomena that relied significantly on common sense as opposed to statistical modeling which the Fed used then and continues to. "Stability leads to instability" was Minsky's mantra, but it still inevitably begged the big question of "when?" We solved that though, by turning credit analysts into pretend home buyers, sending them to Las Vegas, Memphis, Toledo, etc. to learn about "no docs" and "liar loans" long before the Fed did. Shades of the Big Short!

Which reminds me that in 2012, Michael Lewis had come out to interview me several months before his book was written, to explore the historical context of the Great Short and the Great Recession. Perhaps PIMCO's story wasn't extreme enough, because we didn't actually short subprimes, but merely didn't buy many of them, or perhaps I wasn't addled enough like co-star hedge fund manager Michael Burry, who I share affection for and affliction with (and it's not a glass eye). In any case, we weren't part of Lewis' story. Nevertheless, it was a fascinating period of corporate and global financial history, but one which continues to the present day in terms of The Fed, global central banks, and their fixation on statistical modeling to influence monetary policy, as opposed to common sense and financial regulation.

Today's Fed and other model based central banks are, to my way of thinking, the ones that have more and more become "increasingly addled". Their genetic makeup, like that of Delos Roman, seems to have been determined at origin and has since been centered on changes in the policy rate and the observation that higher short rates slow economic growth/temper inflation, and that low (or negative) interest rates do just the opposite. In recent weeks markets have witnessed Mario Draghi of the ECB speak to "no limit" to how low Euroland yields could be pushed – as if he were a two-time Texas Hold Em poker champion. In turn, Janet Yellen at the Fed, at least temporarily, halted their well-advertised tightening cycle at 25 basis points, followed a few days later by the BOJ's Kuroda and a 5-4 committee vote to enter the black hole of negative interest rates much like the ECB and three other European central banks. They all seem to believe that there is an interest rate SO LOW that resultant financial market wealth will ultimately spill over into the real economy. I have long argued against that logic and won't reiterate the negative aspects of low yields and financial repression in this Outlook. What I will commonsensically ask is "How successful have they been so far?" Why after several decades of 0% rates has the Japanese economy failed to respond? Why has the U.S. only averaged 2% real growth since the end of the

Great Recession? "How's it workin' for ya?" – would be a curt, logical summary of the impotency of low interest rates to generate acceptable economic growth worldwide. The fact is that global markets and individual economies are increasingly "addled" and distorted, exemplified by some significant examples featured below:

"How's it workin' for ya?" – would be a curt, logical summary of the impotency of low interest rates to generate acceptable economic growth worldwide.

1) Venezuela – bankruptcy just around the corner due to low oil prices and policy mismanagement. Current oil prices are (in significant part) a function of low interest rate central bank policies over the past 7 years.

2) Puerto Rico – default underway due to overspending, the overpromising of retirement benefits, and the inability to earn adequate investment returns due to ultra-low global interest rates.

3) Brazil – in deep recession due to commodity prices, government scandal and in this case, exorbitantly high real interest rates to combat the effect of low global interest rates, and currency depreciation of the REAL. No country over time can issue debt at 6-7% real interest rates with negative growth. It is a death sentence. In the interim, the monetary authorities deceptively issue, then roll over more than a $100 billion of "currency swaps" instead of selling dollar reserves in an effort to hoodwink the world that there are $300 billion of reserves to back up their sinking credit. This maneuver effectively costs the government 2% of GDP per year, leading to the current 9% fiscal deficit.

4) Japan – 260% government debt/GDP and climbing sort of says it all, but there's a twist. Since the fiscal (Abe) and the monetary (Kuroda) authorities are basically one and the same, in some future year the debt will likely be "forgiven" via conversion to 0% 50-year bonds that effectively never come due. Japan will not technically default but neither will private investors be incented to make a bet on the world's largest aging demographic petri dish. I'm tempted to say that "Where Japan goes – so go we all", but I won't – it's too depressing.

5) Euroland – "Whatever it takes", "no limit", what new catchphrases can Draghi come up with next time? It's not that there's a sufficient recession ahead, it's just that the German yield curve is in negative territory all the way out to 7 years, and the shaky peripherals are not far behind. Who will invest in these markets once the ECB hits an effective negative limit that might be marked by the withdrawal of 0% yielding cash from the banking system?

6) China – Ah, the dragon's mysteries are slowly surfacing. Total debt/GDP as high as 300%; under the table capital controls; the loss of $1 trillion in reserves to support an overvalued currency; a distorted economic model relying on empty airports, Potemkin village housing, and investment to GDP of 50%, which somehow never seems to transition to a consumer led future. Increasingly, increasingly addled.

7) U.S. – Well now, the U.S. is impervious to all this, is it not? An 85% internally generated growth model that relies on consumption which in turn, relies on job growth and higher wages, all of which seems to keep on keepin' on. Somehow, though, even the Fed seems to have doubts, as in last week's summary statement, where for the first time in 15 years they were unable to assess the "balance of risks". "We need some time here to understand what is going on", says Kaplan from the Dallas Fed. *Shades of 2007.* The household sector has delevered, but the corporate sector never did, and with Investment Grade and High Yield yields 200-1000 basis points higher now, what does that say about future rollover, corporate profits and solvency in many commodity-sensitive areas?

OK – that's it for now. As of this writing, stocks are back up, and the prospects for the USA becoming great again are looking skyward as well, at least according to the polls and Donald Trump. Now there's an addled guy but … who knows, sometimes they succeed. What I do know is that our finance-based global economy is transitioning due to the impotence of monetary policy which has always, and is now increasingly focused on the elixir of low/negative interest rates. Don't go near any modern day Delos Romans; don't go near high risk markets, stay safe and plain vanilla. It's not predetermined or guaranteed, but a more prosperous outcome should be somewhere around the corner if you do.

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.

This material may not be reproduced in whole or in part in any form, or referred to in any other publication, without express written permission. Send email requests to mediarequests@csg-pr.com. Janus is a registered trademark of Janus Capital International Limited. © Janus Capital International Limited.

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

AS-0114(43-T)0115 EM Inst