DuPont CAPITAL

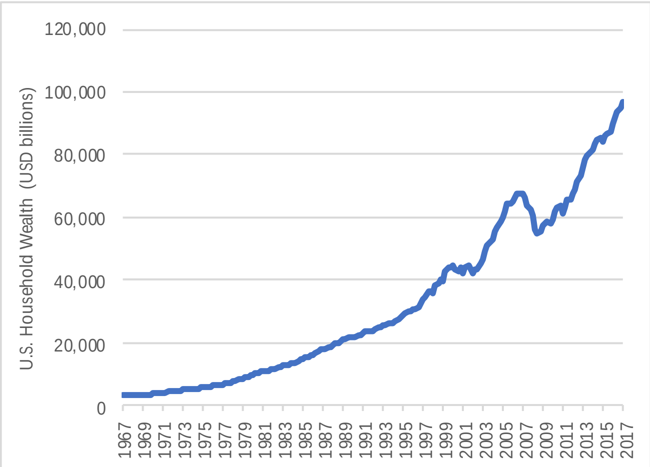
Global Market Positioning

January 2018

Real-time insight on how DuPont Capital has positioned its portfolios as a function of key factors driving the markets.

Key Market Factors (as of January 1, 2018)

U.S. Household Wealth

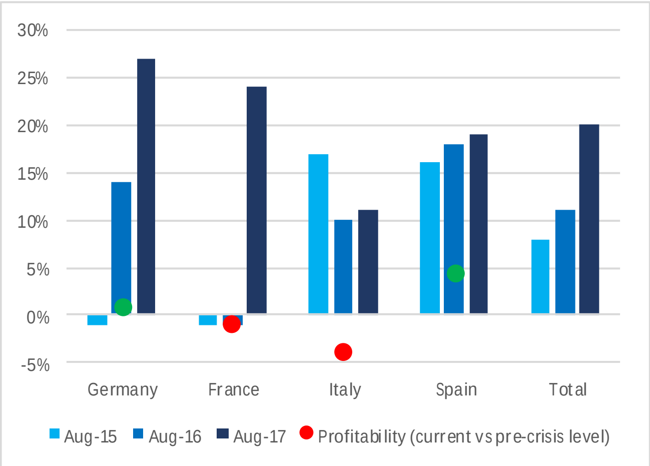


Source: Federal Reserve, Bloomberg

U.S. Household Wealth

- U.S. household wealth has increased over the past few years due to rising financial markets, higher home prices, and to a lesser degree, strong employment. The rising markets have directly impacted household assets, but also those assets held in pension fund reserves.
- The increase in wealth should lead to healthy consumer spending, particularly if wages rise more than 2.5%. Surplus capital will also need to be invested, which should continue to support already stretched asset prices across equities, fixed income, and alternatives.
- Global economic growth looks promising moving into the new year. Moderate U.S. growth is expected over the next year, and Europe and Japan are enjoying growth levels not seen in several years. China should continue to post mid-single digit growth near-term.
- Inflation has been high for asset prices, but more moderate for goods and services. Inflation levels for the later could rise in 2018, which may lead to higher volatility in financial markets.

EU Net Corporate Capex Intentions (2015-2017)



Source: UBS

Europe showing solid potential

- Investors have been focused on lower U.S. tax rates and the potential for reforms to boost corporate capital investments. However, the benefits of tax reform may be muted by the domestic debt and repayment profiles that we highlighted last quarter.
- Eurozone corporate capex intentions are a potential source of upside surprise in 2018. Recent surveys indicate a broad-based willingness to invest in productivity and capacity enhancements. This sign of pro-cyclical confidence is most notable in France where conditions for structural reform are ripe and profit margins remain below potential.
- Reforms, including less tax bureaucracy and labor market regulation, could become part of a broader European economic recovery. Valuations have re-rated in anticipation of more stable growth. We feel there is a better balance between external demand drivers and internal investment dynamics than in prior European up-cycles, which could accelerate underlying earnings potential.

Valerie J. Sill, CFA, CAIA
President & CEO

Lode J. Devlaminck
Managing Director, Global Equity

Krzysztof (Kris) A, Kowal, PhD, CFA
Managing Director, Fixed Income

One Righter Parkway • Suite 3200 • Wilmington, DE 19803 • (302) 477-6000

www.DuPontCapital.com

CURRENT POSITIONING (as of January 1, 2018)

GLOBAL EQUITY

- Equities registered another strong year with pockets of momentum among large-cap industries and themes. Investors continue to reconcile (i) a benign global economic outlook with converging regional growth, (ii) valuation metrics that appear mid-to-late cycle, and (iii) monetary policy normalization and rising rates. While volatility was low and markets steadily rose against this backdrop in 2017, we expect volatility risks are to the upside, although specific triggers and timing are hard to pinpoint.
- We favor European equities due to attractive relative valuations and the potential for structural and re-investment improvements. We expect Banks will perform well, especially since we do not see a deterioration of bottom-up credit conditions near-term. Although ECB monetary policy may remain cautious, well-managed lenders have room for growth even if net interest margin expansion is muted.
- Within emerging markets, we favor pro-cyclical names with undemanding valuations in Consumer Discretionary, Industrials and Financials. China continues to have an outsized influence over the segment, but has recently calmed fears of debt-deflation while migrating up the value chain in manufacturing and exports and expanding domestic service industries. Industry-specific corrections may result from recent policy crackdowns on shadow banking and environmental pollution.
- It appears the tug of war between high valuations and favorable earnings momentum could persist into early 2018, particularly if weaker segments of the market, including energy, periphery Europe, and Brazil, continue to strengthen as more expensive areas level off. Such conditions could precipitate further style rotation within equities. If so, we expect value and quality factors to prevail.

FIXED INCOME

- Global economic growth is more synchronized now than over the past decade. However, inflation remains subdued and is below the Central Bank's targets. We expect inflation to move higher in 2018 with continued moderate economic growth.
- We believe interest rates will rise over the next year as the Federal Reserve continues to tighten; we expect three or four 0.25% hikes. Durations in our fixed income portfolios are currently shorter than the benchmark to protect against rising interest rates.
- We find both U.S. Dollar and local currency emerging markets debt (EMD) to be slightly more attractive relative to other fixed income sectors. However, due to spread tightening, we have reduced overall risk in our EMD portfolios while increasing local currency exposure. In USD sovereigns and quasi-sovereigns, we remain overweight Ukraine and Argentina, as well as higher quality countries, such as Mexico and Brazil. We have also added local currency exposure to Brazil, Poland, and Malaysia.
- Investment grade corporate spreads narrowed slightly last quarter, and more significantly over the past year, but remain the best valued segment within investment grade. We have reduced exposure to the segment in our Core portfolios, but remain slightly overweight, particularly within basic industry, insurance, and capital goods. We are underweight longer duration bonds to reduce spread duration.
- We are maintaining some liquidity in our high yield portfolios due to the significant spread tightening over the past eighteen months. Opportunities are limited, but we are finding a few interesting idiosyncratic situations, and are deploying capital to investments with an attractive risk-reward profile.

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