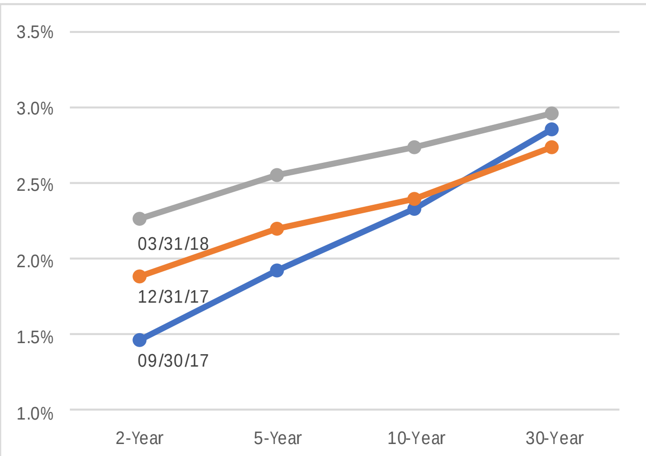
DUPONT CAPITAL

GLOBAL MARKET POSITIONING
April 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 April 1, 2018)

U.S. Treasury Yields

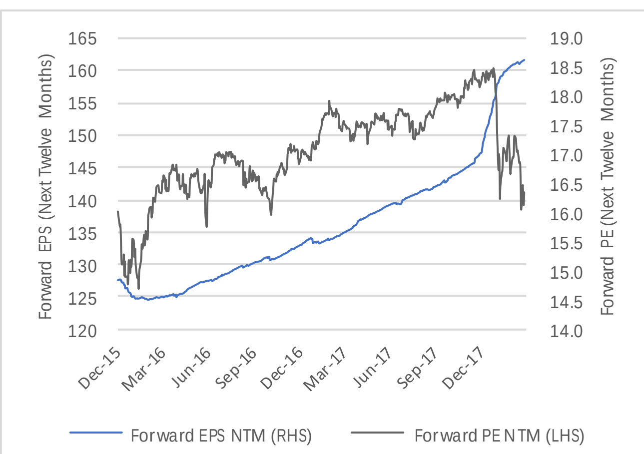


Source: Federal Reserve, Bloomberg

YIELDS ON THE RISE

- Over the past six months, interest rates have risen across the yield curve. The curve flattened in the fourth quarter of 2017 as the yield of shorter maturities rose and very long maturities fell. In 2018, yield increases have been more universal due to inflation concerns.
- The Federal Reserve raised the Funds Rate three times in 2017 and once so far in 2018. Two more hikes are priced in for 2018. We expect that the Fed will continue to move slowly, but we believe we could see three additional hikes this year.
- Economic growth is more synchronized now than it has been in years. Europe is displaying healthy growth and China should continue to post mid-single digit growth in 2018. Growth in Brazil and Russia has improved, partially due to higher commodity prices.
- Higher inflation concerns led to the rise in longer maturities in January and February. Long rates fell in March as inflation concerns eased and the stock market decline led to a small flight to quality.

S&P 500 Forward 12-Month EPS and P/E Ratios



Source: FactSet

U.S. TAX REFORM: NO PANACEA FOR ALL

- Equity markets care less about bottom line growth than revenues or operating profit margins, especially at this late stage of the cycle. Case in point, earnings estimates saw a big jump after the new U.S. tax bill passed, but equity markets did not follow. While it is likely that the markets had already anticipated higher estimates, there has been a simultaneous de-rating of the market of near-equal magnitude as investors shift focus to growing risks to the underlying growth rate.
- One of the real drivers of returns going forward is not the tax benefit by itself, but how companies redeploy the extra cash handed to them. Accretive capital allocation, in the form of capital returns or genuine growth capex, will ultimately flow back to shareholders. However, for structurally challenged companies or highly competitive industries, the tax benefit will be passed along to different stakeholders. It will probably take several quarters to see how cash utilization is reflected in earnings estimates or valuations.

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CURRENT POSITIONING (as of April 1, 2018)

GLOBAL EQUITY

- Up to now, global synchronized growth has been the backbone of our positive view on equities with risks to growth, inflation, and policy rates skewed to the upside.
- Macro data have retreated from recent highs, but remain supportive of healthy earnings growth. As a result, we maintain a pro-cyclical stance in our portfolios. However, we cannot ignore that we are facing stronger than expected near-term headwinds in the form of rising trade concerns, softer economic data, rising rates, and higher volatility. In Europe and Japan, stronger currencies relative to the U.S. Dollar pose additional challenges. All else being equal, these headwinds lead to a higher equity risk premium and lower valuation multiples.
- Given where we are in the cycle and the more aggressive global trade rhetoric heard as of late, we expect volatility to persist. As such, we find exposure to style characteristics like quality, profitability, and free cash flow attractive.
- From a geographic perspective, we remain positively biased towards Europe. Most of Europe's multi-year underperformance (relative to the U.S.) can be explained by its structural economic and earnings growth deficit, technology's small weight in the European index, and persistent net equity issuance (versus buybacks in the U.S.).
- At the same time as we are seeing the structural advantages of the U.S. become less pronounced, we are seeing better cyclical tailwinds for the Eurozone. Because of the overall dynamics, we prefer more domestically oriented exposures.

FIXED INCOME

- Global economic growth remains healthy. Inflation in the U.S. has picked up slightly and we expect it will hit or slightly exceed the Fed's target of 2% later this year.
- We believe interest rates will rise over the next year as the Federal Reserve continues to tighten; we expect three additional 0.25% hikes in 2018. 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 than other fixed income sectors, but EMD valuations have become more expensive. As such, we have reduced the overall risk in our EMD portfolios. We currently favor local currency over U.S. Dollar sovereigns, and have been increasing our local exposure over the past twelve months. In U.S. Dollar sovereigns, we are overweight Ukraine and Argentina and higher quality countries, such as Mexico and Brazil. In local currency, our main exposures are to Brazil, Mexico, Poland, Russia, and South Africa.
- Investment grade corporate spreads widened in the first quarter, but have tightened significantly over the past year. Although corporates remain the best valued segment within investment grade, we have trimmed an overweight in our Core portfolio. We favor basic industry, insurance, and capital goods, but are underweight longer duration bonds to reduce interest rate and spread duration.
- We are maintaining a higher than normal cash position 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 situations, and are deploying capital to investments with an attractive risk-reward profile.

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