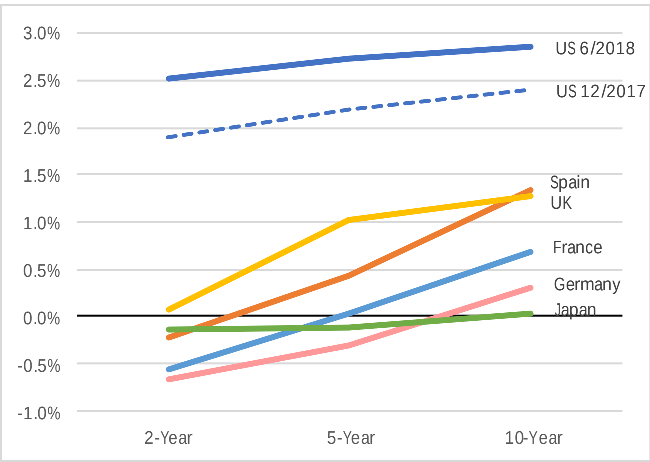
GLOBAL MARKET POSITIONING
July 2018

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 July 1, 2018)

Global Sovereign Yields

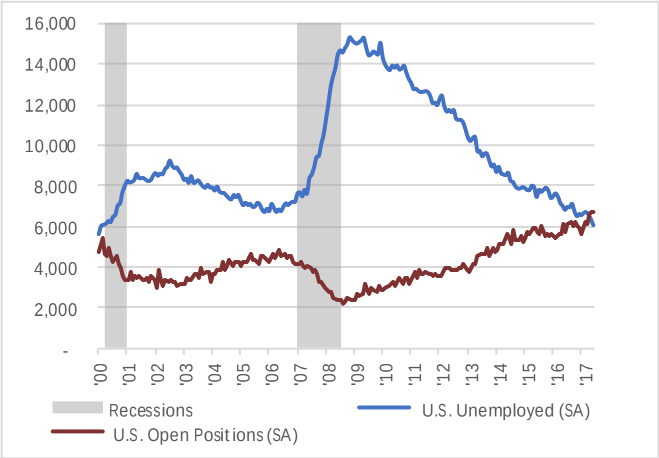


Source: Federal Reserve, Bloomberg
All rates are as of 6/30/2018 except as noted.

U.S. RATES RISING

- U.S. interest rates have increased on stronger economic growth, higher inflation, and tighter monetary policy while other developed countries have remained stable. The U.S. ten-year closed the quarter at 2.85%, compared to 0.30% for Germany and 0.03% for Japan.
- The U.S. yield curve is at its flattest since 2007, and is flatter compared to most other countries. Short maturity yields remain negative for several countries.
- The supply of Treasury issuance is on the rise due to a growing U.S. deficit fueled by tax cuts and fiscal spending.
- The Fed has raised rates five times in the last eighteen months. We expect two additional rate hikes in the second half of the year.
- The disparity in growth, interest rates, and monetary policy between the U.S. and other countries has propelled the U.S. Dollar higher. Many non-dollar asset classes have experienced negative returns.

U.S. Unemployment versus Open Positions
(U.S. Bureau of Labor, seasonally adjusted)



Source: Bloomberg

CONSTRAINTS ON GROWTH

- According to the U.S. Bureau of Labor Statistics, there are now more open positions in the U.S. than there are unemployed people. The gap is undoubtedly larger when the opioid crisis and geographic and skills mismatch are taken into account. As a result, a number of companies are seeing cost inflation surpass top line growth, or finding it increasingly difficult to fill open positions. Anecdotal evidence can be seen in industries that are facing inflationary wage pressures, such as construction and transportation (also driven by higher oil and commodity prices).
- While current economic conditions remain healthy and key growth drivers are still in place, there is a risk that business and consumer confidence is being undermined as a series of lead indicators roll over and global trade relations deteriorate. At least in the short term, an uncertain outlook and mounting inflationary pressures provide a less supportive backdrop for equity returns, and are likely to create greater volatility.

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Current Positioning (as of July 1, 2018)

Global Equity

- While the economy has remained healthy, equity markets have become more pre-occupied with the shift in economic momentum and global trade rhetoric escalating into disruptive action.
- Previously, we cited rising trade concerns, softer economic data, rising rates, and higher volatility as near-term headwinds. These risks started playing out in the second quarter, but differently than expected, as relative valuation levels did not provide as much downside protection as anticipated.
- Given the increased volatility in the equity markets and a deterioration in global trade relations, we have shifted our focus from Europe to the U.S. We expect U.S. equities will hold up better in the more volatile markets given the more attractive profitability and quality characteristics of U.S. companies, less cyclical growth, and greater local exposure.
- Despite a lower valuation, we have turned more cautious on Europe. Europe has a higher sensitivity to global trade, a more cyclical sector composition, and higher political risks, particularly in Germany and Italy. We are also concerned about complacency over the potential implications of Brexit.
- Higher rates in the U.S. and better relative economic momentum are supportive of the U.S. Dollar appreciating relative to other currencies. We believe this will put additional pressure on Emerging Markets, which are already feeling the effects of global trade worries despite many currency regimes being qualitatively more resilient than in prior cycles.

Fixed Income

- U.S. economic growth remains strong, but Europe and Japan have slowed. Inflation in the U.S. has picked up to meet the Fed's 2% target. We believe interest rates will rise slightly in the second half of the year as the Federal Reserve continues to tighten; we expect two additional 0.25% hikes in 2018. The duration of our portfolios is currently shorter than the benchmark to protect against rising rates.
- Emerging markets debt (EMD) has declined significantly in 2018, and is currently underperforming all other fixed income asset classes year-to-date. The decline may continue in the short-term, but we believe valuations in both U.S. Dollar and local currency are more attractive than other fixed income sectors. We currently favor local currency over U.S. Dollar sovereigns, and have been looking for opportunities to increase our local exposure. In U.S. Dollar sovereigns, we are overweight Ukraine and Argentina, as well as higher quality countries, such as Mexico and Brazil. In local currency, our main exposures are to Brazil, Mexico, Poland, and Russia.
- Investment grade corporate spreads have widened from very tight levels earlier this year. Although corporates are still not very attractive, they are the best valued segment within investment grade fixed income. Accordingly, we have a small overweight to corporates 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 slightly higher than normal cash position in our high yield portfolios due to tight spreads within the asset class. Opportunities are limited, but we are finding a few interesting situations, and are deploying capital to investments we believe have an attractive risk-reward profile.

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