DuPont Capital

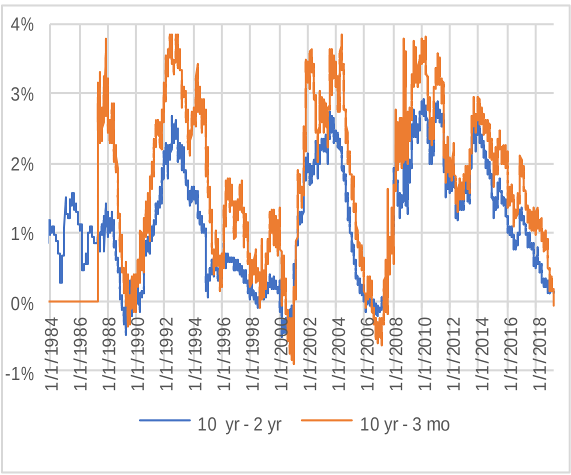
Global Market Positioning

April 2019

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, 2019)

Spreads Widening

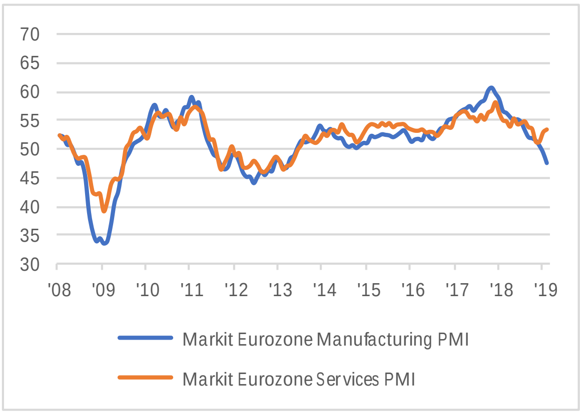


Source: Bloomberg, JP Morgan
As of March 31, 2019

Yield Curve Inverting —A Sign of Recession?

- The spread between the 10-year Treasury note and 3-month bill went into negative territory in March for the first time since 2007. Inversions of this spread have preceded the last seven recessions.
- Although a good indicator, it has had a few false positives including 1966 and 1998. The time between inversion and the beginning of a recession has varied from nine months to almost two years.
- U.S interest rates have declined significantly since November 2018. The close of the ten-year Treasury peaked at 3.24% on 11/8/2018 and declined to 2.41% at the end of the 1st quarter.
- The decline in rates since November was due to a huge sell-off in the equity market, slower global growth, and lower inflation. The Federal Reserve hiked the Funds Rate in December despite the changing environment, but quickly put further hikes on hold in early 2019.
- Credit spreads tightened significantly in the 1st quarter as equities rebounded and the Fed moved into a holding pattern. Currently, credit spreads do not point towards a recession in the near future. Investment Grade spreads tightened by 33 basis points (bps) during the quarter while High Yield tightened by 127 bps.
- Growth was slower in the 1st quarter as we expected, but will most likely remain positive for the year. A recession will most likely not occur in 2019, but growth will not bounce back to the levels seen in the middle of 2018.

Eurozone Purchasing Managers' Indices



Source: Markit Economics
As of March 31, 2019

European Divergence – Confirming the Signal?

- European export-oriented manufacturing industries have diverged from and undershot the equivalent indicator for services, with the preliminary March PMI estimate indicating the largest monthly decline in new orders in over six years.
- In contrast, the Services component saw a slight bounce from December's multi-year low. Overall EU household sentiment remains upbeat despite the negative impact in France from high profile protests. Whether this divergence reconciles itself by a stabilization of durable goods orders or via contagion into consumer confidence should provide a real-time barometer of key issues currently preoccupying investors globally.
- These include whether renewed dovishness from the Federal Reserve, Chinese credit stimulus measures, and a potential trade war resolution can reinvigorated fading growth. Specifically in Europe, endemic threats in the banking and automotive sectors are ultimately tied to global outlooks for interest rates and regulations.
- The probability of a recession within 12-18 months remains non-trivial and bellwether German business expectations have decayed even more rapidly than measures of current activity. However, a lack of further near-term degradation, particularly of earnings, could trigger an extended relief rally. The possibility of new, late-cycle market highs – fueled by falling yields and the "fear of missing out" – remains plausible.

Valerie J. Sill, CFA, CAIA
President & CEO

Lode J. Devlaminck
Managing Director, Equities

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

Current Positioning (as of April 1, 2019)

Global Equity

- On the heels of incremental policy caution from several central banks (notably the US, also Australia and UK) and ongoing unconventional easing measures in Japan and the Eurozone, investors area again hopeful that low but non-inflationary global growth is reasserting itself. Central to this thesis is the assumption that circumstances will mirror those of 2015/16, where a "mid-cycle" slowdown driven by decelerating Chinese growth, tighter US housing metrics, and oil market imbalances threatened but did not deliver an economic hard landing.
- Most economic indicators are not yet flashing high alert. Chinese domestic momentum is ambiguous, with mixed messages from residential, autos, and infrastructure data . Recent bounces in US home and auto sales data have also helped to assuage recessionary fears while the credit cycle has held up year to date.
- As shown, the prospects for Europe are finely balanced but not yet unremittingly negative, although net investor outflows from the UK continue. Japanese equities face the overhang of a previously-delayed consumption tax hike in late 2019 which will, if history is a guide, likely to keep a firm lid on domestic demand.
- At the market level, corporate share repurchases in Japan are becoming a more tangible indicator of corporate governance, although shareholder-friendliness remain selectively modest. Buyback activity in the US – a long-established feature of this cycle - is already trending above last year's record-setting pace.
- Last quarter, our portfolios benefited from their exposure to higher quality and idiosyncratically or cyclically undervalued names. Given prevailing risk conditions, we maintain a preference for these characteristics. In general, many deep value areas lack strategic catalysts for re-rating. We prefer to seek value exposures selectively, with less efficient asset classes (e.g. Emerging Markets) looking more fertile.

Fixed Income

- Global economic growth has slowed and the Federal reserve quickly put the brakes on further tightening. U.S. interest rates have declined significantly over the past six months and may have moved lower than is warranted by the fundamentals. The duration of our portfolios is shorter than the benchmark to protect against rates rising from current levels.
- Emerging Markets Debt (EMD) rebounded in the first quarter after a poor 2018, but with hard currency outperforming local currency. Although slower growth, country specific issues and on-going trade frictions may cause a short-term pull-back, we believe valuations are still more attractive than other fixed income sectors. We added several positions and reduced cash in our portfolios in the second half of 2018, but have been more quiet recently due to the rally. We moved to an overweight position to Turkey in the 2nd half of 2018 after the significant decline in the country's bonds. In U.S. Dollar sovereigns, we are overweight Ukraine, Turkey, and Argentina, as well as Mexico and Brazil. In local currency, our main exposures are to Brazil, Mexico, Poland, and Russia.
- Investment grade corporate spreads tightened significantly in the first quarter and are now close to long-term averages. Although corporate bonds are not cheap, they are the best valued segment within investment grade fixed income. Accordingly, we have an overweight to corporates in our Core and Core Plus portfolios. We favor the basic industry, insurance, and the consumer cyclical sectors, but are underweight longer duration bonds to reduce interest rate and spread duration.
- High yield spreads also tightened significantly in the first quarter. Spreads may tighten further, but the market is not as cheap as at the end of the year. We are monitoring the market and looking for opportunities in select restructuring situations as well as in more liquid investments that we believe have an attractive long-term risk-reward profile.

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