DuPont Capital

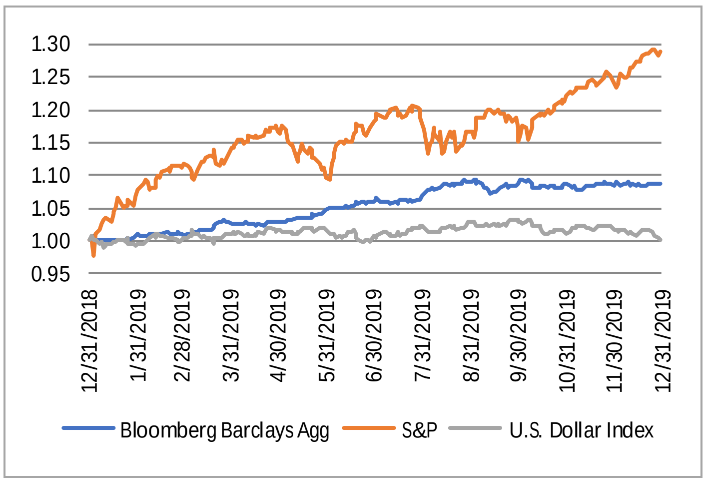
Global Market Positioning

January 2020

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 2020)

2019 Returns

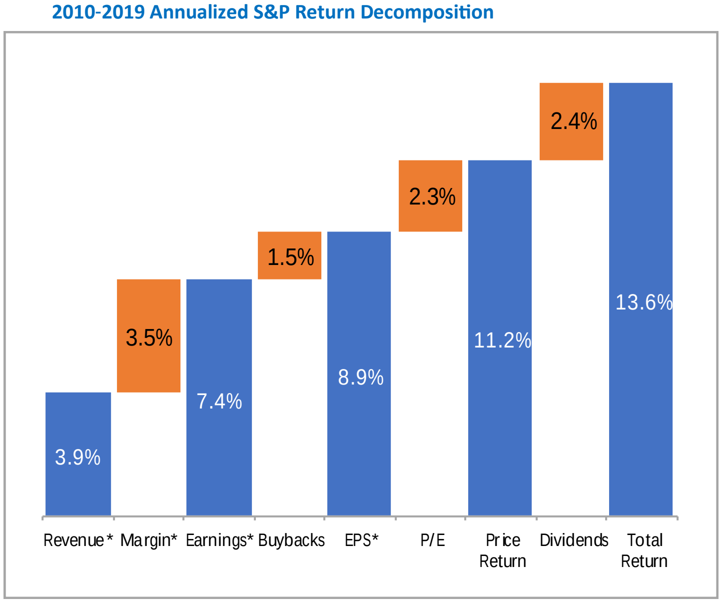


Source: Bloomberg
As of December 31, 2019

2019—The Year of High Returns

- Equity and fixed income returns were very high in 2019 with the S & P up by 31.5% and the Bloomberg/Barclays Aggregate up by 8.7%.
- At the same time, currency volatility was muted with only a small gain for the U.S. dollar against a basket of other currencies.
- 2020 could see a weaker dollar driven by an improving global economy and with the U.S. caught in a tumultuous Presidential election. Will the strong economy be enough to get the President reelected or could the U.S. go down a very different path?
- The Ten-year Treasury in the U.S. declined by 77 basis points in 2019 and closed the year at 1.92%.
- Credit spreads in investment grade corporates, high yield and EMD are all much tighter with fewer opportunities than a year ago.
- Returns in U.S. equities and fixed income will most likely be much lower than 2019, but opportunities still exist.

2010-2019 Annualized S&P Return Decomposition



Note: *Change in forward estimates
Source: Standard and Poor's, Factset, Thomson Financial, Credit Suisse

Decomposing the Decade

- U.S. Large Caps completed a resilient decade, registering an annual return of 31%. Featuring only one calendar year of negative returns (2018's blemish is gone but not forgotten) and seven of double-digit gains, the unassailable market themes of the decade were growth, technological prowess, and corporate efficiency.
- Lackluster GDP growth provided less impetus than prior cycles – hence the muted revenue effect – but cheap money and benign inflation allowed growth traits to prevail and spurred share repurchases.
- Earnings growth – driven by relentless marginal gains in operational profitability – was a bigger determinant of the market's ascent than the revaluation. Price-earnings multiples in isolation were less influential than fundamental dynamics of capital returns, including dividends.
- Has 2019's stellar performance provided the capstone for this current cycle of U.S. prevalence? Margin sustainability and asset turnover trends, abetted by pervasive automation and digital efficiency gains, can remain as significant an influence on market returns as valuation.

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Current Positioning (as of January 2020)

Global Equity

- Equity markets have recovered their poise in the wake of last summer's growth scare and subsequent backstopping measures from central banks. Consequently, the implied probability of a U.S. recession on a one year horizon has waned significantly, although it has not fully reverted to trivial, mid-cycle levels. After spiking in the 40-50% likelihood range, the prospect of an imminent recessionary scenario is now projected as half as likely (<25% chance).
- The phase one U.S.-China trade deal outline has played a role in solidifying the near-term market outlook and business confidence levels; elsewhere, risk appetites have been whetted by less uncertainty surrounding the date and delivery method of Brexit. The loosening of these chokeholds on equity valuations is welcome, but both remain sources of potential tail risk – the respective genies are out of the bottle and root causes, syndromes, and fresh battlegrounds have yet to be addressed.
- We maintain an emphasis on relative valuations, although intra-market dispersion varies due to compositional differences between regions. The structural advantages enjoyed by the U.S. remain intact, but many companies in developed Europe and Asia have also achieved record profit margins of their own, despite choppier economic backdrops. Industry dynamics, corporate agility, and innovation remain important differentiators.
- There remains no need to pursue the more expensive stocks within the more heterogeneous categories of small caps and merging markets. Among these asset classes, with more idiosyncratic and often less correlated drivers of growth, there are ample opportunities to gain exposure to fundamentally attractive characteristics without having to overpay.

Fixed Income

- Inflation is low, economic growth is moderate and the Federal Reserve reduced rates by 75 basis points in 2019. U.S. interest rates declined significantly last year. The Fed is on hold for now, but other central banks may ease further in 2020. U.S. interest rates may stay low for an extended period of time, but our portfolios have durations that are slightly shorter than the benchmark to protect against the possibility of rates rising from current levels.
- Emerging Markets Debt (EMD) performed very well in 2019 after a poor 2018, with hard currency outperforming local currency. Although slower global growth, country specific issues, and on-going trade frictions are headwinds, we believe valuations are still more attractive than other fixed income sectors. We added to a few of the more troubled countries such as Lebanon but have not made many changes this quarter. In U.S. Dollar sovereigns, our main overweights are Ukraine, Mexico, and Brazil.
- Investment grade corporate spreads tightened significantly in 2019 and are now tighter than long-term averages. Although corporate bonds are not cheap, we believe they are the best valued segment within investment grade fixed income. Accordingly, we have a small overweight to corporates in our Core and Core Plus portfolios. We favor the basic industry, insurance, and consumer cyclical sectors, but are slightly underweight longer duration bonds to reduce spread duration.
- High yield spreads have also tightened significantly. The market is expensive, and we believe spreads will widen in 2020. Yields of only 5.2% do not provide much cushion if the market turns down. 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.