DuPont Capital

COVID-19 MARKET OBSERVATIONS
MAY 2020

Market Observations

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As a supplement to our quarterly equity strategy review, we would like to share the collective thoughts of the portfolio management teams from our core U.S., International, and Global fundamental groups about the COVID-19 crisis and the expected economic environment over the coming months. As we gradually find a return to normalcy, we expect several themes will drive equity markets. Some we are well familiar with while others are the product of a new post-pandemic world.

This note contains as many questions as opinions and is by no means intended to be a static document. Given the fluid nature of the current environment, we believe it prudent to remain observant and open-minded. As John Maynard Keynes once quipped, "When the facts change, I change my mind. What do you do, sir?"

Base Case Scenario

Overall, we expect that the reopening of the economy and the subsequent "return to normalcy" will be at a slower pace than what is generally anticipated. Our base case scenario includes the following considerations:

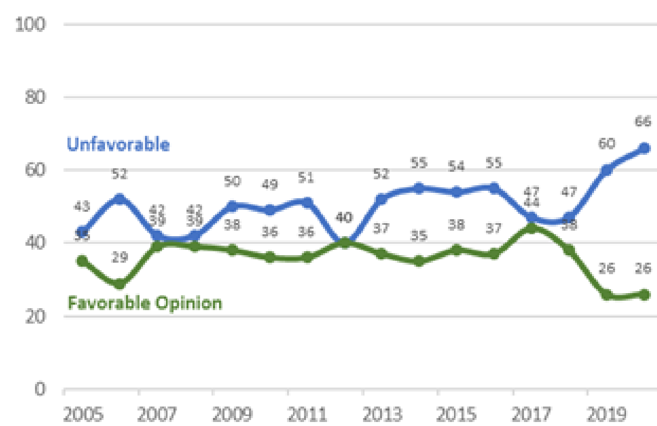
- A restart will not be as simple as flipping a switch. The potential for continued social distancing measures will add an additional layer of complexity to the reopening. Within the manufacturing sector, for example, companies will need to determine how to implement new procedures that ensure the continued safety and wellbeing of their employees. Some individuals may also be reluctant to return to "business as usual" right away.
- Given the source of this crisis is vastly different from what we have experienced previously, we expect the speed of recovery to look very different from one industry to the next (i.e. airlines, travel related companies recover much more slowly).
- Historic unemployment will likely be a hindrance to a quick recovery, especially if extended lockdowns come at the expense of permanent business closures.
- The new issuance of massive levels of debt and an expected rise in the savings rate will again lead to lower trend growth and lower for longer interest rates and inflation (barring short term cyclical moves around a lower base-line). This is important as it will have an impact on the company and investment style characteristics that will be in or out of favor over the medium term.

Geopolitical And Macro Considerations

We are also mindful of several geopolitical issues that have the potential to escalate in the coming months. We believe several of these issues have been brewing beneath the surface for quite some time with controversy around the virus bringing them to the fore.

- Nationalist sentiment is re-strengthening in many countries as the benefits of globalization and the security of key supply chains are questioned. Trust in the Chinese government has significantly deteriorated as they have drawn criticism for their transparency and cooperation during the early stages of the virus [Exhibit 1].

Exhibit 1: % of Americans With a Favorable/Unfavorable View of China



Source: Pew Research Center

- The crisis has laid bare structural/political challenges in Europe. Italy seems to be the flash point, but there is a marked divide between the northern and southern Eurozone countries. There is the risk of a new Euro/Brexit crisis brewing as a result of the COVID-19 pandemic.
- There is also significant risk that the embers of the global trade war rekindle as political leaders seek to pin blame for the impacts of the crisis. This is a risk factor for global trade dependent regions like Europe and Emerging markets.
- Fiscal easing feels more like monetary policy. We have lower conviction on infrastructure spend as nothing was destroyed in this crisis and demand destruction leaves plenty of capacity.

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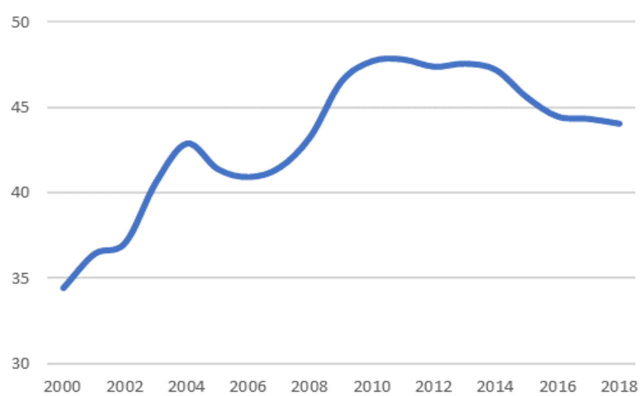
We find the majority of the fiscal easing is actually coming in the form of loan guarantees.

- Linked to the previous point, we expect capex as a percentage of GDP in China will continue to go down. We view this as a long-term structural negative for the materials and energy sectors [Exhibit 2].

EXHIBIT 2: GROSS CAPITAL FORMATION (AS % GDP) - CHINA



Source: The World Bank

Key thought points:

- What are the longer-term effects of substantially lower state tax revenues, particularly coupled with historically high expenditures on unemployment claims? California, for example, has become the first state to borrow from the federal government to cover unemployment payments.
- How will the market look at leverage moving forward? Will investors remain skeptical and how will this impact the Private Equity and M&A markets?

SECTOR IMPLICATIONS

From a sector perspective, we see several overarching themes affecting the markets, as well as some sector specific considerations. Overall, we see the following:

- Fresh in the wake of the US-China trade conflict, we expect COVID-19 will further incentivize companies to gradually shift their supply chains away from China. The move could also be driven by regulatory changes that may require the onshoring of manufacturing for key items to secure strategic reserves and supply chain continuity. Onshoring could also serve as a catalyst for the automation of manufacturing as it becomes more economically feasible in the face of higher labor costs.
- There could be increasing pressure on business models that are dependent on labor casualization (labor and regulation arbitrage models), thereby improving the resiliency of workers in times of severe economic crises.
- The nature of the COVID-19 crisis will accelerate certain structural trends as social distancing measures have encouraged the adoption or increased the use of things like e-commerce, telemedicine, and remote work. Opposite to this, we see business travel as structurally challenged moving forward. We also see cloud computing as a beneficiary as businesses move away from licensed software models to subscription models. This would also drive increased demand for datacenters and edge computing.
- Weaker players will not have the wherewithal to survive the crisis. We expect stronger players will consolidate their leadership position to emerge even stronger after a recovery. The bifurcation will likely be predicated on technology adoption, capital intensity (heavier in intangibles), etc.

Key thought points:

- What are the new defensive end markets in a recessionary environment?
- Where are the overlooked idiosyncratic/self-help/ restructuring opportunities due to COVID-19? We anticipate there will be more restructurings and cost reductions across different (or most) industries.
- How will government aid impact company financials (ability to pay dividends, carry out share buybacks, etc.)?

Consumer:

- We see an acceleration of consumer bifurcation as record unemployment continues to hollow out the middle class in developed markets. Beneficiaries are the high end (luxury) and low end (discount, off-price) of retail.
- A temporary inventory de-stocking at the consumer level is likely as the lockdown gradually ends (Nielsen data already showing this).
- We expect a much longer recovery period for business travel and large-scale events. Business travel could be further dampened by growing ESG-related pressures.
- Healthy living and sports exposed industries and companies should recover faster as COVID-19 underscored the

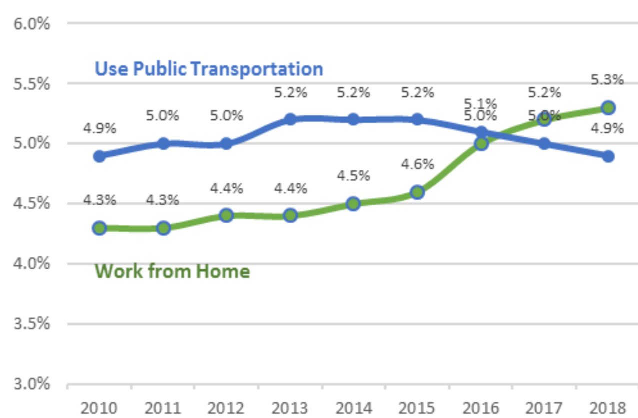
destructive effects of pre-existing health conditions (obesity, diabetes, heart disease, etc.). Tobacco could also come under pressure.

- DIY/housing related sectors could be positively impacted as renovation related spend (more DIY vs DIFM) could be more resilient in a broader down-trading environment. Less short-term travel frees up money for home improvements that had been deferred.

Industrials

- Early cyclicals with healthy end-markets will likely lead the recovery.
- We expect companies with exposure to automation, PPE equipment, and HVAC will be most resilient, while a recovery in aero, autos, and upstream energy will lag.
- The long-term impacts on the auto industry are not entirely visible yet. Increases in telecommuting could dampen demand for autos, while a greater reluctance to use public transportation, which has already been in decline over the last five years [Exhibit 3], could stimulate demand. Will lower mileage put pressure on the auto aftermarket?

EXHIBIT 3: % OF AMERICANS THAT NORMALLY WORK FROM HOME OR TAKE PUBLIC TRANSPORTATION



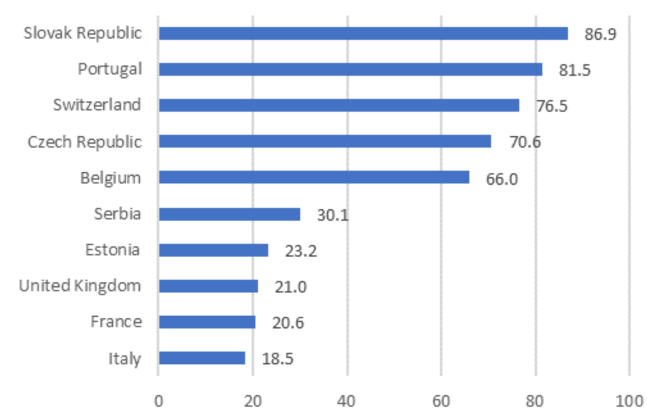
Source: The US Census American Community Survey

- We assign a greater than 50% probability that global flight activity remains between 50-75% of prior levels for 6-12 months as the world slowly recovers from the crisis. Business travel is a low hanging fruit as companies look to cut costs (use Zoom instead) and consumers will likely be reluctant to travel until there is more widespread testing or a vaccine.
- In a drive to conserve cash, airlines will probably park and rotate much of their fleet, reducing demand for new planes and spare parts in the near term. We see a significant impact on the aftermarket segment (service and spare parts). Demand for new planes will be further suppressed by record low oil prices, which diminish the economic attractiveness of newer fuel-efficient aircraft. Combined, this could trim 1-2 full years off delivery forecasts.
- Despite the Tsunami of factors against aerospace, there is very little chance governments let Boeing / Airbus and their supply chains go away given their strategic value.

Financials

- Banks, particularly in Europe, look very cheap given the improved health of balance sheets and capital ratios relative to the Great Financial Crisis (GFC). We see less regulatory pressure or need to facilitate fiscal stimulus this go around. Unfortunately, the group carries a high beta to macro issues.
- Headwinds for the banks are the uncertainty surrounding their SME exposure, as well as ultra low rates for a lot longer.

EXHIBIT 4: SME LOANS AS % OF TOTAL OUTSTANDING BUSINESS LOANS - TOP AND BOTTOM FIVE BY COUNTRY (EUROPE)



Source: OECD (2016)

- Share prices indicate the risks may be higher than expected. European banks have never seriously tackled their structural issues after the GFC and Euro crisis. Inflation is likely required for a sustainable lift.

- We believe banks that are less focused on balance sheet expansion or those that do not require balance sheet expansion to grow earnings are better positioned (e.g. cost focus, fee income, non-lending growth drivers, etc.)

Technology

- Semis are likely to lead the rebound driven by datacenters, 5G roll out and growth, and solid short-term PC demand. Industrials and autos are weak in the short-term but offer a good long-term trend.
- Payment processors are in a good position as the COVID-19 crisis is expected to accelerate the shift away from cash to contactless payment methods (increase in use of cards for smaller transactions), as well as the use of digital banking.
- Remote employment growth will have implications for the hardware/ software shift in demand.
- The current work environment has also allowed companies to test the limits (or non-limits) of virtual design and testing, permitting greater geographic flexibility as employees work from home and less lag time in the design process.

Energy

- We are seeing massive oversupply in the short term, but anticipate a medium-term partial recovery.
- We are negative on energy long-term, primarily due to ESG considerations, growing regulation, declining energy intensity of economic growth, EV adoption, and the improving viability of alternative energy.
- On the flip side, lower oil prices could represent cheaper input prices for segments of the chemicals sector (e.g. paints).

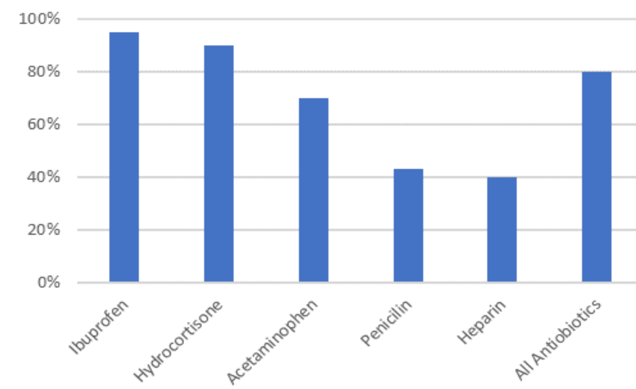
Materials

- Given the nature of the crisis, and the massive but targeted stimulus measures, it is an open question as to whether government spending on infrastructure will materialize or be delayed for budgetary reasons.
- On the consumer side, we are bound to see varying end-market dynamics in between paints/coatings, DIY/DIFM, and autos. Housing/ renovation related spending could do well.
- Chemicals could benefit from lower feedstock prices, but it could be questioned whether demand destruction is too big for there to be positive upside.
- We are seeing high iron & copper inventories relative to 2021 demand levels.

Healthcare

- The COVID-19 crisis could be creating potential supply chain pressures and risks leading to more nationalized manufacturing, strategic reserves, or minimum required inventory levels for certain products [Exhibit 5].

Exhibit 5: US Active Pharmaceutical Ingredients Sourced from China



Source: thepharmaletter.com (data as of 03/17/2020)

- Elective procedures have been delayed in an effort to increase available beds for COVID-19 patients. We expect a recovery as infections begin to decrease.
- We are considering both how to think about greater elasticity of demand with larger out of pocket spending and the impact of greater government control in healthcare delivery and reimbursement in a recessionary environment.
- We feel it is prudent to consider the regulatory implications of the upcoming US elections (Biden vs Trump). That said, it seems less likely that this election will have the same outsized impact on the sector as prior elections given the scale of COVID-19.
- While regulatory risks have increased this quarter, the pace and size of announced M&A deals remain quite healthy. The recent widening of spreads for the aforementioned risk factors provides the opportunity to harness better investment returns for merger arbitrage in the future.

Conclusion / General Outlook

We believe that the COVID-19 pandemic is only accelerating the secular themes that were already in place. We see several key characteristics as medium to long term growth drivers moving forward, including the following:

- Scale is important as large company advantages increase
- Return on intellectual capital outpaces returns on financial or physical assets
- Platform based models will win
- Ecommerce will excel at the expense of traditional retail
- The digital transition will accelerate
- ESG considerations will become more prominent, particularly in the US

We expect global growth to remain under pressure due to demographics in developed markets (aging populations), high government debt levels, increased savings rates and slowing secular growth in China. We further expect social tensions will remain elevated or increase as the bifurcation between rich versus poor, urban versus rural, and conservative versus progressive deepens. As such, we are mindful of the following cyclical considerations, and potential secondary effects on industries and companies.

- Unemployment will remain elevated for the near future
- Travel recovery will be slow (business travel may be permanently impaired)
- The credit cycle may be deeper than most currently expect
- Ad based models will struggle, subscription-based business models are better placed
- Replacement cycles will lengthen (across consumer and industrial customers)
- Spending patterns will be slow to revert to historical patterns

While many of the investment style themes that have been in place remain valid including a preference for large cap, quality, and growth names, we could see a violent but brief traditional value outperformance due to relative performance overshoots. Low interest rates and low inflation pressures are inherently supportive of the investment styles and themes that were already in place. From a geographic perspective, we believe the US remains the best place to invest.

ABOUT OUR FIRM:

DuPont Capital Management is an SEC registered investment advisor based in Wilmington, Delaware. Since the firm's establishment in 1993, we've had a long history of developing global investment opportunities in both traditional and alternative strategies across equity, fixed income and alternative investments. Our investment team structure gives us the ability to be flexible and adapt to changing market conditions. DuPont Capital's focus is delivering consistent investment management results for our clients. Our history of institutional asset management is rooted back to 1942 when our former parent company, DuPont, established a pension plan for its employees. Corteva Inc. succeeded DuPont as sponsor of the DuPont Pension Plan in 2019. DuPont Capital is a wholly owned subsidiary of Corteva and continues to manage the legacy DuPont Pension Plan.

DuPont Capital's President and CEO, Valerie Sill believes in education and diversity of experience as represented in our investment teams which are comprised of PhDs, engineers, medical doctors, and scientists. We believe their global expertise creates a portfolio implementation edge that benefits our clients.

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