VALUE CREATORS - U.S. LARGE AND MID CAP

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During the second quarter, the US and global equity markets sharply rebounded from the pandemic-induced lows of March. The rebound was driven by a "flattening of the pandemic curve" achieved by global social distancing, as well as the unprecedented stimulus provided by the US government's direct stimulus programs and Federal Reserve policy, which served to lower rates and support fixed income markets through a new bond buying program (inclusive of corporate debt).

With the US economy on track to experience its worst quarterly economic contraction and sharpest rise in unemployment in history, it begs the question, how much of this is a temporary or "cyclical" phenomena? As a long-time industrials cyclical investor, I have often asked this question of the traditional heavy cyclical industries such as construction machinery and heavy industrial equipment. However, this pandemic has made the vast majority of companies and industries appear cyclical for the first time in history. For investors with a long term time horizon, an ideal framework for handling this situation is to focus on "normalized" through-cycle earnings power and to use this to anchor the foundation for valuation. When an industry is cyclically depressed due to temporary lack of demand and/or oversupply, industry participants collectively take actions to adjust – suppliers cut production, inventories normalize, demand returns, pricing stabilizes, and production rises. During this cycle, corporate earnings follow in step with the cycle troughs and peaks. For long-term investors, it does not make sense to value companies on trough earnings, as long as you are confident its really a trough. One must "look through the valley" to the other side when things are more normal again. This process must now be applied to nearly every company as the pandemic has caused a cyclical trough demand shock for the vast majority of businesses.

The key challenge is being cognizant of a few factors:

Is the demand trough temporary or cyclical in nature?

Might there be a new normal that differs from history?

How long might the return to normal take?

Has there been permanent damage to the industry supply or demand drivers?

Has the industry structure been altered in any way?

For many traditional industrial companies who produce capital equipment that are critical to the economy, it is unlikely that the long term demand for their products will become obsolete due to the pandemic. The real debate is how long and when

EXHIBIT 1: VALUE CREATORS PORTFOLIO CHARACTERISTICS (AS OF 6/30/20)

	Value Creators - US Mid Cap	S&P 400	Value Creators - US Large Cap	S&P 500
Debt Level				
Debt/Capital	71.3	38.4	48.8	49.5
Debt/Equity	138.2	157.3	222.2	136.2
Debt/EBITDA	2.4	3.0	1.9	2.4
Growth				
Dividend Growth 5 year	16.2	9.8	14.2	11.9
EPS Growth 3 year	20.7	18.9	25.1	21.0
EPS Growth 5 year	18.9	12.4	15.3	13.1
EPS Est Growth 3-5 Year	8.7	9.7	12.0	9.9
Dividend Payout Ratio	21.0	59.2	24.5	49.4
Profitability				
Return on Equity	24.8	13.7	27.5	23.2
Return on Assets	13.6	6.7	11.7	9.2
Valuation				
Price/Earnings using FY2 Est (ex Negatives)	24.7	29.6	28.9	27.6
Price/Cash Flow	14.2	8.8	18.5	12.1
Price/Book	4.7	2.0	5.5	3.3
Price/Sales	4.9	4.0	6.3	5.4
Dividend Yield	1.0	2.0	0.9	1.9

As of June 30, 2020
Source: DuPont Capital, FctSet

might demand return to pre-pandemic levels. However, for other consumer and business services oriented companies, the answer is less clear. Depending on the ultimate depth and duration of the pandemic, certain consumer and business behaviors may be permanently altered. Although it is difficult to estimate the impact on certain industries, we are using the above framework to assess potential opportunities.

During the second quarter, the value creators had mixed performance. The Large-Cap Value Creators portfolio outperformed the benchmark by 211 basis points, returning 22.65%* vs. the S&P 500 index's 20.54% return. The Mid-Cap Value Creators portfolio underperformed its benchmark by 536 basis points, returning 18.71%* vs. the S&P 400 index's 24.07% return.

In both portfolios, we had made modest adjustments to positions in March toward companies with lower risk of permanent loss of capital based on the four factors we mentioned last quarter: (1) balance sheet strength, (2) ability to operate through the crisis, (3) potential for recovery to normalized levels, and (4) probability of permanent damage to the business. In the large-cap portfolio, we benefited from these changes as overweights in pandemic-resistant businesses such as Amazon, Google, and Facebook helped drive outperformance. However, in the midcap portfolio, a significant portion of the recovery rally was driven by lower quality businesses, as the Fed-driven friendly corporate credit markets bolstered many potentially troubled balance sheets. As the mid-cap portfolio typically holds positions in companies with better than average business quality in terms of financial leverage, its recovery lagged the index by a significant margin during the second quarter.

As shown on the previous page (Figure 4), the portfolios have better than average financial leverage and cash flow durability relative to the benchmarks. We believe this better positions the portfolios as we continue to navigate this storm. We also believe the higher than benchmark Return in Equity and Return on Assets and resulting expected cash flows will be key drivers of the portfolio over the long-term.

* Gross of Fees

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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Important Disclosures: