DUPONT CAPITAL

EQUITY STRATEGY REVIEW
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US SMALL CAP, STRUCTURED EQUITIES

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Is value investing dead? It's a question we have seen many times in print over the last few years, and for good reason. Exhibit 1 shows the Russell 2000 Value ETF against the Russell 2000 Index over the last 13 years (indexed to 100 starting in January 2008).

Described verbally, it looks like a runaway downhill train that derailed in a heap last year. But then something unexpected happened – value came alive, back from the dead, so to speak. Value had one of its best quarters ever, outperforming the Russell 2000 index by 8.5. Performance was only better during the dot com bust. This looks even more impressive comparing the Russell 2000 Value ETF (small cap value) to the broader market. The last two quarters rank as the best two quarters in the last 20 years, including the dot com bust. This, of course, was aided by the fact that small caps have been on an historic run, outperforming the S&P 500 index by 30% in the last six months.

Switching to the factor space, the data becomes quite interesting. Exhibit 2 shows the equally weighted factor returns to Value (performance of the best quintile minus the worst quintile). Unlike the index space, Value actually held up quite well in the factor space, with scarcely a negative quarter before 2017. It is only after this that the preponderance of Value factor returns flip negative. 2020 is a train reck no matter which way you look at it. But if we look under the hood in 2020 things get interesting.

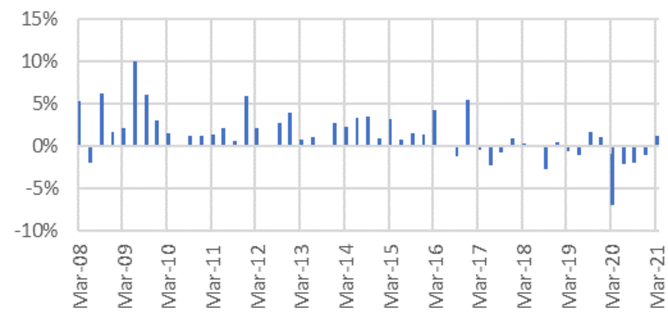
Our value factor composite is comprised of several underlying factors, including Asset Value (asset based value factors like book-to-price), Earnings Value (earnings based value factors like earnings-to-price), and Cashflow Value (cashflow based value factors like free cashflow-to-price). Asset Value tilts toward cyclical stocks whose earnings are depressed at the bottom of the cycle, screening cheap on factors like book-to-price or sales-to-price. They typically produce alpha at the beginning of an economic recovery. Once analysts become confident in the sustainability of the recovery, earnings estimates are revised upwards and stocks that screen cheap on Earnings Value begin to outperform. As the cycle matures, stocks with superior cash flow generation typically outperform. This factor rotation pattern can broadly be seen following the 2008 recession (Exhibit 3), which shows the 6-month rolling average factor return to each of the three components of Value. Asset Value led the recovery, then passed the baton to Earnings Value and Cashflow Value.

The current recovery looks to be following a similar path, albeit from different starting levels. Asset Value outperformed in the back half of 2020, but the poor performance from the other value factors masked the strong performance in the Value composite. Cashflow Value has now responded and while it is not visible in the chart, March was a strong month for Earnings Value.

EXHIBIT 1: 12-MONTH PERCENTAGE OF FACTORS SHOWING NEGATIVE SPREADS

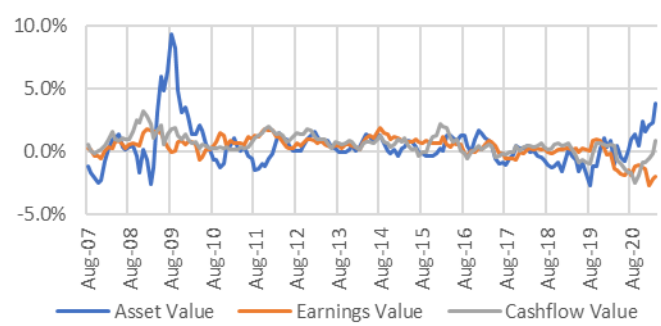
Source: DuPont Capital, Barra

EXHIBIT 2: 12 MONTH ROLLING FACTOR PERFORMANCE



Source: DuPont Capital, Barra

EXHIBIT 3: 12 MONTH ROLLING FACTOR PERFORMANCE



Source: DuPont Capital, Barra

Given the low interest rate environment and the constraints on nominal growth, we are not yet ready to declare the value slump over. But we do think the cyclical recovery playbook outlined above is useful in the current environment. As such, the value exposure in the small cap portfolio hit a 2 year high in February, and we expect to maintain this exposure in the short run as we transition from Asset Value factors to Earnings and Cashflow Value factors in the near future.

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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: