EQUITY STRATEGY REVIEW
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International Equity

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Pent-up travel demand, an easing of international travel restrictions, and a notable affordability tailwind as the US dollar converged toward parity with the euro meant that many American tourists enjoyed their first European vacation since the turn of the decade. Aside from the soaring fares and crowded airports triggered by this snapback in household wanderlust, investors have undertaken their own collective EU vacation (or, put another way, EvacUation) in terms of geographic asset allocation.

Year to date, cumulative outflows in European equities are approaching 6% of total assets under management (equating to $98bn in monetary terms). In contrast, the relative safe haven status of the US has recorded modest net equity inflows of around 1% over the same period. The eight consecutive months of outflows can be rationalized in the context of a prevailing risk off economic environment that is exacerbated by specific geopolitical threats that are concentrated on the European Union's doorstep (Ukraine) and increasingly infiltrating their plumbing (natural gas disruptions). The global headaches of stubborn inflation and burgeoning electoral extremism, most recently in Sweden and Italy, have not spared the region either.

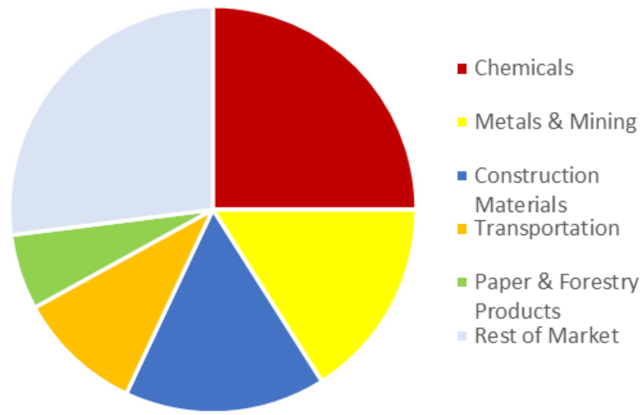
The MSCI Europe Index is now trading at only 11x forward earnings and sitting at a five point multiple discount to the counterpart US benchmark. Furthermore, Bank of America's latest monthly survey of fund managers showed a net bearish positioning skew of 40% in Eurozone equities – compared to 9% in Japan and Emerging Markets and only 4% in the US. For the Eurozone that represents a "weight of money" divergence of more than two standard deviations below the average positioning level of the last decade.

The obvious questions are whether, or how much, these wholesale macro-regional flows are throwing the baby out with the bathwater at the individual stock levels. As is often the case, the answers are dependent on your investment horizon.

For historic context, the aforementioned 6% cumulative outflows in Europe are nowhere close to the 15% exodus seen during the first twelve months of the financial crisis in 2007/08. While not at those epic proportions, we are already at levels in line with the lower water mark seen during the Euro debt crisis of 2011/12. The latter is arguably a better yardstick, given the more localized intensity of risks, but the prospect of a synchronized global recession in 2023 also suggests that respite is not immediately apparent.

Fortunately, at the portfolio level, one of the Euro-centric risks is fairly easy to identify and mitigate. With fears of energy security

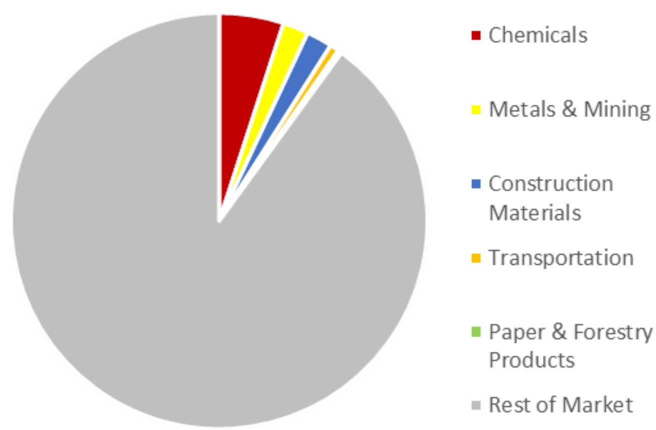
EXHIBIT 1: EUROPEAN STOCKS ENERGY INTENSITY BY INDUSTRY*



*Intensity = MWh/Net Income (€)

Source: SocGen, Stoxx 600 Index (September 2022)

EXHIBIT 2: EUROPEAN STOCKS INDEX WEIGHT BY INDUSTRY



Source: SocGen, Stoxx 600 Index (September 2022)

and gas supplies becoming even more acute if politics and weather prove to be uncooperative, it is useful to recognize that the direct impacts are born far from equally at the industry level. The industrial heartland of Germany sits squarely in the crosshairs of hydrocarbon risks but, across the region overall, five industries account for almost three quarters of aggregate energy intensity .

Averaging megawatt/hour (MW/h) consumption by net income shows that Chemicals (25% share), Metals/Mining (16%) and

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Construction Materials (16%) account for more than half of the total (Exhibit 1). The Paper and Transport industries are the only other outsized contributors. Many of the companies within this cohort already face structural or financial challenges related to competitive dynamics, asset intensity or commoditized pricing-taking regimes and are typically absent or under-represented in our portfolio. The only two current holdings that intersect with these categories are building aggregate specialist CRH, whose growth story is primarily US in nature, and asset light freight forwarder DSV. Both names have high quality management teams and competitive advantages that make them attractive long-term investments because of, not despite, their industry-leading characteristics.

In fact, when looked at in market capitalization terms, the most vulnerable industries only comprise 10% of broader equity markets in Europe (Exhibit 2). This provides ample room to insulate, or even simply sidestep, this primary risk factor.

Of course, the secondary spillover effects of expensive power prices on manufacturing, and even service, sectors need to be stress tested. For example, we have just met with a digital billboard company and discussed their power consumption trends and liabilities associated with French and German cities implementing "go dark" energy-saving measures during overnight hours.

As mentioned in previous bulletins, company-specific pricing power and innovation are often key to providing relative margin resilience on a through-cycle basis. Many European companies with these traits have not been immune from the persistent outflows and top-down selling pressure seen in recent quarters.

Like other regions, equity markets are in the process of trying to calibrate the eventual scope and cadence of further earnings pressures. Pricing in the fluctuating tail risks that fall more squarely on Europe is a more imprecise exercise. For now, uncertain US investors are more likely to be weighing arguments for further fine-tuning, rather than reversing, their aggregate underexposure to European equities. As and when their own overseas vacation, of sorts, starts to unwind they could – like transatlantic travelers this past summer – find the more prestigious destinations in Europe to be offering surprising value for money.

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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