EQUITY STRATEGY REVIEW
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INTERNATIONAL EQUITY

Andrew Smith, CFA, Associate Portfolio Manager and Senior Equity Analyst

At the time of writing in December, the 2022 market switchback ride is not quite complete. However, barring a particularly cruel (or localized) European Yuletide, we are on course for the first calendar year since the Great Financial Crisis when the MSCI Europe benchmark outperforms its U.S. counterpart on both a local currency and US dollar basis.

In recent memory, Europe has only won the annual trophy for transatlantic equity returns a handful of times—once in local currency terms (2015) and twice when dollar-denominated (2012 and 2017). In many ways these outlier or trend-defying events were generally not blue ribbon years for markets overall, with European ascendancy having an air of faute de mieux about it. To help dispel this cliched "even a stopped clock is right twice a day" indifference toward an asset class that has only prevailed (in dollar terms) every fifth year, consider this distinction. Unusually, large cap Europe's relative outperformance in 2022 has come in a predominately risk-off environment of sharply negative, double-digit equity returns globally. Not typically a scenario associated with Euro-defensiveness, particularly when—as we mentioned last quarter—regional equity outflows have been pronounced.

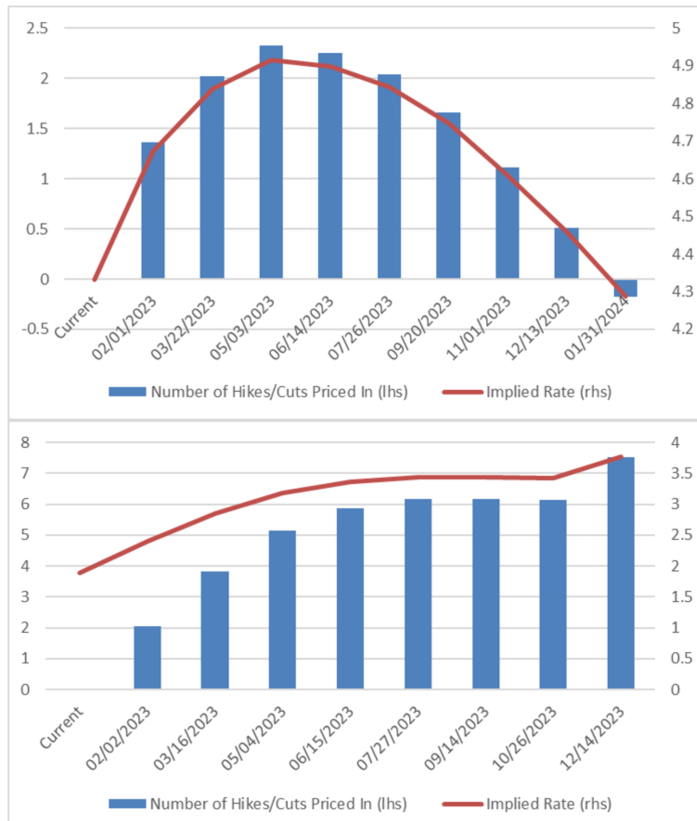
Much of the explanation for this can be attributed to two items. Firstly, the normalization process that is underway in monetary policies as central banks underscore their inflation-taming credentials and commitments. Higher nominal interest rates have led to a heavier discounting and de-rating of long duration growth names in the U.S. Stylistically, it has been a banner year for Value stocks over the Growth champions of the past decade.

Secondly and more fundamentally from a bottom-up perspective, earnings in Europe have demonstrated greater resilience this year, even into the jaws of unfolding economic slowdown. Market composition considerations come into play here, with the higher weighting to previously dormant Energy and Financial sectors becoming catalyzed by oil prices and non-negative base rates. It must also be noted that many globally-competitive European multinationals across Consumer Staples, Pharma, Industrials, and Utilities have enjoyed inflation-matching pricing power and currency tailwinds.

Looking forward, what is the likelihood that Europe can outperform the U.S. for a second consecutive year? After all, we have not witnessed such back-to-back "beats" since the halcyon days of 2006/07 when post-Greenspan excesses and double-digit GDP growth from industrializing China had spillover effects globally.

The prospects of an encore performance seem decent. Interest rate rises in the Eurozone are on a slight lag to those to the U.S.

EXHIBIT 1: FED VS ECB BASE RATE MARKET EXPECTATIONS



Source: Exane, Bloomberg

and are expected to hit a plateau next year while the Federal Reserve should start to ease of the brakes slightly if inflation dynamics cooperate (Exhibit 1). The steeper base rate curve in Europe is fertile ground for banks' net interest margins (deposit-loan spreads) and we have become increasingly interested in countries such as Spain and Ireland where lending conditions are well-supported by structural and product mix factors and macro concerns appear sufficiently allayed by capital buffers. Oil prices are unlikely to unwind dramatically, even if economic activity softens. Russia will remain ostracized even if military tensions de-escalate and the broader OPEC club appears resolute in its own modest, stability-seeking supply responses.

Inflation-busting pricing power among corporates is likely to grow scarcer in 2023 as household savings reserves and corporate confidence wane. However, we reiterate the through-cycle and all-weather nature of many high-quality companies in cyclical sectors. Those with the ability to provide productivity or tangibly accelerated payback periods around themes of digitization (IT

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Services) or energy efficiency (electrical equipment and renewable Utilities) should be able to maintain premium pricing dynamics. Business models with high levels of recurring revenues, often via ancillary services or pre-eminent brands, also tend to see relatively resilient margins during period of above average inflation or economic uncertainty.

It may take a few more quarters for investors globally to fully absorb the regime change away from zero or non-negative nominal interest rates, in terms of re-anchoring from valuation heuristics and "rules of thumb" that held sway for over a decade pre-pandemic. That process could be akin to the mid-2000/02 period in the aftermath of the TMT bubble when, on average, the most expensive stocks and sectors underwent a slow-burn phase of steady underperformance. It was also a period when, despite negative market downdrafts, Europe was consistently able to match the U.S. from both earnings and returns perspectives.

After this year's ride on the roller coaster comes to a halt, investors may have to navigate the geographic house of mirrors in 2023: a disorienting but ultimately less stomach-churning corner of the equities theme park.

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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.

For additional information, please contact:

Mr. William Smith
Managing Director
Business Development and Client Service
(302) 477-6204
Bill.Smith@dupontcapital.com

www.dupontcapital.com

Important Disclosures: