MAY 2024

RESILIENT CONSUMERS SUPPORT GROWTH

Economic forecasters have been revising estimates up for growth all year. Resiliency last year was explained away as funded by excess pandemic savings. So far this year, growth has remained remarkably strong but improvement in inflation data has stalled. Both the resiliency of the economy and upward pressure on prices are a sign of strength. There was some "headline" weakness in first-quarter U.S. Gross Domestic Product due to volatile and unpredictable components, but underlying domestic demand remained strong at over 3%. Consumption, housing and investments all contributed to growth.

With the unemployment rate below 4%, the strength of the consumer is supported by a strong labor market. Payrolls were softer for the first time in April, but these are slowing down from red hot levels which might allow wage growth to cool down. Real incomes are growing as nominal wage growth is ahead of inflation and real incomes are rising across all income quintiles. The savings rate is low, but low rates are associated with periods of rising wealth when consumers are less worried about the future. Consumer balance sheets show few signs of stress. Delinquencies are up from record lows and debt servicing ratios remain near historic lows. Pandemic distortions are still being worked through the spending patterns. Strong economic growth puts some upward pressure on prices, which has been reflected in recent data. We don't view this as a sign of concern but rather of underlying strength.

The impact of monetary tightening is likely behind us. Higher rates may continue to bite those borrowing at these levels but this is not a signal for a recession. Wage growth is moderating and inflation expectations are anchored. The Fed is not likely to raise rates unless inflation reaccelerates, and Chair Powell recently reiterated that this is not the Fed's expectation. We are anticipating cuts from most of the major developed central banks this year. Moreover, economic strength is broadening globally. We see improved momentum in Europe and China as global manufacturing is stabilizing.

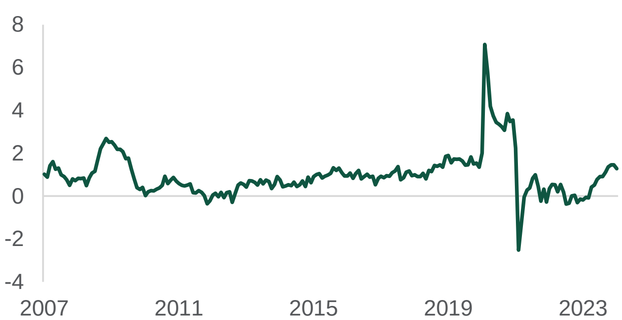
The ongoing expansion points to further upside for global stocks relative to bonds. Although U.S. equity valuations are elevated, we think equities will continue to trend higher if earnings continue to rise as expected. We prefer equities over bonds with overweight exposures across all the major equity regions. We are funding part of that overweight with an underweight to natural resources. Within fixed income, the comparatively longer-duration of investment grade (IG) corporate bonds makes them more vulnerable to rising government bond yields and contributes to our preference for high yield (HY) issues. There is also little scope for a meaningful further tightening of spreads, and we like the return advantage for HY bonds relative to IG bonds from higher income yields. We are underweight IG, inflation-protected bonds, and cash within our fixed income allocation.

Anwiti Bahuguna, Ph.D. – Chief Investment Officer, Global Asset Allocation

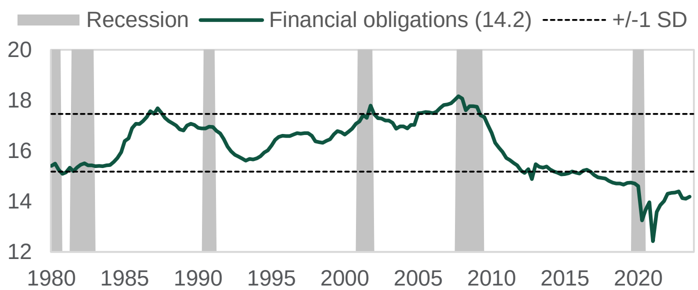
REAL WAGE GROWTH SUPPORTS CONSUMER SPENDING

Real wages have continued to rise, while the aggregate consumer balance sheet shows few signs of stress.

REAL WAGE GROWTH (Y/Y %)



FINANCIAL OBLIGATIONS RATIO (% OF DISPOSABLE INCOME)



Source: Northern Trust Asset Management, Bloomberg, Federal Reserve. Latest data as of 4/30/2024. Real wages are average hourly earnings less personal consumption expenditures. Year-over-year = Y/Y. SD = standard deviation.

Interest Rates

We took the main message from the May Federal Open Market Committee (FOMC) meeting to be that the path of economic data this year, especially inflation data, has not given the Committee "greater confidence that inflation is moving sustainably toward 2 percent"[1] and, as a result, it will take longer than initially expected for the Committee to start cutting rates.

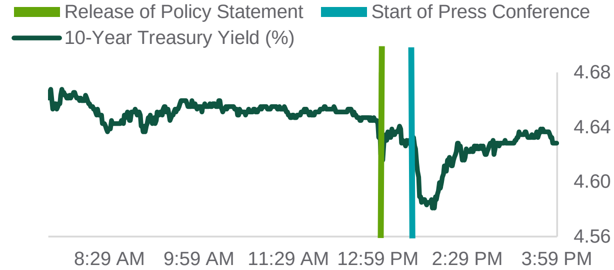
As we discussed last month, the FOMC's policy statement also included an update on the Committee's plan to reduce the size of its balance sheet. Beginning next month, they will, "[reduce] the monthly redemption cap on Treasury securities from $60 billion to $25 billion*."[1] This reduction slightly exceeded the widely held expectation that they would cut the cap in half to $30 billion. The cap on mortgage-backed securities will remain unchanged at $35 billion as widely expected. U.S. Treasury yields were little changed following the release of the statement, as the market (correctly in our view) focused more so on the implications of Powell's press briefing on the Federal Funds Target Range – their main tool for adjusting monetary policy.

- Dan LaRocco, Head of U.S. Liquidity, Global Fixed Income

LONGER THAN EXPECTED

Yields were most responsive to the press conference.

FED DAY (5/1/2024)



Source: Northern Trust Asset Management, Bloomberg. Intra-day data on 5/1/2024. Times are shown in Central Daylight Time (CDT). [1]Federal Reserve.

- Treasury yields were little changed in response to the FOMC policy statement, which stated that the Fed will reduce the pace of Quantitative Tightening.
- Interest rates were more responsive to the post-meeting press conference, when Chair Powell stated it will take longer than initially expected to cut rates.
- We think the Fed remains unlikely to raise rates, and we expect it to start cutting its policy rate in September.

Credit Markets

High yield (HY) saw its worst performance in six months driven by rate and risk volatility. Dispersion continues to be a theme for the asset class with higher quality trading tighter and elevated levels of distress primarily in the TMT sector. Despite valuations in higher quality, the attractive yield carry continues to pique investor interest. Inflation also continues to be topical, especially on the back of heightened geopolitical tensions out of the Middle East. Commodity prices have been on the rise as a result.

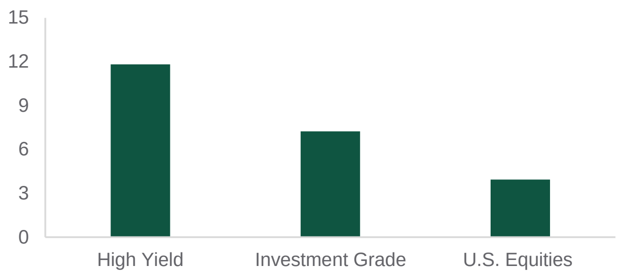
High energy prices can put strain on margins for the overall economy, but the high yield market is better positioned with greater exposure to energy versus most other asset classes. Energy HY index exposure is almost 2x greater than investment grade and 3x greater than the S&P 500. The higher energy exposure allows for a better hedge against rising energy prices. Despite the increase in volatility, fundamentals overall continue to be stable. The number of high yield bond issuers upgraded in April exceeded downgrades. April was the most favorable mix of upgrades versus downgrades since July 2023. This dynamic has provided support for high yield valuations and our recommended tactical overweight to the asset class.

- Eric Williams, Head of Capital Structure, Global Fixed Income

ENERGY EXPOSURE

High yield has a relatively high energy exposure.

ENERGY (INDEX WEIGHT %)



Source: Northern Trust Asset Management, Bloomberg. High Yield = Bloomberg U.S. High Yield 2% Issuer Cap Index. U.S. Equities = S&P 500 Index. Investment Grade = Bloomberg U.S. Credit Index. Data as 5/8/2024. TMT = Technology, Media and Telecom.

- High yield recently saw its worst performance in six months driven by rate and risk volatility.
- Commodity inflation is a tailwind for pockets of the high yield market, and can support high yield valuations.
- We remain 5% overweight high yield given stable fundamentals and an attractive income yield.

Equities

After a 3.2% loss in April, global equities have regained momentum and recovered almost all of that dip so far in May. While U.S. equities have retained year-to-date leadership, non-U.S. markets have outperformed more recently. Over the past month, Europe and emerging market equities have returned more than the U.S. We suspect that part of the recent international leadership has been driven by signs that economic momentum is broadening out from the U.S. to other areas of the world.

We increased our tactical equity positioning to overweight by adding 3% to U.S. equities and 1% to both developed ex-U.S. and emerging market equities. As shown in the chart, there have been limited periods in which bonds have persistently outperformed stocks. Recession has generally surrounded those periods. We assign a low probability to recession, and our baseline outlook for a soft landing and easing central banks should bode well for equities. Easing growth and lower inflation could lead to incrementally lower interest rates, but as long as those moves occur against a non-recessionary backdrop we expect equities to lead other assets. Beyond the macro backdrop, the earnings outlook remains strong across all three major regions.

- Colin Cheesman, Investment Strategist, Asset Allocation

TAKING STOCK

Absent recession, stocks tend to outperform bonds.

Source: Northern Trust Asset Management, Bloomberg. Ratio is the total return of global stocks (MSCI ACWI) versus global bonds (Bloomberg Global Agg), indexed to 100 on 1/31/1990. U.S. recessions shown. Data from 1/31/1990 through 4/30/2024.

- Global equities have regained momentum after a weak April. Non-U.S. equities have exhibited leadership alongside signs that global growth is broadening.
- Absent recession, equities tend to be the better relative return choice vis-à-vis fixed income.
- We added 5% to global equities and are now tactically overweight all three regions. We retain our soft landing base case and assign low probability to recession.

Real Assets

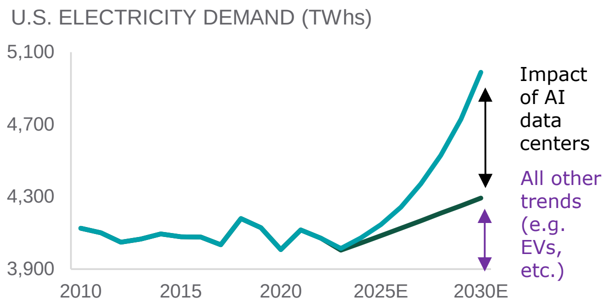
Global power demand has been relatively flat over the past decade with growth slowed by LED lighting adoption. With the arms race for AI market share, data centers are increasingly coming into investor focus. The group is expected to drive an inflection in power demand growth. AI data centers are equipped with vast computing resources specifically designed for AI workloads. These facilities currently use approximately 7x as much power as traditional data centers. It is estimated that AI could add another 700 Terawatt-Hours (TWhs) to U.S. power demand by 2030, which would be a 20% increase from past projections. Utilities and others are expected to utilize a number of sources to meet this increased power load including renewables, nuclear and traditional energy.

Increasing power demand should present significant structural opportunities for real assets whether they are data center owners, integrated and renewable utilities, independent power producers, or midstream energy infrastructure. Further, this increasing demand will require sizable capex to build out the power grid and improve global transmission and distribution of power.

- Jim Hardman, Head of Real Assets, Multi-Manager Solutions

POWER DEMAND SURGE

AI data centers are expected to drive power demand.



Source: Northern Trust Asset Management, Wells Fargo Securities. U.S. electricity demand is measured in Terawatt-Hours (TWhs).

- AI data centers require 7x as much power as traditional data centers. Global power demand is estimated to increase 20% over the next 5-7 years.
- This could provide significant structural growth opportunities across the real assets space.
- While valuations and longer-term trends make for attractive structural opportunities, we are tactically neutral listed infrastructure and real estate, and maintain a 2% underweight to natural resources given our expectation for a slowing-growth environment.

BASE CASE EXPECTATIONS

Sticking the Landing

Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength as labor market/consumer momentum has continued. Inflation will remain above target but continue to proceed toward 2%.

Central Bank Transitions

We expect U.S. and European central banks to transition to rate cuts this year. Economic resilience may afford monetary policymakers more time to confirm that inflation is moving down sustainably.

RISK CASE SCENARIOS

Stubborn Inflation

Inflation does not move lower as a result of several potential factors: economic resurgence, tight labor markets keeping pressure on services, and/or goods and commodity disruptions from conflict in the Middle East.

Lagged Impacts

The market's enthusiasm for a soft landing proves to be misplaced as the cumulative effect of 5%+ rate hikes in two years starts showing up in economic functioning. TAA is not underweight risk enough in this scenario.

GLOBAL POLICY MODEL

Strategic Allocation and Tactical Over/Underweights	FIXED INCOME				EQUITIES			REAL ASSETS			
	Cash	Inv. Grade	Infl. Linked	High Yield	U.S.	Dev. Ex-U.S.	Emerg. Markets	GLI	GRE	NR	Gold
Strategic Asset Allocation	2	30	9	5	28	13	5	2	2	4	0
Tactical Asset Allocation	0	26	7	10	31	14	6	2	2	2	0
Over/Underweight	**-2**	**-4**	**-2**	**5**	**3**	**1**	**1**	**0**	**0**	**-2**	**0**

Source: Northern Trust Capital Market Assumptions Working Group, Investment Policy Committee. Strategic allocation is based on capital market return, risk and correlation assumptions developed annually; most recent model released 8/9/2023.The model cannot account for the impact that economic, market and other factors may have on the implementation and ongoing management of an actual investment strategy. Asset allocation does not guarantee a profit or protection against a loss in declining markets. GLI = Global Listed Infrastructure, GRE = Global Real Estate, NR = Natural Resources.

Indexes used and definitions:

Bloomberg U.S. Corporate High Yield 2% Issuer Cap Index: Measures the performance of high yield corporate bonds, with a maximum allocation of 2% to any one issuer.

Bloomberg U.S. Credit Index: Measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. It is composed of the U.S. Corporate Index and a non-corporate component that includes non-US agencies, sovereigns, supranationals and local authorities.

Bloomberg Global Aggregate (Agg) Index: Flagship measure of global investment grade debt from a multitude of local currency markets. This multi-currency benchmark includes treasury, government-related corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

MSCI ACWI: A free-float weighted equity index that includes both emerging and developed world markets.

S&P 500 Index: Widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

UNLESS NOTED OTHERWISE, DATA IN THIS PIECE IS SOURCED FROM BLOOMBERG AS OF MAY 2024.