THE NORTHERN FUNDS

advantage

April 2016

SLOW GROWTH, CENTRAL BANK POLICIES SHAPE MARKET OUTLOOK

U.S. ASSETS REMAIN MOST ATTRACTIVE ON VOLATILE WORLD STAGE

Despite a volatile start to 2016, Northern Trust's outlook for the year remains intact. Jim McDonald, Northern Trust's chief investment strategist, continues to believe the U.S. and the rest of the world will face continued slow growth and low inflation — an environment that will allow central bank policies to remain broadly accommodative.

CENTRAL BANKS REMAIN ENGAGED

In response to slow growth and muted inflation, developed market central banks have pursued highly accommodative monetary policies since 2008. Although the financial crisis created an atmosphere of cooperation among the leading central banks, the "normalization" process will be an individual affair. Each central bank has modestly different objectives, but lifting inflation is a common goal for all of them.

The Federal Reserve (Fed) became the first to begin a monetary policy normalization process when it ended its near-zero interest rate program by raising the federal funds target rate 25 basis points (0.25%) on December 16, 2015. We expect additional Fed tightening to be a long, gradual process, as inflation in the U.S. and elsewhere remains far below central bank targets.

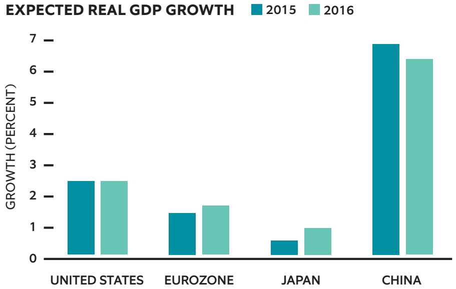
Although the Fed and other central banks may profess to have a domestic focus, they operate in a global economy and financial markets. Therefore, the Fed's ability to raise rates to the level it believes would be optimal likely will be constrained by the U.S. dollar's continued strength. Furthermore, we don't expect any slowdown in the stimulus programs from the European Central Bank and the Bank of Japan, both of which maintain aggressive programs designed to stave off deflation and encourage growth. Accordingly, we believe central bank monetary policies are likely to remain generally accommodative in 2016.

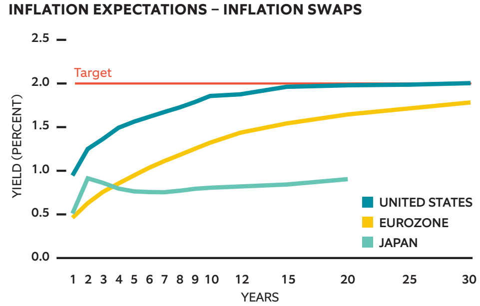
U.S. MARKET STRONGER THAN OTHERS

In analyzing the global investment landscape, the U.S. maintains its relative attractiveness. In particular, we believe U.S. equities should maintain above-median valuations on slow but steady economic growth and continued Fed engagement. The U.S. economy remains in a higher "growth channel" than its developed economy counterparts, which should support earnings and cause further dollar strength, reinforcing our preference for U.S. dollar-denominated asset classes.

As the year unfolds, we expect commodity-sensitive sectors will no longer represent a material headwind to corporate earnings. However, emerging market equities could face negative sentiment and lower total returns due to contracting valuations. We remain cautious toward emerging markets equities, though, partly because of the hurdle posed by a strong U.S. dollar. We want to see currency stability and improving emerging market

GROWTH & INFLATION OUTLOOK IN KEY ECONOMIES





Source: Northern Trust, Blue Chip Economic Indicators, Bloomberg 12/15/2015 swaps curves.

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economic growth before becoming more constructive on the asset class. Conversely, economic momentum and accommodative monetary policy should support European stocks.

CREDIT CONCERNS CONFINED

A key question for fixed-income investors is whether the recent widening of credit spreads (an increase in the yield difference between Treasury and non-Treasury securities of similar maturity) is a "macro" or "micro" issue. A macro issue would portend further deterioration in financial conditions and pressure all risk assets. However, we believe the spread widening is more of a micro issue. In particular, we believe credit concerns are mostly confined to the energy and materials sectors, which have been hampered by plunging commodity prices. We do not believe the spread widening reflects a negative sentiment on the overall economy.

Overall, we believe high-yield issuers are in relatively good financial shape. Furthermore, we believe a slow but positive growth environment, combined with accommodative central bank policies, will support most high yield and investment-grade fixed-income assets. We expect fixed-income returns outside the U.S. to be weaker, reflecting the lower-yield environment and potential pressure from continued U.S. dollar strength.

VOLATILITY HERE TO STAY

We believe volatility will remain heightened in 2016, as evolving monetary policy faces an uneven global economy, less liquid financial markets, and geopolitical concerns. We expect much more "noise" about changes in the economic and monetary policy outlooks than actual fundamental transformations.

Potential risks, which have been fairly consistent over the last several months, include concerns about China's growth prospects and fallout from ongoing U.S. dollar strength. The Fed provided some relief to our third concern — that of a flubbed Fed liftoff — with the 0.25% rate hike in December accompanied by an interest rate outlook that has been well received by the markets. There is still a long way to go on the path to interest rate normalization. For example, the Fed said it would keep its balance sheet at current levels of $4.5 trillion well into the interest rate normalization process. Visibility toward the terminal level of U.S. interest rates may be an important catalyst for improving the outlook among asset classes most harmed by the dollar's strength, including emerging markets and natural resources.

Past performance is no guarantee of future results. Investing involves risk including the possible loss of principal. There can be no guarantee that any investment strategy will be successful.

REMINDER: TAKE ACTION IF YOUR FUND ACCOUNT IS INACTIVE

If you haven't had any activity in your Northern Funds account for a while, please get in touch with us. Otherwise, your assets may be escheated to your state as unclaimed property.

When a fund account goes inactive for a few years (as defined by your state of residence, and generally three or five years), it becomes subject to escheatment. Northern Trust will notify you of this via a letter. To prevent your account from being remitted to the state, you must sign, date, and return the letter by a specified date. Or, you may contact the Northern Funds Service Center at **800-595-9111** to return your account to "active" status.

Failure to respond will result in your account being remitted to your state as unclaimed property. Once the fund balance is remitted to the state, you must make all future claims directly with the state.

IRA, ESA CONTRIBUTION FORMS ARRIVING SOON

Your IRA contributions, including rollover contributions, for the previous tax year are reported annually on Form 5498. Similarly, Form 5498-ESA reports your tax-year contributions to your Northern Funds Education Savings Accounts.

We will mail your Form 5498 and Form 5498-ESA for the 2015 tax year by April 30, 2016. These forms are for your records only; you do not have to send them to the IRS. We report this information directly to the IRS.

contact us

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