

Can the Bull Market Survive Politics and the Fed?

International Family Forum – Managing Change

James D. McDonald
Executive Vice President
Chief Investment Strategist
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NORTHERN TRUST

**Baker
McKenzie.**

AN INVESTMENT STRATEGY WITH TWO DISTINCT TIME HORIZONS

Combining long-term discipline with short-term flexibility aimed to provide “downside protection and upside participation.”

STRATEGIC OUTLOOK

Capital Market Assumptions Group

- **Time Horizon:** Five Years
- **Frequency:** Annual
- **Output:** Long-term asset class forecasts, strategic portfolio
- **Communication Piece:** Capital Market Assumptions (CMA) white paper (*released annually in July*)

TACTICAL OUTLOOK

Interest Rate
Strategy Committee

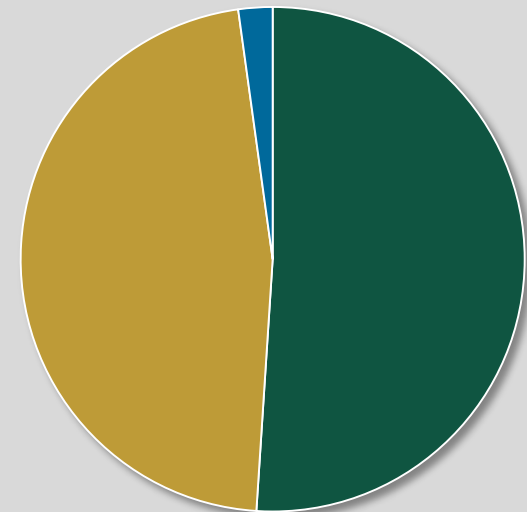
Credit Strategy
Committee

Tactical Asset Allocation Committee

- **Time Horizon:** 12 Months
- **Frequency:** Weekly/monthly (TAA)
- **Output:** Tactical interest rate, credit spread and asset class forecasts, tactical portfolio recommendations
- **Communication Piece:** Monthly Perspective Newsletter and Annual Outlook (*released in December*)

Northern Trust Assets Under Management:

\$942 billion as of 12/31/2016



■ Equity \$481 ■ Fixed Income \$441 ■ Other \$21

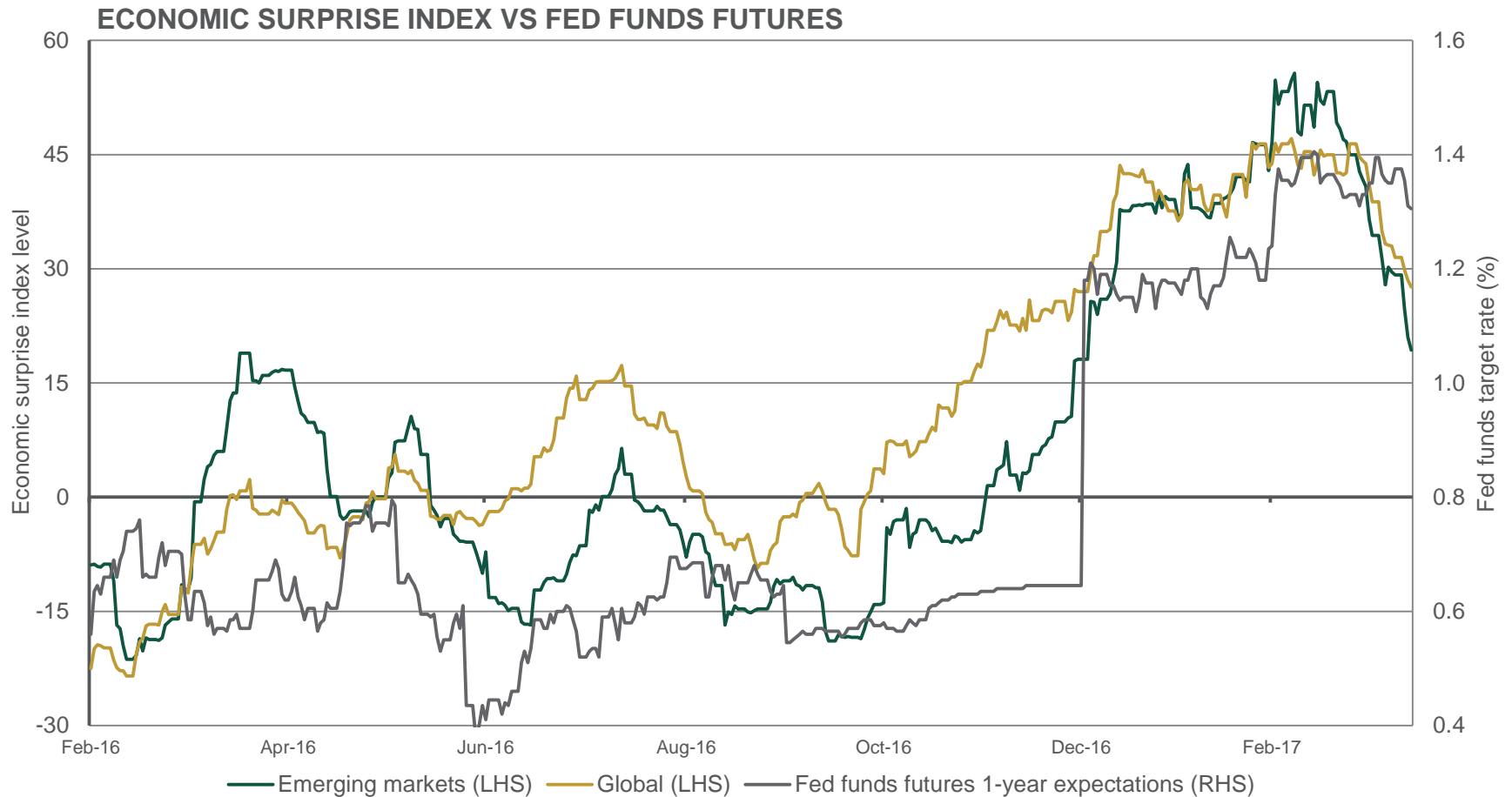
THE ECONOMY IS MORE IMPORTANT THAN POLITICS

Global growth is on the upswing

Interest rates are on the rise

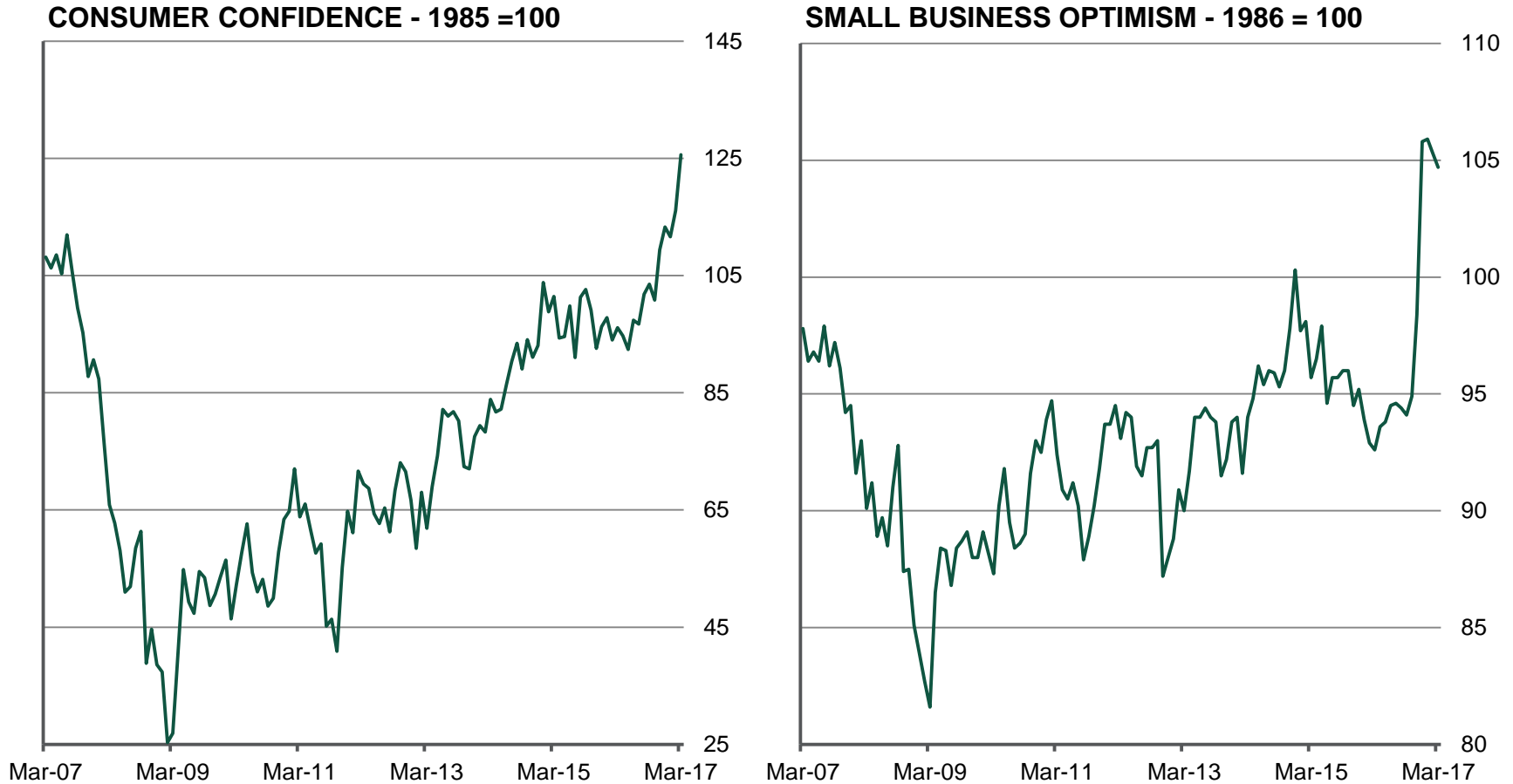
Historically full valuations cap upside potential

GLOBAL GROWTH ON AN UPSWING



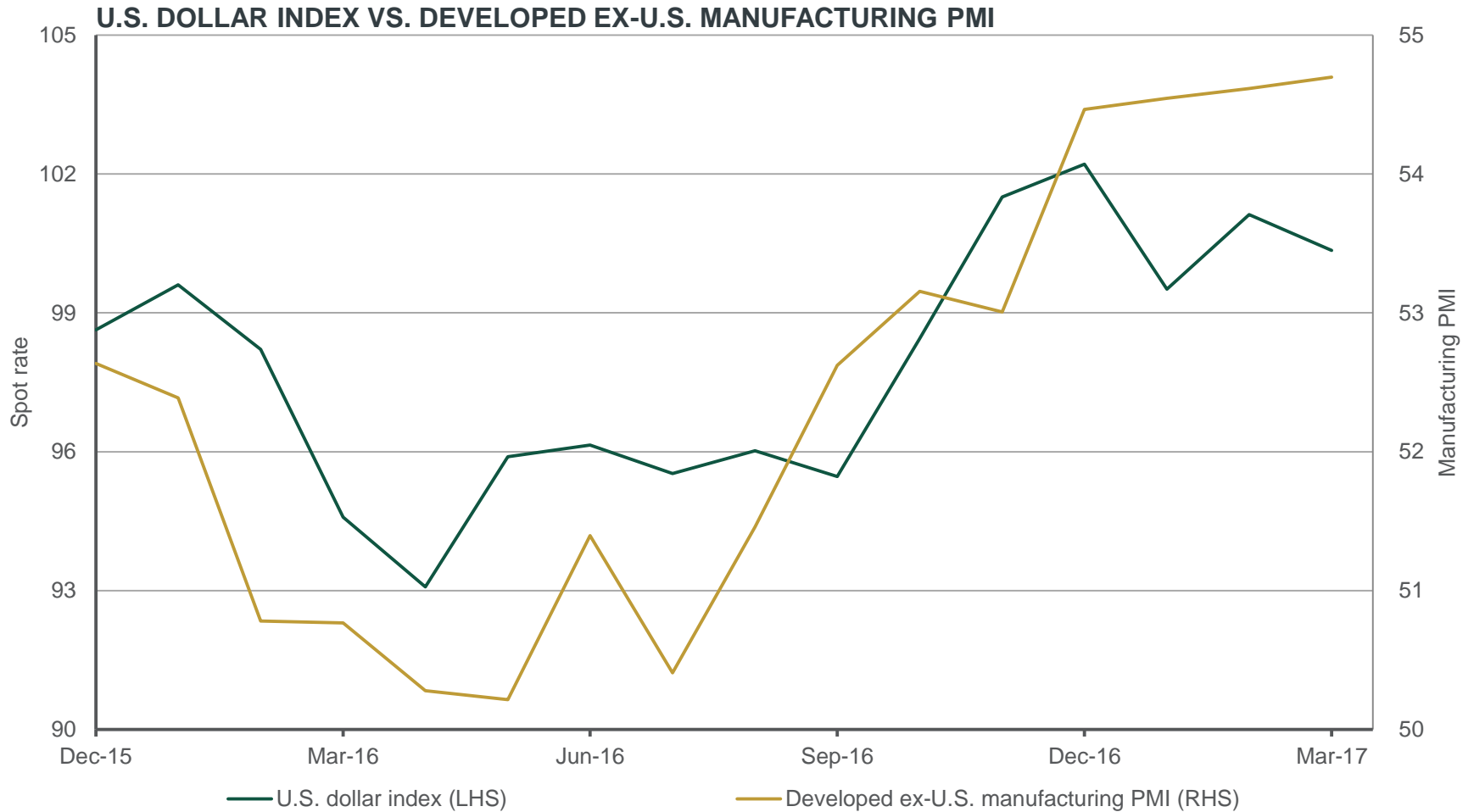
Source: Northern Trust, Bloomberg. Data through 4/12/2017.

ANIMAL SPIRITS ARE STIRRING IN THE U.S.



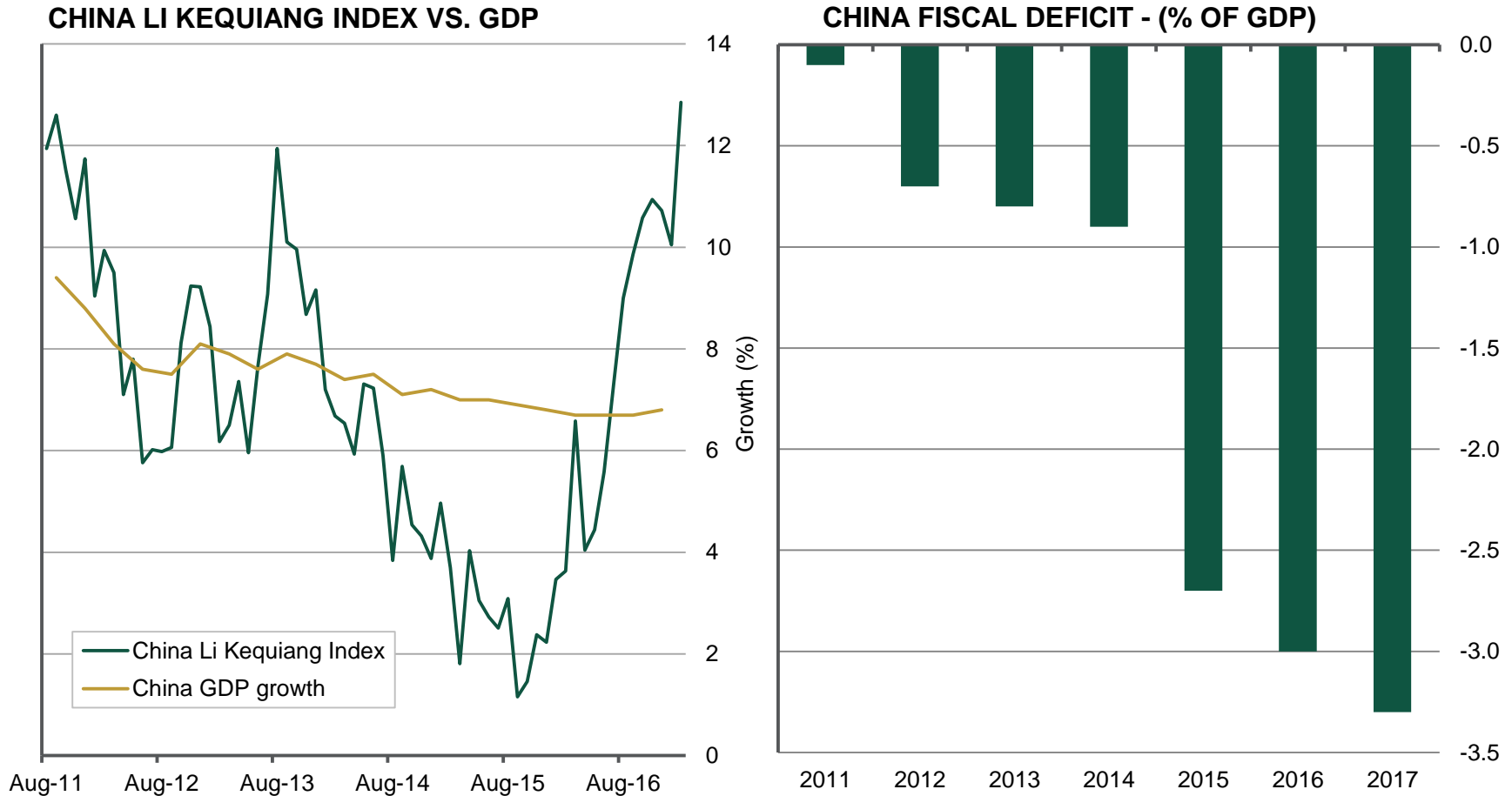
Source: Northern Trust, Bloomberg. Consumer data through 3/31/2017. Business data through 3/31/2017.

EUROPEAN GROWTH HAS BEEN RESILIENT



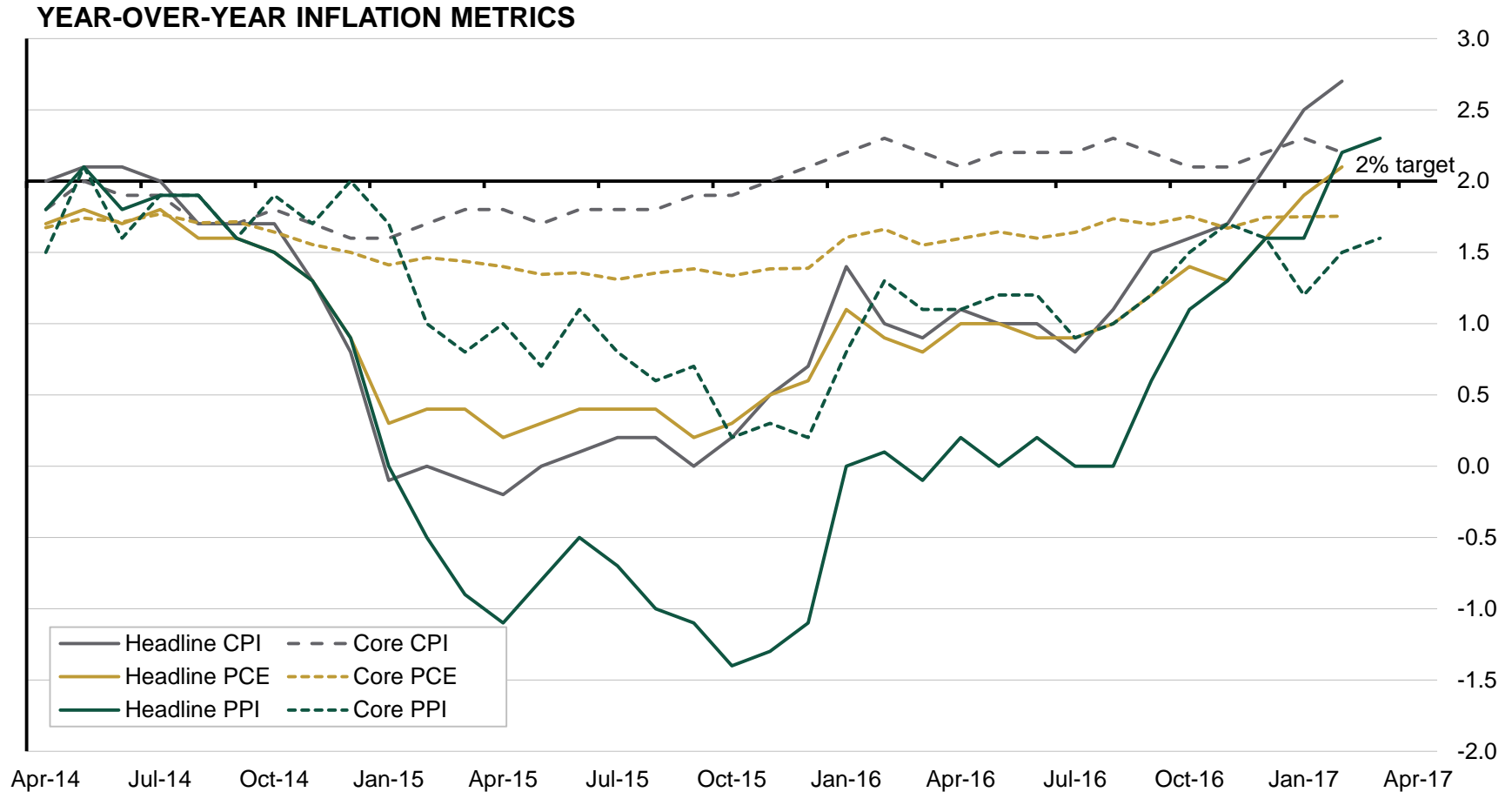
Source: Northern Trust, Bloomberg. Estimated Manufacturing PMI is weighted 50%, 28%, and 22% to Europe, Japan, and U.K..
Data through 3/31/2017.

CHINESE GROWTH: DEFICIT SPENDING



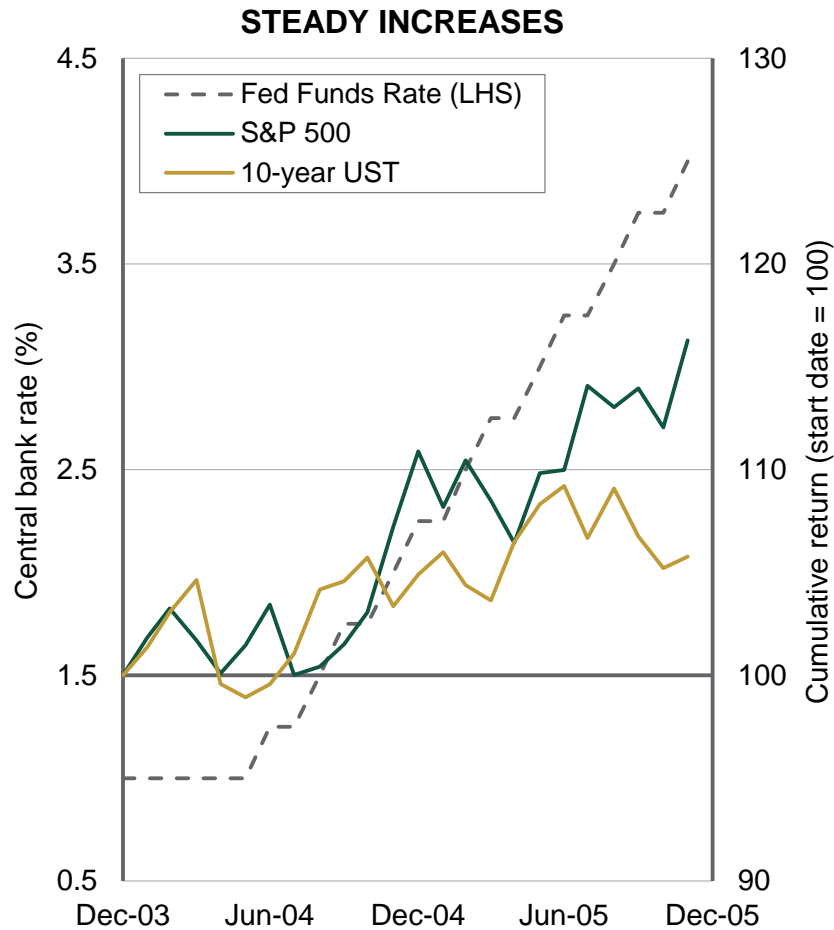
Source: Northern Trust, Bloomberg, IMF Fiscal Monitor Oct. 2016. Data through 2/28/2016. Index is weighted average growth rates of outstanding bank loans (40%), electricity production (40%), and rail freight volume (20%).

INFLATION IS ON THE RISE



Source: Northern Trust, Bloomberg. Data through 3/31/2017.

A STEADY FED WON'T BE A PROBLEM

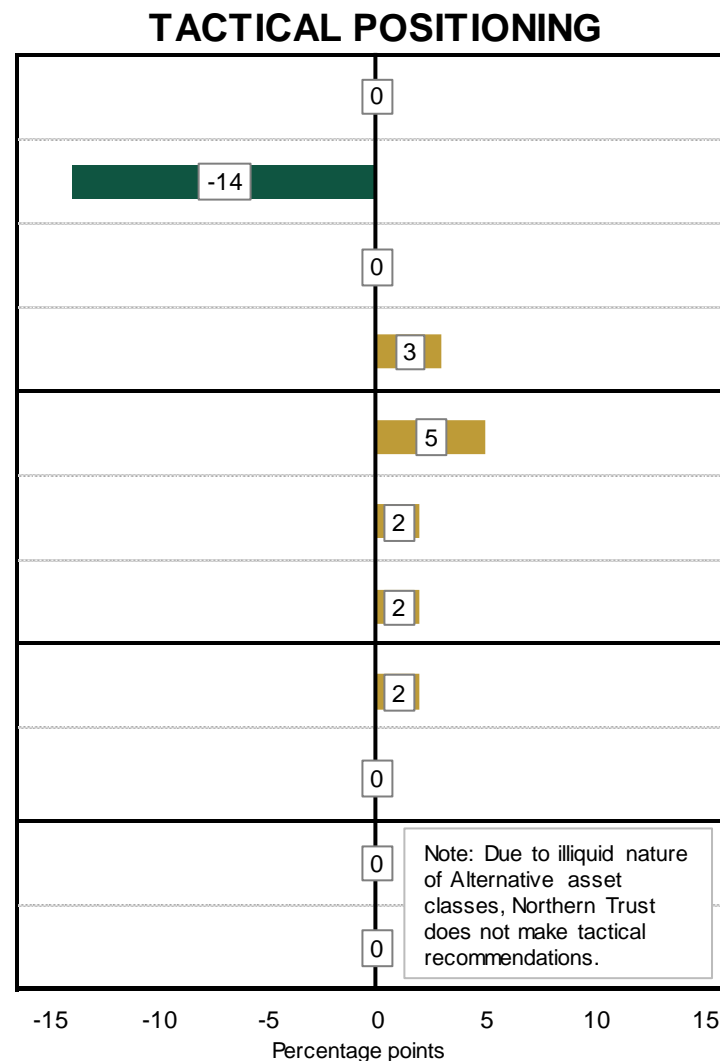


Source: Northern Trust, Bloomberg. First appeared in Sensitivity Training (2013).

Past performance is no guarantee of future results. Periods greater than one year are annualized except where indicated. Returns reflect the reinvestment of dividends and other earnings and are shown before the deduction of investment management fees, unless indicated otherwise. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved






ADDING TACTICAL RISK AFTER THE US ELECTION

		ASSET CLASS	SAA	TAA
Risk Control	Fixed Income	Cash	2	2
		U.S. Investment Grade	36	22
		U.S. TIPS	4	4
		U.S. High Yield	5	8
Risk Assets	Equities	U.S. Equity	15	20
		Dev ex-U.S. Equity	11	13
		EM Equity	5	7
	Real Assets	Natural Resources	5	7
		Global RE/Global Listed Infra.	6	6
	Alternatives	Hedge Funds	5	5
		Private Equity	6	6



Source: Northern Trust. Allocations above reflect Northern's Wealth Management Model (Growth & Income, Accredited investment objective). Tactical recommendations (in the form of over/under/equal weights) are displayed in the bar chart. Allocations as of 3/9/2017. SAA = Strategic Asset Allocation. TAA = Tactical Asset Allocation.

WHO IS AT RISK FROM POPULIST POLITICS?

RISK RANK	COUNTRY	KEY EVENT
Highest risk	Italy 	Rising support for the 5 Star Movement may lead to discussion of an EU-exit.
Medium-high	UK 	Prime Minister May looks to invoke Article 50 in late March.
Medium	U.S. 	GOP sweep could end up being pro-growth.
	France 	Populist Front National is underdog in upcoming elections.
Medium-low	Germany 	Chancellor Merkel's strength is being questioned ahead of September election.
	Netherlands 	The populist PVV party underperformed in the March election.
Low risk	Japan 	Little populist risk due to a stable government and homogenous population.

RISK CASE SCENARIOS

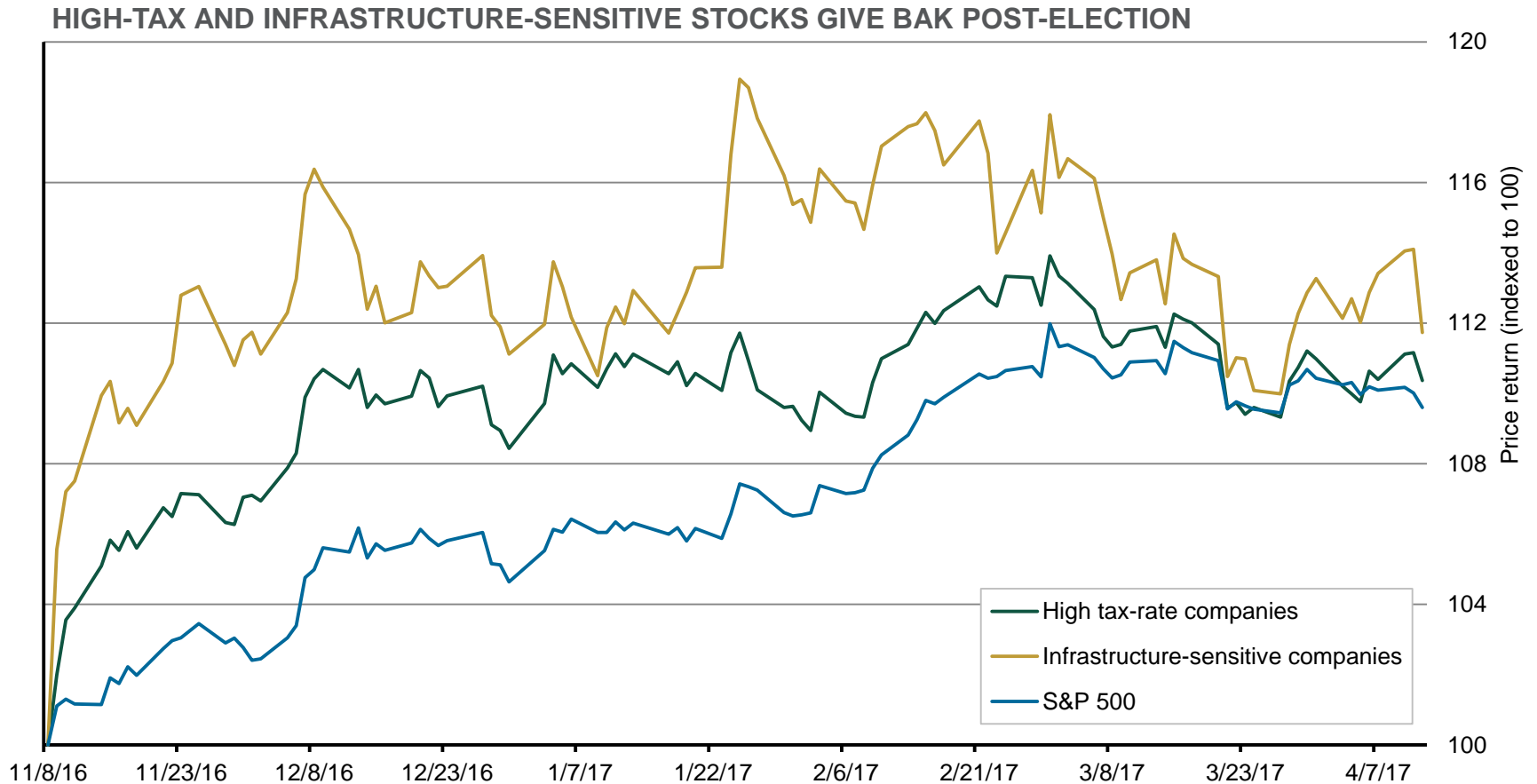
Inflation:

TAA's overweight to risk assumes controlled inflation given the productive capacity of a technology-enabled/less-regulated economy. Unexpected inflation would knock out a key pillar of current risk positioning.

Political Progress Risk:

What began as a U.S.-centered market rally underpinned by expectations of tax reform, regulation rollback and fiscal stimulus has shifted to a global market rally anchored in improving fundamentals. The risk is that U.S. and European Union dysfunction continues and is enough to derail economic momentum.

MARKETS DISCOUNTING LEGISLATIVE SETBACKS



Source: NT Investment Strategy, Bloomberg, GS Investment Research. Data from 11/8/2016 (U.S. election) to 4/12/2017.

GEOPOLITICAL EVENTS TEND TO FADE

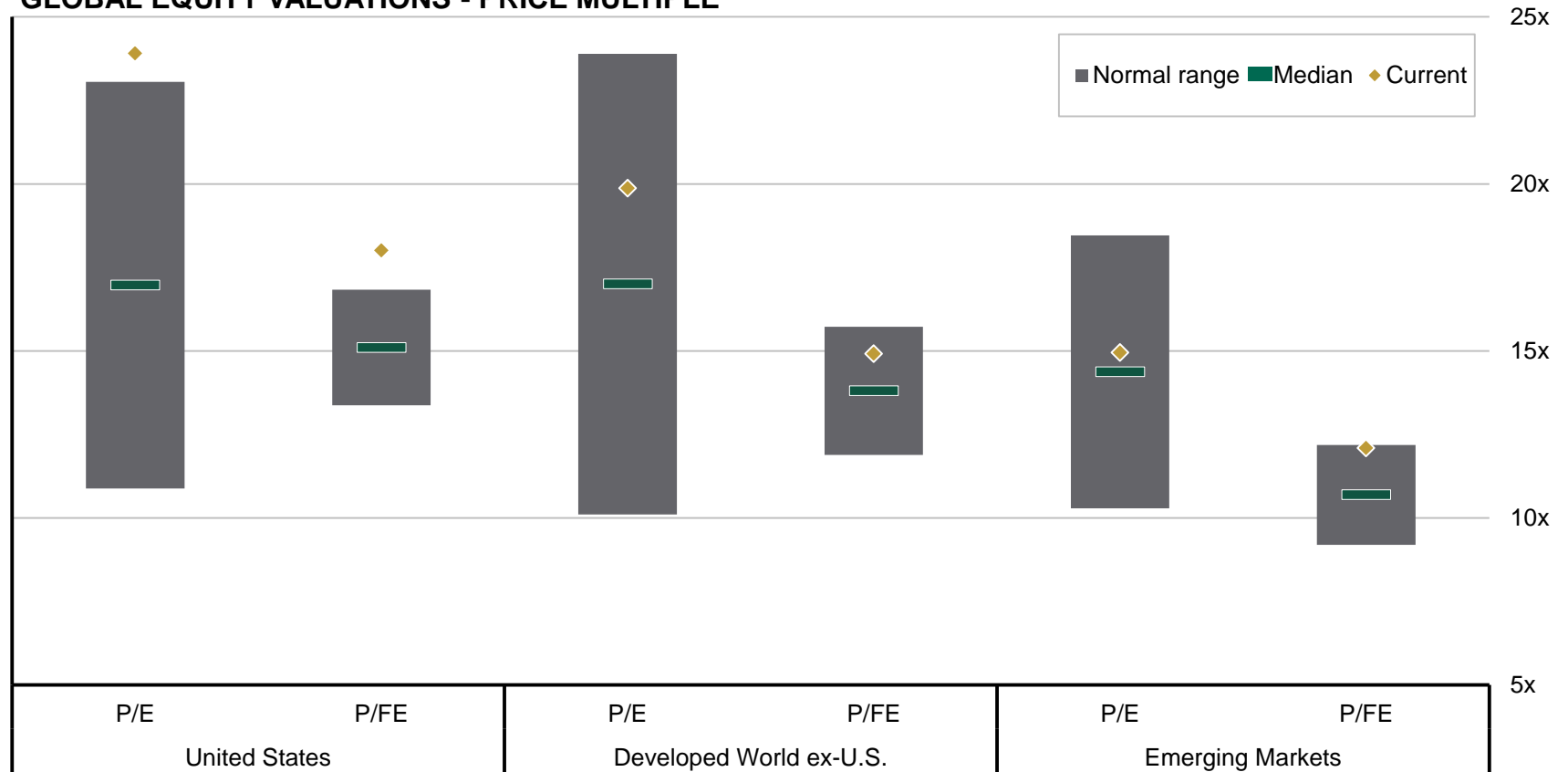
CRISES IN BULL MARKETS				
The Events	Year	During the initial market reaction it declined for	And lost	Market returned to pre-crisis level in
Hunt Brothers silver crisis	1980	43 days	-16%	152 days
Asian currency crisis	1997	6 days	-11%	45 days
President Eisenhower - heart attack	1955	18 days	-10%	76 days
Iraq invades Iran - war	1980	7 days	-5%	52 days
Japan earthquake and tsunami	2011	5 days	-4%	12 days
John F. Kennedy assassinated	1963	1 day	-3%	5 days
Watergate	1972	8 days	-3%	44 days
Average (of 21 post 1940 bull market crises)		8 days	-4%	37 days

CRISES IN BEAR MARKETS				
The Events	Year	During the initial market reaction it declined for	And lost	Market Returned to Pre-Crisis Level In
Arab oil embargo	1973	40 days	-20%	Following bull market
Iraq invades Kuwait	1990	22 days	-14%	Following bull market
Terrorist attack on WTC & Pentagon	2001	11 days	-14%	60 days
Six-Day War	1967	3 days	-2%	5 days
Average (of 13 post 1940 bear market crises)		15 days	-10%	N/A*

Source: Northern Trust, Crandall, Pierce & Company. Note: Data based on Dow Jones Industrial Average; market reaction period defined by Crandall, Pierce & Company. *In most crises during bear markets, the market did not return until its pre-event level until the next bull market.

HISTORICALLY FULL VALUATIONS

GLOBAL EQUITY VALUATIONS - PRICE MULTIPLE



Source: Northern Trust, MSCI. Monthly data through 3/31/2017. Indices are MSCI US, MSCI World ex-US, and MSCI Emerging Markets; U.S. and World ex-U.S. data begin in 1970, EM data begins in 1995. Normal Range: +/- 1 standard deviation from the median. LT: long-term.

Past performance is no guarantee of future results. Periods greater than one year are annualized except where indicated. Returns reflect the reinvestment of dividends and other earnings and are shown before the deduction of investment management fees, unless indicated otherwise. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved

CMA: A REVIEW OF THE RESULTS

Global equity returns are expected to make slow progress in choppy market waters while global interest rates remain anchored at low levels over the next five years.

**SLOW GROWTH
ANGST**

STUCK-FLATION

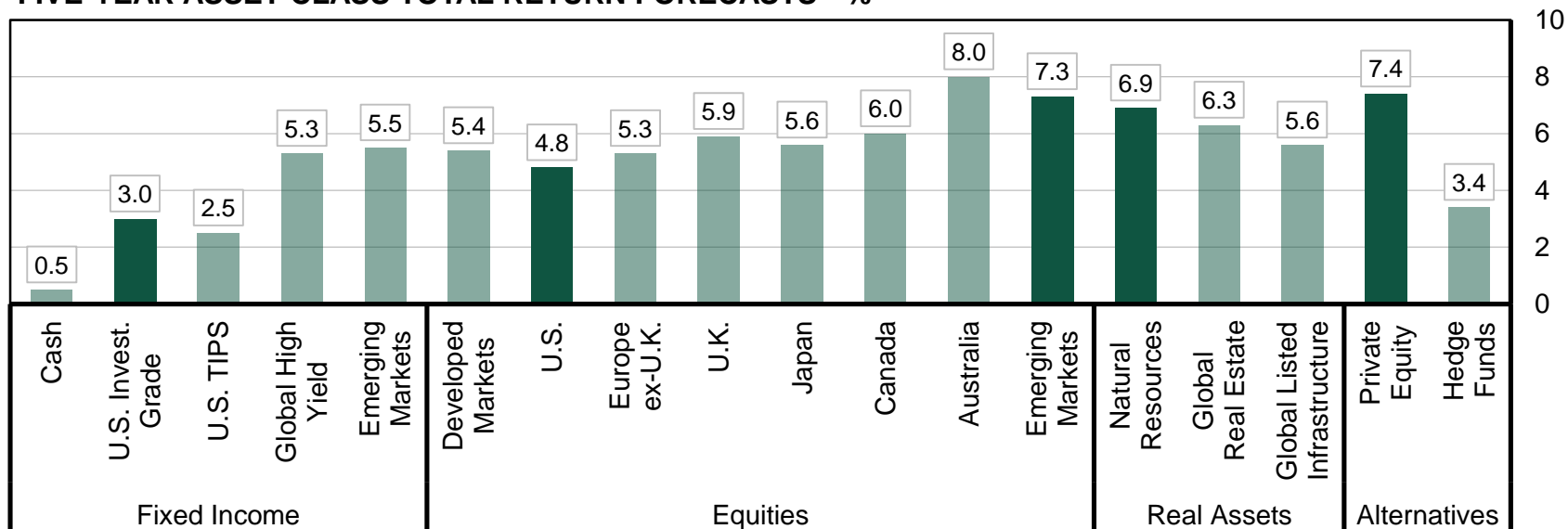
**COSTS OF
ULTRA-LOW RATES**

**POPULIST
ROULETTE**

**TECHNOLOGICAL
TURBULENCE**

**MARKET CYCLES IN A
CYCLE-LESS ECONOMY**

FIVE-YEAR ASSET CLASS TOTAL RETURN FORECASTS - %



Sources: Northern Trust Capital Market Assumptions Working Group, Investment Policy Committee. Five year forecasts developed annually; most recent forecasts released 7/18/2016. Forecasts are developed annually by Northern Trust's CMA Working Group. There are risks involved in investing including possible loss of principal. There is no guarantee that the investment objectives of any fund or strategy will be met. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Please see important information on return forecasts at the end of this presentation.

BIOGRAPHY



James D. McDonald

Chief Investment Strategist

Jim McDonald is an Executive Vice President and the Chief Investment Strategist for Northern Trust. He is the co-portfolio manager of the Northern Global Asset Allocation Fund and he chairs the Northern Trust Tactical Asset Allocation Committee. In addition, he is a member of the Investment Policy Committee and is a trustee of the 50 South Capital Alpha Strategies and Equity Long/Short Strategies Hedge Funds.

Prior to joining Northern Trust in 2001 as the Director of Equity Research, Jim was Director of Equity Research at ABN AMRO in New York and Chicago (1994-2000) and Equity Research Analyst at ABN AMRO following the Environmental Services Industry (1990-1994). He started his professional career in 1981 with Arthur Andersen & Co. in Detroit.

McDonald received a BBA from the University of Michigan and an MBA degree with high distinction from Babson College. He is a member of the CFA® Society of Chicago and a registered CPA in the State of Michigan.

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