WHY WOULD THE FED CUT?

Financial market expectations in 2019 have pivoted from a potential U.S. Federal Reserve rate hike to a rate cut. If rates are cut, what would be the cause – financial market pressures, an economic downturn, or maybe a change in policy?

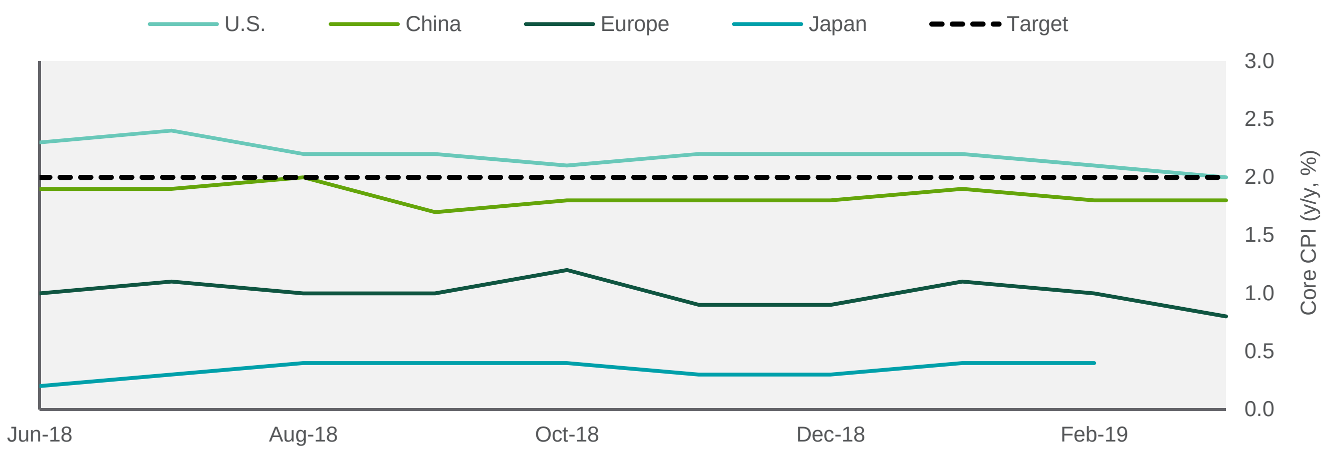
We think a changing policy framework would be the most likely catalyst. A great surprise to central bankers globally has been the benign behavior of inflation despite steadily falling unemployment rates and ultra-easy monetary policy. While disinflation (a falling rate of inflation) is beneficial to consumers, policy makers worry about the deleterious effects of deflation (falling prices), which can wreak havoc on economic activity and the ability to service debt. The risk of deflation should increase markedly during the next recession, warranting current attention. Core measures of inflation, which exclude volatile food and energy prices, have regularly undershot expectations, contributing to the inability to consistently hit the 2% target.

We think central bankers will be increasingly talking about a "symmetrical" inflation target. Achieving an overall inflation level of 2% would require allowing inflation to run above that level to offset the previous softer readings. All else being equal, this would lead to easier monetary policy. While we think global growth will positively surprise investors over the next year, expectations are low and the overall growth rate will remain moderate. This shouldn't lead to demand pressure on global prices, as the sharing global economy continues to aid supply.

Amongst the major economies, the U.S. has the most momentum in current activity measures due to the relative self-reliance of its U.S. economy. The U.S. labor markets bounced back smartly in March, indicating the weak February jobs report was anomalous. Chinese growth is tentatively showing early signs of benefitting from the government's stimulus plans, including tax cuts at both the individual and enterprise level. These actions are significant in size as they are estimated to total 2.5%-3.0% of Chinese GDP. European growth remains the laggard, as steady consumer spending/services growth continues to be held back by trade-restrained manufacturing activity. At present, a hard Brexit scenario has been avoided, as a six-month delay has been agreed (a delay has been our base case scenario). Broad resolution of the U.S./China trade dispute would be a clear positive for global growth, but a more narrow agreement seems the more probable outcome.

REFUSING TO COOPERATE – INFLATION FALLING BELOW TARGET

Only the US is at targeted inflation levels – and it's heading in the wrong direction.



Source: Northern Trust Global Asset Allocation, Bloomberg. Inflation data from 6/30/2018 through 3/31/2019. Japan data is through 2/28/2019.

RECOMMENDATIONS AND VIEWPOINTS (April 11, 2019)

Tactical decision: No changes

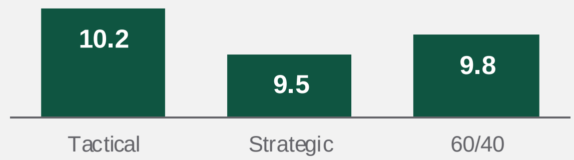
TAA maintained its measured overweight to risk, supported by the recent improvement in economic growth data. TAA recommends 2% overweights to U.S. Equities and Global Real Estate (initiated in January) alongside the 8% overweight to High Yield. All three asset classes will continue to benefit from the Fed's dovish pivot. Meanwhile, TAA retains a 1% underweight to Emerging Market Equities; recent improvement in Chinese economic data is a positive sign but TAA is looking for more confirming evidence before reasserting an overweight. Funding the rest of the overweight to risk are the underweights across all Risk Control assets – including Investment Grade Fixed Income (-5%), Inflation-Linked Bonds (-4%) and Cash (-2%).

Global growth will exceed a low bar. Investor expectations for growth in 2019 are low, especially in Europe, which allows for the prospect of a growth surprise to the upside. Even if only modestly outpacing low expectations, the combination of continued growth, low inflation and easy monetary policy argues for an overweight to risk assets. Recent data supports the view that a broad-based recession will not be a 2019 event. U.S. jobs data picked back up in the March report while Chinese economic data has also improved – including manufacturing purchasing manager index data going back above the important 50 level (dividing mark between contraction and expansion). European manufacturing and trade data remains soft but the consumer is doing better and closely-followed German economic outlook surveys from both ZEW and Ifo have inflected higher. TAA upgraded its outlook for European growth, now believing it will outpace low consensus expectations. This now means that TAA expects all major economic regions to surprise positively, but this is more a function of low expectations and does not mean TAA expects a return to the strong and synchronized global growth that characterized 2017.

The Fed will be forced to cut rates this year. A mix of political and financial market (flat yield curve) pressures will eventually force the Fed to reverse at least one and possibly two of its recent rate hikes. The Fed will be looking for cover for this change to save face and avoid spooking markets. That cover could come in the form of a move to a new symmetric inflation targeting framework – which, in TAA's view, would only be credible if the Fed combined that announcement with an intention to reduce rates (assuming inflation remains at current, below-target levels). The annual Jackson Hole Economic Policy Symposium in late-August would be an ideal time to unveil such a plan.

Performance[1]

Year-to-date returns as of 4/5/2019



Base Case

Global Growth Resilience: Just as our Mild Growth Myopia strategic theme cautioned against getting too excited over strong U.S. growth in early 2018, it also argued against getting overly worried about the recent slowdown. More recent data suggests that global economic growth is edging higher from recent softness.

Fundamentals Over Politics: Despite ongoing political issues – including Brexit, U.S.-China trade negotiations and D.C. drama – investors will continue to focus on the continued 'goldilocks' economic backdrop of slow-but-positive economic growth and stuckflation. This should allow risk assets to remain on an upward trajectory.

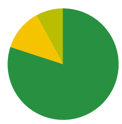
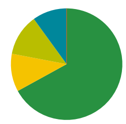
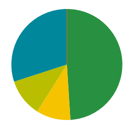
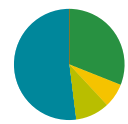
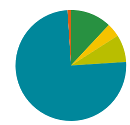
Risk Cases

Inflation: Subdued inflation has been the key driver of favorable risk asset returns over the last few years; an unexpected jump in cyclical inflation could reduce central bank accommodation, harming the risk asset outlook.

Political Miscalculation: Any economic stumbles will likely be man-made. Political battles (U.S.-China and Brexit) are at risk of going past brinkmanship into something harmful, while the risk of a Fed mistake has lessened.

Source: [1]Northern Trust Investment Strategy. Please see important disclosures on page 4.

ASSET ALLOCATION TARGET WEIGHTS (As of April 11, 2019)

	DSP Maximum Growth		DSP Growth with Moderate Income		DSP Growth with Income		DSP Income with Moderate Growth		DSP Income	
Blended Index:	90% / 10%		75% / 25%		60% / 40%		35% / 65%		10% / 90%	
										
	TAA	Over / Under Weight	TAA	Over / Under Weight	TAA	Over / Under Weight	TAA	Over / Under Weight	TAA	Over / Under Weight
Equity	80%	-2%	67%	1%	49%	1%	31%	1%	12%	1%
U.S. Equities	41%	1%	34%	2%	25%	2%	17%	2%	7%	2%
Dev. ex-U.S. Equities	27%	0%	22%	0%	16%	0%	10%	0%	4%	0%
Emerging Markets Equities	12%	-3%	11%	-1%	8%	-1%	4%	-1%	1%	-1%
Real Assets	12%	0%	11%	2%	10%	2%	7%	2%	4%	2%
Natural Resources	8%	0%	6%	0%	5%	0%	3%	0%	1%	0%
Global Real Estate	2%	0%	3.5%	2%	3.5%	2%	3%	2%	2.5%	2%
Global Listed Infrastructure	2%	0%	1.5%	0%	1.5%	0%	1%	0%	0.5%	0%
U.S. High Yield	8%	2%	12%	7%	11%	8%	10%	8%	8%	7%
Fixed Income	0%	0%	10%	-9%	30%	-9%	52%	-8%	75%	-7%
U.S. Investment Grade	0%	0%	10%	-7%	29%	-5%	48%	-4%	69%	-3%
TIPS	0%	0%	0%	-2%	1%	-4%	4%	-4%	6%	-4%
Cash & Short-Term	0%	0%	0%	-1%	0%	-2%	0%	-3%	1%	-3%

The Blended Index is a blend of MSCI ACWI (net). and Barclays U.S. Aggregate Bond Index. The MSCI ACWI Index (net) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. The Barclays U.S. Aggregate Bond Index is an unmanaged index of prices of U.S. dollar-denominated, fixed rate, taxable, investment grade fixed income securities with remaining maturities of one year and longer. Given the stated investment strategy and objectives, these indices are shown because they are considered to be some of the most common indices in the marketplace. An investment cannot be made directly in an index.

TAA – Tactical Asset Allocation represents the current target weights, given our most recent outlook for the capital markets over the next twelve months. These weights are subject to change. Actual client account weights may vary.

Over/Underweight represents the TAA weights relative to the strategic asset allocation weights, which are reviewed annually by the Investment Policy Committee (IPC) and form the baseline portfolio allocations.

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[1] The returns shown are those of the Tactical Asset Allocation (TAA) and Strategic Asset Allocation (SAA) models. TAA/SAA model returns do not show performance of actual client accounts. The returns reflect Northern Trust's Asset Allocation Committee's (a subset of Investment Policy Committee members) asset allocation decisions utilizing asset class index proxies, which cannot be directly invested in and may change over time. The 60/40 benchmark comprises the MSCI ACWI total return and Bloomberg Barclays U.S. Aggregate indices, respectively.

Asset allocation decisions take into consideration Northern Trust's Investment Policy Committee's (IPC) forward-looking annual capital market assumptions. The Capital Market Assumptions Working Group (CMAWG), a subset of IPC members, publishes its assumptions as a white paper report. Forecasts are developed annually; most recent forecasts released 7/12/2018. 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. Model outcomes do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact the future returns. The model assumptions utilize passive indexes only. References to model returns are not promises or even estimates of actual returns an investor may achieve. The assumptions, views, techniques and estimates set out are provided for illustrative purposes only. The ability to achieve similar outcomes is subject to risk factors over which Northern Trust may have no or limited control.

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