MANAGERS OUTLOOK ON U.S. ECONOMY MODERATES, U.S. EQUITY VALUATIONS LESS ATTRACTIVE

June 2016

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Investment managers are moderately less constructive regarding continued growth within the U.S. economy, according to the second-quarter 2016 managers' survey. Managers are a little less optimistic regarding housing prices, job growth, and corporate revenue growth and expect an increase in U.S. equity market volatility. They believe U.S. equity valuations are less attractive versus last quarter and compared to other equity regions. A higher percentage of managers are more defensive in their portfolio positioning, with a relatively high percentage of managers having above-normal cash positions. Managers continue to rank the potential for an emerging market slowdown as the top risk to global equity markets. The U.S. presidential election is ranked fourth, up from eighth position last quarter.

Key Findings: Second Quarter 2016 Survey

- Approximately half of investment managers believe companies are delaying key business decisions due to extensive policy and political uncertainty such as Brexit.
- 78% of investment managers believe the Fed will not raise rates or only raise rates once for the remainder of 2016.
- 58% of managers believe the popularity of passive investing has changed market behavior fundamentally.
- More than one-third of managers believe U.S. job growth will slow or turn negative.
- 42% of managers expect U.S. GDP growth to accelerate, 49% expect it to remain the same.
- 67% of managers expect market volatility to increase.
- The U.S. presidential election moved up in the rankings of risks to global equities to fourth this quarter from eighth last quarter.
- Managers are most bullish on non-U.S. developed equities and information technology sector.

DELAYED INVESTMENTS, BREXIT AND THE FED

The second-quarter 2016 survey was open for investment managers prior to the June 23 Brexit vote and subsequent market sell-off. Northern Trust surveyed approximately 100 investment managers June 3 – 17. During this period, investors were watching for the results of the June 14 – 15 Federal Open Market Committee meeting, watching the Brexit polls in Great Britain, and following the U.S. presidential primaries. In the first quarter of 2016, we asked managers if U.K. voters would favor staying in the European Union or leaving. Fully 82% of managers thought the United Kingdom would vote in favor of staying. Also, 61% of managers believed that a vote in favor of leaving would hurt the British economy.

In this quarter's survey we asked investment managers if they believe that companies they follow are delaying key business decisions due to policy and political uncertainties in the market. Although 52% did not believe companies were postponing their key business decisions due to market uncertainties, 48% believe that companies and other entities are delaying key business decisions, which could prove a possible hindrance to improving global growth. Another focus is Fed policy. Although Fed officials have spoken publicly about the need to normalize rates, recent weaker-than-expected employment data and other concerns have reduced expectations for a Fed rate increase. Two-thirds of managers, 68%, expect that the Fed will raise rates only once from June through year end. Nearly 10% expect the Fed will not raise rates at all this year, and 22% believe the Fed will raise rates twice more in 2016.

VALUE INVESTING

Over long periods, value investments tend to outperform growth investments. However, over the past several years, value investing lagged growth. When a style underperforms for an extended period of time, it often creates attractive investment opportunities. We asked investment managers if they see a higher number of value-oriented opportunities than normal. Only 23% said they are seeing a higher than normal number of value-oriented investment opportunities. Approximately 63% are seeing an average number of value-oriented opportunties. For those seeing more value-oriented opportunties, we asked if they had begun to allocate additional assets to those opportunties. Only slightly more than a quarter of managers, 27%, are beginning to allocate more to value-oriented opportunities at this time.

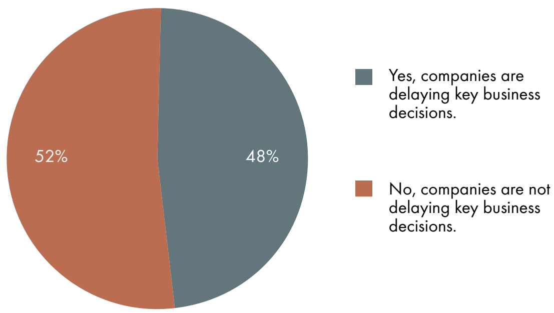
HIGHER YIELDING INVESTMENTS

Flows have been strong into investments with higher yields as investors seek alternatives to very low interest rates on bank, money market, government and investment-grade fixed-income investments. According to Fitch Ratings, the amount of global sovereign debt with negative yields surpassed $10 trillion dollars at the end of May 2016. We asked managers to rank higher-yielding sectors of the market from the most overvalued to the least overvalued. Managers ranked global real estate investment trusts (REITS) as most overvalued followed by higher-yielding stocks and global listed infrastructure. The least overvalued sectors were emerging market debt, high-yield bonds and master limited partnerships (MLPs).

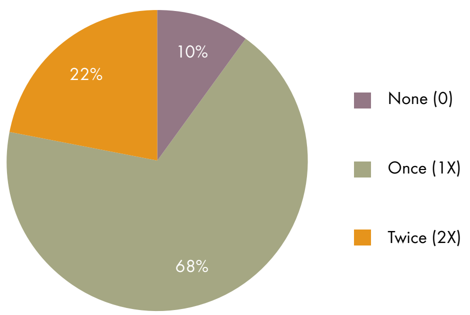
PASSIVE INVESTING

Year-to-date through the end of April, long-term passive funds have gained $117.3 billion in net inflows, while long-term active funds have experienced $34.8 billion in net outflows.

ARE COMPANIES DELAYING KEY BUSINESS DECISIONS DUE TO MARKET UNCERTAINTIES (BREXIT, FED POLICY, U.S. PRESIDENTIAL ELECTIONS)?



HOW MANY TIMES DO YOU THINK THE FED WILL RAISE RATES THROUGH THE END OF 2016?



Higher Yielding Sectors	Relative Valuation	
Global REITS	1	Most Overvalued
Higher Yielding Stocks	2	↑
Global Listed Infrastructure	3	
MLPs	4	
High Yield Bonds	5	↓
Emerging Market Debt	6	Least Overvalued

Fifty-eight percent of managers believe the popularity of passive investments has changed financial market behavior. About one-quarter of those have adjusted their investment processes to address the change. Some of these managers have adjusted processes to address or are more attuned to liquidity, trading, risk factors, quantitative investing, holding periods and setting buy and sell limits.

Investment managers believe investors should allocate some assets to passive investments, with the amount based on the asset class. The asset classes that the investment managers believe should have the lowest or no assets allocated to passive investments were emerging-market debt, U.S. small capitalization equities, high-yield and emerging market equity. The asset classes in which managers believe the most assets should be allocated to passive included U.S. large-cap equities, inflation-linked and U.S. core fixed.

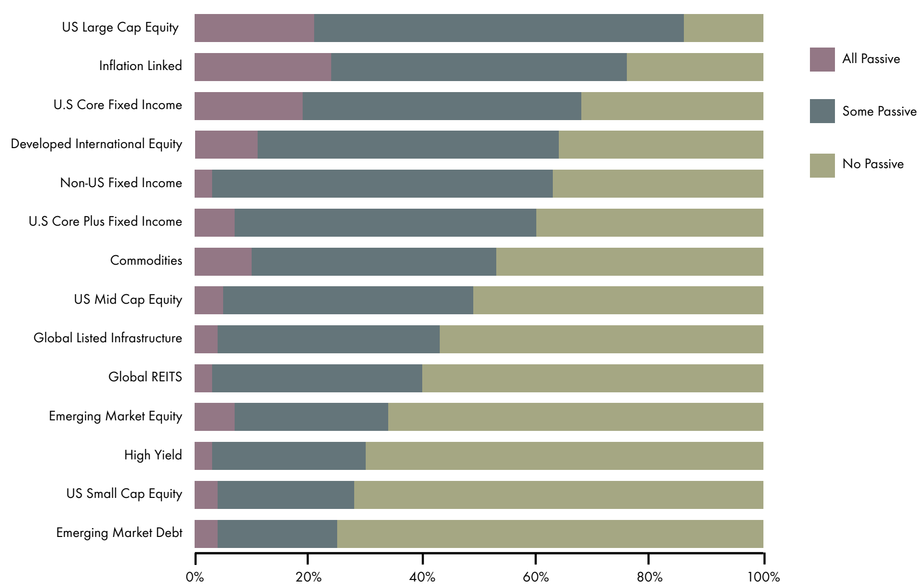
U.S. ECONOMIC GROWTH

A slightly higher percentage of managers believe that U.S. gross domestic product (GDP) growth will accelerate over the next six months: 42% versus 37% last quarter. This is an improvement over the third and fourth quarter of 2015, when only 29% and 23% of managers, respectively, expected U.S. GDP growth to accelerate, a considerable drop from previous surveys. Forty-nine percent, down from 57% last quarter, believe U.S. GDP growth will remain the same.

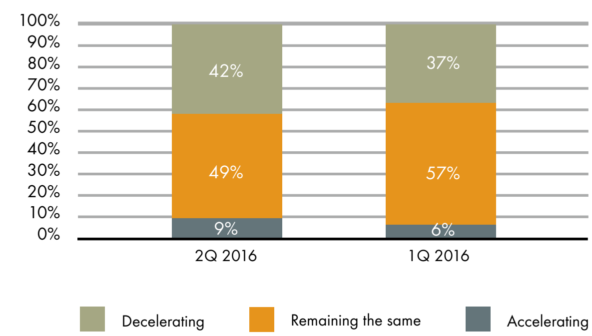
On the less-optimistic side, more investment managers than last quarter, 33% versus 27%, expect U.S. job growth to decelerate but remain positive over the next six months. Only 6% of managers expect job growth to accelerate, the same as last quarter but tied for the lowest reading since we began asking the question in the second quarter of 2011. Most managers, 59%, believe job growth will remain stable.

Ninety-five percent of managers expect housing prices to rise or remain stable over the next six months. Fewer managers, 52% versus 60% last quarter, expect prices to rise, and more managers, 43% versus 35%, expect prices to remain stable.

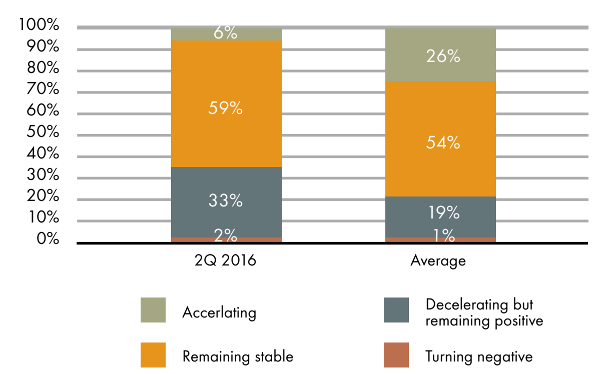
HOW MUCH SHOULD INVESTORS ALLOCATE TO PASSIVE INVESTMENTS?



U.S. GDP GROWTH EXPECTATIONS NEXT 6 MONTHS



U.S. JOB GROWTH EXPECTATIONS NEXT 6 MONTHS



CORPORATE EARNINGS AND REVENUE

Investment managers' views on corporate earnings are largely in line with last quarter. About a quarter of managers, 24%, believe corporate earnings growth will decrease, 44% believe it will remain stable and 33% believe earnings growth will increase over the next three months. A slightly higher percentage of managers, 17% versus 12% last quarter, believe corporate revenue growth will decrease over the next three months. A quarter of managers, 25%, believe revenue growth will increase versus 27% last quarter, and 58% believe it will remain the same.

INFLATION AND INTEREST RATES

Fifty-nine percent of managers believe interest rates will remain the same over the next three months. Fewer managers, 33% compared to 40% last quarter, expect interest rates to increase. The percentage of managers that believe interest rates will fall rose to 9% from 2% last quarter. Most managers, 55%, expect inflation to increase over the next six months, and another 40% of investment managers expect inflation to remain the same. Both are in line with last quarter's survey results.

- Thirty-three percent of managers believe U.S. job growth will decelerate (but remain positive) as compared to 19%, on average, over the survey's history.
- A relatively high percent of managers, 55%, expect inflation to rise.
- Seventy-six percent of managers expect U.S. corporate earnings growth to remain the same or rise.
- Slightly fewer managers, 25% versus 27%, expect corporate revenue growth will increase, and more managers expect it will decrease: 17% versus 12% last quarter.

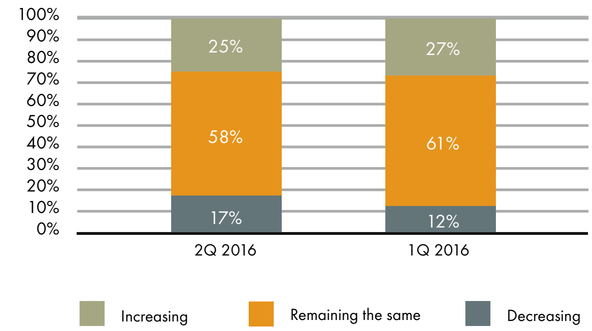
PORTFOLIO POSITIONING

A relatively high percent of managers, 21%, have above-normal allocations to cash. This compares to, on average, 12% of managers over the survey's history from the second quarter of 2009. About 73% of managers, slightly below average, have normal allocations to cash.

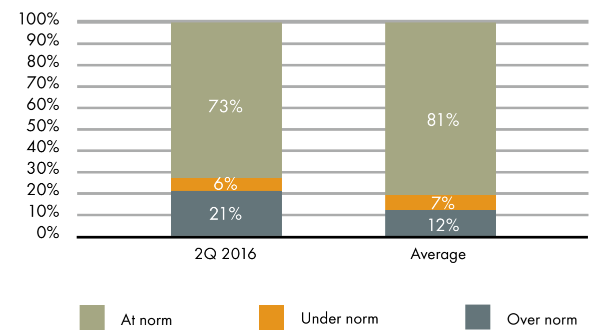
The level of portfolio concentration did not change significantly from last quarter. Seventy-five percent of managers did not change their level of portfolio concentration over the last three months. Slightly fewer managers, 16% versus 20% last quarter, increased the concentration in their portfolios over the previous three months. More managers are more risk averse than they were three months ago: 29% versus 22% last quarter. Six of 10 managers maintained the same level of risk aversion in their portfolios over the last three months.

Although in line with last quarter, a relatively high percentage of managers, 22%, increased their exposure to commodities. Over the survey's history, the average percentage of managers that increase their exposure to commodities is 14%. Only 11% of managers decreased their exposure to commodities, the lowest percentage since the fourth quarter of 2010.

U.S. CORPORATE GROWTH EXPECTATIONS NEXT 3 MONTHS



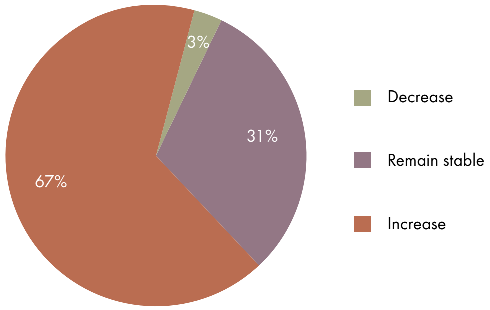
CURRENT CASH LEVEL VERSUS NORMAL



VOLATILITY

Fewer managers, only 2% versus 22% last quarter, expect volatility to decrease over the next six months. Volatility spiked last quarter as the stock market in China fell, the United States had its worst first week of the year, oil prices fell and the Bank of Japan pushed interest rates into negative territory. A market rally followed during the second half of the first quarter. Two-thirds of investment managers, up from 53% last quarter, expect the Chicago Board Options Exchange's Volatility Index (VIX) to increase over the next six months.

MARKET VOLATILITY (VIX) EXPECTATIONS NEXT 6 MONTHS



GLOBAL EQUITY MARKET RISKS

For the fourth quarter in a row, investment managers view the possibility of emerging-market economic growth slowing as the top-ranked risk to global equity markets. This quarter, the possibility of U.S. economic growth slowing rose to second from fourth in the rankings of risk to equity markets. Third ranked was U.S. corporate earnings. The concern that rose most versus last quarter was the U.S. presidential elections, which rose in the ranks of risks to global equities to fourth from eighth. The survey did not include Great Britain's vote on whether to remain or leave the European Union on the list of risks to global equity markets, missing the most-recent catalyst for a shock to global equity markets.

INVESTMENT MANAGERS' RANKINGS OF TOP RISKS TO EQUITIES

RISKS	CHANGE FROM LAST QUARTER	SECOND-QUARTER 2016 RANK	FIRST-QUARTER 2106 RANK
EMERGING MARKETS ECONOMIC GROWTH (E.G., CHINA)	-	1	1
U.S. ECONOMIC SLOWDOWN	+2	2	4
U.S. CORPORATE EARNINGS	-1	3	2
U.S. PRESIDENTIAL PRIMARIES/ELECTION	+4	4	8
GEOPOLITICAL RISKS (E.G., SYRIAN CONFLICT, TERRORISM)	+2	5	7
CHANGE IN U.S. MONETARY POLICY	-3	6	3
RISE IN INTEREST RATES	-1	7	6
EUROPEAN DEBT CRISIS	+1	8	9
OIL/COMMODITY PRICES	-4	9	5
NEGATIVE INTEREST RATES	-	10	10

GLOBAL EQUITY MARKET VALUATIONS

The percentage of managers that believe U.S. equities are undervalued hit an all-time low for the survey, which began in the third quarter of 2008. The percentage of managers that view U.S. equities as undervalued dropped to 18% this quarter from 24% last quarter. Thirty-five percent of investment managers believe U.S. equities are appropriately valued, down from 46% last quarter. At 46%, managers that view U.S. equities as overvalued reached an all-time high and was up from 30% last quarter.

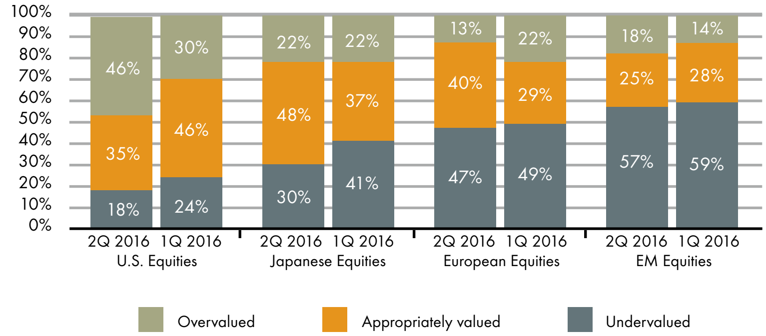
Fewer managers, 30% versus 41% last quarter, believe equities in Japan are undervalued. A complimentary shift occurred as the proportion of managers believing that stocks in Japan are appropriately valued rose to 48% from 37% last quarter. Twenty-two percent of managers view equities in Japan as overvalued.

Investment managers were largely unchanged in their views of valuations for emerging market equities. Overall, 82% of managers believe emerging market equities are appropriately valued or undervalued, a slight drop from 86% last quarter. Fifty-seven percent, the highest percentage of any region, believe that emerging market equities are undervalued.

More managers, 40% versus 29% last quarter, view European equities as appropriately valued. Fewer investment managers, 13% versus 22% last quarter, view European equities as overvalued, and 47% view European equities as undervalued, little changed from last quarter.

Most managers, 53%, believe that Asia-Pacific equities (as represented by the MSCI AC Asia Pacific Index) will perform in line with global equities (as represented by the MSCI ACWI Index). That is an increase from 42% last quarter. Fewer managers, 23% versus 31% last quarter, expect Asia-Pacific equities to outperform over the next six months.

GLOBAL EQUITY MARKET VALUATIONS



Fixed-Income Sectors	Most Attractive
Investment Grade	1
High Yield (U.S.)	2
Euro High Yield	3
Emerging Market Debt	4
Global Developed Sovereigns	5

FIXED-INCOME SECTORS

Within fixed-income markets, managers ranked sectors from most- to least-attractive. The rankings for the first three sectors remained the same from last quarter; the investment-grade sector is viewed as most-attractive, followed by U.S. high-yield and European high-yield. Emerging market debt moved to the fourth rank from the fifth ranked in attractiveness.

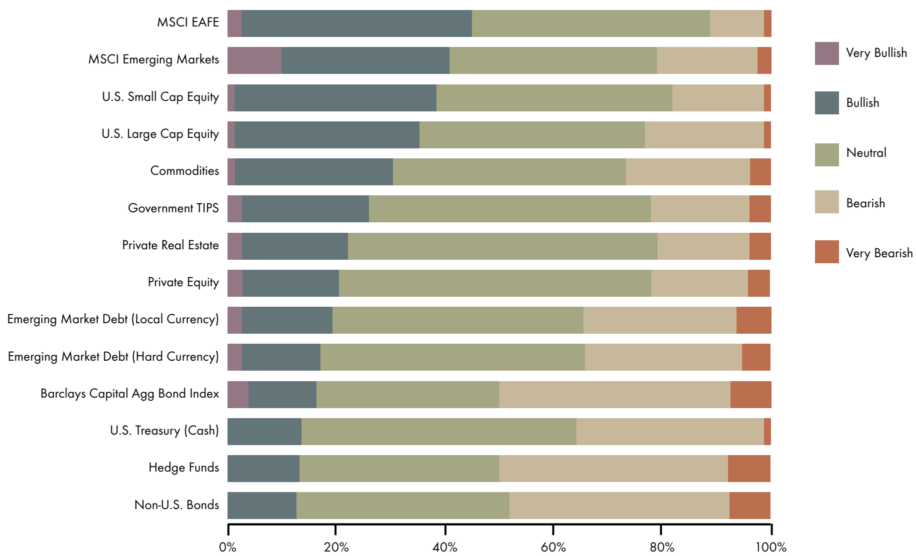
MANAGERS BULLISH ON NON-U.S.DEVELOPED EQUITIES, EMERGING MARKET EQUITIES, INFORMATION TECHNOLOGY AND HEALTH CARE

Managers are most bullish on non-U.S. developed equities (MSCI EAFE Index), and emerging-market (MSCI EM Index) equities are second, switching positions from last quarter. U.S. small- and large-cap equities rank third and fourth, respectively, in bullishness this quarter, the same rankings they held in the previous quarter. Commodities, government Treasury Inflation-Protected Securities and private real estate rank fifth, sixth and seventh, respectively. Managers are most bearish on hedge funds, U.S. bonds (Barclays Capital Aggregate Index) and non-U.S. bonds.

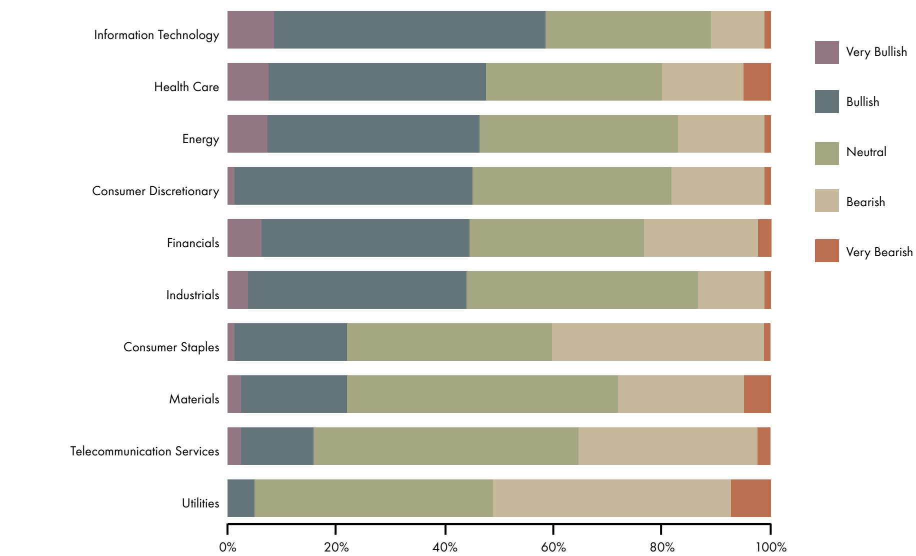
The information technology sector remained in the top-ranked position in bullishness from last quarter, health care moved up to second from fifth rank, and energy moved up to third from sixth rank in bullishness. Consumer discretionary, financials and industrials ranked fourth, fifth and sixth in bullishness, respectively. The most-bearish sectors are utilities, consumer staples and telecommunication services.

- 45% of managers' rate non-U.S. developed equities as bullish (43%) or very bullish (2%).
- 41% of managers are bullish on emerging-market equities; very bullish (10%) or bullish (31%).
- Hedge funds and U.S. bonds both have bearish ratings of 50%.
- Information technology has a bullish rating of 59%, followed by health care at 48% and energy at 46%.
- The bearish rating on utilities is 51%, followed by consumer staples at 40%.

BULL/BEAR INDICATOR (ASSET CLASS)*



BULL/BEAR INDICATOR (SECTORS)*



COMMENTARY FROM OUR MANAGERS

We asked managers this quarter to share their views on the following questions:

Within your investment universe, what opportunities, themes or trends are you most interested in as a potential source of return over the short- to intermediate term?

"Within the large/mid-cap equity universe, we believe that larger, defensively oriented stocks offer the best opportunity in the near term."
– **Geoffrey Gerber, president & chief investment officer, TWIN Capital Management, Inc.**

"1. Interesting, niche-dominant small- and mid-cap names with great management teams that can sustain 15%-plus earnings growth. 2. Companies with strong revenue growth 3. Health care companies that help solve the U.S. over spending on health care."
– **Matt Dent, president and portfolio manager, DF Dent and Company, Inc.**

"We see opportunities in the energy space, particularly companies with strong balance sheets that have survived the collapse in oil prices as oil has bounced back to $50 per barrel."
– **Bobby Mullen, portfolio specialist, Trivalent Investments, a Victory Capital investment franchise**

We also asked managers what other significant risks concern their investment teams and how these are affecting their portfolios? The following comments represent a selection of their responses:

"Brexit and U.S. elections causing loss of business and consumer confidence."
– **Jeffrey Davis, chief investment officer, LMCG Investments, LLC**

"Government policy uncertainty due to rising nationalism and the election cycle may lead to elevated volatility."
– **Brian Beitner, portfolio manager, Chautauqua Capital Management - a Division of Baird**

"Brexit, deflation, lack of robust economic growth are pervasive negative issues that continue to affect the markets. We are positioned in quality franchises where we believe the market is over-discounting these macro issues. No specific changes are being made per se, other than to take action when we see a particularly attractive value proposition."
– **Jennifer Dunne, portfolio manager, Cambiar Investors**

ABOUT THE SURVEY

For our survey, Northern Trust polled a select group of respondents, including fixed-income and equity managers across value and growth styles, with a bias toward fundamental, bottom-up stock-picking strategies. Invitations to complete the survey were only sent to investment managers that currently manage assets for Northern Trust and our clients. As a result, the survey responses should reflect the beliefs of only the managers in which Northern Trust's multi-manager investments group maintains a high conviction. The survey is conducted quarterly so that Northern Trust and participating managers can examine trends in attitudes and allocations.

Percentages in report and graphs may not add to 100 due to rounding. All data analyzed in this report is derived from the Northern Trust Investment Manager Survey.

ABOUT NORTHERN TRUST MULTI-MANAGER SOLUTIONS

Northern Trust is a leading provider of multi-manager investment solutions, with $55.9 billion under management and $53.8 billion under advisement for institutional and personal clients. Having investments with more than 200 external managers worldwide, Northern Trust's multi-manager solutions range from retail mutual funds and alternative asset classes to emerging manager programs and total investment program management for institutions and affluent individuals and families.