FUND PROFILE

Short Stories

Ultra-short bond funds appeal to cash and fixed-income investors

With cash yields still hovering near zero — but unlikely to remain there forever — funds that buy ultra-short-term bonds have attracted a following from people with markedly different objectives.

"Investors are looking for more yield than they've been getting in constant net asset value (NAV) funds," said Carol Sullivan, whose Ultra-Short Fixed Income group manages the Northern Ultra-Short Fixed Income Fund and the Northern Tax-Advantaged Ultra-Short Fixed Income Fund. "Meanwhile, investors in longer-term bonds are interested in reducing their risk exposure to the interest-rate hikes that may be on the horizon."

Sullivan thinks the two Northern ultra-short bond funds could provide relief from those concerns. Both funds buy investment-grade credits that mature within three years for fixed rate and five years for floating-rate bonds, although the target duration of each is actually closer to one year.

Seeking to add income

During a full market cycle, Sullivan estimates that the total return advantage of an ultra-short fund over a traditional money market fund could average about a quarter to half a percentage point per year.

In exchange for taking modest additional interest rate and credit risk, Sullivan believes an ultra-short bond fund may be an appropriate alternative for investing cash with a longer spending horizon.

"An ultra-short bond fund is not a substitute for cash, and it is not the same as cash," she said. "But it could be a prudent way to put money to work that won't be needed for a year, yet still belongs in the conservative portion of a portfolio."

Besides the very short-term nature of the debt obligations, Sullivan said volatility could be dampened by the two Northern Funds' significant allocations to floating-rate securities, whose yields rise with benchmark interest rates. (See fund fact sheets on pages 55 and 59.)

Reducing volatility

The rationale is different, but no less compelling, for holders of longer-duration bonds. That group might be willing to take less current yield in exchange for less volatility as interest rates rise.

Importantly, the Northern Tax-Advantaged Ultra-Short Fixed Income Fund is managed to provide tax relief for middle- and high-income taxpayers as well.

"The ultra-short strategy is time-tested," said Sullivan. "We think it could be a prudent way to put core cash to work for investors willing to take modest additional risk in return for a higher current yield. And equally prudent for bondholders thinking about taking some risk off the table."

Call it a meeting of the minds.

Past performance is no guarantee of future results.

This Fund is not a money market fund, which maintains a $1.00 NAV, and the Fund's share price will fluctuate with its returns. An investment in the Fund can result in the loss of principal.

Bond Risk: Bond funds will tend to experience smaller fluctuations in value than stock funds. However, investors in any bond fund should anticipate fluctuations in price, especially for longer-term issues and in environments of rising interest rates.

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Please carefully read the prospectus and summary prospectus and consider the investment objectives, risks, charges and expenses of Northern Funds before investing.

Call 800-595-9111 to obtain a prospectus and summary prospectus, which contain this and other information about the funds.

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