EXOGENOUS SHOCK

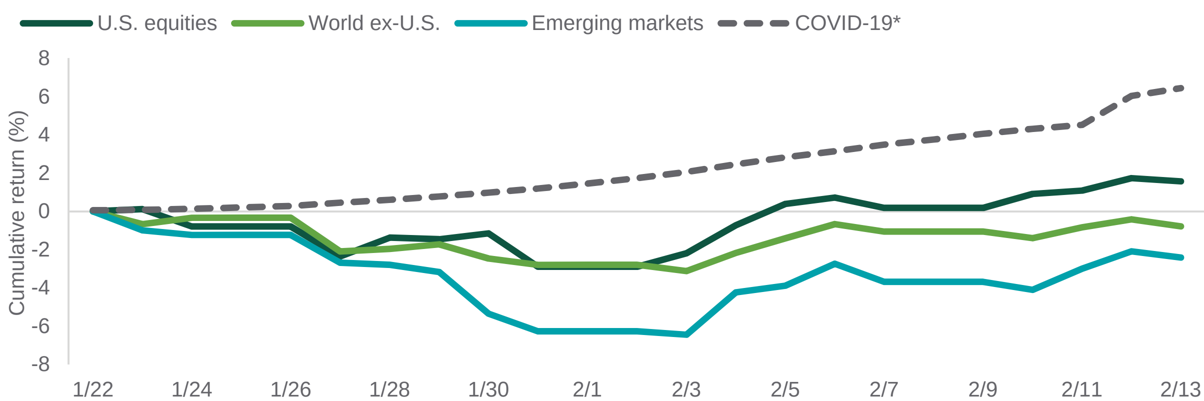
The media, and financial markets, have been consumed by the continuing spread of the coronavirus (now officially named COVID-19) and its impact on health, economic growth and financial markets. As can be seen below, financial markets have been discriminating, as the least-affected economy (the U.S.) has outperformed the most affected (emerging markets, particularly China). This matches up with the fundamental data, which shows a total of 75,300 confirmed cases with only 1,100 of those reported outside mainland China. Of the 2,000 reported deaths, all but six have been in China. The data remains of uncertain reliability, as highlighted by the spike of 15,000 reported cases on February 13th as the government changed its reporting practices. The death rate has moved up to 2.7%, still well below the level of 10% SARS caused in 2003.

From a financial market perspective, the COVID-19 situation is similar to other exogenous shocks, where the focus is determining the magnitude and duration of impact on global growth and inflation. With reported cases not having yet peaked, and news reports indicating that portions of the Chinese economy have ground to a near halt, the near-term impact on Chinese growth will be significant. Financial markets have responded by rallying interest rates and backing off inflation expectations, and there are now nearly two full 0.25% rate cuts by the Federal Reserve priced in over the next year. Reflecting the stability of the U.S. economy, this month we upgraded our U.S. outlook to a "positive surprise" relative to investor expectations while keeping the other major regions categorized as a disappointment. The U.S.'s relatively smaller exposure to Asian economies (see Equities section), alongside durable consumer income growth and spending, should make the U.S. economy an outperformer over the next six to 12 months.

With this upgraded outlook for U.S. growth, we increased our recommended overweight position in U.S. equities, funded equally from developed markets outside the U.S. and emerging markets. This keeps our overall risk level in a moderate overweight position, where we will benefit from a continued positive market environment without taking undue risk. We expect our theme of Structural Monetary Accommodation, which forecasts extended easy monetary policy globally, to support markets. Our risk cases include the impact of the COVID-19 virus on growth and policy in China, and the upcoming U.S. election, which could lead to significant policy shifts. While we are still comfortable putting new money to work in the market, we are favoring "lower-risk" risk assets and expect overall returns to be much more moderate than the robust returns of 2019.

DISCRIMINATING MARKETS

Equity investors have favored markets less exposed to COVID-19.



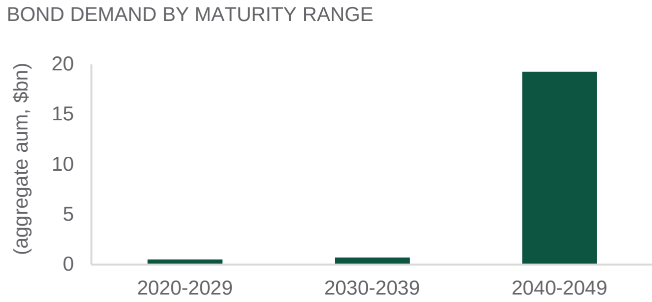
Source: Northern Trust Global Asset Allocation, Bloomberg, CDC. Indices used: S&P 500, MSCI World ex-U.S., and MSCI Emerging Markets. Indices show cumulative price returns. * COVID-19 data units measured in units of 10,000 cases.

Interest Rates

Yields have fallen across the curve, with the 10-year U.S. Treasury yield down by as much as 40 basis points (bps) at the start of February, largely prompted by the COVID-19 outbreak and uncertainties surrounding China's ability to contain the virus. This has negatively affected global growth expectations and reduced inflation expectations. The market is now pricing in an additional 42 bps cut from the Fed over the next twelve months. With talk of the outbreak stabilizing, the decline in Treasury yields has slowed, although the full impact on growth and yields remains undetermined. Demand for longer duration has also ticked up during the early months of 2020. U.S. Treasury stripping data and futures buying data show substantial flows into the back end of the curve. In particular, recent stripping data shows a massive $20B in flows over the last three months, mainly concentrated in 30-year duration bonds; and the Commodity Futures Trading Commission notes that within the futures space, asset managers and hedge funds have recently bought $5.68B in bonds and ultra-bonds. These flows have led to the repricing of the curve to its flattest levels since October 2019. History suggests an increase in market stripping activity is often indicative of back-end yield demand.

GOING LONG

Longer-maturity bonds have been in strong demand.



Source: Northern Trust Global Asset Allocation, Bloomberg. Maturity dates from 2/29/2020–11/30/2049.

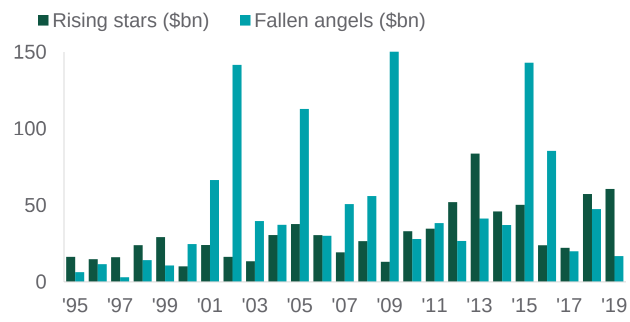
- COVID-19 has driven growth and inflation expectations lower.
- This has boosted demand for longer-dated bonds, flattening the curve.
- Our underweight to investment grade bonds is in place to fund our overweight to risk assets.

Credit Markets

The increase in the size and perceived risk of the BBB portion of the investment grade market continues to be a topic of conversation. Since 2010, this segment has more than doubled its market value to $2.5 trillion. The size of the market is more ominous than the actual rating changes within this sector. In fact, the volume of rising stars outpaced fallen angels in 2019 by the widest margin on record. Additionally, rising star volume in 2019 was the second-largest on record, behind only 2013. This ratings migration demonstrates a trend we have highlighted in the past – the growth of BBBs has been intentional. In the decade since the financial crisis, limited growth potential has incentivized management teams to lever their balance sheets in order to perform shareholder-friendly activities and invest in their businesses. The increase in BBBs resulted from capital structure decisions, not weak fundamentals, which often results in attractive investment opportunities after a downgrade occurs. Stable fundamentals, global accommodative monetary policy and recent rating migration trends suggest the potential for a significant increase in fallen angels is low in the current economic environment.

STARS BEAT ANGELS

Improving credit quality is leading to increased upgrades.



Source: Northern Trust Global Asset Allocation, J.P. Morgan. Rising stars: investment grade bonds originally issued with high yield ratings. Fallen angels: high yield bonds originally issued with investment grade ratings.

- Investors have worried about the surge in BBB-bond issuance.
- We believe the jump has been driven mostly by shareholder return concern.
- Recent trends show a jump in issuers with an improving outlook.

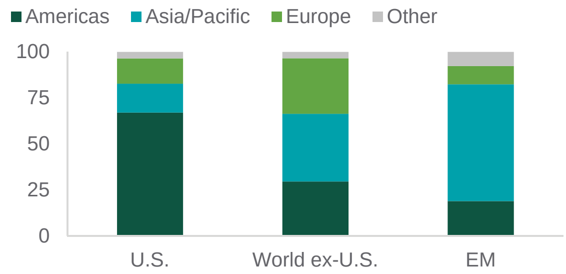
Equities

As the world struggles with the human and economic toll brought by COVID-19, U.S. equity markets have overcome modest initial losses to post new highs, and non-U.S. markets have proven resilient. At over 15% of global gross domestic product (GDP), China has more than three times the impact it did during the SARS outbreak 17 years ago. As an end market for U.S. companies, however, China is closer to 5%. The parts of the U.S. equity market that have exhibited leadership, including FAANMG stocks, have even less exposure. Among those leaders, China is only relevant to Apple, which has disproportionate exposure in terms of sales (17%), and as a supplier (nearly all of Apple products). The rest of FAANMG has minimal-to-no exposure to China as an end market and supplier. Supply chains are the most notable risk, but the recent tariff conflict led U.S. companies to diversify supply chains away from China, which should buffer the impact of COVID-19. Should the manufacturing shutdown in China persist for longer than anticipated, depletion of critical production element inventories could challenge production around the world. With the U.S. having the least direct exposure and solid underlying fundamentals, we continue to prefer U.S. equities and would underweight emerging markets.

ASIAN EXPOSURE

The U.S. market is least exposed to the Asian slowdown.

REVENUE EXPOSURE BY REGION (%)



Source: Northern Trust Global Asset Allocation, FactSet. Indices used: S&P 500, MSCI World ex-U.S., and MSCI Emerging Markets. FAANMG stocks include Facebook, Amazon, Apple, Netflix, Microsoft and Google.

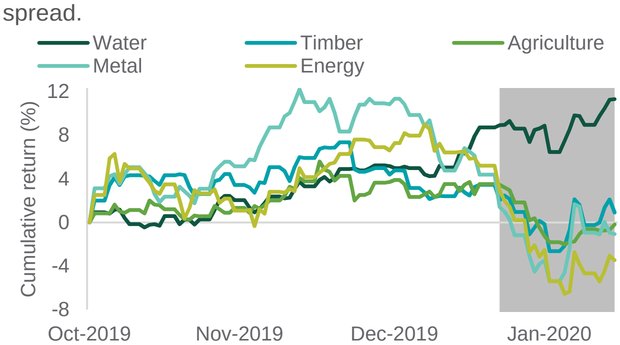
- Chinese economic activity likely slowing to a standstill.
- Predicting when COVID-19 exposure will peak isn't feasible.
- U.S. equities should continue to outperform emerging markets in this environment.

Real Assets

Equity-based natural resources play an important role in our real asset portfolio, as they are the best hedge against the potential of an upswing in inflation. They are also a leveraged play on growth, as they tend to perform well in accelerating economies. The COVID-19 outbreak (the shaded period in the chart to the right) shows both falling growth and inflation hitting the performance of commodity-oriented shares. Investors started downgrading their growth outlooks in mid-January, and this also led to a drop in inflation expectations. Specifically, the 10-year expected rate of inflation increased 24 bps over the last two months of 2019, followed by a 14 bps decline from January 2nd to today. Commodities performed well off accelerating inflation expectations during this period, but gave back those gains over the last six weeks. We are moderately underweight natural resources, as we haven't been optimistic about the global growth or inflation outlook. We didn't change that position this month, as the significant sell-off likely shows the current weakness is discounted in share prices and indicates this may not be the time to further reduce exposures. We like the diversification benefits of natural resources in portfolios, especially the inflation protection they offer relative to the more traditional futures-based commodities strategies.

ECONOMICALLY SENSITIVE

Most commodities have suffered as COVID-19 has spread.



Source: Northern Trust Global Asset Allocation, Bloomberg. Proxies used: Invesco DB Agriculture Fund, SPDR S&P Metals & Mining ETF, Vanguard Energy ETF, Invesco Water Resources ETF and Invesco MSCI Global Timber ETF.

- Natural resource stocks rallied late last year with growth and inflation expectations.
- The spread of COVID-19 has pressured these shares of late.
- We recommend a moderate underweight to natural resources for inflation-hedging purposes.

BASE CASE

Fundamentals vs Geopolitics

Resilient economic data, primarily in the U.S., has helped support financial markets and mitigate investor concerns on the global growth outlook. However, geopolitical uncertainties (e.g. the coronavirus) have the potential to weigh on investor sentiment. Overall, our tactical asset allocation favors “less-risky” risk assets.

Structural Monetary Accommodation

Major central banks globally will maintain current accommodative policy for the foreseeable future (even in the face of some above-target inflation). Central banks will also be more willing to cut interest rates or increase accommodation should geopolitical events pressure the economy or financial markets.

RISK CASES

U.S. Election Clairvoyance

Investors fully expect a highly competitive, down-to-the-wire 2020 election cycle. Events that solidify the expected outcome sooner will likely cause significant shifts in asset prices and flows.

China Coronavirus Challenges

Short-term China growth impacts from the coronavirus combine with ongoing tariff headwinds to form challenges for China’s leadership that eventually lead to longer-term growth headwinds.

INVESTMENT PROCESS

The asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic returns are developed using five-year risk, return and correlation projections to generate the highest expected return for a given level of risk. The objective of the tactical recommendations is to highlight investment opportunities during the next 12 months where the Investment Policy Committee sees either increased opportunity or risk.

The asset allocation recommendations are developed through the Tactical Asset Allocation, Capital Markets Assumptions and Investment Policy Committees. ViewPoints reflects data as of 2/17/2020.