JUNE 2024

RATE CUTS BEGIN

The European Central Bank and Bank of Canada cut rates this month, signaling that the monetary easing cycle is likely underway as long as inflation comes down. The two central banks have diverged from the Fed, but we believe the Fed is also likely to cut rates later this year. Monetary tightening is likely behind us, with the exception of Japan.

In the U.S., we remain focused on inflation and the labor market. There are some soft spots in the labor market with the unemployment rate rising by 0.4 percentage points on a three-month average basis. But, as seen in the most recent May payroll report, job gains are still running well above the breakeven rate for the U.S. economy (estimated to be ~100-125k), which was helped by immigration flows on the margin. Economic growth is normalizing from the red hot pace of the past two quarters. Progress on inflation has been spotty, but it has resumed in the most recent readings. We expect inflation to continue to get closer to the Fed target by the end of the year. With this backdrop, our fixed income team expects about two cuts this year.

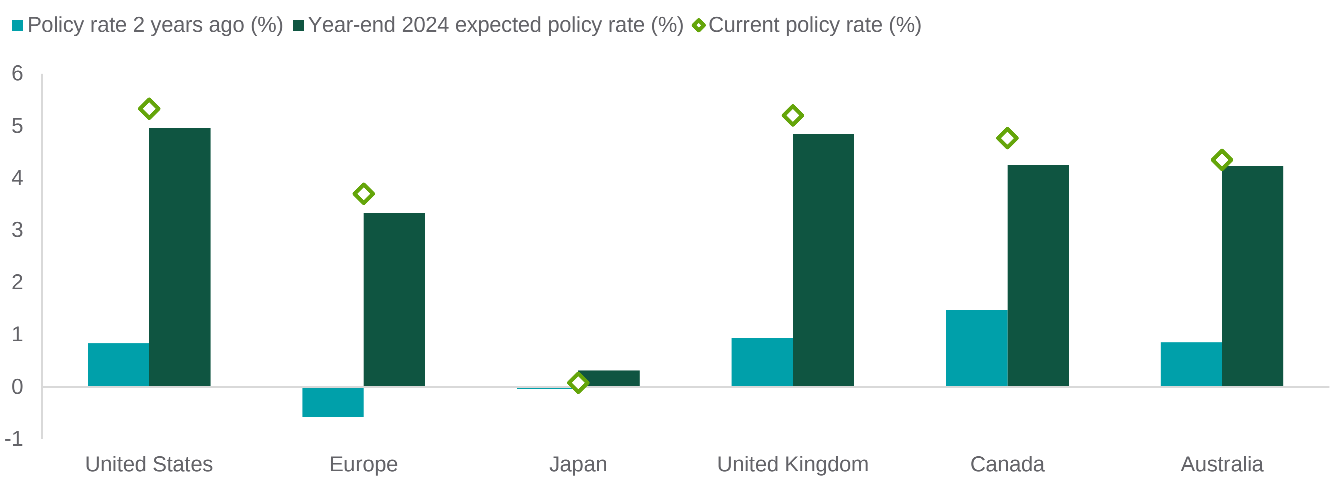
Global Purchasing Managers' Index (PMI) readings are in expansion after being below 50 for two consecutive years. Europe is out of recessionary territory and expected to show positive growth this year. Euro Area inflation ticked up in May and puts into question the pace of easing, but the bias is still to cut rates further for the remainder of the year. Japan is an outlier where we are encouraged to see inflation pick up. This allows for the Bank of Japan to consider tightening policy after decades of deflationary fears. Inflation is stickier in the U.K. and rate cuts expectations have been pushed back but not abandoned. China's economy is showing reliance on exports but not showing much improvement in the property segment which is keeping consumer activity subdued. We expect the ongoing housing downturn to remain a multi-year drag on growth, and continue to think that more policy easing will be necessary to stabilize China's property sector.

There were some election surprises this month, but we did not think there was enough information from these events in terms of changes to fiscal policy to warrant a portfolio adjustment. Earnings revisions are positive and revision breadth is increasing. Looking ahead we see about 12% earnings growth in the U.S. and 11.7% globally. This bodes well for improvement across sectors and globally, potentially broadening the rally. We made no changes to our asset allocation positions this month – we prefer equities over bonds, high yield bonds over investment grade, and we are underweight natural resources.

Anwiti Bahuguna, Ph.D. – Chief Investment Officer, Global Asset Allocation

THE WORST OF TIGHTENING HAS PASSED?

Policy rates are expected to ease moving forward, representing a very different policy environment than the past two years.



Source: Northern Trust Asset Management, Bloomberg. Market expectations implied by futures and overnight index swaps. Data as of 6/7/2024.

Interest Rates

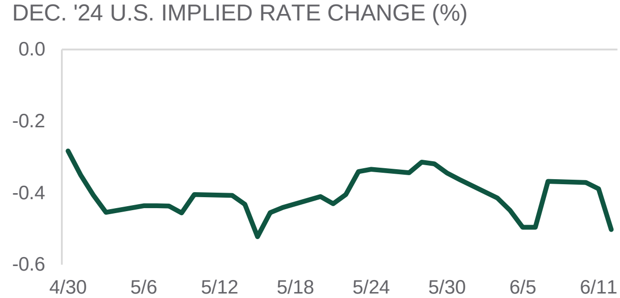
Markets have spent the weeks between the May and June [1]FOMC meetings anticipating one or two quarter-point rate cuts by the end of 2024. During this time, money markets have been very sensitive to incoming economic data, adjusting expectations for cuts when data releases surprised in either direction. We think this sensitivity is warranted as we expect the Fed to proceed carefully with rate cuts, predicated on the incoming data giving them the required confidence that inflation is on a sustainable path to their target in order to deliver policy normalization.

Heading into the May FOMC meeting, disappointing progress on inflation in the first quarter prompted Fed funds futures markets to price in only one quarter point cut this year. Since then, different inflation prints have been understandably influential on market pricing. Data related to the labor market has also moved markets during this period, as Fed Chair Powell noted during a recent press conference that unexpected weakness in the labor market could prompt an adjustment to monetary policy. We view markets pricing between one and two quarter-point rate cuts this year as reasonable, and consistent with our own modal expectation for two cuts.

- Dan LaRocco, Head of U.S. Liquidity, Global Fixed Income

BOUNCING AROUND

Market pricing for rate cuts this year has been volatile.



Source: Northern Trust Asset Management, Bloomberg. December 2024 U.S. implied policy rate change. Data from 4/30/2024 through 6/12/2024. [1]FOMC = Federal Open Market Committee.

- Policy rate expectations have been very sensitive to incoming economic data.
- Progress on inflation will be key to the Fed lowering its policy rate.
- Our base case is that the Fed will deliver two rate cuts this year starting in September.

Credit Markets

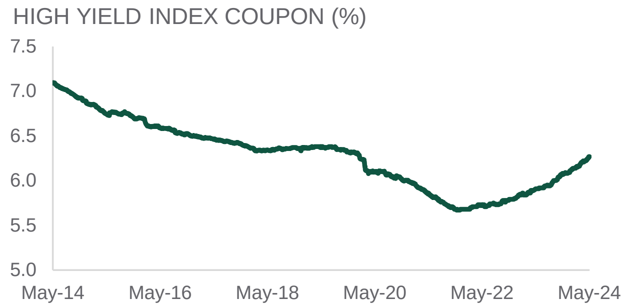
The economic backdrop continues to be supportive of risk broadly, as High Yield (HY) posted positive returns in May. The strength of the primary market continues to be topical, with HY bonds in May registering their largest gross supply in nearly three years. The vast majority of this issuance continues to be refinancing related, with net issuance year-to-date of $27 billion in bonds. Accommodative capital markets have enabled companies to address near-term refinancing needs, helping to extend the maturity wall. With the amount of issuance and where yields are currently, the average coupon has risen (see chart).

Outside periods of shocks, the majority of HY returns have come from income generation since 2000. Excess returns beyond coupon for HY are positive roughly 50% of the time, highlighting the importance coupons have in cushioning the total return profile. Balance sheets for U.S. HY issuers are also in a strong state, heading into what could be a more challenging environment given refinancing at higher rates. Leverage remains comfortably below the long-term average despite a slight uptick and interest coverage metrics remain well above the historical average, which should be supportive of high yield valuations.

- Eric Williams, Head of Capital Structure, Global Fixed Income

COUPON CUSHION

The average high yield coupon has risen.



Source: Northern Trust Asset Management, Bloomberg. Data from 5/30/2014 through 5/31/2024. Past performance is not indicative of future results.

- High yield gross issuance continued to be robust in May.
- With the amount of gross issuance and where yields are currently, the average coupon has risen.
- We continue to like high yield for its income, and we believe that valuations are supported by fundamentals.

Equities

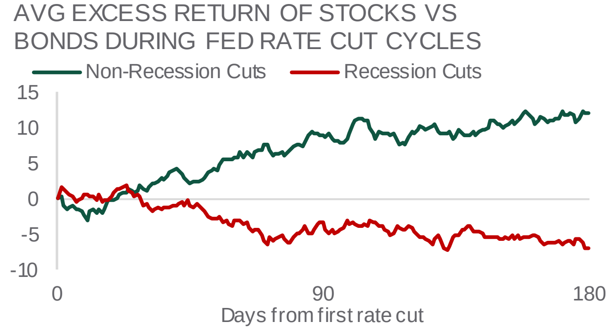
Global equities gained 3.0% over the trailing one-month period through June 12th. U.S. equities were up 3.8% and continued to lead at the regional level. Europe and Japan were up a little over 1.5%, while emerging markets were basically flat (+0.1%). Global risk sentiment was generally positive over the one-month period. After hotter than expected price data in the first quarter of the year, inflation resumed its downward trend in the U.S. Global economic activity held up reasonably well, including a strong U.S. employment report and supportive global Purchasing Managers' Indexes and trade data. Equity markets coalesced around the growth without inflation narrative.

The European Central Bank and Bank of Canada recently became the first major central banks to cut their policy rates this cycle. We remain of the view that the other major developed market central banks (ex-Japan) will follow suit as inflation eases. Per the chart, U.S. stocks have gained 12% in the 180 days following the first Fed rate cut when a recession is avoided, versus a 7% drawdown when it is not. We maintain our soft landing view in which growth stays positive and the Fed maintains an easing bias, and we continue to prefer stocks over bonds.

- Colin Cheesman, Portfolio Manager, Asset Allocation

THE GROWTH VARIABLE

If growth holds up, stocks can do well when the Fed cuts.



Source: Northern Trust Asset Management, Bloomberg. Data shown for Fed easing cycles since 1981. Stocks are proxied by the S&P 500 Index, bonds are proxied by the Bloomberg U.S. Treasury Index. Recession cuts are when a recession occurred during or around the easing period. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

- On average, stocks have outperformed bonds during Fed rate cuts when a recession is avoided.
- We retain our soft landing base case and think that non-recessionary rate cuts are the most likely outcome.
- After adding 5% to global equities last month, we made no changes. We continue to prefer stocks over bonds.

Real Assets

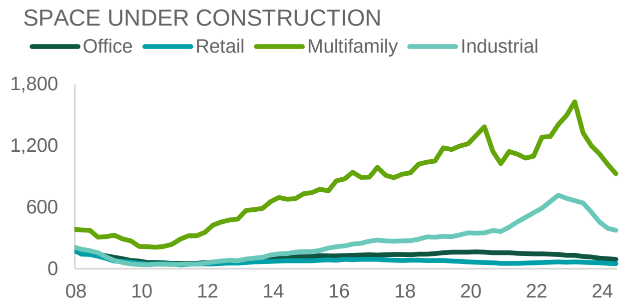
Outside of the office sector, real estate (RE) fundamentals have been resilient with the other major sectors delivering net operating income growth on a year-over-year basis coming out of the pandemic. Multifamily owners have been citing the relative cost of ownership as a driver of continued demand. With higher mortgage rates and property pricing, renters moving out to purchase a home remain well below historical averages. The industrial sector has been especially strong over the last few years with e-commerce and "last mile" demand drivers firmly in place.

The dispersion in rental growth among the various property types is often driven by supply-demand imbalances. One of the most pressing issues in the first half of 2024 is how the multifamily and industrial sectors can weather the supply overhang in the near term, with substantial pockets of supply, especially in the Southeast and Sunbelt markets. Record real estate supply could restrict growth throughout 2024 and perhaps well into 2025. However, owners should see significant relief in 2026/2027 as higher cost and less liquid capital markets have driven declines in permitting.

- Jim Hardman, Head of Real Assets, Multi-Manager Solutions

POST-PANDEMIC REAL ESTATE SUPPLY EXCESS

Short-term supply is restraining RE fundamentals.



Source: Northern Trust Asset Management, CoStar, Goldman Sachs Global Investment Research. Space under construction is measured in square feet (millions). Data from 12/1/2007 through 6/1/2024.

- RE fundamentals have been healthy and landlords have been able to grow net operating income.
- Some property types are experiencing a short-term supply overhang that is limiting rental growth.
- Current supply pipelines and permitting have substantially slowed – this should provide a healthier market in the years to come. Tactically, we remain equal-weight global real estate.

BASE CASE EXPECTATIONS

Sticking the Landing

Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength and labor market/consumer resilience. Inflation will remain above target but continue to proceed toward 2%.

Central Bank Transitions

Major central banks have started to cut policy rates and we expect more to follow suit as the year progresses. Economic growth may afford policymakers more time to confirm that inflation progress is sustainable.

RISK CASE SCENARIOS

Stubborn Inflation

Inflation does not move lower as a result of several potential factors: economic resurgence, tight labor markets keeping pressure on services, and/or goods and commodity disruptions from conflict in the Middle East.

Lagged Impacts

The market's enthusiasm for a soft landing proves to be misplaced as the cumulative effect of rate hikes starts showing up in economic functioning.

GLOBAL POLICY MODEL

Strategic Allocation and Tactical Over/Underweights	FIXED INCOME				EQUITIES			REAL ASSETS			
	Cash	Inv. Grade	Infl. Linked	High Yield	U.S.	Dev. Ex-U.S.	Emerg. Markets	GLI	GRE	NR	Gold
Strategic Asset Allocation	2	30	9	5	28	13	5	2	2	4	0
Tactical Asset Allocation	0	26	7	10	31	14	6	2	2	2	0
Over/Underweight	**-2**	**-4**	**-2**	**5**	**3**	**1**	**1**	**0**	**0**	**-2**	**0**

Source: Northern Trust Capital Market Assumptions Working Group, Investment Policy Committee. Strategic allocation is based on capital market return, risk and correlation assumptions developed annually; most recent model released 8/9/2023.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. Asset allocation does not guarantee a profit or protection against a loss in declining markets. GLI = Global Listed Infrastructure, GRE = Global Real Estate, NR = Natural Resources.

UNLESS NOTED OTHERWISE, DATA IN THIS PIECE IS SOURCED FROM BLOOMBERG AS OF JUNE 2024.