

A large, light blue anchor logo is centered in the background, enclosed within a circular frame. The anchor has a crossbar with four flukes and a rope coiled around its shank.

# Investment Outlook: *Tug of War*

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Northern Trust



# Investment Outlook Summary

## ■ The Debt Hangover:

- ◆ Slower growth, but falling inflation

## ■ Two Speed Economy:

- ◆ Can the U.S. and China lead the way?

## ■ Special Focus:

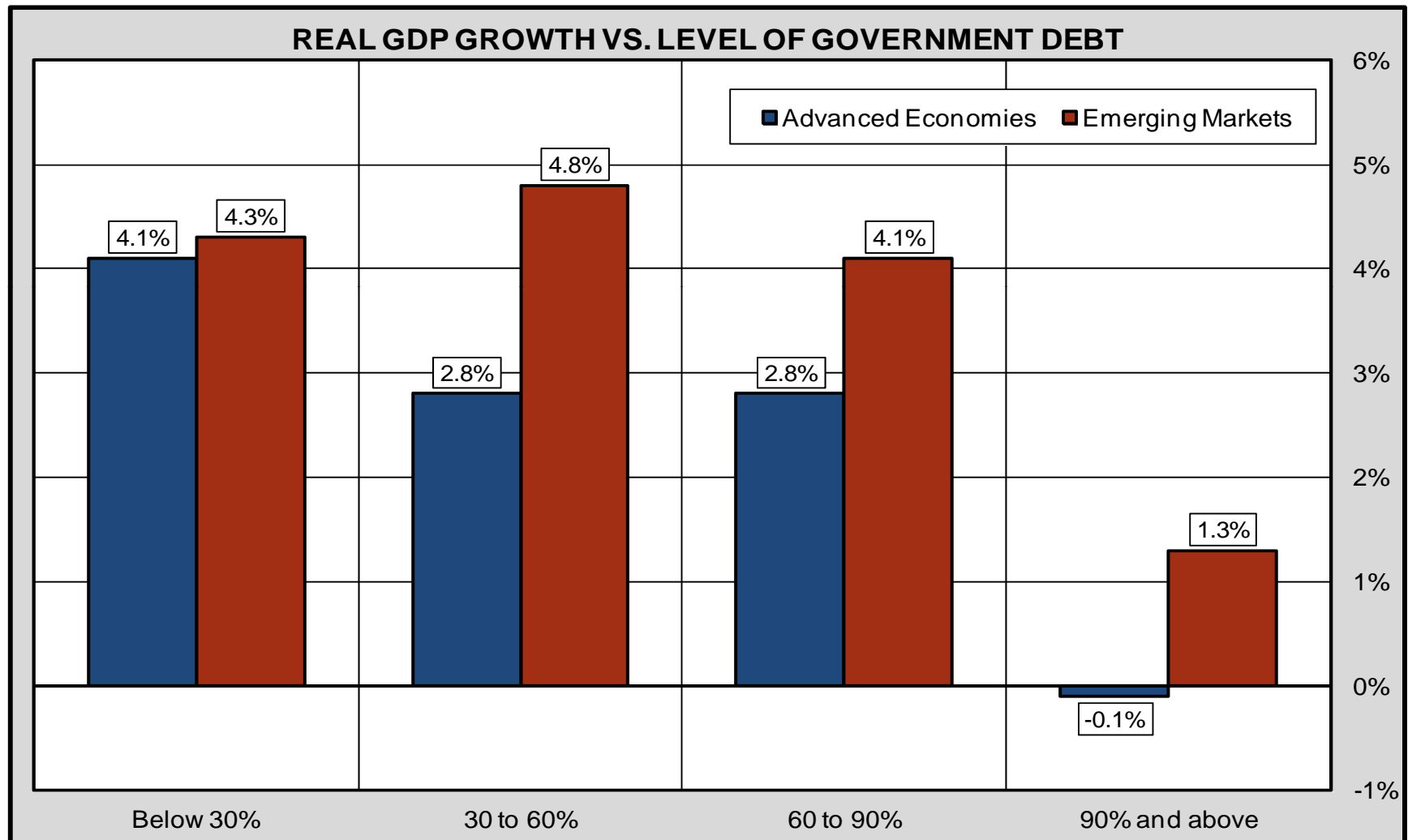
- ◆ Investing in a low-yield world

## ■ Asset Allocation:

- ◆ Looking to manage downside risk while participating in the market's upside potential



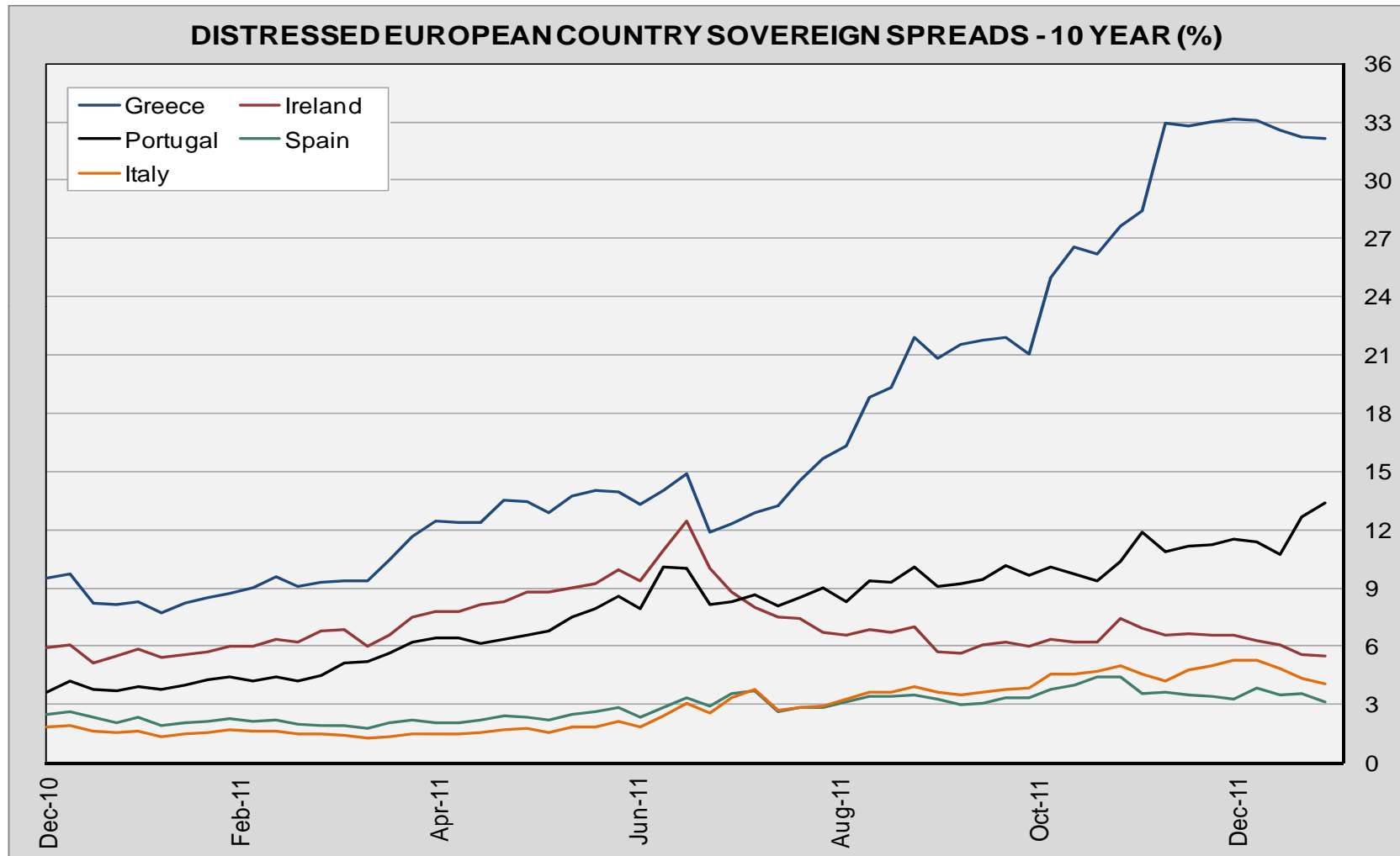
# Debt Drags Down Growth



Source: Reinhart and Rogoff, December 2009 – average GDP growth. Northern Trust Global Investments.



# Need to Manage Greece's Upcoming Default

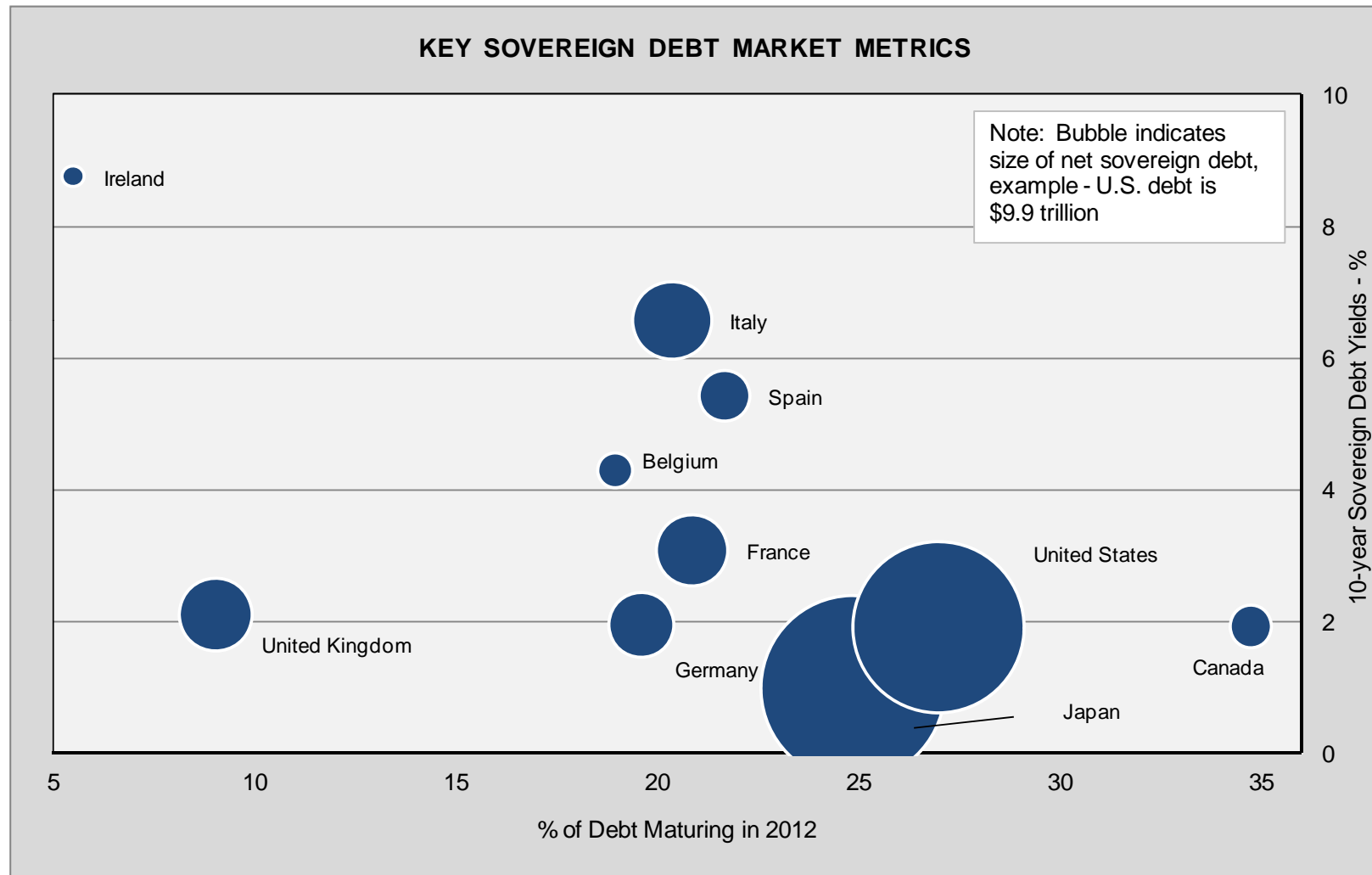


Source: Bloomberg, Northern Trust Global Investments. Data as of 01/27/2012.

Note: Lack of an "on the run" Irish 10-year bond required the use of the Irish 9-year bond in this illustration.



# Refinancing Risks in Europe



Source: Northern Trust Global Investments, Bloomberg. Data as of 12/15/2011. Greece (34.7% 10-year yields, 13% debt maturing in 2012) and Portugal (13.1%, and 15%) not shown on chart. Note: 9-year Ireland yield used.



## Less Stress in the U.S.

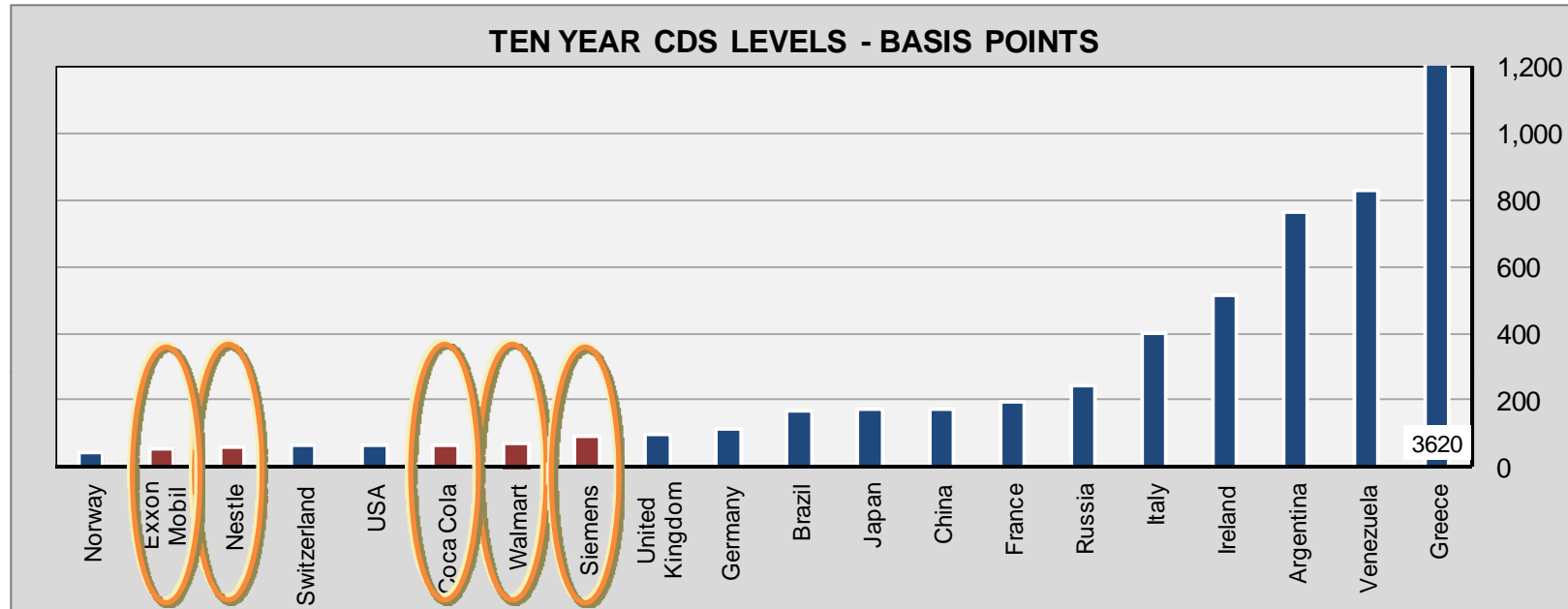
### U.S. FINANCIAL MARKET STRESS INDICATORS

Market Indicator		Current	3/2/2009	+/-	10/6/2008	+/-
Money Market Indicators	3 Month TED Spread	0.50	1.03	+	3.82	+
	Libor-Overnight Index Swaps Spread	0.46	1.01	+	2.89	+
	Commercial Paper/T-bill Spread	0.24	0.35	+	3.56	+
Bond Market Indicators	Investment Grade Option Adj. Spreads	1.92	4.57	+	4.14	+
	High Yield Option Adj. Spreads	6.42	15.81	+	11.99	+
	Municipal Bond/Treasury Spread	0.34	0.58	+	1.00	+
Stock Market Indicators	S&P 500 Index (3 Month Price Return)	4.8	-19.5	+	-15.6	+
	KBW Bank Index (3 Month Price Return)	5.8	-49.7	+	15.6	-
	S&P 500 Volatility Index	19.4	52.7	+	52.1	+

Source: Bloomberg, Northern Trust Global Investments; data as of 1/30/2011.



## In a world of rampant government debt, large cap multi-nationals may just be the new risk free asset



### Theme Key Points:

Government debt has dominated the headlines over the past few years as the great recession shined the spotlight on government profligacy.

As a result, there is a changing perception of the risk of government debt.

Increasingly, the line between the credit worthiness of sovereigns and several global companies (e.g. Nestle) has been blurred.

### Investment Implications:

In the near term, the liquidity of U.S. Treasuries still gives them safe-haven status in times of economic turbulence – ironically displayed by the drop in the 10 year UST yield after the rating downgrade.

However, the debt and equity of multi-national corporates may begin to play a bigger role in investment portfolios – particularly equity, as investors are attracted to decent dividend yields and greater longer-term inflation protection vis-à-vis fixed income.

Source: Bloomberg, Northern Trust Global Investments; data as of 01/30/2012.



## Fundamental Outlook

## Two-Speed Economy

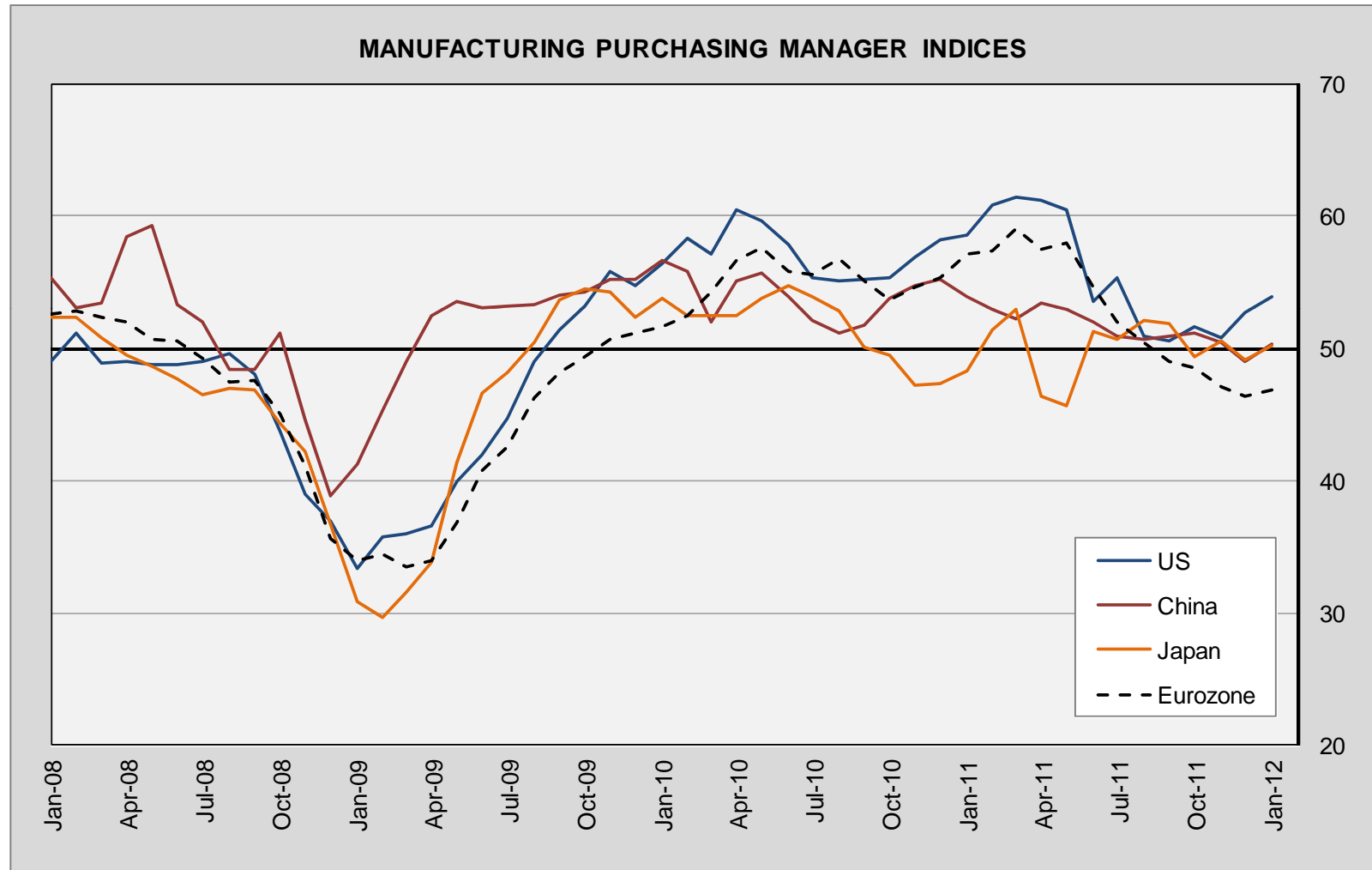


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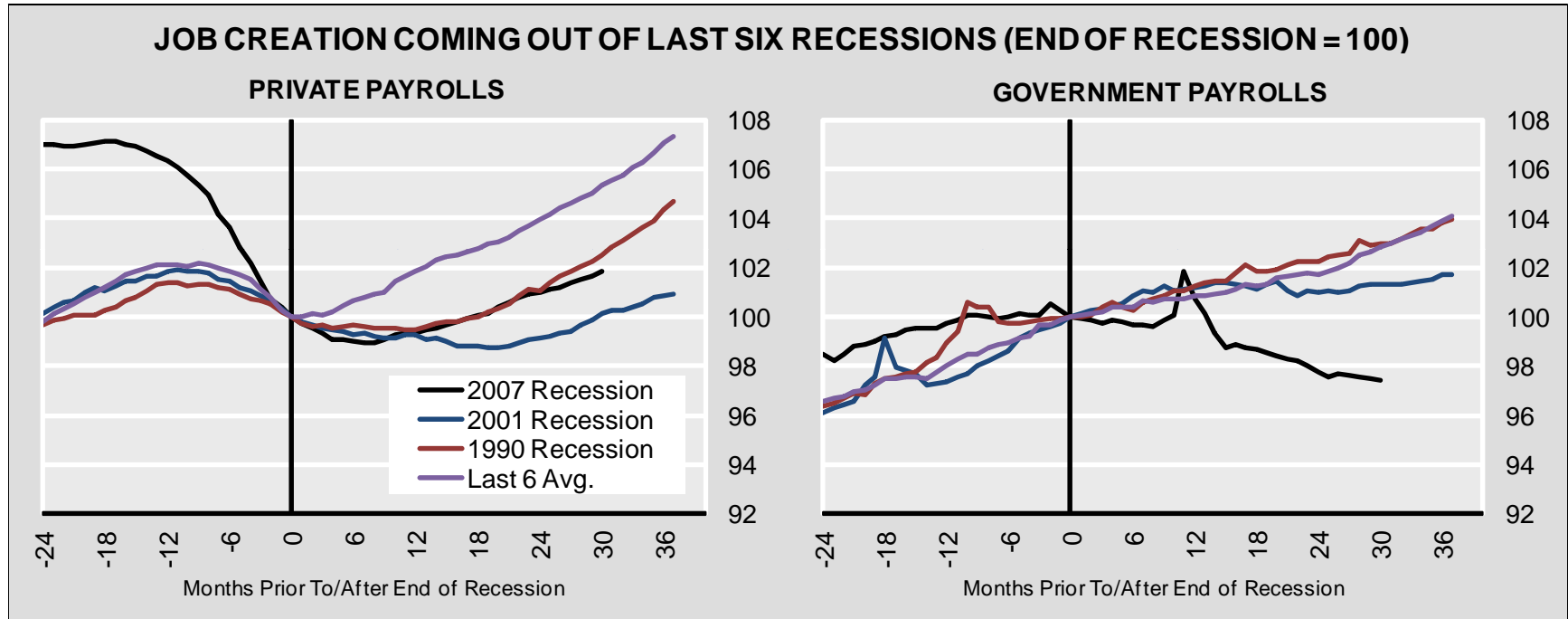
# Manufacturing strongest in the United States



Source: Bloomberg, Northern Trust Global Investments, Bloomberg. Data through 12/31/2011.



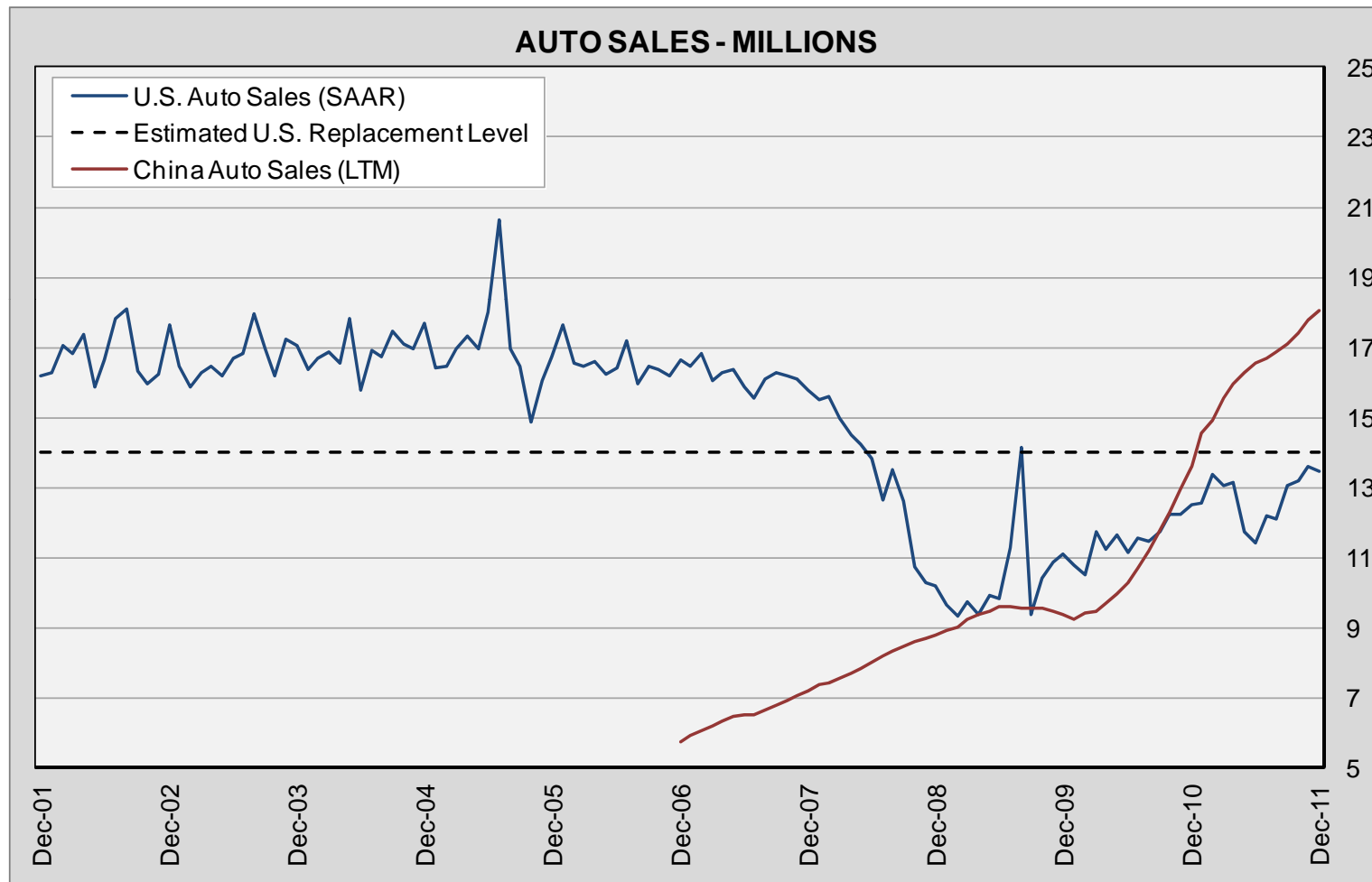
# Private Hiring, Public Firing



Source: Bloomberg, Northern Trust Global Investments. Data through 12/31/2011.



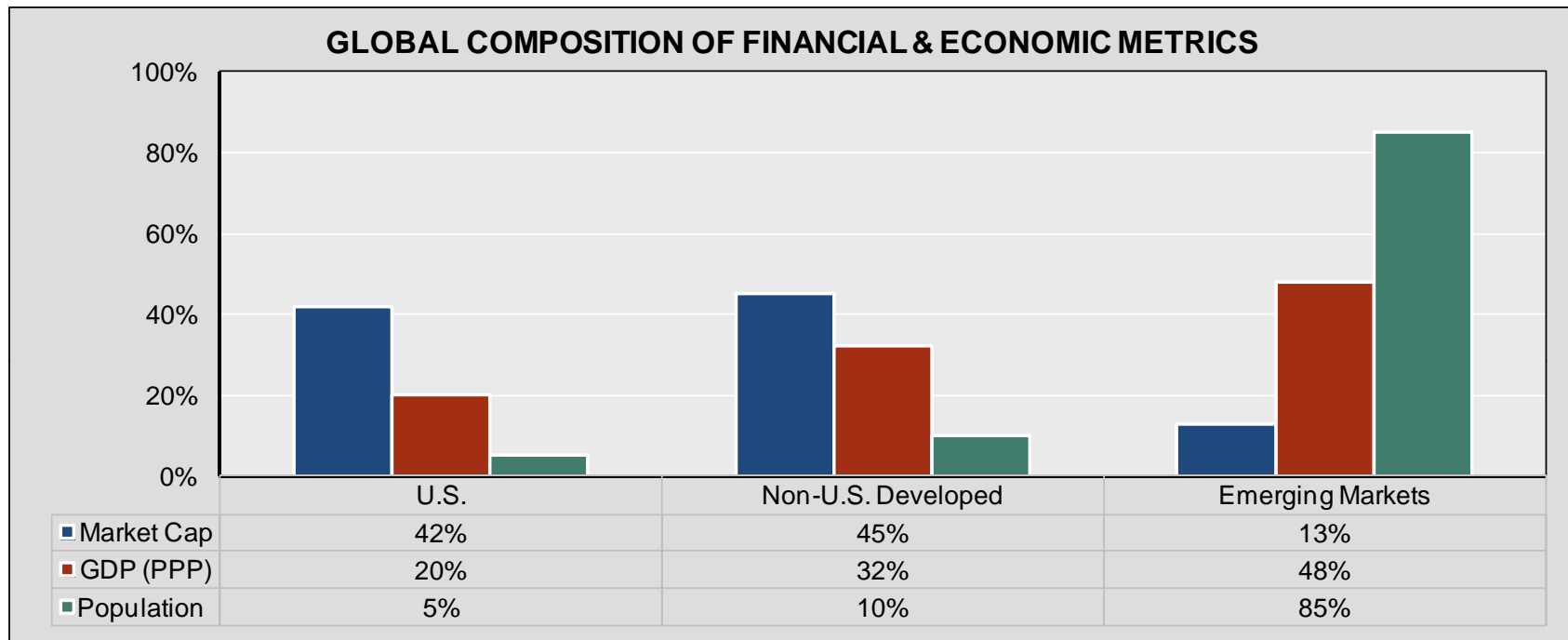
# Pent Up Demand



Source: Bloomberg, Northern Trust Global Investments. U.S. auto sales through 12/31/2011. China auto sales through 12/31/2011.



# Taking Advantage of the Global Economic Rebalance



## Theme Key Points:

Growth in world GDP has clearly been driven by emerging market economies.

The disproportionate growth out of emerging markets led to the global imbalances that were, in part, responsible for the recent financial crisis.

Reversal of these global imbalances (including China's recent resumption of Renminbi appreciation) are underway.

Source: MSCI, IMF. Data as of 2010.

## Investment Implications:

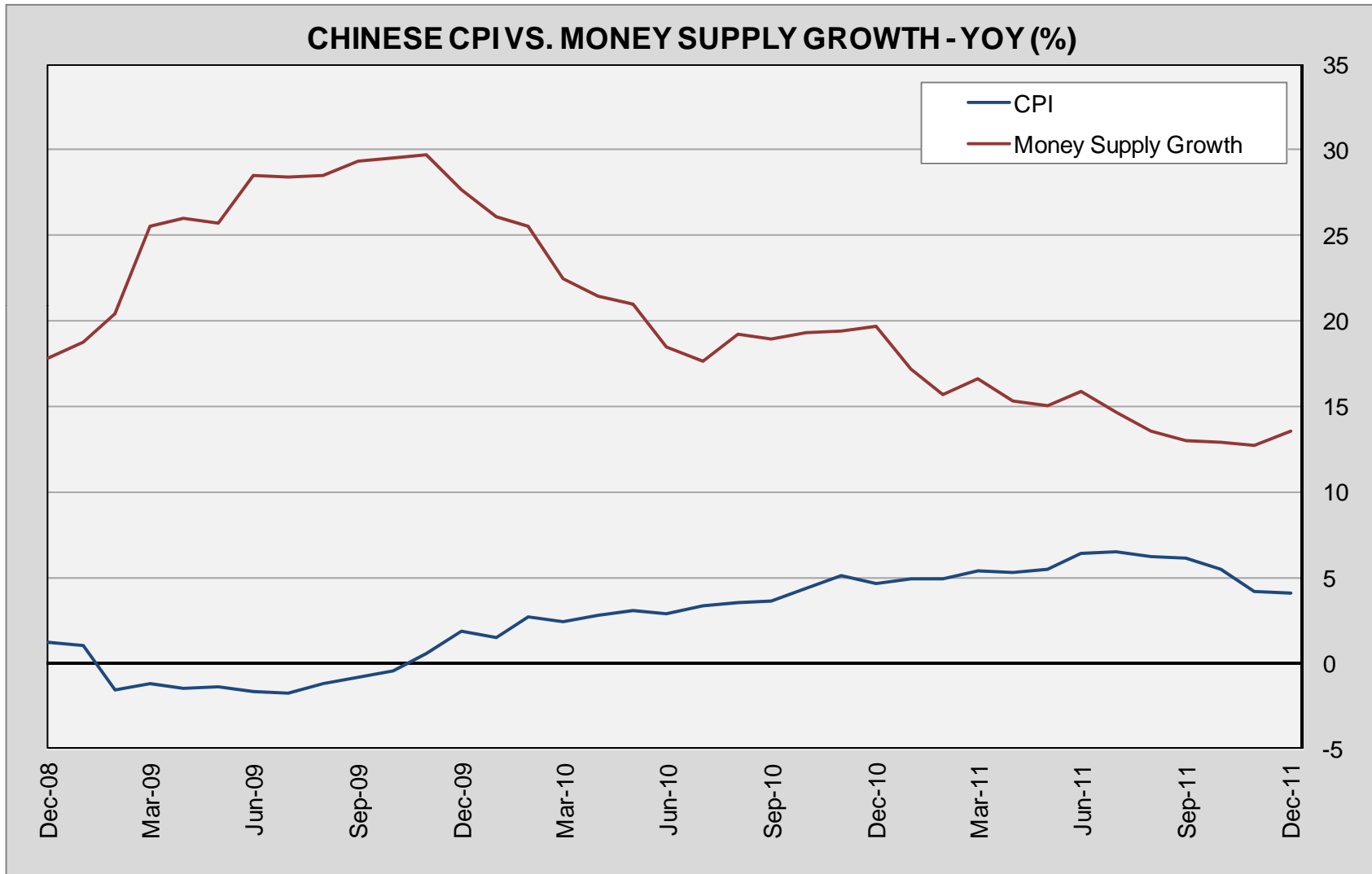
Domestic companies that have a high proportion of international sales are a beneficiary of this trend.

Emerging market equities, with still reasonable valuations, are a long-term beneficiary should this scenario play out.

We prefer emerging market equity over debt due to its better risk-adjusted return outlook.



# China's Foot Has Been On The Brake



Source: Bloomberg, Northern Trust Global Investments. CPI as of 12/31/2011, Money Supply as of 12/31/2011.



## Special Focus

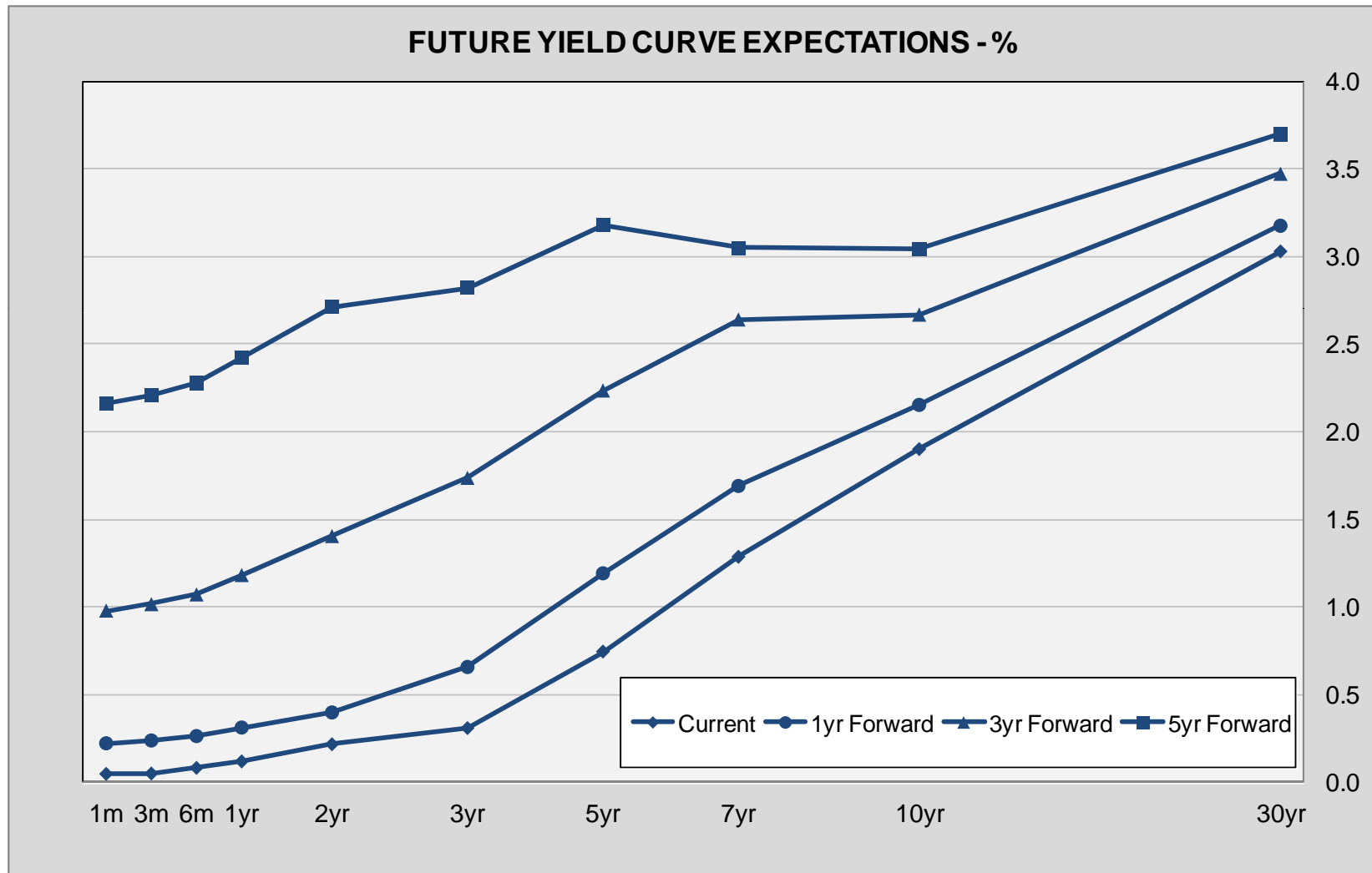
# Investing in a low-yield world



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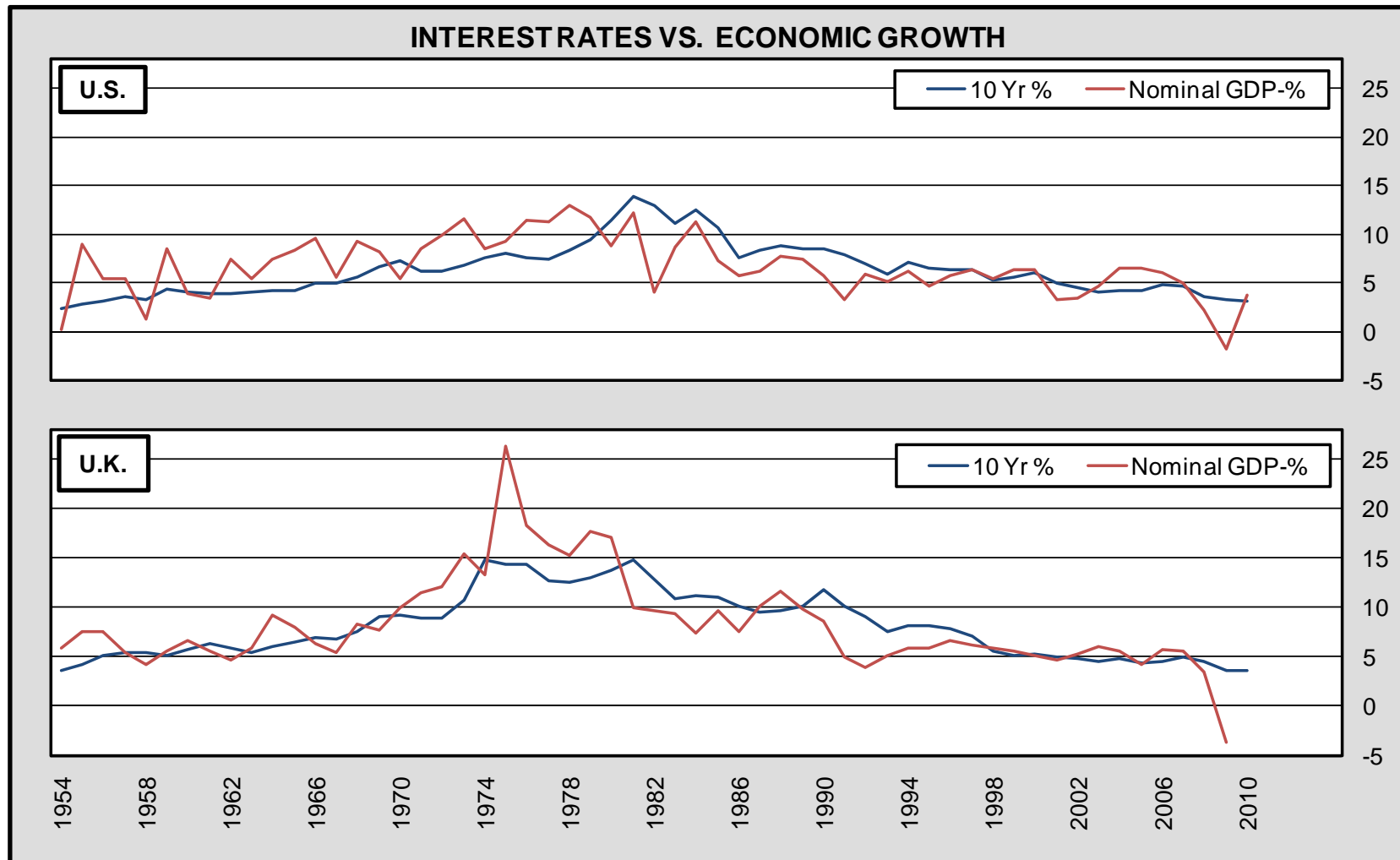
# Markets expecting a Bear Flattening



Source: Bloomberg. Data as of 1/30/2012.



# Growth and Inflation Drive Interest Rates

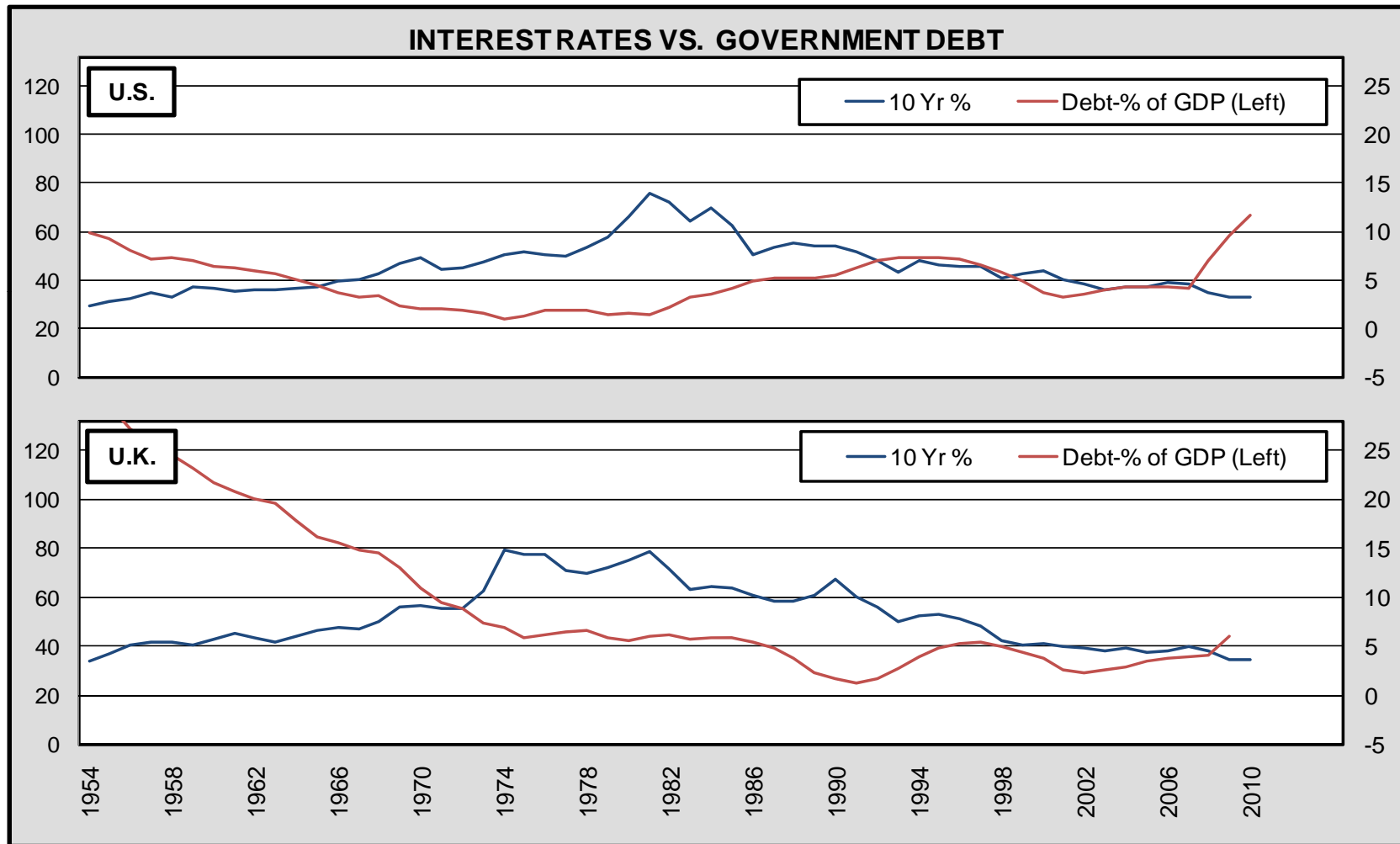


Source: Bloomberg, Haver Analytics, Measuring Worth, Northern Trust Global Investments.





# Deficits Don't Drive Interest Rates



Source: Bloomberg, Haver Analytics, Measuring Worth, Northern Trust Global Investments.



# Labor Costs Required to Drive Inflation

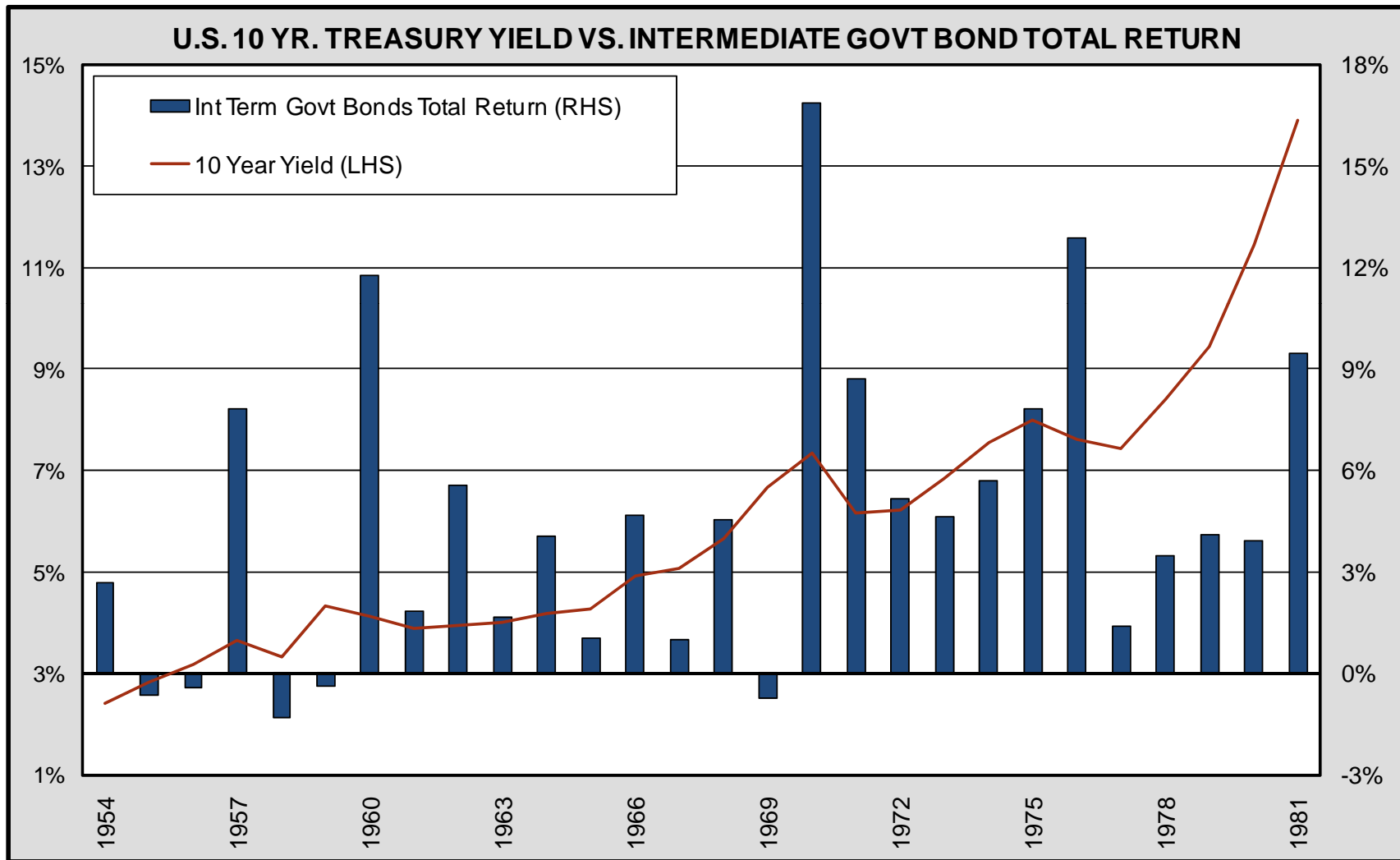
DRIVERS OF INFLATION					
Range	Crude Energy	Crude Food	Unit Labor Cost	CPI	CPI Y+1
9/30/1971 - 8/31/1973	NA	52%	5%	5%	8%
1/31/1978 - 2/28/1981	42%	12%	11%	13%	13%
5/31/1995 - 1/31/1997	39%	10%	1%	3%	2%
6/30/2002 - 5/31/2004	40%	23%	0%	2%	3%
5/31/2006 - 7/31/2008	38%	27%	3%	4%	2%
9/30/2009 - 2/28/2011	22%	31%	-1%	2%	NA

Source: Bloomberg, Northern Trust Global Investments.

Note: Crude materials for further processing are defined as unprocessed commodities not sold directly to consumers. Crude foodstuffs and feedstuffs include items such as grains and livestock. The crude energy goods category consists of crude petroleum, natural gas to pipelines, and coal.



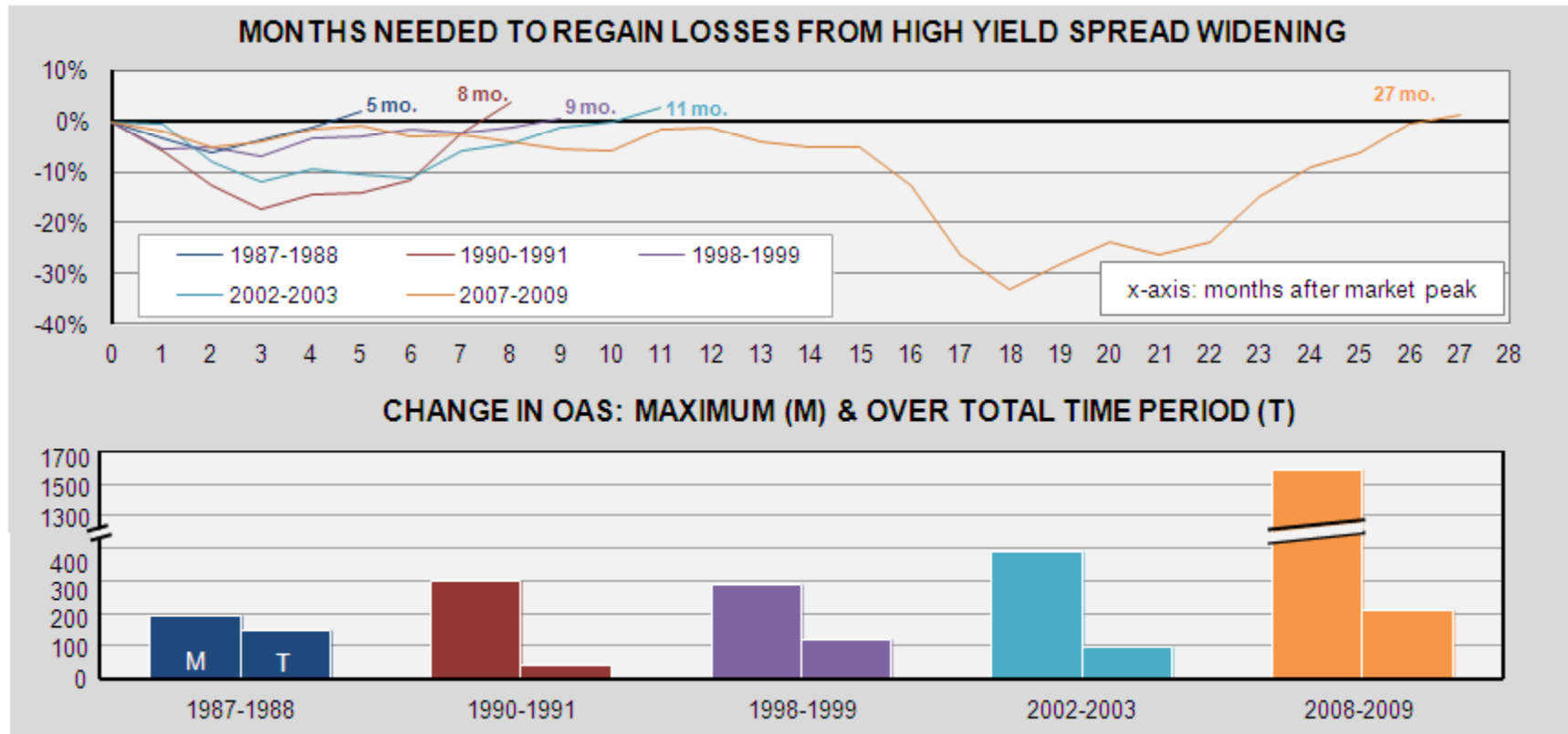
# Successfully Battling Rising Rates



Source: Bloomberg, Ibbotson, Northern Trust Global Investments.



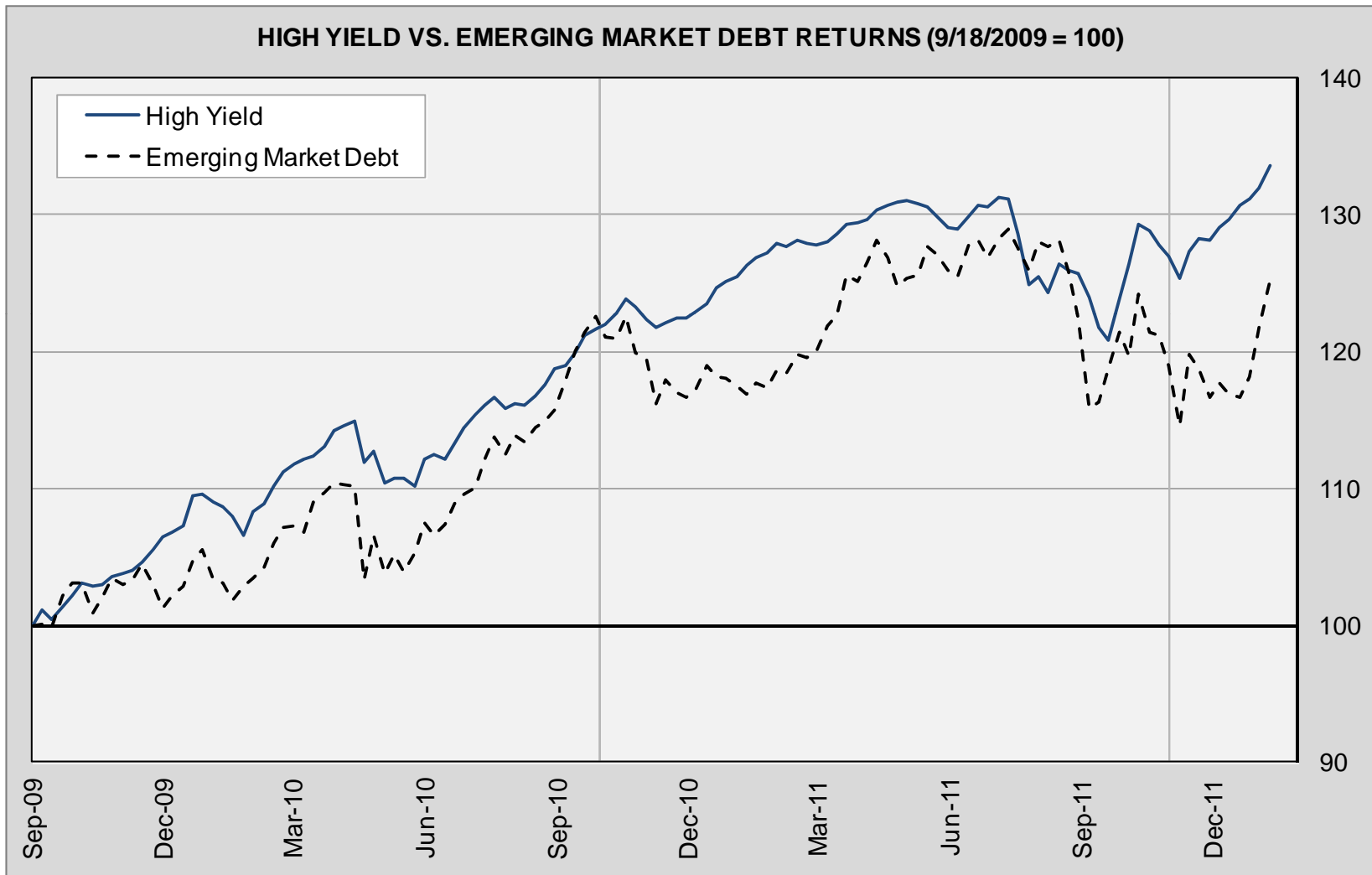
# High Yield: Income Is Your Friend



Source: Moody's, Bloomberg, Barclays Capital.



## High Yield: All of the Return, None of the Currency Risk



Source: Bloomberg; weekly data through 01/27/2012.



## Asset Allocation

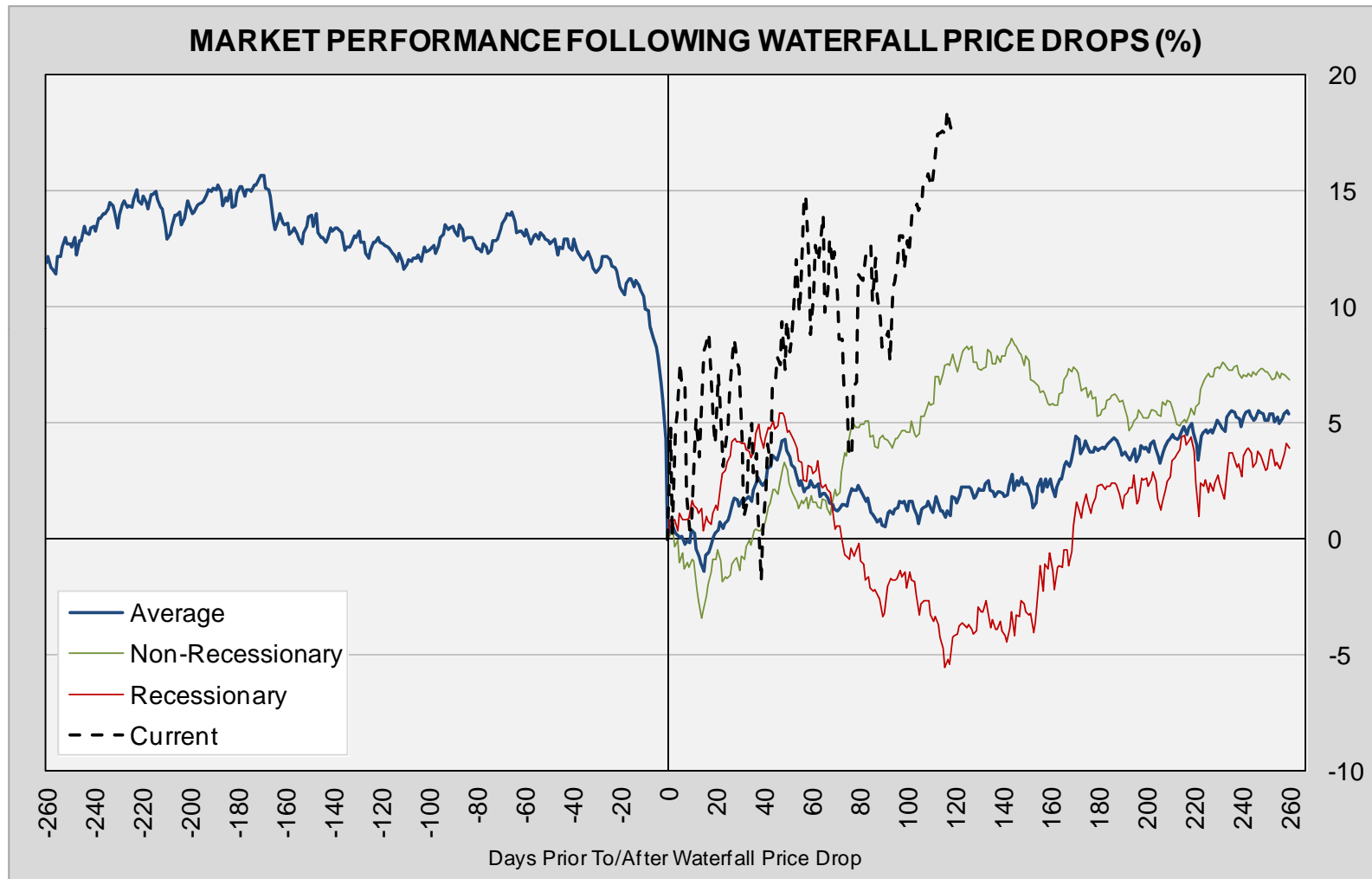
Looking to manage downside risk while  
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# Key Question: Were we headed for a recession?



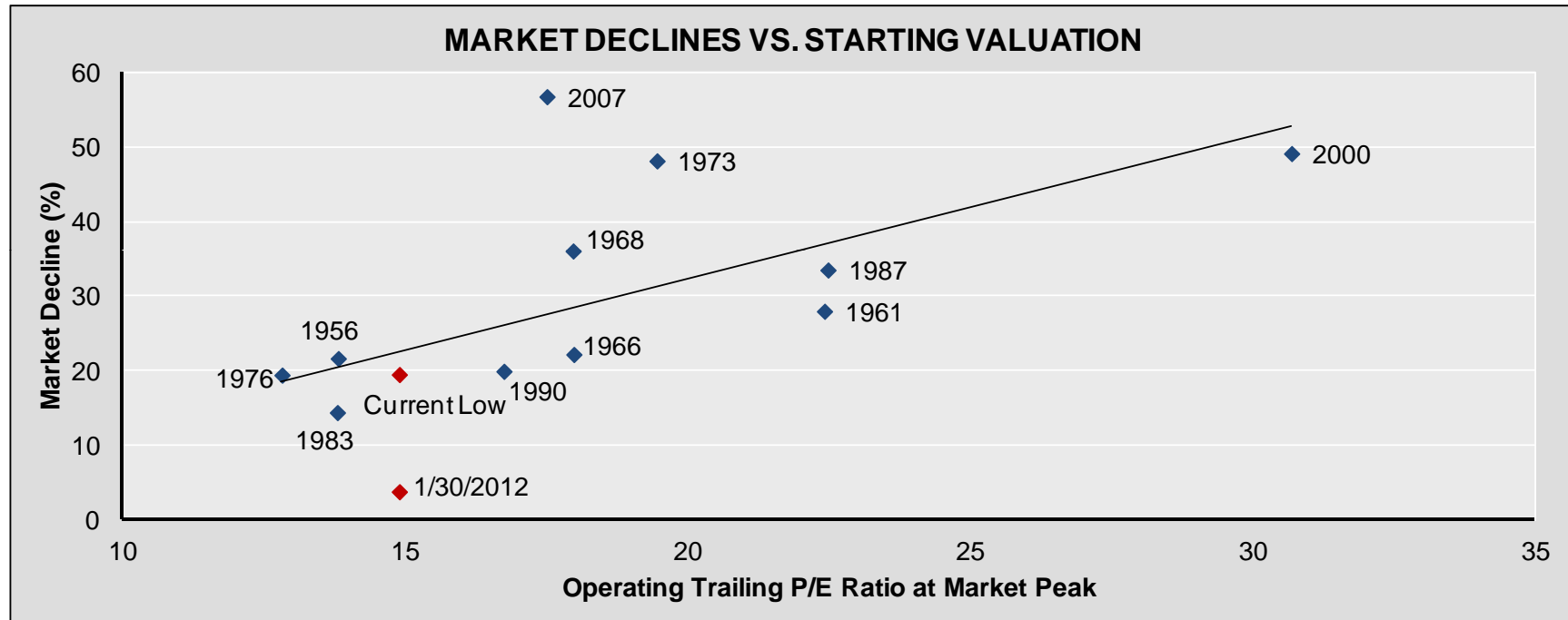
Source: Bloomberg, Northern Trust Global Investments.

Note: Covers 22 episodes of 18% or greater market declines, from 1929 to present.

Chart Concept: Ned Davis Research



# Bear Market Declines

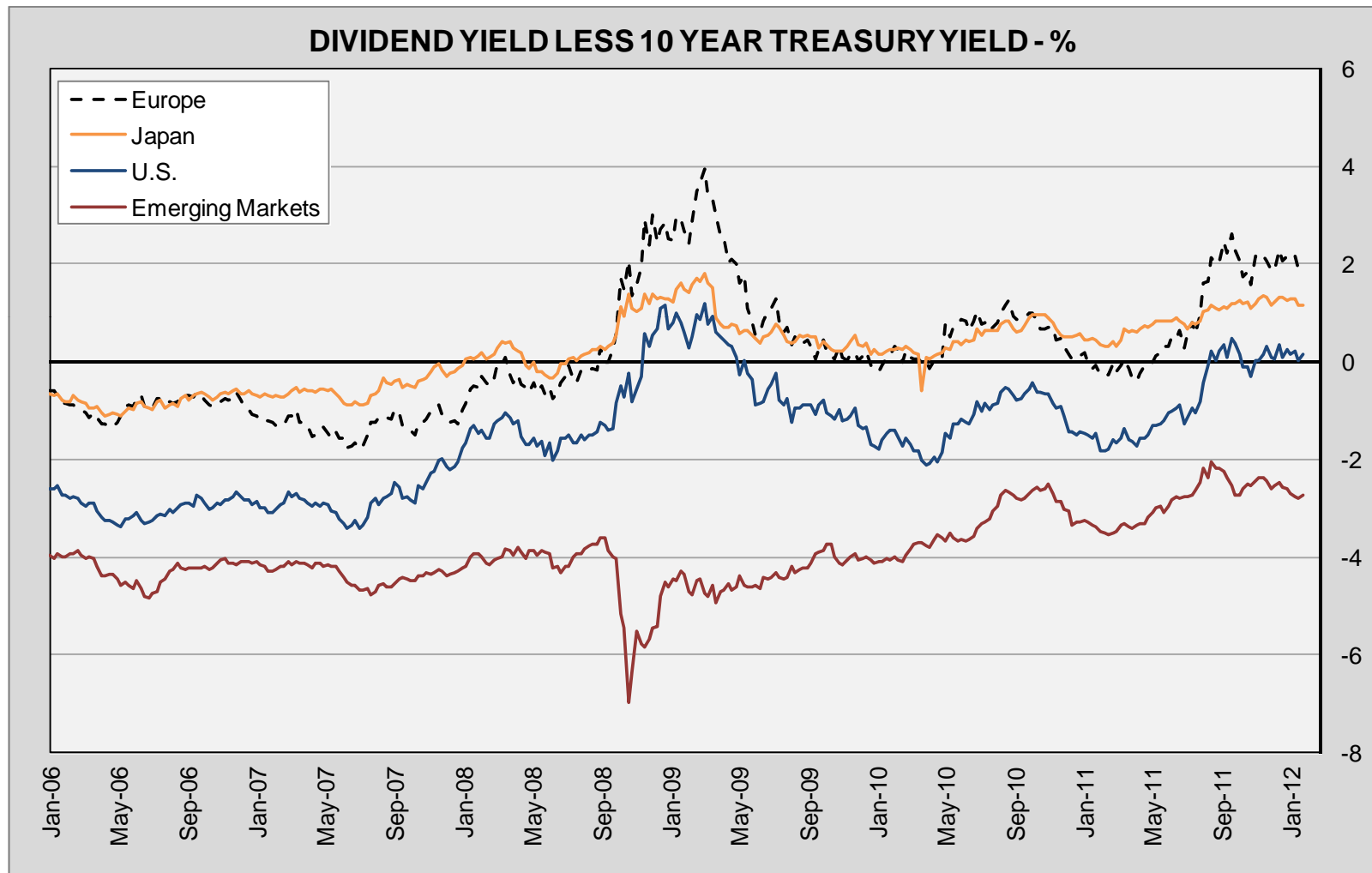


Source: Federal Reserve, U.S. Treasury, Bloomberg, Northern Trust Global Investments.  
Chart Concept: BCA Research.





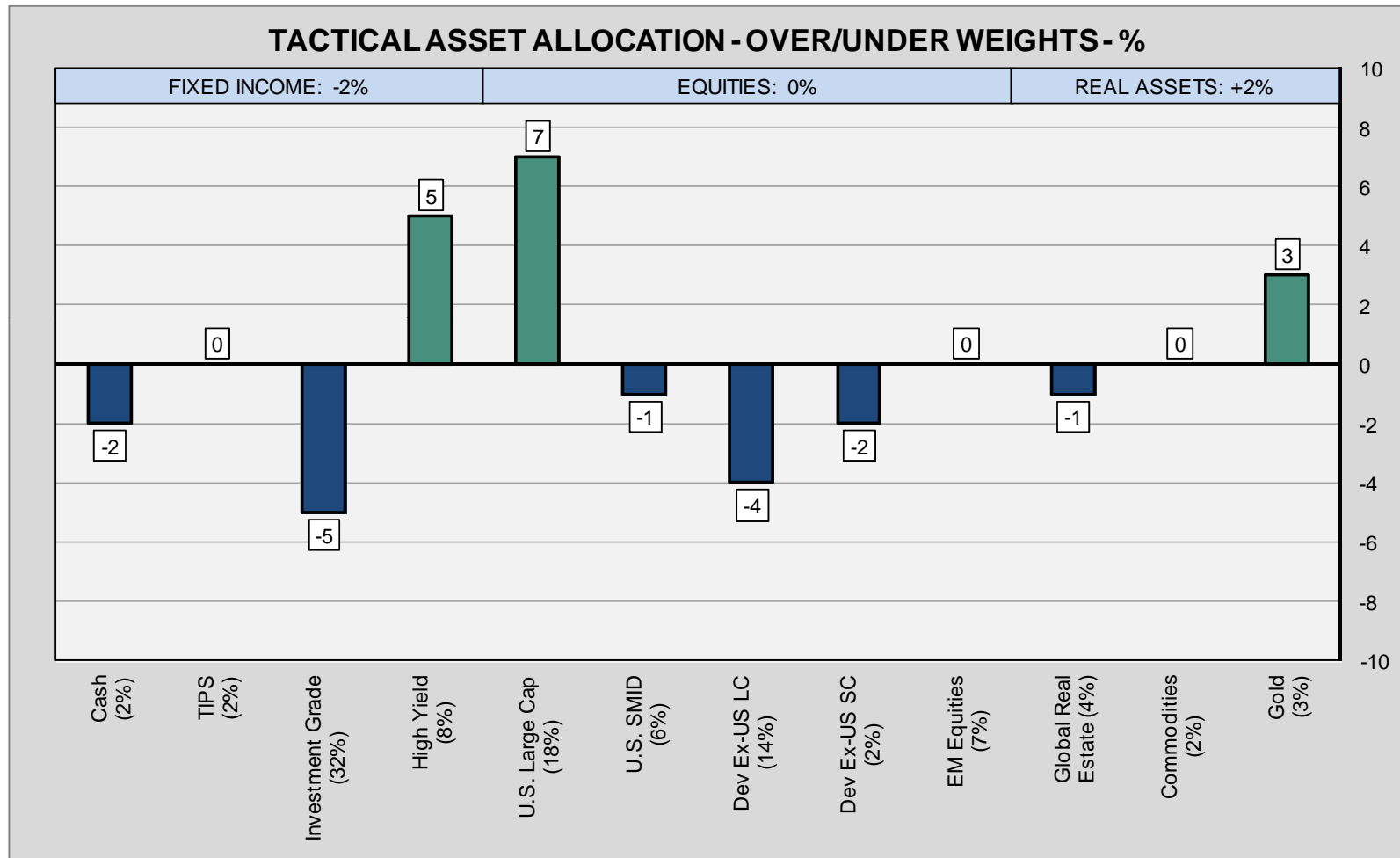
# Valuations Favor Stocks



Source: Bloomberg, Barclays Capital. Data through 01/27/2012. Emerging market 10-year yield is proxied by the Barclays EM Sovereign Index.



# Northern Trust Investment Policy



Allocations above reflect Northern's Growth and Income - Accredited objective; the proxy account for IPC. Strategic allocations are listed across the bottom; tactical recommendations (in the form of over/under/equal weights) are displayed in the bar chart. Tactical allocations as of 01/12/2012.



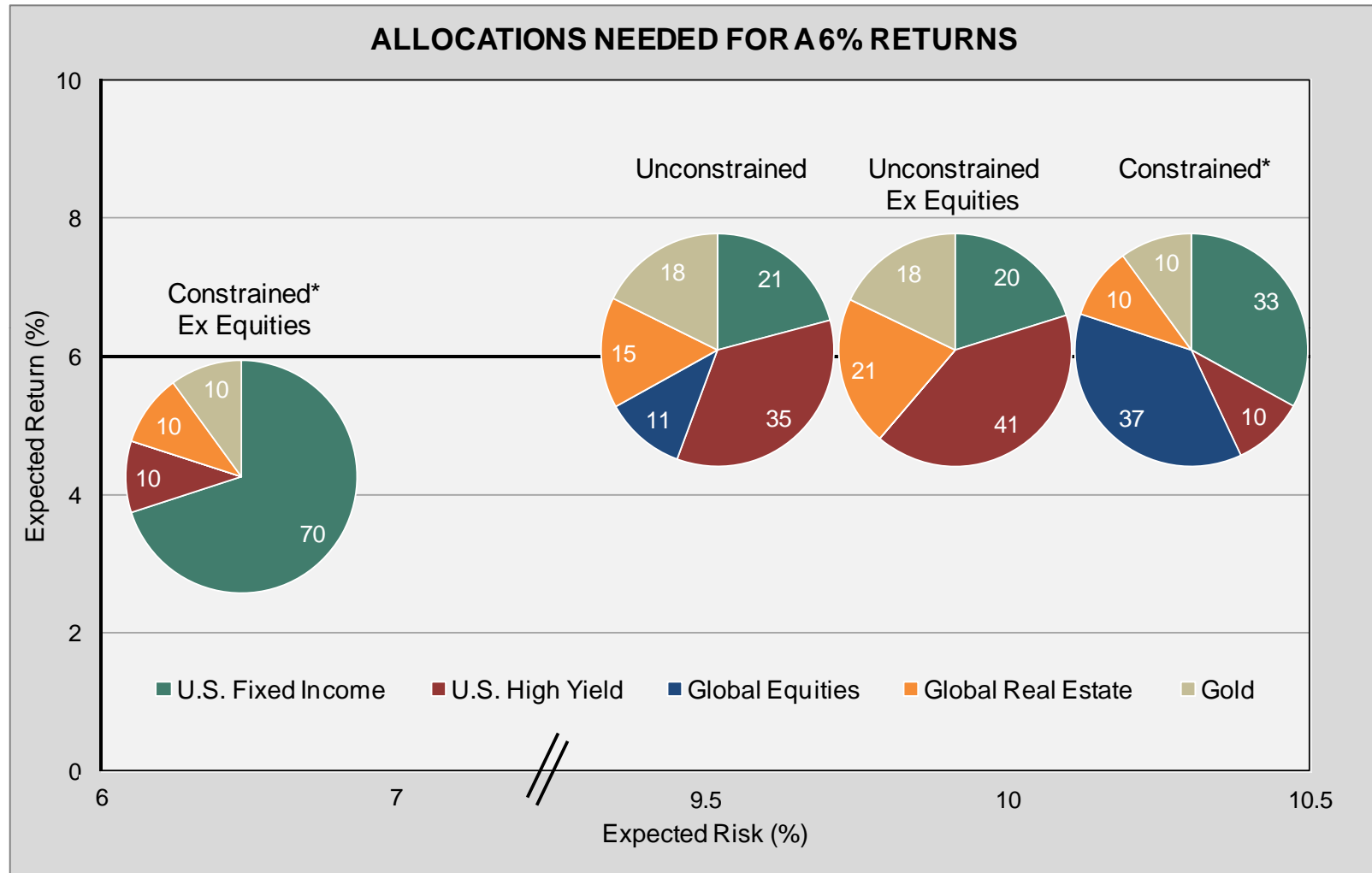
# Long-Term Forecasted Portfolio Return

Asset Class	Weight (%)	5-Year Return Expectation: 2011 Outlook (%)	5-Year Return Expectation: 2010 Outlook (%)	Expected Risk (Standard Dev.)
<b>Fixed Income</b>	<b>37</b>			
Cash	2	1.5	1.5	1.6
Investment Grade	26	3.3	3.2	6.4
High Yield	7	5.6	6.6	10.9
TIPS	2	2.7	2.0	6.6
<b>Equities</b>	<b>33</b>			
US Large Cap	12	7.5	7.5	17.1
US SMID	5	9.0	6.5	23.2
Dev ex-US	8	7.0	7.2	20.0
Dev ex-US Small Cap	2	8.0	6.9	20.9
Emerging Markets	6	10.7	10.5	27.0
<b>Real Assets</b>	<b>9</b>			
Gold	2	6.0	5.0	20.8
Commodities	2	5.3	5.0	19.4
Global Real Estate	2	9.4	9.4	22.9
Direct Real Estate	3	8.2	10.5	12.7
<b>Alternatives</b>	<b>21</b>			
Convergence Trading	3	7.9	7.3	4.7
Corporate Restructuring	3	10.0	10.0	7.2
Opportunistic	3	8.5	7.8	7.9
Market Directional	8	7.6	7.4	9.4
Private Equity	4	11.0	10.0	23.6
<b>Total Portfolio</b>	<b>100%</b>	<b>6.5%</b>	<b>6.4%</b>	<b>8.8%</b>

Source: Northern Trust Capital Market Assumptions Working Group.



## The low rate environment may dictate equity exposure



Note: \* Constrained portfolios limit the allocation to High Yield, Gold and Real Estate to 10% each.

Source: Northern Trust Global Investments. Portfolio characteristics (Return, Risk, Correlation) based off 2011 Capital Market Assumptions.



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# **Investment Outlook: Tug of War Thank You**



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