

2012 OUTLOOK: TUG OF WAR

December 2011



SUMMARY

While nearly all asset classes generated positive returns in 2010, 2011 was a much more difficult market environment. Rising global inflation, slowing growth and uncertainty about the European sovereign debt crisis contributed to investor anxiety and increased risk premiums. Our tactical asset allocation views during 2011 were based on our belief that the U.S. economy would not enter a double-dip recession and that the European Union would avoid calamity, but we wanted some hedges against this latter risk. So while absolute returns were disappointing, we did see strong relative outperformance of U.S. equities over international developed stocks and good absolute performance from gold. We enter 2012 with a neutral tactical risk recommendation, as the relative attractiveness of stocks over bonds is offset by the tail risk represented by the European sovereign debt crisis. We see the markets in 2012 in a “tug of war” between improving growth in the United States and emerging markets and the continuing negative consequences of the global debt crisis. But we do see investment opportunities in this tug of war, and highlight our views on the major asset classes in Exhibit 2.

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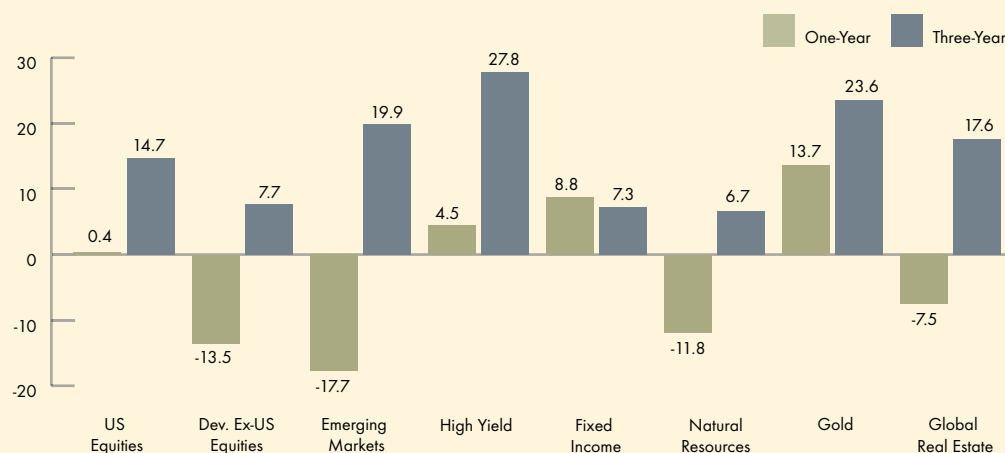
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U.S. economic growth is currently the global standout. We expect the United States to continue its expansion in 2012, but solid global growth is dependent on Europe experiencing only a moderate recession and the emerging market economies gaining momentum as the year progresses. Falling

inflationary pressures should help growth, but intermittent financial market pressures from the European sovereign debt crisis likely will cap investor risk appetite. The key variables for the outlook for the global economy and financial markets are Europe’s handling of the debt crisis and emerging

EXHIBIT 1: BONDS PAID OFF IN 2011

Select Asset Class One and Three Year Total Return – Percent



Source: Northern Trust Global Investments, Bloomberg. Return data through 12/15/2011.



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EXHIBIT 2: 2012 OUTLOOK BY ASSET CLASS

	Asset Class	TAA *	SAA *	Key Views
Equities	U.S. – <i>Overweight</i>	30%	24%	We expect 2012 S&P 500 earnings to grow by 5% to nearly \$100 per share. Trading at ~13x trailing earnings, stocks are reasonably valued given macro concerns. Strong fundamentals, low interest rates, and prospects for increased dividends make the United States our favorite region.
	Dev ex-U.S. – <i>Underweight</i>	10%	16%	Our outlook is clouded by the substantial tail risk posed by the euro debt crisis. Further, with a likely recession in the eurozone (which equals two-thirds of the index), we see muted growth in 2012 earnings and believe the current low valuations are warranted.
	Emerging Markets – <i>Neutral</i>	7%	7%	After enacting strict monetary policy for much of 2011, we believe emerging market policy makers are ready to put their foot to the gas pedal. This should help combat reduced demand for exports due to a slowing global economy, and allow China to avoid a hard landing.
Real Assets	Gold – <i>Overweight</i>	6%	3%	We view gold as a key portfolio diversifier and as a hedge against macro uncertainty. In a low real short-interest rate environment with high budget deficits, gold is an attractive asset. A significant normalization of the global economy would reduce gold's appeal.
	Natural Resources – <i>Neutral</i>	2%	2%	Expectations for tight supply counterbalanced by slow-to-moderate global growth result in our neutral stance. Faster-than-expected emerging market growth would cause us to reconsider this position given developing economies' dependence on infrastructure build.
	Global REITs – <i>Underweight</i>	3%	4%	The index dividend yield of 4% is attractive in the current environment. However, we are underweight in the historically high-beta asset class in the volatile market; instead we are looking for income and capital appreciation through U.S. high yield and equities respectively.
Fixed Income	High Yield – <i>Overweight</i>	13%	8%	Strong corporate balance sheets, low default ratios, and investors searching for yield make high yield one of our favorite asset classes. Favorable valuations, which have priced in a worse economic growth outcome vs. the equity markets (risk-adjusted), support this view.
	Inv. Grade – <i>Underweight</i>	27%	32%	Although we are not negative on investment grade fixed income, we believe there are better alternatives given the low interest-rate environment. The first year of the new presidential term in 2013 may be the pressure point on rates if no progress is made on deficit reduction.
	TIPS – <i>Neutral</i>	2%	2%	Treasury Inflation Protected Securities are an alternative to traditional Treasuries. Current inflation expectations priced into TIPS are not low enough to warrant an overweighted position.
Cash	Cash – <i>Underweight</i>	0%	2%	Cash is not a valued investment in the current environment. The positive aspects from the liquidity the asset provides is more than offset by our fairly-certain near-zero return expectation for 2012 as the Federal Reserve maintains its zero interest rate policy.
Tactical Risk Position: <i>Neutral</i>				We recommend a neutral tactical risk profile – a result of our slightly risk-adverse stance in equities (overweight U.S./underweight the slightly more volatile non-U.S.) combined with an overweight to risk within fixed income (overweight high yield/underweight investment grade). Gold's greater volatility vis-à-vis cash is somewhat offset by the precious metal's expected negative correlation to risk assets.

*TAA = tactical asset allocation; SAA = strategic asset allocation

The recommendations in this table are based on Growth & Income – Standard account, which do not include Alternatives. We believe strategic holdings in both private equity and hedge funds can help increase portfolio efficiency but, due to the nature of the investments, we do not make tactical recommendations.

markets' (particularly China) monetary policy actions to stimulate growth. While we debate the long-term economic return on China's substantial infrastructure investment, we believe the near-term cyclical growth outlook is better understood. Clarity on these prospects is the most likely catalyst for us to change our neutral tactical risk recommendation in 2012.

GLOBAL GROWTH: A SLOWING GLOBAL ECONOMY LOOKS TO THE G-2

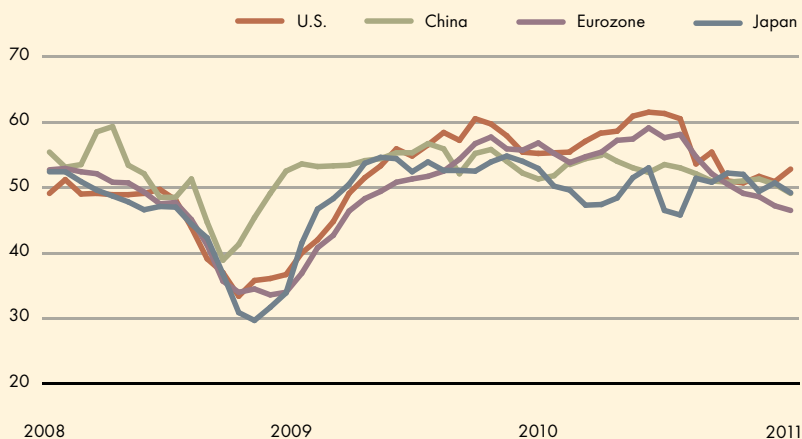
We entered 2011 with considerable momentum in the global economy, with purchasing manager indexes in most countries showing growth. Of the four major countries where growth was negative (the United Kingdom, Australia, Ireland and Spain) the three European Union countries were slowing due to fiscal austerity measures. The seeds of a slowdown were starting to build through budding inflation, but were exacerbated by both the earthquake in Japan and financial market uncertainty in Europe. Rising inflation led to

falling real spending levels, and hit emerging economies particularly hard. In reaction, emerging market central banks undertook a tightening cycle that has successfully (maybe too much so) slowed growth. In addition, the post-financial crisis environment continues to weigh on the growth outlook as different countries. Most notably, Europe's focus on austerity, without much action on fostering stronger growth potential, has been a significant growth headwind that is starting to ripple beyond its shores. These factors leave the global economy at the end of 2011 with highly divergent growth dynamics. The United States could register 3.5% growth in the fourth quarter of 2011, while emerging market growth may barely exceed that of the United States. Europe probably is already in a recession, and the required deleveraging of their banks provides an additional headwind to their growth outlook. The Japanese economy received a post-earthquake bounce in growth this fall, but is expected to revert to sub-2% growth in 2012.

We believe the global growth picture in 2012 will be heavily dependent on the G-2 (United States and China). While the United States has made negligible progress on its fiscal challenges (we believe the will is there, it is the way we need to find), some positive cyclical signs have developed. The long-lamented recovery in the labor markets has shown some progress, with the unemployment rate falling from 10.1% in October 2009 to 8.6% in December 2011. We have also seen improvement in bank credit creation, which has been increasing since March 2011. The U.S. housing market, however, continues to suffer from oversupply of existing houses – which offsets some of the benefits of the current level of affordability.

EXHIBIT 3: GROWTH FADING OUTSIDE THE UNITED STATES

Manufacturing Purchasing Manager Indices



Source: Northern Trust Global Investments, Bloomberg. Data through 11/30/2011.

Emerging market growth is slowing as we enter the new year. A combination of monetary-policy induced slowing alongside weaker exports has tempered the world's fastest growing economies. We expect growth to improve in the second half of 2012 as central bank easing begins to take hold. Europe's outlook remains the most challenged, as austerity and tight financial conditions will continue to suppress growth. We see Europe's economy as less cyclical than those of the United States or emerging markets, so the impact on global growth should be less. All in all, global growth is likely to continue slowing into the new year, before reaccelerating as the benefits of falling inflation and monetary policy take effect mid-year.

MONETARY POLICY: EASY DOES IT

Central bank involvement has been critical to the global financial markets during the last several years, as shown by the balance sheet expansion depicted in Exhibit 4. The activism of the U.S. Federal Reserve in combating the financial crisis of 2008 has continued to date as economic growth has been poor and European financial conditions have deteriorated. We believe the new head of the European Central Bank (ECB), Mario Draghi,

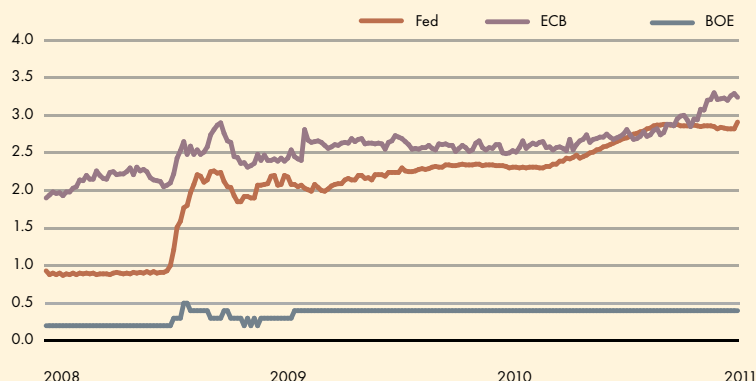
brings with him a greater level of pragmatism than his predecessor. The other key central bank, in our view, is the People's Bank of China (PBOC). In contrast with the independence of the Fed and ECB, we believe the PBOC operates at the direction of the Chinese political leadership and will implement policy as directed.

With policy rates in the developed economies at or near rock-bottom, developed-market central bankers are already facilitating easy monetary conditions. An easing cycle started in emerging markets on August 31, when Brazil cut its benchmark interest rate. China also has started its easing cycle, with the small first step of reducing banks' reserve requirement ratios. Increased loan quotas will be a stronger sign that the government is becoming more serious about stimulating growth.

The developed-market central bank activity in 2012 will likely be more focused on liquidity programs than interest rate policy. We have seen some evidence of this during the last month, as major central banks announced policies to help ease global financial conditions. Six of the largest central banks, led by the Federal Reserve, agreed on November 30 to expand dollar swap facilities to ease liquidity pressures on European banks. Additionally, on December 8 the ECB announced an increased loan program allowing loans to European banks for three-year terms on a loosened range of collateral. In summary, we expect the combination of falling inflation and continuing financial market stresses will keep global central banks in easing mode in 2012.

EXHIBIT 4: CENTRAL BANKS CARRYING THEIR LOAD

Central Bank Balance Sheet Assets – \$ Trillion



Source: Northern Trust Global Investments, Bloomberg. Data through 12/16/2011.

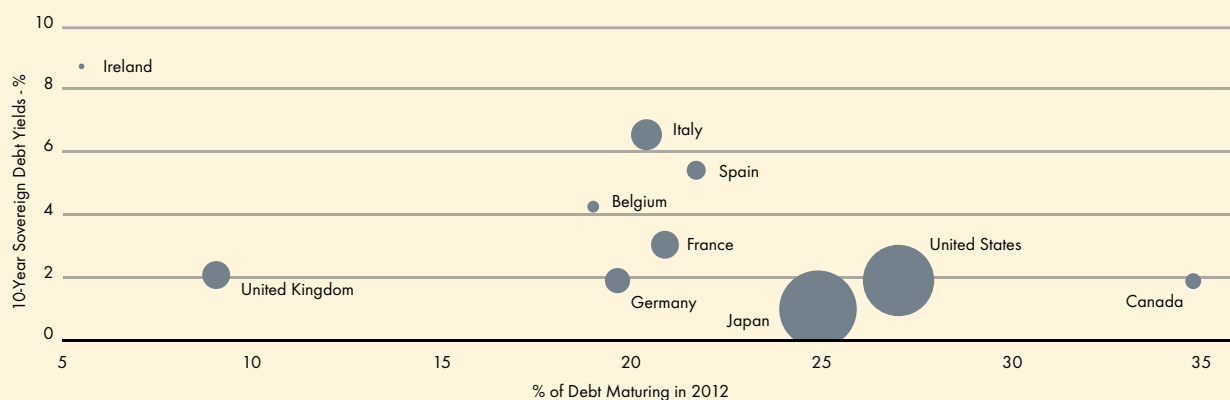
FISCAL REPAIR: HALTING PROGRESS TO BE MADE IN 2012/2013

Excessive debt loads plague many developed economies in the wake of the financial crisis. Financial markets are quick to find weak points, and the governance structure of the European Union is a glaring one. With a common currency and uncommon fiscal policies, imbalances have created great stress in peripheral European debt markets. European leaders have barely kept pace with the deterioration, as reconciling the different desires of the eurozone members has been difficult. We expect volatility in the markets to remain high into 2012 as the European Union continues to deliver the least possible solution at the latest possible date. Additional volatility will likely occur around the pending sovereign ratings reviews by S&P and Moody's. We expect the market already is discounting some level of downgrades amongst Europe's AAA-rated countries (including Austria, Denmark, Finland, France, Germany and the Netherlands), but some holders will be forced to sell on the loss of the AAA rating.

As Exhibit 5 shows, more than 20% of outstanding Italian and Spanish debt needs to be refinanced in 2012. While this is exceeded by the 25% to 27% in Japan and the United States, these issuers are seeing no signs of market stress. In the wake of the recent ECB liquidity program (likely more influential than the EU framework for a fiscal compact) there has been improvement in peripheral yields such as Spain, where the 10-year yield has fallen from 6.70% on November 25 to 5.07% on December 20. We believe, however, that market pressures will continue to force politicians' hands because the ECB will not provide *carte blanche* purchases without fiscal reform. As this continues to be strung out, the odds of this leading to a global financial crisis may diminish as fundamental improvements can occur and investor expectations are shaped. In the United States, we expect markets to give a pass to U.S. fiscal repair until after the 2012 election. If progress is not made in 2013, during the first year of the new Presidential term, the bond market may start to force the issue through higher interest rates.

EXHIBIT 5: REFINANCING RISKS IN EUROPE

Key Sovereign Debt Market Metrics



Note: Bubble indicates level of net sovereign debt - for scaling purposes, the U.S. net sovereign debt level is \$9.9 trillion

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%, 15%) not shown on chart. Note: 9-year Ireland yield used

POLITICAL LEADERSHIP: THE PEOPLE HAVE SPOKEN

From the Arab Spring to the resignation of Italian Prime Minister Berlusconi, 2011 was a year of tremendous political change. The fall of Tunisia's long time President in January was the catalyst for major upheaval in the Arab world. Civil unrest has led to the subsequent fall of the Egyptian, Libyan and Yemeni governments, while unrest continues in Syria and other countries. Additionally, risks may rise in Iraq after the recent

withdrawal of U.S. combat troops. While the Arab Spring was fomented by both a lack of political and economic freedom, the political change washing over the developed world is mostly a repercussion from the global financial crisis. Of the first nine countries shown in Exhibit 6, Canada is the only one whose leader was able to survive an election cycle. Market pressures forced the installation of technocratic governments in Greece and Italy, which we think is a positive development.

EXHIBIT 6: LOTS OF NEW FACES AT THE TOP

KEY COUNTRY ELECTION OUTCOMES			
Country	Election Date	Ruling Party	Notes
Belgium	June 2010	Changed	Conservative party selected new Prime Minister
United Kingdom	May 2010	Changed	Conservative party selected new Prime Minister
Ireland	February 2011	Changed	Center-right party selected new Prime Minister
Canada	May 2011	Maintained	Ruling conservative party gained a true majority
Portugal	June 2011	Changed	Center-right party selected new Prime Minister
Japan	August 2011	Maintained	Prime Minister resigned; ruling party elected a new Prime Minister
Greece	November 2011 *	Maintained	PM resigned and was replaced on an interim basis; next election in Feb 2012
Italy	November 2011 *	Maintained	PM resigned and was replaced on an interim basis; next election in April 2013
Spain	November 2011	Changed	Center-right party selected new Prime Minister
France	April 2012	TBD	President Sarkozy trailing in the polls vs. Socialist party candidates
U.S.	November 2012	TBD	President Obama re-election outlook tied to economy and eventual Republican contender
Germany	September 2013	TBD	Christian Democratic Union party suffered losses in September 2011 state elections

Source: Northern Trust Global Investments

* Date of change of Prime Minister; no election held.

French President Sarkozy faces an election in April 2012 and currently trails in the polls. While the German and U.S. elections are further off, the populace in both countries is angered by the debt build-up and policy remedies that the incumbent politicians have championed. The political balance in the United States has already been changed since the financial crisis, with the rise of the Tea Party, which is focused on shrinking government. We feel that U.S. voters, and even the politicians, have concluded that serious action needs to be taken on the deficit. The debate is on the desired balance between spending cuts and tax increases. The debt ceiling standoff and Congressional Supercommittee failures to address this question were not a surprise, and the bond market took it in stride. We remain of the view that the 2012 election will set the mandate for how the country wants fiscal responsibility restored. The markets likely view a Republican White House and Congress as the most likely power structure to make substantial deficit reduction progress in 2013.

INFLATION: FADING PRICE PRESSURES

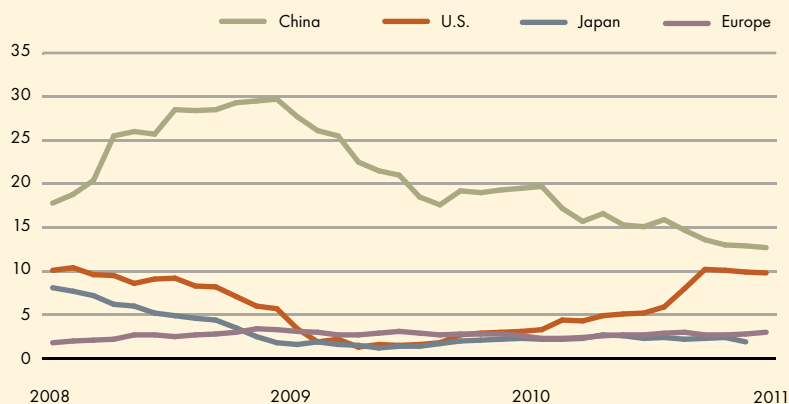
We have experienced a fairly typical inflation cycle over the last several years, although it has been exacerbated by the depth of the financial crisis and the scale of the monetary and fiscal response.

Inflation fell during the global recession (and became deflation in certain areas), and reignited during the recovery. The trough to peak change in U.S. inflation this cycle has been 6%, which has been a considerable headwind to real growth. In addition to normal cyclical price pressures, we have experienced extraordinary agricultural commodity price inflation, which has especially hit the emerging market economies. The biggest impact to date from the rising inflation has been the drain on consumer purchasing power. Secondly, central bank actions in the emerging economies have been constrained by price pressures. We expect these central banks to have less flexibility than their developed market counterparts due to high levels of capacity utilization and employment across their economies. In addition, emerging market consumers spend a considerably higher proportion of their income on highly volatile food and energy supplies, which are likely to show higher long-term price inflation than the consumption basket of the developed market consumer.

Looking into 2012, we expect the slowing economy, along with structurally high unemployment, will ease prices. We also expect the commodity-led price pressures to ease and drive inflation lower globally. An improving inflation outlook also would be beneficial to risk assets, which perform best in a disinflationary environment. An area for close attention will be the trends in money supply. Despite broad central bank interventions, money supply growth in the United States and Europe has been tough to create. During the last six months, U.S. banks have started to create credit – which is key for the sustainability of the U.S. economic expansion. However, this also carries the seeds of potential inflation should the growth exceed nominal gross domestic product (GDP) for an extended period. Because we believe we are still in a long-term deleveraging trend and that overall growth will be below long-term averages, we do not believe we are likely to experience sustained money supply growth-led inflation. If this were to come about, the Federal Reserve would likely immediately start to shrink its balance sheet to reduce available credit and raise interest rates.

EXHIBIT 7: ONLY U.S. MONEY SUPPLY SHOWING SIGNS OF LIFE

Money Supply – Year Over Year Percent Change



Source: Northern Trust Global Investments, Bloomberg. Data through 11/30/2011; Europe through 10/31/2011.

GLOBAL EQUITIES: RETURNS UNUSUALLY DEPENDENT ON RISK APPETITE

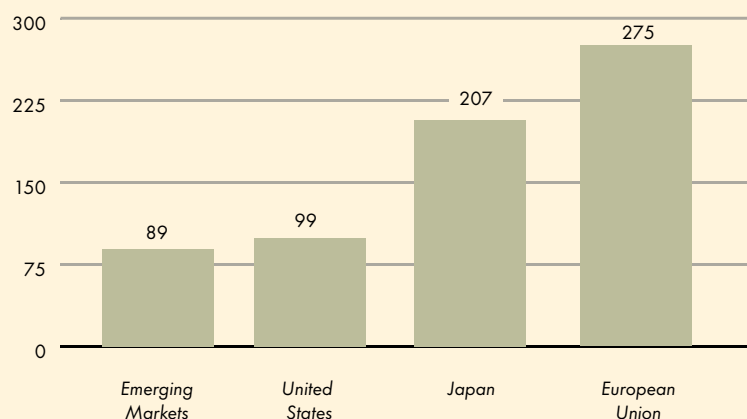
Global equities suffered from a combination of rising inflation, slowing growth and increased uncertainty in 2011. The United States proved the safe haven among equities, with a decline in the S&P 500 of 1% through December 15. Among developed economies, Europe and Japan both fell nearly 20%. The high-beta emerging markets, where inflationary pressures were the greatest, dropped 21%. Reflecting the global nature of today's economy, earnings growth was comparable across the regions, with U.S. earnings set to grow around 14% in 2011, European earnings are estimated to grow 12.5% and emerging markets earnings look to rise nearly 11%.

The equity market declines combined with earnings growth has led to noticeable improvement in valuations this year. U.S. equities started the year valued at 16.5 times trailing earnings, and are currently valued at about 13.3 times. In Europe, the trailing price/earnings multiple has fallen from 14.7 to 10.1, while emerging market valuations have declined from 13.6 to 10.7 times trailing earnings. Due to the volatility of the Japanese earnings, the trailing price/earnings ratio has actually increased from 16.6 times to 18.4 – but this should decline noticeably based on earnings expectations for 2012. The conclusion from this data, where earnings growth across major markets was comparable but stock price performance diverged considerably, is that risk aversion drove differential returns in 2011. Therefore, we see risk appetite as likely the biggest driver of regional returns in 2012.

An additional way to assess the prospects of each economic region is through an analysis of its banking systems. The regions with the largest banking systems remain the most vulnerable to further restructuring. While measures of the overall size of the banking systems are imprecise due to shadow banking operations (a particular issue in China), they are useful nonetheless. The U.S. financial system, which cracked first and has had the most robust policy response, is much smaller as a percentage of its economy. The European banking system, which has been slow to restructure, remains disproportionately large compared to the size of its economy. The European economy is much more dependent on bank lending than the U.S. economy, where companies raise a much greater proportion of funding through the capital markets. Therefore, we expect this deleveraging to hold back European growth and also investor sentiment over the medium term.

EXHIBIT 8: BLOATED BANKING SYSTEMS

Bank Assets – Percentage of Domestic GDP



Source: Northern Trust Global Investments, International Monetary Fund. Data as of 2010.

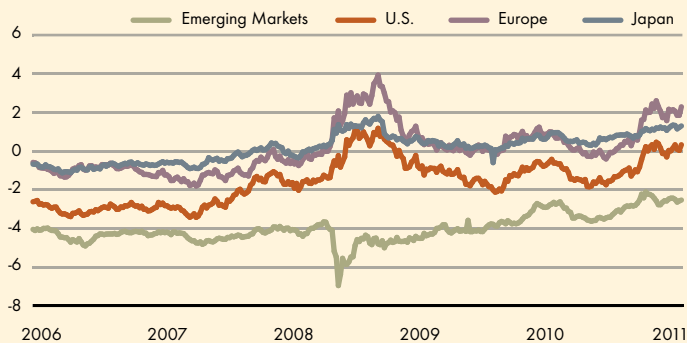
We expect volatility to remain high because of the uncertain way forward in the European sovereign debt crisis and the current slowing global growth. While bottoms-up analyst estimates call for low double-digit earnings growth in the United States and emerging markets, earnings growth is forecasted at a more muted 7% to 8% in Europe. We think profit margin gains are mostly behind us, so earnings growth going forward will be driven by revenue growth. Our best proxy for global revenue growth is nominal global GDP growth, which we are penciling in at around 5% in 2012. This leads to a fairly muted return potential, including dividends, of around 8% before any change in valuation.

United States, a 30-year bull market in bonds has now generated greater returns from Treasuries than from the stock market over the last 30 years. We think this leaves prospective returns from bonds below equities over the medium- to long-term. As shown in Exhibit 9, equity yields exceed the relevant 10-year bond handsomely in Europe and Japan, and barely in the United States. Due to higher structural inflation in the emerging markets, those equity dividend yields still trail the 10-year bond yield.

Valuation is not a timing device. However, we think it supports the view that stocks should handily outperform investment-grade bonds once the uncertainty over the global economy recedes. As long as investors have sufficient liquidity set aside to handle near-term needs, we think they will be rewarded for allocating longer-term capital toward equities at the expense of their investment grade bond allocation.

EXHIBIT 9: STOCKS YIELDING MORE THAN BONDS

Dividend Yield Less 10 Year Treasury Yield - Percent



Source: Bloomberg, Barclays Capital. Data through 12/16/2011. U.S., Europe, Japan and emerging market equities proxied by S&P 500, STOXX Europe 600, Nikkei 225 and MSCI Emerging Market indices respectively. Emerging market 10-year yield is proxied by the Barclays EM Sovereign index.

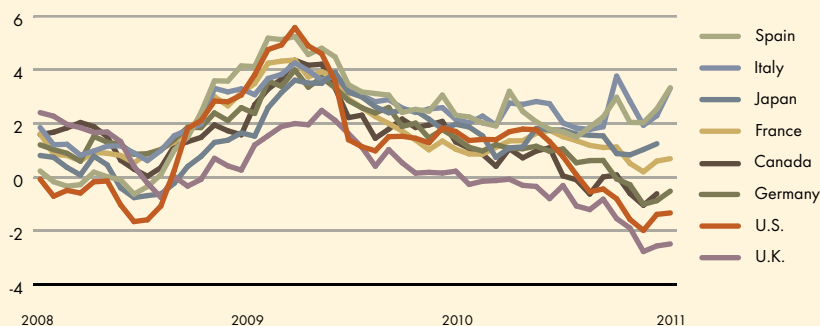
A key wildcard beyond the economic outlook is risk appetite and investor behavior. Investor risk aversion has led to overwhelming flows into the investment grade bond markets during the last several years. Thus far in 2011, bonds outperformed stocks globally – ranging from outperformance of 13% in the United States to 26% in Germany. In the

FIXED INCOME: A YEAR TO CLIP COUPONS

Global fixed income was a standout performer in 2012. Interest rates rallied strongly as economic growth slowed and risk aversion rose. U.S. 10-year yields, which started the year at 3.30%, dropped to 2.07% at November 30. This helped drive an 8.1% return in U.S. government securities, and a 5.5% return in global treasuries (all fixed income returns are the respective Barcap indexes, year-to-date through November 30, 2011). While credit did benefit from the fall in rates, increased risk aversion boosted spreads in U.S. credit (146 basis points (bps) to 225 bps) and U.S. high yield (526 bps to 734 bps). U.S. credit still generated a 6.3% return, while high yield gained 2.3%. Finally, the high profile forecasts of disaster in the U.S. municipal bond market did not come to pass, as this asset class generated an 8.6% return.

EXHIBIT 10: REAL YIELDS REFLECT NEW RISK PREMIUMS

10 Year Sovereign Debt Real Yield - Percent



Source: Northern Trust Global Investments, Bloomberg. Data through 11/30/2011; Canada and Japan through 10/31/2011.

We think the key drivers of rates in 2012 will be economic growth and the European sovereign debt crisis. Current yields in safe-haven sovereign markets like the United States and Germany are being held down by low short rates and safe haven flows. With global growth slowing into 2012, pressure on real rates should be muted. As we discussed in the Inflation Outlook section, we see falling inflationary trends globally in 2012, capping interest rate pressures. Our central tendency forecast for both the U.S. and U.K. 10-year bonds for 2012 is 2%, with a slightly higher forecast for the German bund (2.25%) due a modest risk premium. We believe the ECB will modestly reduce its policy rate further to 0.75% in 2012, while the Fed, Bank of England and Bank of Japan are likely to keep policy rates unchanged all year.

A key variable will be the progress in resolving the European crisis, where a positive tipping point would likely reduce safe haven demand. We do not expect a definitive tipping point to be reached in 2012, so pressure on selected sovereigns and flows to safe havens would continue. With the Federal Reserve committed to keep the Fed Funds rate near 0%

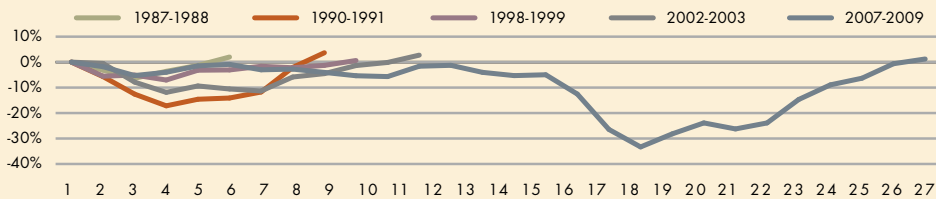
through mid-2013, and the ECB and emerging market central banks starting easing cycles, the rates markets look to be well supported in 2012.

In this low nominal interest rate environment, where many sovereign bonds are generating a negative real interest rate, we find corporate credit attractive. As investors increasingly question sovereign credit, we think corporations are well positioned to manage their balance sheets going forward. Central to our support of high yield is our view that the United States will not enter a double-dip recession. The current yield in high yield will help offset some spread widening. As an example, year-to-date through November 30, U.S. high yield spreads have risen from 5.26% to 7.34%. However, due to the high level of interest payment and the fall in Treasury yields, high yield has generated a total return of 2.30%. In Exhibit 11 we show an exercise that examines prior periods of spread widening in high yield and how long it took to get back to breakeven if you bought high yield at the lowest spreads (most expensive). In four of the five periods of spread widening, the high level of income helped offset the spread widening so that breakeven was achieved in less than a year. The worst scenario was in the 2007-2009 global financial crisis, where it took 27 months.

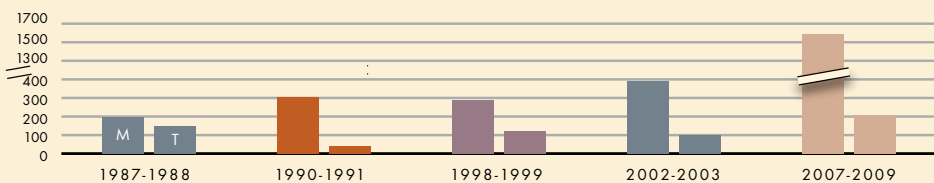
Turning to the important U.S. municipal bond market, technical factors remain very positive after the December 31, 2010 end of the Build America Bond program. The Build America Bond program funded many capital improvement projects. As a result of the program and a slow economy, municipal bond supply in 2011 will be down about 33%. We expect 2012 issuance to be near \$300 billion, a level that will again result in a slight contraction of total market. The yield curve has flattened in 2011 by more than

EXHIBIT 11: HIGH INCOME REDUCES HIGH YIELD RISK

Months Needed to Regain Losses from High Yield Spread Widening



Change In OAS: Maximum (M) & Over Total Time Period (T)



Source: Northern Trust Global Investments, Barclays Capital.

50 bps, and we expect more flattening in the next year as longer municipal rates remain attractive from a fundamental economic standpoint and offer good relative tax-free fixed income value. Investors increased their interest in longer tax-free bonds through mutual fund purchases in a meaningful manner throughout 2011; we feel this trend should continue into 2012. Lastly, major credit concerns did not materialize in 2011, and the lowest rated investment grade bonds (A and BBB) strongly outperformed the highest rated (AA and AAA). Notably, state revenues are showing good momentum from increases in sales, personal and corporate taxes. We still favor the highest quality issuers in 2012 because budget pressures will remain very tight. We would continue to avoid appropriation-type and smaller local government debt, two sectors that could be under pressure from tight budgets and the continued weakness in housing.

REAL ASSETS: IN NEED OF STRONGER GROWTH

Real assets, such as commodities, real estate and inflation protected securities (technically classified as fixed income, but also double as a real asset), generally perform best in those environments where the threat, or reality, of inflation is high. Strong global growth supported real asset performance through 2008, only to experience a major sell-off during the financial crisis. As global central banks, particularly the Federal Reserve, began massive intervention in 2009, real assets went along for the ride. Of late, price performance has been mixed as global growth estimates have fallen and inflationary

worries have abated. The star performer has been Treasury Inflation Protected Securities (TIPS), whose return has been mostly driven by noninflationary factors. Specifically, 9.6% of return has been generated by the real price return (or the increase in bond price due to falling yields) and 1.2% from the coupon return. Only 3.7% was due to the actual inflation experienced during this year. The modest outperformance of the 10-year TIPS versus the straight Treasury security is tied to the fact that inflation was slightly higher than market expectations at the beginning of the year.

The outlook for real assets in 2012 will be driven by the prospects for global growth, which could start to improve in the second half of the year. These assets are heavily influenced by the short-term outlook for growth. But they are also a key play on the outlook for inflation, so monetary policy actions can immediately ripple through this

asset class. So while we think some improvement in the growth picture could support demand for real assets in 2012, the muted inflation out-look likely caps the potential upside. Our favored stance toward gold is not as an inflation hedge – we think broad commodities, real estate and inflation-protected securities are superior in this regard. We favor gold as an alternative currency, which performs well during periods of low real interest rates (which are expected to continue) and financial uncertainty. Strong progress toward resolving the European sovereign debt crisis, and/or the prospects for higher real interest rates, would be the most likely catalysts for a change in our view toward the attractiveness of gold.

EXHIBIT 12: TIPS RETURNS DRIVEN BY RATES, NOT INFLATION

Security	Coupon Return	Real Price Return	Inflation Return	Total Return
10-year Treasury	2.4%	11.8%	0.0%	14.2%
10-year Treasury Inflation Protected	1.2%	9.6%	3.7%	14.5%
Difference	1.2%	2.2%	-3.7%	-0.3%

Source: Northern Trust Global Investments, Bloomberg.
Return data: 12/31/2010 through 11/30/2011.

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