

Northern Income Equity NOIEX

Morningstar's Take | 03-02-10 | by Ryan Leggio

This mutual fund is well worth a look.

Northern Income Equity fills its niche well.

This fund is betwixt and between a couple of fund categories. In an effort to capture an equitylike total return with measurably lower risk (measured by lower volatility and better downside protection than the S&P 500 can offer), the fund allocates its assets among convertible bonds, convertible preferreds, and dividend-paying stocks. One of the more appealing and differentiating aspects of the fund is management's ability to substantially alter the fund's allocation depending on where it is finding the best risk/reward opportunities. As a result, it sometimes has much more in convertibles than stocks. At other times, it is vice versa. Indeed, it once landed in Morningstar's convertibles category before moving to the moderate-allocation group. It shouldn't be a surprise if it moves back at some point.

For now, though, manager Jackie Benson is more content in equities—she's moved up to about 66% of assets in stocks versus 50% in early 2007—and that has meaningful implications for performance. This increased equity exposure, plus the fact that convertibles did not hold up as well in 2008's rough and tumble year as they did in 2002, is the reason the fund lost almost 31% in 2008, for example—in fact, that 12-month period marks one of the fund's worst by a long shot. (This result was still better than the S&P 500's setback, at a negative 37%, and the fund's Merrill Lynch All U.S. Convertible Index's drop—down 35.7%.) Stocks certainly helped in 2009, when the fund recovered 32.2%, though the fund could have done better. Benson acknowledges it was a mistake to sell some of the financial convertible preferreds that the fund owned near the beginning of 2009. Those issues have subsequently rebounded considerably.

Over the long haul, the fund has been able to meet its goal: Over the last five- and 10-year periods, the fund has easily beaten not only the S&P but also its benchmark index with less volatility and better downside protection.

Kudos

- Returns have been strong in value-friendly markets.
- Reasonable expenses.
- Low volatility compared with the S&P 500.
- Good long-term returns.

Risks

- Management's conservative approach can cause the fund to lag when pricey issues lead the market.
- The fund will hold stocks when attractive convertible issues are sparse.

Strategy

Manager Jackie Benson looks for companies that boast both good growth potential and relatively high-quality convertible bonds that trade at a discount to their estimate of their value. As a result, she steers clear of most issues in speculative corners of the convert market, such as tech and biotech. Although she sometimes holds a significant equity stake, she has kept a lid on volatility by capping individual stock holdings at 2% of assets and convertible issues at 3%.

Management

Ted Southworth, the fund's manager since September 1995, retired in May 2009. Jackie Benson, the fund's comanager since March 2007, is now in charge. Prior to joining Northern Trust in 2004, Benson was a senior high-yield analyst within Banc One Capital Markets.

Role in Portfolio

Supporting Player. This fund's above-average equity stake, low volatility, and respectable yield make it an appropriate holding for those looking for a mild alternative to a value-oriented stock fund.

Northern Income Equity NOIEX

Year	Total Return (%)	+/-Category
2009	32.20	8.07
2008	-30.82	-2.82
2007	5.43	-0.56
2006	18.26	7.54

Data through 12-31-09

NORTHERN INCOME EQUITY FUND

Inception 4/1/1994

AVERAGE ANNUAL TOTAL RETURNS AS OF 9/30/10				TOTAL ANNUAL OPERATING EXPENSE RATIOS	
1-Year	5-Year	10-Year	Since Inception	Gross	Net
13.88%	3.93%	4.38%	7.80%	1.23%	1.00%

Performance quoted represents past performance and does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than that shown here. Performance data current to the most recent month end is available by calling 800-595-9111.

The Advisor has agreed to reimburse certain expenses of the Fund. The contractual reimbursement arrangement is expected to continue until at least July 31, 2011. After this date, the contractual arrangements may be terminated if it is determined to be in the best interest of the Fund and its shareholders. In the absence of fee waivers, yield, total return, growth since inception and dividends would have been reduced. Total return is based on net change in NAV assuming reinvestment of distributions.

Equity Risk: Equity securities (stocks) are more volatile and carry more risk than other forms of investments, including investments in high-grade fixed income securities. The net asset value per share of this fund will fluctuate as the value of the securities in the portfolio changes.

High Yield Risk: Although a high yield fund's yield may be higher than that of fixed income funds that purchase higher-rated securities, the potentially higher yield is a function of the greater risk that a high yield fund's share price will decline.

Interest Rate/Maturity Risk: Increases in prevailing interest rates will cause fixed-income securities, including convertible securities, held by the Fund to decline in value.

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