

Northern Tax-Exempt NOTEX

Morningstar's Take | 07-26-10 | by Jonathan Rahbar

Lower costs would build upon this fund's solid case.

Northern Tax-Exempt doesn't venture into murky waters.

This muni fund takes few chances. Manager Tim McGregor generally runs a higher-quality portfolio than most peers. The fund currently holds nearly three fourths of assets in bonds rated AAA and AA, while its typical peer holds closer to 53% in those tiers. McGregor doesn't dabble in some of the notoriously volatile areas of the muni market, such as airline or tobacco bonds, but he'll also avoid sectors that other managers are more sanguine toward. Lately, he's steered clear of bonds financing projects and facilities that depend on government appropriations because there's a risk that state and local governments could cut their support as they strain to balance their budgets.

If that caution left some income and return on the table in 2009 and early 2010's recovery, it should assuage fears that municipalities are struggling through the worst economic climate in decades. Don't expect to see any derivatives or leverage in the portfolio, either. Some managers use these tools to boost yield, but they can cause trouble during rough markets like 2008's. In fact, the fund's forthright, high-quality approach helped it lose less than over 90% of its peers that year.

McGregor's caution shouldn't be mistaken for inaction, however. He looks for bonds with appealing structural traits, such as those with high coupons and short call dates, and picks spots on the yield curve where demand appears lax. He'll also trade more quickly to capture small price movements; the fund's annual turnover is well over 100%, multiples more than the category norm. Higher transaction costs are a danger of that approach, but McGregor says he carefully manages relationships with a select group of brokers.

In all, this strategy holds appeal for conservative types, but its price tag has plenty of room to come down. Its 0.75% expense ratio is well above the median 0.56% levy charged by no-load alternatives.

Morningstar Rating

★★★★

Kudos

- Proven management team.
- Portfolio of quality munis can help during challenging times.
- Strong returns over long and short periods.

Risks

- High price tag.
- May lag when riskier bonds perform well.

Strategy

This fund doesn't make huge calls on the direction of interest rates or dip into riskier areas of the muni market. The team's focus on researching the underlying credit of issuers and understanding the potential risks is a major key. The vast majority of the portfolio is composed of bonds rated A or better, and the fund's duration is typically lower than the category average.

Management

Tim McGregor has been at Northern Trust since 1989 and began managing the fund in 1998. Four additional portfolio managers contribute to the strategy and three muni credit analysts aid the management team.

Role in Portfolio

Core

Northern Tax-Exempt NOTEX

Year	Total Return (%)	+/-Category
2009	12.37	-4.93
2008	-1.80	7.65
2007	2.95	1.68

Data through 12-31-09

NORTHERN TAX-EXEMPT FUND

Inception 4/1/1994

AVERAGE ANNUAL TOTAL RETURNS AS OF 3/31/11				TOTAL ANNUAL OPERATING EXPENSE RATIOS	
1-Year	5-Year	10-Year	Since Inception	Gross	Net
-0.26%	3.56%	4.27%	5.03%	0.85%	0.75%

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.

Bond Risk: Bond funds will tend to experience smaller fluctuations in value than stock funds. However, investors in any bond fund should anticipate fluctuations in price, especially for longer-term issues and in environments of rising interest rates.

Tax-Free/AMT Risk: Tax-exempt funds' income may be subject to certain state and local taxes and, depending on your tax status, the federal alternative minimum tax.

Important Morningstar Information: As of 3/31/11, Northern Tax-Exempt Fund received a 4-star rating for overall performance among 253 Muni National Long funds, 4 stars for 3-year performance among 253 funds, 4 stars for 5-year performance among 233 funds, and 4 stars for 10-year performance among 204 funds.

Star ratings are based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The overall rating is a weighted average of the 3-, 5-, and 10-year (if applicable) returns. 5 stars = top 10% of funds in an asset category; 4 stars = next 22.5% of funds; 3 stars = next 35%; 2 stars = next 22.5% and 1 star = next 10%. A fund must be in existence three years to be rated. Ratings are subject to change monthly.

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