

Northern Tax-Exempt NOTEX

This fund's plain approach has paid off.

2-27-12 | by Kathryn Spica, CFA

Northern Tax-Exempt fund succeeds with a sensible strategy.

Manager Tim McGregor takes a straightforward approach to managing this municipal bond fund. He and his team of four portfolio managers and four credit analysts eschew derivatives and leverage that peers occasionally dabble in, and they tread lightly (if at all) in volatile sectors such as tobacco bonds. Over several years they've mostly avoided health-care bonds as a cautious response to budget cuts in the sector; as of December 2011 the fund had only 3.2% of assets in the sector, well below the 16.4% muni national long category median. The crew also more recently shied away from local government bonds, preferring state-sponsored bonds due in part to their lower reliance on property taxes.

In addition to preferring bonds backed by more reliable income streams, the team is also cautious in terms of credit quality. As of December 2011 the fund held roughly 26.7% of assets in bonds rated AAA, more than double the 13.2% and 12.5% stakes of its Barclays Capital Municipal Bond Index benchmark and average rival, respectively. A conservative credit profile helped the team avoid some of the troubles plaguing municipal bonds in recent years. In 2008, the fund's 1.8% loss proved better than 94% of its peers. A longer duration hurt the fund during late 2010's muni bond sell-off, when its 0.2% gain for the year landed below 89% of its peers, but its cautious approach has paid off over the long term. Since McGregor took the lead at this fund in November 1998 through January 2012, its 5.1% annualized return topped its typical peer's 4.4% with less volatility.

In 2012 the fund's expense ratio was slashed by nearly 30 basis points to 0.45%, making the fund one of the category's cheapest no-load options. All told, it's comforting that the team hasn't needed to lean on riskier assets to overcome its expenses in the past, and the attractiveness of the fund's conservative strategy only increases as its costs have come down.

Morningstar's Take NOTEX

Morningstar Rating	★★★★
Morningstar Analyst Rating	🏅 Bronze
Morningstar Pillars	
Process	⊕ Positive
Performance	⊕ Positive
People	⊕ Positive
Parent	⊖ Neutral
Price	⊕ Positive

Strategy

The team focuses on the underlying credit quality and potential risks of municipal bond issuers, aiming to find pockets of inefficiency in bond prices. The team typically avoids the more volatile sectors of the municipal bond market, such as tobacco bonds, and also stays away from derivatives and leverage. The portfolio has a higher-quality tilt, with the vast majority of its bonds rated AA or better.

Management

Timothy McGregor joined Northern Trust in 1989 and has managed this fund since 1998. Four additional portfolio managers and four dedicated municipal credit analysts contribute to the strategy as well as McGregor's other charge, Northern Intermediate Tax-Exempt NOITX.

Role in Portfolio

This municipal bond fund could be used to support a diversified portfolio.

Fund Performance NOTEX

Year	Total Return (%)	+/-Category
2011	11.87	1.23
2010	0.20	-1.45
2009	12.37	-4.93
2008	-1.80	7.65

Data through 12-31-11

NORTHERN TAX-EXEMPT FUND

Inception 4/1/1994

AVERAGE ANNUAL TOTAL RETURNS AS OF 12/31/11				TOTAL ANNUAL OPERATING EXPENSE RATIOS	
1-Year	5-Year	10-Year	Since Inception	Gross	Net
11.85%	4.95%	5.12%	5.45%	0.86%	0.45%

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 December 31, 2012. 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 12/31/11, Northern Tax-Exempt Fund received a 4-star rating for overall performance among 227 muni national long funds, 2 stars for 3-year performance among 227 funds, 4 stars for 5-year performance among 211 funds, and 4 stars for 10-year performance among 181 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.

Northern Funds are not available for distribution outside the United States.

©2012 Morningstar, Inc. All rights reserved. Morningstar and/or its content providers are the proprietors of this information; do not permit its unauthorized copying or distribution; do not warrant it to be accurate, complete or timely; and are not responsible for damages or losses arising from its use.

This reprint is not intended as a recommendation to buy, hold or sell securities issued by the companies mentioned in the article.

Please carefully read the prospectus and summary prospectus and consider the investment objectives, risks, charges and expenses of Northern Funds before investing. Call 800-595-9111 to obtain a prospectus and summary prospectus, which contain this and other information about the Funds.



Managed by
Northern Trust

NOT FDIC INSURED

May lose value/No bank guarantee

Shares of Northern Funds are distributed by Northern Funds Distributors, LLC, Three Canal Plaza, Suite 100, Portland, ME, not affiliated with Northern Trust.