CITING FISCAL UNCERTAINTY, MANAGERS STAY THE COURSE

Half of investment managers surveyed during the fourth quarter 2012 believed the United States would avoid the fiscal cliff; however, one in five thought it might be unavoidable. Managers agreed the impact of the fiscal cliff on the markets will be negative, while a third of managers thought the impact on U.S. gross domestic product (GDP) growth will be more severe than expected. Despite the uncertainty tied to the fiscal cliff and other macroeconomic concerns, managers are staying the course and making few changes to their portfolios. Most expect the U.S. economy to muddle through the fiscal uncertainty, think the outlook for housing and job growth remains positive through the first half of 2013 and perceive U.S. equities as attractively valued.

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Investment managers surveyed in the fourth quarter 2012 took a wait-and-see approach to the fiscal cliff. Fifty percent of managers thought Congress would find a solution to the fiscal cliff before the December 31 deadline, while 22% thought the fiscal cliff might be unavoidable. Looking ahead, most think the impact on U.S. economic growth will be in line with expectations; however, 34% think the impact may be more severe and 39% think a recession may result. Assuming a fiscal solution would be found, 46% think U.S. GDP growth will remain steady and another 33% think growth will accelerate. Although a meaningful amount of uncertainty surrounded the fiscal cliff, managers did not make significant changes to their portfolios. The vast majority of managers made no change to portfolio concentration or cash levels in the quarter.

The positive trends in job growth and housing seen throughout 2012 continued in the fourth quarter. This quarter, 82% of managers expect home prices to rise in the first half of 2013, an important metric for the U.S. economy and consumer confidence. Nearly 80% of managers also believe job growth will remain stable or accelerate in coming quarters. Managers are less confident about corporate earnings, which many see as a meaningful risk to equity markets in 2013. Other risks investment managers are closely watching include the European debt crisis and U.S. debt ceiling, which ranked second and third after the fiscal cliff.

Key Findings: Fourth Quarter 2012 Survey

- 50% of managers thought the United States would avoid the fiscal cliff; 22% disagreed
- 89% anticipated Congress would raise the debt ceiling; 54% see risk for additional downgrades to U.S. credit rating
- 34% think the impact of the fiscal cliff will be more severe than expected; 39% believe the fiscal cliff may result in a recession
- 82% see housing prices increasing in the next six months – highest since survey inception (3Q 2008) and 13 percentage points higher than 3Q
- 79% see job growth remaining stable or accelerating in the next six months
- 55% think market volatility will increase in the next six months
- 50% of managers believe there is upside in U.S. equities; 57% see upside in emerging market equities

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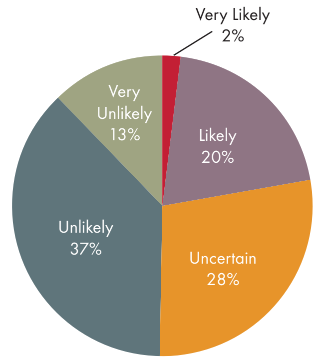
EQUITIES FACE FISCAL CLIFF RISK, MANAGERS FULLY INVESTED

Investment managers surveyed in mid-December ranked the fiscal cliff as the greatest near-term risk to equities. Half of them believed the U.S. government would take appropriate actions to avoid the fiscal cliff. One in five managers thought a resolution would not be found, which the majority agreed would negatively affect both economic growth and the markets.

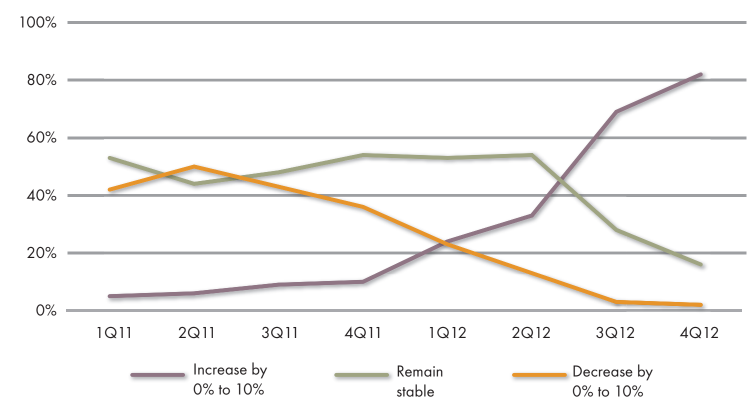
Looking ahead, most believe the impact of the fiscal cliff on economic growth will be in line with Congressional Budget Office (CBO) projections. More than a third of managers, however, think the impact could be more severe and potentially result in a recession. Despite these risks, managers remain fully invested and have not changed their portfolio concentration.

- 50% of managers expect the United States to avoid the fiscal cliff; 22% think it is likely to occur
- 84% believe the fiscal cliff would have a negative impact on the markets
- 39% of managers surveyed think the fiscal cliff could result in recession; 17% do not
- 34% think the impact on GDP growth will be more severe than CBO projections; 16% think the impact will be less severe
- 75% have made no change to their portfolio concentration; 81% are within their normal cash range
- 89% expect Congress to raise the debt ceiling, which 54% think may risk an additional downgrade to the U.S. credit rating

WILL CONGRESS LET THE U.S. GO OVER THE FISCAL CLIFF?



8 IN 10 MANAGERS SEE HOME PRICES RISING



POSITIVE OUTLOOK FOR JOB GROWTH, HOUSING

Despite some looming macroeconomic concerns, managers continue to hold a positive outlook on both job growth and the housing market. In the fourth quarter, the positive trend in the housing outlook continued, with more than 80% of managers expecting home prices to rise over the next six months. This is an increase of 13 percentage points and the highest rate since inception of the survey in the third quarter of 2008. This trend has picked up steam over the last 12 months, and we are now beginning to see evidence of growth in home values. Investment managers are also positive regarding the outlook for employment. Similar to last quarter, a large majority believes job growth will remain stable or accelerate over the next six months. This quarter, the majority (52%) expect job growth to remain stable, while more than a quarter (27%) of managers think job growth will accelerate. Improving clarity around the fiscal cliff may lead to additional hiring by corporations. Inflation is not perceived as a near-term concern, according to the fourth-quarter survey. Seven of 10 surveyed think inflation will remain steady over the next six months. Although there are some areas of economic strength, the majority of managers continue to believe market volatility will increase in the first half of 2013.

- 82% of managers surveyed think housing prices will rise in the first half of next year, up from 69% in the third quarter and 33% in the second quarter
- 27% of managers think job growth will accelerate over the next six months, up from 25% last quarter

- 52% believe job growth will remain stable over the next two quarters
- 72% think inflation will remain steady over the next six months – the highest since the survey's inception
- 55% of managers expect market volatility to increase, down from 69% in the third quarter

MIXED OUTLOOK FOR U.S. GDP GROWTH, CORPORATE EARNINGS

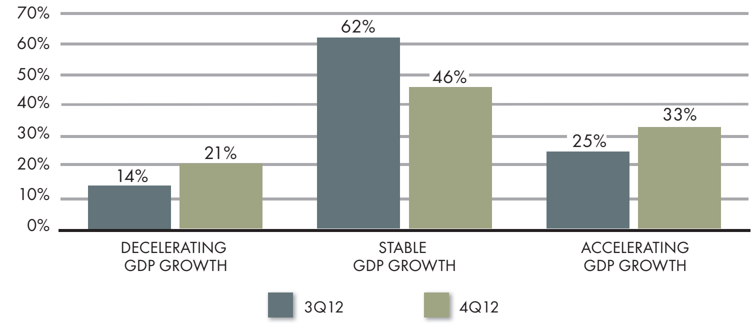
In the fourth quarter, we noted evidence of a growing divergence in managers' views on U.S. economic growth and corporate earnings. This quarter, one-third of managers surveyed expect U.S. GDP growth to accelerate over the next six months, up from 25% in the third quarter. Another 46% think GDP growth will remain steady. However, a growing number (21%) expect GDP to decelerate in the first half of 2013. This divergence is likely tied to the high level of uncertainty regarding the fiscal cliff and the impact it will have on economic growth. Investment managers' expectations for corporate earnings growth are also mixed. Nearly a third think corporate earnings will grow in the first quarter of 2013, while the same number believes earnings will decline. This is the first time since the survey's inception that managers have split on their outlook for earnings.

- One-third (33%) think U.S. GDP growth will accelerate in the first half of 2013, up 8 percentage points and the highest level since the first quarter
- 46% think GDP growth will be stable, down from 62% in the third quarter; 21% think growth will decelerate
- 32% anticipate that corporate earnings will grow in the first quarter 2013 – the highest percentage since the first quarter of 2012
- 32% expect corporate earnings to decline next quarter, virtually unchanged over the last two quarters

MANAGERS SEE UPSIDE IN U.S., EMERGING MARKET EQUITIES

Managers were asked for their views on equity markets in the U.S., Japan and the emerging markets. The majority of investment managers surveyed believe there is upside

WILL THE ECONOMY GROW IN THE FIRST HALF OF 2013?



in equity markets. Most managers viewed the emerging markets as undervalued, while Japan was viewed as less attractively valued. Half of managers surveyed see upside in U.S. equities, down from the third quarter. A large number of managers viewed all three regions as fairly valued, with more upside in the U.S. and emerging markets.

- 57% view equities in the emerging markets as undervalued, compared to 54% last quarter
- 50% of managers think U.S. equities are undervalued; 38% believe they are fairly valued
- The percentage of managers that think the U.S. market is undervalued by more than 10% declined by four percentage points to 12% this quarter
- 45% believe Japanese equities are undervalued; 38% believe they are fairly valued

MANAGERS BULLISH ON U.S. LARGE CAP, EMERGING MARKETS, U.S. SMALL CAP TECHNOLOGY, HEALTH CARE

When asked for their views of various assets classes as well as the broad economic sectors, managers stated they are most bullish on U.S. large caps, U.S. small caps and emerging market equities. The outlook improved for private real estate and international developed equities, and it deteriorated slightly for private equity, hedge funds and government Treasury inflation-protected securities (TIPS).

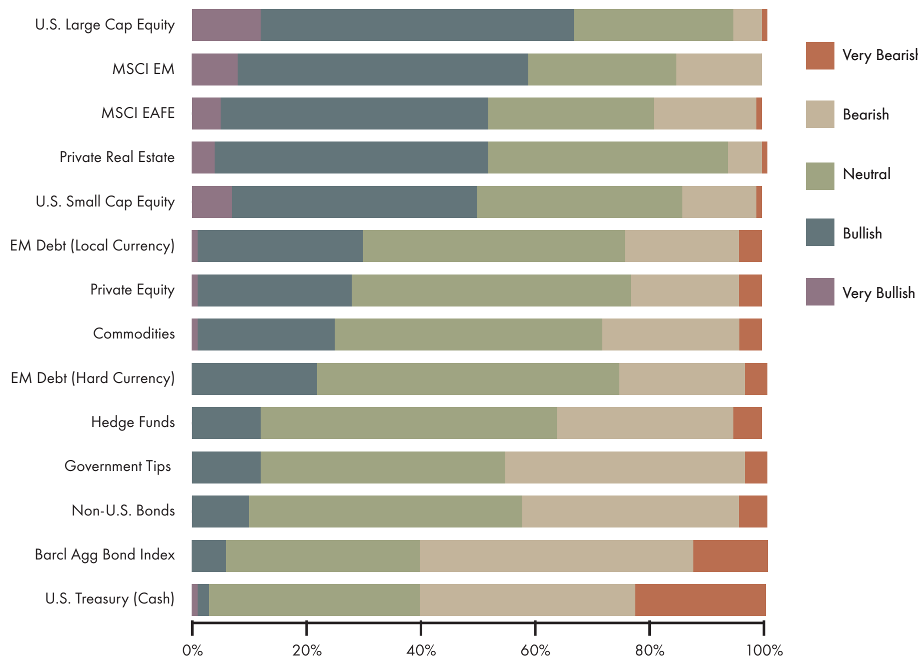
- 67% of managers surveyed are bullish on U.S. large caps, in line with last quarter
- 59% are bullish on emerging market equities, up from 57% last quarter

- 52% have a positive outlook on international developed equities, up from 44% in the third quarter
- More than half (51%) are bullish on private real estate, up from 46% last quarter
- Managers are most bearish on cash (60%), investment-grade fixed income (60%) and government TIPS (45%)

On a sector basis, managers are most bullish on information technology, health care and industrials. The outlook improved for the financial sector, but became more neutral for materials and consumer staples compared to last quarter. Investment managers surveyed in the fourth quarter held the most bearish views on the utilities and telecom sectors, unchanged from the third quarter.

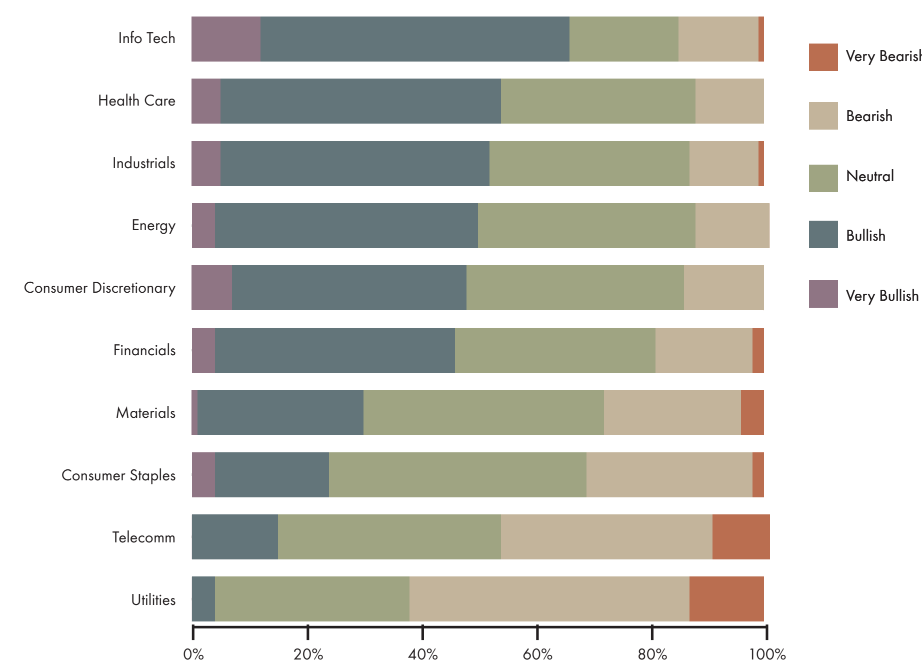
- 66% reported a bullish outlook on information technology, down over the last three quarters from a high of 81% in the first quarter
- 54% expressed a bullish view of the health care sector, unchanged from last quarter
- 52% of the managers held a positive outlook on the industrial sector, up slightly from 51% last quarter
- The outlook for financials improved, with 46% expressing a positive outlook on the sector compared to 39% in the third quarter
- Managers had an increasingly neutral view on consumer staples this quarter at 45%, up from 37% last quarter
- Managers are most bearish on utilities (62%) and telecom (47%)

BULL/BEAR INDICATOR (ASSET CLASS)



Percentages will not add to 100% due to rounding.

BULL/BEAR INDICATOR (SECTORS)



Percentages will not add to 100% due to rounding.

COMMENTARY FROM OUR MANAGERS

This quarter we asked managers to share their views on the fiscal cliff, the expected outcome and the impact on the economy and equity market. The following represents a selection of their responses:

"The economy is already responding negatively to the looming fiscal cliff. Although the equity market appears to be anticipating a resolution, businesses appear to be deferring hiring and investment decisions, holding back growth and employment. While we also anticipate a deal before the next Congressional session begins, failure to reach a deal is likely to be a moderate drag on the economy in the near term."

— Geoffrey Gerber, president/chief investment officer, TWIN Capital Management

"The market is discounting a resolution to the problem. We expect an avoidance of the fiscal cliff but an unsatisfactory solution. The solution will create a modest to moderate impact on the economy but little impact on equity markets."

— Tim Dalton, chairman, Dalton, Greiner, Hartman, Maher & Co., LLC

"Fiscal cliff issues are real and will impact the market if not resolved. Most expect a last-hour announcement of a deal before 12/31 that outlines a broad agreement of higher taxes and slightly reduced spending. Politicians will announce they will tackle the details and the federal debt limit in early 2013. Market will react negatively to any deviation or delay; will react positively if this scenario occurs. Low-quality risk assets are likely to outperform in the short term. However, 2013 is likely to be a tough year. (The) first year of presidential terms (is) traditionally weak. Volatility is likely to increase, not decrease. Corporate earnings are likely to lag. Expect 'grind-it-out' economic environment to continue."

— Matt McCormick, portfolio manager, Bahl & Gaynor Investment Counsel

We also asked managers what other significant risks their investment teams are concerned about and how it is affecting their portfolios. The following represents a selection of their responses:

"We have become less concerned about a hard landing in China. It appears progress is being made as the new leadership is installed, but markets have been bearish on China, so there is some opportunity there. Europe remains a slog, and an example of what lies in store for the U.S. if we do not resolve our fiscal issues. We are modestly increasing our U.S. weightings, staying the course in China, and staying market-neutral in Europe mostly due to low valuation of European equities, not because of high growth expectations."

– Richard Adler, managing director, European Investors Inc.

"Earnings forecasts for next year remain too high. The top-down forecasts for the S&P 500 suggest a big double-digit jump in earnings, which would represent a substantial acceleration from this year's 5% increase. Though some believe this aggressiveness of forecasts is priced in, stocks rarely go up when forecasts are adjusted downward."

— Burns McKinney, managing director/portfolio manager, NFJ Investment Group

"We are worried about a multitude of issues that may have long-term impact on asset valuations and business opportunities. Most of our concerns are well exposed in the mainstream media. Many of these issues are exposed to the point that the perception of a fat tail risk may be fully priced in and, in turn, (pose) less of a risk than generally perceived. So we are partly concerned that we may experience a bigger broader rally as the fiscal cliff gets resolved, the EU makes progress toward centralizing banking oversight and mutualizing debt, and China's new leaders make their policies and goals clear. The absence of these uncertainties – however they are resolved – should enable the markets to advance because generally the markets prefer bad news to uncertainty. Longer term, we are concerned about inflation. Of immediate concern is aggressive monetary ease in the developed world and the effect this is having on the export competitiveness of developing world companies. Moreover, in the U.S. we are seeing the early sign of reflation among consumers and corporations."

— Brian Beitner, managing partner, Chautauqua Capital Management

"Our two biggest concerns outside of the fiscal cliff are whether we will see inflection and acceleration in Chinese and European economic activity, and whether expectations for corporate earnings are too aggressive in 2013. The issues of both level and magnitude of growth have caused us to be less cyclically exposed in the portfolio relative to 2011 and early 2012. We are not making any specific changes to the portfolio as we approach year-end, but have prepared alternatives to address what could be very divergent outcomes over the next three to six months."

— Leo Harmon, managing director, Fiduciary Management Associates

ABOUT THE SURVEY

For its survey, Northern Trust polled a select group of respondents, including fixed income and equity managers across value and growth styles, with a bias toward fundamental, bottom-up stock picking strategies. Invitations to complete the survey were only sent to investment managers that currently manage assets for Northern Trust and its clients. As a result, the survey responses should reflect the beliefs of only the managers in which Northern Trust's Multi-Manager Investments group maintains a high conviction. The survey is conducted quarterly so that Northern Trust and participating managers can examine trends in attitudes and allocations.

ABOUT NORTHERN TRUST MULTI-MANAGER SOLUTIONS

Northern Trust is a leading provider of multi-manager investment solutions, with $37.3 billion under management and $37.6 billion under advisement for institutional and personal clients. Having investments with more than 200 external managers worldwide, Northern Trust Multi-Manager Solutions range from retail mutual funds and alternative asset classes to Emerging Manager programs and total investment program management for institutions and affluent individuals and families.

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