MARCH 2020

CORONAVIRUS CONCERNS

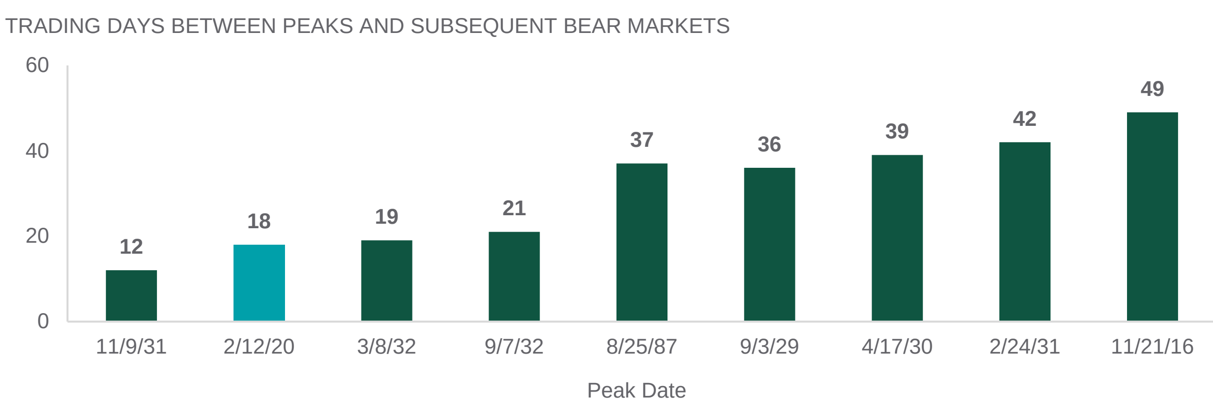
The rapidity of declines in both equity and credit markets over the last month has been of record pace, as investors have grappled with the uncertainty surrounding the economic impact of COVID-19 (coronavirus). In addition, the surprise oil price war between Saudi Arabia and Russia has pressured oil prices and the related energy company bonds and equities. Containment efforts look to be succeeding in the countries hit first (including China and South Korea), but Europe and the U.S. are now seeing an acceleration in cases and implementing containment efforts that will cause a sharp, but short-term, hit to economic growth. The health risk of the coronavirus appears much worse than the seasonal flu, but also much less fatal than the prior coronavirus episodes of SARS and MERS. Our current expectation is to see an acceleration of cases across Europe and the U.S. for the next couple of months, with the potential for a plateauing by July or August.

We are focused on the upcoming policy responses from monetary, fiscal and health authorities. Monetary policy has been first out of the gate, with interest rate cuts and liquidity programs from the U.S. Federal Reserve and aggressive action from the Bank of England. The European Central Bank has been more measured in its actions so far, but monetary policy by itself won't resolve this situation. Fiscal action to "bridge the gap" is necessary, and initial signs are forming of a response in the U.S. where neither party can afford to be obstructionist. Additionally, the European Commission is readying to suspend budget rules that would allow fiscal stimulus.

This leaves us with health policy as the final input, and developments will move quickly on this front. The U.S. has granted accelerated approval to new testing capabilities and it appears a potential vaccine may be going into testing in several weeks. Improved testing can help manage the current case load, while an effective vaccine will reduce the risk of a return next year. The next several months will deliver a lot of new information pertaining to the outlook, making significant portfolio moves at the present risky. In our global policy model, we modestly reduced exposure this month to developed ex-U.S. and emerging market equities, reallocating toward high yield and investment grade bonds. For our Goals Driven Wealth Management clients, we have activated portfolio reserves to fund current spending needs out of risk control assets. In the months ahead, we will pay special attention to policy actions (fiscal, health) and market action (credit spreads, asset price reaction to bad news) as we assess the outlook for risk-taking over our tactical horizon.

ONE OF THE QUICKEST BEAR MARKETS IN HISTORY

Most prior similar episodes happened during the Great Depression – but things aren't going to be that bad.



Source: Northern Trust Global Asset Allocation, Bloomberg. Shortest peak-to-bear market periods shown. Data shown for Dow Jones Industrial Average beginning 1/1/1900. Blue bar denotes recent peak-to-bear market event. Bear market defined as 20% decline from recent peak using end of day prices.

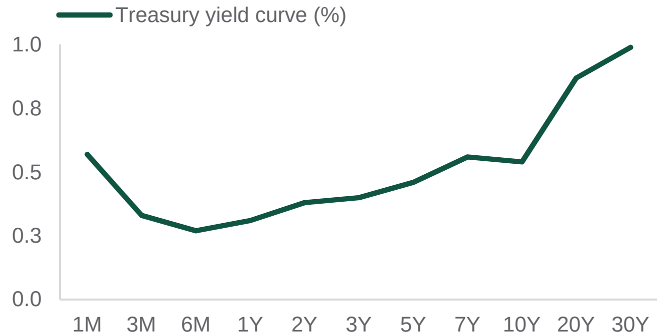
Interest Rates

March has seen rapid declines in U.S. Treasury rates with some steepness reintroduced to the yield curve as the Fed made the surprise decision to cut policy rates by 0.5% in early March. Compounding the virus outbreak, the oil price war sent rates on government bonds to all-time lows with the yield on the benchmark 10-year Treasury briefly falling below 0.4% and the 30-year briefly hitting 0.7% – leaving the whole U.S. yield curve below 1% for the first time in history. Amid deeply unsettled markets, strong demand for central bank liquidity and massive demand for Treasuries led the Fed to increase the size of its repo operations.

As the virus intensifies, risk remains tilted to the downside and Treasury yields are likely to continue to rally. European government bond yields, already in negative territory, declined further with many reaching historic lows. Germany's 10-year yield decreased 15 basis points (bps) to -0.8%, its 8th straight decline and lowest yield on record. Britain's 10-year yield dipped seven bps to 0.1%, reaching its lowest on record with its 15th straight decline. The Bank of England made an emergency 0.5% cut in response to the virus. Central banks across the globe are pledging to do whatever is necessary to limit economic pain. Despite lower rates, we still like duration in this environment.

HISTORY IN THE MAKING

The entire yield curve is below 1% for the first time.



Source: Northern Trust Global Asset Allocation, Bloomberg. Data as of 3/9/2020.

- Interest rates are at historic lows.
- Low rates reflect both a flight to safety and the expectation for slower growth and inflation.
- We continue to like duration exposure in the global policy model.

Credit Markets

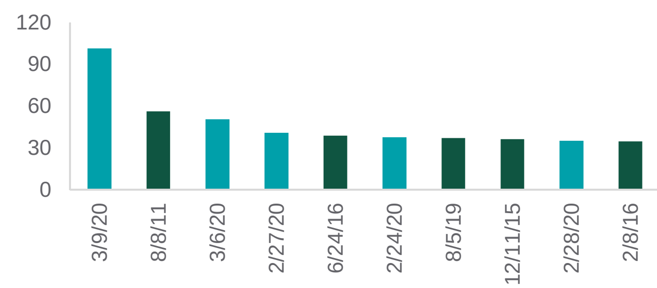
On March 9, the high yield market experienced its second largest decline in 15 years (-3.1%), alongside a nearly 8% decline in the S&P 500 and a $10 drop in the price of oil as an oil price war erupted between Saudi Arabia, Russia and U.S. shale producers. The high yield market widened nearly 100 bps on March 9, driven by the largest one-day widening on record for the energy sector. Issuer performance in this sector will continue to be idiosyncratic and security selection will be crucial.

The past two weeks have been incredibly volatile. As the graph shows, four of the six largest daily spread widenings of the credit cycle have occurred in this period. The market spread is now nearly double what it was at the beginning of the year. Based on the market liquidity premium and expectations for the future default rate, it appears the market is now wide of fair value, which may be supportive of risk assets. The market now offers investors a multi-year high of roughly 7.25% yield with a backdrop of coordinated global monetary policy, expected fiscal response to combat the impact of the coronavirus and a default rate (ex-energy) that is expected to stay below the long-term average. For these reasons, we increased the high yield allocation in our global policy model this month.

CREDIT SPIKES

Recent spikes rank among the biggest of the cycle.

LARGEST DAILY INCREASES IN HY SPREAD (BPS)



Source: Northern Trust Global Asset Allocation, J.P. Morgan. Blue bars denote days in 2020. Data as of 3/11/2020.

- Credit markets have been historically volatile.
- Recent spikes have been tied to oil price weakness.
- We remain overweight high yield as a "lower risk" risk asset that seeks to mitigate downside risk.

Equities

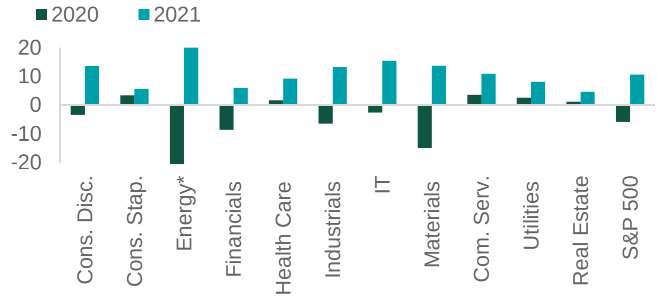
Global equities have retreated sharply over the past month as COVID-19 expanded its reach globally, leading to containment responses that threaten economic activity. Initial supply chain disruption in China and concerns about slowdowns for travel-oriented industries has evolved into a broader disruption of supply and demand. The uncertainty has led to few attempts to quantify the impact by companies and Wall Street analysts. As a result, consensus earnings expectations globally have barely budged despite now being unrealistic. Our new base case for 2020 earnings results in an 11% negative revision to the Street consensus, equating to a 5% decline versus 2019 – somewhat better than we expect outside the U.S.

The chart shows our sector-level framework for the U.S., including significant negative revisions in commodities and financial services (lower interest rates). We do believe a portion of the 2020 decline is a deferral of activity rather than a new baseline of earnings, suggesting 2021 earnings shouldn't necessitate the same level of cuts. Near-term forecasting is challenging, but the resiliency of the U.S. economy, combined with monetary and fiscal support, should serve to limit further downside if the duration of the disruption is limited to a couple of quarters.

EXPECTING A RECOVERY IN 2021

Looking for >10% growth in 2021 after a down 2020.

NT EPS GROWTH FORECASTS (%)



Source: Northern Trust Global Asset Allocation. *Energy forecast reaches -75% in 2020 and 25% in 2021.

- The one-two punch of the coronavirus and the oil price shock should lead to lower earnings growth.
- The severity of the market drop will depend on the duration of the coronavirus fears.
- We favor U.S. equities in this environment.

Real Assets

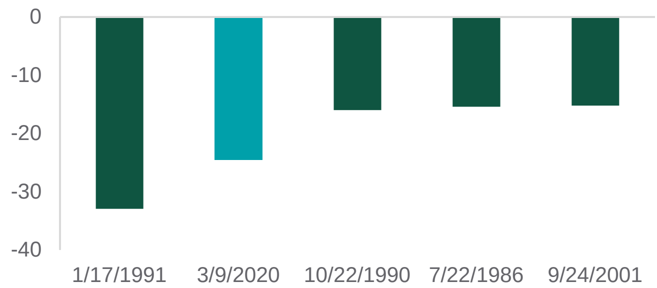
Global oil markets had already been pressured by demand issues related to COVID-19. And they saw another massive leg down as Saudi Arabia initiated a price war after being unable to agree to production cuts with Russia. Saudi Arabia – benefitting from a lower marginal cost of production – moved its production target to 13.0 million barrels/day from the prior target of 12.3 (and actual production levels of 9.7). Effectively, Saudi Arabia is signaling that if Russia doesn't want to participate in deeper production cuts, the Saudis are willing to do whatever is necessary to make Russia feel the pain.

We believe the pressure on Russia to come back to the table and seriously talk about production cuts is rising, but slowly. Saudi Arabia does not appear willing to wait and do nothing, and will press the issue by unleashing a flood of oil by letting the OPEC-plus agreement expire on April 1. The volume of new crude coming to market over the next one-to-two quarters is estimated to be as high as 5 million barrels/day, which would more than offset possible buying for strategic petroleum reserves in the U.S. and China. An agreement could take the pressure off oil prices, but it is difficult to see prices rising back above $50/barrel given the demand overhang from COVID-19. We remain underweight natural resources as a result.

OIL PRICE DROPS

March had the second-largest oil price drop in history.

FIVE LARGEST DAILY DECLINES IN OIL PRICES (%)



Source: Northern Trust Global Asset Allocation, Bloomberg. Blue bar denotes recent daily decline. WTI Crude Oil used as a proxy for oil prices. Data from 3/30/1983 – 3/12/2020.

- Oil prices have fallen precipitously due to both demand and supply issues.
- Saudi Arabia's price war should keep oil prices low.
- A continued low oil price endorses an underweight to natural resources in the global policy model.

BASE CASE

Fundamentals vs Geopolitics

Investor focus has shifted to evaluating the severity of economic impacts from geopolitical uncertainties (primarily the coronavirus). Monetary and fiscal policy responses will be crucial to mitigating virus-related growth disruptions. A resumption of economic activity will help boost investor sentiment.

Structural Monetary Accommodation

Major central banks globally will remain accommodative for the foreseeable future, with near-zero prospects for any rate hikes. Central banks will try to help offset virus-driven economic and financial market pressures, but have limited means to do so and will need to coordinate with fiscal policymakers.

RISK CASES

Sustained Coronavirus Concerns

Containment efforts could fail to slow the global spread of the coronavirus by mid-2020. It could possibly re-escalate in China or spread to India, leading to continued pressure on financial markets.

Geopolitical Skirmishes

Coronavirus uncertainty is viewed as an opportunity by geopolitical actors. Tactics used (e.g. cyberattacks) may offset virus-driven policy responses and weigh on the growth outlook in targeted countries.

GLOBAL POLICY MODEL

Strategic Allocation and Tactical Over/Underweights	RISK CONTROL			RISK ASSETS							
	FIXED INCOME				EQUITIES			REAL ASSETS			
	Cash	Inv. Grade	TIPS	High Yield	U.S.	Dev. Ex-U.S.	Emerg. Markets	GLI	GRE	NR	Gold
Strategic Asset Allocation	2	34	5	5	25	15	6	2	2	4	0
Tactical Asset Allocation	0	30	0	11	31	14	2	4	5	3	0
Over/Underweight	**-2**	**-4**	**-5**	**6**	**6**	**-1**	**-4**	**2**	**3**	**-1**	**0**

Source: Northern Trust Capital Market Assumptions Working Group, Investment Policy Committee. Strategic allocation is based on five-year models developed annually; most recent model released 8/8/2019.The model cannot account for the impact that economic, market and other factors may have on the implementation and ongoing management of an actual investment strategy. Asset allocation does not guarantee a profit or protection against a loss in declining markets.