FIRST QUARTER 2021

HIGHER RATES, LOWER RETURNS

PERFORMANCE

In the first quarter of 2021, the model portfolio returned -3.38% vs. -3.37% for the Barclays U.S. Aggregate Bond Index. Duration positioning and security selection detracted from relative performance, while sector allocation slightly aided relative performance.

MARKET ENVIRONMENT

The Fed made no major policy changes as it stressed the difficulty of realizing persistently higher inflation. Investors challenged the Fed's ability to maintain ultra-accommodative policy against a backdrop of rapidly improving economic activity boosted by huge stimulus. This Fed-investor dichotomy led to a steeper U.S. yield curve with shorter-maturity yields holding firm while investors pushed longer-dated yields above pre-virus levels. Government bond yields faced upward pressure globally, but real yields are still stimulative overall.

The improving economic growth trajectory pushed up future corporate earnings expectations. As is often the case, this led to some spread tightening. Vaccine-led normalizing economic activity and bolstered corporate liquidity, helped by added fiscal stimulus, slowed corporate defaults. Rising interest rates and less room for spread compression weighed on returns in credit-sensitive securities, but fundamentals remain strong.

First quarter performance in the Core Select Bond portfolio was driven primarily by expectations for a strong economic recovery. Interest rates (led by longer maturities) and inflation expectations (driven by near-term maturities) increased, while risk markets performed very well. Lower-quality credit outperformed higher-quality credit.

SECTOR POSITIONING

Our largest overweight at the sector level is in intermediate credit, followed by notably smaller over-weights in long credit and cash. Our largest underweight at the sector level is in 1-10 year government bonds, followed by less significant underweights in commercial mortgage-backed securities, 10+ year government bonds and mortgage-backed securities.

MODEL HOLDINGS

Sector	Exchange Traded Funds	Ticker	Net Expense Ratio	Estimated Trailing 12-Month Yield	Weight
Corporate Bonds					**58%**
	FlexShares Credit--Scored US Corporate Bond Index Fund	SKOR	0.22%	2.14%	45%
	iShares Short-term Corporate Bond	IGSB	0.06%	2.25%	0%
	FlexShares Credit-Scorerd Long Corporate Bond Index Fund	LKOR	0.22%	3.20%	8%
	iShares Long-term Corporate Bond	IGLB	0.06%	3.47%	5%
Mortgage-Backed Securities					**27%**
	FlexShares Disciplined Duratin MBS Indx Fund	MBSD	0.20%	2.84%	14%
	iShares MBS	MBB	0.06%	2.04%	13%
Treasuries					**14%**
	iShares 3-7 Year Treasury Bond	IEI	0.15%	0.98%	5%
	iShares 7-10 Year Treasury Bond	IEF	0.15%	1.02%	2%
	iShares 20+ Year Treasury Bond	TLT	0.15%	1.65%	7%
Cash & Short-term					**1%**
	FlexShares Ready Access Variable Income Fund	RAVI	0.25%	1.04%	1%
	Money Market	NOGXX	0.35%	0.03%	1%
	Total (asset weighted)		**0.18%**	**2.24%**	**100%**

Source: The portfolio holdings, characteristics and sector allocations are for illustrative purposes only, subject to change and can vary for individual accounts. Allocations may not equal 100% due to rounding. Northern Trust Investments, Inc. products including FlexShares ETFs and Northern Funds could represent up to 100% of the portfolio holdings. With respect to such funds, NTI and its affiliates provide investment advisory, custodial, administrative, shareholder support and other services and receive fees. Such investments present a conflict of interest because NTI, an affiliate, or a related person has a financial interest in the transaction.

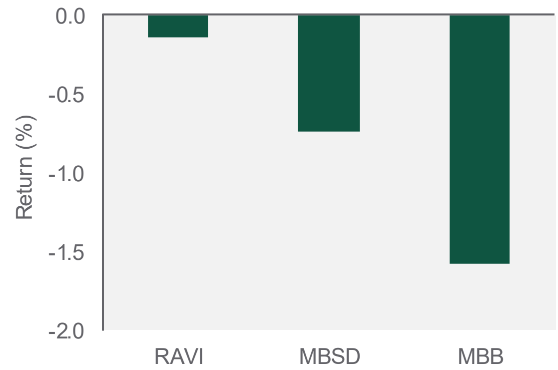
WHAT DID BEST

It was a tough quarter for all component pieces, as the rise in interest rates impacted almost all holdings to a certain degree. That said, some holdings were able to weather the interest rate storm better than others. Specifically, lower duration **(RAVI)** and mortgage-based security **(MBSD/MBB)** holdings.

RAVI did as expected during an interest rate uptick like we saw in the first quarter: it underperformed cash, but held up better than other fixed income sectors and strategies. As interest rates stabilize, and if history is any guide, we would expect **RAVI** to regain a return advantage over pure money market funds (especially as the Fed continues to hold the short-end of the curve at 0%).

MBSD and **MBB** – our index-based and factor-based mortgage-backed security strategies – also provided relative relief in the quarter. A strong housing market and investor flows provided a boost, while rate-volatility and rapidly increasing prepayments were a headwind. **MBSD** outperformed **MBB** due to its targeted duration approach, which further helped alleviate the impact from higher rates.

TOP PERFORMERS



Source: Northern Trust. Chart reflects the return of the top three performing holdings in the portfolio.

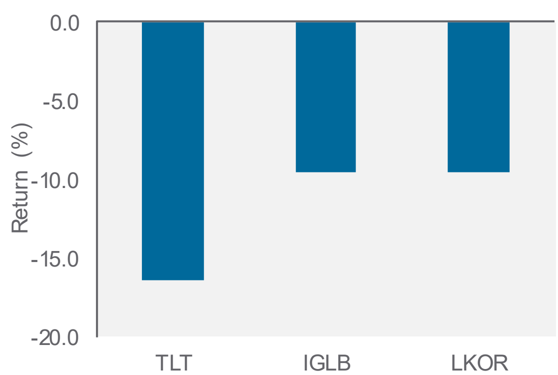
WHAT DID WORST

Longer-duration holdings in the portfolio were hurt as the 30-year U.S. Treasury suffered its worst 3-month performance since 1980. The market move, which had not been seen since the taper-tantrum in 2013 and the election in 2016, meant that the long Treasury **(TLT)** and long credit **(IGLB/LKOR)** holdings suffered.

TLT is a pure play on long-dated U.S. Treasuries and will be most impacted by the rate environment we just witnessed. Inflation expectations hitting levels not seen in 15 years and a market pricing in Federal Reserve tightening much faster than we (or the FOMC) expect weighed on **TLT.**

IGLB and **LKOR**, while also consisting of long-dated securities, received some cushion from credit exposure. Credit markets outperformed rate markets led by down-in-quality credits as the economy recovered and defaults were close to zero. However, even with that cushion, long-dated credit securities saw material headwinds in the form of higher rates – leading to near-double digit return drawdowns. The factor-based **LKOR** performed more-or-less in-line with the index-based **IGLB**.

BOTTOM PERFORMERS



Source: Northern Trust. Chart reflects the return of the bottom three performing holdings in the portfolio.

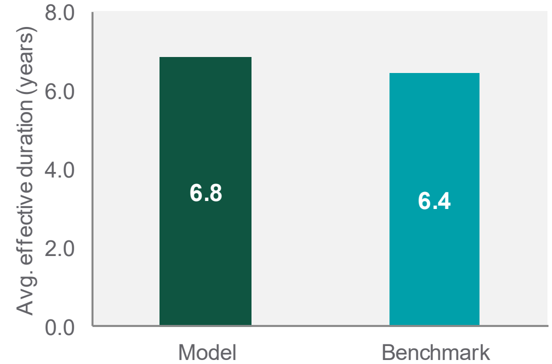
INTEREST RATE VIEWS

Throughout the quarter, we maintained a neutral-to-slightly-longer duration profile. Our curve and duration position held in well through most of the bear steepening, however as rate volatility moved into the curve (3-year-10-year) during March, our performance suffered.

Although the speed of the selloff, increase in inflation expectations, and bringing forward of central bank tightening has moved faster than we thought, risks in our view appear more balanced. It will be up to the near-term economic data, trajectory of the virus, and future tax policy to determine the next move in rates. Longer term we do not feel enough has changed to change our rate outlook and will position accordingly moving forward.

Inflation markets are pricing in inflation expectations not seen in 15 years. Market pricing of Fed policy has brought a tightening cycle forward to 2022, well before even the FOMC expects (2024). Flows continue to pile into the asset, even more so as equity markets reach new highs. Even as growth this year will remain robust, and perhaps into next year, longer-term structural forces will keep rates low and prevent the Fed from a premature tightening cycle.

CURRENT DURATION POSITIONING



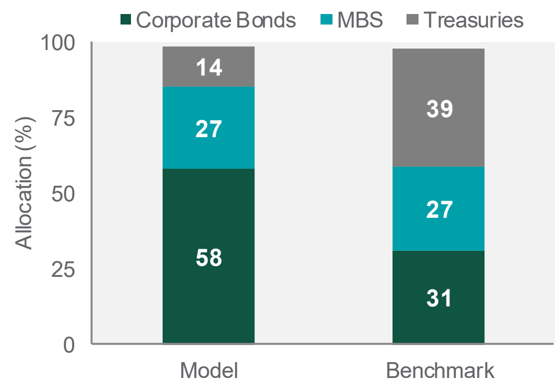
Source: Northern Trust. Model is Core Select Bond Portfolio; Benchmark is Barclays U.S. Aggregate Bond Index. Current as of end of quarter.

SECTOR VIEWS

From an allocation standpoint, we have preferred credit markets over treasuries for some time, and that was maintained during the quarter. Fundamentals continue to improve, supply is expected to slow, and defaults continue to arrive much slower than market expectations. We also remained neutral-to-underweight mortgage-backed strategies as rate volatility and pre-payment speeds became too uncertain.

We enter the second quarter positioned for the same dynamic to continue in risk markets. Along with improving fundamentals and technicals, we also have a central bank committed to keep financial conditions accommodative. Tentative signs are emerging that interest-rate volatility is subsiding, which is also helping credit markets.

CURRENT SECTOR POSITIONING



Source: Northern Trust. Model is Core Select Bond Portfolio; Benchmark is Barclays U.S. Aggregate Bond Index. Positions may not sum to 100 because cash allocation is not included. Current as of end of quarter.

CONCLUSION

In the first quarter of 2021, investors increasingly priced in improving economic data as uncertainties around the U.S. presidential election result, including the makeup of Congress, were lifted in early January and vaccine rollouts picked up pace. Indeed, a new fiscal stimulus package along with increased discussions around an infrastructure package led investors to expect higher inflation and in about 18 months an actual tightening of central bank policy rates. Economies are poised to perform better this year than 2020 and some of the supply disruptions will weigh on goods prices over the near term; however longer-term structural inflation headwinds remain.

Credit markets performed well in the first quarter as improvements in corporate fundamentals and expectations took hold. Rates, and rate-sensitive assets performed poorly as participants re-calibrated expectations. The Core Select Bond portfolio benefitted from the risk allocation, but this was offset by our duration and curve positioning.

Our expectations are that recent rate volatility will subside and eventually the market pricing of runaway inflation and central bank tightening will fade. Risks to our view surround future fiscal policy leading to economic overheating; however, future tax policy (or crowding out due to higher debt loads) could perhaps counteract inflationary pressures from potential spending. We maintain our preference for risk and will watch for signs of interest rate stability before making any significant allocation or duration changes.

We will continue to put our skills to work at identifying medium-to-long-term turning points in interest rate, credit and economic cycles. Maintaining a disciplined portfolio construction process that ensures our risks are intentional and compensated, remains a priority. We look forward to keeping you informed of our thoughts and results going forward.