NORTHERN TRUST

SECOND QUARTER 2021

INCOME

Equity markets performed well in the second quarter, with gains across each major global equity region as well as positive returns across most fixed income asset classes. The global growth backdrop remained constructive as economies moved towards reopening, while better-than-expected earnings growth also helped support equity market returns. Investor concerns focused on the inflation outlook and its potential implications on Federal Reserve policy. After rising to 1.74% by the end of the first quarter, interest rates declined in the second quarter, with the 10-year Treasury yield stabilizing around 1.50% in June and ending the quarter at 1.47%. The credit environment remained constructive with tightening credit spreads in the second quarter across both investment grade and high yield fixed income – helped by improving corporate fundamentals and continued investor demand for yield. In central bank policy, the European Central Bank remained highly accommodative, while Fed leaders reiterated a patient approach towards achieving the central bank's inflation and full employment goals after increased investor concerns that the Fed was becoming more hawkish following the June meeting.

We made no changes in asset allocation in the quarter. We remain constructive on risk assets as the global growth environment continues along a positive trajectory during the pandemic recovery, helped by accommodative monetary policy and our view that the rise in inflation is likely to prove transitory. Currently, the portfolio has broad-based overweights to risk assets including developed ex-U.S. equities, natural resources, global listed infrastructure, U.S. equities and emerging market equities, funded by underweights across cash, municipal investment grade fixed income and inflation-linked fixed income. The portfolio ended the quarter with a higher risk level than its strategic benchmark.

Performance for the quarter was mainly helped by tactical positioning, in addition to more modest support from fund implementation and strategic positioning. Strategic positioning helped performance to a small extent as support from risk assets outperforming risk control assets mostly outweighed some headwinds from municipal high yield fixed income trailing global equities. Tactical positioning benefited performance due to the overweight to natural resources, the overweight to U.S. equities and the overweight to developed ex-U.S. equities. Our municipal investment grade fixed income strategy (NOTEX) and our municipal high yield fixed income strategy (NHYMX) were the main contributors in terms of fund implementation, while our quality dividend U.S. equity strategy (QDF) was the main detractor.

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