



FIVE-YEAR MARKET OUTLOOK

SLOW GROWTH CREATES HEADWINDS FOR PUBLIC FUND AND TAFT-HARTLEY PLANS

Public fund and Taft-Hartley plans face headwinds in today’s market environment and we do not see that changing over the next five years. Getting asset allocation “right” will be paramount in achieving your critically important plan objectives. Our latest five-year market outlook can serve as a useful reference as you tackle strategic portfolio construction decisions.

Equity valuations look high in a historic context, core fixed income yields are low and only a few asset classes are likely to produce high single-digit returns, namely private equity and emerging market equities (see Exhibit 1). This will be the primary challenge pensions face in building cost-efficient and lower risk portfolios that return 6–7% annually over the next five years.

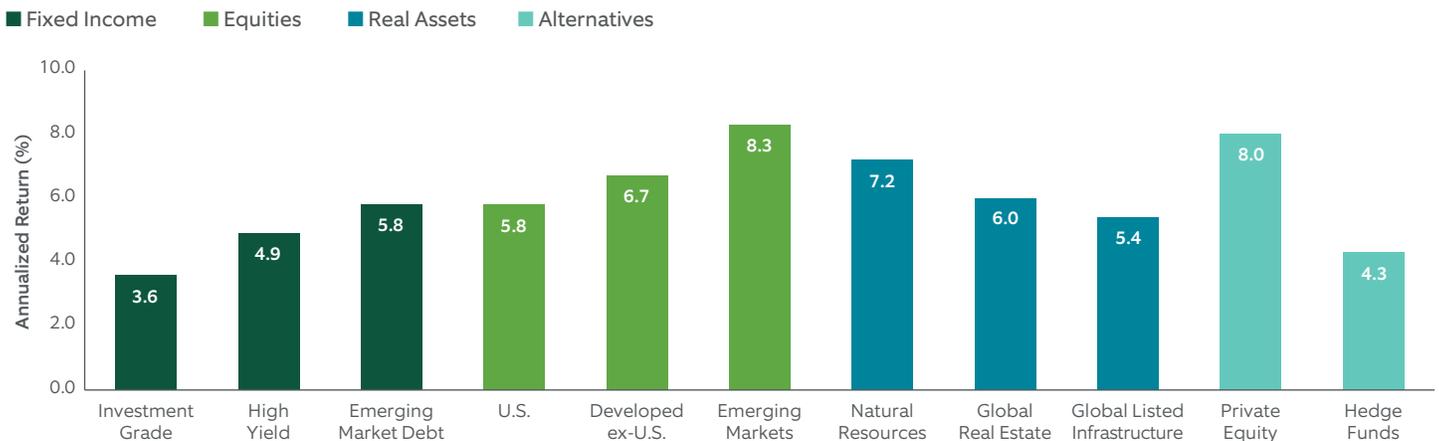
Traditional approaches to bolster returns often resulted in a flight to private markets, but high fees and lack of transparency make that space potentially harder to invest in with today’s heightened

fiduciary standards. High yield, emerging market debt and emerging market equities have been popular public market options that we believe remain attractive over the next five years.

While low interest rates and elevated global equity valuations will persist, a greater focus on risk budgeting may require pensions to expect more active return contributions from their core risk assets.

Two key strategic themes are driving this outlook — **Mild Growth Myopia** and **Stuckflation**.

EXHIBIT 1: FIVE-YEAR FORECASTS FOR KEY ASSET CLASSES



Source: Northern Trust. Forecasts listed here represent total return forecasts for primary asset classes, annualized using geometric averages. Forecast returns are based on estimates and reflect subjective judgments and assumptions. They are not necessarily indicative of future performance, which could differ substantially. Returns are annualized for the five-year period ending 6/30/2018.

U.S. GROWTH: LOW AND SLOW

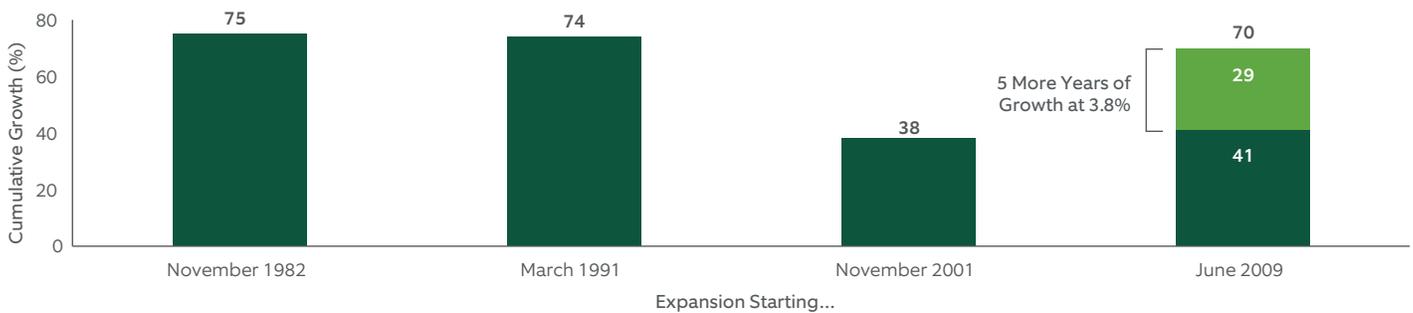
Our **Mild Growth Myopia** theme discusses how the current U.S. economic expansion has been much slower versus previous periods. Nearly 10 years into the current expansion, the cycle has matured and recession odds have risen — but the onset of a slowdown will be later and less threatening than suggested by the standard playbook.

As shown in Exhibit 2, even if the U.S. grew at our expected nominal growth rate of 3.8% for five more years, the cumulative growth would still be less than the boom in 1982 and 1991.

The Bottom Line: Subdued economic cycles and stronger financial systems will push out the next recession and limit its severity. We think this bull market has room to run.

EXHIBIT 2: RECORD-BREAKING EXPANSION LENGTH, BUT NOT MAGNITUDE

Even with five more years of growth, total output will still be shy of 80s and 90s expansions.



Source: NT Global Asset Allocation, Bloomberg.

INFLATION IS NOT GOING ANYWHERE

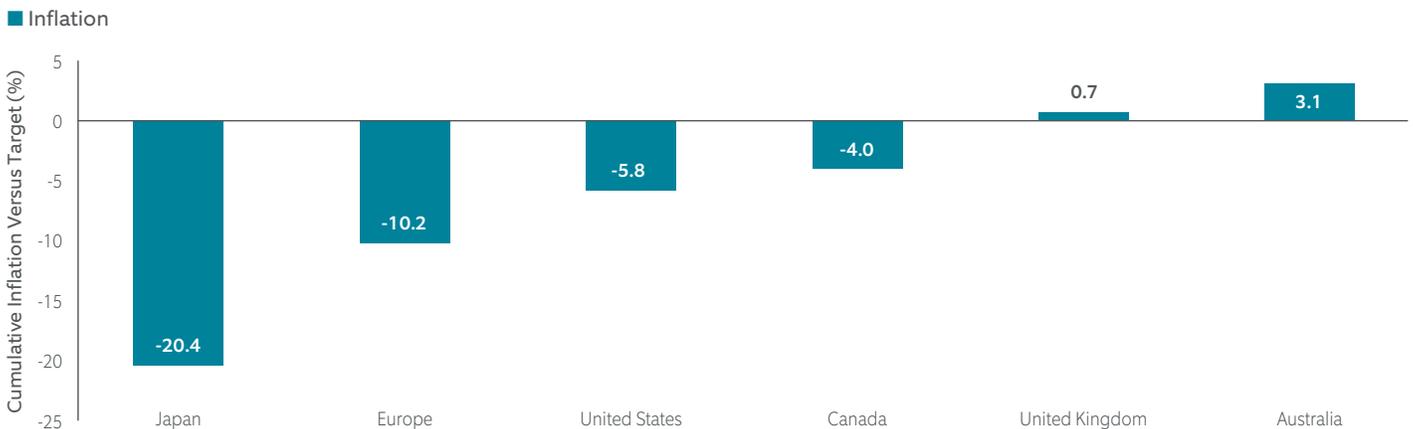
Inflation is “stuck” and has remained below most central banks’ targets of 2% for the last decade and should stay that way for some time. In fact, U.S. inflation has fallen behind the Fed’s 2% target by 5.8% cumulatively, over the last decade (see Exhibit 3).

We believe a modest trade war would have less of an impact on long-term inflation than many fear, while a large trade war would

actually lower inflation because of its damage to confidence and, ultimately, to demand.

The Bottom Line: Low inflation should keep yields down, meaning pension plans may need to consider increasing allocations to high yield, private credit or dividend yielding equities to meet plan distribution objectives.

EXHIBIT 3: CUMULATIVE INFLATION SHORTFALLS OVER THE LAST DECADE



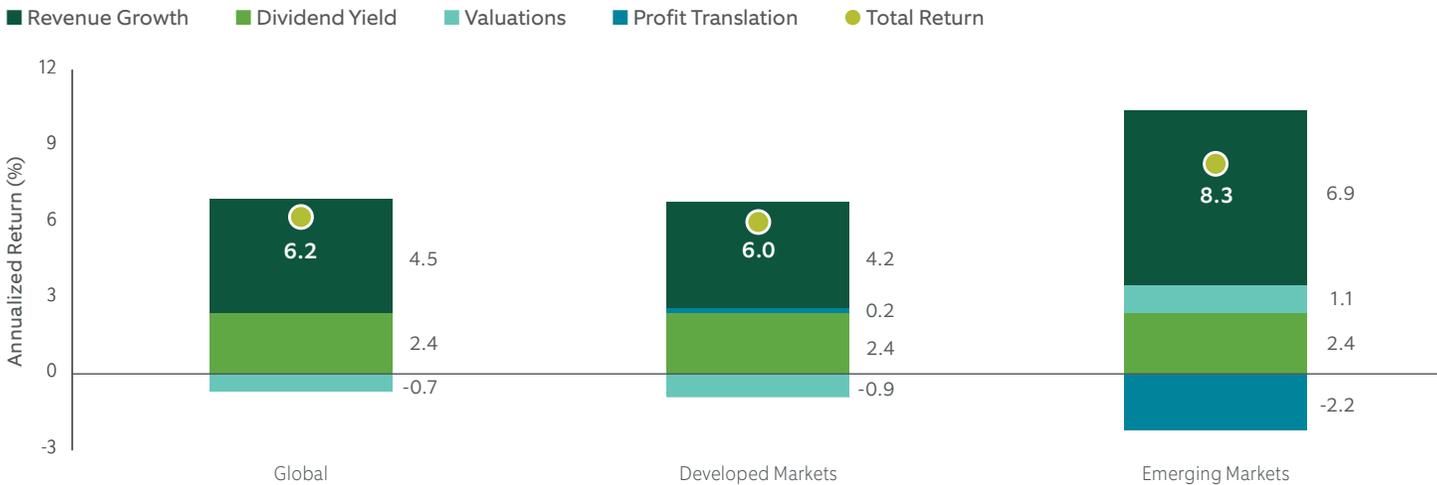
Source: NT Global Asset Allocation, Bloomberg. Data from 6/30/2008 to 6/30/2018. Blue bars represent the core inflation measures.

FINAL THOUGHT: BE CREATIVE WITH RISK

Public fund and Taft-Hartley plans will need to be astute and creative with their risk budgets over the next five-years in order to hit return targets. We believe slow growth will persist and fuel high single-digit returns in equities globally, with only slight valuation contraction in developed market returns and valuation expansion in emerging markets.

Overall these remain attractive core risk assets to potentially garner a return “boost,” with greater liquidity and transparency, to complement your private investments.

EXHIBIT 4: HIGH LEVEL EQUITY RETURN BUILDING BLOCKS



Source: Northern Trust Global Asset Allocation. Forecasts of financial market trends that are based on current market conditions constitute CMAWG judgment and are subject to change without notice.

Explore Our Full Five-Year Outlook

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- Get exclusive access to our full research paper
- Explore our detailed return/risk and correlation matrix

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