## 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.

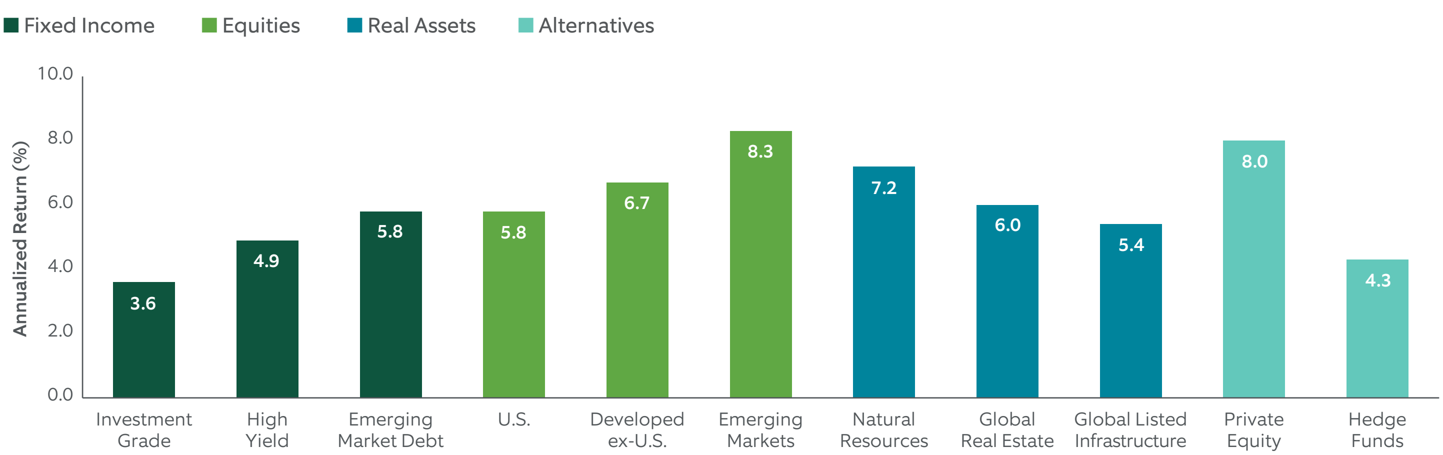
Equity valuations look high in a historic context, core fixed income yields are low and only a few asset classes are likely to produce high single-digit returns, namely private equity and emerging market equities (see Exhibit 1). This will be the primary challenge pensions face in building cost-efficient 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: Nothern 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

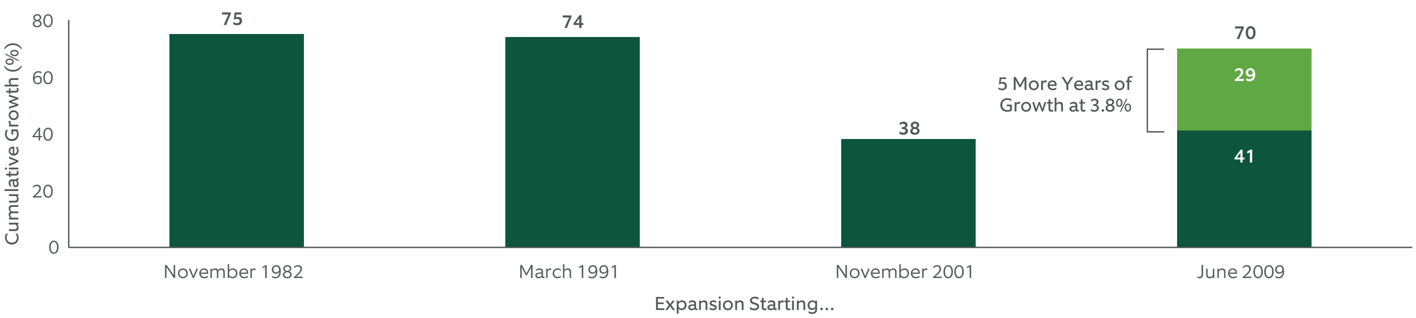
Our **Mild Growth Myopia** theme discusses how the current U.S. economic expansion has been much slower versus previous periods. Nearly 10 years into the current expansion, the cycle has matured and recession odds have risen — but the onset of a slowdown will be later and less threatening than suggested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

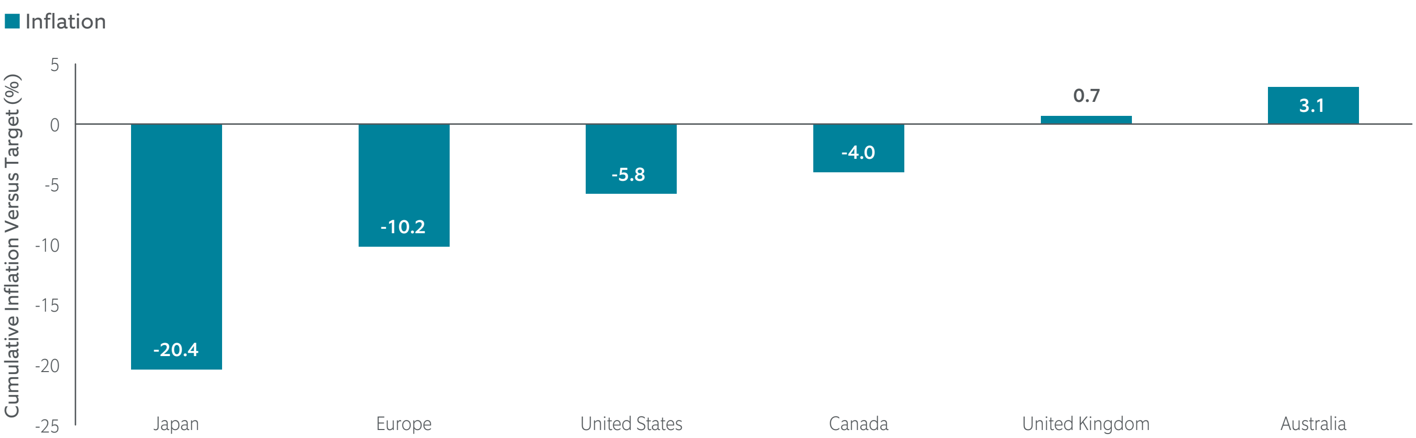
# INFLATION IS NOT GOING ANYWHERE

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**



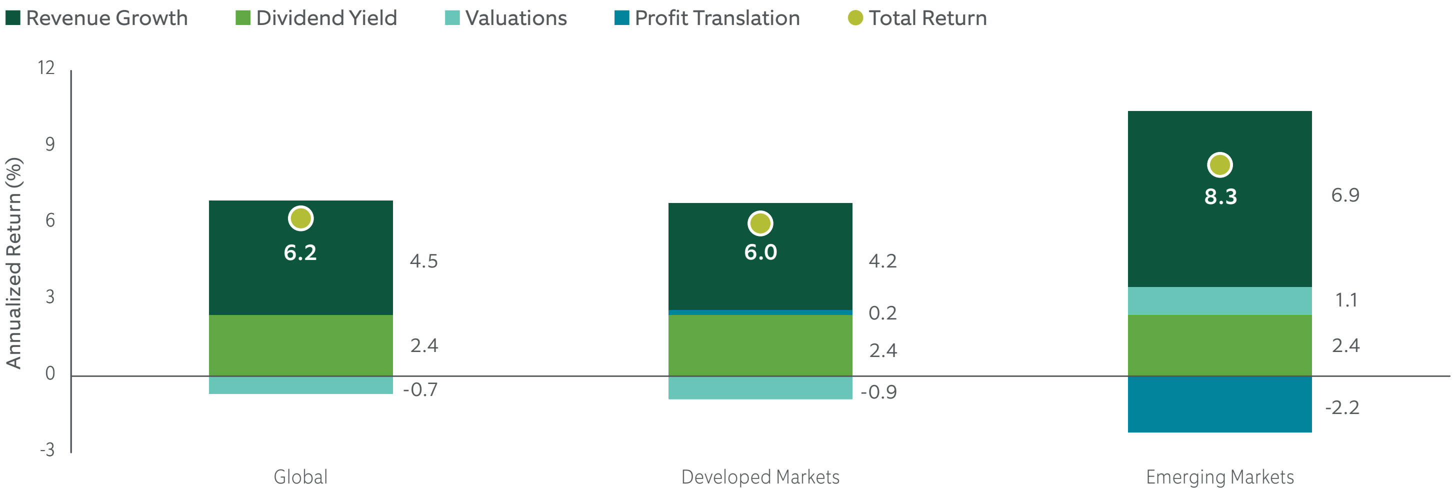

Source: NT Global Asset Allocation, Bloomberg. Data from 6/30/2008 to 6/30/2018. Blue bars represent the core inflation measures.

# 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

Explore our long-term asset class return expectations and forecasts at capitalmarketassumptions.com. Visit today to:

- Gain valuable insights from our investment experts
- Get exclusive access to our full research paper
- Explore our detailed return/risk and correlation matrix

# ABOUT NORTHERN TRUST ASSET MANAGEMENT

Northern Trust Asset Management is a global investment manager that helps investors navigate changing market environments, so they can confidently realize their long-term objectives.

Entrusted with more than $900 billion of assets,[1] we understand that investing ultimately serves a greater purpose and believe investors should be compensated for the risks they take — in all market environments and any investment strategy.

That's why we combine robust capital markets research, expert portfolio construction and comprehensive risk management to craft innovative and efficient solutions that deliver targeted investment outcomes.

As engaged contributors to our communities, we consider it a great privilege to serve our investors and our communities with integrity, respect, and transparency.

1 Assets under management were $946 billion as of June 30, 2018.