AS GOOD AS IT GETS

With robust economies and strong financial markets heading into 2018, this may be as good as it gets. But that can be taken in two ways — either things *have never been* better or things *will never be* better. It is a subtle but important distinction. The first carries an optimistic tone; the other assumes a more pessimistic connotation. Investors are lining up on both sides as they assess the prospects for 2018. Let's review from a variety of angles.

Growth. Synchronized global growth was the catch phrase among investors in 2017 — growth across all major developed economies showed acceleration. Meanwhile, China continued to significantly support global demand. Can this continue? The optimists believe that an object (or economy) in motion will stay in motion — and that "animal spirits" are just now making their presence felt. The pessimists will point out that the two largest economies in the world, the U.S. and China, may have difficulty living up to expectations in 2018. They note that China has started to slow from a debt-fueled growth spurt while the U.S. is growing faster than can be supported by underlying population growth and productivity gains (its economic potential).

Inflation. If the U.S. was truly growing faster than its economic potential, the optimists push back, it should show up in the inflation data. Year-over-year core inflation is at 1.5%, well below the stated 2% target. Other developed economies have even lower inflation levels: Europe at 0.9% and Japan at 0.2%. All this can change quickly, claim the pessimists, especially if wage growth accelerates due to increasingly tight labor markets.

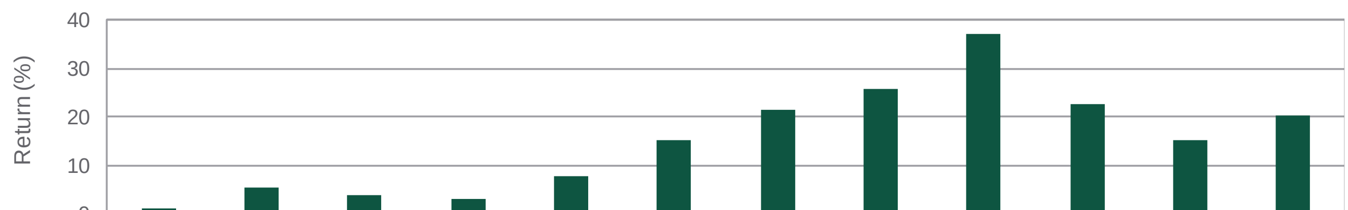
Monetary Policy. With inflation pressures still low, central bankers are constantly being forced to defend any removal of monetary policy accommodation. In this sense, the major central banks are starting to take the pessimists' side — the "things will never be better" side — arguing inflation can only go up from here and must be curtailed before it presents a problem. This is most evident with the Federal Reserve but nascent signs of a move towards reduced accommodation are also percolating at the European Central Bank (ECB) and the Bank of Japan (BoJ) through recent actions and/or rhetoric (see details on next page). The optimists point out that even the worst case expectations call for still-easy monetary policy by all historical standards. And, with inflation so low, the best case scenario may still entail overly accommodative monetary policy well into 2018 and beyond.

Capital Markets. As interest rates remained low around the world in 2017, equity valuations pushed higher. The pessimists will note that current global equity valuations at 21.6 times earnings are materially above the long-term historical average of 17.8. The optimists will counter that, relative to low bond yields, global equities remain very attractive especially in a low volatility world (a premise, pessimists quickly retort, will soon end given rising interest rates and elevated political tensions).

In summary, heading into 2018, the focus will be on the current global growth momentum, whether inflation awakens and how central bankers react to it all. These factors will determine whether this is as good as it gets — or as good as it *will* get.

FOURTH QUARTER AND 2017 TOTAL RETURNS

All asset classes were positive for the year, with equities well into double digits.



	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	EM	NR	GRE	GLI
■ 2017	0.8	5.4	3.5	3.0	7.5	15.2	21.3	25.8	37.3	22.7	15.0	20.1
4Q17	0.3	0.7	0.4	1.3	0.5	0.8	6.3	4.5	7.7	8.6	3.8	1.9

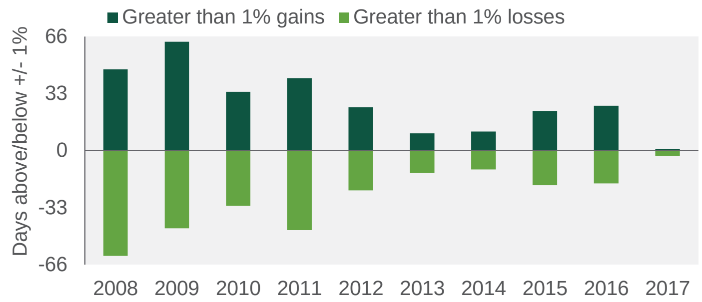
Source: Northern Trust Investment Strategy, Bloomberg. NR = Natural Resources; GRE = Global Real Estate; GLI = Global Listed Infrastructure. EM = Emerging Markets. Indexes are gross of fees and disclosed on last page. **Past performance is no guarantee of future results.**

KEY THEMES

Global Equities: A Year for the Record Books

Global equities returned 25% in 2017. But it's how they did it that's so impressive. Global equities only suffered two days of greater than 1% losses (one prompted by the announcement of the Mueller investigation; the other related to North Korean tensions) and only experienced one day of a greater than 1% gain (the day after Emmanuel Macron won the first round of the French elections). In most years, this metric is well into double-digits on both sides (see chart). The standard deviation of global equities in 2017 was just below 3%, a risk level normally reserved for investment-grade bonds. Further, global equities had positive returns in every single month of 2017 — the first time ever, based on the available data.

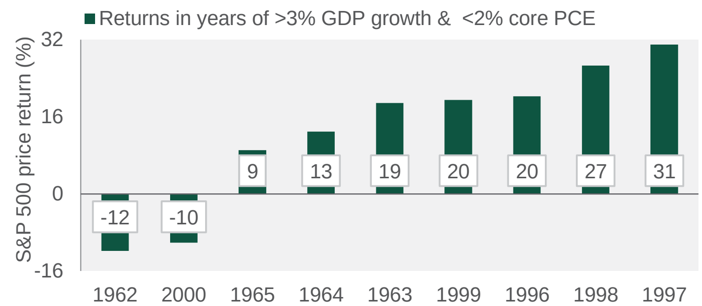
NUMBER OF 1% DAYS ON THE GLOBAL STOCK MARKET



The Powerful Duo of Global Growth and Stuckflation

Global growth was strong all year and accelerated into year's end, allowing for double-digit earnings growth across all major equity markets. Meanwhile, core inflation levels remained stuck below 2% on a global basis, keeping central bank policy easy and equity valuations elevated. U.S. real gross domestic product (GDP) has surpassed 3% in recent quarters while personal consumption expenditure core price index (PCE) remains below the Fed's 2% target at 1.5%. The U.S. has experienced this "goldilocks" (just right) environment in nine prior years (all in the early 60s or late 90s). Returns have been generally good; but with two exceptions: 1962 (the "Kennedy slide") and 2000 (the start of the dot-com bust).

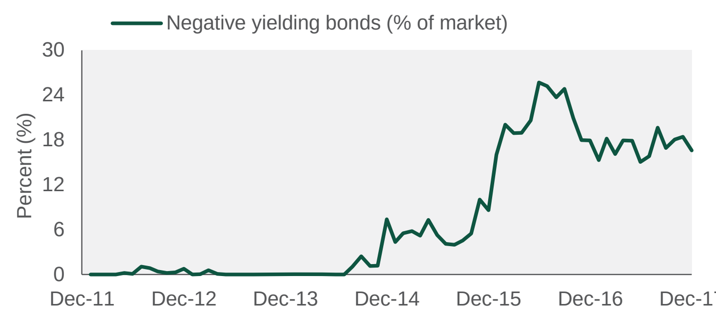
U.S. EQUITY RETURNS IN "GOLDILOCKS" ENVIRONMENTS



Still Accommodative After All These Years

Major central banks, including the Fed, the ECB and the BoJ, have now spent nearly a decade in ultra-easy money mode. There are signs that this is slowly changing. The Fed raised policy rates three times (now targeting a range of 1.25-1.50%) and began to reduce the size of its balance sheet by not reinvesting maturing assets (subject to a cap). The ECB announced that its quantitative easing purchases will be cut in half (from €60 to €30 billion/month) starting in 2018. Even the BoJ hinted at reducing accommodation sometime in the not too distant future (though unlikely in 2018). However, monetary policy remains very easy by historical standards, with 17% of the global bond market carrying negative yields.

NEGATIVE YIELDING DEBT



A Note on Bitcoin

Bitcoin was no doubt a popular discussion topic at holiday dinner tables given its 1,500% price increase in 2017. Bitcoin followers generally fall into one of three camps. The first views bitcoin as the gold of the 21st century. Just like gold, bitcoin has no real intrinsic value but has limited supply and provides an alternative to currencies controlled by printing press-happy central banks. The second groups bitcoin with the long list of asset bubbles — a modern day tulip mania that will end in ruin as demand wanes or dissipates across the hundreds of bitcoin substitutes. The third sees the true value in the blockchain technology that underpins bitcoin, which could materially reduce transactional frictions across multiple markets by eliminating the need for a trusted central clearing agent.

BITCOIN IN 2017

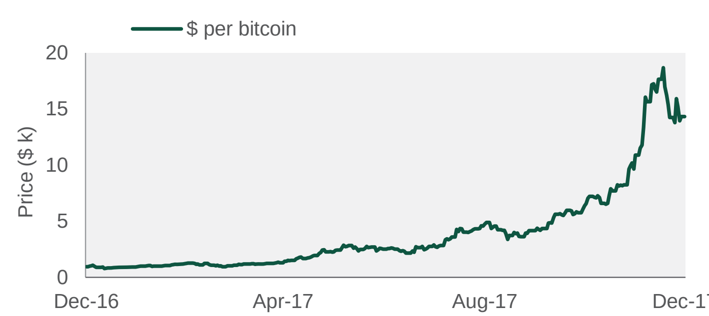


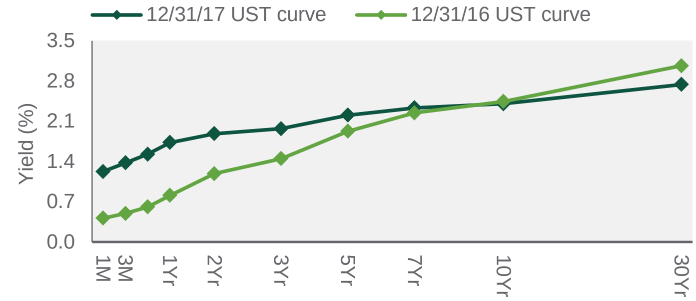
Chart Sources: Northern Trust Investment Strategy, Bloomberg. Indexes are gross of fees. **Past returns are no guarantee of future results.** Charts are as of December 31, 2017.

MARKET REVIEW

Interest Rates

The U.S. yield curve materially flattened in 2017. The Fed managed to push through three rate hikes, lifting the short-end of the yield curve throughout the year. However, low inflation and low/negative interest rates outside the U.S. left the 10-year Treasury yield mostly flat and the 30-year Treasury yield 0.3% lower during 2017. Close attention is paid to the shape of the yield curve as an inverted yield curve (where long-end rates are lower than short-end rates) has historically foreshadowed economic recession. During 2017, the 10-year minus the 2-year yield spread (a common measure of yield curve steepness) fell from 1.3% to 0.5%. This is below the long-term average of 0.9% but still some ways from inversion.

YIELD CURVE



Credit Markets

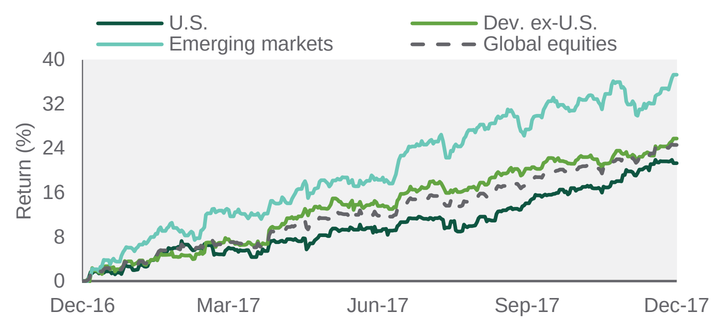
Credit spreads generally moved lower throughout 2017, driven by the combination of solid fundamentals, low interest rates and healthy investor demand. Investment-grade spreads started the year at 118 basis points (bps) and finished at 89 bps, a 29 bps improvement and a level not seen since mid-2007 (the all-time low of ~50 bps was hit in 1997). High-yield spreads started the year at 409 bps and also ended the year lower (by 66 bps to 343 bps) but took a choppier path. On three separate occasions high yield spreads jumped by ~50 bps, driven by temporary technical issues (abnormal supply) and short-lived investor jitters heightened by rich valuations (though spreads still remain ~20 bps above mid-2014 levels).

CREDIT SPREADS

Equities

Global equities had an excellent year. All major equity regions — U.S., developed ex-U.S. and emerging markets — saw greater-than 20% returns. The 21% U.S. equity return was driven by ~14% earnings growth, ~5% valuation expansion and a ~2% yield from dividend payments. Developed ex-U.S. equities returned 26%. Compared with the U.S., earnings were stronger (up ~21%) and dividend income was higher (~4%). The weak dollar provided a currency boost (~9%) but that benefit was entirely offset by valuation contraction. Emerging market equities fired on all cylinders, a 37% return driven by: ~22% earnings growth; ~5% valuation expansion; ~7% currency appreciation and a ~3% dividend yield.

REGIONAL EQUITY INDICES



Real Assets

Real assets performed admirably in 2017 (all with double-digit returns) but failed to match the performance of global equities. Global listed infrastructure (GLI) gained 20% by exploiting 2017's mix of steady interest rates, higher equity markets and somewhat jittery investors (with GLI serving as a lower-risk alternative to listed real estate). Global real estate (GRE), returning 15%, received some of the same benefits from low rates but faced offsetting headwinds in the form of poor investor sentiment, with increased concerns over the technology-induced impacts on retail (Amazon), commercial (shrinking offices) and other rents. Natural resources (NR) overcame first-half commodity supply worries to return 23%.

REAL ASSET INDICES

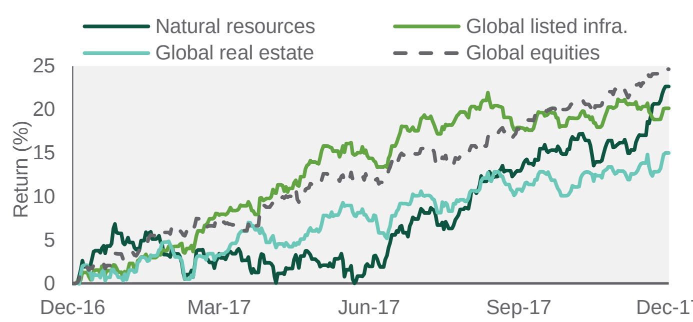
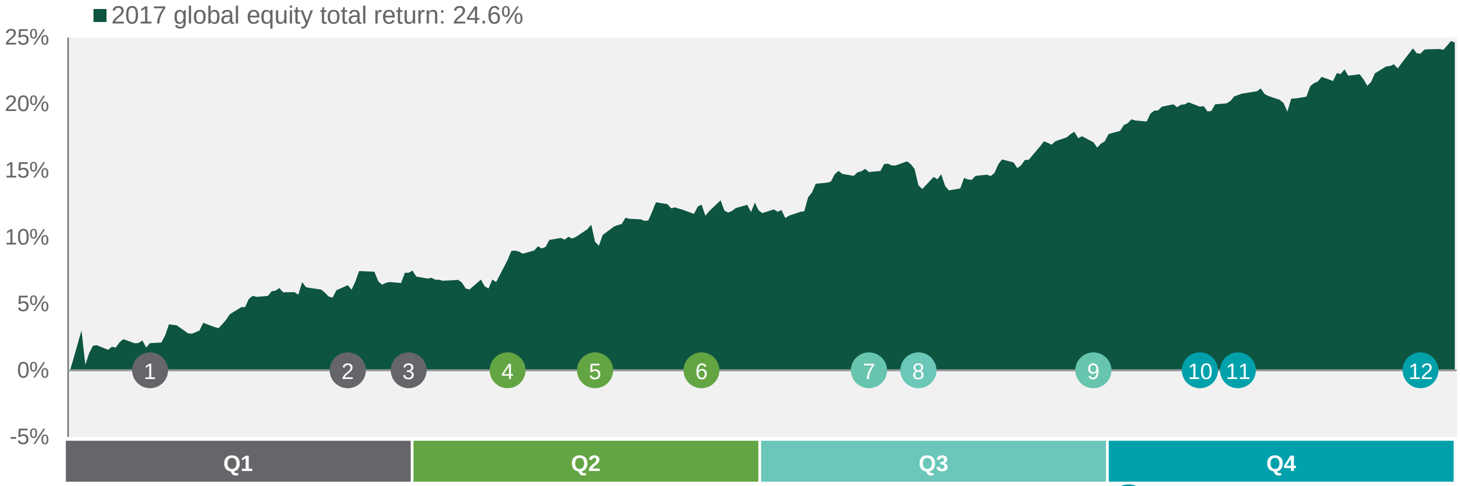


Chart Sources: Northern Trust Investment Strategy, Bloomberg. UST = U.S. Treasury. Indexes are gross of fees. **Past returns are no guarantee of future results.** Charts are as of December 31, 2017.

MARKET EVENTS



Q1	Q2	Q3	Q4
1 Donald Trump becomes the 45th U.S. president, ushering in one-party control of government policy after six years of split power in Washington D.C.	4 European stocks up 2.2% after French voters support Emmanuel Macron for French president in first round of voting; Macron beats Marine Le Pen in runoff two weeks later.	7 John Kelly replaces Reince Preibus as White House chief of staff; White House Comm. Director Anthony Scaramucci fired soon thereafter (just 10 days on the job).	10 Japan Prime Minister Shinzo Abe wins snap election, giving him another four years in office. An improving economy (six straight quarters of growth) helped secure victory.
2 Pro-reform Prime Minister Narendra Modi's BJP party scores big election win in India's largest state; emerging market equities jump 1.3%.	5 U.S. equities suffer a nearly-2% drop as Robert Mueller is named special counsel to oversee investigation into potential Trump-Russian collusion.	8 The volatility index (VIX) reaches its highest level since the U.S. election as military threats are ex-changed with North Korea over nuclear ambitions.	11 Trump nominates Jerome Powell, a current Federal Reserve governor, for Fed chair. He will replace Janet Yellen on February 3, 2018.
3 The U.K. invokes Article 50 of the Lisbon Treaty, formally triggering the start of Brexit negotiations with Europe.	6 Federal Reserve unveils plan for slowly shrinking $4.5 trillion balance sheet accumulated from years of quantitative easing; plan put into action in October.	9 German Chancellor Angela Merkel is re-elected for fourth term but overall results disappoint; right wing AfD party takes 13% of Bundestag seats.	12 Republican-driven tax reform is signed into law. The bill cuts taxes by about $1.5 trillion over 10 years, the biggest change to the tax code since 1986.

Indexes used: Bloomberg Barclays (BBC) 1-3 Month UST (Cash); BBC Municipal (Muni); BBC Aggregate (Inv. Grade); BBC TIPS (TIPS); BBC High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities (Em. Markets Equities); Morningstar Upstream Natural Resources (Natural Res.); FTSE EPRA/NAREIT Global (Global Real Estate); S&P Global Infrastructure (Global Listed Infra.)

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