CLIMBING THE WALL OF WORRIES

Equities in the third quarter continued to climb the wall of worries from potentially market negative events on the horizon. U.S. elections are less than a month away and geopolitical tensions in the Middle East are elevated along with risks from the Russia/Ukraine war. Yet, equity investors have shrugged off the potential impact from these events and global equities were up 6.7%. Fixed income portfolios also fared well returning 5.2% for the benchmark Bloomberg Aggregate Index. A simple balanced portfolio of 60% global equities and 40% investment grade fixed income was up 6.1% as markets climbed a wall of worries.

There were notable developments in the quarter which confirmed our expectations that market breadth would improve. The S&P equal weighted index was up 9.6% for the quarter while the market cap weighted index was up 5.9%. Broadening of stock performance occurred as earnings contribution broadened. A similar broadening occurred internationally with both emerging market equities (up 8.4%) and developed ex-U.S. equities (up 8.2%) outperforming U.S. large cap stocks. U.S. small and mid-cap stocks fared better than large caps. The tech heavy NASDAQ Composite Index lagged and was up only 2.8%.

The macro picture in September was broadly unchanged. If anything it appears to have improved on the growth front. There were a couple of weak employment reports but positive revisions in September showed continued strength in the labor markets. One change that caught our attention was the revisions to GDP/GDI data which, prior to the revisions, were painting different pictures of the economy. Market participants were worried that GDP was overstating the strength of the U.S. economy while the weaker GDI was the truth. Instead, the GDI data was revised up to match the strength in the GDP data. The U.S. economy remains strong, with solid labor markets and inflation normalizing.

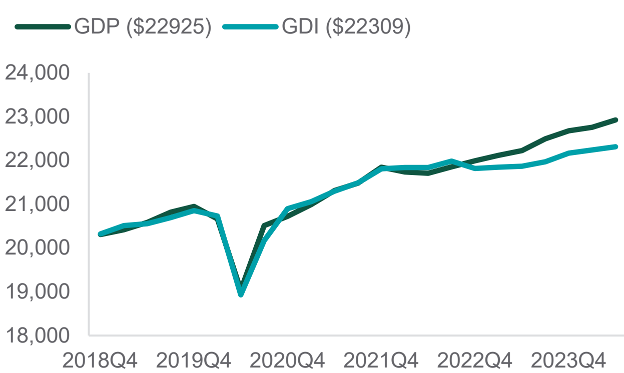
China equities rallied in September as the Chinese authorities announced several measures to boost real estate prices, consumer sentiment and asset prices. At first glance, the monetary measures appear substantial but the magnitude and details of their fiscal plans are not yet clear. Structural adjustments are needed to have a lasting impact on the economy but for the moment the markets are hopeful. We remain slightly overweight emerging market equities in the global portfolios.

Risk of an equity drawdown due to fundamental drivers remains low, but U.S. elections, geopolitical tensions and potential growth shocks in Europe keep us from taking maximum risk in the portfolios. However, the combination of ongoing U.S. growth and easing monetary policy underpins our modest overweight in equities over bonds.

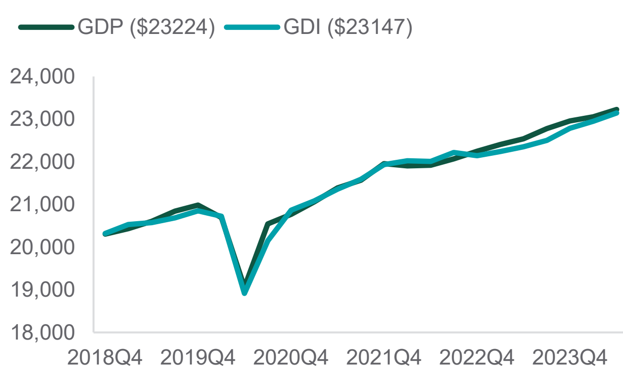
STRONGER GROWTH POST-REVISIONS

The wedge between GDP and GDI barely exists after the annual update of the National Economic Accounts.

PRE-REVISION REAL GDP AND GDI ($B)



POST-REVISION REAL GDP AND GDI ($B)



Source: Northern Trust Asset Management, BEA. GDP = Gross Domestic Product; GDI = Gross Domestic Income. Data as of 6/30/2024.

BASE CASE EXPECTATIONS

Sticking the Landing

Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength and labor market/consumer resilience. Inflation will remain above target but continue to proceed toward 2%.

Central Bank Transitions

Major central banks have started to cut policy rates and we expect this to continue as the year progresses. Economic growth may afford policymakers more time to confirm that inflation progress is sustainable.

RISK CASE SCENARIOS

Stubborn Inflation

Inflation does not move lower due to economic resurgence, tight labor markets, U.S. election-induced pressures related to tariff or immigration policies, and/or disruptions from conflict in the Middle East.

Lagged Impacts

A soft landing is taken off the table as easing economic growth evolves into a traditional demand-led recession. In this scenario, a shallow recession is more likely than a deep contraction.