BUY AMERICA

Since 1987, the average annual return of a portfolio consisting of 60% stocks[1] and 40% bonds[2] has been 8%. So far in 2024, it is up 12%, the second consecutive year of above-average returns for balanced portfolios. Global equities have gained 19%, led by U.S. large caps. Fixed income has produced lower but positive returns, as high yield bonds have buffered modest performance from high-grade credit and Treasurys. Going forward, we expect more modest gains for 60/40 portfolios with U.S. equities leading the charge again.

We maintain a preference for equities over fixed income, reflecting our base case of continued economic growth. As shown in the exhibit, the expected level at which the Federal Reserve policy rate settles this cycle has materially increased since mid-September. We believe this reflects a mix of stronger growth expectations and risk of higher inflation.

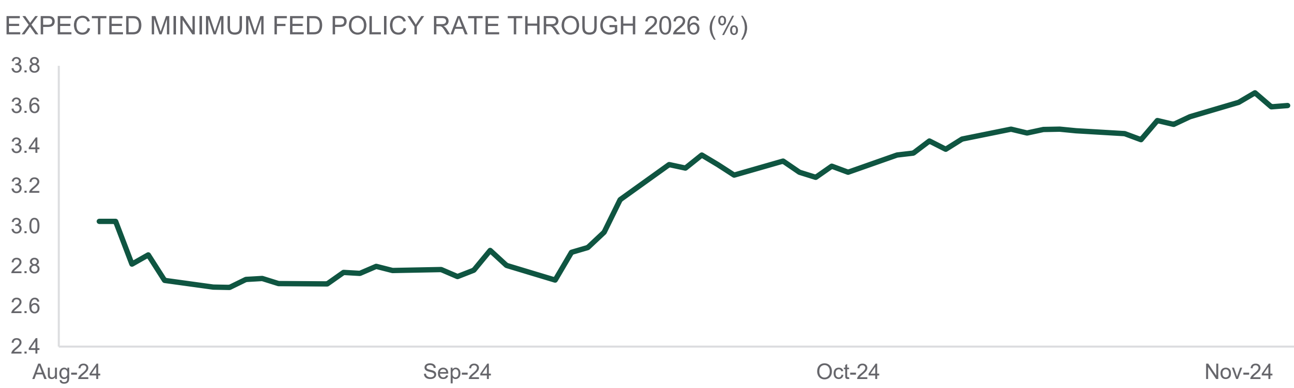
Our top two risk cases incorporate the possibility of inflation as a result of potential U.S. presidential policies. In the more benign risk scenario, stronger growth accompanies inflation. We believe this would result in equities outperforming fixed income. Equities historically have been able to maintain today's valuations with inflation at or even above 4%, but growth is important. In the second risk scenario, there is no positive growth impulse. We would expect higher inflation to weigh on equities and most other major assets, with few other assets such as gold ending up as beneficiaries.

"Buy America" is another one of our key tactical calls. We expect U.S. equities to benefit from a better economic backdrop and healthier corporate profits than most other regions. We also believe that non-U.S. companies are more negatively exposed to the policies floated by the incoming U.S. government. For example, higher tariffs likely would weigh on Chinese and European company profits, while non-U.S. regions would see little benefit from U.S. tax cuts and reduced regulation. With that said, there is a wide range of potential outcomes, supporting regional diversification in a portfolio.

Within fixed income, we continue to like high yield. Its starting yield of above 7% is attractive given strong fundamentals and a supportive technical backdrop. We see more limited upside for investment grade credit and Treasurys given historically tight investment grade spreads and low odds of a sharp drop in rates. Given we do see incrementally higher inflation risks as a result of possible policies from the U.S. government, we think some inflation protection through inflation-linked bonds is prudent.

HIGHER EXPECTATIONS

The expected level at which the Fed policy rate settles this cycle has increased since mid-September.



Source: Northern Trust Asset Management, Bloomberg. Consensus expectations for the Fed Funds rate through 2026. Expectations are from 8/31/2024 through 11/13/2024. Historical trends are not predictive of future results. [1]As represented by the MSCI All World Country Index (ACWI), which tracks the performance of equities globally. [2]As represented by the Bloomberg U.S. Aggregate Bond Index, which tracks to performance of the U.S. bond market. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest in any index.

BASE CASE EXPECTATIONS

Soft Landing

Global growth will settle around trend, supported by ongoing U.S. economic strength and labor market/consumer resilience. Inflation will continue to ease toward 2%.

Central Bank Easing

Lower inflation has allowed major central banks to start cutting policy rates. We expect central bank easing to continue, though the timing and trajectory may vary depending on regional economic conditions.

RISK CASE SCENARIOS

Reflation

Policies of the incoming U.S. Administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

Supply Restraint

Supply-side disruptions from immigration restrictions and higher tariffs weigh on economic activity and halt the disinflationary process until a recession takes shape.