

PRINCIPLES THAT ENDURE

Service

Expertise

Integrity

Risks & Opportunities in Today's Capital Markets

Bob Browne

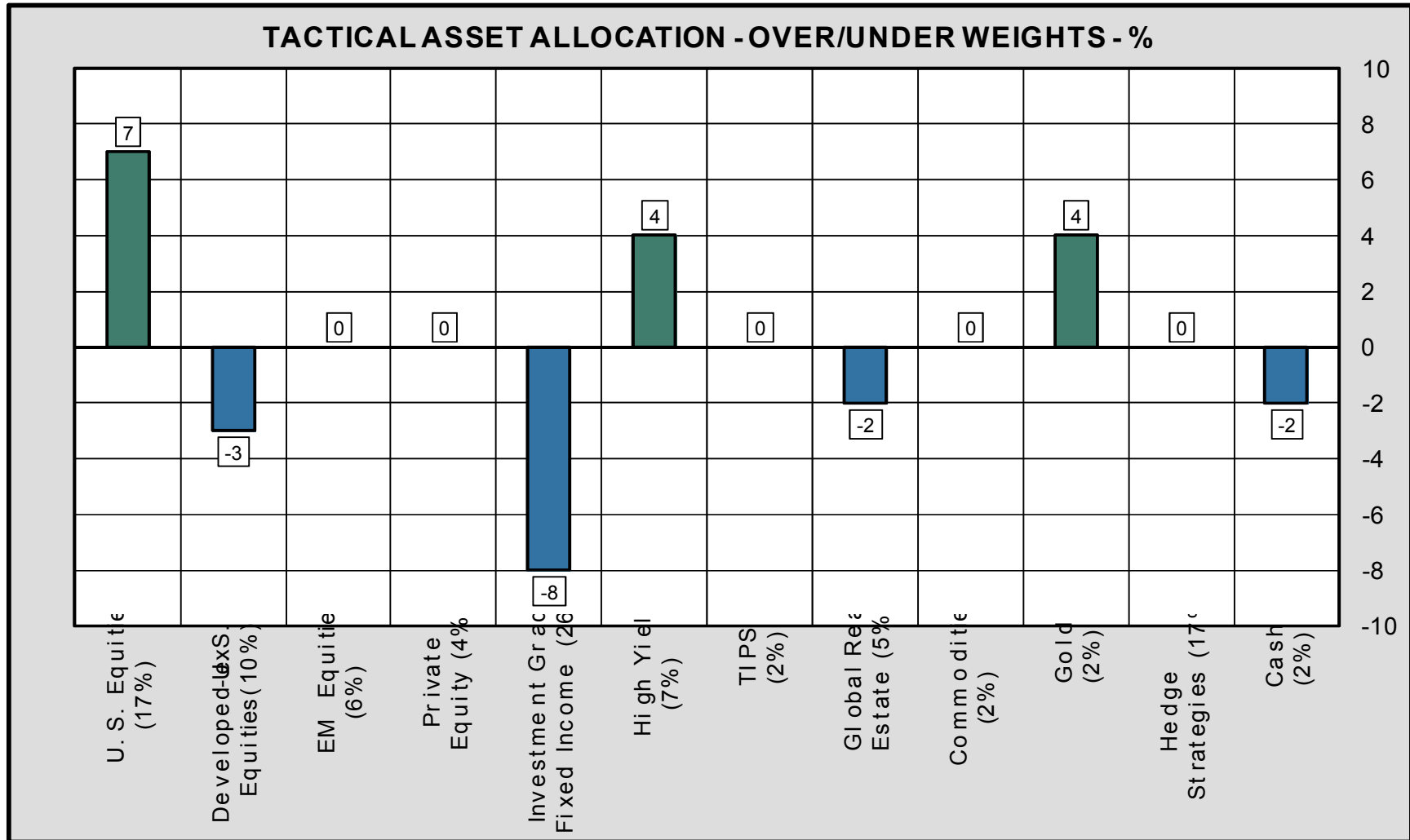
Chief Investment Officer

September 16, 2011





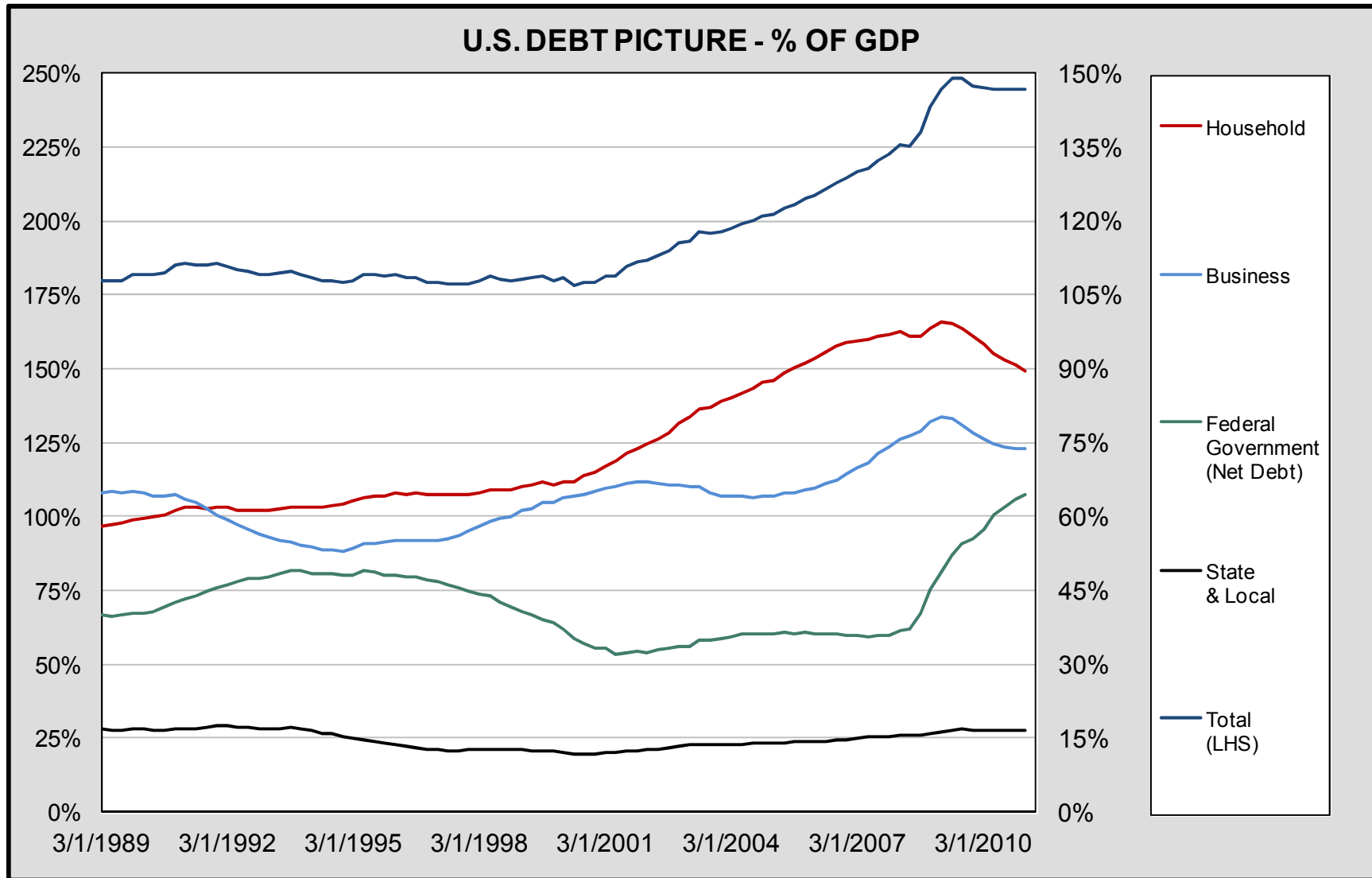
Northern Trust Investment Policy: Let's Start With What We Own



Allocations above reflect Northern's Growth and Income - Accredited objective; the proxy account for IPC. Strategic allocations are listed across the bottom; tactical recommendations (in the form of over/under/equal weights) are displayed in the bar chart. Tactical allocations as of 8/18/2011.



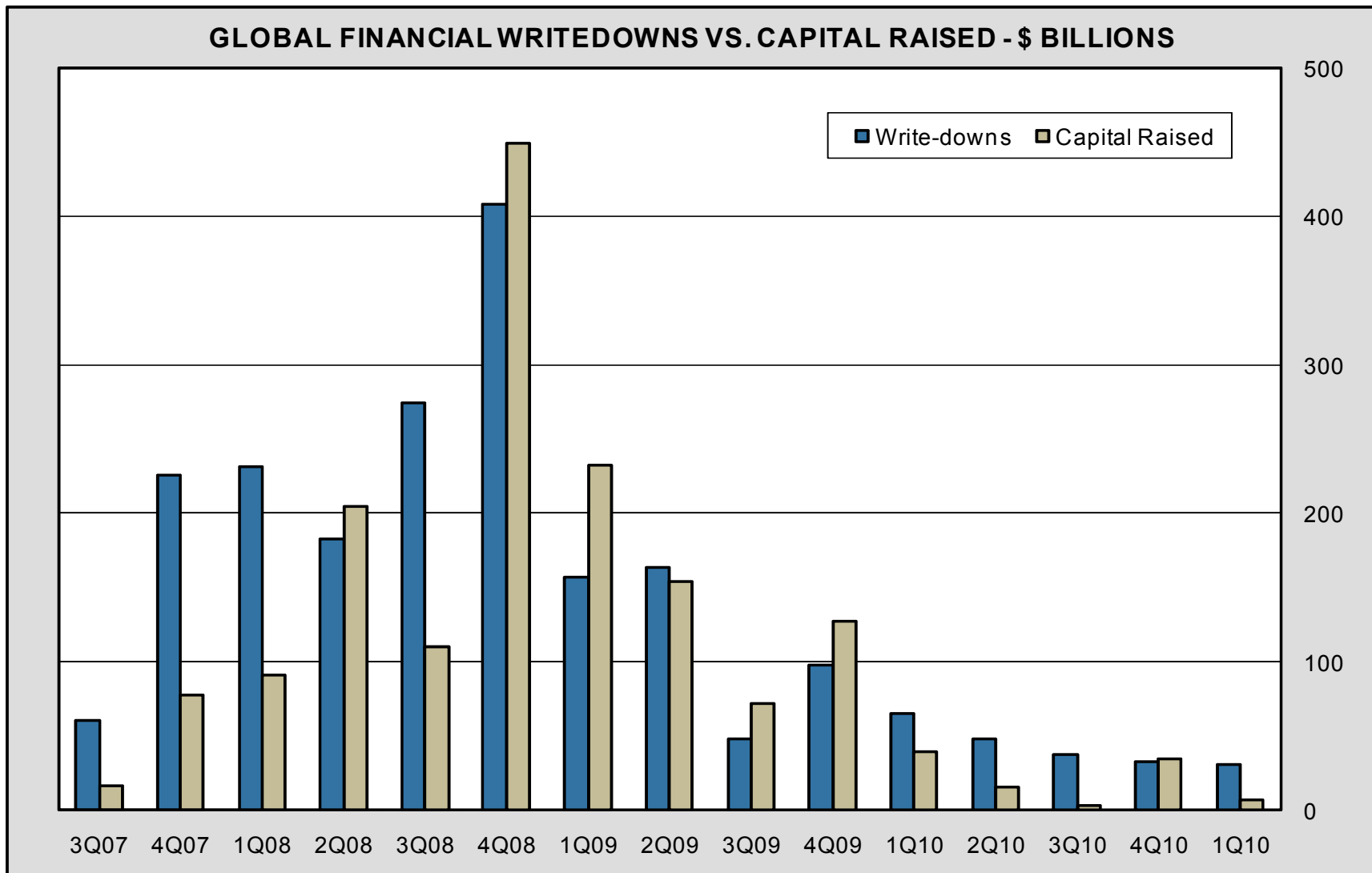
There was too much debt across all sectors of the US...



Source: Bloomberg, Northern Trust Global Investments. Quarterly data through 3/31/2011.



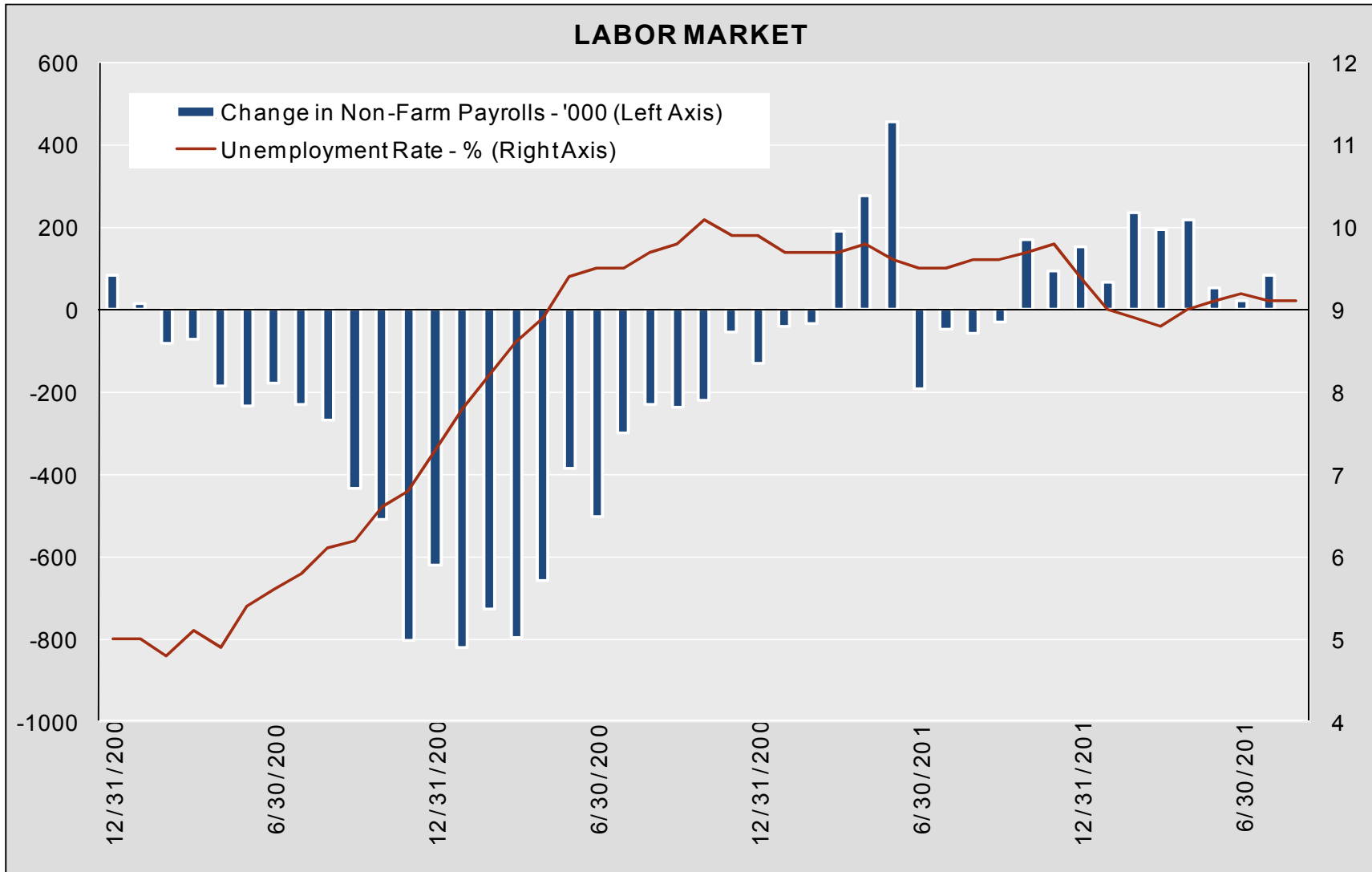
... and eventually a lot of it had to be written off...



Source: Bloomberg, Northern Trust Global Investments. Quarterly data through 3/31/2011.



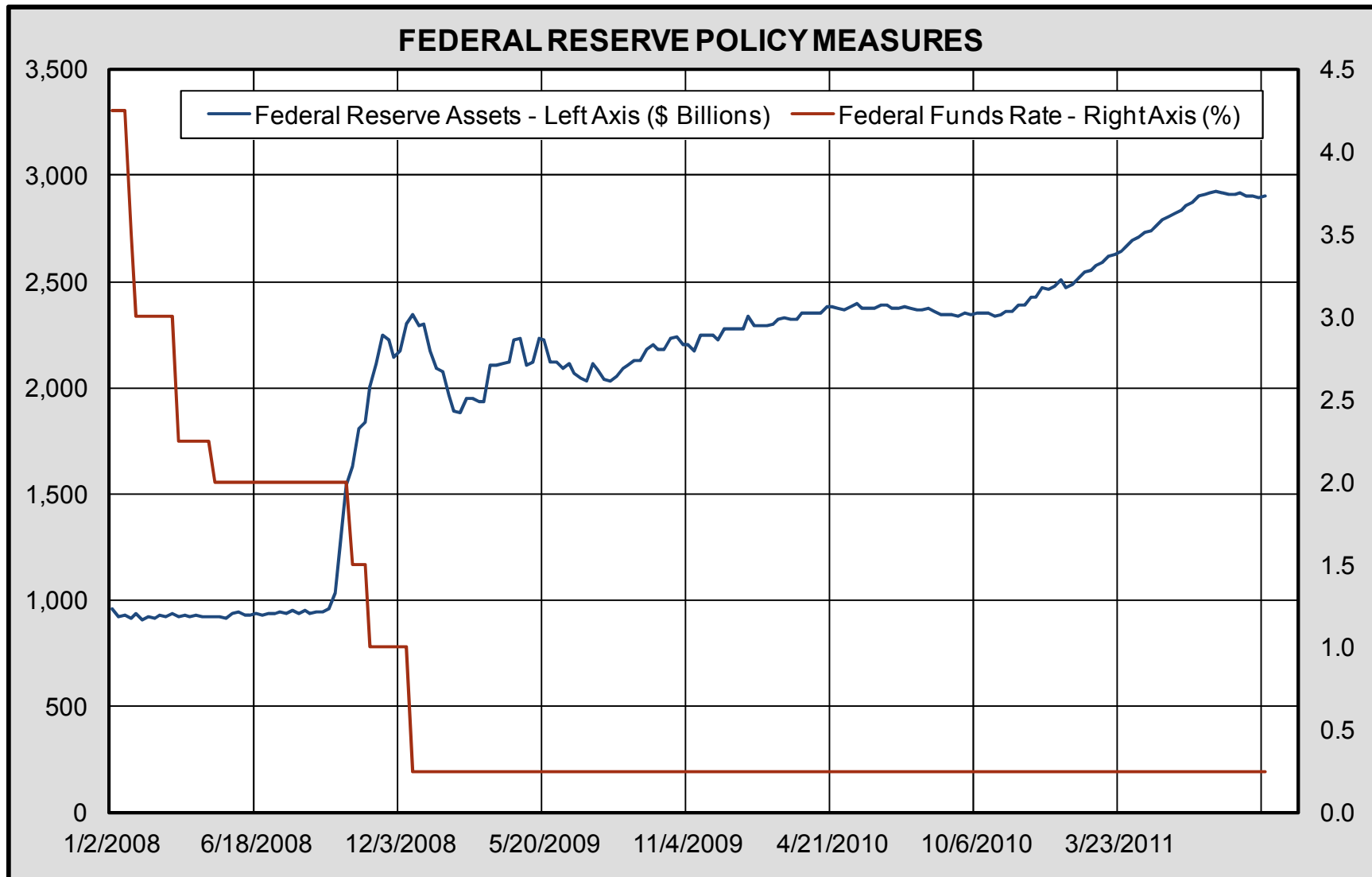
... and then lots of people lost their jobs as a result



Source: Bloomberg. Monthly data through 8/31/2011.



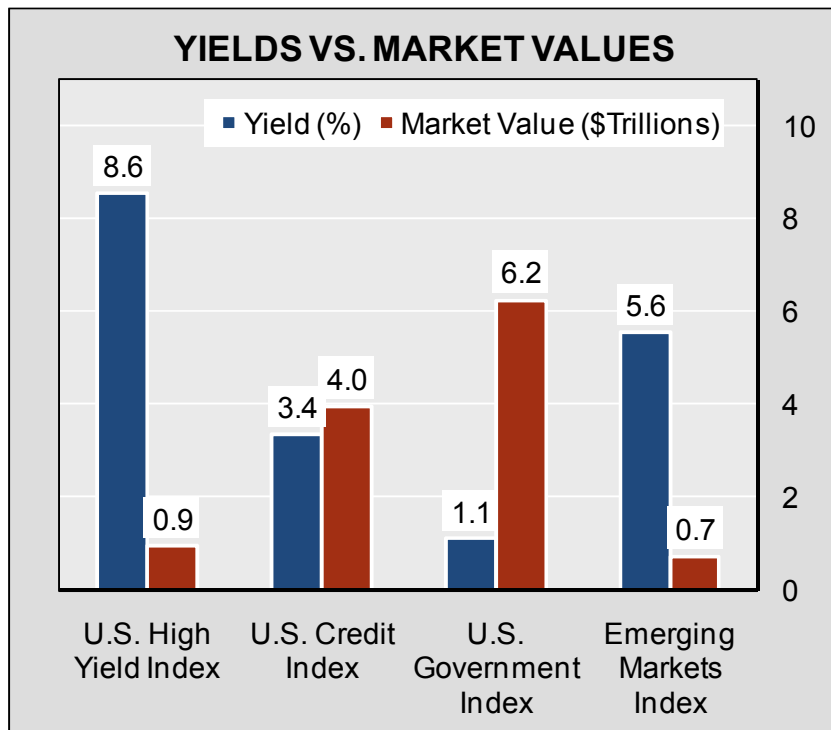
The Fed came to the rescue ...



Source: Bloomberg, Northern Trust Global Investments. Weekly data through 9/7/2011.



... and the story of “unintended beneficiaries” began

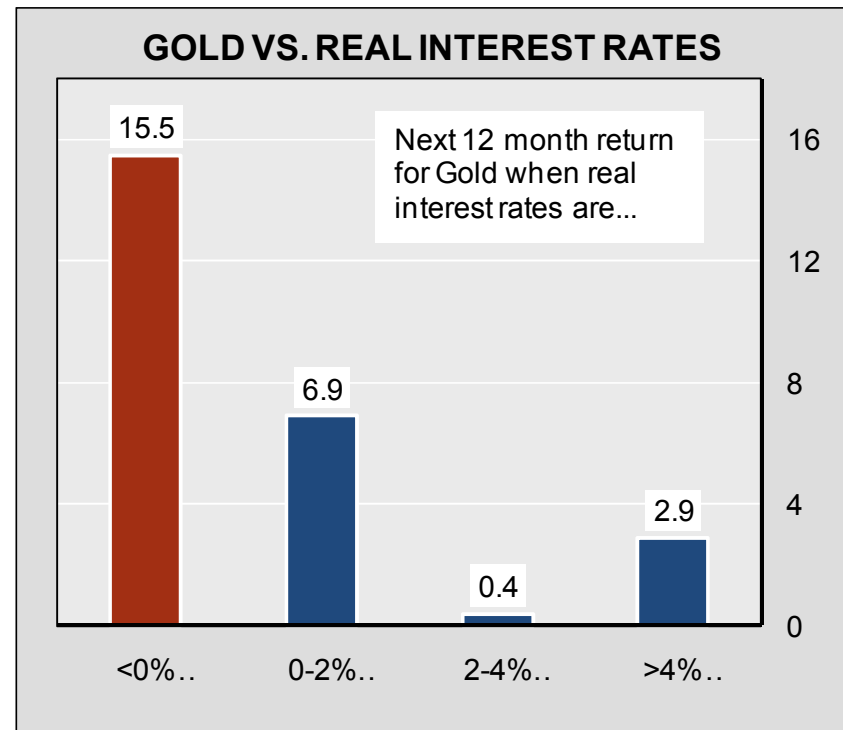


High Yield:

The low rate environment has pushed yield-seeking investors out the credit spectrum.

The constructive outlook for high yield is also supported by strong company balance sheets and the current refinancing environment.

The recent jump in high yield spreads provide some cushion against disappointing growth.



Gold:

Efforts by the Fed to push down interest rates have forced three month U.S. T-bill real yields into negative territory (even given the currently low levels of inflation).

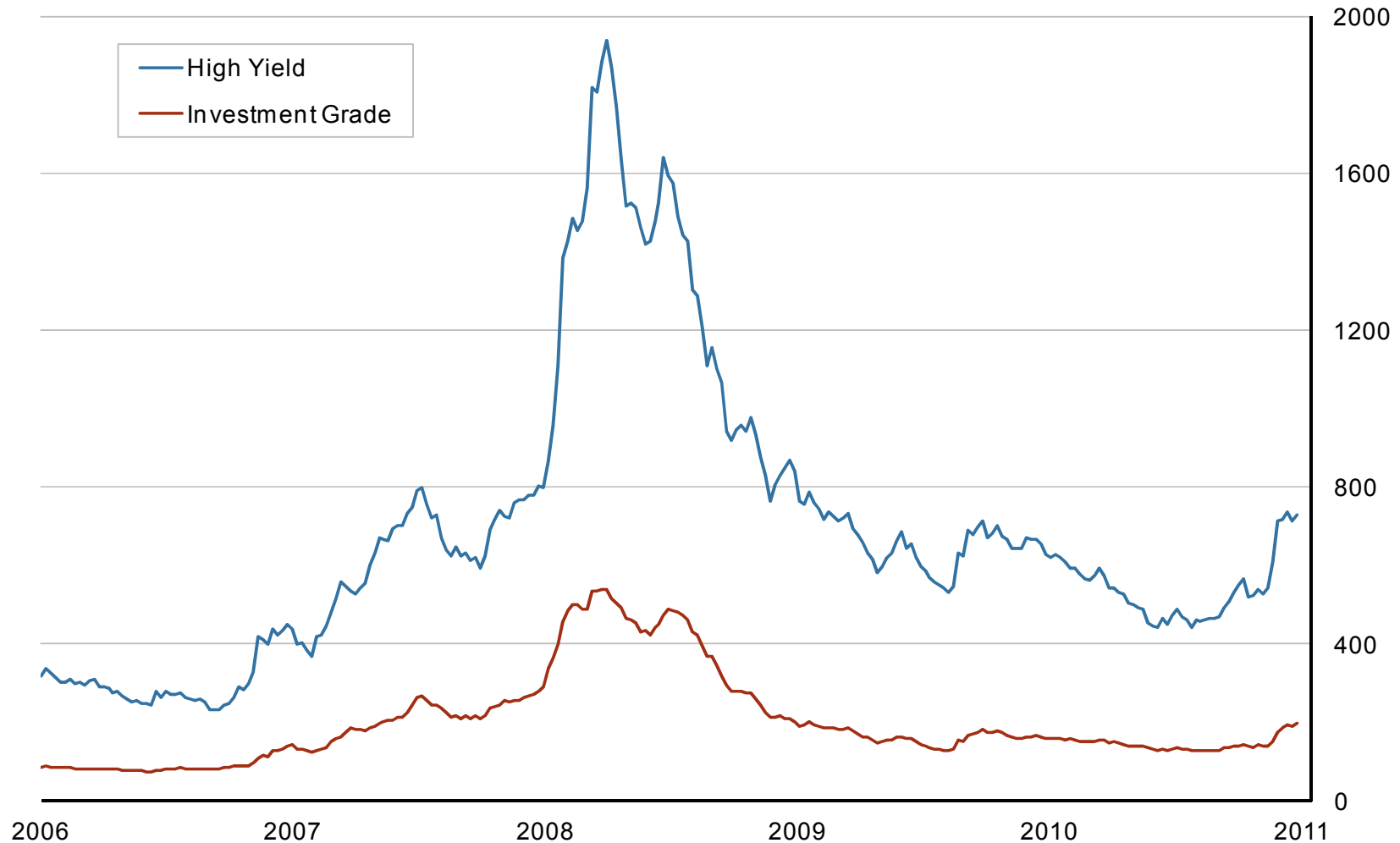
Historically, low real interest rates have meant attractive returns for gold – with a 15.5% average 12 month return when real interest rates are negative.

Source: 1) Barclays Live. Data as of 08/19/2011. 2) Bloomberg. Study consisted of data from 6/30/1983 – 1/31/2011.



The Fed was targeting the MBS and CMBS markets, but the High Yield markets got hit in the bulls-eye ...

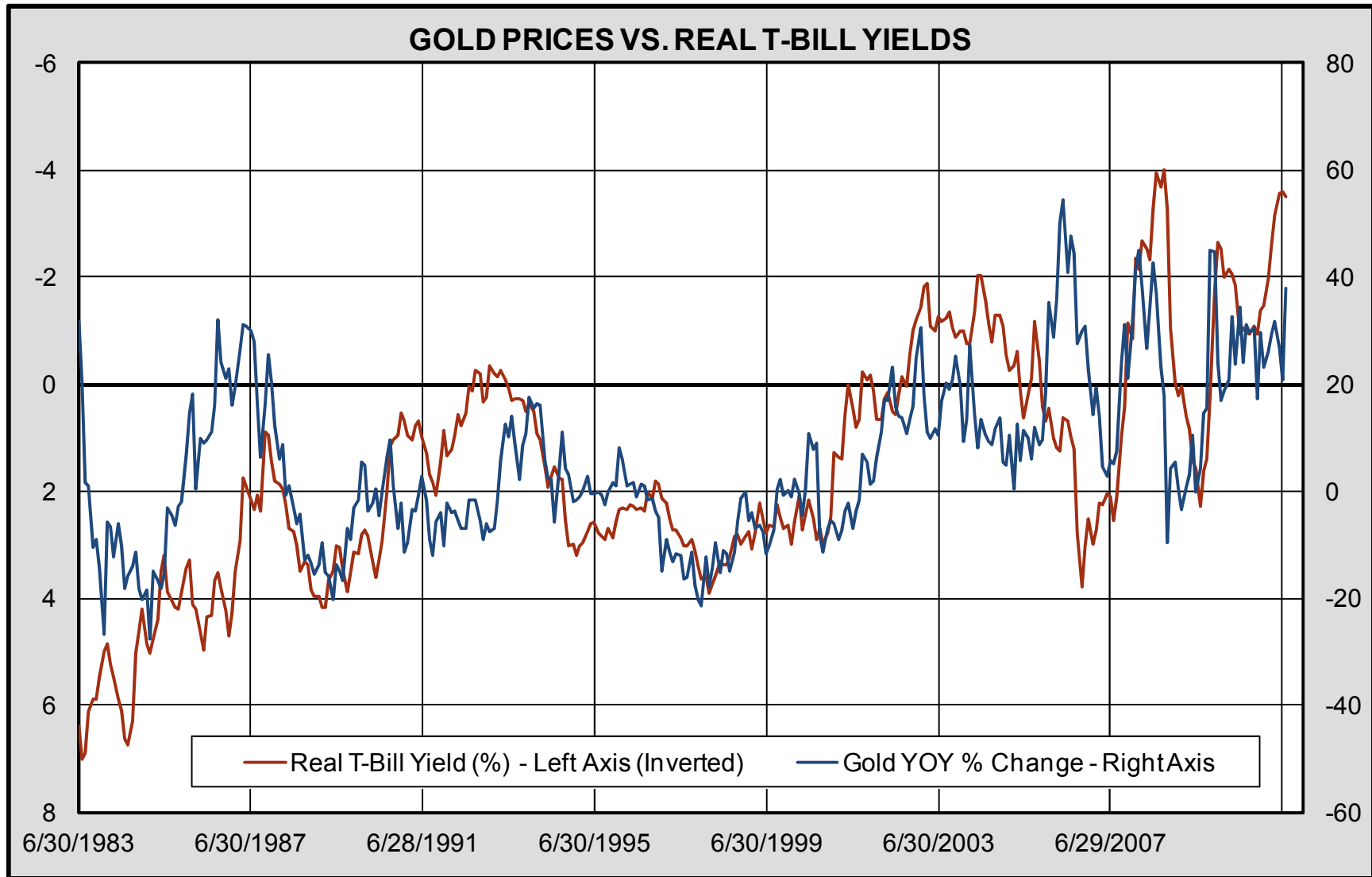
CREDIT PREMIUM: OPTION ADJUSTED SPREADS - BASIS POINTS



Source: Bloomberg, Barclays. Weekly data through 09/09/2011.



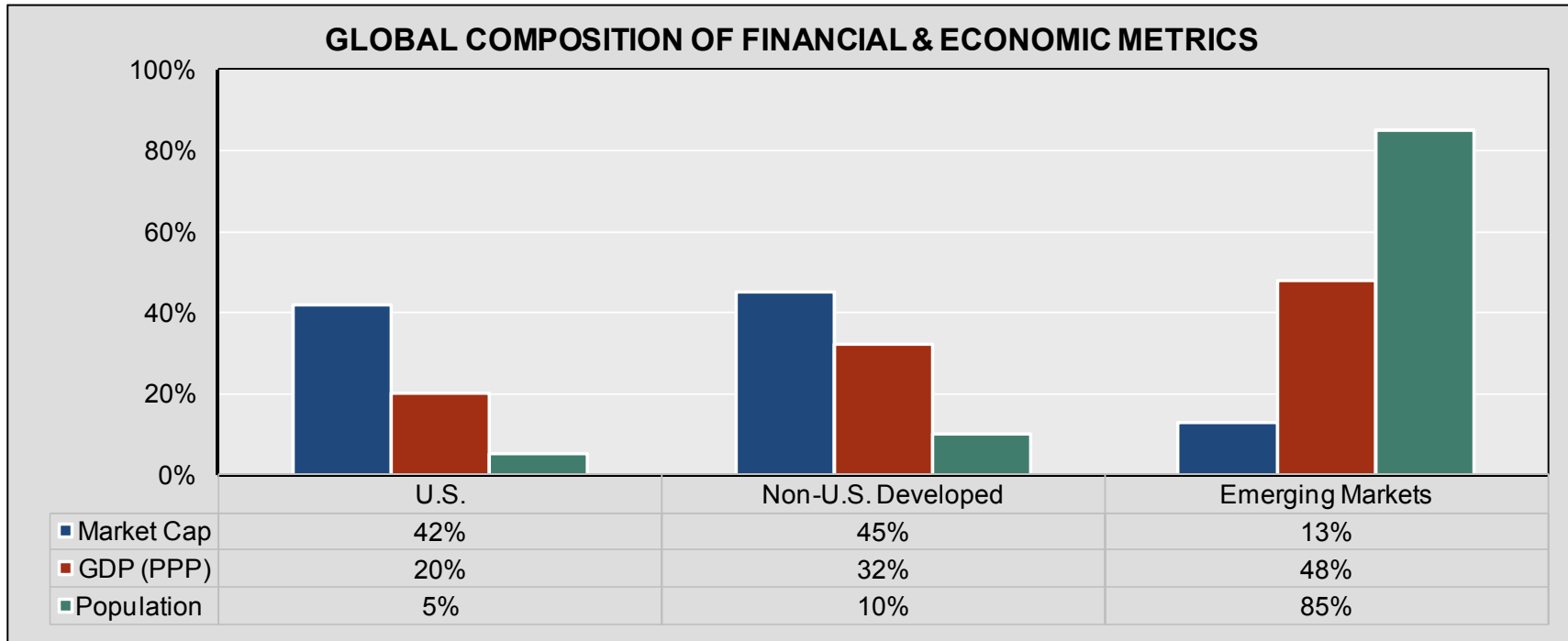
... while liquidity and intermittent bouts of both fear and greed were driving gold



Source: Bloomberg, Northern Trust Global Investments. Data through 3/31/2011.



Meanwhile, emerging markets were never sick, but still received the medicine ...



Theme Key Points:

Growth in world GDP has clearly been driven by emerging market economies.

The disproportionate growth out of emerging markets led to the global imbalances that were, in part, responsible for the recent financial crisis.

Reversal of these global imbalances (including China's recent resumption of Renminbi appreciation) are underway.

Investment Implications:

Domestic companies that have a high proportion of international sales are a beneficiary of this trend.

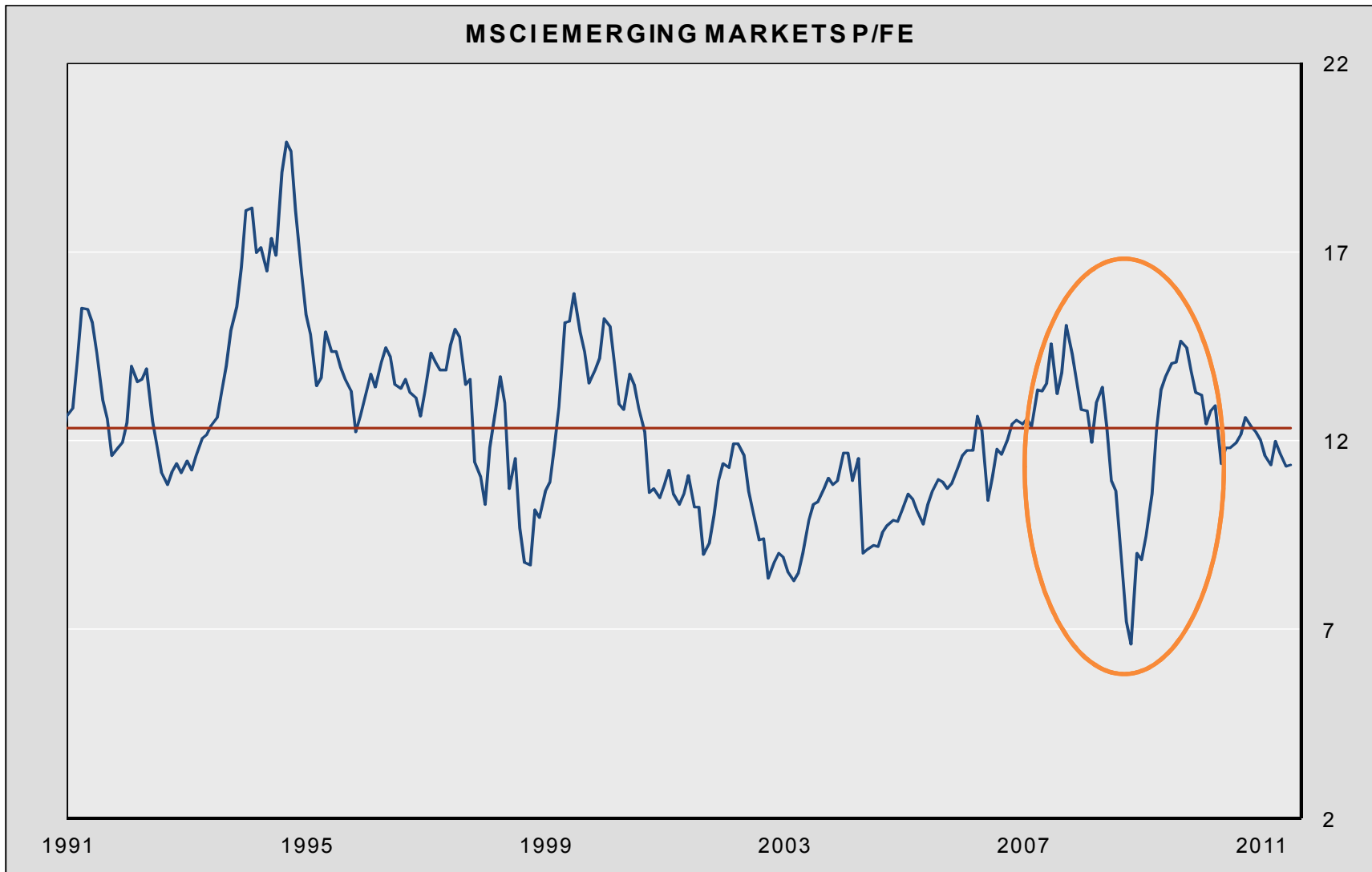
Emerging market equities, with still reasonable valuations, are a long-term beneficiary should this scenario play out.

We prefer emerging market equity over debt due to its better risk-adjusted return outlook.

Source: MSCI, IMF. Data as of 2010.



... and extremely discounted values were quickly reversed



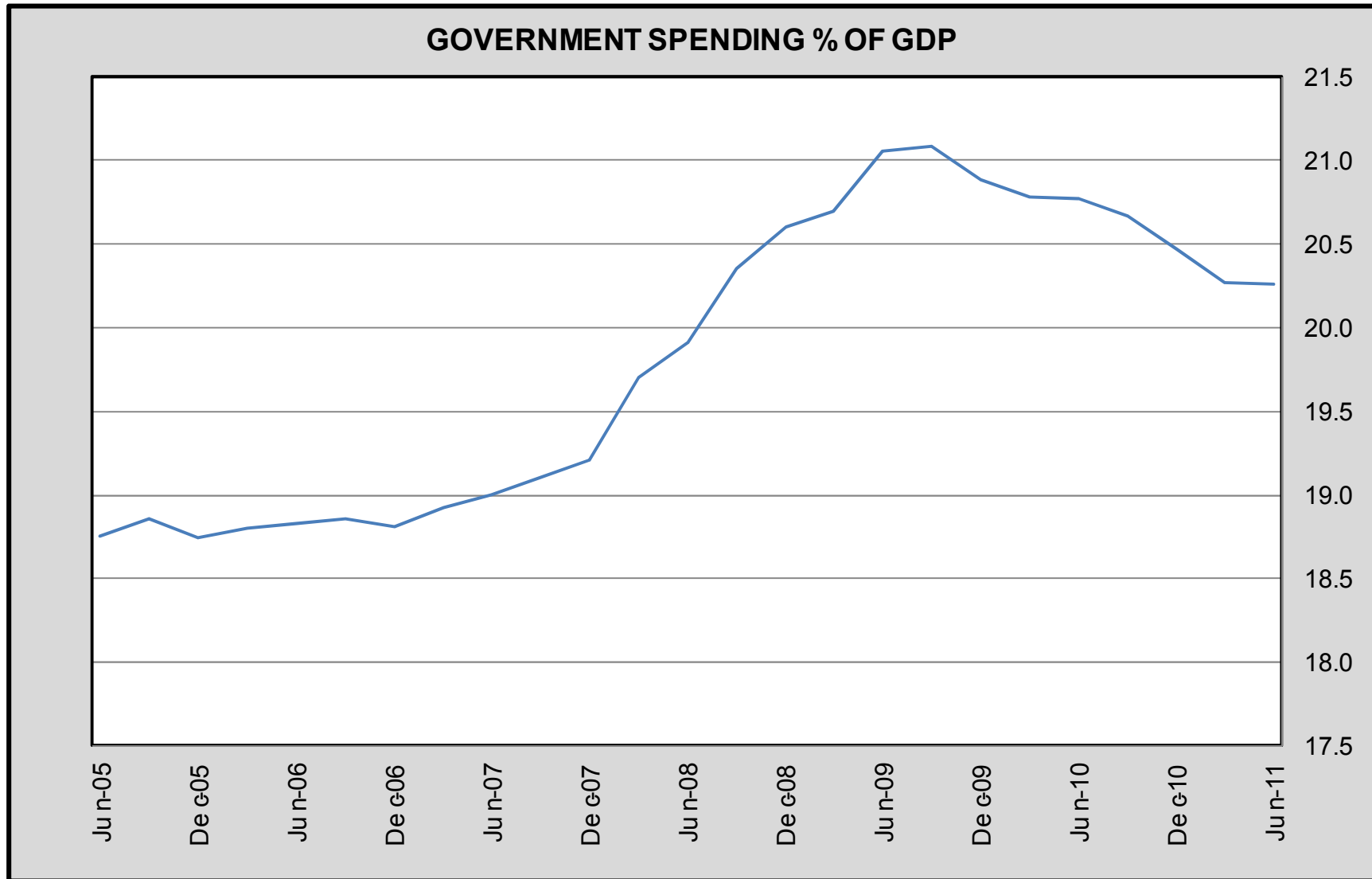
Source: Sanford Bernstein. Data through 8/31/2011.



Economic Recovery is Here for Now – Barely, But it's Not Guaranteed to Stay



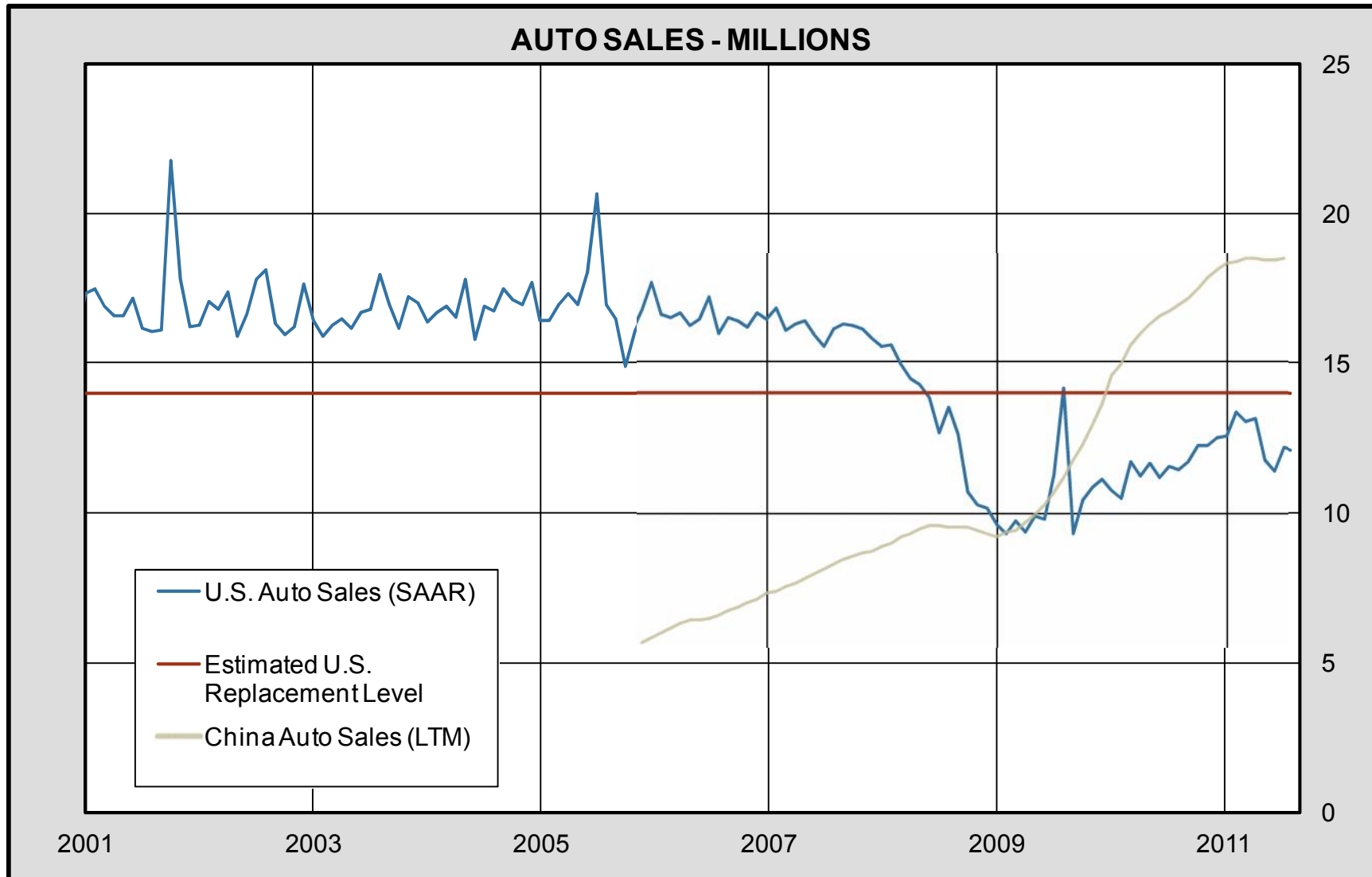
The U.S. government has tried to hand off to the private sector without a fumble, but it has not been easy



Source: Bloomberg. Data as of 6/30/2011



Pent up demand for items such as autos should help sustain the economic recovery...



Source: Bloomberg, Northern Trust Global Investments. Monthly data through 8/31/2011; China data through 7/31/2011.



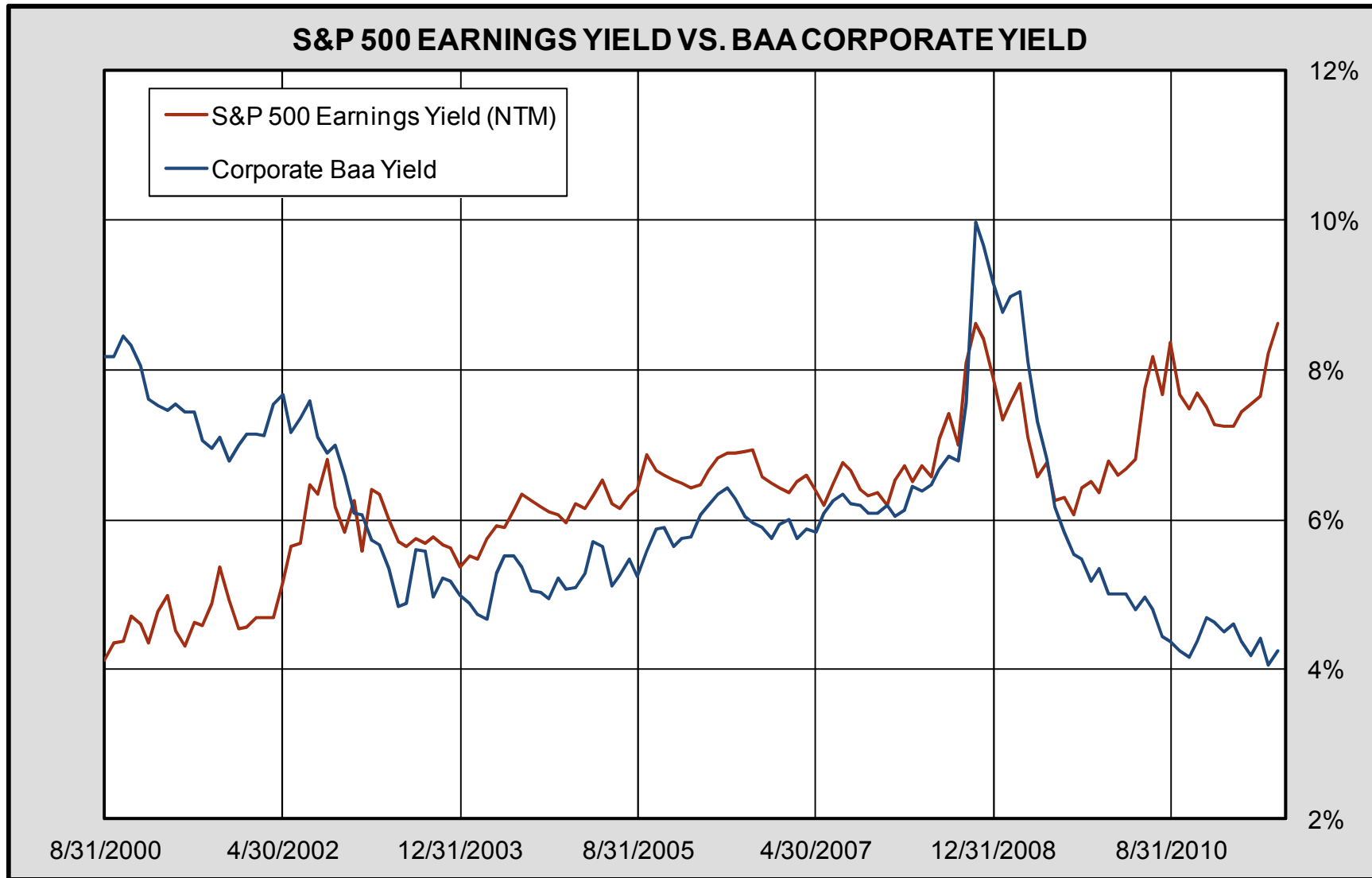
...and drive very strong corporate profits



Source: Bloomberg, Quarterly data through 6/30/2011.



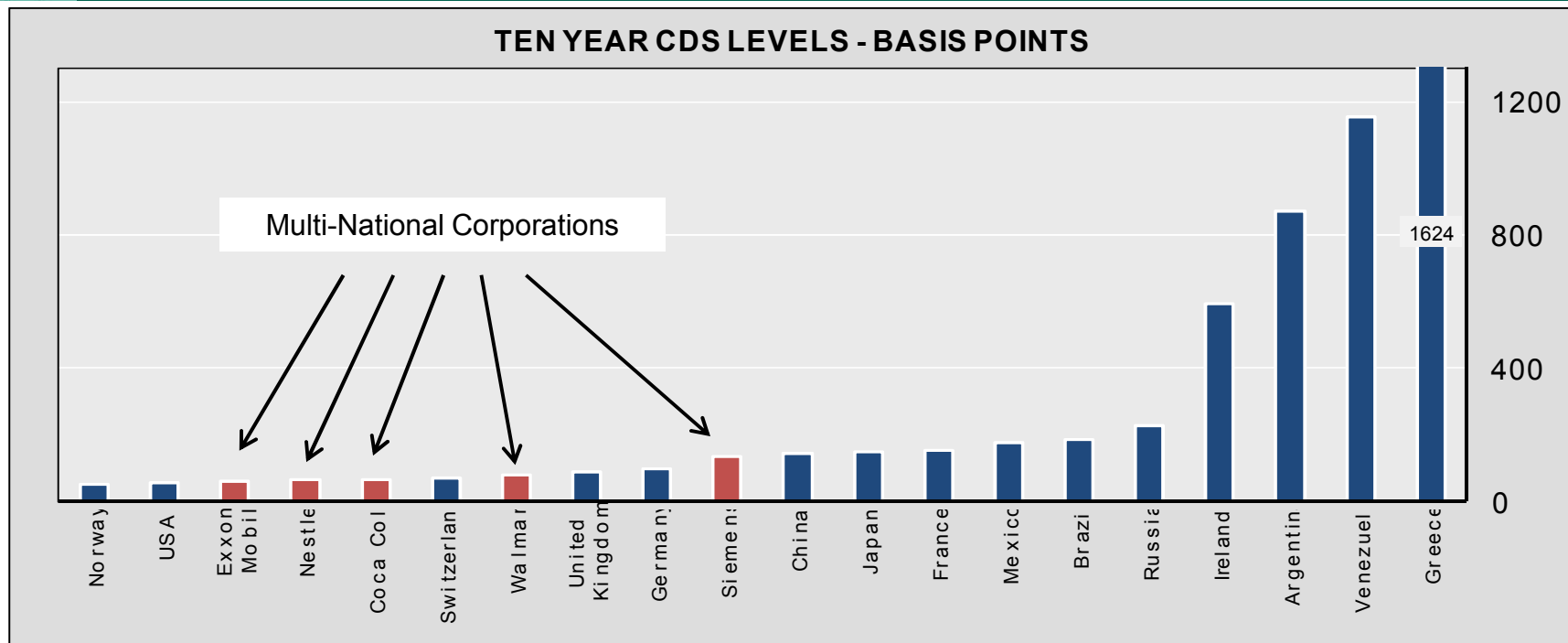
This, along with low interest rates, helps maintain fair equity values despite the run-up in prices over the past two years



Source: Standard & Poors, Barclays, Northern Trust Global Investments. Data as of 8/31/2011.



In a world of rampant government debt, large cap multi-nationals may just be the new risk free asset



Theme Key Points:

Government debt has dominated the headlines over the past few years as the great recession shined the spotlight on government profligacy.

As a result, the assumption that U.S. debt is risk-free is being challenged – culminating in the recent ratings downgrade from S&P.

While still considered a safe asset, the line between U.S. sovereign credit and several global companies (e.g. Nestle) has been blurred.

Investment Implications:

In the near term, the liquidity of U.S. Treasuries still gives them safe-haven status in times of economic turbulence – ironically displayed by the drop in the 10 year UST yield after the rating downgrade.

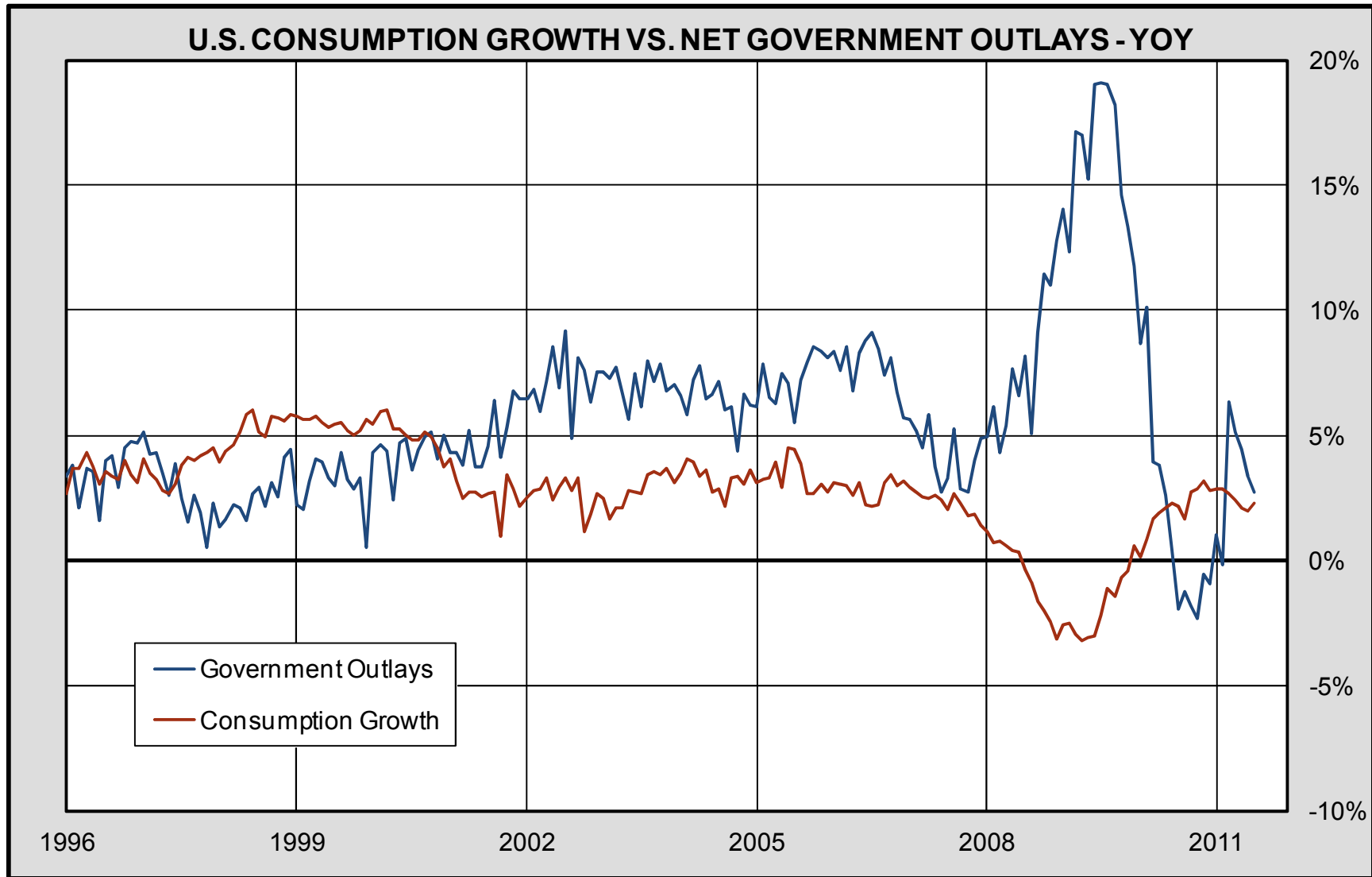
However, the equity of multi-national corporates may begin to play a bigger role in investment portfolios with longer time horizons as investors are attracted to decent dividend yields and greater inflation protection vis-à-vis fixed income.

Source: Bloomberg, Northern Trust Global Investments; data as of 8/19/2011.





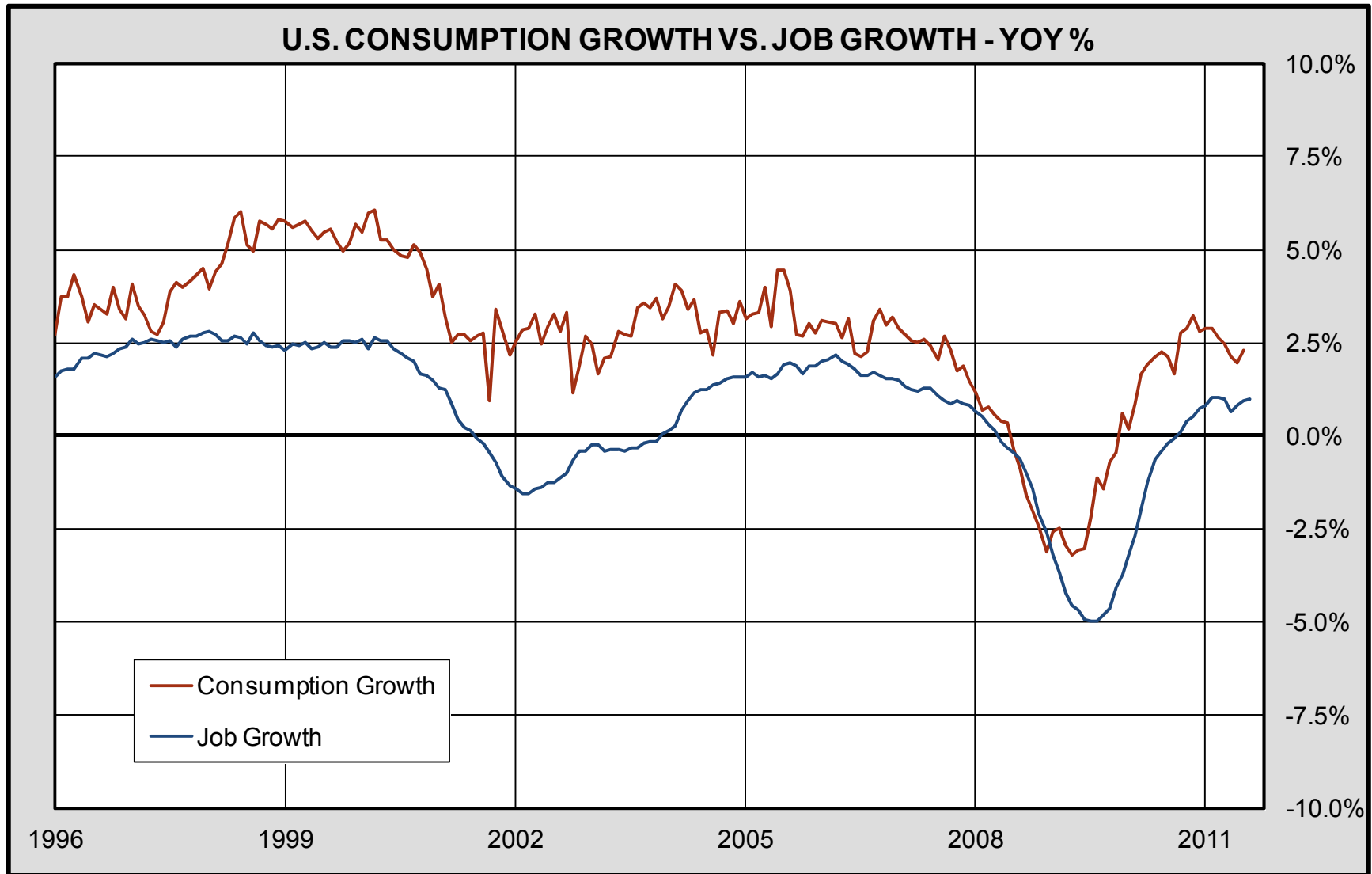
We need a successful “public-to-private” hand-off to maintain the positive momentum...



Source: Bloomberg, Northern Trust Global Investments. Monthly data through 7/31/2011.



...and better job growth than we have had thus far



Source: Bloomberg, Northern Trust Global Investments. Monthly data through 7/31/2011. Job growth data through 8/31/2011.

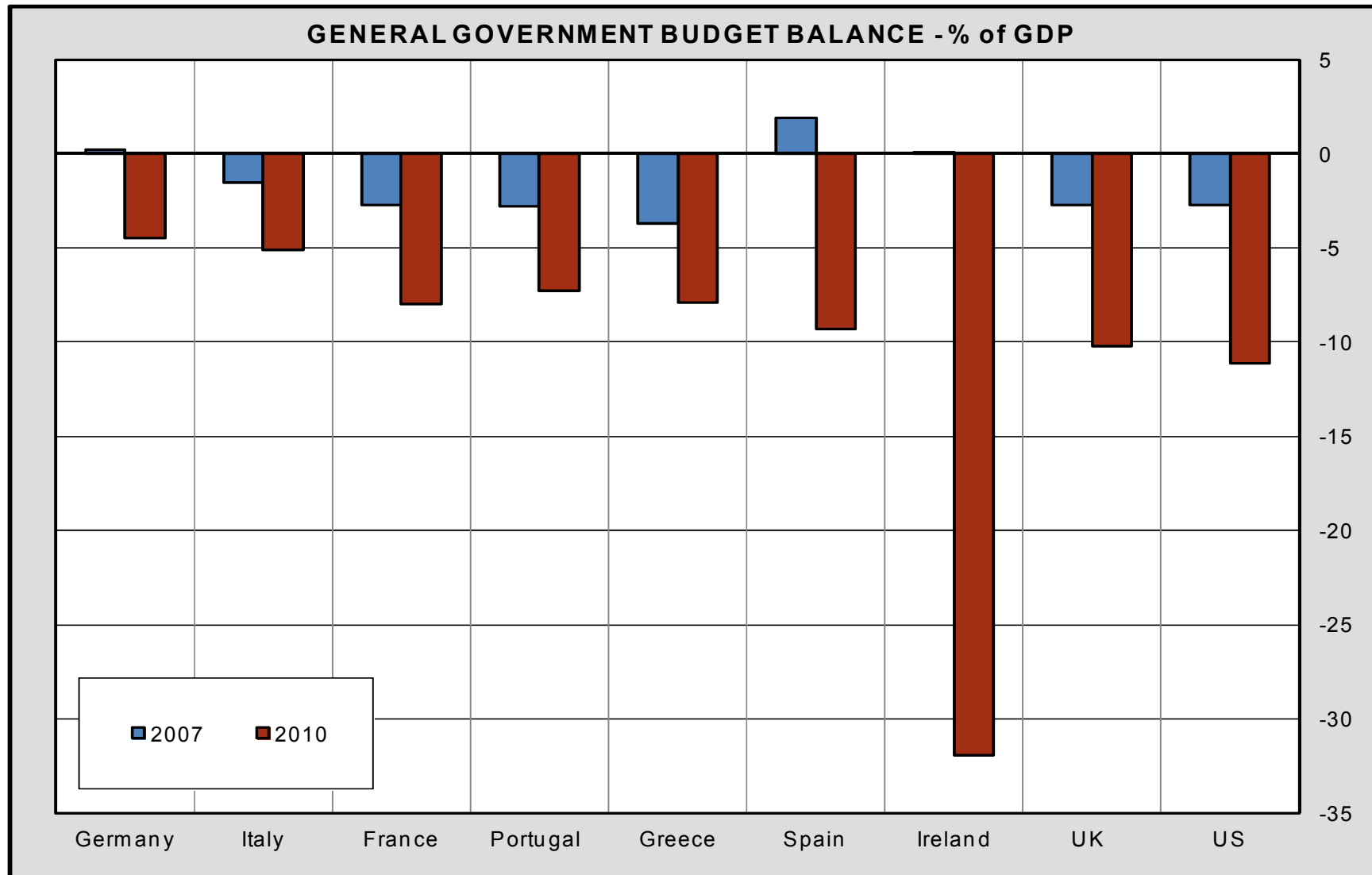


The Specter of Higher Interest Rates, Inflation & Other Bogeymen





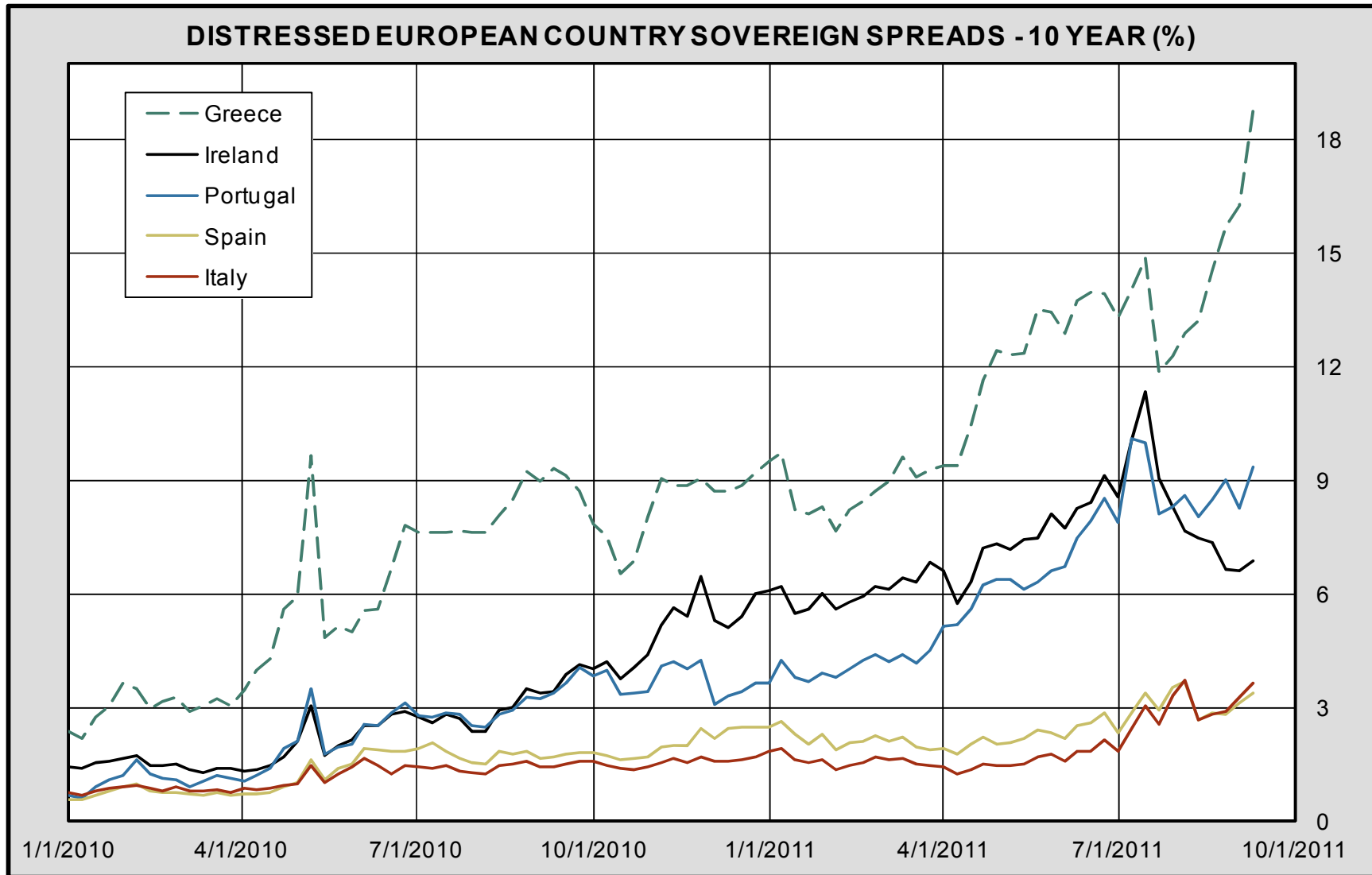
No shortage of debt. It's a short term drag – and is one of our main long term risks...



Source: IMF, Northern Trust Global Investments.



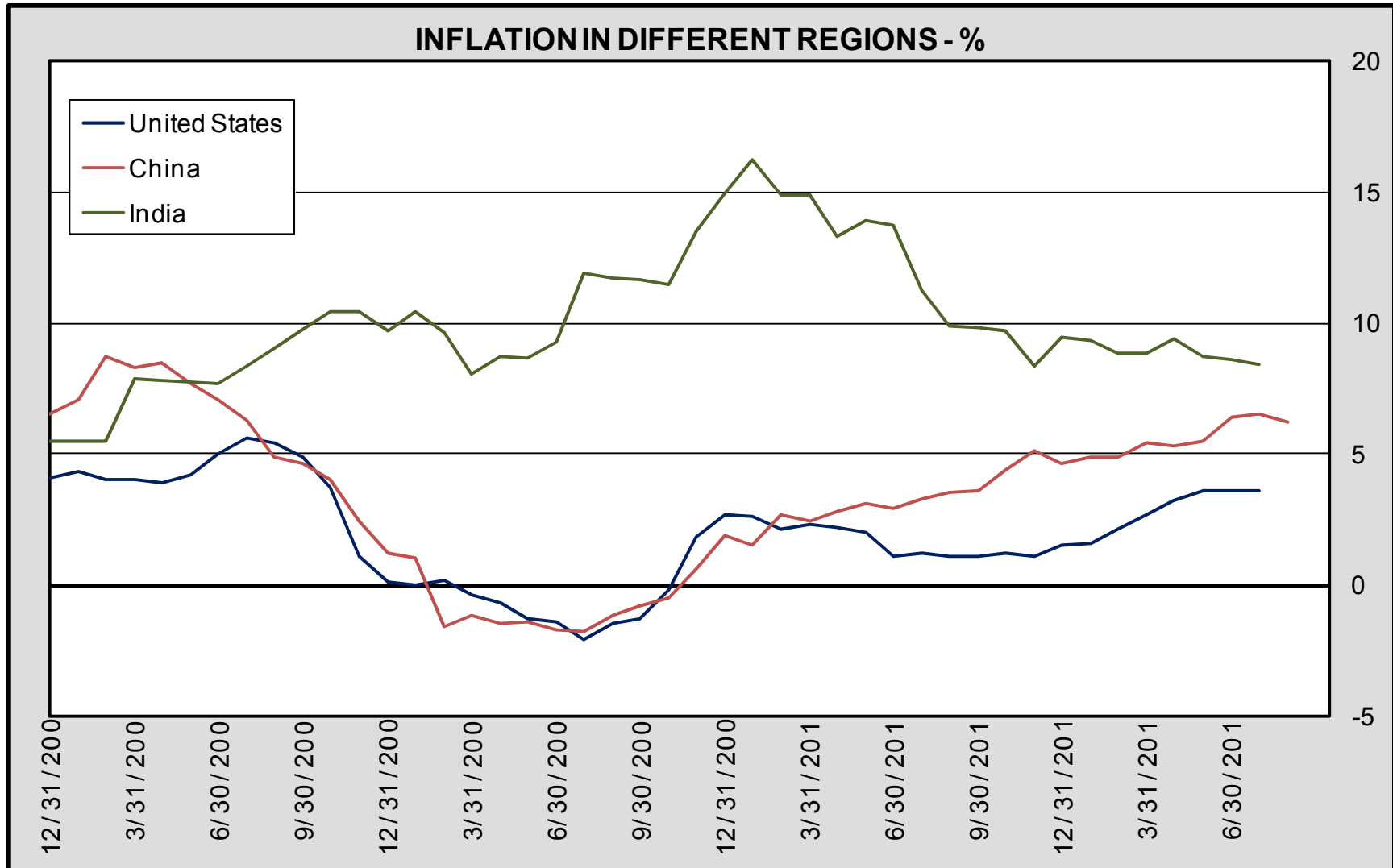
...as certain bond markets already say “no mas, no mas”



Source: Bloomberg, Northern Trust Global Investments. Data as of 9/9/2011.



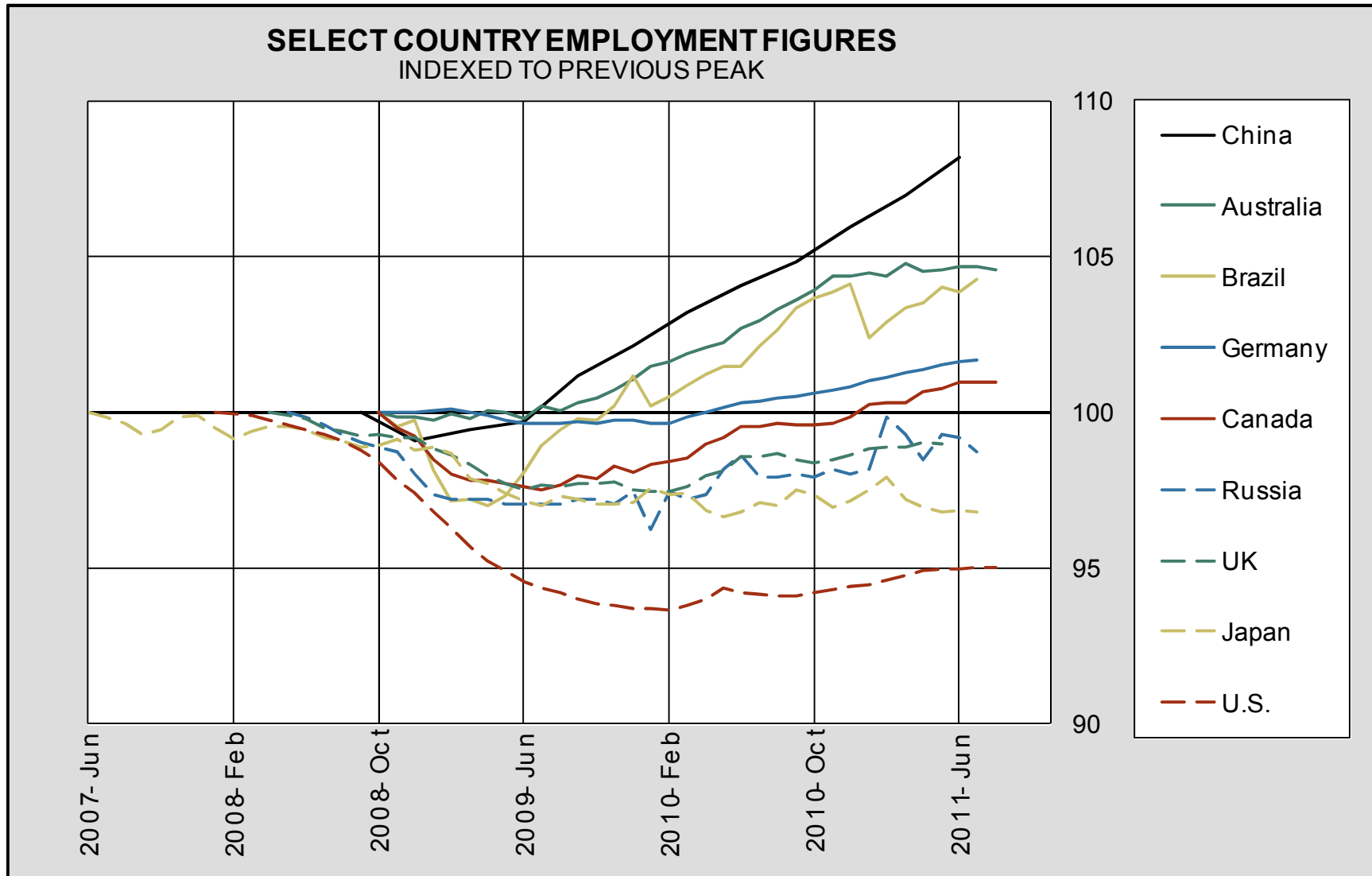
Headline inflation has clearly bottomed, but still is mostly a problem in the Emerging Markets



Source: Bloomberg, Northern Trust Global Investments. Monthly data through 7/31/2011; China through 8/31/2011.



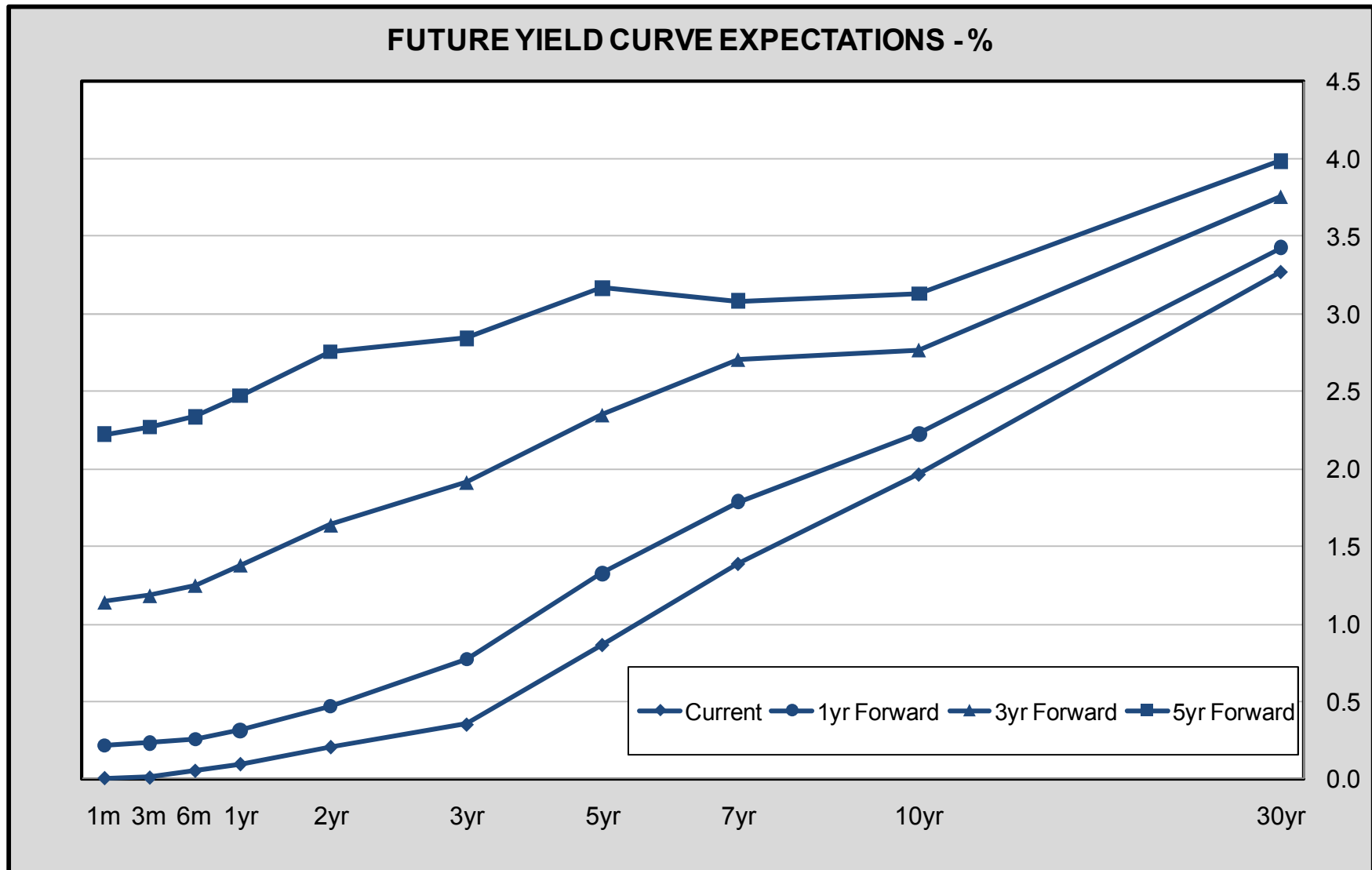
It should be no surprise given divergent economic growth since the crisis



Source: Haver Analytics, Northern Trust Global Investments.



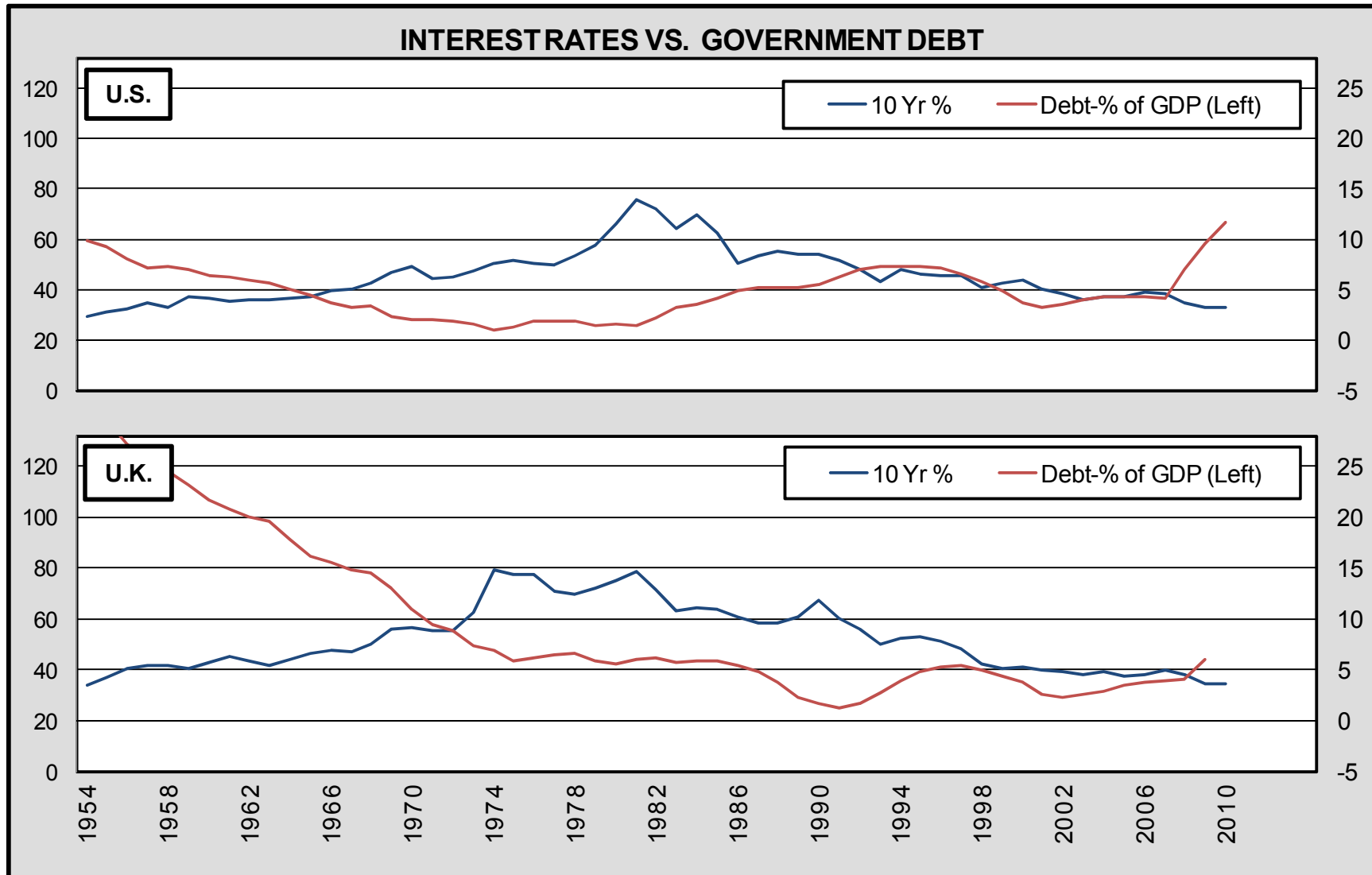
The U.S. bond market is already expecting a bear flattening (short term rates rising sharply relative to long term rates)



Source: Bloomberg. Data as of 9/13/2011



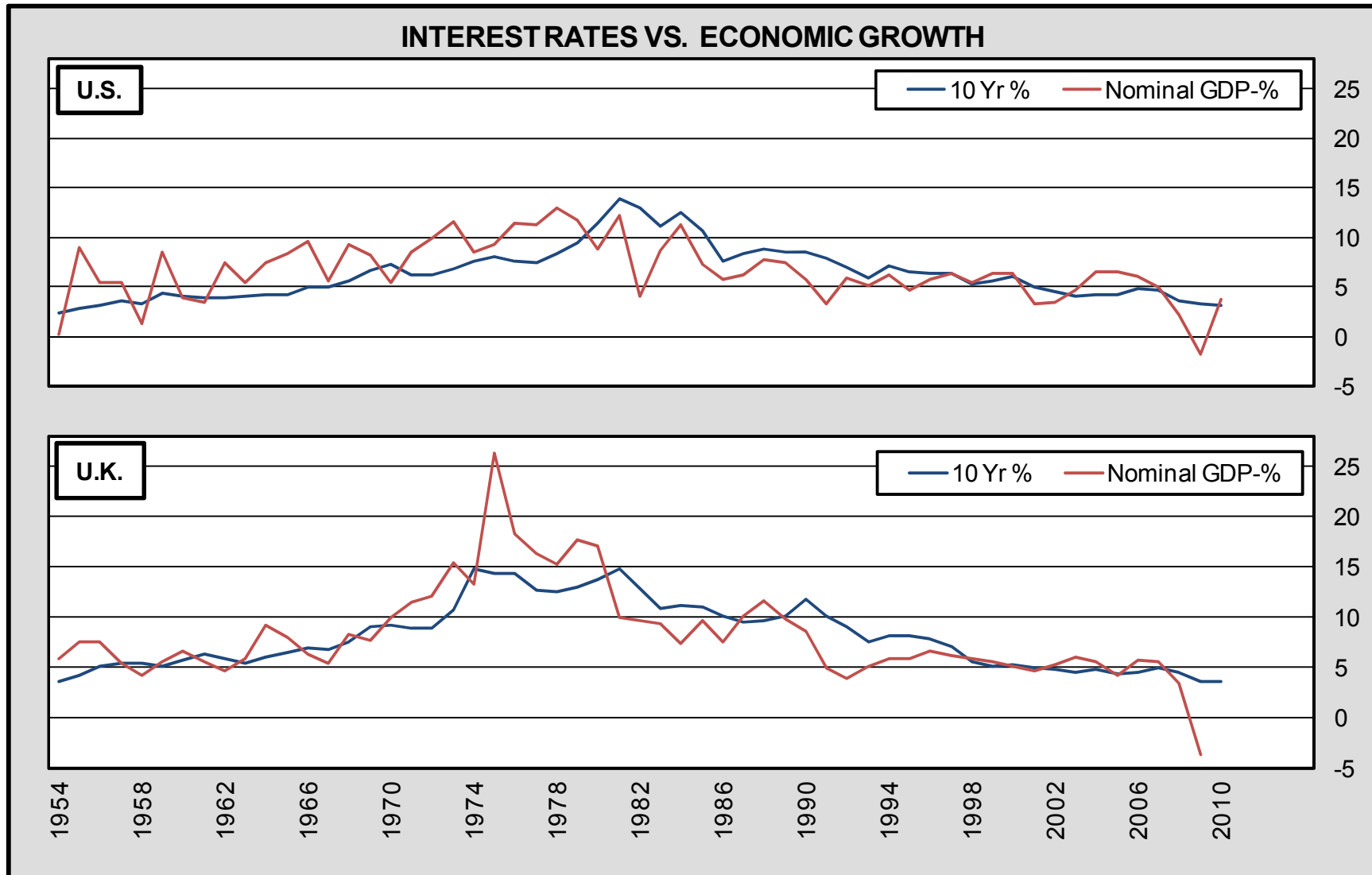
While this time may be different, deficits have not yet driven interest rates higher in the U.S. or the U.K. ...



Source: Bloomberg, Haver Analytics, Measuring Worth, Northern Trust Global Investments.



... but growth and inflation do drive interest rates higher



Source: Bloomberg, Haver Analytics, Measuring Worth, Northern Trust Global Investments.



But what happens when rates actually rise?

Fed Funds Hikes Don't Tank Bond Returns

FEDERAL RESERVE TIGHTENING CYCLES							
Range	Start Point	Cumulative Move	Price Return	Coupon Return	Total Return	Annual Return	S&P Ann. Return
4/29/1983 - 9/28/1984	8.5%	3.3%	-6.5%	16.2%	9.6%	6.7%	5.4%
11/28/1986 - 6/30/1989	5.9%	3.8%	-4.5%	24.0%	19.5%	7.1%	13.7%
1/31/1994 - 6/30/1995	3.0%	3.0%	-3.8%	9.7%	5.9%	4.2%	12.3%
5/31/1999 - 12/29/2000	4.8%	1.8%	2.3%	10.9%	13.2%	8.1%	2.1%
5/31/2004 - 8/31/2007	1.0%	4.3%	-0.7%	15.8%	15.1%	4.4%	10.8%
Average	4.6%	3.2%	-2.6%	15.3%	12.7%	6.1%	8.8%

10-Year Rate Hikes Harder to Overcome

10 YEAR U.S. TREASURY RATE INCREASE CYCLES							
Range	Start Point	Cumulative Move	Price Return	Coupon Return	Total Return	Annual Return	S&P Ann. Return
4/29/1983 - 6/29/1984	10.3%	3.6%	-10.6%	12.5%	1.9%	1.6%	-1.5%
8/29/1986 - 9/30/1987	6.9%	2.7%	-11.2%	8.7%	-2.6%	-2.4%	28.7%
9/30/1993 - 11/30/1994	5.4%	2.5%	-11.4%	7.1%	-4.3%	-3.7%	1.8%
9/30/1998 - 1/31/2000	4.4%	2.2%	-10.2%	7.8%	-2.4%	-1.8%	28.2%
9/30/2002 - 6/30/2006	3.6%	1.5%	-8.9%	16.8%	7.9%	2.0%	14.6%
Average	6.1%	2.5%	-10.5%	10.6%	0.1%	-0.9%	14.4%

Source: Bloomberg, Barclays Capital Live, Northern Trust Global Investments.
 Note: The total return is based off of the index, Barclays US Treasury Aggregate.



Ultimately, labor costs are required to drive inflation

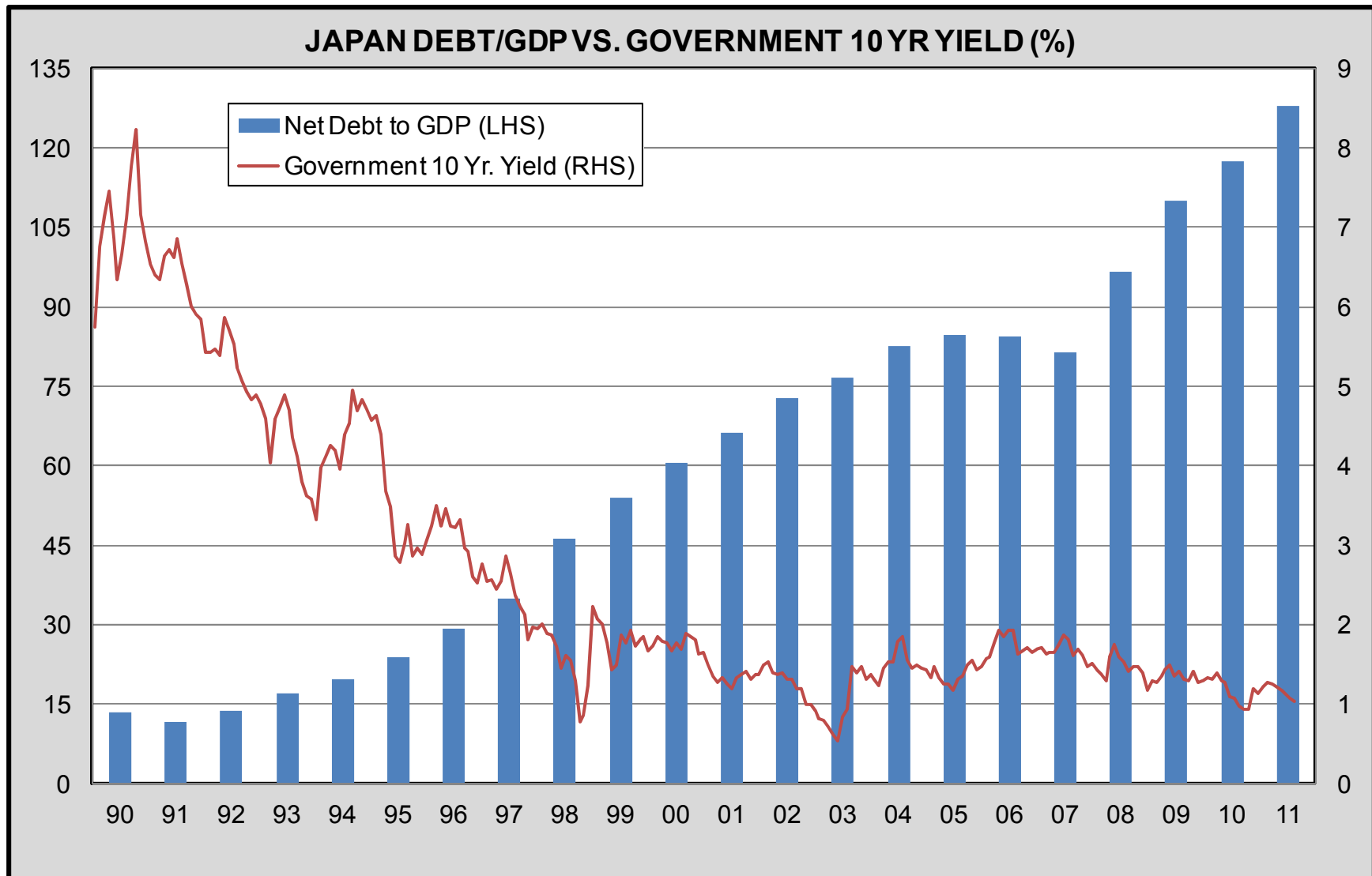
DRIVERS OF INFLATION					
Range	Crude Energy	Crude Food	Unit Labor Cost	CPI	CPI Y+1
9/30/1971 - 8/31/1973	NA	52%	5%	5%	8%
1/31/1978 - 2/28/1981	42%	12%	11%	13%	13%
5/31/1995 - 1/31/1997	39%	10%	1%	3%	2%
6/30/2002 - 5/31/2004	40%	23%	0%	2%	3%
5/31/2006 - 7/31/2008	38%	27%	3%	4%	2%
9/30/2009 - 2/28/2011	22%	31%	-1%	2%	NA

Source: Bloomberg, Northern Trust Global Investments.

Note: Crude materials for further processing are defined as unprocessed commodities not sold directly to consumers. Crude foodstuffs and feedstuffs include items such as grains and livestock. The crude energy goods category consists of crude petroleum, natural gas to pipelines, and coal.



The Japanese experience shows clearly that large fiscal deficits do not necessarily lead to higher interest rates



Source: Bloomberg, IMF, Northern Trust Global Investments. Yield Data as of 08/31/2011. 2010 and 2011 Debt/GDP are IMF Estimates.



Concerns about U.S. deficits and loose money might continue to weaken the dollar rather than lead to sharply higher rates



Source: Bloomberg, Data through 9/9/2011.





One last risk to keep in mind: MENA Oil Exports

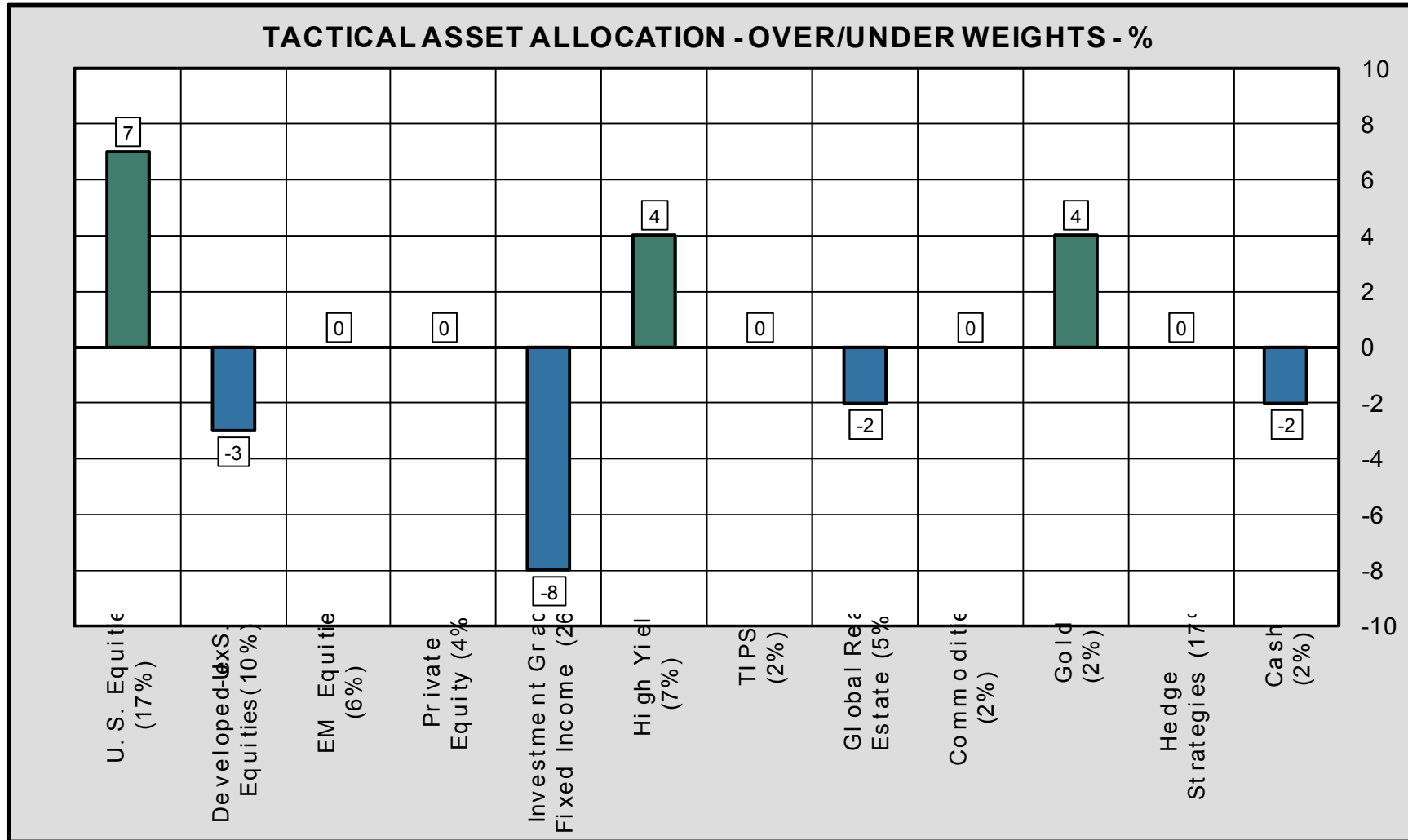
2009 OIL EXPORTS		
Few Signs of Change	Millions b/d	% of Total Exports
Saudi Arabia	6.4	35.8%
United Arab Emirates	2.0	11.2%
Oman	0.6	3.4%
Total	9.0	50.3%
Mild Protests		
Iraq	1.9	10.6%
Kuwait	1.4	7.8%
Other	0.6	3.4%
Total	3.9	21.8%
Threatening Protests		
Iran	2.2	12.3%
Algeria	1.3	7.3%
Other	0.2	1.1%
Total	3.7	20.7%
Overthrown Regimes		
Tunisia	0.1	0.6%
Egypt	0.0	0.0%
Libya	1.2	6.7%
Total	1.3	7.3%
2009 Oil Export Total	17.9	100%

Source: The Economist, Northern Trust Global Investments.

Note: Total world production in 2009 was 80.2 million b/d.



Northern Trust Investment Policy: We end where we started – long U.S. equities, high yield bonds and gold



Allocations above reflect Northern's Growth and Income – Accredited objective; the proxy account for IPC. Strategic allocations are listed across the bottom; tactical recommendations (in the form of over/under/equal weights) are displayed in the bar chart. Tactical allocations as of 8/18/2011.