INVESTMENT
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QUARTERLY REPORT 3Q23

IT'S A MARATHON…

As most of the world's population exits summer, marathon season resumes – with two of the six majors* (Berlin and Chicago) bookending the start and end of the third quarter, and New York coming up in November. The "it's a marathon, not a sprint" analogy is (too) often used to assess investment portfolio performance, but a marathon analogy also applies nicely to current economic dynamics.

Who's winning? The three global economic epicenters – the United States, the European Union and China – have had varying levels of speed and stamina over this post-pandemic** economic marathon. The U.S. economy – fueled by a large fiscal energy boost and harnessing a strong monetary tailwind out of the gate – has grown 5.3% annually in real terms. Adding a hot 5.6% post-pandemic inflation level to the strong real growth has resulted in double-digit nominal economic growth – a speed not seen in the U.S. since the 1970s. This combo led to strong equity returns, with the S&P 500 rising at a 17.4% annualized clip from post-pandemic stabilization.

Europe is modestly off America's pace due to energy security challenges, despite also biting off some of the fiscal stimulus energy bar and enjoying an early easy money tailwind. Post-pandemic splits include 6.0% annualized real economic growth (heavily influenced by an 11.5% quarter out of the gate); a 5.7% annualized rate of inflation; and a 12.7% annualized equity market return (MSCI Europe). But, as the monetary tailwind turned to a stiff headwind, Europe has hit a bit of the proverbial wall – falling back from the U.S. toward a materially slowing China. Reliable economic data is lacking, but Chinese growth is clearly deteriorating in the face of elevated debt levels amid an already slow post-pandemic reopening. Reflecting these challenges, China's stock market has posted a -5.5% post-pandemic annual split (MSCI China).

An economic second wind. As Europe and China fade, there is some evidence that the U.S. may have found its economic "second wind". Once a forgone conclusion that the U.S. would fall prey to recession, most forecasters are now calling for this economic landing to be prefixed with "soft" (inflation falls without the recession) or even "no" (as in no recession but also no respite from high inflation). The consumer will play a large part in this determination. Here, it seems they have the willingness to keep going (thanks to a still-strong job market) but may not have the capacity (as gas prices move higher, mortgage rates hit new highs and student loan debt payments resume). That internal struggle will define where the economic "finish line" sits.

Runner's high? Despite the economic uncertainty, stock market valuations, notably in the U.S., remain elevated – driven, in large part, by the tech sector and the promise of AI. Indeed, whether AI serves as a mere near-term "sugar rush" or a longer-lived (and quickly harnessed) support will go a long way toward determining how this race ends.

**The six majors (calendar order): Tokyo (March), Boston (April), London (April), Berlin (Sep), Chicago (Oct), New York (Nov).*

***Data begins 6/30/20 (economic growth); 4/30/20 (inflation); 3/31/20 (equity returns) – all through most recent as of 9/30/23.*

THIRD QUARTER 2023 TOTAL RETURNS (%)

Natural resources, cash and high yield were the only major assets that didn't stop for breath last quarter.

	RISK CONTROL				RISK ASSETS							
	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	EM	NR	GRE	GLI
	1.3	-3.9	-3.2	-2.6	0.5	-3.3	-3.2	-3.9	-2.0	3.7	-4.9	-7.3
YTD	3.7	-1.4	-1.2	-0.8	5.9	4.3	12.6	6.5	3.7	0.5	-3.6	-3.7

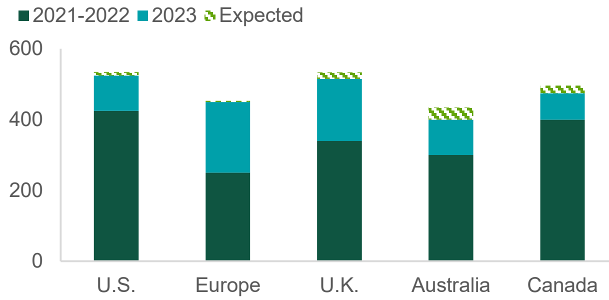
Source: Northern Trust Asset Management, Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure.

KEY DEVELOPMENTS

Approaching the Peak

The broader U.S. economic narrative around resilient – but softening – growth and moderating inflation gained traction. Hopes for a "soft landing" outcome have grown as 2023 recession forecasts have been phased out with more investor expectations around higher-for-longer monetary policy. In addition to the Fed, most major non-U.S. central banks appear to be nearing peak policy rates. Even the previously more-hawkish central banks have moderated their messaging to better balance growth concerns versus still-elevated core inflation.

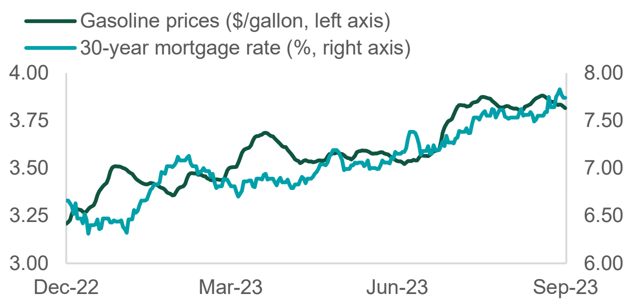
CENTRAL BANK TIGHTENING (BASIS POINTS)



Consumer Challenges

Consumer activity has been a key driver of U.S. economic resilience. Consumers face building headwinds from the lagged and variable impacts of Fed tightening. Higher mortgage rates, rising gasoline prices and resumed student loan payments are all a direct drag on consumers plus broader issues (e.g., U.S. government shutdown risk and the auto labor strike). Consumers may still have an appetite to spend, but their capacity to do so is shrinking as pandemic savings are whittled down and credit card debt levels rise.

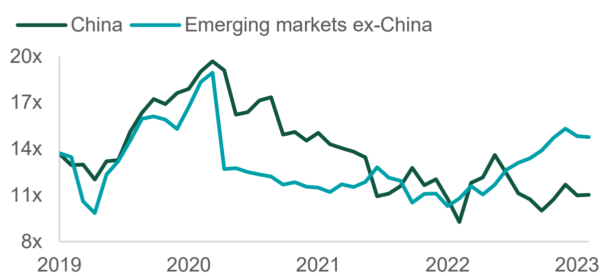
HEADWINDS TO CONSUMER ACTIVITY



China Balance Sheet Woes

China's economic situation marks a reversal from initial optimism on a 2023 rebound. Structural economic challenges are at the forefront, including debt and the property sector. Recent policy support has not moved the needle on property sector confidence or investor sentiment. China's economy benefits from being largely self-financed, but there is no quick fix as economic actors grapple with debt reduction at a time of falling asset prices. China also faces drag from tensions with the West – creating opportunity for other EM countries.

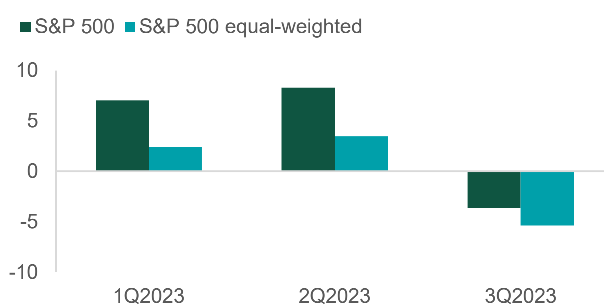
FORWARD P/E MULTIPLES



No Place to Hide?

With muted 3Q returns in the largest tech-related stocks, the S&P 500 (market-cap-weighted) return was closer to its equal-weighted counterpart versus earlier in 2023. Broader U.S. Treasury indexes matched the S&P 500's 3% loss with the move higher in interest rates – leaving balanced portfolios in negative territory. On a more positive note, high yield fixed income posted a modest gain in 3Q (0.5%), showing how credit can enhance diversification in relation to traditional market (equity) and term (interest rate) exposures.

RETURNS BY QUARTER (%)



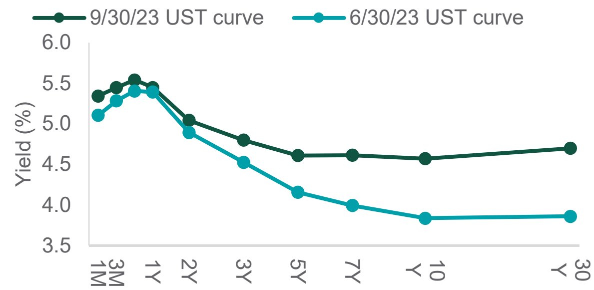
Source: Northern Trust Asset Management, Bloomberg. Data as of 9/30/2023. Fed = Federal Reserve. China and Emerging Markets (EM) ex-China proxied by MSCI China and MSCI EM ex-China Indexes, respectively. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

MARKET REVIEW

Interest Rates

Duration-sensitive assets took a hit as interest rates rose to cycle highs. After hiking in July, the Fed opted to hold its policy rate at 5.5% in September. But it was a hawkish hold given meaningful upward revisions to its median policy rate and economic growth projections. Short-end yields saw modest upward pressure as investors repriced a higher-for-longer policy path. Back-end yields saw more significant upward moves (e.g., 30-year yield was up 84 basis points), with surprising economic durability helping drive a surge in real yields.

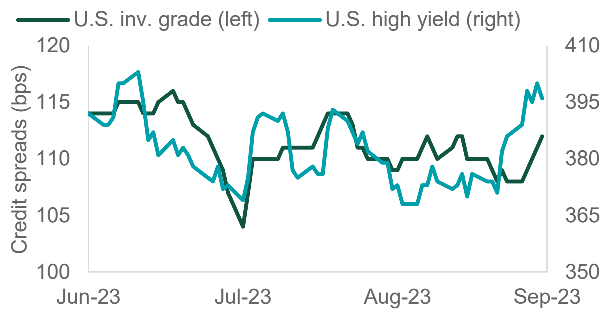
U.S. TREASURY YIELD CURVE



Credit Markets

Credit spreads were mostly rangebound and ended the quarter little changed overall. Investment grade spreads narrowed 2 basis points (bps) to 112 bps and high yield widened 4 bps to 396 bps. High yield (+0.5%) returned more than investment grade fixed income (-3.2%) as higher income yields and less interest-rate sensitivity supported relative performance. Concerns of a default wave resulting from central bank tightening and/or other sources of economic strain were well contained with strong performance across lower-quality credits.

CREDIT SPREADS



Equities

Traditional stock-bond diversification provided little respite as fixed income declines coincided with global equity losses (-3.3%). Equity weakness extended across regions, with only small and temporary boosts to emerging markets from China stimulus. Early-quarter strength came from upside surprises across economic growth data amid lower inflation prints and talks of final policy rate hikes. Returns hooked lower once economic durability fed into higher interest rates, pressuring equities priced for a mostly benign economic outcome.

REGIONAL EQUITY INDICES

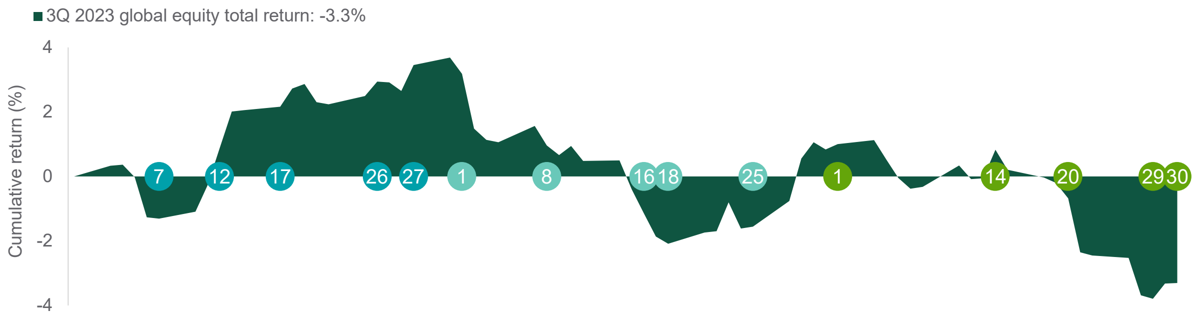
Real Assets

Natural resources (+3.7%) was one of the few bright spots in a quarter where most assets moved lower. Higher energy prices drove most of the gain as oil prices broke out to the upside. Global real estate (GRE, -4.9%) and global listed infrastructure (GLI, -7.3%) severely lagged natural resources and to a smaller but still meaningful extent lagged global equities (-3.3%). All sectors within both GRE and GLI posted losses, suggesting that macro pressures from higher interest rates and negative market sentiment were at play.

REAL ASSET INDICES

Source: Northern Trust Asset Management, Bloomberg. Returns in U.S. dollars. Indexes are gross of fees. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

MARKET EVENTS



JULY	AUGUST	SEPTEMBER
7 Nonfarm payrolls report is not as strong as feared, helping ease concern on labor market overheating from strong ADP jobs data released the prior day.	**1** Fitch downgrades its U.S. sovereign credit rating because of expected fiscal deterioration over the coming years and an erosion of confidence in governance.	**1** U.S. jobs data shows orderly loosening, adding to soft landing hopes fueled by benign inflation and solid consumer spending data the day before.
12 Financial markets embrace lower U.S. Consumer Price Index (CPI) prints, with modest month-over-month changes in headline and core (0.2%).	**8** China CPI moves into negative territory as it contends with weak trade, high youth unemployment and ongoing property- and debt-related stresses.	**14** The ECB raises its key policy rate by 25 bps, but its statement language hints that it is likely done hiking for now.
17 Wheat and other agricultural-related commodities see volatility after Russia backs out of the Black Sea grain deal.	**16** U.K. core CPI remains unchanged at a high level of 6.9% year-over-year – a worrisome development for the Bank of England given accelerating wages.	**20** The Fed holds its policy rate, but the press conference and updated Summary of Economic Projections signal a higher-for-longer policy path.
26 The Fed hikes by 25 basis points (bps) to 5.25-5.50% – the last rate hike of the cycle that investors anticipate.	**18** Rising interest rates weigh on equities with the 30-year Treasury yield hitting its highest level since 2011 (rises about 40 bps more through quarter-end).	**29** Strikes broaden to more plants at the three largest U.S. automakers, with the walkouts poised to enter week three.
27 The European Central Bank (ECB) hikes by 25 bps, but moving forward it signals a more data-dependent approach versus a bias to tighten.	**25** No surprises from Fed Chair Powell at Jackson Hole with Powell noting inflation remains too high and the Fed is prepared to raise rates more if needed.	**30** U.S. unexpectedly avoids government shutdown after last-minute deal provides funding at current levels for six more weeks.

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