SUPPORTIVE FUNDAMENTALS

Global markets were strong over the past month as "soft landing" supportive fundamentals and market conditions unfolded. Increasing confidence in moderating inflation drove significant changes in expectations for the Fed (pricing in earlier rate cuts), and a steep drop in long-term rates. Lower rates combined with still reasonably durable labor market and consumer spending conditions drove a re-rating upward of equity markets as the scenario of falling inflation and non-recessionary growth conditions over the next year became increasingly priced in.

The U.S. 10-year Treasury yield fell a remarkable 0.60% in November, driving a 9% rise in U.S. equities for the month. Futures pricing implies a market expectation that the Fed could cut rates as early as March (~45% chance), and rate cuts totaling over 1% over the next year. While we believe the movement lower in long-rates better reflects our view of fair value, we see a later start to rate cuts by the Fed given still durable macro fundamentals and a desire to ensure inflation has been tamed.

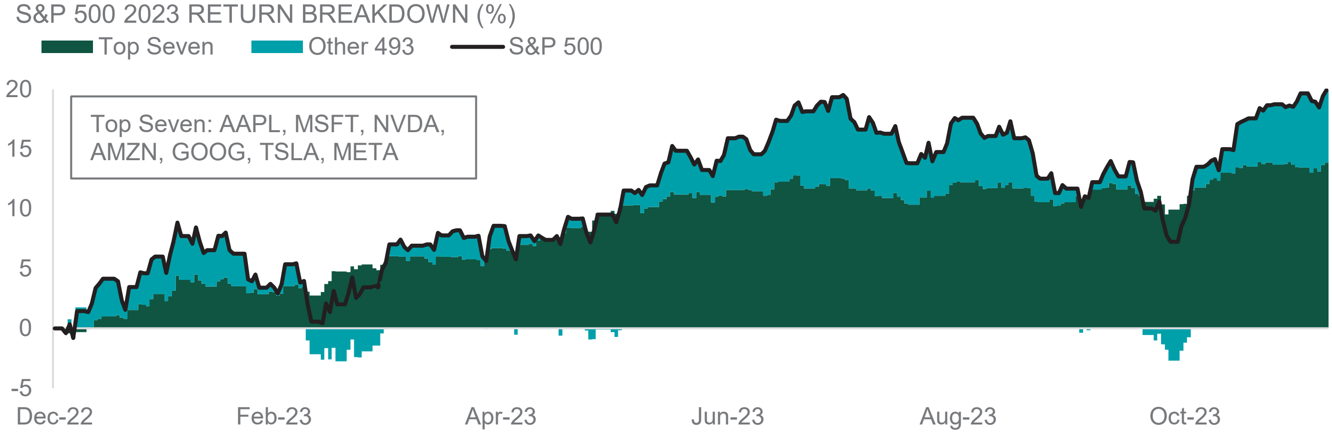
Notably, equity markets have seen a broadening of performance in the most recent rally. While gains earlier this year were driven almost entirely by mega-cap tech-related companies, other sectors and smaller companies are now participating. Key to absolute performance going forward will be if future gains in the non-tech parts of the market represent a churning of the market (mega-cap tech stocks are sold to fund investor interest in other names), or if those gains instead come from fresh capital.

We think absolute upside in equity markets will likely be limited by elevated valuations, but improvements in the macro backdrop have reduced the downside risks in the U.S. Economic conditions remain challenged in emerging markets, though material underperformance and much lower valuations now more fully reflect our concerns.

BREADTH EXPANSION

The U.S. equity market has seen a broadening of performance in the most recent rally.

S&P 500 2023 RETURN BREAKDOWN (%)



Source: Northern Trust Asset Management, Bloomberg. Data from 12/31/2022 through 12/8/2023. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Past performance is no guarantee of future results.

BASE CASE EXPECTATIONS

Sticking the Landing

Global growth – led by the U.S. – slows to below trend growth but remains positive. Inflation remains above target but the disinflation process continues. Risk-taking appetite is tempered by elevated valuations.

Fed Steps Aside

Monetary policy risks are more balanced with the Fed done hiking for the moment. Investor rate cut expectations in the first half of 2024 are misplaced given economic resilience and above target inflation.

RISK CASE SCENARIOS

Central Bank Breakage

The worst of monetary policy lags have yet to be felt and higher rates lead to something "breaking" in the economy. Should that "breakage" cause widespread contagion, we are not underweight risk enough.

Oil Ends the Expansion

The war in Israel expands into a broader Middle East conflict that draws in Iran, putting global oil supply at risk. Central banks would look through the near-term inflation spike anticipating the economic fallout.

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