NORTHERN TRUST

2021 OUTLOOK

A V(ACCINE)-SHAPED RECOVERY

Northern Trust
Global Asset Allocation

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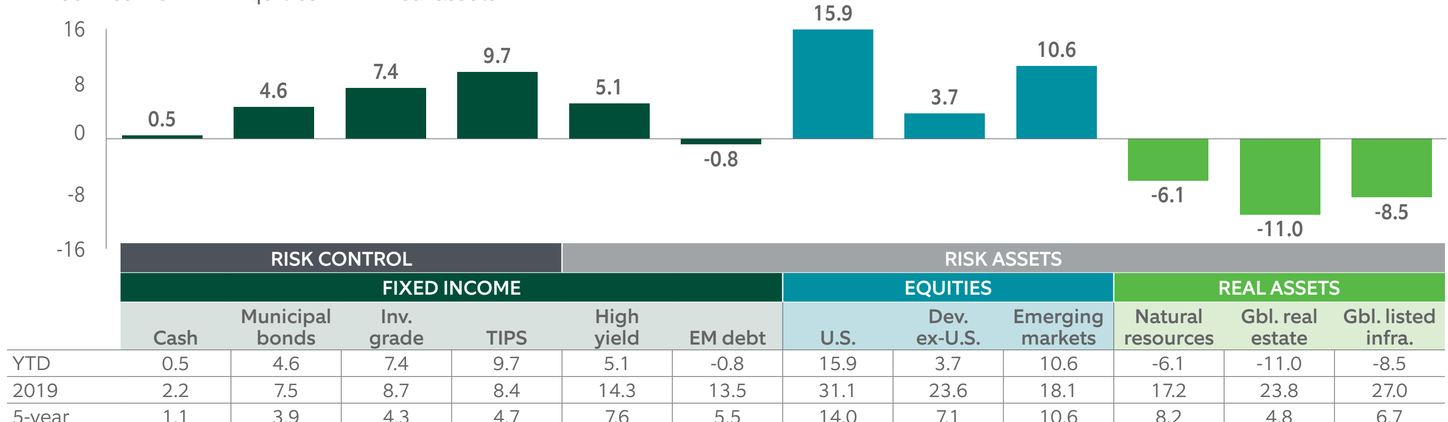
We are moderately overweight risk — with a preference for high yield bonds and global listed infrastructure — entering 2021, as we expect fundamentals will catch up to the recent market surge. Strong economic growth looks likely as vaccination reopens dormant parts of the economy and pent-up demand fuels consumer spending.

We expect positive returns across most markets in 2021, but they will be unlikely to reach the lofty levels realized in 2020 (see below). As we entered 2020, return expectations were muted after the excellent results in 2019. We expected slow growth, and instead we've had what looks to be the fastest recession and bear market in history because of the pandemic. The COVID-19 health crisis pushed aside previous concerns over the U.S.-China trade war, while the U.S. election remained center stage for investors. Our outlook and forecasts for 2021 reflect the effect of the pandemic, which will still loom large as near-term growth will be muted by social distancing globally — but the markets will take comfort in the high likelihood of major vaccination progress by mid-year. The highly successful vaccine trials from Pfizer and Moderna in November, showing nearly 95% efficacy when the market was only expecting 60-70%, can reasonably be called the best-case outcome. U.S. health officials expect vaccinations to begin in December, with the potential that by April or May even healthy young adults may be able to access the vaccine. Europe has also contracted for a significant supply of both the Pfizer and Moderna vaccines, and additional vaccines remain in the pipeline. This may prove critical for less-developed countries, where refrigeration/freezer capacity is less available.

The results of the U.S. election look likely to deliver divided government, although this won't be known for sure until after January 5 Georgia Senate runoffs. A divided government most supports growth due to the likelihood of stimulus without corresponding tax hikes.

EXHIBIT 1: A TRULY WILD RIDE

Markets can always be volatile, but the drawdown and recovery in 2020 was one for the record books.



	RISK CONTROL				RISK ASSETS							
	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Municipal bonds	Inv. grade	TIPS	High yield	EM debt	U.S.	Dev. ex-U.S.	Emerging markets	Natural resources	Gbl. real estate	Gbl. listed infra.
YTD	0.5	4.6	7.4	9.7	5.1	-0.8	15.9	3.7	10.6	-6.1	-11.0	-8.5
2019	2.2	7.5	8.7	8.4	14.3	13.5	31.1	23.6	18.1	17.2	23.8	27.0
5-year	1.1	3.9	4.3	4.7	7.6	5.5	14.0	7.1	10.6	8.2	4.8	6.7

Source: Northern Trust Asset Management, Bloomberg. Year-to-date data through November 30, 2020. Five-year annualized data from November 30, 2015 to November 30, 2020. TIPS are Treasury inflation-protected securities. **Past performance is no guarantee of future results.**

EXHIBIT 2: 2021 OUTLOOK BY ASSET CLASS

Group	Category	Asset Class	TAA*	SAA**	Key Views
Risk Assets	EQUITIES	DEVELOPED MARKETS **Equal-weight**	42%	42%	U.S. valuations are high but a stabilizing U.S. policy outlook and positive COVID-19 vaccine news may open new opportunities. Europe has more attractive valuations but the pandemic has inflicted more damage on the economy, which may recover more slowly.
Risk Assets	EQUITIES	EMERGING MARKETS **Equal-weight**	6%	6%	Emerging markets valuations are attractive and emerging countries have a better handle on the pandemic. Still, they may face headwinds related to China's alienation as China and broader Asia represent 40% and 80% of emerging market equities, respectively. President-elect Biden's approach to the U.S.-China relationship will be key.
Risk Assets	REAL ASSETS	GLOBAL REAL ESTATE/ INFRASTRUCTURE **2% overweight**	6%	4%	Our overweight resides in global listed infrastructure, which has downside protection and cyclical upside as we recover from the pandemic. We are equal-weight global real estate with the offsetting forces of low interest rates (positive) and permanent impairment of some properties because of the pandemic (negative).
Risk Assets	REAL ASSETS	NATURAL RESOURCES **Equal-weight**	2%	2%	Equity-based natural resources can help protect against unexpected inflation and geopolitical risks. Returns have been hurt by falling oil prices. But, despite the headwinds, attractive valuations with higher dividend yields keep us at equal-weight.
Risk Assets	FIXED INCOME	HIGH YIELD **3% overweight**	9%	6%	This is our highest conviction overweight position. High yield bonds historically have participated in equity gains and limited losses when equities fall, making the bonds desirable in the current volatile environment. As corporations sacrifice some growth for more stability, high yield sits in a sweet spot.
Risk Control Assets	FIXED INCOME	INVESTMENT GRADE **2% overweight**	35%	33%	Investment grade bonds remain the best way to stabilize a portfolio during market stress and equity volatility. We are modestly overweight for additional stability. Also, we think central banks will remain on hold and long-term interest rates will remain low, supporting bond prices.
Risk Control Assets	FIXED INCOME	INFLATION LINKED **5% underweight**	0%	5%	The lack of inflationary pressures amid the pandemic drives our biggest underweight. We expect post-pandemic structural forces (efficiency from technology, lower consumer demand) to keep inflation below market and central bank expectations. When we do invest in inflation-linked bonds, we prefer those with short duration because of their higher inflation sensitivity.
Risk Control Assets	FIXED INCOME	CASH **2% underweight**	0%	2%	As the pandemic dragged down the global economy, central banks went firmly back to a zero interest rate policy. Therefore, cash returns will remain near zero over the tactical horizon. In this environment, we believe cash should be held only for near-term liquidity needs.

TACTICAL RISK POSITION:
Moderate overweight to risk

Our overweight positions to high yield bonds and global listed infrastructure equities result in a moderate overweight to risk. Heading into 2021, we believe that the potential for upside is slightly greater than the downside.

*TAA = Tactical Asset Allocation.
** SAA = Strategic Asset Allocation.
These recommendations, based on the Global Policy Model, do not include alternatives. We believe strategic holdings in both private investments and hedge funds can assist in increasing portfolio efficiency. However, we do not make tactical recommendations on these asset classes due to the strategic nature of the investments.

MACRO THEME REVIEW

There have been some interesting developments over the past few months — including the U.S. election — that provide markers on how our themes may progress in the post-pandemic world.

Our 2021 outlook includes a review of our long-term capital market assumption themes, as published each year in our five-year outlook. These themes drive our "forward-looking, but historically aware" approach to strategic asset allocation. They also inform our tactical one-year outlook and asset allocation positioning. We provide a broad narrative of how our themes are progressing below, while Exhibit 3 details the status of each theme individually.

Reviewing long-term themes amid the ongoing pandemic has proven complicated. Most current economic and financial market developments have been driven by the pandemic's economic impacts and policy reactions. We cannot focus on the longer term until the pandemic is behind us. That said, there have been some interesting developments over the past few months — including the U.S. election — that provide markers on how our themes may progress in the post-pandemic world.

With our theme of **Retooling Global Growth**, we believe pandemic-driven changes in business approach (with C-suites moving modestly away from efficiency and toward resiliency) will join with high debt and aging demographics to mute overall economic growth. However, we also expect **Massive Monetary Toolkit** will put a floor under growth — and may even offset some of the growth headwinds noted above. This theme has continued to play out as expected, with ongoing signs of a strong fiscal-monetary marriage. This can continue as long as inflation remains stuck — and that has been the case so far. But **Stuckflation Tested** remains an important theme going into 2021. We expect Stuckflation to survive the recent stimulus surge in the same way it survived U.S. President Donald Trump's tax cuts and tariff era — despite fears at the time. But, should we see elevated inflation, our expectation for slow but steady growth would be at some risk.

EXHIBIT 3: HOW OUR INVESTMENT THEMES ARE PLAYING OUT

CMA Theme	What was said:	What we have seen:
Retooling Global Growth	Companies will prioritize stability over profitability by re-routing their supply chains, moving production inside their home countries and building healthier balance sheets. After the stimulus-induced surge, global growth will settle at low levels.	The global economy has roared back thanks to massive stimulus and the unprecedented speed of the COVID-19 vaccine development which is increasing future economic visibility. But the post-virus economic outlook remains muted given ongoing "retooling" across industries, businesses and labor.
Massive Monetary Toolkit	The controversial Modern Monetary Theory (MMT) — which advocates for greater coordination between monetary and fiscal policy — is, in reality, already being applied. This evolution has given central banks (recently viewed as ineffective) a big new toolkit.	President-elect Joe Biden's nomination of former Federal Reserve chair, Janet Yellen, as Treasury secretary reflects (both symbolically and practically) increased fiscal-monetary policy coordination. Global politicians' current disregard for elevated debt levels comes right out of the MMT playbook.
Stuckflation Tested	Inflation faces a test from many of this year's themes — notably Retooling Global Growth; One World, Two Systems and Massive Monetary Toolkit — but the effects of slow growth, technology and automation will keep inflation at or below central bank targets.	Under the thumb of the pandemic, inflation has remained low globally — with year-over-year inflation levels in the U.S., China and Europe around 1.5%, 0.5% and near-0%, respectively. As noted in the theme title, 2021 will test this theme as economic demand slowly returns.
One World, Two Systems	Last year's Irreconcilable Differences theme is evolving to where the U.S. and China will learn to live on the same planet with their opposing views on economic policy. Collaboration won't be absent but won't be optimal either — leading to inefficiencies.	We expect the Biden administration to continue pressuring China but, compared to Trump, in a more multilateral way. 5G technologies — one root of China-U.S. tensions — continue to bifurcate between systems used in China and those used in most of the Western world.
Reimagining Capitalism	For everyone to believe in (some form of) capitalism, rules alleviating the "winner take all" dynamic must evolve. Business leaders, the ultra-wealthy and politicians representing those left behind will find a way to forge a new capitalism that works better for all.	This election cycle's state referendums provided some insights. Voters rejected some "new capitalism" movements (such as protections for contract workers — think Uber drivers — in California) but embraced others ($15/hour minimum wage by 2026 in Florida).
Stay Focused on Climate Risk	The pandemic took focus off climate-related issues, but the risks have not gone away. In some cases, they have intensified. Post-pandemic economic rebuilding will force leaders to re-engage with climate risk — a headwind for some industries but a tailwind for others.	This theme will play out slowly — especially this year due to the pandemic. But the focus remains. Biden plans to reinsert the U.S. into the Paris Agreement and investor interest in the "E" for environment (as well as "S" for social and "G" for governance) of ESG continues to grow.

GROWTH & INFLATION

Growth will be soft at the start of the year but will rebound strongly as vaccination starts to facilitate the economy's full reopening. Inflation will remain muted.

U.S. economic growth will respond to the course of the pandemic during 2021. Growth will be soft at the start of the year but will rebound strongly as vaccination starts to facilitate the economy's full reopening. Strength in cyclical industries such as autos and housing is offsetting the weakness in services such as restaurants and tourism, which have been held back by social distancing. The average economist expects U.S. growth to approach 4% in 2021 (Exhibit 4). And we believe — in contrast to prior years — the risk is to the upside.

The eurozone outlook will also be defined by the pandemic's course — pre- and post-vaccination — and the region's ability to manage it. With a lot of pent-up demand in the services sector and a likely tailwind from more global trade, we expect the region to grow 4–5%. The U.K.'s outlook is extremely uncertain because of Brexit, which is compounding the pandemic risks. However, that uncertainty mainly affects the speed and degree to which the U.K. will recover. We see economic growth as slightly below economists' estimates of 5–6%, as adjustment to life outside the European Union will be bumpy.

We think Japan's growth will be a dependable but unexciting 2–3%. The global recovery will act as a tailwind for Japan, which relies heavily on exports. But all the usual structural headwinds (e.g., high debt, aging populations, etc.) remain, sapping some strength from the recovery.

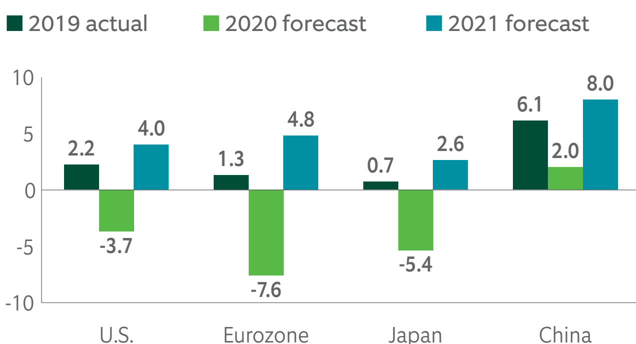
China's growth should be strong, an impressive feat as its economy still expanded in 2020 on domestic demand aided by competent management of the pandemic. A pickup in international trade to build on domestic momentum will have the Chinese economy firing on all cylinders with 7–9% growth likely for 2021.

As for inflation, our **Stuckflation Tested** theme drives our view that inflation will remain muted globally. While the headline numbers will jump around with energy prices, we expect technology's continued impact to contain price increases. U.S. core inflation will likely remain firmly below the Fed's 2% policy target while European inflation will stay under 1%. Inflation in the U.K. should remain contained between 1–2% and we expect inflation of just 0–1% in Japan. These views represent a continuation of the below-target inflation that developed countries have shown the past few years (see Exhibit 4). Finally, China's inflation will remain higher at 2–3%, but this level is actually relatively modest given the country's higher growth trajectory and developing market status.

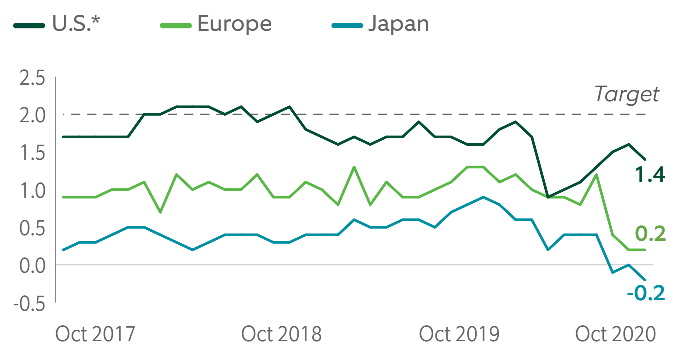
EXHIBIT 4: GROWTH WITHOUT INFLATION

Economic growth should be strong in 2021, but inflation will remain stuck below target.

Consensus Forecasted Real GDP Growth (%)



Core Inflation (year-over-year %)



Source: Northern Trust Asset Management, Blue Chip Economic Indicators November edition. * U.S. uses core Personal Consumption Expenditures (PCE) as an inflation gauge while Europe and Japan use the core Consumer Price Index. Data from 10/31/2017 – 10/31/2020.

MONETARY & FISCAL POLICY

The continuing rebound from 2020's weak first half — along with the vaccine-induced rebound starting in mid-2021 — should more than offset lower government spending.

Central banks globally moved easing into overdrive during the pandemic's early stages. They pulled off the shelf some programs developed during the global financial crisis of 2007–2008 and introduced new ones. Central bankers have faced continued large output gaps (too much supply, not enough demand), below-target inflation and short-term interest rates close to zero. This forced them to become more creative, pledging to keep policy easy for an extended period as well as expanding on quantitative easing programs that increase the amount of money in circulation. The scope of the programs implemented is truly historic, as the collective balance sheets of four big central banks — the Federal Reserve, the European Central Bank, the Bank of England and the People's Bank of China — has risen a stunning 70% to $17 trillion since March. This has swelled the money supply, with 25% and 10% increases in the U.S. and the eurozone, respectively.

We expect the Fed funds rate to remain near 0%, while more asset purchases will meet any economic weakness. The European Central Bank (ECB) is highly likely to keep monetary policy easy as inflation remains absent. We think the Bank of England will also keep interest rates low but positive (unlike the ECB).

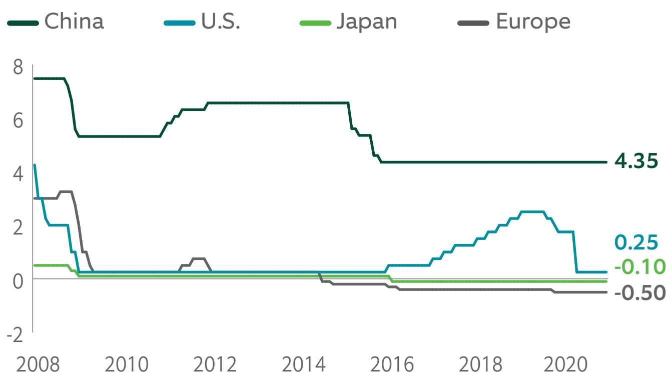
Japan, the home of extraordinary monetary policy, will remain highly accommodative as Abenomics (the "three arrows" of central bank easing, economic stimulus and reforms) continues even without Shinzo Abe as prime minister. Japanese interest rates across the yield curve will remain anchored close to zero. In China, the central bank won't be overly aggressive because it wants to prevent inflation from rising. Instead, we expect policy to consist of small adjustments based on economic performance.

We estimate that direct government aid added 4% to global economic growth in 2020, helping to offset the pandemic's damage. However, we expect government budget deficits (Exhibit 5) to shrink in the coming years as spending falls while the pandemic wanes. This reduction in government spending could represent a 2% headwind to growth in 2021 alone. Thankfully, the continuing rebound from 2020's weak first half — along with the vaccine-induced rebound starting in mid-2021 — should more than offset that headwind. The biggest variation in fiscal policy may happen in the U.S., where changing politics affect the outlook more than in other regions. Likely Republican control of the Senate will tie President-elect Biden's hands, while stronger economic data and pending vaccine distribution could also limit the appetite for broad economic stimulus. We also think fiscal deficits will decline in Europe, the U.K. and Japan — but politicians will be ready to act should growth falter.

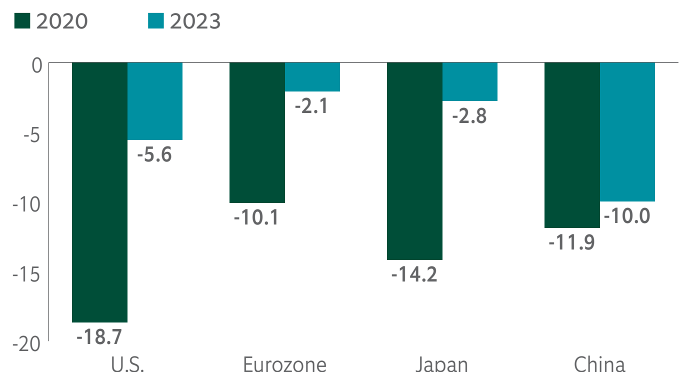
EXHIBIT 5: MONETARY AND FISCAL POLICY COMBINE TO FIGHT PANDEMIC

Central banks have found ways to be effective by joining forces with fiscal policy.

Central Bank Policy Rates (%)



Government Deficit Forecasts (% of GDP, International Monetary Fund)



Source: Northern Trust Asset Management, Bloomberg, IMF. Central bank policy rate monthly data from December 31, 2007, to November 30, 2020. *Budget deficit forecast comes from the IMF Fiscal Monitor: October 2020.

INTEREST RATES

- Just as investors thought we had seen the lowest of lows in global interest rates, the pandemic pushed yields even lower to new record levels.
- We don't expect interest rates to rise in 2021; in fact, we expect U.S. rates to decline as the Fed remains on hold, inflation remains stuck and global interest rates pull down U.S. rates.
- Given the continued low-rate environment, we recommend taking on duration risk in fixed income portfolios relative to the reference benchmark.

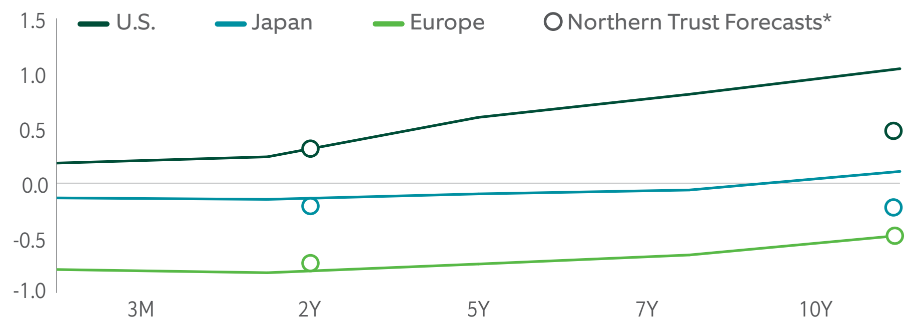
Low yields — pushed lower by the pandemic, and consistent with our long-held prediction that yields will be lower for longer — prevailed globally during 2020. The Fed made two surprise interest rate cuts in the first half of March, lowering the Fed funds target range from 1.50–1.75% to 0.00–0.25%. It also restarted quantitative easing on a massive scale. The Fed was not alone in its uber-accommodation; many global central banks followed suit. With low inflation and the massive flight to safety, the 10-year and 30-year Treasury yields hit all-time lows of 0.51% and 0.99%, respectively. Despite ultra-low levels, U.S. interest rates are among the highest across the developed world — with governments such as Germany, France and the Netherlands enjoying negative interest rates on sovereign debt with maturities out to 10 years and longer, in some cases.

As we head into 2021, we expect yields to remain low and central banks to continue accommodative policy. We believe quantitative easing and immediate lending support, should it be needed, will continue well into the year until the pandemic is behind us. The ongoing spread of COVID-19 should force central banks to work more closely with fiscal policymakers and to take a more active role in ensuring financial stability. We continue to believe in Stuckflation, although there is a risk that continued fiscal stimulus, along with central banks' easy monetary policy, might test this thesis. Despite this risk, our base case remains that inflation still faces many headwinds. Pandemic-related unemployment, demographics, technological efficiencies, low yields globally and a general lack of safe haven assets available to non-central bank investors will override near-term inflation worries. We expect U.S. yields to benefit most, with an expectation that the 10-year Treasury yield will move toward 0.50% next year from just shy of 1% currently.

EXHIBIT 6: NOT QUITE YET

Investors anxiously expect interest rates to rise in 2021; we see low rates continuing.

Market Yield Curve Forecasts (% One-Year Forward Rate)



Source: Northern Trust Asset Management, Bloomberg. Germany serves as a proxy for Europe. One-year forward rates as of December 1, 2020. *Dots represent NT 6-month midpoint forecasts.

CREDIT MARKETS

- Fixed income asset classes performed well in 2020, as interest rates remained low and credit spreads rebounded from the depths of the pandemic-induced financial crisis.
- Returns in the year ahead will be lower in investment grade fixed income, but high yield is expected to generate attractive returns with a lower risk profile than equities.
- High yield represents the highest conviction overweight in our global policy model, given easy monetary policy, low interest rates and improving fundamentals.

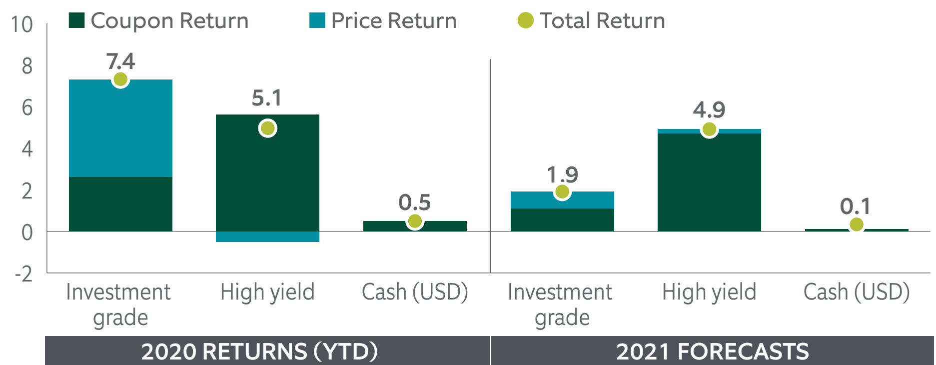
Fixed income returns in 2020 can be characterized as B.C. and A.C. (Before and After COVID-19). After credit spreads reached lows in January, the global economy and capital markets came to a sudden stop. In a matter of weeks, high yield experienced a wave of "fallen angels" (securities falling from investment grade to speculative grade) and defaults not seen since the global financial crisis. Swift actions by policymakers resulted in a reopening of the financial system, allowing the largest-ever issuance of investment grade and high yield bonds to strengthen balance sheets against further economic uncertainty. Offsetting the supply, credit products also received record-breaking inflows, resulting in year-to-date returns (through November) of 7.4% for investment grade fixed income and 5.1% for high yield.

Current spread levels for high yield look attractive, while the outlook for investment grade looks more subdued. We believe interest rates will remain low and investment grade credit spreads can remain at current levels, providing low but dependable total returns. Global investors continue to favor assets that provide income, which should continue to support high yield valuations. We remain favorable on high yield, particularly given ongoing Fed support, likely fiscal stimulus and the increasing probability of an accelerated vaccine timeline. We think improving credit fundamentals and declining default rates — which, when excluding retail and energy sectors, are likely to fall as low as 2% — will serve as tailwinds. Our base case of low rates, improving economic growth and a year of "reopening" should benefit credit valuations. High yield is our highest conviction overweight with a 4.9% one-year return forecast, while our investment-grade one-year return forecast of 1.9% should at least provide a nice return premium over cash in 2021.

EXHIBIT 7: HIGH YIELD IS A SWEET SPOT

Lower-but-positive growth, financial stability and demand for income support high yield.

2020 Returns, 2021 Forecasts (%)



Source: Northern Trust Asset Management, Bloomberg Barclays. 2020 total returns through November 30, 2020. Proxies: IG (Investment Grade) - BBG U.S. Aggregate; HY (High Yield) - BBG High Yield 2% Issuer Capped; USD cash - BBG U.S. Treasury Bills 1–3 months.

Forecasted returns do not show actual performance and are for illustrative purposes only. They do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact the future returns. Stated return expectations may differ from an investor's actual result. The assumptions, views, techniques and forecasts noted are subject to change without notice. Please see additional disclosure at the end of this document.

EQUITIES

- Returns in 2020 were remarkable in the face of the pandemic; global equities look set to finish the year up double-digits with the U.S. again leading the way.
- Valuations are elevated but earnings outlooks are quickly improving, justifying the pricing and leading us to expect mid-single-digit returns across all regions.
- We sit equal-weight across all equity regions heading into 2021, with returns that should compensate for the risk.

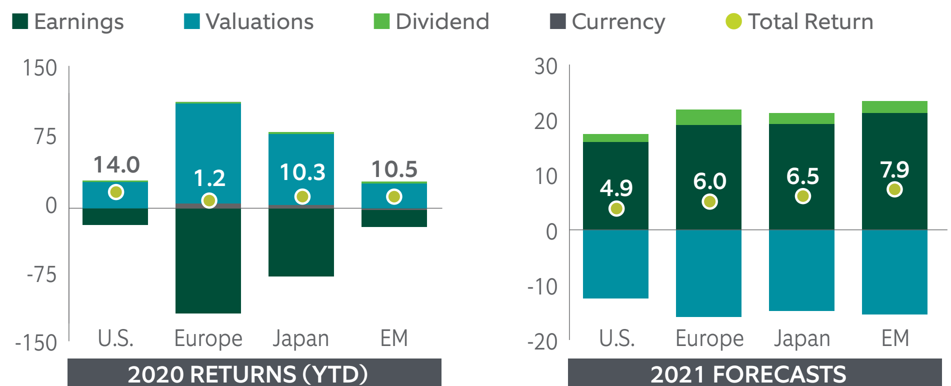
After U.S. equities fell 34% in just 23 days as coronavirus fears gripped the market in February and March, the subsequent recovery has been remarkable. New market highs were reached by August and subsequently surpassed. Technology companies, which have exhibited leadership for the past few years, saw more outperformance. They either fundamentally benefited from the pandemic or, at a minimum, showed significant resilience. Their ongoing outperformance accounted for nearly all of the outperformance of the U.S. market versus the rest of the world (16% vs. 11%). Other major global markets also rebounded strongly. That said, Europe hasn't yet made it back into positive territory — losing 5% year-to-date through the end of November. Meanwhile, Japan returned 7% and emerging markets gained 11% over the same period.

With the market at new highs despite lower 2021 earnings, valuations have expanded significantly as pandemic-damaged earnings haven't recovered nearly as quickly. However, as we look ahead, we see some justification for the market's optimism. Results to date on vaccine timing and efficacy suggest a faster and more substantive return to normalcy than imagined even a couple of months ago, while pent-up consumer demand following elevated saving rates could actually drive a period of robust activity. Such a response could take our near-term earnings assumptions higher. However, with valuations well above normal, we maintain single-digit return expectations across geographies over the next year. Meanwhile, longer-term concerns over what the post-pandemic environment will bring could serve as a headwind. These concerns include a potential return to slow, or even slower, growth relative to pre-pandemic levels and economic scarring, such as delayed bankruptcies for small businesses in forbearance. Overall, with valuations mostly commensurate with next-year earnings growth opportunities, we start 2021 with an equal-weight to equities, including equal-weight positions across each major equity region.

EXHIBIT 8: ANTICIPATING RESUMED EARNINGS GROWTH

Earnings growth will be higher while valuations fall, leading to muted returns.

2020 Returns, 2021 Forecasts (%)



Source: Northern Trust Asset Management, Bloomberg. 2020 returns through November 30, 2020. Proxies: U.S. - S&P 500; Europe - MSCI Europe; Japan - MSCI Japan; EM (Emerging Markets) - MSCI Emerging Markets.

Forecasted returns do not show actual performance and are for illustrative purposes only. They do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact the future returns. Stated return expectations may differ from an investor's actual result. The assumptions, views, techniques and forecasts noted are subject to change without notice. Please see additional disclosure at the end of this document.

REAL ASSETS

- All real assets were hit especially hard in 2020 as the atypical recession led to atypical performance by asset classes acutely harmed by economic shutdowns.
- We expect moderate 2021 returns; global real estate is expected to undershoot its potential; though global listed infrastructure returns could surprise to the upside.
- We are overweight global listed infrastructure and remain equal-weight global real estate and natural resources — as low valuations cushion against high uncertainty.

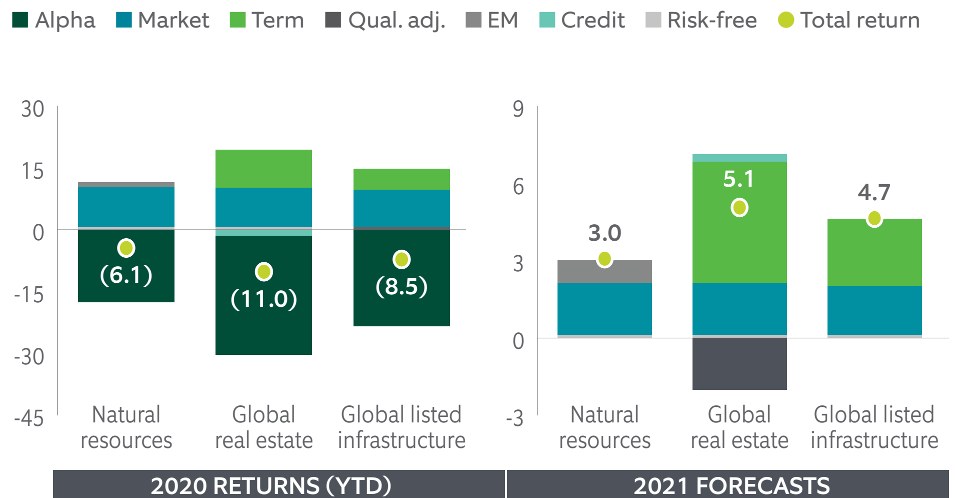
Despite strong November performance, 2020 hit real assets especially hard. We expect poor natural resources returns during a recession given their exposure to economic demand. But worse-than-equity global real estate and global listed infrastructure returns were atypical. Weak equity markets generally correspond with falling interest rates, which in turn support these interest rate-sensitive asset classes. But the pandemic hit global real estate abnormally hard across the hospitality, retail and office sectors. Meanwhile, global listed infrastructure's interest-rate sensitivity — thanks to its 40% utility sector weight — was more than offset by sea/airport, pipeline and railroad weakness. Generally, these sectors can "muddle through" a recession — but not a major global economic shutdown as we have seen this past year.

Global listed infrastructure weakness should prove temporary. As the global economy reemerges post-pandemic, pent-up demand will surface in the sectors hit so hard. A lot of goods, oil and gas need to be moved; helping railroads and pipelines. And, while less business travel will hurt airports, capacity utilization will still greatly improve in 2021. Global real estate may fare worse; many retail and office properties are permanently impaired — though valuations mostly reflect this new reality. We forecast a 5.1% one-year global real estate return, based on our quantitative forecast (factor exposures multiplied by factor return forecasts) less a 2% qualitative haircut to reflect asset class uncertainty. We made no qualitative adjustments to our quantitatively-based 4.7% global listed infrastructure and 3.0% natural resources forecasts. We are overweight global listed infrastructure given its upside potential. Meanwhile, we are equal-weight global real estate and natural resources as uncertainty lingers but valuations are attractive.

EXHIBIT 9: LOWER RATES, SLOWER GROWTH

We expect improvement after real assets underperformed in 2020.

2020 Returns, 2021 Forecasts (%)



Source: Northern Trust Asset Management, Bloomberg. Regressions calculating factor exposure (beta) run from 12/31/2002 to 3/31/2020. Term exposure is defined as the return premium associated with taking on maturity risk; that is, of investing in longer term bonds. EM = Emerging Market. 2020 total returns through November 30, 2020. Proxies: global listed infrastructure - S&P Global Infrastructure; natural resources - S&P Global Natural Resources; global real estate - MSCI ACWI IMI Core Real Estate.

Forecasted returns do not show actual performance and are for illustrative purposes only. They do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact the future returns. Stated return expectations may differ from an investor's actual result. The assumptions, views, techniques and forecasts noted are subject to change without notice. Please see additional disclosure at the end of this document.

CONCLUSION

We recommend a modest overweight to risk, tilted towards asset classes offering downside protection and which benefit from continued low interest rates. In order of conviction, these are: high yield, listed infrastructure and investment grade bonds.

Global stock markets initially followed the course of the pandemic early in the year, but risk assets staged a relentless rally. Investors put their faith in the power of monetary and fiscal stimulus and companies proved resilient to the economic fallout. The likely divided U.S. government and very positive news on the COVID-19 vaccine front provides additional support. Event-driven bear markets have historically averaged an eight-month drawdown and a full recovery in 13 months. This drawdown lasted five weeks, with a full recovery in six months. Many investors found this recovery period too rapid to significantly redeploy risk assets, and equity flows actually remained negative all year until November. Sentiment indicators from the American Association of Individual Investors plummeted in the first half of the year to only now return to excessively bullish levels.

Corporate earnings were clobbered by the pandemic, with U.S., Europe and emerging market earnings all expected to be down materially this year. Both U.S. and emerging market earnings benefitted from a significant contribution from technology companies, who in many cases saw an increase in demand for their products and services during the pandemic. Earnings should rebound strongly in 2021, and in proportion to the declines seen in 2020. U.S. earnings are forecasted to jump 20%, emerging markets up 34% and Europe up a whopping 38% (in euros, which could be further flattered by dollar weakness). Stocks have historically done very well during big earnings declines — maybe counterintuitively — as investors bet on the rebound. Very strong earnings growth has at times led to more muted returns, likely due to investors expecting tighter monetary policy in a normalizing economy. We don't expect monetary policy to tighten over the next year, taking some pressure off valuations but, certainly, a great deal of earnings improvement has been priced in. Credit market fundamentals look strong to us, and we expect high yield defaults to halve from their peak levels as the percentage of distressed high-yield bonds has plummeted from 30% to just 2%.

Our title — *A V(accine)-Shaped Recovery* — ties the expected V-shape of the economic recovery to the importance of vaccine deployment. Health and economic data could be challenging short term as case counts and hospitalizations rise. However, we expect the markets to look through this short-term weakness toward a more robust recovery starting mid-year as shuttered parts of the economy reopen. After relatively strong returns in 2019 and 2020, we expect more muted returns in 2021.

Summarizing our asset allocation views (detailed on page 2), we recommend a modest overweight to risk, tilted towards asset classes offering downside protection and that benefit from continued low interest rates. In order of conviction, these are: high yield, listed infrastructure and investment grade bonds. We source these overweight positions from asset classes that will be hurt by ongoing Stuckflation and ZIRP (zero interest rate policy) — namely, inflation-linked bonds and cash, which we believe is only needed for near-term liquidity needs in the current environment.

How helpful was this paper?

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Every year, Northern Trust's Capital Market Assumptions Working Group develops forward-looking, historically aware forecasts for global economic activity and financial market returns — which drive our five-year asset class return expectations and inform our asset allocation decisions.

All of this comes together in the form of our long-term strategic asset class allocation suggestions, which are used by institutional and individual investors worldwide.

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Special thanks to Thomas O'Shea, Investment Strategist, and Colin Cheesman, Investment Analyst, for data research.

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