

MANAGERS EXPECT SLOWER ECONOMIC GROWTH; SEE EARNINGS IMPACT

KEY FINDINGS: INVESTMENT MANAGER SURVEY, FOURTH QUARTER 2018

EARNINGS, TRADE AND LABOR MARKETS

- 85% of managers expect U.S. equities earnings to decline in 2019.
- 62% believe non-U.S. developed equity markets' earnings will decline and 56% expect a decline in emerging markets.
- 20% of managers believe more than a quarter of their portfolio holdings have been hurt by tariffs.
- 28% believe more than a quarter of their portfolio holdings have been hurt by labor shortages.

U.S. ECONOMIC OUTLOOK

- Only 33% of managers expect economic growth to remain the same or accelerate, down from 63% last quarter.
- 60% expect U.S. job growth to decelerate but remain positive; 40% expect it will remain the same.
- 32% expect corporate revenues to decrease, up from 10% last quarter.

EQUITY MARKETS

- Trade policy remains the top-ranked risk to global equity markets.
- 62% believe U.S. equities are undervalued or fairly valued.
- 80% believe European equities are undervalued or fairly valued, followed by 88% for emerging market equities and 90% for Japanese equities.

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EARNINGS, THE FED, CAPITAL INVESTMENTS, TRADE AND LABOR MARKETS

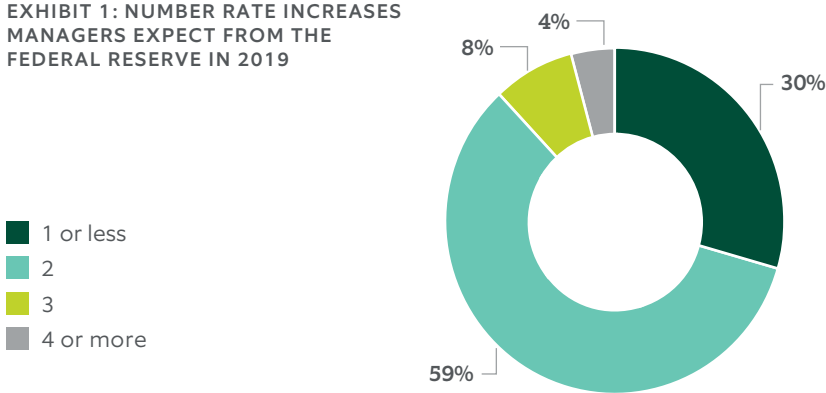
The global equity markets declined in the fourth quarter largely due to increased concerns of an economic slowdown, trade tensions and the potential impact on corporate earnings. Most managers expect corporate earnings to be modestly slower in 2019, but there were some differences by equity region. For U.S. equities, 73% of managers expected modestly slower earnings while nearly 12% expected significantly slower earnings. Approximately 15% of managers expect U.S. corporate earnings to remain the same or increase. Within non-U.S. developed markets, 54% of managers expect 2019 earnings to be modestly slower, 8% expect significantly slower and 38% expect earnings to remain the same or increase. Managers were slightly less pessimistic for emerging markets: 48% expect modestly lower earnings, 8% expect significantly lower earnings, and 44% expect corporate earnings to increase or remain the same.

The markets are also concerned about the potential for future U.S. Federal Reserve interest rate increases and whether those tightening actions may choke off future economic growth. Most investment managers, approximately 59%, expect the Fed will raise rates twice in 2019. Thirty percent expect the Fed to only raise rates once or less. Fewer than 8% expect the Fed to raise rates three times and only 4% of managers expect four or more increases in 2019.

85%

EXPECT SLOWER EARNINGS GROWTH IN U.S. STOCKS

EXHIBIT 1: NUMBER RATE INCREASES MANAGERS EXPECT FROM THE FEDERAL RESERVE IN 2019



SOURCE: Northern Trust Investment Manager Survey, 4TH Quarter 2018

One of the potential economic benefits of the U.S. corporate tax rate reduction and corporate offshore profit repatriation was increased capital investment. Of the investment managers in the survey, 39% estimate that the average company they are invested in increased its capital investments in 2018, another 39% of managers believe their companies invested the same amount, while 22% believe the companies they are invested in, on average, invested less in capital investments in 2018.

As the U.S. continues to use tariffs to renegotiate trade deals with various countries (China being the most important), we asked managers what portion of the companies in their portfolios have been hurt by recently imposed tariffs. Forty-two percent of managers report that less than 10% of their portfolios' holdings have been hurt by tariffs, 38% reported that 10% to 25% of their holdings have been affected, 16% of managers believe 25% to 50% are affected and 4% believe more than 50% of the companies have been hurt by recently imposed tariffs.

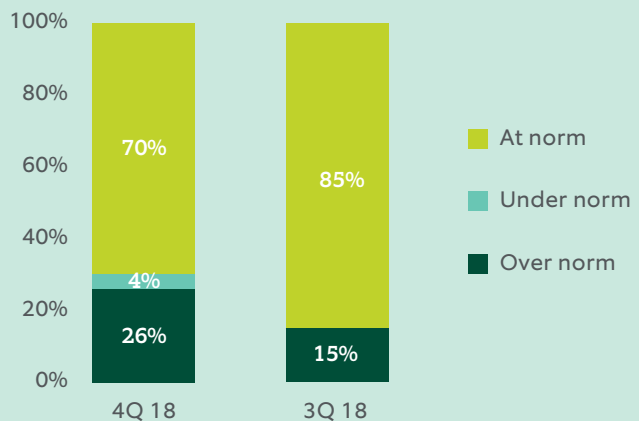
With the U.S. unemployment rate at historical lows, we asked investment managers what portion of the companies in their portfolios are experiencing difficulties filling vacant positions due to labor shortages. Approximately 38% of managers reported that 10% or less of the companies are having problems filling vacant positions, 34% of investment managers report 10% to 25% of their holdings struggling to fill vacant openings, and a little less than a quarter of the managers believe 25% to 50% of their companies are struggling to fill vacant jobs.

PORTFOLIO POSITIONING

Managers are slightly more defensive with their current portfolio positioning:

- 26% have cash levels above their historic norms, up from 15% last quarter.
- 19% reduced their portfolios' concentration, up from 10% last quarter.
- 53% have not changed their level of risk aversion, but 31% up from 22% are more risk averse this quarter.
- 76% of managers have not changed their commodities exposure over the past three months, but 23% reduced exposure to commodities up from 16% last quarter.

EXHIBIT 3: MANAGERS' CURRENT CASH LEVEL VERSUS NORMAL



SOURCE: Northern Trust Investment Manager Survey, 4th quarter 2018

U.S. ECONOMIC OUTLOOK

After an increase in economic activity in 2018, managers expect economic growth to slow in the coming months.

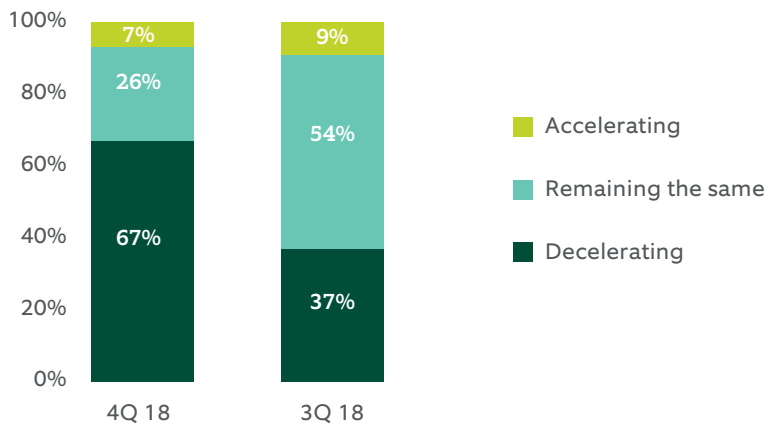
- The highest percentage of managers since 2009, 67%, expect gross domestic product (GDP) growth to decelerate over the next six months, up from 37% last quarter.
- Significantly fewer managers expect housing prices to increase: 18% versus around 50% in the first two of quarters of 2018.
- 46% expect U.S. corporate earnings to decrease, up from 16% last quarter and the highest since first quarter 2009.
- 59% expect U.S. job growth to decelerate but remain positive, up from 37% last quarter and the highest percentage since the second quarter of 2011.

Most investment managers, 62%, expect U.S. GDP to decelerate to under 3.0% growth in the first quarter of 2019, 30% expect the growth rate to remain steady around 3.0% to 3.5%, and 8% of managers expect the economic growth rate to drop below 2.0%. A little more than a third of managers, 36% expect the U.S. 10-year Treasury yield to increase by up to 25 basis points over 2019. Thirty percent expect the rate to increase by more than 25 basis points, while 17% expect the yield to remain the same and 17% expect the yield to decline over 2019.

35%

EXPECT U.S. HOUSING PRICES TO DECREASE

EXHIBIT 2: GROWTH EXPECTATIONS FOR U.S. GDP OVER NEXT 6 MONTHS



SOURCE: Northern Trust Investment Manager Survey, 4th quarter 2018

GLOBAL EQUITY MARKETS

Most managers are expecting increased volatility for the equity markets. Approximately 64% expect market volatility, as represented by the Chicago Board Options Exchange Volatility Index (VIX), to increase over the next six months. Twenty-seven percent expect the VIX to remain at current levels.

Trade policy continues to top the market risks list in the fourth quarter, and it has been the top concern since the first quarter of 2018. Change in U.S. monetary policy moved up to the second-ranked risk to the markets and a U.S. economic slowdown was third.

64%

EXPECT THE MARKET VOLATILITY TO INCREASE

EXHIBIT 4: TOP RISKS TO GLOBAL EQUITIES, FOURTH QUARTER 2018

RANK	RISK	CHANGE FROM LAST QUARTER
1	Trade policy	=
2	Change in U.S. monetary policy	+1
3	U.S. economic slowdown	+3
4	Rise in interest rates	-2
5	EM economic growth	-1
6	U.S. corporate earnings	+1
7	Geopolitical risk	+1
8	Non-U.S. developed markets monetary policy missteps	+1
9	Markets sell-off due to high valuations	-4
10	Oil/commodity prices	=

Although managers continue to view U.S. equities as more expensive than other regions, U.S. valuations have improved:

- 30% of managers view **U.S. equities** as undervalued, up from 17% last quarter.
- 32% believe they are fairly valued.
- Approximately 38% believe they are overvalued, down from 48% last quarter.

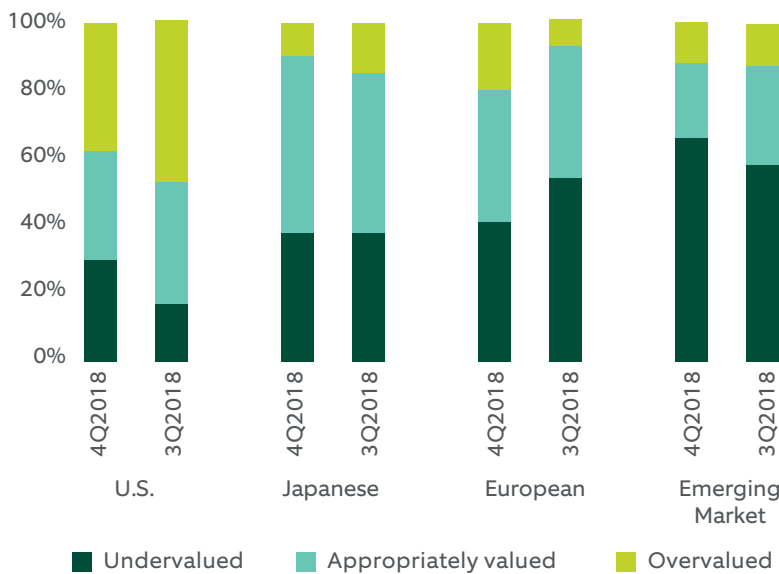
Looking at the global equity markets:

- Managers view **Japanese equities** favorably, with 90% viewing them as fairly valued or undervalued.
- Overall, managers' views on **emerging market equities** are similar with 88% saying they're fairly valued or undervalued. But 66% believe emerging market equities are undervalued – the highest for any region.
- 80% of managers say **European equities** are undervalued or fairly valued, lower than the 93% last quarter, with 41% viewing them as undervalued.
- 44% expect **Asia-Pacific equities*** to outperform global equities; 42% believe they will perform in line.

66%

VIEW EMERGING MARKET EQUITIES AS UNDERVALUED

EXHIBIT 5: GLOBAL EQUITY MARKET VALUATIONS

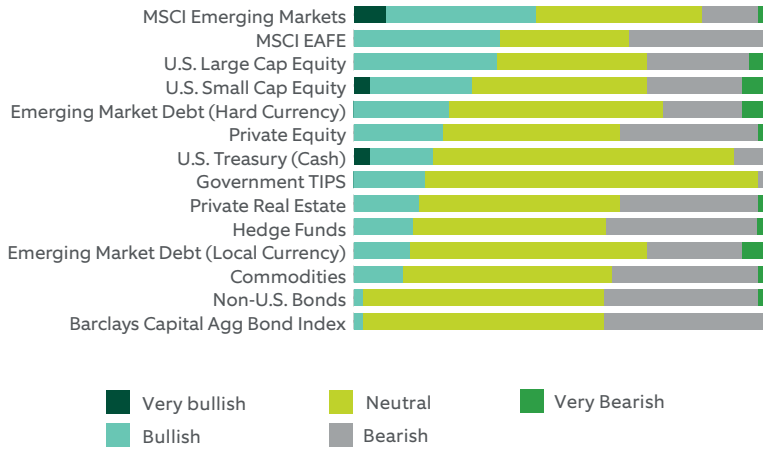


SOURCE: Northern Trust Investment Manager Survey, 4th Quarter 2018

Within fixed income, managers view investment grade, global developed sovereigns and emerging market as most attractive. Least attractive are U.S. high yield, which dropped from second ranked last quarter to fourth this quarter, followed by euro high yield.

*As represented by the MSCI AC Asia Pacific Index.

EXHIBIT 6: BULL-BEAR INDICATOR BY ASSET CLASS



SOURCE: Northern Trust Investment Manager Survey, 4TH Quarter 2018

Emerging market equities, non-U.S. developed equities (MSCI EAFE) and U.S. large cap ranked most bullish among the asset classes.

Looking at sectors, managers were most bullish on health care, which ranked third last quarter, followed by information technology, financials and consumer discretionary. Managers were most bearish on materials, utilities and real estate.

ABOUT THE SURVEY

For our survey, Northern Trust polled a select group of respondents, including fixed income and equity managers across value and growth styles, with a bias toward fundamental, bottom-up stock-picking strategies. Invitations to complete the survey were only sent to investment managers that currently manage assets for Northern Trust and our clients. As a result, the survey responses should reflect the beliefs of only the managers in which Northern Trust's multi-manager investments group maintains a high conviction. The survey is conducted quarterly so that Northern Trust and participating managers can examine trends in attitudes and allocations. Percentages in report and graphs may not add to 100% due to rounding. All data analyzed in this report are derived from the Northern Trust Investment Manager Survey.

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