



NORTHERN TRUST

ASSET MANAGEMENT

How Are Inflation and ESG shaping our Asset Allocation

Strategic themes
Tactical outlook

For Financial Professional-Use Only

What to Watch in the Years Ahead: 5Y Strategic Themes

Slow Growth
Transitions

Inflation
Recalibration

Monetary
Drought

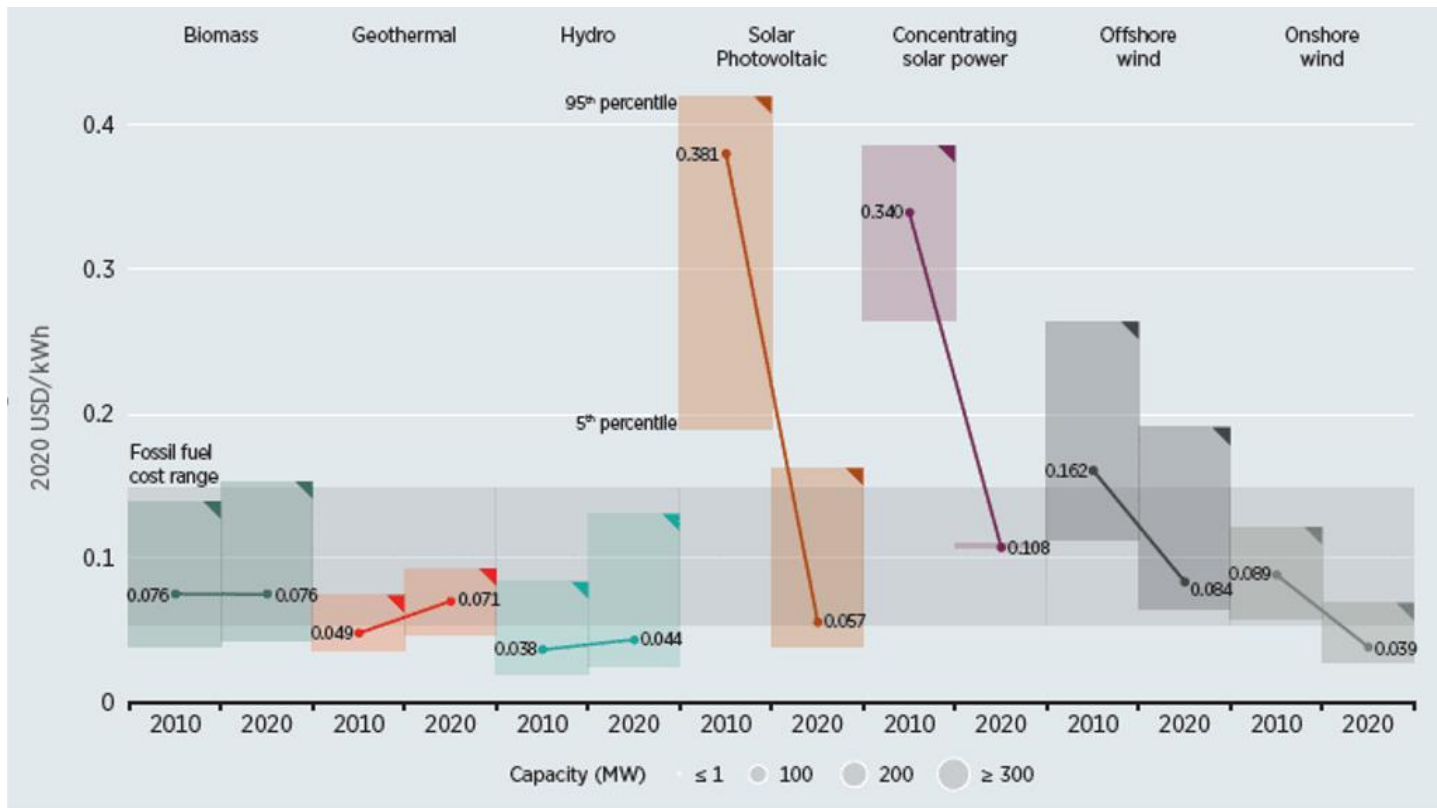
Regional
Rebuilding Blocs

Green Transition
Still a Go

Not So
Negative

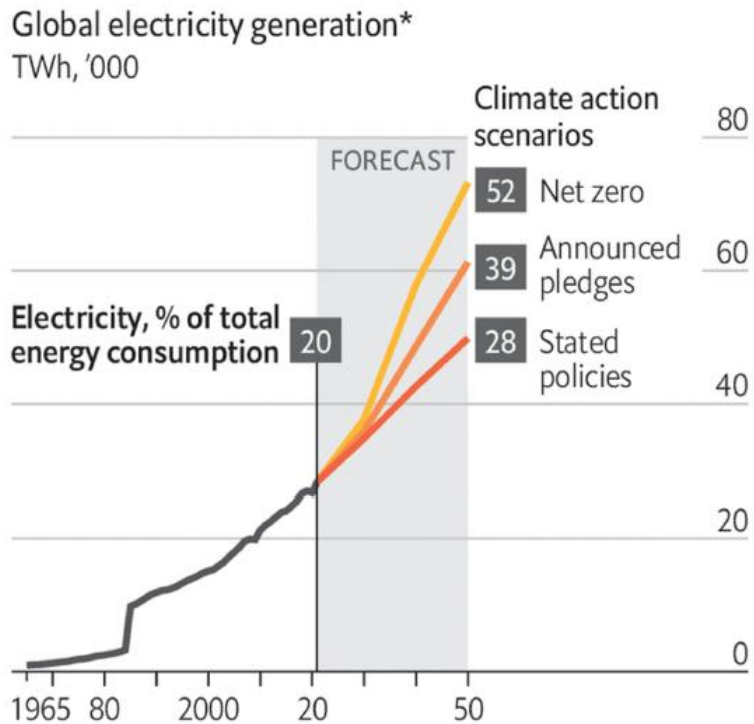
ESG AND CLIMATE CHANGE

Renewable Power Generation is Cheap and Competitive...

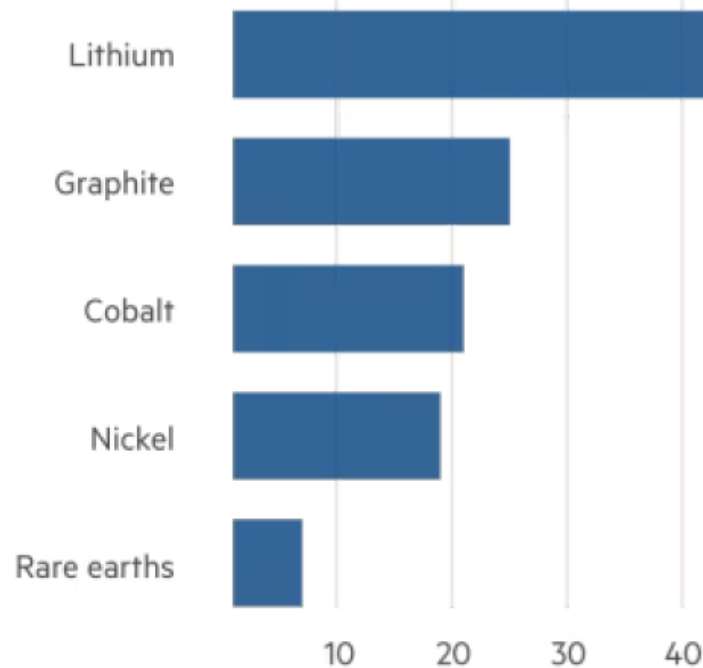


Source: IRENA, Northern Trust Asset Management.

... But the Scale of the Green Transition is Daunting



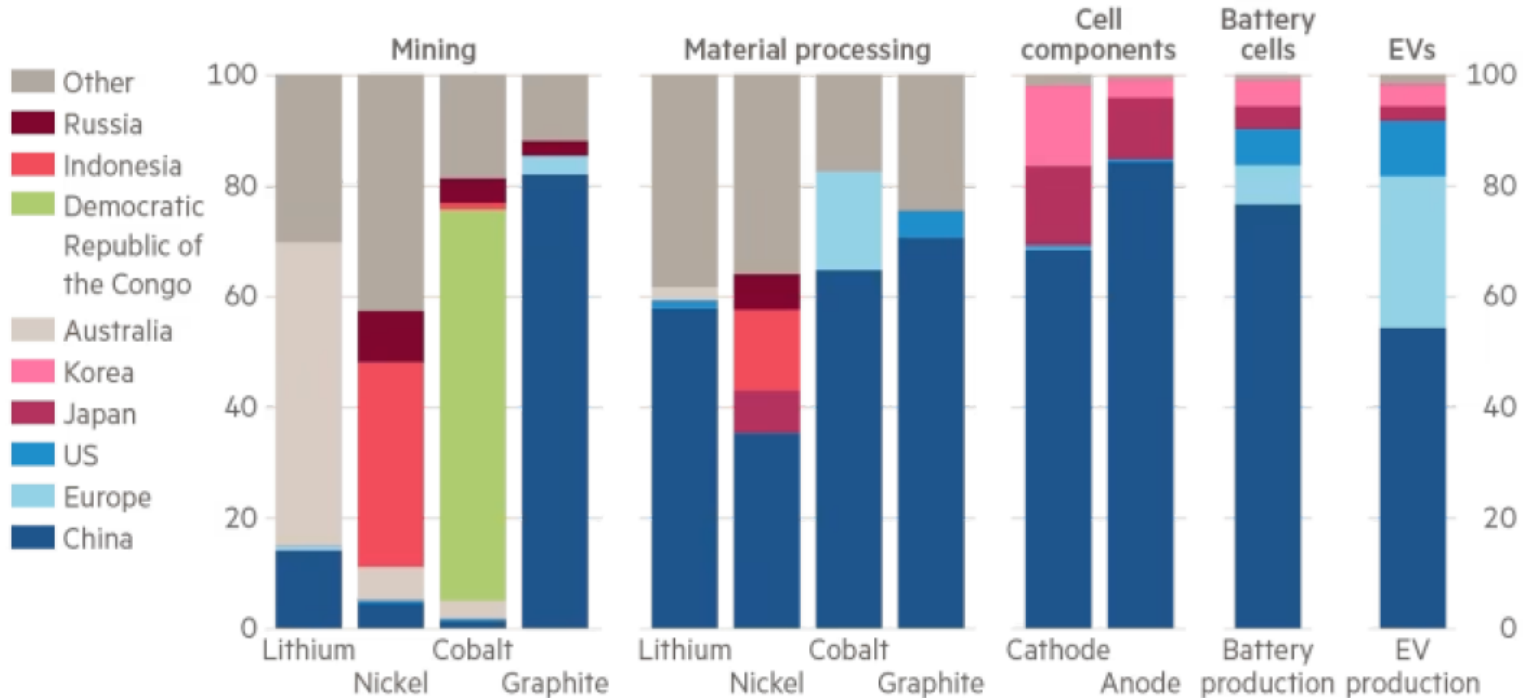
2040 relative to 2020,
index (2020=1)



Source: IEA, Our World in Data, Northern Trust Asset Management.

Geopolitical Realities Need to be Faced

Geographical distribution* of the global EV battery supply chain, 2022 (%)



Source: IEA, Northern Trust Asset Management.

Green Transition Still a Go

The acceleration of efforts to spur the Green Transition on is expected to continue. Beyond the desire to decarbonize, countries are motivated by worries around energy security, economic competition, technological rivalry and the desire to gain a relative edge in future energy markets.

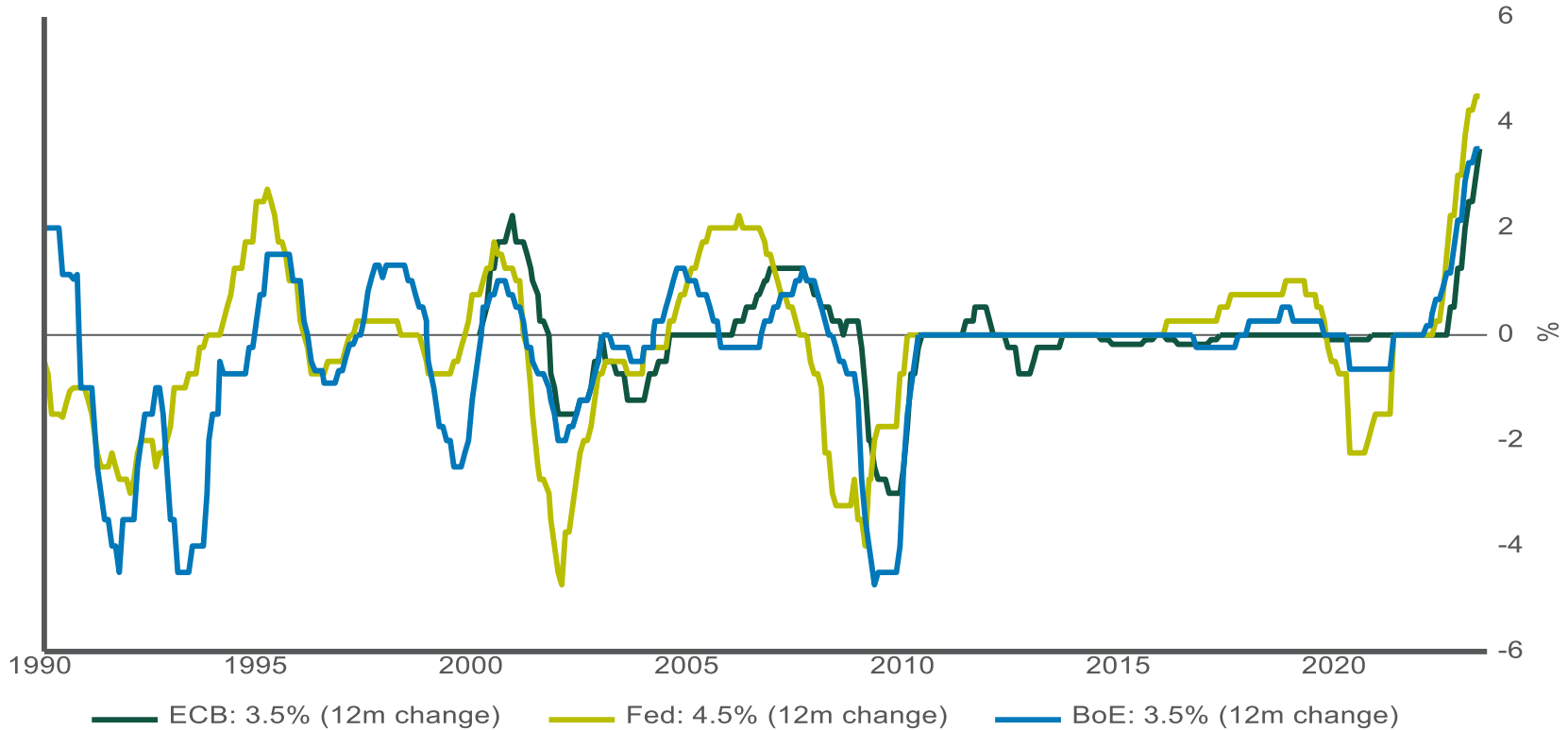
Green Transition Still Difficult

The Green Transition won't be easy or quick. Severe constraints regarding the sourcing of raw materials, the state of electricity grids and the implementation of new technology need to be overcome. And even then the scale of the necessary investments is daunting, which will undoubtedly test the political will to continue at some point.

MARKET OUTLOOK

2023: Aggressive Global Tightening Campaign

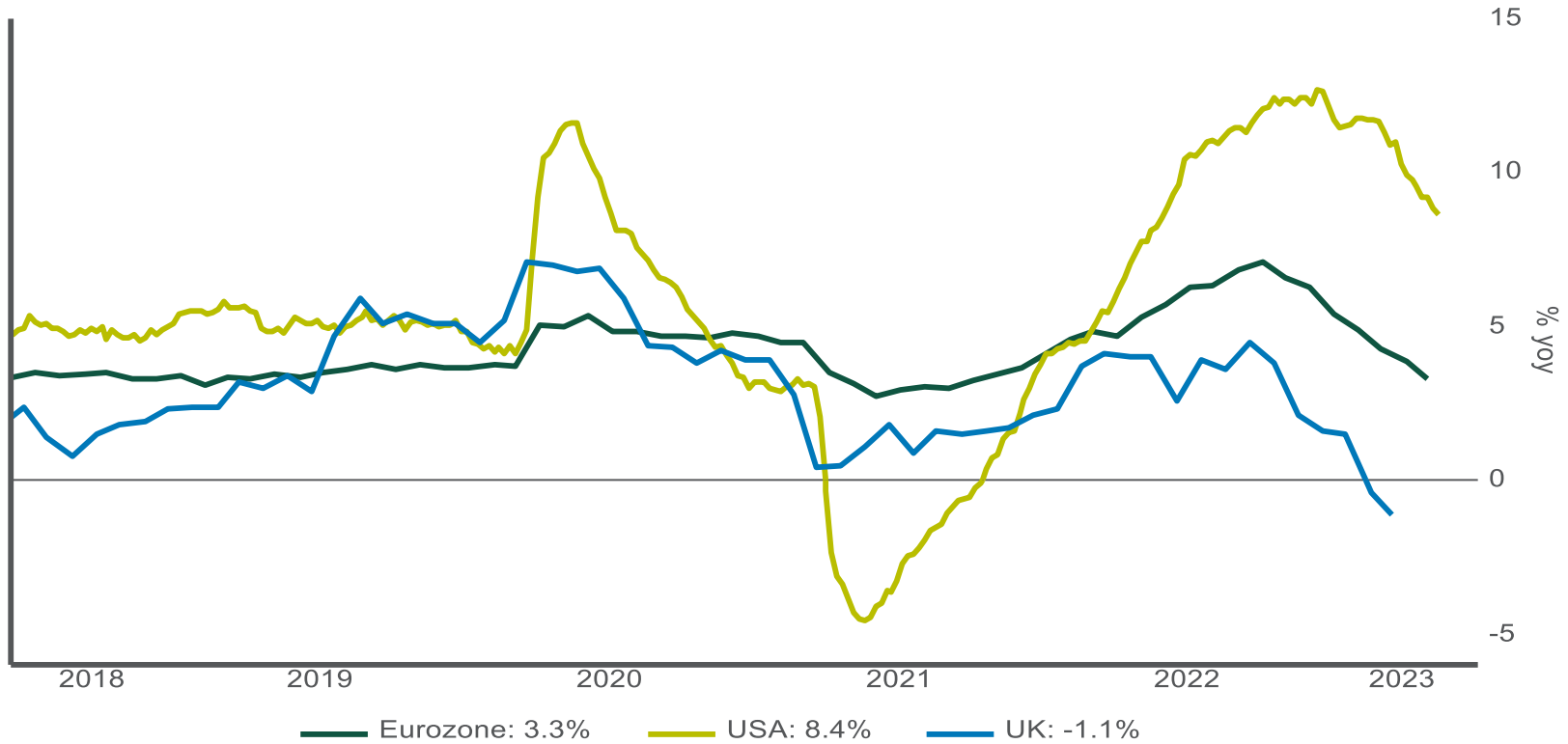
Central bank tightening campaigns



Source: Refinitiv Datastream, Mar 23

2023: Credit Growth is Rolling Over

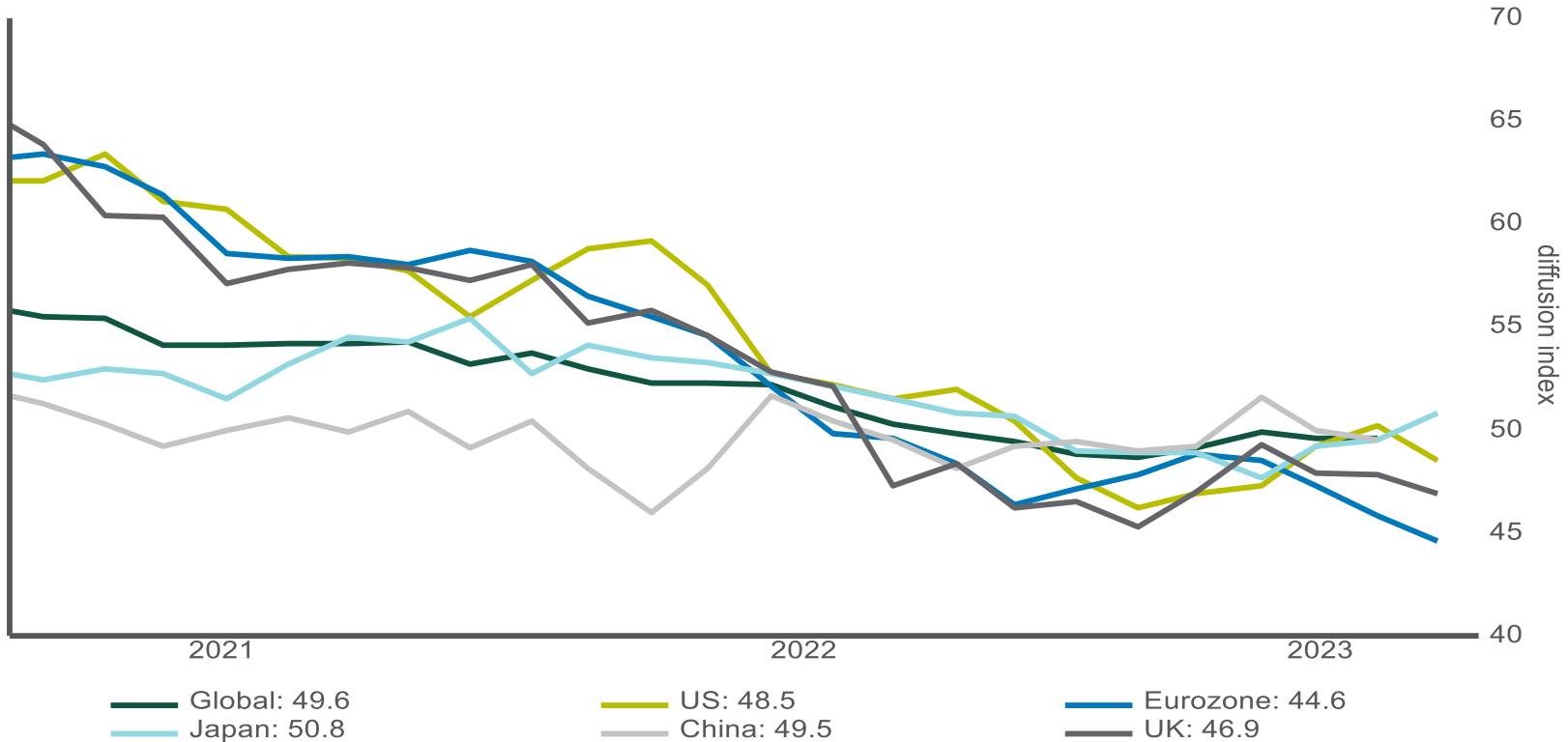
Credit Growth



Source: Refinitiv Datastream, Apr 23

2023: Global Economic Growth is Stalling

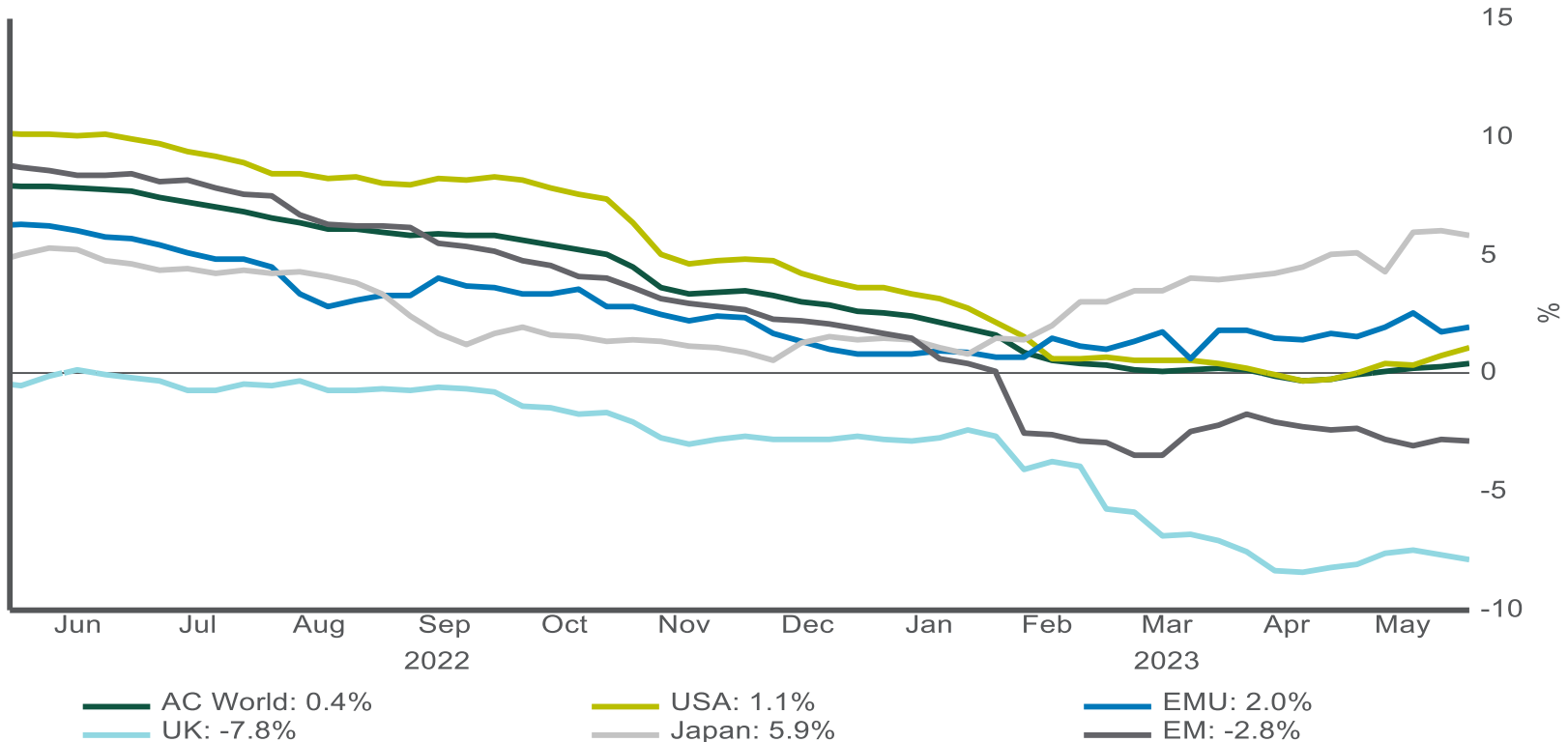
Global manufacturing PMIs



Source: Refinitiv Datastream, Apr 23

2023: Corporate Earnings Growth is Weak

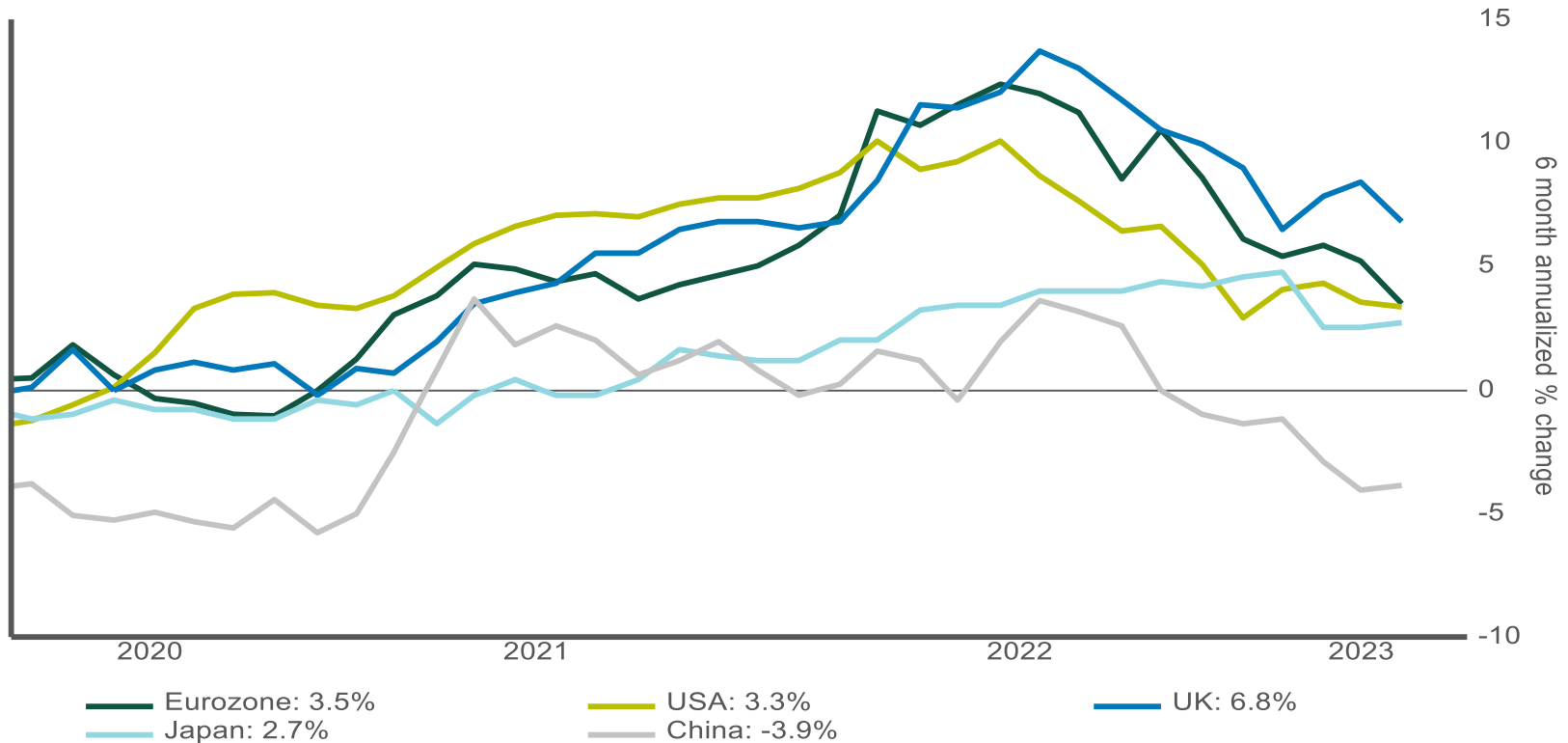
MSCI I/B/E/S 2023 EPS Growth Forecasts



Source: Refinitiv Datastream, 25/05/2023

2023: Headline Inflation is Falling...

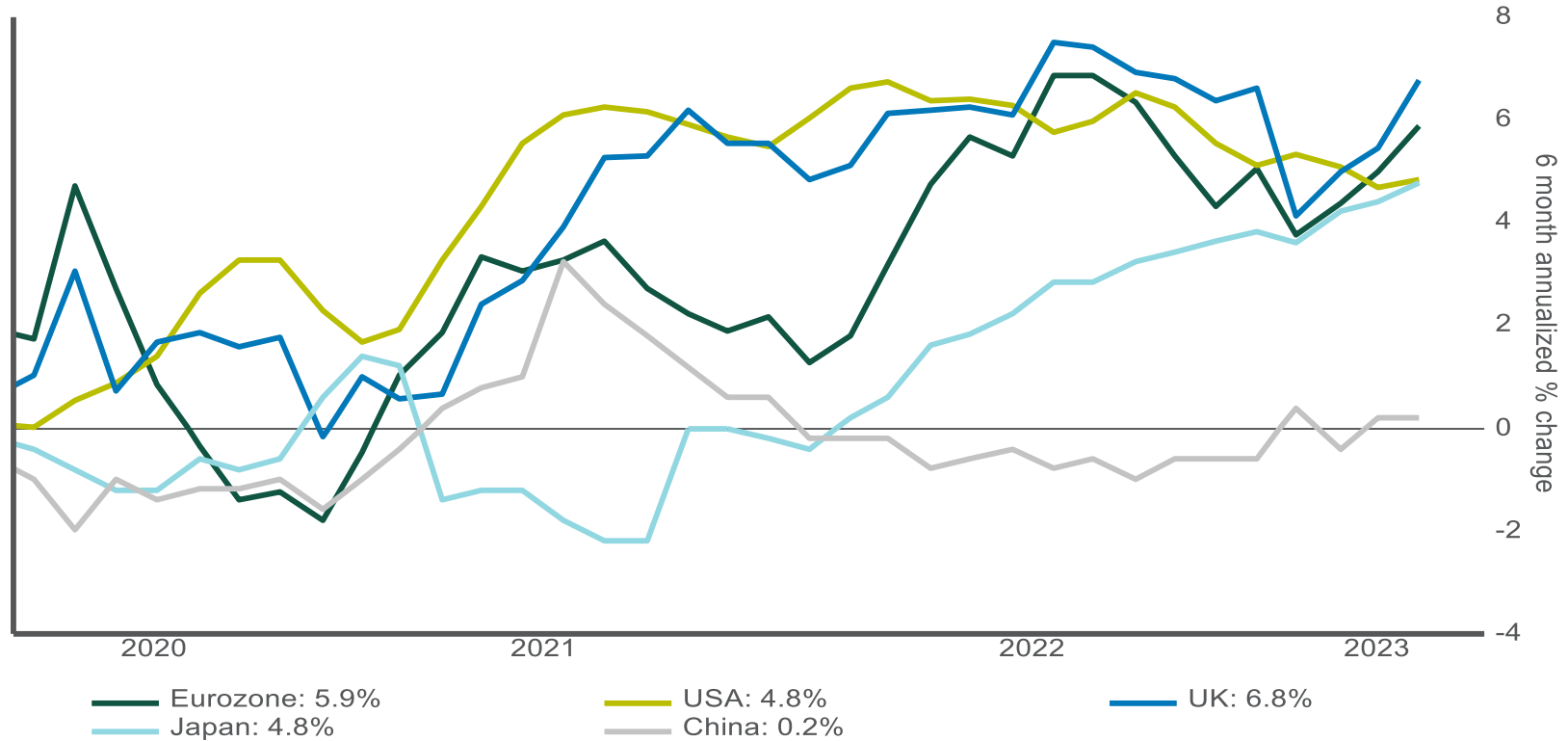
Global Headline Inflation Rates



Source: Refinitiv Datastream, Apr 23

2023: ... but Core Inflation Takes Longer to Decline

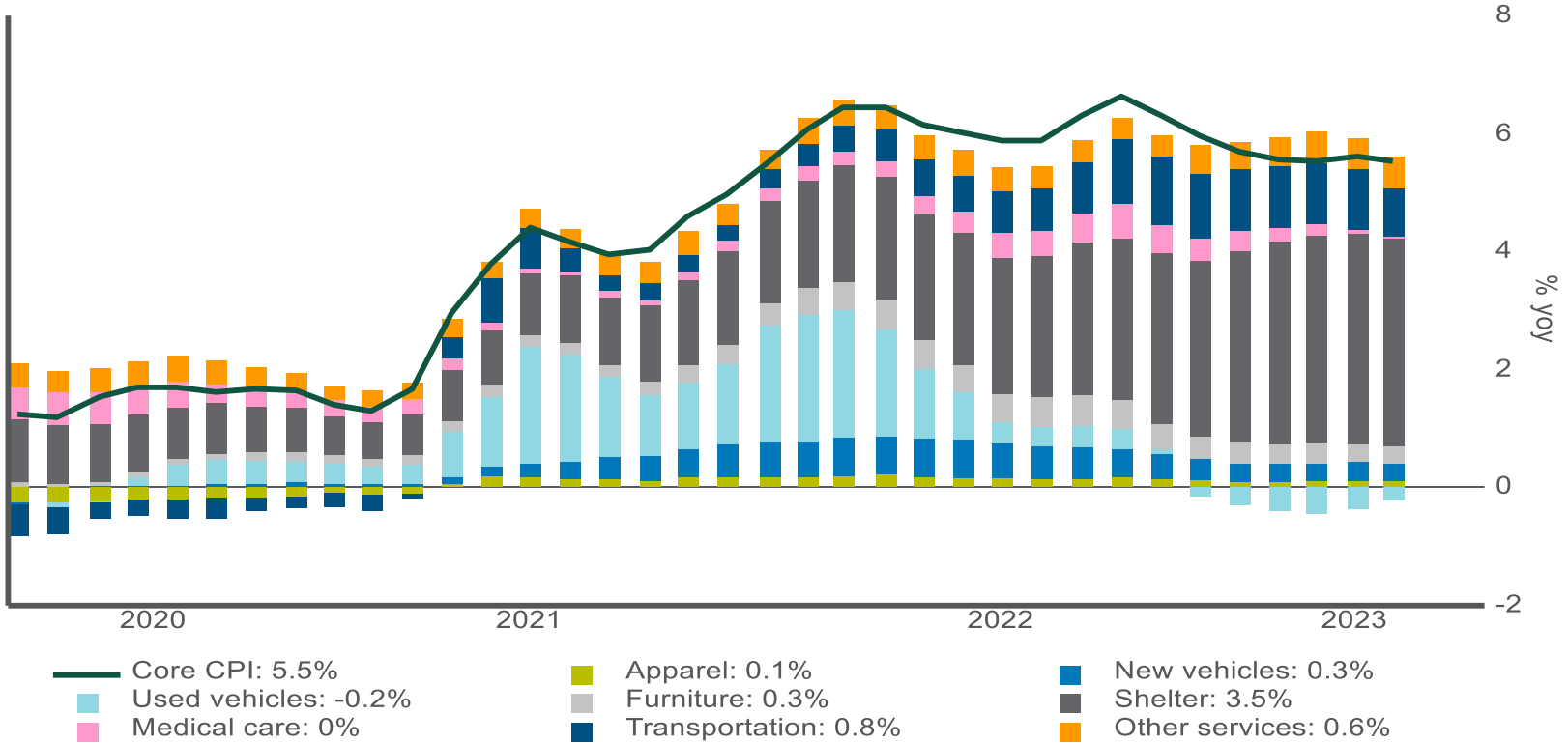
Global Core Inflation Rates



Source: Refinitiv Datastream, Apr 23

2023: US Core CPI Puts Spotlight on Shelter and Services

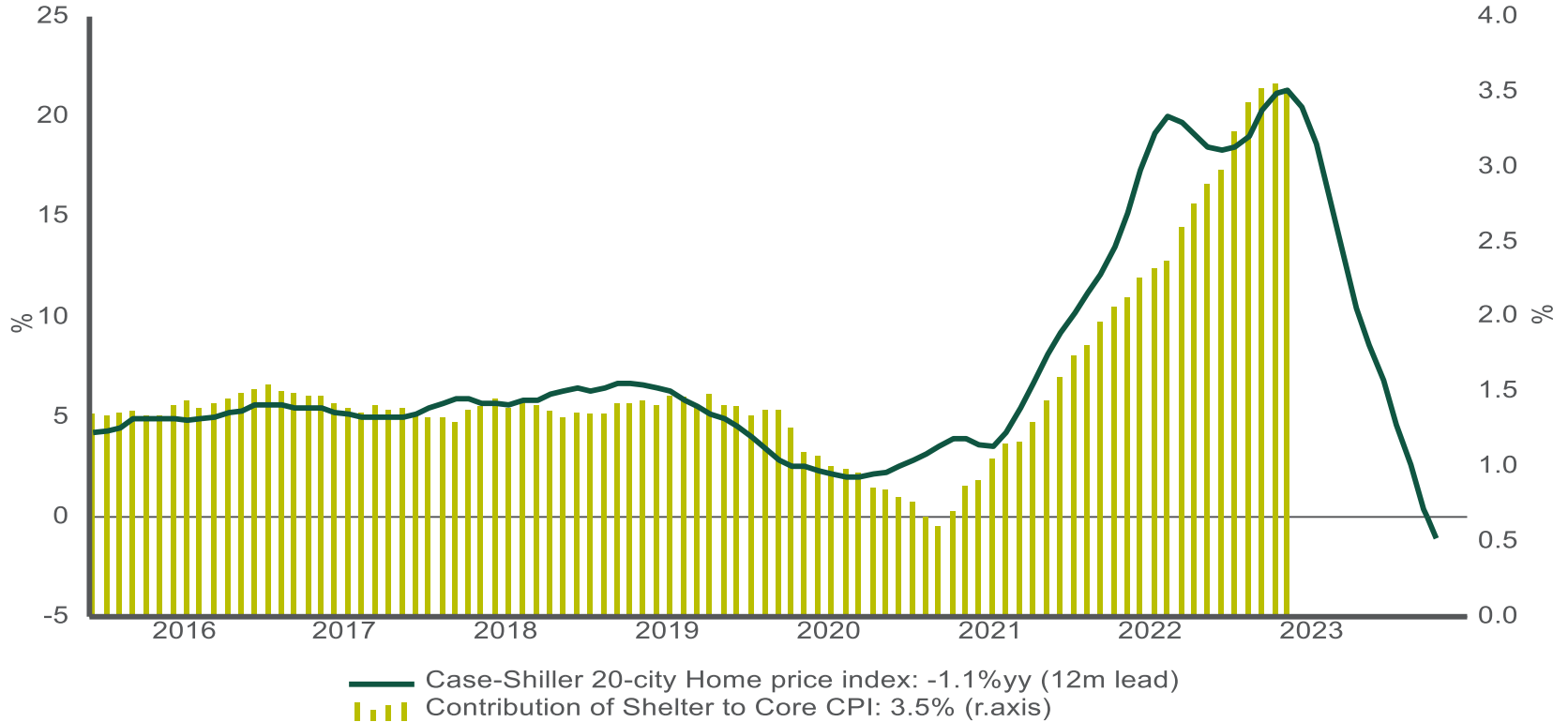
US Core CPI



Source: Refinitiv Datastream, Apr 23

2023: Housing Will Soon Lower Core CPI

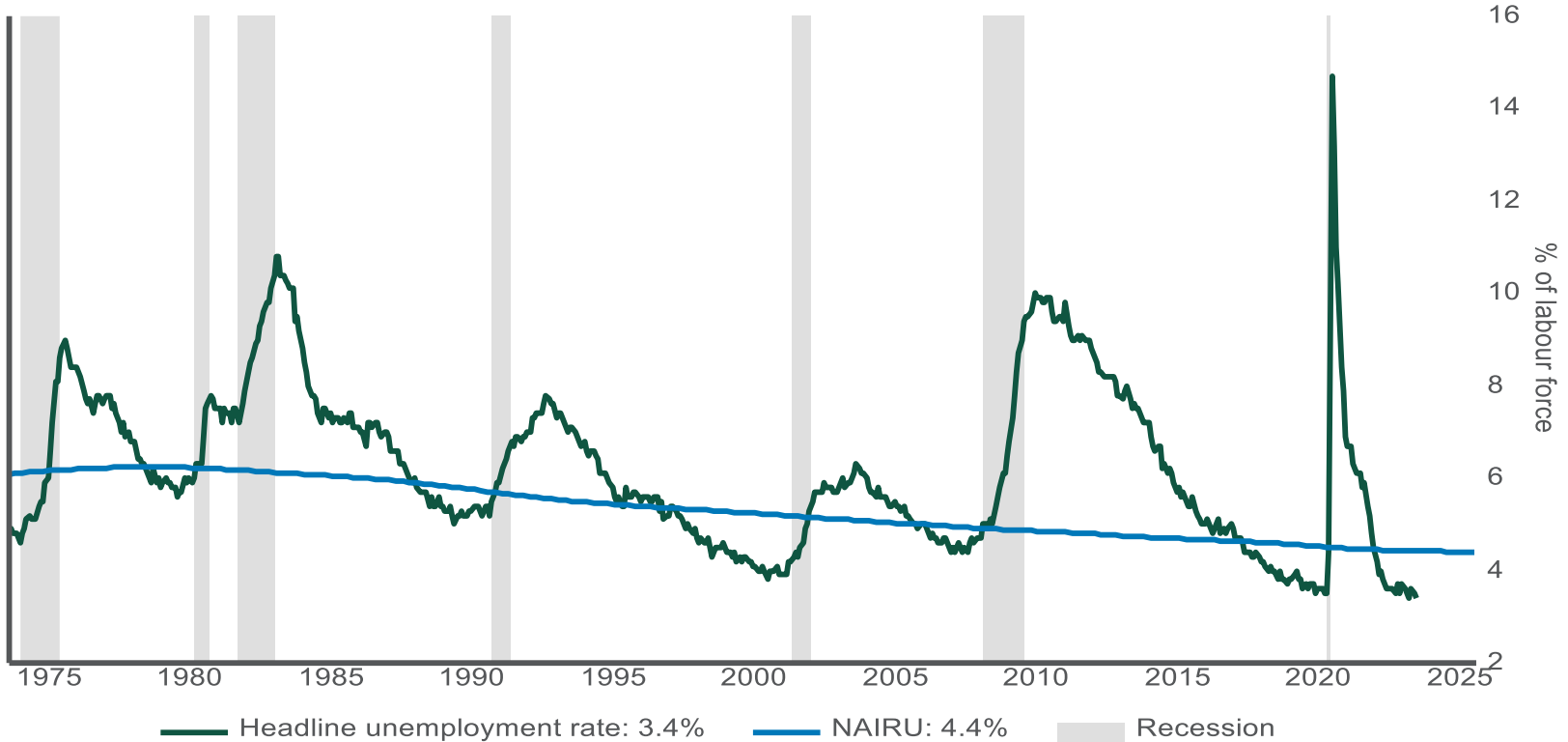
US Home price and Shelter contribution to Core CPI



Source: Refinitiv Datastream, Mar 23

2023: US Labor Market Has Been Strong...

US Headline Unemployment and NAIRU



Source: Refinitiv Datastream, Apr 23

2023: ... but Wage Growth Has Been Slowing Down

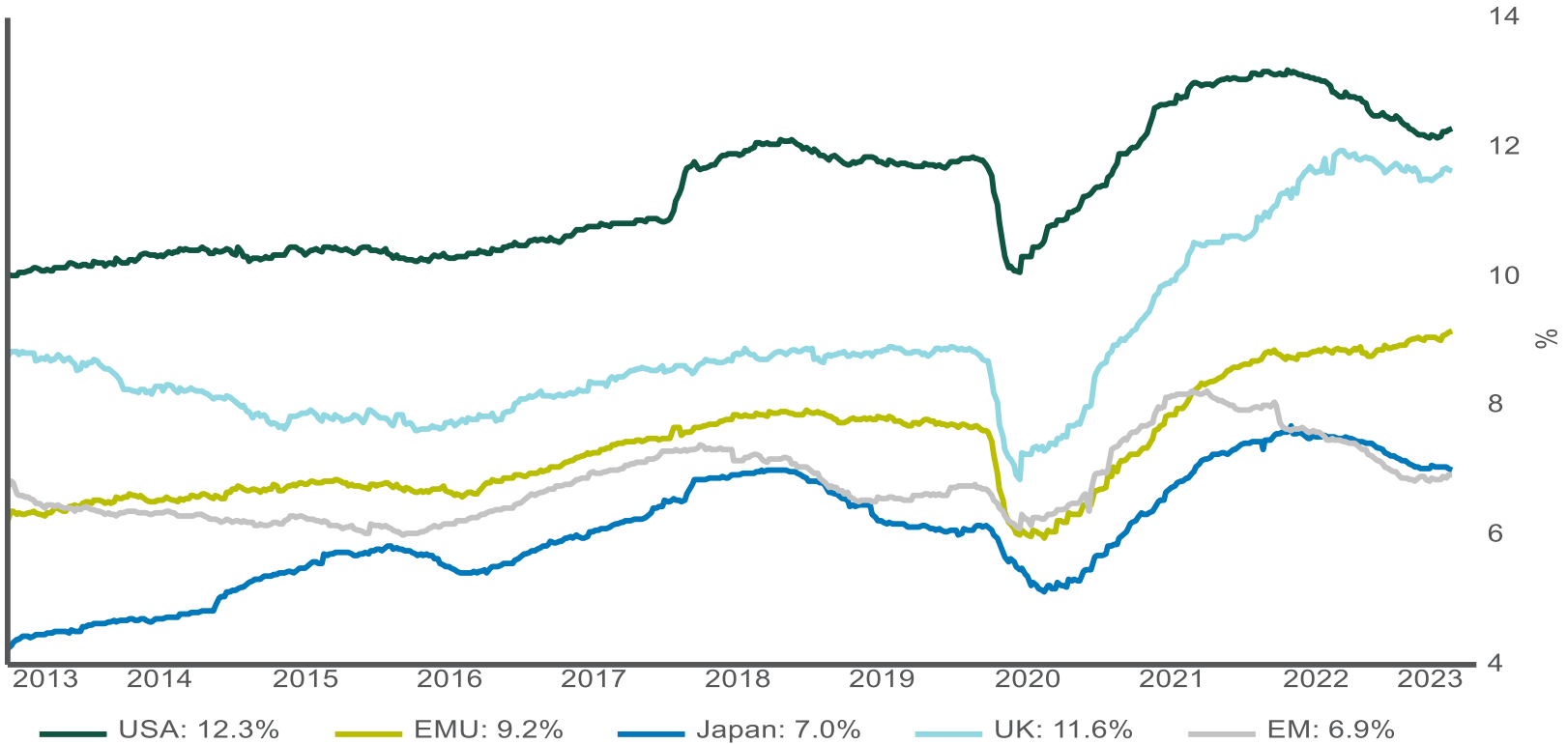
US Wage Growth



Source: Refinitiv Datastream, Apr 23

2023: Profit Margins are in Decline

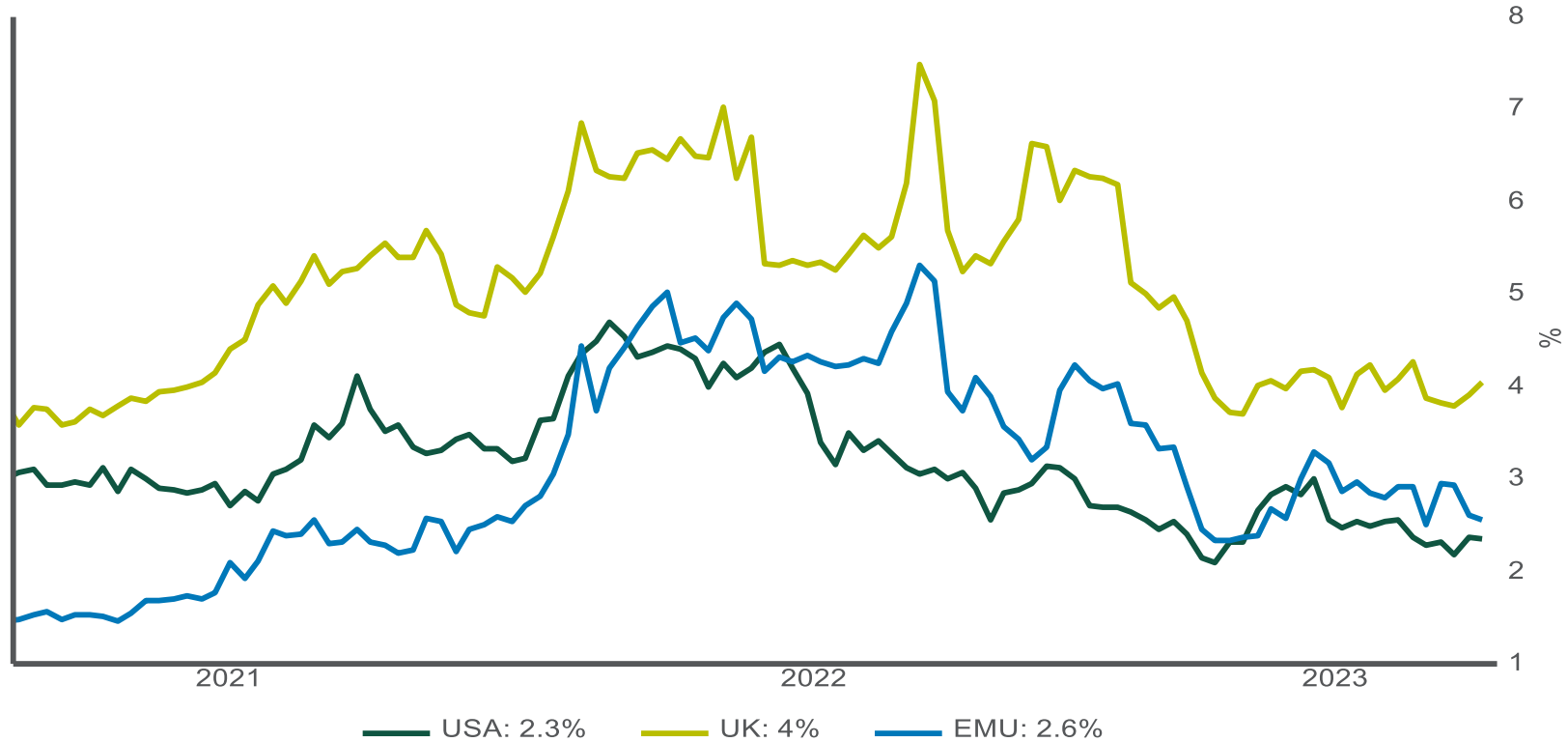
12 Month Forward Profit Margins



Source: Refinitiv Datastream, 25/05/2023

2023: Inflation Expectations Have Declined

Global 2Y Inflation Linked Swap Rate



Source: Refinitiv Datastream, 30/05/2023

TACTICAL ASSET ALLOCATION



2023 Outlook

Base Case Expectations

Approaching Economic Stall Speed

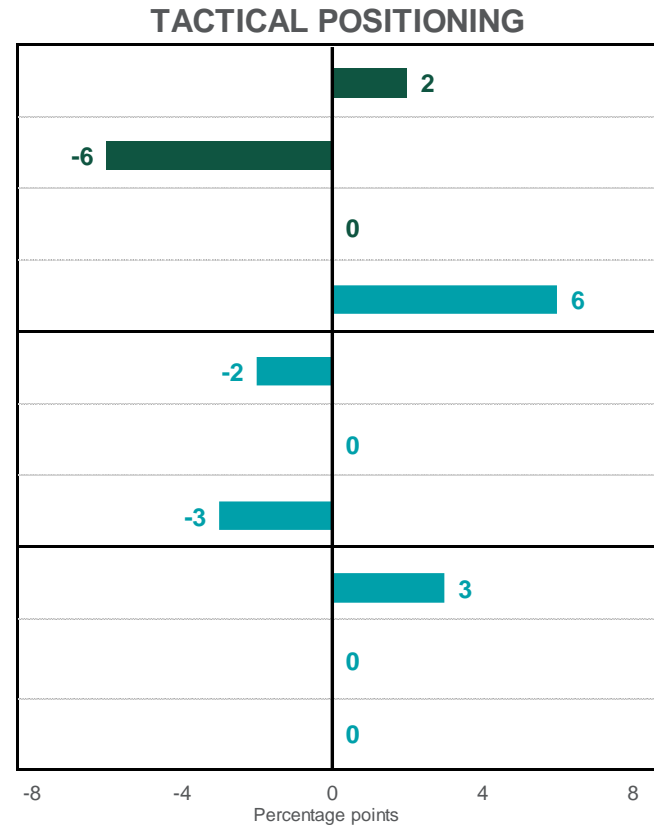
Recent banking issues and consequent impacts on bank lending, as well as spillover economic implications from worsening sentiment, add pressure to the growth trajectory. Other lending sources (think private credit) can partially backfill credit availability, but overall growth should be fairly flat over the next year

Monetary Tightrope

Given concerns regarding financial stability from unexpectedly rapid rate increases, the Fed will likely resort to a slower path of monetary tightening. But inflation has remained sticky, likely necessitating further rate increases. TAA continues to believe the Fed is close to done raising rates, but will remain there throughout 2023.

Tactical Positioning

		ASSET CLASS	SAA	TAA
Risk Control	Fixed Income	Cash	2	4
		U.S. Investment Grade	34	28
		Inflation-linked	5	5
		High Yield	5	11
Risk Assets	Equities	U.S. Equity	27	25
		Dev ex-U.S. Equity	13	13
		EM Equity	6	3
	Real Assets	Natural Resources	4	7
		Global Real Estate	2	2
		Global Listed Infrastructure	2	2



Source: Northern Trust Asset Management. Allocations above reflect Northern Trust's Global Policy Model; the proxy account for the Investment Policy Committee. Allocations as of 4/12/2023. SAA = Strategic Asset Allocation. TAA = Tactical Asset Allocation.

Key Risk Cases to Watch



Labor Market Durability

More persistent tightness in the labor market leads to more stubborn core inflation, necessitating an unexpected monetary policy response that is negative for financial markets.



Debt Dislocations

Further banking fallout (a risk heightened by the steeply inverted yield curve) and/or lack of progress on a debt ceiling deal (which would likely further invert the yield curve) hurts sentiment.

QUESTIONS



FOR MORE INFORMATION

Five-Year Outlook:

[CapitalMarketAssumptions.com](https://www.CapitalMarketAssumptions.com)

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F-042023-2850257-081823

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