VIEWPOINTS

APRIL 2025

Tariff Tantrum

Holding the U.S. base case, but uncertainty is higher: Tariff uncertainty is at all-time highs and we see higher potential for a negative outcome. Regarding broader policy uncertainty, higher tariffs could weigh on low-income consumers, while falling asset prices pose risk to higher-income consumers, and labor market drag from federal layoffs is starting to surface. Uncertainty from tariffs and other government policies could persist for some time due to a lack of clarity. Policy risks have coincided with downward revisions to growth expectations and upward revisions to inflation forecasts. Consensus expectations for full-year 2025 U.S. GDP growth were lowered to 2.0% from 2.2% last month. Expectations for core Personal Consumption Expenditures (PCE) over the next couple of quarters modestly increased. Although while it does appear to be cooling, the U.S. economy is expected to continue to grow, and recession probabilities remain low.

Our base case expectation remains for U.S. economic growth to slow to around trend, inflation to stay subdued with the potential for near-term increases from tariff repercussions, and the US Fed to proceed with a gradual pace of rate cuts. Uncertain tariff policies continue to pose significant risks, including economic disruption from policy shocks.

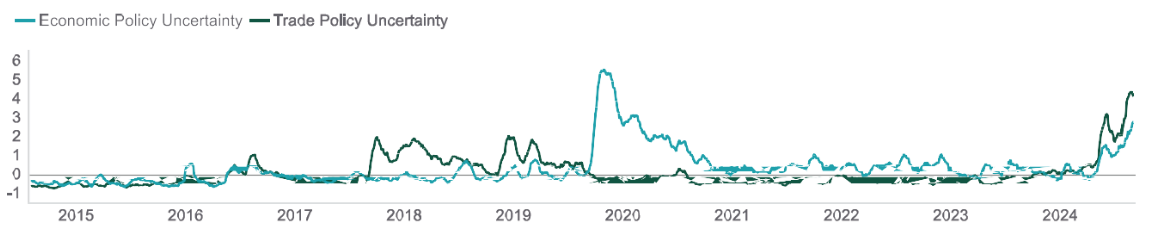
A brighter outlook for Europe: Germany announced massive fiscal reform that would allow defense spending to essentially circumvent the debt brake and also deliver a €500 billion infrastructure fund over 10 years. Approval is still pending, but looks likely. The fiscal boost should provide multi-year support to the European economy and is occurring at a time when central bank rate cuts are starting to lift activity from low levels. We see higher odds that the Euro Area can achieve around 1% real growth. The improved growth outlook has also started to feed through to better earnings revisions for non-U.S. equities, particularly relative to weaker U.S. estimates.

Maintaining the U.S. equity allocation: Government policies have weighed on the U.S. equity market, with the S&P 500 Index nearing a 10% correction in a span of less than a month. Given the recent drawdown, weaker sentiment, and no major change to the baseline economic expectation of a soft landing, we do not think it is an opportune time to reduce U.S. equity exposure. High yield has posted a positive total return year-to-date, which is a notable feat given the magnitude of the U.S. equity market drawdown.

Policy Uncertainty is Very High

A great deal of uncertainty centered on tariff impacts continues to keep equity markets on edge.

SMOOTHED Z-SCORE OF DAILY UNCERTAINTY MEASURES



Source: Northern Trust Asset Management, Macrobond, Matteo Iacoviello, Economic Policy Uncertainty. One-month smoothed measures of daily data. Data from 12/31/2014 through 3/17/2025. Historical trends are not predictive of future results.

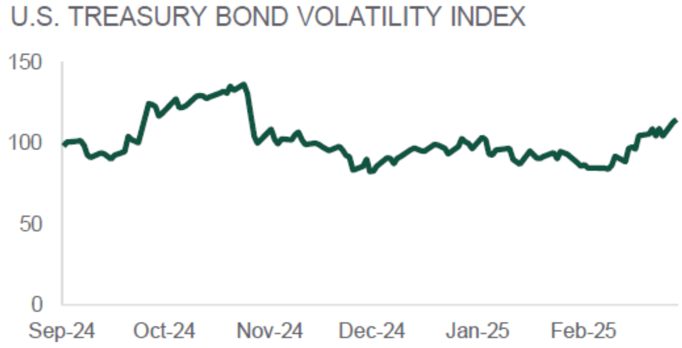
Interest Rates

It has been quite the start to the year in interest rate markets, with ten-year U.S. Treasury yields trading in a 65 basis point (bps) range year-to-date, between ~4.80% and ~4.15%. The recent move lower has returned yields to levels not seen since last Fall, prior to the U.S. Presidential election. Volatility in the market for U.S. Treasuries has also increased, as measured by the MOVE[1] index, increasing to ~115, a level also not seen since last Fall.

So why are we seeing such large moves in interest rate markets? The moves make more sense in a backdrop of significant uncertainty around the near-term path for the macroeconomy. Rapid developments around tariffs and other government policies can send a wave of cross currents through the economy, making it exceedingly difficult to forecast. This becomes even more challenging in an economy already expected to cool. Fed officials have recently commented that, while they continue to monitor the incoming data closely, they aren't in a hurry to adjust policy in response to a few surveys. We tend to agree, and look forward with more confidence that 2026 is likely to bring lower front-end rates, despite elevated uncertainty this year.

RATES ON THE MOVE

Volatility in the U.S. Treasury bond market has increased.



Source: Northern Trust Asset Management, Bloomberg. Data from 9/12/2024 through 3/11/2025. MOVE[1] = Merrill Lynch Option Volatility Estimate. It is a measure of market expectations for future volatility in the U.S. Treasury bond market. Historical trends are not predictive of future results.

- Volatility has increased in the U.S. Treasury market.
- This is a reasonable response to the significant uncertainty around the near-term path for the economy.
- 2026 may bring more certainty, presenting potential opportunities in the 2-3 year sector of the U.S. Treasury curve.

Credit Markets

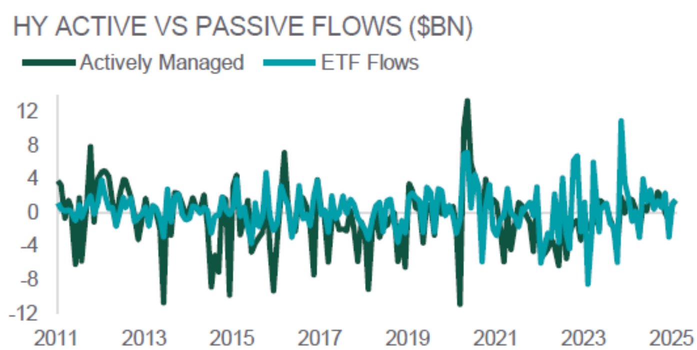
February marked an increase in equity market uncertainty as tariff threats, geopolitical unrest and weaker economic data all contributed to a reset of risk appetite in stocks.

Despite rising equity market volatility, the high yield (HY) bond market held firm with declining Treasury yields helping to offset modest spread widening. High-yield funds have continued to see robust inflows. Assets under management (AUM) for dedicated HY retail bond funds rose to a 3-year high of $360.7bn and are only $13.4bn below the record high. Meanwhile, HY ETFs currently have a record $90.1bn of AUM.

Based on the increase in AUM of these passive products, there could be an increase in forced buying and selling in smaller bonds and issuers than in prior years due to the more retail nature of these products. This cohort of the market can provide an abundance of opportunity for active investors looking to capture mispricing and inefficiencies in the market. Fundamental credit work and security selection is paramount to generating excess returns in this segment of the market especially alongside the complicated economic backdrop.

HY ACTIVE VS. PASSIVE FLOWS

High yield funds have continued to see robust inflows.



Source: Northern Trust Asset Management, Lipper FMI, JPMorgan. HY = High Yield. Data from 12/31/2010 through 2/28/2025. Historical trends are not predictive of future results.

- High yield ETFs have increased meaningfully in size over the last 12 months.
- Based on the increase in AUM of high yield passive products, there could be an increase in forced buying and selling in smaller bonds and issuers than in prior years.

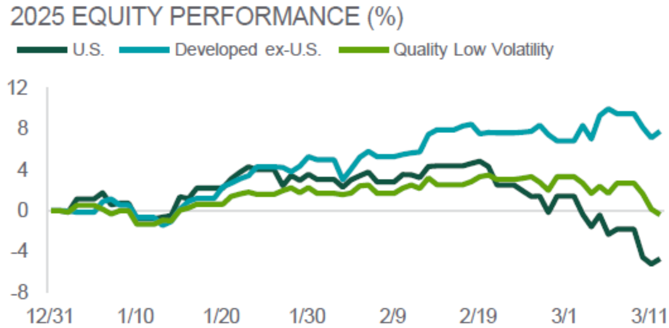
Equities

After hitting an all-time high on February 19, U.S. large caps sold off 9.1% over the next 15 trading sessions. Increased uncertainty has led to a striking reversal in market leadership as investors sought shelter in low volatility and high quality stocks. These stocks have outperformed the broader benchmark by 5.5% since the sell-off began and are essentially flat year-to-date. Outside the U.S., investors are finally reaping the benefits of diversification with developed ex-U.S. markets up 0.2% during the sell-off period and up 7.8% year-to-date.

The U.S. earnings outlook remains constructive despite downward analyst revisions in February. However, given the recent drawdown, weaker sentiment, and no major change to the baseline economic expectation, we do not think it is an opportune time to reduce U.S. equity exposure. For developed ex-U.S. equities, Germany's proposal for massive defense and infrastructure spending is expected to boost growth for several years. Challenges remain, including the ongoing tariff turmoil and other longstanding structural challenges to growth.

SHELTER FROM THE STORM

Defense and Diversification paying off in 2025.



Source: Northern Trust Asset Management, MSCI. U.S. is MSCI U.S., Developed ex-U.S. is MSCI World ex-U.S. and Quality Low Volatility is the Northern Trust Quality Low Volatility Index. Data from 12/31/2024 through 3/12/2025. 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.

- High quality and low volatility stocks provided significant protection for investors during the recent market route.
- Developed ex-U.S. stocks provided much needed diversification as proposed infrastructure and defense spending in Europe boosted markets.

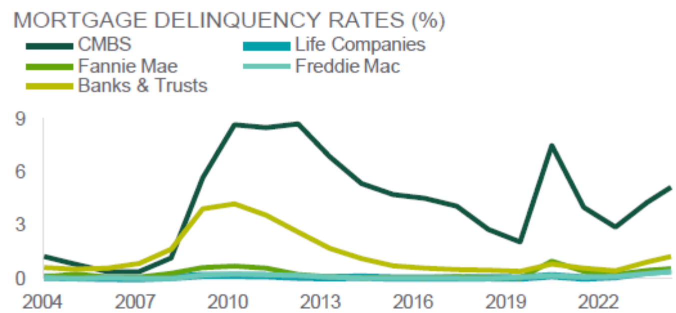
Real Assets

Over the last 24 months, Commercial Real Estate (CRE) investors have been contemplating the CRE "wall of debt maturities". Lenders and borrowers have been modifying their agreements amidst a historic increase in interest rates and a subdued transaction market. Commercial mortgage delinquency rates have been ticking up, but are still far below Global Financial Crisis / COVID pandemic levels.

Today, we seem to be entering an environment where broader market acceptance of "higher for longer" interest rates may be altering behaviors. Market participants are becoming less hopeful that interest rates and borrowing costs will come down through FOMC[1] policies and actions.

DISLOCATION FORTHCOMING?

Historical commercial mortgage delinquency rates



Source: Northern Trust Asset Management, Mortgage Banker Association. Commercial and Multifamily mortgage delinquency rates. CMBS = Commercial Mortgage-Backed Securities. FOMC[1] = Federal Open Market Committee. REIT[2] = Real Estate Investment Trust. Annual data from 12/31/2004 through 9/30/2024. Historical trends are not predictive of future results.

- U.S. economic conditions are so-far supportive of healthy real estate markets, although tariff and other fiscal policy is likely to weight on both prices and sentiment.

Base Case Expectations

Soft Landing

Global growth will settle around trend while evolving government policies keep uncertainty elevated. Inflation will settle at lower levels, but tariffs could cause some bumps along the way.

Central Bank Easing

Lower inflation has allowed major central banks to start cutting policy rates. We expect central bank easing to continue, though the timing and trajectory could be complicated by tariffs.

Risk Case Scenarios

Reflation

Policies of the U.S. Administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

Supply Restraint

Supply-side disruptions from immigration restrictions and higher tariffs in addition to broader policy uncertainty weigh on economic activity and halt the disinflationary process until a recession takes shape.

Indexes Used and Definitions:

MSCI ACWI: A free-float weighted equity index that includes both emerging and developed world markets.

S&P 500 Index: Widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

S&P Global Infrastructure Index: The S&P Global Infrastructure Index includes exposure to 75 companies from around the world tha represent the listed infrastructure universe.