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, 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 several months as processes unfold. 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. While cooling, the U.S. economy is expected to continue to grow, and recession probabilities are low.

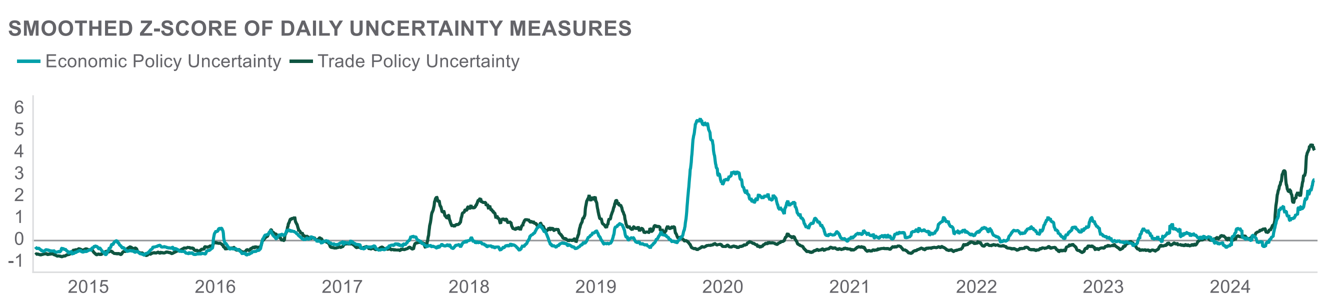
Our base case expectation remains for U.S. economic growth to slow to around trend, inflation to ease with the potential for near-term boosts from tariffs, and the Fed to proceed with a gradual pace of rate cuts. Uncertain tariff policies continue to pose both upside and downside risk, including economic 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 and Russia-Ukraine tensions are easing. We see higher odds that the Euro Area can achieve around 1% real growth. The improved growth outlook has started to feed through to better earnings revisions for non-U.S. equities, particularly relative to weaker U.S. estimates. Tariff risk is still a factor, but we believe the fundamental changes are sufficient to remove the underweight to developed ex-U.S. equities.

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. Instead, we preferred to fund the increased international equity allocation with high yield. 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. We view the trade as an opportunity to take profit in one area in order to reduce underweight exposure to an asset class with the potential for tactical outperformance. Overall, the committee still likes high yield. The tactical portfolio is overweight equities and real assets, and underweight fixed income. We recommend having some inflation protection and staying diversified in what has been an uncertain environment due to government policy.

POLICY UNCERTAINTY IS VERY HIGH

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



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.

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.

INDEX DEFINITIONS

S&P 500 Index: The index, a gauge of the large-cap U.S. equity market, includes 500 companies that represent approximately 80% of the market capitalization of publicly traded U.S. equities.

MSCI World Ex-U.S Index: The index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries, excluding the United States. It covers approximately 85% of the free float-adjusted market capitalization in each country.

Northern Trust Quality Low Volatility Index: The Index is designed to construct a high quality universe of companies that possess lower overall absolute volatility (i.e. risk) relative to the Northern Trust 1250 Index. An emphasis is placed on a company's income and capital growth, while also reducing overall volatility of returns relative to the benchmark. The proprietary Northern Trust quality factor is used to identify companies that exhibit strength in profitability, management efficiency and cash flow.

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ViewPoints reflects data as of 3/18/25.