Northwest Bank & Trust Company
Investment Management Group

AN OBJECT IN MOTION

We remain overweight equities as we enter 2018. The global economy is showing broad momentum and inflation is putting little pressure on monetary policy. In response to strong 2017 market returns, we've been reallocating toward less-expensive asset classes. We believe the two biggest potential threats to the economy and markets "staying in motion" are a central bank mistake and a China slowdown. We entered 2017 overweight risk assets because we believed the global economy was gaining momentum and the U.S. government was set to take some load off of the Federal Reserve. Economic fundamentals have positively surprised in 2017, with the contribution from the U.S. government being more regulatory than legislative in nature. As investors bid up risk assets in 2017, fixed income continues to provide middling return potential. To paraphrase Newton's First Law, an object will remain in motion unless it is compelled to change by an external force. We think that describes the general state of the global economy, which we expect should produce another year of solid growth in 2018.

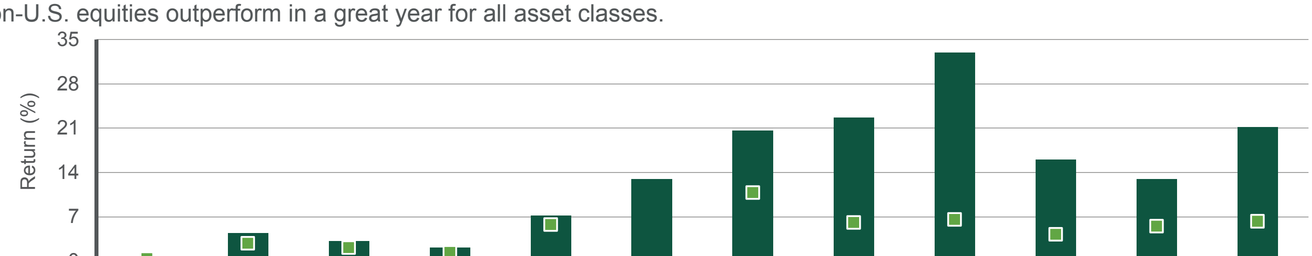
Bull markets are always vulnerable to central bankers "taking away the punch bowl" by raising rates, but we think continued subdued global inflation moderates this risk. In addition, the low level of long-term interest rates globally and the fear of inverting the yield curve should cap how far the Fed raises short-term rates.

Accelerating growth in China has supported the global economic and financial market rebound since early 2016. This growth may have been engineered ahead of the Party Congress this past October. While a material slowdown of Chinese growth is a risk, our base case of modest growth deceleration may help to offset global inflation risks and support risk taking.

Our themes of Enduring Growth, Stuckflation and Waiting for Monetary Godot remain front and center as we look into 2018. Global economic growth has shaken off concerns about the recovery's age, and has actually been gaining momentum toward year-end. The inflation outlook remains "stuck" at low levels, as technology adds supply to the economy and restrains pricing power. This is leading to Monetary Godot, as central bankers debate the cyclical vs. secular nature of inflation and whether they might make a mistake by tightening policy too soon. We see the intersection of these three themes continuing to support risk taking in 2018.

A YEAR TO REMEMBER

Non-U.S. equities outperform in a great year for all asset classes.



	Cash	Muni	Inv. Grade	TIPS	High Yield	Em. Markets	United States	Dev. ex.-U.S.	Em. Markets	Natural Res.	Global Real Estate	Global Listed Infra.
	Fixed Income						Equities			Real Assets		
2017	0.7	4.4	3.1	2.1	7.2	12.9	20.6	22.6	32.9	16.0	13.0	21.2
3-year	0.3	2.8	2.1	1.4	5.7	-0.2	10.8	6.0	6.5	4.2	5.5	6.2

Source: Northern Trust Investment Strategy, Bloomberg. Returns greater than one year are annualized. 2017 return data through 11/30/2017.

CONCLUSION

Asset markets were boosted in 2017 by a combination of conservative positioning, upside earnings growth and predictable monetary policy. Investors ended 2016 having withdrawn $15 billion* from equities, compared with a net investment of $254 billion into fixed income. Investor sentiment improved steadily during 2017, leading to flows into equities of $200 billion in the first nine months of the year – which was still outpaced by $293 billion into fixed income. These investment levels don't compare with the overweighting of equities that occurred at the end of the last two bull markets. In 2007, $212 billion went into equities as compared with $121 billion into fixed income; in 1999 there were flows of $137 billion into equities and just $2 billion into fixed income. The 2017 investment flow data presents a picture of improving optimism, but not one of euphoria.

While the earnings picture in 2018 is highly unlikely to match the robust growth of 2017, the outlook still looks promising. U.S. earnings look to get a one-time boost from pending tax reform, leading to our growth forecast of 14% – as compared with 7% for developed ex-U.S. and emerging markets. U.S. share prices may face some headwind from valuations, while we expect valuation expansion outside the United States. Our work on valuation shows that selling out of the market just because it is expensive hasn't added value in the past, and our approach has been to reallocate within equities to those areas with lesser valuations (i.e., markets outside the United States).

Monetary policy will be in focus in 2018, as balance sheet management along with policy rate adjustments raise the risk of a Monetary Misstep. Too much tightening, without higher inflation, risks inverting the yield curve and bringing consequent negative repercussions. We are also monitoring the risk of China Weakness, because the strong market environment over the last 18 months has been supported by a strong rebound in China. Politics likely will remain center stage, but haven't proven to be much of a risk to markets in recent times, and we actually removed this from our risk cases this month. At the end of the day, we expect again to get paid to take risk in 2018 – and should things change during the year we will be positioned to make the appropriate adjustments.

** Based on investment flow data from JPMorgan.*

ViewPoints reflects data as of 12/11/17.