

Hopeful Signs & Hidden Landmines

OUR ECONOMY MAY BE OUT OF INTENSIVE CARE, BUT IS IT OUT OF THE HOSPITAL?

Many of the positive signs we see in our recovering economy are tempered by challenges, according to Paul Kasriel, chief economist for Northern Trust.

Here's his outlook for the rest of the year and beyond.

JOB PROSPECTS

The prospects are good for some job growth this year. That's the good news. The bad news is, I don't think the job growth is going to be sufficient to make a big dent in the unemployment rate. I think the economy will grow 2.5% to 3%, which creates just enough jobs for new workers coming into the labor force.

Our average workweek in the country is just over 33 hours—the lowest since 1964. So businesses with an increase in demand can simply extend the hours of their current staff rather than hire a lot of new people.

RETRAINING WORKERS

The economy is going through some structural changes today. We're selling about 11 million units of cars and trucks, but we have the labor force to produce 16 or 17 million units. We're not going back to that rate for a long time. That means some of the unemployed autoworkers are probably going to have to get into retraining programs. That takes time.

The same goes for people in jobs created by the housing boom—mortgage brokers, real estate brokers and construction workers. Not all of those jobs are going to come back.

COMMERCIAL SPACE SURPLUS

Another problem area is commercial real estate. The unemployment rate is 9.7% and quite frankly, not likely to vary much over the year. That means there is a lot of empty office space in this country.

Consumer spending is starting to grow, but not surge, still leaving a lot of empty mall space. So commercial real estate is still declining, and it's not likely to stabilize until 2011 at the earliest.

STATE OF STATES AND CITIES

State and local governments helped bring us out of the Great Recession but they'll be a drag in 2010.

Many state and local governments face operating budget deficits. Perhaps more important are the public pension plans that are severely underfunded. So we are going to see a cutback in spending by state and local governments. We'll probably see tax increases, as well.

GLOBAL GROWTH

We are seeing strong growth in the developing economies, such as China, which has become an economic locomotive for the global economy. And it's helping boost our growth.

In the second half of last year, our export growth averaged, at an annual rate, about 20%. The bulk of the increase in our exports was going to Asia (excluding Japan) and South America—emerging markets.

Consumer spending is not terribly strong, but it is growing at 2%. And we are starting to see some increase in business equipment spending. Those are both good signs.

Read more of Kasriel's commentary at northerntrust.com/econtrarian.

SPENDING, NOT LENDING

There has been a lot of concern about debt, both household and governmental.

But households are actually paying down debt in a relatively benign, orderly way. And, though the U.S. Treasury debt relative to the size of the economy, or GDP, hit about 83%, many other countries have much higher ratios. In Japan, debt is 165% of its GDP.

The primary driver of government deficits down the road is going to be spending related to Social Security, and, even more importantly, to Medicare.

Millions of aging Baby Boomers are going to become Medicare beneficiaries—with the projected cost per beneficiary going up.

More and more resources will be used in the economy to take care of retirees. That leaves fewer resources to educate the grandchildren of these retirees and to make them more productive. There will be fewer resources for business investment, as well. This will restrain productivity growth, which in turn restrains long-run growth in the U.S. economy.

We are not going to be able to grow our way out of this. We will have to rein in this projected spending on retirees.

That's why the issue about healthcare costs is so critical. If we can bring down general healthcare costs, then we can turn down those projected increases in Medicare costs.

—PAUL KASRIEL

Chief Economist for Northern Trust



New Plain English Summary Prospectuses

New rules from the Securities and Exchange Commission are changing the way Northern Funds handles mutual fund prospectuses.

At the end of July, Northern Funds shareholders will be mailed a summary prospectus for each fund that they own. It should be easier to read and understand.

In four pages or less, the summary prospectus will provide all the basic and relevant information in a standardized, simple format. Included are:

Investment objectives and strategies

Fees and expenses

Fund performance

Purchase and sale of Fund shares

This allows Northern Funds to provide these documents in a more environmentally friendly manner — with significantly less paper, printing and postage.

For any investor who wants additional, detailed information, the traditional statutory prospectus and SAI will be available online. You can access the statutory, summary prospectuses and SAI at northernfunds.com/prospectus or call the Northern Funds Center at **800-595-9111**.

NEW SEC RULES FOR MONEY MARKET FUNDS

The new risk-limiting money market rules recently adopted by the Securities and Exchange Commission (SEC) began to take effect in May 2010. The regulations are designed to further stabilize money market funds and to increase the safety and liquidity for money market fund shareholders.

Northern Trust already meets many of the new SEC requirements, and we don't expect the rule changes to have an overall effect on the investment strategy of our money market funds.

Below is an overview of key rule changes, compliance dates and what action Northern Trust has or will take to meet these new requirements.

PORTFOLIO LIQUIDITY

New Rule: To facilitate redemptions, under the new SEC rules, all taxable money market funds will be required to maintain at least 10 percent of assets liquid within one day and at least 30 percent within one week.

Deadline: May 28, 2010

Northern Trust Action: Already in compliance with many of the new requirements.

CREDIT QUALITY

New Rule: To reduce risk, money market funds will be limited to investing no more than 3 percent of portfolio assets in lower quality (Tier 2) securities, with a half a percent limit per issuer. Previously, the limit was up to 5 percent of portfolio assets, with a 1 percent limit per issuer. In addition, the new rule does not permit

a fund to invest in lower quality securities with a maturity beyond 45 days.

Deadline: May 28, 2010

Northern Trust Action: Already in compliance with the rule. It has been Northern Trust's practice not to invest in Tier 2 securities.

PORTFOLIO MATURITY

New Rule: To reduce the exposure of funds to specific risks, such as sudden interest rate movements, the maximum weighted average maturity of securities in money market funds will be reduced to 60 days from the current 90 days. The rule also restricts the weighted average life of a fund's portfolio to 120 days (previously, no such limit), which will limit the ability of the fund to invest in long-term floating rate securities.

Deadline: June 30, 2010

Northern Trust Action: Already in compliance with the new requirements.

If you have any questions about the SEC rule changes, please contact your financial advisor or call us at 800-595-9111.

An investment in the Money Market Funds is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Money Market Funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Money Market Funds.

MID CAP FUND

MERGER

In May, shareholders approved the merger of the Northern Mid Cap Growth Fund into the Northern Multi-Manager Mid Cap Fund.

The Northern Multi-Manager Mid Cap Fund blends four outside sub-advisers with complimentary investment styles. These include relative value, deep value, conservative growth and aggressive growth.

The Fund is designed to provide the best combination of risk and return.

Mid Cap Risk: Mid-capitalization stocks typically carry additional risk, since smaller companies generally have higher risk of failure and, historically, their stocks are subject to a greater degree of volatility.

Equity Risk: Equity securities (stocks) are more volatile and carry more risk than other forms of investments, including investments in high-grade fixed income securities. The net asset value per share of this Fund will fluctuate as the value of the securities in the portfolio changes.

If you have any questions about the merger, please contact your financial advisor or call the Northern Funds Center at **800-595-9111**.

contact us

by phone call 800-595-9111, Monday thru Friday, 7:00 a.m. – 7:00 p.m. Central Time

automated information line call 800-595-9111, 24 hours a day, 7 days a week

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