

# Global Markets Overview

## Asset Research Team

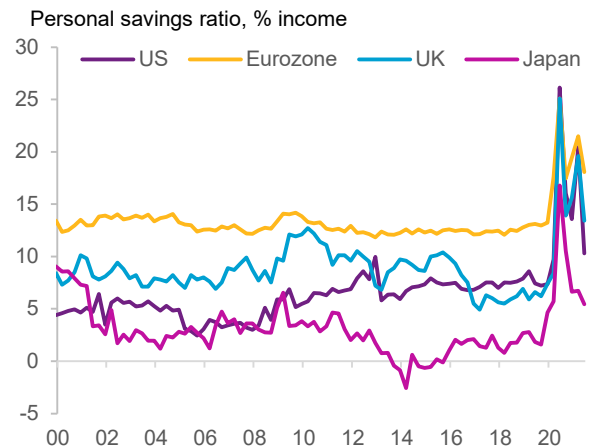
September 2021

### Key developments to watch

#### Household savings remain high with important economic and market implications

- Direct government support to households over the past 18 months has been large and multi-faceted. This support, plus an inability and reduced willingness to spend as normal, meant household savings have increased sharply.
- As the global economy recovers from COVID, savings rates can move to a post-pandemic “normal” as well. How and when this takes place is important to both economic and market outcomes.
- If savings rates decline sharply – as they have done recently – the flip side is higher household spending. This can create strong growth and returns for risky assets, but it can also create inflation pressures and reduce the demand for safe assets such as bonds, increasing yields.
- US equity prices largely discount the strong growth this could create, although higher bond yields might act as a headwind. Conversely, in our view US bond yields under-reflect the risk of inflation and/or the chances of tighter policy and higher bond risk premia.

#### Household savings ratios have fallen from peaks but remain above long-term levels



Source: Willis Towers Watson

#### What are the key market-related themes we think investors should focus on to position themselves for success during 2021 and beyond?

##### Helping you to monitor macro changes

- **We think there are three standout market-related themes investors should focus on** – policy shifts, the rise of China, and sustainability
- **The nature of investing in a complex world is that change often happens slowly and then all at once.** Our three themes are no different
- **A practical means of coping with this slow but uncertain change** is by systematically monitoring those themes through thoughtfully-curated data
- **With this in mind we have developed three dashboards**, which we will keep up to date and evolve over time. They are on the WTW website: [United States](#) [Europe](#) [Hong Kong](#) [Australia](#)

##### More than talking about tapering

- In reference to the extremely large quantitative easing undertaken in response to the pandemic, in June 2020 Jerome Powell US Federal Reserve Chairman, emphatically stated “we are not even thinking about thinking about tapering”. A little over a year later, things have changed, and now the Fed and other central banks are not only thinking about tapering, but in some cases starting it as well.
- In the US, Mr Powell has said the Fed might start reducing its large monthly purchases of bonds this year, with rate rises some way distant. In the Eurozone, the ECB’s has begun to reduce its pace of bond purchases, albeit only through the emergency pandemic programme. Bond purchases are also being tapered in Australia amongst other places.
- These moves reflect the strong sequential economic growth and high inflation rates observed in recent months. Our central view is this pressure will continue; another reason why very low bond yields have upside risks.

## Investment outlook

### Portfolio priorities for 2021

#### The high-level macroeconomic outlook

- Our economic outlook is split between a period of recovery and subsequent growth. Policy stimulus, in particular the ability to combine extremely easy monetary policy with highly reactive and historically sizeable fiscal stimulus, will determine how long the recovery phase lasts. It will also influence subsequent growth rates, although what ultimately drives this growth (productivity) is subject to a number of complex and overlapping factors.
- This new policy regime is likely to dominate the outcomes for the developed world in aggregate, with important differences between countries. In turn, this will impact market pricing and prospective returns. It also suggests less policy emphasis, relative to the past few decades, will be placed on controlling inflation and more on maximising employment, growth, and possibly the inclusiveness of both.
- Market pricing has generally responded to this policy regime but there remain profound implications for portfolio strategy.



#### With this outlook in mind, what are the key market-related themes we think investors should focus on to position themselves for success during 2021 and beyond?

We have narrowed down a potentially long list by assessing the risks and opportunities that are both highly material for current portfolio allocations and relatively more certain. From a macroeconomic perspective, we think three themes stand out:

- 1. Policy shifts:** the post-COVID policy regime has shifted in important ways. Whilst much of this shift was evident before 2020, the policy response to the pandemic has accelerated it. This has important implications for return pathways and downside risk management in particular.
- 2. The rise of China:** China's financial system continues to open, which provides selective investment opportunities, potentially broadens the sources of diversity available to investors, and can aid downside risk management.
- 3. Sustainability:** this encompasses three important topics:
  - a. Climate:** we believe 2021 will prove to be a significant year for the climate transition, with the 26th UN Climate Change Conference of the Parties (COP26) due to take place in November.
  - b. Inclusive growth:** At the same time, the moral imperative to include diverse perspectives, races and life experiences in all spheres of society, including the professional, has been highlighted in 2020. It is also a financial imperative. Our view and hope is that inclusion will become a material influence on investors' choices.
  - c. Stewardship:** in order to manage these imperatives, the need for better practices by governments, regulators, corporates, asset managers, and asset owners is clear and growing.

#### We suggest investors focus on eight key priorities in 2021

- Position for stronger near-term asset returns and lower long-term returns
- Revisit unlisted asset exposure
- Build a balanced exposure to China
- Maintain but evolve downside hedges
- Integrate climate risks & opportunities into portfolio construction
- Embedding inclusion and diversity in all levels of portfolio decision making
- Increase active management
- Monitor macro change

# Tracking recent asset price moves and our outlook

## Summary: government bonds

### Changes to market pricing (government bond yields)

31 August 2021

31 August 2021		Spot yields					What's discounted		
Developed nominal yields	<b>Eurozone</b>								
	1y/cash	-0.70	0.00	-0.04	-0.06	-0.06	-0.78	-0.78	-0.36
	5y	-0.69	0.07	-0.11	-0.04	-0.44	-0.62	-0.51	-0.09
	10y	-0.39	0.08	-0.20	0.00	-0.74	-0.30	-0.20	0.08
	<b>US</b>								
	1y/cash	0.07	0.00	0.01	0.00	-2.41	0.41	0.80	1.68
5y	0.78	0.07	-0.04	0.38	-1.96	1.09	1.38	1.97	
10y	1.36	0.05	-0.30	0.66	-1.50	1.58	1.77	2.13	
Breakeven infl.	<b>US (CPI)</b>								
	3y	2.64	-0.14	-0.14	1.02	0.69	-	-	2.30
	5y	2.60	-0.07	-0.01	0.88	0.57	-	-	2.17
	10y	2.42	-0.01	-0.09	0.68	0.38	-	-	2.10

### A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		<ul style="list-style-type: none"> <li>Across the major developed markets, guidance from central banks remains accommodative. Policy rates are at or near perceived lower bounds and central banks are engaged in asset purchases.</li> </ul>
US		<ul style="list-style-type: none"> <li>Despite some recent moderation, forward short rates remain notably above their levels at the start of the year, which is consistent with an improved economic outlook. This partly reflects rising bond risk premiums. We expect cash rates to remain low as policymakers wait for core inflation consistently at or above target before tightening.</li> </ul>
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		<ul style="list-style-type: none"> <li>As optimism around the economic recovery has grown, intermediate bond yields have risen year-to-date. However, more recently, yields have fallen due to a combination of public health and economic growth concerns and technical demand factors.</li> </ul>
US		<ul style="list-style-type: none"> <li>In the short run, we believe that risks to yields remain skewed upwards. Our outlook for high GDP growth in advanced economies in both 2021 and 2022 is consistent with a higher level of real and nominal bond yields, especially in the US.</li> </ul>
UK		
AAA-Eurozone		

Key: Highly negative Negative Neutral Positive Highly positive

#### US yields have declined recently. Medium-term pricing is reasonable but risks lie to the upside near term

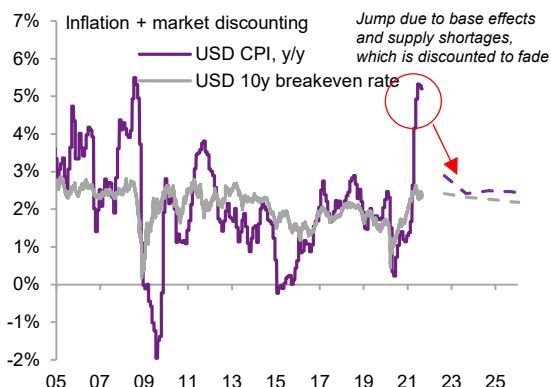
US cash rate and 10y nominal bond yield



Source: FactSet, Willis Towers Watson

#### US breakeven inflation remains anchored. Markets envisage the recent jump in prices to be transient

US CPI inflation rate and inflation market pricing



Source: FactSet, Willis Towers Watson

### Asset Research Team

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# Tracking recent asset price moves and our outlook

## Summary: credit

### Changes to market pricing (credit spreads)

31 August 2021

31 August 2021		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	93	0	0	-39	-29	-0.2%	0.0%	0.0%	-1.0%	-0.7%
	US	92	0	1	-44	-29	-0.2%	0.0%	0.0%	-1.1%	-0.7%
	Eurozone	86	1	0	-28	-34	-0.4%	0.0%	0.0%	-0.7%	-0.9%
	UK	105	-2	-4	-40	-41	0.1%	0.0%	-0.1%	-1.0%	-1.0%
	Canada	115	0	0	-25	1	0.4%	0.0%	0.0%	-0.6%	0.0%
	Australia	92	4	-1	-18	-16	-0.2%	0.1%	0.0%	-0.5%	-0.4%
Low grade	Global HY	366	-16	4	-154	-24	0.9%	-0.2%	0.1%	-2.2%	-0.3%
	US HY	321	-11	-13	-181	-28	0.3%	-0.2%	-0.2%	-2.6%	-0.4%
	Eurozone HY	303	-10	0	-143	-64	0.8%	-0.1%	0.0%	-2.0%	-0.9%
	US loans	405	-1	3	-94	45	1.5%	0.0%	0.0%	-1.3%	0.6%
HC EMD	Hc EMD Corps	273	-22	5	-69	-15	2.3%	-0.2%	0.2%	-1.5%	-0.6%
	HC EMD Sov	265	-12	10	-75	-28	1.6%	-0.3%	0.1%	-1.1%	-0.2%

Source: Credit pricing is from ICE Bank of America and FactSet

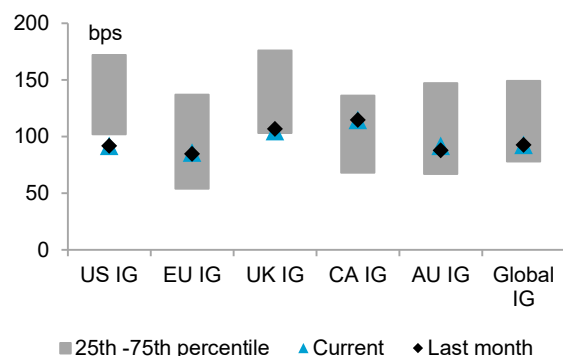
### A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		<ul style="list-style-type: none"> <li>Investment grade markets are pricing in an allowance for a below average level of credit losses</li> </ul>
Inv. grade		<ul style="list-style-type: none"> <li>We expect credit losses to be close to/modestly above these levels, particularly in the nearer term ,but with risks more tilted to higher losses</li> </ul>
High yield		<ul style="list-style-type: none"> <li>At current credit spreads, high quality credit assets are at levels at which they are likely to provide only moderate returns above equivalent maturity government bonds</li> </ul>
US		<ul style="list-style-type: none"> <li>We retain a somewhat cautious outlook for developed market speculative-grade credit. Current pricing implies a below average level of defaults relative to historic average pricing. As such, pricing has moved somewhat to pricing-in an optimistic outlook for corporate credit.</li> </ul>
Europe		
Loans		<ul style="list-style-type: none"> <li>Niche and securitized market pricing appears to be pricing-in a very modestly more pessimistic outlook in aggregate, relative to traditional corporate credit markets</li> </ul>
US		

Key: Highly negative Negative Neutral Positive Highly positive

**Investment grade spreads were largely unchanged over the past month and remain broadly at the lower end of their interquartile range (excl. EU and Canadian markets)**

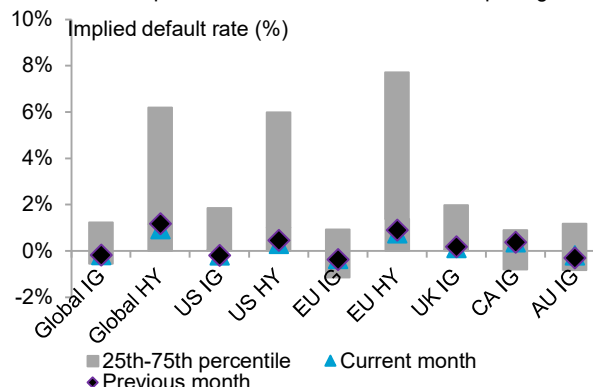
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, Willis Towers Watson.

**Market implied default rates remained low relative to history over the past month**

Estimated implied default rate based on current pricing



Source: FactSet, Willis Towers Watson.

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# Tracking recent asset price moves and our outlook

## Summary: equity

### Changes to market pricing (equity)

31 August 2021

31 August 2021	Δ 1 month			Δ 1 year				Δ 3 years (pa)		
	Total return	EPS	Trailing P/E	Price return	Total return	EPS	Trailing P/E	Total return	EPS	Trailing P/E
Australia	2.1%	34.2%	-24.4%	24.3%	28.4%	16.5%	6.6%	9.3%	-1.7%	8.2%
Canada	1.5%	13.0%	-10.4%	24.0%	27.7%	51.3%	-18.0%	10.8%	4.6%	5.0%
Eurozone	2.4%	32.4%	-23.0%	30.6%	33.5%	72.9%	-25.5%	9.9%	-2.2%	9.9%
Japan	3.2%	38.7%	-25.6%	22.0%	24.7%	62.5%	-24.9%	7.7%	-1.9%	3.1%
UK	1.9%	37.9%	-26.8%	19.1%	23.8%	98.4%	-40.0%	1.8%	-7.3%	4.2%
US	3.0%	20.2%	-14.4%	29.9%	31.9%	40.4%	-7.4%	18.8%	8.6%	6.9%
China	0.0%	3.9%	-3.7%	-6.8%	-5.5%	-0.7%	-11.1%	6.9%	-1.6%	0.3%
MSCI World	2.7%	23.4%	-17.1%	28.3%	30.7%	46.9%	-12.9%	15.3%	4.4%	8.0%
MSCI EM	2.3%	14.9%	-10.9%	16.0%	18.6%	40.3%	-15.3%	10.5%	0.4%	3.2%

Source: FactSet, Willis Towers Watson.

### A summary of our assessment of equity pricing and prospective medium-term outcomes

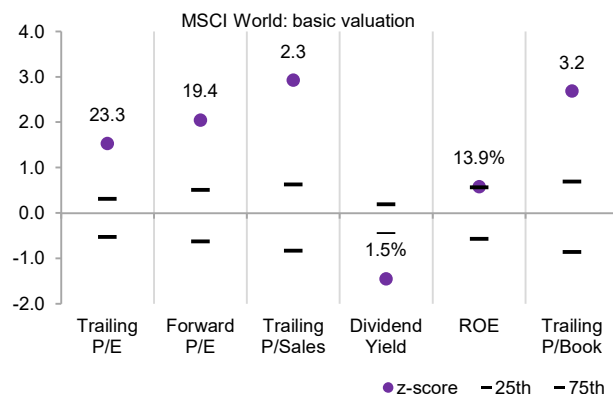
Global equities	Asset return outlook
Developed	
Emerging	

- Price to Earnings ratios have moderated as earnings have recovered from the trough last year caused by COVID related mobility restrictions
- We have seen a material earnings recession in world equity markets but expect a subsequent recovery in 2021/22 – the pace of recovery in each country will depend heavily on how effective fiscal and monetary policy is at underpinning private sector demand.
- US valuations are higher relative to broader developed markets. While this is consistent with higher US fiscal and monetary stimulus, we view European and Japanese equities as moderately more attractive
- EM valuations are lower vs. developed markets, which we see as consistent with higher short-term virus and economic related risks
- Despite rapid equity price rises year-to-date, current equity prices are still consistent with good expected 5-year returns in a scenario where earnings recover quickly in 2021/22. This is contingent on effective policy, with some drawdown risk and uncertainty remaining

Key: Highly negative Negative Neutral Positive Highly positive

**Basic developed market financial ratios are high as investors expect medium term earnings potential to remain relatively unimpacted**

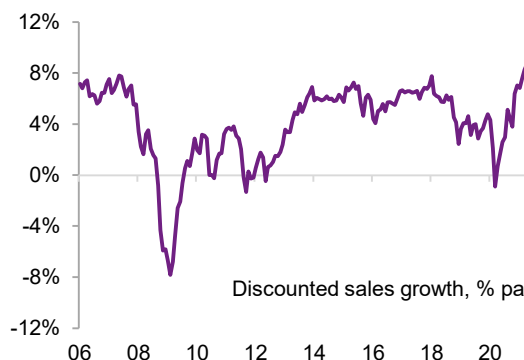
Valuation metrics for the MSCI World equity index



Source: FactSet, Willis Towers Watson.

**The sales growth consistent with current equity prices is somewhat elevated, but we think achievable in the next few years – equities look reasonably valued**

Medium-term growth priced-in by world equity price, % pa



Source: FactSet, Willis Towers Watson.

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