

Global Markets Overview

Asset Research Team

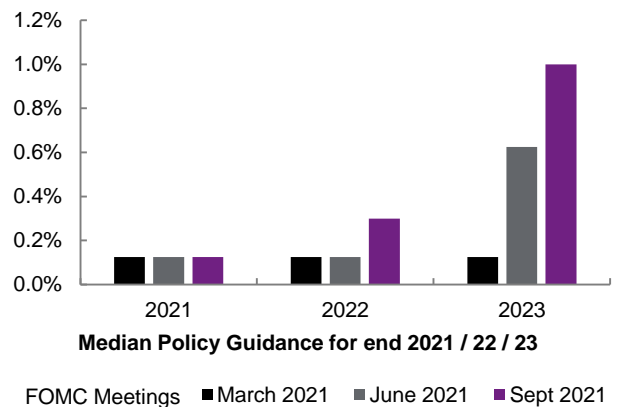
October 2021

Key developments to watch

Diverging policy guidance in the recent announcements from central banks

- The Federal Reserve Open Market Committee (FOMC) has pulled forward their guidance regarding their tapering of asset purchases and interest rate increases.
- We expect the rate of asset purchases in the US to start to slow before the end of this year and to stop by around mid-2022. The Fed has signalled interest rate increases are likely to begin in late 2022, compared to their expectations earlier in the year of no change until 2023.
- In contrast, Chinese authorities have slightly eased monetary policy over the past few months – most notably through lowering banks' reserve requirement ratios.
- The European Central Bank has continued to signal monetary policy will be extremely accommodative for a number of years. This is consistent with expectations that inflation will be below the 2% target by late 2022 and 2023.

FOMC median expectations for the Federal Funds Rate have increased materially over their past three meetings



Source: Federal Reserve, Willis Towers Watson

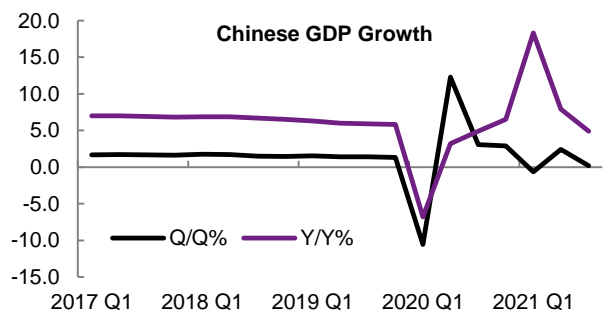
What are the key market-related themes we think investors should focus on to position themselves for success during 2021 and beyond?

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](#)

Chinese economic growth slowed recently but we expect it to remain strong in 2022/23

- The latest data from China shows economic growth slowed in Q3. This was driven by: covid related restrictions to mobility; energy supply shortages limiting industrial production; and weakness in the property market.
- Going forward, we expect Chinese growth to rebound in the coming quarters and remain strong over the next few years, although risks have increased.



Source: FactSet, Willis Towers Watson

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)

30 September 2021

30 September 2021		Spot yields					What's discounted		
% / %pts		Level	Δ 1m	Δ 3m	Δ 1y	Δ 3y	1y fwd	2y fwd	5y fwd
Developed nominal yields	Eurozone								
	1y/cash	-0.72	-0.02	-0.03	-0.05	-0.08	-0.65	-0.58	-0.35
	5y	-0.57	0.16	0.02	0.16	-0.47	-0.50	-0.43	-0.17
	10y	-0.38	0.08	-0.15	0.13	-0.87	-0.29	-0.21	0.05
	US								
	1y/cash	0.08	0.02	-0.01	0.02	-2.51	0.56	1.05	2.01
5y	1.00	0.22	0.12	0.62	-1.96	1.37	1.69	2.23	
10y	1.60	0.26	0.08	0.92	-1.47	1.84	2.03	2.34	
Breakeven infl.	US (CPI)								
	3y	2.55	-0.08	-0.11	1.13	0.52	-	-	2.26
	5y	2.54	-0.04	0.04	0.99	0.47	-	-	2.11
	10y	2.36	-0.04	-0.01	0.76	0.27	-	-	2.05

Source: FactSet

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

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		
US	↑	<ul style="list-style-type: none"> Central bank guidance has become more tilted towards increasing policy rates, especially in the US, in the face of above-target inflation and robust growth. Current short rates remain near their lower bounds and central banks are engaged in asset purchases, but forward short rates are notably above their start of year levels. In most developed markets, this increase leaves expected short-rates in line with our assessment of economic conditions and risks. This is also true in the Eurozone and Japan, but negative/zero rates mean poor returns are likely.
UK	↑	
AAA-Eurozone		
Developed 10-year nominal bonds		
US		<ul style="list-style-type: none"> Intermediate bond yields have also risen in recent weeks. In the short run, we believe that risks to yields remain biased upwards, given the combination of strong growth and price pressures which looks likely near-term. Therefore, we retain our negative outlook for returns from most developed bond markets. Over the medium-term, we expect policymakers to limit yield increases to keep financial conditions broadly accommodative.
UK		
AAA-Eurozone		

Key: Highly negative Negative Neutral Positive Highly positive

US yields have risen recently. Medium-term pricing is reasonable but risks remain to the upside near term

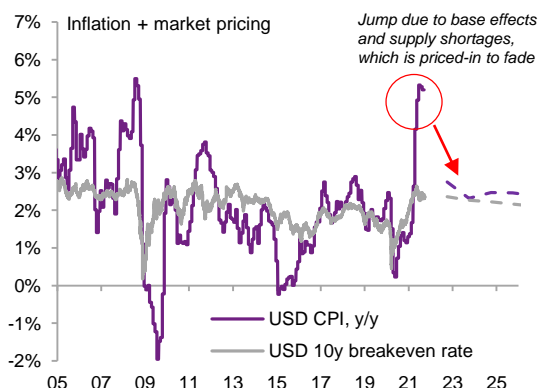
US cash rate and 10y nominal bond yield



Source: FactSet, Willis Towers Watson

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

US CPI inflation rate and inflation market pricing



Source: FactSet, Willis Towers Watson

Tracking recent asset price moves and our outlook

Summary: credit

Changes to market pricing (credit spreads)

30 September 2021

30 September 2021		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	90	-3	1	-48	-25	-0.3%	-0.1%	0.0%	-1.2%	-0.6%
	US	89	-3	3	-55	-24	-0.3%	-0.1%	0.1%	-1.4%	-0.6%
	Eurozone	85	-1	1	-33	-30	-0.4%	0.0%	0.0%	-0.8%	-0.8%
	UK	104	-1	-2	-46	-43	0.1%	0.0%	-0.1%	-1.2%	-1.1%
	Canada	115	0	1	-25	1	0.4%	0.0%	0.0%	-0.6%	0.0%
	Australia	95	3	5	-23	-13	-0.1%	0.1%	0.1%	-0.6%	-0.3%
Low grade	Global HY	373	7	26	-186	9	1.0%	0.1%	0.4%	-2.7%	0.1%
	US HY	315	-6	11	-226	-13	0.2%	-0.1%	0.2%	-3.2%	-0.2%
	Eurozone HY	304	1	8	-168	-51	0.8%	0.0%	0.1%	-2.4%	-0.7%
	US loans	399	-7	-2	-94	43	1.4%	-0.1%	0.0%	-1.3%	0.6%
HC EMD	Hc EMD Corps	289	16	23	-68	26	2.5%	0.2%	0.3%	-1.2%	0.4%
	HC EMD Sov	277	12	16	-58	20	1.8%	0.2%	0.4%	-1.0%	0.4%

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

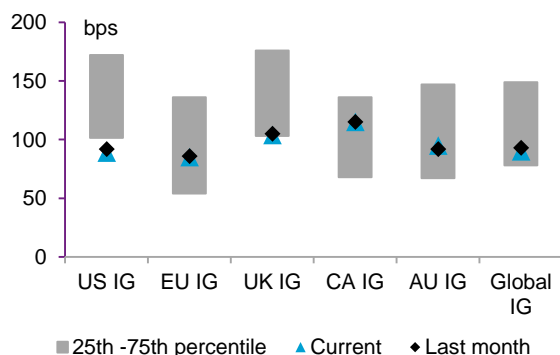
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		<ul style="list-style-type: none"> Investment grade markets continue to price-in an expectation for a below average level of credit losses over the medium-term.
Inv. grade		<ul style="list-style-type: none"> We expect credit losses to be close to or modestly above these levels, particularly in the nearer term, but with risks more tilted to higher losses.
High yield		
US		<ul style="list-style-type: none"> 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 in our view.
Europe		<ul style="list-style-type: none"> We retain a somewhat cautious outlook for developed market speculative-grade credit. Current pricing implies a below average level of defaults relative to historic averages. As such, high yield markets are pricing-in an optimistic outlook for corporate credit.
Loans		
US		<ul style="list-style-type: none"> Niche and securitized market pricing appears to be pricing-in a modestly more pessimistic outlook in aggregate, relative to traditional corporate credit markets

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)

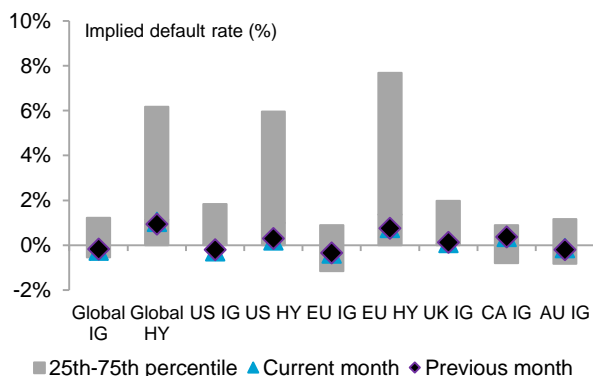
Investment grade corporate option-adjusted spreads, bps



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.

Tracking recent asset price moves and our outlook

Summary: equity

Changes to market pricing (equity)

30 September 2021

30 September 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	-1.8%	-0.7%	-2.0%	25.9%	30.9%	20.6%	4.4%	9.1%	-0.3%	5.8%
Canada	-2.5%	4.0%	-6.5%	24.3%	27.9%	61.7%	-23.1%	10.3%	5.6%	2.7%
Eurozone	-3.2%	-1.7%	-3.4%	29.0%	31.9%	67.3%	-23.8%	8.7%	-2.8%	8.6%
Japan	5.1%	-0.3%	4.6%	26.8%	29.5%	62.0%	-21.7%	7.3%	-2.0%	4.5%
UK	-0.4%	1.0%	-1.7%	20.7%	25.8%	105.1%	-41.1%	1.3%	-6.2%	3.2%
US	-4.9%	-0.7%	-4.3%	28.6%	30.5%	39.4%	-7.7%	16.7%	8.1%	5.4%
China	-2.6%	-1.1%	-1.8%	-8.9%	-7.5%	1.9%	-14.9%	5.7%	-2.5%	-1.4%
MSCI World	-3.8%	-0.9%	-3.5%	27.2%	29.6%	45.6%	-12.8%	13.5%	4.2%	6.6%
MSCI EM	-1.4%	-2.0%	-0.5%	14.5%	17.2%	41.9%	-18.4%	9.8%	0.8%	1.7%

Source: FactSet, Willis Towers Watson.

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

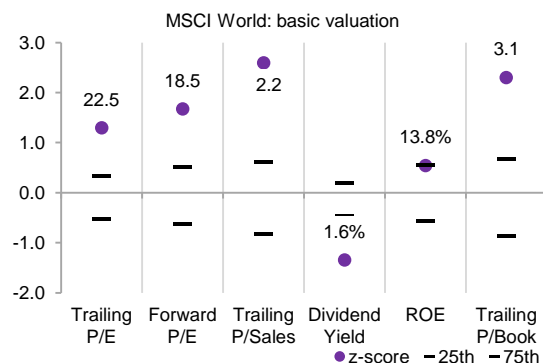
Global equities	Asset return outlook
Developed	
Emerging	

- Earnings in advanced economies have risen significantly over the last year – in line with our expectations – which has reduced core valuation metrics, e.g., price/earnings ratios, relative to a year ago.
- With earnings broadly recovering from their falls last year, future earnings growth 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. We expect relative EM valuations to rise as the global economic recovery broadens further.
- 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 continue to recover quickly. 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 but falling as corporate earnings continue to recover

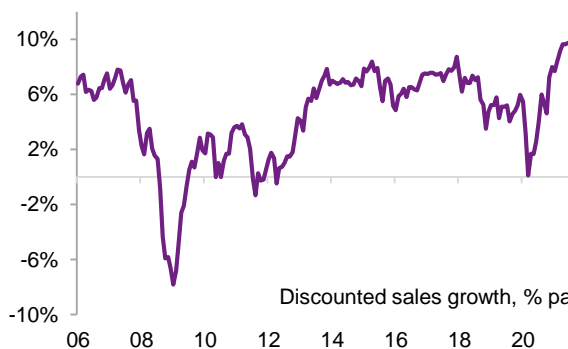
Valuation metrics for the MSCI World equity index



Source: FactSet, Willis Towers Watson.

The earnings 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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