Global Markets Overview

Asset Research Team

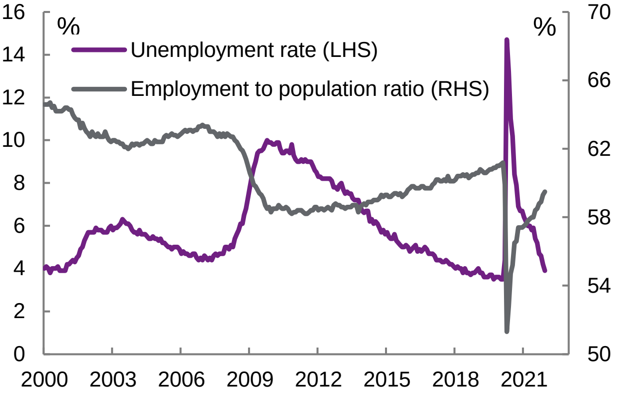
February 2022

Key developments to watch

The US labour market has continued to tighten and supports the interest rate tightening cycle in 2022

- The unemployment rate in the US fell to 3.9% at the end of 2021, slightly below the Federal Reserves' and our estimate of 'full employment' of 4%.
- This "tightening" of the US labour market in 2021 reflects strong growth in employment as well as a notable pickup in wage growth.
- Some labour capacity constraints may be eased given the employment to population ratio is still below 2019 levels, suggesting pandemic or other economic factors are constraining labour force participation – which may unwind in 2022.
- Overall, tightness in labour market conditions and above-target inflation are consistent with the policy rate tightening cycle in the US beginning in 1H 2022.
- We highlight the impact of economic conditions on bond yields on the next page.

US unemployment rate has fallen below our estimates of 'full employment' (%)

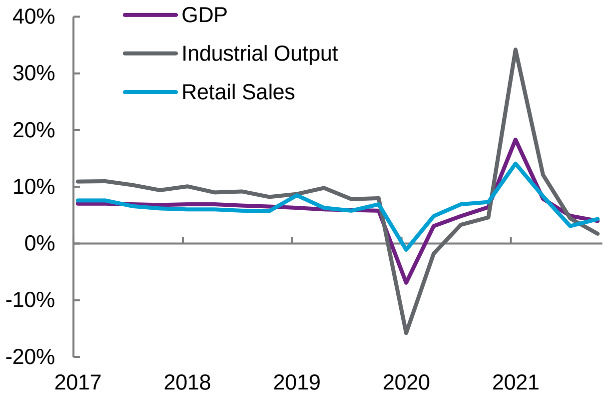


Source: FactSet

Chinese economic growth remained robust over 2021, although authorities have recently eased policy to support growth

- GDP growth in China was 8.1% in 2021, well above authorities' official target of '6% or more'.
- Nevertheless, momentum in growth slowed over the second half of 2021, largely due to weakness in retail sales and the property sector.
- In response, Chinese authorities have signalled cyclical support for growth in the near-term in preference to longer-term structural reforms.
- Recent policy measures have included:
  - Cuts to the bank reserve requirement ratio by 50bps in July and December 2021;
  - A cut to the key 1-year central bank policy rate by 10bps in January 2022.

Chinese Economic Growth



Source: Bloomberg, Willis Towers Watson

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

Updated to 31 January 2022

	Jan 31, 2022 % / %pts	Spot yields Level	Δ 1m	Δ 3m	Δ 1y	Δ 3y	What's priced-in 1y fwd	2y fwd	5y fwd
Developed nominal yields	**Eurozone**								
	1y/cash	-0.67	0.03	0.02	0.01	-0.10	-0.45	-0.25	0.13
	5y	-0.28	0.17	0.09	0.47	0.05	-0.12	0.01	0.23
	10y	-0.01	0.17	0.10	0.53	-0.16	0.08	0.15	0.29
	US								
	1y/cash	0.79	0.43	0.62	0.70	-1.77	1.61	1.87	1.96
	5y	1.65	0.38	0.45	1.18	-0.78	1.86	1.94	2.06
	10y	1.77	0.23	0.14	0.63	-0.88	1.99	2.06	2.19
Breakeven infl.	**US (CPI)**								
	3y	3.14	0.07	0.12	0.90	1.42	-	-	2.44
	5y	2.91	0.08	0.06	0.67	1.15	-	-	2.43
	10y	2.71	0.09	0.16	0.53	0.88	-	-	2.56

Source: FactSet, Refinitiv, WTW

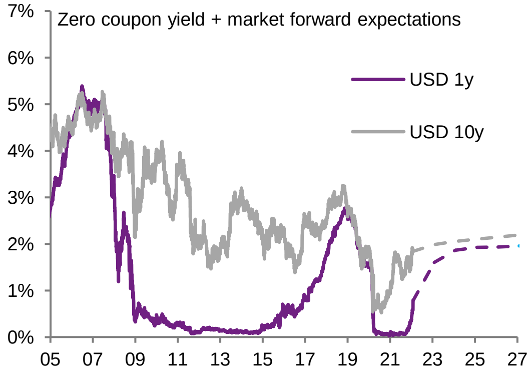
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		• Central bank guidance has become more tilted towards increasing policy rates, especially in the US and UK, in the face of above-target inflation and robust growth. Consistent with this, the Bank of England raised its official rate to 0.25% in December. • Bond markets have adjusted accordingly – while current policy rates remain near their lower bounds, expectations for future policy rates that are priced-into bond markets have risen over the last year. • In most developed markets, this increase leaves expected short-rates in line with our assessment of economic conditions and risks.
US		
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		• Following temporary falls in yields due to the Omicron Covid-19 variant, intermediate bond yields have risen sharply. In the short run, we continue to believe that risks to yields remain biased upwards. Bond term premia on offer appear to be low relative to a plausible range of future policy rate pathways, given our expectation of strong growth and possible upside risks to inflation. • In our base case, we ultimately expect central banks to intervene to manage excessive volatility in bond markets and contain yield rises. However, we retain our cautious outlook for most major developed bond markets for now.
US		
UK		
AAA-Eurozone		

Key: Highly negative | Negative | Neutral | Positive | Highly positive

US bonds look more fairly valued at shorter maturities after recent increases in short-dated yields; we think 10-year bond yields look too low and are more likely to rise than fall

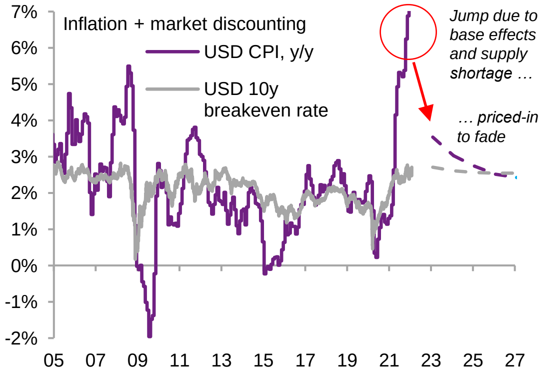
US cash rate and 10y nominal bond yield



Source: FactSet, Refinitiv, WTW

Expectations for future US inflation over the medium- and long-term remains anchored. Markets envisage the recent jump in prices to be temporary

US CPI inflation rate and inflation market pricing



Source: FactSet, Refinitiv, WTW

Asset Research Team

wtwco.com

Tracking recent asset price moves and our outlook

Summary: credit

Changes to market pricing (credit spreads)
31 January 2022

31 January 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	110	10	18	7	-31	0.0%	-0.2%	0.3%	-0.1%	-1.5%
	US	110	12	21	7	-28	-0.1%	-0.1%	0.2%	-0.1%	-1.5%
	Eurozone	107	9	19	13	-37	-0.1%	-0.3%	0.3%	0.1%	-1.4%
	UK	124	9	17	10	-45	0.4%	-0.1%	0.3%	0.1%	-1.7%
	Canada	122	2	10	11	-18	0.5%	0.2%	0.1%	0.1%	-0.7%
	Australia	107	2	5	21	-19	0.1%	-0.1%	0.3%	0.4%	-0.4%
Low grade	Global HY	418	45	31	8	-36	1.0%	-0.9%	0.0%	-0.5%	-2.4%
	US HY	363	53	48	-21	-74	0.1%	-0.8%	-0.1%	-1.1%	-3.2%
	Eurozone HY	367	36	45	17	-82	1.2%	-0.6%	0.4%	-0.3%	-2.5%

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

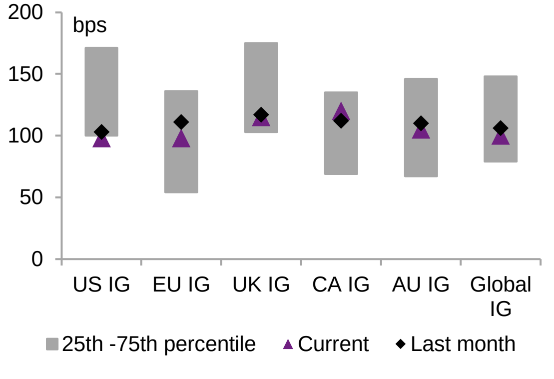
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		• Investment grade markets continue to price-in an expectation for a below average level of credit losses over the medium-term. • 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. • 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. • 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. • Niche and securitized market pricing appears to be pricing-in only a modestly more pessimistic outlook in aggregate, relative to traditional corporate credit markets.
Inv. grade		
High yield		
US		
Europe		
Loans		
US		

Key: Highly negative | Negative | Neutral | Positive | Highly positive

Investment grade spreads tightened modestly over the past month and remain broadly in the mid-to-lower end of their historic interquartile range

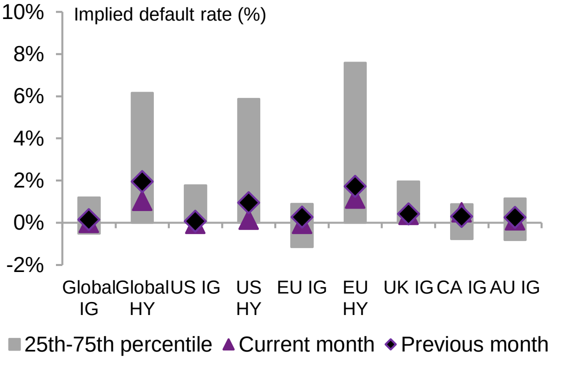
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, Willis Towers Watson.

Market implied default rates remain low relative to history, especially in the US high yield market

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)

31 January 2022

31 January 2022	∆ 1 month			∆ 1 year				∆ 3 years (pa)		
	Total return	EPS	Trailing P/E	Price return	Total return	EPS	Trailing P/E	Total return	EPS	Trailing P/E
Australia	-5.8%	1.1%	-6.4%	4.5%	8.8%	44.8%	-27.5%	9.0%	1.9%	1.1%
Canada	-0.1%	0.1%	-2.1%	23.2%	26.6%	66.1%	-27.2%	13.7%	7.9%	2.4%
Eurozone	-3.0%	-1.6%	-4.2%	19.7%	22.5%	58.9%	-31.4%	12.2%	-2.1%	7.2%
Japan	-5.0%	0.1%	-6.0%	5.4%	7.7%	81.4%	-42.4%	10.1%	0.5%	-0.7%
UK	1.9%	0.0%	1.9%	17.9%	22.7%	118.3%	-45.9%	5.9%	-5.8%	4.8%
US	-5.7%	0.1%	-7.8%	19.3%	20.9%	53.0%	-23.7%	20.9%	9.2%	2.7%
China	-2.9%	1.0%	-6.4%	-30.0%	-29.0%	9.0%	-38.5%	2.7%	-5.7%	-3.9%
MSCI World	-4.9%	-0.4%	-6.6%	17.3%	19.5%	56.3%	-27.8%	17.3%	5.4%	4.3%
MSCI EM	-1.8%	0.0%	-3.3%	-7.5%	-5.3%	55.3%	-42.3%	9.1%	2.3%	-1.8%

Source: FactSet, Willis Towers Watson.

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

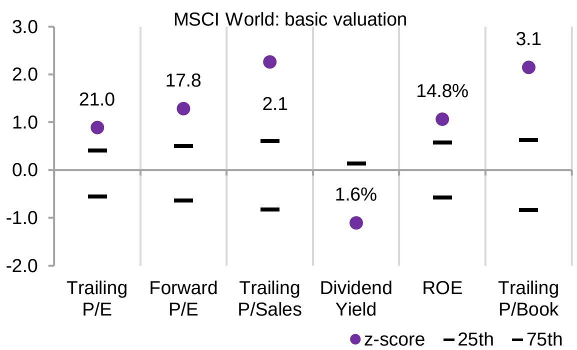
Global equities	Asset return outlook
Developed	
Emerging	

- 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 having broadly recovered from their falls last year, for 2022, the path of inflation and its impact on margins is key for equity markets.
- US valuations remain higher than broader developed markets. This has been concentrated in mega-cap tech stocks, with some recent reversal given their sensitivity to rising US bond yields. We think the outlook for US stocks over the coming five years is less attractive relative to broader markets. Current valuations price-in a continuation of a regime of outsized earnings, inconsistent with a changing policy dynamic in the US, which is less supportive of very high margins and corporations taking an outsized share of profits relative to labour. We continue to think there is moderately better value on offer in European and Japanese markets.
- 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 in 2021, current equity prices are still consistent with good expected 5-year returns in a scenario where earnings continue to grow quickly.

Key: Highly negative | Negative | Neutral | Positive | Highly positive

Basic developed market financial ratios are high but falling as corporate earnings continue to recover

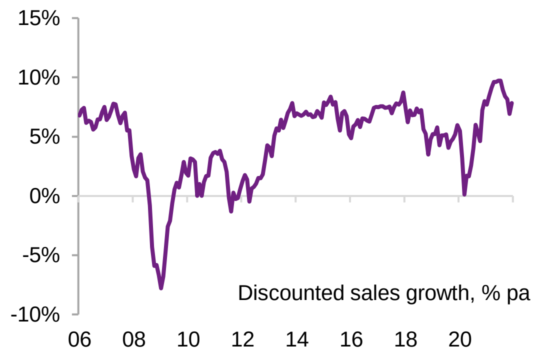
Valuation metrics for the MSCI World equity index



Source: FactSet, Willis Towers Watson.

Earnings growth priced-in to equities is somewhat elevated, but we think achievable in the next few years

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



Source: FactSet, Willis Towers Watson.

Asset Research Team

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