Global Markets Overview

Asset Research Team

February 2022

Our 2022 Investment Outlook

Overview

- As public- and private-sector leaders increasingly integrate economic inclusion and climate change into their policy and growth strategies, investors need to consider the financial benefits and risks which come from the combination effects of this social, environmental, and economic investment
- This is occurring at a time when financial markets are at a pivotal point in the capital cycle. In advanced economies, the major central banks are beginning to tighten monetary policy and governments are slowing their pace of spending in response to strength and high inflation.
- WTW tracks hundreds of specific geographical and sectoral changes driven by changes in policy, supply and demand, investment, and purpose. This type of probabilistic real-world risk assessment enables us to determine which specific components or uncertainties with respect to *prosperity and economic policy*, *inclusive growth*, and *climate transitions* pose the greatest risk and opportunity to financial investors and countries.
- With that we can develop investment strategies that manage that risk, reduce the uncertainty, add financial value, and perhaps create positive social or environmental impact.

Read report Europe North America International

Prosperity: tracking the policy pivot

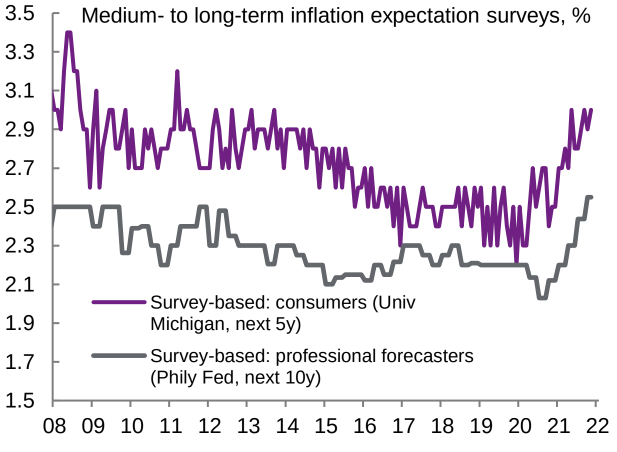
- We have developed a prosperity "dashboard", which aims to help investors track the key features of macro policy and the economy and understand the future financial risk and return environment. It focuses on the following four categories:

  (1) economic policy;
  (2) inflationary pressures;
  (3) the capital cycle; and
  (4) asset prices.

- For example, high current inflation is putting pressure on monetary and fiscal policy. While we forecast inflation to fall in the second half of the year, there is an unusually high level of uncertainty around this outlook. In particular, the risk of high inflation being sustained for longer needs to be watched closely.

Read dashboard
Europe North America International

Survey-based measures of inflation expectations in the US over the next five to ten years have risen to pre-financial crisis levels



Source: FactSet, WTW

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Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

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	-0.69	0.00	-0.01	-0.02	-0.13	-0.43	-0.22	0.16
	5y	-0.26	0.20	0.11	0.49	0.07	-0.09	0.04	0.26
	10y	-0.01	0.18	0.10	0.53	-0.16	0.10	0.18	0.31
	US								
	1y/cash	0.77	0.40	0.59	0.67	-1.80	1.61	1.87	1.97
	5y	1.64	0.38	0.45	1.18	-0.79	1.86	1.94	2.08
	10y	1.81	0.26	0.18	0.67	-0.85	2.00	2.06	2.19
Breakeven infl.	**US (CPI)**								
	3y	3.05	-0.02	0.04	0.82	1.34	-	-	2.20
	5y	2.80	-0.03	-0.05	0.56	1.04	-	-	2.18
	10y	2.52	-0.10	-0.03	0.35	0.70	-	-	2.15

Source: FactSet

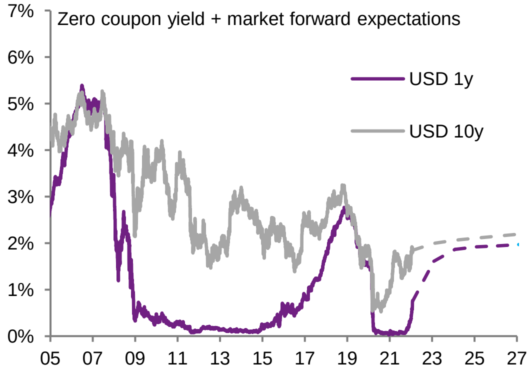
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		• 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 0.50% in February. • 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	Neutral	
UK	Neutral	
AAA-Eurozone	Negative	
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 still 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. Although, the size of this mispricing has fallen. • In our base case we, ultimately, expect structural forces, like debt and demographics, in conjunction with central bank intervention to manage financial conditions, to limit yield escalation. However, we retain a somewhat cautious stance across most major developed bond markets for now.
US	Negative	
UK	Negative	
AAA-Eurozone	Negative	

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

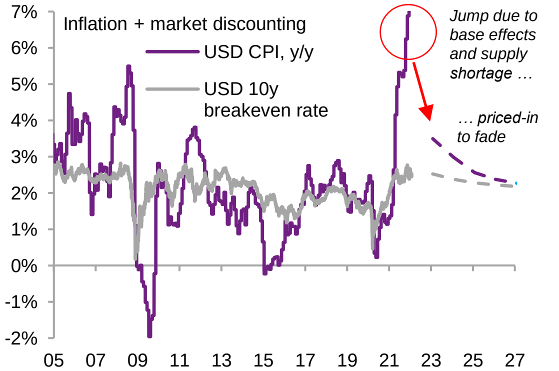
US cash rate and 10y nominal bond yield



Source: FactSet, Willis Towers Watson

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, Willis Towers Watson

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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%
High grade	US	110	12	21	7	-28	-0.1%	-0.1%	0.2%	-0.1%	-1.5%
High grade	Eurozone	107	9	19	13	-37	-0.1%	-0.3%	0.3%	0.1%	-1.4%
High grade	UK	124	9	17	10	-45	0.4%	-0.1%	0.3%	0.1%	-1.7%
High grade	Canada	122	2	10	11	-18	0.5%	0.2%	0.1%	0.1%	-0.7%
High grade	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%
Low grade	US HY	363	53	48	-21	-74	0.1%	-0.8%	-0.1%	-1.1%	-3.2%
Low grade	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

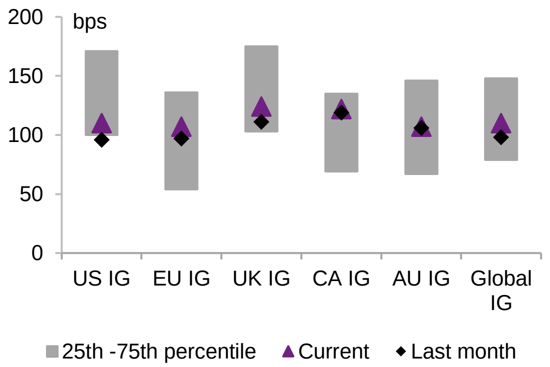
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

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 moderately over the past month but remain broadly in the mid-to-lower end of their historic interquartile range

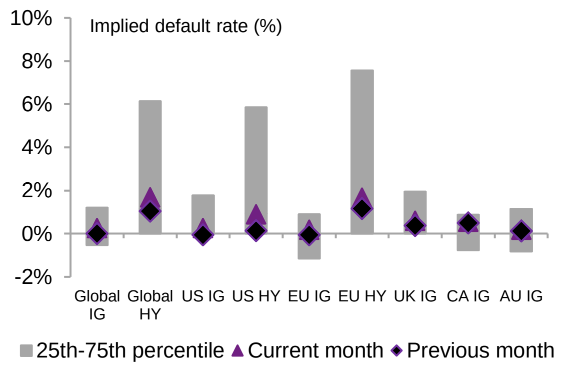
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, Willis Towers Watson.

Market implied default rates remain low relative to history

Estimated implied default rate based on current pricing



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Tracking recent asset price moves and our outlook

Summary: equity

Changes to market pricing (equity)

31 January 2022

31 January 2022	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	-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

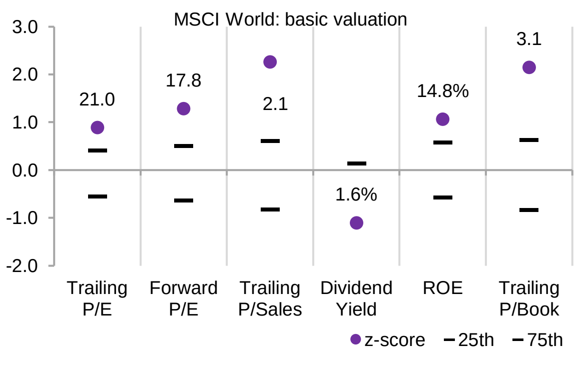
Global equities	Asset return outlook
Developed	
Emerging	

- Markets saw high levels of volatility in January, following a long period without any market corrections. Earnings in advanced economies have risen significantly over the last year – in line with our expectations – which has also 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.
- Overall, we retain a neutral to slightly positive view on equities.

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

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

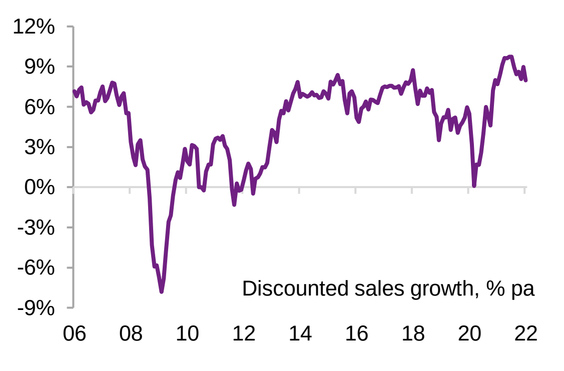
Valuation metrics for the MSCI World equity index



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



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