

Global Markets Overview

Asset Research Team

June 2022

Our latest Investment Outlook & what markets are pricing-in

Overview

- 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. Keeping track of how economic policy “pivots” (tighter) in 2022/23 in response to high inflation, and how much this slows economic growth, is key for portfolio strategy.
- For investors tracking the key features of the economy and understanding the future risk-and-return environment, we suggest focusing on the following three categories:
 - Economic policy:** high inflation is placing pressure on policy to “pivot” tighter. Keeping abreast of both the pace and type of this policy pivot is the first key category of indicators.
 - Inflationary pressures:** high inflation continues to be driven by rising energy and food prices, high demand for goods, and supply chain bottlenecks for those goods. In the US, our baseline remains for CPI inflation to fall gradually from the second half of this year and reach around 2.5% in the second half of 2023. However, 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.
 - Capital cycle:** how the household and business spending cycle responds to higher interest rates and prices will be a key factor in determining both growth and inflation outcomes over 2022/23.

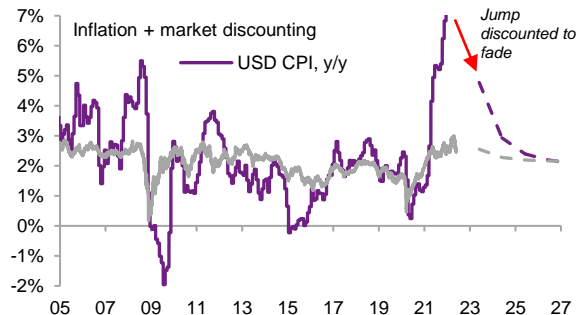
Equity markets have been volatile in recent months as investors gauge these economic and industry impacts. For example, we estimate that US real GDP growth will slow to around 1.5% by the end of this year, with a rising risk of recession. Analyst estimates of future corporate earnings are declining but remain at the higher end of our expectations over the next 1-2 years, considering rising economic risks. This means we have a marginally negative view on the range of equity return outcomes over the shorter-term.

What US markets are pricing-in

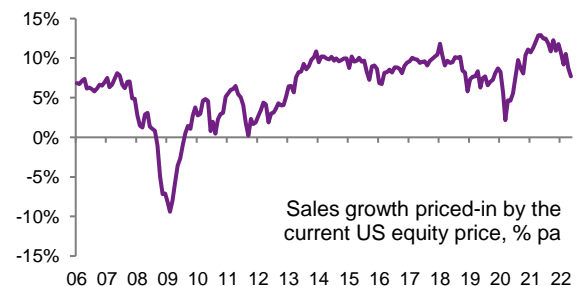
US Treasury yields are more fairly valued following their recent increases, though some upside risks remain in the near term



Expectations for future US inflation over the medium-and-long-term remains anchored. Markets are pricing-in that inflation falls gradually



US equities continue to price-in expectations of high relative earnings growth over the next five years, we think this is unlikely



Source: FactSet, WTW

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

31 May 2022

May 31, 2022		Spot yields					What's priced-in		
% / %pts		Level	Δ 1m	Δ 3m	Δ 1y	Δ 3y	1y fwd	2y fwd	5y fwd
Developed nominal yields	Eurozone								
	1y/cash	0.00	0.26	0.69	0.66	0.57	0.86	1.05	1.23
	5y	0.84	0.15	0.99	1.42	1.42	1.08	1.17	1.34
	10y	1.09	0.21	0.99	1.28	1.27	1.24	1.30	1.41
Developed nominal yields	US								
	1y/cash	2.03	0.01	1.01	1.97	-0.18	3.11	3.10	2.96
	5y	2.85	-0.13	1.07	2.03	0.92	3.01	3.00	3.13
	10y	2.94	0.09	1.08	1.27	0.78	3.10	3.13	3.25
Breakeven infl.	US (CPI)								
	3y	3.41	-0.47	-0.18	0.62	1.90	-	-	2.05
	5y	2.94	-0.39	-0.12	0.34	1.32	-	-	2.09
	10y	2.55	-0.30	-0.10	0.04	0.81	-	-	2.16

Source: FactSet

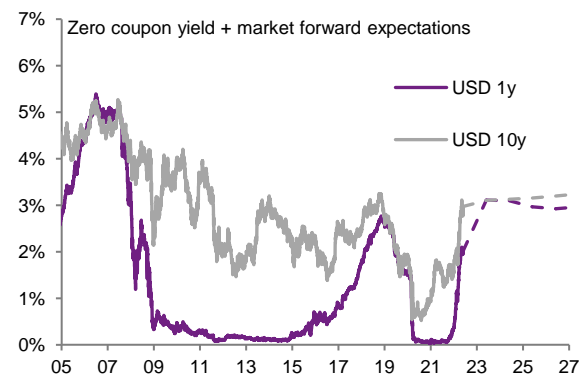
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		<ul style="list-style-type: none"> Central bank guidance is focused on higher policy rates in the face of above-target inflation and reasonable growth, with key markets engaged in hiking cycles.
US		<ul style="list-style-type: none"> The pace of asset purchases has slowed, with the US Federal Reserve now beginning to shrink the volume of assets on its balance sheet. In most developed markets, the future path for short-rates that is priced-in look plausible versus our assessment of economic conditions. This remains true for the Eurozone and Japan, but negative/zero cash rates embed poor returns and an asymmetric risk profile.
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		<ul style="list-style-type: none"> Intermediate bond yields have shifted materially higher since the start of the year, alongside short rate moves, as inflation concern and central bank guidance have shifted. We believe that risks are still skewed to the upside in the near term given ongoing global supply chain risks, low unemployment and rising wage costs, particularly in the US. However, following recent increases in yields, we believe most bond markets are now trading within their medium-term neutral ranges. Under our base case, we expect a combination of tightening monetary and fiscal policy, and stabilizing commodity prices, to help lower inflation gradually. This will likely limit the degree to which yields need to rise from current levels over the medium term.
US		
UK		
AAA-Eurozone		

Key: Highly negative Negative Neutral Positive Highly positive

US Treasury yields are more fairly valued following their recent increases, though some upside risks remain in the near term

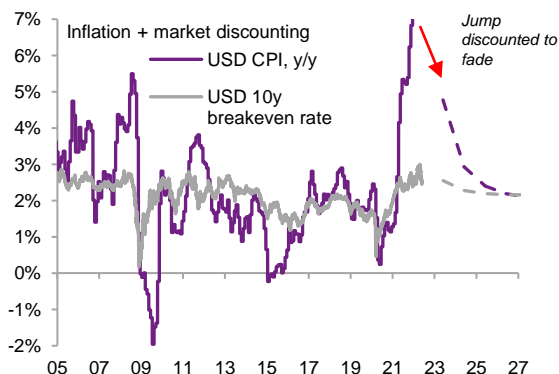
US cash rate and 10y nominal bond yield



Source: FactSet, WTW

Expectations for future US inflation over the medium- and long-term remains anchored. Markets are pricing-in that inflation falls gradually

US CPI inflation rate and inflation market pricing



Source: FactSet, Refinitiv, WTW

Tracking recent asset price moves and our outlook

Summary: credit

Changes to market pricing (credit spreads)

31 May 2022

31 May 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	146	3	10	53	12	1.2%	0.1%	0.3%	1.3%	0.3%
	US	140	-1	10	49	5	1.0%	0.0%	0.3%	1.2%	0.1%
	Eurozone	160	10	12	74	31	1.5%	0.3%	0.3%	1.9%	0.8%
	UK	170	5	17	61	6	1.8%	0.1%	0.4%	1.5%	0.2%
	Canada	162	7	31	47	37	1.6%	0.2%	0.8%	1.2%	0.9%
	Australia	158	12	42	65	45	1.5%	0.3%	1.1%	1.6%	1.1%
Low grade	Global HY	480	28	22	118	11	2.6%	0.4%	0.3%	1.7%	0.2%
	US HY	422	25	45	88	-37	1.7%	0.4%	0.6%	1.3%	-0.5%
	Eurozone HY	474	20	29	171	42	3.2%	0.3%	0.4%	2.4%	0.6%
	US loans	483	67	54	81	76	2.6%	1.0%	0.8%	1.2%	1.1%
HC EMD	Hc EMD Corps	318	18	-46	50	29	4.2%	0.1%	-0.5%	2.1%	0.9%
	HC EMD Sov	362	7	-24	107	47	2.3%	0.3%	-0.7%	0.8%	0.4%

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

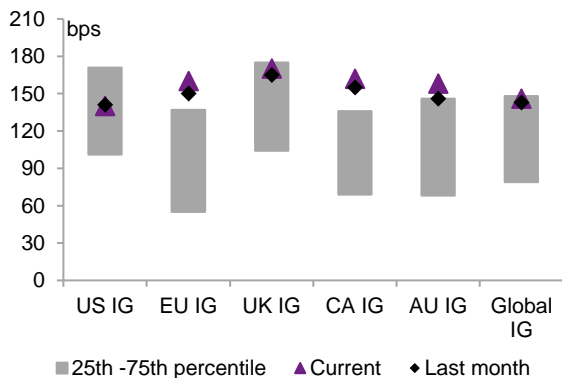
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		<ul style="list-style-type: none"> Increases in investment grade spreads this year means markets are now pricing in a broadly above average allowance for the level of credit losses over the medium-term.
Inv. grade		<ul style="list-style-type: none"> We expect losses to be at or modestly above these levels, particularly in the nearer term, 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 moderate returns above equivalent government bonds.
Europe		<ul style="list-style-type: none"> We retain a somewhat cautious outlook for developed market high-yield credit given shorter-term risks. Current pricing implies a below average level of defaults relative to historic average pricing.
Loans		
US		<ul style="list-style-type: none"> Niche and securitized market pricing appears to be pricing-in only a modestly more pessimistic outlook in aggregate, relative to traditional corporate credit markets.

Key: Highly negative Negative Neutral Positive Highly positive

Global investment grade spreads widened modestly over the past month and are at the upper end of their historic ranges

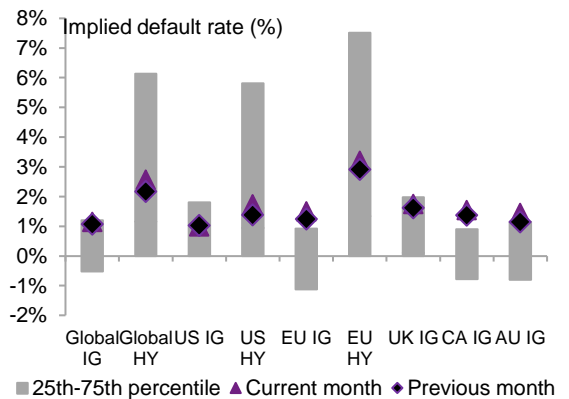
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates also generally increased over the past month

Estimated implied default rate based on current pricing



Source: FactSet, WTW

Tracking recent asset price moves and our outlook

Summary: equity

Changes to market pricing (equity)

31 May 2022

31 May 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	-2.2%	2.5%	-5.0%	0.3%	4.9%	78.3%	-47.7%	7.6%	6.6%	-4.8%
Canada	0.4%	6.2%	-5.6%	4.6%	7.4%	49.2%	-29.3%	11.7%	10.6%	-1.4%
Eurozone	1.7%	4.1%	-2.5%	-6.5%	-3.5%	66.9%	-50.7%	7.8%	6.1%	-4.1%
Japan	-0.6%	-3.6%	3.1%	-2.7%	-0.4%	53.2%	-36.5%	11.1%	5.6%	-1.1%
UK	1.0%	-5.7%	6.8%	10.6%	15.3%	44.7%	-27.4%	5.9%	-2.0%	3.4%
US	0.5%	3.7%	-3.3%	-3.0%	-1.6%	50.6%	-35.6%	16.5%	12.0%	-3.4%
China	-3.2%	-0.4%	-1.4%	-37.7%	-36.8%	-5.6%	-31.0%	-1.5%	-2.6%	-6.9%
MSCI World	0.2%	1.6%	-1.3%	-2.6%	-0.8%	51.0%	-38.0%	13.7%	9.6%	-2.1%
MSCI EM	-3.0%	3.4%	-6.2%	-19.2%	-17.0%	21.3%	-36.7%	5.8%	4.0%	-5.9%

Source: FactSet, Willis Towers Watson.

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

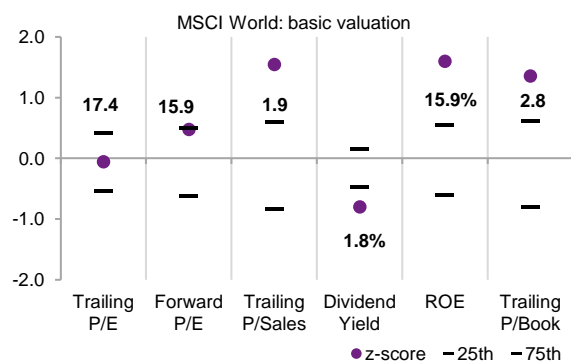
Global equities	Asset return outlook
Developed	Neutral
Emerging	Positive

- Markets continued to experience high volatility in May, driven by valuations pricing-in weakening fundamentals.
- Investors are gauging the expected economic growth impact of continued high inflation, the squeeze in consumer's cost of living, and higher interest rates. Earnings estimates are declining but remain at the higher end of our expectations over the next 1-2 years, considering rising economic risks.
- US valuations continue to price-in expectations of high earnings growth over the next five years, reflecting their long-term earnings outperformance since the global financial crisis; we think this is unlikely in the current macro environment.
- Over the medium term, we see moderately better value on offer in Japanese and emerging markets.
- Recent relative European equity market performance (vs. world equity) has been reasonable, despite the greater economic impact of the current energy supply shock on European economies.
- The weakening near term economic outlook means we have a slightly more negative view on the distribution of equity outcomes, as we see downside risks to consensus earnings estimates over the next year.

Key: Highly negative Negative Neutral Positive Highly positive

Developed market P/E ratios are broadly in line with historical averages, although short-term risks to earnings are rising

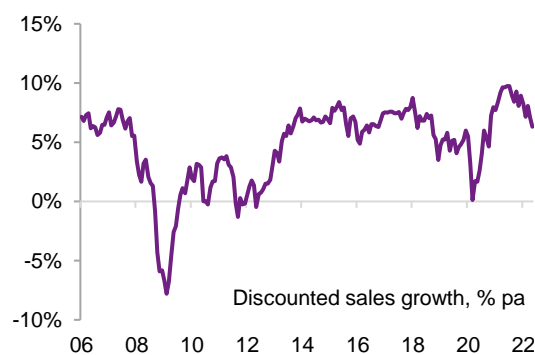
Valuation metrics for the MSCI World equity index



Source: FactSet, WTW

Priced-in sales growth for the next five years has declined over 2022; it remains on the high side after considering the risks to near term earnings estimates

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



Source: FactSet, WTW

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