

# Global Markets Overview

## Asset Research Team

July 2022

### Our latest Investment Outlook & economic developments

#### Overview

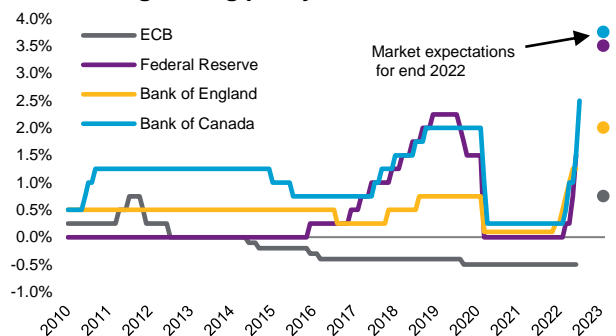
- Financial markets are at a pivotal point in the capital cycle. In advanced economies, the major central banks are aggressively tightening monetary policy and governments are slowing their pace of spending. Keeping track of how economic policy “pivots” (tighter) in 2022/23 in response to high inflation, and how much this slows economic growth, is key for portfolio strategy.
- For investors tracking the key features of the economy to understand 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 duration of this policy pivot is key to monitor.
- 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. 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, particularly in the US where the labour market remains tight.
- 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.

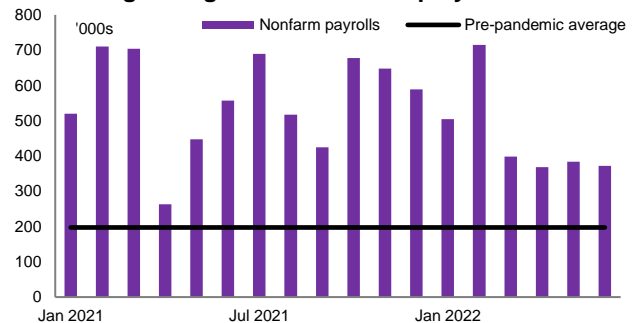
Equity markets have been volatile in recent months as investors gauge these economic and industry impacts. For example, we estimate that US real GDP growth will slow to around 1.5% by the end of this year, with a rising risk of recession. Analyst estimates of future corporate earnings are declining but 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.

#### Key economic developments

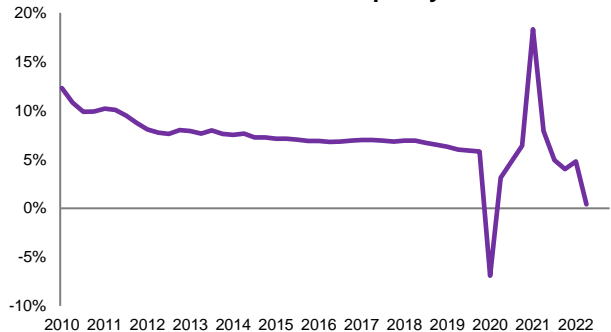
Major central banks have aggressively raised policy rates in recent months and are expected to continue tightening policy in the second half 2022



Job growth in the US labour market has continued to be very strong over the first half of the year, reflecting strong demand from employers



China's GDP growth slowed sharply in the first half of 2022 reflecting the impact of the lockdowns associated with the zero-Covid policy



Source: FactSet, WTW

# Tracking recent asset price moves and our outlook

## Summary: government bonds

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

30 Jun 2022

June 30, 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	<b>Eurozone</b>								
	1y/cash	0.49	0.56	0.93	1.17	1.08	0.83	1.06	1.60
	5y	1.03	0.37	0.55	1.62	1.68	1.25	1.42	1.69
	10y	1.36	0.44	0.76	1.58	1.66	1.49	1.58	1.72
	<b>US</b>								
	1y/cash	2.69	0.72	1.02	2.60	0.77	3.40	3.02	2.99
5y	2.97	0.19	0.42	2.09	1.21	3.02	2.97	3.20	
10y	3.08	0.28	0.80	1.56	1.06	3.15	3.15	3.30	
Breakeven infl.	<b>US (CPI)</b>								
	3y	3.22	-0.19	-0.76	0.56	1.82	-	-	2.00
	5y	2.78	-0.16	-0.55	0.28	1.23	-	-	2.11
	10y	2.48	-0.07	-0.35	0.12	0.81	-	-	2.23

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"> <li>Central bank guidance has become more tilted towards higher policy rates in the face of above-target inflation and robust growth, with key markets engaged in hiking cycles.</li> </ul>
US	↑	<ul style="list-style-type: none"> <li>The pace of asset purchases has slowed, with the Fed gradually beginning to shrink assets on its balance sheet, and forward short rates are notably higher than a year ago.</li> </ul>
UK		<ul style="list-style-type: none"> <li>In most developed markets, priced-in short-rates look plausible versus our assessment of economic conditions. This remains true for Japan given yield curve control, but negative/zero cash rates embed poor returns and/or an asymmetric risk profile.</li> </ul>
AAA-Eurozone		
Developed 10-year nominal bonds		<ul style="list-style-type: none"> <li>Intermediate bond yields have risen materially year-to-date, alongside short rate moves, as inflation concerns have grown, and central bank guidance has become more hawkish.</li> </ul>
US		<ul style="list-style-type: none"> <li>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.</li> </ul>
UK		<ul style="list-style-type: none"> <li>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.</li> </ul>
AAA-Eurozone		

Key: Highly negative Negative Neutral Positive Highly positive

#### US Treasury bonds imply further hikes during H2 2022, with easing pressures further out. Plausible but risks to yields lie somewhat to the upside in the near term

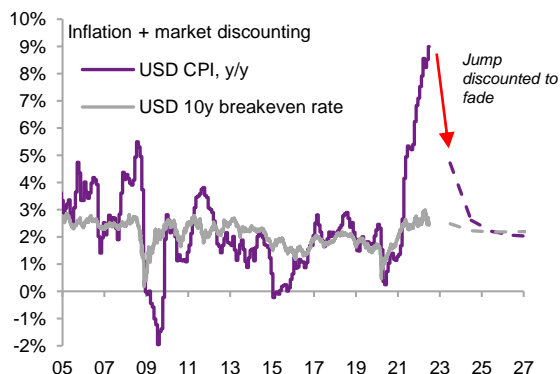
US cash rate and 10y nominal bond yield



Source: FactSet, WTW

#### Expectations for future US inflation have declined, despite strong inflation momentum. Whilst we expect inflation to fall, expectations may under-reflect inflation risks

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)

30 June 2022

30 June 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	176	30	51	87	54	1.9%	0.8%	1.3%	2.2%	1.4%
	US	164	24	42	78	42	1.6%	0.6%	1.1%	2.0%	1.1%
	Eurozone	212	52	83	128	98	2.8%	1.3%	2.1%	3.2%	2.5%
	UK	206	36	61	100	57	2.7%	0.9%	1.5%	2.5%	1.4%
	Canada	166	4	19	52	44	1.7%	0.1%	0.5%	1.3%	1.1%
	Australia	182	24	45	92	74	2.1%	0.6%	1.1%	2.3%	1.9%
Low grade	Global HY	642	162	230	295	224	4.9%	2.3%	3.3%	4.2%	3.2%
	US HY	587	165	244	283	180	4.1%	2.4%	3.5%	4.0%	2.6%
	Eurozone HY	641	167	241	345	270	5.6%	2.4%	3.4%	4.9%	3.9%
	US loans	554	71	124	153	141	3.6%	1.0%	1.8%	2.2%	2.0%
HC EMD	Hc EMD Corps	366	48	63	100	94	5.7%	1.4%	2.2%	3.4%	3.1%
	HC EMD Sov	433	71	111	172	153	3.0%	0.7%	1.0%	1.5%	1.4%

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

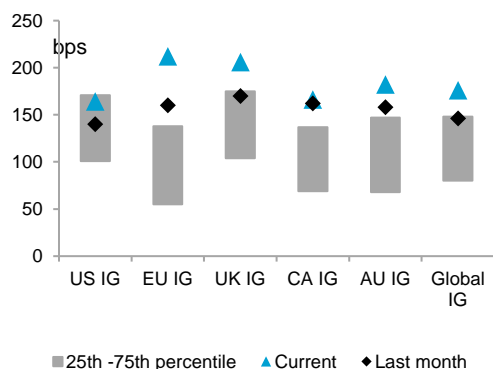
### A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

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

Key: Highly negative Negative Neutral Positive Highly positive

Investment grade spreads widened modestly over the past month and have moved beyond the upper end of their interquartile ranges

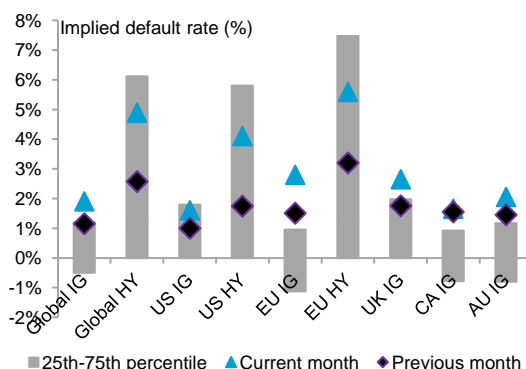
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates also generally increased over the 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)

30 June 2022

30 June 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	-8.1%	-0.9%	-7.4%	-9.1%	-5.0%	75.6%	-48.3%	3.3%	6.5%	-7.2%
Canada	-8.5%	3.5%	-12.0%	-6.1%	-3.4%	43.8%	-34.7%	7.6%	11.6%	-5.4%
Eurozone	-9.4%	-1.4%	-10.5%	-15.6%	-12.8%	65.7%	-55.1%	2.5%	6.2%	-8.0%
Japan	-1.2%	0.1%	-1.5%	-3.9%	-1.6%	56.3%	-38.5%	9.5%	6.4%	-2.3%
UK	-4.8%	0.0%	-5.1%	4.8%	9.2%	45.9%	-28.2%	2.8%	-1.5%	1.4%
US	-8.9%	0.4%	-9.4%	-14.0%	-12.8%	48.5%	-42.1%	10.4%	12.4%	-6.5%
China	11.6%	0.0%	10.4%	-32.0%	-30.7%	-6.2%	-26.0%	-0.4%	-2.7%	-4.2%
MSCI World	-8.1%	-0.5%	-8.7%	-12.4%	-10.7%	48.3%	-43.1%	8.4%	9.7%	-5.0%
MSCI EM	-1.6%	-0.6%	-3.5%	-22.2%	-19.9%	20.8%	-39.8%	3.6%	3.9%	-7.2%

Source: FactSet, Willis Towers Watson.

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

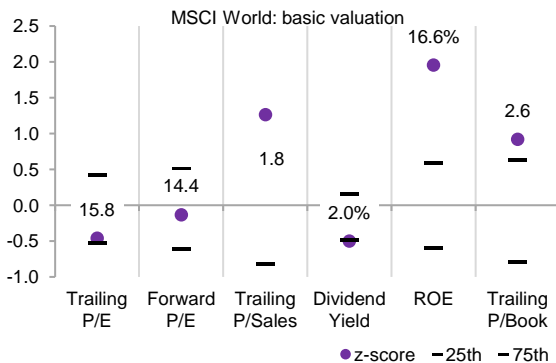
Global equities	Asset return outlook
Developed	
Emerging	

- Company earnings in advanced economies have risen significantly over the last year – in line with our expectations – which, along with higher bond yields, 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. Leading growth indicators have weakened recently as confidence has been impacted by the cost of living squeeze caused by rising prices.
- Many key global equity markets are in a bear market, defined as a fall of 20% from peak. However we remain cautious for the near term outlook, as negative price movements have not been driven by material changes in earnings expectations
- US valuations remain higher than broader equity markets. We think the outlook for US stocks over the coming five years is less attractive relative to wider equities. 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.
- EM valuations are lower vs. developed markets – we expect relative EM valuations to rise.
- Overall, we retain a neutral view on equities over a five-year horizon.

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, WTW

#### 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, WTW

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