Global Markets Overview

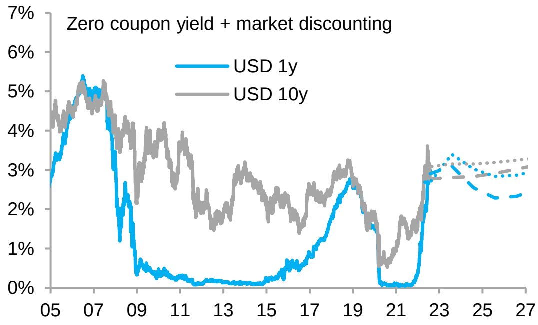
Asset Research Team

August 2022

Tracking changes in global interest rates markets over three months

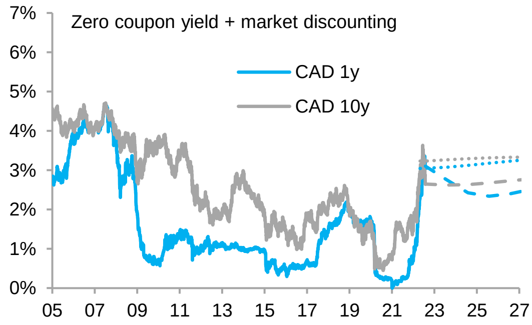
US bond yields still imply further policy rate hikes over the next year but more aggressive easing afterwards

US cash rate and 10y yield



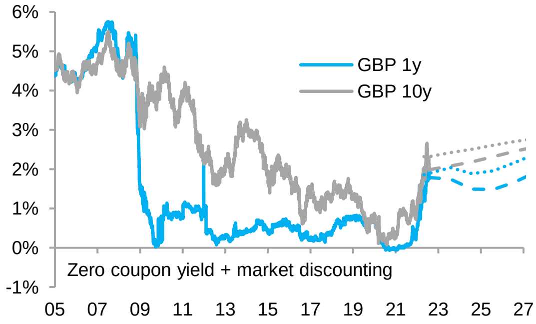
The expected peak in Canadian policy rates is unchanged; the future easing priced-in is in-line with the US

Canada discounted cash rate and 10y yield



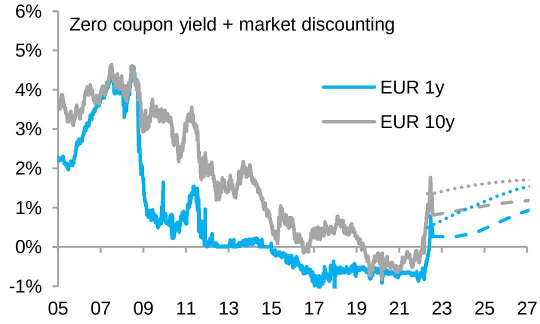
Expectations for UK rates have fallen by less than the US; consistent with UK inflation being more "sticky"

UK discounted cash rate and 10y yield



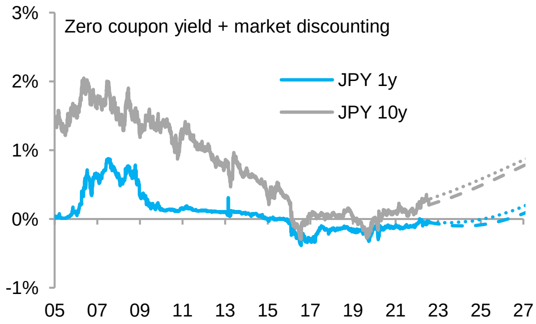
Eurozone policy rates are now expected to fall over the next two years; recession fears are driving bond yields

Eurozone discounted cash rate and 10y yield



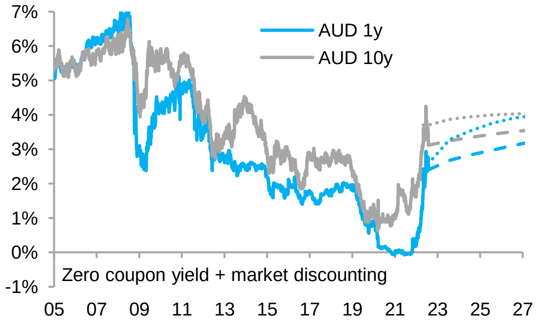
Japanese bond yields and priced-in policy rates are largely unchanged due to central bank yield control

Japan discounted cash rate and 10y yield



Australian bond yields are the highest among the major markets and rates are priced to carry on rising

Australia discounted cash rate and 10y yield



Discounted 1y rate — Discounted 10y rate — Discounted 1y rate (3m ago) — Discounted 10y rate (3m ago)

Source: Factset, Refinitiv, Willis Towers Watson

wtwco.com

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

31 July 2022

July 31, 2022 % / %pts		Spot yields					What's priced-in		
		Level	Δ 1m	Δ 3m	Δ 1y	Δ 3y	1y fwd	2y fwd	5y fwd
Developed nominal yields	**Eurozone**								
	1y/cash	0.27	-0.22	0.53	0.98	0.94	0.25	0.36	1.01
	5y	0.46	-0.57	-0.22	1.22	1.19	0.61	0.79	1.15
	10y	0.82	-0.54	-0.06	1.29	1.25	0.91	1.01	1.20
	US								
	1y/cash	2.91	0.22	0.89	2.84	0.93	3.10	2.55	2.52
	5y	2.65	-0.32	-0.33	1.94	0.81	2.56	2.49	2.91
	10y	2.75	-0.33	-0.10	1.44	0.71	2.81	2.83	3.13
Breakeven infl.	**US (CPI)**								
	3y	2.98	0.12	-0.92	0.19	1.52	-	-	2.05
	5y	2.74	0.27	-0.55	0.07	1.14	-	-	2.02
	10y	2.41	0.05	-0.51	-0.02	0.71	-	-	2.04

Source: FactSet

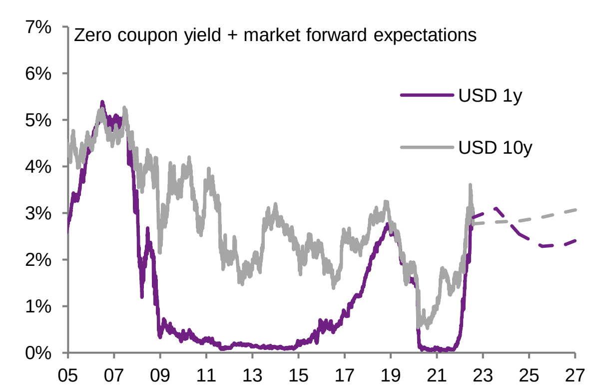
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		• Central bank guidance has become more biased towards higher policy rates in the face of above-target inflation and acceptable growth, with key markets engaged in hiking cycles. • The pace of asset purchases has also slowed, with the Fed gradually beginning to shrink assets on its balance sheet. • In most developed markets, priced-in short-rates look plausible versus our assessment of economic conditions. While this is true for Japan, given yield curve control, their negative/zero cash rates embed poor returns and/or an asymmetric risk profile.
US		
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		• Intermediate bond yields have risen materially year-to-date, alongside short rate moves, as inflation concerns have grown and central bank guidance has focused on tightening. • We believe that risks are still skewed towards higher bond yields in the near term, given ongoing global supply chain risks, low unemployment and high 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 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 bond yields imply further rate hikes during H2 2022, with easing pressures further out; while plausible, risks to yields are somewhat to the upside in the near term

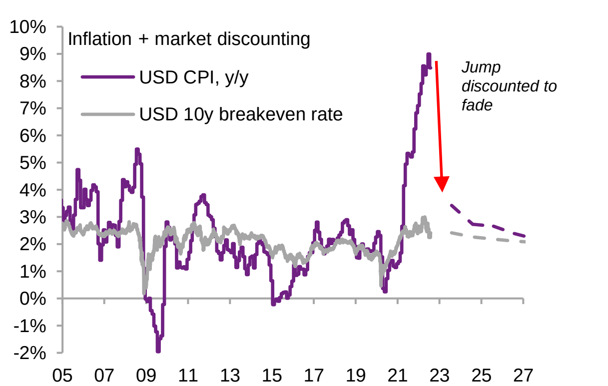
US cash rate and 10y nominal bond yield



Source: FactSet, WTW

Expectations for future US inflation have declined, despite high current inflation. While we expect inflation to fall gradually, expectations may under-reflect inflation risk

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 July 2022

31 July 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	163	-13	20	70	50	1.6%	-0.3%	0.5%	1.8%	1.3%
	US	153	-11	12	61	39	1.3%	-0.3%	0.3%	1.5%	1.0%
	Eurozone	184	-28	34	99	82	2.1%	-0.7%	0.9%	2.5%	2.1%
	UK	193	-13	28	86	49	2.3%	-0.3%	0.7%	2.2%	1.2%
	Canada	169	3	14	54	53	1.7%	0.1%	0.4%	1.4%	1.3%
	Australia	174	-8	28	86	73	1.9%	-0.2%	0.7%	2.2%	1.8%
Low grade	Global HY	559	-83	107	177	152	3.7%	-1.2%	1.5%	2.5%	2.2%
	US HY	483	-104	86	151	90	2.6%	-1.5%	1.2%	2.2%	1.3%
	Eurozone HY	581	-60	127	268	212	4.7%	-0.9%	1.8%	3.8%	3.0%
	US loans	514	-41	98	107	104	3.1%	-0.6%	1.4%	1.5%	1.5%
HC EMD	Hc EMD Corps	367	1	67	72	109	5.4%	-0.2%	1.3%	2.9%	3.2%
	HC EMD Sov	422	-11	67	145	158	3.0%	0.0%	1.0%	1.1%	1.7%

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

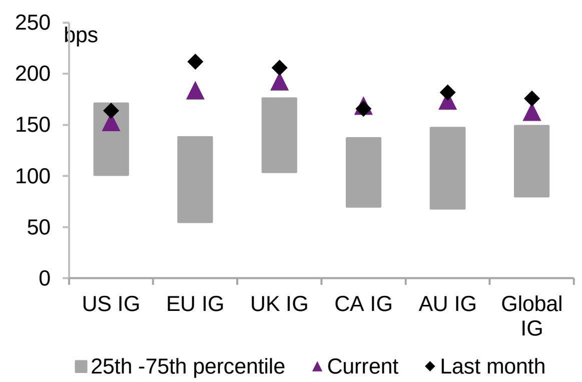
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		• Increases in investment grade spreads this year mean markets are now pricing in a broadly above average allowance for the level of credit losses over the medium-term. • We expect losses to be at or modestly above these levels, particularly in the nearer term, with risks tilted towards higher losses. • At current credit spreads, high quality credit assets are at levels at which they are likely to provide moderate returns above equivalent maturity government bonds. • We retain a somewhat cautious outlook for developed market speculative-grade credit given shorter-term risks. After the falls in high yield spreads in July, current pricing implies an average-like level of defaults relative to historic average pricing – again we think risks are more tilted towards higher losses in the shorter-term.
Inv. grade		
High yield		
US		
Europe		
Loans		
US		

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

Investment grade spreads tightened over the past month but remain at or above the upper end of their historic interquartile ranges

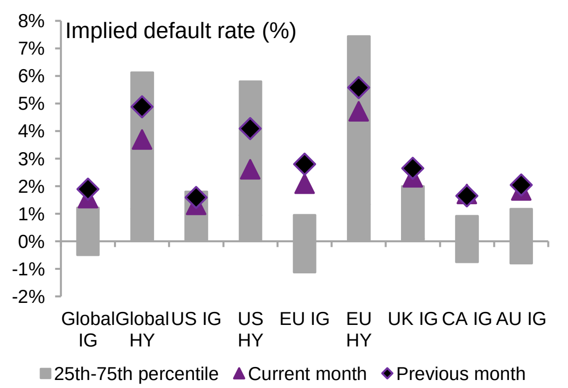
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates across global investment grade and high yield markets also fell moderately in July

Estimated implied default rate based on current pricing



Source: FactSet, WTW

Asset Research Team

Tracking recent asset price moves and our outlook

Summary: equity

Changes to market pricing (equity)

31 July 2022

31 July 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	5.0%	-0.4%	5.4%	-5.4%	-1.0%	75.4%	-46.0%	4.1%	6.4%	-5.6%
Canada	4.3%	-0.2%	4.2%	-2.9%	-0.1%	43.9%	-32.5%	9.1%	11.4%	-4.2%
Eurozone	7.5%	-1.9%	6.8%	-10.3%	-7.4%	60.2%	-51.8%	5.0%	5.7%	-6.0%
Japan	4.0%	0.1%	3.9%	2.3%	4.8%	55.7%	-34.3%	10.6%	6.5%	-1.0%
UK	3.5%	0.9%	2.5%	8.2%	12.8%	63.4%	-33.8%	3.3%	1.7%	-0.9%
US	9.3%	-0.2%	9.4%	-8.2%	-6.9%	47.3%	-37.5%	13.2%	12.4%	-3.7%
China	-9.3%	2.1%	-11.3%	-28.7%	-27.1%	-3.3%	-24.4%	-3.4%	-2.6%	-7.9%
MSCI World	8.0%	-1.1%	9.1%	-7.0%	-5.2%	46.0%	-38.6%	10.8%	9.6%	-2.5%
MSCI EM	0.2%	-2.4%	1.7%	-17.2%	-14.6%	17.3%	-33.8%	4.0%	3.8%	-6.8%

Source: FactSet, Willis Towers Watson.

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

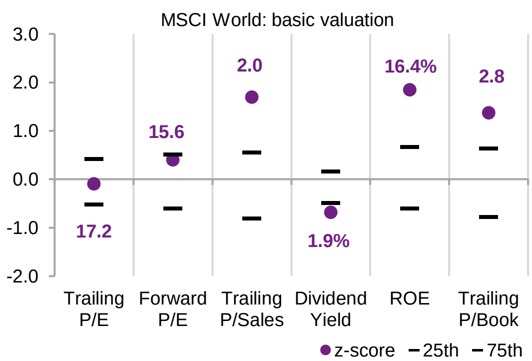
Global equities	Asset return outlook
Developed	
Emerging	

- 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 regional equity markets still have negative returns over the last year, despite their partial recovery in July. However, we remain cautious for the near term outlook, as these negative price movements have not been driven by material downward revisions in earnings expectations.
- US valuations remain higher than broader equity markets. Over the medium term, we see moderately better value on offer in Japanese and UK markets.
- EM valuations are lower vs. developed markets – we expect relative EM valuations to rise and are neutral to moderately positive on EM.
- Overall, we retain a broadly neutral view on equities over a five-year horizon.

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

Basic developed market financial ratios are in-line with historical averages but still face potential near term earnings risk

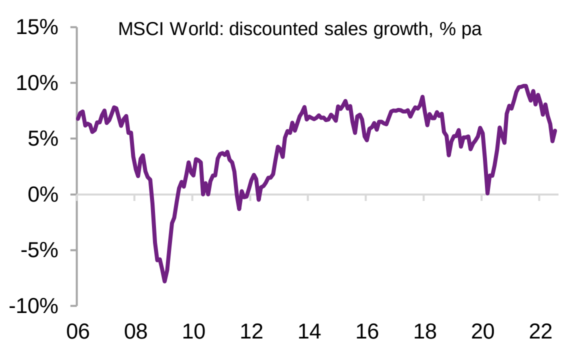
Valuation metrics for the MSCI World equity index



Source: FactSet, WTW

Earnings growth priced-in to equities has fallen over 2022; over the short-term it remains somewhat elevated relative to expectations but is achievable over five years

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



Source: FactSet, WTW

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