Global Markets Overview

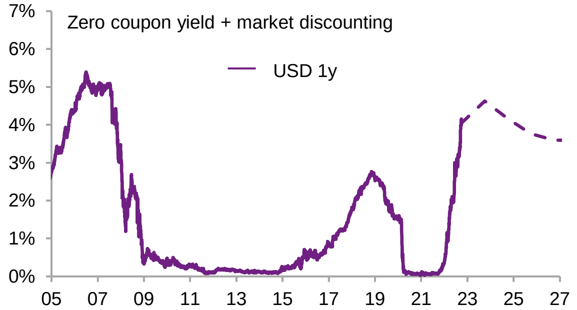
Asset Research Team

October 2022

Markets remain focused on Goldilocks rather than the bear(s)

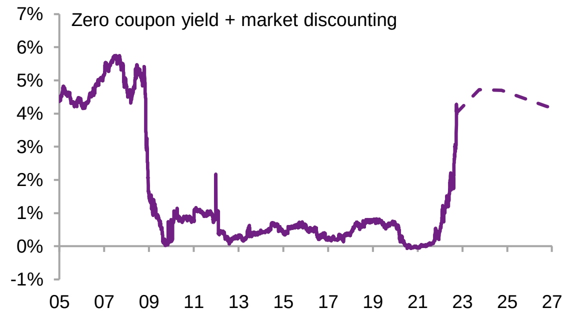
Markets are pricing-in that the US Federal Reserve will continue to hike its policy rate over the next 6-months …

US 1-year yield, %



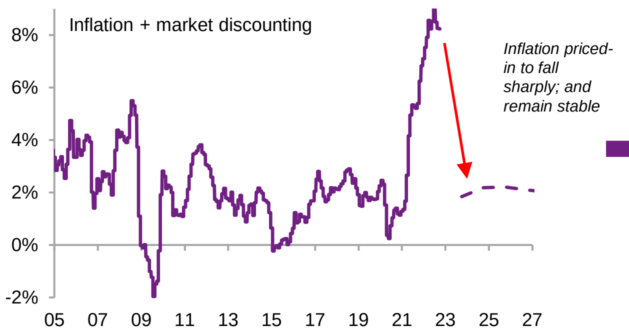
… and so will the Bank of England.

UK 1-year yield, %



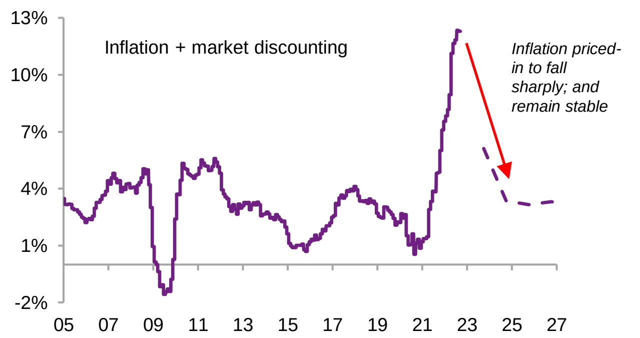
Bond investors are expecting these tighter monetary conditions to bring down inflation quickly in the US in 2023 …

US CPI inflation rates



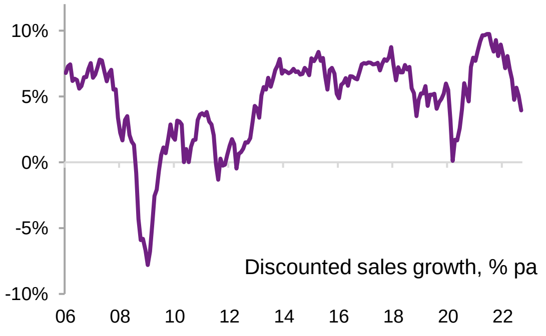
… and also in the UK.

UK RPI inflation rates



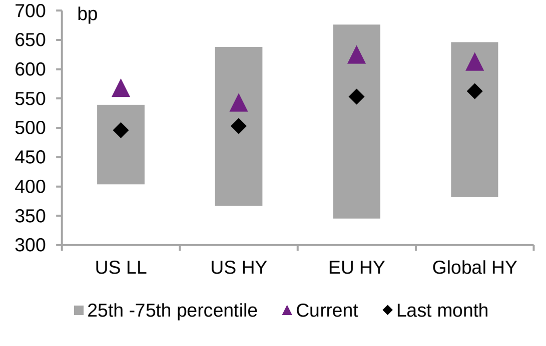
Equity markets are also pricing-in that this will be achieved with only a small slowdown in GDP and earnings growth …

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



… and so are corporate credit markets, especially in the US.

Credit spreads on leveraged loans (LL) and high yield (HY), bp



Source: Factset, Refinitiv, Federal Reserve, Bank of England, WTW

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)
30 September 2022

	Sep 30, 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	1.64	0.93	1.15	2.35	2.37	1.77	1.91	2.20
	5y	1.90	0.61	0.87	2.46	2.68	2.01	2.10	2.22
	10y	2.06	0.58	0.70	2.26	2.64	2.12	2.16	2.19
	US								
	1y/cash	4.05	0.69	1.36	3.97	2.30	4.62	4.16	3.59
	5y	4.06	0.75	1.09	3.07	2.51	3.95	3.75	3.72
	10y	3.85	0.71	0.77	2.25	2.16	3.86	3.79	3.82
Breakeven infl.	**US (CPI)**								
	3y	2.12	-0.64	-0.74	-0.46	0.88	-	-	1.96
	5y	2.13	-0.59	-0.34	-0.44	0.77	-	-	1.99
	10y	2.10	-0.39	-0.26	-0.31	0.63	-	-	1.93

Source: FactSet

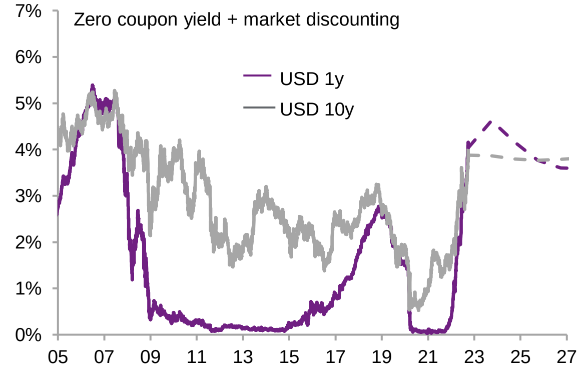
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		• Central bank guidance remains 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 slowed and moved negative (via sales or redemptions) for some central banks, while forward short rates are notably higher than a year ago. • In most developed markets, priced-in short-rates look plausible versus our assessment of economic conditions.
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. • While yields may continue to push higher while central banks are engaged in hiking, following recent increases, we believe most bond markets are now trading within their neutral ranges. • This is most clearly the case in the US. In the UK, fiscal and financial stability risks mean this outlook is less certain. In wider Europe, greater exposure to the Ukraine conflict through energy prices increases both inflation and recession risks – the implication for nominal bond returns is uncertain.
US		
UK		
AAA-Eurozone		

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

US Treasury bond yields imply further rate hikes over the next 6 months, with easing pressures further out; this is plausible but there are a wide range of outcomes around it

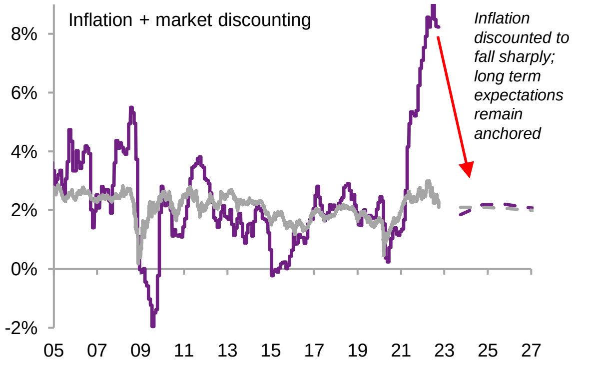
US cash rate and 10y nominal bond yield



Source: FactSet, WTW

US inflation expectations have declined despite high current inflation. We expect inflation to fall gradually, but the pace of decline may be slower than priced-in

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 September 2022

30 September 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	180	19	4	90	59	2.0%	0.5%	0.1%	2.3%	1.5%
	US	167	19	3	78	45	1.7%	0.5%	0.1%	2.0%	1.1%
	Eurozone	221	23	9	136	109	3.0%	0.6%	0.2%	3.4%	2.7%
	UK	244	42	38	140	91	3.6%	1.1%	1.0%	3.5%	2.3%
	Canada	173	7	7	58	47	1.8%	0.2%	0.2%	1.5%	1.2%
	Australia	184	12	2	89	81	2.1%	0.3%	0.0%	2.2%	2.0%
Low grade	Global HY	613	51	-29	240	188	4.5%	0.7%	-0.4%	3.4%	2.7%
	US HY	543	40	-44	228	141	3.5%	0.6%	-0.6%	3.3%	2.0%
	Eurozone HY	625	72	-16	321	259	5.4%	1.0%	-0.2%	4.6%	3.7%
	US loans	568	72	14	169	132	3.8%	1.0%	0.2%	2.4%	1.9%
HC EMD	Hc EMD Corps	357	23	-9	68	72	5.4%	0.8%	-0.2%	2.9%	2.2%
	HC EMD Sov	421	40	-12	144	108	2.9%	0.4%	-0.1%	1.0%	1.1%

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

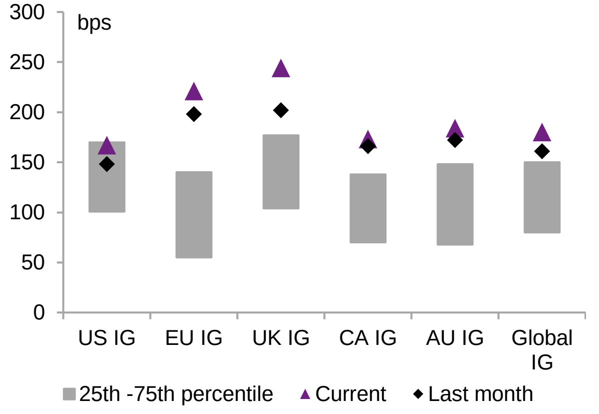
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		• Increases in investment grade spreads this year mean markets are now pricing in an 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 government bonds. • We retain a somewhat cautious outlook for developed market speculative-grade credit given shorter-term risks. Current pricing implies a roughly average level of defaults relative to historic average pricing, despite rising economic and corporate risks. • Niche and securitized market pricing appears to be pricing-in similar 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 widened over the past month and are above the upper end of their interquartile ranges

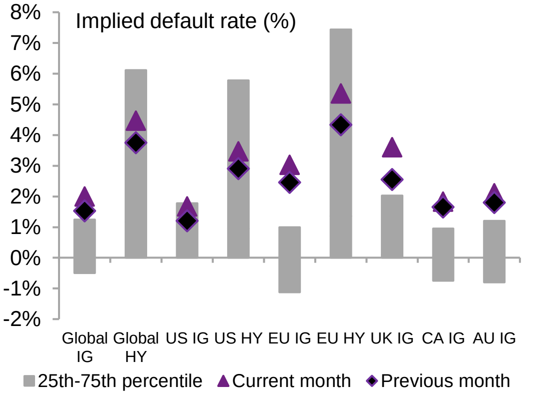
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates increased moderately in all corporate credit markets over the past month

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)

30 September 2022

30 September 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	-5.9%	0.0%	-7.4%	-10.4%	-6.0%	28.7%	-30.4%	2.3%	6.7%	-9.4%
Canada	-4.9%	-0.6%	-4.7%	-7.9%	-5.0%	24.1%	-25.8%	6.2%	10.5%	-7.0%
Eurozone	-7.0%	-4.1%	-5.0%	-19.3%	-16.6%	12.9%	-39.5%	0.3%	4.3%	-9.2%
Japan	-6.5%	0.0%	-7.5%	-10.3%	-7.9%	6.7%	-15.9%	7.7%	4.3%	-1.3%
UK	-6.0%	0.4%	-6.6%	-0.2%	3.8%	41.2%	-29.3%	1.6%	8.0%	-9.4%
US	-10.0%	-0.6%	-9.6%	-18.5%	-17.2%	18.5%	-31.2%	8.1%	11.0%	-7.0%
China	-13.7%	-2.6%	-9.6%	-35.2%	-33.8%	-13.6%	-19.7%	-6.8%	-6.2%	-8.8%
MSCI World	-8.9%	-1.4%	-8.8%	-16.8%	-15.1%	14.4%	-30.9%	6.3%	8.2%	-6.1%
MSCI EM	-9.2%	-3.0%	-9.1%	-23.7%	-21.1%	-0.2%	-30.0%	1.4%	2.7%	-10.0%

Source: FactSet, Willis Towers Watson.

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

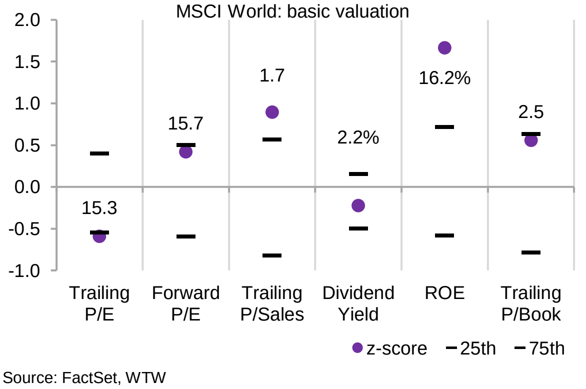
Global equities	Asset return outlook
Developed	
Emerging	

- Company earnings in advanced economies have risen 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. Earnings are likely to begin to show signs of weakness as the world economy slows; the extent of short term risks is also not currently reflected in analyst earnings expectations.
- With earnings having broadly recovered from their falls last year, for 2023, the path of inflation, growth and interest rates and their impact on margins is key for equity markets. Leading growth indicators have continued to weaken with confidence 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 the earnings outlook.
- We continue to see value in Japanese equities; with valuations remaining low relative to broader DM counterparts. Recent price moves also make UK equities more attractive.
- Overall, we retain a neutral view on equities over a five-year horizon but are cautious nearer-term, despite the fall in equity prices over the last year.

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

Basic developed market financial ratios are high – due to the US – despite shorter-term economic risks

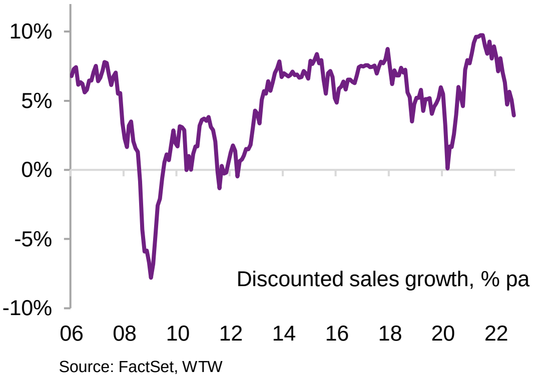
Valuation metrics for the MSCI World equity index



Source: FactSet, WTW

Earnings growth priced-in to equities remains elevated – earnings risk is to the downside over the next year

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



Source: FactSet, WTW

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