Global Markets Overview

Asset Research Team

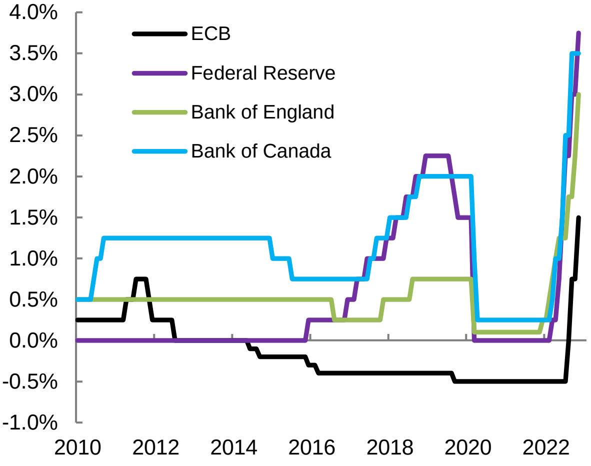
November 2022

Our latest economic outlook is characterised by higher than normal uncertainty and high regional differences

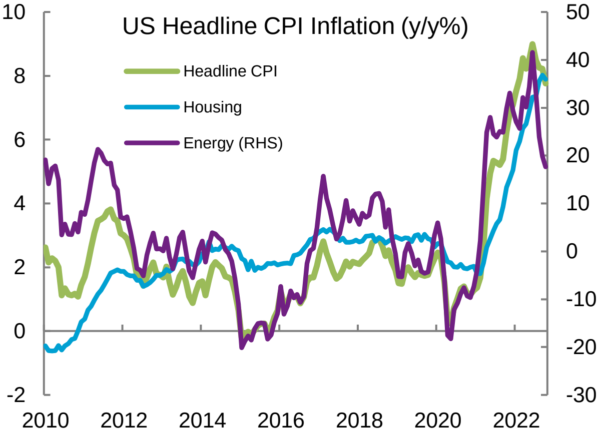
Major economies outlook

- We expect material slowdowns in GDP growth in the US and Europe in 2023. This is, in part, driven by the aggressive increase in policy rates that we have seen over 2022 and concerns over energy supply in Europe.
- Central banks in the major western economies have continued to increase policy rates at a fast pace in the second half of 2022; we expect them to increase policy rates further over the next four months, but at a slower pace.
- The latest US CPI data is consistent with our view that headline inflation has peaked and will decline over 2023:
  - The inflationary impact from energy, food, and goods prices is declining;
  - Shelter cost inflation is likely to gradually fall, given broader housing market weakness.
- However, unemployment rates are very low in the US and Europe and wage pressures either remain high or are rising. This leads to the risk of wage growth and core inflation becoming more entrenched in 2023 than expected. Ultimately, this would likely require even more monetary tightening to bring down inflation, which would increase the likelihood of a deeper and longer economic contraction.
- Therefore, as we move towards these late-cycle dynamics in 2023, there is a wider than normal range of possible economic outcomes in western advanced economies.
- Economic conditions are expected to be more favourable next year in the major Asian economies, on a relative basis, particularly in China and Japan.

Central bank policy rates are now well above pre-pandemic levels in most major advanced economies; we expect rates to increase further and this increases recession risks



Recent price data in the US shows a decline in headline inflation in line with our expectations; housing costs have been a major driver recently – this should also decline over 2023 as the housing rental market cools.



Source: FactSet, WTW

wtwco.com

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

31 October 2022

October 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	1.86	0.22	1.59	2.49	2.45	1.97	1.88	2.24
	5y	1.99	0.09	1.52	2.37	2.62	2.08	2.13	2.25
	10y	2.15	0.09	1.33	2.25	2.55	2.17	2.19	2.25
	US								
	1y/cash	4.56	0.51	1.65	4.38	3.04	4.72	4.13	3.89
	5y	4.21	0.15	1.56	3.02	2.69	4.06	3.93	4.16
	10y	4.16	0.31	1.41	2.53	2.45	4.16	4.14	4.31
Breakeven infl.	**US (CPI)**								
	3y	2.64	0.52	-0.34	-0.38	1.39	-	-	2.32
	5y	2.56	0.42	-0.18	-0.30	1.19	-	-	2.37
	10y	2.50	0.40	0.08	-0.06	1.02	-	-	2.38

Source: FactSet

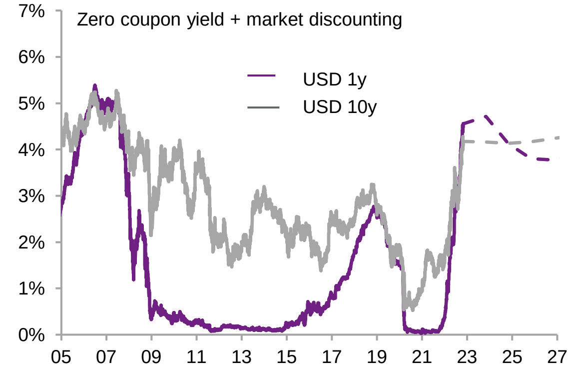
A summary of our assessment of government bond pricing and prospective medium-term outcomes

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, with key markets engaged in hiking cycles. • The pace of asset purchases has also slowed and moved negative (via sales or redemptions) for some central banks, which is an additional tightening. • 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 wider Europe, greater exposure to the Ukraine conflict through energy prices increases both inflation and recession risks – the implication for nominal bond returns is especially uncertain.
US		
UK		
AAA-Eurozone		

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

US Treasury bond yields imply further rate hikes over the next 4-6 months, with easing pressures further out; this is plausible but there are a wide range of outcomes around it

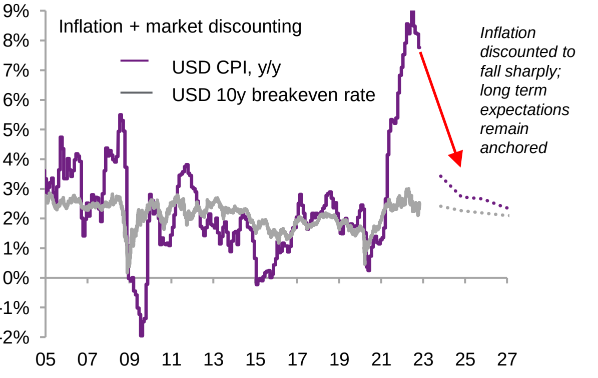
US cash rate and 10y nominal bond yield



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

Asset Research Team

Tracking recent asset price moves and our outlook

Summary: credit

Changes to market pricing (credit spreads)
31 October 2022

31 October 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	180	0	17	88	65	2.0%	0.0%	0.4%	2.2%	1.6%
	US	166	-1	13	77	49	1.7%	0.0%	0.3%	1.9%	1.2%
	Eurozone	216	-5	32	128	113	2.9%	-0.1%	0.8%	3.2%	2.8%
	UK	227	-17	34	120	83	3.2%	-0.4%	0.9%	3.0%	2.1%
	Canada	184	11	15	72	59	2.1%	0.3%	0.4%	1.8%	1.5%
	Australia	207	23	33	105	103	2.7%	0.6%	0.8%	2.6%	2.6%
Low grade	Global HY	550	-63	-9	163	124	3.6%	-0.9%	-0.1%	2.3%	1.8%
	US HY	463	-80	-20	148	48	2.3%	-1.1%	-0.3%	2.1%	0.7%
	Eurozone HY	580	-45	-1	258	208	4.7%	-0.6%	0.0%	3.7%	3.0%
	US loans	490	-78	-24	89	34	2.7%	-1.1%	-0.3%	1.3%	0.5%
HC EMD	Hc EMD Corps	372	15	5	68	95	4.9%	-0.5%	-0.5%	2.3%	1.6%
	HC EMD Sov	397	-24	-25	117	80	3.1%	0.2%	0.1%	1.0%	1.5%

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

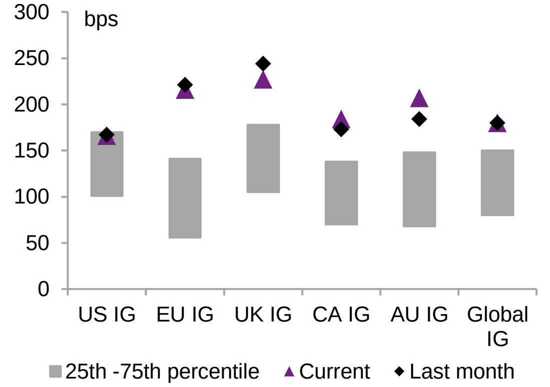
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		• 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 broadly average level of defaults relative to historic average pricing; too low relative to rising economic and earnings risks. • Niche and securitized market pricing appears to be pricing-in a 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 tightened modestly over the past month but remain above the upper end of their historic interquartile ranges

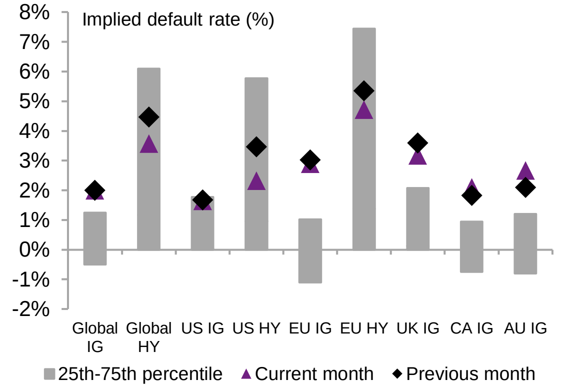
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates also fell moderately over the past month; in high yield especially

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 October 2022

31 October 2022	Δ 1 month			Δ 1 year				Δ 3 years (pa)		
	Total ret	EPS	Trailing P/E	Price return	Total ret	EPS	Trailing P/E	Total ret	EPS	Trailing P/E
Australia	4.8%	0.0%	4.7%	-6.1%	-1.4%	28.4%	-26.9%	4.0%	6.7%	-8.0%
Canada	6.0%	-0.1%	5.9%	-7.3%	-4.4%	24.1%	-25.3%	8.6%	10.5%	-5.2%
Eurozone	7.7%	-0.3%	9.7%	-16.8%	-14.1%	12.8%	-36.5%	2.5%	4.4%	-6.3%
Japan	4.0%	0.1%	3.9%	-5.5%	-3.0%	6.7%	-11.5%	7.4%	4.3%	-0.1%
UK	2.2%	0.3%	1.8%	-0.4%	3.6%	46.4%	-31.9%	3.0%	7.7%	-9.1%
US	8.7%	0.3%	8.3%	-17.1%	-15.9%	18.3%	-30.0%	10.4%	11.1%	-4.5%
China	-15.3%	0.9%	-14.5%	-46.7%	-45.5%	-10.4%	-34.5%	-12.9%	-6.4%	-13.4%
MSCI World	7.5%	0.4%	7.3%	-15.2%	-13.5%	14.8%	-29.7%	8.2%	8.3%	-3.8%
MSCI EM	-3.1%	0.3%	-3.7%	-26.6%	-24.2%	1.7%	-34.3%	-0.6%	3.7%	-11.1%

Source: FactSet, Willis Towers Watson.

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

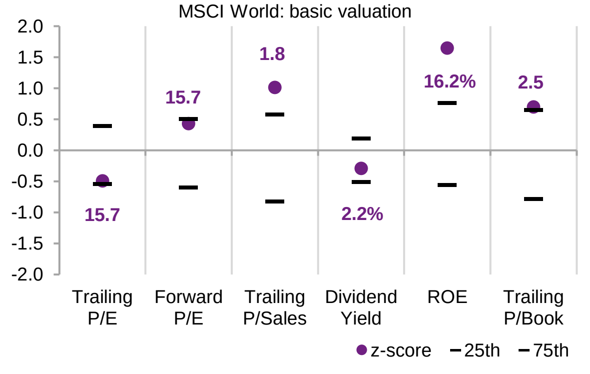
Global equities	Asset return outlook
Developed	
Emerging	

- Company earnings in advanced economies rose sharply earlier in the 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 now beginning to show signs of weakness as the world economy slows; however, the extent of short term risks are still not currently reflected in analyst earnings expectations for 2023.
- Two aspects are important: (1) future earnings estimates are declining but remain at the higher end of our expectations over the next 1-2 years, considering rising economic risks; and (2) our assessment of equity price declines year-to-date is that they have mostly been caused by rising interest rates, rather than lower growth expectations. Therefore, equities are not pricing-in future earnings weakness and face near term downside risks if growth weakens further and/or earnings expectations get revised down.
- We continue to see value in Japanese equities; with valuations remaining low relative to broader DM counterparts.
- 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 remain high – due to the US – despite shorter-term economic risks

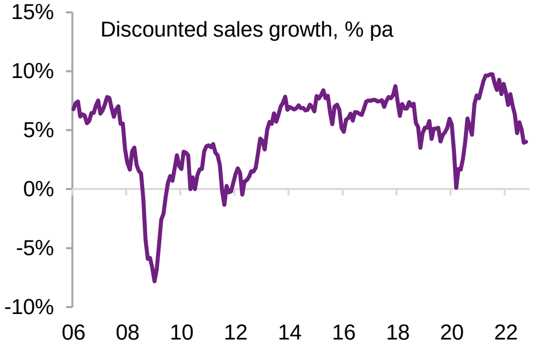
Valuation metrics for the MSCI World equity index



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

Asset Research Team

Disclaimer

WTW has prepared this material for general information purposes only and it should not be considered a substitute for specific professional advice. In particular, its contents are not intended by WTW to be construed as the provision of investment, legal, accounting, tax or other professional advice or recommendations of any kind, or to form the basis of any decision to do or to refrain from doing anything. As such, this material should not be relied upon for investment or other financial decisions and no such decisions should be taken based on its contents without seeking specific advice.

This material is based on information available to WTW at the date of this material and takes no account of developments after that date. In preparing this material we have relied upon data supplied to us or our affiliates by third parties. Whilst reasonable care has been taken to gauge the reliability of this data, we provide no guarantee as to the accuracy or completeness of this data and WTW and its affiliates and their respective directors, officers and employees accept no responsibility and will not be liable for any errors, omissions or misrepresentations by any third party in respect of such data.

This material may incorporate information and data made available by certain third parties, including (but not limited to): Bloomberg L.P.; CRSP; MSCI; FactSet; FTSE; FTSE NAREIT; FTSE RAFI; Hedge Fund Research Inc.; ICE Benchmark Administration (LIBOR); JP Morgan; Markit Group Limited; Russell; and, Standard & Poor's Financial Services LLC (each a "Third Party"). Details of the disclaimers and/or attribution relating to each relevant Third Party can be found at this link https://cms.willistowerswatson.com/en-GB/Notices/index-vendor-disclaimers

This material may not be reproduced or distributed to any other party, whether in whole or in part, without WTW's prior written permission, except as may be required by law. In the absence of our express written agreement to the contrary, WTW and its affiliates and their respective directors, officers and employees accept no responsibility and will not be liable for any consequences howsoever arising from any use of or reliance on this material or any of its contents.

About WTW

At WTW (NASDAQ: WTW), we provide data-driven, insight-led solutions in the areas of people, risk and capital. Leveraging the global view and local expertise of our colleagues serving 140 countries and markets, we help you sharpen your strategy, enhance organizational resilience, motivate your workforce and maximize performance.

Working shoulder to shoulder with you, we uncover opportunities for sustainable success—and provide perspective that moves you.

Learn more at wtwco.com.

Towers Watson Limited is a limited liability company registered in England and Wales under registered number 5379716.
Registered address: Watson House, London Road, Reigate, Surrey, RH2 9PQ, United Kingdom