

Global Markets Overview

Asset Research Team

December 2022

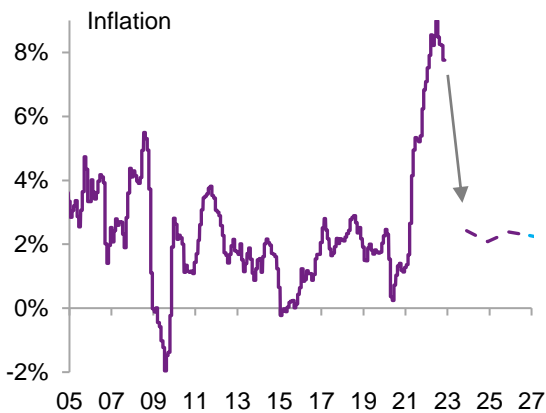
A recap of economic conditions in 2022; looking forward to 2023

The outlook for the major economies

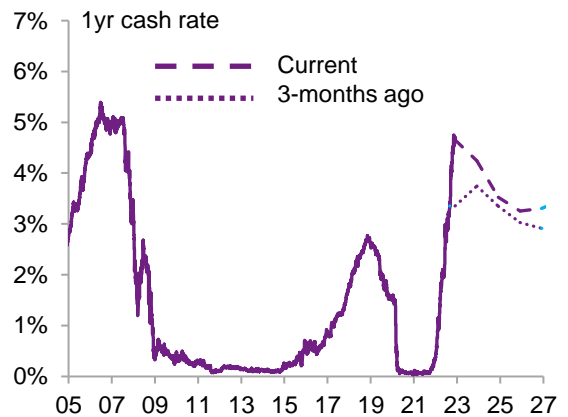
- High levels of spending growth in 2021 were supported by high levels of central bank and government COVID-related stimulus. When combined with widespread disruptions in the supply of commodities, goods, and workers, it has led to demand outstripping supply in most economies over the past 18 months.
- The resulting high inflation has seen aggressive rises in central bank policy rates over this year – the speed and magnitude of this tightening has been the biggest in the past 40 years.
- Nevertheless, economic growth in most major advanced economies over 2022 has been more resilient than expected, supported by the previous rounds of monetary and fiscal stimulus, especially in the US.
- Our view moving into 2023, is that the main drivers of economic conditions in advanced economies will pivot from one of rising inflation and rising central bank policy rates to a significant slowing of economic activity.
- Uncertainty and regional differences remain important considerations for our economic outlook, e.g., the Chinese authorities' unexpected relaxation of their zero-covid policy will improve China's growth.

2022	2023
Surprisingly resilient growth	Growth contraction
High, "sticky" inflation	Moderating inflation
Aggressive rises in interest rates	Policy remains restrictive

US CPI inflation, % yoy



US monetary policy, %



Source: FactSet, Refinitiv, Federal Reserve, WTW

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

30 November 2022

Nov 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	Eurozone								
	1y/cash	2.00	0.20	1.28	2.83	2.56	2.16	1.89	1.83
	5y	1.92	-0.02	0.63	2.55	2.49	1.91	1.84	1.83
	10y	1.92	-0.15	0.44	2.28	2.25	1.87	1.83	1.83
	US								
	1y/cash	4.65	0.17	1.29	4.44	3.06	4.24	3.52	3.48
5y	3.80	-0.36	0.49	2.64	2.18	3.56	3.45	3.77	
10y	3.78	-0.30	0.64	2.29	1.99	3.72	3.70	3.92	
Breakeven infl.	US (CPI)								
	3y	2.34	-0.27	-0.42	-0.73	0.99	-	-	2.01
	5y	2.32	-0.21	-0.40	-0.47	0.87	-	-	1.99
	10y	2.19	-0.28	-0.30	-0.37	0.62	-	-	2.11

Source: FactSet

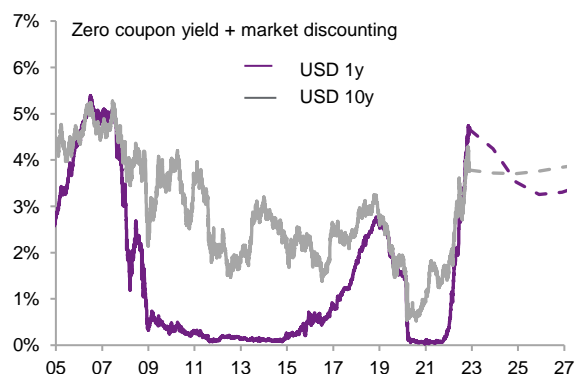
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		<ul style="list-style-type: none"> Central bank guidance remains biased towards higher policy rates in the face of above-target inflation and acceptable growth, with key markets still engaged in hiking cycles. The pace of asset purchases has also slowed and moved negative (via sales or redemptions) for some central banks. 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		<ul style="list-style-type: none"> While lower over November, 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 rise further while central banks are engaged in hiking, following year-to-date increases, we think most bond markets are now trading within their neutral ranges. This is most clearly the case in the US. In 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 possibilities around it

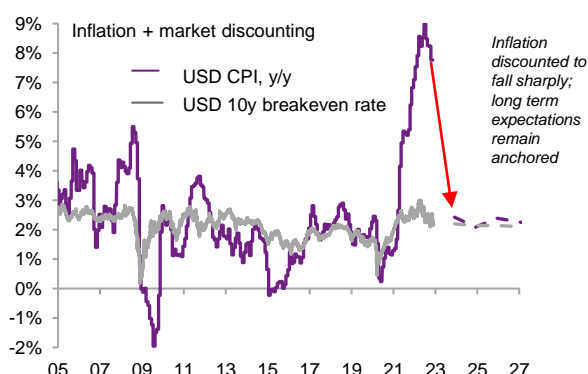
US cash rate and 10y nominal bond yield



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 November 2022

30 November 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	155	-25	-4	49	43	1.4%	-0.6%	-0.1%	1.2%	1.1%
	US	142	-24	-3	39	31	1.1%	-0.6%	-0.1%	1.0%	0.8%
	Eurozone	179	-37	-14	68	75	2.0%	-0.9%	-0.4%	1.7%	1.9%
	UK	203	-24	5	86	62	2.6%	-0.6%	0.1%	2.2%	1.6%
	Canada	179	-5	14	67	60	2.0%	-0.1%	0.4%	1.7%	1.5%
	Australia	196	-11	24	86	92	2.4%	-0.3%	0.6%	2.2%	2.3%
Low grade	Global HY	508	-42	-37	71	95	3.0%	-0.6%	-0.5%	1.0%	1.4%
	US HY	455	-8	-35	88	53	2.2%	-0.1%	-0.5%	1.3%	0.8%
	Eurozone HY	506	-74	-35	135	158	3.7%	-1.1%	-0.5%	1.9%	2.3%
	US loans	481	-9	-15	70	32	2.6%	-0.1%	-0.2%	1.0%	0.5%
HC EMD	HC EMD Corps	322	-50	-10	-2	50	3.8%	-1.1%	-0.7%	0.5%	0.4%
	HC EMD Sov	342	-55	-37	26	21	2.3%	-0.8%	-0.2%	0.0%	0.8%

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

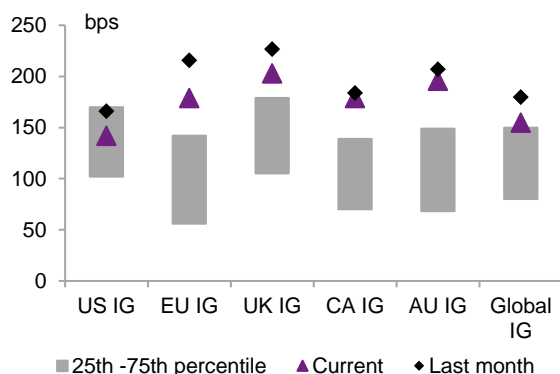
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		<ul style="list-style-type: none"> Increases in investment grade spreads this year mean markets are now pricing in a moderately 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 tilted towards 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 maturity government bonds.
Europe		<ul style="list-style-type: none"> We retain a somewhat cautious outlook for developed market speculative-grade credit given shorter-term risks. Current pricing implies a slightly 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 similar outlook in aggregate, relative to traditional corporate credit markets.

Key: Highly negative Negative Neutral Positive Highly positive

Investment grade spreads tightened over the past month, outside of the US they remain above the upper end of their historic interquartile ranges

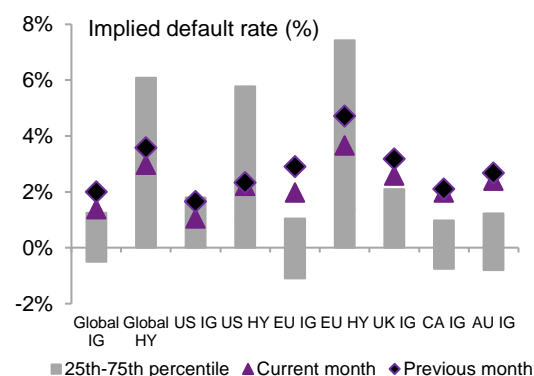
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates also fell over the past month across all corporate credit markets

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 November 2022

30 November 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	8.2%	1.3%	6.3%	2.6%	7.7%	21.3%	-15.4%	5.8%	7.8%	-6.1%
Canada	5.3%	-0.5%	5.5%	-1.0%	2.2%	18.3%	-16.3%	9.2%	9.7%	-3.5%
Eurozone	9.2%	-0.5%	13.4%	-5.6%	-2.6%	6.3%	-18.7%	4.6%	5.8%	-2.3%
Japan	4.7%	8.3%	-3.3%	1.8%	4.5%	6.5%	-4.4%	8.4%	9.0%	-1.2%
UK	7.8%	10.4%	-2.8%	9.5%	13.9%	59.0%	-31.2%	5.0%	12.2%	-9.7%
US	4.7%	-1.5%	6.0%	-12.5%	-11.0%	6.8%	-18.0%	10.7%	11.4%	-2.6%
China	26.7%	6.0%	18.6%	-28.3%	-26.6%	-0.2%	-21.0%	-6.3%	-6.0%	-8.3%
MSCI World	5.3%	-1.1%	7.4%	-9.5%	-7.6%	5.8%	-17.1%	8.9%	8.7%	-1.5%
MSCI EM	12.2%	-3.0%	18.6%	-15.1%	-12.2%	-8.8%	-12.0%	3.1%	3.2%	-5.9%

Source: FactSet, Willis Towers Watson.

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

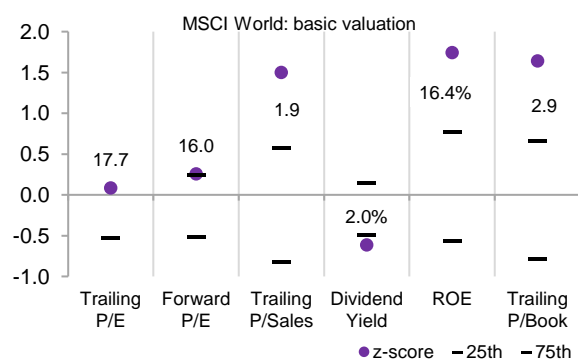
Global equities	Asset return outlook
Developed	
Emerging	

- 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

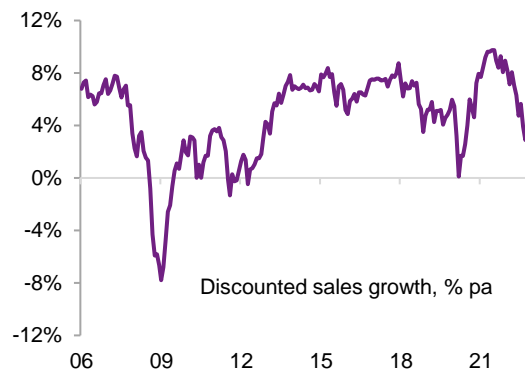
Valuation metrics for the MSCI World equity index



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

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