Global Markets Overview

Asset Research Team

June 2023

Opportunities for alpha

Broaden the investment opportunity set to manage uncertainty

Background

Demand and supply conditions in the major advanced economies remain out of balance; inflation, interest rates, and growth are likely to remain volatile in 2023/24. Asset market pricing implies a rapid fall in inflation to central bank targets, cuts in policy rates, and only a moderate slowdown in economic and corporate earnings growth. We think this understates the potential for higher than expected inflation, higher than expected interest rates, and/or lower than expected growth. We believe diversity with downside protection and active management continues to be the best way to maximise the chance of investment success.

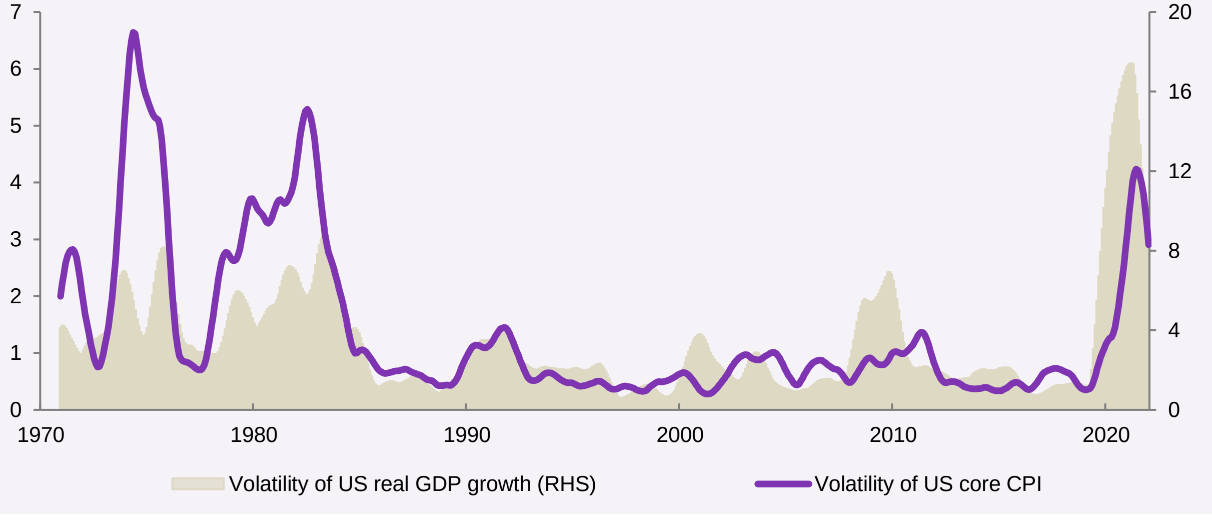
Positioning for higher economic and policy differentiation in 2023/24

In 2022, most economies tightened monetary policy aggressively in response to high inflation. The macro outlook for 2023/24 is highly uncertain, with higher variance across countries and within their capital markets. In these conditions, the return from skilled active management is outsized – our track record shows it can be found. Multi-strategy hedge funds can:

1. Take advantage of this macro divergence;
2. Add downside protection to portfolios during equity falls.

Multi-strategy hedge funds can provide a differentiated return profile in volatile macro environments

Rolling 12-month volatility of YoY US growth and core inflation (12mma)



Sources: Refinitiv Eikon, WTW

Note: 12mma is the 12-month moving average

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

31 May 2023

May 31, 2023 % / %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	2.97	-0.07	-0.16	2.97	3.60	2.37	1.95	2.20
	5y	2.24	-0.03	-0.44	1.40	2.90	2.11	2.09	2.31
	10y	2.25	-0.05	-0.33	1.16	2.67	2.23	2.23	2.35
	US								
	1y/cash	5.12	0.34	0.09	3.09	5.03	3.47	2.96	3.37
	5y	3.71	0.23	-0.42	0.86	3.32	3.18	3.20	3.64
	10y	3.74	0.20	-0.24	0.80	3.08	3.46	3.50	3.76
Breakeven infl.	**US (CPI)**								
	3y	2.17	-0.02	-0.49	-1.23	1.61	-	-	2.24**
	5y	2.16	-0.04	-0.32	-0.75	1.31	-	-	2.34
	10y	2.25	0.10	-0.19	-0.39	1.13	-	-	2.42

Source: FactSet, WTW Note: **discounted 1y rate, 5 years forward

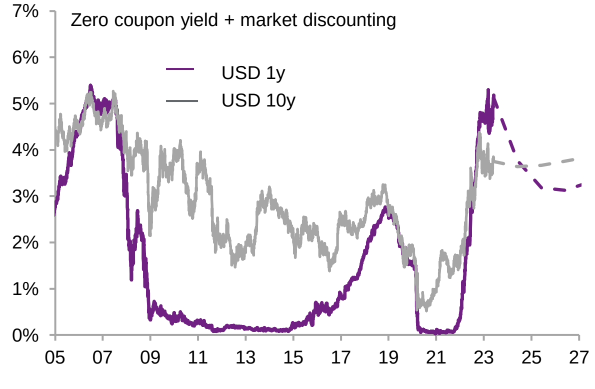
A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		• Central bank guidance remains biased towards keeping interest rate policy restrictive in the face of above-target inflation and tight labor markets. • Policymakers were quick to extend support to the banking sector following recent volatility. While they acknowledge uncertainty, central banks see the wider system as being resilient. • Short rates in the US have risen over the past month. We continue to think they under-reflect how high interest rates will need to stay to bring inflation down sustainably.
US		
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		• A downward trend has been observed in intermediate yields with some volatility in recent months and across countries. Rates markets have reacted, first, to banking sector concerns and, second, to weakening economic data, e.g., recent manufacturing surveys. • Though we believe rates are trading in a neutral range from a medium-term perspective, our view is that they currently lie in the lower half of that range, with risks skewed towards bond yields rising in the near term. • Cooling growth, post-covid supply-chain bottlenecks fading, and lower gas prices in Europe should benefit global inflation dynamics. However, labour markets are tight, and wages and services inflation remain high across key markets. Our view is that inflation is likely to prove stickier than markets expect, which may place upwards pressure on yields.
US		
UK		
AAA-Eurozone		

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

US Treasury bond yields are now pricing-in significant rate cuts over the next twelve months. This is only likely if inflation and economic growth slow quickly

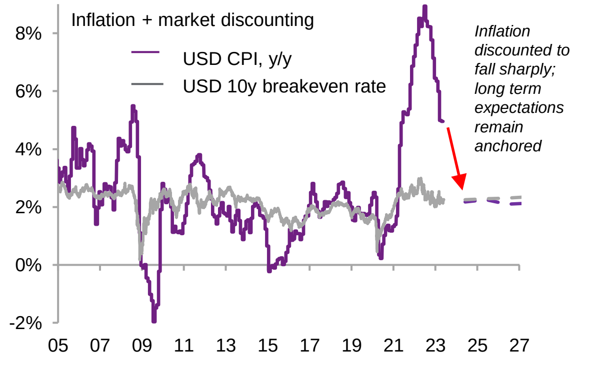
US cash rate and 10y nominal bond yield



Source: FactSet, WTW

US inflation expectations have fallen in recent weeks. We believe that risks are tilted towards stickier inflation than markets are pricing-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 May 2023

31 May 2023		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	150	3	15	4	-34	1.3%	0.1%	0.4%	0.1%	-0.9%
	US	142	1	12	2	-45	1.1%	0.0%	0.3%	0.1%	-1.1%
	Eurozone	169	8	22	9	3	1.7%	0.2%	0.6%	0.2%	0.1%
	UK	175	2	7	5	-22	1.9%	0.1%	0.2%	0.1%	-0.5%
	Canada	169	1	12	7	-28	1.7%	0.0%	0.3%	0.2%	-0.7%
	Australia	172	-6	9	14	22	1.8%	-0.2%	0.2%	0.4%	0.6%
Low grade	Global HY	510	9	56	30	-166	3.0%	0.1%	0.8%	0.4%	-2.4%
	US HY	469	16	47	47	-185	2.4%	0.2%	0.7%	0.7%	-2.6%
	Eurozone HY	483	4	62	9	-74	3.3%	0.1%	0.9%	0.1%	-1.1%
	US loans	541	25	34	58	-59	3.4%	0.4%	0.5%	0.8%	-0.8%
HC EMD	Hc EMD Corps	300	-6	30	-18	-152	4.0%	-0.1%	0.5%	-0.2%	-1.5%
	HC EMD Sov	352	-3	26	-10	-77	2.0%	-0.1%	0.5%	-0.3%	-2.3%

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

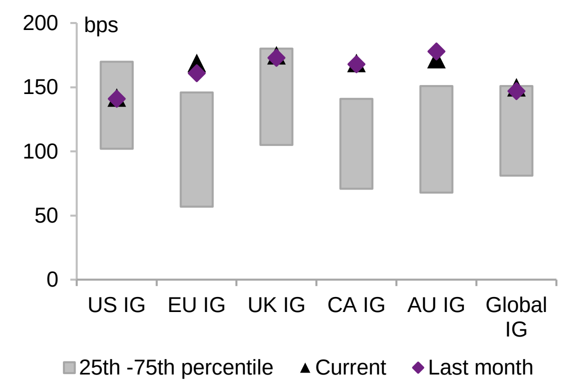
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		• Global investment grade spreads are pricing in an above average allowance for the level of credit losses over the medium-term, with a big difference between US and non-US markets. • We expect losses to be at or modestly above these levels, particularly in the nearer term, with risks tilted towards higher losses, especially in the US. • 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 high yield grade corporate credit given shorter-term risks. Current pricing implies a broadly average level of defaults relative to historic average pricing, despite downside 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 very lightly over the past month, outside of the US they remain at the upper end or above their interquartile ranges

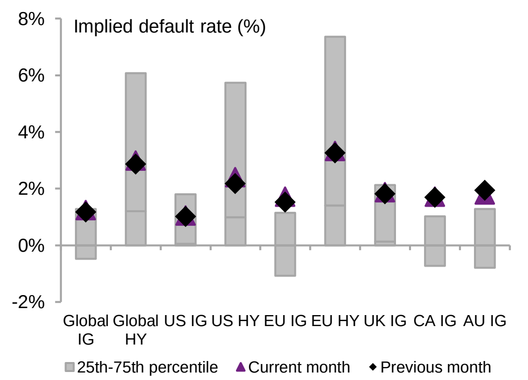
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

Market implied default rates were relatively unchanged over the past month in most markets

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 May 2023

31 May 2023	∆ 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	-2.8%	1.1%	-4.3%	-1.7%	3.3%	14.0%	-13.7%	12.2%	10.5%	-7.2%
Canada	-5.2%	-1.5%	-4.0%	-5.8%	-2.5%	3.7%	-9.1%	12.0%	15.7%	-4.5%
Eurozone	-1.9%	3.0%	-9.3%	8.5%	12.0%	4.8%	3.0%	14.1%	17.6%	-3.0%
Japan	4.5%	16.7%	-10.5%	10.9%	14.0%	3.5%	7.2%	14.1%	14.2%	1.0%
UK	-5.2%	13.4%	-16.8%	-2.7%	1.3%	62.0%	-39.9%	11.6%	27.5%	-15.4%
US	0.7%	-2.1%	2.6%	1.1%	2.8%	-8.7%	10.8%	12.5%	11.8%	-0.3%
China	-8.2%	1.5%	-7.8%	-15.8%	-13.8%	-2.3%	-8.9%	-8.3%	-7.6%	-8.8%
MSCI World	-0.1%	1.8%	-3.0%	1.4%	3.7%	-4.6%	5.1%	12.2%	12.3%	-0.7%
MSCI EM	-1.0%	-4.9%	3.2%	-7.4%	-4.3%	-11.1%	0.1%	5.3%	6.4%	-5.3%

Source: FactSet, Willis Towers Watson.

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

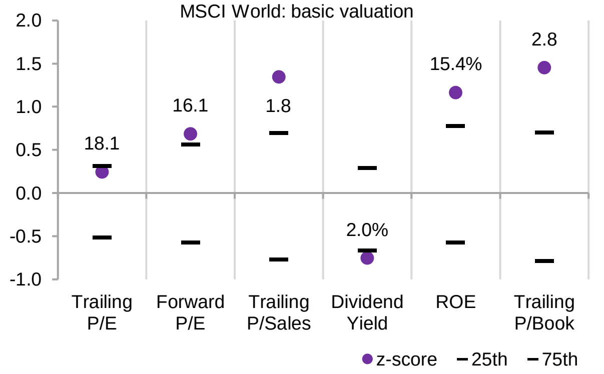
Global equities	Asset return outlook
Developed	
Emerging	

- Developed equity market returns were mixed over the month.
- Earnings in the US are beginning to show signs of weakness as its 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 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 in 2022 is that they were mostly 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 and UK equities; with valuations remaining low relative to broader DM equities.
- Overall, we retain a neutral view on equities over a five-year horizon but are cautious nearer-term.

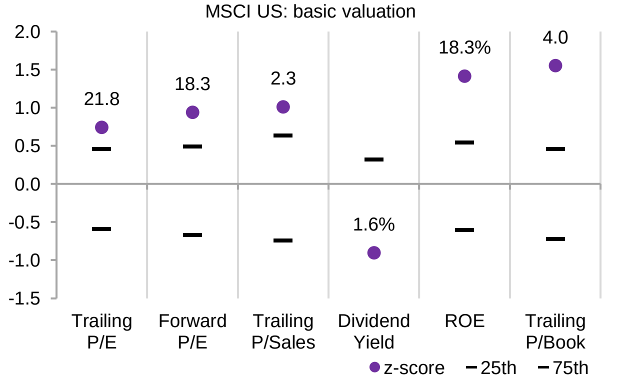
Key: Highly negative | Negative | Neutral | Positive | Highly positive

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

Valuation metrics for the MSCI World equity index (left) and MSCI US (right)



Source: FactSet, WTW



Source: FactSet, WTW

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