Global Markets Overview

Asset Research Team

July 2023

Diversify

Macro volatility remains an important theme for 2023/24, supporting portfolio diversification

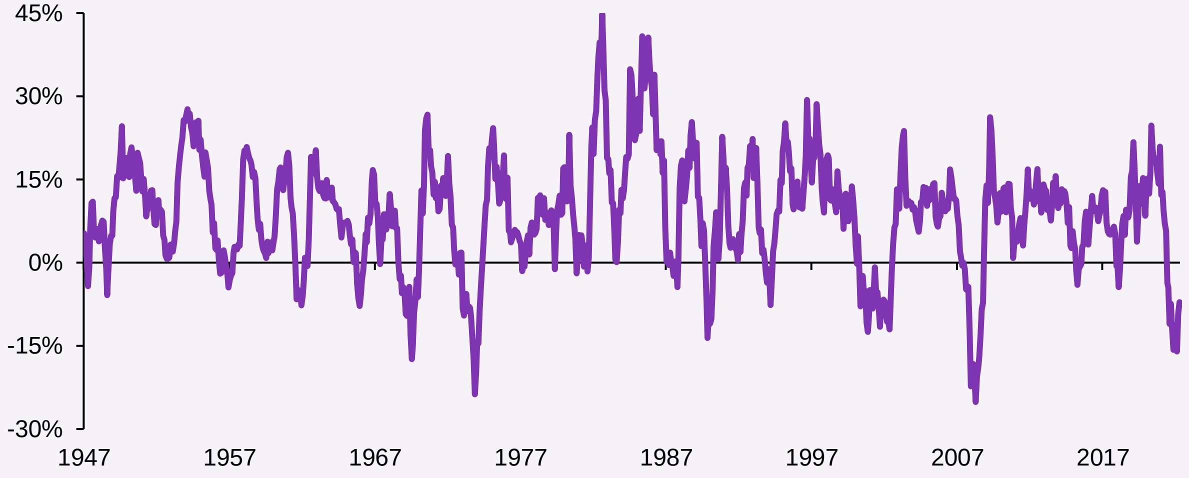
Background

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.

Diversity

- An equity-bond portfolio performed poorly in 2022 because inflation and real interest rates were higher than expected; this remains a material risk in 2023/24, despite the year-to-date rise in equity prices.
- Many investors could still benefit from diversifying equity risk. Simple ways of doing so include investing in hedge funds, alternative credit, and real assets.

Rolling 12-month nominal total return for a 60/40 portfolio.
60% US and global equity / 40% US intermediate bonds



Sources: Refinitiv Eikon, FactSet, Robert Shiller, McCulloch, J., and Kwon, H., 1993, WTW

Note: The proxy for equities is the S&P 500 index (1947-1969) and the MSCI World Index (1970-2023); the proxy for US intermediate government bonds is the 10-year US Treasury bond; an assumed TER of 0.1% p.a. has been added

Values may go down as well as up. Past performance is not a reliable indicator of future returns.

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

30 June 2023

June 30, 2023		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	3.39	0.38	0.53	2.90	4.07	2.90	2.33	2.04
	5y	2.54	0.20	0.16	1.51	3.25	2.26	2.10	2.20
	10y	2.36	0.03	0.04	1.00	2.82	2.27	2.22	2.31
	US								
	1y/cash	5.35	0.17	0.73	2.66	5.26	4.58	3.66	3.49
	5y	4.05	0.27	0.41	1.09	3.67	3.68	3.49	3.72
	10y	3.89	0.09	0.24	0.81	3.23	3.74	3.68	3.83
Breakeven infl.	**US (CPI)**								
	3y	2.14	0.01	-0.27	-0.72	1.08	-	-	2.13**
	5y	2.15	0.01	-0.22	-0.33	0.93	-	-	2.20
	10y	2.17	-0.04	-0.15	-0.19	0.88	-	-	2.30

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

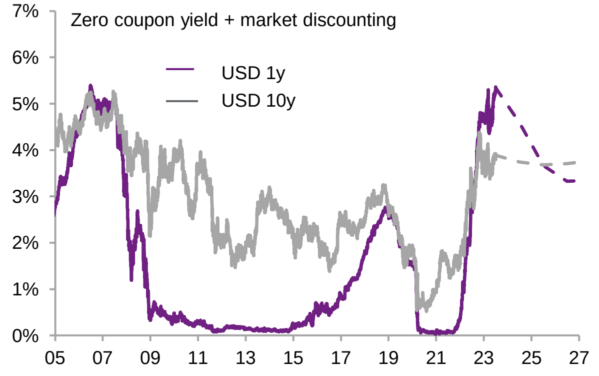
A summary of our assessment of government bond pricing and prospective medium-term outcomes

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 notably over the past three months. While there is a risk that they climb further, pricing now appears more consistent with inflation pressures.
US		
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		• Bond markets have been volatile in the face of sticky inflation and weakening, albeit mixed, economic activity data. However, the net trajectory of yields has been upwards over the past two months. Major central banks have reiterated the need for further rate hikes. • We expect volatility to continue from here, although yields (ex. UK) appear to be in a neutral range from a medium-term perspective. Cooling growth, post-covid supply-chain bottlenecks fading, and lower energy prices should benefit global inflation dynamics, but labour markets are tight, and wage growth and services inflation remain high. • In the UK, we expect hiking-induced growth stresses to reduce longer-term rates. In the US, we have a bias towards TIPS as breakeven pricing under-reflects inflation risks.
US		
UK	↑	
AAA-Eurozone		

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

US Treasury bond yields are pricing-in significant rate cuts next year. This is possible, but requires inflation and economic growth to continue to slow

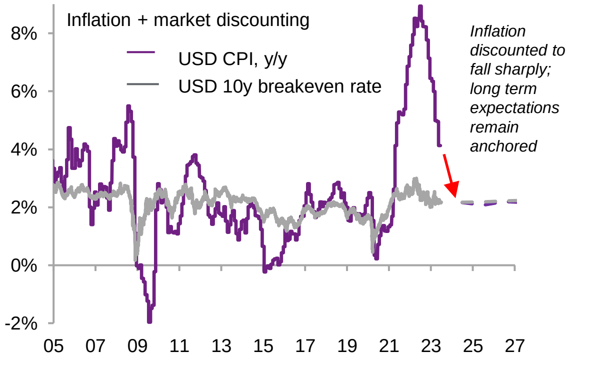
US cash rate and 10y nominal bond yield



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)

30 June 2023

30 June 2023		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	140	-10	-13	-36	-19	1.0%	-0.3%	-0.3%	-0.9%	-0.5%
	US	130	-12	-15	-34	-30	0.8%	-0.3%	-0.4%	-0.9%	-0.8%
	Eurozone	161	-8	-7	-51	13	1.5%	-0.2%	-0.2%	-1.3%	0.3%
	UK	174	-1	-17	-32	-1	1.9%	0.0%	-0.4%	-0.8%	0.0%
	Canada	165	-4	-15	-1	-1	1.6%	-0.1%	-0.4%	0.0%	0.0%
	Australia	166	-6	-18	-16	33	1.7%	-0.2%	-0.5%	-0.4%	0.8%
Low grade	Global HY	450	-60	-51	-192	-193	2.1%	-0.9%	-0.7%	-2.7%	-2.8%
	US HY	405	-64	-53	-182	-239	1.5%	-0.9%	-0.8%	-2.6%	-3.4%
	Eurozone HY	446	-37	-28	-195	-75	2.8%	-0.5%	-0.4%	-2.8%	-1.1%
	US loans	501	-40	-23	-53	-77	2.9%	-0.6%	-0.3%	-0.8%	-1.1%
HC EMD	Hc EMD Corps	273	-27	-37	-93	-130	3.4%	-0.6%	-0.7%	-2.2%	-1.5%
	HC EMD Sov	321	-31	-34	-112	-74	1.6%	-0.4%	-0.6%	-1.4%	-2.0%

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

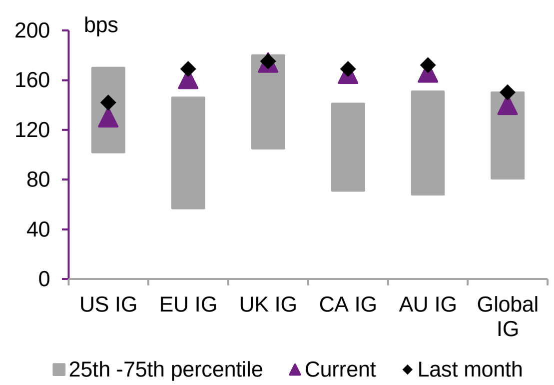
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

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 over the medium term. • We retain a somewhat cautious outlook for developed market high yield grade corporate credit given shorter-term risks. Current pricing implies a slightly below average level of defaults relative to historic 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 tightened over the past month; outside of the US they remain at the upper end or above their historic trading ranges

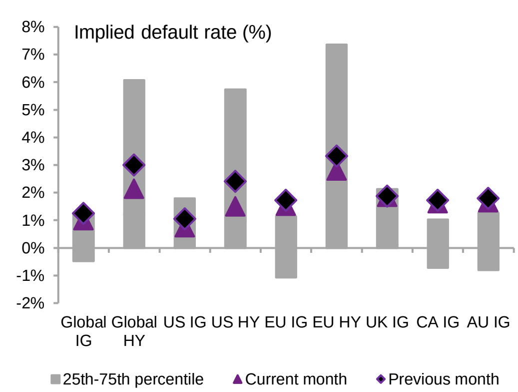
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, WTW

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

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 June 2023

30 June 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	0.4%	0.0%	0.1%	9.5%	15.0%	7.3%	2.0%	11.9%	11.2%	-6.6%
Canada	2.9%	-3.0%	5.7%	6.9%	10.7%	-2.8%	10.1%	12.6%	16.1%	-2.4%
Eurozone	2.5%	1.9%	2.2%	24.2%	28.2%	6.7%	21.4%	13.6%	20.6%	-1.9%
Japan	6.3%	2.5%	3.6%	22.9%	26.2%	-2.7%	26.3%	16.9%	12.4%	5.6%
UK	0.2%	1.6%	-1.6%	3.9%	8.1%	64.5%	-36.8%	11.5%	29.5%	-15.7%
US	6.1%	-0.7%	6.7%	17.6%	19.6%	-10.0%	30.6%	14.1%	12.2%	2.1%
China	2.6%	-2.3%	6.4%	-17.4%	-15.6%	-2.6%	-9.2%	-9.6%	-5.8%	-7.2%
MSCI World	4.9%	0.2%	4.7%	16.2%	18.9%	-4.8%	22.4%	13.4%	12.9%	1.4%
MSCI EM	2.5%	-1.3%	3.3%	0.4%	3.8%	-10.1%	10.0%	4.3%	8.2%	-4.4%

Source: FactSet, Willis Towers Watson.

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

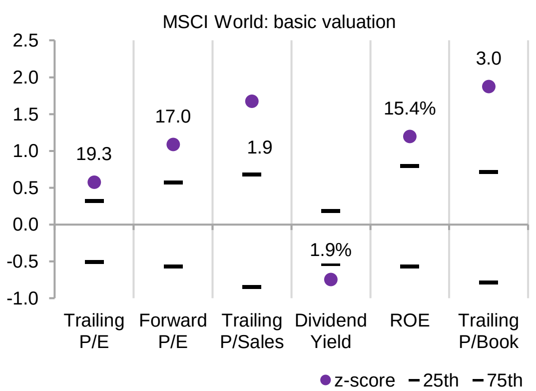
Global equities	Asset return outlook
Developed	
Emerging	

- Equity markets generally moved higher over the month and were up strongly over the first half of 2023 in advanced economies.
- Earnings are showing signs of gradual weakness in response to rapidly tighter monetary policy and deteriorating economic fundamentals. However, valuation increases have more than offset this earnings weakness suggesting the market believes this deterioration is temporary.
- 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) increased interest rates in recent weeks may begin to place downward pressure on valuations as well as the wider economy. Overall, we think equities will 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 equities.
- Overall, we retain a neutral view on equities over a five-year horizon but are cautious nearer-term.

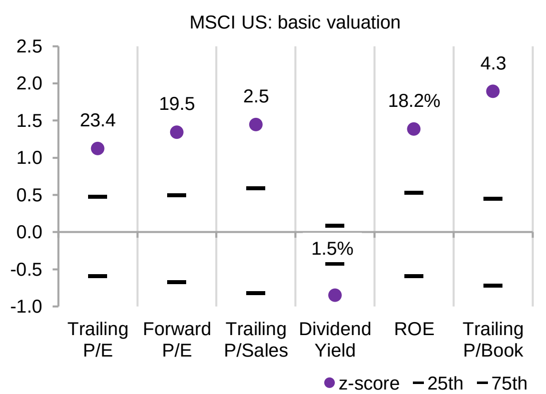
Key: Highly negative | Negative | Neutral | Positive | Highly positive

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

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