Global Markets Overview

Asset Research Team

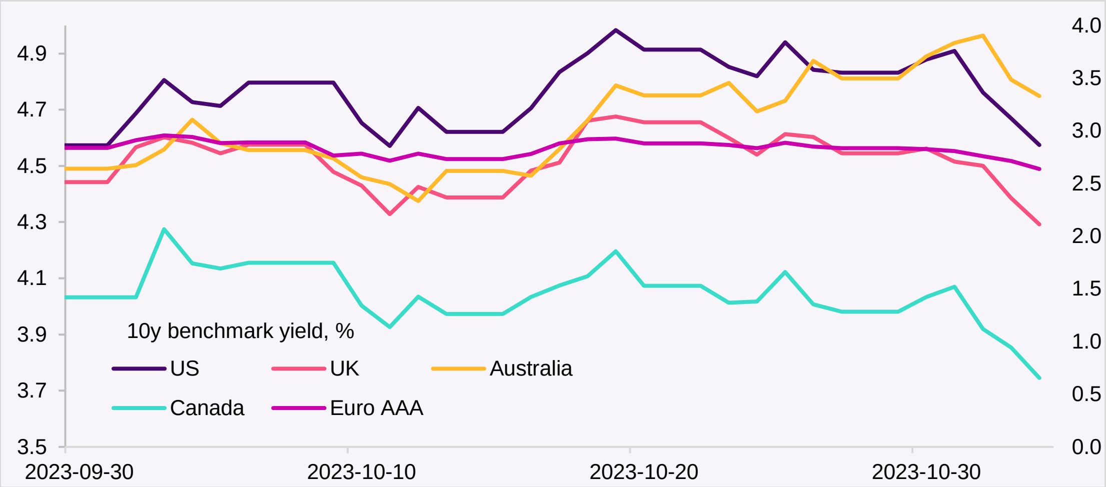
November 2023

Major markets at a glance

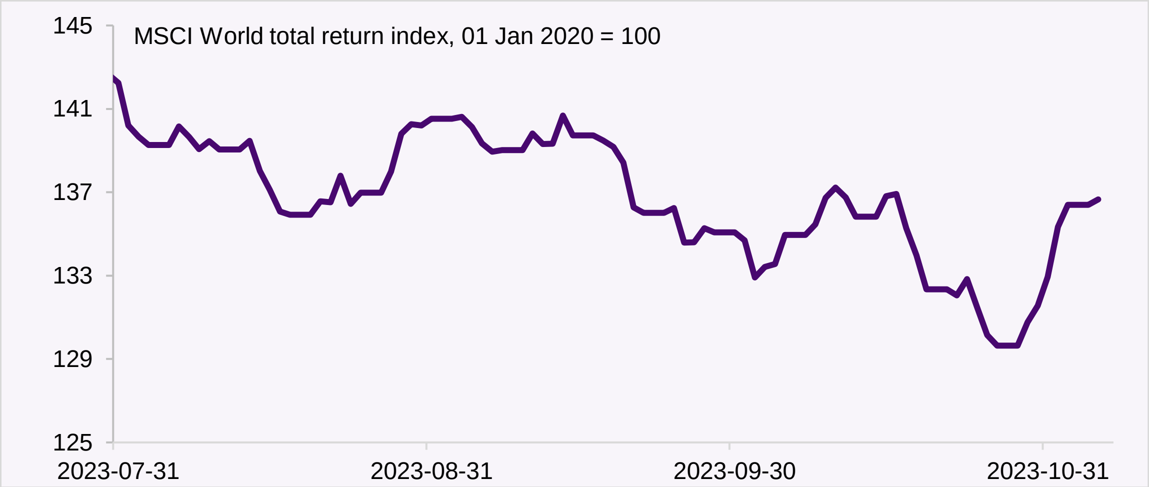
- **Bond yields** in key markets continued to trend higher during much of October but have since reversed significantly.
- The US saw a flurry of positive economic growth surprises towards the start of September that has since been partially mitigated by weaker data. In addition, the US Treasury announced that it would be issuing less debt at longer maturities.

- **Global equities** continued to fall over October, with the S&P 500 touching a bull market correction – defined as a 10% price fall from the peak in July.
- However, equities have bounced sharply in the first week of November as bond yields fell.

Global 10-year benchmark nominal bond yields over the past month



Global developed market equities over the past three months



Sources: Refinitiv Eikon, WTW

Government bonds

At current yield levels we believe that selective government bonds offer downside protection

What's happened over the month:

Bond yields in key markets continued to trend higher during much of October but have since reversed sharply. US 10-year yields touched 5% at one stage but are now back to 4.6% (as of 3 Nov). Other markets have moved to varying degrees. Canadian yields have had the biggest fall since September while Japanese, and notably Australian yields, moved higher.

Factors influencing market trends:

Bonds have been impacted by economic data and policy decisions. The US saw a flurry of positive economic growth surprises towards the start of September that has since been partially mitigated by weaker data and a decision to hold rates more recently**.** In addition, the US Treasury announced that it would be issuing less debt at longer maturities. The lower supply this creates has pushed up (down) bond prices (yields) particularly at longer-dated maturities.

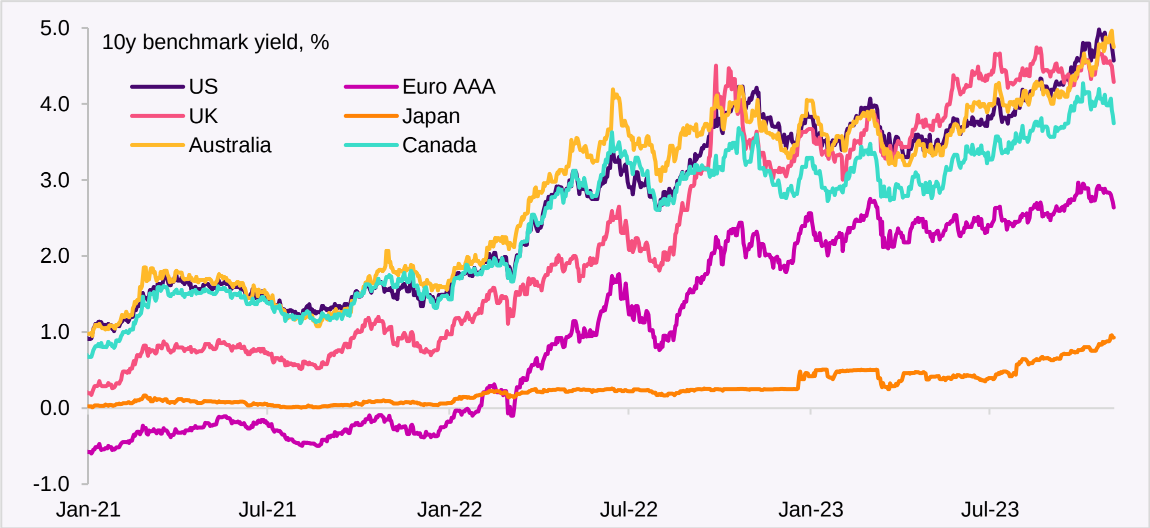
In Australia, the quarterly CPI inflation print was hotter-than-expected, which pushed up future rate hike expectations and yields with it, **while Canada saw the opposite, explaining their relative moves.**

Looking ahead:

Yield volatility may continue in the near-term. However, as more consumers and businesses are confronted with higher borrowing costs, we expect economic headwinds and downside risks to rise. **Over the medium-term, we think it is likely that bond yields will fall relative to current levels as these risks materialise**, protecting return-seeking portfolios.

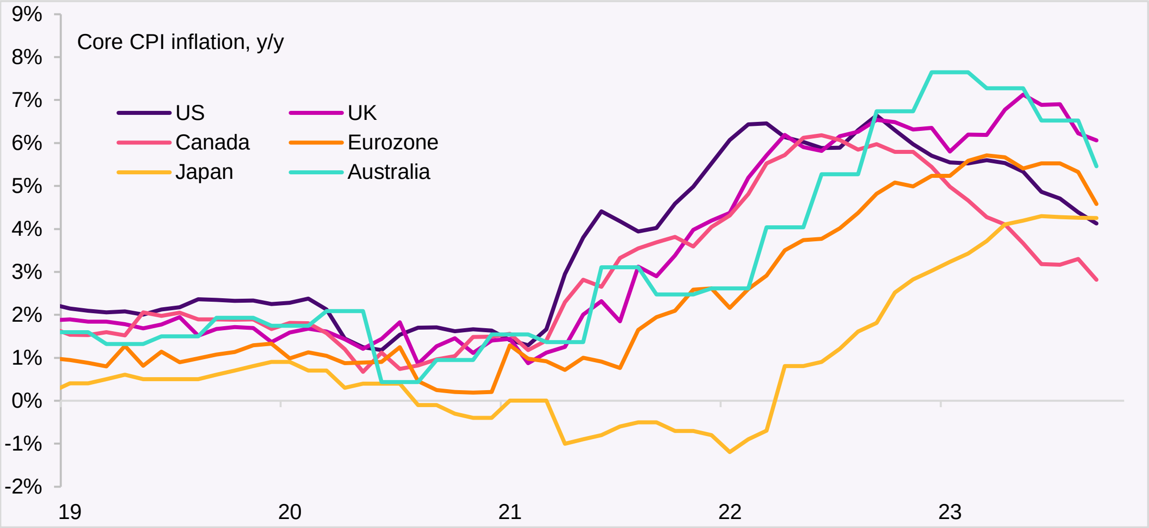
For under-hedged liability-driven-investment portfolios current pricing provides a good opportunity to return towards target levels. This will help to maintain funding levels in a scenario where yields adjust down. This is a risk, particularly in the UK, given high starting yields and signs of economic weakening.

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

Annual CPI inflation rate – excluding food and energy prices



Sources: Refinitiv Eikon, WTW

Credit

High quality credit assets are likely to provide moderate returns above government bonds

What's happened over the month:

Global investment grade and speculative grade credit spreads widened modestly in October, led by the US. US investment grade spreads widened modestly by c.7bps to 132 bps; US speculative grade spreads also widened by c.39bps over the month to 442bps but have rallied strongly in the first week of November. In Europe, corporate credit spreads followed a similar trajectory.

What has influenced recent market dynamics?

Relatively **healthy interest coverage ratios** and **a notable phase of corporate issuers terming out their debt maturities**, prior to the recent rate hiking cycle, has somewhat cushioned corporate credit markets from cyclical pressures to the global economy. The **corporate default cycle has been more muted** as a result.

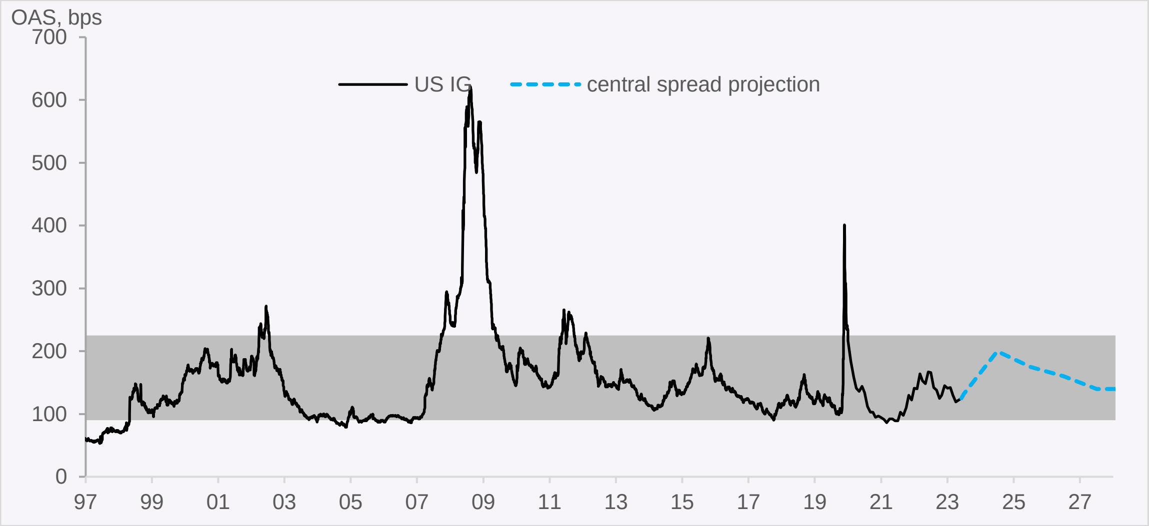
Over the past month, economic data releases have surprised to the downside and at the same time central banks have held rates at current levels, reiterating inflationary concerns. Both of these factors were key determinants of the modest spread widening in corporate credit markets over October.

Our forward-looking expectations – we expect corporates to feel the pain of higher borrowing costs eventually

Investment grade spreads are pricing in a moderately above average allowance for the level of credit losses over the medium-term, with important differences between tighter US and higher world ex-US spreads. **We expect losses to be at or modestly above these levels, particularly in the nearer term**.

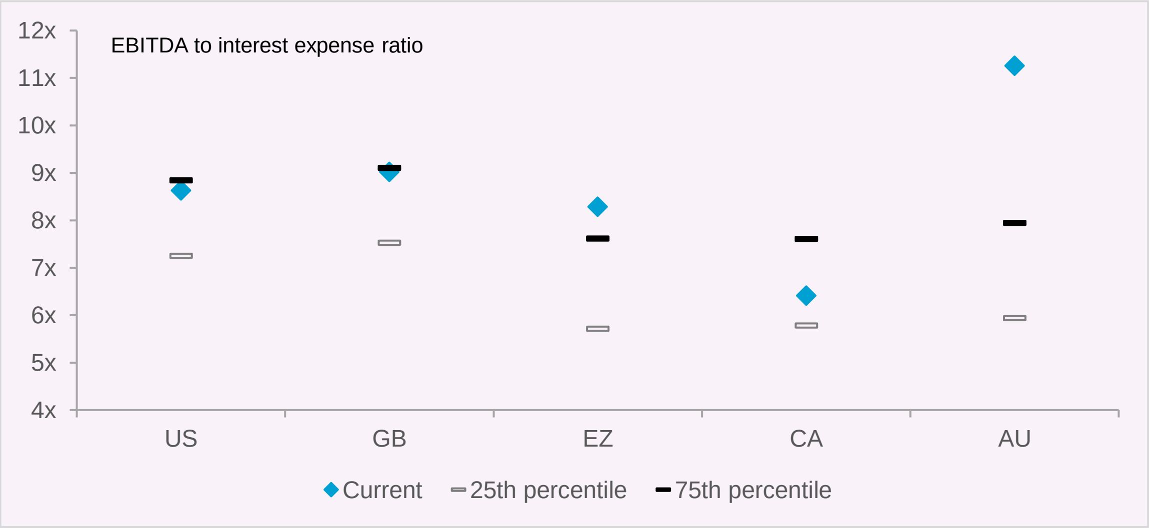
We **retain a cautious outlook for developed market speculative-grade credit** given the prevalence of nearer-term cyclical risks.

Global Investment grade and speculative grade spreads



Sources: FactSet, WTW

Cash flow-based measures show little sign of corporate stress in headline numbers. We expect this to adjust negatively going forward



Sources: FactSet, WTW

Equities

Continued declines over the month

What's happened over the month:

Global equities continued to fall over the last month, with the S&P 500 touching a bull market correction – defined as a 10% price fall from the peak in July. However, equities bounced as bond yield fell in the first week of November. Despite China equity weakness, emerging markets outperformed developed markets for the month and quarter. Japanese equities remain a top performing market year-to-date.

Factors influencing broad market trends:

Equity earnings have been weaker than usual over the year to date. Looking to forward earnings, both analyst earnings estimates and market pricing imply that earnings have troughed in aggregate. Our assessment of economic fundamentals leads us to a more cautious view based on weak leading economic indicators.

Recently, changes in interest rate policy and yield curve levels have been a key driver of broad equity pricing and valuations. From here, we expect fundamentals will become a more prominent factor. Equities will continue to face near-term downside risks if we see more evidence of growth weakening further and/or downside revisions to earnings expectations.

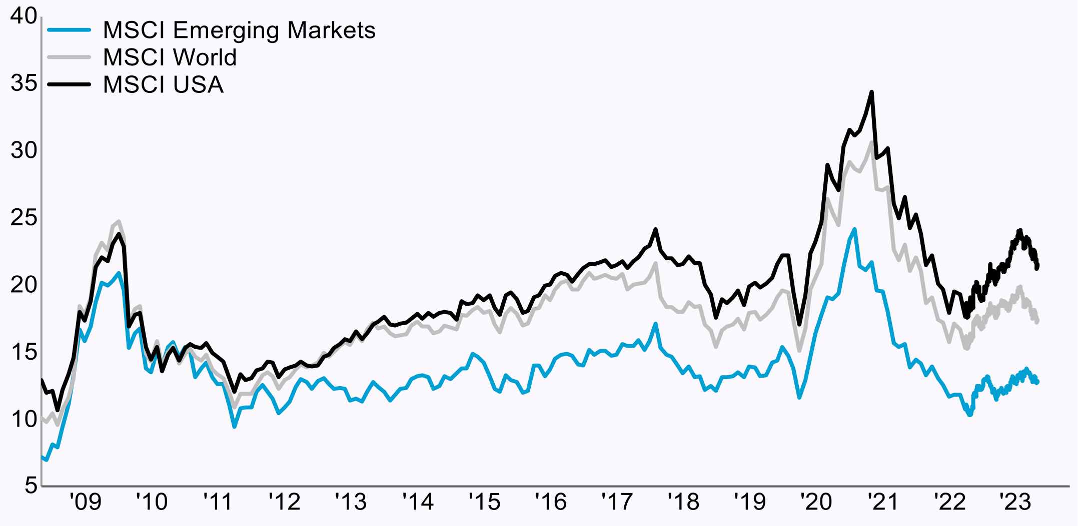
Looking ahead:

We continue to see value in Japanese equities, with valuations remaining low relative to broader equities.

Over the month, we saw additional fiscal support announced from the Chinese government. Stimulative policy should support a China economic recovery, and with China equity valuations at low levels, provides a potentially attractive entry point.

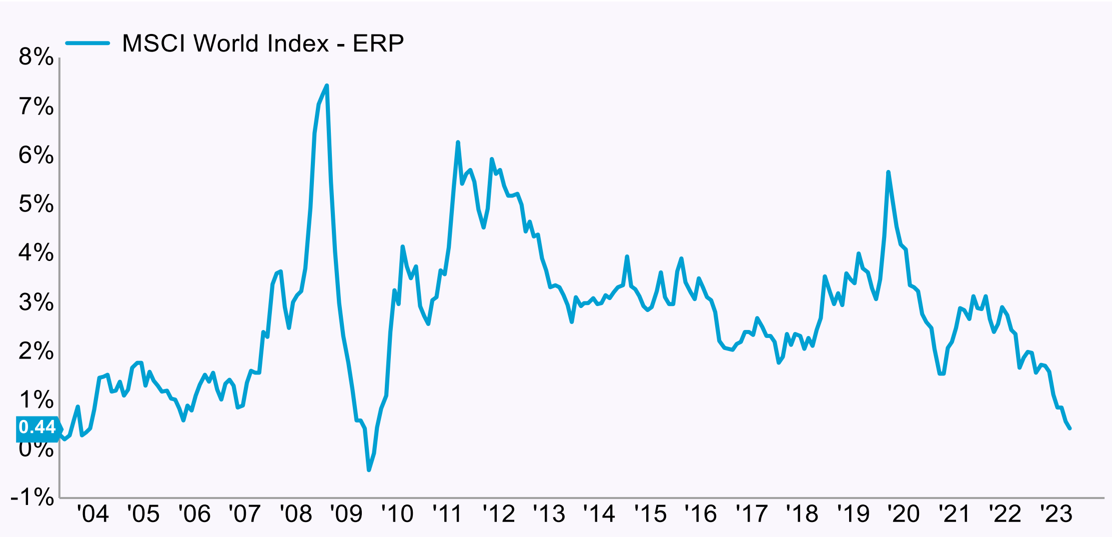
Overall, we retain a neutral view on equities over a five-year horizon but remain cautious in the nearer-term.

Global equity valuations



Sources: FactSet, WTW

Our estimated equity risk premium has meaningfully contracted since the end of July



Sources: FactSet, WTW

FX

We hold a neutral view across most developed market currencies relative to the US dollar

What's happened over past month:

FX markets have been led by bond markets. Most currencies depreciated against the dollar in the last month but have witnessed a sharp reversal more recently.

Factors influencing market trends:

Changes in interest rate differentials between countries have played a key role. US yields rose in September against most markets, increasing the relative attractiveness of US risk-free investments, and drawing in capital flows. The opposite has occurred as yields have fallen in November.

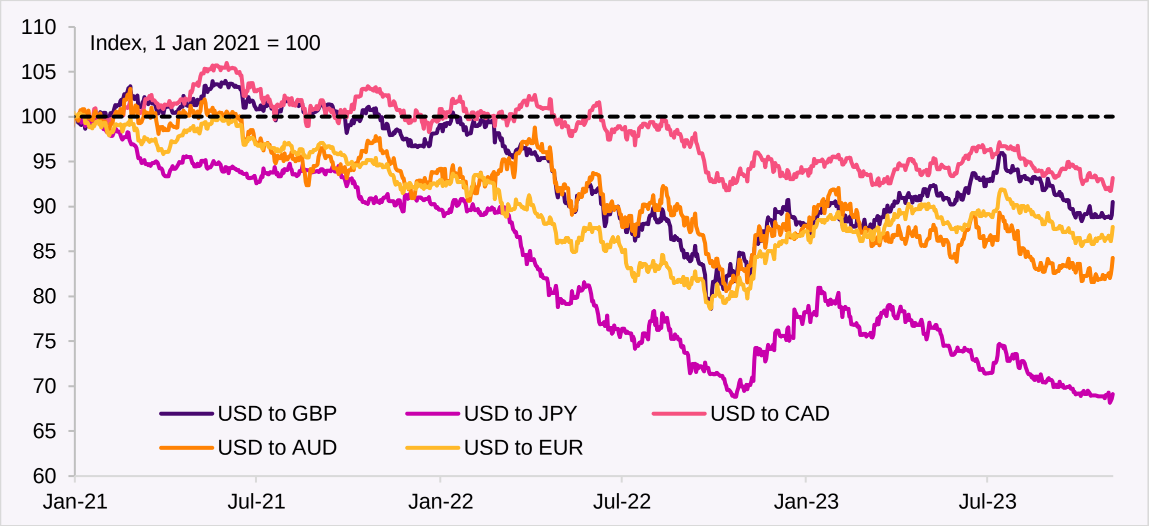
Over a two-to-three-year horizon, the dollar remains significantly up. Apart from interest rates, **growth and terms-of-trade have also played a key role,** with the US economy growing more rapidly than other major advanced economies this year. Additionally, the US is a net oil exporter, which means it has been impacted less by the oil price shocks from the Russia-Ukraine conflict, compared to countries like Japan and most of Europe.

Looking ahead:

Following its appreciation, the US dollar has become more expensive against other major currencies on our preferred medium-term fair value metrics. This may suggest downwards pressure over a 3-to-5-year horizon. In the near term, however, the relative strength of the US economy could lead to further appreciation.

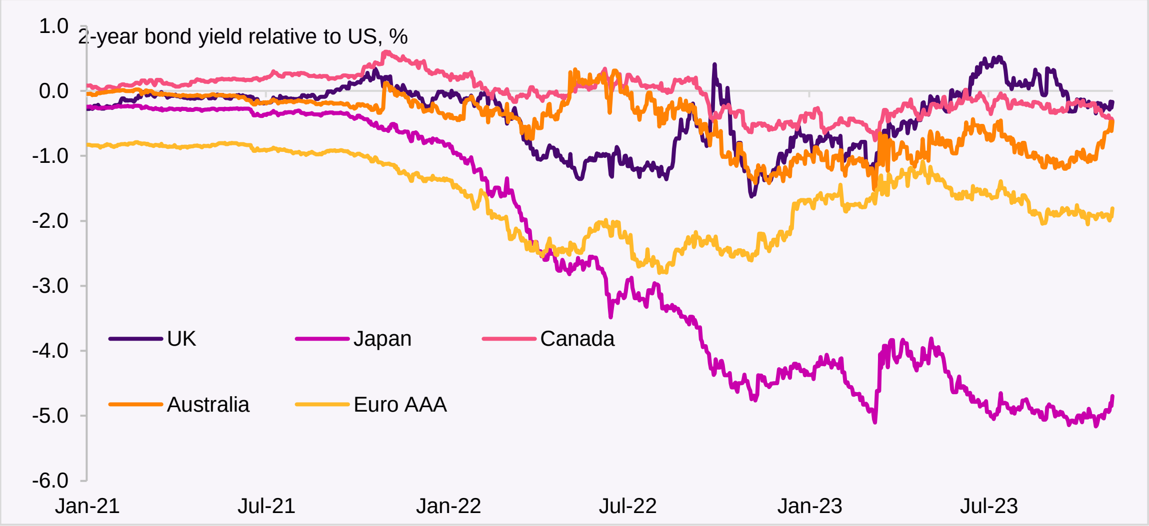
On balance, **we hold a neutral view on most developed market currencies against the dollar.**

Developed spot exchange rates versus the dollar



Sources: Refinitiv Eikon, WTW

FX rate dynamics have been driven primarily by interest rate differences. This is evident from the similarity of the patterns



Sources Refinitiv Eikon, WTW

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