Global Markets Overview

Asset Research Team

January 2024

2023 at a glance

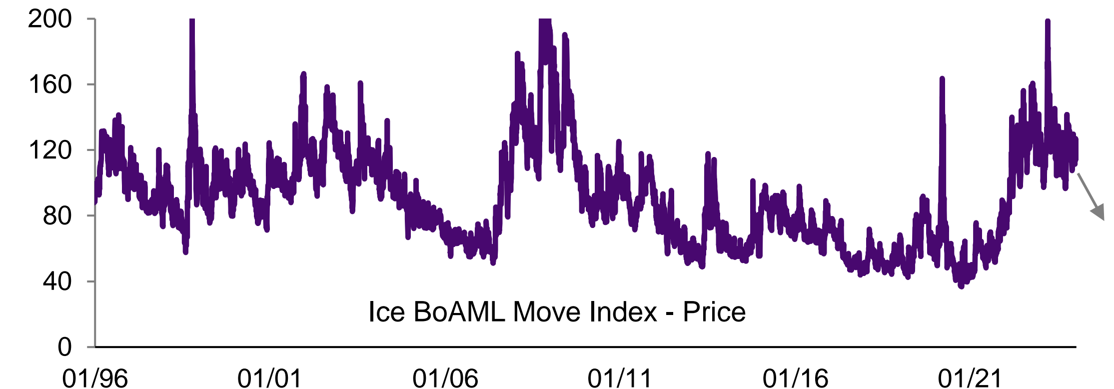
The top 5 performing major markets

2019	2020	2021	2022	2023
MSCI World, 28.1%	Gold, 24.6%	Commodities, 40.4%	Commodities, 26%	MSCI World, 23.7%
Listed infra., 26.2%	MSCI EM, 19.5%	REITs, 36.9%	USD, 6.4%	US HY credit, 13.5%
REITs, 25.3%	MSCI World, 14.1%	MSCI World, 24.7%	Gold, -0.4%	Gold, 13.3%
Gold, 18.9%	US 10y TIPS, 13.1%	Listed infra., 15.9%	Listed infra., -5%	Local EMD, 11.4%
MSCI EM, 18.5%	US 10y treasury, 12.1%	US 10y TIPS, 6%	EM FX (vs. USD), -5%	MSCI EM, 10.3%

1. **One of the key characteristics of 2023 was high interest rate volatility**. Despite this, the U.S. 10-year Treasury yield ended the year almost exactly where it began – at c. 3.88%.
2. **An expected recession in the U.S. didn't materialise**. Bloomberg reported that 85% of polled economists had predicted a U.S. recession in 2023. Instead, the U.S. economy exhibited continued resilience over the year, especially in consumer and services sectors, helping equities achieve an exceptional return.
3. **Inflation fell significantly across most developed economies**, gradually lowering its influence on market price action in the fourth quarter – US CPI (year-over-year) was 7.1% at the end of 2022 and in a 3.0 – 3.7% range between July and December.

2024 at a glance

Interest rate volatility stayed high in 2023, well above its post-global financial crisis average – we expect it to fall in 2024 but not to 2013-2019 levels



1. **Government bonds are attractive for hedging against downside risks**. We expect that interest rate volatility will decline and elevated nominal and real yields will fall over 2024, as central banks cut policy rates as inflation falls and/or because the risks of slowing growth rise.
2. **Intra-asset class alpha opportunities**: equity alpha, hedge funds, and selective investments in private credit and real assets offer a potentially attractive source of return and diversification in a world of still high uncertainty.
3. **Macro alpha opportunities**: target relative value opportunities, for example, long Japan equity relative to world equity or UK government bonds relative to US government bonds.

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Sources: FactSet, MSCI, ICE Bank of America Merrill Lynch, WTW

Government bonds

At current yield levels, we believe that selective government bonds are attractively priced

What happened over the past month:

Bond prices continued to rally sharply in December, led by the US. US 10y nominal bond yields fell almost 0.5%, bringing the collective decline since the start of November 2023 to roughly 1%. Other major developed markets (except for Japan) followed suit, with UK 10y yields registering the sharpest decline.

Factors influencing market trends:

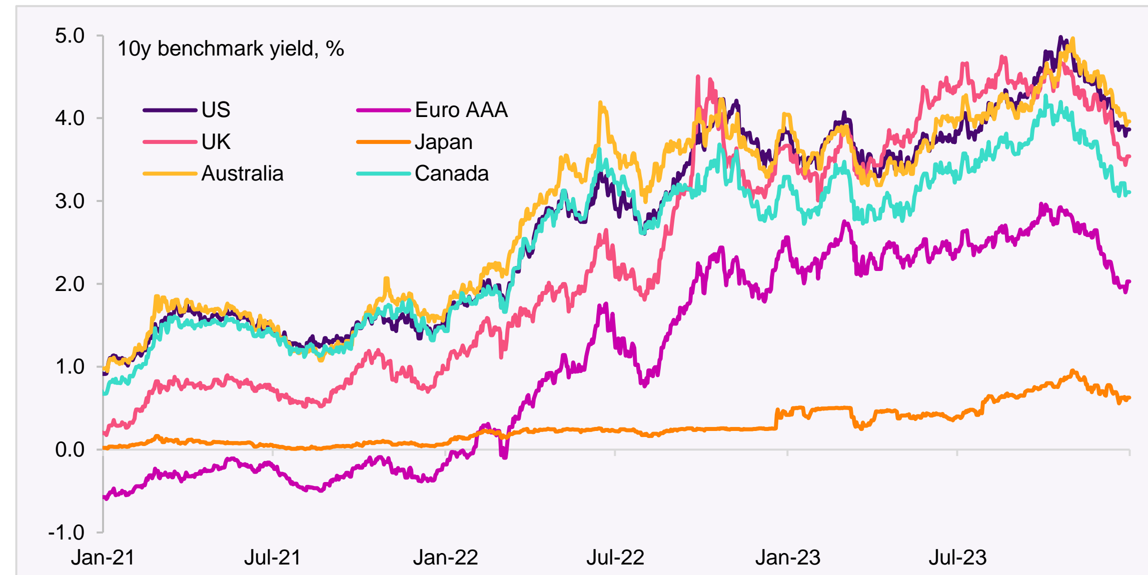
Bond markets continue to show significant sensitivity to economic data and announcements. In December, a key catalyst was the US Fed Open Market Committee meeting. While the policy rate was held at 5.25% to 5.5%, Fed comments were notably more accommodative than prior meetings, seeing risks around its inflation and employment objectives as being more balanced. This shift in tone was reflected in their closely-followed dot plots, which provides committee members' forecasts for the Fed Funds rate – the median projection now suggests three 25bp cuts in 2024, lowering bond yields and raising bond prices.

Looking ahead:

Yield volatility may continue for the next few months. Having fallen so sharply, there is a growing risk that yields correct higher, near-term. However, as more consumers and businesses are confronted with higher borrowing costs, we expect economic headwinds ultimately to dominate, pushing yields lower. **Over 2 to 3 years, we think it is probable that bond yields (prices) fall (rise) relative to current levels**, protecting return-seeking portfolios, albeit less than a couple of months back.

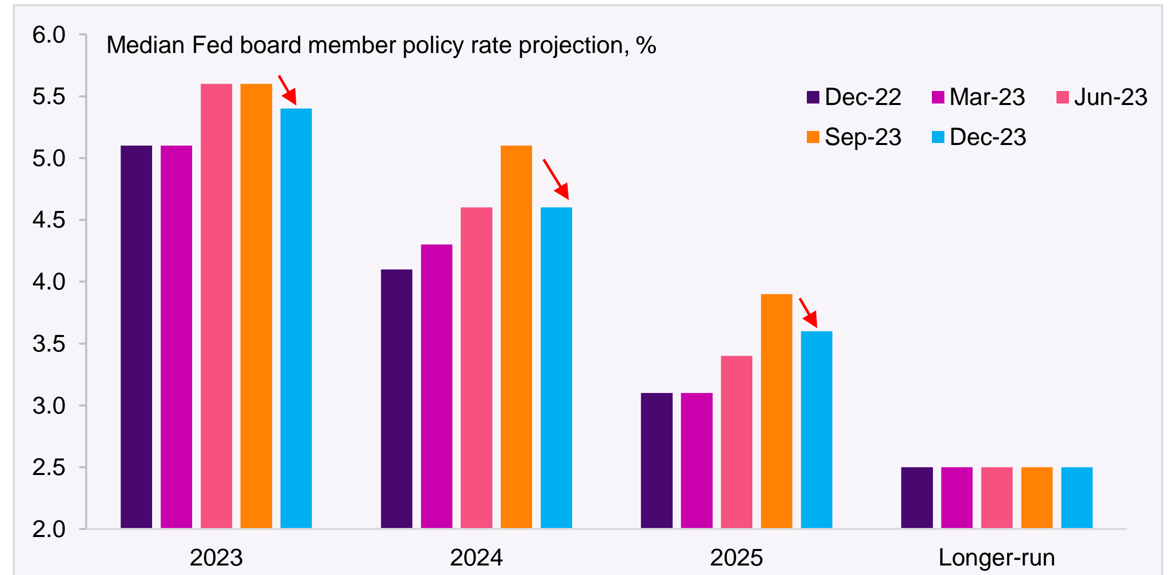
For under-hedged liability-driven-investment portfolios current pricing appears reasonable to return towards target levels. This will help to maintain funding levels in a scenario where yields adjust down. This is a risk, particularly in the UK, given high starting yields and signs of economic weakening.

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

US Federal Reserve policy rate projections were revised down in December after a series of upwards revisions over the last year



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Credit

Over five years we expect investment grade credit to moderately outperform government bonds

What happened over the past month:

Global investment grade corporate credit spreads fell moderately in December – narrowing by 7bp over the month, 33bp over 2023, and ending the year at a relatively low level of 115bp. Global high yield credit spreads moved in-line with positive equity returns in December, with spreads narrowing by 39bp, to cap a good year for high yield bond performance.

What has influenced recent market dynamics?

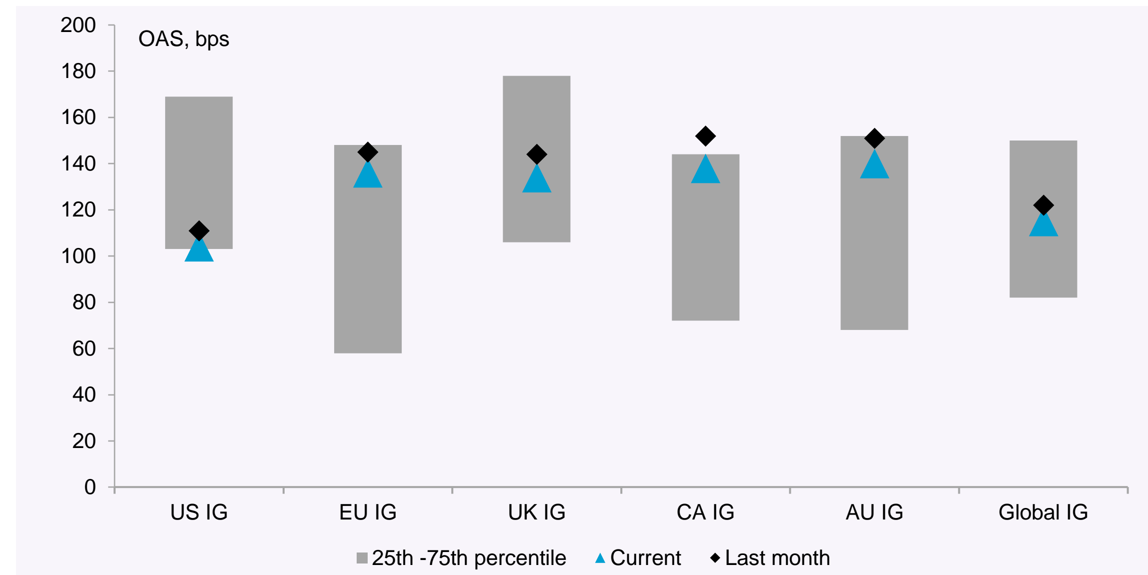
Relatively **healthy interest coverage ratios** and **a notable phase of corporate issuers terming out their debt maturities** prior to the recent rate hiking cycle, has cushioned corporate credit markets from the slowdown in global economic growth. The exceptional resilience of the US economy – with a much better-than-expected real GDP growth rate of 2.8% in 2023 – was also a key support. As a result, the **non-financial corporate default cycle was relatively benign throughout 2023**.

Looking ahead:

Over a three-to-five year horizon, we expect global investment grade corporate credit to provide moderate returns above government bonds, with some important differences between the major markets. Similarly, we expect global high yield credit to outperform government bonds and investment grade credit over the medium-term.

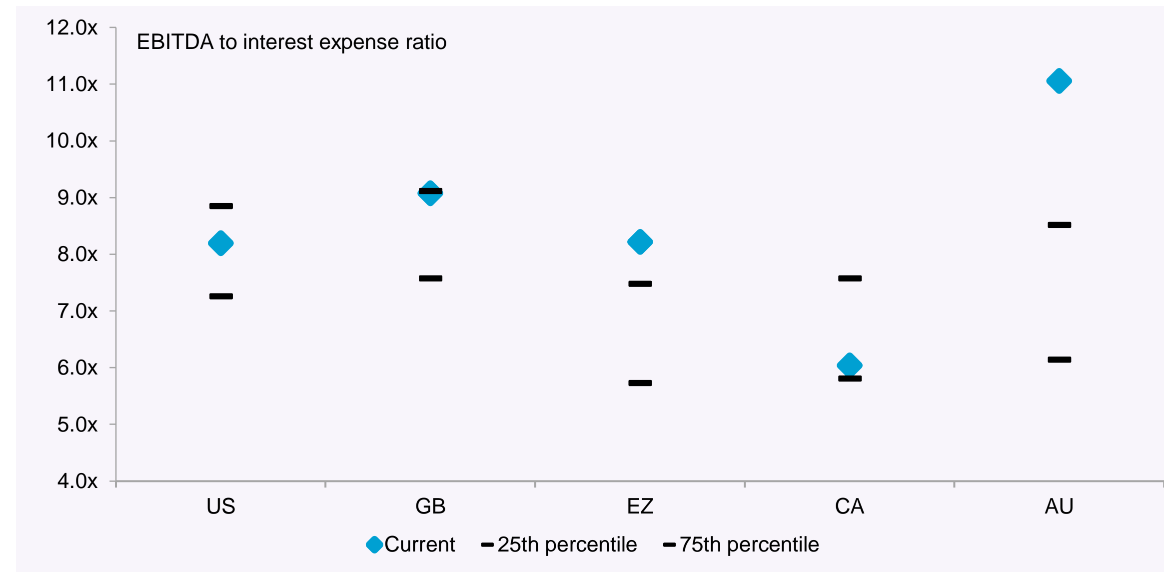
We are more cautious in the shorter-term, given the narrowing of corporate credit spreads in 2023, their low levels currently, and our slight tilt towards downside risks to earnings growth in 2024. US corporate credit spreads are especially low, are pricing-in a very good set of fundamental conditions for company debt, and are at risk of disappointing market expectations in our view.

Investment grade spreads by country



Sources: FactSet, WTW

For the time being, company cashflow-based measures show little sign of corporate stress in the headline numbers – we expect this to adjust negatively going forward



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Equities

A positive December and exceptionally strong equity returns over 2023

What happened over the past month:

Global equities extended their November rally into December, contributing to an exceptionally strong world equity market return over 2023. The guidance from the US Federal Reserve in December added to positive market sentiment, as the Fed spoke to a higher likelihood of a "soft landing".

Broad market trends:

Company earnings growth was relatively weak over the past year in most major economies. Looking to forward earnings, equity pricing and analyst forecasts for future earnings growth both show an expectation that earnings will pick up significantly in 2024, in the US especially. Our assessment of economic fundamentals leads us to a marginally more cautious view based on weakening leading economic indicators.

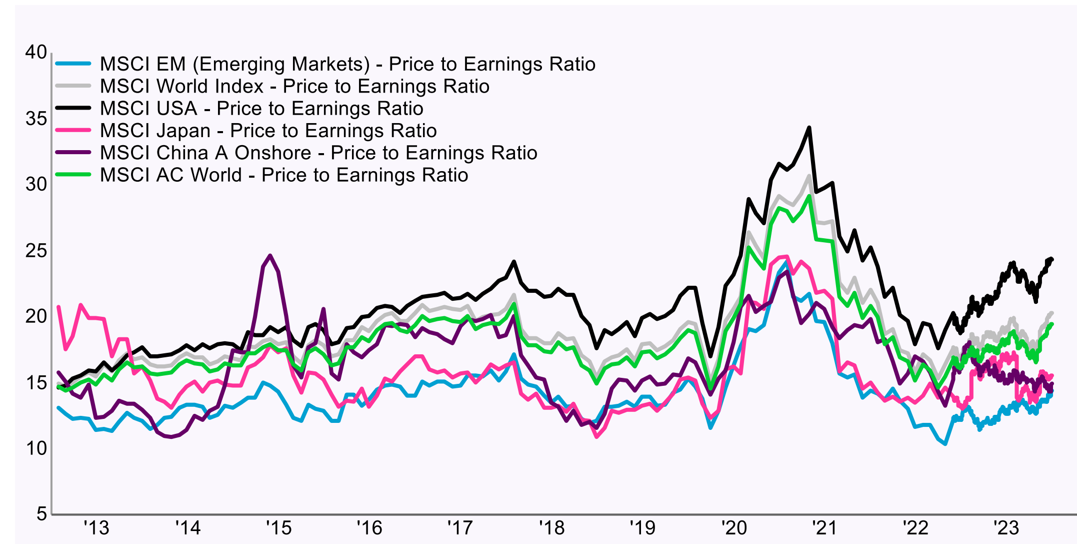
Currently, changes in interest rate policy and yield levels are a key driver of broad equity market pricing and valuations. Equity markets are extrapolating an expectation of falling interest rates to be a positive for stock prices. However, we expect that from here, a more accommodative central bank stance would be more consistent with weaker economic fundamentals. That is, equities will continue to face near-term downside risks if we see more evidence of growth weakness and/or a downside revision to earnings expectations.

Looking ahead:

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

We continue to see value in Japanese equities, given the positive impact on fundamentals of a push to improve corporate governance, stimulative policy, and good cyclical economic growth conditions.

Global equity valuations



Sources: FactSet, WTW

The world equity risk premium is at the low end of its 20-year trading range, after the very strong returns from equities in 2023

Sources: FactSet, WTW

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FX

We hold a positive view on most developed currencies relative to the US dollar over the long term

What happened over the past month:

Most major currencies rose against the dollar last month. The Japanese yen saw the largest move, rising almost 5%, with the Canadian and Australian dollar appreciating around 3%. European currencies were relatively flat.

Factors influencing market trends:

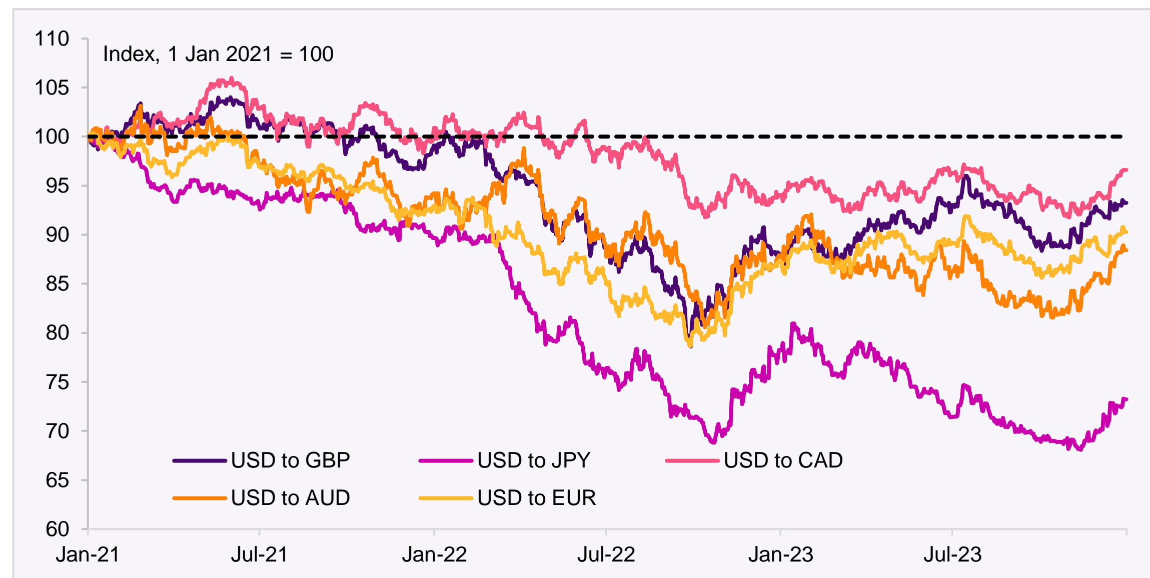
Changes in interest rate differentials between countries continue to play a key role. The recent depreciation of the US dollar coincided with a dip in US yields versus other bond markets, particularly Japan. This reduces the relative attractiveness of US bond investments, pushing capital flows outwards.

Over a two-to-three-year horizon, the US dollar remains significantly stronger. Higher interest rates have favoured the currency over this longer period. Additionally, **growth and terms-of-trade have been supportive**. The fact that the US economy has been as resilient as it has been – many were predicting a recession in 2023 – has supported an extended period of strong capital flows into the US.

Looking ahead:

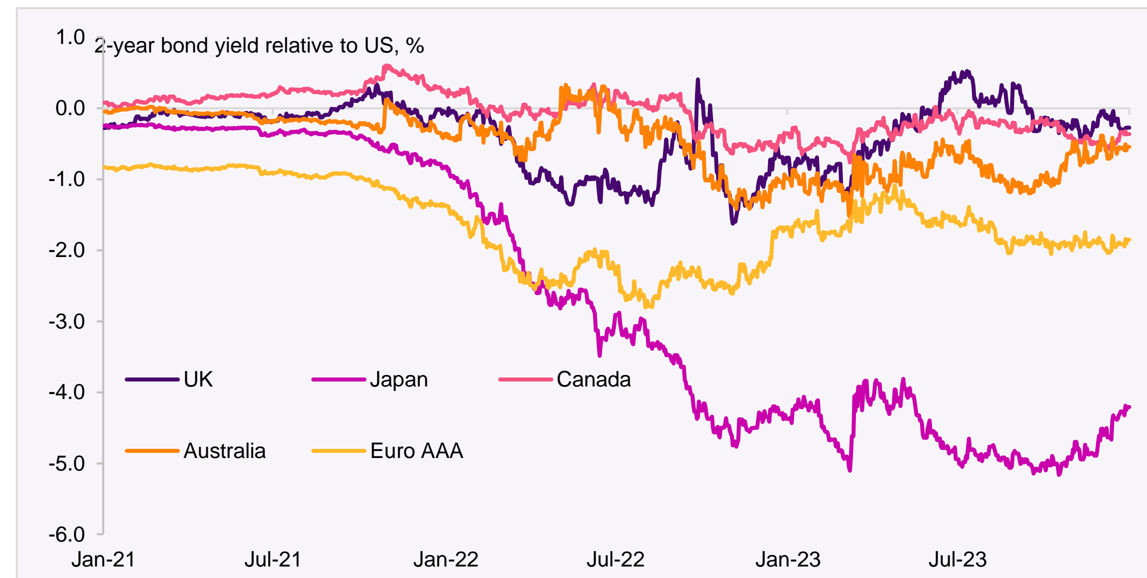
Following its appreciation, the US dollar has become more expensive (less competitive) against other major currencies on our preferred medium-term fair value metrics. This suggests downwards pressure over a 3-to-5-year horizon and **a positive view on most developed market currencies against the dollar**. In the near term, however, the relative strength of the US economy and/or its safe-haven status could lead to further appreciation. In the shorter term, we are neutral on most currencies except for a positive view on the Japanese yen.

Developed exchange rates versus the dollar



Sources: Refinitiv Eikon, WTW

To a significant degree recent exchange rate dynamics have been driven by differences in interest rates between countries



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