

Global Markets Overview

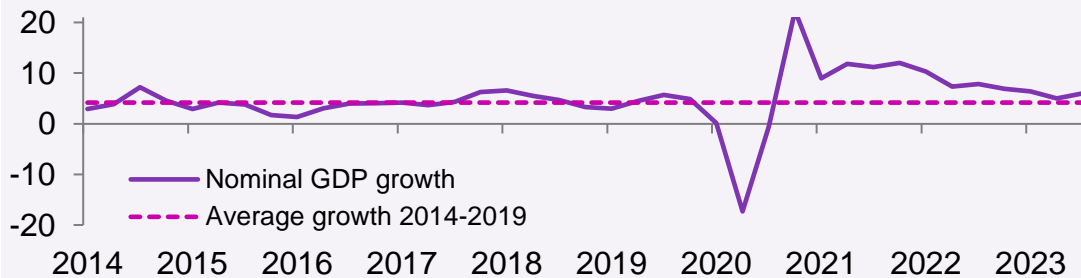
Asset Research Team

February 2024

Our global outlook at glance

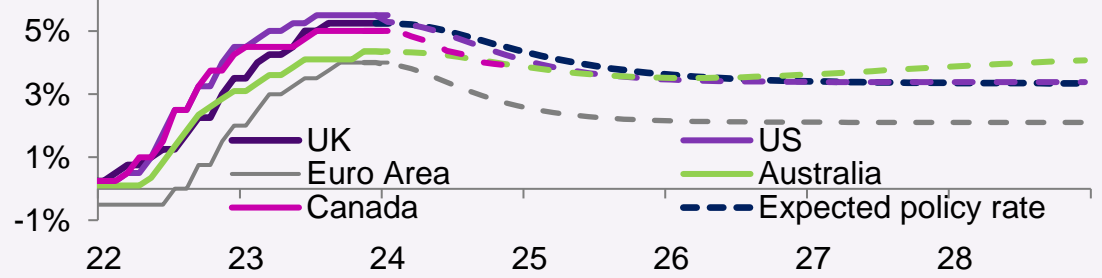
Nominal GDP growth is returning to a normal range

US nominal GDP growth, six-month chg. annualised, %

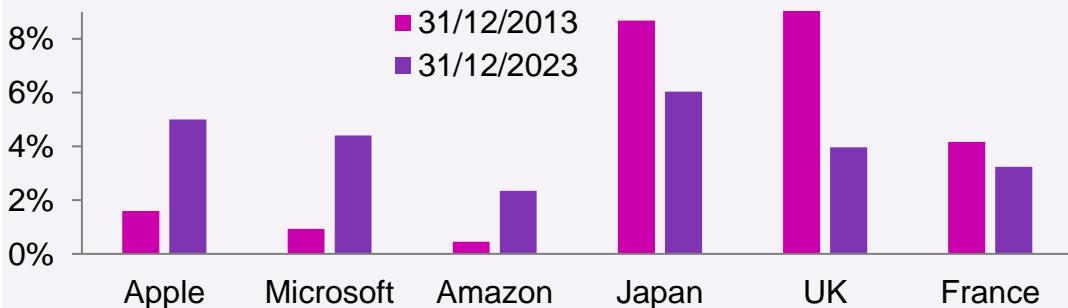


Bond markets are pricing policy rates to fall in 2024 – we agree

Policy rates and market implied path, %



The size of three stocks in a global index almost equals all of the stocks in three major economies



Position for high economic and policy differentiation

For 2024/25, we prefer a balanced portfolio, with a higher weight to government bonds, equity alpha and other uncorrelated diversifying alphas

- Risks around our growth outlook are tilted slightly to the downside
- We expect interest rate volatility and government bond yields to fall
- Stock concentration, valuation and dispersion supports active equities

Government bonds

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

What happened over the past month:

It has been a volatile start to the year in bond markets. Year-to-date (as of 05 February) US 10yr bond yields have risen 16bps but that masks some sizable intra-week swings. In terms of other major markets, the biggest 10yr yield jump occurred in the UK (38bps). By contrast, Australian 10yr yields were flat.

Factors influencing market trends:

Bond markets continue to show significant sensitivity to economic data and policy announcements. The US held interest rates at the end of January. Bond yields declined leading up to the decision following promising inflation data during the preceding week, supporting faster rate cuts. The US Treasury announced it would borrow less than expected to boot. But robust wage and employment data has seen a reversal in early February. The main factor contributing to the rise in UK bond yields was above consensus

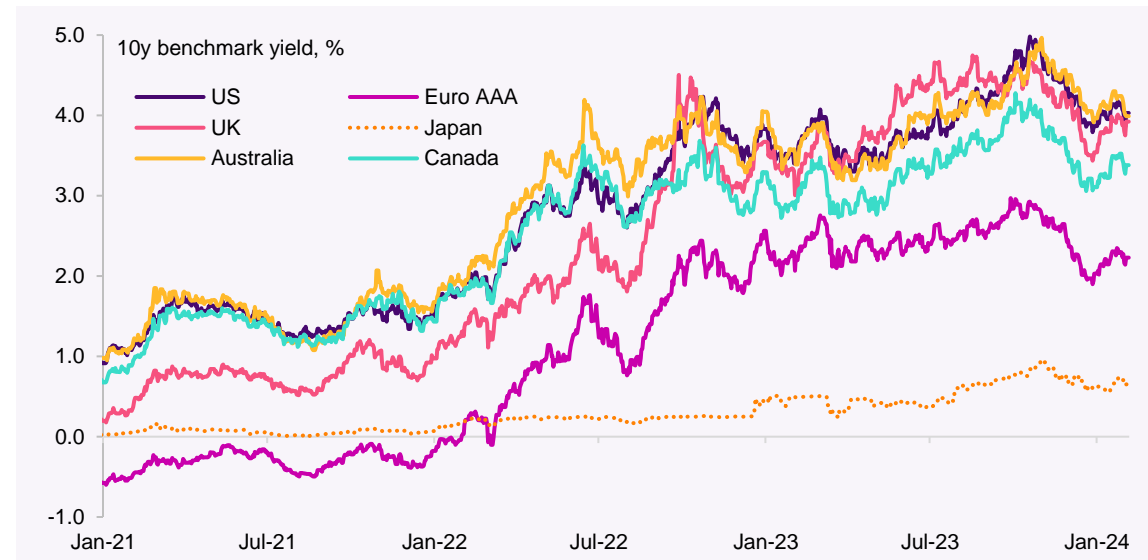
inflation. In Australia, conversely, economic and inflation data has been softer than expected.

Looking ahead:

Yield volatility may continue for the next few months. Having fallen so sharply in Q4 2023, 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.

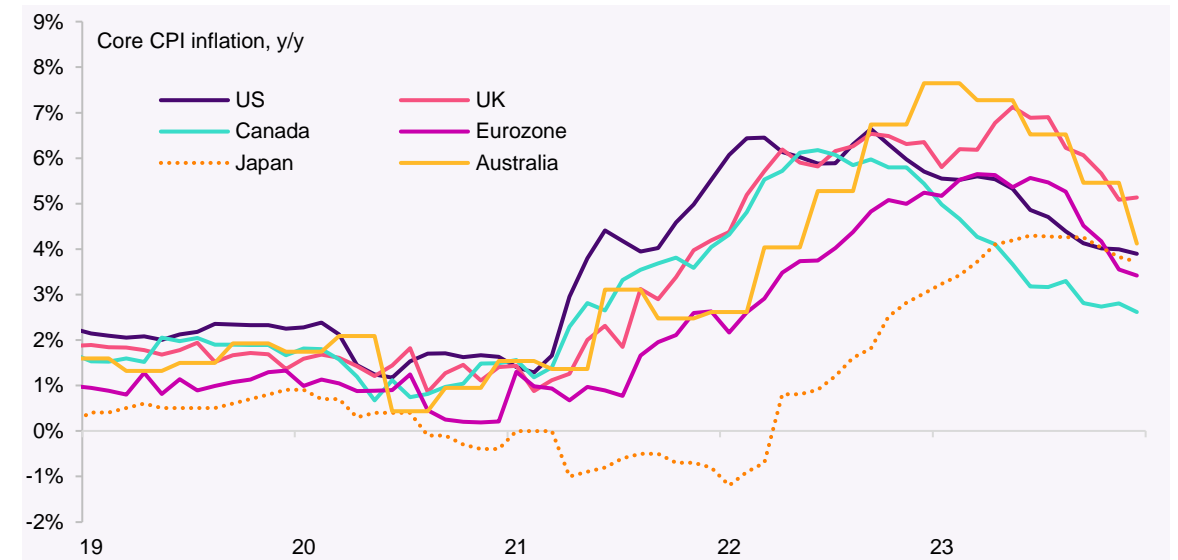
For under-hedged liability-driven-investment portfolios, current pricing appears reasonable to return towards target levels. This will help to maintain funding levels in a scenario where yields adjust down. This is a risk, particularly in the UK, given high starting yields and signs of economic weakness.

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

Core inflation is falling relatively quickly in most economies



Sources: Refinitiv Eikon, WTW

Credit

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

What happened over the past month:

Global investment grade corporate credit spreads fell slightly in January – spreads fell by 4bp from 115bp to 111bp, with spreads slightly lower in all major advanced economy credit markets. Global high yield credit spreads bucked the trend, rising by 6bp from low levels to 391bp, driven by a widening of US spreads.

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 economic growth in various advanced economies. The exceptional resilience of the US economy has also been a notable support. As a result, the **non-financial corporate downgrade and**

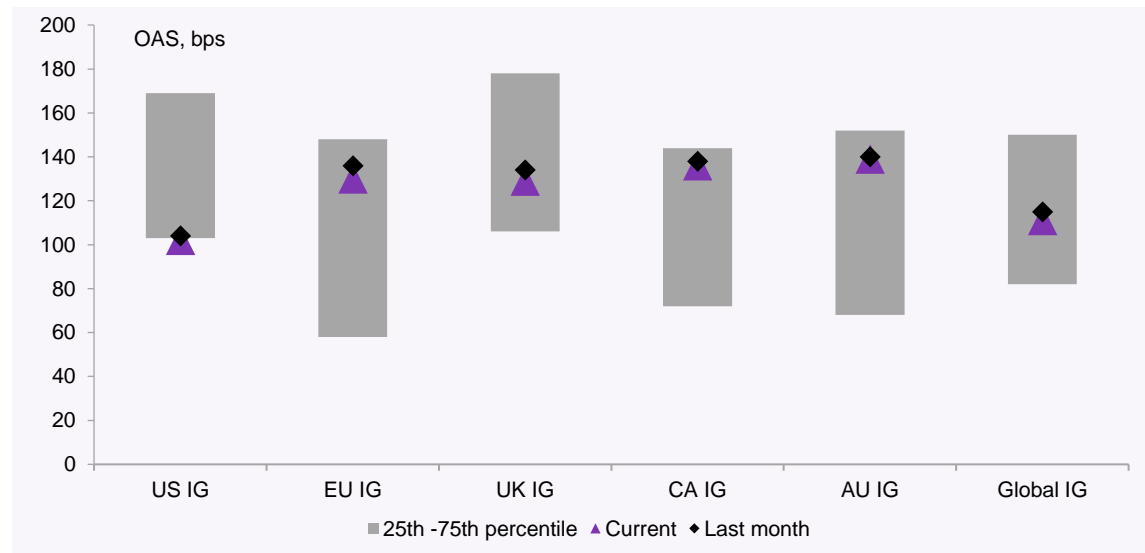
default cycle has been relatively benign throughout 2023 and into 2024.

Looking ahead:

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

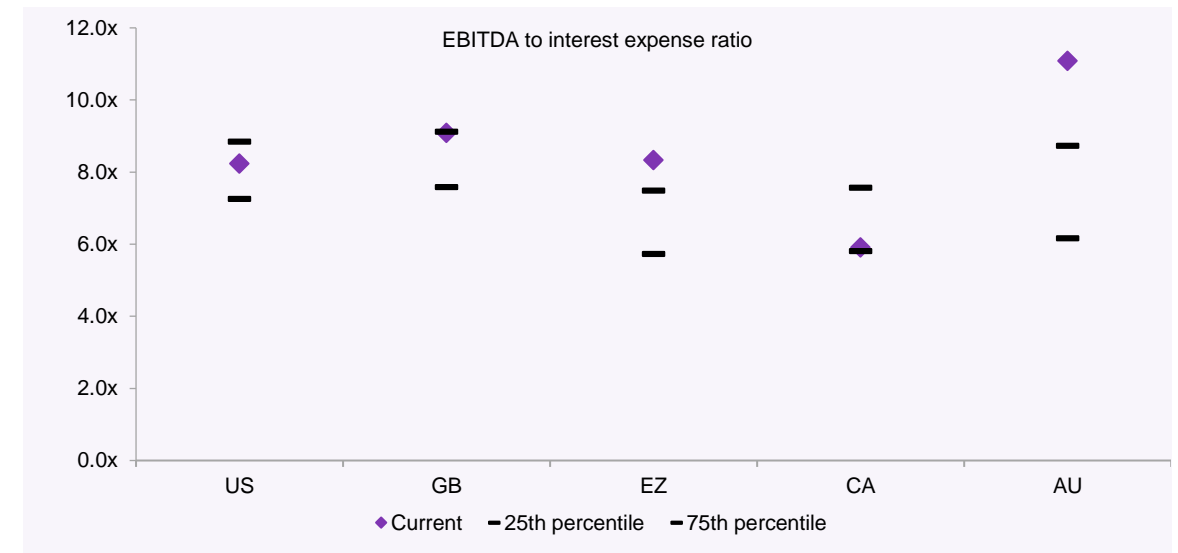
We are more cautious in the shorter-term, given the narrowing of corporate credit spreads in 2023, their low levels currently, and our slight tilt towards downside risks to earnings growth in 2024. US corporate credit spreads are especially low, are pricing-in a very good set of fundamental conditions 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 gradually weaken going forward



Sources: FactSet, WTW

Equities

Divergent performance between country equity markets at the start of the year

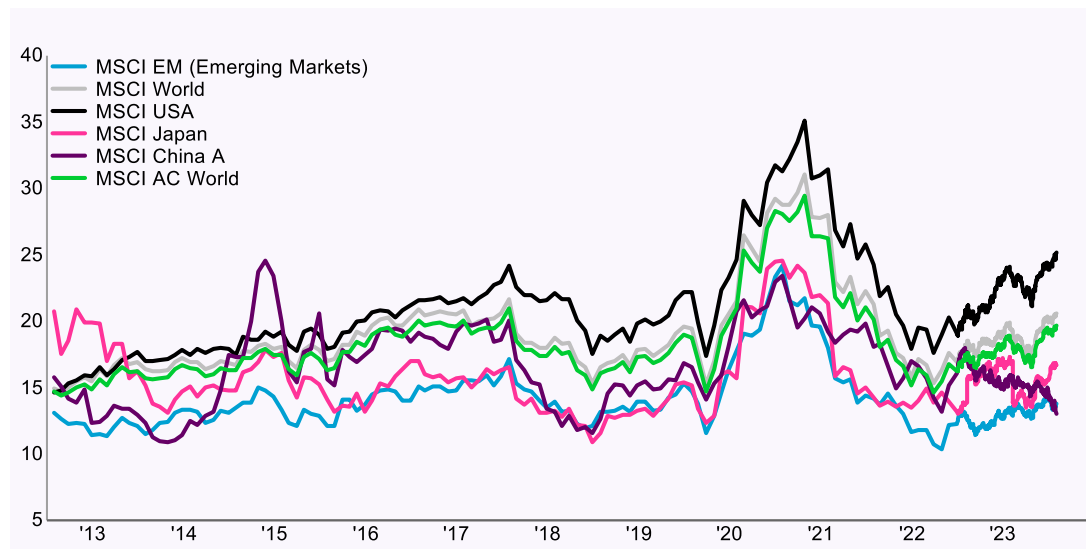
What happened over the past month:

Global equities experienced mixed performance by country in January 2024. The **MSCI Japan price index surged** by 8.6%, continuing its strong performance in 2023. This was driven by a combination of continued expectations of improvements in Japanese corporate governance and profitability and a weak Yen. The **MSCI US price index reached record highs during the month**, driven by optimism for a 'soft landing' and robust labour market data. Meanwhile, **China equities struggled** with slow retail spending, housing activity weakness, and limited expansionary stimulus from policymakers.

Broad market trends:

Equity earnings growth was relatively weak over the past year in most major economies, including a three quarters' US earnings recession that ended in Q2 2023. Looking to forward earnings, both equity pricing and analyst forecasts for future earnings growth expect that earnings will pick up significantly in 2024, in the

Global equity valuations (trailing price to earnings ratio)



Sources: FactSet, WTW

US especially. Our assessment of economic and corporate fundamentals leads us to a marginally more cautious view based on slowing 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 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.

The world equity risk premium is at the lower end of its 20-year trading range



Sources: FactSet, WTW

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:

The Japanese yen and Australian dollar depreciated close to 5% versus the US dollar. Other major currencies also declined versus the dollar, although the moves were smaller, with the UK pound especially resilient.

Factors influencing market trends:

Interest rate differentials between countries have played a key role in driving shorter-term currency volatility. Over the past month the 2-year interest rate in the UK has risen 33 basis points relative to the US, increasing the short-term relative attractiveness of the UK pound. The opposite occurred in Australian markets, with two-year interest rate differentials falling 16 basis points.

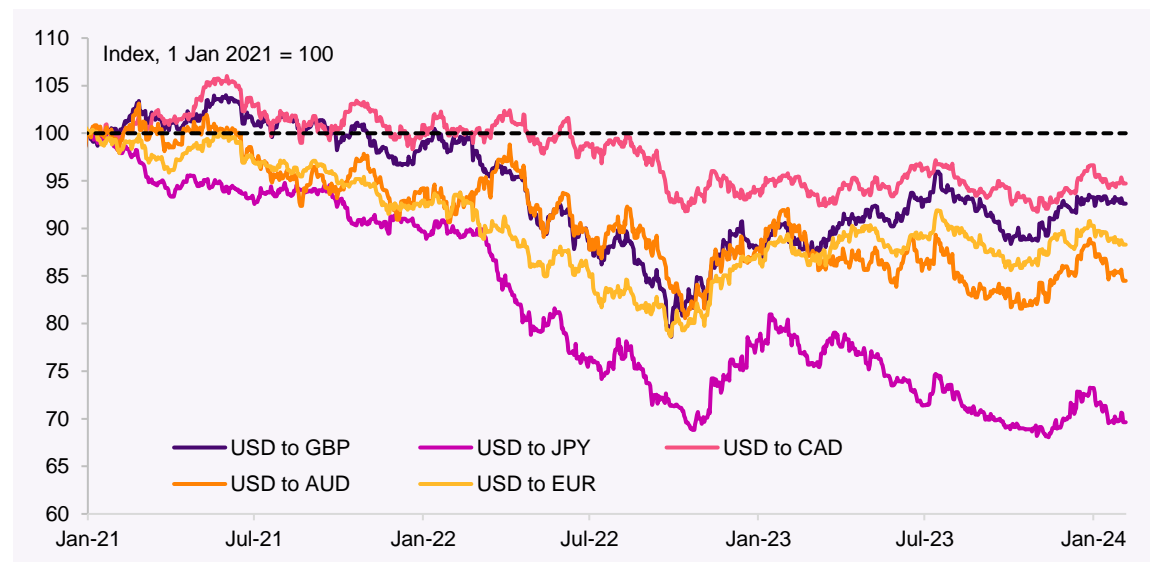
Over a two-to-three-year horizon, the US dollar remains significantly stronger. Higher US interest rates

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:

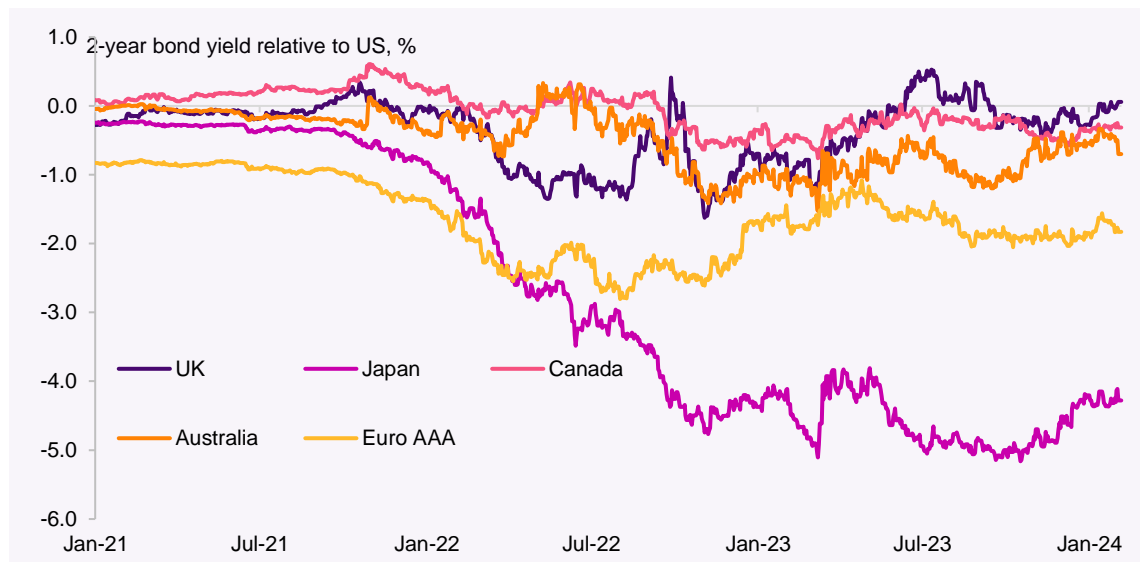
Following its appreciation, the US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and a **positive view on most developed market currencies against the dollar**. 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 US dollar



Sources: Refinitiv Eikon, WTW

Short term exchange rate dynamics have been influenced by differences in interest rates between countries



Sources Refinitiv Eikon, WTW

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