

Global Markets Overview

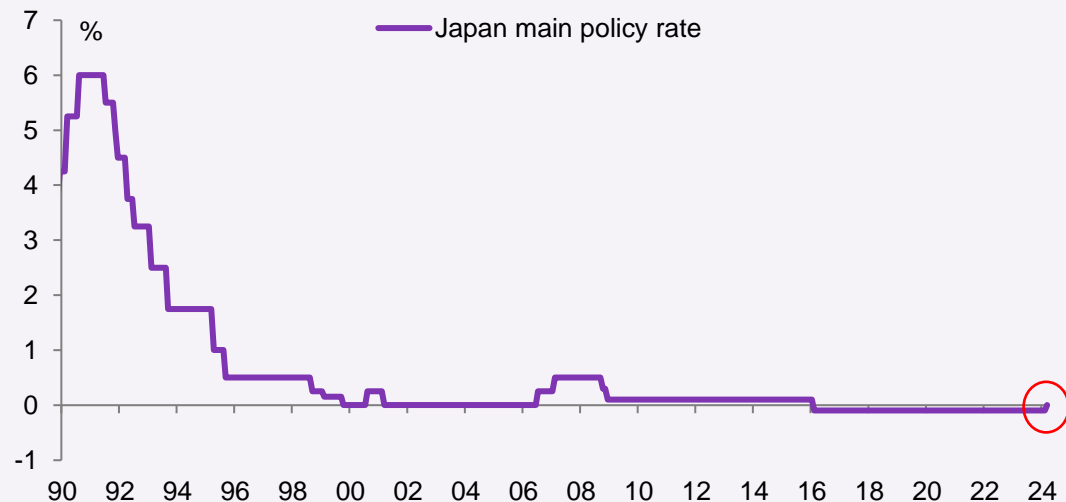
Asset Research Team

April 2024

The end of negative interest rate policy

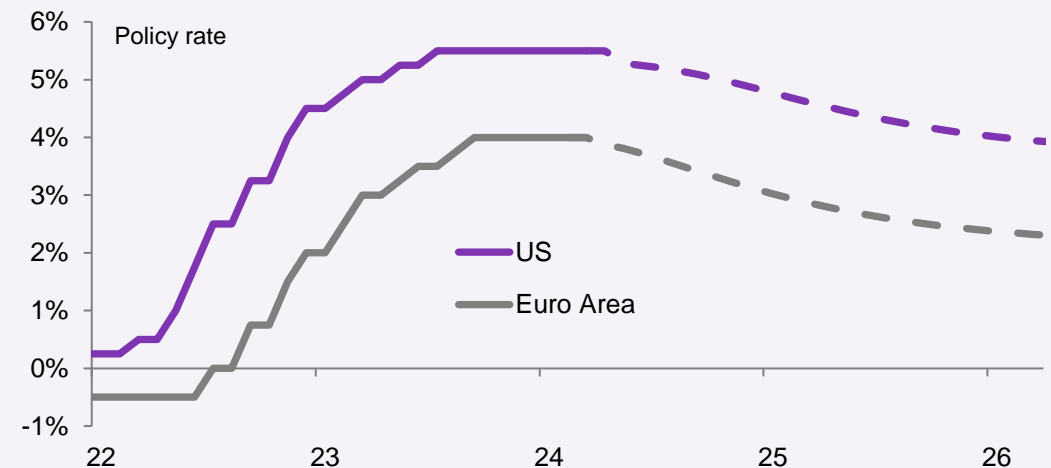
- **The Bank of Japan (BoJ) raised its policy rate from -0.1% to 0% to 0.1% – its first hike for 17 years.** This marked the end of negative interest rate policy. While doing away with a specific bond yield target, the BoJ opted to continue purchases of government bonds at a similar rate to previously.
- **The Swiss National Bank became the first advanced economy central bank to start interest rate cuts** – from 1.75% to 1.5% – in the current economic cycle. The country faces very different conditions to other major economies, with core inflation currently at only 1.1%.

Japanese policymakers raised the policy interest rate for the first time in 17 years



- **The US Federal Reserve voted to hold rates at 5.25 to 5.5% in their March meeting.** New economic projections from committee members were released as well – the median projection for rate cuts this year remained at three. Additionally, Fed chairman Powell noted that the process of slowing quantitative tightening (QT) could start “fairly soon”. Overall, the Fed still expects inflation to fall towards target by the end of this year. Despite this, US bond yields have risen since the beginning of March on the back of strong US economic growth and employment data, although wage growth continues to slow.

The market now expects fewer than three interest rate cuts in the US this year



Note. Dashed lines represent expected policy rates based on derivative pricing as of 5 April

Government bonds

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

What happened over the past month:

US bond yields have risen since the end of February. US 10y yields are currently trading around 4.4% (10 April) – the highest levels that we have witnessed this year. Other markets have followed to varying degrees. Yields in Canada and Japan also rose over the period, albeit less than the US, while UK yields dipped over the period – UK 10y rates fell 5 basis points while 10y rates are down around 20 basis points.

Factors influencing market trends:

Bond markets remain sensitive to economic data and policy news. US Federal Reserve officials continue to predict three rate cuts according to forecasts released following their March meeting. Nevertheless, more recently, US consumption and employment data has been robust, which has led investors to push back their expectations for rate cuts, driving Treasury yields higher. By comparison, UK

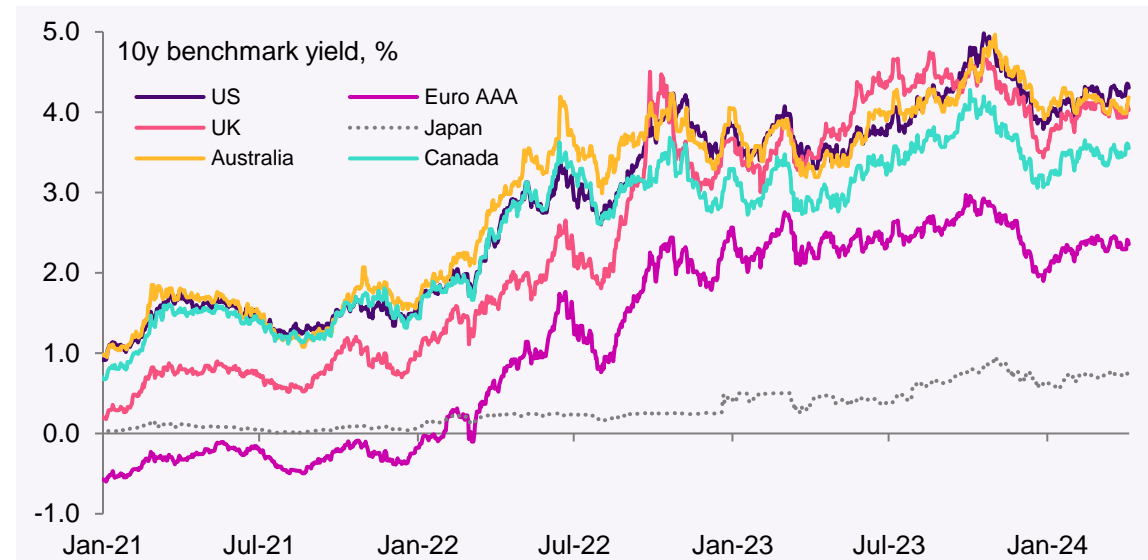
economic data has been relatively weak and Monetary Policy Committee members previously calling for hikes voted to hold last month. Alongside falling, albeit still high, inflation, this has lowered gilt yields.

Looking ahead:

Yield volatility is likely to continue for the next few months. However, as more consumers and businesses are confronted with high borrowing costs, we expect slowing economic growth 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.

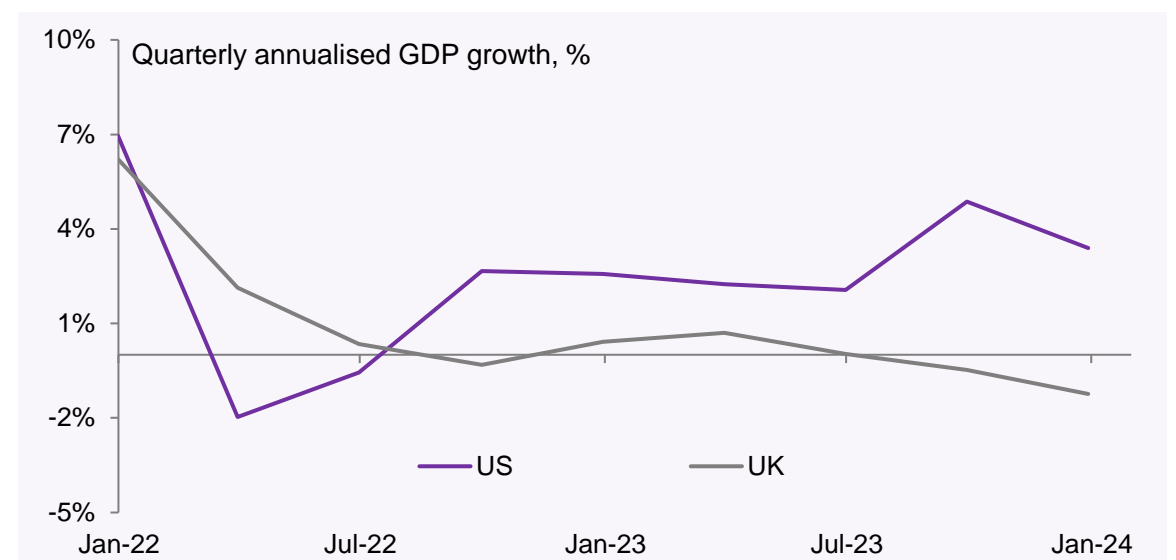
For under-hedged liability-driven-investment portfolios, current pricing appears reasonable to return towards target levels. This will help to maintain funding levels in a scenario where yields fall. This is a risk, particularly in the UK, given high starting yields and continued signs of economic weakness.

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

US versus UK real GDP growth



Sources: FactSet, WTW

Credit

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

What happened over the past month:

It was another good month for global investment grade corporate credit spreads, which fell again – spreads fell by 6bp from 107bp to 101bp. In March, it was US and European credit markets which drove these falls, with Canadian and Australian credit spreads largely unchanged. Global high yield spreads also contracted, with divergence between the main markets as US high yield spreads fell and European's rose.

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

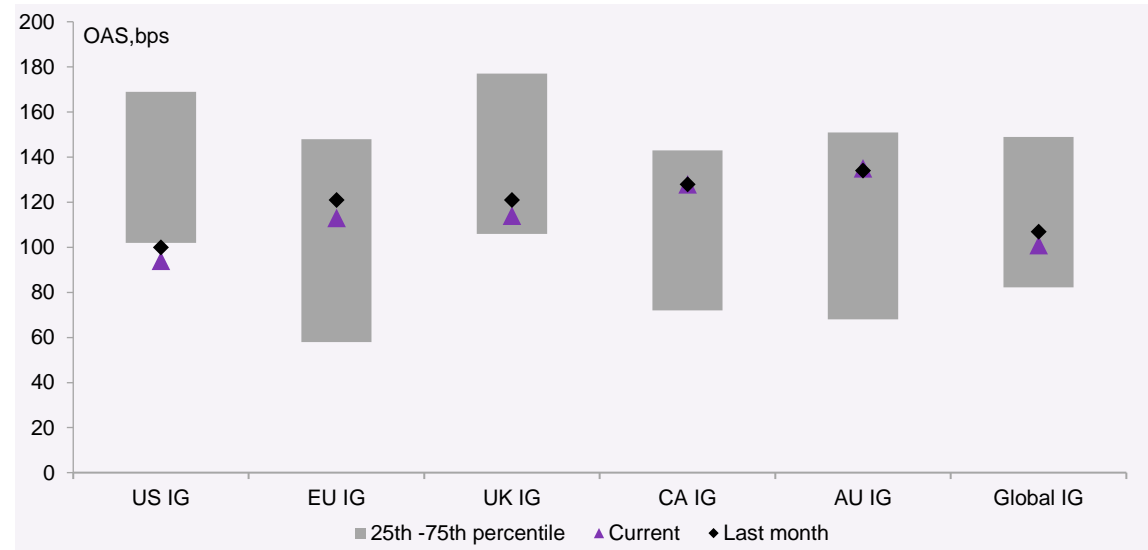
default cycle has been relatively benign throughout 2023 and into 2024. The high total yields on offer in corporate credit markets, relative to the past decade, is also attracting capital.

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.

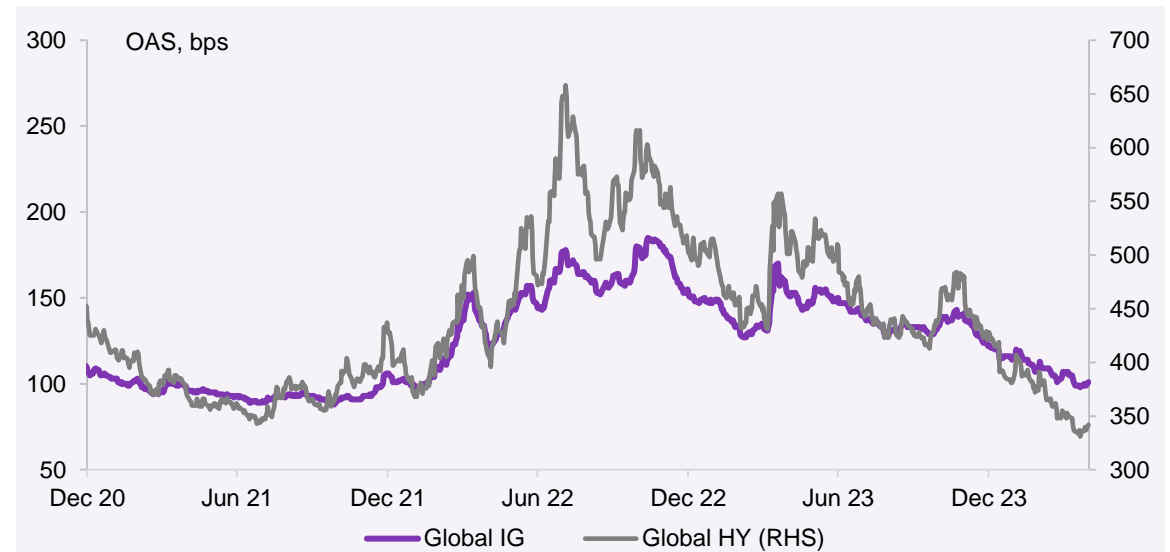
We are more cautious over 2024/25 given the narrowing of corporate credit spreads over the last 15 months and their low levels currently. Overall, we think that equities have better upside return potential than the excess returns available from corporate credit spreads, while their negative return potential is similar, on a risk-adjusted basis. We currently prefer equities and government bonds to corporate credit spreads.

Investment grade spreads by country



Sources: FactSet, WTW

Credit spreads and company debt measures show little sign of corporate stress currently – we expect both to gradually weaken in 2024/25



Sources: FactSet, WTW

Equities

Overall we retain a neutral view on equities over a five-year horizon

What happened over the past month:

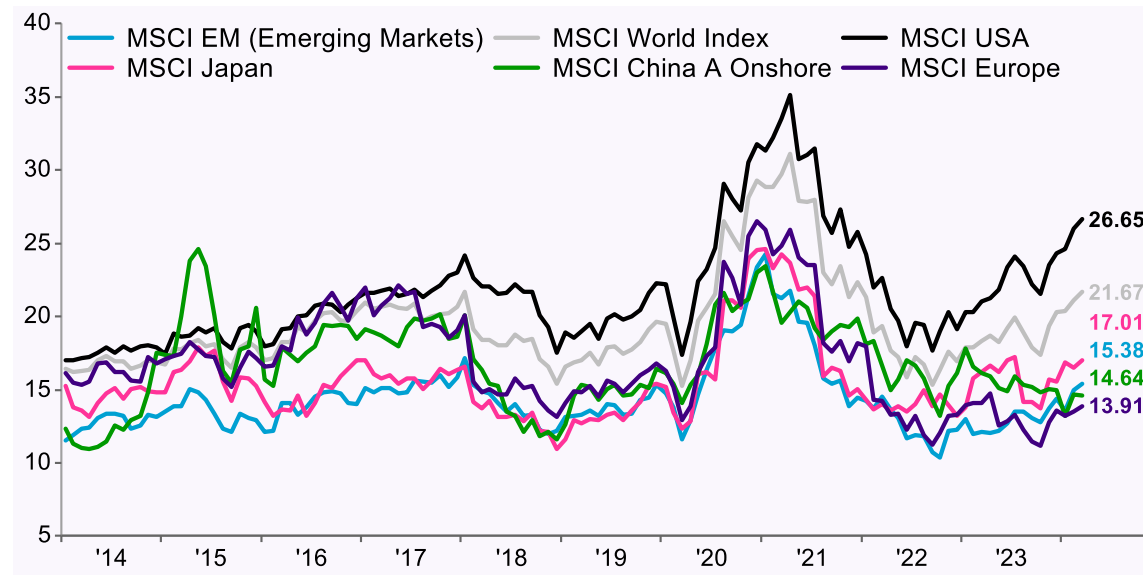
In March, global stock prices rose. On a geographical basis, March also showed improved relative performance outside of US stocks. The S&P 500 and Euro Stoxx 600 returned 3.1% and 3.7% respectively in price return terms over the month. The FTSE 100 had its strongest month since November 2022, returning 4.2% on a price return basis, while the German DAX index returned 4.6% on a total return basis.

Broad market trends:

Over the first quarter of 2024, global equity price returns continued the trends of 2023 in terms of market leadership by sector. Over the quarter, the Communication Services (CS) and Information Technology (IT) sectors returned 12.7% and 12.1% respectively. These sectors include five of the “Magnificent Seven” stocks – Microsoft (IT), Apple (IT), Nvidia (IT), Meta (CS), and Alphabet (CS).

Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

Looking to forward earnings, analyst forecasts have earnings picking up significantly in 2024, in the US especially. Our assessment of economic and corporate fundamentals leads us to a marginally more cautious view given the tight level of monetary policy currently. However, declining inflation and our outlook for a gradual easing of monetary policy in advanced economies, should support stock prices. We remain balanced in our outlook for equity returns in 2024/25.

Looking ahead:

Overall, we retain a neutral view on equities over a five-year horizon. 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 equity risk premium has fallen significantly as equities have rallied in the last 15 months



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:

Currency markets have painted a mixed picture since the end of February. Most major currencies have been flat versus the US dollar. The largest mover has been the Japanese yen, which has depreciated by -1.2%.

Factors influencing market trends:

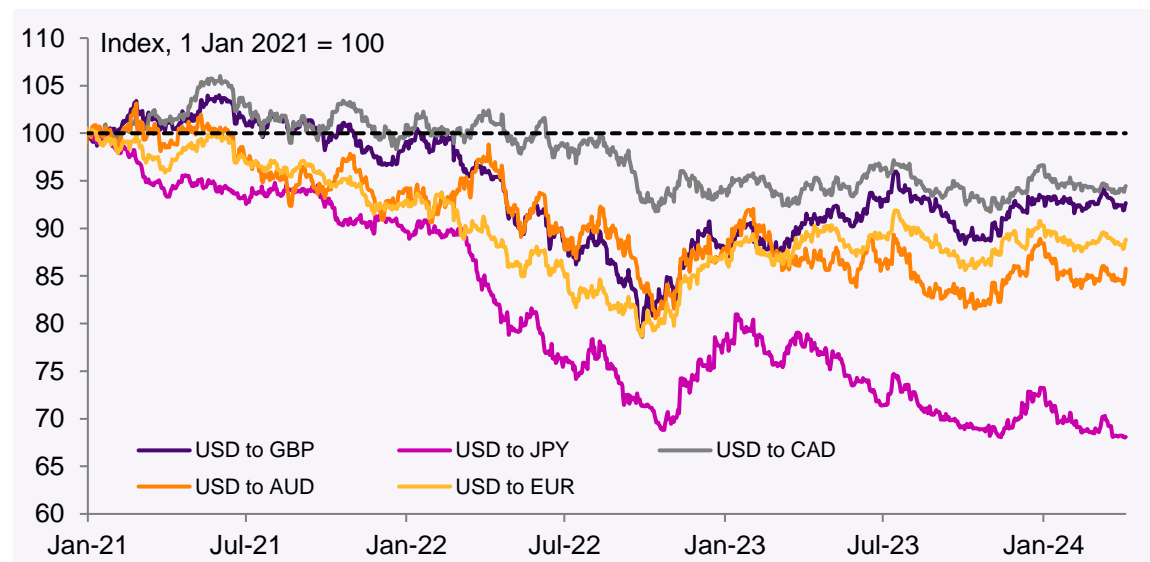
Interest rate differentials play a key role in driving short-term currency volatility. The Bank of Japan hiked its policy rate for the first time in 17 years in March. However, this was largely anticipated and accompanying comments from central bank governor, Ueda, were interpreted as being dovish. This led to short-dated Japanese yields that embed policy expectations falling versus the US.

Over a three-year horizon the US dollar has appreciated markedly across the board. 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 has supported an extended period of strong capital flows into the US.

Looking ahead:

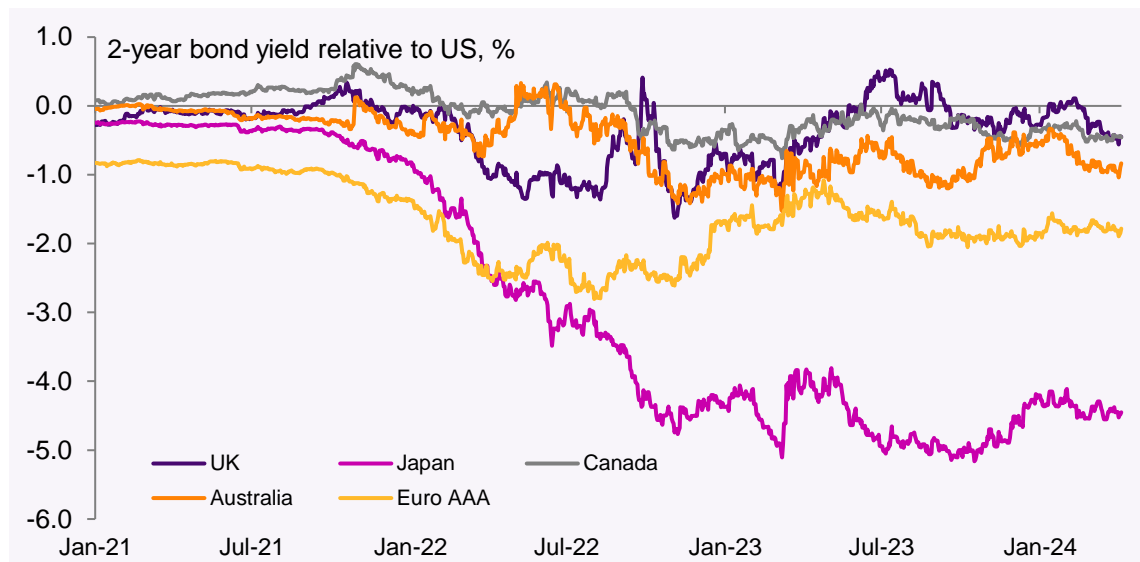
The US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and **a positive view on most developed market currencies against the dollar.** In the near term, however,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