

Viewpoints

The Path to Finding Attractive Assets

Dr. Isaac Poole, Head of Capital Market Research, Asia Pacific, talks about what the Asset Research team does at Willis Towers Watson and also how the team and other specialist groups collaborate to help Asian clients.



Isaac Poole

Tell us about your background and your role at Willis Towers Watson.

ISAAC: I'm an economist by background. I started my career at the Reserve Bank of Australia, the central bank "Down Under", as a graduate economist. After a couple of years I started a PhD in economics that took me to Oxford in the UK for a while. I eventually ended up working part time, first as an economist at Lloyds Banking Group in London during the Global Financial Crisis of 2007–2008, then as the head of economics at New South Wales Treasury Corporation in Sydney while I finished the PhD part time.

My wife was eventually transferred to Hong Kong. When I moved over here, I found a role with legacy Towers Watson as the Head of Capital Market Research in Asia Pacific.

Which part of the research process is the Asset Research team heavily involved in?

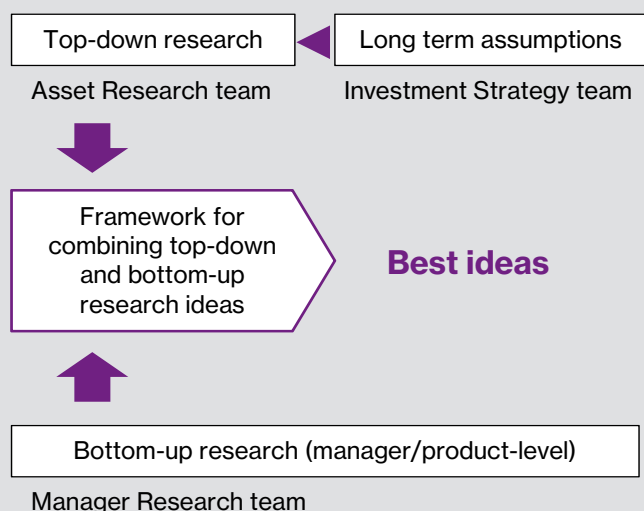
ISAAC: The Asset Research team is responsible for developing house views across asset classes and geographies. Our top-down research complements the work done by the Investment Strategy team and Manager Research team to build Willis Towers Watson's best ideas (see *Figure 1*).

As a team, we believe that economic fundamentals will assert themselves on asset prices over a medium-term outlook. We use quantitative models and our expert qualitative insights to build out our views.

We spend a lot of time thinking about the macroeconomic outlook, globally and regionally. We carefully consider asset markets to determine the set of economic conditions those asset markets are discounting. Where our assessment differs to that discounted by markets, we try to understand why, and consider the balance of pressures around the differences. When those differences are significant, we can build a view on the attractiveness of the asset class.

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Figure 1. **Research ideas joined up to build best ideas**



How does the Asset Research team help institutional investors identify risks and opportunities with asset classes?

ISAAC: Most of our research is focused on a five-year outlook. This is the timeframe that we think will be most useful for most of our investment clients. To that end, we publish an annual *Five-year Capital Market Outlook* (to be released in February) that gives our best estimate of the risks and opportunities available to clients over the coming five years (*Figure 2*).

We augment this with a monthly *Global Markets Overview* and a *Global Markets Monthly* publication. These provide our latest research on the key issues we think investors should be aware of. In these publications, we also share a clear set of ratings and our five-year return expectations across asset classes. Each rating and return forecast is accompanied by a clear narrative giving the reasoning behind our thinking.

We work closely with the Advisory Portfolio Group for Asia (APG Asia) on dynamic asset allocation using this research. Key members of APG Asia are portfolio construction specialists at Willis Towers Watson.

We also spend a good amount of time thinking about risk. Given our forward thinking process, we need to consider where we can be wrong. This lends itself to scenario analysis. We have considered a suite of different scenarios – both downside and upside risks – to consider the impact on client portfolios.

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Your work involves market and economic outlook that has return forecasts. The Investment Strategy team also does modelling of assets with return forecasts. What is the difference or linkage?

ISAAC: Our work complements the work done by the Investment Strategy team, and there are a lot of linkages. We take the long-term assumptions used by Investment Strategy into account when we build our own forecasts. But we are less constrained by these assumptions. As a result, our forecasts and return expectations can be useful for clients who want to be more market aware, especially given the historically low level of interest rates currently priced into markets.

Clients may want to consider using our return expectations and forecasts to dynamically bolster their medium-term portfolio construction, taking into account the modelling done by Investment Strategy.

who are worried about path-dependency (that is, an event persistently follows its legacy) and who are able to exploit medium-term mispricing in asset classes.

Can you share any new initiative you have been working on?

ISAAC: The Asset Research team is continuously updating and improving its processes, using new research and new techniques.

Recently, we have been working on improving our understanding of the linkages between economic fundamentals and industry sectors. We think this will improve our understanding of equity market returns.

We have also been considering return expectations over a longer timeframe than just five years. We have spent time thinking about mega-trends and themes, such as resource scarcity, climate change and demographic transitions among others. These could play out over a 10-year horizon, or longer. We expect that a deeper understanding of the potential impact of these themes on asset returns will be important for investors. ■

Figure 2. Publications produced by the Asset Research team

Willis Towers Watson

Five-year capital market outlook
March 2016

Hope for the best; plan for the worst

Background
On occasion, hindsight can be kind. The key features of our last Secular Outlook – which for precision's sake we rename the Five-year capital market outlook – have been borne out in economic and market outcomes since it was formed, with a few inevitable surprises. We believe the framework we set out in that report remains valid; therefore, in this version we update it and expand it in areas we hope will be useful. Critically, we retain the expression of our outlook in the form of scenarios in the hope that investors can use that framework to further investigate their own beliefs about the outlook and path for returns. The starting point for that path remains highly uncertain and while we have our own views, what is important is that investors develop their own.

Our central outlook
In our view, global spare capacity and high debt levels remain an important constraint on demand and policy, in large parts of the world (US especially), households, governments and central banks have adjusted to the macro settings and economic equilibrium is more or less operating. However, there are clear exceptions – for example, oil, US dollar, China, European institutions – which threaten a disruptive end to this economic and market cycle. Since our last Outlook (published August 2015) risky asset prices have fallen, but so has our assessment of economic fundamentals. With a few exceptions, we retain our central expectation for low, volatile and negatively-skewed asset returns over the next five years. We suggest investors adopt a cautious approach to portfolio risk as a consequence.

Structure
Section 1 examines the key events of 2015 from both an economic and markets perspective, and contrasts them with our outlook.
Section 2 reaffirms that the basic framework we used to express last year's Outlook holds, but updates it for changes in economic fundamentals and market price moves.
Section 3 discusses the practical actions we believe investors should be taking. Our client base is global and diverse; therefore these recommendations are broad.
For more information, contact your usual Willis Towers Watson consultant.

1. Five-Year Outlook Market Outlook 2016

Five-Year Capital Market Outlook

The five-year capital market outlook considers the plausible distribution of outcomes that investors face over the next five years. We start by examining the key events of 2015 from both an economic and markets perspective and look at the practical implications our Outlook has for investors. Our simplified decision tree, included in this report, allows investors to apply their own context and prioritise their actions based on recommendations from our Asset Research team.

Global Markets Overview

Global Markets Overview is a monthly document that provides a high level review and outlook for markets and economies.

Global Markets Overview
Asset Research Team
November | December 2016

The economic implications of changes in US policy

- We are now three weeks from Mr. Trump's election victory.
- What do we know about the likely policies of a Trump administration and their economic implications and ...
- ... as importantly, what don't we know yet?
- We think there is a high probability that spending and tax policy will be more expansionary in 2017/18.
- However, the size of stimulus is unclear – it will likely be significantly limited due to an unwillingness to materially increase the government deficit and debt ceiling.
- Post-election, we have seen US real yields and discounted inflation rates rise significantly, the US dollar strengthen, and US equity prices increase.
- In general, we think it makes sense that asset prices have moved to discount this moderately more expansionary and inflationary environment.
- In particular, the level of US bond yields is now more consistent with a US economy that is moving into the late stage of its business cycle, with inflation gradually rising.

1. Monthly overview
The constitutional referendum in Italy on 4 December is the most noteworthy upcoming political event. Rising anti-establishment sentiment amongst the global electoral base, primarily due to slower growth and rising inequality, has already shown its effects in the US election and Brexit Referendum. It remains to be seen if this political risk surfaces in Italy too.
The Italian Prime Minister, Matteo Renzi, is holding a referendum in December to amend the Italian constitution so that the government can improve efficiency and reduce costs of its operation. A rejection of the political proposals would likely lead to the government resigning and possibly to new parliamentary elections. The anti-globalist and Eurosceptic 5Star Movement is currently being fed for the lead in the polls.

2. US policy and its implications
We are now three weeks from Mr. Trump's election victory and the outcome of an all-Republican government. What do we know about the likely policies of a Trump administration and their economic implications? Just as important, what don't we know? And, broadening our perspective, what other political events are we following closely?

Asset price changes since the election
On election night, equity markets initially fell by 3-5% on average, US 10-year bond yields fell by as much as 15bps, the dollar fell against the yen and euro but strengthened against emerging market currencies such as the Mexican Peso. These price changes were consistent with higher uncertainty and higher risk premiums.
However, after those initial price moves, we have seen US real yields and discounted inflation rates rise significantly, the dollar strengthen against most developed world and emerging currencies, and US equity prices increase. These price changes are consistent with:
• Large expansionary policy, e.g., increased government spending and/or large tax cuts;
• Higher US real GDP growth rates and higher US inflation;
• A faster pace of interest rate increases by the Federal Reserve;
• Increased risks to emerging economies from protectionist trade policy and/or tightening dollar liquidity.

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Global Markets Monthly

Global Markets Monthly provides indepth analysis of markets and economies together with asset class ratings and is offered to clients through paid subscription.

Global Markets Monthly
Asset Research Team
December 2016

Sustainable investing, ESG factors and asset class returns

- We introduce some key aspects of our sustainability framework and ...
- ... the work we are doing to quantify the impacts of multiple sustainability trends and ESG (environmental, social and governance) factors on economies, industries and asset classes.
- One of the pillars of our sustainability analysis is industry-level research to determine how business profit pools are likely to change and how private and public capital will be allocated.
- When complete, the total framework will allow investors to seamlessly integrate the same financial, sustainability and ESG metrics into all aspects of portfolio management, i.e., from risk management, through portfolio construction, all the way down to security analysis.
- We briefly highlight how the framework can be used to understand and quantify climate-related risks, opportunities and financial returns.
- This is topical since the Task Force on Climate-related Financial Disclosures has just issued its recommendations to the Financial Stability Board.
- We have developed voluntary, consistent financial disclosures that "will help ensure that climate-related risks, opportunities and financial returns."

1. Monthly overview

Asset class ratings
December 2016

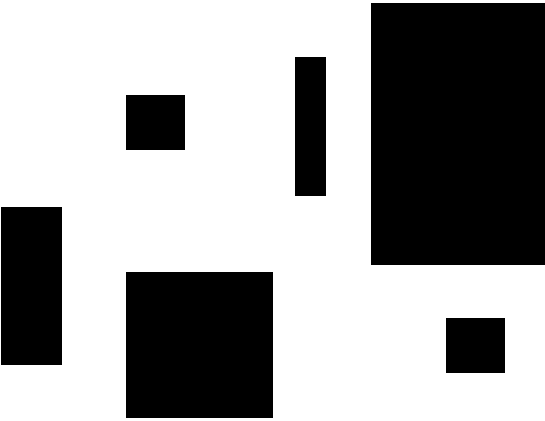
Asset class	Five-year rating	Asset class	Five-year rating
GOVERNMENT BONDS		CREDIT	
Developed world 10 year	Neutral	Global investment grade	Moderately underweight
US 5 year	Neutral	US investment grade (all maturities)	Moderately underweight
US 10 year	Neutral	US investment grade (long maturities)	Moderately underweight
US 15 year	Neutral	European investment grade	Moderately underweight
German 5 year	Moderately underweight	UK investment grade	Moderately underweight
German 10 year	Moderately underweight	US high yield	Moderately underweight
UK 5 year	Moderately underweight	Euroland high yield	Moderately underweight
UK 10 year	Moderately underweight	US leveraged loans	Moderately underweight
Australian 5 year	Neutral	EM external currency	Moderately underweight
Australian 10 year	Neutral	EQUITIES	
Japanese 5 year	Moderately underweight	World	Moderately underweight
Japanese 10 year	Moderately underweight	Developed vs World	Moderately underweight
Canadian 5 year	Neutral	Emerging vs World	Neutral
Canadian 10 year	Neutral	US (large cap) vs World	Moderately underweight
EM local currency debt	Moderately underweight	US (small cap) vs World	Moderately underweight
INFLATION LINKED BONDS		EM external currency	Moderately underweight
Developed world 10 year	Neutral	Euroland vs World	Moderately overweight
US 5 year	Moderately overweight	UK vs World	Neutral
US 10 year	Moderately overweight	Japan vs World	Neutral
Euroland 5 year	Neutral	Australia vs World	Neutral
Euroland 10 year	Neutral	FX (vs. USD)	
UK 5 year	Neutral	Euro	Moderately underweight
UK 10 year	Neutral	Sterling	Neutral
Australian 5 year	Neutral	Yes	Neutral
Australian 10 year	Neutral	Australian Dollar	Neutral
COMMODITIES		Canadian Dollar	Neutral
Oil	Neutral	EM currency	Moderately underweight
Industrial metals	Neutral	LIQUID ALTERNATIVES	
Ratings change in last Source: Willis Towers Watson		Reinsurance	Moderately underweight

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Global Markets Monthly 3

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