

Global Markets Overview

Asset Research Team

March 2022

Our 2022 Global Investment Outlook

- As public- and private-sector leaders increasingly integrate economic inclusion and climate change into their long-term policy and growth strategies, investors need to consider the financial benefits and risks which come from the combination effects of this social, environmental, and economic investment.
- This is occurring at a time when financial markets are at a pivotal point in the capital cycle. In advanced economies, the major central banks are beginning to tighten monetary policy and governments are slowing their pace of spending in response to strong growth and high inflation.
- WTW tracks hundreds of specific geographical and sectoral changes from policy, purpose, and demand changes. This type of probabilistic real-world risk assessment enables us to determine which specific components or uncertainties with respect to monetary and fiscal policy, inclusive growth, climate transitions, and – currently – geopolitical risks and conflict pose the greatest risk to financial investors and countries. With that we can develop investment strategies that manage that risk, reduce the uncertainty, and preserve financial value.
- Our observations below are focussed solely on our outlook for global economic conditions rather than the humanitarian effects of the Ukraine-Russia crisis.

Economic categories	Our outlook at the start of 2022	An update
Economic policy	<ul style="list-style-type: none">▪ Strong aggregate demand and high inflation is placing pressure on monetary and fiscal policy to “pivot” tighter in advanced economies	<ul style="list-style-type: none">▪ Our outlook for the pace of economic policy tightening is broadly unchanged▪ The central bank trade-off between controlling inflation and supporting growth is more complicated
Inflationary pressures	<ul style="list-style-type: none">▪ High inflation has been driven by rising energy and food prices, high pandemic-related demand for goods, and bottlenecks in the supply of these goods▪ Our outlook is for inflation to fall in the second half of 2022 and over 2023 but the risk around this is tilted towards higher inflation	<ul style="list-style-type: none">▪ We now expect higher commodity prices in 2022 and for improvements to supply-chain bottlenecks to take longer▪ This means average inflation in 2022 will be higher than we expected in the US and Europe; nevertheless, we still expect inflation to gradually fall back to around central bank targets in 2023
The capital & spending cycle	<ul style="list-style-type: none">▪ US and European households and businesses have high amounts of cash on their balance sheets▪ We expect some of this excess cash to be spent, supporting good economic growth rates in the major advanced economies in 2022/23	<ul style="list-style-type: none">▪ Higher average inflation in 2022, means a bigger squeeze on household real incomes and spending and, potentially, weaker confidence▪ While this will slow growth, it is occurring from a high base of strong employment growth and high savings – we still expect good economic growth rates in 2022/23

Tracking recent asset price moves and our outlook

Summary: government bonds

Changes to market pricing (government bond yields)

11 March 2022

March 11, 2022		Spot yields					What's priced-in		
% / %pts		Level	Δ 1m	Δ 3m	Δ 1y	Δ 3y	1y fwd	2y fwd	5y fwd
Developed nominal yields	Eurozone								
	1y/cash	-0.62	0.00	0.15	0.04	-0.06	-0.18	0.10	0.42
	5y	-0.01	-0.05	0.58	0.64	0.36	0.20	0.32	0.46
	10y	0.22	-0.01	0.59	0.57	0.16	0.34	0.40	0.47
	US								
	1y/cash	1.25	0.15	0.94	1.18	-1.29	2.29	2.33	1.95
5y	2.03	0.12	0.77	1.25	-0.41	2.14	2.08	2.13	
10y	2.01	0.03	0.48	0.40	-0.65	2.18	2.21	2.37	
Breakeven inf.	US (CPI)								
	3y	3.69	0.53	0.62	1.10	1.76	-	-	2.13
	5y	3.10	0.32	0.36	0.62	1.22	-	-	2.26
10y	2.72	0.23	0.22	0.34	0.84	-	-	2.17	

Source: FactSet

A summary of our assessment of government bond pricing and prospective medium-term outcomes

Sovereign bonds	Asset return outlook	Comments
Developed short interest rates		
US		<ul style="list-style-type: none"> Central bank guidance is focused on interest tightening in the major advanced economies, in the face of significantly above-target inflation and robust growth; the Federal Reserve, Bank of England, and Bank of Canada have increased policy rates; central banks have also slowed their pace of asset purchases. Forward short rates and/or bond yields are materially above levels from 12-months ago. In most of the major bond markets, this increase leaves market expectations for future interest rates broadly in line with our assessment of economic conditions and risks.
UK		
AAA-Eurozone		
Developed 10-year nominal bonds		
US		<ul style="list-style-type: none"> Despite bond market volatility around the Ukraine crisis, intermediate yields remain much higher than the start of the year. In the short run, we believe that risks to yields remain biased upwards. Bond risk premia appear low relative to the plausible range of future policy rate increases, given our expectation of good growth and upside risks to inflation; this view is stronger in the US than other bond markets. In our base case we, ultimately, expect structural forces, like debt and demographics, in conjunction with central bank intervention to manage financial conditions and limit significant yield rises. However, we retain a somewhat cautious stance within key developed bond markets for now, especially for US bonds.
UK	↑	
AAA-Eurozone	↑	

Key: Highly negative Negative Neutral Positive Highly positive

US bonds now look more fairly valued at shorter maturities after recent increases in short-dated yields; we think 10-year bond yields look too low and are more likely to rise than fall

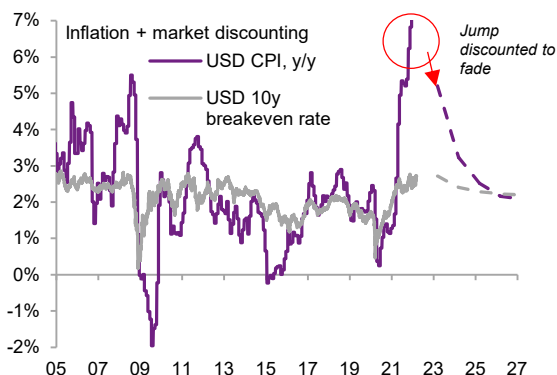
US cash rate and 10y nominal bond yield



Source: FactSet, Willis Towers Watson

Expectations for future US inflation over the medium- and long-term remains anchored; markets are pricing in that the recent jump in prices will fade

US CPI inflation rate and inflation market pricing



Source: FactSet, Refinitiv, Willis Towers Watson

Tracking recent asset price moves and our outlook

Summary: credit

Changes to market pricing (credit spreads)

28 February 2022

28 February 2022		Pricing - Option adjusted spreads, bps					Implied defaults				
		Current	Δ1m	Δ3m	Δ1y	Δ3y	Current	Δ1m	Δ3m	Δ1y	Δ3y
High grade	Global	136	26	30	41	5	0.9%	0.7%	0.8%	1.0%	0.1%
	US	130	20	27	35	1	0.8%	0.5%	0.7%	0.9%	0.0%
	Eurozone	148	41	37	59	18	1.2%	1.0%	0.9%	1.5%	0.5%
	UK	153	29	36	46	-9	1.3%	0.7%	0.9%	1.2%	-0.2%
	Canada	131	9	19	25	-1	0.8%	0.2%	0.5%	0.6%	0.0%
	Australia	116	9	6	34	-6	0.4%	0.2%	0.2%	0.9%	-0.2%
Low grade	Global HY	458	40	21	75	47	2.3%	0.6%	0.3%	1.1%	0.7%
	US HY	377	14	10	20	-15	1.1%	0.2%	0.1%	0.3%	-0.2%
	Eurozone HY	445	78	74	121	48	2.8%	1.1%	1.1%	1.7%	0.7%
	US loans	429	20	18	22	31	1.8%	0.3%	0.3%	0.3%	0.4%
HC EMD	Hc EMD Corps	364	67	40	98	97	4.7%	1.6%	1.4%	2.4%	2.4%
	HC EMD Sov	386	78	70	121	121	3.0%	1.0%	0.6%	1.5%	1.5%

Source: Credit pricing is from ICE Bank of America and FactSet

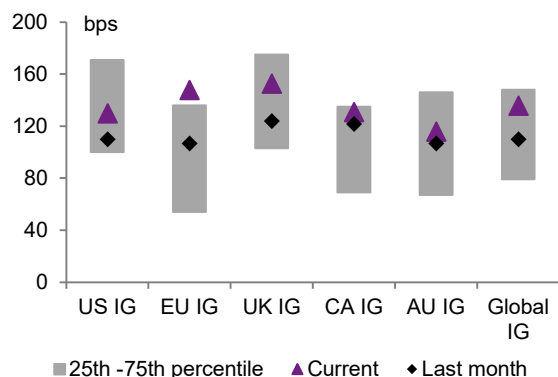
A summary of our assessment of corporate credit pricing and prospective medium-term outcomes

Credit	Asset return outlook	Comments
Corporate credit		
Inv. grade		• Increases in investment grade credit spreads over the last month mean markets are now pricing-in an expectation for a broadly average level of credit losses over the medium-term.
High yield		• We expect credit losses to be close to these levels, particularly in the nearer term, but with risks moderately more tilted to higher losses.
US		• At current credit spreads, high quality credit assets are at levels at which they are likely to provide moderate returns above equivalent maturity government bonds in our view.
Europe		• We retain a marginally more cautious outlook for developed market speculative-grade credit. Credit spreads have risen, however, pricing still implies a slightly below average level of defaults relative to historic averages.
Loans		
US		• The relative value of securitized credit markets is broadly comparable to traditional corporate credit markets.

Key: Highly negative Negative Neutral Positive Highly positive

Investment grade spreads widened materially over the past month and have moved broadly towards the mid and upper end of their historic ranges

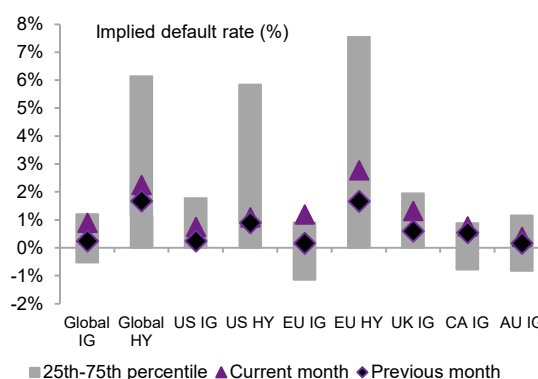
Investment grade corporate option-adjusted spreads, bps



Source: FactSet, Willis Towers Watson.

Rising investment grade spreads have increased our measure of implied credit losses to more attractive levels; HY spreads are slightly less attractive

Estimated implied default rate based on current pricing



Source: FactSet, Willis Towers Watson.

Asset Research Team

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Tracking recent asset price moves and our outlook

Summary: equity

Changes to market pricing (equity)

11 March 2022

11 March 2022	Δ 1 month			Δ 1 year				Δ 3 years (pa)		
	Total return	EPS	Trailing P/E	Price return	Total return	EPS	Trailing P/E	Total return	EPS	Trailing P/E
Australia	-0.2%	16.4%	-15.6%	4.9%	9.7%	100.1%	-47.6%	8.0%	6.7%	-4.8%
Canada	-0.8%	6.6%	-7.1%	14.1%	17.2%	66.9%	-31.6%	12.8%	12.4%	1.4%
Eurozone	-11.8%	12.7%	-24.8%	-3.6%	-1.3%	71.0%	-48.1%	5.7%	2.7%	-1.7%
Japan	-8.8%	3.7%	-12.1%	-6.3%	-4.3%	72.6%	-45.7%	7.0%	4.0%	-3.6%
UK	-5.1%	19.2%	-21.1%	8.4%	12.9%	89.3%	-42.7%	3.1%	-0.2%	-1.1%
US	-5.1%	7.1%	-11.5%	4.8%	6.3%	66.9%	-37.2%	16.0%	10.3%	-1.6%
China	-19.3%	-5.5%	-15.3%	-40.9%	-40.1%	-3.6%	-40.5%	-5.2%	-4.8%	-7.4%
MSCI World	-5.8%	8.7%	-14.0%	3.3%	5.2%	66.9%	-39.3%	12.8%	8.0%	-0.5%
MSCI EM	-10.7%	-7.9%	-4.9%	-17.7%	-15.6%	27.1%	-37.0%	5.1%	-0.4%	-2.2%

Source: FactSet, Willis Towers Watson.

A summary of our assessment of equity pricing and prospective medium-term outcomes

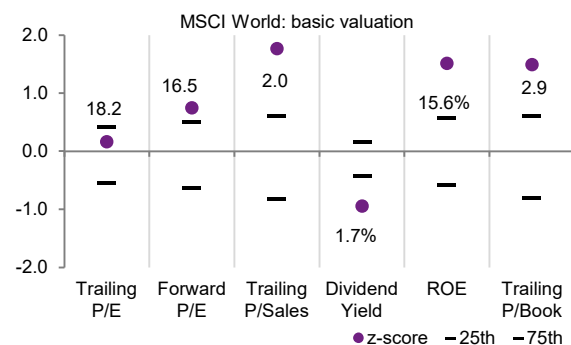
Global equities	Asset return outlook
Developed	
Emerging	

- The market volatility of January extended over the last six weeks, due to the escalation of the Russia-Ukraine crisis, higher commodity prices and expected inflation in 2022, and rising government bond yields.
- Earnings in advanced economies have risen significantly over the last year – in line with our expectations – which has also reduced core valuation metrics, e.g., price/earnings ratios, relative to a year ago. With earnings having broadly recovered from their falls last year, the path of inflation and its impact on margins remains key for equity markets in 2022..
- US valuations remain higher than broader developed markets. This has been concentrated in mega-cap tech stocks, with some recent reversal given their sensitivity to rising US bond yields. We think the outlook for US stocks over the coming five years is less attractive relative to broader markets. Current valuations price-in a continuation of a regime of high earnings, inconsistent with a changing policy dynamic in the US, which is less supportive of very high margins and corporations taking an outsized share of profits relative to labour. We continue to think there is moderately better value on offer in European and Japanese markets.
- EM valuations are lower vs. developed markets. We expect relative EM valuations to rise as the global economic recovery broadens further.
- Overall, we retain a neutral view on equities.

Key: Highly negative Negative Neutral Positive Highly positive

Basic developed market financial ratios remain moderately high despite falling prices over the last month

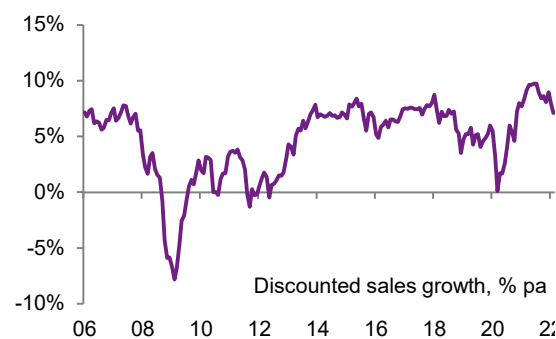
Valuation metrics for the MSCI World equity index



Source: FactSet, Willis Towers Watson.

Earnings growth priced-in to equities is somewhat elevated, but we think achievable in the next few years

Medium-term growth priced-in by world equity price, % pa



Source: FactSet, Willis Towers Watson.

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