

Global Markets Overview

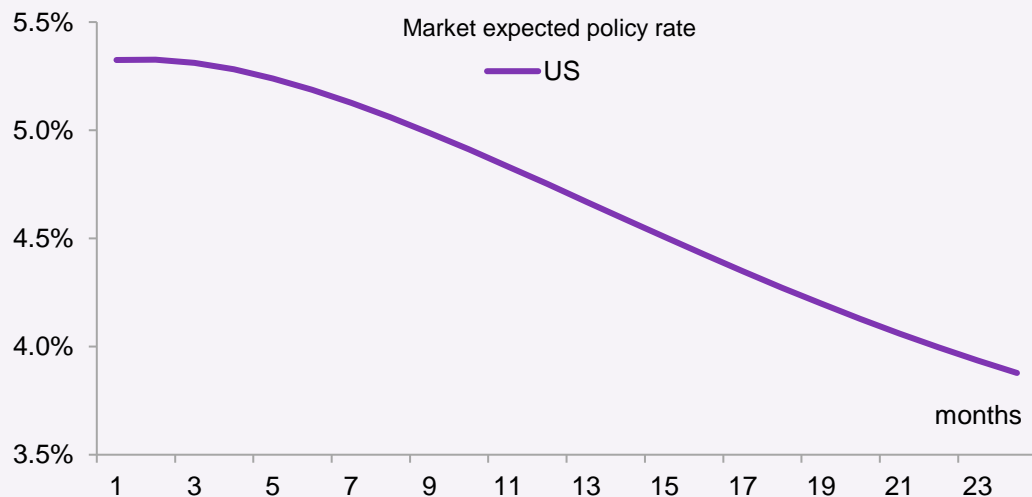
Asset Research Team

May 2024

What's been driving markets in the US?

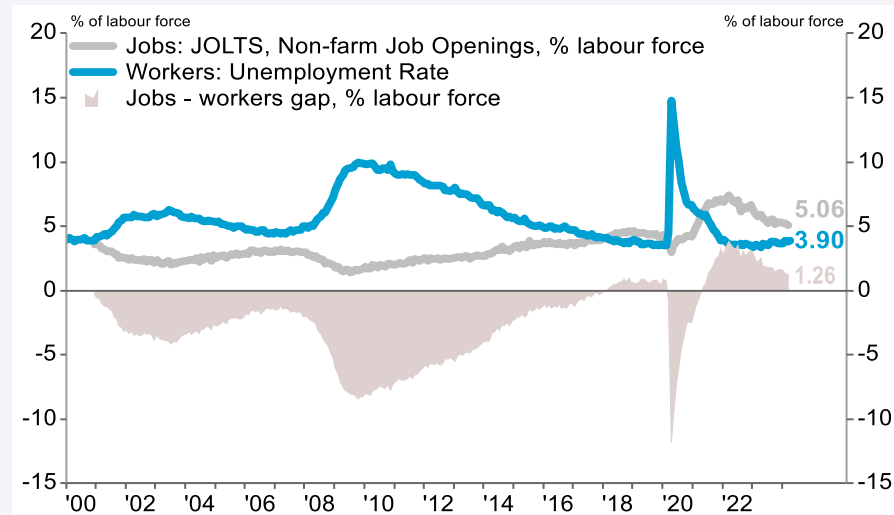
- **The US FOMC left the Fed Funds rate on hold in its May meeting.** At the press conference Chair Powell stated that it is unlikely the next policy move will be a rate hike and reiterated “we do not expect that it will be appropriate to reduce the target range for the federal funds rate until we have gained greater confidence that inflation is moving sustainably toward 2%”.
- We think the latest US economic statistics mainly point towards a labour market that is gradually rebalancing, which should lead to lower wage growth, lower services inflation, and US core inflation returning towards the Fed target.

The expected path for US policy rates priced into the bond market



- For example, employment grew by 175,000 in April, the smallest gain in six months and well below market expectations. The unemployment rate increased to 3.9% and average hourly earnings rose by 0.2% on the month and 3.9% over the year – the slowest rate in nearly three years.
- While this remains our central outlook, US economic data remains mixed and inconclusive – the weaker payroll report contrasted with the strong gains in the employment cost price index released a little earlier. We continue to monitor the risk of US inflation staying higher than we expect.

The US labour market continues to rebalance in our view



Government bonds

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

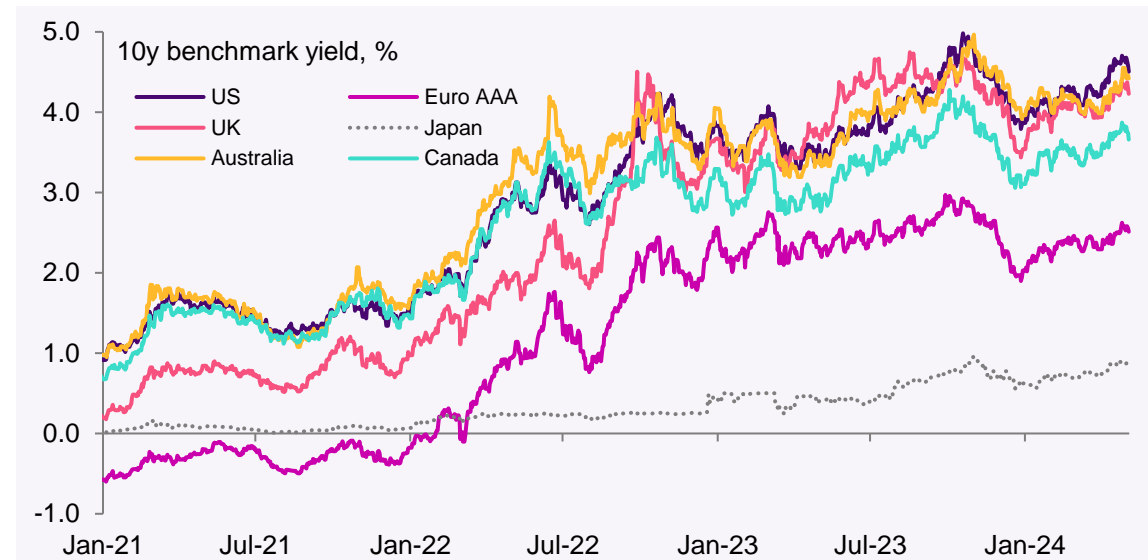
What happened over the past month:

Developed market bond yields continued to rise through much of April but have fallen more recently. US 10y benchmark yields moved above 4.7% at one point but have since fallen to around 4.5% as of May 9. Australian 10y yields have risen the most among major developed markets, jumping close to 50 basis points since March.

Factors influencing market trends:

Bond markets remain sensitive to economic data and policy news. Last month saw several upside surprises in US data. Inflation surprised to the upside, rising to 3.5% from 3.2%. Retail sales growth was more than double consensus expectations. Such surprises led to concern that inflation might not drop towards target this year, leading to markets revising up interest rate expectations and driving up bond

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

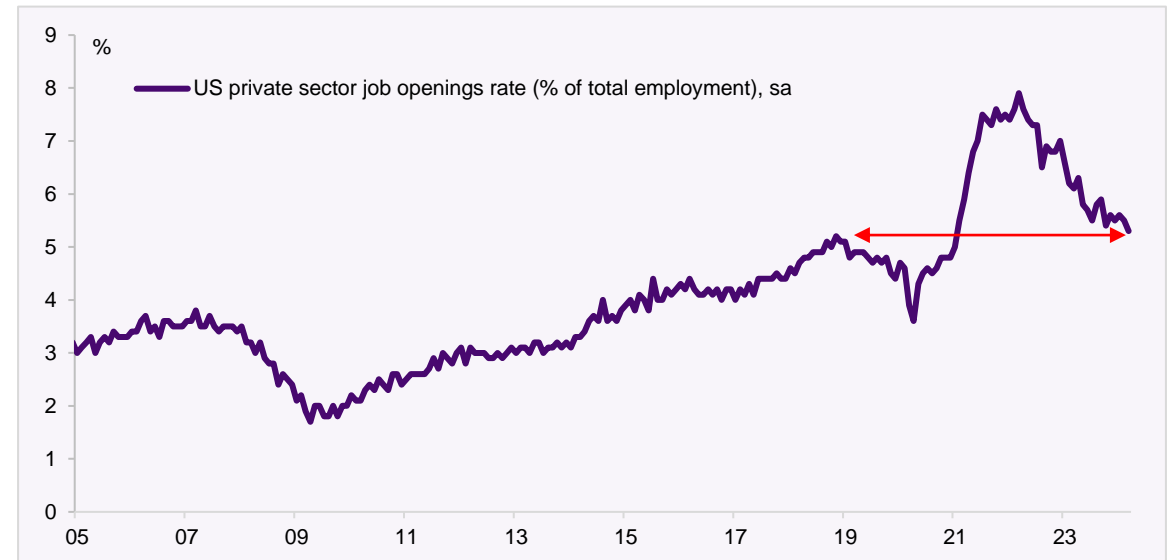
yields. More recently, US labour market data has pointed to rebalancing and cooling wage growth, easing inflation fears and lowering the US bond yield. Australian government bonds were also impacted by a domestic inflation surprise.

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 economic growth to track a little below trend, labour markets to keep rebalancing, and inflation to fall to central bank targets. This will allow central banks to cut interest rates. **Over 1 to 3 years, we think it is likely 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.

US job openings have trended down in a sign of continued labour market rebalancing



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 continued their year-to-date march downwards, although moves in April were much more incremental – spreads fell by 3bp from 101bp to 98bp, largely due to falling US credit spreads. Global high yield had a volatile month, with spreads rising by 20bp at one point, before ending April 3bp lower.

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**

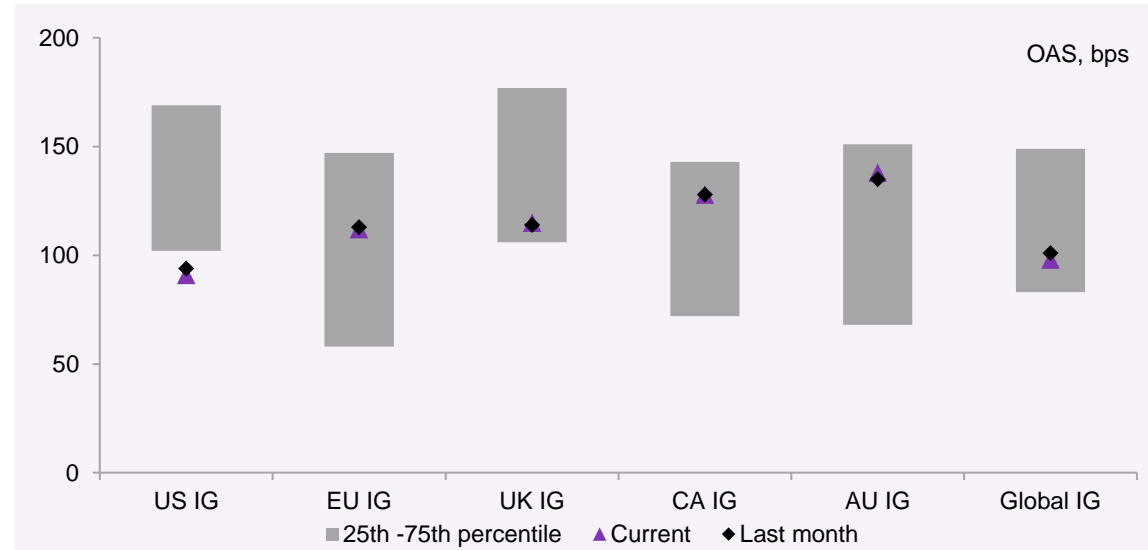
default cycle has been relatively benign throughout 2023 and into 2024.

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.

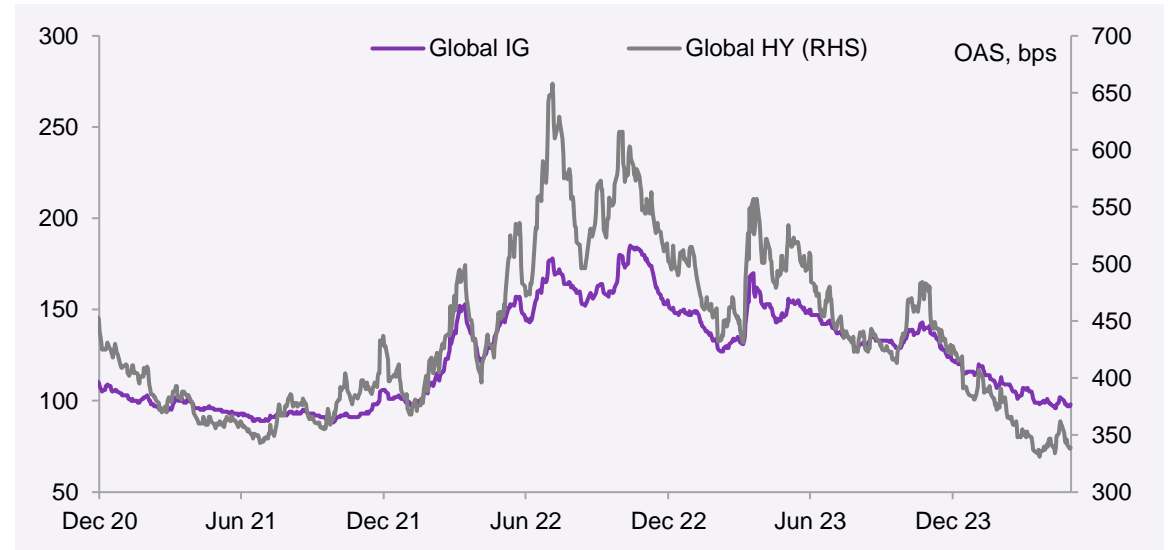
We are more cautious in the shorter-term, given the narrowing of corporate credit spreads in 2023, their low levels currently, and possible risks to earnings growth in 2024. US corporate credit spreads are especially low, are pricing-in a very good set of fundamental conditions for company debt, and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

Investment grade spreads by country



Sources: FactSet, WTW

For the time being, both credit spreads and company debt measures show little sign of corporate stress – we expect this to gradually weaken going forward



Sources: FactSet, WTW

Equities

Resilience and Economic Strength

What happened over the past month:

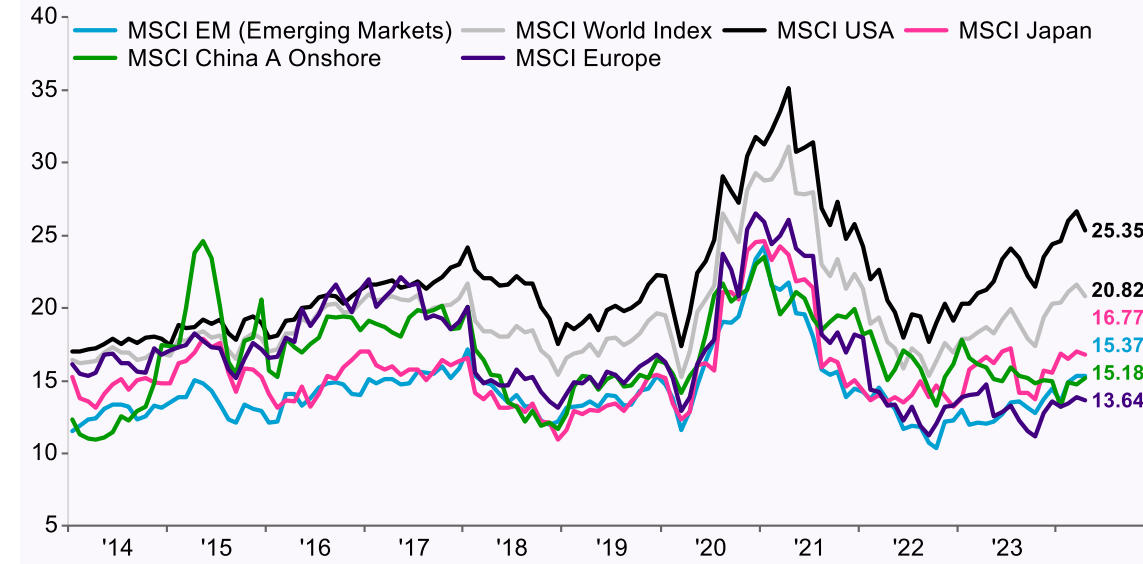
In local currency total return terms, global equities fell over the last month by 2.7%. The MSCI EM Index rose by 1.7%, while the developed market MSCI World Index dropped by 3.2%. European equities outperformed their US counterparts, supported by improved growth prospects and inflation dynamics, while UK equities posted one of the strongest developed market returns of 2.8%. **US equities fell more than 4%** due to the pressure from rising bond yields, despite supportive corporate earnings. Japanese equities were broadly flat over April.

Broad market trends:

Over the first months of 2024, global equity price returns continued the trends of 2023 in terms of market leadership by sector. The Communication Services (CS) and Information Technology (IT) sectors have

Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

delivered strong returns. These sectors include five of the “Magnificent Seven” stocks – Microsoft (IT), Apple (IT), Nvidia (IT), Meta (CS), and Alphabet (CS).

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 as both bond yields and equity prices have risen



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 been mixed since March. Aggregate moves have not been large in the context of FX volatility, however. The most significant move was the Australian dollar, which appreciated 1.3% against the US dollar. Most other major currencies depreciated.

Factors influencing market trends:

Interest rate differentials play a key role in driving short-term currency volatility. Since the end of March while most markets saw interest rate differentials (carry) deteriorate versus the US, Australian carry improved by 26 basis points. This likely helped draw capital towards the market, supporting its currency.

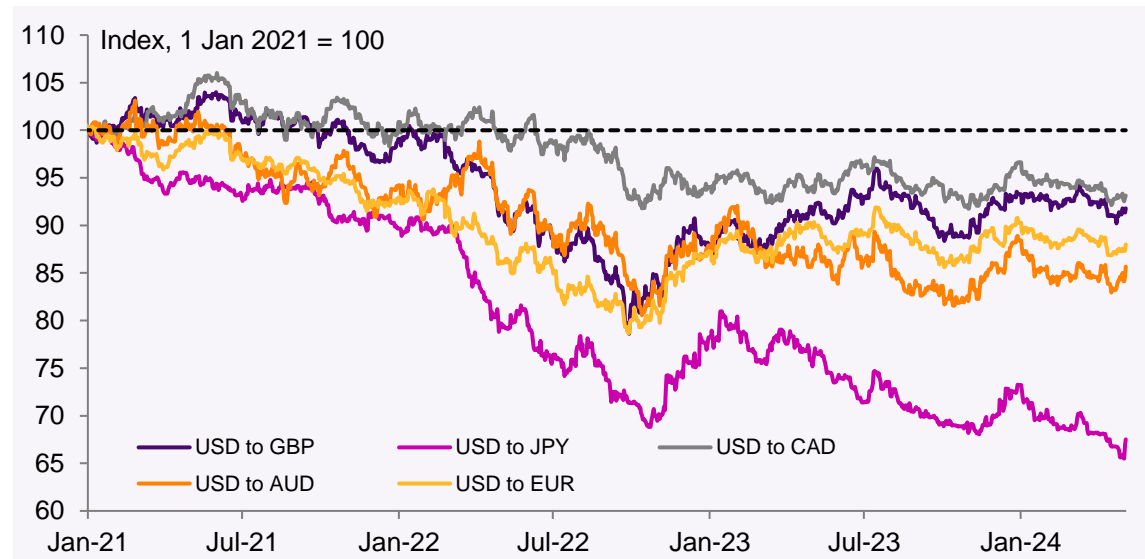
Over a three-year period, the US dollar has appreciated markedly across the board. Higher US interest rates combined with the US dollar's reserve status have favoured the currency over this longer

horizon. Additionally, US 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:

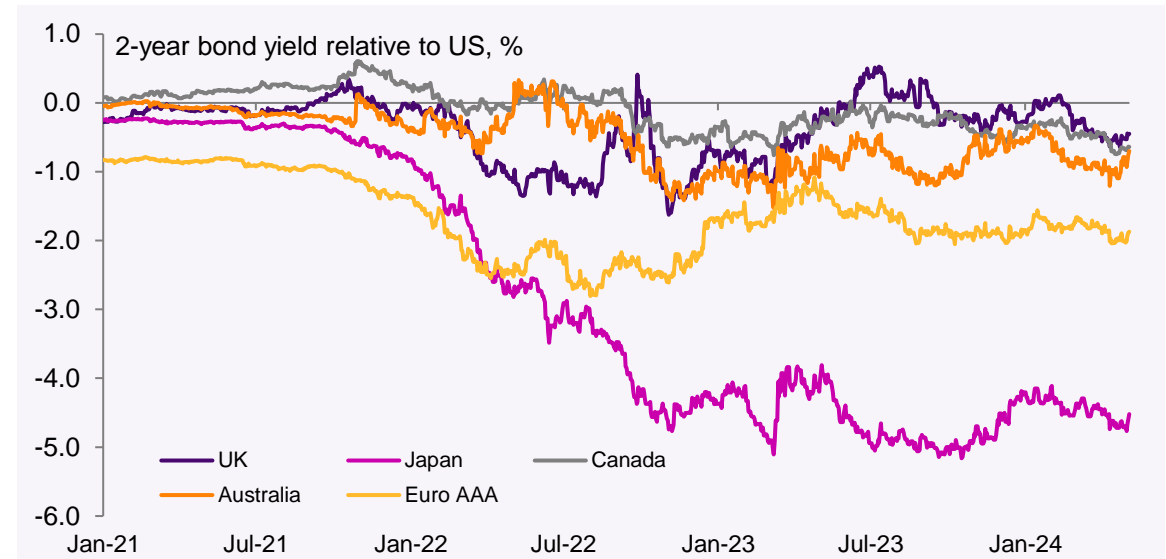
The US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and **a positive view on most developed market currencies against the dollar.** In the near term, however,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