

Global Markets Overview

Asset Research Team

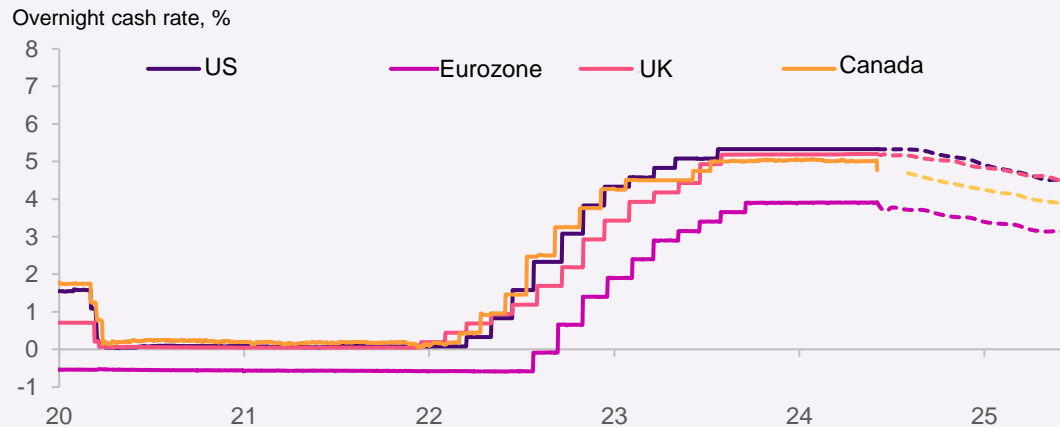
June 2024

What's been driving markets?

- Both the **Bank of Canada and the European Central Bank cut headline policy interest rates** a quarter point to 4.75% and 3.75% respectively. Both central banks flagged greater confidence that inflation is falling sustainably to target and both emphasised future actions will remain dependent on incoming data. While the US is not expected to cut at its monetary policy setting meeting this week, in our view these two G7 interest rate cuts are the first of many.
- Economic data in the US was mixed.
 - Job openings declined and the unemployment rate increased, suggesting US labour market rebalancing

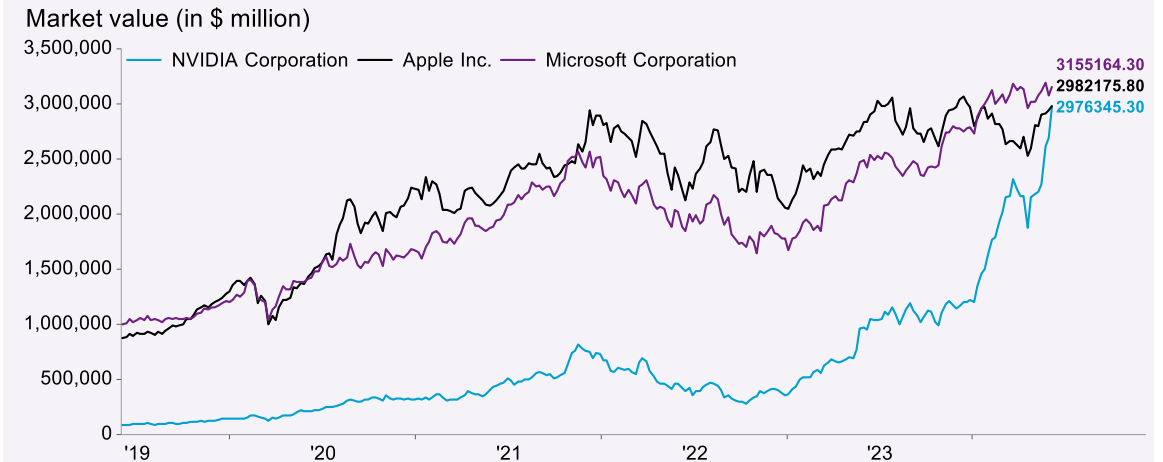
- is continuing, supporting lower future inflation pressures;
 - Manufacturing activity survey data disappointed expectations but services activity was consistent with strong output and declines in prices paid by services companies for their inputs;
 - Employment and earnings data beat expectations, scaling back market expectations of cooling demand.
- Evidence of continued robust demand pushed equities higher, along with continued expectations of a widespread AI build-out. Nvidia become only the third company to breach a \$3 trillion market capitalisation, alongside Microsoft and Apple.

The expected path for policy rates priced into interest rate swap markets



Sources: FactSet, WTW

NVIDIA's market cap soared as Q1 results beat already high expectations



Sources: FactSet, WTW

Government bonds

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

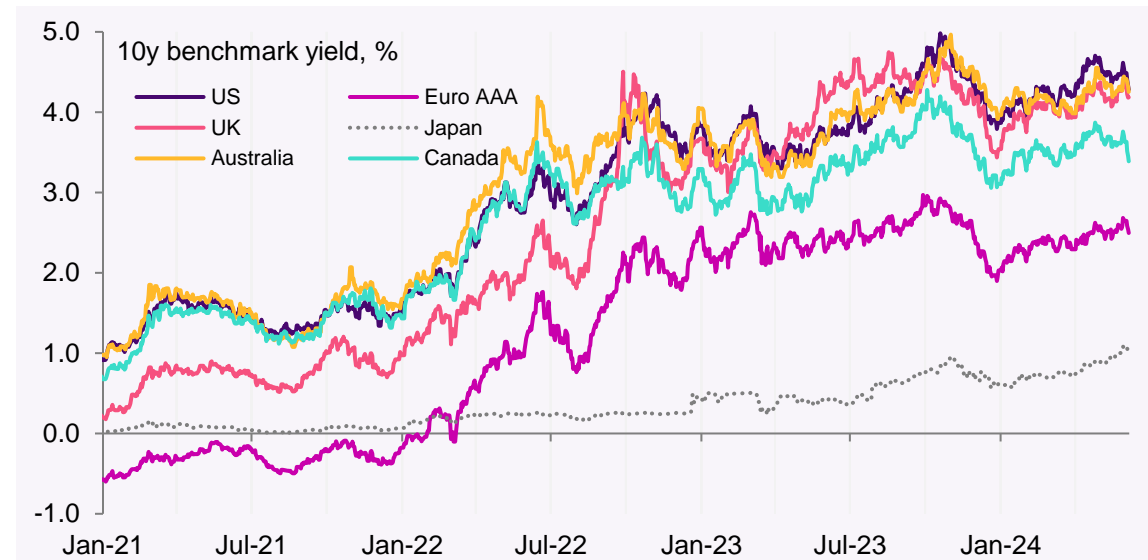
What happened over the past month:

After rising over much of the year, bond yields have witnessed a reversal more recently. Since the end of April, US and Canadian 10-year nominal bond yields have fallen around 40 bps (as of 05 June 2024 – but have risen again up to 10 June). Most other developed bond market yields also declined, albeit to a lesser extent. The exception is Japan, where yields rose 14 bps.

Factors influencing market trends:

Bond markets remain highly sensitive to economic data and policy news. The uptrend in yields earlier in the year coincided with hotter-than-expected US economic outcomes. The recent reversal has occurred amongst signs of cooling inflation and labour markets. The latest core PCE inflation numbers – the Fed's preferred metric – came in below consensus, rising only 0.2% in April. The number of job openings have continued to decline – the latest figure of 8.06 million is the lowest since February 2021. Although, the latest

Global 10-year benchmark nominal bond yields



Sources: Refinitiv Eikon, WTW

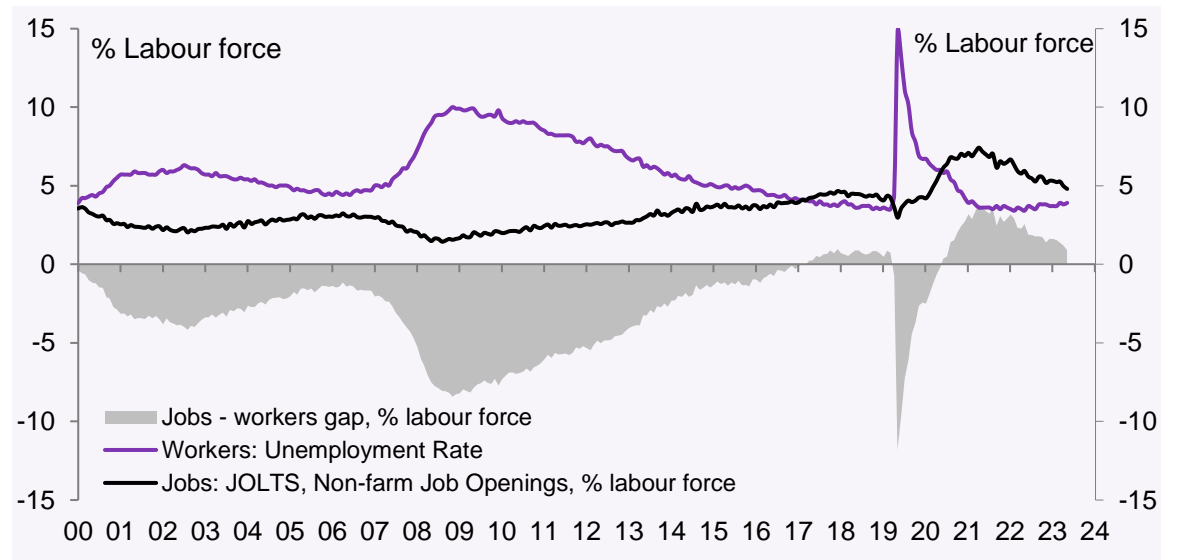
employment and earnings data beat expectations, scaling back estimates of cooling demand.

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 ease policy. We have started to see this transpire. The Bank of Canada and ECB both cut their respective benchmark rates by 25bps over the first week of June.

Over 1 to 3 years, we continue to 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: FactSet, 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 – spreads fell by another 3 bps from 98 bps to 95 bps. Spread tightening was seen across all major developed IG credit markets, with Australian spreads falling the most. Global high yield spreads mirrored higher grade spreads, ending April 5bps lower, driven by a big fall in European spread levels (-21 bps).

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**

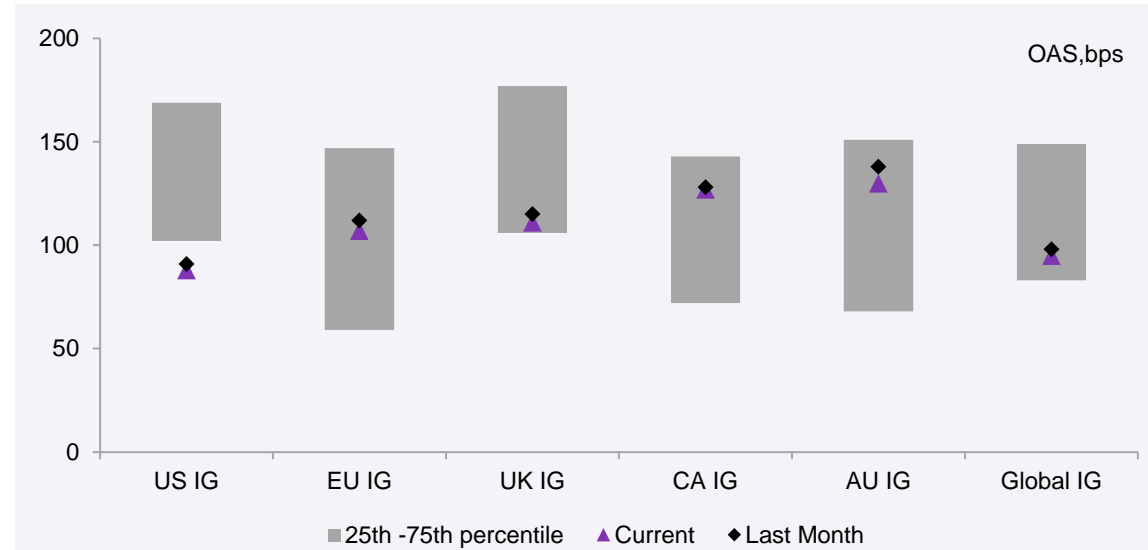
default cycle has been relatively benign throughout 2023 and into 2024.

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.

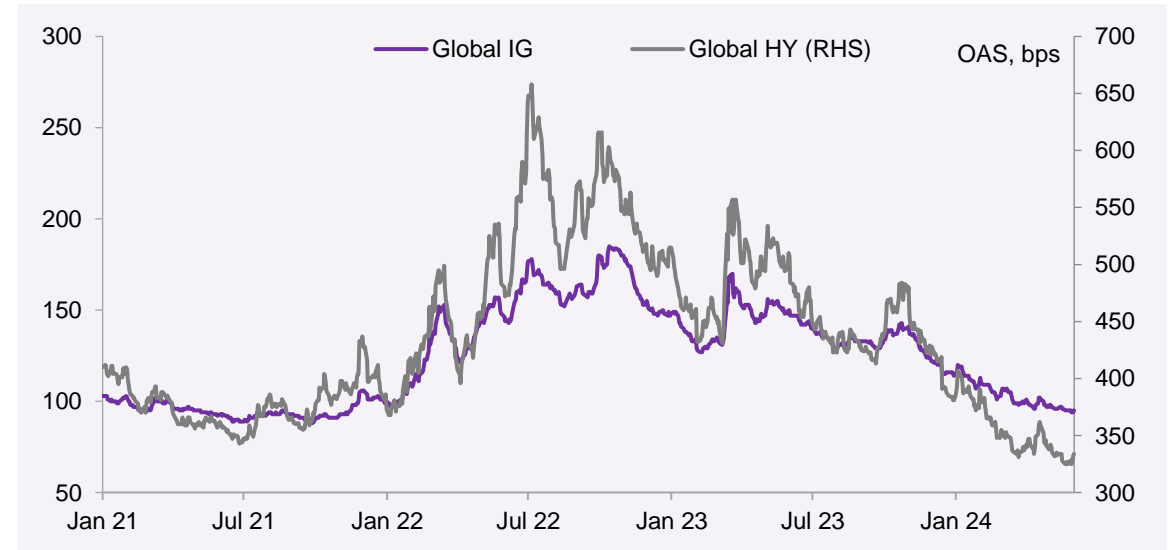
We are more cautious in the shorter-term, given the narrowing of corporate credit spreads in 2023 and year-to-date, their low levels currently, and possible risks to earnings growth in 2024. US corporate credit spreads are especially low, are pricing-in a very good set of fundamental conditions for company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

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

What happened over the past month:

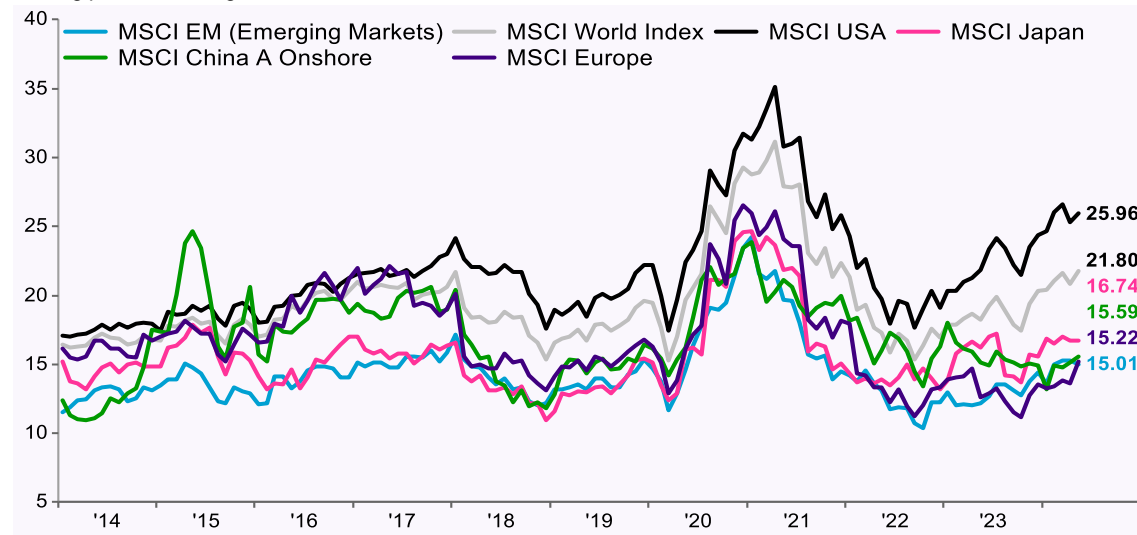
Global equities performed strongly with a 3.8% total return over the month of May, bringing the year-to-date total return to 11.1%. Developed markets outperformed emerging markets by 3.6% over the month. Broadly, developed markets performance was underpinned by strong "risk on sentiment". In particular, expectations of a June interest rate cut by the ECB was a driver of the positive return in European equities, while US equities gained 4.8% in May, supported by above-consensus earnings growth and an increase in consumer confidence. In Asia, Japanese equities underperformed broader developed markets but continue to lead the MSCI World over the year-to-date.

Broad market trends:

In 2024, global equity returns have largely continued the trends of 2023 in terms of market leadership by sector. Over the last three months, the top performing sectors have been Utilities (13.1%), after relatively

Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

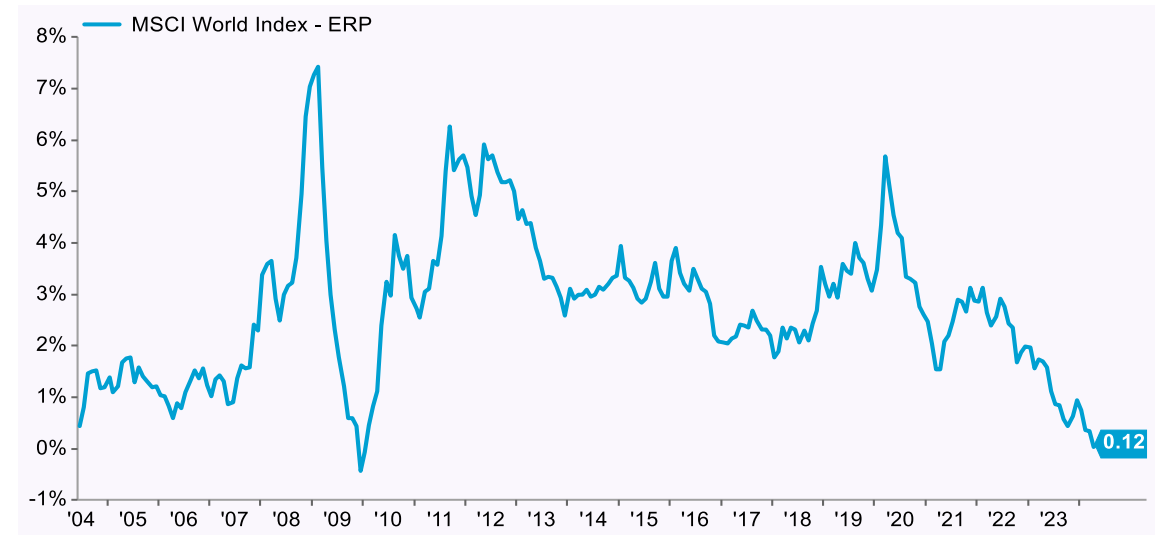
weak returns in 2023, Communication Services (11.7%), and Information Technology (8.4%). These latter two sectors include five of the "Magnificent Seven" stocks – Microsoft (IT), Apple (IT), Nvidia (IT), Meta (CS), and Alphabet (CS).

Looking to forward earnings, analysts forecast earnings picking up significantly in 2024, particularly in the US. 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 in the last two years



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:

Most of the currencies we track have appreciated versus the US dollar since the end of April. The largest mover (as of 05 June 2024) has been the Australian dollar which is up around 2.1%. The euro and pound have also appreciated between 1.5% and 2.0%, while the Japanese yen is up around 0.7%.

Factors influencing market trends:

Interest rate differentials play a key role in driving short-term currency volatility.

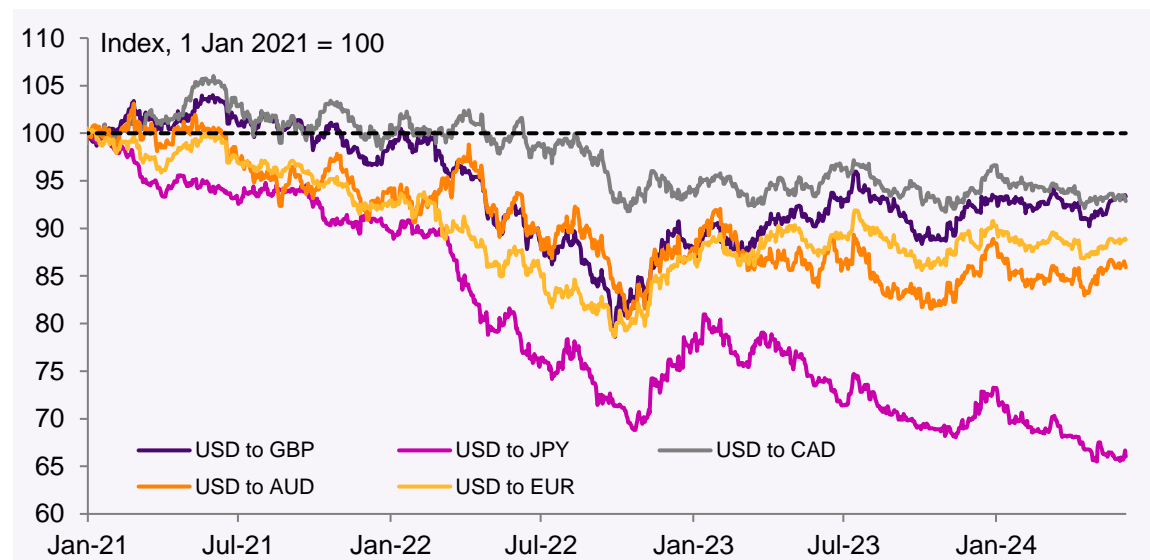
At the end of May, US bond yields declined more sharply than most other bond markets, which resulted in more favourable interest rate differentials in non-dollar currencies, helping to attract capital flows. The biggest improvement occurred vis-à-vis Japan, with 2-year interest rate differentials narrowing around 40bps. This makes the muted appreciation of the yen surprising, especially given Japanese authorities intervened to the tune of 9.8 trillion yen in late April / early May.

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 highly resilient has supported an extended period of strong capital flows into the US.

Looking ahead:

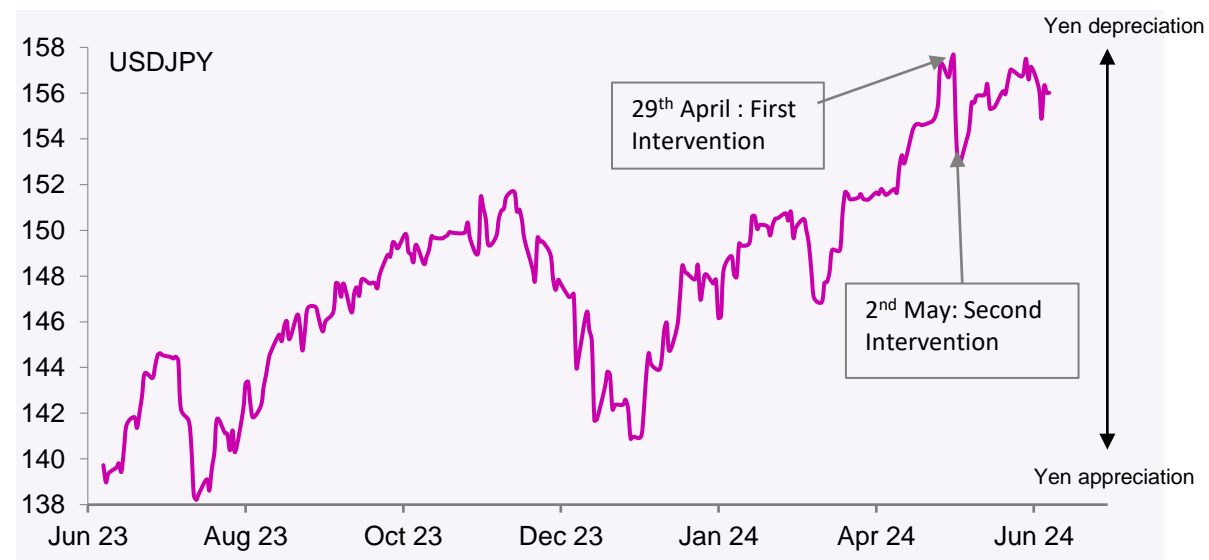
The US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and a positive view on most developed market currencies against the dollar. In the near term, however,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

Yen weakness has persisted despite better carry and intervention



Sources: FactSet, WTW

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