

Global Markets Overview

Asset Research Team

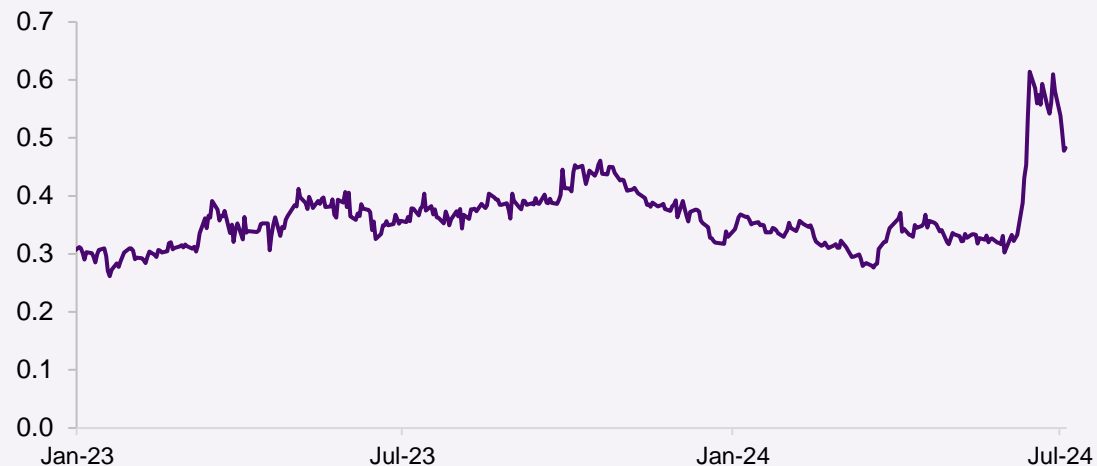
July 2024

What's been driving markets?

- **US policymakers voted to keep the Fed Funds Rate on hold at 5.25% to 5.5%.** The Fed's closely watched dot-plots were also released. Median projections for inflation ticked up as did its policy rate projections. Notably, FOMC forecasts suggest only one interest rate cut this year, versus three cuts previously and policy rates are, ultimately, predicted to settle at 2.8% instead of 2.6% over the "longer run".
- **Political developments** around the world continued to influence financial markets in June. US Treasury yields rose temporarily after the debate between US President Biden and former President Trump, perhaps because Trump's policy proposals of tax cuts and tariffs are perceived as more inflationary. In any

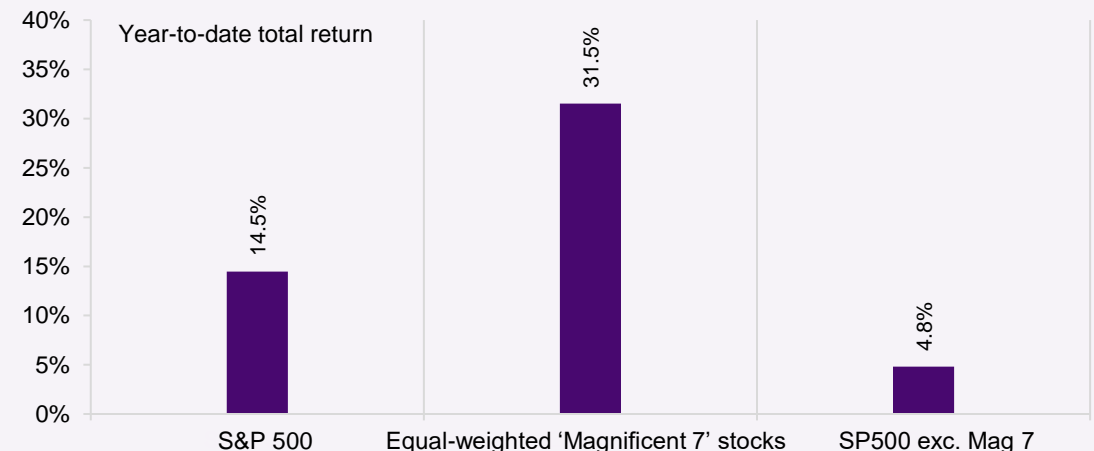
- event, the immediate reaction by betting markets was a sharp fall in the odds of a Biden victory in the November elections.
- In France, high vote shares for the far-right and left-wing alliances in the first round of its elections, the uncertainty over the outcome, and France's debt position, led to **a big jump in the volatility of French financial markets**. In bond markets, the premium that investors demand to own French bonds over German bonds widened to levels not seen since 2017, reflecting concern around a potential fall in fiscal discipline, depending on the election result. However, asset prices recovered partially in early July as it became clear there would be no far right or leftwing overall majority.

5-year France bond yield spread vs. Germany, %



Sources: LSEG Datastream, WTW

US technology stocks have outpaced the wider index by a huge margin year-to-date



Sources: FactSet, WTW

Government bonds

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

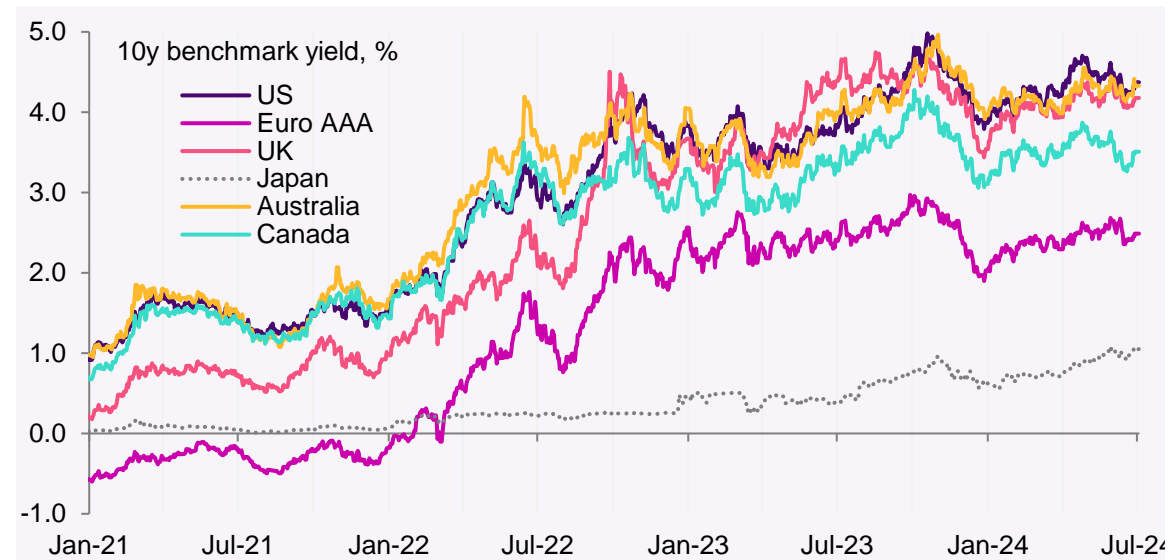
What happened over the past month:

After rising for much of the year, bond yields have seen a partial reversal more recently. In June, yields fell slightly across most major developed markets. While bond volatility has come down since the beginning of 2023, it still remains much higher than it was pre-pandemic.

Factors influencing market trends:

Bond markets remain highly sensitive to economic data and policy news. The rise in yields earlier in the year coincided with hotter-than-expected US economic outcomes. The recent reversal has occurred amongst signs of cooling economic activity, inflation and labour markets. Political forces have also led to market fluctuations. The high vote shares for the far right and left-wing alliances in France, uncertainty over the French election outcome, and France's debt position, led to a big jump in the volatility of French financial markets. The yield on French government bonds rose, which reflects the potentially higher credit

Global 10-year benchmark nominal bond yields



Sources: LSEG Datastream, WTW

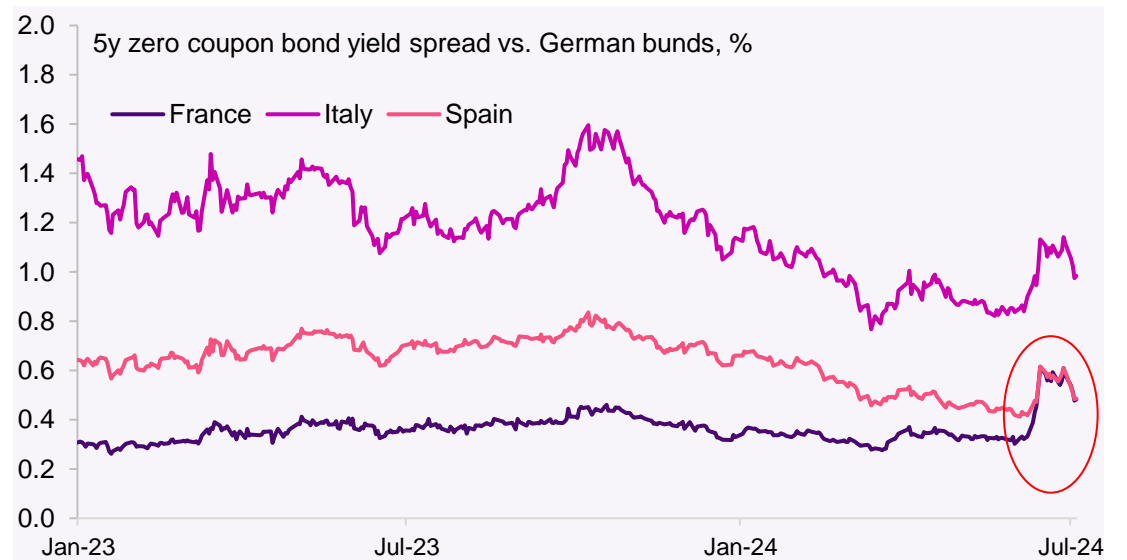
risk of the government if debt levels were to increase further. Yields have fallen partially as it became clear there would be no far-right or leftwing majority and clear policy mandate for these blocs.

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 and inflation to fall towards central bank targets. This will allow central banks to ease policy, e.g. the Bank of Canada and ECB both cut their 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.

European sovereign bond yield spreads vs. Germany, notably French, have risen



Sources: LSEG Datastream, 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 widened by 8 bps from 95 bps to 103bps in June. Spread widening was seen across all major developed IG credit markets but was most notable in the US and Eurozone. Global high yield spreads also rose but by less (+5bp). However, this masks a substantial jump in Eurozone spreads (+24bp) driven, in part, by political uncertainty in France.

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

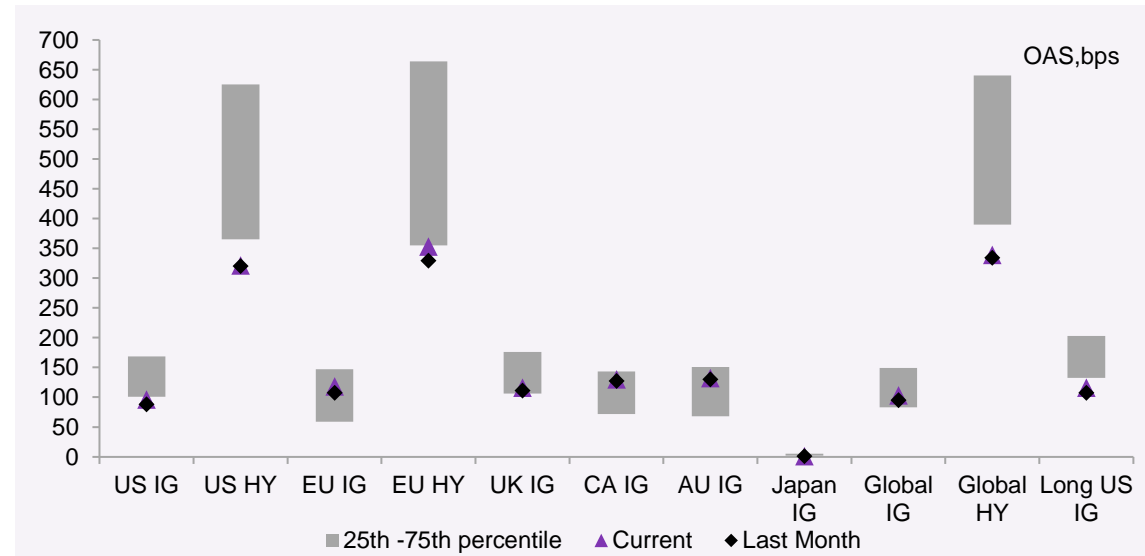
default cycle has been relatively benign throughout 2023 and 2024.

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.

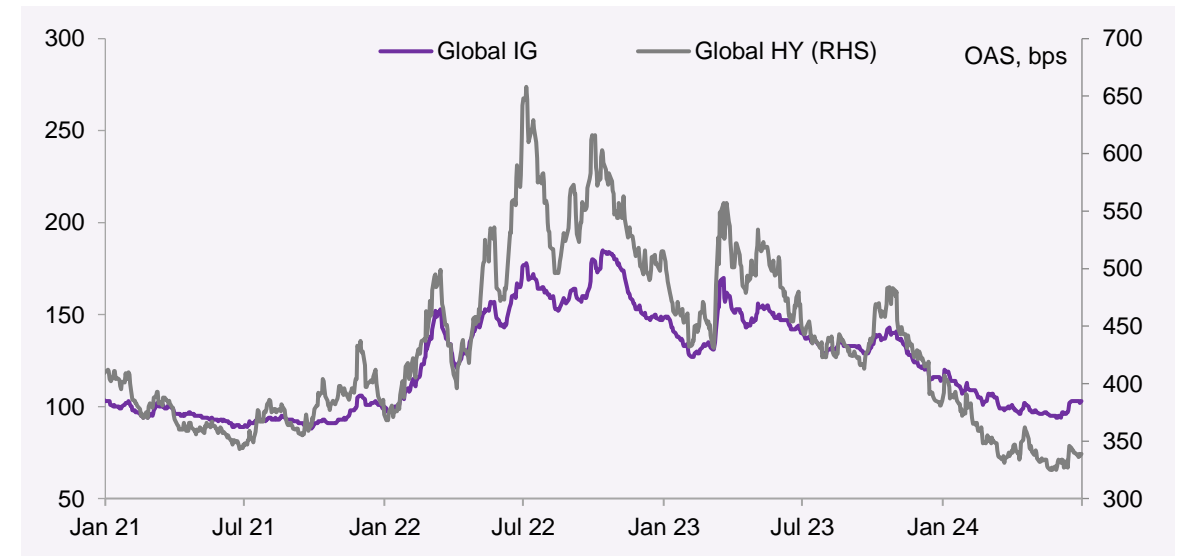
We are more cautious in the shorter-term, given the narrowing of corporate credit spreads in 2023 and year-to-date, their low levels currently, and possible risks to earnings growth in 2024. US corporate credit spreads are especially low, are pricing-in a very good set of fundamental conditions for company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

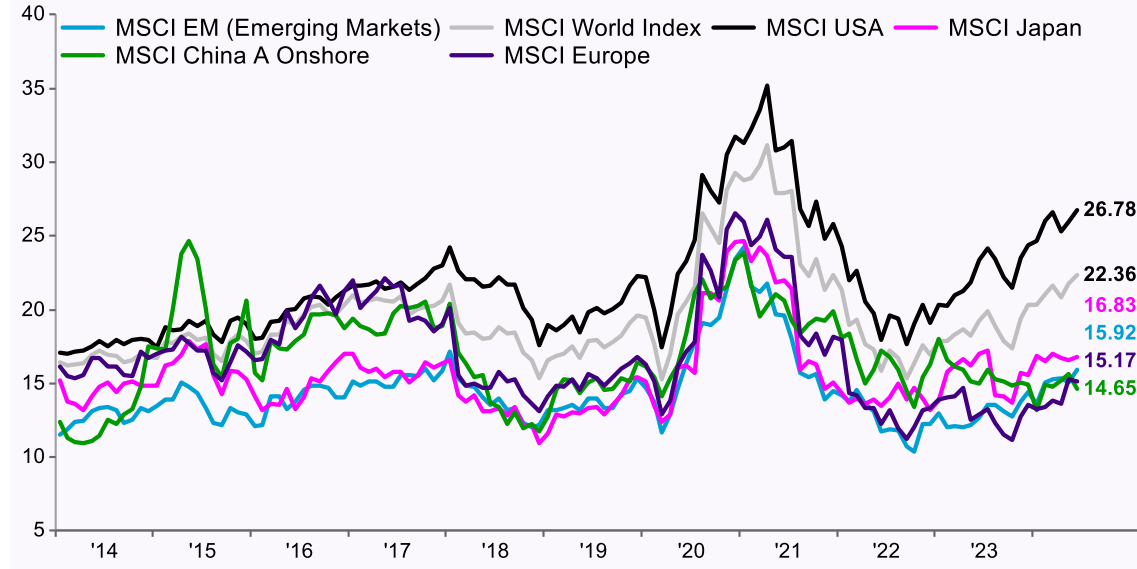
Global equity markets rose 3.1% in total return terms over the month, bringing their year-to-date gain to 13.5% and marking a 24.2% rebound from their October lows. In June, returns were driven by strong earnings growth, falling inflation, and AI advancements, with the US market leading the way. AI-related spending boosted earnings but also created a split market, with US technology stocks significantly outperforming. Selective Asian markets, led by Taiwan (+10.5%), also outperformed, while European equities faced volatility due to political uncertainties. Emerging markets posted a 3.6% return, despite mixed performance across regions.

Broad market trends:

As we moved through the second quarter, initial concern over the US economy overheating faded and hopes for a soft landing increased, with the expected number of interest rate cuts by the Federal Reserve

Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

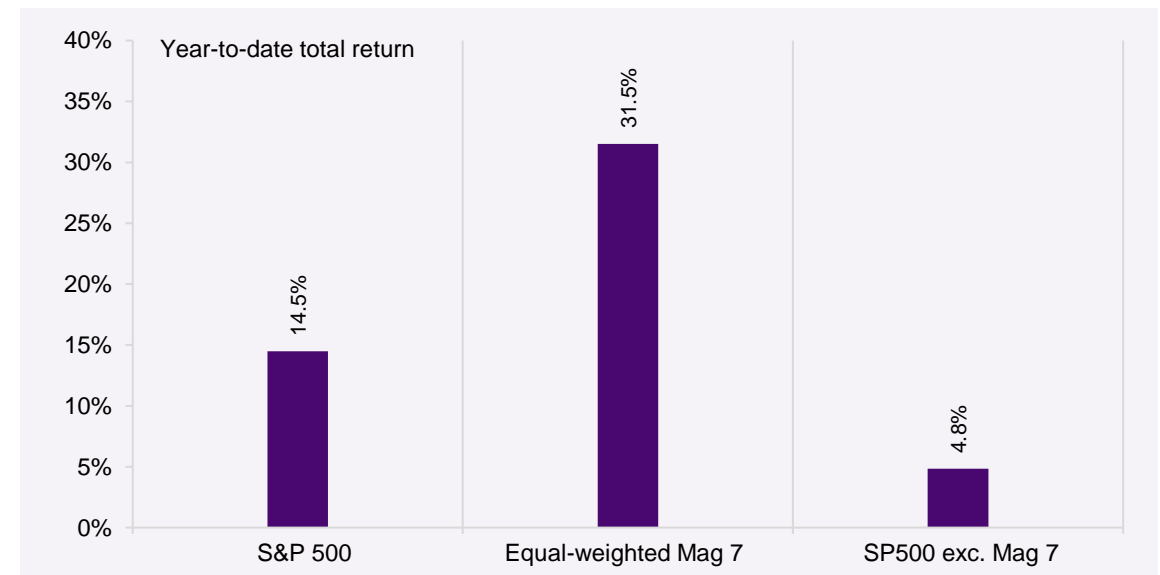
increasing. Over the last six months, the top performing sectors have been Information Technology (25.2%), Communication Services (22.2%), and Financials (10.5%).

Looking to forward earnings, analysts forecast earnings to pick 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.

US technology stocks have outpaced the wider index by a huge margin year-to-date



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 depreciated against the US dollar this year. The biggest mover has been the yen. This has fallen over 12% year-to-date, with c. 2.5% depreciation over the month of June. Other major currencies we follow have seen smaller moves.

Factors influencing market trends:

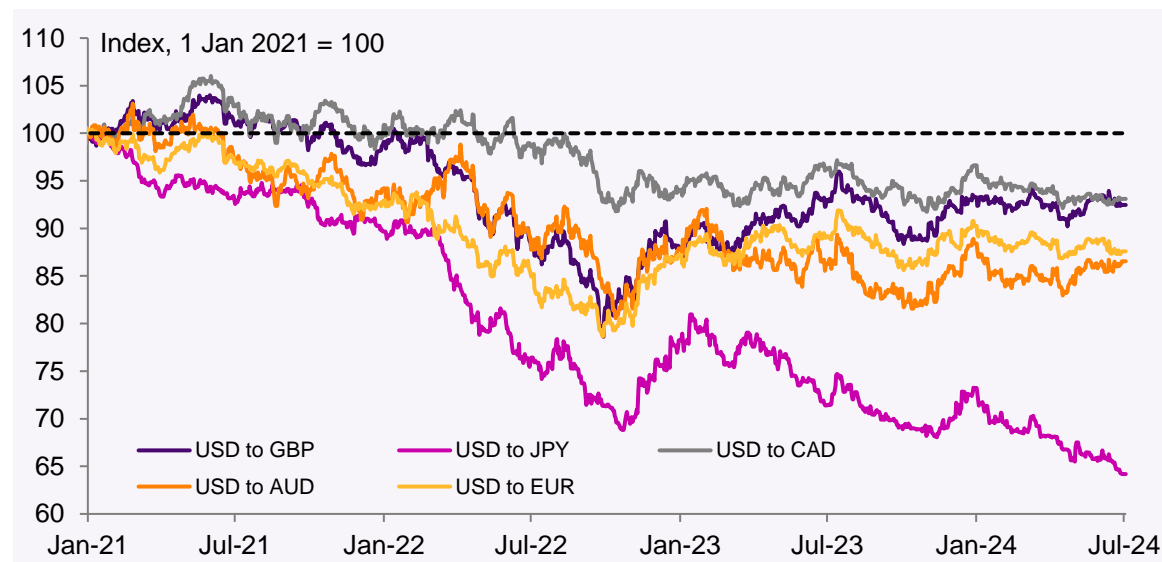
Interest rate differentials help drive currency moves. US rates have risen more than most other markets this year. This more favourable interest rate differential has helped to attract capital flows from non-dollar currencies, driving some of the appreciation in the USD we have seen in 2024. **Other factors also play a key role.** Growth in the US has been more far more resilient than other economies, drawing portfolio flows, as has the currency's reserve status. On top of this, the US terms of trade has been more supportive,

helped by its high level of domestic energy production. **Over a three-year period, the US dollar has appreciated markedly versus all major advanced economy currencies.**

Looking ahead:

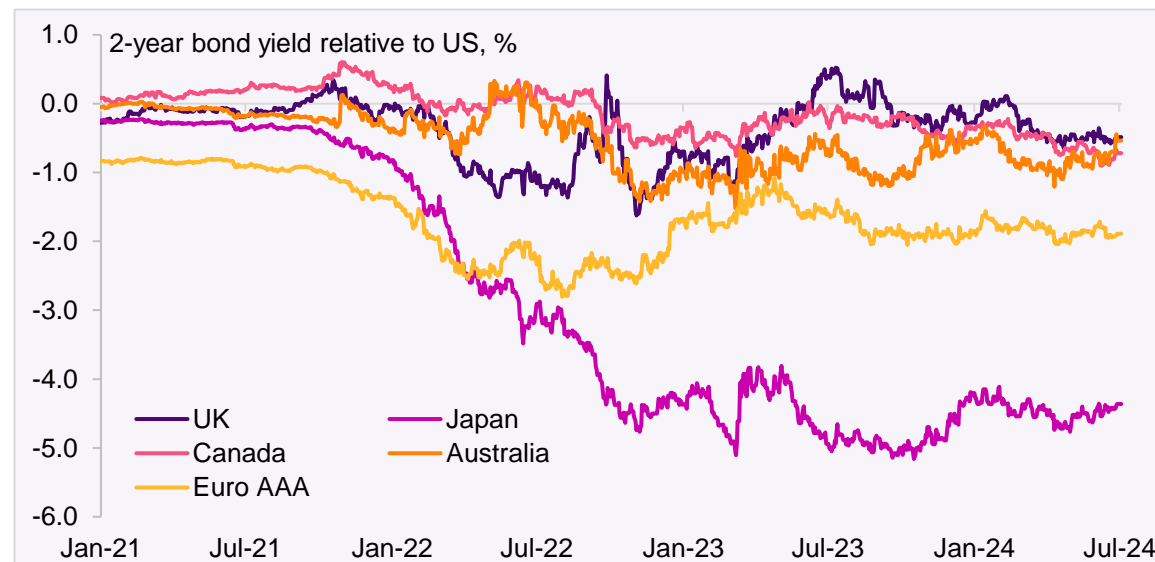
Following a sustained period of appreciation, the US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and **a positive view on most developed market currencies 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: LSEG Datastream, WTW

Short term exchange rate dynamics have been influenced by differences in interest rates between countries



Sources: LSEG Datastream, WTW

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