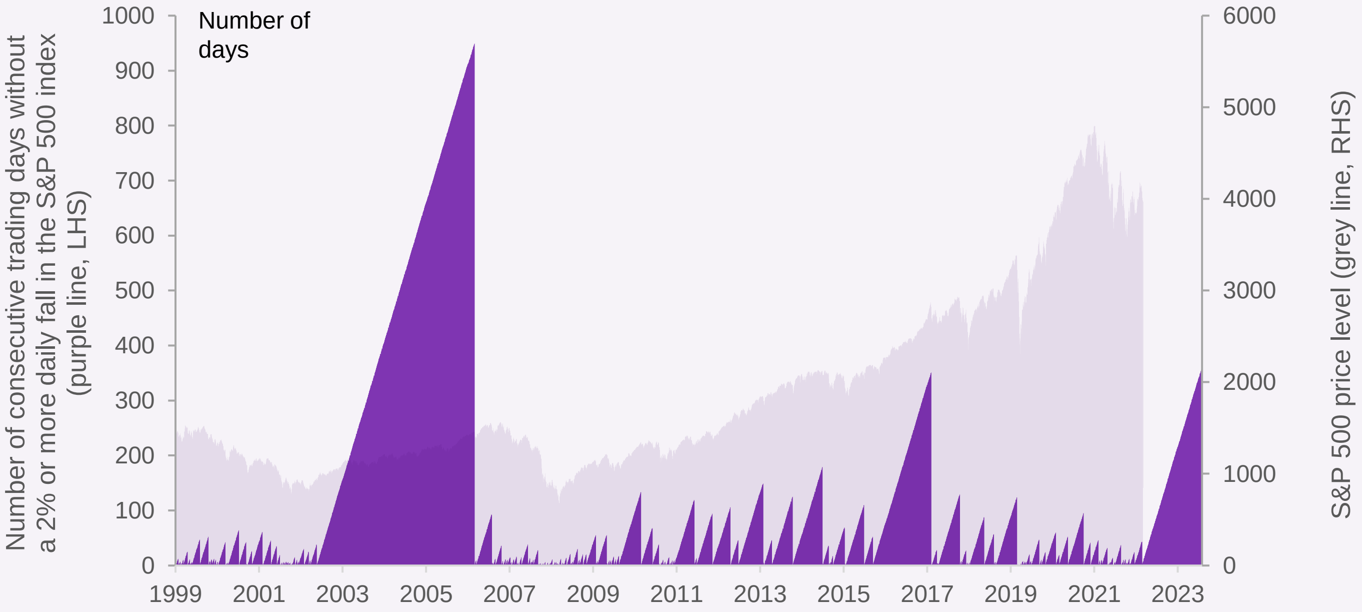
Global Markets Overview

Asset Research Team

August 2024

Chart of the month

Were equity markets due a correction? – until the last few weeks the S&P 500 equity price index had achieved its longest period without experiencing a 2% daily fall since 2007



Sources: Data from FactSet. Chart from an original idea by Bloomberg

- **Global equities have registered notable declines over the last three weeks.**
  - For example, the S&P 500 equity index of US large companies has fallen c. 9% since its mid-July peak.
  - At first glance, this looks large. However, US equities are still up c. 10% year-to-date (as of market close on 7 August), despite these recent falls.
- **This marks the end of one of the longest consecutive periods of gains in the S&P 500 price index, without a meaningful daily fall – which we define as a 2% fall in one day – over the last 20 years.**
- **The main drivers of equity volatility in recent weeks have been:**
  - Recent US labour market and wider US economic activity datapoints have disappointed expectations.
  - This has occurred at the same time as Japan increased its policy interest rate and the yen appreciated sharply. This has caused a rapid unwinding of leveraged global trades that borrowed in low interest rate currencies and invested in a range of different assets, including global equities.
  - The earnings results for large cap technology stocks, which had been mainly driving equity markets upwards year-to-date, were mixed in the second quarter.

Government bonds

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

What happened over the past month:

Global bond yields (prices) fell (rose) materially over the past month, led by the US. Since the beginning of June, the 10-year US intermediate bond yield has fallen c. 58bps and is currently trading around 392bps (as of 8 August 2024). Other major markets have followed suit to varying degrees.

Factors influencing market trends:

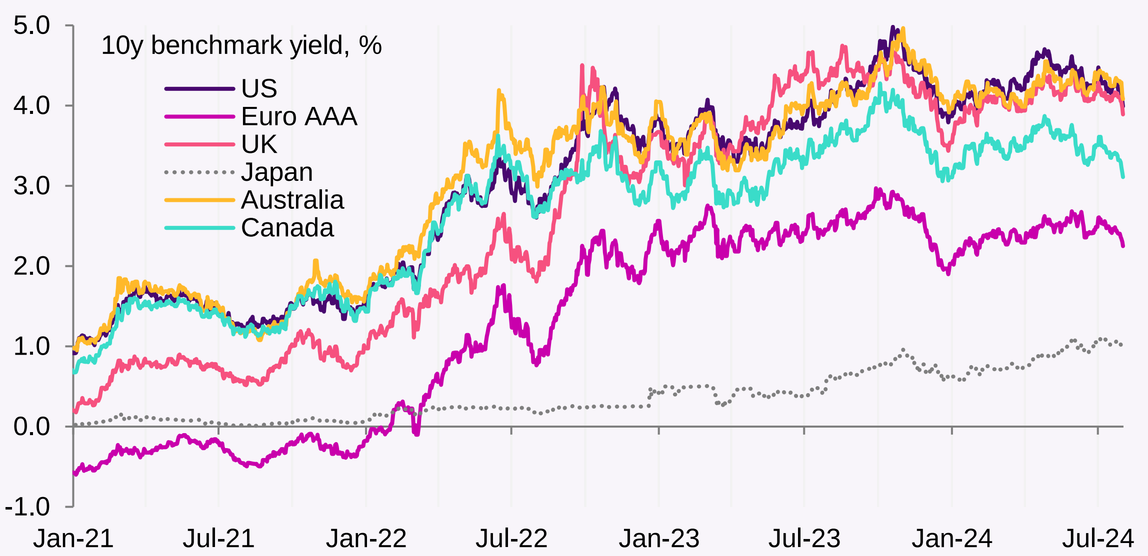
Bond markets remain highly sensitive to economic data and policy news. The rise in bond yields earlier in the year coincided with hotter-than-expected US economic outcomes. The recent dip has occurred alongside signs of slowing economic activity, inflation, and labour market gains. Over the past week, US PMI survey data pointed to a significant decline in manufacturing activity. Labour market data also pointed towards cooling – payroll growth in July was much lower than expected, while average hourly earnings growth slowed to 3.6%, also below market expectations.

Looking ahead:

Yield volatility is likely to continue for the next few months. 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. However, the speed and depth of that easing cycle is uncertain.

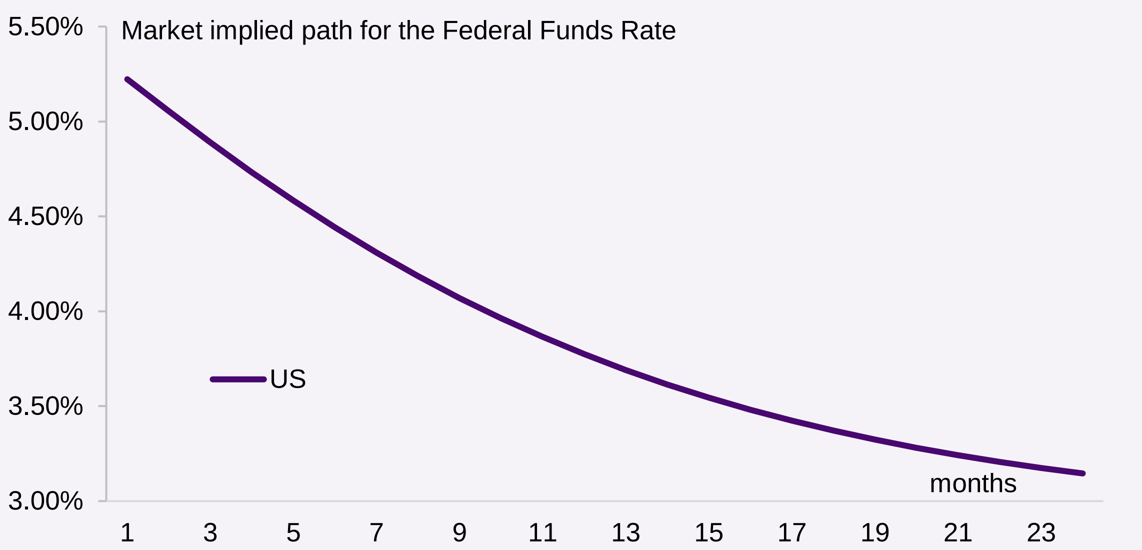
After the recent drop in yields, we think that most bond markets are neutrally priced over a one to three-year horizon. Although, they continue to see provide a valuable role in protecting return-seeking portfolios. **For under-hedged liability-driven-investment portfolios, current pricing remains reasonable to return towards target levels**.

Global 10-year benchmark nominal bond yields



Sources: LSEG Datastream, WTW

US fixed income derivative pricing is now pricing-in 3 to 4 cuts by the Fed this year



Sources: LSEG 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 were largely immune from wider asset volatility in July, although spreads did rise moderately in the first week of August. In July, IG credit spreads narrowed marginally by 2 bps, from 103 bps to 101bps. The US experienced a small uptick in spreads (+1bps) which, given its substantial representation in global credit markets, offset some of the spread narrowing observed in other major developed investment grade markets. Global high yield spreads widened by 5bps.

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:

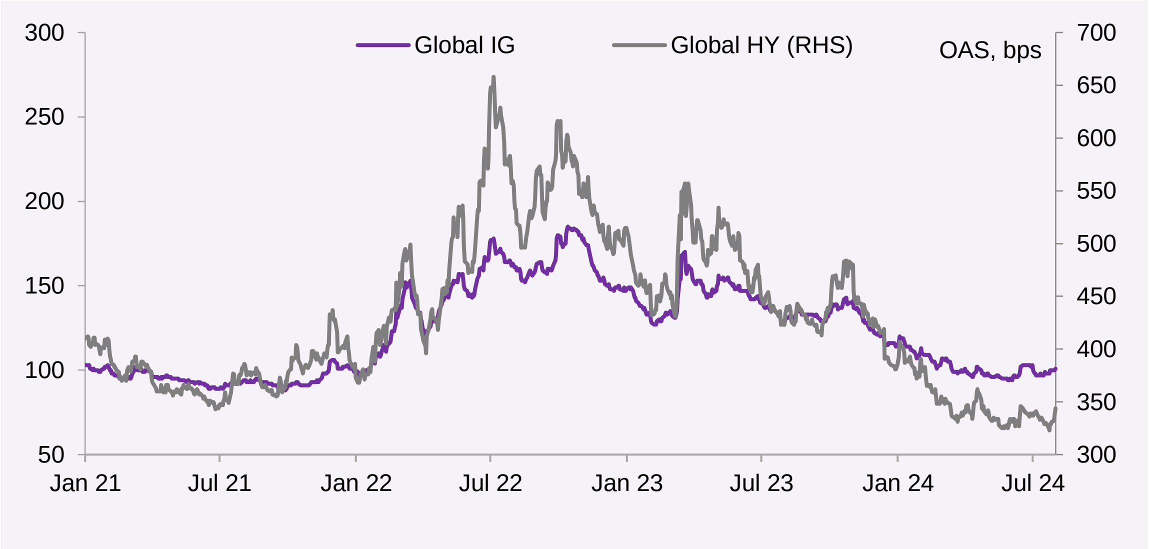
Over a three-to-five year horizon, we expect global investment grade corporate credit to provide moderate returns above government bonds. Similarly, we expect global high yield credit to outperform government bonds and investment grade credit over the medium-term.

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.

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:

Global equity markets were volatile in the last five weeks due to weaker than expected US labour market and activity data, impacts from currency volatility, and falls in technology and artificial intelligence related stocks. Many of the equity market moves in July were reversed in the first week of August. However, looking at July: there were gains for interest-rate sensitive equities, with small-cap stocks rising by c. 6%%; overall, advanced economy equities rose 1.3%, although growth stocks declined by 1.4% as enthusiasm for the A.I. theme weakened; UK stocks outperformed on above-consensus economic data; MSCI Japan fell due to tech stock weakness and a stronger yen following Bank of Japan policy changes; and emerging markets lagged developed markets, with Chinese equities declining 1.3%.

Broad market trends:

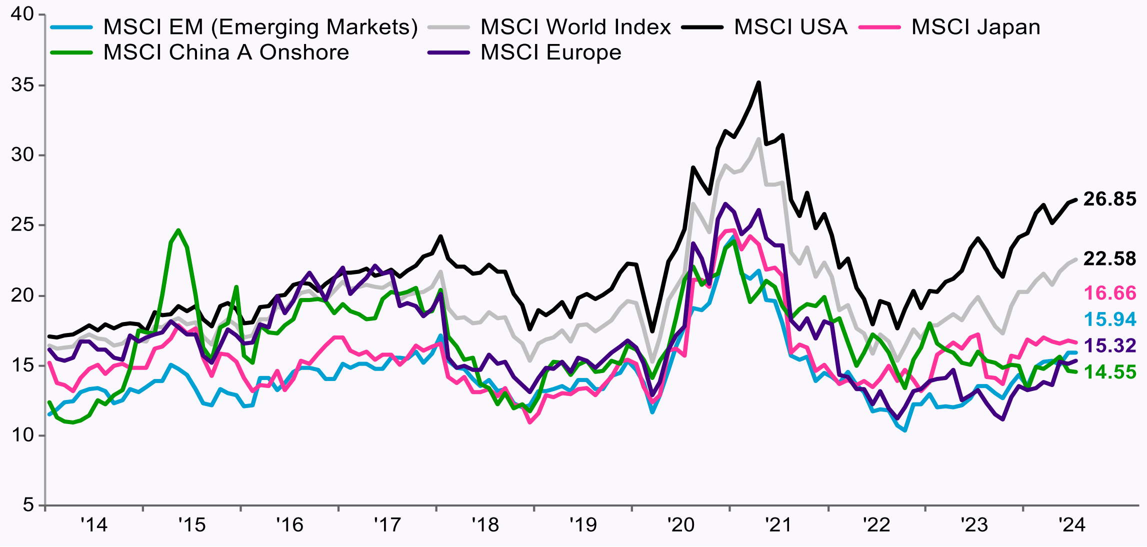
Looking to forward corporate earnings, analysts continue to forecast earnings picking up significantly in 2024, particularly in the US. Our assessment of economic and corporate fundamentals leads us to a marginally more cautious view given the tight level of monetary policy currently. However, declining 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 medium-term value in Japanese equities, despite their recent falls, given the positive impact on fundamentals of a push to improve corporate governance, stimulative policy, and good cyclical economic growth conditions.

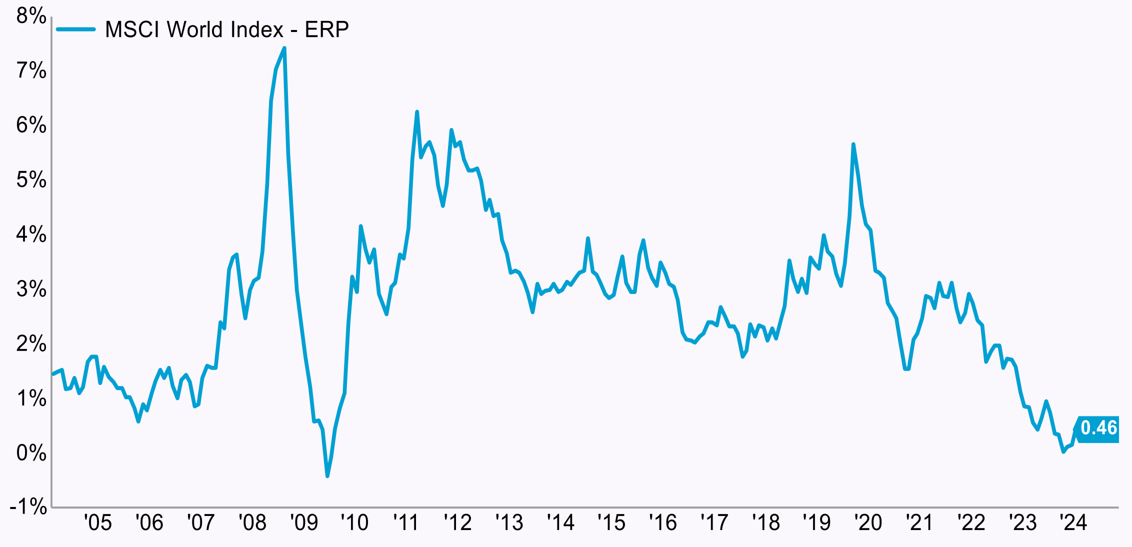
Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

The Equity Risk Premium has picked up at the end of July



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 moves since the start of June have been mixed. The Japanese yen was by far the largest mover, appreciating over 7% versus the US dollar (as of 1 August 2024). Amongst other developed currencies, the Australian and Canadian dollars depreciated slightly, while the euro and pound strengthened.

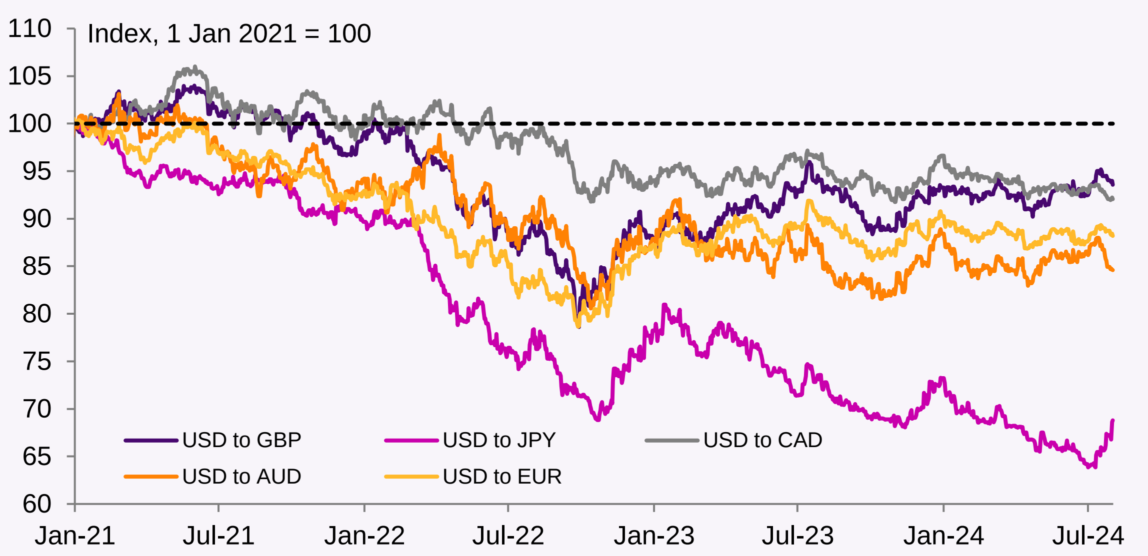
Factors influencing market trends:

Interest rate differentials help drive currency moves. Following weaker US economic data in recent weeks, US short rates have fallen significantly as markets now expect swifter rate cuts. Conversely, the Bank of Japan hiked its interest rate for a second time. This has helped shift capital away from the US towards Japan. However, the interest rate differential between the two countries remains high and the dollar has still outperformed the yen year-to-date. **Other factors also play a key role**. Growth in the US has been more resilient than other economies, drawing portfolio inflows, as has the currency's reserve status. **Over a three-year period, the US dollar has appreciated markedly versus all major advanced economy currencies**.

Looking ahead:

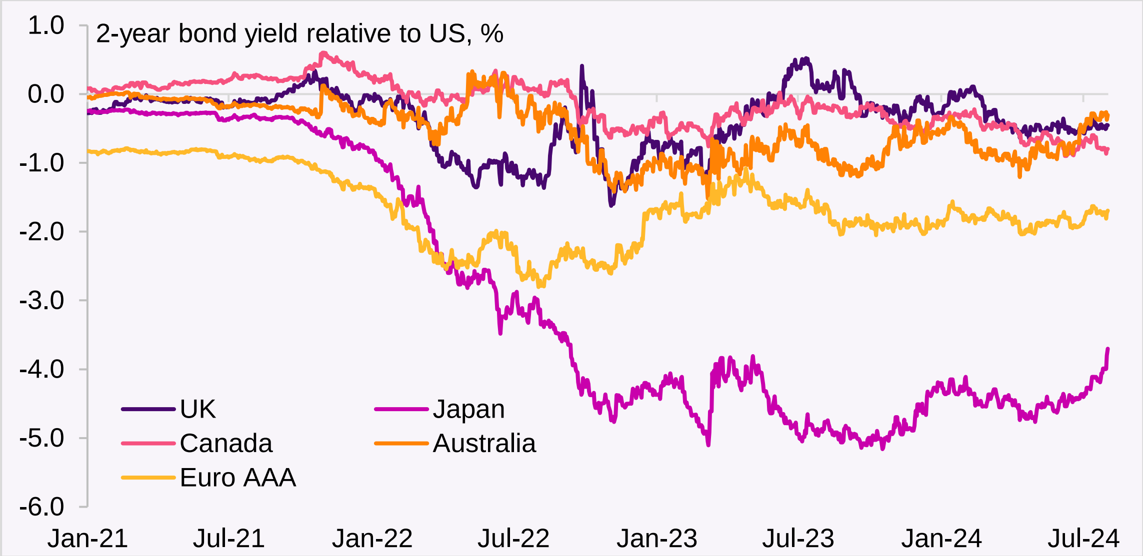
Following a sustained period of appreciation, the US dollar has become more expensive and less competitive against other major currencies on our preferred medium-term fair value metrics. This suggests downward pressure over a 3-to-5-year horizon and **a positive view on most developed market currencies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