Global Markets Overview

Asset Research Team

January 2025

Chart of the month

What happens to US interest rates and bond yields is critical for assets everywhere. During December, an important shift occurred in US policy makers' expectations for interest rates, which is relevant to all investors' portfolios.

In the US, monetary policy is set by the Federal Reserve Open Market Committee (FOMC). The chart plots each voting member's view of the appropriate policy rate at the end of the calendar year shown, and over the "long run", for the September and December releases. The median or the middle projection is a closely-followed statistic and is representative of the FOMC's collective view, which is highlighted in red.

The implications of the most recent release are (numbers correspond to annotations on the chart):

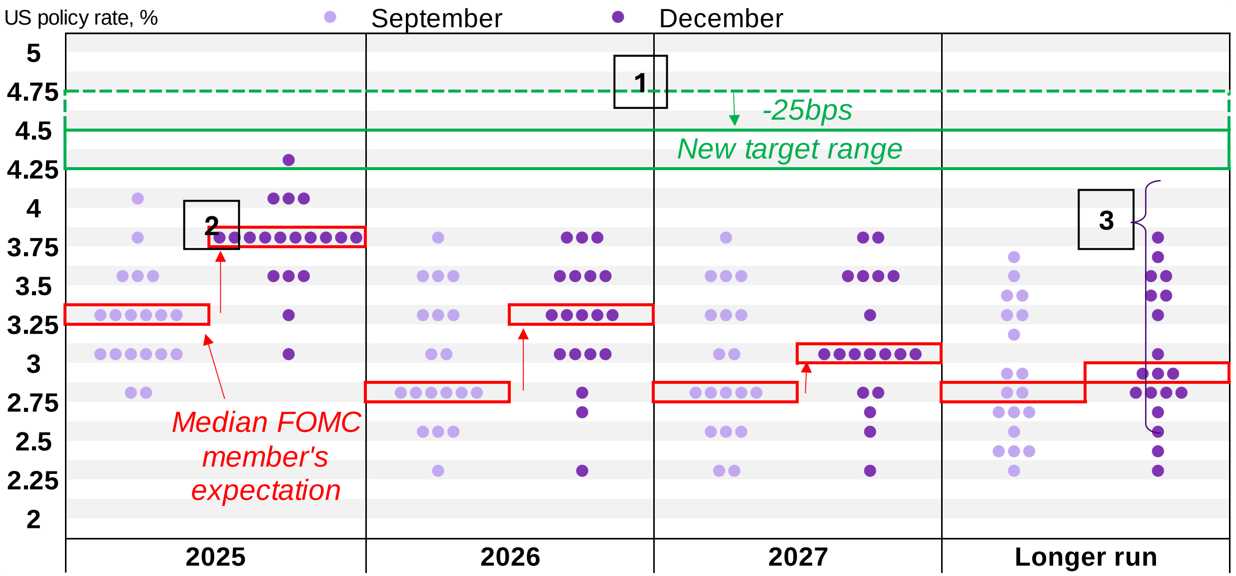
1. **As widely expected, the FOMC chose to cut policy rates by 25bps in December, to a target range of 4.25 – 4.5%**. All else equal, this would be a stimulative move, adding support to US growth and asset prices.

2. **However, the FOMC also increased its expectation for future interest rates by around 50bps this year and next.** The median voting member now expects to cut interest rates less in 2025 and 2026 than they did in September, which tends to act as a headwind (relative to September guidance) on growth and asset prices. In other words, while the Fed cut rates, the cut was dominated by a hawkish (upward) shift in future guidance for interest rates. This outcome was a critical driver of global bond yields and equity markets over December and into January.

3. **There remains considerable uncertainty over where US interest rates will fall to this cycle**. This so-called "terminal rate" is summarised by the FOMC's longer-run expectations, which continue to exhibit a wide spread. Whilst some members place this rate in the region of 2.5%, implying significant cuts in interest rates from here, others think 3.75% is a more appropriate number. This uncertainty around terminal rates is present in most bond markets and, along with other sources of policy uncertainty, is a key driver of relatively high volatility in rates markets recently, and probably going forward.

In December, the Federal Reserve cut interest rates but signalled a higher future interest rate path than in September

FOMC members' expectations for US policy rates over the next few years



Sources: Federal Reserve, WTW

Government bonds

At current yield levels we believe most bond markets offer value on a three-year horizon

What happened over the past month:

Global bond yields (prices) have, generally, risen (fallen) over the past month. Over the 4-week period ending 6 Jan, US 10y Treasury yields rose by around 50bps, while UK 10yr gilt yields increased by a similar amount to 4.8%, nearing its highest level since August 2008. China bucked the global trend, with Chinese yields falling around 35bps.

Factors influencing market trends

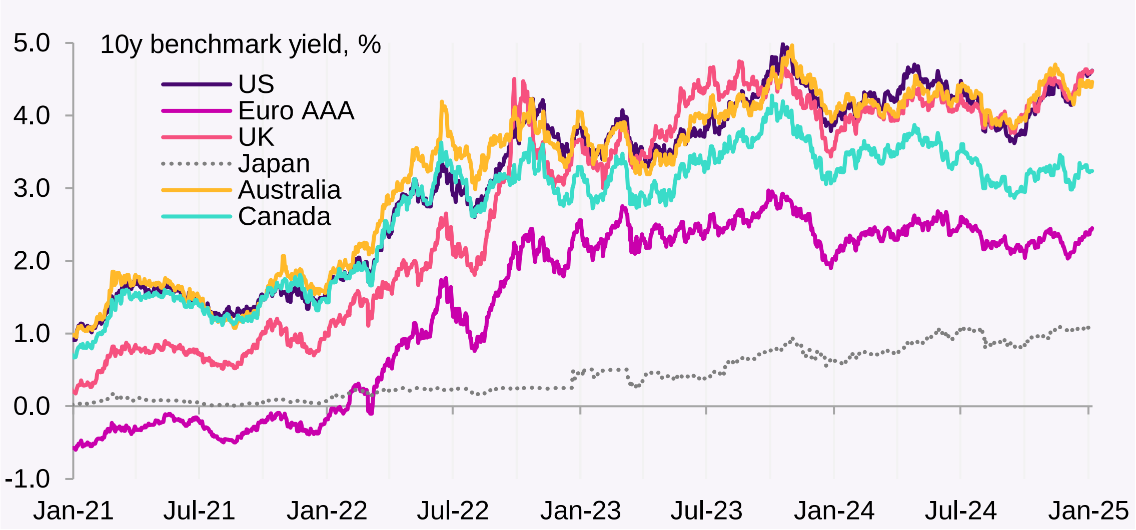
Bond markets remain very sensitive to economic data and policy changes. After falling in November, US yields rose due to a mix of (1) the possible inflationary impact of the incoming Trump administration, (2) good US economic activity data, and (3) more cautious comments by the Federal Reserve on the pace of rate cuts. US increases drove global rates higher in other developed markets. In the UK, the Bank of England held rates steady, amplifying market concerns around an uptick in inflation and wage data.

Looking ahead:

We expect bond yields to remain volatile in the near term. US bond markets, which impact global bond markets, will remain focused on updated policy proposals from President-elect Trump. The impact on growth, inflation, and financial markets will, ultimately, be contingent on the actual policies that are implemented.

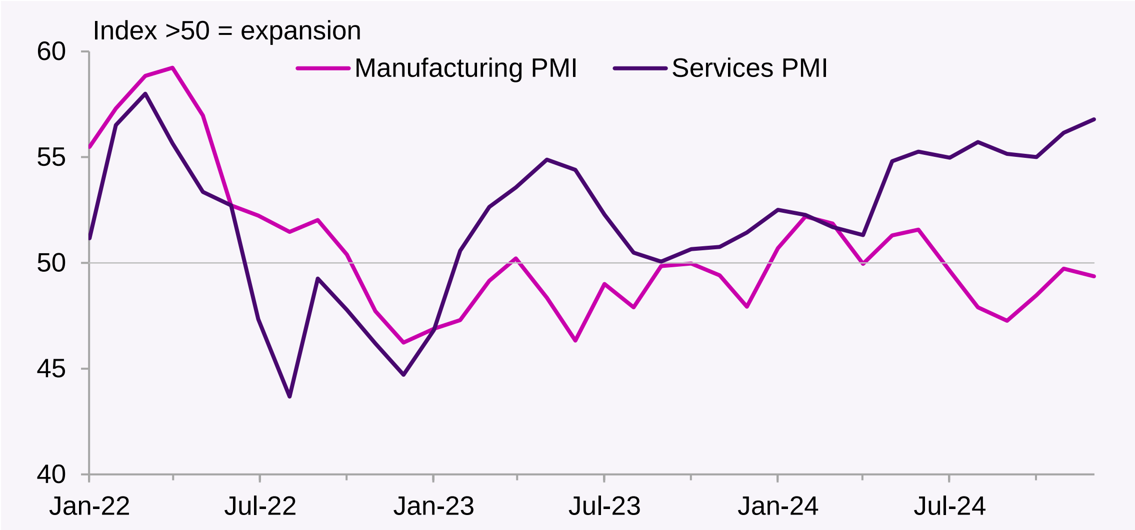
In 2025, we expect inflation to moderate, allowing central banks to ease policy. However, the speed and depth of that easing cycle will vary by country. **We think that many developed bond markets offer value over a three-year horizon**. In general, this suggests building bond exposure for many investors, either through liability hedges, downside protection strategies or – for highly agile investors only – a dynamic overweight. However, the devil lies in the detail of wider portfolio context, starting points, and available opportunity sets, so we encourage investors to discuss the implication of this for their portfolio with their advisers.

Global 10-year benchmark nominal bond yields



Sources: LSEG Datastream, WTW

Strong US jobs and services business spending data shift Fed rate cut expectations



Sources: FactSet, WTW

Credit

Over five years we expect investment grade credit to outperform government bonds moderately

What happened over the past month:

December capped a very good year for corporate credit markets in excess return terms. Over the month, global investment grade credit spreads fell by 2bps, with spreads declining in all major developed markets. The big mover was in the UK with spreads falling 12bp. Over 2024, global spreads fell by 27bp. As in November, it was a mixed picture within global high yield markets in December. However, the geographic performance was reversed. In December, US high yield spreads rose 18bp, consistent with US equity market falls, while European high yield spreads fell by 20bp. Over the year, global high yield spreads fell by 77bp.

What has influenced recent market dynamics?

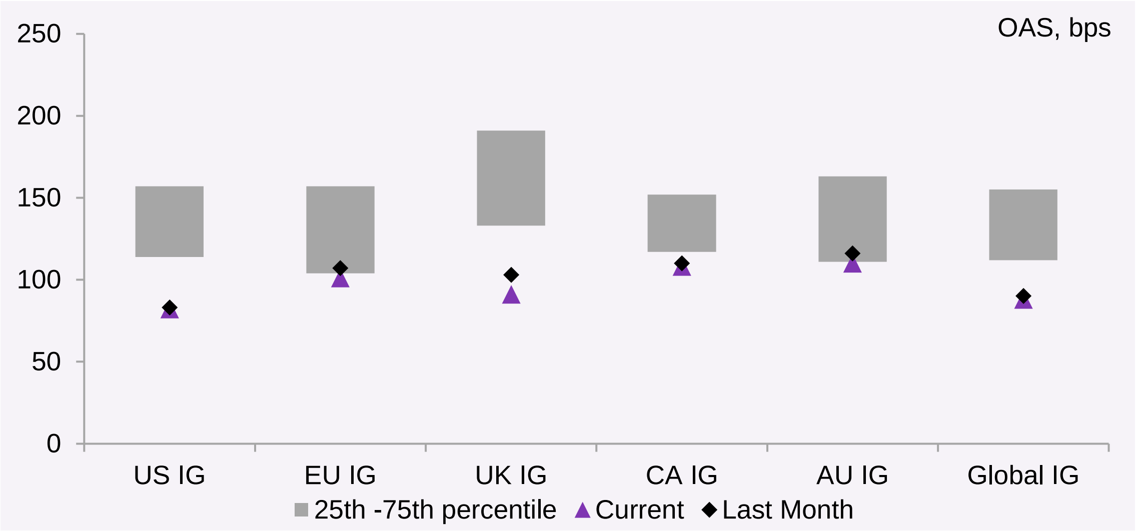
Relatively **healthy interest coverage ratios** and **a notable phase of corporate issuers terming out their debt maturities** prior to the recent rate hiking cycle has cushioned corporate credit markets from the slowdown in economic growth in some advanced economies (e.g., the Eurozone). The exceptional strength of the US economy has also been a notable support. Our outlook is for US growth to continue to provide support to credit markets throughout 2025, with the **benign non-financial corporate downgrade and default cycle likely to continue through 2025.**

Looking ahead:

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

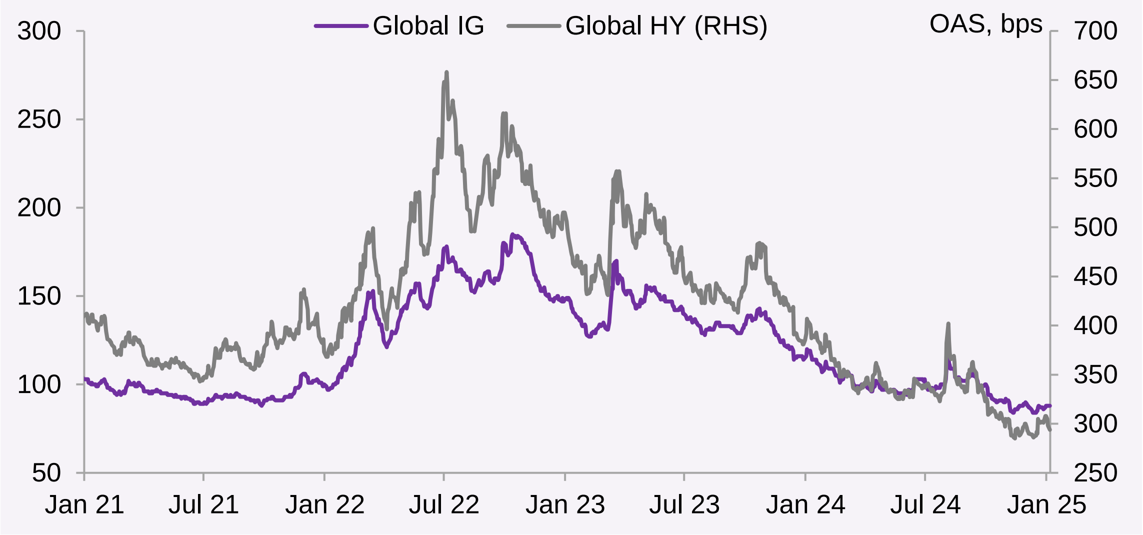
We are balanced over 2025, given good underlying macro and earnings conditions, in the US especially, which nets off against the narrowing of corporate credit spreads in 2024 and their low levels currently.

Investment grade spreads by country



Sources: FactSet, WTW

Both credit spreads and company debt measures show little sign of corporate stress



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 ended December with a loss of 1.9% over the month, but still rose 21.6% in total return terms over the year. The decline in markets was partially caused by the Federal Reserve press briefing on 18 December, in which Jerome Powell highlighted that inflation may be slower to fall and, consequently, the Fed may cut interest rates more slowly in 2025 than previously expected. This led equity investors, at the margin, to reappraise the value of future corporate earnings given the potential for a slightly higher future interest rate.

European equities rose in December as core inflation showed signs of declining in month-on-month data and economic growth remained positive. In Asia, Chinese equities recovered partially from their November underperformance, which had been negatively impacted by the higher risk of new US tariffs following the US election. Japanese equities performed strongly in December, with a return of 4.3% - Japan's government stimulus plan was received positively by markets.

Broad market trends:

Looking to forward earnings, analysts already forecast earnings picking up significantly in 2025, particularly in the US. Nevertheless, our outlook for inflation remaining close to central bank targets, good economic growth in the US, and a gradual easing of monetary policy in advanced economies, should support stock prices. We remain moderately positive in our outlook for equity returns over 2025.

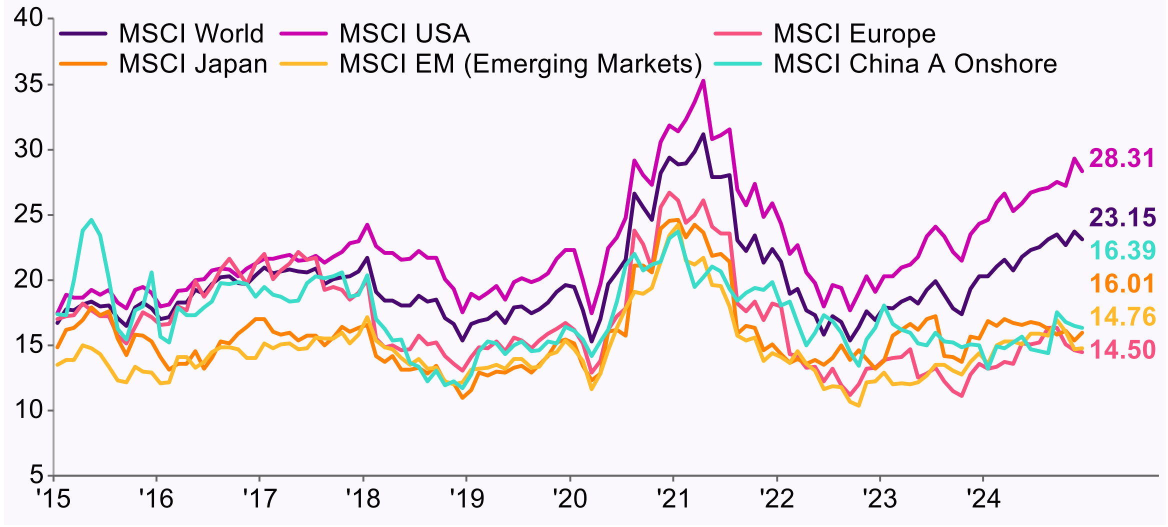
Over the last three months, the top performing sectors have been Consumer Discretionary (8.8%), Communication Services (6.8%) and Information Technology (4.7%).

Looking ahead:

Overall, we retain a neutral view on equities over a five-year horizon. In the shorter-term, we see value in Japanese equities and US small caps given the positive impact on fundamentals of stimulative monetary policy and good cyclical economic growth conditions.

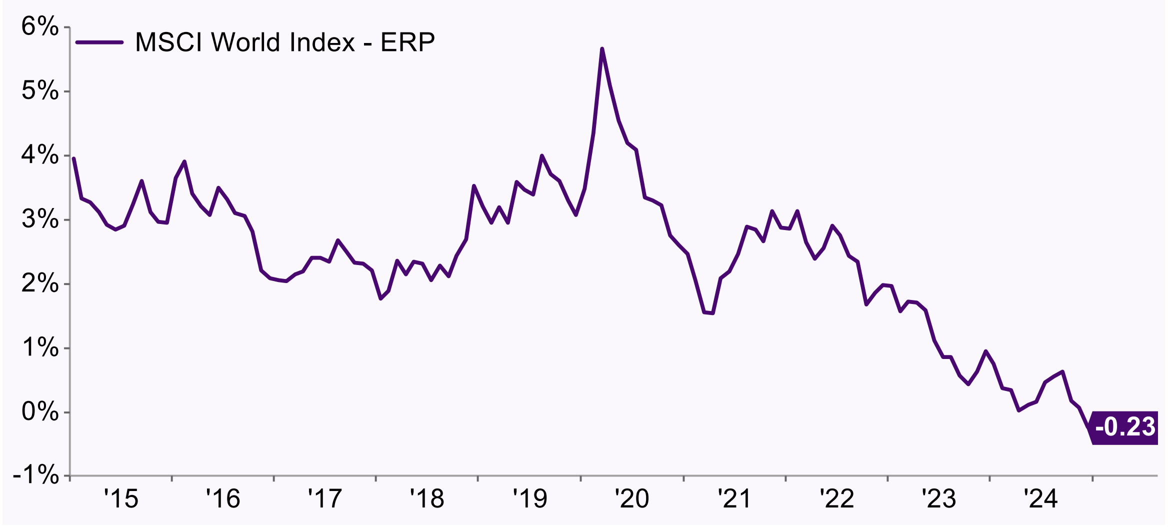
Global equity valuations

Trailing price to earnings ratio



Sources: FactSet, WTW

The global equity risk premium declined significantly over 2024



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:

The US dollar has continued to strengthen against the major currencies. Since the beginning of November, the dollar has appreciated c. 4% against the Australian dollar, and 2% to 3% against the euro and British pound (as of 6 Jan). The yen weakened to around 157 per dollar, near a five-month low.

Factors influencing market trends:

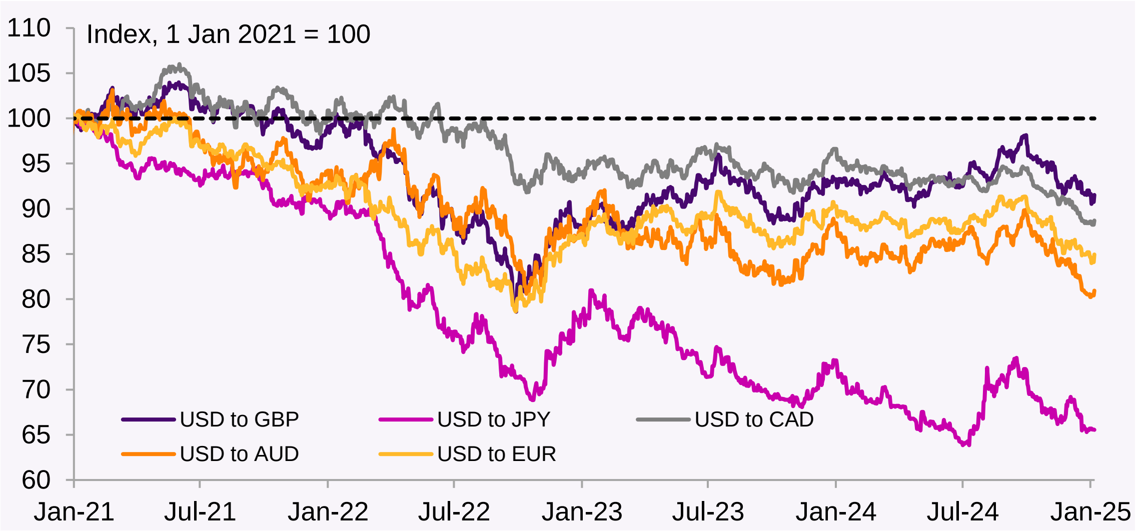
Interest rate differentials help to explain these currency moves. The recent strengthening of the dollar has coincided with US Treasury yields rising relative to most other bond markets, helping to draw in capital. Since the beginning of November 2-year interest rates have risen in the US relative to many other countries, particularly the Euro area. **Other more structural factors also play a key role**. Growth and innovation have been consistently better in the US than other economies for many years, attracting investment and supporting the currency. Consequently, **over a three-year period, the US dollar has appreciated versus all major advanced economy currencies, particularly the yen.**

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**.

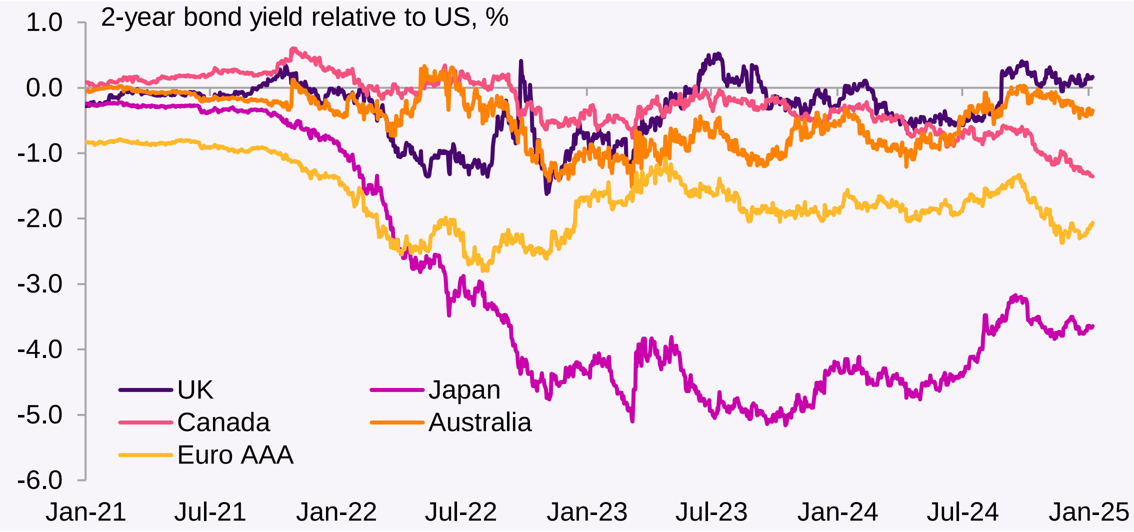
In the near term, however, the relative strength of the US economy, its safe-haven status, its competitive strength in new technologies such as AI, and the potential for additional trade tariffs by president-elect Trump could lead to further appreciation. In the shorter term, we are neutral on most currencies 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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