Global Markets Overview

Asset Research Team

February 2025

Chart of the month

President Trump has issued a flurry of executive orders spanning different areas:

- **Trade –** the US ordered an additional 10% tariff on all US imports from China, with China retaliating. The US also initially set additional 25% tariffs on Mexico, 25% on non-energy products from Canada, and 10% on Canadian oil and energy, which have since been suspended. The likelihood of trade tariffs against the EU was also emphasised by President Trump.
- **Immigration –** new policies indicate a significant shift in immigration policy, emphasising stricter enforcement and reducing legal entry pathways, e.g., a national border emergency was declared.
- **Regulation –** the new orders mark a shift away from promoting electric vehicles and renewable energy, alongside an attempt to boost US oil and gas production. Separately, there was a focus on "Strengthening American Leadership in Digital Financial Technology."

Our assessment of the economic impact of the active tariff policies

- The 10% tariff on Chinese goods by the US is below the 20% tariff we had assumed in our baseline economic outlook for 2025, while we had also incorporated a measured retaliatory response from China. Consequently, *currently*, trade policies have been a positive moderate surprise relative to our forecasts, although it is possible to likely that further additional tariffs are announced on China.
- Particularly, if the 25% tariffs against Mexico and Canada and other possible policies are not enacted, our end-2025 forecast for annual US core inflation of c. 2.5% would be lower by 0.2%.

Despite pockets of volatility, overall, moves in financial markets have been relatively limited

- 10-year US government bond yields are slightly below where they stood before 20th January. Global equity prices have risen slightly. Looking at the currencies of the countries at the centre of the recent trade policy announcements, the US dollar is roughly flat against the Chinese Yuan, the Mexican peso, and Canadian dollar.
- This suggests that the overall trajectory of US policy, so far, has been broadly in line with pre-inauguration market expectations – and our forecasts – with no big surprises.

Tracking US and global trade policies

<table>
<tr><th></th><th>US action</th><th>Response</th><th>Potential impact*</th></tr>
<tr><td>Active tariffs</td><td>On China – 10% additional tariffs on top of existing measures so far</td><td>China imposed 10-15% tariffs on selected U.S. products; filed a case with the WTO; anti-trust lawsuit against Google</td><td>10% added tariffs is below our previous baseline<table><tr><th></th><th>GDP</th><th>Inflation</th></tr><tr><td>US</td><td>minimal</td><td>-0.15</td></tr><tr><td>CH</td><td colspan="2">Moderate +ve GDP impact</td></tr></table></td></tr>
<tr><td>Suspended tariffs</td><td>On Mexico – 25% tariffs on Mexican imports (suspended for 1 month)

On Canada – 25% tariffs on Canadian non-energy imports, 10% tariffs on oil and natural gas (suspended for 1 month)</td><td>Initial retaliation but suspended post negotiations

Mexico agreed to deploy 10,000 National Guard troops to the U.S. border,

Canada implemented a $1.3 billion border security plan</td><td>25% tariffs is above our previous baseline**<table><tr><th></th><th>GDP</th><th>Inflation</th></tr><tr><td>US</td><td>-0.30</td><td>+0.50</td></tr><tr><td>MX</td><td colspan="2" rowspan="2">Much bigger -ve impact; -2% to -3% impact on 2025 GDP</td></tr><tr><td>CA</td></tr></table>** If enacted - unlikely in our view</td></tr>
<tr><td>Likely future policies</td><td>On the EU – leaders warned tariffs likely

On steel and aluminium – 25% on US imports</td><td>EU considering retaliatory measures, e.g., US service exports (such as digital services) into EU possible</td><td>Contingent on scope, severity, and retaliation

Major exporters to US are Canada, China, and Mexico</td></tr>
</table>

Sources: WTW * this shows the potential impact of the policy measures on our baseline economic forecasts for 2025. We have not changed our baseline forecasts because we still think additional tariffs are likely.

Government bonds

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

What happened over the past month:

After climbing during the first half of January, global bond yields have generally declined year-to-date. Currently (06 February), US 10-year bond yields are trading around 444bps, 13bps below end-December levels. Yields for Canadian 10-year bonds have fallen the most among the major markets, by around 27bps. By contrast, Japanese yields have bucked the trend, rising by 19bps over the period.

Factors influencing market trends

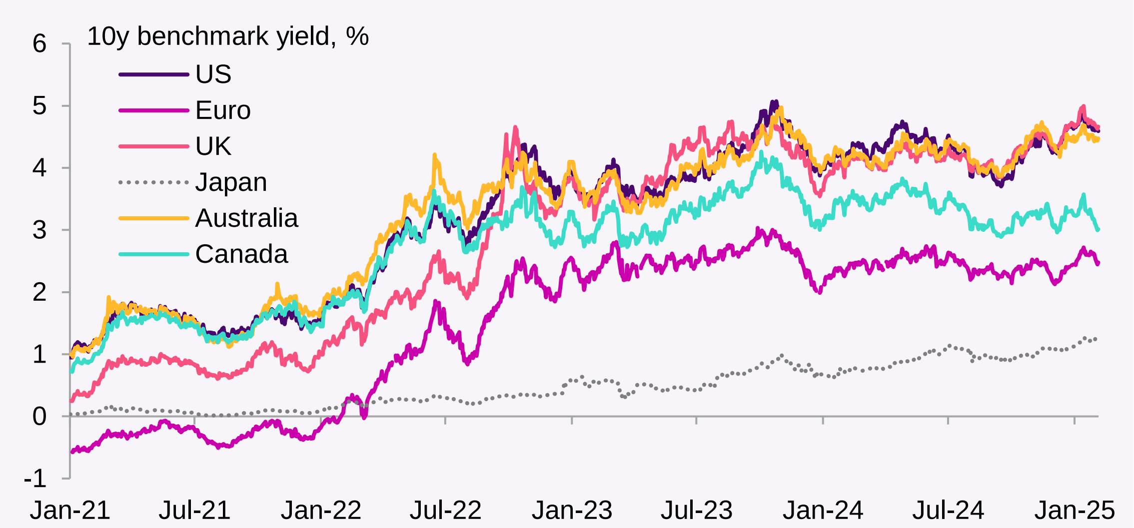
Bond markets remain sensitive to economic data and policy. Yield rises in early January were driven in part by stronger than expected US payroll data, while the subsequent fall was aided by CPI and PPI data that was cooler than expected. In Canada, apart from domestic weakness, bonds have responded to tariff risks from the Trump administration given the value of Canadian exports to the US are roughly 20% of Canada's GDP. In Japan, yields have trended higher on continued signs of a virtuous growth-inflation cycle.

Looking ahead:

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

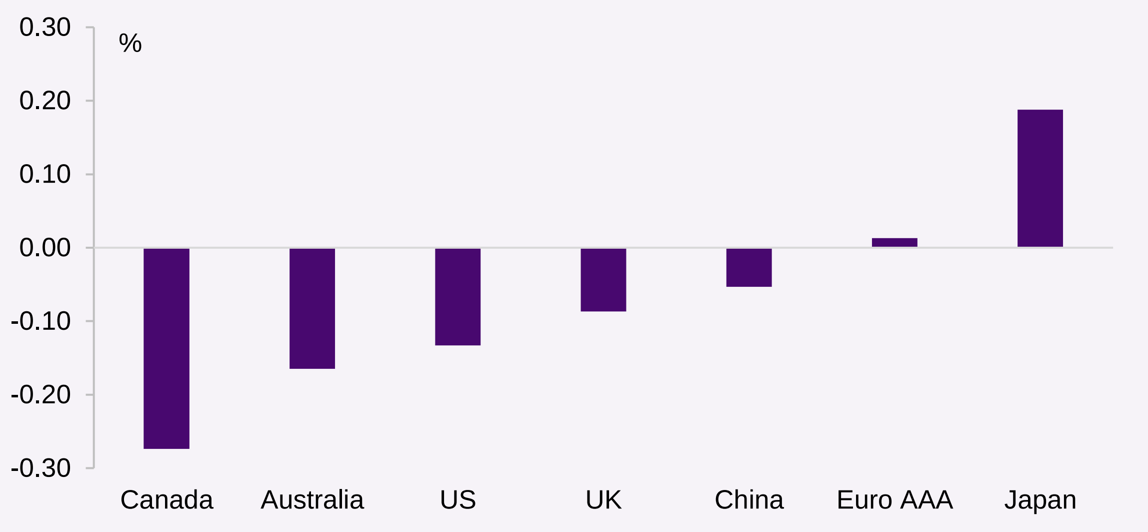
In 2025, our base case is for inflation to moderate, allowing central banks to ease policy. However, the speed and depth of that easing cycle will vary by country. **We think that key developed bond markets offer value over a three-year horizon**. In general, this suggests building bond exposure for 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: FactSet, WTW

Global bond yield moves in 2025 (as of: 06 February)



Sources: Refinitiv Eikon, WTW

Credit

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

What happened over the past month:

January saw moderate-to-good performance from global credit markets, with Euro area investment grade (IG) credit outperforming. Over the month, global IG credit spreads fell by 3bps. While US IG spreads were unchanged at 82 bp, Euro area IG spreads fell from 101 bp to 90bp, mimicking their outperformance in equity markets. However, this relative regional performance didn't extend across the full credit ratings structure, with US high yield credit spreads falling 24 bp compared to a 9 bp decline in the Euro area in January.

What has influenced recent market dynamics?

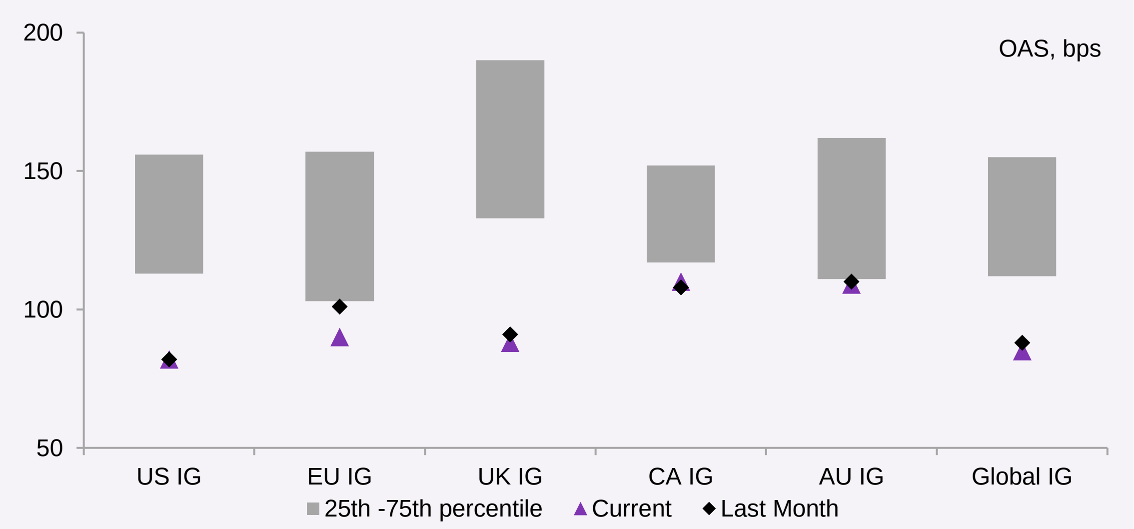
Relatively **healthy interest coverage ratios** and **a notable phase of corporate issuers terming out their debt maturities** prior to the recent rate hiking cycle has cushioned corporate credit markets from the slowdown in economic growth in some advanced economies, in Europe especially. The exceptional 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. Additionally, demand for corporate credit should remain supportive given high all-in yields.**

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.

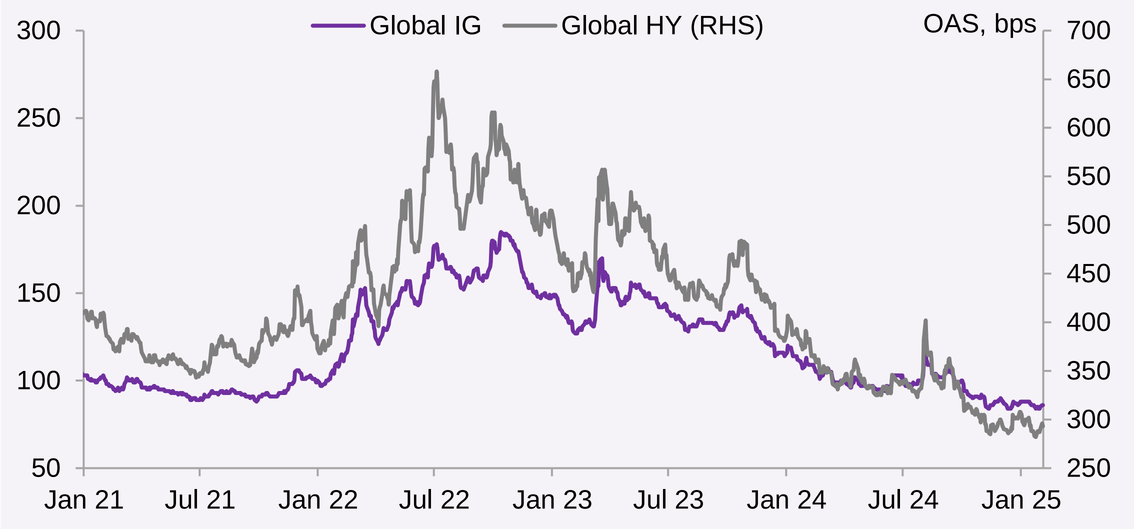
We are balanced over 2025, given good underlying macro and earnings conditions, in the US especially, which nets off against the narrowing of corporate credit spreads in 2024 and their low levels currently.

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:

In January, global equities posted very good returns, with the total return in developed markets (3.5%) outpacing emerging markets (1.6%). The MSCI US index advanced 3.0%, driven by robust economic data and optimism surrounding deregulation, although Nvidia's significant decline exerted some downward pressure. Euro area equities led developed markets, rising 7.6%, bolstered by strength in the financials and consumer discretionary sectors, improved eurozone economic data, and a lower exposure to technology.

The UK equity market also performed well, with the MSCI UK index climbing 6.0%, benefiting from sterling depreciation, which provided a tailwind to companies with significant foreign revenue exposure. Japan lagged, gaining only 0.1%, as the Bank of Japan's interest rate hike and a stronger yen posed challenges for export-oriented firms. In emerging markets, Chinese equities saw modest gains, supported by positive economic indicators and a more moderate stance on US tariffs.

Broad market trends:

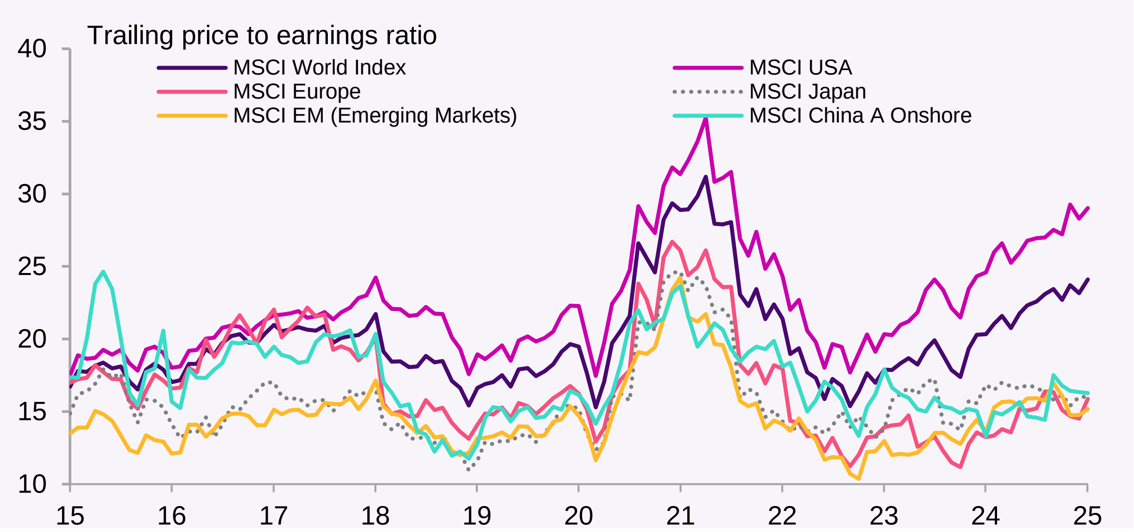
Looking to forward earnings, analysts already forecast earnings picking up significantly in 2025, particularly in the US. Nevertheless, our outlook for inflation remaining close to central bank targets, good economic growth in the US, and a gradual easing of monetary policy in advanced economies, should 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 (17.2%), Communication Services (14.6%), and Financials (10.3%).

Looking ahead:

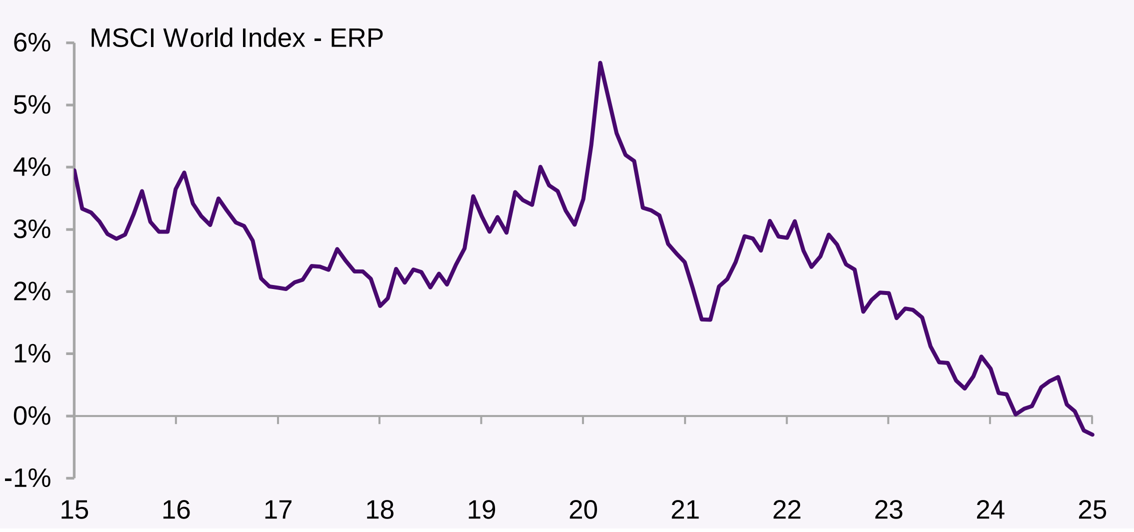
Overall, we retain a neutral view on equities over a five-year horizon. In the shorter-term, we see value in Japanese equities and US small caps given the positive impact on fundamentals of stimulative monetary policy and good cyclical economic growth conditions.

Global equity valuations



Sources: FactSet, WTW

The global equity risk premium is low currently



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 major currencies are relatively flat against the US dollar so far this year. The most material change has been in the Japanese yen, which has appreciated approximately 3.6% against the US dollar in 2025 (as of 06 February).

Factors influencing market trends:

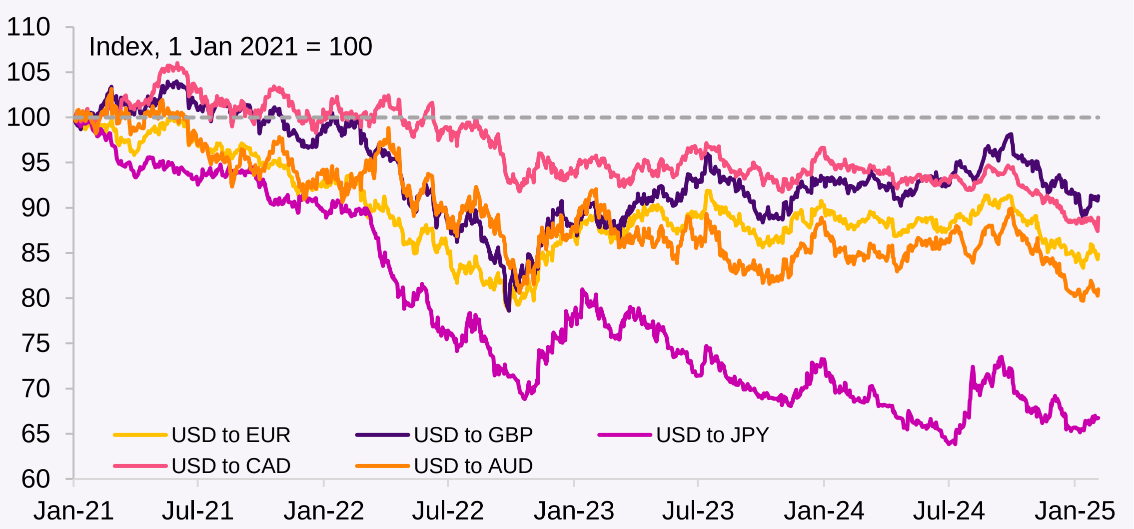
Interest rate differentials help to explain these currency moves. The strengthening of the yen in 2025 has been aided by rising Japanese interest rates against the US, making the differential less negative. This contrasts with the picture of the past few years where higher US rates have tended to support dollar strength, especially against the Japanese yen but also more broadly. **Other more structural factors have also played 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.

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**.

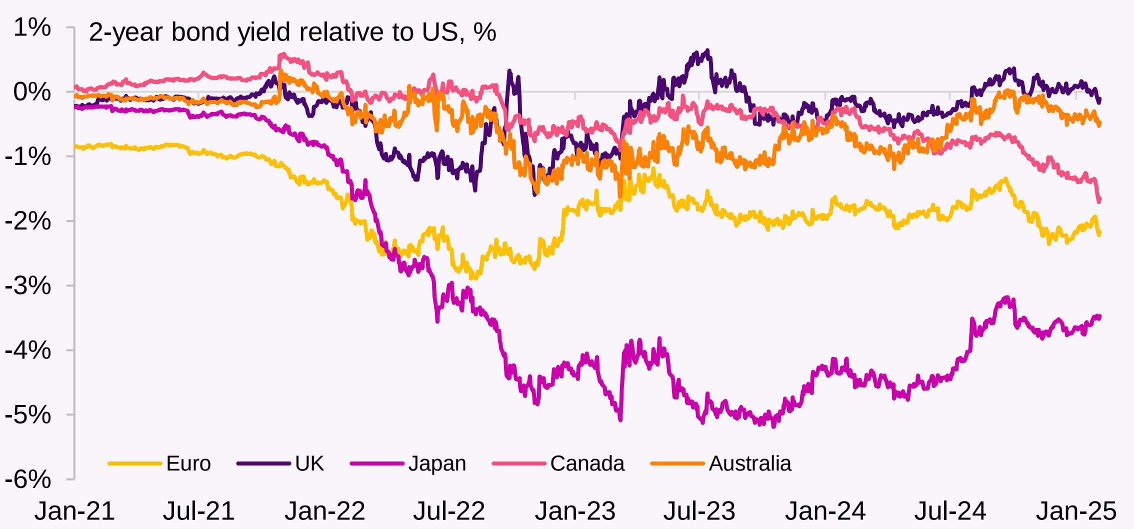
In the near term, however, the relative strength of the US economy, its safe-haven status, its competitive strength in new technologies such as AI, and the potential for additional trade tariffs by president-elect Trump could lead to further appreciation. In the shorter term, we are neutral on most currencies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

Developed exchange rates versus the US dollar



Sources: FactSet, WTW

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



Sources: FactSet, WTW

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