

Global Markets Overview

Asset Research Team

February 2019

Tracking recent changes in equity prices

1. Monthly overview

- The US Federal Reserve has signalled that they will likely pause their current action to shrink their balance sheet, which is withdrawing liquidity and tightening financial conditions. They noted this was in response to rising downside risks to the economy. The fading of last years fiscal stimulus, lagged impact of previous rate hikes, slowing global growth and heightened trade tensions have contributed to a slowdown in US growth. Bond markets are pricing-in a set of monetary conditions that are consistent with this – the short-end of the Treasury yield curve is pricing-in that the Fed will not increase policy rates again in 2019/20.
- Chinese authorities have stated that they intend to liquidate nearly all zombie companies by 2020 with a view to improving resource allocation and efficiency in the economy. The closing down of these unprofitable and overleveraged companies is expected to have a moderately negative impact on growth and labour markets, especially given the current slowdown. However, we expect targeted fiscal and monetary stimulus measures to support an economic recovery in China towards the end of this year.
- On 14th February, the UK Parliament rejected a motion to support the government's negotiating strategy, creating more obstacles for Prime Minister May to reach a conclusive Brexit deal with the EU. European Commission president Jean Claude Juncker has reiterated that the EU are not willing to renegotiate the draft withdrawal agreement. With around five weeks left until the UK officially departs from the EU, uncertainty around the final deal remains high.

2. Our Five-Year Outlook

In January, we published our Five-Year Outlook. A summary of this is provided below:

- **First**, we expect a material slowdown in growth in most of the major economies in 2019, with downside risks rising as we move into 2020.
- The main driver of weaker conditions is the gradual tightening of financial conditions, as the major central banks have raised interest rates and/or withdrawn money from the financial system.
- We believe that a recession in one or more of the major economic regions is likely over the next three years – a more cautious view than in 2018.
- **Second**, relative to our medium-term outlook, we think valuations for growth-related assets are still high and expect low returns on average over five years, ...
- ... putting pressure on savers' wider financial positions.
- **Third**, achieving investment return targets – and hence meeting savers' expectations – is going to be difficult in this environment in our view, even over longer time periods.

Five portfolio priorities for a surprise-free 2019/2020

- Diversify;
- Reduce unrewarded risks;
- Account for the macro & use dynamism;
- Innovate through alpha;
- Innovate to find diversity, e.g., China now offers a new and diversifying set of assets for investors.

Tracking recent changes in equity prices

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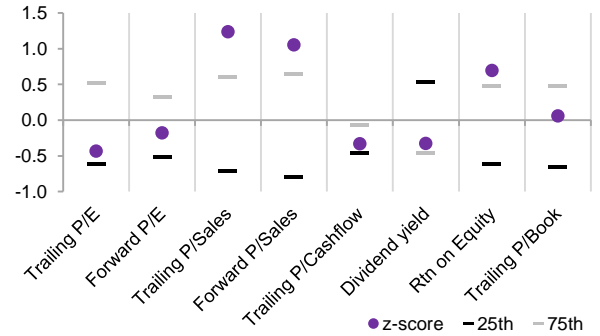
Equity prices rose in all major markets in January, either partially (Europe, Japan and China) or fully (the US) offsetting negative price returns in 2018.

While the valuation of most indices is now lower than a year ago, our analysis suggests investor expectations for future earnings growth are still moderate.

It is our opinion that consensus and market pricing requires a continuation of recent good corporate outcomes. We expect economic growth and earnings growth to be lower than market expectations and expect low equity returns on average over five years.

MSCI World: basic valuation

Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is "attractive" and a positive score is "unattractive"



Source: Factset, Willis Towers Watson

Changes to market pricing

15 February 2019

	Δ 1 month			Δ 1 year				Δ 3 years, pa		
	Total ret	EPS	Trailing P/E	Price	Total ret	EPS	Trailing P/E	Total ret	EPS	Trailing P/E
Australia	1.0%	-0.1%	1.1%	-0.6%	4.0%	3.4%	-3.8%	5.7%	11.3%	0.8%
Canada	3.8%	0.1%	3.6%	1.1%	4.2%	-3.4%	4.6%	15.0%	10.0%	-7.1%
Eurozone	2.9%	0.1%	3.0%	-4.6%	-1.2%	-1.2%	-11.2%	10.2%	7.9%	-5.3%
Japan	2.3%	0.0%	2.3%	-7.5%	-5.3%	10.8%	-16.5%	11.8%	8.8%	-4.8%
UK	2.0%	0.1%	1.9%	-3.1%	1.0%	2.1%	-5.1%	19.3%	8.9%	-12.4%
US	4.6%	0.0%	4.5%	-0.2%	1.6%	19.1%	-16.2%	10.2%	14.5%	1.9%
China	6.4%	-0.1%	6.3%	-16.4%	-14.6%	15.7%	-23.5%	7.6%	18.7%	8.6%
MSCI World	3.9%	0.0%	3.7%	-1.8%	0.6%	10.4%	-13.4%	10.6%	12.1%	-0.9%
MSCI EM	3.8%	0.0%	4.3%	-8.3%	-5.7%	2.3%	-14.8%	9.8%	13.8%	2.3%

Source: Factset, Willis Towers Watson

MSCI World: what's priced-in over the long-run

L-t discounted nominal earnings growth, % pa

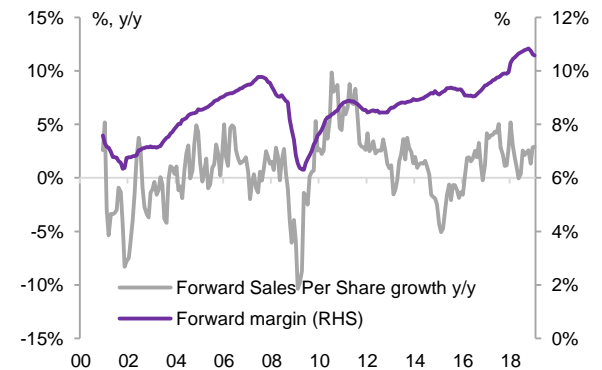


Source: Factset, Willis Towers Watson

Discounted earnings growth determines the long term earnings growth required to deliver the current price, after making neutral assumptions for future interest rates and the equity risk premium

MSCI World: what's priced-in over the short-run

Analysts' expectations for earnings/margins next yr.



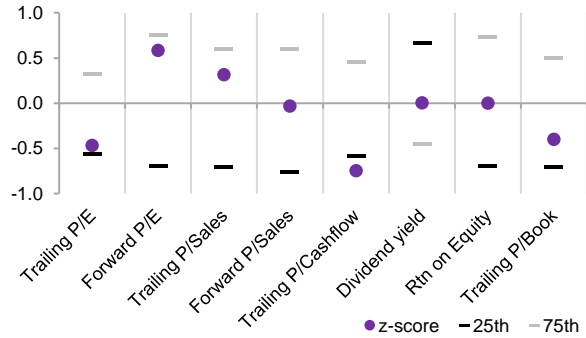
Source: Factset, Willis Towers Watson

Asset Research Team

Tracking recent changes in equity prices

MSCI EM: basic valuation

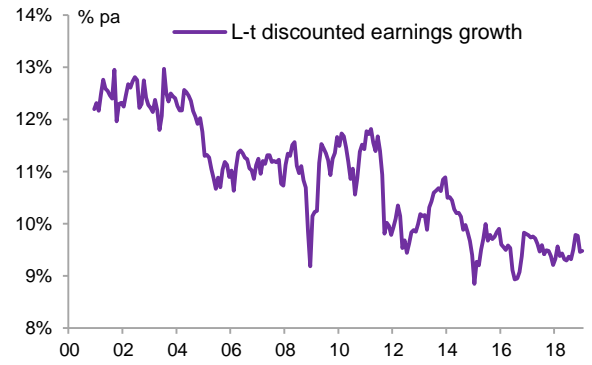
Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is “attractive” and a positive score is “unattractive”



Source: Factset, Willis Towers Watson

MSCI EM: what's priced-in over the long-run

L-t discounted nominal earnings growth, % pa



Source: Factset, Willis Towers Watson

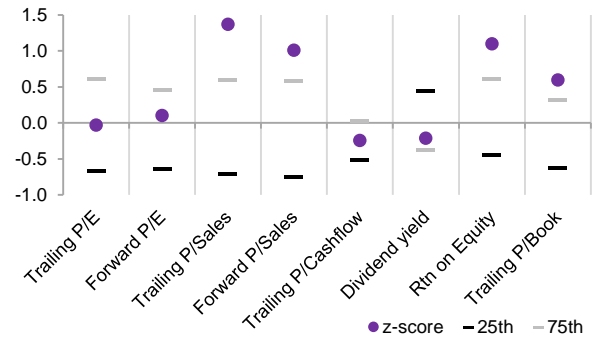
MSCI EM: historic sales growth and margins



Source: Factset, Willis Towers Watson

US: basic valuation

Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is “attractive” and a positive score is “unattractive”



Source: Factset, Willis Towers Watson

US: what's priced-in over the long-run

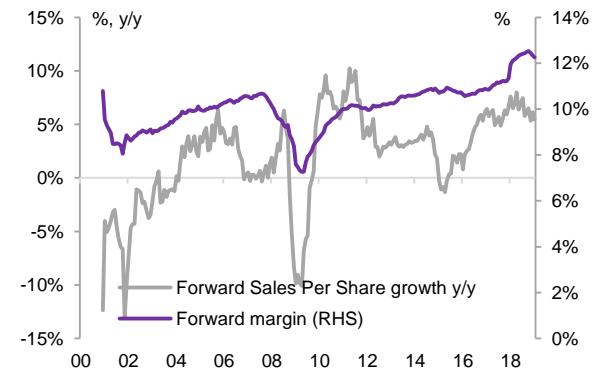
L-t discounted nominal earnings growth, % pa



Source: Factset, Willis Towers Watson

US: what's priced-in over the short-run

Analysts' expectations for earnings/margins next yr.

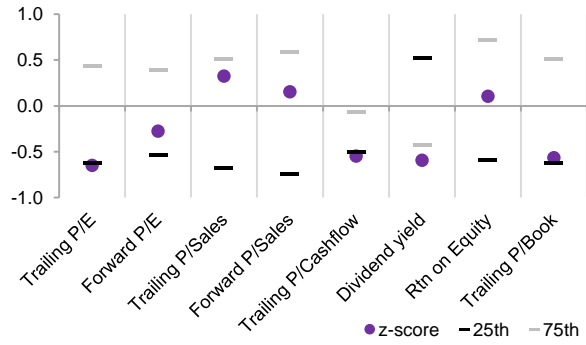


Source: Factset, Willis Towers Watson

Tracking recent changes in equity prices

Eurozone: basic valuation

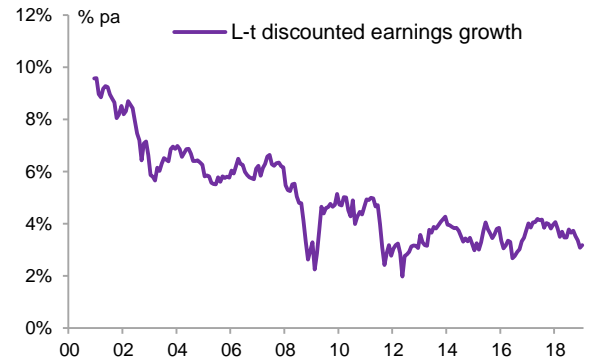
Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is “attractive” and a positive score is “unattractive”



Source: Factset, Willis Towers Watson

Eurozone: what's priced-in over the long-run

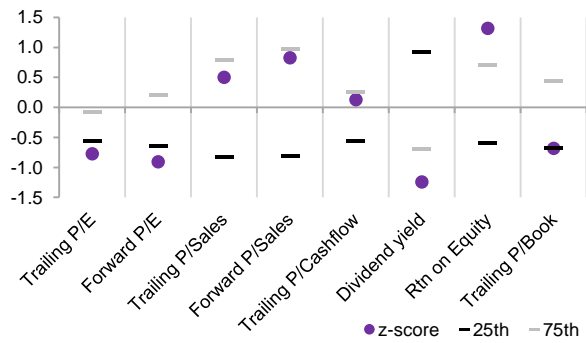
L-t discounted nominal earnings growth, % pa



Source: Factset, Willis Towers Watson

Japan: basic valuation

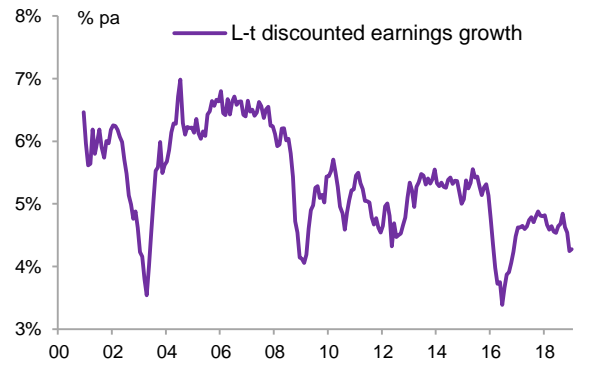
Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is “attractive” and a positive score is “unattractive”



Source: Factset, Willis Towers Watson

Japan: what's priced-in over the long-run

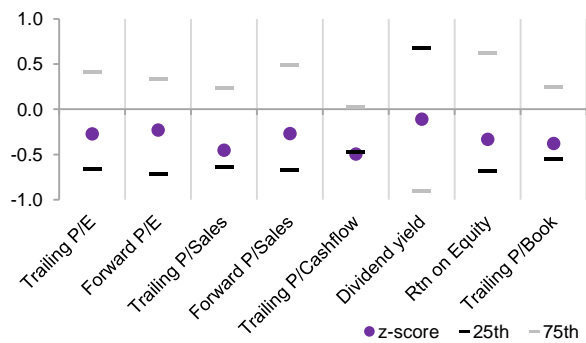
L-t discounted nominal earnings growth, % pa



Source: Factset, Willis Towers Watson

China: basic valuation

Z-score (std devs from average since Jan 2000). For all valuation multiples (excl. ROE) a negative score is “attractive” and a positive score is “unattractive”



Source: Factset, Willis Towers Watson

China: what's priced-in over the long-run

L-t discounted nominal earnings growth, % pa



Source: Factset, Willis Towers Watson

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