Expected Returns for Asset Classes

Robert G. Kahl, CFA, CPA, MBA
https://SabinoIM.com

Research Affiliates publishes monthly updates to their 10-year expected returns for various asset classes. Below are their nominal (after inflation) return expectations for equities as of November 30, 2024. Research Affiliates currently forecasts inflation to average 2.5% during the next 10 years. The low expectations for US large cap stocks reflect mean reversion to a more normal valuation range. The range of expected volatility for equity returns (one standard deviation for a single year) varies from 15.2% (developed markets large cap) to 20.3% (US small cap).

Expected Equity Nominal Returns (Annualized) for 10 years
Source: Research Affiliates

- US Large cap 3.2%
- US Small cap 6.8%
- US real estate investment trusts 6.5%
- Developed Markets w US Large 4.8%
  - DM Large Value 5.4%
  - DM Large Growth 2.9%
- Developed Markets w US Small 7.9%
  - DM Small Value 8.6%
  - DM Small Growth 7.3%
- Developed excluding US Large 9.3%
- Europe 9.0%
- Emerging Markets 9.0%
  - EM Value 10.2%
  - EM Growth 6.3%

The most common index for developed markets is the MSCI World Index, which is a capitalization weighted index with a 73.9% weighting in the United States and a 26.1% weighting in technology. Thus, expectations for developed markets excluding the

United States are higher than expectations for developed markets including the United States.

Research Affiliates also has higher expectations for value stocks compared to growth stocks, with the largest difference in emerging markets. Value stocks are those that sell at lower valuations based on earnings, cash flow, or book value.

Fixed income expectations are consistent with the current level of interest rates. So, Research Affiliates does not anticipate any dramatic changes in the fixed income markets. The expected volatility for fixed income has a broader range, reflecting the difference in duration: 1.7% for US Treasury short-term securities to 12.5% for US Treasury long-term securities.

Expected Fixed Income Nominal Returns (Annualized) for 10 years
Source: Research Affiliates

- US Treasury
  - Short 4.5%
  - Intermediate 4.8%
  - Long 4.2%
  - TIPS 2.4%
- US Corporate
  - Intermediate 5.3%
  - Bank Loans 4.7%
  - High Yield 5.2%
- Other
  - Emerging Market US$ 5.0%
  - Global Corporate 4.9%

While I believe the methodology of the Research Affiliates is sound, it does not reflect the impact of potential macroeconomic changes such as a major reduction in US government deficit spending (lower GDP accompanied by lower corporate earnings) or a credit contraction. We also have an ongoing loss of reserve currency status for the US dollar which can lead to a currency devaluation, higher inflation, and higher interest rates.

If you have any questions or comments, please contact me. Wishing you and your family a happy and prosperous New Year!

Sincerely,
Robert G. Kahl
CFA, CPA, MBA