



ASSET ALLOCATION

Quick Clips: 2022 Capital Market Assumptions for Major Asset Classes

January 27, 2022

Since 2014, we have published our capital market assumptions for major asset classes, focusing on medium-term expected returns. During that time, rising valuations have delivered strong realized returns at the cost of falling expected returns. At the start of 2022, expected real returns for all asset classes remain depressed due to exceptionally low real cash rates.

Our outlook on stock/bond portfolios differs from the past decade (0:26):

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As well as traditional asset classes, we also estimate long-term returns for style-tilted long-only portfolios and long/short style premia. Our research has shown that timing factor exposures based on their valuations is difficult, but tilts may be warranted at extremes. At the start of 2022, we believe the continued extreme cheapness of value could warrant an overweight to that style in a multi-factor strategy.

We outline our assumptions for Alternative Risk Premia, noting the difficulty of factor timing (0:55):

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Previous forecasts of low expected returns turned out to be too pessimistic. We compare the assumptions stated in our paper of a decade ago (link 5% Solution paper) to the outcomes in the subsequent decade, and find that equity market richening was the main driver of strong realized returns. We do not believe a repeat of the past decade is likely.

We consider a scenario that could deliver a 5% real return for traditional portfolios (0:58):

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We consider practical incremental changes that could increase expected returns without adding substantial risk. Those changes include allocating to defensive equity, adding exposure to bonds and commodities, and adding diversifying liquid alternatives to a portfolio.

We explain the potential outcome of implementing these practical portfolio changes, according to our assumptions (0:44):

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