Asset Allocation

2016 Capital Market Assumptions for Major Asset Classes

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This issue updates our multi-year expected return assumptions for major stock and bond markets, and investigates methods for estimating expected returns for credits and commodities. Compared with historical averages of value metrics, we are still very much in a world of low expected returns.

- Our current estimate for U.S. stocks' long-run real return remains near 4%, lower than in European and emerging markets. In the U.S. and several other markets, modest increases in earnings and dividend yields over the past year have been offset by reductions in forecast earnings growth.
- For 10-year U.S. Treasuries, our long-run real return estimate remains near 0.5%. From a century-long historical perspective, both equity and bond expected returns remain exceptionally low, especially when taken together.
- This year we include long-run expected returns for credits and commodities, explaining our chosen methodology for each asset class. For U.S. investment grade and high yield credit, we estimate real returns of around 1% and 3%, respectively. For a risk-weighted portfolio of commodities, we estimate a long-run real return of around 3%. We also discuss return expectations for alternative risk premia and cash.

This report again highlights the low expected returns in traditional asset classes. It also expands our menu of assumptions for additional sources of return that may prove valuable in this challenging environment. We believe investors should diversify as much as constraints permit across many sources of expected returns.

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