Double digit no more

Same sobering thoughts about long-term equity return prospects

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This two pager is an extract from **The Equity Thematician: Bracing for lower long-term equity returns** which you can also find on the Investment Strategy Webpage.

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Did you know?

- US is now on one of the longest-lasting economic expansion cycles in the history after having expanded for 115 months already – the longest of the cycles lasting 120 months, the shortest lasted for about 12 months, the average expansion lasting for 58 months.
- During the current expansion US equities have delivered around 12% geometric returns, 40% more than their long-term average (between 1900 and 2015)!
- A reversal to that average would imply significantly lower returns for the 2020s, compared to those we have seen in the 2010s.
- However, over long-run equities have delivered superior returns when compared with bonds and cash thereby proving essential assets in multi-asset portfolios.
- Equity investors who stayed invested for ten years never lost money.

What?

Drivers and worrying signs of long-term slowdown in equity returns

STRUCTURAL DRIVERS

- Weaker demographic dividends
- A protracted low growth environment
- A reversal in disinflation/ normalisation of interest rates
- A reversal in globalisation
- Political economy and wealth redistribution

SOME WORRYING SIGNS

- Peak corporate profits
- Elevated levels of corporate leverage
- Expensive valuations
- Expansion in equity risk premia

So what?

Implications of lower return expectations

Lower equity returns are likely to have wider implications for a range of economic segments – including investors, asset managers, students and policy makers. Against the backdrop of pensions being underfunded (and unfunded in many cases), the funded portion is likely to face lower returns. Retirement planners and wealth managers need to consider longer time frames to generate a certain level of income/wealth from financial markets. Rising savings will translate into weaker consumption trends in consumer-led economies. As university endowment funds face lower returns, students' cost rise on the backdrop of already high levels of student debt. Asset managers face margin pressure and those with a cost advantage outperform. Lower expected returns on the benchmark indices allows scope for active managers to outperform.

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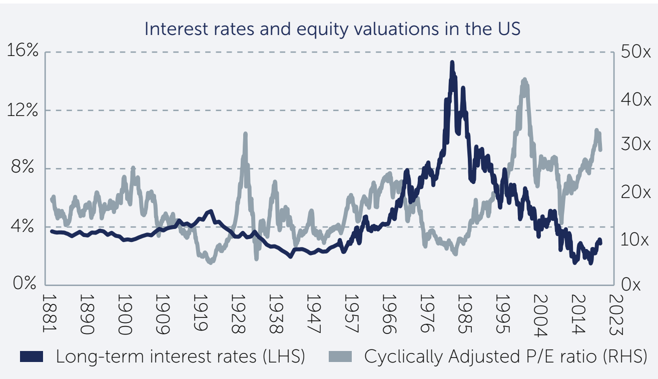
Now what?

What is the antidote for this situation?

Notwithstanding the likelihood of substantially lower long-term equity returns, the asset class remains an indispensable component of any global multi-asset approach as bonds and cash are unlikely to deliver the returns required by investors. Rather, good returns are increasingly likely to be generated by those asset managers that are able to capture the winning countries and sectors in a world that will be characterized by more volatility and by returns that are on average lower. Informed decision taking, reflected in thematic investing, and risk-adjusted investing in high-return assets, like emerging markets, will still allow for the possibility to beat those benchmarks, which are likely to deliver lower returns.

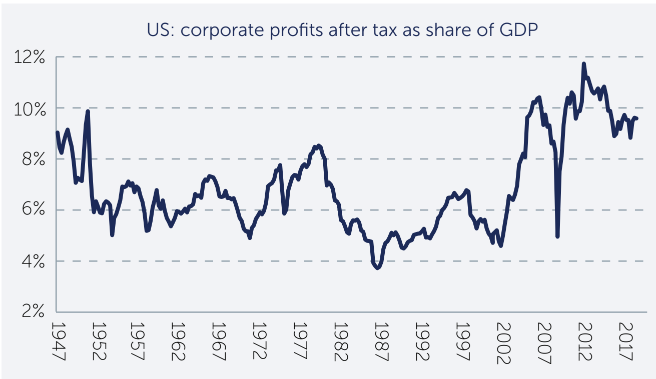
Our Investment Strategy and Investment Advisory teams have identified a number of themes that will allow you to take advantage of long-term trends, which are also in line with our house view. Please reach out to your relationship manager to see what we can do to help you navigate what we see as a rather low-return environment in the coming decade.

US interest rates have reached their historical low?



Source: Robert Shiller Data (Published in the book, "Irrational Exuberance", Princeton University Press 2000)

US corporate profits as high as it can get?



Source: US Bureau of Economic Analysis

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