INVESTING SPECIALISTS

Experts Forecast Stock and Bond Returns: 2021 Edition

Nearly every firm has ratcheted down return expectations, but international equity remains a bright spot.

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Jan 20, 2021

When I last compiled investment firms' long-term asset-class return forecasts, in April 2020, most of the companies surveyed were feeling at least somewhat sanguine about stocks' prospects. Equities had fallen sharply in the first quarter of 2020, and several of these firms cited attractive valuations as a likely contributor to better returns ahead.

Nine months and a series of strong stock and bond returns later, however, and bullish forecasts for the U.S. equity market are scarce. Bond-market bulls are few and far between, too. While a 60/40 portfolio composed of U.S. large caps and investment-grade bonds has been tough to beat over the past decade, most of the firms in our survey are forecasting constrained returns for those asset classes going forward. One glimmer of hope is that each of the firms is forecasting better returns for foreign stocks than U.S.-domiciled companies. Firms differ on whether emerging-markets or developed-markets stocks have more upside potential today, however. Whereas a year ago many of the firms believed that emerging markets would enjoy better returns than developed markets, several believe that a strong recovery in emerging-markets equities in 2020 diminishes their upside potential going forward.

How to Use Them

Predicting the market's direction, especially over the short term, is tricky, and some investors might be inclined to dismiss asset-return forecasts altogether.

But return expectations can be useful--and are arguably even mission-critical--when setting up your financial plan. After all, you need to plug in some type of long-term return assumption when deciding whether your savings rate and time horizon are appropriate given what you'd like to achieve. And if you're retired, being realistic about return expectations is also essential when determining an sustainable withdrawal rate. Low return expectations for U.S. stocks and bonds are a key reason that retirement researchers like Wade Pfau believe that new retirees should be conservative with their withdrawal percentages.

Before you embed these or any other return forecasts to into your plan, however, it's important to bear in mind that these return estimates are more intermediate-term than they are long. The firms I've included below all prepare capital markets forecasts for the next seven to 10 years, not the next 30. As such, these forecasts will have the most relevance for investors whose time horizons are in that ballpark, or for new retirees who face sequence-of-return risk in the next decade. Investors with very long time horizons (20-30 years or longer) can reasonably employ long-term historical returns, but they may want to haircut them a little bit to incorporate what could be a tough next decade.

It's also important to note that the parameters for these return estimates vary a bit; some of the return expectations are inflation-adjusted, while most are not (nominal). In addition, some of the experts forecast returns for the next decade, while others employ slightly shorter time horizons. The firms also vary in their approaches to formulating the forecasts, though most rely on some combination of valuations, current yields, and earnings growth and inflation expectations to arrive at return expectations. Finally, it's worth noting that the market is always moving, so expect these forecasts to be pretty ephemeral, too.

Exhibit 1: Expert Forecasts for Long-Term Asset-Class Returns

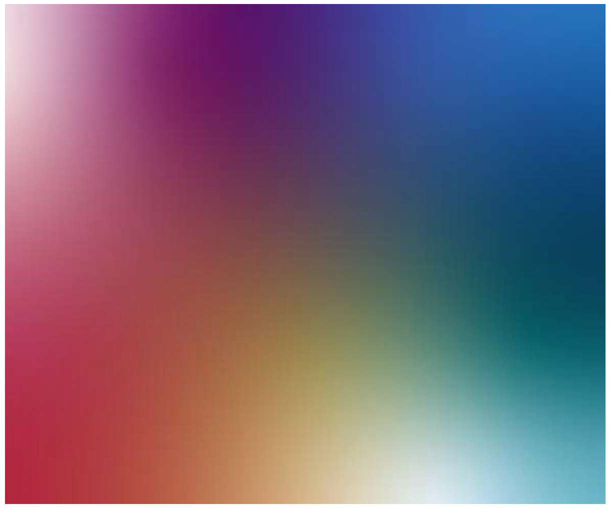
Firm	Date	U.S. Equities	Developed-Markets Equities	Emerging-Markets Equities	U.S. Bonds
BlackRock	Sep 2020	5%	7%[a]	6.40%	0.80%
JPMorgan[b]	Dec 2020	4.10%	5%-6%	7.20%	2.5%[c]
Morningstar Inv. Mgmt.	Dec 2020	-0.10%	4.80%	4.50%	1%
Research Affiliates	Dec 2020	2%[d]	6.30%	7.90%	1.10%
Vanguard	Dec 2020	3.7%–5.7%	7%–9%[e]	7%–9%[e]	0.75%–1.75%

[a] European equities.
[b] 10–15 year horizon.
[c] Investment-grade corporates.
[d] U.S. large caps.
[e] Estimate is for all non-U.S. equities.

BlackRock

Highlights: 5% 10-year expected nominal return from U.S. equities, 7% 10-year average expected return from European equities, 6.4% average expected return from emerging markets equities, 0.8% for U.S. aggregate bonds (September 2020). All return assumptions are nominal (non-inflation-adjusted).

Given that both U.S. stocks and bonds performed well in 2020, it's not surprising that BlackRock has lowered its return-assumptions for these asset classes in the decade ahead. While the firm was forecasting returns of roughly 6% from U.S. large caps in September 2019, that forecast was down to 5% a year later. In keeping with lower yields, the firm's 10-year outlook for U.S. aggregate bonds also declined by nearly a percentage point, to 0.8% on a nominal basis.



BlackRock continues to be more sanguine in its outlook for international stocks, assuming nominal 10-year returns of 6% for emerging-markets equities and 7% for European stocks over the next decade. BlackRock reserves its highest return expectations for private equity: It's expecting an average nominal return of nearly 17%, albeit with a huge amount of variability/uncertainty, over the next decade. BlackRock's capital markets assumptions are easy to use and the time frames are adjustable, allowing investors to adjust the time horizon to suit their own.

Grantham Mayo Van Otterloo (GMO)

Highlights: Negative 5.8% real (inflation-adjusted) returns for U.S. large caps over the next seven years; negative 3.5% real returns for U.S. bonds; 0.4% real returns for emerging-markets equities; 0.2% real returns for emerging-markets debt (Oct. 15, 2020).

In keeping with the firm's reputation as perennially pessimistic about plain-vanilla equities and bonds, GMO's seven-year forecast for U.S. stocks and bonds isn't pretty. It expects a real (inflation-adjusted) loss of roughly 6% from U.S. large caps over the next decade, and U.S. and hedged non-U.S. bonds to experience losses in the neighborhood of 4%. All of those return expectations are appreciably worse than what GMO was forecasting in late 2019 and in April 2020. Even emerging-markets equities, one of the few pillars of strength in GMO's forecast in years past, are forecast to land only modestly in the black over the next seven years. That represents a sharp turnabout from late 2019, when GMO was expecting a 4.5% real annualized return from emerging-markets equities over the next seven years. The firm's sole pocket of enthusiasm remains the value slice of emerging-markets equities: Its real return expectation of 9% remains roughly where it was a year ago.

JPMorgan

Highlights: 4.1% nominal returns for U.S. equities over a 10-15 year horizon; 2.5% nominal returns for U.S. investment-grade corporate bonds over a 10-15 year holding period (December 2020).

JPMorgan's Long-Term Capital Markets Assumptions report provides a good deal of data, as well as thorough background on the firm's economic and market forecasts, which are based on qualitative and quantitative inputs. As with all of the other firms, JPMorgan has reined in its return expectations for U.S. stocks owing to higher valuations: The firm's expected returns over the next 10-15 years dropped to just 4% from nearly 6% a year ago. Return assumptions for developed-markets equities are a touch higher, though: about 5% for European and Japanese equities and 6% for U.K. equities. The firm's return expectations for emerging markets equities have dropped a bit from the 2020 forecast but are still at a robust 7.2% in U.S. dollar terms.

On the fixed-income side, the firm is employing low return assumptions of just 2.5% for U.S. investment-grade corporates, thanks to low starting yields, and even lower returns for U.S. government bonds. JPMorgan is more optimistic in its outlook for high-yield bonds, however: While return expectations for the next 10-15 years have decreased by 40 basis points, they're still at 4.8%. The firm is also enthusiastic about the prospects for emerging-markets hard-currency debt, forecasting a return of 5.2%.

Morningstar Investment Management (forthcoming in *Morningstar Markets Observer*)
Highlights: Negative 0.1% 10-year nominal returns for U.S. stocks; 1% 10-year nominal returns for U.S. aggregate bonds (Dec. 31, 2020).

The Morningstar Investment Management team's forecast for U.S. equities leans toward the pessimistic side of our collected forecasts: While it isn't expecting sizable losses like GMO, it's still expecting a slightly negative return from U.S. stocks on a nominal basis in the decade ahead. MIM's outlook for non-U.S. stocks is sunnier: a 4.8% return (nominally) for developed-markets equities and 4.5% for emerging-markets equities.

MIM expects U.S. aggregate bonds to land in the black--albeit just slightly--on a nominal basis over the next decade. Owing to tightening yield spreads, the firm's outlook for high-yield bonds has declined sharply over the past three months. Whereas it was forecasting a nearly 4% return from high yield in September 2020, its 10-year expected return as of December-end was just half that.

Research Affiliates
Highlights: 2% nominal (negative 0.2% real) returns for U.S. large caps during the next 10 years; 1.1% nominal (negative 1.1% real) returns for the Bloomberg Barclays U.S. Aggregate Bond Index (Dec. 31, 2020; valuation-dependent model).

Research Affiliates' expected returns model is customizable and fun to use. Whereas most firms show expected returns for five or six asset classes, the Research Affiliates model gets more granular, allowing users to home in on smaller segments of the stock and bond markets. Better yet, it's updated monthly, incorporating more recent market action.

Not surprisingly, the firm's return expectations for U.S. stocks and bonds have declined from a year earlier, so much so that it expects that both will land in negative territory in real terms over the next decade. The firm is more optimistic in its expectations for non-U.S. stocks and bonds, however. Its valuation-dependent model is forecasting a whopping 7.9% nominal (5.7%

real) return from emerging-markets equities over the next 10 years and 6.3% nominal (4.1% real) for the MSCI EAFE index of developed-markets stocks.

Vanguard

Highlights: Nominal U.S. equity-market returns in the 3.7%-5.7% range during the next decade; 7%-9% returns for non-U.S. equities; 0.75%-1.75% expected returns for U.S. fixed income (December 2020).

Whereas most of the firms ratcheted their equity return expectations downward from where they were at the outset of 2020, Vanguard maintained the same general return targets in its forecast for 2021 and beyond that it did last year. The headline is that the firm is expecting better performance from non-U.S. equities than U.S. equities over the next decade, mainly owing to foreign stocks' lower valuations and higher dividend yields. Vanguard is also expecting value stocks to outperform growth.