Ten Years After: Rocking To Investment Returns Over The Next Ten Years

Saturday's With Jim

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Dear Friends,

Investors, like most people, appreciate some certainty in their uncertain lives. Accommodatingly, investment houses crank up their research arms to produce future estimated investment returns. Some might think investment projections to be silly stuff, an edifice built on a bed of cotton candy. Yet, the longer we project returns the more accurate they are likely to be IF the assumptions that go into them generally play out. Today we present Vanguard's recently issued ten-year forecast (available on their Financial Advisors' site to advisors).

The 10-year annualized nominal return projections, based on market conditions as of June 30, 2019, are:

Asset Class	**10-Yr Annualized Projected Returns**
Equities	
Global Equities Ex-U.S. (Unhedged)	6.5%–8.5%
U.S. Equities	3.5%–5.5%
U.S. Real Estate Investment Trusts	2.5%–4.5%
Fixed Income	
U.S. Bonds	1.5%–3.5%
U.S. Treasury Bonds	1.0%–3.0%
Global Bonds Ex-U.S. (Hedged)	1.0%–3.0%
U.S. Credit Bonds	2.0%–4.0%
U.S. High-Yield Corporate Bonds	3.0%–5.0%
U.S. Treasury Inflation-Protected Securities	1.0%–3.0%
U.S. Cash	1.0%–3.0%

Source: Vanguard Investment Strategy Group, Sept. 25, 2019

How Vanguard arrived at the numbers

The Vanguard Capital Markets Model runs tens of thousands of simulations for each of the asset classes named in the table above. Their projections, then, are based on statistical analysis which is of course highly dependent on the inputs. The analysis may seriously overestimate or underestimate the actual results and the path to them. But these numbers do offer a rough investment roadmap based on the markets' tendency to return to a long-term trend after a time of overperformance or underperformance of that trend. The most important model input, we think, are current valuations within the asset classes. When valuations such as a comparison of stock prices to earnings rise above or fall below a long-term trend, they either revert to trend or very occasionally will create a new trend which itself could be reversed in time. Confusing? Welcome to our world.

Cutting to the Chase

Our method of setting investment focus according to the level of risk the business cycle allows us to make relatively small course corrections which alleviates the risk we would have if we relied on long-term projections like Vanguard presents here.

We are still overweight U.S. stocks compared to the rest of the world because the U.S. has a lot of momentum as seen in its outperformance over other countries during the last ten years. But we, like Vanguard, see changes coming that might cause other country markets to outperform those in the U.S.

Specifically, the U.S. hegemony over the world's economic system will likely fracture during the next ten years, with the U.S. dollar no longer being the world's currency. The buck will likely weaken, making imports more expensive, exports more attractive and international market investments more attractive to a U.S. investor. Beyond stocks, we find bond yields unappealing, yet we might need them for volatility/risk ballast. We will probably invest in some high yield bonds and will certainly maintain our investments in leveraged bond funds, which borrow money at low rates to invest at higher rates. The leveraged bond funds magnify our bond returns, but they also increase total account volatility a bit.

Finally, Vanguard does not think that inflation will be a serious threat, as inflation-protected Treasuries don't have a higher return than cash or non-inflation protected Treasuries.

Concluding

Assuming that humans can tame climate warming and assuming no geopolitical conflagration, we still think that the world of the next ten years will look different than the world of the last 70 years. Stay tuned. It's going to be interesting.

Cheers,

Jim

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The projections and other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of June 30, 2019.