MacroResearchBoard
mrb partners LONG-TERM RETURNS
Independent Investment Strategy
November 14, 2024

Perpetual Reflation Is Unsustainable

"The first one now will later be last, for the times they are a-changin'" Bob Dylan

- Investors should expect lower real returns on a 60/40 equity-bond portfolio over the next 10 years compared with the last decade as equity returns are expected to moderate. Only a modest structural overweight on equities versus bonds is appropriate.
- G7 10-year government bond yields will rise further over the next decade, but real returns should be mildly positive after the losses of the past 10 years. Credit will outperform government bonds, albeit by less than the average in the past.
- U.S. equities will deliver near zero real returns in the decade ahead, weighed down by high starting valuations and earnings. Non-U.S. equity real returns will be solid and boosted by healthy dividend yields. EM, euro area and U.K. are projected to be comparative winners.
- Commodities prices are projected to edge lower in real terms, reflecting lower real gold prices and only modestly higher real industrial commodity and crude oil prices. Commodity prices will thus underperform other risk assets.
- The U.S. dollar is projected to depreciate on a real trade-weighted basis over the forecast horizon given its elevated starting point.

The capital markets landscape is set to change markedly over the next decade, with the huge gap in recent performance between stocks and bonds set to narrow or even reverse. Moreover, the benefits that investors have enjoyed in the past four decades from the persistent reflationary policies of the U.S. and other major economies will inevitably lose momentum, with inherent inflation risks and bloated public debts eventually constraining returns.

The capital markets landscape is set to change markedly over the next decade

Investors should temper their overall return expectations over the next 10 years, despite the current risk-on climate. As we regularly note, valuations are rarely a driver of returns on a 1-3 year horizon, but are powerful predictors of long-term returns[1]. Elevated valuations for equities and credit point to pedestrian real returns in the decade ahead. The same likely looms for other recent high-fliers such as private equity and credit, as well as gold and cryptocurrencies.

1 **MRB** "*Long-Term Returns: A Reckoning Is Inevitable*", May 24, 2022

One obvious hurdle for a balanced global portfolio is that U.S. stocks now represent about 65% of global equity market capitalization and are very expensive by historical standards, which undermines their return prospects in the future. Forecasting the day of reckoning for U.S. stocks is challenging, but it stretches credulity to believe it will be beyond our 10-year projection horizon. As we discuss below, we expect U.S. stocks to deliver meagre real returns in the next decade.

A threatening geopolitical environment casts a potential cloud over the economic outlook, given tensions in Asia, the Middle East and Ukraine, and between the U.S. and China. Incoming President Trump's promise to implement stiff trade tariffs could amplify geopolitical stresses, including among U.S. allies.

Yet our outlook should not be interpreted as bearish. We expect the global economy to expand at a decent pace over the next 10 years, with scope for upside if A.I. delivers even a fraction of what its advocates promise. Such growth should bolster non-U.S. equity markets that have lagged for most of the past decade. Meanwhile, after a grim past three years, bonds should deliver positive real returns over our forecast period given the current starting point of yields.

We expect the global economy to expand at a decent pace over the next 10 years

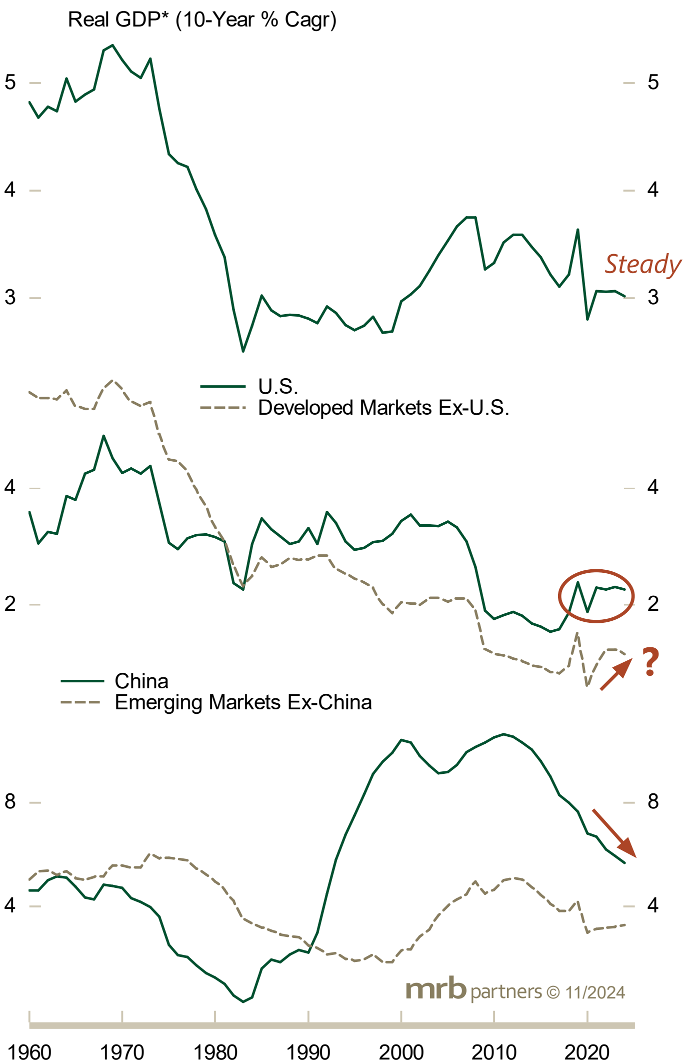
Investors should note that our 10-year return projections are intended to indicate underlying trends rather than point forecasts. Asset prices inevitably will swing around the trend according to the stage of the economic and policy cycles, which is the focus of the bulk of our regular research work and reports.

Our methodology is built on projections of macroeconomic and capital market fundamentals rather than the risk premium approach underpinning the *Capital Asset Pricing Model*. Stated differently, our forecasts are based on projected ex-post returns rather than ex-ante risk premiums. You can't always get what you want.

The Economic Outlook

The global economy struggled through much of the 2010s as the U.S. and euro area household sectors deleveraged and China downshifted from the supercharged growth of the prior two decades. The pandemic provided a pronounced disruption, albeit with variable impacts across regions depending on health and fiscal policies. Overall global real growth has averaged approximately 3% annually in the past 10 years (**chart 1**).

Chart 1 **Healthy But Unspectacular Global Economic Growth Ahead**



* Source: The Conference Board Total Economy Database

Chart 2 **Diverging U.S., China Productivity Growth Trends**

* Real GDP per hour; source: The Conference Board Total Economy Database

Underlying growth momentum is improving in the U.S., with the economy expanding at a strong pace since the pandemic. After the lackluster performance in the 2010s, labor productivity growth is also trending higher, which we believe is sustainable (**chart 2**). Supported by moderate population growth, we expect U.S. real GDP to expand by around 2.4% annually over the next decade.

Underlying growth momentum is improving in the U.S.

We also expect GDP growth in DM ex-U.S. to improve modestly in the coming decade, reflecting better growth in the euro area and Japan, with the former as the drags from the 2010s deleveraging and the Ukraine war fade, and the latter as a more profitable corporate sector increases investment and consumers benefit from rising wages.

Table 1 The Global Economy Should Generate Healthy Growth In The Next Decade

Country/Region	Economic Forecasts* (2024-2034) Real GDP (% CAGR***)	Population** (% CAGR***)	GDP Deflator (% CAGR***)	Historical 2013-2023 Real GDP (% CAGR***)
Australia	2.1	1.0	3.0	2.4
Brazil	2.0	0.5	3.5	0.5
Canada	1.3	0.7	2.9	1.7
China	3.4	-0.2	2.9	6.0
Euro Area	1.4	0.0	2.5	1.5
Germany	1.2	-0.1	2.5	1.1
India	6.5	0.8	4.0	5.9
Japan	0.7	-0.5	1.4	0.6
Sweden	1.4	0.5	2.6	2.2
Switzerland	1.7	0.8	2.2	1.8
UK.	1.3	0.4	3.0	1.5
U.S.	2.4	0.5	2.8	2.3
Developed Markets	1.8	0.3	2.5	1.9
Emerging Markets	3.9	1.1	4.1	4.0
Global	2.7	1.0	3.2	2.7

* Sources: IMF World Economic Outlook and MRB calculations ; note: global GDP growth is measured at market exchange rates
** Population forecasts from UN
*** Compound annual growth rate

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While investors are generally too bearish about the economic outlook for China, growth will continue to slow in the coming years on a trend basis as the population ages and infrastructure and real estate investment downshift as urbanization runs its course. Still, China has ample catch-up potential with developed economies given its human resource and technology endowments, and the fact that China's GDP per capita in 2023 was just 15% of the U.S.' and just over 25% of the euro area's[2].

China has ample catch-up potential with developed economies

Table 1 shows our forecasts for real GDP and population growth, as well as inflation across key regions and individual economies. Global GDP growth is projected to average 2.7% annually over the next decade, with DM economies growing 1.8% annually, and EM growing 3.9% per year. Largely as a result, EM GDP in nominal U.S. dollars rises from 41% of the global total last year to 49% in 10 years. The U.S. share is relatively flat, with the share of other DM economies declining from 32% to 25% over the period.

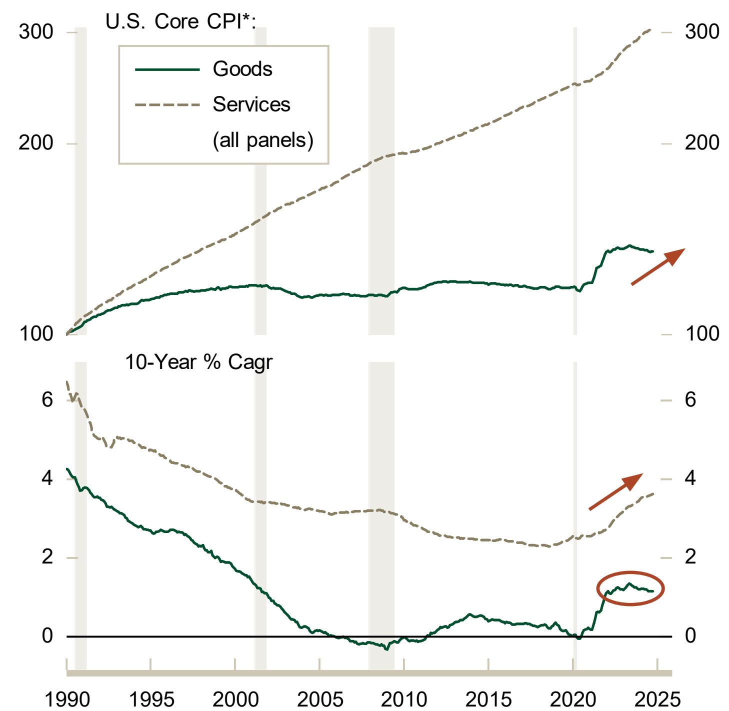
A key feature of our outlook is the projection that DM inflation will average around 2.5% over the next 10 years, and above the central bank target in each of the main economies. In the U.S. for example, we expect higher underlying goods price inflation as past tailwinds from globalization fade and the flat prices of the 2000-2020 era give way to moderate, but steady increases, while services price inflation remains

[2] MRB "*China: The Hazards Of Mental Models*", October 8, 2024

Marky Marky has the complete opposite view on inflation

sticky and overall inflation runs at about 2.8% annually (**chart 3**)[3]. Moreover, with high and rising fiscal deficits and debts in many DM economies, we believe central banks will accept moderately higher inflation to support economic growth[4].

Chart 3 De-Globalization = Higher Goods Inflation = Higher Inflation



* Rebased; source: Bureau of Labor Statistics
Note: Core goods excludes food & energy; core services excludes energy
Shaded for NBER-designated U.S. recessions
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Continued technological advances, whether from A.I. or elsewhere, represent the most obvious potential source of upside global growth surprises[5]. U.S. labor productivity growth accelerated materially in the 1990s and early-2000s as computing power increased and the internet was adopted, and ongoing improvements suggest another boost is possible. The earlier U.S. productivity gains were less apparent in the rest of the DM economies, but given the latter's lackluster recent performance, there is scope for prospective gains above our embedded assumptions.

Potential productivity improvements among EM economies are difficult to gauge given the huge gap that has existed between China and the rest of the group. Despite its current challenges, China has scope for greater technology-driven productivity gains than many assume. The latter is also the case in India, but history argues it is premature to bet on it lifting the EM world to a similar magnitude as China has done over the past 30 years.

Technological advances represent the most obvious source of potential upside growth surprises

Final Word: *The global economy is projected to grow at a healthy 2.7% annual pace over the next decade, led by 3.9% growth in EM and a more modest 1.8% in DM, which is broadly consistent with the trends over the past decade. The U.S. is expected to be the fastest growing economy within the DM group, while India will lead in EM as Chinese growth continues to moderate. EM's share of global GDP will continue to rise and reach nearly 50% over the forecast period. We expect DM inflation to average about 2.5% per annum, as central banks tolerate above current target inflation in order to support growth.*

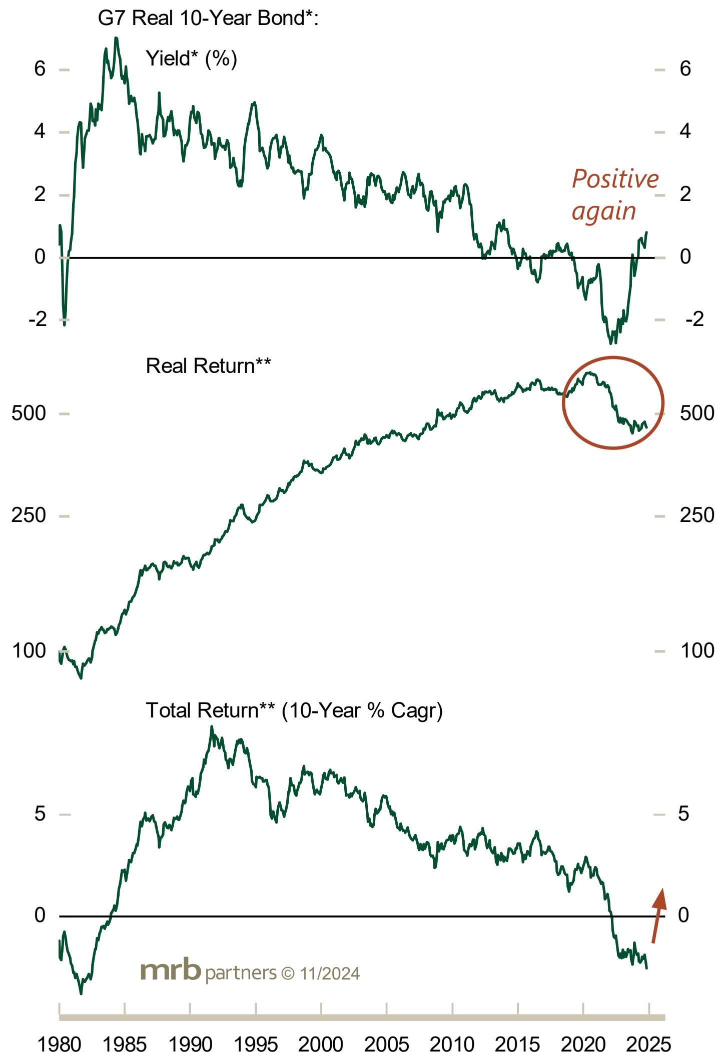
[3] **MRB** "*U.S. Inflation: What Will Be The Underlying Run Rate?*", June 5, 2024

[4] **MRB** "*U.K. Policy: What You Need To Know About The Budget And Fiscal Outlook*", October 29, 2024 and "*U.S. Fiscal Policy Outlook: Tough Choices Loom*", October 29, 2024

[5] **MRB** "*Artificial Intelligence: Less Than Meets The Eye For Equities*", July 18, 2023

Fixed Income

Chart 4 Better Starting Point For Bond Returns



* GDP-weighted average; deflated by G7 CPI; sources: Bloomberg, OECD
** Local currency

The upward adjustment to global bond yields since 2022 has further to run across the DM, with policy rates higher than markets are currently discounting and yield curves steepening toward historical norms[6].

While yields have risen materially since early-2022, the G7 real 10-year government bond yield remains historically low, and has only nudged into positive territory in the past year (**chart 4**). However, there is considerable variation in real yields across the major DM economies, with the real 10-year yield just under 2% in the U.S. and -1.5% in Japan.

A G7 aggregate 10-year government bond in local-currency terms has posted an inflation-adjusted loss of about 2.5% annually over the past decade, albeit all since late-2020. That followed nearly 40 years of consistent gains, even luring investors receiving negative real yields amidst the pandemic.

Table 2 shows our forecasts for 10-year government bond yields and implied returns for select developed markets. The 10-year real return is based on a buy-and-hold strategy, with the current nominal yield minus the forecast 10-year inflation rate determining the real return. The forecast of the 10-year bond yield at the end of our horizon is constructed from the expected monetary policy rate and a term premium.

G7 real 10-year government bond yields remain low

In recent years, policy rate expectations and bond yields have been anchored by the post-Great Recession economic backdrop, which we view as misguided and unduly bond bullish. Our basic framework is that the average interest rates in DM economies should be approximately equal to underlying nominal GDP growth. On average, the policy rate will be modestly below the nominal GDP growth rate and the 10-year government bond yield somewhat above over the investment horizon.

Hence, our forecast for average annual U.S. nominal GDP growth of just over 5%, translates into an expected fed funds rate of 4.5% over the next decade, and a

[6] MRB "*Fixed Income: The Return Of The Term Premium*", October 31, 2024

10-year Treasury yield of approximately 5.2%. Using this framework, the 2.9% long-run equilibrium policy rate included in the Fed's latest *Summary of Economic Projections* is unrealistically low (**chart 5**). The discrepancy between our forecast and the Fed estimate is equal parts our higher inflation forecast and our higher assumed real equilibrium policy rate (i.e. r*)[7]. The Fed's 0.9% r* assumption is inconsistent even with its too-cautious real GDP forecast.

Policy rates in other DM economies range from a low of 1.6% in Japan to a high of 4.8% in Australia 10 years from now, while 10-year government bond yields are projected to range from 2.1% in Japan to 5.4% in Australia.

Despite the expected rise in DM bond yields, real returns over the next decade are expected to be positive in most individual markets. The U.S. 10-year Treasury is projected to deliver a 1.8% annual real return over the next 10 years, with Australia, Canada, the euro area and the U.K. also producing real returns of 1% or more annually. Low current nominal yields condemn 10-year Japanese and Swiss bond to produce a negative real return over the period.

The outlook is generally brighter for credit given higher starting yields, even though the latter are projected to rise over the forecast period (**table 3**). EM U.S. dollar debt is projected to produce a real return of 2.4% annually (adjusted for U.S. inflation), reflecting it current yield of nearly 7%. A strong U.S. dollar is the principal risk to this forecast, but our base-case scenario is for a modest real depreciation of the dollar over the next decade.

Table 2 **Generally Positive Real Returns For Bonds**

Bond Market Forecasts*			
Country/ Region	Bond Yield (%, Current)	Bond Yield (%, 2034)	Real Total Return (% CAGR)
Australia	4.67	5.4	2.1
Canada	3.32	4.6	1.3
Euro Area	3.37	3.9	1.0
Germany	2.39	3.2	0.2
Japan	1.04	2.1	-0.6
Sweden	2.17	4.5	0.4
Switzerland	0.40	3.6	-1.0
U.K.	4.52	4.5	1.4
U.S.	4.44	5.2	1.8
Developed Markets	3.73	4.4	1.0

* Total return is based on a buy-and-hold strategy with reinvested coupons; compound annual growth rate from current levels to 2034; MRB calculations

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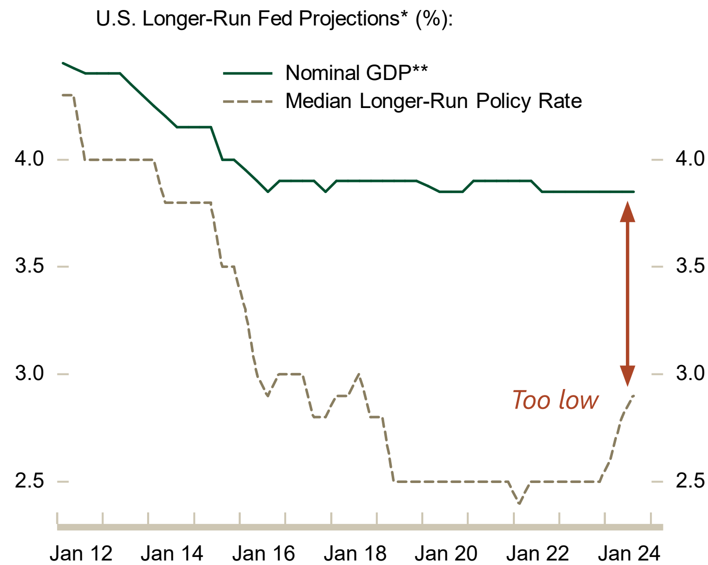
Chart 5 **Fed: Equilibrium Policy Rate Headed Higher**



* Source: Federal Reserve
** Midpoint of central tendency plus 2% inflation

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[7] MRB "*The Impact Of A Higher Neutral Fed Funds Rate*", July 17, 2024

The starting point for corporate credit is tough, with spreads well below historical norms (**chart 6**). U.S. high-yield debt is forecast to produce a real return of 2.9% annually, while its euro area counterpart delivers 2.5%. Investment-grade corporates in the U.S. and euro area produce modestly lower returns than their high-yield brethren, and in the case of the euro area meaningfully better returns than similar duration government bonds.

Final Word: *Bonds should deliver moderately positive real returns over the next decade, reversing the losses over the past 10 years. Nonetheless, G7 and DM 10-year government bond yields are poised to trend higher over the next decade, consistent with our economic growth and inflation forecasts. Credit should continue to outperform government bonds, but with starting spreads tight, outperformance will be modest.*

Table 3 Moderate Returns For Credit

Bond Market Forecasts*

Asset	Current Yield (%)	Projected Yield (%, 2034)	Real Total Return** (% CAGR)	Nominal Total Return (US$, % CAGR***)
EM US$ Debt	7.05	7.8	2.4	5.3
Euro Area High-Yield Debt	5.36	6.8	2.5	6.9
Euro Area Investment-Grade Debt	3.28	4.7	2.3	4.8
U.S. Investment-Grade Debt	5.23	5.9	1.9	4.8
U.S. High-Yield Debt	6.98	8.8	2.9	5.7
U.S. 10-Year TIPS	2.08	2.4	2.2	4.9

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* MRB calculations
** Real return based on local inflation rates except emerging market US$ sovereign debt, which is deflated by U.S. headline CPI, includes re-invested coupons; compound annual growth rate from current levels to 2034
*** Compound annual growth rate from current levels to 2034

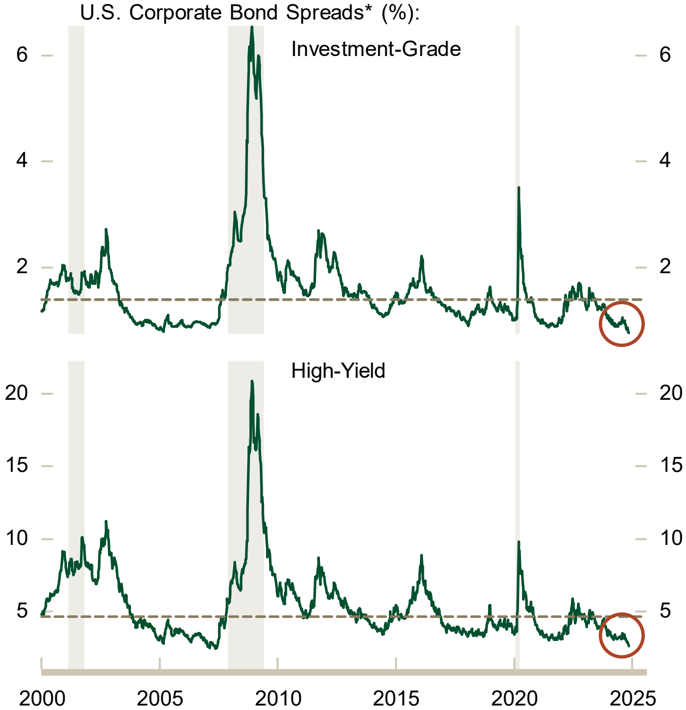
Equities

Global equity total returns are at an all-time high, continuing their strong recovery from the pandemic and from the Great Recession in 2008-2009 (**chart 7**). The 10-year compound annual total real return is an impressive 8%.

The global real returns mask considerable divergence between U.S. and global ex-U.S. performance over the past decade (**chart 8**). The former has posted a 10% annual real return in the past 10 years, while the latter has produced only half that. The divergence was quite pronounced in the 2010s and has persisted since the pandemic.

The outlook for global equities hinges substantially on the U.S. since the latter now accounts for about 65% of total market capitalization and the highest

Chart 6 Low Corporate Spreads Will Hinder Prospective Returns



* Source: ICE Data Indices
Note: - - - period median; shaded for NBER-designated U.S. recessions

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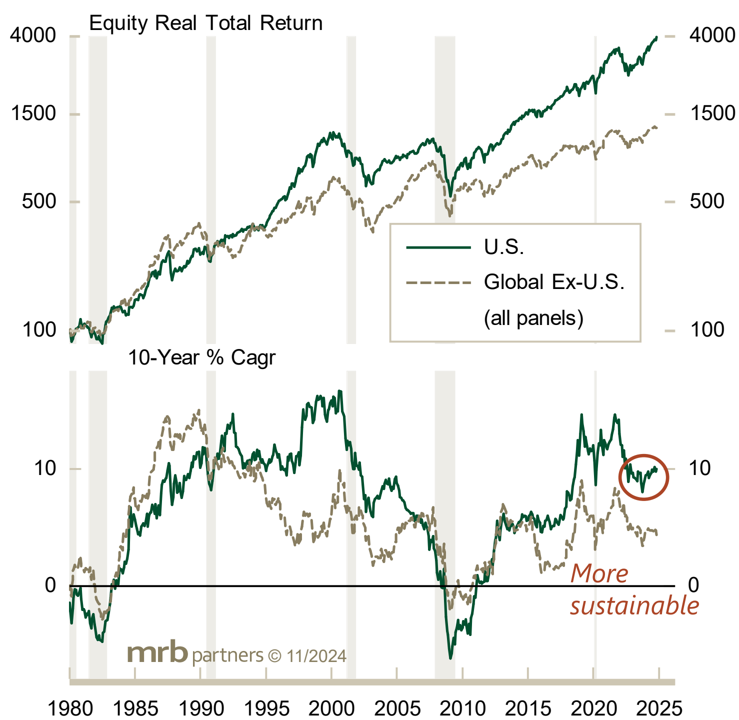
Chart 7 **Tougher Return Outlook For Equities**

* Local curency; deflated by G7 CPI; rebased; sources: MSCI, OECD
Note: Panel 1 shown in log scale; shaded for NBER-designated U.S. recessions

Chart 8 **Stellar U.S. Equity Performance Will Cool**



* Local curency; deflated by U.S. or G7 ex-U.S. CPI; rebased; sources: MSCI, OECD
Note: Panel 1 shown in log scale; shaded for NBER-designated U.S. recessions

in five decades (**chart 9**)[8]. At the same time, global equity market capitalization relative to global GDP is also at an historic high. The latter is consistent with a conclusion that global equities are expensive by historical standards, although that implies little about equity performance in the immediate future.

Our long-term equity return forecasts are based on global and domestic economic growth, the starting point for earnings and valuations are key drivers. Real global earnings are near a record high, having risen in choppy fashion since in the aftermath of the Great Recession and despite the sharp pandemic contraction (**chart 10**). Equities have re-rated significantly over the past decade, accounting for a big chunk of the real total return during the period. The global trailing P/E ratio is now modestly above the post-1990 median (Japan distorted the global

Chart 9 **Global Equities: Overconcentrated In The U.S.**

* U.S. dollars; sources: MSCI, IMF

[8] MRB "*The U.S. Equity Market Is Both More And Less Diverse Than Elsewhere*", July 23, 2024

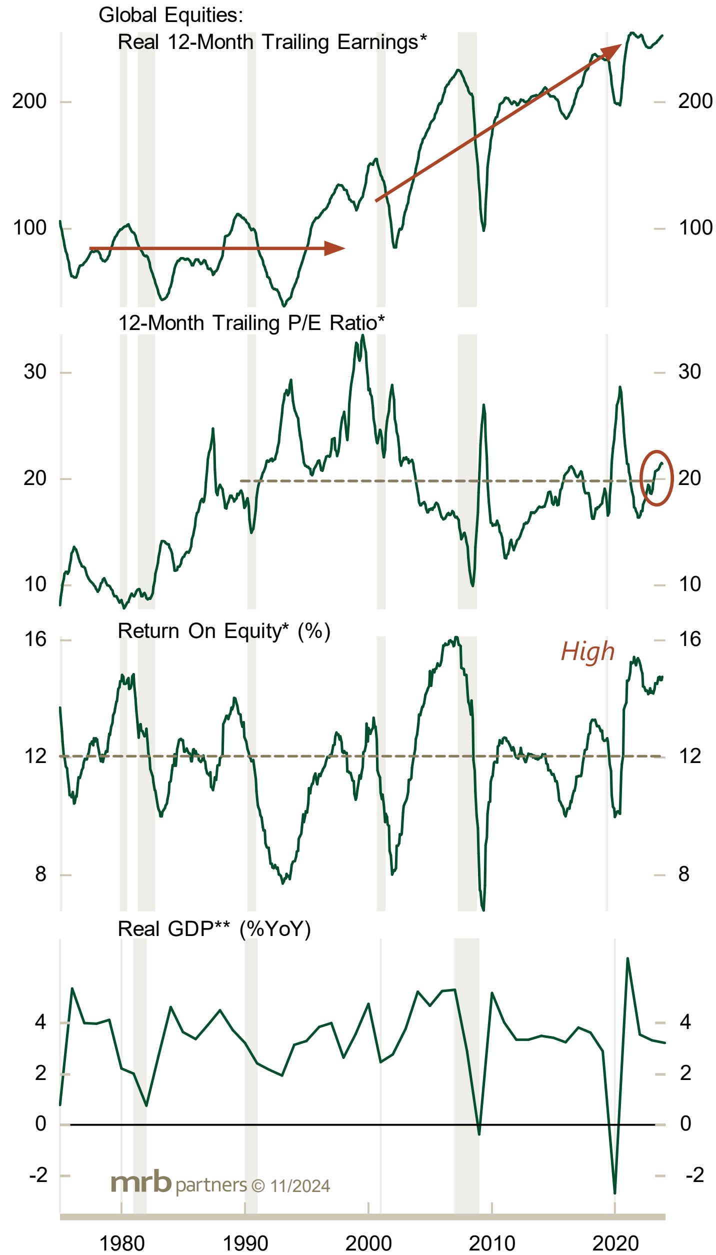
average during its 1980s bubble), which should be expected to limit or impinge upon prospective equity returns.

The elevated level of corporate profitability or return on equity (ROE) is a bigger constraint on global equity returns in the next decade. Global ROE is far above its historical median and has been a median reverting series. ROE is pro-cyclical and thus its current level is more consistent with past peak cycles than the norm that can be expected to prevail over the next decade given our global economic growth forecast. Of course, global ROE typically falls well below its historical median during economic recessions.

Our forecasts reflect the earnings and valuation divergences between the U.S. and many non-U.S. markets, as well as a general reversion to or toward historical norms, translating into equity real returns (**table 4**). Annual global real earnings growth is projected to be approximately 1.5% in the next decade, consistent with decent global real GDP growth but a decline in ROE. A slight de-rating reduces the annual real stock price gain to just 0.6%, while the 2.2% dividend yield boosts the annual real total return to 2.7%. Thus, dividends account for the bulk of the equity total return.

Emerging markets should enjoy solid real earnings growth and real total returns of 5.5% per annum over the period[9]. Several other non-U.S. markets outpace that, including Brazil, the U.K., euro area, and China, although the source of the gains varies significantly. Only in China and India are real stock price gains expected to exceed the contribution of dividends to total equity returns. Meanwhile, global and developed market real returns are weighed down by the projected poor returns in the U.S. (see the page 11 for details).

Chart 10 **Eventual Valuation And Earnings Constraints For Equities**



* Deflated by G7 CPI; rebased; smoothed; sources: MSCI, OECD
** Sources: World Bank, IMF
Note: Panel 1 is shown in log scale; - - - in panel 2 is mean since 1990; - - - in panel 3 is period median; shaded for NBER-designated U.S. recessions

[9] MRB "*U.S. Equities – Tech Charts That Make You Go Hmmm…*", July 1, 2024

Table 4 A Shift In Equity Market Leadership Looms In The Next 10 Years

	Equity Market Forecasts*						
Country/ Region	Real Earnings Growth (%CAGR**)	ROE (%, 2034)	P/E Ratio (2034)	Real Stock Price (%CAGR**)	Dividend Yield (%)	Real Total Return (%CAGR**)	Nominal Total Return*** (US$, %CAGR**)
Australia	2.1	11	16	-0.5	3.8	3.2	6.0
Brazil	0.2	14	13	2.7	4.7	7.3	11.7
Canada	2.2	11	17	0.8	3.1	3.8	7.2
China	4.0	12	13	3.5	2.7	6.2	9.6
Euro Area	1.9	12	16	3.1	3.4	6.4	11.0
Germany	1.8	11	16	2.9	3.0	5.8	10.3
India	6.0	17	22	3.9	1.4	5.2	7.7
Japan	1.2	9	16	1.6	2.3	3.8	8.1
Sweden	0.1	14	16	2.1	3.8	5.8	10.8
Switzerland	0.1	16	19	0.7	3.2	3.8	8.3
U.K.	2.1	14	14	3.0	4.1	7.0	11.2
U.S.	0.6	16	21	-1.7	1.7	-0.1	2.7
Developed Markets	1.2	13	19	-0.5	2.2	1.6	4.2
Emerging Markets	3.0	12	15	3.2	2.4	5.5	6.8
Global	1.5	13	19	0.6	2.2	2.7	5.3

* Source: MRB
** Compound annual growth rate from current levels to 2034
*** Nominal returns reflect real returns plus domestic inflation and changes in the domestic exchange rate relative to the U.S. dollar

U.S. Equities: Is It Different This Time?

U.S. stocks have been on fire since late-2022, led by mega-cap technology/A.I.-related stocks . Trump's election has added to investor enthusiasm, with optimists arguing a further multi-year bull run may lie ahead.

Investment sentiment can carry markets a long way, but math eventually gains sway. As the saying goes, multi-year bull markets typically grow out of the ashes of a recession, when earnings and valuations are depressed, and sentiment is washed out.

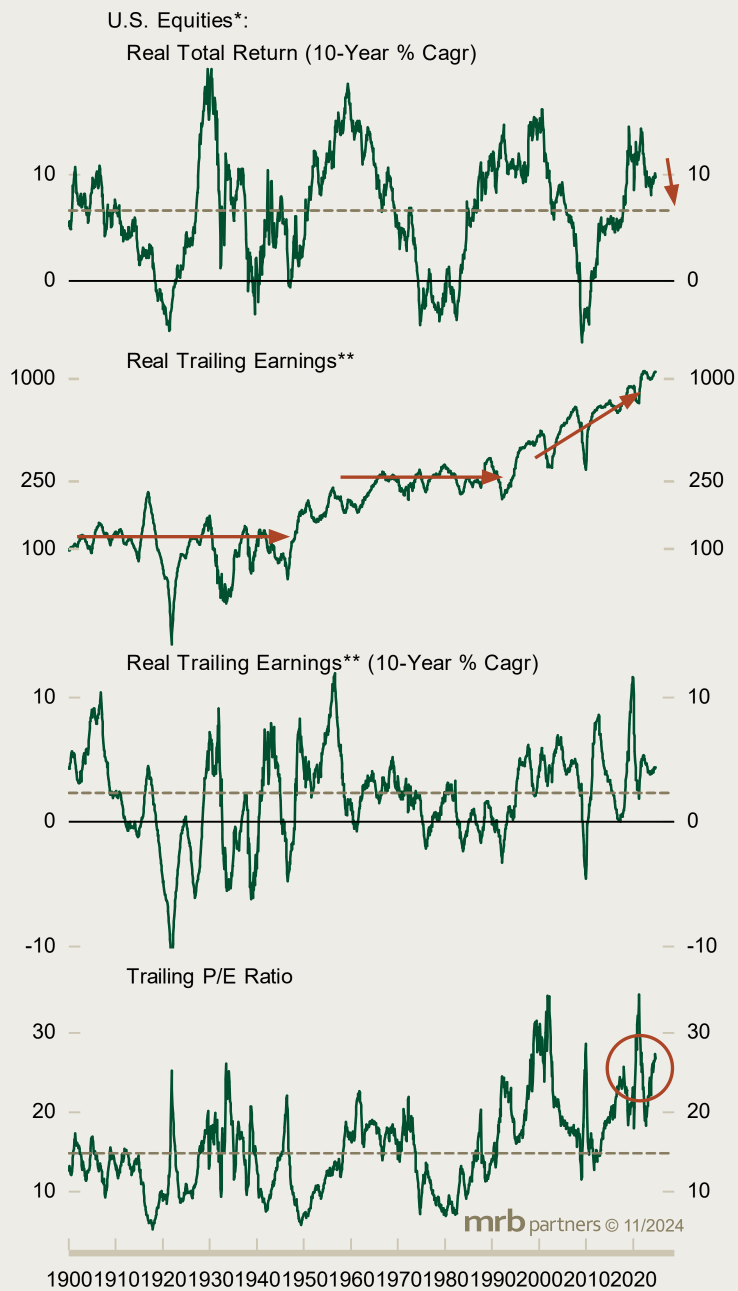
Such a condition obviously is not the case today. U.S. equities have produced stellar 10% real annualized returns over the past decade, well above the post-1900 median of 7% (**chart 11**). Real earnings have grown nearly five-fold over the past three decades, and some 4% annually over the past 10 years. Equity returns have been goosed by a huge re-rating over the past decade, with the trailing P/E ratio climbing some 40% to an historically high 27.

A glance at the 10-year compound growth rate of U.S. equity total returns implies that prospective real returns over the next decade will likely be lower. Indeed, history suggests that real returns could be very low or even negative over the next decade.

Optimists would likely point to the potential for a replay of the late-1990s, when the U.S. economy grew at a robust 4% annual rate, earnings were strong, inflation was low, and stocks ripped. Yet the trailing P/E ratio for the U.S. market in early-1995 was 17 and subsequently marched above 30 before the bubble finally burst. Investor exuberance could push the trailing P/E ratio back toward the late-1990s' peak and thereby enable outsized equity returns to continue for a while, but history implies that the P/E ratio is much more likely to decline over the next decade than stay at its current elevated level, let alone rise.

Similarly, history argues for skepticism that strong earnings growth can enable another decade of high real returns. The U.S. return on equity (ROE) is nearly 19% and far above its median over the past 50 years (**chart 12**). ROE stayed elevated in the late-1990s, but subsequently collapsed amidst the shallow economic recession in 2001. From this lofty perch, history indicates that ROE and earnings risks are emphatically to the downside in the decade to come.

Chart 11 High Hurdles For The U.S. Equity Market

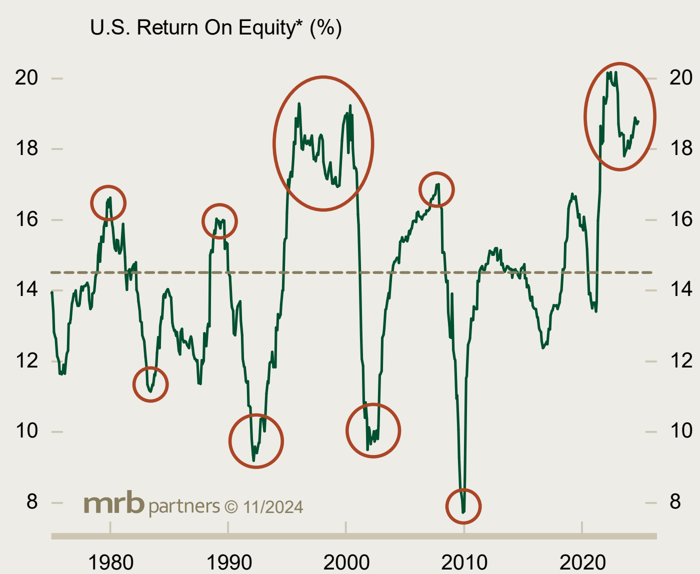


* Deflated by U.S. CPI; rebased; sources: Robert Shiller Bloomberg and BLS
** Rebased
Note: - - - period median; panel 2 is shown in log scale

Indeed, our 10-year forecast is for U.S. real earnings to rise only about 0.6% annually over the next 10 years, and for the P/E ratio to decline and lop nearly 2% per annum off returns. With a scant 1.7% dividend yield, our forecast is that U.S. equities will deliver a near-zero real total return over the next decade, which would represent a sobering comedown from today's near euphoria.

As a reminder, our long-term return forecast says nothing about how U.S. stocks will fare over the next 1-3 years. While unlikely, stocks could continue to power ahead for some time, until a catalyst undermines earnings prospects and/or triggers a significant equity market de-rating. The bigger picture, however, is that time will eventually work against stocks given the starting point of elevated earnings and valuations. We are betting that this time will NOT be different.

Chart 12 Unsustainably High U.S. Return On Equity

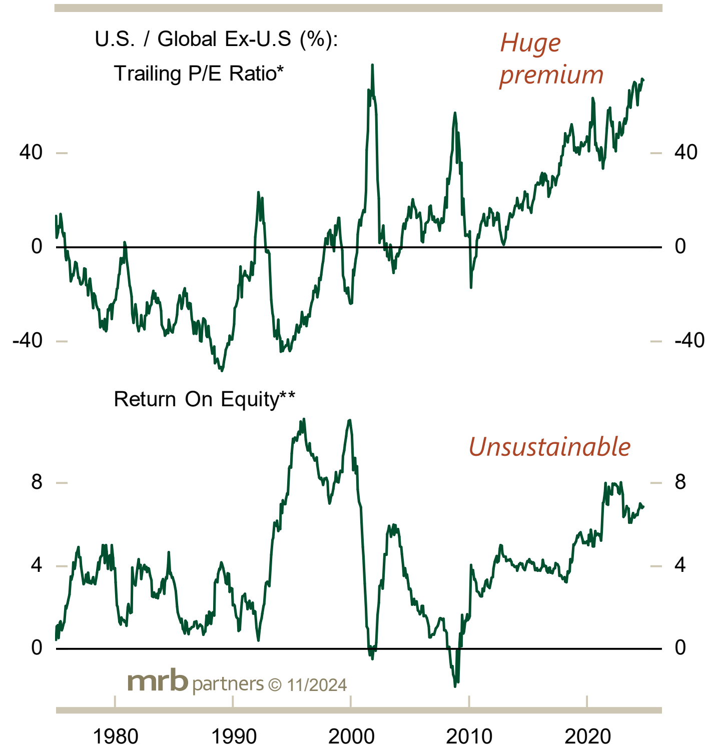


* Source: MSCI
Note: - - - period median

Stepping back, a key aspect of our equity return projections is that a major shift in relative performance between the U.S. and rest of the world looms after nearly two decades of consistent U.S. outperformance[10]. Such an outcome defies current market sentiment and perceived U.S. exceptionalism, and relies on an eventual pickup in economic growth outside the U.S. that many investors remain leery of front-running. Yet both the U.S. ***relative*** P/E ratio and ROE are stretched, with each expected to partially unwind in the next 10 years toward its historical norms (**chart 13**).

Final Word: *Investors should expect much lower real total returns from global equities in the next decade compared with the last as U.S. returns stall after their very strong gains since the Great Recession. Indeed, projected very low real earnings growth and a material de-rating indicate that U.S. stock prices*

Chart 13 U.S.-Global Ex-U.S. Valuation, Earnings Gaps Should Narrow



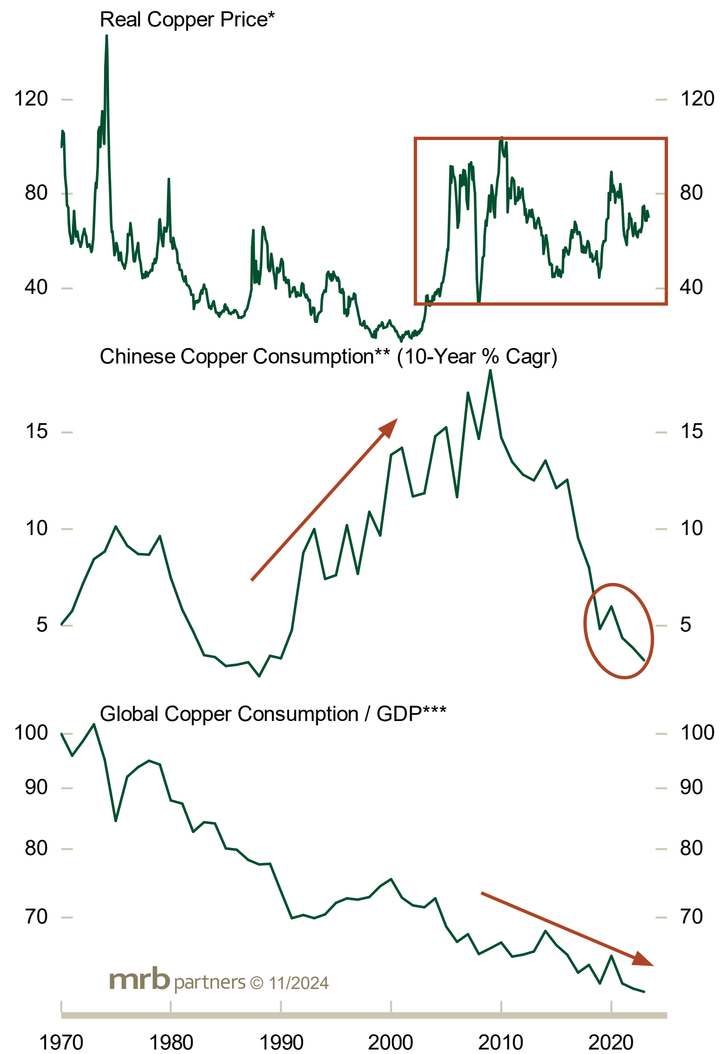
* Percent premium (+) or discount (-); source: MSCI
** U.S. minus global ex-U.S.; source: MSCI

[10] MRB "Emerging Market Equities: Earnings Are Outperforming, Prices Will Follow", September 10, 2024

Chart 14 **Real Commodity Prices Remain Under Pressure**

* Deflated by U.S. CPI; sources: Bloomberg, U.S. Bureau of Labor Statistics
Note: Panel 1 shown in log scale

Chart 15 **Electrification Will Struggle To Match China Impact On Copper**



* Deflated by U.S. CPI; rebased; source: Bloomberg, U.S. Bureau of Labor Statistics
** Source: Copper Study Group
*** Rebased; sources: Copper Study Group, IMF

will decline modestly in real terms over the next decade. Partly as a result, non-U.S. markets are poised to outperform the U.S. in the next decade, led by European and emerging market stocks.

Commodities & Currencies

Commodities

Optimists' hopes a few years ago for another commodity supercycle were never realistic given slowing Chinese economic growth and the absence of replacement source of commodity demand[11].

Optimists' hopes for another commodity supercycle were never realistic

The CRB index of spot commodity prices (excluding energy) in real terms has had a downward bias over the past decade, albeit boosted significantly during the pandemic (**chart 14**). Looking back over the past five decades, real prices have also trended lower, with the primary exception of the 2000-2010 China induced boom.

[11] **MRB** "*Regional Equities: Policy Tailwinds For A Gradual Rotation*", September 24, 2024

Chart 16 Gold: All That Glitters Is Already Discounted

* Deflated by U.S. CPI; rebased to latest value; sources: Bloomberg, U.S. Bureau of Labor Statistics
Note: Both panels shown in log scale

Much of the earlier optimism about another commodity supercycle was based on a "green" energy boom that would fuel demand for industrial metals such as copper. Copper prices spiked during the pandemic but have since retreated and in real terms are in the middle of the range of the past 10-15 years (**chart 15**, previous page). However strong the green energy boom might be, it will be a mighty task to coincide with the demand boom from China in the 1990s and 2000s, as China industrialized and built out its copper-intensive infrastructure and real estate. China's copper consumption increased at a ferocious 18% annual rate during the first decade of this century, overtaking the U.S. as the largest source of global copper demand and now accounting for more than half of all global annual copper consumption.

However, the China copper boom has passed, along with its construction boom, and the 10-year compound growth rate has slipped to around 3%, which is now likely to be the more normal run rate. Moreover, the copper intensity of global GDP continues to trend lower, as it has for decades. Our base-case scenario is that the green energy transition will trigger a mild upturn in the copper intensity of global GDP growth that should allow copper prices to rise commensurately in real terms. That said, we do not expect the overall industrial commodity index to generate a significant structural investment opportunity in the next 10 years.

We expect gold prices in real terms to decline approximately 2% annually in the next decade

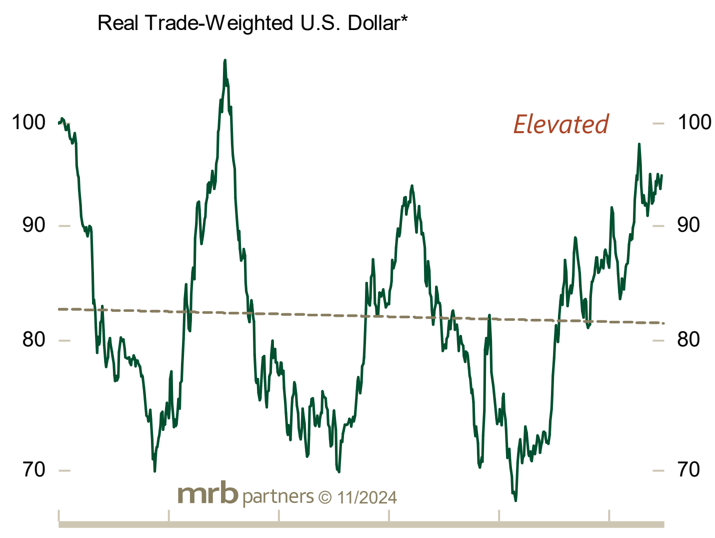
The contrasting starting points for gold and oil are key drivers of prospective real returns (**chart 16**). Gold prices are currently elevated, bolstered by central bank demand for diversification from the U.S. dollar, the poor U.S. and DM fiscal outlook and the buoyant current global liquidity environment[12]. Already discounted, those factors are likely to gradually fade as drivers, and we expect gold prices in real terms to decline approximately 3% annually in the next decade, albeit to a still elevated level by historical standards. For perspective, the U.S. dollar value of the total stock of global gold ever mined relative to global GDP would edge lower from its current level but still remain historically high over our forecast horizon.

[12] **MRB** "*Commodities: Supercycle Narrative Is Off Base*", May 18, 2021

In contrast, crude oil prices are expected to rise modestly in real terms from their recently depressed starting point. We expect global oil consumption to increase 0.5-1% annually over the next decade, with declining consumption in the DM offset by rising consumption in the EM (apart from China).

Overall, we expect real commodity prices to decline 0.6% annually over the next decade.

Chart 17 History Points To A Weaker U.S. Dollar



* Source: Federal Reserve and Bank for International Settlements
Note: - - - = period trend

Currencies

The U.S. dollar will remain the world's reserve currency in the next decade, but on a real trade-weighted basis, we expect it to depreciate modestly from its current lofty perch (**chart 17**).

The dollar currently benefits from significant economic growth and interest rate advantages that have helped drive it to an elevated level since the pandemic. The current profile is somewhat unique in that a spike in the real trade-weighted dollar has typically been followed by an abrupt and pronounced decline from overvalued to undervalued over the course of several years.

That said, the dollar's decline in the early-1970s followed the end of the Bretton Woods (largely) fixed-exchange rate system enacted after World War II, while the decline in the mid-1980s followed the Plaza Accord when G7 governments deliberately acted to bring the dollar down. The sharp dollar depreciation beginning in 2002 has been the only example in recent decades when free-market forces were the main driver.

We expect real commodity prices to decline 0.6% annually over the next decade

While the dollar is historically expensive and incoming President Trump appears to have a bias toward a weaker dollar, there is no clear alternative given lingering investor uncertainty about the vitality of the euro area and euro and the geostrategic role of China and the yuan. Nonetheless, the corollaries to the elevated real trade-weighted dollar are the historically weak euro, yen and various other currencies against the U.S. dollar.

On balance, we expect most major currencies to appreciate modestly versus the U.S. dollar in both nominal and real terms over the next decade, albeit remaining well below historical highs. On a real trade-weighted basis, the dollar would remain above its long-term descending trendline.

Final Word: *We expect real commodity prices to edge lower over the next decade, with gold declining more significantly and crude oil and industrial commodity prices gaining modestly. The U.S. dollar is projected to decline moderately on a real trade-weighted basis, including against most major currencies, albeit while remaining historically elevated.*

Chart 18 Equity-Bond Performance Divergence Will Narrow

* Local curency; rebased; source: MSCI
** Local currency; weighted average; rebased; source: Bloomberg
Note: Panel 1 shown in log scale; shaded for NBER-designated U.S. recessions

Asset Allocation & Investment Conclusions

Investors should expect the next decade to result in lower real returns for global equities, higher real returns for G7 government bonds and slightly lower real returns for a 60/40 equity/bond portfolio than during the past 10 years.

This outlook largely reflects the unusual starting point. As noted earlier, global equities have delivered strong real returns over the past decade that are unsustainable given current valuations and corporate profitability, especially in the U.S. (**chart 18**). Conversely, bond losses in real terms over the past 10 years are poised to improve since real yields are again positive (and based on a buy-and-hold forecast at current yields).

More striking is the huge gap between the real returns of the two asset classes over the past decade, which will narrow in favor of bonds versus stocks. Only a modest structural overweight on stocks versus bonds in a multi-asset portfolio is appropriate.

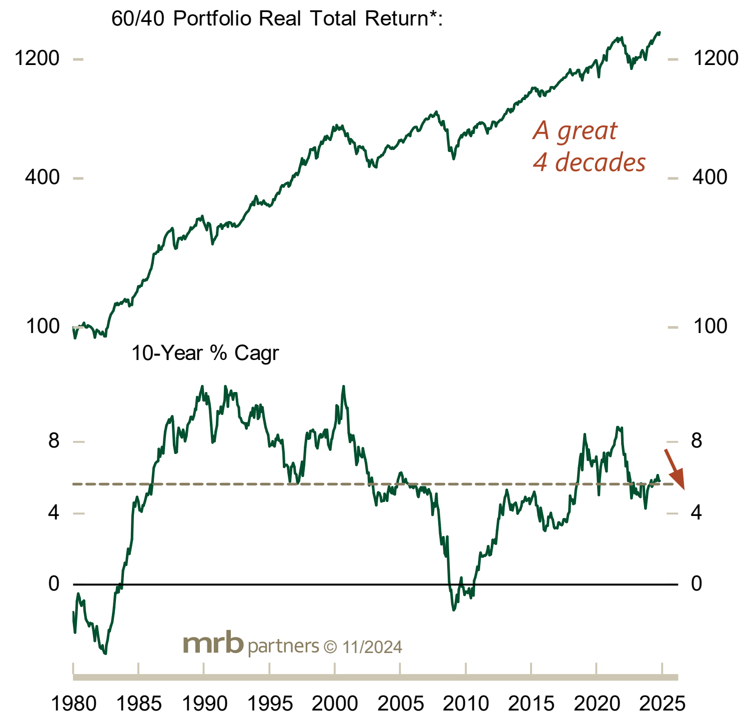
The closing of that performance gap will contribute to lower expected real returns for a 60/40 portfolio of global equities and G7 10-year government bonds in local-currency terms (**chart 19**). While the performance of such a portfolio over the past decade has been in-line with the norms of the past four decades, the projected ***improvement*** in real bond returns (better by 3.5% annually compared with the past decade) will be insufficient to make up for the much lower expected real return on global equities (worse by 5% annually compared with the past decade) A 60/40 equity/bond portfolio is forecast to generate a 2% annual real return over our forecast horizon.

A 60/40 equity/bond portfolio is forecast to generate a 2% annual real return over our forecast horizon

Table 5 shows the projected real returns for U.S. dollar, euro and sterling-based portfolios for the next decade. The portfolios include global equities, credit and commodities translated into domestic currency, and domestic 10-year government bonds and cash. The weights vary, with conservative and aggressive portfolios holding less or more of the five asset classes.

A balanced U.S. dollar portfolio is forecast to generate a 2.1% annual real return, with equities contributing 2.5%, Treasurys 1.8%, spread products (i.e. credit) 2.2%, cash 1.6% and commodities -0.6%. These returns underscore that the macro outlook and starting points for the different asset classes do not result in ex-post risk premiums consistent with conventional perceptions of ex-ante risk premiums. Current elevated valuations for risky assets including stocks and credit inherently imply subpar relative returns versus lower risk assets such as bonds and cash.

Chart 19 **Balanced Portfolio Returns: Tougher Times Ahead**



* 60% global equities, 40% G7 10-year government bonds; deflated by G7 CPI; rebased; sources: MSCI and Bloomberg
Note: - - - period median; panel 1 is shown in log scale

Table 5 **Only Modest Real Returns Projected For Balanced Portfolios**

	Balanced Portfolio Returns* (%, CAGR)		Conservative Portfolio Returns** (%, CAGR)		Aggressive Portfolio Returns*** (%, CAGR)	
	Real Return	Nominal Return	Real Return	Nominal Return	Real Return	Nominal Return
U.S. Dollar Portfolio	2.1	4.9	2.0	4.8	2.3	5.2
Stocks	2.5	5.3	2.5	5.3	2.5	5.3
Fixed Income	1.9	4.8	1.9	4.8	1.9	4.8
Government Bonds	1.8	4.6	1.8	4.6	1.8	4.6
Spread Products	2.2	5.0	2.2	5.0	2.2	5.0
Commodities	-0.6	2.2	-0.6	2.2	-0.6	2.2
Cash	1.6	4.4	1.6	4.4	1.6	4.4
Euro Portfolio	0.8	3.3	0.8	3.3	0.9	3.4
Sterling Portfolio	1.2	4.2	1.2	4.2	1.3	4.3

% Cagr: Compound Annual Growth Rate From Current Levels To 2034
* Balanced portfolio is 50% global equities, 25% domestic 10-year government bonds,15% spread products, 5% global commodities, and 5% domestic cash, measured in local currency
** Conservative portfolio is 35% global equities, 45% domestic 10-year government bonds, 10% spread products, 5% global commodities, and 5% domestic cash, measured in local currency;
*** Aggressive portfolio is 70% global equities, 17.5% domestic 10-year government bonds, 12.5% spread products, 0% global commodities, and 0% domestic cash, measured in local currency;
Note: Spread Products are a weighted average of global corporate and EM US$ sovereign bonds; portfolios are rebalanced annually

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While our focus is on publicly-listed assets, we expect a broadly similar outcome for private assets including private equity and credit, real estate and exotics such as cryptocurrencies. Returns on most risk assets over the past several decades have been boosted by persistent reflationary monetary and fiscal policies and generous liquidity conditions that are unsustainable over the long term.

Real returns will be more modest in the next decade

There will still be plenty of money to be made in the next decade, but real returns will be more modest and more difficult to sustain than has generally been the case since the early-1980s. Buy-and-hold was generally a winning strategy over the past four decades, but more tactical allocation will be necessary to generate historically good returns in the next 10 years.

Peter Perkins
Partner, Global Strategy

MacroResearchBoard

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