Long-Term Capital Market Assumptions

Each year, key investment strategists develop a set of projections for asset-class returns, volatilities and correlations over the coming 10-15 years. These projections, or so-called "long-term capital market assumptions," are used by investment managers as a guide to developing reasonable investment return expectations and asset allocation frameworks in order to effectively manage client portfolios. Equilibrium relationships between markets and trends in economic growth over the long term, informed by current market and macroeconomic conditions, are key drivers in the process.

Below, we display a chart of 2020 long-term capital market assumptions developed by three prominent investment players.

2020 Capital Market Assumptions by Asset Class

	Callan Associates	J.P. Morgan	Rockefeller Family Foundation	Average Projection
Fixed Income				
U.S. Fixed	3.75%	4.00%	3.40%*	3.72%
High Yield	5.35%	5.50%	5.30%	5.38%
Equity				
Large Cap	7.00%	5.25%	6.00%	6.08%
Mid Cap	7.25%	5.75%	7.00%	6.67%
Small Cap	7.25%	6.00%	7.30%	6.85%
International	7.25%	6.75%	6.90%	6.97%
Emerging Mkt	7.25%	8.50%	8.50%	8.08%
REITs	NA	6.25%	7.30%	6.78%

** U.S. Taxable Investment Grade Long Term*

*** Average Projection is the simple average of returns projected by Callan Associates, J.P. Morgan, and Rockefeller Family Foundation*

The projections themselves represent baseline average returns over the projected horizon. Applying a volatility assumption to each projected return provides an expected range of returns around each baseline. For example, using the average baseline return projection for large-cap equities of 6.08%, coupled with a 14.34% volatility assumption for that asset class, produces a range of expected annual returns for large-cap equities of 3.27-8.89% over the next 10 years or so. Similarly, long-term investment-grade bonds are projected to return 3.72% on an annual basis, with a range of 3.05-4.39%.

The projections simply represent realistic, well-grounded return assumptions, and, despite the two decimal-place presentation, are not meant to convey any particular level of precision. Rather, along with projected correlations between asset classes, they are meant to be used in designing optimal investment portfolios and investment programs. Below, we display a chart of actual large-cap and aggregate taxable fixed-income annual returns over the past 10 and 15 years compared with the investment strategists' average projected returns over the next 10-15 years.

	Historical Annual Return		Projected Annual Return
	10 Years	15 Years	10-15 Years
Large-Cap Equities	13.54%	8.99%	6.08%
Aggregate Bonds	3.74%	4.15%	3.72%

As can be seen in the chart, above, forward equity returns are assumed to be well below those that prevailed over the past decade or so due to the current relatively high valuation levels for equities, while fixed-income returns are expected to average at the low end of realized annual returns over the past 10-15 years as interest rates remain well below average historical levels.

How accurate are these prognostications? As an anecdotal test, we used JPMorgan forward capital market assumptions for two asset classes made on December 9, 2011 and compared them with actual realized annual returns through December 31, 2019, with the following results:

	Expected Return	Range	Actual Return
Large-Cap Equities	8.00%	4.18-11.80%	14.86%
Aggregate Bonds	3.00%	2.27-3.73%	2.90%

Given expectations for lower returns on equities and bonds over the next few years, both may fall within the range projected by JPMorgan back in 2011 over a full 10-15 year period. The results suggest that capital market assumptions, while not infallible, can provide a meaningful framework for strategic asset-allocation decisions.