ACIMA PRIVATE WEALTH

ECONOMIC & INVESTMENT PERSPECTIVES

February 3, 2025

JANUARY: A POSITIVE START FOR 2025
LONG-TERM CAPITAL MARKET RETURN FORECASTS

Figure 1: 1/31/2025 Returns (source: FactSet)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	3 MO	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	0.5%	-0.1%	2.0%	-4.5%	2.7%
Investment Grade Corp Bonds	LQD	0.6%	-0.4%	1.9%	-5.8%	3.2%
U.S. 20+ YR Treasuries	TLT	0.5%	-4.0%	-5.5%	-13.7%	3.4%
Muni Bonds	MUB	0.0%	0.3%	1.2%	-2.1%	1.5%
US High Yield	HYG	1.4%	2.2%	9.3%	-0.8%	5.5%
Non-US Corp Bonds	IBND	0.6%	-3.2%	0.2%	-9.2%	3.0%
Emerging Markets Bond LC	EMLC	1.9%	-0.8%	0.4%	-7.8%	2.7%
Global Equity						
ACWI Global Equity	ACWI	3.1%	4.5%	20.8%	-1.9%	17.9%
ACWI Global Equity ex US	ACWX	3.5%	0.4%	10.8%	-6.9%	8.4%
International Developed	EFA	4.8%	1.4%	9.0%	-6.3%	7.2%
Emerging Markets	EEM	2.2%	-2.3%	13.9%	-9.9%	11.1%
Global Equity by Region						
United States	VTI	3.0%	6.6%	26.2%	-1.4%	23.0%
Europe	IEUR	6.4%	1.5%	9.0%	-7.1%	7.8%
Asia ex-Japan	AAXJ	0.7%	-2.9%	17.4%	-11.7%	15.1%
China	MCHI	3.3%	0.1%	35.6%	-19.0%	34.8%
Japan	BBJP	1.7%	1.9%	5.9%	-7.9%	11.5%
Latin America	ILF	9.8%	-2.9%	-11.8%	-21.0%	10.2%
US Equity						
US S&P 500	IVV	2.7%	6.2%	26.3%	-1.5%	23.0%
NASDAQ 100 QQQ	QQQ	2.2%	8.1%	26.0%	-3.1%	26.4%
US Large Growth	IWF	1.9%	9.6%	32.5%	-2.4%	29.8%
US Large Value	IWD	4.5%	3.7%	19.3%	-3.4%	17.8%
US Eqwt S&P 500	RSP	3.4%	3.2%	17.7%	-3.7%	16.1%
US Mid Cap	IJH	3.8%	4.9%	20.3%	-5.4%	19.4%
US Small Cap	VTWO	2.5%	4.4%	19.1%	-7.6%	19.3%

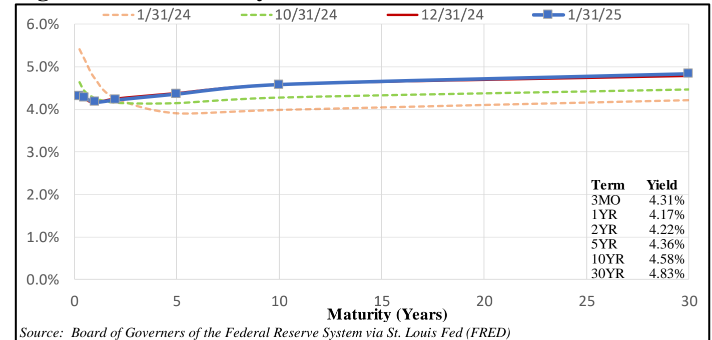
Market volatility continued in January as investors digested strong economic data amid uncertainty about the new administration's policies and the potential impact on the economy and markets. Still, global stocks and bonds ended the month with solid gains. Performance highlights for January and the last three months since the election (3MO) are below.

- Bonds: The US Aggregate index (AGG) rose 0.5% this month (-0.1% 3MO) as yields stabilized around muted expectations for further Fed rate cuts. Long-term Treasuries (TLT) are very sensitive to interest rates, rising 0.5% (-4.0% 3MO). Corporate bonds (LQD) rose 0.6% (-0.4% 3MO); high yield (HYG) rose 1.4% (+2.2% 3MO). January's market action partially reversed post-election trends toward higher rates and a stronger dollar.
- Global equity (ACWI): +3.1% in January (+4.5% 3MO).
- US Equity: The broad market (VTI) rose 3.0% (+6.6% 3MO), and the S&P 500 (IVV) gained 2.7% (+6.2% 3MO). Small stocks (VTWO) were up 2.5% this month (+4.4% 3MO). Ten of eleven sectors were up in January, with gains of more than 5% in Health Care, Financials, Communications, Materials and Industrials. US markets have been strong since the US elections, led higher by Financials and the "Magnificent 7".
- Non-US Equity: Non-US stocks rebounded this month, aided by a weaker US dollar. Developed markets (EFA) gained 4.8% (+1.4% 3MO), and emerging market stocks (EEM) gained 2.2% (-2.3% 3MO). Almost all major markets we track posted gains for the month, but returns have been mixed in the three months since US elections, with US equity outperforming by a wide margin and losses in Korea, India, Brazil and Mexico.

Interest Rates and the Economy

Interest rates were volatile in January, rising after a strong December jobs report (+256k jobs, 4.1% unemployment), then declining after the latest CPI inflation came in at 2.9% as expected. After cutting interest rates by a total of 1.00% over their last three meetings, the Federal Reserve (Fed) held rates steady in January (4.25-4.50% target range). Investors continue to focus on incoming economic data to calibrate expectations for future rate cuts, with just two more 0.25% cuts currently forecast in 2025. The yield curve (Figure 2) plots the interest rates for various US Treasury maturities. US 10-year Treasuries now yield 4.58%.

Figure 2: US Treasury Yield Curve

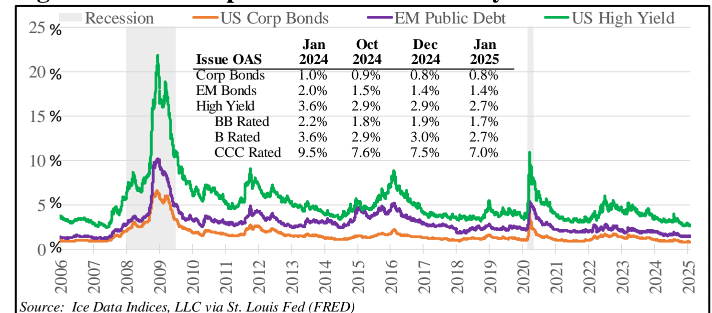


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism; high or widening spreads signal fear. Spreads on high yield bonds narrowed notably this month, reflecting a strong appetite for risk.

- Investment grade corporate bond spreads were stable at +0.8% but have narrowed from +1.0% over the past year.
- High yield (non-investment grade) spreads narrowed to +2.7% last month and are down significantly from +3.6% a year ago. Spreads of the riskiest bonds (rated CCC & below) narrowed to +7.0% and are well below +9.5% spreads one year ago.
- Emerging market spreads were steady at +1.4% but have tightened over the past year; investors see low risk in EM debt.

Figure 3: Credit Spreads vs. U.S. Treasury Yields



Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

Capital Market Assumptions: Forecasts

At the beginning of each new year, we seek a longer-term perspective regarding markets and potential future returns. Many research-intensive investment firms maintain long-term capital market assumptions (expected asset class returns, volatility and correlations) and publish them annually, including JP Morgan (some of the most robust research on the topic) and other well-respected firms such as BlackRock, Invesco, Vanguard, Research Affiliates and Grantham Mayo (GMO). Together, these firms manage over $26 trillion on behalf of institutional and individual investors. Figure 4 summarizes their long-term forecasts.

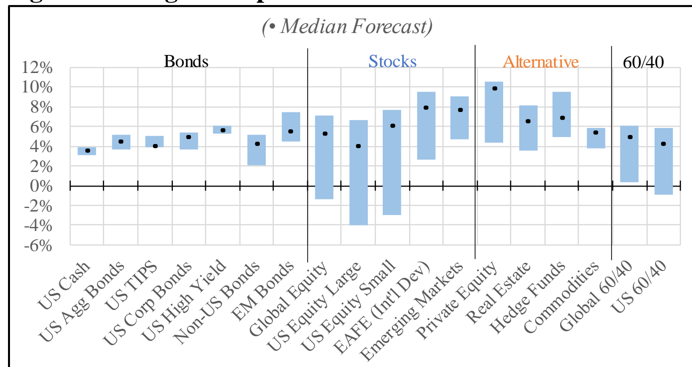
Figure 4: 10-year Return Forecasts (Nominal, Geometric)

Class	Asset	Median E(R)	Change vs. 2024	JP Morgan	Black Rock	Invesco	Vanguard	Research Affiliates	GMO
Inflation	US Inflation	**2.4%**	**-0.1%**	2.4%			2.4%	2.5%	2.3%
Cash & Bonds	US Cash	**3.6%**	**-0.5%**	3.1%	3.9%		3.6%	3.6%	3.8%
	US Agg Bonds	**4.6%**	**-0.5%**	4.6%	3.7%	4.5%	4.8%	5.1%	3.8%
	US TIPS	**4.1%**	**-0.3%**	4.1%	4.0%	4.3%	3.9%	5.1%	4.0%
	US Corp Bonds	**5.0%**	**-0.5%**	5.0%	3.6%	4.7%	5.1%	5.4%	
	US High Yield	**5.7%**	**-1.1%**	6.1%	5.7%	5.7%	5.8%	5.3%	
	Non-US Bonds	**4.4%**	**-0.6%**	4.2%	4.1%	4.5%	4.8%	5.1%	2.1%
	EM Bonds	**5.6%**	**-0.8%**	6.1%	4.5%	5.6%	5.5%	7.4%	4.8%
Equity	Global Equity	**5.4%**	**-1.6%**	7.1%	6.8%	5.4%	5.2%	5.3%	-1.4%
	US Equity Large	**4.1%**	**-1.8%**	6.7%	6.2%	4.7%	3.5%	3.4%	-4.0%
	US Equity Small	**6.1%**	**-0.3%**	6.9%	5.4%	7.7%	5.2%	7.4%	-3.0%
	EAFE (Int'l Dev)	**8.0%**	**0.3%**	8.1%	7.9%	5.9%	8.3%	9.5%	2.7%
	Emerging Markets	**7.7%**	**-1.2%**	7.2%	8.2%	8.5%	6.2%	9.0%	4.7%
Alt	Private Equity	**9.9%**	**0.6%**	9.9%	10.5%			4.3%	
	Real Estate	**6.6%**	**0.9%**	8.1%	3.5%	6.2%		7.0%	
	Hedge Funds	**7.0%**	**1.1%**	4.9%	9.5%	6.6%		7.4%	
	Commodities	**5.4%**	**-1.1%**	3.8%		5.4%		5.9%	
Portfolio	Global 60/40	**5.0%**	**-1.2%**	6.1%	6.1%	5.0%	5.1%	5.5%	0.4%
	US 60/40	**4.3%**	**-1.3%**	5.9%	5.2%	4.6%	4.0%	4.4%	-0.9%

Sources: JP Morgan, BlackRock, Invesco, Vanguard, Research Affiliates & GMO

Figure 5 is a graphical summary of the data in Figure 4, illustrating the range of return estimates for each asset class and the median forecast for each. We focus on the median rather than a simple average of forecasts to limit the impact of outliers. Expected returns have declined measurably since last year's survey, reflecting outsized US and global stock market advances in 2024, lower interest rates and inflation. The forecasts are summarized below.

Figure 5: Range of Expected Return Forecasts



Bonds: The Fed and many global central banks began cutting interest rates in 2024, resulting in lower current yields and long-term return forecasts for bonds relative to last year's survey:

- Cash: Expecting 3.6% p.a. (per annum, i.e., annualized over the next 10 years), down from 4.1% forecast last year; this makes sense given interest rate cuts by global central banks.
- US bonds: Forecasting 4.6% p.a., down from 5.1% last year
- US corporate bonds: Forecasts decreased to 5.0% p.a.
- High yield bonds: Forecasts declined from 6.8% to 5.7%, reflecting tight but relatively stable credit spreads going forward.
- Non-US bonds: Forecasts decreased to 4.4% p.a., similar to the expected returns for the US Aggregate bond index; emerging market debt return forecasts moved lower to 5.6% p.a.

Stocks: Given the strong equity performance in 2024, return forecasts for stocks are significantly lower now versus last year's forecasts (having achieved outsized gains last year):

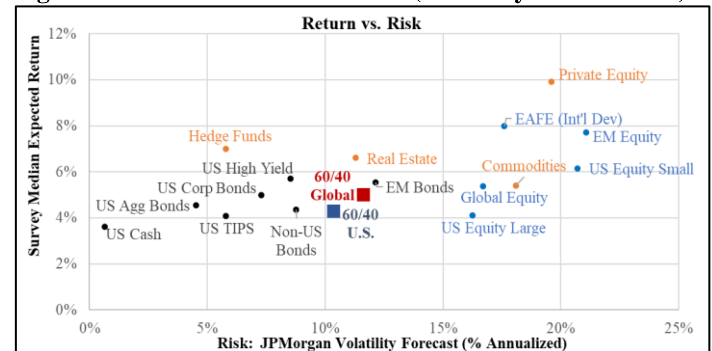
- Global equity: 10-year forecast decreased to 5.4% p.a.
- US equity: The forecast for large cap US stocks over the next 10 years decreased the most in this year's survey, down from 5.9% to 4.1% annually for large US stocks (S&P 500), reflecting the strong outperformance this segment realized in 2024; small cap forecasts declined to 6.1% p.a. versus 6.4% last year.
- Non-US equity: Developed non-US equity (EAFE) forecasts increased this year and now offer the highest public market returns at 8.0% p.a. (up from 7.6% last year); emerging market forecasts are strong at 7.7% p.a. (down versus 9.0% last year).

Alternatives: Large institutional investors will continue to invest in illiquid assets in search of returns and diversification because hedge funds, real estate and commodity returns have low correlations with stock and bond returns. Return forecasts for alternative assets mostly rose in this year's survey, particularly for private investments as investors factor in lower borrowing costs associated with these debt-financed investments:

- Private Equity: Forecasts increased to 9.9% p.a.
- Real Estate: Forecasts increased to 6.6% p.a.
- Hedge funds: Expectations increased to 7.0% p.a.
- Commodities: Forecasts declined to 5.4% p.a.

Risk: Returns are only part of the investment process. Figure 6 plots the risk/return tradeoff for the various asset classes discussed in this article (median expected return on the Y-axis, and JP Morgan's annualized volatility estimate on the X-axis). Over the long run, higher returns can only be achieved by taking more risk; therefore, it makes sense that less risky assets like cash and bonds fall in the lower left while riskier asset classes like emerging market and private equity lie in the upper right.

Figure 6: Return vs. Risk Forecast (Volatility source: JPM)



Bottom Line

Stocks began the new year on a positive note, but strong recent returns have resulted in lower future return expectations (higher starting point). Forecasts for the S&P 500 are just 4.1% p.a. for the next 10 years, as much of the future growth is already priced in at current high valuations. Expected returns are higher for non-US equity investments, but that has been the case for years, even as US markets have continued to outperform. A balanced US portfolio (60% US stocks, 40% US bonds) is expected to earn just 4.3% p.a. over the next decade; global portfolios offer 5.0% p.a.

Seeking higher returns requires more risk, with larger allocations to alternatives and non-US assets. Diversification is critical given elevated uncertainty (interest rates, tariffs, geopolitics, etc.).

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