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LOOKING FORWARD: LOWER (BUT POSITIVE) RETURNS

Equities are currently enjoying their longest-ever bull run. Since the March 2009 stock market lows of the financial crisis—except for the final quarter of 2018—equity markets have climbed almost relentlessly. Year to date, global and U.S. indexes have enjoyed healthy double-digit returns.

Bond markets, meanwhile, have been trading upwards for almost four decades—to such an extent that almost a third of the global bond market now trades with negative yields.

As we enter 2020, this makes asset allocation decisions challenging to say the least, particularly given the growing likelihood of a recession within the next five years. But it doesn't mean that investors won't have positive returns. It just means that they are likely to be lower than in recent years.

Medium-term single digit returns

Over the next five years, we expect annual returns from all risk assets to be in the single digits. For U.S. equities, this equates to predicted annual returns of around 6%. For emerging market equities, the figures are around 8% annually over the same period.[1]

But given the importance of the final resolution of U.S./China trade talks, timing in emerging markets will be key: emerging market equity indices are dependent on the fortunes of Asia, because over 70% of the component companies of the MSCI Emerging Markets Index are based there. Reduced friction in U.S./China trade would benefit equity markets generally but emerging market equities specifically.

Over the next year, we do not foresee significant changes to bond markets, which means there are minimal prospects for capital gains from this asset class. This will make them very different to 2019, where the dramatic pivot by the U.S. Federal Reserve, which saw it introduce three rate cuts over the year, helped drive a bond market rally. Over the last 12 months, 10-year U.S. Treasury yields have fallen from over 3% to just over 1.8%.

Instead, in 2020, we expect to take advantage of trading opportunities within specific yield ranges within bonds, particularly as the likelihood of further rate cuts from the Fed is diminishing. Typically, we expect yields to move within a range of around 0.25 percentage points, giving rise to modest, but not insignificant, trading opportunities.

[1] Source: Columbia Threadneedle Investments. Equity forecasts are based on three components: expected dividend payments, expected earnings growth and change in valuation levels (price-to-earnings ratios). Expected earnings growth is driven by expected economic growth, input cost changes and pricing power. Asset classes discussed are based on the following indices: U.S. large-cap stocks (S&P 500 Index), U.S. small-cap stocks (Russell 2000 Index), emerging market stocks USD (MSCI EM Index). Please see https://www.columbiathreadneedleus.com/content/columbia/pdf/CAPITAL_MARKET_ASSUMPTIONS_7_19.PDF for more information.

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