JANUARY 2022

COLUMBIA THREADNEEDLE INVESTMENTS

UPDATE: 5-year capital market assumptions

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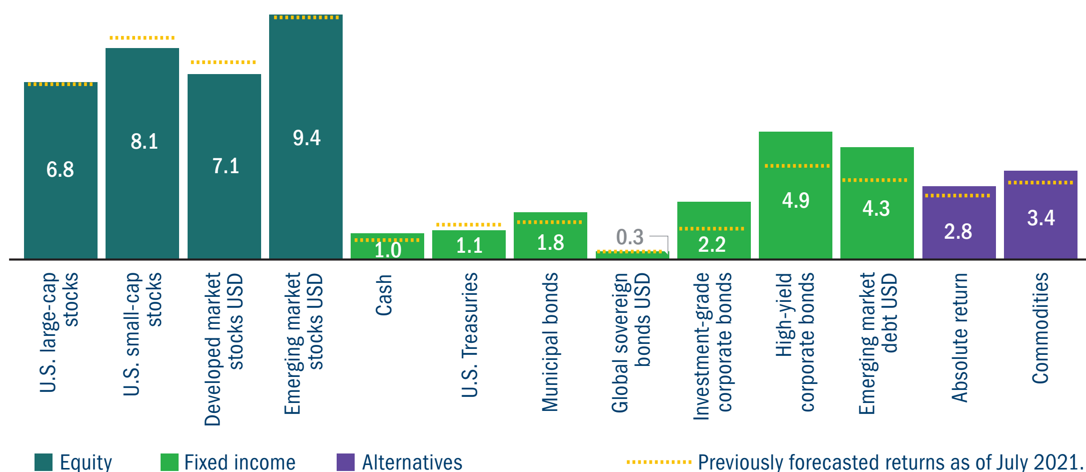
Twice a year, we conduct an extensive update of our five-year return forecasts. The purpose of this exercise is two-fold. First, taking a longer term perspective helps set strategic asset allocations and design portfolios for diverse investment goals. Second, and equally important, maintaining long-term forecasts provides helpful context for responding thoughtfully to daily swings in market prices.

Forecasted five-year total average returns



Please see disclosures for asset class definitions.

Summary

- **We are not recovering from a typical recession.** The intentional shutdown of the economy and the massive, global synchronous fiscal and monetary support have created distortions across the economy — from shifts in patterns in consumption to the labor force. This has put policymakers and central bankers in uncharted waters; it's unusual to have higher-than-expected inflation alongside a labor market that is still recovering.
- **Inflation data will get worse before it gets better.** Inflation is proving to be both more persistent and higher than the Fed (and the markets) initially anticipated. Rising costs are impacting a wider set of goods and services, and the supply distortions that are driving this are not likely to end quickly. While the Fed wants to see some level of inflation, timing the use of its tools to control higher prices requires a new surgical precision. If various forces keeping inflation high ease next year, then the Fed can implement rate hikes in a measured fashion. This is the Goldilocks scenario.
- **In 2021, we knew the Fed would stay accommodative; we don't have that certainty in 2022.** For the markets, the flood of supportive programs introduced during the pandemic had the beneficial effect of lifting nearly all assets. As that support is withdrawn, there will be clear winners and losers. Current estimates forecast similar or higher returns across most asset classes, except for U.S. small caps, developed markets and U.S. Treasuries. Return forecasts increased the most for U.S. high yield and emerging market debt.

Strategic outlook: Two scenarios

To calculate the five-year forecast, we consider two scenarios and calculate a weighted average based on the likelihood of each.

Most likely (70%): Goldilocks

Inflation eases in 2022 and gets back closer to the Fed's acceptable range. But growth is generally well above trend and supported by a strong labor market. Inflation is also above what we are used to over the last decade. In this scenario, we see effective handling of monetary policy with modest market turbulence.

Slightly less likely (30%): COVID continues

Growth is downgraded as COVID variants disrupt activity and result in a continuation of supply bottlenecks and inflation. The Fed turns hawkish to manage inflation expectations and high market volatility in the earlier part of the forecast horizon.

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Bar chart represents forecasted five-year total average returns as of December 2018. Dotted line represents previously forecasted returns as of December 2021. Source: Columbia Management Investment Advisers, LLC. **Past performance does not guarantee future results. It is not possible to invest in an index.**

Important note: This chart is for illustrative purposes only and is not intended to represent any investment product. All of the above are forecasts based on Columbia Management Investment Advisers, LLC models and analysis. As such, there is high likelihood that actual returns and economic results will deviate from our expectations.

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. Fixed-income forecasts are based on the shape of the yield curve, direction of interest rates, increase/decrease in yield spreads and timing of those changes. The major asset classes are based on the following indices: Large-cap stocks: S&P 500 Index; Small-cap stocks: Russell 2000 Index; Developed market stocks: MSCI EAFE Index; Emerging market stocks: MSCI EM Index; Cash: Citigroup U.S. Domestic 3-Month T-Bill Index; U.S. Treasuries: Bloomberg Barclays U.S. Treasury Index; Global sovereign bonds: Bloomberg Barclays Global Treasury Index (excl. U.S.); Investment-grade corporates: Bloomberg Barclays U.S. Aggregate Credit Index; High-yield bonds: Bloomberg Barclays Corporate High Yield Index; Emerging market debt: JPMorgan EMBI Global Diversified Index; Commodities: Bloomberg Commodity Index plus active management component: Municipal Bonds: Bloomberg Barclays Municipal Bond Index

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