CIBC
Asset Management

LONG-TERM CAPITAL MARKET RETURNS (10 YEAR)

April 21, 2020

The COVID-19 pandemic and oil supply shocks have had swift and major ramifications for the global economy and financial markets. These shocks also have important implications for expected long-term asset returns. In January, we published the latest edition of our annual Long-Term Capital Market Returns research paper with projections for a number of asset classes. The conclusions made for relatively sober reading. Most asset classes were overvalued, and expected returns were commensurately low. That outlook has been significantly altered by subsequent developments. For wealth management, one of the few positives to be drawn from the current situation is price corrections sow the seeds of the next investment opportunities. In this sense at least, this period of market dislocation is no different than previous episodes.

Reflecting the magnitude of changes to the outlook for expected returns, this is a supplement to our annual paper. Long-term expected returns are determined by two, broad drivers: slow-moving fundamental forces that shape the global economy and changes in current asset prices. Both have been significantly impacted by the combined pandemic and oil shocks. In this supplement, we focus on the change in expected returns due to price changes.

We are deferring a thorough analysis of the impact of changes in central bank policy caused by the current crises, and related changes in the investment and saving decisions of governments, firms, and individuals. These potential changes could affect the long-term paths of productivity, corporate earnings, and interest rates.

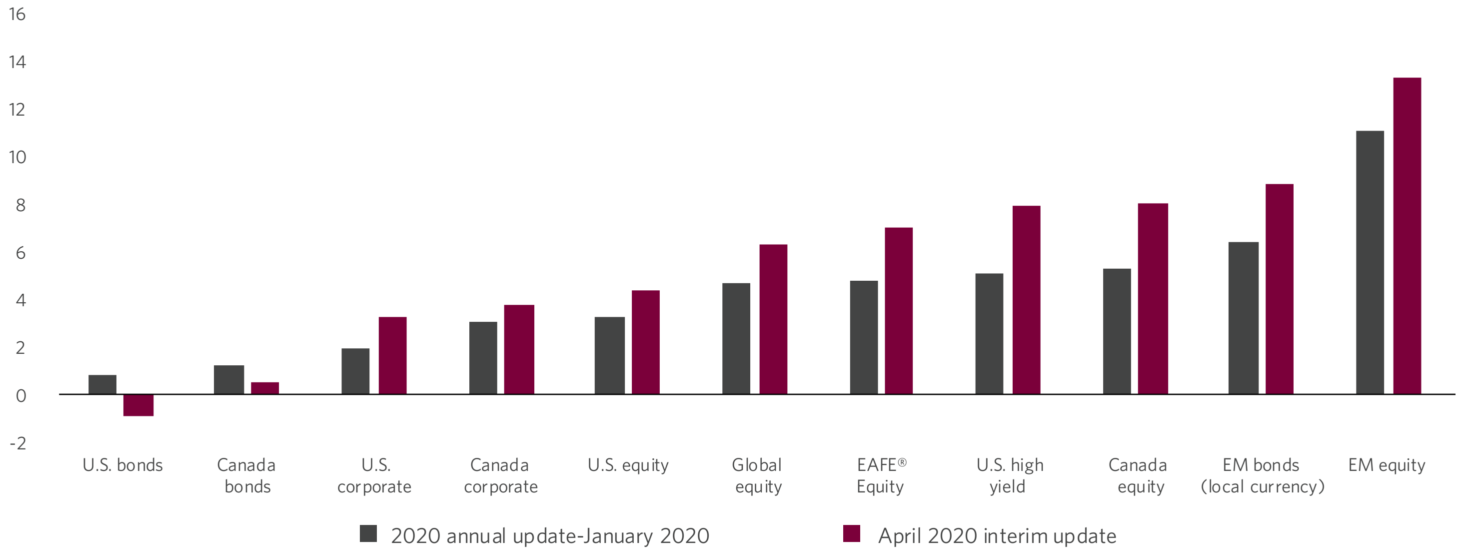
Long-term capital market returns (10 year) : Updated forecast

These revisions provide an interim assessment. Extensive policy actions have ensured that risks have become more symmetrical. A definitive turn higher in investor risk appetite and the price of risk assets will only become more likely when two conditions are met. First, the virus spread is clearly under control globally and second, market return expectations have corrected enough to reflect the scale of the gathering global recession. We don't believe either condition exists at this point.

- Expected long-term annualized equity returns have increased substantially as a result of price corrections. All markets in our investment universe have become more attractive than they were in January.
- Some equity markets remain more attractive than others and the relative return outlook is unchanged. Emerging markets, broadly, began the year at relatively cheap levels, and have become cheaper. The U.S. and other advanced economy equity markets began 2020 in overvalued territory. These markets have corrected back closer to fair value.
- Valuations of other risk assets have also become more attractive. These include developed market (DM) corporate and high yield bonds, and emerging market debt.
- Expected long-term returns for DM sovereign bonds have decreased. Yields, which are a good proxy for long-term returns, have fallen to unprecedented levels due to an investor flight to safety and newly announced quantitative easing (QE) by major central banks. For the first time, this includes the Bank of Canada. The flatness of DM yield curves means investors will not be rewarded for taking duration risk.
- Low nominal and real yields render DM bonds less capable of performing a long-term stabilizing role in investor portfolios. Other complementary investments that offer protection during equity corrections will become increasingly relevant. This will include gold, as well as alternative strategies that include allocations to a range of diversifying asset classes.

Long-term expected returns

10 year average expected returns (%)



Source: CIBC Asset Management Inc. based on data available April 1, 2020

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