Are long term portfolio return outlooks below average?

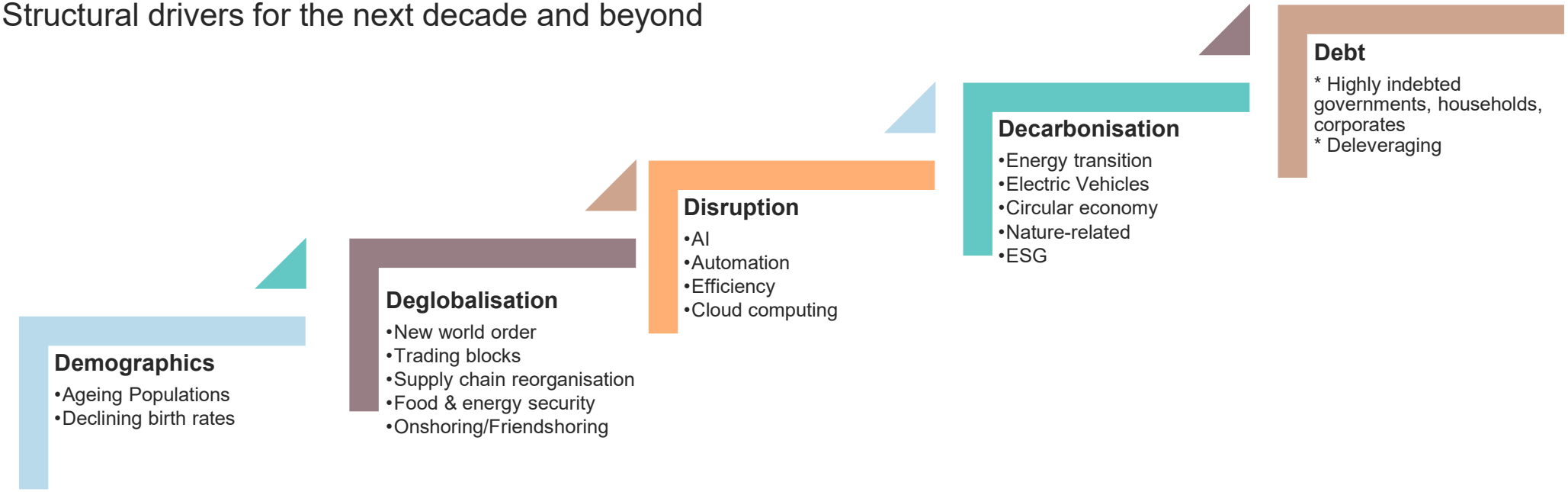
Lonsec Investment Solutions | Deanne Baker

March 2024

Lonsec

Long-term structural drivers

Structural drivers for the next decade and beyond



- Structural shifts have taken place across the global economy in the aftermath of the COVID-19 pandemic.
- The 5 D's (demographic changes, deglobalisation, disruption, decarbonisation and debt) continue to evolve and shape the long-term macroeconomic outlook.
- The effects of these structural changes will be felt differently across regions, countries, industries and asset classes.
- Regime shifts in inflation, growth, liquidity and volatility need to be factored into long-term risk/return expectations as portfolios designed for the next decade will look decidedly different from those in the post gfc era.
- Structurally higher inflation, less liquidity and higher volatility are likely to feature.

Modelling Capital Markets Assumptions

Grinold and Kroner Dividend Discount Model

	Nominal Earnings growth (I + G)		Dividend Yield (D/P - ΔS)	Repricing Δ PE	Forecast Return
	Inflation	*Real EPS Growth*			
Australian Equities	2.6%	2.0%	4.1%	-0.3%	8.4%
Developed Global Equities	2.1%	1.9%	2.1%	-1.7%	4.4%
US Equities	2.2%	2.2%	2.1%	-2.5%	4.0%
Emerging Markets	3.6%	3.8%	2.4%	0.1	9.9%

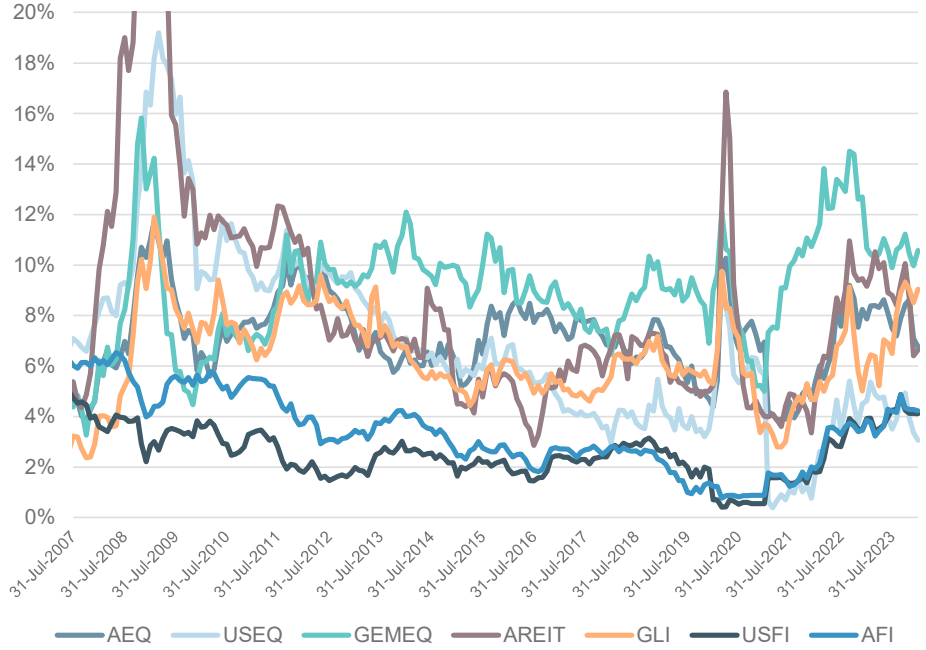
- Structurally higher inflation underpins expected returns as investors demand higher returns ('inflation risk premia').
- Growth outlook is less clear (disruption v deglobalisation)?
- Starting point valuations are driving the bulk of the dispersion we are seeing across equity market expected returns.
- US equities in particular look expensive. This flows into our expectations for developed global equities. Starting valuations in Australian equities and emerging markets are less stretched.

Source: Lonsec. This table does not represent Lonsec's current capital market assumptions. Illustrative model only.

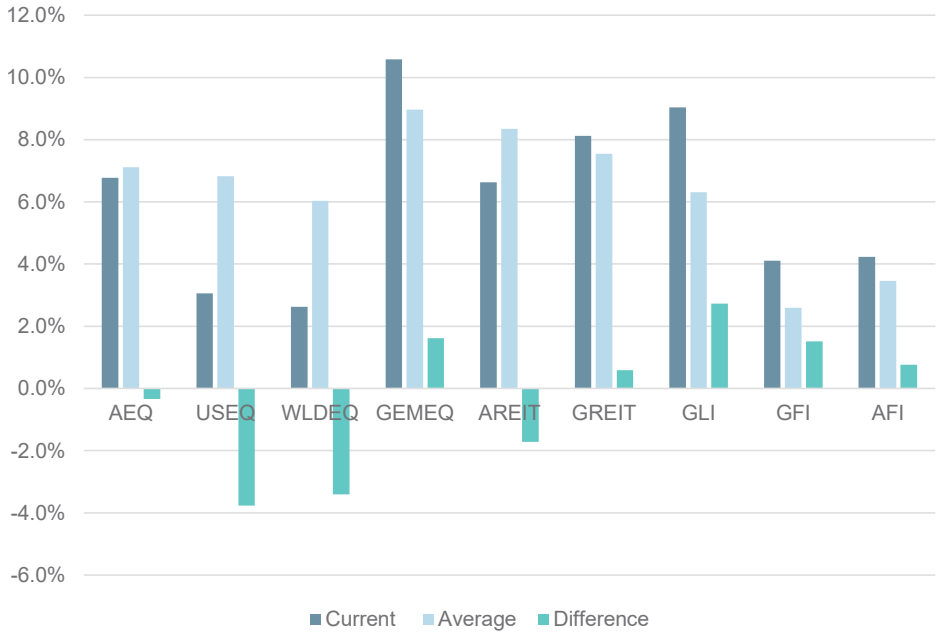
Expected returns for some assets are higher

Expected returns for bonds and bond proxies are mostly higher than pre-pandemic

Lonsec 10 Year IRR Model



10 Year IRRs versus History

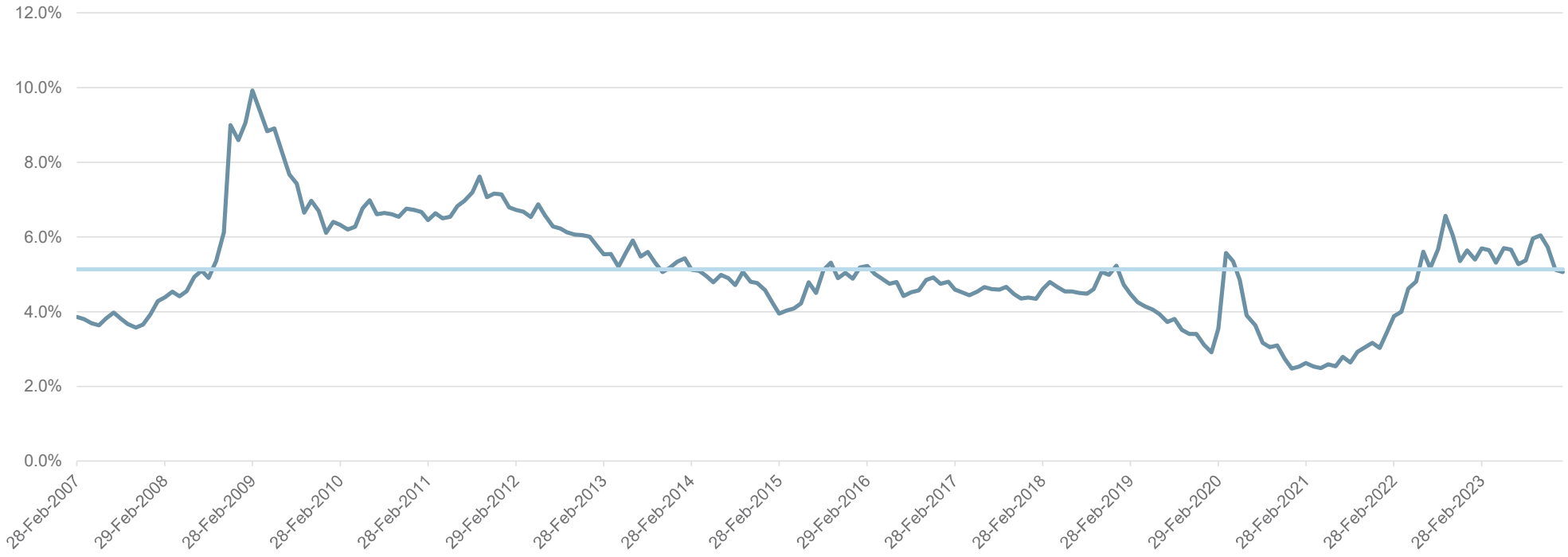


- Expected returns for many asset classes are in fact higher than the average
- Fixed income return expectations are higher than pre-pandemic due to higher starting bond yields.
- US is the exception, pulling down expectations for global equities as a whole. The US makes up 63% of the MSCI World ex Aust Index.

Source: Lonsec. This table does not represent Lonsec's current capital market assumptions. Illustrative model only.

Lonsec 10 Year Expected Returns

Australian investor 60/40 Balanced Portfolio



- Long-term (10 year) return expectations for an Australian balanced investor is in-line with long-term average returns.
- Lower returns expectations for US and global equities has been offset by higher expectations for cash, fixed income and some bond proxies.

Source: Lonsec. Using Lonsec's Traditional SAA and IRRs (not optimised).