
LONG-TERM CAPITAL MARKET ASSUMPTIONS

INVESTMENT STRATEGY GROUP

January 2025



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Mike Halloran is an Equity Strategist with more than 25 years of experience as a strategist, mutual fund analyst and investment banker. He analyzes all asset classes with particular emphasis on equity research.

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This report establishes our long-term return assumptions across major asset classes and includes representative model portfolios.

2024 saw healthy returns for most risky assets, with the S&P 500 index up 25% after 2023's 26% return. With this strong 2-year rally in stocks, valuation is now well above historical averages and suggests muted future stock returns. While off historically high levels, elevated corporate profit margins remain a potential headwind for future stock market returns.

However, with cash yielding over 4.0% and the 10-year Treasury trading above our long-term estimate, cash and bonds are in a position to provide meaningful return additions to portfolios.

The 2025 update of our long-term outlook calls for similar returns across most asset classes relative to 2024. Due to higher cash and bond yields, this outlook is well above the previous decades' call for muted returns. However, expected lower potential economic growth rates due to aging demographics and a slow-growing labor force still present headwinds for future returns.

ISG's projections suggest reasonable return assumptions are around 7.3% for an all-equity portfolio and 6.5% for a balanced 60% stock and 40% bond portfolio.

CASH

The Federal Reserve has begun lowering short-term interest rates as inflation moves closer to its 2.0% target, with short-term rates now below 5%. In the longer run (beyond 2027), the Federal Reserve projects short-term interest rates to be between 2.8% – 3.6% after peaking above 5.0% in 2023 and falling to 4.5% in 2024. Given this relatively high level of short-term interest rates, our projected return for cash equivalents stands at 3.2%.

BONDS

We project the 10-year Treasury note to yield 4.0% in the longer run. This is consistent with the projections of the Federal Reserve and the Congressional Budget Office of about 2.0% economic growth and 2.0% inflation over the long run.

Investment-grade corporate bonds should see yields average about 1.0% higher than the equivalent Treasury bond, while high-yield bonds should see yields about 2.5% higher than the equivalent Treasury. This is consistent with bond yields over the last several economic cycles.

The 10-year Treasury note is trading above our 4.0% long-term estimate at about 4.6%, while investment-grade and non-investment-grade bonds start 2025 at yields of 5.4% and 7.6%, respectively. This supports long-run estimates of investment-grade corporate bond yields of 5.25% and non-investment-grade bond yields of 6.50%. In aggregate, we would expect longer-term returns from a portfolio of Treasuries and investment-grade corporate bonds to provide about 5.0% returns, which is consistent with the returns assumed above and the yield on the U.S. Aggregate Bond Index of 4.9% at the start of 2025.

U.S. STOCKS AND REAL ESTATE

We anticipate that U.S. large-cap stocks and U.S. REITs will provide 7.0% returns. This is consistent with lower potential economic growth, valuations at the high end of historical averages, and elevated profit margins. Small-cap stocks are projected to have 8.5% returns. These returns are consistent with a 4.0% 10-year Treasury, a 4.5% equity risk premium, and better valuation relative to large caps.

INTERNATIONAL STOCKS

For developed world stocks, demographics and potential economic growth are less favorable than in the U.S. However, the valuation is more favorable, and we anticipate stock market returns of 8.0% for developed international stocks. We see more favorable long-term economic growth conditions and valuation for emerging markets and expect returns of 8.5%.

COMMODITIES

We expect returns of 5.0% for commodities, consistent with historical returns of the last 20 years. However, there has been a lack of investment in commodities over the last decade, especially for traditional energy and base metals, while the movement to clean energy requires significant base metals. This implies a potential upside to our 5.0% estimate.

ALTERNATIVES

Alternatives offer the potential to enhance returns while mitigating portfolio volatility. However, we see a wide range of potential returns, income, and diversification attributes for alternatives.

Alternative investments include private equity, hedge funds, real assets (including energy and commodity investments), commercial real estate, and private credit. This broad range of potential investments, coupled with many managers and investment styles, implies a wide variation of returns is possible for alternatives.

For our representative returns and recommended allocations, we include a broad alternatives class and break out private equity and debt as standalone asset classes.

We assume that broad alternatives (including relative value, equity hedge, event-driven, global macro, and multi-strategy) provide returns of about 5.0%, acknowledging a wide range of potential returns. This is consistent with alternative returns over the last 10 years and the future expected returns from stocks and bonds.

Private equity and private debt have been top-performing asset classes over the last decade. Consequently, they are receiving significant investor attention, with individual investors getting better access to the space. We assume private equity and debt will provide returns of 9.0% and 6.75%, respectively. This is consistent with our return assumptions for public markets plus a premium for potential illiquidity risk.

IMPORTANCE OF CORRELATION

Correlation measures how closely the price movement of two assets are related. A correlation of one means both assets move up or down by the same percentage. A correlation of negative one means they move opposite one another, while a correlation of zero means there is no relationship between their price movement.

Correlation is the key attribute for portfolio diversification. Ideally, a well-diversified portfolio combines assets that are not highly correlated to each other, so portfolio volatility gets dampened.

Figure 1 lists representative correlations among the various major asset classes.

Figure 1

Asset Class	1	2	3	4	5	6	7	8	9	10	11	12
1. Large Cap Stocks	1.00											
2. Small Cap Stocks	0.90	1.00										
3. Developed International Stocks	0.81	0.76	1.00									
4. Emerging Market Stocks	0.70	0.67	0.79	1.00								
5. Investment-Grade Bonds	0.28	0.23	0.26	0.24	1.00							
6. High-Yield Bonds	0.68	0.67	0.64	0.62	0.49	1.00						
7. Cash Equivalents (US Treasuries)	(0.03)	(0.06)	(0.02)	(0.02)	0.14	(0.03)	1.00					
8. Real Estate	0.57	0.57	0.50	0.45	0.27	0.49	(0.03)	1.00				
9. Hedge Funds	0.71	0.70	0.68	0.66	0.26	0.63	(0.01)	0.45	1.00			
10. Commodities	0.34	0.35	0.42	0.42	0.06	0.37	(0.00)	0.25	0.40	1.00		
11. Private Equity	0.75	0.96	0.66	0.61	0.18	0.55	(0.07)	0.48	0.62	0.29	1.00	
12. Private Debt	0.55	0.55	0.49	0.50	0.17	0.66	(0.08)	0.37	0.55	0.33	0.58	1.00

Source: Janney ISG, Horizon Actuarial Services, Morningstar

OBSERVATIONS FROM CORRELATION MATRIX

1. Large-cap stocks have their highest correlation with other stocks (0.90–0.70), private equity (0.75), hedge funds (0.71), high-yield bonds (0.68), and private debt (0.55).
2. Investment-grade bonds have their highest correlation with high-yield bonds (0.49), real estate (0.27), hedge funds (0.26), private equity (0.18), and private debt (0.17).
3. High-yield bonds have their highest correlation with private debt (0.66) and stocks (0.68–0.62).
4. Real Estate has its highest correlation with stocks (0.57–0.45), high-yield bonds (0.49), private equity (0.48), hedge funds (0.45), and private debt (0.37).
5. Hedge funds have their highest correlation with stocks (0.71–0.66), high-yield bonds (0.63), private equity (0.62), private debt (0.55), and commodities (0.40).
6. Commodities have their highest correlation with international (0.42) and emerging market stocks (0.42).
7. Private equity has its highest correlation with stocks (0.96–0.61), hedge funds (0.62), private debt (0.58), high-yield bonds (0.55), and real estate (0.48).

8. Private debt has its highest correlation with high-yield bonds (0.66), private equity (0.58), hedge funds (0.55), stocks (0.55–0.49), and real estate (0.37).

9. It's important to note that these correlations change or drift over time.

REPRESENTATIVE PORTFOLIOS

Figure 2 summarizes our long-term capital market assumptions and includes representative weightings and returns for equity growth to income portfolios.

COMPARISON OF JANNEY TO CONSENSUS ESTIMATES

Our LTCM assumptions are submitted to Horizon Actuarial Services, which compiles consensus estimates from many investment firms (41 firms participated in 2024). While significant variation exists for the estimates that comprise the consensus, Janney's estimates have generally been consistent with the consensus.

Figure 2

Asset Class	Expected Return (%)	Equity Growth Portfolio Weights (%)	Diversified Growth Portfolio (%)	60/40 Balanced Portfolio (%)	40/60 Balanced Portfolio (%)	Diversified Income Portfolio (%)	Income Portfolio Weights (%)
Large-Cap Stocks	7.0	50	40	30	20	10	0
Small/Mid-Cap Stocks	8.5	10	8	6	4	2	0
Developed International Stocks	8.0	14	11	8	6	3	0
Emerging Market Stocks	8.5	5	4	3	2	1	0
Private Equity*	9.0	7	6	5	3	2	0
Real Estate	7.0	5	4	3	2	1	0
Investment-Grade Bonds	5.25	0	18	35	52	69	88
Private Debt*	6.75	0	2	4	6	8	10
Hedge Funds	5.0	3	2	2	1	1	0
Commodities	5.0	4	3	2	2	1	0
Cash Equivalents (US Treasuries)	3.2	2	2	2	2	2	2
Expected Portfolio Return	-	7.3	6.9	6.5	6.1	5.7	5.4

Source: Janney ISG, Horizon Actuarial Services, Morningstar

*Private equity and debt weightings are assumptions with actual values determined by portfolio liquidity needs.

Figure 3 shows the consensus estimates for the 2024 survey and illustrates the significant variation that exists for the major asset class estimates.

Figure 4 compares Janney’s estimates to the consensus and the 10-year historical returns for the major asset classes.

Figure 4 also indicates Janney projections and consensus estimates for a blended equity growth and a balanced stock-bond (60/40) portfolio. These projections suggest reasonable return assumptions are around 7.3% for an all-equity portfolio and 6.5% for a balanced 60% stock and 40% bond portfolio.

Figure 3

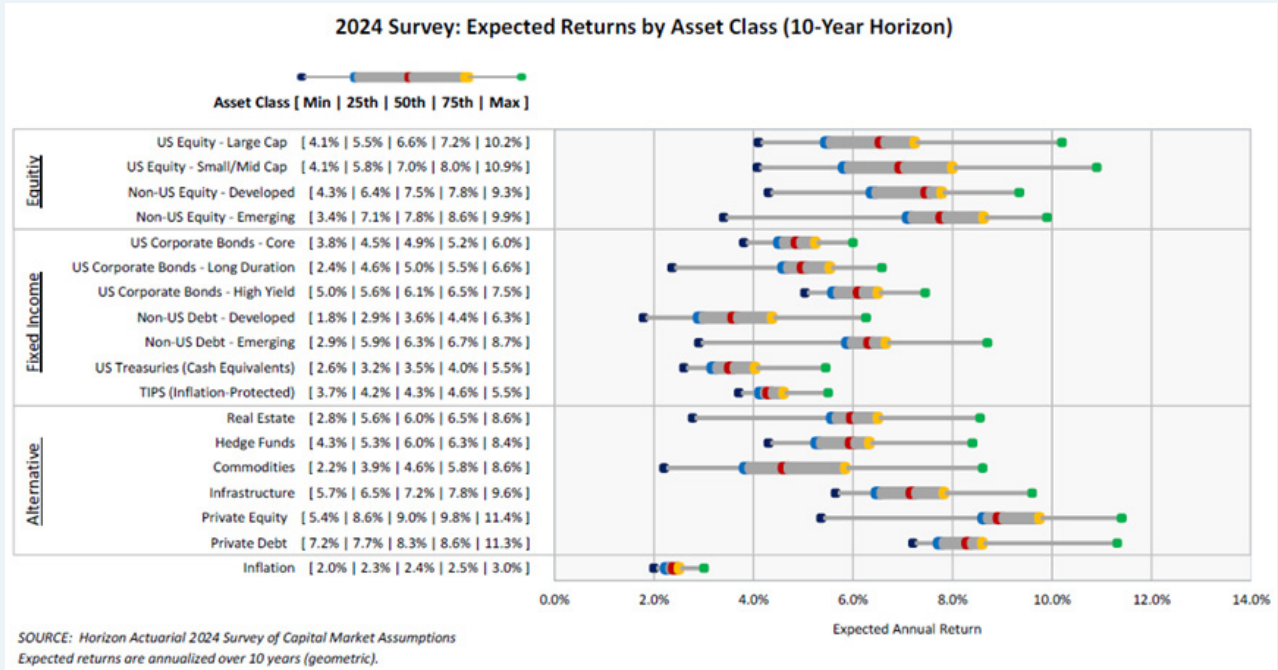


Figure 4

Asset Class	Janney's Projection	Consensus Expected Return*	10-Year Historical Return	Comments
Large-Cap Stocks	7.0%	6.6%	13.1%	11.4% average annual return since 1926. Lower projected returns are consistent with lower potential economic growth, relatively full current valuations, and elevated profit margins.
Small-Cap Stocks	8.5%	7.0%	7.8%	16.0% average annual return since 1926. Over the very long term, small-cap stocks have been rewarded with higher returns as compensation for higher volatility associated with owning them.
Private Equity	9.0%	9.0%	13%	We assume lower future returns for private equity given significant fund flows into the asset class which increases competition for assets and could result in lower returns.
Investment-Grade Bonds	5.25%	4.9%	1.3%	6.0% average annual return since 1926. We anticipate corporate bonds to see yields average about 1.0% higher than the equivalent Treasury bond, consistent with yields over the last several economic cycles.
High-Yield Bonds	6.5%	6.1%	5.1%	We anticipate high-yield bonds to see yields average about 2.5% higher than the equivalent Treasury bond, consistent with yields over the last several economic cycles.
Private Debt	6.75%	8.3%	8.0%	We assume lower future returns for private debt given significant fund flows into the asset class which increases competition for assets and could result in lower returns.
Cash	3.2%	3.5%	1.8%	3.4% average annual return since 1926. Consistent with Federal Reserve longer-run projections for short-term interest rates of between 2.8%–3.6%. This return level is low by historical standards and reflects the lower level of potential economic growth.
Equity Growth	7.3%	6.8%	-	Includes U.S. Large-Cap (50%) and Mid-Small Caps (10%), U.S. REITs (5%), International Developed (14%), Private Equity (7%), Emerging Markets (5%), Hedge Funds (3%), Commodities (4%), and assumes 2% cash position.
Balanced 60% Equity–40% Fixed Income	6.5%	6.2%	-	Includes U.S. Large-Cap (30%) and Mid-Small Caps (6%), U.S. REITs (3%), International Developed (8%), Private Debt (4%), Private Equity (5%), Emerging Markets (3%), Hedge Funds (2%), Commodities (2%), U.S. Bonds (35%), and assumes 2% cash position.

Source: Janney ISG, Horizon Actuarial Services, Morningstar
*Consensus as of midyear 2024.

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