Capital Market Assumptions Survey: Response Summary

Capital Market Assumptions Research Note | April 2024

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Introduction

In February, Addepar, in partnership with the London School of Economics, launched a fourth round of surveys about managers' capital market assumptions (CMAs).

Strategic portfolio construction critically relies on CMAs, in that they provide a basis for return expectations and risk-return tradeoffs. Although various sources of CMAs are available, distinct approaches to portfolio management in institutions and among individuals mean that return expectations may differ in different investor groups. In addition, market information is constantly evolving.

The survey covers expectations for short-term and long-term returns across a wide range of asset classes, as well as macroeconomic outcomes. Between mid-February and mid-March, over 80 investment professionals responded.

Key takeaways

Respondents' expectations for the economic environment are becoming more aligned and optimistic in the short term, in contrast to the broader range of responses in the third quarter of 2023.

- GDP growth expectations have become more upbeat, rising from 2% to 2.5%
- Expectations for one-year inflation further decreased from 4% to 3%
- Median recession expectations have reduced from above 50% to 31%

Over four survey rounds, we have consistently found respondents to view private capital as high-performing over the long term and corporate and Treasury bonds as sources of diversification in recessionary environments.

- Venture capital and private equity are expected to return 15% and 13%, respectively, on an annualized basis over the next 10 years.
- Treasury and corporate bonds are expected to provide positive returns in a recession, while most other asset classes are expected to detract from overall portfolio performance.
- While hedge funds with equity strategies are expected to moderately detract from performance in a recessionary scenario, the median respondent expects positive returns from multi-strategy hedge funds in a recession.

Near-term uncertainty

Between the third quarter of 2023 and the latest survey round, respondents have tended to agree on short-term expected returns for public US equities, private equity, venture capital and real estate. Median expectations are slightly higher across all asset classes; however, respondents have a broader range of views on the returns from global equities and hedge funds relative to the range of views in the previous survey.

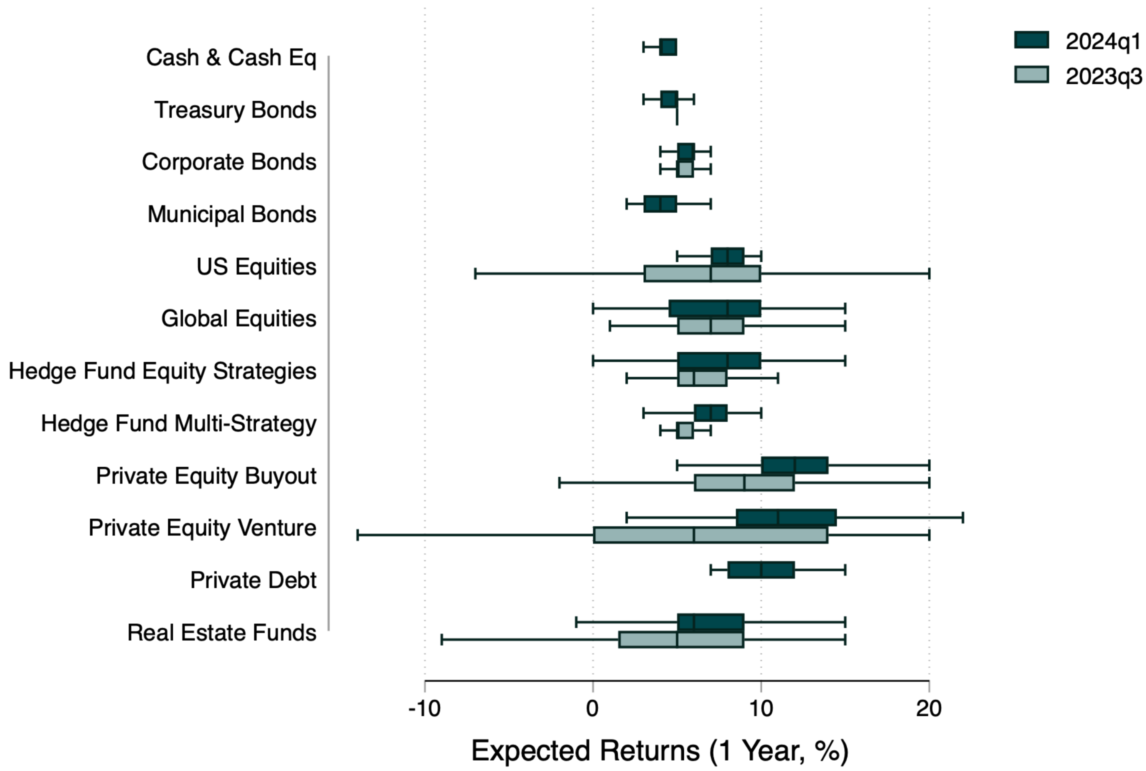
Of note, the results showed lower uncertainty (i.e., less disagreement) over returns from US equities, potentially a reflection of greater optimism following the change in the Fed's stance last fall. Exhibit 1 shows the median and interquartile range for expectations over a one-year horizon by asset class in our two latest CMA surveys.

The latest survey round included new asset classes, including cash and cash equivalents, municipal debt and private debt. Since these asset classes were not included in the previous survey round, they cannot be compared to prior expectations. Median expected returns on cash over the next year are 4%, on municipal bonds 4% and private debt 10%.

Exhibit 1

Investors tend to have similar expected returns for bonds but varying expectations on equities

Range of one-year expected returns, Q3 2023 vs. Q1 2024



Source: Addepar

Long-term growth

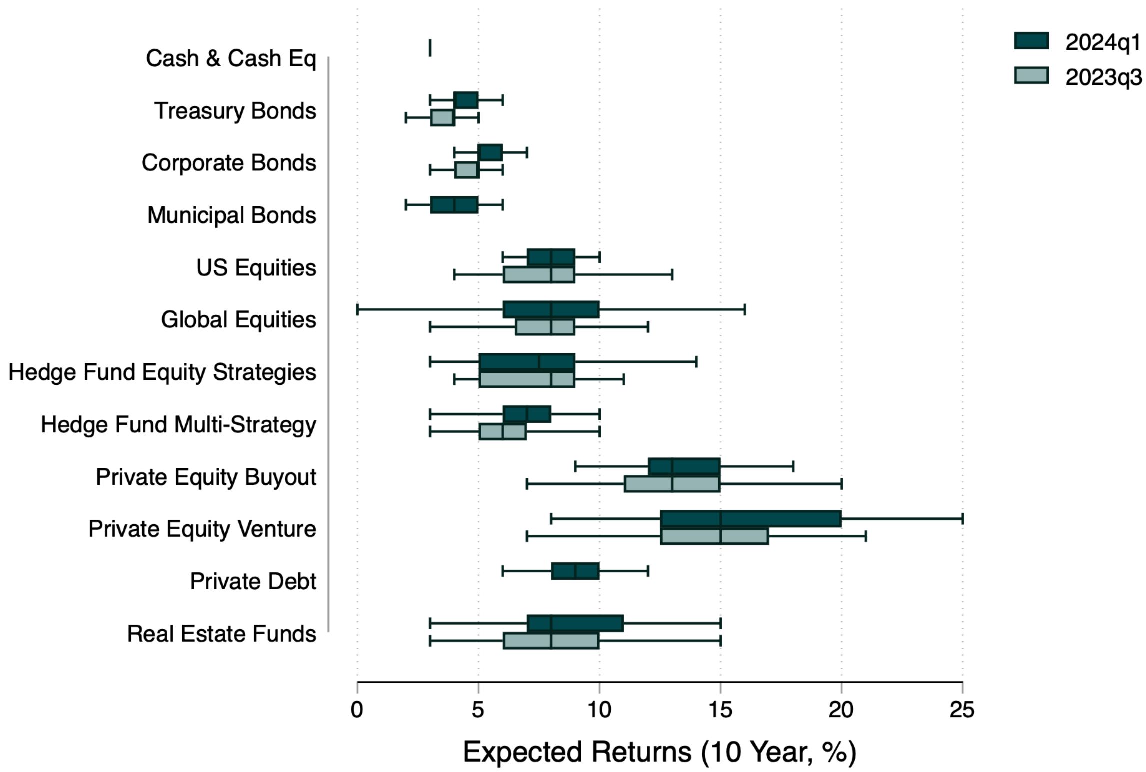
Over a 10-year horizon, investors continue to expect substantial opportunities for market outperformance, particularly in private equity and venture capital (Exhibit 2). The distribution of median expectations compared to short-term expected returns has remained largely stable. Keep in mind that respondents vary across survey rounds, so some of the differences in the results may be due to variation in the sample of respondents. Of note is the greater dispersion in expectations for returns on global equities and the greater expected potential upside for venture capital.

The long-term expected return to cash and cash equivalents is 3%, on municipal bonds 4% and on private debt 9%.

Exhibit 2

Venture capital and private equity are expected to return 15% and 13% over the next 10 years

Range of 10-year expected returns, Q3 2023 vs. Q1 2024



Source: Addepar

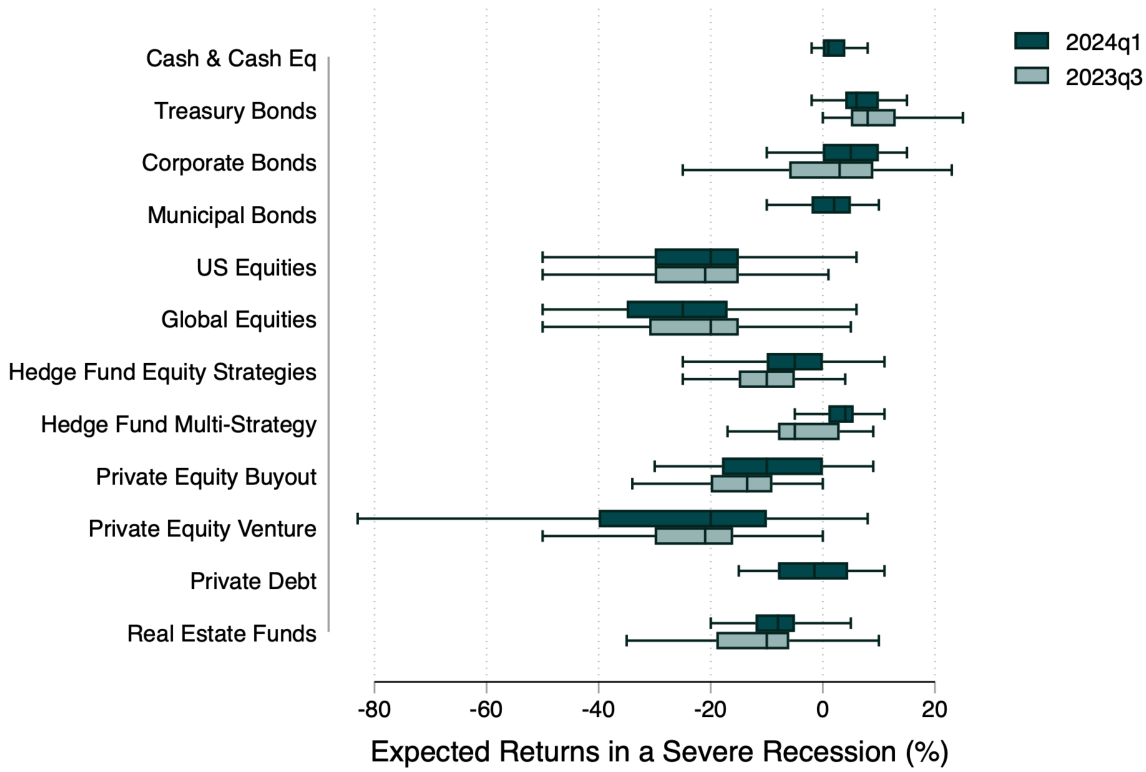
Risk and hedging

In each survey round, we asked respondents about their expectations of asset-class performance in a severe recession (Exhibit 3). This gives a sense of respondents' potential downside risk and diversification expectations across asset classes. Respondents continue to expect bonds to provide the best diversification benefit. In the latest survey round, respondents also expect multi-strategy hedge funds to provide diversification benefits.

Exhibit 3

Treasury and corporate bonds are expected to provide positive returns in a recession

Range of expected returns during a severe recession, Q3 2023 vs. Q1 2024



Source: Addepar

Macroeconomic outlook

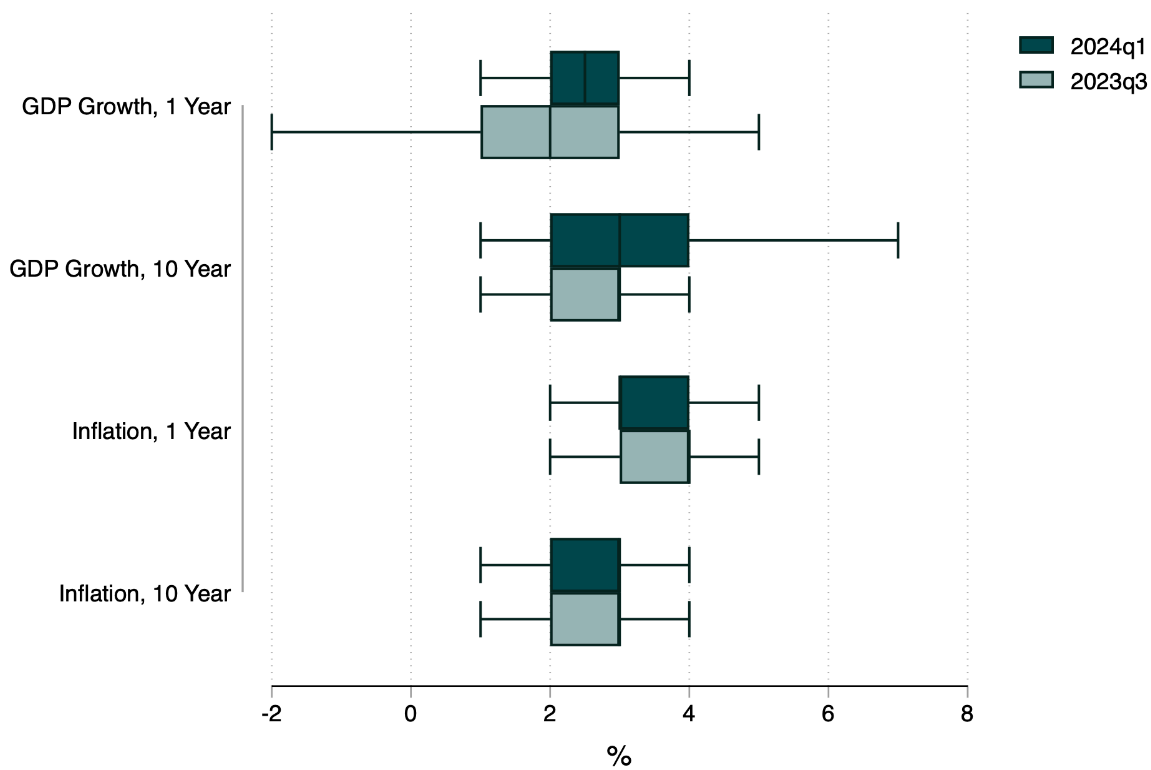
Per Exhibit 4, expectations of nominal GDP growth reflect a substantial reduction of downside risk over the next year, as respondents now anticipate nominal GDP growth of between 2% and 3%. Relative to earlier survey rounds, this survey reveals both less dispersion in expectations for short-term nominal GDP and greater potential upside for long-term nominal GDP growth. Surprisingly, survey responses imply greater dispersion over long-term nominal GDP growth expectations than expectations for the near term.

Inflation expectations have remained moderate, between 3% and 4%. Over the next 10 years, respondents expect inflation to return to a slightly lower level, between 2% and 3%. Interestingly, the market is pricing inflation (break-even inflation or the difference between nominal and TIPS yields) to normalize at 2.3%, and the inflation expectations of survey respondents align well with this.

Exhibit 4

Investors have more upbeat growth expectations and stable inflation expectations compared to Q3 2023

Range of growth and inflation expectations over time, Q3 2023 vs. Q1 2024



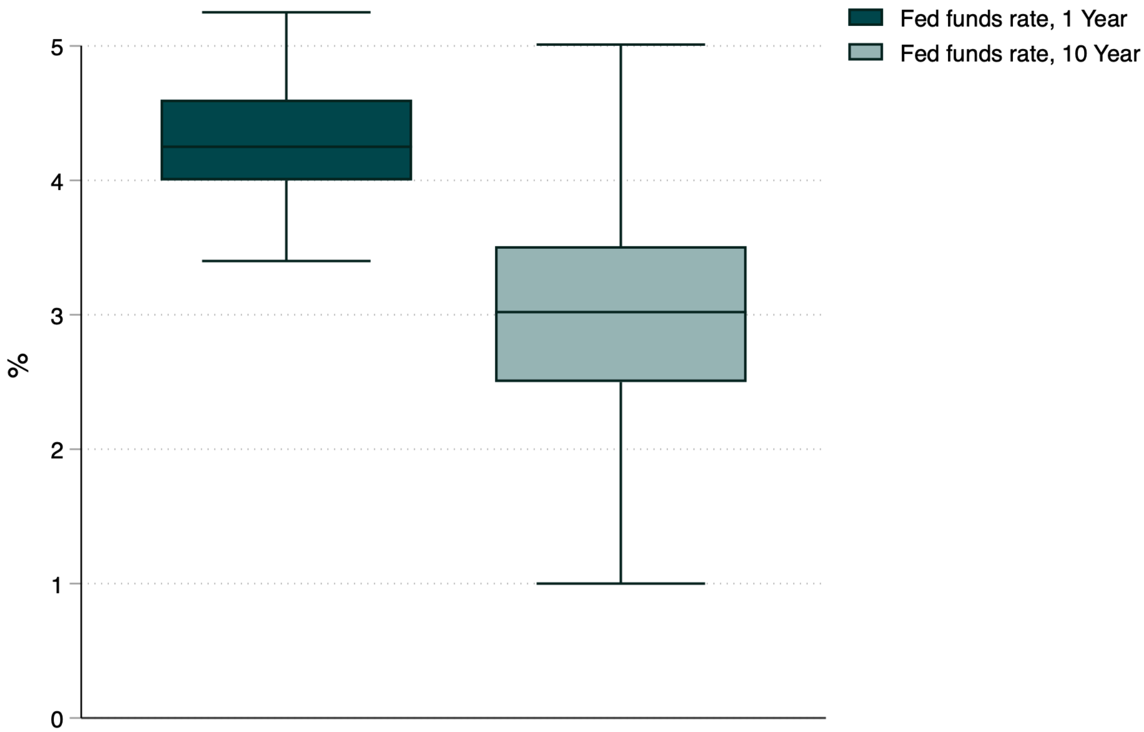
Source: Addepar

However, the median of long-run inflation expectations at 3% is higher than the Federal Reserve target of 2%. In addition, as shown in Exhibit 5, median expectations for the Fed Funds rate in one year and in the long term are 4.25% and 3.0%, respectively. This is higher than FOMC participants' median projections in both December 2023 and March 2024, and signals that respondents expect potentially higher policy rates than guidance indicates.

Exhibit 5

Fed Funds rate expectations

Range of the expectations for the Fed Funds rate in one year and ten years, Q1 2024

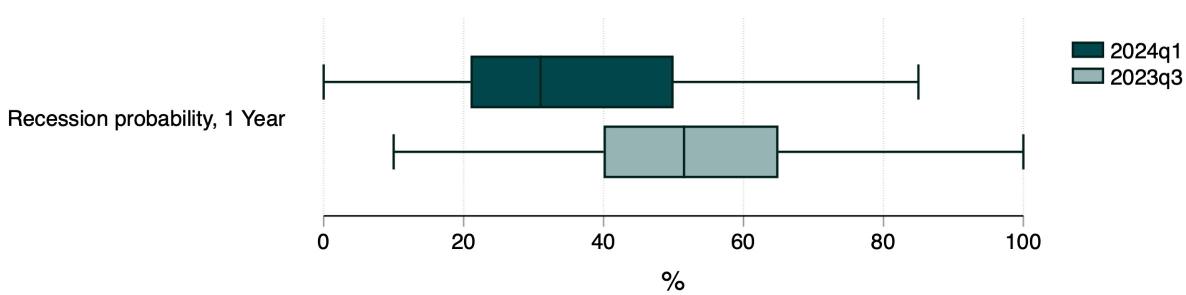


As shown in Exhibit 6, median recession expectations have cooled from 51.5% in Q3 2023 to 31% in Q1 2024. This is consistent with slightly more optimism regarding economic growth, as demonstrated in Exhibit 4.

Exhibit 6

Median recession expectations have further cooled to 31%

Range of the probability of a recession in the next year, Q1 2023 vs. Q3 2023



Source: Addepar

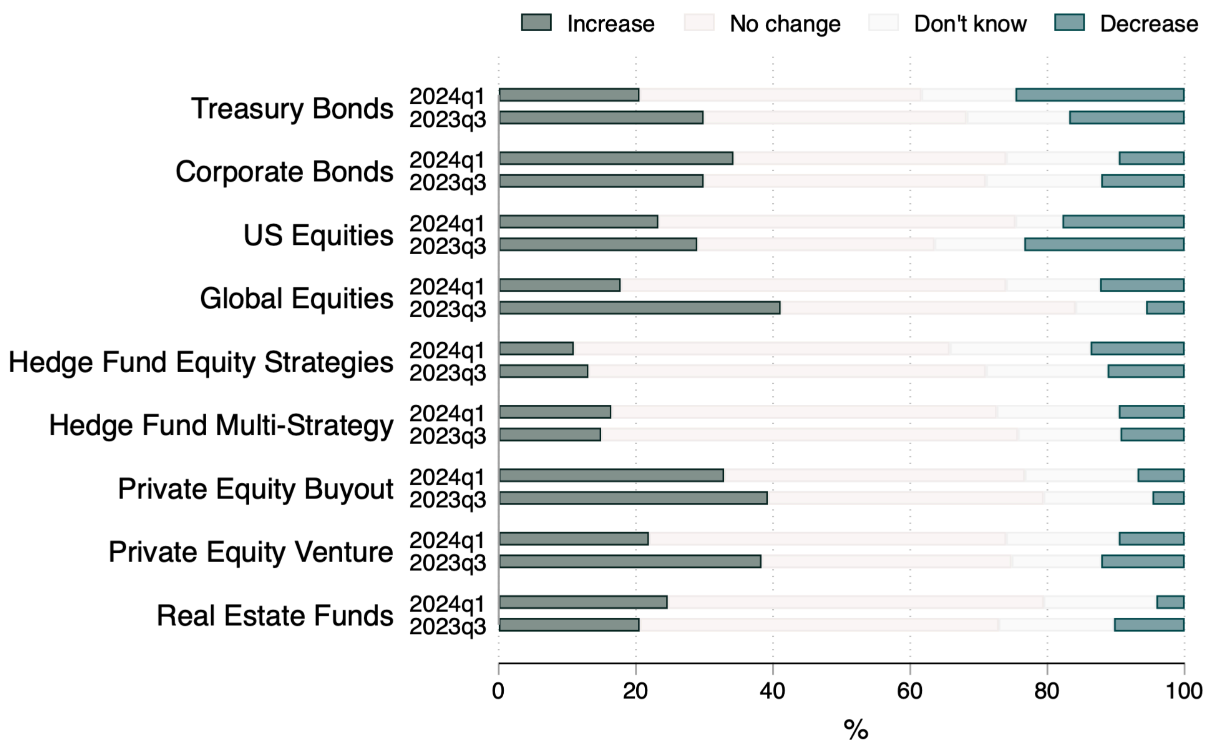
Planned portfolio changes

Exhibit 7 shows that more respondents plan to increase their portfolio allocations in many asset classes, including bonds, public equities and private equity. Relative to Q3 2023, slightly more respondents plan to decrease their allocations to Treasuries and global equities. In addition, fewer investors plan to increase their allocations to U.S. equities, global equities and venture capital.

Exhibit 7

More investors plan to increase allocations to bonds and equities as compared to those who plan to decrease those allocations

Percentage of respondents planning to change asset class allocations, Q3 2023 vs. Q1 2024



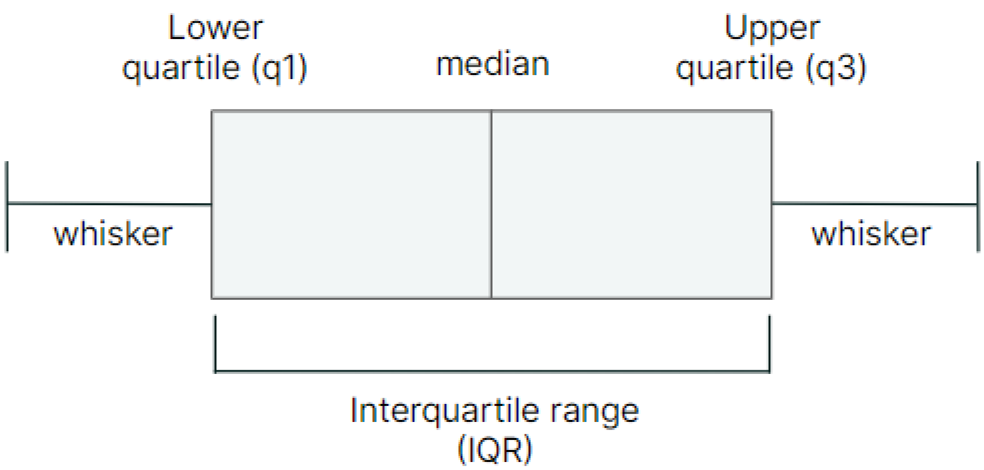
Source: Addepar

Conclusion

We will continue to run the Capital Market Assumptions survey periodically. In the coming months, we'll send instructions for participating in the next installment.

Appendix: Methodology

Box plots are generated as per the chart below:



*Whiskers span data points within 1.5 IQR of the nearer quartile.

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