Capital Market Assumptions Survey: Response Summary

Capital Market Assumptions Research Note | August 2023

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Introduction

Capital market assumptions are a critical part of strategic portfolio construction because they provide a basis for expectations of both returns and risk. While many sources of capital market assumptions exist, there are differences in institutional and individual approaches to portfolio management, and information about the trajectories of economies and markets is constantly evolving.

In June, Addepar, in partnership with the London School of Economics, launched a third round of surveys about managers' capital market assumptions (CMAs). We asked about expectations for short-term and long-term returns, macroeconomic outcomes and recessionary risk. Between June 29 and July 28, 125 investment professionals representing 28,561 portfolios and $283 billion in assets responded.

Key takeaways

Respondents' expectations for the economic environment are trending toward a 'soft landing' narrative, although there is a broader range of views relative to responses in the first quarter of 2023.

- Expectations of a recession have cooled from 65% to 50.5%
- Growth expectations have become more upbeat, rising from 1% to 2%
- Expectations for one-year inflation decreased from from 5% to 4%

Within specific asset classes, respondents continue to view private capital as high-performing over the long-term, with 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 other asset classes are expected to detract from portfolio performance.
- Of note, hedge funds, which traditionally is considered a diversifying asset class, is expected to moderately detract from performance in a recessionary scenario.

Near-term uncertainty

Between the beginning of 2023 and the latest survey round, respondents tend to agree on short-term expected returns for bonds and multi-strategy hedge funds. In contrast, respondents have a broad range of views on the returns from private and public equities in both the U.S. and globally.

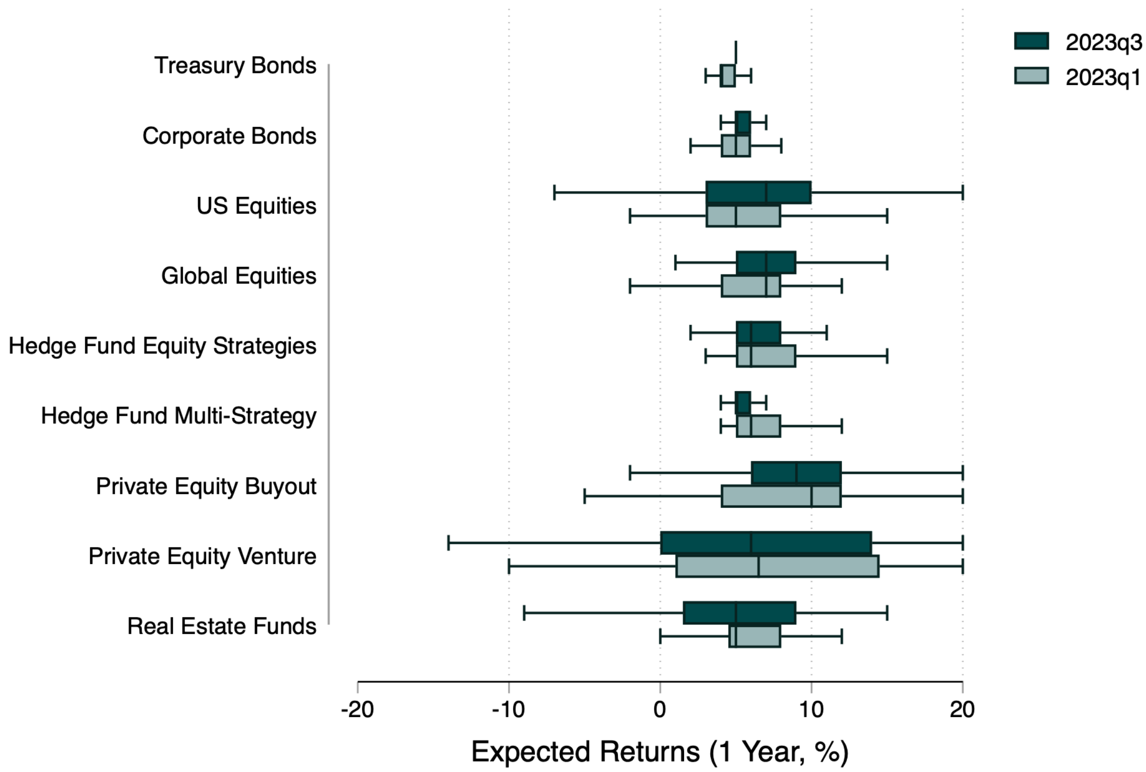
Of note, the results showed higher uncertainty (i.e. greater disagreement) over returns from real estate funds, potentially a reflection of greater variation in expected returns from real estate sub-strategies given elevated policy rates.

Generally more disagreement may also reflect the resolution of some aspects of underlying uncertainty, particularly inflation, while others — such as geopolitical and recession risk — remain elevated. Exhibit 1 shows the median and interquartile range for expectations over a one-year horizon by asset class across our two latest CMA surveys.

Exhibit 1

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

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



Source: Addepar

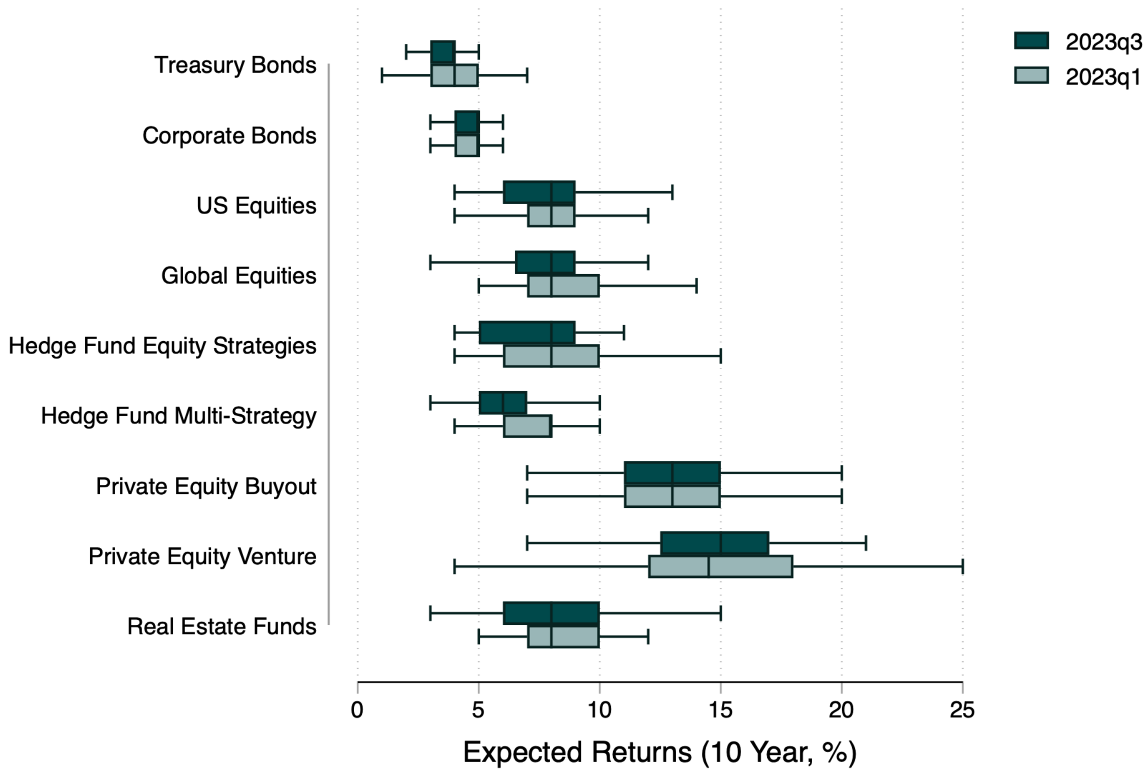
Long-term growth

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, respondents vary across survey rounds, so some of the differences in the results may be due to sample variations. In all survey rounds, expectations are more consistent for the likely long-run performance of most asset classes, with substantial and persistent dispersion, especially around the highest expected performance opportunities.

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, Q1 2023 vs. Q3 2023



Source: Addepar

Risk and hedging

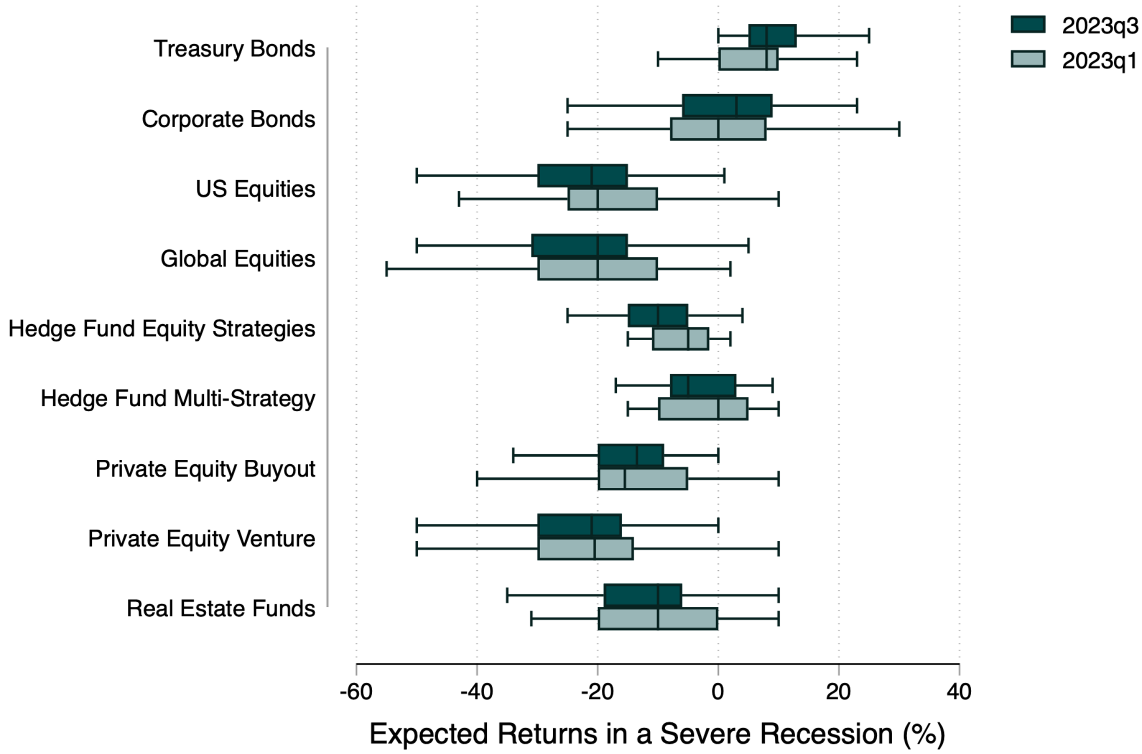
In each survey round, we asked respondents about their expectations of asset-class performance in a severe recession (Exhibit 3). This gives a sense of respondents' potential downside risk and diversification expectations across asset classes. Respondents continue to expect bonds to provide the best diversification benefit[1].

[1] Note that different managers responded to each round of the survey. Therefore, small changes in the distributions reflect even greater agreement by investors.

Exhibit 3

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

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



Source: Addepar

Macroeconomic outlook

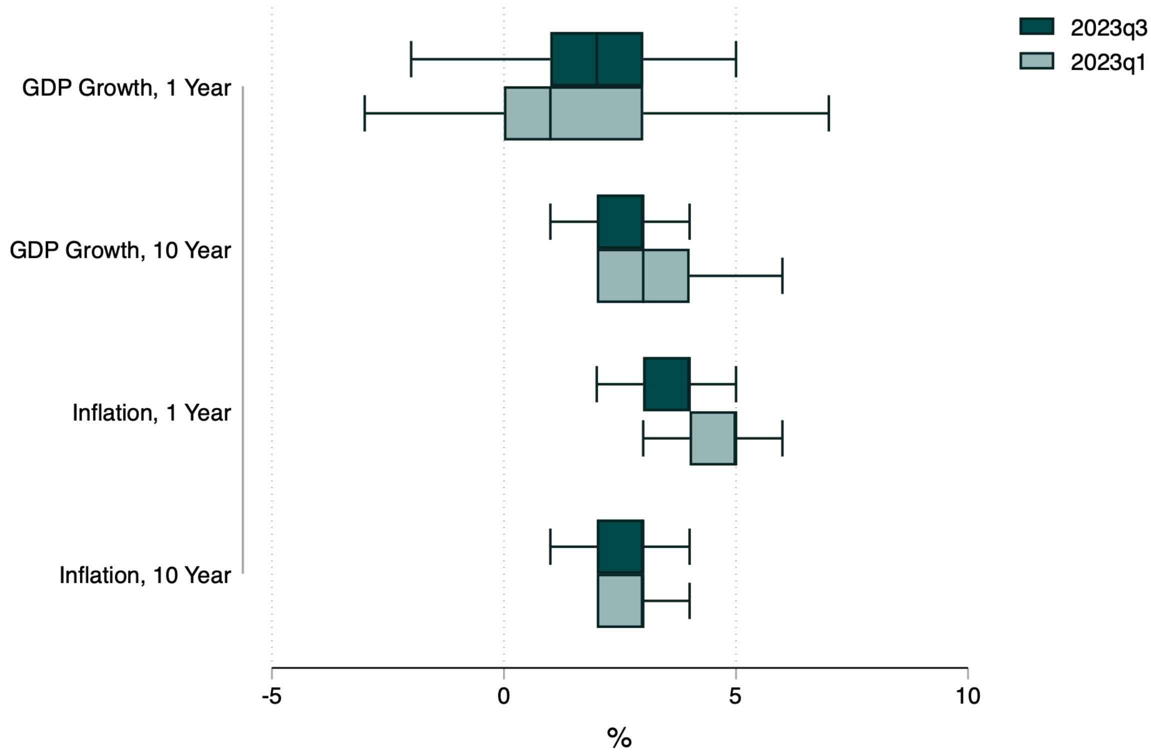
Per Exhibit 4, expectations of nominal GDP growth reflect continuing resolution of downside risk over the next year, as respondents anticipate nominal GDP growth of between one and three percent. Inflation expectations have continued to moderate to between three and four percent. Relative to earlier survey rounds, there's less dispersion in expectations for short-term nominal GDP.

For nominal GDP growth, we see a continued pattern of greater dispersion over expectations for the near term versus the long term. Over the next 10 years, respondents expect growth to remain stable and inflation to return to a slightly lower level, between two and three percent. Interestingly, the market is pricing inflation (break-even inflation or the difference between nominal and TIPS yields) to normalize at 2.4%, and inflation expectations of survey respondents align well with this.

Exhibit 4

Investors have more upbeat growth and cooler inflation expectations compared to Q1 2023

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



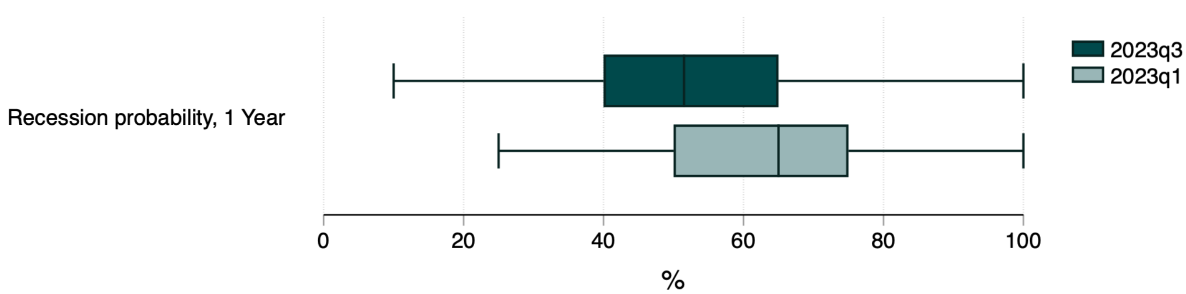
Source: Addepar

As shown in Exhibit 5 below, median recession expectations have cooled from 65% in Q1 2023 to 50.5% in Q3. This is consistent with slightly more optimism regarding economic growth, as demonstrated in Exhibit 4.

Exhibit 5

Median recession expectations have cooled from 65% to 50.5%

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



Source: Addepar

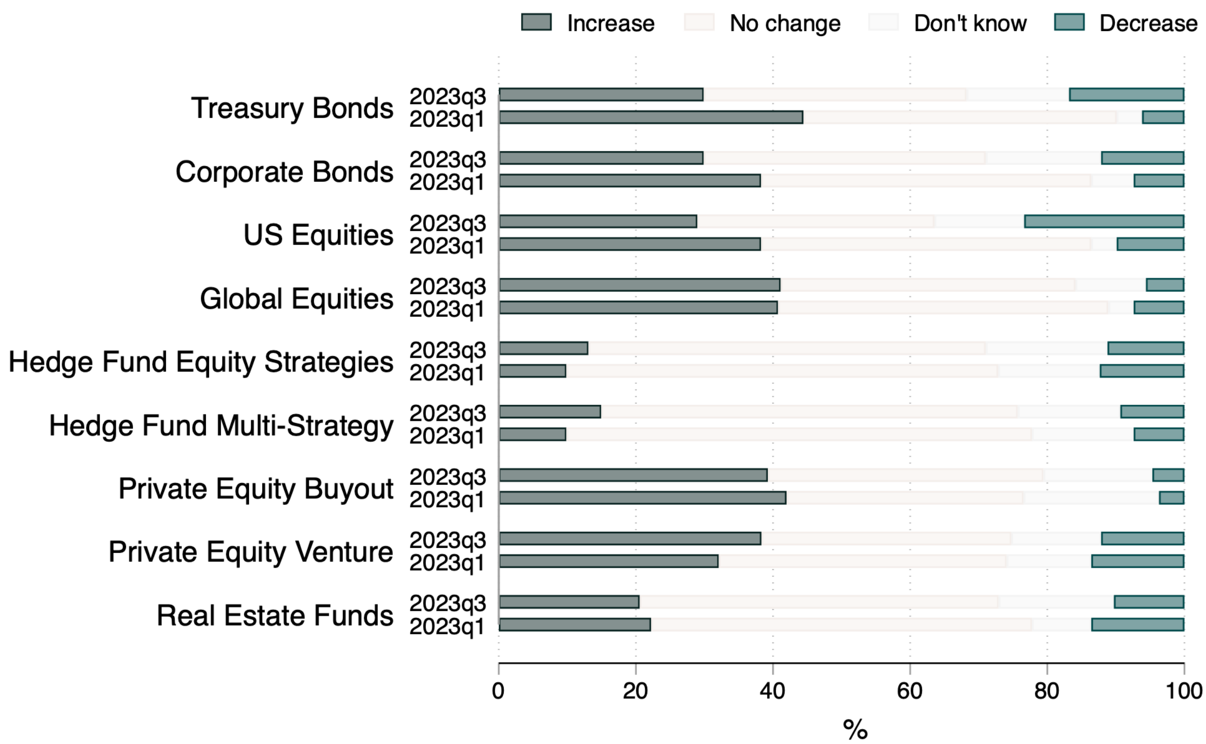
Planned portfolio changes

Exhibit 6 shows that more respondents plan to increase their portfolio allocations in many asset classes, including bonds, public equities and private equity. Relative to Q1, slightly more respondents plan to decrease their allocations to bonds and U.S. equities. However, fewer investors plan to change their allocations to hedge funds and real estate.

Exhibit 6

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, Q1 2023 vs. Q3 2023



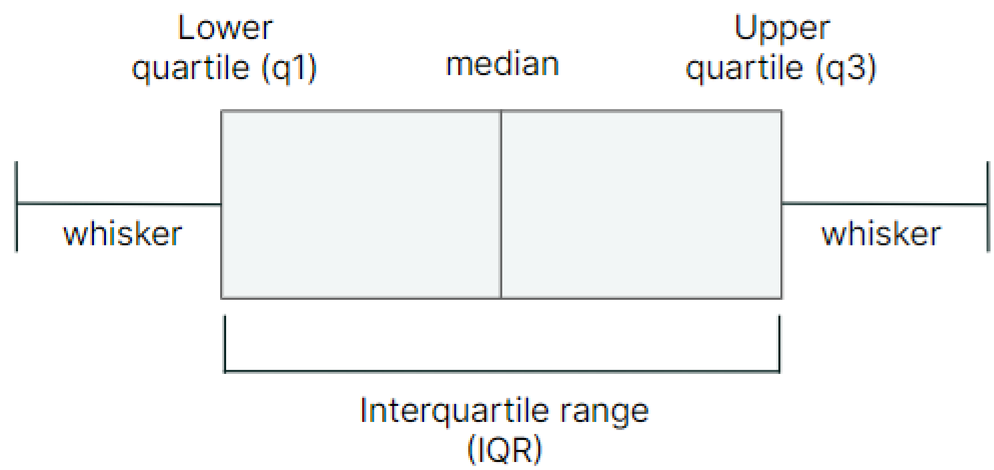
Source: Addepar

Conclusion

We'll continue to run the Capital Market Assumptions survey on a periodic basis. 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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