



# FIVE-YEAR MARKET OUTLOOK

## THE MARKETS ARE RUNNING A MARATHON, NOT A SPRINT

Advisors face headwinds in today’s market environment and we do not see that changing over the next five years. Getting asset allocation “right” and unhinging client complacency will be paramount in achieving your critically important investment objectives. Our latest five-year market outlook can serve as a useful reference as you tackle strategic portfolio construction decisions.

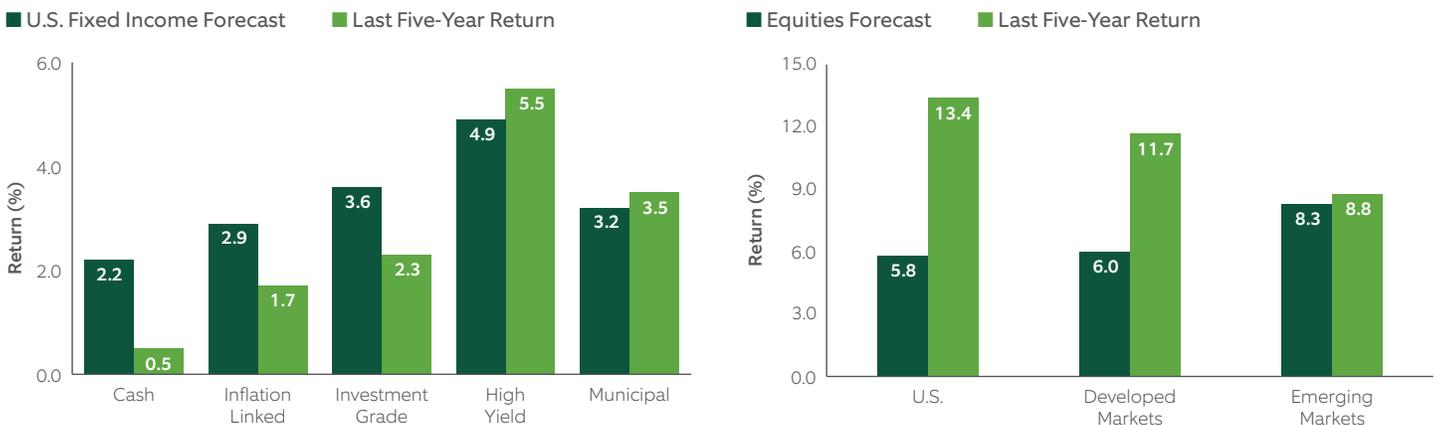
We see good-but-not-great returns from equities and low-but-positive fixed income returns over the next five years. This is in sharp contrast to the last five years when equities broadly posted double digit returns (see Exhibit 1).

Interest rates should remain low and below investor expectations, with inflation continuing to be held in check by the same structural forces, including technology, that have kept it muted for years. Advisors will likely continue to face challenges generating meaningful yield in this environment, so high yield fixed income or lower-volatility dividend-focused equity strategies remain attractive options.

While the search for yield and elevated global equity valuations will persist, a greater focus on risk budgeting may require advisors to expect more active return contributions from their core risk assets.

Advisors must also be aware of macroeconomic risks that could negatively affect returns, increase market volatility and cause client anxiety. Two key strategic themes are driving this outlook — **Mild Growth Myopia** and **Stuckflation**.

**EXHIBIT 1: FIVE-YEAR FORECASTS AND LAST FIVE-YEAR RETURNS**



Source: Northern Trust. Forecasts listed here represent total return forecasts for primary asset classes, annualized using geometric averages. Forecast returns are based on estimates and reflect subjective judgments and assumptions. They are not necessarily indicative of future performance, which could differ substantially. Returns are annualized for the five-year period ending 6/30/2018.

# U.S. GROWTH: LOW AND SLOW

The economic slowdown has caused investors to worry that a recession is coming, but we think this is a case of **Mild Growth Myopia**. The economy is pacing itself for a prolonged — but slow — expansion.

Our theme discusses how the current U.S. economic expansion, although weaker than previous growth periods, should continue due to recent tax cuts and other economic drivers. While this continued growth does heighten the odds of a recession,

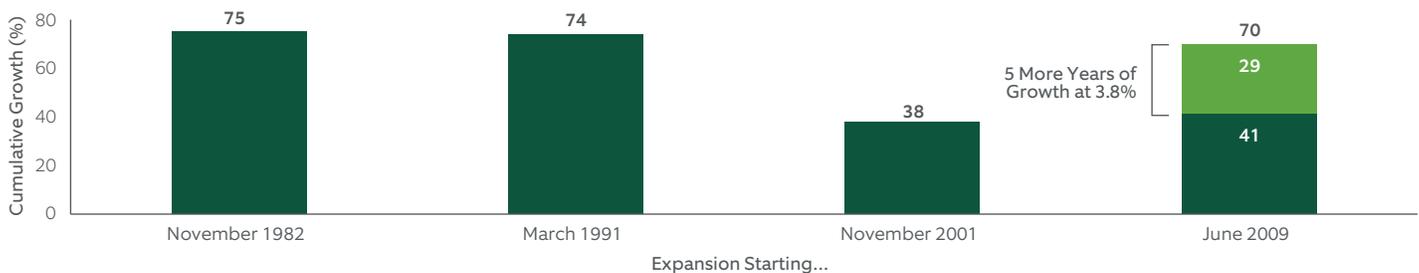
the mild growth rate tempers our concern of a recession in the short term.

As shown in Exhibit 2, even if the U.S. grew at our expected nominal growth rate of 3.8% for five more years, the cumulative growth would still be less than the boom in 1982 and 1991.

**The Bottom Line:** Subdued economic cycles and stronger financial systems will push out the next recession and limit its severity. We think this bull market has room to run.

## EXHIBIT 2: RECORD-BREAKING EXPANSION LENGTH, BUT NOT MAGNITUDE

*Even with five more years of growth, total output will still be shy of the expansions of the '80s and '90s.*



Source: Northern Trust Global Asset Allocation, Bloomberg.

# THE FED MUST NOT FAIL

Without a template for policy normalization, central banks' efforts cannot be graded — other than they must not fail. The **Pass/Fail Monetarism** theme calls for interest rates to remain stable and low near term, which should moderate portfolio volatility.

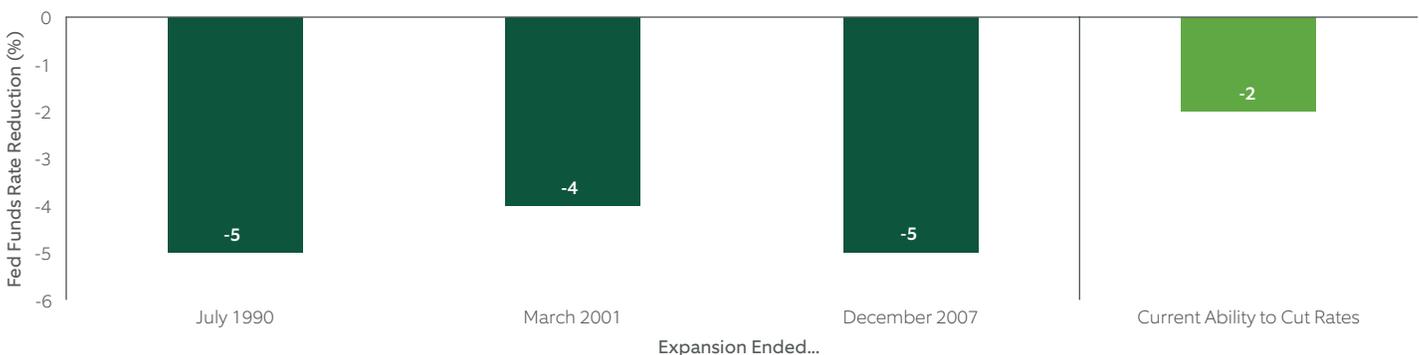
This will most likely be the result of central banks focusing on protecting economic expansion through small and infrequent rate hikes, or even rate cuts should recessionary pressures build.

Unfortunately, central banks have little room to cut rates, as shown in Exhibit 3.

**The Bottom Line:** If the Fed makes a mistake (or "fails") in managing the economy, capital markets and portfolio volatility could rise. This would prove problematic to complacent client portfolios that have run up an over-allocation to risk assets in recent years.

## EXHIBIT 3: LESS ROOM FOR MANEUVERING

*Current Fed policy is 2% from zero — just half of the normal Fed easing cycle.*



Source: Northern Trust Global Asset Allocation, Bloomberg. Data from 12/31/1989 to 6/30/2018.

# FINAL THOUGHT: BE PROACTIVE AND NIMBLE

Over the next five-years advisors will need to be proactive with their risk budgets to ensure necessary diversification and nimble across asset classes to appropriately address client income and return objectives..

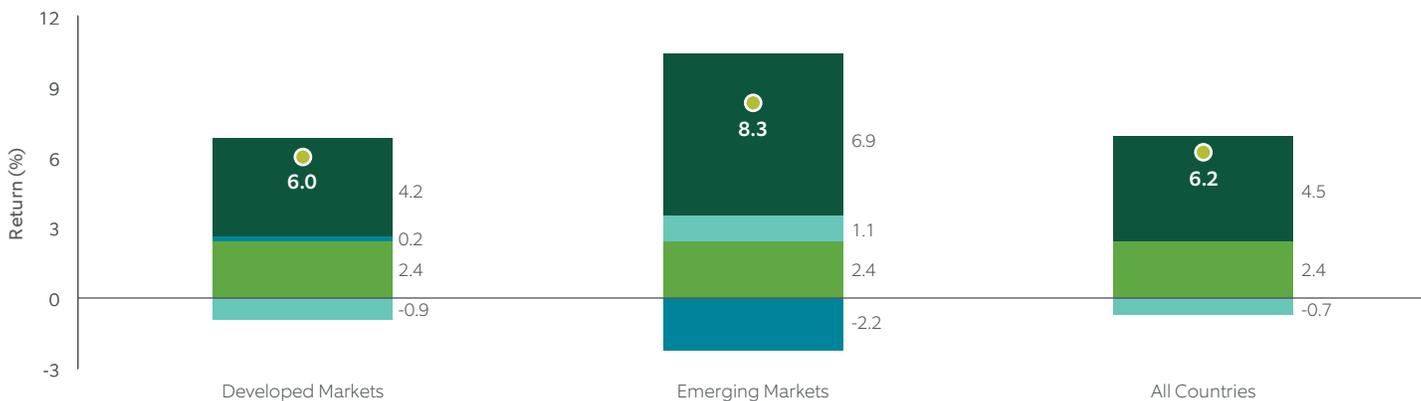
We believe slow growth will persist and fuel high single-digit returns in equities globally, with only slight valuation contraction

in developed market returns and valuation expansion in emerging markets (see Exhibit 4).

Overall these remain attractive core risk assets to potentially garner a return “boost” and potentially higher yields that may still be hard to come by in the fixed income market.

## EXHIBIT 4: HIGH LEVEL EQUITY RETURN BUILDING BLOCKS

■ Revenue Growth ■ Dividend Yield ■ Valuations ■ Profit Translation ■ Total Return



Source: Northern Trust Global Asset Allocation.

### Explore Our Full Five-Year Outlook

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- Gain valuable insights from our investment experts
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<sup>1</sup> Assets under management were \$972 billion as of September 30, 2018.

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