

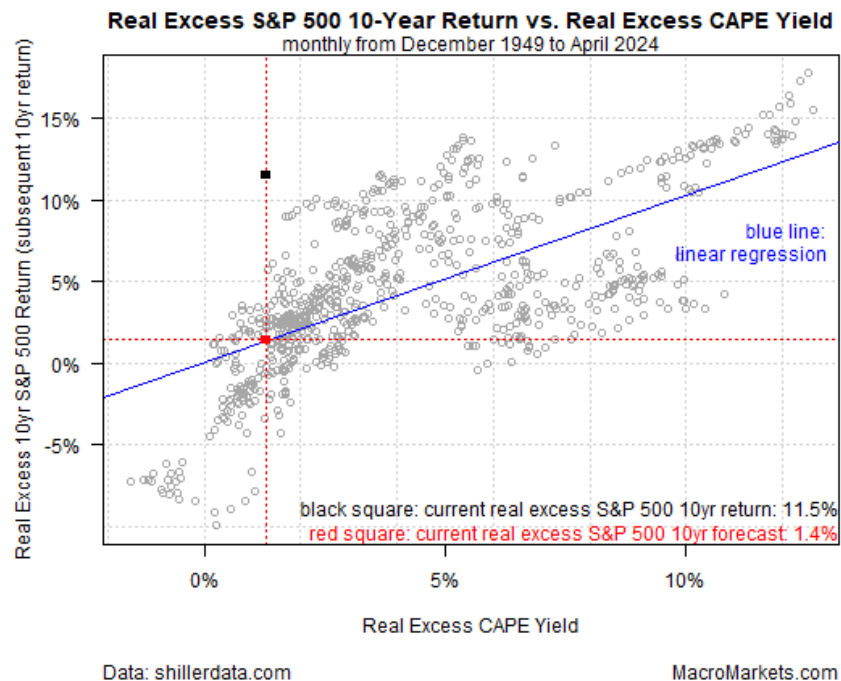


S&P 500 10-Year Real Excess Return Forecast Near Lowest Level In Over 70 Years

Key Points:

- *The outlook for the stock market's inflation-adjusted (real) 10-year excess return (equities less bonds) is near the lowest level for the past 70-plus years.¹*
- *Although there's no guarantee that the model's forecast will be correct, the ex ante estimate suggests that performance for the US stock market will be conspicuously lower over the next decade compared with the past 10 years.*
- *A key factor in the model's relatively low equity market forecast is linked to the dramatic rise in rolling 10-year performance numbers for the S&P 500 in recent years compared with its long-run history.*

Ben Graham, the father of modern securities analysis, famously observed: "In the short run, the market is a voting machine, but in the long run, it is a weighing machine." By that he meant that the collective mood (driven by emotion, speculation, rumor and other transitory factors) dominates market behavior in the short run. By contrast, over longer periods, the crowd tends to price securities in line with fundamentals, such as earnings, cash flow and other factors that determine the true worth of equities. As a result, periodically evaluating the stock market's outlook via fundamentals is a practical tool for developing strategic perspective on asset allocation and other aspects of portfolio design and management. On that basis, a review of current conditions implies that US equities face stronger headwinds relative to recent history.



Using a regression model that compares the real excess CAPE yield against the real excess 10-year S&P 500 return implies that the US stock market will earn a relatively modest premium over its equivalent for US bonds in the decade ahead.² The current 1.4% annualized real excess return forecast equates with the 15th percentile vs. realized

performance in the post-World War II era. Note, too, that the realized 10-year real excess return for the S&P (through April 2024) is dramatically higher at 11.5%, a risk factor of its own vis-à-vis reversion to the mean dynamics.

Although caution is always warranted for estimating future market returns, the combination of a comparatively low point forecast and an unusually wide gap between current realized performance and the current ex ante outlook suggests that expectations for US stocks should be trimmed relative to the past decade.

¹ The real excess S&P 500 annualized return is based on calculations published at shillerdata.com, a web site run by Robert Shiller, a professor of economics at Yale University. The data reflects real performance of the S&P 500 Index less the equivalent for US bonds.

² The excess CAPE Yield (ECY) is calculated as the CAPE yield less the real US 10-year Treasury yield. CAPE (cyclically adjusted price-to-earnings ratio), a.k.a. the Shiller P/E, is defined as the S&P 500 Index divided by the average of ten years of earnings and adjusting for inflation (Consumer Price Index).

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