THE NEXT 10 YEARS: POSITIONED DIFFERENTLY TO MAKE A DIFFERENCE

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Part 1: The Challenge Ahead

As we approach the final stretch of 2024, Wall Street firms are busy releasing their outlooks for the coming year and updating long-term forecasts.

While the consensus forecast for annualized stock returns in the next ten years still hovers around +11%—down from last decade's actual +13% but nonetheless signaling robust growth—a newly publicized forecast with a baseline of just +3% stands out, raising a cautionary yellow flag [1].

In our practice, we expect that as more outlooks are updated, the consensus will likely drift toward low single-digit figures, and there are compelling reasons for this adjustment:

Several key metrics for the US equity market appear to be at exalted levels, which historically have signaled downward corrections ahead. These include strained valuations (the S&P 500's Cyclically Adjusted Price-to-Earnings/CAPE stands at 38), extreme market concentration (the ten largest stocks make up a record 36% of S&P 500's capitalization), high household exposure to stocks (approaching 50%, the all-time high seen just before the dot.com collapse), and meager excess stock yields over Treasuries (already below 2% and trending toward zero).

While we acknowledge the compelling historical perspective, we strongly disagree with Wall Street's growing pessimism and, above all, its conventional guidance.

In response to lower forecasts, traditional advice calls for portfolios to downshift their 'strategic' positioning, migrating to lower stock allocations coupled with higher allocations to bonds, cash and, perhaps, 'alternatives.'

We disagree.

As I explain below, we view such a long(er)-range, 'strategic' downshift to be fanciful at best and mal-adaptive at worst.

To start, the historical record of long-range forecasts is checkered, to say the least—the 'lost decade' of the 2000s would be a mere footnote if the consensus had foreseen it—and the penalties for mispositioning over such an extended period can be steep.

But there is an even more critical reason to question conventional guidance, as we explore in Part 2.

Part 2: Adaptive Navigation, Not Strategic Re-Allocation

In Part 1, we surveyed the gathering evidence suggesting the next ten years could deliver depressed overall returns [1]. While we believe that forecasting is inherently unreliable, we also see a fundamental flaw in the conventional approach that advises investors to migrate to a lower-exposure 'strategic asset allocation.'

As market history teaches us, long-term average returns are built from clusters of quarterly and even annual returns that differ widely from the overall average. For our market-adaptive and risk-controlled strategies this insight is invaluable:

Historically, 10-yr. annualized inflation-adjusted returns have hovered around 3% only during three distinct periods—the Great Depression of the 1930s (+0.3%), the Great Stagflation of the 1970s (-1.0%), and the Lost Decade of the 2000s culminating in the Great Financial Crisis of 2008+ (-6.1%). While these periods saw poor 10-yr. annualized returns, each also contained sustained S&P 500 advances that extended beyond mere fleeting 'market timing' episodes and provided substantial opportunities for market-adaptive strategies—such as the +140% 1933-1938, the +260% 1975-1980, and the +81% 2003-2007 gains [2].

As we have noted elsewhere [3], these statistics reveal the unmistakable dynamic of lost decades. Such periods are driven by *market regime* transitions—large-scale pendulum swings, expansive both in time and scope, between sustained bullish and bearish orientations. Sometimes, these periods begin with a 'melt-up' rally (1990+) or a sideways glum (1960+), leading into a bear collapse that eventually bottoms out before the explosive onset of the next bull market regime. In other cases, the collapse comes first (1930's), followed by the robust emergence of a new bullish regime.

So, what are investors supposed to do?

Conventional guidance suggests 'trimming the sails' in advance by shifting portfolios to a lower-exposure 'strategic asset allocation' in anticipation of unfavorable long-term returns—a typical approach for large institutional funds.

We see this as a mal-adaptive, wasteful stance. Poor average long(er)-term returns obscure the reality of cycles of sustained advances and declines that, while offsetting each other in aggregate, create ample growth opportunities for market-adaptive and risk-controlled strategies like ours, which are engineered to navigate market-regime shifts.

Will the next ten years be challenging? We say, good—bring it on. Our strategies specialize in tracking and adapting to market regime shifts.

[1] GS, Global Strategy Paper (10/18/2024)

[2] R. Shiller/Yale online Database; A. Damodaran/NYU data library; YCharts; RWM.

[3] https://fa.wellsfargoadvisors.com/gnh-capital-group/mediahandler/media/455234/GNH%20Capital%20Group%20-%20Our%20Offering.pdf