BLOG POST
Capital Market Assumptions
12/21/2020

For the past 25 years, JP Morgan has published their annual capital market assumptions about potential returns for major asset classes and their overall economic outlook over the foreseeable future. While there is no crystal ball – nobody knows the future, obviously – we find their forecast report thoroughly researched and insightful. Below are excerpts from JP Morgan's most recent report with additional comments. The full report is available to the public at the following address: https://am.jpmorgan.com/us/en/asset-management/institutional/insights/portfolio-insights/ltcma/.

Macro-Economic Assumptions:

From JPM: The macroeconomic forecasts underlying our annual asset class assumptions grapple this year with the changes wrought by the global pandemic, the long-term impacts of which are not yet clear. Given that the coronavirus recession depressed economic starting points, we add a small cyclical bonus to most growth projections.

Our 2021 assumptions anticipate slow real GDP growth globally, with little change to trend assumptions but small cyclical bonuses applied to several economies

EXHIBIT 1: MACROECONOMIC ASSUMPTIONS (%)

	Real GDP			Inflation		
	2021	2020	Change	2021	2020	Change
DEVELOPED MARKETS	1.6	1.5	0.1	1.6	1.6	0.0
United States	1.8	1.8	0.0	2.0	2.0	0.0
Euro area	1.3	1.2	0.1	1.3	1.3	0.0
Japan	1.0	0.6	0.4	0.7	0.8	-0.1
United Kingdom	1.6	1.2	0.4	2.0	2.0	0.0
Canada	1.7	1.6	0.1	1.8	1.8	0.0
Australia	2.4	2.2	0.2	2.3	2.3	0.0
Sweden	2.0	1.7	0.3	1.6	1.6	0.0
Switzerland	1.5	1.1	0.4	0.5	0.5	0.0
EMERGING MARKETS	3.9	3.9	0.0	3.3	3.3	0.0
China	4.4	4.4	0.0	2.5	2.5	0.0
India	6.9	7.0	-0.1	5.0	5.0	0.0
Brazil	2.4	2.4	0.0	4.3	4.5	-0.2
Russia	1.1	1.2	-0.1	5.3	5.5	-0.2
Korea	2.1	2.2	-0.1	1.8	2.0	-0.2
Taiwan	1.6	1.6	0.0	1.0	1.1	-0.1
Mexico	2.5	2.2	0.3	3.7	3.7	0.0
South Africa	2.5	2.2	0.3	5.3	5.3	0.0
Turkey	3.1	3.0	0.1	8.5	8.0	0.5
GLOBAL	2.4	2.3	0.1	2.2	2.2	0.0

Source: J.P. Morgan Asset Management; estimates as of September 30, 2020. Emerging markets aggregate derived from nine-country sample.

Based on JPM's GDP and inflation assumptions (see table above), we generally see GDP growth over the next year across developed countries at less than 2%, except for Australia. Japan is the laggard at 1% projected GDP growth while the U.S. is estimated at 1.8%. Meanwhile, GDP growth across emerging markets is projected at 3.9%. Inflation expectations remain largely unchanged.

From JPM: Our inflation forecasts have not moved much this year, but we see notably more uncertainty than historically around the long-term outlook. On the one hand, the creation of significant slack in most economies, at a time when central banks had been persistently missing their targets, points to the risk that inflation expectations become unanchored to the low side. At the same time, some of the forces that generated that extended period of disinflation may now be diminishing – and we see new possible factors that may drive inflation upward. As a result, we find noteworthy tail risks on both sides of our projections.

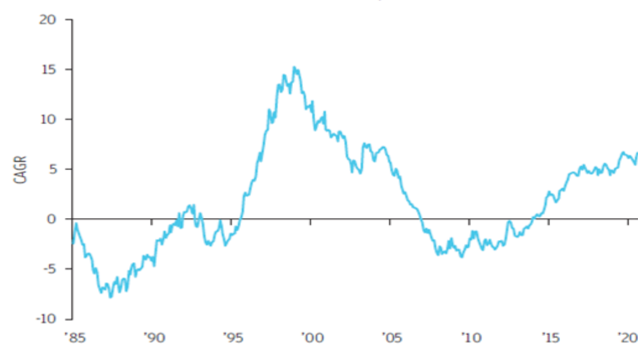
While the expected rate of inflation remains unchanged, there is heightened uncertainty around the estimate. Could 2021 be the year where the combined effects of prolonged monetary easing and fiscal spending finally push inflation higher, or does sluggish economic growth keep inflation under wraps? According to JPM, it's not worthwhile to make an investment decision based inflation forecasts, at least for now.

Asset Class Return Assumptions:

(Fixed Income) From JPM: We foresee three phases for major economy government bonds: In the first phase, we expect stable risk-adjusted returns for government bonds. In the second phase, we see capital depreciation as yields rise; in the third phase, as equilibrium yields are reached, we expect core fixed income returns to improve and return to a positive level.

We might experience stable returns from government bonds in the near-term, until we reach a point where yields normalize somewhat (perhaps 2-3 years from now). An increase in yields would push bond prices lower in the short run, but would ultimately make government bonds a more attractive asset class. Bear in mind that any run up in yields will be closely followed by the Fed.

(Equities) From JPM: We lower our long-term (10- to 15-year) equity return assumptions across most regions, with developed markets and emerging markets both down year-over-year. The projected gap in returns between emerging and developed equities compresses to 2.30% in U.S. dollar terms.



Source: Datastream; data as of August 2, 2020.
CAGR = Compound annual growth rate.

Overall, JPM expects lower forward returns across equities in the near-term given current valuations (which are high based on historical measures). Likewise, they expect that the outperformance of U.S. equites over developed international markets could be coming to an end.