Expect slow growth over next decade: Vanguard

By Editor Test *Mon, Dec 19, 2011*

The fact that 10-year Treasury rates are only about 2% indicates the market's belief that the U.S. economy will grow slowly over the next decade, Vanguard pointed out.

Annual returns from a 50/50 equity/bond portfolio are likely to average between 4.5% and 6.5% in nominal terms and 3.5% to 4.5% in real terms over the next decade or so, according to forecasts in a November research brief from Vanguard.

Such returns would be below the historical average since 1926, (8.2% nominal, 5.1% real), but higher than in the past ten years in either the US or Japan. The estimate was based on Vanguard's proprietary Capital Markets Model, as of September 30, 2011.

The fact that 10-year Treasury rates are only about 2% indicates the market's belief that the U.S. economy will grow slowly over the next decade, Vanguard pointed out. Even if growth picks up and interest rates rise, bond prices will fall, hurting the returns of bondholders.

"But the future need not be dark, either," Vanguard's economics say. "Indeed, the present levels of interest rates and stock market valuations are arguably closer to the levels of the 1950s and 1960s, environments that over time produced respectable balanced portfolio returns.

"… We believe that realistically recalibrating one's return expectations for a balanced portfolio is more prudent than making a drastic shift in allocation in an attempt either to defend against elevated market volatility or to pursue higher returns under the allure of higher yields, higher economic growth, or alternative investments," they wrote.

"Investors who are unwilling or unable to lower their targeted rates of return or spending requirements may need to increase their savings rates—an approach that Vanguard research has shown can be quite effective in raising the odds of investment success.

"An alternative approach, for investors who feel locked to their return or spending targets, would be to adopt a somewhat more aggressive strategic asset allocation by increasing their holdings of equities. Of course, a direct result of this approach would be for the investor to bear higher portfolio volatility and greater downside risk.

To forecast U.S. bond market returns, Vanguard used the Standard & Poor's High Grade Corporate Index from 1926 to 1968, the Citigroup High Grade Index from 1969 to 1972, the Lehman Brothers U.S. Long Credit AA Index from 1973 to 1975, and the Barclays Capital U.S. Aggregate Bond Index thereafter.

For U.S. stock market returns, Vanguard used the S&P 90 from 1926 to March 3, 1957; the S&P 500 Index from March 4, 1957, to 1974; the Dow Jones Wilshire 5000 Index from 1975 to April 22, 2005; and the MSCI US Broad Market Index thereafter. For international stock market returns, Vanguard used the MSCI

EAFE Index from 1970 through 1988, and a blend of 75% MSCI EAFE Index and 25% MSCI Emerging Markets Index thereafter.