Research Institute

DWS Long View

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Marketing material

Long View Q4

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- Return forecasts for the next decade are modestly higher versus the end of Q3, with fixed income and rate-sensitive asset classes experiencing the most positive quarter-over-quarter changes
- A marginally higher annual return forecast across global equities is reflective of a slight increase in global growth estimates (driven by the US) and less challenging valuations in Europe. Our strategic return outlook for European equities now exceeds the US by roughly 65bps per annum.
- Within fixed income, the strategic outlook for US credit markets has increased, reflecting higher long-term yields we saw during Q4. Notably, this has pushed the forecast for US High Yield back in line with US equities.
- Return forecasts across alternatives are largely unchanged with the exception of REITs whose attractiveness has increased primarily because of 40-50bps higher dividend yields.

Summary

In this report, we present the DWS long-term capital market assumptions for major asset classes as of the end of 2024 while exploring the risks to these forecasts.

Throughout the fourth quarter of 2024, global equity markets experienced some choppiness, driven by concerns around Fed policy but bolstered by continued resilient earnings growth. Despite the volatility, the MSCI All Country World (“ACWI”) index was down just -1.0% for the quarter. Over the same period, the S&P 500 returned 2.4%, while international developed markets and emerging markets were down -8.1% and -8.0%, respectively, driven predominantly by weakness in non-dollar currencies. In local currency terms, MSCI EAFE was down just -0.4%, while MSCI Emerging Markets returned -4.4% for Q4.

Global fixed income markets experienced a somewhat challenging quarter, as US sovereign bond yields in particular repriced higher in anticipation of potentially more stubborn inflation stemming from global trade tariff policy. For the quarter, the 10-year US Treasury yield increased by 79bps (from 3.79% to 4.57%), resulting in the Bloomberg US Aggregate Bond Index and the Bloomberg US Treasury Index each returning -3.1%. Alternatively, the Bloomberg Global Aggregate Bond Index was down a more modest -1.0%. Across the credit complex, modest tightening in credit spreads helped to alleviate some of the move higher in interest rates. The shorter duration, most spread-driven Bloomberg US High Yield Bond Index was modestly positive for the quarter, returning 0.2%, while the longer-duration, higher quality Bloomberg US Corporate Bond Index returned -3.0%.

Heading into 2025, questions still remain around government policy and its potential to impact inflation, and by extension, interest rates. Optimism around the transformative impact of Artificial Intelligence remains firm; however, investors are becoming increasingly concerned about the risk concentration and demanding valuations among the Magnificent 7 stocks. Looking at the long-term outlook, global equities face a potentially more difficult decade relative to the lofty return experience of the previous decade. In fixed income, despite higher inflation levels and tight credit spreads, sovereign bond yields provide increasingly favorable starting income levels for strategic investors.

Our models now forecast an annual local currency return of 5.9% for the MSCI All Country World Index (“ACWI”) over the next decade, versus 5.7% three months prior as well as an increase for the Global Aggregate Bond Index from 3.2% to 3.7%. At an aggregate level, we estimate the forecasted rate of return on a diversified portfolio at 5.6%*, up from 5.2% at the end of Q3.

*Source: Bloomberg as of 31 December 2024. DWS Calculations for a strategic asset allocation that targets volatility of 10%.

Table 1: DWS Ten-year annualized forecasted local currency returns

	As of 31 Dec 2024	Δ since 30 Sep 2024
MSCI ACWI	5.8%	0.2%
MSCI World	5.8%	0.2%
MSCI Emerging Markets	5.9%	-0.1%
S&P 500	5.9%	0.2%
MSCI Europe	6.6%	0.4%
MSCI Germany	4.8%	0.0%
MSCI UK	8.1%	0.2%
MSCI Japan	4.4%	0.1%
Bloomberg Barclays Euro Treasury	2.6%	0.2%
Bloomberg Barclays Euro Aggregate Corporate	3.2%	0.0%
Bloomberg Barclays Pan-European High Yield	4.6%	-0.1%
Bloomberg Barclays US Treasury	4.4%	0.7%
Bloomberg Barclays US Corporate	5.1%	0.6%
Bloomberg Barclays US High Yield	5.9%	0.5%
Bloomberg Barclays Emerging Markets USD Sovereign	6.7%	0.3%
S&P Developed REIT	4.7%	0.6%
S&P USA REIT	5.1%	0.6%
DJ Brookfield Global Infra. Equity	7.1%	0.1%
DJ Brookfield US Infra. Equity	7.0%	0.0%
NFI-ODCE Value Weighted US Private Real Estate Equity	4.7%	-0.1%
EDHEC Infrastructure 300 EW Equity	13.6%	0.3%
Private Infra (EDHEC Private Infra 300 Equity)	3.2%	0.0%
Private (Markit iBoxx EUR Infrastructure)	4.6%	0.2%
Bloomberg All Hedge Fund	5.3%	0.0%
Bloomberg Commodity	4.5%	-0.2%

Source: DWS Investments UK Limited. 10Y Forecast as of 31 December 2024. Due to various risks, uncertainties and assumptions made in our analysis, actual events or results or the actual performance of the markets covered may differ materially from those described.
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1 / Long View Forecasts

1.1 Equity Forecasts

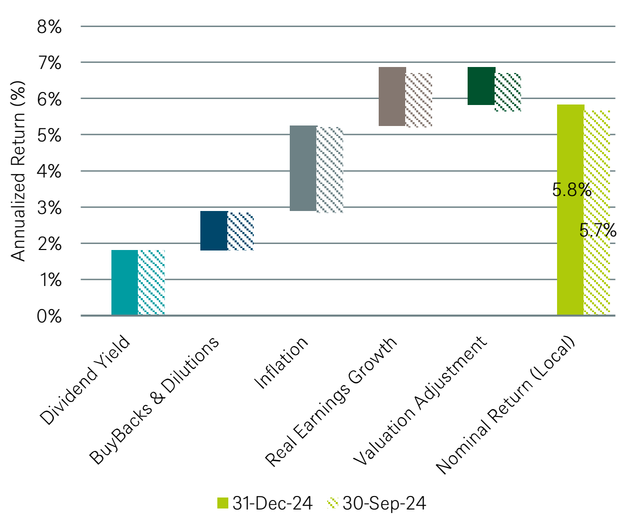
For our equity return forecasts, Figure 2 illustrates the changes to our return pillars for our 10-year MSCI All Country World ("ACWI") local currency return forecast. Forecasted returns for global equities were relatively unchanged, increasing to 5.8% from 5.7% at the end of September. Incrementally higher buybacks and dilutions, inflation, and real earnings growth were the drivers of the small increase in return forecasts, while the valuation adjustment component continues to be a modest drag on the strategic return outlook, potentiallyequating to about -1.0% per annum in return contribution.

Figure 1: Pillar decomposition for equities

Income		Growth		Valuation
Dividend yield	Buybacks & dilutions	Inflation	Earnings growth	Valuation adjustment

Source: DWS Investments UK Limited.

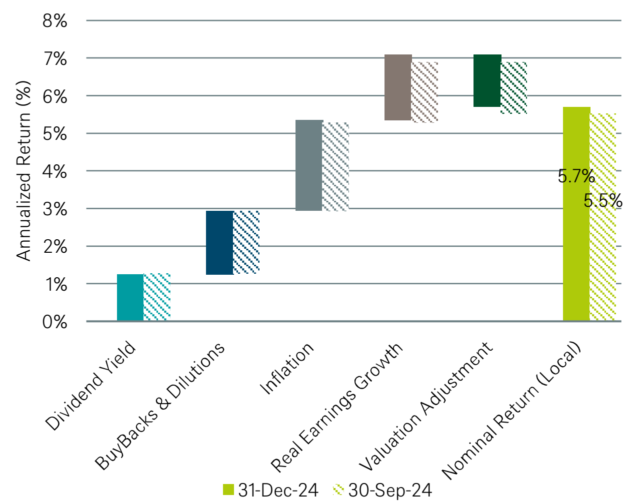
Figure 2: MSCI All Country World: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

Our US equity forecasts are also marginally higher relative to the end of September. Similarly to MSCI ACWI, the 10-year return forecasts for MSCI USA increased marginally from 5.5% to 5.7%, primarily driven by the real earnings growth going from 1.6% to 1.8%, as shown in Figure 3.

Figure 3: MSCI USA: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

1.2 Liquid Real Assets Forecasts

While REITs and Infrastructure both leverage very similar pillars to equities (see Figure 4), returns are derived largely from income via dividend distributions as shown in Figure 5 and Figure 6.

Figure 4: Pillar decomposition for REITs and Infrastructure

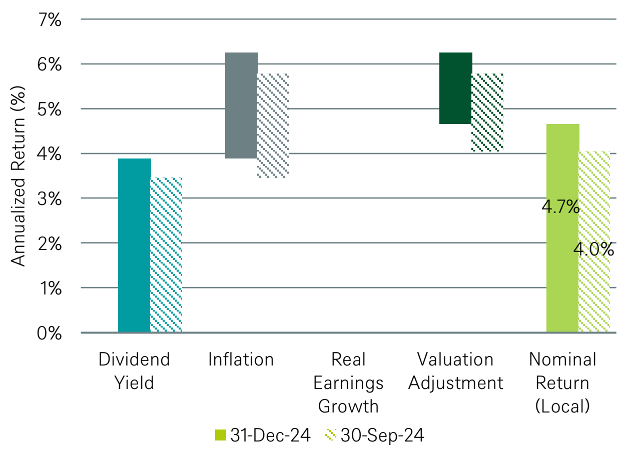
Asset Class	Income	Growth		Valuation
Listed real estate equity	Dividend yield	Inflation		Valuation adjustment
Listed infrastructure	Dividend yield	Inflation	Earnings growth	Valuation adjustment

Source: DWS Investments UK Limited.

Across liquid real assets, our return forecasts are within a reasonable range as compared to traditional markets. Global REIT returns are expected to provide less incremental yield spread given higher real interest rates while our Infrastructure equity outlook provides a potential return outlook modestly above traditional public equity markets.

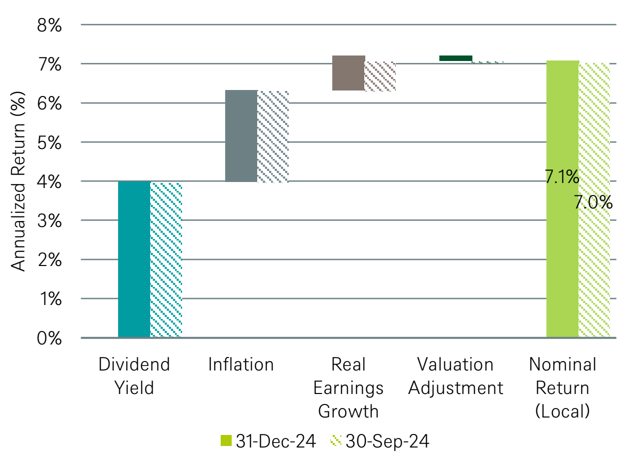
Relative to the previous quarter, our 10-year return forecast for Global REITs increased from 4.0% to 4.7%, reflecting higher dividend yield contribution (3.9% versus 3.5% at the end of Q4). Global Infrastructure forecasted returns increased marginally from 7.0% to 7.1%, reflecting an increase in real earning growth from 0.8% to 0.9%.

Figure 5: Global REITs: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

Figure 6: Global Infrastructure: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

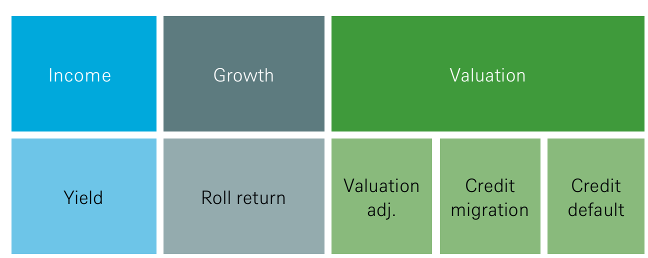
1.3 Fixed Income Forecasts

Global bond yields moved higher in Q4 driven by concerns around the inflationary implications of impending US tariff policy amid the political transition. Throughout the quarter, the 10-year US Treasury yield moved higher by 79bps from 3.78% to 4.57%, with the majority of the yield move driven by an increase in the 10-year real yield of 63bps as inflation risk premia reentered the picture as a significant macroeconomic risk driver

The short end of the US Treasury also experienced a significant selloff, with the 2-year US Treasury yield moving from 3.64% to 4.24% over the course of Q4. As economic growth fears became more subdued and inflationary risks became the dominant macro driver, market pricing of Fed rate cuts changed dramatically, with the December 2024 Fed Funds future contract pricing in 3.91% as of the end of December yield versus 2.96% just 3 months prior.

This selloff in US Treasury yields further tightens the interest rate component of financial conditions for borrowers, reflecting a potential headwind for domestic and global economies as the reality of sustained higher real and nominal borrowing rates contrast with the much easier monetary outlook from the summer of last year. Conversely, fixed income investors face a more sanguine strategic outlook, both in absolute terms and relative to equities, than they have in well over a decade. The net effect of the move higher in interest rates is reflected in higher yield contributions to our strategic return outlook for sovereign bonds. Starting yield is by far the most important driver of return contribution in our building blocks shown in Figure 7.

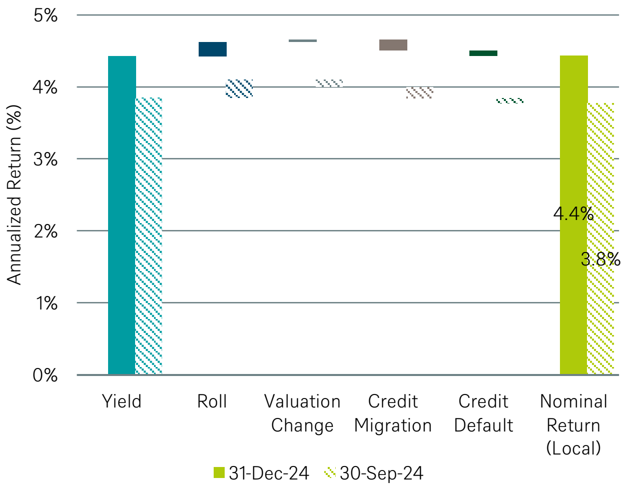
Figure 7: Pillar decomposition for Fixed Income



Source: DWS Investments UK Limited.

The 79bps move higher in the 10-year US Treasury yield in Q4 increased yield contribution for our Bloomberg US Treasury Bond Index forecast from 3.9% at the end of September to 4.4% at the end of Q4. This has moved our total return forecasts for the US Treasury Bond index higher to 4.4% as shown in Figure 8.

Figure 8: US Treasury Bond Index: Expected contribution to 10-year forecasted hypothetical annualized returns

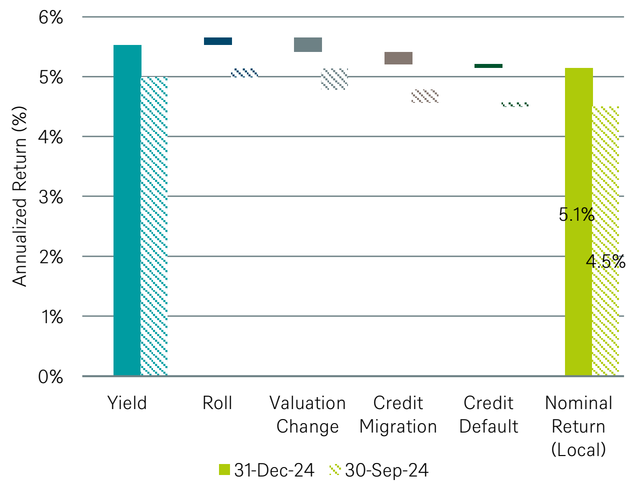


Source: DWS Investments UK Limited. Data as of 31 December 2024.

Return forecasts across corporate credit markets reflect a modest tightening in credit spreads from already very tight levels relative to history. In Q4, the US Investment Grade Corporate OAS tightened from 0.89% to 0.80% while the US High Yield Corporate OAS tightened from 2.95% to 2.87%, an incremental move relative to the aforementioned selloff across the US Treasury yield curve. Despite very demanding credit spread valuations, all-in yields could continue to look attractive relative to the past decade.

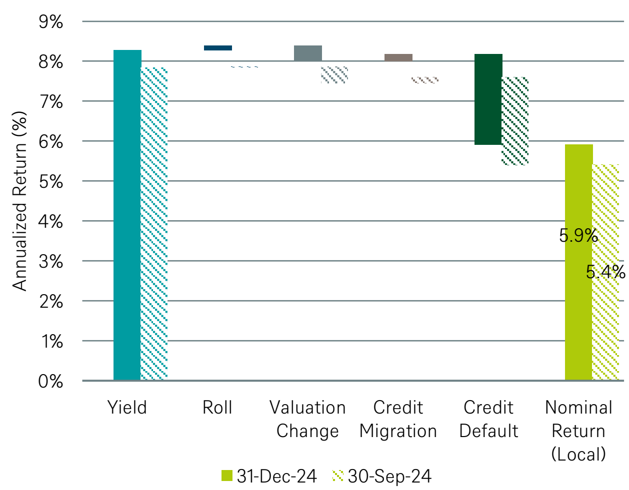
Over the course of Q4, our total return forecast for US Investment Grade Corporate Bonds increased from 4.5% to 5.1% (reflecting an increase in the yield pillar contribution from 5.0% to 5.5%) and our US High Yield Corporate Bond forecast increased from 5.4% to 5.9% (with the yield pillar contribution increasing from 7.8% to 8.3%). Credit default losses for the Bloomberg US High Yield Corporate Bond Index increased modestly from -2.2% to -2.3%, which represent proportionately high default losses relative to spread compensation. Figure 9 and Figure 10 show US Investment Grade and US High Yield return forecasts, respectively. The high starting nominal yield for US High Yield in contrast with historically tight equity risk premia for US equities results in a very similar strategic return outlook between the S&P 500 and the Bloomberg US High Yield Index now after these two estimates had been converging towards each other for several quarters.

Figure 9: US Investment Grade Corporate Bond Index: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

Figure 10: US High Yield Bond Index: Expected contribution to 10-year forecasted hypothetical annualized returns



Source: DWS Investments UK Limited. Data as of 31 December 2024.

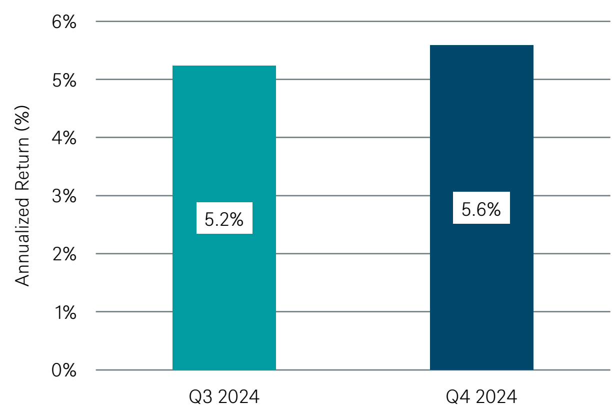
2 / Conclusion

Return forecasts across asset classes are modestly higher as compared to the end of Q3, with the most significant move higher across fixed income return forecasts. Higher nominal and real global treasury yields, especially in the US, reflect higher short-term inflationary risk but result in potentially more attractive starting yield levels for strategic fixed income investors. The gap between equity and fixed income asset class forecasts continues to look narrow both in absolute terms and relative to historical realized returns, reflecting continued optimistic US Large Cap valuations. Artificial Intelligence continues to drive this optimism both in terms of macroeconomic impact and corporate profitability, furthering the gap in valuations between technology growth companies and more value-oriented or smaller domestically-oriented companies. While Investment Grade and High Yield credit markets reflect optimistic bond spreads relative to history, credit valuations look a bit more reasonable comparable to valuations across these technology and AI-related industries.

The question for investors remains whether the valuations around growth technology companies will be justified by what has been outsized contribution to earnings growth. History tells us that, while the outlook is fundamentally constructive for these companies, valuations and earnings yields are ultimately important components of long-term expected returns and should not be ignored. When considering strategic investments across asset classes, the absolute and relative attractiveness of real and nominal bond yields relative to history is difficult to ignore even amid a reemergence in inflationary risks.

As such, the strategic outlook for investors reflect these higher real yields but still tight equity and credit risk premia. As a result, our 10-year return forecasts shown in Figure 11 illustrates our 10-year return forecasts for a moderate strategic asset allocation multi-asset[1] portfolio, which have increased by about 0.4% over the most recent quarter.

Figure 11: 10-year forecasted hypothetical annualized returns of moderate strategic asset allocation in local currency



Source: DWS Investments UK Limited. Data as of 31 December 2024.

[1] Moderate strategic asset allocation refers to a portfolio that targets annualized volatility of roughly 10%

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