



NORTHERN TRUST

ASSET MANAGEMENT

# CAPITAL MARKET ASSUMPTIONS THROUGH A LONG-DURATION LENS:

## Key Considerations for Family Offices Over the Next Five Years

The next five years may be unusually critical for meeting portfolio objectives, given the challenging market environment and the unique asset allocation needs of long-duration investors like family offices. Our forward-looking, historically aware approach to developing long-term return forecasts across asset classes can help in tackling strategic portfolio construction decisions.

Northern Trust's 2023 Capital Market Assumptions Five-Year Outlook explores return forecasts and long-term investment themes. With below-average returns expected over the next five years, we believe getting asset allocation right will be essential to delivering on the key challenges of our time: achieving purchasing power parity and avoiding any permanent capital impairment.

Using a forward-looking, historically aware framework, we develop long-term return forecasts across asset classes, which can guide family office and other long-duration investors as they tackle strategic and tactical portfolio construction decisions.

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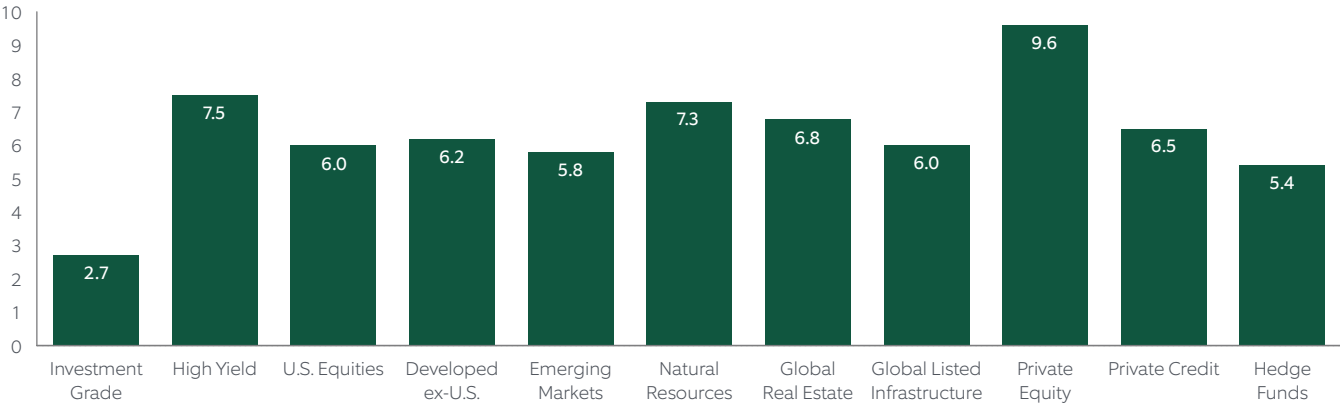
**Slow Growth Transitions** and **Inflation Recalibration** are the two key strategic themes affecting long-duration asset owners over the next five years.

We expect slower economic growth and higher interest rates to result in positive but below-average five-year returns for most asset classes (**Exhibit 1**). Higher interest rates will likely challenge equity returns with a lower valuation ceiling and profit margin compression. These forecasts create potential hurdles for asset owners looking to build cost-efficient, lower-risk portfolios with adequate performance over the next five years. To overcome these challenges, we anticipate that family offices will favor lower volatility exposures and private investments in equity, credit, infrastructure and real estate for diversification and higher risk-adjusted returns. While private investments potentially provide attractive premiums relative to public markets, the wide return dispersion among strategies means that manager selection will be paramount.

**Slow Growth Transitions** and **Inflation Recalibration** are the two key strategic themes affecting long-duration asset owners as they seek to balance their risk, return and cash flows relative to their obligations over the next five years.

**EXHIBIT 1: FIVE-YEAR FORECASTS FOR KEY ASSET CLASSES**

Annualized Return (%)



Northern Trust Asset Management, Bloomberg. Annualized return data in local currency from 6/30/2017 to 6/30/2022. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Past performance is not indicative of future results.

**SLOW GROWTH TRANSITIONS**

There are three major shifts on which we believe investors will need to focus on if they are to succeed over the medium term:

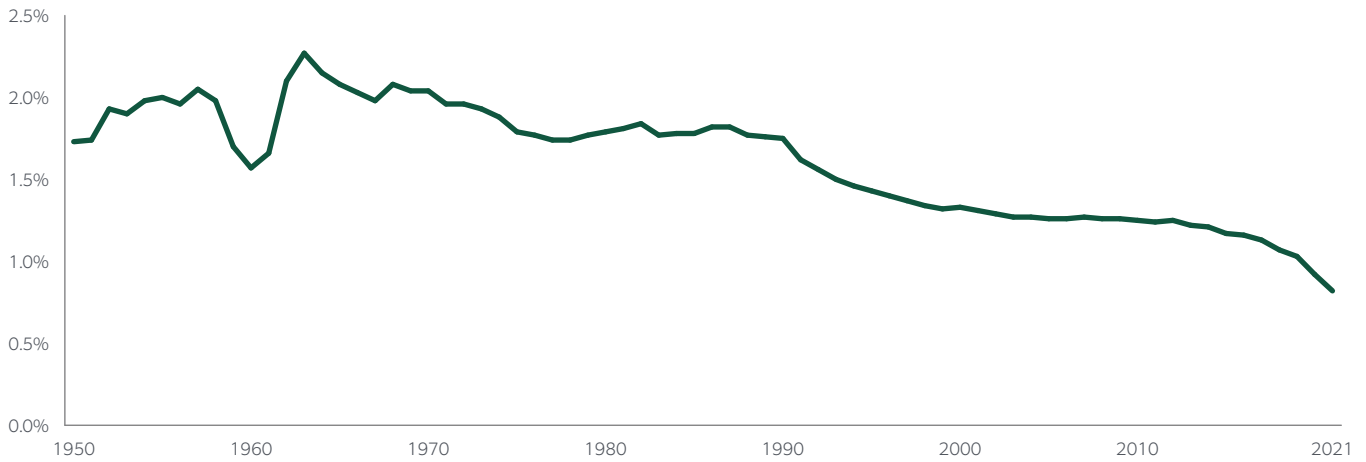


These economic challenges are taking place in a global economy already facing high debt (pandemic stimulus increased global debt by 30 percentage points in 2020<sup>1</sup>) and slowing population growth (**Exhibit 2**).

<sup>1</sup>Source: Brookings Institution, 2020.

## EXHIBIT 2: WORLD POPULATION GROWTH RATE, 1950 TO 2021

The growth rate is the population change determined by births, deaths, and migration flows.



Source: United Nations World Population Prospects (2022).

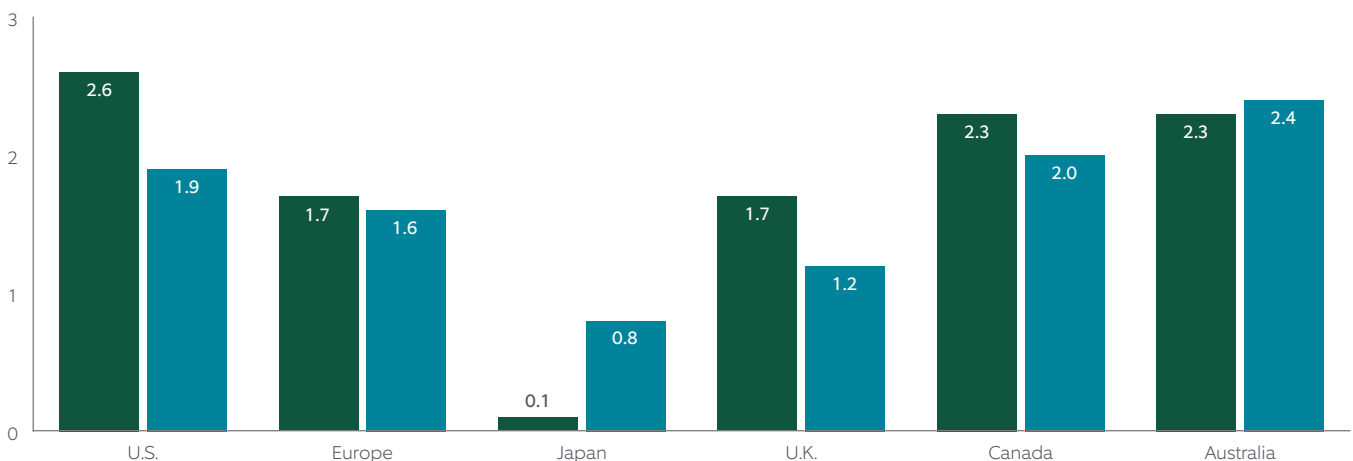
We expect 2.6% annualized real global economic growth over the next five years. As shown in **Exhibit 3**, our 1.9% U.S. forecast marks a notable slowdown from the past five years, but the U.S. is still ahead of most other advanced economies, largely due to our better demographics.

## EXHIBIT 3: GOOD WHILE IT LASTED

We think the past two years' stimulus-boosted growth will revert to previous slow form.

Annualized Real GDP Growth (%)

■ Last 5 years ■ Northern Trust 5-year forecast



Source: Northern Trust Asset Management, Bloomberg. Data from 3/31/2017 to 3/31/2022.

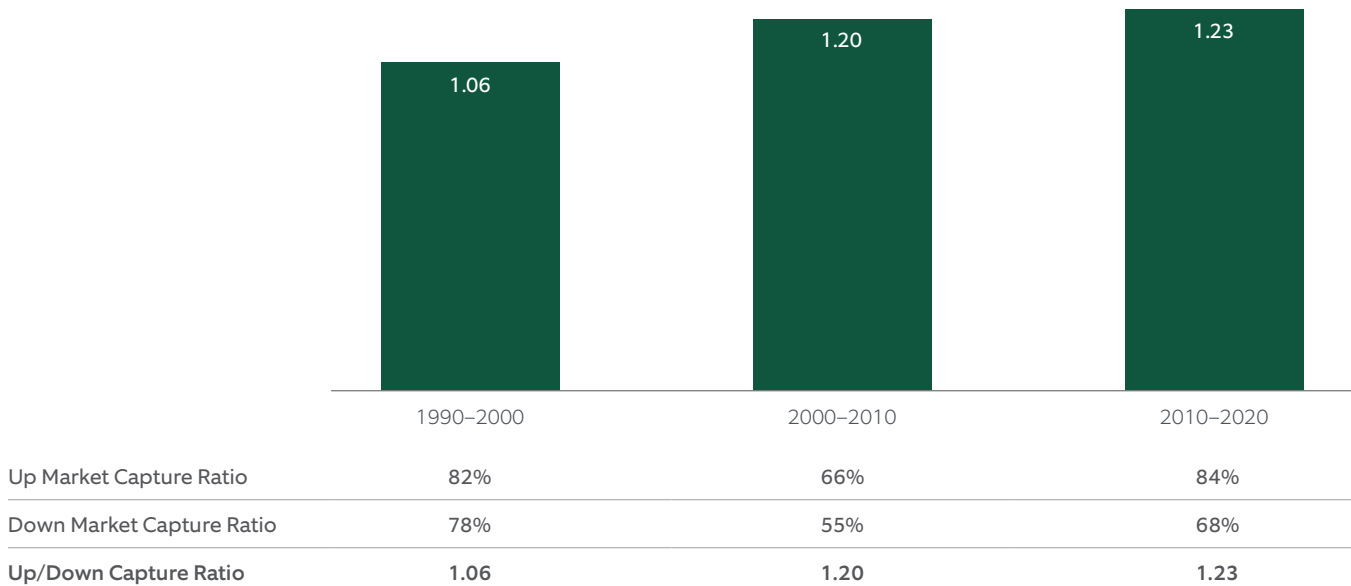
## Key Considerations for Family Office and Long-Duration Investors

As the slow growth economic transitions unfold over the next five years, market volatility and uncertainty will likely remain high. In addition to slower growth, lingering supply chain issues are potential contributors to increased volatility as investors adapt to the shift from economic globalization to regionalization. In this turbulent environment, adding a low volatility strategy to a multi-asset class portfolio has the potential to increase risk-adjusted returns. Lower volatility equities have historically demonstrated asymmetric returns, meaning they tend to capture more upside than downside when equities move, as shown in Exhibit 4.

### EXHIBIT 4: THE ASYMMETRIC RETURN PROFILE OF LOW VOLATILITY STOCKS

Over the past three decades, the ratio of upside capture to downside capture in the Russell 1000 Index has increased, a return profile that makes outperformance more likely during turbulent markets.

Up/Down Capture Ratio of Low Volatility Equities<sup>2</sup>



<sup>2</sup>Low Volatility research portfolios are formed by selecting the bottom 30% of securities ranked by trailing 1-year daily volatility. Research portfolios are capitalization weighted and rebalanced quarterly.

Source: Northern Trust Asset Management, FactSet, Russell 1000 Universe, 12/31/1989 through 12/31/2019. For illustrative purposes only. Past performance is no guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

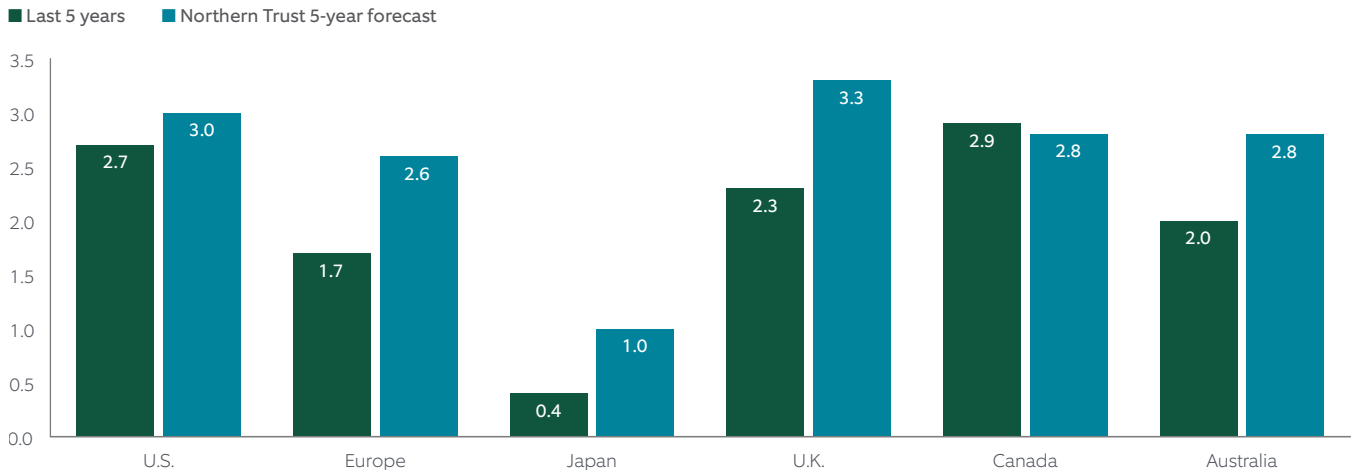
## INFLATION RECALIBRATION

Post-pandemic global supply chain complications and worker shortages left a bigger-than-expected mark on inflation. Initially, many investors and policymakers believed inflation was “transitory” and would eventually revert to normal levels. While there were cracks forming in the “transitory” thesis, assumptions officially changed with the war in Ukraine, due to soaring food and energy prices. With the inflation genie having escaped the bottle, monetary and fiscal policymakers will be on alert as the struggle to recapture the high ground now has an even more meaningful impact on investor allocations and outcomes.

## EXHIBIT 5: THE END OF AN ERA

The Stuckflation regime is over, replaced by a period of recalibration back toward target levels.

### Annualized Inflation (%)



Source: Northern Trust Asset Management, Bloomberg. Data from 3/31/2017 to 3/31/2022. All regions use headline Consumer Price Index as the inflation metric.

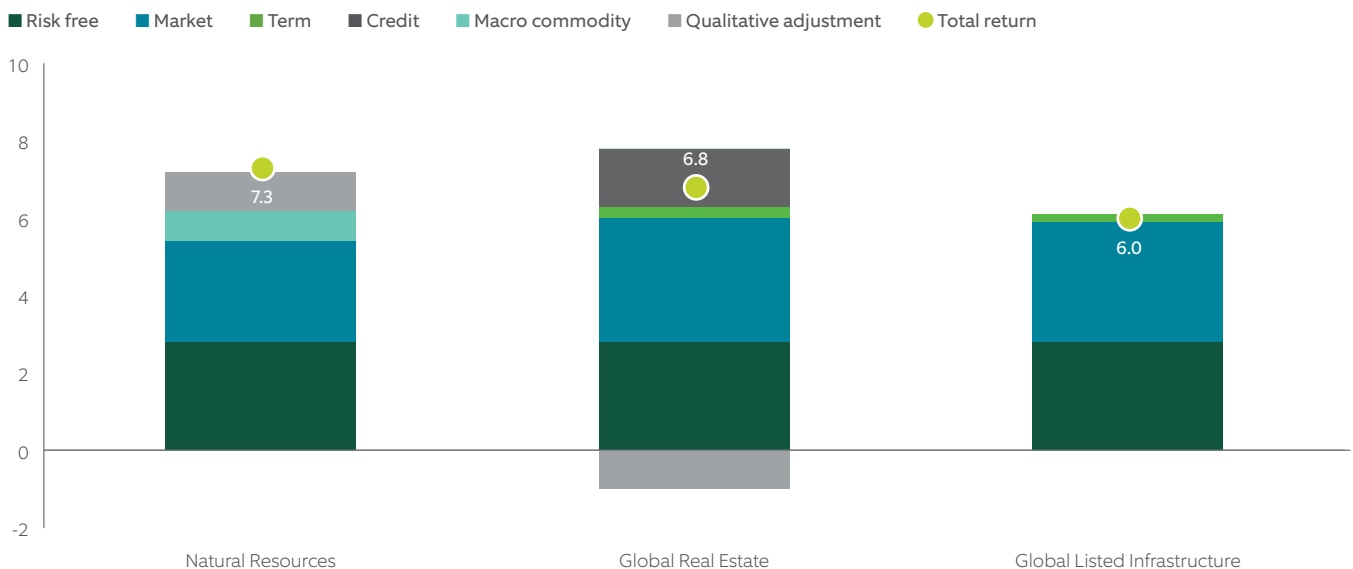
## Key Considerations for Family Office and Long-Duration Investors

With inflation likely elevated in the near future, investors need to reassess the risks it creates in their portfolios. Real assets — both public and private — can provide protection against unexpected inflation, while real estate and listed infrastructure diversify portfolio risk exposures and offer higher yields than traditional equities.

## EXHIBIT 6: DIVERSIFICATION ON DISPLAY

Real assets should shine in a more uncertain and higher inflationary risk regime.

### Northern Trust Five-Year Annualized Real Assets Return Forecast (%)



Source: Northern Trust Asset Management, Bloomberg.

## FINAL THOUGHT: BE CREATIVE WITH RISK

As noted earlier, we anticipate some continued deterioration in the public market equity environment, due to the historically high levels of developed country corporate profit margins. Family office investors will likely need to be nimble and dynamic with their risk budgets in order to hit both their short- and long-term return objectives — likely venturing beyond internal investment expertise as we head into uncharted waters. Given the anticipated dual headwinds of slow growth and slow-to-fall inflation, investors can look to private markets or low volatility strategies to close the return gap forecasted from their equity allocations over the next five years (Exhibit 7).

We strongly encourage you to review our Capital Market Assumptions and the underlying themes that drive them.

### EXHIBIT 7: NEXT FIVE-YEAR FORECASTS ARE LOWER

Northern Trust Five-Year Annualized Equity Return Forecast by Country (%)



Source: Northern Trust Asset Management. EM is emerging markets.

# ABOUT NORTHERN TRUST ASSET MANAGEMENT

Northern Trust Asset Management is a global investment manager that helps investors navigate changing market environments, so they can confidently realize their long-term objectives.

Entrusted with \$999.1 billion of assets,<sup>3</sup> we understand that investing ultimately serves a greater purpose and believe investors should be compensated for the risks they take — in all market environments and any investment strategy. That's why we combine robust capital markets research, expert portfolio construction and comprehensive risk management to craft innovative and efficient solutions that deliver targeted investment outcomes.

As engaged contributors to our communities, we consider it a great privilege to serve our investors and our communities with integrity, respect, and transparency.

## Explore Our Full Five-Year Outlook

Explore our long-term asset class return expectations and forecasts at [capitalmarketassumptions.com](https://capitalmarketassumptions.com). Visit today to:

- Gain valuable insights from our investment experts
- Get exclusive access to our full research paper
- Explore our detailed return/risk and correlation matrix

<sup>3</sup>As of September 30, 2022.

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CMA model expected returns are based on IPC forecasted returns and reflect Northern Trust's Investment Policy Committee's (IPC) forward-looking annual capital market assumptions. The Capital Market Assumptions Working Group (CMAWG), a subset of IPC members, publishes its assumptions as a white paper report. Forecasted returns are annual returns (geometric basis). The model cannot account for the impact that economic, market and other factors may have on the implementation and ongoing management of an actual investment strategy. Model outcomes do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact future returns. The model assumptions are passive only. References to expected returns are not promises or even estimates of actual returns an investor may achieve. The assumption, views, techniques and estimates set out are provided for illustrative purposes only. Forecasts of financial market trends that are based on current market conditions constitute CMAWG judgment and are subject to change without notice. "Expected" or "alpha" return estimates are subject to uncertainty and error. The ability to achieve similar outcomes is subject to risk factors over which Northern Trust may have no or limited control.

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