Future Returns based on Mean Reversion

We now move on to the data-heavy back section of the report which includes all the long-term returns data from bonds and equities across numerous global markets. First we update our annual mean reversion exercise. One of the original motivations for first compiling this report back in 2005 was the belief that traditional developed world asset classes exhibited a rhythm of returns through time that were subject to clear mean reversion tendencies. In every edition of this report we've updated what we consider to be the potential future returns of various asset classes based on them mean reverting over different time horizons.

This is a US centric exercise given the long unbroken history available. However we continue to include EUR and GBP credit. In Figure 72 we show what nominal and real returns could be over the next decade if assets revert back to their long-term average valuations. A brief appendix is posted at the end of this section that takes us through our methodology for the mean reversion exercise. It basically assumes that earnings, PE valuations, inflation, real yields and economic growth return to their long-run averages/trend.

The results are only meant to be a relative value guide and work best on a relative basis across asset classes and the longer the time horizon you view them over. As discussed earlier, we have mainly concentrated on US assets in this section. This enables us to delve deeper into history to analyse the long-term rhythm of returns. In reading the results, hopefully one will be able to understand the type of returns that a sophisticated Developed Market sees through time.