

Executive Summary

2023 Capital Market Assumptions

The 2023 edition of our 10-Year Capital Market Assumptions (CMAs) offers our projections for asset class returns, volatilities and correlations over the next decade. This yearly exercise helps in shaping the design of our investors' long-term portfolios.

Slowing global economic growth and the persistence of elevated inflation have weighed heavily on market returns in 2022. With limited evidence of victory in their battle against inflation, monetary policymakers have remained resolute in their hawkish view and continue with tightening monetary policy. There have been few “safe-haven” assets in 2022, regardless of asset class, geography, market cap, style, credit quality and/or duration.

However, looking forward, the increased market volatility and asset repricing during 2022 have driven notable changes to our 2023 forecasts relative to our forecasts just a year ago.

Key Takeaways: Higher Expected Returns

- Our 2023 10-Year CMAs forecast higher expected returns across most asset classes when compared to 2022 assumptions (see table below).
- Equity market expected returns have increased due to slightly higher long-term growth rates and upward valuation adjustments (most notably in emerging markets).
- Fixed income asset class expected returns have reverted to levels not seen in many years, significantly higher when compared to 2022 given the dramatic increase in global bond yields.
- Alternative asset class expected returns are generally higher and in line with publicly traded markets on a risk-adjusted basis plus incremental return for alpha and illiquidity.

Snapshot of 2023 vs 2022 10-year Capital Market Return Assumptions

| | | 2023 | | 2022 | |
|----------------|-----------------------------|-----------------|--------------------|-----------------|--------------------|
| | | Expected Return | Standard Deviation | Expected Return | Standard Deviation |
| Equity Markets | U.S. Equity | 6.5% | 18.0% | 5.9% | 17.4% |
| | International Developed | 6.9% | 17.1% | 5.8% | 17.4% |
| | Emerging Markets | 9.3% | 20.0% | 7.6% | 21.2% |
| Fixed Income | U.S. Aggregate | 4.1% | 4.3% | 1.2% | 3.4% |
| | U.S. High Yield | 6.2% | 9.4% | 1.9% | 9.0% |
| | U.S. Intermediate Municipal | 2.8% | 4.3% | 0.9% | 3.8% |
| | Global Agg. Ex-U.S. | 3.0% | 7.9% | 0.3% | 7.3% |
| | EM Local Currency | 4.0% | 9.5% | 3.8% | 9.8% |
| Alternatives | Absolute Return | 4.3% | 5.0% | 3.2% | 5.2% |
| | Hedge Funds | 4.9% | 6.9% | 3.9% | 7.0% |
| | U.S. Private Equity | 8.2% | 21.3% | 7.9% | 20.5% |
| | U.S. Core Real Estate | 6.0% | 8.5% | 4.7% | 8.1% |

Source: BNY Mellon Investor Solutions. Data as of September 30, 2022.

For Financial Professionals and Institutional Investors Only.

Themes to Watch

Looking beyond the next 10 years, we also explore the impact of themes that may shape market expectations and impact these forecasts over a longer timeframe.

- **Geopolitical challenges** — Continued geopolitical tensions may result in further deglobalization and reshoring, impacting variable costs, corporate margins and investor returns.
- **Environment, Social and Governance** — We expect ESG and responsible investing to increasingly influence investor allocation decisions and thereby have a potentially larger impact on financial markets for years to come.

Macroeconomic Backdrop

When building capital market assumptions, we start with projections of inflation, real GDP growth, short-term interest rates and currency rates. Inflation and real GDP growth are key drivers of our expected earnings growth for equity. Projections of inflation and real cash rates are extremely influential in projecting fixed income yields and returns.

The economic projections underpinning our asset class return assumptions are based on three economic scenarios outlined in [BNY Mellon Investment Management's 2022 Q4 Vantage Point](#). These scenarios take into account pressing issues facing the world economy including the ongoing energy crisis, triggered by Russia's invasion of Ukraine; persistent core inflation driven by tight labor markets and high wage inflation and, China's zero-Covid policy and property deflation.

We develop return expectations under each of these scenarios, then probability weight the returns to determine our overall “expected” return. This approach allows us to not only analyze portfolios based on the expected case, but also to shock the portfolio under the various scenarios. We encourage you to read the latest Vantage Point to learn more about our economic projections.

Importance of Capital Market Assumptions

Capital market assumptions are the initial building block for the development of an investor's strategic asset allocation (SAA). However, forecasting is an inherently error-prone endeavor, because financial market performance exhibits a high degree of uncertainty.

When designing a policy portfolio to weather the highs and lows of the coming market cycle, we propose investors consider a “robust” portfolio, rather than an “optimal” one. To learn more, please contact your BNY Mellon representative.

Download the full Capital Market Assumptions here.

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