



# The Past Is NOT Prologue

## A Look at Projected Long-Term Returns Accepting Average III





Accepting Average III – a new white paper by Portfolio Manager, CIO/CEO  
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Investors are warned that past performance is not a guarantee of future returns, yet extrapolation remains the most commonly used forecasting tool. Advice that the “market” will always bail out the buy-and-hold investor over time depends on the starting point for the key drivers (e.g., earnings and the P/E ratio for equities), as well as the economic outlook.

A casual glance at the long-term performance of the S&P 500 Index reinforces how important timing is in projecting returns. There have been four main periods since 1900 during which the nominal or real 10-year compound price change was near zero or negative. Each of those periods followed a period of strong gains, as has recently occurred. There have been periods where strong 10-year compound gains have been sustained, but the odds of them doing so diminish with time.

Most investors view asset performance through the prism of the past several decades, which coincided with the most extraordinary period in modern capital market history – namely, the 40-year period of declining interest from the early 1980s until 2022. That timeframe included a period of negative interest rates and bond yields in parts of Europe and Japan. The decline fueled massive price appreciation for virtually all asset classes, ranging from equities to bonds, real estate, artwork, and other collectibles.

U.S. stocks were among the biggest beneficiaries. The S&P 500 traded at a puny forward P/E ratio of 6x in mid-1982, soaring to over 25x during the 1990s bubble, and is roughly 23x today. The re-rating since the early 1980s has accounted for 40% of the S&P 500’s appreciation over the period. History suggests the U.S. equity market is likely to be de-rated in the decade ahead, but at a minimum, the tailwind of a rising P/E ratio that boosted price gains over the past four decades will not be repeated.

Multi-asset portfolios were also big winners, with both equities and bonds delivering strong returns for much of the period. Leveraged portfolios fared even better, as interest rates declined.

But the past is not prologue. Prospective real returns for equities, bonds, and most other asset classes for our 10-year forecast horizon will inevitably be lower without the tailwind of declining interest rates. At the same time, historically anomalous valuation disparities within and between asset classes are generally expected to narrow. That is notably the case in equities, where we suspect the U.S. market could underperform the rest of the world in the next 10 years, starting from its current lofty perch.

Any long-term capital markets forecasts are fraught with uncertainty, given the unpredictability of global events, economic and other policies, and investor sentiment. Moreover, factors like AI and other technologies, as well as geopolitical conflicts, could have a profound impact on economic performance, for better or worse.

## Economic Growth

The global economy has generally struggled in the aftermath of the global financial crisis (GFC) of 2007-2009. Real GDP has been disappointing, particularly in the first half of the 2010s, when the U.S. and European economies were deleveraging after the 2000s credit bubble. The pandemic was akin to a natural disaster that temporarily upended the global economy and triggered an unprecedented peace-time dose of fiscal and monetary stimulus that is still spilling through the system.

Global growth has largely been driven by the U.S. and China with 10-year compound growth rates strong during the 1990s until the GFC, and weaker since. The U.S. has seen an improvement in real GDP in recent years, but primarily due to ongoing fiscal and monetary support that is unsustainable.

In China's case, the slowdown in growth in the past decade is primarily structural. The population is now declining and the dependency ratio (the elderly and children relative to the working age population) is rising. Labor productivity growth is naturally slowing as the economy advances, and the easy gains of the past are being exhausted. We expect China's real GDP growth to end up around 3% over the next 10 years, compared with 5.8% in the past 10 years.

The new U.S. administration is trumpeting the prospect of 3-4% real GDP growth in the next decade in response to deregulation, technology gains, and a steady closing of the trade deficit, among other factors. It is more realistic to expect real growth on the order of 2-2.5% given low population growth, reduced immigration, political polarization that discourages policy continuity to address key challenges, and a needed skills upgrade for a sizeable portion of the labor force. It is unclear whether AI can deliver on the promised productivity gains without simultaneously creating significant economic disruption.

## Inflation

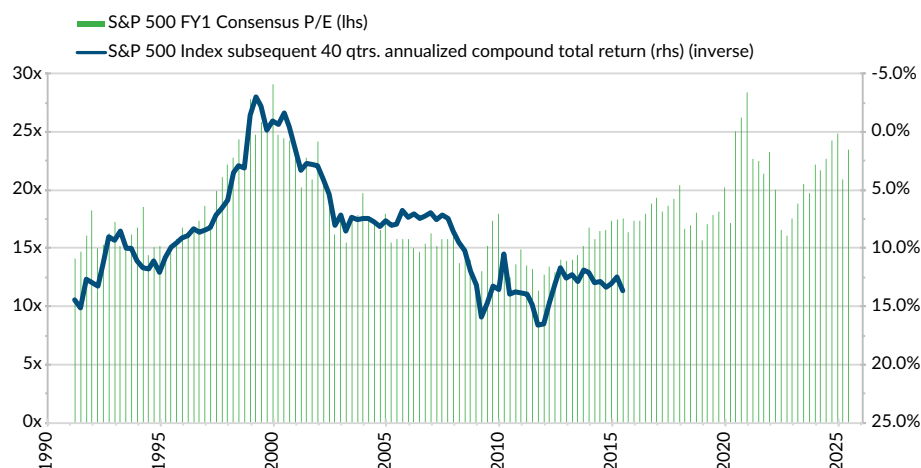
We continue to believe investors and central bankers are overly complacent about inflation in the years ahead, as the prior benefits from globalization erode further, and both fiscal and monetary authorities regularly err on the side of easy policy to support economic growth. Inflation in the U.S. and euro area, in particular, was also depressed during the 2010s because of private-sector deleveraging that is no longer at work. We expect developed-market inflation to average 0.5-1% above respective central bank targets over the forecast horizon, with risks tilted to the upside.

U.S. trade tariffs reinforce the upshift in the inflationary regime that has been underway for some time. Global import prices were largely flat during the 2010s, but rose sharply during the pandemic and appear poised to move higher again given the U.S. tariffs and a weakening dollar.

The trendsetting U.S. economy has been among the biggest beneficiaries of globalization, with non-oil import prices virtually flat for the past three decades. Even a "modest" 10% across-the-board tariffs will push goods import price inflation to problematic levels, especially since the U.S. dollar has also recently weakened. The current administration favors a weaker dollar to reduce the U.S. trade deficit, which, in conjunction with the tariffs, risks undermining consumer and investor confidence in the 2% Fed inflation target.

The U.S. is not alone, although its tariffs and a weaker dollar mean it is more vulnerable to inflationary pressure. The euro area and U.K. formally remain committed to 2% inflation mandates, but inflation has been sticky at above-target levels for some time even as economic growth has been lackluster. Political pressure from both the right and the left to boost economic growth in both economies signals that the respective central banks will also likely accept moderately higher inflation to buttress economic growth. The easy days of inflation always returning to 2% or less are likely over.

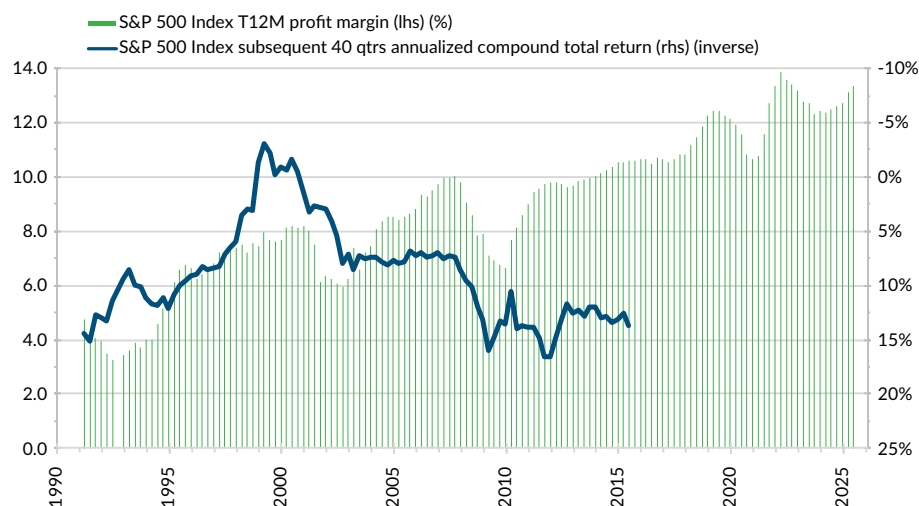
## Future equity returns as a function of starting P/E ratios



Consensus P/E multiples at quarter-end	Subsequent 40 quarters annualized total return	# of Obs. (40 qtrs.)	% of Obs. (40 qtrs.)
< 9.99x	-	-	-
10-14.99x	12.65%	27	27.6%
15-19.99x	9.60%	52	53.1%
20-24.99x	2.24%	15	15.3%
> 25	(1.18%)	4	4.1%
> 20	1.52%	19	19.4%

Source: Bloomberg as of 6/30/25

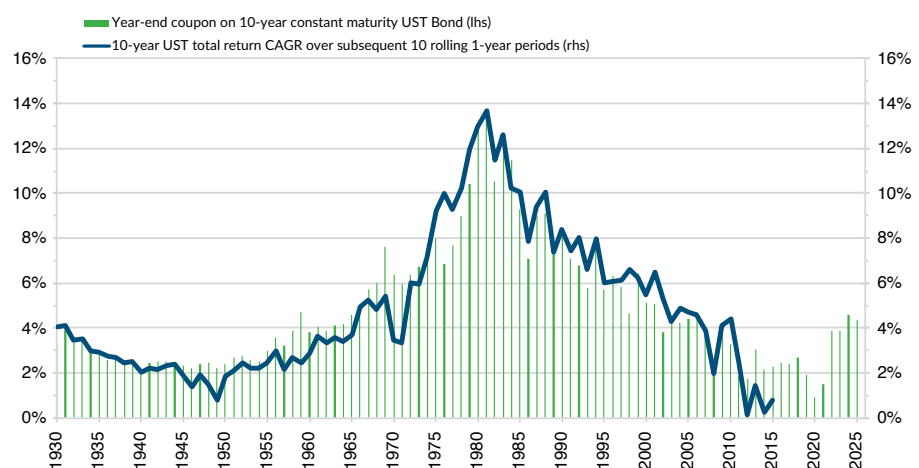
## Future equity returns as a function of starting profit margins



"Starting S&P 500 T12M profit margin"	Subsequent 10-year annual total return (%)	# of Obs.	% of Obs.
<3%	-	-	-
3-5%	11.72%	13	13.4%
5-7%	8.79%	20	20.6%
7-9%	5.78%	36	37.1%
9-11%	11.57%	28	28.9%
> 11%	N/A	N/A	N/A

Source: Bloomberg as of 6/30/25

## Future fixed income returns as a function of starting interest rates



10-year UST yield at start of year (1930-2025)	Subsequent 10-year total return CAGR	# of Obs.	% of Obs.
0-2%	1.26%	2	-
2-4%	2.52%	38	13.4%
4-6%	4.73%	19	20.6%
6-8%	6.87%	15	37.1%
8-10%	9.56%	6	28.9%
> 10%	12.16%	6	N/A

Source 1930-2024: Dr. Aswath Damodaran, [http://people.stern.nyu.edu/adamodar/New\\_Home\\_Page/datacurrent.html](http://people.stern.nyu.edu/adamodar/New_Home_Page/datacurrent.html)

Source 2025: Bloomberg. As of 7/9/25. Assumes that the constant maturity yield of the 10-year UST bond on 7/9/25 holds through 12/31/25.

## Monetary Policy

Consistent with our forecast of above-target inflation, we expect developed market central bank policy rates to be higher, on average, than for most of the past two decades.

We expect the Fed funds rate to average approximately 3-4% over the next decade, which is the current level of the upper-bound and slightly higher than the Fed's optimistic 3% projected long-run rate. That would imply neither restrictive nor easy policy, on average, in contrast to the current conventional wisdom about today's Fed funds rate.

## Fixed Income

The outlook is mixed for global fixed income in the next decade. We expect bond yields to be above today's levels at the end of our forecast horizon. Still, real total returns over the next decade will be higher than those of the past decade, although that is a low bar.

The bond math for our forecast period is straightforward. Real yields are currently modestly positive, which is comparatively favorable compared with most of the past decade. Given current nominal yields and projected inflation rates slightly below the current level, G7 real 10-year government bonds are expected to produce a mildly positive real return in the decade ahead. That is a massive turnaround from the past decade, when a basket of G7 10-year government bond produced significant losses in real terms.

In the U.S. Treasury market, our policy and economic forecasts imply that the 10-year Treasury yield will fall modestly over the next decade. This is at risk of being breached absent a meaningful reduction in the expected fiscal deficit. The large fiscal deficit and associated inflation risk, combined with the threat of a politicized Fed, could push the 10-year Treasury term premium up in the years ahead, which would add to upside for the 10-year yield.

## Equities

The long-run outlook for global equities is mediocre at best, given a starting point of elevated profitability and valuations. Dividends are projected to account for the majority of real equity total returns. We expect the U.S. equity market in real terms to be lower at the end of the forecast horizon than at present. The 20-fold gain in real global equity total return over the past 45 years has been driven by a nearly three-fold rise in real earnings, a similar increase in the P/E ratio and the reinvestment benefits of a 2.6% average dividend yield.

Like the elevated global P/E ratio, the historically high level of global return on equity (ROE) and earnings relative to GDP imply slower earnings growth in the coming decade. Global ROE has been a mean-reverting series over the past 50 years, and thus can be expected to erode over our forecast period. The same is the case for global earnings relative to GDP, especially against a backdrop of a U.S. economy shifting away from the benefits that globalization has provided to its corporate sector.

Our return forecasts would represent a major change in the performance and structure of the global equity market, reversing the dominance of the U.S. The U.S. accounts for a nearly five-decade high of 64% of global market capitalization, more than double its share at the low in 1990. A decline back toward 50% would be consistent with the post-1990 norm and would reflect the combination of a relative de-rating of the U.S. from near an all-time high, weaker relative earnings growth, and a depreciation of the U.S. dollar.

## Unprecedented Policy Risks

Policy risk in the U.S. is arguably at the highest level in our lifetimes (fiscal unsustainability, the growing impotence of Congress, the collapse in the credibility of non-government institutions). The federal deficit is at an all-time high for a peacetime economy not in recession and trending in the wrong direction. Heightened polarization has changed how Congress operates. The mainstream media is no longer trusted as an arbiter of basic facts. The weaponization of government has taken an ominous turn.



# Conclusions

**1** Bonds are expected to produce modestly positive real returns over the next decade, in contrast with the difficulties of the last decade.

**2** Equity investors should expect more muted returns than recent decades due to starting points for valuation and earnings.

**3** A significant issue could be the risks associated with the potential downsides stemming from large fiscal deficit/debt issues.

**4** The U.S. dollar will likely depreciate from current levels.

**5** Conditions should support better returns for active over passive management.

Notes:

Sources: MRB, BCA, Strategas, Piper Sandler

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