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GLOBAL INVESTMENTS

Rethinking Returns

Stocks, Bonds, & Investing in the Decade Ahead

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Rethinking Returns: Stocks, Bonds, & Investing in the Decade Ahead

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Near-Term Comments

We have been arguing that we are in a "high risk bull market." Requirements for the "bull" to remain intact are 1) continued upward earnings revisions, and 2) at worst, a neutral Fed. Until recently, both conditions persisted. Currently, we are concerned that the number two requirement could fall short, if indeed the Fed raises rates. In the last two-three months, despite the averages stalling out, the average stock continues to hold up far better than the cap-weighted indexes. Should that condition deteriorate, we will become more concerned. Meanwhile, earnings estimates continue to rise, but at a decelerating pace.

Nevertheless, we remain concerned about the seemingly intractable position in the U.S.-Iran conflict, the stickiness of inflation, the rise in Treasury yields, the socialist acceleration in Washington D.C., and the search for an encore to the amazing earnings performance of corporate America, not to mention full valuations on record high profit margins. I am reminded of a quote from one of my favorite market observers and former colleague, Howard Marks: "Prices are too high is far from synonymous with 'the next move will be downward.' Things can be overpriced and stay that way for a long time … or become far more so."

Higher oil prices did not have the impact on economic growth that everyone had expected at the start of the conflict, and prices of the commodity fell much further and much more quickly after the tenuous memorandum of understanding (MOU) was signed. Exceptional earnings in 1Q26 (+28%) and expectations for the calendar year (+24%), along with relatively tame long-term interest rates have, surprisingly, led to multiple contractions thus far this year. So strong has the capital spending cycle been that investors have been able to ignore some troublesome economic, political, and geopolitical developments in recent months – a ceasefire that doesn't seem to stop the shooting, incipient inflationary pressures that might lead to a tightening of monetary policy, a meaningful lurch toward "democratic socialism" in the U.S. at the local level, and now, once again, the imposition of new tariffs.

It appears that the President has lost patience with the Iranians and that some sort of settlement strong enough to keep oil flowing consistently through the Strait of Hormuz, and perhaps the Red Sea, is not close at hand. Although upward earnings revisions may be showing signs of peaking, earnings growth is likely to be exceptional this year. Unfortunately, the market may need to deal with concerns regarding inflation, the political landscape, and trade policy over the next several months.

The Current Situation

The current economic and capital markets cycles are mature. The pandemic was more like a natural disaster that temporarily disrupted the global economy than a true end of cycle event associated with a monetary squeeze or other excesses that had reached an unsustainable level. The pandemic recession in the U.S. lasted only two months, according to the National Bureau of Economic Research, and was quickly quelled by unprecedentedly large fiscal and monetary stimulus. That brief retrenchment aside, the U.S. economy has been in expansion mode for 17 years, which would constitute the longest ever economic expansion.

History indicates that investors are too optimistic about capital markets continuing to deliver strong returns in the coming years. Global corporate earnings and equity valuations are historically elevated. Inflation expectations remain low, as are expected equilibrium central bank policy rates, thereby dampening government bond yields. U.S. corporate bond spreads are historically tight and corporate return on equity (ROE) is at the top of its multi-decade range, implying predominantly downside risk.

The past behavior of these fundamental variables implies that the G7 unemployment rate will likely be higher over the next decade than at present, that credit spreads will be wider and that corporate ROE will be lower.

It is dangerous to extrapolate the capital market returns of recent decades into the future, given dramatically different starting points. This is especially the case for equities, whose strong returns since the early 1980s reflect a marked rise in the P/E ratio and extraordinarily strong corporate earnings growth, neither of which can be expected to persist in the decade to come. Returns on risk assets have also been boosted by the dramatic decline in bond yields from the early 1980s until early 2022.

Investor optimism has also been buoyed by the advance of AI, which has the potential to provide huge productivity benefits and, in the eyes of many, make it easier for central banks to contain inflation. Yet there is still considerable uncertainty about how AI will play out and whether the adoption will be economically seamless and positive, or bumpy and occasionally disruptive. That said, it defies logic to assume that corporate profits (and margins) are no longer cyclical, even if the last several economic expansions have been longer than those in earlier decades.

We forecast that capital market returns will be more muted over the next decade than most investors expect, with U.S. equities poised to generate only modestly positive inflation-adjusted total returns in the next 10 years. While non-U.S. equities may fare better, the huge U.S. weight in the global benchmark means mediocre returns for global equities. Bonds will likely give equities tough competition, especially adjusted for volatility.

Upside inflation risks also point to weaker prospective returns than many investors have discounted. The combination of aging populations, chronic government budget deficits, and high debt levels will test investors' current inflation complacency, especially as the disinflationary forces of globalization continue to wane. While a repeat of the 1970s is not our forecast, inflation will be a higher and thornier problem in the coming 10 years than for most of the past few decades.

Economic Outlook

We expect the global economy to expand at a moderate 2½-3% annual rate over the next decade, led by emerging-market (EM) economies, expected to grow at about 4% annually, while developed-market (DM) economies grow at about 2% annually. (We assume the Strait of Hormuz will soon reopen and oil and gas flows will return to normal over time.) While our forecasts reflect expected trends rather than cyclical dynamics, the mature stage of the economic expansion implies that the odds of a recession in the next few years are high and that the path over the next decade could be bumpy.

Economic indicators and capital markets pricing are consistent with late-stage conditions. The G7 unemployment rate is close to a 50-year low, indicating limited scope for any sustained further decline that would reinforce the economic expansion as new employees earn and spend income. The aging population in DM economies, combined with already weak fiscal fundamentals and efforts to onshore strategic industries, signal that average inflation is unlikely to align with central bank targets. We expect DM inflation to average 2½%+ in the coming decade.

The advance of AI promises to have profound implications for the global economy, but it is premature to factor in a dramatic rise in global economic growth and productivity into the outlook for capital markets in the coming decade. Optimism about the implications of AI on corporate profits over the long term may already be significantly discounted.

S&P 500 average forward returns (%)

Starting P/E	1-year	3-year	5-year	10-year
<10x	13.4	11.2	12.3	11.5
10–12	14.9	13.0	10.4	10.5
12–14	10.5	9.1	8.5	9.6
14–16	12.4	10.9	9.8	9.3
16–18	6.4	6.3	5.4	5.7
18–20	7.7	6.0	5.9	4.4
>20	5.2	4.8	5.5	3.0

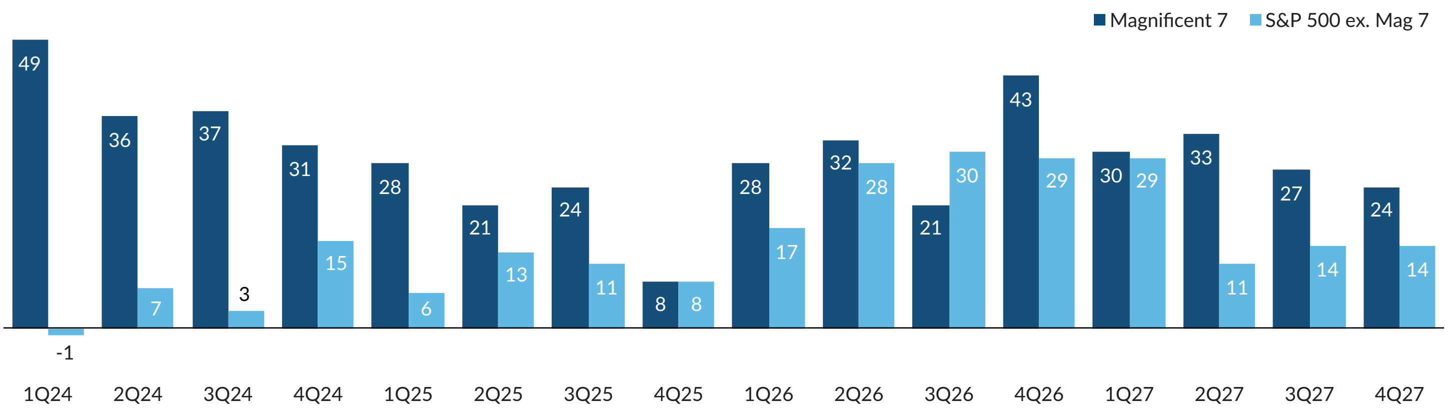
Source: Strategas, as of 6/30/26

10-year return forecast

Asset class	Range (%)
Equities	**5–7**
U.S.	5–7
Non-U.S. developed markets	5–7
Emerging markets	5–7
Bonds	**4–6**
U.S. government	3–5
U.S. investment grade	3–5
U.S. high yield	4–6
Emerging market sovereign	4–6
Cash	**2–4**
Inflation	**2–4**

Source: Crossmark, as of 6/30/26

Earnings growth expectations: Mag 7 vs. the rest of the S&P 500



Source: JP Morgan, as of 6/30/26

Valuation levels remain high

S&P 500 valuation: Current percentile rankings relative to history

Source: Strategas, FactSet, Bloomberg, Robert Shiller, as of 6/30/26

Fixed Income

Government bonds should deliver moderate positive real returns over the next decade, given current and forecast yields. Investors should expect a U.S. 10-year Treasury yield to average about 5% over the next decade, similar to U.S. nominal GDP growth.

Barring an outbreak of much higher inflation, DM longer-term bonds should generate moderately positive real returns in the next decade, marking a significant improvement from the past 10 years. Corporate bonds and other credit products will likely outperform similar-duration government bonds, but by less than the historical average (as credit spreads widen modestly).

Equities

Global equities have generated historically strong annual real returns of approximately 10% in local currency terms in the past decade. Both the U.S. and global ex-U.S. benchmarks have contributed solid gains, albeit with the U.S. outperforming. Global total returns have been driven primarily by strong real earnings growth and a rising P/E ratio. Decade-long meaningfully positive contributions from both earnings and the P/E ratio historically have been rare occurrences.

The elevated starting point for global equity valuations and earnings indicates subpar total returns in the next 10 years, albeit with higher returns for select non-U.S. markets compared with the U.S. P/E ratios are above long-term averages, while return on equity (ROE) is at the upper end of its 50-year range. The best bet is that each will retreat toward past norms. The implication is that a slowdown in earnings growth and profitability will translate into lower equity returns in the next 10 years compared with most of the past several decades.

The U.S. market is particularly vulnerable, since both the P/E ratio and ROE are historically elevated. [The trailing P/E ratio is 28 versus a 25-year average of 21. Meanwhile, return on equity is just over 20 compared with a 50-year average of 15 (and a similar 25-year average).]

Investment Implications

The coming 10 years promise to be difficult for global multi-asset portfolios. Most assets have benefited in recent years/decades from highly supportive but ultimately unsustainable fiscal, monetary, and other policies. Global equity valuations are notably elevated, as are corporate earnings. Global equities have massively outperformed bonds over the past decade, with stocks generating very strong returns and bonds exceptionally weak returns. That relative performance is poised to shift in the next 10 years, as real returns for equities decline while real returns for bonds turn mildly positive.

U.S. equity market capitalization as a share of global and the real trade-weighted dollar are at or near historic highs. Economic and capital market fundamentals indicate that they will unlikely stay there.

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.**

About Crossmark Global Investments

Crossmark Global Investments is a faith-based investment management firm that creates and manages values-based investment strategies with a goal of providing performance excellence for financial intermediaries and their clients. Founded in 1987, the firm specializes in developing tailored solutions and has a rich history of inspiring and equipping its clients to align their investments with their values. For more information, visit crossmarkglobal.com.

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