Return expectations in a low-return environment

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The last decade has been a difficult time of falling real interest rates, as the world's policy makers (especially central banks) have struggled to significantly increase economic growth rates after the global financial crisis (in 2008). For many major developed markets, interest rates have decreased into very low and even negative territory, while inflation has remained stubbornly low.

Lower interest rates result in lower cash returns for investors. Interest rates and, in particular the lowest-risk interest rates for a good credit quality country (for instance the US), are called the risk-free rate. This is an important measure in investment markets, as it is used as the basis for developing expectations and required returns from many investments. The basic principle of investing is there should be some return compensation for taking on more risky investment opportunities. This is typically referred to as the risk premium of an asset class relative to the risk-free rate of return. When these risk premia for the different fixed interest and growth asset classes are added to a low real risk-free rate base, the expected future returns for riskier asset classes are lower.

Momentum Investments estimates suitable longer-term forward-looking expected returns for various asset classes. These returns are calculated using theoretical models with market information at a certain point in time being key inputs to the model. This allows the investment team to estimate what can be expected from a return perspective over a reasonable investment cycle. It is evident from the table below that if these forward-looking return expectations based on 2018 calculations are compared to the same asset classes five years ago, the return expectations have reduced.

This is also aligned to the expected returns, which have continued to be driven lower after the global financial crisis. The table represents the change in return expectations for the various asset classes from 2013 estimates to those of 2018.

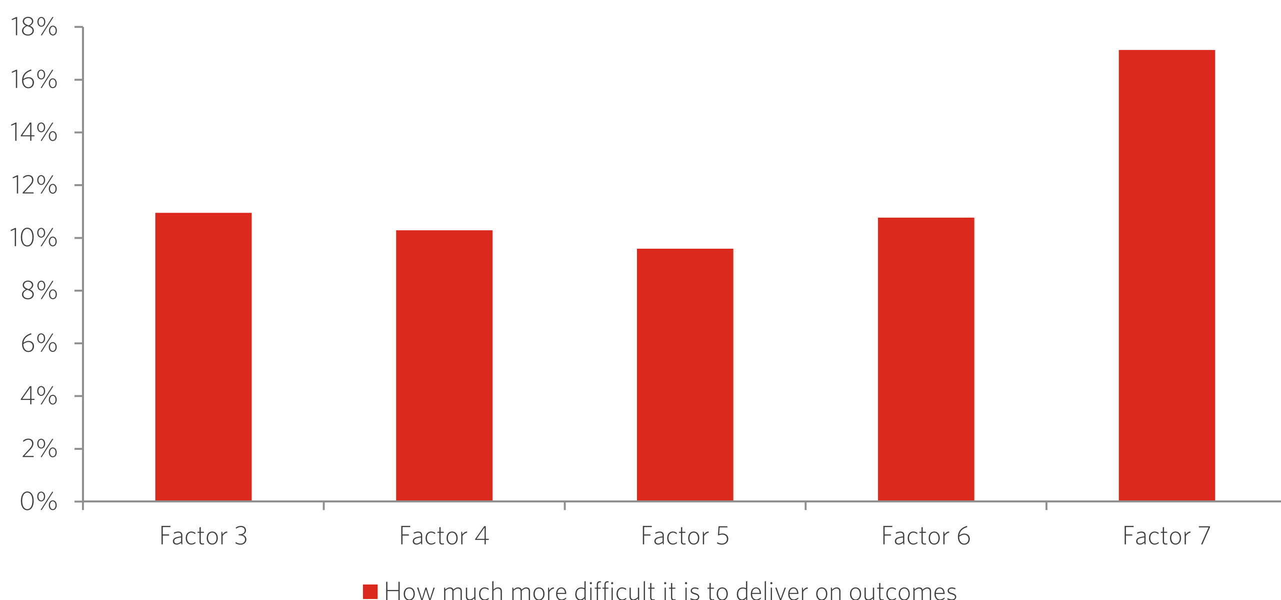
Asset class	Change in return expectations from 2013 to 2018
Local equity	-2.25%
Local bonds	0.50%
Local cash	-1.25%
Local property	0.25%
Local inflation-linked bonds	-0.25%
Global equity	-0.50%
Global bonds	-3.00%
Global property	-2.00%

Higher global risk-free rates are required for better long-term asset class returns and it seems likely that, during the initial phase of an envisaged transition from low to higher risk-free rates in the coming years, investors could face a challenging combination of lower asset class returns and increased volatility. This also means resultant lower expected returns for multi-asset class portfolios across the risk spectrum.

For a multi-asset class solution, it also becomes increasingly difficult to deliver on predefined objectives. It is therefore expected that portfolios should deliver lower returns in general and, as a result, objectives significantly higher than inflation become increasingly difficult to deliver.

The chart below represents multi-asset class solutions designed to deliver on different inflation objectives. The likelihood of delivering on the respective inflation objectives are compared using expected returns of 2013 compared to 2018. This shows it has become 10% to 17% more difficult to deliver on the same objectives compared to five years ago.

Increased difficulty of delivering on outcomes



Even though Momentum Investments expects a low-return environment for an extended period, there are a number of behaviours, which should be considered and implemented to navigate this low-return environment. These are mentioned below:

- Minimising unnecessary trading costs, switches between portfolios and investment fees add to the return of a client – every rand saved in fees, adds to rands in a client's pocket
- Save more, spend less
- Avoid taking excessive risk to boost returns
- Avoid chasing last year's investment winners – last year's returns are not indicative of future returns

Diversification and risk management are the fundamental building blocks of portfolio construction and management. Diversification across asset classes and risk factors can potentially deliver better return outcomes. However, no amount of portfolio construction or sound portfolio management will count for much, if investors don't remain focused on the outcome, ride the inevitable ups and downs in line with the defined risk parameters they are comfortable with and ultimately stay the course and remain invested. The best determinant of success is not timing markets, but time in the markets! Instead of investing in a portfolio with a goal of outperforming a particular benchmark or peer, the focus should remain on achieving the objective within the predefined risk parameters through a suitable outcome-based investment portfolio.

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