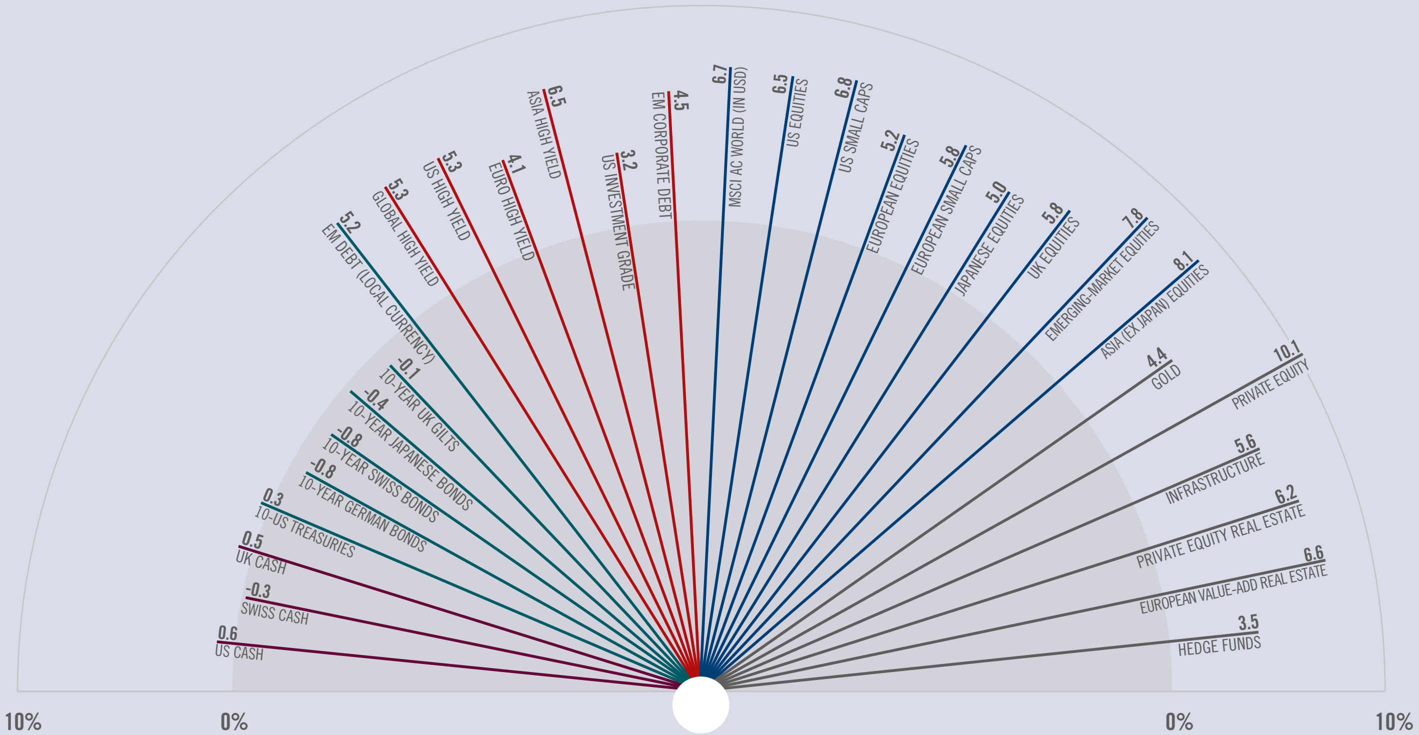
HORIZON

RETURN EXPECTATIONS FOR THE NEXT 10 YEARS
NEW APPROACHES TO INVESTING



CASH

GOVERNMENT BONDS

CORPORATE BONDS

EQUITIES

ALTERNATIVES AND GOLD

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OUR CENTRAL, DOWNSIDE AND UPSIDE SCENARIOS FOR REAL GROWTH AND INFLATION

Average 2020

Inflation %	Switzerland	US	Euro area	UK	Japan	China	India	World
Downside	-1.0%	0.2%	-0.3%	-0.5%	-0.3%	2.5%	2.2%	1.8%
Central	**-0.5%**	**0.4%**	**0.2%**	**0.0%**	**0.2%**	**3.0%**	**3.2%**	**1.9%**
Upside	0.4%	0.5%	0.8%	0.7%	0.5%	3.5%	4.2%	1.9%

Real GDP growth	Switzerland	US	Euro area	UK	Japan	China	India	World
Downside	-10.0%	-12.3%	-14.0%	-12.0%	-7.8%	-2.7%	-4.0%	-7.0%
Central	**-7.5%**	**-7.7%**	**-9.5%**	**-10.5%**	**-5.8%**	**1.2%**	**-2.7%**	**-4.1%**
Upside	-4.0%	-4.2%	-4.7%	-5.5%	-3.3%	2.8%	-1.5%	-1.2%

Average 2029

Inflation %	Switzerland	US	Euro area	UK	Japan	China	India	World
Downside	0.7%	1.8%	1.0%	1.9%	0.0%	2.0%	4.0%	2.3%
Central	**1.4%**	**1.9%**	**1.7%**	**2.1%**	**0.8%**	**3.0%**	**5.0%**	**2.8%**
Upside	1.9%	4.0%	2.0%	4.0%	1.2%	4.0%	6.0%	3.9%

Real GDP growth	Switzerland	US	Euro area	UK	Japan	China	India	World
Downside	1.3%	1.4%	0.8%	0.9%	0.2%	4.1%	6.3%	2.5%
Central	**1.7%**	**2.1%**	**1.3%**	**1.5%**	**0.7%**	**4.6%**	**6.8%**	**2.9%**
Upside	2.0%	2.5%	1.7%	1.9%	1.2%	5.1%	7.3%	3.6%

Source: Pictet WM-AA&MR, June 2020

PICTET WEALTH MANAGEMENT'S AVERAGE ANNUAL RETURN EXPECTATIONS FOR THE NEXT 10 YEARS*

	10-YEAR	NOMINAL TOTAL RETURNS BY CURRENCY USING MODIFIED PURCHASING POWER PARITY (PPP)			
	Local (Modified PPP)	CHF	USD	EUR	GBP
CASH					
US cash	**0.6%**	0.6%	0.6%	-0.6%	-1.0%
Europe cash	**-0.1%**	1.1%	1.1%	-0.1%	-0.5%
Swiss cash	**-0.3%**	-0.3%	-0.4%	-1.4%	-1.9%
UK cash	**0.5%**	2.2%	2.1%	0.9%	0.5%
Japan cash	**0.0%**	0.8%	1.3%	0.2%	-0.1%
GOVERNMENT BONDS					
Global government bonds, all maturities	**0.6%**	0.4%	0.6%	-0.6%	-1.0%
10-year global government bonds	**0.5%**	0.4%	0.5%	-0.7%	-1.0%
10-year US Treasuries	**0.3%**	0.3%	0.3%	-0.9%	-1.3%
10-year German Bunds	**-0.8%**	0.3%	0.3%	-0.8%	-1.2%
10-year Swiss bonds	**-0.8%**	-0.8%	-0.9%	-1.9%	-2.4%
10-year Japanese bonds	**-0.4%**	0.5%	1.0%	-0.2%	-0.4%
10-year UK gilts	**-0.1%**	1.6%	1.5%	0.3%	-0.1%
EM debt (local currency)	**5.2%**	5.3%	5.2%	4.1%	3.6%
EM debt (hard currency)	**4.7%**	4.8%	4.7%	3.6%	3.1%
CORPORATE BONDS					
Global high yield	**5.3%**	5.3%	5.3%	4.1%	3.7%
US high yield	**5.3%**	5.4%	5.3%	4.1%	3.7%
Euro high yield	**4.1%**	5.2%	5.2%	4.1%	3.7%
Asia high yield	**6.5%**	6.6%	6.5%	5.3%	4.9%
Global investment grade	**3.1%**	3.1%	3.1%	1.9%	1.5%
US investment grade	**3.2%**	3.3%	3.2%	2.1%	1.6%
Euro investment grade	**1.8%**	2.9%	2.9%	1.8%	1.4%
Asia investment grade	**4.0%**	4.0%	4.0%	2.8%	2.4%
EM corporate debt	**4.5%**	4.6%	4.5%	3.3%	2.9%
EQUITIES					
MSCI World (in USD)	**6.5%**	6.5%	6.5%	5.4%	5.0%
MSCI AC World (in USD)	**6.7%**	6.7%	6.7%	5.5%	5.1%
US equities	**6.5%**	6.6%	6.5%	5.3%	4.9%
US small caps	**6.8%**	6.9%	6.8%	5.7%	5.3%
European equities	**5.2%**	6.3%	6.3%	5.2%	4.8%
European small caps	**5.8%**	7.0%	7.0%	5.8%	5.4%
Euro equities	**5.4%**	6.6%	6.6%	5.4%	5.0%
Japanese equities	**5.0%**	5.8%	6.3%	5.2%	4.9%
Swiss equities	**5.8%**	5.8%	5.8%	4.7%	4.2%
UK equities	**5.8%**	7.4%	7.4%	6.2%	5.8%
Emerging-market equities	**7.8%**	7.9%	7.8%	6.7%	6.2%
Asia (ex Japan) equities	**8.1%**	8.2%	8.1%	7.0%	6.6%
ALTERNATIVES AND GOLD					
Gold	**4.4%**	4.5%	4.4%	3.3%	2.8%
Private equity	**10.1%**	10.1%	10.1%	8.9%	8.5%
Infrastructure	**5.6%**	5.7%	5.6%	4.5%	4.0%
Private equity real estate	**6.2%**	6.3%	6.2%	5.1%	4.6%
European value-add real estate	**6.6%**	7.8%	7.8%	6.6%	6.2%
Hedge funds	**3.5%**	3.5%	3.5%	2.3%	1.9%

* Past performance and forecasts are not per se a reliable indicator of future performance.
Source: Pictet WM-AA&MR, June 2020

A FRESH APPROACH TO STRATEGIC INVESTING POST THE PANDEMIC

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Dear Reader,

It is with special pleasure that we present the 2020 edition of *Horizon*, devoted to our long-term, top-down view of economies, expected returns and strategic asset allocation.

This year, the covid-19 outbreak compelled us to hold back on publication for a few weeks as we tried to assess what the pandemic would mean for markets and economies beyond the short-term plunge and relief rally. Although we are in completely uncharted territory and it will take a couple of years before the consequences of the pandemic are fully understood, we have used the publication delay to re-assess our economic forecasts and return expectations across asset classes.

Sticking to our time horizon of 10 years, which we believe is the most relevant for strategic investing, we are of the view that **the sudden, violent recession triggered by covid-19 has generally provided further impetus to a number of pre-existing economic and market dynamics.** For example, having had to step in to buy massive new government debt issuance, central banks are moving away from any thought of 'policy normalisation', while new ideas for stimulating economies like Modern Monetary Theory and yield curve control have gained ground. In all, we are in what we call a 'debt dominance' monetary policy regime that aims to durably suppress rates. This has a number of consequences for asset-class returns. First and foremost, it means a paradoxical improvement in equity returns since we predict we will remain in the same regime over the time horizon of this publication. There is also an improvement in our return expectations for private assets. By contrast, suppressing interest rates means return prospects for government bonds and cash are decreasing. The turn in monetary policy also confirms that the endowment style of investing remains the most appropriate strategic asset allocation-style.

We maintain our belief that the concepts of regime and regime shift are vital to understanding the economic and inflation dynamics that underpin trends in asset classes. The most obvious example of a 'regime shift' is China, where annual GDP growth dropped from 12% in real terms in the early 1990s to under 7% after 2015 and will drop further, to around 4% over the coming 10 years. While we expect inflation in China to increase to an annual average of 3%, our core scenario is that we will remain in a low inflation regime in major economies. However, the massive injections of liquidity by central banks into financial systems to deal with the effects of the coronavirus pandemic mean there is the chance of a 'regime shift' toward higher levels of global inflation, possibly triggered by currency depreciation and debasement.

Among classic asset classes, our analysis was already showing that returns for core sovereign bonds would be lower than in the past: now **we expect average annual nominal returns of 0.3% for US Treasuries over the next 10 years (versus 9% for the best part of four decades)**. Previous editions of *Horizon* also argued that the decline in return expectations for cash meant it should simply be a way for storing value until more attractive investment opportunities appear rather than as an intrinsic part of strategic asset allocation. As a result of the regime shift underway in monetary policy, this year's edition of *Horizon* forecasts a further decrease in annual returns for cash over the next 10 years. By contrast, gold is one of the assets that should benefit the most from the shift in the monetary policy regime (and possibly inflation regime), with an expected average annual return of over 4% (in US dollars). Ever since we first compiled our return expectations in 2013, we have been improving and extending our coverage of top-down investment drivers, with analysis of economic issues feeding into our expected returns for an ever-increasing number of asset classes and then into our strategic asset allocation. This year sees a number of additions to the asset classes we cover, bringing the total to 41 in four currencies. As private assets play an increasing role in our investment strategy, this year we present our expectations for infrastructure. Asian credit also makes an appearance in *Horizon* for the first time. In parallel, we continue to extend our research into strategic asset allocation, with this year's edition offering insight into behavioural finance and goals-based investing.

The broadening of our coverage is part of Pictet Wealth Management's efforts to better identify return dynamics across asset classes. This involves furthering our analysis into 'regimes' and ensuring the modelling we use in our financial analysis remains robust.

Now we want to delve further into deep-rooted structural trends that could have an impact on long-term return expectations, leading to the launch of 'Beyond *Horizon*'. **'Beyond *Horizon*' is a new development in our top-down research, based on the premise that behind changes in economic regimes are a number of precise structural drivers.** Our research is leading us to concentrate on seven structural drivers, some of which will be familiar to readers of previous editions of *Horizon*.

For example, we have been integrating issues around innovation into our expected return analysis since 2014. Likewise the 'great divergence' in debt dynamics and sustainability around the world, demographic change and the rise of populism. Events in the first half of 2020 strengthened the momentum behind a number of these structural drivers. For example, debt sustainability is likely to be a thorny issue in the years ahead, with a rocketing of the public debt-to-GDP ratio in developed countries from an average of 105% to 130% in the space of a few months. **China's challenge to the US is likely to gain momentum, with the prospect for the first time ever of a bipolar world in terms of technological and economic leadership.** Such developments have important consequences for our economic and asset class forecasts.

> "We foresee an improvement in long-term returns for private assets and, paradoxically, for equities. But the suppression of interest rates is hurting prospects for cash and government bonds"

Designing a strategic asset allocation is one of the most important steps of any investment process. Upon it rely tactical asset-allocation decisions and the bulk of long-term performance. Arriving at the most appropriate strategic asset allocation for the times we live in is a fundamental reason for developing further our research and combining our macro-economic analysis, asset class convictions and tactical asset allocations in the most coherent and resilient way possible.

This edition of *Horizon* also includes the latest refinements to our estimates of risk, based on the idea that volatility offers too restrictive a view of the risk that investors actually bear. In previous years, we proposed looking at drawdowns as a better gauge of risk. This explains why this edition looks at behavioural finance, which naturally leads to examining the potential for goals-based investing, an area that has a lot to offer to strategic asset allocators. We hope that this issue of *Horizon* provides you with insight into the top-down issues that Pictet Wealth Management looks at in its strategic asset allocations as well as ideas for achieving your own investment goals. Happy reading! ■

Secular outlook and trends

1 **Return expectations swayed by pandemic.**
The severe pressure that risk assets came under as covid-19 spread across the world, together with structural changes to the global economy and the distortions caused by policy responses to the pandemic, are all leading us to alter our long-term return expectations across a range of assets, including cash, bonds and equities.

2 **Long-term growth factors to the fore again.**
The coronavirus pandemic alters the trajectory for the global economy, which should rebound strongly in 2021 after contracting in 2020. China should recover relatively quickly and move back to its lower long-term growth equilibrium as internal structural changes continue. A slight pick-up in productivity growth driven by technology means we are more bullish on the long- and medium-term prospects for the US economy than US official institutions. The US should cement its growth advantage over Europe.

3 **A 'debt dominance' monetary policy regime.**
Covid-19 will accelerate a number of long-term trends, such as the rise of the virtual economy and the growing concentration of value creation. It will also hasten the move to new approaches to economic policy, with unorthodox policy making ensuring that interest rates remain low for a long time.

4 **Rising populism threatens forecasts.**
Our central scenario is that we will remain in a mild innovation-driven growth regime that will be prolonged by increased central bank activism. Our negative scenario captures the risk that various forms of populism end up benefiting from the coronavirus pandemic, threatening GDP growth over the long term.

Expected returns

5 **Cash is no longer king.**
Our analysis came to the same conclusion in previous years, but our belief that we will see a period of financial repression to keep borrowing costs low for governments and companies alike means that we estimate that real average annual returns will be negative for cash in Swiss francs and euros over the next 10 years, while US cash will offer a paltry 0.6%. Investors will need to consider other liquid alternatives to improve prospects in a prolonged period of rock-bottom interest rates.

6

Equity returns to increase.
Mechanically, taking as a starting point a year like 2020, when earnings will decline significantly as a result of the coronavirus, results in a rise in our 10-year return expectations for equities compared to our initial calculations. The persistence of low bond yields will likely prolong equities' appeal. However, the fallout from the covid-19 outbreak could mean that equity income in the form of dividends declines.

7

Negative returns for sovereign bonds, better prospects for high yield.
Prolonged downward pressure on interest rates will mean that 'core' government bonds will deliver paltry or even negative average annual returns over the next 10 years. Persistently low rates mean that core bonds will provide scant protection against even a slight rise in inflation. Their safe-haven status may even come into question. While the feeble outlook for government bonds will affect investment-grade returns, long-term return expectations for high-yield bonds, which have more equity-like features, look like improving as a result of recent events. The expected returns from emerging-market debt also look correspondingly more attractive for investors willing to tolerate the risk.

8

The case for accepting the illiquidity premium.
Against a backdrop of diminishing returns for traditional asset classes like bonds and cash, investors will continue to be attracted to alternatives capable of boosting the prospects of a diversified portfolio. We believe the pandemic opens up new avenues for assets with long lock-up periods like private equity, which could achieve double-digit annual returns on average over the next 10 years.

Asset allocation

9

Higher volatility ahead
Investors will have to become used to much higher volatility in the coming years, with an increase in the frequency and magnitude of temporary drawdowns. As a result, diversification and selectivity must remain paramount in investors' considerations and they will need to refine their approach to risk tolerance. We see behavioural finance growing further in relevance in efforts to improve portfolio returns.

10

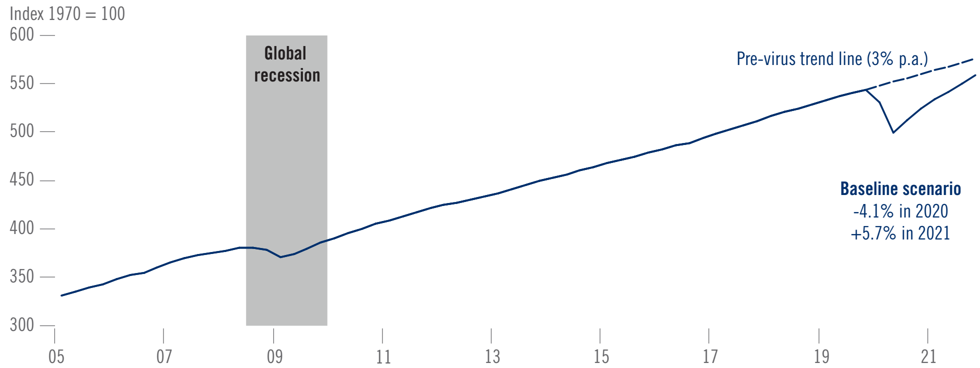
The endowment approach maintains its allure.
The diminished potential of traditional 60/40 portfolios (60% equities and 40% bonds) because of fading returns from bonds will increase the urgency to find alternative approaches to strategic asset allocation. We believe that carefully calibrated endowment-style investing, which incorporates hefty exposure to private equity, real assets and absolute-return strategies, has the potential to boost long-term returns.

COVID-19 WILL LEAVE AN INDELIBLE MARK ON LONG-TERM RETURNS

The long-term consequences of the coronavirus pandemic on the global economy and markets vary. More than ever, proper diversification and selection are key to a strategic asset allocation.

The first and most obvious consequence of the covid-19 pandemic is that the risks surrounding our central scenario for the long term have increased. At this stage, one can more easily see new risks rising disproportionately to opportunities. The second point is that the global economy is now on a different trajectory to the one is was on before covid-19. The global recession in 2020 will be on a scale never seen before. Our central forecast is for global GDP to contract by over 4% in 2020 before rebounding by 5.7% in 2021 (*see chart 1*).

CHART 1: GLOBAL RECESSION IN 2020: OUR CENTRAL SCENARIO



Source: Pictet WM-AA&MR, International Monetary Fund, Thomson Reuters, April 2020

It will be 2022 before we see world real GDP return to its level at end-2019. And, as is often the case after an economic crisis, the growth trend over the coming decade will be lower than in the previous 10 years. In other words, as in all crises, the pandemic will lead to a permanent loss of GDP.

Our world GDP forecasts for 2020 and 2021 are based on two assumptions: first, that there will not be a second (or third) wave of the coronavirus and, second, that the most drastic nationwide lockdowns do not go beyond 60 days.

The third point to be made is that **our 10-year return expectations across asset classes have been significantly distorted by the pandemic** (*see chart 2*). Our expectations have had to be modified not only because the world economy will follow a different growth trajectory, but also because the starting point for forecasts on most asset classes has completely changed. For example:

- Nominal US Treasury yields reached an all-time low of 0.6% in early May 2020 and we expect them to remain low given the lasting change in the monetary policy regime. As a result, we expect the total return on core sovereign bonds, including US Treasuries, to decline by up to 150 bp in the period 2020-2029.

- The decline in the main equity market indices between mid-February and mid-March, automatically improves 10-year equity returns by around 90bp compared with our estimates in 2019. As usual, a crisis such as the one seen in 2020 offers better entry points and therefore better opportunities for long-term investors.
- We expect spreads on good-quality corporate bonds to decrease significantly over the coming 10 years, with their nominal annual returns in the US and Europe increasing by around 90bp and 140bp, respectively, compared to last year's edition of *Horizon*.

The adjustments to our return expectations are occurring in a complex interaction between political, geopolitical, economic and financial markets.

Economic and political impact

The **economic and political** consequences of the pandemic outbreak are varied and tend to reinforce structural trends identified previously. Seven general points can be made in that regard:

1. Rising public and private debt levels could eventually reduce potential real growth levels in developed and emerging economies alike.

2. Central bank action has prevented both a liquidity squeeze and a credit crunch—but at the cost of increased financial instability. Our return expectations include recognition that debt levels will rise across all major economies, with a concomitant rise in financial instability. The next crisis could hit harder and prove tougher to deal with.

3. The question of how to fund outsized public deficits significantly increases the risk of financial repression and confiscation. There could be higher taxes on businesses and households.

4. The independence of central banks will be increasingly called into question as countries with large budget deficits and high debt ratios are tempted to take control of central banks to use monetary policy for political purposes.

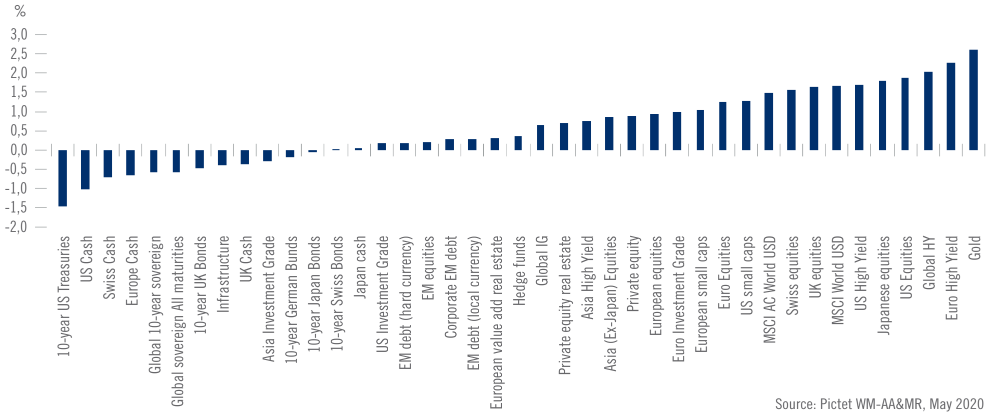
5. Pressure to monetarise government debt, including currency devaluation, could lead to a resurgence in inflation and growing mistrust of the currency in question. Such a scenario could ultimately increase the risk of financial and economic crises.

6. The monetisation of public debt is already being achieved through the direct or indirect purchase of government-issued bonds by central banks. In the process, we are approaching the ideas set out in Modern Monetary Theory. Increasingly, it is governments that determine the amount of money in circulation, irrespective of the level of economic activity. Should governments end up determining policy interest rates, conventional credit mechanisms will be changed, with artificially low rates translating into artificial valuations of assets.

7. We will probably see de-globalisation gain momentum, while a further rise in nationalism and populism as a result of the fallout from the pandemic could profoundly change styles of economic policy.

"Our 10-year return expectations across asset classes are significantly distorted by the pandemic"

CHART 2: CHANGES IN OUR 10-YEAR EXPECTED RETURNS AS A RESULT OF COVID-19 (MAY 2020 VS. MARCH 2020)



Source: Pictet WM-AA&MR, May 2020

> “The pandemic has increased the appeal of the endowment approach to investing”

Financial markets and asset allocation

Following the pandemic, we can expect some of the economic trends and changes in monetary and fiscal policy style that we identified and wrote about in previous editions of *Horizon* to accelerate.

1. Economists and strategists argue about the fundamental factors that have hastened the general decline in interest rates to close to or below zero since the appearance of the coronavirus. Nevertheless, it is reasonable to think that the turn in central banks' monetary styles is one factor. We see central banks tending to adopt a style that combines yield curve control and Modern Monetary Theory (MMT). In short, **central banks will be financing government deficits while setting their financing costs at levels significantly below nominal growth.**

2. As a result, with the Federal Reserve already holding 26% of all government bonds issued by the US Treasury, **bond market mechanisms are being dislocated with the risk that 'core' sovereign bonds lose their safe-haven status.**

3. The very low returns on core sovereign bonds are leading to capital erosion in real terms (financial repression) **and making it increasingly difficult to create a well-diversified portfolio through a balanced strategic asset allocation.**

4. We have previously argued that **'cash is no longer king'** when it comes to strategic asset allocation. The kind of MMT + yield curve control being adopted by central banks supports this argument.

5. **The classic 60/40 strategic asset allocation (60% equities, 40% core government bonds) is losing its lustre** due to the growing cost of diversification brought about by increasingly negative real returns on government bonds. By contrast, the appeal of the endowment style, which makes significant allocations to alternative assets (private equity, real assets, absolute-return strategies), is growing as a result of the pandemic.

6. However, **the worrying rise in debt levels raises the issue of debt sustainability.** The need for selectivity is becoming increasingly acute. Private equity firms' access to financing at a reasonable cost and their resilience to economic shocks must increasingly be part of the equation when selecting deals.

In brief, after the coronavirus crisis, the key words in strategic asset allocation are now more than ever diversification and selection.

BEYOND *HORIZON*

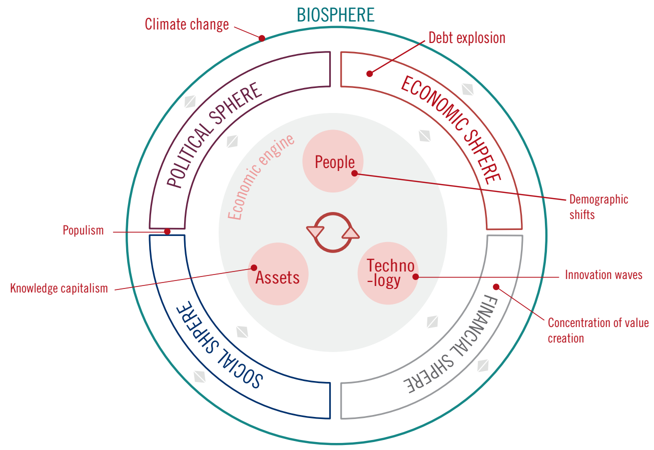
Pictet Wealth Management has developed a new initiative, called 'Beyond *Horizon*' to expand our understanding of the underlying drivers of economic regimes and their consequences for asset classes.

'Beyond *Horizon*' is a vehicle for examining structural drivers that have far-reaching and potentially massive consequences on our geopolitical, economic and financial environment. This initiative is aimed specifically at deepening our understanding of economic and asset class regimes' underlying drivers and their impact on asset performance. This, in turn, should help us continuously improve and adjust our long-term projections and asset allocation choices.

So far, we have identified seven drivers of economic regimes and asset classes: climate change, innovation, demographics, populism, debt issues, the growing concentration of value creation and the growing importance of intellectual capital. More will be added as time goes on. Three of these drivers—**demographics, innovation and populism**—are actually already at the heart of the analysis we carry out for *Horizon*.

To these three long-term drivers we are now adding four others. First, **climate change** has rapidly risen up the list of people's concerns and is affecting the prospects of all economies. Second, **the explosion of debt** at a time of relatively feeble growth means the capacity to discriminate between different levels of solvency will remain at the fore of investor concerns. Third, the transition towards **knowledge capitalism** based on intangibles and fuelled by the exploitation of data is well underway and marks a major change in opportunities (and sources of risk) for all economic actors. Fourth, **the concentration of value creation** in the hands of a limited number of economic agents is leading to substantial changes in the investment universe. Our long-term forecasts for economies, asset classes and asset allocation will be further enhanced as we delve deeper into the new topics outlined and others.

SEVEN DRIVERS AND HOW THEY FIT INTO AA&MR'S GLOBAL TOP-DOWN FRAMEWORK



Source: Pictet WM - AA&MR, 12 June 2020

ENDURINGLY LOW RATES MEAN IMPROVED RETURNS FOR EQUITIES AND EQUITY-LIKE ASSETS

Persistently low rates are the common thread running through our return expectations for the coming 10 years. First, central bank moves to suppress interest rates mean return prospects for government bonds and cash will fall. Because of low rates and the regime shift underway in monetary policy towards versions of Modern Monetary Theory (MMT), we forecast a further decrease in annual returns for cash over the next 10 years. Average annual returns for cash in euro and Swiss francs will be negative, we believe. With 10-year return well below 1% in the US and negative return in Europe and Japan, expected returns for government bonds have decreased.

By contrast, the effects of policy responses to the coronavirus together with adjustments to our analysis of valuations mean there is an improvement in return expectations for equities. Assuming an unchanged end-economic regime, the huge gap between actual returns this year and annualised return forecasts made last year means equities mechanically see their projected returns for the next 10 years increase.

Low rates and improving valuations are also improving return expectations for private assets such as real estate and private-equity deals. Our analysis finds that average annual returns for private equity could reach over 10% (in US dollars) and private real estate equity over 6%.

Gold is one of the few assets that should benefit the most from the shift in the monetary policy regime (and possibly inflation regime), with an expected average annual return of over 4% (in USD dollars). For those willing to assume the risk, emerging-market debt and high-yield bonds offer interesting potential.

Cash is no longer king

Analysis shows that cash has provided only very modest post-inflation returns over the past 30 years. At a time of very low or even negative short-term interest rates, it is important to distinguish between real and nominal returns. Taking taxes and inflation into account, real returns from cash look even less appealing (*see table 1*). Overall, while low rates were already pushing us to reduce our expectations, the regime shift underway in monetary policy means we forecast a further decrease in annual returns for cash over the next 10 years. Average annual returns for cash in euro and Swiss francs will be negative and 0.5% in UK cash.

To raise return potential, cash investors need to consider how well they are disposed to different forms of risk, such as market and liquidity risk, duration and credit risk.

TABLE 1: CAPITAL EROSION OF 100 UNITS OF CASH IN SELECT ECONOMIES OVER THE NEXT 10 YEARS DUE TO INFLATION AND WEALTH TAXES

	Average inflation forecast %	Wealth tax %	Remaining capital	Capital erosion %
US	1.71	0	84.17	-15.8
US[1]	1.71	6	50.85	-49.1
Japan	0.68	0	93.41	-6.6
Euro area	1.39	0	86.95	-13.1
Switzerland	1.09	1.01	80.89	-19.1

[1]If a 6% wealth tax is applied starting on 1 January 2021

Source: Pictet WM-AA&MR June 2020

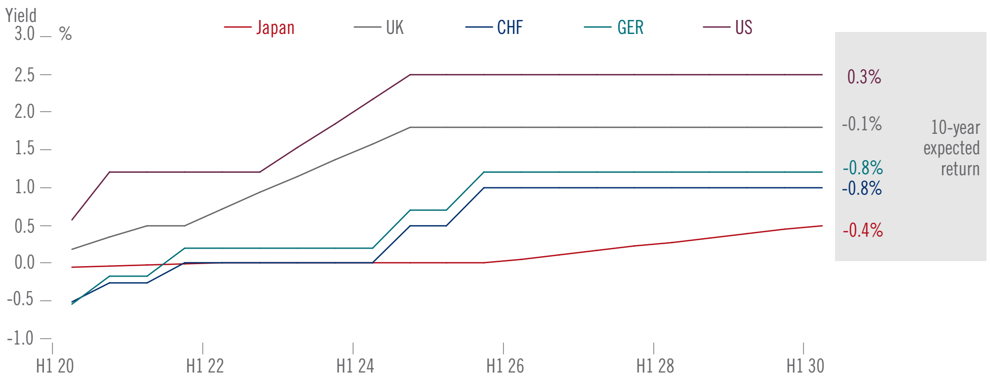
Sovereign bonds: portfolio protection will come at a price

Nominal average annual returns for US government bonds could be just 0.3% for 10-year US Treasuries. But this is better than our expectations for Japanese bonds of the same maturity (-0.4%) or German Bunds (-0.8%, *see chart 1*).

Overall, central banks' enduring suppression of interest rates means that, as with cash, return prospects for 'safe haven' government bonds are poor. Long-term interest rates should rise gradually in the next 10 years, with the 10-year US Treasury yield rising from about 0.6% to 2.5%. However, we expect that sovereign yields will remain structurally below nominal GDP growth over the next 10 years. The gap in the US is now expected to be 150bps compared with 50 bps in the 2019 edition of *Horizon*. As a result, **we believe that coupon payments on sovereign bonds will not compensate for the loss of value associated with what rate rises there are, except in the US and UK.**

The regime shift towards structurally lower government bond yields means that investors must be prepared for low returns, or even to pay (through negative interest rates) for the desired level of portfolio insurance traditionally provided long-term government bonds. In short, **the protection that benchmark sovereign bonds provide to portfolios will cost investors in terms of performance potential.**

CHART 1: SCENARIOS FOR MAJOR 10-YEAR SOVEREIGN BOND YIELDS AND EXPECTED RETURNS*



* Past performance or forecasts are not per se a reliable indicator of future performance

Source: Pictet WM - AA&MR, June 2020

> “We expect the Asian corporate bond market to continue to expand and mature”

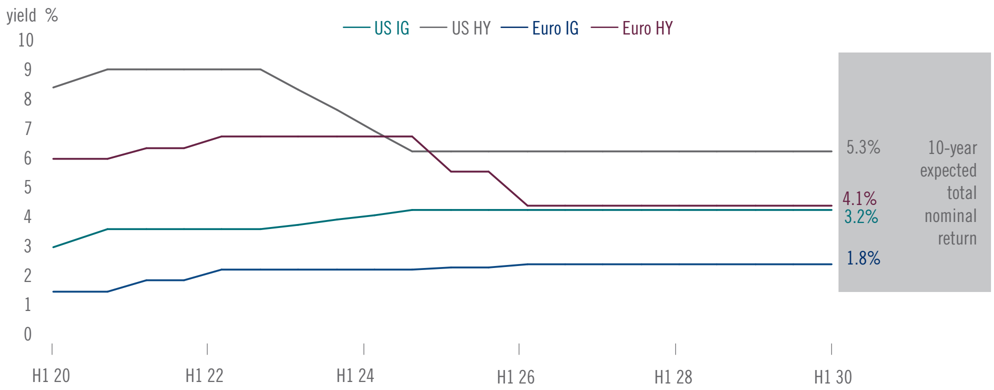
Corporate bonds: high yield to keep its allure

We expect total average annual returns of 3.2% for US investment-grade (IG) corporate bonds over 10 years, basing our calculation on a combination of our expectations for the 10-year sovereign yield and for the yield spread between IG corporate bonds and 10-year sovereigns. We expect average annual returns of 1.8% for euro IG over the same period (*see chart 2*).

The widening of spreads due to the covid-19 outbreak in 2020 provides an improved starting point for high yield: with enhanced potential for spread compression in the 10 years ahead, we have revised upward our 10-year average annual return expectations for US high-yield bonds to 5.3% (in US dollars) from 4.4% in 2019. The annual average return for US high yield is expected to be superior to returns from euro high yield, from which we expect 4.1% (in euros).

While high-yield spreads tend to climb in tandem with equity risk, this correlation has its limits. Indeed, the widening of high-yield spreads as covid-19 fears hit markets in March this year was muted in comparison with the rise in equity risk as policy responses by central banks and governments rushed to provide liquidity to financial markets.

CHART 2: SCENARIOS FOR DEVELOPED-MARKET CORPORATE BOND YIELDS AND EXPECTED RETURNS*



* Past performances are not per se a reliable indicator of future performance.

Source:Pictet WM - AA&MR, FactSet, April 2020

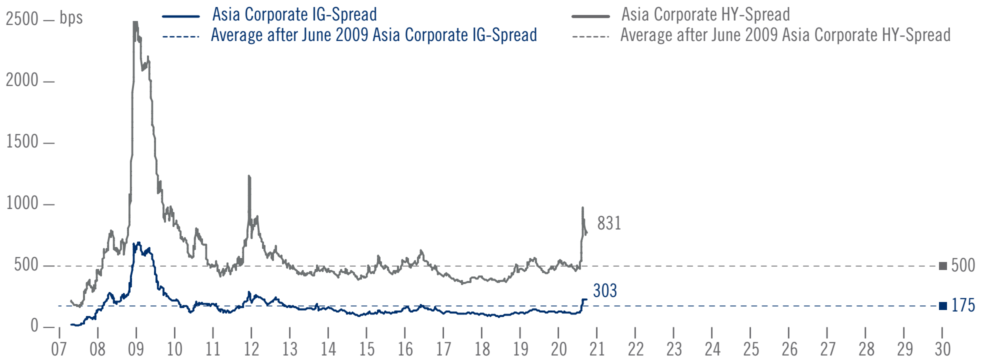
Asian corporate bonds offer the prospect of higher expected returns

Asian corporate bonds in hard currency have been attracting foreign investors thanks to tempting credit spreads and improving credit quality, with the market growing seven-fold since 2008.

Taking into account our expectations for tightening of credit spreads in the years ahead (*see chart 3*) as the Asian credit market matures (albeit they should remain higher than for developed-market credit), we foresee an average annual return of 4.0% for Asian (ex-Japan) investment-grade hard-currency bonds and 6.5% for Asian (ex-Japan) hard-currency high-yield bonds over the next 10 years. As such, the annual average return in US dollars from Asian credit is expected to be superior to the returns from US credit, both investment grade and high yield.

We expect the Asian corporate bonds market to continue to expand and mature over the coming decade. The reasons for this growth include rapid economic expansion in the region, the desire of Asian corporates to diversify their sources of funding, the need for Asian issues operating in US dollar-denominated industries to minimise currency mismatches and, last but not least, the growth in global investor appetite.

CHART 3: ASIAN CORPORATE IG AND HY SPREADS, INCLUDING FORECASTS FOR THE NEXT 10 YEARS*



* Past performance or forecasts are not per se a reliable indicator of future performance.

Source: Pictet WM-AA&MR, FactSet, May 2020

Pandemic improves returns for developed-market equity returns, but they will still be below their long-term average

At 6.5% (in US dollars), expected annual returns for US equities over the next 10 years will be around half the past rolling 10-year average. Our 5.4% average annual return expectation for European equities is also lower than the historic average. The decrease in return expectations would have been even greater had it not been for the low base point that is one of the side-effects of the covid-19 outbreak, which means that our long-term return expectations are higher than last year.

There are two main factors putting pressure on equities: the increase in valuations since the global financial crisis and the expected slowdown in earnings growth, in line with a softening of the secular outlook. As sovereign yields are expected to remain fairly low, our valuation expectations have been revised up from last year. Given the current backdrop, the dividend yield is expected to account for around 60% of equity returns in Europe and close to 40% in the US, above the long-term average (*see table 2*).

Small caps face specific risks, with a valuation premium that is highly unstable over time. This means greater uncertainty surrounds our expectations, although we presently expect an average annual return of 6.8% for US small caps and 5.8% for euro area equivalents (both figures in local currencies).

TABLE 2: KEY FACTORS IN LONG-TERM EXPECTED RETURNS* (IN %)

	Target dividend yield	Starting PE	Target PE	Target earnings growth %
US	2.1	16.9	16.5	4.0
US small caps	1.7	21.7	22.0	4.6
Europe equities	3.1	13.2	12.0	3.0
Euro area equities	2.9	12.7	12.0	3.0
Europe small caps	2.6	14.0	12.0	4.6
UK equities	2.5	11.1	11.0	4.2
Swiss equities	3.0	15.2	13.0	4.3
Japan equities	2.2	11.9	12.0	1.8

*Past performances and forecasts are not per se a reliable indicator of future performance

Source: Pictet WM - AA&MR, FactSet, April 2020

Emerging-market equities: a tiger in the tank

Overall, EM equities are expected to keep delivering high average annual returns in the next 10 years (7.8%), thanks to superior economic growth. Our expected returns have increased since last year on the back of anticipation for lower dilution, a positive foreign-exchange impact and a favourable base effect due to the covid-19 crisis.

Emerging-market (EM) equities have significantly outperformed developed-market (DM) ones over the long run, and our expectation is for this to remain the case in the 10 years to come (*see chart 4*). But

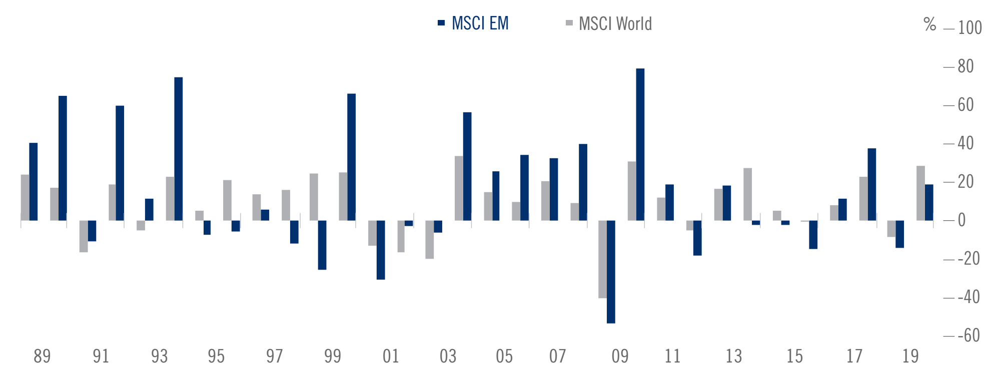
“EM equities have significantly outperformed over the long run, and we expect this to continue in the 10 years to come”

the gap is smaller than one might expect by looking solely at economic growth differentials. One important reason is the vital need for EM companies to raise capital and invest, which automatically dilutes earnings on a per share basis. In addition, EM equities' superior returns have come at the expense of higher risk, which has been sufficiently compensated less than half of the time. Nonetheless, the asset class remains an attractive one for long-term investors willing to bear the additional risk.

Breaking down EM equity returns shows that dividends and currency effects should not be overlooked. The former typically account for a third of total returns over time, whereas the latter can have an outsize impact on performance, especially over shorter-term horizons.

Within EM, the stellar rise of Chinese equities is far from over, as the progressive opening of China's economy is likely to lead to their further inclusion in benchmark indices and investor allocations. China's share of the EM space is already significant: investing in emerging markets increasingly means investing in China. In addition, South Korea and Taiwan, the second- and third-largest EM countries by market capitalisation are closely tied to Chinese production and supply cycles.

CHART 4: ANNUAL NOMINAL RETURNS OF EM AND DM EQUITIES (IN USD)*



*Past performances and forecasts are not per se a reliable indicator of future performance.

Source: Pictet WM – AA&MR, FactSet, 6 January 2020

Currencies: question marks over the dollar

According to our model, the US dollar and the Swiss franc are the most overvalued major currencies, whereas the Japanese yen is the most undervalued. We expect the US dollar to depreciate against most currencies over a 10-year horizon as favourable interest-rate differentials deteriorate and real US yields remain enduringly low. Our model shows the yen as having the most upside potential.

Our findings also show that sterling is undervalued. We therefore see sterling as the most likely to appreciate over 10 years against all currencies except the yen. However, a return to that currency's long-term equilibrium value is highly dependent on the UK's future relationship with the EU. Brexit highlights the limits of our model. Classic valuation models fail to grasp the potential regime shifts caused by political shocks. The risk of such shocks has increased with the global rise of populism(s).

A golden era ahead for gold

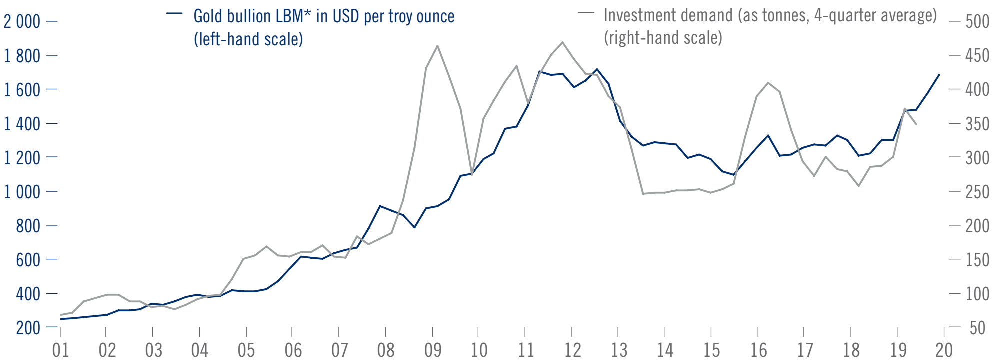
Based on our model, we see a gold bullion price of around USD2,470 per troy ounce over a 10-year time horizon (compared to around USD1,520 at the end of 2019). This translates into a 4.4% annual return over the same period. The boost to gold from our expectation that the dollar index will decline by around 14% over the same period and that the Fed's balance sheet will increase (at a rhythm significantly higher than US nominal economic growth) is slightly offset by the expected rebound in US real rates. Combined with our enhanced expectation for US dollar depreciation, **policy rates at their effective lower bound for an extended period of time coupled with increasing public debt is making US government bonds less attractive than gold, which bears no credit risk and has a strong track record as a store of value.**

While investment demand (*see chart 5*) accounts for only about 30% of total gold demand, a variety of reasons means it is the focus of our gold price projections. We use the US dollar, the 10-year US real rate and the size of the US Federal Reserve's balance sheet to estimate investment demand for gold.

While we see a rebound in real rates, it is now seen as being very modest and the Fed's balance sheet is expected to grow at a significantly more rapid pace than last year given the resumption of a broad quantitative easing programme. The combination of increasing levels of debt and massive expansion of the Fed's balance sheet to offset the effect of the covid-19 crisis suggest that any return to more 'normal' conditions will be challenging.

"Low policy rates for an extended period and increasing public debt are making US Treasuries less attractive than gold"

CHART 5: GOLD AND INVESTMENT DEMAND



*London Bullion Market

Source: Pictet WM – AA&MR, Refinitiv, April 2020

Private equity: the high-octane asset

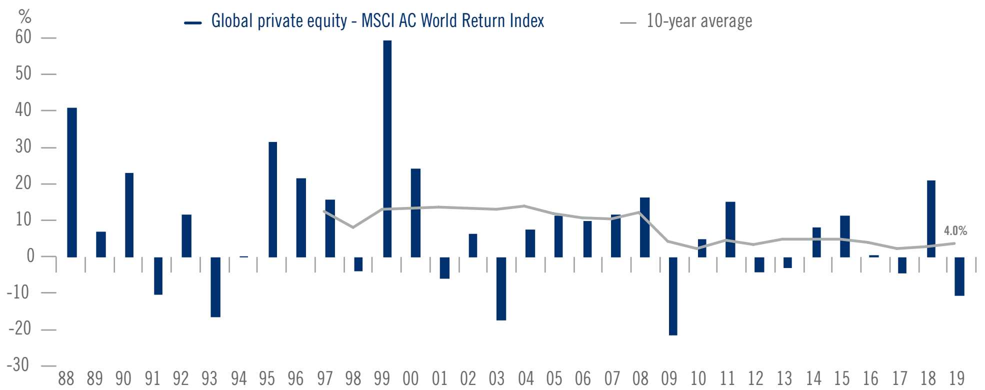
We expect private equity to deliver average annual returns of around 10% per year over the next 10 years, considerably more than global equities.

The decline in expected returns for classic 60/40 portfolios has led investors to consider alternatives, meaning tremendous growth in private equity and private assets in general over the past decade. **Expectations that low yields will persist mean that leverage should continue to support private-equity returns going forward.**

Private equity offers diversification benefits, steady returns and considerable alpha relative to public equities (*see chart 6*)—but manager selection is paramount. Company control, the ability to time the exit from investments, sector allocation and the proper use of financial leverage are the pillars of superior returns from private equity investments.

Venture capital, which accounts for about 13% of private-equity assets, performs more or less in line with private equity as a whole.

CHART 6: GLOBAL PRIVATE EQUITY: ANNUAL PERFORMANCE SPREAD OVER MSCI AC WORLD'S TOTAL NOMINAL RETURN*



*Past performance or forecasts are not per se a reliable indicator of future performance.

Source:Pictet WM-AA&MR, Pitchbook, March 2020

Infrastructure, a key asset class in the years to come

The strong performance delivered by private core infrastructure in the past 10 years (8.5% per annum) is expected to continue at a healthy, albeit slower, pace in the coming decade (5.6% per annum, *see chart 7*).

Among infrastructure's attractions are the high visibility and predictability of revenues. In addition, unlisted infrastructure, similar to many other private assets, has only a limited correlation with listed markets and can improve the risk/return profile of portfolios.

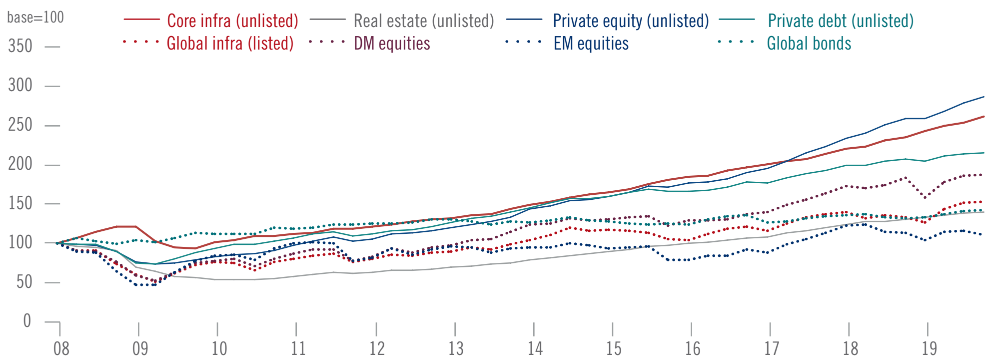
Private infrastructure – core infrastructure equity in particular – is a relatively new asset class but it has seen its popularity increase among long-term investors attracted by the promise of robust returns and portfolio diversification.

Infrastructure as an investment theme is here to stay. There will be a massive need for investments worldwide in the coming decades that the public sector is not able to meet fully, requiring private players to fill the gap. In addition, the tight link between the UN's Sustainable Development Goals and infrastructure makes the latter attractive to ESG-conscious investors.

The asset class is far from being homogeneous, covering a wide range of risk profiles, sectors and asset maturities. The many types of financial wrappers also add to the complexity. A careful understanding of risks is therefore warranted. In addition, as an asset class, private infrastructure needs to be further tested in adverse market conditions to assess the appropriate structural role it can play in long-term investors' asset allocation.

"The strong performance of private core infrastructure is expected to continue"

CHART 7: UNLISTED ASSETS TEND TO OUTPERFORM—HISTORICAL PERFORMANCE OF SELECT ASSET CLASSES



Source: Pictet WM – AA&MR, Pictet Alternative Advisors, FactSet, Preqin Ltd., April 2020

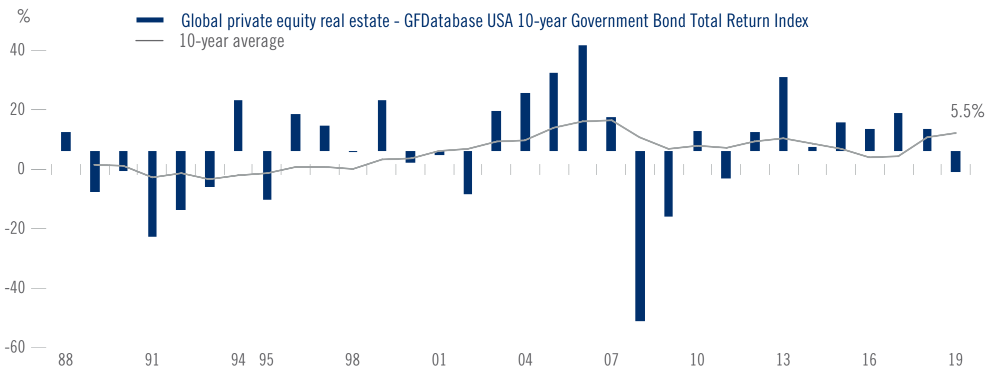
Good reasons for including private equity real estate in a strategic asset allocation
Global private equity real estate is expected to deliver 6.2% per year in dollars and 5.1% in euros on average over the next 10 years.

In global private equity real estate, the return is defined as the spread over 10-year US Treasuries. While the long-term spread since 1988 stands at 0.7% on average, the spread over the last 10 years has risen to 5.5%, showing the impact of the subprime crisis and the low-rate environment that has prevailed since. Furthermore, covid-19 persuaded central banks, including the Fed, to undertake yet more quantitative easing. The 10-year average premium return offered by private-equity private assets stands at 5.5% (*see chart 8*) but we expect this to increase slightly given the prevailing yield environment. **Long-term yields that are expected to remain lower for longer should enhance the interest in real estate investments and support real-estate valuations.**

Expected returns in real estate can be split into four main components: the current yield, which is expected to drive one third of total returns in the coming years, financial leverage (16% of total returns at least) and value-add (up to 35%), with a residual amount coming from smart location choices. In other words, as in other private equity investments, a value-add real estate manager has two main levers to boost returns and generate additional alpha: optimal use of financial leverage and property enhancement to boost revenues and value. This explains why we expect European value-add real estate to deliver an average annual return of 6.6% in euros over the next 10 years, with managers boosting returns via financial leverage and value creation.

Real estate can defend portfolios against inflation better than sovereign bonds. An increase in inflation tends to lead to a rise in interest rates, which translates into a drop in the price of existing bonds, and hence losses for sovereign bond portfolios. But in real estate, rents are generally indexed to the consumer price index.

CHART 8: GLOBAL PRIVATE EQUITY REAL ESTATE NOMINAL RETURN PREMIUM RELATIVE TO 10-YEAR US TREASURIES*



*Past performance or forecasts are not per se a reliable indicator of future performance.

Source: Pictet WM-AA&MR, Burgiss, Global Financial Data, May 2020

Hedge funds: equity-like assets with lower beta
Hedge fund indices show a lower beta than their global equity equivalents, meaning that they display lower volatility than equities but also provide lower returns. This beta stood at 0.7 before the global financial crisis of 2007-2008 and has decreased to 0.5 since. Our 3.5% average annual total returns expectation for hedge funds over the next 10 years assumes that the average beta relative to equities remains unchanged over the next decade.

In a nutshell, there is no free lunch. Being lower beta than equities means that hedge funds offer lower volatility, but also lower returns. Hedge funds therefore look more attractive in bad times than in good. **However, choosing the most appropriate strategy and manager can enhance expected returns from hedge funds.**

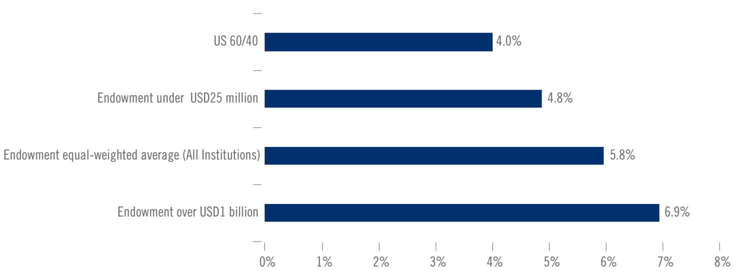
THE APPEAL OF ENDOWMENT-STYLE INVESTING

Faced with declining returns from a classic 60/40 portfolio, investors will need to consider alternative assets. This has led to increasing interest in the approach to portfolio diversification adopted by endowment funds, which promise better returns.

Since 1900, 60/40 portfolios (60% equities, 40% bonds) have delivered an average annual return of 8% in every rolling 10-year period since 1900. Since 1980, their 10-year average annualised return has been around 10%, and even higher from the late 1980s to the late 1990s. In that period, equities performed well and, thanks to the drop in long-term yields, so did bonds. However, in the next 10 years, we expect a basic 60/40 US portfolio is expected to return 4% on average annually—half the average return since 1980—largely because of declining returns from bonds.

In such a context, endowment-style investing offers an interesting substitution or supplement. Endowment funds are pools of capital set up on behalf of non-profit organisations and funded through gifts and donations. The largest funds are run on behalf of US universities.

10-YEAR NOMINAL RETURN EXPECTATIONS FOR ENDOWMENTS VS A 60/40 US PORTFOLIO



Source: Pictet WM-AAMR, FactSet, NACUBO, June 2020

Long-term expected returns for US endowments stands at 7% per annum on average, according to NACUBO (7.2% in 2018). Our own forecast is for endowment funds to provide an average annual return of 5.8% over the next 10 years, with the largest endowments returning 6.9% on average and the smallest 4.8% (*see chart*).

There is no single endowment strategy. On average, endowments invest 30% in alternative assets, but this can rise to over 60% in the case of some of the largest endowments, which goes a long way to explaining why the largest endowments (with assets under management of over USD1 bn) perform better than smaller ones.

The long-term risk-adjusted returns achieved by the largest endowment funds may look appealing, but few private investors can invest in alternative assets such as private equity, direct real estate and some hedge funds at the heart of endowment funds' superior returns because they require a specific expertise, higher initial investment and do not provide the same liquidity as listed markets. Nonetheless, with returns from balanced 60/40 portfolios likely to remain lacklustre, a style of asset allocation closer to that adopted by endowment funds still looks appealing.

GOALS-BASED INVESTING: THE NEW STRATEGIC ALLOCATION STYLE

Just like the endowment approach, goals-based investing represents a break with the traditional approach to portfolio asset allocation. By putting shifting investor goals at the heart of the investment by process.

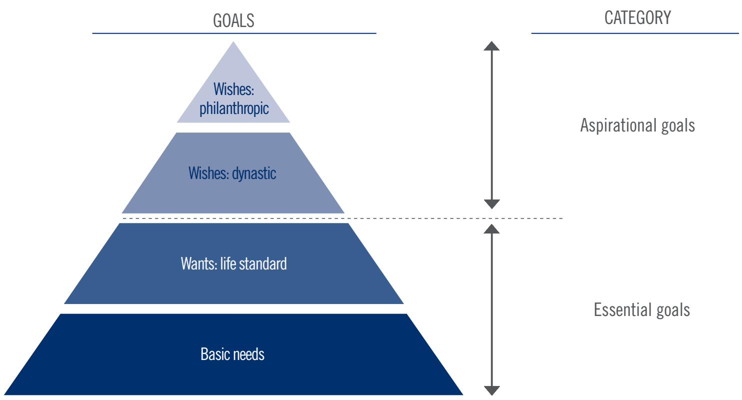
Goals-based investing (GBI) is an investment approach that aims to maximise the probability of achieving investors' goals by putting them at the heart of the process. GBI goes beyond traditional approaches to investment management, which aims to construct an optimal asset allocation that outperforms the market based solely on the investor's risk profile and available wealth. GBI's main advantage over traditional approaches to asset allocation is that it takes the particularities of every investor into consideration, incorporating recent advances made in behavioural finance. Assets under management that use GBI methodology have grown substantially in recent years, to around USD2 trn.

GBI starts from the premise that the factors investors take into account may actually be much too varied to be reduced to the two parameters commonly consider when investing (a desired level of profitability and the degree of acceptable volatility), especially since risk cannot be measured merely in terms of an asset class's price volatility.

Investors' goals and the way they reach these goals are intimately linked. One might even say that how investment goals are achieved are as important as the goals themselves for some investors. In GBI methodology, goals are be broadly divided between essential and aspirational. Within these two broad categories, there are many different types of goals: basic necessities (needs); standard of living (wants); philanthropic (wishes); and dynastic (wishes, *see diagram*).

The GBI approach has many major advantages. It: gives greater insight into investors' emotional and behavioural biases; clearly sets out the capital required to achieve goals and define longer-term commitments; is just as suitable for bespoke asset allocation as for mass customisation; can calculate the probability of achieving an investor's goals; helps measure how much value a wealth manager is contributing to an investor's goals rather than in reference to a benchmark or competitor; contributes to a 'natural', coherent integration of behavioural finance into the investment process; and provides a more accurate and relevant definition of risk than traditional investment management and relevant definition of risk.

THE 'GOALS' OF GOAL-BASED INVESTING



Source : Pictet WM – AA&MR, January 2020

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July 2020

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