13.02.2025

Economico

info@economico.ch

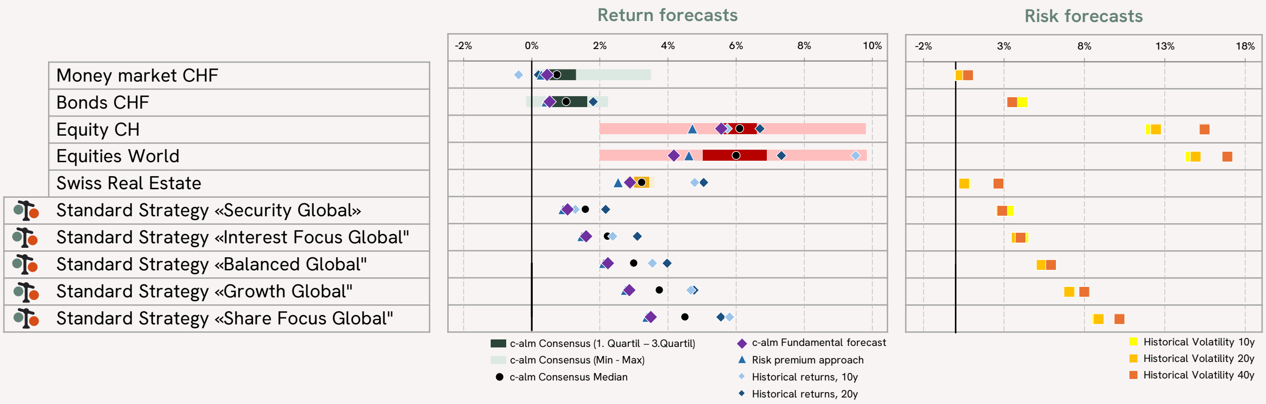
Dr. Ueli Mettler,
c-alm AG

Follow us on
Linkedin

Economico Flash ⚡#17

Investment strategy: Long-term return and risk forecasts

Chart der Woche: Long-term return and risk forecasts



Source: AUGUR forecast application by c-alm AG, as at 31.12.2024 / Bonds CHF: Swiss Bond Index AAA-BBB; Equities Switzerland: Swiss Performance Index; Equities Global: MSCI World DC Index; Real Estate Switzerland: SWX Real Estate Fund Index / Gross yield estimates before costs and taxes

Based on the investor profile discussed in Economico Flashes 14, 15 and 16, we are now getting down to business and focusing on a sensible composition of the investment portfolio.

To do this, we need to have an opinion on the future return and risk behavior of the various asset classes. The big problem is that nobody - not even the self-proclaimed professionals - has a crystal ball. Institutional investors have therefore started to assess the risk/return potential of asset classes on the basis of various forecasting approaches in order to base their allocation decisions as broadly as possible.

I would like to take you on a corresponding tour d'horizon - with reference to the specific data prepared in the illustration as at 31.12.2024 - starting with the return forecasts. All forecasts are based on a long-term horizon of 5 years:

- **Historical average returns:** All those who rely on past averages for their forecasts pragmatically assume that the future will bring what we already know from the past. The crux of the matter: which period of the past is taken as a basis? Depending on the choice of time window, there are considerable differences.
- **Risk premium approach:** The sum of the risk-free interest rate (typically approximated by the yield on a 10-year government bond) and a constant, category-specific risk premium is formed. This risk premium is estimated historically, which in turn raises the question of the choice of time window.
- **Consensus forecasts:** As many market participants as possible are asked about their expectations and the average is calculated or, as illustrated above, the resulting forecast intervals are considered. The median of the consensus forecasts is used in Economico as the value for the expected return of the standard portfolios.
- **Fundamental forecasts:** The fundamental approach measures the capital yield potential in the various asset classes: for nominal values with the yield to maturity, for equities with the earnings yield, and for real estate with the net cash flow yield.

With regard to the prediction of future risk behavior, the historical average fluctuations are aggregated with the so-called volatility indicator, which can be calculated both per asset class and weighted at portfolio level. Here too, the choice of the underlying time window is decisive for the resulting forecast values.

Takeaways

- Depending on the method, this results in completely different return and risk forecasts
- It can be assumed that equities yield better than bonds “in the long run”.