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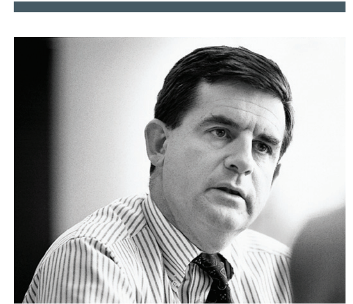
# 10 Predictions for the Next 10 Years

*Since the 1990s, Bob Doll, BlackRock Vice Chairman and Chief Equity Strategist for Fundamental Equities, has published a series of economic and market predictions at the beginning of each year. Typically, these predictions address the state of the US and global economies, potential returns for equities and other asset classes, significant geopolitical developments and other topics that can have a significant impact on investors. As the global economy and world financial markets are currently in the midst of an important recovery from near-depression conditions, and with the dawning of a new decade, we thought it would be useful for our clients if we were to also offer a series of 10 predictions for what might unfold during the next 10 years.*



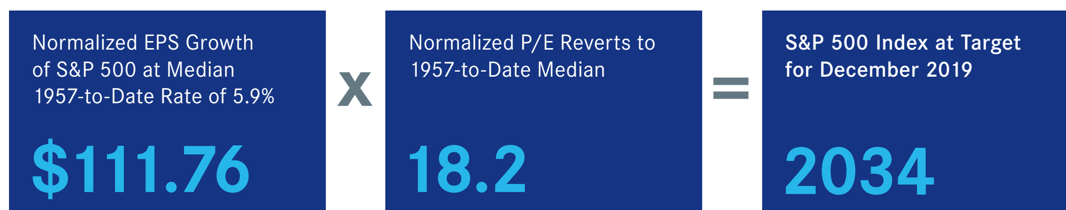
Bob Doll is Vice Chairman and Chief Equity Strategist for Fundamental Equities at BlackRock®, a premier provider of global investment management, risk management and advisory services. Mr. Doll also is lead portfolio manager of BlackRock's Large Cap Series Funds. Prior to joining the firm, Mr. Doll was President and Chief Investment Officer of Merrill Lynch Investment Managers.

## 1. US equities experience high single-digit percentage total returns after the worst decade since the 1930s.

Many investors would like to forget the last 10 years, which featured the two worst bear markets since the Great Depression. From our vantage point, we are expecting the next 10 years to produce a significantly better environment, but not one that matches the boom conditions of the 1980s and 1990s. On the positive side, we think the likelihood of two disastrous decades in a row is extremely low. However, we are aware that ongoing deleveraging and significant structural problems makes it unlikely that we will witness double-digit returns for stocks in the coming 10 years. Altogether, we are forecasting annualized US stock market returns of close to 8% for the coming decade.

The obvious question is how we arrived at that number. There are clearly a multitude of factors that will affect the markets, but as an overly simple forecasting tool, we can look at earnings growth and valuation metrics throughout the past several decades to provide a starting point.

Simple 10-Year Stock Market Forecast




*Source: Ned Davis Research.*

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*While in the short term, we do expect the current recovery to transition into an outright expansion, we also believe that recessions will occur more frequently.*

If we assume that the normalized earnings per share growth and the P/E ratios for the S&P 500 approach during the next 10 years match their median rates since 1957, that would result in an S&P 500 Index level of 2,034 by the end of this decade. Breaking that down further, that would translate into an annualized price gain of 6.2% and a dividend yield of 1.9% to arrive at an estimated total return of 8.1%. To us, these numbers seem reasonable as a starting place to look at the coming decade.

As a corollary to this prediction, we also expect that US equity returns will outpace those of other developed markets in the coming years for a number of reasons, including more attractive valuation measures, stronger secular growth, more shareholder-friendly management practices and more serious structural problems in non-US economies.

## 2. Recessions occur more frequently during this decade than only once a decade as occurred in the last 20 years.

Over the past 20 years, recessions were relatively infrequent, and many investors may have gotten used to such an environment. Looking ahead, we expect that this frequency will increase. It is important to recognize that we are not calling for some sort of abnormal environment; rather, we are pointing out that the last 20 years were abnormal and we are expecting to see a more normal occurrence of recessions. According to data provided by Ned Davis Research, over the past 100 years a recession occurred, on average, every 3.8 years. Over the past 20 years, however, recessions have occurred only once every 8 years. We think we will be seeing something closer to the former number in the coming decade.

### Frequency of Recessions

| | Number of Recessions | Average Frequency of Recessions |
|---|---|---|
| **Since 1910** | 20 | Every 3.8 years |
| **Since 1990** | 3 | Every 8.0 years |

*Source: Ned Davis Research.*

From a structural perspective, one of the main reasons we believe we are returning to a more normal cyclical environment is that we are unlikely to see a synchronous global expansion due to broad debt and leverage issues. US consumers are still burdened by high debt levels, the banking system in the developed world remains highly troubled and, as the European sovereign debt crisis shows, the globe is still subject to deleveraging problems. While in the short term, we do expect the current recovery to transition into an outright expansion, we also believe that recessions will occur more frequently.

## 3. Healthcare, information technology and energy alternatives are leading growth areas for the United States.

These sectors of the economy are likely to experience significant innovation that will act as key drivers for economic growth in the coming years. Within healthcare, we have only seen the tip of the iceberg in terms of the effects of the aging boomer population – healthcare spending levels are almost certain to continue to rise. Advances in biotechnology are also likely to continue at a rapid pace, and we could see new treatments in such forms as gene-specific therapies and increasing utilization of stem cells. Additionally, the rise in patient-driven research and an increasing move toward digital healthcare record-keeping are potential growth areas for the healthcare sector.

Technology has long been a growth area for the United States, and should continue to be one in the coming decade. The sheer growth of new types of computers and entertainment devices is unlikely to slow down, we should continue to see advances in microprocessor speed and capacity. Innovations such as cloud computing have the potential to lower costs and increase productivity. Additionally, we have probably only begun to see the impact of social networking tools as economic growth engines.

The rise of alternative energy as an important source of growth is also likely to continue. We expect to see increasing taxes on carbon emissions in the coming years, which will provide an economic incentive to further explore alternatives. Additionally, the realities of supply (such as diminishing coal availability) and geopolitical issues (much of the world's oil is controlled by governments that have unfriendly relations with the United States) will push innovation. In addition to "traditional" alternatives such as wind power and solar power, there are also a wide range of new ideas and new technologies being explored (such as fuels being produced by biological substances including algae and sewage) that should gain traction.

## 4. The US dollar continues to become less dominant as the decade progresses.

The dollar bear market has (with some interruptions) been in place for the last 10 years, and we expect the prominence of the greenback to continue to fall in the coming decade as increasing debt levels for the United States will likely act as a drag on the value of the dollar.

Importantly, however, there is no obvious replacement currency for the dollar as the world's main currency reserve. The yen is plagued by the fact that Japan remains in a deflationary environment and the euro remains under tremendous stress as the European economies are experiencing their own debt issues. As a result, we do expect that the US dollar will remain the world's principal reserve currency. It is still the most liquid currency available; the market for US government paper remains the world's largest, and the US dollar is likely to still be one of the primary beneficiaries of "flights to quality" that occur during financial crises.

Over the next 10 years, we believe that the dollar is likely to gain ground against the yen and the euro, but it will also likely lose value against the world's minor currencies. Additionally, we expect to see gold prices remain at elevated levels as many have been turning to the precious metal as a form of "alternative currency" in the face of uncertainty – a trend we do not believe will be ending any time soon.

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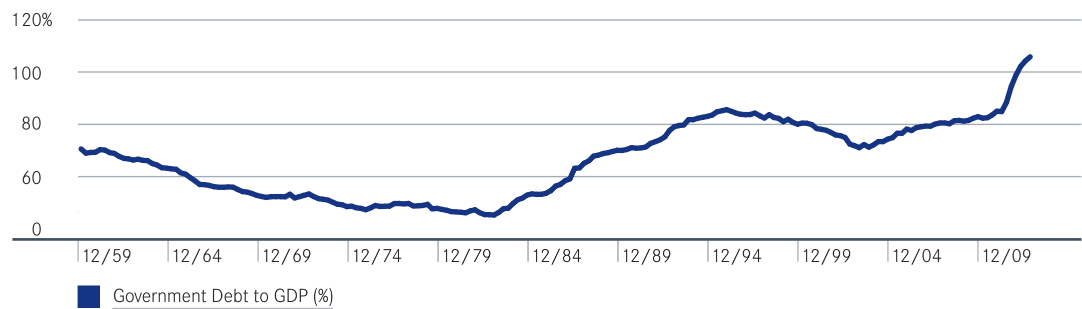
*Throughout the next 10 years, we expect the global economy to gradually transition from being dominated by deflationary trends to being dominated by inflationary pressures.*

## 5. Interest rates move irregularly higher in the developed world.

By our analysis, global interest rates are at a cyclical low, and we are expecting to see a reversion to a more normal environment. In the United States, public debt levels as a percentage of gross domestic product (GDP) are rising rapidly, which translates into the likelihood of higher rates. We expect other developed markets will also likely see higher rates in the years ahead.

US Government Debt (Federal, State and Local) as a Percentage of GDP




*Source: Ned Davis Research.*

Today's accommodative monetary policy, quantitative easing measures and historically low interest rates are collectively working to stimulate demand. Throughout the next 10 years, we expect the global economy to gradually transition from being dominated by deflationary trends to being dominated by inflationary pressures.

## 6. Country self-interest leads to more trade and political conflicts.

Trade liberalization has been on the rise for many decades before the last couple of years, and that trend appears to be changing. The sharp reduction in economic growth brought about by the credit crisis also resulted in a noticeable increase in protectionist trade policies – similar to what happened in the late 1970s when a series of financial shocks resulted in increased government intervention in the capital markets.

We have already seen signs that the United States has engaged in some new protectionist leanings (such as the debates over the inclusions of "Buy American" provisions that were part of the 2009 stimulus package and the ongoing disputes with China over the latter's currency policies). Other countries are increasingly looking to protect domestic industries in a difficult growth environment as well. As individual economies continue to struggle, politicians around the world will be reacting to high levels of unemployment, meaning that "trade scapegoating" is likely to rise. As a result, we expect to see protectionist measures as well as trade and political conflicts increase.

## 7. An aging and declining population gives Europe some of Japan's problems.

From an economic perspective, Europe today has several of the same structural issues that have acted as a drag on Japanese growth levels since the early 1990s. European policymakers have been relatively slow to react to financial crises. The European Central Bank (ECB) continued to raise interest rates through mid-2008 as the credit crisis was emerging and as asset prices were already beginning to collapse. Likewise, the ECB and individual governments received much criticism for their slow reaction

to the developing Greek debt crisis. Additionally, both Europe and Japan are highly dependant on exports for economic growth, making these regions more subject to external shocks and negatively affected by the increase in value of their currencies that have occurred over the last ten years.

From a demographic perspective, Japan has been hurt for many decades by a shrinking labor force. While Europe has not yet seen its labor force actively decline, its population is aging, which points to the likelihood that it will soon occur. Europe also has been experiencing declining birth rates. The combination of these factors has resulted in shrinking population levels in several European countries, including Germany and Italy. Together, these structural economic problems and demographic issues are likely to act as a drag on European economic growth.

## 8. World growth is led by emerging market consumers.

The recovery in the global economy that began to emerge in 2009 was led by emerging markets, and we expect that leadership will continue through the coming decade. Private consumption growth in emerging markets is already higher than that of developed markets, wage growth remains high and emerging market population is relatively young and increasingly well educated. Emerging economies also have a vibrant and growing middle class of people who are increasing spending levels for both big-ticket items (most noticeably automobiles) as well as personal luxuries. Looking ahead, we expect that domestic demand within emerging markets, rather than exports, will increasingly become a driver of growth. The chart below compares the productivity levels of several different countries around the world (by measuring the incremental capital-to-output ratio), and shows that the efficiency of major Asian emerging markets capital spending remains superior to Japan, the United States and Germany, which should lead to further foreign direct investment into emerging markets. According to an analysis conducted by PricewaterhouseCoopers, the largest seven emerging economies (China, India, Brazil, Russia, Mexico, Indonesia and Turkey) will be close to 50% larger than the current G7 (United States, Japan, Germany, United Kingdom, France, Italy and Canada) by 2050. This analysis suggests that China will overtake the United States as the largest economy at some point around 2025, and India has the potential to surpass US growth levels by 2050. We think these estimates appear reasonable, and expect that, over the coming decades, the United States will remain a global leader in terms of economic power, but it will no longer be the undisputed king.

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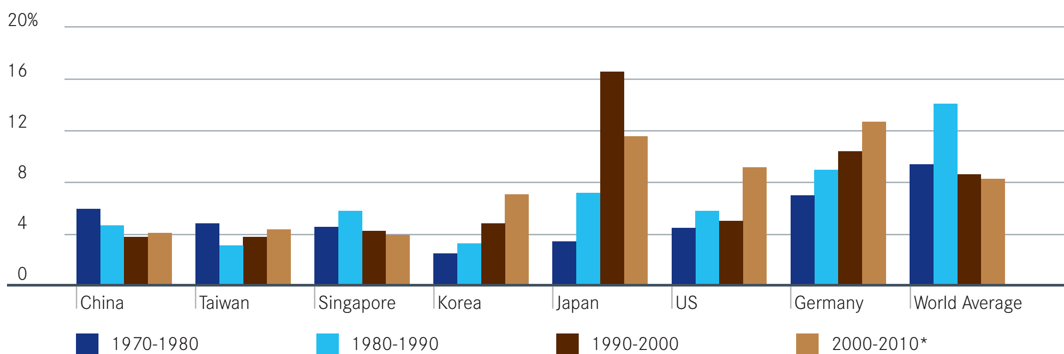
### Incremental Capital-to-Output Ratio

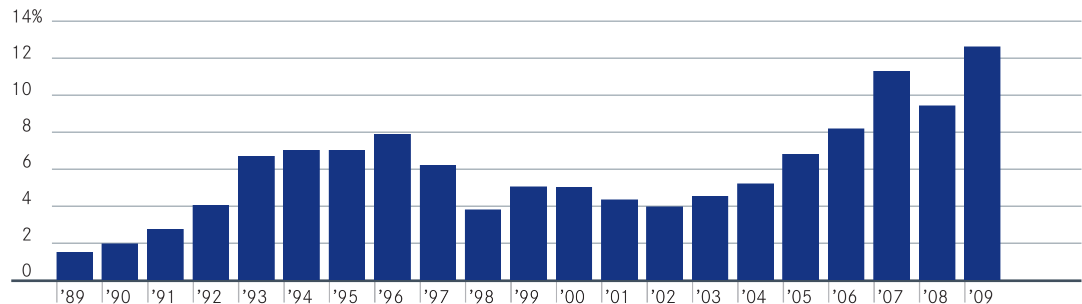



*Source: BCA Research. Note that when the respective economies were in recession, those years were not included in this calculation.* For the "World Average" category, the last column reflects 2000 through 2005 due to the availability of data.*

## 9. Emerging markets weighting in global indices rises significantly.

Coincident with the rise in the importance of emerging markets in the global economy, we also expect to see emerging countries become an increasingly larger part of the global equity market.

Emerging Markets as a Percentage of MSCI All Country World Index




*Source: MSCI. Markets weights are as of year end.*

In 1989, the MSCI All Country World Index included only eight emerging markets, accounting for less than 2% of the index. Today, there are 22 emerging markets in the index, accounting for 12%. We expect that level of growth to accelerate and anticipate that in 10 years, that level will be noticeably higher.

## 10. China's economic and political ascent continues.

Chinese economic growth and geopolitical importance has, for some time, been a powerful force affecting the global landscape. In 2009, China surpassed Germany as the world's largest exporter, and it is likely that China will surpass Japan and become the world's second-largest economy during the next year. China is also already the world leader in automotive sales and in steel production and is the largest buyer of US Treasury paper and largest holder of foreign currency reserves.

Despite all of this, China is still only in the initial stages of industrialization. The Chinese population continues to grow rapidly; the country has a wide array of available natural resources; Chinese per-capita consumption levels are low, and are likely to rise; and the Chinese government is actively engaged in promoting policies designed to further "urbanize" the country by encouraging its population to shift away from agriculture and into manufacturing.

China does have some structural problems, including an aging population, the ongoing threat of political unrest and an economy that is still largely state-controlled and hampered by low levels of innovation. In any case, however, we expect that the growing prominence of China on the world's economic and political stage is unlikely to be altered.

## What Does All of this Mean for Investors?

Given this backdrop, what should investors expect during the next decade? Overall, we think investors should prepare themselves for a general "reversion to the mean" in terms of economic growth and market performance. We expect to see relatively slow (but positive) levels of economic growth in the coming years, marked by occasional and more frequent recessions. From an equity markets perspective, we are forecasting decent, but not stellar, returns in the coming decade.

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## Within the context of investors' long-term plans, we can also suggest a few specific areas of opportunity:

**1. Overweighting stocks and other risk assets versus Treasuries and cash:**
If we are correct that stocks will return in the high single digits in the years ahead, then we are likely in a world where equities should perform irregularly well, outperforming Treasuries and cash in the decade ahead. While equities are unlikely to achieve their long-run low double-digit compound returns, returns in the high single digits would still represent a number that other asset classes will struggle to achieve.

**2. Overweighting US stocks versus other developed market equities**:
Although we are predicting a slower growth environment in the United States marked by more frequent recessions, on a comparative basis, US growth should still be stronger than that of other developed markets. Europe remains plagued by credit-related issues and Japan is still facing some serious deflation threats that are likely to limit growth. Over the past six months, US stocks have dramatically outperformed their international counterparts, and we expect this trend will continue for some time. This is not to say that international equities should be avoided, since they continue to represent a valuable diversification tool, but we think US markets simply present better opportunities.

**3. Focusing on Opportunities in Emerging Markets:**
Several of our predictions focus on the growing importance of emerging markets in the world economy, so it should not come as any surprise that we believe that emerging market equities are particularly attractive. In addition to direct investments in emerging markets, we would encourage investors to also consider gaining exposure through large US multinational companies. In general, companies in this area of the market are innovative; they have a record of effectively allocating capital; they operate under stronger corporate governance standards; and they have a greater shareholder orientation than most companies in the developing world. These companies range across industry groups and sectors, from cyclical to defensive branded franchises to commodity producers. What they have in common is a strong business position and exposure to the global economy at what we believe to be compelling valuations with good visibility for growth.

**4. Allocating to Better-Positioned Sectors:**
As discussed in our third prediction, we believe there is tremendous long-term growth potential in the healthcare, information technology and energy sectors within the United States. As such, it would make sense for investors to consider overweighting those sectors in their investment portfolios.

Finally, given that we believe that relatively high levels of investment uncertainty are likely to continue over the next 10 years, we would emphasize that we encourage investors to focus on some of the basic tenets of investing. We believe a renewed focus on asset allocation and risk management is critical. Remaining focused on long-term goals, sticking with diversification strategies to maximize the risk/reward balance, regularly rebalancing your portfolio and remaining in close contact with your financial professional are all strategies we would continue to recommend.

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