

Bloomberg Business

The Next 10 Years Will Be Ugly for Your 401(k)

We're about to pay the price for all the good times.

[Suzanne Woolley WealthWatch](#) October 26, 2016

It doesn't seem like much to ask for—a 5 percent return. But the odds of making even that on traditional investments in the next 10 years are slim, according to a new report from investment advisory firm Research Affiliates.

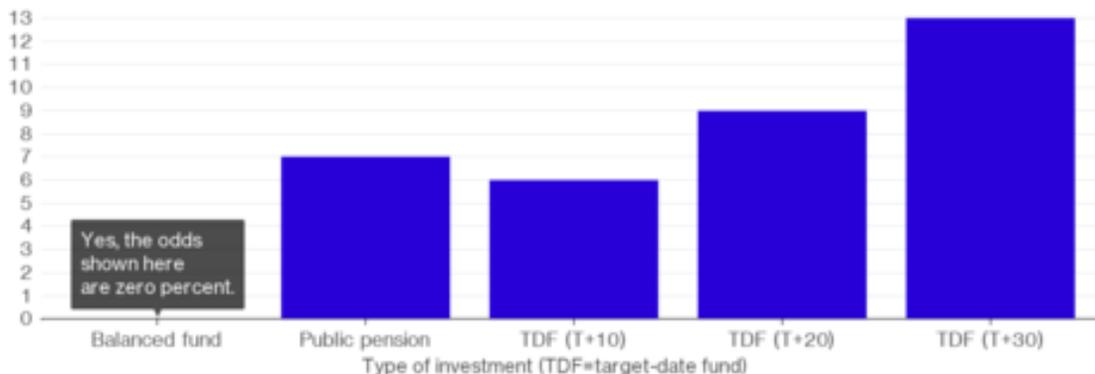
The company looked at the default settings of 11 retirement calculators, robo-advisers, and surveys of institutional investors. Their average annualized long-term expected return? 6.2 percent. After 1.6 percent was shaved off to allow for a decade of inflation¹, the number dropped to 4.6 percent, which was rounded up. *Voilà*.

So on average we all expect a 5 percent; the report tells us we should start getting used to disappointment. To show how a **mainstream stock and bond portfolio** would do under Research Affiliates' [10-year model](#), the report looks at the typical balanced portfolio of 60 percent stocks and 40 percent bonds. An example would be the \$29.6 billion Vanguard Balanced Index Fund (VBINX). For the decade ended Sept. 30, VBINX had an [average annual performance](#) of 6.6 percent, and that's before inflation. Over the next decade, according to the report, "the ubiquitous 60/40 U.S. portfolio has a 0% probability of achieving a 5% or greater annualized real return."

Odds That Mainstream Investments Will Earn 5% Are Slim

A typical balanced fund with 60 percent stocks and 40 percent bonds has a zero chance of returning 5 percent or more over the next 10 years, according to Research Affiliates. For someone in a target-date fund with 10 years to retirement, odds are about 6 percent.

■ Odds (%) of an inflation-adjusted 5% return



Source: Research Affiliates

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One message that John West, head of client strategies at Research Affiliates and a co-author of the report, hopes people will take away is that the high returns of the past came with a price: lower returns in the future.

“If the retirement calculators say we’ll make 6 percent or 7 percent, and people saved based on that but only make 3 percent, they’re going to have a massive shortfall,” he said. “They’ll have to work longer or retire with a substantially different standard of living than they thought they would have.”

Research Affiliates’ forecasts for the stock market rely on the cyclically adjusted price-earnings ratio, known as the CAPE or Shiller P/E. It looks at P/Es over 10 years, rather than one, to account for volatility and short-term considerations, among other things.

The firm’s website lets people enter their portfolio’s asset allocation into [an interactive calculator](#) and see what their own odds are, as well as how their portfolio might fare if invested in less-mainstream assets (which the company tends to specialize in). The point isn’t to steer people to higher risk, according to West. To get higher returns, you have to take on what the firm calls “maverick” risk, and that means holding a portfolio that can look very different from those of peers. “It’s hard to stick with being wrong and alone in the short term,” West said

At least as hard though is seeing the level of return the calculator spits out for traditional asset classes. Splitting a portfolio evenly among U.S. large-cap equities, U.S. small-cap equities, emerging-market equities, short-term U.S. Treasuries, and a global core bond portfolio produced an expected return of 2.3 percent. Taking 20 percent out of short-term U.S. Treasuries and putting 10 percent of that into emerging-market currencies, and 10 percent into U.S. Treasury Inflation Protected Securities, lifted the return to 2.7 percent. Shifting the 20 percent U.S. large-cap chunk into 10 percent commodities and 10 percent high-yield pushed the expected return up to 2.9 percent. Not a pretty picture.

Moral of the story: Since most people’s risk tolerance isn’t likely to change dramatically, the amount you save may have to.