

STREETWISE

J.P. Morgan forecasts that the S&P 500 will return 5.7% a year, on average, over the next decade. That compares with 11% a year since World War II.

The Stock Market Is Priced for Middling Returns From Here

Brace for stimulation. The Federal Reserve just slashed interest rates for the first time in four years to goose the economy. Already, young families shopping among seven-figure tear-downs near city centers can finance them at 6.1%, down from 6.5% a month ago. Housing crisis solved.

Next is supposed to be a rip-roaring stock market rally, as falling rates spur company profits and reduce the relative allure of bonds. I'm thinking about celebrating with something only rich people can afford, like dinner and a movie.

Only here comes J.P. Morgan saying that returns over the next decade are likely to be ho-hum, maybe even half-hum, simply because investors have had it too good for too long. And then there's BofA Securities ruining the mood on artificial-intelligence upside. Earnings growth forecasts for shares in AI exchange-traded funds have tumbled from a high of 18% last year to a recent 5%, the bank notes. That's slower than the broad stock market's expected earnings growth.

On Wednesday, the Fed cut its target federal-funds rate by a half-point to a range of 4.75% to 5%. That has a fairly direct effect on short-term rates earned by savers and paid by businesses, and a looser one on mortgage and credit-card rates and longer-term bond yields. The average effective fed-funds rate is 4.6% in data going back to 1954.

The Fed kept rates close to zero for nearly a decade following the 2008-



BY JACK HOUGH

09 financial crisis, then took them above 2% before heading back toward zero during the Covid-19 pandemic. When a combination of stimulus cash, rebounding consumer demand, and supply-chain kinks sent inflation to double-digit percentages, the Fed quickly raised rates to their recent peak to cool demand.

Rising rates could have cut into stock prices, but instead, the S&P 500 index returned 35% over about 2½ years, led by **Nvidia**, up 375% on soaring demand for AI chips. (Another of the S&P 500's AI companies, **Super Micro Computer**, gained 937% over that stretch despite a recent tumble, but it was added to the index only this year.)

The argument for a half-point rate cut now was that inflation had cooled to 2.5% over the year through August, while job growth had slowed. The Fed's two jobs are to promote stable prices and maximum employment. Jobs need more attention than inflation at the moment, the thinking goes. But just as rising rates didn't hurt stocks, don't expect falling rates

to now send stocks to rapturous new highs.

For one thing, the effect on stocks of the first rate cut during a cutting cycle depends greatly on whether the economy is headed for a soft or hard landing. During past hard-landing cases, stocks lost an average of 6% over three months following initial rate cuts, according to BofA. Signs of a hard landing now are few, but credit-card and car-loan delinquencies have risen, and private-sector hiring looks weak.

The bigger obstacle for stocks is that they've gotten expensive. The S&P 500 traded recently at 23.7 times trailing operating earnings, versus a 35-year average of 19 times. That means stocks are already pricier than they were when rates were near zero. In the near term, the stock market's valuation is a poor predictor of price swings, but over the long term, it's as reliable an indicator of returns as researchers have found. JPM's forecasting model takes the S&P's current plus-size price to mean that it will return 5.7% a year, on average, over the next decade. That compares with 11% a year since World War II.

What to do? Two suggestions: nothing, and something. I prefer nothing. Last week in this space, I touched on my investing strategy of tactical sloth, and in past columns, I've discussed my philosophy of financial nudism. Strip portfolios to the bare essentials—cheap index funds tracking quality stocks and bonds will suffice—and do as little as possible for as long as possible.

Timing downturns is impossible. Waiting them out isn't. Note that JPM's even longer-term return forecast—8.1% a year, on average, over 20 years—implies sunnier days eventually.

For more-tactical investors, BofA recommends overweighting defensive and dividend-rich sectors like utilities and real estate investment trusts, along with stocks with high free cash flow, like those in the **Pacer U.S. Cash Cows 100** ETF (ticker: COWZ).

For bonds, it likes the simplicity of long-term Treasuries along with something decidedly more complicated called AAA-rated collateralized loan obligations and found in the **Janus Henderson AAA CLO** ETF (JAAA). BofA also recommends overweighting a market that knows a thing or two about lost decades for stocks: Japan.

There are some wild cards here. U.S. corporate profit margins have nearly doubled over the past 30 years. Globalization gave companies expanded access to cheap labor markets. To try to attract or keep jobs, countries slashed their tax rates. Effective U.S. corporate tax rates have fallen below 15% from about 35% in the mid-1980s. Concentrated industries abound.

Historically, when power has shifted greatly in favor of companies, the result has been political backlash, fueled by public anger. Think trust-busting Teddy Roosevelt, whose presidential term coincided with publication of *The Jungle* by Upton Sinclair, with its unsavory details about Chicago's meatpacking plants.

The backdrop is different now. "Consumers do not appear to have problems relying on the services and products of the top two smartphone brands, app stores, search engines, online merchants, cloud managers, online video music streamers, ETF producers, passive mutual fund managers, and banks," write JPM's strategists. If conditions change and corporate profit margins revert toward their historical average, even modest return expectations for the next decade could prove too high. **B**

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