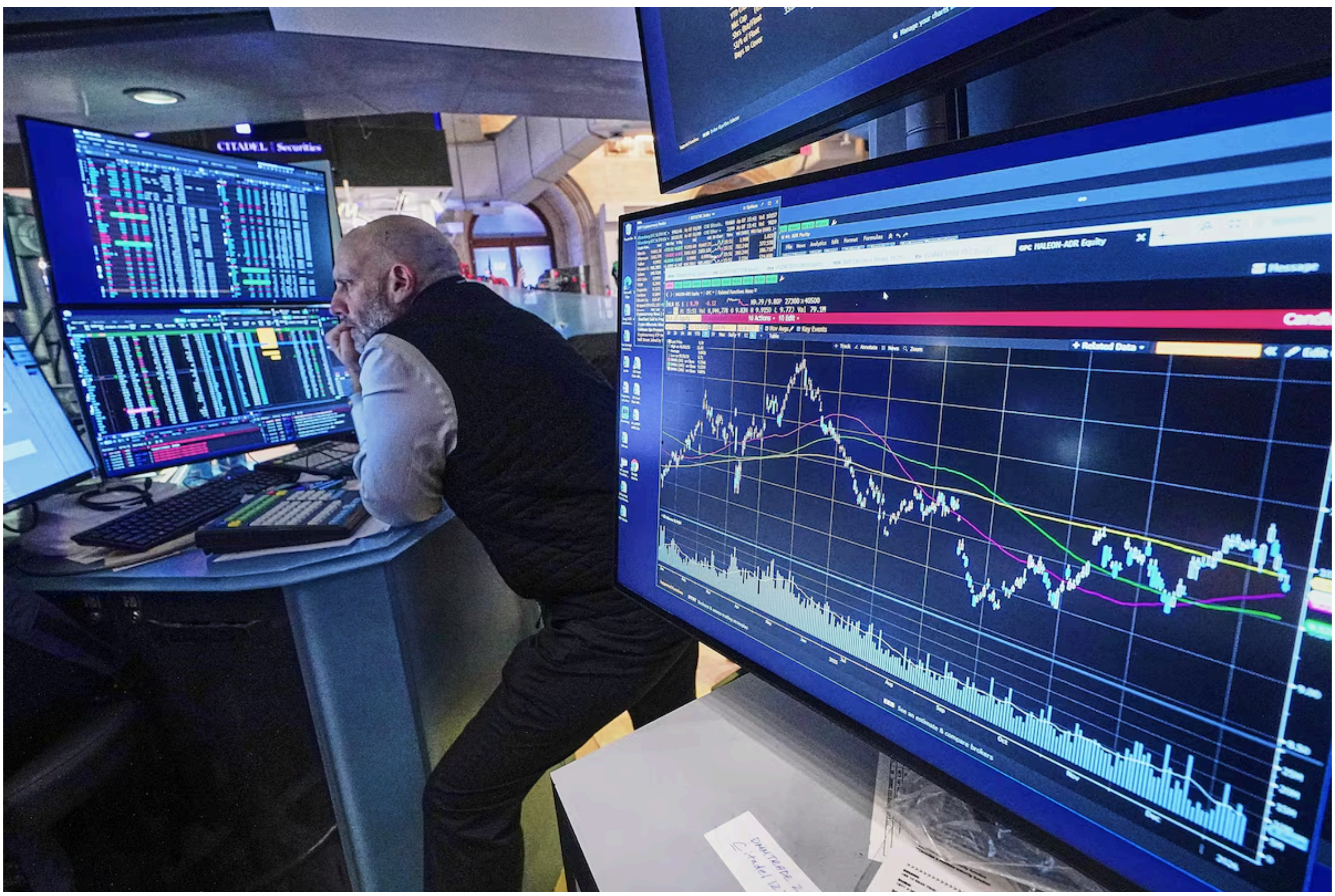
OPINION

What will future stock market returns most likely look like? Get ready to cry

GEORGE ATHANASSAKOS
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 3 HOURS AGO



The floor of the New York Stock Exchange. What should we realistically expect from the stock market over the next 10 years?

RICHARD DREW/THE ASSOCIATED PRESS

Listen to this article

Despite the fear factor surrounding tariffs and geopolitical developments, the bull market in stocks could last for years to come, according to some strategists' upbeat forecasts, which are driven by the belief that the fundamentals surrounding the influence of artificial intelligence on corporate earnings will be so strong that they would justify double-digit percentage annual gains in the stock market.

As Globe and Mail columnist Ian McGugan has recently written, "every company is now [thought to be] a growth company." In fact, there have been projections that the S&P 500 Index INX will return an average of 8 to 10 per cent per year for the next decade.

I found such projections interesting and set out to examine how realistic they are, and answer the following question: What should we realistically expect from the stock market over the next 10 years? I would like to address the question using recent academic research on the subject.

I started by decomposing annual stock returns over a given forecast period to their components, namely:

1. The current dividend yield;
2. The annualized growth of expected corporate earnings over the forecast period;
3. The annualized change in the valuation multiple, such as the price-to-earnings ratio (P/E), over the forecast period.

Then I examined the likely contribution of each of these components to forecast total stock returns from 2026 to 2035.

The decomposition can help an investor forecast stock returns as well as examine the plausibility that any given forecast of stock returns can come to pass.

A recent paper by Javier Estrada of IESE Business School in Barcelona helps us shed light on the question.

Prof. Estrada first establishes that there is a negative correlation between the annual growth of corporate earnings and changes in P/E, something very interesting and possibly unexpected. He used U.S. data from 1871 to 2024 and examined the relationship between the annual growth of earnings and changes in P/E over periods of 10 years, among other time intervals.

In all cases, the correlation between annual earnings growth and annualized changes in P/Es was negative and significantly different from zero. For example, the correlation between the two variables over 10-year periods was minus 0.50.

The implication of this finding, according to Prof. Estrada, is that if a given bullish stock market forecast is supported by the combination of fast earnings growth and a large expansion of P/E, it will be unrealistic as both cannot happen at the same time.

Considering this evidence, Prof. Estrada sets several examples to show the most likely forecast of expected future returns in the U.S. market. Between 2015 and 2024 (a 10-year period), the average annual return of U.S. stocks was 13.3 per cent – much higher than the 9.2 per cent realized return between 1872 and 2024, a period in which corporate earnings grew, on average, by 4.2 per cent per annum and the P/E was 16 times.

The dividend yield and P/E of S&P 500 in June, 2025, were 1.3 per cent and 27 times, respectively. Given this dividend yield, if currently an investor naively extrapolates the annualized return of the 2015 to 2024 period of 13.3 per cent going forward from 2026 to 2035, this will require an assumption of an annual earnings growth of 9.5 per cent, and a terminal (2035) P/E of 35 times, both of which are much higher than historical long-term averages (i.e., 13.3 = 1.3 + 9.5 + 2.5, the latter figure representing the annualized 10-year increase of P/E from 27 times to 35 times).

Opinion: The tectonic shift of long-term higher interest rates

Mortgage investment corporations offer good cash flow, but investors must be wary of the risk

How about if an investor extrapolates the long-term annual return of 9.2 per cent for the period 2026 to 2035? If earnings grow at annual rate of 7 per cent (vs. the historical average of 4.2 per cent), the terminal P/E would have to be 30 times (vs. the historical average of 16 times) to expect an annualized return of 9.2 per cent going forward. And if earnings grow at 9 per cent, then the terminal P/E would have to be 25 times to get to the realized long-term return.

Finally, if the annual earnings growth and terminal P/E were to be 4.2 per cent and 16 times, respectively (i.e., the long-term averages), then the next 10-year annualized return would be just 0.4 per cent (i.e., 0.4 = 1.3 + 4.2 - 5.1, the latter figure representing the annualized 10-year decline of P/E from 27 times to 16 times).

So, barely positive. Unimpressive, isn't it? This could be the most likely scenario as reversion to the mean is one of the most reliable forces in the stock market.

Prof. Estrada concludes his paper by stating that "the evidence suggests that the conditions that would sustain high returns [going forward] are not very likely to happen, and those sustaining relatively poor returns are more likely to happen."

The past decade has been all about passive money. Autopilot investing worked well in a rising market. The number of actively managed funds and active managers who, like value investors, think about due diligence, valuation and the long run, dwindled. Given this article's conclusion, however, that markets are more likely to sustain poor returns going forward, the next 10 years could witness the renaissance of actively managed money at the expense of passive investing.

George Athanassakos is a professor of finance and holds the Ben Graham Chair in Value Investing at the Ivey Business School, Western University. His latest book is Value Investing: From Theory to Practice.

Report an editorial error

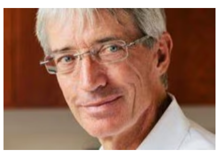
Report a technical issue

Editorial code of conduct

Related stories

How to brace for the stock market crash everyone's talking about

TIM SHUFELT



Why those consensus market predictions can be way off the mark

TOM BRADLEY

U.S. stocks leadership showing signs of broadening beyond tech