OneAscent INVESTMENTS

Capital Market Assumption Process

Our Framework

"If you don't know where you are going, any road will get you there." – Lewis Carroll

Capital Market Assumptions are a valuable tool, setting expectations for how long-term strategic asset allocations are likely to perform and helping investors plan the best route to meet your financial goals.

The OneAscent Capital Market Assumptions (CMAs) process helps us envision what the roads will look like. Having guidance on how the markets are likely to move over the market cycle allows you to lay out a roadmap for the journey to financial success.

We forecast long-term capital market assumptions because they:

1. Communicate our expectations for returns over the coming decade, giving essential feedback to the financial planning process.
2. Anchor to the fundamentals, allowing us to identify likely trends. Starting valuations are a particularly important driver for long-term returns.
3. Provide a framework for cyclical adjustments based on economic and market cycles as well as valuation relationships between asset classes.

OneAscent's 2025 Capital Market assumptions:

Asset Class	2025 CMA Return Assumption	2024 CMA Return Assumption
Treasury Bonds	4.5%	4.5%
Corporate Bonds	5.15%	5.5%
High Yield Bonds	6.25%	7.3%
US Large Cap Equity	5.9%	7.0%
US Small/Mid Cap Equity	7.5%	8.8%
International Equity	7.0%	7.5%
Emerging Markets Equity	7.8%	9.5%
Hedged Alternatives	6%	5%
Private Equity	10%	10%
Venture Capital	11.5%	
Private Real Estate	8%	
Private Credit	9.5%	

Fundamental Principles

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go." – Benjamin Graham

Our process for capital market assumptions includes four fundamental principles:

1. We use a **building block approach**, modeling asset class expectations from the bottom up. We start with inflation and economic growth and then model asset class fundamentals, finishing with changes in valuation.
2. We model expectations over a **full market cycle** of 7-10 years.
3. We incorporate **current valuations** into our process.
4. Finally, we pay attention to what market and Wall Street forcasts and consider a **diversity of opinions** on consensus projections.

Our Process

"The investor's chief problem – and even his worst enemy – is likely to be himself." – Benjamin Graham

Our process puts in place a structure to turn our weaknesses – behavioral biases such as herding, hindsight, loss-aversion, and overconfidence – into strength. Here are the steps:

I. Form economic scenarios for growth and inflation

II. Analyze historical data, relationships, and returns to formulate expectations
  - Bonds: Changes in yield curve, credit spreads, and default rates
  - Stocks: Sales growth, profit margins, dividends, and valuations
  - Alternatives and Private Assets: Market exposure and manager alpha

III. Construct optimal portfolios using projected returns alongside historical asset class volatility and correlations

I. Economic Assumptions

Ultimately, the economy drives investment markets.

Our process begins with a fundamental view of the most likely paths for inflation and economic growth over the coming decade.

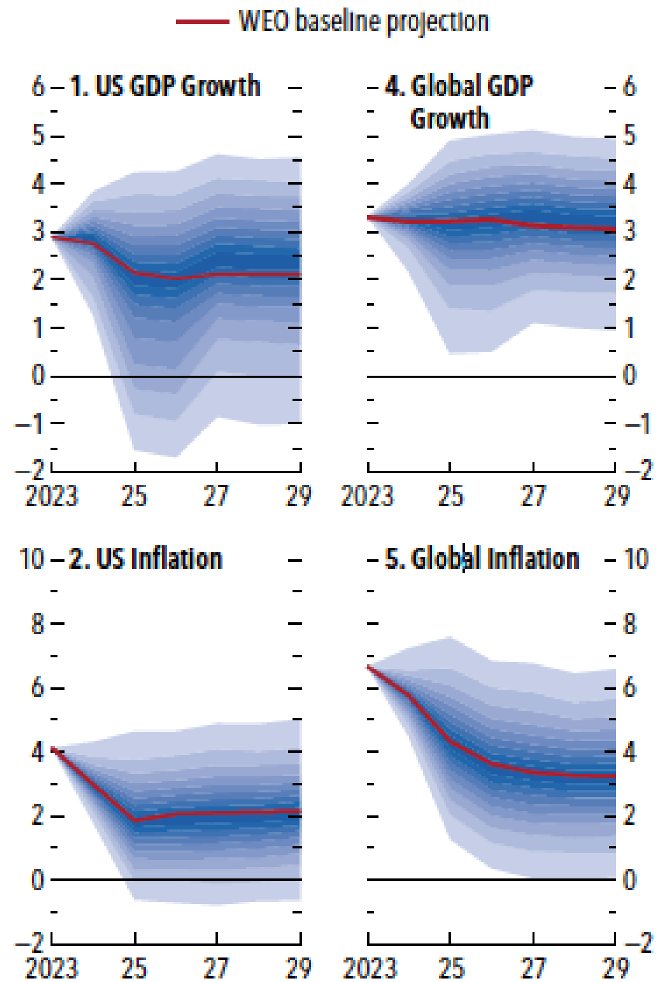
Inflation:

» The IMF World Economic Outlook expects global inflation to revert to historical averages over the coming few years (see chart). Additionally, the US Federal Reserve projects inflation to return towards its long-term target of 2.0 – 2.5%. The fly(s) in the ointment are the fact that a) Trump policies are expected to be inflationary and b) the NY Fed's research shows that 5-year inflation expectations remain at 2.8%[i]. We model 2.5% inflation over the next ten years.

Growth:

» Global GDP Growth is forecast to decline alongside inflation. The end of a secular decline in interest rates alongside a global increase in debt levels means that both the public and private sectors are carrying a higher burden of interest cost, limiting growth opportunities. An aging global population and 'de-globalization' are two other forces likely to slow the global economy in the next decade. We model real economic growth of 1.5% - 1.8% for developed economies and 3% for Emerging Markets, consistent with IMF projections.[ii]

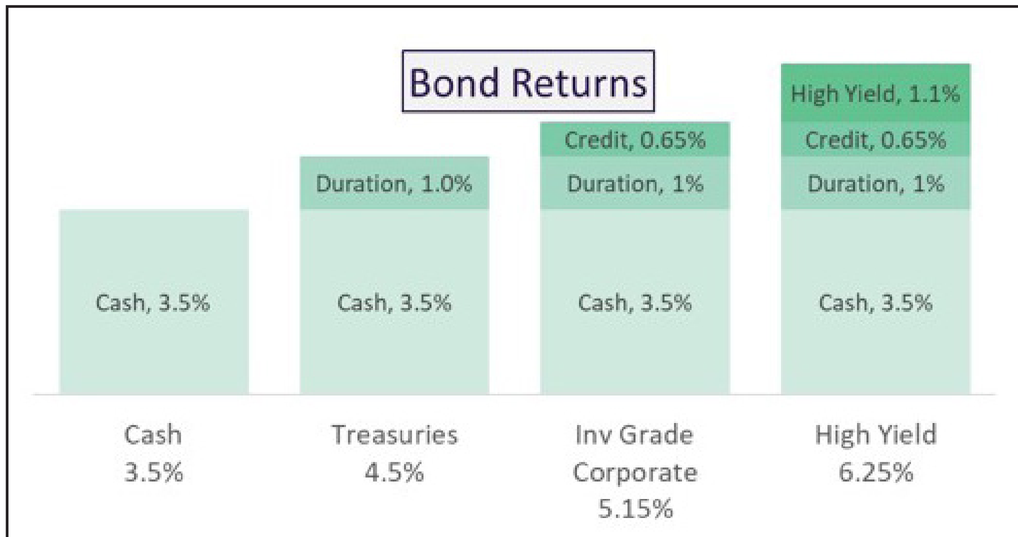
Figure 1.2.1. Forecast Uncertainty around Global Growth and Inflation Projections
(Percent)



II. Historical Data & Investment Assumptions

The four most dangerous words in investing are, 'This time it's different.'" – Sir John Templeton

History informs our process, helping us make effective decisions regarding likely outcomes over the economic cycle. Though it may not exactly repeat itself, the past enlightens assumptions about future investment fundamentals and likely returns.



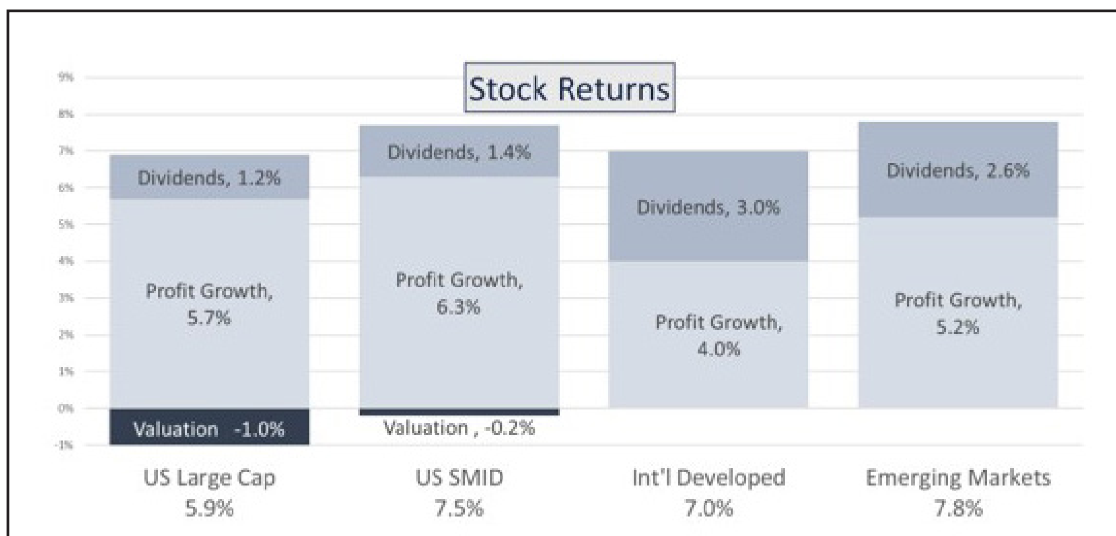
Bonds

» Cash yields have returned to a more normal premium to inflation. We model a 1 percent premium to 2.5% inflation.

» The yield curve is in the process of normalizing to a higher yield for longer maturities; We model a 1% premium for 10-year bonds over cash yields.

» Investment grade corporate bonds yield near an all-time low premium to treasury bonds, suggesting lower returns. We model a 0.65% credit premium.

» High yield bonds also trade near all-time low yield premiums. We model an extra return premium for High-yield bonds, less expected defaults, of 1.1% additional return over investment grade corporate bonds.



Stocks

- Profit growth is forecast to be slightly lower than history, based on the interaction of sales growth and profit margin components:
  - We forecast a deceleration in revenue growth to levels slightly below long-term averages. Despite likely fiscal stimulus in a Trump administration, the following factors suggest slower growth: 1) the magnitude of the fiscal deficit in the US will likely slow growth 2) monetary policy support is limited by the fact that inflation remains above the Fed's target 3) higher interest costs on government debt likely to increase corporate borrowing costs.
  - Profit margins for US Large Cap companies are below the stimulus driven peak levels of early 2022, but above pre-pandemic levels. Many forecasters assume incremental investments into Artificial Intelligence will continue the trend of rising margins. However, abnormally high monetary and fiscal stimulus measures created a strong cyclical tailwind for the large cap tech universe that should eventually dissipate. History has shown that profit margins are cyclical, and extremely high margins are difficult to sustain. Therefore, we forecast stable margins overall for global equities.
  - Profit growth is modeled higher for US Large and SMID, 5.7% and 6.3% respectively, compared to Developed International of 4.0% based on superior forecast sales growth. Key drivers for this difference include favorable demographics and a stronger economic distribution towards secular growth sectors. We model profit growth for Emerging Markets (EM) at 5.2%. Dividend yields are expected to remain relatively close to current payout ratios across markets given stable tax dynamics and corporate preferences.
- Dividend yields are historically low for US Large Cap equities at about 1.2%, while they average about 3% for International Developed equities. This should signal a lower return profile for US equities over the forecast period than experienced over the last decade. Nonetheless, current payout ratios across markets are expected to remain in place given stable tax dynamics and corporate preferences. We model dividend yields to remain relatively consistent with current levels for each asset class.
- US stocks trade, by most objective measures, above their average valuations, while international stocks currently trade closer to their historical averages. We model a slight decrease in valuations for US large cap (1% per annum) and small cap stocks (just 0.2% per annum) as we anticipate some reversion towards historical norms. International Developed and EM valuations are expected to remain close to current levels.

III. Portfolio Construction – Returns, Volatility and Correlation

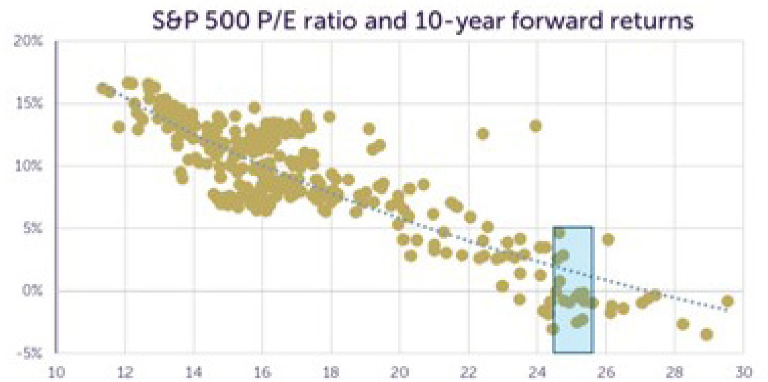
"History may not repeat, but it rhymes." – Mark Twain

Valuations and Future Returns

The price you pay today significantly impacts long-term returns. Therefore, as an additional check and balance, we look at current valuations for asset classes to confirm that our long-term expectations are reasonable.

Bond returns tend to correlate with starting bond yields, as you can see in the chart below. Over the long-term, starting yields (gold) relate closely to the next 5 years' returns (blue). The most recent period has been an exception to the rule, given the sharp bond losses in the last couple of years. However, we expect starting yields to revert to a more normal relationship to returns. On November 30, 2024, the ten-year treasury bond yielded 4.2% while corporate and high-yield bonds yielded over 5% and 7%, respectively.

Stock market returns tend to relate closely to their starting valuations. The chart to the right suggests that the Large Cap US equity market is in a valuation range that would historically indicate the most likely outcome is mid-to-low single-digit returns for stocks over the coming decade.



We should note that valuations have become quite skewed in favor of the largest market cap equities within the large cap universe. This group of stocks, often referred to as the 'Magnificent Seven' or more broadly the 'mega-caps', has dramatically bifurcated the US equity market. Large Cap US equities collectively trade greater than 6 multiple points higher than Small and Mid-Cap US equities representing a historically wide premium.

The chart to the left shows that, while the S&P 500 is meaningfully above its long-term average (dotted lines), Mid-Cap and Small Cap stocks are closer to their long-term averages. These valuations indicate strong potential for more attractive relative returns from smaller cap stocks over the next ten years.

Keeping Emotions at Bay: Volatility and Correlation

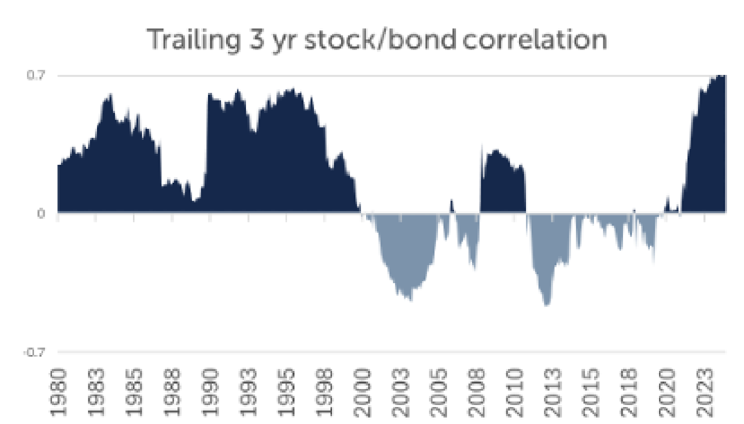
"You will be much more in control, if you realize how much you are not in control." – Benjamin Graham

We can't control the markets. We can, however, focus energy on controlling our emotions. This is crucial to success in investing and life. A common investor shortcoming is allowing decision making to become emotional and irrational.

The most important way to control your emotional impact on the portfolio is by being diversified. If something is working in your portfolio, you are less likely to make a bad decision by selling a good investment that isn't working. In the last seven decades, a balanced portfolio of stocks and bonds has never lost money over a 5-year period![iii]

One of the key aspects of diversification is the correlation benefit of adding bonds to a stock portfolio; we can look at this by comparing stock returns to bond yields. For most of the time between 2000 through 2020 stocks and bonds had low correlation, and bonds were a good diversifier[iv].

However, as inflation rose in 2021 the correlation increased; the discount rate applied to stocks rose as bond yields rose, causing both asset classes to sell off. If inflation worries increased over the next few years, bonds would be less likely to offset stock portfolio losses.



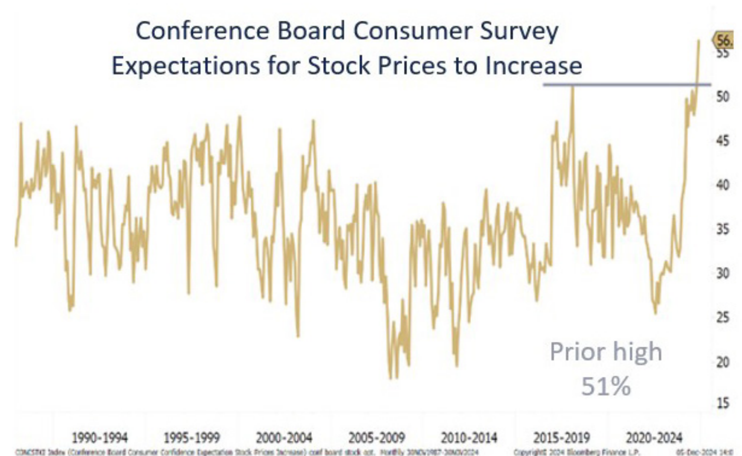
We have talked about how valuation matters over the long term. Another factor that affects long-term, but not necessarily short-term, returns, is how many stocks investors hold in portfolios today. These two charts, from the St. Louis Fed (left) and conference board (right), show investors' stock holdings as a percent of their total portfolio and their optimism about future returns.

There are a couple of things worth noting:

1) Allocations to stocks are at an all-time high, eclipsing the prior all-time high in 2021, as well as the prior peak in 1999. Investors may be holding on to stocks after strong returns or buying more based on recent returns.
2) When holdings decline after peaks in investor allocation (such as 1968, 1972, 2000, 2007 and 2021), poor stock returns have usually followed[v].
3) Investors are more bullish about stock returns than they have ever been.

Investor equity allocations and optimism have never been this high. These factors, along with frothy valuations for US Large Caps, suggest investors may be blinded by rampant overconfidence. Stock prices could therefore be more vulnerable than many people believe, and volatility could increase dramatically should stocks enter a corrective phase.

We counsel investors to be prepared for periods of higher volatility in the coming years due to high valuations, potentially lower diversification benefits of a balanced portfolio construction, and high investor allocations to stocks.



Addition of Hedged Alternatives and Private Assets

When the search for diversification moves beyond stocks and bonds, we turn towards hedged **alternative assets** for three reasons.

» **Diversification across different sources of return**: Real assets, trading strategies, and relative value hedged strategies have provided additional sources of return than those found in the stock and bond markets alone.

» **Low correlation to stock and bond market returns**: Historically, alternative strategies have exhibited low correlation to the traditional stock and bond markets, providing real downside protection and reducing portfolio volatility.

» **Potential hedge against inflation**: Exposure to real assets has, time and time again, provided a hedge against decreased purchasing power.

While Alternatives can reduce portfolio volatility and expose portfolios to different sources of returns; the search for higher returns causes us to turn to the **private markets**.

Historically, institutional investors have achieved better returns in the private markets compared to public market returns[vi]. As the chart below indicates, despite the dominance of the S&P 500 over the last ten years, private markets have outperformed public markets[vii]. We seek higher returns in three broad categories of private assets:

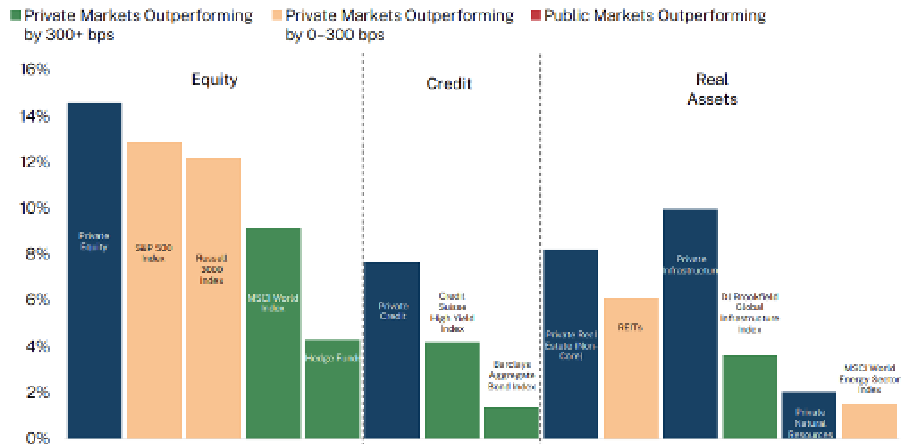
» Private Equity: Includes both private equity and venture capital. Companies have more flexibility to make long-term business decisions when quarterly earnings pressure is eliminated. Many companies can be purchased at a lower price in the private markets. Investors can often have more direct interaction with company leadership to help actively increase value in the company. These are some of the characteristics that allow private equity exposure to drive returns.

» Private Credit: Companies use private credit instead of bank loans or public bond offerings for the ability to customize their borrowing offering, for speed of execution, for certainty of closing, and to limit broad distribution of potentially sensitive information. The trade-off for those benefits can be a higher return to the lender.

» Private Real Assets: Includes real estate, natural resources and infrastructure. Real assets can provide diversification to stocks and bonds. Many real assets can be purchased at lower prices in the private market. These assets may provide stability amidst the volatility of the public market with potential to earn higher returns.

10-Year Asset Class Performance

Annualized Time-Weighted Return as of 06/30/2024



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Conclusion

"Planning is important, but the most important part of every plan is to plan on the plan not going according to plan." – Morgan Housel

Two of the most difficult aspects of managing investment portfolios are keeping emotions in check and minimizing mistakes. Our Capital Market Assumptions process aims to help you do both.

Our 2025 process highlights six key expectations:

1. We expect higher inflation and lower growth than than Prior to the Pandemic.
2. Given higher inflation and starting yields, we expect bond returns to be attractive but to provide less diversification benefit than they have offered in the low inflation regime of the last 40 years.
3. We expect stock returns to be modest given headwinds of higher interest burdens and lower global growth.
4. We expect attractive returns from small cap and international stocks.
5. In keeping with history, investors can expect alternative investments to reduce risk and diversify portfolios.
6. We also expect private markets to offer higher return potential than public markets.

We encourage clients to maintain discipline, incorporate diversification, and stay on the long-term course, even though the next decade may be a bumpier leg of the financial journey.

Sources:

[i] Source: New York Federal Reserve Inflation Expectations - FEDERAL RESERVE BANK of NEW YORK

[ii] Source: IMF world Economic Outlook.

[iii] Source: Visual Capitalist The Top Investment Quotes Every Investor Should Know (visualcapitalist.com)

[iv] Source: Bloomberg

[v] Source: Bloomberg- returns following prior peaks: 1969: -11%, 1973: -17%, 2000: -10%, 2008: -38%, 2022: -20%

[vi] Source: Chartered Alternative Investment Analyst Association Long-Term Private Equity Performance: 2000 to 2021 | Portfolio for the Future | CAIA

[vii] Source: Hamilton Lane Data via Cobalt, Bloomberg. Indices used: Hamilton Lane All Private Equity with volatility de-smoothed; S&P 500 Index; Russell 3000 Index; MSCI World Index; HFRI Composite Index; Hamilton Lane Private Credit with volatility de-smoothed; Credit Suisse High Yield Index; Barclays Aggregate Bond Index; Hamilton Lane Private Real Estate with volatility de-smoothed; Hamilton Lane Private Infrastructure with volatility de-smoothed; Hamilton Lane Private Natural Resources with volatility de-smoothed; FTSE/NAREIT Equity REIT Index; DJ Brookfield Global Infrastructure Index; MSCI World Energy Sector Index. Geometric mean returns in USD. Assumes risk free rate of 2.4%, representing the average yield of the ten-year treasury over the last ten years. (November 2024)

OneAscent INVESTMENTS

Nathan Willis

Director of Portfolio Strategy

Nathan Willis is Director of Portfolio Strategy for OneAscent Investment Solutions and has 25 years of investment experience, including 20 years investing in illiquid strategies.

Nathan holds a bachelor's degree in Business Administration with a concentration in Information Systems and a minor in Economics from Taylor University. He is a holder of the CFA Charter and CAIA designation. Nathan started his career at NationsBank where he spent several years managing institutional bond portfolios and an equity mutual fund.

Prior to joining OneAscent, Nathan served as Chief Investment Officer of Greenhawk Corporation, a single-family office. At Greenhawk, Nathan was responsible for portfolio strategy and manager diligence. During his time at Greenhawk Nathan developed the allocation, sourcing, and diligence strategy for the private equity portfolio.

Prior to Greenhawk, Nathan spent almost 15 years with GenSpring Family Offices, a unit of SunTrust Banks, where he constructed portfolios for multi-generational families. While at GenSpring, Nathan served on the Investment committee and manager selection committee and served developed programs to mentor junior investment staff. Prior to GenSpring, Nathan spent four years with the family office group of Wachovia Bank.

Peter Klingelhofer

Director of Research

Pete Klingelhofer is Director of Research and Senior Portfolio Manager for OneAscent Investment Solutions. He has over 27 years of experience in securities analysis, portfolio management and asset allocation and he holds designations as a Chartered Financial Analyst (CFA) and a Certified Kingdom Advisor (CKA).

Pete was previously an Executive Director and Senior Portfolio Manager at JP Morgan Asset Management, where he co-managed the Investor Funds suite of target-risk multi-asset funds and was a contributing author for the JP Morgan Long-Term Capital Market Assumptions (LTCMA) process. He started his career at the State Teachers Retirement System of Ohio, where he co-managed a $2 billion Large Cap Value Fund. In his most recent roles, Pete was CIO of Wealthstone Investments and a managing director at Hamilton Capital, both Columbus, Ohio-based registered investment advisors. Pete earned bachelor's degree from Washington & Lee University, where he played collegiate Baseball.

Pete and his wife, Suzanne, have been married for over 20 years and they reside in Columbus, Ohio. They are parents to Tyler Smith Bringman, Kathryn Taylor Bringman, Jackson Phillips Klingelhofer, Wilson Sharp Klingelhofer and Elliott Paige Klingelhofer.

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