Vanguard

OCTOBER 2020

Market perspectives

Vanguard's monthly economic and market update

KEY TAKEAWAYS:

- It will take until the end of 2021 for U.S. GDP to return to pre-COVID levels.
- Vanguard expects agreement on a continuing resolution to fund the government at least through the election.
- Monetary policy should remain loose into 2021, with risks skewed toward further easing.
- Global trade is poised for a sharp rebound through October, followed by a slower recovery.
- Vanguard expects core inflation to remain below 2% over the medium term.
- The United States will finish 2020 with an unemployment rate in a range of 7% to 9%.

Asset-class return outlooks

Our ten-year, annualized, nominal return projections, as of June 30, 2020, are shown below. Please note that the figures are based on a 1.0-point range around the rounded 50th percentile of the distribution of return outcomes for equities and a 0.5-point range around the rounded 50th percentile for fixed income.

Equities	Return projection	Median volatility
U.S. equities	**3.9%–5.9%**	17.9%
U.S. value	**5.0%–7.0%**	19.9%
U.S. growth	**1.6%–3.6%**	19.5%
U.S. large-cap	**3.7%–5.7%**	19.4%
U.S. small-cap	**4.0%–6.0%**	23.5%
U.S. real estate investment trusts	**3.4%–5.4%**	19.9%
Global equities ex-U.S. (unhedged)	**7.4%–9.4%**	18.6%
U.S. inflation	**0.5%–1.5%**	2.4%

Fixed income	Return projection	Median volatility
U.S. aggregate bonds	**0.7%–1.7%**	4.0%
U.S. Treasury bonds	**0.3%–1.3%**	4.2%
U.S. credit bonds	**1.4%–2.4%**	5.7%
U.S. high-yield corporate bonds	**3.2%–4.2%**	10.7%
U.S. Treasury inflation-protected securities	**0.4%–1.4%**	6.4%
U.S. cash	**0.5%–1.5%**	0.9%
Global bonds ex-U.S. (hedged)	**0.5%–1.5%**	2.5%
Emerging market sovereign	**3.1%–4.1%**	11.1%

These probabilistic return assumptions depend on current market conditions and, as such, may change over time.

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results.

Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of June 30, 2020. Results from the model may vary with each use and over time. For more information, see page 4.

Source: Vanguard Investment Strategy Group.

Region-by-region outlook

Economic growth picture brightens a bit

United States. The second government estimate of second-quarter GDP in the United States, at negative 31.7%, confirmed an economy-wide collapse in activity led by services. But that data came in at the more optimistic end of Vanguard's forecast range.

- Some parts of the economy rushed to reopen, leading to a mixed bag of worsening virus infection trends alongside a brighter near-term U.S. economic picture.
- With these unexpected developments, Vanguard sees a shift forward in growth expectations, with higher economic growth in 2020 owing to less-stringent lockdowns (full-year 2020 GDP around negative 4%, compared with our previous view of negative 7% to negative 9%), but a slower pace of recovery in 2021 (reduced to around 4% growth, compared with a range of 7% to 9% previously). In all, the longer-term picture hasn't changed.
- We still see it taking until the end of 2021 for GDP to return to pre-COVID levels and into 2022 to reach a pre-COVID trajectory, or where GDP would have been had COVID never happened. Our view anticipates further fiscal stimulus of around $1 trillion; we'd likely reduce our outlook in the absence of such stimulus.

Euro area. Vanguard continues to foresee a full-year economic contraction around negative 10% for the euro area economy in 2020 as both headwinds and tailwinds strengthen.

- A strengthening in the euro against other major currencies since May, including a nearly 10% strengthening against the U.S. dollar, is a negative for exports that are now more expensive, which could weigh on GDP.
- We expect economic recovery for the rest of the year to be gradual. Although most supply has come back online, it will take longer for demand to return as households remain reluctant to engage in highly social activities.

China. Vanguard continues to foresee full-year growth for China in a 1% to 3% range.

- Vanguard is seeing a broadening in China's export goods after a period where exports were concentrated in protective equipment, medical instruments, and work-from-home technology.
- We'll watch for whether subdued spending in the developed world may weigh on China's exports in the months ahead.

Japan. Vanguard expects the resignation of Prime Minister Shinzo Abe to have little near-term effect on the economy or consumer sentiment in Japan. We continue to foresee Japan's full-year GDP contracting in a range around negative 3% to negative 5%.

Emerging markets. The International Monetary Fund foresees emerging markets contracting by negative 3.0% before rebounding to growth of 5.9% in 2021.

- The outlook for Latin America, under assault from COVID-19, is particularly pessimistic.
- Emerging markets will be watching developments in U.S.-China relations, which have implications for supply chains and trade-related growth.

Expect agreement on a continuing resolution

Averting a U.S. government shutdown

Vanguard expects agreement on a continuing resolution to fund the government at least through the November 3 presidential and congressional elections, averting a shutdown in the interim.

- The government is required to authorize funding each fiscal year for the approximately one-third of the federal budget that isn't authorized automatically. When it doesn't do so, certain government operations cease to function.

New approach to inflation

Monetary policy to remain loose

Given our expectation for a slow recovery in demand amid pandemic containment efforts, Vanguard continues to expect monetary policy to remain loose into 2021, with risks skewed toward further easing.

The Fed. The Fed said it expects to maintain the current target range of 0%–0.25% until it assesses that inflation "is on track to moderately exceed 2% for some time."

- U.S. Federal Open Market Committee (FOMC) members broadly expect the Fed will keep the current federal funds target rate at today's level through 2023, even as they expect inflation to then finally reach 2%.

The ECB. Vanguard expects little change in ECB policy over the next 12 months.

China. Vanguard expects China to largely maintain the status quo in both monetary and fiscal policy as it tries to balance near-term growth and medium-term financial stability.

Inflation should be tame

Core inflation should remain below 2% over the medium term

We see inflation remaining below 2% by the end of 2021, though virus-related supply shocks, fiscal support and/or monetary stimulus, and willingness by the Federal Reserve to tolerate above-target inflation may serve as potential spurs to higher prices.

Sharp rebound ahead?

Global trade has swung back to an upward trajectory

Similar to the trajectory of broader economic recovery in many places, the leading indexes imply a sharp rebound for global trade through October, followed by a slower recovery to pre-pandemic levels.

- We expect global inventory drawdowns prior to the crisis to act as a tailwind to global trade, as firms rebuild depleted inventories.

China. The country remains the standout in trade, its exports buoyed by products that were in demand during COVID lockdowns, such as protective gear, pharmaceuticals, and office equipment.

- China has been supported by its position at the center of global goods production and by lower commodities input prices.

Finishing 2020 with an unemployment dip

Employment better than expected

United States. The U.S. labor market has surpassed expectations in recent months, and our view that U.S. growth will accelerate for the rest of the year supports our view that the United States will finish 2020 with an unemployment rate in a range of 7% to 9%, lower than our prior view of a range of 8% to 10%.

All investing is subject to risk, including possible loss of principal.

Investments in bonds are subject to interest rate, credit, and inflation risk.

Investments in stocks or bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk. These risks are especially high in emerging markets.

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The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

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