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Updated Bond and Stock Return Projections

Fourth Quarter of 2023

Projecting forward returns of the stock market requires just simple arithmetic. For example.....

Most recent quarterly sales per share of the U.S. stock market (S&P 500) was \$462. That's an annual run rate of \$1,848.

The long-term average sales growth rate is 4% implying annual sales per share of about \$2,960 in twelve years.

S&P 500 profit margin in 12 years around its long-term average of 8% implies S&P 500 *earnings per share* of \$237 (8% x \$2,960 sales per share).

Assume the price / earnings multiple ends around its long-term average of 17x. The implied price of the S&P 500 in twelve years would be \$4,029 (17 x \$237 earnings per share).

But, wait, the current price of the S&P 500 is \$4,174. Does that mean the market is priced to go backwards for a 12-year period? Yes! That is exactly what that implies. U.S. stock investors are essentially investing in the U.S. stock market for its dividend, which is currently at only 1.6%.

Meanwhile, 0- to 10-year treasury bonds are priced to yield about 4.9% to 5.5% per year when held to maturity!



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Simple, right?

The difficult part is that we don't know exactly what sales growth will be over any period of time, or what the profit margin and earnings multiple will be at any point in the future.

Although, over longer periods of time (10-12 years) sales growth, profit margins and earnings multiples tend to oscillate around their long-term averages. So, by using a 10-12 year timeframe we can project a reasonable *range* of forward returns.

This is why I use a *matrix* to illustrate a potential range of return outcomes for a range of inputs.

A Matrix of Potential Returns

The matrix of estimated forward annual returns for the next 12 years is displayed below.

12-Year Hypothetical Annualized Forward Returns Matrix

Prepared 10/30/2023 (Sales Per Share as of 2023.Q2)

Price/Earnings →	14x			17x			20x		
	Profit Margins			Profit Margins			Profit Margins		
Annual Sales Growth	6%	8%	10%	6%	8%	10%	6%	8%	10%
3%	-3.5%	-1.2%	0.6%	-2.0%	0.4%	2.2%	-0.7%	1.7%	3.6%
4%	-2.6%	-0.3%	1.6%	-1.0%	1.3%	3.2%	0.3%	2.7%	4.6%
5%	-1.7%	0.7%	2.5%	-0.1%	2.3%	4.2%	1.2%	3.7%	5.6%

3-Year Treasury Rate = 4.9

Dividend yield = 1.62%

Sales Per Share (run rate) = most recent quarter x 4 = \$1,848.52

Observe the range of returns is a 3.5% annualized LOSS to a 5.6% annualized gain with an average estimate of just 1.3% annualized. You might think this seems very low... because it is!

The long-term average annual return for the S&P 500 is closer to 8%-10% so, yes, 1.3% is indeed very low. Further consider that the annualized yield of a low-risk 3-year treasury bond is about 4.9%. This makes the twelve-year annualized return estimate for stocks especially unattractive given the much greater risk and volatility inherent in stocks relative to short-term treasury bonds.



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For contrast, let's perform the same analysis from a different point in time near the *bottom* of a market cycle (mid-2009) as opposed to the *top* of a market cycle.

12-Year Hypothetical Annualized Forward Returns Matrix

As of 06/30/2009 (Sales Per Share as of 03/31/2009)

Price/Earnings →	14x			17x			20x		
	Profit Margins			Profit Margins			Profit Margins		
Annual Sales Growth	6%	8%	10%	6%	8%	10%	6%	8%	10%
3%	4.0%	6.4%	8.4%	5.6%	8.1%	10.1%	7.0%	9.6%	11.6%
4%	5.0%	7.4%	9.4%	6.6%	9.1%	11.1%	8.0%	10.6%	12.6%
5%	5.9%	8.4%	10.4%	7.6%	10.2%	12.2%	9.1%	11.6%	13.7%

3-Year Treasury Rate as of 06/30/2009 = 1.64%

Dividend yield = 2.76%

Sales Per Share (run rate) = most recent quarter x 4 = \$887

Notice in the case from fourteen years ago (06/30/2009), using the exact same methodology, the range of returns was +4.0% to +13.7% with an average estimate of 9.1%! The *low* end of that 2009 range is almost equal to the *high* end of the current range. Furthermore, the 9.1% average estimate is seven times greater than the current average estimate.

Certainly, the U.S. stock market provided a far more attractive investment opportunity back in 2009 than it does today based on this analysis.

Recall that 2009 was the bottom of the Great Financial Crisis where the U.S. stock market lost 55% top to bottom. So, it makes sense that the valuations near the bottom in 2009 were relatively cheap and forward return estimates were much higher.

This information can then be incorporated into personal financial projections to assist in building reasonable recommendations for savings rates, retirement age, financial goals, investment strategy, social security commencement, pension, etc...

Disclosure: This matrix does not include every potential return outcome. The purpose is to show a likely range of outcomes but cannot show every potential outcome. Actual outcomes could deviate significantly from the estimates.



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Implications

This information is not at all reliable for predicting short-term returns, however, the implication is that U.S. stock market returns over the next decade or so will likely end up being significantly lower than historical averages. Also, the path the market takes to achieve those returns along the way is completely unknowable

It's important to understand this analysis and incorporate reasonable, realistic assumptions into our financial projections. By simply relying on historical averages we are more likely to make poor, suboptimal decisions and/or take on far more risk than we're comfortable with.

At this point it appears the U.S. stock market may have peaked around January 1st of 2022 (see chart below).



Disclosures:

Past performance is no guarantee of future results. All investments maintain risk of loss in addition to gain.

Data from third-parties is believed to be reliable but accuracy is not guaranteed. Much of the data used to interpret the markets and forecast returns are often at odds with each other and can result in different conclusions.

This is not investment advice but merely a general commentary. Individualized investment advice cannot be provided until a thorough review of your unique circumstances and financial goals is completed.

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