MEKETA

Expectations vs. reality: a five-year retrospective on asset class performance

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CONTRIBUTORS
STEVE MCCOURT, CFA
ZACH STEVENS, CAIA
LAUREN GIORDANO

In early 2020, few could have predicted the scale of disruption that COVID-19 would bring to markets, economies, and everyday life. As we look back on the last five years, it is worth asking: how did our expectations for major asset classes hold up in the face of such unprecedented events? Where were we right—and where did the market surprise us?

In this piece, we revisit our pre-pandemic return assumptions and compare them with actual outcomes from 2020 to 2024. Along the way, we explore some of the macroeconomic forces—like inflation, interest rate shifts, and earnings growth—that helped shape the results.

Key takeaways

- → Comparing Meketa's 2020 pre-pandemic projections for major asset classes' future returns with the assets' actual returns highlights the variability and unpredictability of the market over the last five years.
- → Fixed income asset classes generally underperformed expectations, with investment grade bonds, TIPS, high yield bonds, and emerging market debt experiencing significant declines during the rising interest rate environment from early 2022 to late 2023.
- → US equities, driven by the growth of large technology-focused companies known as the "Magnificent Seven," posted significantly better-than-expected returns, while international equities struggled due to factors such as a strong US dollar and lower earnings growth.
- → Private markets, including private equity, private debt, and private infrastructure, outperformed expectations due to factors such as exposure to the US economy, low initial interest rates, and smoothed valuation methodologies.

2020 to 2024 asset class returns vs. expectations

In this section, we compare what we expected from major asset classes back in 2020 with how they performed over the past five years. We have included simple visuals to show where our assumptions held up and where reality took a different turn. Some returns landed right where we thought they might, while others moved far beyond the typical range. This is not just a numbers exercise – it is a way to better understand how markets behaved during an extraordinary period, and what that might mean for the road ahead.

The charts throughout this paper compare Meketa's 2020 (pre-pandemic) projections for major asset classes' future returns versus the actual returns that occurred. In addition, we include a +/- 1 standard deviation "range" to help visualize just how unlikely (statistically speaking) some of the returns that occurred during this period were.[1]

The expected returns shown in the charts are from Meketa's 2020 Capital Markets Expectations ("CMEs"). We use the 20-Year annualized CME expected return (blue text) to then calculate what the cumulative return (blue dotted line) would be, given that the annualized return rate stays the same.

Finally, we use the standard deviation from Meketa's 2020 CMEs to create the +/-1 standard deviation "range."

The actual, or realized, returns shown in the charts are based on an index proxy for each asset class. They represent the cumulative (orange line) and annualized (orange text) return that occurred over the shown period.

[1] Returns that were outside of this +/- 1 standard deviation range theoretically occur less than 33% of the time, assuming a normal shaped distribution of outcomes. The range gets wider over time but at a decreasing rate.

More information on Meketa's annual Capital Markets Expectations can be found by clicking here.

Fixed income

Overall, most fixed income asset classes underperformed expectations over the course of the past five years. The one exception was bank loans, whose yields typically float with interest rates and benefited from rising rates. Investment grade bonds, TIPS, high yield bonds, and emerging market debt all took a sharp downward turn during the rising interest rate environment that lasted from early 2022 to late 2023 (see Figures 1-5).

Investment grade bonds, typically considered a "safe haven" asset, were hit unusually hard during this period, dropping well below one standard deviation.[2] Since the rising interest rate period ended in late 2023, investment grade bonds have somewhat rebounded, though they remain outside the range of expected returns that had been forecasted five years prior.

[2] A one standard deviation event is a statistical probability projected to occur roughly 16% of the time.

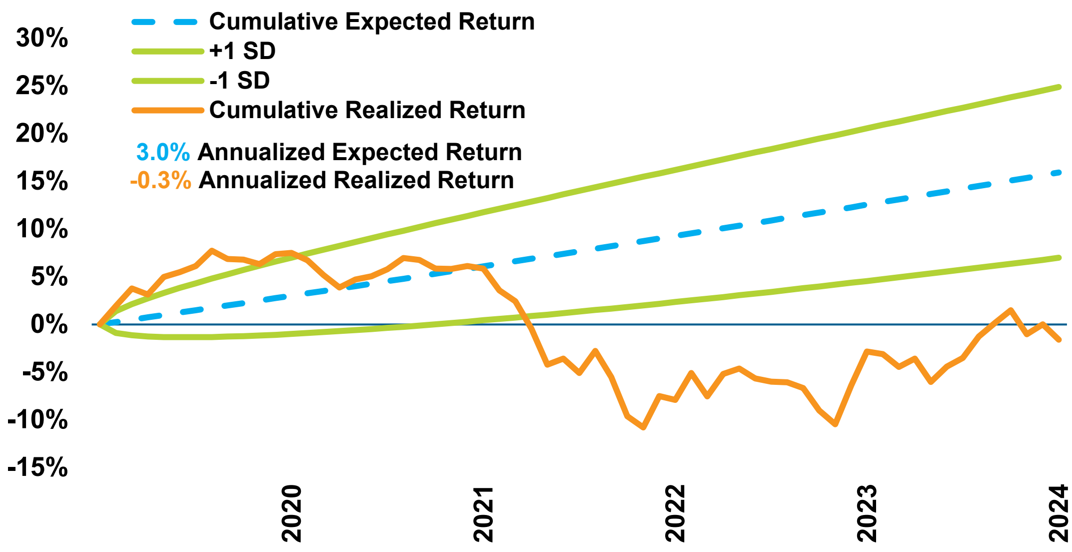
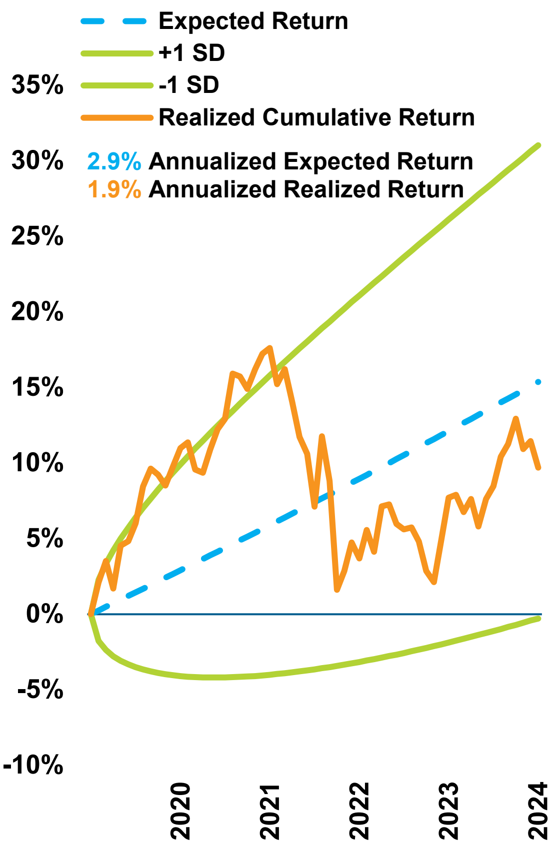


FIGURE 1
Investment Grade Bonds

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the Bloomberg US Aggregate Bond Index.



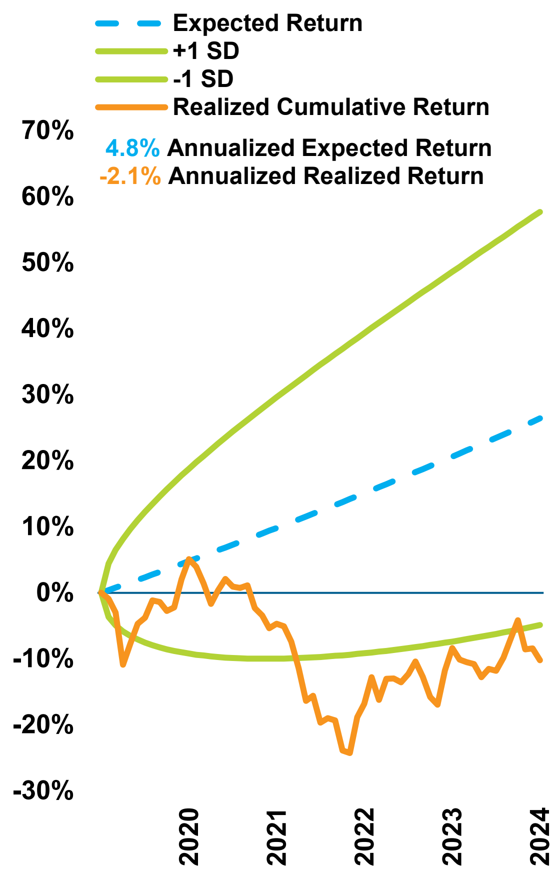


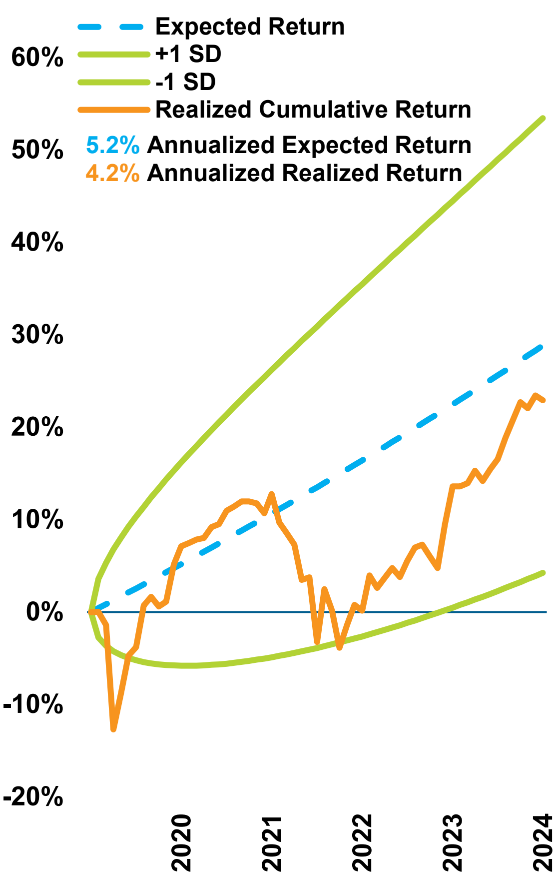
FIGURE 2 AND 3

Left Chart: TIPS

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the Bloomberg US TIPS Index.

Right Chart: Emerging Market Debt

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the Bloomberg EM Local Currency Government Diversified Index.



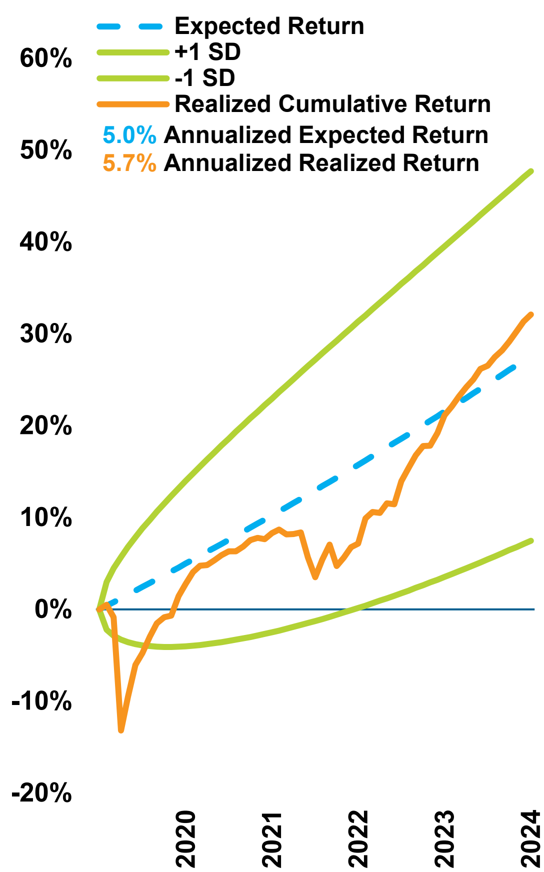


FIGURE 4 AND 5

Left Chart: High Yield

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the Bloomberg US Corporate High Yield Bond Index.

Right Chart: Bank Loans

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the S&P UBS Leveraged Loan Index (formerly Credit Suisse Leveraged Loans).

Equities

Equities produced mixed results relative to expectations. US stocks surprised to the upside, while non-US stocks disappointed. Earnings growth and currency movements were a key part of the story.

Driven by the stratospheric rise in large technology-focused companies, often referred to as the "Magnificent Seven," US equities posted significantly better-than-expected returns over the past five years. These companies, which include Apple, Microsoft, Amazon, Google, Facebook, Tesla, and Nvidia, experienced unprecedented collective growth, propelling the overall market to new heights.

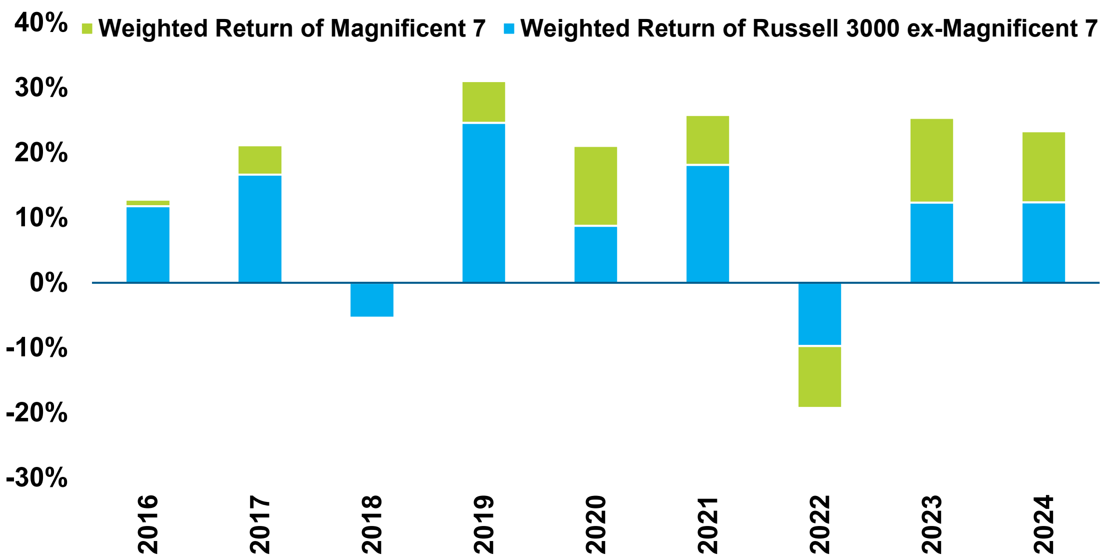


FIGURE 6

The Magnificent Seven's Contribution to Russell 3000's Return

Source: FactSet, as of December 31, 2024. Alphabet Class A and C were combined into one category for this analysis. In 2018, the Russell 3000 returned -5.21% while the Magnificent Seven returned 0.16%.

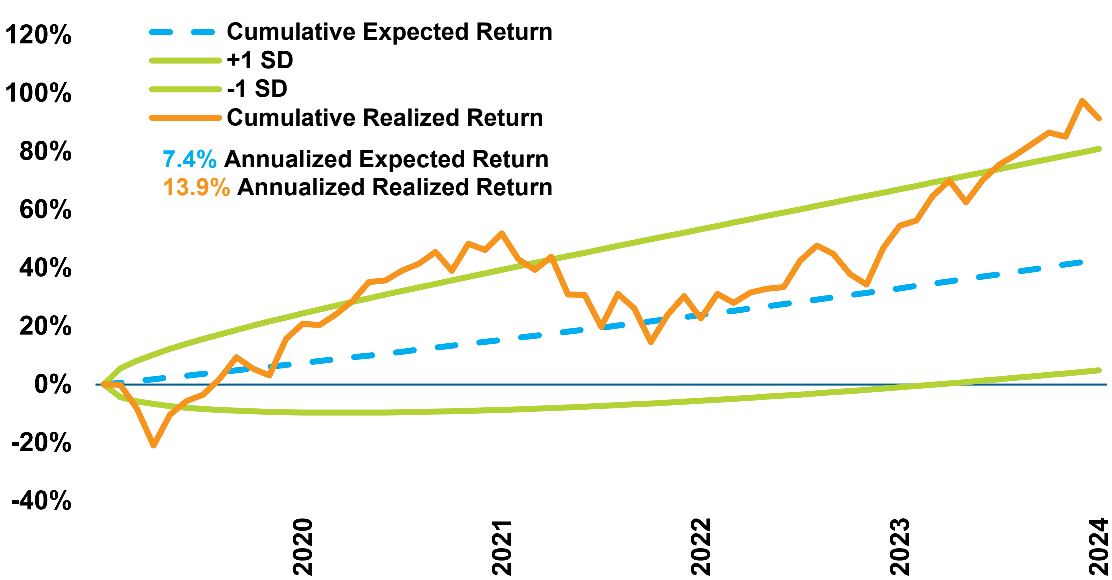


FIGURE 7

US Equity

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the Russell 3000.

Despite the economic dislocation caused by the COVID-19 pandemic and the historic rise in interest rates, the resilience and performance of these tech behemoths provided a strong foundation for the US stock market such that its returns were outside the range of expectations, but unlike bonds, to the upside.

However, the story was quite different for international equities. Despite a strong start during the COVID-19 recovery period, these markets struggled to keep pace with their US counterparts in the years that followed. This was in no small part because these international equities lacked exposure to the Magnificent Seven stocks. However, there were also other major contributing factors to international equities' relative underperformance. The strong US dollar further compounded the challenges faced by international equities, as dollars invested in foreign currencies lost value when translated back into a strengthening US dollar. Additionally, lower earnings growth in many international markets – in some cases flat or even negative – contributed to the underwhelming performance. Consequently, non-US equities posted only modest gains that fell below expectations. Emerging market equities were also negatively impacted by a strong US dollar and disappointing earnings growth. Moreover, a decelerating Chinese economy failed to support the emerging markets complex, and returns were well below expectations.

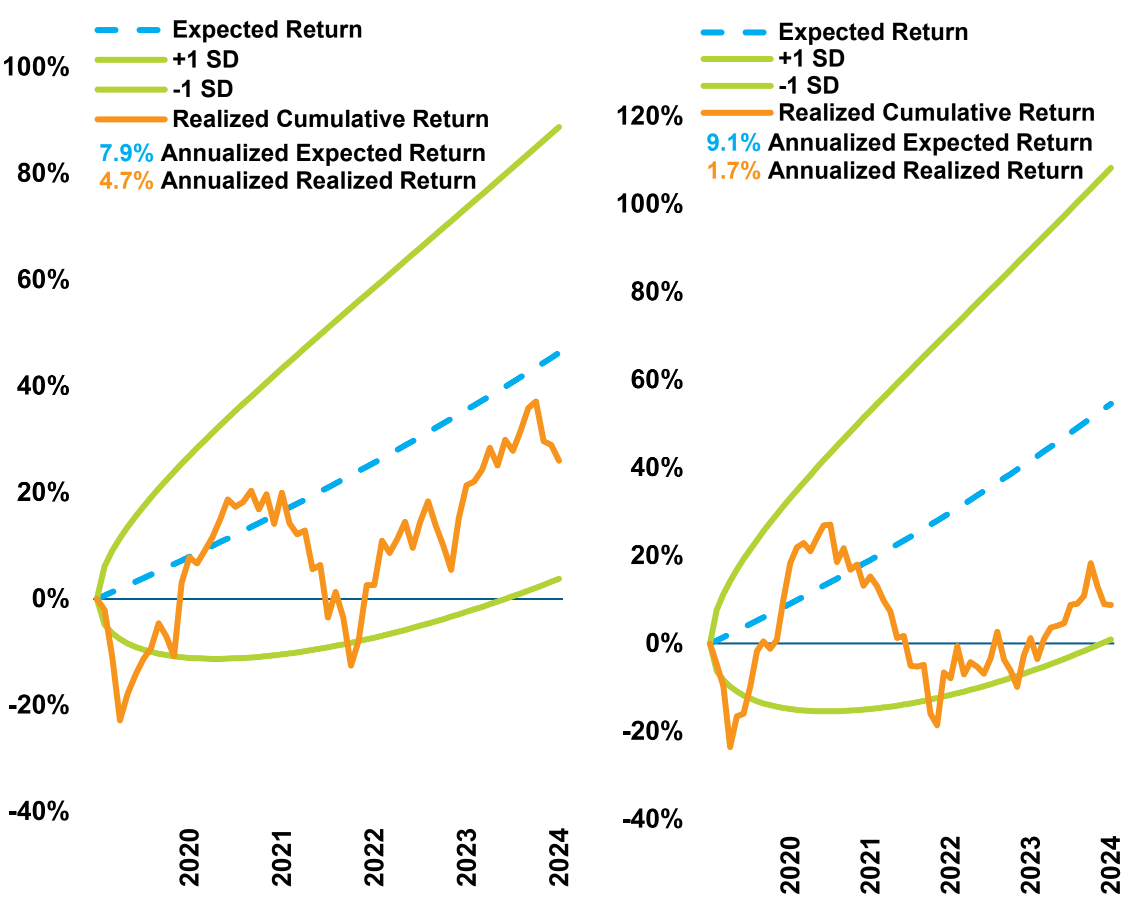


FIGURE 8 AND 9

Left Chart: Non-US Developed Equity

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the MSCI EAFE Index.

Right Chart: Emerging Market Equity

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from the MSCI EM Index.

Figures 10 and 11 depict two of the factors explained above that led to US equity's outperformance of expectations and international equity's underperformance. The first factor, appreciation of the US dollar, reduced returns in the MSCI EAFE index by 2.9% and the MSCI EM index by 2.8% on average per annum. The strong dollar impacted all unhedged foreign investments made by US investors, thus making the strength of the US dollar a critical component in shaping the financial outcomes for US investors.

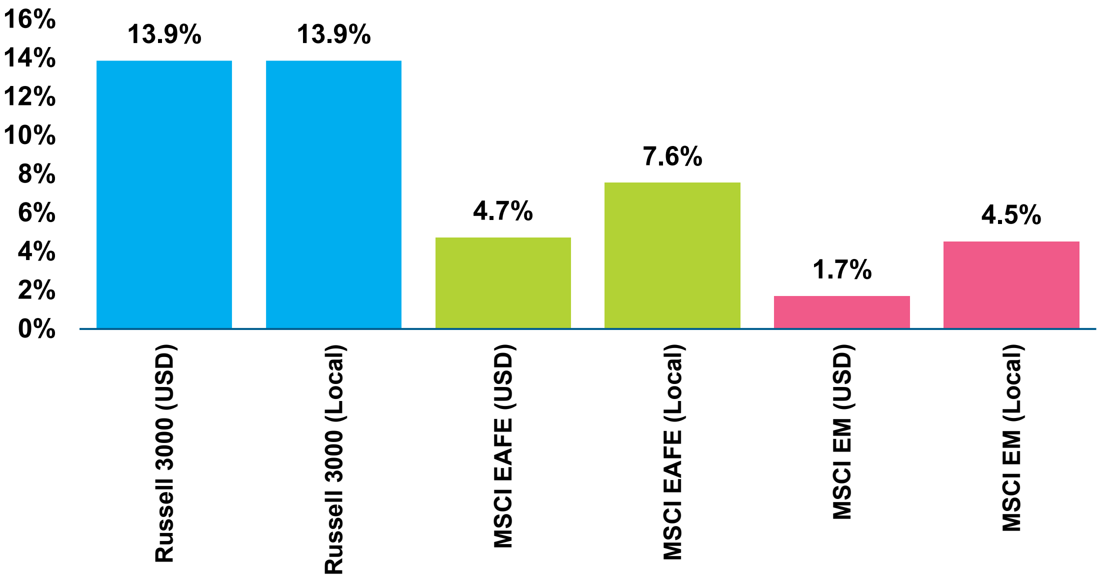


FIGURE 10

5-Year Annualized Equity Returns in Dollars and Local Currency

Source: FactSet, as of 12/31/2024. For the period 1/1/2020 to 12/31/2024. Indices: Russell 3000 USD and Local, MSCI EAFE USD and Local, MSCI EM USD and Local.

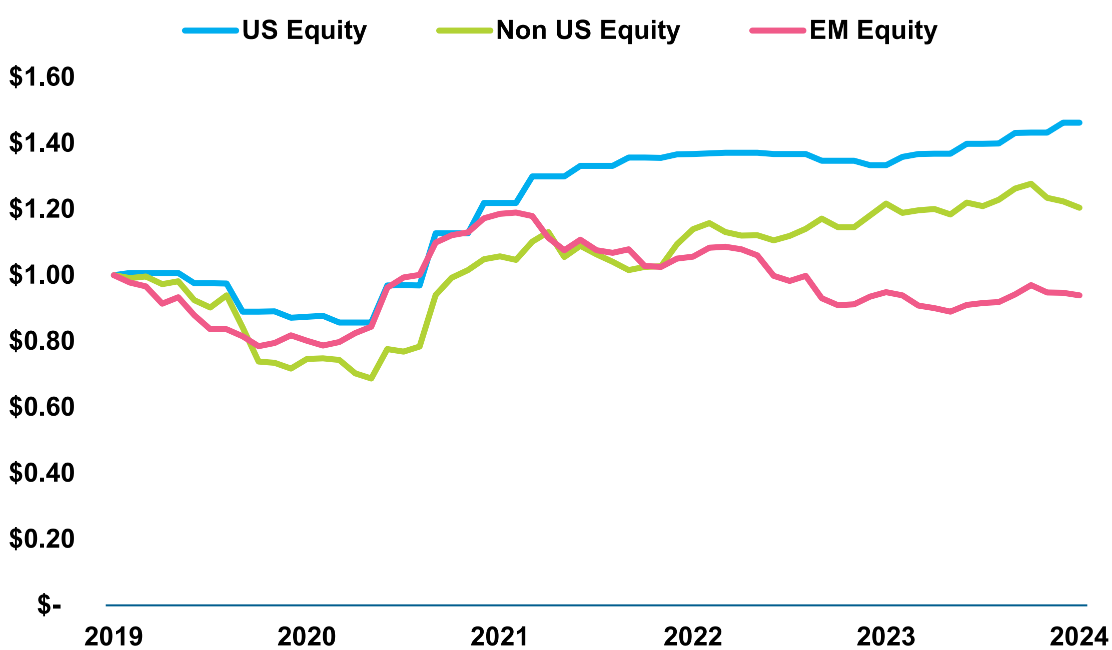


FIGURE 11

Earnings Per Share: Growth of a Dollar

Source: Meketa analysis of Bloomberg data as of December 2024. Note that earnings are in local currency.

The second factor was the significantly greater earnings per share ("EPS") growth from 2020 to 2024 experienced by the US. This high EPS growth was driven by a combination of higher earnings and net share repurchases. During this period, many companies in the US saw substantial improvements in their profitability, fueled by a robust economic recovery, technological advancements, and strong consumer demand. Additionally, numerous corporations took advantage of favorable market conditions to buy back their own shares, thereby reducing the number of outstanding shares and boosting EPS. As a result, the EPS growth for US equities outpaced that of non-US and emerging markets.

Private markets

Returns in private markets were generally above expectations, with real estate being the rather notable exception. The level of and changes in interest rates had a notable impact on each sector.

Private equity returns were well above expectations for the five-year period, even surpassing the higher end of the +1 standard deviation range at times. These investments benefited from significant exposure to the US economy and a low interest rate environment up until late 2021. Low interest rates made borrowing cheaper, allowing private equity firms to leverage their investments more effectively. This, combined with the market's economic recovery and a large influx of capital in the space, drove the substantial returns. Moreover, when rates rose, private equity GPs did not mark down asset values as quickly or steeply as was experienced for public markets in 2022.

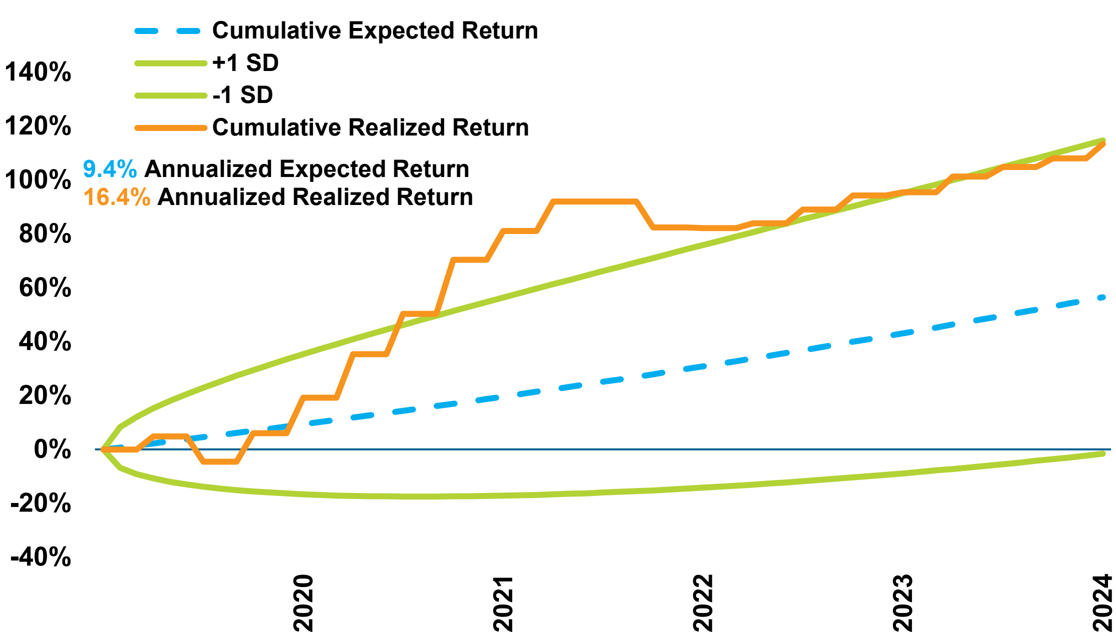


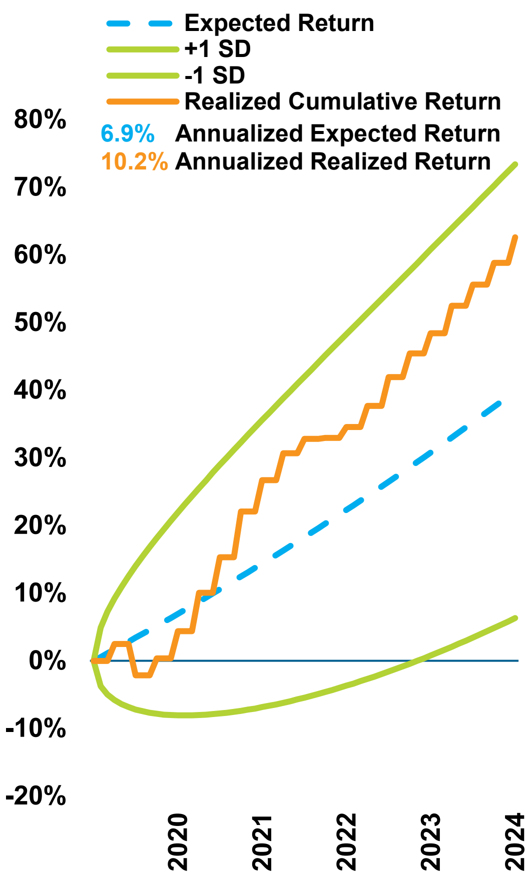
FIGURE 12

Private Equity

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from Cambridge Associates' US Private Equity Composite. Note that Cambridge Associates data is 1-quarter lagged.

Like private equity, private debt and infrastructure also outperformed expectations. Private Debt, which incorporates yields that float with interest rates and benefits from smoothed valuation methodologies, posted strong results, particularly during the rising interest rate environment. This asset class is uniquely positioned to thrive when interest rates increase because the floating yields adjust upward, providing higher returns to investors.

Private infrastructure's strong performance is perhaps unsurprising given its inherent characteristics of low correlations with traditional stocks and bonds, protection during historical market downturns, and its role as a historical inflation hedge, which is especially relevant during the recent high inflation years. Additionally, for all private market asset classes, the use of smoothed valuation methodologies helps to mitigate volatility and present a more stable performance profile.



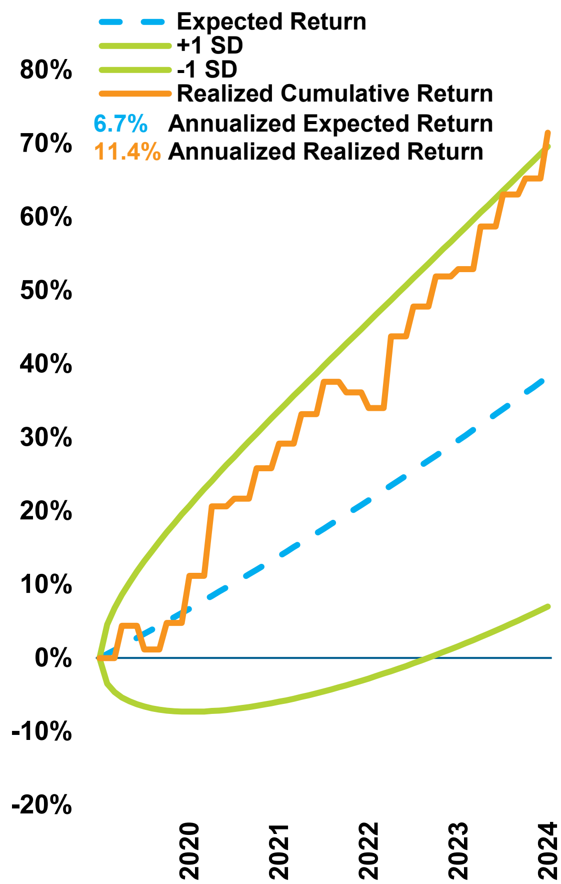


FIGURE 13 AND 14

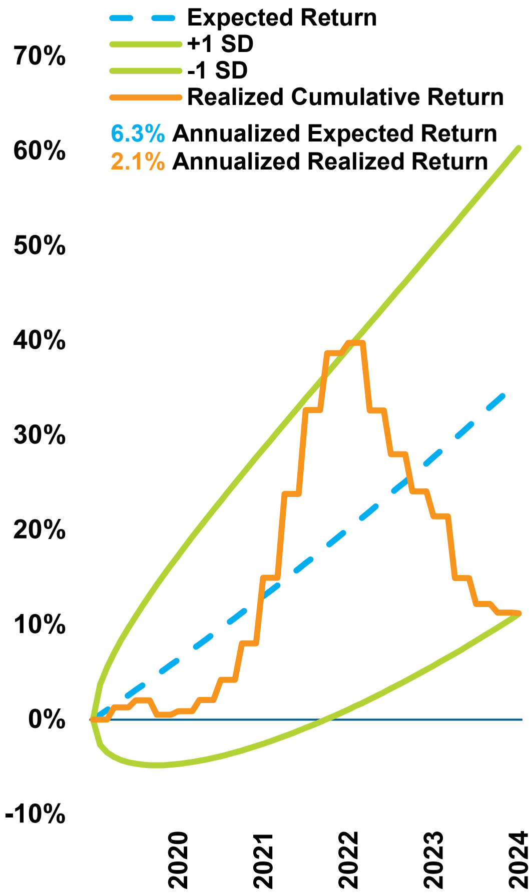
Left Chart: Private Debt

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from Cambridge Associates' Private Debt Composite. Note that Cambridge Associates data is 1-quarter lagged.

Right Chart: Private Infrastructure

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from Cambridge Associates' Private Infrastructure Composite. Note that Cambridge Associates data is 1-quarter lagged.

Both core and value add real estate returns dipped, understandably, as the world experienced a global shutdown during the COVID-19 pandemic and the market evolved into its new "normal," as vacancy rates remained elevated for some sectors such as offices properties. Despite these persistent vacancy rates in certain sectors, the real estate market experienced a boom that began in 2021 and peaked in late 2022, fueled by the combination of low interest rates and robust demand. Specifically, it was the appreciation component of returns that drove the climb and subsequent downturn (see Figure 17). As interest rates began to rise in 2022, the cost of borrowing increased, making real estate investments less attractive and more expensive to finance. Ultimately this led to a slowdown in real estate investment activity and a prolonged decline in property values.



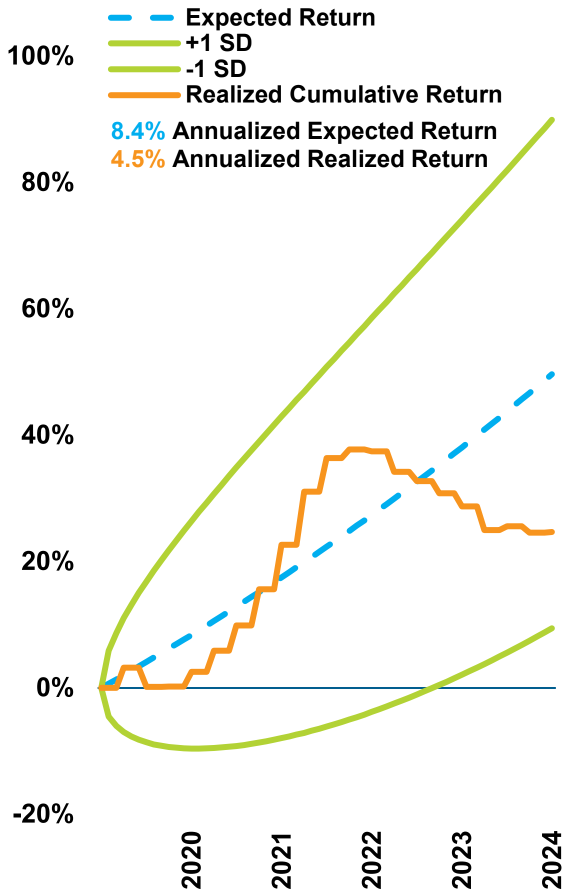


FIGURE 15 AND 16

Left Chart: Core Real Estate

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns are NCREIF ODCE Equal Weighted Index..

Right Chart: Value Added Real Estate

Expected returns and standard deviation sourced from Meketa's 2020 Capital Markets Expectations, actual returns from Cambridge Associates' Real Estate Value Add Composite. Note that Cambridge Associates data is 1-quarter lagged.

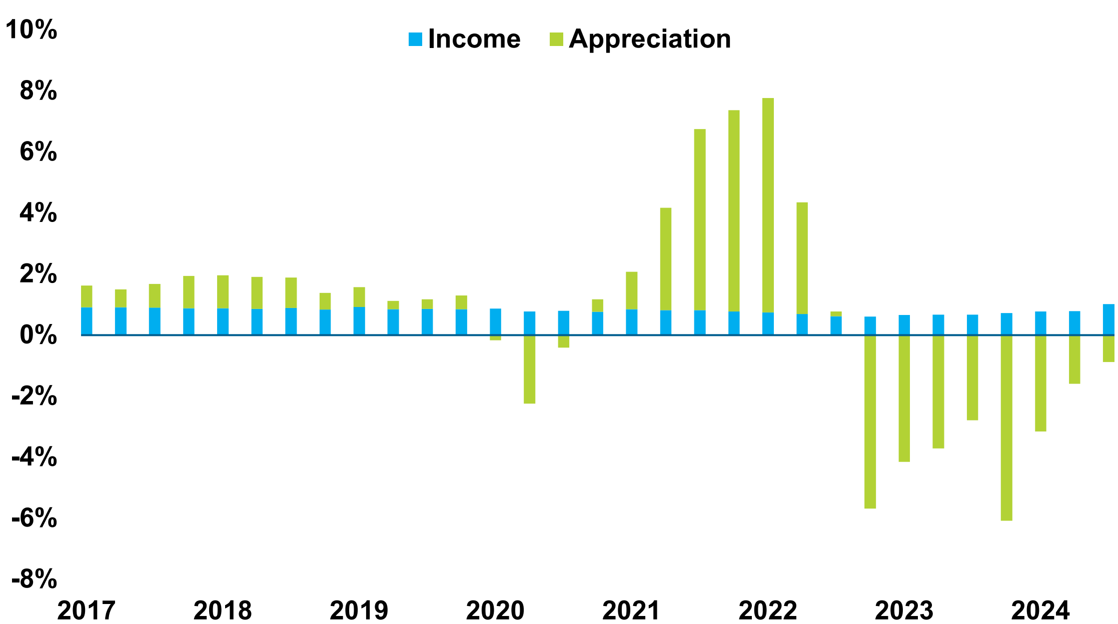


FIGURE 17

Core Real Estate's Return Components

Source: NCREIF ODCE Equal Weighted Net Index, Quarterly Return Components, as of September 2024.

What impact would this have had on a diversified portfolio?

While the analysis thus far shows how the returns of individual asset classes differed from expectations, it does not provide sufficient context for the impact on a multi-asset class portfolio. To examine this, we constructed a "diversified portfolio" that resembles what we see among some institutional investors, with the caveat that there is no standard portfolio for such investors given their varying objectives and risk tolerance. The table below shows the composition of this portfolio, as well as a comparison of the expected return with the realized return of this portfolio (see Figure 18).

FIGURE 18
Diversified Portfolio Expected and Realized Annualized 5-Year Returns

Expected returns sourced from Meketa's 2020 Capital Markets Expectations, and actual returns are from the benchmarks listed in the table. Note that Cambridge Associates data is 1-quarter lagged.

	Diversified Portfolio Allocation	Benchmark Used
US Equity	27.5%	Russell 3000 Index
Investment Grade Bonds	25.0%	Bloomberg US Aggregate Index
Private Equity	10.0%	Cambridge Associates' US Private Equity Composite
Non-US Equity	7.5%	MSCI EAFE Index
EM Equity	5.0%	MSCI EM Index
Private Debt	5.0%	Cambridge Associates' Private Debt Composite
TIPS	5.0%	Bloomberg US TIPS Index
Value Added Real Estate	2.5%	Cambridge Associates' Real Estate: Value Add Composite
Private Infrastructure	2.5%	Cambridge Associates' Private Infrastructure Composite
Core Real Estate	2.5%	NCREIF ODCE Equal Weighted Index
Bank Loans	2.5%	S&P UBS Leveraged Loan Index
High Yield	2.5%	Bloomberg US Corporate High Yield Bond Index
EM Debt	2.5%	Bloomberg EM Local Currency Gov't Diversified Index
Expected Portfolio Annualized Return	**6.2%**	
Realized Portfolio Annualized Return	**7.1%**	

These differences between the actual and expected returns had varying impacts on a diversified portfolio. For example, fixed income assets such as investment grade bonds, high yield bonds, and TIPS underperformed while US equities and private markets assets such infrastructure and debt outperformed. In total, only five of the 13 asset classes shown in Figure 19 performed better than expected. However, the total portfolio managed to realize a higher return than originally expected.

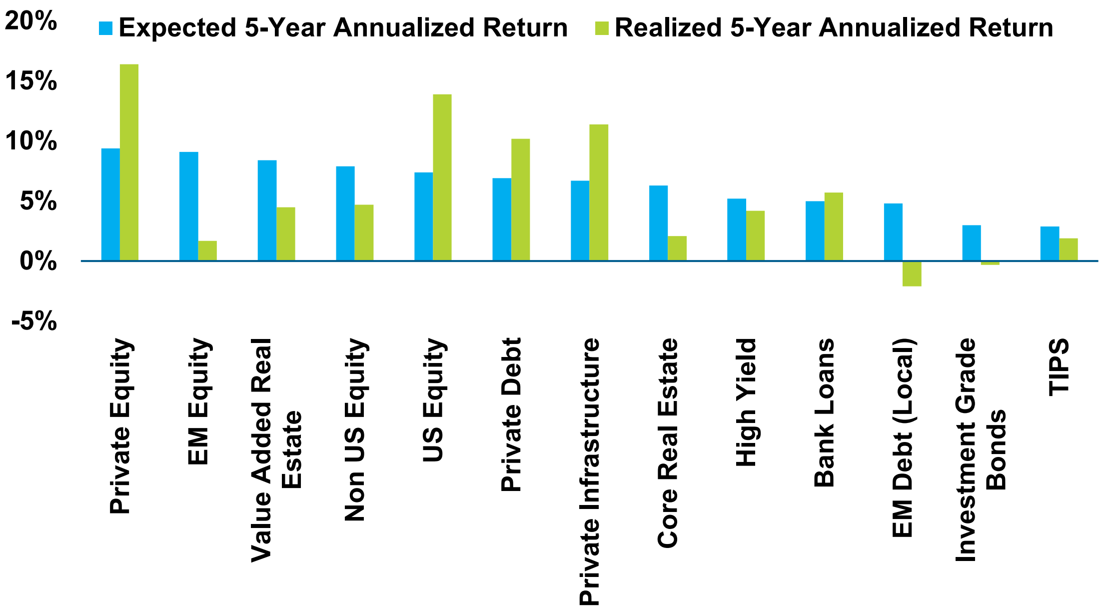


FIGURE 19

Expected versus Realized Annualized 5-Year Returns

Expected returns sourced from Meketa's 2020 Capital Markets Expectations, actual returns from Bloomberg US Aggregate Index, Bloomberg US TIPS Index, S&P UBS Leveraged Loan Index (formerly Credit Suisse Leveraged Loans), Bloomberg EM Local Currency Government Diversified Index, Bloomberg US Corporate High Yield Bond Index, Russell 3000, MSCI EAFE, MSCI EM, Cambridge Associates' US Private Equity Composite, Cambridge Associates' Private Debt Composite, Cambridge Associates' Private Infrastructure Composite, Cambridge Associates' Real Estate: Value Add Composite, NCREIF ODCE Equal Weighted Index. Note that Cambridge Associates data is 1-quarter lagged.

Ultimately, it was the magnitude of outperformance that occurred in the assets with larger allocations that resulted in the realized portfolio's success. Namely, the largest contributors to the realized portfolio's returns (US equity and private equity) are two of the three largest portfolio allocations and were able to generate the two highest returns over the past five years.

Summary

The last five years have been an unusual period, marked by unprecedented events and significant deviations from expected outcomes. The data presented in this document highlights the variability and unpredictability of asset class returns during this time. As we reflect on these years, we must have humility in acknowledging the wide range of possible outcomes when forecasting future returns as it is unlikely anyone could have foreseen the events that occurred or the market's reaction.

Forecasts are intended to help investors think through the best course of action to help them achieve their goals. Diversification remains a crucial strategy to mitigate risks and enhance resilience in the face of uncertainty. Maintaining a diversified portfolio can help portfolios navigate the complexities of the financial landscape and adapt to unforeseen challenges.

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