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Drivers of Total Return for US large Cap Equities (Next 5 years)

According to Capital Group's 2025 CMA White Paper, total equity returns can be broken down into four main components: earnings growth (EPS growth), shareholder yield (dividends), valuation changes (e.g., P/E expansion or contraction), and net share buybacks. This provides a useful lense for thinking about what will drive the total returns of US large cap equities over the next 5years, as we can examine the impact of each driving force on each of the above levers of returns.

A complex interplay between demand and supply drivers, structural “mega forces” (BlackRock, 2025), and macro conditions shapes these mechanics of total return. Below, I explore why technological transformation, geopolitical movement, and the rise of passive investment will be the main drivers of total returns for US large cap equities over the next five years.

AI and Technology

AI and technology will be the key drivers of U.S. large cap equity performance over the next five years. Though valuation multiples are above historical norms, BlackRock believes this is justified by shifts toward high-growth, high-margin tech sectors and durable AI-driven earnings (BlackRock, 2025). AI is strengthening total return through greater productivity, infrastructure investment, and global innovation leadership. I explore this below:

AI is a Productivity Engine

Generative AI enhances efficiency and reduces costs across all industries (not just tech), accelerating innovation and allowing companies to sustain high margins. McKinsey estimates AI adoption could add “[up to] 3.4 percentage points annually to productivity growth” (McKinsey, 2023), directly supporting robust EPS growth - the primary driver of total return.

Infrastructure Investment

BlackRock highlights U.S. leadership in AI data centres, semiconductors, and power systems, which are reinforced by the 2022 CHIPS and Science Act (CHIPS and Science Act, 2022) and the July 2025 Presidential Executive Order, aimed at fast-tracking AI data centre and associated infrastructure permitting and construction (Morganlewis, 2025), support durable revenue streams and justify higher valuation multiples for those



companies with the capacity and capability to take advantage (US large caps), contributing to their total returns.

Innovation and Regulatory Leadership

BlackRock and Capital Group both highlight that the U.S. is structurally advantaged in attracting and scaling AI talent, intellectual property, and investment (pp 10-11 BlackRock, 2025; pp 5-6 Capital Group, 2025). This ecosystem accelerates the pace at which AI breakthroughs are translated into profitable business models, supporting higher earnings quality and justifying premium valuation multiples.

Strategic Geopolitical Action

Strategic geopolitical action is now a key structural force for US large-cap equities. As SSGA explore in their Geopolitical Outlook 2025, trade realignment, rising defence spending, and assertive fiscal policy place the US central to it all. These trends are increasing geopolitical risk and changing the competitive landscape for large-cap companies (pp 5-6 PineBridge, 2024).

Trade wars and supply chain reshoring / “friend-shoring”

Trade fragmentation and tariff escalation (e.g., baseline 10% tariff) are accelerating the realignment of global supply chains toward regionalisation and friend-shoring (BlackRock, 2025). Policies, like the CHIPS Act incentives, are driving the reshoring of critical industries like semiconductors and advanced manufacturing. U.S. large caps have invested more heavily in domestic or nearshore supply chains than their foreign or smaller US peers (56% of US large caps have already invested in reshoring or nearshoring, with 73% increasing their “friend-shoring” (Capgemini, 2025)), and are positioned to benefit from elevated pricing power, improved utilisation, and greater margin stability as global trade barriers persist – leading to stronger earnings growth relative to their peers.

Fiscal wars and Interest Rates

Governments are deploying fiscal policy as a geopolitical tool (pp 3-7 PIMCO, 2025), with the U.S. maintaining expansive spending on defence, infrastructure, and technology. This supports demand and earnings visibility for key sectors but also creates persistent fiscal deficits and contributes to persistent inflation – both of which lead to higher interest rates. While the higher interest rates are generally negative for equities overall, U.S. large caps are likely to maintain high earnings growth due to their strong balance sheets, pricing power and lower leverage are better equipped to navigate this environment than other markets / market cap sizes (Wellington Management, 2025)



and will be better able to capture the upside of policy-driven demand while managing higher funding costs.

Defence Spending

Heightened geopolitical tensions and increased defence spending globally reinforce the earnings base for U.S. firms leading in defence platforms, cybersecurity, and advanced manufacturing (SSGA, 2025). 16 of the top 25 global defence firms (accounting for \$743B in Market Cap alone) (Lu, 2025) and the US Defence Market is projected to grow at CAGR 4.01% from 2025 to 2033 (Yahoo!Finance, 2025). The FY26 defence budget of nearly \$961.6 billion (US Congress, 2025) which is almost a 10% increase from FY25 anchors multi-year procurement pipelines for defence contractors and technology suppliers, which in turn will drive total returns for U.S. large-cap equities through sustained revenue growth, expanding margins, rising earnings per share, stronger free cash flow, enhanced dividend yields, and justifiably high valuation multiples for companies whose operations relate to national security or critical infrastructure.

Index architecture and passive allocation

Index architecture and passive allocation have become the third structural force shaping US large-cap equity returns over the next five years. The rise of passive investing as investors chase low-fee beta, the concentration of benchmark-driven flows (BlackRock, 2025), and the inelastic nature of equity markets (explored below) together create a persistent demand anchor for US large caps, which primarily supports valuation multiples through price appreciation.

Passive investing creates a structural demand for US large cap equities

ETFs took in a record \$1.1T in 2024, pushing U.S. ETF assets past \$10T (Morningstar, 2024). This represents a structural funnel that disproportionately channels investment to US large caps - as of June 2025, 61.8% of all U.S. domestic passive vehicles are allocated to US equities, which are overwhelmingly large-cap dominated since most passive strategies track benchmarks like the S&P 500 or total market indexes (Investment Company Institute, 2025). This persistent net demand provides ongoing support at the benchmark level for US large cap equities total returns.

Inelastic Markets create a proportionate demand for US large caps based on their benchmark weight

The Inelastic Markets Hypothesis (IMH) finds that each \$1 of net equity buying can increase the market's aggregate value by roughly \$5 (NBER, 2021). In an inelastic market where many allocators maintain target weights, sustained inflows from index



funds and ETFs translate into price appreciation and valuation resilience, particularly for US large cap equities since these are a huge chunk of passive investments (as above (Investment Company Institute, 2025). Additional evidence from the Bank for International Settlements in their 2021 Working Paper No. 952 shows that inflows to ETFs can exert non-fundamental price pressure in underlying markets, highlighting the mechanical channel between ETF activity and total returns.

US Benchmark dominance

As of 1 July 2025, the total market cap of the US large cap equities (Top 500) stood at \$52.5 trillion USD (SIBLIS Research, 2025), representing 41% of the total global \$128.07 trillion USD (Statista, 2025). This means that every dollar allocated to “global equities” or “developed markets” through passive vehicles sends a disproportionate share into U.S. large caps (Capital Group, 2025). As sovereign wealth funds, pensions, and model portfolios continue to adopt low-cost beta (Margaria, 2024; OECD, 2024), this benchmark centrality ensures structural demand for U.S. large caps.

Drivers of Total Return for US Bonds: Barclays US Aggregate Government Index (Next 5 Years)

Total return for US government bonds (across maturities from 3 months to 30 years) is determined by two primary components: yield (income) and price change (capital appreciation or depreciation).

Below, I explore why portfolio diversification during volatility, the geopolitical risk premium and “safe haven” demand, and structural changes in the buyer base, term premium, and persistent deficits will be the main drivers of total returns for US government bonds over the next five years.

Portfolio diversification during market volatility

BlackRock, PIMCO, PineBridge and Morningstar all highlight their view that we are in a multi-year period of heightened volatility. In the past, periods of heightened market volatility and structural uncertainty have reinforced the critical role of US bonds as a stabilising force in diversified portfolios. Below, I explain how these mechanisms



contribute to US Bond Market total returns in the near term by increasing price appreciation through demand and improving income by ‘locking-in’ higher yields.

Investors looking to diversify their portfolios during period of heightened equity volatility

Structural uncertainty which is being driven by AI disruption, the energy transition, and geopolitical fragmentation, has increased dispersion and downside risk in equity markets (BlackRock, 2025; PineBridge, 2024; Morningstar, 2025). With equity valuations stretched and the equity risk premium near historic lows, investors are reallocating to high-quality US bonds for stability (PIMCO, 2025). This persistent demand supports bond prices and compresses yields, directly contributing to both the income and capital gains components of total return.

Negative or low correlation with equities reduces portfolio volatility

US bonds have historically exhibited negative or low correlation with equities, especially during equity market decline. This diversification benefit means that when stocks fall, bonds often rise or hold steady, cushioning overall portfolio losses. For multi-asset investors, this stabilising effect translates into higher risk-adjusted returns and more predictable income streams.

Attractive starting yields create ‘lock-in’ income advantage

Current yields on US bonds (e.g., Bloomberg US Aggregate ~4.65% as of March 2025) are historically correlated with strong five-year forward returns (PIMCO, 2025). As investors rebalance into bonds for diversification, they lock in these attractive income streams, which form the foundation of total return – especially if inflation expectations remain anchored, since current nominal yields will translate into attractive real yields. If yields reduce due to increased demand for these heightened yields, the income component remains robust for those who enter early as they are poised to take advantage of the price appreciation caused by the capital appreciation due to inflows.

Geopolitical risk premium and “safe haven” demand

PineBridge, in their AUD Capital Market Line report, highlight both the elevated volatility and dispersion, as well as elevated opportunities for US Treasuries provided by Geopolitical events and risks. Below, I explore three mechanisms of Geopolitics as a key driver of total returns for the U.S. bond market over the next five years by driving price appreciation.

Persistent geopolitical fragmentation elevates risk premiums

The global landscape is increasingly defined by “slow-moving fragmentation,” with



military conflicts, trade wars, and fiscal “wars” between blocs (notably the US, China, and their allies) raising uncertainty and risk premiums across markets. SSGA’s and BlackRock’s 2025 Global/Geopolitical Outlooks both highlight that these persistent tensions are not cyclical, but structural, and are likely to remain a defining feature of the next five years. This environment drives both episodic and ongoing demand for US Treasuries, which are considered the most liquid “safe haven” asset and are valued for stability and liquidity during market stress.

Crisis episodes trigger episodic demand for high quality instruments

Periods of acute geopolitical stress such as the Ukraine war, Middle East conflicts, or major trade disruptions have historically triggered sharp, episodic inflows into US Treasuries and the US dollar. SSGA notes that while gold has been a primary beneficiary, crisis periods also encourage appreciation of classic safe haven currencies, implicitly including US dollar-denominated bonds. PIMCO’s Cyclical Outlook April 2025 and PineBridge’s Capital Market Line both observe that this increased demand compress yields and drive price gains, especially at the long end, directly boosting total returns during volatility spikes.

US’s relative global advantage

In a world of heightened geopolitical risk and fragmented trade, US Treasuries retain a unique advantage: unrivalled liquidity, depth, and reserve currency status. This ensures that, during global stress, US bonds outperform other sovereign debt, attracting institutional rebalancing flows and reinforcing their role as the global anchor asset (pp 3, 8-9 PIMCO, 2025).

Structural Shifts in the US Bond Market (Buyer Base, Term Premium, and Persistent Budget Deficits)

As previously mentioned, BlackRock and PIMCO share a strong conviction that we are not in a typical business cycle – below, I explore 5 facets that demonstrate US Bond market structural change as a key driver of total returns over the next 5 years.

Buyer Base Rotation: From Central Banks to Price-Sensitive Investors

The U.S. Treasury market is undergoing a fundamental shift as the Federal Reserve and foreign official holders reduce their share, while private investors (banks, money market funds, hedge funds) absorb a growing proportion of new issuance (pp 1, 9, Capital Group, 2025). This transition increases the term premium, as private buyers demand more compensation for duration risk, and leads to greater yield volatility, directly



impacting both the income (yield) and capital appreciation (price) components of total return.

Persistent deficits and elevated long term supply

Large and persistent U.S. fiscal deficits keep Treasury issuance at record highs (SSGA, 2025; Capital Group, 2025). With the Fed in quantitative tightening mode and foreign Government demand waning due to geopolitical tensions, private balance sheets must absorb more duration and therefore greater interest rate risk. This classic supply/demand imbalance is a structural driver of higher term premium's and places upward pressure on long-term yields as the private market demands greater yields, increasing the income component of US Bonds (PineBridge, 2024).

Term premium reset

Since late 2024, the 10-year term premium has surged to its highest level since 2011, exceeding 0.8% in January 2025 and accounting for more than half of the post-September rise in 10-year yields (Federal Reserve Bank of St. Louis, 2025). This reflects a structural repricing of long-end risk as markets adjust to persistent fiscal deficits, quantitative tightening, and heightened uncertainty (especially around inflation and monetary policy) (Federal Reserve, 2024). BIS analysis notes that expectations of increased long-term debt supply (see: persistent fiscal deficits, above) can place upward pressure on term premia (Bank for International Settlements, 2023).

Evaluation of SSGA's CMAs

SSGA's general method, inflation assumption and intermediate risks:

Since the document doesn't specify, I assume SSGA's 3–5 year forecasts adapt its 10-year CMAs by incorporating current market conditions—such as bond yields and equity valuations—while applying gradual mean reversion toward long-term fundamentals. This aligns with industry best practice, as seen in Capital Group and BlackRock, who also emphasize the predictive value of current valuations and financing conditions. However, SSGA's framework lacks explicit scenario ranges, sensitivity analyses, and stated assumptions on the pace of mean reversion, which reduces confidence in its intermediate forecasts. Interpretability could be improved through fan charts, scenario-based trajectories, and elasticity analyses—recommendations also made by Morningstar and PIMCO.

SSGA anchors inflation forecasts using long-term expectations and TIPS breakevens, a method also used by Capital Group and PIMCO, who stress blending market-implied and structural signals. SSGA acknowledges that intermediate-term forecasts are more



exposed to political and monetary policy risks than 10-year projections. This is echoed by BlackRock and PineBridge, who highlight geopolitical fragmentation and policy volatility as key drivers of uncertainty. Notably, SSGA's forecast was published in October 2024, before Trump's January 2025 inauguration, which has since triggered significant market volatility—further amplifying the uncertainty around these projections.

SSGA's Method for forecasting US large Cap Equities:

SSGA employs a building-block approach, combining dividend yield, GDP-linked real earnings growth, net buybacks, and valuation multiple adjustments. This aligns with the Gordon Growth Model and is consistent with methodologies used by Capital Group and Morningstar. Another strength is SSGA's use of "R-Factor" as a risk modifier is in line with PineBridge's "ESG 2.0" approach, which emphasizes engagement and risk adjustment over exclusion

SSGA could enhance transparency by disclosing margin and payout assumptions, mean reversion mechanisms, and sensitivities to changes in the equity risk premium and P/E ratios. This is a common industry gap, as noted by Morningstar, who advocate for more explicit scenario and sensitivity analysis to support robust portfolio construction.

Bonds

SSGA's bond forecasts are anchored on prevailing yields and model the evolution of real and nominal yield curves, consistent with industry standards. The predictive strength of starting yields is recognised by both PIMCO and PineBridge.

SSGA could improve by disclosing assumptions about the neutral real rate, term premium decomposition, and the effects of Treasury supply and Fed balance sheet policy. This is supported by PIMCO and Capital Group, who both highlight the importance of scenario analysis and explicit modelling of policy and supply dynamics.

SSGA's incorporation of uncertainty

SSGA's dual-risk framework includes both short-horizon volatility and long-horizon dispersion aligning themselves with both Capital Group and BlackRock. However, SSGA does not currently publish uncertainty bands or scenario probabilities for 3–5 year forecasts.

Overall assessment:

SSGA's CMA framework follows a robust methodology broadly aligned with industry practice, mirroring peers like Capital Group and BlackRock. Anchoring inflation



assumptions on long-term expectations and TIPS breakevens is also a strength, ensuring forecasts reflect both structural and market-implied signals.

However, transparency gaps increase uncertainty for intermediate-term (3–5 year) projections. SSGA does not disclose the pace of mean reversion, scenario ranges, or sensitivity analyses, limiting interpretability. This is significant because intermediate horizons are more exposed to policy shocks, inflation volatility, and geopolitical fragmentation - risks amplified by the post-2024 (Trump) policy environment.

Bond forecasts rely appropriately on starting yields, but lack clarity on neutral rate assumptions, term premium decomposition, and Treasury supply dynamics. Similarly, equity forecasts would benefit from explicit assumptions on payout ratios, margins, and equity risk premium elasticity.

Additionally, when considering reliance on these CMAs as of mid-2025, it is important to recognise that they were published prior to several significant developments. Notably, the Trump administration imposed a 145% tariff on Chinese imports, reigniting the US-China trade dispute. The United States also enacted reciprocal tariffs on multiple countries, with rates between 10% and 41%, contributing to heightened economic uncertainty. The SSGA October 2024 CMAs were likely published under the assumption of a more stable policy environment.

I therefore conclude that there should be a moderate-to-high amount of uncertainty for SSGA's 3–5-year forecasts. While the methodology is sound, the absence of scenario-based outputs and sensitivity disclosures, combined with heightened macro volatility, and out of date policy assumptions widens the range of plausible outcomes.

References and Use of AI

AI used: Microsoft's in-built Co-Pilot tool

Purpose: To reduce words and improve the tone of the writing for the Audience (Board)

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