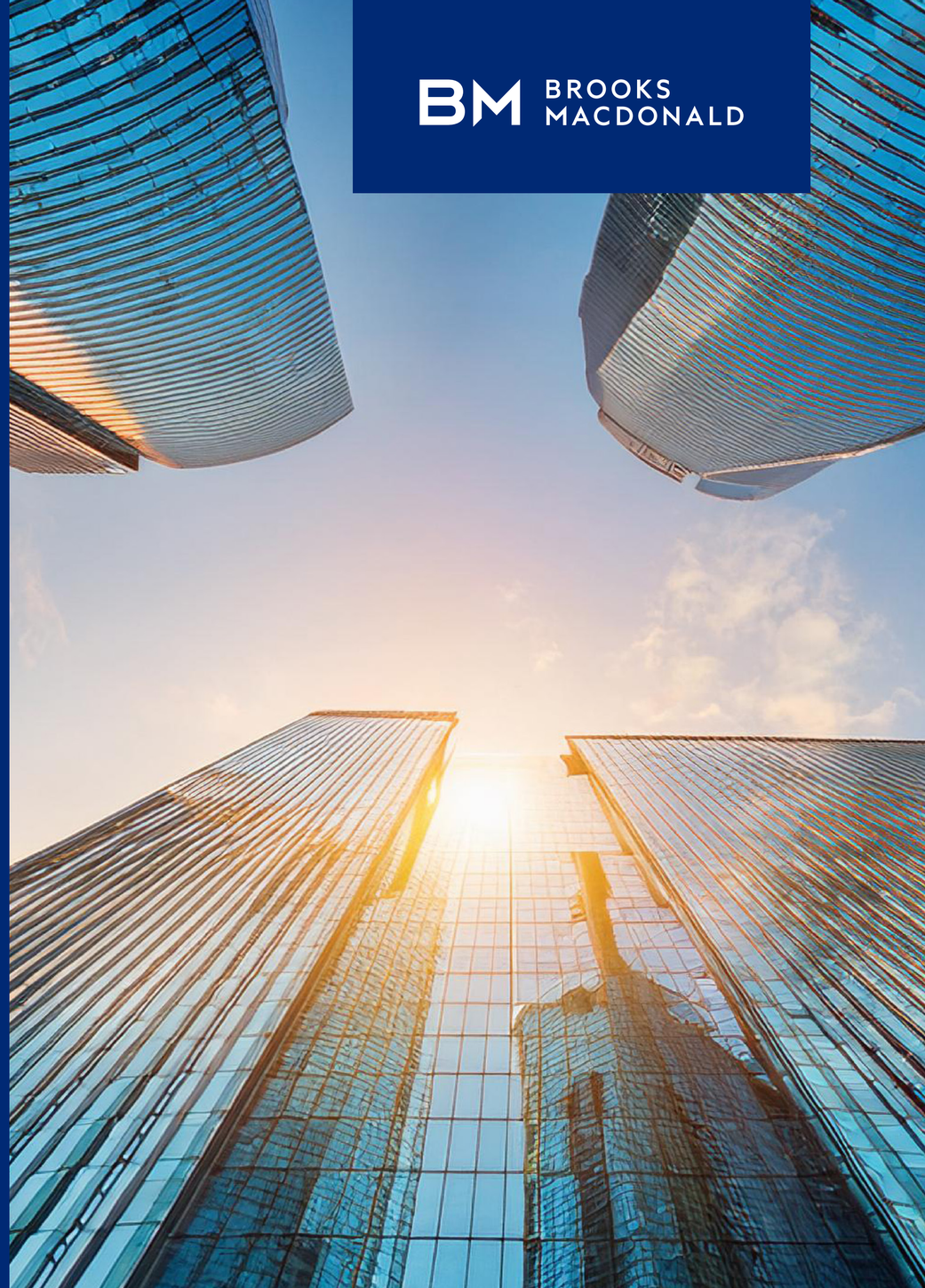
FOR PROFESSIONAL ADVISERS ONLY

Capital Market *Assumptions* 2026

A guide on how long-term return assumptions support portfolio construction.

BROOKS MACDONALD



Introduction

Capital Market Assumptions (CMAs), are long-term estimates of the returns that different asset classes may reasonably be expected to deliver over time.

They are not short-term market forecasts, nor are they predictions of what will happen in any one year. Instead, they provide a disciplined framework for thinking about the long-term prospects for major asset classes.

At Brooks Macdonald, CMAs are part of how we build strategic asset allocations. Strategic asset allocation is the long-term mix of assets designed to align a portfolio with a risk level. In practice, CMAs help answer a simple but important question: given today's market conditions, what level of return might investors reasonably expect to receive for taking different types of investment risk over the long term?

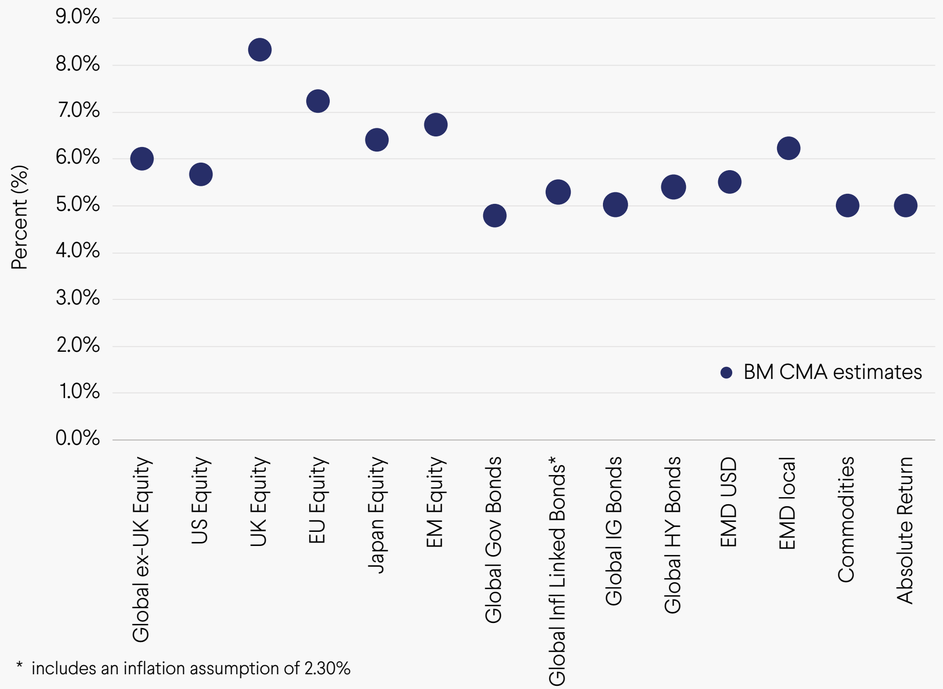
We typically think about CMAs over a long horizon, such as five to ten years. This is long enough to look beyond short-term market noise, but not too long that today's starting conditions become irrelevant.

Over such a horizon, the income available from bonds, the valuation of markets, the growth of company earnings, inflation, interest rates and currency effects can all play an important role in shaping investment outcomes.

CMAs therefore support portfolio construction in three ways:

- They provide a consistent starting point for comparing asset classes.
- They help us assess the balance between expected return and risk.
- They encourage discipline by grounding decisions in a structured process rather than short-term sentiment.

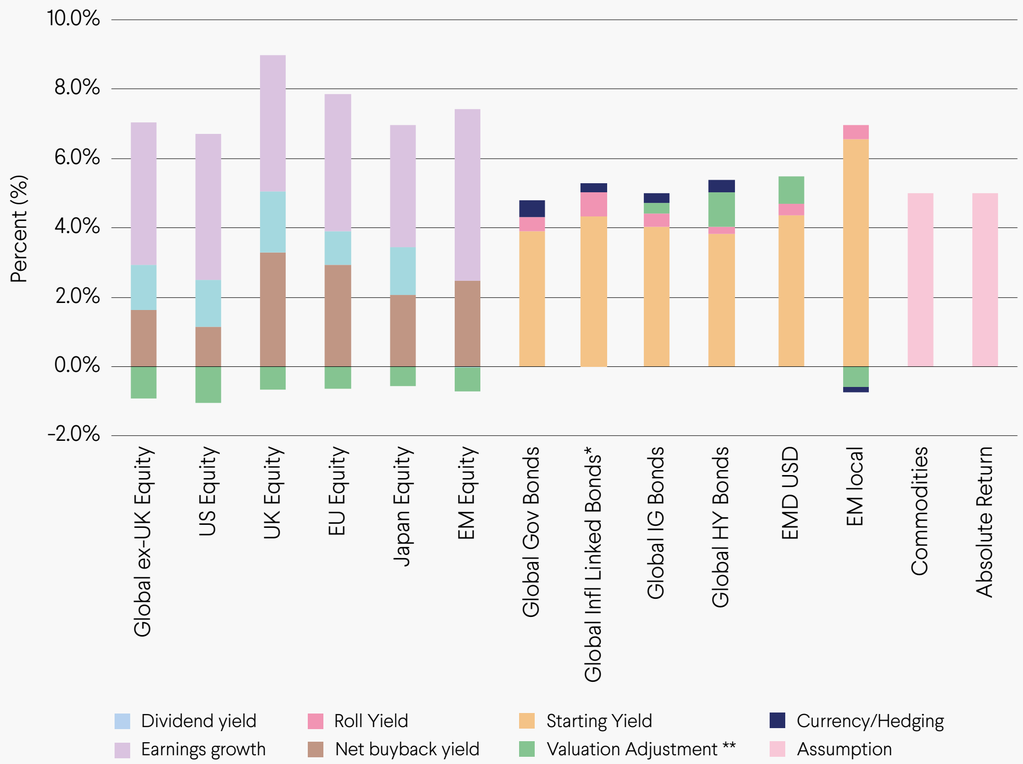
Capital Market Assumptions



* includes an inflation assumption of 2.30%

Source: Brooks Macdonald calculations

Capital Market Assumptions components



* includes an inflation assumption of 2.30%
** for IG / HY / EMD this is reflected as a haircut on credit spread income

Source: Brooks Macdonald calculations

A compass, not a precise estimate

Our CMA framework is built around a few core principles. The first is that long-term investing should be forward-looking. Historical returns provide useful context, but they should not be treated as a reliable guide to the future. Starting valuations, current yields, inflation, economic growth and market structure all matter. A bond purchased at a higher yield today has a different long-term return profile from one purchased when yields are very low. Similarly, an equity market that begins from an elevated valuation may face a different outlook from one priced more conservatively.

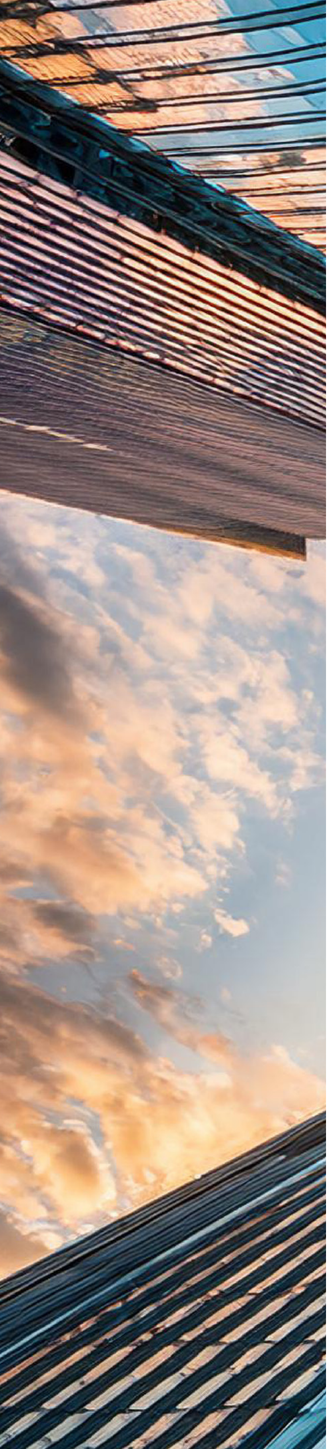
The second principle is economic realism. Our assumptions should be grounded in observable investment drivers: income, growth, inflation, interest rates, credit spreads and currency effects. Where judgement is required, we aim to be transparent and proportionate rather than overly precise.

Finally, our approach reflects humility about forecasting. We do not believe portfolios should depend on a single economic view or a highly precise estimate of the future. Diversification across asset classes, regions, sectors and investment styles remains central to how we manage uncertainty. This mirrors Brooks Macdonald's broader investment philosophy.

Building Capital Market Assumptions

Our approach uses a common framework across asset classes, while recognising that different assets are driven by different factors. We begin with the information available in markets today and the economic forces that are most relevant to each asset class. For bonds, this includes yields, the shape of the yield curve and credit spreads. For equities, it includes the income companies return to shareholders and the growth of revenues and profits.

We then apply a valuation adjustment where necessary. This asks whether today's starting point looks unusually expensive, unusually cheap or broadly fair relative to a reasonable long-term anchor. Where markets appear far from those anchors, expected returns may be adjusted to reflect the possibility that valuations move gradually back towards more typical long-term levels. This is where disciplined investment judgement is important. The aim is not to predict short-term market moves, but to make sure our long-term assumptions are grounded in today's market conditions while remaining realistic about what may change over time.



Fixed Income

For fixed income, the starting point is yield. The yield available on a bond is one of the clearest indicators of its prospective long-term return. This provides a simple and observable anchor. We then consider the shape of the yield curve. As bonds move closer to maturity over time, the slope of the yield curve can add to or subtract from returns. This is often described as “roll-down”, it reflects the fact that a bond’s return is influenced not only by its starting yield, but also by how yields differ across maturities.

For assets with credit risks, such as investment grade corporate bonds and high yield bonds, investors receive an additional yield over government bonds. This additional yield, or credit spread, compensates investors for taking credit risk. However, not all of that spread should be treated as expected return. Defaults, downgrades and other credit events can reduce the return ultimately received by investors. We therefore make prudent adjustments for expected credit losses where relevant.

We also apply a valuation layer. This means considering whether today’s yield curve or credit spreads appear high, low or broadly fair compared with reasonable long-term anchors. For government bonds, those anchors may include inflation expectations and term premia. For credit markets, they may include more normal levels of compensation for taking credit risk.

Where overseas fixed income is held in sterling-based portfolios, we consider market-implied hedging costs, such as the difference between short-term interest rates in sterling and the relevant foreign currency. This helps ensure the assumptions are consistent with how fixed income is implemented in client portfolios.

Equities

For equities, we start with the cash that companies return to shareholders. This includes dividends and share buybacks, together often described as shareholder yield. Dividends are familiar to most investors, while buybacks are another way companies can return capital by reducing the number of shares in issue.

The second building block is fundamental growth. Over time, equity returns are supported by the growth of company revenues and profits. A useful starting point for revenue growth is nominal economic growth, i.e., real economic growth plus inflation. However, stock markets do not always mirror their domestic economies. Many companies earn revenues globally, so we take account of the geographic exposure of revenues within each equity market.

The final building block is valuation. If an equity market begins at a high valuation, future returns may face a headwind if valuations gradually move back towards more normal levels. Conversely, a cheaper market may have more scope for valuation support. We therefore consider long-term valuations, while recognising that valuation adjustment is uncertain and should be applied carefully rather than mechanically.

Alternatives

Alternative assets are diverse, so no single framework applies to all of them. Our approach is to identify the most relevant return drivers for each type of alternative exposure and keep the explanation straightforward.

For commodities, return expectations can be linked to inflation, a real commodity risk premium and the return available on collateral. In other words, commodities may be expected to deliver a return over cash over the long term, while also offering diversification benefits in certain environments, particularly when inflation risks are elevated.

For absolute return strategies, the framework is simpler: expected returns are typically anchored to cash, plus an assumed excess return from the strategy. We do not assume that such strategies benefit automatically from economic growth or valuation re-rating. Outcomes can vary significantly by manager, strategy and market environment, so assumptions should remain measured and realistic. Internal analysis similarly notes that hedge fund and absolute return approaches often converge around a cash-plus framework, with wide dispersion and implementation dependence.

Important information

The information in this document does not constitute advice or a recommendation and you should not make any investment decisions on the basis of it. Past performance is not a reliable indicator of future results.

This document is intended for professional advisers only and should not be relied upon by any persons who do not have professional experience in matters relating to investments. The value of your investments and the income from them may go down as well as up and neither is guaranteed.

Brooks Macdonald is a trading name of Brooks Macdonald Group plc used by various companies in the Brooks Macdonald group of companies. Brooks Macdonald Asset Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England No: 03417519. Registered office: 40 Leadenhall Street, London, EC3A 2BJ.

More information about the Brooks Macdonald Group can be found at **brooksmacdonald.com**

BM-2026-0926-001