Why the high market returns of the last decade are unlikely to continue

Extending a decade of returns of around 13% on the stock market requires two conditions that have almost never coincided.

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Between 2015 and 2024, the mean annual return on the U.S. stock market was 13.3%, well above the historical mean return of 8.9% until the end of 2014. During those years, optimism surrounding the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) and the technology sector in general dominated financial headlines.

When a decade offers such figures and strings together years of gains, investors tend to extrapolate the good times and continue to expect high returns. However, sustaining high returns requires exceptional earnings growth or even higher valuations. Historically, these rarely happen simultaneously.

In "Expected Stock Returns in Bullish Times," IESE Prof. Javier Estrada analyzes what would have to occur for investors' expectations to become reality.

The risk of extrapolation

Investors tend to extrapolate both good and bad periods when they are prolonged, assuming that returns will continue at the same level.

But the longer a trend lasts, the more demanding the conditions necessary for it to continue become. Therefore, instead of speculating about whether such a return will continue, it's better to consider which conditions make it possible and how plausible they are.

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The consistency test

Estrada uses a simple breakdown of expected returns. In the long term, stock market returns come from three sources:

1. How much is being paid today — the observed dividend yield.
2. How much corporate profits grow — the expected growth of earnings.
3. How much investors are willing to pay — the expected change in the P/E or price-to-earnings ratio.

The model attempts not to predict the future but to subject any forecast to a consistency test. If an expectation of 12% per annum implies doubling historical earnings growth and maintaining a P/E ratio well above its average, the hypothesis is not impossible but it is demanding. And the more demanding the assumptions, the lower their likelihood.

Earnings and P/E ratios do not move in tandem

Estrada warns that, over 10-year horizons, earnings growth and P/E ratio movements do not tend to move in the same direction. In fact, they are negatively correlated. In practical terms, when earnings rise rapidly, the P/E ratio tends to fall, and vice versa. Historical evidence suggests that it is rare for both factors to drive returns at the same time over an entire decade.

For example, at the end of 1999, after a decade of annual returns of 17.9%, the S&P 500 was trading at a P/E ratio of 29.7 and a dividend yield of 1.2%. Maintaining similar returns over the following decade required conditions that Estrada describes as “rather spectacular,” making that forecast “extremely unlikely.” The result is well known: Between 2000 and 2009, the annual return was -0.7%.

What returns can we expect over the next decade?

In June 2025, after another solid decade (13.3% annually between 2015 and 2024), the U.S. market was trading at a P/E ratio of 27.0, compared with a historical average of 16.0.

According to the study’s scenarios, repeating returns of around 13% over the next decade would require earnings growth of 9%-10% per annum and a P/E ratio of around 35, well

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above its historical averages.

If, on the other hand, earnings growth and the P/E ratio converged toward their historical averages, the implied return between 2025 and 2035 would be close to 0.4% per year.

Estrada does not predict that this scenario will materialize, but he does point out that "reversion to the mean is one of the most reliable forces in the stock market." We should all calibrate expectations.

About the research

The study analyzes the U.S. market (S&P 500) using annual data from 1872 to 2024. After breaking down returns into three components — dividend yield, earnings growth and change in P/E ratio — the author examines the historical relationship between growth and valuation over horizons of up to 20 years, with a particular focus on 10-year periods.

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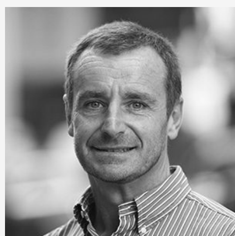

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