BOOK REVIEW

Investing Amid Low Expected Returns: Making the Most When Markets Offer the Least

BY ANTTI ILMANEN
Reviewed by Margaret M. Towle, PhD, CAP®, CIMA®, CPWA®, FSA®, RICP®

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Regardless of your investment philosophy, Antti Ilmanen’s 2022 book *Investing Amid Low Expected Returns* provides investors with a detailed road map for navigating what appears to be a challenging capital markets environment. In it, Ilmanen succinctly and thoroughly outlines a comprehensive toolkit of strategies and guidelines for mitigating risks and drawdowns in the coming years. Throughout the book, Ilmanen provides an abundance of historical data—far too much to discuss in this review.

Ilmanen built his investment acumen fusing academic accomplishments (his thesis advisors at the University of Chicago were Nobel laureate Eugene Fama and Professor Kenneth French) with a successful career on Wall Street at credit shop Salomon Brothers and global macro hedge fund Brevan Howard. Ilmanen now hangs his hat at AQR, a systematic global investment firm. Thus, it is no coincidence that his latest book provides readers with a well-built bridge between the practitioner and academic worlds.

Ilmanen dedicated the book “to the young retirement savers across the world—who have been handed a bad draw—and to everyone working for their benefit.” He references the Serenity Prayer¹ when he lets investors know they can choose from three options for dealing with lower expected returns: save more, assume greater investment risk, or just accept the situation.

To Ilmanen, investors appear complacent about the challenges of investing in an environment of low returns. Rather than accepting a need to moderate future spending plans, i.e., save more, many are moving into riskier investments. In Ilmanen’s view, investors have “borrowed returns” from the future through regardless of your investment philosophy, Antti Ilmanen’s 2022 book *Investing Amid Low Expected Returns* provides investors with a detailed road map for navigating what appears to be a challenging capital markets environment. In it, Ilmanen succinctly and thoroughly outlines a comprehensive toolkit of strategies and guidelines for mitigating risks and drawdowns in the coming years. Throughout the book, Ilmanen provides an abundance of historical data—far too much to discuss in this review.

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¹ Serenity Prayer: “God grant me the serenity to accept the things I cannot change, courage to change the things I can, and wisdom to know the difference.”

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Figure 1: **Annual Excess Returns and Sharpe Ratios of Main Asset Class Premia and Alternative Risk Premia, 1926–2020**

Source: Ilmanen (2022, from page 9)

Data from AQR. Notes: Geometric means and Sharpe ratios of nine return series, which exclude cash return but are before subtracting trading costs and fees. Equities and (government) bonds are GDP-weighted multi-country composites. Credit is a U.S. corporate portfolio over matching Treasury. Commodity is an equally weighted portfolio of available commodity futures. The five long/short style premia use simple specifications applied to many asset classes (cf. Chapter 6 and Ilmanen et al. [2021a]) and one-month implementation lag, and are scaled to 5 percent volatility.
the windfall gains of ever-lower yields and ever-richer asset valuations. However, a day of reckoning may soon be upon us. Like Hester in The Scarlet Letter, who “could no longer borrow from the future to help her through the present grief,” our time has run out.

Ilmanen divides the book into three parts. The first part sets the stage. It outlines the low expected return challenge and different investors’ responses within a broad historical context, then makes the case that most assets are expensive compared to their history—it is not just bonds.

The author then offers the unexpected advice that good investing practices such as discipline, humility, and patience are timeless but become even more important in tough times.

Part two outlines the building blocks of long-run returns, focusing on which factors have been well-rewarded historically. Included in this section is an overall discussion of liquid asset class premia, illiquidity premia, style premia, and alpha (and its cousins). Figure 1 displays those factors rewarded over the long run, as measured by annual excess returns and Sharpe ratios of main asset class premia and alternative risk premia.

Ilmanen believes that the equity premium and other asset class premia are the most important long-run return sources for the majority of investors. Throughout this section, he comments on current valuations, e.g., at the time of writing (2021) equities looked cheap versus cash but promised below-average total or real returns for the coming decade. He provides an illuminating discussion around investing in commodities, asserting that the long-run commodity premium is not predictable from spreads or valuations. Using historical data, he demonstrates that a diversified portfolio of commodity futures historically has earned 3-4 percent over cash, while single commodities averaged 0 percent over cash. In his estimation, direct real estate has earned any illiquidity premium over listed real estate investment trusts. Historical returns for the long-run private equity industry match fairly evenly with small-cap value stocks once you adjust for the smoothing effect. And, although many investors seek manager-specific alpha beyond systematic market and alternative risk premia, it is generally elusive and costly.

Part three pulls it all together through an insightful discussion of the perils of overlooking costs, risk management, and portfolio construction—regardless of the environment and expected return. In Ilmanen’s estimation, active investing is almost a zero-sum game. However, diversification remains the one almost-free lunch in investing. (Ilmanen calls it “turning water into wine.”)

The one criticism that I offer relates to Ilmanen’s treatment of environmental, social, and governance (ESG) investing. In this chapter he states: “ESG is almost interchangeably called responsible, sustainable or impact investing, or corporate social responsibility.” I respectfully disagree. To me ESG investing represents neither an ideology nor a set of principles. Instead, ESG investing represents a robust analytical tool with which to measure non-financial key performance indicators, using a nontraditional industry classification system.

Ilmanen’s book provides an overview of good investing practices backed by empirical research (a significant portion of which he sourced from his current firm). However, in Ilmanen’s estimation, the book does not offer investment advice. Instead, it suggests useful insights to enhance investment decision-making. How you use these insights will depend on your firm’s or individual investment philosophy. The book is perhaps most relevant to institutional investors—especially asset allocators. However, select sections may resonate with asset managers, wealth managers, and do-it-yourself investors.

Margaret M. Towle, PhD, CAP®, CIMA®, CPWA®, FSA®, RICP®, is the principal of Yakima River Partners, LLC. She provides holistic advice to family offices, foundations and endowments, and financial intermediaries on all things pertaining to ESG and impact investing. Contact her at margaret@yakimariverpartners.com.

ENDNOTES
1. German-American theologian and Christian ethicist Reinhold Niebuhr penned the words of what became this prayer in 1932. It states: “God, grant me the serenity to accept the things I cannot change, the courage to change the things I can, and the wisdom to know the difference.”

REFERENCES