

NO ORDINARY DISRUPTION

THE FOUR GLOBAL FORCES BREAKING ALL THE TRENDS

Four disruptive forces changing the picture



1

Industrialization
and urbanization
in emerging
economies

2

Disruptive
technologies

3

An aging
world

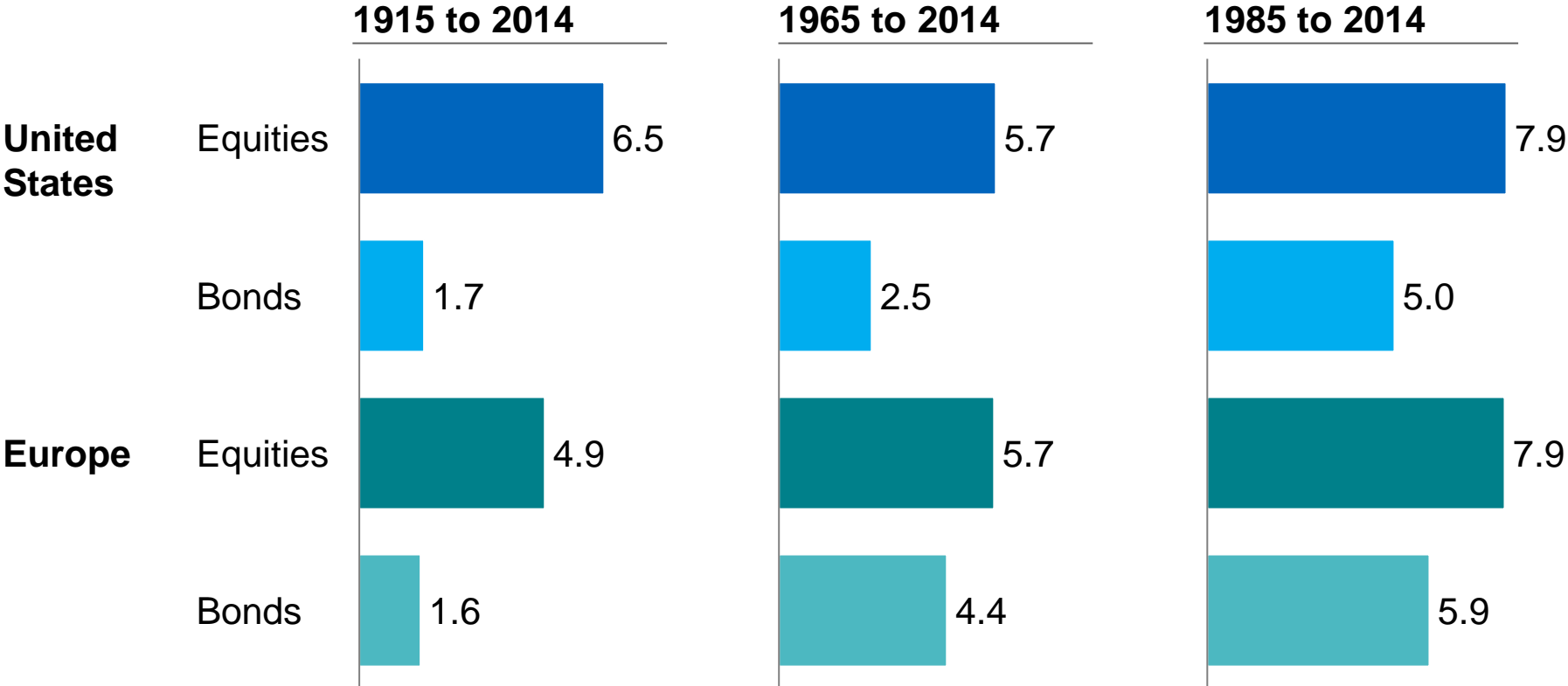
4

Greater global
interconnections

Returns on equities and bonds have been high over the past 30 years relative to the long-term average

Total real returns

Percent, based on 3-year average index at start and end year
Range refers to start-of-year to end-of-year

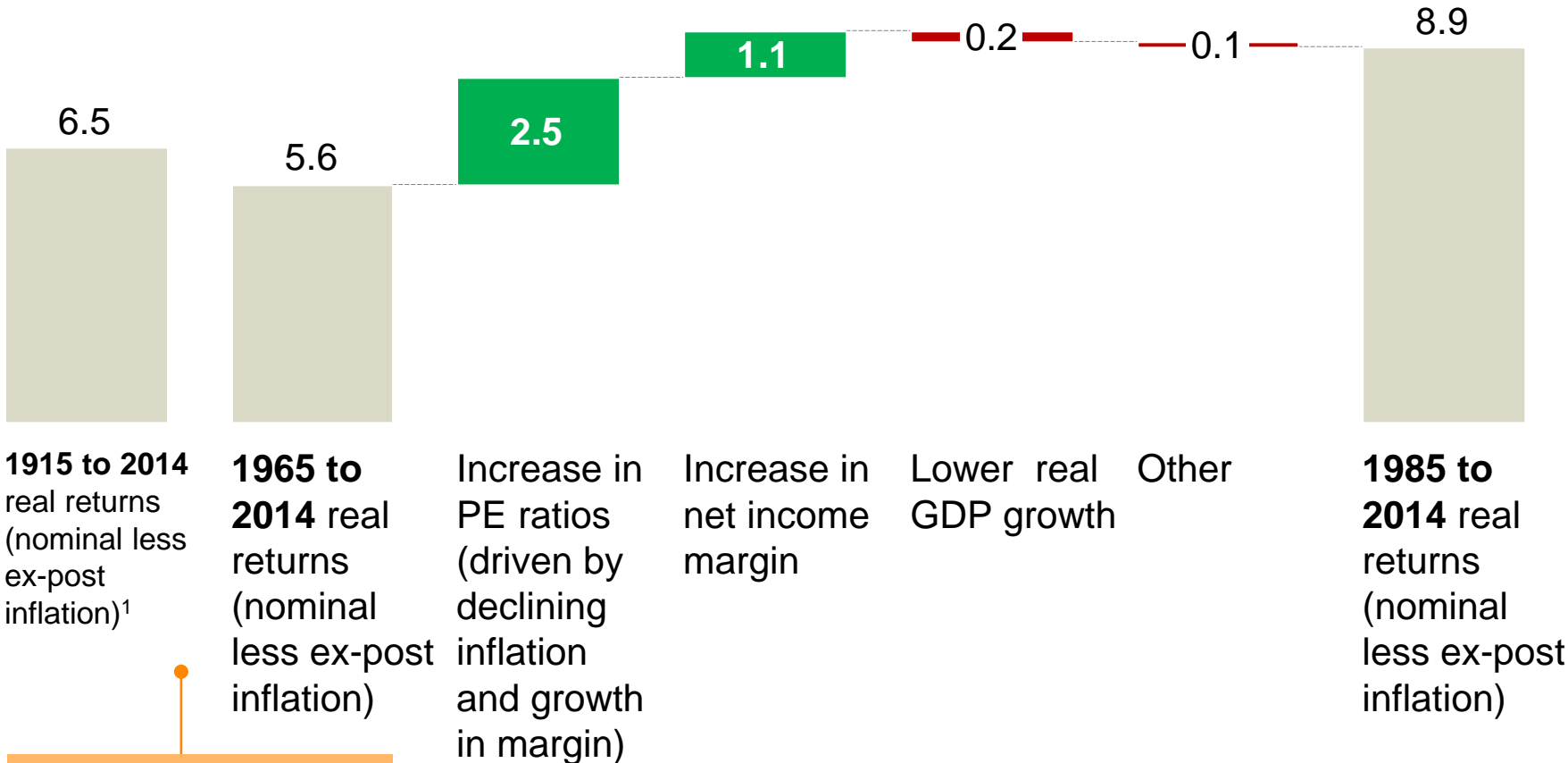


Declining inflation, which increased PE ratios, and increasing margins drove higher equity returns in the United States in the last 30 year

Equity returns, United States

% annualized

- Drivers that increased 30-year returns
- Drivers that reduced 30-year returns



“Long-run” normal returns

The four factors that boosted returns in the past 30 years have stalled or could reverse direction

Inflation has been tamed

Last 30
Fell from above 10% in many countries in early 1980s to below 2% after 2008

Next 20
More likely to rise than fall as economy recovers

Interest rates at historic lows

Last 30
Nominal rates on 10-year government bonds fell from above 10% in 1980s to about 2% or lower today in many countries

Next 20
Little room to fall further but speed of future increases is uncertain

GDP growth blues

Last 30
Robust growth due to strong productivity gains and increased employment

Next 20
Without big productivity gains, growth could be weaker as employment growth slows

Corporate profits under pressure

Last 30
New markets, low-cost labor, global supply chains, and falling corporate taxes boosted

Next 20
Emerging-market companies, SMEs and new tech competition could cut margins

The global corporate profit pool will continue to grow, but by 2025, they could lose the relative gains of the past three decades

1980 2013 2025

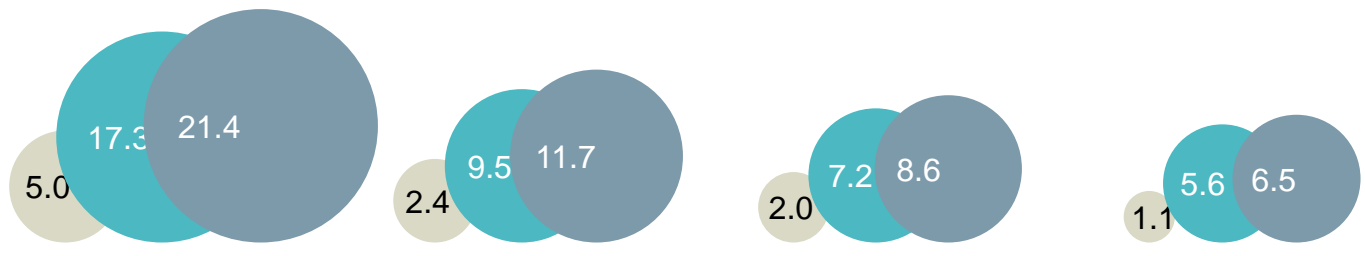
Gross pre-tax
Earnings before interest, taxes, depreciation, and amortization (EBITDA)

Net pre-tax
Earnings before interest and taxes (EBIT)

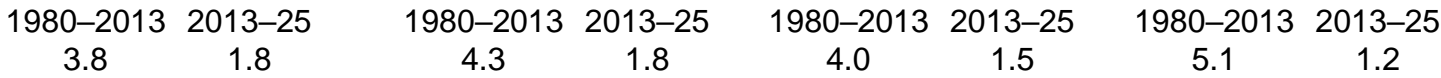
Net post-tax
Net operating profit less adjusted taxes (NOPLAT)

Net income

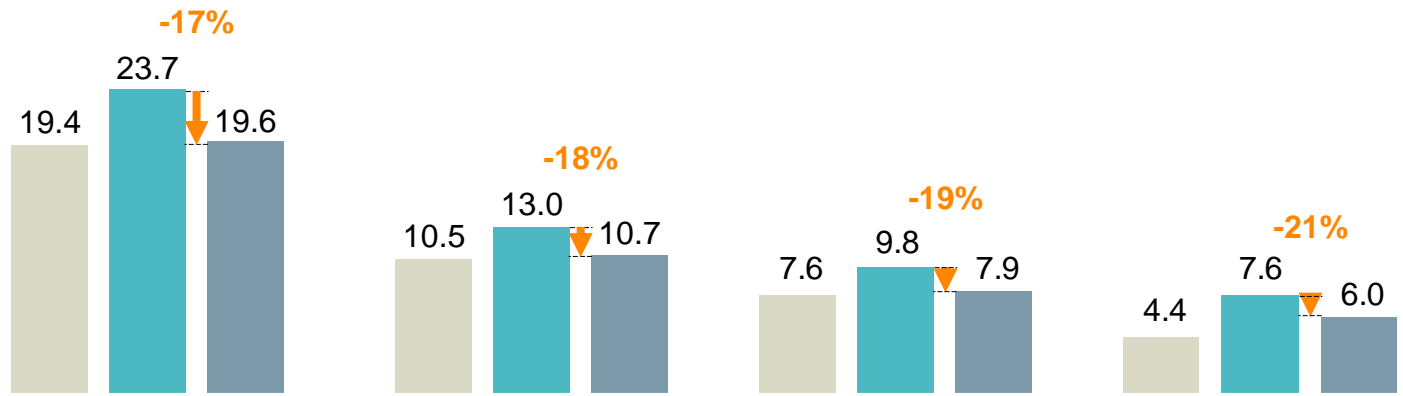
Total size of profit pool
\$ trillion, 2013 dollars



Compound annual growth rate (%)



Corporate profit pool
% of world GDP

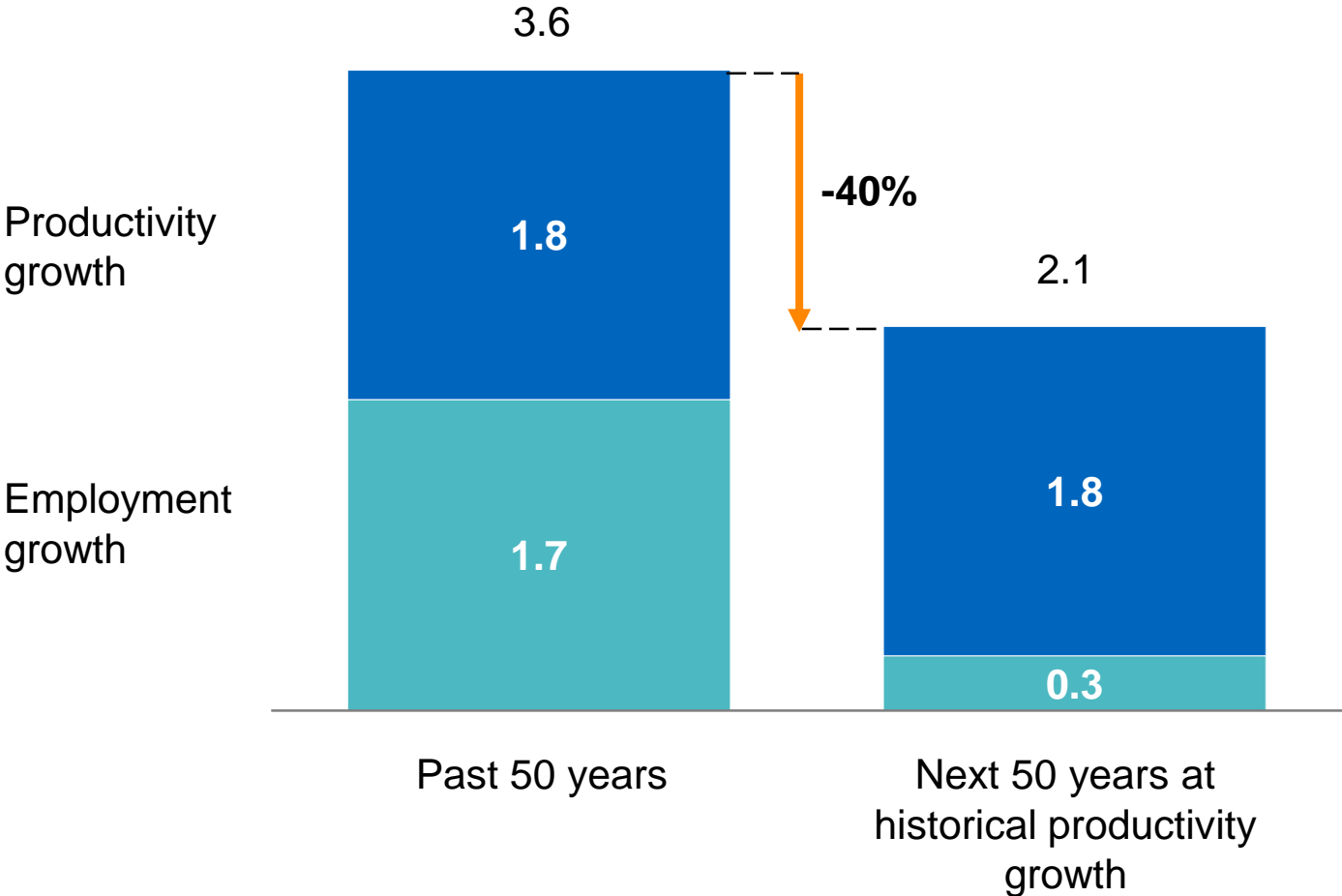


SOURCE: World Bank; OECD; Bureau van Dijk; European Commission AMECO database; US Bureau of Economic Analysis; IHS; Oxford Economics; McKinsey Corporate Performance Analysis Tool; McKinsey Global Institute analysis

At past rates of productivity growth, GDP growth would slow by about 40 percent

GDP of G19 and Nigeria

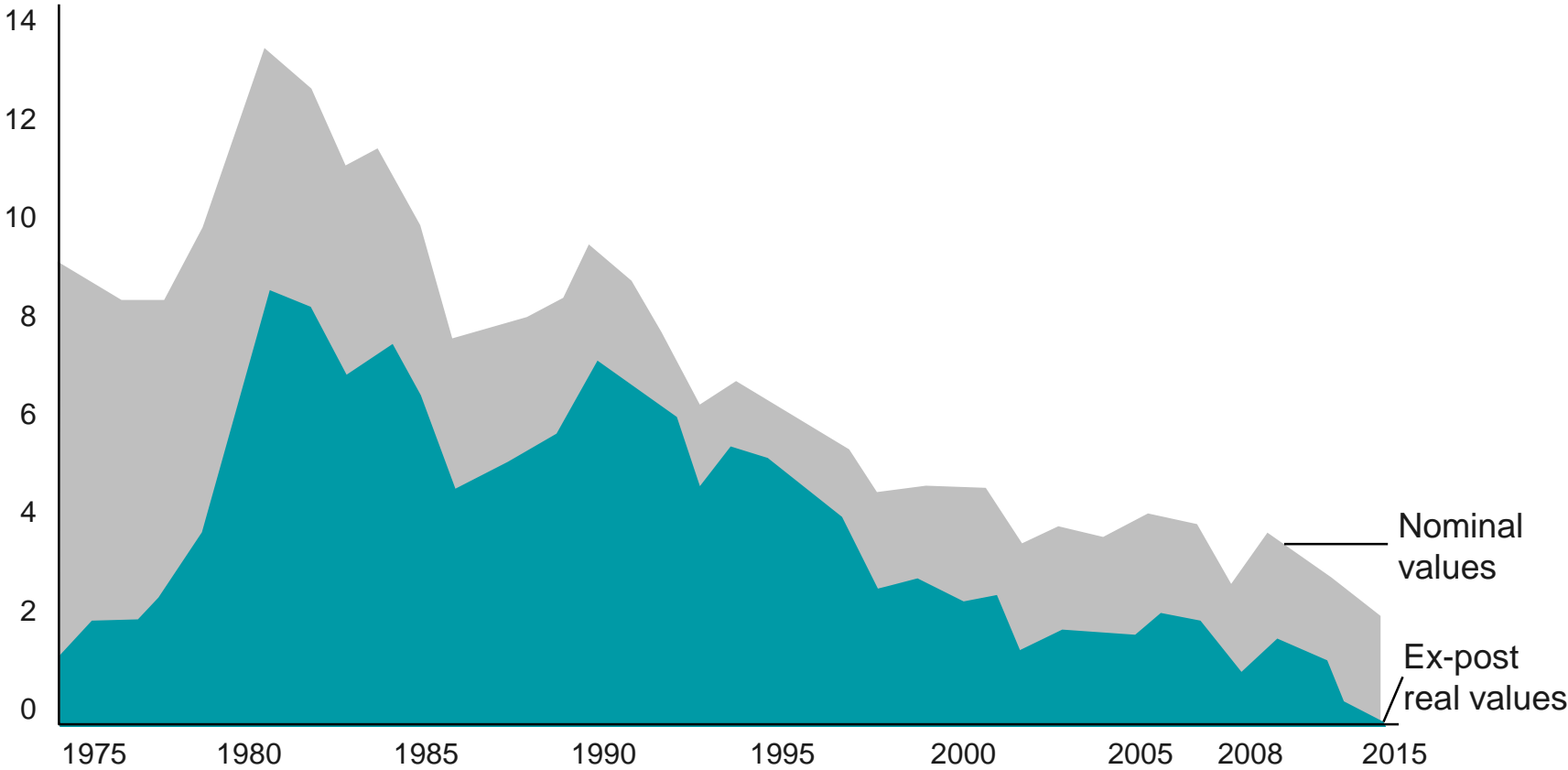
Compound annual growth rate, %



Capital has become increasingly cheaper

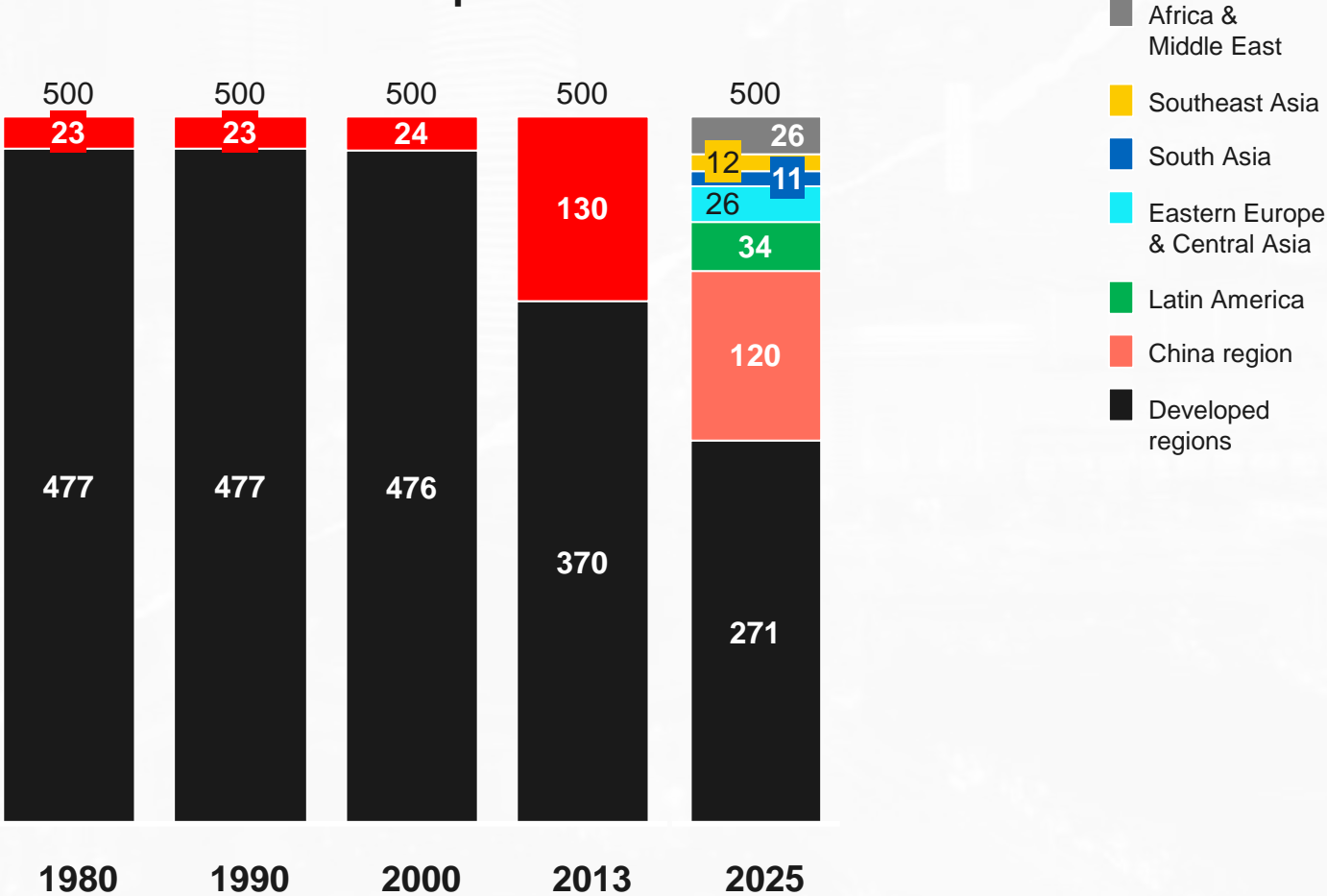
Long-term government interest rates in select developed economies

%



By 2025, the China region alone will be home to almost one-quarter of Fortune Global 500 companies

Number of Fortune Global 500 companies

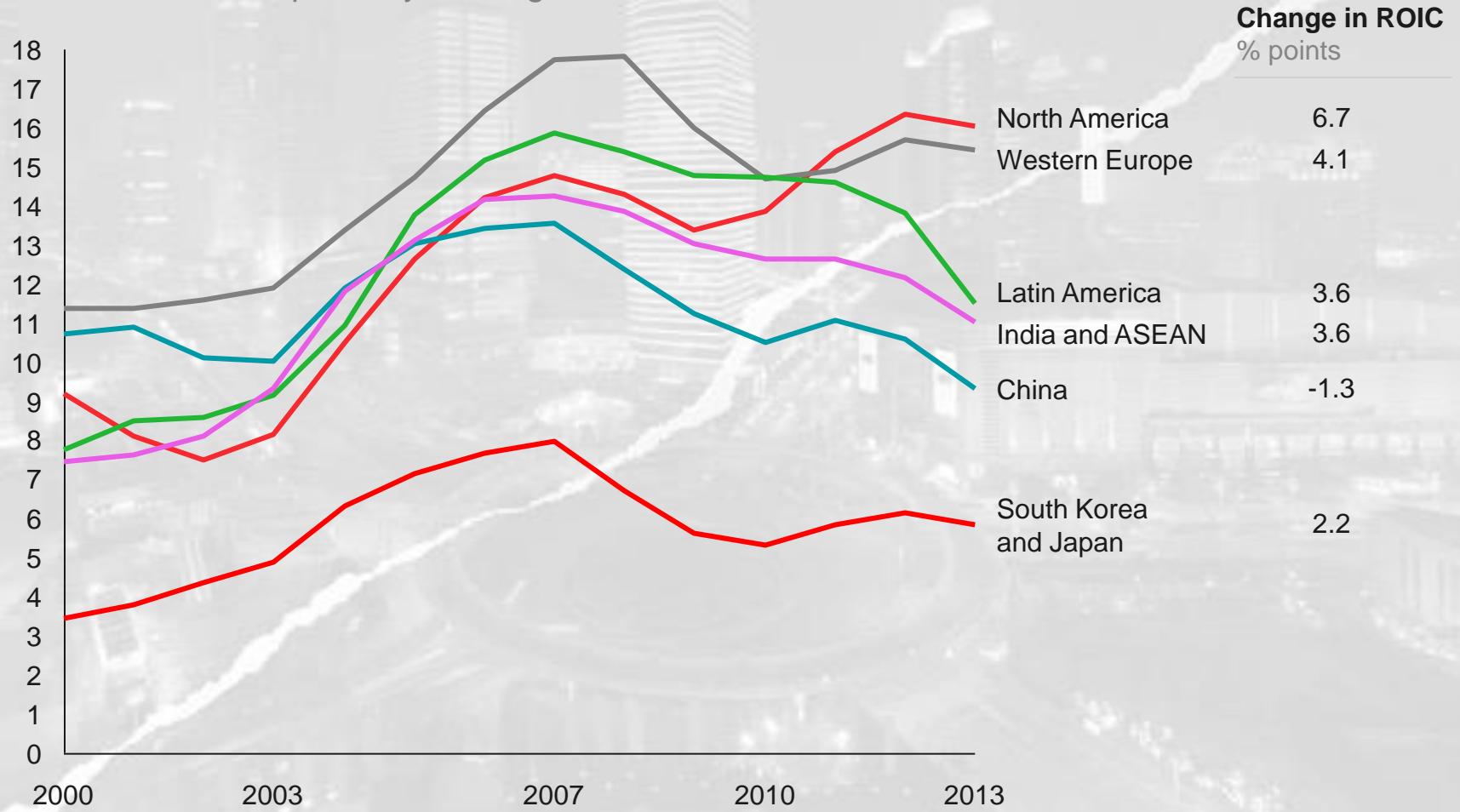


SOURCE: Fortune Global 500; MGI CompanyScope; McKinsey Global Institute analysis

Western firms have seen the largest growth in return on invested capital

Change in ROIC, excluding change in goodwill

Profit / Invested capital, 3-yr averages, %



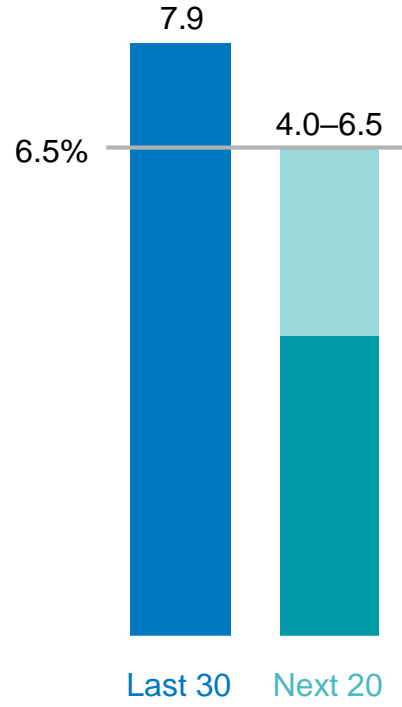
Returns over the next 20 years could be lower than long term averages

The past 30 years saw returns that exceeded the long-run average

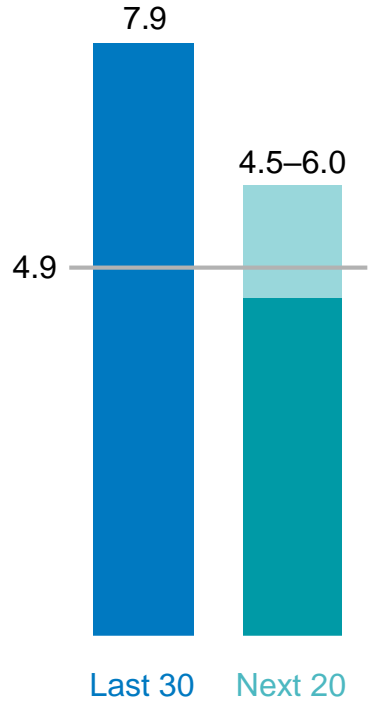
The next 20 years could be more challenging



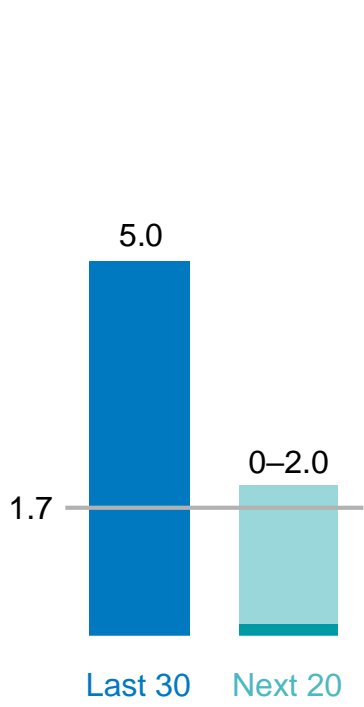
US equities



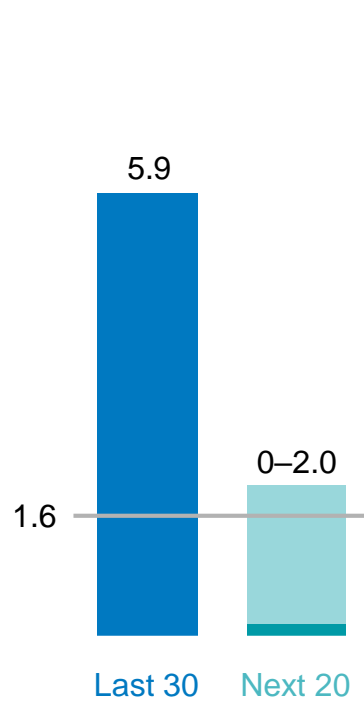
European equities



US bonds



European bonds¹



¹ Historical returns for Western Europe are based on treasury bonds, typically of 20-year duration. Future returns are based on 10-year treasury bonds

Reference reports

- Playing to win: the new global competition for corporate profits (MGI)
- The New Rules of Competition (HBR)
- Diminishing returns (MGI)
- No Ordinary Disruption (Public Affairs)

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