BLOG POST

Equity Valuations and 2019 Stock Returns

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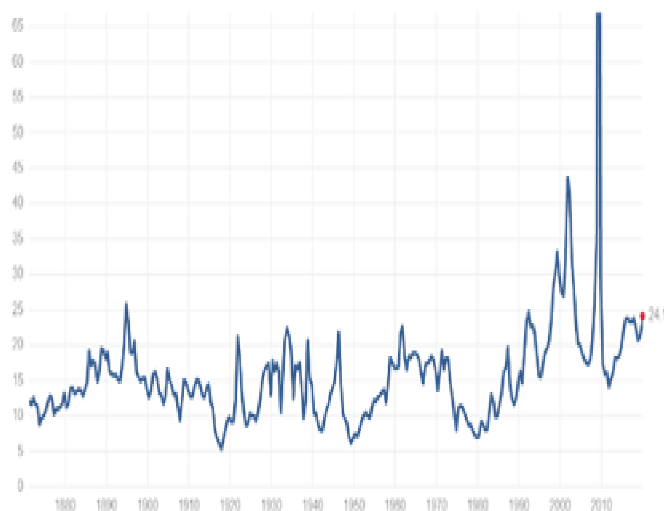
While we are not in the business of predicting short-term market returns, examining current valuations in relation to longer-term averages can help us gauge if the odds for a good year are in our favor. Perhaps the most common measure of equity valuations is the price-to-earnings ratio (P/E) on the S&P 500 Index. Essentially, it measures how much an investor is willing to pay today for a stream of cash flows in the future. The table to the left plots the P/E for the S&P 500 going back over 100 years. The average P/E is roughly 15.8. Today, the P/E stands at roughly 24.3. The results in the chart are based on as-reported trailing 12-month earnings, and are provided by Roger Shiller in his book, “Irrational Exuberance.”

- It would seem at first glance that with a P/E of 24.3 versus a long-term average of 15.8 we are currently overvalued. In other words, we are paying too much for earnings today, which in turn increases the probability of a pullback in near- to intermediate-term.

- We must consider the level of interest rates, however, and what other options are available to us as alternatives to stocks. Currently, the dividend yield on the S&P 500 of 1.9% is roughly the same as the yield on the 10-year Treasury. There’s no overwhelming reason to rotate out of equities and into bonds.

- The lowest reading occurred in 1917, while the highest reading occurred in 2009, at the height of the Great Recession.

S&P500 P/E Ratio



Source: Robert Shiller

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