Q: Are we approaching Irrational Exuberance?

Brian Lockhart: You could easily make an argument that Irrational Exuberance has been in the rear view mirror for most of 2020, if not before that time. Let's try to put today's market in context. Forward 12-month earnings estimate on the S&P 500 today is around $150, down about 20% from the $180 level at the end of 2019. The last time forward EPS was at the $150 level was mid-2016, a little over 4 years ago. The price of the S&P 500 in mid-2016? Around 2,200 compared to today's value of over 3,600. This means stocks have gone up in price almost 65% without any higher earnings to justify the increase.

If you think analysts might be too conservative in their estimates and earnings will be higher than forecasted, I have some beachfront property to sell you, in Arizona! According to FactSet, over the last 20 quarters (4Q2015) only twice have earnings come in higher than what was forecasted. The average "miss" where earnings come in below estimates over that same period is approximately 3.5%, suggesting actual earnings on the S&P 500 could be closer to $140 in 2021.

A lot depends on where you are investing as well. 3rd quarter year-over-year earnings are down 6.3% according to FactSet, but if you eliminate oil and gas, airlines and hotel industries, then earnings would actually show a rise of 4.3%.

Clint Pekrul, CFA: As I am writing my response, the Dow Jones Industrial Average just broke 30,000 and is on pace for its best month since 1987, which is quite an accomplishment considering we are in the middle of a pandemic. At this point, I think the market is looking past the record number of new COVID cases to the promise of a vaccine as early as the end of the year. In other words, the market is telling us that while the number of new cases and hospitalizations is alarming, in the not-too-distant future the vaccine will bring us back to normal.

When thinking about equity valuations, you must consider the alternatives. With interest rates close to historic lows, there is not much competition from bonds in terms of asset allocation. The current dividend yield on the S&P 500 index is higher than the yield on 10-year Treasuries, even though the index is trading at all-time highs. Still, earnings ultimately matter. Either earnings must rise to meet expectations and support current valuations, or prices must fall back in line. If you look under the hood, there are swaths of the market that are trading below historical valuations based on earnings ratios. Broadly speaking, I think it is a stretch to draw valuation comparisons between now and the late 1990s.