**BLOG POST**
Q&A
Part 1
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**Q: Should investors be concerned about data from the Buffet Indicator?**

**Brian Lockhart:** In the short term, probably yes, you should be concerned. For those unaware of what the Buffett Indicator is, it is an elegant and simple way of measuring if stocks are over or under valued using a rather common sense approach. It simply compares the market value of the entire stock market to the value of the economy. This intuitively makes sense because as GDP grows, corporate earnings should grow and stock prices should rise in tandem. When GDP shrinks, the same occurs with earnings and you would expect stocks to do the same. Measuring the ratio of stock market valuation to the economy over long periods of time is very useful to determine how stretched valuations might be.

The ratio is higher today than at any point in history, including the tech bubble in 2000 (the only other time valuations exceeded by more than 2 standard deviations). I understand the argument that we are still “normalizing” from the impact of COVID-19 that only caused a hiccup with stock prices, but we are still in uncharted territory with valuations and I expect we will see a sizable correction sooner rather than later.


**Clint Pekrul, CFA:** It is noteworthy. The Buffett Indicator measures the ratio of the total capitalization of the U.S. equity market relative to gross domestic product (GDP). To estimate the market capitalization of equities, we would typically use a broad index like the Wilshire 5000. GDP is measured quarterly and reflects the recent economic output of the U.S. economy. While equity valuations are forward looking, GDP measures prior economic activity. By comparing the ratio of the two numbers – equity valuations to GDP – we can get a sense of how reasonably stocks are valued. Ultimately, economic productivity and output must support the forecasted valuations embedded in stock prices. If this support does not materialize, then equity valuations will likely fall.

The Buffett Indicator currently sits at an all-time high, which some would argue is a bearish signal for stocks (i.e., markets are overvalued). But remember, investors must have other options available before they begin a wholesale rotation out of equities. Thanks to central banks, cash has a negative real return and yields on bonds are often less than the dividend yields on stocks. Higher valuations could persist for longer this time around, but ultimately economic output has to support forward expectations. So, keep an eye on Buffett’s indicator.