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MONTHLY MARKET PERSPECTIVE

The S&P 500 Is Expensive

By James M. Walden, CFA

For the 12 months ended March 10, 2024, the S&P 500 returned 30.4% in total. After such outsized gains, is the S&P 500 a bargain today? We say no. Rather, we think it's expensive.

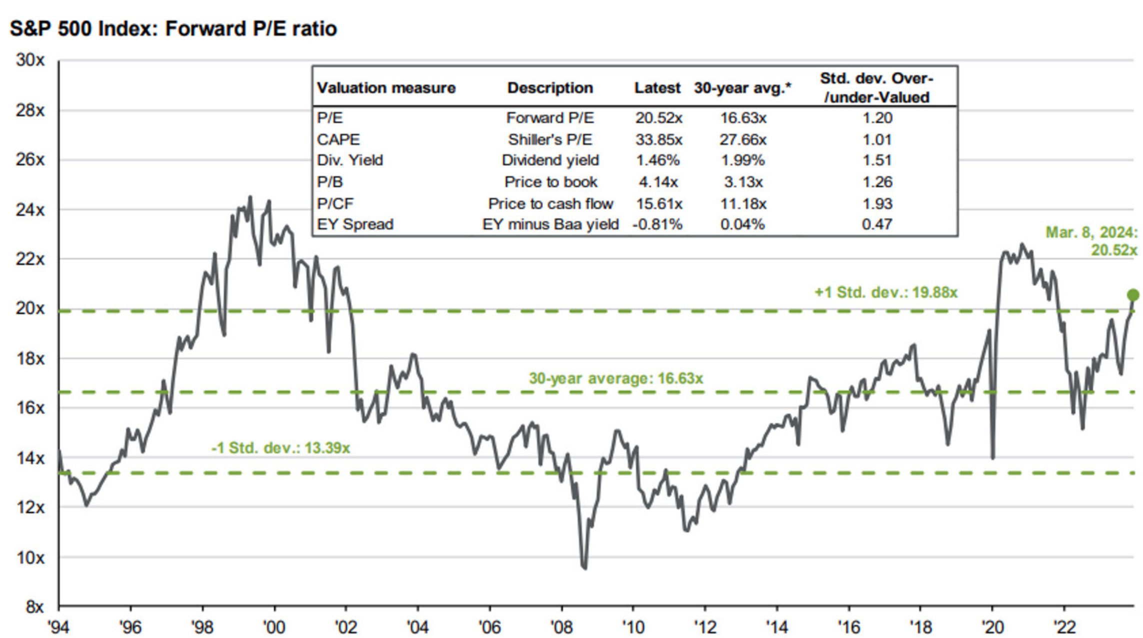
The price-to-earnings (P/E) ratio is one metric used to determine how cheap or expensive the stock market is. It measures how much investors are willing to pay for a hypothetical dollar of earnings. The higher the P/E, the more expensive it is, all else equal.

The S&P 500's current P/E ratio using forward earnings estimates is 20.5x, well over its long-term average of 16.6x. It's been this expensive just 12% of the time over the past 30 years, clustered in two distinct eras: the dot-com bubble and the period immediately after the strong V-shaped rally post-Covid (and right before the last bear market).

DASHBOARD

- Business Cycle
- Valuation
- Trend

Exhibit: The S&P 500 Is Expensive



Valuation measure	Description	Latest	30-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	20.52x	16.63x	1.20
CAPE	Shiller's P/E	33.85x	27.66x	1.01
Div. Yield	Dividend yield	1.46%	1.99%	1.51
P/B	Price to book	4.14x	3.13x	1.26
P/CF	Price to cash flow	15.61x	11.18x	1.93
EY Spread	EY minus Baa yield	-0.81%	0.04%	0.47

Source: FactSet, Federal Reserve Board, Refinitiv Datastream, Robert Shiller, Standard & Poor's, ThomsonReuters, J.P. Morgan Asset Management, Clayton Wealth Partners.

Valuation is a condition, not a catalyst. Just because stocks are expensive doesn't mean prices will go down right away. Stocks can stay expensive for a long time and can get even more expensive in the short run. But it is a mean-reverting series, which means that it tends to head back toward its long-term average over time. In today's case, that direction would be down.

There are two ways in which reversion to the mean can occur. The preferred, benign way would be for earnings to grow into the multiple. Here, growth in earnings would need to exceed any price gains of the S&P 500 for an extended period. The second way would involve a meaningful price decline in the S&P 500. This is what eventually occurred during the previous two episodes of such lofty valuations. Today, it would require a 19% decline to get to the long-term P/E of the S&P 500, all else equal.

Time will tell which of the two paths a mean reversion takes. In the meantime, from a valuation perspective, intermediate-term risks appear to be skewed toward the downside.

Bullish

- The Fed has made good progress in reducing inflation.
- The Fed appears poised to start cutting interest rates in 2024.
- The services sector of the U.S. has remained strong.
- The most attractive yields for fixed income and cash in years.
- Consumer and corporate balance sheets generally remain healthy.

Bearish

- Slowing global economic growth with recession pressures mounting.
- Banks are tightening lending standards.
- Housing affordability remains at a decades-low.
- Leading indicators of unemployment are generally trending down.
- Delinquency rates on consumer loans are rising.
- Russia-Ukraine war, Israel-Hamas conflict, and other geopolitical concerns.
- China is experiencing a growth recession, with deflation fears growing.
- Federal debt and deficits have ballooned.

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As Partner and Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner and management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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