SUREVEST

WEALTH MANAGEMENT

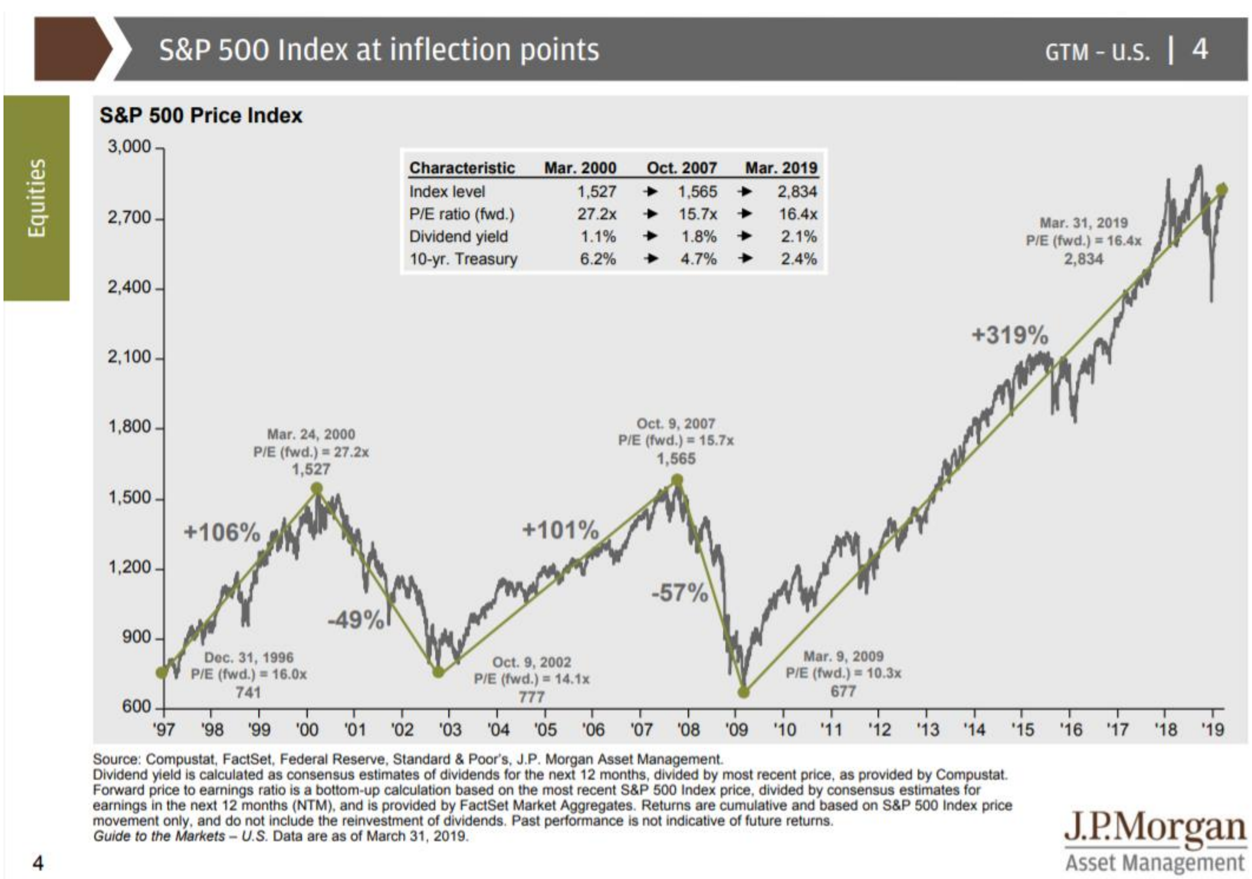
Are Stocks Too Expensive?

This rally can't last forever. We are due for a recession. This is already the longest bull market in history. The politicians are going to tank the market. The deficit is out of control. Ahhhh….

These are the same reasons we have heard for the past few years as the market continues to march higher. The good news is stocks are still reasonably valued (by historical standards) even though the market has risen dramatically over the past decade.

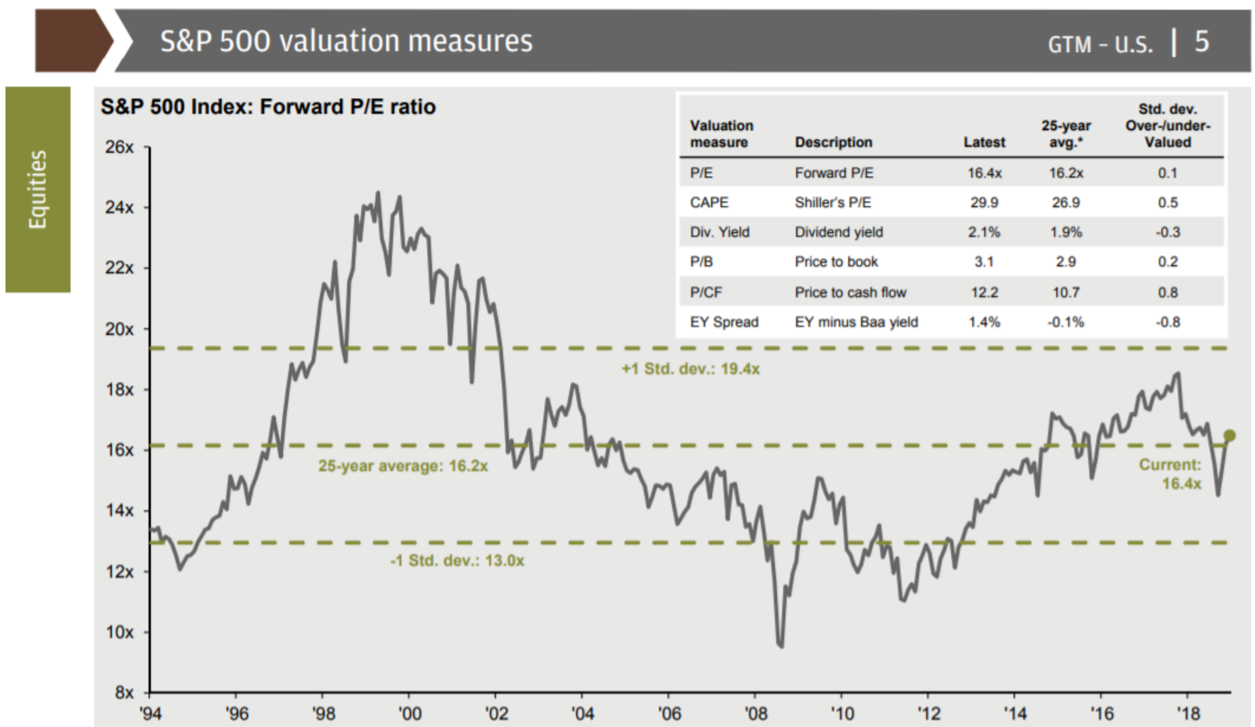
Today, I want to share a couple of my favorite charts that explain current stock valuations. These charts are from JP Morgan's "Guide to the Markets." The first chart shows the S&P 500 over the past 21 years. You can see:

- The size and duration of each bull and bear market. The market had a frustrating boom and bust pattern from 1997–2009 but has been in a strong bull market since March of 2009.
- Many people would think this means we are due for a correction, but the more relevant information is the box in the center. The price of a stock compared to the underlying company's expected earnings (P/E) ratio is currently at 16.4. This is very close to the S&P 500 stock index's 25-year average valuation.
- The dividend yield that investors currently receive compared to the interest rate on 10-year US government bonds is much for favorable for stocks than at the beginning of the last two major downturns.



The next chart shows how valuations have changed over time. Here are the items that grab my eye:

- The downturn from 2000-2002 looks reasonably predictable. The S&P 500 was well above its historical valuation range. Three years of double-digit price declines were required just to get back to the S&P 500's 25-year average valuation.
- The downturn in stock prices from Oct 2007 to March 2009 started when stocks were already reasonably priced (based on earnings). The "great recession" and stock market downturn was caused by a global liquidity panic, which ended with stocks being significantly undervalued. Naturally, that did not last.
- The box at top right shows the current valuation of large cap domestic stocks (measured by the S&P 500) compared to its 25-year average based on 6 different valuation metrics. This shows 4 of the metrics indicate a very slight overvaluation and 2 of the metrics indicate a slight undervaluation.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	16.4x	16.2x	0.1
CAPE	Shiller's P/E	29.9	26.9	0.5
Div. Yield	Dividend yield	2.1%	1.9%	-0.3
P/B	Price to book	3.1	2.9	0.2
P/CF	Price to cash flow	12.2	10.7	0.8
EY Spread	EY minus Baa yield	1.4%	-0.1%	-0.8

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since April 1994, and FactSet for March 31, 2019. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow data availability.
Guide to the Markets – U.S. Data are as of March 31, 2019.

The bottom line is stocks are not overly expensive, despite the large run up in prices over the past 10 years. They're also not dirt cheap. Stock prices appear reasonable.

Does this mean the bull market will continue? Not necessarily, but it very well could. We remind you that even during sustained uptrends, you have periods of consolidation and short-term pullbacks. I always also like to reiterate that past performance is not a guarantee of future results.

Let me know what you think of these charts.

Have a great week.

-Jeremy Kisner, Director of Financial Planning and Senior Wealth Advisor