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Market Commentary

Weekly perspective on current market sentiment **March 20, 2024**

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Last week's S&P 500 Index: -0.1%

Valuations, then and now

Key takeaways

- Investors are asking how the valuation of the S&P 500 Index now compares to the Tech bubble that peaked in March 2000.
- One of the key differences between then and now is the quality of the companies leading the charge higher.

As the old market bromide goes, "Just because stocks are expensive now doesn't mean they won't be more expensive later." Wise words to live by for investors. Picking market tops and bottoms is never an easy exercise and almost impossible to do consistently. Of course, after the big market surge higher off the late-October 2023 lows (a touch more than 25%), many analysts and investors are concerned that the S&P 500 Index (SPX) price-to-earnings (P/E) ratio, a common measure of the number of dollars an investor is prepared to pay for a dollar of earnings, is too high relative to the historical average. In other words, stocks, or at least a number of high-profile equity sectors, are too expensive to buy at recent levels.

Our regular readers know that we are not in favor of chasing the SPX higher at current levels. We think valuations are stretched by most measures, including the P/E ratio. But, as a reminder, we do think there are equity portfolio actions investors can take now. First, we believe the Information Technology (neutral rated), Communication Services (neutral rated), and Consumer Discretionary (unfavorable rated) sectors are meaningfully overvalued and suggest trimming exposures in each to reflect our current portfolio recommendations. Then, with those funds, we suggest bringing the Industrials, Energy, Materials, and Health Care sectors (all rated favorable) up to our recommended portfolio allocations.

Investors are asking how the valuation of the SPX now compares to the Tech bubble that peaked in March 2000. Let's take a look at what the basic math tells us. Right now, based on our 2024 earnings per share estimate of $230, the SPX is trading at a P/E of 22.4x this year's earnings projection (5,160/$230 = 22.4). Using Bloomberg data, at the height of the market in March 2000 (1,527) and using the actual earnings for that year of $56.53, the P/E calculated to 27x, so meaningfully higher than the current P/E based on our earnings estimate. If we applied the March 2000 valuation to our 2024 earnings estimate for comparison, that would put the SPX at 6,210 or slightly more than 20% higher than the current level.

As was the case in the rally leading up to the March 2000 SPX high, the recent market rally has featured a relatively small number of technology-oriented stocks pushing the SPX higher. However, one of the key differences between then and now is the quality of many of the companies leading the charge higher. Today, the companies driving the rally are showing strong revenue and earnings growth to go along with robust balance sheets and acceptable debt levels. Back in 2000, many of the companies carried the SPX to record levels based on high hopes of one day producing strong revenues and earnings.

P/E ratios are not a timing tool. Stocks are richly valued, but prices could go higher. We expect increased volatility in coming quarters that may provide downside opportunities to increase exposure to stocks at more reasonable valuations.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. . The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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