Equity Investors Still Have The Fundamentals On Their Side

View from the Observation Deck

1. Equity investors endured another pullback in the stock market recently and it was accompanied by the usual dose of scary headlines and dire predictions.

2. From 9/18/14 (all-time high) through 10/15/14, the S&P 500 Index posted a total return of -7.28%, according to Bloomberg. From 10/15/14 through 10/27/14, however, the index was up 5.34%.

3. In our opinion, the reason why the S&P 500 hasn’t experienced a 10% or greater correction since Q3’11 is because investors have continuously bought the dips.

4. Today, thanks to the Internet, investors have access to an abundance of information about the economy and the markets, both domestically and globally. Sifting through it all can be a daunting task.

5. Focusing on the fundamentals is always a good place to start, in our opinion. The chart above features two key indicators that are fundamental in nature: corporate earnings and P/E ratios.

6. When comparing 2007 (pre-financial crisis) results with those from 2013, the thing that stands out is that the year-end P/E ratios are nearly the same (17.36 vs. 17.30), yet index earnings were considerably higher in 2013 ($84.59 vs. $106.82).

7. As of 10/28/14, the consensus 2014 and 2015 earnings estimates for the S&P 500 from analysts tracked by Bloomberg were $120.03 and $131.47, respectively.

8. As of 10/28/14, the consensus 2014 and 2015 P/E estimates from analysts tracked by Bloomberg were 16.42 and 14.99, respectively. The index’s average P/E over the past 50 years was 16.50 (as of 10/28/14).

9. Fundamentally speaking, investors are currently paying close to a normal market multiple for record-level earnings.

This chart is for illustrative purposes only and not indicative of any actual investment. There can be no assurance that any of the projections cited will occur. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks used to measure large-cap U.S. stock market performance.