

Cash Flow and Carey



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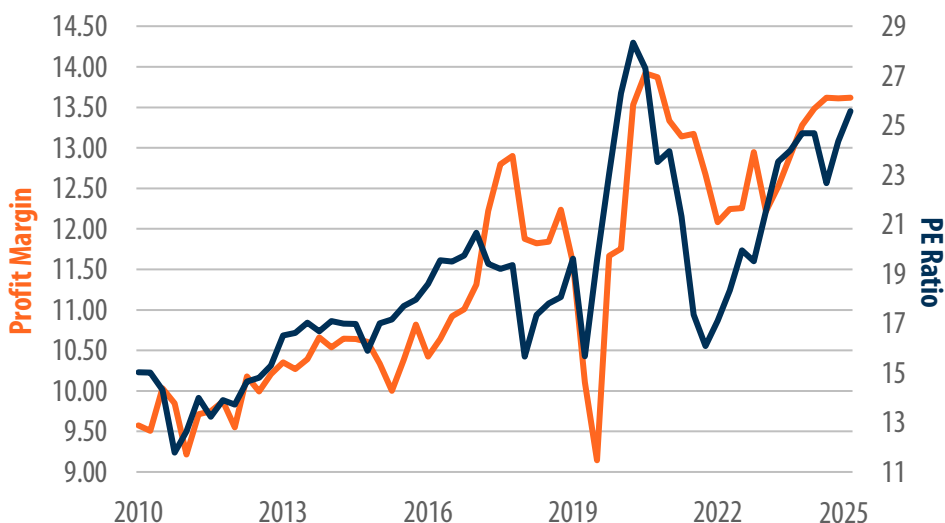
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This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is a capitalization-weighted index comprised of 500 companies used to measure large-cap U.S. stock market performance, while the 11 major S&P 500 Sector Indices are capitalization-weighted and comprised of S&P 500 constituents representing a specific sector.

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Increased Margins = Higher Valuations

S&P 500 Index Profit Margin vs. P/E Ratio



Source: Bloomberg. Quarterly observations from 12/31/10 to 9/30/25.

View from the Observation Deck

The S&P 500 Index ("Index") closed at 6,654.72 on 10/13/25, representing a price-only increase of a 33.55% since its most recent low of 4,982.77 just over six months prior (4/8/25). The Index's meteoric rise has many investors questioning whether current price levels are sustainable, especially given comparatively stretched valuation metrics and eroding economic data. For today's post, we set out to view current valuations, as measured by the Index's price to earnings (P/E) ratio, through the lens of profitability, as measured by profit margins, over time.

- As revealed in today's chart, there appears to be a positive correlation between profit margins and P/E ratios.
- The Index's P/E ratio increased from 15.03 in Q4'10 (start of our chart) to 25.57 in Q3'25.
- The Index's profit margin stood at 13.62% in Q3'25, up from 9.57% in Q4'10, according to data from Bloomberg. For comparison, the Index's record profit margin of 13.92% was set in Q2'21.
- While not in today's chart, data from FactSet revealed that the four Index sectors with the highest estimated net profit margins for Q3'25 were as follows: Real Estate (34.1%), Information Technology (26.6%), Financials (19.1%), and Utilities (16.3%).

Takeaway

As we see it, the Index's elevated P/E ratio may not be cause for alarm, especially if coincident data supports higher valuations. As of 9/30/25, the P/E ratio for the Index stood at 27.57 - well above the chart's time series average of 18.75. That said, the Index's profit margins were near all-time highs as of the same date (13.62%). As the chart reveals, companies are increasingly effective at allocating capital and investors are reaping the rewards. Bear in mind that technology companies, which are estimated contribute the second-largest share of the Index's net profits in Q3'25, accounted for 34.8% of the Index's market capitalization as of 9/30/25. While we believe this concentration could lead to pain in the long run, determining the timing of that pain will be nearly impossible. Stay tuned!