Market Commentary Blog

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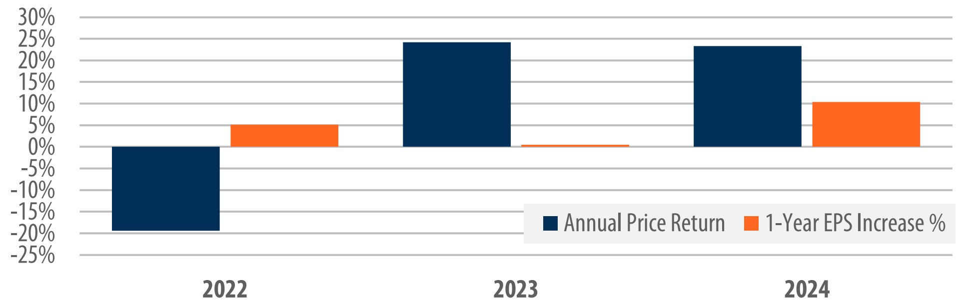
3/11/25

Another Perspective on S&P 500 Index Performance

S&P 500 Index Price Returns & Earnings Growth Rates



Source: Bloomberg, FactSet. Earnings growth rates are annual, year-over-year figures. **Past Performance is no guarantee of future results.**

View from the Observation Deck

Understandably, accelerating losses among U.S. equities captured investors' attention over the past several weeks. At market close on 3/10/25, the S&P 500 Index ("Index") had given back all its early-year gains and moved into negative territory, posting a total return of -4.30% year-to-date (YTD). March has been a particularly harsh month for equity investors, with the Index declining 5.66% (total return) month-to-date thru 3/10. While the sell-off is broad-based across U.S. equity indices, certain market segments are being hit harder than others. Total returns for the tech-heavy Nasdaq 100 and Magnificent 7 Indices were -7.39% and -15.51%, respectively, YTD thru 3/10. There are numerous theories and possibilities for stocks' recent rout. For today's post, we set out to offer additional perspective to what we're seeing reported by most news outlets. The chart above compares the annual price returns for the Index along with the year's corresponding change in earnings per share (EPS) stated as a year-over-year percentage.

The Index's price increased at a faster pace than its constituents' earnings over the period captured in today's chart.

As many investors are likely aware, there is a fundamental correlation between a company's market value and earnings. The Index's price increased by 23.40% over the three-year period in today's chart. By contrast, the Index's earnings increased by 16.56% over the same time frame. Removing 2022's result skews the data further, with the Index's price increasing 53.19% compared to a 10.87% increase in earnings. In our view, the latest weakness in equity prices may reflect growing concern over this recent valuation expansion.

Earnings estimates reflect strength in the year ahead.

Data from FactSet revealed that the Index's Q4'24 blended, year-over-year earnings growth rate stood at 18.2% on 2/28/25, marking the highest observation for the metric since Q4'21. Estimates point to earnings increasing in the years to come as well. As of 3/7/25, analysts estimated that the Index's total earnings per share would increase from $243.02 in 2024, to $271.23 and $309.16 in 2025 and 2026, respectively. That said, these are estimates and are subject to change as new information is made available.

The Index's earnings yield suggests equities are undervalued when compared to the yield on the 10-year treasury note ("T-note").

The earnings yield, which is calculated by dividing the Index's 2025 estimated EPS by its current price surged to 4.83% on 3/10/25, up from 4.41% on 2/19/25 (the Index's all time high). For comparison, the yield on the 10-year T-note stood at 4.22% at the close on 3/10/25.

Takeaway

We believe that earnings growth is foundational to higher equity prices over time. It follows, then, that we expect equity prices will return to growth if earnings continue to increase. Currently, analysts estimate that Index earnings will increase 11.61% in 2025 and 13.98% in 2026. Keep in mind that these estimates are subject to change. Case-in-point, the likelihood of a U.S. economic recession is rising, putting the profitability of U.S. companies at risk. As recession risk increases, so do the odds that the Fed will cut interest rates. As of 3/10/25, the federal funds rate futures market implied that the Fed would lower interest rates to 3.50% by year-end. For comparison, the metric stood at 3.90% at the close of 2024. Declining interest rates could push borrowing costs lower and increase the profitability of companies' future projects. In other words, the Fed's defense against recession could prove to buoy equity prices to some extent. There are many ways to dissect the Index's recent price fluctuation. We trust this post offers further insight and a unique perspective. We will update you as new information becomes available.