Market Commentary Blog

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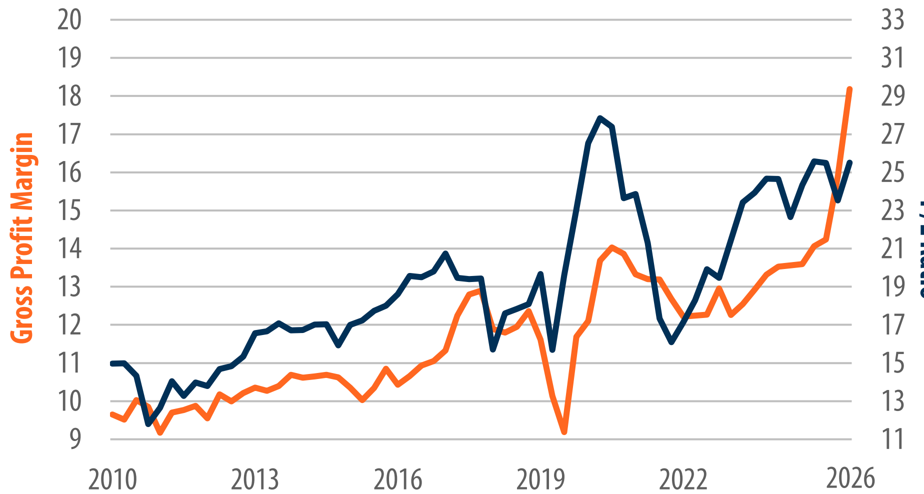
Profit Margins and Valuations

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



Source: Bloomberg. Quarterly observations from 12/31/10 to 6/30/26.

View from the Observation Deck

The S&P 500 Index ("Index") closed at 7,673.52 on September 8, 2026, representing a price-only increase of 54.0% since its most recent low of 4,982.77 on April 8, 2025. The Index's meteoric rise has many investors questioning whether current price levels are sustainable, especially given persistent inflationary pressures, surging bond yields, and the growing likelihood of higher interest rates by year end. Today's post offers an alternative view of current price levels by plotting the Index's valuation, as measured by its trailing 12-month price to earnings (P/E) ratio, against profitability, as measured by gross profit margins. Click here to view our previous discussion on this topic.

- As revealed in today's chart, there appears to be a positive correlation between profit margins and P/E ratios.
- The Index's trailing 12-month P/E ratio increased from 14.96 in Q4'10 (start of our chart) to 25.51 in Q2'26.
- Analysts estimate that the Index's profit margin reached a record 18.2% in Q2'26, up from 9.7% in Q4'10, according to data from Bloomberg. This marks the fourth quarter in a row of record profit margins for the Index.
- While not in today's chart, data from FactSet revealed that the three Index sectors with the highest estimated net profit margins for Q2'26 were as follows: Real Estate (33.9%), Information Technology (32.4%), and Communication Services (28.6%).

Takeaway

As today's chart reveals, the Index's trailing 12-month P/E ratio jumped from 23.53 in Q1'26 to 25.51 in Q2. Gross profit margin surged as well, increasing to a record 18.2% in Q2'26, representing the fourth quarterly record for the Index's gross profits. For comparison, the Index's profit margin averaged 11.7% between Q4'10 and Q2'26. At 25.51, the Index's trailing 12-month P/E ratio remains above its average of 19.1 over the observed time frame. While today's data focused on historical results, future earnings estimates may lend further context to current price levels. When substituting forward 12-month earnings estimates for trailing 12-month results, the Index's forward P/E ratio declines to just 19.5, below its 5-year average of 19.8, according to FactSet. As noted in our discussion earlier this week, the Index's earnings are surging, with earnings per share increasing by an astonishing 52.4% year-over-year in Q2'26. Estimates for Q3'26 reveal more of the same, with FactSet reporting analysts estimating the Index's year-over-year earnings growth rate will be 28.5% during that quarter.