

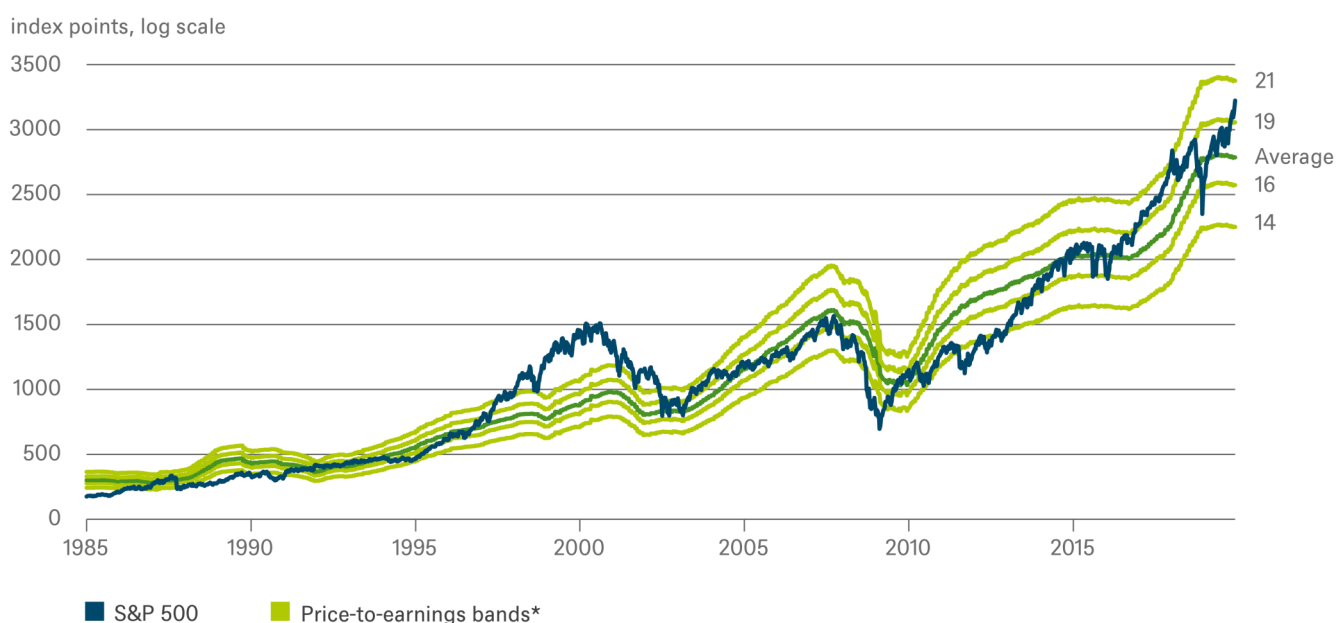
STOCKS IN 2019: WHAT A DIFFERENCE ONE YEAR MAKES

In 2018, earnings were growing at double-digit rates, while equity markets were trading down. In 2019, however, earnings stagnated, and equities rose substantially.

What a year! From today's point of view, market comments from one year ago are a fun reading. Back then, people had trouble explaining what had just happened to them: on December 24, 2018, the S&P 500 fell to 2351, its lowest level since May 2017 and, after a decline of 19.75% since September 2018, only a whisker away from a bear market. "What on earth is the market trying to tell us?" was the question of the day. The irony is that earnings in 2018 were growing at double-digit rates, while equity markets were trading down. In 2019, however, earnings stagnated, but global equities (MSCI World Index) rose 25%.

This week, we're unearthing our beloved chart of S&P 500 valuation bands. Our "Chart of the Week" shows, that going back to 1970, the average price-to-earnings (P/E) ratio of the S&P 500 was 17.3, based on last-twelve-months (LTM) earnings. Given current earnings and prices, we calculate a P/E ratio of above 20, which is not at a record level, but qualifies for being classified as stretched.

However, as Thomas Bucher, equity strategist at DWS, keeps saying, today's valuation doesn't tell you anything whether the market will go up or down tomorrow. In fact, even on a 12-month horizon, valuation has only a limited explanatory power of stock returns. This correlation, however, increases with the time horizon: elevated valuations do suggest that the expected equity returns over the next, say, 10 years are likely to be below the long-term average. But that's still way off, and we'll probably post an updated valuation-band chart next year again.



* Each band represents the S&P 500's hypothetical price development assuming a P/E multiple of 14, 16, 19, 21 and the average since 1970 (17.3)
Sources: Refinitiv, DWS Investment GmbH as of 12/27/19

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Source: DWS Investment GmbH

GLOSSARY

Technically, a **bear market** refers to a situation where the index's value falls at least 20% from a recent high.

Correlation is a measure of how closely two variables move together over time.

The **MSCI World Index** tracks the performance of mid- and large-cap stocks in 23 developed countries around the world.

The **price-to-earnings (P/E) ratio** compares a company's current share price to its earnings per share.

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Valuation attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

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