



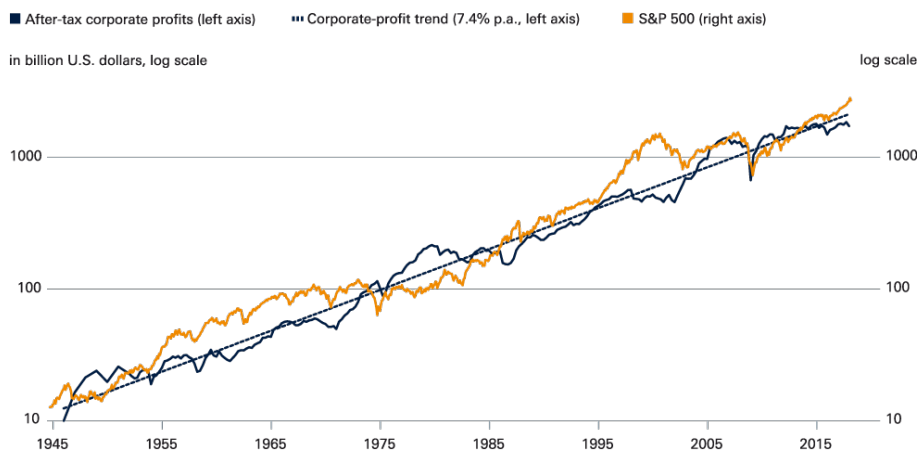
Chart of the week

Over the long run, stock-price returns closely follow corporate-profits

What explains stock-market performance? A lot of factors come to mind, at least in the short term. Over a long-term horizon, however, stock prices tend to very much aligned with earnings. In our Chart of the Week, we look at the S&P 500, and compare it to U.S. after-tax corporate profits as published in the US Federal Reserve's "Flow of Funds" report. By relying on data reflecting the overall economy, we avoid any discussions about inflated earnings, e.g. due to share buybacks. (To be sure, this excludes some foreign earnings, but includes the earnings of foreign-owned subsidiaries.)

According to this statistic, earnings have been growing by 7.53% per year since 1946. Using the S&P 500 as a reference, we find that stock prices have risen by 7.44% over the same period. Quite a synchronous move over seven decades!

For the years and decades to come, we believe that earnings growth will remain the variable with the highest explanatory power for stock-price returns. However, we would be reluctant to extrapolate past corporate-profit growth rates forever. After all, corporate-profit growth outpaced the increase in nominal U.S. gross domestic product by about one percentage point per year since WWII. It's unlikely that this can last indefinitely.



Sources: Board of Governors of the Federal Reserve System, Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH, as of 3/15/18

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Glossary

Gross domestic product (GDP)

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

S&P 500

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

U.S. Federal Reserve Board (the Fed)

The **U.S. Federal Reserve Board**, often referred to as "**the Fed**", is the central bank of the United States.

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