

THE S&P 500 SHOWS ONLY HALF OF THE FEAR

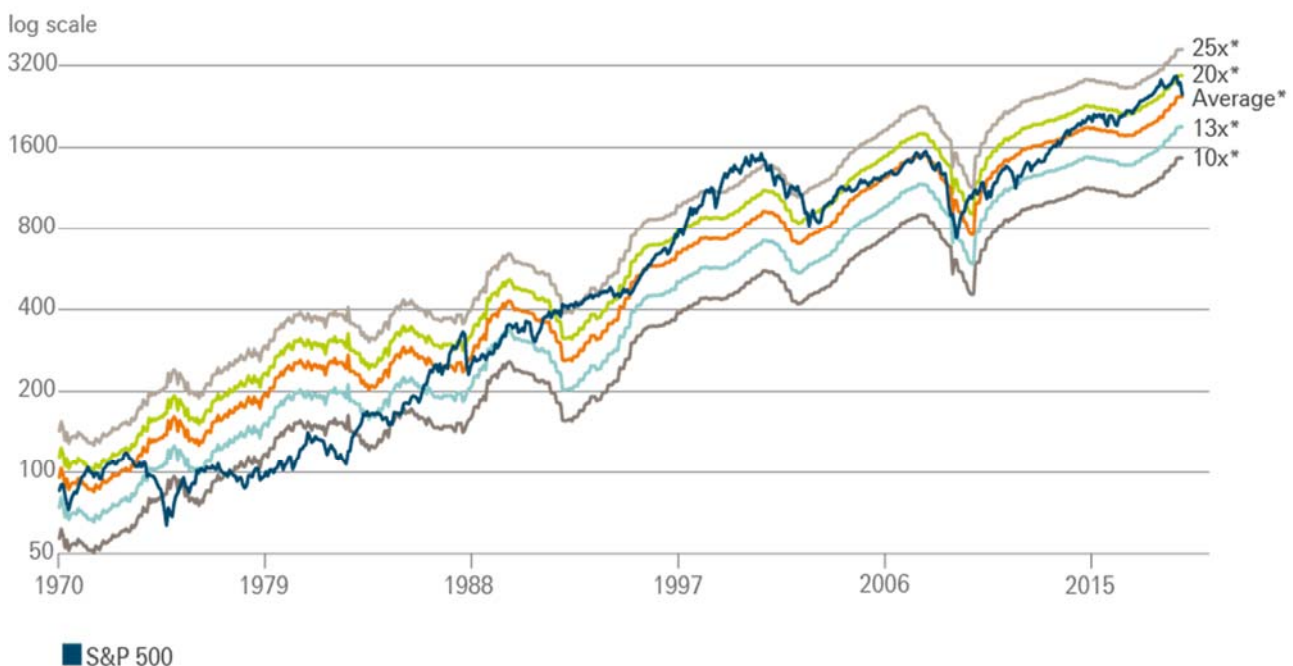
The extent to which investor confidence suffered in 2018 is reflected more clearly in the price-to-earnings ratio than in the S&P 500 itself.

The price-to-earnings (P/E) ratio is a popular, albeit not perfect, indicator for stock valuation. In a previous Chart of the Week, we called the P/E ratio the hotdog of stock valuation: even though everyone knows there are more elegant, modern and balanced alternatives, it remains everybody's darling.

2018 was a remarkable year for U.S. equities and for their average P/E ratio. It started very promising with a big leap in the S&P 500, reflecting the two factors that have been driving the index since 2012: rising corporate earnings and higher P/Es. Earnings as calculated for "one unit" of the S&P 500 rose from 123 to 146 U.S. dollars in 2018, but the P/E ratio fell significantly during the course of 2018. Calculated on the basis of the profits of the past twelve months, it fell from its peak of 23 in January to now just over 17. Although the tax package played a role in January's peak – prices rose in anticipation of higher net profits, which only

materialized at the end of the first quarter – the loss of confidence remains considerable. Investors are even paying a significantly lower multiple for profit today than in September 2016, i.e. before the U.S. presidential election. This may be due to the more mature cycle and doubts about the sustainability of record profit margins. However, we also see considerable market doubts about the sustainability of the White House's economic and foreign policy.

The P/E ratio is now almost exactly in line with the average of past decades, as our Chart of the Week shows. This is not yet a reason for euphoria and does not mean much for the short-term market outlook. Thomas Bucher, Equity Strategist at DWS, emphasizes that the valuation today unfortunately says very little about tomorrow's share-price performance. Only when the forecast horizon is significantly extended does the P/E ratio become more meaningful.



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 12/28/18
* Calculated based on last twelve months' earnings.

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GLOSSARY

Margin

Margin describes borrowed money that is used to purchase securities.

Price-to-earnings (P/E) ratio or multiple

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

U.S. dollar (USD)

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

Valuation

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

White House

The **White House** is the official residence and principal workplace of the President of the United States.

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