CRESTMONT RESEARCH

THE P/E SUMMARY:

PERIODIC SUPPLEMENT TO THE P/E REPORT

By Ed Easterling

October 9, 2023

NOTE: This report provides intra-year updates to key tables and graphs from The P/E Report, Crestmont's annual review of P/E, earnings, and related outlooks.

	AS OF: SEP 30, 2023	REPORTED	ADJUSTED[1]	CRESTMONT[2]
"P"	Closing Price (S&P 500 Index)[3]	4288	4288	4288
"E"	Current Estimate (S&P 500 EPS)[4]	$187	$149	$134
P/E	Price/Earnings Ratio[5]	22.9	28.8	32.1

Notes:
(1) adjusted using the methodology popularized by Robert Shiller (Yale; Irrational Exuberance*), as modified for quarterly data*
(2) based upon historical relationship of EPS and GDP as described in chapters 5 & 7 of Probable Outcomes *and chapter 7 of* Unexpected Returns; *useful for predicting future business cycle-adjusted EPS*
(3) S&P 500 Index is the value at the date listed in the table
(4) 'Reported' is based upon actual net income for the past year (trailing four quarters); 'Adjusted' is an inflation-adjusted multi-year average; 'Crestmont' see note 2
(5) P divided by E

CURRENT STATUS **(Third Quarter 2023)**

In the third quarter, the stock market decreased by -3.6%, and normalized P/E decreased to 32.1. The Adjusted P/E (Shiller's CAPE P/E10) fell to 28.8. Both normalized values are above the As Reported P/E of 22.9. All versions of P/E are relatively high for an environment with elevated inflation and rising interest rates.

For now, the stock and bond markets expect the recent surge in inflation will moderate back near 2% within the next three to five years. The outlook for inflation over the subsequent five years is currently expected to average 2.5%. Inflation at that level would justify normalized P/E in or below the low 20s.

Despite the decline in EPS last year-end, the market appears to accept that the doubling of EPS during 2021 will remain the new base level for future EPS growth. That is the most significant assumption driving the current level of the stock market. The next few years, and potentially some point in the meantime, will be determined by the future level of EPS.

Note: The comments provided above about the current status of market valuation do not incorporate the concepts discussed in the new article titled The Big Shift *[see Featured Items at CrestmontResearch.com]. Until the likelihood of such secular realignment can be validated, this report and its conclusions will be based upon historical relationships and data.*

Figure 6. Stock Market Gain/Loss To Low Inflation P/E Levels

	AS OF: SEP 30, 2023			CRESTMONT[2]
“P”	Closing Price (S&P 500 Index)[3]			4288
“E”	Current Estimate (S&P 500 EPS)[4]			$134
P/E	Price/Earnings Ratio[5]			32.1
		P/E	EPS	
	3-Year Restoration (2Q2026)	22.5		
	Projected Normalized EPS[2]		$156	
	Implied S&P 500 Index			3467
	Annual Compounded Gain			-6.5%
	5-Year Restoration (2Q2028)	22.5		
	Projected Normalized EPS[2]		$173	
	Implied S&P 500 Index			3835
	Annual Compounded Gain			-2.0%

Notes 1-5: see footnotes in Figure 1

Figure 7. Crestmont Research Outlook (S&P 500 Total Return)

AS OF: SEP 30, 2023 — ***ANNUALIZED TOTAL RETURN FOR S&P 500*** *(nominal returns)*

	Ending P/E Ratio (P/E10)		
YEARS	**10**	**15**	**22.5**
5	-14.4%	-7.4%	0.3%
7	-8.8%	-3.4%	2.2%
10	-4.7%	-0.9%	3.2%
20	1.1%	3.1%	5.2%

Notes 1-5: see footnotes in Figure 1; also, includes dividend yield of 2%

CONCLUSION

Today's normalized P/E is 32.1; the stock market remains positioned for below-average long-term returns. The valuation level of the stock market is above average. Relatively high valuations lead to below-average returns. Further, the valuation level of the stock market is relatively high given the currently elevated inflation rate and interest rate environment.

This summary assesses the current valuation level in the context of the longer-term market environment. The goal is to help investors and market spectators assess the current conditions more quickly.

In this environment, as described in Chapter 10 of *Unexpected Returns*, investors can take a more active "rowing" approach (i.e., diversified, actively managed investment portfolio) rather than the secular bull market "sailing" approach (i.e., passive, buy-and-hold investment portfolio over-weighted in stocks).

Ed Easterling is the founder and president of Crestmont Research. He is the author of award-winning Unexpected Returns: Understanding Secular Stock Market Cycles and Probable Outcomes: Secular Stock Market Insights*. In addition, he previously served as an adjunct professor and taught a course on alternative investments and financial markets for MBA students at SMU in Dallas, Texas. Mr. Easterling publishes provocative research and graphical analyses on the financial markets at www.CrestmontResearch.com.*