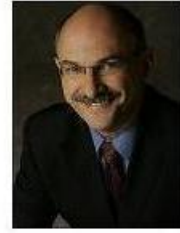


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FINANCIAL MANAGEMENT



## Is The Stock Market Too Expensive?

By now, many of my listeners and readers are familiar with the intellectual challenge, exhilaration, exasperation and confusion in my line of work – this devilish work which I embrace most wholeheartedly. When I try to make sense of my friend and nemesis - the market – there are six-metrics I can turn to. With the help of Jacob Wolinsky, I present them to you.

1. **P/ E-TTM Ratio** which is the market's index price (P) divided by its earnings per share for the past or trailing twelve months (E-TTM.) This ratio is currently at 18.3 for the market as a whole – slightly higher than the 17.2 reading last month and suggests the market may be slightly overvalued.
2. **P/E-10 Year Ratio** uses average earnings per share over the past 10 years to smooth out fluctuations due to unexpected events such as say 9/11. This ratio is currently at 20.5 and indicates that the market may be overvalued.
3. **Dividend Yield** is the ratio of the S&P 500's annual dividends to its index price. The average dividend yield for stocks is currently at 1.99%, lower than 2.13% from last month.

Dividend Ratios have shown to be an unreliable indicator of market valuations, but we keep an eye on them anyway.

4. **Price / Book-Value (P/BV)** currently averages 2.09, marginally below the 2.11 This is well below the 30-year average of 2.41 for the S&P 500 - suggesting that the market may be slightly undervalued.

Note: Legendary investor Martin Whitman believes P/BV is a better measure of value than P/E because book values are harder to fudge than earnings, and are less affected by near-term economic cycles.

5. **Total Market Capitalization / GDP** ratio currently stands at 78.7%, higher than 73.4% last month. This ratio has historically ranged between 35% in 1982 and 148% in 2000.

**Note:** Warren Buffett believes that this ratio is "probably the best single measure of where valuations stand at any given moment" and investing website, GuruFocus, predicts that based on current levels for this ratio, the market should return about 6.5% in the coming year.

6. **Tobin's Q** is the ratio of market capitalization to the replacement value of all of the company's assets. Q is currently at 0.98 compared to 0.92 last month and an average of 0.72 over the past several decades. Some estimate that the market may be over-valued by 39% based on Tobin's Q.

To recap, the measures are mixed. 3 suggest over-valuation, 1 fair-value and 1 undervalued.

Based on my decades of experience analyzing such valuation ratios, I believe the market is moderately overvalued at current levels. These levels would suggest single digit market performance over the next 5-7 years, and predict that returns will at least meet or beat inflation, but not offer the high returns we have come to expect.