Brinker Capital

WEEKLY WIRE | NOVEMBER 18, 2019

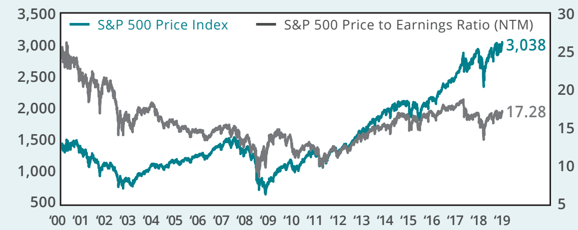
Earnings yield - What it is and what it says about stocks today

We would argue the most popular way to value individual stocks and the stock market is using earnings, with investors taking what a company or the market has earned ("reported earnings") or what a company or the companies that make up the market are expected to earn ("estimated earnings") and applying a multiple ("Price to Earnings" or "P/E Ratio") to that number and arriving at how a company or the market is valued or how they think a company or the market should be valued, typically using the S&P 500 as a proxy for the broad market. Investors often disagree about what constitutes a "fair" multiple for a company or the market, but most agree a low interest rate environment supports a higher multiple, which is one of the reasons we feel the S&P 500 isn't overvalued at 17x its next twelve month ("NTM") earnings. While using earnings is the most popular way of valuing a stock or the stock market, it is also an absolute approach to valuation, meaning it doesn't really help us consider the valuation of the stock market relative to other asset classes, which brings us to the point of this week's Weekly Wire, which is Earnings Yield, which is simply the inverse of the market's P/E Ratio and a great tool for comparing stocks and bonds and a number easily arrived at… for example, if the S&P 500 is at 3,037 and Wall Street expects the index to produce $176 in EPS over the NTM it has a NTM P/E of 17x (3,037/$176) and an earnings yield of 5.8% ($176/3,037).

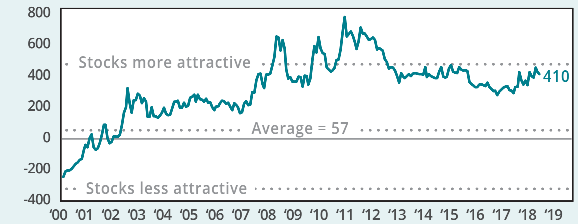
Since the two asset classes of greatest importance to most US investors are US stocks and US bonds – one has historically been a hedge against the other and US investors are most impacted by how our markets are doing – it makes sense to think about the valuation of US stocks and US bonds on both an absolute basis and relative to each other, which brings us back to the earnings yield of the S&P 500 and how it compares to the yield of the US 10-year note. At the end of October, the 5.8% earnings yield of the S&P 500 was more than 400 basis points – or 4% -- higher than the yield of the US 10-year note (5.8% - 1.70%), and historically such a positive spread has indicated US stocks are attractively valued relative to bonds. To put the spread between the earnings yield of the S&P 500 and the yield of the US 10-year note in greater historical context, just before the stock market bubble of the late 1990s burst the yield of the US 10-year note EXCEEDED the earnings yield of the S&P 500 by more than 200 basis points.

We continue to believe that US stocks are reasonably valued on an absolute basis, and attractively valued relative to traditional fixed income.

S&P 500 Price Index



S&P 500 Earnings Yield - 10-Year Treasury Yield (bps)



Stocks, bonds, and commodities (11/16/19)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	3120.46	4.83%	24.48%	14.04%
MSCI AC World ex USA	290.55	4.52%	13.76%	8.48%
MSCI EAFE	1976.69	4.62%	14.93%	9.04%
MSCI EM	1048.79	4.77%	8.60%	6.34%
Bloomberg Barclays US Agg	105.68	-0.53%	5.58%	7.34%
Crude Oil WTI	57.93	7.14%	27.57%	2.21%
Natural Gas	2.68	14.85%	-6.14%	-37.36%

Treasury rates (11/16/19)

	Price	Yield
2Y	99.246 / 0.000	1.614
3Y	100.010 / 0.000	1.612
5Y	99.092 / 0.000	1.648
7Y	99.056 / 0.000	1.750
10Y	99.066 / 0.000	1.835
30Y	101.096 / 0.000	2.313

Weekly reports

This week

- Philadelphia Fed Index
- Markit PMI Mfg.

Last week

- NFIB Small Business Index 102.4
- Capacity Utilization 76.7

Brinker Capital Market Barometer

NOVEMBER 2019

The weight of the evidence leans positive, in line with our modest overweight to risk across portfolios.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	→			●	Market momentum continues to improve
Trend	→			●	S&P 500 Index hit new high; trend is solid
Investor sentiment			●		Sentiment survey data shifted more neutral; equity flows still negative
Seasonality				●	4Q tends to be the most constructive for equities

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Fiscal stimulus potentially offset by tariffs in 2020
Monetary policy				●	The Fed has cut three times and remains accommodative
Inflation				●	Global inflation low and inflation expectations muted
Interest rate environment			●		US yield curve has largely “un-inverted” but more progress is needed
Macroeconomic			●		Global growth slowdown but still positive; US/China trade war concerns
Business sentiment	←	●			CEO confidence has fallen sharply; small business confidence still elevated
Consumer sentiment				●	Measures have ticked down but remain at elevated levels
Corporate earnings			●		US earnings growth slowing but positive; weaker ex-US
Credit environment				●	Credit spreads have tightened; little sign of stress in financial conditions

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation			●		US equity valuations at long-term averages; more attractive ex-US
Business cycle	←		●		Longest expansion on record but also the slowest
Demographics			●		Mixed (US and emerging markets positive; developed int’l negative)