Client's Corner

"The Market's Too High." Where Have I Heard That Before?

Check in with your financial advisor on this issue, but I suspect he/she will agree: the market can't be consistently timed, not least of all because the economy can't be consistently forecast.

I'VE BEEN READING, WATCHING AND LISTENING TO FINANCIAL journalism for more than five decades. I think it's fair to say that the general tone of the more popular financial "news" outlets is one or the other of two common overviews.

When the equity market has declined enough for most investors to get worried, financial journalism is always there to say: yes, stocks may have gotten cheaper—that is, their valuations may have improved—but they can get a whole lot cheaper because of this, that and the other economic/financial crisis. Don't buy.

And when the market has rallied considerably, journalism says: stocks are overvalued and the market's too high; they can't go up much further—if at all—from here. Don't buy.

I've concluded from this that in the world of financial "news," it's never really a good time to buy stocks. This is odd, because since the end of WWII, mainstream equities have been compounding at 11% annually. You would think there must have been at least a couple of moments along in there when "Don't buy" was not actually very good advice.

But I digress.

I was prompted to write this little essay by an interview I saw just this morning on one of the two all-day financial "news" cable channels. And a fellow who has a lot of very serious credentials was saying that the market (at 4,770 on the S&P 500) is "significantly overvalued."

The interviewer seemed eager to hear this, and proceeded to ask where the interviewee thought we should park our money, presumably to wait for stocks to stop being overvalued. I confess I don't remember what the fellow said.

You see, I thought there were a couple of really good questions he might have been asked—better questions than "Where should we hide out?" But he wasn't. So I thought I'd pass them along to you, just in case you yourself encounter someone saying, very authoritatively, "The market's too high/overvalued."

The two follow-up questions I'd hoped to hear, in no particular order, are:

"How are you defining overvaluation?"

"Have you found valuation to be an effective market timing tool?"

I'll be the first to acknowledge that the S&P 500's price to earnings ratio (again, at 4,770) is higher than its average. Specifically, using FactSet's consensus earnings estimate for 2024 of $245, the P/E is 19.5. My handy Guide to the Markets from JP Morgan Asset Management tells me that the 30-year average P/E is 16.6.

But if I look back at March 2000, when the 12-month forward consensus P/E was 25.2—or even at January 2022, when it was 21.4—I'm inclined to say: Yes, the current 19.5 is well up on the high side of average, but it's nowhere near unprecedented. It's not a number that's, like, ***never been seen before.***

(By the way, a dollar invested in the S&P 500 in March 2000 and left to compound is five dollars today. Though that's below the Index's long-term average return, I suspect that there are any number of people who've been chasing their tails trying to time the market since 2000, who might be very glad to have gotten that return. But that's neither here nor there.)

My other question—the better one—is whether the expert on deck today has found valuation to be an effective market timing tool. Because the overwhelming statistical evidence I've seen suggests that it's not—and that neither is anything else.

By all means check in with your financial advisor on this issue, but I suspect he/she will agree: the market can't be consistently timed, not least of all because the economy can't be consistently forecast.

Successful long-term equity investing is first and foremost about compounding. And as the late, lamented Charles Munger so memorably said, "The first rule of compounding is never to interrupt it unnecessarily."

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Sources: Standard & Poor's, JP Morgan Asset Management, FactSet, DQYDJ/Robert Shiller.