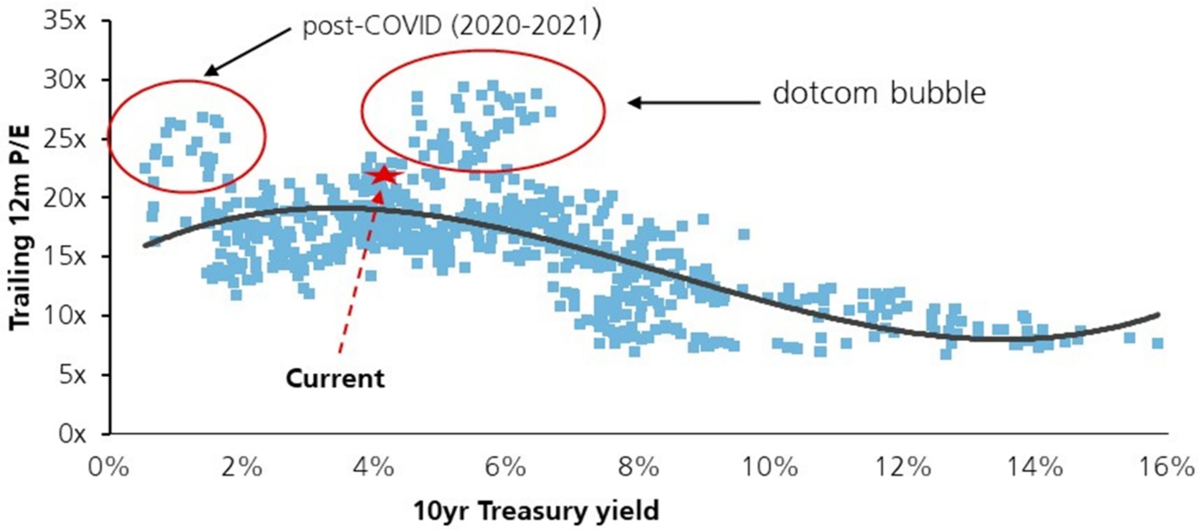
Current valuations are trading close to the average trend in relation to 10-year Treasury yields

S&P 500 trailing P/E, x, and 10-year Treasury yield, %



Source: Refinitiv, Bloomberg, UBS, as of March 2024

Despite record highs, the market is in line with fundamentals

05 March 2024, 8:28 pm CET, written by UBS Editorial Team

The S&P 500, our proxy for US equity markets, has been grinding higher for quite a few months now, persistently posting new record highs. This outstanding rally—roughly 25% since last October's lows—has taken place amid better-than-expected results from companies leveraged to AI, a stronger-than-expected economy, inflation that has generally trended lower, and policymakers signaling that they will likely start cutting rates this year. Hence, it should come as no surprise that as the market keeps climbing higher, investors are starting to wonder whether we are nearing a cliff. It is an understandable concern, but this risk seems no higher than normal, in CIO's view.

The chart above is one of the many metrics that provide the Chief Investment Office with confidence that the recent market performance is largely justified. The current relationship between the market's 12-month-trailing price-to-earnings ratio relative to the 10-year US Treasury rate is largely in line with historical averages (see the red star and its proximity to the trend line).

In moments when valuations have been clearly stretched, they stray notably from the trend line (see the red circles). The dotcom bubble (1999–2000) was a clear moment when risk appetite resulted in too much exuberance in risk assets. Similarly, in the post-COVID period, fiscal and monetary stimulus and large accumulated savings, along with the rise of retail trading platforms, largely influenced unwarranted valuations.

However, this week's chart, in line with other analyses that CIO has carried out, shows that equities on average are trading neither "expensive" nor "cheap." Rather, the market seems appropriately priced.

Therefore, even though at first blush—and amid the stories of new historic highs—some may be concerned, CIO thinks the risks investors face right now are pretty much the same as those of any other period. Perhaps, that is why the VIX index, a measure of market volatility, is currently below its average in the 2010–19 period (a pre-pandemic benchmark).

So, while pullbacks are always possible, CIO thinks investors should stay calm and remain invested.

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