Harry's Take

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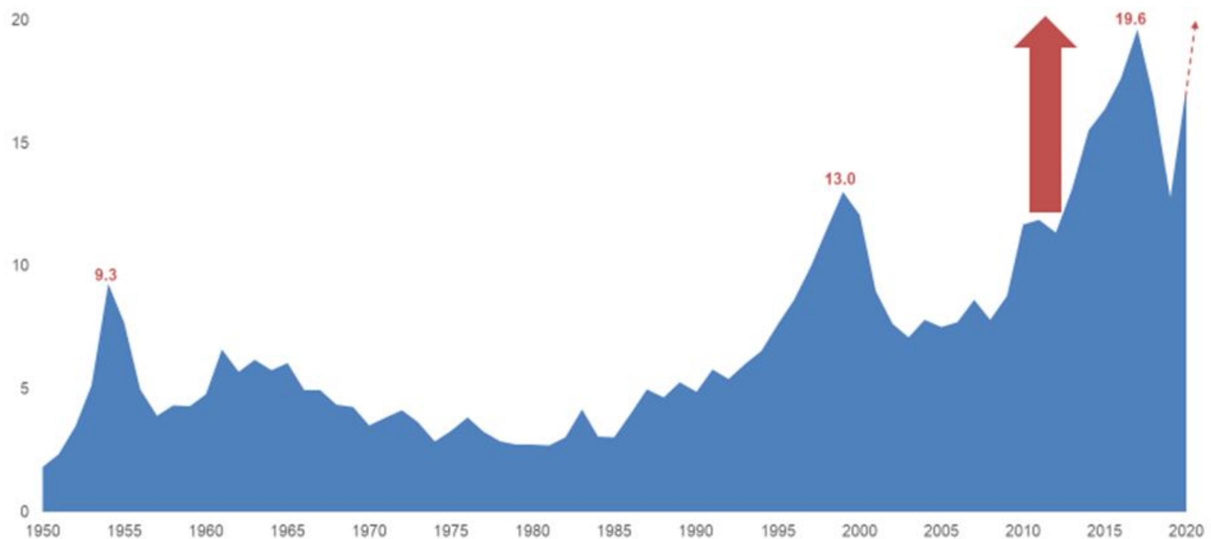
Bubbleheads Say Stocks Are Not That Overvalued: They Are, More Than Ever!

This article is a must-read for our newer subscribers who have come in since late last year. One of the many ways that analysts and economists justify such an extreme market during the bubble is by comparing the price-to-earnings (P/E) ratio with past peaks and saying, "It's not as high as it was in the last tech bubble that peaked in early 2000."

The best model for measuring valuation comes from Robert Shiller. He took the standard P/E ratio and adjusted it for the cyclicality of earnings, which can distort that model very severely, especially around tops and bottoms. He used a 10-year average of earnings, which was a big improvement. But even that model shows that over the past century, out of 7 major tops, the present market is lower only than the market was during the very extreme peak of early 2000. The present P/E ratio is 34.6, lower than during that rare period, at 44.2. But the third-highest peak, at 33.2, was in the extreme scenario of 1929, and that's the previous one on my infamous 90-year Super Bubble Cycle.

That gives little cause for comfort, but it is still a great understatement in this weird period. We don't usually see such frothy markets and high valuations when the economy is growing sooo slowly—and never mind the massive stimulus needed to achieve even that. Average growth since 2012 has been a mere 1.65%, vs. 4.08% during the last tech bubble.

Hence, I take the next obvious step and adjust Shiller's model for GDP growth using the same 10-year average Shiller used to smooth out earnings. Would a stock have the same valuation at a low earnings growth rate as a higher one? Of course not! Here, you get the real picture of this sucky economy!



Now, the valuation on this model at a 19.0 P/E is 51% higher than the 13.0 P/E in 2000. It is 110% higher than the peak valuation before that, after World War II in 1954, at a 9.3 P/E.

So, who are you going to listen to? Bubbleheads… or me?

Harry

Got a question or comment? You can reach us at info@hsdent.com.