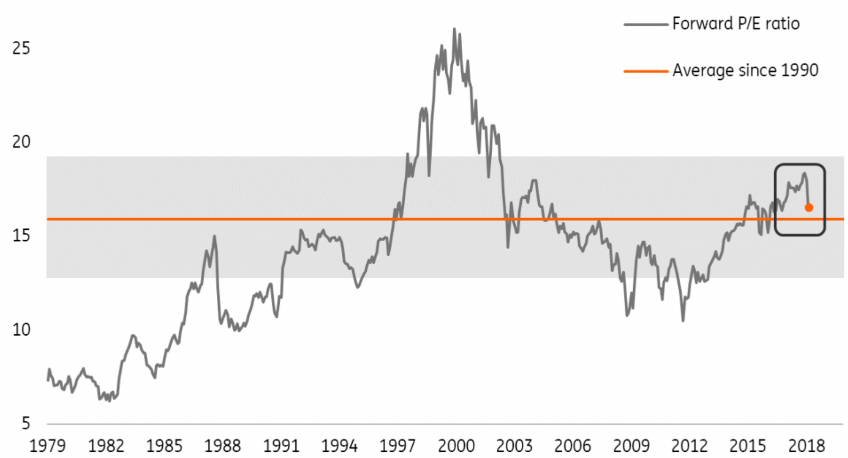
Article | 16 April 2018

Sliding equity valuations... is it price or earnings?

After reaching its post-crisis peak in early 2018, diminishing risk appetite amid higher trade and geopolitical uncertainty on the surface has weighed on the US equity market. But given that most of the adjustment in the forward price-to-earnings ratio has been due to falling prices - and not stronger earnings - this suggests risky assets remain supported in the absence of any further rise in trade or geopolitical tensions

S&P500 forward price-to-earnings ratio is drifting back to its long-run historical average

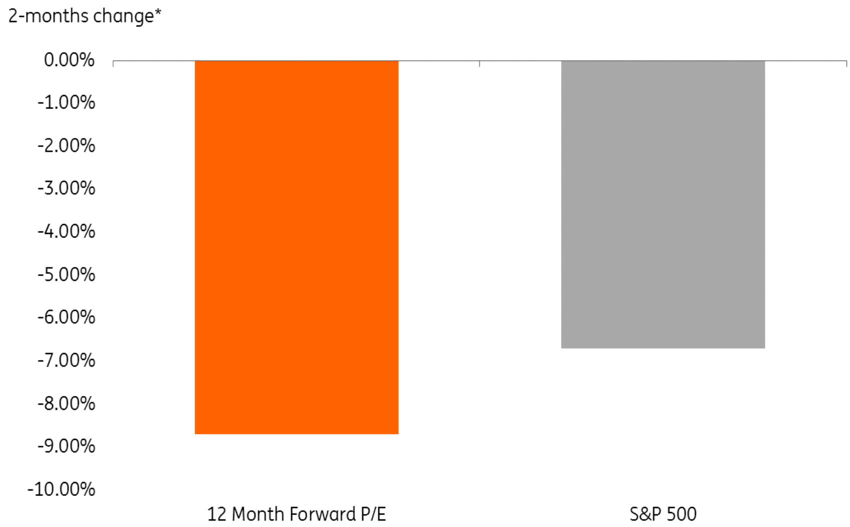


Source: ING estimates

The stock market correction explains most of the fall

A closer look at the data in the last two months suggests that around two-thirds of the adjustment is due to the recent stock market correction, but because the forward price-to-earnings ratio declined more than the S&P500, we think that some of the remaining change might be explained by higher earnings estimates due to the US tax bill. In either case, we need to take these numbers with a pinch of salt.

Firstly, the 25-year average of price-to-earnings ratio has been skewed by the early 2000s dot-com bubble. Secondly, all this comes against the backdrop of higher trade and geopolitical risks, although as our economists suggest here and here, the underlying story of the US economy remains positive, especially given strong domestic growth, the competitive exchange rate and the strengthening global economy.



Source: ING estimates;
*data from Feb 2018 - Mar 2018