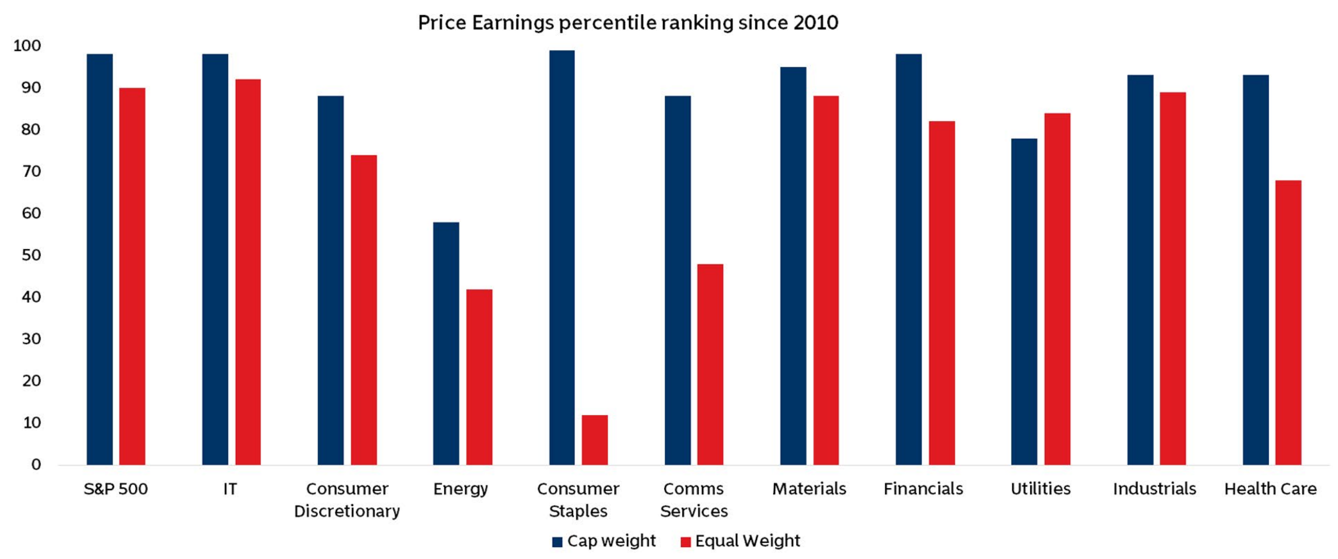
Chart of the Week

16 December 2024



Source: Bloomberg Finance L.P., December 2024.

Can US equity valuations be justified?

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What this chart shows

This chart shows a detailed view of US equity valuations, not only presenting the current market valuation as a percentile relative to the past 14 years but also breaking it down by sector. A closer look at the sectors reveals factors that make the broader index seem more expensive than it might otherwise appear. While elevated valuations of mega-cap stocks play a significant role, even an equal-weighted measure suggests that stocks remain high, trading at 19.1x earnings. These lofty multiples naturally generate headlines and raise concerns about long-term returns, but it's important to consider the underlying factors driving these elevated levels.

Why this is important

It is important to look past the headlines for greater granularity, especially over the basis of that valuation. In 2010, tech-related companies made up 18% of S&P 500 market cap; today it is circa 40%. Over this period, the fundamentals have improved as they have grown their revenues faster, with higher margins. Turning to S&P 500 companies in general, they have become less capital intensive, with both TECH+ and non-TECH+ companies becoming far more cash flow generative. Higher free cash flow companies generally return more to shareholders and should trade at higher P/E ratios. Using a combination of treasury yield and credit spreads suggest the current cost of capital is lower than the long-term average supporting a higher multiple.

Many investors assume that stock valuations, or equity risk premia, mean revert toward fair value, yet multiples generally only contract during recessions. The current consensus suggests above average earnings growth and accommodative monetary policy. Some caution is required at current euphoric sentiment/levels and clearly if monetary policy is less accommodative, due to inflationary surprises or fiscal sustainability concerns driving term premia higher and/or growth declines to promote recession risks, then multiples could contract sharply.

Weekly market update

week ending 13 December 2024

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Global financial markets navigated mixed signals from central banks, with US and European policymakers leaning towards rate cuts while Japan maintained its dovish stance. Inflation trends, regulatory challenges in tech, and commodity price dynamics shaped the week's movements.

US

» US markets saw mixed movements with strong performances in the tech sector driving Nasdaq to new all-time highs. Meanwhile, the Dow lagged, weighed down by energy and utilities.

» Inflation data remained a key focus, as markets anticipated a potential interest rate cut by the Federal Reserve following "lukewarm" labour market updates.

» Significant stock movements included Nvidia facing pressures from ongoing China tech probes however, Donald Trump has said to have invited Xi to his inauguration.

» Consumer discretionary sectors posted gains, signalling consumer confidence despite broader market volatility.

UK

» The Bank of England hinted at potential monetary policy adjustments as inflation data showed slower-than-expected progress towards targets.

» Consumer spending trends improved, boosting retail and housing market sentiment.

» Sir Keir Starmer will task local UK councils with meeting mandatory housebuilding targets to help meet his goal of delivering 370,000 homes per year.

» The UK government plans to slash more than 10,000 civil service jobs amid a cost-cutting drive. Chancellor Rachel Reeves has vowed to tackle "wasteful spending" and find savings of up to 5% within departments.

Europe

» The European Central Bank cut rates by 25 basis points, signalling a dovish tone amid subdued growth and moderating inflation.

» Energy prices remained stable, offering relief to industries, though labour strikes in France created logistical disruptions.

» German industrial production data showed unexpected resilience, suggesting a potential stabilisation of the eurozone's largest economy.

» The top European stock index gained, driven by strong performances in the healthcare and consumer goods sectors.

Rest of the World/Asia

» China's export figures showed a slight rebound in November, but domestic consumption remained sluggish, challenging the recovery narrative.

» China's 10-year bond yields slid to a record low on hopes of policy easing

» The yen stabilised after recent declines, as the Bank of Japan maintained its ultra-loose monetary policy stance.

» Commodity-dependent economies like Brazil and Australia benefited from higher metal and energy prices.

Weekly market data

week ending 13 December 2024

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Asset Class / Region	Currency	Cumulative returns: Week ending 13 December	Month to date	YTD 2024	12 months
Developed Markets Equities					
United States	USD	-0.6%	0.4%	28.0%	29.8%
United Kingdom	GBP	-0.1%	0.1%	11.0%	13.8%
Continental Europe	EUR	-0.9%	1.6%	9.0%	10.2%
Japan	JPY	0.7%	2.5%	18.6%	19.4%
Asia Pacific (ex Japan)	USD	-0.2%	1.6%	13.2%	19.8%
Australia	AUD	-1.5%	-1.7%	13.2%	18.5%
Global	USD	-1.0%	0.2%	22.1%	24.9%
Emerging Markets Equities					
Emerging Europe	USD	-0.7%	4.8%	9.1%	11.6%
Emerging Asia	USD	0.2%	2.8%	14.8%	20.7%
Emerging Latin America	USD	0.1%	0.2%	-21.5%	-16.2%
BRICs	USD	0.3%	2.5%	13.3%	17.3%
China	USD	0.5%	3.1%	19.9%	23.3%
MENA countries	USD	0.8%	2.3%	1.5%	6.2%
South Africa	USD	1.2%	4.8%	18.5%	30.7%
India	USD	0.2%	2.4%	13.2%	17.7%
Global emerging markets	USD	0.3%	2.7%	10.6%	16.5%
Bonds					
US Treasuries	USD	-1.4%	-1.0%	1.2%	2.3%
US Treasuries (inflation protected)	USD	-1.0%	-0.8%	2.7%	3.6%
US Corporate (investment grade)	USD	-1.3%	-0.8%	3.8%	5.1%
US High Yield	USD	-0.3%	0.2%	8.8%	11.3%
UK Gilts	GBP	-0.9%	-1.2%	-2.4%	-0.1%
UK Corporate (investment grade)	GBP	-0.2%	-0.1%	2.6%	5.1%
Euro Government Bonds	EUR	-0.9%	-0.7%	2.6%	3.9%
Euro Corporate (investment grade)	EUR	-0.2%	0.0%	5.1%	6.6%
Euro High Yield	EUR	0.2%	0.8%	8.8%	10.5%
Global Government Bonds	USD	-1.3%	-1.1%	-1.6%	0.9%
Global Bonds	USD	-1.3%	-1.0%	-0.3%	2.1%
Global Convertible Bonds	USD	-0.9%	-0.6%	7.9%	11.5%
Emerging Market Bonds	USD	-0.8%	-0.1%	7.1%	10.1%

Asset Class / Region	Currency	Cumulative returns: Week ending 13 December	Month to date	YTD 2024	12 months
Property					
US Property Securities	USD	-1.6%	-4.0%	11.6%	14.1%
Australian Property Securities	AUD	-2.0%	-4.7%	17.2%	22.4%
Asia Property Securities	USD	-2.6%	-1.7%	-7.9%	-2.6%
Global Property Securities	USD	-1.9%	-3.3%	6.4%	10.8%
Currencies					
Euro	USD	-0.5%	-0.7%	-5.1%	-2.7%
UK Pound Sterling	USD	-0.8%	-0.8%	-1.1%	0.9%
Japanese Yen	USD	-2.4%	-2.6%	-8.4%	-5.5%
Australian Dollar	USD	-0.3%	-2.5%	-7.0%	-3.3%
South African Rand	USD	0.8%	0.7%	2.1%	6.7%
Swiss Franc	USD	-1.5%	-1.3%	-6.0%	-1.7%
Chinese Yuan	USD	0.0%	-0.4%	-2.4%	-1.4%
Commodities & Alternatives					
Commodities	USD	2.0%	1.4%	6.0%	9.3%
Agricultural Commodities	USD	0.1%	0.6%	4.2%	4.5%
Oil	USD	4.7%	2.1%	-3.3%	0.3%
Gold	USD	0.6%	0.2%	28.4%	33.6%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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