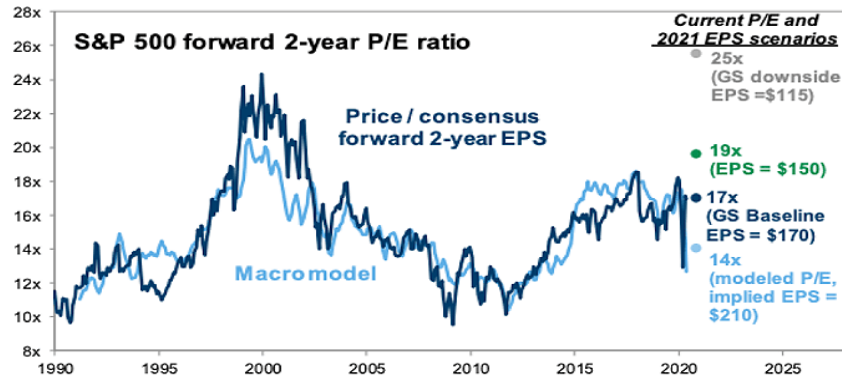


Some Ideas on Stock Market Valuation

July 12, 2021

As of Friday, all three major stock market indices achieved record highs. As the stock market continues to set records, many observers have attempted to demonstrate that the stock market is overvalued, and investors should be “safe” and reduce their holdings in stocks. One of the traditional measures of stock market value is the P/E ratio or a measure that divides the price (of a stock or the market) by the earnings per share (of a company or of a specific index). In the current environment, this ratio is not overly bullish at 17x as can be seen in the chart below. This measure is likely to fall as earnings surge into 2022 and beyond.

Exhibit 2: Current P/E valuation based on 2021 EPS scenarios
as of May 7, 2020



Source: Compustat, IBES, Goldman Sachs Global Investment Research

No matter how many years of experience we have, there is no sure way of forecasting the future of the economy or the stock market. The P/E ratio may be a good indicator of value in an historical context, but does it give us any solid evidence of where the stock market is going?

Recently we have come across some indicators that the stock market could go a lot higher even if P/E ratios are near or at all-time highs. The first indicator is the price a company will pay to acquire another company. Spending billions of dollars to purchase a company requires a lot of financial and market research that contribute to the final decision. One good example of this decision is the recent agreement by Stamps.com to be acquired by private-equity firm Thoma Bravo in an all-cash deal that values the e-commerce shipping software company at about \$6.6 billion. Stamps.com stockholders will receive \$330 a share in cash, a 67% premium over the company’s \$197.72 closing price last Thursday. Does the buyer really think that the company commands a 67% premium over the market where everything is supposedly valued by millions of investors as reasonable? Or is the overall market still undervalued when individual companies are concerned?

In other words, the economy is likely to improve and the stock market will reflect that improvement. Or has it already? We keep looking for these confirming indicators that the bull market in stocks will continue.