13th September 2021

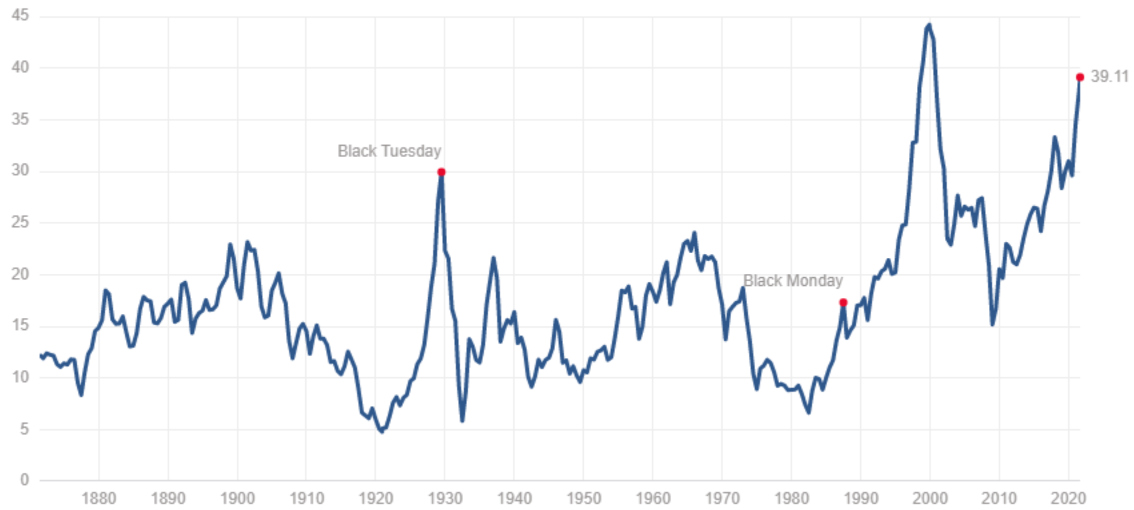
S&P 500 Indicators

The Cape Shiller Index

The 'CAPE' ratio (Shiller P/E ratio) is a valuation metric applied to the US S&P 500 equity market. It measures real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle The index is generally used to assess whether the market is undervalued or overvalued. It considers the impact of the economic influences by comparing a stock price to average earnings, adjusted for inflation.

The index ratio is currently almost at a record high, sitting at 39,11%, as indicated by the graph below. The S&P 500 has only been this expensive for 4% of the past 140 years. Owing to very accommodative monetary policy from the US Federal Reserve (the *Fed*), stocks on the S&P 500 have been propelled upwards, unhinging them from the fundamentals which usually drive valuations. The significant momentum in the ICT sector (FAANG Bubble) has owed much to the COVID pandemic keeping consumers in lockdown conditions and spending much time online. However, valuations are stretched, trading well above their long-term means, like what was witnessed in the 2000 tech bubble.

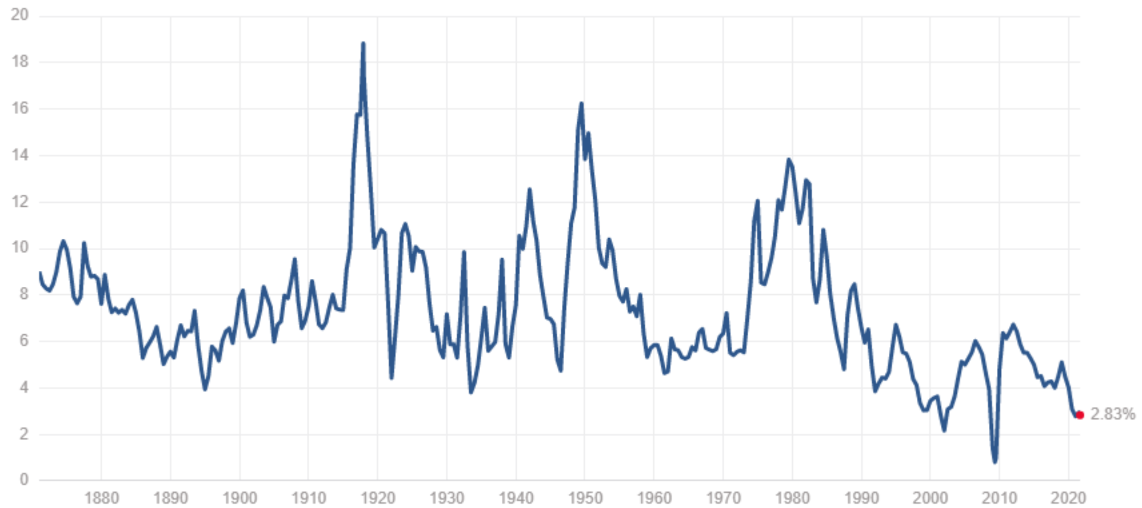
**Cape Shiller Index Ratio – 31st August 2021*



Email: roscoecj@rockmancap.com | http://rockmancap.com | Telephone: + 230 214 2251
3 River Court, St Denis Street, Port Louis, Mauritius

The S&P 500 earnings yield

**S&P 500 Earnings Yield 31st August 2021*



Relative to the CAPE ratio, we also consider the S&P 500 earnings yield. This currently sits at a low 2,83%. As the average dividend yield across the S&P 500, this value indicates the level of return investors are receiving from taking the risk of investing in US equities. However, with US inflation rate, currently at 5,2%, substantially greater than normalized interest rates, investors real rate of return is in fact negative. Over the last couple of years we have witnessed stock share prices increase greater than their increase in earnings. This is owing to numerous factors, including:

- The continuous printing of money by the FED.
- Highly accommodative fiscal policies by all major global economies.
- The refinancing of corporate debt, at record low interest rates.
- Momentum in valuation growth in the S&P 500, led by the FAANG stocks.
- High levels of liquidity and retail traders, driving momentum, through stock- platforms such Robinhood.

As a house, we remain cautious when entering the market. We believe there is significant risk to the downside in the present market. We focus on defensive, strong balance sheets, low beta, consistent dividend paying sectors, diversified earnings basis, large moats and market leadership.

The Taper Tantrum

Since March 2020, the Fed has printed USD 4.2 trillion (the Fed's balance sheet is presently USD 8.3 trillion). This is to ease capital market liquidity constraints, reduce long-term interest rates and in the face of COVID-19 shut-downs, support the US economy. Tapering refers to the withdrawing of Fed support to capital markets.

On the back of uncertainty regarding the stickiness of inflation, volatility again has returned to capital markets. This is owing to uncertainty around the Fed's timing on the easing up of asset repurchases and the possible raising of interest rates. As a house, we currently believe that the Fed will remain hesitant in the face of the delta COVID-variant and delay changing tack. This is until they have certainty around the strength of the economy's recovery and the trajectory of inflation.