

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.

Delta manages portfolios at TD Ameritrade and Schwab.

Please contact Delta at info@deltaim.com or 415-249-6337 to learn more.

October 15, 2021

What Should the S&P 500 P/E Be?

Consensus analysts' estimates for the S&P 500 earnings in 2022 is \$220.47. The S&P 500 index is trading at about 4430 currently. If we divided Price (P, 4430) by earnings (E, \$220.47), the S&P 500 P/E on 2022 estimated earnings is roughly 20x. Based on these inputs, that is the number. Is it "fair?"

Is it "fair" is a complex question. The Price/Earnings (P/E) multiple is both a mathematical and investor sentiment measure. From a mathematical perspective, P/E is a ratio with a numerator and denominator. Changes to these inputs mathematically cause the ratio to change.

The difficult part of understanding if the P/E is "high, low or fair" is the investor sentiment aspect. Is investor confidence too high or low. Are investors accurately predicting future events like GDP growth, earnings growth, interest rates, etc. Is the risk premium at an appropriate level?

Dollars paid to you in the future are worth less than dollars paid to you today. Dollars to be paid in the future may not be paid at all and they will be paid in depreciated dollars because of inflation. If you are handed a dollar today, you may invest it "risk-free" in a one-month US treasury and presumably have more money in the future. This is why we discount future dollars/earnings back to a present value today.

The risk-free yield today is nearly zero. All of the future expected return of the market is essentially the risk premium. The S&P 500 is currently offering an earnings yield/risk premium of about 5%. Fair?

Relative to prior market peaks in 2007 and 2000, this is very fair. The risk premium in those years was either flat or negative and the risk-free rate of return was in excess of 5% in both 2007 and 2000.

P/E includes a viewpoint on profitability and growth. Today's leading companies dwarf companies of ten and twenty years ago in terms of size, growth and profitability. Apple's market capitalization is currently \$2.3 trillion. Microsoft is \$2.2 trillion. Google and Amazon are on their way to \$2 trillion. Ten years ago, the largest company in the stock market was Walmart. Its market capitalization was roughly \$200 billion.

Relative to 10 and 20 years ago, profit margins of the S&P 500 have roughly doubled. As the S&P 500 becomes increasingly dominated by Internet/information technology/software companies rather than by capital-intensive, old-economy companies like Walmart, Exxon and General Electric, profit margins should remain elevated relative to long-term trends.



It would not be unreasonable to believe that the growth drivers of information technology/Internet/software are more powerful and durable than the drivers of growth for Walmart, GE and Exxon currently.

Covid and the Financial Crisis of 2008/09 taught us that the Federal Reserve and Federal Government will take extreme measures to support and protect American consumers and capitalism in times of severe economic dislocation. The safety net government backdrop may be adding a few points to the multiple.

Over the past 25 years, the average P/E multiple for the S&P 500 is 16.8x. Given how the leading constituents of the S&P 500 have evolved, how low interest rates have

fallen and how far the government will work to create economic stability, the current 20 P/E seems fair. In hindsight, it may even look inexpensive.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.



"Bond. James Bond."

MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

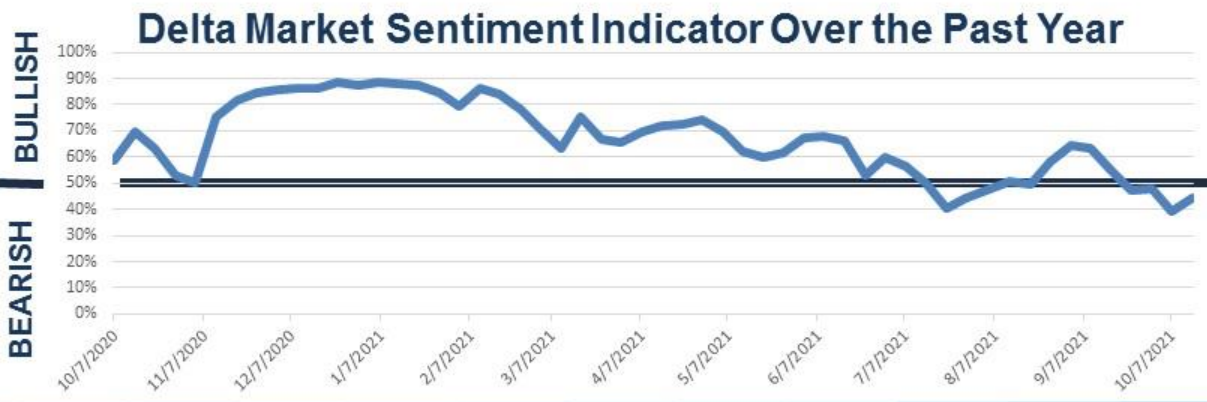
44.4

Our technical indicator increased
from 39.5 to 44.4 this week

INDICATOR STATISTICS

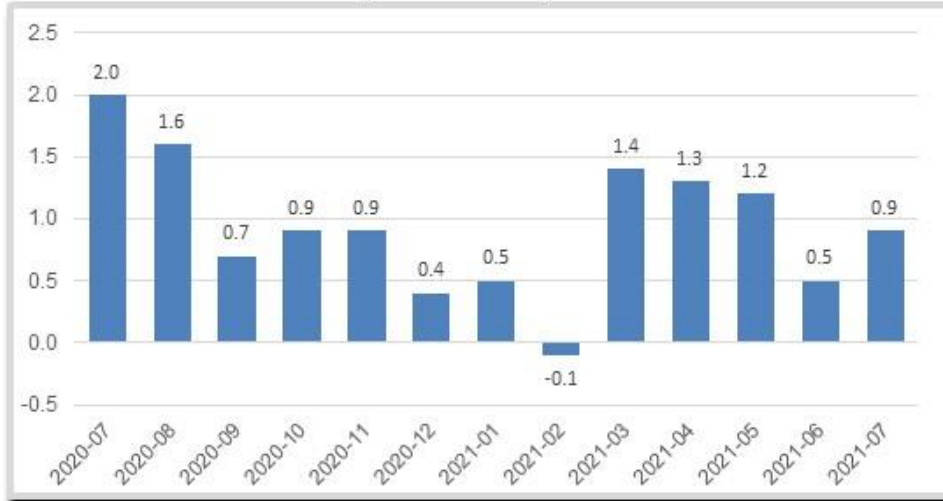
Consecutive Bearish Weeks:	2
Cycle Inception Date:	10/7/2021
Range:	39.5 – 44.4
Mean:	42.0
Bullish Weeks YTD:	36
Bearish Weeks YTD:	5
*S&P 500	0.8%
*DJIA	0.6%
*NASDAQ	1.1%

** Percentage change during current cycle*



Delta Stock Market Dashboard

Leading Economic Index % Change Monthly July 2020 – July 2021



Source: The Conference Board – last update 08/19/2021

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