Jeffrey D. Saut, Chief Investment Strategist | (727) 567-2644 | jeffrey.saut@raymondjames.com

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Morning Tack - "Valuations?!"

"Hey Jeff, we just read the attached article that says the equity markets are still over valued by most valuation metrics even after the recent decline to 2346 by the S&P 500. What say you to this article?"

. . . A Raymond James financial advisor

Said article was written by Mark Hulbert and read:

- The price/book ratio, which stands at 3.0 to 1. This ratio is lower than that at 22 of the 29 major market tops since 1929.
- The price/sales ratio, which stands at an estimated 1.9 to 1. At 18 of the 19 market tops since the mid-1950s, the price/sales ratio was lower.
- The dividend yield, which currently is 2.3% for the S&P 500. At 31 of the 36 bull-market peaks since 1900, the dividend yield was higher.
- The cyclically adjusted price/earnings ratio, which currently stands at 29.0. This is the ratio championed by Yale University's Robert Shiller. It was lower than where it is today at 32 of the 36 bull-market highs since 1900.
- The so-called "Q" ratio, which is calculated by dividing market value by the replacement cost of assets. According Stephen Wright, an economics professor at the University of London, and Andrew Smithers, founder of the U.K.-based economics consulting firm Smithers & Co., the Q-ratio currently is higher than it was at 30 of the 36 bull-market tops since 1900.
- P/E ratio. This is the valuation indicator that is currently painting the least bearish (most bullish) picture. Perhaps not coincidentally, it is the indicator that is most often quoted in the financial press. Nevertheless, according to data on as-reported earnings compiled by Yale's Shiller, and based on S&P estimates for the fourth quarter, this ratio currently stands at 18.4 to 1. That's still higher than 67% of past bull-market peaks.

While it is true by some measurements that the equity markets are expensive on a historical basis, the Price Earnings measurement may not be as good a measurement as it has been in the past. Indeed, because of the way the tax code for corporations is written as it relates to the deductibility of debt, companies are going to be accelerating their depreciation and amortization as quickly as possible. To me, this fundamentally shifts the argument about the P/E valuation of the domestic market because if companies are intentionally accelerating the depreciation of non-cash items, historical valuations go out the window. Further, there has been a tectonic shift from tangible assets on corporate balance sheets to intangible assets, which cannot be put on corporate balance sheets. So what's an intangible asset? Well, Facebook has 2.2 billion imbedded users; what are they worth? They're worth a lot, but can't be put on a corporate balance sheet as an asset. By definition, intangible assets should command a higher valuation metric than the historical norm.

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	24065.59	155.75	0.65%	3.16
Dow Jones Transports	4719.09	-13.80	-0.29%	2.47
Dow Jones Utilities	701.69	6.61	0.95%	-1.58
S&P 500	2610.30	27.69	1.07%	4.13
NASDAQ	7023.84	117.92	1.71%	5.86
Russell 2000 (Smallcaps)	1445.22	12.40	0.87%	7.17
BKX (Banking)	92.56	0.93	1.01%	7.89
BTK (Biotech)	4803.73	115.21	2.46%	13.81
XOI (Oil Index)	1249.82	3.41	0.27%	7.83
SOXX (Semiconductor)	1197.03	2.75	0.23%	3.62

Key Commodity Prices	Last	Net	
Crude Oil WTI (NYM $/bbl) Continuous	51.710	-0.40	
Gold (NYM $/ozt) Continuous	1289.200	1.00	
Silver (NYM $/ozt) Continuous	15.585	-0.03	
United States Dollar Index	96.162	0.12	
Market Valuation	**2017**	**2018E**	**2019E**
Consensus S&P 500 EPS	$132	$160	$171
P/E	19.8	16.3	15.3
Treasury Yields	**90D**	**10 Yr**	**30 Yr**
	2.44	2.71	3.07
Source: Factset Data as of:	1/16/2019		

We think a lot of investors are missing this revaluation point. Verily, if you don't change your metrics for the changing causal relationships you are doomed!

As for the here and now, the buying stampede continued yesterday, bringing the upside skein to 15 sessions as we approach the typical duration of 17 – 25 sessions. This morning the S&P futures are better by some 5 points as we write at 4:57 a.m. Due to the upcoming expiry as traders shooting for 2600 on the S&P 500 Index, the U.S. stock market has broken out of its four-day trading range. Thus, Thursday's Outside Day was resolved to the upside. However, the breach to the upside on Tuesday was not a robust breakout. Ergo, traders will try to effect a Weird Wednesday rally that squeezes expiring calls. If there is no robust rally today, it would be a negative development. BAC and GS results could impact trading. We still think the SPX will break out above the 2600 – 2650 on this move.

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