CAPITAL GROUP

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A Caution Signal for the U.S. Equity Market?

Forward-looking U.S. equity valuations are at levels that would suggest future returns may be less robust, as shown in chart.

U.S. equity markets have been on an impressive run during the past five years. The S&P 500 Composite Index returned 15.8% on average annually from 2013 through 2017. Many measures of equity market valuations have risen during this time, including the 12-month forward price-to-earnings ratio, which measures current market price against future earnings expectations. The price-to-earnings ratio at the end of February, which was 17.0, may suggest that future U.S. stock market returns will be modest. Since 1985, when the S&P 500's price has been between 16 and 18 times earnings, annual returns in the following five-year period, on average, were around 4%. Whether this relationship will hold true moving forward is uncertain, but a flexible portfolio may help investors pivot should the investment environment become more difficult to navigate.

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