

## S&P 500 Valuation - Overvalued Until It Is Not

### Introduction

For more than a decade, analysts and investors have cautioned that the S&P 500's valuations were elevated by historical standards. Ultra-low interest rates, strong consumer demand, Fed balance sheet expansion and flows into passive investment vehicles allowed multiples to climb, while corporate earnings and AI-driven CAPEX added further support. Those tailwinds are now fading, leaving valuations high just as fundamental and macro headwinds build.

### Historical Valuation Observations Since the Great Financial Crisis

- **Post-Financial Crisis Recovery (2012–2015):** Valuation concerns emerged as multiples expanded more quickly than earnings. Critics pointed out PE ratios already stretching beyond long-term averages.
- **Pre-Pandemic Cycle (2017–2019):** The Shiller CAPE ratio stayed above 30, levels historically associated with low forward returns, while market leadership narrowed to a handful of mega-cap technology and consumer platform companies.
- **Pandemic Era (2020–2021):** Aggressive policy support sent valuations above 20x forward earnings, often compared to the late-1990s bubble.
- **Monetary Normalization (2022–2024):** Inflation drove rate hikes, while trillions in fiscal spending fueled liquidity, pushing valuations even higher.

S&P 500 (SPX) Price Growth Since 2012



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Source: Zacks

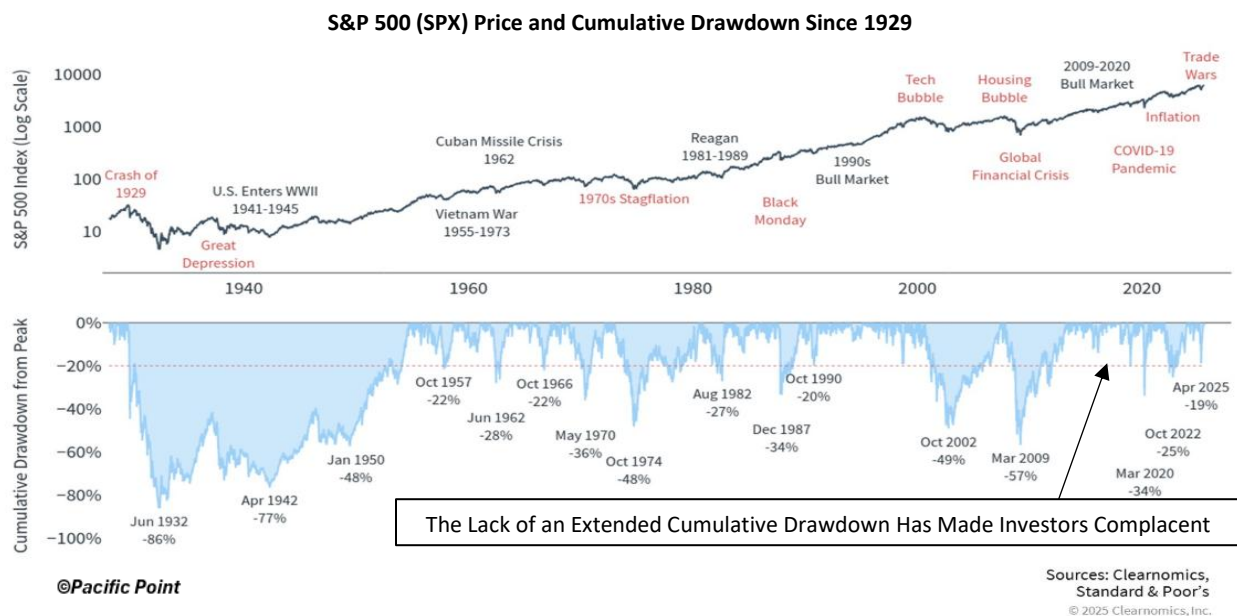


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### Impact of the Lack of an Extended Cumulative Drawdown After the Great Financial Crisis

The chart below illustrates historical drawdowns for the S&P 500 since the Great Depression and highlights that the market has experienced many prolonged downturns over the past century. Since the Great Financial Crisis, there has been a notable decline in:

1. The number of drawdowns.
2. The depth of drawdowns.
3. The recovery time of drawdowns.



***The Pacific Point Investment Committee believes that this lack of an extended cumulative drawdown period has resulted in persistent overvaluation that has made investors complacent, making the market increasingly vulnerable to slower growth, renewed inflation, or reduced risk appetite.***

This historical perspective is important for investors to consider. Our research indicates that there is now an entire generation of investors that have never faced a multi-year drawdown, and most lack the emotional experience and discipline to manage their way through such a prolonged event.



## Fundamental Evidence of Overvaluation

- **Forward P/E Multiples:** The index trades at 22.5x forward earnings versus a 15-year average of 17x. Even assuming earnings growth is sustainable, this multiple leaves little margin for error.
- **Price-to-Sales Ratios:** Now above 3.1x forward sales, surpassing dot-com bubble peaks, with half the revenue growth but margins twice as high as those seen in 2000.
- **Profit Margins Under Pressure:** Current corporate profit margins remain elevated by historical standards. Rising wage costs, higher interest expenses, and regulatory scrutiny threaten to erode margins, which would challenge earnings assumptions that justify current valuations.
- **Market Concentration:** The top ten predominantly mega-cap technology companies account for nearly 40% of the index's market capitalization but only 33% of its profits. Such concentration raises risks of overvaluation spillover, as earnings and multiple compression in these firms could disproportionately affect index performance.
- **Equity Risk Premium:** The gap between the S&P 500's earnings yield (~4.5%) and the 10-year U.S. Treasury yield (~4.1%) has compressed toward zero, signaling equities no longer offer a compelling risk-adjusted return advantage.
- **Buffett Indicator (Market Cap-to-GDP):** U.S. equity market capitalization remains above 200% of GDP, far above the long-term average near 100%. Historically, elevated readings have foreshadowed weaker forward returns.
- **Shiller CAPE Ratio:** Currently in the high-30s, compared to a long-term average of ~17x. Historically, CAPE readings above 30x have preceded periods of muted or negative real returns.

## Empirical Evidence Also Suggests Overvaluation

At Pacific Point, we model the historical performance of the S&P 500 and then use the current price to derive implied growth and earnings assumptions. As a point of reference, over the past 25 years, through three business cycles, the S&P 500 annual total return is roughly in line with the annual EPS growth rate of 6.6%.

*At the current value of the S&P 500, investors are assuming there will be no future business cycle.*

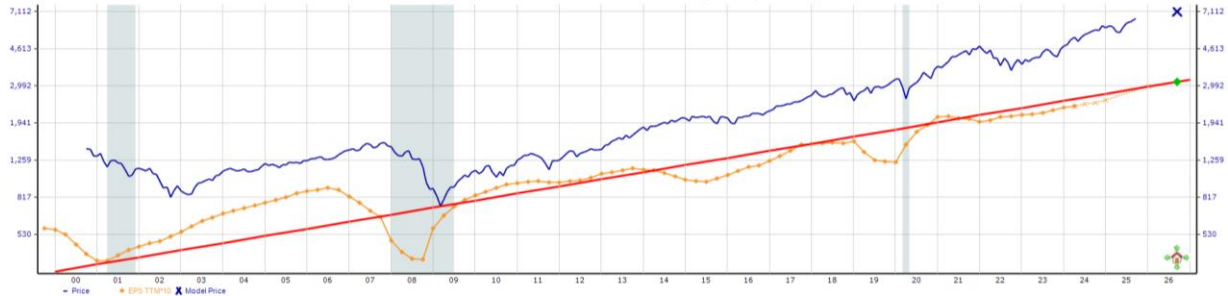
### 1. Long-term EPS growth vs. market expectations

- Zacks consensus EPS estimates for 2025 and 2026 are \$268.60 and \$300 respectively.
- History, incorporating the impact of business cycles, suggests that 6.6% annual EPS growth is a conservative growth rate when benchmarking forecast EPS growth assumptions.
- ***Today, at a price of 6,500, the Zacks valuation tool produces a market-implied growth rate of 8.6% which implies little to no probability of a business cycle on the intermediate term horizon, over the next 3-7 years.***



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Valuation Model (EPS Lagged 1 Year)  
S&P 500 (SPX) Market Implied EPS Growth Rate = 8.6%



Zacks Valuation Model				Zacks Consensus Estimates			Normalized Earnings
	Current	House	1-Year		2025	2026	FYE: December
Risk Free Rate (10Yr Treas)	4.04%	4.04%	4.04%	Mean Estimate	268.60	300.00	2023 230.91
Equity Risk Premium	0.94%	1.29%	0.94%	Change Y/Y	15%	12%	2024 250.85
Company Specific Risk	0.00%	0.00%	0.00%	High	275.00	300.00	2025 272.51
Total Equity Discount Rate	5.33%		5.33%	Low	260.00	300.00	2026 296.04
Actual PE F12M	22.71	21.03		Total	5	1	2027 321.61
Model PE F12M	22.71	22.71		#Up (4 weeks)	0	0	2028 349.39
Model Price	6584.44	7112.09 x		#Down (4 weeks)	0	0	2029 379.56
Model EPS F12M	289.93	313.17		Mean Estimate	268.60	300.00	2030 412.34
Model Return	0.00%	9.22%		PE Intraday	24.5	21.9	2031 447.95

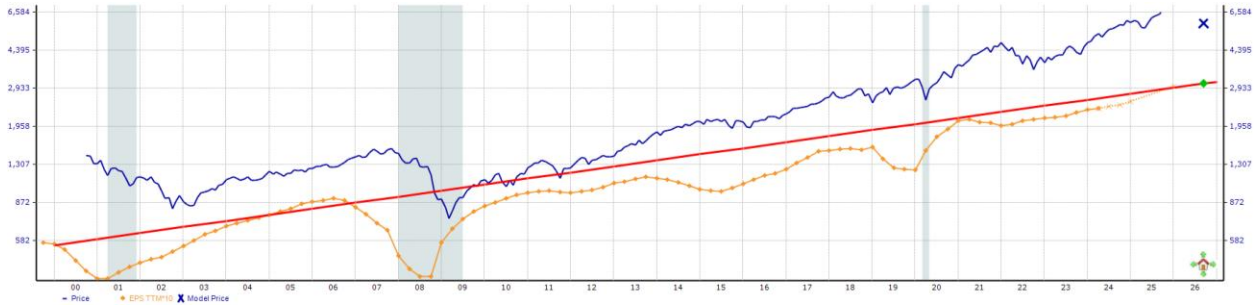
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Source: Zacks

## 2. Valuation using normalized growth assumptions

- Holding S&P 500 current price and Zacks consensus EPS estimates for 2025 and 2026 constant at 6,500, \$268.60 and \$300 respectively.
- Assuming the S&P 500 valuation reverts to a 6.6% conservative, long-term trend level of EPS growth, the Zacks valuation model produces a current fair value of 5,517 which represents a 16.2% decline from current price levels.**

Valuation Model (EPS Lagged 1 Year)  
S&P 500 (SPX) 25-Year Annual EPS Growth Rate = 6.6%



Zacks Valuation Model				Zacks Consensus Estimates			Normalized Earnings
	Current	House	1-Year		2025	2026	FYE: December
Risk Free Rate (10Yr Treas)	4.04%	4.04%	4.04%	Mean Estimate	268.60	300.00	2023 243.20
Equity Risk Premium	0.94%	1.29%	0.94%	Change Y/Y	15%	12%	2024 259.34
Company Specific Risk	0.00%	0.00%	0.00%	High	275.00	300.00	2025 276.55
Total Equity Discount Rate	5.33%		5.33%	Low	260.00	300.00	2026 294.90
Actual PE F12M	22.71	21.37		Total	5	1	2027 314.47
Model PE F12M	19.03	19.03		#Up (4 weeks)	0	0	2028 335.34
Model Price	5517.14	5863.52 x		#Down (4 weeks)	0	0	2029 357.59
Model EPS F12M	289.93	308.12		Mean Estimate	268.60	300.00	2030 381.32
Model Return	-16.21%	-9.74%		PE Intraday	24.5	21.9	2031 406.63

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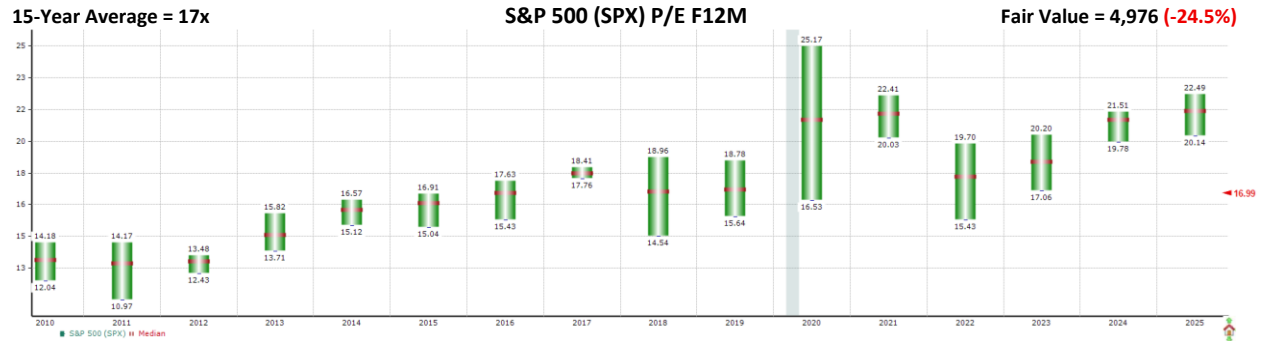
Source: Zacks



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### 3. Forward 12-Month P/E Multiple (P/E F12M) – normalized valuation assumption

- The S&P 500 trades at 22.5x forward earnings versus a 15-year average of 17x.
- Holding S&P 500 the forward 12-month EPS estimate constant at \$292.91.
- **Assuming the P/E F12M reverts to long-term average levels of 17x, the current fair value of 4,976 represents a 24.5% decline from current price levels.**

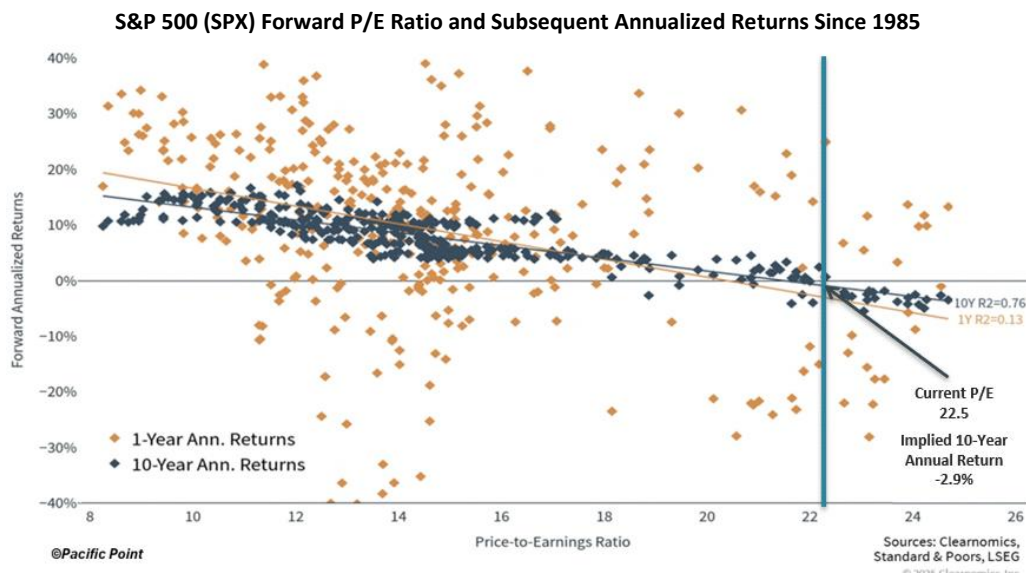


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Source: Zacks

### 4. Forward P/E F12M vs. Subsequent Annualized Returns Since 1985

- For each month-end since 1985, the S&P 500 forward P/E was plotted against its subsequent 1-year and 10-year annualized returns.
- Regression analysis shows:
  - Short Run (1 Year):  $R^2 = 0.13$ , indicating limited predictive power for valuations over short horizons.
  - Long Run (10 Years):  $R^2 = 0.76$ , showing a strong relationship between valuations and long-term returns
- **Based on today's forward P/E of 22.5x, the implied annualized return for the next 10 years is -2.9%.**





## Valuation Takeaways

The S&P 500's current valuation rests on optimistic assumptions of uninterrupted earnings growth, maintaining or improving historically high margin levels, and resilient consumer demand. Today's conditions present a compelling case that the index may be overvalued. Both fundamental indicators and empirical models suggest downside risk of 16 - 25% if valuations revert to historical norms.

Elevated multiples, narrow market leadership, compressed risk premiums, and mounting pressures on profitability all signal that past tailwinds are giving way to mounting headwinds. History suggests lower long-term returns.

Regression analysis of S&P 500 P/E ratios to annual returns since 1985 shows that valuations have limited predictive power over 1-year returns, meaning that even in the current market environment with elevated valuation multiples, the S&P 500 can still deliver double-digit returns in the short-term. Longer term, the sentiment of the Pacific Point Investment Committee aligns with the strong correlation of the 10-year return study which implies a negative expected annualized return for the S&P 500 over the next decade.

The Pacific Point Investment Committee notes that while markets currently appear overvalued across most fundamental and empirical measures, history shows they can remain irrational longer than investors can remain solvent. This environment calls for tempered return expectations and extended time horizons. Portfolio strategy should emphasize quality and valuation in stock selection, while prioritizing disciplined risk management to mitigate downside exposure

## The Solution for Staying Invested in an Overvalued Market

Trying to time the market rarely works over the long run. That's why it makes sense to focus on companies with strong fundamentals and efficient use of capital. Businesses that have consistently delivered stable earnings through different economic cycles can help protect your portfolio during periods of market volatility. By investing in these types of companies, investors reduce overall risk, increase diversification, and improve portfolio long-term risk-adjusted returns.

***Consolidated earnings stability at the portfolio level has historically provided the Stable Earnings™ family of core equity portfolios with relative levels of downside protection against loss of capital during periods of market turbulence, economic recession and unforeseen events.***

The Stable Earnings™ core equity portfolios are designed and maintained to deliver long-term equity market returns (or better) with lower volatility, lower drawdowns and reduced exposure to economic cycles and equity market concentration. The portfolios aim to provide peace of mind in turbulent markets and reduce emotional stress during extended periods of high volatility.

The Stable Earnings™ family of "core" equity portfolios are available in three different strategies: Core, Dividend and ESG.

## Contact us to learn more about Pacific Point Stable Earnings™ Portfolios



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### **Our Discipline, Your Strength**

All Stable Earnings™ portfolio companies have a demonstrated 25-year history of capital efficiency, profitability, and overall fundamental quality. Management of the Stable Earnings™ family of equity portfolios is a well-defined discipline that seeks consistent application of the strategy through economic cycles.

### **Client Focused | Performance Driven | Technology Enabled**

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To learn more about Pacific Point's Stable Earnings™ portfolios, please contact Tim Nyland, Jay Winship or Mike Licosati.





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