HOUSTON
CAPITAL PARTNERS

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Just Saying…

We have recently gone through a significant repricing of equities. As the markets continue to "sort things out", we thought our clients would like to understand what we are seeing on valuations, and what we should look forward to.

First, we believe prices should "revert to the mean". They don't have to, but usually do. See Chart #1, "S&P 500 Forward Earnings" below:

S&P 500 Forward Earnings

* 52-week forward consensus expected S&P 500 operating earnings per share. Monthly through April 1994, then weekly.
** Compounded monthly to yield 7% annually.
Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Thomson Reuters I/B/E/S.

We use the Price/Earnings ratio (P/E) for our main source of valuation. We understand that the 25 years average for this ratio is 15.7 (not provided). So, "generally speaking", we could assume a P/E ratio of 17.7 would dictate an expensive market and 13.7 would dictate a cheap market (yes, this is a very broad brush statement). Looking forward to year-end 2015 we expect the earnings to be around $127, so at the current S&P 500 price (1890+/-) we have a P/E Ratio of 14.88, not cheap, but below average (see Chart #2) below:

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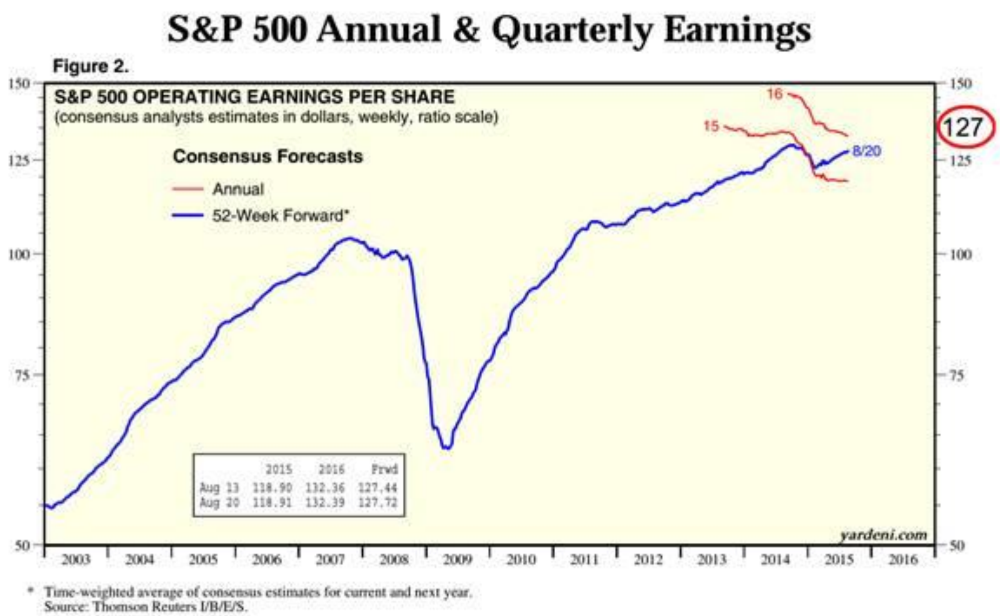
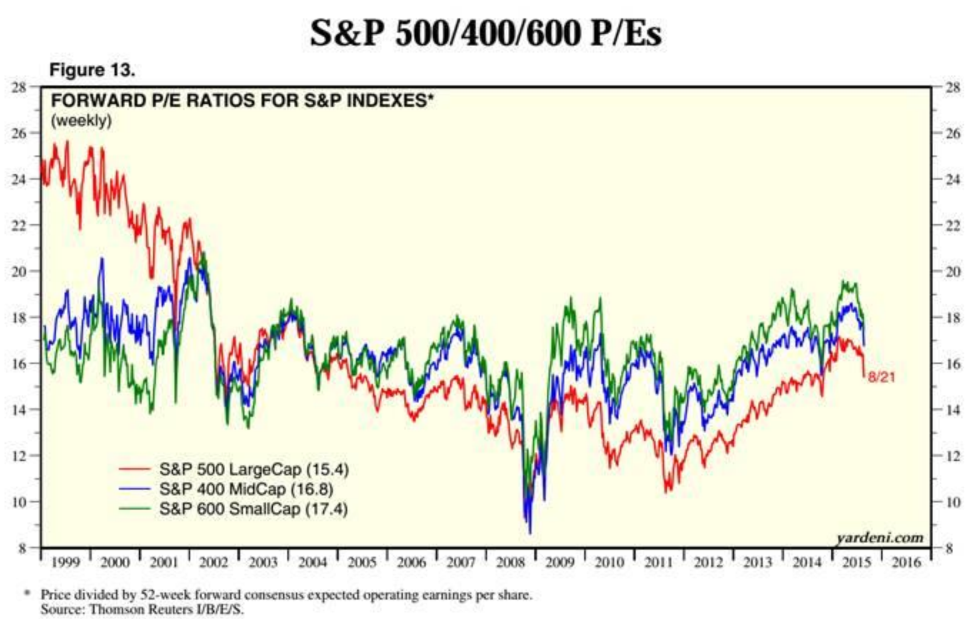


Soon we will be looking at 2016 (markets like to look at 6 – 12 months down the road, see Chart #3):



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Early "guesstimates" are 8-12% higher. So, if we see earning next year around the $140 year, that would make the current market P/E at 13.5, in the "cheap" area.

So, here's the punchline, if we do get the earning we expect, plus if the market "reverts to the mean" (a 15.7 median P/E) that could put the S&P 500 at around 2200, or 16.4% higher than it is now. Just saying…

If you would like to discuss the market and/or your account(s), please call me at 713.428.2050, x2 or via email to josborn@houcap.com.

John W. Osborn, PhD, *CFP®*, CFS, ChFC, BCS, AIF

Past performance is not a guarantee of future results. Indices mentioned are unmanaged and cannot be invested into directly. These are the opinions of John W. Osborn and not necessarily those of Cambridge. The views expressed herein are for informational/educational purposes only and should not be construed or acted upon as individualized investment advice.

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