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Today's 'Stock Traders and Investors Free Weekly Wrap' Article is based on an EXTRACT from our recent Edition 380 of the Mentoring style '*Investing & Online Trading'* Newsletter

Melbourne and Perth: '*An Evening With Jim Berg'*

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1. **Melbourne:** Thursday 8 November
2. **Perth:** Tuesday 13 November

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As Jim will encourage questions and interaction during these evening seminars, places at each location are limited. To secure your seat or to discover more, **Click Here Now >>>**

US Reporting and US & ASX Market Valuations

By James Gerrish

Disclaimer: The opinions and views on events, market direction and price targets provided by others in this newsletter are not necessarily shared by ShareTradingEducation.com.

Today we feature this special report with our thanks to James Gerrish, Portfolio Manager at Novus Capital Ltd in Sydney which he wrote at www.mymarketview.com.au on Monday 29 October:

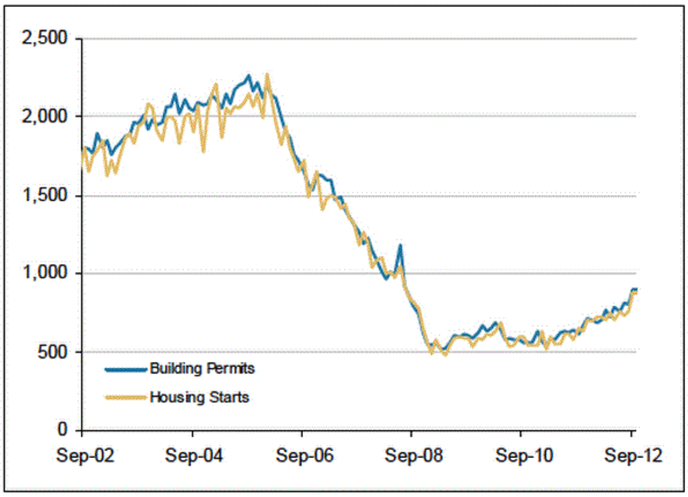
US Reporting

* The US reporting season continued last week and there are a couple of obvious themes playing out. Collectively, earnings have beaten expectations 62% of the time according to Bloomberg data which is pretty much in line with historical trends.

* When you drill down into the composition of these earnings though, one element that we monitor closely is revenue. We put a lot emphasis on revenue because it's a good indication of top line growth and takes out the impact of cost cutting measures - reductions in provisions and the like.

* Revenues have only beaten expectations 37% of the time for S&P 500 companies so far, which is below the historical averages. This explains why a lot of the company CEO's in the States have been relatively downbeat even when headline earnings have actually held up pretty well.

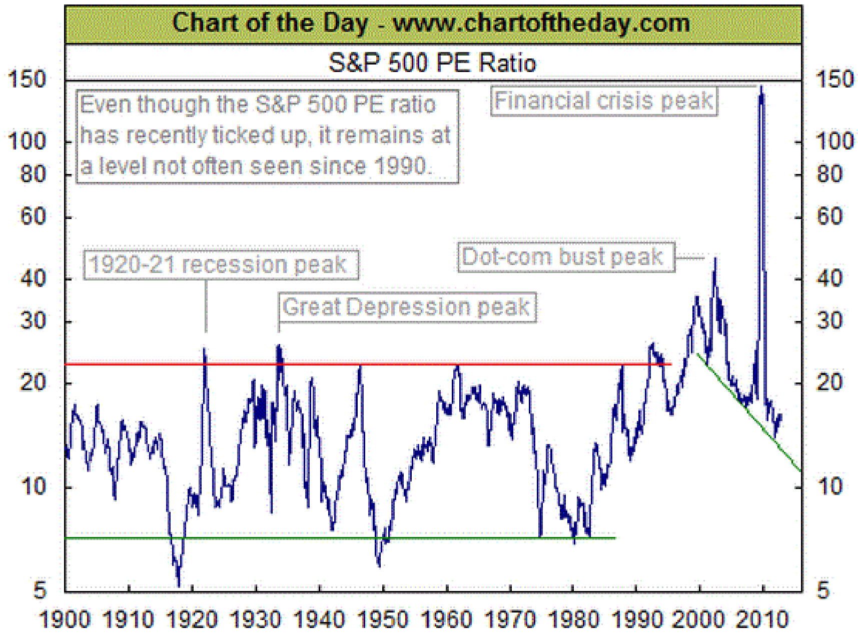
* That said, economic indicators in the US seem to be picking up in Q3 - the housing market is an example of this as the chart below shows - and this has helped to support an uptick in US economic growth from 1.3% to 2%. Clearly this should be a positive for US corporates and their Q4 numbers.



Source: Morgan Stanley Wealth Management Research

* So, this prompts the obvious question of valuation; ***Is the market still cheap or are valuations stretched?.***

In a nutshell, I think the market is still cheap from a historical context and this holds more water given the policy intervention from central banks globally.

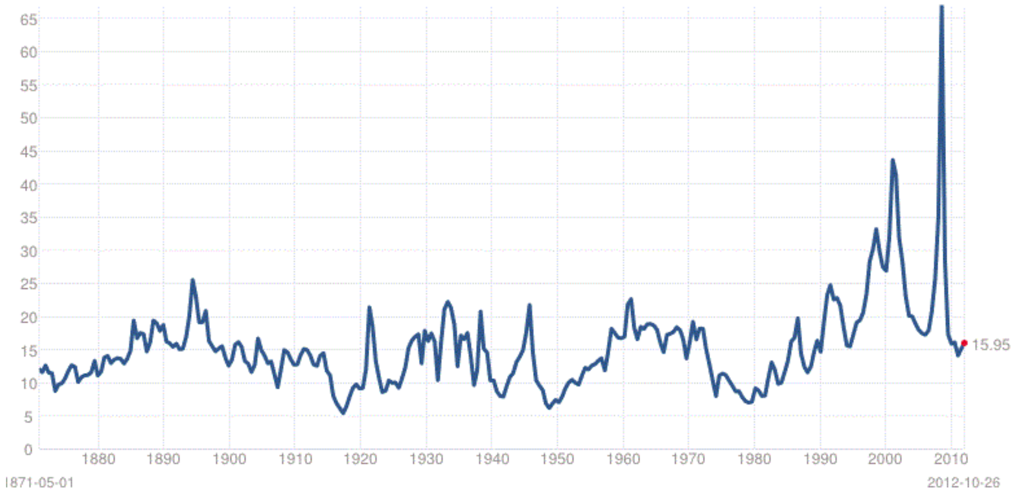


* Today's chart (*above*) illustrates the price to earnings ratio (PE ratio) from 1900 to present. Generally speaking, when the PE ratio is high, stocks are considered to be expensive. When the PE ratio is low, stocks are considered to be inexpensive.

* From 1900 into the mid-1990s, the PE ratio tended to peak in the low to mid-20s (red line) and trough somewhere around seven (green line). The price investors were willing to pay for a dollar of earnings increased during the dot-com boom (late 1990s), surged even higher during the dot-com bust (early 2000s), and spiked to extraordinary levels during the financial crisis (late 2000s).

* Since the early 2000s, the PE ratio has been trending lower with the very significant but relatively brief exception that was the financial crisis. More recently, the PE ratio has moved slightly higher. It is worth noting, however, that even with this recent uptick, the PE ratio still remains at a level not often seen since 1990. (Source; chartoftheday.com)

* Here's another view of PE's for the S&P 500



Current S&P 500 PE Ratio: 15.95

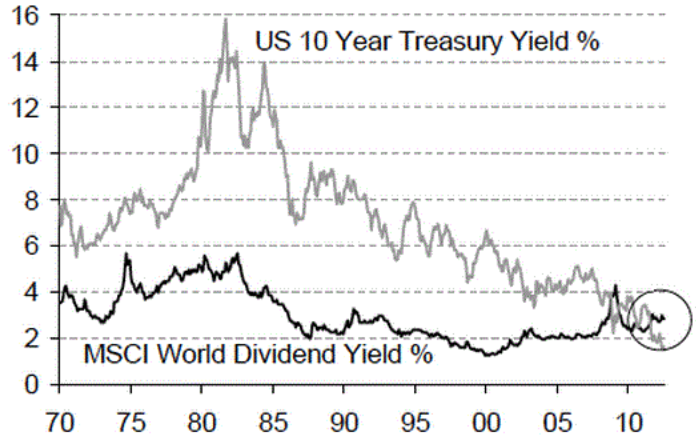
Mean: 15.48; *Median:* 14.45; *Min:* 5.31 (Dec 1917); *Max:* 123.79 (May 2009)

* So although the PE on the S&P 500 is around long term historical averages, if we focus on the last 20 years of data - it looks cheap.

* I also think there's a strong case that PE's should be higher largely on the back of the stimulatory programs being rolled out by central banks globally.

* Now I'm certainly conscious of the fact that Central Banks are being active because the global economy collectively is still fairly weak and there seems to be some structural issues in some parts of the world, but the main supporting factor of higher PE's comes as a result of what the bond buying programs have done to the other main asset class.

* Bond yields have been crunched as the chart below shows (as have the returns from cash) - and equities are now yielding more which hasn't been the case historically.



Source: Citi Research

* So, it's a case where the alternative has now become a lot less attractive, and anyone wanting to maintain anything that resembles a decent return, needs to hold equities.

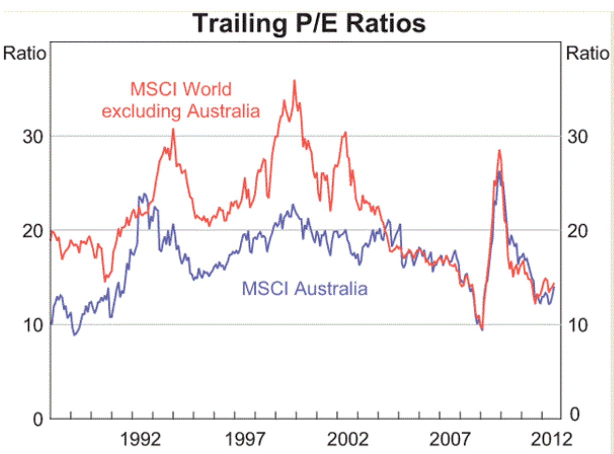
* I think this is probably a good indication of what is likely to play out in Australia over the next 12 months of so. Cash rates will continue to come down - ditto to bond yields and equity markets will finally break out of their 3 year trading range.

* If the global economy doesn't get any worse, and financial conditions remain accommodative, there is no reason why equity markets can't continue to rally. Any surprises to the upside from an economic standpoint, could really get the market moving.

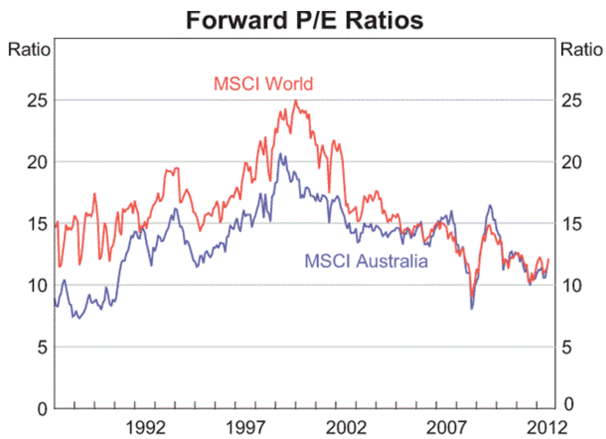
* There's little doubt that markets are still factoring in very subdued growth and that's why valuations remain below historical averages - so if growth starts to surprise to the upside - as we've seen by some measures particularly in the US, then the market can go a lot higher.

2.1.2 The Australian Context

* The charts below show both trailing and forward looking PE's for the Australian market. Clearly, valuations are not stretched and from a historical perspective, the market seems to bottom at 10 times earnings.

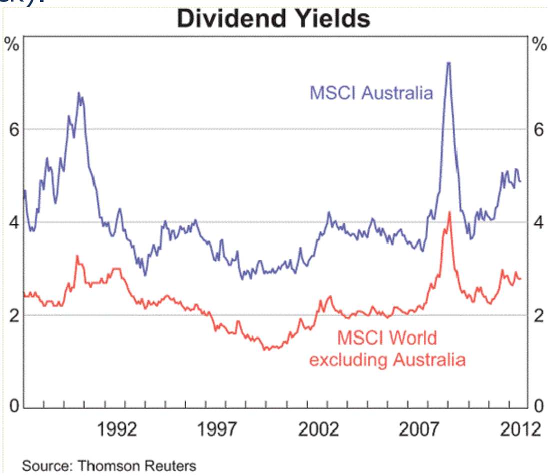


Source: Thomson Reuters



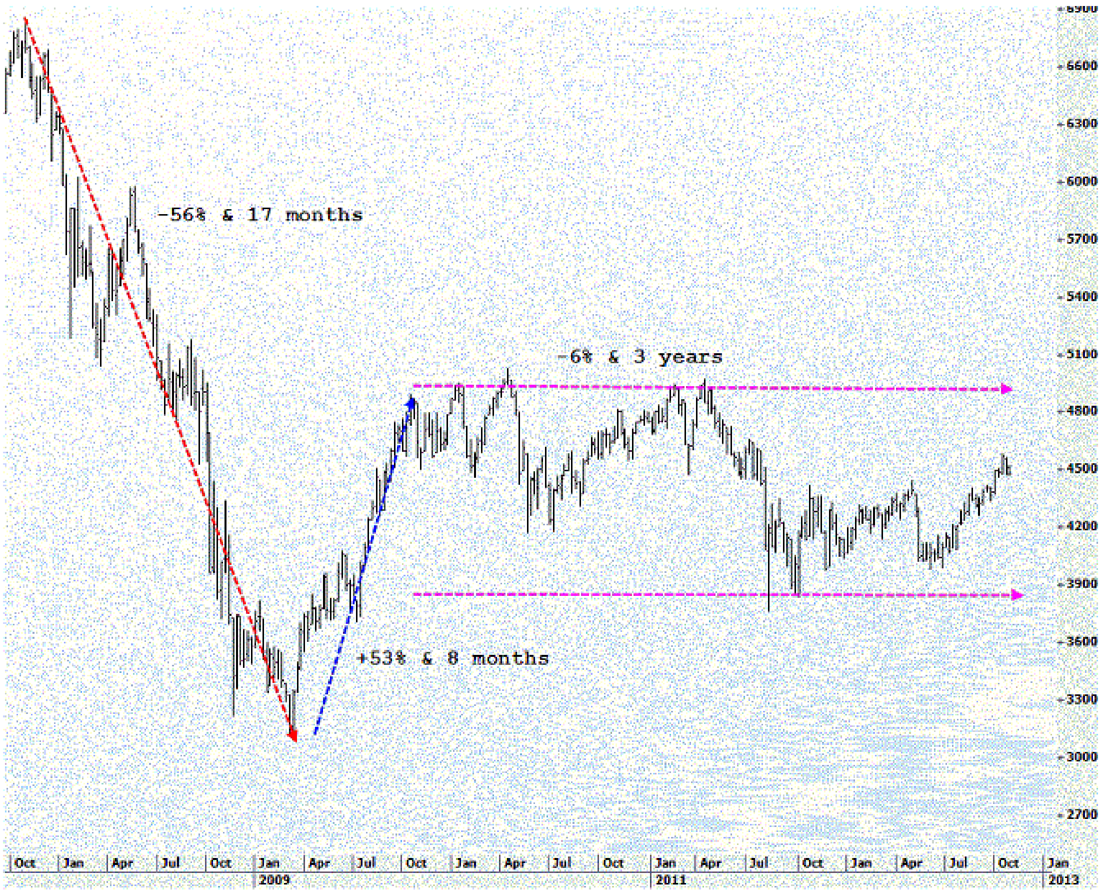
Source: Thomson Reuters

* Combine this with rising dividends yields - which are high relative to other markets + other asset classes and this should provide another supporting factor for share prices going forward (as interest rates come back).

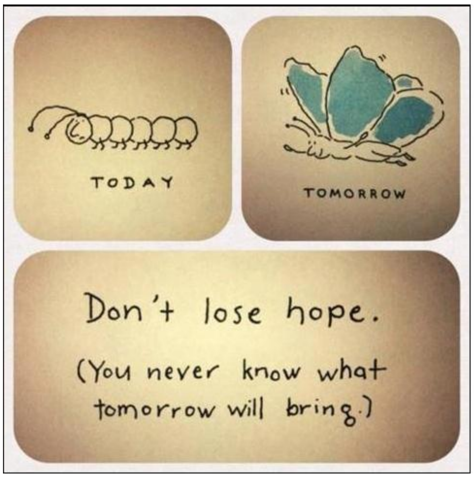


* This brings into play the longer term structure of the Australian share market. Clearly, we're at an inflexion point after 3 years of going nowhere (- 6%).

Given the above metrics, I think the logical assumption is that the market is going higher over the next few years - I sincerely hope that's the case.



Source; IRESS



" Allow the time for change and transformation. It doesn't happen overnight, but it will happen if it remains a focus "

Catherine Taylor
CEO Powerhouse Coaching & Consulting

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