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INVESTMENT SOLUTIONS

weekly investment focus

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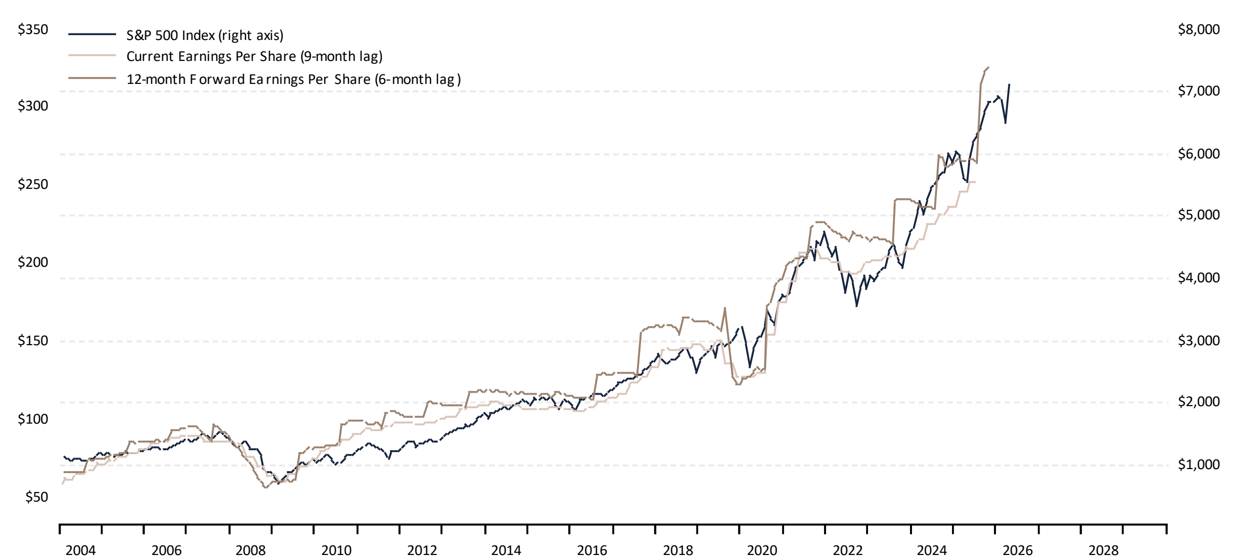
"CAN VALUATIONS RISE ANY FURTHER?"

- Corporate earnings are rising very rapidly
- And analysts' forecasts are rising even faster
- Will valuation ratios fall or reach new records?
- Probability calculations reveal surprising results

CHART OF THE WEEK: "Corporate earnings are expected to rise sharply"



Source: Bloomberg, Altitude IS

FINANCIAL MARKETS ANALYSIS

US stock markets are breaking record after record, which is hardly surprising given that corporate earnings continue to rise. The question nagging investors is rather whether this pace of growth is sustainable or, on the contrary, too rapid. To put it simply, **the issue is not whether the music is good, and even less whether it will stop, but whether investors are dancing at a faster pace than the tempo of earnings.** As is often the case in such situations, several indicators contradict one another. The pessimists have just as many tangible arguments to put forward as the optimists. The former, looking at current earnings, those already generated by companies, conclude that stock market indices appear far too high. In fact, profits would need to grow by 28% over the next nine months to justify the current level of the S&P 500, at $7,165 (see Chart of the Week). Conversely, optimists refer to forward earnings, those based on forecasts for the next twelve months. From this equally valid perspective, the flagship US equity index could rise to at least $7,400.

The counterpart to these analyses is found, with relentless mathematical precision, in the comparison of valuation ratios. **The 500 leading US shares are trading at 28.3 and 21.8 times earnings, depending on whether the earnings are current or forward-looking.** In the first case, this is overpriced. In the second case, it is in line with the weighted median of the last 30 years. An even more intriguing phenomenon is that **the gap between the two approaches has never been so wide,** with the understandable exception of the pandemic (see Fig. 2). Why such a discrepancy? Are the productivity gains linked to the deployment of artificial intelligence capable of generating earnings growth of 30% per year? And can this be achieved without a contraction in employment undermining households' ability to consume and, consequently, companies' ability to sell and generate profits?

Fig. 2 – Current and forward-looking valuations

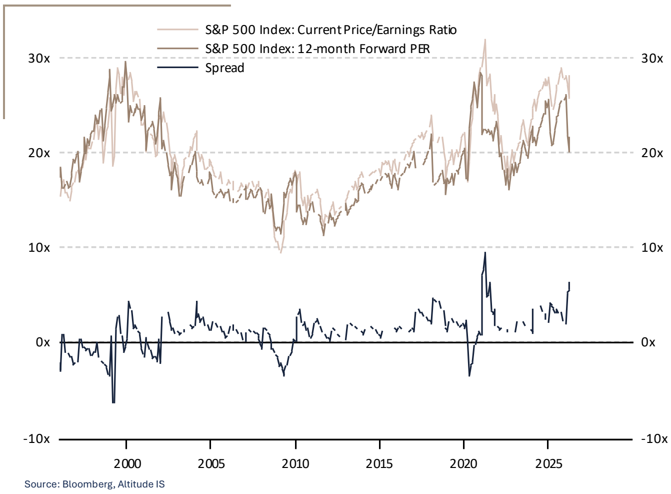
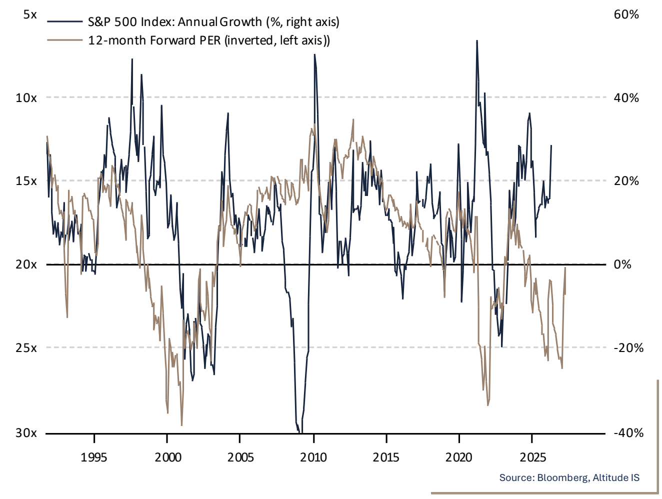


Fig. 3 – Valuation & annual performance



When the internet took off in the late 1990s, the economic and financial landscape was not exactly the same as it is today, but it was, nonetheless, very similar. The index of leading US equities had managed to rise for a time (1999 and 2000) whilst valuation multiples were climbing dangerously high (see Fig. 3). Subsequently, and despite significant productivity gains, the indices eventually came back down to earth, falling by 20% per annum between 2001 and 2003.

There is another valuation indicator that is currently reaching record highs: the cyclically adjusted price-to-earnings ratio (CAPE), developed by Nobel Prize-winning economist Robert Shiller. It allows one to assess, independently of economic cycles, whether a market is overvalued or undervalued. It is calculated by dividing the S&P 500 index by the average earnings of the last 10 years, adjusted for inflation. At the end of April, it exceeded the psychological threshold of 40 times earnings (see Fig. 4). **Since 1871, this ratio has been higher than today in only 1% of cases,** or 18 months out of the 1,864 under review. Clearly, there are few historical instances where investors have been so euphoric, and this should encourage them to exercise caution over the coming years. But what about the coming months?

It is important to remember that these 18 months are not randomly distributed across the entire series. They all occurred between February 1999 and August 2000, with the first half rising and the second half falling. Throughout this period of euphoria, the US index was performing well, having continued to rise by +23%. It then took seven months of losses to wipe out the initial gains. **Today, investors face the same difficult choice. The first is to keep dancing until the music stops,** to make the most of the entire rally, even if it means taking the initial losses. **The second is to sit out the final dance** and the profits that go with it, whilst arming oneself with patience. It is everyone's risk aversion that must enable them to make the wisest choice.

Fig. 4 – US equity valuations, cyclically adjusted

To take the analysis further, simple descriptive statistics are not enough. It is necessary to use complementary approaches, with all the reservation that the scarcity of data demands. **Conditional probabilities and analogical approaches allow the estimation of the likelihood of the ratio rising and, why not, reaching a new high.** Given that Shiller's P/E ratio has exceeded its current level on only one occasion in history, the probabilities that can be derived from this are more comparative benchmarks than statistical laws. Otherwise, absurdly, one might conclude that in 100% of cases where the ratio has crossed this threshold, it has continued to rise and therefore that the upward momentum is not exhausted.

The Excess CAPE Yield approach allows the refining of this assessment. This indicator, which Shiller himself developed to complement his ratio, measures the real risk premium offered by equities relative to bonds. It is calculated by subtracting the real ten-year rate from the implied return on equities (the inverse of the CAPE). With a CAPE of 40.65x, this implied return stands at 2.46%. As ten-year US Treasury Inflation-Protected Securities (TIPS) currently offer 1.90%, the risk premium on equities is now only +0.56%. It is virtually zero. In December 1998, when the CAPE first crossed the 40x threshold, this same calculation yielded a result of -1.39%. Bonds were outperforming equities in terms of real returns, and yet the rally continued. **The interest rate environment is therefore not fundamentally different from that which prevailed at the start of the previous episode, in 1999. It is even slightly more favourable to equities.** This observation is worth highlighting, as it contradicts the common perception that the rise in real interest rates since 2022 has made equity markets structurally less attractive. On this specific criterion, the comparison with the dot-com bubble suggests a continuation of the current momentum rather than its immediate loss of steam.

To take this analysis a step further, and thanks to the computational power of AI, seven other analytical methods have been employed. These range from purely historical approaches to the most sophisticated mathematical models. **On average, the probability that the Shiller P/E ratio will rise above its current level is 41%. The probability that it will beat its all-time high, set in December 1999 at 44.19, is 3%** (see Fig. 5). The spread of results, from 0% to 8%, is relatively narrow, although the analysis of a historically unique phenomenon must be conducted with the utmost caution.

Fig. 5 – Probability of further increases in the Shiller P/E ratio

#	Method of analysis	Higher ratio probability	New record probability	Time horizon	Method reliability
1	Ornstein-Uhlenbeck (mean-reversion)	43%	5.8%	12 months	High
2	Bootstrap high valuation regime (CAPE 38–46)	27%	7.9%	12 months	High
3	Bayesian inference (neutral prior)	41%	3.0%	1 month	High
4	Empirical conditional probabilities (CAPE > 40)	41%	0.0%	1 month	High
5	Glick record theory (1978, conditional CAPE > 40)	n/a	5.0%	n/a	Medium
6	Markov chains (9 discrete states)	46%	0.0%	12 months	Medium
7	Generalised Pareto Distribution (upper tail, 25)	n/a	0.15%	any	Medium
	Median	**41%**	**3%**	**12 months**	

Source: Multipl, Claude, Altitude IS

Two families of models are at odds. Analogy-based approaches and Bayesian models are the most optimistic. They argue that, since this extreme event has already occurred once from this level, it could happen again. Conversely, fundamental models such as regression, resampling or conditional probability models are the most pessimistic. They highlight that, across all periods where the Shiller P/E ratio exceeded 35x, further price increases materialised in only a minority of cases.

On the question of timing, the models are more in agreement. **In most analyses, if the record were to be broken, it would be within a median timeframe of twelve months.** This figure is explained by the structural slowness of the Shiller P/E ratio, which is a ten-year average of earnings and not a market indicator in the strict sense. It cannot therefore double in a matter of weeks, as a real-time ratio would.

Conclusion:

Despite the lack of available data, these considerations highlight two key conclusions. Firstly, analysts are very optimistic about the future earnings of listed companies. Secondly, setting a new valuation record would be difficult but less unlikely than it seems... a one-in-thirty-three chance.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2026 Year-to-Date (%)	2025 (%)	2024 (%)
Equities							
World (MSCI)	1 105.6	76.11	2.4%	7.4%	9.7%	22.9%	18.0%
USA (S&P 500)	7 399	74.58	2.4%	9.2%	8.5%	17.9%	25.0%
USA (Dow Jones)	49 609	59.73	0.2%	3.6%	3.7%	14.9%	15.0%
USA (Nasdaq)	26 247	80.02	4.5%	16.0%	13.1%	21.2%	29.6%
Euro Area (DJ EuroStoxx)	634.9	53.97	1.2%	1.4%	5.2%	21.2%	10.2%
UK (FTSE 100)	10 233	44.04	-1.2%	-3.2%	4.4%	25.7%	9.6%
Switzerland (SMI)	13 101	49.73	-0.2%	1.2%	n.a.	18.0%	7.5%
Japan (Nikkei)	62 487	69.93	5.4%	11.4%	n.a.	28.7%	21.3%
Emerging (MSCI)	1 711	72.03	6.9%	11.3%	22.6%	34.3%	8.0%
Brasil (IBOVESPA)	184 108	40.98	-1.7%	-4.2%	14.3%	34.0%	-10.4%
Mexico (IPC)	69 856	56.66	3.0%	-0.2%	9.3%	35.1%	-11.0%
India (SENSEX)	76 463	50.18	0.5%	-0.3%	-9.1%	10.5%	9.6%
China (CSI)	4 939	66.65	1.3%	6.1%	n.a.	21.0%	18.2%
Com. Services (MSCI World)	176.5	74.38	1.9%	10.2%	7.9%	33.0%	31.9%
Cons. Discretionary (MSCI World)	454.9	66.63	2.0%	7.6%	-0.2%	9.8%	20.7%
Cons. Staples (MSCI World)	305.6	53.47	-0.3%	0.6%	6.6%	9.3%	4.7%
Energy (MSCI World)	326.7	40.76	-4.9%	-3.1%	24.7%	14.8%	2.9%
Financials (MSCI World)	224.0	53.08	-0.2%	1.2%	0.2%	29.5%	25.1%
Health Care (MSCI World)	368.4	39.47	-1.1%	-4.0%	-5.9%	15.3%	1.5%
Industrials (MSCI World)	527.5	58.12	1.1%	3.1%	13.7%	26.2%	12.8%
Info. Tech. (MSCI World)	1 173.4	83.07	7.8%	21.3%	21.7%	26.6%	31.9%
Materials (MSCI World)	449.9	58.38	3.0%	0.9%	14.9%	32.5%	-7.6%
Real Estate (MSCI World)	1 066	60.69	0.6%	3.7%	8.2%	3.6%	-0.4%
Utilities (MSCI World)	209.1	40.17	-2.9%	-2.7%	9.1%	24.7%	13.0%
Bonds (Bloomberg)							
World (Aggregate)	3.76%	58.40	0.4%	0.4%	0.7%	8.2%	-1.7%
USA (Sovereign)	4.20%	51.01	0.2%	-0.1%	0.2%	6.3%	0.6%
Euro Area (Sovereign)	3.19%	56.00	0.5%	-0.1%	0.2%	0.6%	1.9%
Germany (Sovereign)	2.86%	53.35	0.2%	-0.3%	-0.1%	-1.6%	0.6%
UK (Sovereign)	4.87%	51.85	0.5%	-1.0%	-1.1%	6.1%	-3.0%
Switzerland (Sovereign)	0.57%	56.23	0.3%	0.1%	0.1%	0.3%	5.4%
Japan (Sovereign)	2.18%	44.43	0.2%	-0.5%	-1.6%	-4.6%	-2.1%
Emerging (Sovereign)	6.03%	63.02	0.8%	1.0%	1.4%	13.1%	7.0%
USA (IG Corp.)	5.10%	54.00	0.7%	0.3%	0.4%	7.8%	2.1%
Euro Area (IG Corp.)	3.57%	56.57	0.4%	0.5%	0.2%	3.0%	4.7%
Emerging (IG Corp.)	6.16%	69.71	0.3%	1.2%	1.4%	8.1%	7.0%
USA (HY Corp.)	6.94%	59.79	0.2%	0.6%	1.4%	8.6%	8.2%
Euro Area (HY Corp.)	5.86%	69.60	0.4%	0.9%	0.8%	5.2%	8.2%
Emerging (HY Corp.)	7.34%	68.42	0.8%	1.6%	2.8%	13.9%	14.9%
World (Convertibles)	625.2	73.80	2.6%	7.9%	16.0%	22.4%	9.4%
USA (Convertibles)	826.7	70.47	2.8%	8.8%	18.1%	16.9%	10.1%
Euro Area (Convertibles)	305.7	52.79	-0.2%	0.1%	5.2%	24.8%	14.7%
Switzerland (Convertibles)	293.6	52.57	-0.2%	1.6%	3.8%	17.5%	-10.5%
Japan (Convertibles)	303.4	75.42	3.8%	5.5%	17.6%	13.8%	6.4%
Hedge Funds (Bloomberg)							
Hedge Funds Industry	1 878	77.72	n.a.	3.6%	n.a.	3.8%	11.1%
Macro	1 557	74.57	n.a.	2.9%	n.a.	6.1%	7.4%
Equity Long Only	2 530	66.21	n.a.	6.6%	n.a.	2.3%	12.0%
Equity Long/Short	2 043	75.78	n.a.	4.2%	n.a.	3.7%	14.0%
Event Driven	1 988	76.54	n.a.	3.0%	n.a.	3.5%	8.7%
Fundamental Equity Mkt Neutral	1 950	86.06	n.a.	1.0%	n.a.	4.1%	12.4%
Quantitative Equity Mkt Neutral	1 861	78.75	n.a.	3.4%	n.a.	2.9%	9.8%
Credit	1 755	90.76	n.a.	1.6%	n.a.	2.1%	8.5%
Credit Long/Short	1 763	94.77	n.a.	-0.4%	n.a.	1.7%	10.0%
Commodity	2 086	81.29	n.a.	1.4%	n.a.	4.3%	14.7%
Commodity Trading Advisors	1 588	71.53	n.a.	3.8%	n.a.	11.8%	7.9%
Volatility							
VIX	17.19	40.87	1.2%	-18.3%	15.0%	-13.8%	39.4%
VSTOXX	22.40	45.61	-1.0%	-9.4%	52.2%	-13.5%	25.3%
Commodities							
Commodities (CRB)	565.3	n.a.	1.0%	2.4%	4.7%	0.6%	5.1%
Gold (Troy Ounce)	4 660	n.a.	3.1%	-1.7%	7.9%	64.6%	27.2%
Silver (Troy Ounce)	80.15	n.a.	10.2%	6.0%	11.8%	148.0%	21.5%
Oil (WTI, Barrel)	95.42	n.a.	-6.4%	1.1%	66.2%	-19.9%	0.1%
Oil (Brent, Barrel)	104.94	n.a.	-10.6%	-15.7%	68.1%	-15.7%	-4.6%
Currencies (vs USD)							
USD (Dollar Index)	98.15	44.39	-0.2%	-0.5%	-0.2%	-9.4%	7.1%
EUR	1.1754	55.48	0.5%	0.0%	0.1%	13.4%	-6.2%
JPY	157.13	56.48	0.1%	1.5%	-0.3%	0.3%	-10.3%
GBP	1.3587	56.65	0.4%	0.6%	0.8%	7.7%	-1.7%
AUD	0.7236	61.07	1.0%	2.0%	8.4%	7.8%	-9.2%
CAD	1.3684	50.92	-0.4%	0.8%	0.3%	4.8%	-7.9%
CHF	0.7791	56.83	0.6%	0.6%	1.7%	14.5%	-7.3%
CNY	6.7958	70.55	0.5%	0.5%	2.8%	4.5%	-2.7%
MXN	17.222	60.20	1.7%	0.5%	4.6%	15.7%	-18.5%
EM (Emerging Index)	1 880.5	61.58	0.8%	0.6%	1.5%	7.2%	-0.7%
XBT	80 826	n.a.	-0.7%	10.2%	-7.8%	-6.5%	120.5%

Source: Bloomberg, Altitude Investment Solutions

Total Return by asset class (Negative \ Positive Performance)

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