OUR TWO CENTS

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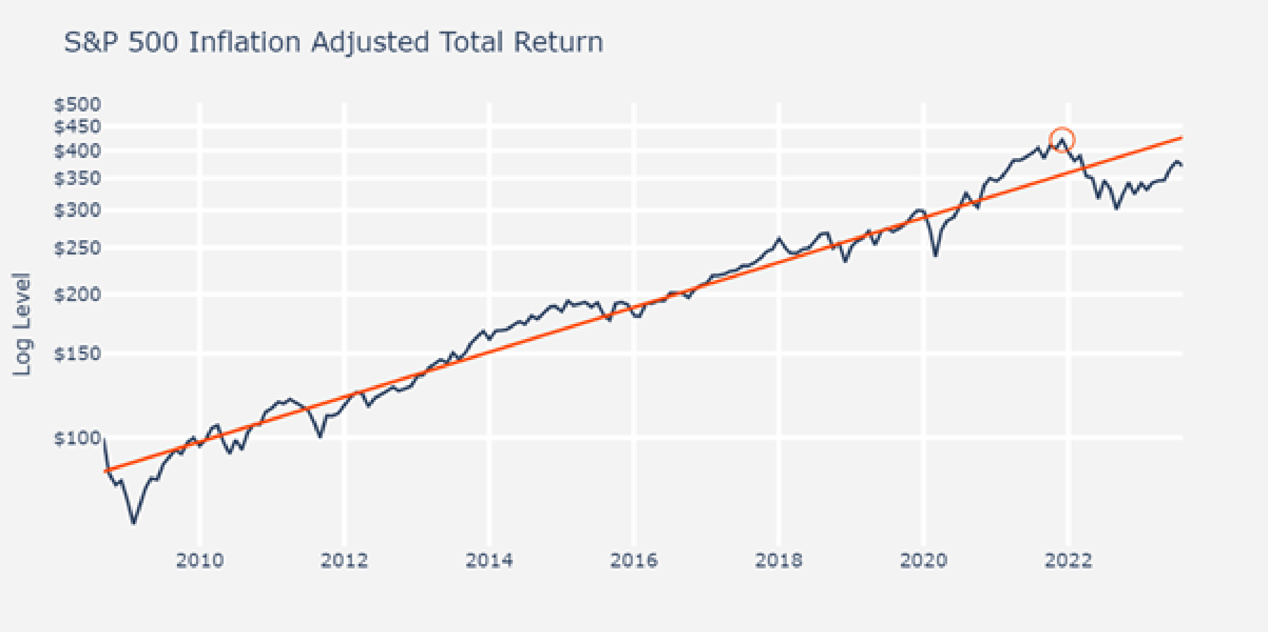
After graduating as a chemical engineer, Garrett pursued his master's degree in finance and investments and is currently writing his CFA exams. Garrett gained experience in the modelling and optimisation of financial data through his postgraduate research. As one of the newest members of the New Road Capital team, he enjoys his role as an investment analyst, where he gets to follow his passion in solving challenging problems using mathematics and technology. In his free time, Garrett never misses a Grand Prix, and has been doing Brazilian Jiu Jitsu for more than 10 years.

Are US Equities Really Expensive?

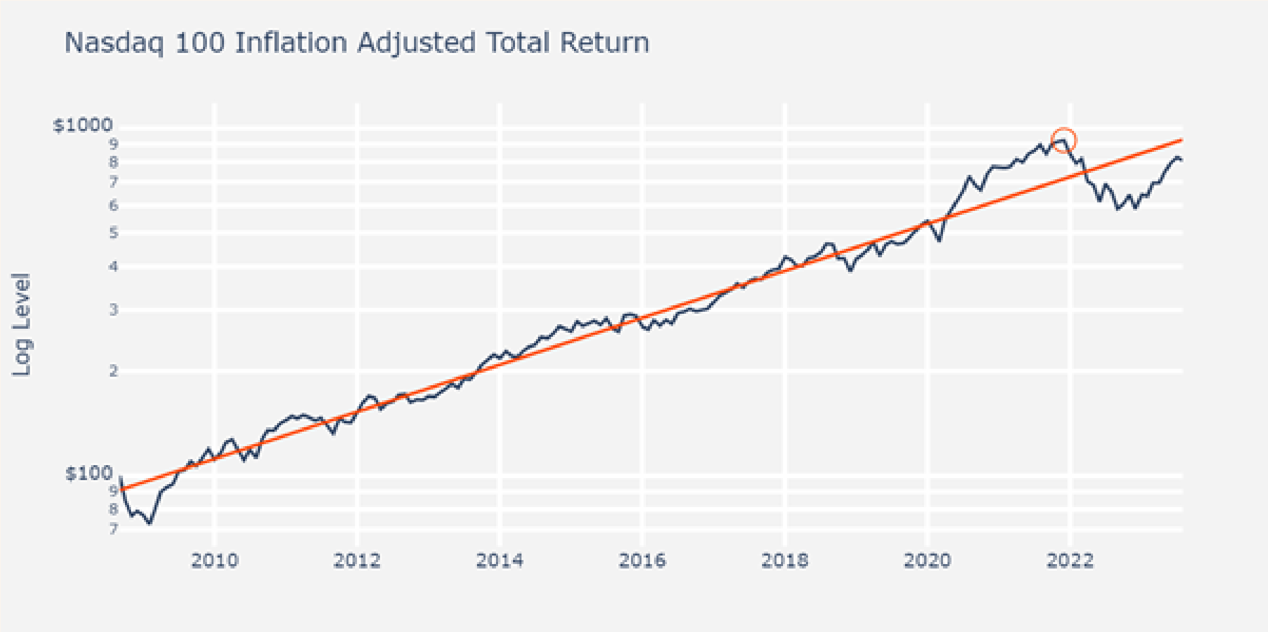
By Garrett Nel

US equities have had a good year of returns so far in 2023, with the S&P 500 having given investors 18.7% for the year up to the end of August. This is despite fears of a recession on the back of the US Fed continuing to raise interest rates at a rapid pace. Although the returns could appear disconnected from the economic backdrop, the equity levels seen today are not unusual when taking into account the rate of inflation experienced in the US over the same time period.

The following figure presents the growth of the S&P 500 Total Return index over the past 15 years, adjusted for inflation. Despite the run in US equities this year, as of the latest inflation print, the index level is still well below the highs reached at the end of 2021 in real terms. In fact, current equity levels are still below the long-term trend seen since the 2008 Global Financial Crisis, with a full recovery roughly 11.7% away in real terms.



A very similar trend can be seen in the Nasdaq 100 below, which after its impressive 42.5% return thus far for 2023, is still 12.5% away from its inflation adjusted all time high.



As we near the end of the rate hiking cycle, the current state of the US economy still appears to be stable. GDP figures are in line with pre-pandemic levels, unemployment levels remain low and many analysts who were previously predicting an economic downturn have now shifted toward a low chance of a recession. In addition to this, earnings are continuing to surprise on the upside, especially with the boost in demand found in tech companies exposed to AI. If the current 15-year trend continues—which is likely the case if the soft landing scenario plays out—the US equity market still has strong growth potential for the rest of the year and beyond with little reason to slow down just yet.