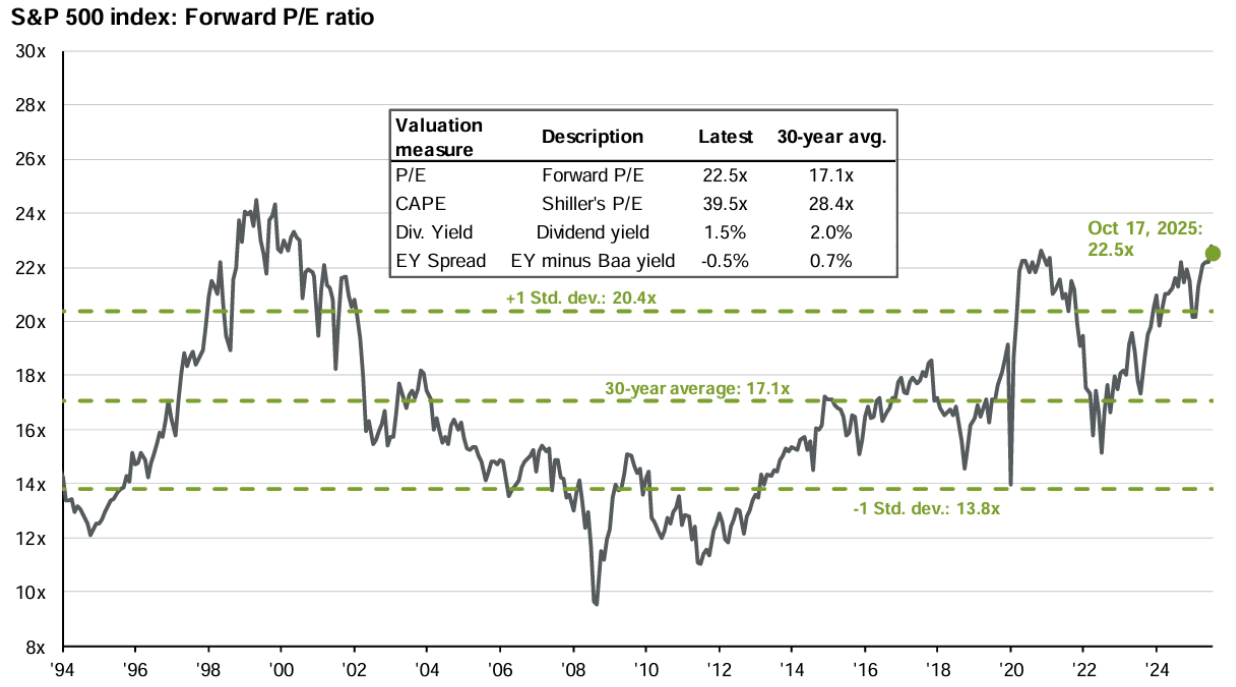
The S&P 500 is Not Expensive

It is risky to say the market is not expensive or to say that opportunity is available. If the market falters for any reason, it will look foolish. A single social media post, a Chinese policy change, or a high-profile bankruptcy can cause such statements to backlash. These events don't necessarily determine whether the market is cheap or expensive, but they do influence trading behavior and sentiment. A valuation implicitly has assumptions around earnings and interest rates, and the assumptions change but are longer term in nature. With that in mind, it's important not to declare that the market is "cheap" unless there is a significant margin of safety in your return expectation.

With all that in mind, I do not think the market is expensive. I also think there is opportunity, but I may not go as far to say the market is cheap.

The constant chatter that the market is expensive stems from the historically elevated forward P/E ratio of the market. JPMorgan has an excellent chart that shows that it is more than one standard deviation higher than the 25-year average.



Source: Bloomberg, FactSet, Moody's, Refinitiv Datastream, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
Forward P/E ratio is the most recent S&P 500 index price divided by consensus analyst estimates for earnings in the next 12 months, provided by IBES since March 1994 and FactSet since January 2022. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as consensus estimates of dividends in the next 12 months, provided by FactSet, divided by the most recent S&P 500 index price. EY minus Baa yield is the forward earnings yield (the inverse of the forward P/E ratio) minus the Bloomberg U.S. corporate Baa yield since December 2008 and interpolated using the Moody's Baa seasoned corporate bond yield for values beforehand.
Guide to the Markets – U.S. Data are as of October 17, 2025.

J.P.Morgan
ASSET MANAGEMENT

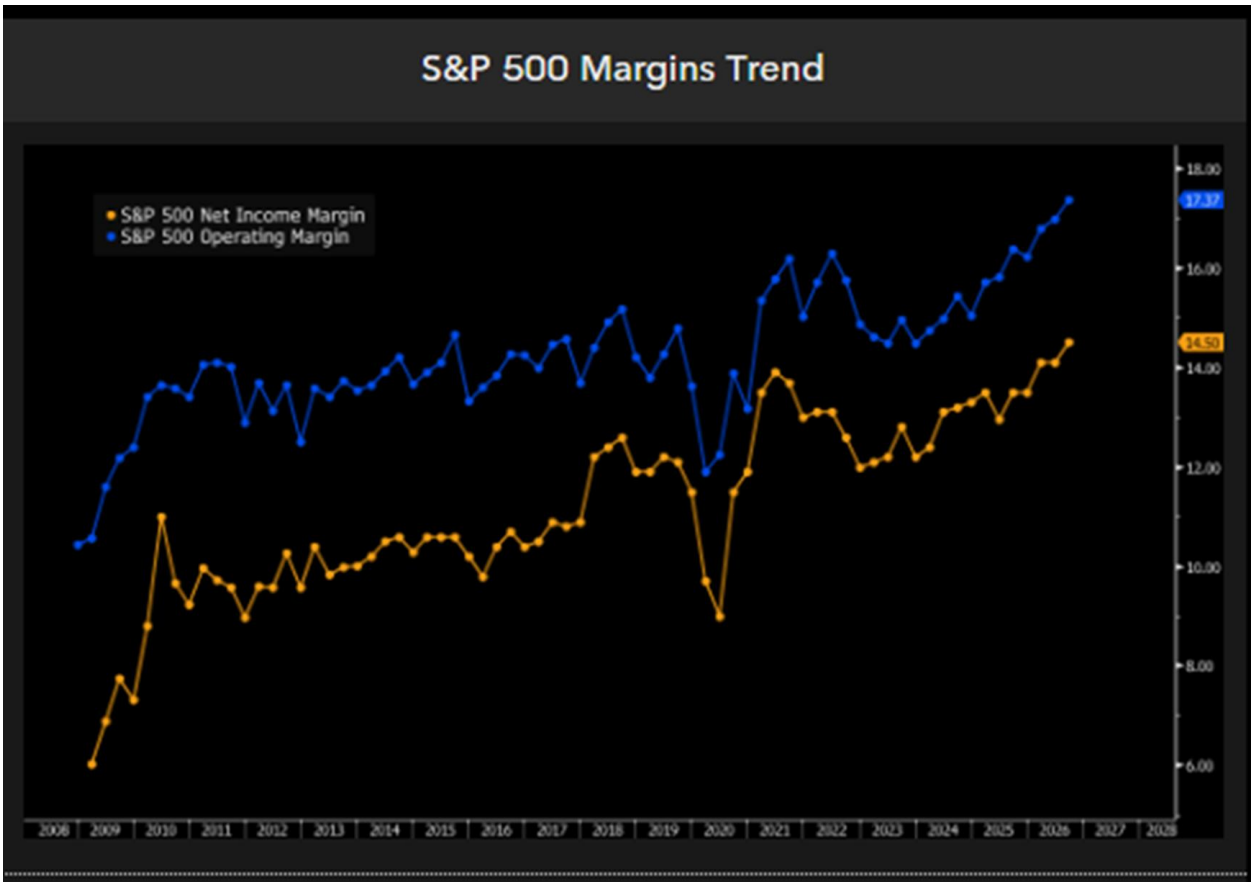
The P/E Ratio is Higher for Good Reasons:

1) Bits and Bytes Economy

It is important to note that the 25-year average has been inching higher over time. The reason is that the economy and the companies driving the P/E ratio in the S&P 500 have changed a lot. Here is a representation of top stocks in 1995 vs. Q2 2025.

1995 Top Stocks	1995 Weight (%)		2025 Top Stocks	2025 Weight (%)
General Electric	5.6		Microsoft	7.2
ExxonMobil	3.7		Apple	6.8
Coca-Cola	2.8		NVIDIA	5.1
Merck	2.6		Amazon	3.4
Procter & Gamble	2.5		Meta Platforms	2.3
Philip Morris	2.3		Alphabet (Class A)	2.1
IBM	2.2		Alphabet (Class C)	2
Intel	2.1		Berkshire Hathaway	1.6
Wal-Mart	2		Tesla	1.5
AT&T	1.9		UnitedHealth	1.4

Margins have grown through the transformation from a brick-and-mortar economy to a bytes and bits economy. ExxonMobil was the second largest stock in 1995, and it currently has an operating margin of nearly 12%. Apple is the second largest company on this list, and it currently has an operating margin of 31.5%. The margins of the underlying stocks in the index have been increasing consistently over years.



As of Q2 2025

2) Predictability of Cash Flow

Predictability of cash flow has increased also. Businesses have not only transitioned to bytes and bits, but they have moved to subscription web-based models. The result has been smoother cash flow, greater network effects, pricing power, and lower turnover. Amazon Prime members have a 93% retention rate after the first year. Costco has a 90.2% retention rate. Netflix; 98.2%. Microsoft; 97%.

3) Discounting Cash Flow at Lower Rates

Now, let's get to some nuts and bolts of valuation. If you're reading this, there is a good chance you've done a discounted cash flow analysis in your life. One of the many large assumptions made in that valuation assessment is the discount rate. The lower the discount rate – the higher the valuation – all else equal. The chart below shows the 10-year treasury from 1995 to today, and you can see the late 90s and early 2000s had much higher rates.

Another aspect of the discount rate would be the premium needed above treasuries. With smoother, more predictable cash flows you would expect a smaller premium which would lead to higher forward P/E. When we view the higher P/E ratio from this lens we can see that the P/E is not a measure of valuation, but it is a measure of expectations and confidence which is reasonably better than it was in 1995.



As of Oct 20, 2025

4) Attractive Earnings Growth: Historically and Recently

Finally, and most importantly, average annual earnings growth for the S&P 500 over the last 30 years has been a very impressive 6.7%. A 6.7% earnings growth rate plus a 4.4% earnings yield (with our 'high' P/E), gets to a 11.1% expected return which is attractive but not overwhelming. A good argument can be made that in the post-COVID world earnings have been irrationally high, and we need a mean reversion in growth since earnings growth has been 14.3% since 2020. There is an equally strong argument that stronger growth is more normal. Since the financial crisis, the average annual earnings growth has been 10.2%. Unsurprisingly, the average annual return of the S&P 500 for the last 15 years has been 14.3%. The average annual growth rate (10.2%) plus the current earnings yield (4.4%) is only a little higher than that average annual return.

What's Cheap? What's Expensive? What's Fair Value?

Given this data dump, what do I think would be a cheap valuation, and what do I think would be expensive? A cheap valuation would have a 25% expected return, which is a return hurdle that has been reached five of the last ten years. I would characterize the market as expensive if the expected return is below the B-BB High Yield index plus a modest spread. I have a 14% expected return over the next 12 months based on my assumptions, which is not cheap, but much better than expensive. It fits nicely into the 'fair value, fair return' bucket.

Sources:

1) P/E Chart from JPM Guide to the Market
2) Market Cap Data estimated from Microsoft Co-Pilot
3) Margin Chart from Bloomberg
4) Rate Chart from Ycharts

This information is not intended as a recommendation. The opinions are subject to change at any time and no forecasts can be guaranteed. Investment decisions should always be made based on an investor's specific circumstances. Investing involves risk, including possible loss of principal.

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