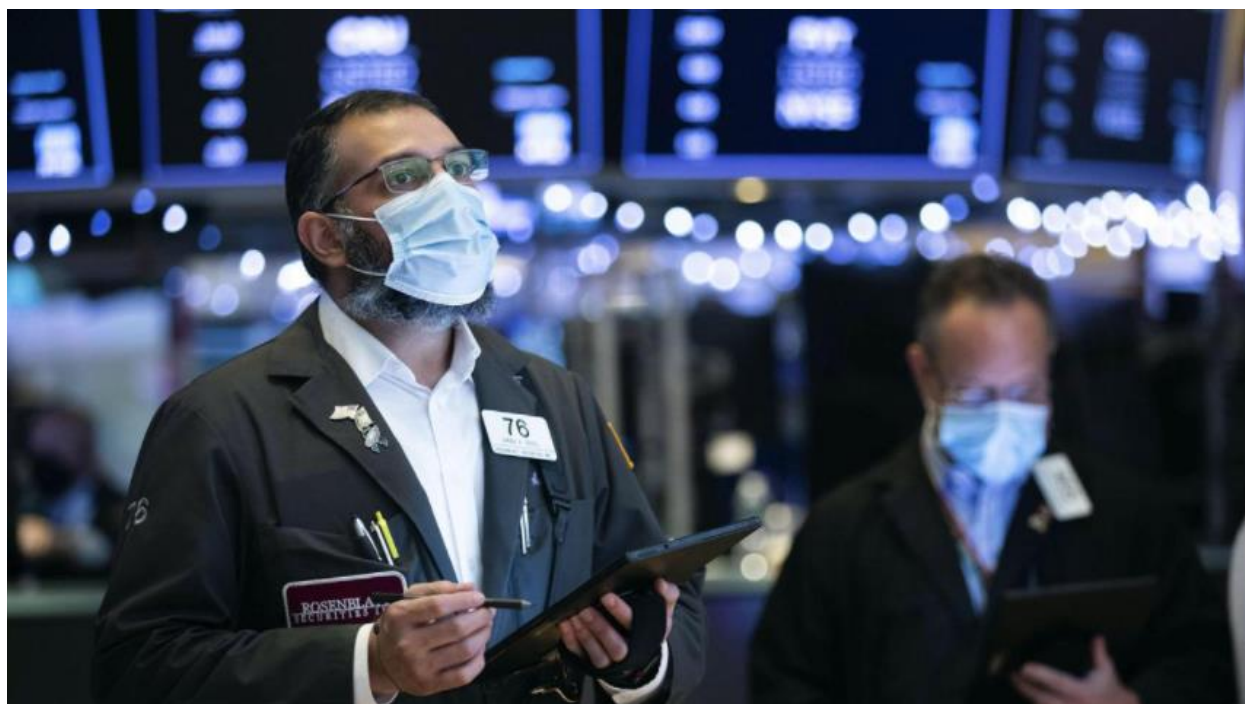


THE  TIMES

Have American shares become too expensive?

Some US shares may be overpriced, but there's still value to be had in American equities



Investors in the US stock market have been the biggest winners in the 12 years since the financial crisis. Shares in the MSCI USA Index, home to some of the largest companies in the world, are up 641 per cent since the market low of March 9, 2009. In comparison, stocks from the rest of the world, measured by the MSCI World ex USA index, rose 246 per cent in that time.

A gap has remained between the two since the pandemic: US share



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

prices have risen 60 per cent since March 16 last year while the rest of the world's stocks are up 45 per cent.

Even when markets were wobbling in February, the S&P 500, a collection of the largest listed firms in the US, was hitting record highs. It shot past 4,000 for the first time on April Fool's Day and has continued to advance since.

Investors are now starting to ask if US shares have become too expensive.

On some metrics the MSCI USA index has only been more expensive once in its history – in the run-up to the dotcom bust in 2000, when investors piled into unprofitable tech stocks en masse.

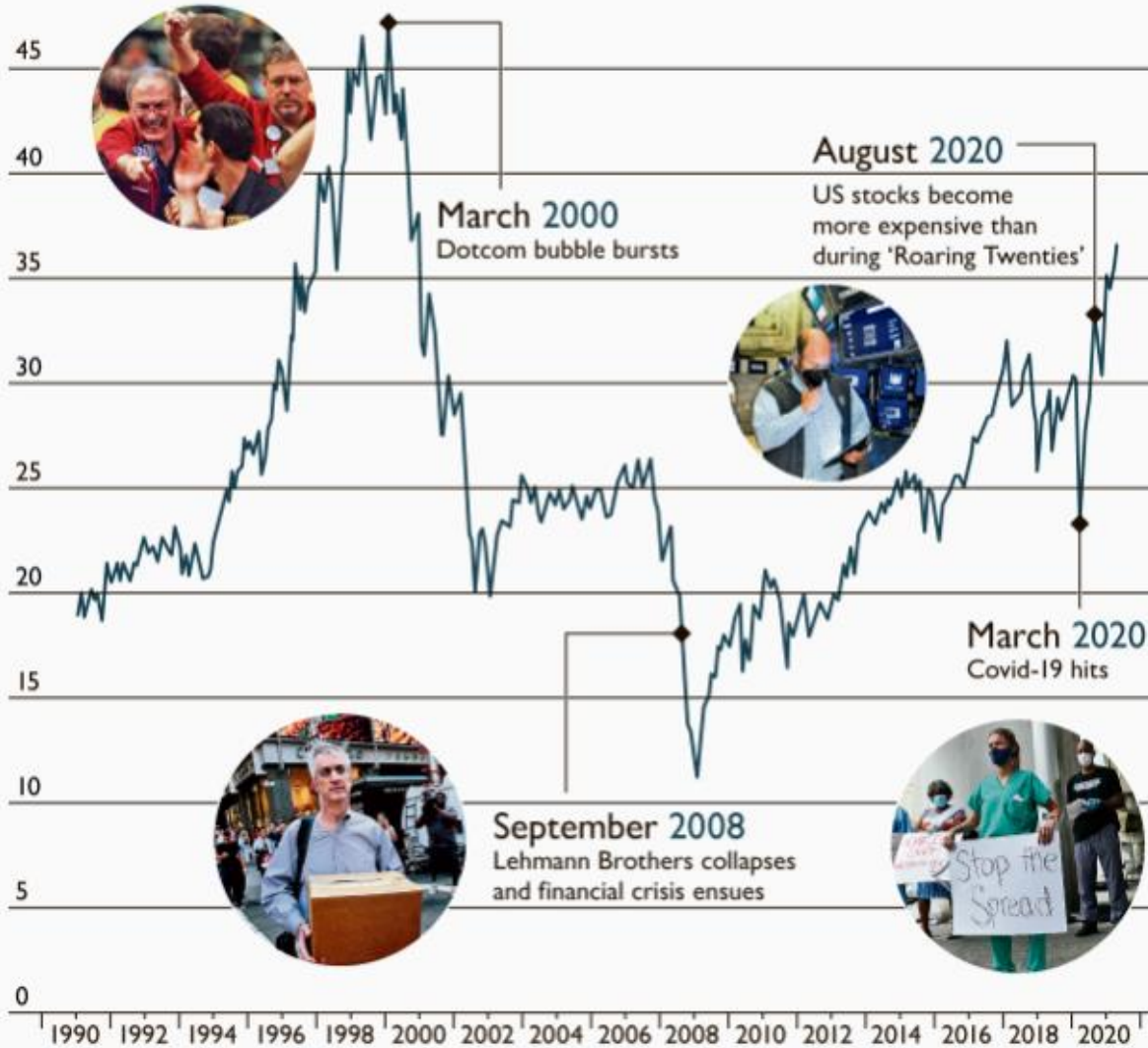
Today excesses seem abundant, whether that's from investors putting billions of dollars into special purpose acquisition companies (Spacs), which float on the stock market and then look for a private company to merge with; meme stocks such as GameStop; or cryptocurrencies invented as a joke, such as Dogecoin.

“It is story time in America. The better the story, the better the stock,” said Eric Lynch, a co-manager of the Oyster US Value fund. “Not since the tech bubble have earnings become so disconnected from stock prices.”



Sky-high valuations

◆ The cyclically adjusted price/earnings ratio of the MSCI USA index



Graphic: The Times and The Sunday Times • Source: Barclays via Datastream

The best measure of how expensive stocks are is the cyclically adjusted price-to-earnings, or Cape, ratio. The Cape ratio for the MSCI



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

USA Index stood at 36.8 on March 31: essentially share prices were almost 37 times greater than companies' average earnings. This is higher than the level reached immediately before the Great Depression in September 1929, when the equivalent ratio would have been 32.6. Before the dotcom bubble burst in 1999 it reached 47.1.

The Cape ratio is calculated by taking the price of an index or stock and dividing it by its average earnings, adjusted for inflation, over the past ten years.

Michael Walsh from T Rowe Price said: "There is no real getting away from it, across almost all valuation metrics the US market is at or as close to as expensive as it's been."

Walsh said there were some big potential risks lurking in the background too. Any negative news on the pandemic would knock stocks, while tax rises are in the offing, which will hit profits. News of an increase in capital gains tax by President Biden sent some stocks sinking last week.

Analysts think US companies will report big profits for 2021 and 2022, boosted by post-pandemic optimism. While that will be good news if they hit their targets, should the final numbers come in lower than expected, "you could see sentiment turn pretty sharply", Walsh said, and investors may seek to sell up quickly.



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

Take Netflix. The video-streaming service announced that revenues for the first three months of its financial year had increased more than forecast, but new subscriptions, a key barometer of the company's success, came in at 3.98 million – much lower than the expected 6.2 million. Netflix's share price fell 7.5 per cent.

For others, however, US equities are anything but overvalued. Low interest rates mean stocks are the best place for investors to source returns. Safer investments such as government bonds offer almost nothing.

Cash has been flowing into the US economy from the Federal Reserve, its central bank, since the financial crisis, and that has boosted stock markets. Even the US government has got in on the act as it tried to shelter the economy from the ravages of Covid-19.

Tony DeSpirito from BlackRock, an investment manager, predicted that the impact of the pandemic on US gross domestic product (GDP) was a quarter that of the 2009 financial crisis, yet the policy response has been six times larger.

The success of the vaccination programme and pent-up demand from consumers as bars, restaurants and shops reopen should also be positive for stocks, he added. "For these reasons we believe a strong acceleration in economic growth is possible. As a result, earnings are likely to exceed expectations," he said.

And US markets are home to a wide range of businesses, so taking a



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

view on valuations as a whole across the market could mean you're missing out on some cheap firms.

While many believe the Faang stocks (Facebook, Amazon, Apple, Netflix and Google) are the poster children for expensive stocks, others see value even within this acronym.

Christopher Rossbach from J Stern & Co, an investment manager, said Facebook is cheap despite shares having advanced by 62 per cent in the year to April. He said the social media giant was looking at a price-to-earnings ratio of 20, a cheap multiple that means "it is poised to outperform".

He noted that the outlook for the digital advertising market was strong post-pandemic.

Rossbach thinks the payments specialist Visa will be a beneficiary of consumer spending coming roaring back as economies around the world reopen. The shift to contactless payments and growth of ecommerce will be a boon too.

Chris Elliott and James Knoedler at Evenlode, an investment manager, expect Accenture to be the leading technology services provider, well placed to capitalise on businesses increasingly outsourcing services such as cloud computing and artificial intelligence.

Duncan Goodwin from Premier Miton Investors, a wealth manager, said the increase in merger and acquisition activity bore out his view that there is value in the healthcare sector. He likes Stryker, which



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

makes medical equipment, and the clinical research firm Icon, as well as the food ingredients companies Ingredion and Darling Ingredients. For fund investors, now could be the time to seek out active managers working within the US stock market, rather than sticking with passive funds, according to Robert Burdett at BMO Global Asset Management.

The accepted wisdom is that because the US is the biggest and most high-profile market, it is harder for stockpickers to outperform the market. As a result, investors may as well stick their cash in a low-cost fund that simply tracks an index such as the S&P 500 or Nasdaq Composite.

In the ten years to December 31, 2020 no active fund investing in US large-cap growth stocks outperformed its passive counterparts, according to Morningstar, a research provider. And in Morningstar's US large-cap blend category, which holds value and growth companies, only 6 per cent of active managers outperformed passive funds.

One reason humans have found it hard to beat the market is because the biggest companies have historically made up a low proportion of the index. That is not the case today.

Apple, Microsoft, Amazon, Facebook, Alphabet (Google's owner) and Tesla account for 21 per cent of the 621-strong MSCI USA index. This means index-tracking investors probably have too much of their



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

portfolio exposed to these stocks, which could tilt things in favour of active managers.

Burdett prefers boutique fund houses because they tend to give their fund managers more scope to back their convictions and are generally better aligned with end investors.

The Artemis US Select fund is one of these. Run by the former Columbia Threadneedle stockpicker Cormac Weldon, the fund invests in between 50 and 70 companies, with a portion in smaller firms. Amazon, Alphabet and Facebook are in the fund's top five holdings but feature alongside the transport company Norfolk Southern Railway and the chip-maker Broadcom.

Burdett also holds Majedie US Equity, run by the former Fidelity manager Adrian Brass. The fund has 37 holdings at present, led by Microsoft and three of the Faangs. Behind them come Fiserv, the fintech payments firm, US Foods, a food distributor, and the health insurance company Anthem.

The research firm Capital Economics thinks stock markets may not advance much further through the rest of 2021. Its chief market economist, John Higgins, noted that the recent surge in the S&P 500, to 4,189, leaves the index just 11 points below the company's end-of-year forecast.

Which stocks are overvalued and undervalued?



Source: The Sunday Times
Date: 02/05/2021
Pages: Online

J. STERN & CO.
The Value of Long Term Investing

Overvalued

Tesla

Netflix

Zoom

Undervalued

Stryker

Visa

Ingredion

