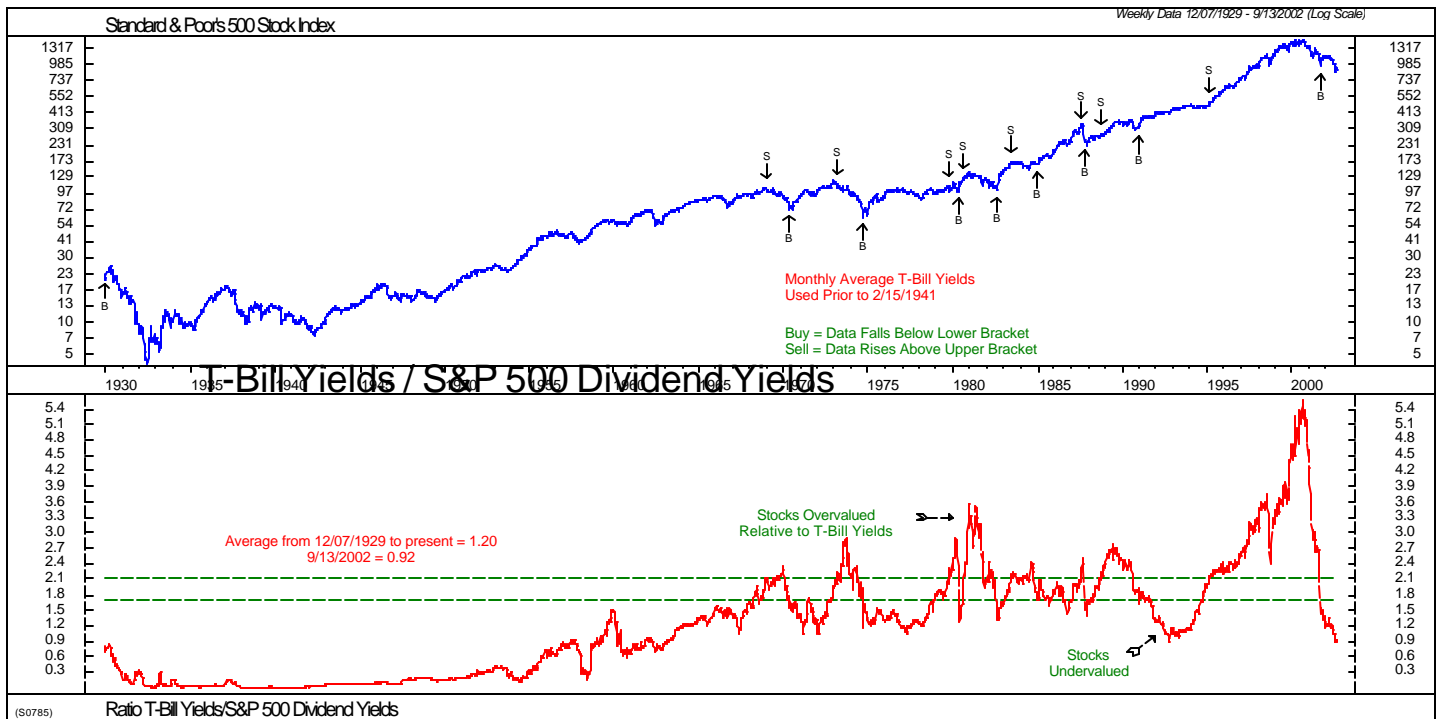


# S&P 500 stocks undervalued? By one measure, yes.

by Howard Spieler



Currently, the Price to Earnings Ratio (P/E) of the S&P 500 is 33. The historical average is around 15. Bull markets have usually ended when the P/E rose to around 22. How can stocks be undervalued? Reference the lower half of the chart above, T-Bill yields divided by S&P 500 dividend yields. When the reading is below one, as it is now, that means that S&P 500 dividend yields are greater than T-Bill yields. This is in contrast to the end of the last bull market, which produced readings as high as 5.2. Current low readings are probably a result of two factors: #1, interest rates, by historical measures, are very low, and to a lesser extent, #2 stock prices are also low, boosting the dividend yield percent (not necessarily that dividends are higher, just that stock prices are lower). Note: S&P 500 stock prices as well as dividend yields are at approximately 1997 levels. The current dividend yield of about 1.8% is very low by historical standards (the twenty five year average is 3.25%).

In general, T-Bills should yield less than stocks, given the risk free nature of the debt and the risk associated with buying securities. Prior to 1955, these low ratios were common (reference the chart above); however, as faith in the stock market grew, it became more common for stocks to provide lower yields than the risk free T Bills. Stocks are evaluated by two measures: Growth potential and dividends. When growth potential appears favorable, investors are willing to sacrifice dividend yield. If the market or the economy is depressed, as they are now, then the tolerance becomes lower.