

Markets AND Valuations Keep Continuing Skyward

Markets continue to march steadily and quickly upward. After the tech heavy NASDAQ reached a new record in early June, the S&P 500 followed in mid-August, and the Dow Jones Industrial Average, despite much lower exposure to technology shares, is about even on the year. All this comes despite unemployment numbers around 10% and weekly jobless claims that remain stubbornly above 1 million.ⁱ

After the S&P 500 set a new high on Tuesday August 18, surpassing its February high, valuations have continued to climb to levels only reached two times in previous history (1929 and 1999), and by some measures, valuations have never been higher. Investors seem to be betting that the current recession will pass quickly and that corporate earnings, the primary driver of stock prices, will bounce back strongly. Claims of a potential vaccination helped boost investment sentiment further, again driving up stock prices.ⁱⁱ

The price/earnings ratio (P/E) on the S&P 500, measured against the past 12 months of earnings, is over 25, the highest level since 2002. The forward price/earnings ratio (P/E), measured against earnings expectations for the next year, is at 26, a mark last hit in September 2000, just prior to the dot.com bubble bursting. The index itself is trading at the 98th percentile. The valuation of the median (not average) stock in the S&P 500, measured by forward P/E, is now in the 100th percentile, the highest level possible, according to Goldman Sachs Group, although this measure only goes back four decades.



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The Shiller P/E ratio, CAPE Ratio, or PE10, which divides the price of the S&P 500 index by the average inflation-adjusted earnings of the previous 10 years to better focus on long-term trends, sits around 32 which is two standard deviations above its average level. Research notes that using data post 1995, the CAPE ratio's current value of 30 plus would predict a real 10-year U.S. equity return of between 0% and 5%.ⁱⁱⁱ

It appears that the only way for valuations to continue higher would be for markets

to duplicate the tremendous runups of the 1920s and 1990s when the booming economy propelled stocks to the only two periods during which stock market valuations exceeded those of today.

Beyond valuations, other dynamics have created a highly unusual market. Many have noted the seeming disconnect between today's struggling economy and the highflying stock market. Yet, more than probably any other time, the stock market is not the economy. As has been discussed in past newsletters, a very small number of equities are disproportionately driving stock market returns. As a capitalization weighted index, over 20% of the S&P 500's returns derive from only five technology stocks – Amazon, Apple, Facebook, Microsoft and Google. Taken a bit further, the 10 biggest technology companies in the S&P 500 weighted equally were up more than 37% through the end of July of this year. The other 490 equally weighted stocks were down about 7.7%.

In many cases, the most visible and highly impacted industries have been the most impacted by economic shutdowns. Through the end of July, department stores were down 62.3%, but on a market-cap basis they are a mere 0.01% of the S&P 500. Airlines, down 55%, weigh in at 0.18% of the index. Every stock in these sectors could go to zero and the index would barely budge. Other smaller sectors are also off sharply including travel services down 51.4%; oil and gas equipment and services, down 50.5%; and hotel and motel real estate investment trusts, off 41.9%.

ⁱ <https://finance.yahoo.com/news/jobless-claims-coronavirus-unemployment-week-ended-august-22-2020-181644541.html>

ⁱⁱ <https://www.wsj.com/articles/the-median-s-p-stock-has-never-been-more-expensive-11598202000?mod=searchresults&page=1&pos=1>

ⁱⁱⁱ <https://www.morningstar.com/articles/993648/maybe-theres-something-to-the-shiller-cape-ratio-after-all>

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MARKET COMMENTARY

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By contrast, the Nasdaq Composite 100 Index, which is dominated by big tech companies, is up about 30% on the year and nearly 50% in the last 12 months. On August 17th, the Index set another new record with its 20-day simple moving average (SMA) rising for 89 consecutive days.^{iv}

The world's largest stock by market capitalization, Apple, provides some insight into the returns. It took about 38 years for Apple to reach the \$1 trillion mark, and only two years to double to \$2 trillion. At their current valuation of more than 32 times earnings, investors appear to be valuing Apple as if nothing could go wrong. This is Apple's highest valuation in more than a decade and double the P/E multiple investors paid when Apple's market value first crossed the \$1 trillion mark, meaning that Apple investors are now paying twice as much for the same earnings outlook.^v High valuations across the big tech companies (Amazon's trailing twelve month P/E ratio sits at a lofty 130) are big drivers of the current rally.

Yet, as expensive as stocks are now, credible arguments exist that suggest prices could climb even higher. The Fed announced at the end of August that, unlike in the past, it does not intend to raise rates even if inflation picks up. By some comparisons, stocks are actually cheap compared to bonds, and the prospect of extended low rates potentially increases the attractiveness of stocks. For investors following a traditional stock and bond model, the lack of appeal for bonds could continue to push money into stocks, further propelling stocks.

Furthermore, as high as the valuations are and as much as high valuations suggest returns will be muted in the future, valuations are poor near-term

performance indicators. The Shiller or PE 10 ratio in particular is very good at identifying longer-term trends, but has generally been of little value in determining short-term trading strategies.

For investors, today's high valuations and highly uncertain economic conditions likely suggests caution, but not panic. Markets are trading at high levels, and they could continue to push forward for the foreseeable future, particularly if the economy bounces back quickly as seems to be expected by today's prices. Yet, today's valuations also strongly suggest that longer-term returns for stocks could be lower – possibly significantly – than during the past decade. Another significant economic disruption, or even something as simple as the contentious U.S. elections, could also derail the market leading to a sharp pullback to more “average” market multiples. Regardless, today's high prices may offer investors an excellent time to assess their portfolio and possibly explore attractive diversification opportunities.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before investing. This and other important information is contained within the Fund's Prospectus, which can be obtained by calling (888) 445-6032 or by visiting the Fund website www.wildermuthendowmentfund.com. The Fund's Prospectus should be read carefully before investing.

Wildermuth Advisory, LLC is an SEC-Registered Investment Adviser that advises the Wildermuth Endowment Fund.

Investing in the Fund involves risk, including those summarized below. An investment in the Fund is generally subject to market risk, including the loss of the entire principal amount invested.

The value of your investment in the Fund at any point in time may be worth less than the value

of your original investment, even after taking into account any reinvestment of dividends and distributions.

You should consider the shares to be an illiquid investment. Even though the Fund will make periodic repurchase offers to repurchase a portion of the shares to provide some liquidity to shareholders, only a limited number of shares will be eligible for repurchase by us.

You should carefully consider that you may not have immediate access to the money you invest for an indefinite period of time. An investment in our shares is not suitable for you if you need immediate access to the money you invest. Certain investments in the Fund are illiquid making it difficult to sell these securities and possibly requiring the Fund to sell at an unfavorable time or price. The value of certain Fund investments, in particular non-traded investment vehicles, will be difficult to determine and the valuations provided will likely vary from the amounts the Fund would receive upon sale or disposition of its investments.

Wildermuth Endowment Fund's principal underwriters and co-distributors are:

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Definitions

S&P 500- A market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

Nasdaq Composite 100 Index- The market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange.

CAPE Ratio (aka Shiller P/E ratio or P/E-10 Ratio) - The CAPE ratio, an acronym for Cyclically Adjusted P/E (i.e., Price-Earnings) is a valuation measure that uses real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits.

Price/Earnings Ratio (P/E) - The ratio for valuing a company that measures its current share price relative to its earnings per-share.

^{iv}<https://www.marketwatch.com/story/nasdaq-sets-a-momentum-record-which-in-the-past-has-led-to-declines-2020-08-14>

^vhttps://www.wsj.com/articles/apple-at-2-trillion-leaves-no-room-for-error-11597831200?mod=hp_lead_pos13