Is it a bad time to invest in U.S. stocks ?

In recent months, there are a lot of experts who are negative about U.S. markets, claiming that U.S. markets are too expensive. All these arguments are based on pointing out that the U.S. market and its P/E ratio are at all-time highs. Others argue that Trump is bad for the future of the U.S., an argument that was also made at the time of the election when eminent economists such as Paul Krugman, Nobel Prize winner, predicted a recession if Trump got elected

The problem with P/E ratios and experts

Using a P/E ratio puts excessive weight on E, short term earnings. The value of a company is the present value of its expected cash flows from now until infinity, which should make short term earnings irrelevant. The only way that this valuation metric would measure long term value is if these earnings would grow at a constant rate forever. I am not aware of any company that has a constant growth rate “forever”. It also assumes that every firm that loses money, such as Apple in 1997, is overvalued. Apple was trading below $ 1 in 1997 so with a current stock price of $ 157 this would have been a bad forecast.

The fact that the market is at an all-time high should not come as a surprise. Stock prices follow a random walk with positive drift, not a mean reverting process. So, stock prices are **expected** to go up, regardless of the level. The price of a share today is the resent value of the share tomorrow. As long as the discount rate is positive the expected returns from investing in stocks are positive. So, the best forecast of the stock market is that it goes up. The expected rate of return is a topic of debate in academia, depending on the model. The assumption of all models is that you are expected to earn a risk-free rate of return plus a risk premium. According to one model, the CAPM, if past risk premia are a good predictor of future risk premia, you would expect a risk premium of 5 % above the risk-free rate of return. With a risk-free rate of 2 %, one can expect a 7 % rate of return per year.

Of course, occasionally markets crash but crashes are unpredictable. Those who claim to have forecasted the 2008 crash were lucky. The true test of forecasting ability comes after the forecaster is declared a guru, A typical example is Nouriel Roubini, an economist, who became a guru after forecasting the 2008 crash. Since then Roubini has made numerous wrong forecasts. He joins many other gurus. A recent study of the forecasting ability of so called experts shows that they are right about 50 % of the time, the same predictive ability as tossing a coin.

https://money.usnews.com/money/personal-finance/mutual-funds/articles/2015/06/15/the-dangers-of-listening-to-financial-pundits

Despite this, experts and gurus keep parading on TV and are rarely questioned about their wrong past forecasts. In that sense journalists are like markets: they have no memory.

PV Buyback USA and “the market”.

The statement that “the market” is overvalued ignores that there are many funds that are not representative of the market. The “market” is the S&P 500 dominated by large cap stocks as the index is a value-weighted index of the largest 500 companies. PV buyback USA contains small medium cap companies, many of which have not benefitted from the stock market rise. One better statistic to judge undervaluation is the market-to-book ratio. According to Bloomberg, the current average market to book ratio of PV Buyback USA is 1.38. This is below the 2.36 of the Russell 2000 and even below the 1.57 of the Russell 2000 Value Index and clearly far below the 6.79 of the Russell 2000 Growth Index. So, the average stock in our fund is not apparently overvalued. Not surprising as when we pick stocks we buy beaten up value stocks, not glamourous winners.

What about Trump ?

A recent study from the Harvard Business School has found that 95 % of all the media reporting on Trump is negative. These are U.S. media. I suspect that the percentage for the European media is 100%, as most of them get their information from CNN and the New York Times. The fact is that Trump, despite his obvious short-comings, is the most pro-business president in history. He has cut numerous regulations through Executive Orders and has announced an ambitious corporate tax cutting plan. The fact that he failed to convince his Republican colleagues to overturn Obamacare does not mean he will also fail to pass tax legislation. First, repealing Obamacare was going to take away benefits from people, a politically hard thing to do. Cutting taxes is something most people like. Second, unless if they pass tax reforms, Republican politicians will be wiped out in the forthcoming November 2018 elections. We must assume that the politicians' instinct for self-preservation will prevail. Regardless of politics and fake news, the real news is that US GDP grew at 3 % during the last two quarters and consumer confidence rose to an all-time high since December 2000.

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