Global Matters Weekly

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The price of patience

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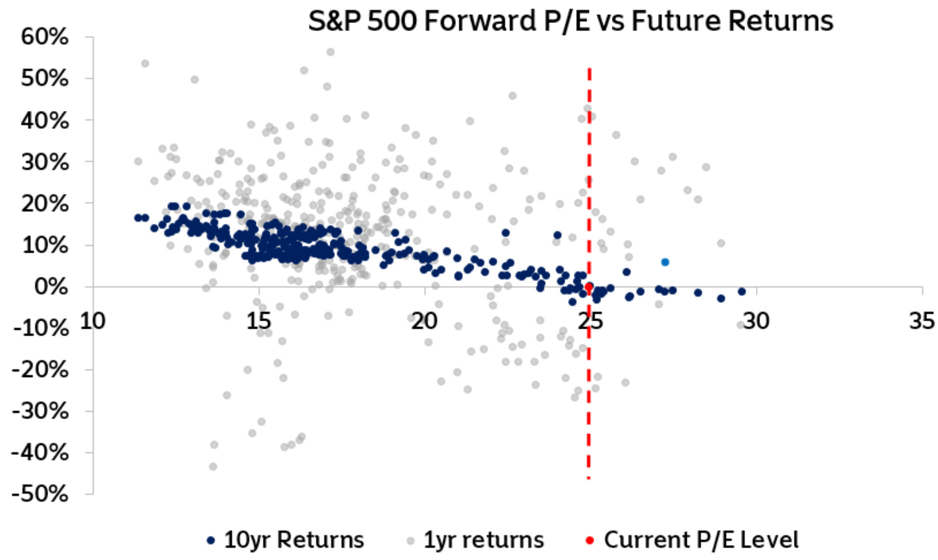
Chart of the Week



Sources: Momentum Global Investment Management, Bloomberg Finance L.P. data to 31 October 2024

What this chart shows

This chart illustrates the relationship between the S&P 500's forward Price-to-Earnings (P/E) ratio and subsequent returns over one-year and ten-year periods. Each dot represents a specific starting P/E level and the S&P 500's return from that point, either over one year (grey dots) or ten years (blue dots). The red dashed line marks the current forward P/E level for reference. The one-year returns are scattered, with little consistent pattern relative to the starting P/E, suggesting short-term returns are not strongly affected by initial valuation. In contrast, the ten-year returns show a clear downward trend as the starting P/E increases, indicating a stronger relationship between valuation and long-term performance. This means that the lower the starting P/E, the higher the probability of achieving robust returns over the following decade, while elevated P/E levels have historically been associated with lower ten-year returns. The current forward P/E, positioned above 25, suggests a cautionary outlook for ten-year returns from this valuation level.

Why this is important

The chart highlights a fundamental principle of long-term investing: valuation matters. Over short periods, market returns are influenced by a multitude of factors, including economic cycles, interest rates, and investor sentiment. As a result, the starting P/E ratio has minimal impact on one-year returns, making short-term performance difficult to predict and often unrelated to valuation. However, the ten-year return pattern underscores that valuations become crucial over longer time horizons. Historically, entering the market at lower P/E levels has been associated with strong long-term returns, benefiting from both earnings growth and potential valuation expansion. Conversely, starting at high valuations, such as the current forward P/E level above 25, may lead to subdued or even negative returns as valuations revert to more sustainable levels over time. For long-term investors, this chart emphasizes the importance of patience and discipline when investing in attractively valued markets. With the current high P/E suggesting lower expected returns, investors may need to adjust expectations or prioritise undervalued opportunities to enhance long-term return potential.

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