Equity valuations

If investment strategy was easy in early 2009, its because it was. Valuations of equities relative to cash or treasuries was at an extreme low making equities highly attractive. Equities were highly unattractive on the basis of their earnings yield gap in the periods 1981, 1983, 1987 and the early 1990’s. Equities have been attractive throughout the last 10 years. 2009 was an obvious buy. That’s all changed now and the earnings yield gap on the S&P now stands somewhere in the middle, indeterminate, providing no direction. If we have no view as to earnings prospects except that they grow at the long term rate of GDP growth and we expect treasury yields to rise on increased issuance, deteriorating public finances, then treasuries are a short and the yield gap is due to deteriorate further.

The picture of earnings yield spread against credit tells a similar picture. But neither credit nor equities are cheap after the 2009 rally.

The picture is pretty much the same in a global context.

Japan is looking better domestically.

The UK is no longer cheap.

Neither is Europe.

For the USD investor, US large caps look cheap. So does emerging market equities. Hong Kong and H shares as well as Brazil look cheap relative to India, Europe and Japan. In a local context Japan looks interesting despite a recent rally, which is interesting given the lack of domestic investor participation in recent times. Hang Seng and H shares still look cheap. India looks expensive.