"Who do you believe?"

By Tommy Williams, CFP®

Tommy Williams

How do you figure out what a stock is worth?

If you look at conventional measures – like price-to-earnings (P/E) ratios – then U.S. stock markets appear to be pricey. The Wall Street Journal reported trailing 12-month P/E ratios are high when compared to 10-year averages. However, high P/E ratios haven't dampened investors' interest in U.S. stocks, and share prices have been moving higher. The Dow Jones Industrial Average (Dow), Standard & Poor's 500 Index, and NASDAQ all reached new highs recently – the first time that has happened since 1999.

Barron's suggested investors' enthusiasm for stocks is rooted in the search for yield. "With the Treasury's 10-year note yielding 1.5 percent – near lows not seen before in modern history – there's no alternative to stocks for investors who want returns." Of course, that's a bit of

hyperbole since there are many types of investments that offer income to investors. Let's focus on stocks and bonds, though.

The relationship between stock yields and bond yields may have some investors measuring market valuations in different ways. Investopedia reported, during the late 1990s, Wall Street professionals came up with a new method for gauging stock market valuation. It was called The Fed Model and it determined full valuation by comparing stock yields to bond yields. (Please note: 'The Fed Model' wasn't created by the Federal Reserve System, and the Federal Reserve System does not endorse it.)

The Wall Street Journal offered this analysis:

"…the so-called Fed model, which says that stocks' earnings yields – that is, expected annual earnings divided by the share price – should equal the yield on the 10-year Treasury note. With the 10-year now yielding 1.52 percent, the Dow would be fairly valued at 66 times earnings rather than the current, measly 18. Dow 68,000 anyone?"

It's an enthusiastic estimate. While some analysts are speculating the Dow could surpass 20,000 during the next 12 months, according to CNBC, others are suggesting investors proceed with caution. Disagreement amongst analysts is as common as it is between presidential candidates. However, when forecasting the future of the economy, it becomes especially

Reprinted with permission of the Shreveport Times August 28, 2016.

confusing when credible analysts and institutions can't agree, or even announce entirely opposing predictions. As investors, who are we to trust?

For example, Citigroup, Goldman Sachs and other credible financial institutions have bumped heads on occasion when forecasting oil price movements. Goldman, with a notoriously pessimistic view on oil, was predicting prices would fall to $20 a barrel early this year while Citigroup has maintained a more optimistic forecast. According to Bloomberg early this year,

"Stick with oil, it could be the 'trade of the year,' according to Citigroup, Inc. Citigroup is among forecasters predicting a gain in the second half, projecting an average Brent price of $41 a barrel in the third quarter and $52 in the last three months."

Likewise, I urge you to 'Google' the phrase *"negative interest rates"*. You're likely to find a long list of headlines that promote a rate reduction mixed in with eye-catching articles that warn us that negative interest rates will cause the apocalypse. I don't think the apocalypse is coming; but, you can always find a pessimist in any crowd.

No matter the source of information, we must always trust our gut (or our trusted advisor) and remain informed. If you find yourself questioning legitimacy and truth, remember the words of President Ronald Reagan, *"Trust, but verify."*

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. This material was prepared in part by Peak Advisor Alliance.

Visit us at www.williamsfa.com. Tommy Williams is a CERTIFIED FINANCIAL PLANNER™ Professional with Williams Financial Advisors, LLC. Securities offered through LPL Financial, Member FINRA/SIPC. Investment advice offered through RFG Advisory Group, a registered investment advisor. RFG Advisory Group, Williams Financial Advisors, LLC, and Peak Advisor Alliance are separate entities from LPL Financial. Branch office is located at 6425 Youree Drive, Suite 180, Shreveport, LA 71105.

Reprinted with permission of the Shreveport Times August 28, 2016.