Stocks Due for an Upturn, says CRR

By Editor Test *Wed, Mar 16, 2011*

Even if GDP growth remains low, corporations can use stock repurchases to boost the growth of their stock prices to match past rates of appreciation, say researchers at the Center for Retirement Research at Boston College.

In contrast to more bearish observers who still regard the U.S. stock market as over-priced, researchers at the Center for Retirement Research are bullish. But they don't appear to be using the cyclically-adjusted P/E that some observers use.

"Stocks currently are priced near 15 times earnings, offering stockholders a potential real return of 6.5 percent," write CRR's Richard W. Kopcke and Zhenya Karamcheva in a new article. "Over the coming decade, if earnings continue to recover as they have during past business cycles, stocks are likely to pay returns that compare favorably to their historical averages."

"After falling sharply during the last recession, margins for nonfinancial corporations have recovered substantially, reaching 8.5 percent of output despite the weak expansion of business activity," they added. "… If margins remain near 8%, thereby splitting the difference between the high margins of the 1950s and 1960s and the low margins of the 1970s and 1980s, stock prices would likely remain at or above 15 times earnings as they have done in past economic expansions."

Even if the overall economy doesn't improve, stocks can still gain value, the article said. "Even if the growth of GDP remains relatively low for much of the coming decade, corporations can use stock purchases as they have over the last 25 years to boost the growth of their stock prices to match past rates of appreciation," the authors write.

"The additional appreciation resulting from these purchases generally will not affect the rate of growth of the total value of outstanding stock. Therefore, the additional growth in stock prices will be matched by the rate at which the number of shares shrinks," they add.

Not all market watchers are as optimistic. In mid-February, John Hussman of Hussman Funds, who relies on the Shiller P/E (this "cyclically-adjusted P/E" or CAPE represents the ratio of the S&P 500 to 10-year average earnings, adjusted for inflation), wrote that the market is still overvalued.

"Last week, the S&P 500 Index ascended to a Shiller P/E in excess of 24. Prior to the mid-1990's market bubble, a multiple in excess of 24 for the CAPE was briefly seen only once, between August and early-October 1929," he wrote. "Based on our standard methodology (elaborated in numerous prior weekly comments), we presently estimate that the S&P 500 is priced to achieve an average total return over the coming decade of just 3.15% annually."

In a March 1, column, Doug Short of dshort.com, wrote that the S&P 500 has recovered enough from its March 2009 bottom so that the Shiller P/E ratio is now in its second-highest quintile. In other words, stocks went from being undervalued back to being slightly overvalued.

His conclusion: "The Financial Crisis of 2008 triggered an accelerated decline toward value territory, with the ratio dropping to the upper second quintile in March 2009. The price rebound since the 2009 low pushed the ratio back into the top quintile. By this historic measure, the market is expensive."