

BOND YIELDS AND PE RATIO

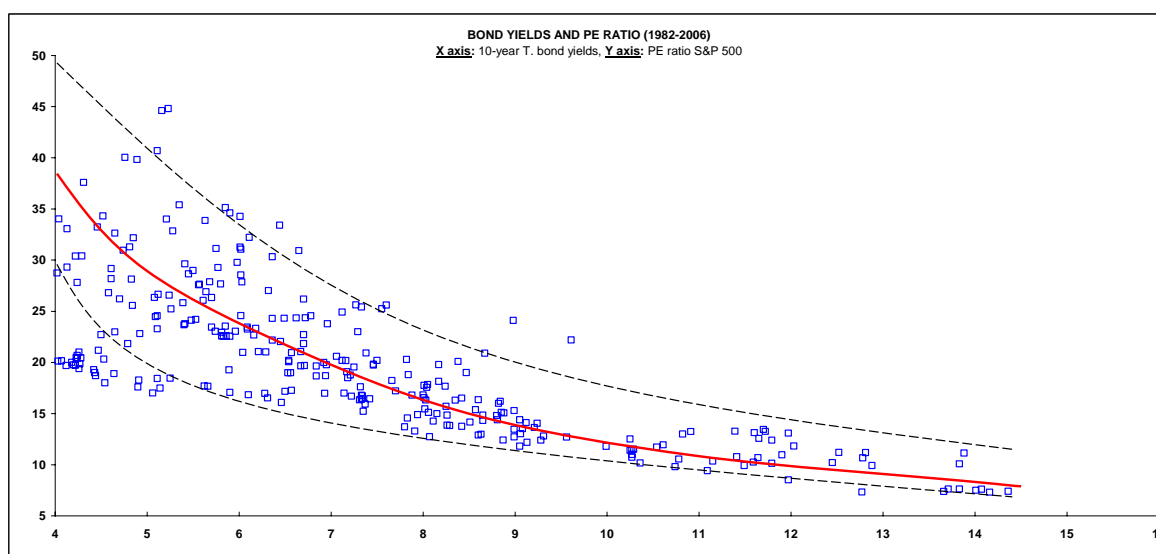
Bond yields and PE ratio of the S&P 500 are related by a simple and well known rule. The PE ratio declines during times of higher yields and rises when yields head lower.

The graphs shown below add more information to this rule. They show the range historically associated with a given level of bond yields.

In the early 1980s, when yields were above 10%, the PE ratio stayed close to 10. When yields declined to 8% the PE ratio moved between 12 and 20.

Yields on the 10-year Treasury bonds are now 4.91%. The historical range for the PE has been between 20 and 35 when yields are at current levels. Right now the PE ratio is 17.6.

In other words, the market is not expensive according to this relationship.



This chart shows the relationship between bond yields and the PE ratio of the S&P 500. At the current level of bond yields (about 5%), the PE ratio of 17.6 reflects a relatively inexpensive stock market.

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The Peter Dag Portfolio Strategy and Management
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