Everything Is Relative

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In 1789 Benjamin Franklin wrote, “Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes.” While I might add the absolutes of gravity and time to Benjamin’s death and taxes, everything else is relative.

We perceive the world through our own individual lenses. Facts may be undisputable, but how we interpret and use those facts can be quite personal. Investing is not much different. Sure, there are absolute facts, but interpretation is relative. For example, I often refer to the price-to-earnings ratio when writing about the market’s valuation. While I use this metric because it’s easily understood and the most common valuation measure, there are many others to consider. Regardless of the metric(s) you choose, it does not mean much were they to be used as an absolute. Consider the current P/E of 25. It is a fact that cannot be disputed. It is absolute. However, other than meaning that investors are paying $25 today for $1 of last-year’s earnings, it doesn’t tell us much more. Is it expensive, cheap or just right? In the same way Goldilocks found the most comfortable bed, we must make the absolute relative. In investing, we do so by comparing current facts to their history and/or close competitors. Using this simple technique to assign relativity, we can better interpret the importance of any fact.

The US stock market is the biggest in the world, and by a large margin. The nearest competitor is Japan, followed by the UK and Hong Kong. China, for all the talk, remains behind Holland in terms of size. Big however, does not always mean better – except in Texas. Like a company, countries compete. As we’re seeing from Trump, they compete for growth, exports and jobs, among other things. To influence the flow of these things in one direction or the other, nation states rely on tax policy, specifically corporate tax rates and tariffs, as well as monetary policy, immigration policy and cheating – in the form of subsidies. All of these, and more, affect the underlying facts, represented by economic growth, trade deficits, employment, etc. However, like Goldilocks and P/E, an absolute fact means nothing without the ability to give it context. For example, China’s economy has been growing roughly 7% (or more) for several years while the US has been closer to 2%. There are reasons for that; chiefly China’s anti-agricultural revolution, currency manipulation and cheap labor. However, notice that each of these things are relatives and not absolutes. As China has developed, there has been massive population movement from rural agricultural communities to larger communities and cities. This has hastened their growth, relative to other developed countries, as demand for goods and jobs have followed. Likewise, China’s currency manipulation (the Yuan is pegged to the US Dollar) is intentional in order to facilitate trade with the US flowing in one direction. Lastly, “cheap” labor is a relative definition and only has meaning when compared to other countries. For all of these reasons, China has been able to grow faster than most other countries in recent times.
While I often look at the market’s valuation relative to its own history, we can also compare the US’s valuation to that of other countries. What follows is just such a comparison. Put another way, we will make the absolute relative.

Using data at the end of March, I refer you to our old friend P/E. Using this metric, the US is the 10th most expensive stock market in the world. Not bad, and about the same, or less, than all developed markets and developed Europe, but well above many emerging markets.

With Shiller’s P/E, we see that the US is the 3rd most expensive market in the world, eclipsed by only Denmark and Ireland. Above all developed markets and well above Europe and all emerging markets.

Price-to-cash flow continues the trend, showing the US 8th most expensive.
And again with price-to-book.

And price-to-sales.

Yet again with dividend yield.
So, the US is expensive relative to its country competitors, and from previous posts, relative to its own history. But it has performed well right? Well, yes and no. Good for sure, but there have been better. Relative strength is a performance measurement. It shows how one country (or stock) has performed relative to another.

Using 26-week relative strength, we see the US lagging others, 14th worst, albeit still positive.

We see a similar story when using 52-week relative strength, albeit more positive. Credit the market’s reaction to Trump’s pro-growth agenda here.

So, where does this put us? Relatively speaking, the US is expensive when compared to most competitors yet has performed roughly at, or below the average. Combining high valuation with average performance and a picture begins to emerge – there are 34 better countries to invest than the US.

One caveat to this relative analysis – it is backward looking. The equation for relative economic growth, and therefore earnings growth, may change depending on Trump’s ability to influence the growth of the US, which in turn, may make the US look better… relatively speaking.