



Important Topic: Appreciating Valuations

We've written before about valuations — whether markets or companies are considered high or low, expensive, or cheap. This month, we'd like to add an important layer of understanding.

Consider the Price/Earnings (P/E) ratio, which is simply the share price divided by the company's earnings. While every industry differs, the 30-year market average has been about 17× earnings. That means a company earning \$1 per share might reasonably trade at \$17.

However, valuations do not just reflect what a company earns today. Valuations also attempt to capture what the company is expected to earn in the future.

A Simple Example

ASuppose a company is expected to grow earnings from \$1 this year to \$4 next year. On such an expectation of growth, investors may be willing to pay upwards of \$68 per share today since $\$4 \times 17 = \68 is the expected reasonable value next year. At first glance a P/E of 68 today, ($\$68/\1 current earnings) appears unreasonable but it would prove to be quite reasonable if the company does earn \$4 next year.

In other words, investors are willing to pay today for tomorrow's success.

The lesson: The value of a company is dependent on its future.

The US Index (S&P 500)

The S&P500 market in August 2020 was at 3,500 and earnings were 148, giving a P/E of 23.6. Now the market is around 6,900 and earnings are 300, giving a P/E of 23. In other words, the market has almost doubled over this time because the earnings almost doubled. So even though a P/E of 23 is higher than the historical average, it did not point to an over valuation. It did not mean that the markets were facing an imminent downturn. If, as over the last 5 years, earnings continue to grow, we can see the market continue to rise.

The lesson: Higher P/E can prove to be reasonable if justified by future earnings.

Value vs. Growth Stocks

If a stock trades below 17 times its earnings, it's often labeled a "Value" stock. It appears inexpensive. The low P/E may reflect an expectation that earnings decline. But if earnings do not decline or even rise, such an investment may prove to be very smart in hindsight.

If a stock trades above 17 times earnings, it's considered a "Growth" stock. You appear to be overpaying at that moment because the market expects higher future earnings. If those earnings materialize, the company will "grow into" its price and paying the high value may prove to be very smart in hindsight.

The lesson: Value stocks look cheap now because expectations are low. Growth stocks look expensive now because expectations are high. Both can be rewarding, depending on how the future unfolds.

Expectations Matter Most

This helps explain why companies sometimes report excellent results and still see their stock price fall.

It's not just about how well the company performed — it's about whether it did better or worse than expected.

For example, if investors expected earnings of \$4 and the company delivered only \$3, the fair price might fall from \$68 to \$51 — a 25% decline — even though profits tripled from the previous year.

The lesson: markets reward companies that exceed expectations and penalize those that fall short, no matter how strong the results appear in isolation.

Risk

What a higher P/E ratio does tell us is that the Price depends more heavily on future success. This is risk.

A high P/E that does not justify itself with future earnings can fall considerably and quickly. In contrast, low P/E companies represent lower risk.

Conclusion

Companies and markets may appear expensive or inexpensive — but we only know for sure after the fact. It all depends on how the future unfolds.

High valuations signal higher dependence on future success. They carry more risk, but also the potential for greater reward. What matters is whether earnings ultimately exceed, meet or fall short of the expectations.

Market Update: October 2025 – Sticking to a Multifaceted Plan

Markets rose again in October. This is the sixth month of broad-based gains producing very attractive year-to-date returns.

Very few took President's Trump announcements on April 2, "Liberation Day", as a reason to invest. On the contrary, many foresaw the introductions of tariffs as the beginning of a market downturn and called for selling. But as with all predictions of the future, circumstance changed, people changed, policies changed, rendering the prediction not only false but detrimental to all who followed such advice.

Admittedly, our team had no special access to information, no crystal ball, no ability to know if the prediction would prove true. So why did we stick to plan and ignore this reasonable fear?

In short, because we build multifaceted portfolios for all seasons, using hundreds of possible futures, and never based on one. Equally, we are highly skeptical of the value/accuracy of predictions.

But let us take a moment to assess what one does when one does not know what to do.

There are usually two courses of actions:

First, since we do not know, we find someone who does, and we accept their recommendation.

I do not say this disparagingly. This is what we do often, and we should. It makes sense. We do this with doctors, lawyers, repairmen, even landscapers. We turn to experts for good reason.

One can also do one's own research into the recommendation to decide if it makes sense and whether one agrees.

In the above case, all analysis of past tariffs would provide ample evidence that tariffs have negative effects on economies. The research would support the fact that Liberation Day was in fact going to lead to a downturn.

But it did not.

Second, since we do not know, we consider whether anyone can.

The distinction here is that we are not dealing with an illness, a legal problem, a broken appliance or what to do with our front lawn. In this case we are dealing with projections - about the future!

The distinction is that such a prediction can only come true if a slew of variables remain constant.

But they do not. Tariffs thrown up on a Wednesday are removed on Friday. Companies who say they are concerned about the future on Monday start hiring new employees the following week. Interest rates that are supposed to remain the same are cut.

As such, projections only come true under a specific set of circumstances. In other words, the prediction is only one possible way forward.

And if a specific prediction is appealing, it is wise to seek out those who hold the opposite position. Listen to their arguments and review their supporting data.

I can almost guarantee that selecting the more persuasive argument will be near impossible.

It is the balance of the strengths of the two opposing views that results in the market price.

Conclusion

We accept that the future is unknown. We accept that any point in time the world can change, and that it can change in any one of hundreds of ways. This cannot be predicted.

We build multifaceted portfolios to succeed in many possible futures and to weather the unexpected. We use thousands of simulated possible futures to stress test portfolios.

This is what gives us comfort that we are prudently positioned.

While we do not know what will happen or when, we continue to believe that the economy will push forward. As long as earnings continue to grow, consumers continue to spend, and wages remain strong, we do not expect markets to fall any further than usual and believe the odds remain in favour of attractive gains.

We remain cautious about the short term (anything can happen) and positive and optimistic about the medium, and long term. To be clear, this is based on over 100 years of data and the continued success of capitalism in allocating scarce resources best.

Most importantly, we are confident that working together we can meet your, our client's, objectives. At the end of the day this is all that truly matters.

Portfolio Update

Index	Month	Year to date
Bonds FTSE Canada Universe Bond Index - CAD	0.70%	3.70%
Canadian Equity - S&P/TSX 60 Index - CAD	0.80%	23.00%
US Equity – S&P 500 - CAD	2.30%	15.80%
International – MSCI EAFE Index - USD	1.20%	27.10%
Global Small Companies - CAD	0.90%	14.20%
Emerging Markets - MSCI Emerging Markets Index - CAD	4.30%	29.80%
Real Estate - Dow Jones® Global Real Estate Index - USD	- 1.40%	7.90%
S&P/TSX Preferred Share Index - CAD	1.90%	14.20%

Have a great month and let us know if there is anything we can do for you,

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