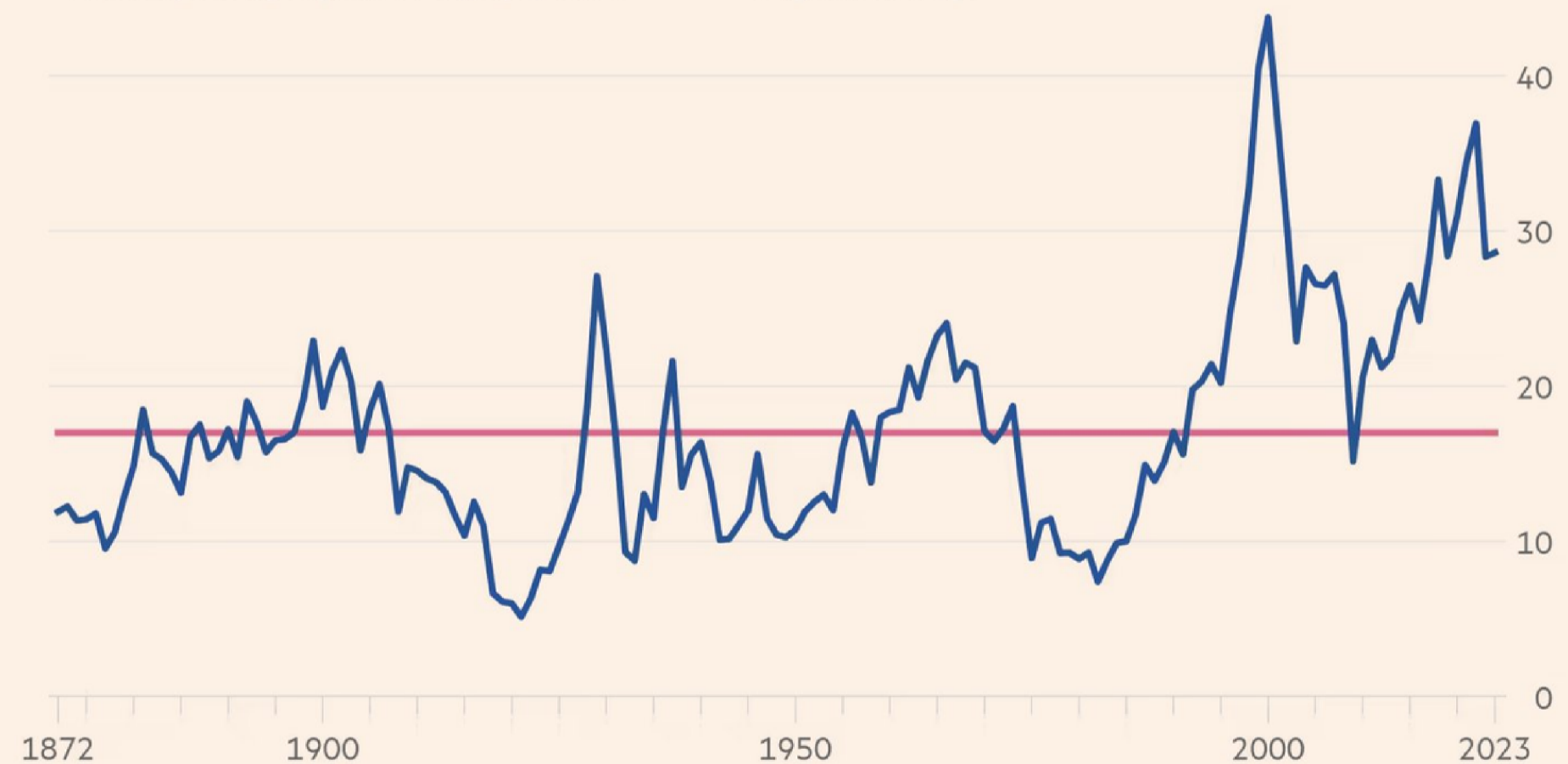


Demystifying CAPE Ratio

Cape ratio suggests valuations for US stocks remain lofty

S&P 500 index

— Shiller cyclically adjusted PE (Cape) ratio — Long-run average



Source: Robert Shiller

© FT



What is CAPE Ratio?

CAPE Ratio, also known as Shiller PE Ratio, stands for Cyclically Adjusted Price-to-Earnings Ratio.

It's a valuation metric used to assess whether a stock market is overvalued, undervalued, or fairly valued over a long-term period.

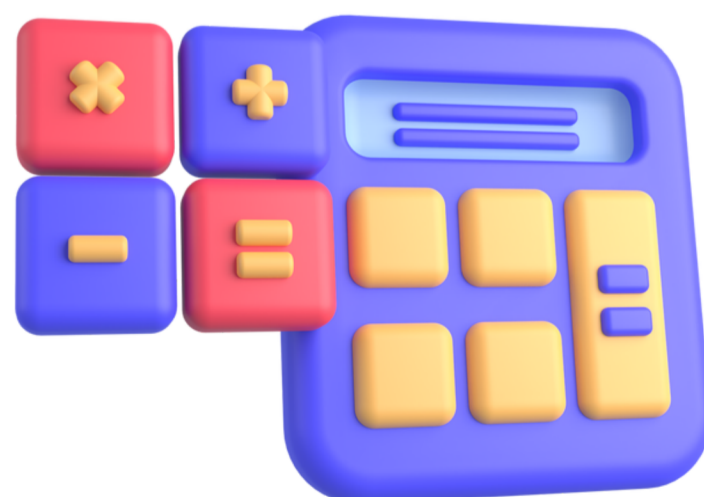




How is CAPE Ratio Calculated?

$$\text{Shiller PE (CAPE Ratio)} = \frac{\text{Current Market Price}}{\text{Inflation Adjusted Earnings}_{10\text{-Year Avg.}}}$$

The 10-year average smooths out earnings fluctuations, providing a more stable assessment of valuation.





Interpreting CAPE Ratio

- **High CAPE:** The market may be overvalued, with the potential for lower future returns.
- **Low CAPE:** The market may be undervalued, with the potential for higher future returns.

Compare CAPE to historical averages for better context.





Benefits of CAPE Ratio

- **Long-Term Perspective:**
Focuses on economic cycles, not short-term fluctuations.
- **Smoothing Effect:** Averages out abnormal earnings years.
- **Comparative Analysis:**
Allows cross-market and cross-country comparisons.





Limitations of CAPE Ratio

- **Subjectivity:** Choosing the "correct" earnings average can vary.
- **Ignores Short-Term Factors:** Doesn't account for recent market developments.
- **Globalization Impact:** This may not be as accurate in today's globalized economy.





Key Takeaways

- CAPE Ratio assesses market valuation over long periods.
- A high CAPE suggests potential overvaluation and a low CAPE suggests undervaluation.
- Consider CAPE along with other valuation metrics for a comprehensive analysis.



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Kapil Juneja

