

Market Commentary

June 8, 2007



Delivering financial peace of mind.

Are Stocks Overvalued?

By Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

This seems to be a primary question on client minds; most recent meetings early address this thought.

Following the S&P 500 establishing a new market high, recovering back to its peak of 7 years ago, and the Dow Jones Industrials notching their 45th new high since October 2006, many investors wonder if the stock market is overvalued. The month of May added another 3.8% increase in value to the S&P 500, which followed on the heels of a similar return in April. Year-to-date, the S&P has advanced almost 9%. Are stocks overvalued?

The simple answer is "no". In fact, we believe this market has more room to run and should provide an attractive 2007 performance.

While the S&P 500 is now up 100% from its October 2002 lows (making it back to its market peak occurring in March 2000), corporate earnings have grown over 140% in that same time. That means stock prices have grown much slower than company earnings. The Price/Earnings ratio has actually contracted from 19x to 17x over the past 7 years. That is atypical during a bull market (prior bull market P/E multiples expanded, in the 1990's from 13x to 28x). The length of this bull market matches the average for prior bulls, but the magnitude of the advance is way off the pace.

Further, the economic setting in which stocks trade today is different than the "irrational exuberant" days of March 2000. Interest rates then were 7.2% (today 5%) and inflation was over 4% versus around 2% today. In March 2000, both interest rates and stock valuations were high (a dangerous mix). Today, while interest rates are up from 1%, they are not significantly high with stock prices extended to set-up a correction scenario.

If you add the huge growth in money (liquidity) around the world to reasonable valuations, this market has some room to roam. (More thoughts in a moment...).

Below are the style performance returns for May and year-to-date:

	<u>May</u>	<u>YTD</u>
Small growth	4.5%	9.9%
Mid growth	4.0%	12.8%
Small value	3.7%	6.2%
Large growth	3.6%	9.7%
Large value	3.6%	8.7%
S&P 500	3.5%	8.7%
Mid Value	3.4%	11.8%
Foreign	3.1%	11.3%

As interest rates rose in mid-May, bonds did not fare well; recording small losses. Rising interest rates are temporarily providing return competition to stocks.

So why are stock and bond markets pulling back in early June? If valuations are not extended and there is lots of money, why a pause? The current near-term worry relates to another growth scare. First quarter GDP (+0.6%) was really soft and may represent the mid-cycle slowdown low point. Recent economic data in June suggests an economic rebound (albeit slow). That's not news investors want to hear. Too much growth could mean that stubborn inflation heats up; the Fed does not lower interest rates this year, but instead "thinks" about raising rates again. Thus, the markets don't like this growth scare scenario. It will prove temporary.

For new clients, or those with cash to invest, this dip by the stock market will provide another opportunity to invest with great mutual funds positioned for the stock market's continued advance. We remain a long-term, "time in the market" investor. This philosophy has worked well for our client accounts. We expect more attractive returns for investors via a diversified mix of different style no-load mutual funds.

We would like to share our historical investment performance; call us for details.

CONTACT US:

2310 Home Road
Delaware, Ohio 43015
740.917.9234

WWW.NVESTWEALTH.COM
Email: info@investwealth.com