Validea Market Valuation Tool User Guide

Our market valuation tool allows you to look at the valuation of the US stock market and subsets of it like small, mid and large-cap stocks, value and growth stocks, and individual sectors, in a historical context. Our system looks at the valuation of the median stock in our investable universe from the beginning of 2006 to the present. On each date, we rank all stocks using a variety of valuation ratios and select the value for each metric that has half of the universe above it and half below. That becomes the median valuation for that day. We then graph that value over time to generate the market valuation chart and statistics.

As is the case with all market valuation measures, it is important to understand what a median value does and does not tell you. It is a good indication of the valuation of the average stock within our universe of approximately 2800 securities, but it tells you very little about the valuation of market-cap weighted indexes like the S&P 500. As a way to understand the difference, consider the valuation of the S&P 500 using a weighted average mean calculation relative to our median calculation. The S&P 500 only includes the largest 500 stocks in the market and is market-cap weighted. To calculate the valuation of the S&P 500 at any given time, you would only use the valuations of 500 of the largest stocks in the market, and since the index is market-cap weighted, the valuations of the largest companies in the index would be much more important to its overall valuation than the smallest companies within it. Our system includes all stocks, uses a median valuation instead of a mean, and does not give more weight to the largest companies. As a result, it is more of a representation of the valuation of an average company and is not useful for looking at the valuation of a large-cap market-cap weighted index.

We currently track six different valuation metrics: the trailing twelve-month PE ratio, the current year PE ratio, the cyclically adjusted PE ratio (which utilizes ten years of earnings), the Price/Sales, the Price/Book and the Price/Cash Flow. For the purposes of our calculations, we define value stocks as the least expensive 20% of our database using any given metric and growth stocks as the most expensive 20%.

Using Our Market Valuation Page

Our market valuation page allows you to look at valuations on both an absolute and relative basis. For example, if you wanted to look at the valuation of small-cap value stocks relative to their own history using the PE Ratio, you would select small-cap stocks from the left drop-down box on the page, TTM PE Ratio from the second, and value from the right box. The resulting chart would look at the median valuation of value stocks (the cheapest 20% of our database) from 2006 to the present. The data below the chart allows you to compare the current median value to the average over the full period, and the high and low value for the period. It also shows you where the current value is on a percentile basis relative to history. The over(under) valuation figure compares the current valuation to the average over the full period. For example, if this number is -25%, then small-cap value stocks are 25% below their long-term average valuation.

The second section of drop-down boxes allows you to compare the valuation of one group of stocks to another. Continuing my previous example, if I wanted to now compare the valuation of small-cap value stocks to large-cap growth stocks, I would select large-cap from the left comparison drop-down and growth from the right one. The graph will then refresh to show the ratio between the valuation of these two groups of stocks. A new set of text will also appear at the bottom of the page that looks at this ratio relative to its average over time and its high and low values.

The final drop-down box on the page allows you to choose how companies with null values for the valuation metric you are looking at are handled. To illustrate this, let's consider an example of using the PE ratio to evaluate small-cap stocks. Some stocks do not have a PE ratio because their earnings are negative. There are two ways you can handle this when ordering stocks to calculate a median value. The first way is to exclude them and only rank the stocks that do have a PE ratio. That is the default approach on the page. A second approach would be to treat these null values as having the highest PE ratios and to rank them at the end of the list. If you wanted to utilize this approach, you would switch the drop-down box to include nulls. There are arguments to be made in favor of both approaches so we have decided to include both in our calculations.