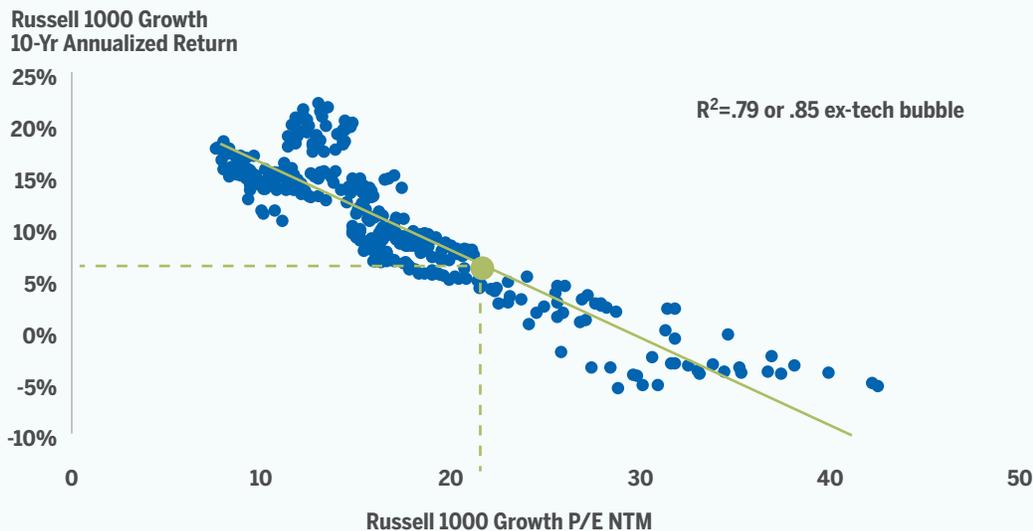


# Growth Stock Valuations in Perspective

While higher valuations for growth stocks relative to the broader market cause some investors anxiety, historical data suggests current valuations may produce solid long-term annualized returns in the U.S. For example, as of the end of August the price-earnings ratio of the Russell 1000 Growth Index indicates a potential 10-year annualized return that we believe is attractive relative to our view of prospective fixed income returns, based on the historical relationship between valuation and long-term returns.

**Aggregate Valuation Drives Long-Term Returns**  
December 1978 to August 2018



Source: FactSet. Each dot represents the P/E during that month and the returns generated over the subsequent 10 years. The starting P/E ratio is the price divided by the next 12-month earnings per share estimate at the start of each 10-year period measured. The tech bubble, represented by the 10-year returns beginning in April 1987-March 1990 and ending in April 1997-March 2000, skewed the regression by resulting in higher returns for given valuations than the historical relationship would imply.  
Note: P/E is price-earnings ratio, which measures a stock's share price relative to its per-share earnings. NTM is next twelve months.

- R-squared, or the “coefficient of determination,” denotes how much of the movement of one variable is attributable to another. In this case, nearly 80% of the Russell 1000 Growth Index’s 10-year returns can be explained by the starting price-earnings ratio (P/E).
- Growth stock valuations are higher than those of the broad market as measured by the S&P 500 Index. There is good reason. Growth stocks have higher returns on capital, faster growth, and less debt (see p. 23 of the [Summer 2018 Capital Markets Presentation](#)).
- The higher absolute valuations of growth stocks can cause investors apprehension. Historically speaking, however, the current 21x P/E of the Russell 1000 Growth Index (as of 08/31/18) has been correlated with an attractive annualized 10-year return of approximately 7% shown in the above regression.

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