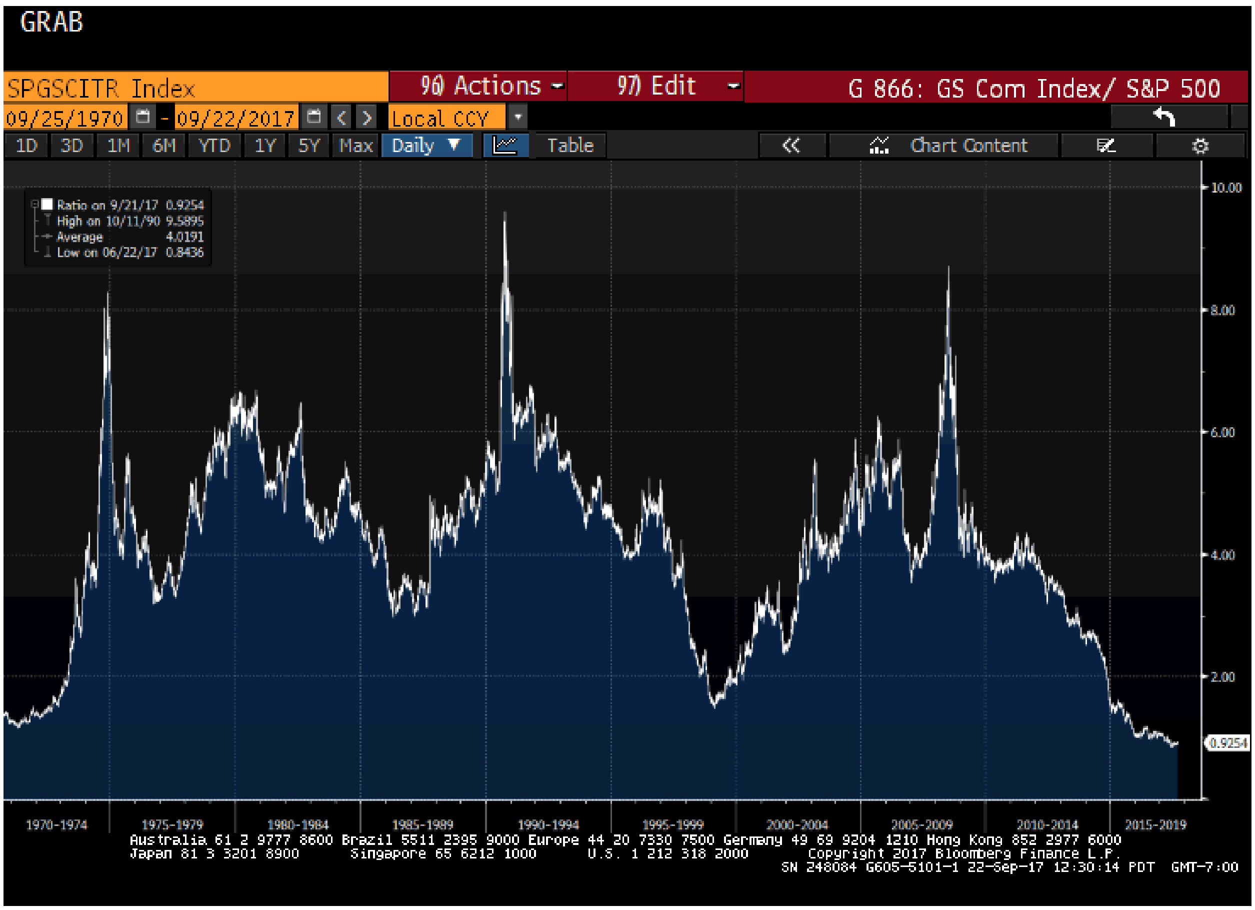
Pricing Extremes: Fortunes Made & Lost

In my commentary on the S&P 500 two weeks ago, I revealed how expensive stock prices are today (17 year highs) relative to the revenues of the underlying companies.

Today I will show how expensive bellwether U.S. stocks are relative to global commodity prices. In doing so, you will see that there is plenty of room for U.S. stocks to fall and/or commodity prices to rise over the coming years.



The chart above shows the Goldman Sachs Commodity Index divided by the S&P 500 Index over the last 38 years; a high ratio corresponds to high commodity prices relative to stocks, while a low ratio corresponds to overpriced stocks relative to commodity prices. If history is any guide, the graph implies **there is currently extreme overpricing of U.S. stocks, and/or underpricing of commodities**. In fact, the extreme pricing is unprecedented dating all the way back to 1970. Why?

In my opinion quantitative easing by central banks since 2009 has led to pricing misallocations. Investors, having a herd mentality, have crowded into large cap stocks. The implications of an unwind could be substantial. Central banks are beginning to tighten again, so don't be surprised to see a reversal of fortunes between commodity prices and stocks in the coming years. Fortunes are made and lost in extreme pricing scenarios, today's environment is no different.

Please feel free to reach out to us for further details.