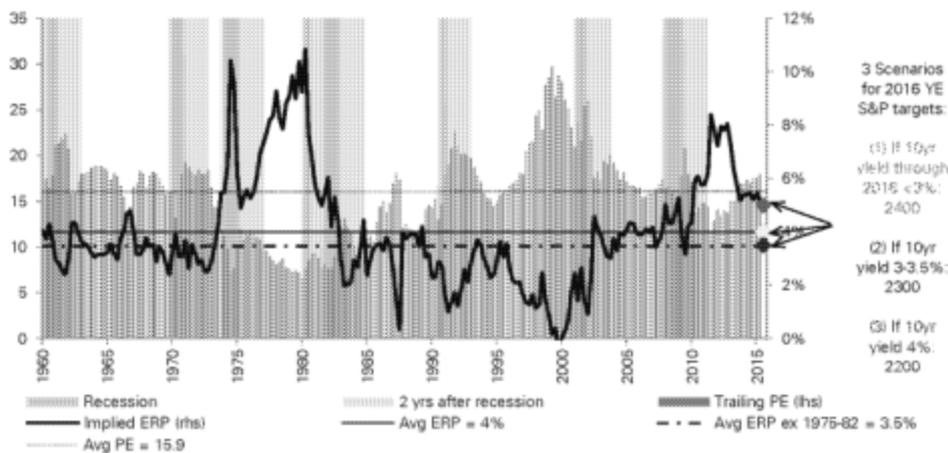




PE at post-crisis high on delayed Fed hike expectations, boosts S&P to record

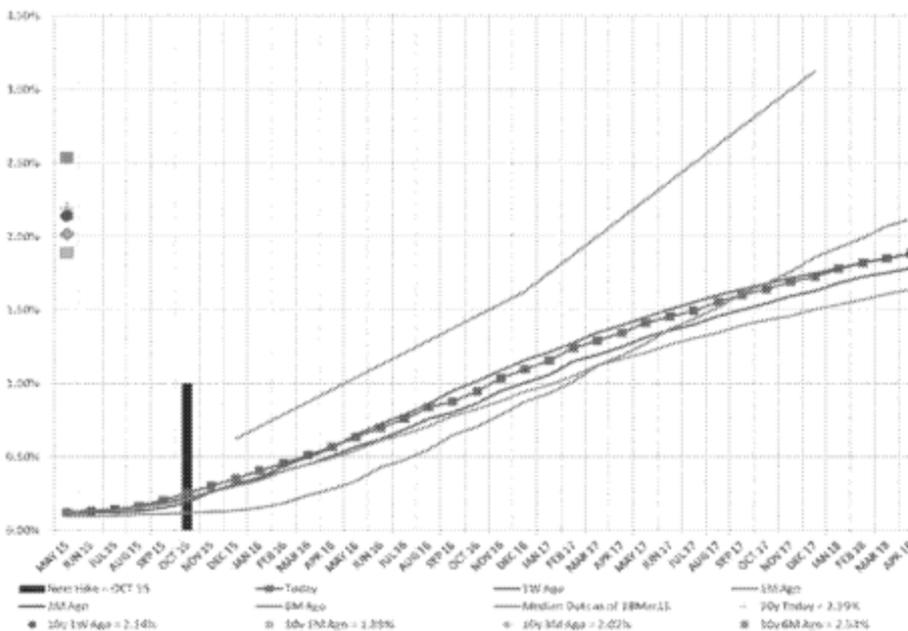
S&P grinds higher despite continued soft macro data on dovish central bank communications. S&P trades at 18x trailing 4-qr EPS (2Q14-1Q15), the highest since 2010. Fed lowered its 2015-16 FF rate outlook in March and the April minutes dismiss the June hike. Market liftoff expectations are slipping to after Sept. ECB reiterates its asset purchase goals. Liftoff accompanied by Fed forecasts of a 2% plateau rate this cycle would pave the road for a S&P trailing PE of 18.5 at 2015 end and perhaps higher in later years if 10yr Treasury yields do not materially exceed 3%. But waiting too long to hike raises the risk of unit labor cost acceleration and a disorderly climb to higher 10yr yields.

Figure 1: S&P 500 PE and ERP: 3 scenarios



Source: Federal Reserve, S&P, Deutsche Bank

Figure 2: Implied future Fed Funds rate and timing of liftoff



Source: Bloomberg Finance LP, Deutsche Bank