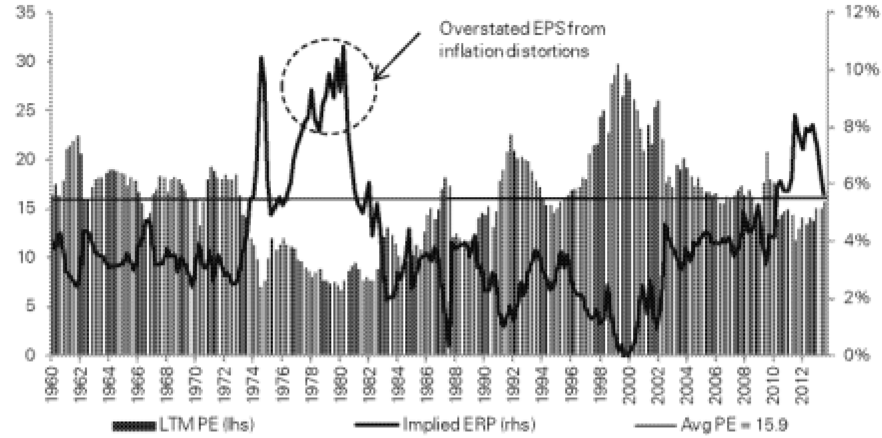
Figure 6: S&P 500 trailing PE and implied equity risk premium: PE is now close to long-term historical average but ERP is still 200bps higher than its average of 390bps.



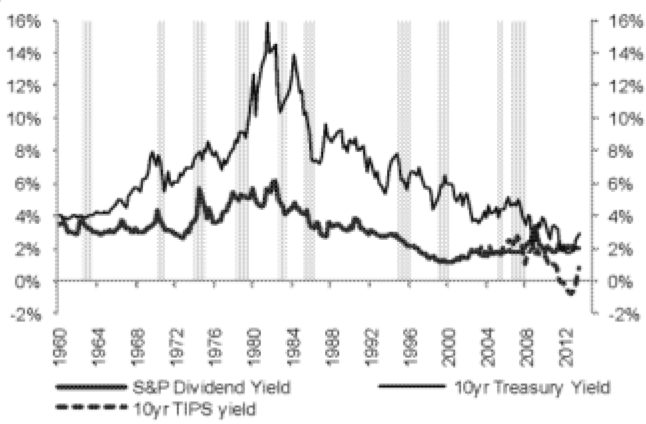
Source: S&P, FRB, Deutsche Bank

A ~15 forward PE wouldn't be threatened until 10yr yields are well over 4% or 10yr TIPS exceed 2%.

Treasury yields now exceed the dividend yield, but dividends should grow double-digit for the next few years as the payout ratio rises from 33% now.

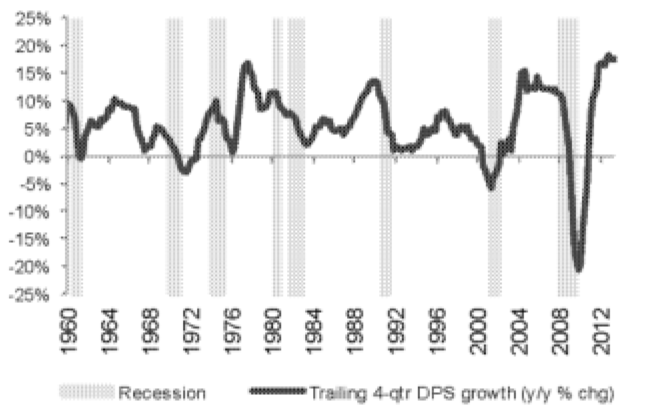
Dividend yields like earnings yields represent real yields. Expected inflation must be added to these observed yields in order to compare them to nominal interest rates. The 10yr TIPS yield provides a comparable real interest rate, which at 0.75% suggests that EPS and DPS yields remain very attractive. The S&P's indicated dividend yield is 2.1% and we expect long-term DPS growth to be ~15% next year with at least 6% growth thereafter. This suggests an offered long-term nominal return on S&P ownership over 8% with the ability of that offered nominal return to adjust for inflation variations over the long term.

Figure 7: S&P Dividend yield, 10yr Tsy and TIPS yield



Source: S&P, FRB, Deutsche Bank

Figure 8: S&P 500 dividend growth (y/y % chg)



Source: S&P, Deutsche Bank