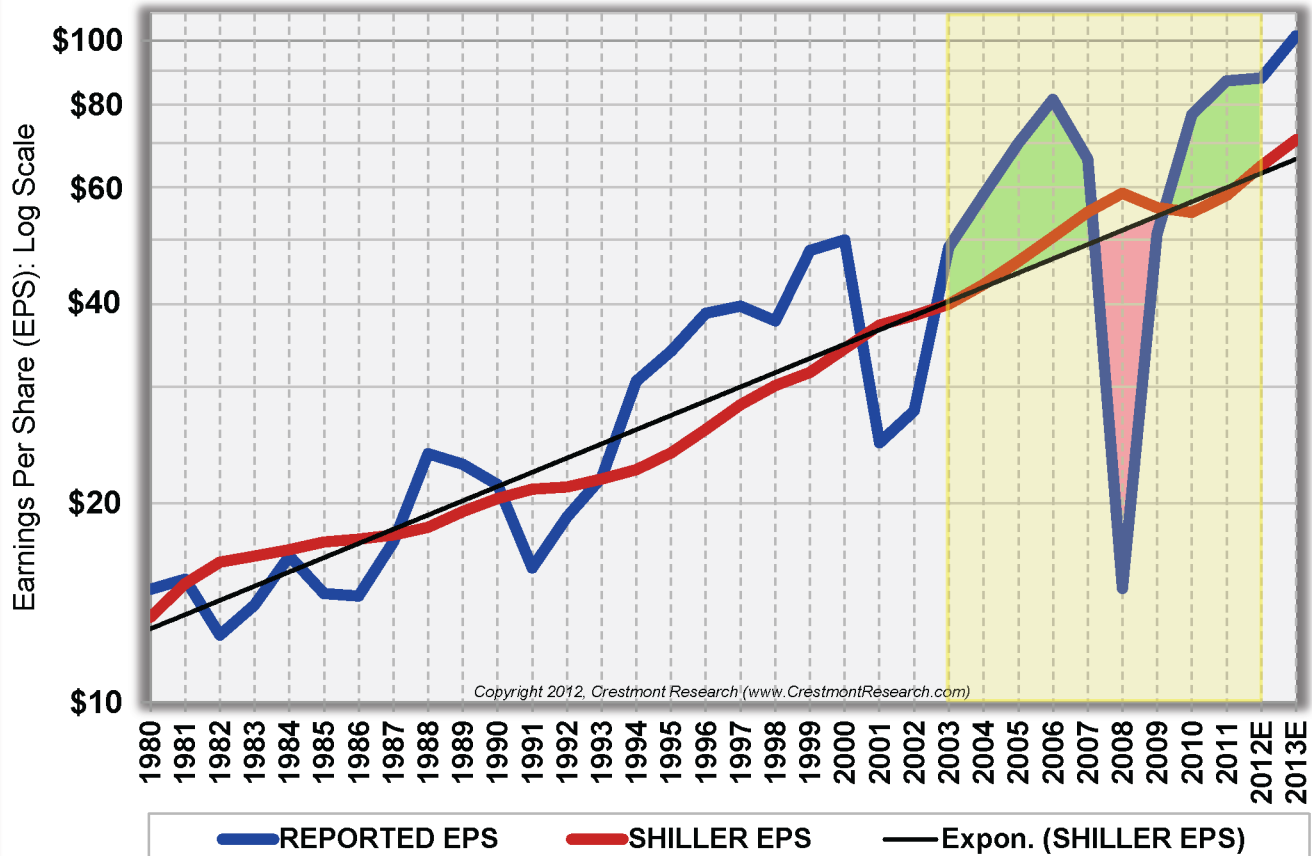


## SIEGEL'S SHORTFALL: The 2008 Distortion To Shiller's P/E10 Has Reversed!



The earnings cycle for the S&P 500 is highly variable, as reflected above by the blue line. A price/earnings ratio (P/E) that uses reported earnings will often be distorted, when reported earnings is above or below its long-term trend.

For a more accurate and valid P/E, a methodology is needed to normalize reported earnings. One such method is the Cyclically Adjusted P/E (CAPE or P/E10) popularized by Robert Shiller at Yale--the red line in the graph. That method averages ten years of reported earnings (in current dollars). Thus, the 2012 Shiller EPS includes the period highlighted on the graph in yellow.

Shiller's friend Jeremy Siegel (*Stocks for the Long Run*) has been saying that the 2008 plunge in earnings distorts P/E10 upward and diminishes its value. While P/E & EPS may be distorted due to the 2008 earnings decline, the effect is no more than the offsetting distortion from the periods of above-average profits on both sides of 2008 (highlighted in green and pink).

The high profit margins of 2003-2006 had already started to distort CAPE EPS to the *high-side* before 2008. Then 2008 more than offset the average to the low-side. But, recent record profit margins, coupled with the high profit margins before 2008, have fully restored CAPE EPS back to its long-term trend line.

Plan ahead for 2015-2018, when the Shiller EPS will experience a hiccup as the 2006-2008 period leaves the ten-year average...