

# Keep calm about equity valuations and carry on investing

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**Daniel Casali**  
Chief Investment Strategist

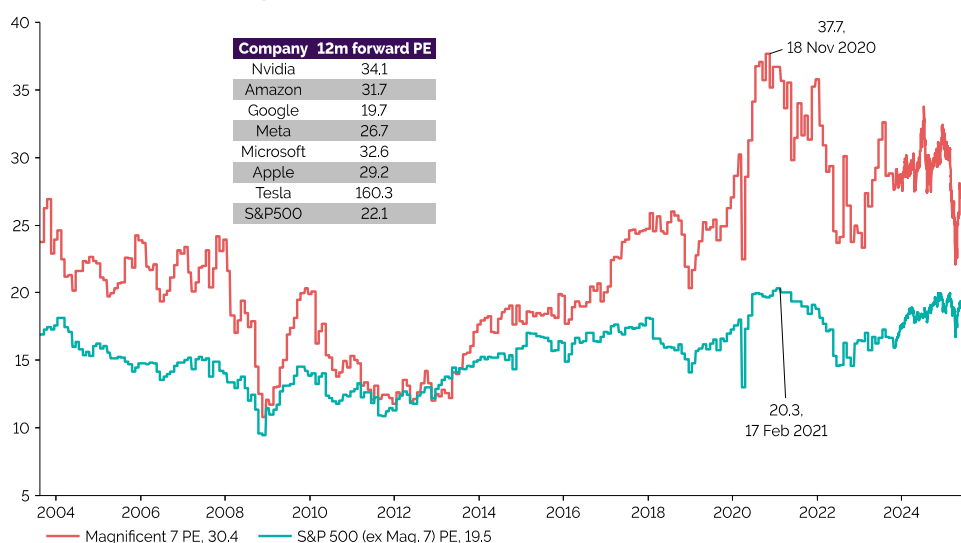
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As equity markets continue to inch higher, so do investors' concerns about market valuations. With headlines like artificial intelligence (AI) startup Perplexity bidding \$35 billion for Google Chrome—twice its own valuation—it's easy to feel like things are getting frothy. But before asset allocators think about heading for the exit, it's worth taking a step back. Valuations matter, yes—but mostly over the long term.

Let's start with the state of play. The S&P 500's one-year forward price-to-earnings (PE) ratio is currently around 22x, which is at the higher end of its historical range.<sup>1</sup> It's not quite at the dizzying heights of 2020 or the dot-com bubble, but it's elevated enough to raise eyebrows. Breaking it down, the Magnificent Seven stocks trade at 30x in aggregate—still below their 2020 peak of 38x—while the broader market (the other 493 stocks) sits at 19.4x, also below its previous high.<sup>2</sup>

US S&P Magnificent 7: 12-month forward valuations (PE)

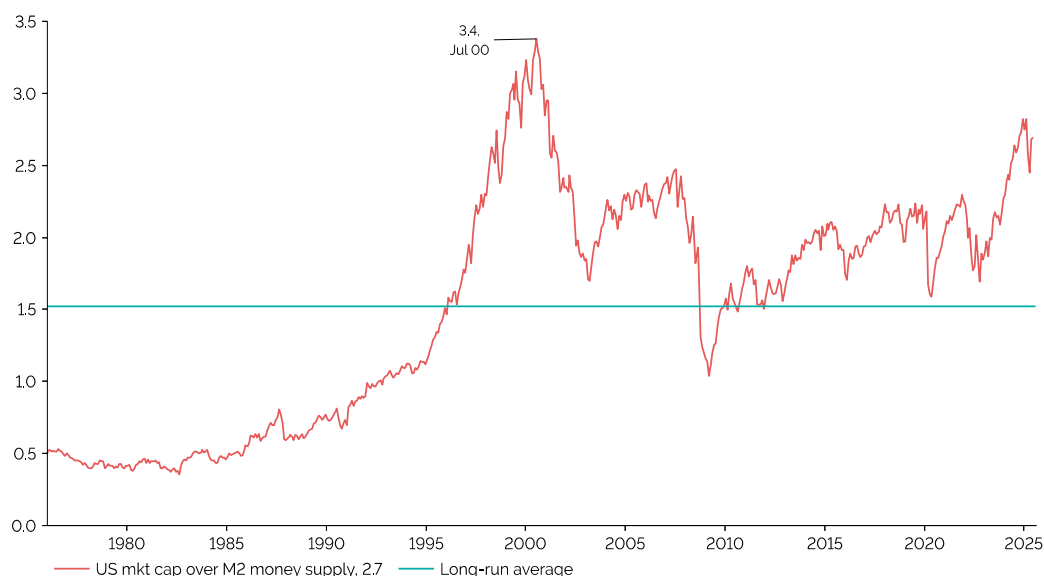


Source: LSEG Datastream/Evelyn Partners, Data as at 18/08/2025

## Looking across other valuation metrics, the picture is nuanced.

**First**, US market cap relative to broad money supply—a proxy for how high the market is valued versus deposits in the financial system—stands at 2.7x, above the long-term average of 1.5x, but below the dot-com peak of 3.4x.<sup>3</sup> This implies there is potentially more money available to buy stocks and lift the market higher.

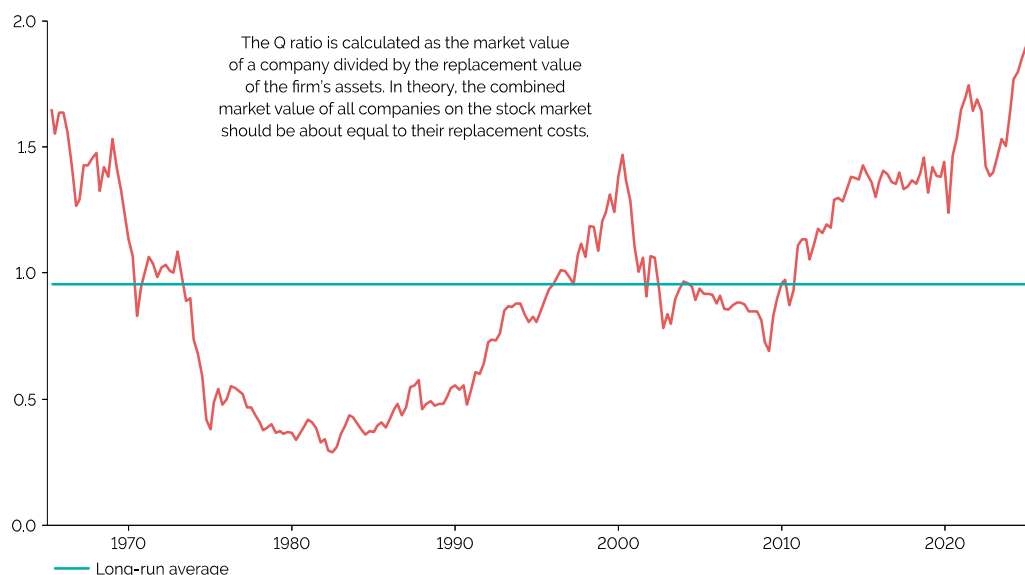
### US equity market cap as a % of broad M2 money supply



Source: LSEG Datastream/Evelyn Partners, Data as at 15/08/2025

**Second**, Tobin's Q, which compares market value to replacement cost, is near record highs, though it has remained above its long-term average for the best part of 15 years. However, Tobin's Q has been a poor timing tool for picking turning points in the market.

### US Tobin's Q ratio



Source: LSEG Datastream/Evelyn Partners, Data as at 15/08/2025

**Third**, equities look only slightly expensive compared to bonds. The US equity earnings yield (the inverse of a PE ratio) less the US 10-year bond yield currently stands at -0.7% points, which is above a gap of -3.5% just before the peak of the equity market during the dot.com bubble in 2000.<sup>4</sup> This metric shows that equities are not extremely over valued versus bonds.



Source: LSEG Datastream/Evelyn Partners, Data as at 15/08/2025

The key takeaway? Valuations are elevated, but they are probably not in bubble territory. And timing the market based on valuations is notoriously difficult.

### History shows that valuation extremes can persist for years before correcting.

The dot-com bubble took nearly three years to unwind. The 2008 financial crisis wasn't driven by valuations at all—it was about leverage in the financial system and a US housing bubble. Post-COVID, valuations spiked in 2021 due to policy easing and increased e-commerce activity from lockdowns but corrected quickly. Today's valuation levels are high, but not unprecedented.

**Investment horizon** is what really matters. Our analysis shows that valuations have weak predictive power over one-year periods but become much more meaningful over ten-year horizons. In other words, if you're investing for the next decade, valuations deserve your attention. If you're trying to time the next quarter, then good luck.

Of course, there are risks. Market concentration is one. The top 10 stocks' market value now makes up 38% of the S&P 500, nearing dot-com levels, but still lower than a high of 54% in 1974, based on our available data.<sup>5</sup>

Then there is overinvestment risk. In 2025, the Magnificent Seven tech giants are expected to invest north of \$300 billion in AI infrastructure, or more than 1% of U.S. GDP.<sup>6</sup> This represents the largest tech buildout since the dot-com era. However, the scale of investment raises concerns that returns may fall short of investor expectations.

### So, what's the strategy?

**Stay calm. Stay invested. And think long term.** Valuations are a useful guide, but they're not a precision stopwatch. If you're building a portfolio for the next decade, today's prices may not be cheap—but they're not irrational either with strong fundamentals, supportive liquidity, and structural themes like AI are driving real earnings growth.

In short, valuations may be warm, but they're not boiling—so keep your cool and stay invested for the long term.

#### Sources:

<sup>1,2,3,4,5</sup> LSEG, Evelyn Partners

<sup>6</sup> <https://www.cnbc.com/2025/02/08/tech-megacaps-to-spend-more-than-300-billion-in-2025-to-win-in-ai.html>