

The Disciplined Investor Podcast – Guest Interview Summary

Guest: Ed Easterling

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Summary

Long-Term Market Valuation Concerns

Ed Easterling, a market climatologist at Crestmont Research, explained their approach to financial market analysis, focusing on long-term trends rather than short-term fluctuations. He highlighted that current market valuations, as measured by the cyclically adjusted PE (CAPE) ratio, are at historically high levels, similar to those seen only briefly in 1999-2000. Ed emphasized that while short-term investors may focus on daily market movements, long-term investors should be concerned about the long-term implications of these high valuations, particularly given the current high profit margins and economic factors.

Market Valuation and CAPE Analysis

Ed and Andrew discussed market valuation, focusing on the cyclically adjusted PE (CAPE) ratio and its relevance to long-term market analysis. They explored how CAPE and the Crestmont PE method adjust for earnings cycles, providing a more accurate measure of market valuation than raw PE ratios. The conversation highlighted concerns about current market valuations being at historically high levels, with Ed noting that while this is a data point confirming excess valuation, it aligns with other measures indicating a frothy market. They also discussed how share buybacks and reduced company share counts have contributed to earnings per share growth, while questioning whether price discovery is functioning normally in today's market environment.

Inflation Projections and Fed Expectations

Ed and Andrew discussed the current state of inflation, with Ed noting that the Cleveland Fed estimates a 3% increase for November's report, which will be based on extrapolated data due to the Bureau of Labor Statistics not producing a bottoms-up number for October. They anticipate a moderation in inflation, but Ed predicts that even a zero inflation rate for November could result in an increase in the reported inflation rate on a year-over-year basis. Ed also expects inflation to decline in the first quarter of 2025, potentially reaching 2.5%, but emphasizes that this decline is due to statistical factors rather than a decrease in actual

prices. They discuss the Fed's recent interest rate cut and its anticipation of potential inflation increases in the coming months, as well as concerns about job market softness and the possibility of job numbers being overstated.

Economic Indicators and Inflation Concerns

Ed and Andrew discussed the current economic indicators, noting that while the economy is not in crisis, there are concerns about persistent inflation. They highlighted that the Federal Reserve's projections show inflation remaining above the 2% target for the next decade, which could negatively impact stock valuations. Andrew emphasized the artificial transparency of economic projections and the lack of accountability for overly optimistic statements from companies and investors, suggesting that the current market environment is driven by long-term expectations rather than immediate performance.

Investment Trends and Market Outlook

Ed and Andrew discussed investment trends, with Ed noting that while stocks have historically provided returns over time, alternative investments like bonds and real estate offer different opportunities. They explored concerns about private credit markets, with Ed suggesting that while there are signs of market vulnerability, specific issues in subsectors are not yet clear. Ed forecasted that over the next 5-10 years, investors could expect below-average returns of mid-single digits due to current high valuations, particularly given the lack of diversification in the S&P 500 index. Ed also shared his personal experience dealing with a recent injury, emphasizing the importance of maintaining a positive attitude during recovery.