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## SUMMARY

- US stocks are trading above their own return trend, suggesting lower long-term returns, in our view.
- However, strong fundamentals suggest to us that stocks could stay above trend for some time.
- Stock valuations relative to bonds are no longer 'cheap' in our view...but neither are they 'expensive.'

Source: RiverFront Investment Group, calculated based on data from CRSP 1925 US Indices Database ©2025 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Data from Jan 1926 through May 2025. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Blue line represents the Large Cap Real Return Index. Yellow line represents the Annualized Real Trend Line of Large Cap Real Total Return Index according to Price Matters®. Shown for illustrative purposes only, not indicative of RiverFront portfolio performance.

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## Are Stocks 'Expensive'? Depends on the Lens Stocks Do Not Appear Excessively Overvalued to Us

In asking financial advisors and clients what is most on their minds concerning markets, we found that concern about US stock valuation was top of mind. We believe that 'value' is in the eye of the beholder and thus deserves a thoughtful analysis.

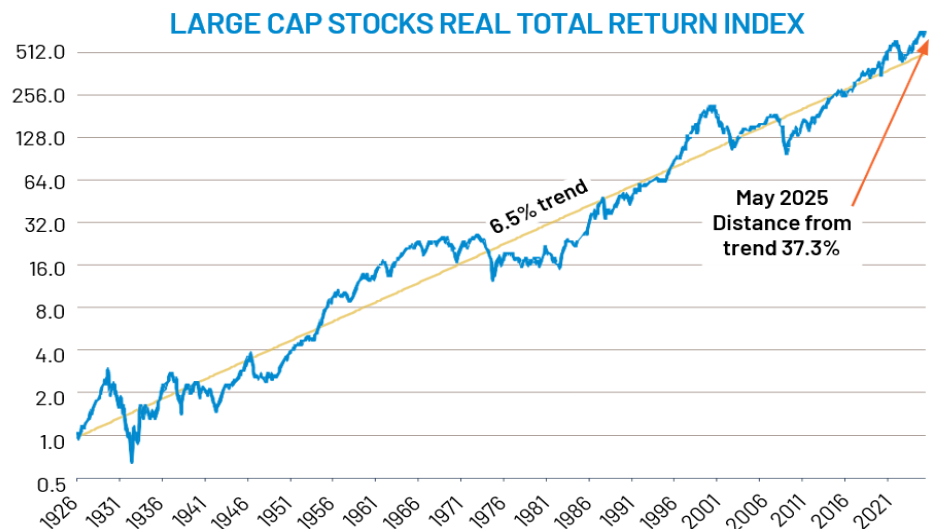
For US large-cap stocks, it is tempting to look at the last few years' outsized gains and the 12-month forward price-to-earnings (P/E) ratio of ~22.5x and conclude stocks are 'expensive'. However, the answer is more nuanced, in our view. At the risk of dramatically oversimplifying, there are at least two distinct frameworks to look at stock valuation:

1. In **absolute terms: i.e., in comparison to that asset's own history**
2. In **relative terms: i.e., in comparison to other assets such as US bonds**

### CONCLUSION: Stocks Look Pricy Relative to History... but Fundamentals and Interest Rates Suggest They Could Stay That Way

In *absolute terms*, a 22.5x forward P/E ratio sits well above the 40-year average of about 16x. In addition, US large-cap stocks are currently trading ~37% above their century-long real total return trend (Chart 1). RiverFront's historical analysis of this data – known as '[Price Matters](#)' – suggests that returns over the subsequent decade from today's starting place are likely to be lower than average... a conclusion that concurs with our [Long-Term Capital Market Assumptions \(CMAs\)](#). However, valuation is not necessarily a good timing tool – assets that appear expensive often grow more expensive over time, and vice versa. Instead, we think valuation must be placed into proper context to be useful to investors with time horizons shorter than a decade.

### CHART 1: STOCKS ABOVE THEIR LONG-TERM RETURN TREND



Against the current context of solid underlying fundamentals, 22.5x earnings appear justified to us. Corporate earnings growth has been robust, generating strong cash flows and leading to sustainably higher profit margins. Since we don't anticipate a recession in the foreseeable future, and think inflation resulting from tariffs will be contained, we think current valuations could persist.

In particular, we believe the conversation around US large-cap profit margins (Chart 2, below) merits further exploration as it relates to valuation. Many believe that profit margins are 'mean-reverting' over time. Their argument is that while margins at times become elevated due to cyclical macroeconomic strength, this strong profitability will eventually 'mean-revert' back towards a long-run average. This is due to high margins getting competed away and/or degraded by a weakening economic cycle. However, we believe the actual data over the past four decades challenges this notion, as margins since the 1980s have actually displayed a distinct upward bias. While margins do exhibit some mean-reversion around economic cycles (see shaded recession bands in Chart 2), they appear to do so around an upward-sloping trend channel (see red lines on Chart 2, below) ...suggesting profitability is growing *structurally* higher over time. Currently profit margins are in the middle of this upward channel, but still among the highest levels relative to history.

### Historical Index Composition Matters for Valuation – Today's Tech-Heavy Index is Higher Margin

Why do large-cap companies appear structurally more profitable today versus decades ago? We believe it has a lot to do with changes in the composition of the stock index itself over time. In 1985, when the profit margin data in our chart above begins, financial companies such as banks made up the single-largest sector in the S&P 500. Today, the technology sector is now by far the largest. Tech today represents around 34% of the index, rising to almost 43% when the tech-adjacent communication services sector is included. Strikingly, the top 10 largest stocks in the S&P 500 today- nine of which are technology or tech-related- represent about 39% of the index, almost twice the weight as the top 10 did in 1985, according to NDR Research.

This matters to index profit margins because properly scaled tech business models tend to have much higher margins than banks and other financial companies... or in fact the average S&P 500 company.

This is particularly true for many of the largest tech companies, as their asset-light business models often lead to high cash flow growth... a topic we have previously touched on when discussing our preference for tech as an investment. Tech-related companies tend to trade at structurally higher valuations due to these robust growth and profitability characteristics...and thus, **comparing valuation on the US large-cap stock index today relative to its history is less straightforward than it seems.** As an aside, this stronger cash flow generation and growth is one of the reasons that RiverFront continues to favor mega-cap tech stocks as a secular growth theme.

CHART 2: US PROFIT MARGIN TREND IS UPWARD-SLOPING OVER TIME



Source: LSEG Datastream, RiverFront. Data monthly as of August 2025. Chart shown for illustrative purposes. Past performance is no guarantee of future results.

## Stock Valuation Relative to Bonds: Back to Pre- 'Financial Repression' Averages

Aside from comparing US stocks to their own history, in relative valuation terms, the picture is similarly nuanced. Currently, the S&P 500's 'earnings yield' (the amount of corporate earnings divided by index price) after the multi-year stock rally is now roughly equal to the yield on 10-year Treasuries (Chart 3, below). Relative to the last 15 years, when earnings yields were meaningfully higher than Treasury yields, today's condition of roughly equivalent earnings and bond yields (solid green line on Chart 3) could be viewed as 'expensive'.

However, the unique feature of this most recent period is just how historically low inflation and interest rates were during this time. RiverFront refers to this peculiar era as ['Financial Repression'](#), as it forced savers and anyone on a fixed income into taking more risk than they would otherwise feel comfortable doing given the lousy absolute returns available in low-risk bonds. In our opinion, the US officially exited the Financial Repression era in 2022 when the Federal Reserve started what would eventually be over 500 basis points of rate hikes during the subsequent year-and-a-half.

Viewed through a less recent historical lens, today's yield differential for US stocks relative to bonds is right in line with the average level that relative earnings yields traded at during 1985-2007's more 'normal' interest rate environment - before economic crisis and deflation risk allowed the Fed to engage in Financial Repression. **Put another way, if we remain -as we expect - in a more normalized interest rate environment for the foreseeable future, stocks appear neither expensive nor cheap to us relative to interest rates today.**

### Conclusion: We Believe the US Stock Market is Not as 'Overvalued' as a cursory Glance Would Suggest

To paraphrase famous investor Warren Buffett, 'price' is what you pay for an asset, but 'value' is what that asset is actually worth. While the concept of value is nuanced, multi-faceted and thus open to interpretation, we believe that the current price investors are paying for US stocks, while higher than average, represents reasonable value given the current fundamental and macroeconomic backdrop. Should our belief in this backdrop change, our views on valuation - and thus on our positioning - in US stocks would naturally change. Nonetheless, for the time being RiverFront balanced portfolios remain overweight US equities, with a particular emphasis on mega-cap, high free cash flow generating technology companies and themes.

CHART 3: EARNINGS YIELDS VS. BOND YIELDS – STOCKS AROUND FAIR VALUE



Source: LSEG Datastream, RiverFront. Data monthly as of August 2025. Chart shown for illustrative purposes. Past performance is no guarantee of future results.

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*Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.*

*In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.*

*Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.*

**Index Definitions:**

*Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.*

*U.S Market Cap index information calculated based on data from CRSP 1925 US Indices Database ©2025 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Used as a source for cap-based portfolio research appearing in publications, and by practitioners for benchmarking, the CRSP Cap-Based Portfolio Indices Product data tracks micro, small, mid- and large-cap stocks on monthly and quarterly frequencies. This product is used to track and analyze performance differentials between size-relative portfolios. CRSP ranks all NYSE companies by market capitalization and divides them into ten equally populated portfolios. Alternext and NASDAQ stocks are then placed into the deciles determined by the NYSE breakpoints, based on market capitalization. The series of 10 indices are identified as CRSP 1 through CRSP 10, where CRSP 10 has the largest population and smallest market-capitalization. CRSP portfolios 1-2 represent large cap stocks, portfolios 3-5 represent mid-caps and portfolios 6-10 represent small caps.*

**Definitions:**

## WEEKLY VIEW

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*A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth indicate a recession. However, more complex formulas are also used to determine recessions.*

*Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.*

*Deflation is when consumer and asset prices decrease over time, and purchasing power increases.*

*Financial repression is a term that describes measures by which governments channel funds from the private sector to themselves as a form of debt reduction. The overall policy actions result in the government being able to borrow at extremely low interest rates, obtaining low-cost funding for government expenditures.*

*Price-Earnings Ratio (P/E Ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings.*

*A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. (bps = 1/100th of 1%)*

*The earnings yield is a financial ratio that describes the relationship of a company's LTM earnings per share to the company's stock price per share. The earnings yield is the inverse ratio to the price-to-earnings (P/E) ratio. The quick formula for Earnings Yield is E/P, earnings divided by price.*

*The 10-year Treasury bond yield is the interest rate the U.S. government pays to borrow money for a decade. It serves as a benchmark for other interest rates and a key indicator of investor sentiment about economic conditions.*

*Interest rate sensitivity is a measure of how much the price of a fixed-income asset will fluctuate as a result of changes in the interest rate environment. Securities that are more sensitive have greater price fluctuations than those with less sensitivity. This type of sensitivity must be taken into account when selecting a bond or other fixed-income instrument the investor may sell in the secondary market. Interest rate sensitivity affects buying as well as selling.*

*US large cap equities include equities of companies with a market capitalization of over \$10 billion. Although large cap equities are generally considered to be safer securities, large cap equities are still subject to the risks associated with stocks.*

*Mega cap is a designation for the largest companies in the investment universe as measured by market capitalization. While the exact thresholds change with market conditions, mega cap generally refers to companies with a market capitalization above \$200 billion.*

*RiverFront's Price Matters® discipline compares inflation-adjusted current prices relative to their long-term trend to help identify extremes in valuation.*

*When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit [riverfrontig.com](http://riverfrontig.com) or contact your Financial Advisor.*

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