

# NO ROOM FOR ERROR

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There is no room for error when markets are priced for perfection.

The [S&P 500 Index's forward price-to-earnings \(P/E\) ratio](#) of 18-19x is nearly 20% above its average since 1986.<sup>1</sup> This [valuation](#) tells us little about the short-term direction of U.S. equities, but over five to ten years, returns tend to be closely tied to starting valuations.

Some models for valuation-based market returns suggest returns are going to be below average going forward—perhaps as low as 4% annualized over the next decade. This compares to 13.5% returns for the past 10 years, over three times higher.

Wharton Professor Jeremy Siegel uses broad-market [earnings yields](#) (the inverse of the P/E ratio) as a guidepost for *real* (after inflation) equity returns of around 5%—nominal returns of 7%, assuming 2% inflation—for the S&P 500.

While a decent return, that would still be below his long-term average return of 6.8%.

## S&P 500 Index Forward Earnings Yield



Sources: WisdomTree, FactSet. Data from 12/31/1994 to 12/31/2019. Past performance is not indicative of future results. You cannot invest directly in an index.

With these tepid outlooks for the broad index, WisdomTree believes investors must reevaluate how to position their portfolios to achieve adequate long-term goals.

An important variable to consider, alongside starting [price-to-earnings multiples](#), is total shareholder yield—the combination of [dividend](#) yield and [net buyback yield](#).

Assuming no growth in earnings or multiple expansion, a higher starting shareholder yield could provide investors an important capital-return cushion.

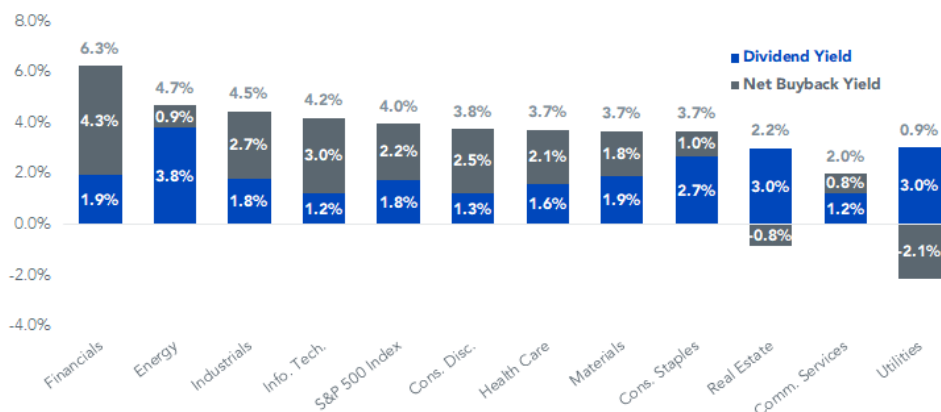
Many segments of the market can provide combined dividend and buyback yields that get very close to Professor Siegel's 5% return expectation number.

This means you don't necessarily need real growth in [fundamentals](#). Current [cash flows](#) from today's valuations can support returns.

Based on total shareholder yield, Financials and Energy have the highest yields at 6.3% and 4.7%, respectively, while Real Estate, Communication Services and Utilities, traditional high-dividend sectors, have the lowest.

## Financials: The Highest Payout Sector

### S&P 500 Index - Total Shareholder Yield by Sector



Sources: WisdomTree, FactSet. Data as of 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index.

Take the [WisdomTree U.S. LargeCap Dividend Index \(WTLDI\)](#).

WTLDI weights the 300 largest-market-cap dividend payers in the U.S. by indicated [cash dividends](#). That tilts it toward the sectors with higher [dividend yields](#)—Consumer Staples, Energy, Utilities, Financials and Real Estate—and away from the lower-dividend-yielding sectors such as Information Technology, Consumer Discretionary and Communication Services.

As a result, the WTLDI has a slightly lower net buyback yield than the S&P 500, but it more than makes up for this with an advantage in dividend yield. WTLDI's shareholder yield is 101 [basis points \(bps\)](#) higher than the S&P 500 and is currently 27% greater than its own historical average.

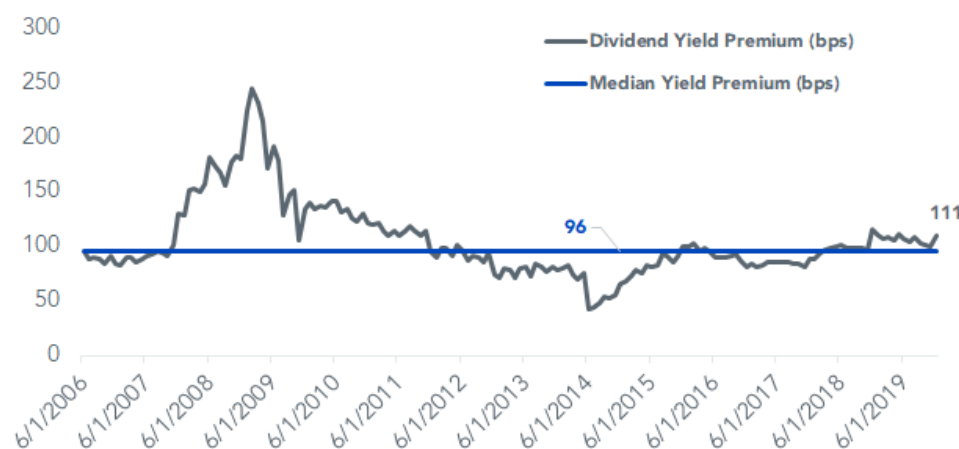
Index	Current			% Difference vs. LT Average
	Dividend Yield	Net Buyback Yield	Shareholder Yield	Shareholder Yield
WTLDI	2.89%	2.08%	4.97%	27.38%
S&P 500	1.78%	2.18%	3.96%	-14.41%

Sources: WisdomTree, FactSet. Data from 6/30/06 to 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index.

### Raising Dividend as Source of Return

WTLDI's starting dividend yield advantage is a critical component to improving long-term return expectations. The Index's historical average yield premium has been 96 bps. Following the Index's annual December rebalance, that premium increased to 111 bps.

### Historical Dividend Yield Premium: WisdomTree LargeCap Dividend Index vs. S&P 500 Index



Sources: WisdomTree, FactSet. Data from 6/30/06 to 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index.

Amid a low-return environment, the WisdomTree U.S. LargeCap Dividend Index offers some attractive fundamental characteristics relative to the broad S&P 500 Index: a dividend yield of 2.9% and a total shareholder yield of 5.0% (both a roughly 100 bp improvement) and a forward P/E ratio of 16.2x (about a 13% discount).

Both higher capital distributions and a discounted starting valuation can help improve long-term return expectations relative to today's outlook for a market cap-weighted approach.

<sup>1</sup>U.S. Equity Strategy in Pictures, "Tabula rasa," BofA Global Research, page 21, 1/6/20.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

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You cannot invest directly in an index.

## **DEFINITIONS**

**S&P 500 Index** : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

**Forward P/E ratio** : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

**Valuation** : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Earnings yield** : The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.

**Earnings multiple** : another way of saying price-to-earnings multiple.

**Dividend** : A portion of corporate profits paid out to shareholders.

**Net Buyback Yield** : A company's net share buyback is the difference between the capital raised by issuing new shares and the money the company spent on buying back any outstanding shares. A positive net share buyback means that more was spent on buying back existing shares than received from issuing new shares. Net buyback yield is the amount of a company's net buybacks divided by its market capitalization. Please note that net buyback yield does not represent a dividend paid by the company.

**Fundamentals** : Attributes related to a company's actual operations and production as opposed to changes in share price.

**Cash flows** : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

**Market capitalization-weighting** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Regular cash dividends** : Dividends that companies indicate they will commit to paying on an ongoing basis at a set frequency.

**Dividend yield** : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

**Basis point** : 1/100th of 1 percent.