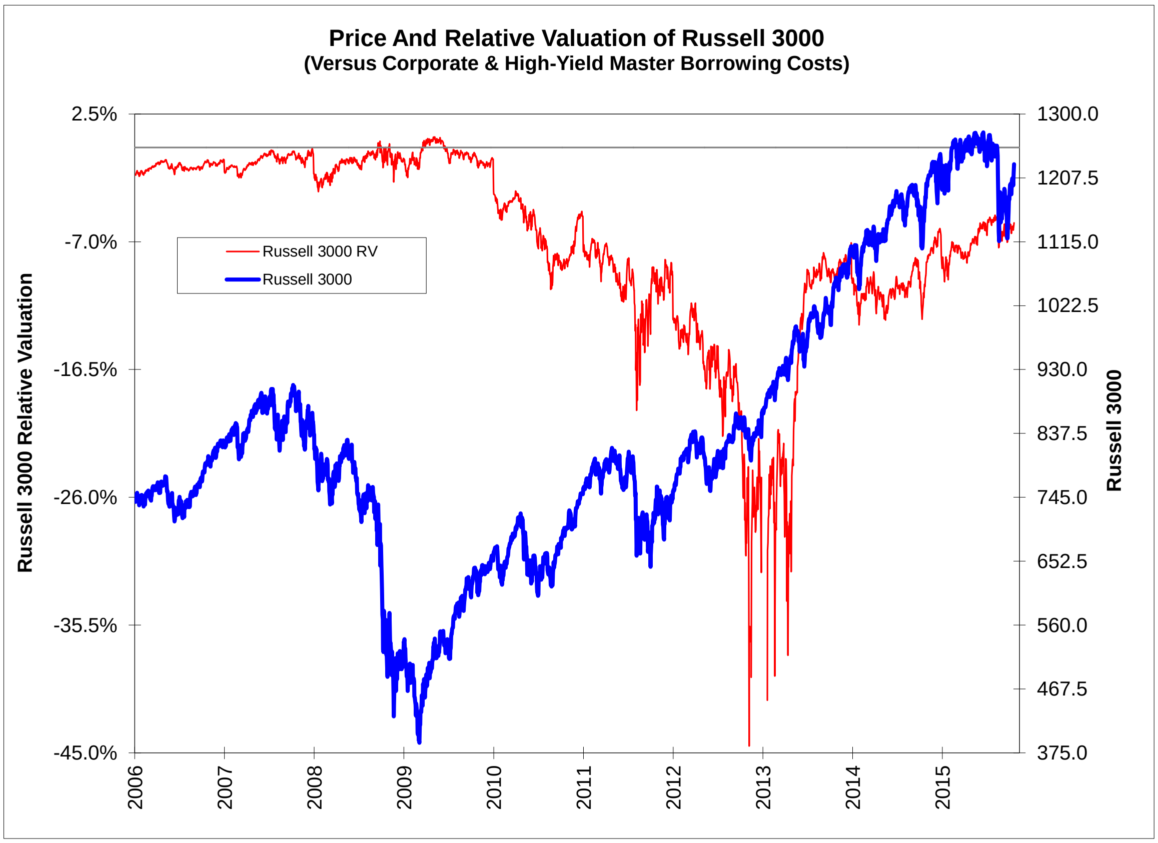
U.S. Equities Remain Undervalued Relative To Corporate Bonds

The top-down forward-looking P/E for the Russell 3000 of 18.48 is an E/P of 5.412%. This compares favorably to a yield of 4.189% on the Corporate & High-Yield Master index, and this is prior to taking the Russell 3000's 1.99% dividend yield into account. As an aside, stocks' dividend yield is just below the 2.026% yield on the ten-year UST.

Stocks thus remain undervalued relative to corporate bonds. The degree of undervaluation has narrowed rapidly since equities' successful test of the August low on September 28, 2015; it increased from -7.04% to -5.59%. The year-to-date range has been a maximum undervaluation of 9.99% on January 15, 2015 and a minimum undervaluation of 5.03% on August 10, 2015.

The contraction of equity undervaluation has been accompanied by a contraction in corporate bond risk. OAS levels have decreased from 274 basis points on October 2, 2015 to 249 basis points at present. A further contraction in these OAS levels likely is necessary for the equity rally to proceed. Interestingly, the current OAS level is the virtually the same as the reaction high reached on June 24, 2013, the end of the "taper tantrum." It is also 55 basis points over level reached during the crude oil-induced selloff of December 2014. As the difficulties of the energy industry remain, a decline in OAS levels to those reached in December 2014 may be the best result the current wave of global monetary accommodation can induce.



Correlation Of Returns

The rolling three-month correlation of returns between stocks and corporate bonds turned negative on June 17, 2015, ending a period of positive correlations prevailing briefly since the end of April. It bottomed on September 22, 2015, just after the FOMC postponed a move higher in U.S. short-term interest rates. The present correlation level of -0.232 is well within the normal bounds prevailing since the start of the ZIRP era in December 2008.