CAPE Ratio

- The CAPE ratio is a valuation measure that uses real earnings per share (EPS) over a 10 year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.
    - EPS is calculated as a company's profit divided by the outstanding shares of its common stock.

Company	Net Income	Preferred Dividends	Weighted Common Shares	Basic EPS
Ford	$7.6B	$0	3.98B	$7.6B/3.98 = $1.91
Bank of America	$18.23B	$1.61B	10.2B	($18.23 – $1.61)/10.2 = $1.63
NVIDIA	$3.05B	$0	.599B	3.05/.599 = $5.09

    - CAPE stands for cyclically adjusted price-to-earnings ratio
    - It is also known as the Shiller P/E ratio
- This ratio is useful for determining if a stock is **overvalued or undervalued**.
- Throughout the business cycle, a firm's profits change with the economy. In a period of expansion, a firm's profits will rise as consumers spend more, but in recession, a firm's profits will drop. Using the CAPE ratio will allow you to compare **consistent** earnings between firms.
- The CAPE ratio has a long-time average of 16.80.
    - In June of 2018, it reached 33.78 which lead some analysts to expect a recession since the CAPE has only passed 30 in 1929 and in 2000, just before 2 large market corrections
    - As of November 2019, the CAPE remains at 30
    - 

CAPE Ratio

- As you can see from the graph the CAPE has generally been a good predictor of future market corrections, but it is not considered a strong indicator of future market behavior since the CAPE is backward-looking
- Another argument has been made that the CAPE ratio has become too negative looking due to changes in GAP which the CAPE uses when looking at earnings