



S&P 500 Valuations Are Near Historical Highs: What Comes Next?

The US equity market remains a key focus for investors. After the decline of 2022, the S&P 500 recovered and moved into a strong growth phase, supported largely by expectations around artificial intelligence, technology companies and a potential new investment cycle.

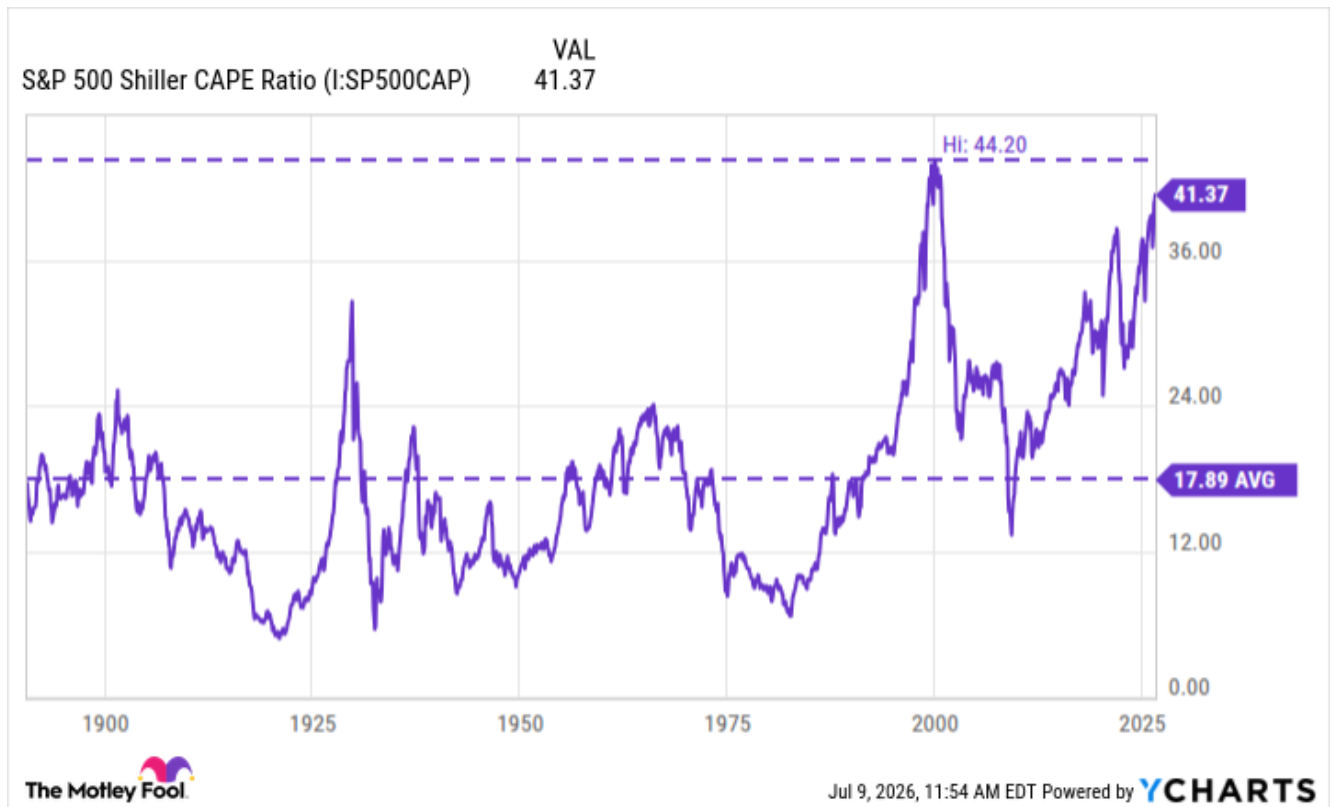
However, as the market rises, questions about its valuation are also increasing. By a number of valuation metrics, US equities are close to historically high levels. This does not automatically mean that the market is about to reverse immediately, but it does require investors to pay closer attention to risks, portfolio structure and their investment horizon.

Why Investors Are Again Talking About an Overheated Market

One of the widely used indicators of long-term market valuation is the Shiller CAPE ratio for the S&P 500. It compares the current value of the index with companies' average earnings over the past ten years, adjusted for inflation. This approach helps smooth out the effects of individual phases of the economic cycle and allows the market to be assessed from a longer-term perspective.

When CAPE is significantly above its historical average, it may indicate that investors are paying substantially more for stocks than usual. In the past, such periods have often been accompanied by higher volatility and more restrained long-term returns in subsequent years.

Today, the market is supported by strong expectations around artificial intelligence. Investors are pricing in a scenario in which AI can radically improve business efficiency, transform technological infrastructure and create new sources of profit for companies. This is especially visible in the valuations of the largest technology issuers.



Parallels with the Dot-Com Bubble

The current situation partially resembles the late 1990s, when the rapid expansion of the internet triggered a massive inflow of capital into the technology sector. At that time, investors also expected fundamental changes in the economy, while companies actively invested in the infrastructure of the new digital world.

In the long term, many of those expectations proved justified: the internet did indeed transform the economy, business and everyday life. But at the initial stage, the market overestimated the speed and scale of the commercial effect. Infrastructure was built too quickly, company valuations became excessive, and a significant portion of investment capital was ultimately lost.

Artificial intelligence may prove to be as important a technology as the internet. But even if the long-term potential of AI is real, this does not eliminate the risk of inflated expectations, overvaluation of individual companies and a painful correction if investors become disappointed.

High Valuations Do Not Mean an Immediate Decline

It is important to understand that an expensive market does not have to fall tomorrow. History shows that periods of high valuations can last for quite some time. The market can continue to rise for months or even years if corporate earnings grow, liquidity remains sufficient and investors continue to believe in the long-term investment story.

In addition, the causes of major market declines are rarely obvious in advance. Serious corrections usually occur not because of the risk everyone is already discussing, but because of a factor that the market underestimated or did not have time to price in.

For this reason, the investor's task is not to try to guess the exact date of the next decline, but to understand how well their portfolio is prepared for different scenarios.



What Investors Can Do

The first question to ask is the investment horizon. For an investor with a 10–20 year horizon, short-term volatility may be less significant, especially if the portfolio is diversified and built around broad index instruments.

The situation is different for an investor who may need capital in the coming years. In this case, high concentration in individual stocks, especially in technology companies that have grown rapidly, may create increased risk.

Investors should assess:

- how dependent the portfolio is on a few of the largest companies;
- what share is held in technology stocks and companies linked to AI;
- how realistic the profit growth expectations are for companies trading at high multiples;
- whether the investor could calmly withstand a portfolio decline of 20% or more;
- whether the portfolio contains instruments that reduce dependence on a single sector or investment theme.

Concentration Risk in the S&P 500

Many investors consider the S&P 500 to be a fully diversified instrument. Formally, this is true: the index includes shares of 500 large US companies. However, because it is weighted by market capitalisation, the largest issuers have a very significant weight in the index.

This means that the performance of the S&P 500 depends heavily on a small number of the largest technology companies. If interest in the artificial intelligence theme weakens or earnings expectations are not met, pressure on these companies may affect the entire index.

One way to reduce concentration is to consider more equal-weighted approaches, where each company in the index has approximately the same weight. This approach does not eliminate market risk, but it reduces the portfolio's dependence on a small group of the largest issuers.

Possible Scenarios

It is important for investors to consider not one forecast, but several scenarios.

Positive scenario: investment in AI gradually leads to productivity growth, corporate profits increase, and high valuations receive fundamental support.

Neutral scenario: the market remains expensive but does not collapse; returns become more moderate, and growth is distributed unevenly across sectors.

Negative scenario: expectations around AI prove excessive in the short term, companies' capital expenditures begin to pressure margins, and investors reassess valuations in the technology sector.

None of these scenarios can be considered guaranteed. But each of them should be taken into account when building a portfolio.

Key Takeaway

High market valuations are not a reason to panic, but they are a reason for discipline. Investors do not necessarily need to fully exit equities or try to guess the market peak. It is far more important to review portfolio structure, concentration levels, investment horizon and readiness for volatility.

If a portfolio is aligned with the investor's goals, investment timeframe and acceptable level of risk, short-term market fluctuations should not become a reason for emotional decisions. But if the growth of



recent years has led to excessive concentration in individual stocks or sectors, the current moment may be appropriate for rebalancing.

The equity market does not provide precise warnings about the future. But it regularly reminds investors that return and risk always go together.

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