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This and prior newsletters are available at www.Higginsinvestment.com

The Markets

	November	Change in Month	Year –To- Date
S&P TSX	31382	3.7%	26.9%
S&P 500	6840	0.1%	16.6%
Dow 30	47716	0.3%	12.3%
Oil	\$58.55	–4.0%	–18.4%
Gold	\$4254	6.5%	61.2%

The market went from fear to euphoria in November. For most of the month the market was in a steady decline. Investors were concerned about the valuation of the AI related stocks. NVIDIA reported strong earnings but still declined. After the initial decline the tech stocks began to recover. It is interesting that crypto currencies have been blamed for some of the market movements. Earlier this year it was explained that Gold lagged as young investors preferred crypto currency to gold as a safe haven. For most of the year there were enough funds seeking safety that both crypto currencies and gold rose. Then the crypto currencies began to decline. Since many deploy leverage to purchase the crypto currencies, any decline could lead to a margin call. One argument offered for the decline in the equity markets was crypto investors sold their stocks to meet margin calls. It seems crypto currency can be an explanation for any underperforming asset that is not a crypto currency.

Commodity based stocks were the market leaders. Gold stocks were up almost 18% after being supported by a 6.5% increase in the price of Gold. Despite weakness in the underlying commodity Energy stocks rose close to 10% this month. The third strongest sector was Consumer Staples. The Staples include the grocery stores that benefit from food inflation. At the other end of the spectrum was Information Technology that declined more than 5%. Info Tech was pulled down by weakness in the big weights. Those stocks declined based on concerns about the impact of AI on software companies. Real Estate and Industrials also had negative performance this month. As mentioned in the first paragraph, Crypto currencies were punished. Bitcoin fell from \$110 thousand on November 1st to \$90 thousand on November 30th. The other crypto currencies declined in sympathy with the decline in Bitcoin.

The chart on the next page presents the performance of the S&P 500 and the S&P TSX for the last 6 months.

6-Month Performance S&P 500 and TSX



TSX, S&P 500 source google.com/finance

Economic Indicators

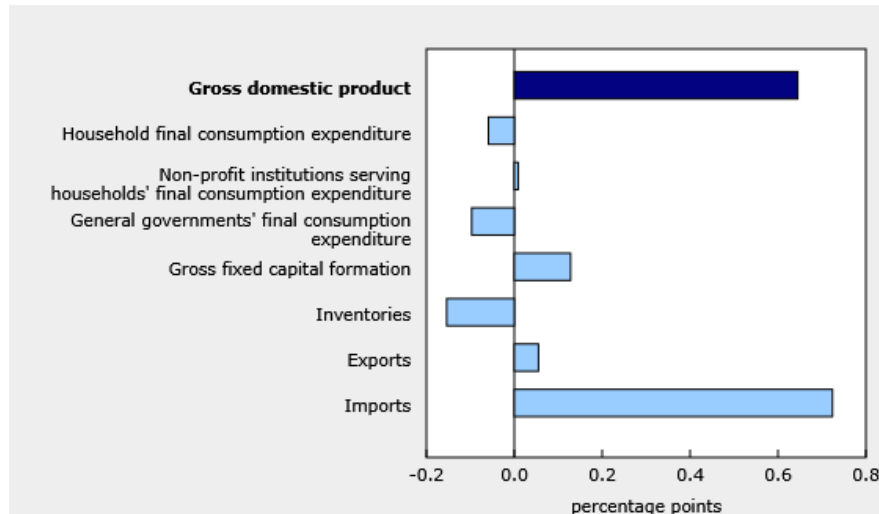
1. Canada GDP

When the Gross Domestic Produce came in better than expected some offered reasons not to be optimistic. Many expected GDP to show the economy contracted and since it would be the second consecutive quarter with a decline, we would be in a technical recession. When Statistics Canada reported growth in the third quarter it was a pleasant surprise. Some argued that it was only positive due to changes in exports and imports. The definition of GDP includes the net change in exports and imports so you cannot exclude it when it suits you. Just think of the debate over the growth to GDP that will occur if we export more oil from the west coast of Canada. Would Alberta tell you that that change to GDP should not be included?

Real Gross Domestic Product (GDP) in Canada grew by 0.6% in the third quarter of 2025, rebounding after a 0.5% decline in the second quarter. This was primarily fueled by a strengthening trade balance. Imports saw their sharpest decline since 2022 (down 2.2%), while exports edged up slightly (0.2%). Increased capital investment also contributed positively, driven entirely by a 2.9% rise in government spending—notably on weapon systems and institutional buildings like hospitals. Non-government business investment remained flat. The expansion was restrained by several factors, including a decrease in household spending, a drop in government final consumption expenditure, and a slower rate of business inventory accumulation. It can be a positive that inventories are lower, as it can lead to more spending to replenish inventories to their normal levels. However, if companies are lowering inventories as they expect lower sales then it could be a negative. Slower growth in immigration helped keep the per capita GDP close to the real GDP.

The 0.1% decline in household final consumption expenditure was largely attributed to fewer purchases of vehicles and international trips by Canadians. Business capital investment stalled, as growth in residential structures and engineering work was offset by declines in machinery, equipment, and non-residential buildings. While the economy expanded, the pace of manufacturing inventory accumulation slowed, dampening overall growth. Despite the mixed activity, household saving rates increased slightly to 4.7% as disposable income gains—driven by a 1.1% rise in employee compensation across most industries—outpaced spending increases. Corporate income also rebounded from a second-quarter dip.

The chart on the next page shows the major contributors to GDP.



Source: Statistics Canada

Reflection

Is the stock market overvalued? (time to run? was the working title)

Please read this section to the end to make sure everything is in perspective.

I keep reading that the market is in a bubble and that the risks outweigh the rewards. We will look at some of the factors that may give you pause before you make an investment. I am going to outline the reasons some have for selling the market.

The table below details the reasons some offer to avoid the stock market.

Indicator	Current Level	Historical Average	Warning Signal
S&P 500 P/E	28.16	~16.18	Extremely High
CAPE Ratio	40.01	16–18	Near record high
Buffett Indicator	230%	~100%	Severe overvaluation
Fed Funds Rate	5.25–5.50%	~1–2% typical of bull markets	Pressures stock multiples
Magnificent 7 S&P 500 share	25–30%+	Normally ~10–15%	Dangerous concentration

Elevated Valuations vs. Historical Norms

The primary argument for overvaluation is that stock prices have risen much faster than corporate earnings.

S&P 500 Price-to-Earnings (P/E) Ratio

The P/E ratio measures how much investors are paying for each dollar of earnings.

Key Data:

- As of **November 26, 2025**, the S&P 500 P/E ratio was **28.1**
- Long-term historical average: **~16.1**
- During the dot-com bubble peak in 2000, P/E exceeded **30**

Investors are paying roughly **75% more per dollar of earnings** than the historical norm. This level of valuation requires extremely strong and sustained earnings growth to justify today's prices — otherwise, a correction becomes more likely.

Shiller CAPE (Cyclically Adjusted P/E) Ratio

The CAPE ratio smooths earnings over 10 years to reduce the impact of economic cycles.

Key Data:

- CAPE ratio in **November 2025**: **40.0**
- Long-term average (since 1880): **16–18**
- Dot-com bubble peak (2000): **~44**
- 1929 crash peak: **~30**

A CAPE above **40** is the **second-highest level in recorded history**, surpassed only by the dot-com bubble. Historically, CAPE ratios at these levels have been followed by **low or negative real returns over the next 10–20 years**.

Disconnect Between the Stock Market and the Real Economy

The Buffett Indicator (Total Market Cap to GDP)

This metric compares the total value of U.S. public stocks to the size of the U.S. economy.

Key Data:

- September 30, 2025: **230%**
- Long-term historical average: **~100%**
- Dot-com bubble peak (2000): **144.25%**
- Just before the 2022 bear market: **195.62%**

Warren Buffett famously remarked that approaching **200%** means investors are “playing with fire.”

At **230%**, the stock market is valued at over **2.3x the size of the U.S. economy**, suggesting a major detachment from economic fundamentals. Historically, such extreme levels have preceded market corrections or long periods of underperformance.

Concentration Risk: Market Dominated by a Few Stocks The “Magnificent Seven”

The market’s performance has been heavily driven by:

- Apple
 - Microsoft
 - Alphabet
 - Amazon
 - Nvidia
 - Tesla
 - Meta
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- In **2023**, these 7 stocks accounted for approximately **60–70% of the total return of the S&P 500**.
 - Their combined index weight exceeded **25–30%** of the entire S&P 500 — levels not seen since:
 - The **Nifty Fifty era** (1970s)
 - The **dot-com bubble** (late 1990s)

This level of concentration makes the market structurally fragile. If just a few of these firms suffer earnings disappointments or valuation declines, the entire index could fall sharply.

Market Breadth Weakness

To evaluate participation, analysts compare:

- **Market-weighted S&P 500**
- **Equal-weighted S&P 500**

Key Data:

- During 2022 and parts of 2023, the **equal-weighted S&P 500 significantly underperformed** the market-weighted index.

This suggests that most stocks were not participating strongly in the rally. A truly healthy bull market typically shows **broad participation**, not heavy dependence on a handful of giants.

Federal Reserve Interest Rates

Valuations over the last decade were supported by ultra-low rates. That environment has changed.

Key Data:

- Fed Funds Rate (2023–2024): **5.25% – 5.50%**
- This is the **highest level in over 22 years**
- In contrast, rates were near **0%** throughout most of 2010–2021

Impact on Stock Valuations

Higher rates affect stocks in two major ways:

1. **Discount Rate Effect**
Higher interest rates reduce the present value of future corporate earnings, mathematically lowering fair stock values.
2. **Competition from Safe Assets**
With risk-free assets like U.S. Treasuries offering **5%+ yields**, stocks must offer significantly higher future returns to justify their risk — yet valuations remain historically high.

P/E Multiple Compression Concern

Historically:

- When interest rates were last this high in the early 2000s, the S&P 500's P/E ratio was in the **low 20s**.
- In 2025, it remains near **28**, despite much higher rates.

If rates remain elevated, further **P/E compression** may occur, which could lead to falling stock prices even if earnings remain strong.

AI Investment Boom

A major driver behind recent stock gains, especially in tech, has been enthusiasm around artificial intelligence.

- Trillions of dollars have flowed into AI-related companies.
- Valuations of key AI-driven firms have expanded rapidly, often far faster than their actual profit growth.
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While AI could be transformational, many analysts argue that current stock prices assume **near-perfect execution and adoption**, which historically has led to boom-bust cycles (similar to the dot-com era).

AND THE OTHER SIDE OF THE STORY

The market PE is high but one must consider future earnings not past earnings. We do not own NVIDIA but it is trading at 40 times earning with an expected growth rate of 40%. If the company grows at that rate for 3 years and the price does not change it would be trading at a PE of less than 15 times. It is logical to assume the growth rate will slow so maybe the stock will only be worth 15 times earnings in a few years. I would say it is overpriced but I thought it was overpriced when earnings estimates were lower and the stock traded at 100 times earnings. I missed the dramatic run up but using the PE ratio NVIDIA should have been avoided when it was trading at half the price but with a higher expected PE. Remember the E stands for earnings but also for estimated earnings.

Some argue the market has excess concentration. That is a very valid point.

The Buffet Indicator. Note the indicator was 65% at the peak in 1987, 138% in dot com bubble 138% in 2019 and it never dropped below that level. When do you sell? If you used 1987 as your guide you would have sold you shares in 2019 and never reinvested. There is one problem with the indicator as the stock market does not include the value of private companies, it may not be the best proxy for the price one is paying versus the level of GDP.

Interest rates in the US are too high and should draw capital away from the market. A higher interest rate implies a higher discount rate on future earnings. A higher discount rate means a lower valuation. Interest rates are a dual edged sword. They are high because the Fed fears inflation, but companies generally pass on higher costs by raising prices so earnings rise. On the other hand, if you believe inflation is tame then you believe interest rates will come down. The market seems to have priced in some further rate decreases. It is not just the level of the interest rates that matters but the direction. If rates are high and declining then you should use the lower rate when making your investment decisions.

Summary

“Double, double toil and trouble; / Fire burn and cauldron bubble?” Shakespeare’s Macbeth

One comment I heard is that the only bubble is the number of people saying the market is in a bubble. Many factors indicate the market might be overvalued. The list includes P/E ratio, the CAPE ratio, the Buffett indicator, the Fed Funds rate and market concentration. All these indicators show the market is overvalued. Just remember the Federal Reserve opined that the market was a victim of irrational exuberance more than 3 years before the decline. The Buffett indicator shows the market is expensive, but it showed the market was no where near a peak just before the market meltdown in 1987. Some of the arguments are circular. The market Price Earnings ratio is extended but it is influence by a few stocks. One concern is the market is being

driven by the magnificent 7 in the US. That may mean the other 493 stocks in the S&P 500 are not overpriced. Next month I might list 5 reasons the market is undervalued.

Remember the market can remain irrational longer than you can remain liquid so be careful when making your asset allocation based on a few indicators.

We reiterate that we focus on individual stocks when making investment decisions. The fact the overall market has a high Price Earnings ratio is less relevant when we purchase a stock trading with a P/E ratio significantly lower than that of the market and with a higher yield than the market. One instance are the Canadian banks; they are trading with P/E ratios near 15 times and have dividends around 4%. Yes, when the markets swoon all stocks tend to get taken down but not to the same extent. Take this year, gold stocks have soared after years of being told crypto currencies have usurped gold's role as a haven. Bitcoin is down slightly year-to-date while gold stocks have powered upwards. It might take time but companies with solid balance sheets and reasonable valuations can provide good long-term returns.

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