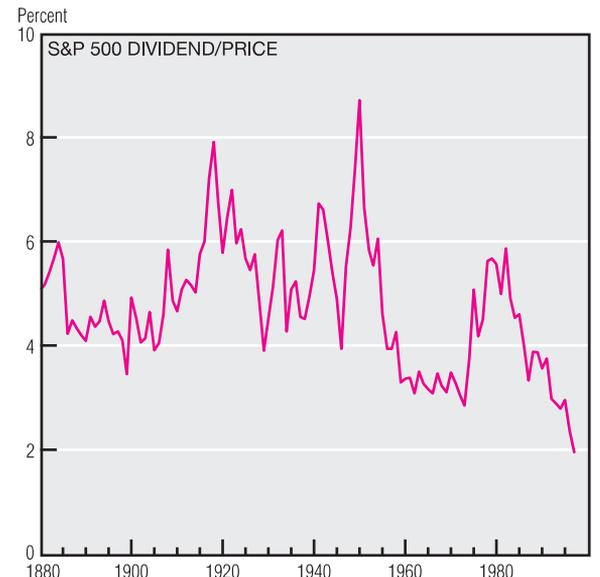
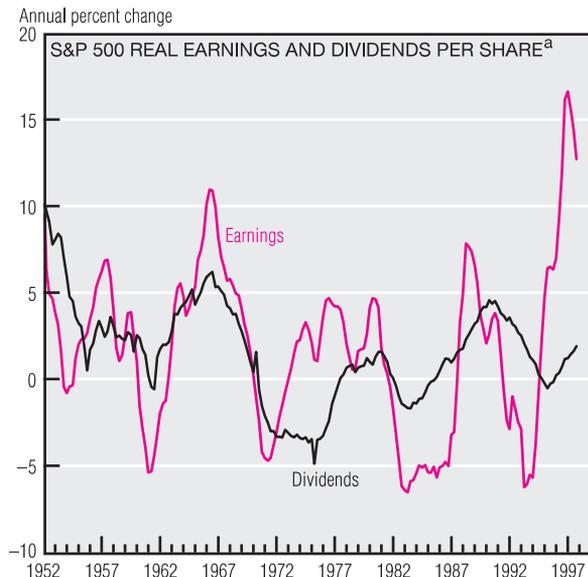
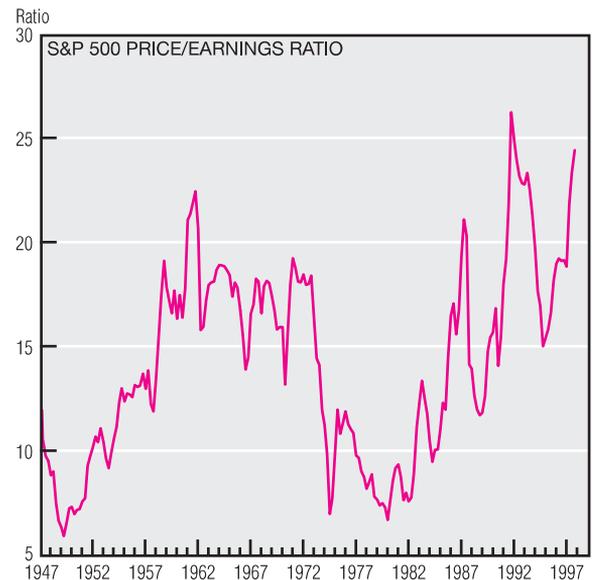
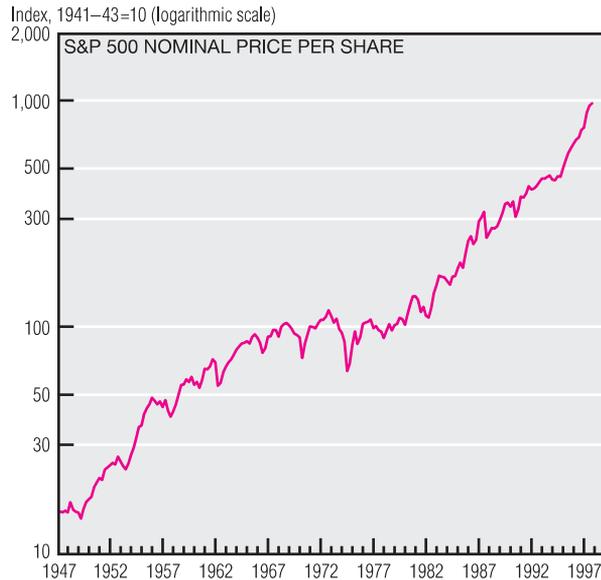


Equity Prices



a. Real earnings growth is the compounded growth rate of four-quarter total real earnings divided by four-quarter total real earnings four years earlier. Real dividend growth is the compounded growth rate of the current-quarter real dividend divided by the real dividend four years earlier.
 SOURCES: Robert J. Shiller, *Market Volatility*. Cambridge, Mass.: MIT Press, 1989; and Standard & Poor's Statistical Service, *Security Price Index Record*, various issues.

The stock market is again hitting new highs almost daily. Some analysts think this means a bubble is about to burst, while others believe it heralds a "new economy" of strong growth with low inflation. A closer look suggests that evidence can be marshaled on both sides.

Plotting the Standard & Poor's (S&P) 500 index on a logarithmic scale underscores the bias that high levels can impart to changes: A 100-point increase means much

less when the index stands at 1,000 than when it stands at 100. Nonetheless, doubling from 500 to 1,000 in only three years is impressive on any scale.

Pessimists point to very high price/earnings (P/E) ratios—which are approaching post-World War II records—and predict that prices will come back into line with earnings. Optimists believe current P/E ratios are justified by strong earnings growth, which they expect to con-

tinue despite some slackening in recent quarters. More of the earnings do seem to be passed on to shareholders via dividends, but share repurchases might have the same effect. The dividend/price ratio, often an accurate predictor, is signaling low expected returns to equity holdings. Whether this means a permanently higher plateau for prices, a bear market, or just a mistake, remains to be seen.