

All This, and Still at All-Time Highs?

Thoughts on the Market



DUALITY RESEARCH

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During one of the [most aggressive bouts of selling on record](#), we dismissed the breadth scare, looked past the seasonal headwinds, focused on our *improving* Proprietary Risk Model, and actively increased our risk exposure as the parts of the market that matter most continued to show strength.

And last week, the headline numbers finally started catching up.

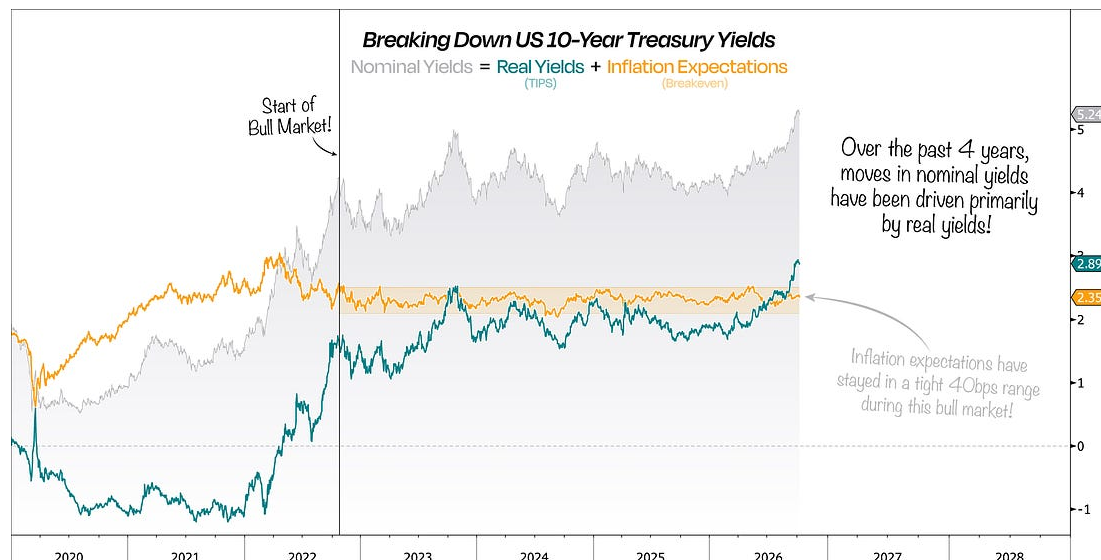
For the first time in weeks, the S&P 500 saw more stocks making new 52-week *highs* than new *lows*, finally bringing an end to a remarkably persistent streak of negative breadth.



Now, with the S&P 500 sitting at fresh all-time highs, there's another development that seems to be causing plenty of confusion: ***the higher Treasury yields go, the higher stocks seem to follow.***

But a quick look at our next chart, where we break down the US 10-year Treasury yield, should help clear things up. As it turns out, the recent move higher in yields has been driven almost entirely by *rising real yields*, rather than *inflation expectations*, which have remained stuck in a remarkably tight range for years now.

And with nominal growth having been exceptionally strong this year, perhaps the move in Treasuries shouldn't be all that surprising after all.



As we've pointed out repeatedly, stocks have already shown they can live with higher yields as long as growth and earnings remain strong enough to absorb the pressure.

Higher rates are weighing on valuations, pushing forward P/E multiples lower. But so far, earnings growth has more than made up for that contraction, allowing stocks to keep marching higher even as investors pay less for each dollar of forward earnings.

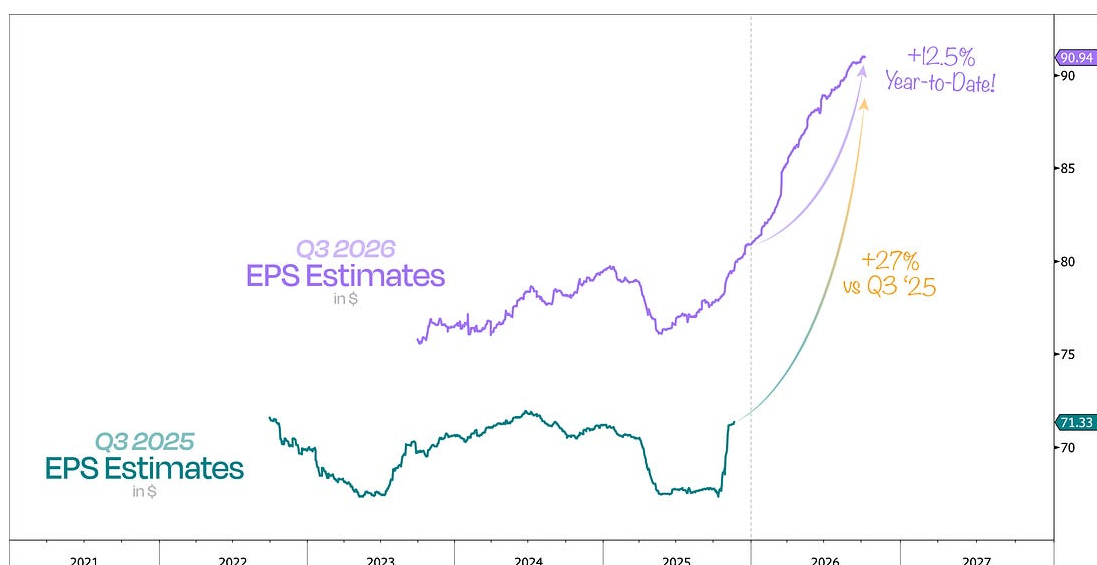
Of course, that doesn't mean higher yields aren't hurting anyone. Quite the opposite. The parts of the market that aren't delivering meaningful earnings growth are feeling the pressure much more directly.

So it goes without saying: ***the higher yields go, the more important it becomes what Corporate America delivers and has to say about the economy.***

That's precisely what makes the earnings season kicking off this week so important. After all, earnings strength has provided the greatest insulation against growing macro risks.

Treasury yields are now roughly 70 basis points higher than they were last earnings season, putting even more pressure on companies to deliver the earnings growth needed to offset the drag on valuations. The only thing keeping us slightly worried is that expectations are already running exceptionally high. Q3 earnings estimates have climbed a remarkable 12.5% this year alone, putting the bar at a whopping **27% year-over-year earnings growth.**

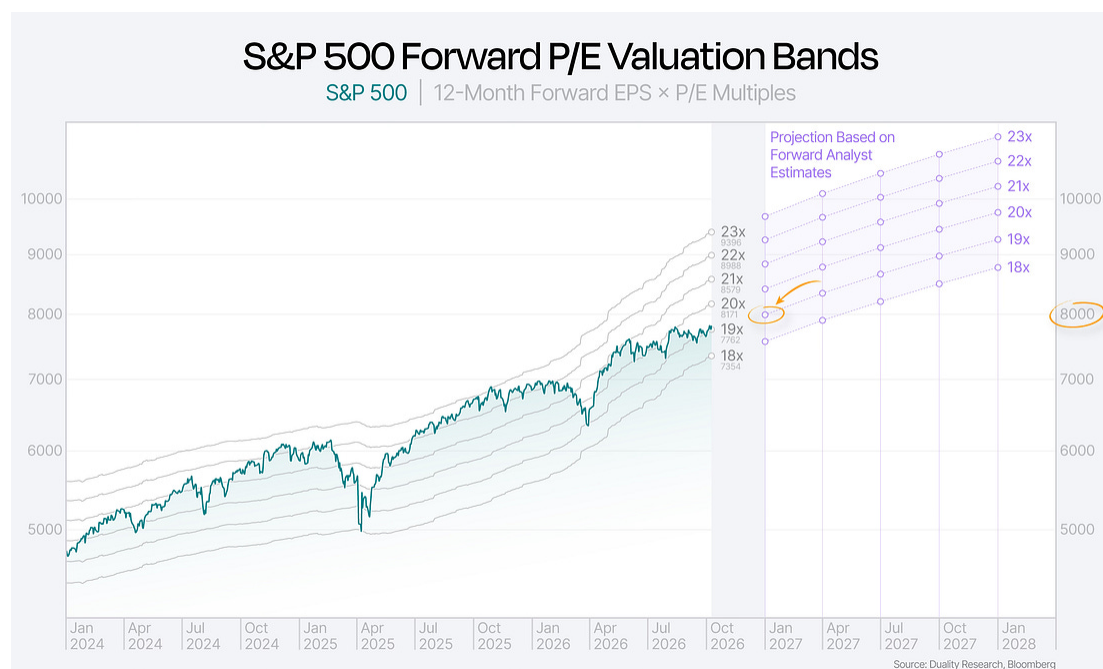
In other words, strong earnings aren't just a nice bonus anymore. They're increasingly becoming a necessity.



But let's also not forget that Corporate America has repeatedly managed to impressively beat even these lofty earnings expectations in recent quarters.

And as we pointed out previously, even if earnings come in roughly in line with expectations, the S&P 500 no longer requires anything other than stable multiples to reach 8,000 by year-end.

At roughly 19x forward earnings, there's no need for a *re*-rating, multiple expansion, or any valuation tailwind. Earnings growth alone can get us there.



So, the natural question to ask is: if we remain confident in the earnings growth picture, what could push forward P/E multiples lower from here and ultimately put an S&P 500 year-end close above 8,000 further out of reach?

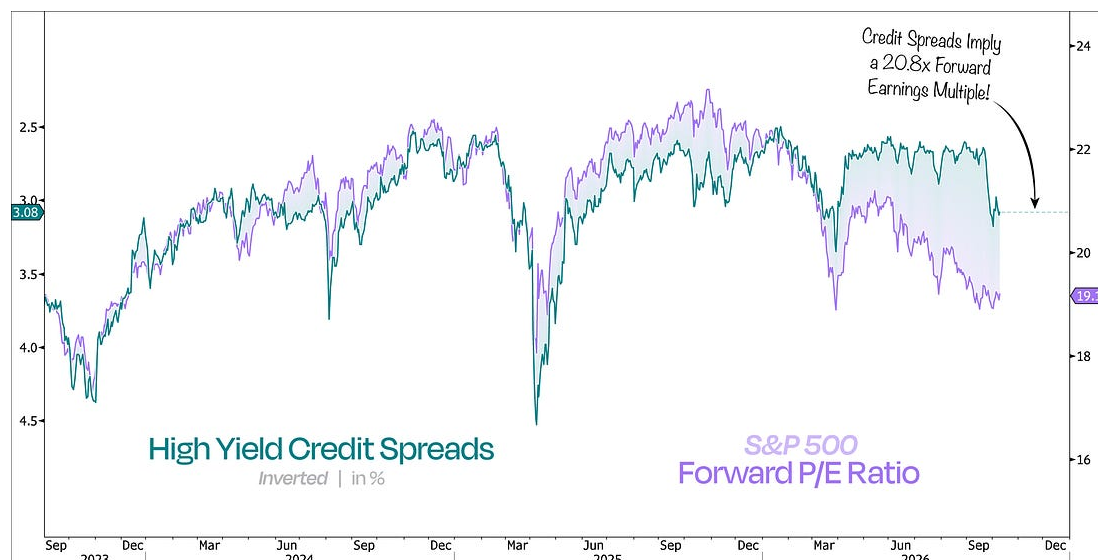
Well, barring any major macro or geopolitical shocks, one obvious candidate would be another leg higher in yields. Do we expect yields to rise as much as they did over the past quarter? Probably not. Could

they continue moving higher? Absolutely. We shouldn't be surprised to see the 10-year Treasury yield move toward 5.5%. But even in that scenario, we believe the S&P 500 trading at roughly 19x forward earnings already offers a meaningful buffer against further valuation pressure.

And this is where credit spreads become particularly interesting.

As our next chart shows, the historical relationship between high-yield credit spreads and the S&P 500's forward P/E ratio suggests that valuations have already *de-rated* meaningfully relative to the risks out there. The recent widening in spreads has lowered the valuation ceiling implied by that relationship, but the S&P 500 still trades materially below it.

In other words, even after accounting for the deterioration in credit conditions, current valuations appear to leave room for the market to absorb further macro pressure without necessarily derailing our year-end target.



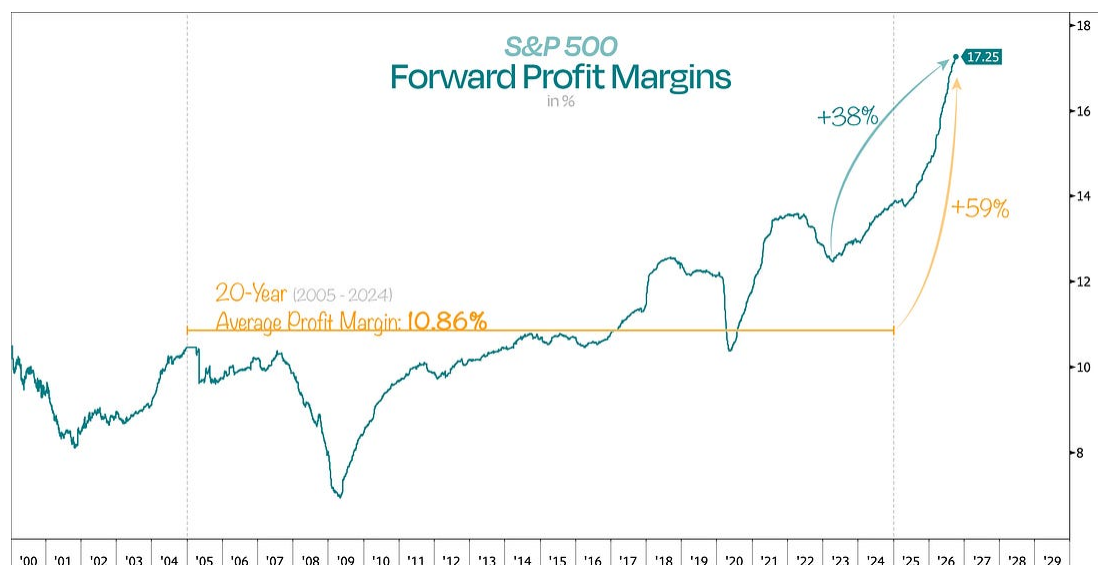
Another perspective we regularly use to gauge valuations is through the lens of profitability. Because as we've always said around here, higher

margins don't just *support* higher valuations, they tend to *drive* them over time.

So, to put the recent rise in forward profit margins into historical perspective, let's look at two comparisons that help illustrate just how different today's market is:

- S&P 500 companies are generating about **38% more profit on the same dollar of revenue** than they were 3.5 years ago.
- S&P 500 companies are generating about **59% more profit on the same dollar of revenue** than the 20-year average leading up to 2025, before margins started to surge materially higher.

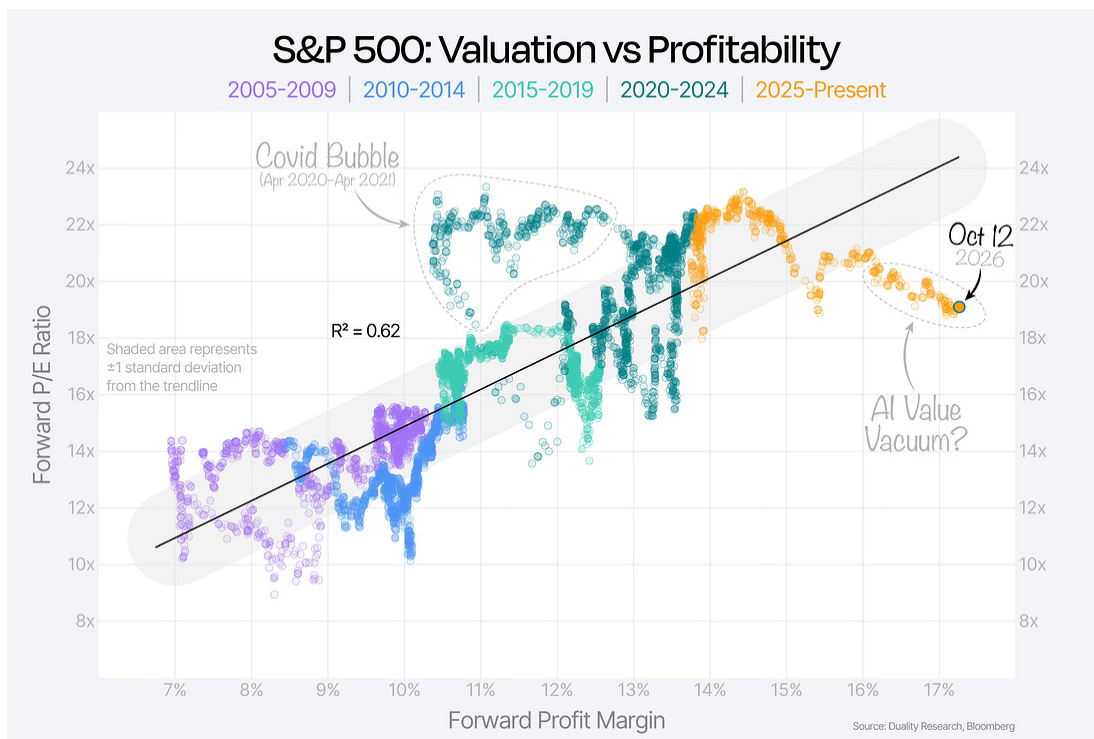
That context matters!



Now, when we map recent developments onto our **Valuation vs Profitability** framework chart, we can see that the market is now trading close to three standard deviations below its long-term trend.

And considering that forward profit margins explain roughly 62% of the variation in forward P/E multiples, we believe the discount implied by

this framework further reinforces our earlier point: **valuations have already *de-rated* meaningfully relative to the risks out there.**



To us, that suggests the market is already pricing in more than just the obvious outcome — slower earnings growth at some point and some moderation in margins from here. In other words, valuations appear to reflect considerably more than a simple normalization in profitability.

So, where does that leave us?

Frankly, and quite literally, in a very comfortable place.

Not because the risks have suddenly disappeared, or because yields can't move higher from here. They absolutely can. But after weeks of deteriorating breadth, rising Treasury yields, and growing macro concerns, we believe the market has already done a meaningful amount

of the *de*-rating needed to account for those risks — and yet, we're at all-time highs!

In other words, the market has taken a hit — just not in price. And that's largely thanks to earnings growth remaining strong while profit margins hold up — a combination that means the S&P 500 no longer needs multiple expansion to reach 8,000 by year-end.

And that's an important distinction. We're not relying on investors suddenly becoming more optimistic — we're relying on Corporate America continuing to deliver.

Of course, with expectations already running this high, there's not a whole lot of room for disappointment. If earnings or margins start to roll over, we'd have to rethink that view.

But for now, we're sticking with our constructive view. Our Proprietary Risk Model keeps improving, valuations have come down, and earnings are still holding up.

We'll keep following the evidence, not the noise.

That's all for today. Thanks for reading! 🙌🧐
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