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Nifty 50's earnings yield has surged by 131 bps over the bond yield for the first time since May 2009

Widening Yield Gap Makes Equities Cheaper Relative to Bonds Globally

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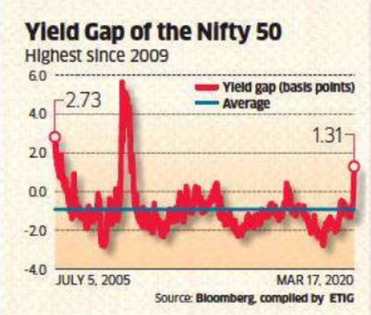

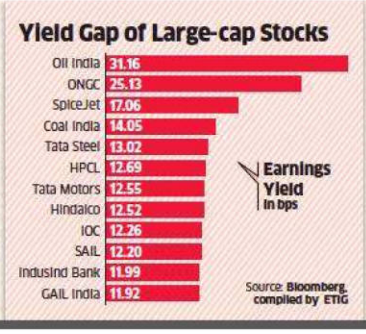

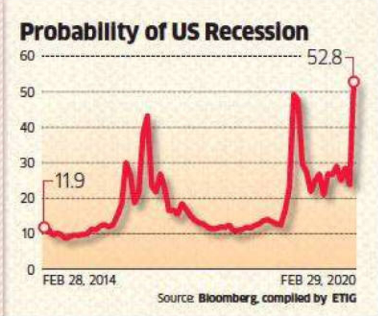

ET Intelligence Group: A sharp fall in the stock market over the past two weeks has made equities cheaper relative to bonds, according to the ET Intelligence Group's analysis of the earnings yield of the benchmark Nifty 50 and the 10-year bond yield compiled from Bloomberg. The Nifty 50's earnings yield — the inverse of the price-earnings multiple — has increased by 131 basis points over the bond yield for the first time since May 2009. The spread had averaged at 92 basis points in the past fifteen years. Nearly one-third of the BSE 500 stocks (excluding financials) are having earnings yield of more than 400 basis points.

More than two-third of the global equity markets have lost more than 20% from their peaks, a situation technically referred to as a bear phase. Also, bond yields in these markets have fallen to record levels, thereby widening the yield gap. The 10-year bond yield in the US has dropped below 1% for the first time in 150 years, which widened the yield spread with equities to 743 basis points.

Theoretically, a rising yield suggests that equities are undervalued. Under usual circumstances, it prompts portfolio managers to increase exposure to equities. Historically, when the earnings yield exceeded the bond yield during the Taper tantrum in 2013 and demonetisation in 2016, the equity indices gained in the next twelve months.

This time, however, a pandemic of Covid-19 has raised concerns of a global recession, which affected bond yields. The probability of the US recession in the next 12 months has risen to 52.8%, according to Bloomberg Economics data. Therefore, portfolio managers would observe more caution while taking fresh positions in equities despite their improved attractiveness.