

Opinion **Markets Insight**

Reasons for caution amid America's triumphant market surge

With most traditional valuation indicators now flashing amber, investors should be vigilant

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The US stock market has been on an extraordinary ascent, but there are the negative forces © Michael Nagle/Bloomberg

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The American stock market has been on an extraordinary ascent, buoyed by investors' faith in robust corporate balance sheets, surging earnings and a vision of future productivity gains.

This exuberance has been underpinned by an economy that has proven remarkably resilient in the face of unusual policy-induced volatility. Yet, with most traditional valuation indicators now flashing amber, the path forward hinges on a delicate interplay of economic and financial influences.

This week the S&P 500 closed at another record high — its 15th of the year — in a climb that has included the fastest recovery from a market correction of more than 15 per cent, according to Goldman Sachs. While an important share of this gain has been attributed to a handful of familiar technology firms, the broader market has also registered respectable returns.

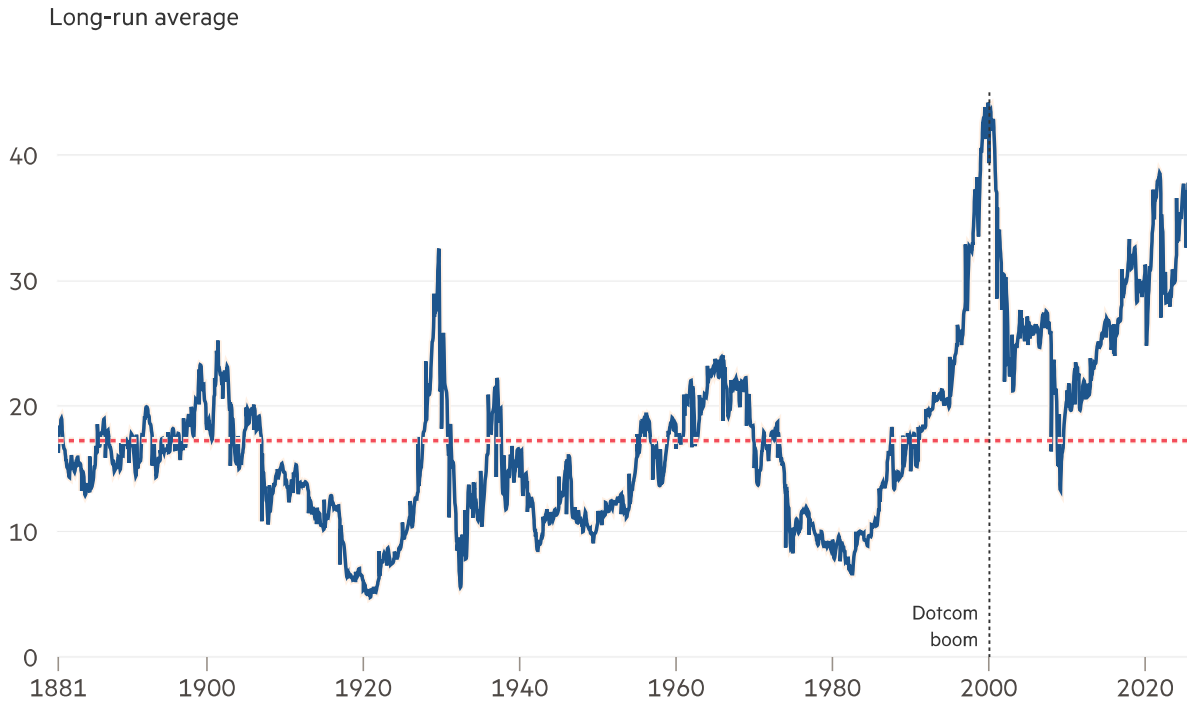
Much of the capital flowing into US equities reflects a renewed bet on US economic exceptionalism, albeit with a narrowed focus on favour of corporate America and away from the sovereign. Many market watchers might have doubts about the sustainability of such a decoupling, but it has allowed the stock market to flourish even as gold, a traditional indicator of “risk-off” sentiment, has repeatedly scaled new record highs.

Investors are comfortable with the notion that an exceptional trifecta for tech companies in particular — solid earnings, easy access to funding, and deeply promising innovations — will shield valuations from more negative forces. The latter includes the weaponisation of tariff. With that, market valuations have reached levels that would typically warrant caution.

No single valuation metric, of course, provides a reliable picture. However, the current environment is notable for the breadth of indicators signalling caution. The cyclically-adjusted S&P 500's Shiller CAPE Ratio currently hovers just under 40, more than twice its long-term average and approaching the dotcom bubble's peak of 44. The narrower forward price-to-earnings ratio stands at 22, notably above its long-term average as does the price-to-sales ratio. Warren Buffett's favoured indicator — total market capitalisation to GDP — is at an all-time high and the US dividend yield has slumped to almost 1 per cent.

Shiller valuation gauge signals lofty US stock market levels

Shiller cyclically adjusted PE (Cape) ratio



FINANCIAL TIMES

Source: [Shiller Data](#)

Those who dismiss such cautionary signals typically lean on two arguments. The first is captured by the market adage “the trend is your friend”. Advocates argue investors should continue to take a “high risk” approach until there is compelling evidence of the wave breaking. The second argument runs deeper, anchored in techno-optimism, or what Nouriel Roubini termed “tech trumps all”: well-funded and dynamic technology firms will legitimately drive markets to ever-higher valuations.

All this stands in contrast to the wider economy, where a more anxious “wait and see” attitude prevails. Recent data suggests some reversion to dispersion trends evident in earlier years: a K-shaped economy, where the wealthy accumulate more while lower-income households struggle; growth in services versus pressure on manufacturing; and significantly more favourable funding prospects for large companies relative to small businesses.

These contrasts underscore why equity investors should remain vigilant, closely monitoring the balance of forces that will probably take months, if not quarters, to play out. The most potent driver capable of higher valuations is a rapid and widespread diffusion of innovations throughout the economy. Crucially, this is not about a new wave of even more exciting discoveries — though these are highly probable, especially in artificial intelligence, life sciences, robotics and eventually quantum computing. Rather, it is about gains in productivity and growth from the broad diffusion of already introduced technology.

Against this, there are the negative forces. The first being mounting concerns about excessive public debt in many advanced economies, including the US. This risks triggering notably higher interest rates and a steeper rise in bond yields from short-term debt to longer maturity paper. Such a scenario would squeeze corporate profitability, strain household budgets and complicate government finances. The second potential negative force is the risk that the emerging global tariff regime disintegrates into a trade war rather than stabilising after recent deals. This could mean widespread retaliatory measures that stifle economic activity and further disrupt global supply chains.

Like many, I hope that the broad and inclusive diffusion of innovations will prevail with the rise of AI benefiting every citizen. However, this is far from a sure bet amid such unusual policy-induced volatility.

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