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**Ask a trust officer:
P/E ratios**

DEAR TRUST OFFICER:

What is the P/E ratio? Is it important? —NOVICE INVESTOR

DEAR NOVICE:

The price/earnings ratio (P/E ratio, for short) is the comparison of a firm's current stock price to its earnings, either reported earnings or projected earnings. As such, it tells us if investors are willing to pay a high price or a low price for a stock. Careful consideration of the P/E ratio was advocated by value-investing theorists Benjamin Graham and David Dodd in the 1930s.

A low P/E ratio may mean that a stock has become unpopular with investors, so it may be undervalued. Or it could mean that investors sense trouble ahead for the company. A high P/E ratio could suggest the opposite, that a stock has become overvalued and is heading for a fall. Or it could mean that investors believe that a company with low current earnings is poised for explosive future growth. The P/E is a useful metric in investment analysis, but it can't provide absolute answers.

Looking at the P/E ratio for the market as a whole tells us something about overall investor sentiment. A year ago, according to *The Wall Street Journal*, the P/E of the market was 23.1, and now it is about 14.9, based upon trailing earnings. That's the biggest 12-month decline since 2003. A year ago the P/E was elevated because the denominator, the earnings, was depressed by the recession. Corporate earnings have since recovered, but that hasn't translated into sharply higher stock prices. In fact, the Dow Jones Industrial Average just had its worst August since 2001.

The P/E ratio fell during the Great Depression, and it bottomed out at 5.90 in 1949. When stocks were out of favor in the 1970s, the P/E ratio again fell sharply, reaching 6.97 in 1974 and 6.68 in 1980.

Market observers suggest that a cloud of economic uncertainty still hangs over the stock market, which may be responsible for the decline in the P/E ratio.

Investing in stocks today can be daunting. To learn more about our capabilities in this area, we invite you to come in to speak with our investment professionals.

Do you have a question concerning wealth management or trusts? Send your inquiry to dave.fisher@bankibt.com.

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