Earnings Yield, G-sec Yield & Market Returns

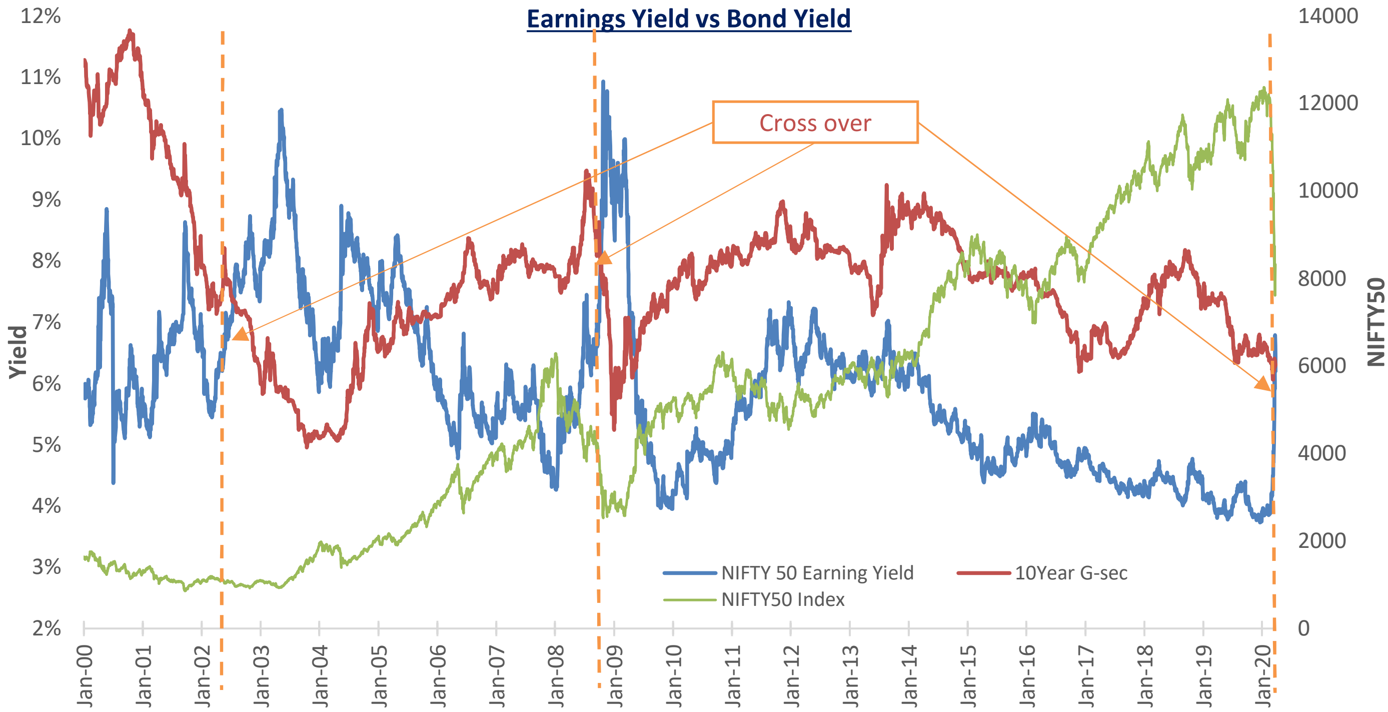
What is Earnings Yield ?

The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of how much a company earned per share (in this case, NIFTY50). Earnings yield is one indication of value, as a low ratio may indicate an overvalued stock/ index or a high value may indicate an undervalued stock/ index.

What is G-sec Yield?

The 10 Year G-sec Yield is the yield or rate of return received for investing in an Indian government issued security that has a maturity of 10 year.

A comparison of the yield between the two capital instruments, equity and debt, can be used to assess the risk-reward for investing. This tool has been a very important indicator to identify the bottom of the equity market. Whenever the earnings yield has crossed bond yields, it implies that even assuming nil earnings, growth in perpetuity equity will deliver better returns than debt. Similarly, when equity yields are lower than bond yields, it indicates that equities are expensive than bonds.



Data Range - 1/1/2000 to 25/3/2020

- From the data revealed in the chart above, we can observe that lately the divergence between bond yields and earnings yield has sharply decreased. This means equity markets have become relatively cheaper and there is more value created in investing in equity rather than debt.

Date of Cross	22-7-02	10-10-08
1-Y Return on NIFTY post cross	9.60%	50.77%
2-Y Return on NIFTY post cross	32.28%	86.08%
Days to Reversion of yield	1109	220

- In the past 20 years, there have been only 2 instances when Earnings Yield have crossed Bond Yields in India and both have presented excellent opportunities for Equity returns going forward (2002 and 2008; refer to table). On 23rd March, 2020 we saw the third instance of crossover. If past data is anything to go by, then we may see good returns from Equities in one and two year time frames.

Source - Investopedia, EquityMaster, Bloomberg