Notes on P/E Ratios

The P/E Ratio is a valuation ratio of a company's current share price compared to its per-share earnings.

Calculated as: Market Value per share / Earnings per share (EPS)

EPS is usually from the last four quarters (trailing P/E), but sometimes can be taken from the estimates of earnings expected in the next four quarters (projected or forward P/E). A third variation is the sum of the last two actual quarters and the estimates of the next two quarters.

Sometimes the P/E is referred to as the "multiple," because it shows how much investors are willing to pay per dollar of earnings.

In general, a high P/E means high projected earnings in the future. However, the P/E ratio actually doesn't tell us a whole lot by itself. It's usually only useful to compare the P/E ratios of companies in the same industry, or to the market in general, or against the company's own historical P/E.

Historically, the average P/E ratio in the market has been around 15-25. This fluctuates significantly depending on economic conditions at the time. The P/E can also vary widely between different companies and industries.

If a company has a P/E higher than the market or industry average, this means the market is expecting big things over the next few months or years. A company with a high P/E ratio will eventually have to live up to the high rating by substantially increasing its earnings, or the stock price will need to drop.

The P/E ratio is a much better indicator of the value of a stock than the market price alone. For example, all things being equal, a $10 stock with a P/E of 75 is much more "expensive" than a $100 stock with a P/E of 20. That being said, there are limits to this form of analysis -- you can't just compare the P/Es of two different companies to determine which is a better value.

P/E ratios are generally lower during times of high inflation.