Corporate profits that doubled since 2009 have left the Standard & Poor’s 500 Index cheaper than at all 34 peaks since 1989, even as options traders push the cost of protecting against losses to the highest in four years.

Companies in the benchmark gauge of U.S. stocks trade for 14.1 times earnings after advancing 102 percent since March 2009 to an almost four-year high last week, data compiled by Bloomberg show. Valuations are lower than at every 52-week peak since 1989. Traders have pushed the price of contracts that pay should the S&P 500 drop 20 percent to the most since 2007 compared with ones betting on a rally of the same size.

Rising oil prices and concern European leaders have yet to contain the credit crisis are keeping investors from paying more for profits, which are projected to reach annual records through 2013. Bears say equities aren’t cheap because the profit estimates are too optimistic. Bulls say shrinking price-earnings ratios provide a margin of safety should gains in the U.S. economy fail to match forecasts.

“Stocks have just gotten too cheap,” Paul Zemsky, the New York-based head of asset allocation for ING Investment Management, said in a telephone interview. His firm oversees $160 billion. “We were worrying about a Chinese hard landing that didn’t happen. We worried about a U.S. double dip and that didn’t happen. We worried about Europe disintegrating, that didn’t happen. The worst risks have passed.”

Weekly Gain

The S&P 500 climbed 0.3 percent to 1,369.63 last week and closed at 1,374.09 on March 1, the highest since 2008, as jobless claims fell to a four-year low and consumer confidence improved. The gauge slipped 0.3 percent to 1,365.66 at 9:36 a.m. New York time today.

The index was 6 points above its 2011 high of 1,363.61 last week, even as its price-earnings ratio fell from 15.6. Companies from Abbott Laboratories (ABT) in Abbott Park, Illinois, to Memphis, Tennessee-based International Paper Co. (IP) have rallied while valuations shrunk.

Profits grew 99 percent between the end of 2009 and 2011, and are forecast to rise another 12 percent this year and 13 percent next, data compiled by Bloomberg show.

Nine quarters of earnings growth have outpaced the index’s advance, leaving valuations 14 percent below the five-decade average of 16.4. The price-earnings ratio hasn’t been this low while the index was at a 52-week high in 23 years, according to data compiled by Bloomberg that excludes peaks that occurred within a month of one another.

Stay Away

Investors are shunning equities after one of the most volatile years on record, a period when 10-year U.S. Treasury bonds returned 9.8 percent compared with nothing for stocks. Concern Greece would default on its debt, six increases to lender reserve requirements by the People’s Bank of China and U.S. unemployment above 9 percent sent the S&P 500 down more than 19 percent between April and October before recovering.
“What you’re seeing is a gigantic exercise in behavioral finance,” Brian Barish, who helps oversee about $7 billion as Denver-based president of Cambiar Investors LLC, said of the multiple in a Feb. 29 phone interview. “It isn’t fair, but it is understandable. The ability to scare the hell out of people is much greater than the ability to attract them to equities.”

Options traders have increased bearish bets even as shares gained and earnings exceeded estimates by 3.1 percent in the fourth quarter. Six-month puts to protect against a 20 percent decline in the S&P 500 have an implied volatility of 29.09. That’s 2.2 times higher than calls to bet on a 20 percent gain, Bloomberg data on the price relationship known as skew show.

Peak Margins

Low valuations and rising options costs reflect investor concern about earnings after profit margins in the S&P 500 rose nine straight quarters and reached 14 percent between October and December, said Eric Teal, who manages $4 billion at First Citizens Bancshares Inc. Profitability has only been higher during five quarters in 2006 and 2007 and one in 1999. In both cases, the S&P 500 was in a bear market within a year. Margins averaged 10 percent between 1991 and 2006, according to data compiled by Bloomberg.

“There is an underlying concern that profit margins have peaked and will begin to contract in coming years,” Teal, the Raleigh, North Carolina-based chief investment officer, said Feb. 28. “Thus, investors are unwilling to pay up for earnings that are clouded with uncertainty.”

Bearish Bets

For Keith Wirtz, who oversees $14.6 billion as chief investment officer for Fifth Third Asset Management in Cincinnati, there’s little surprise in options rising after the S&P 500 gained 25 percent in five months. The last time bearish bets were this high relative to bullish ones was in May 2007. The S&P 500 reached the highest price-earnings ratio in two years the following month and a record high of 1,565.15 in October 2007. What followed was the worst financial crisis since the Great Depression, with equity losses of 57 percent through March 2009.

“You’ve got risk coming from everywhere,” Wirtz said in a Feb. 29 phone interview. “That’s why the markets are skittish. You can’t put a measurement against those risks. How do you put probabilities on these kinds of outcomes? You just have to discount the worst, which is what they’re doing.”

The rally that restored more than $3.2 trillion to U.S. equity value since October is pushing up indicators used by analysts who use charts to predict future prices. About two-thirds of New York Stock Exchange-listed companies closed last week above their 200-day moving average. The 14-day relative strength index for the S&P 500, which compares the magnitude of gains and losses, has exceeded 70 on 13 days since Jan. 25. Some investors use that level as a signal a rally has come too far, too fast.

Reaching Peaks

Of the 500 companies in the benchmark equity gauge, 67 reached 52-week highs last week, data compiled by Bloomberg show. That compares with 31 in the same week last year. Shares of Abbott, the maker of nutritional drinks, heart stents and drugs, reached the highest level in three years, even as its earnings multiple shrunk to 12.1 from 12.6 in May, data compiled by Bloomberg show. Profits excluding some items increased 12 percent a year since 2009 while shares rose an average 2.4 percent each year.

International Paper’s earnings haven’t trailed analyst forecasts since 2008 and the stock reached its highest
price since November 2007 last week. The world's largest pulp and paper producer's price-earnings ratio fell 35 percent in the past 12 months to 10.1, data compiled by Bloomberg show.

Target Earnings

Annual profit at Target Corp. (TGT), the second-largest U.S. discount retailer, has climbed 15 percent on average since fiscal 2010. Even after reaching an almost 14-month high on March 1, the shares are trading at 13.5 times earnings, compared with 13.6 in October and the average of 19 since 1990.

“A number of recent trends have emerged which should support stronger corporate profits, including better U.S. economic data, less-severe results in Europe, higher oil prices and reduced financial sector stress,” Jonathan Golub, chief U.S. market strategist at UBS Securities LLC in New York, wrote last week, raising his year-end estimate for the S&P 500 to 1,475 from 1,325. “Conditions support further increases in both earnings and stock prices.”

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