Price-Earnings Ratio

The term P/E Ratio stands for Price-Earnings Ratio which means a valuation ratio of a company's current share price compared to its per-share earnings.

$$\text{Price-Earnings Ratio} = \frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

Stock Market Example – A company's market value share is selling for $10.75 and their earnings per share is $1.37.

$$\text{Price-Earnings Ratio} = \frac{\$10.75}{\$1.37} = 7.85$$

Real Estate Example – If a price of a house is $100,000 and if you can earn $10,000 a year in rent after expenses.

$$\text{Price-Earnings Ratio} = \frac{\$100{,}000}{\$10{,}000} = 10$$

In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. The lower the P/E ratio the better the investment is in that group.

You want to use this formula for similar investments. For stocks you want to make sure if you're using this formula to have the companies in the same industry. You don't want to compare a technology companies P/E ratio to a utility companies P/E ratio.

Same with real estate investments you want to compare single family homes together and not compare a single family home to an apartment building.