

## PEG Ratio

The PEG ratio is the price-to-earnings ratio (P/E) divided by the historical or projected growth rate of the earnings. The P/E has a fairly good track record of identifying undervalued stocks and of beating the market. However, the P/E ratio alone makes no attempt to identify companies that also have good growth prospects. By dividing the P/E ratio by earnings growth, it is hoped that the number that results, the PEG ratio, will also identify stocks that have superior growth potential.

Generally, a PEG ratio below 1.0 is considered a good buy and a ratio above 1.0 is not. However, there is nothing magical about the number 1.0. In fact, the average PEG ratio is probably above 1.0. And investors could invest in stocks with PEGs far above 1.0 and still be investing in stocks with below average PEG ratios.

The PEG ratio is a simple way to get very rough estimate of how favorably priced a stock is. However, it is not much more accurate than the P/E ratio. And it has many of the same problems as the P/E ratio. It becomes undefined when earnings are zero or below. And it reflects only the equity portion of a firm instead of the whole firm.