The last two columns provide two estimates of the implied equity risk premium, with the first leaving the cash payout ratio unchanged over time (allowing dividends plus buybacks growing at the same rate as earnings, and the second allowing the cash payout ratio to change over time to a sustainable growth rate, computed using the expected growth rate after year 5 and the return on equity of the S&P 500 companies:

Sustainable Payout ratio = 1 – Expected Growth Rate in Perpetuity/ Return on Equity

As you can see, the implied equity risk premium has been volatile over the fifteen years, with premiums exceeding 6% in some years, and a median value of 5.20%. At the start of 2023, the implied equity risk premium was 5.94%, towards the top of the range of equity risk premiums between 1960 and 2023, but it dropped to 4.60% at the start of 2024 and to 4.33% at the start of 2025. The drivers of the implied equity risk premium are listed below:

1. Index level: The most volatile input into the ERP calculation is the level of the index, and with all else held constant, higher values for the index translate into lower equity risk premium. Intuitively, paying more for an asset up front will reduce the expected return you can expect to generate on that investment, and that is why as stock prices rise, equity risk premiums tend to decrease.
2. Long-term riskfree rate: The ten-year treasury bond rate affects the equity risk premium in two ways. The first is that treasury bond rate is netted out from the expected return on stocks that you obtain, based upon the level of stock prices, and expected cash flows, to estimate an equity risk premium. Higher treasury bond rates, holding all else constant, will lead to lower equity risk premiums. The second is that we use the treasury bond rate as our proxy for nominal growth in the long term, and thus as a cap on the growth rate in earnings beyond year 5.
3. Base-year Earnings: The base year earnings represent the starting point for your forecasts of future years, and a higher earnings value, all else held constant, should result in a higher implied equity risk premium. In fact, we noted that there are some who use the ratio of earnings to price, i.e., the inverse of the PE ratio, as a proxy for the expected return on stocks.
4. Growth in earnings: While we can get estimates of growth for individual companies in the S&P 500 and take a weighted average, that number is flawed for two reasons. The first is that since these growth rates are usually in earnings per share, we risk double counting the effect of buybacks, first as a cash flow and then again as a higher growth rate in earning per share. The second is that, as noted earlier in this paper,