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The Dow 20,000...Should We Care?

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"Dow 20,000"

Those two words encapsulate three concepts: 1) the Dow is a relevant economic indicator; 2) 20,000 is a noteworthy milestone; 3) special consideration should be given to investing at all-time highs. I'll examine each in turn.

The Dow is an imperfect representation of the market.

The Dow index is a price average of 30 stocks chosen by committee. It has long been criticized for its relatively small number of stocks, the arbitrary way they're chosen, and that it's calculated as an archaic average of the actual prices of the stocks rather than their market capitalization. Furthermore, the 30 stocks are not the largest firms, nor are they necessarily selected from every industry. But even though the Dow may not be the best representation of the US or global economy, it has at least been highly correlated with the US market. More significantly, it has historical importance as a continuously priced index since 1896. Though it has been remarkably resilient at tracking broader and less arbitrary measures of the market, it's unreasonable to continue to rely on a committee to anticipate the most relevant companies into the future. The Dow did its job, but the 500 stocks of the S&P will likely be a better representation of the market, and total market indexes further avoid selection bias and are generally the best available measures.

20,000 is just a number.

First, how is the Dow calculated? The Dow Jones Industrial Average (DJIA or Dow for short) is an equally weighted average of the prices of the 30 stocks currently in the index divided by a multiplier. The multiplier changes over time to maintain continuity of the index (otherwise, there would be price jumps every time a stock splits or issues dividends). As of the end of 2016, what it literally means for the Dow to reach 20,000 is that the average price of the 30 stocks chosen by the Wall Street Journal just exceeded roughly $97.35 (20,000 ~= average DJ stock price of $97 x 30 stocks / current DJ multiplier of ~.146). What exactly are we to make of the average price of 30 stocks going up from $96.47 one day to $97.35 the next? Focusing on a specific number is little more than numerology.*

Besides, what's in a number? When I was 27, I told a friend of a similar age that we were about to turn 10,000 days old. He responded with "you're so base-10 centric. Let's celebrate when we're 16,536 days old, at least powers of 2 are mathematically

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meaningful." While not looking forward to another 17 years, it made a point against being attached to round numbers.

It's not generally a good idea to sell when stocks reach a new high.

Neither new highs nor numerical milestones signal market peaks and future market declines. Historical evidence suggests that future returns are likely to be better than average at market highs, albeit with greater volatility.

On the other hand, it's not generally a good idea to buy more when stocks reach new highs either. Talk and even books written about the Dow reaching future milestones is common while the market is rising. Some favorites include Dow 36,000: The New Strategy for Profiting From the Coming Rise in the Stock Market (published near the peak of the tech bubble in 1999) and even "Dow, 30000 by 2008" Why It's Different This Time (Amazon reviews are an excellent source of dark humor. For example, "It's only October [2008], give the author the benefit of the doubt.")

Rationality and prudent investing lie between greed/exuberance and fear of the future. A consistent investment strategy is often the right choice.

*Surprisingly, the period beginning December 9, 2016 where the index seemed to hover just below 20,000 gives empirical evidence that the market does care about the number 20,000. Check back for forthcoming blog: The Statistical Oddity of the Dow and 20,000.

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