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Dow 22,000: What Does It Really Mean to You?

The Dow Jones Industrial Average (DJIA)—usually known as "the Dow"—has had a pretty good few months. Just five months after setting a new high at 21,000 on March 1, 2017, the venerable stock index closed above the 22,000 mark on August 2. As is usual when the Dow sets a record high, the event generated a lot of media fanfare. In the accompanying stories and analyses, an abundance of pundits espoused the "inevitable" conclusion that the market is bound for still higher territory. An equal number of prognosticators warned solemnly—backed by "irrefutable" data—that the market could not possibly sustain such high levels and that a pullback—or a correction, or a crash—was unavoidable.

But what does the record-high close of the Dow really mean for the individual investor? Is there anything inherently magical about 22,000? Or 23,000? Or 17,000?

First of all, it's important to remember that the DJIA—first compiled in 1896 by Charles Dow, who also co-founded the *Wall Street Journal*—comprises a rather arbitrary group of thirty stocks, chosen to somewhat represent a broad sweep of the American economy. “Somewhat represent” is the operative phrase; the companies that make up the DJIA are not necessarily the largest, nor is every industry sector represented. For example, the Dow does not include the two companies with the second- and fifth-largest market capitalizations in the world: Alphabet Inc. (parent of Google) and Amazon.com. Apple, Inc. the largest, was added to the Dow in 2015, and no automobile manufacturers have been included since 2009. In fact, since there are approximately 7,000 publicly traded stocks in the United States, some might suggest that the DJIA is hardly representative at all.

Next, we should recall that the index—the number reported in each day’s financial news—does not represent actual dollars. Instead, it is made up of “points” that are a price-weighted representation of the aggregate change in value for stocks in the DJIA. To arrive at the value for the index, the thirty companies’ stock prices are added together and then divided by a factor called the “Dow Divisor,” which is adjusted to account for stock splits, dividends, or divestitures, all of which affect the share prices of the indexed stocks. This means that price movements in the DJIA’s higher-priced stocks will affect the index more than movements in its lower-priced stocks. So, a 10-percent change in the share price of Apple (which recently closed at $160 per share) will have a greater effect on the DJIA than a 10-percent change in the price of General Electric ($25 per share).

We can draw several conclusions from this. First, let’s suppose an individual investor owns shares of GE, purchased at, let’s say, $10 per share. If GE went from $10 to $20 per share on a particular day, yet Apple, Boeing, and several other higher-priced DJIA stocks lost a portion of their value or even remained flat, the DJIA might actually go up very little, or even decline. And yet, our GE investor would have a strong gain on the day, despite the relatively modest increase—or loss—reflected in the DJIA. In other words, a gain or loss in the Dow is not necessarily directly reflective of any individual investor’s actual experience. Second, we can conclude that the Dow, by the nature of its construction, represents a fairly narrow segment of the stock market. It is still useful, to some extent, because of its long history and its characteristics as a sort of “quick reference,” but it is certainly limited in what it can tell us about the broad spectrum of publicly traded companies.

There are broader stock market indexes available, and these are generally the preferred reference points for financial professionals. One of the most-watched of these is the Standard & Poor’s 500 (S&P 500). Unlike the DJIA, the S&P 500 is made up of 500 (actually 505, at last count) of the largest publicly traded companies in the United States, on the basis of market capitalization. This is a much broader swath of American industry than the DJIA, and this index number is weighted by market capitalization rather than stock price. Thus, movement in the S&P 500 is more broadly indicative of actual trends in value among its companies.

Ultimately, any stock index is just a number, and our human fascination with patterns and round numbers dictates that we will continue to pay undue attention to any new record, especially if it involves a lot of zeroes. What matters most in terms of company value—and therefore, the increase or decrease of an investment portfolio—are the underlying economic realities that American companies navigate, every day. Currently, the American economy remains sound: employment is growing, albeit slowly; interest rates are historically low; inflation remains under control; the dollar is in a favorable position relative to other world currencies; and well-run companies continue to turn in strong earnings growth. These fundamental factors point toward continued health in the economy and, therefore, to strong future prospects for increased company values as reflected in their stock prices. This is actually good news for stock investors.

So, the next time you see a headline trumpeting “New Highs for the Dow,” you should probably take it in stride. To the degree that a new record for the DJIA indicates that American industry is enjoying an environment of growth, you can feel a certain sense of satisfaction—assuming, of course, that you are invested in stocks. You should also be wary of anyone who points to such a headline as evidence that you should sell everything (“because the market can’t possibly go much higher”) or buy more (“because this bull market is going to last for the foreseeable future”). In fact, you should never abandon your investment plan just because some guru or pundit is predicting something. Instead, stick to your strategy and rebalance your portfolio appropriately. And remember … it’s just a number.

Stay Diversified, Stay the Course!

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