



January 25, 2017
Volume 14, Issue 2

The Stevens Advisor

Stevens, Foster Financial Services, Inc. Registered Investment Advisor
7901 Xerxes Avenue South, Suite 325, Bloomington, Minnesota 55431
stevensfoster@stevensfoster.com

Virginia Sweeny, Editor
952.843.4200
www.stevensfoster.com

The Dow Jones Industrial Average

Turn on any news source today and you are sure to be bombarded by news of the Dow Jones hitting 20,000 for the first time in its history. We would urge you not to get caught up in the media hype, and take a minute to understand why The Dow Jones Industrial Average is not a good measure of the U.S. stock market.

What is the Dow Jones?

The Dow is an average of 30 blue-chip stocks that are "generally" the leaders in their industry. The index was created on October 1, 1928, and is a price-weighted index where the dollar price per share of a company means more than the total stock market value of that company. For example, Goldman Sachs (GS) is a \$236 stock and represents an 8% weight in the Dow Jones. By comparison, the actual value of Goldman Sachs is about \$94 billion, which represents less than half a percent weight in a different index, the S&P 500.

Is the Dow Jones actually a bad measure of the U.S. stock market?

By nature, in a price-weighted stock index like the Dow Jones, gains by stocks with a higher stock price (e.g., Goldman Sachs) will cause changes in the index that are out of proportion to the company's impact on the actual economy. In contrast, companies with a lower stock price like Apple (AAPL) at \$121, will have a smaller impact on the index even though they may have a much larger value in the economy. Apple's market cap is \$639 billion, almost seven times larger than Goldman Sachs', yet Goldman Sachs has a larger impact on the index than does Apple. Furthermore, the Dow Jones represents only 9 of the 11 Sectors of the U.S. economy: Real Estate and Utilities are not present in the Dow Jones.

Simply put, the purpose of an index is to eliminate discussions about individual stocks and talk about the "stock market" in general. With only 30 stocks in the Dow Jones index, the stock price of very few companies determine the level of the Dow. That defeats the purpose of an index.

If it's a not a good measure of the U.S. markets, why is the Dow Jones so widely quoted by pundits?

It's an accident of history that the Dow Jones is the most widely cited measure of how the overall stock market is doing. The index became popular because the Wall Street Journal had every incentive to promote it --- they originally owned the index and used it prominently in their reporting.

What would be a better indicator?

We believe the best measure of success is the health of your balance sheet. At Stevens Foster we are in the business of helping you grow your balance sheet. We adhere to the proven belief that asset allocation among a blend of funds in diversified asset classes is the prudent path to a combination of investment risk and reward that suits your objectives. With our holistic method of combining investments with tax planning and income management, we will continue helping to preserve and grow your wealth.

"The Stevens Advisor" is a market update from sources deemed reliable, but Stevens, Foster Financial Services, Inc. does not make any warranties of its accuracy. The opinions and forecasts are those of the author and are subject to change without notice; no representation is made concerning actual future performance of the markets or economy. The opinions voiced herein are for general information only and are not intended to provide specific advice or recommendations for any individual. Past performance is no guarantee of future results.