

KIM: “Dow Tops 20000” a great headline, but DJIA a flawed market indicator

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Even casual stock market observers know the Dow Jones Industrial Average (“DJIA”) closed above 20000 for the first time on January 25, 2017. U.S. stocks have enjoyed a massive rally since the DJIA closed at 6547 on March 9, 2009, even as it closed at 15660 (a 2-year low) as recently as February 11, 2016.

The DJIA is the default, shorthand answer to, “What did the ‘market’ do today?” While the DJIA is iconic and the most commonly referenced stock market benchmark, you may not know how it began and its flaws as a measure of the overall stock market.

According to *The Wall Street Journal (WSJ)*, the DJIA or “Dow” was created by Charles Dow, first editor of the WSJ and co-founder of Dow Jones & Co., to illustrate stock-market movements to his readers. The first iteration of the DJIA was printed in the WSJ’s predecessor publication in 1884 and averaged the closing prices of 11 stocks—nine railroads, one steamship company and Western Union.

The WSJ itself launched in 1889 and a 12-member DJIA comprised of “smokestack” industrial companies was first published on May 26, 1896. The DJIA was expanded to 20 stocks in 1916 and 30 “blue chip” stocks in 1928, where it remains today.

Although the DJIA remains a ubiquitous part of stock market lexicon, it has two major shortcomings that cause professional investors to use indexes like the S&P 500 (500 stocks-- representative of U.S. market for large stocks) or Russell 3000 (3000 stocks-- representative of the overall U.S. stock market), both market capitalization-weighted indices, as performance benchmarks. The market capitalization of a stock is simply the number of shares outstanding multiplied by the price.

First, the DJIA contains only 30 stocks, which obviously represents a much narrower sample than either the S&P 500 or Russell 3000.

Second, the DJIA is a **price-weighted** index, which means the performance of stocks with the highest dollar price have a much bigger impact on the index than those with the lowest prices. For example, Wall Street titan Goldman Sachs (GS-\$250) has the highest price of the 30 stocks (8% weighting), while General Electric (GE-\$30) has the lowest price (1% weighting). **See chart on page 2.**

To understand the absurd and arbitrary nature of price-weighting, **if** Goldman had twice as many shares outstanding, priced at \$125 instead of \$250, its market capitalization would remain the same, but its weighting in the DJIA would be halved to 4%. While Apple’s (AAPL-\$135) market capitalization (biggest in U.S.) and S&P 500 weighting (3.6%) is **seven times larger** than Goldman’s (0.5%--#46 of 500), Apple has **half** Goldman’s impact on the DJIA.

Indeed, according to the WSJ, Goldman’s 30% rise contributed **378.91 (21.9%) of the 1735.77 point gain** in the DJIA since November 8 as Goldman miraculously transformed from pre-election pariah to post-election darling.

It took 76 years for the DJIA to close above 1000 (11/14/1972). When I started in this business (August 1982), the DJIA was around 800 (no typo). The first close above 5000 was on 11/21/1995, 10000 on 3/29/1999 and 15000 on 5/7/2013.

Crossing DJIA milestones is fun, but remember the DJIA’s flaws make it a good **directional** indicator of stock prices, not a measure of the overall stock market.


















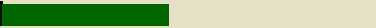
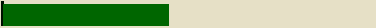
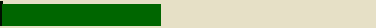
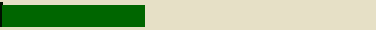
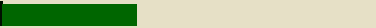
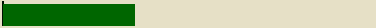
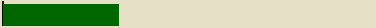
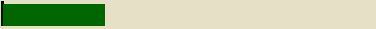
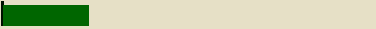
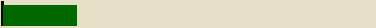
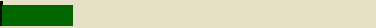
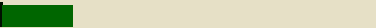
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Index Component Weights of Stocks in the Dow Jones Industrial Average

Updated: Saturday, Feb-18-2017
2:30am ET

Sorted by % Weight in the Index

(The following table is sorted by % Weight in the Index, in descending value.
The table is sorted by stock name in the table at the bottom of this page.)

No.	Stock	% Weight in the Index	Cum %	Bar Graph of % Weight in the Index
1	Goldman Sachs	8.31	8.31	
2	3M	6.07	14.39	
3	IBM	6.00	20.39	
4	Boeing	5.73	26.12	
5	UnitedHealth Group	5.23	31.36	
6	Home Depot	4.75	36.11	
7	Apple	4.51	40.61	
8	McDonalds	4.24	44.86	
9	Travelers	4.05	48.91	
10	Johnson & Johnson	3.95	52.85	
11	United Technologies	3.72	56.58	
12	Chevron	3.66	60.24	
13	Disney	3.65	63.89	
14	Caterpillar	3.28	67.18	
15	Procter & Gamble	3.02	70.20	
16	JPMorgan Chase	3.00	73.20	
17	Visa A	2.90	76.10	
18	ExxonMobil	2.71	78.82	
19	American Express	2.65	81.46	
20	Dupont	2.57	84.04	
21	Wal Mart	2.30	86.34	
22	Merck	2.17	88.51	
23	Microsoft	2.15	90.66	
24	NIKE B	1.88	92.54	
25	Verizon Communications	1.63	94.17	
26	Coca-Cola	1.37	95.54	
27	Intel	1.21	96.75	
28	Cisco Systems	1.12	97.88	
29	Pfizer	1.12	98.99	
30	General Electric	1.01	100.00	