

DOW 12000!!! Why isn't everyone clapping?

The Dow Jones Industrial Average hit an all time high last month and closed above the 12000 for the first time in history. With such an important milestone seemingly assured, one might wonder whether more people should be ecstatic about the news. While making some headlines, the event has not garnered the euphoria one would expect from a major equity index at record levels. As the DOW has moved into historically uncharted territory, one would expect this to be a sign of positive times to follow. Why haven't we seen such optimism recently?



Perhaps, that is because the other major indexes have not followed suit. The S&P 500 at 1350 is still 13% lower than the year 2000 high water mark of 1550. Most people consider the broader S&P 500 a better representation of the market than the Dow. Furthermore, the Nasdaq composite is not even close to the 5000 mark at the height of the internet bubble. Currently, the Nasdaq is 50% of that 2000 high. In addition, the DOW is a rather narrow index of 30 stocks. It has little meaning in comparison to most equity portfolios. In particular, those investors that accumulated positions in the heavily technology weighted NASDAQ stocks during the 1999-2001 timeframe are probably significantly down in returns. Therefore, many investors probably have not seen their portfolios eclipse the values set in that year. Remember also, the DJIA differentiates itself from the other market indices by its method of calculation. It is a price based index rather than the market capitalization method used for computing the

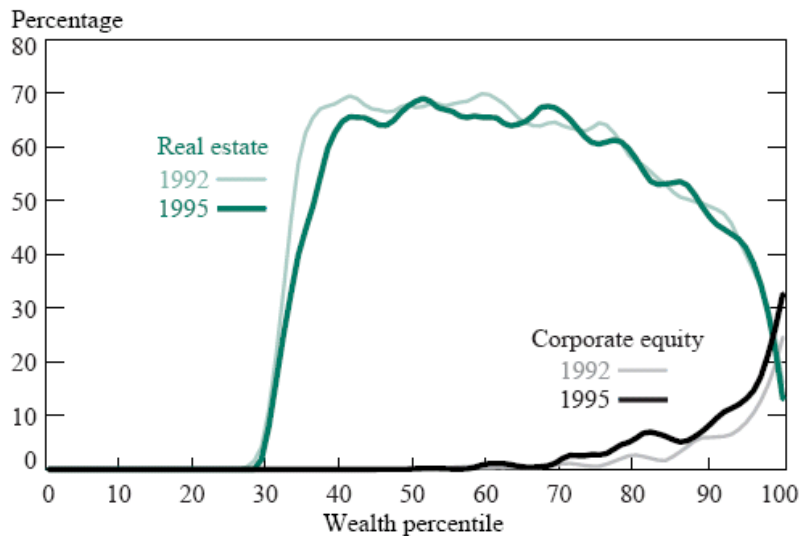
S&P 500 and Nasdaq. Price weighted indices have much less relevance for investors. They are interested in portfolio percentage returns rather than nominal price changes.

Furthermore, there are questions as to whether the average investor has participated in the latest move upward. According to the Investment Company Institute, "Funds that invest primarily in the US had an outflow of \$2.97 billion in September, vs. an outflow of \$3.70 billion in August."¹ Has the retail investor missed this rally by selling out even as the markets rise has broadened. Breadth in the market as measured by the advance/decline line has shown strength. In any case, it may not have an adverse effect on household wealth and this may be the key to the consumer's ability to spend going forward. Remember, personal consumption is very important to GDP growth and this consumption is heavily tied to gains in household wealth and income.

Real Estate and Household Wealth Matters More:

Additionally, American households traditionally have the majority of their wealth coming from residential housing. The gains from property in the last 5 years have been the source of significant gains in household wealth. The slowdown in the housing market would negate any euphoria of the DJIA's performance. Of particular concern is the possibility of further eroding of the wealth situation as a result of the expected downturn in housing appreciation. Rex Nutting of Marketwatch reports that housing starts are on track to fall 11% in 2006 to 1.69 million and that the National Association of Realtors is predicting another 12% drop in 2007 to 1.63 million.² Is this the floor for housing? Nutting points to another estimate even lower at 1.5 million for 2007.³ The importance of the housing market is significant to household wealth in this country. It appears for the majority of households, 2/3 of their assets are in real estate.⁴ Therefore, it should come as no surprise that the talk around the water cooler is more likely to be around housing prices than about how much the DOW was up or down during the day.

Chart 2
Portion of Household Assets in Corporate Equity
and Real Estate by Wealth Percentile, 1992 and 1995



Source: Survey of Consumer Finances.

Source: "Are Stocks Overtaking Real Estate in Household Portfolios?" Tracy, Schneider and Chan, Federal Reserve Board of New York: Current Issues in Economics and Finance, April 1999

¹ http://www.ici.org/stats/latest/trends_09_06.html#TopOfPage "Trends in Mutual Fund Investing"

² "Negative Numbers Popping Up in the Data", Rex Nutting, MarketWatch November 10,2006
<http://www.marketwatch.com/News/Story/G2sjSz6ZNVR5sj8t9K8SF9G?siteid=google&dist=morenews>

³ "Negative Numbers Popping Up in the Data", Rex Nutting, MarketWatch November 10,2006
<http://www.marketwatch.com/News/Story/G2sjSz6ZNVR5sj8t9K8SF9G?siteid=google&dist=morenews>

⁴ "Are Stocks Overtaking Real Estate in Household Portfolios?" Tracy, Schneider and Chan, Federal Reserve Board of New York: Current Issues in Economics and Finance, April 1999