Chart of the Month

December 2016

The Dow Jones Industrial Average, Standard & Poor's 500, and Nasdaq Composite closed at record highs on Tuesday with the Dow rapidly approaching 20,000 for the first time ever. The index has gained 8.6% since the election and is now less than 1% from this milestone. If 20,000 is reached by Christmas, it would be the quickest 1,000-point move in history. That said, it is important to recognize that such absolute changes are less meaningful in terms of percentages as the market climbs higher and higher.

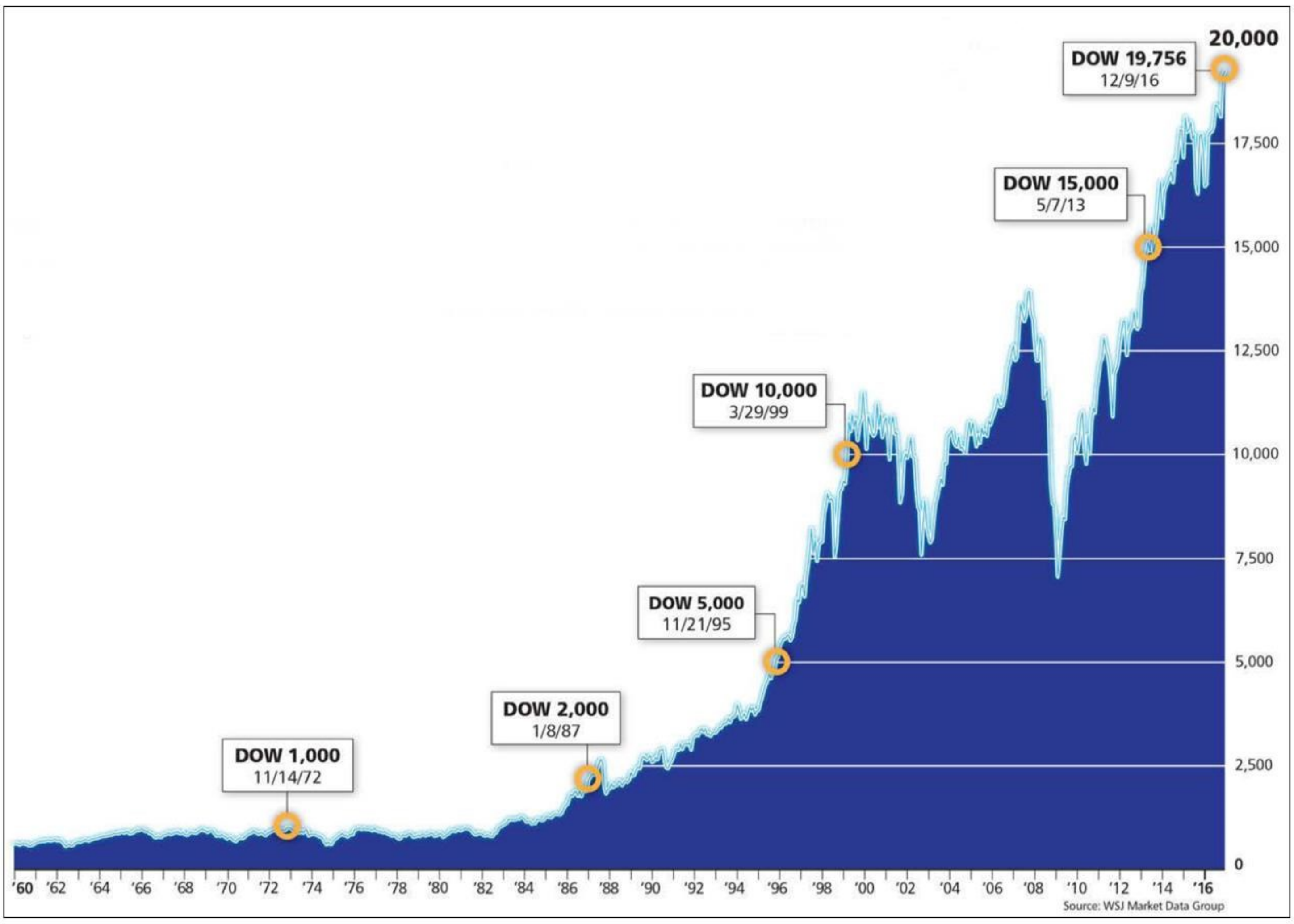
Of more significance, the DJIA has tripled from its low of 6,547 on March 9, 2009 and climbed almost 500-fold since its founding in 1896 when the original index stood at 40. As shown in the chart, the Dow crossed the 1,000 threshold in 1972 and then traded sideways for the following decade before rising more than ten times to over 10,000 during the 1982-2000 bull market. The venerable index scaled 15,000 in 2013 and is now closing in on the magic number of 20,000. If the Dow advances at a 4% annual rate — roughly its pace since 1999 — it will surpass 25,000 in 2022 and 30,000 in 2027 while providing a total return (inclusive of dividends) in excess of 6% per year.

After trailing the S&P 500 for six of the past seven years, the DJIA has been the best-performing index in 2016, thanks to its heavier weighting in financials and manufacturing companies that have disproportionately benefited over the past five weeks from the perception of pro-growth policies likely to be enacted in the new year. However, the Dow is a quirky index, unlike any other, with its value based on the combined prices of all 30 stocks multiplied by 6.85, giving outsize influence to the *highest-priced shares* (such as Goldman Sachs) rather than those with the *greatest-market capitalizations* (Apple, Microsoft, Exxon, and Johnson & Johnson).

While a more business-friendly environment should be positive for the overall economy, the direction of the stock market in the short run promises to be dominated by the Federal Open Market Committee meeting on Wednesday. With the market fully expecting that the FOMC will announce a 25 basis points (0.25%) increase to its fed funds rate, we believe this news will be overshadowed by the economic projections and discussion about the pace and magnitude of future hikes during the post-meeting press conference. If investors sense a dovish tone (i.e., one or two forecasted bumps over the next year), then the "risk-on" rally will probably continue. However, a more hawkish stance could lead to profit taking and a retrenchment in prices.

Although the future is always uncertain, we would argue that it is even more unpredictable than normal due to the fact that fiscal and monetary policies are at important turning points (with the former loosening and the latter tightening). As such, the rewards and risks of investing have been heightened, especially with the market at an all-time high.

Dow Jones Industrial Average



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