TIME Magazine

TIME

Business & Money

Stocks

Dow Jones Closes at Record High — So What?

By Martha C. WhiteMarch 06, 20137

SPENCER PLATT / GETTY IMAGES

Traders work on the floor of The New York Stock Exchange on March 5, 2013 in New York City. Within the first few minutes of trading Tuesday, the Dow gained nearly 100 points, rising as high as 14,226.20, a new record high.

RELATED

- Groupon Fires CEO Andrew Mason: The Rise and Fall of Tech's Enfant Terrible
- Why Warren Buffett Loves Ketchup, Plain and Simple
- What Happens When the Fed Really Does Run Out of Ammunition?
- Dow Jones Hits Record High *Reuters*
- The Dow Jones's New High is Fake *The Washington Post*
- Dow Jones High on Fed Steroids *USA Today*

- FacebookTwitterTumblrLinkedInStumbleUponRedditDiggMixxDeliciousGoogle+When the trading day ended on Tuesday, the Dow Jones Industrial Average closed at a record high of 14,253.77. It surpassed the index's previous closing high of 14,164.53 reached back in the pre-recession days of October 2007. For all the headlines devoted to the event, you'd think this was a really big deal — either a signal that our economy has zoomed past the lingering aftereffects of the Great Recession, or evidence of a bubble about to pop, as CNBC wondered a little while ago.

  The reality is probably much less exciting. "Investors should curb their enthusiasm," says Mitchell O. Goldberg, president of ClientFirst Strategy. Experts say the Dow's record high means relatively little in the grand scheme of things. Here are a few reasons why:

  The Dow Doesn't Reflect the Entire Economy

  "To the average guy in the public, the Dow means the market," says Wayne S. Kaufman, chief market analyst at John Thomas Financial. "But it's only 30 stocks." What's more, the index is price-weighted, meaning more expensive stocks have an outsized impact on the number.

  The 30 stocks that currently constitute the Dow Jones Industrial Average make up a pretty narrow slice of American economic output. Analysts say the S&P 500, a much bigger index, is more reflective of the market as a whole. (It ended Tuesday at a five-year high, but fell short of record-breaking status.)

  (**MORE:** Are We Already Planting the Seeds of the Next Financial Crisis?)

  Also, the companies included in the Dow have changed over the years, and inflation is not factored in, so measuring today's record against its previous high is an apples-to-oranges comparison. "When you see the Dow hitting new highs, it's not the same Dow we had in '07," Goldberg says. He points out that manufacturing stalwart General Motors was booted out, as were Citigroup and Kraft, and he argues the current index skews too tech-heavy to encompass the true scope of the U.S. economy.

  The Fed Did This — and It Can Undo It Too

  Stocks have been particularly buoyant because they're floating on an ocean of liquidity, courtesy of the Federal Reserve. The Fed has been buying up trillions of dollars of bonds to stimulate the economy. That has driven down yields and interest rates. "Back in 2007, bond yields were 5% on a 10-year [government] bond," Kaufman says. "Today, we're at 1.9%." As a result, many investors who are looking for better returns have given up on bonds and piled into the equities market, since many are still soured on real estate as an investment vehicle.

"So long as the Fed is in an accommodative mode and the economy is out of recession, the odds are that you will have a bull market," David Rosenberg, chief economist at Gluskin Sheff and Associates, told the *New York Times* Tuesday.

"The Fed seems willing to remain accommodative," says Matthew Coffina, editor of Morningstar's StockInvestor subscription newsletter. Plus, he adds, stocks are considered to be a better hedge against inflation when the economy does pick up steam again.

(**MORE**: Why Many Americans Feel Like They're Getting Poorer)

In addition to the Fed, central banks around the world have engaged in "globally synchronized asset purchase programs," Kaufman said, which pumps more money into the system.

Other Numbers Matter More

Morningstar's number-crunchers take the price of each stock they cover, divide it by what their analysts think it's worth, rank all of them and take the median. (You can see the current ratio in this chart here.) Lately, it's been pretty close to zero, which indicates a more or less fair value for the market in aggregate.

"The thing to focus on is price to fair value ratio," Morningstar's Coffina says. "Right now, our analysts think the market is right about fairly valued."

The robust balance sheets of corporations help justify high stock prices. "I think the main positives for the market have been relatively strong corporate earnings," Coffina explains. "Companies have been able to take advantage of high productivity."

Even so, high stock prices don't necessarily signify a strong economy. "I think the market may be feeling more strength than the consumer is feeling," Coffina says.

(**MORE:** Warren Buffett on Berkshire's 'Subpar' Year, Big-Game Hunting and Why He Loves Newspapers)

There are several other key data points to consider. "The most important metric people should be looking at is employment, bar none," Goldberg says. "The second figure everybody has to look at is inflation. The third figure is bank lending." Following that advice gives you a much more mixed bag concerning the overall health of the economy: Unemployment is stubbornly high, inflation isn't really an issue, and bank lending looks encouraging.

We're Not Out of the Woods Yet

Whether or not the market will continue its upward march is anybody's guess. People get paid huge amounts of money to figure it out, and they still get it wrong more often than not. Analysts like to point out that it's foolish to try to time the market right, and that there are still plenty of risks that could topple the market's ascent.

"You have to trust [Federal Reserve chairman Ben] Bernanke and company to thread the needle and pull back on their easing policies without disrupting the domestic economy," Goldberg says.

As Warren Buffet pointed out on CNBC on Monday, the economy could be rattled when this happens. "There are an awful lot of people who want to get out of a lot of assets if they think the Fed is going to tighten a lot," he said. Even if the Fed chairman can get everything right, lawmakers could still make a mess of things, between dickering over sequester cuts and the looming budget showdown coming at the end of the month, analysts say.

(**MORE:** 6 Reasons Why the Stock Market Could Do Surprisingly Well in 2013)

Trouble could come from overseas, too. Goldberg says bold moves by the European Central Bank have mitigated the threat of a cascade of major bank failures, but an anemic Eurozone economy would be bad news for American export-driven companies.

"Although Europe is not nearly as significant a trading partner for the U.S. as it used to be, it still is a massive part of the developed world," he says. "If consumers and businesses cut back, it hurts."