Cracking the Dow 20,000 Barrier

The closely-watched Dow Jones Industrial Average (The Dow Industrials) just breached the psychologically-important 20,000 milestone level. The Dow Industrials, which surged 16.5% last year for its best annual gain since 2013, is operated, maintained and defined by S&P Dow Jones Indices as a price-weighted index that measures the performance of 30 U.S. blue-chip companies. Price-weighted means that the effect that a single stock has on the Dow's overall index level is proportional to its size. Collectively, the top ten constituents have a combined weighting of nearly 60%. All 30 companies are characterized as mega-cap in size, ranging in market capitalization from $33.6 billion to $629.2 billion.

Interestingly, the component companies in the Dow Industrials are not all classified as "industrials." In fact, only a majority of major industries are represented within the index, leaving a significant swath of the equity market unrepresented, namely transportation, utilities and real estate. This is the primary reason that more broad-based indices, such as the S&P 500, are a better representation of market returns.

While it is fun to quote this index as a measure of market returns, it is not a true measure of overall performance. The Dow Industrials was introduced in May 1896 and rightfully bills itself as one of the "best-known icons of American culture and stock market observers around the world." We can see it is not a broad-based index and possesses subjective membership criteria that allow just a few stocks to significantly move the index.

Is Attaining Dow 20,000 a Bellwether Event?

History shows the Dow Industrials first broke above the 10,000 mark on March 29, 1999 when internet stocks bedazzled investors. Back in the late 1990's, many may recall then-Federal Reserve Chairman Alan Greenspan labeling the equity markets as having "irrational exuberance" in the period just ahead of dot.com bubble burst and steep equity correction that soon followed. "Dow 15,000" was reached not that long ago in May 2013. More recently, despite a lengthy period of see-sawing above and below Dow 18,000 during the first half of 2015, who can forget the 12.5% and 13.4% market plunges ending respectively on February 11th and August 15th this past year. More recently, its strongest post-election run-up for any incoming new U.S. president on record helped the Dow reach 19,000 this past November 22nd.

While we take time to celebrate the Dow reaching 20,000 and reminisce about how far and fast stocks have moved in ages past and more recently, we should always remember that market experts agree these thresholds themselves really do not influence the market's longer-term direction. Financial analysts, strategists and other modern portfolio theorists agree that it's the fundamentals — like earnings, stock valuations, and overall economic growth — that in the end decide future market performance.

Overall, our outlook remains one of tempered optimism, with the bull market likely to remain intact, but facing headwinds from stretched valuations, diminishing central bank stimulus and frothy investor sentiment. Looking at the broader-based S&P 500, at present elevated levels, we remain concerned that financial markets may have gotten ahead of themselves too quickly. Notably, the 12-month forward P/E ratio for the S&P 500 has traded above its long-term averages. For now, we view concerns for an overly aggressive Fed rate hike environment and current geopolitical issues as moderate tail risks that could disrupt our expectations for another solid year for global equities.

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Glossary
*The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.*

*The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index.*

*The **Russell 2000 Index** measures the performance of the small-cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.*

*The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*

*The **S&P SmallCap 600** measures the small-cap segment of the U.S. equity market. Introduced in 1994, the index is designed to track the performance of 600 small-size companies in the U.S, reflecting this market segment's distinctive risk and return characteristics. The index measures a segment of the market that is typically known for less liquidity and potentially less financial stability than large-caps, the index was constructed to be an efficient benchmark composed of small-cap companies that meet investability and financial viability criteria.*

*The **S&P MidCap 400** provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500®, measures the performance of 400 mid-sized companies, representing more than 7% of available market cap.*

*The **S&P Composite 1500** combines three leading indices, the S&P 500, the S&P MidCap 400, and the S&P SmallCap 600 to cover approximately 90% of the U.S. market capitalization. It is designed for investors seeking to replicate the performance of the U.S. equity market or benchmark against a representative universe of tradable stocks.*

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