



SIGMA
Investment Management Company
Knowledge plus Discipline

March 1999

10,000 Maniacs

The recent surge towards 10,000 on the Dow appears to have unhinged TV reporters, busying themselves with putting champagne on ice and shaking their cheerleader pom-poms. Sure, we could bore you with a pedantic discussion about how the 30 Dow Industrial companies are not representative of the market, how sensitive the index is to its particular component companies, how meaningless the absolute index level is by ignoring dividends and inflation, and the flaws inherent in the construction of a price-based index. But let's face it -- the Dow Jones Industrial Average is what's reported on the news every night, and that's what everyone watches.

Instead, let's look at the previous magic level of Dow 1000, and how frustrating it was for the market cheerleaders three decades ago. After the wilderness years of the Great Depression, the Dow didn't reach its 1929 peak (another "magic" number) again until 1954. The media, with typical timing acumen, were full of stories predicting another crash. The market continued its strong advance, but nobody thought about 1000 on the Dow until the early 1960's. In late 1965 and early 1966, a surge brought the index within striking distance of the magic number.

TV reporters are so excited about Dow 10,000 that they are shaking cheerleader pom-poms and putting champagne on ice.

As if to torture its closest watchers, the market nudged above 1000 intraday four times in January and February, but the highest it could close was 995 on February 19, 1966. Remember that date for later on. The market then fell 25 percent. The Dow again approached the magic 1000 in December 1968, but the cheerleaders again were tortured as the highest close the Dow could muster was 985, followed by a 36 percent decline. The Dow Industrials finally closed above 1000 for the first time in November 1972, close to seven years (and a lot of investor pain) after the first champagne was chilled.

So the Dow had passed the magic 1000 level and everything was well in the world, right? The initial euphoria did catapult the index to 1052 in January 1973. Instead of continuing upward, however, the Dow fell 45 percent until December 1974. At that level, ignoring dividends, the investor at the 1929 peak had earned less than 1 percent annual price appreciation in the subsequent 45 years. The Dow took six and a half years to again reach 1000 in April 1981. Once again, the magic level seemed to be more like a magic lid, and the Dow fell 24 percent until August 1982. The 1000 level was finally exceeded for good in October 1982. Since the Dow first crossed the magic 1000 level intraday, more than 16 and a half disappointing years had passed.

As the market first tickled the 1000 level in 1966 and 1968, the U.S. economy was booming, investor sentiment was high and consumers were confident. We were on our way to the moon. Europeans were so afraid of our economic might that they were debating "The American Challenge" (similar to our fears of the Japanese 10 years ago when the Nikkei was at three times its recent low -- but that's another newsletter). Economists and the government had learned how to "fine tune" our economy, repealing the business cycle. In other words, nobody foresaw the 16 years of subsequent investor frustration.

A money fund investor in 1966 did better than a Dow Jones Industrial Average investor for 21 years, with many fewer Roloids consumed

Since investor sentiment lags investment performance, the smart set at the market bottoms in 1974 and 1982 were talking about the death of equities and the superiority of commodity investments.

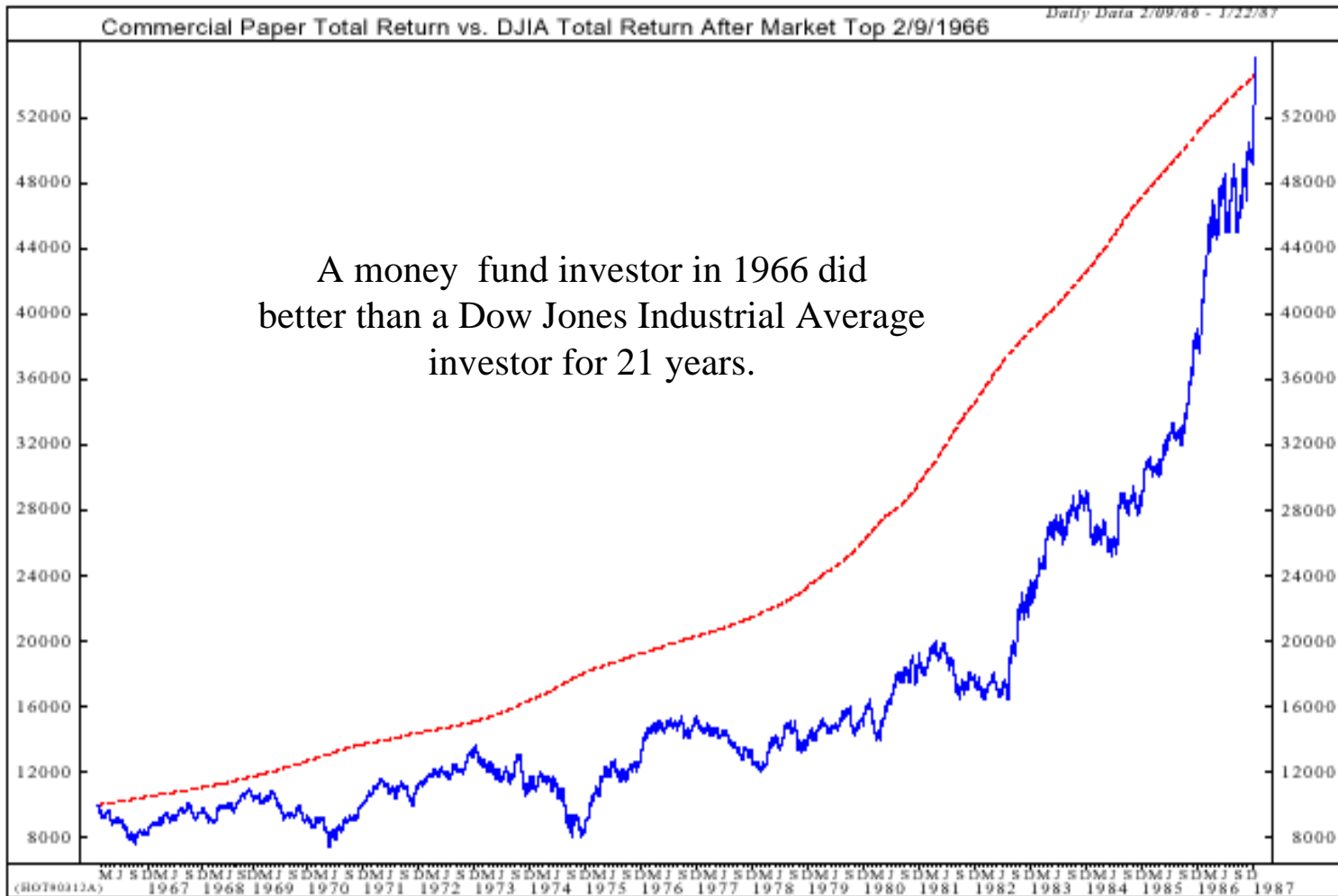
Now, after many years of the biggest bull market in U.S. history, a lot is written about "stocks for the long run." Everyone knows that stocks have performed better than alternatives in the long run, but sometimes the long run is longer than an investor's relevant time horizon.

The enclosed chart shows the fate of two investors on that day in 1966 we asked you to remember, when the Dow was first approaching the magic 1000 level. The first investor held onto the Dow Jones Industrial Average, reinvesting all dividends. The second investor sold everything and put her money in a money fund (commercial paper). The equity index investor would not have caught up with the money fund investor until 21 years later in January 1987. Look at the equity curves on the chart -- who do you think was sleeping better at night during those 21 years? Remember, the curve assumes that the "long run" index investor didn't get disgusted and sell in periods like 1974 when he was down more than 40 percent. It also assumes he did as well as the index in his investing.

"Magic" levels like 10,000 on the Dow are no more magic than any other number -- what matters is that your overall investment program is rationally constructed, consistent with your individual goals and financial/emotional limitations. Stocks historically *have* returned more than alternative investments in the long run, but the length of that "run" may be greater than you think, particularly when the current market excites you about potential returns. The 21 year wait in the example above is longer than most people's retirements. As John Maynard Keynes once said, "In the long run, we are all dead."

A balanced, diversified approach is more likely to get you where you want to go than deciding, based upon recent market history, that a single type of investment is the magic bullet. We have no clue when the Dow will substantially pass the 10,000 mark, but if you would like help constructing the right kind of portfolio, please contact us.

The Fate of Two Investors



Source: Ned Davis Research