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03/14/13: Markets Reach New Highs! It Doesn't Matter!

Over the past weeks, newspaper headlines have excitedly announced new record highs for the Dow Jones Industrial Averages and the S&P 500 index. As I write this, the DOW is at 14,522, which is about 2.5% higher than its record closing high of 14,164.53 set on October 9, 2007 (5 ½ years ago), and the S&P large cap index, at 1,561, is extremely close to its record of 1,565 set on the same day.

But these records are somewhat meaningless to investment professionals and people who make a living giving investment advice. Why? Because the record really isn't the record in real terms.

Excuse me? Index milestones don't take into account several factors. Like dividends. Barron's has reported that the past year's dividends on the Dow have added the equivalent of almost 350 points to the average, and the previous year, that figure was 320 points. On a total return basis, investors in the Dow or the S&P 500 "saw" their asset levels reach record highs some time ago.

This picture is also complicated by inflation. Even if the levels of the index are the same on two different dates, the actual purchasing power of the money invested in the index will be lower on the second date. By how much? Since October of 2007, the Consumer Price Index has risen by about 10%. That would suggest that the Dow would need to reach 15,500 to set a new record level, *adjusted for inflation*. The S&P 500 would have to reach 1,700 before it would be in record territory on a real, after-inflation basis.

What does this mean? It means that the daily market movements, and especially market milestones, should generally be regarded as entertainment rather than real news. In the short term, market movements are a reflection of the mood of the moment--do investors feel good or bad about the future, and about stocks? In the long term, the underlying trend is usually positive, as companies gradually, through the daily efforts of their workers and the decisions of their managers, become more profitable and more valuable to their stock investors.

Sources:

http://www.fool.com/retirement/general/2013/01/30/why-dow-records-wont-matter-at-all.aspx

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