BANKING & FINANCE

BY DEBBIE CRAIG, *columnist*

The Secret of the Dow

One of the most upsetting things to investors is the emotionally-charged, nonstop market commentary. Many updates are designed to grab the listener's attention: the Dow "plunged," the Nasdaq "soared," etc. I rarely hear a com- mentator say words like "up" or "down." In the new age of fewer pensions and delayed Social Security, it's difficult to feel confident in one's investment choices when the radio, TV, social media and apps all utilize "loaded language." So, let's take a look at the indices being reported and what it might mean for an individual's portfolio.

The DJIA (Dow Jones Industrial Average) is the index I see most frequently quoted in the media. Hearing "The Dow hits a high," or "The Dow sinks in late trading," are common. Yet I believe both comments can result in listeners feeling discouraged. If the Dow is hitting a high, the intimation is that it must be time to go down. If the Dow is "sinking," it implies that all investors' accounts must have also sunk that day.

I have clients call and lament "the Dow" or want to make changes based on the DJIA. I recently asked a client in my office if she knew how many stocks make up the Dow. She didn't. I replied 30 and watched her mouth drop to the floor. She asked, "You mean if I didn't own those particular 30 stocks, my portfolio might not have gone up or down?" Yes, ma'am, that's exactly what I mean. Her next ques- tion, "Do other people know this?" Well, I thought so, but now I'm rethinking it. During a review this week, a client requested that I sell all of his stocks because they were "as high as they will ever go." I asked what data made him think so. He replied, "the DJIA is at a high." Wanting to test my hypothesis again, I inquired if he knew how many stocks were reflected in the Dow number. He chuckled and said, "Yeah, I know, I know." When I persisted, he said, "A lot." Again, I informed him there were 30.

While there are lots of lessons to be learned here, let's illuminate two.

First, Charles Dow invented the DJIA in 1896. Stock and economic information wasn't readily available 123 years ago like it is today. His development of this index was meant to reflect a general economic "temperature" with the selected companies indicative of the U.S. econo- my in general. (The initial Dow was com- posed of just 12 companies in the railroad, cotton and industrial sectors.) The index expanded to 30 companies in 1929. There are about 7,000 publicly-traded companies in the U.S. today.

Second, I believe that most, if not all, investors have

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better portfolio allocations than just investments in the DJIA. International stocks (one index here is the EAFE), fixed income instruments (some times reflected by the ML Aggregate Bond index) and small cap stocks (tracked by the Wilshire 5000) exist in most client portfolios. Additionally, there are sometimes broader allocations to emerging markets, private equity, real estate, commodities, alternatives and cash.

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A helpful conversation to have at your next visit with your financial advisor is to inform yourself about your asset allocation. How much of a weighting do your investments have to U.S. stocks? International equities? Bonds? Perhaps your individual portfolio might be more correlated with changing interest rates rather than the DJIA?

Plunging and soaring is no fun for any- one. Ask a few questions about your investments and the DJIA. Information is empowering.

Debbie Craig, CFP®, MBA, CRPS® is branch manager of Craig Wealth Advisors. She started her career in the financial services industry 19 years ago and has owned her independent practice for 10 years. She is the author of "Piece by Piece™ A Commonsense Approach to a Secure Retirement." Contact her at Debbie.craig@raymondjames.com or (231) 943-2920 or craigwealthadvisors.com.