Keeping up with the (Dow) Joneses – A Turbulent Start to the Third Millennium

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The Dow Jones Industrial Average was first published on May 26, 1896. That same year the modern Olympics began in Athens and it is incidental that both the Olympics and the Dow, in their respective fields, are a professional measurement of performance

The Dow Jones is the oldest index still in use today and is considered the weather vane of the world's established stock markets, proved by the old bromide that "when the Dow sneezes, the rest of the world catches cold".

The original Industrial Average, which was based on the shares of 12 companies, represented all types of businesses except railway companies – since these had their own separate Railroad Average, comprised of 20 railway company shares.

In 1916, the Industrial Average was increased to 20 companies, and in 1938 to 30 – the same number as today. There is only one survivor from the 1938 list – General Electric.

In my Sunday Times column "Money Matters" of 25th April 1993, I had listed the 30 component companies which made up the Dow Jones Industrial Average. In the 13 years since, no fewer than 12 companies have either been replaced or merged into today's Dow components to reflect the changes in the most active sectors of the U.S. economy.

But my objective today is to focus on the performance of this index since the start of the new millennium. The chart highlights the major events and their effect on the index.

Remember 31st December 1999? We had spent the year in anticipation of what was to be, by some accounts, the end of the world! The fear of God was put into us that computer-dependent systems would go bananas unless the two-digit year "00" could be understood as 2000 rather than 1900. Y2K disaster scenarios were only limited by the vivid imagination of those who foresaw a nightmare on a global scale which never happened. The new millennium rolled in and the correct dates rolled over on virtually all computers, with a few irrelevant exceptions.

The new millennium saw the Dow Jones peak at an all-time closing high of 11722.98 on January 14th, **2000**. Six and a half years later, the closest the Dow has been to breaking this all-time high was just 80.33 points short when, on 10th May 2006, it closed at 11642.65.

By mid-February 2000, the Dow had collapsed by more than 10% when the oil price surged to more than $30 a barrel which, at the time, was proving a near insurmountable obstacle for energy-dependent companies. By February 25th, it had closed below 10000, and after briefly resurfacing for a breather, it dived to what was to be the lowest closing price of the year 2000, at 9796.04 on March 7th.

As the money spent from the capital budgets of companies' IT Departments (in preparing for Y2K by upgrading all the programmes and systems to read four-digit dates) ran out, there was little left to sustain the technology-driven growth, and the internet-led tech boom. The Nasdaq composite index sky-dived from its March 10th all-time high, and by Friday, April 14th 2000, it had dropped to 3321, hiving more than one-third off its value just one month and four days earlier. On that day, the tail wagged the dog and the Dow Jones fell a then-record 617 points in one day.

Investors who had borrowed, or bought on margin into the raging bull market, started getting margin calls. As they sold into a collapsing market, the pressure on the Nasdaq index caused it to vortex to a bottom of 2332.78 on December 20. Add to this the six-week indecisive presidential election, which the Supreme Court finally resolved in favour of George W. Bush, and it makes you wonder how the first year of the new millennium saw the Dow fall by only 6.18%, to end in negative territory for the first year since 1994.

"When the Dow sneezes, the rest of the world catches cold"

In **2001**, G. "Dubya" Bush took the oath of office on 20th January. Not even Nostradamus could have predicted that within 8 months the economic heart of America would be ripped out by the infamous terrorist attack of September 11th. The economy had slipped into recession by March, but it might have ended sooner had it not been for the atrocities committed.

On the New York Stock Exchange, which was undamaged, trading was suspended for four days, due to the destruction of the World Trade Centre, and the Lower Manhattan infrastructure. When trading resumed on the September 18th, the Dow collapsed 684.81 points, and by September 24th, it had experienced its worst weekly percentage loss in 61 years, with a 14.3% decline.

Monthly real gross domestic product and sales by manufacturers, wholesalers and retailers reached their lows in September, but the National Bureau of Economic Research (NBER) put the recession's end at mid-November, following the Federal Reserve Board's tenth interest-rate cut of the year on November 7, to 2%. In response, the Dow rose to a post September 11th high of 9591.12. Meanwhile, the war on terror, which had seen the first U.S. and British attacks on Taliban positions in Afghanistan on October 8th, routed the Taliban from Kabul on November 14th. In retrospect, the 7.1% fall in the Dow for 2001 to 10021.50 could have been equally acceptable even at twice that rate.

2002 would prove to be the third consecutive yearly index fall, with an 18.8% decline – its worst performance since 1977. This was the year of the introduction of Euro notes and coins, and Greenspan's reducing the Fed's interest rate to 1.25% - causing investors to flee to the safety of U.S. Treasury bonds. Stock market gloom was intensified by corporate accounting scandals, primarily at Enron and WorldCom. The scandals destroyed the accounting and auditing firm Arthur Andersen, then one of the Big Five. Confidence in listed companies' accounts evaporated and resulted in a loss of public trust in accounting and reporting practices. This was offset later in the year when the Sarbanes-Oxley Act was passed, to strengthen Corporate governance and restore investor confidence. It was sponsored by US Senator Paul Sarbanes and US Representative Michael Oxley.

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As the effects of the September 11th attacks continued to weigh on the travel industry in 2002, USAir and United filed for bankruptcy, and American Airlines restructured. However, the housing market continued booming as buyers took advantage of falling mortgage rates to trade up to larger homes and investors poured cash into commercial properties.

With the benefit of hindsight, we now know that the Dow Jones Industrial Average hit a five-year closing low of 7286.27 on October 9, 2002 – just days before terrorists bombed a night club on the island of Bali and seized a theatre in Moscow, and a month before the U.S. began ratcheting up the pressure on Saddam Hussein to open Iraq to U.N. weapons inspections.

With hindsight we now know that for the 4th time in history, we had three consecutive years of the Dow in negative territory. The other 3 times were: (i) 1901,1902,1903, (ii) 1929,1930,1931,1932 (iii) 1939, 1940, 1941.

Part II of this article will cover the second three years of the first decade of this millennium.