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DOW JONES INDUSTRIAL AVERAGE NOT AT RECORD HIGH ONCE INFLATION IS TAKEN INTO ACCOUNT

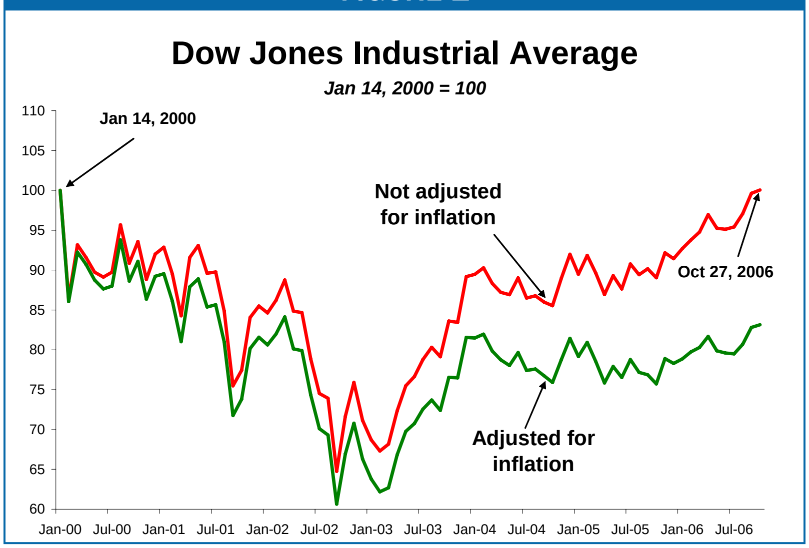
Dow Still 14 Percent Below Its Peak

by Jason Furman

On October 27, 2006, the Dow Jones Industrial Average closed at 12,090. Adjusted for inflation, that is down 14 percent from its all-time high on January 14, 2000.[1] The Dow would need to rise another 1,946 points to set a new record, adjusted for inflation. It is only when no adjustment is made for inflation that the Dow can meaningfully be said to have closed at a record high.

Measuring how the Dow has done relative to inflation is the most meaningful way to assess its performance over time and what it means for investors and the economy more broadly. To fail to adjust for inflation, and to say that the Dow has passed its previous peak, is like saying that a worker whose wages are a few cents an hour above where they were six or seven years ago is better off today, even though the purchasing power of his or her wages has fallen significantly. This is why, when the Census Bureau reports on median household income each year, it reports on median income *adjusted for inflation*.

FIGURE 1



The broader stock market is even further below its 2000 peak. On October 27, 2006, the Dow Jones Wilshire 5000, which tracks more than 5,000 stocks and is the most comprehensive measure of the U.S. stock market, was 21 percent below its record close on March 24, 2000, after adjusting for inflation. (Even without adjusting for inflation, the Wilshire 5000 was 6 percent below its March 24, 2000 peak.)

Some of the value of the Dow when it hit its peak in 2000

[1] Using CPI-U from the Bureau of Labor Statistics. Note, this note assumes zero inflation since the last Consumer Price Index data, which were for August 2006.

undoubtedly was the result of an unsustainable bubble. And it is good news that the Dow Jones Industrial Average, adjusted for inflation, has risen at a 6 percent annual rate over the last four years. (Note: a careful study by economists at the Federal Reserve found no evidence this was caused by the dividend or capital gains tax cuts enacted in 2003.[2]) But simple statements that the Dow is at an all-time high are more likely to create a misleading impression than to enlighten people about the current state of the stock market.

[2] Gene Amromin, Paul Harrison, and Steve Sharpe, "How Did the Dividend Tax Cut Affect Stock Prices?" October 11, 2005.