



As the Dow Jones Industrial Average rose above 10,000, much has been made of this largely arbitrary threshold in reviewing the strength of the recovering markets. When the Dow fell below this level last October, it certainly triggered an acceleration in the sell-off that eventually bottomed in March of this year with the Dow below 6,600. Behaviorists would tell us that that is how the human mind works, and even more so in groups, or herds. But is a 10,000 Dow truly indicative of a fulcrum between strong and weak markets, or is the recent rise above 10,000 lulling investors into a false sense of complacency?

It has been 10 years since the Dow Jones first crossed 10,000. In looking back, things could not be more different than they are today. Contrast that in 1999 we had unemployment at 4% and falling; whereas, today the unemployment rate is nearing 10%. In 1999 the federal government was running its finances at a surplus. We just finished our fiscal 2009 year with a record \$1.4 trillion deficit. Ten years ago we were finishing our seventh consecutive year of economic growth. In 2009, we are in our longest and deepest post World War II recession. In 1999 the U.S. Dollar was strong and rising in value. Today, our Dollar is close to an all-time low versus major foreign currencies. In short, the macro-economic environment in 1999 was 180 degrees different than it is today.

Given this backdrop, most would believe the market was in far better shape in 1999 than it is today. However, the stock market was already pricing in the stellar fundamentals of the U.S. economy. In fact the price-to-earnings ratio of the overall market was at its highest level since the 1920's. That is, the market was priced to perfection. As we know, a recession hit a year later, fiscal surpluses turned into deficits, we began fighting two wars, the dollar started its long decline, and employment peaked.

It is when the economy is at the bottom of a long decline that investing becomes most profitable. When the Dow Jones crossed 1,000 for the last time in 1982, interest rates were at double digits and the unemployment rate was at its peak of 10.8%. Very few investors felt this was an opportune time to buy stocks, yet it turned out to be a generational opportunity to do just that.

The Dow Jones Industrial Average is populated with many companies that are global leaders in their industries. These companies have been able to continually grow their earnings over the last decade in the face of macro-economic weakness. Price-to-earning ratios are not the only way to value companies, but they do offer some historic comparisons from one era to the next. After all, it is earnings that give corporations the ability to both grow and pay dividends to its shareholders.

The following chart compares price-to-earnings ratios of selected Dow Jones stocks from 1999 and today:

| <b>Company</b>    | <b>Price 12/99</b> | <b>1999 P/E Ratio</b> | <b>Price 10/09</b> | <b>2009 P/E Ratio</b> |
|-------------------|--------------------|-----------------------|--------------------|-----------------------|
| Johnson & Johnson | 46.63              | 30                    | 60.46              | 12                    |
| Coca-Cola         | 58.25              | 37                    | 55.01              | 16                    |
| Procter & Gamble  | 54.78              | 38                    | 57.44              | 15                    |
| IBM               | 107.88             | 24                    | 121.64             | 11                    |
| Wal-Mart          | 69.13              | 48                    | 51.22              | 13                    |
| Pfizer            | 32.44              | 33                    | 17.77              | 9                     |
| Merck             | 67.19              | 24                    | 33.21              | 10                    |
| Exxon-Mobil       | 40.28              | 20                    | 73.12              | 15                    |
| Microsoft         | 58.38              | 65                    | 26.50              | 16                    |

The table clearly illustrates the differences in valuations of Dow Jones 10,000 circa 1999 and Dow Jones 10,000 circa 2009.

Headwinds facing an economy do not necessarily portend low stock market returns. In fact, history shows that when current economic conditions are most bleak, outsized stock market returns are most likely. This is because investors tend to extrapolate both good and bad news, but trends do reverse and revert to a long-term mean. The stock market may very well pause now that the psychological threshold of 10,000 has been reached; however, even with the significant rise of the market since early March, valuations are not extended and further gains should be expected.

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