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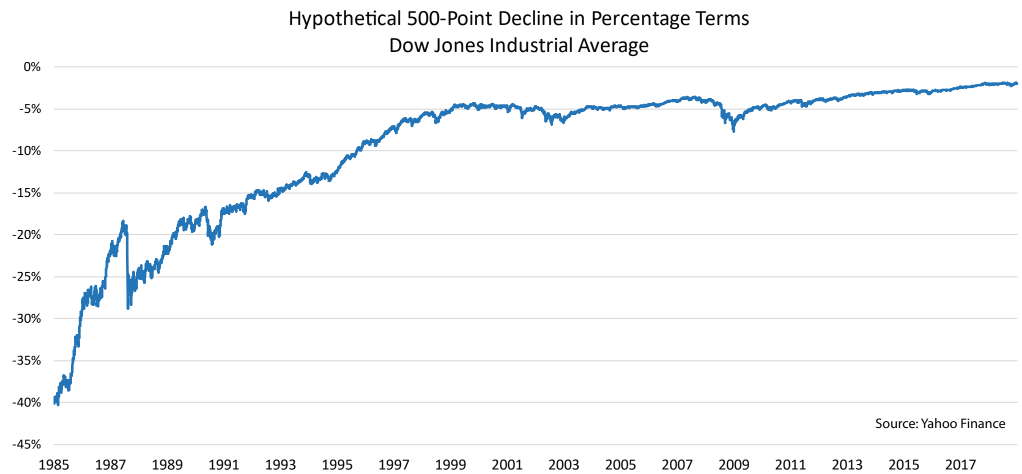
Like baseball, the stock market produces a lot of statistics. Some of this data is very helpful to investors, like that used to develop the evidenced-based investment strategies we use in your portfolio. In fact, it was the richness and sheer volume of data produced by financial markets that originally attracted academic researchers to study the stock market in the 1950s and 1960s. After all, computing power was just beginning to develop and data scientists needed numbers to crunch.

Of course, when you have a lot of data it can be hard to extract useful information out of all the noise. Just like having too many choices at the store makes it hard to decide what to buy, having too much data can make it hard to understand the true meaning of what it shows.

For example, you have probably either lived through or read about the October 19, 1987 stock market crash. Known as Black Monday, the Dow Jones Industrial Average fell an astonishing 508 points in a day, for a record one-day loss of 22.6%.

The Dow closed that day at 1,738.74, so 508 points was a massive loss in percentage terms. Today, the Dow is around 25,500 but it still makes headlines if prices rise or fall more than a few hundred points. This is great for media companies who profit from attracting an audience with sensationalistic headlines, but it is confusing and unnecessarily stress-inducing for many investors.



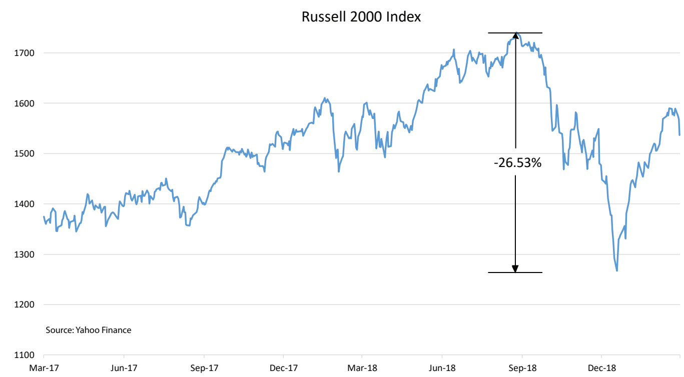
Even for those who regularly follow markets, it's hard to interpret what a Dow point means because our memories get anchored in the past when prices were much lower—yet the value of a point never changes. As a result, a 500-point change today doesn't have anywhere near the same impact on our portfolios or the market as it used to. In addition, the Dow measures only 30 large U.S. companies while our portfolios are typically globally diversified and include both stocks and bonds.

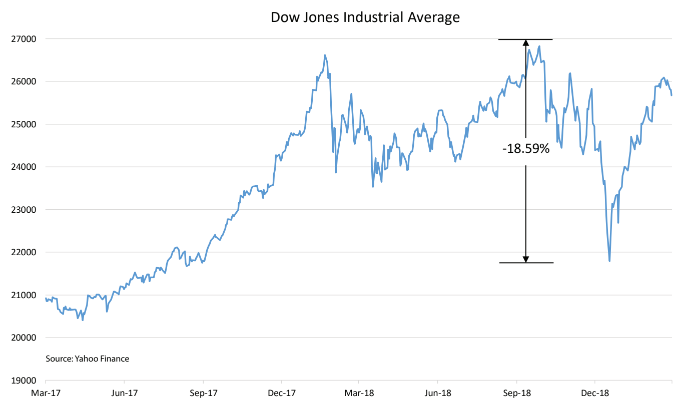
Another statistical oddity is that the Dow calculates the weighting of each of its 30 stocks using market *prices* rather than market *capitalizations*. This means the price changes of companies with high stock prices have an unduly large effect on the index. The recent fall in the price of Boeing stock is an example of this. Boeing currently has the largest weighting in the Dow of any company at over 11%. This is nearly double that of any other stock.

The Dow is widely followed largely because of tradition. The Dow Jones Industrial Average is probably not the most accurate measure of the U.S. stock market, but it is the second-oldest and best known. Another tradition of stock market watchers is to characterize a price decline of more than 20% as a bear market, and a gain of more than 20% as a bull market.

We use labels like these because it is a deeply rooted tendency for human beings to classify and categorize things. This allows us to avoid getting overwhelmed by new information, but can cause faulty thinking that leads us to incorrect conclusions. For example, even though the terms "bull market" and "bear market" as defined above only measure past performance, it feels like they also predict the future. In other words, if prices were to drop more than 20% over the next few months and we accept that we have entered a "bear market," wouldn't we also tend to think that more losses are coming—just based on the descriptive words and how our brain interprets their meaning?

Furthermore, using simple and arbitrary definitions can lead to distracting disagreements and useless debates. Consider the charts to the right that measure the losses from the stock market highs in September to its lows in December using intraday prices. The S&P 500 index and Russell 2000 index declined more than 20%, but the Dow Jones Industrial Average did not. So did we enter a bear market or not? To make it even more unclear, when measured using *closing* prices rather than *intraday* prices, the S&P 500 only declined 19.75%, slightly less than the 20% cutoff.





This has led to numerous articles and opinion pieces in the financial press recently about (1) whether or not the bull market ended in September and we are now in a bear market, (2) how long the bull market actually lasted (since there were other declines beyond 20% in some indexes since 2009), and (3) when the current bull market started (some say a bull market only starts after prices reach a new high, and therefore the current bull started in 2013 rather than 2009).

Of course, none of the answers is helpful to investors.

There is no predictive value in past prices, and trying to categorize price patterns to some standard definition does not help investors make decisions today. We shouldn't fault the media and financial bloggers for needing something to write about, but let's make sure we don't allow ourselves to get sidetracked into thinking they are communicating something educational or useful. It's really just entertainment.

As always, thank you for you continued trust and confidence.

Warm regards,

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