

Whither the Dow?

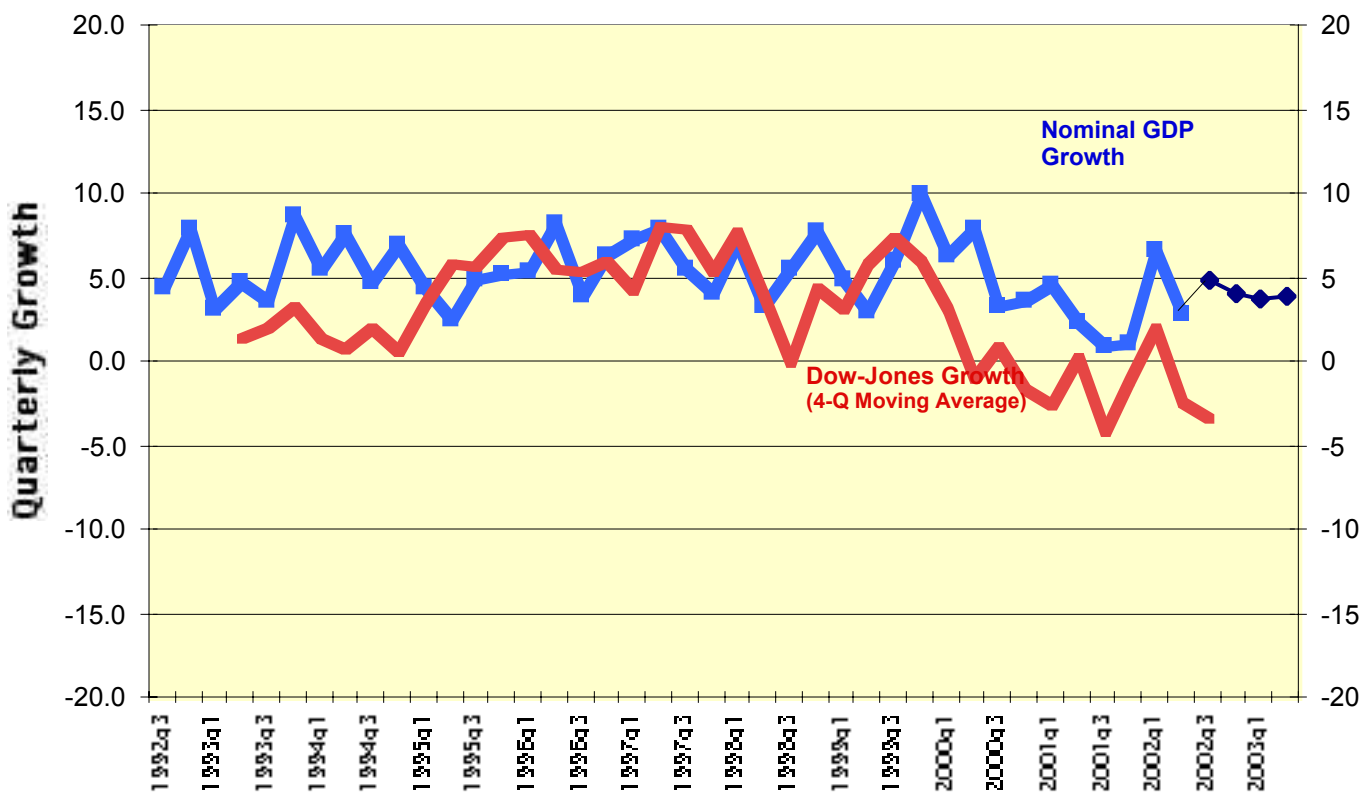
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When that great market prognosticator, Abby Cohen, announced 12,500 as her Dow-Jones target for the next 18 months, my confidence rose. And when economy.com's stock market calculator showed, with plausible assumptions, that at 7,500 the Dow was undervalued by as much as 50%, my confidence was given another dose of starch. You see, I had just completed a graphical analysis that strongly implied a sharp positive move in the Dow during this year's 4th quarter. Indeed, my crude analysis says the Dow will rise to 9,450 by the end of the year. Let me explain.

In a search to identify a systematic relationship between growth in the Dow and nominal GDP, I mapped quarterly data beginning in the third quarter of 1992 and ending with estimates reaching to the third quarter of 2003. I used a four-quarter running average for the Dow in an effort to smooth the normal jagged movement that takes place otherwise. After all, GDP numbers are based on a heavily churned data set. The results I obtained are shown below.

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GDP & Dow-Jones Growth 3Q1992--3Q2003



As the chart indicates, there is a rather faithful relationship between GDP growth and growth in the Dow-Jones Industrial Average. The zigs and zags sort of move together. The point of interest, though, comes at the end of the chart where GDP predictions are given for the next few quarters. The numbers here are a composite based on the Blue Chip and other estimates. Of course, they could be wrong, but let's assume they are correct.

If GDP growth continues as expected, we should see Dow-Jones growth head north for a change. Now, here's the interesting part of the story. For fourth quarter Dow growth, stated as a 4-quarter moving average, simply to reach positive territory, which means doing better than zero growth, this quarter must register a 26% increase. Put differently, the average growth for the other three quarters going into the 4-quarter average is minus 26%.

This means the year will end with the Dow at approximately 9,450. And that leaves 15 months for Abby Cohen's 12,500 to be achieved.

Let's hope we are both right!

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