CAPITAL INVESTMENT COUNSEL

The Columns

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If you're negative on the markets, you may want to look away. Investors hoping for a market selloff may be disappointed as it looks like the Dow Transportation Average may have just given the secret handshake to the Dow Jones Industrial Average. According to the Dow Theory, the new 52 week high in the Trannies combined with the Industrial's new high indicates better times may be on the horizon. My S&P 500 data set shows that the S&P rallies an average of 11% after a Dow Theory buy signal is registered. That would put the market at 5054 if history holds true in 2023.

Dow theorists believe that the Industrial's high *confirms* the Transportation high and validates a new up leg for both the economy and the markets. It makes sense as new highs mean that the industrials are making more products and also means that it's being shipped to consumers. Either way, in my experience the market performs better when both averages are in harmony. The Dow Theory came from the writings of Charles Dow, co-founder of a little firm called Dow Jones. Jones died in 1902, but his theory lives on.

To give you an idea of the Theory's effectiveness, let's take look at the last 25 years. It's a small sample size but applying the Theory helped me navigate some of these booms and busts.

1. A Dow Theory sell signal registered on September 23, 1999. This alert indicated that the late 90's Bull Market was potentially running on fumes. Six months later, the market peaked, and the 2000 technology meltdown began.

2. Three years later, the Dow Theory indicated a buy signal in June of 2003. It occurred within a few percent of the market bottom and gave a subtle hint that prices might be heading higher. The market embarked on a four- year bull run.

3. Another sell signal registered on November 21, 2007. Although we didn't know it at the time, the signal warned of the coming housing crisis.

4. Finally, in March of 2009, with the Dow Industrials trading at 6500, the Dow Theory registered a buy signal. That signal led the Dow to rally over 20,000.

The Dow Theory isn't a magic bullet. It doesn't register many signals, so I pay attention when it does. I don't use the Theory like a stop light that tells me when to get in or out of the market. Instead, I use it to evaluate the potential quality of a given market move. Unfortunately, there's no crystal ball in real life, but the Dow Theory can be a big help.

Consumer spending makes up 68% of GDP so it's not a stretch to say it underpins the US economy. Some people are worried about that. Lately, it's looked like consumers may be losing steam due to higher rates and inflation, but help is on the way. New liquidity injections courtesy of the US Government is riding to the rescue. The resumption of student loan payments may slow the economy but this year's cost of living adjustment to Social Security will be 8.75%. Mickey Levy at Berenberg Capital estimates that will add $100 billion to consumer incomes this year. Levy also notes that COLA adjustments for all government programs will inject another $250 billion. It feels to me the market is taking note, and maybe another reason stocks continue to climb. If you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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