What We're Thinking

Change you can believe in

As a group, humans don't like change. In some cases, even though we know intellectually that our current strategy doesn't work, we don't act until we perceive a tangible threat. By then, it can be too late.

Most of us will relate to this phenomenon. As a child, I always rode full speed on my bike, slamming on the brakes to stop. This strategy worked well enough — until I started riding adjustable-speed bikes with larger wheels.

One sunny spring afternoon, I was riding a bit too fast on my big, 24-inch bicycle. I saw an obstacle and waited until it was almost upon me to brake. By the time I realized my current strategy no longer worked, I was flying over the handlebars, my head about to dent the door of a neighbor's Suburban. At that point, it was too late to change tactics.

Many of us encountered something similar in the market last year and can still feel the bruises. In our view, the market's crash hammered home the importance of the three changes in investment tactics discussed in the following paragraphs.

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Managing Editor

Don't trust dividend histories

Track records don't seem to mean much these days, as even longtime dividend growers are cutting their payouts. Standard & Poor's expects dividends for S&P 500 companies to drop 13% in 2009, the worst annual decline since 1942. From 2003 through 2007, S&P 500 components only posted 12 dividend cuts. After notching 62 cuts in 2008, S&P 500 components made 14 cuts in the first five weeks of 2009.

Our advice: Investors seeking dividend income should focus on companies with strong profits and cash flow and moderate payout ratios (dividends as a percentage of earnings) *in addition to* a history of growing their dividend. Such firms are less likely to cut their dividends.

Don't rely on the government

Numbers like $787 billion in stimulus and $1 trillion for the purchase of toxic assets make for good headlines, but perhaps not much else. Most economists agree that expansionary fiscal policy (such as the proposed new spending and tax cuts), while popular with politicians and individual consumers, has little long-term effect on the stock market. With regards to the bank bailouts, we lack reliable precedents. The price is very high, even if the strategy works — and it may not work.

Our advice: Don't expect government action to have a lasting effect on stocks. Shrewd investors will not alter their asset allocation or change their long-term investment expectations based on what the feds do.

Keep your chin up

By the numbers, it looks bad. The Dow Jones Industrial Average is flirting with a significant low that would reconfirm the Dow Theory's bear-market signal. The Blue Chip Economic Indicators consensus projects a 1.9% decline in gross domestic product this year. Just five months ago, expectations called for 1.5% *growth*. The consensus also projects 2009 declines in industrial production, corporate profits, and personal-consumption expenditures, as well as an unemployment rate of 8.3%, which would be the highest since 1983. But pessimism has risen to the point that just a modest dose of good news could increase sentiment enough to spark a nice rally.

Our advice: Change your thinking about gloom and doom by remembering the one characteristic that every bear market in history has shared. Whether sparked by a tragedy, bad politics, or the old-fashioned economic slowdown, every bear market has ended in a bull market. This one will be no different.

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Dow Theory Forecasts (ISSN 0300-7324 USPS 997-000) published weekly by Horizon Publishing Company, 7412 Calumet Ave, Hammond, Indiana 46324-2692. Subscription Rate $279 a year. Back issues are available for $10 each by writing to the address above, or free to our subscribers on our Web site at www.DowTheory.com. Periodicals postage paid at Hammond, Indiana, and at additional mailing offices. When you move— Please notify us three weeks in advance of any change in address. This will insure uninterrupted service. Periodically we rent our mailing list to companies with products that may be of interest to subscribers. If you would prefer not to be included in these mailings, please notify us in writing.
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