The Stock Market

Dollars, in logarithms

S&P 500 PRICE PER SHARE[a]

Real[b]

Nominal

Ratio

S&P 500 DIVIDEND/PRICE RATIO

Standard deviation

S&P 500 MARKET VOLATILITY, STANDARD DEVIATION

Kurtosis

S&P 500 MARKET VOLATILITY, KURTOSIS
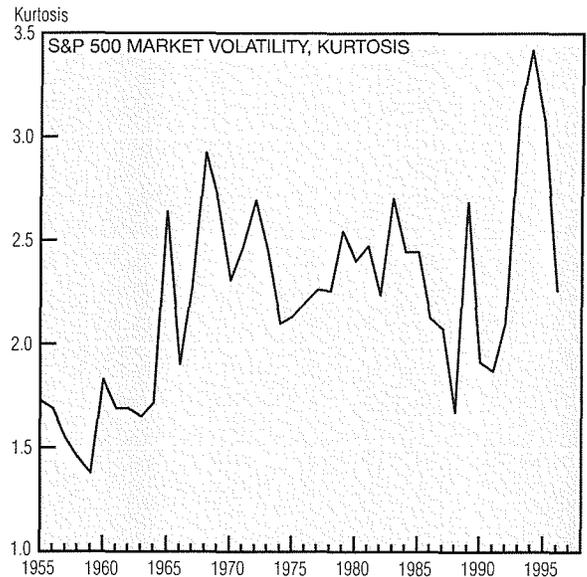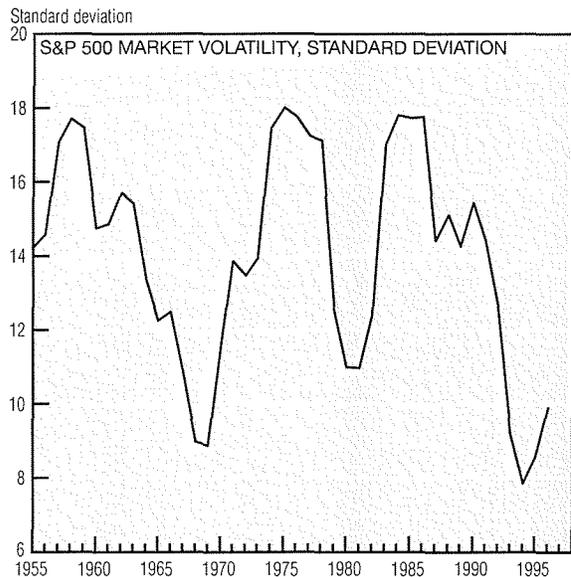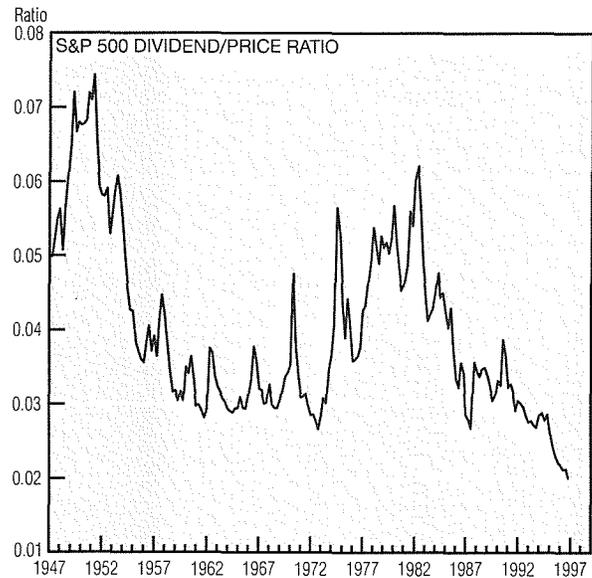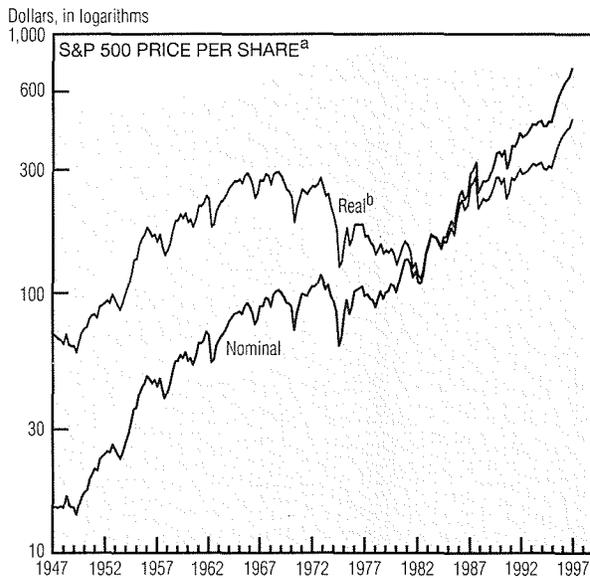
a. Last plot is the December 31 closing price.
b. Real S&P 500 is the nominal S&P 500 divided by the Consumer Price Index.
SOURCE: DRI/McGraw-Hill.

The bull market of 1996–97 continues to garner headlines. The standard graphs may exaggerate recent gains, however, because they do not take account of the market's previous run-up. A logarithmic, or proportional, scale adds a useful perspective that makes recent gains, though noticeable, look less specular. Investors who bought the Standard and Poor's (S&P) 500 at 33 and held it to 100 tripled their money, but had to wait until the average hit 300 to triple their money again.

One possible reason for the market's recent gains is that it is moving up to a higher plateau with lower future returns. This view is corroborated by the dividend/price ratio, a fairly accurate predictor of stock market returns, particularly over periods of two to seven years. This ratio is at a post–World War II low, suggesting small returns in the future.

To explain the drop in market returns, some analysts cite the possibility that investing in stocks has gotten safer, and investors thus bear less risk. The standard deviation is at a low level relative to most years, al-

though the bull market coincided with a small recent increase. The kurtosis gives a slightly different picture of risk: High kurtosis implies a greater probability of market extremes, both jumps and crashes. This measure indicates that risk did fall over the past two years, but this drop merely returned the risk to average levels. Perhaps some combination of factors is driving the results: People see the low standard deviation, along with less chance of market extremes, and feel safer.