Why You Don’t Always Want to Keep Up with the Dow Joneses

Recent changes to the 128-year-old Dow Jones Industrial Average are in the news.

The folks at S&P Dow Jones Indices just gave the boot to one of the biggest losers among the Dow stocks and are replacing it with a new stock they *hope* will be a winner and perform better.

But the truth is that, historically, the losers that get booted from the Dow often outperform the replacements. First I’ll review what you need to know. Then, we’ll look at what other “ugly ducklings” among Dow stocks might just turn into beautiful swans, according to our *TradeSmith* indicators.

Yesterday before the markets opened, Amazon.com (AMZN) was added to the lineup, replacing Dow dog Walgreens Boots Alliance (WBA). Also, Uber Technologies (UBER) replaced JetBlue Airways (JBLU) in the Dow Jones Transportation Average (DJTA).

So, if you have WBA or JBLU in your portfolio, should you automatically sell after they got the Dow boot? And if you want to track the Dow indices with your own portfolio, should you definitely buy AMZN and UBER?

Well, not so fast.

The Dow has made plenty of changes over the years, with more than 50 switches in all since the start in 1896. The same is true with the S&P 500 and other popular stock indices.

And those changes don’t always work as planned.

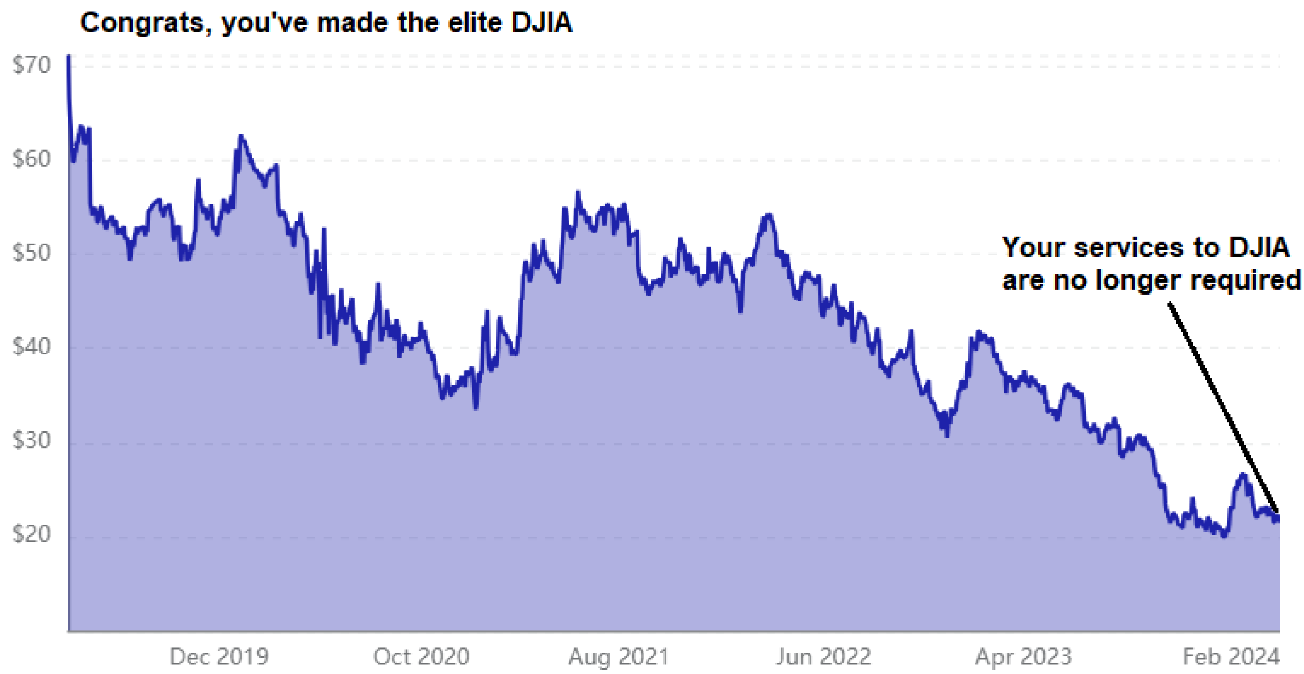
In fact, many stocks like WBA that get the boot ultimately *outperform* the stock they’re replaced by, and outperform the Dow overall.

Just look at the cautionary tale of WBA itself.

The leading pharmacy chain in America joined the Dow on June 26, 2018. Its price at that time was more than $60 a share.

WBA’s stock price today is $21. That replacement resulted in a 65% loss for investors who kept up with the Dow Joneses. Ouch.

NASDAQ: WBA
Walgreens Boots Alliance



And which blue-chip did WBA replace in the Dow back in 2018? It was none other than General Electric (GE), which had been a continuous component of the Dow since 1907.

Sure, owning GE stock was no picnic for several years after getting the boot. Shares dropped more than 50% at one point. But after the recent recovery, GE shares are now up more than 90% since getting the boot in 2018.

Hmm, do you see a pattern here?

Editors and writers at Barron’s magazine see the pattern, reporting that: “Recent history suggests that stocks exiting the index do better one year after their removal than those that were added.”

Between 1999 and 2018, 17 stocks were added to the Dow, which also means 17 losers got the boot.

According to Barron’s calculations, stocks added to the Dow lost an average of 8%, and stocks departing the index were slightly below flat at -0.6%.

The last five changes in that period delivered a 3% gain for the stocks added to the Dow, while the dumped stocks rose 43% – or roughly 14 times better performance for the losers over the winners!

How Do We Account for this Performance Gap?

By the time the Dow Jones folks get around to dumping an underperforming stock, the bad news has likely discounted the price already.

Meanwhile, new stocks being added may be joining at the height of popularity when expectations are high. Perhaps too high. This probably explains why the losers reverse higher and the winners fall from their lofty perch.

And don't forget: Sometimes stodgy old companies are beautiful.

After boring old aluminum maker Alcoa (AA) was dumped from the Dow in 2008, for example, it was replaced by Bank of America (BAC).

Both stocks have moved since then – AA up and BAC down – by about 90%.

Now, don't take this as a suggestion to rush right out and buy WBA shares while shorting AMZN in some sort of loser-vs.-winner pair trade.

WBA has been in our *TradeSmith* Health Indicator Red Zone for over a year and has a Bearish stock rating.

But also, don't assume that, because a stock was removed from a high-profile index, it must be bad news for the company.

Sometimes ugly ducklings turn into beautiful swans.

Here are the Other High-Quality Household Names Languishing in the Dow

Below is a partial list of the 30 Dow stocks sorted by one-year change. And yes, you guessed it, WBA sits at the top of the list, down 35% as it exits stage left:

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Saved Screeners (30 results)

Ticker	Rating	Health	VQ%	Sector	Latest Close	52 Week High	1 Y Change % ▲	Money Movers Score	Business Quality Score
WBA Walgreens Boots	Bearish	1y+	23.21%	Consumer Staples	$21.73	$34.19	-35.06%	25	58
NKE NIKE -B-	Strong Bullish	5d	24.29%	Consumer Discretio...	$105.63	$127.40	-9.36%	-65	97
MMM 3M	Bullish	1w+	18.61%	Industrials	$92.58	$108.85	-8.62%	-50	67
CVX Chevron	Strong Bullish	4m+	21.34%	Energy	$154.66	$168.08	-0.83%	-25	88
BA Boeing Co	Bearish	1m+	29.71%	Industrials	$200.83	$267.54	1.35%	-25	36
DOW Dow	Bullish	1y+	20.76%	Materials	$56.39	$56.82	2.85%	0	48
CSCO Cisco Systems	Strong Bullish	3m+	17.33%	Information Techno...	$48.86	$57.74	3.11%	-50	96
KO Coca-Cola Co	Strong Bullish	4m+	12.01%	Consumer Staples	$61.20	$63.49	5.50%	-50	95
HON HONEYWELL INTL	Bullish	4m+	16.68%	Industrials	$200.63	$210.61	6.22%	-25	80
JNJ Johnson&Johnson	Strong Bullish	4m+	12.31%	Health Care	$161.84	$172.01	6.95%	0	100
DIS Walt Disney	Bullish	2y+	22.55%	Communication Ser...	$107.74	$112.92	7.77%	-58	52
UNH Unitedhealth Gro	Strong Bullish	1m+	16.47%	Health Care	$527.24	$554.70	10.50%	-25	97
GS Goldman Sachs Gr	Bullish	1m+	20.97%	Financials	$391.05	$396.79	10.88%	-25	43
VZ Verizon Comm	Bullish	2m+	14.85%	Communication Ser...	$40.66	$43.21	12.79%	-25	55
MCD McDonald's	Strong Bullish	2m+	12.89%	Consumer Discretio...	$297.75	$302.39	15.48%	0	91
PG Procter&Gamble	Strong Bullish	4m+	13.48%	Consumer Staples	$161.03	$161.74	18.57%	-58	93
MRK Merck	Strong Bullish	2m+	15.59%	Health Care	$129.45	$130.24	21.10%	-58	79

But notice that quite a few other quality stocks are still in the Health Indicator Green or Yellow zones. This includes Nike (NKE), which I'm aiming to buy at a discount right now in my *Ultimate Income* trading service.

And even some stocks currently in the Red Zone are still high-quality companies. This includes Johnson & Johnson (JNJ), Cisco Systems (CSCO), and Coca-Cola (KO).

I believe many of these stocks are quite capable of rebounding in price, so keep a watchful eye on them.

Now, if *they* were dumped from the Dow, it might speed up their rebound.

Mike Burnick's Bottom Line: Sometimes when stocks get dumped from popular indices like the Dow or S&P 500, it can be the ultimate contrarian signal to take a closer look at the losers, if not buy them. And *TradeSmith's* tools can help you do just that.

Good investing,

Mike Burnick

Senior Analyst, *TradeSmith*