Stock Splits and Dow Jones Industrial Average Revamp
What is the Connection?
September 10, 2020

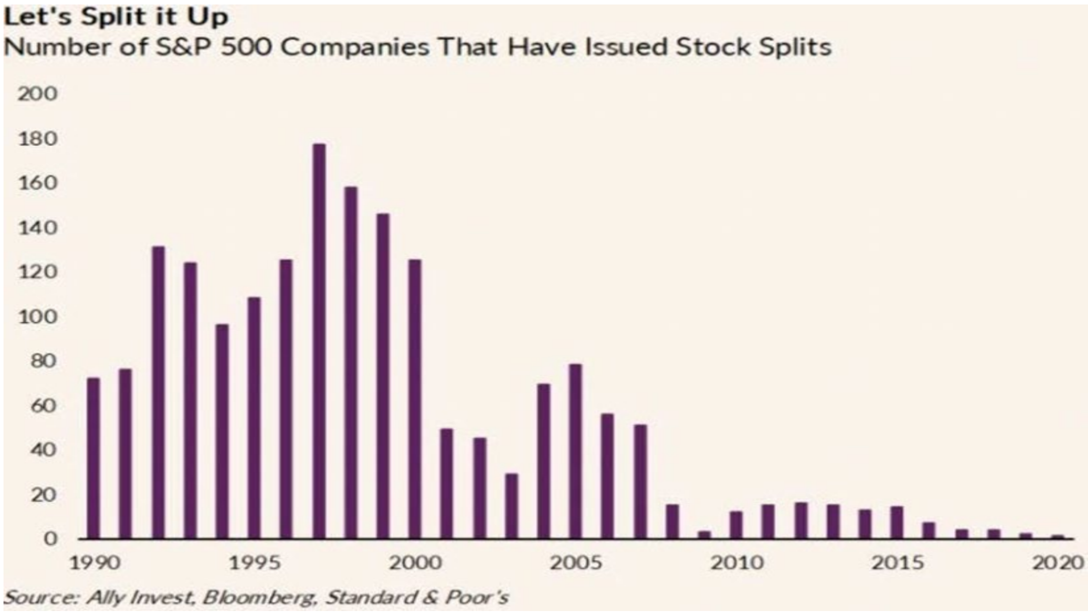
In August, two prominent companies announced stock splits – Apple 4-for-1 and Tesla 5-for-1. Also, in August, it was announced the Dow Jones Industrial Average Index (Dow) would be getting a makeover. What do these two seemingly unrelated events have in common for investors (both effective 8/31/2020)?

In our Summer 2020 Economic and Investment Strategy Outlook, we noted the effect of concentration and price surges of technology stocks on indices – primarily the S&P 500 and NASDAQ. Since that writing, those same conditions surrounding technology stocks continues. Now, we look at that same effect on the Dow. For purposes of this article, we will concentrate our focus on the Apple split as Tesla is neither a member of the Dow nor S&P 500, for that matter.

To begin the analysis, what is a stock split? A stock split occurs when a company divides (splits) each existing share into more than one share. The most common splits are 2-for-1 or 3-for-1, giving the stockholder 2 or 3 shares for each share originally owned. Stockholders still have the same value or amount of money invested, but now they own more shares at a lower price. Think of it this way, if you swapped a dollar bill for four quarters, it would not change the value of your money.

Why do companies split their stock? First and foremost, a stock split is a CEO's positive assessment on a company's financial health and industry and market prospects. CEO's use stock splits to make their shares more attractive to retail investors and thus increase liquidity. Apple CEO, Tim Cook, said in a CNBC interview on 7/31/20 – "Hey, I want more people in the stock." Although debatable, another reason may be that some studies have shown that stock splits may increase stock prices.

Lately, we have seen a dearth of stock split activity, which is why the Apple and Tesla splits have been newsworthy. For the S&P 500, in 1997, at the most recent peak of stock split actions, 102 companies split their shares, compared to 3 stock splits in 2019 (Source – Barron's). Some reasons for the decreased split activity include the dominance of large institutional trading activity, growth of mutual funds and ETFs, CEO's desire for less volatility in stock prices, the proliferation of new platforms and products that allow investors to purchase fractional shares and CEO's belief that a high stock price is prestigious. Apple has had 5 stock splits since going public in December 1980. If Apple had never split its stock, it would have been worth $27,957.44 per share on market close on 8/28/20.



So, how does the Apple split affect the Dow? The Dow is one of three major U.S. stock market indexes and is comprised of 30 stocks which have historically been described as large "Blue Chip" publicly traded companies that represent the broad American economy. In comparison, the S&P 500 follows 505 companies and the NASDAQ tracks more than 2,500. The Dow was created in 1896 and although still popular, is primarily followed by individual investors. Operationally, the Dow differs from the S&P 500 and NASDAQ in calculation of the index value, as it weights its stocks by price rather than market capitalization. Thus, for the Dow, higher priced stocks have more influence on daily index performance. Prior to the split, Apple was the highest price stock in the Dow after soaring more than 70% to become the first U.S. company to reach $2 Trillion in market capitalization and adding more than 1,400 points to the index. Post-split, Apple's ranking in the index fell from the number one spot to 17th. As such, its weighting dropped in the index from 12% to 3% and accordingly lowered the technology representation from 27% to 20%.

All of the changes resulting from the decrease in the Apple share price prompted the S&P Dow Jones Indices Committee to add Salesforce (replacing Exxon) to boost the Technology sector back to a more representative weighting, moving it to 24% and eliminate overlap in the energy sector. At the same time, two other modifications were implemented to reflect the changing picture of the U.S. economy. These modifications substituted Amgen for Pfizer and Honeywell International for Raytheon Technologies. The last time three concurrent changes were made to the index was in 2013.

Dow Jones Industrial Average
Stocks and Weighting Ranking
as of 9/5/2020

DJIA Stock	% Weight	DJIA Stock	% Weight	DJIA Stock	% Weight
UnitedHealth Group	7.3%	3M	3.9%	American Express	2.5%
Home Depot	6.3%	Johnson & Johnson	3.5%	JPMorgan Chase	2.4%
Salesforce.com	6.0%	Caterpillar	3.5%	Merck	2.0%
Amgen	5.8%	Walmart	3.3%	Chevron	1.9%
Microsoft	5.0%	Procter & Gamble	3.2%	Verizon Communications	1.4%
McDonalds	5.0%	Disney	3.1%	Coca-Cola	1.2%
Goldman Sachs	4.9%	IBM	2.9%	Intel	1.2%
Visa A	4.8%	Apple	2.8%	Dow	1.1%
Boeing	4.0%	Travelers	2.7%	Cisco Systems	0.95%
Honeywell International	3.9%	NIKE B	2.6%	Walgreens Boots Alliance	0.86%

Source – Slickcharts

The changes made to the Dow were executed to keep it relevant with transformations in U.S. markets and economy. Our observations from these changes do not warrant any immediate portfolio modifications but do emphasize the constant considerations that must be given to the use and understanding of indexes and benchmarks as well as their constituents and the forces that act upon them. These considerations reflect broader trends and movements that may affect investment approaches.

If you have any questions or would like to discuss PeoplesBank Wealth Management's investment strategy further, please call or send an email to your relationship or investment officer.

The Investment Strategy Committee