

The Dow[®] and the S&P 500[®]: Where it all Began

“A person watching the tide coming in, and who wishes to know the spot which marks the high tide, sets a stick in the sand at the points reached by the incoming waves until the stick reaches a position to where the waves do not come up to it, and finally recede enough to show that the tide has turned. This method holds good in watching and determining the flood tide of the stock market. The average of [stock prices] is the peg which marks the height of the waves. The price-waves, like those of the sea, do not recede all at once from the top. The force which moves them checks the inflow gradually, and time elapses before it can be told with certainty whether high tide has been seen or not.”

— Charles Dow, creator of the Dow Jones Industrial Average, in the Jan. 31, 1901, edition of *The Wall Street Journal*

DOW JONES INDUSTRIAL AVERAGE

The [Dow Jones Industrial Average](#) (The Dow) made its debut on May 26, 1896. It was the brainchild of Charles Dow, the tall, bearded, and unassuming journalist who cofounded Dow Jones & Co., publisher of *The Wall Street Journal* (Dow's partner, Edward Jones, also has his name attached to the average, but he had nothing to do with its creation).

The Dow was initially made up of 12 stocks (versus 30 today), including a leather maker, a steel provider, and a sugar producer. It was calculated by adding up the prices of the component stocks and dividing the sum by a divisor.

The Dow Jones Industrial Average wasn't Mr. Dow's first foray into measuring the market. In 1884, he produced an average of 11 stocks, mainly railroad companies. This market indicator was intermittently published in the “Customer's Afternoon Letter,” a precursor to *The Wall Street Journal*.

But Dow believed that the rails only presented a partial picture of the economy; and that industrial companies, whose stocks were considered highly speculative at the time, were crucial contributors to America's growth. And because the goods produced by the industrials were being delivered by the railroads, Dow reasoned that two separate measures could confirm broad market trends. Thus *The Wall Street Journal* began publishing the industrial average and the railroad average in every issue, and has done so ever since. With airplanes and trucks bringing competition to the railroads, the components of the railroad index evolved to reflect the changing landscape and, in 1970, the railroad average was renamed the Dow Jones Transportation Average™.

At the time of The Dow's introduction, investing in the stock market was considered a highly speculative activity. And so in its early years, The Dow achieved little prominence outside the narrow canyon of Wall Street. By the 1920s, however, ordinary citizens began investing in stocks, driving the industrial average from the 100 range in 1924, up to nearly 400 before the crash of 1929. Ironically, it was the market's fall that brought The Dow's reputation to the

attention of everyday investors, as the index lost nearly 30% of its value over the course of two days. Before that, investors had been more focused on their individual stocks. But after the crash, investors were more interested in following general market conditions, and [The Dow](#) allowed them to do just that.

S&P 500

The Standard “500” was introduced at a luncheon for the press on Feb. 27, 1957, at the Lawyers Club in New York, with a turnout of 35 top financial writers. Between the main dish and coffee, Lew Schellbach—a Standard & Poor’s editor, PR director, and economist considered the “Father of the [S&P 500](#)”—described the new index and improvements reflected in the expanded market indicator.

It had been more than 30 years since S&P created its first market indicator—a 90-stock measure that included 50 industrial companies. Based at 100, it didn’t claim to be an average, but rather an “index” that would allow investors to more easily gauge market performance relative to previous levels.

But it wasn’t until 1957 that the Standard “500,” as it was then known, emerged. Its introduction was enabled by an electronic calculation method developed by Boston-based Melpar, Inc., that allowed S&P to perform index calculations much more efficiently than before.

With this new technology, S&P could have covered every stock traded on the New York Stock Exchange. However, some stocks were traded so thinly and infrequently—or garnered such limited public interest—that they didn’t warrant a place in the index. As a result, Lew Schellbach and colleague George Olsen combed the list to find the most meaningful stocks. Ultimately, they settled on a group of 500—425 industrials, 25 rails, and 50 utilities—that they considered most representative of the overall market. These 500 stocks accounted for over 90% of total U.S. market value.

The new Standard “500” was groundbreaking not only for its breadth, but also because it could be calculated and distributed on an hourly basis. From its inception, it was a market-cap index, accounting for the price of each stock as well as the number of shares outstanding for each security.

Anticipating the need for historical data, Olsen and his crew assembled an 80-page document that listed daily figures for the index and its industrial, railroad, and utility subgroup indices back to 1928 (with weekly data for 1926-1927), along with commentary on their construction and use. The document was distributed to security analysts, members of the American Stock Exchange, and other interested parties.

The new index was heralded by S&P not only for its “electronic wizardry,” but as a solution for investors seeking a broader and timelier measure of the market. To be sure, it set a precedent and a vision for the future, as S&P described in its in-house newsletter, *The Spectator*:

“Before too long we hope to perfect a whole new series of companion indexes, which will provide our subscribers with standard composite balance sheet data for each of the 91 industrial groups. These will provide the analytical profession with a whole new set of tools that should put the art of security analysis years ahead. In other words, we have just begun to tap the electronic age at Standard & Poor’s.”

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