BIANCO RESEARCH, L.L.C.
AN ARBOR RESEARCH & TRADING, INC. AFFILIATE
1000 HART ROAD • SUITE 250 • BARRINGTON, ILLINOIS 60010
E-MAIL: jbianco@biancoresearch.com • WEB SITE: www.BiancoResearch.com
TOLL FREE 800-876-1825 • PHONE 847-304-1511 • FAX 847-304-1749
James A. Bianco, CMT

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MARKET FACTS

A Historical Look At The Markets
July 20, 1999

Unrealized Gains in Domestic Equity Mutual Funds are Booming

The top panel of the attached chart illustrates a concept of the average Dow Jones Industrial Average (DJIA) purchase price for all domestic equity mutual funds. The concept is that as long as market prices are above the average purchase price, the public keeps investing. When the market prices sink below their average purchase price, they start selling.

Between October 1990 and May 1999, the public has plowed $1.1 trillion of new money into domestic equity mutual funds. During this entire period, market prices have stayed above the public's average purchase price. **Currently, the average purchase price, using the Dow Jones Industrial Average (DJIA) as a proxy of the market, is 5,917.** (Note: using an index like the S&P 500 or the Wilshire 5000 does not materially change this story. We use the DJIA, as we believe it is the index most readers are comfortable with)

The bottom panel expresses the same concept in dollar terms, or as we call it, "unrealized profits." Notice that from October 1990 to early 1995, the average purchase price was slightly below the current market prices (see the top panel). Likewise, the bottom panel shows that the amount of unrealized profits generated over this period was not that large. However, since early 1995, the DJIA has put a considerable distance between itself and the average purchase price, and the amount of unrealized profits has boomed.

When the DJIA doubled between October 1990 and July 1995, the amount of unrealized profits was $125 billion. Over this period, the public plowed $405 billion into domestic equity mutual funds. Between July 1995 and December 1998, as the DJIA doubled again, the public invested $593 billion into domestic equity mutual funds. The amount of unrealized profits soared by $491 billion, or more than four times the first double.

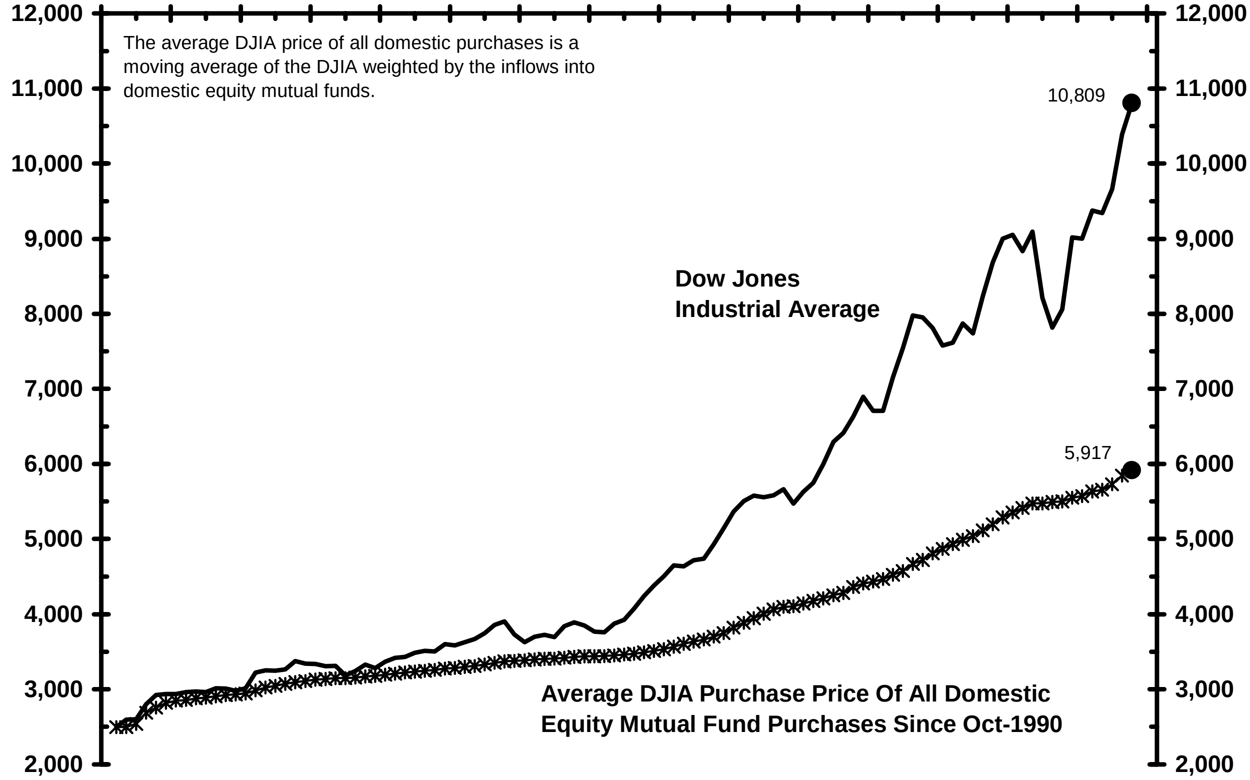
Over both doubles, the amount of money that the public invested in domestic equity mutual funds was not proportional to the gains made. During the first double, the public was putting money into a rising market in increasing amounts. Between October 1990 and July 1995, the public moved from no monthly inflows to inflows of nearly $20 billion a month. This made the average purchase price calculation keep pace with the market's rise. When the DJIA finished doubling in mid-1995, they had few profits to show.

During the second double, from July 1995 to December 1998, monthly inflows did not change much, holding steady near $20 billion a month. Since the public had not been chasing this double by putting even larger sums of money into the domestic equity mutual funds, they were in the position to profit handsomely from this rise. This is why the "wealth effect" is having such a "supercharged" effect on the economy -- the public is profiting from the current rise "hand-over fist" as opposed to bullying the market higher with increasing sums of money.

This "supercharged" effect is really having an influence in 1999. The amount of unrealized profits held in domestic equity mutual funds has increased by $279 billion in just the first five months of this year – from $616 billion in December 1998 to $895 billion as of May 1999 (latest data). This is one of the largest gains over such a period ever.

Why does this matter? It suggests that the wealth effect on the economy in 1999 is as strong as ever. So, will the economy slow as much as the consensus expects? If the attached chart has any influence on it, probably not.

Measuring The Public's Breakeven Point



Measuring The Wealth Effect

Unrealized Profits Held In Domestic Equity Mutual Funds Are Booming!