

# Strategies for Investing in the Dow Jones Industrial Average

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Credit: Bloomberg/Getty Images

The Dow Jones Industrial Average (DJIA) is one of the most closely followed stock market indexes in the world. Although the Dow, as it's commonly known, is watched by millions of people on a daily basis, many of its viewers neither understand what the Dow really measures or represents, nor do they understand how to capitalize on the information provided to them. Let's look at the structure of the Dow, an important type of investment vehicle that replicates the performance of the Dow, and three investment strategies you can use to bolster your knowledge and net worth.

## Structure of the Dow Jones Industrial Average

The DJIA was created in 1896, and it is the second-oldest stock market index in the U.S.; the Dow Jones Transportation Average came first. The DJIA consists of 30 large-cap blue-chip companies that are, for the most part, household names.

Ironically, the DJIA is no longer a true proxy for the industrials sector, because only a fraction of the companies that make up the Dow are classified as industrials. The remaining companies are assigned to one of the remaining sectors found in the Global Industry Classification System. The only sector that is not represented by a company in the DJIA is the utilities sector.

The table below lists the companies included in the DJIA currently:

Symbol	Company Name	Market Cap	1st Year in the Dow
AAPL	Apple Inc.	\$3.36T	2015
NVDA	NVIDIA Corporation	\$2.94T	2024
MSFT	Microsoft Corporation	\$2.93T	1999
AMZN	Amazon.com, Inc.	\$2.17T	2024
JPM	JPMorgan Chase & Co.	\$697.71B	1991
WMT	Walmart Inc.	\$684.04B	1997
V	Visa Inc.	\$669.75B	2013
UNH	UnitedHealth Group Incorporated	\$471.08B	2012
JNJ	Johnson & Johnson	\$392.54B	1997
PG	The Procter & Gamble Company	\$381.06B	1932

<b>HD</b>	<b>The Home Depot, Inc.</b>	\$360.24B	1999
<b>KO</b>	<b>The Coca-Cola Company</b>	\$296.06B	1987
<b>CVX</b>	<b>Chevron Corporation</b>	\$291.82B	2008
<b>CRM</b>	<b>Salesforce, Inc.</b>	\$276.35B	2020
<b>CSCO</b>	<b>Cisco Systems, Inc.</b>	\$242.2B	2009
<b>IBM</b>	<b>International Business Machines Corp.</b>	\$230.76B	1979
<b>MRK</b>	<b>Merck &amp; Co., Inc.</b>	\$227.75B	1979
<b>MCD</b>	<b>McDonald's Corporation</b>	\$219.2B	1985
<b>AXP</b>	<b>American Express Company</b>	\$194.83B	1982
<b>GS</b>	<b>The Goldman Sachs Group, Inc.</b>	\$189.07B	2013
<b>VZ</b>	<b>Verizon Communications Inc.</b>	\$183.23B	2004
<b>DIS</b>	<b>The Walt Disney Company</b>	\$182.74B	1991
<b>AMGN</b>	<b>Amgen Inc.</b>	\$166.43B	2020
<b>CAT</b>	<b>Caterpillar Inc.</b>	\$163.7B	1991
<b>BA</b>	<b>The Boeing Company</b>	\$136.83B	1987
<b>HON</b>	<b>Honeywell International Inc.</b>	\$136.64B	2020
<b>NKE</b>	<b>NIKE, Inc.</b>	\$98.42B	2013
<b>SHW</b>	<b>The Sherwin-Williams Company</b>	\$85.77B	2024
<b>MMM</b>	<b>3M Company</b>	\$83.34B	1976
<b>TRV</b>	<b>The Travelers Companies, Inc.</b>	\$58.79B	2009

*S&P Global Indices and Trading View. You can click the arrow in the above-right to get all 30 stocks. Market cap as of March 2025.*

Table: Investopedia/Peter Gratton

In addition to the sector diversity of the Dow, further diversification is provided by the multinational operations of its constituents. This means that investors can gain indirect exposure to the international markets, and use the global diversification of the companies in the index to hedge against the negative impact of a weak U.S. economy. Moreover, the companies that make up the Dow generate a significant amount of revenue each year. This helps to reduce the business risk of the companies that make up the index.

# Criticism of the Dow Jones Industrial Average

While the DJIA has many excellent attributes, one of its biggest criticisms stems from the fact that it is a price-weighted index. This means that each company is assigned a weighting based on its stock price. In comparison, most companies that make up an index are weighted according to their market capitalization. The S&P 500, an index that is different from the DJIA in many ways, is a good example of this.

As you can assume, there would be a significant difference in the weighting of the companies in the Dow if the index committee used market capitalization instead of stock price to structure the index proxy. That said, there is really nothing that makes a price-weighted index inferior to a market cap-weighted index, or even an equally-weighted index or a revenue-weighted index. This is because the idiosyncratic nature of each index construction methodology has many strengths and weaknesses that make it difficult to reach consensus on the best methodology to use.

## An Important Distinction Between Risk and Volatility

When analyzing the performance of the Dow, it is important to keep in mind that it is considered by some to be a volatile index. Therefore, many investment professionals will not typically recommend investing in products that track the DJIA. That said, there is a significant difference between the business risk of the companies that make up the Dow and the volatility of the index. This is because the companies that make up the DJIA represent 30 of the most well-established companies in the world. Therefore, their business risk is relatively low because it is very unlikely that they will go bankrupt.

Nevertheless, the stock price of these companies can fluctuate greatly over short periods. As a result, investment products that replicate the performance of the Dow can experience significant short-term gains and losses.

## Old Investment Strategies for New Investors

Investors must understand that there is the potential for extreme losses if they invest in products tied to the Dow. Therefore, the following strategies are not for inexperienced investors who want to use an "invest and forget it" approach. That said, there are a host of strategies that you can use that are superior to the strategies touted by most financial advisors. However, these strategies also require a change in philosophy, from the

simple buy-and-hold mentality to strategies that have a much shorter time horizon. Such strategies include:

## **Protective Put**

A protective put strategy consists of a long position in a Dow exchange-traded fund (ETF) and the purchase of put options on the same underlying ETF. This strategy will pay off if the DJIA goes up, and will protect your investment if the DJIA goes down.

## **Short Selling**

In contrast, investors can implement a protective short selling strategy by selling short the Dow ETF and buying call options on the same underlying ETF. This strategy will pay off if the DJIA goes down and will protect your investment if the DJIA goes up.

## **Covered Call**

Finally, investors can generate a modest premium on top of a long Dow ETF position by implementing a covered call strategy. This strategy entails buying the DJIA ETF and selling call options on the same underlying ETF. This strategy will profit if the Dow remains relatively flat, and does not exceed the strike price of the call options sold. That said, there is no downside protection provided by a covered call strategy, so investors must be confident that the Dow is going to remain flat before implementing this strategy.

The benefit of these strategies is that investors can select the amount of risk that they want to take, or the extra premium that they want to receive, by establishing the strike price on the put or call options that they use. As you can see from these examples, derivatives can be used to mitigate or eliminate the risk of loss on an investment, and they can be used to generate a modest risk-free rate of return. Based on these strategies alone, it should be clear that derivative instruments are not "weapons of financial mass destruction"—at least not if they are used appropriately by competent investors.

## **Top Ten**

This strategy involves investing equal amounts in the 10 stocks on the DJIA with the highest dividend yield at the start of a year, and holding them until year-end, at which time the investor sells that year's stocks and deploys the proceeds into the new stocks for the year ahead. This strategy has generally produced favorable results over time.

# Forecasting the Dow

Now that your focus is on the Dow, and you know the type of investment vehicle that you should use and the appropriate investment strategy to use in each type of market environment, the next two questions that you should ask are: "How can I determine if the current level of the DJIA is undervalued, fairly valued or overvalued, and how can I determine which direction the DJIA is likely to move?"

Unfortunately, there is no sure way to forecast the future direction of the markets. However, investors can assess the premiums associated with the options tied to the Dow ETF to gauge the current view of the anticipated volatility in the market. This determination should be based on the cost of the options, where higher option premiums are indicative of higher implied volatility in the market.

In addition, investors can use the cost of the options tied to the Dow to determine the breakeven amount on the Dow ETF. By using these approaches, investors can determine if the current risk in the Dow merits market participation. Moreover, if you are willing to take the time to analyze the historical range of the stock prices associated with the components that make up the Dow, and then review the market multiples of the companies that make up the Dow, you should be able to accurately gauge the valuation level of the index, and therefore, its potential volatility.

Finally, by using this approach, you should also be able to gauge the direction the Dow is trending, the appropriate strategy to employ, and the risk and potential profit that you stand to make over your investment time horizon.

## The Bottom Line

There's a strategy available for trading the Dow Jones Industrial Average for investors of every persuasion, from beginners with limited capital to invest to aggressive traders and high net worth individuals with large pools of capital at their disposal. Individual investors who want to increase their investment knowledge, gain more hands-on investment experience and take control of their personal investment responsibilities should consider investing in an ETF that is tied to the Dow Jones Industrial Average.