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Article

What is the Intrinsic Value of the Dow?

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Abstract

We model the time-series relation between price and intrinsic value as a cointegrated system, so that price and value are long-term convergent. In this framework, we compare the performance of alternative estimates of intrinsic value for the Dow 30 stocks. During 1963–1996, traditional market multiples (e.g., B/P, E/P, and D/P ratios) have little predictive power. However, a V/P ratio, where V is based on a residual income valuation model, has statistically reliable predictive power. Further analysis shows time-varying interest rates and analyst forecasts are important to the success of V. Alternative forecast horizons and risk premia are less important.

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