The importance of the market factor

The average proportion of variability explained by the market varies from year to year. This chart shows the average R-squared between the trailing 52-week returns on the market and the stocks in the Dow Jones index. Notice the spikes in the influence of the market in 1987, 2002-2003, and 2008-2011. In these periods specific risk was relatively more important, and there was less opportunity to reduce risk through diversification.