



Stock Market Indexes

We often hear different indexes quoted by the media without necessarily understanding what they are. So, I thought I would explain the major U.S. indexes, some of which seem to be referenced on a regular basis. Basically, an index is nothing more than a list of stocks. However, the *major* indexes have gained reputations and are also backed by the substance of the companies that publish them.

Dow Jones Industrial Average

This index is also referred to as the "Dow" or the "DJIA". It is owned by the Dow Jones & Company, the same company that publishes the Wall Street Journal. It was started in 1896 by Charles Dow. It began with 12 stocks and is now comprised of 30 stocks. These stocks are some of the most familiar blue chip companies in the U.S. and cover all major areas of the U.S. economy except the transportation and utility sectors. There are two disadvantages to this index: It is price-weighted rather than market capitalization-weighted, and it only contains 30 companies out of a field of more than 10,000. Therefore, the DJIA doesn't even come close to being a benchmark for the entire market. For this reason, the S&P 500 is beginning to take over as the benchmark of choice.

S&P 500 Index

The S&P 500 Index includes 500 companies, which is certainly an improvement over the Dow. This index was created by Standard & Poors Index Services. The companies in this index are *large cap* companies but not necessarily the *largest* companies. The S&P 500 tries to cover all major areas of the U.S. economy. These companies are the most widely held companies, chosen on a basis of market capitalization, liquidity, and industrial sector. The selections are made by the S&P Index Committee with approximately 25 – 50 changes occurring every year due to mergers, fallouts, etc. This index accounts for approximately 70% of the U.S. market and is one of the best indicators of market performance. Therefore, the goal of many mutual fund managers is to beat this index.

The Nasdaq Composite Index

The Nasdaq Composite represents every stock that trades on the Nasdaq stock market. This index has received much attention over the last 10 years due to the popularity of technology, internet and biotech stocks and their presence on the Nasdaq stock market. It was created in 1971 and contains more than 4000 companies. Since this index contains stocks that tend to be more risky and speculative than the other major indexes, this index also has the tendency to be more volatile. (This index should not be confused with the Nasdaq 100, which is made up of the 100 largest non-financial companies on the Nasdaq stock market.)

The Wilshire 5000 Index

Contrary to the name, this index contains over 6,500 stocks traded in the U.S. Because of the large number of stocks represented in this index, it

is often referred to as the "total market index". This index was created by Wilshire Associates in 1980 and covers all industries, and all New York Stock Exchange, Nasdaq and Amex stocks. This index is weighted by market capitalization. As the most diversified index in the world, it covers virtually all of the public companies in the U.S. but not companies headquartered outside the U.S.

The Russell 2000 Index

This index measures the performance of Small Cap stocks that are many times not included in the larger indexes previously mentioned. The average market capitalization of companies in the Russell 2000 is approximately \$530 million. (Often times Small Cap companies are defined as companies with a market capitalization under \$2 billion.) Due to the small size of the companies listed on this index, it can be more volatile than the larger indexes and also may be more cyclical in nature, doing well when small cap stocks are in favor but doing poorly when small caps are not doing well.

There are many other indexes that are not as often referenced, such as the following:

S&P MidCap 400 Index

This index obviously includes mid-cap companies (ranging in market capitalization from \$2 billion to \$6 billion). It is not as popular as some of the other indexes due to the limited mid-cap size limitation for its listed companies, some of which appear on other indexes as well.

S&P SmallCap 600 Index

This index tracks small cap companies as does the Russell 2000. However, it is not as widely followed as the Russell 2000.

In addition to the U.S. indexes, most countries have indexes that represent their own stock exchanges as well. Some of the larger ones are:

Nikkei – Japan

FTSE 100 – United Kingdom

Hang Seng – Hong Kong

Toronto Stock Exchange (TSX) – Canada

DAX – Germany

CAC 40 – France

As we select a specific index against which to compare the performance of our mutual funds, it is important to select the correct index. As you can see, they all have different advantages and potential disadvantages which must be considered.

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