

History 101:

Market Indexes and How They Affect You



Many of us are used to seeing the value and price movement of an index quoted in points. Headlines about the Dow Jones Industrial Average or the S&P 500 often reference how many points the index gained or lost during the day. You are not alone if you only vaguely understand what these points mean and how they are calculated. Essentially, these points express the cumulative value of the stocks in the index adjusted for stock splits and companies entering or leaving the index. Given that these points represent the value of an index, it would make sense that investors pay close attention to them. However, as the value of the index grows, each incremental point becomes less relevant as it is a smaller and smaller portion of the total index value. In other words, a point isn't what it used to be, which can make it easy to overemphasize the value of a point today.

Financial media headlines often quote the number of points that an index gained or lost in a day for dramatic effect. Often these headlines reference the Dow Jones Industrial Average (Figure 1). For many investors, these headlines can seem downright scary and may prompt flashbacks to historic stock market crashes (Figure 2). Quoting an index in points is not useless, but it is widely misunderstood. For instance, both of the headlines shown here only quote the number of points that the index moved and not the value that the index was moving from. In other words, they are quoting the nominal move when what really matters to investors is the percentage move. For example, if we look closer at the two cases shown in the headlines we can see that although the headlines

appear similar, the reality for investors during these periods was quite different. In 1987 that drop of more than 500 points, known as Black Monday, was a calamitous event during which the Dow declined more than 22%. In 2019 that drop of 600 points equates to a decline of 2.4% which is mildly unpleasant but should be of minimal concern to most investors.

Figure 1. Headline in 2019



Figure 2. Headline in 1987



Figure 3. Annual Index Returns Ranked in Order of Performance (Percentage)

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
DJIA 36.41	S&P 15.06	DJIA 5.53	MSCI ACWI IMI 16.38	S&P 32.39	S&P 13.69	S&P 1.38	DJIA 13.42	DJIA 25.08	S&P -4.38
S&P 26.46	MSCI ACWI IMI 14.35	S&P 2.11	S&P 16.00	DJIA 26.50	DJIA 7.52	MSCI ACWI IMI -2.19	S&P 11.96	MSCI ACWI IMI 23.95	DJIA -5.63
MSCI ACWI IMI 18.82	DJIA 11.03	MSCI ACWI IMI -7.89	DJIA 7.25	MSCI ACWI IMI 23.55	MSCI ACWI IMI 3.84	DJIA -2.23	MSCI ACWI IMI 8.36	S&P 21.83	MSCI ACWI IMI -10.08

Source: Morningstar Direct. Stock indices ranked: Dow Jones Industrial Average Index (DJIA), S&P 500 Index (S&P), and MSCI All Country World Investable Market Index (MSCI ACWI IMI).

While the Dow and other indices are frequently interpreted as indicators of broader stock market performance, the stocks composing these indices may not be representative of an investor's total portfolio today. As illustrated in the sidebar ("Index Construction & Design Differences"), the DJIA and S&P only represent U.S. large cap stocks while the MSCI ACWI IMI represents a much larger universe of global stocks – U.S. and international. In our view, the MSCI ACWI IMI Index is a much better representation of an investor's stock allocation today. The stock opportunity set today goes well beyond the U.S., and we believe it is extremely important to maintain exposure to leading companies around the world. For example, the U.S. market cap is just over half of the global market cap today, and the number of U.S. stocks is 3,585 versus 9,995 for international companies. Furthermore, you can see in Figure 3 how different the performance can be from one stock index to another.

It is also important to note that some investors may be concerned about other asset classes besides stocks. Depending on investor needs, a diversified portfolio may include a mix of global stocks, bonds, real estate, commodities, and any number of other assets not represented in a stock index. A portfolio's performance should always be evaluated within the context of an investor's specific goals and mix of assets. Understanding how a personal portfolio compares to an appropriate broadly published index such as the MSCI ACWI IMI can give investors context about how headlines apply to their own situation. For example, Savant's monthly market commentary published on our website is an easy way to follow the performance of the global stock market today.

SUMMARY

The lesson for investors should be to always view the point movements of an index within a percentage context and to account for how an index is constructed. Different indices measure different sets of stocks, and even those with some of the same components can be impacted very differently. The insights that headlines offer may be limited, especially if investors hold portfolios designed and managed daily to meet their individual goals, needs, and preferences in a broadly diversified and cost-effective manner.

Sources: Morningstar, Dimensional Fund Advisors, USA Today, and The Philadelphia Inquirer archives

This is intended for informational purposes only and should not be construed as personalized investment advice. Please consult your financial advisor regarding your unique circumstances.

Index Construction & Design Differences

Dow Jones Industrial Average Index (DJIA)

A basket of 30 U.S. large cap stocks first calculated in 1896 weighted according to each stock's price. A company with a higher stock price gets a larger weight in the index.

\$7 trillion market cap

S&P 500 Index (S&P)

A basket of 505 U.S. large cap stocks first calculated in 1923 in which the stocks are weighted by market capitalization (cap). Market cap means that companies in the index are weighted by taking the number of outstanding shares of the company's stock multiplied by the stock price.

\$24 trillion market cap

MSCI All Country World Investable Market Index (MSCI ACWI IMI)

A market cap weighted index covering over 8,700 large, mid, and small cap stocks in 23 developed and 24 emerging markets countries.

>\$50 trillion market cap