

## **For Older Americans, Stock Averages Are Anything But Average**

By Hillard Rest

When most older Americans were growing up, the only stock average was the Dow Jones Industrial Average. Today there are lots of different stock averages and indices to follow, and it is quite easy for *any* investor, let alone an older investor, to get a bit confused.

“I see all these advertisements for mutual funds that compare how they’ve done versus some index, but I don’t know what that means,” said Celina Aguilera. “I assume it means that it’s done well, but how do I know when I don’t even know what that index is?”

Stock averages and indices are put together to inform investors about changes in the market. They also serve as models against which the performance of investors’ portfolios and the performance of money managers may be compared, such as those who manage mutual funds. The dozens of indices in existence vary greatly by the industries or markets that they track.

The best known among these averages is the Dow Jones Industrial Average, which consists of only 30 blue-chip companies. Usually, when people talk about how the market did yesterday, they’re talking about the change in the Dow 30 Industrials. But many other averages and indices are reported in today’s markets. For example, the Wilshire 5000 is an index of every U.S.-based security.

It’s important to know that there is a difference in the quality of the information between a stock average (the “Dow”), which usually contains a smaller number of stocks, and an index, which tracks a broad segment of a market and is measured against its base value.

The Standard & Poor’s 500 (S&P 500) is comprised of 500 different stocks from the New York Stock Exchange and the over-the-counter market known as Nasdaq. It is a value-weighted index, which means that larger capitalized companies carry more weight than do smaller companies. It is almost 50 years old and is the most popular index used by investment professionals as the benchmark against which their performance is compared.

While both the Dow and S&P 500 move somewhat in tandem, they are not identical. In fact, in 2005, the S&P showed a larger gain than did the Dow.

The Russell 2000 Index, another well-known value-weighted index, is used to benchmark small capitalization companies. Although the stocks issued by smaller capitalized corporations are generally considered to be more volatile than the stocks of larger corporations, “small-cap” stocks are generally considered to offer more growth potential and those who wish to invest in them would be wise to consider following this index.

Finally, the EAFE index (pronounced as “EE-fuh”, which stands for Europe, Australia, and the Far East) was created as a measure of the international securities markets. Many investors with portfolios consisting mainly of U.S. stocks often add a portion of foreign stocks to their portfolios for the additional diversification that foreign stocks offer. In that case, it might be wise to follow the EAFE.

Whichever index you choose to follow, make sure that it reflects the composition of your portfolio or of the investments you are considering making. Otherwise, it could mislead you.