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Topic 1: Market indices - measuring the market

An understanding of the language of the sharemarket is essential if you wish to properly communicate with your adviser and benefit from the market information available to you. For example you may have heard on the news something like

"After a slow start, turnover on the sharemarket was strong today, with the All Ords finishing up 23 points to 5,200. On overseas markets, the Dow Jones rose slightly to 11,340."



What does that really mean? Listeners are being given an indication as to the general trend of the sharemarket both in Australia and in the USA. The "All Ords" and "Dow Jones" are indices.

An index is simply a measure of performance over time. A sharemarket index is a measure in the change in price of a basket of shares. The number of shares in the basket will determine how closely the index represents the entire market.

The concept of an index is not only used in the sharemarket. Inflation is the change in price of a basket of goods. This is measured by the Consumer Price Index - CPI.

The All Ords

The All Ordinaries or All Ords is a measure of the overall performance of the Australian sharemarket at any given point in time. It is made up of the share prices for 500 of the largest companies.



S&P/ASX 200	5388.1	▲ 35.8
ALL ORDS	5358.8	▲ 34.1

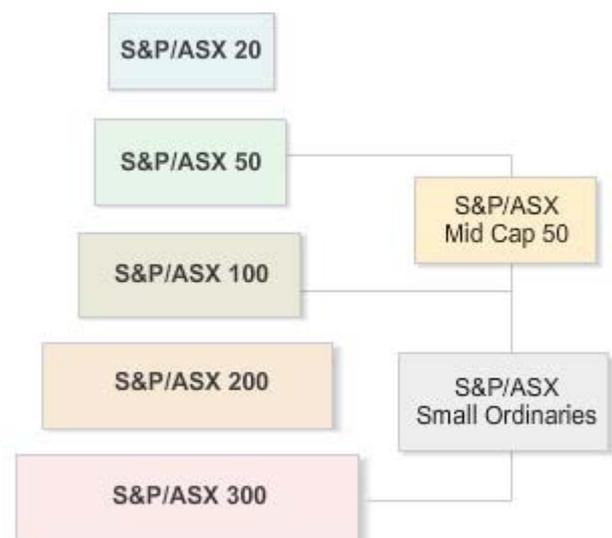
The companies are weighted according to their size in terms of market capitalisation (total number of shares on issue multiplied by the share price). For example, Telstra and National Australia Bank have very large market capitalisations and represent a large component of the All Ords. Movements in their share price have a marked effect on the level of the All Ords index.

The All Ords does not include the value of any dividends paid to shareholders and therefore does not reflect the total returns made from sharemarket investments during that period. An index that takes into account both price movements and dividends is called an accumulation index. There is an All Ordinaries Accumulation Index, however this is not regularly quoted in the finance media.

Standard & Poor's Index Services

Standard & Poor's (S&P) Index Services provides the index calculation services for the Australian sharemarket.

While the All Ordinaries has been a popular index for many years, the main index used in the Australian market is the S&P/ASX 200 index. It is recognised as the investable benchmark for the Australian equity market. It addresses the needs of investment managers to benchmark against a portfolio characterised by sufficient size and liquidity. The S&P/ASX 200 is comprised of the S&P/ASX 100 plus an additional 100 stocks. It forms the basis for the SPI 200 and the SPDR S&P/ASX 200 exchange-traded fund.



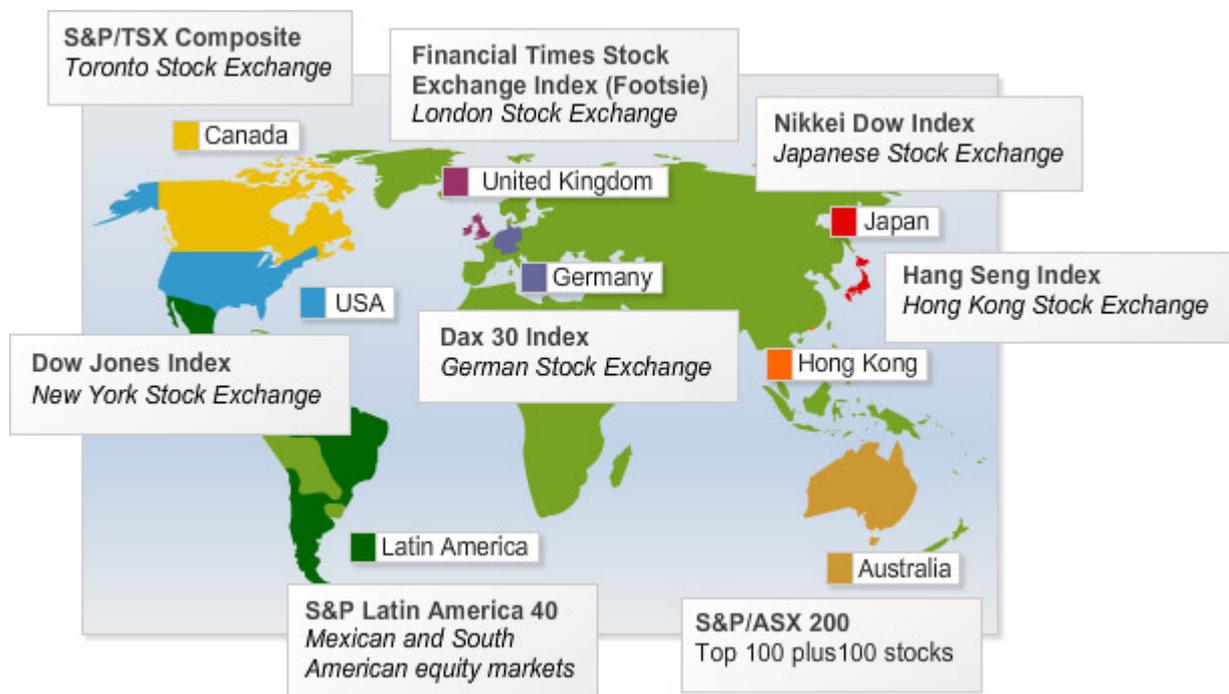
Taken from - S&P/ASX Indices, *The Gauge of the Australian Equity Market*

International indices

Indices are used to benchmark sharemarkets all around the world, with the most well known being the Dow Jones Index, a share price index that measures the market prices of the top companies listed on the New York Stock Exchange.

Each country tends to have a major benchmark index to measure the performance of their sharemarket. Roll your mouse over the countries to the right to learn the names of some of the major indices.

The German Stock Exchange Dax 30 (covering 30 blue chip stocks) is unusual in that it is an Accumulation Index, whereas all the others are price indices, meaning they do not include dividends.



Topic 2: Market sectors

Organising ASX listed companies into market sectors

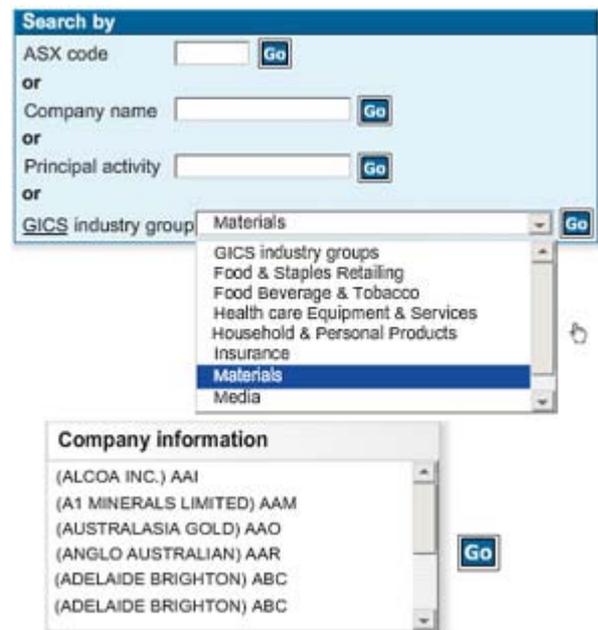
To give order to the 2,000+ companies listed on ASX, they can be categorised in a number of ways.

Companies can be ordered by their relative size, large capitalisation versus small capitalisation companies. Market capitalisation is calculated by multiplying a company's share price by the number of shares it has on issue.

Companies can also be divided by their historical performance and price volatility.

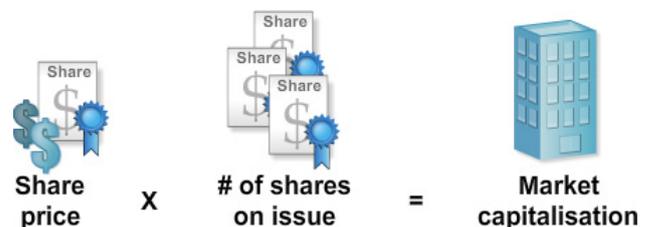
Companies can also be categorised across a broad industry divide, industrial companies and resources companies. To give more meaning to this categorisation a global standard is used to group companies into their main areas of business. This approach is known as the Global Industry Classification Standard or GICS sectors.

You can use the [ASX website](#) to search for a company by industry group.



Large and small capitalisation companies

Large financial institutions, such as superannuation funds and insurance companies, oversee the investment of billions of dollars of funds. Nearly all of those institutions invest a considerable portion of the funds in shares, so their fund managers are in constant touch with sharemarket analysts who recommend stocks that they expect will perform best in the future. Their recommendations reflect most fund managers' preference for investing in large companies offering low volatility, strong performance and high liquidity, over smaller companies with low liquidity or turnover, or a limited record of business successes.



The preference for larger companies with higher liquidity means that those companies included in the S&P/ASX Index calculations, especially the largest fifty or top one hundred shares, are generally more regularly traded by institutions. Institutions can be in charge of millions of dollars worth of investments, so their decision to buy or sell any particular share can significantly affect share prices.

Industrials and Resources companies

The companies listed on ASX can also be divided into two broad categories, industrials and resources. Resource companies include those involved in exploration and mining of minerals, oils and gas. All other companies fall into the industrials sector.

This broad categorisation is most commonly used in the share price tables in the newspaper. Some companies listed on ASX are involved in both the industrial and mining sectors, the most obvious example being BHP.

Australia has always been a significant exporter of commodities such as coal, metals, oil and gas. The graph opposite shows that in the late 1970s, resource companies used to make up over half of the companies listed. From 2000 to 2009 the graph also shows a reversal of the downward trend in the number of resource companies listed as the resources boom takes hold.

Initially, many resources companies explore or mine land and sea to determine if mineable resources exist. If, for example, oil or gold is discovered, then shares in the company will quickly come into demand, usually raising the share price dramatically. This gives the investor the potential to benefit from dramatic growth in a short period of time.



However, the obvious disadvantage in some resource shares is that exploration could continue indefinitely with the company eventually giving up the search to move to another area or even to wind down. Mines are also a wasting asset, because as the minerals are dug out of the ground, the value of the discovery must diminish over time.

The Australian resources sector can be difficult to value, as earnings from this particular sector can be quite volatile. Metal prices and exchange rates fluctuate daily, and a small change in the Australian dollar selling price can have a much greater impact on the earnings per share of a resources sector company than an industrial company.

Topic 3: Market sectors continued

GICS sectors

GICS (Global Industry Classification Standard) is a joint Standard and Poor's/Morgan Stanley Capital International product aimed at standardising industry definitions. Companies are grouped into GICS sectors reflecting their main business activities.

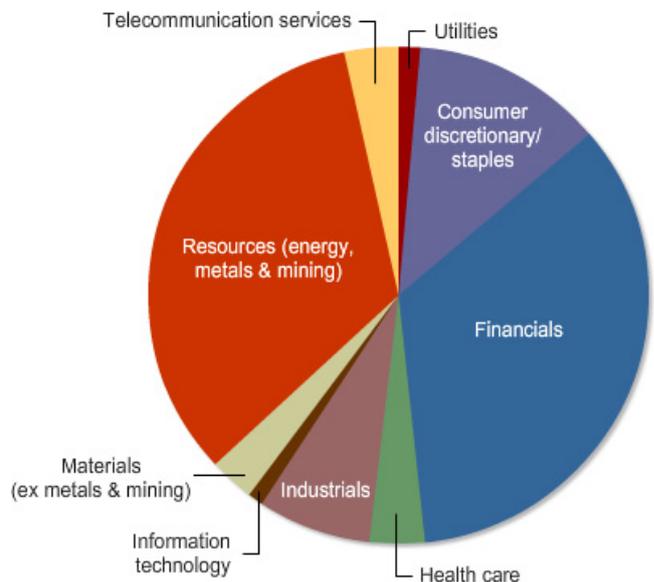
The standardised classification system has the advantage that it encourages foreign investors to look into local markets, as well as allowing local investors to look at the rest of the world and compare stocks via industry classification. This approach contributes to transparency and efficiency in the investment process.

Using a sector index to identify performing companies

You can review an index to identify the general trend in the market. Broad market indices (S&P/ASX 200) can be broken into smaller components, such as their GICS sector indices. GICS indices give you a better picture of which area of the market is driving its performance. For example, the Resources Index may be showing much higher rates of return than the Utilities Index and the Consumer Discretionary Index may be showing a poor reaction to a recent rise in interest rates.

Having used a sector index to identify general areas of good performance it is then possible to drill down to the actual companies that make up that index to identify those companies which are contributing to the good performance of that sector.

Market capitalisation by industry



Index Name	Symbol	Value	Change	Previous Close
S&P/ASX 200 Consumer Discretionary (Sector)	XDJ	1,560.9	7.0	1,553.9

You can look at the performance of the Consumer Discretionary sector. This will show you how the share prices of the companies that make up this sector (retailers & department stores) are performing.

Summary

- An index is used as a measure of a change in value.
- In the case of the sharemarket, there are many different types of indices that measure the change in value of certain groups of shares.
- Sharemarket indices are used to compare the relative performance of one group of shares against their past performance and against other groups of shares.
- The GICS sectors are a method of grouping companies along the lines of their main business activities.
- Companies can also be grouped by their relative size and past price performance.