

Measuring Up

By Bill Dickneider

“Rachel’s homework was to pick a newspaper article and write a story about it. She chose one about the stock market and began to read it in the quiet of her bedroom. “Who can possibly understand all these different measures of stock prices,” she sighed.

“... cereals on a supermarket aisle,” interrupted a squeaky voice. Rachel nearly fell out of her chair. There, standing on her desk, was her wooden ruler. It was tapping its foot impatiently and looking right at her.

Benevolent Ruler

No need to be afraid, Rachel. I’m a benevolent ruler, and I’m an expert in measurements.” Rachel’s heart was still pounding. “A talking ruler?” she gasped. “Sure. We rulers have been around for centuries. Why, the pyramids wouldn’t have been built without our help. But my task now is to help you understand these confusing stock market measurements. Don’t they seem as plentiful as cereals on a supermarket aisle?”

“You’re right about that,” agreed Rachel. “But at least I can read a cereal box to find out what’s inside.

“Then, I’ll take you for a tour.” said the ruler. “Here, take my hand.” Rachel took the ruler’s tiny hand and suddenly they were at a supermarket aisle stocked with cereal boxes — or so they seemed.

The ruler grabbed two boxes from

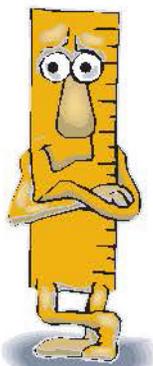
the shelf. “Here are two of the most popular measures. This one is the Dow Jones Industrial Average, or Dow. And this one is the Standard & Poor’s 500 index, which everyone calls the S&P 500. Each one is an index of stock prices.”

“What’s an Index?” asked Rachel.

“It’s a yardstick that uses specific stocks to measure price changes in the stock market. The Dow uses the stocks of 30 large, well-known companies, like Wal-Mart and McDonald’s. The S&P 500 includes these two companies plus many other large ones — 500 altogether. The companies are very large, too. The market value of all companies in each index is a huge part of the market value of all companies in the stock market. That’s why some investors use these yardsticks to measure the whole stock market.”

“Market value? What’s that?” asked Rachel.

“It’s a company’s current stock price times the number of shares stockholders own,” answered the ruler. “Wal-Mart’s closing price today was



How did the ruler define a stock market index? How many stock market indices can you find online?

DOW for large-cap companies. Uses stocks of 30 large companies that represent major industries of the economy.

S&P 500 for large-cap companies. Uses stocks of 500 large companies in leading industries in the economy.

RUSSELL 2000 for small-cap companies. Uses stocks of the smallest 2000 companies in the Russell 3000 index.

NASDAQ Composite for technology stocks. Uses stocks of all companies in NASDAQ Stock Market.

changes in the Dow or S&P 500 to measure the performance of the overall stock market. But suppose you also want to know if large company stocks are doing better or worse than small company ones. You could compare the percentage changes between a small-cap index and a large-cap index. Or what if you want to know how the stocks in a particular industry, like technology or health care are doing? You could compare the performance of this industry's index to the overall market."

\$56, and its stockholders own about 4 billion shares. So its market value is \$56 times 4 billion or ... \$242 billion."

"Is that what this newspaper article means by 'market cap'?" asked Rachel.

"Right," said the ruler. Market cap is short for market capitalization. It's just a company's market value. Companies with market caps of \$5 billion or more are large-cap companies. Wal-Mart is an example."

"What about the other boxes?" asked Rachel.

"Besides the Dow and S&P 500, there are many other stock market indices. That's innn-di-seeees," said the ruler, clearly emphasizing each syllable. "Here's another popular one," it said, while grabbing yet another box from the shelf. "It's called the Russell 2000 index. Many of its 2,000 stocks are small-cap companies. These are companies with market values under \$500 million."

"What about this one?" asked Rachel, as she took another box from the shelf. "It says 'NASDAQ Composite on it."

"That's another popular index," explained the ruler. "It uses all the stocks on The NASDAQ Stock Market. Many are technology companies. Some are small, and some are big, like Microsoft. This index is a popular yardstick for technology stocks.

"Big, small, medium — you name the size of the company and there's an index for that kind of stock," continued the ruler. "There also are indices for different industries, such as technology, health care, utilities, and telecommunications."

"It's confusing," said Rachel. "There are so many. How does an investor use them all?"

"Like I said, some investors use percentage

"What if I want to know how well a stock that I own is doing?" asked Rachel.

"As a general rule, be sure to use the right yardstick. If it's a large-cap stock, don't measure its performance with a small-cap yardstick," answered the ruler. "If it's a technology stock, compare its performance to an index of technology stocks. Here, take this little summary sheet," said the ruler. "It'll help you with your homework assignment."

Rachel suddenly awoke and realized she must have drifted off and been dreaming. She looked at her desk, and, sure enough, there was her ordinary wooden ruler. But she also noticed a sheet of paper next to it. At the bottom was the brief note. "Good luck, Rachel. I know you'll measure up."

Write Now

Are you invested in one or more of the companies used in any of the indices mentioned in this newsletter? Which ones? How are the indices they are included on performing compared to each other? Why?

Choose one of the companies you listed above. Why did you invest in it? How is it doing compared to its index? How is it doing compared to another company included on its index? What do you think is influencing its price?