Market Talks
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STOCKS · BEGINNER · LESSON 5 OF 15

Stock Indices Explained

What the S&P 500, the Dow, the Nasdaq 100 and other indices measure, how they are calculated and why the method matters

12 min read 8 quiz questions with answer key

STOCKS · BEGINNER · LESSON 5 OF 15

Stock Indices Explained

IN ONE SENTENCE

A stock index tracks the value of a group of stocks with a single number, so you can see at a glance how a market or part of a market is doing. Most indices weight each company by its market value, but some, like the Dow and the Nikkei 225, weight by share price. You cannot buy an index directly, but you can follow it through index funds, ETFs, futures and other products.

One number for a whole market

When a news presenter says "the market rose 1% today", they almost never mean every stock. They mean a **stock index**: a single number that tracks the combined value of a chosen group of stocks. If most of the stocks in the group rise, the index rises; if most fall, it falls.

Think of an index as a basket. The index provider decides which stocks go in the basket and how much of each, and then calculates the value of the basket throughout the trading day. The best-known baskets are:

- the **S&P 500**, about 500 of the largest US companies,
- the **Dow Jones Industrial Average**, or simply "the Dow", 30 large US companies,
- the **Nasdaq-100**, 100 of the largest companies listed on Nasdaq.

Indices are used in three main ways: as a quick **summary** of how the market is doing, as a **benchmark** to judge whether an investor or fund did better or worse than the market, and as the basis of **products**, such as index funds and futures, that let people trade the whole basket at once.

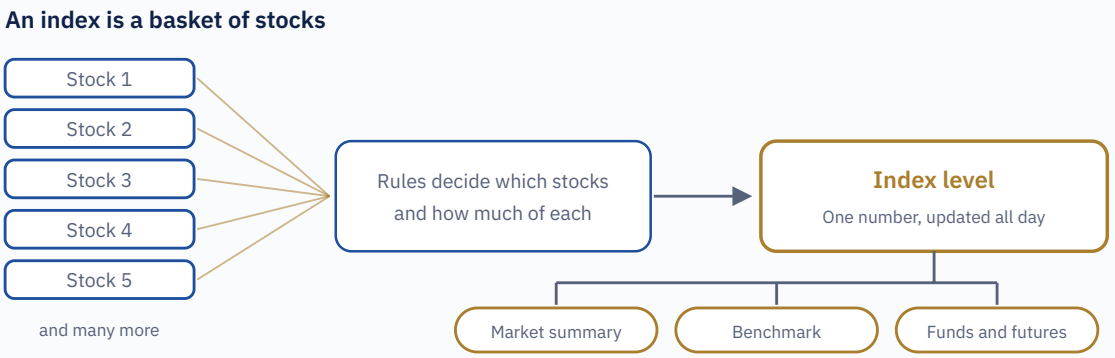


Figure 1. An index is a basket of stocks chosen by set rules. Its value is one number, used as a summary, a benchmark and the basis for products.

Points, levels and percentages

An index is measured in **points**, not in dollars. Each index starts from a chosen **base value** on its first day, often 100 or 1,000, and then moves up and down with its stocks. The FTSE 100 in London, for example, started at 1,000 points in 1984, and the DAX in Germany at 1,000 points in 1988. The level itself has no deeper meaning; it only shows how far the basket has moved since it started.

That is why indices should be compared using **percentages**, not points. Different indices have very different levels, so the same number of points can mean very different moves.

EXAMPLE: POINTS VERSUS PERCENTAGES

Suppose one day the Dow rises 400 points from 45,000, and the S&P 500 rises 60 points from 6,000. The Dow's move sounds bigger, but in percentage terms it is 400 ÷ 45,000 = **0.9%**, while the S&P 500's is 60 ÷ 6,000 = **1.0%**. The S&P 500 actually had the stronger day. These levels are only an illustration, so always check the latest values on a live quote.

How an index is weighted

The most important question about any index is how much weight each company gets. There are three common methods:

- **Market-cap weighted.** Each company counts in proportion to its market capitalization: share price multiplied by the number of shares. The biggest companies have the biggest influence. Most major indices work this way, including the S&P 500, the Nasdaq-100, the FTSE 100 and the DAX. Most use the **free float**, which counts only the shares available to trade and leaves out large blocks held by founders or governments.
- **Price weighted.** Each company counts in proportion to its share price, no matter how large the company is. The Dow and Japan's Nikkei 225 work this way.

- **Equal weighted.** Every company counts the same. This is less common for headline indices, but many index funds offer equal-weighted versions.

Figure 2 shows the same three companies under each method. Company B is by far the largest business, but in a price-weighted index Company A, with the highest share price, dominates.

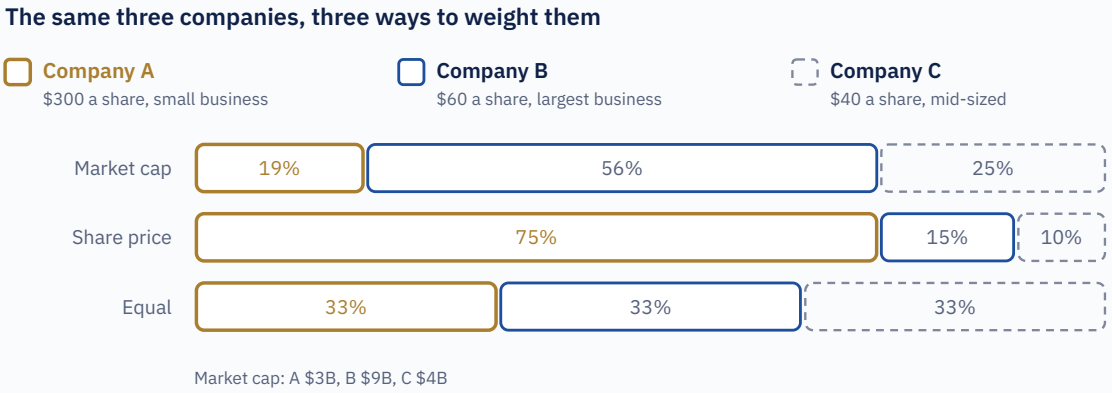


Figure 2. Three fictional companies weighted three different ways. The method decides who has the most influence.

Why the method matters

The weighting method decides how much each company's move changes the index. Using the same three companies, suppose one stock rises 10% while the others stay the same:

- If **Company B**, the largest business, rises 10%, a market-cap weighted index rises about **5.6%**, but a price-weighted index rises only **1.5%**, because B's share price is low.
- If **Company A**, with the highest share price, rises 10%, the price-weighted index jumps **7.5%**, while the market-cap weighted index rises less than 2%.
- In an equal-weighted index, a 10% rise in any one of the three adds about **3.3%**.

This is why the Dow and the S&P 500 sometimes move differently on the same day. A large move in a high-priced Dow stock can push the Dow more than the S&P 500, even if the company is not especially large. It is also why a company's share price can matter for joining the Dow: a stock with a very high or very low price would have too much or too little influence.

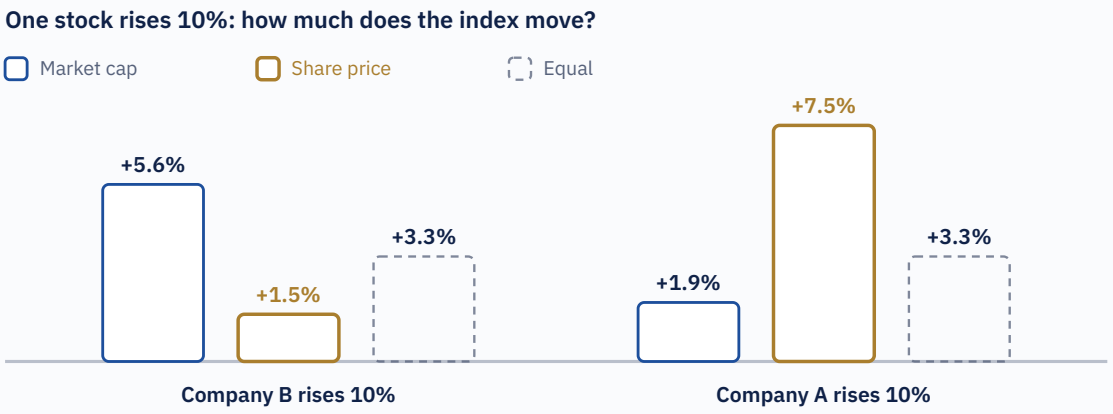


Figure 3. The same 10% rise in one stock moves each kind of index by a very different amount.

The main US indices

Because the US market is the largest in the world, its indices are watched everywhere:

Index	What it holds	Weighting	Started
S&P 500	About 500 large US companies, around 80% of the value of the US market	Market cap (free float)	1957
Dow Jones Industrial Average	30 large, well-known US companies	Share price	1896
Nasdaq-100	100 of the largest non-financial companies on Nasdaq	Market cap, with limits on the largest	1985
Nasdaq Composite	Almost all stocks listed on Nasdaq, several thousand	Market cap	1971
Russell 2000	About 2,000 smaller US companies	Market cap (free float)	1984

Professionals mostly use the S&P 500 as "the market", because it is broad and weighted by size. The Dow is the oldest and most famous, but with only 30 stocks and price weighting it is a narrower measure. The Nasdaq-100 is heavy in technology, so it usually moves more than the S&P 500 in both directions. The Russell 2000 shows how smaller companies are doing, which often reflects the health of the US economy at home.

A few giants move the S&P 500

Market-cap weighting has an important result: when a few companies become very large, they drive the whole index. According to S&P Dow Jones Indices, at the end of June 2026 the S&P 500 had

503 constituents (some companies have two share classes), but its **10 largest stocks made up 36.4%** of the index. The single largest company, Nvidia, made up **7.5%**.

The other top ten names were Apple, Microsoft, Amazon, Alphabet (two share classes), Broadcom, Micron Technology, Meta Platforms and Tesla. Most of them are technology or internet companies.

So when people say "the S&P 500 rose today", it may mainly mean that a handful of giant technology stocks rose. A strong index can hide a weak market underneath, and the opposite can also happen. Traders check measures of **market breadth**, such as how many stocks rose compared with how many fell, to see whether a move is broad or narrow. The Intermediate level covers breadth in detail.

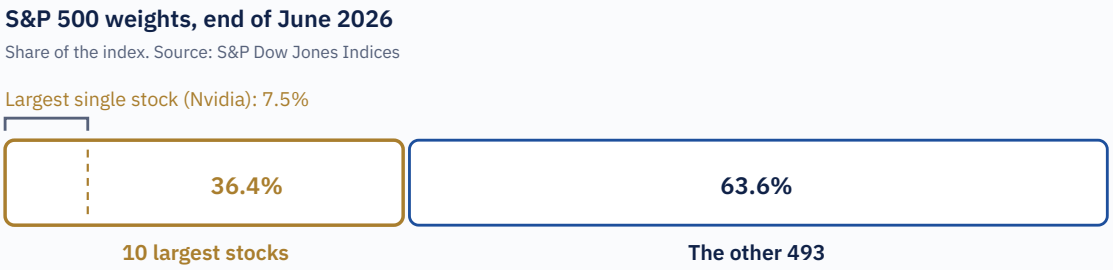


Figure 4. In June 2026, the 10 largest stocks made up more than a third of the S&P 500.

Indices around the world

Every major market has its own headline index, usually run by the exchange or by a specialist index company:

- **Europe:** the FTSE 100 (UK), the DAX (Germany, 40 companies since September 2021), the CAC 40 (France) and the Euro Stoxx 50, which covers 50 large companies from across the euro area.
- **Asia:** the Nikkei 225 and the broader TOPIX (Japan), the Hang Seng (Hong Kong), the CSI 300 (mainland China), the Nifty 50 (India) and the KOSPI (Korea).

There are also global indices. The **MSCI World** tracks large and mid-sized companies in 23 developed countries. At the end of October 2026 it had **1,248 constituents**, and US companies made up **72.8%** of it, a reminder of how dominant the US market has become.

When you compare indices from different countries, remember that each is calculated in its own currency. A year when the Nikkei 225 rises 10% in yen can be a much smaller gain, or even a loss, for an investor who measures in dollars or euros.



Figure 5. Some of the most watched stock indices outside the United States.

Price indices and total return

Most headline indices, including the S&P 500, the Dow and the FTSE 100, are **price indices**. They follow share prices only. When a company pays a dividend, its share price usually drops by about the amount paid, but the index does not add the dividend back. So a price index understates what investors actually earned.

A **total return index** assumes every dividend is reinvested in the index. Germany's DAX is an unusual example of a headline index calculated this way, which is one reason it can look stronger than other European indices over long periods.

Over many years the difference becomes large. Figure 6 shows a simple example: $10,000 growing at 7% a year from price gains alone becomes about **$76,100** after 30 years, while adding 2% a year of reinvested dividends, for 9% a year in total, turns it into about **$132,700**. The numbers are only an illustration, but the lesson is real: dividends matter, and comparing a price index with a total return index is not a fair comparison.

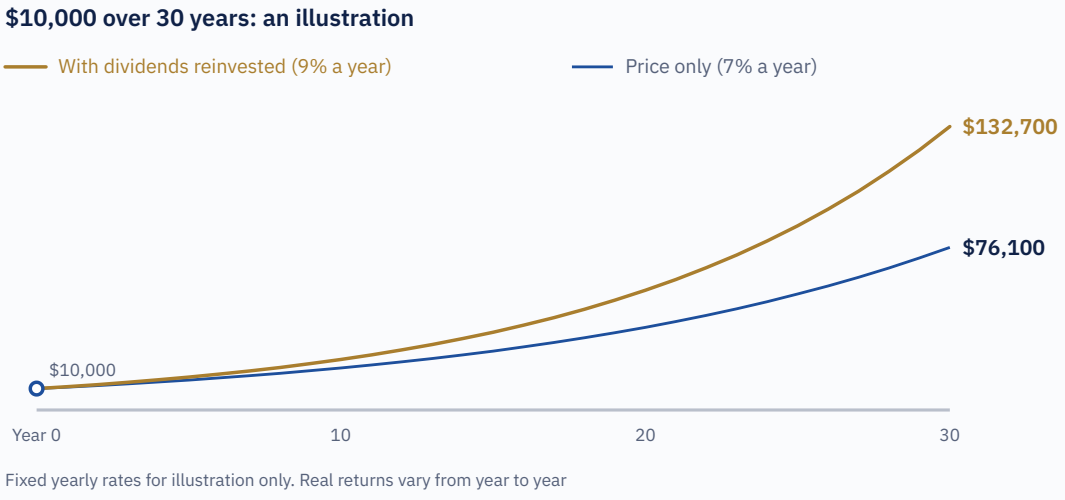


Figure 6. Reinvested dividends make a large difference over long periods. The rates are an illustration, not a forecast.

How people trade an index

An index is only a calculation, so you cannot buy it directly. Instead, people use products that follow it:

- **Index funds and ETFs.** Funds that hold all, or nearly all, of the stocks in an index, so their value follows it closely, minus a small yearly fee. They are the most common way for long-term investors to own "the market". Lesson 13 explains them in detail.
- **Futures.** Contracts on the future value of an index, such as the E-mini S&P 500, which trade almost 24 hours a day on weekdays. They use leverage and are mostly used by professionals and active traders. The Advanced level covers them.
- **CFDs.** Many brokers outside the United States offer contracts for difference on indices such as the "US500" or "GER40". They are leveraged and high risk, and in many countries they are not available to everyone. US retail investors cannot use them.
- **Options.** Contracts that give the right to buy or sell an index level at a set price, used for both hedging and speculation.

Index names on trading platforms vary. The S&P 500 might appear as SPX, US500 or under the name of an ETF such as SPY, and the Nasdaq-100 as NDX, NAS100 or US100. Always check exactly what a product follows before you trade it.



Figure 7. An index cannot be bought directly. These are the main products that follow one.

Why this matters for traders

- **Indices set the tone.** Most stocks move in the same direction as their main index on most days. Many traders check the S&P 500 or Nasdaq-100 before trading any single US stock.
- **Know the weighting.** In a market-cap index, a few giant stocks can move the whole index. In the Dow or the Nikkei 225, high-priced stocks have the most influence.
- **Compare in percent.** Points depend on the level of the index. Percentages let you compare indices fairly.
- **Indices link markets.** US index futures trade almost around the clock, so they are often the first place where overnight news shows up, and they often move together with bitcoin and react to the same interest rate news as the dollar and gold.

Key terms

Stock index	A single number that tracks the combined value of a chosen group of stocks.
Index points	The unit an index is measured in. The level depends on the index's starting base value.
Benchmark	An index used to judge whether an investment did better or worse than the market.
Market-cap weighted	A method in which each company counts in proportion to its market value.
Price weighted	A method in which each company counts in proportion to its share price. Used by the Dow and the Nikkei 225.
Equal weighted	A method in which every company in the index counts the same.
Free float	The shares available for public trading, leaving out large blocks held by insiders or governments.
Market breadth	How many stocks are taking part in a market move, for example the number of rising stocks compared with falling ones.
Price index	An index that follows share prices only and does not include dividends.
Total return index	An index that assumes all dividends are reinvested.

Key takeaways

1. A stock index tracks a basket of stocks with one number. It is used as a market summary, a benchmark and the basis of products like index funds and futures.
2. Indices are measured in points from a base value. Compare them in percentages, not points.
3. Most major indices are weighted by market cap. The Dow and Nikkei 225 are weighted by share price, which gives high-priced stocks more influence.
4. In June 2026 the 10 largest stocks made up 36.4% of the S&P 500, so a few giants can drive the whole index.
5. Most headline indices leave out dividends. You cannot buy an index directly, but you can follow it through ETFs, futures, CFDs and options.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. What is a stock index?

- A A single stock that represents the whole market
- B A number that tracks the combined value of a chosen group of stocks
- C A list of companies that pay dividends
- D The price of a share on an exchange

2. The Dow rises 400 points from 45,000 and the S&P 500 rises 60 points from 6,000. Which rose more?

- A The Dow, because 400 is more than 60
- B The S&P 500, because 1.0% is more than 0.9%
- C They rose the same
- D It cannot be compared

3. In a market-cap weighted index, which company has the most influence?

A. The one with the highest share price
B. The one with the largest market capitalization
C. The oldest one
D. Every company has the same influence

4. Which two indices are price weighted?

A. S&P 500 and Nasdaq-100
B. FTSE 100 and DAX
C. Dow Jones Industrial Average and Nikkei 225
D. Russell 2000 and MSCI World

5. Company A has a share price of $300 but is a small business. Company B has a price of $60 but is the largest business. In a price-weighted index, a 10% rise in which company moves the index more?

A. Company A
B. Company B
C. Both the same
D. Neither moves a price-weighted index

6. In June 2026, what share of the S&P 500 did its 10 largest stocks make up?

A. About 2%
B. About 10%
C. About 36%
D. About 90%

7. What is the difference between a price index and a total return index?

A. A total return index includes reinvested dividends
B. A price index includes dividends
C. A total return index only counts falling prices
D. There is no difference

8. Why can you not buy the S&P 500 index itself?

A. It is only for US citizens

B. An index is a calculation, so you use products that follow it, such as ETFs or futures

C. It is closed to new investors

D. It only trades on weekends

Answer key

1 B

A number that tracks the combined value of a chosen group of stocks

An index tracks a basket of stocks with one number, such as the S&P 500 for about 500 large US companies.

2 B

The S&P 500, because 1.0% is more than 0.9%

Compare in percentages: 400 ÷ 45,000 is about 0.9%, while 60 ÷ 6,000 is 1.0%.

3 B

The one with the largest market capitalization

In a market-cap index, each company counts in proportion to its market value. The S&P 500 and Nasdaq-100 work this way.

4 C

Dow Jones Industrial Average and Nikkei 225

The Dow and the Nikkei 225 weight companies by share price, so high-priced stocks have the most influence.

5 A

Company A

Price weighting only looks at the share price. Company A's higher price gives it more influence, however large Company B is.

6 C

About 36%

According to S&P Dow Jones Indices, the top 10 made up 36.4% of the index, and the largest single stock, Nvidia, 7.5%.

7 A

A total return index includes reinvested dividends

A price index follows share prices only. A total return index assumes dividends are reinvested, so it grows faster over time. The DAX is a total return index.

8 B

An index is a calculation, so you use products that follow it, such as ETFs or futures

An index is a number, not something you can own. Index funds, ETFs, futures, CFDs and options are built to follow it.

SOURCES

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