What index analysis is actually for

> **INDEX ANALYSIS**
>
> Forming a view about a number computed from hundreds of businesses. It cannot tell you what will happen, and on an index it cannot even tell you what is happening to most constituents - only what the weighted sum did. Its honest use is narrowing the range of outcomes you are prepared for.

Analysis is usually sold as prediction. It is more useful to treat it as the work of deciding what you would be surprised by, because that is a thing it can actually deliver.

Two questions worth separating

What is the index doing, and why is it doing it. The first is observation and the chart answers it. The second is inference and the chart never answers it - it can only be consistent with several explanations at once.

Most bad analysis is the second question answered with the first question's evidence.

The index-specific limit

An index is a weighted sum. A 1% move tells you the sum moved 1%, and nothing about how many constituents participated, which ones, or whether the median share went the other way.

So a conclusion about "the market" drawn from an index level is a conclusion about a calculation. Module 1 lesson 7 made that point about concentration; this module has to keep making it, because every technique here operates on the sum rather than on its parts.

What analysis can do

Establish context: where price sits relative to where it has been.Identify levels other participants are watching, which is self-fulfilling to a degree.Bound expectations: what a normal day looks like against an unusual one.Say what would falsify a view, which is the most useful output and the least discussed.

What it cannot do

Tell you what happens next. That is not a limitation of your technique; it is a property of a number produced by hundreds of businesses reacting to information nobody has all of.

A read that cannot be wrong is not a read. If you cannot say what would change your mind, you have a preference rather than an analysis, and module 6 will have nothing to test.

The two halves of this module

Lessons 2 to 4 are what moves an index as a whole: earnings in aggregate, rates, and the handful of companies large enough to move it alone.

Lessons 5 to 9 are technical structure - trend, levels, averages, breadth - on a series that nobody trades. Both halves come with the same caveat and it is worth carrying: you are analysing the sum.

Check your understanding

1. What does a 1% index move tell you about its constituents?

a. That most of them rose about 1%
b. Only that the weighted sum moved 1%
c. That the largest constituents rose

Answer: b. The index is a weighted sum. Participation, direction of the median share and which companies moved are all invisible in the level.

2. What distinguishes a read from a preference?

a. A read is based on more indicators
b. A read states what would falsify it
c. A read includes a price target

Answer: b. If nothing could change your mind there is nothing to test, and module 6 has nothing to work with.