What actually moves an index

> **INDEX CONCENTRATION**
>
> The degree to which an index's movement depends on a small number of its constituents. In a capitalisation-weighted index the largest few companies can account for a large share of any day's move, so a headline about 'the market' is often a headline about a handful of firms.

An index is an average, and averages are reassuring. This one should not be, because the weighting means it is not the average you probably picture.

One company can move a major index

In a cap-weighted index the largest constituent might carry several times the weight of the median one. A large single-company move - an earnings miss, a regulatory decision - can move the whole index on a day when most constituents did very little.

So the honest reading of a 1% index move is not "the market fell 1%". It is "the weighted sum of these constituents fell 1%", and the difference between those two sentences is sometimes the entire story.

Sector concentration does the same thing more quietly

Indices are not evenly spread across industries. Some are heavily weighted toward one or two sectors, and a sector-wide move then reads as a market move.

This is why comparing two countries' indices as a proxy for their economies is unreliable. You may be comparing a technology-weighted index with a bank-and-energy-weighted one, and learning about sectors rather than about countries.

The genuinely index-wide drivers

Interest rate expectations, which change what future company earnings are worth today.Broad risk appetite, which moves everything together and is what makes correlations rise in a selloff.Currency, for indices whose constituents earn abroad - a weaker home currency can lift the index while nothing improves domestically.

That last one catches people out. An index rising because the currency fell is not the same event as an index rising because business improved, and in the local currency they look identical.

And flow, which is not a view at all

Lesson 3 covered it: tracker inflows, rebalancing, hedging. On a quiet day this can be most of what you are looking at, which is why hunting for the news behind every move sometimes finds nothing. There was no news. There was a calendar.

Check your understanding

1. Why can a single company move a major cap-weighted index?

a. Because indices give equal weight to each constituent
b. Because the largest constituents carry several times the weight of the median one
c. Because index providers adjust the divisor for large moves

Answer: b. Influence is proportional to market value. One very large company having a bad day can outweigh most of the index doing very little.

2. An index rises while its home currency falls sharply. What might have happened?

a. Nothing improved domestically - constituents earning abroad are worth more in local terms
b. The divisor was adjusted for the currency
c. The index automatically hedges its currency exposure

Answer: a. For an index whose constituents earn abroad, a weaker home currency lifts the local-currency value of those earnings. In the local currency it looks the same as a genuine improvement.