Why two indices disagree about the same day

> **INDEX WEIGHTING**
>
> The rule deciding how much each constituent contributes to the index. Capitalisation weighting gives a company influence in proportion to its market value; price weighting gives it influence in proportion to its share price alone. Two indices covering the same market can move in opposite directions on the same day because of this and nothing else.

Two indices, same country, same session, one up and one down. This is not an error in either of them.

Capitalisation weighting

Most major indices weight by market capitalisation: a company worth £200bn moves the index twenty times as much as one worth £10bn, for the same percentage change in its share price.

The logic is that this mirrors what an investor holding the whole market would experience. The consequence is concentration, and it is not small: in several major indices, the largest handful of companies account for a substantial share of the whole calculation.

Price weighting

A price-weighted index treats each constituent's share price as its weight. A company whose shares cost $500 has ten times the influence of one whose shares cost $50, regardless of which company is larger.

Share price is largely an accident of how many shares a company has issued. A firm can halve its share price with a two-for-one split and become, overnight, half as important to a price-weighted index while being exactly the same business. The Dow Jones Industrial Average is the well-known example, and it is why it can disagree with the S&P 500 about a day.

Equal weighting

Every constituent counts the same. This sounds neutral and is a strong choice in its own right: it systematically gives smaller companies more influence than their size warrants, so an equal-weighted version of an index tells you about the average constituent rather than about the market's value.

What follows for a reader

Two indices disagreeing is usually a fact about the formulas, not a signal."The market was up" is incomplete until you say which index and how it is weighted.A cap-weighted index can rise while most of its constituents fall, if the largest ones rose.

That last point is the one worth sitting with, and lesson 7 returns to it.

What this lesson is not about

How constituents get chosen, replaced or rebalanced - the review meetings, the buffers, the effective dates - is a different subject with its own mechanics, and it lands in module 8. Here the question is only why the same market produces different numbers.

Check your understanding

1. Why can a share split change a company's influence on a price-weighted index?

a. Because the split changes the company's market value
b. Because the weight is the share price, and a split halves it
c. Because split shares are excluded for a period

Answer: b. The business is unchanged and its market value is unchanged. Only the price per share moved, and in a price-weighted index that price is the weight.

2. In a capitalisation-weighted index, can the index rise while most constituents fall?

a. Yes, if the largest constituents rose
b. No, the index is an average of the constituents
c. Only if the divisor is adjusted that day

Answer: a. Influence is proportional to market value, not headcount. A few large companies can outweigh a majority of smaller ones falling.