STEWARD

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An Index Overview

Part 2: Index Points

As we covered in our last piece, indexes have their uses. They can roughly gauge the mood of a market and its participants. If you've got an investment strategy that's designed to capture that market, you can see how your strategy is doing in comparison ... again, roughly. You can also invest in an index fund that tracks an index that tracks that market.

This may help explain why everyone seems to be forever watching, analyzing and talking about the most popular indexes and their every move. But you may still have questions about what they are and how they really work. For example, when the Dow Jones Industrial Average (the Dow) exceeded 35,000 points in July of 2021, what were those points even measuring?

> ***An index's total points represent a relative value for the market it is tracking, calculated by continually assessing that market's "average" performance.***

If that's a little too technical for your tastes, think of it this way: Checking an index at any given time is like dipping your toe in the water to see how the ocean is doing. You may have good reasons to do that toe-check, but as with any approximation, be careful to not misinterpret what you're measuring. Otherwise, you may succumb to misperceptions like: "The Dow is so high, it must be in for a fall. I'd better get out." With that in mind, when it comes to index points, we'd like to make a few points of our own.

Indexes Are Often Arbitrary

It helps to recognize how popular indexes become popular to begin with. In our free markets, competitive forces are free to introduce new and different structures, to see how they fly. In the same way that the markets "decided" that the iPhone would prevail over the Blackberry, popular appeal is effectively how the world accepts or rejects one index over another. Sometimes the best index wins and becomes an accepted reference. Sometimes not.

Measurements Vary

Different indexes can be structured very differently. That's why the Dow recently topped 35,000, while the S&P 500 is hovering in the 4,000s, even though both are often used to gauge the same U.S. stock market. The **Dow** arrives at its overall average by adding up the price-weighted prices of the 30 securities it's tracking and dividing the total by a proprietary "Dow divisor." The **S&P 500** also takes the sum of the approximately 500 securities it's tracking ... but weighted by market cap and divided by its own proprietary divisor.

With mysterious divisors, terms like "price-weighted" and "market cap," and additional details we won't go into here, this probably still doesn't tell you exactly what index points are.

Think of index points as being like thermometer degrees. Most of us can't explain exactly how a degree is calculated, but we know hot from cold. We also know that Fahrenheit and Celsius both tell us what the temperature is, in different ways.

Same thing with indexes. You can't directly compare an S&P 500 point to a Dow point; it doesn't compute. Moreover, **neither index adjusts for inflation**. So, while index values offer a relative sense of how "hot" or "cold" a market is feeling at the moment, they can't necessarily tell you whether a market is too hot or too cold, or help you precisely predict when it's time to buy or sell into or out of them. The *"compared to what?"* factor is missing from the equation.

Models Are Approximate

There's an important difference between hard sciences like thermodynamics and market measures like indexes. On a thermometer, a degree is a degree. With market indexes, those points are based on an approximation of actual market performance — in other words, on a model.

A model is a fake copy of reality, with some copies rendered considerably better than others. Here's what Nobel Laureate Eugene Fama has said about them: "No model is ever strictly true. The real criterion should be: Do I know more about markets when I'm finished than I did when I started?"

According to Professor Fama's description of a model, indexes have long served as handy proxies to help us explore what is going on in particular slices of our capital markets. But, they also can do damage to your investment experience if you misinterpret what they mean.

Your Take-Home

For now, remember this: An index's popular appeal is the result of often-arbitrary group consensus that can reflect both rational reasoning and random behavioral bias. Structures vary, and accuracy is (at best) approximate. Even the most familiar indexes can contain some surprising structural secrets. In our next post, we'll unlock some of them for you.

Until next time, no regrets!

David Bromelkamp
President and CEO

FINANCIAL PLANNING TIP

Events That Should Trigger an Estate Plan Review

An out-of-date estate plan can sometimes result in unintended consequences and significant problems for surviving spouses and family members. A best practice is to review your estate plan with your financial advisor annually to see if there are planning opportunities that may benefit you based on changes to your life or situation. Beyond the annual review, below are seven key events that should cause you to review your plan to make sure it will still work for you.

Change in Marital or Relationship Status

Marital status. Marriage, separation, or divorce, and sometimes the death of a spouse may require changes to an estate plan. Removing a divorced or deceased spouse as a beneficiary is the most common change. Even a new girlfriend or boyfriend should trigger a discussion. For example, a divorced person might change a beneficiary to a new girlfriend or boyfriend, thereby disinheriting children and causing a great deal of family hurt. It is precisely because relationship changes can be so highly emotional that it is important to talk with an advisor before taking actions to make sure you are aware of the possible consequences.

Other Changes in Status

Financial status. The sale of a business, retirement, or receiving an inheritance can significantly change someone's financial picture. With more assets, taxes become much more important. Estate planning considers both types of taxes (income and estate) and the ways those taxes can be mitigated.

Moving to a different state. Moving from one state to another warrants a review of the estate plan to ensure it will work as expected under the laws of the new state. Going from a common law to a community property state (and visa-versa) may change how your estate plan works. Estate taxes vary from state to state also. Owning homes in multiple states should also trigger a review of how the properties are titled for probate-avoidance purposes.

Changes in charitable intentions. Many people put a bequest to a favorite charity in their will or trust or make the charity an IRA beneficiary. What happens down the road when the charity no longer exists or when one's charitable intention changes? It is wise to review charitable bequests every few years to make sure your intentions will be met.

Family Changes

Birth or death of a beneficiary or fiduciary. The birth of a child or grandchild often leads to education planning, the creation of gift trusts, and ILITS for life insurance proceeds. The death of a beneficiary may require updates to beneficiary designations. The death of a family member or friend named as a personal representative or successor trustee may result in the need to appoint someone else or to name a corporate trustee.

Family member health. A change to a family member's health or ability to care for themselves may mean you have an adult dependent. You will want to make sure the dependent is properly taken care of in the event of your passing.

Changes regarding beneficiaries or fiduciaries. Life changes may occur. For instance, has a parent, sibling or friend become too old or ill to serve as a trustee or fiduciary? Has a fiduciary (personal representative, guardian, or trustee) moved too far away to be able to serve, or have you and the fiduciary simply parted ways? Is the guardian named to care for minor children still the best choice? Does a beneficiary have a drug dependency or spending habit that causes concern? Has a child become a mature adult and should now serve as co-trustee, successor trustee or another fiduciary?

Every few years there are significant changes to the tax law that impact one's estate plan. Reviewing your plan at least annually will help allow you to take advantage of any new planning opportunities the law changes may require or provide.

Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

2022 Headlines

- Dave Bromelkamp, Eric Hutchens, Derek Van Calligan and Saul Baumann presented the webinar *"Cryptocurrency — What to Know as a Long-Term investor"* on January 25. In case you missed it, the webinar recording is posted on our website's events page.
- Allodium was pleased to welcome five new clients during the fourth quarter of 2021.
- Our office will be closed April 15 and May 30 for company holidays.

Note: To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

HEADLINES

Upcoming Events

April 21, 2022

Join Kate McBride and Allan Henriques as they present *15 Ways to Enhance Donor Trust by Improving Your Investment Stewardship* at an Allodium webinar for nonprofit leaders. Details will be coming soon.

May 24, 2022

David Bromelkamp will deliver a live webinar for Lorman Education Services called *Using Investment Policy Statements as an Investment Tool: It's an Art, Not a Science.*

June 7, 2022

Save the date for our Spring Wealth Management webinar. Watch for details coming soon.

EVENTS

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

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