Index Funds

What's inside my index fund?

ALEX
That's the mill from my retirement statement! Did my last paycheck help buy that truck?

SAM
Let's look at what you bought. What name is next to the dollar amount?



ALEX
The fund's name. The mill shows up one page later, under "holdings."

SAM
There you go. You own shares in the fund. The fund owns a little of the mill.



The morning flour delivery

The flour truck arrives just before the morning rush. Alex holds the bakery door while the driver wheels in six sacks. At lunch she spots the same company name on her fund's holdings list.

A list of rules becomes a fund

Index Funds

ALEX
If an index is a list, who decides what goes on it?

SAM
The index provider sets rules. Let's invent one for four neighborhood businesses.



ALEX
You gave the delivery company four blocks and the publisher only one. Why?

SAM
Our rule gives bigger companies more weight. An index fund buys holdings to track that mix. Some funds use a sample.



A fictional four-company index

Harbor Freightways · delivery	**40%**
Maple Mills · flour	**30%**
Orchard Tools · equipment	**20%**
Cedar Press · publishing	**10%**

What does a 30% weight mean?

Index Funds

ALEX
If I put $100 in our fund, how much of it moves with the mill?

SAM
The mill has three of our ten blocks. That's $30 out of your $100.



ALEX
So if the mill gains 10%, my piece gains $3. What if the publisher gains 10% instead?

SAM
Its piece starts at $10, so it gains $1. Same percentage move, different effect on your savings.



Suppose only Maple Mills rises 10%

Maple Mills before the rise	**$30**
Maple Mills after the rise	**$33**
The other three together	**$70**
Her fund holding, before fees	**$103**

Read a real fund fact sheet

Index Funds

ALEX
I found two funds with a hundred companies each. Are they equally spread out?

SAM
Look up the largest company in each. How much of each dollar goes there?



ALEX
Three cents here. Eighteen cents there. Now I know which fund would feel its bad day more.

SAM
And before you choose one, check the benchmark it follows and the annual fee. They’re right on the fact sheet.



Alex’s notes

Which index does it follow?	**Benchmark**
Which companies weigh the most?	**Top holdings**
What does it cost each year?	**Expense ratio**

Try it: which would move the fund more, a 5% fall in a 3% holding or in an 18% holding? The larger holding costs the fund about 0.90%, versus 0.15%.

Sources Index funds