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M Intelligence

Enhancing understanding of sophisticated planning strategies and their applications.

A Basic Overview of Stock Indexes

Stock Index Basics

Indexed universal life (IUL) insurance products continue to increase in popularity, as does interest in the underlying stock indexes used to generate an IUL policy's crediting rate. An index is a passively managed basket of investments that can consist of a variety of assets, including equity or debt securities. Each index is created with a different strategy in mind; some to provide a general performance overview of asset positions in a certain geographic region, while others are industry or even commodity specific.

Major Stock Indexes

While the number of indexes continues to grow, several commonly referenced indexes provide a proxy for the daily performance of financial markets. These indexes are typically comprised of a specified number of large, publicly traded companies in a certain geographic location or that trade on a specific stock exchange. The number of these assets or securities included in an index, and the methodology of asset selection, varies widely, making it important to understand the fundamental underlying assets within an index. The following matrix explains the structure of several indexes commonly included in IUL products.

Index	Constituent Assets	General Methodology	Weighting
S&P 500	500	Stocks chosen for market size, liquidity, and industry grouping, among other factors.	Market Capitalization
Dow Jones Industrial Average	30	Average of 30 actively traded blue-chip stocks, primarily industrials.	Price weighted; adjusted for splits and dividends
Russell 3000	3,000	Largest U.S. stocks accounting for 98% of the U.S. equity market.	Market Capitalization
Euro Stoxx 50	50	Large Cap companies from 12 Eurozone countries.	Market Capitalization
Wilshire 5000	3,000–7,500	All U.S. public companies' stocks actively traded in U.S. Markets.	Market Capitalization
Nikkei 225	225	Large Cap Tokyo Stock Exchange companies.	Price weighted by par value at specified rate
Hang Seng	50	Largest Hong Kong Stock Exchange companies.	Market Capitalization

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The matrix shows how the major indexes represent a wide spectrum of diversification between companies, geographic representation, and structure. Another important element to consider is the method by which an index weights holdings amongst the constituent assets.

Index Weighting Methodology

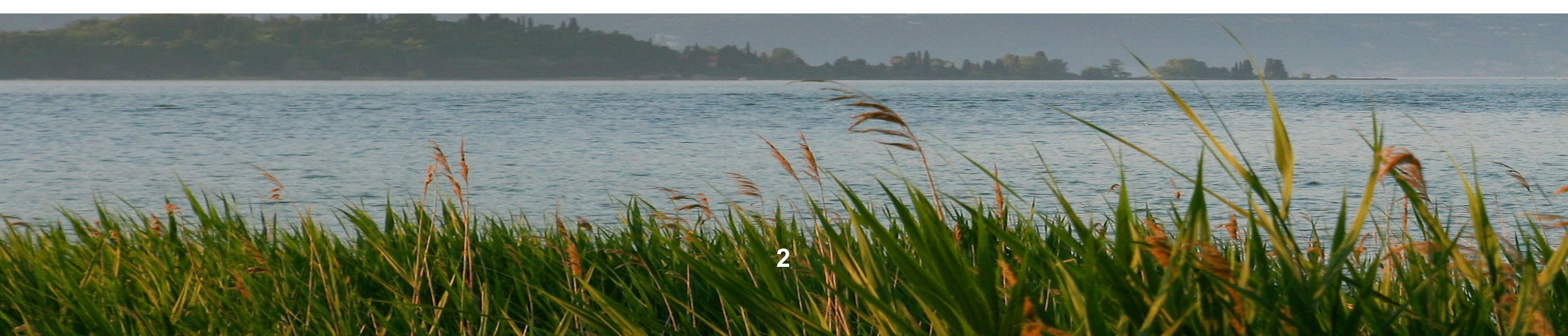
When reviewing an index, it is important to consider the index weighting, or the methodology by which an index allocates proportionate holdings of different assets. The most commonly used weighting methodologies take into consideration market capitalization, asset price, and/or other fundamental financial measures.

- Market capitalization is defined as the price of a security multiplied by the security's number of shares currently issued and outstanding. Therefore, a market capitalization index weighting means that the largest companies within the index comprise a disproportionate share of the overall holdings and performance of the index. This methodology is effective at translating momentum in market performance into index returns, but results in the index's performance being overly reliant on a few key companies.
- A price-weighted index is designed to allocate holdings within the index based on the price of the underlying asset. These indexes are therefore disproportionally reliant on assets with higher relative price, regardless of the number of shares outstanding. Many price-weighted indexes make adjustments based on stock splits and dividends, often employing more complex calculations to derive the ultimate index holdings.
- An index using the fundamental financial performance of a collection of assets for weighting purposes is a value-based approach that utilizes quantitative ratios—book value, sales, dividends, or earnings—to balance the holdings of the index among the constituent assets. This approach is less common as it requires more active investment management expertise than is typically utilized to manage an index.
- Finally, an equal weighted index removes the systematic overweighting and underweighting of the other index-weighting methodologies by holding assets in equal amounts regardless of market price, capitalization, and fundamentals. This type of index design is less responsive to changes in asset market prices and is less common.

Implications for IUL Purchasers

It is important to note that the purchaser of an IUL product is not directly purchasing a given stock index; rather, the IUL account is mirroring the performance of that index over a specified time period and applying a cap, floor, and participation rate to arrive at an IUL crediting rate. It is also important to remember that while many stock indexes include dividends in their performance calculations, IUL accounts typically do not. If a client seeks direct participation in the performance of a stock index, including dividends, funds that emulate several common indexes are frequently available in variable universal life (VUL) products.

Index mechanics have several implications for purchasers of IUL products. IUL products can provide downside protection and a potential reduction in investment risk, as compared to VUL products which invest directly in securities and transfer all investment risk from the insurance carrier to the policyowner. In order to select the appropriate IUL product, a policyowner should consider the nature of the index responsible for crediting the growth to the policy. This could include the geographic and market segment diversification, volatility rate, company size, and the index's weighting methodology.



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Variable life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and it entails risk, including the possible loss of principal.

Variable Universal Life insurance combines the protection and tax advantages of life insurance with the investment potential of a comprehensive selection of variable investment options. The insurance component provides death benefit coverage and the variable component gives you the flexibility to potentially increase the policy's cash value.

Securities offered through M Holdings Securities, Inc. a registered broker/dealer, member FINRA/SIPC.

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