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Index Funds Explained

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Summary:

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Article Body:

We have all heard of the familiar indices such as the Dow Jones Industrials or the S&P 500, but we don't necessarily know how they relate to us as investors.

An index in a book helps us find a particular topic or subject within a big book, and similarly an index of stocks helps us to sample a much larger group of stocks, and to learn about the entire subject by watching just a portion of it. The indices are basically just lists of particular stocks that meet certain guidelines or criteria for being included in the index.

For example, the stocks that make up the Dow Jones Industrials meet certain qualifications. They are stocks in industrial companies, and they are stocks that are traded on the Dow Jones. Furthermore, the creators of the index choose them because of the way they tend to represent the other stocks that fall into those categories. So when they choose index stocks, it is sort of like choosing a political representative who shares the views of the other people from his or her town or region. Because the stocks and their companies change over time, the indices are also changed. The Dow Jones index will usually add a new stock or two each year, and let others drop out of the index. In this way the most appropriate stocks are kept in the index, and then those who watch the changes in the index can get a general idea of the movement of the whole Dow Jones market of stocks.

One of the most interesting things about these indexed stocks is that you can purchase shares of the index, without having to go out and buy each individual stock in the entire index. Let's say that for instance you like Dow Jones stocks. You can buy an index fund that invests in the funds found in the Dow Jones index. If the stocks on average go up, so will your investment in the fund

that is tied to them. By buying the index you get diversity to protect you from losses and to help you take advantage of gains.

You can buy all sorts of index funds that participate in various types of stocks, because an index fund is sort of like a mutual fund that buys a particular type of stock. If you want to invest in the Japanese stock market or the London stock market, there are funds you can buy that are exclusively tailored for investors like you. And if you like transportation stocks, you can buy an index fund of transportation stocks. The same applies to stocks related to silver, gold, livestock, European currency, or a number of other different assets. There are even index funds to help you buy and sell based on the ups and downs of the market in options and futures.

To learn about index funds, and which ones might look like attractive investment vehicles for you, you can follow them in business newspapers. Or better yet, ask your local stockbrokerage firm to give you more information about index funds, and what sectors or areas of emphasis they participate in or target on behalf of their index fund stockholders.