Which Measure, Which Index? — Comparison Tables

Reading 3 has two big comparisons: money-weighted vs time-weighted returns, and the five index weighting methods. Most conceptual questions in this reading are answered by these two tables.

Money-Weighted vs Time-Weighted Return

Feature	Money-weighted return (MWR)	Time-weighted return (TWR)
Also called	Dollar-weighted return; IRR of the portfolio	Compound (geometric) growth rate of $1
Question answered	What did the **investor** earn?	How did the **investment / manager** perform?
Affected by timing and size of cash flows?	**Yes** — more weight to periods with more money	**No** — each period weighted equally
How to calculate	IRR of net cash flows (PV inflows = PV outflows)	Subperiod HPRs at each cash flow, linked, then annualized by years
Money added before a strong period	MWR higher than TWR	Unchanged
Money added before a weak period	MWR lower than TWR	Unchanged
Best used when	Manager **controls** cash flows (e.g. private equity)	Clients control cash flows (most funds) — preferred for evaluating managers
GIPS	Allowed when manager controls flows; closed-end; fixed life; committed capital; illiquid	Required by default
Practical Indian example	XIRR on your mutual fund / SIP statement	Scheme CAGR on the fund factsheet

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Index Weighting Methods Compared

Method	Weight based on	Who dominates	Matching portfolio	Divisor for splits?	Rebalancing need	Key drawback	Suitable for / examples
Price-weighted	Share price	Highest-priced stocks	Equal number of shares of each	**Adjusted**	Low	Price says nothing about company size	DJIA, Nikkei 225
Equal-weighted	Same for all	No one — equal vote	Equal value in each stock	Not applicable	**High** (frequent)	High transaction costs; small-cap tilt	Limiting large-cap exposure; Value Line, FT Ordinary
Market-cap-weighted	Price × shares outstanding	Largest companies	Proportional to market cap	**Not adjusted**	Automatic	Overweights possibly overvalued stocks	Passive strategies; S&P 500
Float-adjusted market cap	Price × shares available to investors	Largest investable companies	Proportional to float cap	Not adjusted	Automatic	Same as market cap	Nifty 50, Sensex
Fundamental-weighted	Earnings, dividends, cash flow, revenue, assets	Largest by fundamentals	Proportional to fundamentals	Not applicable	**High**	May exclude non-payers / loss-makers; sector bias	Value strategies; active managers (value tilt)

Same Stocks, Same Year, Three Answers

Method	Return	Why
Price-weighted	12.5%	Stock C has a high price ($34) and fell — it drags the index
Equal-weighted	13.5%	Simple average of the price changes: (27.3% + 25.0% - 11.8%) / 3
Market-cap-weighted	18.13%	Stock B is about 75% of total market cap and rose 25%

Maintenance	What changes	Who needs it most	Market effect
Rebalancing	**Weights** back to target (usually quarterly)	Equal- and fundamental-weighted indexes	Sells winners, buys losers — contrary to trend-following
Reconstitution	**Members** added or deleted	All indexes (criteria, bankruptcy, delisting, maturity)	Added stocks tend to rise; deleted stocks tend to fall

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