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CAMBRIDGE ASSOCIATES LLC

EUROPEAN MARKET COMMENT

THE ALL-SHARE GROWS MORE CONCENTRATED

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The All-Share Grows More Concentrated

The Royal Dutch/Shell merger will create the world's third-largest listed oil company by market capitalization and make the already top-heavy FTSE indices even more concentrated. The marriage, scheduled to take place in July, will expand Shell's market-cap weighting in the All-Share from 3.2% to 7.8%, and in the FTSE 100 from 3.8% to 9.4%, according to our estimates. The merger will also increase the weighting of the resources economic group from 17.3% to 21.9%, thereby supplanting non-cyclical consumer goods as the All-Share's second largest economic group. This does not take into account the redistribution of market caps to the index and resources sector.

The U.K. market is already dominated by a few shares and sectors. Within the All-Share, the three largest constituents[1] currently represent 21.2% of its market cap. The Royal Dutch/Shell union will push this figure up to 22.8%, substantially higher than its post-1986 average of 15.1% (Table A). Among the largest 100 companies, the merger will expand the market-cap share of the three largest companies from 25.4% to 27.4%. This degree of concentration will not be not unprecedented, however. While it will be higher than its 105-year average of 21.1%, the three largest companies made up a *higher* market share during the early 1900s, 1920s to 1930s, and late 1970s to early 1980s. In fact, since 1900 there have been 25 years when the three largest companies accounted for more than 25.4% (or 23.8% of the time) of the 100 largest companies.

The merger will also magnify the sector concentration of the All-Share. The three largest economic groups in the All-Share currently represent a combined market cap of 63.0%, which is substantially higher than the post-1986 average of 59.1%, and the union will increase the cohort's weight to 67.7% (Table B).

The FTSE indices have been growing increasingly concentrated since the late 1990s and early 2000-01, a trend that was punctuated by Vodafone's takeover of telecom rival Mannesman in 2000. The merged Vodafone/Mannesmann made up a full 14.8% of the market cap of the FTSE 100 and 12.0% of the All-Share. Although among the largest 100 companies this level of concentration had been breached two times before (1935 and 1936), the Vodafone/Mannesmann merger represented the first time a single holding made up such a large percentage of the standard market indices since adoption of passive, index-fund investing. European law prohibits unit trusts from holding more than 10% of their portfolio in a single stock. After the Vodafone merger, U.K.'s Financial Services Authority was forced to issue waivers allowing unit trust mangers to own index weight of Vodafone in tracker funds or in actively managed accounts explicitly designed to shadow these indices. Since Royal Dutch/Shell will represent less than 10% of the index's market cap, investors will not need this type of waiver—at least for now.

The mounting concentration of the FTSE indices suggests its risk is higher, since performance will increasingly depend on the most dominant companies. Therefore, investors obtaining their U.K. equity exposure through index funds, exchange-traded funds, and benchmark sensitive managers are exposed to a higher degree of risk than in the past. In order to allay concerns about the growing domination of a few

[1] The single largest constituent will remain BP, with an 8.2% share of market cap in the All-Share. With the merger, Shell's relative position will jump from sixth to second.

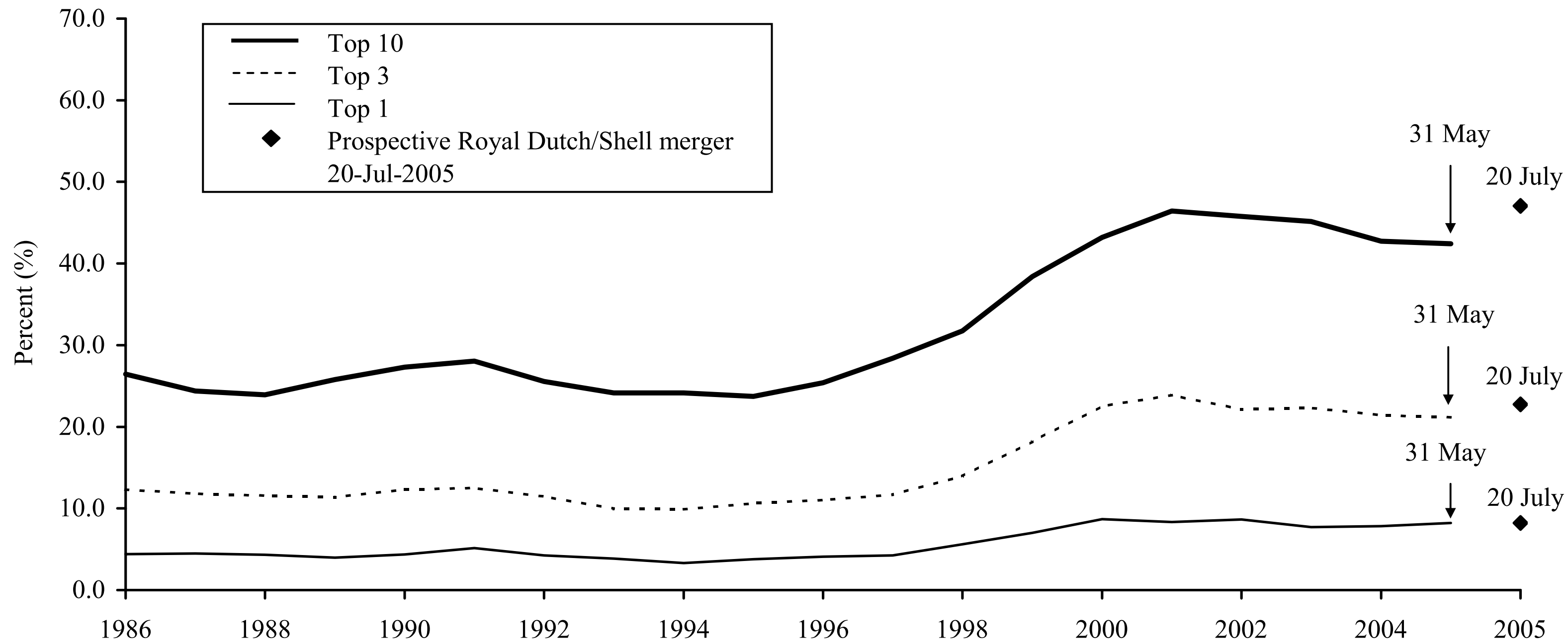
companies, on June 20, 2005, FTSE introduced capped versions of FTSE 100 and All-Share that limit the weight of an individual stock to 5% of the index. The constituents will be the same as those in the standard FTSE 100 and All-Share indices, but weightings will be capped back to 5%. The All-Share is also available capped at 4%. Currently, there are four constituents, excluding Shell, in All-Share that sport a market cap greater than 5% and 4%. Investors should be aware that while these capped indices do reduce the concentration of the indices, they do so at the expense of creating tracking error, as they do not capture the entire opportunity set of equities.

We cannot help but wonder what the merger portends for the world's third largest listed oil company, as well as for the overall market. In retrospect, the timing of the Vodafone/Mannesmann union could not have been much worse for shareholders: it occurred in February 2000, only weeks before the market peaked, and over the following year its share price halved, posting a -46.9% return, compared to only -2.9% and -1.9% returns for the FTSE 100 and All-Share over the same period, respectively. The non-cyclical services economic group, which contains the telecommunications sector, posted a -43.9% return over the 12 months following the merger. Vodafone's market cap in the All-Share has subsequently shrunk to 6.2%.

Table A

CONCENTRATION OF THE TOP COMPANIES IN THE FTSE ALL-SHARE

1986-2005



	Average	Current (%)	Post-Merger (%)
Top 10	32.2	42.4	47.0
Top 3	15.1	21.2	22.8
Top 1	5.6	8.2	8.2

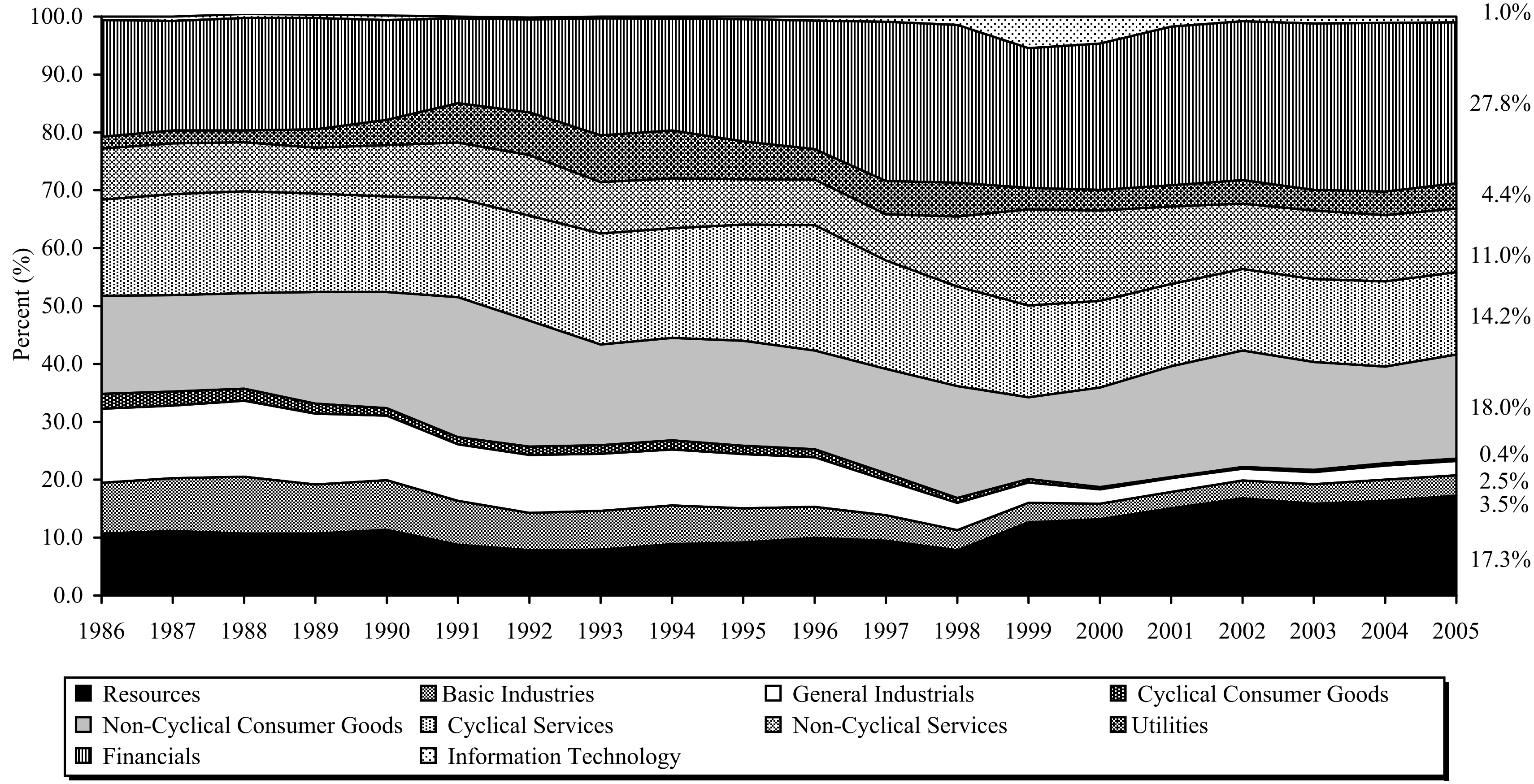
Sources: Factset and FTSE International Limited.

Notes: Data for 2005 are through 31 May. July data refer to the prospective merger of Royal Dutch and Shell Transport and Trading Co. and predictions are based upon current prices.

Table B

FTSE ALL-SHARE ECONOMIC GROUP BREAKDOWN

31 December 1986 - 31 May 2005



Sources: Factset and FTSE International Limited.

Notes: Data are as of year-end. Data for 2005 are as of 31 May.