



C A M B R I D G E A S S O C I A T E S L L C

EUROPEAN MARKET COMMENT: FTSE FREE FLOAT

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FTSE Free Float

In June, FTSE restructured their indexes to reflect the constituent companies' available share capital, as opposed to full market capitalisation, to better represent the investable universe. The reweighted indexes reflect the constituent companies' free float thereby excluding cross-holdings, long-term holdings by founders/directors or families thereof, government holdings, foreign ownership limits, and (restricted) employee share schemes.

FTSE adopted a banding system to achieve balance between capturing only the investable universe through free-float weighting and minimising turnover costs. The table below shows that the banding system is relatively narrow for companies that have a relatively low percentage of tradable capital and is wide for companies with more than half of capital available for trade. The bands are structured in this manner to limit shifts in index weightings of large companies to significant corporate events.

Table A

Percentage of Shares Available for Free Float	Free Float Band: Percentage of Shares Used in Calculating Constituent Weighting
<5%	Excluded from FTSE indexes
>5% to 15%	Actual
>15% to 20%	20%
>20% to 30%	30%
>30% to 40%	40%
>40% to 50%	50%
>50% to 75%	75%
>75%	100%

Overall, the impact of the change to the FTSE All-Share Index was relatively minor, with total market capitalisation falling by 2.3%, compared to the market capitalisation of the FTSE Europe ex U.K. Index, which fell by 12.4% because major founder and family holdings remain commonplace on the Continent. In looking at the effect on turnover (buys + sells), Goldman Sachs estimated 4.1% for the All-Share, the majority of which is intra-FTSE 100, and 18.8% for the FTSE Europe ex U.K. Index.

The effect on the weightings of the economic groups of the All-Share also was minimal. Table B shows that the largest increase in weighting took place in the financial sector (+0.4%) that did not suffer from reductions due to the shift to free-float weights, whereas the cyclical services sector lost out (-

0.6%) with BSkyB feeling the pinch. News Corporation holds a 36% controlling stake of BSkyB and Vivendi owns a further 22%, and therefore BSkyB was given only a 50% free-float weight in the index, and subsequently went from being the 21st largest to the 43rd largest constituent of the FTSE All-Share Index.

Given that the majority of the largest companies in the FTSE All-Share Index are classified in the 100% free-float band, the downward adjustments of smaller companies have increased the concentration of the index slightly. The top ten weight gainers are the ten largest market-cap stocks in the index. As can be seen in Table C, the largest 20 companies accounted for 56.4% of the All-Share at close on June 15, 2001, whereas post free-float adjustment, they represented 57.3%.

The market has dictated that free-float is the index construction methodology of choice and every major index provider seems to be implementing free-float weightings in their indexes. MSCI will implement stage one of their free float adjustment at the end of November, and most of the largest FTSE flows will be in the same direction as those of MSCI. Any differences will be due primarily to the distinct free-float adjusting systems, with the FTSE system resulting in slightly less turnover than that of MSCI. For example, take company X that has no foreign ownership limits and a 77% free float. According to MSCI's banding system,¹ the company would be classified with an 80% free float, yet the company is classified as a 100% free float using the FTSE methodology.

The largest stocks in the FTSE All-Share Index, which retain their 100% market-cap weighting, should receive the largest performance boost as the increase in their index weighting has resulted in the need for passive fund managers benchmarked to this index to increase their exposures to these stocks. Goldman Sachs estimates that approximately \$225 billion, or 9.5% of the index market capitalisation, is held by passive managers. In addition, companies that will be added to the MSCI indexes as they increase their market coverage from 60% to 85%, such as Shell T&T and Royal Sun Alliance, will get a performance boost relative to their peers over the coming 12 months, as passive fund managers benchmarked against MSCI indexes will be obliged to buy them.

Globally, it is apparent that the free-float adjustment of FTSE indexes is a lot different in scale than the MSCI adjustments. Goldman Sachs estimates that nearly \$400 billion is passively tracked against various portions of the MSCI World indexes, compared to \$90 billion against FTSE World indexes excluding the \$225 billion passively managed against the FTSE All-Share Index. To FTSE's credit, they had made

¹ For stocks not subject to foreign ownership limits, and having a free-float greater than 15%, the constituent weighting is the estimated free float rounded up to the closest 5%.

available indicative free-float weightings months before the change to lessen any sudden market impact of affected stocks, which partially offset the fact that the changes were implemented on one day. Few of the changes created more than two days of significant increases in trading volume from passive fund managers.

Table B**U.K. EQUITY ECONOMIC GROUP ALLOCATIONS
FOR THE FTSE ALL-SHARE INDEX****Sterling (£)**

	As of 15 June 2001	As of 18 June 2001
<u>Economic Group</u>	<u>Percent of Index (%)</u>	<u>Percent of Index (%)</u>
Basic Industries	2.7	2.7
Cyclical Consumer Goods	0.4	0.4
Cyclical Services	14.1	13.5
Financials	25.9	26.3
General Industrials	2.6	2.7
Information Technology	2.5	2.5
Non-Cyclical Consumer Goods	19.1	19.2
Non-Cyclical Services	12.9	12.6
Resources	16.1	16.3
Utilities	3.8	3.9
FTSE All-Share	100.0	100.0

Source: FTSE International.

Note: Percentages may not total due to rounding.

Table C

**U.K. EQUITY INDEX ALLOCATIONS
FOR THE FTSE ALL-SHARE INDEX**

Sterling (£)

<u>Index</u>	As of 15 June 2001	As of 18 June 2001
	Percent of <u>All-Share Index (%)</u>	Percent of <u>All-Share Index (%)</u>
Top 20	56.4	57.3
FTSE 100	83.4	83.9
FTSE 250	12.8	12.5
FTSE SmallCap	3.8	3.6
FTSE All-Share	100.0	100.0

Source: FTSE International.

Notes: Percentages may not total due to rounding. Figures for the Top 20 represent the 20 largest companies ranked by market capitalization in the FTSE All-Share.