|  |  |
| --- | --- |
| Memorandum |  |
|  |  |
| **To:** | Market Participants |
| **From:**  | Indices Department  |
| **Date:** | 17 October 2011 |
| **Title:**  | **JSE Market Consultation on down weighting FTSE/JSE Shareholder Weighted indices (SWIX) constituents.** |
|  |  |
|  |  |

**Introduction**

The Shareholder-weighted (SWIX) indices currently adjust the free float of all dual listed constituents by excluding foreign holdings. Only dual listed companies are down weighted due to a limitation of data availability when the index was originally constructed. The data on the foreign / local shareholder split is now available for all JSE listed companies. Therefore, FTSE/JSE proposes that the index methodology be changed to down-weight all constituents according to their foreign holdings. The proposed change aligns the SWIX indices closer to the original goal of considering only the locally held free float for all index constituents.

The FTSE/JSE Advisory Committee (AC) is in principle happy with the change. However, FTSE/JSE would appreciate your feedback on the suggested change. All responses and input from the market will be considered.

**Background**

The two SWIX indices, FTSE/JSE SWIX All Share (J403) and FTSE/JSE SWIX Top 40 (J400), were launched on 1 July 2003 following market demand for indices with an adjusted constituent weighting to exclude foreign holdings. At the time, a small number of companies constituted a large portion of the existing indices by weight, causing concerns in the areas of legislative compliance and risk management, among others. The problem was compounded by a perceived overweighting in Resource stocks, which appeared to be held preferentially by foreign investors, particularly through dual listings. As a result, the SWIX indices were developed with the purpose of providing a more accurate reflection of local investor holdings and therefore a more reflective benchmark for the South African investor.

At that stage, the shareholder breakdown available from STRATE was only for dual listed companies, and it was decided to launch the index with weight adjustments for dual listed stocks only. This was intended as an interim measure, as can be seen in an extract from the Ground Rule below.

*Each index will follow the construction of the existing FTSE/JSE All-Share index with regards to constituents, but additionally certain constituents’ weights will be further adjusted for non South African shareholdings. The goal is to eventually down weight (exclude) all foreign free float holdings. Therefore the free float figure of a company in the index will be adjusted to reflect only the locally held free float. Due to the fact that this data on foreign free float holding is not readily available, the shareholder weighting adjustment will commence with dual listed companies only. A dual listed company, in this context is one, which has a listing (secondary and primary) on any foreign index.*

STRATE has been providing the JSE with the above data on a monthly basis since December 2008. Initially, the data has been for dual listed companies only, but more recently STRATE has been providing data for all companies.

**Sector Weighting Change**

By applying the adjustment of foreign holdings in the SWIX 40 Index to all index constituents, the S.A. sector weight changes for the past four quarters are observed in Table 1 below.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |   |   |   |   |   |   |   |   |   |   |
|  |   |   | **ALSI Top 40 (J200)** |  | **Current SWIX Top 40 (J400)** |  | **SWIXTop 40 - All Down Weighted** |
|  |   |   | **# Instruments** | **% Wght** |   | **# Down Wght** | **% Wght** |   | **# Down Wght** | **% Wght** |
|  | **Sep-10** | Financials | 13 | 19.70% |   | 5 | 25.75% |   | 8 | 27.87% |
|  | Industrials | 18 | 35.85% |   | 4 | 43.03% |   | 12 | 37.12% |
|  | Resources | 11 | 44.45% |   | 8 | 31.23% |   | 8 | 35.00% |
|  |   | **TOTAL** | **42** |  |  | **17** |  |  | **28** |  |
|  |
|  | **Dec-10** | Financials | 13 | 17.93% |   | 5 | 24.04% |   | 8 | 26.55% |
|  | Industrials | 18 | 35.92% |   | 4 | 43.21% |   | 12 | 36.71% |
|  | Resources | 11 | 46.15% |   | 8 | 32.76% |   | 8 | 36.74% |
|  |   | **TOTAL** | **42** |  |  | **17** |  |  | **28** |  |
|  |
|  | **Mar-11** | Financials | 13 | 16.91% |   | 5 | 23.29% |   | 8 | 25.12% |
|  | Industrials | 18 | 35.05% |   | 4 | 42.36% |   | 13 | 36.50% |
|  | Resources | 11 | 48.04% |   | 8 | 34.34% |   | 8 | 38.39% |
|  |   | **TOTAL** | **42** |  |  | **17** |  |  | **29** |  |
|  | **Jun-11** | Financials | 13 | 17.25% |   | 5 | 23.50% |   | 8 | 25.73% |
|  | Industrials | 18 | 37.42% |   | 5 | 44.33% |   | 12 | 38.07% |
|  | Resources | 11 | 45.33% |   | 8 | 32.18% |   | 8 | 36.20% |
|  |   | **TOTAL** | **42** |  |  | **18** |  |  | **28** |  |

 Table 1: S.A Sector weight changes in the SWIX 40 Index (J400)

Looking at the data for June 2011 in table 1 above, SWIX 40 consists of 42 instruments with Investec and Mondi having two instruments. Using the current methodology of adjusting for only dual listed companies, 18 companies are adjusted for foreign holdings. However, when all companies are adjusted for foreign holdings, an additional 10 companies are impacted, thus setting the total adjustment to 28 companies. More details about the changes can be found in Appendix A.

**Conclusion**

The amended SWIX methodology will provide a more accurate reflection of the market it seeks to benchmark. Down-weighting all the constituents in the index will ensure that the primary index purpose is better realized and that a consistent methodology is applied to all constituents. This is not a change to the overall philosophy of the index, but an enhancement of the existing index.

**Responding to the consultation**

# It is important to FTSE/JSE to be aware of any unintended consequences of the change and the impact on clients. Therefore, FTSE/JSE would appreciate comments on the proposed change and its possible impact, particularly on traded products. All feedback received will be presented at the December 2011 FTSE/JSE Advisory Committee Meeting, followed by a public announcement on the final decision.

# This document is not confidential and should be distributed as widely as possible to all stakeholders.

Please provide us with your comments and suggestions by **Friday, 17 November 2011** to the following email address: indices@jse.co.za

**Appendix A**

Table 2 below detailed the 10 non-dual listed constituents in the SWIX Top 40 index that will be affected by the proposed change based on June 2011 data.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Instrument Name** | **Sector** | **SWIX FF** | **New SWIXFF** | **Wgt SWIX**  | **New SWIX Wgt**  |  **Wgt Change** |
| MTN Group | IND | 100 | 75 | 12.17% | 9.90% | -2.28% |
| Truworths International | IND | 100 | 40 | 1.61% | 0.70% | -0.91% |
| Shoprite | IND | 100 | 75 | 2.66% | 2.16% | -0.50% |
| Vodacom Group | IND | 30 | 20 | 1.80% | 1.30% | -0.50% |
| Sanlam | FIN | 100 | 75 | 2.53% | 2.06% | -0.47% |
| Bidvest Group | IND | 100 | 75 | 2.24% | 1.82% | -0.42% |
| Absa Group | FIN | 50 | 40 | 2.24% | 1.94% | -0.30% |
| Steinhoff International  | IND | 100 | 75 | 1.57% | 1.27% | -0.29% |
| African Bank Invest | FIN | 100 | 75 | 1.23% | 1.00% | -0.23% |
| ArcelorMittal S.A | IND | 50 | 40 | 0.61% | 0.53% | -0.08% |

Table 2: Non-dual listed SWIX 40 constituents.

The biggest weighting change is MTN with -2.28%. The rest of the change is not significant as seen from table 2 above.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|   |   | **All Share (J203)** |  | **Current SWIX All-Share (J403)**  |  | **SWIX ALSI - All Down Weighted** |
|   |   | **# Stocks** | **% Wght** |   | **# Down Wght** | **% Wght** |   | **# Down Wght** | **% Wght** |
| **Sep-10** | Financials | 40  | 20.31% |   | 5 | 25.51% |   | 9 | 27.69% |
| Industrials | 104  | 41.69% |   | 9 | 49.41% |   | 33 | 44.68% |
| Resources | 21  | 38.00% |   | 9 | 25.08% |   | 10 | 27.63% |
|   | **Total** | **165** |  |  | **23** |  |  | **52** |  |
| **Dec-10** | Financials |  40 | 18.69% |   | 5 | 23.89% |   | 9 | 26.36% |
| Industrials |  105 | 41.78% |   | 9 | 49.97% |   | 30 | 44.84% |
| Resources | 21  | 39.53% |   | 9 | 26.14% |   | 10 | 28.80% |
|   | **Total** | **166** |  |  | **23** |  |  | **49** |  |
| **Mar-11** | Financials |  42 | 18.30% |   | 5 | 24.11% |   | 9 | 26.03% |
| Industrials | 100  | 40.09% |   | 8 | 48.12% |   | 30 | 43.44% |
| Resources |  21 | 41.61% |   | 9 | 27.77% |   | 11 | 30.53% |
|   | **Total** | **163** |  |  | **22** |  |  | **50** |  |
| **Jun-11** | Financials | 46  | 18.98% |   | 6 | 24.75% |   | 10 | 27.05% |
| Industrials | 96  | 41.89% |   | 9 | 49.19% |   | 31 | 44.09% |
| Resources |  22 | 39.13% |   | 9 | 26.06% |   | 10 | 28.87% |
|   | **Total** | **164** |  |  | **24** |  |  | **51** |  |

 Table 3: S.A Sector weight changes in the SWIX All-Share (J403)

In the SWIX All Share index, the biggest 3 companies that would be affected by the change are MTN with an change of -1.88%, Truworths International with -0.17% and Shoprite with change of -0.41%.