

The FTSE 100 – what does it all mean?

We all hear about the FTSE 100 every day on the news, and read about it in the papers – but what exactly is the FTSE 100? What does the figure we see quoted every day actually mean, and why should we be interested? FTSE Group's Imogen Dillon Hatcher explains what lies behind this household name.



Simply, but with a few exceptions, the FTSE 100 is an index composed of the 100 largest companies listed on the London Stock Exchange (LSE). These are often referred to as 'blue chip' companies, and the index is seen traditionally as a good indication of the performance of major companies listed in the UK.

The FTSE 100 gets its name from FTSE – the company which calculates the index, and the fact that it contains 100 companies. FTSE is actually FTSE Group, and is 50/50 owned by the Financial Times and the London Stock Exchange (hence FTSE - FT and SE). Although the FTSE 100 is the most famous index the company produces, FTSE Group also

calculates over 100,000 other indices, covering markets around the world, every day.

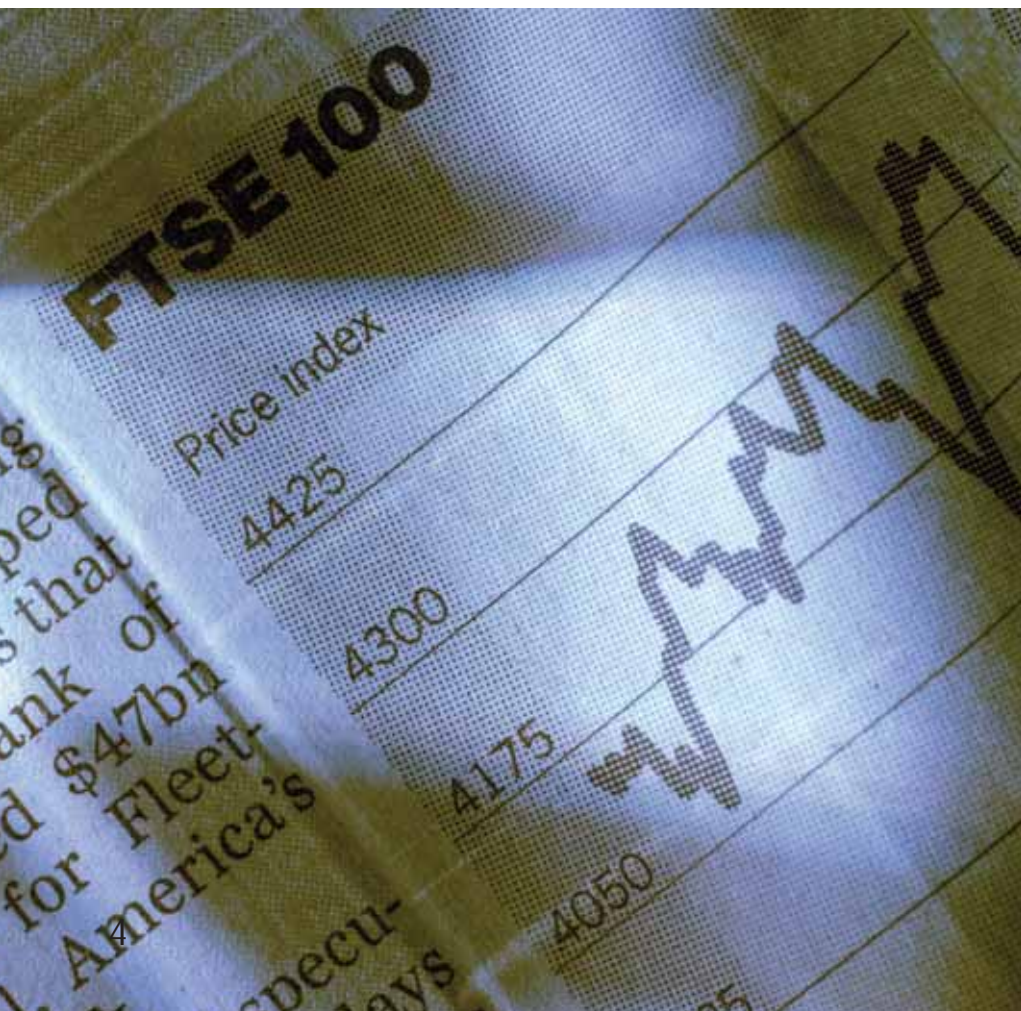
In the UK market, the other FTSE UK indices include the FTSE 250 (the next 250 largest companies after the FTSE 100) and the FTSE SmallCap (the companies smaller than those). The FTSE 100 and FTSE 250 together make up the FTSE 350; add in the FTSE SmallCap and you get the FTSE All-Share.

The FTSE 100 was launched on 3 January 1984 and had a start value of 1,000.0. Since then the make-up of the index has changed almost beyond recognition - mergers, takeovers and disappearing companies have all meant the index only has 21 of the original constituents left in it – underlining the index's purpose of acting as a barometer of market activity. A fair number of constituents have changed their names too – remember Midland Bank (HSBC), Commercial Union Assurance (Aviva), Reckitt & Colman (Reckitt Benckiser) and British Gas (now BG Group and Centrica).

Ins and Outs

Of course, the index must be changed to make sure it still reflects the top 100 companies listed on the LSE – if it wasn't, we would still have an index containing companies such as Trafalgar House and Rowntree Mackintosh. These changes happen once a quarter, although if there are takeovers or mergers in between these times affecting companies in the FTSE 100, the index will be changed accordingly.

The process for reviewing the index is straightforward – all companies listed on the LSE and eligible for the FTSE UK indices are ranked in order of their size, or market capitalisation (calculated by



multiplying the number of issued shares of a company and the current share price).

A committee, made up of independent market experts meets in March, June, September and December and considers which companies should be allowed into the FTSE 100. Simply, if a company is in the FTSE 250 and climbs into the top 90 companies, it can enter the FTSE 100. If a FTSE 100 company falls to 111th position or below in the rankings, it will fall into the FTSE 250. So it is not just a case of picking the largest 100 companies and drawing a line – a banding system is in place.

These 'bands' exist so there are not too many changes at each review – the index needs to be kept fairly stable for investors not to have excessive and expensive changes to make to their portfolios. On some occasions, no changes to the FTSE 100 have been made at a review, but during the dot com boom, market activity meant that large numbers of companies could enter and leave the index when

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changes were made. The changes made at each quarterly review are often covered by market reporters in the business sections of the national press.

Ups and downs

The figure seen on the evening news is, in fact, the closing value of the FTSE 100. The index is actually calculated every 15 seconds on every week day (excluding UK public holidays), from 8 in the morning (market opening) until 4.30 in the afternoon (market close).

The level of the FTSE 100 affects most people in the UK even if they don't directly invest for themselves: as pension fund holders whose investments are probably invested in UK equities, how well the index is performing directly affects the return they will receive.

The FTSE 100 is also a pretty good reflection of economic and international events – often it will tumble in response to markets falling around the world, for example the recent dip which occurred when the markets fell in China. The largest one-day percentage fall was on 20 October 1987 at 12.22%; this was the day following 'Black Monday'. The largest one-day points fall was on September 11, 2001 when the index fell by 287.7 points.

The rapid boom in technology companies during the late 1990s pushed the FTSE 100 to its all time closing high on 30th

At a glance

Started in Jan 1984.

Measures the total value of the top 100 companies.

Provides a barometer of the UK's economy.

Companies promoted and relegated quarterly.

Highest point
6930.2 – 30 Dec '99;
Lowest point
978.7 – 12 July '84.

December 1999, of 6930.2. The record closing low of the index was on 12th July 1984 when it fell to 978.7.

There has only been one day when the FTSE 100 was not calculated – Friday 16 October 1987, the day following the hurricane that brought chaos to London and the Southern half of England. The index did not operate as not enough market practitioners made it in to work to open share prices on the London Stock Exchange trading system!

The level of the FTSE 100 is calculated using the total market capitalisation of the constituent companies, and the index value, to produces the single figure you see quoted. Because the total market capitalisation is affected by the individual share prices of the companies, as share prices change throughout the day, so the index value changes. When the FTSE 100 is 'up' or 'down' the change is being quoted against the previous day's close.

And as this chart graphically illustrates, the index has grown significantly over its 23 years. When the index was launched, the total market capitalisation of the companies was just over £100 billion, now it is £1.6 trillion – over 15 times larger. Now, if only you'd been holding the FTSE 100 ishare over that time ...

