

**MANAGEMENT DISCUSSION SECTION****Company Representative**

Welcome to Financial Research Perspectives with FactSet. Today, we're joined by Andy Harvell, Head of Quantitative Indices at FTSE Group. Today, we are continuing a conversation that we began last week with Andy Harvell. This week, we'll be looking at a sector-by-sector outlook for the U.K. market. And the possibility that there is cap bias in the major U.K. indices, as well as addressing the performance of the U.K. markets on a granular level. So, Andy, the first thing I wanted to talk to you about today was the sector and industry performance in the U.K. market. Can you give us a little overview of that?

**Andy Harvell, Director of Quantitative Indices, FTSE Group**

Well, obviously, over the 12 months, it has been a very bumpy time for the U.K. and the investors have suffered quite a large fall. But I'm glad to say now things appear to be recovering a bit. We've seen some really large gains over the last 12 months, for example, in the industrial metals sector, technology, hardware, and equipment. But we've obviously seen big falls in banks and real estate as the financial were obviously hit quite hard. But we're also finding that utilities haven't done very well like the fixed-line telecoms, electricity, gas, water. They haven't performed very well. But if you look at the last quarter, for example, banks returned 39%, which is fantastic return, and I personally don't actually remember it being that high previously. Leisure goods were up 52% and even industrial engineers were up 45%, so we've seen a really good turnaround.

In the shorter term over the last month, we've had good returns from food price sectors, but industrial metals have fallen. Fixed-line telecoms have continued falling. Banks have been up a small amount, so that's good, and real estate has fallen a bit further. So we're seeing a bit of a sector bias coming through here. Oil and gas has done extremely well again, and given the fact that the oil price has declined quite a lot over the last year, but we're seeing recent increases, that's helping out all the oil producers.

We've seen small falls in construction and materials, which again is a bit of an economic indicator, because the construction industry is in a bit of doldrums around here in the U.K. We're seeing life assurance has actually bounced back. Well, life assurance is quite a good barometer of the actual U.K. market as a whole, because if share prices are rising, then the life insurance company investments tend to rise in line with the market, so that's positive for them.

Overall, we've seen the FTSE 100 up just under 21% over the last quarter which is the biggest ever rise it's had in one quarter. And the Small Cap index did even better, up 29%. And over the last month, we've seen the FTSE 100 up 4.6%, so continuing the rise. And FTSE 250s, the smaller cap indices as well doing extremely well, with the All-Share being up 21% over the quarter and up 6% over the last 12 months. So it's actually starting to regain some ground after all its recent falls.

**Company Representative**

You mentioned about the possibility of a sector bias developing. Is that something that we're also seeing in terms of a cap bias, such as is there a bias towards large, mid, or small caps in this market?

**Andy Harvell, Director of Quantitative Indices, FTSE Group**

At the moment, it seems to be the small caps again that seem to be doing the best. I think one of the reasons for that probably is because companies within the FTSE 100, the banks, for example, which were – had a huge weighting, for example, at the end of 2008, and banks accounted for 11.9% of the All-Share, they've increased now to 16.8. But they had been higher. They had -- at one point in 2006, they were 21% of the All-Share. We've seen oil and gas increasing as well.

Going back to the banks, one of the issues with the banks is the way that the FTSE Indices work where they are free float adjusted, with the government taking controlling stakes, that actually means that, that controlling stake isn't available for investment. So that reduces the weight of the company within the actual index itself. So effectively, what happens is that the sector weight will reduce in line with the decline in index market cap for the banks, taking account of the government's share in those companies.

Now, that's one of the reasons why it's in investor's interest that the government holdings are disposed of quickly is because obviously their weightings increase in the index and the stock becomes much more easily tradable, and hopefully they'll return to their own control rather than having government interference all the time.

**Company Representative**

You mentioned the over-performance of banks and a couple other interesting sectors. Would you say that you would pick among those sectors, one that's had a particularly good recovery and by contrast a particularly bad recovery in terms of the sectors?

**Andy Harvell, Director of Quantitative Indices, FTSE Group**

Well, it depends on you're looking at the short-term or longer-term. If we said we looked over a year, then banks haven't done very well. They're down just under 16%, whereas conversely, if you look, industrial metals are up just over 51% and technology, hardware and equipment is up just under 60%. So there is a bit of a theme there. If you're staying out of financials longer term, you tend to have been fairly – done fairly well.

Saying that though, general industrials have obviously been hit, so has the automotive industry. They've been hit quite hard by the lack of credit facilities, which has driven quite a few of the engineering companies to the wall and some of the automotive companies that have either closed production or put production on hold for large periods of time, so that hasn't helped any of the component suppliers or anything.

Looking at the quarterly performances, where we've seen a bit of a bounce back. We've had forestry and paper that have done very well. We've had leisure goods that have done very well. The banks have done well. And technology, hardware, and equipment has – that sector has done well, and real estate and life assurance have bounced back.

Some of the sectors that have performed not very well over 12 months will actually start to pick up again now. A classic example is general industrials. They were up just under 25% on the quarter. And electronic and electrical equipment was up just under 27%. And basically, over the longer term, general industrials is down just under 10%, and electronic and electrical equipment is down just under 8%. So we are now seeing a bit of a bounce back.

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**Company Representative**

You've obviously talked a lot about the way the that things have shifted in the last 12 months, but I also wanted to look at a longer-term perspective both from the idea of maybe the past few years in terms of sector performance, as well as in terms of weightings in the FTSE 100.

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**Andy Harvell, Director of Quantitative Indices, FTSE Group**

Okay. That's quite an interesting point. I did a quick bit of studying on some historic data and going back to 1995, banks accounted for 12% of the All-Share index; industrials were 10%; and oil and gas was 10%. Now, if we looked at it now, banks are 16.8%; industrials have fallen back to 4.2, and oil and gas is 20.5. So we're now seeing that banks again, as a large sector, were larger, and oil and gas has now come up to be one of the most dominant sectors, whereas we've had a decline in engineering and industrial.

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**Company Representative**

All right. Andy, is there anything else you'd like to add today?

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**Andy Harvell, Director of Quantitative Indices, FTSE Group**

Actually, one of the things I did want to mention actually is the weight of the FTSE 100 in the All-Share. In 1995, it was 71% and now it's 86%. So we've seen a size bias, i.e., the FTSE 100 is getting bigger. In fact, the top 10 companies in the All-Share Index account for about 50% of the market cap, so there is quite a large concentration bias now. Interestingly, from the lows, the FTSE 100 at the end of September was up 46%; the 250 was up just under 67%; the Small Cap was up 78%; and the All-Share overall up just under 48%. So pretty good recoveries, but you would say, from a low base.

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**Company Representative**

It's showing that it's gotten back a lot of what it lost, got you a little bit closer to what we were before, I mean, obviously not on a total basis but in some regard.

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**Andy Harvell, Director of Quantitative Indices, FTSE Group**

Yeah. And what we've seen really is the fact that over the last three months, all the – what we call the size indices within the U.K. have actually had positive returns. So a whole quarter of positive returns, whereas prior to that, you had mixed quarters basically.

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**Company Representative**

What are some of the size indices that have experienced some of the greatest returns or some of the best returns?

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Small – Small Cap has done fairly well. They've been the best performer over the last two months. And in April, it was the best performing index. It was up just under 26%, whereas this was really the major turning point in the market I think, because at the end of April, in that month, the FTSE 100 was up 8%, the 250 was up 18% and the Small Cap, as I said, was up just under 26% against the All-Share being up 9.5%, so that was a pretty good turnaround.

**Company Representative**

Andy, I appreciate your help.

**Andy Harvell, Director of Quantitative Indices, FTSE Group**

You're welcome.

**Company Representative**

Thank you for listening. Next week on the podcast, we'll be finishing our discussion with Andy Harvell with a conversation on the increased globalization of the FTSE indices. And we will be discussing whether truly regional indices are possible, given the multinational trend of major corporations. In FactSet, you can access many of FTSE's major indices, some of which you heard Andy talk about today. These are available for all of your markets and economic analysis needs on FactSet. Thank you for listening.

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