

## NZSE's new-look indices: good news for investors

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There is a lot of talk in the market now about indices - mostly because the NZSE plans big changes to the way our indices are constructed.

So here is an update on the importance of indices, the changes we are proposing and how the new indices will work positively for investors.

Let's start with some theory. When I look up "index" in the Concise Oxford Dictionary, I get three definitions: "A pointer showing value of quantity, or a position on a scale; a quantity indicating a relative level of prices at a particular date, compared with that at a date taken as standard; a guiding principle - a thing pointing to a conclusion."

The first definition points to the underlying role of an index: to help investors to understand the value of the quantity of stocks in the market - in other words, to measure the market's performance. By bundling a set of companies into one value, an index allows investors to gauge market performance. Therefore it is critical that the companies in the index are representative of the overall market.

On the second point, most indices (such as the NZSE40 or NZSEAll index) are designed to allow you to track your portfolio's performance against the market, as well as track the performance of the market over time. The gross index value of the NZSE40 at November 13, for example, was 3959.98. Ten years before, it was 1517.58. The index has increased overall by more than 10 per cent a year, therefore, in theory, if you had invested \$10,000 in stocks in the NZSE40 index in 1992, you should now be sitting on stock worth \$26,094. Therefore, you can calculate the likely movement of your portfolio against the movements in the index value.

The third definition, "a guiding principle or a thing pointing to a conclusion", is important. As many investors will know, the NZSE is reviewing the construction and nature of the indices to ensure that they give all investors a guiding principle or an overriding conclusion about how the market is performing.

One of the overriding changes is to move our indices from a "capital" basis to a "gross" basis. For a long time, our market has been under-represented as far as value is concerned. By moving our headline index to a gross reporting basis, we are ensuring that New Zealand investors have an accurate gauge of what their investments in New Zealand shares, in NZ dollars, are returning. This is done by including dividends in the gross value, as well as tax imputation credits.

New Zealand companies return one of the highest rates of dividend yield of any OECD nation - in fact we are ranked number five in the world. By moving our indices to gross, we are ensuring that investors here have a more relevant basis on which to draw conclusions.

So, keeping it simple, what can you conclude about the changes to the NZSE indices? The improvements we want to make can be summarised in two key phrases - "measurability" and "investibility". The indices we will introduce next January will be as follows:

- \* The headline NZSE40 will be replaced with a new headline index - the NZSE50.
- \* All indices will be promoted as gross, rather than capital.
- \* Both the NZSE50 and the narrower NZSE10 will be free float indices.

This last point is important, because if shares are not "free float" they are impossible to buy on the open market and thus need to be excluded.

And serious investors should note that we will continue tracking the old-style indices for some time - so there is no need to panic and readjust portfolios overnight. What these changes mean is all good news.

The major indices will better reflect the nature of our market, and this will be reflected in the value of stocks in our indices. By tracking your portfolio against an index, assuming you are reinvesting your dividends, you should be able to get a better idea of how your portfolio is performing against the market, and of how much money you have in your pocket.

The NZSE50 will now represent a wider range of stocks and be a stronger representation of the overall market. The new NZSE50 and the NZSE10 (which tracks our top 10 companies) will be based on the "investible" or "tradeable" amount of stock in the market. In other words, not all stocks will rank with equal value.

Stocks with a large proportion of their shareholdings tied up in strategic holdings - such as Air NZ (which the Government owns a majority share in) - will be represented in value only by the proportion that is freely available to trade. Feel free to keep the comments coming though - our door is always open.

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