



Product Profile | Equities

FTSE Taiwan RIC Capped Index

March 2024

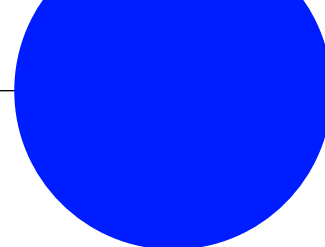


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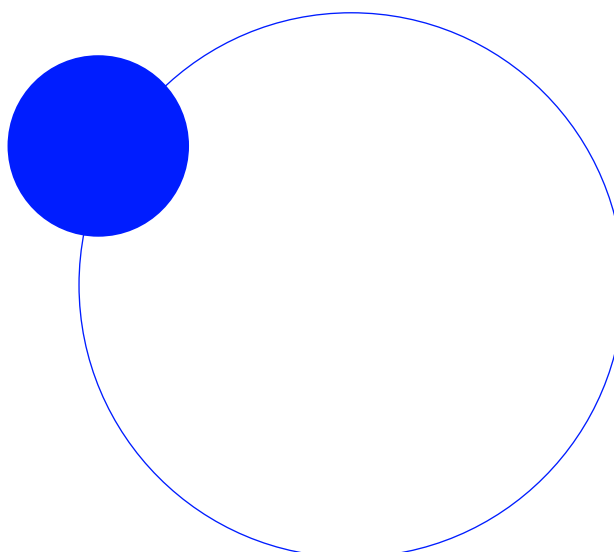
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Introduction

FTSE Russell provides various indices representing the Taiwan equity market to suit different investor needs. The simplest offering includes an uncapped, market-cap weighted FTSE Taiwan Index, which is designed to represent the large- and mid-cap stocks in Taiwan. FTSE Russell also provides a capped version of this index, the FTSE Taiwan RIC Capped Index. The capped and uncapped index share the same list of constituents.



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The capping methodology

The FTSE Taiwan RIC Capped Index follows a capping methodology that reflects Regulated Investment Company (“RIC”) concentration requirements for US registered funds, which limits concentration in any single security within the index.

The constituents of the FTSE Taiwan RIC Capped Index are capped quarterly so that no more than 20% of the index’s weight will be allocated to a single constituent and the sum of the weights of all constituents representing more than 4.5% of the index will not exceed 48% of the total index weight. The FTSE Taiwan RIC Capped Index demonstrates a strong defensive nature with its significantly better industry diversifications with lower volatility when compared with the uncapped FTSE Taiwan Index.

The capping levels utilised in the FTSE Russell RIC Capped methodology are set below the allowed levels under the RIC rules. The differences aim to provide a buffer to minimise the potential of a breaching of the RIC rules due to market movement.

Exhibit 1. Regulatory capping levels vs. FTSE Russell capping limits

	Regulated Investment Company (RIC) rules	FTSE RIC Capped Index methodology	Why the difference?
Individual company weights	Limited to 25%	Limited to 20%	Reduces the concentration of the largest companies
Aggregate company weights	Companies whose weights >5% cannot be greater than 50% in aggregate	Companies whose weights >4.5% cannot be greater than 48% in aggregate	Provides a buffer to prevent breaching RIC rules
Combined rule	25/5/50	20/4.5/48	Combined approach reduces the possibility of breaching RIC rules at implementation
Review frequency	Quarter close	Quarterly, with intra-quarter IPO exceptions	Reflect target opportunity set

Source: FTSE Russell, Capping Methodology. https://www.lseq.com/content/dam/ftse-russell/en_us/documents/policy-documents/capping-methodology-guide.pdf.

Industry diversification

As semiconductors become indispensable in today’s technology era, Taiwan Semiconductor Manufacturing Co Ltd (“TSMC”) - a Taiwan-based leading semiconductor foundry - has gradually grown in size and has become the largest Taiwan stock over the past decade. From late 2014, the size of TSMC has been large enough to trigger the weight capping mechanism in the FTSE Taiwan RIC Capped Index.

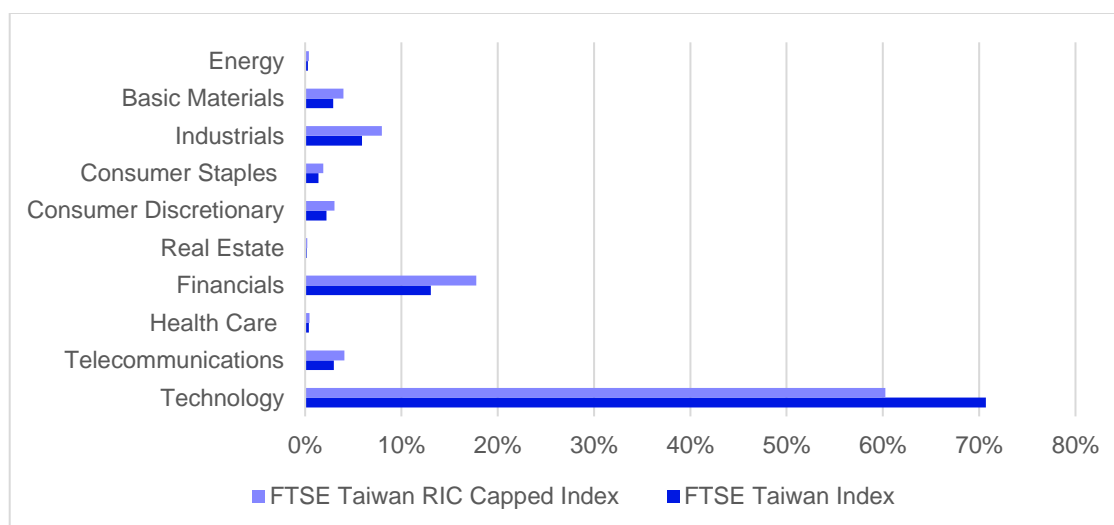
As at the end of January 2024, TSMC alone accounted for over 40% of the uncapped FTSE Taiwan Index, resulting in a substantial concentration risk associated with a single company and Technology industry. Such a concentration also comes at the cost of a reduced exposure to other industries. Meanwhile, TSMC only accounted 21% of the FTSE Taiwan RIC Capped Index.

Exhibit 2. Top 10 constituents

Company Name	Industry	FTSE Taiwan RIC Capped Index	FTSE Taiwan Index
TSMC	Technology	21.33%	41.75%
MediaTek	Technology	5.42%	3.98%
Hon Hai Precision Industry	Technology	4.61%	3.39%
Quanta Computer	Technology	2.48%	1.82%
Delta Electronics	Industrials	2.28%	1.67%
United Microelectronics	Technology	2.17%	1.59%
CTBC Financial Holding	Financials	1.96%	1.44%
Fubon Financial Holdings	Financials	1.88%	1.38%
ASE Technology Holding	Technology	1.75%	1.29%
Chunghwa Telecom	Telecommunications	1.71%	1.25%
Total		45.59%	59.56%

Source: FTSE Russell; as of 31 January 2024.

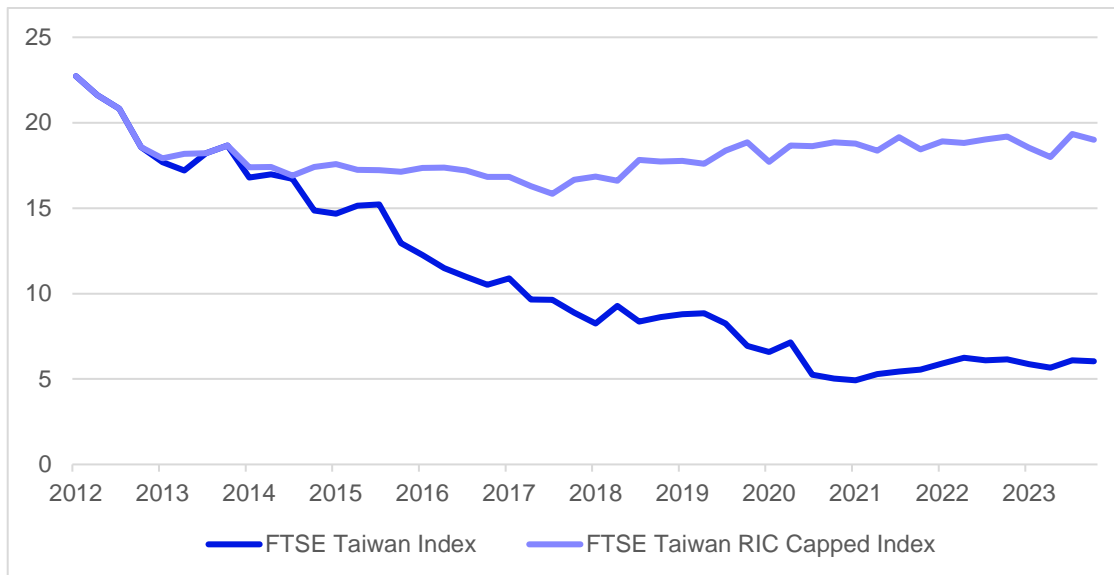
Exhibit 3. FTSE Taiwan RIC Capped Index demonstrates a better industry diversification



Source: FTSE Russell; as of 31 January 2024.

The capping methodology (particularly due to the capped weight in TSMC) in the FTSE Taiwan RIC Capped Index adds a crucial diversification element to the index composition. The Effective N ratio (a measure of industry diversification illustrating that a high Effective N value equates to a better diversification) of the capped index was at 19.01 as of December 2023, more than 3 times the figure of the uncapped index, which came in at 6.04.

Exhibit 4. FTSE Taiwan RIC Capped Index shows consistently higher Effective N values



Source: FTSE Russell; as of 31 January 2024.

The significant difference in TSMC’s weightings has driven the difference between the cumulative returns of the FTSE Taiwan RIC Capped index and the FTSE Taiwan Index over the past decade, as shown in the table below.

Exhibit 5. TSMC weights have driven the difference

Index	Cumulative Return (%)							
	1M	3M	6M	YTD	1Y	3Y	5Y	10Y
TSMC	5.9	18.7	11.2	5.9	20.3	6.3	184.2	498.1
FTSE Taiwan RIC Capped Index	-3.1	16.0	4.9	-3.1	14.9	17.2	106.5	198.0
FTSE Taiwan Index	-1.4	17.9	6.8	-1.4	15.6	12.0	124.7	232.2
Differences *	1.7	1.9	2.0	1.7	0.7	-5.2	18.3	34.2

* Differences = cumulative return of the FTSE Taiwan Index – cumulative return of the FTSE Taiwan RIC Capped index

Source: FTSE Russell; as of 31 January 2024.

Lower volatility

The FTSE Taiwan RIC Capped Index has historically displayed lower annualised volatility than the FTSE Taiwan Index over different economic cycles. Volatility has been consistently lower for the capped index when comparing data over the short, medium or long term.

The differences in volatility between the two indices has become more pronounced over the last 5 years, during which time the constituent weightings and the Technology industry weightings within the FTSE Taiwan Index have become more concentrated.

Exhibit 6. Better diversification has led to a lower volatility in the FTSE Taiwan RIC Capped Index

Volatility (%pa)				
Index	1Y	*3Y	**5Y	**10Y
FTSE Taiwan RIC Capped Index	14.8	19.7	22.4	18.5
FTSE Taiwan Index	16.3	21.3	24.3	19.8

Source: FTSE Russell; as of 31 January 2024.

September index review – Constituent update

In the quarterly index review that took place in September 2023, the following changes were made to the FTSE Taiwan RIC Capped Index:

- Alchip Technologies Inc., Gigabyte Technology, Global Unichip, Tatung and PharmaEssentia were added to the index. The companies were classified as either large or medium-cap stocks in the recent review of the FTSE Global Equity Index Series (GEIS)
- Taiwan Semiconductor Manufacturing Co Ltd was re-capped at 20% in the FTSE Taiwan RIC Capped Index

Conclusion

The capping methodology applied in the FTSE Taiwan RIC Capped index has equipped the index with the benefits of lower volatility and better industry diversification. These features allow the index to be more defensive during volatile macroeconomic periods by mitigating the impact of a falling market, relative to the uncapped index, while maintaining the upside potential for investors in a rising market.

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