



FINANCIAL MARKETS SERIES

EQUITY MARKETS

OCTOBER 2011



TheCityUK champions the international competitiveness of the financial and professional services industry. Created in 2010, we support the whole of the sector, promoting UK financial and professional services at home and overseas and playing an active role in the regulatory and trade policy debate.

TheCityUK has a global export focus with a commitment to help UK based firms grow their business in other parts of the world. In 2010, the financial services industry accounted for 10% of UK GDP and 11% of UK tax receipts. The sector currently employs 1 million people, more than 66% of whom work outside London, and underpins the businesses that drive jobs and growth. Added together with the further 900,000 employed in professional services, it is easy to see the importance of a sector that employs 6% of the working population.

TheCityUK provides constructive advice and is the practitioner voice on trade policy and all aspects of taxation, regulation, and other legislative matters that affect the competitiveness of the sector. We conduct extensive research and run a national and international events programme to inform the debate. Our senior team regularly engages with regulators and policymakers at home and overseas, ensuring the sector's views are represented at the highest levels. We are tasked with creating a new vision for the financial services sector. We are focused on supporting policymakers and business to deliver the new policy ideas which will help deliver growth.

EQUITY MARKETS

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The global equity markets continued their recovery for the second year running in 2010 with bouts of volatility so far in 2011. As this report shows, the UK's substantial domestic market in equities is complemented by London's role as a major centre for trading in foreign equities.

SUMMARY

Global equity market The value of the global equity market increased by 5% in 2010 to \$54.9 trillion following a 45% rise in the previous year (Chart 1). Market capitalisation fell to \$44.9 trillion by the end of September 2011, 26% below the end-year peak in 2007. Markets posted strong returns for the second year running in 2010 with the MSCI World Index returning 10% following a record 27% return in the previous year. Bouts of volatility persisted in 2011 with a 14% fall in the value of the index between January and September. With the economic recovery expected to be sustained over the next few years, the markets are likely to continue their gradual recovery, with emerging markets continuing to be an important driver of growth.

Over \$1 trillion in new capital was raised on the global equity markets in 2010, up 6% on the previous year. Following two years of subdued activity, the value of IPOs climbed above the pre-crisis peak from 2007 to over \$400bn in 2010 accounting for 40% of capital raised. In the previous two years, more than 80% of capital was raised through further issues. The value of IPOs totalled over \$160bn in the first 9 months of 2011, with some \$300bn raised in secondary issues.

Turnover on global equity markets increased by 3% in 2010 to \$63.1 trillion, with a further \$50 trillion traded between January and September 2011. Trading has, since the start of the economic downturn, been well below more than \$110 trillion traded in both 2006 and 2007. Most large exchanges saw a modest increase in turnover in US dollar terms during 2010. The London Stock Exchange saw a 7% increase, Deutsche Borse 14%, NYSE Euronext (US) 2%, Tokyo Stock Exchange 2%. Trading on the NASDAQ on the other hand fell 7% during the year.

UK equity market The market value of 1,093 UK incorporated companies trading on the Main Market of the London Stock Exchange (LSE) grew 13% in 2010 to £1,952bn following a 34% increase in the previous year. The FTSE-100 index gained 9% in 2010, the second successive year of growth. This was followed by a 9% decline in the first eight months of 2011. The FTSE-AIM index also performed strongly in 2010 with a 42%

Market capitalisation of the global equity market up 15% in 2010 to **\$54.9 trillion**

Chart 1
Global equity markets capitalisation & turnover¹

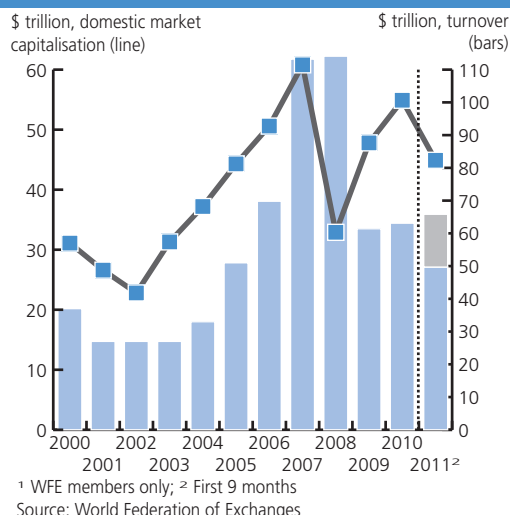


Chart 2
London's share of international equity markets



gain followed by a 17% fall in the first eight months of 2011.

Equity issues on the Main Market and AIM totalled £30.9bn in 2010, down from £82.6bn in the previous year. IPO activity increased to £10bn in 2010 from £1.8bn in the previous year. Strong issuance continued in 2011 with £11.6bn in IPOs in the first 8 months, accounting for more than half of all issues. Prior to this, in 2008 and 2009 more than 90% of capital raising was in secondary issues. Money raised on AIM during 2010 totalled £7.0bn, up on £5.6bn in the previous year but down on the record £16.2bn raised in 2006. The AIM nevertheless retains its unique role as one of the world's leading growth company markets.

Secondary trading on the LSE totalled £1,976bn in 2010. In addition to the LSE's Main Market and AIM, trading in UK equities is facilitated by PLUS Markets which also has a recognised exchange status and a number of Multilateral Trading Facilities (MTFs) which have captured a growing share of secondary trading since 2007. Overall trading of UK equities, including trading on these venues, totalled over £3,300bn in 2010.

London's importance as a centre for equity trading is illustrated by its 19% share of the number of foreign listed companies in 2010; its 12% share of international IPOs by number (Chart 2); its 7% share of global equity market capitalisation; its 6% share of further issues. Relative to the size of the economy, London also has the highest equity market capitalisation of largest countries at 161% of GDP.

Contribution to the UK economy Excluding support and back office staff, the number employed in the UK in the securities market totalled around 47,000 at the end of 2010. Securities dealing generated net exports of £1.4bn in 2009. Operating profits of securities dealers totalled £1.8bn in 2010.

EQUITY MARKETS WORLDWIDE

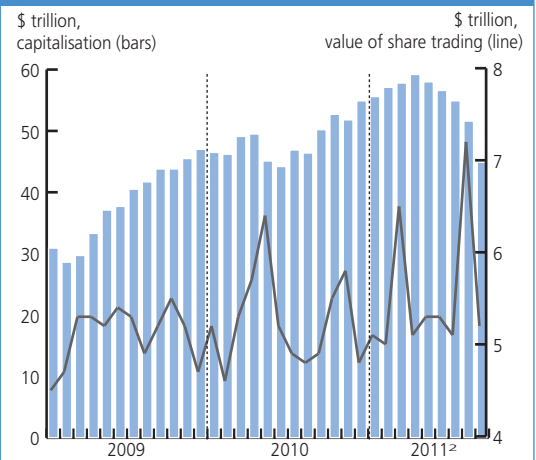
Global equity markets posted strong returns in 2010 for the second year running. The 10% increase in the MSCI World Index during the year followed a record 27% return in the previous year. The market however gave back some of these gains in the first 9 months of 2011 with a 14% fall during this period (Charts 1 and 3). Issuance on the global equity markets remained strong in 2010 with IPOs recovering to pre-crisis levels during the year before falling back somewhat in 2011.

With the economic recovery expected to be sustained over the next few years, equity markets are likely to continue their gradual recovery although bouts of volatility are likely to persist for some time. Emerging markets which have been an important driver of growth in recent years are likely to remain so in the next few years.

Primary market

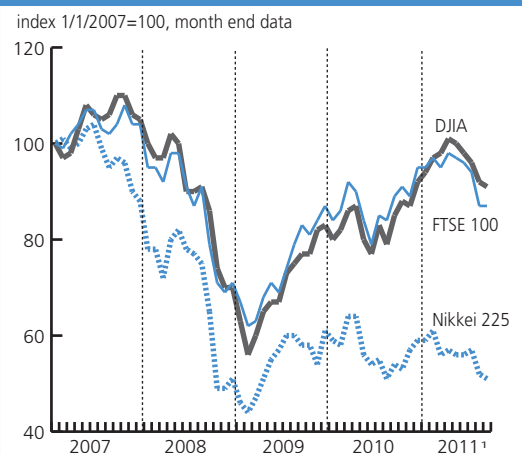
Domestic market capitalisation of the global equity markets increased by 15% in 2010 to \$54.9 trillion (Charts 1, 3 and 4) following a 45% increase in the previous year. This fell to \$44.9bn by the end of September 2011, 26% below the end-year peak in 2007. The US accounted for around a

Chart 3
Equity market capitalisation and turnover



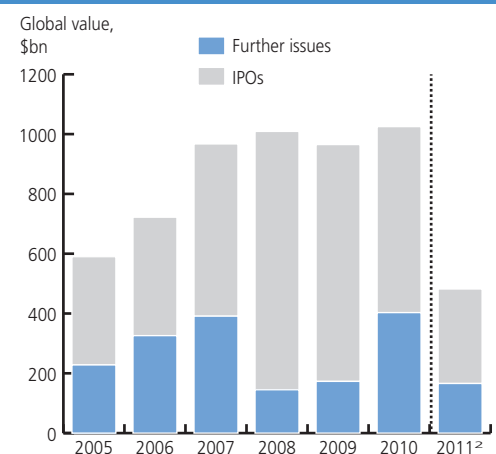
¹ WFE members only; ² September
Source: World Federation of Exchanges

Chart 4
World equity indices



¹ up to September
Source: Yahoo Finance

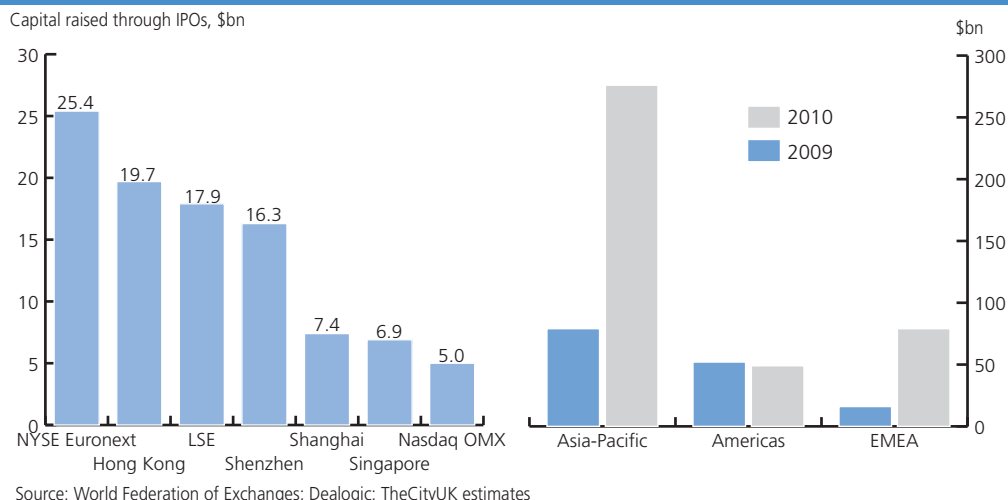
Chart 5
New capital raised by shares¹



¹ WFE members only; ² First 9 months
Source: World Federation of Exchanges

third of the global equity market capitalisation at the end of 2010, a reflection of the large size of the US economy. NYSE Euronext (US) was the world's largest equity exchange with domestic market capitalisation of \$13.4 trillion or a quarter of the global total. The Tokyo stock exchange and Nasdaq OMX were the next largest with around 7% of the total each. They were followed by the London Stock Exchange 6.6% and NYSE Euronext (Europe) 5.3%. In relation to GDP, London had the highest market capitalisation of the largest countries with 161% in 2010. This was several times that of other large European countries.

Chart 6
Global capital raised through IPOs



Capital raised by share issues Over \$1 trillion in new capital was raised through World Federation of Exchanges (WFE) member exchanges for foreign and domestic companies in 2010. This was up 6% on the previous year. Following two years of subdued activity, in 2010 the value of IPOs climbed above the pre-crisis peak from 2007 to over \$400bn. The trend in the previous two years was for companies with existing listings to raise capital through further issues as companies shifted to raising capital from equity rather than bank borrowing. Strong secondary issuance

continued in 2010 (Chart 5) although the \$622bn in secondary issues was below the \$792bn raised in the previous year and \$864bn in 2008. The value of IPOs totalled \$166bn in the first 9 months of 2011, with \$316bn raised in secondary issues.

The Asia-Pacific region has been the driver of IPO issuance in recent years. The Bombay Stock Exchange was the biggest source of new capital for companies in 2010 with some \$80bn raised through IPOs. It was followed by the Hong Kong Exchanges with \$57bn and SIX Swiss Exchange with \$45bn. The two Chinese exchanges, Shanghai Stock Exchange and Shenzhen Stock Exchange, raised a combined value of \$74bn in 2010. NYSE Euronext (US) was the top exchange for secondary issues with some \$174bn raised during the year. London Stock Exchange was the third largest exchange in terms of the number of new foreign companies listed in 2010 (Chart 7).

Secondary market

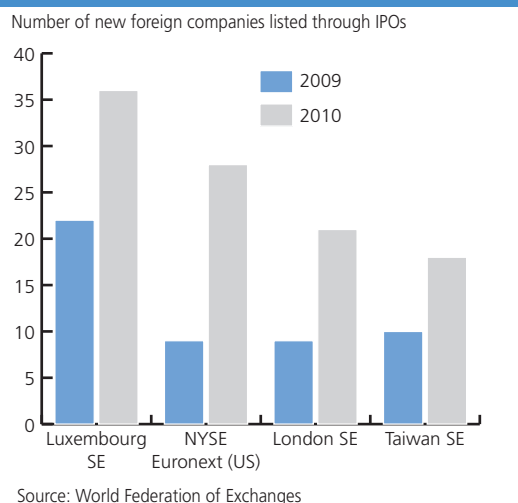
Turnover Equity market turnover in domestic and foreign companies on WFE member exchanges increased by 3% in 2010 to \$63.1 trillion, with

Table 1
Domestic equity markets

2010	Market value \$bn	% of total	Domestic turnover \$bn	% of total	Number of domestic companies	-----concentration-----		
						% of market value	% of trading value	Value as % of GDP
NYSE Euronext (US)	13,394	24.4	17,795	28.2	2,238	57.0	93.0	118 ²
NASDAQ OMX	3,889	7.1	12,659	20.1	2,480	71.9	68.7	118 ²
Tokyo SE Group	3,828	7.0	3,793	6.0	2,293	60.1	70.6	70
London SE	3,613	6.6	2,749	4.4	2,966	82.3	54.1	161
NYSE Euronext (Europe)	2,930	5.3	2,022	3.2	1,135	68.9	77.2	---
Shanghai SE	2,716	4.9	4,486	7.1	894	55.8	25.1	46
Hong Kong Exchanges	2,711	4.9	1,496	2.4	1,413	69.4	67.3	1,205
Others	21,873	39.8	18,078	28.7	32,089	---	---	---
Total	54,954	100.0	63,078	100.0	45,508	---	---	---

¹ London figures are LSE only and exclude Borsa Italiana; ² Includes both New York and Nasdaq
Source: World Federation of Exchanges

Chart 7
Top exchanges by new foreign listings



around \$50 trillion traded in the first nine months of 2011. Trading since the start of the economic downturn has been well below the \$110 trillion average traded both in 2006 and 2007. Most large exchanges saw a modest increase in trading in US dollar terms during 2010. London Stock Exchange saw a 7% increase, Deutsche Borse 14%, NYSE Euronext (US) 2%, Tokyo Stock Exchange 2%. Trading on NASDAQ on the other hand decreased 7% during the year. Turnover relative to market value in 2010 at more than three times market capitalisation was highest on Nasdaq with its concentration of technology stocks. Turnover on the London Stock Exchange was equivalent to 76% of market value. The global average totalled 115%.

The average size of share orders on global exchanges has fallen sharply in recent years. This is partly a result of the development of automated and "high-frequency" trading as well as the proliferation of electronic trading platforms which has made it easier to access the market. The average order on the London Stock Exchange amounted to around \$13,300 in 2010, well down on more than \$85,000 five years earlier. The average value of trades totalled \$8,700 on NYSE Euronext (US) and \$7,300 on the NASDAQ OMX in 2010, also down on recent years' levels. Falling trade sizes translate into more trades, which is to an extent helping to offset the impact of the reduction in trade fees in recent years resulting from greater competition.

Market concentration The largest 5% of companies on the London Stock Exchange accounted for 82% of domestic market capitalisation and 54% of turnover (Table 1). In terms of market capitalisation, this was more concentrated than on the NYSE Euronext (US), where the largest 5% of companies accounted for 57%. Mergers between exchanges in recent years have included the merger between the London Stock Exchange and Borsa Italiana in October 2007, the acquisition of the Nordic Exchange (OMXC) by NASDAQ to form NASDAQ OMX in February 2008; and the merger between the NYSE and Euronext in 2007 and its subsequent acquisition of AMEX in October 2008. Further alliances and consolidation activity are likely to continue in the coming years as markets become increasingly integrated.

Multilateral Trading Facilities (MTFs) Over the past decade, many securities exchanges have undergone significant automation-led structural changes. This includes deregulation of exchanges, the opening of markets to foreign owned intermediaries and the proliferation of electronic trading. The introduction of MiFID in November 2007, has promoted the emergence of a number of MTFs. A MTF is, in broad terms, a system that brings together multiple parties that are interested in buying and selling financial instruments and enables them to do so. These systems can be crossing networks or matching engines that are operated by an investment firm or a market operator. Instruments may include shares, bonds and derivatives.

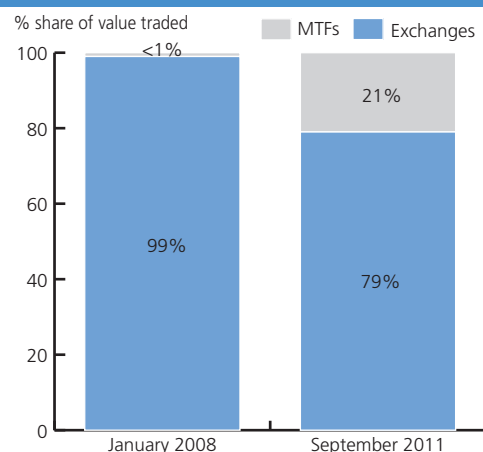
MTFs have captured a growing share of secondary trading since their introduction (Table 2, Chart 8). They accounted for over a fifth of trading in European equities in 2010 and first nine months of 2011, having increased their share from less than 1% at the start of 2008. Figures in Chart 8 exclude trading on Markit BOAT, which is a trade reporting platform used by a number of investment firms to meet their OTC equity MiFID reporting obligations. This means that no actual trades actually take place on Markit BOAT.

Table 2
European equity market share by trading platform

September 2011		
	€ bn	% share
Markit BOAT	400	22
LSE Group	301	17
Euronext	238	13
Chi-X Europe	173	10
Deutsche Boerse	150	8
MICEX	106	6
Six Swiss Exchange	72	4
Spanish Exchanges	58	3
Nasdaq OMX Nordic	56	3
Turquoise	53	3
BATS Europe	50	3
Other	135	8
Total	1,792	100

¹ Markit BOAT is a reporting platform for OTC trades which means that no actual trades take place
Source: Thomson Reuters

Chart 8
MTFs share of European trading



¹ Excluding trading reported on Markit BOAT
Source: Thomson-Reuters

Table 3
Markets for foreign equities

	----- 2010 -----			----- 2009 -----	
	No. of foreign cos. listed	% of global	Turnov. \$bn	No. of foreign cos. listed	% of global
London	604	19	265	613	20
New York	518	16	1,736	495	16
Nasdaq	298	9	1,178	283	9
Germany	75	2	161	79	3
Johannesburg	45	1	89	45	1
Others	1,616	51	166	1,580	51
Total	3,156	100	3,691	3,095	100

¹ London figures include AIM; ² London's share is understated as it excludes trading executed on, or reported to, other venues.
Source: World Federation of Exchanges

Foreign equities

To gain access to foreign capital many companies seek a listing on other national exchanges in addition to their own domestic stock market. Companies can list on a foreign market through: direct listings, where a company lists their equity directly on a foreign market either as a 'primary' or 'secondary' listing; or through depositary receipts which are tradable securities held in the custody of a depositary bank in the issuers' home market which can be traded independently from the underlying shares.

MTFs in general tend to be selective across markets and typically focus on secondary trading of shares which are the most liquid to trade. Therefore there is a lot of competition in capturing market share in trading of the most liquid markets and equities. PLUS Markets on the other hand offers trading in more than 8,500 small and mid-cap shares, while the MTF PEX offers trading in Portuguese equities. A number of exchanges have set up MTFs, in order to diversify the model of service they provide. This includes for example Smartpool run by NYSE Euronext. London Stock Exchange Group took a majority stake in Turquoise (a MTF set up in 2008 by a group of nine investment banks) in 2010 to create a new pan-European trading platform.

A result of increased competition is that secondary market trading has become more commoditised and technology has become more important in providing services. Most exchanges have been building their technology offerings in a bid to compete more effectively with MTFs and expanding the range of services on offer to open up additional sources of revenue.

Markets for foreign equities Global turnover in foreign equities on WFE member exchanges totalled \$3.7 trillion in 2010 (Table 3). NYSE Euronext (US) exchange accounted for 47% of the total, followed by Nasdaq 32% and LSE 7%. London's share is, however, understated as it includes London Stock Exchange trading only and does not include foreign equity trading executed on, or reported to, other venues.

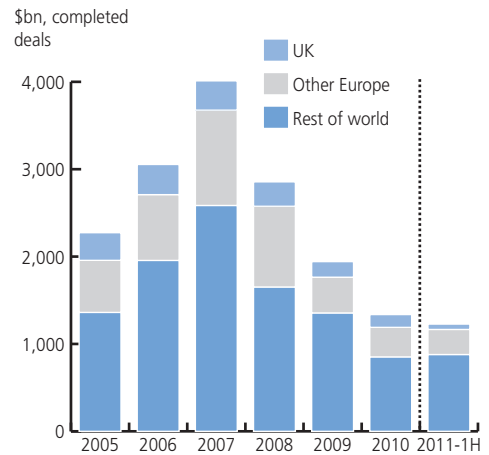
The 604 foreign companies listed on the LSE (including AIM) was ahead of NYSE Euronext (US) (518) and Nasdaq (298). Excluding OTC trading, foreign companies trading in London generated turnover of \$265bn in 2010. Around a half of foreign equity turnover in London in recent years has been undertaken in companies based in Europe with German and French equities forming the largest single blocks with around 10% each. Trading in Japanese equities is also significant with around a 15% share. The share of trading in US stocks tripled to around a fifth of foreign equity trading in London during the past decade.

Mergers and acquisitions (M&As)

The value of completed worldwide M&A deals totalled \$1.2 trillion during the first half of 2011, a 35% increase from the same period in the previous year. This was the strongest first half for global M&A activity since 2008. By number of deals, M&A activity fell around 2% compared to the previous year.

Cross-border M&A activity accounted for a third of overall activity during the first half of 2011, down from 36% in the first six months of 2010.

Chart 9
Global M&A activity



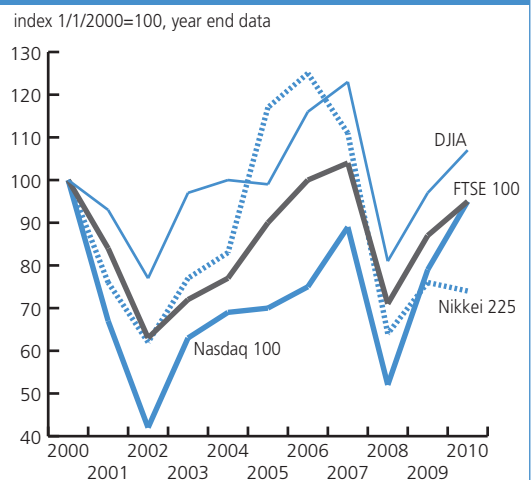
Source: Thomson Financial

Table 4
Equity market returns worldwide

MSCI Index, US\$	2010	3yr	5yr	10yr
Japan	13.4	-6.3	4.0	-0.2
US	13.2	-4.8	0.3	-0.4
Switzerland	9.8	-2.6	3.9	3.8
Global	9.6	-7.0	0.4	0.5
Germany	6.0	-12.1	3.7	1.8
UK	5.2	-10.6	-1.2	-0.1
France	-6.7	-13.1	-0.9	-0.1

Source: MSCI

Chart 10
World indices



Source: Yahoo Finance

Private equity backed deals accounted for 8.2% of worldwide activity during the first half of 2011 with deal making in the United Kingdom, Sweden, France, Italy and Germany accounting for nearly three-quarters of activity in Europe.

Based on the location of the target company, the Asia-Pacific region saw the biggest increase in activity with a 53% rise in the 12 months to June 2011. The US and Europe saw growth of over 40% each. Deal making activity in Japan on the other hand fell by a fifth during this period, while deals in the Africa/Middle East region fell by 51%.

Equity markets for small companies Shares and other equities are an important source of finance for industrial and commercial companies. Smaller companies tend to be more dependent on bank borrowing, although the formation of second tier markets such as AIM and third tier OTC markets provide additional sources of equity capital for these companies. These markets have simpler listing requirements and regulatory regimes than major stock exchanges. Alternative platforms for trading equities of small companies such as MTFs are also on the rise since the introduction of MiFID.

On the LSE, smaller companies are categorised in the FTSE SmallCap or FTSE Fledgling indices. There is also the All Small Market Index, which combines the FTSE Fledgling and SmallCap indices. AIM has become the world's leading small-cap market with 1,195 companies and a combined market capitalisation of £79bn at the end of 2010. Over 160 companies listed on the London-based Plus-quoted market had a total market capitalisation of some £2.5bn at the end of 2010.

Other exchanges for small companies in Europe include Euronext Alternext, Star and AIM Italia although they are smaller in terms of market capitalisation and number of listed companies than AIM in the UK. Over the past few years a number of exchanges for small companies in Europe have closed down operations including Nasdaq Europe and the German Neuer Markt.

Equity market returns worldwide Most large exchanges saw modest gains in value during 2010. The MSCI World Index increased 10% in 2010 following a record 27% gain in the previous year (Table 4). The market gave back some of the gains of the previous two years in the first nine months of 2011 with a 14% decline in the value of the index. Over the long term, equities have historically produced higher returns than other forms of investment such as bonds, property or cash. Long periods can occur, however, when markets under or over-shoot the assumed returns.

Equity comparisons of share ownership The proportion of shares held by UK individuals at 10% (Chart 19) was lower than in Spain and Italy at around 20%, and comparable with Germany (13%). However, the greater size of the UK equity market relative to these countries indicates a much more significant penetration of the UK market.

The UK is also distinct from other European countries in the relative size of shareholdings of the financial sector and companies. The 45% share held

Chart 11
London Stock Exchange equity market value

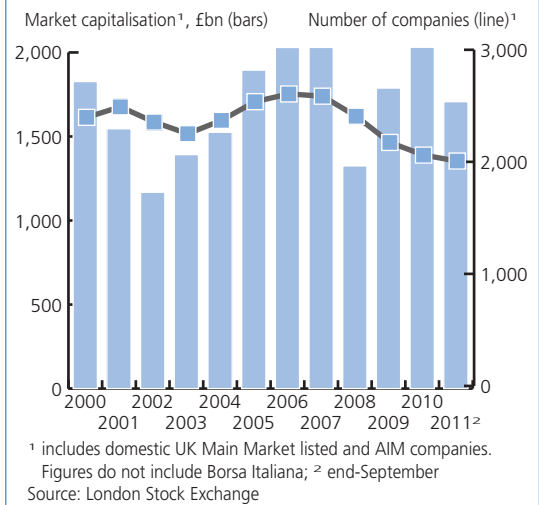


Chart 12
FTSE index movements

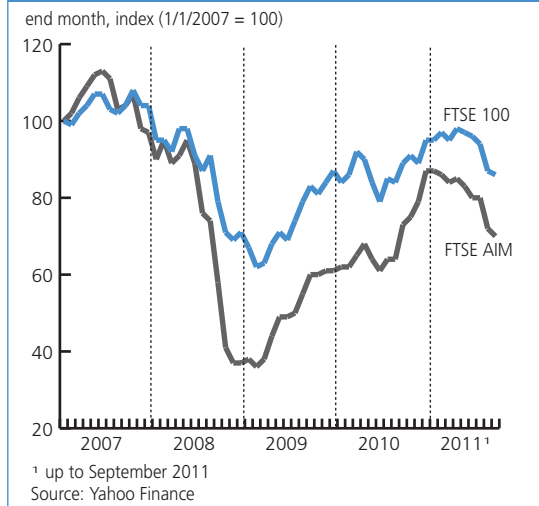
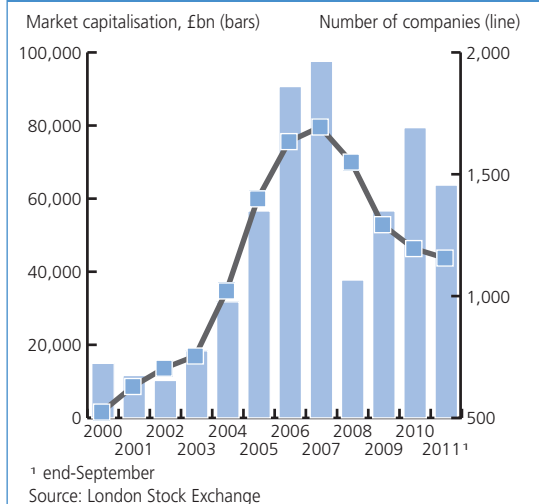


Chart 13
Alternative Investment Market (AIM)



by the UK financial sector compares with 15-25% in most other countries, reflecting the large volume of UK institutional funds and their preference for investing in equities. Private and non-financial companies in other European countries tend to hold a much larger portfolio of shares than the 3% held by UK non-financial companies, ranging from France (13%) to Germany (40%). This illustrates the high prevalence of equity cross-ownership between companies elsewhere in Europe.

EQUITY MARKETS IN THE UK

The London Stock Exchange (LSE) plays an important role in maintaining London's position as one of the world's leading financial centres. In addition to being the main exchange for the trading of UK securities it is also the world's most international equity market with more foreign listed companies than any other exchange. In 2007 the LSE merged with Milan-based Borsa Italiana to form the London Stock Exchange Group plc. Trading in many UK equities is also facilitated by the PLUS Markets Exchange, a small and mid-cap stock recognised exchange, and a number of Multilateral Trading Facilities (MTFs).

Primary market

Domestic market capitalisation The market value of 1,093 UK incorporated companies trading on the Main Market of the LSE grew 13% in 2010 to £1,952bn (Chart 11) as equity markets recovered following a 34% increase in the previous year. The FTSE-100 index gained 9%, the second successive year of growth. This was followed by a 9% decline in the first nine months of 2011. The FTSE-AIM index also performed strongly in 2010 with a 42% gain following a 66% increase in the previous year. The index fell however by 20% in the first nine months of 2011 (Chart 12).

Advantages of London as a centre for securities dealing

London is one of the most important international centres for securities dealing. Many factors have contributed to this:

- Dynamic, transparent and liquid markets;
- Most of the largest investment banks and securities houses have major securities operations in London. They facilitate access to a huge pool of global capital;
- Technologically advanced trading systems have helped to reduce the costs of execution;
- A consistent, politically neutral legal system that is widely used and understood globally, and confers confidence in doing business with the UK and in investing in the UK;
- The UK has the second largest fund management industry, which has helped to bring additional business in securities dealing to London;
- The large pool of skilled labour in international financial markets concentrated in central London;
- London's position as the financial services gateway to the Single European Market and the European time zone;
- Lower costs of capital for companies issuing shares, a result of the deep pool of funds and efficient market structures;
- Strong reputation and experience, built up over several centuries.

Table 5
Distribution of companies by equity market value

Market value range £m	Number of companies	% share	Equity market value £bn	% share
2010				
> 2,000	124	6	1,697	83
500-2,000	197	9	196	10
50-500	686	31	119	6
< 50	1,146	52	19	1
unvalued/suspended	45	2	-	0
	2,198		2,032	
2009				
> 2,000	102	4	1,482	83
500-2,000	164	7	171	10
50-500	670	29	115	6
< 50	1,335	58	21	1
unvalued/suspended	48	2	0	0
	2,319		1,789	

Source: London Stock Exchange

Chart 14
Total equity issues

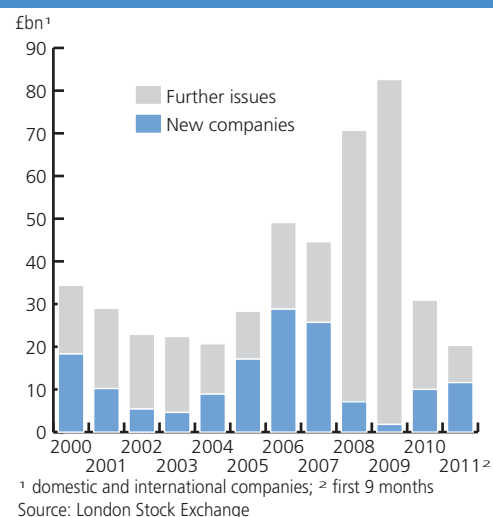
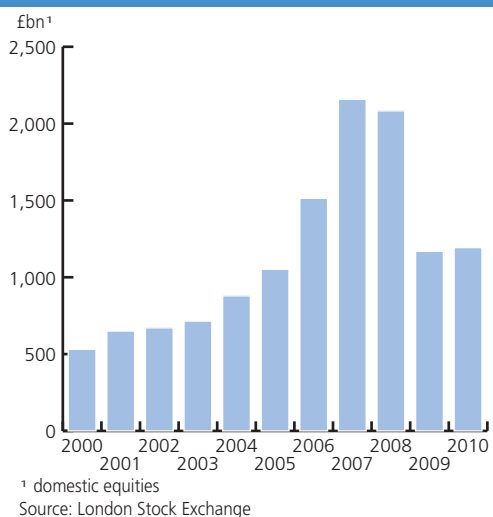


Chart 15
London Stock Exchange orderbook trading



The UK equity market is heavily dominated by large companies (Table 5). At the end of 2010, 124 companies, each with a market valuation in excess of £2bn, accounted for over 80% of market capitalisation. This indicates the strong influence on market movements of companies in the FTSE-100.

The five largest companies accounted for more than a quarter of the market value. At the other end of the scale, the smallest 1,146 companies, each with a market value of less than £50m, made up 52% of all those quoted but less than 1% of market capitalisation.

The UK has two markets for small and medium sized companies. The Alternative Investment Market (AIM) and the PLUS-quoted market:

AIM was introduced in 1995 as a second tier market for small or young companies whose shares are not traded on the main exchange. AIM Italia, Borsa Italiana's market dedicated to small and medium sized Italian enterprises, was launched in January 2009. Compared with the Main Market, AIM has simplified admission requirements and regulatory framework tailored for small and medium sized enterprises. At the end of 2010, AIM provided trading for shares of 1,195 companies with a combined market value of £79.4bn (Chart 13). This was up by over 40% on the previous year's total and more than twice the total two years earlier. It was still however 19% below the 2007 peak. AIM is one of the leading global markets for smaller companies. In terms of market capitalisation, around a fifth of companies listed on AIM were from overseas. London accounted for the largest share of companies from the UK with 43% (by region of registration), followed by the Channel Islands 14% and North-West 9% (Chart 17).

Plus Markets has had a Recognised Investment Exchange status since 2007. It facilitates the trading of around 8,500 securities including both equity and debt and primarily focuses on attracting retail investor volumes. The 166 Plus-quoted/listed companies had a market capitalisation of £3.0bn. In contrast to AIM, Plus Markets has attracted more private than institutional investments. In 2010, Plus Markets set up the Plus Derivatives Exchange (Plus-DX). In conjunction with LCH.Clearnet and FTSE International, Plus-DX provides listing, execution and clearing services for the Medium Term Interest Rate Swap Index Series.

Total equity issues Equity issues by domestic and international companies on the UK Main Market and AIM totalled £30.9bn in 2010, down from £82.6bn in the previous year (Chart 14). IPO activity increased to £10bn in 2010 from £1.8bn in the previous year. The strong IPO activity continued in 2011 with £11.6bn issued in the first 9 months, accounting for more than half of all issues. Prior to this, in 2008 and 2009, strong issuance activity was underpinned by a number of substantial secondary issues. More than 90% of equity issues in 2009 and 2008 were in further issues.

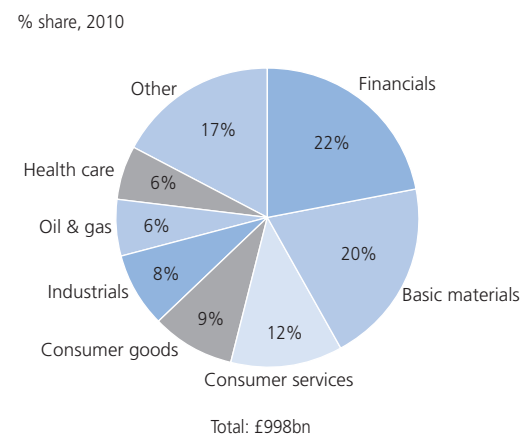
Money raised on AIM during 2010 totalled £7.0bn, up on £5.6bn in the previous year but down on the record £16.2bn raised in 2006. AIM nevertheless retains its unique role as one of the world's leading growth company markets.

Table 6
Largest UK companies

July 2011	Market value £bn	% of total market value
Royal Dutch Shell	141	7.2
HSBC Holdings	106	5.4
Vodafone Group	88	4.5
BP	87	4.4
Glaxosmithkline	70	3.6
Rio Tinto	64	3.3
British American Tobacco	56	2.9
BG Group	49	2.5
BP Billiton	49	2.5
Astrazeneca PLC	41	2.1
Others	1,210	61.7
Total	1,961	100.0

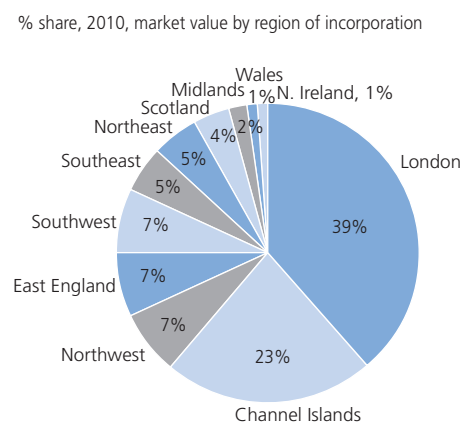
Source: London Stock Exchange

Chart 16
FTSE orderbook trading by industry



Source: London Stock Exchange

Chart 17
Geographical distribution of AIM companies



Source: London Stock Exchange

Secondary market

Trading on the LSE totalled £1,976bn in 2010, down from £2,342bn in the previous year. The value of domestic equity traded through the orderbook totalled £1.2 trillion, slightly up on the previous year (Chart 15). Dealing business on AIM totalled £32.7bn in 2010, down from £33.7bn in the previous year. In 2010 shares worth over £94bn were traded on Plus Markets, up from around £53bn in the previous year.

According to Thomson-Reuters data, overall trading of UK equities, including trading on Plus Markets, MTFs and the OTC trading reporting platform Markit BOAT totalled over £3,300bn in 2010. The implementation of MiFID in November 2007 has increased competition for securities trading business. In July 2011, the LSE Group and Markit BOAT each accounted for around 35% of trading in FTSE-100 shares. They were followed by CHI-X 14%, Turquoise 4% and BATS Europe 4% (Table 7). It is likely that the next few years will see consolidation between the MTFs that have been established in Europe since 2007.

The most actively traded equities are typically the largest companies. Trading in FTSE-100 companies represented nearly three-quarters of UK orderbook trading in 2010 compared with 60% a decade earlier. Equities are also traded on derivatives markets but coverage of this is the subject of a separate TheCityUK report - Derivatives.

The majority of UK quoted companies by market value are drawn from services (mainly banks and telecommunications), oil and gas and manufacturing (Table 6, Chart 16). These sectors have a high proportion of large firms which account for the bulk of activity. Companies in the telecommunications and information technology sectors have seen their share of market value and turnover fall over the past decade from 15% to 5%. Financial services companies have increased their share of market turnover in recent years and accounted for nearly a quarter of the total in 2010.

Client profile The bulk of UK shares are held by institutional investors such as pension funds and insurance companies and overseas investors. Private clients' share has gradually fallen over the past few decades. Major investors in UK shares include:

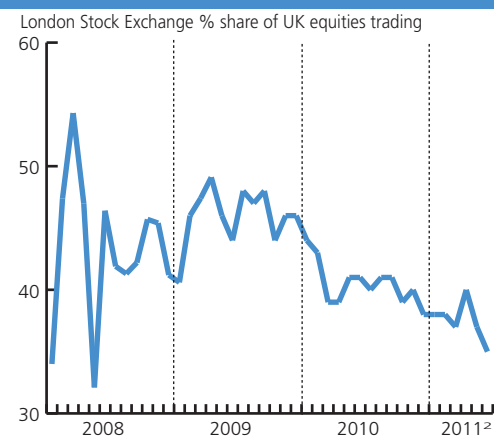
- *Institutional investors* hold the majority of UK listed equities. At the end of 2008 they accounted for close to a half of UK ordinary shareholdings. The largest holders were pension funds and insurance companies with 27% of the overall total (Chart 19).
- *Private clients* Individual shareholding as a proportion of total share ownership has been on a downward trend since the 1960s, from over 50% to around 30% in 1980 to 10% in 2008. This, however, does not include shareholdings held indirectly through unit trusts.
- *Overseas investors* The proportion of UK ordinary shares held by overseas investors increased from 4% in 1981 to 42% in 2008. This reflects both international mergers where the new company is listed in the UK and also flotations of UK subsidiaries of foreign companies. It is

Table 7
UK share trading by trading platform

July 2011	€ bn	% share
Markit BOAT	109	35
LSE Group	107	35
CHI-X	44	14
Turquoise	13	4
BATS Europe	13	4
Johannesburg	6	2
Euronext	5	2
Stuttgart	3	1
Plus Markets	3	1
Nasdaq OMX Nordic	1	0
Smartpool	1	0
Others	4	1
Total	309	100

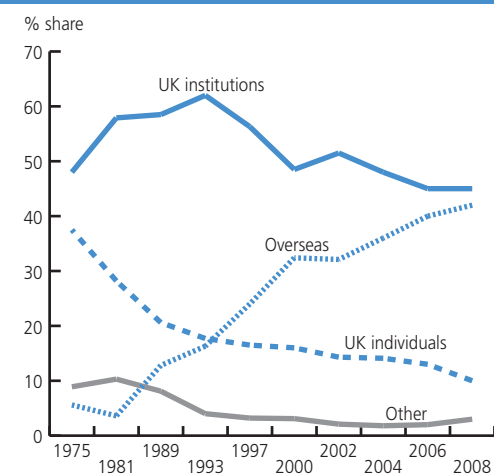
¹ Markit BOAT is a reporting platform for OTC trades which means that no actual trades take place
Source: Thomson Reuters

Chart 18
London Stock Exchange share of trading



¹ Excluding trading reported on Markit BOAT LSE's share in July 2011 was 53%; ² up to July 2011
Source: Thomson-Reuters

Chart 19
UK share ownership



Source: Office for National Statistics

also due to the greater internationalisation of institutional investors' portfolios. Their share ownership is mostly in FTSE-100 companies.

OTHER ACTIVITIES

The role of traders Traders retain a crucial role in equity markets although the basis of their involvement has changed. The proportion of trading undertaken on traders' own books throughout Europe has declined over the past decade with a much higher proportion of trades now worked through the exchanges through for example SETS on the London Stock Exchange. To facilitate growth in trade sizes, intermediaries are committing more capital to accommodate institutional customers with large orders which demand immediacy. This involves a degree of risk that the price of the share may move in the time it takes to organise the sale. London retains a large and influential role in this process because investment banks located there remain the main suppliers of this risk capital, providing immediate liquidity for large block trades in many European stocks. London's role in providing risk capital is long standing and reflects the way the market has evolved. Many of the traders are based in London, although some are also located in other European cities.

Clearing and settlement Despite the gradual integration of European securities markets, its clearing and settlement system remains fragmented. The charges for clearing and settling cross-border trades in Europe are several times higher than for domestic trades although this is gradually coming down following the implementation of MiFID. The European Code of Conduct for clearing and settlement of cash equities, implemented in January 2008, represents a market-led initiative to create a cost efficient European framework for the trading, clearing, settlement, and custody of cash equities. Pan-European settlement systems such as Clearstream and Euroclear provide services in both domestic and international securities. In addition to the pan-European clearing and settlement systems, there remains a significant number of different national providers of these services. The FSA has responsibility for overseeing the integrity of UK investment markets. It recognises five clearing houses.

Custody is concerned with the safe keeping of assets and settlement of trades on behalf of fund managers. Its rapid growth over the past decade has been fuelled by the growth of fund management operations, increased cross-border trading and expansion into new service areas. It is expected that the shift towards private pension provision in Europe in the next decade will add further stimulus to its growth. The global custody market is highly concentrated with a small number of firms dominating the market. At the end of 2010, BNY Mellon was the largest global custodian with some \$25bn of assets under management. It was followed by State Street \$22bn and JP Morgan \$16bn (Table 8). Clearing banks and fund management companies hold a large slice of the local custody markets in the UK. However a segment of the market has now been captured by foreign institutions established in the UK, particularly US banks and trust companies.

Clearing houses in the UK

Clearing houses in the UK recognised by the FSA include:

Euroclear UK and Ireland is the recognised settlement system for the UK market and Irish equities. In September 2002, CRESTCo, which has previously been the settlement system for the UK stock market, became a part of the Euroclear group. On 1 January 2007, EMXCo also became part of the Euroclear group.

LCH.Clearnet In December 2003 London Clearing House merged with Clearnet to create LCH.Clearnet. This is the leading independent CCP group in Europe, serving major international exchanges and platforms, equity markets, exchange-traded derivatives markets, energy markets, the interbank interest rate swaps market and the majority of the Euro-denominated and sterling bond and repo markets.

ICE Clear Europe which provides clearing services for all ICE Futures Europe contracts and all cleared OTC contracts transacted in ICE's global OTC markets.

European Central Counterparty Ltd is the European subsidiary of The Depository Trust & Clearing Corporation that provides pan-European clearing services. EuroCCP clears for Turquoise, SmartPool and NYSE Arca Europe. EuroCCP clears and settles trades in partnership with Citi Global Transaction Services, who acts as EuroCCP's settlement agent, in 15 major national markets in Europe including the UK.

CME Clearing Europe is a London-based clearing house, wholly owned by CME Group. CME Clearing Europe has been established in London with the aim of offering services as a multi-asset class European clearing house focused on non-US customers.

Table 8
Largest international custodians

end-2010	Assets (\$m)
BNY Mellon	25,000
State Street	21,530
J.P. Morgan	16,100
Citi	12,600
BNP Paribas	6,074
HSBC Securities Services	5,700
Société Générale	4,455
Northern Trust	3,700
UBS AG	3,700
CACEIS	3,200

Source: Pensions & Investments

Regulation

UK regulation The Financial Services Authority (FSA) regulates over 1,000 firms involved in dealing or advising in securities or derivatives. The Listing function was transferred to the FSA from the London Stock Exchange in 2000. The FSA also recognises and supervises a number of Recognised Investment Exchanges (RIEs) under the Financial Services and Markets Act 2000. The RIEs in September 2011 included the London Stock Exchange and Plus Markets and four derivatives exchanges - EDX London, ICE Futures Europe, LIFFE Administration and Management, and the London Metal Exchange.

EU regulation The EU also has a major influence on the regulation of trading in securities markets mainly through MiFID which replaced the Investment Services Directive in November 2007. The main objective of MiFID is to increase competition and consumer protection in investment services. MiFID is the cornerstone of the European Commission's Financial Services Action Plan whose measures will significantly change how EU financial service markets operate. MiFID provides a single passport for EU investment firms which enables them to engage in investment services throughout the EEA without separate authorisation by the Member State in which the firm does business. MiFID has facilitated competition in the trading of shares on stock exchanges for the first time. It also allows investment firms from one Member State the right of access to counterparty clearing and settlement systems in another Member State.

CONTRIBUTION TO THE UK ECONOMY

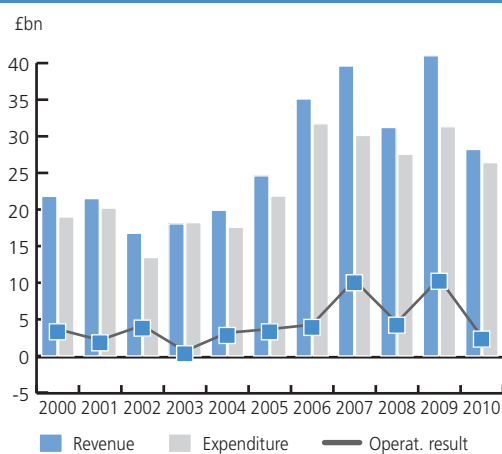
The UK securities market includes trading in domestic and international securities, both equities and bonds, most of which is centred in London. The securities markets' wider contribution to the economy is demonstrated in the integral role they play in enabling governments, companies and other organisations to raise money to meet their future financing needs. This has particularly come to the forefront during the recent economic downturn where the securities markets to a large extent filled the gap in financing brought about by the fall in liquidity and capital constraints in the banking sector.

Revenue and profits Securities dealers, perhaps more than any other part of the financial sector, tend to experience a large degree of volatility in their revenue and profits, depending on the performance of the markets in a given year. This volatility arises largely from fluctuations in profits and losses in market making, rather than commission and fee income which is more stable.

Operating profits of securities dealers totalled £1.8bn in 2010, down from £9.7bn in the previous year (Chart 20). In the decade prior to this, securities dealers results fluctuated between a loss of £0.2bn and a profit of £9.5bn. The smaller operating profit in 2010 was due both to a decline in commission income and a fall in profits from securities dealers' dealing on own account.

Employment Excluding support and back office staff, employment in securities dealing totalled around 47,000 at the end of 2010, down from

Chart 20
Operating results of UK securities dealers



Source: Office for National Statistics

Table 9
Net exports of UK securities dealers

£m	Exports		Total Exports	Imports	Net Exports
	Commission and fees	Spread earnings			
1999	3,996	1,209	5,205	829	2,865
2000	5,632	1,033	6,665	1,199	3,172
2001	5,211	1,492	6,703	1,296	3,380
2002	4,290	1,168	5,458	1,009	3,091
2003	3,922	1,316	5,238	795	3,294
2004	4,316	1,666	5,982	862	3,658
2005	4,628	1,918	6,546	1,244	2,266
2006	6,316	2,544	8,860	1,643	2,983
2007	8,429	2,815	11,244	985	4,763
2008	8,362	1,779	10,141	1,119	3,972
2009	6,829	713	7,542	716	1,428

Source: Office for National Statistics

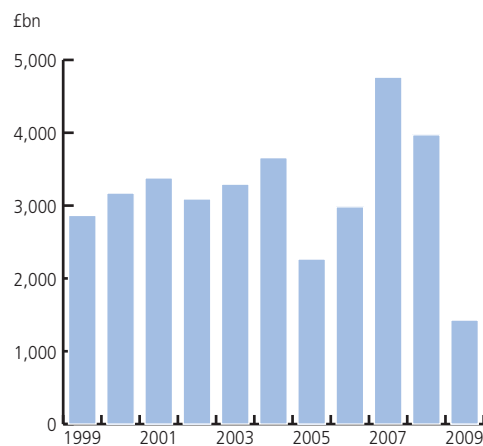
Employment in securities dealing totalled
47,000 in 2010

over 54,000 in the previous year. Most of the decline was due to a fall in securities dealers trading on own account category, which accounted for 21% of the number of employed in 2009, down from 27% in the previous year. About two-thirds of employed in securities dealing are located in London.

Value added No official estimate is made for securities dealers' contribution to GDP, but it is possible to make an estimate from market data. Figures however can be volatile due to varying market conditions. They also exclude trading on securities dealers' own account which does not form a part of GDP. In recent years, typically this contribution ranged between 0.1% and 0.6% of GDP in "value added" terms.

Net exports of securities dealers make a significant contribution to the UK balance of payments. They consist of fees and commissions, spread earnings and income and payments relating to other services. In total, net exports fell to £1.4bn in 2009 from £4.8bn in 2008 (Table 9, Chart 21). A fall in imports by securities dealers was more than offset by rising exports in both commissions and spread earnings.

Chart 21
Net exports of UK securities dealers



Source: Office for National Statistics

OTHER SOURCES OF INFORMATION

Bank for International Settlements
www.bis.org

Centre for Economic and Business Research
www.cebr.com

Financial Services Authority
www.fsa.gov.uk

Institutional Investor
www.institutionalinvestor.com

London Stock Exchange
www.londonstockexchange.com

National Statistics
www.statistics.gov.uk

Plus Markets
www.plusmarketsgroup.com

Thomson-Reuters
www.thomsonreuters.com

UBS Global Asset Management
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