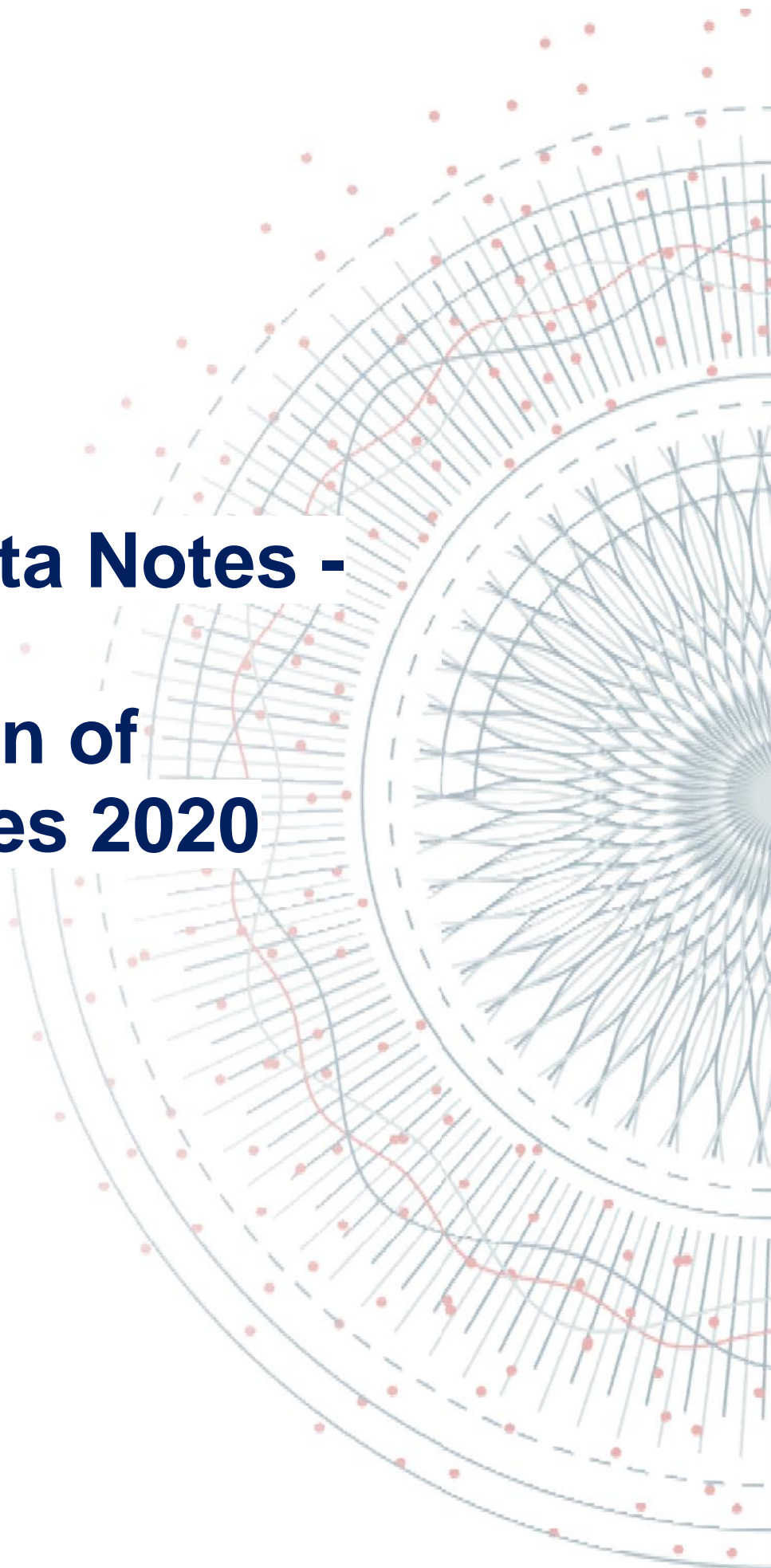# Axiomatic Data Notes -

Reconstitution of Russell Indices 2020

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Key Findings:

⟩ While technology companies continue to dominate the large-cap index, the highest percentage of new entrants in Russell 3000 in 2020 belonged primarily to the Professional and Scientific industry group.

⟩ Not surprisingly due to COVID-19, there were five companies belonging to the Accommodation and Food Services industry that exited the Russell 3000, but none within that industry entered the Russell.

⟩ Companies exiting the Russell indices were more likely to have a legacy defined-benefit plan, leading to additional stock price pressure on these bigger companies along with under-funded defined benefit plans (see http://www.axiomaticdata.com/blogPosts/covid-19-effect-on-defined-benefit-plans).

Introduction:

Every year FTSE Russell creates a family of indexes, called the Russell 1000, 2000, and 3000 indexes that consist of the largest 1000, 2000, and 3000 US public companies by market capitalization. For over 30 years these indexes have been used as a benchmark for measuring the performance of public companies in the US equity market. The Russell index is the most comprehensive indicator of financial health of the US equity market due to its breadth of industries, ensuring consistency, transparency, and reliability of US equity markets for global investors.

The annual "Russell reconstitution" took place in June. This is the rebalancing of Russell indexes based on each stock's performance relative to its target market segment over the preceding year and a resulting change in the market- cap rankings. From the time preliminary Russell lists are announced in May to Russell reconstitution day at the end of June, there is an increase in trading volumes as investors rebalance portfolios reflecting the new index components. This makes June 30 one of the highest trading-volume days of the year in US equity markets. Russell reconstitution is an important driver of short-term shifts in supply and demand for US equities, with significant movements in price and volatility of individual stocks or industry sectors.

Russell reconstitution post-COVID-19:

On May 8, FTSE Russell posted its preliminary lists of companies entering and leaving the Russell indexes this year. This list included 143 projected additions and 205 projected deletions. Although the total equity market-cap was down 1%, the market cap of the 10 largest US stocks was up more than 20% as compared to the previous year. The large end of the US equity market grew significantly since the 2019 rebalance. The six largest companies remained unchanged since last year's Russell

reconstitution. Microsoft is the largest company in the index again, followed by Apple, which traded spots with Amazon for second place.

For the first time in the history of Russell US Indexes, there are companies exceeding $1 trillion in total market cap: Microsoft, Apple, and Amazon, while the smallest company in the Russell 2000 (Limestone Bancorp) stands at a market cap of less than $100 million, for the first time since the recession of 2009. Six IPOs were added to the Russell 2000, all classified in the Health Care sector.
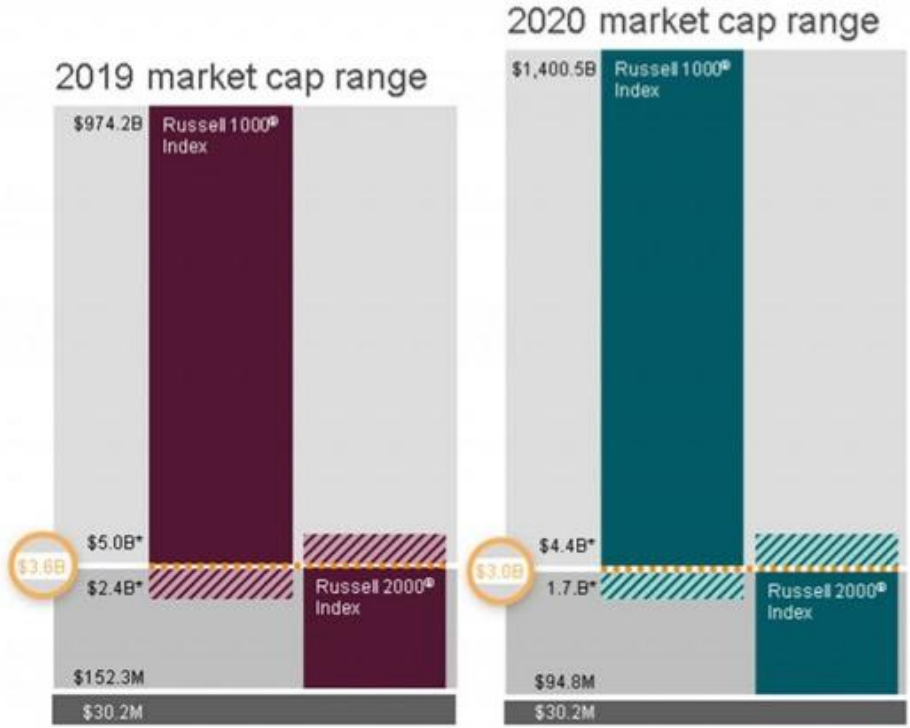
Source: FTSE Russell. May 10, 2019, and May 8, 2020

It was not surprising that technology companies dominated the large-cap index as they benefit the most from the new normal following the pandemic, while healthcare became the biggest sector in the Russell 2000, due to the outperformance of biotech and pharmaceutical companies.

Axiomatic Data for Russell 3000 companies:

As part of Axiomatic monthly data runs, we match / map data from Form 5500 filings and associated EINs to the Russell 3000 tickers using our Russell 3000 base fileand SEC 10-k filings. Additional data such as secondary name, EIN, and address aremapped from the 10-k filings to the Russell 3000 base file. For unmatched tickers, additional name derivations are investigated and used for matching. For example, while a bank's holding company might match the Russell 3000 ticker from SEC filings, Form 5500 data might be matched to the bank itself.

With the annual Russell reconstitution in June, new tickers were added to the Russell 3000 as part of Axiomatic's monthly data processes. The data was retained for all tickers ever in Russell 3000 for broader coverage. Adjustments were made for ticker changes to all tickers ever in Russell 3000 since 2013 (approximately 4500 tickers in our historical file). In other words, we provide coverage for more than the current Russell 3000 population to our clients. As part of our monthly data run process, we examined new EINs which previously have not filed Form 5500s and determined if they match to any of the unmatched Russell 3000 tickers.

The companies that entered the Russell 3000 in the 2020 reconstitution were younger than the companies that exited the Russell 3000, as observed by the axiomatic data field "cl_age_old_plan", a proxy for age derived from the age of employee benefit plans. We also noted that the companies exiting the Russell were more likely to have a legacy defined-benefit plan, leading to additional stock price pressure on these bigger companies with underfunded defined-benefit plans. The economic downturn caused by COVID-19 has led to a fall in the discount rate used by corporate sponsors of defined benefit plans to calculate pension plan liabilities. The resulting increase in pension plan liabilities coupled with a decline in many plan's asset values was observed to have significant implications for pension plan obligations, and may lead to financial distress for many firms in the near future. (See http://www.axiomaticdata.com/blogPosts/covid-19-effect-on-defined-benefit-plans for more information on defined-benefit plan obligations.)

While technology companies dominated the large-cap index, the highest percentage of new entrants in Russell 3000 belonged primarily to the Professional and Scientific industry (IRS industry classification, similar to NAICs). On the other hand, not surprisingly (post COVID-19), there were five companies belonging to the Accommodation and Food Services industry that exited the Russell 3000, but none within that industry entered the Russell. The largest company (in terms of employee count) that exited the Russell 3000 was Genesis Healthcare (GEN), while the largest company that entered the Russell 3000 was Five Star Living (FVE).

About Axiomatic Data:

The Axiomatic Data database contains quantitative data on public and private U.S. companies, extracted and aligned from Form 5500 (ERISA) filings. Form 5500 filings are mandated jointly by the U.S. Department of Labor and the Internal Revenue Service. The filings cover employee retirement and welfare benefit plans and are a required filing for all US companies that have over 100 employees or that offer their employees a pension plan.

The database contains reliable, accurate firmographic and employee benefits information on over 650,000 US companies. Levels of, and changes to employer contributions to employee benefit plans are frequently used as a measure of financial health. It makes sense – companies that regularly increase the contributions they make to employee benefit plans must have the current and future cash flow to afford the contributions. Companies that decrease contributions to employee benefit plans would only do so if they were in, or expected to be, in financial distress.