Making It Worth The Weight

Exploring the proposal for an expanded FBMKLCI

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A paper was published by FTSE Russell Market Consultation in late March to seek feedback on enhancing the FTSE BURSA Malaysia Index Series. A key proposal, among others (exhibit 1) is to expand the FBM KLCI constituents from 30 to 50 names. Investing using a benchmark is the domain for institutional fund managers, and as we note a sizeable proportion of foreign investors adopt passive investment strategies, the market impact could still be felt for most investors. The discussions in this note are therefore more technical in nature. The proposals are still in consultation stage, with implementation at the earliest at end-2026.

Overall, we welcome the change of expanding to 50 names for the FBM KLCI compoment stocks, which will provide slightly better representation of the economy. A 50-stock bellwether benchmark will better showcase industrials, property, and tech sectors at the expense of financials and utilities. In this note, we examine the correlation of sector returns and find that the expanded sectors are indeed lowly correlated with the dominant financials sector (exhibit 4), supporting argument of greater diversity, reducing potential large index swings. This low correlation could mean portfolio managers carefully choosing the right sector exposures becomes more crucial to determining overall performance.

There is also an option being proposed for capping at 10% exposure to one single company, which we support. If a cap of 10% were to be applied, this will potentially shift weightage and attention to the mid-tier banks in our view (given the top market-cap names are quite big-cap bank dominated), making them potential beneficiaries. For now, the stocks ranked 31-50 (which we refer to as next 20, see exhibit 3) have slightly weaker trading liquidity than FBM KLCI top 30 stocks, and some improvement can be envisaged, which will also enhance their appeal.

There may be some potential trade-offs, nevertheless. Notwithstanding the fact that a 50-stock FBMKLCI delivered a better annualized return by 60 bps over close to the past decade, the stocks ranked 31-50 (next 20) is slightly inferior to the existing FBM KLCI from a profitability-valuation trade off standpoint, as a snapshot in time. They are also slightly dilutive to the dividend yields as a whole of the FBM KLCI, a key appeal.

Revisting the bellwether benchmark construction

Proposed enhancements. In end-March 2026, FTSE Russell published a paper (link) on enhancing the FTSE BURSA Malaysia Index Series. The proposals, as per Exhibit 1 below, are in consultation phase (with submission of by 24 April). The changes, if approved, will be effective on either 21 December 2026 or 21 June 2027, depending on the market consultation.

Exhibit 1: Proposed changes
1. Expanding the FBM KLCI from 30 to 50 constituents.
2. Applying a 10% company-level capping to FBM KLCI constituents.
3. Reducing the FBM70 from 70 to 50 constituents.

Source: Kenanga, FTSE Russell

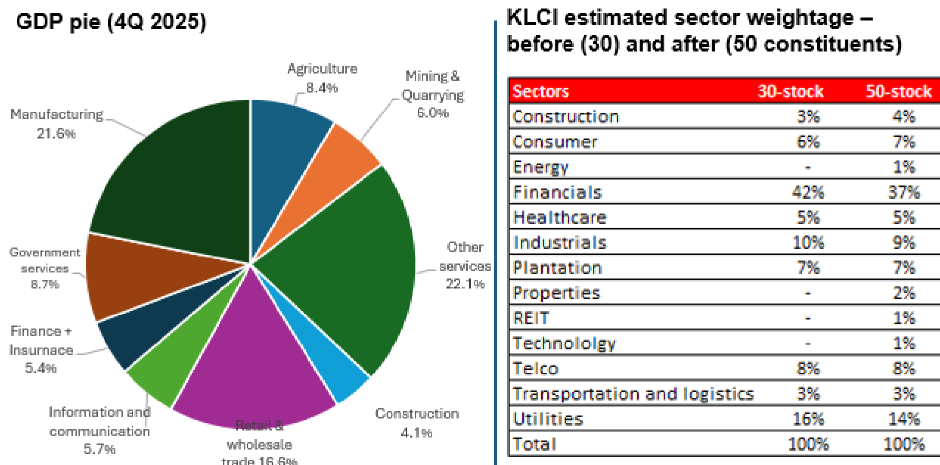
Sizeable investors employ tracking index as an investment method, and thus the market impact could be felt across board. Following a benchmark closely to allocate investments is the domain for institutional fund managers, and we note a sizeable proportion of foreign investors adopt such strategies - we observe acccording to the Securities Commission (*special feature: growth of passive funds*), this older study published in 2022 showed that 40.59% of foreign non-strategic investors were passive investors. As such, the market impact could still be relevant across most investors types, despite local unit trust funds especially with active investment strategies may not adhere to the weights strictly.

The proposal for FBM KLCI top 50 raises market capitalization coverage to 70% from 60%, seen more in line with peers. FTSE Russell pointed out that the representativeness of FBMKLCI has come under scrutiny, as the market broadened, with the evidence being a long-term decline in the proportion of market capitalization captured by the index. Another point highlighted was the dominant role of Financials in terms of representation. In our view, this move to increase the coverage from 60% to 70% is relevant as when we compare with neighbouring countries, the representation of the Stock Exchange of Thailand's 50 (SET50) index to the larger Thai stock universe is about 78%. Peering over to Indonesia, the 45-consituent LQ45 index in Indonesia Stock Exchange (IDX), which comprises among the largest market capitalization stocks, these formed a smaller 48% of the IDX.

Towards better diversification and representation

More representative. A list of the next 20 stocks that could make the 50 stock FBM KLCI per the consultation is based on a certain cut off date (December 2025 review), and thus we expect this list, as shown in exhibit 3 below, to be hypothetical. Including these stocks into the construction, we note that generally the FBM KLCI portrays better representations in areas such as Energy, Properties, REIT, and Technology stocks. This would at the expense of almost 5 ppts drop in Financials and to a smaller extent in utilities. While still not mirroring the economic pie, better alignment is achieved in certain areas such as construction, and mining and quarrying/energy.

Exhibit 2: GDP Breakdown Mix for 4Q2025 Aad Estimated Sector Weightage for FBMKLCI and FBMKLCI Top 50



KLCI estimated sector weightage – before (30) and after (50 constituents)

Sectors	30-stock	50-stock
Construction	3%	4%
Consumer	6%	7%
Energy	-	1%
Financials	42%	37%
Healthcare	5%	5%
Industrials	10%	9%
Plantation	7%	7%
Properties	-	2%
REIT	-	1%
Technololgy	-	1%
Telco	8%	8%
Transportation and logistics	3%	3%
Utilities	16%	14%
Total	100%	100%

*Source: Kenanga Research. *Note for sectors exposure above, this involves Kenanga's own calculation. The sector classifications generally follow the BURSA classification, aside where more clarity for investors are useful.*

Exhibit 3: Hypothecial List of Names Provided in the FTSE Russell Paper As the Next 20 Per December 2025 (We Don't Expect Names to be Static as the Implementation Would Take Pplace Only by December 2026 or June 2027

Industrials	MCEMENT, IJM, SUNCON, HAP, WESTPORTS
Real estate	IOIPG, IGBREIT, SIMEPROP, SUNREIT, PAVREIT
Consumer	GENM, GENT, UP
Technology	VITROX, INARI
Others	TIMECOM, KPJ, ABMB. ECOSHOP, DIALOG

Source: FTSE Russell, Kenanga Research.

We use a correlation matrix approach to prove diversification benefits. One of the factors pointed out by FTSE Russell was that previously, given that Financials persistently formed more than 30% of the index, this has limited diversification effects. We thus sought to explore whether expanding more into the industrials, technology, and property could indeed improve the diversification. Using a more simplistic correlation tool via a matrix wwas our approach, whereby in our sample below, we used BURSA classification and have mapped out the correlation using weekly returns from 2022 onwards (which coincided with the phase where Financials sector as a proportion of the total index started to climb). We note for example that these few sectors mentioned above (bolded) generally have low correlation (generally below 0.5) with the dominant financials index.

Exhibit 4: Matrix of Correlation of Weekly Returns from 2022 to March 2026

Sectors	Financials	Construction	Technology	KLCI	Property	Plantation	Consumer	Utilities
Financials	-	0.28	0.27	0.81	0.38	0.35	0.42	0.27
Construction	**0.28**	-	0.52	0.44	0.66	0.17	0.38	0.45
Technology	**0.27**	0.52	-	0.45	0.56	0.14	0.55	0.47
KLCI	0.81	0.44	0.45	-	0.50	0.56	0.65	0.49
Property	**0.38**	0.66	0.56	0.50	-	0.23	0.52	0.56
Plantation	0.35	0.17	0.14	0.56	0.23	-	0.40	0.21
Consumer	**0.42**	0.38	0.55	0.65	0.52	0.40	-	0.42
Utilties	0.27	0.45	0.47	0.49	0.56	0.21	0.42	-

Source: BURSA, Bloomberg

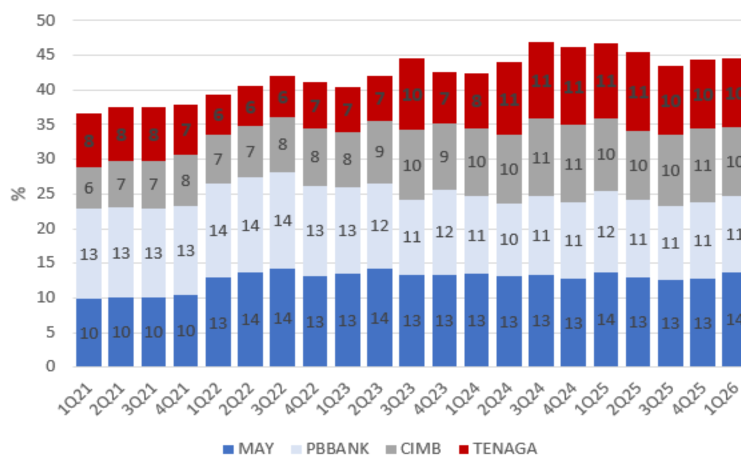
The implication of the above is that during a Financials stock rally for example, we don't expect the rest of the portfolio to gain together with high synchronization. This is a proof that diversification is achievable. That said, this also places the onus on the investor/fund manager to choose sectors wisely, as picking the right sector for performance becomes more paramount (given smaller correlation between sectors).

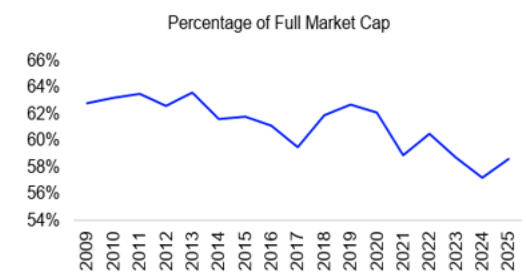
Applying a cap of 10% is prudent in our view

In a stock index such as the FBMKLCI which is a free-float market capitalization weighted index, what could happen is that certain names become large and thereafter create some concentration challenges. We have noted for example that while the assertion is true that the FBMKLCI as a proportion of the entire Malaysia stock exchange market capitalization has been reducing (exhibit 5), there is an argument from Kenanga's observation that the density of the top four stocks – 3 of the 4 being banks – have in fact been growing. The weightage of the 4 names in exhibit 5 are shown based on a 30 stock index, and expanding to 50 stocks should see likely Maybank more at risk (of being more than 10%).

The below chart shows both trends side by side, with the left depicting the quarterly weight of each of the top four stocks in the FBM KLCI over the past five years. The right chart shows the market cap coverage of the top 30 stocks. Thus there is an argument to say a cap is required at the proposed 10%. We opine that if a cap was to be installed, this will likely give more weightage for middle tier banks, and in that way create more attention into those names to a small degree, as well as non-banks. Overall, we support the cap to give more weightage and representation to non-financials sectors. Operationally, we believe commonly that adding a cap could also mean that stocks that drift past the 10% could thereafter be resized, or to use a jargon, the portfolio has to be rebalanced.

Exhibit 5: Market Cap Coverage of the Top 30 Stocks and The Quarterly Weight Of the Top 4 Stocks in FBM KLCI (before expanding to 50 stocks)

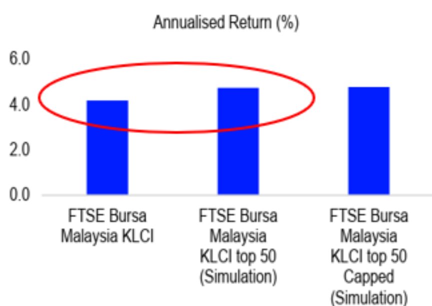


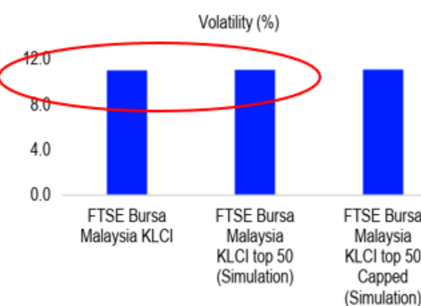


Source: Kenanga Research.

Supportable by better risk-adjusted returns over time… Per FTSE Russell's work done on the returns for a 50 stock FBM KLCI, the returns would be 60 basis points better (annualized) basis over the 30-stock version, if mapped over the horizon of June 2016 to December 2025. We further observe that as stock volatility (via the eye-test in the graph below, as numbers were not shared) remained steady, one could conclude therefore that as a portfolio the risk-adjusted returns turned out favouring the expanded index, over that investment horizon.

Exhibit 6: FTSE Russell Computation of Returns and Volatility for the FBM KLCI and FBM KLCI Top 50





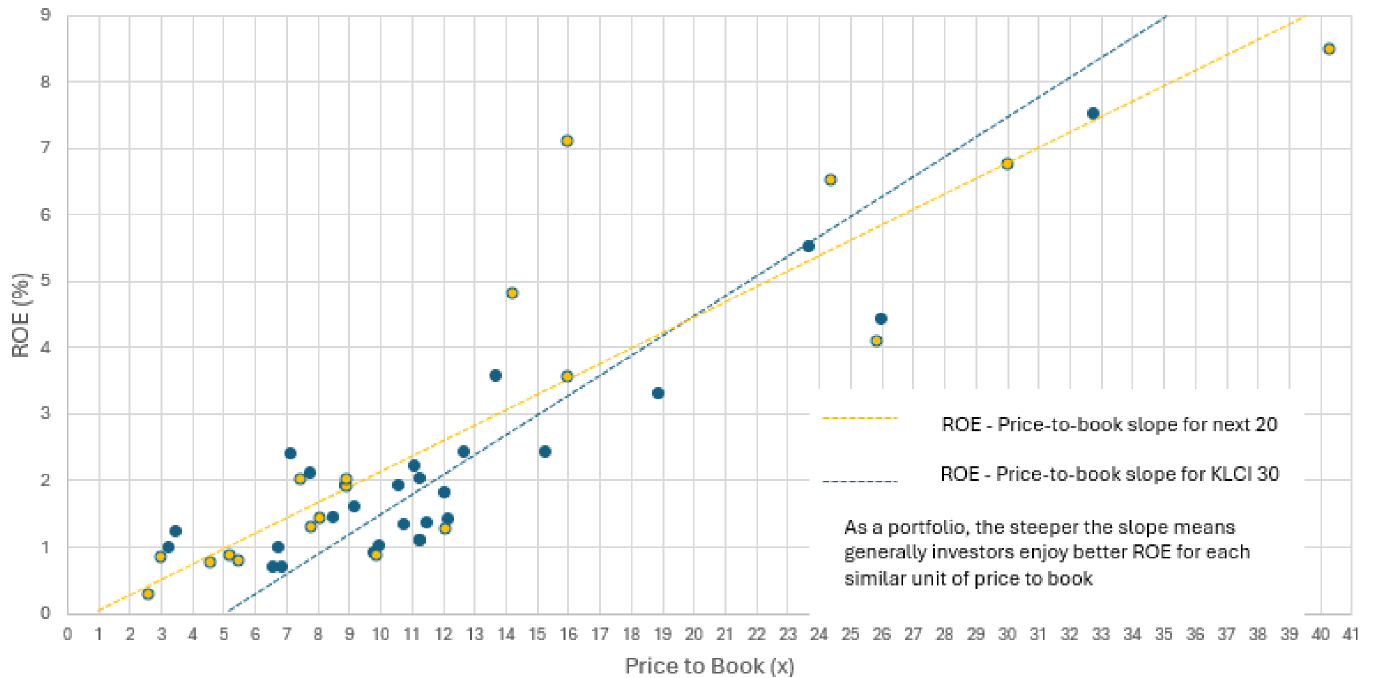
Annualized return at 60 bps higher using data from June 2016 to Dec 2025

While returns were 60bps higher, from eye-test volatility is stable, implying better risk-adjusted returns, in our view

Source: Kenanga Research.

…but we watch for current PB-ROE trade off. While we don't have push-back over the above data and attainment over that long-term horizon, we think the snapshot-in-time view for adding the Next 20 into the 30-stocks FBMKLCI would be adding on a lesser risk-reward portfolio. This is a conclusion we draw from mapping the entire 50 stocks for its expected Return on Equity against the its Price to Book (by consensus). In such as scenario, we find that the risk-reward for the FBM KLCI 30 stocks is still slightly superior, judging from the fact that the slope of the PB-ROE chart is steeper (meaning lower price-to-book for the same level of ROE). We think that using price-to-book is acceptable for this comparison given that we expect generally larger companies in terms of market capitalization to be more stable and mature.

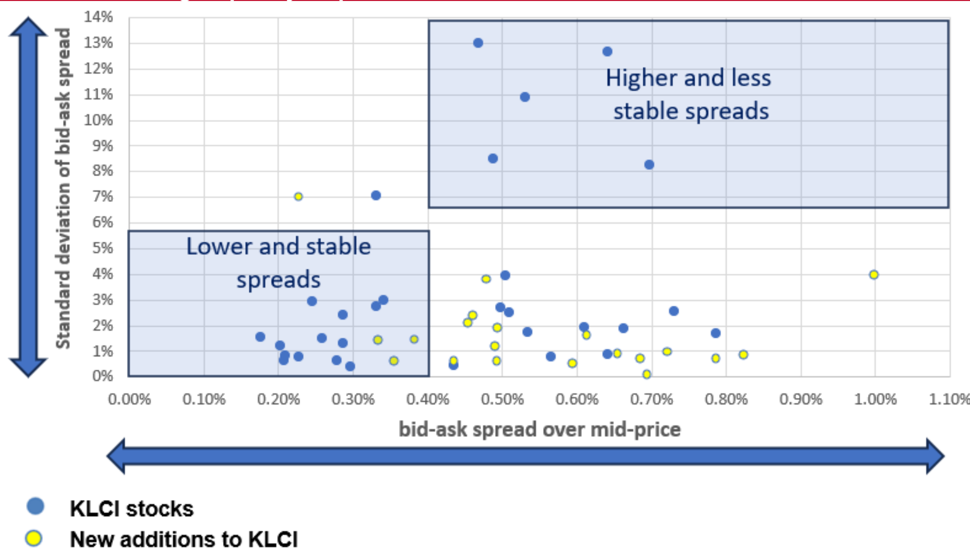
Exhibit 7: ROE tto Price to Book Trade-Off for the 30 Stocks in the FBM KLCI (in Blue) and the Expected Hypothetical 20 Stocks to be Added (in Yellow)



Source: Kenanga Research.

Some dividend yield dilution, from optics standpoint. We also observe that FBM KLCI has often boasted an established position of having strong divdiends appeal, largely anchored by a high mix of financials and to a lesser extent utilities sectors. By reducing the weightage to these two sectors, is to reduce dividends yields from an optics standpoint. This is driven by the fact that the 20 stocks to be added carry a yield on average for dividends of 3.7%. Compared to the FBM KLCI's current 4.3% yield, we therefore estimate slight dilution in dividend yield to be possible.

Exhibit 8: Trading Liquidity Gap Should Narrow Between FBM KLCI and the Next 20 stocks



Source: Kenanga Research.

Some narrowing of gap in trading liquidity position expected for the next 20 stocks. We believe that one small benefit that could emerge from expanding the FBM KLCI into 50 stocks is in the trading liquidity for the next 20 stocks. We examine from the angle of bid-ask spreads – which should narrow versus the current incumbents of the FBM KLCI 30 stock names. Put plainly, a smaller spread between buyers and sellers generally indicate a stock being more liquid and vice versa. We plotted the 50 names in exhibit 8 above, where the X-axis showed the spread measured as a percentage of share price (mid-price). On the Y-axis, we examine how volatile this spread is over a period of a decade. We arrived at the conclusion that lion's share of stocks that occupy the low spread with low volatility quadrant are mostly the FBM KLCI 30 stocks, with only a small minority of that from the Next 20 names. We expect therefore that the entry into the FBM KLCI top 50 could be a catalyst for the latter's trading liquidity.

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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