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The Four Companies That Control the 147 Companies That Own Everything

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Markets

I write on investing, markets and movers. I'm a technical analyst (CFTe) and a long-time business reporter with an interest in ESG.

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There may be 147 companies in the world that own everything, as colleague Bruce Upbin points out and they are dominated by investment companies as Eric Savitz rightly points out. But it's not you and I who really control those companies, even though much of our money is in them. Given the nature of how

money is invested, there are four companies in the shadows that ***really*** control those companies that own everything.

Before I reveal them, some light math:

According to the 2011 annual factbook from the Investment Company Institute, there is $24.7 trillion in all the mutual funds in the world (a little less than half from the US). Based on data from the ICI, $1.24 trillion of this is directly invested in index funds, plus another $992 billion in assets beyond that $24.7 trillion in Exchange Traded Funds, which aren't mutual funds but are index funds. That means the bulk of that money is in "active" managed funds or fund of funds.

But then consider this: the chief of hedge funds at a very large asset manager told me last week (alas, I cannot identify either) that an internal study his firm recently performed found that the vast majority of mutual funds defined as actively managed see 95% of the assets they hold determined by an index. That

means just 5% of actively managed funds really are driven by the active manager's judgment.

This less-than-active management is for two reasons: one is to maintain the fund in a style box (i.e. large value stock, medium value stocks) and comply with the reality all mutual funds are required to have a benchmark index they compare their relative performance to. The other reason is to adhere to risk metrics to which most of the fund industry is beholden. This second point is partly due to Modern Portfolio Theory (a complex topic we won't debate here) and to the human nature that active managers tend to build portfolios close to the indexes they benchmark against to avoid really awful downward relative performance years that ends up costing them their jobs.

So of the $25.69 trillion in worldwide assets we've identified, $2.23 trillion are directly in indexes (ETFs and index mutual funds) with another $22.3 trillion indirectly beholden to

indexes (that 95% of actively managed fund holdings said to be determined by an index).

You can see where I'm headed here. That means the real power to control the world lies with four companies: McGraw-Hill, which owns Standard & Poor's, Northwestern Mutual, which owns Russell Investments, the index arm of which runs the benchmark Russell 1,000 and Russell 3,000, CME Group which owns 90% of Dow Jones Indexes, and Barclay's, which took over Lehman Brothers and its Lehman Aggregate Bond Index, the dominant world bond fund index. Together, these four firms dominate the world of indexing. And in turn, that means they hold real sway over the world's money.

While that may seem benign - they are indexers after all you may say - a financial index isn't cut and dried like the index of a book. It's a misperception indexers merely do some simple math like identifying the 500 largest US companies and *voila!* you have the S&P 500. Every indexer has a fudge factor that

allows them to say one company is more "economically significant" for the index at hand than another company. To again take the S&P 500 as an example, the 502-largest company by market cap could get the nod over number 500 by size if S&P decides it wants to.

The power is even more obvious in bonds. The now-Barclays Aggregate Bond Index attempts to mirror volume of bond issuance in a region or the world, but it can't include even a sizable percentage of all the bonds issued. Essentially, there's a big judgment call in there in what bonds it adds to its index. A judgment that influences bond fund flows worldwide.

What does all this mean? Researchers at a desk in midtown Manhattan are the butterflies that cause the hurricanes in the markets. For instance, 37% of all index funds in stocks are in a S&P 500 index fund. That's $370 billion directly buying and selling stocks based on when the S&P analysts decide to drop ITT from the S&P500 and replace it with just one of three ITT spin-off, Xylem, as announced on

Monday. Then add on top of that all of the so-called active mutual funds aiming to beat the S&P 500 (but still reflect 95% of the S&P in their funds) who react to the change and then all of the hedge funds who trade ahead of time trying to guess what S&P may drop or add.

I don't have a grudge against any indexer (and full disclosure, I've done work for some of them). And the folks at McGraw-Hill don't seem to spook people the way George Soros manages to. But when you discuss power in the world markets, the answer isn't what you think it is.

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