

Index investing will evolve to cope with mega IPOs

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This year marks 50 years since index investing was introduced to everyday investors. At the time, the concept drew scepticism. Why would anyone settle for “average” returns rather than trying to beat the market?



Today, it’s facing a different kind of test, one defined by a new wave of mega initial public offerings from companies such as SpaceX, Anthropic and OpenAI.

Those IPOs are raising questions about whether index funds will be forced to buy them at scale, exposing them to risks.

When indexing began a half-century ago, IPOs looked very different. Offerings were smaller and a larger share of the company was listed and traded from the outset. That’s no longer the world we live in. With the upcoming IPOs, a smaller portion will probably be made available with additional shares entering the market for public consumption over time.

Today’s pipeline of IPOs includes companies with trillion-dollar valuations, placing them among the largest companies in the market.

This shift has fuelled debate about how indices should incorporate these mega flotations amid claims that IPO structures — and even index inclusion rules — are being engineered to take advantage of passive flows.

But that framing misunderstands how indexing works and how markets ultimately absorb supply and determine prices over time.

From the start, index investing rested on a few core principles — broad diversification, low costs, transparency and letting the markets determine outcomes.

Those principles weren’t designed for any single era. They were designed to hold up as markets change. And the market always changes.

Over the years that Vanguard has been offering index-tracking funds, methods have evolved in response to those changes.

One of the most important has been the shift towards float-adjusted market capitalisation, meaning a company's weight in the index is based on the shares investors can actually buy, not including shares held by insiders and other private investors that aren't listed.

This matters enormously for today's mega IPOs. SpaceX may carry a trillion-dollar valuation but only a fraction of its shares is likely to be available for trading, the so-called free float. Float-adjusted indexing ensures that portfolios reflect what investors can actually buy, not the full headline valuation.

Float-adjusted indices are not allocating capital based on hype, they are allocating based on investable reality.

Even with a relatively small float, SpaceX will probably be the largest IPO to date so the dollar value available to trade will still be substantial, supporting liquidity and efficient price discovery.

For most portfolios, the impact may be modest but these mega IPOs will probably trade easily from day one.

This high liquidity explains why large IPOs are sometimes included in indices sooner than smaller ones. This is often described as a rush but, in practice, it's the opposite. Large groups that meet size and liquidity thresholds simply satisfy inclusion rules faster than others.

What indexing resists, by design, is the temptation to embed narratives into long-term portfolios. Indices don't predict which IPOs will succeed or stumble. They don't pass judgment on business models. They take the market as it is.

They promise exposure to the investable market over time with clear rules. Sometimes that means adding companies that later disappoint, but it also means owning companies early that go on to reshape industries.

Facebook's 2012 IPO offers a useful illustration. After its debut, the stock fell nearly 50 per cent in the first few months. Now called Meta, it has a market capitalisation of more than \$1.5tn. This underscores the difference between short-term volatility and long-term investing. As the late Vanguard founder John Bogle was fond of saying, don't look for the needle, just buy the haystack.

Indexing has endured because it continues to adapt. With several mega IPOs expected in the near term, many index providers are continuing to refine criteria for index inclusion.

By tying inclusion to what investors can actually buy, indices stay grounded in economic reality rather than reacting to the excitement surrounding the deal.

Fifty years ago, indexing offered investors a simple proposition — participate in the growth of markets without needing to outguess them. That proposition still holds. As IPOs grow larger and structures more complex, the value of disciplined representation only matters more.