

Numis Smaller Companies Index

Q2 2013 Review

UK smaller companies have outperformed by almost 5% over the first half of 2013. The Numis Smaller Companies index, excluding Investment Companies, has returned 13.2%, compared to the FTSE All-Share return of 8.5%. Momentum (buying winners) and Value have been the favoured style factors so far this year. Despite significant outperformance over the last five years, smaller company absolute and relative valuations (trailing P/E) remain relatively close to their historical average.

- **Smaller Companies outperform in H1 2013:** Smaller Companies have continued to outperform in 2013, with the Numis Smaller Companies Index ex Investment Companies ahead of the FTSE All-Share by 4.7% in the first half of the year. Over the last five years the Numis Smaller Companies Index ex ICs is up by over 90%, compared to the FTSE All-Share up by 40%.
- **Value & Momentum outperform:** We monitor the performance of a number of style factors on a monthly basis. Over the last six months Momentum (buying previous share price winners and selling losers) has had an extremely strong run. Also, Smallcap Value has continued to outperform against Smallcap Growth, having started to outperform in mid-2012, after a number of years of Growth outperformance. Looked at by industry group, Resources sectors have been particularly weak, while Consumer Services sectors (Travel & Leisure, Media and Retail) have been notably strong.
- **Smaller company valuation:** We estimate that the Numis Smaller Companies Index now trades on a trailing P/E of 14.3x. This is a small premium of 2% to the main market, and a modest premium to the 30-year PE average of 13.3x. Given the very strong performance of smaller companies on both a one and five year view, we think investors should be encouraged that smaller company valuations in aggregate remain relatively close to long-term historical averages.
- **Numis Smaller Companies Index:** The Numis Smaller Companies Index is the most widely used UK smaller companies benchmark. The index is compiled by Professor Paul Marsh and Professor Elroy Dimson of London Business School, and has been distributed by Numis since March 2012. The index was first published in 1987, with a back-history dating from 1955. The primary index covers around 800 companies which make up the bottom 10% of the UK main listed market by value. Over 1955-2012 the Numis SC Index ex Investment Companies total return beat the FTSE All-Share by an average of 3.4% pa.

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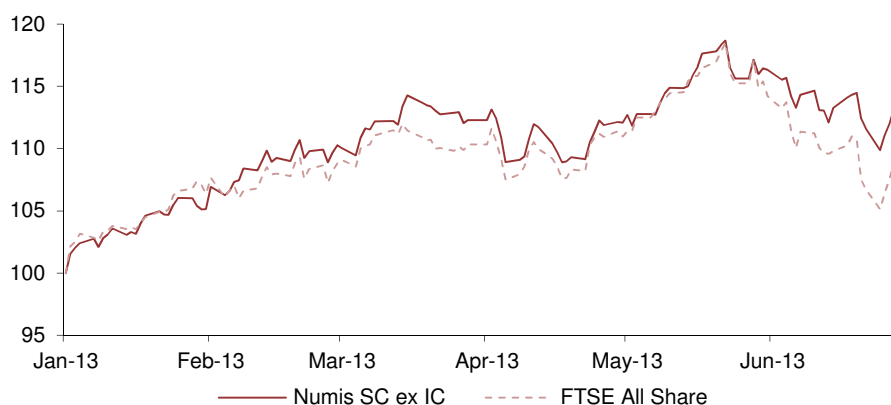
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Smaller company performance

Over the first half of the year the benchmark Numis Smaller Companies index, excluding Investment Companies, has generated a total return of 13.2%. This compares to the FTSE All-Share total return of 8.5%, giving smaller company outperformance of 4.7%.

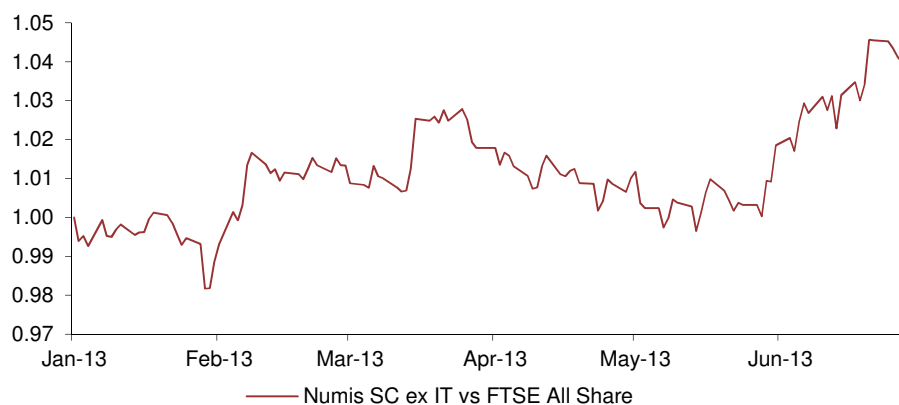
Figure 1. Numis Smaller Cos index & All-Share Index total return



Source: Numis Securities Research Department, Datastream

The relative performance chart below perhaps shows the timing of the outperformance more clearly. Most of the smaller company outperformance has come since late May, as the FTSE All-Share has fallen back more steeply than the Numis Smaller Companies index.

Figure 2. Numis Smaller Cos index total return relative to All-Share Index



Source: Numis Securities Research Department, Datastream

The table below shows the performance of various indices for H113, including performance splits for Q113 and Q213. The AIM index has once again performed poorly, influenced in part by its heavier weighting to resources sectors (Mining, Oil & Gas), particularly in the second quarter. The Numis Smaller Companies index has been a slightly easier benchmark to beat than the FTSE Smallcap index during the first half of 2013. The FTSE Midcap index also performed well during the half.

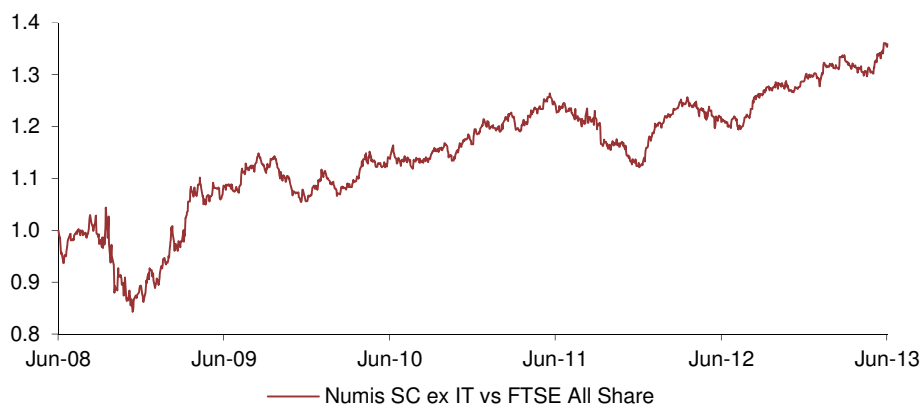
Table 1. UK index performance, H1 2013

	% change (capital gains)			% change (total returns)		
	Q113	Q213	H113	Q113	Q213	H113
Numis SC Index (ex Inv Cos)	11.8	(0.3)	11.4	12.3	0.8	13.2
Numis SC Index (ex Inv Cos) rel All-Share	2.5	2.4	5.1	2.0	2.4	4.7
Numis SC + AIM (ex Inv Cos)	9.2	(1.6)	7.5	9.7	(0.7)	9.0
Numis SC + AIM (ex Inv Cos) rel All-Share	(0.0)	1.1	1.2	(0.6)	1.0	0.5
Numis SC Index (inc Inv Cos)	11.1	(0.6)	10.5	11.8	0.4	12.2
Numis SC + AIM (inc Inv Cos)	9.4	(1.5)	7.8	10.0	(0.7)	9.2
Numis 1000 Index (ex Inv Cos)	10.6	2.4	13.2	10.9	3.6	14.9
Numis 1000 Index (inc Inv Cos)	10.4	0.6	11.0	10.9	1.6	12.7
FTSE All-Share	9.3	(2.7)	6.3	10.3	(1.7)	8.5
FTSE 100	8.7	(3.1)	5.4	9.8	(2.0)	7.6
FTSE 250 (inc Inv Cos)	12.5	(0.9)	11.5	13.0	0.1	13.2
FTSE 250 (ex Inv Cos)	13.0	(0.6)	12.3	13.5	0.5	14.0
FTSE 350	9.2	(2.8)	6.2	10.3	(1.7)	8.4
FTSE SmallCap (inc Inv Cos)	11.3	0.3	11.6	11.8	1.2	13.1
FTSE SmallCap (ex Inv Cos)	10.6	2.6	13.5	11.0	3.8	15.3
FTSE Fledgling (inc Inv Cos)	10.7	2.8	13.9	11.1	3.7	15.2
FTSE Fledgling (ex Inv Cos)	7.8	5.5	13.8	8.0	6.6	15.2
FTSE AIM All-Share	3.4	(5.4)	(2.2)	3.5	(5.2)	(1.8)

Source: Numis Securities Research Department, Datastream

Looked at over a longer time period, UK smaller companies have been a very strong asset class. In absolute terms the Numis SC index ex ITs has returned 91% over the last five years (13.8% pa compound), compared to the FTSE All-Share return of 40% (7.0% pa compound). This gives 36% outperformance over the five years (on a compound basis), or 6.3% pa.

Figure 3. Numis SC index relative performance, last 5 years



Source: Numis Securities Research Department, Datastream

Industry group and stock performance

The table below shows the performance of broad industry groupings within the Numis SC Index, excluding Investment Companies.

Table 2. Industry group total return within the Numis Smallcap Index

	Returns Q113	Returns Q213	Returns H113	Returns CY12	Weighting Start of 2013	Weighting Jun-13
Consumer Services	14	8	23	44	24	25
Financials	16	3	20	31	17	18
Support Services	14	2	16	34	15	16
Industrials (1)	11	1	13	26	12	12
Technology	13	(7)	5	43	6	6
Oil & Gas	8	(13)	(6)	11	5	5
Mining	(13)	(30)	(39)	(27)	4	2
Healthcare	11	(4)	6	23	3	3
Other (ex Inv Cos)	12	1	12	37	13	13
Index (ex Inv Cos)	12	1	13			

(1) The ICB Industrials sector ex Support Services (includes Construction, Capital Goods and Industrial Transportation)
Source: Numis Securities Research Department

During 2013 the Consumer Services industry group has been the strongest performer in the Numis Smaller Companies Index, followed by Financials and Support Services. The Resources sectors have been the weakest. After relatively little sector differentiation in Q113 (except Mining), Q213 saw a more diverse sector performance, with Consumer Services (Travel & Leisure, Media, Retail) continuing to do well, while Oil & Gas, Technology and Healthcare fell back, alongside continued poor Mining performance.

Looking at the key industry groups in turn:

- **Consumer Services:** The best performing group in H113, with the component sectors of Retail, Travel & Leisure and Media all performing well. Notable strong individual stock performances came from Ocado (the highest positive contributor to index performance overall), Dunelm, Dixons, Thomas Cook (the second highest overall contributor), Playtech, Domino's Pizza, PERFORM and moneysupermarket. Weak performers include First Group and Debenhams.
- **Financials:** The second best performing group in H113, with all component sectors performing well. Notable strong stock performers include Intermediate Capital, Beazley and IPF.
- **Support Services:** We separate out the Support Services sector, which is the largest sector at 16% of the NSCI ex ICs. The sector has performed well, with strong performance from Essentra (nee Filtrona), Howden and Regus. Weak performers include Carillion and Michael Page.
- **Industrials:** A strong performance by the Construction sector, with broadly in line performance from Capital Goods companies. Notable strong performers include Xaar and BBA Aviation, with weak performers including Fenner and Oxford Instruments.
- **Technology:** Q1 performance was in line, but Q2 was weak. Strong performers include CSR, with key weak performers Imagination Technologies and SDL.
- **Resources:** Almost all Mining and Oil share prices are down so far in 2013, with the miners particularly badly hit. The Mining sector now only accounts for 2% of the index, having been almost 7% just 18 months ago.
- **Other:** Strong performers include the Housebuilders (notably Bellway). Weak performers include AZ Electronics and Premier Foods.

Style returns in UK smaller companies

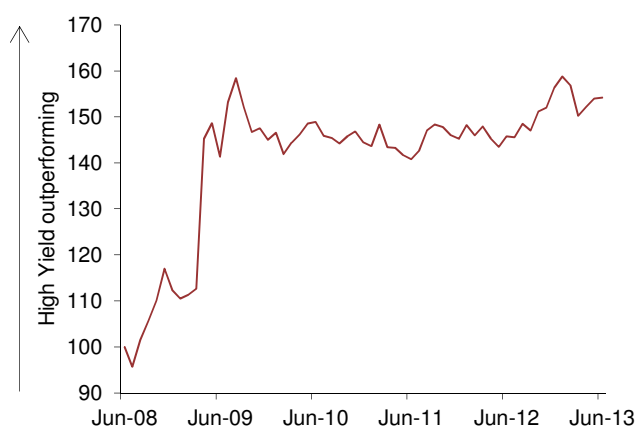
We look at four different style definitions. Long term performance data quoted here all refer to the period up to the end of 2012:

- Yield:** We define high yield and low yield as the 30% of highest and lowest yielding stocks immediately prior to the start of the year. We also monitor the performance of non-dividend payers. Since 1956 high yield UK smaller companies have returned 18.5% annualised total return, low yield UK smaller companies have returned 13.8%, and non-dividend payers have returned 9.2%.
- Value:** Value is measured by ranking stocks by their ratio of equity book value to market value. The 40% highest book-to-market group are measured as Value, and the 40% lowest as Growth. Since 1955 Value has outperformed Growth by +4.7% per annum. While Value has beaten Growth over the very long term, over the last 10 years Growth has outperformed Value by 1.6% pa.
- Size:** In addition to the comparison of the overall bottom 10% of the market with the whole market, shown above, we also provide data on size performance within the Numis SC Index. We divide into smaller small (the 70% of the Numis SC Index by number with the lowest capitalisation) and larger small (the top 30%). Since 1955 smaller small companies have modestly outperformed larger small companies (+0.9% pa), although in the last twenty years smaller small and larger small have performed exactly in line with each other.
- Momentum:** We produce two momentum measures. The primary measure that we focus on is "12-1-1". This involves ranking stocks by their returns over the past 12 months and defining winners as the top 20% of performers, and losers as the bottom 20%. The strategy is to then wait 1 month before investing for 1 month in the winners and losers, then to repeat the process, rebalancing each month. We also provide data on a "6-1-6" strategy (measure over 6 months, wait 1 month, hold for 6 months, rebalance every 6 months). Over the very long term, winners have very strongly outperformed losers, on average by 18% pa since 1955, using the 12-1-1 approach.

High Yield versus Low Yield

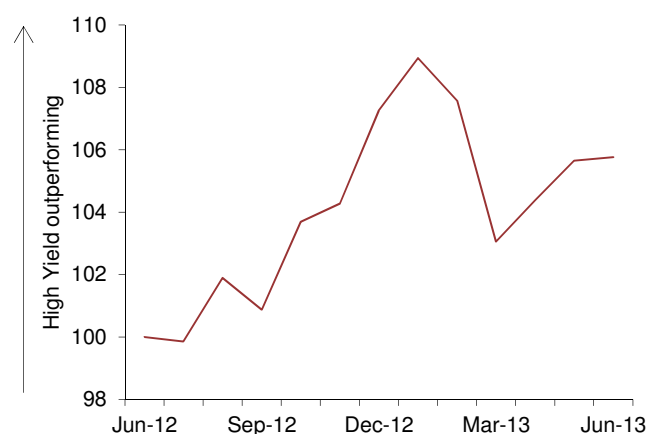
Through the last few months of 2012 High Yield performed well against Low Yield. Since the start of 2013 Low Yield has modestly outperformed High Yield.

Figure 4. High Yield vs Low Yield (5 years)



Source: Numis Securities Research Department

Figure 5. High Yield vs Low Yield (12 months)

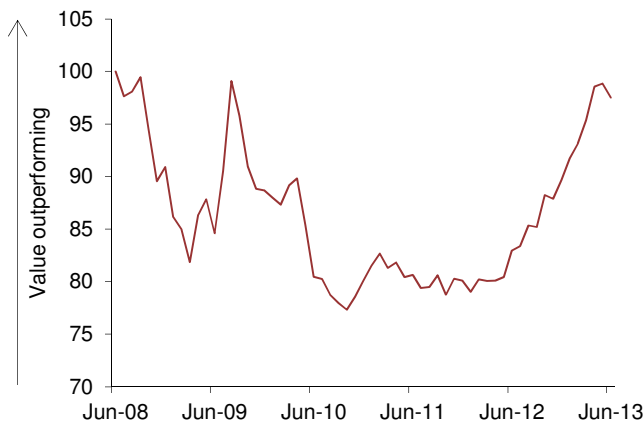


Source: Numis Securities Research Department

Value versus Growth

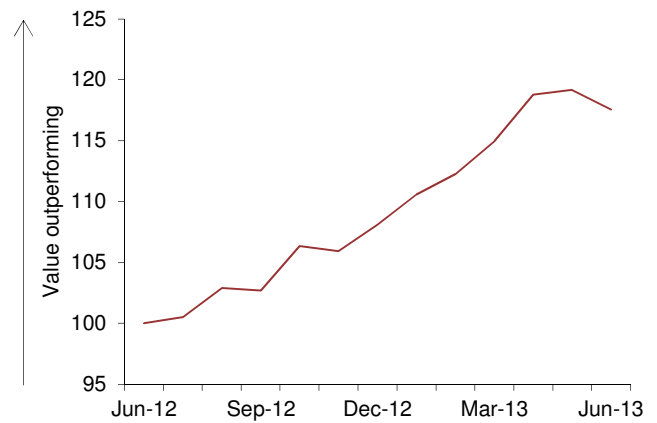
The Value style has outperformed significantly since around the middle of 2012. Relative outperformance has been fairly steady through the first half of 2013, with the exception of the latest month. After a strong period for Growth over 2008-2010, Value's recent outperformance means that there is little to choose between Value and Growth on a 5-year view.

Figure 6. Value vs growth (5 years)



Source: Numis Securities Research Department

Figure 7. Value vs growth (12 months)

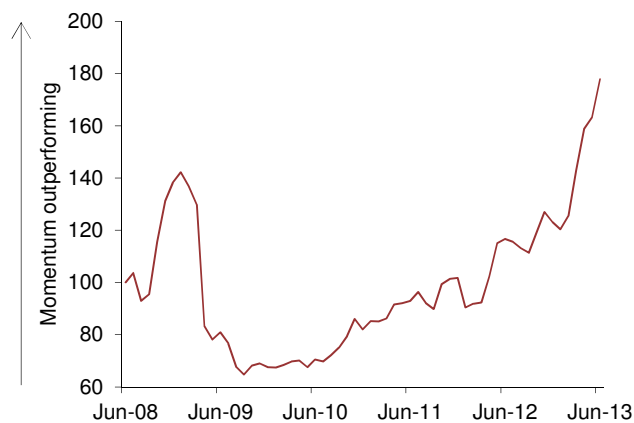


Source: Numis Securities Research Department

Momentum

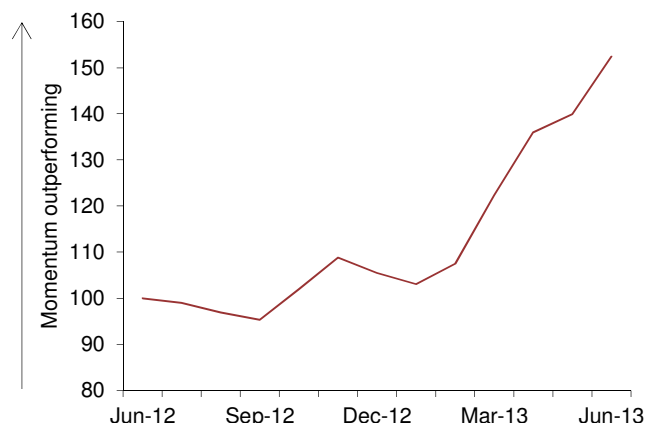
Momentum has been a very strong style factor in recent months. In 2013 YTD a strategy of buying winners has performed particularly strongly.

Figure 8. Winners vs losers (5 years)



Source: Numis Securities Research Department

Figure 9. Winners vs losers (12 months)

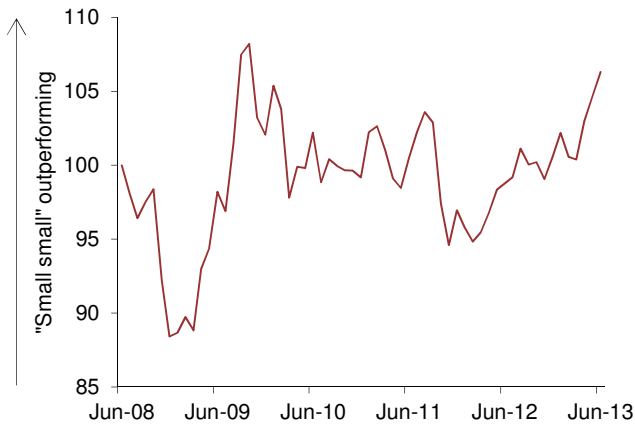


Source: Numis Securities Research Department

“Large small” versus “small small”

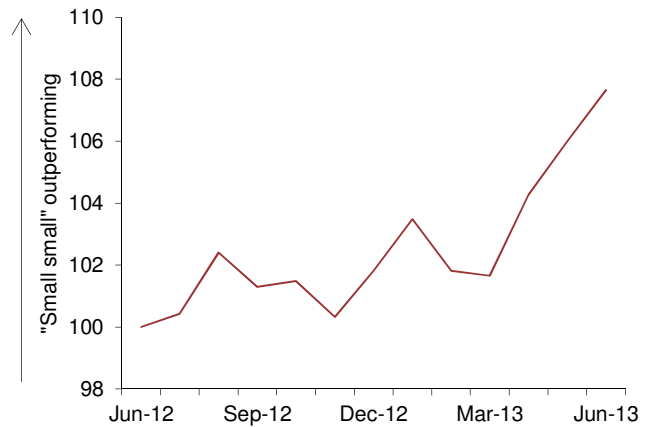
Over the last few years there has been little to choose between larger small companies and smaller small companies. However in the last few months in particular the smaller small companies have performed particularly well. One interpretation is that smaller small companies have not participated so materially in the recent market pull-back.

Figure 10. "Large small" vs "small small" (5 years)



Source: Numis Securities Research Department

Figure 11. "Large small" vs "small small" (12 months)

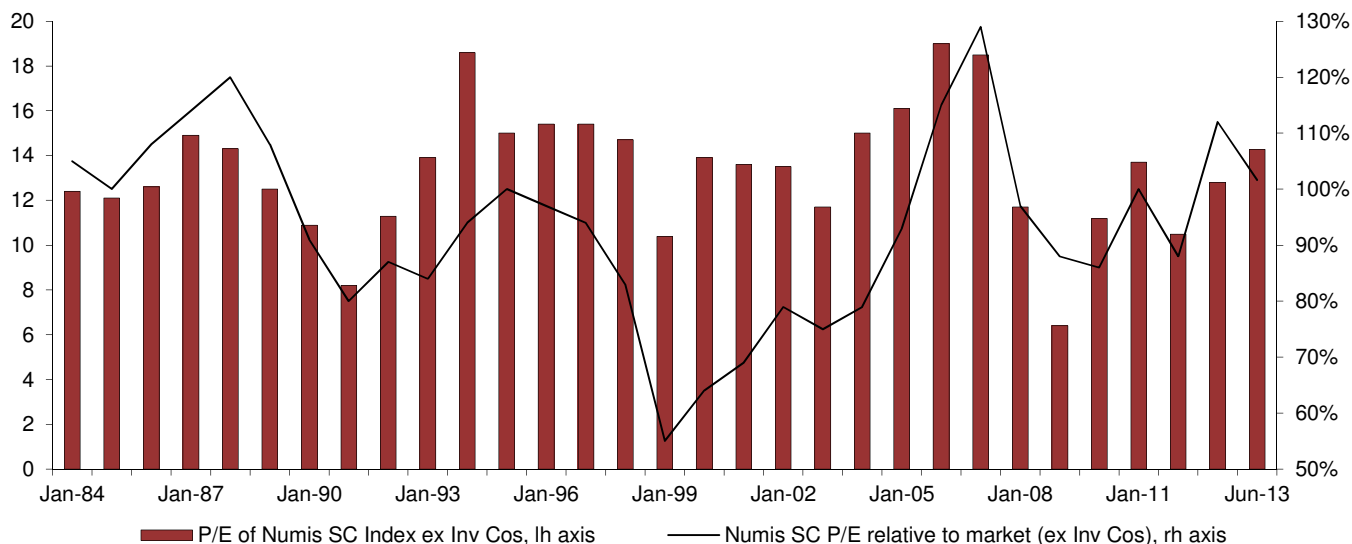


Source: Numis Securities Research Department

Smaller Company P/E Ratios

The chart below shows the trailing PE of the aggregate Numis Smaller Companies index, by comparison to the trailing PE of the market overall.

Figure 12. Smaller company trailing P/E ratios



Source: Numis Securities Research Department

We estimate that the Numis Smaller Companies Index, excluding Investment Companies, currently trades on a trailing P/E of 14.3x. This is a very modest premium to the overall market, which we estimate stands on a trailing P/E of 14.1x.

Looked at in absolute terms, the current trailing P/E of 14.3x compares to a 30-year average over 13.3x, so is modestly more highly rated than its 30-year historical average in absolute terms. On average over the last 30 years smaller companies have traded on a 7% discount to the market, so in relative terms smaller companies are also modestly more highly rated than their 30-year historical average.

We caution that these valuation calculations are backward rather than forward-looking. However, given the very strong performance of smaller companies on both a one and five year view, we think investors should be encouraged that smaller company valuations in aggregate remain relatively close to long-term historical averages.

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Add	26.0%	26.2%	26.1%	22.5%
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