

## Numis Smaller Companies Index

### Q3 2013 review

UK smaller companies have had another excellent year so far. The Numis Smaller Companies index, excluding Investment Companies, has returned 26.3% through to the end of September 2013, compared to the FTSE All-Share return of 14.6%. Within the overall smaller company universe, the smallest companies have performed best, in particular in recent months. The bottom 2% of the market has outperformed the bottom 10% by about 7% for the year to date, most of which has come in the third quarter.

- **Smaller Companies strong outperformance in 2013:** After a good first half, UK smaller companies have had a particularly strong Q3. The Numis Smaller Companies Index, excluding Investment Trusts, has produced a 26.3% total return so far this year. This is almost 12% ahead of the FTSE All-Share. Relative outperformance has been +6% in Q313 alone. Over the last five years the Numis Smaller Companies index ex ICs total return is +144%, compared to the FTSE All-Share total return of +64%.
- **The smallest companies have done best:** The most notable style factor in recent months has been the particularly strong performance by the smallest companies. In Q313 the Numis 1000 (the bottom 2% of the UK market) has outperformed the main Numis index by over 4%, and outperformed the FTSE All-Share by over 10%. Funds biased to the smallest companies should therefore have outperformed. In the last two years both Value and Momentum have been very strong style factors, but both have been broadly neutral in the latest quarter.
- **Better performance by Resources:** The Resources sectors of Oil & Gas and particularly Mining have been very weak over the last three years. However in the latest quarter these sectors have performed in line with the main Numis SC index. The strongest sectors in Q313 were Industrials and Support Services. The traditional "growth" sectors of Technology and Healthcare have continued to lag in Q313.
- **Looking forward to re-balancing:** The Numis indices are rebalanced only once a year, at the calendar year end, in order to help to minimise the costs of following the index. In this note we present a list of potential index new entries and exits, had the rebalancing taken place at the end of September 2013.
- **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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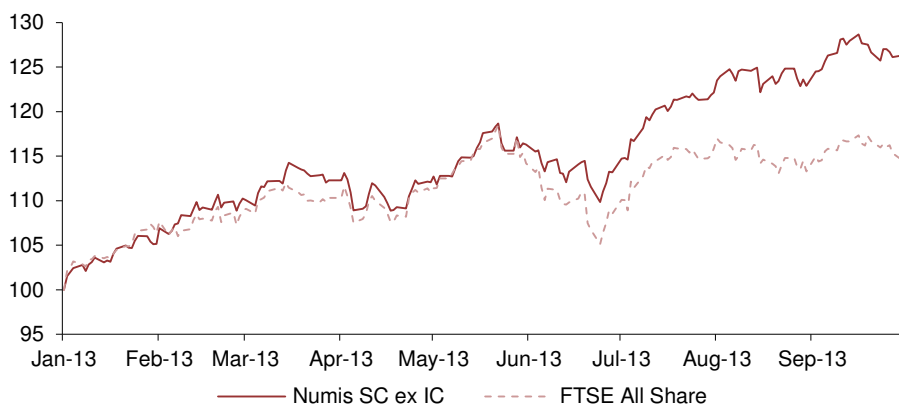
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## Smaller company performance

The third quarter of 2013 has been another strong quarter for smaller companies, building on a good first half. The benchmark Numis Smaller Companies Index excluding Investment Companies has generated a total return of 26.3% year to date. This compares to the FTSE All-Share total return of 14.6%, giving smaller company outperformance of 11.7% on an arithmetic basis, or 10.2% on a geometric basis.

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



Source: Numis Securities Research Department, Datastream

Most of the smaller company outperformance this year has come since late May, as shown in the chart below.

**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 year to date, including quarterly splits. We pick out two notable points:

- Performance is progressively better the smaller the companies. The Numis Smaller Companies index has performed better than the FTSE 250 in Q3, turning modest underperformance in H1 2013 into modest outperformance for the year to date. Lower down, the Numis 1000 index excluding IT (the bottom 2% of the market by market value) has returned 33% YTD. This is almost 7% better than the main NSCI, and over 18% ahead of the FTSE All-Share. The FTSE Smallcap and FTSE Fledgling indices show a similar picture at the bottom end of the market.
- AIM has performed much better in Q313, having been a drag in the first half of the year. For the third quarter the strong performance of the main market Numis Smaller Companies index has been matched by the Numis + AIM index. We note below the better performance of the Resources sectors in the main market Numis index, and a similar factor has helped the Resources-heavy AIM index.

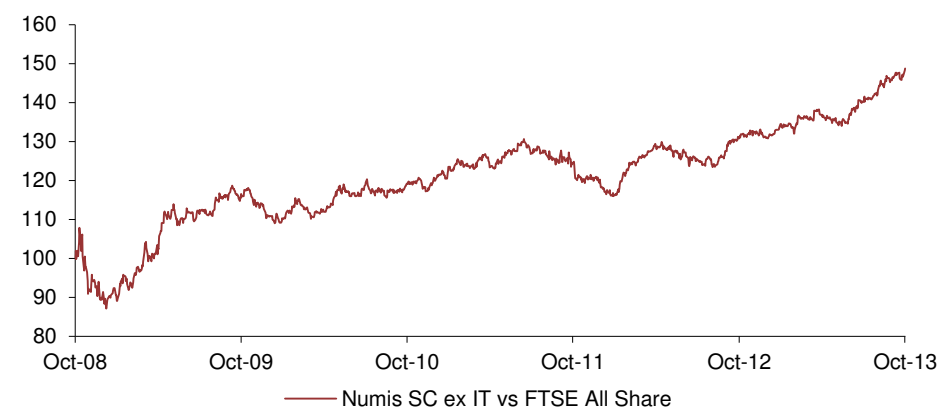
**Table 1. UK index performance, 2013 YTD**

	% change (capital gains)				% change (total returns)			
	Q113	Q213	Q313	YTD	Q113	Q213	Q313	YTD
Numis SC Index (ex Inv Cos)	11.8	(0.3)	10.9	23.5	12.3	0.8	11.6	26.3
Numis SC Index (ex Inv Cos) rel All-Share	2.5	2.4	6.2	12.2	2.0	2.4	6.0	11.7
Numis SC + AIM (ex Inv Cos)	9.2	(1.6)	10.8	19.1	9.7	(0.7)	11.5	21.5
Numis SC + AIM (ex Inv Cos) rel All-Share	(0.0)	1.1	6.1	7.8	(0.6)	1.0	5.9	6.9
Numis SC Index (inc Inv Cos)	11.1	(0.6)	8.8	20.2	11.8	0.4	9.5	22.8
Numis SC + AIM (inc Inv Cos)	9.4	(1.5)	9.0	17.4	10.0	(0.7)	9.7	19.8
Numis 1000 Index (ex Inv Cos)	10.6	2.4	15.2	30.4	10.9	3.6	15.8	33.0
Numis 1000 Index (inc Inv Cos)	10.4	0.6	10.1	22.2	10.9	1.6	10.7	24.8
FTSE All-Share	9.3	(2.7)	4.7	11.3	10.3	(1.7)	5.6	14.6
FTSE 100	8.7	(3.1)	4.0	9.6	9.8	(2.0)	4.9	12.9
FTSE 250 (inc Inv Cos)	12.5	(0.9)	8.0	20.5	13.0	0.1	8.7	23.1
FTSE 250 (ex Inv Cos)	13.0	(0.6)	8.8	22.2	13.5	0.5	9.5	24.9
FTSE 350	9.2	(2.8)	4.5	11.1	10.3	(1.7)	5.5	14.3
FTSE SmallCap (inc Inv Cos)	11.3	0.3	10.2	23.0	11.8	1.2	10.8	25.3
FTSE SmallCap (ex Inv Cos)	10.6	2.6	15.5	31.1	11.0	3.8	16.1	33.8
FTSE Fledgling (inc Inv Cos)	10.7	2.8	11.8	27.3	11.1	3.7	12.5	29.6
FTSE Fledgling (ex Inv Cos)	7.8	5.5	17.0	33.1	8.0	6.6	17.6	35.5
FTSE AIM All-Share	3.4	(5.4)	14.7	12.2	3.5	(5.2)	15.0	12.8

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 144% over the last five years (19.6% pa compound), compared to the FTSE All-Share return of 64% (10.5% pa compound). This gives 49% outperformance over the five years (on a geometric basis), or 8.2% pa.

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



Source: Numis Securities Research Department, Datastream

## Possible index inclusions & exclusions

The Numis Smaller Companies Index is rebalanced at the end of each year. If the rebalancing were to have taken place at the end of September, the cut-off would have been just under £1.5bn. The table below shows potential new entries to the index. Any main market IPOs during the next three months would also be eligible for entry to the NSCI on re-balancing at the end of the year.

**Table 2. Potential index new entries, >£200m MV (ex Investment Companies)**

	Price (p)	Market cap	Comment
<b>NSCI ex IT</b>			
Kazakhmys	266	1,393	
Grafton #	€6.99	1,354	
Renishaw	1,803	1,312	
Countrywide	525	1,152	
Ferrexpo	177.2	1,043	
esure	244.3	1,018	
Al Noor	817	955	
Crest Nicholson	331.7	834	
Foxtons	270	762	
African Barrick	164	673	
Hochschild Mining	181.2	613	
HellermannTyton	271	584	
Platform Acquisition Hlgs	\$10.66	583	
Caracal Energy	460	532	
Tyman	206.25	350	Remains in NSCI + AIM
<b>NSCI + AIM ex IT</b>			
Energy XXI (Bermuda)	\$28.00	1,311	

# Subject to cancellation of ISE listing in mid-October 2013, as announced on 16 Sep 2013  
Source: Numis Securities Research Department

The table below shows companies that would have been excluded had rebalancing taken place at the end of September, mainly for being too big. Others close to the cut-off include Shaftesbury, N.Brown, Perform, Euromoney, BBA, FirstGroup and Britvic.

**Table 3. Potential index exclusions (ex Investment Companies)**

	Price (p)	Market cap	Comment
<b>NSCI ex IT</b>			
Ocado	396	2,303	
Thomas Cook	153.4	2,230	
Playtech	736	2,153	
Dunelm	924	1,874	
Howden	291.5	1,874	
Intermediate Capital	446.4	1,795	
Essentra	748.5	1,758	
Greene King	801	1,749	
Close Brothers	1,169	1,727	
Regus	182	1,718	
Dixons	46.7	1,699	
Mitchells & Butlers	411	1,689	
Jupiter	367	1,680	
Phoenix Group	745	1,675	
Hays	118.4	1,665	
Bellway	1315	1,601	
Berendsen	907.5	1,565	
Michael Page	492.3	1,525	
Afren	138.3	1,508	
Intl Personal Finance	610.5	1,490	
<b>NSCI + AIM ex IT</b>			
Sherborne Investors B	104.5	216	Move to Specialist Funds market

Source: Numis Securities Research Department

## Index group and stock performance

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

**Table 4. Industry group total return within the Numis Smallcap Index**

	Returns Q113	Returns Q213	Returns Q313	Returns YTD	Returns CY12	Weighting Start 2013	Weighting Sep-13
Consumer Services	14	8	11	37	44	24	25
Financials	16	3	11	32	31	17	18
Support Services	14	2	16	35	34	15	16
Industrials (1)	11	1	15	30	26	12	13
Technology	13	(7)	7	12	43	6	5
Oil & Gas	8	(13)	13	6	11	5	5
Mining	(13)	(30)	12	(31)	(27)	4	2
Healthcare	11	(4)	8	15	23	3	3
Other	12	1	7	20	37	13	13
Index (ex Inv Cos)	12	1	12	26	30	100	100

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

Perhaps the most notable point about sector performances in Q313 has been that the Resources sectors have performed in line with the overall index, for the first time since 2010. Support Services and Industrials were strong in Q3, while Technology and Healthcare (and, within Other, Chemicals) underperformed.

- **Consumer Services:** The best performing group year to date, with Retail and Travel & Leisure in particular outperforming. Particular strong performing contributors include Ocado, Thomas Cook, Playtech and Dixons, with weak performances from Debenhams and FirstGroup.
- **Support Services:** Another strong performing area year to date. Leading companies include Howden, Regus, and Berendsen, while Carillion has been the biggest negative performance contributor in the sector.
- **Financials:** The Financials sector is up by 6% relative year to date. IPF, Bank of Georgia and Intermediate Capital have been the strongest contributors, while Lancashire and Shaftesbury, while both still up YTD, have been relatively the most significant negative contributors.
- **Industrials:** Another modest outperforming sector. Leading outperformers are Xaar and Bodycote, while leading underperformers are Oxford Instruments and QinetiQ.
- **Healthcare:** The sector has underperformed modestly. However there are no individual performances that have had a substantial impact on the index overall.
- **Technology:** A relatively weak performance YTD, with notable underperformers being Imagination, Spirent and SDL.
- **Oil & Gas:** Relative performance has stabilised in the third quarter. For the year overall however performance is still relatively weak, held back most notably by Salamander, Hunting and Afren.
- **Mining:** Similar to Oil & Gas, Mining has performed better in Q3. Year to date key underperformers include New World Resources and Petropavlovsk.
- **Other:** Within the smaller sectors, AZ Electronics, Victrex, KSK and New Britain Palm Oil have contributed to overall underperformance by the group we have labelled "Other".

## Style returns in UK smaller companies

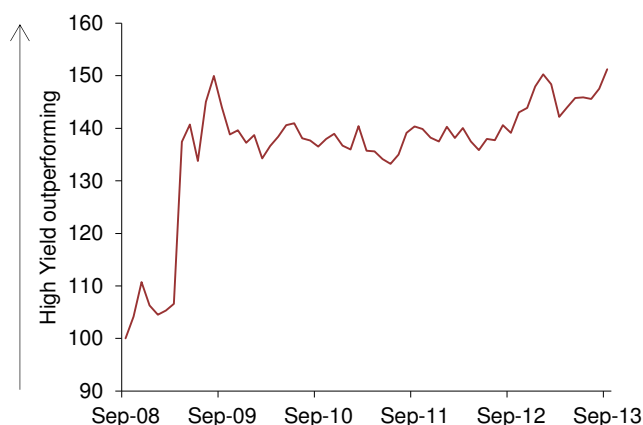
We look at four different style definitions. Long term performance data quoted here all refer to the period up to the end of 2012:

- **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

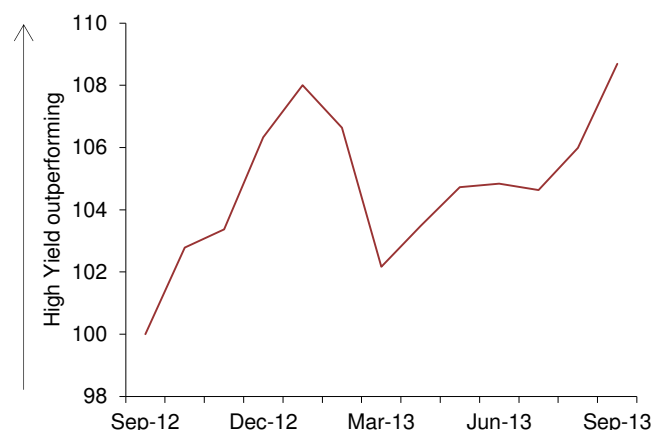
High Yield has outperformed in recent months, having fallen back early in the year.

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



Source: Numis Securities Research Department

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

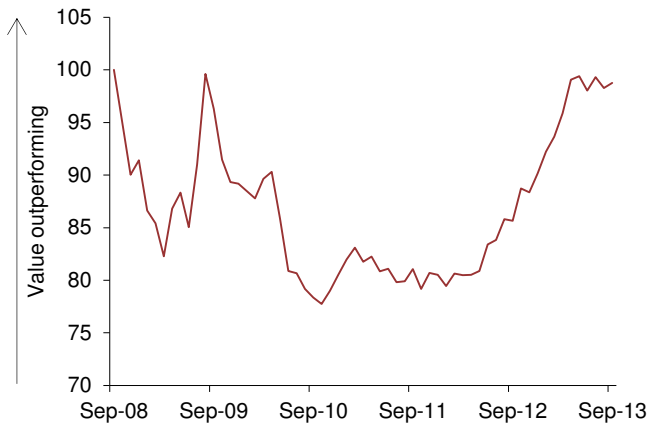


Source: Numis Securities Research Department

**Value versus Growth**

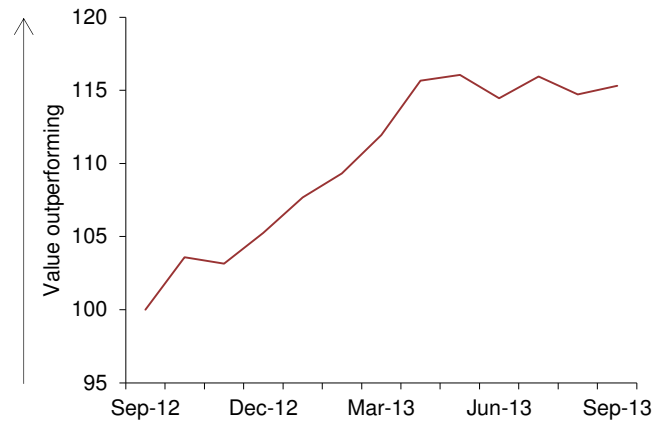
The Value style outperformed significantly from the middle of 2012 through to Q2 2013. Relative performance has been fairly steady in the last few months. After a strong period for Growth over 2008-2010, Value's recent outperformance means that there is little to choose between Value and Growth on a 5-year view.

**Figure 6. Value vs growth (5 years)**



Source: Numis Securities Research Department

**Figure 7. Value vs growth (12 months)**

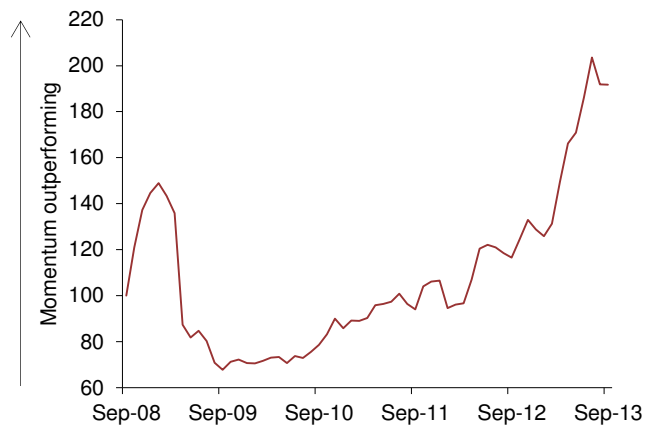


Source: Numis Securities Research Department

**Momentum**

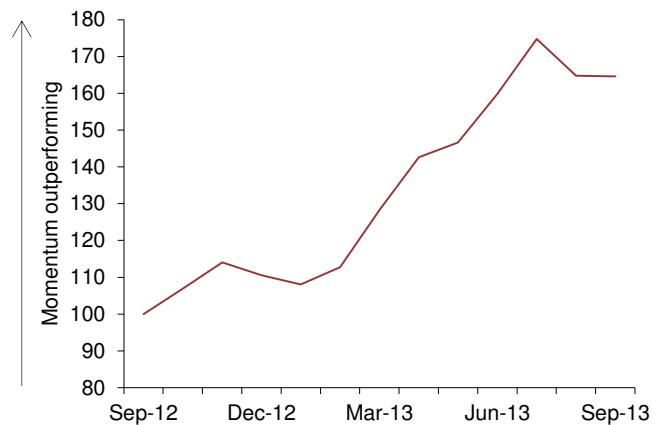
Momentum has been a very strong style factor over the last few years. In the last quarter the performance of Momentum has however been more mixed.

**Figure 8. Winners vs losers (5 years)**



Source: Numis Securities Research Department

**Figure 9. Winners vs losers (12 months)**

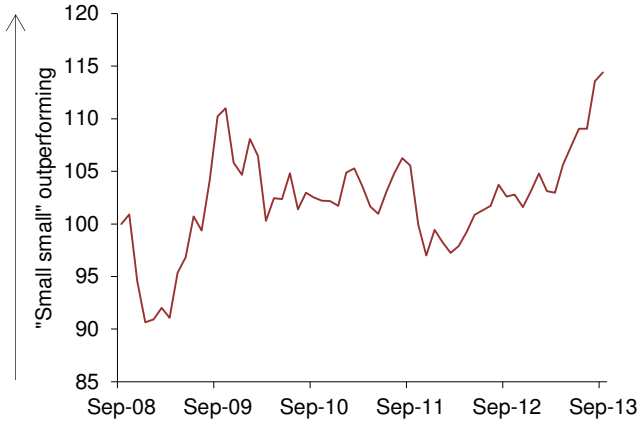


Source: Numis Securities Research Department

**“Large small” versus “small small”**

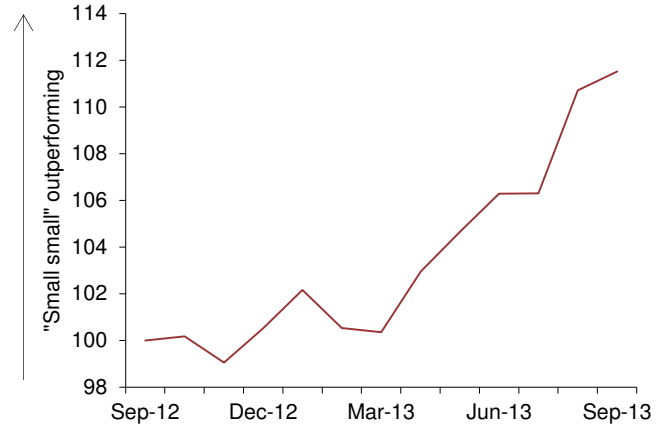
For a number of years through until the start of 2013 there was little to choose between larger small companies and smaller small companies. However in the last few months in particular the smaller small companies have performed particularly well.

**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



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Our sector notes may contain references to information on companies (e.g. target prices and recommendations) which has already been published by us (see our website at <http://www.numiscorp.com/x/us/research.html>) and consequently, details of our assumptions, the material investment risks and/or the basis for each company's target price may not be repeated in these sector notes.

## Valuation and Risks

For details relating to valuation and risks in printed research, please refer to the company comment contained herein. In electronic pieces of research please refer to the relevant company section of the Numis website <http://www.numis.com/x/us/research.html>

## Ratings Key

In making a recommendation the analyst should compare his target price with the actual share price and then make a recommendation derived from the percentage thus calculated.:

**As from 14 February 2005, the formula is:**

Buy	> +20%
Add	> +10% to +19.99%
Hold	0% to +/-9.99%
Reduce	-10% to -19.99%
Sell	> -20%

With effect from 9 February 2010 upon the initial establishment of a recommendation and target price for a company, an additional 10 % deviation in the price from the default bands set out above is permitted before the recommendation has to be changed in subsequently published research documents.

## Distribution of Ratings

	US Requirement 01/10/12 - 30/09/13		UK Requirement 01/07/13 - 30/09/13	
	All Securities	Corporate Clients	All Securities	Corporate Clients
Buy	32.0%	54.5%	35.7%	62.8%
Add	28.2%	33.0%	28.2%	26.6%
Hold	31.4%	12.5%	29.4%	10.6%
Reduce	5.8%	0.0%	3.9%	0.0%
Sell	2.6%	0.0%	2.7%	0.0%
Total	100%	100%	100%	100%

*The above table shows the split of recommendations based on the last recommendation for each research stock during the last four calendar quarters.*

*The above table shows the split of recommendations based on all recommendations during the last calendar quarter for all securities and within each category the proportion of issuers to which Numis supplied material banking services.*

For the split of recommendations by sector for the period from 1 Jan 2012 to 31 Dec 2012, please contact the Research Department of Numis Securities Ltd.