

Numis Smaller Companies Index

Q2 2012 Review

UK Smaller Companies returned to form in the first half of 2012. In the period the Numis Smaller Companies Index ex Investment Companies returned +11.6%, or 8.3% more than the FTSE All-Share. Over the last five years, almost precisely since the market's peak at that time, the Numis index has outperformed by over 1% pa. This performance coincides with the worst UK economic downturn since the 1930s, directly contrary to perceptions that UK smallcaps are a domestic cyclical sector.

- **Numis Smaller Companies Index:** The Numis Smaller Companies Index (formerly the RBS Hoare Govett Smaller Companies Index) is compiled by Professor Paul Marsh and Professor Elroy Dimson of London Business School. The index was first published in 1987, with a back-history dating from 1955. The primary index covers over 800 companies which make up the bottom 10% of the UK main listed market by value. Over 1955-2011 the Numis SC Index ex Investment Companies total return has beaten that of the FTSE All-Share by an average of 3.2% pa.
- **Smaller company performance in H1 2012:** The period from 2000-2011 was a strong one for smallcaps, with the Numis SC ex IC index total return outperforming the FTSE All-Share by 3.4% pa. Looking recently, 2011 was disappointing, down 5.6% relative to the market, after two years of strong outperformance. However UK smallcaps have returned to form in 2012. The Numis SC ex IC index total return was 11.6% over the first half of the year. This is 8.3% outperformance versus the FTSE All-Share, which produced a total return of 3.3%. A particularly strong bounce in Q1 accounted for this smallcap outperformance, with Q2 relatively slightly behind (-3.0% relative to the market).
- **Sectors:** Year-to-date the strongest performing industry group in the Numis SC ex IC index has been Technology, helped by several large bids. Mining has been the weakest of the main sectors, deteriorating through the year. The Oils industry group was one of the strongest in Q1, but turned sharply down in Q2 and is now the second weakest contributor to overall performance year-to-date. Perhaps contrary to consensus at the beginning of the year, Consumer Services (particularly Retail) has been one of the stronger performing segments of the Index.
- **Style:** From this month we are providing regular style performance data to Numis Smaller Company index users. The most notable style factor during the first half of 2012 has been momentum – this style outperformed strongly in April and May in particular (i.e. prior share price winners beat prior share price losers). Value has outperformed Growth over the very long term, but the reverse has been the case in UK smaller companies over the last five years. However Value outperformed Growth by a little under 4% in the first half of 2012, driven by a particularly good June.

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Smaller company performance

UK smaller companies have had a strong first half to 2012. The Numis Smaller Companies Index, excluding Investment Companies, generated a total return of 11.6%, compared to the FTSE All-Share total return of 3.3% - arithmetic outperformance of 8.3%. Looking a little further back, smaller companies outperformed in both 2009 and 2010, but underperformed in 2011 by 5.6% (ex Investment Companies, relative to the FTSE All-Share). The 8.3% outperformance of smaller companies in H112 therefore more than recoups the underperformance recorded last year. Looked at by quarter, Q112 was particularly strong, while smaller companies underperformed modestly in Q212. Relative to the FTSE 250 index the Numis SC Index (total return, ex investment companies) outperformed by 0.6% in H112, gaining 1.9% in Q112 and then losing 1.3% in Q212.

The table below shows the performance of various indices for the first half of 2012 overall, and split into two quarters.

Table 1. Smaller company index performance, H1 2012

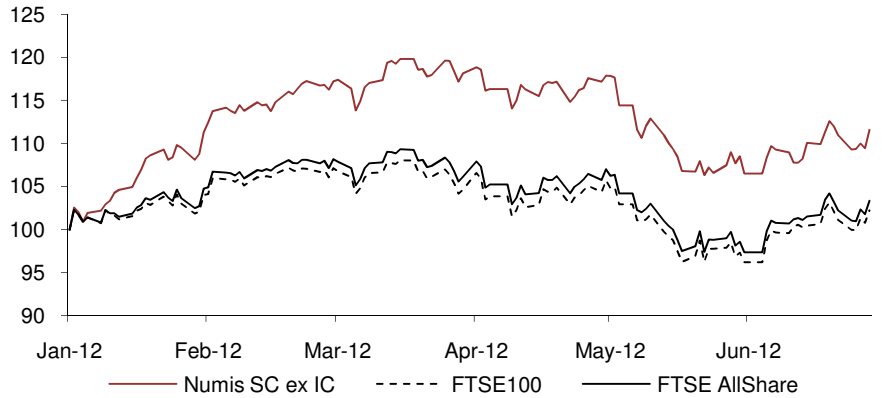
	% change (capital gains)			% change (total returns)		
	Q112	Q212	H112	Q112	Q212	H112
Numis SC Index (ex Inv Cos)	17.7	(6.6)	9.9	18.1	(5.6)	11.6
Numis SC Index (ex Inv Cos) less All-Share	12.6	(2.9)	8.7	12.0	(3.0)	8.3
Numis SC + AIM (ex Inv Cos)	16.0	(8.3)	6.4	16.4	(7.5)	7.7
Numis SC + AIM (ex Inv Cos) less All-Share	10.9	(4.6)	5.2	10.3	(4.9)	4.3
Numis SC Index (inc Inv Cos)	15.0	(6.1)	8.0	15.5	(5.1)	9.6
Numis SC + AIM (inc Inv Cos)	14.2	(7.6)	5.5	14.6	(6.8)	6.9
Numis 1000 Index (ex Inv Cos)	18.4	(7.0)	10.1	18.8	(5.9)	11.7
Numis 1000 Index (inc Inv Cos)	13.9	(6.2)	6.9	14.5	(5.2)	8.5
FTSE All-Share	5.1	(3.7)	1.2	6.1	(2.6)	3.3
FTSE 100	3.5	(3.4)	0.0	4.6	(2.3)	2.2
FTSE 250 (inc Inv Cos)	14.2	(5.3)	8.2	14.7	(4.2)	9.9
FTSE 250 (ex Inv Cos)	15.4	(5.4)	9.3	15.9	(4.2)	11.0
FTSE 350	4.9	(3.7)	1.0	5.9	(2.6)	3.2
FTSE SmallCap (inc Inv Cos)	14.3	(5.2)	8.3	14.8	(4.2)	9.9
FTSE SmallCap (ex Inv Cos)	17.7	(5.3)	11.5	18.2	(4.1)	13.4
FTSE Fledgling (inc Inv Cos)	12.3	(7.4)	4.0	12.8	(6.3)	5.6
FTSE Fledgling (ex Inv Cos)	15.0	(10.3)	3.1	15.3	(9.2)	4.7
FTSE AIM All-Share	14.7	(15.1)	(2.6)	14.8	(14.8)	(2.2)

Source: Numis Securities Research Department, Datastream

AIM performed poorly again in H112, and the FTSE AIM All-Share index was down 2.2%. Related to this, the Numis SC + AIM index (ex Inv Cos) outperformed the FTSE All-Share by 4.3%, or only around half of the outperformance of the main listed Numis Smallcap index.

The first chart below shows the performance for the key Numis SC Index (ex Investment Companies) and two larger company indices over the last six months.

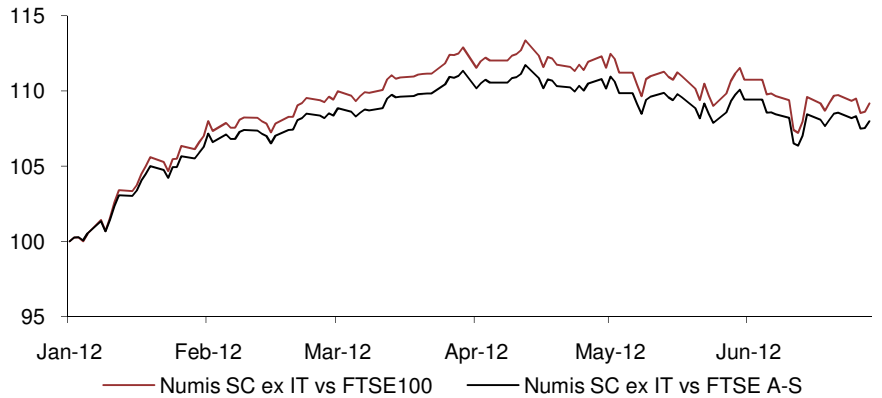
Figure 1. Total return YTD (indexed)



Source: Numis Securities Research Department, Datastream

In the second chart we show the relative performance of the key Numis SC index with these two larger company indices over the last six months.

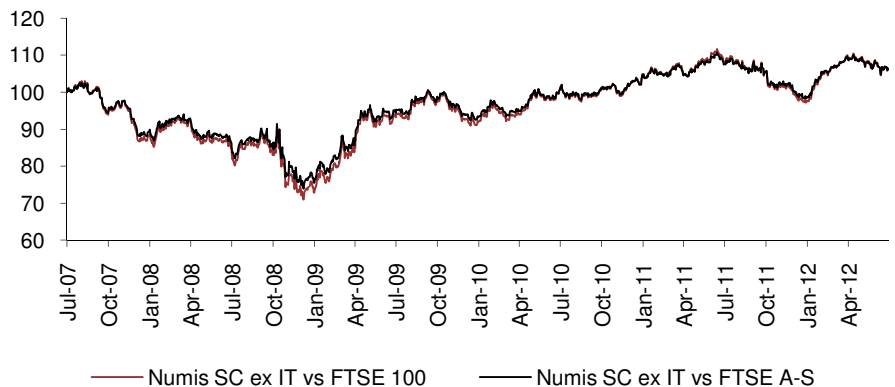
Figure 2. Relative total return YTD (indexed)



Source: Numis Securities Research Department, Datastream

In the third chart we show the relative performance of the key Numis SC index with these two larger company indices over the last five years.

Figure 3. Relative total return over 5 years (indexed)



Source: Numis Securities Research Department, Datastream

Over this five year period the Numis Smallcap index has outperformed by over 1% pa, in the worst UK economic downturn since the 1930s, contrary to perceptions that the UK smallcap asset class is a domestic cyclical.

Industry group performance

Rather than looking at the minutiae of performance for every different sector, we look at aggregate performance for seven industry groupings plus the rest. This helps to draw out the major themes without getting lost in too much detail. Performance by industry grouping is shown in the table below:

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

	Weighting (start of year)	Q112	Q212	H112
Consumer Services	20	19	(3)	15
Financials	17	15	(4)	10
Support Services	14	21	(8)	11
Industrials (1)	12	18	(5)	12
Technology	8	28	0	28
Mining	7	5	(21)	(17)
Oil & Gas	6	24	(17)	2
Other	18	17	1	16
Index (ex Inv Cos)		18	(6)	12

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

We draw out the following notable points:

- The Technology sector has been the best performing industry group in the Numis Smallcap index during H112, up 28% YTD. Split by quarter the group performed well in both Q1 and Q2. The outperformance of the sector this year can be largely attributed to the takeovers of Logica and Misys, both with significant weightings in the index, although strong performances by Telecity, Spirent and Micro Focus have also contributed.
- The Mining sector has been the worst performing industry group in the Numis Smallcap index during H112, down 17% YTD. Split by quarter the group has also performed worst in both Q1 and Q2. Most of the companies in the group are down YTD, reflecting renewed global growth concerns, and China worries in particular. Aquarius Platinum and New World Resources have been the largest contributors to poor performance.
- The Oils industry group was among the strongest groups in Q1, but fell back significantly in Q2. Overall the sector has underperformed the index YTD. Looked at by stock, Ophir Energy has continued to perform strongly, is the largest single contributor to index performance YTD (50bp), and is now the largest company in the index. Most other larger companies have fallen back in Q2 (e.g. Afren, Enquest, Lamprell, Hunting, Yule Catto).
- The Consumer Services industry group comprises Retailer, Travel & Leisure and Media. Despite seemingly limited positive press headlines about the consumer, weak sentiment at the start of the year has allowed this group to outperform steadily, led by Retail (Smallcap Retail up 21% YTD). Key stocks in Retail have been Sports Direct, Debenhams and Dixons. PERFORM leads for the Media sector, followed by UBM. Domino's Pizza and Ladbrokes have contributed the most to Travel & Leisure sector performance.
- Major Smallcap Financials sectors (Financial Services and Non-Life Insurance) have performed broadly in line with the Index, with modest underperformance from the group overall coming from Property.
- Within "Other", strong performers include Chemicals (Elementis, AZ), Telecoms (C&W Worldwide, TalkTalk, and Colt, offset by C&W Comms), and Housebuilders (Barratt, Taylor Wimpey). Healthcare and Food Producers have both performed broadly in line.

Style returns in smaller companies

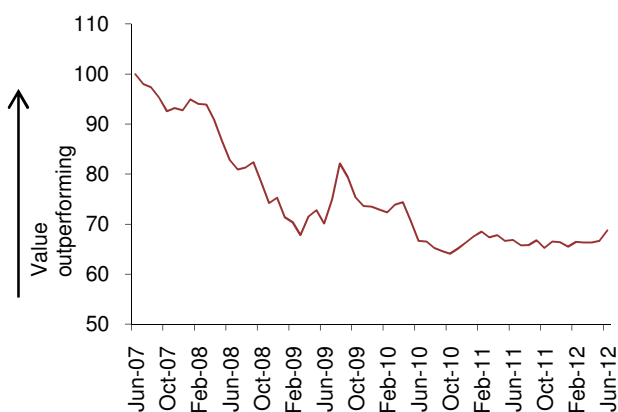
In the past, Dimson & Marsh have produced data on style returns in their Annual Review. This data will now be made available each month to index subscribers. Three sets of style performance are currently provided:

- **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 (+4.5% pa 1955-2011), and while Value has also beaten Growth over 20 and 10 years, over the last five and a half years (2007 to date) Growth has had a very strong run, outperforming Value by 8.0% 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 by number with the lowest capitalisation) and larger small (the top 30%). Since 1955 smaller small companies have modestly outperformed larger small companies (+0.8% pa 1955-2011), although over the last 20 years the effect has been the reverse (-1.7% pa since 1990).
- **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 17% pa since 1955, using the 12-1-1 approach.

The charts below show these style effects over the last 5 years and the last 6 months.

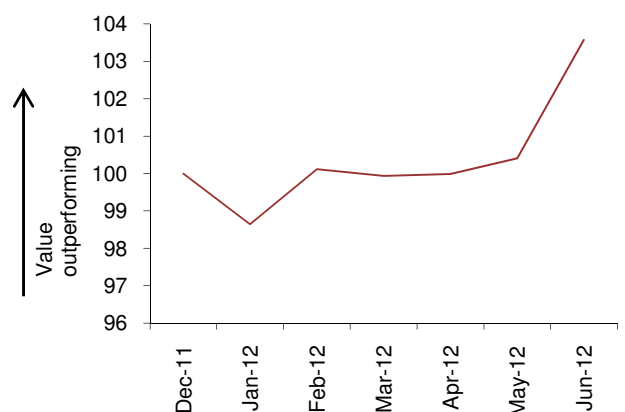
Value based on Price/Book has been comparatively neutral for the last two years, after a period of strong growth outperformance in the three years prior to that. In 2012 Value initially underperformed in January, before making back lost ground in February. After a neutral period over March-May, June saw meaningful one month outperformance for Value.

Figure 4. Value vs growth (5 years)



Source: Numis Securities Research Department

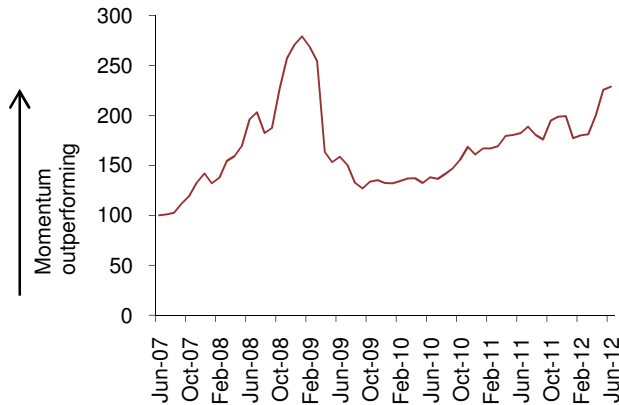
Figure 5. Value vs growth (6 months)



Source: Numis Securities Research Department

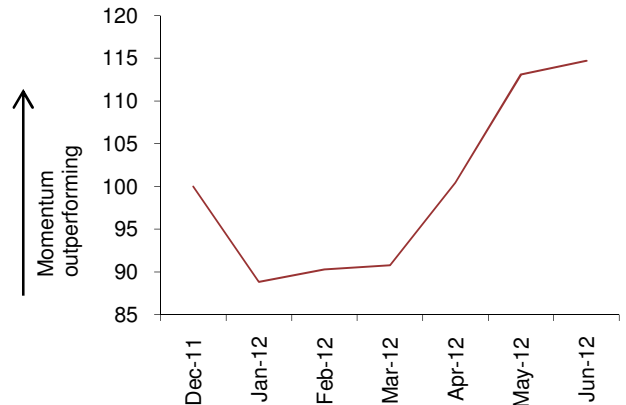
Perhaps the most significant style effect captured in our analysis is the recent strength of Momentum (i.e. recent winners). Losers outperformed very significantly in January 2012. However Q2 2012 has seen the sharpest outperformance of momentum since late 2008, substantially more than unwinding the January move. Often momentum and value move, in the short term, in opposite directions (such as over 2007 to mid-2009). However for Q212 both value and in particular momentum were winning styles.

Figure 6. Winners vs losers (5 years)



Source: Numis Securities Research Department

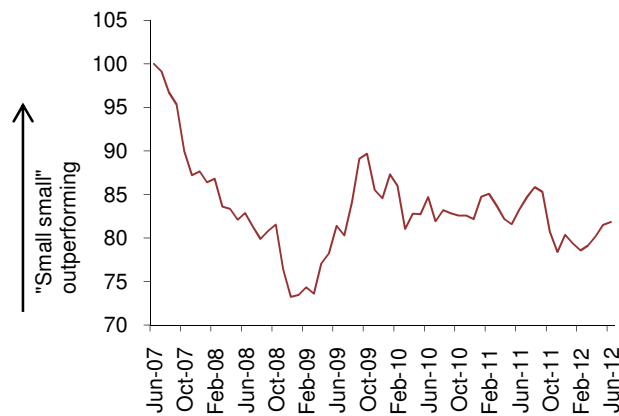
Figure 7. Winners vs losers (6 months)



Source: Numis Securities Research Department

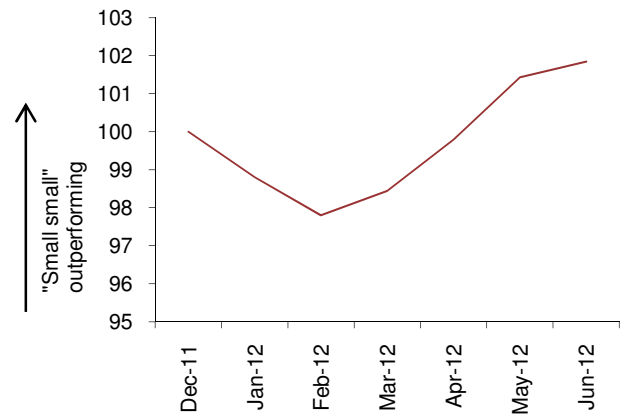
Looking at size effects within smaller companies, over 5 years "large small" has outperformed "small small". However in the last four months "small small" has outperformed by around 4%, although this has only recouped about half of the steep underperformance between October 2011 and February 2012.

Figure 8. "Large small" vs "small small" (5 years)



Source: Numis Securities Research Department

Figure 9. "Large small" vs "small small" (6 months)



Source: Numis Securities Research Department

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Add	23.6%	19.8%	20.9%	16.3%
Hold	28.0%	9.4%	25.9%	8.2%
Reduce	2.9%	0.0%	2.6%	0.0%
Sell	3.2%	0.0%	1.4%	0.0%
	100%		100%	
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