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Numis Indices

2022 Annual Review

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Foreword

by the Head of Research, Numis

It is with great pleasure that Numis publishes the Annual Review of the Numis indices. Formerly the Smaller Companies Index Annual review, this year the name has changed to reflect the coverage of the entire UK market and not just the smaller companies of the Numis Smaller Companies Index (NSCI). Over the last 35 years, the Numis indices have been produced by Professor Elroy Dimson and Professor Paul Marsh of London Business School. Scott Evans took over Elroy Dimson's role from 2016. Through their production of the NSCI and their associated research on smaller companies, the Numis index team has had a major impact on the practicalities of investing in smaller and mid-sized companies in the UK. With the launch of the Numis All Share index in 2021, Numis now provides a complete set of benchmarks for the UK equity market.

During their careers at London Business School, and through their widely cited book, Triumph of the Optimists, and other publications, Elroy and Paul have made a profound contribution to investment research. As part of the original design team for the FTSE 100 Index, as well as their creation of the Numis indices and the long-run DMS global investment return indices, they have also had a central role in the design of stock market indices in this country and around the world. Scott Evans brings to the team a deep knowledge of UK equities and small-caps gained from over 20 years of working at a senior level in investment banking, together with his extensive experience as an academic and researcher.

The Numis Indices is a central part of the extensive range of research services that Numis provides to investors as well as to corporate clients. With a back history for the indices that now covers 67 years since 1955, the NSCI and the family of Numis indices provide a remarkable opportunity to set contemporary issues in a truly long-term context. It enables investors to take a strategic view on today's markets that is based on evidence that is comprehensive and authoritative, and underpinned by research of the highest quality.

The Numis family of indices provides the definitive measure of the performance of low, mid, and large capitalisation companies. The indices are a unique research resource for the serious investor in smaller companies and in the UK equity market given their consistent definition and the length of the index history. We congratulate the authors on completion of this detailed and comprehensive study. It contains many insights that will help you as an investor. Please do not hesitate to contact Numis if you would like to follow up on the ideas presented in this volume.

Will Wallis

Head of Research, Numis Securities

Highlights

by Scott Evans and Paul Marsh

An excellent year for equities

2021 was an excellent year for UK equity investors as the chart below shows. The total return on the UK market, as measured by the Numis All Share index, was 17.1%, with the Numis Large Cap index performing slightly better at 17.4%. Smaller companies had an even better year with the Numis Smaller Companies index (NSCI) excluding investment companies (XIC) giving a return of 21.9% and the minnows of the NSC 1000 XIC once again providing the best performance with a total return of 25%.

Small-cap premium now 3.6%

As we discuss in this Review, the strength of small-caps and the 4.5% outperformance over larger companies has ensured the long-term record of a positive size premium has been maintained. Measured over the 67-year history of the NSCI XIC, the size premium stands at 3.6%. For the NSC 1000, it is even higher at 5.2%. Over the long-term, small-cap returns have been above large-cap returns in 41 of the 67 years since 1955.

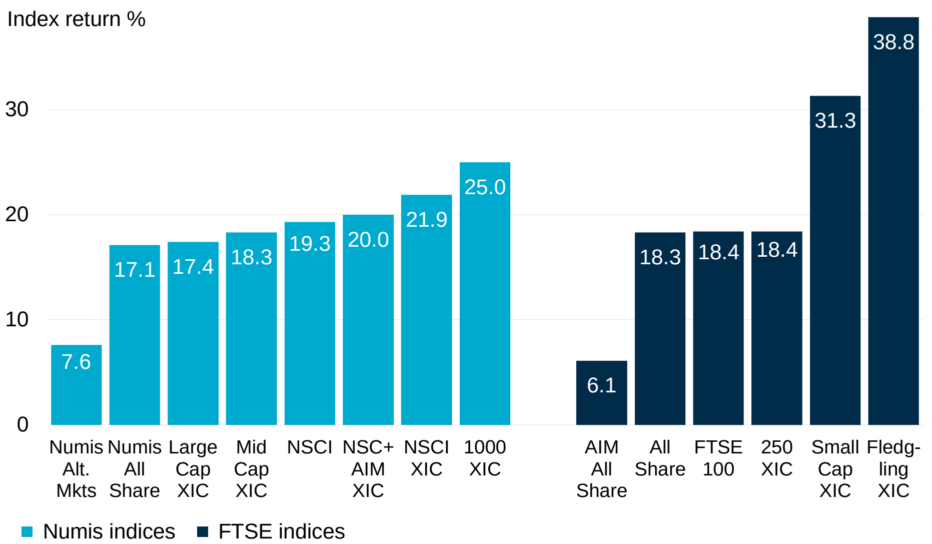
Revival in dividend payments

Along with small-cap outperformance, a feature of 2021 discussed in detail in this Review is the significant turnaround in dividend payments. In 2020, the onset of the Covid-19 pandemic led to the largest annual cut to dividend income in the history of the Numis indices. The cuts in dividends in 2020, which ranged from −45% for large-caps, to −57% for mid-caps, were followed by increases of 30% and 84% in 2021. For the NSCI, the reversal in dividend cuts resulted in the largest one-year increase in real dividend payments on record. Having fallen by 33% in 2020, they increased by 33% in 2021.

The importance of dividends for total returns

The importance of dividends is something we regularly emphasise in the Annual Review and this year is no different. Looking over the longer-term, we show that reinvested dividends have had an enormous impact on total returns. £1 invested in the minnows' index of the NSC 1000 XIC would, if all dividends had been reinvested, have been worth £26,383 by start-2022. The equivalent figure for the NSCI XIC would have been £10,139, compared with "just" £1,210 for investors in the Numis Large Cap XIC. Without the reinvestment of dividends, £1 invested in the NSC 1000 would have grown to the considerably smaller amount of £1,063, while the equivalent investment in the Numis Large Cap would have yielded a terminal value of just £66. Investing in small-caps over the long-run while reinvesting dividends has been a winning strategy, certainly for those clever enough – and old enough – to have done so from 1955.

Figure 1. Performance of the Numis indices in 2021



Source: Scott Evans and Paul Marsh, Numis; FTSE Russell.

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Value and size provide positive factor returns

The analysis of factor returns has often featured in the Review, and from this year we have made it a permanent addition. For 2021, we examine five factors, value, income, size, volatility, and momentum across three universes, small-caps (NSCI), all UK fully listed companies, and AIM (the Numis Alternative Markets index). For small-caps, the analysis shows that in 2021, the best returns came from value and size (i.e., the smaller smalls). For all fully listed UK companies, value was also a positive factor, but it was low volatility stocks that performed best. Momentum had a very poor year, while income was also disappointing. Over the longer-term, however, we show that momentum remains the winning strategy and has outperformed all other factors by a considerable margin.

Value and low volatility best for AIM

As the chart on the previous page shows, AIM was the laggard last year, with the Numis Alternative Markets index underperforming the Numis All Share by 9.5%. As we show in our section on AIM, this was partly explained by the poor performance of the largest AIM companies. AIM's distinctive sector composition, on the other hand, did little to explain its underperformance. However, analysis of the five factors that we monitor did reveal some interesting performance differences. The best relative returns within AIM came from low volatility and value stocks. Furthermore, low volatility and value stocks have also done very well within junior markets such as AIM over the long-run. This seems a little ironic given the nature of AIM as a market for higher risk growth stocks.

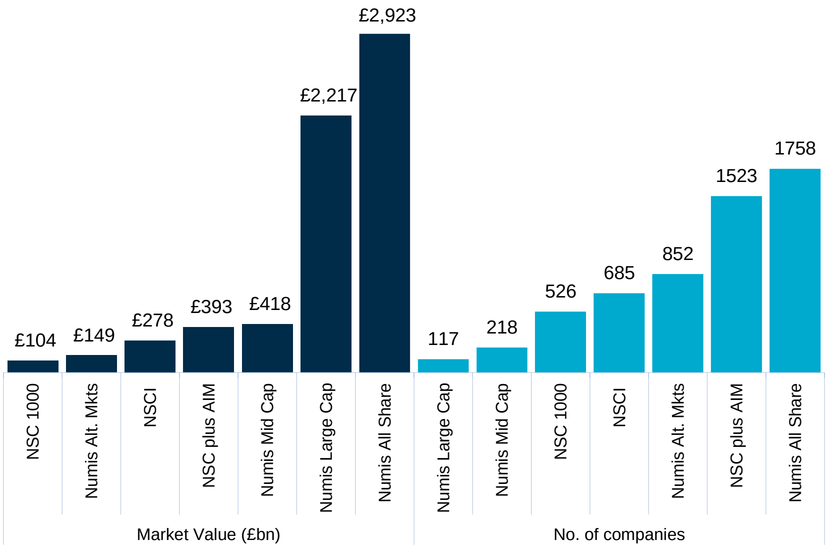
Better year for IPOs

One positive for AIM was the resurgence in the IPO market in 2021, which led to 123 IPOS entering the Numis indices. 71 were listed on AIM with the remainder fully listed. As we show in our long-term analysis of IPOs, this was the second highest number since 2007, although it was still a long way below the peak of 459 in 2005. A less positive aspect of IPOs last year was their performance. Our analysis shows the weighted average return from all new issues was just 7%. After stripping out the first day price moves, this reduced to −4%. However, we also show that smaller IPOs did a lot better than larger IPOs with the average return of the smallest IPOs being 26% compared to just 6% for the largest.

Increase in listed companies

The combination of a higher number of IPOs and a below average year for company departures led to a net increase in the number of listed companies. For the indices this has meant post-rebalancing constituent numbers have bucked the long-run trend and increased year-on-year. Figure 2 summarises the capitalisations and constituent numbers for the rebalanced indices. In section 3 of the Review, we discuss the rebalancing and characteristics of each member of the expanded range of indices now provided by Numis.

Figure 2. Numis indices for 2022



Source: Scott Evans and Paul Marsh, Numis;

Size cut-offs increase

As the market has rallied, the cut-off values for inclusion in the size-based indices have increased. Following the end-year rebalancing, the size cut-offs are as follows: £663 million for the NSC 1000, £1.64 billion for the NSCI and NSCI plus AIM, between £880 million and £4.12 billion for the Numis Mid Cap, while the Numis Large Cap index has a lower cut-off value of £4.12 billion. The Numis Alternative Markets index has no upper cut-off and includes everything listed on AIM. The Numis All Share includes everything on the main market and on AIM.

Different index characteristics

As well as providing details of the indices as they enter 2022, section 3 provides an analysis of the characteristics of the indices and highlights the differences between them with regards to size distribution and industry/sector composition. For the latter we show the NSCI XIC has a high exposure to industrials (26%) and consumer discretionary (20%), whereas the Numis All Share's highest exposures are to financials (15%) and Consumer Staples (14%). In addition to differences in size and sector composition we also look at relative exposure to factors such earnings multiples, new issues, liquidity, and risk.

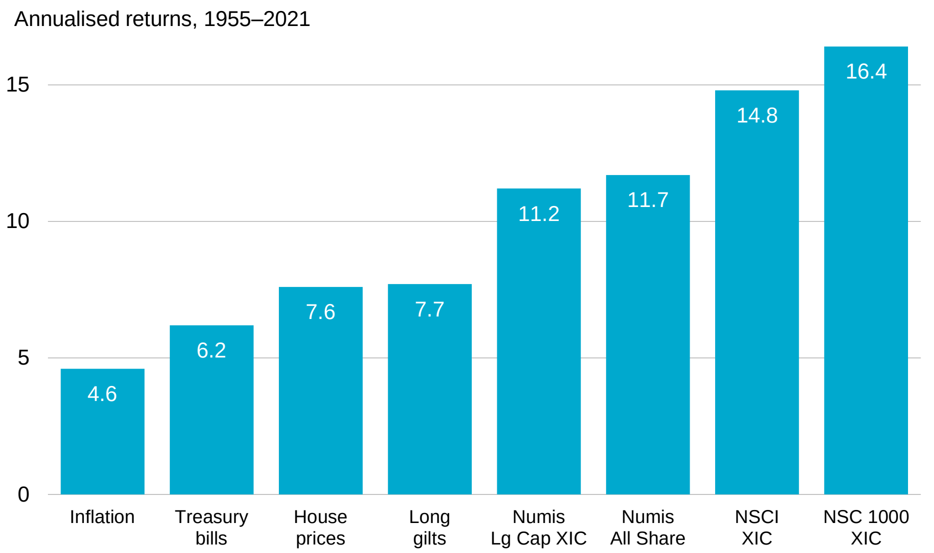
Individual small-caps are higher risk, but diversification eliminates much of this

Risk is discussed throughout the Review. We show that compared with large-caps, the dispersion of small-cap returns is far wider. But while individual small-caps tend to be much riskier than large-caps, diversification eliminates a large part of this additional risk. However, compared to the Numis All Share, we show that NSCI XIC has seen a sharp increase in absolute and relative volatility since the Covid pandemic. The differential with the market is now close to an all-time high with the five-year historical volatility for the NSCI XIC now at 18.4% compared to 13.9% for the Numis All Share. The true differential is almost certainly lower than this, as these estimates continue to include data from the Covid crisis. We also analyse the correlations between small and large-caps. These reveal invaluable risk reduction opportunities for large-cap oriented investors to diversify into small-caps.

Small-caps best of all

This year, we have included a new section on investing in UK assets for the long-run. The findings are summarised in the chart below which ranks the total annualised returns from equities, bonds, cash, houses, and inflation. Measured over the long-run, cash has done better than inflation, houses have outperformed cash, bonds have marginally beaten house prices, but equities have done best of all. Within equities, small-caps have outperformed large-caps and the smallest companies have performed the best of all. We hope you enjoy the new look Annual Review.

Figure 3. The Numis indices and comparative asset returns, 1955–2021



Source: Scott Evans and Paul Marsh, Numis.

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1. The Quick Guide to the Numis Indices

Coverage of the UK market

The Numis family of indices trace its origins back to 1987 with the launch of a smaller companies' index developed by Elroy Dimson and Paul Marsh of London Business School. Numis became its sponsor in 2013, since when it has become the pre-eminent benchmark for investors targeting UK small- and mid-cap companies. In addition to the original Numis Smaller Companies index (NSCI), Numis now provide a range of indices covering the entire UK equity market. All the Numis indices are produced both as capital gains and total returns indices, and both including and excluding investment companies. None of them exclude companies based on liquidity or free float. Those targeting the main market also include Standard listed stocks, but exclude non-UK companies. The indices are rebalanced once a year at the end of December. As of January 2022, the Numis range of indices includes the following:

NSCI

The Numis Smaller Companies index or NSCI targets the bottom 10% of the main UK market by value. It was launched in 1987 and has a back history to 1955.

NSC plus AIM

The NSC plus AIM includes all the constituents of the NSCI and all companies listed on AIM that fall below the NSCI size cut-off. It was launched alongside the NSCI in 1987 and has a back history to 1955. Prior to the launch of AIM, the index and its back history included companies listed on the (now closed) USM and Third Market.

NSC 1000

The NSC 1000 targets the bottom 2% of the main UK market (XIC) by value. Apart from a lower size cut-off, in all other respects its construction and composition are the same as the NSCI.

Numis Mid Cap

The Numis Mid Cap index was launched in 2014 and targets the bottom 20% of the UK main market but excludes the smallest 5%. By design it covers 15% of the UK main list by value. The largest companies of the NSCI are also constituents of the Numis Mid Cap as the indices overlap.

Numis Large Cap

The Numis Large Cap index was launched in 2020 and targets the top 80% of the UK main list by value. It has a lower, but no upper size limit. It has a back history to 1955.

Numis Alternative Markets

The Numis Alternative Markets index was launched in 2017 and covers all companies listed on qualifying alternative markets. Currently only AIM qualifies but its back history to 1980 includes all constituents of the USM and Third Market.

Numis All Share

The Numis All Share is the most recent addition to the family and was launched in 2021. It contains all fully listed stocks plus all stocks listed on AIM. It therefore includes all the constituents of the NSCI, Numis Mid Cap and Numis Large Cap as well as all the constituents of the Numis Alternative Markets index. It has a back history to 1955.

Table 1. The history of the indices and basis for inclusion

Index	Launch year	Back history	Basis for inclusion
NSCI	1987	1955	Bottom 10% of main listed market
NSC 1000	1994	1955	Bottom 2% of the main listed market XIC
NSC plus AIM	1987	1955	NSCI plus junior listed cos below NSCI cut-off
Numis Mid Cap	2014	1955	Bottom 20% of the main listed market excluding the smallest 5%
Numis Large Cap	2020	1955	Top 80% of the main listed market
Numis Alternative Mkts	2017	1980	All constituents of qualifying alternative markets (currently only AIM qualifies)
Numis All Share	2021	1955	All fully listed companies and all junior market (currently AIM) companies

Source: Scott Evans, Paul Marsh and Elroy Dimson, Numis