



Nifty Smallcap250 **Quality 50 Index**

Tracking quality stocks within small cap segment

February 2023

Introduction

Imagine there is a one day cricket match between England and South Africa and the match ends up in tie. The umpire decides to introduce Super Over to decide the winner of the match. Each team can play only three batsmen and only one bowler gets to bowl and has only two wickets to play with during the Super Over. The captains of both the team are in a dilemma – a tough choice to select the batsmen and a bowler for the Super Over who can be relied on for winning the match. Finally, the captains have made up their mind and undoubtedly, the best players of the respective teams are selected based on their past performance.

In equity investments also, we often face such dilemma of identifying the right stock that is expected to perform well in most of market phases, especially in smallcap segment, where it is crucial to evaluate company level risk and earnings growth variability. Banking upon ‘quality’ stocks in such a dilemma may turn out to be a more appropriate investment strategy, especially in the long run. Profitability, positive earnings growth and leverage related investment

characteristics tend to capture most of the quality return premium.

Quality based factor investing seeks to identify companies with strong financial and business characteristics, such as high ROE, positive EPS growth variability and low debt to equity ratio within the smallcap segment that are more likely to deliver strong returns over longer term periods. This investing style would eventually help investors to select stocks which are consistently generating positive earnings growth over a multi-year period.

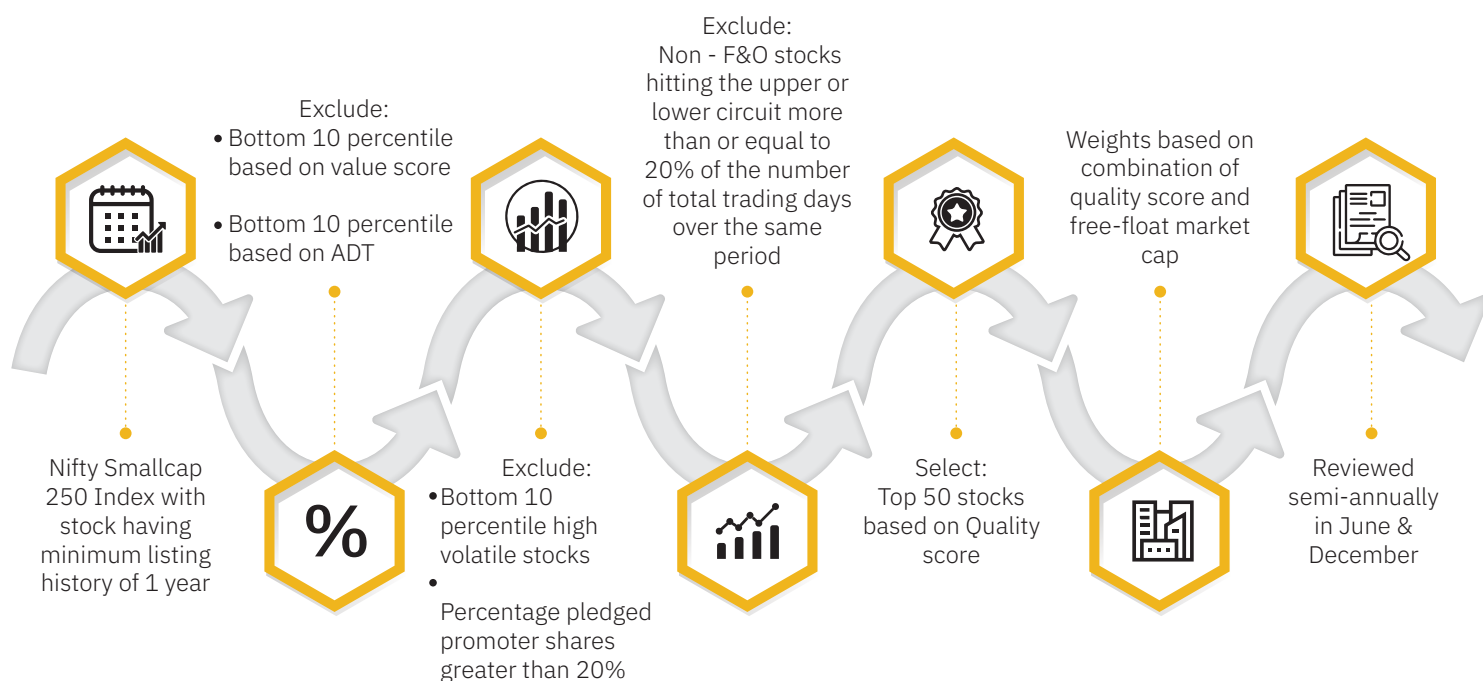
To provide a pool of such quality stocks in the small cap segment, NSE Indices Limited has developed an index using a similar strategy – Nifty Smallcap250 Quality 50 Index. The Nifty Smallcap250 Quality 50 Index tracks the performance of the top 50 quality stocks which are selected based on profitability (read success rate), leverage (read self-reliance), and earnings growth variability (read consistency in performance).

About the Nifty Smallcap250 Quality 50 Index

The Nifty Smallcap250 Quality 50 Index tracks the performance of the small cap quality stocks selected based on high profitability, low leverage, and low earnings growth variability. Stocks forming part of Nifty Smallcap250 index are first filtered based on the value score, average daily turnover (ADT), percentage pledged shares, high volatility to form an

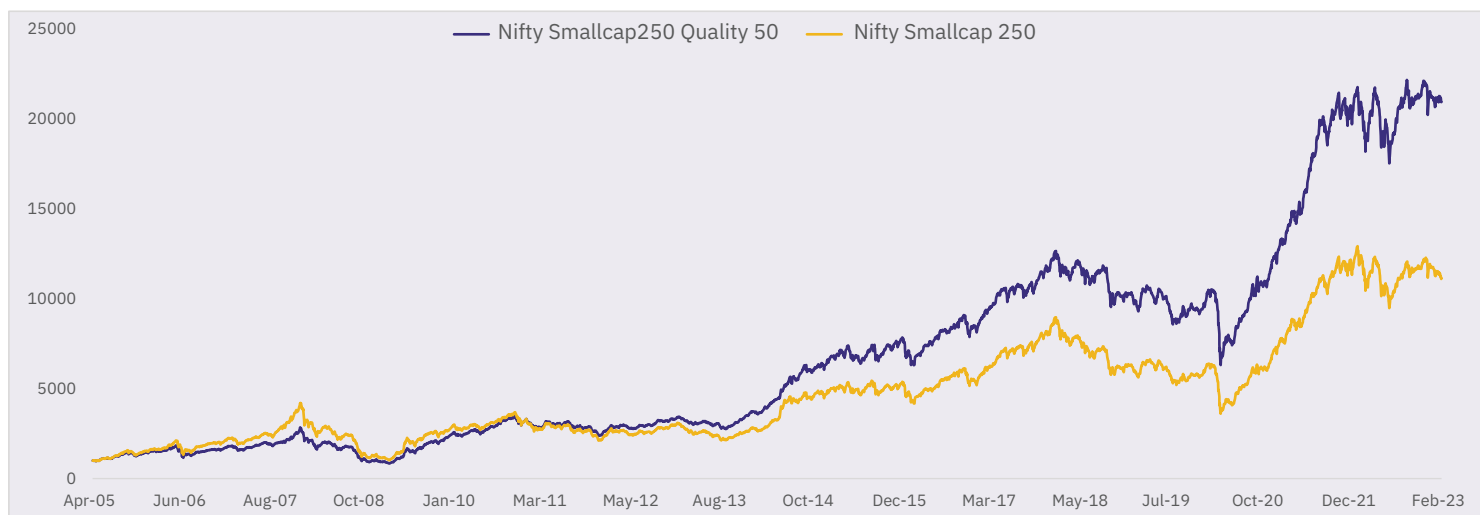
eligible universe for the Nifty Smallcap250 Quality 50 Index. The top 50 stocks are then selected from the eligible universe based on their quality scores. The quality score for each eligible company is determined based on return on equity (ROE), financial leverage (Debt/Equity Ratio) and earnings (EPS) growth variability analyzed during the previous 5 years.

Exhibit 1: Nifty Smallcap250 Quality 50 Index methodology



The Nifty Smallcap250 Quality 50 Index has significantly outperformed its parent index over the long term horizon

Exhibit 2: Nifty Smallcap250 Quality 50 and Nifty Smallcap 250 Index performance



Source: NSE Indices. Data as of February 28, 2023

Exhibit 3: Nifty Smallcap250 Quality 50 and Nifty Smallcap 250 Index performance table

Period	CAGR returns		Volatility		Return-risk	
	Nifty Smallcap250 Quality 50	Nifty Smallcap 250	Nifty Smallcap250 Quality 50	Nifty Smallcap 250	Nifty Smallcap250 Quality 50	Nifty Smallcap 250
Since Inception*	18.51%	14.41%	19.76%	22.06%	0.94	0.65
15 years	16.41%	8.89%	18.95%	21.22%	0.87	0.42
10 years	21.01%	15.68%	17.51%	19.43%	1.20	0.81
7 years	18.63%	15.05%	17.98%	19.41%	1.04	0.78
5 years	12.24%	6.75%	19.32%	20.47%	0.63	0.33
3 years	28.46%	23.93%	21.50%	22.49%	1.32	1.06
1 year	9.84%	1.40%	16.12%	17.47%	0.61	0.08
6 months	-0.87%	-3.54%	13.67%	14.95%	-0.06	-0.24
3 months	-4.23%	-7.41%	14.90%	16.24%	-0.28	-0.46

Source: NSE Indices. Data as of February 28, 2023. * Based on inception date of April 01, 2005. Returns based on TRI values. Returns for the period upto 1-year are absolute returns. Returns for the period greater than one year are CAGR returns; daily standard deviation is annualized

The Nifty Smallcap250 Quality 50 Index has outperformed the Nifty Smallcap 250 Index in 15, 10, 7, 5, 3 and 1 year horizon period. In the last 10 years, the Nifty Smallcap250 Quality 50 Index has returned 21.01% CAGR compared to 15.68% CAGR for the Nifty Smallcap 250 Index. Since inception (April 2005), the Nifty Smallcap250 Quality 50 index has delivered 18.51% CAGR return against 14.41% return for the Nifty Smallcap 250 Index.

The Nifty Smallcap250 Quality 50 Index has been less

volatile than the Nifty Smallcap 250 Index over all the horizon periods analyzed in exhibit 3 above. Since inception the Nifty Smallcap250 Quality 50 Index has had annualized volatility of 19.76% against the 22.06% for the Nifty Smallcap 250 Index. The Nifty Smallcap250 Quality 50 Index has a higher return to risk ratio over 15, 10, 7, 5 and 3 year horizon period. For example, over the last 3 years, the return to risk ratio of the Nifty Smallcap250 Quality 50 Index is 1.32 vs 1.06 for the Nifty Smallcap 250 Index.

The Nifty Smallcap250 Quality 50 has outperformed the Nifty Smallcap 250 Index in 12 years out of 18 calendar years

Exhibit 4: Performance of the Nifty Smallcap250 Quality 50 and Nifty Smallcap 250 Index by calendar year

Calendar Year	Nifty Smallcap250 Quality 50	Nifty Smallcap 250
2005*	47.13%	55.76%
2006	14.54%	32.85%
2007	62.88%	97.44%
2008	-63.28%	-68.58%
2009	140.60%	117.37%
2010	35.36%	17.63%
2011	-26.43%	-35.07%
2012	38.52%	40.39%
2013	11.68%	-6.44%
2014	74.70%	71.66%
2015	19.82%	11.27%
2016	7.35%	1.39%
2017	45.51%	58.47%
2018	-15.62%	-26.15%
2019	-7.37%	-7.26%
2020	33.57%	26.46%
2021	66.06%	63.34%
2022	0.51%	-2.64%

Source: NSE Indices. *Data for the year 2005 is from April 01, 2005 to December 30, 2005. The cells in green (red) are the calendar years when the Nifty Smallcap250 Quality 50 Index outperformed (underperformed) the Nifty Smallcap 250 Index

The Nifty Smallcap250 Quality 50 Index has outperformed the Nifty Smallcap 250 Index in 12 out of the last 18 calendar years from CY2005-22. The Nifty Smallcap250 Quality 50 index has outperformed its parent Nifty Smallcap 250 index during periods of economic downturn (Global Financial Crisis 2008) as it delivered -63.28% return as against -68.58% return for the Nifty Smallcap 250 index. The Nifty Smallcap250 Quality 50 index has outperformed the Nifty

Smallcap 250 index during the economic recovery of 2009 as it delivered 140.6% return vs 117.37% return for the Nifty Smallcap 250 index generating an alpha of ~23.23%. The relatively robust performance of the Nifty Smallcap250 Quality 50 index can be seen during global economic slowdown of 2011. The Nifty Smallcap250 Quality 50 index has outperformed the Nifty Smallcap 250 index from CY2020 to CY 2022.

The Nifty Smallcap250 Quality 50 Index has outperformed the Nifty Smallcap 250 Index on a daily rolling return basis across 10, 7, 5, 3, 2 and 1 year horizon period

Exhibit 5: Instances of outperformance of the Nifty Smallcap250 Quality 50 Index vs Nifty Smallcap 250 Index on daily rolling return basis

Percentage of total instances of Outperformance and Underperformance vs Nifty Smallcap 250 Index on daily rolling return basis					
Investment Horizon	Nifty Smallcap250 Quality 50				
	Instances of underperformance vs Nifty Smallcap 250	Instances of Outperformance vs Nifty Smallcap 250			
		Excess Return (<0% CAGR)	Excess Return >=0% CAGR	Excess Return (0-2% CAGR)	Excess Return (2-4% CAGR)
10 years	0.0%	100.0%	0.0%	3.7%	96.3%
7 years	0.0%	100.0%	0.9%	15.8%	83.3%
5 years	4.2%	95.8%	2.2%	12.3%	81.3%
3 years	10.3%	89.7%	4.7%	15.9%	69.1%
2 years	17.5%	82.5%	6.6%	11.8%	64.2%
1 year	28.8%	71.2%	5.3%	8.5%	57.4%

Source: NSE Indices. Instances of outperformance or underperformance calculated using daily rolling returns. Analysis period is from April 01, 2005 to February 28, 2023

Historically, the Nifty Smallcap 250 Quality 50 Index has outperformed the Nifty Smallcap 250 Index 100% of the times over the 10-year and 7-year horizon and the number of instances fall to 71.2% over the 1-year horizon on the daily rolling return basis indicating a lower magnitude of outperformance over the short-term horizons. From exhibit 5

above, we observe that for the 5 years daily rolling return, 81.3% of times the Nifty Smallcap250 Quality 50 index outperformed the parent index with excess returns more than 4% p.a. and for the 10 years daily rolling return, 96.3% of the times the Nifty Smallcap250 Quality 50 index outperformed the parent index with excess returns more than 4% p.a.

The Nifty Smallcap250 Quality 50 index is presently overweight to Capital goods & Information Technology and underweight to Financial Services & Automobile and Auto components

Exhibit 6: Sector exposure between the Nifty Smallcap250 Quality 50 and the Nifty Smallcap 250 Index

Sector	Nifty Smallcap250 Quality 50	Nifty Smallcap 250
 Capital Goods	21.56	14.30
 Information Technology	12.92	6.45
 Consumer Durables	10.17	6.25
 Chemicals	8.69	7.36
 Services	7.99	4.88
 Fast Moving Consumer Goods	7.94	4.85
 Financial Services	7.63	19.12
 Oil, Gas & Consumable Fuels	7.01	1.96
 Healthcare	5.50	8.32
 Construction	3.13	3.99
 Textiles	2.78	2.09
 Diversified	1.91	0.49
 Automobile and Auto Components	1.43	5.39
 Consumer Services	1.35	4.44
 Others	-	10.10

Source: NSE Indices. Data as of February 28, 2023

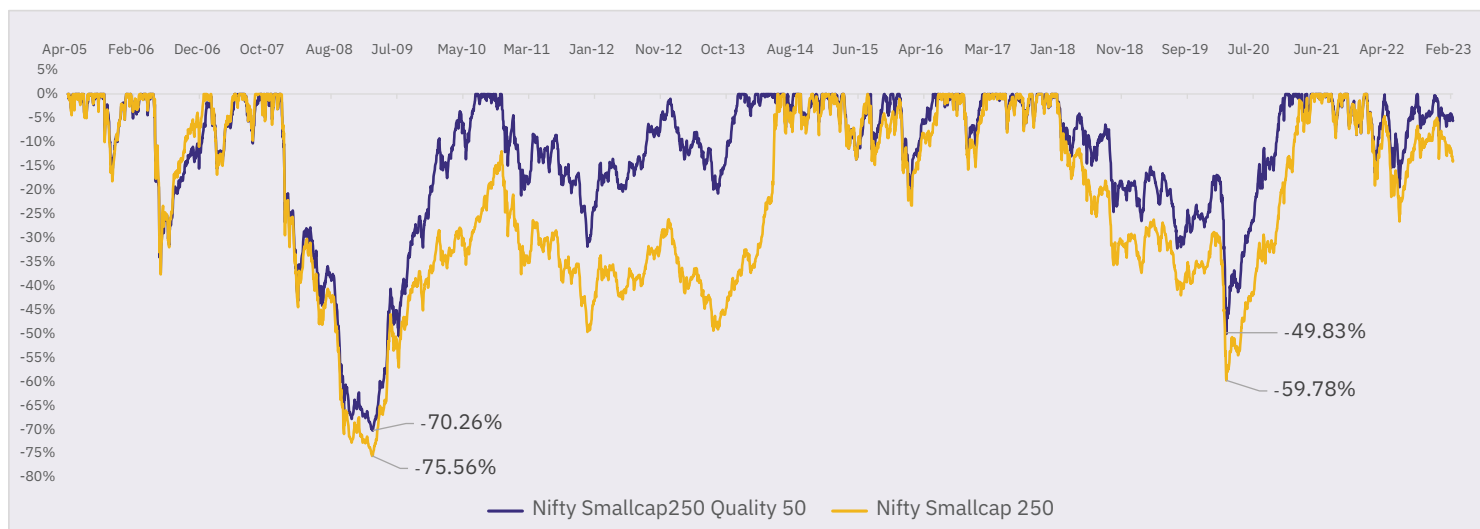
The Nifty Smallcap250 Quality 50 Index has a diversified portfolio with present exposure to 14 sectors (based on the Standard Industry Classification published by NSE Indices Ltd.). Of these 14 sectors, the index has highest exposure to Capital goods (21.56%), Information Technology (12.92%), Consumer Durables (10.17%), Chemicals (8.69%), Services (7.99%), accounting for ~61.33% of the portfolio and the remaining 38.67% weight is distributed among the remaining 9 sectors.

As on February 28, 2023, the largest sectors of the Nifty Smallcap250 Quality 50 Index are the Capital Goods,

Information Technology and Consumer Durables sectors with 21.56%, 12.92% and 10.17% weight. These 3 sectors together account for 44.65% of the weight of the Nifty Smallcap250 Quality 50 Index as against 27.0% in the Nifty Smallcap 250 index (parent index). The Nifty Smallcap250 Quality 50 Index was overweight the Capital goods, Information Technology and Consumer Durables sector by 7.26%, 6.47% and 3.93% respectively and underweight the Financial Services and Automobile and Auto Component sector by 11.49% and 3.96% respectively, relative to the Nifty Smallcap 250 Index.

Nifty Smallcap250 Quality 50 Index had lower drawdown as compared to Nifty Smallcap 250 Index

Exhibit 7: Drawdown (%) comparison between the Nifty Smallcap250 Quality 50 and the Nifty Smallcap 250 Index



Source: NSE Indices. Analysis period: April 01, 2005, to February 28, 2023. Return based on TR index values

Drawdown refers to the peak to trough decline during a specific period of investment. It is reported as the drop from peak to subsequent trough in percentage terms. The Nifty Smallcap250 Quality 50 Index witnessed maximum drawdown of -70.26% in March 2009 whereas during the same period the Nifty Smallcap 250 index had witnessed a maximum drawdown of -75.56%. During the period of March

2012 to March 2019, the Nifty Smallcap 250 Quality 50 index had a drawdown lower than -30%. During the covid period, the Nifty Smallcap250 Quality 50 index witnesses a drawdown of -49.83% vs -59.78% drawdown by the Nifty Smallcap 250 index. It can be seen in exhibit 7, that the Nifty Smallcap250 Quality 50 Index always had lower drawdown as compared to the Nifty Smallcap 250 Index.

Signing off...



The Nifty Smallcap250 Quality 50 Index tracks the performance of the top 50 small cap quality stocks selected based on high profitability, low leverage, and low earnings growth variability



Since inception on April 01, 2005, till January 31, 2023, the Nifty Smallcap250 Quality 50 index has delivered 18.51% CAGR return against 14.41% return for the Nifty Smallcap 250 Index



The Nifty Smallcap250 Quality 50 has outperformed the Nifty Smallcap 250 Index in 12 years out of the 18 calendar years



The Nifty Smallcap250 Quality 50 Index has outperformed the Nifty Smallcap 250 Index majority of times on a daily rolling return basis across 10, 7, 5, 3, 2 and 1 year investment horizon



The Nifty Smallcap250 Quality 50 index is presently overweight to Capital goods & Information Technology and underweight to Financial Services & Automobile and Auto components



The Nifty Smallcap250 Quality 50 Index always had a lower drawdown as compared to Nifty Smallcap 250 Index



About NSE Indices Limited:

NSE Indices Limited (formerly known as India Index Services & Products Ltd. - IISL), a subsidiary of NSE, provides a variety of indices and index related services for the capital markets. The company focuses on the index as a core product. The company owns and manages a portfolio of indices under the Nifty brand of NSE, including the flagship index, the Nifty 50. Nifty equity indices comprises of broad-based benchmark indices, sectoral indices, strategy indices, thematic indices and customised indices. NSE Indices Limited also maintains

fixed income indices based on Government of India securities, corporate bonds, money market instruments and hybrid indices. Many investment products based on Nifty indices have been developed within India and abroad. These include index based derivatives traded on NSE, NSE IFSC and Singapore Exchange Ltd. (SGX) and a number of index funds and exchange traded funds. The flagship 'Nifty 50' index is widely tracked and traded as the benchmark for Indian Capital Markets.

For more information, please visit: www.niftyindices.com

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