

In the Markets Now

Going small to go big

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

PWM Equity & Fixed Income Research

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THE CASE FOR SMALL-CAPS

While certain small-cap stocks have been in the news lately for...less-than-fundamentally sound reasons, the mania around GameStop, AMC, and other small companies may actually be obscuring the underlying strength in the asset class. The Russell 2000 (a common small-cap index) has outperformed the S&P 500 by over 40% off the March 23 lows, and despite this outperformance, [the case for small-cap exposure remains strong](#). We outline a few of key reasons why below.

Small-caps outperform off of bear market lows.

Coming off the last three major recession-bear market double whammies (1991, 2001, and 2009), small-caps outperformed large-caps over the subsequent one- and three-year time periods. While small-caps often underperform during big selloffs, they tend to outperform once the recovery is underway. Though we're nearing a year since March 23, 2020, the data indicate that small-caps might have room to run.

Small-caps are more levered to the US economy.

Given their size, small-caps tend to be more domestically-focused than larger companies. In fact, the S&P 500 gets nearly twice as much revenue from outside the US than the Russell 2000 does. And US economic growth looks set to boom with vaccine momentum building, consumer health holding steady, accommodative monetary policy in place, and additional fiscal stimulus in the pipeline. This growth should benefit the more economically sensitive areas of the US market like small-caps, which are already seeing a rapidly improving earnings outlook.



Small-caps are the only asset class to beat inflation in every decade since 1930. This great stat from our friends at Strategas may be further reason to have an allocation to small-caps. Though we believe the fears of rampant hyperinflation are overdone, inflation expectations are still rising. In addition to traditional hedges like commodities and TIPS, small-caps have outpaced inflation across a range of different economic and market environments over the last century or so.

Small-cap indexes are less concentrated than large-cap. The five biggest companies in the S&P make up 22% of the index, while the five biggest in the Russell 2000 make up just 3%. There's also more sector diversity in the small-cap indices, with no one sector coming close to the ~30% weight of Technology in the S&P 500. As cyclical sectors continue to look attractive, small-caps' overweight to Financials and Industrials could be a boon.

Asset allocation decisions are incredibly important to building a portfolio, but should ultimately be consistent with one's overall financial plan and risk tolerance. Though small-caps offer outperformance potential, they are generally more volatile and riskier than large-cap stocks. Work with your Advisor today to develop a robust allocation plan and portfolio to match.

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