

ABOVE THE FRAY

Can Small Caps Weather the Storm?

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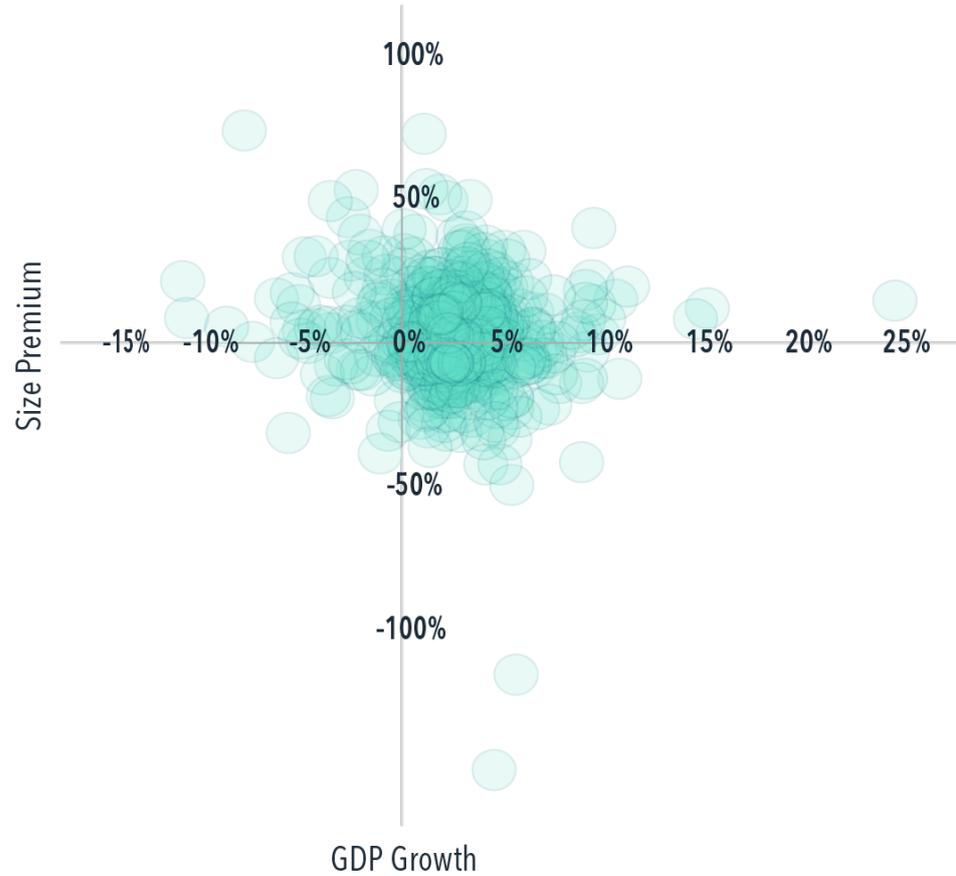
Historically, the broad stock market has often been positive [even at the start of economic recessions](#). But what about small cap stocks? Conventional wisdom holds that smaller companies often bear the brunt of economic downturns. So, what does the data tell us about the size premium when gross domestic product growth slows?

Plotting annual return differences between small cap and large cap stocks against contemporaneous GDP growth for developed markets shows no discernible relation between the two. For example, there were 73 instances of a country experiencing a decline in GDP for the year. Small caps outperformed large caps in that country/year 47 out of those 73, or 64% of the time. That's higher than the frequency across all country/year observations, which was 54%.

These results shouldn't be too surprising, since [markets are forward-looking](#). As expectations for the future change, market prices continuously reset to a level where investors can expect positive premiums, including the size premium. This means small caps can still outperform, even if we eventually find ourselves in an environment unfavorable to small-company success.

Exhibit 1

**Annual Size Premium
vs. Annual GDP
Growth, Developed
Markets, 1994–2023**



Past performance is not a guarantee of future results. Actual returns may be lower.

In USD. GDP growth data is from the International Monetary Fund World Economic Outlook. The size premium is computed as the difference in the annualized compound returns of annually rebalanced portfolios comprising the bottom 12.5% and the top 87.5% of market cap sorted on firm size. Data is provided by Bloomberg. Sample period by country: developed markets size premium from 1994 (unless stated differently)—Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland, UK, US.

This article originally appeared in Above the Fray, a weekly newsletter for Dimensional clients.

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