The Case for Small-Cap Stocks
Wainwright Investment Counsel, LLC

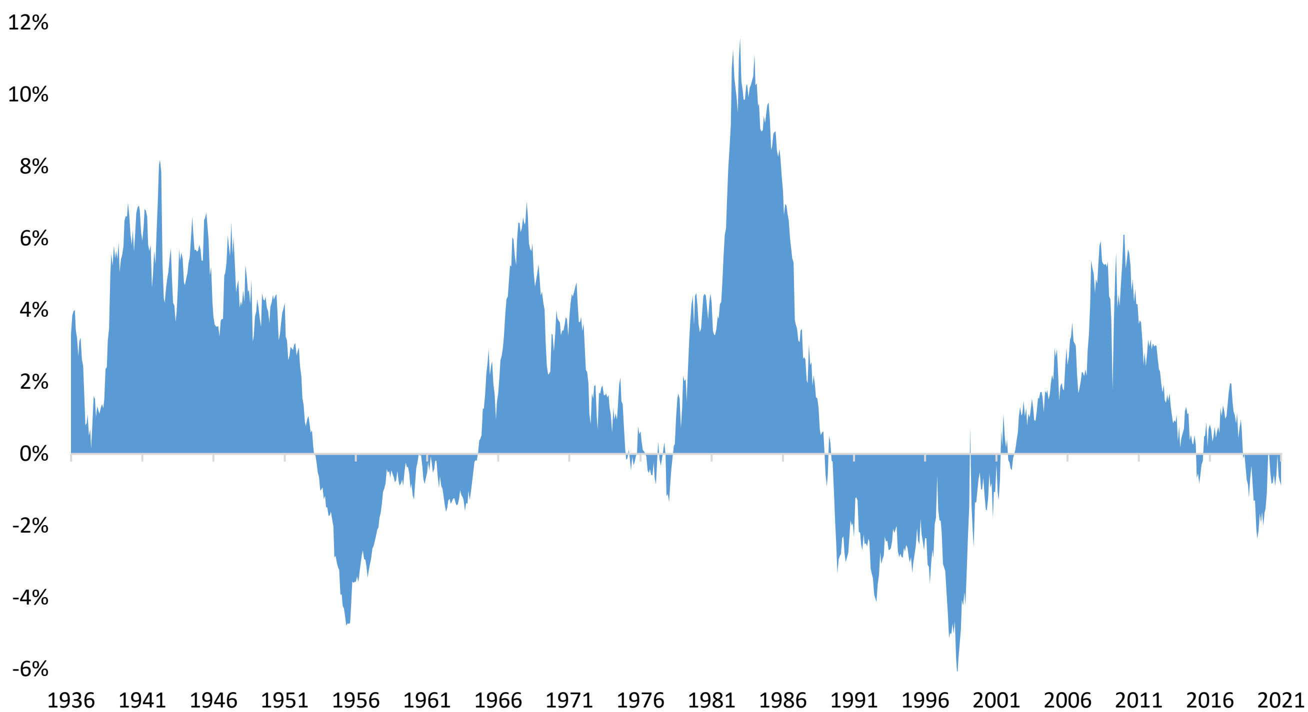
March 2022

1 Small Stocks, Mighty Returns?

Since the end of the Great Financial Crisis[1], large and mega-sized U.S. company stocks have overwhelmingly led the market. The S&P 500 Index, which is comprised of ≈500 of the largest U.S. publicly traded companies, gained +28.7% on a total return basis in 2021 compared to +14.8% for the Russell 2000 Index of smaller-company stocks. The annualized trailing 10-year return, through 2021, for the S&P 500 was +16.6% versus +13.2% for the Russell 2000, however, when one looks at the returns through a longer lens, one observes that small-cap stocks have historically outperformed large-caps. This seems reasonable, as smaller firms may not suffer from the laws of large numbers and thus are capable of generating more rapid revenue and earnings growth than their large-cap brethren. Further, small-cap firms are riskier than large-cap firms, their future success less certain, and thus their stocks typically exhibit a higher beta (a standard measure of risk) than large-cap stocks, and theory holds that investors should, over time, be rewarded for taking on risk.

The chart below illustrates the 10-year annualized return differential on a monthly basis of small-cap stocks versus large-cap stocks, as compiled by Kenneth French at the Tuck School of Business[2]. Over the period July 1926 through December 2021, small-cap stocks had an annualized return of 12.4% versus 11.0% for large-cap stocks. Additionally, small-caps outperformed large-caps 65% over the same time period on an annualized 10-year basis.

Rolling 10 Year Annualized Return Difference
Small-Caps minus Large-Caps
July 1926 to December 2021



2 Effects of Interest Rate Increases on Small-Cap Stocks

As the Federal Open Market Committee (FOMC) has begun an interest rate tightening cycle, one may reasonably wonder about the effect of interest rate increases on small-cap stocks versus large-caps. Over the previous four interest rate tightening cycles, small-cap stocks have proven relatively resilient, as shown in the tables below. The Russell 2000 posted double-digit cumulative returns 24 months after the first Fed Funds Rate increase in each of the past four cycles. Further, in only one 12-month period after the initial rate increase were small-caps down. That compares favorably to the S&P 500, which also had strong performance 24 months after the initial rate increase, but performance generally lagged that of the Russell 2000. There was also one period when the S&P 500 had a negative cumulative return 24 months post rate increase while the Russell 2000 did not have any.

Wainwright is not suggesting a complete shift away from large-caps to small-caps, but we emphasize the importance of small-cap stocks in any well-diversified portfolio. Large-caps have jumped out of the gates fast, in particular of late, but long-term, small-caps win the race.

Should you have any questions or comments, please contract a member of Wainwright's Investment Advisory team at 617-531-3100 or at info@winvcounsel.com.

	Russell 2000 Cumulative Returns[3]	
First Month After Rate Increase[4]	**12 Month Cumulative Returns**	**24 Month Cumulative Returns**
March 1994	-1.7%	26.4%
July 1999	14.3%	15.0%
July 2004	9.4%	25.4%
January 2016	21.3%	39.1%
Average	**10.8%**	**26.5%**

	S&P 500 Cumulative Returns[3]	
First Month After Rate Increase[4]	**12 Month Cumulative Returns**	**24 Month Cumulative Returns**
March 1994	7.4%	44.6%
July 1999	7.2%	-8.7%
July 2004	6.3%	15.5%
January 2016	12.0%	36.4%
Average	**8.2%**	**22.0%**

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Disclosures

Additional information about Wainwright Investment Counsel, LLC is also available at www.adviserinfo.sec.gov.

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[1] June 2009 – According to the National Bureau of Economic Research.
[2] Fama, E. F., & French, K. R. (1992). The Cross-Section of Expected Stock Returns. The Journal of Finance, 47(2), 427–465. https://doi.org/10.2307/2329112.
Data from: https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.
[3] Index data compiled from Morningstar Direct.
[4] FOMC's target federal funds rate increase taken from https://www.federalreserve.gov/monetarypolicy/openmarket.htm.