



Anticipating Small Cap Leadership

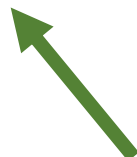
Patrick Riley, CFA, Partner, Small Cap Quality Growth Portfolio Manager



October 6, 2025

THE PENSION FORMULA

$$\text{Contributions} + \text{Income} = \text{Benefits} + \text{Expenses}$$





SITUATION: The 2020s are not the 2010s

The 2010s were defined by quantitative easing, where zero interest rate policy and cheap capital allowed companies with suspect balance sheets to survive and even thrive.

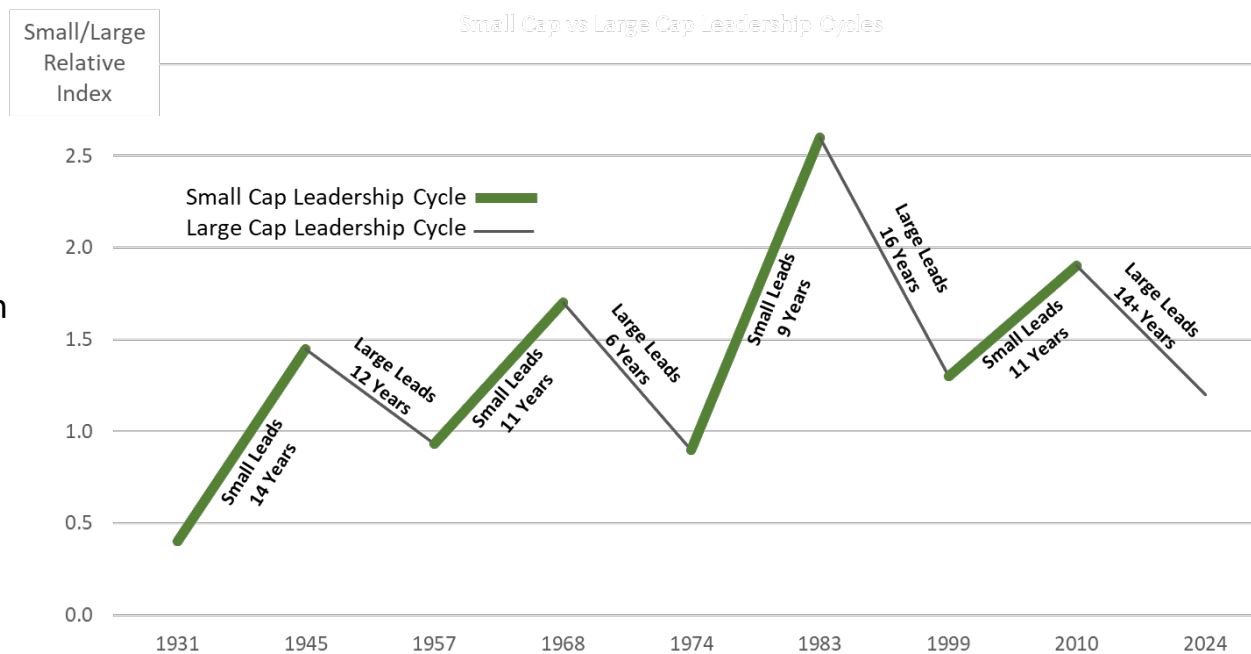


Today, quantitative tightening prevails, favoring fundamentally sound, high-quality businesses with robust balance sheets and operational efficiencies.



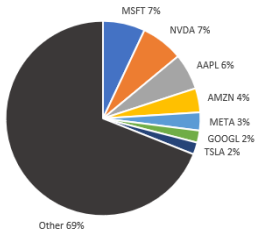
DURATION: Large cap leadership cycle is mature

Small caps exchange leadership cycles with large caps as shown in the graph to the right. The large cap cycle is extended.



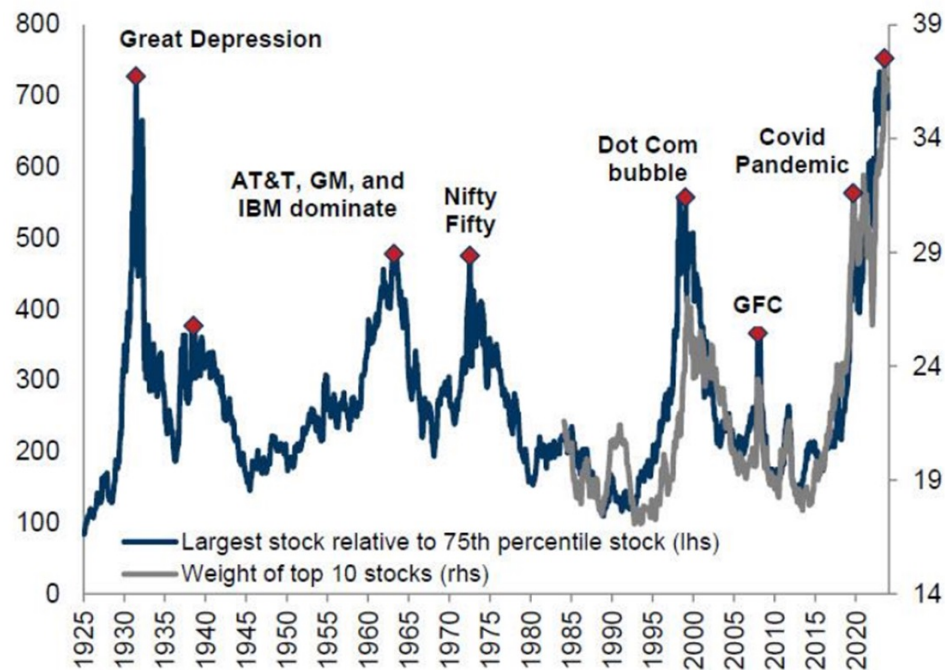
Large has led small for the past 14+ years. The average length of a large cap leadership cycle is 11.5 years; 16 years has been the longest.

Source: Furey Research Partners



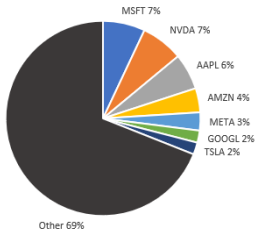
CONCENTRATION: Full-Century Extreme

Mega-cap concentrations, here the top ten stocks in the market, have preceded market cap leadership shifts as these stocks become over owned and overvalued.



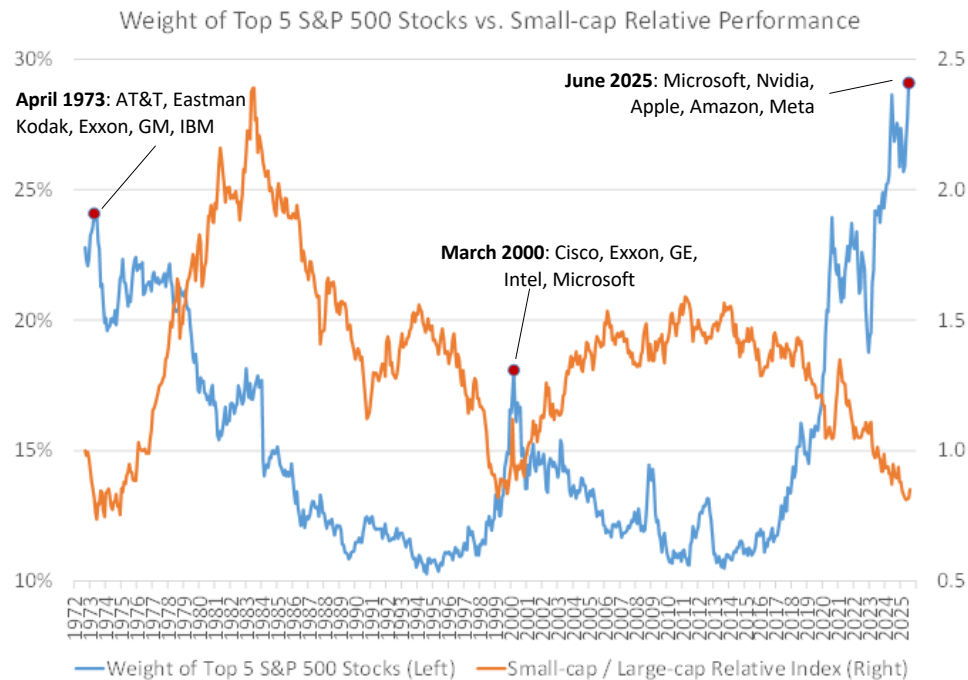
Investors seek value which leads to distributions out of mega-caps into small caps. At 1Q25, small caps represented as little a portion of the total U.S. equity market since the Great Depression.

Source: Compustat, CRSP, Kenneth R. French, Goldman Sachs GIR; 12/31/2024



CONCENTRATION: Half-Century Extreme

The concentration of the Magnificent 7 at over 30% of the S&P 500 is reminiscent of concentrations that have historically foreshadowed shifts to smaller companies.



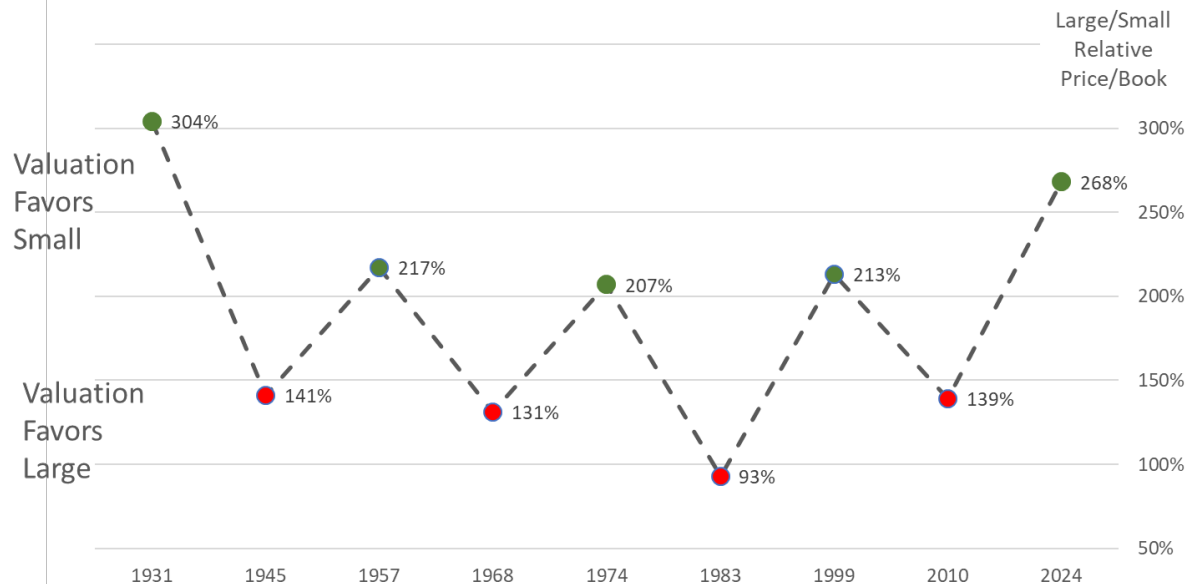
Source: Furey Research Partners

The peak of mega-cap concentration portends a size leadership switch as those leading companies become overvalued and over owned.

**SALE!
SALE!
SALE!**

VALUATION: Large Cap Valuations Are Stretched

Every small cap leadership cycle that has occurred since 1931 has seen Large/Small relative Price/Book ratio in excess of 200%.



At YE23 the ratio registered 234%; at YE24 it stood at 268%. Small cap P/B is cheap relative to large cap P/B. Can it approach 1931's level?

Source: Furey Research Partners



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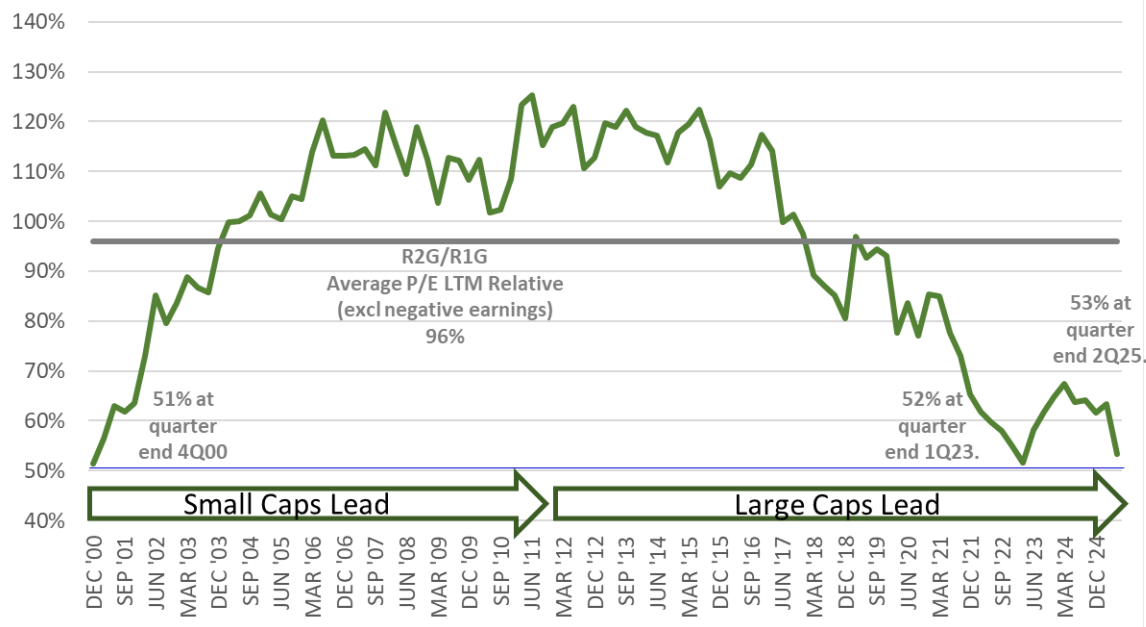
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**SALE!
SALE!
SALE!**

VALUATION: Small caps are attractively valued

Small-cap valuations are at trough levels relative to large caps. When such lows have been reached in the past, investors rotate toward undervalued opportunities.



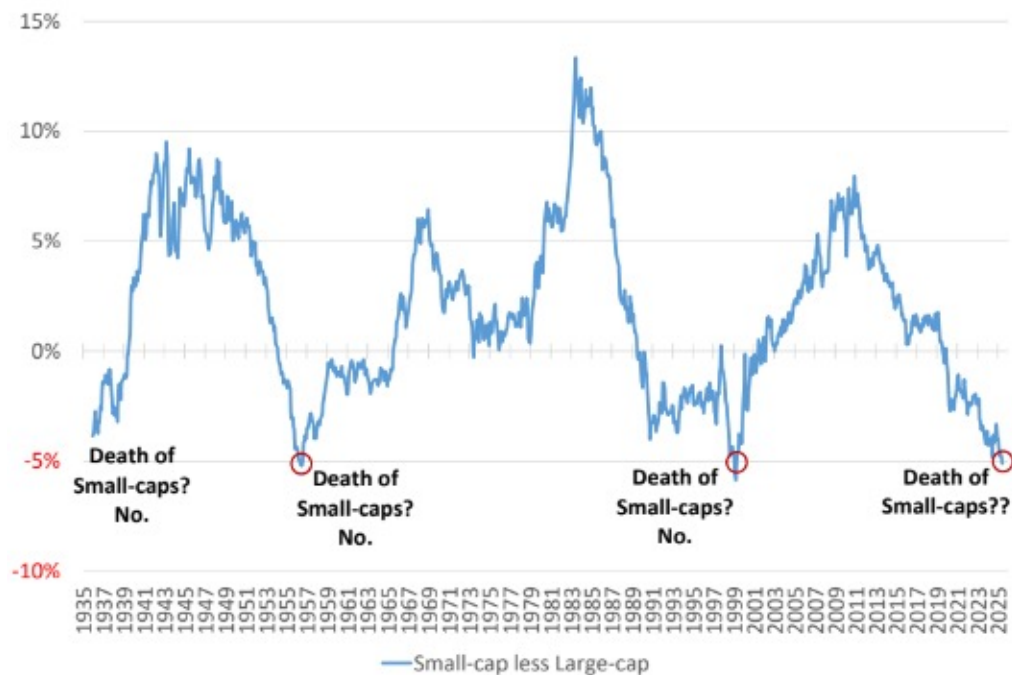
At 1Q25, Nvidia was worth 1.3x the entire Russell 2000 Index. It won't take much of a fracture in the mega caps to set fire to a small cap leadership cycle.

Source: FactSet, Russell

Is Small Cap
Dead?

DETERIORATION: Relative Performance Washout

Ten-year small cap returns relative to large caps are at lows seen only three times, almost four, since the Great Depression, i.e., -5%.



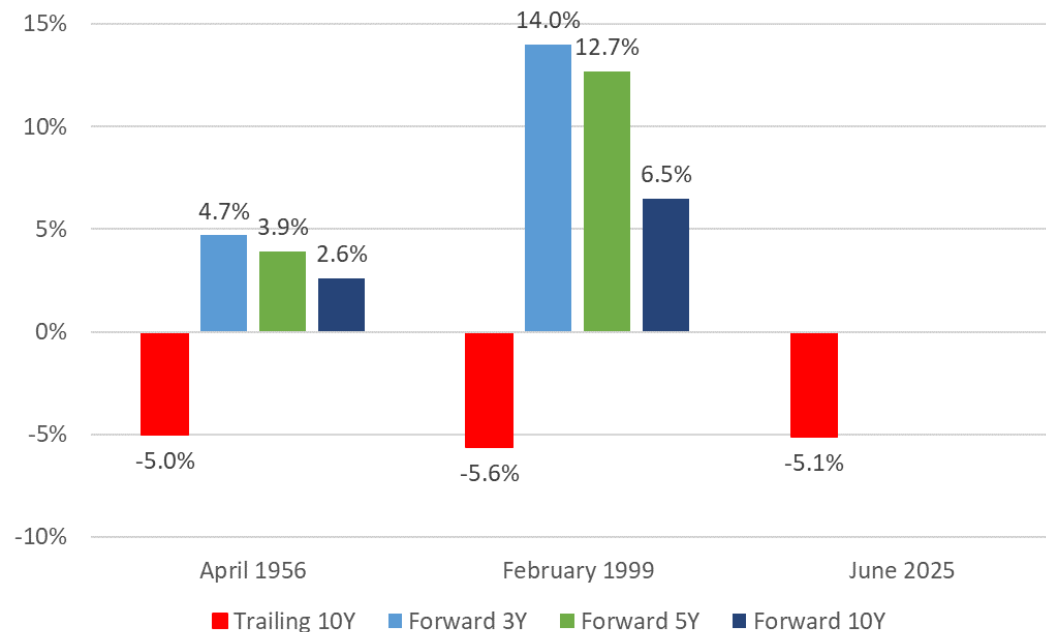
The latest instance occurred in June 2025. Each instance marked a major opportunity for small cap investing

Source: FRP, FactSet, Morningstar; as of 6/30/25; Small-cap employs CRSP 6-8 Market Cap Decile Index returns from 1926 to June 2001 and CRSP Small Cap Index returns from July 2001 to present; Large-cap employs S&P 500 returns for all periods



APPRECIATION: Relative Performance Winner

Small-caps' trailing relative return versus large-caps is approaching the worst level on record but there's a silver lining...



... In the prior two occasions when relative performance reached such depths, long-term forward relative performance was positive in all periods.

Source: FRP, FactSet, Morningstar; as of 6/30/25; Small-cap employs CRSP 6-8 Market Cap Decile Index returns from 1926 to June 2001 and CRSP Small Cap Index returns from July 2001 to present; Large-cap employs S&P 500 returns for all periods



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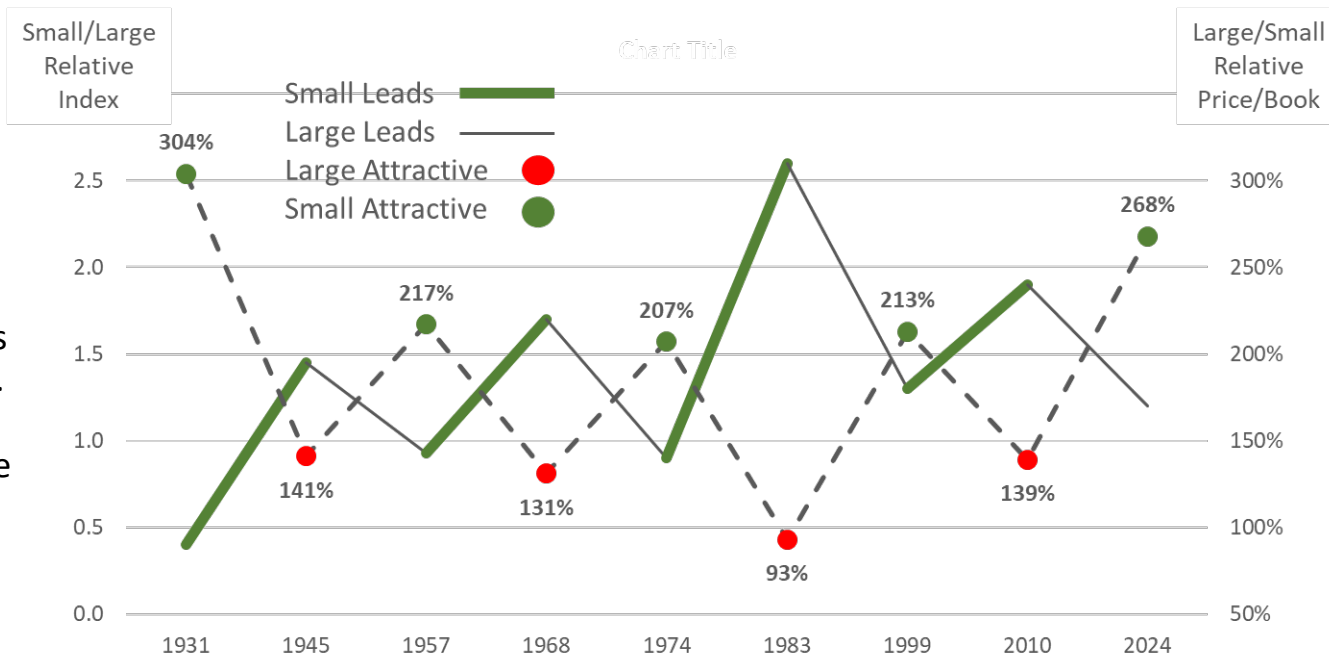
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CULMINATION: Small Cap Poised To Lead

Small cap leadership cycles have begun when the relative price/book ratio of small vs large is $\geq 200\%$. The large cap leadership cycle is extended at 14+ years in length.



Overvalued large caps and an extended large cap leadership cycle portend a size leadership switch from large caps to small caps.

Source: Furey Research Partners

Questions