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# Small-cap stocks have more room to run

The category has had a strong year, but that doesn't scare some financial advisers

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By **Jeff Benjamin**  

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Despite the run-up by small-cap stocks this year, the longer-term view still favors smaller company stocks over larger companies, according to some market watchers.

Small-cap growth funds tracked by Morningstar gained an average of **6.6% since the start of the year**, while large-cap funds averaged 2.85%.

But over the past three years, large cap funds averaged 9.1%, while small cap funds averaged just 5%.



“Many investors and their advisers seem to have only considered large caps, especially in the U.S., which is perhaps related to fear of economic uncertainty,” said Kashif Ahmed, president of American Private Wealth.

“Many folks don't realize there are plenty of small caps with dividends, and they deliver sound dividend growth,” he added.

Paul Schatz, president of Heritage Capital Management, is also firmly in the **small-cap bull camp**.

“I have been continuously long small caps since May, and remain bullish today,” he said. “Although they haven't exceeded their June 2015 peak, the group has been leading this rally and I expect it to see all-time highs this year.”

Rose Swanger, president of Advise Finance, has enjoyed the recent small-cap run, but is now playing the category more cautiously.

“Small caps are at 52-week highs, so in the quarterly reviews I've been doing with clients we've been cutting back that exposure,” she said. “If I'm putting money to work right now I would not put it into small caps because of the higher valuations.”

It is, in many respects, a matter of preference that is often determined by risk tolerance levels, according to Todd Rosenbluth, director of mutual fund and ETF research at CFRA.

“Investors typically have stronger growth expectation when it comes to small caps, but that comes with more risk because they are less-proven companies,” he said.

The inch-worm pace of the **U.S. economic recovery**, a near-constant threat of higher interest rates, and an unprecedented presidential election season all combine to represent risk to investors, according to Mr. Rosenbluth.

With the in mind, it would not be surprising to see investors favoring the more defensive large-cap categories over small caps, he added.

An August survey of more than 200 financial professionals, conducted by Alger, found that 76% described themselves as bullish on U.S. small-cap stocks.

But that same survey also showed just 30% of respondents expect small caps to outperform large- and mid-cap stocks over the next 12 to 24 months.

According to Morningstar, actively managed small-cap equity funds have seen \$13.8 billion in net outflows this year through August, which equals a 3.5% category asset drop.

Large-cap active funds, over the same period lost \$115.9 billion, or about 4%.

## **Large cap and small cap actively managed mutual funds outflows**

Created with Highcharts 4.1.6\$-115.93B\$-13.81B\$-256.64B\$-62.19BNet flow - YTDNet flow - 3YRLarge CapSmall Cap\$-300B\$-200B\$-100B\$0B

*Source: Morningstar, Inc.*

But over the past three years, active small-cap fund assets lost \$62.2 billion, or about 14%, while large-cap funds lost \$256.6 billion, or 8.7%.

In essence, small-cap funds have taken the biggest hit, which goes against the grain of the attitude of most financial professionals, according to Brad Neuman, vice president and chief investment strategist at Alger.

“The experts are bullish on small caps, but investors have not been following that with their money,” he said.



**What do you think?**

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