

The enigma of small caps... or of large ones?

18 March 2024

Dear Clients and Partners,

The underperformance of European small caps against indices is filling a lot of column inches. Is it all an illusion or a genuine issue ?

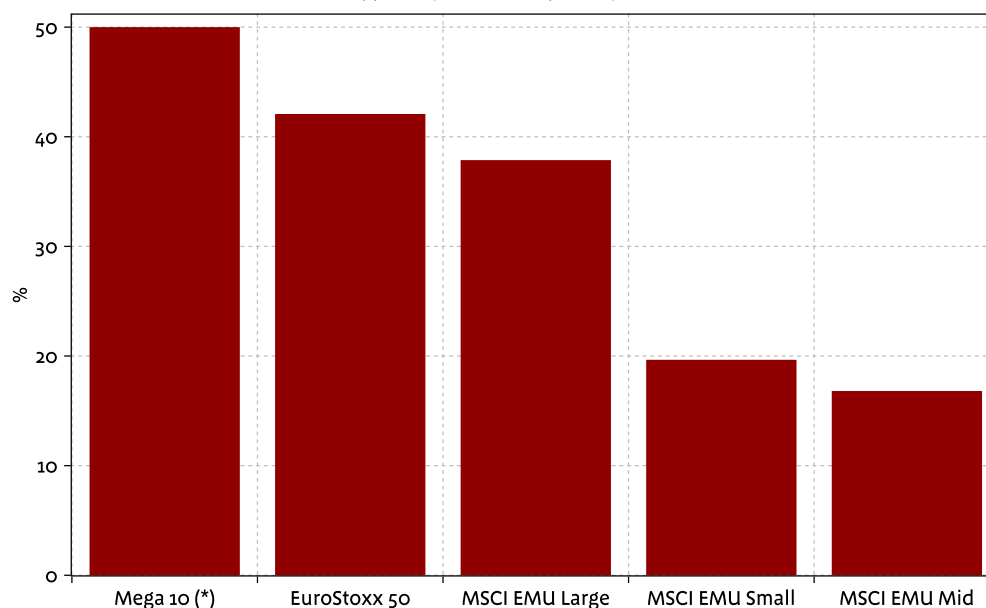
Since the start of the recovery of the stock market – i.e. when it was at its lowest ebb in November 2022 – European small caps appear to be lagging behind the rest of the market. Upon closer inspection (cf. chart 1), that impression is misleading in some respects. Mid caps (€7 billion average capitalisation) have, in fact, performed the same as small caps (€1 billion average capitalisation). So, what we can observe is more of a stock market trend currently favouring large caps in general, and a few titans in particular.

Eurozone stock performance since November 2022 by size cluster

"Net return" performance ; (*) "Mega 10" = 10 largest caps as of 1 Nov 2022

Performances des actions de la zone euro depuis novembre 2022, par clusters de taille

Performances 'net return' ; (*) 'Mega 10' = 10 plus grosses valeurs au 1er nov. 2022



Dorval Asset Management – 15/03/2024 – Source : Macrobond

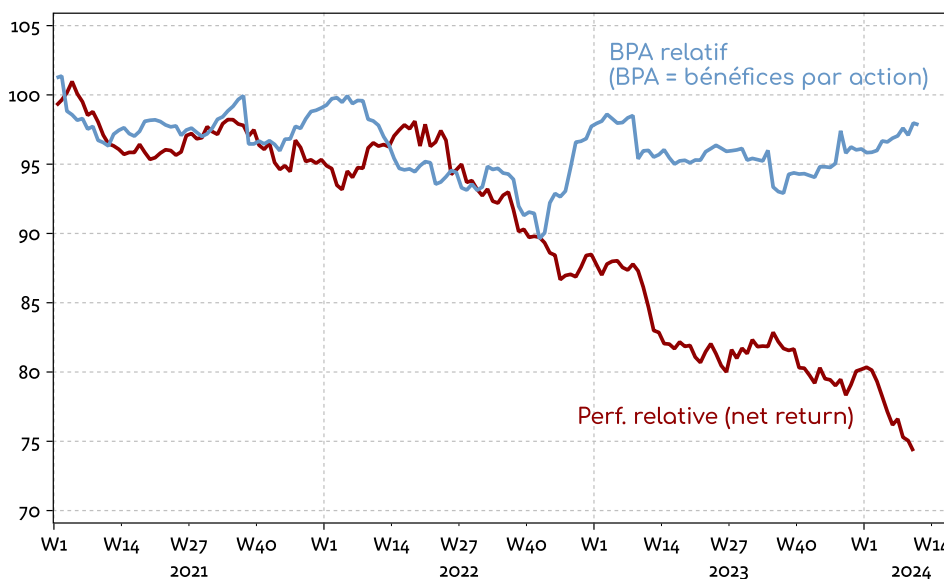


Finer analysis reveals that this “large cap” effect is not chiefly due to sectoral composition differences between the indices. According to Bloomberg calculations, while the Euro Stoxx 50 has outperformed the MSCI EMU Small Cap Index by 22% since 1 November 2022, sectoral differences account for only 6% in that regard.

One possible explanation is earnings, the question being whether large caps outperformed small caps simply because their profits piled up more quickly ? Well, no. Because in terms of EPS (earnings per share), small and mid caps have not performed badly at all. Their EPS have, in fact, risen at the same rate as companies in the Euro Stoxx 50 over recent years, which is in stark contrast to relative stock market performance (cf. chart 2). This result runs contrary to the oft-advanced idea that the small caps’ profits suffer more than large caps’ due to the greater impact of Europe on their turnover.

Divergence between stock market and profit performance
MSCI EMU SMID vs Euro Stoxx 50

La divergence
entre performance boursière et bénéficiaire
MSCI EMU SMID vs Euro Stoxx 50



Dorval Asset Management – 15/03/2024 – Source : Macrobond

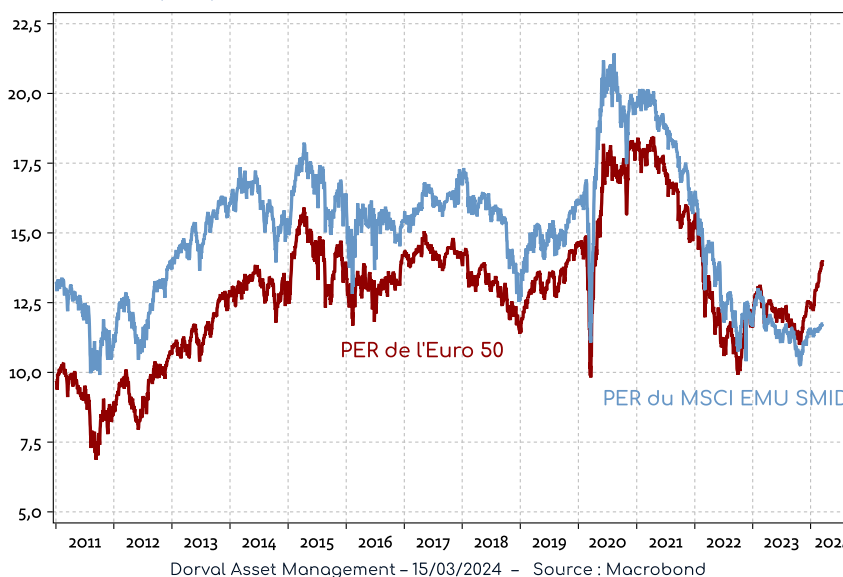
Relative EPS (EPS = earnings per share) / Relative perf. (net return)

The mathematical result of this divergence between economic and stock market performance is a fall in terms of valuation (cf. chart 3). Not only has the PER of small and mid caps gone above that of very large caps for the first time, their absolute PER is at the same level as during the existential euro crisis of 2011-2012. Such large falls seem difficult to explain. At this level, the European SMID cap universe looks very attractive to us.



European SMID caps as cheap as during the euro crisis of 2011-2012.

Les SMID européennes aussi bon marché que pendant la crise de l'Euro de 2011-2012



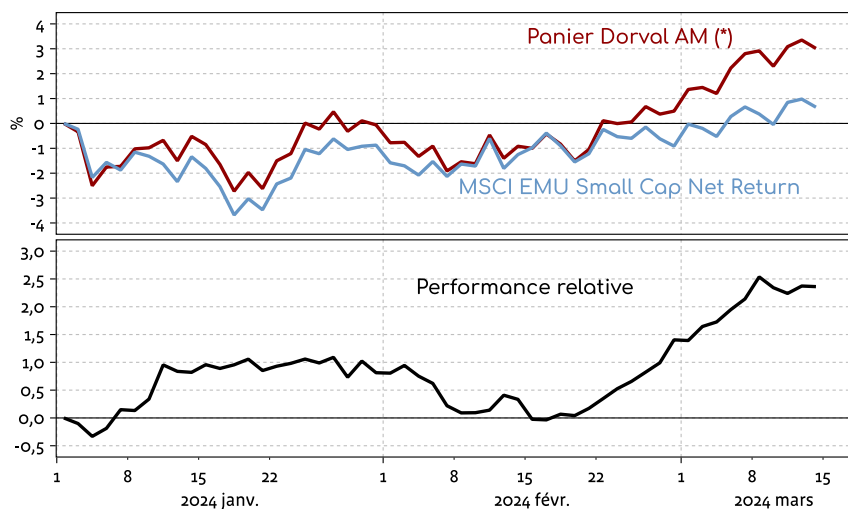
PER for the Euro Stoxx 50 / PER for the MSCI EMU SMID

In our European flexible funds, we maintain a significant level of exposure of 8.5% to eurozone small caps. This exposure takes the form of an equally weighted basket of 50 small caps to which we have applied liquidity, financial strength and profit growth filters, and which are set apart by their governance ratings. This basket is currently outperforming the MSCI EMU Small Cap index (cf. chart 4).

Dorval AM selection of 50 small caps vs MSCI EMU Small Net return perf.

Sélection Dorval AM de 50 petites valeurs vs MSCI EMU Small

Perf. net return



(*) Panier de 50 valeurs sélectionnées sur des critères de liquidité, de solidité et de gouvernance

Dorval AM basket (*) / MSCI EMU Small Cap Net Return / Relative performance

(*) Basket of 50 stocks selected based on liquidity, strength and governance criteria.



Our exposure rates are as follows:

- Dorval Convictions: The equity exposure rate is 63%.

Dorval Asset Management

Public limited company with share capital of €303,924

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