MARKET INSIGHTS

from Ziegler Capital Management

Time to Rebalance Your Portfolio?

History May be Signaling an Opportunity in Small Caps

Many headlines over the past year have been focused on mega capitalization stocks such as Apple, Tesla, Facebook, and Google. Concentration in these stocks has led to a top-heavy market that, historically, has generated extreme performance differences between large and small cap stocks. We believe this may be an opportunistic time to look at the other side of your portfolio.

KEY POINTS

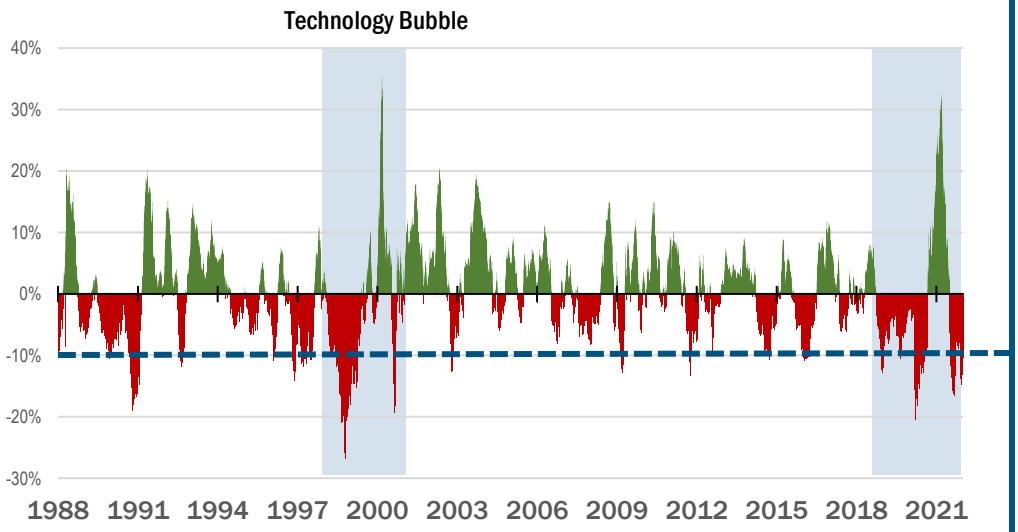
- Favorable opportunities exist during extreme market events
- Extreme events are more common than many realize
- Forward 12-month small cap returns are favorable after extreme periods, both absolute and relative to large caps

The Signal

Historically, the market tends to oscillate between extremes. In 2000, technology stocks could do no wrong as many investors said, "Thanks old economy, we will take it from here!" As it turns out, that famous comment marked the end of the extreme Technology Bubble. During that period, the market concentration in a small number of tech stocks caused significant performance gaps between large and small cap stocks. Sound familiar?

As we look back, it is apparent that over the last 30 years these extreme periods were not uncommon. In fact, these extreme performance events were quite common, and it benefited investors who took advantage of these opportunities.

Rolling 6-Month Price Return Spread Between The Russell 2000 and S&P 500



Source: Bloomberg, Data from 1/8/1988 – 12/31/2021

53 Extreme Periods (Spread below -10%)

Russell 2000 12-Month Forward Price Returns

Absolute	
Percent of Positive Periods	Median Return
91%	27.1%

Vs S&P 500	
Percent of Positive Periods	Median Return
62%	6.2%

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The Opportunity

Analyzing the rolling six-month relative price return spread between the Russell 2000 (representing Small Cap stocks) and the S&P 500 (representing Large Cap stocks), a clear range emerges. Over the more than 30-year period, the Russell 2000 versus S&P 500 spread fell below -10% just 53 times.

Historically, the forward returns tend to support small cap investment. After an extreme event, the 12-month absolute returns for small cap stocks were positive 91% of the time, with a median return of 27.1%. Additionally, over the same observations, small cap stocks beat large cap stocks 62% of the time, with median outperformance of 6.2%.

Thus, as the market oscillates, we remind investors that performance extremes are quite common. History suggests that investors can use these events to opportunistically invest or rebalance their portfolios to achieve their desired investment results.

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21-02001
Printed Internally