

Global Small-Cap Stocks: Three Signs of a Resurgence

BY THE SPECIAL GLOBAL EQUITY TEAM

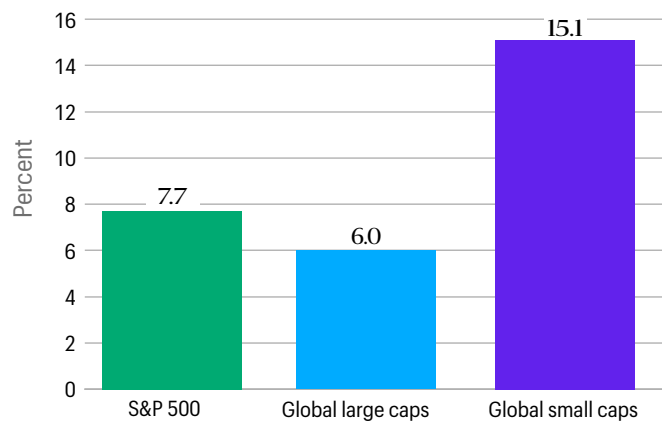
Small-cap stocks have long enjoyed a reputation as an attractive asset class for long-term stock price appreciation. However, due to strong recent large-cap performance, this reputation has been called into question. Despite this, three compelling data points suggest small caps could be poised for a resurgence.

01 U.S. large-cap concentration historically signals global small-cap outperformance

A significant theme in the U.S. large-cap universe of late has been a lack of market breadth. This extreme concentration is widely acknowledged, yet its ramifications are largely underappreciated. To understand these implications, we observed the average one-year forward returns for global large caps, global small caps, and the S&P 500 Index when concentration levels reached **two critical thresholds** (both of which exist today):

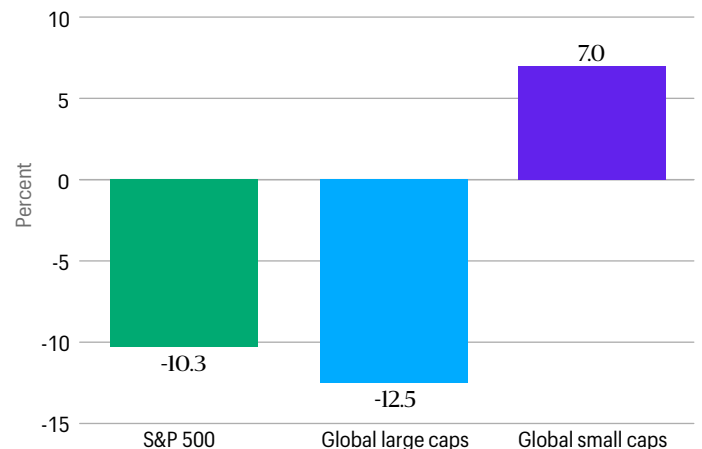
- The **top 10** constituents in the S&P 500 Index **move above 25%** of the index.

AVERAGE 12-MONTH FORWARD CUMULATIVE RETURNS BY INDEX



- The **top 5** constituents in the S&P 500 Index **move above 15%** of the index.

AVERAGE 12-MONTH FORWARD CUMULATIVE RETURNS BY INDEX



Sources: Maestro and Allspring. Observations taken from 02-Apr-00 to 17-Mar-23. "Global large caps" and "global small caps" are represented by the MSCI World Large Cap Index and MSCI World Small Cap Index, respectively. Past performance is no guarantee of future results.

Market concentration can occur for various reasons, but the average forward-looking returns observed above indicate that these conditions have historically preceded strong relative performance for global small-cap stocks.

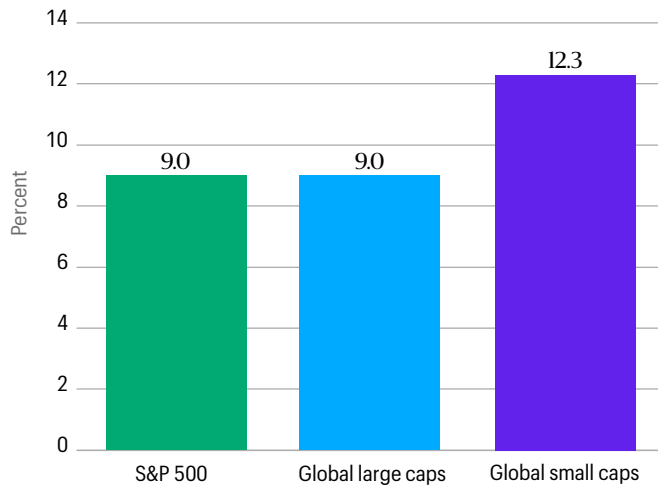


02 High but falling inflation supports a rotation to small caps

Much of the world continues to grapple with high inflation, even as the opening of global supply chains and tightening of monetary policy begin to move inflation lower. Although the inflation trajectory from here is uncertain, many investors believe the path to normalization will persist. To understand what the past may tell us about the relationship between inflation and global small-cap performance, we again looked at the average one-year forward returns for the same indexes, this time focusing on instances during which inflation was high¹ but falling, similar to the conditions we are observing today.

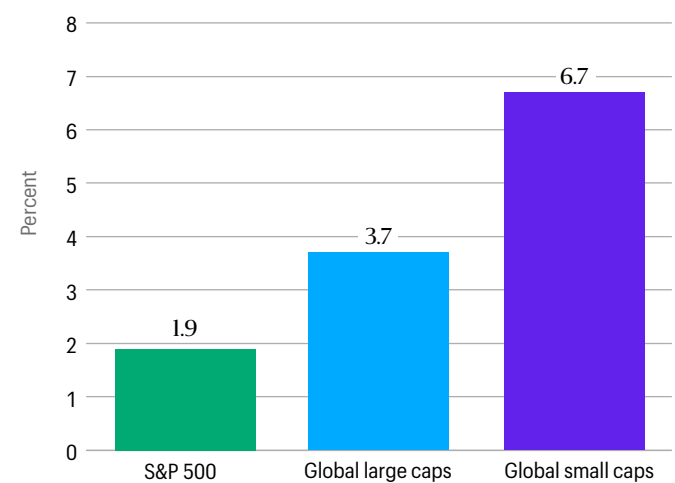
- U.S. Consumer Price Index (CPI) **falling from above 3.7%:**

AVERAGE 12-MONTH FORWARD CUMULATIVE RETURNS BY INDEX



- U.S. Personal Consumption Expenditures Price Index (PCE) **falling from above 2.3%:**

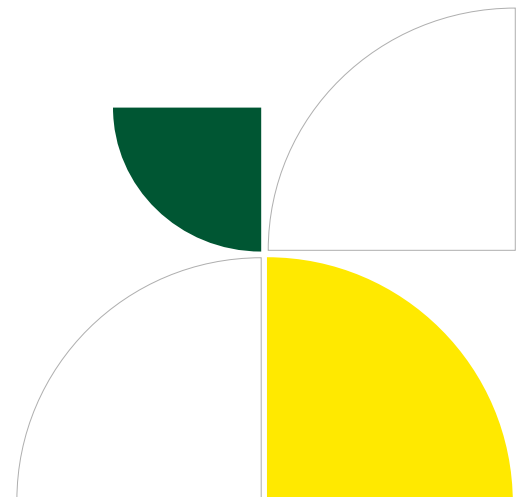
AVERAGE 12-MONTH FORWARD CUMULATIVE RETURNS BY INDEX



Sources: Maestro and Allspring. Observations taken from 05-Jan-01 to 06-Jan-23. "Global large caps" and "global small caps" are represented by the MSCI World Large Cap Index and MSCI World Small Cap Index, respectively. **Past performance is no guarantee of future results.**

1. High inflation is defined as the top 85th percentile for the CPI and PCE.

These observations demonstrate that past instances of high but falling inflation have led to outperformance for global small caps.



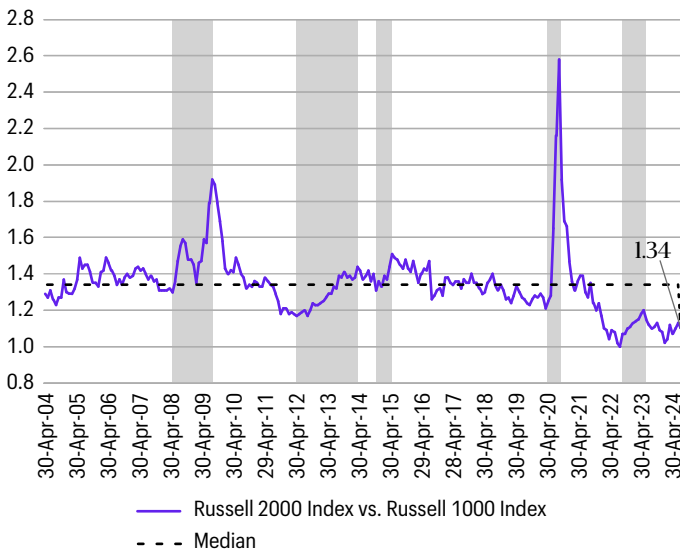


03 Small-cap stock valuations are attractive relative to large caps in many regions

While valuation is rarely the sole reason for a stock purchase, the price paid certainly matters over the long term. Historically, when valuation spreads between large and small caps get wide enough, a relative rebalancing tends to follow (a phenomenon captured by the gray shading in the charts below).

Over the past 20 years, **U.S. small-cap stocks** have averaged a premium of 34% relative to U.S. large-cap stocks (represented by the Russell 2000 Index and Russell 1000 Index, respectively). Today, that **premium has shrunk to 10%**.

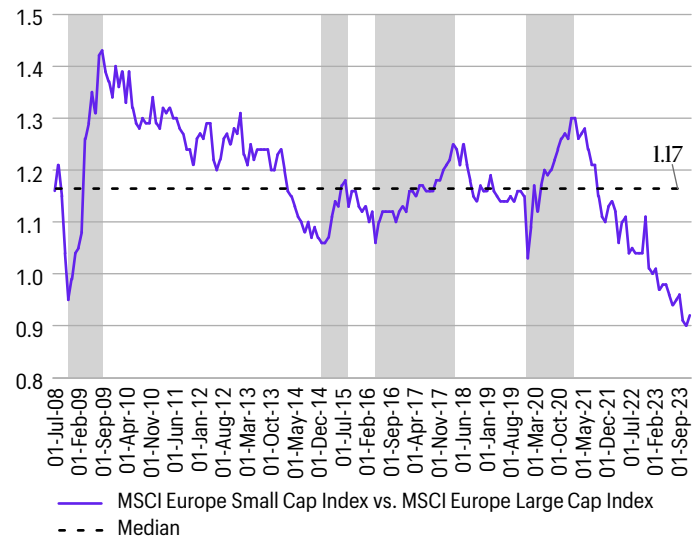
NEXT 12 MONTHS' PRICE/EARNINGS (P/E)



Sources: Maestro and Allspring, from June 2004–April 2024. Past performance is no guarantee of future results.

A similar dislocation and potential opportunity can be observed in Europe, as the relative premium of **European small-cap stocks** relative to European large-cap stocks has dropped from 17% to a **discount of 8%** (represented by the MSCI Europe Small Cap Index and MSCI Europe Large Cap Index, respectively).

NEXT 12 MONTHS' P/E



Sources: Maestro and Allspring, from July 2008–March 2024. Past performance is no guarantee of future results.

With large-cap relative valuations currently below their historical medians, it appears small caps in the U.S. and in Europe may be at attractive entry points.

Small-cap stocks provide an important diversification benefit within the context of a balanced portfolio and can improve long-term risk-adjusted returns. Beyond these benefits, three current market conditions also appear to be setting the stage for this asset class:

01 Concentration in equity markets

02 High and falling inflation

03 Valuation dislocations

We believe appreciating the significance of these three key points can unlock a well-timed opportunity to allocate to global small-cap stocks within investor portfolios.



For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Visit our website at www.allspringglobal.com.

Contact details

FOR U.S. INVESTORS ONLY

- For retail clients, contact your financial advisor.
- To reach our intermediary sales professionals, contact your dedicated regional director, or call us at **+1-866-701-2575**.
- To reach our institutional investment professionals, contact your existing client relations director, or email us at **AllspringInstitutional@allspringglobal.com**.
- To reach our retirement professionals, contact your dedicated defined contribution investment only specialist, or call us at **+1-800-368-1370**.

FOR EMEA AND APAC INVESTORS ONLY

- To reach our EMEA- and APAC-based investment professionals, contact us at **AllspringInternational@allspringglobal.com**.

FOR SUSTAINABLE INVESTING

- To discuss sustainable investing solutions, contact **Henrietta Pacquement**, head of Sustainability, and **Jamie Newton**, deputy head of Sustainability, at **henrietta.pacquement@allspringglobal.com** and **jamie.newton@allspringglobal.com**.

This marketing communication is for professional/institutional and qualified clients/investors only (as defined by the local regulation in the respective jurisdiction). Not for retail use.

THIS DOCUMENT AND THE INFORMATION WITHIN DO NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

Allspring Global Investments™ (Allspring) is the trade name for the asset management companies of Allspring Global Investments Holdings, LLC, a holding company indirectly owned by certain private funds of GTCR LLC and Reverence Capital Partners, L.P. Unless otherwise stated, Allspring is the source of all data (which is current or as of the date stated all investments contain risk; content is provided for informational purposes only with no representation regarding its adequacy, accuracy, or completeness and should not be relied upon; views, opinions, assumptions, or estimates are not necessarily that of Allspring and are subject to change without notice; and this communication does not contain investment advice, an investment recommendation, or investment research, as defined under local regulation of the respective jurisdiction.

FOR INVESTMENT PROFESSIONAL, INSTITUTIONAL INVESTOR, AND QUALIFIED INVESTOR USE ONLY.