

A DIVERSIFYING OPPORTUNITY: THE CASE FOR SMALL CAP INVESTING

In a rapidly evolving investment environment, small cap equities continue to offer compelling opportunities to enhance portfolio growth and diversification. As global economic conditions and supply chain structures undergo structural change, smaller companies are increasingly well positioned to capture emerging opportunities – arguably to a greater extent than in prior market cycles.

This discussion examines the strategic case for allocating to small cap equities, focusing on their agility in responding to supply chain realignments and their potential to benefit from evolving market trends and innovation driven growth.

Smaller companies are a segment of the global financial market comprising firms with a market capitalisation towards the smaller end of the market cap scale, which can vary between different countries and stock markets. They are represented across a wide range of industries and can be innovative and agile, adapting quickly to market changes.

By focusing on growth through reinvesting profits, smaller companies (commonly abbreviated to small caps) can offer higher returns over time and diversification benefits for investors relative to their larger peers, although they also require careful research to consider and address any associated risks.

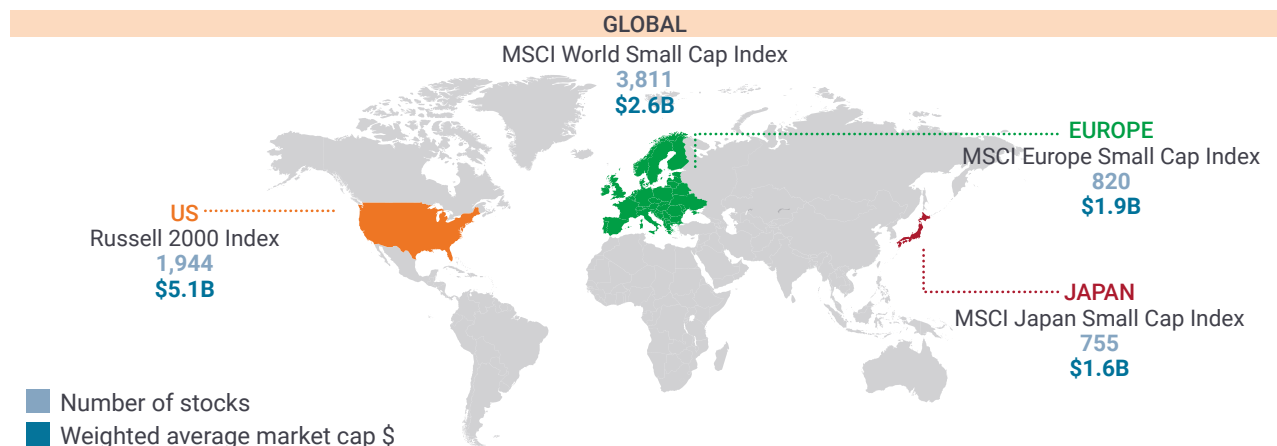
Key takeaways:

- ▶ **Diversification and growth potential:** Allocating to small cap equities can broaden portfolio diversification across market caps, regions, and sectors, while providing access to a deep and diverse universe of growth opportunities.
- ▶ **Structural advantages:** Small cap companies often benefit from structural tailwinds, including their attractiveness as M&A targets, lower index concentration risk, and limited analyst coverage, creating mispricing opportunities for active, research-driven investors.
- ▶ **Resilience and valuation appeal:** With greater operational flexibility and a strong local market focus, small caps are well positioned to adapt to ongoing global supply chain realignments, such as nearshoring and regionalisation, due to their agility and localised market focus.

How can an allocation to smaller companies benefit your portfolio?

Small-cap equities can play a valuable role in investors' portfolios, helping to improve diversification by market cap, as well as geographical and sector exposure with a huge range of opportunities available across the main major markets in the US, Europe and Japan.

Extensive global and regional opportunities



Source: MSCI, at 28 February 2026. Russell 2000 Index, at 31 January 2026

Marketing communication

The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

What are the key reasons for investors to look at global small caps?

1. Long-term return potential
2. M&A as a structural feature
3. Lower concentration risk
4. More stocks, more mispricing opportunities
5. Supply chain realignment
6. Greater dispersion in performance
7. Small caps can shine in higher rate environments
8. Attractive valuations

1. Long term return potential: Historically, small caps have outperformed large caps globally over the long term (Figure 1), reflecting their ability to capture higher levels of earnings growth and agility to adapt to market changes, although this comes with higher potential share price volatility risk.

These companies, often in the nascent stages of development, have ample room to expand geographically, deepen customer penetration, or extend product offerings. They typically tend to be more sensitive to economic changes, meaning they remain closely aligned to economic momentum. Smaller companies retain greater capacity to grow their earnings and revenue base, an advantage that large cap stocks struggle to replicate consistently.

Additionally, smaller companies can operate in more specialised or innovation-driven niches, areas where differentiation and market focus can reduce direct competition – including from larger rivals – supporting resilient margins and pricing power.

Figure 1: Small caps have outperformed large caps globally



Source: Refinitiv Datastream, Janus Henderson Investors analysis, 31 December 1997 to 31 December 2025 – rebased to 100 at start date. Indices used: MSCI World Small Cap and MSCI World Large Cap. **Past performance does not predict future returns.**

2. M&A as a structural feature: Smaller companies are frequent acquisition targets for larger firms seeking growth, innovation, or market access, taking advantage of their unique characteristics or niche market positions. Between 1995 and 2025, the vast majority of global merger and acquisition (M&A) activity involved a smaller company being purchased by a larger company, with an average premium of more than 30% on the target company's share price (Figure 2).

The past few years has seen a slow resurgence in dealmaking, following a relatively fallow period for M&A activity post-COVID, as higher interest rates and economic uncertainty clouded appetite. As balance sheets normalised and borrowing became more accessible, smaller companies have increasingly featured as acquisition targets once more, particularly in sectors where scale, technology or regional expertise are strategically valuable.

Figure 2: M&A activity often sees a premium being paid for small caps

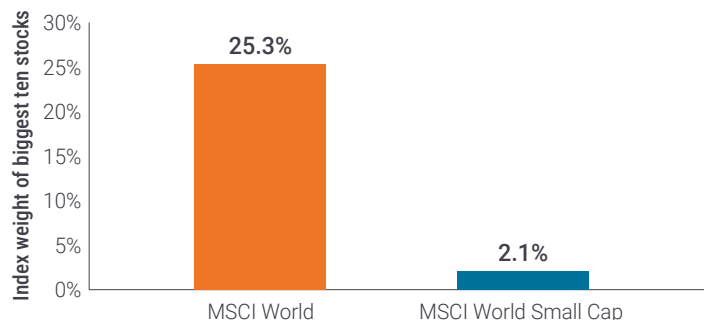


Source: Bloomberg, Factset, JP Morgan calculations, Janus Henderson Investors analysis, as at 7 November 2025. Stocks below US\$100m total market capitalisation are excluded. **There is no guarantee that past trends will continue, or forecasts will be realised.**

3. Lower concentration risk: Equity market concentration remains elevated, with a small number of large companies continuing to exert a disproportionate influence on index returns. Small cap indices, by contrast, remain more evenly distributed across companies and sectors, offering exposure to a wide range of economic drivers and reducing reliance on a narrow leadership group. Smaller companies also tend to carry less debt, proportionally, than larger companies, with 46% of small cap companies in a net cash position, compared to 28% for large-cap companies¹.

This means that investors can potentially use an allocation to smaller global companies to improve the diversification of their portfolio across market capitalisation, sectors, business models, and regions. Often with less overlap to mega cap dominated indices, and lower exposure to debt.

Figure 3: Small cap indices have less concentration risk



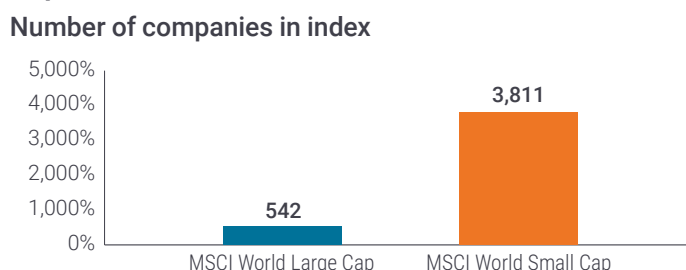
Source: Bloomberg, Factset and J.P. Morgan calculations, Janus Henderson Investors analysis, as at 7 November 2025.

4. More stocks, more mispricing opportunities: Global smaller companies represent an overlooked, often mis-priced part of the market, due to pricing inefficiencies and lower analyst coverage. While large caps attract extensive attention, with almost 98% of companies listed in the World Large Cap Index covered by more than 10 analysts, over 35% of stocks in the MSCI World Small Cap Index are covered by five or fewer analysts.

This can create pricing anomalies that offer significant growth opportunities for astute active stock pickers. The scale of the small cap universe, comprising thousands of companies worldwide, across all industries and sectors, provides substantial investment opportunities for investors.

During periods of higher pricing dispersion, this under-researched universe can amplify the impact of active security selection, as fundamentals increasingly drive performance differences between companies.

Figure 4: Wider breadth of choice from small-cap markets

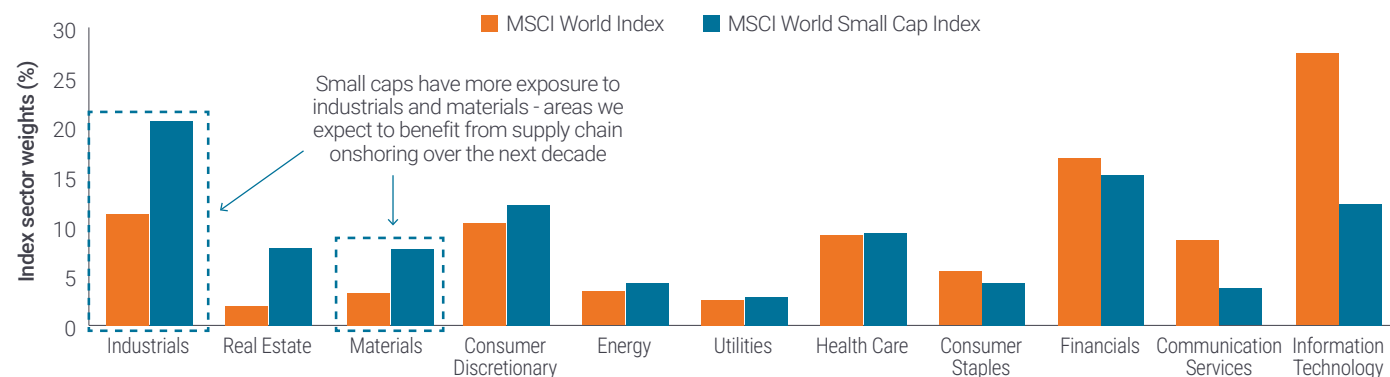


Source: Bloomberg, Janus Henderson Investors analysis, MSCI World Small Cap Index as at 30 January 2026.

5. Supply chain realignment: Persistent geopolitical uncertainty is reshaping corporate and national supply chains, driving a sustained shift toward onshoring and nearshoring. While the AI mega-trend has dominated large-cap performance and index weightings in recent years, supply chain realignment represents a distinct and durable growth theme.

Smaller companies are disproportionately exposed to this transition, given their relatively large presence in the industrials and materials sectors, and greater domestic exposure. As firms invest to shorten supply chains and localise production, these businesses stand to benefit more from higher domestic spending and economic activity.

Figure 5: Smaller companies are well positioned to benefit from nearshoring



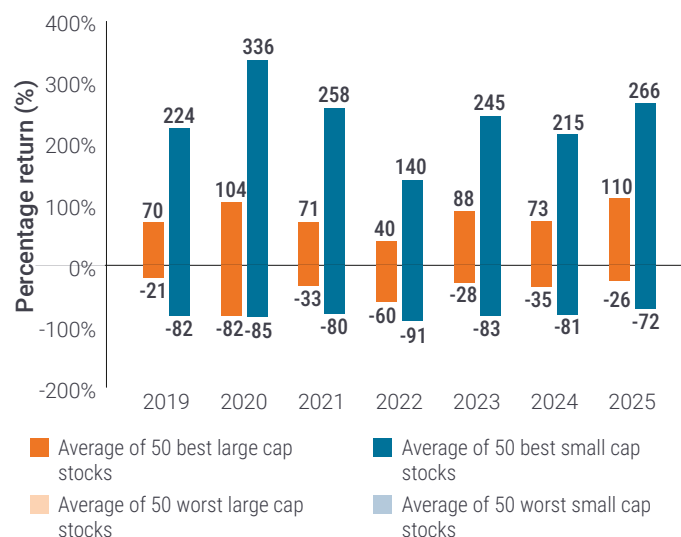
Source: Bloomberg, Janus Henderson Investors analysis, as at 31 December 2025.

¹Source: Bloomberg, Factset and J.P. Morgan calculations, Janus Henderson Investors analysis, as at 7 November 2025. Net debt is calculated by subtracting a company's total cash and cash equivalents from its total short-term and long-term debt. Net cash is when total cash and cash equivalents is greater than total debt.

6. Greater dispersion in performance: The years following the Global Financial Crisis (GFC) were characterised by near-zero interest rates, where companies – even unprofitable ones – were able to navigate financial waters with relative ease. That era is now behind us. The transition away from ultra low interest rates has increased differentiation between stronger and weaker business models, and with borrowing costs normalising, the gap between successful companies and those struggling has room to become more pronounced.

While the small-cap space contains plenty of opportunities, it comes with a greater proportion of loss-making firms than typically found in large-cap indices (Figure 6) – reinforcing the importance of balance sheet discipline, pricing power and cash flow generation.

Figure 6: Greater opportunities to select higher-performing stocks

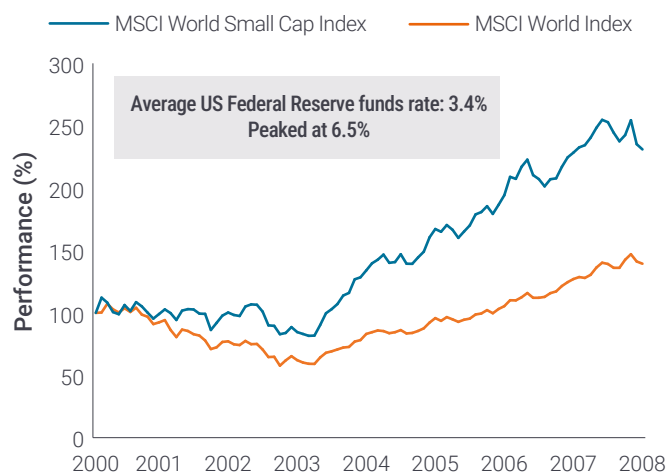


Source: Bloomberg, Janus Henderson Investors analysis, MSCI World Large Cap Index, MSCI World Small Cap Index, as at 31 December 2025. **Past performance does not predict future returns.**

7. Small caps can shine in higher rate environments: Global smaller companies have performed better than larger companies during persistent periods of higher interest rates, such as 1970–1984 and from 2000 to early 2008, before the onset of the Global Financial Crisis. In both periods, higher rates went hand in hand with rising prices and changes in how economies behaved. Historically, small cap equities have tended to lag during periods of rising interest rates, reflecting their greater sensitivity to higher borrowing costs and tighter financial conditions. However, they have often performed more strongly during extended periods of elevated but stable rates.

When interest rates are high yet no longer increasing, smaller companies typically focus on strengthening balance sheets and reducing leverage, which helps to lower uncertainty. As market attention then shifts toward stabilisation and the prospect of economic recovery, smaller, more agile firms have historically been well positioned to outperform.

Figure 7: Higher rates does not mean small cap underperformance



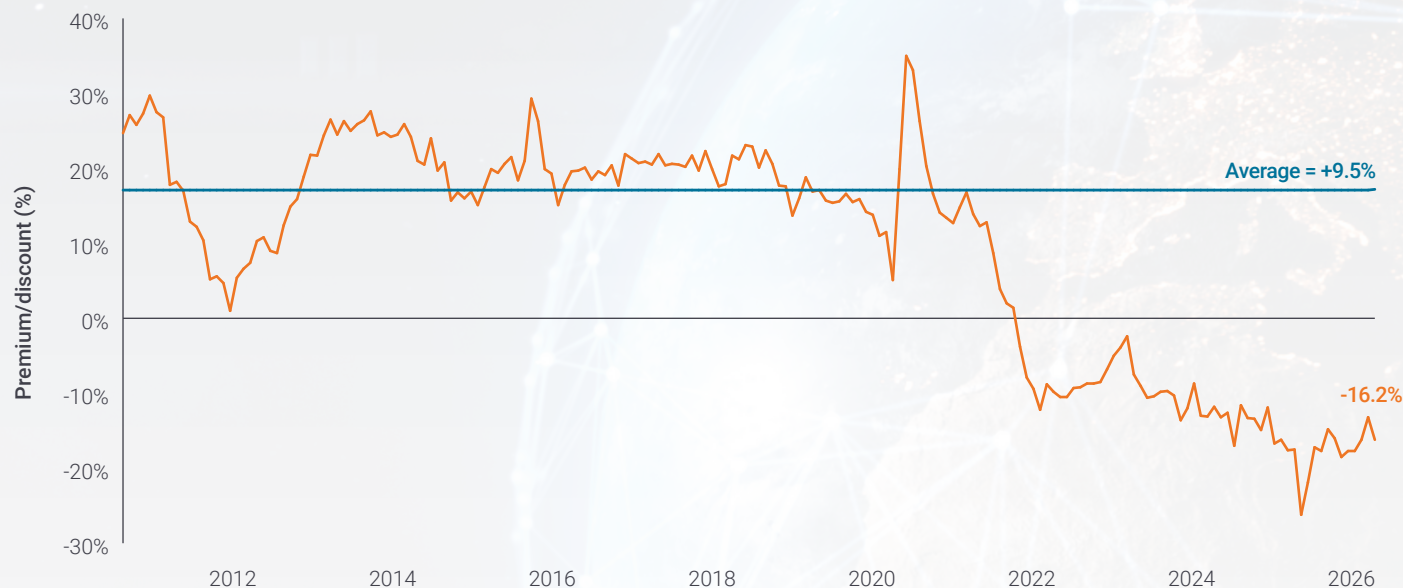
Source: Bloomberg, Janus Henderson Investors analysis, 29 February 2000 to 31 December 2007. Rebased to 100 at start date. **Past performance does not predict future returns.**

8. Attractive valuations: After a prolonged period of underperformance, for the past few years small-cap valuations have remained at a discount versus larger companies. Global smaller caps endured a difficult time during a period of higher financing costs and elevated risk aversion, which saw investors favour larger companies more generally perceived as defensive, disproportionately challenging smaller businesses.

While discounted valuations do not imply an imminent turning point, they suggest expectations are already conservative, increasing sensitivity to incremental improvements in earnings, financing conditions or macro stability.

As monetary policy continues to normalise, financially stronger small-cap companies are better positioned to benefit. Historically, small caps have performed well during periods of economic recovery, supporting the case for a broader equity market revival driven by earnings upgrades.

Figure 8: Global small caps are priced at a discount to large caps (forward PE)



Source: Bloomberg, Janus Henderson Investors analysis, MSCI World Small Cap Index, MSCI World Index, price/earnings (PE) ratios, 30 August 2010 to 11 March 2026. There is no guarantee that past trends will continue, or forecasts will be realised. Past performance does not predict future returns.

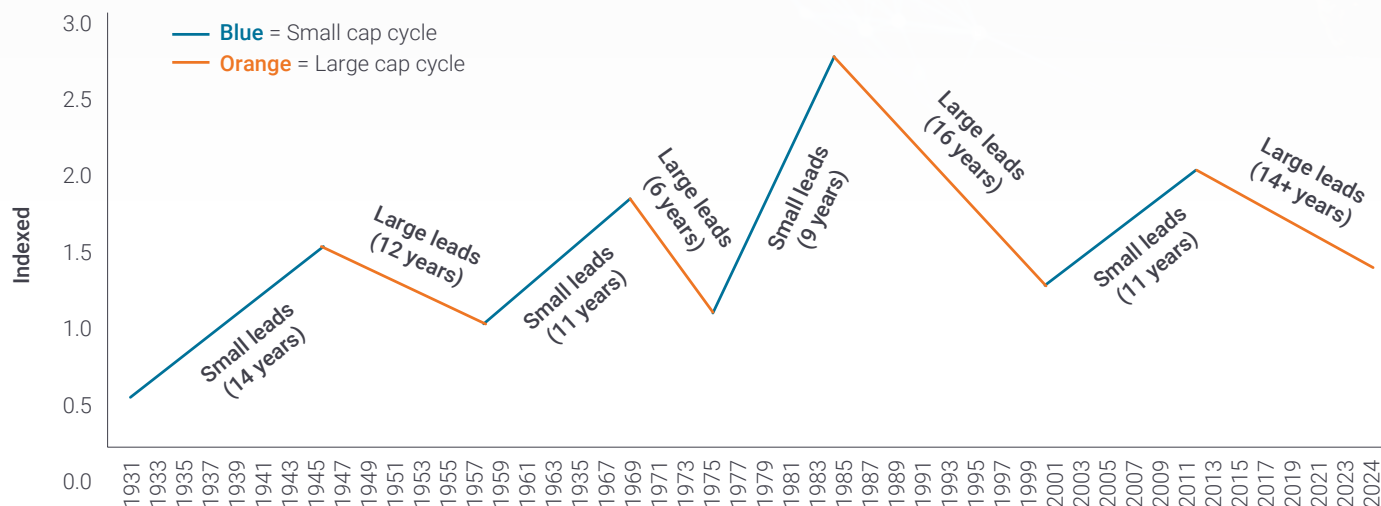
Is this a favourable environment for small caps?

The dominance of large-cap technology has continued to shape equity market performance, and recent returns have remained highly concentrated in a small group of mega-cap stocks. But history shows that leadership patterns are cyclical rather than permanent; as 2025 and the current backdrop has shown, sentiment can change rapidly on geopolitical factors or corporate results.

It is easy to fall into a trap of recency bias, but market leadership inevitably changes over time (Figure 8). As policy settings evolve and growth drivers broaden beyond a narrow set of themes, the conditions for rotation are gradually forming.

Investors do not need outsized small-cap allocations to benefit from their diversification potential across sectors and performance drivers. When leadership broadens, even modest exposure could benefit from a closing valuation gap, making this an opportune time to look beyond the market's largest names.

Figure : US small cap vs large cap dominance (1931–2025)



Source: FRP, FactSet, Morningstar. Russell 2000 Index, S&P 500 Index, at 31 December 2025. There is no guarantee that past trends will continue, or forecasts will be realised.

Glossary

Balance sheet: A financial statement that summarises a company's assets, liabilities, and shareholders' equity at a particular point in time. Each segment gives investors an idea as to what the company owns and owes, as well as the amount invested by shareholders.

Cash flow: The net balance of cash that moves in and out of a company. Positive cash flow shows more money is moving in than out, while negative cash flow means more money is moving out than into the company.

Dispersion: Dispersion measures the range of returns for a group of stocks. Higher dispersion opens up opportunities for stock pickers to outperform by selecting the winners and avoiding the losers, given that stock returns are spread more widely on either side of the benchmark.

Global Financial Crisis (GFC): The global economic crisis from mid-2007 to early 2009 that began with losses related to mortgage-backed financial assets in the US and spread to affect financial markets and banks globally. Also known as the 'Great Recession'.

Interest rates: The amount charged for borrowing money, shown as a percentage of the amount owed. Base interest rates (the Bank Rate) are generally set by central banks, such as the Federal Reserve in the US or Bank of England in the UK, and influence the interest rates that lenders charge to access their own lending or saving.

Large-cap stocks: Well-established companies with a valuation (market capitalisation) at the larger end of the market scale.

Market capitalisation (market cap): The total market value of a company's issued shares. It is calculated by multiplying the number of shares in issue by the current price of the shares. The figure is used to determine a company's size.

Mega caps: The largest designation for companies in terms of market capitalisation. These tend to be major, highly recognisable companies with international exposure, often comprising a significant weighting in an index.

Monetary policy: The policies of a central bank aimed at influencing the level of inflation and growth in an economy. Monetary policy tools include setting interest rates and controlling the supply of money.

MSCI World Index: An equity index that tracks the performance of large and mid-cap stocks across 23 developed market countries, commonly used as a benchmark for global equity funds.

Please note: Past performance does not predict future returns. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested. There is no guarantee that past trends will continue, or forecasts will be realised.

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MSCI World Large Cap Index: An index of stocks capturing large-cap representation across 23 developed market countries, covering approximately 70% of the total market capitalisation in each country.

MSCI World Small Cap Index: An index of stocks capturing small-cap representation across 23 developed market countries, covering approximately 14% of the total market capitalisation in each country.

Onshoring/reshoring: The process of bringing business operations back in-house, or relocating them within domestic (or regional, in the case of the EU) borders. While it can be more expensive to run local operations due to higher wages or the cost of regulation, it offers more control and helps reduce the impact of geopolitical uncertainty or currency changes.

Premium: When the market price of a security is thought to be more than its underlying value, it is said to be 'trading at a premium'.

Price-to-earnings (P/E) ratio: A popular ratio used to value a company's shares compared to other stocks or a benchmark index. It is calculated by dividing the current share price by its earnings per share.

Pricing power: A company has pricing power when it can raise prices regardless of the economic backdrop without losing to competitors, whether that is due to the unique nature of its product, or specific market demand.

Russell 2000 Index: The primary benchmark for companies at the smaller end of the market cap scale in the US, comprising the (approximately) 2000 smallest companies in the broader Russell 3000 Index.

Small-cap stocks: Companies with a valuation (market cap) at the smaller end of the market scale.

S&P 500 Index: A widely used index of stocks that indicates the performance of the largest 500 US companies, by market capitalisation.

Valuation: The process of determining the current worth of an asset, company, or security, assessing factors like financial statements, market conditions, and future earnings potential.

Volatility: The rate and extent at which the price of a portfolio, security, or index, moves up and down. The higher the volatility, the higher the risk of the investment.

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