



"HIGHER FOR LONGER" AND THE SMALL CAP RALLY

Highlights

- The European economy is recovering, which should support small caps compared to large caps
- Following cycle lows, small caps on average outperform large caps by nearly 16% within 12 months

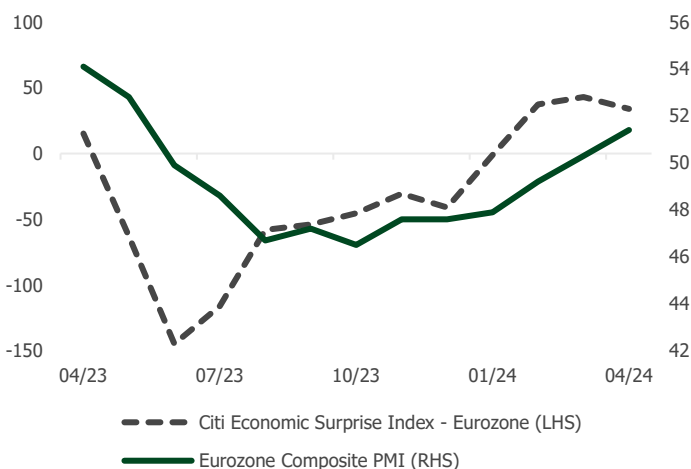
The discussions about a **"higher for longer"** interest rate regime in the USA have shaped recent market events. But how does this trend in interest rates affect the **outperformance of European small caps**? To answer this question, the portfolio managers at CHOM CAPITAL have analyzed the economic cycle and the performance of small caps compared to large caps in different phases.

The recent economic data points for Europe are **significantly more positive** than before and are no longer negatively surprising, as indicated by the Citi Economic Surprise Index - Eurozone. Leading indicators suggest a **bottoming out**, confirmed by the Eurozone Composite PMI, which stands above 50, portraying a **positive picture**. Additionally, the IFO Business Climate Index rose in April from 87.8 to 89.4, surpassing expectations set at 88.8. Order entry data indicate a **positive trend**, while hard data such as industrial production in the first quarter show **stability**.

What does the **improvement of the economic cycle** mean for small caps, especially compared to the larger companies which have performed significantly better recently?

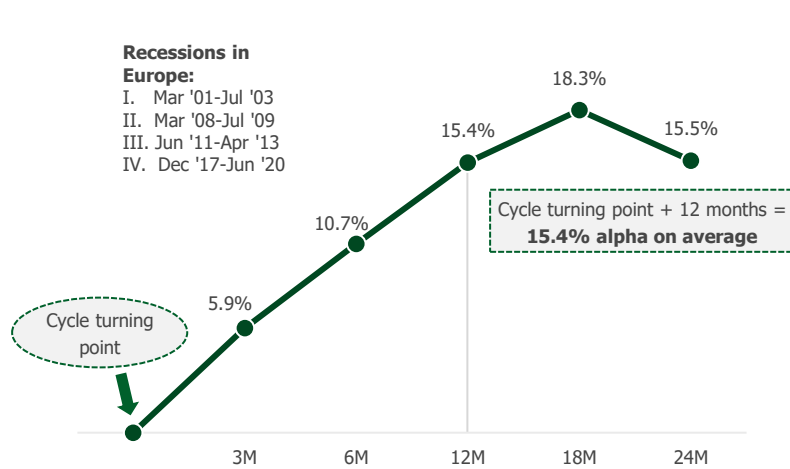
Considering the OECD recession indicator and analyzing the historical performance since the year 2000, it becomes evident that **small caps have consistently outperformed large caps following a cyclical low**, especially in the subsequent year. On average, the **outperformance has been over 15%** over a 12-month period. With brighter signals emerging from the real economy, small caps should therefore expect a **noticeable tailwind** in the coming years.

BOTTOMING OUT IN THE ECONOMIC CYCLE



Source: FactSet, Bloomberg, Own Calculations

OUTPERFORMANCE OF SMALL CAPS AFTER A CYCLICAL TURNING POINT



Source: FactSet, Bloomberg, Own Calculations

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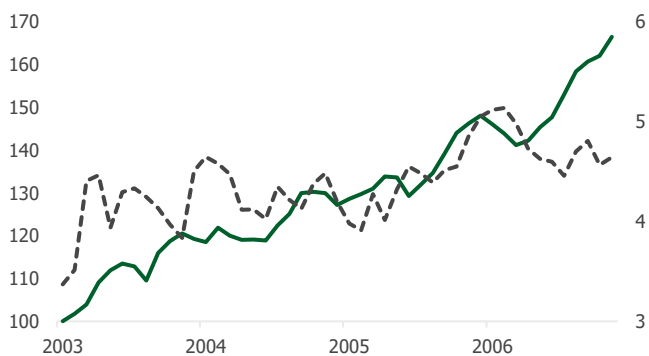
"HIGHER FOR LONGER" AND THE SMALL CAP RALLY

Highlights

- Rising interest rates could signal an improved growth environment and support the outperformance of European small caps
- ZEW sentiment as a reliable leading indicator for small-cap outperformance

Over the past 24 months, the relative performance of small caps compared to large caps has closely correlated with the interest rate environment. During a cycle of interest rate hikes, this suggested more restrictive financing conditions. However, this perspective neglects the **improving growth environment** in the current phase. Rising interest rates can also reflect an improved growth outlook. The periods from 2003 to 2007 and 2016 to 2018, characterized by an **enhanced** global growth environment, provide empirical evidence of the **outperformance of European small caps**, even during phases of rising US interest rates.

INTEREST RATES AND SMALL CAPS



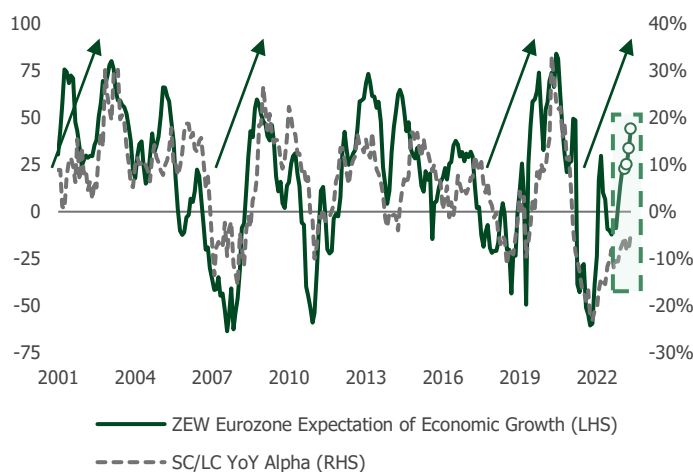
Source: FactSet, Bloomberg, Own Calculations

The recent **positive turnaround** in the ZEW Economic Sentiment also reflects the **improving growth environment**. An analysis of the historical performance of small caps compared to large caps since 2001 shows that the ZEW sentiment is a **reliable leading indicator** for the **outperformance** of small caps. Historically, a **positive development** in the ZEW sentiment has been followed by an **outperformance** of small caps.

Our analysis series confirms that the statements regarding the potential **return of small-cap outperformance** in this context remain relevant and valid. These conclusions are supported by both **historical data** and **current economic developments**.

In the long term (since 2000), the small-cap performance (measured by the TMI Small Cap Index) has averaged approximately **7% annually**, about **400 basis points per annum higher** than that of large caps (Stoxx50 Europe) – we anticipate a **REVIVAL of SMALL CAPS**.

ZEW ECONOMIC SENTIMENT AND SMALL CAPS



Source: FactSet, Bloomberg, Own Calculations

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