SUSTAINAMENTALS® Insight

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UNIVERSAL INVESTMENT

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SMALL AND MEDIUM-SIZED ENTERPRISES: THE ENGINE OF THE EUROPEAN ECONOMY WITH IMPRESSIVE GROWTH

Highlights

- Small and medium-sized companies, often global market leaders, drive the European economy forward
- Since 2000, small caps have generated an annual return of a solid 7%, approximately 4% alpha to large caps
- The recent phase of weakness in small caps offers investors an attractive entry opportunity

Small and medium-sized companies, also known as small and mid caps, are often **global market leaders** that are strongly positioned in the value chains of **important economic sectors**, but at the same time are unknown to the wider market and receive less attention from analysts. They are characterized by **resilient**, **structural** and **significant** growth. Proprietary technologies and a long-term orientation are among these companies' **recipes for success**, ensuring alignment of interests with investors and making them the **driving force behind the European economy**. Smaller companies are also indispensable for the upcoming **sustainability transformation.**

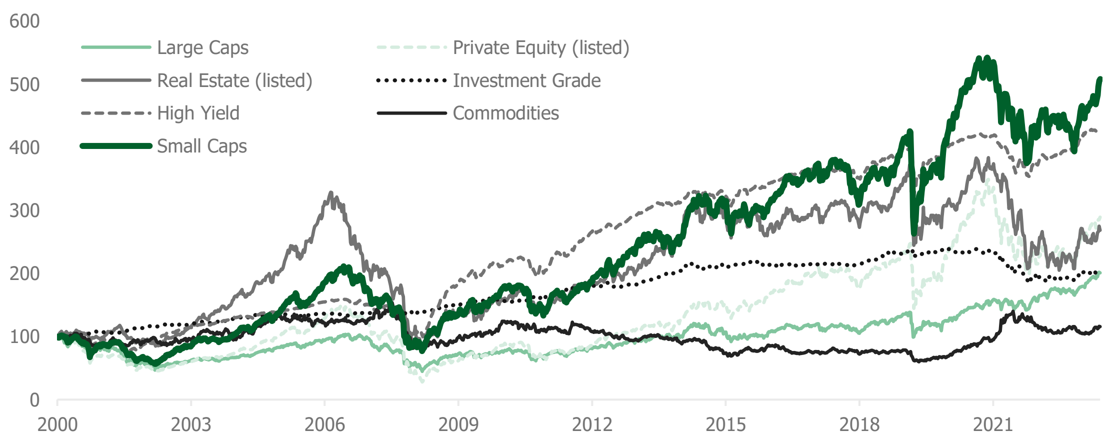
Since 2000, small caps have **risen** by an **impressive 395%**, which corresponds to an **annual return** of a good **7%** (approximately 4% per year better than large caps). Since 2003, the annual return has even been around **10%**, which is well above the growth of comparable, other liquid asset classes.

This underlines the strong **growth potential** of these companies and the long-term **superiority** of this asset class.

But how have small caps performed over the last 24 months? Small companies have faced significant challenges and headwinds during this period as they have been confronted with economic uncertainty, increased costs and volatile market conditions. At the same time, many investors have increasingly shifted their funds into large caps, which are seen as more stable and less risky.

In retrospect, phases of underperformance have always been followed by pronounced **outperformance phases**. In view of the long-term superiority of the asset class, this should now be an **attractive entry point** for investors who are anti-cyclical and forward-looking in their allocation.

A COMPARISON OF LISTED ASSET CLASSES



Source: FactSet, Bloomberg, Own Calculations

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FOR PROFESSIONAL INVESTORS ONLY

Small and medium-sized enterprises: the engine of the European economy with impressive growth

Highlights

- The major catalysts for a small-cap outperformance are: Interest rate cuts, an improving economic outlook, historically low valuations and the current under-allocation of investor money
- All four catalysts begin to interlock with each other and develop positively

The main **catalysts** that could trigger the start of the **small-cap outperformance** are:

- **Catalyst 1:** Interest rate cuts:

Lower interest rates reduce financing costs, improve profit margins and encourage investment. Central banks such as the ECB, the SNB and the Riksbank have already **cut interest rates** and thus initiated a **turnaround** in **monetary policy**. Historically, interest rate cuts have always been followed by small-cap outperformance phases.

- **Catalyst 2:** Improved economic outlook, with leading indicators above expectations:

A **positive economic outlook**, supported by strong leading indicators, can **boost confidence** in small businesses and improve their growth prospects.

- **Catalyst 3:** Low valuation both in absolute terms and relative to large caps:

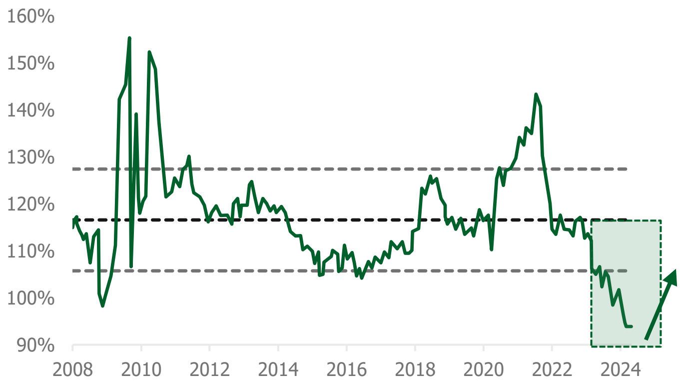
Small caps, which are currently cheaply valued, offer attractive **upside potential** compared to more expensively valued large caps, making them an **enticing investment opportunity**.

- **Catalyst 4:** Current under-allocation of institutional investors (flow of funds):

Since 2022, institutional investors have invested less capital in small caps, which means that these companies could **benefit** significantly from a shift in investment flows. Historically, flows have followed the **outperformance** of small caps and had a trend-reinforcing effect. A **self-amplifying mechanism** can be observed.

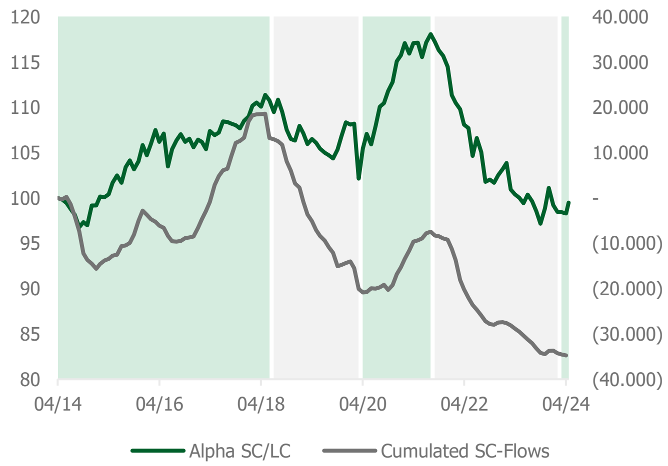
All four catalysts are currently signaling a very **positive risk/reward ratio** for European small caps and are beginning to interlock.

C3: Low relative valuation of small caps vs. large caps



Source: FactSet, Bloomberg, Own Calculations

C4: Small caps are currently heavily underallocated



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