

➤ **The Investment Perspective – AUGUST 2024**



“Neither the investing method nor the fundamentals of the business are right or wrong because the mood of the market is favourable or unfavourable toward the “stock”. That is because when you really think about it, “stocks” (shares) are all about the financials and the trading price, the share price...the cash up value. What matters more is the economics of the business.”

-Peter Flannery

Peter Flannery, CFP FA

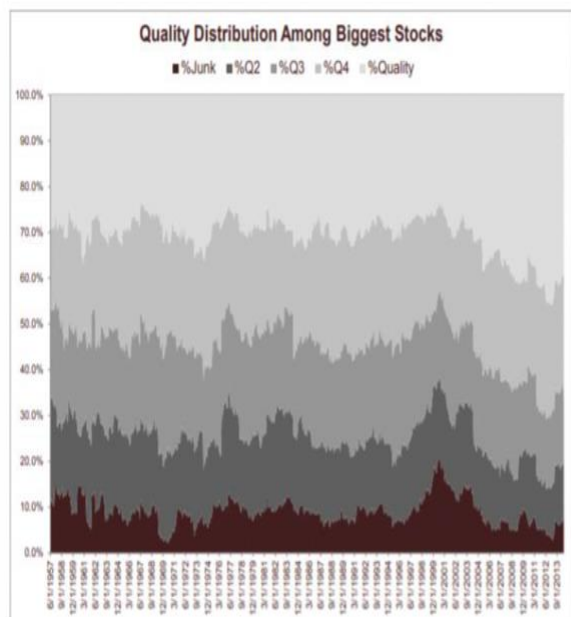
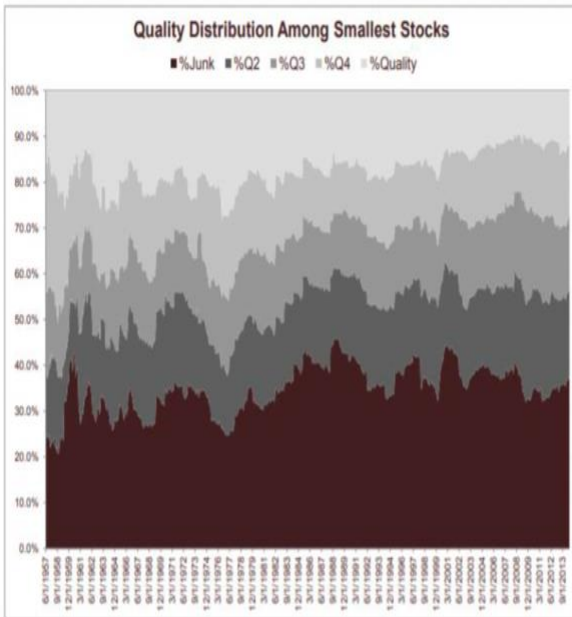
Small Cap, Mid Cap

Small caps are small businesses – US\$2 billion or less in size by market capitalization (the number of shares on issue x the trading price).

Mid caps are medium-sized businesses – US\$2 billion - US\$10 billion in size by market capitalization.

Belief 3 cont.: Small and quality investing styles blend beneficially

FAIRLIGHT



Source: Asness, Frazzini, et al. "Size matters, if you control your junk", 2018.

The graphs above compare the quality of the business and and size

Understanding the Graphs - Easy

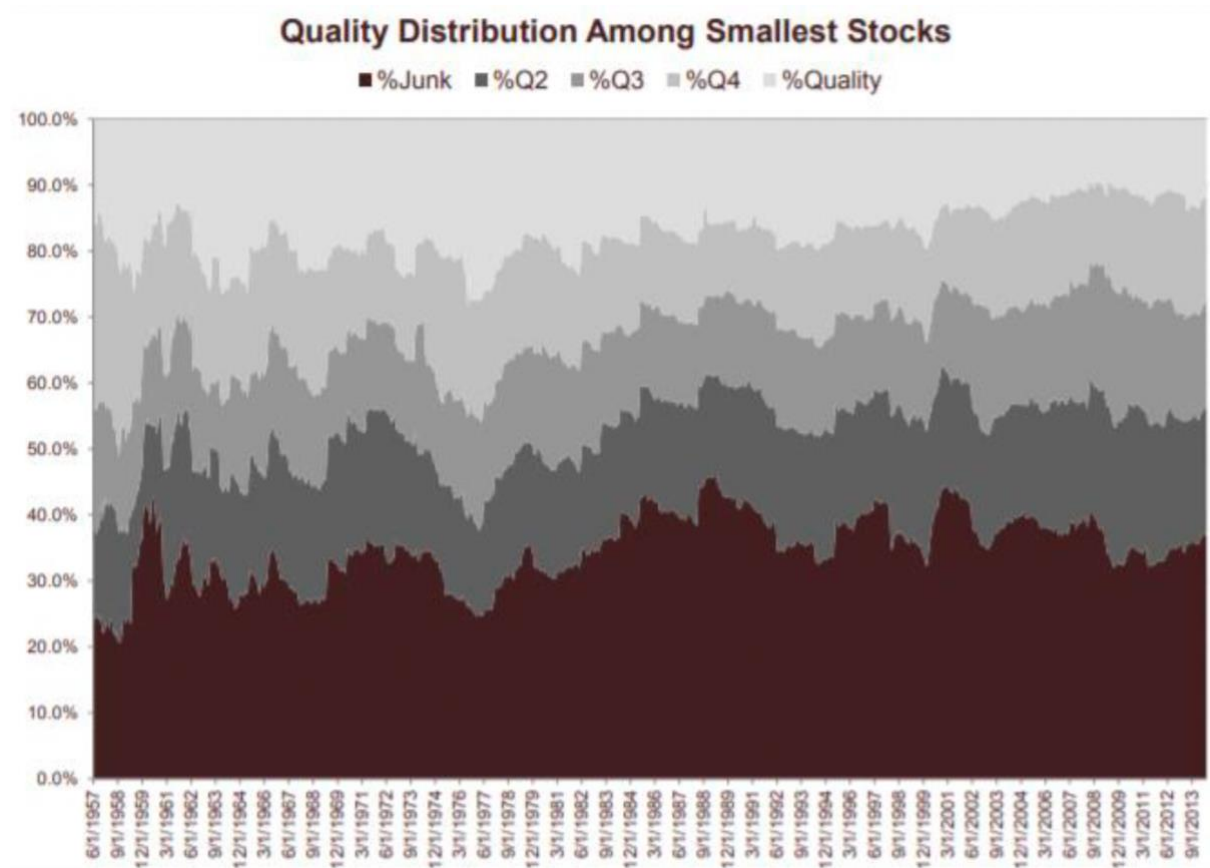
Looking at the graphs above, I know they look messy and hard to read, but they are straightforward.

Both graphs

The horizontal axis is time – 1957 to 2013

The vertical axis is the mix between the various levels of quality (junk, Q2, Q3, Q4, quality).

The graph to the left



The above graph shows that there is varying quality across small caps. The darker the colour the lower the quality. Lots of low-quality across the small cap cohort.

These businesses can be trouble, challenging and rewarding.

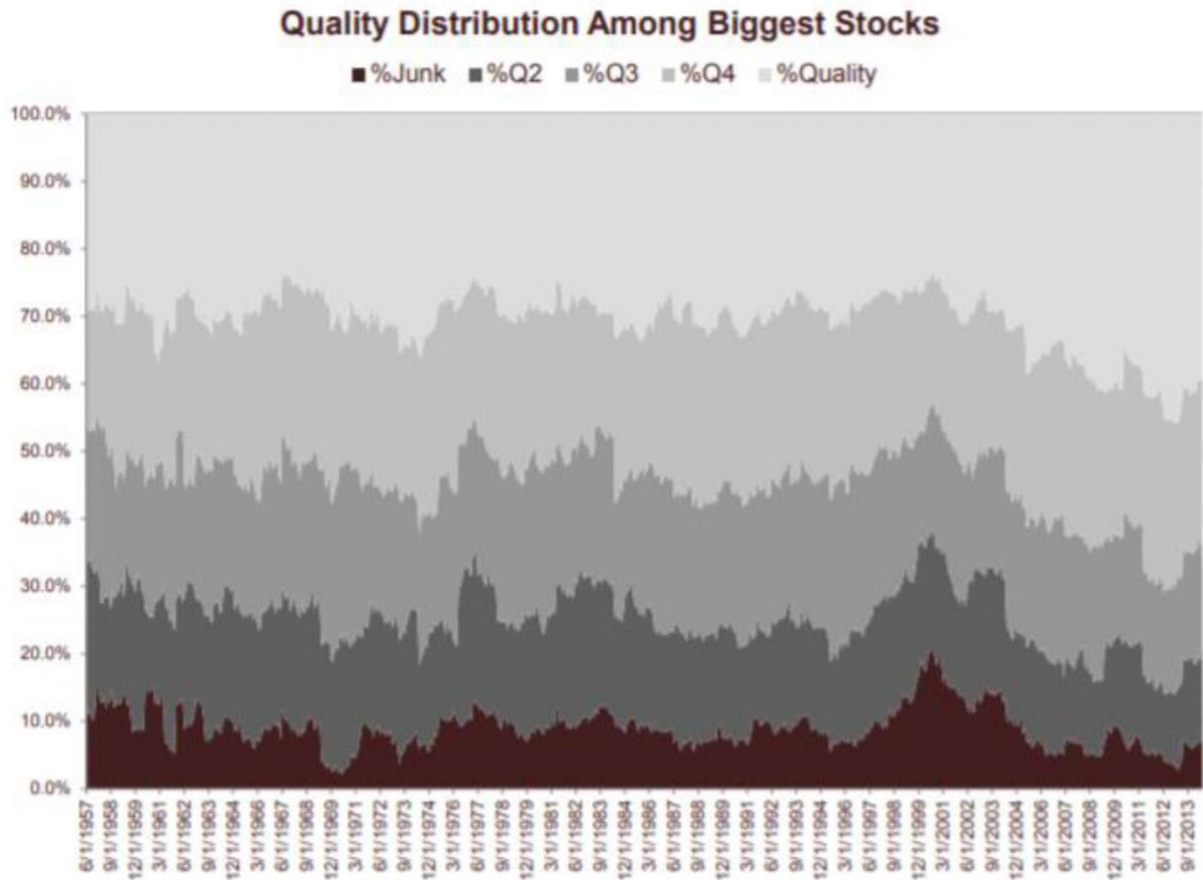
They are only for advanced investors and certainly not for the faint-hearted!

They can require significant tolerance and patience.

All large businesses were small once. That growth in the middle is what we seek. Not easy, but worth it.

Two examples of small-cap currently are Synlait Milk and Tasty. Still, there is good quality, e.g. Heico back in the day, Judges Scientific.

The graph to the right



Notice the lighter colour showing a greater level of quality across the larger business segment.

Efficient Markets

This is where markets and trading prices reflect all known information. In other words, if everybody knows all there is to know about a business, then there is no arbitrage or opportunity.

Markets have become much more 'efficient' over the last few years because of technology.

A Small Cap Advantage

The small size of small cap businesses can be a significant advantage.

Small businesses can grow into big businesses. Selecting the right ones is 'the trick', not easy.

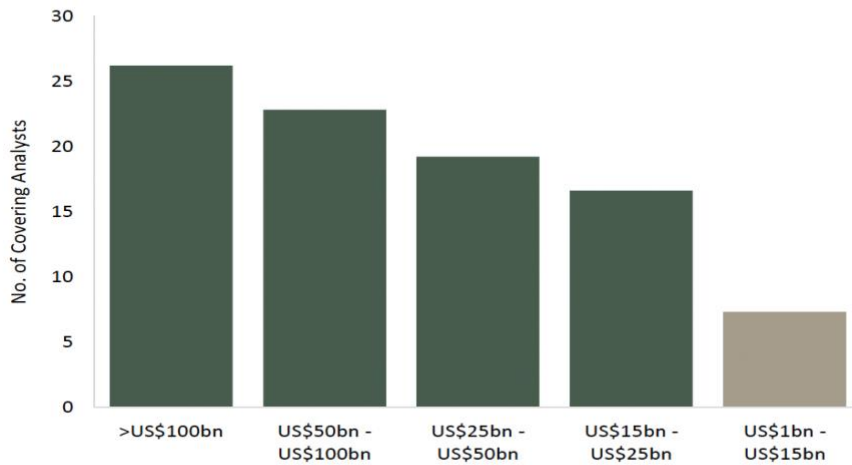
From there, time (to allow the small business to grow), tolerance (the revenue, earnings and trading prices can be very volatile) and patience are useful.

Small caps can also require real resolve as the market noise becomes very negative, at times.

Inefficiency across markets is a small cap advantage too...

SMID segment is under researched...

There are five times less analysts covering our cohort of stocks compared to mega caps and the disparity is only increasing due to cost pressures.



Source: i) FactSet; ii) Evaluating Opportunities in Active Management, Gupa, Oberoi & Subramanian, 2018

The graph above shows the changing number of analysts covering stocks as the size of the business declines.

With a smaller number of analysts covering a particular stock, there is an increased trading price mismatch to value. In other words, we can buy some small caps at a favourable price because the trading price might not reflect current and future value.

Companies can be overlooked because they are small.

Inefficient Market Opportunity?

Small companies are trading near the largest discount to large companies in over two decades

FAIRLIGHT



Source: MSCI, FactSet, Updated July 2024.

The graph above shows that small caps are trading at low prices compared to large companies.

Opportunity.

“In this business, if you are good, you’re right six times out of ten.”

-Peter Lynch

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