

July 2024

SMALL CAPS ARE BEAUTIFUL – JULY UPDATE

In our May 2024 whitepaper titled “[Small Caps Are Beautiful: 2024++](#)”, we acknowledged the dominance of ‘The Magnificent Seven’ stocks and their significant weighting in the market¹. We further emphasized how small-cap companies can be prime beneficiaries of the current market dynamics and how these smaller companies are well-positioned to thrive in a declining interest rate environment.

At the time when we published our report on May 20th, the Russell 2000 was trailing the Russell 1000 by over 700bps year-to-date, after underperforming by over 950bps in 2023.

Table 1

	<u>Prior to Our Published Report:</u>		<u>Since Our Published Report:</u>	
	2023	2024 (as of 5/20)	2024 (5/20-7/19)	July 2024 (as of 7/19)
R2000	16.9	4.2	4.5	6.7
R1000	26.5	11.5	3.6	1.0

Source: FTSE Russell

Since we published our report, we have seen evidence in the market that small-cap investors are starting to be rewarded. This rotation could be attributed to the bullish narrative surrounding upcoming rate cuts and new expectations for the U.S. election outcome.

As we previously mentioned, small-cap companies are poised to benefit from interest rate relief in 2024/2025. Interest rate cuts can lead to lower borrowing costs, increased consumer spending, renewed investor risk appetite, higher valuation multiples for small-cap stocks and robust M&A activity.

Regarding the expectations for the U.S. Presidential election, recent political events have led to a shift in predictions about who may win the next election. Small-cap stocks have traded higher as investors anticipate that these companies should benefit strongly if former President Donald Trump wins in November. While investors may not know the specific details of Trump’s policy proposals, higher tariffs, lower taxes, and reduced regulation are expected to directly benefit domestic stocks.

While small-cap constituents have gained almost 600 basis points in July as of this writing, valuations continue to remain very attractive on a relative basis shown in the table below. While Russell Growth indices are currently awarded with higher forward valuation multiples versus their Value counterparts, street estimates continue to expect higher EPS growth expectations over the longer term. It is also worth reiterating a point made in our May whitepaper, “*Nearly 50% of the names in the Russell 2000 Index are covered by fewer than five analysts. In contrast, 99% of the names in the Russell 1000 Index are covered by more than five analysts.*”. 12-month forward P/E is calculated based on street consensus, without universal coverage of all index held constituents, forward P/E valuation could potentially be lower when factoring in uncovered names.

¹ Our firm also discussed this dynamic in our other whitepapers titled “[The Magnificent Seven vs The Market Bandits](#)” and “[The Nation State Companies](#)”

Table 2 Current Valuations: Russell 1000/1000G/1000V vs. Russell 2000/2000G/2000V

Index name	Trailing P/E	Forward P/E	3-5 Year Est. EPS Growth
Russell 1000 Index	26.6x	22.6x	16%
Russell 1000 Growth Index	38.9x	31.6x	21%
Russell 1000 Value Index	19.4x	17.2x	10%
Russell 2000 Index	14.2x	16.3x	14%
Russell 2000 Growth Index	22.9x	21.1x	17%
Russell 2000 Value Index	10.7x	13.4x	9%

Source: FactSet

As we previously discussed in our report from May, the dominance of select mega-cap “tech” stocks continue to be the core driver of benchmark performance while also continuing to command a large concentration of the overall index. As of this writing, 47% of Russell 1000 Index year-to-date return has been derived from the top five year-to-date contributors versus only 26% for the Russell 2000 Index. More noteworthy, the sum of those five positions for the Russell 1000 Index is 23.9% versus only 0.8% for the Russell 2000 Index (MSTR, SMCI, & CVNA were more recently removed from the Russell 2000 Index due to market cap size constraints). This dynamic between return and weight concentration is even more distinguishable when comparing the Russell 2000 Value and Russell 1000 Growth indices.

Table 3 YTD Contributors to Return: Russell 1000/1000G/1000V vs. Russell 2000/2000G/2000V

Index name	#1		#2		#3		#4		#5		Top 5 Index Contribution	% Total Index Return
	Symbol	CTR	Symbol	CTR	Symbol	CTR	Symbol	CTR	Symbol	CTR		
Russell 1000 Index	NVDA	3.8	MSFT	1.1	AAPL	0.9	META	0.7	AMZN	0.7	7.2	47%
Russell 1000 Growth Index	NVDA	7.0	MSFT	2.0	AAPL	1.6	META	1.3	AMZN	1.3	13.2	67%
Russell 1000 Value Index	BRK.B	0.7	JPM	0.6	WMT	0.4	GE	0.4	XOM	0.4	2.4	25%
Russell 2000 Index	SMCI	1.0	CVNA	0.3	MSTR	0.3	INSM	0.3	FTAI	0.2	2.2	26%
Russell 2000 Growth Index	SMCI	2.1	MSTR	0.6	INSM	0.5	FTAI	0.5	ELF	0.3	4.0	40%
Russell 2000 Value Index	CVNA	0.4	JXN	0.2	RNA	0.2	ANF	0.2	CRS	0.2	1.2	16%

Source: FactSet

CTR: Contribution to Return

As active managers with our Private Market Value with a Catalyst™ methodology, we believe the current environment is particularly favorable for our approach for investing in small-cap stocks. We leverage our global research capabilities to identify and purchase excellent businesses that are trading at a discount to their Private Market Value, focusing on those with catalysts in place to unlock their potential value.

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