The Case for Small Caps in a Rising Rate Environment

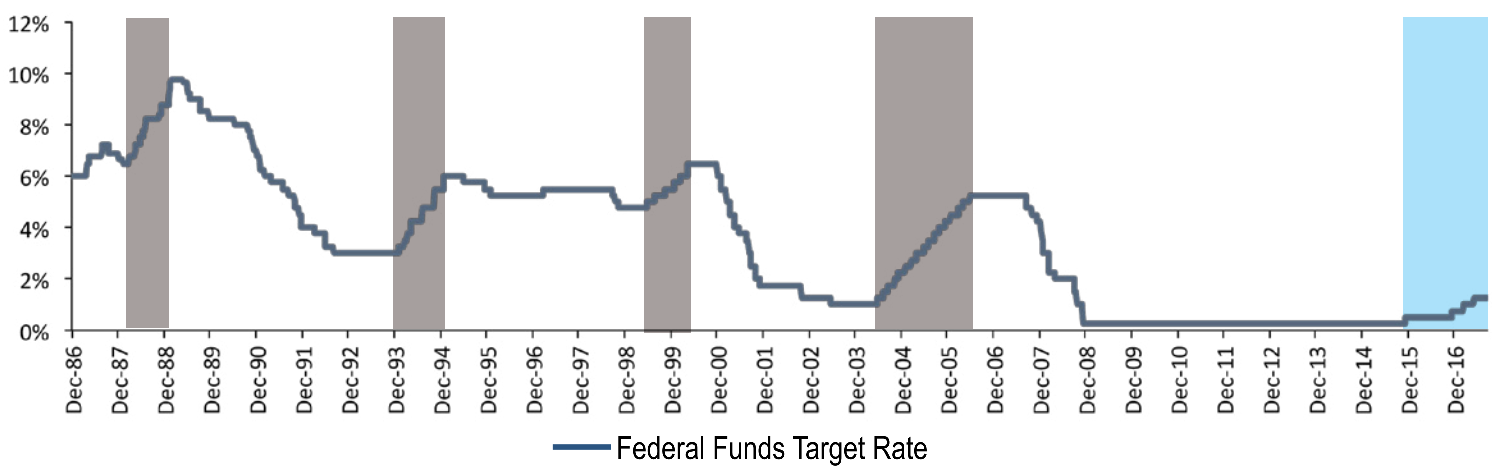
Do Small Cap Stocks Deserve an Allocation in an Equity Portfolio During Fed Tightening Cycles?

- As the Fed hikes rates, investors will look for sources of outperformance in the their core equity portfolios. Small cap stocks may be the answer.
- The first chart is the average total return for the Russell 2000,and the S&P 500 during the past 4 rate hikes. Small cap stocks have outperformed large cap stocks in 3 of the past for Fed tightening events and are outperforming in the current cycle we are presently in.
- The second chart depicts the Federal Funds Target Rate with periods of Fed tightening shaded in gray. The current period is shaded in blue.
- There are several possible reasons to explain why small caps outperform large caps in this environment. One reason is, foreign sales by small cap companies tend to make up a smaller percentage of total sales compared to large cap companies, thus they are less exposed to increases in the U.S. dollar, which may strenghten as rates rise. Rising rates tend to coincide with economic expansion which would also benefit smaller companies.

Average Total Return, Fed Rate Hike Cycles

Index	Hike 1 2-29-88 to 5-31-89	Hike 2 1-31-94 to 2-28-95	Hike 3 6-30-99 to 5-31-00	Hike 4 6-30-04 to 6-30-06	Current 12-15-15 to 9-29-17	Average
Russell 2000 Index	25.8%	-3.6%	5.2%	25.3%	35.2%	17.6%
S&P 500 Index	25.3%	4.4%	4.7%	15.5%	28.0%	15.6%

Periods of Fed Tightening



OUSM: O'Shares ETFs approach to U. S. Small Caps, visit oshares.com

Source: Bloomberg. Data as at 9/30/2017.
Past performance does not guarantee future results.

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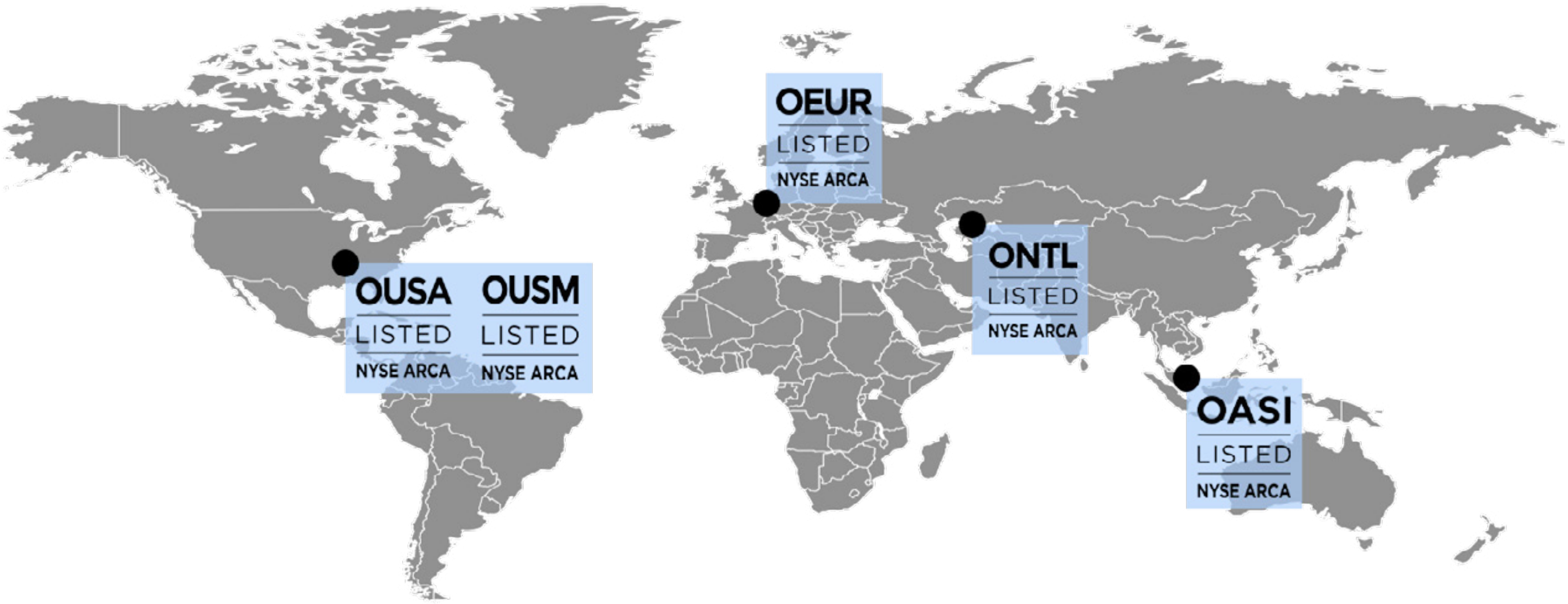

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