

# Exploring Opportunities for Global Small- and Mid-Cap Stocks in the Next Cycle

## Author

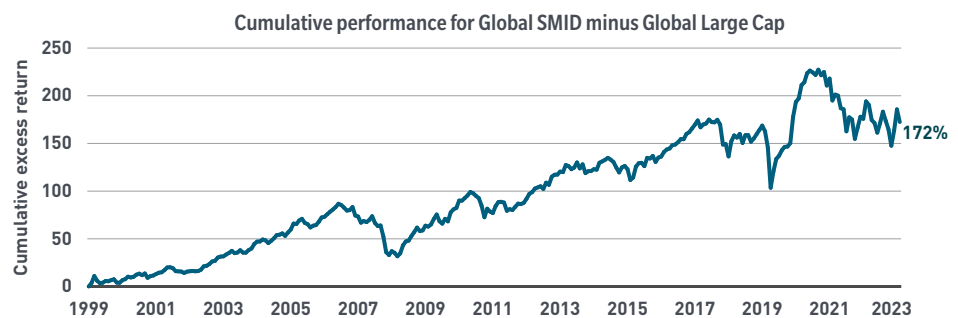


Nicholas J. Paul, CFA  
Institutional Portfolio Manager

## Why consider investing in global small- and mid-cap stocks?

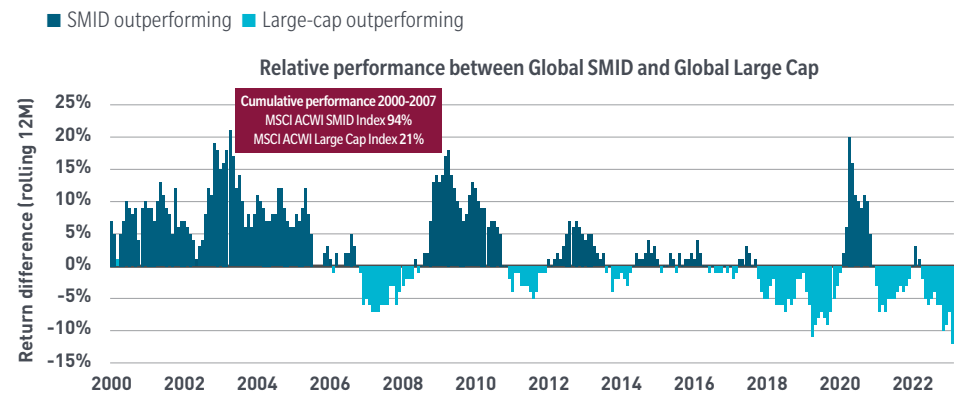
The global small- and mid-cap asset class has strongly outperformed large-cap stocks over the long term (Exhibit 1), and while market leadership ebbs and flows over shorter periods of time (Exhibit 2), we feel the asset class appears well-positioned to potentially assume a leadership role in the next rotation.

### Exhibit 1: Global Small/Mid-Cap Stocks Have Strongly Outperformed Large-Caps Over Time



Source: FactSet. Monthly data as of 31 December 1999 to 31 January 2024. Series shows the cumulative excess returns for MSCI All-Country World SMID Index (ACWI SMID) minus MSCI ACWI Large Cap Index (ACWI Large). Total returns are net and in US dollars. Past performance is no guarantee of results. It is not possible to invest directly in an index.

### Exhibit 2: While leadership Has Tended to Rotate Every Few Years, Small/Mid-Cap Outperformed During Much of the 2000s



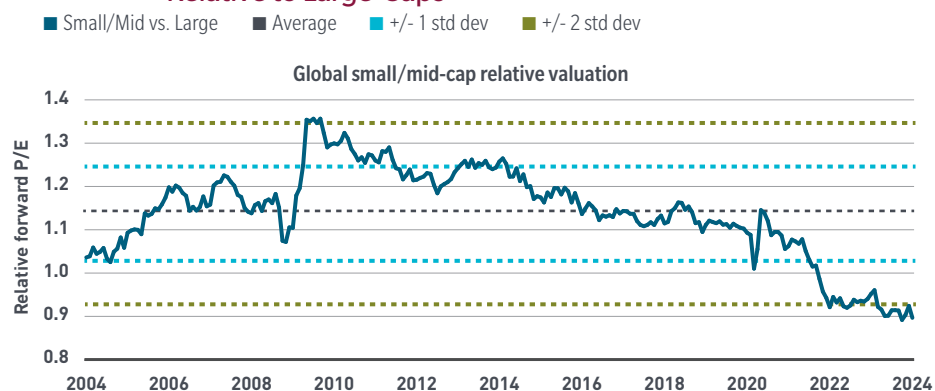
Source: FactSet. Monthly data as of 31 December 1999 to 31 January 2024. Series shows the rolling 12-month excess returns for MSCI All-Country World SMID Index (SMID) relative to MSCI All-Country World Large Cap Index (Large-cap). Values shown in call-out are cumulative returns, calculated from 31 December 1999 to 31 December 2007. Total returns are net and in US dollars. Past performance is no guarantee of results. It is not possible to invest directly in an index.



### Why consider investing now?

In our view, the opportunity set for small- and mid-caps appears particularly attractive. Referring back to Exhibit 2, from end of the dot-com-era (early 2000s) up until the early days of the global financial crisis (GFC) (2008), global small- and mid-cap stocks significantly outperformed relative to their large-cap counterparts with the MSCI ACWI SMID Index returning 94% vs. the MSCI ACWI Large Cap Index return of just 21%. While no two periods are perfectly alike and past performance is no guarantee of future results, one could draw a number of similarities between that roughly eight-year period from the early to late 2000s to today’s environment. First, and importantly, valuations potentially offer investors a buying opportunity not seen in decades (Exhibit 3), as valuations are close to two standard deviations “cheap” relative to large caps.

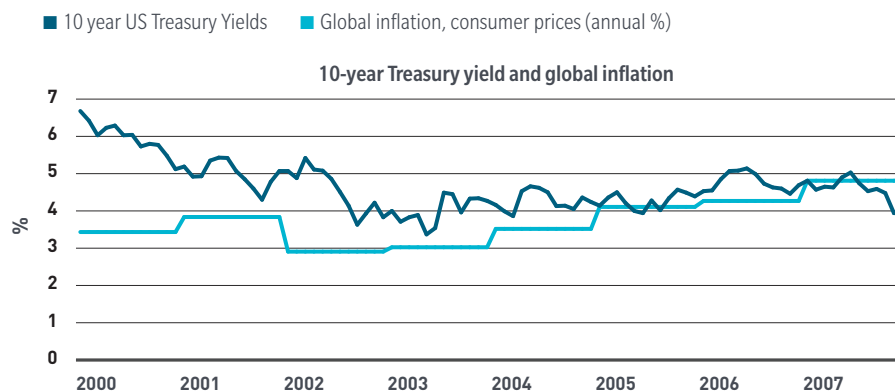
### Exhibit 3: Global Small/Mid-Cap Valuations at Multi-Decade Lows Relative to Large-Caps



Source: FactSet. Monthly data as of 31 January 2004 to 31 January 2024. Series shows the relative forward price-to-earnings (next-twelve-months) for MSCI All-Country World SMID Index (ACWI SMID) relative to MSCI All-Country World Large Cap Index (ACWI Large).

Next, inflation and interest rates during the run up to the GFC are more aligned with today’s reality versus what we witnessed in the decade following the GFC to the culmination of the COVID Pandemic. At that time, inflation was essentially non-existent and global yields were either close to zero or even in negative territory. In fact, from 2000 through the end of 2007, the 10-year US Treasury yield averaged 4.7% and global inflation averaged 3.7% (Exhibit 4). That period is not all that different from today.

### Exhibit 4: 2000 – 2007: Inflation and Interest Rates More Reminiscent of Today’s Environment



Source: FactSet for 10-year US Treasury Yield. Monthly data as of 31 January 2000 to 31 December 2007. Global Inflation, consumer prices (annual %) - World Development Indicators. Data from database: World Development Indicators. Annual data from 2000 – 2007.



Markets during the pre-GFC period also witnessed a dramatic sell-off as the dot.com bubble burst. The high-flying technology stocks with unattainable growth expectations — think irrational exuberance — of that period are rather analogous to the meme stocks of today. Looking at the concentration of the Russell 1000 Growth Index at the end of 2001, similarities are again quite apparent post-Covid (Exhibit 5).

### Exhibit 5: A Handful of Large-Cap Stocks Dominated Performance Then and Now

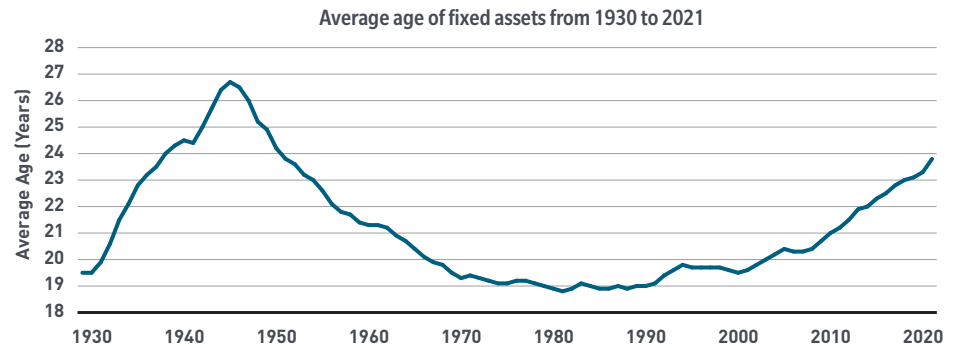


Source: FactSet. Monthly data as of 31 December 1998 to 31 January 2024. Past performance is no guarantee of results. It is not possible to invest directly in an index. The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product.

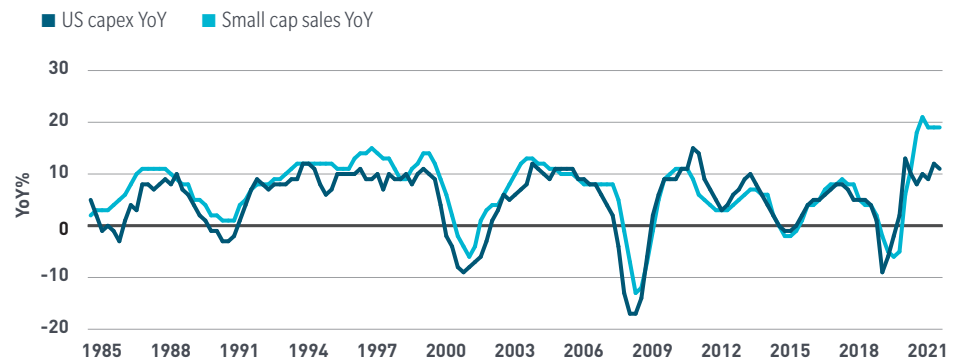
In addition to the similarities we can draw to the past, we feel future spending trends may benefit a wider cohort of sectors and industries, including small- and mid-cap stocks, rather than just the mega-cap technology companies that garnered the dominant share of spending in the past decade. Specific to small- and mid-cap stocks, spending trends may be driven by a 70-year high in the average age of fixed assets as sales have benefitted during past capex cycles (Exhibit 6). Further, a move to localization as governments and companies around the world onshore supply chains to improve their supply chain resilience could provide a tail-wind to the small- and mid-cap asset class. We believe the local nature of small- and mid-cap companies could work in their favor while large-cap company margins may come under pressure as benefits of globalization (lower taxes and labor costs) subside as onshoring gears up.



**Exhibit 6: Small/Mid-Caps May Benefit as Aging Fixed Assets May Drive Capex Which Has Been Highly Correlated With Sales Growth**



Source: Bureau of Economic Analysis. Annual data from 31 December 1930 to 31 December 2022 (latest available).

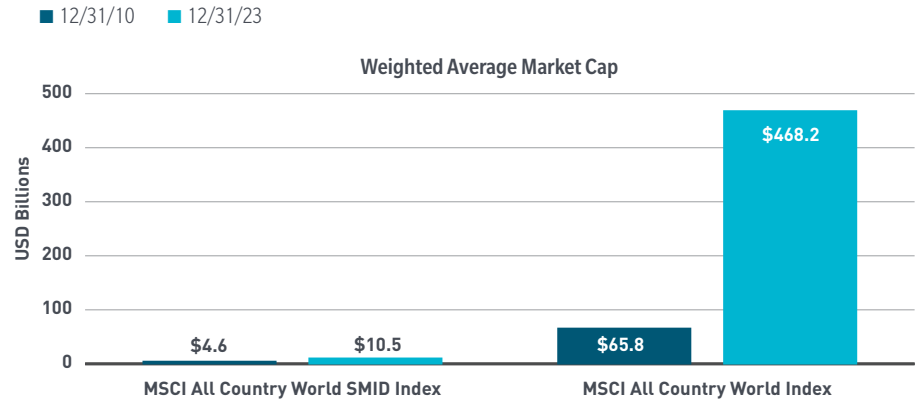


Source: FactSet, Haver Analytics, BofA US Equity & US Quant Strategy. Quarterly data as of 31 December 1985 to 31 December 2022 (latest available).

With all of that said, we believe the biggest reason to consider a dedicated allocation for suitable investors to the global small- and mid-cap asset class today is that global investors are significantly less able to gain exposure to small- and mid-cap stocks through the traditional standard global benchmark allocation. This is primarily due to the strong performance of a handful of US technology stocks during the past decade (and their ensuing increase in market capitalization). In our view, the dominance of the most influential large-cap stocks can be better appreciated when viewed from the perspective of market-capitalization buckets, as illustrated in Exhibit 7, where exposure to small- and mid-cap stocks in the MSCI All Country World Index has declined from 45% in 2010 to only 21% at the end of 2023, as the weighted average market cap of that index has gone from \$66B to an astounding \$468B over that same period. It is worth noting where this percentage change was reallocated: stocks with a market capitalization of greater than \$300 billion in the index increased significantly.



### Exhibit 7: Changing Landscape of Global Large Cap Benchmarks



Source: Factset/MFS Research. Data as of 31 December 2010 and 31 December 2023.

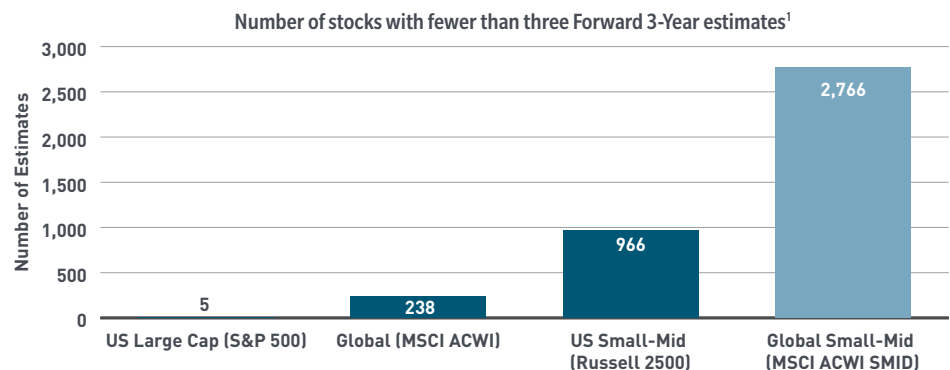
		31-Dec-10 Index Weight %	31-Dec-23 Index Weight %	% Change	Market Cap Segmentation
Market Cap – MSCI All Country World Index	Up to \$30bn	45.49	21.44	-53%	Small-Mid Cap
	\$30bn - \$300bn	53.16	51.02	-4%	Large Cap
	Over \$300bn	1.35	27.54	1940%	Mega Cap

Source: FactSet/MFS Research. Data as of 31 December 2010 and 31 December 2023.

### Why consider active management?

We believe this asset class may present more alpha opportunity for active managers. The universe receives substantially less research coverage by sell-side analysts compared to other asset classes, particularly large-cap stocks (Exhibit 8). The return dispersion for small- and mid-cap stocks is more than double that of large-caps (Exhibit 9). We feel both of these factors present ample opportunity for active managers with the experience and deep research resources to identify attractive stock opportunities.

### Exhibit 8: Lack of Research Coverage May Offer Opportunity for Active Managers with a Global Research Platform



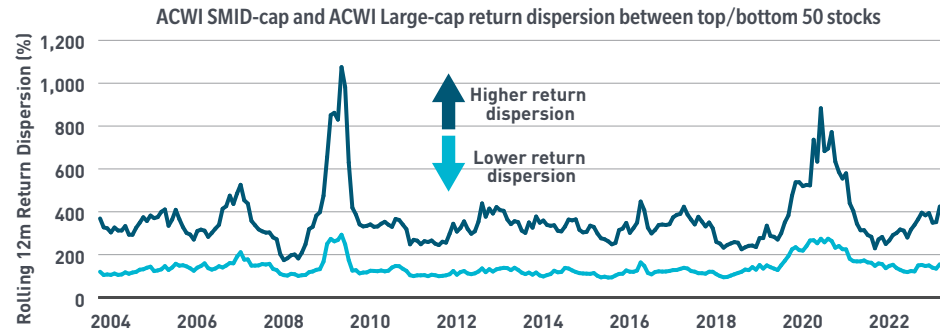
Source: FactSet data as of 31 December 2023.

<sup>1</sup> Estimate counts and averages are based on the number of I/B/E/S (Institutional Brokers Estimates System) earnings estimates reported for the 3rd fiscal year forward as of 31 December 2023.



## Exhibit 9: Higher Dispersion for Global Small/Mid-Cap May Present More Alpha Opportunity for Active Managers

■ MSCI ACWI SMID Index ■ MSCI ACWI Large Cap Index



Source: FactSet Portfolio Analysis. Monthly data as of 30 July 2004 to 31 December 2023 for MSCI ACWI Large Cap Index and MSCI ACWI SMID Index. Return dispersion is based on underlying stock returns for the best (top 50) and worst (bottom 50) performing stocks on a trailing 12-month basis. Buckets are constructed each month for the Top 50 and Bottom 50 returning stocks based on their trailing 12-month return. A simple average of their returns is used each month to calculate the Top-50 and Bottom-50 group's return for each index.

### Why MFS?

With our nine investment research offices around the globe and our collaborative global research platform, we can place analysts in local markets, where they perform in-depth company research and cross-border comparisons on a stock-by-stock basis. We believe the breadth and depth of our platform allows us to cover and uncover stocks that others may miss, and we strive to deliver a well-diversified global small- and mid-cap portfolio.

All told, MFS has:

- The opportunity to invest in a relatively inefficient and less-followed asset class on a global basis
- The ability to leverage the MFS global research platform and our long-term time horizon to potentially identify unique opportunities in the global small- and mid-cap universe
- A long history of managing small- and mid-cap strategies on behalf of clients globally (US\$55 billion under management in small- and mid-cap portfolios as of 12/31/23)
- A seasoned portfolio management team averaging 18 years with MFS and a strong background in managing small- and mid-cap strategies

The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product. ▲

# Equity Insights

March 2024

## Important Risk Considerations:

**Stock:** Stock markets and investments in individual stocks are volatile and can decline significantly in response to or investor perception of, issuer, market, economic, industry, political, regulatory, geopolitical, environmental, public health, and other conditions.

**International:** Investments in foreign markets can involve greater risk and volatility than U.S. investments because of adverse market, currency, economic, industry, political, regulatory, geopolitical, or other conditions.

**Mid-cap:** Investments in mid-cap companies can be more volatile than investments in larger companies.

**Small-cap:** Investments in small-cap companies can be more volatile than investments in larger companies.

Index data source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

Frank Russell Company ("Russell") is the source and owner of the Russell Index data contained or reflected in this material and all trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes and/or Russell ratings or underlying data and no party may rely on any Russell Indexes and/or Russell ratings and/or underlying data contained in this communication. No further distribution of Russell Data is permitted without Russell's express written consent. Russell does not promote, sponsor or endorse the content of this communication.

**The views expressed are those of the author(s) and are subject to change at any time. These views are for informational purposes only and should not be relied upon as a recommendation to purchase any security or as a solicitation or investment advice. No forecasts can be guaranteed. Past performance is no guarantee of future results.**

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by: **U.S.** – MFS Institutional Advisors, Inc. ("MFSI"), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited. **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited ("MIL UK"), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER. **Note to Europe (ex UK and Switzerland) readers:** Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore** – MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand** - MFS International Australia Pty Ltd ("MFS Australia") (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong** - MFS International (Hong Kong) Limited ("MIL HK"), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the "SFC"). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to "professional investors" as defined in the Securities and Futures Ordinance ("SFO").; **For Professional Investors in China** – MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan** - MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments; **Bahrain** - This document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally. The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the statements and information contained in this document and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this document. The Board of Directors and the management of the issuer accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the board of directors and the management, who have all taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the reliability of such information.; **Kuwait** - This document is not for general circulation to the public in Kuwait. The information has not been licensed for offering in Kuwait by the Kuwait Capital Markets Authority or any other relevant Kuwaiti government agency. No private or public offering of the information is being made in Kuwait, and no agreement relating to the information will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the information in Kuwait.; **Oman** - For Residents of the Sultanate of Oman: The information contained in this document does not constitute a public offer of securities in the Sultanate of Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98). This information is being circulated on a limited basis only to corporate entities that fall within the description of sophisticated investors (Article 139 of the Executive Regulations of the Capital Market Law). The recipient acknowledges that they are a sophisticated investor who has experience in business and financial matters and is capable of evaluating the merits and risks on an investment.; **South Africa** - This document has not been approved by the Financial Services Board and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.; **UAE** - This document, and the information contained herein, does not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The information is only being offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural Qualified Investors: (1) an investor which is able to manage its investments on its own, namely: (a) the federal government, local governments, government entities and authorities or companies wholly-owned by any such entities; (b) international entities and organisations; or (c) a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person; or (2) an investor who is represented by an investment manager licensed by the SCA, (each a "non-natural Qualified Investor"). The information and data have not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority, the Dubai Financial Services Authority, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the "Authorities"). The Authorities assume no liability for any investment that the named addressee makes as a non-natural Qualified Investor diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document you should consult an authorised financial adviser.; **Saudi Arabia** - This document may not be distributed in the Kingdom except to such persons as are permitted under the Investment Funds Regulations issued by the Capital Market Authority. The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers of the securities offered hereby should conduct their own due diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document, you should consult an authorised financial adviser.; **Qatar** - This material/fund is only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such material/fund. The material does not constitute an offer to the public and is for the use only of the named addressee and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof). The fund has not been and will not be registered with the Qatar Central Bank or under any laws of the State of Qatar. No transaction will be concluded in your jurisdiction and any inquiries regarding the material/fund should be made to your contact outside Qatar.