

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <https://www.djreprints.com>.

<https://www.wsj.com/articles/small-cap-stocks-take-on-new-shine-as-markets-slump-small-cap-stocks-take-on-new-shine-as-markets-slump-11546943401>

MARKETS

Small-Cap Stocks Take On New Shine as Markets Slump

Profits across the Russell 2000 are seen growing nearly 16% in quarter, far outpacing earnings growth for S&P 500 firms

By Michael Wursthorn

Updated Jan. 8, 2019 4:37 p.m. ET

Small-capitalization companies are projected to notch another year of big profit gains, potentially making their shares a haven for investors as earnings at larger firms slow.

With companies including Apple Inc. slashing revenue expectations for the first quarter, investors are on edge that profits, the stock market's engine, will sag this year under the weight of a continuing trade spat between the U.S. and China, a broader economic pullback and the fading benefit of last year's tax-cut stimulus.

But small companies appear to be a relative bright spot. Analysts are expecting firms in the Russell 2000 index of small-capitalization companies collectively to post double-digit profit gains throughout 2019, according to financial-data provider Refinitiv, far outpacing the S&P 500. Russell 2000 companies tend to have market capitalizations of \$300 million to \$2 billion.

"We're positive on small-caps," said Paul Lambert, a portfolio manager at Wasatch Advisors. "We're finding quality [small-cap] companies growing faster than mid- and large-cap companies."

The bruising selloff briefly knocked valuation measures of small companies to their lowest level in six years and below that of their bigger counterparts in the S&P 500, according to FactSet. That could attract cost-conscious investors, such as Mr. Lambert, who believe the smaller companies have been oversold in recent weeks.

Expectations that the U.S. economy will keep growing, even if more slowly than last year, are behind the upbeat profit projections, analysts said. Solid consumer confidence is helping smaller, domestically focused companies, while big multinationals have to contend with

regional slowdowns in Europe and Asia and a strong U.S. dollar that makes converting foreign sales more costly.

Newsletter Sign-up

Profits across the Russell 2000 are projected to grow by nearly 16% in the first quarter from a year earlier, building on the 12.6% earnings growth rate those companies were expected to hit in the final three months of 2018, according to Refinitiv's data. By the fourth quarter of 2019, profits in the Russell 2000 are expected to balloon more than 30% above the year-earlier period. The S&P 500 is projected to expand earnings by around 6% in each of the first two quarters of the year.

For now, investors haven't been pricing in the rosy profit expectations for small-cap stocks, analysts said. Instead, shares of smaller companies have tumbled into bear-market territory in the final weeks of the year, victim of a broader stock-market pullback brought on by a perfect storm of heightened anxieties around trade, interest-rate and growth concerns.

The Russell 2000 fell 12% in December, its worst month ever, as it slid more than 20% from its Aug. 31 record to enter bear-market territory and post its worst annual performance since the 2008 crisis.

For some investors, the pullback among small-caps has been indiscriminate and overdone, giving them an opportunity to pounce on companies that appear to be cheap buys.

"With the market headed down, we're seeing attractive opportunities," said Mr. Lambert, whose fund is now looking to put money to work from some of the stock sales it executed last year, prior to the market's downturn.

Shares of small companies traded in late December at valuations unseen in six years. The S&P 600 Small Cap Index traded as low as 13.4 times projected earnings over the next 12 months, down from nearly 18 times around the end of August and on par with valuations at the end of 2012, according to FactSet.

But good valuations alone won't revive small-cap stocks, analysts said, adding that investors need to see a resolution to the U.S. trade fight with China and get a handle on the future pace of interest-rate increases for prices to rebound.

Investors' faith in U.S. economic growth has been shaken amid the confluence of tariffs and rising rates, leading many to pare back their risky stock investments. While most analysts say

MORE

- Corporate Profit Crunch Looms as Stocks Slide
- Apple's Stock Drops on Revenue Warning
- Fed Chairman Powell Sees Flexibility on Rates This Year

fears of a recession this year are overblown, small-cap stocks got caught up in the selloff: Investors worried that tariffs would increase costs across company supply chains and crimp demand, while higher interest rates would likely burden debt-heavy businesses.

Following Apple's warning on Thursday that first-quarter revenue would come in below analysts' expectations due to slowing demand in China, shares of small companies fell alongside the broader stock market. But the Russell recouped those losses Friday, rising alongside the broader market following signals from Federal Reserve Chairman Jerome Powell that the central bank could adopt a more flexible path on interest-rate hikes.

The index is in the midst of a three-session winning streak, putting it up 5.8% to start the year, better than the S&P 500's 2.7% gain since Dec. 31.

"If the economy steadies and a trade war dissipates, economic growth will remain more resilient and small-caps can do well in that environment," said Edward Rosenfeld, a fund manager at Lazard Asset Management.

Corrections & Amplifications

The profit growth of companies in the Russell 2000 is set to outpace that of S&P 500 firms in 2019. A chart accompanying an earlier version of this article misstated the time period. (Jan. 8, 2019)

Write to Michael Wursthorn at Michael.Wursthorn@wsj.com

Copyright © 2019 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <https://www.djreprints.com>.