

It is no secret that the small cap space has been challenging for a historic period of time. To put numbers to it, the Russell 2000® Index has underperformed the S&P 500® Index on a 1, 3, 5, and 10-year basis. While recent underperformance is not a sufficient basis for a bullish thesis on the asset class, we think there are several factors that support improved performance from here. In this piece, we hope to provide you with facts and statistics that support the case for small caps going forward.

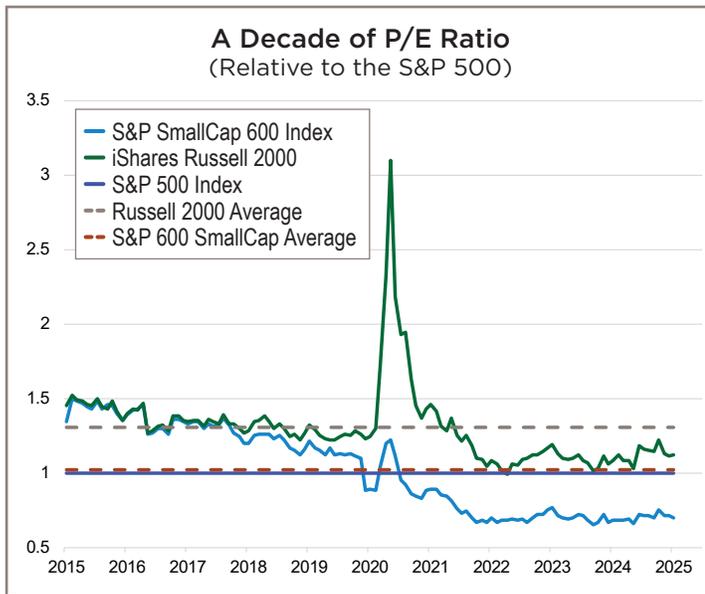


**Christopher G. Pearson, CFA®**

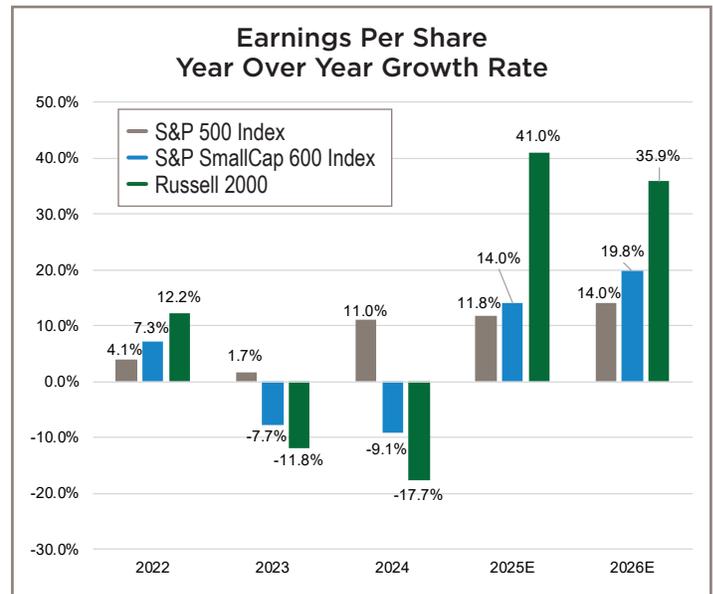
Senior Vice President  
Member, Investment Policy Committee

(804) 698-2638  
cpearson@investdavenport.com

- **Valuation:** Small caps appear inexpensive on a relative price to earnings (P/E) basis. The Russell 2000 is trading near multi-decade lows. The S&P SmallCap 600® Index, which used to trade at a premium to the S&P 500, now trades at a material discount.
- **Earnings growth:** After experiencing earnings declines in 2023 and 2024, we believe small cap earnings are poised to rebound in 2025. Though we are skeptical of the 40%+ headline growth implied by consensus 2025 Russell 2000 earnings expectations (40% of the Russell is unprofitable), we note that analysts expect earnings growth in the mid/high teens for the S&P SmallCap 600 Index (a higher quality index).



Source: FactSet financial data and analytics



Source: FactSet financial data and analytics

- **Mergers and acquisitions (M&A):** Given interest rate volatility coupled with an unfavorable regulatory environment, M&A activity has been muted over the last few years. Going forward, we are optimistic that a stabilizing interest rate backdrop along with a more business friendly political environment can give way to more deal activity. Small caps that screen as attractive targets for larger strategic buyers and private equity could stand to benefit.
- **Interest rates:** Small cap companies tend to operate with higher debt levels than larger cap peers. As such, small-caps have been adversely impacted by the dramatic increase in interest rates over the last few years. A stabilization in the rate outlook could enhance financing flexibility for smaller companies, while also paving the way for valuation upside.
- **Domestic focus:** Nearly 80% of Russell 2000 revenues are derived from the United States. This theoretically insulates the category against currency fluctuations and tariff impacts relative to the S&P 500, which derives approximately 40% of its revenues from international sources.

Despite a slow start to 2025, the tailwinds outlined above lead us to believe in the potential for small caps to improve performance through the latter part of the year. Current prices may provide an attractive entry point for long-term investors looking to diversify their investment portfolios.

As of 2/28/2025

**Important Disclosures:** The statements and opinions expressed in this article are those of the authors as of the date of the article, are subject to rapid change as economic and market conditions dictate, and do not necessarily represent the views of Davenport & Company LLC. This article does not constitute investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. Investing in securities carries risk including the possible loss of principal. Individual circumstances vary. Diversification and asset allocation does not ensure a profit or guarantee protection against a loss. Small and mid cap company stocks may be more volatile than stocks of larger, more established companies.

**Important Definitions:** The **S&P 500® Index** is comprised of 500 U.S. Stocks and is an indicator of the performance of the overall U.S. stock market. The **S&P 600 Index** is comprised of smallcap stocks managed by Standard & Poor's. The index is a product of S&P Dow Jones Indices LLC, a division of S&P Global, or its affiliates ("SPDJ"). Standard & Poor's® and S&P® are registered trademarks of Standard & Poor's Financial Services LLC, a division of S&P Global ("S&P"); Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). The **Russell 2000® Index** measures the performance of the 2000 smallest companies in the Russell 3000® Index, representing approximately 8% of the total market capitalization of the Russell 3000. The **iShares Russell 2000 ETF** seeks to track the investment results of an index composed of small-capitalization U.S. equities. London Stock Exchange Group PLC and its group undertakings (collectively, the "LSE Group"). © LSE Group 2025. FTSE Russell is a trading name of certain LSE Group companies. "Russell®" is a trade mark of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote/sponsor/endorse the content of this communication