VAN LANSCHOT KEMPEN

INVESTMENT MANAGEMENT

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The overlooked engine

How small caps can enhance portfolios and unlock value

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Global equity markets have become highly concentrated, with only a few 'mega caps' driving most of the returns year-to-date. Their dominance has delivered strong short-term gains for investors, but is at risk of leaving portfolios exposed to only a narrow set of themes. Recent market signals suggest that breadth may be starting to reassert itself, suggesting a shift in investor's perceptions of the sustainability of market leadership.

Why breadth matters

Diversification is more than a risk-control tool. It is a source of resilience for portfolios when market narratives shift. Small-caps offer something that large-caps cannot: access to a broader set of companies, sectors and geographies that are often under-represented in global benchmarks. They bring exposure to real-economy businesses that can often be more sensitive to the impact of monetary policy and consumer demand than their large-cap peers.

Figure 1: The benefits of breadth
Top 10 holdings dominate MSCI World vs MSCI World Small Cap

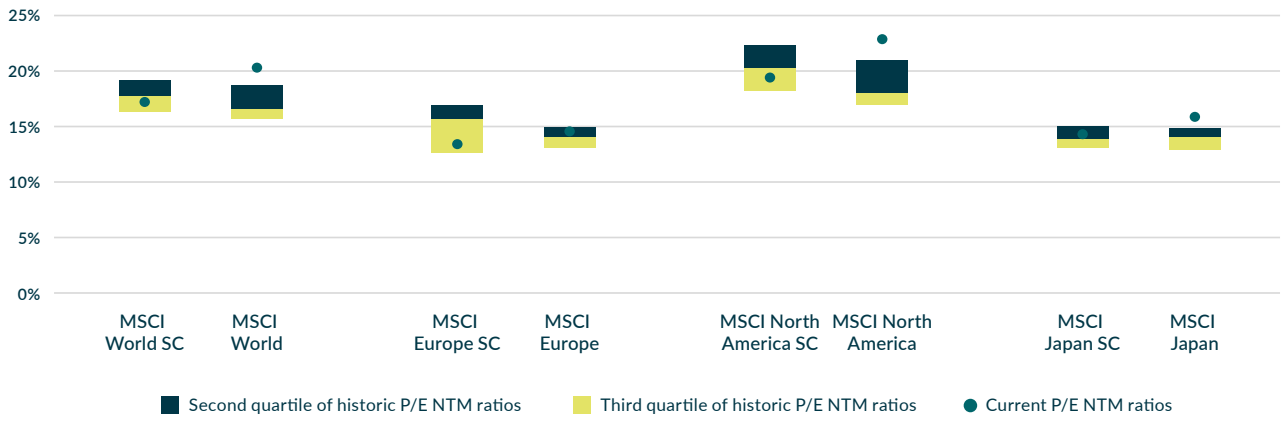
Source: Van Lanschot Kempen, FactSet, for the period 01/10/2005 (indexed at 100) to 30/09/2025.

Valuations tell a different story

While large-caps re-rated on the back of strong earnings and liquidity, small-caps remain at a discount to their long-term average valuation. This is the case across most regions. The gap is particularly wide in Europe, where there have been heavy penalties on cyclical exposure as these companies tackle macro uncertainty and negative sentiment. For investors willing to look beyond the headline indices, this creates an opportunity to add growth potential at an attractive entry point.

Figure 2: Valuations vs. history across regions

Small-caps trade below long-term averages across regions



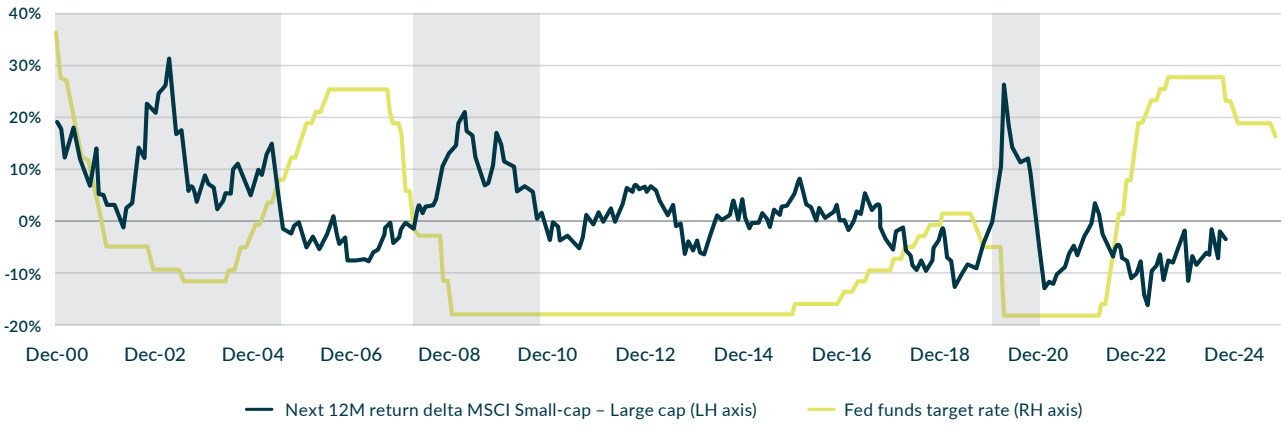
Source: FactSet, Van Lanschot Kempen. (*) Period from 30/09/2015 to 30/09/2025.

Valuation alone does not drive returns, but it can improve the balance of risk-reward. The imbalance between sentiment and fundamentals often creates space for strategic re-entry, especially in areas tied to real economic recovery.

Periods of extreme concentration rarely last forever. After the dot-com bubble in 2000, leadership broadened and small-caps outperformed for years. The same happened after the global financial crisis and again after the pandemic shock. In each case, small-caps began from a position of undervaluation and recovered strongly as broader conditions improved.

Figure 3: Historical small-cap vs. large-cap recovery

Small-caps historically outperform after downturns, showing a strong recovery after both the Great Financial Crisis as well as the pandemic shock



Source: Van Lanschot Kempen, FactSet, for the period 01/10/2005 (indexed at 100) to 30/09/2025.

A key role for small-caps in portfolio construction

The benefits of allocating to small-caps are about positioning for a wider set of outcomes and long-term growth themes. Small-caps can provide exposure to sectors tied to long-term themes such as automation, housing, ageing demographics and digital infrastructure. These are the multi-year trends and structural forces shaping the next phase of global growth.

These exposures can broaden strategic positioning and add flexibility for future growth. When leadership rotates, portfolios anchored in breadth can be better positioned to capture the upside.

Positioning for resilience and renewal

The signals are clear: index concentration is high, valuations in small caps are compelling and structural growth drivers remain intact. For investors seeking balance, current conditions highlight a segment of the market that has historically offered strong returns when starting from a position of undervaluation.

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