

The large advantages of small companies

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Small companies are quite easy to ignore. After all, analysts rarely cover them, you may not have heard of them, and you are unlikely to have their products in your home. However, small companies are often the ones that offer the biggest potential.

Consider that small companies are innovative. They are creating the products, services and technologies we may not know today, but will come to rely on tomorrow. Certainly, they come with more risk, but they also come with more reward potential. In fact, over the long-term, small cap stocks have outperformed both their large cap brethren and the market in general, as you can see here.

Behold the power of small cap stocks in the Eurozone

Sources: Bloomberg, MSCI, 31 December 2000 to 31 July 2018 You cannot invest directly within an Index.

Historical performance is not an indication of future performance and any investments may go down in value.

The dividends of small caps

Additionally, it is worth noting that, in addition to their growth potential, small companies in Europe often pay dividends. Dividends provide:

- A potentially growing stream of income
- A measure of protection in down markets

In the Eurozone a focus on dividends provided risk mitigation during a tough market (31 March 2000 to 31 March 2003)

Sources: Bloomberg, MSCI, 31 March 2000 to 31 March 2003. Includes Backtested Data. The MSCI EMU High Dividend Yield Index began live calculation on 31 October 2006.

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Capturing inefficiencies

We believe that small companies can provide growth opportunities to investors. Further, we believe that small cap dividend payers may help to mitigate the volatility of small cap investments. It is worth noting that, as small companies are not as widely followed as their larger counterparts, there is more opportunity for a stock's price to be out of alignment with the company's true value.

At WisdomTree, we weight indices by dividend in order to magnify the effect dividends have on performance. We use a rules-based process and rebalance back to relative value at least annually. In our opinion, less efficient markets, like the small cap arena, are precisely where our rules-based process can work best.

In our next instalment, we'll discuss where small cap opportunities may be most exciting.

Important Risks Related to this Article

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