

Are Global ex-US small caps set to play a starring role in The Great Rotation?



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As global investors reconsider their concentration in US equities, Europe and Japan's overlooked small caps may offer the highest upside potential.

The hyper-concentration of US equities as a share of global market capitalisation reached extreme levels in recent years. Policy uncertainty means we have likely passed the point of peak US exceptionalism, however. Investors are reassessing risk, growth and inflation assumptions in a US market that was priced for perfection.

A major driver of the strong gains in Europe and Japan this year is the rapid influx of fund flows in to European and Global ex US equity Funds.¹ When inundated with new capital, the most liquid opportunities tend to benefit first. It takes time for fund flows to trickle down to small caps, where valuations are most attractive and the upside potential from mean reversion looks greatest.

Smaller firms, which tend to generate a higher share of their revenue domestically, may have an edge if there is further international trade disruption or increased fiscal spending.

Investors believe European fiscal stimulus and Japanese governance reforms are likely to improve the outlook for equity returns outside the US. However, what has been overlooked is that small cap earnings and dividends in Europe, Australasia and the Far East (Global ex-US) have already established a strong track record of growth since the COVID-19 pandemic ended.

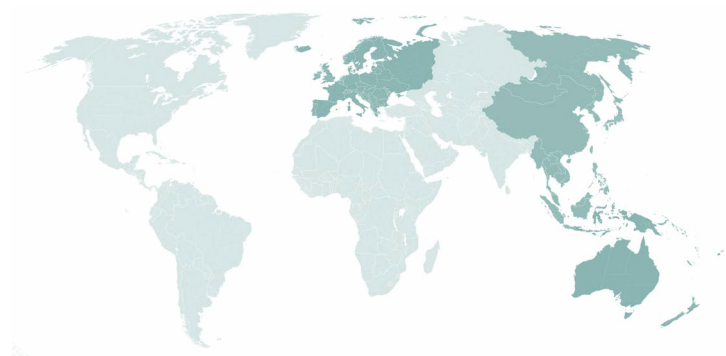
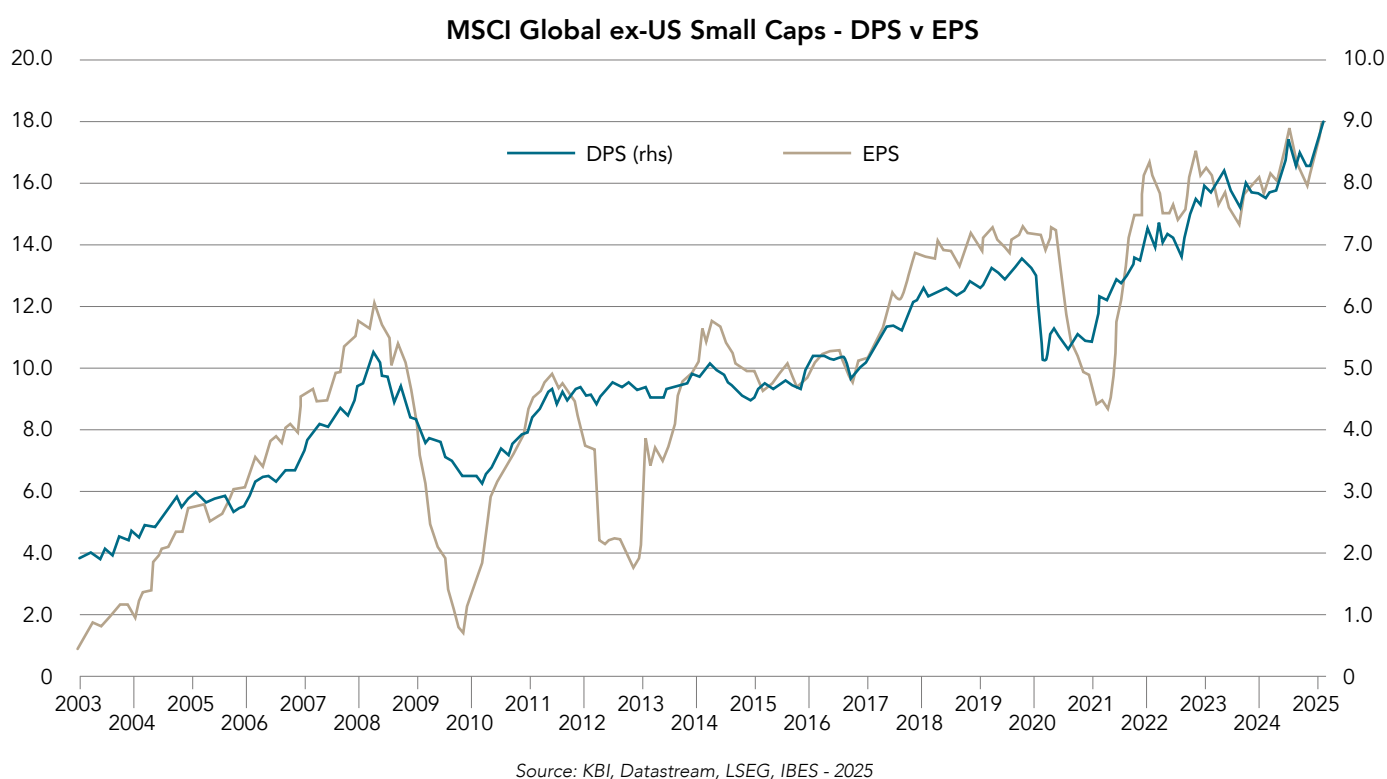


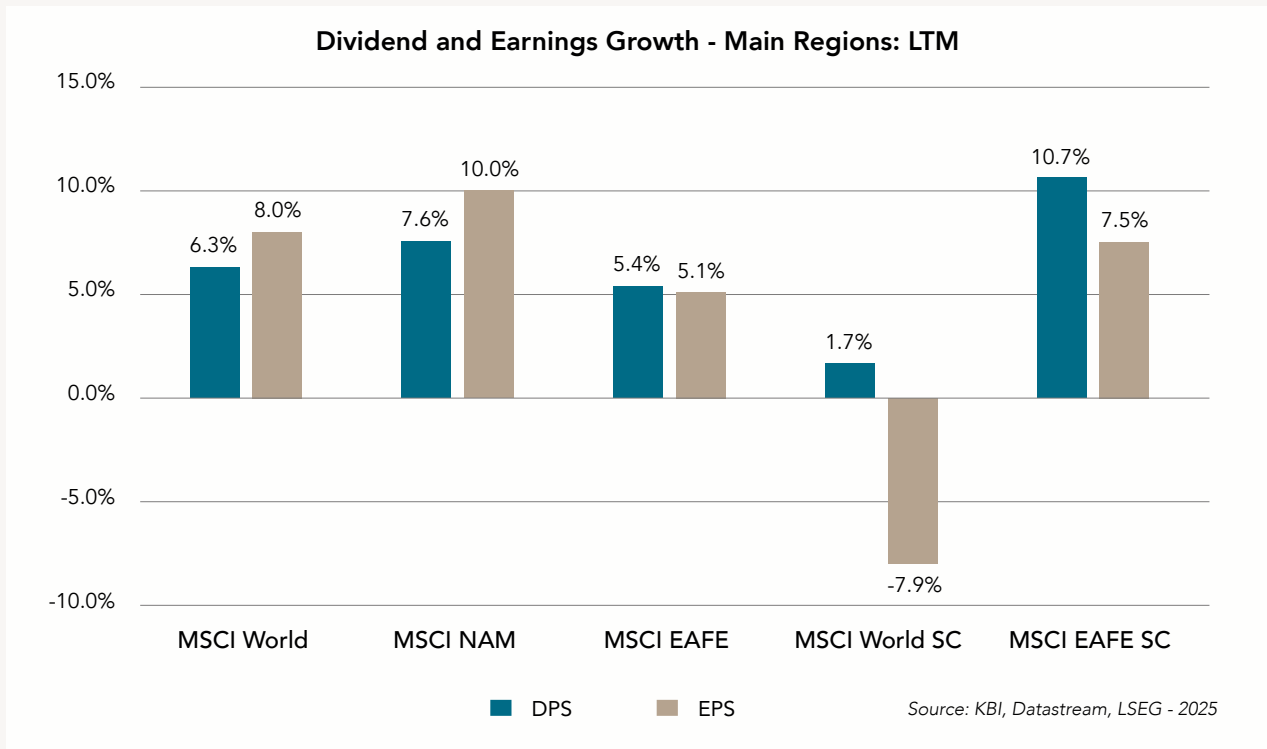
Fig. 1 - Global ex-US Small Cap has a strong growth record in recent years



In fact, they're growing as strongly as US large caps and considerably more strongly than US small caps, which continue to struggle with these fundamental measures.

¹ For example, Vanguard, one of the biggest ETFs tracking the broad European market received more inflows in Q1 2025 than in any other quarter over the past five years. The FT reports that circa. €2.5bn has flowed into Global ex-US equity mandates from Europe and Japan in Q2.

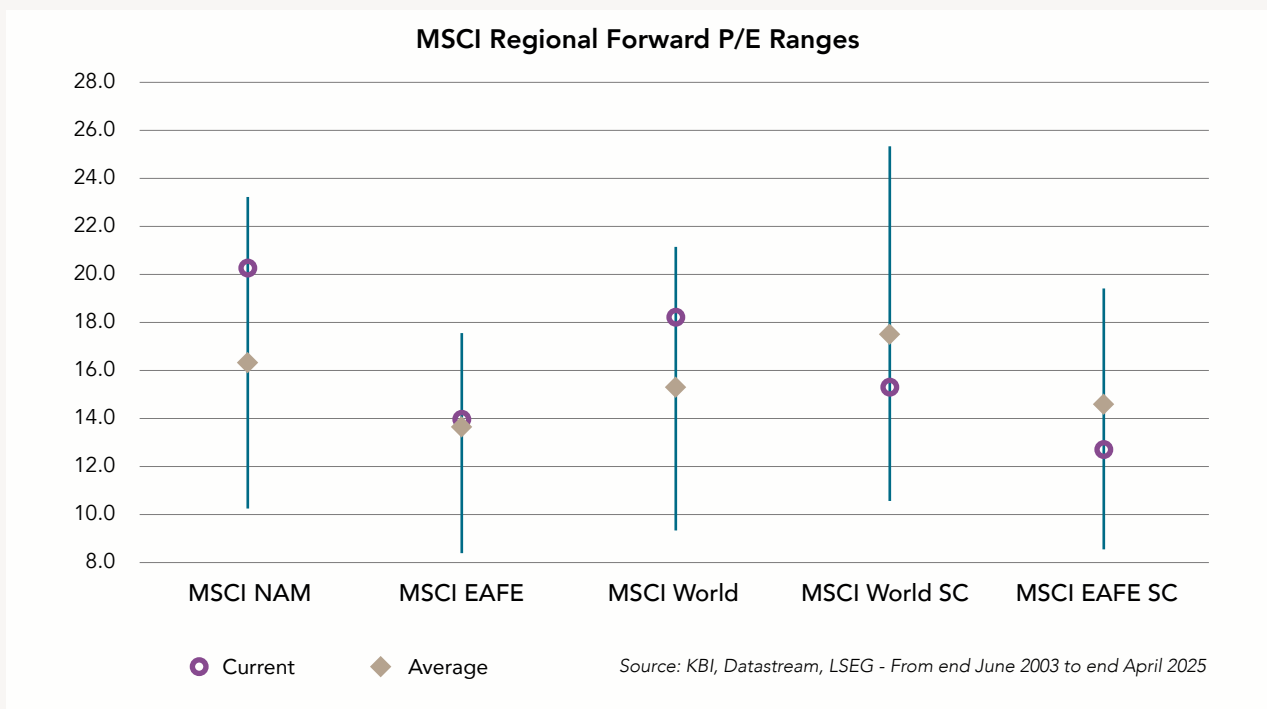
Fig. 2 - Global ex-US Small cap growth has compared well with US large caps



The narrow focus of global investors on US large caps, together with the poor performance of both US small caps and Global ex-US large caps, has meant many have overlooked Global ex-US small caps.

As a result, they're cheap on both an absolute and a relative basis.

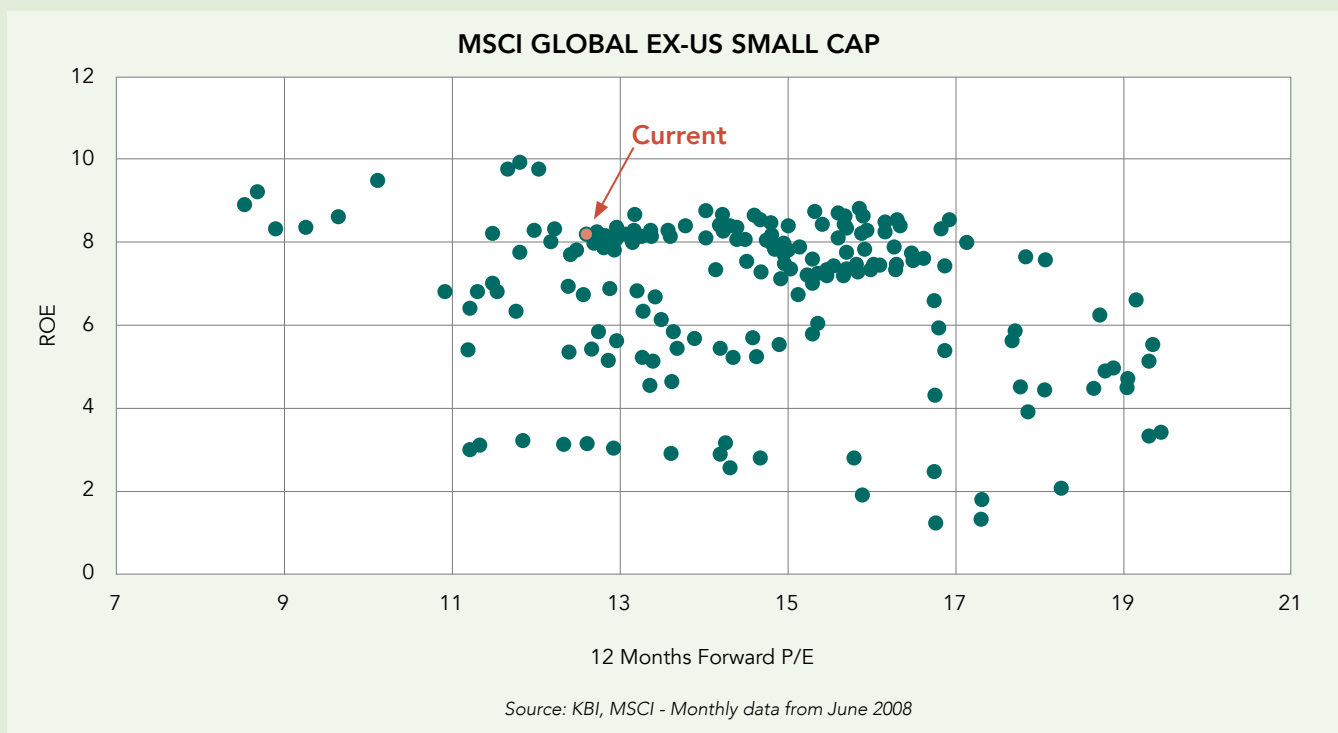
Fig. 3 - Global ex-US Small caps are cheap relative to their history, and US large caps are expensive



When you combine
**above-average
profitability** with a
below-average valuation,
you typically have an
excellent entry point.



Fig. 4 - Global ex-US small caps: above-average profitability, below-average valuation



Adding our active management skills to the mix improves the proposition further (see Fig. 5 below, which shows portfolio characteristics). The valuation is less than half that of US large caps. There is notable upside potential as fund flows, which have started to move out of the US, are initially focused on large caps, but will eventually flow into less liquid corners of international markets.

These stocks also offer dividend yields north of 4% and strong double-digit dividend growth. That means investors can be rewarded while they wait for mean reversion to normalise the valuation.

Fig. 5 - Portfolio characteristics – high yields and high growth

	EAFE Small Cap Strategy	MSCI EAFE Small Cap Index	
Dividend Yield (%)	4.5	3.3	Better Total Return
Dividend Payout (%)	50.2	41.2	
Dividend Growth (%)	17.4	9.8	
Total Payout Yield (%)	5.2	3.1	
P/E 1 Year Forward	10.8	13.6	Better Value & Risk
Price/Book	1.1	1.3	
Price/Cashflow	7.2	8.1	
Weighted Average Mkt. Cap \$ (bn)	2.9	3.3	
Weighted Average Carbon Intensity	43.0	131.8	Lower Carbon
ROE (Realised, %)	13.9	11.4	Better Quality Management & Balance Sheets
ROIC (Realised, %)	10.0	8.1	
Net Debt/Equity (%)	9.3	22.5	

Source: KBI, MSCI - 2025

Removing the impact of currency, international markets are up over the year-to-date period to the end of April. Meanwhile, expensive US equity indices have declined, showing the benefit of international diversification. As markets evolve from the recent period of hyper-concentration, it'll be crucial to identify allocations that maximise diversification potential as well as alpha.

Fig 6 shows, Global ex-US small cap stocks been much better at diversifying US large-cap risk in portfolios than US small caps over the past 24 years.

Fig. 6 - Correlation table – Global ex-US small caps are an effective diversifier of US large-cap risk

2000 - Dec. 2024	Dev ex-US Small Growth	Dev ex-US Small Neutral	Dev ex-US Small Value	US Large Growth	US Large Neutral	US Large Value	Dev ex-US Large Growth	Dev ex-US Large Neutral	Dev ex-US Large Value
Dev ex US Small Growth	1.000	0.960	0.891	0.763	0.725	0.624	0.901	0.879	0.804
Dev ex US Small Neutral	0.960	1.000	0.964	0.731	0.768	0.677	0.892	0.933	0.888
Dev ex US Small Value	0.891	0.964	1.000	0.647	0.739	0.666	0.817	0.906	0.893
US Large Growth	0.763	0.731	0.647	1.000	0.835	0.743	0.851	0.797	0.720
US Large Neutral	0.725	0.768	0.739	0.835	1.000	0.913	0.763	0.855	0.837
US Large Value	0.624	0.677	0.666	0.743	0.913	1.000	0.643	0.769	0.806
Dev ex US Large Growth	0.901	0.892	0.817	0.851	0.763	0.643	1.000	0.921	0.822
Dev ex US Large Neutral	0.879	0.933	0.906	0.797	0.855	0.769	0.921	1.000	0.950
Dev ex US Large Value	0.804	0.888	0.893	0.720	0.837	0.806	0.822	0.950	1.000

Source: Fama Library - Developed ex-US and US factors formed on Size and B/P with Average Value Weighted Returns

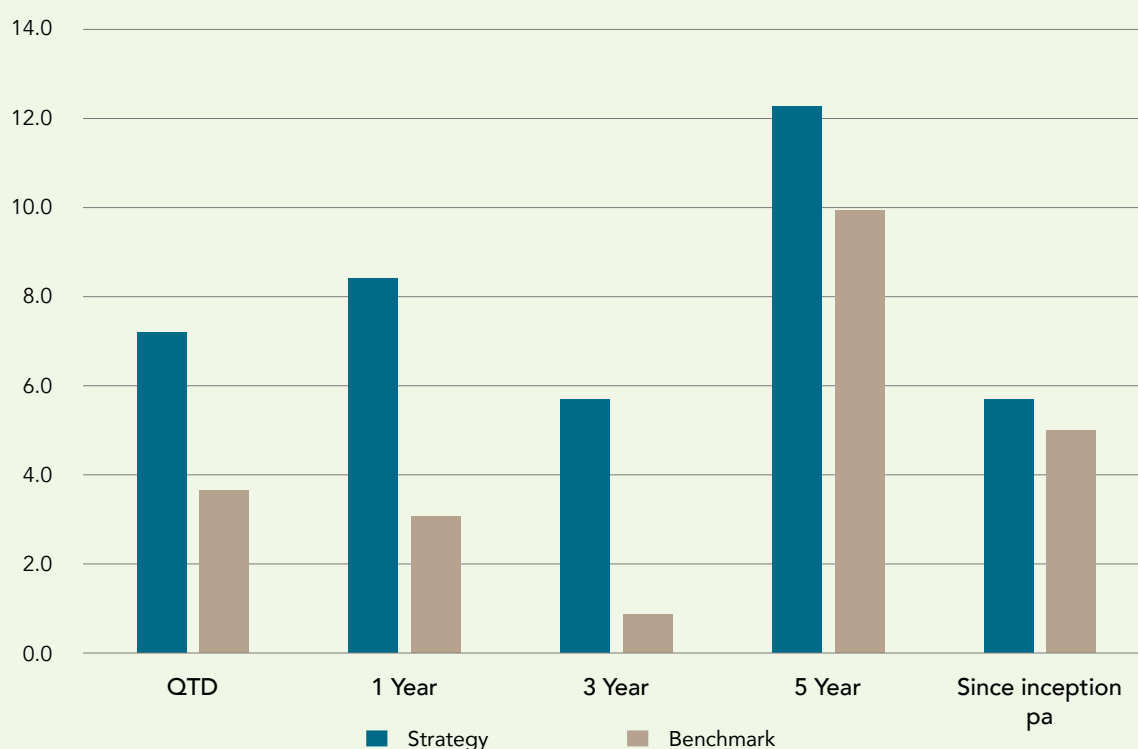
It's our view this means that an allocation to Global ex-US small caps can play a vital role, helping to generate alpha and reduce risk from an overall equity portfolio perspective.

Benefit from our expert guidance

KBIGI has a strong track record of adding value to this asset class. As investors look to diversify away from over-owned and over-valued US large caps, there's a compelling case for the overlooked attractions of our Global ex-US Small Cap Portfolio.



Fig. 7 - KBIGI Global ex-US Small Cap performance track record



Source: KBI Global Investors, Datastream and Bloomberg. Returns are gross of fees in USD to 31st March 2025. See disclaimers for further information.

MSCI Global ex-US Small Cap Net Return benchmark returns assume the reinvestment of dividends after the deduction of withholding taxes. See disclaimers for description of index information.

Returns are gross of fees in USD. Returns from 07/01/2015 are based on the KBIGI Global ex-US Small Cap equity component of the KBIGI Global Small Cap Strategy managed by KBIGI to an identical process applied to all KBIGI Global Equity Strategies.

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Portfolio returns are gross of fees in **USD**.
All returns are to **31/03/2025**.

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MSCI Global ex-US Small Cap: The MSCI Global ex-US Small Cap Index covers more than 2,200 securities across small-cap stocks and across style and sector segments in 21 developed markets.

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Contact Information:

Ambassador Funds Management Services
Level 12, 3 Spring Street, Sydney NSW 2000, Australia.
Ph: 61 2 9081 0230. Fax: 61 2 9081 0231

Level 16, 461 Bourke Street, Melbourne VIC 3000, Australia. Ph: 61 3 8652 2848. Fax: 61 3 8652 2849

www.ambassadorfms.com

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