Small Talk

OPPENHEIMER

July 2026

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We suspected that the Magnificent 7's reign at the top in global market performance would meet with a rotational correction; rotation is when investors sell one sector of the market to buy into another. Rotation is underway. The Magnificent 7 have returned essentially 0% this year at writing. Sectors other than technology are rising, including previously lagging—in relative terms— healthcare and value stocks.

We waited two years for the market to broaden from its narrow reliance on tech. Broadening helps sustain a bull market.

A standout performer has been the Russell 2000, the index that represents shares of small companies, aka small cap. It rose 22% in the first half—more than double the S&P 500's 9.4%.

Small Caps Are Beating the S&P 500 by the Widest Margin Since 2003.

— *Motley Fool* - 2 Jul 2026

The generally accepted market values for large and small caps were:

Micro-cap:	Below $250 million
Small-cap:	$250 million – $2 billion
Mid-cap:	$2 billion – $10 billion
Large-cap:	$10 billion and up

Source: www.finra.org

With the great increase in value of the largest companies, the value of relatively smaller ones has crept up too.

The average market capitalization of Russell 2000 companies is $4.2 billion. The index operates with a median market cap of $1.18 billion
Source: FTSE Russell

Before their recent rise, we had puzzled over small caps stagnating while headline indexes kept hitting all-time highs. Last September, I circulated a graph showing small caps mired below late-2020 levels, and their historically long and halting effort to dig out of that slump.

Source: Thomson Reuters

This more recent graph shows the strong breakout to the upper right.

The financial press cites this as the strongest half year performance since 1991.

When a market shows rotation, capital can slosh around like water in a bucket without mounting a lasting wave. Eight months do not a trend make. Still, this rally deserves notice.

Small cap devotees cite 1928-2024 long-term annualized returns:

Small caps	**+11.7%**
Stocks	**+9.9%**
Bonds	**+4.5%**
Cash	**+3.3%**
Real estate	**+4.2%**
Gold	**+5.1%**

Source: Prof. Aswath Damodaran, New York University.

That outperformance comes at some cost of interim volatility.

The Russell 2000 is historically 15% to 20% more volatile than the S&P 500 .

Investopedia.com

Over the last decade, Russell 2000 has experienced deeper maximum drawdowns, e.g. 41.75%, compared to S&P 500's 33.79%

Curvo.com

A young investor can well take the long-term view and plump for a larger allocation in small cap in her portfolio. Does that mean an investor over 50 should skip small cap? Not at all. It provides diversification. Small cap alternates with large in cycles of outperforming and underperforming each other, rather in the way both Earth and Moon waltz around a common center of mass in our forward progress around the sun (the barycenter, if you'd like to know).

Synthesizing research from Erik Norland at CME, here is that performance oscillation:

1979-1983: Small outperformed

1983-1990: Large outperformed

1990-1994: Small

1994-1999: Large

1999-2014: Small

2014-2024: Large

The alternation suggests that a mix of large and small stocks can smooth volatility over time.

Oddly enough, small outperformed amid poor economies. The 1979-1983 period, as a notable example, lurched from extreme inflation to the Volker Fed's correspondingly extreme interest hikes and two back-to-back recessions; it seems counterintuitive that small companies should have outperformed, being the more economically sensitive. Perhaps it shows the market's often uncanny prescience in anticipating economic upturns (there is an academic paper for someone to write on small cap sensitivity to business cycle precursors).

Another reason small caps can be useful diversification is what is often their weakness: a greater dependence on the domestic economy.

….the non-US revenue share for the Russell 2000 has consistently remained low, generally hovering between 15% and 20%

Source: Alliance Bernstein

S&P 500 large companies derive 40% of revenues internationally. When the Trump Administration launched international tariff disputes, we thought domestically focused companies might be less affected, absent those heavily reliant on imported materials.

In non-US markets, small caps recently lagged large. Higher energy costs impact European and Asian domestic economies more than the US.

Earnings

A meaningful earnings recovery powered the recent small cap rally, with analysts ratcheting up reckonings of profits to come.

Consensus forecasts for Russell 2000 companies' 2026 earnings growth have climbed to 38% from about 23% at the start of the year, ...

Source: Columbia Threadneedle

That certainly exceeds estimated S&P 500 large cap earnings growth of 24%.

Russell 2000 experienced an earnings recession in 2023-2024 and investors waited to see growth actually resume before buying in volume. Small stocks did not rally in anticipation of earnings as they had in past. Perhaps the market was so AI-focused that it overlooked other possibilities.

Fewer small cap opportunities of interest?

One reason for relative indifference toward small caps is a structural change in financing. The last time we saw young companies in numbers zooming to highs was the 1990s. They came to market small and grew in value as their shares were bid up. To raise expansion capital, new companies were obliged to seek listing on a stock exchange. That created real opportunity for small cap investors. In contrast, today's emerging enterprises can raise significant capital without needing to go public. Vast sums are available from private equity funds and other sources.

The global private equity market has reached approximately $9.7 trillion… including both invested capital and un-invested liquidity.

Source: Institutional Limited Partners Association

Available private capital at the start of the Dotcom boom was a fraction of that:

By the end of 1995, the total amount of private equity capital under management (or outstanding) reached ~ $175 billion, having grown from less than $5 billion in 1980.

Source: Federal Reserve Bank of Dallas

At its 1997 initial public stock offering, Amazon had a market value of $438 million. AI pioneer Anthropic is still private. Its recent private funding round valued it at $965 billion—worth two-thousand times the early Amazon.

Summary

In overseeing our clients' capital, we are not per se seeking to trade a short-term rally. It is helpful when the market supports a selection process that includes small and midsized companies. When the earnings trend is supportive, we can reasonably allocate more. When the S&P 500 lopsidedly over-weights mega-cap momentum stocks, looking into small is prudent diversification.

How to play a small cap rally

Our service team relies on our Firm's Chief Market Strategist for ETF ideas and we do not make one-off recommendations ourselves. If anyone is minded trade an index ETF to capitalize on a hoped-for small cap trend, I would point out differences to observe between two small cap indexes.

I would also warn that after a big run up, a near term correction is something to watch for during the summer.

When speaking of "small cap" it is conventional to refer to the Russell 2000. The FTSE Russell indexes are widely used in the investment profession. The Russell 3000 covers up to 98% of US stocks; the Russell 1000 encompasses the largest; the 2000 includes the next 2,000 down in value which together represent only 7% of market value. 40% of Russell 2000 companies are not currently reporting profits. The formerly independent Russell company is now owned by the London Stock Exchange Group (LSEG).

The S&P SmallCap 600 is compiled by DowJones Standard & Poors. Unlike the Russell, its constituent companies are filtered for profitability. In its 2 July 2026 issue, Barron's cites S&P 600 consensus earnings growth estimates of 12% in 2026 and 18% in 2027. That is lower than the 38% estimate for the Russell 2000. However, Barron's puts the S&P 600's PE at only 17x while Russell 2000 is 27x.

One must beware that initial earnings estimates for small caps are often later revised downward and to a greater degree than is the case for large cap. There is also a mass of conflicting and stale data in investment media reporting on small companies— not just an annoyance for investment professionals but a risk for part time investors.