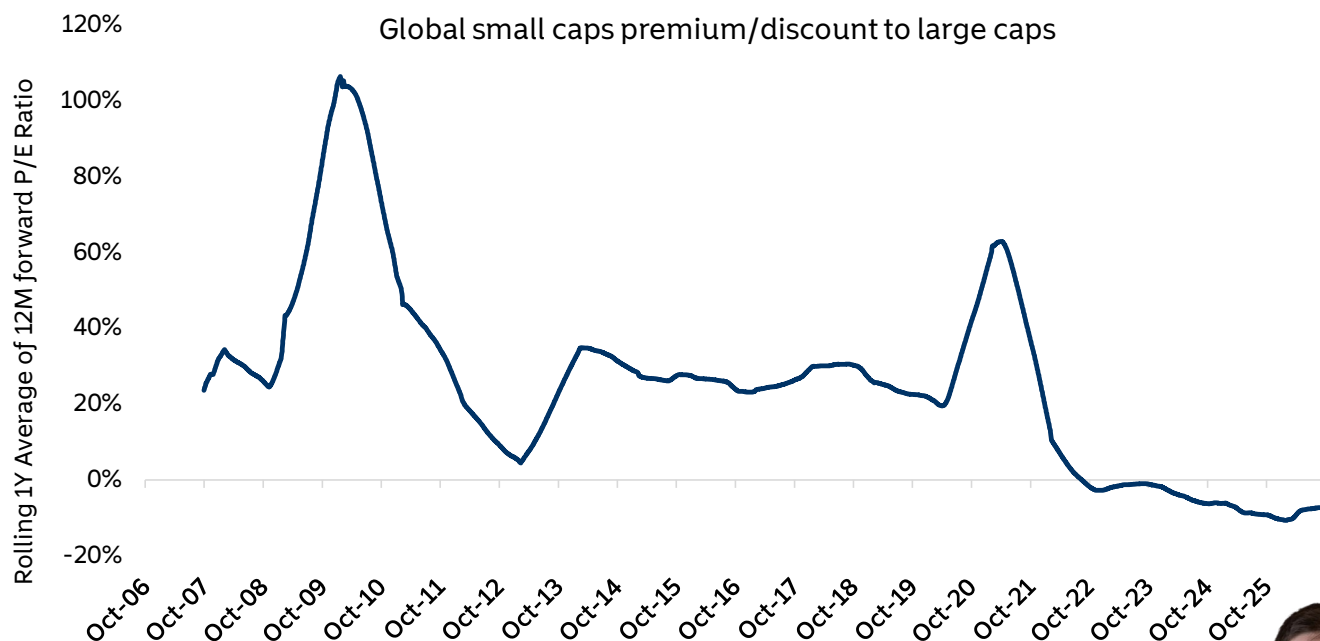




Chart of the Week

26 October 2026

momentum
global investment management



Source: Absolute Strategy Research, MSCI, Bloomberg Finance L.P., as of 22 October 2026

David cheaper than Goliath

Lorenzo La Posta, CFA - Portfolio Manager



What does the chart show?

Small caps have moved from a valuation premium to a discount. The chart compares global small-cap and large-cap forward price-to-earnings ratios, using a rolling one-year average. Smaller companies traded at higher multiples for much of the past two decades, but this relationship has reversed in recent years. The latest reading shows an average discount of approximately 8%, giving investors a very different starting point from the premiums seen previously.

Why is it important?

The investment case rests not just on cheaper valuations, but on evidence that fundamentals are stronger than prices suggest. Concerns about borrowing costs are understandable: smaller companies typically have lower credit ratings and more floating-rate debt, rising corporate bond yields have therefore weighed on their relative performance.

However, financing costs are only part of the picture. The ability to service debt also depends on revenues and profits. Small- and mid-cap operating margins are at record levels, with sales growth estimated to be in double digits. Pricing power has supported high revenues and helped companies absorb higher interest charges. Crucially, the typical interest-cover ratio has risen during 2026, suggesting that debt-servicing capacity has improved, not weakened.

The earnings outlook adds support. Although earnings revisions have softened ahead of third-quarter results, small- and mid-cap revisions remain historically strong. Their expected earnings growth is almost as strong as that of US large caps (excluding AI hyperscalers), hence investors can access broadly comparable expected growth at substantially lower valuations, without necessarily accepting weaker growth for a cheaper price.

Smaller companies also offer different equity exposure, with only 14% in technology, versus 32% for large caps, and greater exposure to industrials, financials, health care and consumer discretionary. This offers potential diversification for portfolios whose returns have become increasingly dependent on the AI investment cycle.

Today's discount deserves attention, but cheapness is not everything, as higher borrowing costs remain a risk, and record margins may be difficult to sustain. Nevertheless, discounted valuations, resilient earnings and improving debt coverage make a stronger case for considering small caps now than valuation alone would suggest. The opportunity is to invest before these strengths are fully reflected in prices.



Markets balanced persistent inflation and geopolitical energy risk against resilient activity and lower bond yields. Technology volatility exposed concentration concerns, while regional policy and fiscal differences produced increasingly varied market outcomes.



US

- » Artificial-intelligence shares experienced renewed volatility as investors questioned the scale, funding and near-term returns of data centre spending. The move was concentrated rather than a broad market retreat, with smaller companies and several defensive sectors proving more resilient.
- » Treasury yields fell sharply late in the week as weakness in highly valued technology shares increased demand for government bonds. The move eased financial conditions at the margin, even though inflation remained above the Federal Reserve's target.
- » The housing market weakened further: housing starts declined for a third consecutive month, while builder confidence and pending sales remained subdued. High mortgage rates and construction costs continued to constrain activity.
- » Third quarter company results presented a mixed but broadly stable economic picture. Consumer demand and industrial activity remained resilient, while higher energy, freight and other input costs placed pressure on some profit margins.



UK

- » Consumer-price inflation rose to 3.5% in September, with higher fuel and services prices reinforcing concerns about domestic price pressures. Markets consequently placed greater weight on the possibility of a BOE rate increase in November.
- » Labour market data were mixed: the unemployment rate improved, but the claimant count increased and pay growth remained firm. This combination complicated the Bank of England's assessment of how much demand had cooled.
- » Government borrowing was higher than expected ahead of the 28 October Budget, keeping fiscal credibility and future gilt issuance in focus. Investors remained sensitive to any measures that could increase medium-term funding needs.
- » Business surveys suggested manufacturing output may be stabilising, but weak orders, high costs and limited investment intentions continued to signal a fragile recovery. Sterling was supported by the comparatively firm interest-rate outlook.



Europe

- » French fiscal stress stayed central to European bond markets. Higher sovereign yields tightened financial conditions and raised questions about how far the European Central Bank might need to respond if market pressure intensified.
- » ECB communication remained cautious. Policymakers acknowledged above target inflation, but also noted that higher bond yields could slow growth and reduce the need for a more forceful interest-rate response.
- » Corporate results were uneven. Energy, healthcare and selected industrial companies benefited from pricing power or strong orders, while technology, banks, travel and consumer facing companies faced pressure from higher costs and demanding expectations.
- » Higher oil prices and renewed Middle East tensions lifted energy shares but created a less comfortable backdrop for transport, manufacturing and household spending. This reinforced Europe's difficult trade off between weak growth and inflation risk.



Rest of the World/Asia

- » Chinese equities remained under pressure as investors weighed softer domestic confidence against strong export growth. Evidence that some shipments had been brought forward raised questions about the durability of the external growth contribution.
- » In Japan, expectations for further monetary policy normalisation strengthened. Bank of Japan communication suggested underlying inflation was approaching its target, increasing attention on the possibility of a rate rise later in the year.
- » Across Asia, technology shares remained volatile as concerns about artificial intelligence financing and elevated expectations spread from the United States. Semiconductor demand stayed robust, but valuation and funding risks drove sharp market dispersion.
- » Brazil Lula has narrowly defeated Flávio Bolsonaro, taking 51.8% of the vote vs 48.2%. The tight result and Bolsonaro's challenge could keep political uncertainty elevated, with the initial market reaction potentially negative as polls had suggested a narrow victory for the more market-friendly Bolsonaro.



Weekly market data

Week ending 23 October 2026

Cumulative returns					
Asset Class / Region	Currency	Week ending 23 October	Month to date	YTD 2026	12 months
Developed Markets Equities					
United States	USD	-0.5%	-0.3%	12.1%	14.1%
United Kingdom	GBP	-1.7%	1.2%	10.9%	15.7%
Continental Europe	EUR	-1.3%	-0.4%	8.5%	11.7%
Japan	JPY	-2.5%	-3.5%	18.8%	24.6%
Asia Pacific (ex Japan)	USD	-2.2%	-7.4%	14.6%	15.9%
Australia	AUD	-0.1%	0.1%	3.8%	0.7%
Global	USD	-0.7%	-0.5%	11.2%	13.6%
Emerging Markets Equities					
Emerging Europe	USD	-4.1%	-6.0%	17.9%	25.4%
Emerging Asia	USD	-2.7%	-9.0%	15.4%	16.9%
Emerging Latin America	USD	-0.3%	9.1%	25.2%	37.1%
BRICs	USD	-3.4%	-2.5%	-12.4%	-14.3%
China	USD	-4.5%	-6.6%	-17.7%	-21.3%
MENA countries	USD	-3.5%	-6.5%	-7.7%	-12.8%
South Africa	USD	-4.3%	-2.2%	-6.3%	4.6%
India	USD	-2.3%	1.1%	-17.2%	-18.3%
Global emerging markets	USD	-2.6%	-7.4%	14.3%	16.6%
Bonds					
US Treasuries	USD	0.6%	1.9%	-0.9%	-1.3%
US Treasuries (inflation protected)	USD	0.6%	2.2%	-0.1%	-0.9%
US Corporate (investment grade)	USD	0.3%	1.6%	-1.3%	-1.6%
US High Yield	USD	-0.2%	-0.2%	-0.1%	1.1%
UK Gilts	GBP	0.1%	1.0%	-1.5%	-0.9%
UK Corporate (investment grade)	GBP	-0.3%	0.2%	-1.0%	-0.2%
Euro Government Bonds	EUR	-0.3%	0.6%	-2.7%	-3.6%
Euro Corporate (investment grade)	EUR	-0.4%	0.4%	-0.9%	-1.3%
Euro High Yield	EUR	-1.1%	-1.6%	-1.6%	-0.8%
Global Government Bonds	USD	0.4%	1.1%	-1.5%	-2.0%
Global Bonds	USD	0.2%	1.1%	-2.1%	-2.1%
Global Convertible Bonds	USD	-0.6%	-5.7%	5.8%	5.8%
Emerging Market Bonds	USD	0.0%	1.2%	-1.3%	0.4%
Property					
US Property Securities	USD	1.1%	1.9%	11.6%	8.3%
Australian Property Securities	AUD	0.2%	-2.0%	-16.8%	-21.9%
Global Property Securities	USD	0.8%	1.0%	3.4%	1.9%
Currencies					
Euro	USD	-0.2%	-1.3%	-4.6%	-3.6%
UK Pound Sterling	USD	0.4%	0.8%	-0.6%	0.4%
Japanese Yen	USD	0.8%	0.2%	-0.1%	-2.7%
Australian Dollar	USD	1.2%	1.2%	5.4%	8.0%
South African Rand	USD	-0.7%	-1.0%	-0.2%	4.5%
Swiss Franc	USD	0.0%	1.2%	-3.8%	-3.6%
Chinese Yuan	USD	0.2%	0.5%	4.8%	6.8%
Commodities & Alternatives					
Commodities	USD	-0.2%	3.2%	46.7%	48.2%
Agricultural Commodities	USD	-2.2%	-3.4%	12.6%	10.8%
Oil	USD	6.2%	12.7%	91.8%	76.9%
Gold	USD	-3.9%	-3.8%	-7.4%	-3.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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