

What's Coming in 2024 for Small-Cap Stocks

DOUG GERLACH • EDITOR-IN-CHIEF • FEBRUARY 2024



About Our Stock Newsletters

Investor Advisory Service

- Started in 1973.
- Recommends long-term stock picks (small, mid, large).
- Focuses on total return largely driven by capital appreciation.
- Named to **Hulbert Investment Newsletter Honor Roll** for last 13 years for long-term outperformance in both bull & bear markets.

SmallCap Informer

- Started in 2012.
- Recommends long-term-oriented small company stocks with strong value component to total return approach.
- Provides monthly follow-ups & sale recommendations.
- Outperformed S&P SmallCap 600 in last 1-, 3-, 5-, 10-year & lifetime of newsletter.

Dividend Informer

- Started in 2023.
- Recommends fundamentally-strong dividend payers, seeking total return with strong dividend & buyback components.
- Published online & via email throughout month with analyses, updates, commentary.

Using Our Stock Newsletters



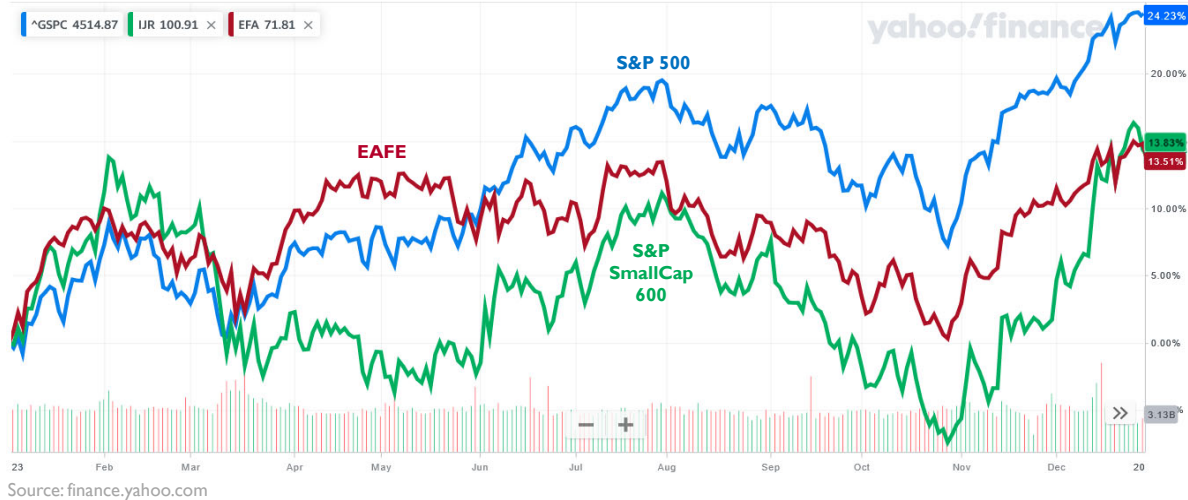
- We do not manage “model portfolios” with picks.
- Serve instead as **research service**, identifying stocks of interest.
- Recommend stocks each month for subscribers to consider.
 - Update buy/sell prices of all covered stocks.
 - Discontinue stocks/make sell recommendations as needed.
- Subscribers construct own portfolios using our guidance.

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Looking Back at Stock Market Performance in 2023



2023 Performance Small vs. Large vs. International



2023 Performance Trends

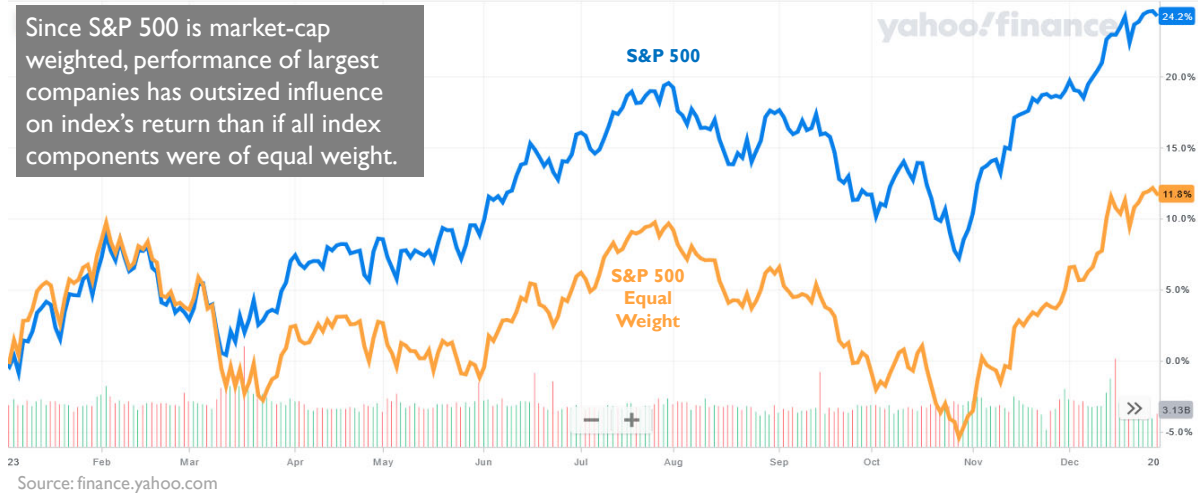


- Each of these segments (large, small, international) led during some part of year.
- S&P 500 ended year up near-record 24.2% (led by “Magnificent 7”).
- Small-caps posted 13.8% gain.
- EAFE posted 13.5% gain.

Magnificent 7 Impact on S&P 500



Since S&P 500 is market-cap weighted, performance of largest companies has outsized influence on index's return than if all index components were of equal weight.



Small Companies Held Back in 2023

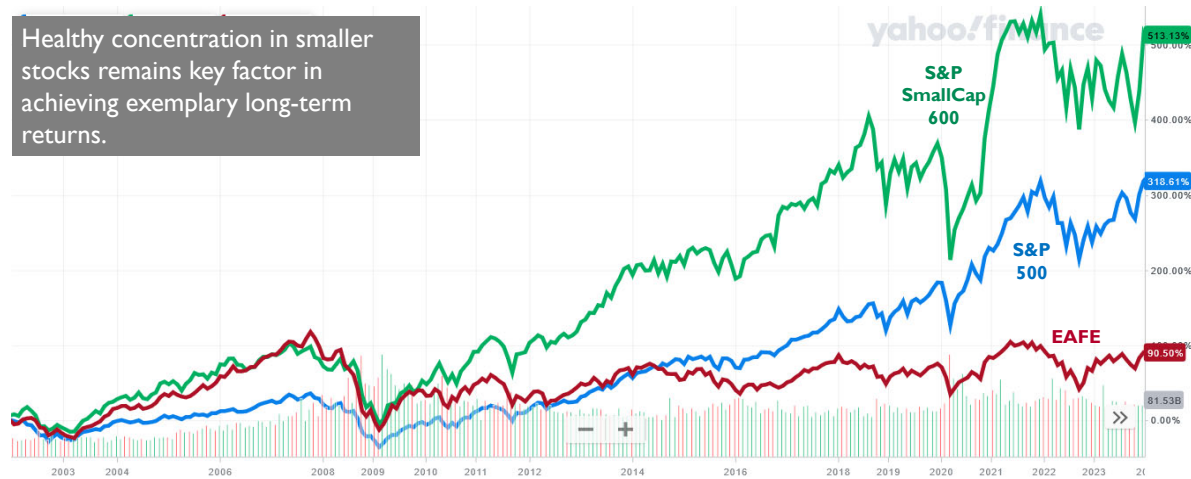


- Nervous investors prefer large stocks during uncertain times, but will rush to small stocks when optimistic.
- Small-caps lead early in year before dropping off due to worries about recession & higher interest rates.
- Led all segments downward for most of year.
- Were biggest beneficiary of October optimism about coming Fed rate cuts.

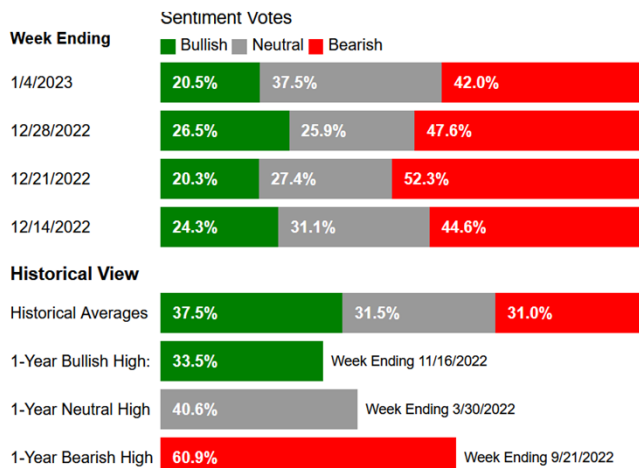
What's Coming in 2024 for Small-Cap Stocks by Doug Gerlach
 Founder & Editor-in-Chief, *SmallCap Informer*

Small vs. Large vs. International (2002-2023)

Healthy concentration in smaller stocks remains key factor in achieving exemplary long-term returns.



Investors Were Bearish in Jan '23 (Which is Bullish)



← 1/4/2023: Where did AAll members feel the stock market would be in the next 6 months?

Key Takeaways on Current Economy



My 2022 Predictions Were Correct

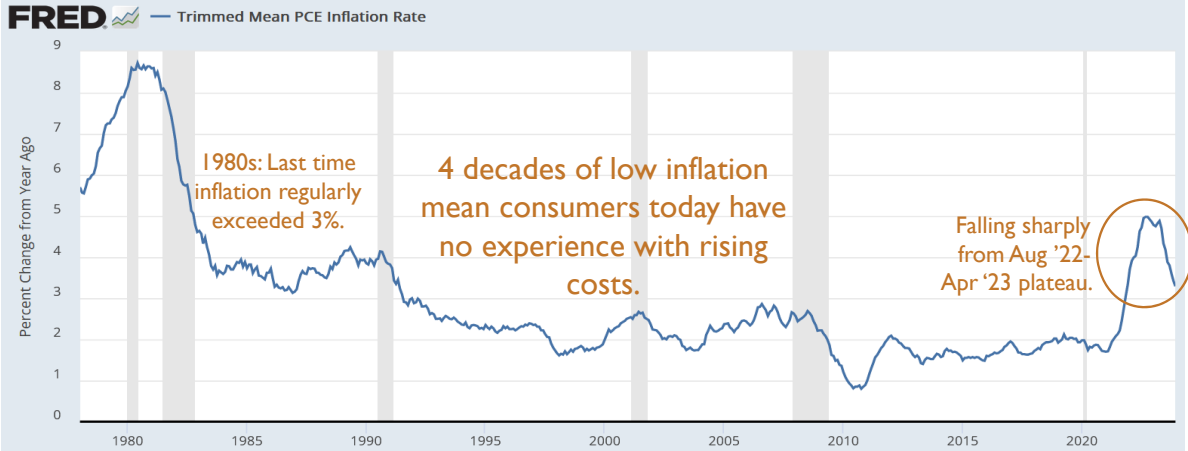


- In early 2024, there is finally growing consensus that risk of significant or lengthy recession is low, matching my observations of 2022.
- My assessments:
 - ✓ Economy wouldn't deteriorate significantly worse than it had by mid-2022.
 - ✓ Gradual economic recovery was more likely than continued drop-off.
 - ✓ Mixed economic signals throughout year meant there were always pockets of strength that would forestall disaster.
 - ✓ Americans lack of experience with inflation, higher interest rates, & bare product shelves caused drop-offs in consumer confidence but few meaningful shifts in behavior.

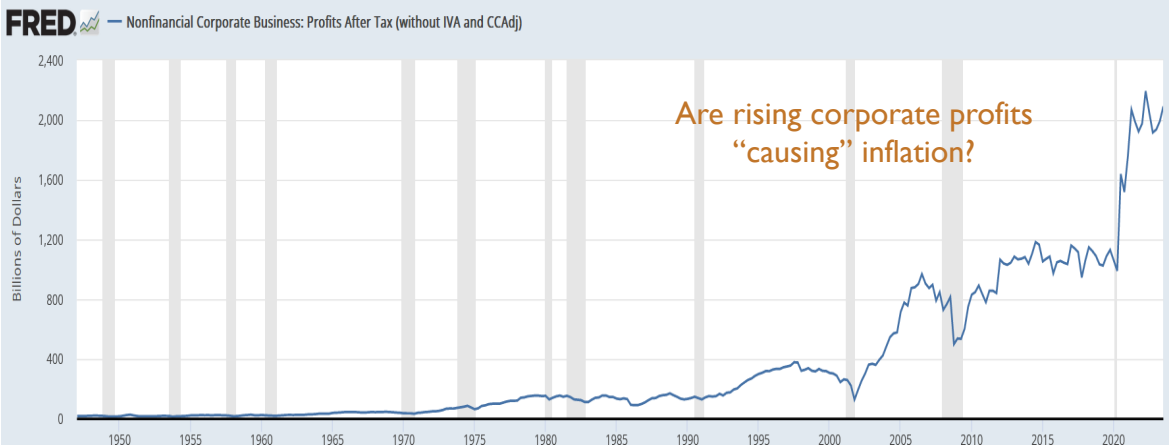
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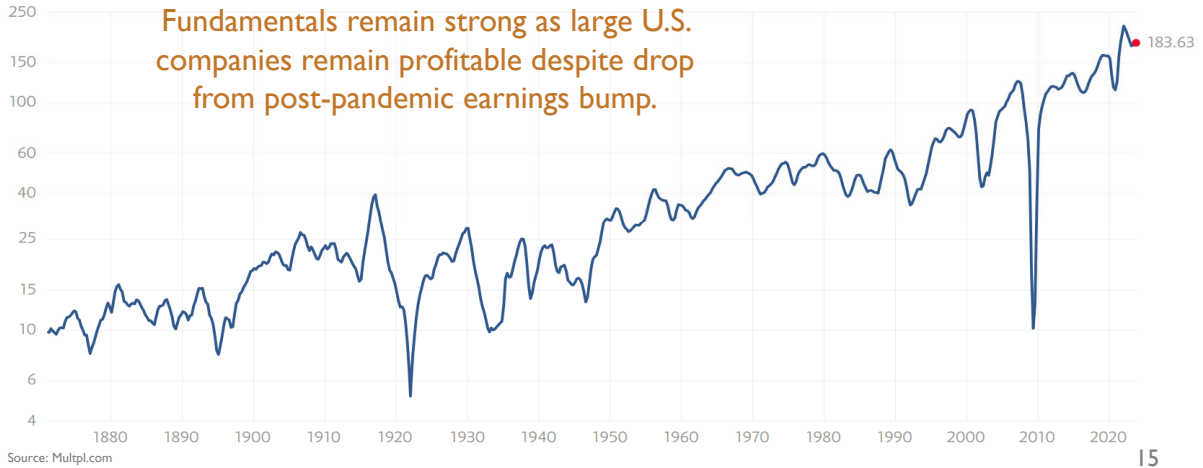
Unusual Times for Core Inflation



Unusual Times for Corporate Profits

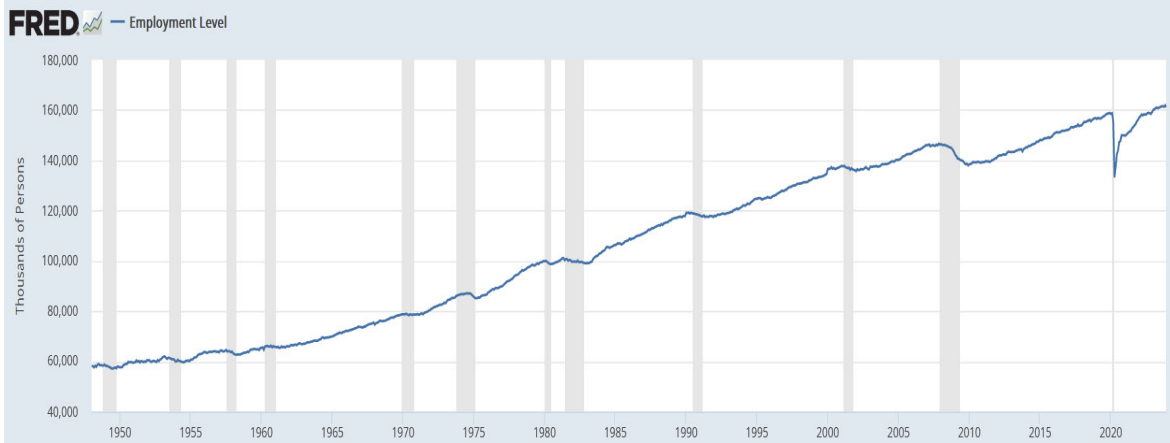


S&P 500 Earnings Still Strong



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Americans Are Working



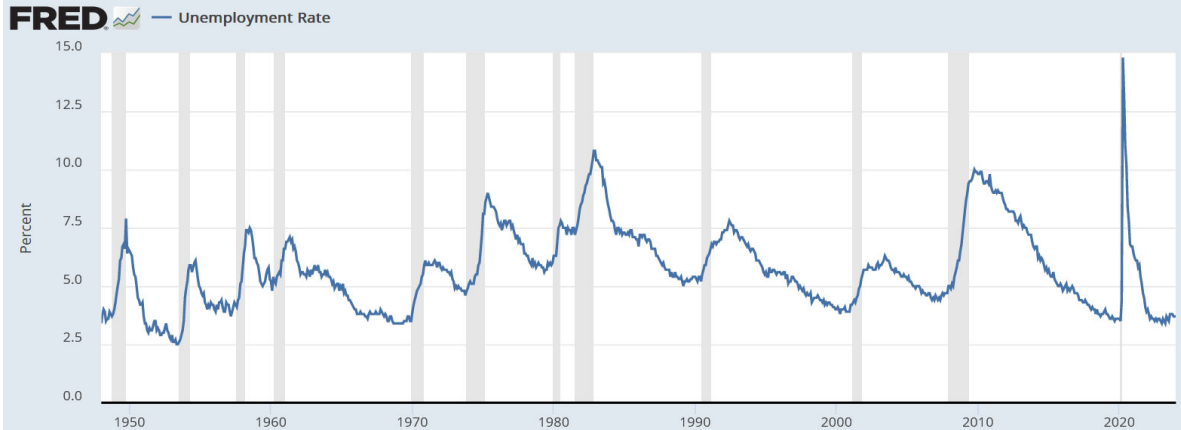
U.S. Bureau of Labor Statistics, Employment Level [CE16OV], retrieved from FRED, Federal Reserve Bank of St. Louis

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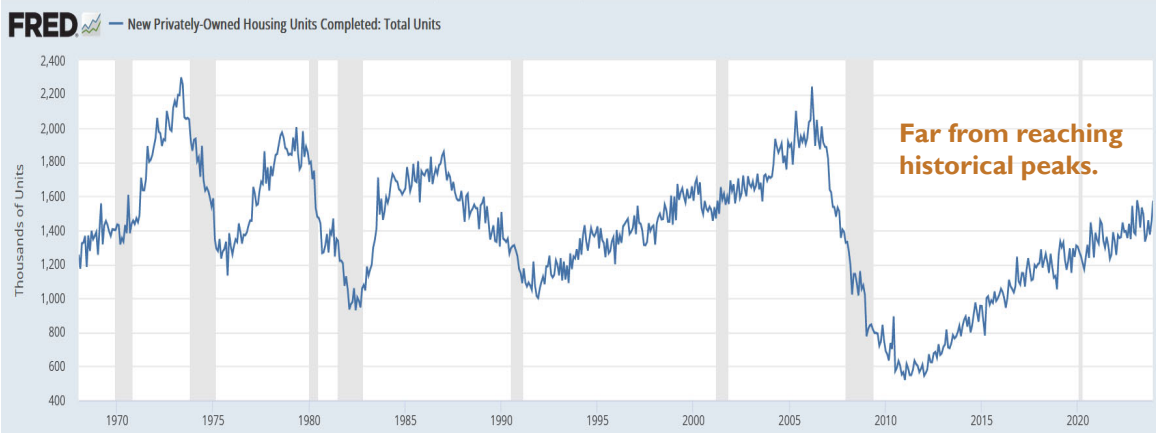
Founder & Editor-in-Chief, *SmallCap Informer*

Unemployment Is Low



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New Housing Units Completed



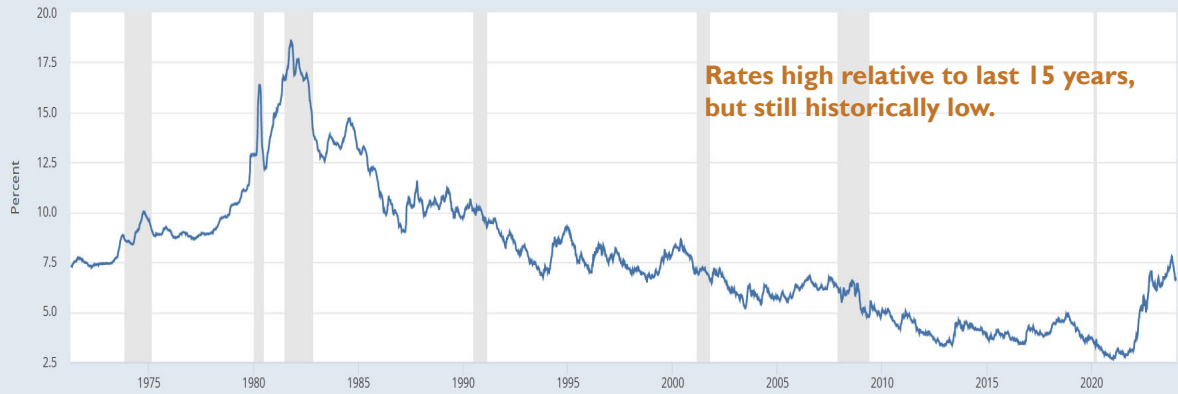
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30-Year Fixed Mortgage Rates Over Time



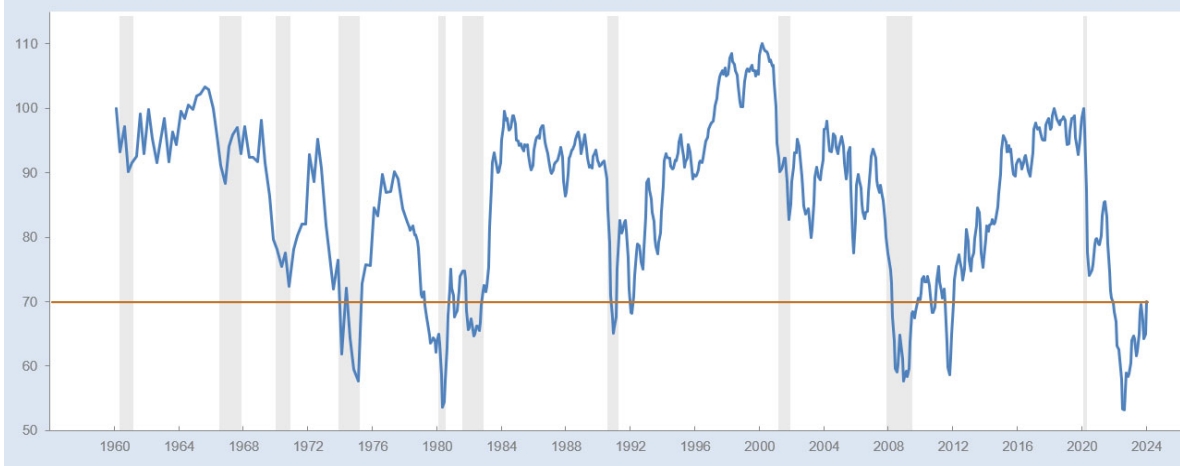
FRED — 30-Year Fixed Rate Mortgage Average in the United States



Retrieved from FRED, Federal Reserve Bank of St. Louis.

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Consumer Sentiment Is Rising



Source: University of Michigan Surveys of Consumers

Small-Caps & the Economy



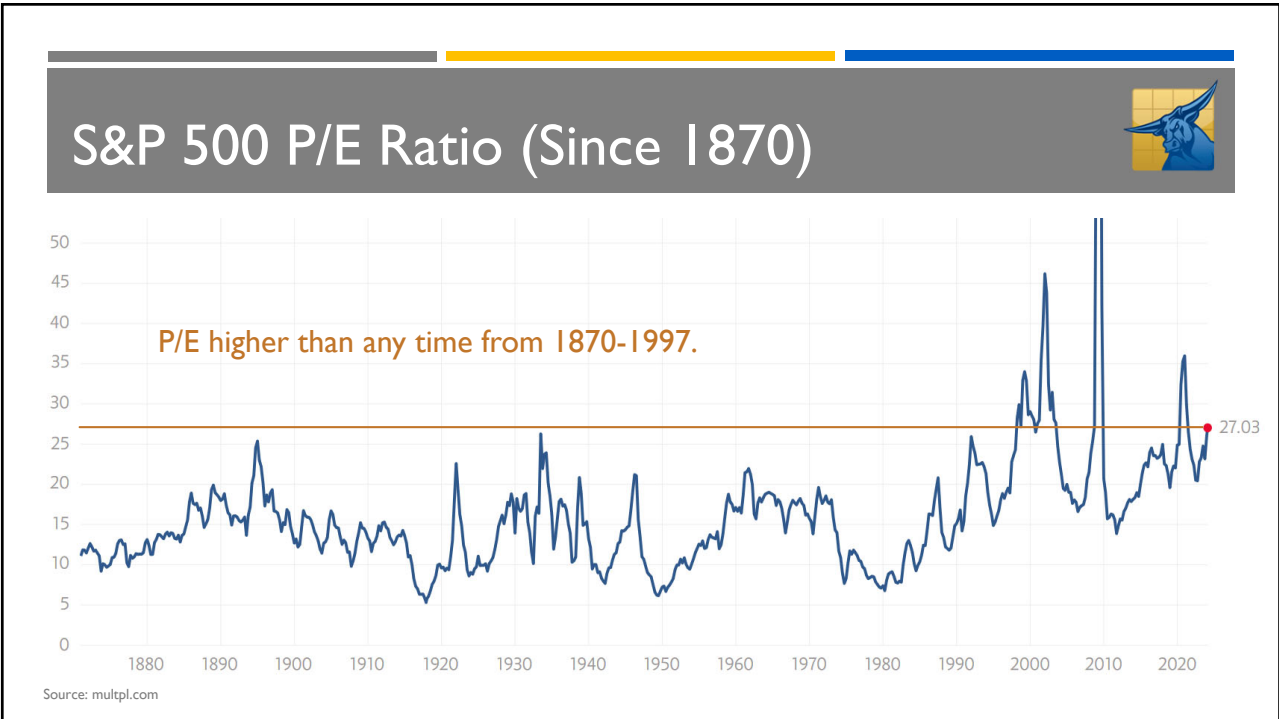
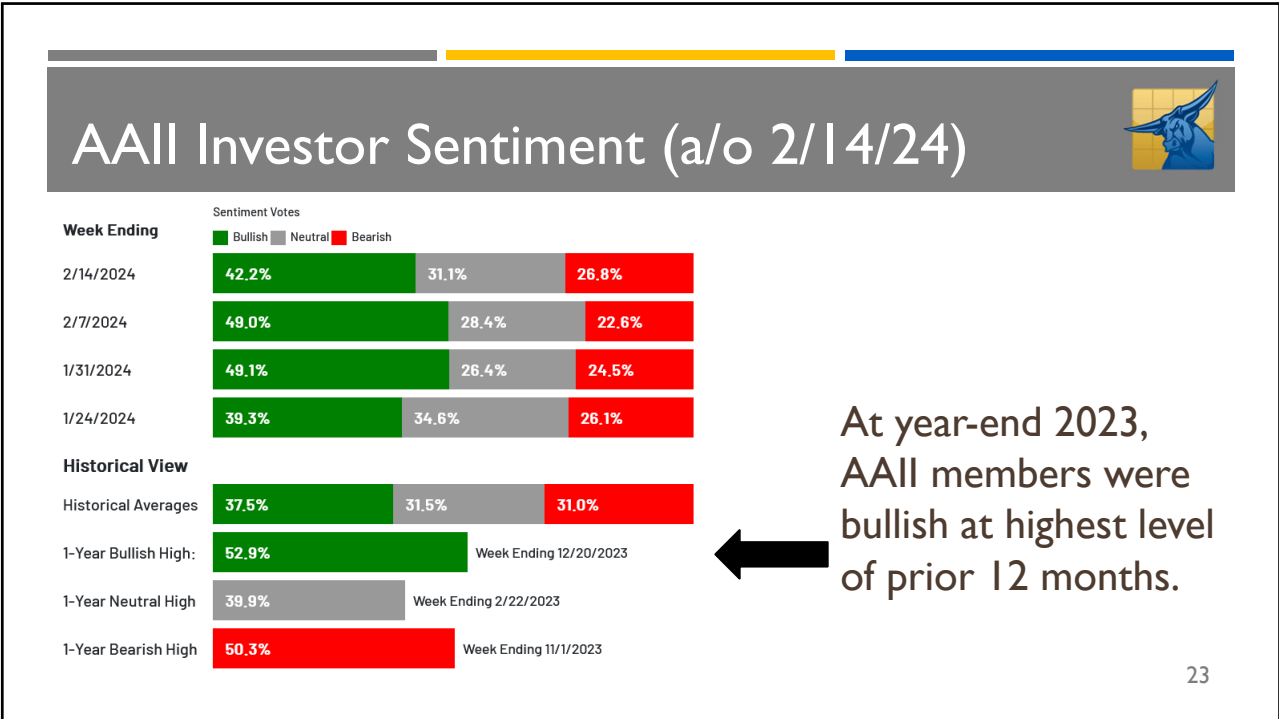
- Small companies are perceived as being more susceptible to recessions & higher interest rates/borrowing costs.
 - Last October's small-cap surge came as expectations grew that Fed rate cuts were on the way.
- In uncertain times, investors stick with known names & leave behind small companies.
- This creates opportunities which are magnified after macroeconomic improvements.

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Market Outlook for 2024 (& Beyond)

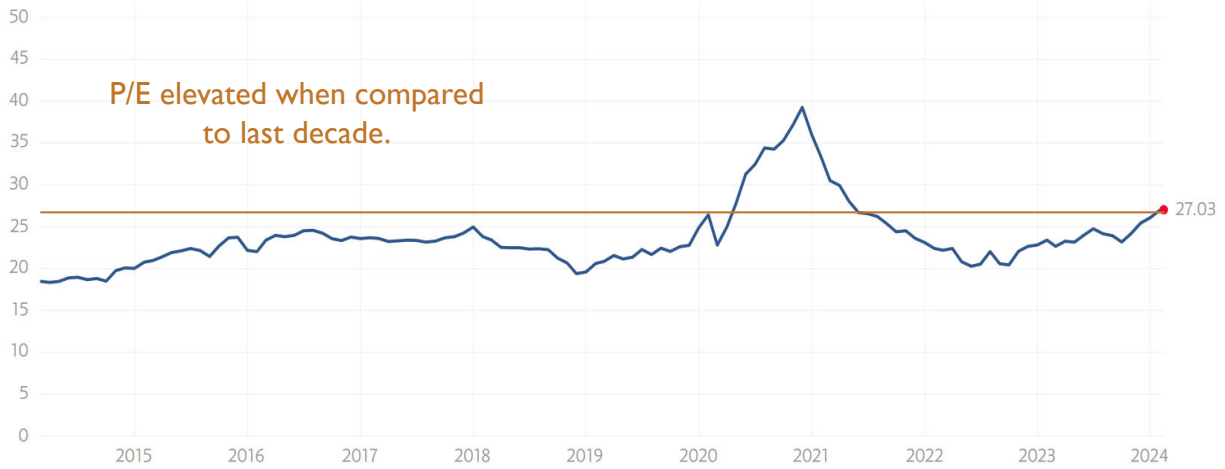


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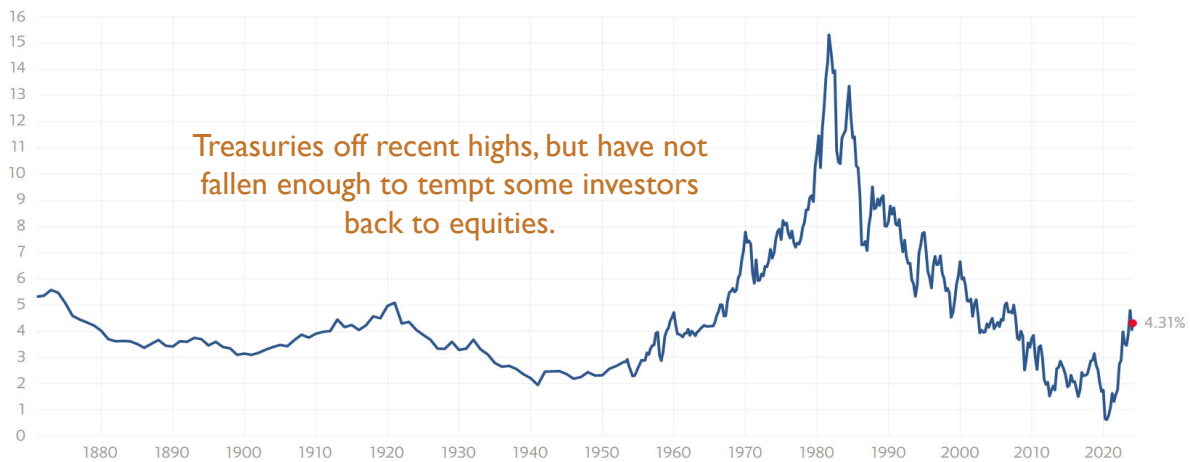
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S&P 500 P/E Ratio (Since 2014)



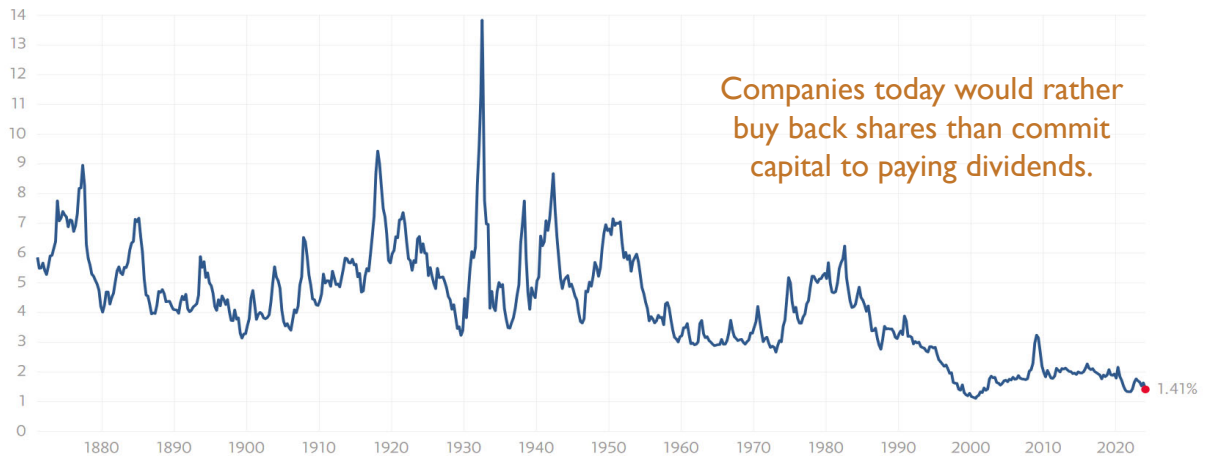
Source: multpl.com

10 Year Treasury Rate



Source: multpl.com

S&P 500 Dividend Yield



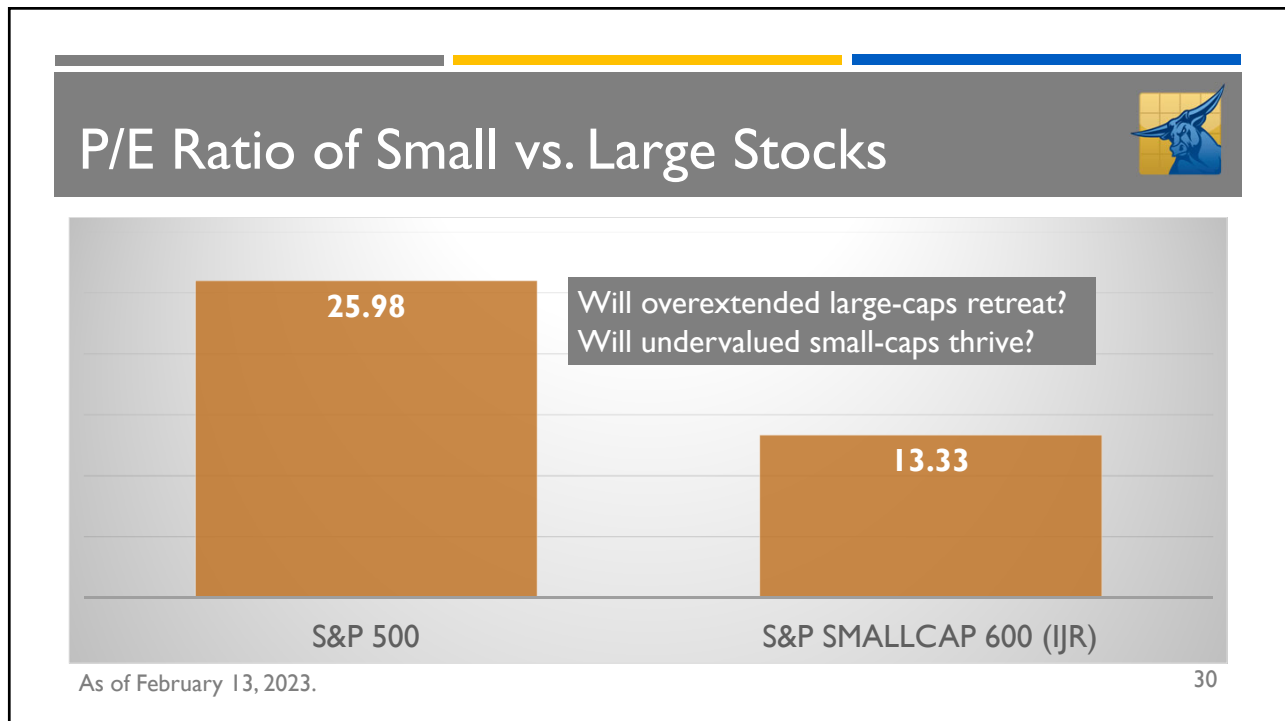
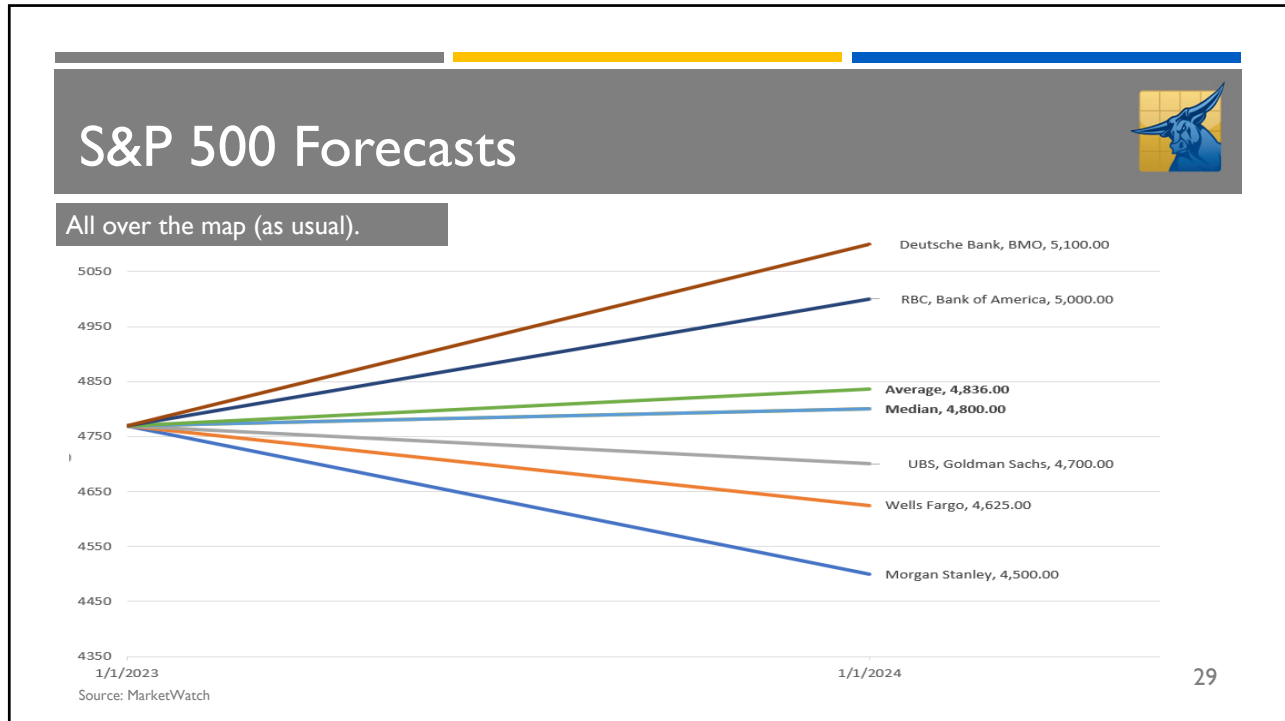
Source: multpl.com

The Bear Case for Large-Caps in 2024



- P/Es are above historical median since 1999 across **all** S&P 500 industry groups.
- Bloomberg: Median target among 20 Wall Street strategists tracked shows S&P 500 finishing 2024 at 4,850, less than 2% higher than where it closed 2023.
- Aoifinn Devitt, London CIV: “Valuations of tech stocks suggest that growth is due to have a pullback.”

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Bull Cases for Small-Caps in 2024



- Bank of America Global Fund Manager Survey: For 1st time since June 2021, more managers expect large-caps to gain **less** than small-caps in next 12 months.
- Chuck Royce: “I think that small-cap stocks are poised for recovery. And while I usually prefer to avoid economic predictions, I also believe that many small-caps have already priced in a recession or economic slowdown.”
- Tom Lee, Fundstrat: “I think small caps could rise 50% next year easily. And Financials could rise 30%...When it comes to positioning no one owns Financials and no one's really long small caps. There's a lot of upside.”
- David Kostin, Goldman Sachs: “An environment of falling interest rates and improving economic growth expectations historically has been supportive for small-caps, which have recently traded at depressed valuations.”

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My Take on Market in 2024



- Hard to see Magnificent 7 continuing to rise from here.
- But even if rest of S&P 500 performs well, it will be difficult to catch Magnificent 7-level returns.
- Improving consumer confidence & perceptions of market valuations will serve small- & mid-caps to larger degree than large-caps.
- Most of Fed's expected interest rate moves already baked into market valuations.

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Whatever Happens in Market...



- Maintain your plan & stay the course.
- Companies that grow their **EPS over time** will see their share prices grow **over time**.
- Focus on higher-quality companies relative to peers.
- Avoid buying stocks solely due to near-term catalysts ***unless*** you have plan to mitigate volatility.
- Be prepared for sudden market reversals, but know that they may only be temporary.

2024 Top Small-Cap Stocks



Top Small-Cap Stocks for 2024



- Email me at gerlach@iclub.com for PDF of report.
- Report published in mid-January based on stocks with best potential for total return in 2024, selected from current coverage.
- Focus is on long-term performance, but Top Stock selections offer “second look” at previously-recommended stocks with metrics that warrant consideration.

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What Do We Look For in Small Stocks?



- Companies should be above \$100M & below \$2B in TTM revenues when coverage initiated.
 - Do carry companies in newsletter as they get bigger as long as fundamentals remain strong.
- Companies must be profitable.
- Companies typically have >3 years of operating history.
- We call our analysis methodology “**Q-GARP.**”
 - **Growth At a Reasonable Price** (GARP) with a significant **Quality (Q)** component.

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Q-GARP Investing



- **Growth** – Company must be profitable with acceptable historical growth, typically not below 8% annualized.
 - Must have identifiable future growth drivers.
- **Reasonable Price** – Stock should be selling at or below average past & future valuations.
 - Buying below-average P/E ratio provides margin of safety if fundamentals stagnate.
- **Quality** – Company must have pre-tax profit margins that compare well to peers & industry averages.
 - These margins serve as proxy for other balance sheet & management ratios.

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What We Avoid



- Unprofitable companies.
- Companies with long-term downtrends of sales/EPS.
- Turnaround companies.
- Hyper-valued stocks.
- Penny stocks/micro-caps.

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We Skew Towards Small-Cap Value



- Over time, best-performing sub-asset class is **small-cap value**.
 - However, this can be difficult to achieve as investor in individual equities, since requires buying stocks that no one has heard of & no one likes.
- Our coverage skews towards:
 - Stocks with lower P/E ratios than market.
 - Companies with slower growth than many growth investing strategies require.
 - Fallen angels (though cautious

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SCI Top Stocks for 2024



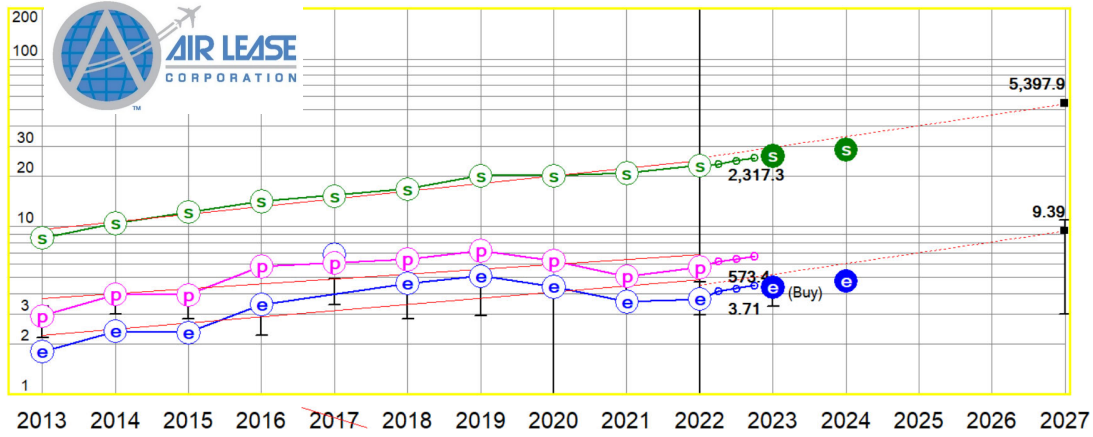
Sym	Company	Curr Price	Curr P/E	Proj EPS Grth	Proj Tot Ret	Rel Value	U/D Ratio	Curr Yld	Buy Up To	Sell Above
AL	Air Lease	\$42.29	9.5	16.0%	22.3%	82.4%	5.5	2.0%	50.1	\$90
ALNT	Allient	\$27.88	19.2	11.0%	23.5%	70.4%	13.7	0.4%	38.0	\$66
IIPR	Innovative Industrial	\$92.76	11.8	8.0%	22.8%	78.3%	4.0	6.2%	99.9	\$172
INMD	InMode	\$22.90	10.9	13.8%	32.1%	60.3%	15.8	0.0%	36.9	\$74
INTT	inTest Corp	\$11.92	11.6	12.0%	27.8%	67.3%	8.9	0.0%	16.7	\$33
OBDC	Blue Owl Capital Corp.	\$14.81	7.3	8.0%	20.8%	90.1%	4.6	9.5%	15.9	\$23

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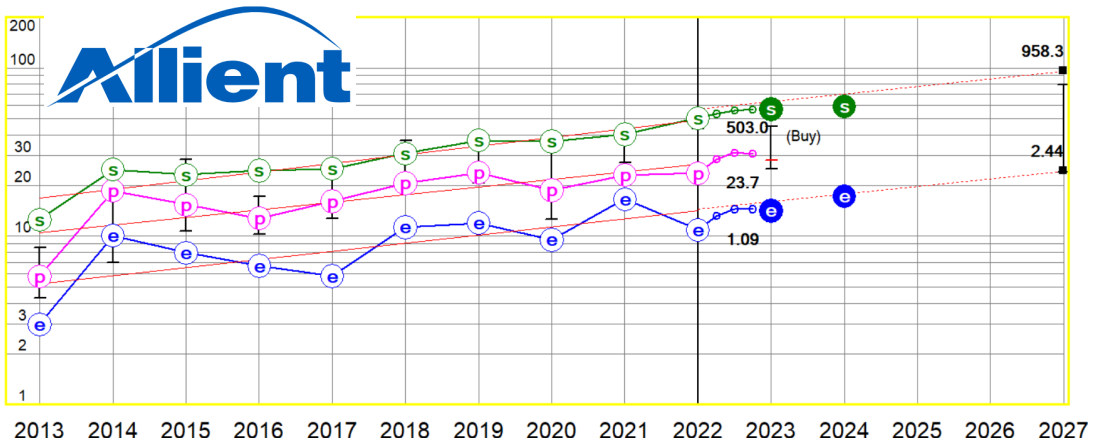
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Air Lease (AL)



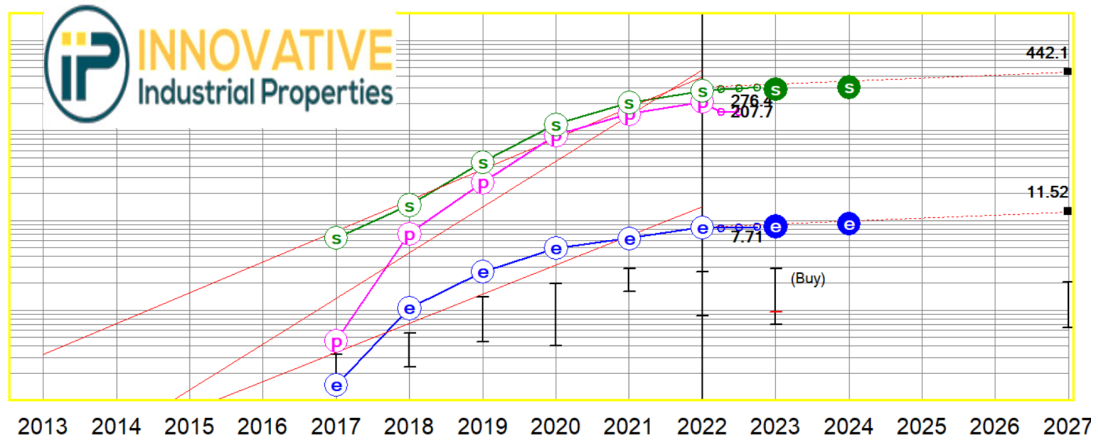
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Allient (ALNT)



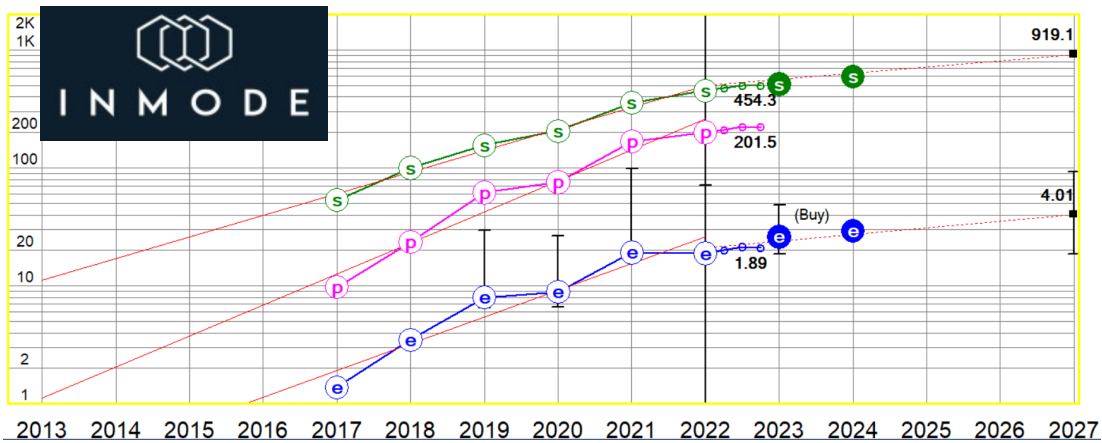
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Innovative Industrial Properties (IIPR)



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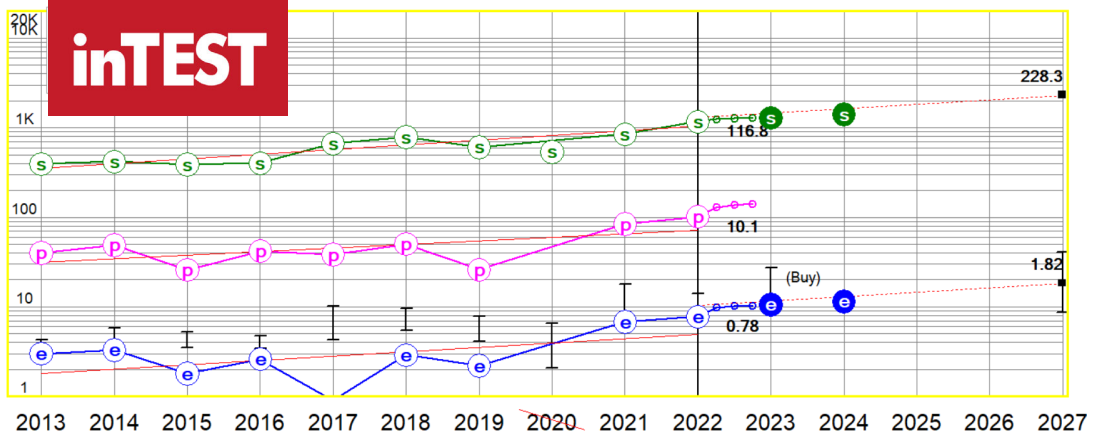
InMode (INMD)



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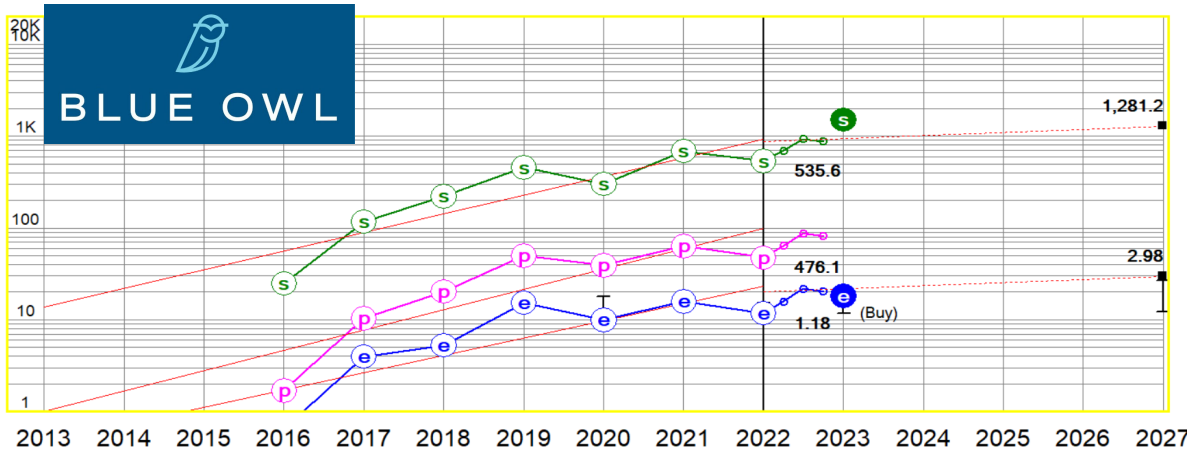
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InTest (INTT)



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Blue Owl Capital Corp. (OBDC)



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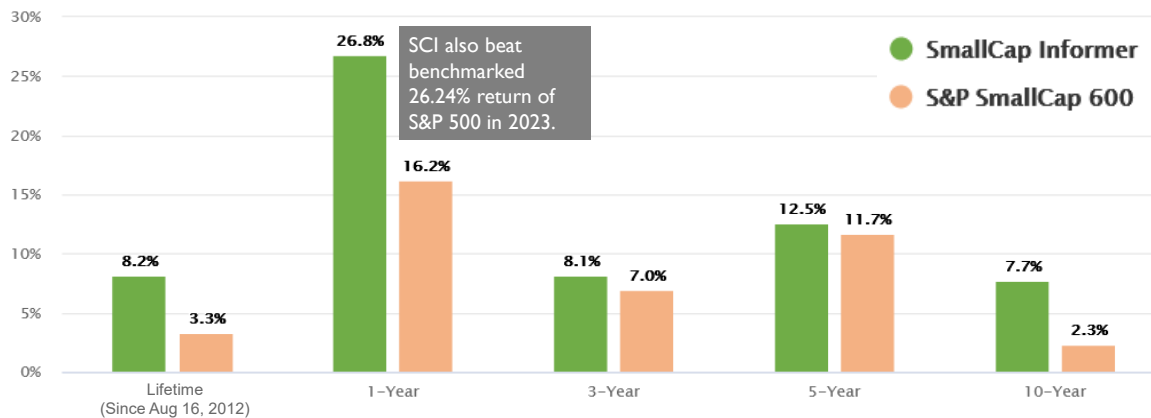
Our Newsletters' Performance Records



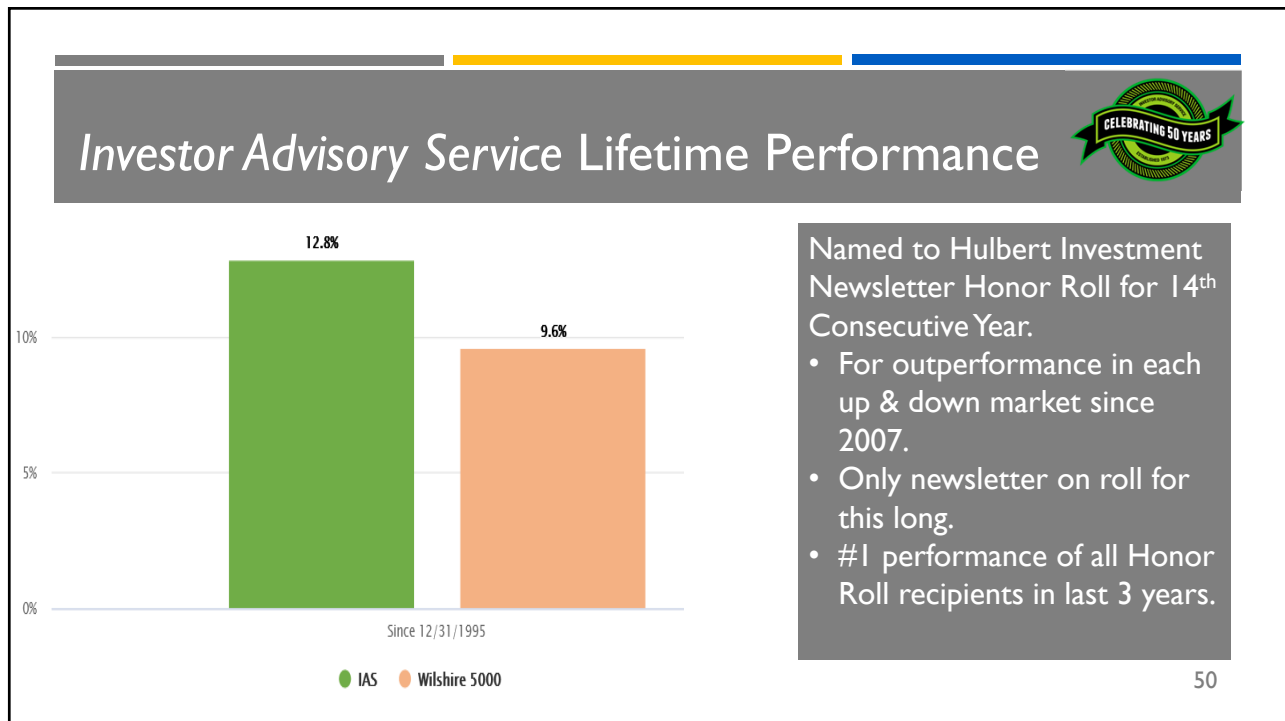
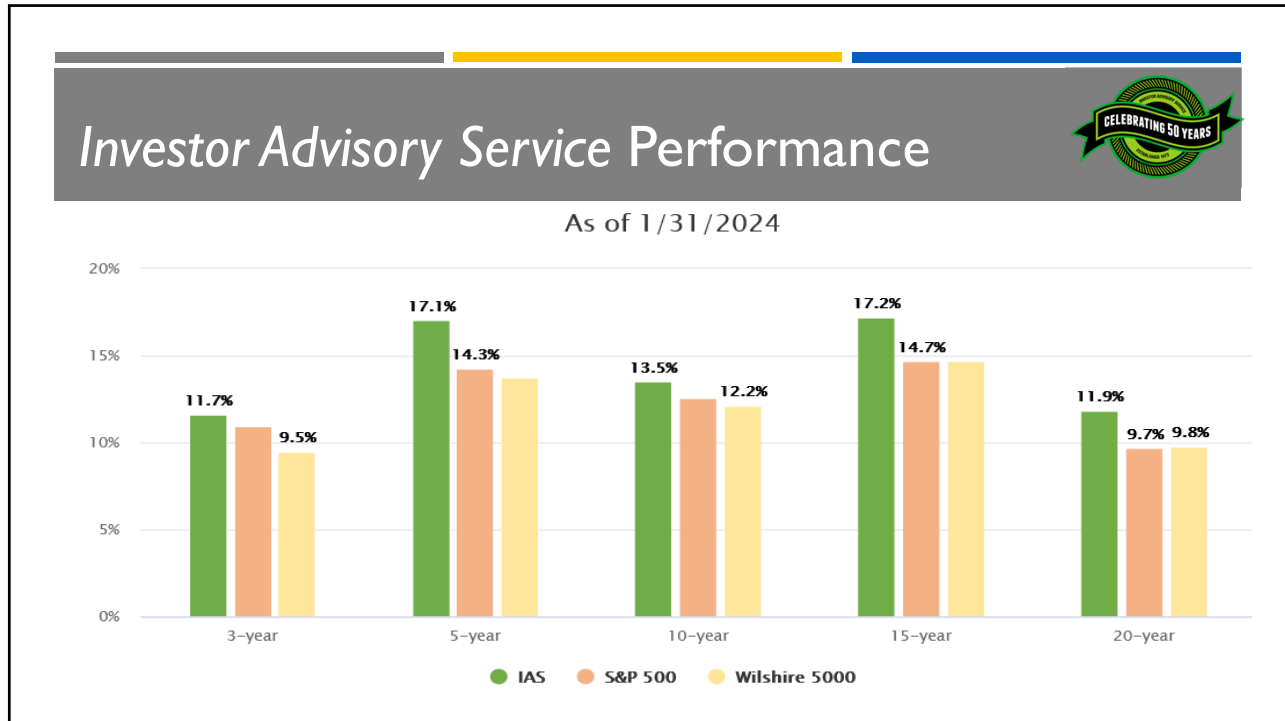
SmallCap Informer Performance



Compound Annual Return for Periods ending December 31



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How Our Newsletters Differ



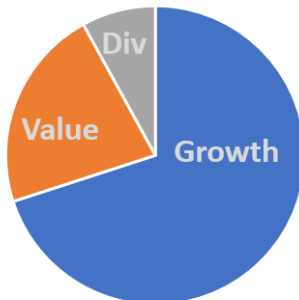
- All are focused on long-term buy-and-hold style investing in individual stocks
- Aim to generate sufficient total return to outperform market or segment.
- Differences come from where returns are generated:
 - Capital appreciation (growth).
 - Dividends.
 - P/E expansion (value).

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Source of Total Return in Newsletters



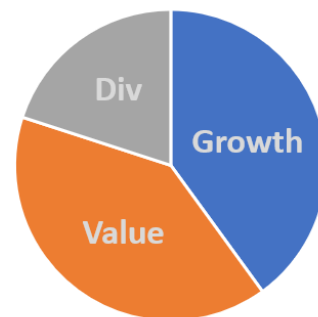
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Stocks for 2024” Special
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