

Small/Mid-Cap Valuations

Small caps priced for conditioned credit deterioration, no manufacturing recovery

Small Cap

Small caps got cheaper in January

SMID-cap multiples contracted amid Jan.'s sell-off: the Russell 2000 forward P/E fell to 14.3x from 14.7x and the Russell MidCap P/E fell to 17.0x from 17.2x. Meanwhile, the Russell 1000 forward P/E expanded to 19.9x from 19.7x. This put the relative P/E for small vs large at 0.72x (from 0.75x), 28% below the historical average. Small caps remain the only size segment that is historically cheap, with their P/E 6% below avg. vs. 28% above avg. for large caps and 11% above avg. for mid caps. For long-term investors (where P/E is more predictive over a 10yr horizon than near term), valuations imply 10% annualized returns over the next decade for the Russell 2000 vs 3% for the Russell 1000.

What's priced in now? Cont'd Mfg. recession, tighter credit

The most correlated macro indicator with small caps' relative performance is the ISM Mfg. index, which has been in contractionary territory. But small cap valuations today discount this trend continuing (pricing in ISM = 48, below today's level of 49). But several leading indicators of the ISM – including Korean exports and rail carloads – suggest a bottom/marked improvement going forward. The Russell 2000 also discounts further tightening of credit conditions (Senior Loan Officer Opinion Survey net % tightening credit standards in line with 3Q23 highs), despite improvement in the last two quarters. See page 5. Other correlated macro indicators (Global Wave, [17 January 2023](#)), consumer confidence, small business sentiment) have also bounced off bottoms.

What to own? SMID Cap Value

With duration/non-earner risk in the Growth benchmark, our conviction remains high in sticking with Value within SMID for 2024 – which has more high quality stocks/fewer non-earners and historically outperforms when profits growth inflects (happening now) and when the Fed is done hiking (BofA base case). Within both small and mid caps, Growth looks expensive vs. Value relative to history on the majority of metrics we track by an average premium of 5% within small and 18% within mid (Exhibit 16-Exhibit 17)

Small cap sectors: cyclicals > defensives

Based on our small cap quant sector ranks (which rank sectors on relative valuation, estimate revisions, technicals and BofA analyst rating upgrades-downgrades), Financials continues to rank #1, while Communication Services moved to #2 and Industrials (a key beneficiary of ISM improvement above) now ranks #3. Energy, previously second, fell to fifth on deteriorating BofA analyst sentiment. Two defensive sectors – Utilities & Staples – rank last, while Health Care held up in the middle of the pack after improving in recent months; the [M&A pick-up \(podcast link\)](#) is also positive for Health Care.

Relative value in mid cap Staples, Materials

Both small and mid caps have outperformed large caps following narrow markets, during Fed cutting cycles, and following troughs in profits growth – but small caps offer greater valuation upside, and trade near record discounts vs. mid. However, two sectors offer relative value opportunity in mid vs. small: Staples and Materials. Our [Best SMID Cap Ideas for 2024](#) (see report) within both of these sectors fall into the MidCap benchmark.

Trading ideas and investment strategies discussed herein may give rise to significant risk and are not suitable for all investors. Investors should have experience in relevant markets and the financial resources to absorb any losses arising from applying these ideas or strategies.

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Refer to important disclosures on page 12 to 14.

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Small Cap Research
United States

Jill Carey Hall, CFA
Equity & Quant Strategist
BofAS
+1 646 855 3327
jill.carey@bofa.com

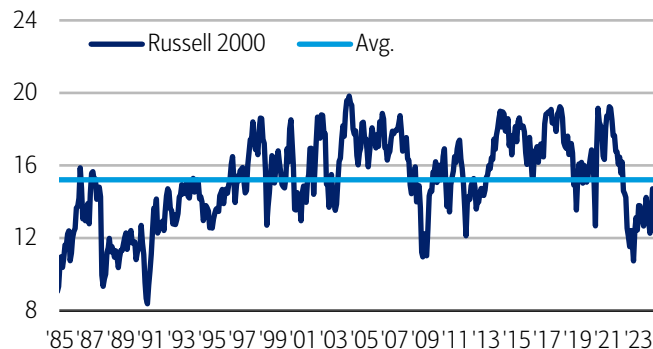
Nicolas Woods
Equity & Quant Strategist
BofAS
+1 646 556 4179
nicolas.woods_barron@bofa.com

Small/mid cap valuations

Russell 2000 and Russell Midcap valuations at-a-glance

Exhibit 1: Small cap forward P/E below the long-term average

Russell 2000 Forward P/E, 1985-1/31/2024

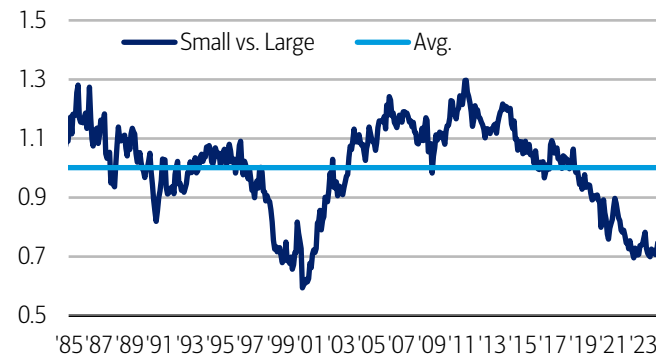


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 2: Small caps remain historically cheap vs large caps

Relative Forward P/E: Russell 2000 vs Russell 1000, 1985-1/31/2024

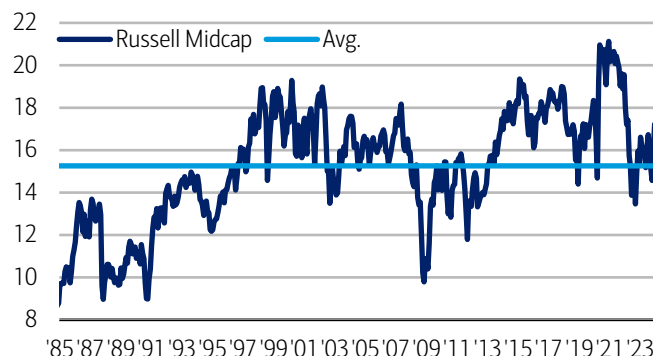


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 3: Mid-caps trade above long-term average

Russell Midcap Forward P/E, 1985-1/31/2024

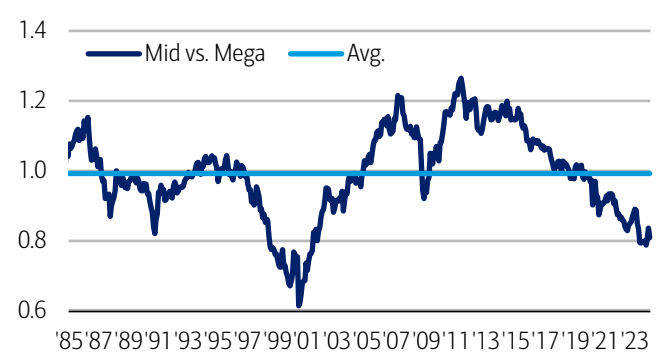


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 4: Mid-caps remain historically inexpensive vs mega caps

Relative Forward PE of Russell Midcap vs Russell Top 200, 1985-1/31/2024

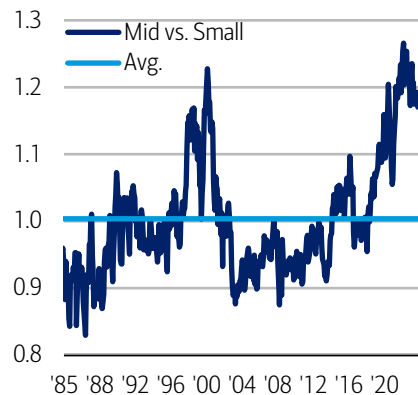


Source: BofA US Equity & Quant Strategy, FactSet.

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Exhibit 5: Mid-caps trade at a near record premium to small caps

Relative Forward PE of Russell Midcap vs Russell 2000, 1985-1/31/2024

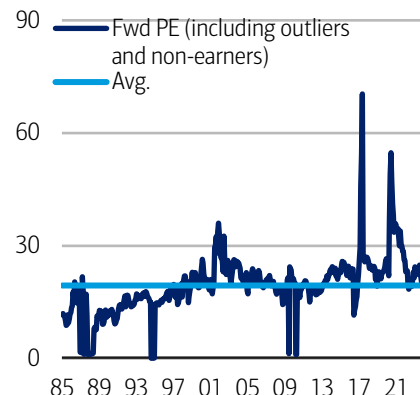


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 6: Small cap forward P/E including non-earners is slightly above average

Russell 2000 Forward P/E (including outliers & non-earners), 1985-1/31/2024

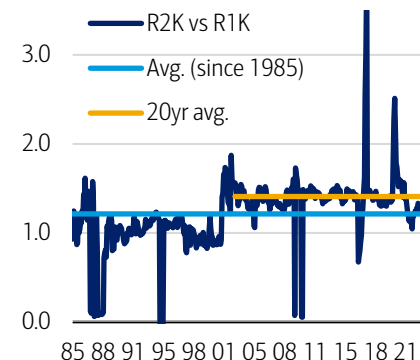


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 7: Relative forward P/E of small vs large including outliers & non-earners is below average

Relative Forward P/E (including outliers), 1985-1/31/2024



Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 8: Small caps trade below average on most metrics

Absolute valuations for the Russell 2000 (1/31/1985-1/31/2024)

Valuation Metric	Absolute Valuation			% Difference From			
	As of Jan-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	15.7	24.3	10.4	18.1	-35%	51%	-13%
Forward P/E	14.3	19.8	8.4	15.2	-28%	71%	-6%
Price/Book	1.99	2.90	1.12	2.05	-31%	77%	-3%
Price/Sales	1.51	2.21	0.40	1.18	-31%	277%	28%
P/E To Growth	0.97	2.09	0.53	0.99	-53%	83%	-2%
Enterprise Value to FCF	17.3	24.8	9.2	17.6	-30%	89%	-1%

Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 9: Small caps trade at a historical discount vs large on all metrics we track

Relative valuations for the Russell 2000 vs the Russell 1000 (1/31/1985-1/31/2024)

Valuation Metric	Relative Valuation			% Difference From			
	As of Jan-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	0.64	1.27	0.54	1.00	-50%	18%	-35%
Forward P/E	0.72	1.30	0.59	1.00	-45%	21%	-28%
Price/Book	0.45	1.11	0.44	0.75	-60%	1%	-40%
Price/Sales	0.52	1.02	0.43	0.74	-49%	19%	-31%
P/E To Growth	0.59	1.07	0.49	0.77	-44%	22%	-23%
Enterprise Value to FCF	0.63	1.22	0.56	0.84	-49%	11%	-26%

Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 10: Mid-caps trade above history on all metrics

Absolute valuations for the Russell Midcap (1/31/1985-1/31/2024)

Valuation Metric	Absolute Valuation			% Difference From			
	As of Jan-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	20.4	26.6	10.4	18.3	-23%	96%	11%
Forward P/E	17.0	21.1	9.0	15.3	-20%	90%	11%
Price/Book	2.97	3.73	1.31	2.41	-20%	126%	23%
Price/Sales	2.05	2.96	0.56	1.39	-31%	267%	47%
P/E To Growth	1.64	3.02	0.76	1.24	-46%	115%	32%
Enterprise Value to FCF	23.6	26.5	9.3	19.7	-11%	153%	20%

Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 11: Mid-caps trade at a discount to mega caps across most metrics

Relative valuations for Russell Midcap vs the Russell Top 200 (1/31/1985-1/31/2024)

Valuation Metric	Relative Valuation			% Difference From			
	As of Jan-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	0.79	1.29	0.56	0.99	-39%	40%	-20%
Forward P/E	0.81	1.26	0.61	0.99	-36%	32%	-18%
Price/Book	0.55	1.06	0.46	0.81	-48%	21%	-32%
Price/Sales	0.58	1.06	0.47	0.78	-46%	22%	-26%
P/E To Growth	0.98	1.57	0.61	0.94	-38%	60%	3%
Enterprise Value to FCF	0.80	1.27	0.46	0.92	-37%	73%	-12%

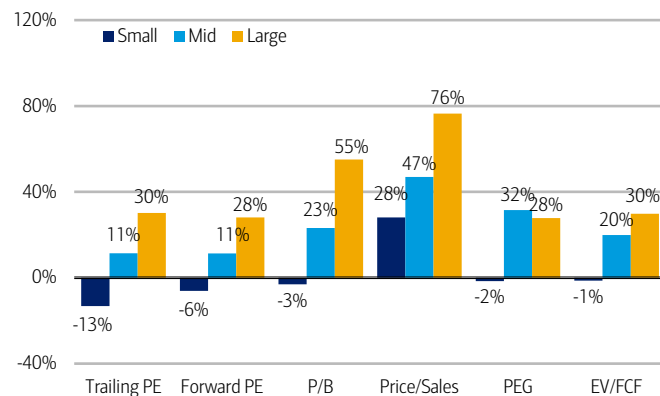
Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 12: Small caps least expensive vs history on half of metrics except Price/Sales

Russell 2000, Russell Midcap and Russell 1000: Valuation premium (discount) vs history across metrics (1/31/1985-1/31/2024)

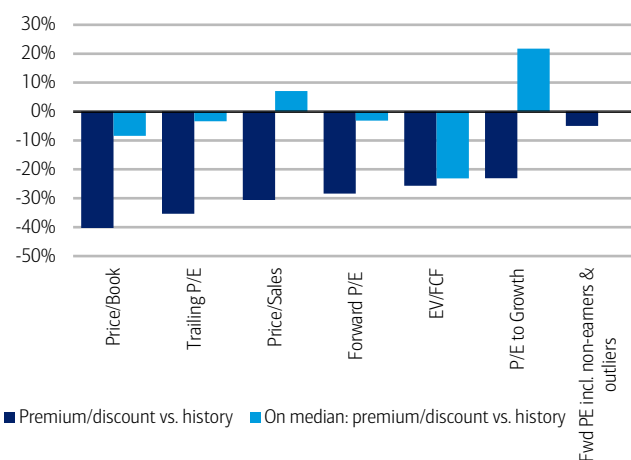


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 13: Small vs large: cheap vs history most metrics

Russell 2000 vs Russell 1000 valuations vs history (1985-1/31/2024)



Source: BofA US Equity & Quant Strategy, FactSet

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Growth vs Value valuations

- Within small caps, Growth trades at a historical premium to Value on four of the six metrics we track.
- In mid-caps, Growth trades at a premium to Value on five of the six metrics.

Exhibit 14: Small cap Growth is broadly expensive vs Value

Relative valuations for the Russell 2000 Growth vs the Russell 2000 Value (1/31/1985-1/31/2024)

Valuation Metric	Relative Valuation			% Difference From		
	As of Jan-24	Max	Min	Long	Long	Long
				Term Ave	Term Ave	Term Ave
Trailing P/E	1.80	2.18	1.08	1.41	-18%	67%
Forward P/E	1.56	2.34	1.06	1.34	-33%	47%
Price/Book	3.15	3.94	1.66	2.42	-20%	89%
Price/Sales	1.66	4.39	1.29	1.90	-62%	29%
P/E To Growth	0.44	1.70	0.26	0.76	-74%	68%
Enterprise Value to FCF	1.59	2.45	1.10	1.44	-35%	45%

Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 15: Mid-cap Growth is broadly expensive vs Value

Relative valuations for the Russell Midcap Growth vs the Russell Midcap Value (1/31/1985-1/31/2024)

Valuation Metric	Relative Valuation			% Difference From		
	As of Jan-24	Max	Min	Long	Long	Long
				Term Ave	Term Ave	Term Ave
Trailing P/E	1.80	3.21	1.04	1.51	-44%	73%
Forward P/E	1.63	3.37	1.07	1.44	-52%	52%
Price/Book	4.46	5.41	1.74	2.66	-18%	156%
Price/Sales	2.19	6.07	1.24	1.92	-64%	77%
P/E To Growth	0.83	1.40	0.54	0.82	-41%	54%
Enterprise Value to FCF	1.46	3.15	1.07	1.55	-54%	36%

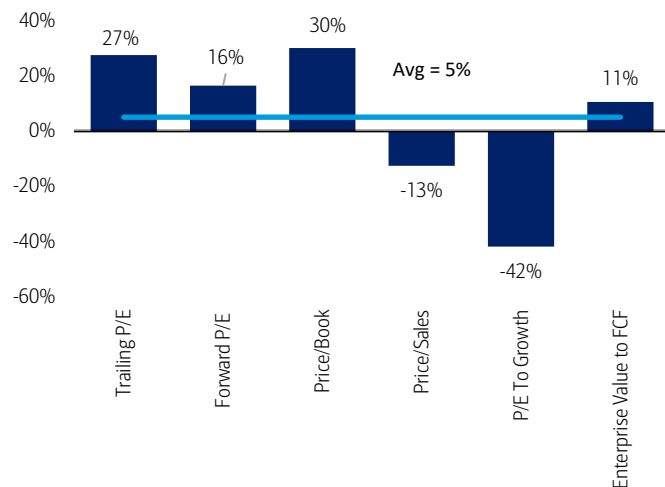
Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 16: Small cap Growth is historically expensive vs Value on four of the six metrics we track

Relative premium (discount) to the historical average multiple for Russell 2000 Growth vs Russell 2000 Value (1985-1/31/2024)

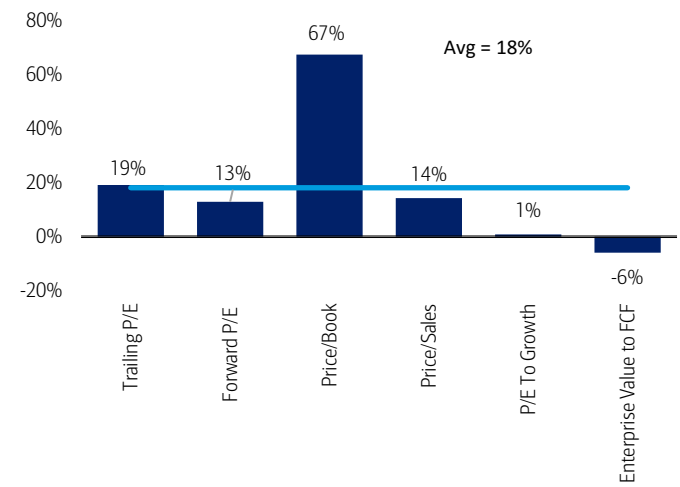


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 17: Mid cap Growth is historically expensive vs Value on five of the six metrics we track

Relative premium (discount) to the historical average multiple for Russell MidCap Growth vs Russell MidCap Value (1985-1/31/2024)



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 18: Profits cycle accelerations positive for Value vs. Growth, particularly within small caps

Avg. annualized quarterly performance of Growth vs. Value (based on Fama French data) in periods of accelerating vs. decelerating corporate profits, 1925-present

	Small Value	Small Growth	Relative	Large Value	Large Growth	Relative
Accelerating Profits	24%	13%	10%	19%	13%	6%
Decelerating Profits	14%	12%	2%	12%	10%	2%

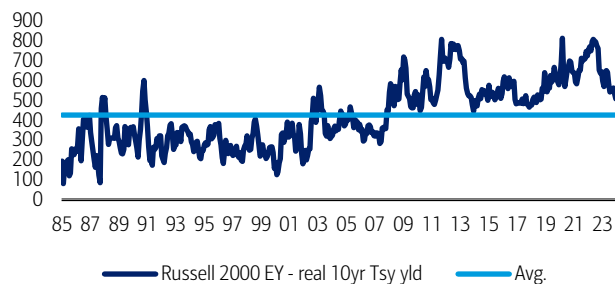
Source: FactSet, Fama French (https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html), BofA US Equity & US Quant Strategy

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Other small cap valuation charts

Exhibit 19: Small cap equity risk premium remains well above history

Russell 2000 forward earnings yield – real 10-year Treasury yield (1985-1/2024)

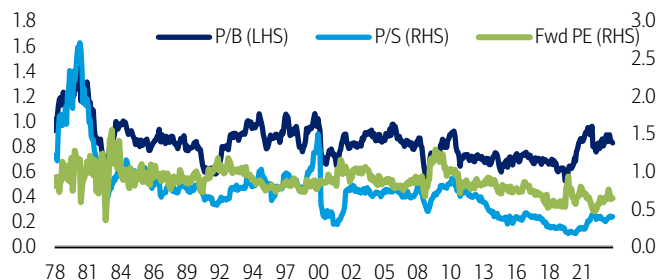


Source: FactSet, Bloomberg, BofA US Equity & Quant Strategy

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Exhibit 20: Small cap cyclicals: relatively cheap vs defensives on P/E and sales, less so on book

Relative median valuation of Russell 2000 cyclical vs defensive sectors (1978-1/2024)



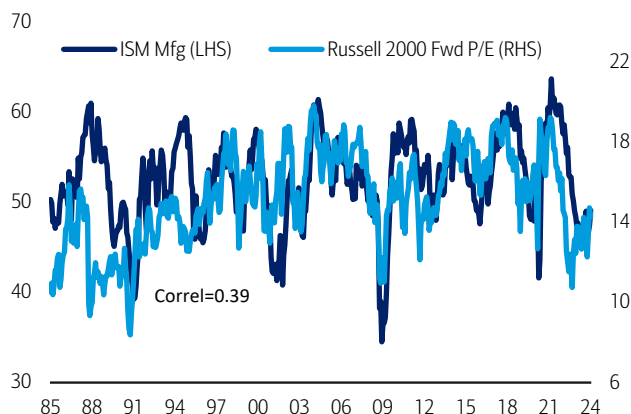
Source: BofA US Equity & Quant Strategy, FactSet

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Macro: what's priced in?

Exhibit 21: Small cap valuations correlated with ISM, pricing in ISM of 48 (below current levels)

Russell 2000 Fwd P/E (LHS) vs ISM Mfg. Index (RHS), 1985-1/2024

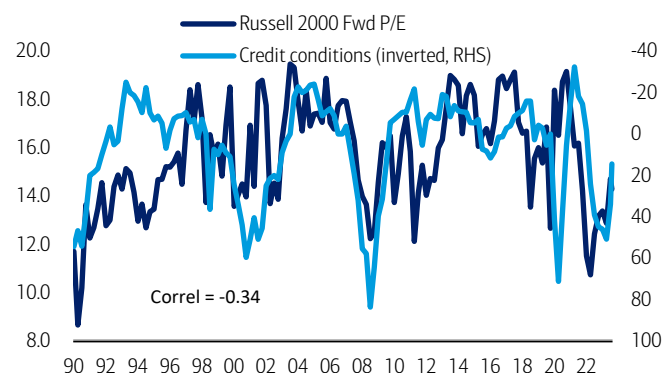


Source: Haver Analytics, BofA US Equity & Quant Strategy

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Exhibit 22: Small cap valuations also correlated with credit conditions, discounting further tightening in the SLOOS

Russell 2000 Fwd P/E (LHS) vs Senior Loan Officer Opinion Survey (SLOOS) net % tightening loans (RHS, inverted), 1990-1/2024



Source: Haver Analytics, BofA US Equity & Quant Strategy

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Exhibit 23: Korea exports rebounded recently, pointing to a manufacturing recovery

Korea exports YoY vs. ISM Manufacturing PMI (1997-1/24)

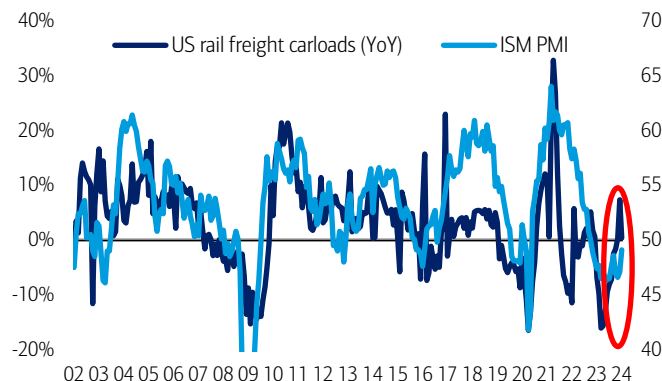


Source: Bloomberg, BofA US Equity & Quant Strategy

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Exhibit 24: Rail freight carloads also rebounded, pointing to a manufacturing recovery

US rail freight carloads YoY vs. ISM Manufacturing PMI (2002-1/24)



Source: Bloomberg, BofA US Equity & Quant Strategy

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Sector valuations

Small cap sector valuations: absolute and relative to large caps

- Small cap **Energy** and **Financials** screen as broadly the most **inexpensive** vs history (trading at a discount to the historical relative multiple on most of the six metrics we track).
- Small cap **Tech** and **Industrials** screen as broadly the most **expensive** vs history (trading at a premium on all of the six metrics we track).
- Relative to their large caps peers, most of small caps sectors trade at a discount on a majority of metrics we track, except for **Staples**.

Exhibit 25: Relative median valuations for Russell 2000 sectors versus the benchmark

as of 1/31/2024

	Relative (vs R2000) median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
Russell 2000	1.19	1.81	1.85	14.7	13.2	19.35	1.03	1.58	2.01	17.6	14.7	21.59	16%	14%	-8%	-17%	-10%	-10%
Comm Svcs	1.38	0.58	1.08	1.48	1.35	0.88	1.23	0.92	1.32	1.31	1.35	1.10	12%	-37%	-18%	13%	0%	-20%
Discretionary	1.17	0.41	1.13	1.05	1.00	0.79	0.91	0.46	1.00	0.98	0.96	0.96	29%	-11%	12%	7%	5%	-17%
Energy	0.61	0.68	0.70	0.62	0.69	0.71	1.07	1.21	0.88	1.05	1.04	0.94	-43%	-44%	-21%	-41%	-34%	-25%
Financials	0.77	1.07	0.57	0.76	0.80	N/A	1.15	1.32	0.68	0.79	0.82	N/A	-33%	-19%	-17%	-3%	-2%	N/A
Health Care	1.66	4.33	1.57	2.08	1.61	1.08	1.00	2.85	1.71	1.49	1.33	1.27	65%	52%	-8%	40%	21%	-15%
Industrials	1.05	0.62	1.13	1.49	1.10	1.03	1.01	0.52	1.02	1.04	1.02	0.97	4%	19%	10%	43%	8%	6%
Materials	1.28	0.58	0.86	1.14	1.06	0.97	1.14	0.52	0.93	0.96	0.92	0.99	12%	12%	-7%	19%	16%	-2%
Real Estate	1.57	2.17	0.67	0.75	0.85	0.53	1.88	2.36	0.78	0.75	0.81	0.77	-17%	-8%	-15%	1%	5%	-31%
Staples	1.77	0.47	1.15	1.28	1.60	1.02	1.23	0.43	1.08	1.07	1.11	1.11	44%	8%	7%	20%	44%	-8%
Technology	1.00	1.55	1.80	1.72	1.80	1.43	0.97	1.29	1.24	1.43	1.24	1.02	3%	21%	46%	20%	45%	40%
Utilities	1.93	1.29	1.00	1.26	1.09	1.98	2.83	0.84	0.83	0.93	0.98	1.04	-32%	54%	20%	35%	12%	90%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 26: Relative median valuations for the Russell 2000 vs Russell 1000 sectors

as of 1/31/2024

	Relative median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
R. 2000/R. 1000	0.65	0.73	0.55	0.7	0.8	0.68	0.80	0.91	0.78	1.0	1.0	0.88	-18%	-20%	-29%	-32%	-22%	-23%
Comm Svcs	0.88	0.43	0.57	0.90	0.87	0.71	0.87	0.73	0.95	1.05	1.06	0.93	2%	-42%	-40%	-15%	-18%	-24%
Discretionary	0.80	0.47	0.42	0.76	0.78	0.62	0.85	0.66	0.66	0.94	0.92	0.81	-5%	-28%	-36%	-20%	-15%	-24%
Energy	0.25	0.71	0.63	0.89	0.79	0.93	0.78	1.01	0.83	1.01	1.00	0.78	-67%	-30%	-24%	-12%	-21%	20%
Financials	0.84	1.01	0.58	0.78	0.92	N/A	1.04	1.12	0.91	1.02	1.02	N/A	-19%	-10%	-36%	-23%	-10%	N/A
Health Care	0.86	1.99	0.73	0.91	1.10	0.66	0.88	1.65	0.88	1.10	1.17	1.01	-2%	21%	-17%	-18%	-5%	-35%
Industrials	0.69	0.53	0.46	0.86	0.73	0.69	0.82	0.69	0.71	0.97	0.98	0.85	-16%	-23%	-36%	-11%	-25%	-19%
Materials	0.65	0.73	0.65	0.78	0.85	0.77	0.79	0.72	0.74	0.93	0.93	0.80	-18%	2%	-13%	-16%	-9%	-3%
Real Estate	0.44	0.55	0.62	0.74	0.75	0.19	0.91	0.74	0.73	0.86	0.86	0.73	-51%	-26%	-15%	-14%	-13%	-74%
Staples	0.96	0.59	0.59	0.82	1.20	0.74	0.79	0.55	0.56	0.97	1.02	0.85	21%	7%	5%	-15%	17%	-12%
Technology	0.52	0.48	0.50	0.72	0.85	0.78	0.86	0.73	0.72	0.98	1.00	0.93	-40%	-34%	-31%	-26%	-15%	-16%
Utilities	0.89	1.10	1.14	1.04	0.95	0.89	1.03	0.92	1.01	1.09	1.08	0.96	-14%	20%	12%	-5%	-12%	-7%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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Mid-cap sector valuations: absolute and relative to small

- Within mid-caps, **Energy** and **Financials** screen as the most broadly **inexpensive** vs history across all metrics we track.
- **Technology**, **Industrials** and **Health Care** screen as broadly the most **expensive** vs history (trading at a premium on most metrics we track).
- Most **mid-cap sectors** except **Staples** and **Materials** are trading at a **premium** vs **their small cap peers** across a majority of metrics.

Exhibit 27: Relative median valuations for Russell Midcap sectors versus the benchmark

as of 1/31/2024

	Relative (vs benchmark) median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
Russell Midcap	1.83	2.23	2.96	20.8	16.4	28.52	1.24	1.66	2.54	18.7	15.3	23.67	47%	35%	17%	11%	8%	20%
Comm Svcs	1.37	1.34	1.19	1.44	1.39	0.98	1.23	1.33	1.28	1.20	1.29	1.03	11%	1%	-7%	20%	7%	-5%
Discretionary	0.90	0.60	1.25	0.94	0.93	0.80	0.87	0.69	1.26	0.99	1.01	1.00	4%	-13%	0%	-5%	-8%	-20%
Staples	1.11	0.45	0.97	1.09	0.99	0.93	1.24	0.58	1.39	1.09	1.09	1.11	-10%	-21%	-30%	1%	-9%	-16%
Energy	0.35	0.75	0.69	0.42	0.69	0.60	1.07	1.11	0.87	1.14	1.11	1.19	-68%	-32%	-21%	-63%	-38%	-50%
Financials	0.58	0.84	0.60	0.64	0.68	N/A	0.90	1.11	0.66	0.75	0.79	N/A	-36%	-24%	-10%	-14%	-14%	N/A
Health Care	1.26	1.74	1.24	1.70	1.23	1.19	0.94	1.58	1.48	1.37	1.21	1.18	34%	10%	-16%	24%	2%	1%
Industrials	0.99	0.92	1.40	1.24	1.23	0.99	0.98	0.73	1.15	1.08	1.04	1.00	1%	26%	22%	14%	18%	0%
Materials	1.53	0.61	0.81	0.80	0.91	0.75	1.13	0.64	1.01	0.99	0.95	1.07	35%	-5%	-20%	-20%	-4%	-30%
Real Estate	2.22	3.12	0.67	0.69	0.88	N/A	1.79	3.05	0.80	0.82	0.93	N/A	24%	2%	-16%	-15%	-6%	N/A
Technology	1.28	2.18	1.94	1.59	1.56	1.27	0.90	1.61	1.35	1.44	1.25	1.04	43%	35%	43%	10%	24%	23%
Utilities	1.41	0.90	0.55	0.85	0.93	1.40	2.17	0.85	0.67	0.82	0.92	1.52	-35%	6%	-19%	4%	1%	-8%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: Data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 28: Relative median valuations for the Russell Midcap vs Russell 2000 sectors

as of 1/31/2024

	Relative median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
R. Mid/R. 2000	1.54	1.23	1.60	1.42	1.25	1.47	1.23	1.05	1.23	1.01	1.00	1.11	25%	17%	31%	40%	24%	33%
Comm Svcs	1.53	2.84	1.76	1.38	1.28	1.64	1.23	1.36	1.10	0.98	1.03	1.04	24%	109%	60%	40%	24%	58%
Discretionary	1.19	1.78	1.78	1.27	1.16	1.49	1.17	1.50	1.47	1.06	1.08	1.20	1%	19%	21%	20%	7%	24%
Staples	0.97	1.20	1.35	1.21	0.77	1.33	1.21	1.44	1.49	1.03	0.96	1.14	-20%	-17%	-9%	18%	-19%	17%
Energy	0.87	1.35	1.58	0.97	1.25	1.24	1.20	1.06	1.20	1.08	1.08	1.31	-27%	28%	31%	-10%	16%	-5%
Financials	1.16	0.98	1.70	1.20	1.07	N/A	0.98	0.92	1.09	0.98	0.99	N/A	18%	7%	55%	22%	8%	N/A
Health Care	1.17	0.50	1.27	1.16	0.95	1.62	1.12	0.53	1.06	0.94	0.90	1.03	4%	-6%	19%	24%	6%	58%
Industrials	1.45	1.83	2.00	1.18	1.40	1.42	1.19	1.38	1.38	1.05	1.02	1.16	22%	33%	45%	12%	37%	23%
Materials	1.84	1.31	1.51	0.99	1.07	1.14	1.26	1.37	1.31	1.03	1.06	1.22	46%	-4%	15%	-4%	0%	-7%
Real Estate	2.18	1.77	1.60	1.30	1.29	N/A	1.09	1.32	1.33	1.14	1.15	N/A	99%	34%	21%	14%	12%	N/A
Technology	1.98	1.73	1.73	1.31	1.08	1.31	1.13	1.31	1.31	1.03	1.00	1.10	74%	33%	32%	27%	8%	19%
Utilities	1.13	0.87	0.88	0.96	1.06	1.04	0.97	1.05	0.98	0.93	0.93	1.03	17%	-18%	-10%	4%	13%	1%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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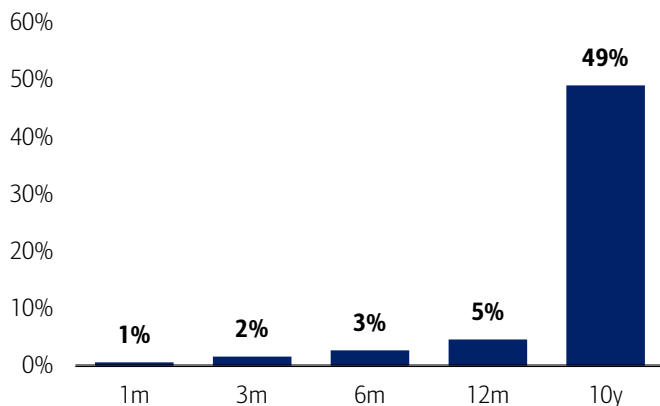
Valuations matter... over the long run

Our work suggests that valuation tends to be a poor short-term timing indicator, but it matters much more for long-term (10-year) returns. This also applies when looking at the relationship between relative small vs large cap valuations and subsequent relative returns (Exhibit 29), particularly at extremes.

Today, multiples in small caps suggest 10% annualized returns over the next 10 years vs 3% annualized returns for large caps (based on the historical regression of P/E vs subsequent returns for the Russell 2000 and Russell 1000 indices). The relative forward P/E multiple of the Russell 2000 vs Russell 1000 also suggests that small caps could outperform large caps over the next ten years (Exhibit 30).

Exhibit 29: Valuations have the highest explanatory power over long-term (ten-year) returns

R^2 of relative forward P/E vs subsequent return spread over various time horizons (since 1985): Russell 2000 vs Russell 1000, as of 1/31/2024

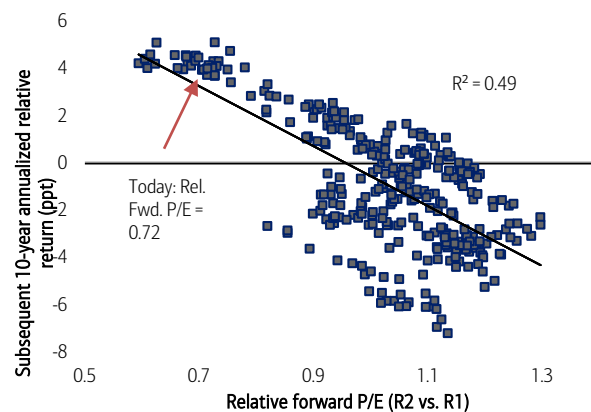


Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling returns differential. Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 30: Relative multiple suggests that small caps could outperform large caps over the next ten years

Relationship between relative fwd. P/E of Russell 2000 vs Russell 1000 and subsequent 10yr annualized relative returns, 1985 – 1/31/2024



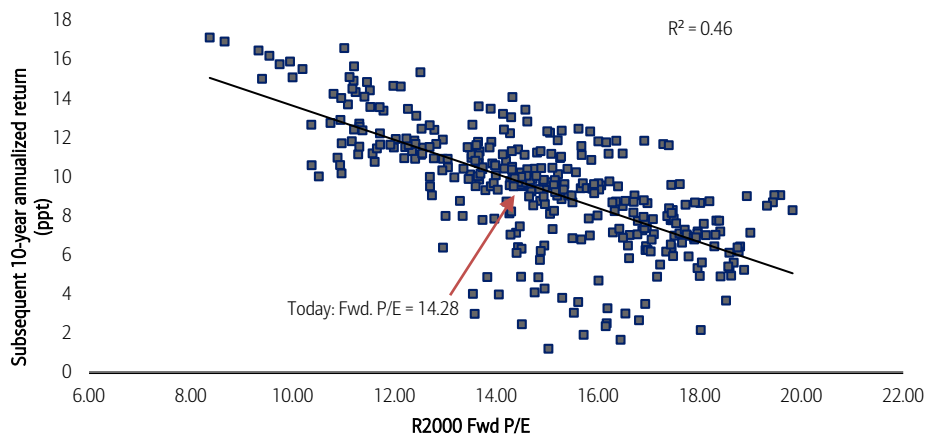
Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling 10-year annualized returns differential.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 31: The absolute forward P/E for the Russell 2000 suggests double-digit annualized ten-year returns

Russell 2000 forward P/E vs subsequent ten-year annualized returns, 1985-present (as of 1/31/24)



Source: BofA US Equity & Quant Strategy, FactSet

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Small cap quantitative sector ranks

We provide an update to our quantitative small cap sector ranks, which we introduced in our [Small Cap Outlook 5 August 2018 report](#). These tactical ranks are based on four factors: (1) estimate revisions (one of the most alpha-generative small cap factors); (2) relative valuation vs history; (3) price momentum; and (4) BofA Global Research rating changes (BofA Sentiment), where we found that the net proportion of upgrades-downgrades in a sector by our analysts is positively correlated with subsequent returns, particularly over the short term. For more details on these ranks, please see the Appendix.

Ranks as of the latest month-end are presented in the table below (ranked highest at top to lowest at bottom).

- **Financials** ranks #1 and **Communication Services** now ranks #2 after ranking #3 last month.
- **Real Estate** saw the biggest improvements in rank moving from second-to-last to #6 with improvements in revision and momentum ranks.
- **Energy** saw the biggest downgrade in rank and now ranks #5 given to big deterioration in sentiment rank. **Utilities** still ranks last.

Exhibit 32: Financials ranks highest, Utilities lowest

Small cap quantitative sector ranks (11=highest, 1=lowest) as of 1/31/2024

Sector	Combined Rank (highest to lowest)	Valuation Rank	Revisions Rank	Momentum Rank	BofA Sentiment Rank
Financials	11	10	9	10	10
Communication Services	10	9	8	4	9
Industrials	9	4	11	11	3
Consumer Discretionary	8	7	6	6	7
Energy	7	11	1	8	4
Real Estate	6	8	4	9	1
Materials	5	4	3	3	11
Health Care	4	3	10	2	5
Information Technology	3	1	5	7	6
Consumer Staples	2	4	7	5	2
Utilities	1	2	2	1	9

Source: BofA US Equity & Quant Strategy, FactSet

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Appendix

Methodology – small cap quantitative sector ranks

Our small cap quantitative sectors ranks, first introduced in our [Small Cap Outlook report](#) (5 August 2018), rank sectors from highest to lowest based on an average of four factors: valuation, estimate revisions, price momentum, and BofA analyst sentiment.

1, Valuation: Relative EV/FCF, Fwd P/E and P/S vs history

We compute the median relative multiple for each sector (vs the Russell 2000 median multiple) as of month-end and calculate how far above/below it is from its long-term median (since 1994). We do this on enterprise value (EV)/free cash flow (FCF), historically the best Value factor for selecting stocks within small caps, along with Forward P/E (the most generally applicable metric across sectors) and Price/Sales (to account for sectors that have negative earnings or FCF or for which FCF is not a meaningful metric). We compute the overall valuation rank by ranking sectors based on an average of their EV/FCF, Forward P/E, and Price/Sales ranks or as many of the three that are available/applicable. (Note: companies with negative FCF or earnings are excluded from the median calculations. For P/E, funds from operations (FFO) is used for real estate investment trusts (REITs). Financials and REITs are excluded from the EV/FCF ranks).

2. Fundamentals: Estimate revision ratios

We rank sectors from highest to lowest based on their three-month earnings estimate revision ratio (number of consensus estimates revised up vs number revised down within each sector each month, computed over a three-month period as of the latest month-end on the S&P 600 universe). Of the Growth factors we track, our work suggests that estimate revision factors are the best stock-selection factors.

3. Momentum: Change in the 200-day moving average

We rank sectors from highest to lowest based on the median one-month change in the 200-day moving average for the stocks in that sector as of the latest month-end, where this has historically been the best stock-selection measure among the momentum factors that we track.

4. BofA analyst sentiment: proportion of ratings upgrades-downgrades

Our work suggests that our BofA Global Research analysts' rating changes within the Russell 2000 are correlated with subsequent performance, particularly over the short term, and that this was true across nearly all sectors over each subsequent time period shown in the chart above. This was particularly true of ratings downgrades, and correlations were higher for our analysts' ratings changes than for the mean consensus analyst ratings change. We thus rank sectors from highest to lowest by the net proportion of ratings upgrades less downgrades (rolling three-month sum) as of the latest month-end.

Disclosures

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R1}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R1} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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