

Small/Mid-Cap Valuations

Where to find value

Small Cap

Russell 2000 P/E now in-line with history...

Amid February's rally, multiples expanded across the board, led by small caps: the Russell 2000 forward P/E rose to 15.3x from 14.3x, the Russell MidCap P/E rose to 17.9x from 17.0x and the Russell 1000 forward P/E rose to 21.7x from 21.0x. Small caps are now trading in-line with their historical average multiple (15.2x) for the first time since late 2021 – but still remain the most attractive of the size segments relative to history, with mid and large caps trading 17% and 33% above average, respectively.

...but still far from “normal” relative to large

While equities broadly have gotten more expensive, the relative forward P/E of small vs. large is still 26% below average – near historic lows, implying 9% annualized returns over the next decade for the Russell 2000 vs 2% annualized returns for the Russell 1000. Relative multiples could remain below average given risks around higher-for-longer rates (refinancing risk, where 40% of small cap debt is short-term or floating, and duration risk, where 20% of index market cap is non-earners). But we still see some upside potential for small cap multiples this year; after all, the Russell 2000 is discounting a further tightening of credit conditions and only a modest improvement in the ISM Mfg. index (Exhibit 21-Exhibit 22). More of the performance upside this year, however, is likely to be driven by earnings growth– which is accelerating/surprising to the upside.

Value still historically cheap

Within both small and mid caps, Growth continues to look historically expensive vs. Value on the majority of metrics we track, by an average premium of 9% within small and 22% within mid. Small cap Value also looks inexpensive vs. its own history, trading at a fwd. P/E of 12x (vs. 13x historically). Combined with continued evidence of an accelerating profits cycle, we continue to favor Value over Growth – where small cap Value also has more high quality stocks/fewer non-earners than small cap Growth.

Quant framework says: cyclicals > defensives

Based on our small cap sector ranks (which rank sectors on relative valuation, revisions, technicals and BofA analyst upgrades-downgrades), Financials continues to rank #1, while Consumer Discretionary moved to #2 from #4 and Industrials remains at #3. Three defensive sectors – Utilities, Staples and Health Care – rank last. While the Russell 2000 overall is now in-line with its historical average P/E, there are still multiple small cap sectors that trade below their average absolute multiples (most of which are cyclical): Consumer Discretionary, Energy, Financials, Real Estate and Communication Services.

Rel. value opportunity: small cap Discretionary vs. Staples

We recently issued deep-dives on the US Consumer sectors (see: [large cap note/ SMID cap note](#)), where macro data plus commentary at BofA's Consumer Conference this week suggest that the US consumer remains resilient. In both large and SMID, Discretionary screens favorably to Staples in our work – and we see relative value opportunity in small cap Discretionary relative to small cap Staples, where the relative multiple is 30% below avg. on P/E and below average across all other valuation measures we track (Exhibit 25).

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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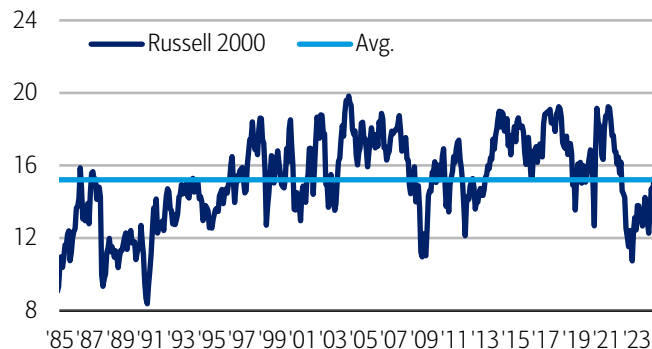
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Small/mid cap valuations

Russell 2000 and Russell Midcap valuations at-a-glance

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

Russell 2000 Forward P/E, 1985-2/29/2024

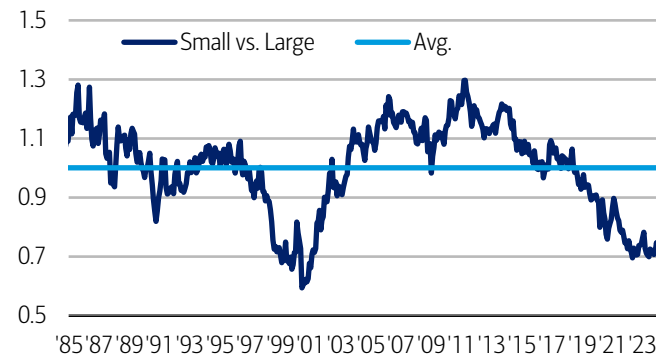


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 2: Small caps remain historically cheap vs large caps

Relative Forward P/E: Russell 2000 vs Russell 1000, 1985-2/29/2024

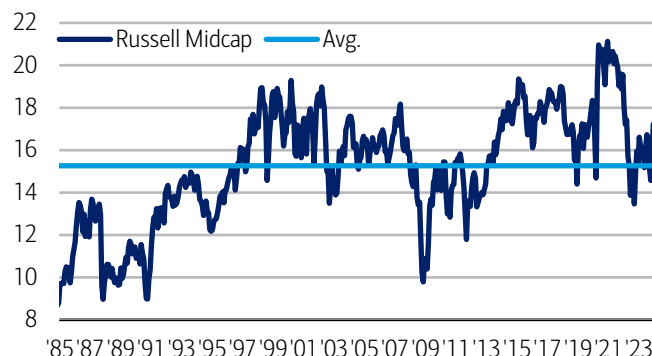


Source: BofA US Equity & Quant Strategy, FactSet

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

Russell Midcap Forward P/E, 1985-2/29/2024

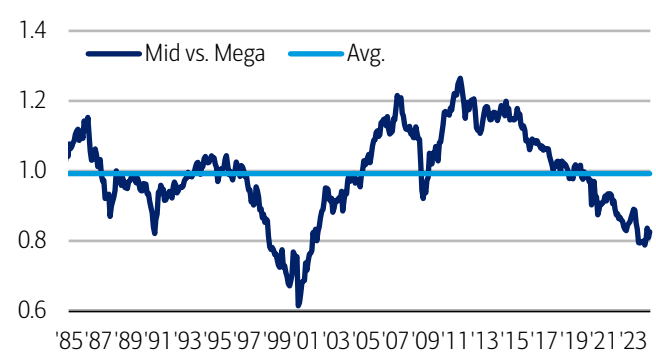


Source: BofA US Equity & Quant Strategy, FactSet

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

Relative Forward PE of Russell Midcap vs Russell Top 200, 1985-2/29/2024

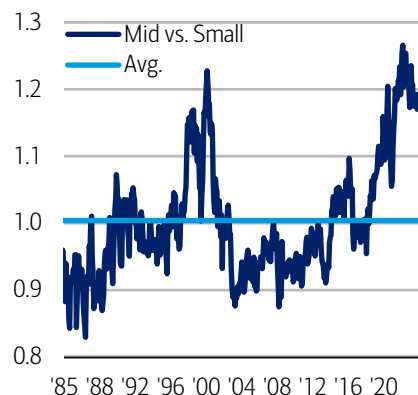


Source: BofA US Equity & Quant Strategy, FactSet.

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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, 1985-2/29/2024

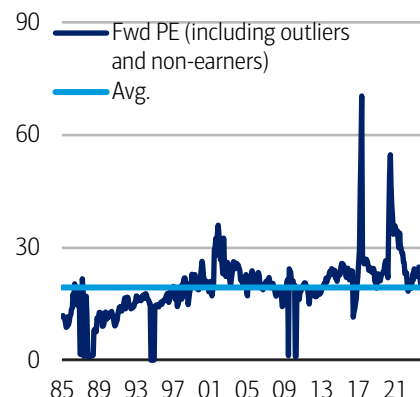


Source: BofA US Equity & Quant Strategy, FactSet

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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), 1985-2/29/2024

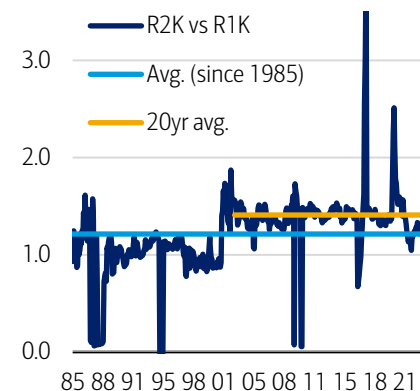


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 7: Relative forward P/E of small vs large including outliers & non-earners is slightly above average (but below 20yr avg)

Relative Forward P/E (including outliers), 1985-2/29/2024



Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 8: Small caps trade below average on half of the metrics

Absolute valuations for the Russell 2000 (1/31/1985-2/29/2024)

Valuation Metric	Absolute Valuation			% Difference From			
	As of Feb-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	16.7	24.3	10.4	18.1	-31%	60%	-8%
Forward P/E	15.3	19.8	8.4	15.2	-23%	83%	0%
Price/Book	2.09	2.90	1.12	2.05	-28%	86%	2%
Price/Sales	1.62	2.21	0.40	1.19	-27%	303%	37%
P/E To Growth	0.95	2.09	0.53	0.99	-55%	78%	-4%
Enterprise Value to FCF	16.5	24.8	9.2	17.6	-33%	80%	-6%

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 (1/31/1985-2/29/2024)

Valuation Metric	Relative Valuation			% Difference From			
	As of Feb-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	0.67	1.27	0.54	0.99	-48%	23%	-33%
Forward P/E	0.74	1.30	0.59	1.00	-43%	24%	-26%
Price/Book	0.47	1.11	0.44	0.75	-58%	5%	-38%
Price/Sales	0.53	1.02	0.43	0.74	-48%	21%	-29%
P/E To Growth	0.61	1.07	0.49	0.77	-43%	26%	-21%
Enterprise Value to FCF	0.62	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 (1/31/1985-2/29/2024)

Valuation Metric	Absolute Valuation			% Difference From			
	As of Feb-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	21.2	26.6	10.4	18.3	-20%	104%	16%
Forward P/E	17.9	21.1	9.0	15.3	-15%	100%	17%
Price/Book	3.10	3.73	1.31	2.41	-17%	136%	29%
Price/Sales	2.15	2.96	0.56	1.40	-28%	285%	54%
P/E To Growth	1.58	3.02	0.77	1.25	-48%	107%	27%
Enterprise Value to FCF	22.3	26.5	9.5	19.7	-16%	136%	13%

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 (1/31/1985-2/29/2024)

Valuation Metric	Relative Valuation			% Difference From			
	As of Feb-24	Max	Min	Long-Term Average	Max	Min	Long-Term Average
Trailing P/E	0.80	1.29	0.56	0.99	-38%	43%	-19%
Forward P/E	0.83	1.26	0.61	0.99	-35%	34%	-17%
Price/Book	0.58	1.06	0.46	0.81	-45%	28%	-28%
Price/Sales	0.58	1.06	0.47	0.78	-46%	22%	-26%
P/E To Growth	1.01	1.57	0.61	0.94	-36%	65%	7%
Enterprise Value to FCF	0.78	1.27	0.46	0.92	-39%	67%	-15%

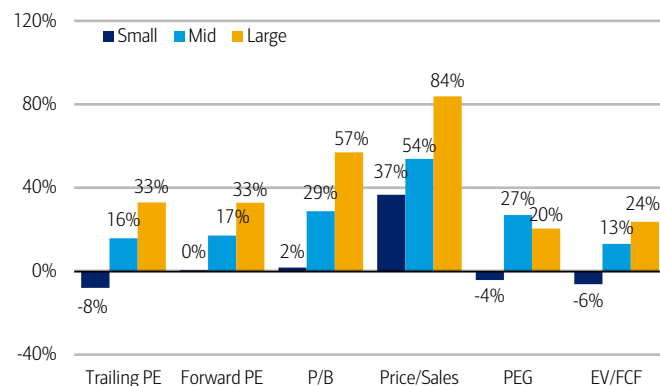
Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 12: Small caps least expensive vs history on half of metrics

Russell 2000, Russell Midcap and Russell 1000: Valuation premium (discount) vs history across metrics (1/31/1985-2/29/2024)

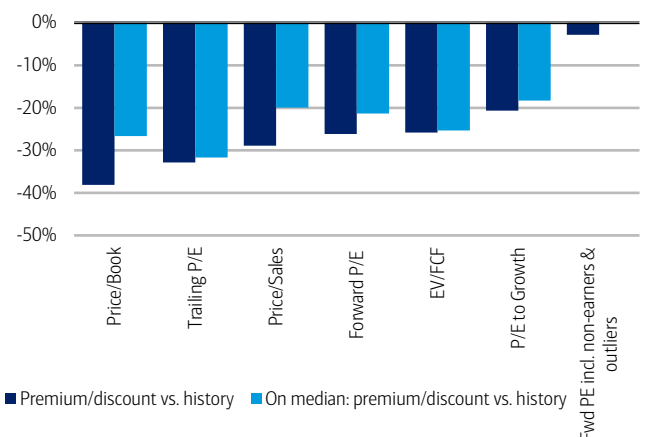


Source: BofA US Equity & Quant Strategy, FactSet

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

Russell 2000 vs Russell 1000 valuations vs history (1985-2/29/2024)



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 (1/31/1985-2/29/2024)

Valuation Metric	Relative Valuation			% Difference From		
	As of Feb-24	Max	Min	Long - Term Average		Long - Term Average
				Max	Min	
Trailing P/E	1.81	2.18	1.08	1.41	-17%	67% 28%
Forward P/E	1.69	2.34	1.06	1.34	-28%	60% 26%
Price/Book	3.25	3.94	1.66	2.42	-17%	96% 34%
Price/Sales	1.70	4.39	1.29	1.90	-61%	31% -11%
P/E To Growth	0.57	1.70	0.26	0.76	-67%	114% -26%
Enterprise Value to FCF	1.49	2.45	1.10	1.44	-39%	36% 4%

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 (1/31/1985-2/29/2024)

Valuation Metric	Relative Valuation			% Difference From		
	As of Feb-24	Max	Min	Long - Term Average		Long - Term Average
				Max	Min	
Trailing P/E	1.76	3.21	1.04	1.51	-45%	68% 16%
Forward P/E	1.69	3.37	1.07	1.44	-50%	58% 17%
Price/Book	4.35	5.41	1.74	2.67	-20%	150% 63%
Price/Sales	2.26	6.07	1.24	1.92	-63%	83% 18%
P/E To Growth	1.00	1.40	0.54	0.82	-29%	86% 21%
Enterprise Value to FCF	1.54	3.15	1.07	1.55	-51%	44% -1%

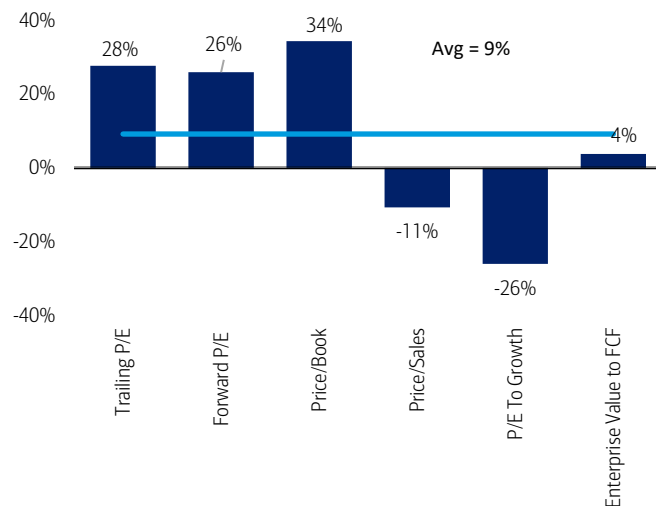
Note: P/E measures exclude negative earnings. Forward P/E is on I/B/E/S consensus N12m forecast earnings. EV/FCF excludes negative FCF.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 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 (1985-2/29/2024)

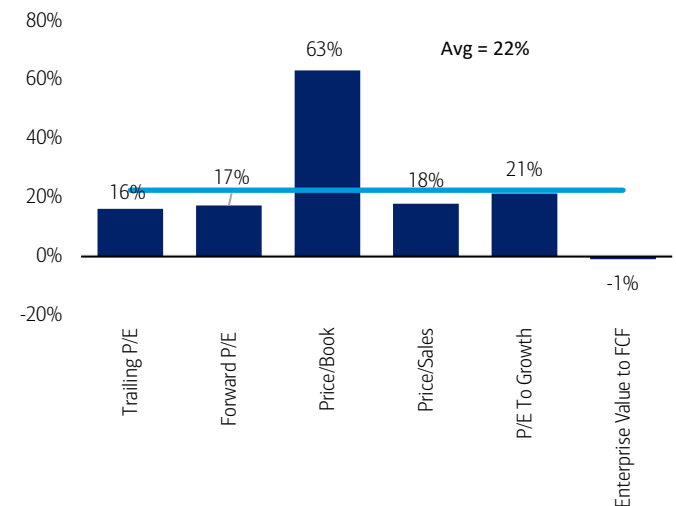


Source: FactSet, BofA US Equity & US Quant Strategy

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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 (1985-2/29/2024)



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%

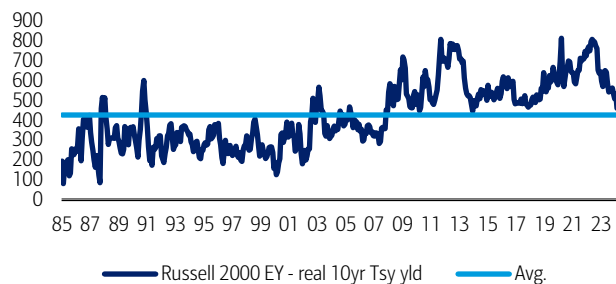
Source: FactSet, Fama French (https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html), BofA US Equity & US Quant Strategy

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Other small cap valuation charts

Exhibit 19: Small cap equity risk premium remains above historical avg.

Russell 2000 forward earnings yield – real 10-year Treasury yield (1985-2/2024)



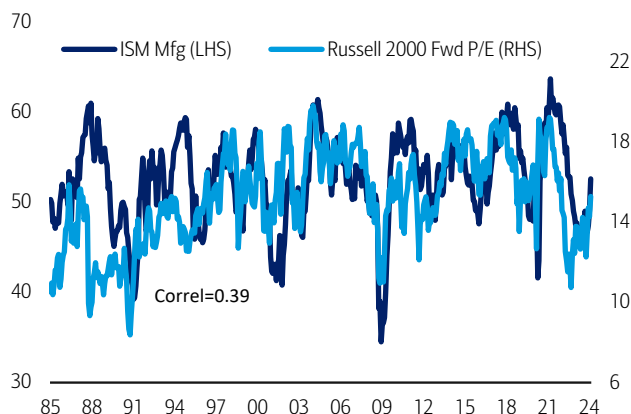
Source: FactSet, Bloomberg, BofA US Equity & Quant Strategy

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Macro: what's priced in?

Exhibit 21: Small cap valuations correlated with ISM, pricing in ISM of 53 (slightly above current levels)

Russell 2000 Fwd P/E (LHS) vs ISM Mfg. Index (RHS), 1985-2/2024



Source: Haver Analytics, FactSet, 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 (1997-2/24)

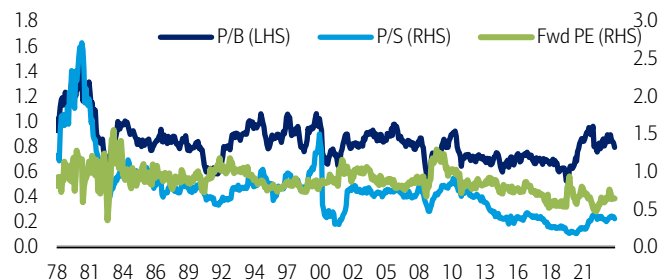


Source: Bloomberg, BofA US Equity & Quant Strategy

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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 (1978-2/2024)

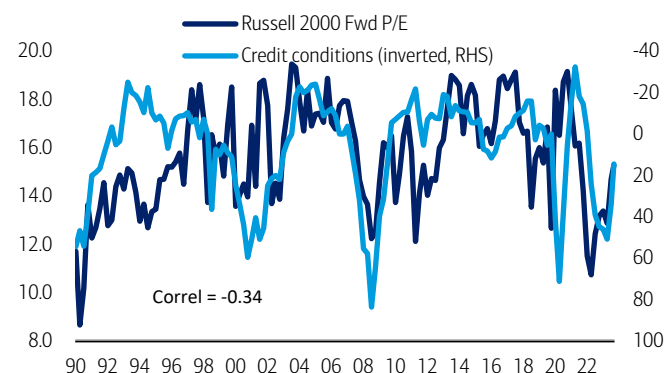


Source: BofA US Equity & Quant Strategy, FactSet

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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), 1990-2/2024

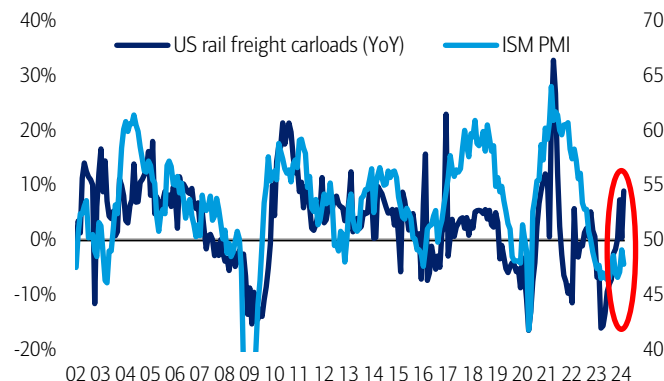


Source: Haver Analytics, FactSet, BofA US Equity & Quant Strategy

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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 (2002-2/24)



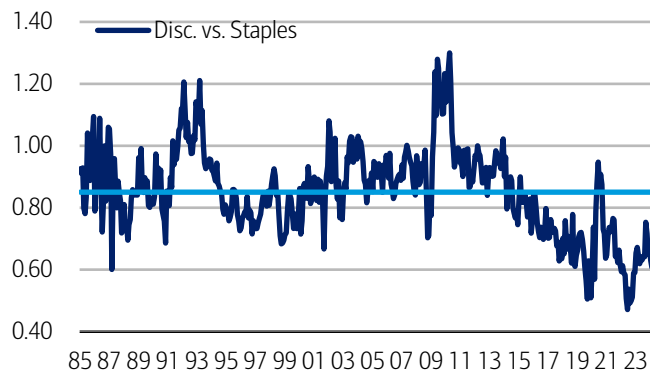
Source: Bloomberg, BofA US Equity & Quant Strategy

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Spotlight: relative value opp'y in Discretionary vs. Staples

Exhibit 25: Small cap Discretionary historically cheap vs. Staples

Relative forward P/E: Russell 2000 Consumer Discretionary vs. Russell 2000 Consumer Staples (1985-2/2024)



Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 26: Small cap Discretionary look inexpensive vs. small cap Staples across most metrics (not the case in mid and large)

Relative multiple of Russell 2000 Consumer Discretionary vs. Russell 2000 Consumer Staples vs. the historical average (1985-2/2024)

Metric	% above (below) historical avg.		
	Small Cap	Mid Cap	Large Cap
Cons. Disc. vs. Staples			
PEG	-18%	13%	0%
P/Sales	-26%	10%	16%
P/BV	1%	88%	90%
Trail P/E*	-3%	-6%	-2%
Fwd P/E*	-29%	-3%	5%
EV/FCF**	-1%	-16%	-5%
Avg.	-13%	14%	17%

Source: FactSet, 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** and **Utilities**.

Exhibit 27: Relative median valuations for Russell 2000 sectors versus the benchmark as of 2/29/2024

	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	1.13	1.84	1.93	15.4	13.6	17.65	1.03	1.58	2.01	17.6	14.7	21.58	10%	16%	-4%	-13%	-7%	-18%
Comm Svcs	1.45	0.62	1.12	1.75	1.31	0.94	1.23	0.92	1.32	1.31	1.35	1.10	18%	-33%	-15%	34%	-3%	-15%
Discretionary	1.13	0.44	1.09	1.10	1.01	0.80	0.91	0.46	1.00	0.98	0.96	0.96	24%	-6%	9%	12%	6%	-17%
Energy	0.70	0.73	0.69	0.62	0.73	0.64	1.07	1.21	0.88	1.05	1.04	0.94	-34%	-40%	-22%	-41%	-30%	-32%
Financials	0.67	1.00	0.52	0.71	0.75	N/A	1.15	1.32	0.68	0.79	0.82	N/A	-42%	-24%	-24%	-10%	-8%	N/A
Health Care	1.71	4.76	1.66	2.12	1.71	1.21	1.00	2.85	1.71	1.49	1.33	1.27	70%	67%	-3%	42%	28%	-5%
Industrials	1.03	0.62	1.14	1.57	1.16	1.02	1.01	0.52	1.02	1.04	1.02	0.97	2%	19%	11%	51%	14%	5%
Materials	11.09	0.64	0.87	1.08	1.14	1.03	1.14	0.52	0.93	0.96	0.92	0.99	871%	25%	-6%	12%	24%	4%
Real Estate	10.96	2.08	0.62	0.71	0.82	0.42	1.88	2.36	0.78	0.75	0.81	0.77	482%	-12%	-20%	-5%	1%	-46%
Staples	1.82	0.52	1.15	1.26	1.67	0.93	1.23	0.43	1.08	1.07	1.11	1.11	48%	20%	6%	18%	50%	-17%
Technology	1.16	1.58	1.68	1.77	1.93	1.44	0.97	1.29	1.24	1.43	1.24	1.02	20%	22%	36%	23%	55%	41%
Utilities	2.15	1.36	0.96	1.27	1.12	1.23	2.83	0.84	0.83	0.93	0.98	1.04	-24%	63%	15%	36%	15%	18%

*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 28: Relative median valuations for the Russell 2000 vs Russell 1000 sectors as of 2/29/2024

	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	0.57	0.7	0.8	0.66	0.80	0.91	0.78	1.0	1.0	0.88	-18%	-20%	-27%	-32%	-21%	-25%
Comm Svcs	0.98	0.45	0.63	1.14	0.89	0.68	0.87	0.73	0.95	1.05	1.06	0.93	12%	-38%	-33%	8%	-16%	-27%

Exhibit 28: Relative median valuations for the Russell 2000 vs Russell 1000 sectors

as of 2/29/2024

	Relative median valuation						Long-term median (since 1985)						% difference from long-term median					
Discretionary	0.81	0.47	0.37	0.80	0.79	0.58	0.84	0.66	0.66	0.94	0.91	0.81	-4%	-29%	-44%	-15%	-13%	-29%
Energy	0.40	0.70	0.65	0.80	0.80	0.66	0.78	1.01	0.83	1.00	1.00	0.77	-49%	-31%	-22%	-20%	-20%	-15%
Financials	0.74	0.90	0.57	0.74	0.87	N/A	1.04	1.12	0.91	1.02	1.02	N/A	-29%	-20%	-37%	-28%	-15%	N/A
Health Care	0.89	2.16	0.81	0.94	1.13	0.70	0.88	1.65	0.88	1.10	1.16	1.01	0%	31%	-7%	-15%	-3%	-31%
Industrials	0.59	0.53	0.46	0.90	0.76	0.66	0.82	0.69	0.71	0.97	0.98	0.85	-27%	-22%	-36%	-8%	-22%	-22%
Materials	7.75	0.78	0.68	0.64	0.89	0.82	0.79	0.72	0.74	0.93	0.93	0.80	884%	8%	-8%	-31%	-4%	2%
Real Estate	2.66	0.55	0.58	0.75	0.76	0.13	0.91	0.74	0.73	0.86	0.86	0.72	191%	-26%	-21%	-13%	-12%	-82%
Staples	0.92	0.61	0.63	0.83	1.27	0.59	0.79	0.55	0.56	0.97	1.02	0.85	16%	11%	11%	-14%	24%	-31%
Technology	0.55	0.47	0.44	0.73	0.90	0.75	0.86	0.73	0.72	0.98	1.00	0.93	-36%	-36%	-39%	-26%	-10%	-20%
Utilities	1.04	1.17	1.15	1.16	1.00	1.18	1.03	0.92	1.01	1.09	1.08	0.96	0%	28%	13%	7%	-7%	23%

*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 29: Relative median valuations for Russell Midcap sectors versus the benchmark

as of 2/29/2024

	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	1.71	2.33	2.98	21.4	17.1	26.18	1.24	1.66	2.54	18.7	15.3	23.67	37%	41%	17%	15%	12%	11%
Comm Svcs	1.23	1.11	1.15	1.43	1.34	0.93	1.23	1.33	1.28	1.20	1.29	1.03	0%	-16%	-10%	19%	4%	-10%
Discretionary	0.95	0.61	1.58	0.95	0.95	0.83	0.87	0.69	1.26	0.99	1.01	1.00	9%	-11%	25%	-4%	-6%	-17%
Staples	1.14	0.46	0.88	1.09	1.04	1.06	1.24	0.58	1.39	1.09	1.09	1.11	-8%	-19%	-36%	0%	-4%	-4%
Energy	0.40	0.76	0.68	0.52	0.73	0.73	1.07	1.11	0.87	1.14	1.11	1.19	-62%	-31%	-22%	-54%	-34%	-38%
Financials	0.58	0.87	0.56	0.66	0.67	N/A	0.90	1.11	0.66	0.75	0.79	N/A	-35%	-22%	-15%	-12%	-16%	N/A
Health Care	1.28	1.61	1.21	1.62	1.28	1.23	0.94	1.58	1.48	1.37	1.21	1.18	36%	1%	-18%	19%	6%	4%
Industrials	1.17	0.92	1.52	1.26	1.22	1.01	0.98	0.73	1.15	1.08	1.04	1.00	19%	25%	33%	17%	17%	1%
Materials	0.89	0.60	0.81	0.95	0.97	0.79	1.13	0.64	1.01	0.99	0.95	1.07	-21%	-7%	-20%	-4%	2%	-25%
Real Estate	2.63	2.89	0.69	0.65	0.83	N/A	1.79	3.05	0.80	0.82	0.93	N/A	47%	-5%	-13%	-21%	-11%	N/A
Technology	1.42	2.14	1.83	1.57	1.61	1.26	0.90	1.61	1.36	1.44	1.25	1.04	58%	33%	35%	9%	28%	21%
Utilities	1.37	0.88	0.54	0.77	0.90	0.65	2.16	0.85	0.67	0.82	0.92	1.52	-37%	4%	-20%	-7%	-2%	-57%

*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 30: Relative median valuations for the Russell Midcap vs Russell 2000 sectors as of 2/29/2024

	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	1.51	1.27	1.55	1.40	1.26	1.48	1.23	1.05	1.23	1.01	1.00	1.11	23%	20%	26%	38%	25%	33%
Comm Svcs	1.28	2.28	1.59	1.14	1.28	1.48	1.23	1.36	1.10	0.99	1.03	1.04	4%	67%	45%	16%	25%	42%
Discretionary	1.27	1.76	2.24	1.21	1.18	1.54	1.17	1.50	1.47	1.06	1.08	1.20	8%	17%	52%	15%	8%	29%
Staples	0.94	1.13	1.19	1.21	0.78	1.70	1.21	1.44	1.49	1.03	0.96	1.14	-22%	-21%	-20%	18%	-18%	49%
Energy	0.86	1.32	1.53	1.18	1.26	1.69	1.20	1.06	1.21	1.08	1.08	1.31	-28%	24%	27%	9%	16%	29%
Financials	1.32	1.10	1.67	1.30	1.12	N/A	0.98	0.92	1.09	0.98	0.99	N/A	34%	20%	53%	32%	13%	N/A
Health Care	1.13	0.43	1.13	1.07	0.94	1.50	1.12	0.53	1.06	0.94	0.90	1.03	0%	-19%	6%	14%	5%	46%
Industrials	1.71	1.87	2.08	1.12	1.33	1.47	1.20	1.38	1.38	1.05	1.02	1.16	43%	36%	51%	7%	30%	27%
Materials	0.12	1.17	1.44	1.24	1.07	1.15	1.26	1.37	1.31	1.03	1.07	1.22	-90%	-14%	10%	20%	1%	-6%
Real Estate	0.36	1.76	1.71	1.28	1.26	N/A	1.09	1.32	1.33	1.14	1.15	N/A	-67%	33%	29%	12%	10%	N/A
Technology	1.84	1.72	1.69	1.24	1.04	1.30	1.13	1.31	1.31	1.03	1.00	1.10	63%	31%	29%	20%	4%	18%
Utilities	0.96	0.82	0.88	0.84	1.00	0.78	0.97	1.05	0.98	0.93	0.93	1.03	-1%	-22%	-11%	-9%	7%	-24%

* 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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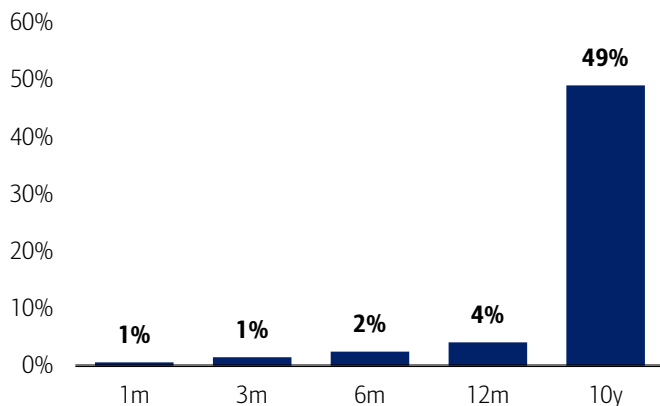
Valuations matter... over the long run

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 31), particularly at extremes.

Today, multiples in small caps suggest 9% annualized returns over the next 10 years vs 2% 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 32).

Exhibit 31: 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 2/29/2024

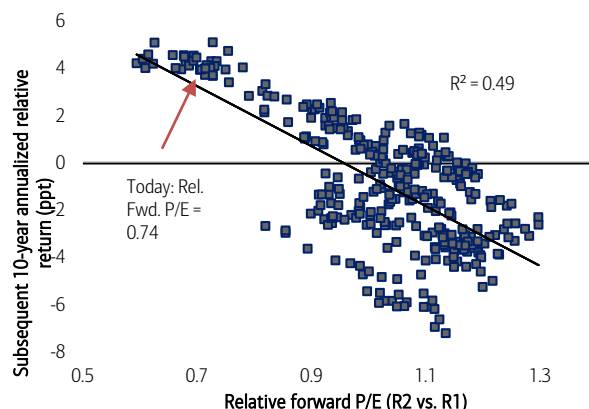


Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling returns differential. Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 32: 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 – 2/29/2024



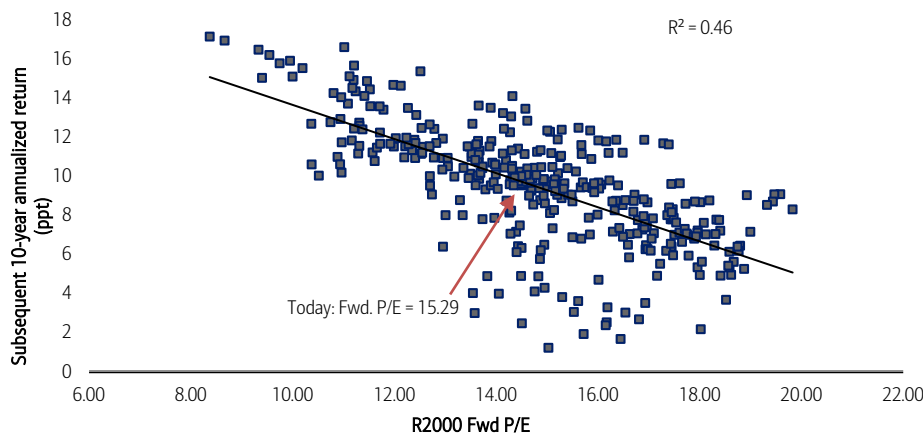
Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling 10-year annualized returns differential.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 33: The absolute forward P/E for the Russell 2000 suggests 9% annualized ten-year returns

Russell 2000 forward P/E vs subsequent ten-year annualized returns, 1985-present (as of 2/29/24)



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** continues to rank #1 and **Consumer Discretionary** now ranks #2 (up from #4 the prior month).
- **Consumer Discretionary**, **Real Estate** and **Materials** saw the biggest improvements in ranks, moving from fourth to second (Cons. Disc.), sixth to fourth (Real Estate) and seventh to fifth (Materials).
- **Communication Services** saw the biggest deterioration in rank, now #6 from #2 previously, given to big deterioration in its revisions rank. **Utilities** still ranks last.

Exhibit 34: Financials ranks highest, Utilities lowest

Small cap quantitative sector ranks (11=highest, 1=lowest) as of 2/29/2024

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

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.

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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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