

Market Update – The case for small companies

October 2026

Small companies in Australia have experienced a volatile year with rising inflation leading to four interest rate hikes so far this year, and ongoing geopolitical risk causing uncertainty and supply chain concerns from the Middle East. The more uncertainty we have then the more likely investors gravitate to larger companies, in a 'flight-to-safety' trade.

So far this calendar year, Australian small companies have underperformed their large cap peers, but the opposite has occurred within the global market, where global small companies have outperformed their large cap peers. The main reason is that a greater number of global smaller companies, in particular within the US, are either directly or indirectly benefitting from the AI theme, and the extraordinary capital expenditure that has taken place to buildout the infrastructure required to meet these demands.

However, we believe investors should look through any short-term volatility and persist with both domestic and global smaller companies for the following reasons. For analysis purposes we will focus more on the Australian market than the global:

- Smaller companies have greater growth potential than large companies that tend to be constrained by the level of economic growth. The small companies universe naturally has businesses that are disrupters and can grow faster than the economy, which can lead to more attractive returns for shareholders;
- ASX listed large companies are quite well researched by brokers and fund managers, such that the chance for analysts to discover unrecognised opportunities within the investment universe is significantly curtailed. Smaller companies are not as well covered by brokers and fund managers, leading to active managers having greater opportunity to add value within small companies versus large companies; and
- Valuations are cheaper and investors can invest in the various life cycle stages of a corporate, compared to larger companies that are typically mature businesses.

The case for active management in small companies, over large companies, is supported by historic results, presented below, where data from December 1990 through to June 2026 shows the median active large companies fund manager failing to add any value against the All-Ordinaries Index. In contrast the median active small companies fund manager outperformed the Small Ordinaries Index by close to 5% and in the process outperformed the median large companies fund managers despite the Small Ordinaries Index lagging the All-Ordinaries Index performance over the same period.

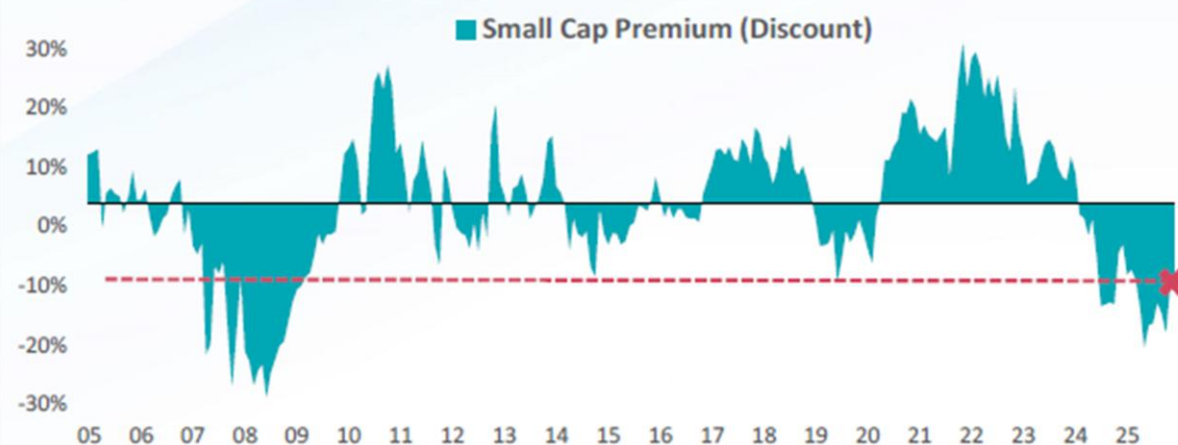


We believe quality is an important factor for active investors to consider when investing into smaller companies, which should add value longer term. When analysts assess small companies they can bias towards smaller companies that have a proven track record of profitability with real revenues. This avoids higher risk businesses with unreliable earnings, poorly run businesses, and early startup businesses, where a business may not survive.

Presently, smaller companies characteristics remain quite attractive relative to larger companies within Australia. At the end of August 2026, the Small Ordinaries Index showed a lower PE Ratio, 16.4x. versus the ASX300 Index at 17.9x. Furthermore, the Small Ordinaries forward 12-month PE chart relative to the ASX100 Index shows smaller companies PEs have been lagging large companies PEs for some years now when historically they have tended to trade at levels higher than the ASX100 Index due to the earnings growth outlook for smaller companies typically being greater than that of larger companies.



Source Bloomberg



Source Bloomberg

In addition, price-to-book valuations are also lower for the Small Ordinaries Index, at 1.9, versus the ASX300 Index at 2.5. A lower price-to-book ratio also implies more attractive valuations.

While some metrics indicate attractive valuations existing within Australian small companies, other metrics highlight the importance of active management within the space. Return on Equity is lower for small companies and Debt/Asset is higher. These both suggest poorer quality companies do exist within the small companies universe, so active management can help to safeguard against such risks.

Therefore, we continue to have confidence in actively managed Australian smaller companies and maintain a bias to the asset class with our clients. We firmly believe maintaining such a position in the current environment should lead to longer term outperformance within client portfolios.

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