



NCPERS Public Safety Conference 2018

Is Now The Time for Public Safety Plans to Consider International Small Cap?

Jennifer Mink
Principal
jmink@ips-net.com



A world map with a blue ocean and green/yellow landmasses, serving as a background for the text.

**US Investors hold, on average,
15% of their investment portfolio
in international investments.**

Source: CNBC.com

What is considered an International investment?

Markets outside of the U.S.

- **Developed**

Most advanced economically; highly developed capital markets with high levels of liquidity, meaningful regulatory bodies, large market capitalization, and high levels of per capita income.

→ EX: **Canada, Continental Europe, Japan**

- **Emerging**

Countries in the *process of rapid growth and development* with lower per capita incomes and less mature capital markets .

→ EX: **Brazil, Russia, India, China**

- **Frontier**

Countries with little market liquidity. Marginally developed capital markets, and yet to undergo meaningful economic development.

→ EX: **Argentina, Kuwait, Vietnam**

What is the MSCI EAFE Index?

- An international equity index: **E**urope **A**ustralia **F**ar **E**ast
- 21 developed markets outside of the U.S. and Canada

Only includes
Large Cap and Mid Cap
companies!



Australia



Hong Kong



Norway



Austria



Ireland



Portugal



Belgium



Israel



Singapore



Denmark



Italy



Sweden



Finland



Japan



Switzerland



France



Netherlands



Spain



Germany



New Zealand



United Kingdom

What is Market Capitalization?

- Market value of a company's outstanding shares
- Calculated by taking a company's stock price and multiplying it by the total number of shares outstanding

Stock price X Number of outstanding shares = Market Capitalization

What is Market Capitalization?

	Company A	Company B
Stock price	\$60	\$50
Shares outstanding	<u>x 100 million</u>	<u>x 500 million</u>
	\$6 billion market cap	\$25 billion market cap

Common Market Capitalization Categories

Large Cap

\$10 to \$200 Billion

Considered to be relatively stable and secure.

Mid Cap

\$2 to \$10 Billion

Considered to be more volatile than the large-cap companies. Some of the companies might not be industry leaders, but they are well on their way to becoming one.

Small Cap

\$300 million to \$2 Billion

Although their track records won't be as lengthy, small caps do present the possibility of greater capital appreciation, but with greater risk

Why International Small Cap?

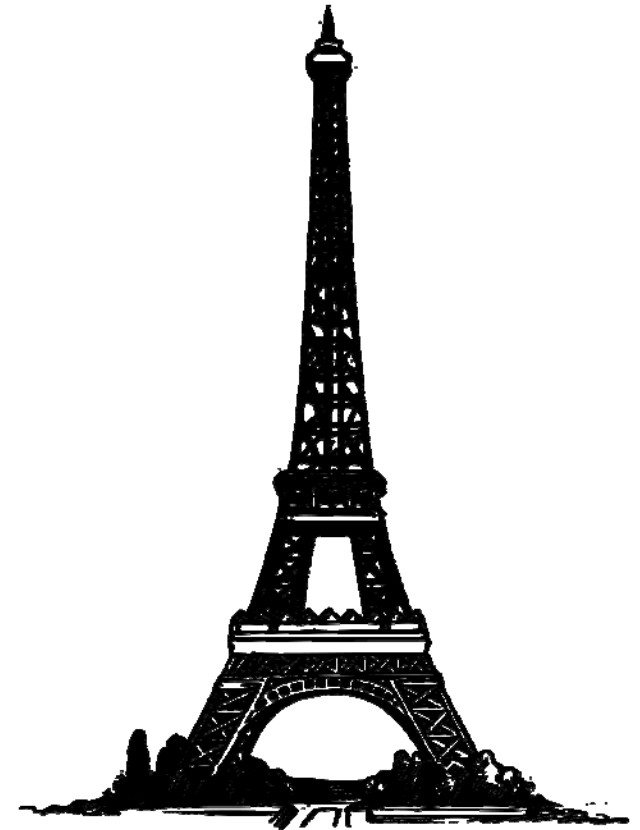
- **Increased diversification**
- **Potential for higher returns**
- **Dynamic opportunity set**

Why International Small Cap?

Diversification

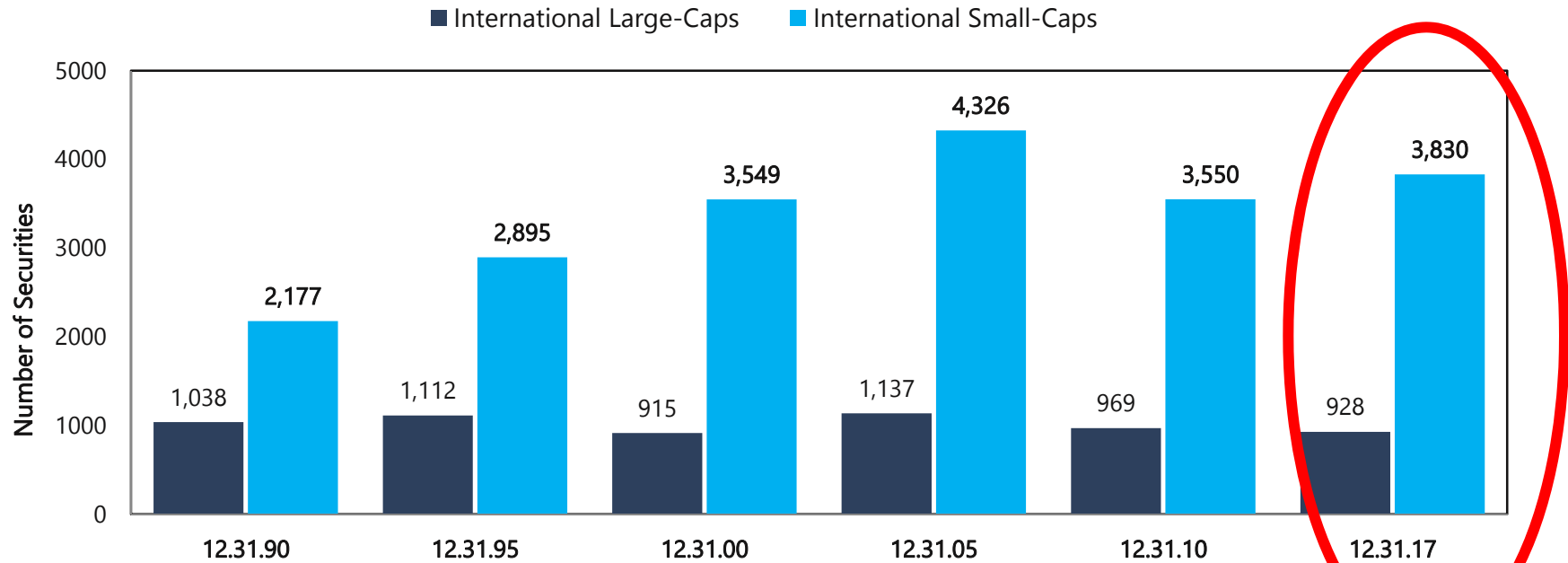
International Small Cap ...

- **Approximately 4,000 companies**
- **Developed non-US markets**
- **Market Cap less than \$3.5 billion**



Triple the Stock Universe

The international small-cap opportunity set has increased significantly over the last 25 years and now offers investors more than triple the number of stocks to invest in than international large-caps.

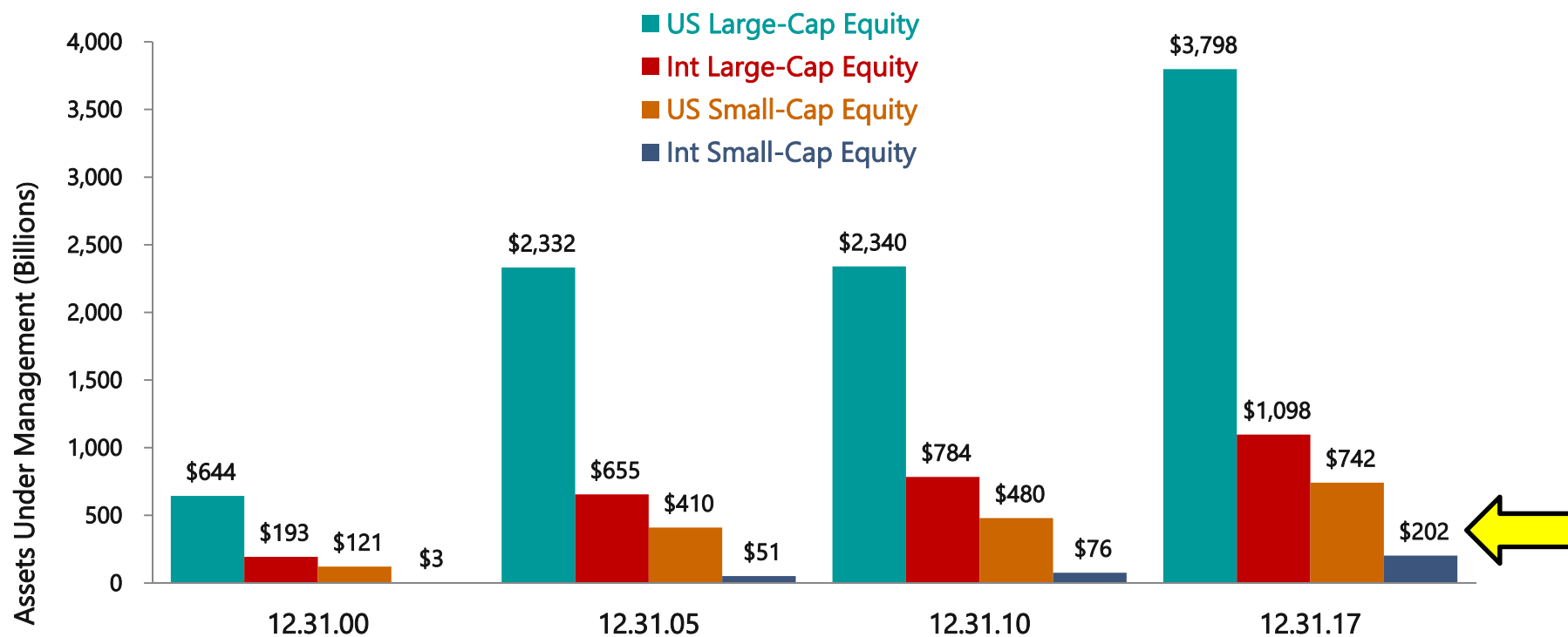


Source: MSCI & FactSet. International large-caps and international small-caps are represented by the MSCI EAFE and the S&P® Developed ex-U.S. SmallCap Indices, respectively

Courtesy of Truident Investments/ Victory Capital .

Under Represented in Asset Allocation

Assets Under Management of Various Asset Classes (as of 12.31.17)

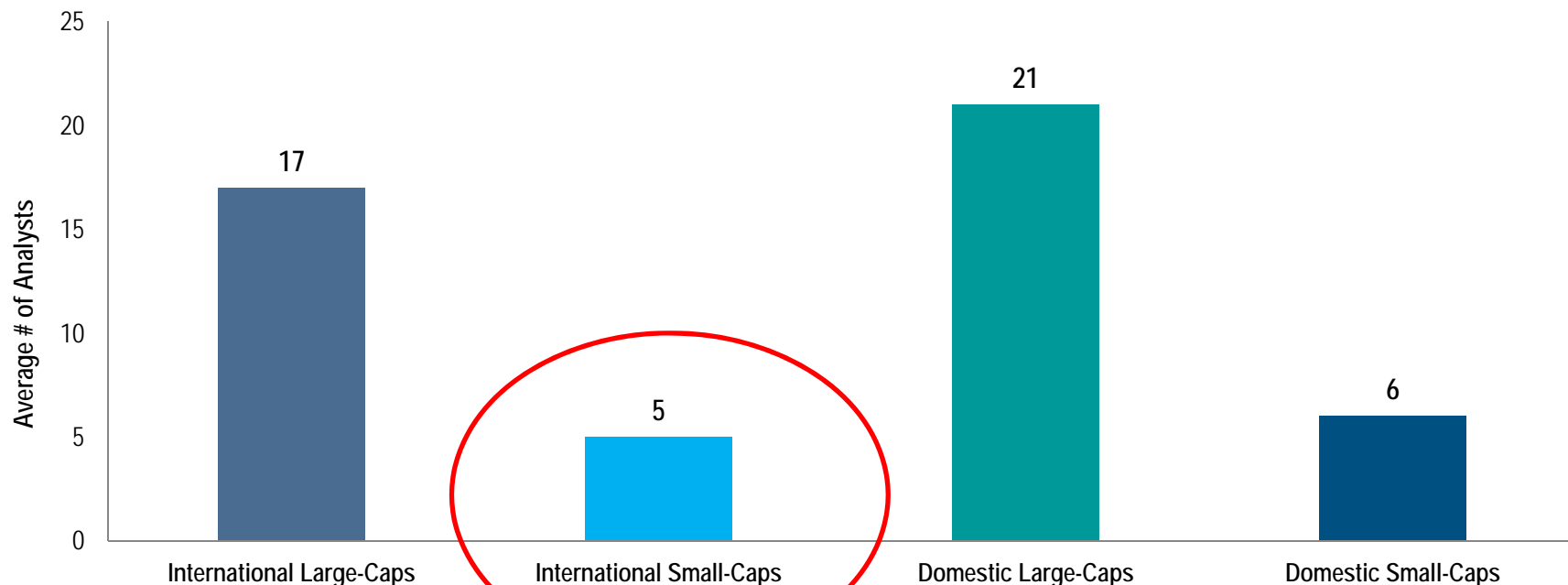


Source: Evestment Alliance. US large-caps, international large-caps, US small-caps, international small-caps are represented by the US large-cap, Non-US diversified large-cap, US small-cap, and the Non-US diversified small-cap universes, respectively.

Courtesy of Trivalent Investments/Victory Capital

Less Efficiently Researched Market

Average Analyst Coverage of Various Asset Classes (as of 12.31.17)



Source: Factset. International large-caps, international small-caps, domestic large-caps and domestic small-caps are represented by the MSCI EAFE, S&P® Developed ex-U.S. SmallCap, Russell 1000®, and the Russell 2000® Indices, respectively.

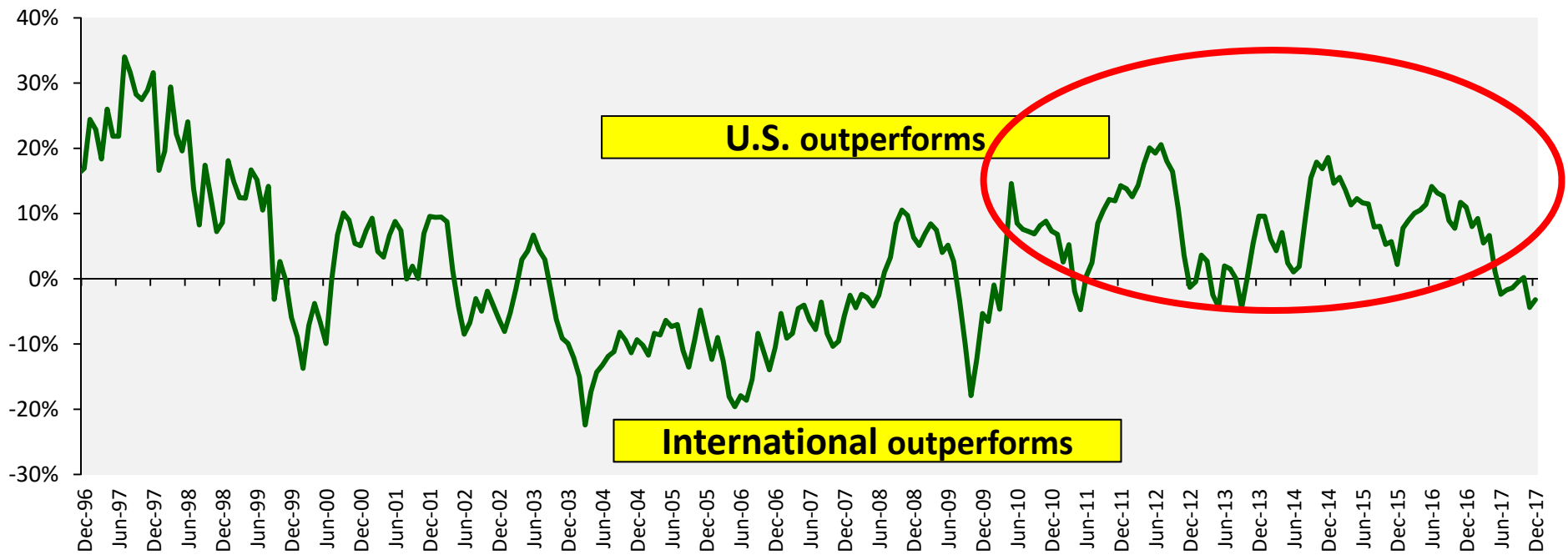
Courtesy of Trivalent Investments/Victory Capital

Why International Small Cap?

Higher Expected Returns

Market Cycles – U.S. vs. International Equity

S&P 500 vs. MSCI EAFE: Rolling One-Year Returns



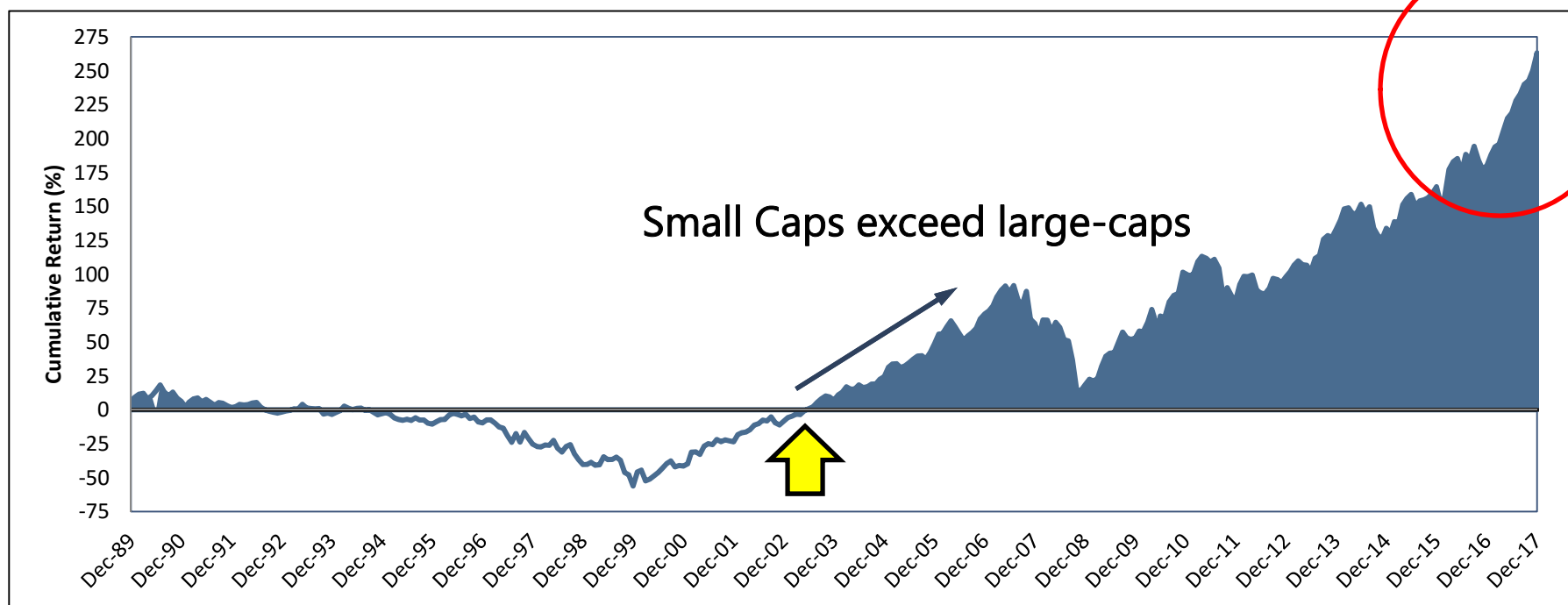
Historical Returns

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Best ↑ ↓ Worst	US Small Cap -33.8%	EM Equity 78.5%	US Small Cap 26.9%	US Large Cap 2.1%	MSCI ACWI 22.8%	US Small Cap 38.8%	US Large Cap 13.7%	EAFE Small 9.6%	US Small Cap 21.3%	EM Equity 37.3%
	US Large Cap 37.0%	EAFE Small 46.8%	US Mid Cap 25.5%	US Mid Cap -1.6%	EAFE Small 20.0%	US Mid Cap 34.8%	US Mid Cap 13.2%	US Large Cap 1.4%	US Mid Cap 13.8%	EAFE Small 33.0%
	US Mid Cap -41.5%	US Mid Cap 40.5%	EAFE Small 22.0%	Small Cap -4.2%	EM Equity 18.2%	US Large Cap 32.4%	US Small Cap 4.9%	EAFE -0.8%	US Large Cap 12.0%	EAFE 25.0%
	MSCI ACWI -42.2%	MSCI ACWI 34.6%	EM Equity 18.9%	MSCI ACWI -7.4%	EAFE 17.3%	EAFE Small 29.3%	MSCI ACWI 4.2%	MSCI ACWI -2.4%	EM Equity 11.2%	MSCI ACWI 24.0%
	EAFE -43.4%	EAFE 31.8%	US Large Cap 15.1%	EAFE -12.1%	US Mid Cap 17.3%	MSCI ACWI 22.8%	EM Equity -2.2%	US Mid Cap -2.4%	MSCI ACWI 7.9%	US Large Cap 21.8%
	EAFE Small -47.0%	US Small Cap 27.2%	MSCI ACWI 12.7%	EAFE Small -15.9%	US Small Cap 16.3%	EAFE 22.8%	EAFE -4.9%	US Small Cap -4.4%	EAFE Small 2.2%	US Mid Cap 18.5%
	EM Equity -53.3%	US Large Cap 26.5%	EAFE 7.8%	EM Equity -18.4%	US Large Cap 16.1%	EM Equity -2.6%	EAFE Small -5.0%	EM Equity -14.9%	EAFE 1.0%	US Small Cap 14.7%

Source: Wilshire. Large Cap Equity: S&P 500 Index; Mid Cap Equity: Russell Midcap Index; Small Cap Equity: Russell 2000 Index; International Equity: MSCI EAFE Index; International Small Cap: MSCI EAFE Small Cap Index; Emerging Markets: MSCI EM Index; Global Equity: MSCI ACWI Index. Past performance is not indicative of future returns.

Excess Return of International Small Cap

International Small Cap vs. International Large Cap (6/1/89 to 12/31/17)

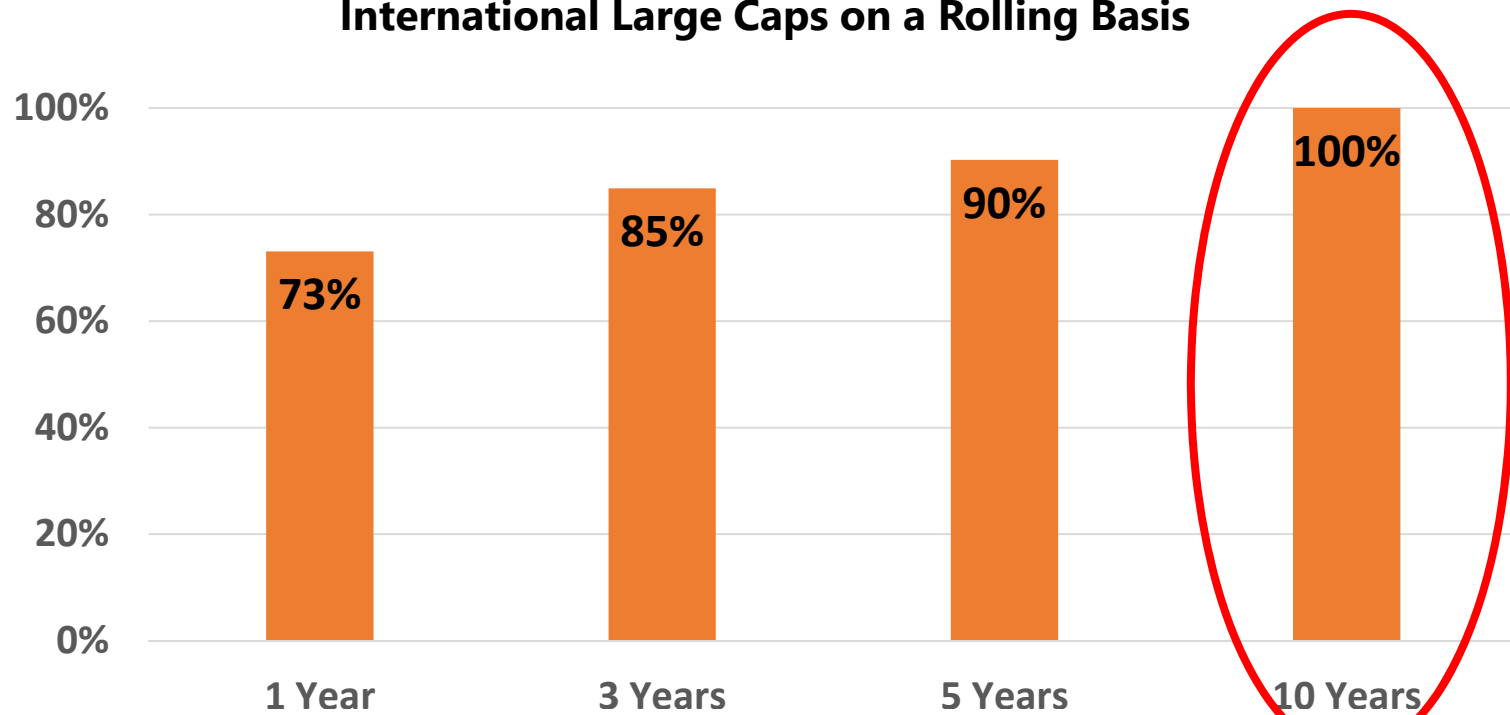


Source: MSCI®, Standard & Poor's, eVestment as of 12.31.17 International large-caps and international small-caps are represented by the MSCI EAFE and the S&P® Developed ex-U.S. SmallCap Indices, respectively.

Courtesy of Trivalent Investments/Victory Capital

Consistent Outperformance of International Small Cap

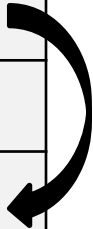
Percentage of Time International Small Caps Outperform International Large Caps on a Rolling Basis



Source: Wilshire Compass. International large-caps and international small-caps are represented by the MSCI EAFE and the MSCI EAFE Small Indices, respectively. For period of 12/31/99 to 6/30/18.

Asset Class Assumptions: 10-20 years annualized

Equity Asset Class	Return	Risk
U.S. Large Cap	7.00%	16.00
U.S. Mid Cap	7.25%	18.00
U.S. Smid Cap	7.38%	21.00
U.S. Small Cap	7.50%	24.00
International Large Cap	7.50%	18.00
International Small Cap	8.00%	22.00
Emerging Markets	9.50%	25.00
Global Equity	7.25%	17.50



Note: Annualized investment return net of fees.

Source: Investment Performance Services, LLC

International vs. US Small Cap

As of 12/31/17	MSCI AC World ex US Small Cap Index	Russell 2000 Index
Market Capitalization	\$2.4 billion	\$2.4 billion
# of Securities	4,355	1,983
Price/Earnings	13.9	20.1
Estimated 3-5 year EPS Growth	14.4	12.5
Dividend Yield	2.2	1.2
Return on Equity	11.7	6.5

Source: MSCI, Russell, Factset as published by DuPont Capital

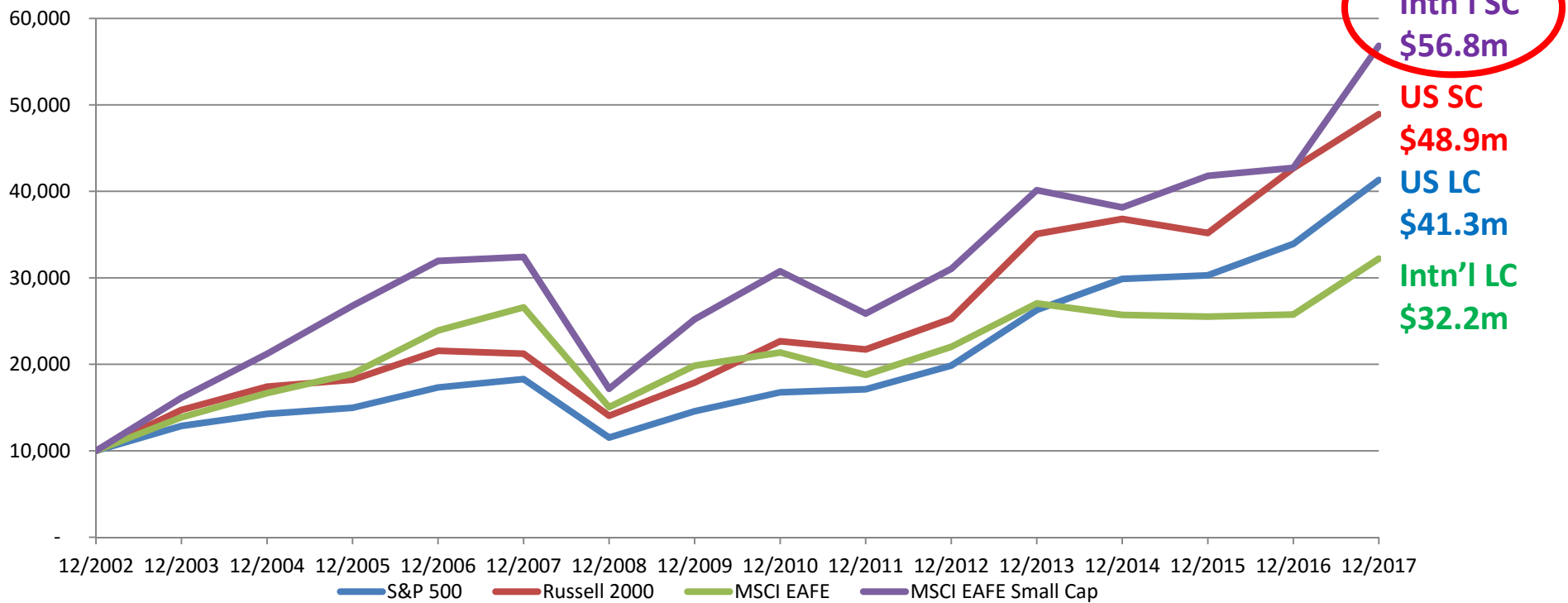
International vs. US Small cap

Currently, 39% of the companies in the Russell 2000 (US small cap) index are unprofitable or trading above 50x earnings!

In contrast, only 12% of the global small cap index share the same profile.

Growth of \$10 Million

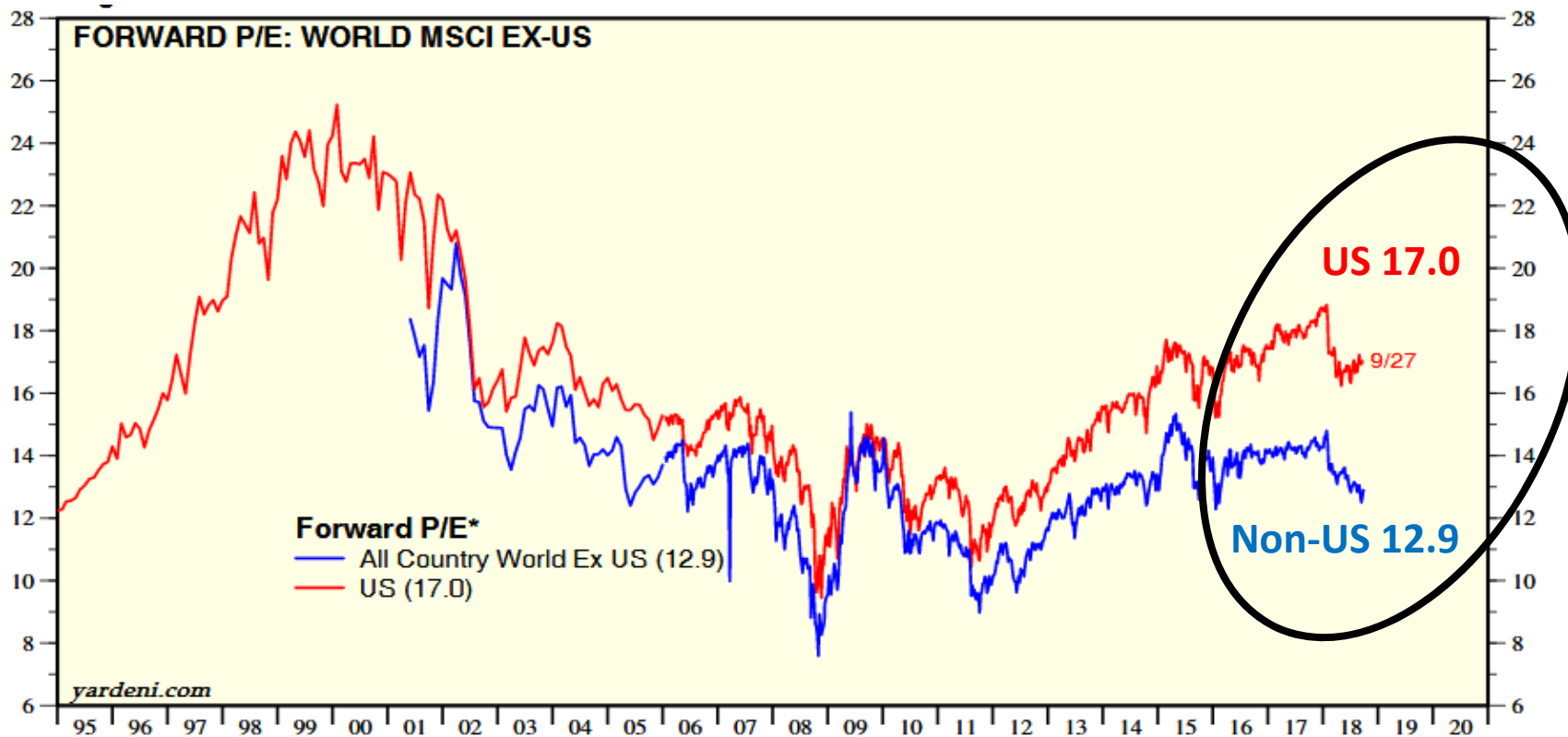
Fifteen Years Ending December 31, 2017



Why International Small Cap?

Opportunity

The US Market is Getting Expensive



Source: Yardini Research

Performance Gap Widens



The Need to Rebalance

As of October 1, 2018						Expected Annualized Return 10+ years (NOF)
Index	Style	1Q18	2Q18	3Q18	YTD	
S&P 500	US Large Cap	-0.8%	3.4%	7.7%	11.0%	7.50%
Russell 1000 Growth	US LC Growth	1.4%	5.8%	9.2%	17.4%	
Russell 1000 Value	US LC Value	-2.8%	1.2%	5.7%	4.2%	
Russell 2000	US Small Cap	-0.1%	7.8%	3.6%	10.0%	
MSCI EAFE	International Equity (Developed)	-1.7%	-1.1%	1.4%	-1.4%	8.00%
MSCI EAFE Small Cap	International Small Cap (Developed)	-0.2%	-1.3%	-0.9%	-2.2%	3.25%
Barclays Aggregate	Investment Grade Fixed Income	-1.7%	-0.2%	0.0%	-1.6%	
Barclays High Yield Ba/B 2% Cap	High Yield Fixed Income	-1.2%	0.1%	2.3%	1.8%	
NCREIF ODCE Equal Weighted	Real Estate	2.2%	2.1%	-	4.3%	

Key Takeaways Why International Small Cap?

Diversification

- **Underrepresented in most portfolios**
- **Not widely followed by analysts**
- **4,000 securities in universe**

Key Takeaways Why International Small Cap?

Potential for Higher Returns

- **Higher expected returns than US equities or International Large Cap**
- **Lower standard deviation than US Small Cap or Emerging Markets**

Key Takeaways Why International Small Cap?

Dynamic Opportunity Set

- **Revenues derived in local markets**
- **Need for portfolio rebalancing**
- **Ability to “buy low”**



Capacity
constrained.
Products
may close!



Jennifer Mink
Principal

jmink@ips-net.com

Thank you!



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