

US small cap value outlook 2027

From speculation to differentiation: positioning for a more selective market

By John Albert, Senior Portfolio Manager

Kevin Finn, Senior Portfolio Manager

26 November 2026

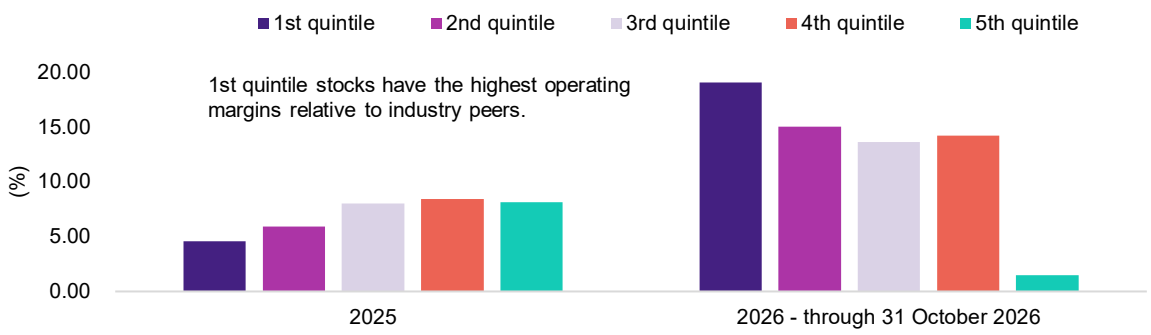
Summary

- Quality returned to favour in US small caps in 2026 after a speculative 2025. We believe this is the start of a more durable shift, not a one-year correction.
- A primary driver is the higher cost of capital. With the Federal Reserve (Fed) tightening again and an energy shock still working through the system, the gap between self-funding and capital-dependent businesses is expected to widen in 2027.
- We expect a year of dispersion rather than a broad rally. This is likely to reward disciplined stock selection that pairs attractive valuations with strong fundamentals. For global investors, US small cap value also offers domestic, economically sensitive exposure that differs sharply from the mega-cap technology leadership in global indices.

Quality returned in 2026. What comes next?

Going into 2026, Amova Asset Management's Global Equity Team observed that quality stocks had just suffered their steepest underperformance in two decades and that history pointed to a rebound. In US small cap value, that view has broadly played out. In 2025, speculative, lower-quality companies led while profitability, balance-sheet strength and cash generation were ignored. The market became more discriminating in 2026. Operating margin is one example: firms with the highest margins relative to their industry peers have outperformed those with the lowest by a wide margin (Chart 1).

Chart 1: Russell 2000 Value constituents, total return by operating margin quintile



Source: Factset, LSEG Data & Analytics, Amova AM

The question for 2027 is whether this is a one-year correction of the excesses in 2025 or the start of a more durable regime. We believe it is the latter, largely due to the return of a real cost of capital. The “Fed cuts, small caps rally” narrative that framed much of the past two years no longer fits the facts, and we believe that matters more for small companies than for large ones.

Capital has a cost again

The Fed raised its policy rate in September 2026, its first increase since 2023; as of this writing, the futures markets imply the Fed Funds rate rising from roughly 3.9% to about 4.6% by late 2027. Our focus, however, is less on the precise path of monetary policy than on its economic and market consequences.

For small caps, the impact of rates depends less on their direction than on when and at what cost companies must refinance. Compared with large caps, small companies typically have less mature balance sheets, lower free cash flow and greater reliance on outside capital. They also tend to carry more debt, and a larger share of it is floating-rate or shorter-dated. Many small companies are now replacing debt raised cheaply in 2020–2021 with materially more expensive borrowing. Self-funding and low leverage businesses, by contrast, are largely insulated. Higher rates therefore do not lift or sink small caps evenly; they separate strong businesses from weak ones.

History favours quality when capital costs rise

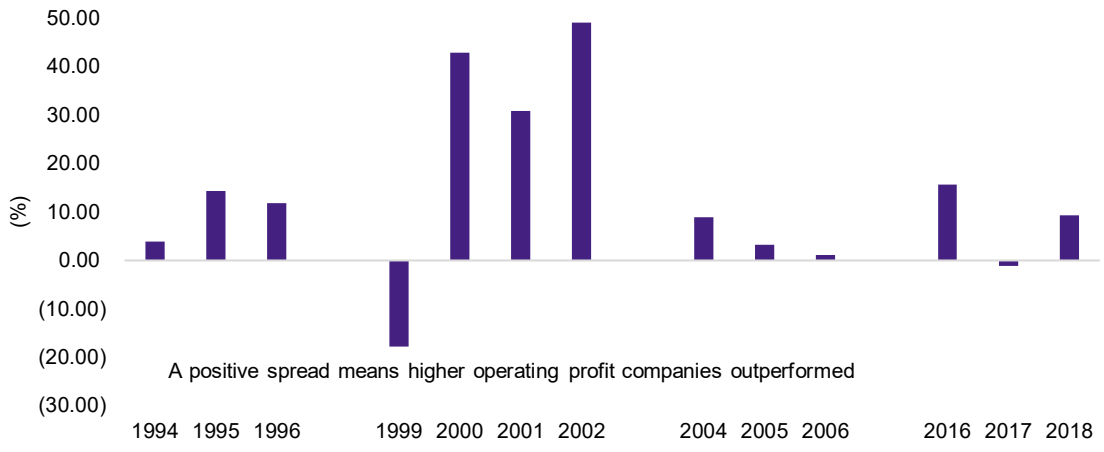
No single period is a perfect analogue, so we test several, asking how higher- and lower-quality US small cap value stocks performed under different cost-of-capital regimes.

Table 1: Historical regimes and their relevance to 2027

Period	Backdrop	Relevance to 2027
1994–96	Fed tightening followed by continued expansion	Small caps can work through a hiking cycle if growth holds
1999–2001	Highly concentrated leadership, then broadening	Broadening in 2027 does not require mega-cap technology to collapse
2004–06	Healthy nominal growth, meaningfully positive real rates	Cost of capital can reward profitable, self-funding businesses
2016–18	Rising rates with strong domestic economy and policy support	Domestic policy tailwinds vs. rate headwinds

The pattern is consistent: in most of these periods, companies with the highest operating margins outperformed those with the lowest (Chart 2).

Chart 2: Russell 2000 Value constituents, total return of top 20% less bottom 20% by operating margin



Source: Factset, LSEG Data & Analytics, Amova AM

Same economy, different outcomes

Interest rates are only part of the story. The US economy has outperformed expectations in 2026, with business investment as a share of GDP near the top of its historical range, driven by the artificial intelligence (AI) buildout. We expect business investment to continue and broaden in 2027. In small caps, the second-order beneficiaries are capital goods, electrical and industrial services, and power equipment and grid suppliers. The opposite risk sits with service businesses built on lower-cost labour, such as outsourcing, staffing and IT services, whose work AI may increasingly automate.

The energy shock is creating a similar split. The conflict involving Iran remains the main source of inflation risk. Brent crude has ranged from roughly US dollar (USD) 70 to USD 118 per barrel since February 2026, Persian Gulf flows, while they have recovered, remain at only about 80% of pre-conflict levels and refined products remain constrained. The disruption extends to liquefied natural gas, fertiliser and helium, adding cost pressure in chemicals, agricultural inputs and transport. Higher input costs fall hardest on thin-margin, leveraged businesses, which widens the same gap rising rates are already creating.

Meanwhile, expectations are high for small caps. Consensus estimates call for small-cap earnings per share to grow 37.9% in 2027, versus 15.8% for large caps. That supports a constructive view of the asset class, but it also raises the bar. With growth this uneven across industries, meeting those expectations will be a company-by-company exercise.

A distinct exposure for global investors

For non-US investors, US small caps are not simply a smaller version of the S&P 500. Global indices are heavily concentrated in a handful of US technology giants, while US small cap value is driven by domestic demand, regional banking, industrial activity, US policy and the cost of capital. Because these companies earn most of their revenue at home, they are less exposed to global trade disruption than small caps elsewhere. Nearly 90% of oil passing through the Strait of Hormuz flows to Asia, leaving the US relatively insulated, although companies that rely on Asian supply chains still carry disruption risk.

The trade-off is greater sensitivity to US interest rates and fiscal policy. With markets also pricing further tightening by the European Central Bank and the US dollar holding firm, currency is part of the return for non-US investors, and hedging decisions deserve explicit attention.

Conclusion: a favourable environment for active value

In our view, a meaningful cost of capital, widening fundamental dispersion and a broadening economy should create a more favourable backdrop for active value investing. We believe 2027 will be a market in which valuation and fundamentals matter increasingly at the company level, creating greater opportunity for disciplined stock selection. For global investors looking beyond concentrated mega-cap leadership, US small caps offer not just diversification, but a broader opportunity set in which selectivity can make a meaningful difference.

Important information: This document is prepared by Amova Asset Management Co., Ltd. and/or its affiliates（hereinafter referred to as" the Group"）and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect the Group's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. The Group makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

The Group accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of the Group under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by the Group is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Regional Finance Bureau (Financial Instruments firms) No. 368 Member Associations: Investment Management Association of Japan, Type II Financial Instruments Firms Association.

United Kingdom: This document is communicated by Amova Asset Management UK Limited, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

Ireland: This document is communicated by Amova Asset Management Ireland Limited, which is authorised under the European Union (Markets in Financial Instruments) Regulations 2017 (S.I. 375 of 2017) (as amended) and regulated in Ireland by the Central Bank of Ireland (C565118) and includes branches in Germany and the Netherlands. This document is for information purposes only and does not constitute an offer, invitation, or solicitation to invest in any fund or investment product, or recommendation to sell any financial instrument, nor does it constitute investment advice. This document is not intended for distribution to, or use by, any person in any jurisdiction where such distribution would be contrary to local law or regulation and is directed at professional investors only.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. An offering of any investments, securities or investment advisory services with respect to securities may only be made by receipt of relevant and complete offering documentation and agreements, as applicable. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Amova Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors, accredited investors as defined in the Securities and Futures Act 2001, and intermediaries only. Amova Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Amova Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Amova Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Malaysia: This document is issued by AHAM Asset Management Berhad (Registration No. 199701014290 (429786-T)), a company licensed by the Securities Commission Malaysia under the Capital Markets and Services Act 2007 to carry on fund management in relation to portfolio management, dealing in securities restricted to unit trusts, and dealing in private retirement schemes. This document has not been reviewed by the Securities Commission Malaysia.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Amova Asset Management UK Limited, which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Amova Asset Management UK Limited.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Amova Asset Management UK Limited is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Amova Asset Management UK Limited and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the group or Sumitomo Mitsui Trust group and not available to Amova Asset Management UK Limited because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Amova Asset Management UK Limited. No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Amova Asset Management UK Limited.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Amova Asset Management UK Limited.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. The Company is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.

Canada: The information provided herein does not constitute any form of financial opinion or investment advice on the part of the Company and it should not be relied on as such. It does not constitute a prospectus, offering memorandum or private placement memorandum in Canada, and may not be used in making any investment decision. It should not be considered a solicitation to buy or an offer to sell a security in Canada. This information is provided for informational and educational use only.