

Views From the Stream

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Equities: It's A Small, Small World By, Paul L. Sloate, CEO

For those of us who remember the 1990s Bull Market, it stood a wonderful and miraculous decade. The decade started with a major financial crisis. Housing Prices collapsed. Commercial Real Estate (CRE) Prices collapsed. Transportation Asset Prices collapsed. And Leveraged Buyout (LBO) Debt values collapsed. Numerous banks went out of business. Drexel Burnham Lambert, the junk bond king, disappeared overnight. And the Federal Government possessed no choice but to rescue Citigroup and Banc America and forge rescues of the major insurance companies who held large exposures to CRE and LBO Debt. In addition, despite an economic recovery early in the decade, the recovery became known as The Jobless Recovery, with economic growth paired with stubbornly high unemployment.

Out of this morass arose a massive recovery in the industrial economy. In addition, after collapsing from 1987 – 1993, Housing bottomed and began a long term recovery that would continue until the 2006 – 2007 Housing Bubble. Layered on top of this was the transition from analog wireless to 2G digital wireless telecom. This led to a significant buildout of wireless infrastructure and wired infrastructure to connect the towers to the telecom system. Separately, in 1996, in order to encourage the modernization of U.S. telecom infrastructure, Congress passed the 1996 Telecommunications Deregulation Act. This forced the incumbent telecom operators to open up their systems and allow competitors to connect to their networks and to collocate equipment in their facilities. This led to a boom in independent telecom companies known as CLECs, Competitive Local Exchange Companies. As a result, there occurred a massive buildout of telecom infrastructure as digital telecom replaced analog, both by the incumbent operators to remain competitive and by new companies determined to take share. On top of this, with the need to connect cities with digital infrastructure that could move the data between customers, there occurred a massive buildout of long range fiber networks. And lastly, due to the Y2K Bug, corporate computer networks needed upgrading in the second half of the decade. All of this combined drove massive, investment led growth in the 1990s.

Of course, things got out of hand at the end of the decade with massive overinvestment. And it ended badly in the early 2000s, with numerous companies going out of business. But it drove a long term Bull Market, led by Technology stocks. The likes of Intel, Cisco, and Corning became darlings of the market,

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FAMILY OFFICE

WSL Family Office
175 Strafford Avenue, Suite One
Wayne, PA 19087

www.wslfamilyoffice.com

trading at multiples of revenue and earnings not seen since the Nifty 50 of the late 1960s and early 1970s. And the picks and shovels of the time, semiconductors and optical equipment manufacturers, saw demand for their products explode, adding to the Technology driven Bull Market. Growth dominated over Value investing as they stood the beneficiaries of the renewal and establishment of digital telecom infrastructure. Small and Midcap stocks in traditional industries, from restaurants to consumer stocks to manufacturing to commodities, got left behind. By the late 1990s, many of them traded at mid single digit multiples of earnings as investor money flooded into Technology. Some even traded below four times their net income after tax.

However, with the popping of the Technology Bubble in 2000, Small Cap and Mid Cap stocks began to outperform their large cap brethren, which dominated the S&P 500 and NASDAQ. With better growth, these companies became the leaders of the market until the 2008 Financial Crisis. In addition, Commodities bottomed in 1998 and began a long term Bull Market that peaked a decade later in 2008. As an example, oil prices, which traded below \$6 per barrel in 1998, peaked at over \$140 per barrel in 2008. Combined, from an extreme nadir, these sectors went on to dominate for a decade.

Today, not surprisingly, after a decade long Technology-led Bull Market, performance and relative valuations eerily mimic those in the 1999 – 2000 period. The Top 10 Companies make up 39.3% of the S&P 500 weighting. (We note this is weightings 1 – 11 as Alphabet, formerly known as Google, receives two weightings in the Top 10 weightings due to its two classes of stock.) And, relative performance looks just the same:

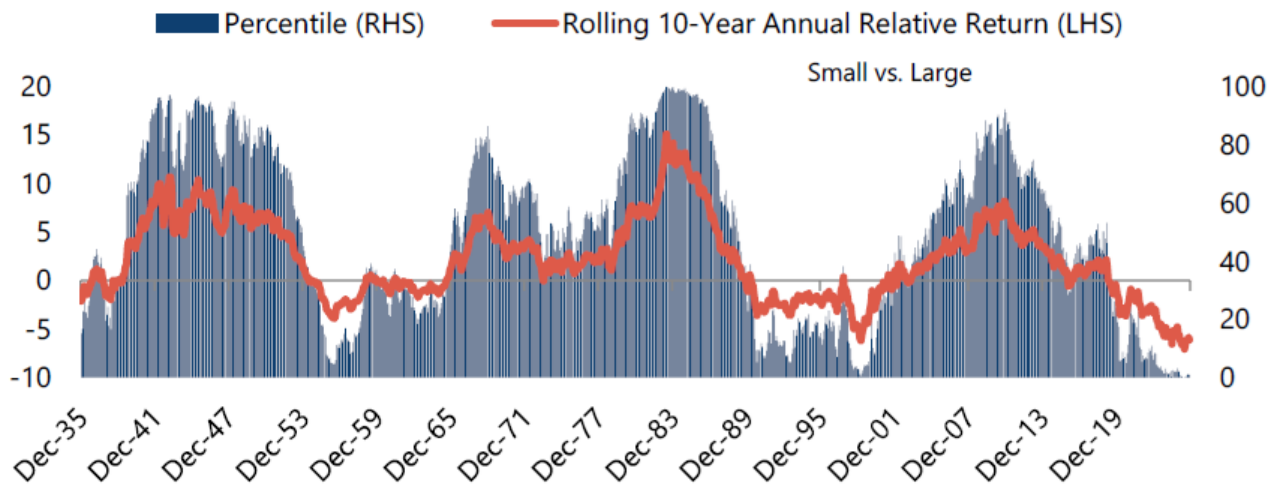


Chart courtesy of Jefferies, LLC

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It mimics the bottoms reached in 2000 and, before that, 1956, an incredibly rare occurrence. In addition, as of December, Small Cap stocks represented just 3.0% of the overall Equity Market. This compares to a long term average of 7.2%. And they stood in the 1st Percentile of Relative Performance. From these starting points of (10%) relative annual underperformance for a decade in 1956 and 2000, Small Caps reached outperformance of over +15% relative annual outperformance within 10 years. While the future remains uncertain, statistical extremes rarely last for long in the markets and tend to go to opposite extremes.

While history never repeats exactly, it rhymes, as Mark Twain once famously said. And, in this rhyming, there exists opportunity. With Small Cap Equities standing at such an extreme valuation relative to Large Caps in December 2025, it appears that the process to rectify this anomaly already began in January 2026, with Small Caps outperforming by almost 4%. Once this process starts, it rarely looks back. For Small Caps, the biblical phrase may apply, “The first shall be last and the last shall be first.” And while this may take a decade to fully unfold, for Equities, It’s A Small, Small World.

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