

## Rare Valuation Gap Between Small and Large Caps

Over the past five years, Swedish small caps have oscillated between a 10 percent premium and a 10 percent discount relative to large caps, according to a research note by a fund manager at SEB. In the preceding decade, however, they traded at an average premium of roughly 10 percent. Today, valuations point to a 5-10 percent discount, depending on the metric applied. "The gap between large and small has rarely been this wide," confirms Marcus Wahlberg, manager of the small and micro-cap focused long/short equity fund Elementa.

Going into 2025, sentiment toward Swedish small-cap equities was notably optimistic. Inflation was easing, policy rates appeared to have peaked, and expectations of an economic recovery supported a favorable macro narrative. Instead, the segment delivered one of its weakest relative performances versus the broader market in more than a decade. The start of 2026 has offered little relief. "These have been tough times for the stock market's small caps and micro companies," says Wahlberg.

Swedish small caps are trading below their historical valuation averages, a development partly explained by persistent negative fund flows. Historically, the segment has shown a clear relationship between flows and performance: periods of net inflows have typically coincided with strong returns, while sustained outflows have tended to accompany weaker performance. In 2025, Swedish small-cap funds experienced substantial redemptions, with outflows intensifying in the fourth quarter and adding further pressure on returns, according to the research note from SEB. The pattern has continued into early 2026.

"When we say we see many opportunities in small caps, we mean that these outflows have created significantly more long-term stock-picking opportunities than we've seen at any point in the past ten years," says Wahlberg. However, he draws a clear distinction between selective exposure and broader market beta. In his view, broad small-cap index exposure carries excessive market risk and includes companies that are effectively too large to offer true small-cap alpha. "We do not mean buying a broad small-cap index, which carries too much beta and includes companies that are too large," he explains.

While Wahlberg sees compelling bottom-up opportunities within the small- and micro-cap universe, the fund's positioning is predominantly shaped by the unusually wide valuation gap between small and large companies. The rising stock market has been driven by low-growth companies, which should not be sustainable over time, considers Wahlberg. "We normally don't invest in spreads, but this one is too good not to take advantage of," he says. "From these levels, we believe the probability of success over time is high."

Elementa is long a portfolio of carefully selected small-cap names and short large-cap companies, as well as certain small caps. Overall, the fund maintains a net short exposure on a fully delta-adjusted basis, with the short book in large caps, partly implemented through put options, exceeding the long exposure in small caps. For Wahlberg, the current imbalance between segments represents a rare opportunity where relative value, rather than broad market direction, is expected to be the primary driver of returns.