TOP 10 REASONS TO OWN SMALL CAP EQUITIES

AlphaNorth
Asset Management

1. SMALL CAP EQUITIES OUTPERFORM OVER THE LONG TERM

Historical data demonstrates that over the long term, the small cap equity asset class significantly outperforms other investment alternatives. Since 1950, U.S. small cap equities have returned 13.6% as compared to the next best major asset class, U.S. large cap equities (S&P 500 index) , which returned 11.0%.

Source: 2011 Morningstar Andex Chart

2. ATTRACTIVE RISK/REWARD

It has been demonstrated in recent years that even what investors consider AAA or "blue chip" companies can lose all or a substantial portion of their value. Examples include Nortel, General Motors, Bank of America, Enron, etc. When purchasing shares, the downside is always 100%, regardless of whether an investor buys shares for $100 per share in a "blue chip" or $0.10 in a junior mining company. However, the reward potential is typically dramatically higher for small companies. For example, investors purchasing shares in Apple today cannot reasonably expect to achieve 1,000%+ returns within a reasonable period of time, if at all.

3. HIGHER GROWTH RATES

It is much easier for small companies to grow quickly in percentage terms. Often high percentage growth rates translate into correspondingly high share price gains. Over the years, the AlphaNorth team has invested in a number of companies over the years where gains in excess of 1,000% were realized while a few have been as high as 100x our initial investment.

4. BROADER SELECTION

The number of companies listed on the TSX is over 4,000. Only 229 of these companies have a market capitalization over $1 billion. *(As of Jan 1, 2012)*

5. OVER THE LONG TERM SMALL CAP EQUITIES ARE LOW RISK AND PROVIDE ONE OF THE BEST WAYS TO BUILD LONG TERM WEALTH

There is a common misperception in the media and amongst professional investors that small caps are high risk investments. Often, investors focus on the short term volatility of monthly returns to measure risk. It is from this perspective that small cap equities can be considered higher risk. However, over the long term, the true risk to investors is not meeting their wealth accumulation goals due to insufficient growth and the loss of real purchasing power. For long-term investors with the goal of building long-term wealth, the risk is quite low. In fact, other asset classes and other low volatility strategies put investors at increased risk of not meeting their long-term financial goals.

6. QUICKLY ADJUST TO CHANGING MARKET CONDITIONS

The ability to act quickly and possibly even change the entire focus of the company have allowed many small cap companies multiple chances at success.

7. LOWER VALUATIONS DUE TO LIQUIDITY DISCOUNT

Despite higher growth rates, which should command a premium valuation compared to their peer group, small companies often trade at a liquidity discount. Small cap investors who invest from a longer term perspective can benefit from this favourable pricing.

8. MARKET VALUATION INEFFICIENCIES

There is considerable potential to add value through proprietary research and active management. Share prices are often less efficient as there are fewer investors focused on this area and there is often no analyst coverage. Many mutual funds do not have the ability or investment mandate to purchase small companies.

9. FAVOURABLE TAX TREATMENT

Gains for small cap equities are usually taxed as capital gains which has more favourable tax treatment as compared to dividends and interest income.

10. ACTIVE MANAGEMENT ADDS VALUE

Most often, small cap companies obtain financing by way of selling units which include the free upside leverage of warrants. Passive fund investment strategies as well as many retail investors are unable to participate in these deals. Fund managers can take advantage of these opportunities to add value (alpha).

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