

# NICHOLAS INVESTMENT PARTNERS

January 2019

## Investment Insights:

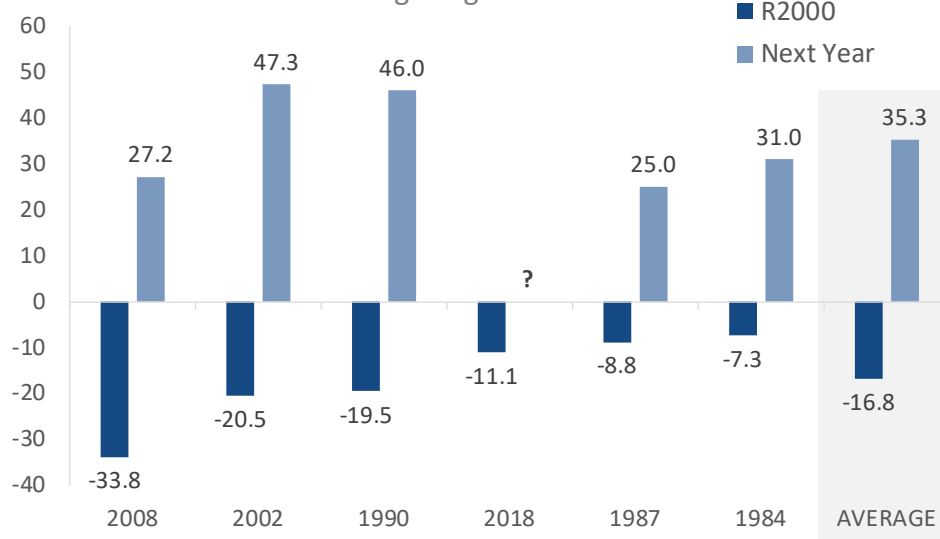
### 4Q 2018 US Small Cap Bear Market Creates Opportunity

The Russell 2000 Index fell -27% in 4Q 2018 with more than 2 out of 3 stocks falling over 20%, in bear market territory. This pullback resulted in the Russell 2000 Index dropping -11.1% for 2018, the fourth worst year since the inception of the Russell 2000 Index in 1979. Historically, strong performance for small cap has followed a big negative year:



**Catherine Nicholas**  
Managing Partner and  
Chief Investment Officer

Russell 2000 Index Performance  
Following a Big Calendar Year Loss



As of December 31, 2018. Source: FTSE Russell, Jefferies, Nicholas Investment Partners. Supplemental information. Results may vary for different time periods. Past performance is no guarantee of future results.

## KEY TAKEAWAYS

- 4Q 2018 Small Cap Bear Market Creates Opportunity
- Better Valuations for Small Cap
- Stronger Earnings Expectations for Small Cap



## Better Valuations for Small Cap

As a result of the 4Q 2018 pull back, small cap valuations are more compelling relative to their long-term historical averages and large cap. M&A activity targeting small cap is picking up as valuations have fallen and corporate cash holdings are at a record high.

Valuation Metrics	Russell 2000			Russell 1000			R2000 v. R1000		
	Current	LT Avg	% Diff	Current	LT Avg	% Diff	Current	LT Avg	% Diff
Trailing P/E (Non negative)	16.1	17.5	-8.5	18.1	17.5	3.3	0.9	1.0	-13.5
Forward P/E	18.0	15.9	12.9	16.7	15.4	8.6	1.1	1.1	2.7
Price to Book	1.9	2.0	-8.5	2.7	2.7	2.0	0.7	0.8	-13.8
Price to Cash Flow*	16.9	16.4	3.4	12.3	12.5	-0.9	1.4	1.3	4.4
Price to Sales	1.7	1.1	53.9	2.2	1.4	56.4	0.8	0.8	-4.2

\*Price to cash flow started in 2002. Note: from March 31, 2016 forward Jefferies estimates. As of December 31, 2018. Source: FactSet, FTSE Russell, Jefferies, Nicholas Investment Partners. Supplemental information. Results may vary for different time periods. Past performance is no guarantee of future results.

## Stronger Earnings Expectations for Small Cap

Small cap's more US-focused revenues are better insulated from the current US-Chinese trade war and the economic slowdown in Asia and Europe. This is causing analysts to cut earnings estimates for large cap. Small cap consensus earnings are now more compelling on an absolute and relative basis to large cap.

### Conclusion

2019 has gotten off to a good start with the Russell 2000 Index up 7.20% vs. 4.40% for the Russell 1000 Index through the first half of January.\* We positioned Nicholas Partners US Small Cap portfolio to capture the opportunity created by the 4Q 2018 pull back. For example, we bought back a number of stocks at 20–30% discounts from where we had sold them earlier in 2018, when they reached our previous price targets. We believe that the better relative valuations and earnings for small cap stocks creates more opportunity, especially as growth becomes more scarce so it commands more of a premium.

\*Index performance from January 1 through January 15, 2019.

### Forecasted Earnings Estimates

Quarter	Year-Over-Year Earnings (In %)		
	Small	Mid	Large
Q4 2018	12.0	13.0	12.6
Q1 2019	4.2	5.0	3.8
Q2 2019	7.1	5.7	4.5
Q3 2019	13.4	6.1	4.7
Q4 2019	23.7	15.7	11.9
<b>2019</b>	<b>15.2</b>	<b>9.2</b>	<b>6.9</b>

As of December 31, 2018. Source: FactSet, Standard & Poor's, Jefferies, Nicholas Investment Partners. Supplemental information. Results may vary for different time periods. Past performance is no guarantee of future results.

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