



C A M B R I D G E A S S O C I A T E S L L C

EUROPEAN MARKET COMMENT: SMALL, BUT SIGNIFICANT

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Small, but Significant

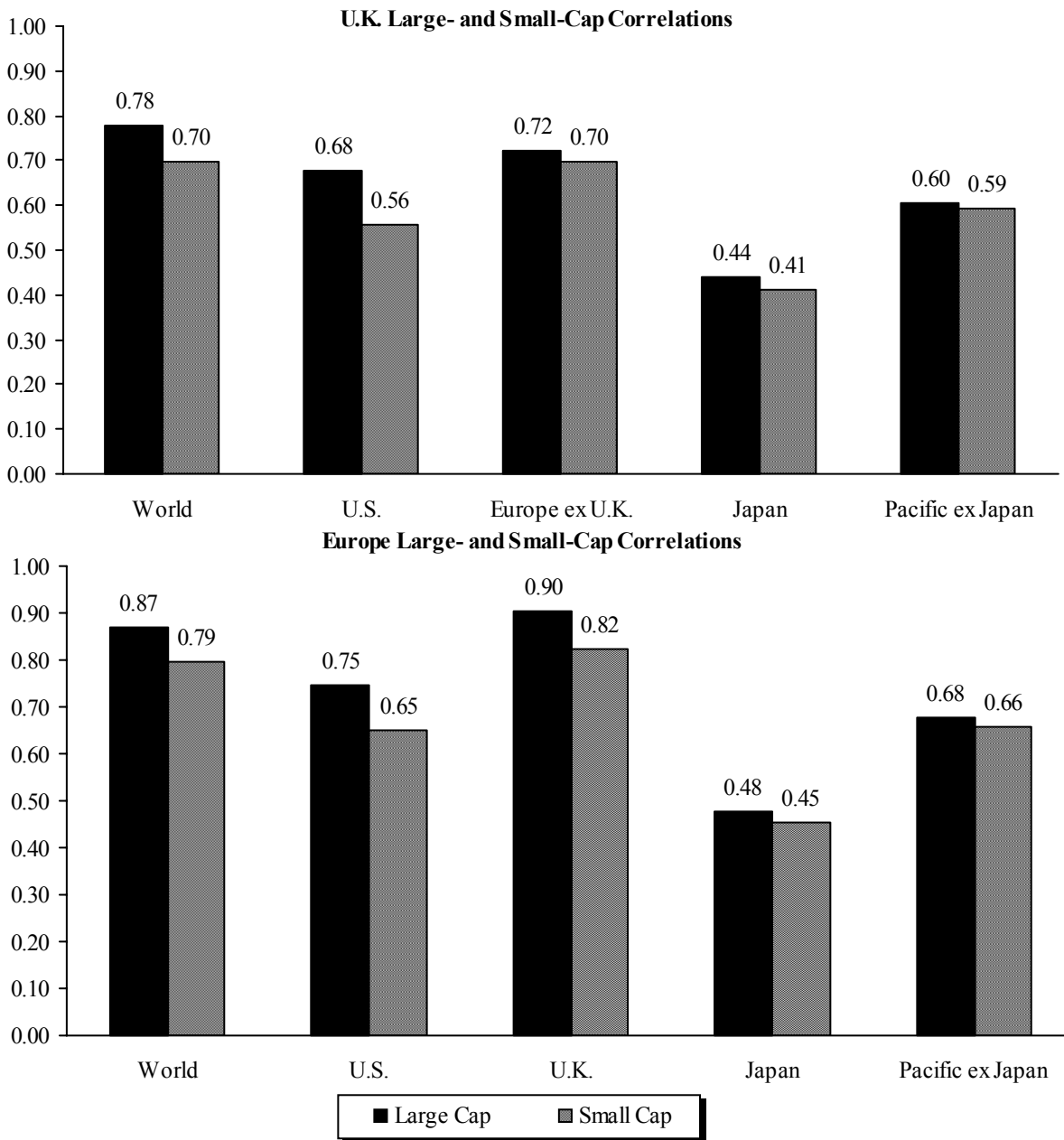
At times of economic dislocation, investors tend to prefer the relative security of blue chip stocks. Illiquid small-cap stocks also lose out as traders mark down prices in a bid to get them off their books. Prior to October, smaller companies suffered as money fled to the safe havens of oil companies, pharmaceutical companies, and banks. Some market strategists have argued that investors should not sell off small caps because their greater domestic focus can offer greater diversification possibilities amid increasingly correlated global equity markets.

Right song wrong lyrics. Small-cap stocks are attractive, but not because of their global diversification characteristics. As indicated in Table A, the correlation of U.K. and European small-cap shares with those of other global developed markets is only slightly lower than that of larger-cap issues—not enough of a difference to be statistically meaningful. However, there are two valid reasons for investing in small-cap issues today. First, as shown in Table B, small-cap stocks do provide some added diversification within *domestic* markets, as the relative outperformance of small caps and large caps are largely counter-cyclical. Second, valuations of small-cap stocks in the United Kingdom and Europe are more attractive than those of their large-cap brethren.

Table A

U.K. AND EUROPE CORRELATIONS WITH SELECTED REGIONS

1 July 1989 - 31 October 2001



Source: Salomon Smith Barney.

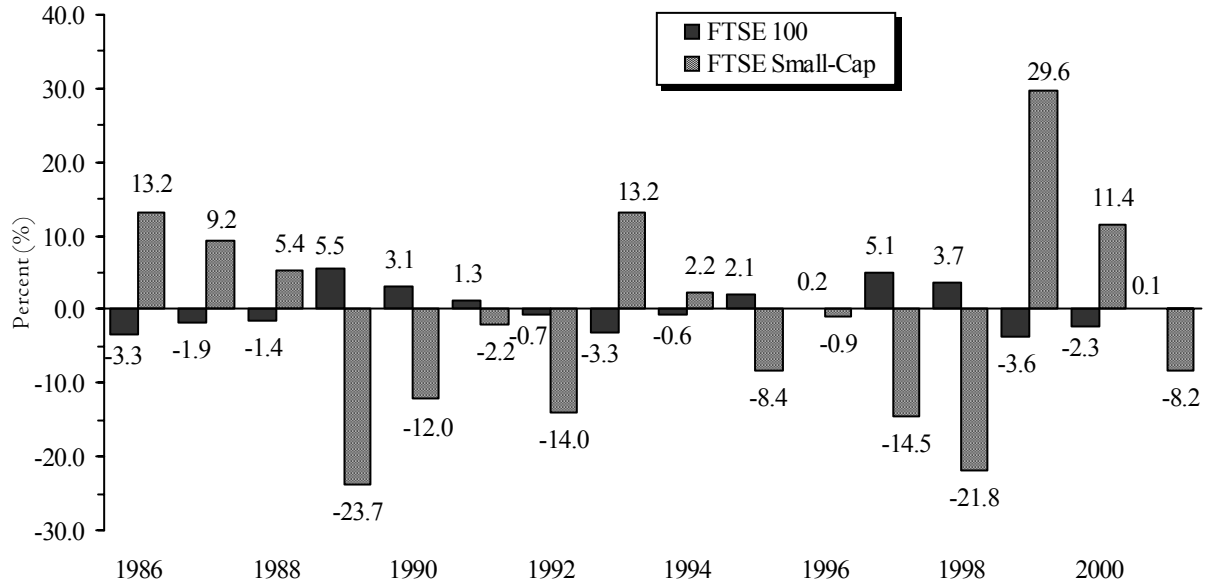
Notes: Large- and small-cap stocks are represented by the Salomon Smith Barney U.K. and Europe Primary and Extended Market Indexes. Correlation data consist of monthly returns for Europe and U.K. against Salomon Smith Barney Broad Market Indexes for the selected regions.

Table B

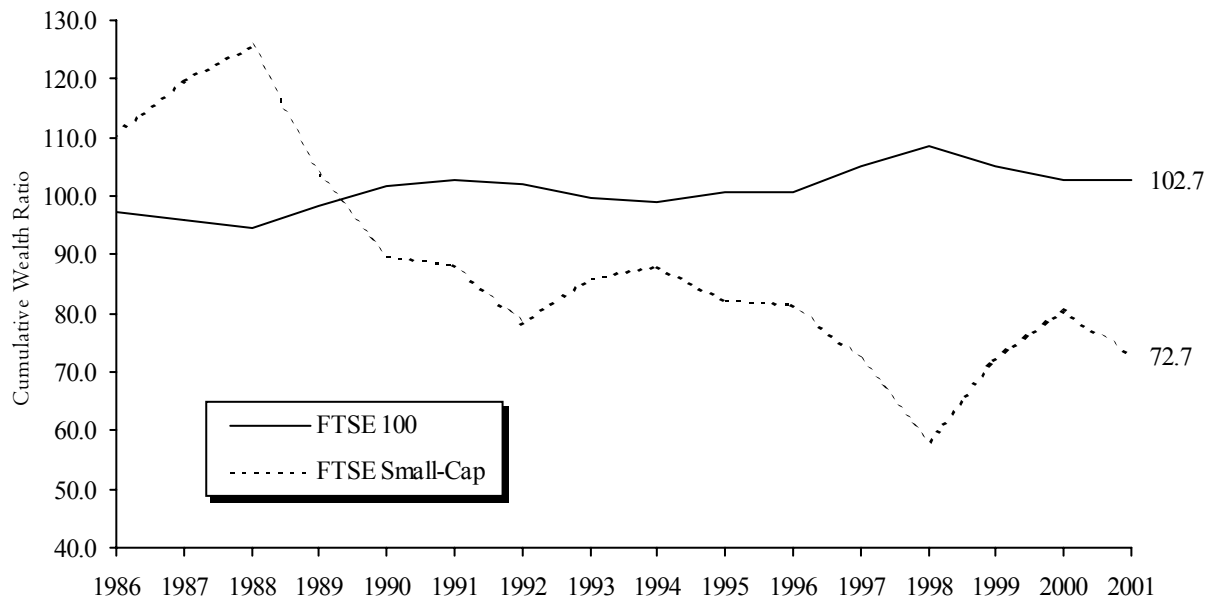
FTSE RELATIVE RETURNS AND CUMULATIVE WEALTH

1 January 1986 - 31 October 2001

Annual Returns (%) Relative to the FTSE All-Share



Cumulative Wealth Relative to the FTSE All-Share



Source: Datastream International.

Note: 2001 data reflect a cumulative return from January through October.