

Mini Ratna

Portfolio of Smallcaps with the Potential to Become Future Mid & Largecaps

What Makes us Positive on Smallcap Index Rebounding Going Ahead?



Massive Erosion in Marketcap of Smallcap Stocks



A Ratio you can not Ignore



In a rare instance, midcap index valuations trading below Nifty valuations

➤ Massive Erosion in Marketcap of Smallcap Stocks

Timing is one of the main factors for earning handsome returns in Smallcap stocks. Given that timing is crucial, what is the best time to invest in Smallcaps?

It is when pessimism in these stocks is at its peak.

With a fair amount of confidence, we conclude that the pessimism in these stocks have reached a peak given the deep correction stocks prices have been through. Market capitalization of Smallcap companies as highlighted in red has seen correction to the tune of 38.3% and 66.6% respectively since January 2018. This is in contrast to top 25 Nifty companies which witnessed a positive move of 28%.

Segregation of Listed Companies as Per Latest Market Cap	Market Cap as on 31 Dec 2019 (in cr)	Market Cap as on 15 Jan 2018 (in cr)	Change in Market Capitalization	Median Price/Earnings (PE)
1-25	7392224	5765494	28.2%	28.2
26-50	2065873	2011840	2.7%	32.5
51-100	1964240	2180572	-9.9%	30.0
101-250	2297754	2672909	-14.0%	24.3
251-500	915463	1482798	-38.3%	19.9
501-1109	330292	987616	-66.6%	11.5

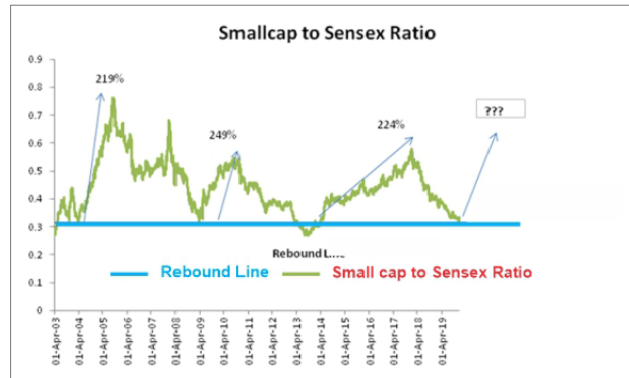
Source: ACE Equity

These smallcaps are trading at a very attractive valuation owing to such a deep correction. Median price/earnings (PE) ratio of these companies is trading at a huge discount to largecaps as seen in the table.

➤ A Ratio you Cannot Ignore

This ratio is Smallcap Index to Sensex Ratio. To simplify, if Smallcap Index is trading at 7000 and Sensex is trading at 35000, then Smallcap Index to Sensex Ratio stands at $(7000/35000) = 0.2$.

We studied how this ratio has moved since 2003. And the most important number to keep in mind is 0.3. Everytime this ratio has moved to 0.3 as seen in the chart below, there is a huge up-move in the Smallcap index.



Source: ACE Equity

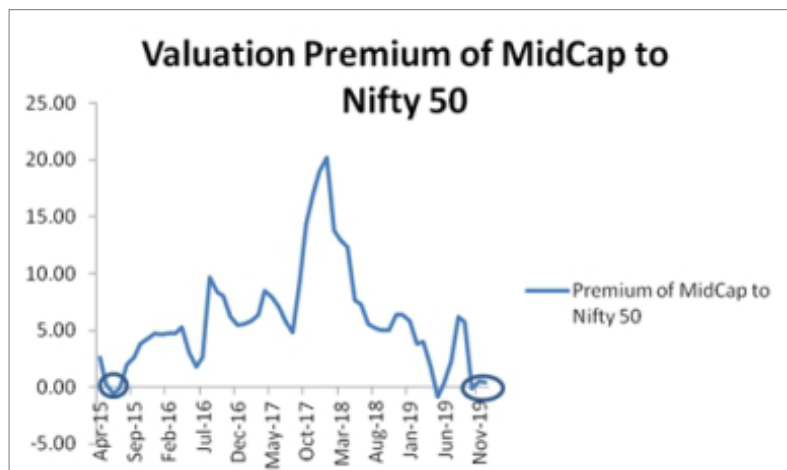
The first time it happened in 2003 – the index jumped by 219%. The second time it happened in 2009 – the index jumped by 249%. The third time it happened in 2013 – the index jumped by 224%.

Now the ratio has once again touched this Rebound Line. And there is a possibility of the index to rebound massively from current levels.

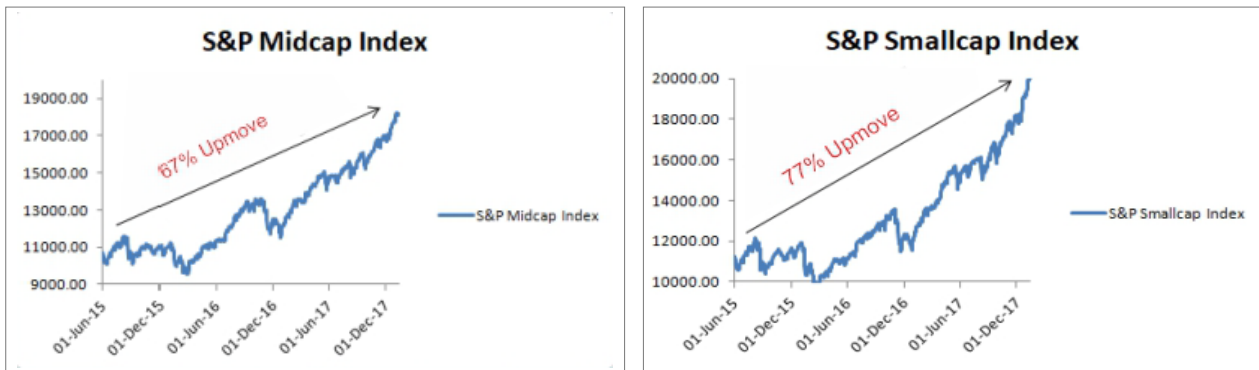
➤ In a Rare instance, Midcap index Valuations Trading Below Nifty Valuations

Price/ Earnings valuation of Midcap and Smallcap indices either trade at a discount or premium to Nifty index. To simplify, if Nifty trades at a price/earnings multiple of 30x and Midcap index trades at 28x, then we conclude that Midcap Index is trading at a discount to Nifty Index by $(28x-30x) = - 2x$. In the similar example, wherein Midcap index trades at 33x, then Midcap Index is trading at a premium to Nifty Index by $(33x-30x) = + 3x$.

Historically, Midcap and Smallcap index have traded at a premium to Nifty Index. However, given the massive correction seem since January 2018, valuation premium has now converted to discount as circled in the chart. A similar phenomena also happened in June 2015 as see in the chart.



It's interesting to see how Midcap & Smallcap index recovered since June 2015 given the attractive valuations.



Midcap and Smallcap index moved higher by 67% & 77% higher in a span of just two and a half years. Given that valuations again are trading at a discount, there could be a similar up-move in the indices.

Please refer to the disclaimers on the [website](#)