

What Has Private Equity Done to Small-Cap Stocks?

Private markets have grown exponentially over the last two decades, driven by attractive long-term returns, diversification benefits, and early-stage value creation. As companies stay private longer, much of their initial growth can be realized outside of public markets, which could challenge the small-cap premium and contribute to a shift in the composition of public markets. The following newsletter examines this dynamic and potential impact on small-cap stocks.

PRIVATE EQUITY LANDSCAPE

Performance has been one of the primary drivers of private market growth. Over the long term, private equity has consistently outperformed public markets, as shown in Exhibit 1. However, exceptionally strong equity markets in 2023 and 2024 have challenged more recent relative performance between public and private markets. That said, the attributes of private markets extend beyond returns. More specifically, private markets offer diversification benefits which can reduce overall portfolio volatility¹ while enhancing long-term gains. Additionally, private equity investors — through majority control or active ownership — can implement operational efficiencies and strategic growth initiatives which drive higher profitability and long-term capital appreciation.

Exhibit 1: Long-term performance

	1 Yr (%)	3 Yr (%)	5 Yr (%)	10 Yr (%)	15 Yr (%)	20 Yr (%)
U.S. Private Equity	6.7	2.7	16.6	15.1	15.8	13.9
Russell 3000	35.2	10.3	15.3	12.8	13.8	10.6
Russell 2000	26.8	1.8	9.4	8.8	10.6	8.5

Source: Bloomberg, Burgiss U.S. Private Equity as of September 30, 2024

¹ Private equity achieves this through quarterly valuations instead of daily market pricing, insulating it from short-term public market swings.



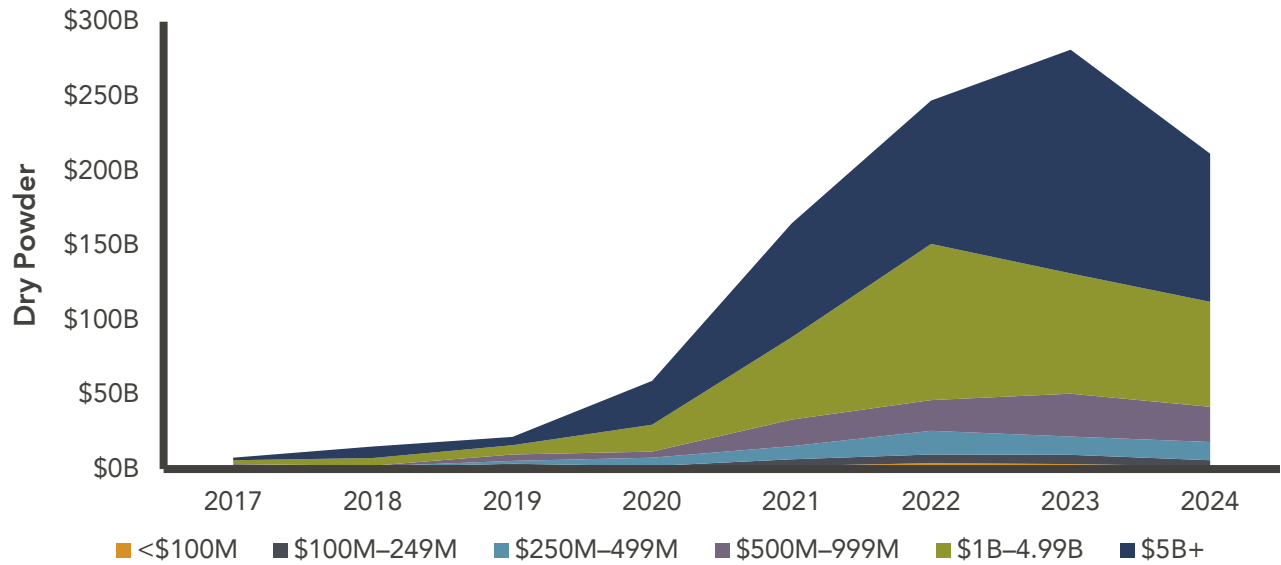
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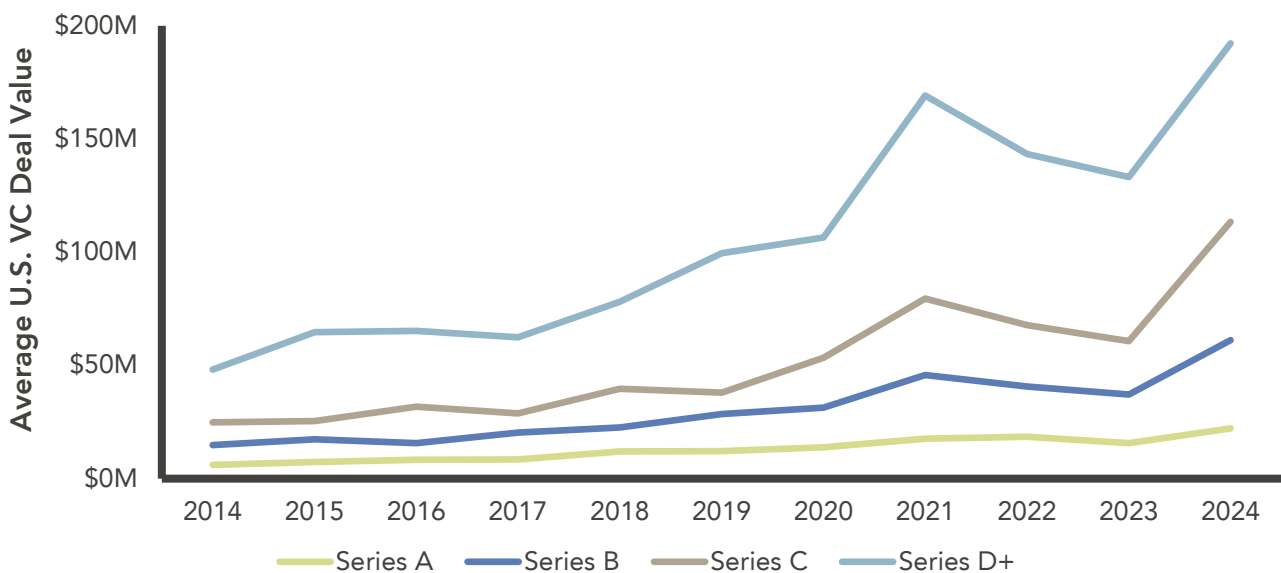
Predictably, these benefits have led to increasing investor allocations, which are reflected in the substantial capital raised by private equity and venture capital (VC) firms. While fundraising has slowed from its 2021 peak, the industry still holds significant levels of dry powder, which supports the expansion and innovation of private companies. As shown in Exhibit 3, the majority of capital is raised at the upper end of the market, allowing firms to invest in more established businesses. Larger funds, having raised substantial amounts of capital, can support bigger deals in the later-stage VC market. The average Series D round has grown from approximately \$50 million in 2014 to nearly \$200 million in 2024. This financing enables companies to undertake large-scale transformations that previously required an initial public offering (IPO). As a result, companies can fund growth, scale operations, and drive technological advancements without the immediate need to go public.

Exhibit 2: U.S. private equity dry powder by size bucket



Source: Pitchbook as of December 2024

Exhibit 3: U.S. venture capital deal value by series

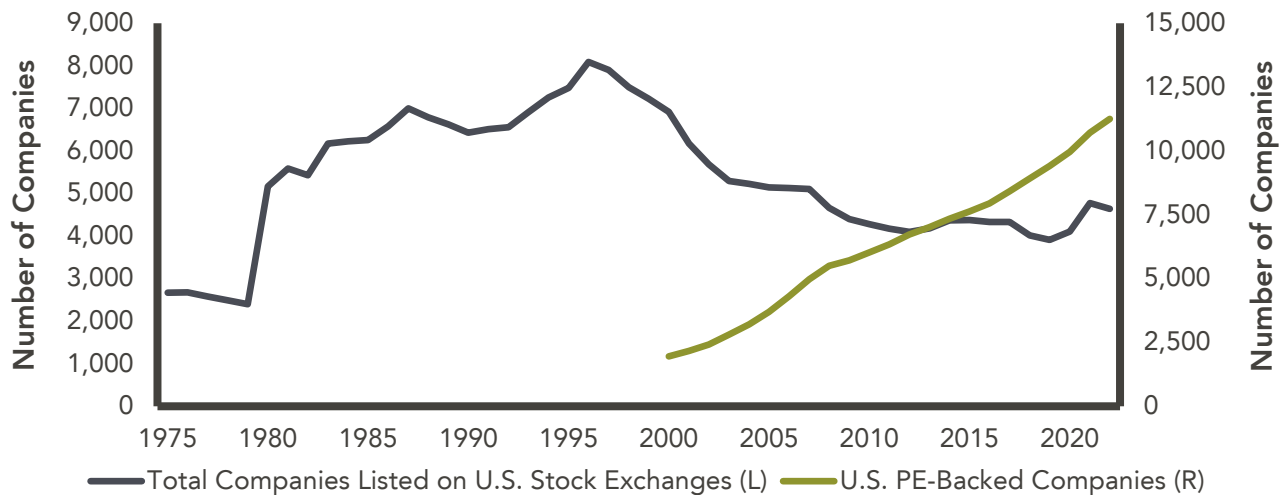


Source: Pitchbook as of December 2024

PUBLIC EQUITY LANDSCAPE

As private markets have grown in popularity, the trend in U.S. equities appears less favorable. The number of companies listed on U.S. stock exchanges has decreased substantially since its peak in 1996, as it nearly halved to less than 4,700 in 2022. At the same time, as shown in Exhibit 4, the number of U.S. PE-backed companies grew to over 11,000. There are several reasons for this decline, including a decrease in IPOs and an increase in merger and acquisition activity, as companies have opted to stay private for longer. Since 2000, the IPO market has not been as prosperous. The number of annual IPOs has fallen to an average of roughly 250, with the exception of an outlier year in 2021 when over 1,000 companies went public. Additionally, the average age of companies at IPO increased from about four years to twelve.² There are a variety of reasons behind these trends but one notable motivation for companies to remain private is a considerably lower regulatory burden. Public companies must adhere to strict reporting requirements which can be costly and time-consuming, while also exposing companies to immense public scrutiny. As a result, private markets have become a more attractive option for many businesses. There are potential consequences as more companies opt to remain private, however, as decreased regulatory oversight hinders market transparency, which may diminish investor trust in the market and potentially overall confidence.

Exhibit 4: Historical number of public and private equity companies

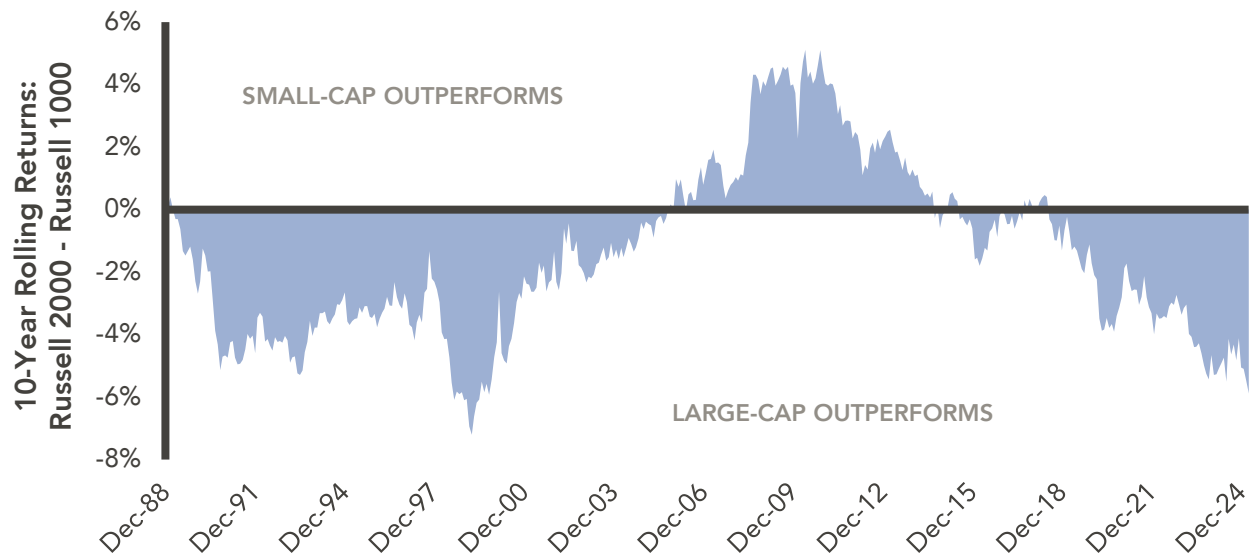


Source: World Bank Group, Pitchbook; data for U.S. PE-Backed companies available since 2000

For U.S. equity markets, this trend has put pressure on the small-cap premium as the Russell 2000 underperformed the Russell 1000 in 10 of the last 11 calendar years. While prolonged periods of leadership in public markets are not unusual, small-cap underperformance has been historically notable amidst one of the longest large-cap cycles in history. The last small-cap cycle began after the Dot-Com Bubble but the composition of the public equity market has since evolved, particularly as the amount of capital invested in private equity has ballooned. This may impact the outlook for small-cap equities if a new cycle emerges. Given the current period of underperformance, mean reversion suggests markets are poised for a small-cap revival as valuations for high-quality small-cap companies that grow at structurally high rates are more attractive than large-cap peers. This alone, however, will not be enough to drive a pronounced market shift. Small-cap earnings have been depressed and a reversal in this trend is a necessary catalyst for a meaningful change. Furthermore, the quality of the small-cap equity market has come into question with non-earners surpassing 40% of the Russell 2000. These companies are more commonly distressed or illiquid with lower average returns which may negatively impact relative performance.

² Source: Statista

Exhibit 5: Long-term performance for U.S. equity markets



Source: eVestment as of March 31, 2025

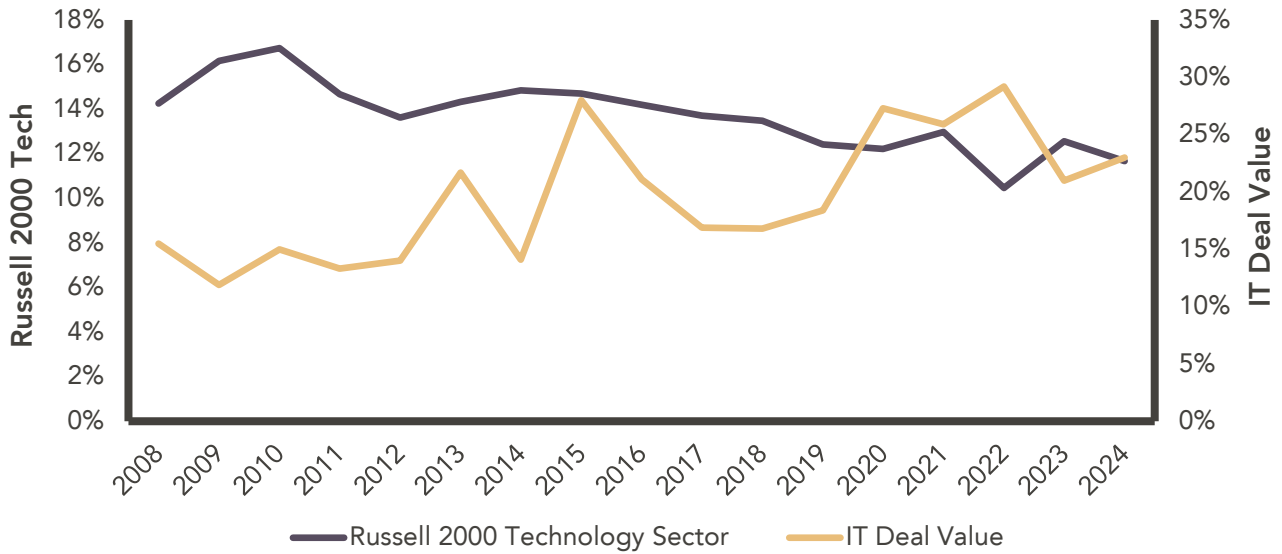
PUBLIC AND PRIVATE EQUITY INTERTWINED

Many high-quality small-cap companies that traditionally pursued IPOs are increasingly opting to remain private. This shift may fundamentally alter where value creation occurs, with an argument that early-stage growth may be increasingly realized in the private sector rather than after a public listing. Historically, much of a company's growth and value generation occurred after it went public, allowing retail investors to participate in its early success. Today, however, companies are staying private for longer, often until they are well-established and mature. For example, the average age of a technology company at IPO has risen to approximately 14 years, compared to just six years in 2000.³ By the time these firms enter public markets, a larger proportion of their explosive growth has already been captured by private investors.

This has implications for small-cap equities, as companies going public larger and older could threaten the small-cap premium evident in prior cycles. While there are still ample companies in the small-cap universe that can achieve meaningful growth, the universe has shrunk while the number of high-quality larger-cap growth companies has increased. Additionally, as private equity has seen increased deal value in the Information Technology, Healthcare, and Consumer sectors — the notoriously growthier segments of the public market — there may be shifts in public market composition. For example, the Information Technology sector grew to compose the largest share of U.S. private equity deal value in 2022, while its makeup in the Russell 2000 fell to its lowest level. These structural shifts may raise questions about the persistence of the small-cap premium. Despite these potential challenges, however, small-cap equities still offer benefits, most notably diversification, liquidity, and attractive valuations relative to other segments of the U.S. equity market.

³ Source: Apollo

Exhibit 6: Shift in market composition



Source: Bloomberg, Pitchbook as of December 31, 2024

As both the private and public equity markets evolve, it is critical to consider private equity exposure when thinking about a small-cap allocation, given how these asset classes are inherently intertwined. For example, factors including market cycles, sector dynamics, and capital availability may create more similar return drivers than expected. Conversely, ownership structures differ fundamentally as private equity investors typically have concentrated active ownership with direct influence over management, while small-cap public equities are broadly held and subject to market-driven governance. It is also important to be aware of the distinct benefits and risks of both allocations. Public markets offer better liquidity and lower fees while private markets may mitigate volatility. Despite their differences, these asset classes offer investors access to growthier segments of the market. Although early-stage growth may increasingly be realized by private investors, the small-cap universe remains sizeable with ample opportunities to capture growth, as well. By recognizing how these markets complement and interact with each other, investors can make better-informed decisions and align their allocations with long-term growth and liquidity goals. ■

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