

Market Perspectives

4Q25 Small-Cap Recap

By Francis Gannon Last updated January 02, 2026

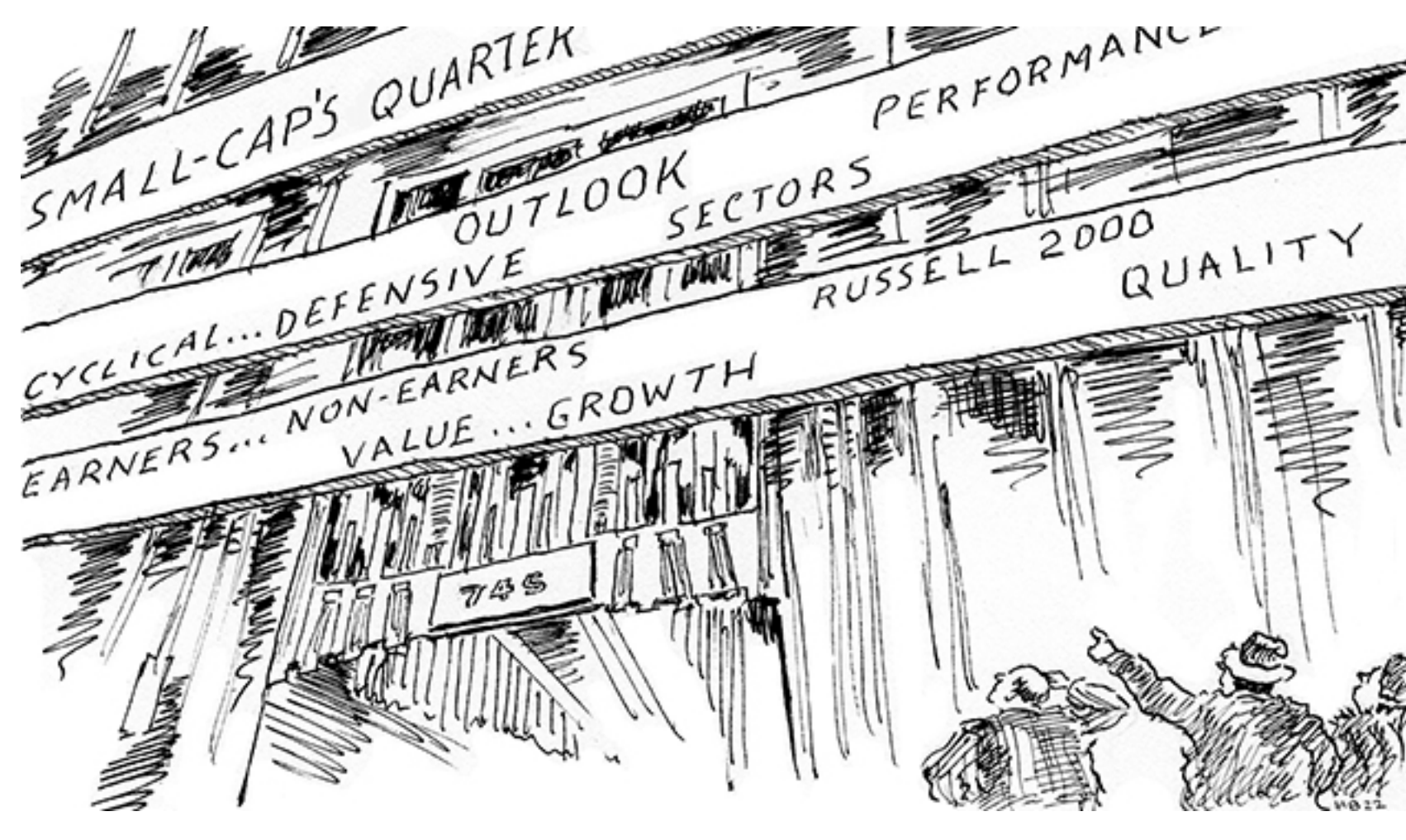
More about Francis Gannon

Francis Gannon
Co-Chief Investment Officer, Managing Director

19
YEARS AT ROYCE

33
YEARS OF EXPERIENCE

Small-Caps Stay Positive, Micro-Caps Take the Lead



TELL US WHAT YOU THINK

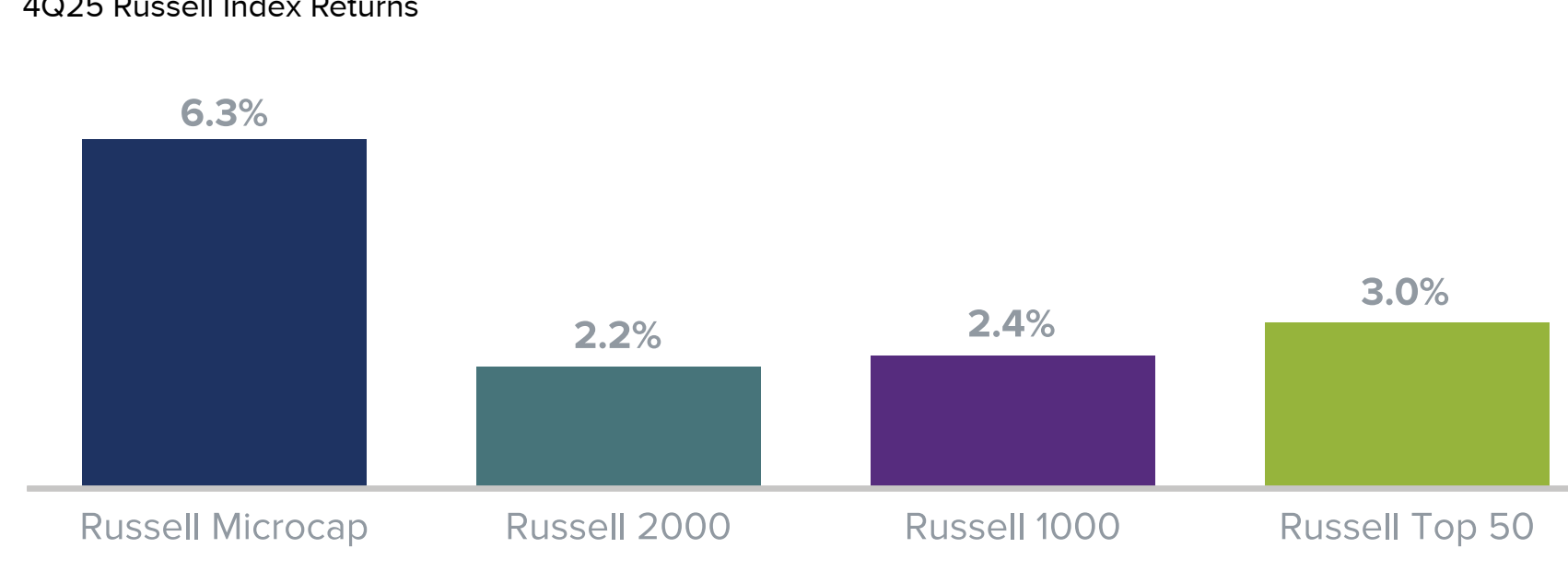
f t in ✉ 📧

In the eventful quarter that closed the books on 2025, the small-cap Russell 2000 and Russell Microcap Indexes were each in positive territory, while the micro-cap index led all the major domestic indexes, solidifying the market leadership that began off the April low.

The market backdrop was decidedly more volatile in 4Q25. On one side, there was lingering inflation, increased unemployment, periodic unwinding of the AI trade, talk of market bubbles, and declines in consumer confidence; on the other, there was a growing U.S. economy, a still resilient stock market, and lower interest rates—all of which more than counterbalanced the uncertainty and bad news.

For 4Q25, the Russell 2000 increased 2.2% while the Russell Microcap advanced 6.3%, the twelfth largest quarterly spread between the small- and micro-cap indexes since the inception of the Russell Microcap in 2000. By comparison, the large-cap Russell 1000 index was up 2.4%, while the mega-cap Russell Top 50 Index gained 3.0%, showing signs—at long last we would argue—of relinquishing leadership.

Micro-Caps Finished Strong



Past performance is no guarantee of future results.

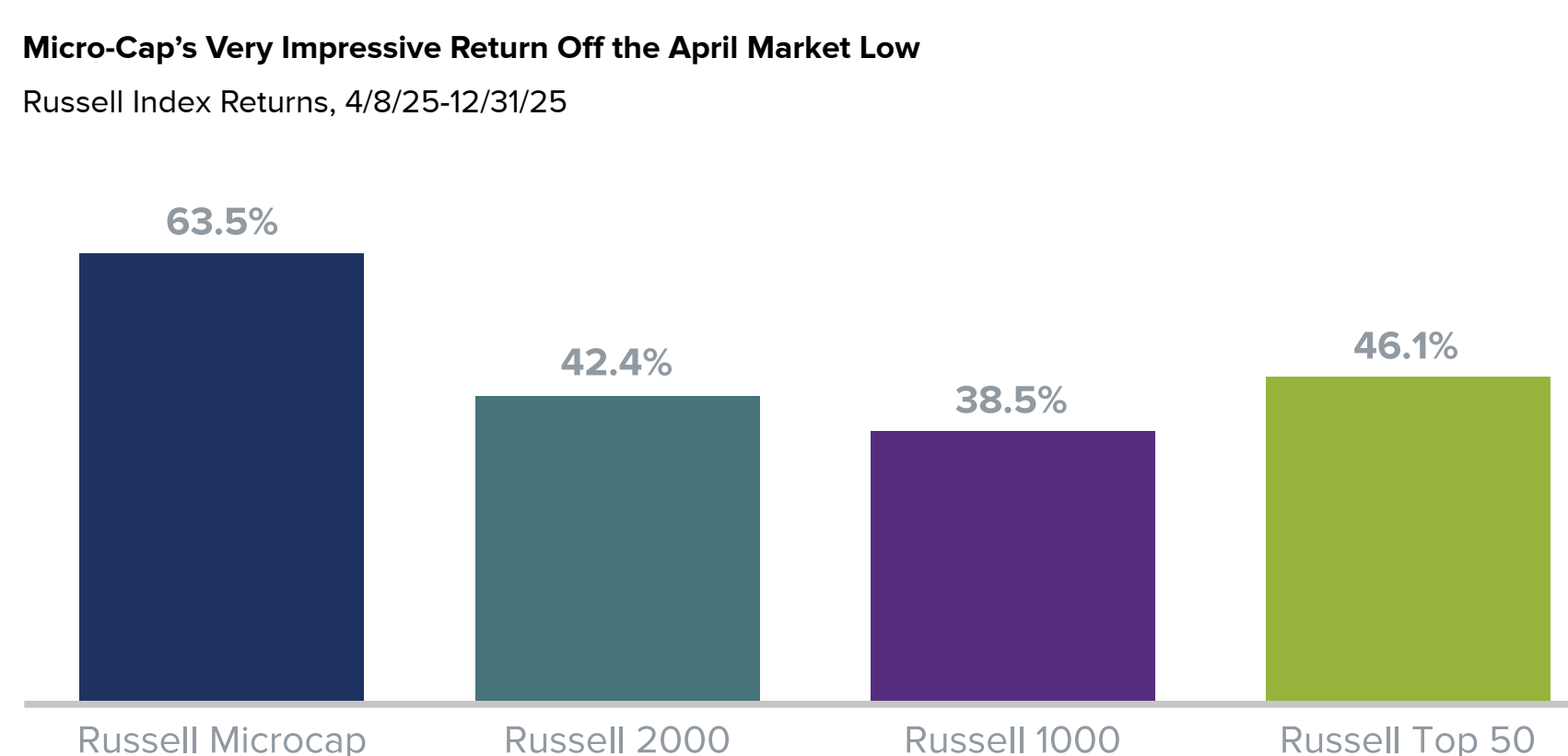
For the calendar year, the Russell Microcap led the way, while small-caps trailed large- and mega-cap stocks, thanks in large part to a dismal 1Q25 for the Russell 2000. For 2025 as a whole, the Russell Microcap was up 23.0%, the Russell 2000 gained 12.8%, the Russell 1000 rose 17.4%, and the Russell Top 50 increased 19.9%. The calendar-year spread between the small- and micro-cap indexes was the third widest since the micro-cap index's 2000 inception.

Small- and Micro-Caps Show Their Strength Off the Market Low

We have often talked about the importance of market cycle performance. We have always seen it as the true test of an investment strategy's mettle. So, while the calendar year's relative returns were somewhat disappointing for the Russell 2000, we were pleased with both the absolute and relative results for small-cap from the market low on 4/8/25 through the end of the year—and even happier with the extraordinary results for micro-caps.

From 4/8/25 through 12/31/25, the Russell Microcap advanced an impressive 63.5%, and the Russell 2000 rose 42.4%, while the Russell 1000 was up 38.5%, and the Russell Top 50 gained 46.1%.

Micro-Caps' Very Impressive Return Off the April Market Low



Past performance is no guarantee of future results.

Foreign Affairs

Results for non-U.S. stocks were similar to their stateside peers in 4Q25, though they favored large-cap over small. The MSCI ACWI ex-USA Small Cap Index rose 3.0% in 4Q25 while its large-cap counterpart, the MSCI ACWI ex-USA Large Cap Index, was up 5.5%.

Calendar year performance was impressive for both asset classes. Non-U.S. large-caps outpaced non-U.S. small-caps, but the spread was not wide. The MSCI ACWI ex-USA Small Cap advanced 29.3% in 2025 while the MSCI ACWI ex-USA Large Cap gained 32.5%. Some of the reasons behind large-cap's advantage included higher interest rates outside the U.S., widespread macroeconomic uncertainty, the view that larger international companies offer more earnings stability, and an emerging markets rally that disproportionately benefited large-cap stocks in 2025.

The Small-Cap Style Story

For the second consecutive quarter, the Russell 2000 Value Index beat the Russell 2000 Growth Index, up 3.3% versus 1.2% in 4Q25, a somewhat counterintuitive stretch of outperformance in that small-cap value often trails in the kind of dynamic upswing small-caps have been enjoying since early April.

And while small-cap growth had the advantage in 2025, the spread was quite narrow. For the calendar year, the Russell 2000 Growth advanced 13.0% versus 12.6% for the Russell 2000 Value. As is typically the case, annualized results over longer periods were mixed in terms of style leadership. Small-cap growth was ahead for the 3-year (+15.6% versus +11.7%) and 10-year (9.6% vs. 9.3%) periods. Small-cap value, however, had a decisive advantage for the 5-year span, rising 8.9% compared to 3.2% for the small-cap growth index.

Unsurprisingly, small-cap growth had the advantage off the April low, though once again the performance spread was thin. From 4/8/25-12/31/25, the Russell 2000 Growth was up 45.0% versus a 39.7% advance for the Russell 2000 Value.

The Small-Cap Sector Story: A Healthy Quarter

Six of the 11 sectors in the Russell 2000 were in the black in 4Q25. Health Care contributed the most by a wide margin, boosted by biotechnology and pharmaceuticals. Financials and Materials were the other top contributors while the top detractors were Information Technology, Consumer Discretionary, and Industrials.

For 2025, Industrials, Health Care, and Financials led nine sectors that finished the year in the black while the two detractors were Consumer Staple and Energy. As they were in the fourth quarter, biotech stocks were especially strong in 2025, thanks in part to the FDA fast-tracking a number of drugs, treatments, and breakthrough therapy designations. Other factors driving performance for the industry were attractively low valuations for many companies at the beginning of 2025, as well as advances in gene editing, RNA therapies, and AI-enhanced drug discovery. The dynamic performance of biotech also helps to explain the strength of small-cap growth in 2025.

A Confident Forecast for Small-Cap and Active Management

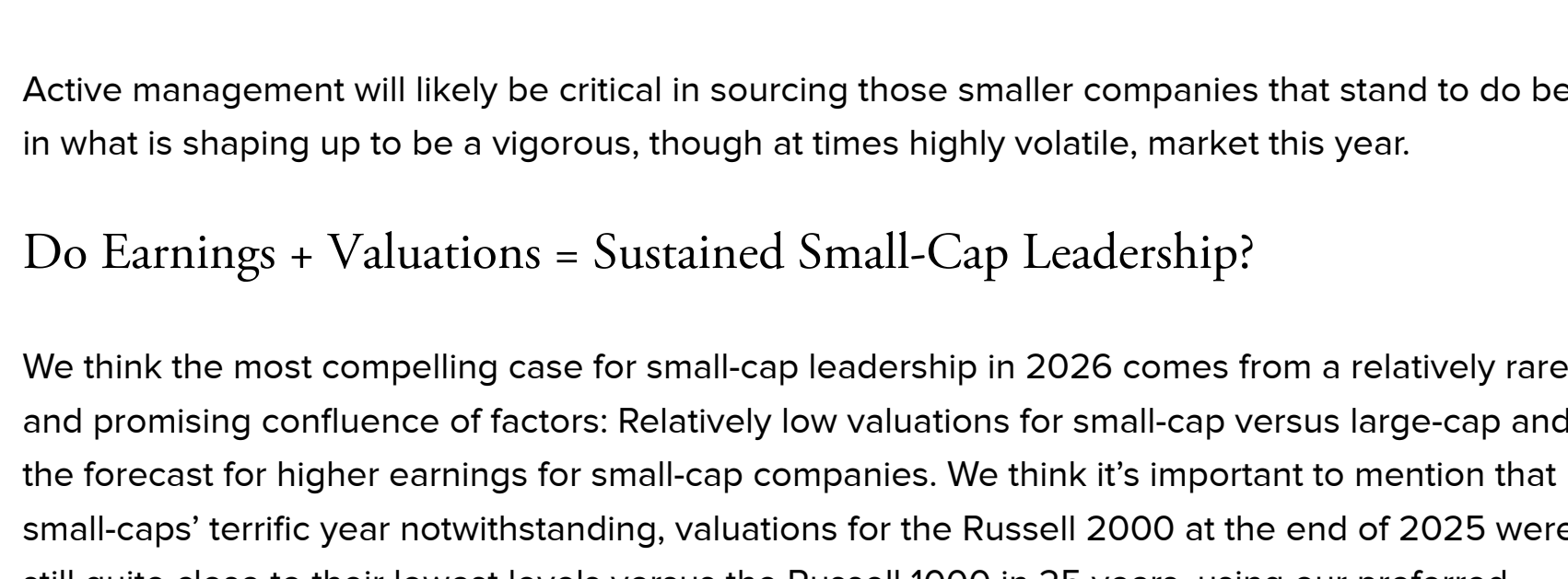
As we think about small-cap's prospects in the new year, we see several factors that can drive both strong returns and overall market leadership. For the purposes of this discussion, we include micro-caps under the broad and diverse small-cap universe. First, one of the more interesting elements in the "Big, Beautiful Bill" signed earlier this year is the fact that companies can have 100% depreciation on research and CapEx—which suggests that we could see a robust CapEx cycle in 2026. Such cycles have typically meant good things for small-cap stocks, though the market has not yet caught on to this. We expect that to change as the year progresses.

We also see a shift in the AI trade, which has mostly benefited the very largest companies thus far. We anticipate two developments that can benefit smaller companies. First, we think investors will begin to recognize the large number of small-cap businesses that are supplying the AI revolution, including, but not limited to, the semiconductor components that enable various AI applications, energy providers crucial to the functioning of data centers, and the construction companies that are building them. Second is a shift emphasis from the mega-cap companies that are providing AI to the many companies that will begin to benefit from AI in 2026.

Active management will likely be critical in sourcing those smaller companies that stand to do best in what is shaping up to be a vigorous, though at times highly volatile, market this year.

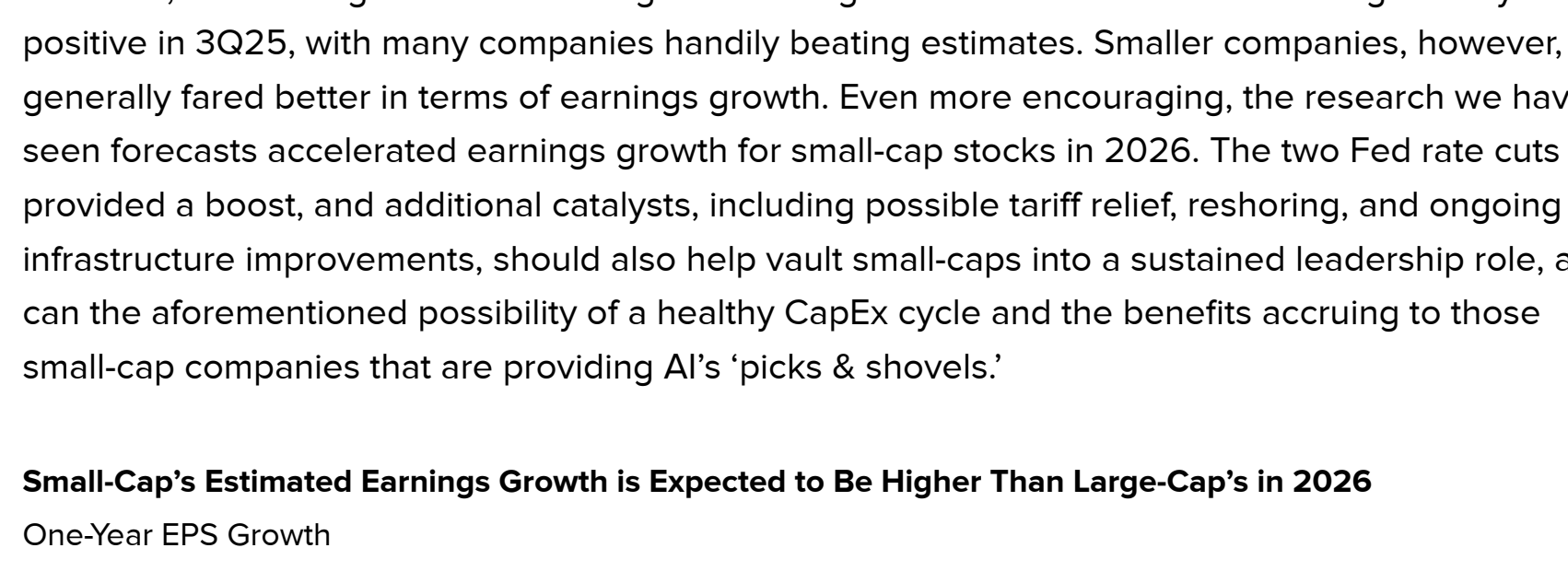
Do Earnings + Valuations = Sustained Small-Cap Leadership?

We think the most compelling case for small-cap leadership in 2026 comes from a relatively rare and promising confluence of factors: Relatively low valuations for small-cap versus large-cap and the forecast for higher earnings for small-cap companies. We think it's important to mention that small-caps' terrific year notwithstanding, valuations for the Russell 2000 at the end of 2025 were still quite close to their lowest levels versus the Russell 1000 in 25 years, using our preferred index valuation metric of EV/EBIT or enterprise value over earnings before interest and taxes.



Source: FactSet

But the argument in favor of small-cap leadership is greatly enhanced by the promising earnings picture for 2026. We have always subscribed to the adage that psychology runs the market in the short run, but earnings run it in the long run. Earnings for across asset classes were generally positive in 3Q25, with many companies handily beating estimates. Smaller companies, however, generally fared better in terms of earnings growth. Even more encouraging, the research we have seen forecast accelerated earnings growth for small-cap stocks in 2026. The two Fed rate cuts provided a boost, and additional catalysts, including possible tariff relief, reshoring, and ongoing infrastructure investments, should also help vault small-caps into a sustained leadership role, as can the aforementioned possibility of a healthy CapEx cycle and the benefits accruing to those small-cap companies that are providing AI's 'picks & shovels.'



Past performance is no guarantee of future results.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The EPS Growth Estimates are the pre-calculated mean two-year EPS growth rate estimates by brokerage analysts. Estimates are the average of those provided by analysts working for brokerage firms who provide research coverage on each individual security as reported by FactSet. All non-equity securities, investment companies, and companies without brokerage analyst coverage are excluded. Source: FactSet

We enter 2026 with yet more than the usual amount of uncertainty for both the U.S. economy and on the geopolitical front. Yet our investment teams remain confident that small-cap can build on its nascent market leadership. Finally, we want to remind investors that the opportunity still exists to build one's small-cap allocation at attractive valuations. We continue to see the current period as an opportune time to invest in select small-caps for the long run.

Important Disclosure Information

The thoughts concerning recent market movements and prospects for small-company stocks are solely those of Royce Investment Partners, and, of course, there can be no assurances with respect to future small-cap market performance. Past performance is no guarantee of future results. Historical market trends are not necessarily indicative of future market movements.

The performance data and trends outlined in this presentation are presented for illustrative purposes only. Past performance is no guarantee of future results. Historical market trends are not necessarily indicative of future market movements.

This material is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money. The performance data and trends outlined in this article are presented for illustrative purposes only. Past performance is no guarantee of future results. Historical market trends are not necessarily indicative of future market movements. Investments in securities of micro-cap, small-cap, and/or mid-cap companies may involve considerably more risk than investments in securities of larger-cap companies. (Please see "Primary Risks for Fund Investors" in the prospectus.)

Investments in foreign companies may be subject to different risks than investments in securities of U.S. companies, including adverse political, social, economic, or other developments that are unique to a particular country or region. (Please see "Investing in International Securities" in the prospectus.)

Frank Russell Company ("Russell") is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes and / or Russell ratings or underlying data and no party may rely on any Russell Indexes and / or Russell ratings and / or underlying data contained in this communication. No further distribution of Russell Data is permitted without Russell's express written consent. Russell does not promote, sponsor or endorse the content of this communication. All indexes referenced are unmanaged and capitalization weighted. The Russell 2000 Index is an index of domestic small-cap stocks that measures the performance of the 2,000 smallest publicly traded U.S. companies in the Russell 3000 Index. The Russell 1000 Index is an unmanaged, capitalization-weighted index of domestic large-cap stocks. It measures the performance of the 1,000 largest publicly traded U.S. companies in the Russell 3000 Index. The Russell 2000 Value and Growth Indexes consist of the respective value and growth stocks within the Russell 2000 as determined by Russell Investments. The Russell Top 50 Index measures the performance of the largest companies in the Russell 3000 Index. It includes approximately 50 of the largest securities based on a combination of their market cap and current index membership and represents approximately 40% of the total market capitalization of the Russell 3000 Index. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained hereon. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This material is not approved, endorsed, advised or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. The MSCI ACWI ex USA Small Cap Index is an unmanaged, capitalization weighted index of global small-cap stocks, excluding the United States. The MSCI ACWI ex USA Large Cap Index is an unmanaged, capitalization weighted index of global large-cap stocks, excluding the United States. The performance of an index does not represent exactly any particular investment, as you cannot invest directly in an index.

This material is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money. Small-cap stocks may involve considerably more risk than larger-cap stocks. (Please see "Primary Risks for Fund Investors" in the prospectus.)

SHOW LESS

Insights & News



The Royce Roundtable: Small-Caps Looking Strong in 2026



4Q25 Small-Cap Recap

September 11 **September 2025 Distributions for the Total Return Funds**

September 09 **Francis Gannon on the Small-Cap Surge with Reuters**

September 02 **Royce Closed-End Funds 3Q25 Distributions**

Share: [in](#) [t](#) [f](#)

Follow: [in](#) [t](#) [v](#) [y](#) [t](#) [s](#)

Subscribe: [MANAGE SUBSCRIPTIONS](#)