Institute of Advanced Investment Management
THE UNIVERSITY OF UTAH

# Too Small To Fail

## Profit Prophets

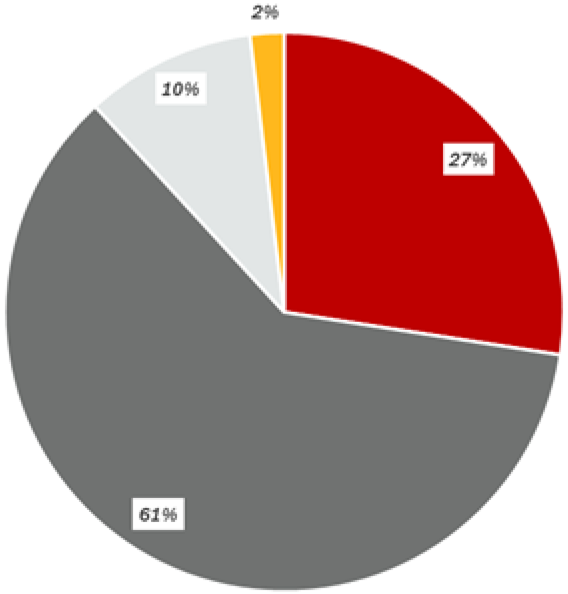
Trevor, Jackson, Ryan, Ishmit

*3/31/2025*

# Current State MSIF Portfolio

# 11%

Percent of Fund Allocated to Financial Sector




Current Allocation By Cap Size

# Executive Summary

| | |
|---|---|
| **Strategy** | Momentum strategy focused on small cap equities in the financials sector |
| **Performance** | 310.3% 10-year return compared to SPY's 239% return. Sharpe ratio of .63 and Beta of .85 |
| **Recommendation** | We recommend investing $13,000 in this strategy. |

# MSCGA

**Article Title**:
It’s Time to Make Small Cap Great Again
(Global Alpha)

## Key Takeaways:

- Small Caps are particularly sensitive to changes in interest rates and economic policies
- Valuation spread between small and large caps is near historic highs in recent months
- Periods of large cap dominance are often followed by small-cap rallies

# Financial Services Article

**Article Title**:
**"3 Small-Cap Financial Services Stocks to Buy Amid Tariff Uncertainty"**

**Highlight:**

- Small caps typically produce most revenue domestically
- Financial services *will likely* face tariff related headwinds
- Avoiding over-valued stocks (high P/E ratio) key for economic uncertainty

# Financials Sector and Business Cycles

**Article Title**:

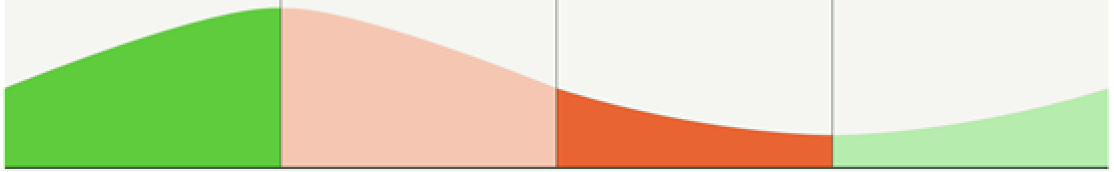
Sector Business Cycle Analysis
(State Street Global Advisors)

**Highlights:**

- **During Economic Slowdowns Financials** average period return **~13.7%** (Trailing only Healthcare and Consumer staples)
- **During Economic Expansion Financials** average period return **~18.7%** (Trailing only Technology)

**A Sector Roadmap for Business Cycles**

| Expansion | Slowdown | Recession | Recovery |
|---|---|---|---|
| • Growth reaches its peak<br>• Increasing capex to improve productivity and meet increasing demand<br>• Interest rates start rising from their relatively low levels | • Capacity utilization peaks<br>• Positive output gaps<br>• Positive but decelerating growth<br>• More restrictive monetary policy | • Declining economic outputs<br>• Falling demand from both consumers and businesses<br>• Increasing unemployment<br>• Low consumer confidence<br>• Easing monetary policy | • Economy rebounds but below trends<br>• Consumer expectations improve<br>• Discretionary spending increases<br>• Businesses stop cutting back on commercial activities<br>• Monetary policy remains accommodative |
| ++<br>Financials<br>Technology<br>+<br>Communication Services<br>–<br>Consumer Staples<br>– –<br>Health Care<br>Utilities | ++<br>Consumer Staples<br>Health Care<br>+<br>Industrials<br>–<br>Materials<br>– –<br>Consumer Discretionary<br>Real Estate | ++<br>Consumer Staples<br>Utilities<br>+<br>Health Care<br>–<br>Communication Services<br>– –<br>Real Estate<br>Technology | ++<br>Consumer Discretionary<br>Real Estate<br>+<br>Materials<br>–<br>Health Care<br>– –<br>Consumer Staples<br>Utilities |



Source: SPDR Americas Research, as of December 31, 2019. ++/-- indicates the two best/worst-performing sectors. +/- indicates the third-best/worst-performing sectors. **For illustrative purposes only.**

# Strategy Design

**Description**

- Focus on investing in small-cap financial services companies within the United States with the premise that we may be underweighted in small-caps and that small-caps are less reliant on foreign revenue

**Origin**

- This strategy leans heavily on the historical valuation spread between small and large-cap companies as well as identifying lower P/E stocks in the financial services sector that primarily serve domestic business

**Goal**

- Generate a superior risk-adjusted return compared to the SML factor. This necessitates identifying small-cap financial companies with both growth potential and downside protection

**Parameters**

- Specific screening criteria includes an emphasis on the financial services sector, companies listed exclusively on US exchanges, a market cap between $250MM and $2B, return criteria, a P/E below 20 and a ranking system based on 1-month annualized return Sharpe ratio.

# Screening Criteria

| Parameter | Description | Stock Universe |
|---|---|---|
| **Sector** | Financial Services | 28,273 |
| **Exchange** | Stocks traded in United States | 1886 |
| **Market Cap** | 250 Million <= 2 Billion | 277 |
| **Return** | 3 Month Average Total Return >= 1 Year Average Return | 128 |
| **PE Ratio** | Current PE Ratio <= 20 | 44 |
| **Price** | Price 1 Day Ago >= 10 | 31 |
| **Ranking** | Top 15 Sequential Rank - Higher is Better (1 Month Annualized Return Sharpe Ratio) | 15 |

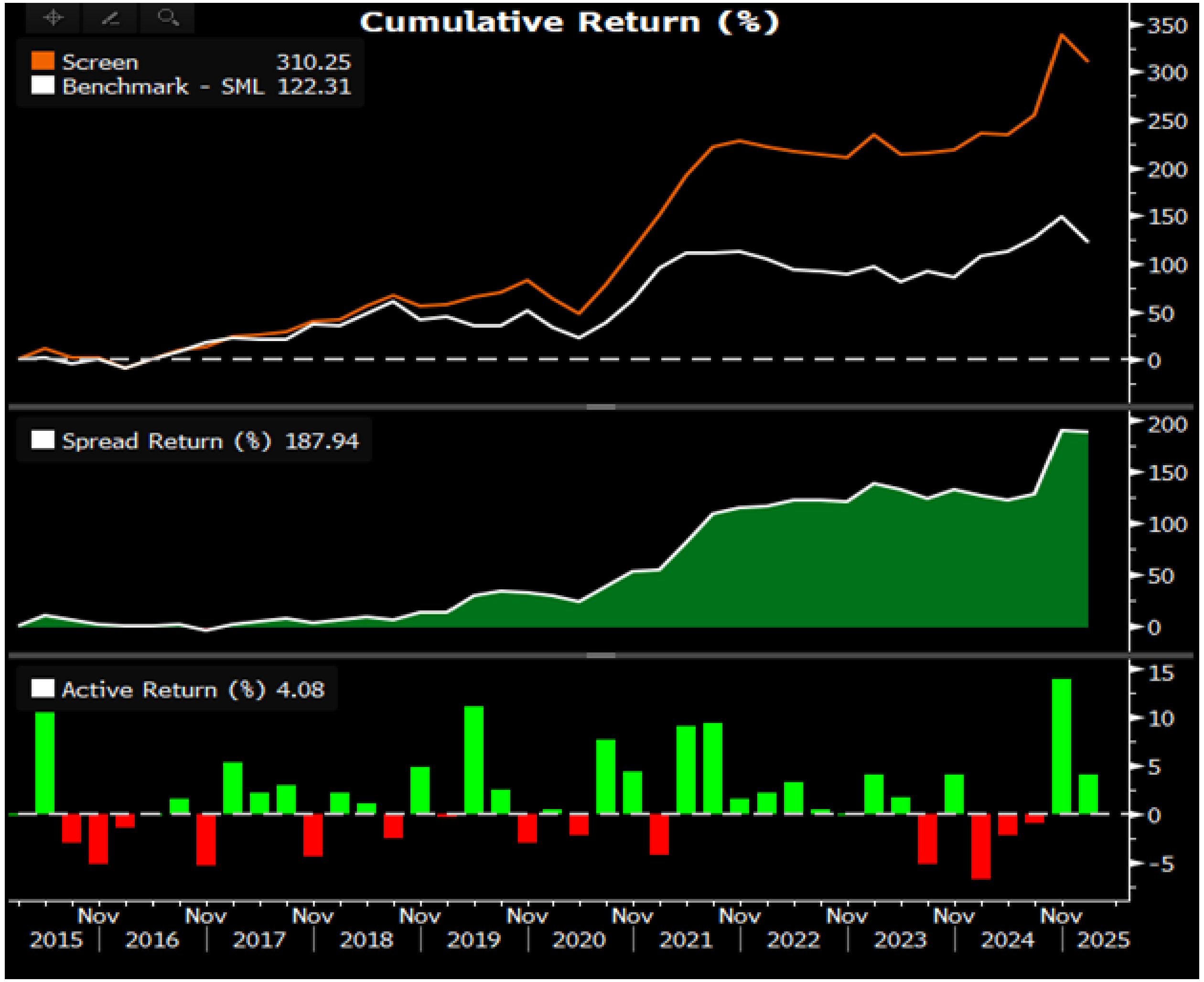
# Backtesting Structure

## Sub-Criteria

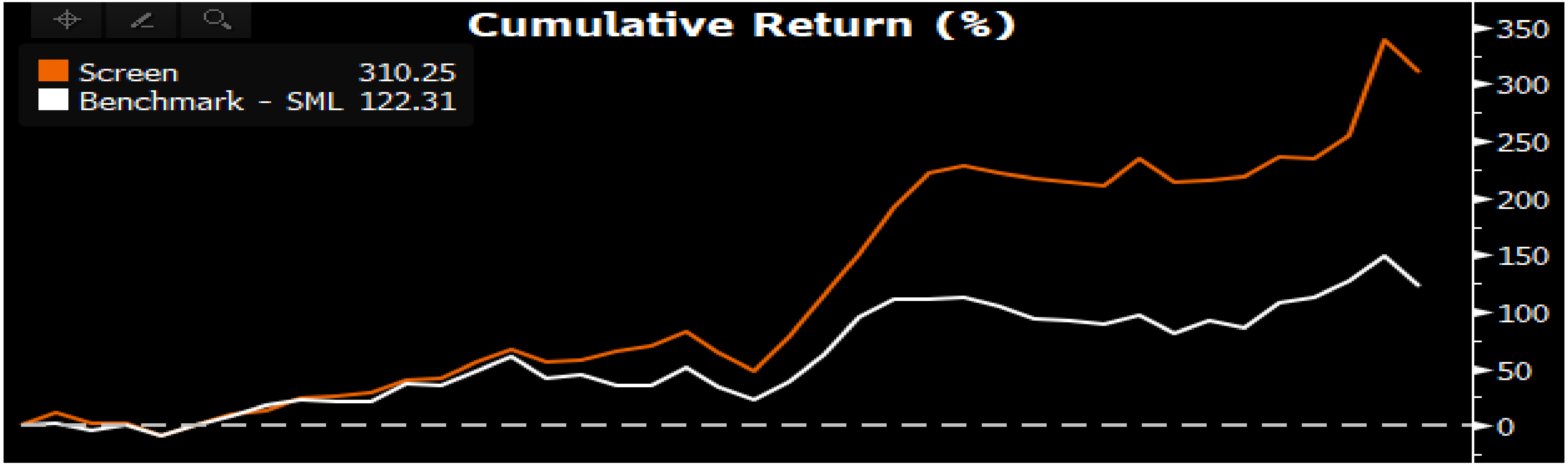
| Criterion | Description |
|---|---|
| **No of Holdings** | 15 |
| **Testing Period** | 10 Years, 5 Years, 3 Years & 1 Year |
| **Benchmark** | SML |
| **Rebalance Freq.** | 3 Months |
| **Weighted Scheme** | Equally Weighted Returns |

# Backtesting Results – 10 Yr performance

| Year | Strategy Return | SML Return | SPY Return | Spread Return (SPY) | Strategy Turnover |
|---|---|---|---|---|---|
| **2015** | 3.63% | 1.30% | 1.21% | 2.42% | 66.66% |
| **2016** | 11.79% | 16.92% | 7.99% | 3.8% | 75% |
| **2017** | 22.24% | 16.39% | 20.32% | 1.92% | 78.33% |
| **2018** | 11.07% | 5.32% | 6.69% | 4.38% | 83.33% |
| **2019** | 16.78% | 6.27% | 16.48% | 0.3% | 78.33% |
| **2020** | 20.68% | 10.36% | 17.64% | 3.04% | 76.66% |
| **2021** | 45.33% | 29.52% | 25.71% | 19.62% | 78.33% |
| **2022** | -5.25% | -11.28% | -12.93% | 7.68% | 88.33% |
| **2023** | 3.98% | -1.39% | 15.94% | -11.96% | 88.33% |
| **2024** | 34.55% | 30.39% | 30.12% | 4.43% | 90% |

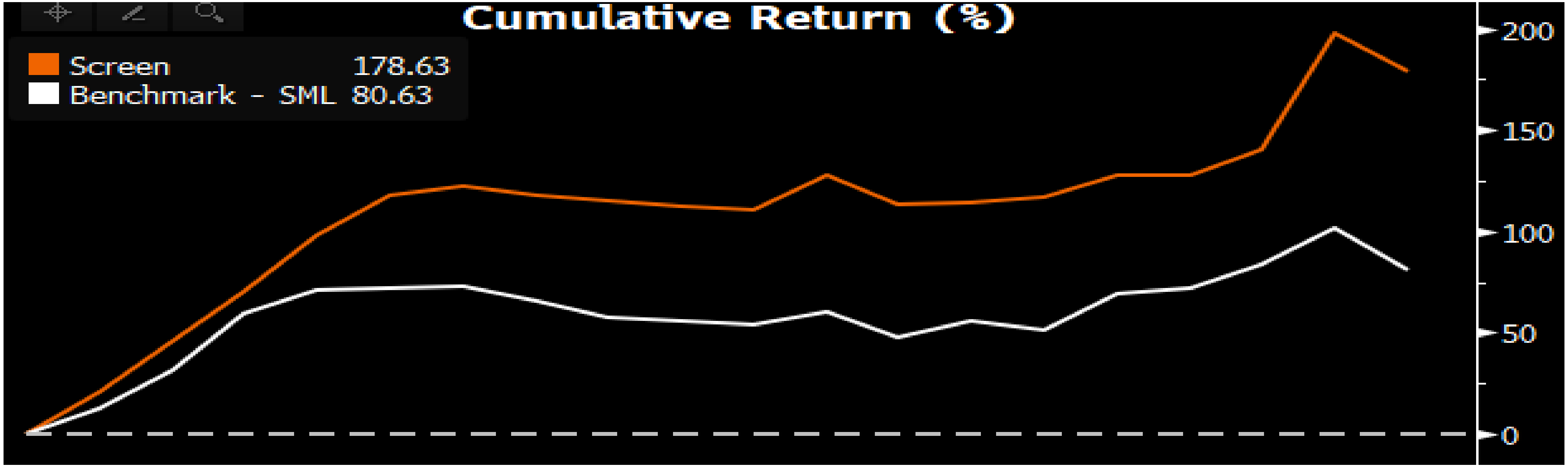


# Backtesting Results – 10 Yr Statistics



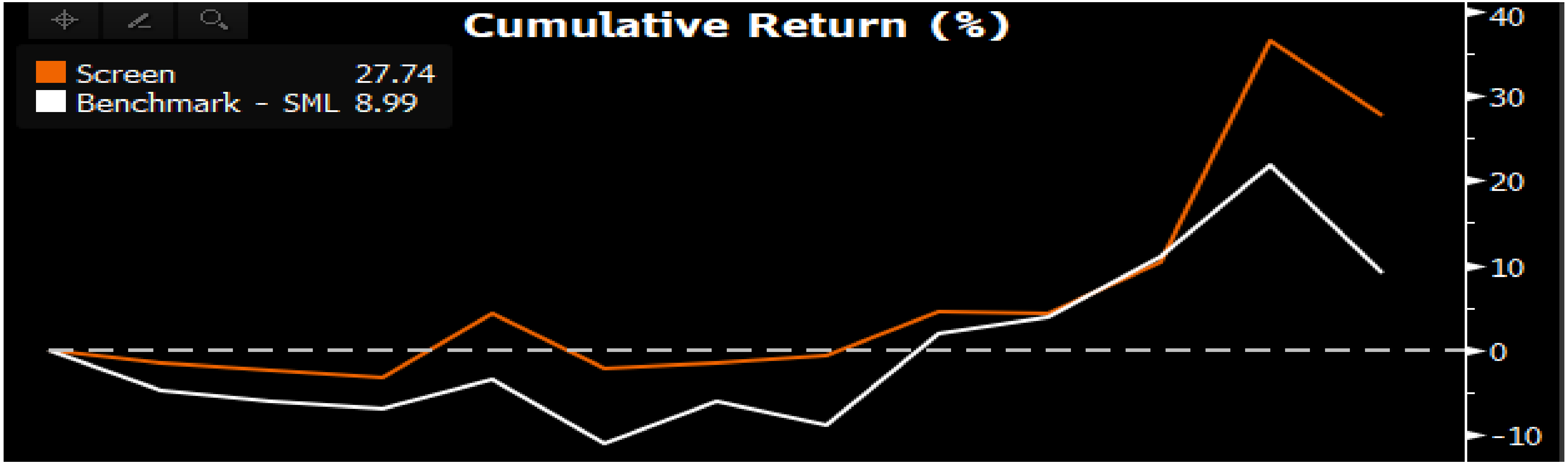

| Period | Return | α* | β* | σ* | Max DD* | Sharpe* | Correl. | Info Ratio* |
|---|---|---|---|---|---|---|---|---|
| **10 Yr Strategy** | 310.5 | 9.27 | 0.70 | 20.43 | -19.59% | 0.63 | 0.78 | 0.40 |
| **10 Yr SML** | 135.7 | | | 22.43 | -23.64% | 0.44 | 1 | 0.72 |

# Backtesting Results – 5 Yr Statistics



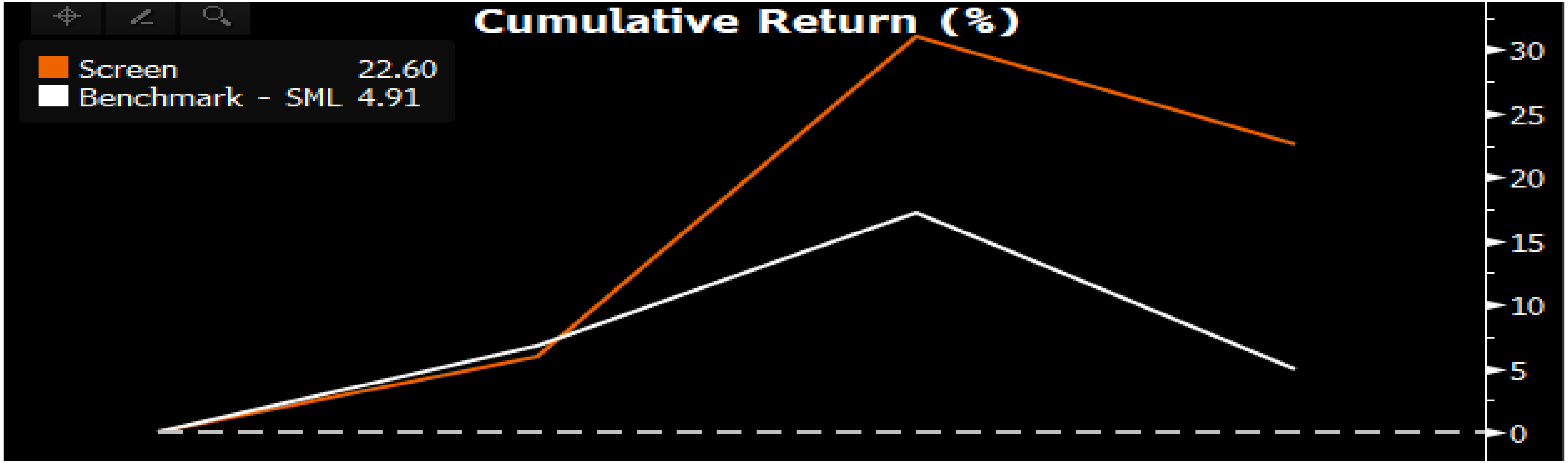

| Period | Return | α* | β* | σ* | Max DD* | Sharpe* | Correl. | Info Ratio* |
|---|---|---|---|---|---|---|---|---|
| **5 Yr Strategy** | 178.6 | 15.5 | 0.57 | 16.9 | -10.02% | 0.33 | 0.76 | 0.57 |
| 5 Yr SML | 86.3 | | | 22.21 | -14.73% | 0.66 | 1 | 0.69 |

# Backtesting Results – 3 Yr Statistics




| Period | Return | α* | β* | σ* | Max DD* | Sharpe* | Correl. | Info Ratio* |
|---|---|---|---|---|---|---|---|---|
| **3 Yr Strategy** | 22.7 | 5.03 | 0.53 | 15.72 | -6.44% | -0.13 | 0.73 | 0.29 |
| **3 Yr SML** | 11.52 | | | 21.33 | -11.10% | 0.08 | 1 | 0.97 |

# Backtesting Results – 1 Yr Statistics




| Period | Return | α* | β* | σ* | Max DD* | Sharpe* | Correl. | Info Ratio* |
|---|---|---|---|---|---|---|---|---|
| **1 Yr Strategy** | 22.6 | 26.7 | 0.68 | 19.62 | -6.44% | -0.09 | 0.69 | 1.48 |
| **1 Yr SML** | 5.31 | | | 19.88 | -10.52% | 0.23 | 1 | 0.60 |

# Recommended Purchase Plan

| Name | Ticker | Market Cap ($M) | P/E | Share Price | # of Shares | Allocation Total |
|---|---|---|---|---|---|---|
| Bain Capital Specialty Finance | BCSF | 1,080 | 9.03 | $ 16.71 | 60 | $ 1,000 |
| Cion Investment Corp | CION | 554 | 16.59 | $ 10.45 | 96 | $ 1,000 |
| EZCORP Inc | EZPW | 806 | 12.87 | $ 14.68 | 68 | $ 1,000 |
| Franklin BSP Realty Trust | FBRT | 1,067 | 15.83 | $ 12.98 | 77 | $ 1,000 |
| Fidus Investment Corp | FDUS | 714 | 8.57 | $ 20.56 | 49 | $ 1,000 |
| Gladstone Investment Corp | GAIN | 501 | 7.12 | $ 13.60 | 74 | $ 1,000 |
| Greystone Housing Impact Investors LP | GHI | 297 | 16.79 | $ 12.76 | 78 | $ 1,000 |

# Recommended Purchase Plan Cont.

| Name | Ticker | Market Cap ($M) | P/E | Share Price | # of Shares | Allocation Total |
|---|---|---|---|---|---|---|
| PennyMac Mortgage Investment Trust | PMT | 1,271 | 10.68 | $ 14.63 | 68 | $ 1,000 |
| Chicago Atlantic Real Estate Finance, Inc | REFI | 320 | 8.14 | $ 15.30 | 65 | $ 1,000 |
| Saratoga Investment Corp. | SAR | 362 | 10.04 | $ 25.20 | 40 | $ 1,000 |
| Stellus Capital Investment Corp. | SCM | 392 | 7.96 | $ 14.25 | 70 | $ 1,000 |
| SLR Investment Corp. | SLRC | 936 | 9.74 | $ 17.15 | 58 | $ 1,000 |
| Trinity Capital Inc. | TRIN | 994 | 7.54 | $ 15.83 | 63 | $ 1,000 |

# Company Bios

Bain Capital Speciality Finance
(NYSE: BCSF)
$16.71

**Credit**
Provide loans to mid-market businesses.

Cion Investments
(NYSE: CION)
$10.45

**Credit and Real Estate**
Buy real estate or lend to businesses, generating returns on rent or interest.

EZCORP Inc.
(NASDAQ: EZPW)
$14.68

**Pawn Shops and Short Term Loans**
Gives people quick access to cash by keeping valuables as collateral. Offer Buy - Sell - Trade services.

Franklin BSP Realty Trust
(NYSE: FBRT)
$12.98

**REIT**
Primarily invest in commercial real estate. Generate income on rent and property value appreciation.

Fidus Investment Corp
(NASDAQ:FDUS)
$20.56

**Business Development Company**
Provide equity financing or debt financing to small and mid market businesses (Mezzanine Financing).

Gladstone Investment Corp
(NASDAQ:GAIN)
$13.60

**Business Development Company**
Private equity fund focused on acquiring mature, lower mid market companies.

Greystone Housing Impact Investors
(NYSE:GHI)
$12.76

**Real Estate**
Focus on affordable housing through investment in development and preservation of low income rentals.

PennyMac Mortgage Investment Trust
(NYSE:PMT)
$14.64

**REIT**
Buy mortgage loans and mortgage backed securities and earn interest.

Chicago Atlantic Real Estate Finance
(NASDAQ: REFI)
$15.30

**REIT**
Invest in mortgage loans and loans tied to income-producing properties such as office buildings and retail.

# Company Bios (Pt. 2)

Saratoga Investment Corp
(NYSE:SAR)
$25.20

**Business Development**
Provides debt and equity to mid-market businesses.

Stellus Capital Investment Corp
(NYSE:SCM)
$14.25

**Business Development**
Specializes in providing secured debt financing to lower mid-market companies.

SLR Investment Corp
(NASDAQ:SLRC)
$17.15

**Business Development**
Focuses on direct lending to domestic mid-market organizations.

Trinity Capital Inc
(NASDAQ:TRIN)
$15.83

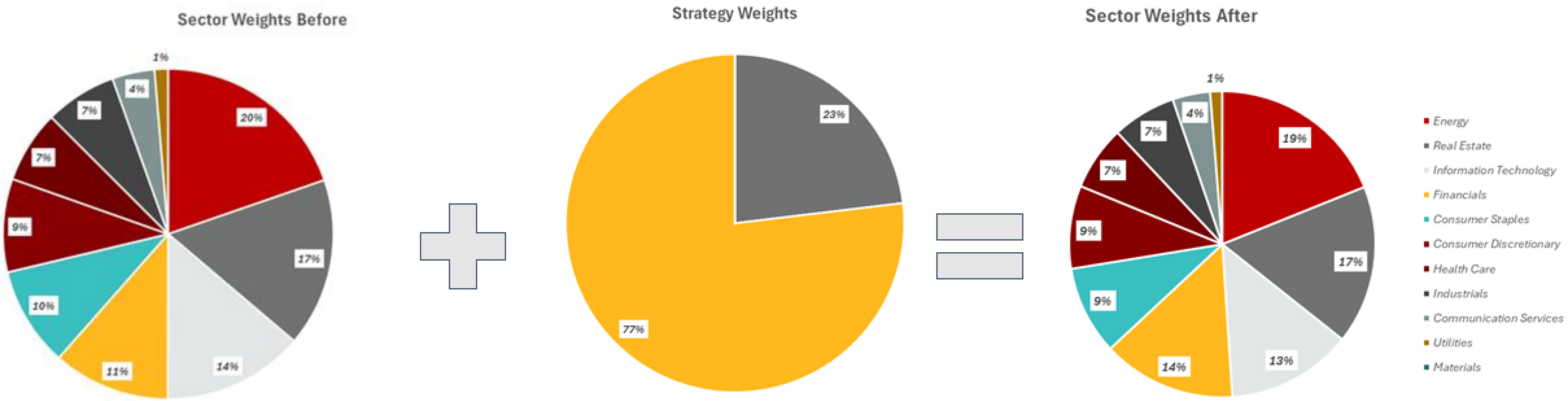
**Venture Debt**
Provides growth-stage loans to technology startups

# Sell Proposal – Performance Comparison

| | SPDR S&P 500 ETF Trust (SPY) | iShares Ultra Short-Term Bond Active ETF (ICSH) | Too Small to Fail |
|---|---|---|---|
| **Date Adopted** | 11/26/24 | 11/26/24 | TBD |
| **Profile** | Large Cap | Fixed-Income | Systematic |
| **% of Overall Fund** | 40.0% | 32.8% | 1.5% |
| **$ Allocated** | $287,832 | $236,329 | $13,000 |
| **Return (10 yr)** | 239.0% | 23.1% | 310.3% |
| **β (10 yr)** | 1.00 | 0.05 | 0.85 |
| **σ (10 yr)** | 16.2% | 0.8% | 17.3% |
| **Sharpe (10 yr)** | 0.76 | 0.63 | 0.63 |

*Proposal : Sell off ~ $13,000 of SPY ETF, leave ICSH as is*

# Effect on the Portfolio – Sectors




| <u>Portfolio</u> | Exp. Return | St. Dev* | Beta* | Sharpe Ratio* | Idios. Risk* |
|---|---|---|---|---|---|
| **Existing** | 17.53% | 7.37% | 0.73 | 1.80 | 3.47% |
| **Adjusted** | 17.26% | 7.33% | 0.73 | 1.78 | 3.40% |

# Effect on the Portfolio – Total Market Cap


| <u>Total Market Cap</u> | ICSH | Large | Mid | Small |
|---|---|---|---|---|
| **Existing** | $236,329 | $523,016 | $84,994 | $16,855 |
| **Adjusted** | $236,329 | $510,016 | $84,994 | $29,855 |
| **Change** | ⇔ - | ⬇ ($13,000) | ⇔ - | ⬆ $13,000 |

# Effect on the Portfolio - Active Market Cap


| Active Market Cap | Large | Mid | Small |
|---|---|---|---|
| **Existing** | $235,184 | $84,994 | $16,855 |
| **Adjusted** | $235,184 | $84,994 | $29,855 |
| **Change** | ⇔ - | ⇔ - | ↑ $13,000 |

# Summary & Recommendation

## Strategy Merits

**Strong Historical Performance:** Strong 10-year return compared to the SPY ETF, indicating likely potential for outperformance

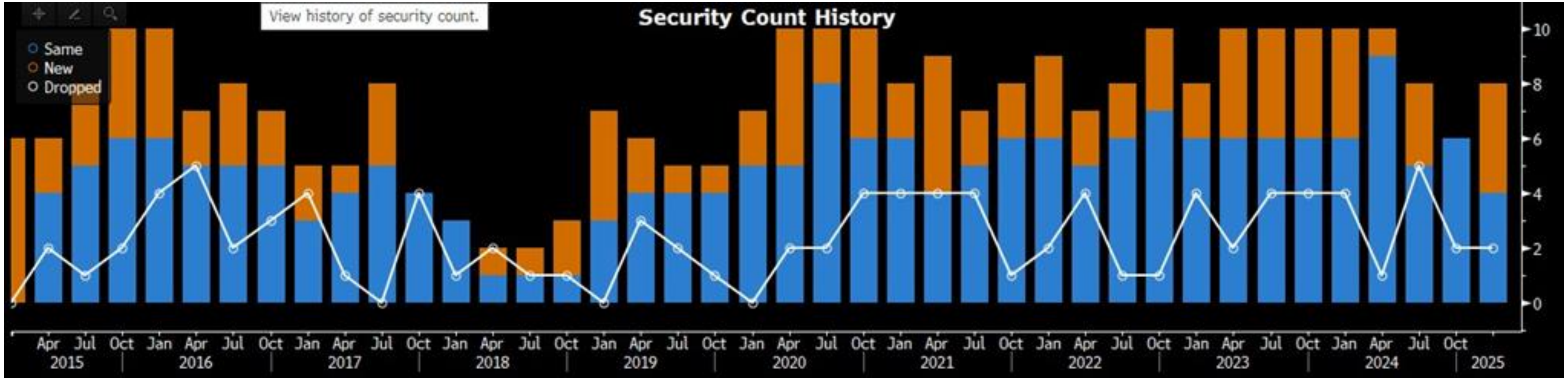
**Favorable Risk-Adjusted Returns:** Positive Sharpe ratio (0.63) suggests strong returns relative to risk

**Seeking Alpha:** Strategy's historical alpha of 9.27 indicates that is has the potential to generate returns that are not necessarily dependent on market movement

## Action Plan

- **Recommendation**: **Yes**
- **Sell $13,000 of SPY to buy an equally weighted portfolio of 13 stocks.**

# Appendix Slide



# P/E Ratio Info for The Sector

Average P/E Ratios in the Financial Services Sector:

1. **Overall Financial Sector:**
   - The S&P 500 Financials Sector has a P/E ratio of **18.46** as of March 2025, which is higher than its 5-year average range of **13.08 to 15.91**, indicating that it is currently expensive [1].
2. **Subsector Breakdown:**
   - **Banks**: Average P/E ratio is **12.7**.
   - **Credit Services**: Average P/E ratio is **14.0**.
   - **Asset Management**: Average P/E ratio is **8.8**, one of the lowest in the sector.
   - **Capital Markets**: Average P/E ratio is **26.8**, significantly higher than other subsectors.
   - **Insurance**: Average P/E ratio is **12.3** [2].
3. **Historical Context:**
   - The broader financial services industry is trading close to its 3-year average P/E of **16.2x**, suggesting valuations are not dramatically out of line with recent norms [6].

https://worldperatio.com/sector/sp-500-financials/

https://www.investopedia.com/ask/answers/032315/what-average-pricetoearnings-ratio-financial-services-sector.asp