

ABOVE THE FRAY

Rate Sensitivity \neq Price Predictability

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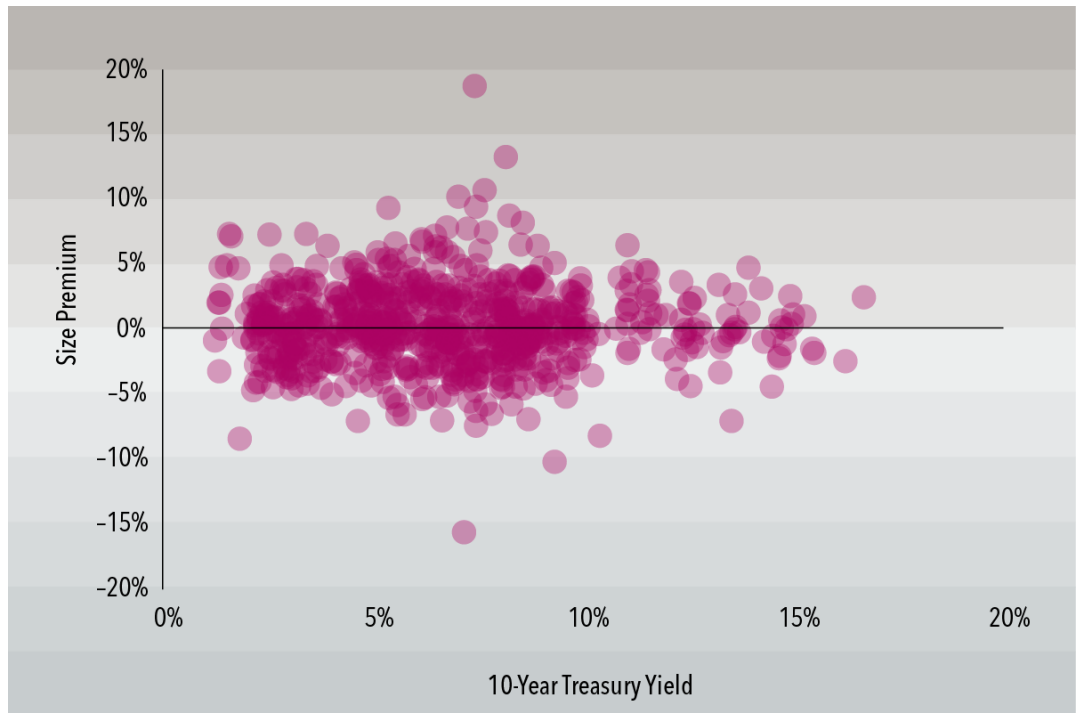
While the market sees an [increasing likelihood of Fed rate cuts](#) later this year, the highest probability outcome for the December Fed meeting is a target range of 425–450 basis points—still above the historical median federal-funds rate.¹ That leaves some investors wondering what’s in store for small cap stocks, which are often perceived to be more sensitive to interest rates than large cap stocks. Fortunately for small cap investors, this relation hasn’t exactly panned out in the data.

Plotting monthly returns for the Fama/French size factor versus 10-year Treasury yields shows little correlation between the two. Months with high interest rates have been associated with both positive and negative relative returns for small caps. The same is true for low interest rate months. There’s no clear trend among the observations, good or bad.

This is not to imply small companies are insensitive to interest rates. Rather, the market’s expectations for interest rates and their impact on cash flows for small cap companies are incorporated into current market prices. The expected size premium should therefore be positive regardless of the prevailing interest rate outlook.

Exhibit 1**Monthly Fama/French
US Size Factor Returns
against the 10-Year
Treasury Yield**

July 1964–June 2023

**Past performance is not a guarantee of future results.**

Sources: US Treasury data available from FRED, Federal Reserve Bank of St. Louis. Fama/French small-minus-big (SMB) size factor data are provided by Ken French. Monthly size factor returns are plotted against 10-year Treasury yields for the same month.

Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

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Fama/French small-minus-big (SMB) size factor data: July 1926–present: For July of year t to June of $t + 1$ includes all NYSE, AMEX, and Nasdaq stocks for which we have market equity data for December of $t - 1$ and June of t , and (positive) book equity data for $t - 1$. Source: [Kenneth R. French - Data Library \(dartmouth.edu\)](https://dartmouth.edu/~kenfrench/)

Results shown during periods prior to each index's inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

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1. Based on the effective federal-funds rate from July 1954 to June 2024. Data from [FRED](#).

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