

A Week of Big Moves for Small Caps

Elevated trade tensions between the U.S. and China continued to occupy investors' attention last week. Sentiment, as measured by the American Association of Individual Investors (AAII) weekly survey, had previously begun to look at least slightly bullish, **only to revert back to net bearish last week.** Fundstrat Head of Technology Tom Lee and Head of Technical Strategy Mark Newton agree that **this is good for stock investors.** "I view this as **contrarian positive,**" Lee wrote, pointing out that "if conviction wavers easily, that is a sign that sentiment is not ebullient."

Further supporting Lee's bullish view for the final quarter of the year is the underperformance of active fund managers during the first three quarters of the year, with only 22% of them beating their benchmarks, according to data compiled by Jefferies. This represents some of the worst performance by this group in decades. That means **"there's pressure for funds to outperform into year end,"** Lee observed. For underperforming managers to do that, **they will likely need to move cash off the sidelines and put it to work,** and that's arguably constructive for the markets.

Small Caps

As followers of our work know, Lee has long been overweight small caps, seeing the sector as both undervalued and especially well-positioned to benefit from a Fed rate-cut cycle that now looks to have begun. Fed Chair Jerome Powell on Tuesday made remarks supportive of that thesis, reiterating the message that inflation remained largely under control while "downside risks to employment" had risen.

As Mark Newton observed at our weekly huddle last week, **“small caps officially have broken out,”** pushing through to new all-time highs on Wednesday before settling back slightly on Friday. As a sector, small caps (\$IWM) had a good week on an absolute basis, advancing 2.38% to close on Friday at 243.45. Yet the sector’s relative performance has been impressive as well. While small-caps have outperformed equal-weighted S&P 500 (\$RSP) for the last six months, as Newton observed, “what many people haven’t realized is that when you look at the larger ratios of IWM versus SPY, we’ve now broken out of the entire four-year downtrend since 2021.” **On a month-to-date basis, small caps are now also outperforming both the S&P 500 and the Mag Seven.**

To be sure, some of that outperformance has resulted from recent underperformance of Mag Seven stocks like Meta, Microsoft, and even Nvidia. Nevertheless, Newton views this week’s small-cap action as intermediate-term bullish. **“I think this persists into the year-end,”** he said. Aligning with Lee’s outlook on the sector, Newton said: “It’s right to be long small caps. It’s right to overweight small caps versus large caps.”

Live Webinar with Q&A

Crypto Market Update

Tuesday, October 28 @ 2pm ET

Mark Newton
Head of Technical Strategy

Sean Farrell
Head of Digital Assets

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Chart of the Week

VIX: Highest since April-May 2025 tariff period



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Volatility, which spiked after President Trump's truculent response to China's intensified rare-earth export restrictions, continued to rise this week as China reacted in turn. Worries over the state of U.S. credit markets after the collapses of First Brands and Tricolor also contributed to uncertainty. As our Chart of the Week shows, VIX is now at its highest level since President Trump launched his tariff broadside in April and May – though still significantly lower than its springtime peak. Still, history shows that VIX surges greater than 30%, as we saw on Oct. 10, are often a sign of a local bottom, with media gains for the S&P 500 one month later at 2.8%. This week's higher volatility does not change Lee's view.

Recent *FlashInsights*



Tom Lee, CFA, CFA_{AC}

Head of Research

Good anecdote from “tireless Ken” regarding USA and China



Ken Xuan VIP 10:41 AM

CCTV-6 (China Central Television’s movie channel) is airing Captain America. Usually, whatever airs on that channel reflects the government’s attitude.

Airing Captain America is a good sign.

Oct 15 • 1:07 PM



Tom Lee, CFA, CFA_{AC}

Head of Research

Today is the day IRS filing deadline for those US taxpayers who filed an extension

- this means there was “cash raising” into today
- with this pressure behind us, stocks can lift

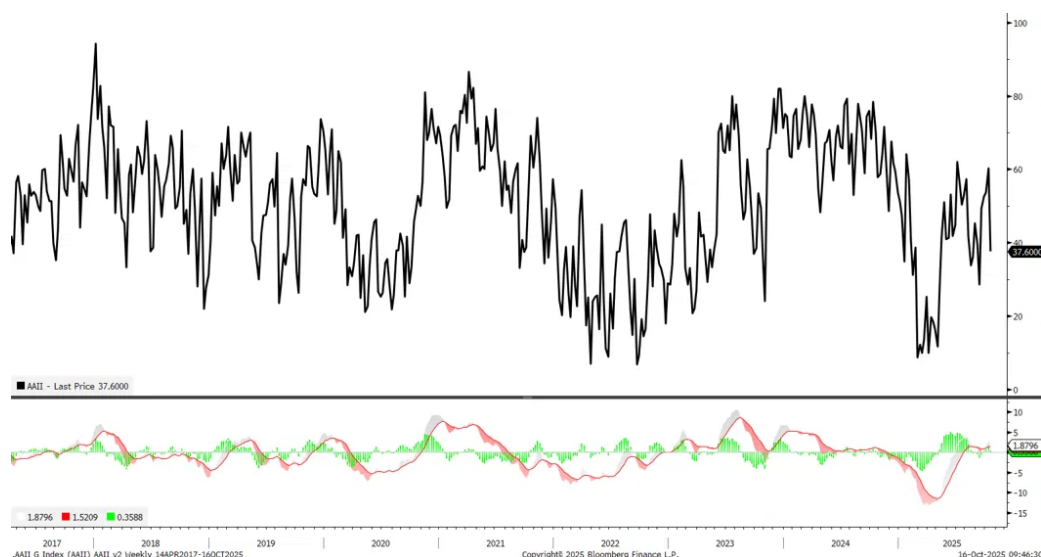
Oct 15 • 7:46 AM



Mark L. Newton, CMT_{AC}

Head of Technical Strategy

Today's AAll sentiment data flipped back to bearish as the trade tension has caused both price action and sentiment to grow a bit skittish this week. Overall, this is a positive from a contrarian perspective as the Shutdown nor trade tension with China have not resulted in any break in the larger uptrend for SPX. As of now, AAll bears stand at 46.10% while Bulls are 33.70%. As can be seen, Sentiment is very much mid-range, not really extremely bullish nor bearish but did turn more mildly bearish last week, which is unusual after a 35% rally since April lows and more than 85% gains since 2022. However, this goes to show that the investing public remains very susceptible towards letting their own market sentiment be dictated by what's happening in the news and media, geopolitics and politics, rather than concentrating on price trends, or earnings. This is generally a mistake. An interesting time indeed.



Oct 16 • 12:10 PM

FS Insight Video: Weekly Highlight



Key incoming data

- ~~10/14 6:00 AM ET: Sep Small Business Optimism Survey~~ **Tame**
- ~~10/15 8:30 AM ET: Oct Empire Manufacturing Survey~~ **Tame**
- ~~10/15 2:00 PM ET: Fed Releases Beige Book~~ **Mixed**
- ~~10/16 8:30 AM ET: Oct Philly Fed Business Outlook~~ **Tame**
- ~~10/16 8:30 AM ET: Sep Core PPI MoM~~ **Delayed due to Shutdown**
- ~~10/16 8:30 AM ET: Sep Retail Sales~~ **Delayed due to Shutdown**
- ~~10/16 10:00 AM ET: Oct NAHB Housing Market Index~~ **Tame**
- ~~10/17 9:00 AM ET: Oct M Manheim Used Vehicle Index~~ **Tame**
- ~~10/17 4:00 PM ET: Aug Net TIC Flows~~ **Delayed due to Shutdown**
- 10/23 8:30 AM ET: Sep Chicago Fed Nat Activity Index
- 10/23 10:00 AM ET: Sep Existing Home Sales



- 10/23 11:00 AM ET: Oct Kansas City Fed Manufacturing Survey
- 10/24 8:30 AM ET: Sep Core CPI MoM
- 10/24 9:45 AM ET: Oct P S&P Global Services PMI
- 10/24 9:45 AM ET: Oct P S&P Global Manufacturing PMI
- 10/24 10:00 AM ET: Oct F U. Mich. 1yr Inf Exp
- 10/24 10:00 AM ET: Sep New Home Sales



Mark Newton's Live Technical Analysis

October 13 at 2pm ET

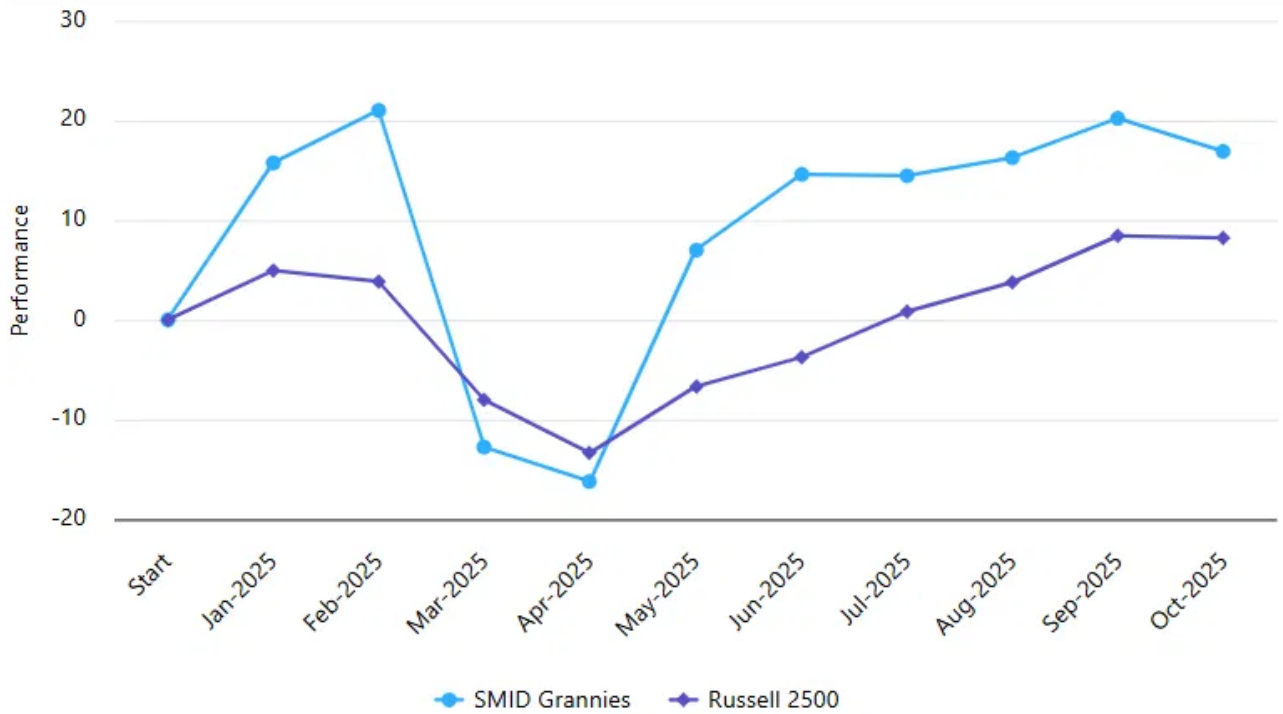


Mark Newton, CMT
Head of Technical Strategy



Stock List Performance

Year to Date SMID Granny Shots Performance

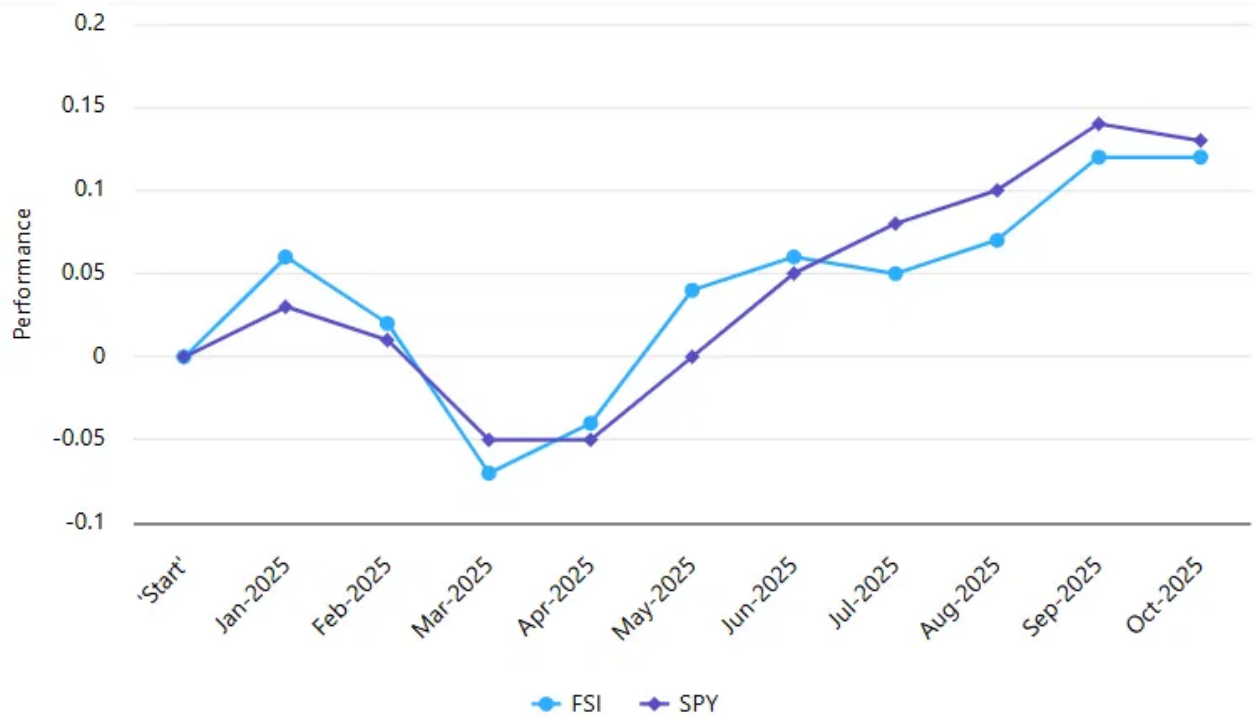


Highcharts.com

Performance period: January 01, 2025 through October 17, 2025



Upticks vs SPY (Year to Date)



Highcharts.com

Performance period: January 01, 2025 through October 17, 2025

In the News

Tom Lee: Private credit concerns don't change market's long list of tailwinds

Oct 17, 2025



Tom Lee joins Squawk Box to discuss what Friday's sell-off could mean for markets



Oct 13, 2025



Tom Lee: Market pullback may be overdue to an extent

Oct 10, 2025



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