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When Recessions End, Small Caps Have Led the Way

According to the National Bureau of Economic Research, the economy has been in a recession since December 2007. Since the average recession lasts about 11 months, the current downturn will end up being longer than usual. Still, it's never too early to prepare for a recovery. And when the recovery does arrive, it may be led by small-cap stocks.

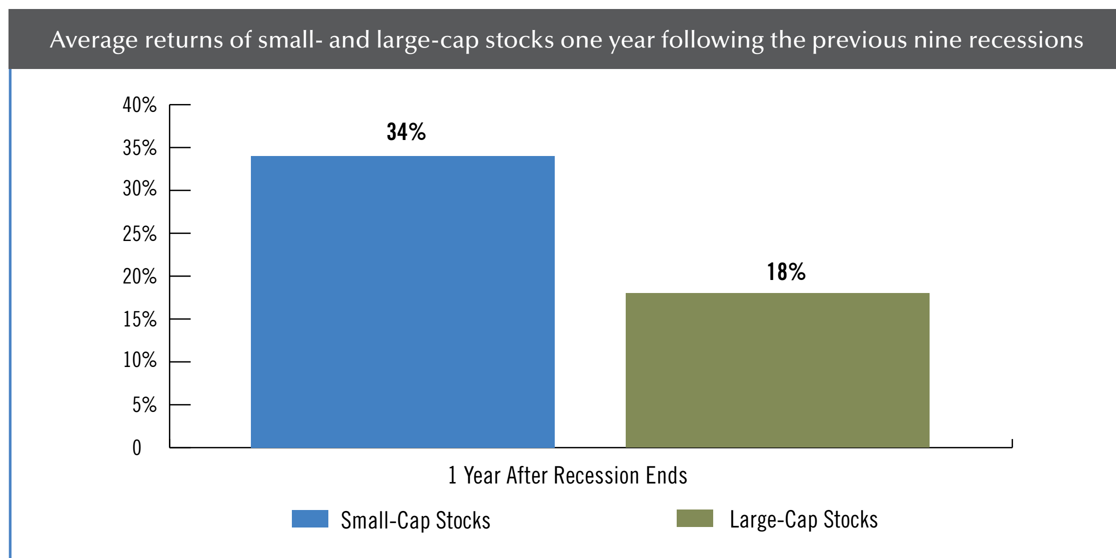
Recessions Often Hit Small Caps First

Recessions typically cause volatility in the stock market as investors exit equities and head for the sidelines in search of more stable investments. Smaller companies (small caps) tend to be more sensitive to changes in the economy than larger companies (large caps). As a result, small-cap shares have historically sold off faster during a recession, leading to rapidly deteriorating returns for those stocks.

But Small Caps May Recover Faster

Since smaller companies tend to be more nimble and often react faster to changes in the business environment than larger companies, they may bounce back more quickly and grow more rapidly in a recovery. In fact, small caps have significantly outperformed large-company stocks in the first year following 9 out of the last 9 recessions.

Since no one can predict when the recession will end, maintaining a diversified asset allocation regardless of market conditions is a sensible approach to investing. And part of that strategy means considering an appropriate exposure to small-cap stocks to potentially get the most out of the next recovery. Keep in mind that asset allocation and diversification do not assure a profit or protect against loss in declining markets.



Keep in mind that investing involves risk. The value of your investment will fluctuate and, when sold, may be worth more or less than its original cost.

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Small-Cap Stocks Have Outperformed Large-Cap Stocks Following the Last Nine Recessions

Source: Morningstar Direct, Ibbotson Associates. Small stock returns for 1953–1980 are those of stocks comprising the fifth quintile of the New York Stock Exchange. Thereafter, returns are those of the Dimensional Fund Advisors (DFA) Small Company Fund, which is a market-value weighted index of the ninth and tenth deciles of the New York Stock Exchange (NYSE), plus stocks listed on the American Stock Exchange and the over-the-counter with capitalization that is the same as or less than the upper bound of the NYSE ninth decile. Large stock returns are based on the S&P 500, a market-weighted index of 500 stocks (currently) in a variety of industries. It is often used as a broad measure of stock market performance. The performance above does not reflect the impact of taxes, management fees or sales charges. Investors cannot invest directly in an index.

Small-cap investing involves special risks. Small-cap stocks have limited marketability and may be subject to more abrupt or erratic market movements than large-cap stocks.

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IFS-A159264 JD2563 Ed. 01/01/2009