

Investing in Small Cap Stocks and Hoping for the Next Big Thing

Every investor dreams about finding the next big thing. If only they could have had the foresight to invest in companies like Microsoft, Amazon and even Google before everyone else then they too would be multi-millionaires. Consequently, one of the places that many investors seek such a needle in a haystack is with small cap stocks.

Small cap is simply an abbreviation which means 'small capitalization.' While the definition can vary from financial institution to financial institution, for the most part, a stock that is considered to be a small cap stock will have a market capitalization of about \$300 million to \$2 billion. This is an important distinction as mid cap and large cap stocks will obviously have market capitalizations that are much higher.

One of the main reasons that many investors like playing in the small cap stock arena is that they feel they have a chance to discover a hidden gem of a company and gobble up some shares before big financial institutions will. This is mainly due to the fact that most financial institutions that buy stocks for those investing with them, such as mutual funds, will have a limit on how low in capitalization a stock that they purchase can be. In fact, some of the larger brokerage firms will not even allow their brokers to buy and sell small cap stocks for their clients.

When I was a stock broker and money manager, I worked for a boutique firm, or smaller firm, and we had no rules on what we could and couldn't buy and sell for our clients. During the boom of the last part of the 1990s, it was not unusual for many small cap stocks to make a big impact, though most stocks were going straight up at that time.

So, the big question is, are small cap stocks a good investment? Well, the answer to that question is not simply a yes or no. First of all it comes down to individual risk tolerance. Yes, small cap stocks can hit big and an investor who buys stock at \$4 per share will make huge money if that stock's underlying company is the next big thing and the stock goes to \$10, \$20 or more.

But there is a flip side as well. A fledgling company that is not making any money and not well established has just as much of a chance to be a big bust sending the stock price to mere pennies or less. Therefore, an investor in small cap stocks has to have the stomach for whatever unfolds.

Additionally, any investor who thinks about getting involved with small cap stocks should not do so with their entire fortune. I have personally seen the negative effects of someone losing everything they had because they refused to listen when I told them to

only allocate a small percentage of their worth into a particular small cap stock and it wasn't pretty.

When it comes to small cap stocks, I always told my clients to only devote about five percent of their portfolio to the game and to always stay well diversified. This will of course vary from money manager to money manager, but any investor should consult with their own personal money manager before jumping into small cap stocks.

I'm not saying that small cap stocks are a bad investment either. I am only suggesting that a good deal of thought and research should precede any investment. After all, what might look like the next big thing one day can quickly turn into the next big flop on another.