

SMALL CAP STOCKS: START OF A NEW CYCLE

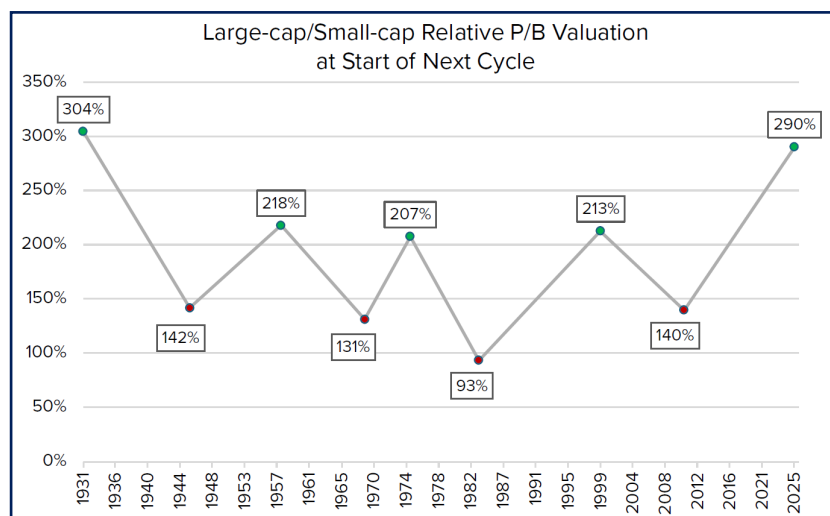
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After 18 months of false rallies, the Russell 2000® Index (“Index”) reached new highs for the first time in over three and a half years, marking the second-longest stretch between peaks in its history. We view this milestone as a pivotal signal that a new small-cap cycle is underway. Our conviction is building that small-cap equities are poised not only to recover lost ground but also to deliver a sustained period of outperformance versus large-caps. The Index’s April low increasingly appears to have been the clearance event necessary to reset sentiment and establish a durable foundation for small-cap leadership. Since then, the Index’s recovery has gained momentum, supported by favorable technical and fundamental underpinnings. Critical tailwinds are aligning—lower interest rates providing a cost-of-capital advantage, extreme market concentration creating opportunities in under-owned segments, historically attractive valuations relative to large-caps, and constructive trading behavior that suggests consistent institutional re-engagement in the asset class. These dynamics represent the most compelling setup for small-cap outperformance in over a decade. We believe investors who strategically rotate into small-cap equities today could be well-positioned to capture outsized returns as this cycle matures.

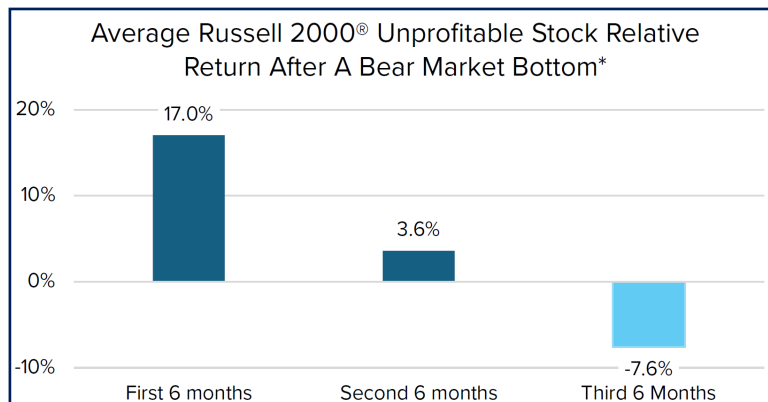
With the Federal Reserve lowering the Federal Funds Rate and signaling the potential for two additional cuts later this year, interest rate visibility has improved considerably—an essential catalyst for small-cap performance. Small-cap companies, which are generally more sensitive to financing costs and domestic economic conditions, stand to benefit significantly from this supportive monetary backdrop. Within small-caps, economically sensitive industries such as Industrials, Materials, and Financials could benefit the most, but we believe the Banking industry emerges as a particularly compelling opportunity. Lower long-term interest rates and tax incentives for capital investment should accelerate loan demand, while a more favorable regulatory landscape is creating greater flexibility for regional bank M&A. Consolidation among small-cap banks has historically been highly accretive, as acquirers often realize substantial cost synergies by reducing the expense base of acquired peers with smaller footprints—directly enhancing earnings potential. Taken together, the Fed’s policy pivot and the improving operating environment not only strengthen the earnings outlook for small-cap banks but also reinforce the foundations of the next phase of small-cap leadership across the broader equity market.



Source: Furey Research Partners. As of June 30, 2025.

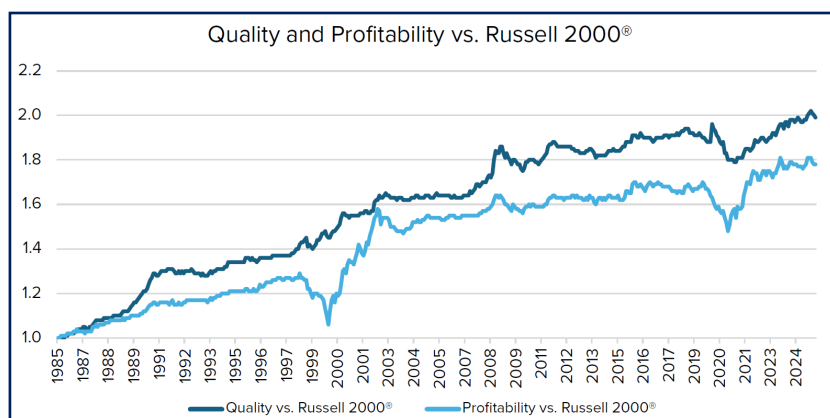
While the S&P 500® Index continues to hit record highs, it has increasingly become very concentrated with AI-driven technology leaders pushing relative valuation measures firmly in favor of small-cap equities. As of August 31, 2025, the S&P 500® Index traded at 22.3x forward earnings, compared with 15.8x for profitable Russell 2000® constituents and 16.0x for the Russell 2500™—discounts of nearly 30%. On a Price-to-Book basis, the divergence is even more pronounced, with large caps commanding a 290% premium, the widest gap since 1931. Given that roughly one-third of the Russell indices are unprofitable, Price-to-Book provides the clearest signal: small-caps are trading at a historic discount to large-caps, presenting a potentially attractive opportunity for active investors to identify mispriced leadership candidates.

Since bottoming in April, the small-cap rally has followed a familiar historical pattern in which lower-quality factors—such as profitability, smaller market capitalization, and heavily shorted stocks—tend to lead in the early stages of recovery. Research by Furey Research Partners shows that unprofitable companies have historically delivered the strongest gains in the first six months after a market trough, with performance typically fading thereafter. As this initial post-trough rally matures, leadership often rotates from low-quality names to higher-quality companies with stronger fundamentals. These include businesses with solid earnings, reasonable valuations, high returns on equity and invested capital, and sustainable business models.



Source: Furey Research Partners, FactSet Research Systems, Inc.
As of September 5, 2025.

* Includes bear markets from 1987, 1990, 1998, 2002, 2009, 2011, 2016, 2018, 2020, and 2023.



Source: Furey Research Partners. As of August 31, 2025.

As evidenced by the chart to the left, over the long term, quality and profitability factors have consistently driven superior and more durable performance, outpacing the broader Index.

Following its widest divergence on August 8, when the Russell 2000® lagged the S&P 500® by 9.2%, the Russell 2000® has since outperformed by 5.6% relative to S&P 500® through August 31, 2025. Importantly, participation within small caps has broadened. The top 100 stocks now account for 55% of the Index's quarter-to-date return, compared with roughly 80% in the second quarter, signaling more inclusive market leadership.

We believe the backdrop for small-cap equities has become increasingly constructive and the risk-return profile of these companies has improved at a time when most allocators have all but given up on this historically important asset class. Lower interest rates, pro-growth fiscal policies, elevated market concentration of large caps, and attractive relative valuations are creating a supportive environment for potential small-/smid-cap outperformance. With small- and smid-cap companies at record-low weights of the total U.S. equity market, we believe the risk-reward dynamic is particularly compelling. Our conviction has grown that this is an opportune time to allocate capital toward quality, profitable small- and smid-cap stocks.

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The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. It consists of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

The Russell 2500™ Index measures the performance of the small- to mid-cap segment of the U.S. equity universe. It consists of approximately 2,500 of the smallest securities based on a combination of their market cap and current index membership.

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