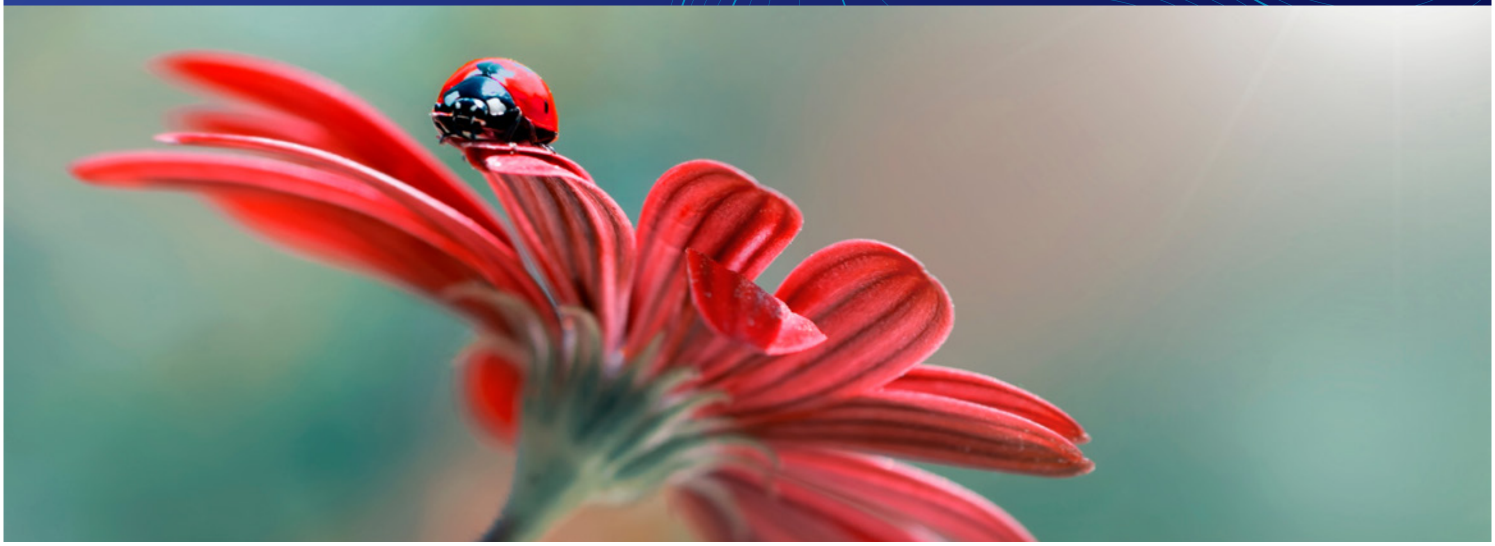

4Q25 Small Cap Market Overview

The good news is that 2025 was the third consecutive year of gains by small cap stocks. The bad news is that it was the fifth consecutive year that small caps lagged larger names.

The Russell 2000 Index's 2.2% advance in the fourth quarter contributed to an annual total return of 12.8%; this compares to respective gains of 2.7% and 17.9% by the S&P 500 Index. That said, we are encouraged by the momentum evident in the small cap market. Notably, the Russell 2000 has rallied more than 42% since hitting its 2025 low in early April, outpacing the S&P 500 by nearly 375 basis points.[1]

Have the Winds Begun to Shift in Favor of Small Caps?

Smaller company stocks in general have appeared cheap for some time, in our estimation, and history has taught us that they can stay this way for an extended period before the market recognizes their value. As fundamental investors, we believe that earnings growth is among the more durable catalysts for such recognition and can help boost performance even without multiple expansion. There are signs that a resurgence in small cap earnings may at last be underway after a long period in the shadow of the market's larger names.

Amid a backdrop of 4.3% GDP growth and manageable inflation, Russell 2000 year-over-year growth in the third quarter came in at nearly 64%, trouncing the consensus estimate heading into reporting season. Forecasts call for a similar level of growth in the fourth quarter, bringing calendar 2025 earnings growth to about 45%—well above the S&P 500's 13% growth. This trend is expected to persist through periods for which estimates have been published, with the Russell 2000 forecast to deliver earnings growth of 63% in 2026 and 32% in 2027 compared to 16% and 15%, respectively, for the S&P 500. Similarly, the small cap revenue growth rate is forecast to improve over the next several quarters and ultimately surpass that of large cap stocks.[2]

Helping support improved small company earnings has been the lower cost—and greater availability—of capital. Smaller companies tend to be far more reliant on short-term, floating-rate debt compared to large cap names. Since the Federal Reserve's rate-cut cycle began in September 2024, the secured overnight financing rate (SOFR)—the reference rate for many smaller borrowers' loans—declined more than 160 basis points, providing

1. Source: FactSet; data as of December 31, 2025.
2. Source: LSEG I/B/E/S; data as of January 9, 2026.

companies carrying variable-rate debt with hard-dollar savings. Because SOFR trades very closely with the federal funds rate, additional rate cuts in 2026—futures markets suggest the fed funds rate will be 25 basis points lower at midyear and 50 basis points lower by year end—could provide small companies with further savings on interest expenses.[3]

More stable interest rates could also help support the market for initial public offerings (IPOs), which has been slowly coming back to life after cratering in 2022 with the onset of Fed rate hikes. Even amid 2025's tariff volatility and government shutdown, 202 IPOs were priced during the year, a four-year high and 35% increase from 2024.[4] Given an administration that has demonstrated a hands-off approach to regulatory matters, continued improvement in IPO activity during 2026 would not come as a surprise, especially as financial buyers look to monetize the investments they have held for several years.

A Tentative First Step

The strong rally in smaller stocks following the post-Liberation Day swoon reminded us that this beast still has claws.[5] Despite this recent show of strength, longer-term performance trends remain skewed toward large names, with the relative performance of small caps remaining near previous cyclical troughs.[6]

Respecting the tendency for reversion to the mean, our confidence in eventual strong sustained returns from small caps—driven by fundamentals—remains firm. In the meantime, we'll remain focused on ensuring that valuations are overall cheaper than the market and well-positioned for upside should recent momentum persist.

> Our confidence in eventual strong sustained returns from small caps—driven by fundamentals—remains firm.

3. Source: CME FedWatch; data as of January 12, 2026.
4. Source: Renaissance Capital; data as of January 2, 2026
5. Source: FactSet; data as of December 31, 2025.
6. Source: Furey Research Partners, FactSet; data as of November 28, 2025.

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Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Gross domestic product (GDP) measures the total value of all economic output in goods and services for an economy.

Secured Overnight Financing Rate (SOFR) is broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

Indexes are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

Russell 2000® Index (Gross/Total) measures the performance of the small cap segment of the US equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. A total-return index tracks price changes and reinvestment of distribution income.

S&P 500 Index (Gross/Total) measures the performance of 500 of the top companies in the leading industries of the US economy and is widely recognized as a proxy for the US market as a whole. A total-return index tracks price changes and reinvestment of distribution income.

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M-TL-SCT-MO25Q4-D-LT