



The Small Idea: Onward, Small Cap Soldiers!

During the seemingly eternal trial of small cap underperformance, we took comfort in George Harrison's reassurance that "All Things Must Pass."

With the Russell 2000 Index at a 52-week high—having logged a return exceeding 65% since "Liberation Day"—small caps are now just one year into what we hope will be an extended redemption tour.¹ As we near the end of first-quarter reporting season, spirits remain high thanks to a large number of what we consider stellar earnings reports from smaller companies. After underperforming for what seemed forever, small caps have finally demonstrated what a boost can come from a spurt of strong earnings.

Pundits, finally, have largely dropped the "small caps are dead forever and should be avoided at all costs" mantra after some Magnificent-Seven names proved fallible after all, while some small companies astounded with quality businesses and solid balance sheets. Recent "big winners" lists have been graced with more than a sprinkling of small cap names in biotech, energy and data centers—sometimes with daily gains that might previously have been considered laudable full-year returns.²

At this juncture, we small cap investors may be tempted to plant a victory flag and bask in anticipation of endless celebratory parades ahead. On the other hand, the song says *all* things must pass. So we are forever looking forward, fortifying our portfolio for whatever siege may lie ahead.

While it would have been easy for small cap managers to lose heart during the brutal four-year-plus stretch when large caps seemingly outperformed every day, we stuck to what we view as a tried-and-true process. That is, acquiring good companies at what we perceive to be attractive prices, then patiently waiting for the rest of the market to recognize the underappreciated value in our holdings. And that is what we are doing, still.

Whatever comes next, we diehard small cap managers will always have a long road ahead. Volatility remains a feature of our asset class, and what we perceive as unrealized value is often dismissed by the marketplace in the short run. So, the joy I feel during periods of strong small cap performance is often tinged with melancholy. After slogging through the fallow periods, we've finally seen our work pay off and reinforce confidence in our process. After taking a breath, though, it's time to wonder what comes next.

1. Source: FactSet; data as of May 6, 2026.

2. Source: Reuters; data as of April 22, 2026.

Successful stock selection and good results bring high expectations. Stocks are up, but are they up enough? Is the virtuous cycle just beginning, or has it reached an apex? My former partner in Boston was fond of taunting me with the reminder that “Fear is temporary, but greed gnaws forever.” With hope that the dark days of discouraging small cap performance are behind us, we are following a number of bright beacons still on the horizon.

Earnings upswing. For the first time in several years, earnings for the Russell 2000 are projected to outstrip those of the S&P 500 Index for at least the next two years.³

Software-enabled efficiencies. Outsourced software and servicing solutions may provide resources for small companies to scale their operations, improve efficiency and facilitate the conversion of some costs from fixed to variable, easing the need for working capital.

AI-driven growth. Artificial intelligence (AI) may enable some small cap companies—including suppliers to infrastructure and data center construction—to expand their customer bases without incremental spending on research and development, underpinning both top-line growth and margin expansion. Healthcare and consumer goods companies could conceivably see even greater benefits from AI through enhanced development of premium products that drive pricing power.

We are following bright beacons still on the horizon as we pursue underappreciated value.

Policy and economic tailwinds. A more benign regulatory environment may spur mergers and acquisitions activity, while reindustrialization and reshoring trends could be of benefit to smaller domestic-focused businesses.

A resurgent IPO market. With free money a thing of the past, private equity sponsors may be incentivized to monetize their investments through initial public offerings (IPOs). Increased liquidity and investor focus on private-to-public marks could more broadly enhance valuations and performance for publicly traded small cap companies overall.

In the final analysis, cycles will be with us always. Sometimes, there is no place to hide, but history has shown that fundamentals eventually prevail. In good and bad times alike, we do what we have always done: rely on our disciplined research process to assemble a portfolio of what we consider underappreciated value.

3. Source: FactSet; data as of May 15, 2026.

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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.

Magnificent Seven is widely used in the financial media and elsewhere to refer to seven very large US technology-related stocks—Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

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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