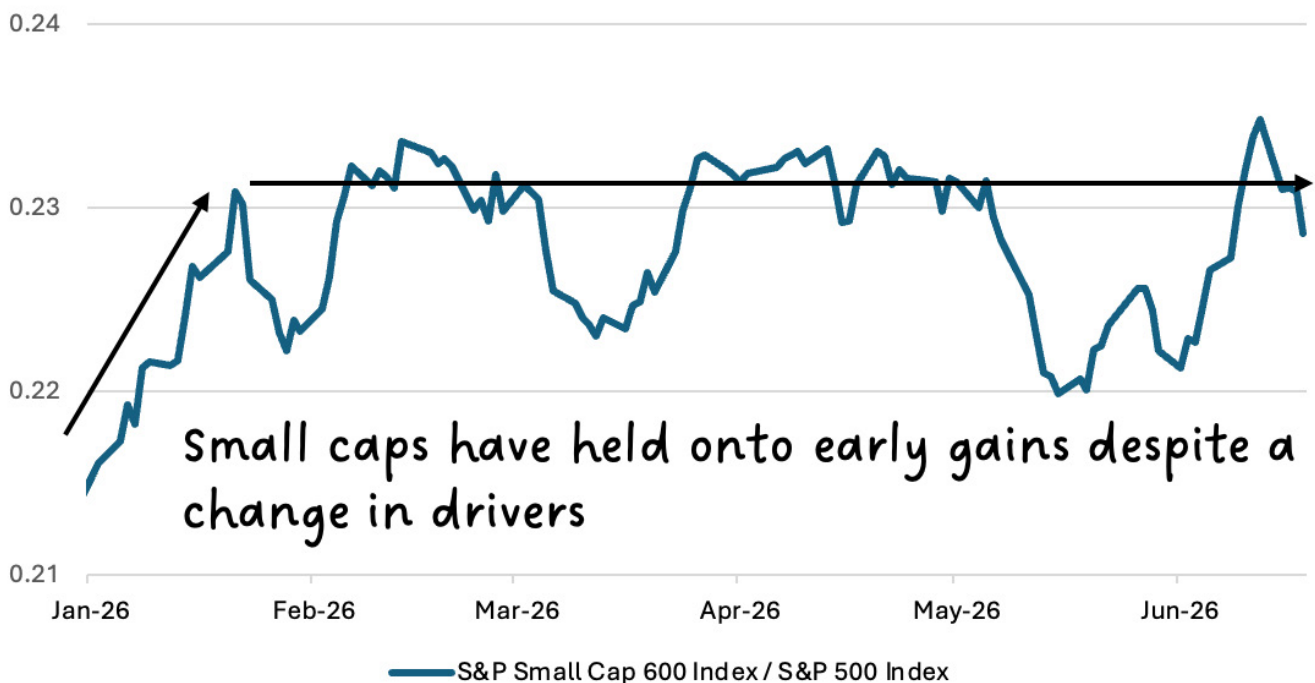




## Small Caps Deserving of Another Look

- ▶ Most of small caps' relative outperformance this year occurred during the first weeks of January. The rally was broad-based as overall market leadership began to shift away from mega-cap stocks. After several years of lagging large caps, investors were drawn to the more attractive valuations of smaller companies as the Fed appeared likely to continue easing monetary policy and consumers were expected to benefit from larger tax refunds.
- ▶ Leadership shifted over the following months. Technology, Industrials, and Materials emerged as the primary drivers of performance. Unlike the more speculative January rally, these sectors have been supported by tangible spending trends tied to AI infrastructure, data center construction, rising power demand, and defense investment. As a result, we see this trend as more durable.
- ▶ Looking ahead to the second half of the year, there is the potential for broader participation. Lower fuel prices, continued wage growth, and possible fiscal support ahead of the midterms could provide a tailwind for more consumer-oriented areas of the small cap market. It has also been encouraging to see earnings expectations move higher rather than lower, a welcome change from the pattern of the past two years.
- ▶ The interest rate outlook has become somewhat less favorable. New Fed leadership has struck a more hawkish tone than many investors expected. Even so, it remains unclear whether rates will move higher, and any increase is unlikely to mark the beginning of a prolonged tightening cycle.
- ▶ Looking further ahead, AI could help level the playing field for smaller companies. Historically, larger firms benefited from greater resources, technology budgets, and back-office economies of scale. Advances in AI may lower some of those barriers by allowing smaller firms to automate tasks, improve productivity, and compete more effectively.
- ▶ **The key takeaway:** Small caps won January on changing investor expectations. Their ability to hold those gains is encouraging, even as the original rate-cut narrative faded and tax refunds were eaten up by higher fuel prices. Growing investment in AI infrastructure is creating visibility for earnings growth in several leading sectors, while improving consumer fundamentals could support broader participation. If consumer activity strengthens and AI-driven productivity gains become more widespread, we could see a broader and more sustained rally.

## Relative Performance



Source: Bloomberg. As of June 19, 2026.

### Word About Risk

Fixed-income securities can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities may be downgraded by a Nationally Recognized Statistical Rating Organization to below investment grade status. Non-investment grade debt securities are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and has had more frequent and larger price changes than other debt securities. Equities are subject to market volatility and loss. Growth stocks may be more volatile than investing in other stocks and may underperform when value investing is in favor. Value stocks may not appreciate in value as anticipated or may experience a decline in value. Stocks of large-cap companies may be unable to respond quickly to new competitive challenges. Stocks of small- and mid-cap companies may be subject to more erratic market movements than stocks of larger, more established companies. Investments in foreign, and emerging market securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The risks associated with investing in foreign markets are magnified in emerging markets, due to their smaller and less developed economies.

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