

Small Cap Quality Growth Portfolio Review – 4Q25 and 2025

Market Review

- The Russell 2000 Growth (R2G) experienced modest gains in 4Q25, delivering a total return of 1.2% amid a broader market environment where small-cap growth stocks showed restrained momentum compared to earlier quarters. The R2 gained 2.2% while the R2V returned 3.3%.
- Modest gains were posted in October, supported by improving small-cap sentiment amid interest rate dynamics, while November saw a slight decline with limited momentum. Growth stocks faced further headwinds in December as large-cap and value segments outperformed, contributing to subdued quarterly results overall.
- The R2G delivered a solid annual return of 12.5% in 2025, overcoming an early-year downturn through strong mid-year rebounds fueled by easing trade tensions and supportive economic conditions. The R2 gained 12.8% while the R2V returned 12.6%.
- 1Q25 saw a sharp decline of 11.1%, driven by tariff talk, extending a bear market that began in Nov 2024. A robust rally began in 2Q25 with a gain of 11.8% and 3Q25 followed with a 12.0% gain, as de-escalating trade concerns boosted confidence. 4Q25 ended with subdued growth as noted above.
- Only 2 of 11 sectors within the R2G outperformed the total index for the quarter: Health Care and Real Estate. Utilities lagged. A feast or famine look defined the year: Health Care, Materials, Industrials and Technology all returned greater than 20% while Communications and Discretionary lost 14% and 12% respectively.
- Low-quality led 4Q25 and the year: high short interest, low share price, low P/E, low NTM sales growth, low EV/EBITDA, and high bankruptcy risk were leading factors in both time periods. Dividend payers, low leverage, low beta, and high NTM EPS growth stocks lagged the most. Loss-makers outperformed profitable companies by over 350 bps in 4Q25 and while profitable companies led by 880 bps in 1Q25, loss-makers outperformed profitable by over 2200 bps in the last three quarters.
- Microcaps led for the quarter and the year, evidencing the risk on nature in the market, with Microcap Value performing exceptionally well. While Value was the obvious style leader in 4Q25 regardless of size, style leadership amongst sizes was grouped: micro-, large-, small-, and mid-. *Microcaps outperforming bodes well for small caps!*
- The relative valuation of small versus large stocks continues to be at 20-year lows in favor of smaller stocks.

Portfolio Review:

- Small Cap Quality Growth (SCQG) underperformed for 4Q25 (-0.5% vs the R2G's 1.3%) as well as the year, returning 7.7% versus the R2G which generated a 13.0% return.
- Our favored factors, lower volatility, lower market sensitivity, higher earnings yield, higher momentum, and higher profitability were mixed for the quarter and year. High-volatility led strongly during both periods. Low-beta stocks led in the more-cautious quarter, high-beta stocks led for the risk-on full year. Loss making biotechs were seemingly impervious to beta trends, performing well regardless of volatility trend.
- Security selection was negative for the quarter and the year with Health Care being the largest detractor. The portfolio protected capital well throughout the small cap bear market which began in Nov 2025. The rally which began straight out of the small-cap bear market in early-April 2025, modeled rallies that are historically similar: strong performance is marked by low-quality balance sheets, high-volatility price movements and operational inefficiencies – a detritus-based start to a new bull market.
- For the quarter, Health Care stocks dominated the strongest contributors, with four holdings in the top 10. Iridimed (IRMD) contributed over 100bp of return while Bright Spring (BTSG) and Sanmina (SANM) contributed better than 50bp each. The cybersecurity company Commvault (CVLT) was the largest detractor. For the year, Technology and Industrials were prominent among the top 10 contributors, with three holdings each. Iridimed (IRMD), Artivion (AORT), Willdan (WLDN), StoneX (SNEX) and Sanmina (SANM) all contributed greater than 100bp of return for the year. Progress Software (PRGS) and Corvel (CRVL) were laggards.

Outlook:

- The argument for the advent of the “small-cap decade” continues to grow. We have stressed three linchpins for the large to small switch for multiple quarters: the relative **valuation** discount of small cap to large cap – continual trough valuations; the **concentration** of mega-caps as a percent of the total equity market – always a herald of large to small leadership switches; and finally, the **duration** of the large cap leadership cycle is the second longest in U.S. stock market history.
- Sawgrass’ risk-conscious Small Cap Quality Growth strategy generates portfolios exhibiting lower price volatility; stable, consistent growth; and attractive valuations. It is built for this market. The rubber band of the “linchpins” is stretched tight. When it snaps, small caps are likely to generate historical **appreciation**.