

# Small Cap Quality Growth Portfolio Review – 1Q26

## Market Review

- The Russell 2000 Growth (R2G) declined -2.8% in 1Q26 in a volatile quarter overshadowed by geopolitics. The R2 eked out a modest +0.9% gain while the R2V rose +5.0%, marking the third consecutive quarter of Value outperforming Growth. The quarter featured rare intra-quarter swings — an up 5%+ month and a down 5%+ month in the R2 — driven by the U.S./Israel war with Iran and the closure of the Strait of Hormuz, which sent oil prices surging +76.6%.
- Small-caps demonstrated resilience and strong relative performance. The R2 outperformed the S&P 500 by +522 bps, the Russell 1000 by +510 bps, and the Russell Top 50 by nearly 900 bps. For the 1-year period ended 3/31/26, the R2G advanced +23.6% while the R2 gained +25.7% and the R2V returned +28.1%. From the April 2025 market low, the R2G rose +42.0% versus +47.9% for Value.
- Only four of 11 sectors in the broader Russell 2000 finished the quarter positive. Within the R2G, Energy returned 29%. Communications was the significant drag with Health Care, Information Technology (software), and Financials being large detractors as well.
- Quality factors (e.g., profitable, ROE, ROIC) led performance in 1Q26 and continue to trade at an unprecedented discount versus the broader market, providing both downside protection and attractive upside potential going forward.
- Microcaps led size categories for the quarter (+1.5% vs. R2 +0.9%), extending their outperformance off the April 2025 low and reinforcing the risk-on tone across smaller-cap leadership. Microcaps have dominated, returning 61%+ from April 8, 2025, through close of 1Q26. Allocation dollars are moving down cap.
- Small-caps continue to exit an earnings recession with a markedly improved fundamental backdrop. Revenue growth tied to an accelerating 2026 CapEx cycle is expected to drive mid-teens EBIT growth and 20-30% pre-tax earnings gains.
- The relative valuation of small-caps versus large-caps remains near 25-year lows on an EV/EBIT basis, still highly attractive despite recent outperformance and supportive of further small-cap leadership.

## Portfolio Review:

- In 1Q26, the SCQG strategy returned +0.8%, meaningfully outperforming the R2G, which declined -2.8%. This positive absolute return and strong relative result occurred amid a challenging market rotation where small-cap growth lagged value stocks (R2 Value +~5%), highlighting SCQG's resilience in a volatile environment.
- SCQG's disciplined quality-growth approach continued to add value. Key drivers aligned with our favored characteristics—low price volatility (underweight exposure delivered +1.36 impact), higher profitability (overweight +1.32), stable/consistent growth, high quality, attractive valuations, and solid medium-term momentum—provided a defensive edge in a low-quality, risk-on environment.
- Security selection was strongest in Financials (total effect +1.81, led by exceptional stock picks), Health Care (+1.10), and Consumer Discretionary (+0.84). These areas more than offset weaker results in Technology (-0.46) and Industrials (-0.43), where larger populations of underperformers weighed on returns.
- The top contributors were SNEX (StoneX Group, Financials, +1.04), AEIS (Advanced Energy, Technology, +0.88), AROC (Archrock, Energy, +0.74), and PAHC (Phibro Animal Health, Health Care, +0.74). The largest detractors were AORT (Artivion, Health Care, -0.79), RDVT (Red Violet, Communications, -0.79), UPWK (Upwork, Technology, -0.68), and HURN (Huron Consulting, -0.62). Notably, seven sectors were represented among the top-10 contributors, reflecting broad-based stock selection with a 16-month average holding period.

## 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. These factors have contributed to a historic **depreciation** of small cap returns relative to large caps in the post-Depression era.
- 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**.