

Investment Commentary: Small Cap Q2 2025

Quality More Critical Than Ever

Small cap stocks continue to lag large caps. While they have snapped back from the big tariff selloff with the rest of the market, they were weaker coming into that period and remain 10% below their November 2024 highs, while the S&P 500 has been setting new all-time highs nearly every day.

Quality Factor	S&P 500	Russell 2000	Van Hulzen
Cash Flow ROI - 2025E	17.8%	6.3%	15.9%
Sales growth - 5 year	8.1%	10.9%	11.9%
Leverage	21.3%	25.3%	9.5%
Default Probability	0.9%	6.3%	0.1%

Source: UBS HOLT

One clear distinction between large caps and small caps is quality. The statistics below demonstrate this well.

- **Cash Flow ROI.** The average Cash Flow ROI (2025E) for the Russell 2000 is only 6.3%, barely above the cost of capital, while the average ROI for the S&P 500 is 17.8%. Cash Flow ROI is a good proxy for cash flow generation and economic value added.
- **Sales Growth.** Sales growth (5-year average) is higher for the Russell, but higher growth does not create value unless it's profitable growth. And nearly 40% of the companies in the Russell 2000 are not profitable.
- **Leverage/Default Risk.** This is a big one for small caps. Not only does the average small cap have higher leverage than its larger counterparts, but roughly 38% of the companies in the Russell 2000 are considered "zombies," meaning they only generate enough cash to cover their interest costs. This is near historic highs, even surpassing levels during the 2008 Financial Crisis. The next section outlines why we place such emphasis on leverage in our stock selection process.
- **How Van Hulzen Stacks Up.** The stats for our small cap strategy compare very favorably to the Russell 2000 (see far right column). Much higher ROIs, higher sales growth, and lower leverage and default risk.

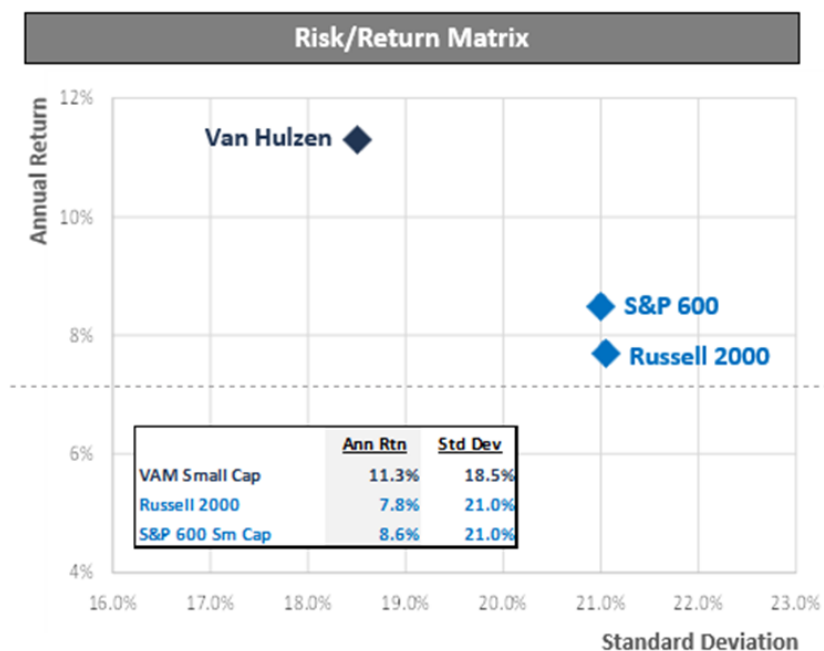
Leverage: A Major Factor Over The Long Run

Our team places significant emphasis on leverage risk in our stock selection process—and with good reason. In a recent study of the components of the Russell 2000, we sorted the index into quintiles based on leverage and analyzed total shareholder returns (TSRs) over various periods. Banks were excluded from this analysis, as they are spread businesses that carry "operating" debt.

Source: UBS HOLT

Leverage Quintiles	Leverage	P/E	TSR 6mo	TSR 2yr	TSR 3yr	TSR 5yr	TSR 10yr
Top (lowest leverage)	1.5	12.7	0.3	14.1	26.0	38.8	129.4
2nd	7.7	12.4	(6.1)	9.7	19.1	9.6	125.2
3rd	19.3	14.9	(3.5)	1.6	16.8	25.0	112.6
4th	36.0	13.2	(3.8)	(0.1)	9.7	9.3	60.1
Bottom (highest leverage)	61.0	8.3	(9.2)	(22.3)	(21.5)	(26.0)	(28.2)

Van Hulzen intentionally avoids these over-leveraged names. And our disciplined focus on leverage has been a key contributor to our alpha generation over time (4.6% annually for 9½ years), enabling us to deliver stronger returns with lower risk relative to our covered call benchmark (see below Risk/Return analysis, since inception).



Source: Tamara, Bloomberg

From an attribution standpoint, we believe as much of half of our alpha may come simply from avoiding the bottom two quintiles in the above table (the highest leveraged companies), with the other half coming from fundamental stock selection.

Q2 & YTD Performance

The strategy returned **+10.1%** in Q2, outperforming the Russell 2000's **8.5%**. Through the first two quarters of 2025, year-to-date performance stands at **+1.6%** vs. **-1.8%** for the index. The team credits this outperformance to portfolio quality, which helped mitigate losses during the recent tariff storm.

Since its 2015 inception, the strategy has delivered a **11.3% annualized return** vs. 7.8% for the Russell 2000—resulting in **4.6% annualized alpha** thanks to higher returns and lower volatility.

TOP 5 PERFORMERS

		Return	Description	Actions/Notes
STRL	Sterling Infrastructure	103.8%	Engineering & Construction	-
BWXT	BWX Technologies	46.3%	Nuclear components for Navy	-
FSS	Federal Signal	45.2%	Environmental & safety equipment	Trimmed in Q2
HWKN	Hawkins	34.3%	Water treatment systems	-
BMI	Badger Meter	28.9%	Industrial meters	-

BOTTOM 5 PERFORMERS

		Return	Description	Actions/Notes
VNOM	Ciper Energy	-14.3%	Oil & natural gas	-
JJSF	J&J Snack Foods	-14.2%	Snack foods	Added in Q2
MMSI	Merit Medical Systems	-11.6%	Healthcare supplies	Adding in Q3
PBH	Prestige Consumer Health	-10.4%	Consumer products	Added in Q2
WHD	Cactus	-10.2%	Oil & gas equipment	Sold in Q2

Source: Tamara, Bloomberg

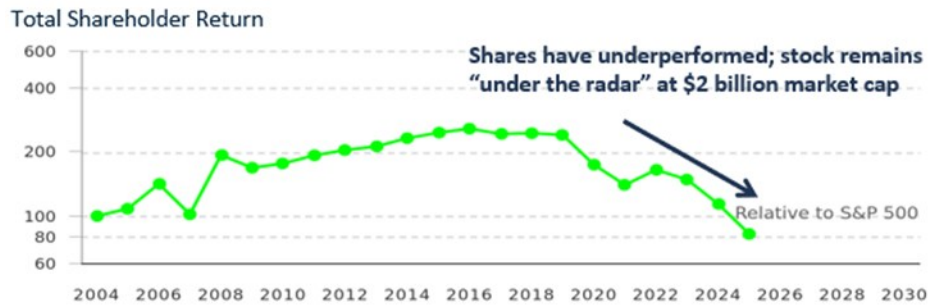
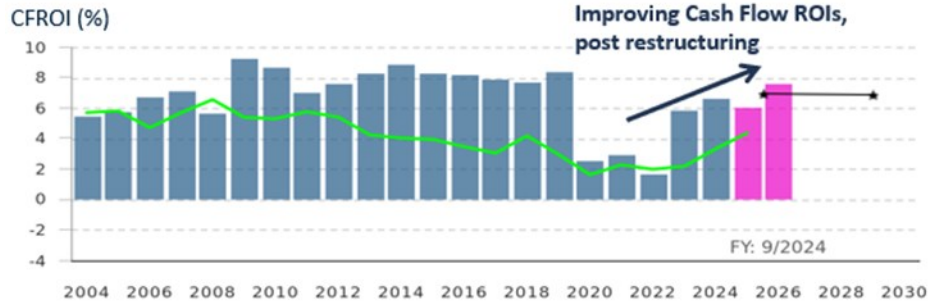
Recent Trade / Example

The team added to its J&J Snack Foods (ticker JJSF) position in Q2, taking advantage of its recent selloff. JJSF manufactures and distributes snack foods, primarily in the US. Some of its leading brands are New York Pretzel, Brauhaus, Dippin'Dots, Whole Fruit, Icee and Minute Maid.

The stock price peaked at \$196 in October 2019, but missteps resulted in a significant loss of shareholder value in 2020-21. The company appointed Dan Fachner President in May 2020 (and then CEO a year later) and embarked on a restructuring plan to improve efficiency. This involved some small divestitures, a lease termination and a supply chain overhaul. These actions have increased both margins and asset utilization, resulting in two consecutive years of Cash Flow ROI improvement (see below chart from UBS HOLT™). That's our cue.

These actions have not yet been recognized by the market, as JJSF remains "under the radar" at a \$2 billion market cap. The stock price is currently \$115 (40% below its all-time high) but is gaining relative strength. We believe it is a solid add to the portfolio.

J & J SNACK FOODS CORP (JJSF)

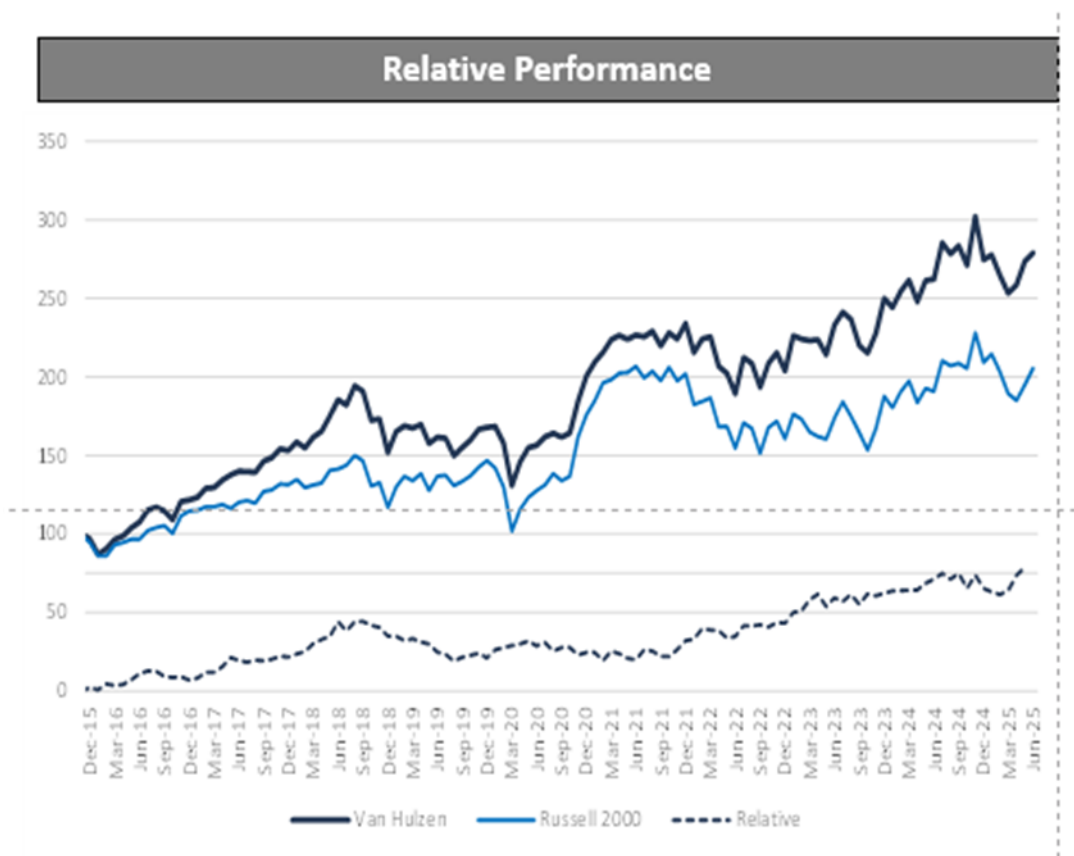


Note: Above charts from UBS HOLT™

Long Term Performance & Outlook

With an annualized return of **11.3% vs. 7.8%** for the Russell 2000, the strategy has produced an **annualized alpha of 4.6%**. The dotted line below shows relative performance, which has reached an all-time high.

The environment remains uncertain, but we recommend investors exercise patience. Markets rotate through long cycles, and the recent large cap dominance cannot last forever. And today's leading small caps are tomorrow's large caps. One thing appears clear – quality will continue to matter, more than ever.



Alpha

$$a = R_p - [R_f + (R_m - R_f) \beta]$$

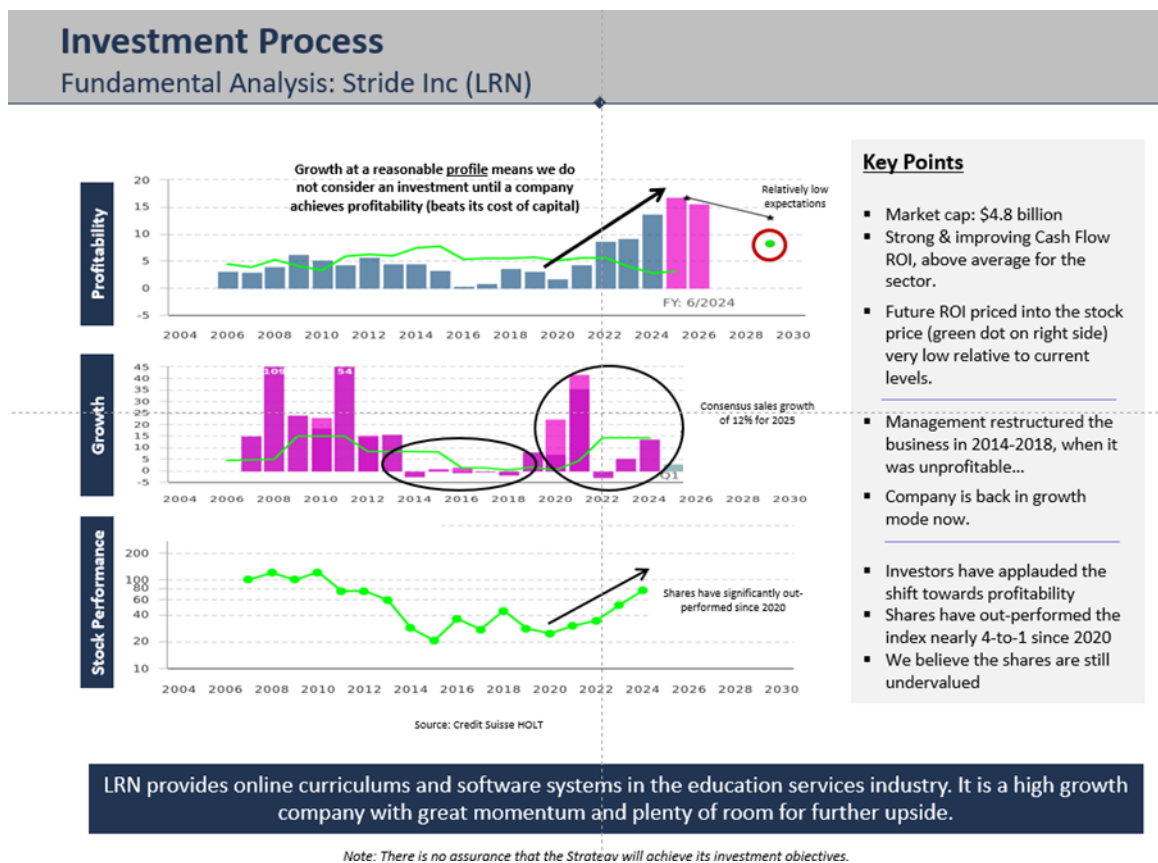
	Russell 2000	S&P 600
R _p = Realized return of portfolio	11.3%	11.3%
R _m = Market return	7.8%	8.6%
R _f = risk-free rate	1.8%	1.8%
β = Beta	0.82	0.82
Alpha (relative to RUT)	4.6%	3.9%

Source: Tamara, Bloomberg

Key Takeaways

- The portfolio outperformed the Russell 2000 in the first two quarters of 2025.
- Tariff risks have been assessed and addressed through strategic portfolio adjustments.
- A small-cap rebound may be delayed, but is still expected due to:
 - A wide valuation gap between small and large caps
 - Continued rate cut environment, which historically favors small caps
 - Long-term tailwinds from deglobalization and onshoring
- The portfolio remains focused on **high-quality, low-debt, cash-generating companies**—a strategy that has delivered consistent outperformance for more than nine years.

Investment Process



Top 10 Holdings (06/30/2025)

Company	Business description	Weight	Mkt Cap (\$mm)
Qualys (QLYS)	Cyber security	5.6%	5,060
Hamilton Lane (HLNE)	Investment bankin	4.7%	8,200
Hawkins (HWKN)	Water treatment	4.0%	3,270
Stride (LRN)	Learning tech systems	3.9%	9,490
Sterling Infrastructure (STRL)	Engineering & construction	3.8%	1,960
Progress Software (PRGS)	Open source business apps	3.7%	2,120
Applied Industrial (AIT)	Motion/fluid/power control	3.6%	9,720
Axos Financial (AX)	Regional banking	3.6%	4,830
Inter Parfums (IPAR)	Perfumes	3.5%	4,330
J&J Snack Foods (JJSF)	Snack foods	3.5%	2,260



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