



Investment Commentary: Small Cap Q1 2026

What War?

V Shaped Rally Pushes Markets to New All-Time Highs

Executive Summary

U.S. small-cap equities had a choppy start to 2026 but modestly outperformed large caps in Q1 as momentum continued from the second half of 2025. Performance was highly bifurcated, with profitable, cash-generative companies holding up better than more speculative, financing-dependent names - particularly in March. Despite brief volatility around geopolitical headlines and the related oil shocks, markets quickly stabilized in April and pushed to new highs, reinforcing a resilient risk appetite.

Max Dispersion

U.S. small-cap equities delivered mixed performance in the first quarter of 2026 amid persistent macro uncertainty and tighter financial conditions. While headline indices such as the Russell 2000 scratched out a positive return, underlying dispersion remained pronounced. Higher-quality small caps—those with durable margins, consistent free cash flow, and lower leverage—generally outperformed, particularly in the March sell-off, while more speculative segments continued to struggle.

And then the script flipped. Markets bottomed with a sharp “V” in early April, based largely on ceasefire messaging, underscoring how quickly sentiment can pivot in a market still dominated by macro headlines. So while equity markets initially reacted defensively to geopolitical escalation surrounding Iran, with energy prices spiking and risk assets briefly softening, that move proved short-lived. Equities have not only recovered the losses but ultimately have pushed to fresh highs in the subsequent weeks. This “sell-the-news, buy-the-dip” pattern reinforced the resilience of broader risk appetite and optimism about earnings in the face of potentially higher-for-longer energy prices.

Within small caps, pockets of strength persisted as earnings came in positive, particularly among domestically oriented industrials, services, and niche technology businesses. These companies benefited from steady end-market demand and selective pricing power, even as the broader asset class struggled to sustain momentum. Importantly, valuation dispersion remains significant. Small caps continue to trade at a meaningful discount to large caps on both earnings and cash flow metrics. However, that discount has persisted longer than many anticipated, reflecting ongoing skepticism around earnings durability and the structural impact of higher financing costs.

Q1 Biggest Winners & Losers

Van Hulzen’s small cap strategy under-performed slightly in Q1, turning in a -1.6% return compared to +0.9% for the broad Russell 2000. Small cap growth stocks fared particularly badly in March, and the Russell growth index finished the quarter with a -2.8% return. Energy and industrials led the way in the portfolio, with consumer staples, healthcare and insurance lagging. See the top 5 & bottom 5 performers below. We have rarely seen such dispersion (ranging from +73% to -54%) in a single quarter.

TOP 5 PERFORMERS

| | | Return | Description | Actions/Notes |
|------|-------------------------|---------------|-----------------------------|----------------------|
| BWXT | BWX Technologies | 72.9% | Nuclear components for Navy | - |
| STRL | Sterling Infrastructure | 72.6% | Engineering & Construction | <i>Trimmed in Q4</i> |
| MLI | Mueller Industries | 46.3% | Water management systems | - |
| DGII | Digi International | 43.2% | Open source business apps | - |
| YOU | Clear Secure Systems | 35.1% | Security systems | <i>Add in Q4</i> |

BOTTOM 5 PERFORMERS

| | | Return | Description | Actions/Notes |
|------|----------------------|---------------|----------------------------------|----------------------|
| CORT | Corcept Therapeutics | -53.6% | Treatments for Cushings syndrome | - |
| SPSC | SPS Commerce | -50.4% | Supply chain software | <i>Added in Q3</i> |
| SMPL | Simply Good Foods | -48.3% | Food | - |
| BWIN | Baldwin Insurance | -38.2% | Insurance brokerage | <i>Sold</i> |
| JJSF | J&J Snack Foods | -38.1% | Snack foods | <i>Sold</i> |

Outlook

Looking ahead, the outlook for the remainder of 2026 is likely to remain highly sensitive to the trajectory of inflation, interest rates, and geopolitical risk. Energy price volatility tied to the Iran situation remains a key near-term variable, as sustained increases in oil could complicate the inflation outlook and delay expectations for policy easing. Conversely, continued de-escalation would likely be supportive for duration-sensitive assets, including small caps, by easing inflation pressures and improving financial conditions. In that environment, more speculative segments could experience continued upside given their higher sensitivity to discount rate shifts.

From a positioning standpoint, we continue to favor market leaders with fortress balance sheets, strong returns on invested capital, and above-average organic growth profiles. These companies are better positioned to navigate a wide range of macro outcomes while still offering durable long-term compounding potential. Notably, many of these names avoided the speculative excess seen in the latter half of 2025 and remain attractively positioned from a fundamental perspective. The portfolio has a lower-than-average beta.

Mid-Term Years Present Elevated Volatility

As expected, the start to 2026 has been quite volatile. And we expect more to come. Mid-term election years are famously choppy, particularly from April-September. The chart below shows the average mid-term election year since 1946 (in blue) compared to the average of the other three years of the election cycle (in black). The contrast is stark. Q1 and Q4 tend to be positive in all years, but the uncertainty and anxiety around the mid-terms typically results in underperformance in Q2-Q3 during those years.

Average S&P500 level (indexed at 100 in Jan) for midterm and non-election years. Sample starts in 1946



Source: J.P. Morgan

Relative Performance Since Inception

Since inception, Van Hulzen’s small cap strategy has delivered an annualized return of 9.4%, versus 8.8% for the Russell 2000, producing 2.0% annualized alpha.

While the market backdrop remains uncertain, we continue to advocate patience with small caps. The era of large-cap dominance is showing signs of fatigue, and although low-quality, highly levered companies may lead in the early stages of a rebound, quality tends to win in the end. Today’s disciplined small caps are the likely large cap leaders of tomorrow.

Alpha

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

R_p = Realized return of portfolio

R_m = Market return

R_f = risk-free rate

β = Beta

Alpha (relative to RUT)

Russell 2000

9.4%

8.8%

2.0%

0.81

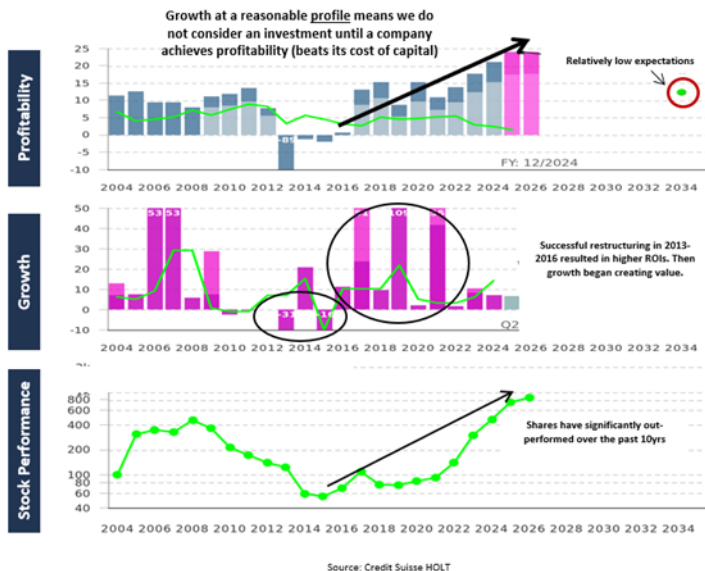
2.0%

Concluding Thoughts

In summary, while small-cap equities remain challenged in the near term, the environment is increasingly defined by elevated dispersion and rapidly shifting macro sentiment. The recent sequence of geopolitical volatility followed by a swift recovery to new highs underscores both the fragility and resilience of risk appetite. In this backdrop, disciplined fundamental selection remains critical, and the ability to selectively lean into dislocations is likely to be a key driver of excess returns across the remainder of the year.

Investment Process

Fundamental Analysis: Sterling Infrastructure (STRL)



- #### Key Points
- Market cap at entry point: \$4.8 billion
 - Strong & improving Cash Flow ROI, above average for the sector.
 - Future ROI priced into the stock price (green dot on right side) very low relative to current
 - Management restructured the business in 2013-2016, when it was unprofitable...
 - Company is back in growth mode now.
 - Investors have applauded the shift towards profitability
 - Shares have out-performed the index nearly 12-to-1 since 2016
 - We believe the shares are still undervalued

STRL is an engineering and construction company that provides e-infrastructure, transportation, and building solutions in the United States. It is a high growth company with great momentum and plenty of room for further upside.

Note: There is no assurance that the Strategy will achieve its investment objectives.

Top 10 Holdings

| Company | Business description | Weight | Mkt Cap (\$mm) |
|--------------------------------|------------------------------|--------|----------------|
| Qualys (QLYS) | Cyber security | 5.1% | 4,800 |
| Hamilton Lane (HLNE) | Investment banking | 5.0% | 8,500 |
| Sterling Infrastructure (STRL) | Engineering & construction | 4.4% | 10,700 |
| Progress Software (PRGS) | Open source business apps | 4.1% | 1,700 |
| Applied Industrial (AIT) | Motion/fluid/power control | 4.0% | 10,600 |
| Merit Medical (MMSI) | Medical supplies | 4.0% | 4,900 |
| Viper Energy (VNOM) | Oil & natural gas | 3.8% | 3,800 |
| Addus HomeCare (ADUS) | Personal home care & Hospice | 3.7% | 1,900 |
| American States Water (AWR) | Water Utility | 3.5% | 2,900 |
| SPS Commerce (SPSC) | Supply chain software | 3.5% | 3,400 |



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