Investment Commentary: Small Cap Q2 2026

THE GREAT AI BUILD-OUT

Small Cap Edition

Market Paying for the Story, Not Current Fundamentals

Van Hulzen's small cap strategy emphasizes strong ROIs and growth rates, strong balance sheets and low financial risk. The portfolio turned in a +15.8% quarter in Q2 2026. This performance, while impressive, still lagged that of the major small cap indices. The S&P 600 Small Cap index rose 19.7% while the higher beta Russell 2000 rose a staggering 21.5%. The more speculative microcap index did even better, at +25.7%. Because our strategy emphasizes established, higher-quality small-cap businesses with lower betas, we typically lag during periods of market exuberance. But this quarter we decided to dive deeper to understand the current AI trends and sub-sector contributors.

What we found: The small-cap AI infrastructure trade has produced some of the market's largest gains and has made an outsized contribution to index performance. In fact, Goldman Sachs estimated that AI infrastructure stocks accounted for roughly **40% of the Russell 2000's first half return**, despite representing a tiny fraction of the index.

The market is currently rewarding perceived exposure to future AI spending more than demonstrated profitability, balance-sheet strength or current revenue growth.

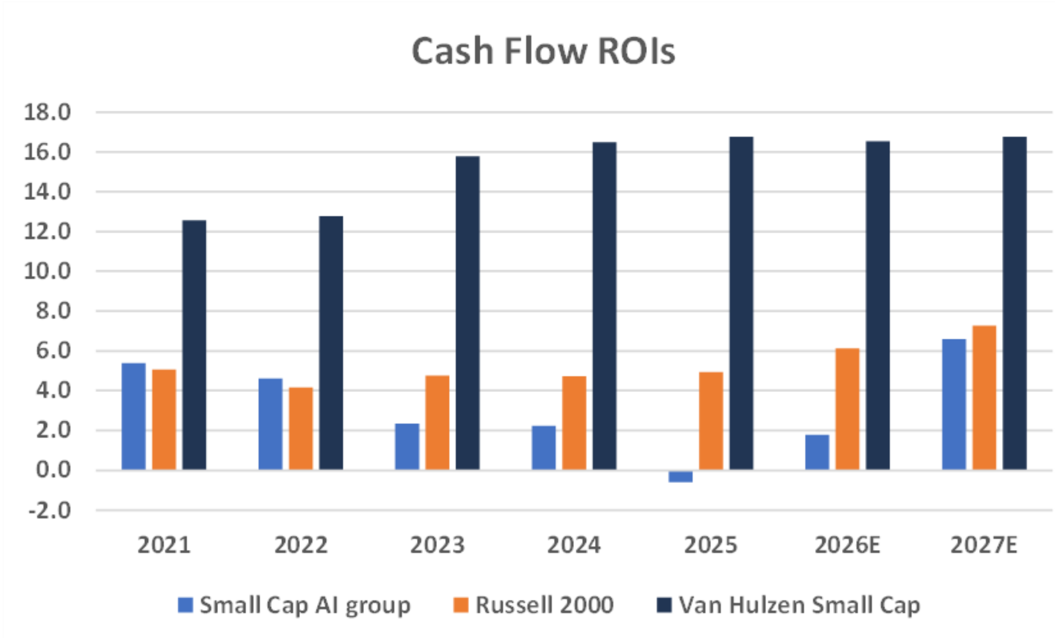
Small Cap AI Infrastructure Ecosystem (H1 2026)

The following "AI infrastructure" companies were among the top performers in the Russell 2000 in Q2.

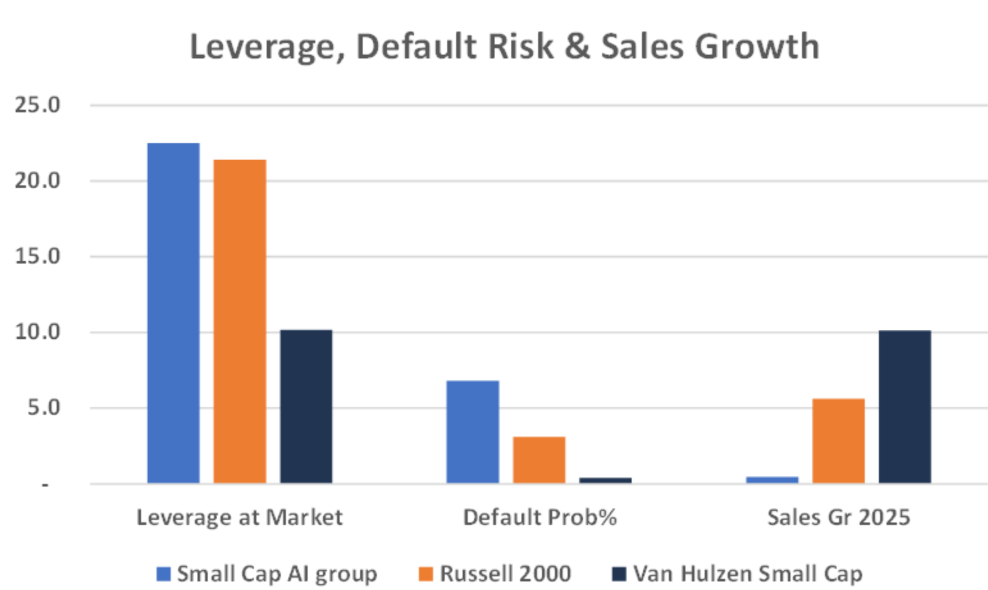
Category	Companies	Why they benefited
Semiconductor Equipment	**UCTT**, **ICHR**	Components and fluid systems used to manufacture AI chips
Semiconductor Test	**AEHR**, **COHU**, **FORM**	Testing increasingly complex AI processors and advanced packaging
Networking / Optical	**AAOI**, **MXL**	High-speed optical interconnects and networking to connect AI clusters
Power Infrastructure	**NVTS**, **VICR**	Power conversion and delivery for AI servers and GPU racks
Cloud / AI Compute Services	**RXT**	Hosting, managed cloud and AI infrastructure services

Quality Disconnect

But a disconnect has emerged. The underlying fundamentals have yet to justify the magnitude of the moves for this group. These top performing AI infrastructure companies have historically generated cash-flow returns on investment of only 2%–5%. Their median ROI actually fell below zero in 2025 and is expected to recover to just 6.6% by 2027. By comparison, our portfolio has consistently generated cash-flow ROIs near 16%, reflecting materially greater profitability and capital efficiency. See below.



The contrast extends to balance-sheet quality. The AI group carries substantially more leverage and a meaningfully higher probability of default than our holdings. Yet despite the enthusiasm surrounding AI capital spending, these companies produced little aggregate sales growth in 2025. Our portfolio grew revenue by approximately 10% while maintaining far stronger returns on capital and lower financial risk.



Despite these weaker fundamentals, the lower-quality AI cohort significantly outperformed both in 2025 and during the first half of 2026. In our view, the market is currently rewarding perceived exposure to future AI spending more than demonstrated profitability, balance-sheet strength or current revenue growth. Whether today's valuations ultimately prove justified will depend on whether future earnings growth matches investors' expectations. But for now their performance appears driven primarily by expanding expectations and valuation multiples rather than realized operating results.

Similar Trends in the Large Cap Space

Artificial intelligence has been the dominant investment theme for nearly four years. But the leadership has not been static.

The market has progressed through distinct phases. Nvidia and a handful of large cap semiconductor companies dominated the early stages. Attention then shifted to the hyperscale technology platforms expected to monetize AI. More recently, investors have rewarded the companies supplying the infrastructure required to support unprecedented AI capital spending. This has included small cap names such as those listed above.

Estimated Average Returns by Market Segment

Group	2024	2025	1H 2026
AI Platforms (MSFT, GOOGL, AMZN, META)	53%	25%	16%
AI Infrastructure (Top 20 2026 performers)	32%	95%	199%
Rest of the S&P 500 *(estimated)*	18%	14%	2%
S&P 500	23%	24%	10%

Stocks representing just 3.3% of the S&P 500 at the beginning of the year generated approximately three-quarters of the index's first-half return.

Our Portfolio

The strongest contributors to performance in Q2 were HNGE (a virtual platform for physical therapy services) and STRL (an engineering & construction company involved in the AI infrastructure space) – each rising more than 100% during the quarter. We believe both have additional long-term upside potential.

The weakest performers in Q2 were in the consumer products and financial services industries. Prestige Consumer Healthcare (PBH) sells a broad collection of over-the-counter personal care brands. The Company has had some temporary supply chain issues and is pursuing a vertical acquisition to resolve the issue. The consumer goods sector has also lagged as investors have chased AI and semiconductor stocks.

Hamilton Lane (HLNE) is a capital allocator in the private equity space. HLNE has sold off in connection with liquidity concerns across the industry, but no company-specific issues have been highlighted. While private equity sentiment has weakened amid industry liquidity concerns, we continue to believe Hamilton Lane possesses a durable competitive position and remains well positioned for the eventual recovery in private capital markets. Also, insiders have purchased approx. $14 million of stock in the last 3 months – clearly a bullish sign.

Also, insiders have purchased approx. $14 million of stock in the last 3 months – clearly a bullish sign.

TOP 5 PERFORMERS

		Return	Description	Actions/Notes
HNGE	Clear Secure Systems	**115.2%**	Virtual platform for PT services	*Added in Q2*
STRL	Sterling Infrastucture	**104.3%**	Engineering & Construction	*Trimmed in Q2*
QLYS	Qualys	**58.1%**	Cybersecurity	*Added in Q2*
DGII	Digi International	**55.9%**	Open source business apps	*Trimmed in Q2*
SXI	Standex International	**40.9%**	Industrial supplies	-

BOTTOM 5 PERFORMERS

		Return	Description	Actions/Notes
PBH	Prestige Consumer Healthcare	-20.3%	Consumer healthcare products	-
HLNE	Hamilton Lane	-20.0%	Investment banking	-
USLM	US Lime & Minerals	-19.4%	Construction materials	-
FSM	Fortuna Mining	-14.9%	Precious metals mining	-
RLI	RLI Corp	-14.8%	Insurance	*Sold in Q2*

Our Research on Market Cycles

This quarter we also completed an in-depth study comparing today's AI infrastructure buildout with the telecom boom of the late 1990s and the mortgage securitization cycle preceding the Global Financial Crisis.

Our research identified several recurring characteristics:

- Genuine innovation attracts extraordinary capital.
- Investment often accelerates faster than economic demand.
- Financial structures evolve to sustain the boom.
- Valuations eventually matter.
- The winning technology does not always produce the winning investment.
- We believe AI has the potential to transform the global economy. The more difficult question is whether today's investment and valuations accurately reflect the pace at which those economic benefits will ultimately be realized.

New Research Report

Three Cycles, One Pattern: *What the History of Complex Financial Structures Tells Us About Today's AI Infrastructure Boom*

Read the full report here.

Key Takeaways & Outlook

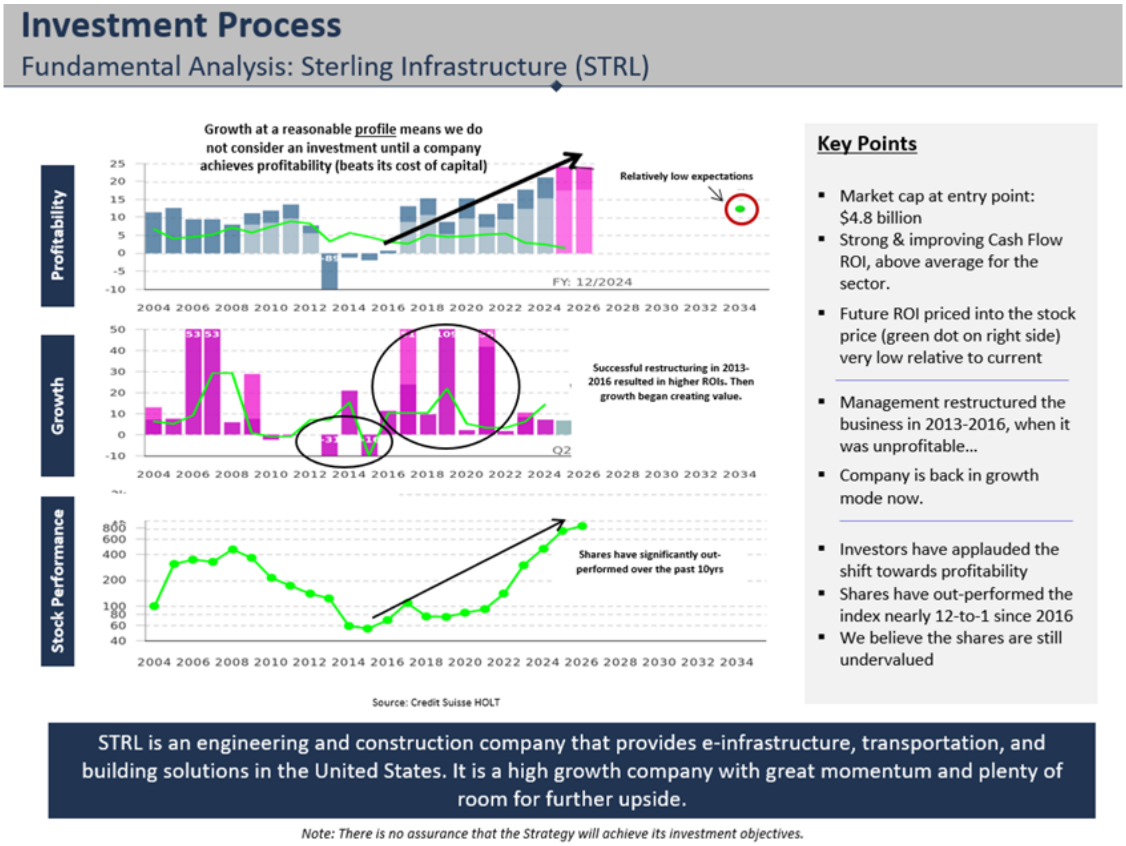
The first half of 2026 demonstrated just how concentrated this bull market has become. Rather than broad participation, returns were driven overwhelmingly by a relatively small group of companies supplying the infrastructure behind artificial intelligence.

The lopsided preference for AI and semiconductor stocks has transformed markets over the past 12-18 months. The beta of the top performers – the Russell 2000 as well as the S&P 500 – has been 1.8-2.0x. High-quality strategies have fallen slightly behind during this period. But we believe this preference for high-beta, speculative names will eventually wane and investors will once again turn to quality in the end.

We believe AI will remain one of the defining investment themes of this decade. At the same time, history reminds us that transformational technologies rarely produce smooth investment cycles. Leadership changes, valuations become stretched, and periods of speculation often give way to consolidation.

We remain comfortable emphasizing businesses that already generate attractive returns on capital, possess sound balance sheets and deliver sustainable growth. That discipline can lag when investors aggressively pursue a narrow theme, but over a full market cycle, we believe actual cash flows and financial strength remain more dependable sources of long-term shareholder value.

Investment Process



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

Qualys.

ADDUS HOMECARE
A Family Of Companies

Progress

Hamilton Lane

STERLING