

Is Now a Turning Point for Small Caps?

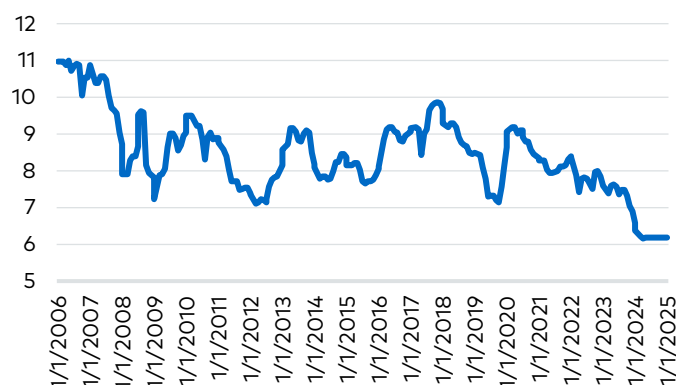
Rate cuts have grabbed investors' attention of late, causing them to wonder if we could finally be on the brink of a cycle of small cap leadership. While declining rates should provide an outsized tailwind to small caps—both in terms of reduced interest costs and a boost in sentiment—it's only one piece of a broader puzzle. Moving past the headlines, the bigger reason to get excited is that earnings growth across small caps appears to be accelerating. We believe this has been the missing link in the "case for small cap" literature in recent years which has largely anchored to the narrative that relative valuations were cheap vs large caps. Now, there's evidence of "green shoots"¹ emerging and that should be a cause for optimism.

"Green Shoots" on the Horizon

As we look ahead to 2026, we expect earnings growth to accelerate on the back of expanding profit margins related to AI-related efficiency gains, slowing wage inflation, and cost-cutting related to de-regulation. Furthermore, small caps tend to derive a greater benefit from fiscal stimulus that incentivizes re-shoring manufacturing and building out domestic infrastructure. In this same vein, small caps tend to be more insulated against tariffs—broadly speaking—given their revenues and costs are often more concentrated in the US. Finally, if we see a pick-up in revenue growth as the economic backdrop improves, that would further magnify the positive impact on earnings growth.

As investors come to appreciate these potential emerging tailwinds—a more favorable rate environment, improving fundamentals, and attractive valuations—it could very well cause a re-think of their underweight to the asset class, which sits at multi-decade lows (Exhibit 1). Moreover, if these allocations get right-sized, it holds the potential to power a more sustainable cycle of small cap leadership in the years ahead.

Exhibit 1: US Small Cap as a % of Domestic Equity ETF AUM



Source: Topdown Charts, LSEG, ICI. As of 8/31/2025.

Dispelling a Widely Held Myth About Small Caps

Approaching small caps with a purely tactical mindset can risk missing the bigger picture:

We think small caps are home to some of the most innovative, dynamic companies in the world.

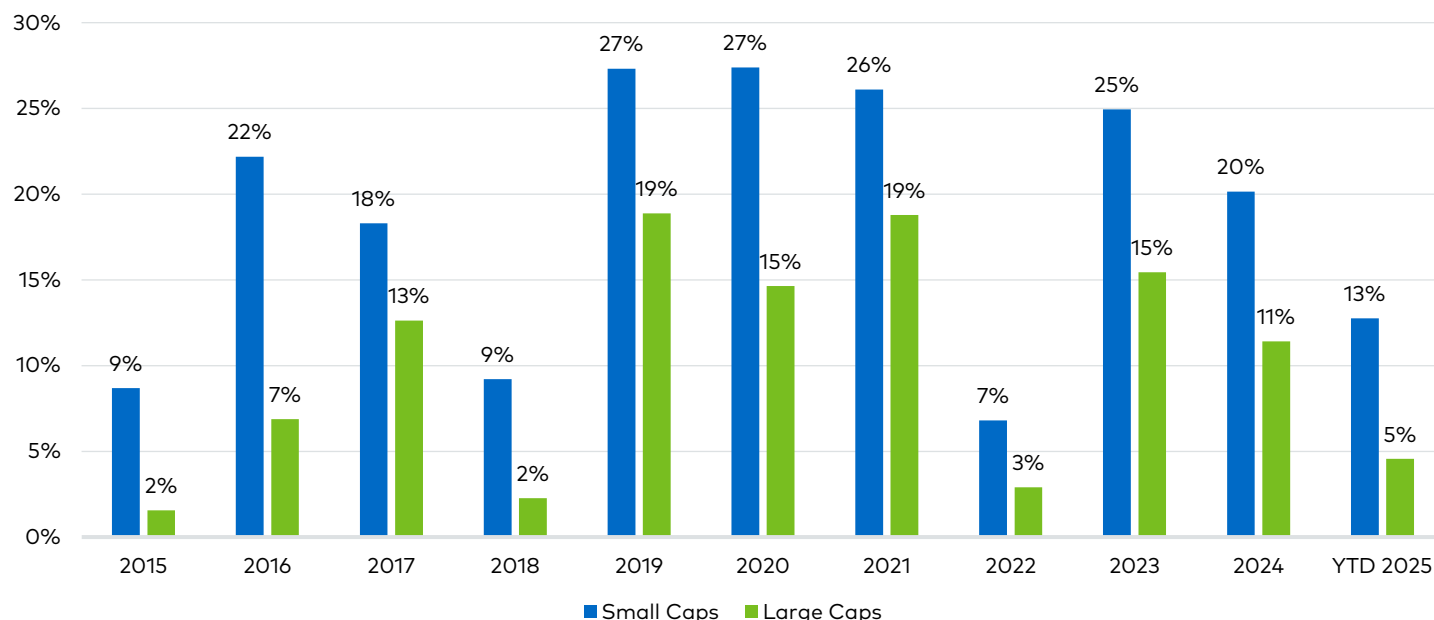
While they don't tend to garner the same headlines as their mega cap counterparts, many small caps play a critical role in solving today's most pressing issues—which in turn provides them with a long runway for growth.

¹ "Green shoots" refers to the first promising signs of recovery and growth following a period of economic weakness. The metaphor compares these early economic improvements to new plants sprouting from the ground after winter, suggesting a new season of prosperity is on its way. The phrase was popularized by former Fed Chairman Ben Bernanke.

Yet, the broad underperformance of small caps versus large caps in recent years has helped to perpetuate the myth that small cap investing suffers from a lack of opportunity as companies stay private longer/go public at a higher market cap. In our view, this line of thinking is misplaced. The problem here is not a lack of opportunity—it's not having a process that can shine a light on the opportunities right in front of you.

Many would be surprised to learn that there's been a higher percentage of stocks in the small cap investable universe that were up more than 50% in a given calendar year, as compared to large cap (Exhibit 2). On average, an investor could find nearly twice as many 50%+ "winners" in small caps than in large caps over this sample period—including in 2025. This effectively shows that extreme concentration in large cap has masked the potential richness of the small cap opportunity set—especially for managers with the process and flexibility to look beyond conventional screens.

Exhibit 2: Percentage of Stocks Up >50% by Calendar Year



Source: Bloomberg, Polen Capital. YTD as of 8/31/2025. "Small Caps" refer to the Russell 2000 Index and "Large Caps" refer to the Russell 1000 Index. To control for liquidity, a minimum market cap threshold of \$1B was imposed at the start of the respective calendar year. Percentages are provided to neutralize the impact of more stocks in the small cap universe.

A Differentiated Approach to Small Cap Investing

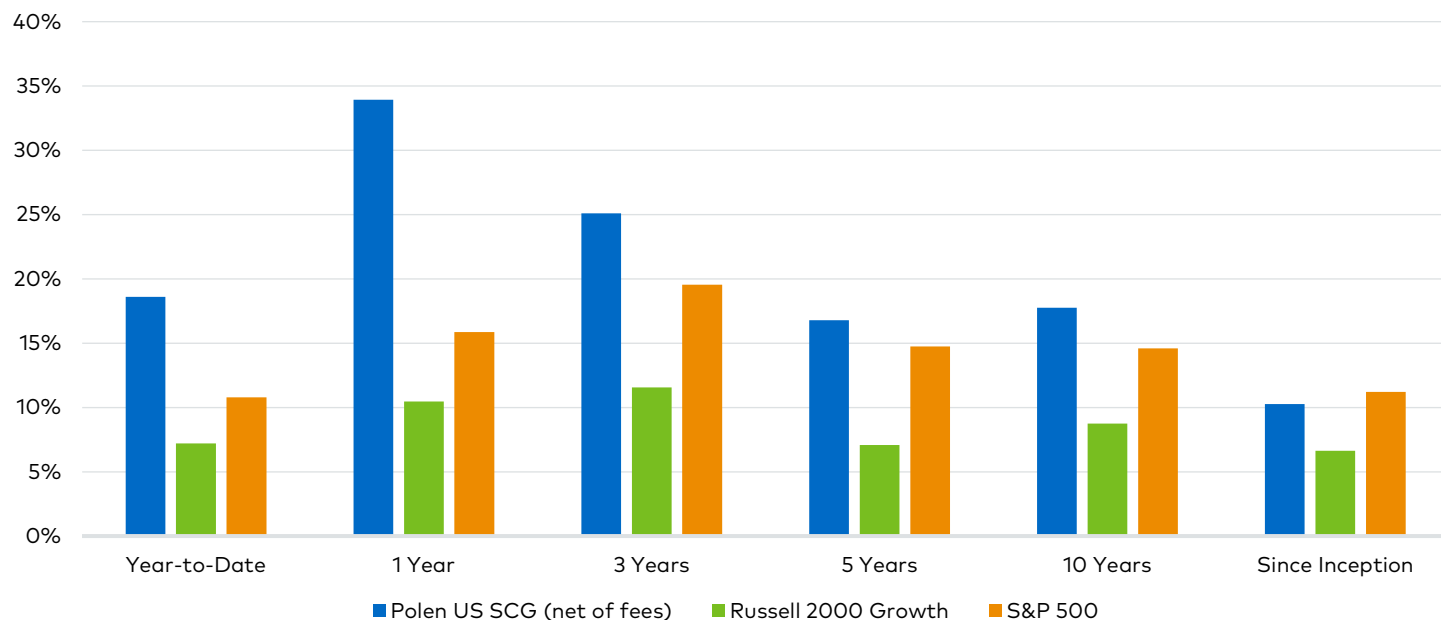
In that spirit, we would like to introduce Polen's U.S. Small Cap Growth ("Polen U.S. SCG") approach. To address the aforementioned issue around "seeing the opportunities right in front of us", we take a more holistic approach, complementing a core fundamental discipline with thematic and technical disciplines. We believe this allows us to see more opportunities at the outset of our process—a stark contrast with the typical exclusionary approach many managers employ to screen a given universe. 2025 provides a great example of this. YTD as of 8/31, nearly half of the

small caps that have delivered a >50% return are unprofitable on a trailing 12-month GAAP EPS basis². If you are a quality manager that categorically screens out unprofitable businesses, that represents a big headwind to overcome. For us, a core tenet of our investing philosophy is that great stocks can come from anywhere, and we've built a disciplined process to accommodate that.

Harnessing an open-minded approach to small cap investing, Polen U.S. SCG has delivered consistent outperformance against both small AND large cap indices, even when small caps have broadly lagged large caps. As one proof point, the approach has outperformed the S&P 500 70% of the time net of fees over rolling

² Russell 2000 Index used as a proxy for small cap universe. We have excluded securities <\$1B market cap for liquidity reasons. >50% total return threshold is meant to illustrate well above average performance. "Trailing 12-Month GAAP EPS" refers to Earnings Per Share ("EPS") calculated over the trailing 12 months as of the latest filing date. "GAAP" specifically refers to "Generally Accepted Accounting Principles", the standard reporting format companies have to abide by in the US.

Exhibit 3: Annualized Trailing Performance



Source: Polen Capital. As of 8/31/2025. Please find all index definitions under "Important Disclosures" at the end of this paper.

5-yr periods since its inception in November-2000³. By contrast, the Russell 2000 Growth index has only outperformed the S&P 500 slightly more than half the time over that same period.

Come for the Rate Cuts, Stay for the Rate of Change

Moments like these, headlined by a rate-cutting cycle, tend to spark a lot of interest in the small cap asset class. Understandably, investors have been slow to embrace small caps given the experience of the past 15 years, and so any evidence that an improving macro backdrop could provide a source of tailwinds to small caps makes for interesting conversation. While we readily acknowledge some of the developments in recent weeks and months have increased the odds of a more sustainable stretch of small cap outperformance, we think it misses the bigger point:

We believe the real catalyst for sustainable small cap leadership is the accelerating pace of innovation. This ever-changing landscape marked by innovation and disruption favors managers with an open-minded process that not only tolerates these dynamics but uses them as a rich source of opportunity.

If you'd like to discuss how Polen's process-driven approach to small cap investing could fit within your allocation, our team would welcome a conversation.

³ Polen U.S. SCG has outperformed the S&P 500 73% of the time gross of fees. The S&P 500 is used here as it is often a broad proxy for a broad US large cap allocation.

Going Beyond with Polen Capital

Polen Capital is a team of experienced investment professionals who share an unwavering commitment to our clients, investors, community, and each other. For more than three decades, we have been dedicated to serving investors by providing thoughtfully managed portfolios shaped by our long-term perspective and investment expertise. At Polen Capital, we have built a culture focused on achieving results, which inspires our belief in going beyond what's expected for the people and communities we serve.

Performance shown represents results achieved at prior firms. The Polen U.S. Small Cap Growth strategy (the "Strategy") began in November 2000 and was managed by Cupps Capital until October 2016 at which time it was transitioned to Advisory Research Investment Management. In March 2024, it transitioned to Bosun Asset Management, and subsequently in June 2025, it transitioned to Polen Capital. Andrew Cupps has served as the portfolio manager of the Strategy since inception. Mr. Cupps has been supported in his role as portfolio manager by various individuals, including Kevin Leitner and Chris Bush. Mr. Leitner has worked on the Strategy since inception. Mr. Bush began working on the Strategy in 2007. At all times during his tenure as portfolio manager, Mr. Cupps has had ultimate decision-making authority with respect to the Strategy. Mr. Cupps, Mr. Leitner and Mr. Bush joined Polen Capital on June 30, 2025. Performance results presented in materials prior to June 30, 2025 reflecting the same name (i.e., the Polen U.S. Small Cap Growth strategy) were achieved by a team that is no longer with Polen Capital. Past performance does not guarantee future results. Returns are presented net of management fees and include the reinvestment of all income. Historical net of fee performance was calculated using either actual management fees or highest fees. During certain periods of the track record, net of fee performance was calculated using actual management fees, while the highest fee was used during others. Beginning, October 31, 2016, net of fee performance is being calculated using highest fee. Prior period net of fee performance was calculated using actual management fees plus fund expenses (where applicable).

Important Disclosures

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The Russell 1000® Index measures the performance of the large-cap segment of the US equity universe and is a subset of the Russell 3000® Index which is designed to represent approximately 98% of the investable US equity market. The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe and is a subset of the Russell 3000® Index. The Russell 2000® Growth Index is a market capitalization weighted index that measures the performance of the small-cap growth segment of the U.S. equity universe. It includes Russell 2000® Index companies with higher price/book ratios and higher forecasted growth values. The index is maintained by the FTSE Russell, a subsidiary of the London Stock Exchange Group. The S&P 500® Index is a market capitalization weighted index that measures 500 common equities that are generally representative of the U.S. stock market. The index is maintained by S&P Dow Jones Indices.

Past performance is not indicative of future results. It is impossible to invest directly in an index. The performance of an index does not reflect any transaction costs, management fees, or taxes.

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