



PCS ADVISORS

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Small Cap Backdrop

2025

An Unusual Year for Small Cap



2025 has been a turbulent year with a new administration, tariff announcements, and a Fed rate cut.



Equities saw a massive rally on the heels of clarity on tariffs, stronger than expected earnings, and the Fed rate cut.



Rallies coming out of a market bottom tend to involve higher speculation.



Unprofitable, highly shorted, high beta companies outperform in this risk-on environment.



These environments tend to be relatively short lived and quality factors come back into favor.



Active managers on average underperform during these times, due to active managers investing in higher quality companies.

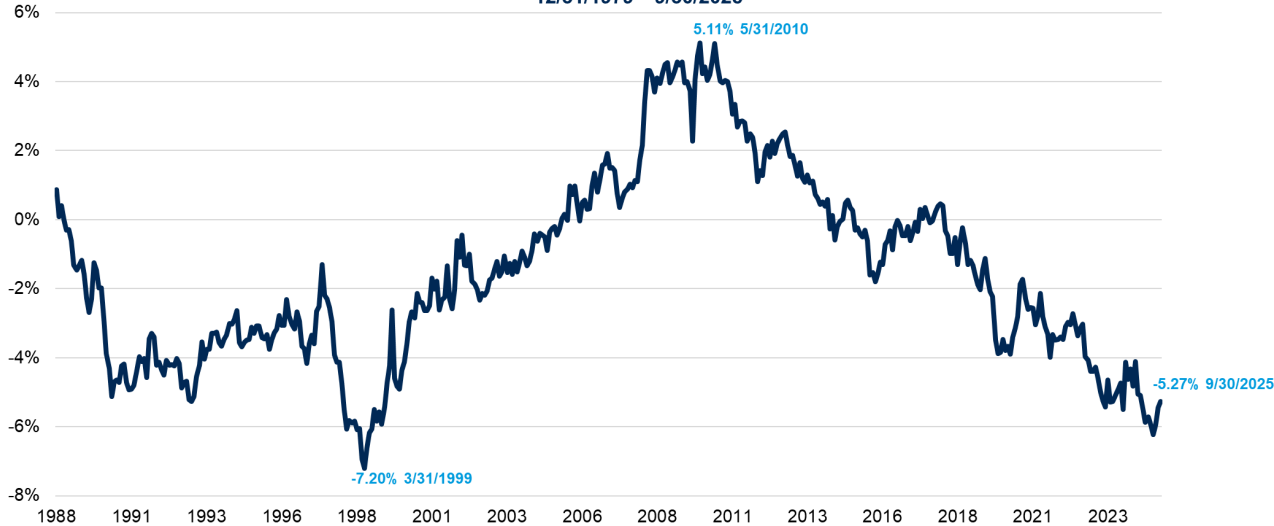


Downside protection tends to be where active managers add their most value.

Current Market Backdrop

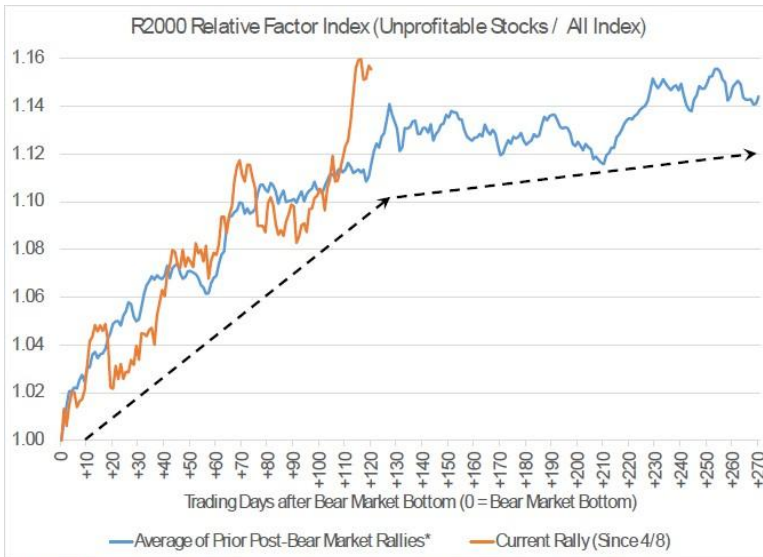
Small Cap Performance

Russell 2000 vs Russell 1000 10-Year Average Annualized Total Return Spread
12/31/1979 - 9/30/2025



Source: Morningstar Direct. As of September 30, 2025. Returns are Total Returns

Going back to 1980, June saw the largest dispersion of the large and small indices since 1999, Q3 saw a reversal in favor of small caps outperforming.



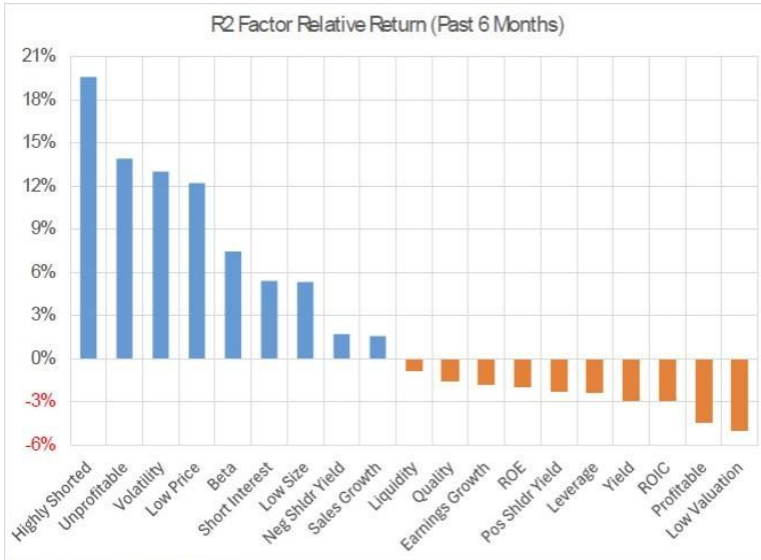
Source: FRP, FactSet; as of 9/30/25; *Rallies include those started in 2002, 2009, 2011, 2016, 2020, 2023

It is not uncommon to see unprofitable stocks outperform coming out of a bear market. However, this current rally has seen outsized relative performance.

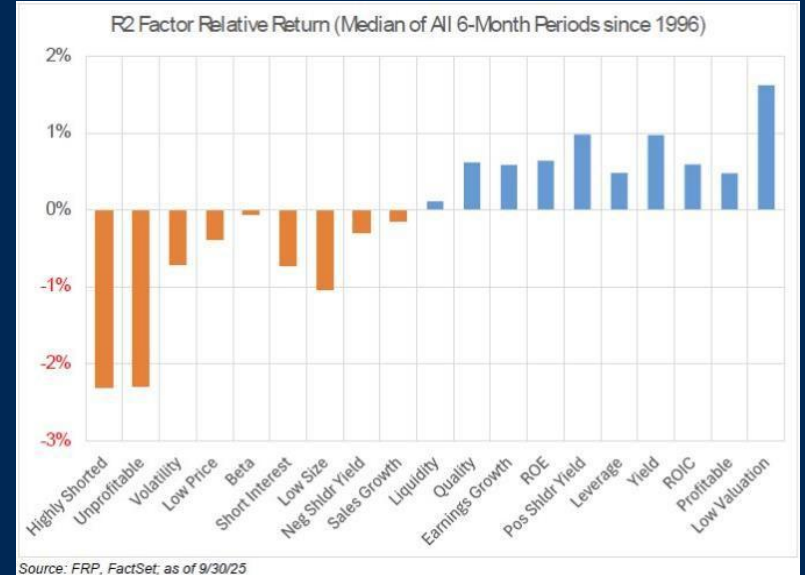
These rallies don't last forever. History shows that this outperformance tends to slow six months after the bottom, and to reverse in the next six months.

In the long-run, unprofitable stocks underperform the broad market index. These rallies tend to be blips in time.

Points In Time vs Over Time



Source: FRP, FactSet, as of 9/30/25



Source: FRP, FactSet, as of 9/30/25

Narrow Windows w/ Unique Results

In any short timeframe returns can defy long-term expectations. However, especially in periods of a large market rally, “catch up” can occur where speculative investors try to make up for lost time by jumping into the hottest stocks making up for lost time. Evidence of this behavior has been seen in 2025.

Quality Often Wins Over Time

Intuition and data show us over time inexpensive, higher quality stocks create more value over longer periods of time than the inverse.

The Spread is Additive

The magnitude of underperformance from the most unloved stocks to those with lower valuation and higher return potential is over 3% annualized potentially adding meaningful return.

Market Themes Are Being Narrowly Expressed

Inflation trade post tariff announcements (Metals & Mining), AI enthusiasm (Semis & Semi Equipment), and the “Catch Up” after April market bottom (Pharma Biotech & Life Science) are having a large impact on outcomes.

	Absolute Return (%)						Relative Return (%)					
	1Q25	2Q25	3Q25	YTD	12/31 to 4/8	4/8 to 9/30	1Q25	2Q25	3Q25	YTD	12/31 to 4/8	4/8 to 9/30
R2000												
Metals & Mining	(1.9)	25.0	55.8	91.0	(16.2)	127.9	7.5	16.5	43.4	80.6	4.6	88.6
Semis & Semi Equip	(28.4)	35.1	39.1	34.5	(42.0)	132.0	(18.9)	26.6	26.7	24.1	(21.2)	92.7
Real Est Mgmt & Dev	(1.1)	(7.3)	27.8	17.2	(13.0)	34.8	8.4	(15.8)	15.4	6.8	7.7	(4.5)
Pharma Biotech & Life Sci	(10.6)	1.2	24.9	13.0	(24.9)	50.5	(1.1)	(7.3)	12.5	2.7	(4.1)	11.2
Capital Goods	(11.8)	20.6	21.4	29.1	(21.2)	63.8	(2.3)	12.1	9.0	18.8	(0.4)	24.5
Automobiles & Components	(15.9)	15.6	20.1	16.8	(26.3)	58.5	(6.4)	7.1	7.8	6.4	(5.5)	19.1
Cons Durables & Apparel	(12.3)	(5.1)	19.1	(0.8)	(24.7)	31.8	(2.8)	(13.6)	6.7	(11.2)	(4.0)	(7.5)
Media & Entertainment	(14.2)	4.9	18.1	6.4	(25.3)	42.4	(4.7)	(3.6)	5.7	(4.0)	(4.5)	3.1
Oil & Gas	(13.2)	5.5	17.8	7.9	(30.6)	55.4	(3.7)	(3.0)	5.4	(2.5)	(9.8)	16.1
Cons Disc Dist & Retail	(25.5)	17.2	15.8	1.0	(34.6)	54.6	(16.0)	8.7	3.4	(9.4)	(13.9)	15.3
Cons Stpls Dist & Retail	13.3	5.2	13.3	35.0	6.0	27.3	22.8	(3.3)	0.9	24.6	26.8	(12.0)
Energy Equip & Svcs	(12.4)	(10.4)	12.9	(11.4)	(35.2)	36.7	(2.9)	(18.9)	0.5	(21.7)	(14.4)	(2.6)
Utilities	5.3	(1.3)	12.8	17.3	(1.0)	18.5	14.8	(9.8)	0.4	6.9	19.8	(20.9)
Index	(9.5)	8.5	12.4	10.4	(20.8)	39.3						
Tech Hardware & Equip	(14.4)	29.6	11.8	24.0	(26.5)	68.6	(4.9)	21.1	(0.6)	13.6	(5.7)	29.3
Telecom Services	(8.8)	19.1	10.5	20.0	(21.4)	52.7	0.7	10.6	(1.9)	9.6	(0.6)	13.3
Software & Services	(17.2)	11.6	10.2	1.8	(26.6)	38.7	(7.7)	3.1	(2.2)	(8.6)	(5.8)	(0.6)
Transportation	(18.9)	7.0	8.1	(6.2)	(32.3)	38.6	(9.4)	(1.5)	(4.3)	(16.6)	(11.6)	(0.7)
Chemicals	(9.8)	4.9	7.4	1.6	(22.4)	31.0	(0.3)	(3.6)	(5.0)	(8.7)	(1.7)	(8.3)
Banks	(5.6)	4.3	6.3	4.6	(16.5)	25.4	3.9	(4.2)	(6.1)	(5.8)	4.2	(13.9)
Hth Care Prov & Svcs	3.3	9.3	6.0	19.7	(3.7)	24.3	12.8	0.8	(6.4)	9.3	17.1	(15.0)
Equity REITs	(3.2)	(1.2)	4.8	0.2	(16.5)	19.9	6.2	(9.7)	(7.6)	(10.2)	4.3	(19.4)
Comm & Prof Svcs	(6.0)	3.4	4.2	1.2	(14.7)	18.6	3.4	(5.1)	(8.2)	(9.2)	6.1	(20.7)
Financial Services	(4.9)	10.7	3.9	9.3	(16.4)	30.8	4.6	2.2	(8.5)	(1.1)	4.3	(8.5)
Food Bev & Tobacco	(6.3)	(3.9)	0.6	(9.5)	(11.6)	2.4	3.2	(12.4)	(11.8)	(19.8)	9.2	(36.9)
Other Materials	(9.2)	2.3	(0.6)	(7.6)	(20.2)	15.7	0.3	(6.2)	(13.0)	(18.0)	0.6	(23.6)
Consumer Services	(8.8)	15.5	(1.2)	4.1	(17.8)	26.6	0.7	7.0	(13.6)	(6.3)	2.9	(12.7)
Insurance	4.5	5.8	(4.0)	6.1	(5.4)	12.2	14.0	(2.7)	(16.4)	(4.3)	15.4	(27.1)
Hhold & Personal Prod	(6.6)	(4.8)	(6.0)	(16.3)	(17.4)	1.3	2.9	(13.3)	(18.4)	(26.7)	3.3	(38.0)
Hth Care Equip & Tech	(10.6)	0.9	(7.6)	(16.7)	(20.4)	4.7	(1.2)	(7.6)	(20.0)	(27.1)	0.4	(34.6)

Source: FRP, FactSet; as of 9/30/25; Sorted by 3Q25 return

Small Cap Opportunity

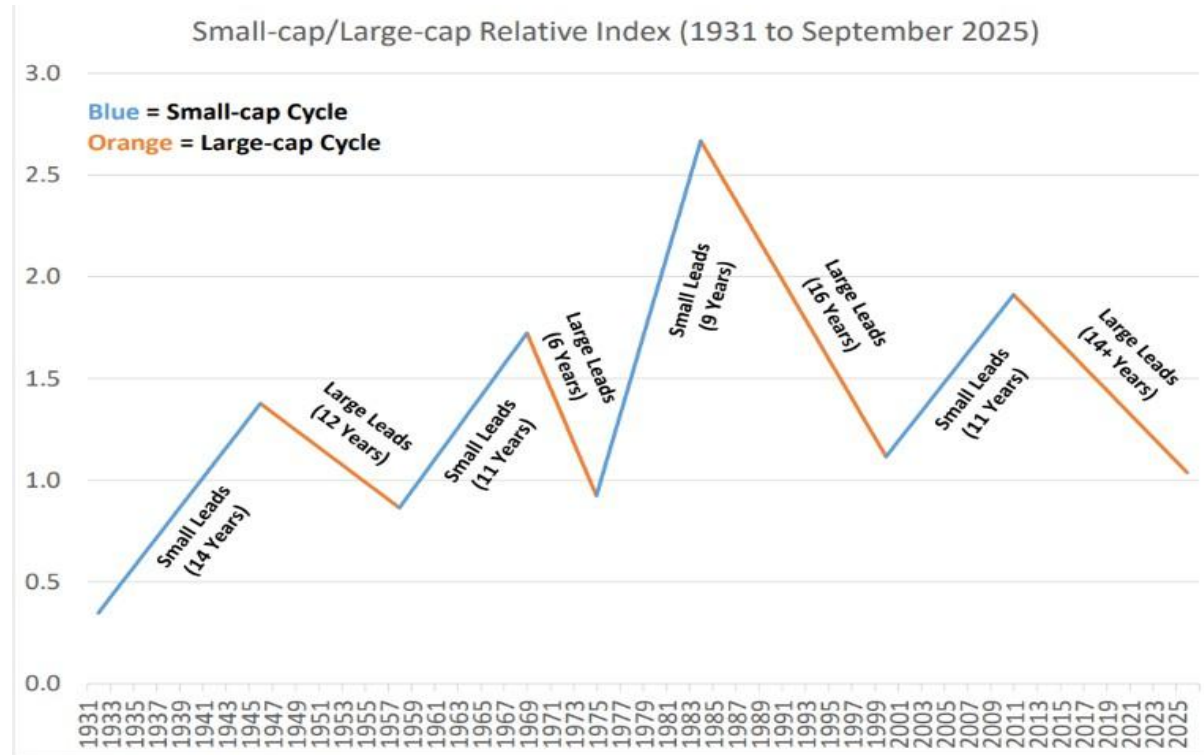
Prospective Active Opportunity

Historically, small cap cycles have averaged more than a decade.

Secular changes in economic trends, interest rates, and monetary and fiscal policies continue to alter the long-term investment landscape.

The winners under the past decade's zero interest rate, low inflation, and low nominal growth regime will no longer lead.

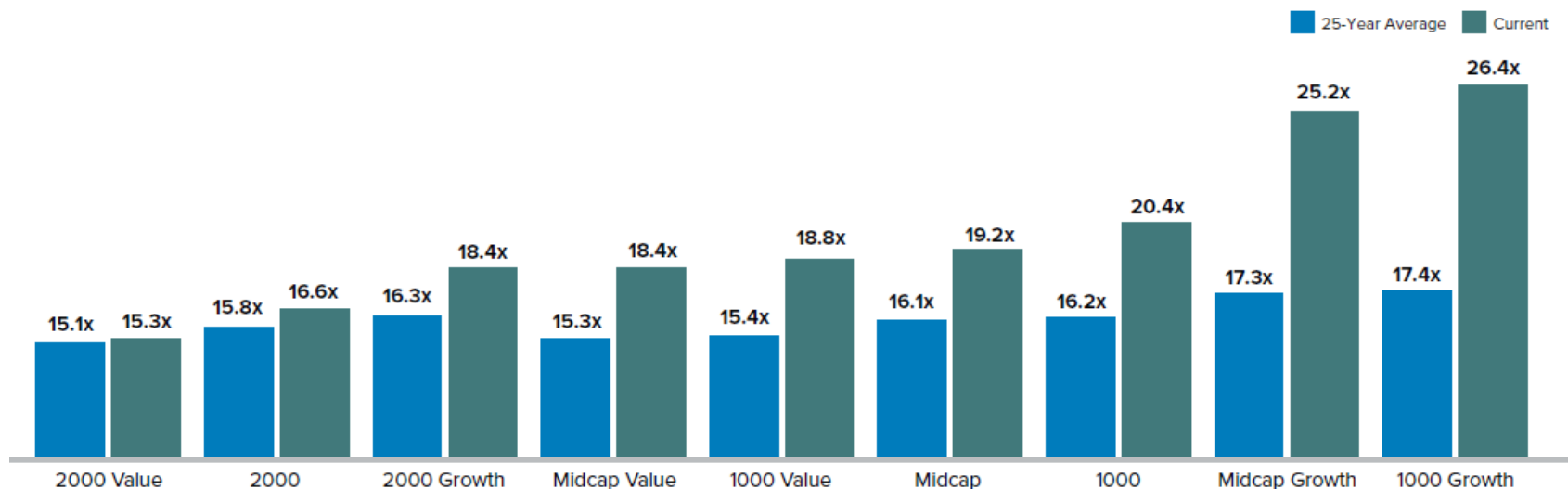
The unfolding macro environment points to the small-cap asset class being able to sustain, not just tactically outperform, large-cap.



Prospective Active Opportunity

Small-Cap Value and Small-Cap are the Only Indexes Near Their Historical Average

Current and 25-Year Average Median EV/EBIT¹ (ex. Negative EBIT) Levels for Russell Indexes as of 6/30/25



¹ Enterprise Value/Earnings Before Interest and Taxes
Source: FactSet.

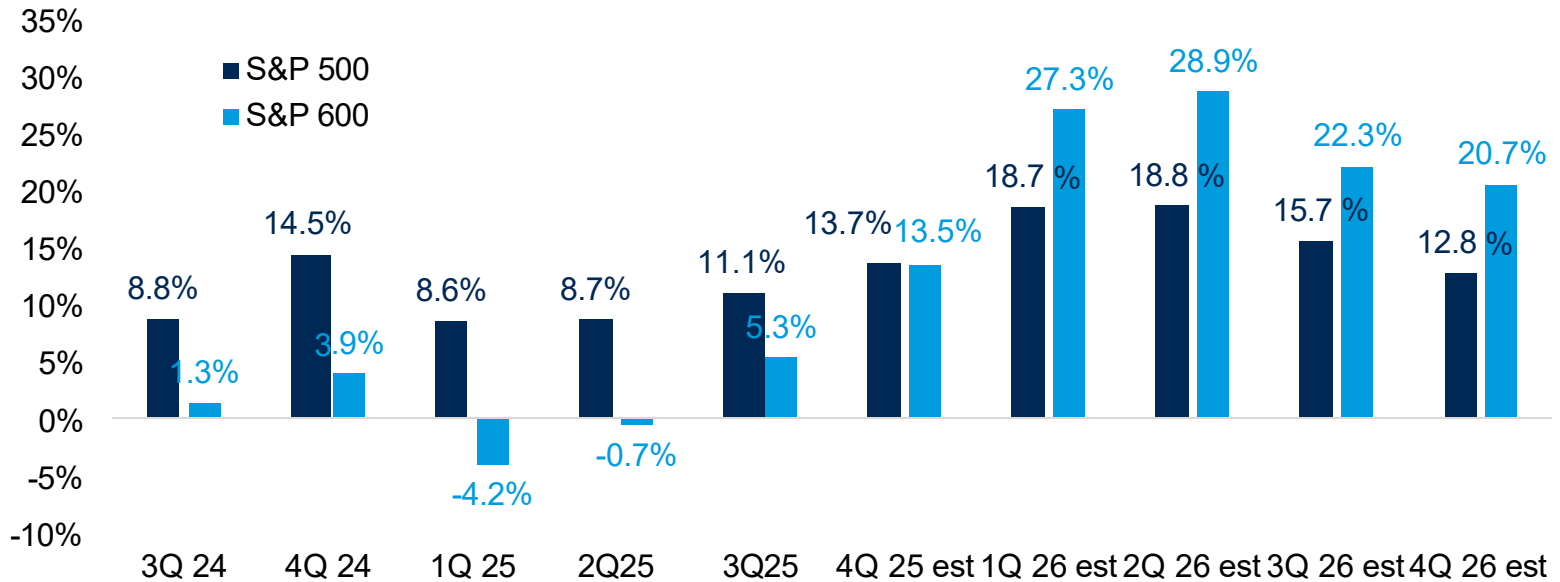
Small cap stocks are significantly cheaper than mid and large cap segment sizes.

While all three value segments (small cap, mid cap, and large cap) have very similar 25-year average valuations, their current valuations are vastly different.

Mid cap growth, large cap growth, and overall large cap valuations still have a long way to fall to reach their 25-year average valuations.

Small Cap: Earnings Expectation Shift

S&P 500 vs. S&P 600 Quarterly Y/Y EPS Growth



Source: Strategas, Bloomberg. As of September 19, 2025.

Small cap Earnings expected to be stronger than large caps.

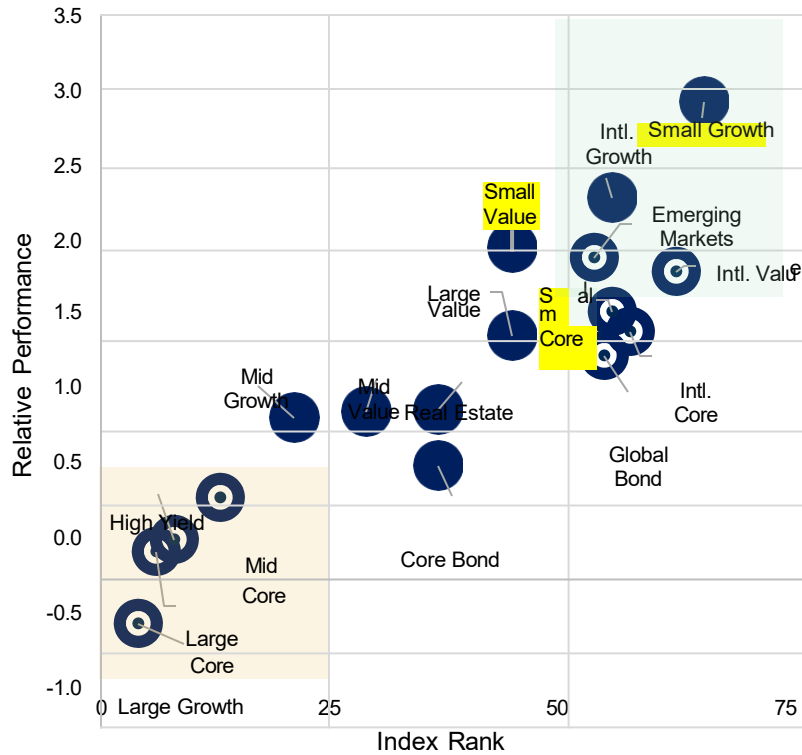
Many small cap companies are emerging from a two-year earnings recession.

Better earnings growth can boost performance for the asset class that has lagged large cap for several years now.

Opportunity in Active Small Cap

Reward is Not Without Risk

Average Top Quartile Manager
Trailing 10-Years as of December 31, 2023

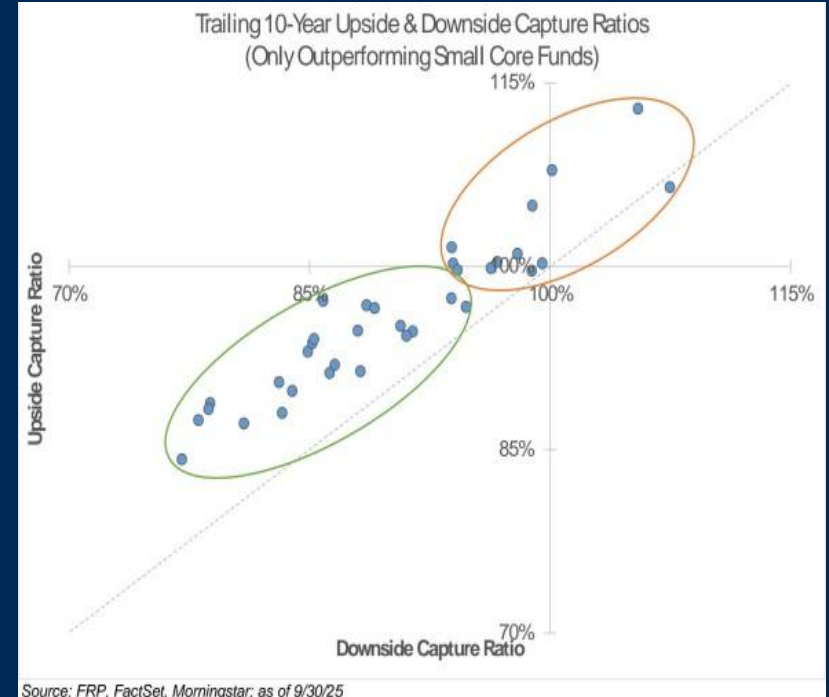


Source: Morningstar, Fiducient Advisors' analysis; as of December 31, 2023.

Historically Opportunity for Active

Historically, active small cap allocations have been a fruitful place for active management.

Most managers are willing to forego gains
On the upside to protect on the downside



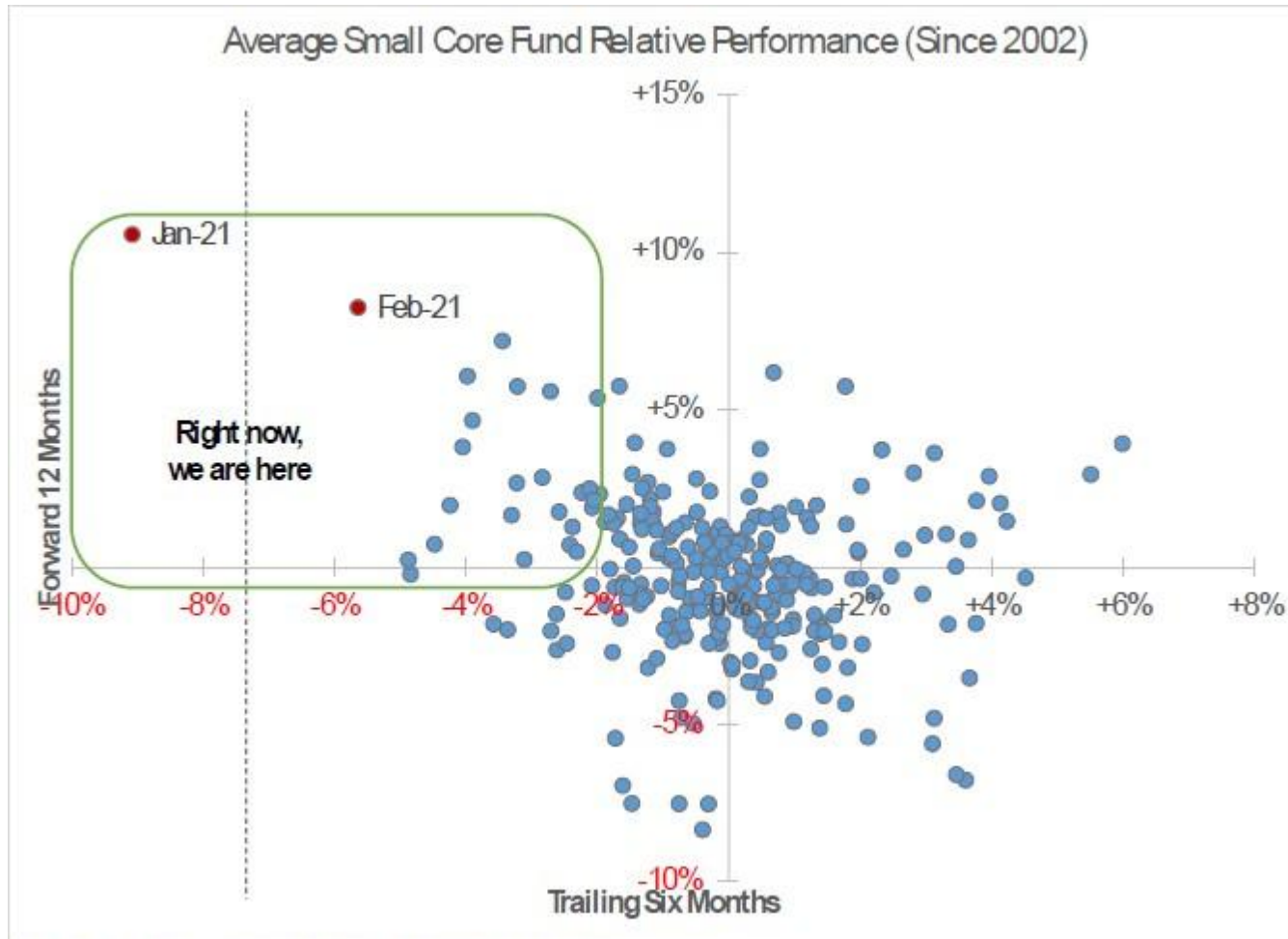
Source: FRP, FactSet, Morningstar; as of 9/30/25

Active Is Naturally Defensive

Businesses most often sought after by active management have defensive characteristics. In period of rapid rising markets, they tend to underperform.

Prospective Active Opportunity

When the average manager lags by this much, things usually reverse meaningfully.



Source: FRP, FactSet; as of 9/30/25; All periods employ log returns

Fiducient Recommended Mangers

Hotchkis & Wiley Diversified Small Cap Value Performance

- Hotchkis & Wiley has returned +1.22% YTD through 9/30/2025, compared to the Russell 2000 Value returning +9.04%
- A significant portion of YTD underperformance relates to factors that typically challenge Hotchkis' higher-quality portfolio. As is characteristic of recoveries following market bottoms, lower-quality factors tend to drive returns in the early stages. This was the case as investors began rotating into riskier assets on April 9th and these assets drove returns through quarter end.
- R2 factor performance since 4/8 has been led by low quality factors. These include but are not limited to stocks with large short interest, low price stocks or penny stocks, high volatility stocks and unprofitable stocks.
- YTD, stock selection in the materials, technology and financials sectors has weighed on performance.
 - Within technology, there were several stocks that Hotchkis does not own that have returned over 100% YTD (ASGN, Photronics, Vishay Technology). Hotchkis also had exposure to several tech stocks that underperformed due to modest earnings misses or disappointing guidance.
 - Within financials, payment processors were notable detractors as shares of these companies declined due to the uncertainty surrounding tariff effect.
 - Within materials, it was lack of exposure to the more speculative metals and mining companies that weighed on performance.

Hotchkis & Wiley Small Cap Diversified Value

Firm & Team

- Hotchkis & Wiley, founded in 1980, is independent and majority owned by employees. With over \$30 billion in firm assets, Hotchkis & Wiley offers value equity strategies across the capitalization spectrum as well as expertise in high yield credit.
- Judd Peters has been a portfolio manager on the Hotchkis & Wiley Small Cap Diversified Value strategy since inception while Ryan Thomas joined him as co-portfolio manager in 2014. The two are supported by Hotchkis & Wiley's 26-person research team.
- The investment team averages 24 years in the industry and 17 with the firm.

Strategy Overview

- The strategy identifies companies that are trading at a discount to normalized earnings and returns on equity and benefit when fundamentals begin to return to normal.
- Quantitative valuation models are used to replicate fundamental work performed by the analyst to narrow the universe and the analysts' expert knowledge to determine the final candidates for the portfolio.
- The portfolio will hold a large number of securities – typically 350 – 400. The large number of securities held and small position sizes allow the investment team to allocate effectively to micro-cap companies or companies with market capitalizations under \$1 billion..
- With the high number of securities in the portfolio, individual position sizes are typically less than 50 bps while sector allocations will be kept relatively close to benchmark.
- Turnover in the portfolio averages 50% annually.

Competitive Advantages

- **Depth, tenure and stability of the analyst team.** – The analyst team in this strategy is arguably more important than the portfolio managers given the heavy reliance on their industry knowledge. The 26-person analyst team has, on average, 24 years of experience in the industry and 17 years of experience at the firm. The tenure of the team allows for an accumulation of knowledge over time. Given the number of securities in this portfolio a less experienced analyst team would be spread too thin to effectively cover the space.
- **Screening capabilities built to mimic analyst work** – The quantitative work at Hotchkis & Wiley is differentiated and intentional. Almost all companies have some version of a screen to narrow the universe for a more manageable workload before fundamental due diligence begins. Traditionally, these screens are built in order to derive certain characteristics that the portfolio managers want their portfolio to take. The valuation model implemented by the portfolio managers at Hotchkis & Wiley was built to mimic what the analysts do from a fundamental perspective as opposed to select names that contain a certain characteristic of factor. This results in an output which is a) differentiated from peers and b) will be much more useful to the analysts when they pick up the fundamental work. A better “mouse trap” up front logically leads to better outcomes
- **Dedication to maintaining style consistency** – The portfolio managers recognized (at inception) that exposure to micro-cap names is a large component of why this strategy has outperformed historically. In order to maintain exposure, they fully understand the limitations from an AUM standpoint and have established a capacity of \$4 billion

Key Risks

- **Turnover among the analyst team** - The group of analysts, their depth, and experience are no doubt important to this strategy. Members of this team leaving and being replaced would be cause for concern as new analysts would be required to get up to speed on a large number of names compared with the current team that has had the benefit of time to learn the names in the portfolio and universe.

Conestoga Small Cap Performance

- Conestoga has returned -9.0% YTD through 9/30/2025, compared to the Russell 2000 Growth returning $+11.7\%$.
- In Q3, Conestoga returned -1.47% versus the index 12.19% , lagging the index by -13.67% and falling into the 93rd percentile of the Morningstar Small Growth peer group.
 - Technology continues to be a significant detractor for the strategy YTD and in Q3
 - The strategy is heavily weighted in Software (Q3 weight 21.7% versus Russell 2000 Growth weight 6.82%), where many of their names have rerated and undergone stock specific headwinds throughout the year.
 - Semis saw a significant rally in the year, fueled by the AI theme, this is an industry that Conestoga does not tend to find ideas that fit their high-quality criteria. The strategy currently has no exposure and this lack of exposure detracted -131 bps in Q3 alone.
 - Healthcare
 - Healthcare up and down the market cap spectrum has faced headwinds this year due to NIH funding and budget cuts.
 - Biotech is an area the strategy has very little exposure to, tending to avoid names with binary outcomes. Biotech rallied in the quarter, and the 1 biotech holding, Vericel, struggled in the quarter. The strategy is underweight healthcare driven by the minimal exposure to biotech. The lack of exposure to biotech weighed on performance in Q3 while biotech ran, detracted -303 bps of relative performance.
- Lower-quality names at high valuations continued to rally in the third quarter. Unprofitable names in Q3 returned $+27.10\%$ where as profitable companies in the Russell 2000 Growth returned only $+10.1\%$. The top 10 names in the Russell 2000 Growth in the 3rd quarter alone, contributed to nearly 50% of the indexes return.
- Conestoga looks for high-quality, profitable businesses with long-term growth opportunities. Their style and companies have faced both style headwinds and individual company challenges this year, but the team remains convicted in the fundamental growth stories of the businesses they own.

Conestoga Small Cap

Firm & Team

- Conestoga Capital Advisors is a 100% employee-owned firm, founded in 2001. The firm manages roughly \$7.5 billion across micro, small and mid-cap equities as of 9/30/2025. The Small Cap strategy has approximately \$5.5 billion in total assets.
- Bob Mitchell (Co-Founder, PM since inception) and Joseph Monahan (PM since 2008) serve as Portfolio Managers of the small-cap equity strategy, along with the assistance of five analysts.

Strategy Overview

- The team's approach can be described as high quality, conservative growth as the team targets companies with sustainable and stable earnings growth over 15%, strong balance sheets, significant management ownership, and a preference for recurring revenues.
- Businesses held in the portfolio are typically one of the top two players in their market with defensible competitive positions that can double in the coming years through earnings power alone. The investment process is long-term oriented and collaborative with each team member helping the lead analyst vet businesses throughout the investment process.
- The strategy historically trades with lower volatility than its peers and has historically produced alpha through attractive downside capture (77%).
- The resulting portfolio is low turnover (10-30%), 45-50 holdings, and has a concentration in industrials and technology and a limited health care allocation relative to peers.

Competitive Advantages

- **Stringent Discipline in Identifying High-Quality Market Leaders Compounds Returns** – Conestoga's investment approach focuses on identifying highly profitable businesses with low leverage and long runways of growth. The team is stringent in its discipline of only investing in 50 businesses that are one of the top two players in a market and hold defensible and competitively advantaged positions. This conservative approach to growth investing has resulted in the strategy capturing only 77% of down-market returns and 90% of up-market returns. This positive asymmetry has allowed the strategy to compound returns over-time, driving the strategy's outperformance.
- **Collaborative Team of Experienced Generalist Investors Enhances Assessment of Relative Value** – Each of the eight investment team members acts as a generalist covering small- and mid-cap equity. The team has developed a culture of challenge and collaboration, two to three team members will work together during the due diligence process with the vetting of the broader team as well. This multiple eyes approach has helped uncover risks in holdings contributing to the strategy's strong downside capture, streamlines the decision-making process, and helps mitigate behavioral biases and blind spots.

Key Risks

- **Impediments to Long-Term Mindset** – Conestoga's ownership structure and institutional client base support the firm's long-term investment approach. To this end, the introduction of a poorly aligned outside investor or move towards a more retail-oriented client base could mitigate this advantage.
- **Decline in the Quantity of Quality Small Cap Growth Businesses** – Conestoga predominantly focuses its efforts on those small-cap companies with profitable growth. In recent years, the index has become increasingly composed of pre-profit businesses. If this trend continues, it may narrow the team's investment universe to a point that constrains alpha potential.

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