

# SMALL CAP VALUE

## MARKET COMMENTARY

The Russell 2000 Index returned +8.5% in the second quarter of 2025 in one of the more volatile quarters in recent memory. Following the so-called “liberation day” tariff announcement on April 2<sup>nd</sup>, the index cratered -14% over four trading days. The market bottomed on April 8<sup>th</sup>. The Russell 2000 was down more than -20% for the year at that point, before returning +24% over the next ~11 weeks. It ended the quarter down -1.8% since the beginning of the year.

The primary reason for the recovery seems to be that the market believes tariffs will be less draconian than they appeared originally. Equities rallied when the Administration showed an openness to negotiate down and/or delay the implementation of tariffs. Corporate earnings also helped boost the recovery, with nearly two-thirds of Russell 2000 companies beating consensus expectations. Despite the portfolio’s underperformance in the quarter, 70% of its holdings exceeded consensus earnings expectations. Interestingly, small companies without earnings meaningfully outperformed those companies with earnings. This phenomenon was a significant performance headwind for us in the second quarter.

The Russell 2000 Growth Index outperformed the Russell 2000 Value Index in the quarter by a wide margin (+12% vs. +5%) and is now ahead since the beginning of the year. Small caps’ best performing sectors were technology and industrials, both of which comprise larger portions of the growth index than the value index. The real estate, utilities, consumer staples, and energy sectors declined; three of the four comprise larger portions of the value index than the growth index (consumer staples is slightly larger in growth). Momentum strategies/factors performed well in the quarter.

Inflation continued to show signs of moderation, though the latest Core PCE (Personal Consumption Expenditures) reading—the Fed’s preferred inflation gauge—was 2.7%. This is above its 2% long-term target. Accordingly, the FOMC (Federal Open Market Committee) left the Fed Funds

rate unchanged, at 4.25-4.50%, citing its objective of containing inflation while supporting economic growth. The futures market is still pricing in two 25-basis point rate cuts by year-end, though these are now expected to occur later in the year with a less than 10% chance of a rate cut at the upcoming July meeting.

Small cap equities continue to exhibit valuations that are more attractive than long-term averages, particularly small value stocks. Large cap equities continue to exhibit valuations that are well above long-term averages, particularly large growth stocks. The valuation gap between large and small is among the widest on record, only rivaled by the dot.com era, after which small caps outperformed handsomely. The portfolio’s price-to-earnings ratio is well below its long-term average, using either consensus earnings or our own estimate of normal earnings. We are not, however, “reaching” for value. We adhere to our Fundamental Risk Rating framework and are willing to pay higher multiples for quality businesses that are well capitalized and well managed.

## ATTRIBUTION ANALYSIS – 2Q25

The Small Cap Value portfolio underperformed the Russell 2000 Value Index in the second quarter of 2025 (gross and net of management fees). Stock selection in technology, communication services, and energy detracted the most in the quarter. The overweight in energy also detracted modestly. Conversely, the overweight in technology helped to offset some of the negative selection effect. Stock selection in consumer discretionary and financials also worked well, as did the underweight and stock selection in real estate.

As of 6/30/25, net of fee composite and Russell 2000 Value performance for 1-, 5-, and 10-year periods: 1.54%, 18.73%, 7.31% and 5.54%, 12.47%, 6.72%, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees; the composite includes all Small Cap Value discretionary accounts. Additional disclosures provided in Endnotes.

Past performance is no guarantee of future results.



# SMALL CAP VALUE

**Endnotes:**

All investments contain risk and may lose value. This commentary is for general information only and should not be relied on for investment advice or recommendation of any particular security, strategy, or investment product.

Portfolio characteristics and attribution are based on a representative Small Cap Value portfolio. Attribution is an analysis of the portfolio's return relative to the index, is calculated using daily holdings information and does not reflect management fees and other transaction costs and expenses; interaction effect is combined with stock selection. Returns can differ from certain client portfolio(s) due to data differences, cash flows, trading, and other activity (data source: Bloomberg, Russell).

The value discipline used in managing accounts in the Small Cap Value strategy may prevent or limit investment in major stocks in the Russell 2000 Value and returns may not be correlated to the index. Composite performance is available at [www.hwcm.com](http://www.hwcm.com), located on the strategy's Performance tab along with important disclosures included in the strategy's [GIPS Report](#); quarterly characteristics and portfolio holdings are located on the Portfolio and Literature tabs. For a list showing every holding's contribution to the overall account's performance and portfolio activity for a given time period, contact H&W at [hotchkisandwiley@hwcm.com](mailto:hotchkisandwiley@hwcm.com). Portfolio information is subject to the firm's portfolio holdings disclosure policy.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000® Growth Index measures the performance of those Russell 2000® Index companies with higher price-to-book ratios and higher forecasted growth values. Any indices and other financial benchmarks shown are provided for illustrative purposes only, are unmanaged, reflect reinvestment of income and dividends and do not reflect the impact of advisory fees. It is not possible to invest directly in an index.

Russell Investment Group is the source and owner of the Russell Index data contained herein (and all trademarks related thereto), which may not be redistributed. The information herein is not approved by Russell. H&W and Russell sectors are based on the Global Industry Classification Standard (GICS) by MSCI and S&P.

Equity securities may have greater risks and price volatility than U.S. Treasuries and bonds, where the price of these securities may decline due to various company, industry and market factors. Investing in smaller and/or newer companies involves greater risks than those associated with investing in larger companies, such as business risk, significant stock price fluctuations and illiquidity. Investment risk disclosures for the firm's strategies are described in Part 2A of Form ADV of H&W.

A value-oriented investment approach involves the risk that value stocks may remain undervalued or may not appreciate in value as anticipated. Value stocks can perform differently from the market as a whole or from other types of stocks and may be out of favor with investors and underperform growth stocks for varying periods of time.

Information contained in this material may represent or be based on forward-looking statements. Due to various risks and uncertainties, actual events/results or performance of the strategy may differ materially from those reflected or contemplated in such forward-looking statements. Information based on forecasts, proprietary or third-party estimates cannot be guaranteed and are subject to change. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness.

Portfolio managers' opinions and data included in this commentary are as of June 30, 2025. Any discussion or view of a security, an asset class/segment, industry/sector and/or investment type are not investment recommendations, should not be assumed to be profitable, and are subject to change without notice. **Past performance is no guarantee of future results.**