Title: Small Cap Update 2Q2025

Description: Portfolio Manager Evan Fox, CFA provides an update on the second quarter for our Small Cap Value strategies.

Transcript: I'm Evan Fox, one of Pzena Investment Management's small cap portfolio managers, and we just finished the second quarter of 2025.

This was quite a volatile period that we came through because it starts in April with Liberation Day and the tariffs that were put into place, which really drove down markets and especially small cap stocks before markets really recovered throughout the course of May and June. Although throughout that whole period, small caps really underperformed their large cap peers. It's really just been in this long period we've been in of small caps underperforming large caps. And one of the incredible statistics is that right now Nvidia by itself is 126% of the market cap of the entire Russell 2000 stocks. That's the highest percentage we've ever seen for an individual name. It's just an extreme gap we're at today.

Throughout the course of the quarter, value underperformed growth across a range of market caps as markets did go up, but really they benefited the more expensive stocks and less undervalued stocks. We underperformed slightly during this period with the biggest movers in both directions really being driven by tariffs.

When you look at the sectors that detracted the most, it was basic materials and consumer staples. And the biggest detractors were all tied to tariffs in different ways. Two of them were Helen of Troy and Spectrum Brands, both of which make consumer products, both of which source a lot of their products from Asia and are subject to those tariff issues. What's interesting is that both have footprints that are very similar to their peers. So from a competitive cost position, it's not a major issue, but the bigger issue is actually that if they do put through pricing, it could negatively impact demand going forward, and that is a concern that drove the stocks down.

Another one is Varex Imaging, which is an X-ray tube manufacturer based in Salt Lake City. They are very well positioned globally, but they actually sell heavily into China. And so the reciprocal tariffs of China putting tariffs on products coming from the US put them at a disadvantage versus Philips and Siemens and some of their European competitors that they face. So this is really one of these ones that's been negatively impacted from other countries reacting to what we've done here in the US.

When you look at what the contributors have been, the biggest sectors that contributed were industrials and financials. And just as I said earlier, the tariffs impacted the positive and the negative. A couple of the biggest names were ones that had been driven down in March by tariffs when they were discussed on the automotive side before Liberation Day, and how some of that has unwound a bit.

So for example, our biggest contributor was Adient, which is a seat manufacturer for cars. They rebounded from being a top detractor last quarter as the auto tariff impacts became less than originally feared and as suppliers have worked to put through pricing.

Another one is Shyft Group, which makes a range of step-in vehicles — this is UPS and FedEx trucks and other specialty vehicles — that rebounded from tariff concerns and also approved a merger with AB Schmidt, a German competitor.

When you look at activity that we were doing during the quarter, we did add a new name, Teleflex, which is a medical device company really focused on single-use products, especially in the hospital setting. When we looked at this, the stock had been quite weak, driven by two main things. One was they had a urology product that was particularly disappointing in how it had been growing. And then also they announced a plan to spin off or divest some of their underperforming businesses, which led to a lack of faith in the management's direction. We had this opportunity to invest in it because some of these concerns really mask a strong core business that's well positioned in defensible high-margin niches, and so that was one we added.

We also did take advantage of weakness in some of the other names in the portfolio to buy more — such as Robert Half, the staffing company, and HNI Furniture — and we funded these by exiting Phibro Animal Health, Dana, and Jeld-Wen.

We continue to face a challenging market for small caps generally. The valuation gaps are about as extreme as we've ever seen, which makes this a really, really exciting time to be investing — even as we look at this saying it's been painful getting to this point. We're very excited for the opportunities in small cap and in value small cap specifically.