CORNERSTONE
INVESTMENT PARTNERS, LLC

Small Cap Market Review

Q2 2026

A Quarter of Strong Performance—and a Meaningfully Different Benchmark

The second quarter was exceptionally strong for equity markets. Following the uncertainty that characterized much of the first quarter, geopolitical tensions in the Middle East eased considerably as a ceasefire framework emerged between Israel and Iran. Oil prices retraced sharply from their wartime highs, reducing one of the market's inflation concerns, and helping restore investor confidence. At the same time, continued enthusiasm surrounding artificial intelligence infrastructure spending, resilient corporate earnings, and expectations that monetary policy would remain supportive drove equities meaningfully higher. Small-cap stocks were among the quarter's biggest beneficiaries, with the Russell 2000 Index outperforming the S&P 500 by over 600 basis points, its 4th best relative quarter in 20 years. The Russell 2000 Value Index generated strong returns, up ~17.2%, still outpacing Russell 1000 Value Index, as investors continued rotating into smaller companies following their first-quarter resurgence.

The Benchmark Changed More Than the Market

While market performance was encouraging, perhaps the most significant event affecting our strategy occurred near quarter-end with Russell's annual index reconstitution. Every June, Russell updates its indices to reflect changes in company size, style characteristics, and market capitalization. This year's reconstitution was particularly meaningful for the Russell 2000 Value Index. Many of the market's strongest AI-related performers appreciated enough over the past year to migrate out of the Value index, while the upper end of the benchmark's market capitalization range declined meaningfully. As a result, the Russell small cap and style Indices today look different than they did just a quarter ago. They have become smaller in average market capitalization and less exposed to many of the technology and AI beneficiaries that have meaningfully influenced performance over the past year. We should note that the benchmark is now going to reconstitute semiannually, in June and December, going forward.

AI Leadership Continues to Evolve

Artificial Intelligence remained one of the defining investment themes during the quarter, although leadership within the AI ecosystem continued to broaden. Rather than being driven solely by semiconductor manufacturers, investor interest expanded to companies providing the infrastructure required to move, connect, and manage the enormous amounts of data required by AI workloads. Optical networking, high-speed connectivity, and other enabling technologies remain attractive areas where we continue to see compelling long-term opportunities. At the same time, parts of the software industry faced increasing pressure as investors evaluated whether AI could compress pricing power, shorten product cycles, or reduce barriers to entry. We believe these concerns create both risks and opportunities, reinforcing the importance of fundamental research in distinguishing durable competitive advantages from businesses whose economics may be more susceptible to disruption.

Our Process Remains Unchanged

While the benchmark evolved considerably this quarter, our investment philosophy did not. We continue to focus on identifying high-quality businesses trading below our estimate of intrinsic value while maintaining a portfolio that appropriately reflects our opportunity set. Although individual holdings will inevitably change over time, our discipline does not. We remain committed to the same research process, valuation framework, and long-term perspective that have guided the strategy since inception.

Sincerely,
The Cornerstone Investment Team

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