

Differentiated Alpha:

The Case for Small-Cap Stocks and Why Now Matters

Second Quarter 2026

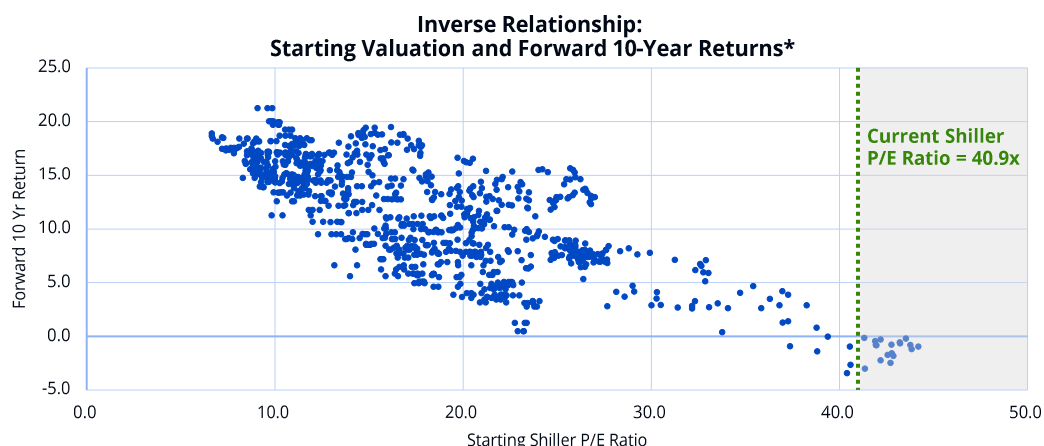
Key Takeaways

- Elevated valuations and narrow leadership point to lower future returns for U.S. large-caps.
- Large-cap dominance has historically rotated, and today's concentration exceeds prior cycles.
- Small-cap stocks are near historically wide discounts, creating an attractive entry opportunity.
- The broad small-cap universe offers diverse and overlooked growth potential.

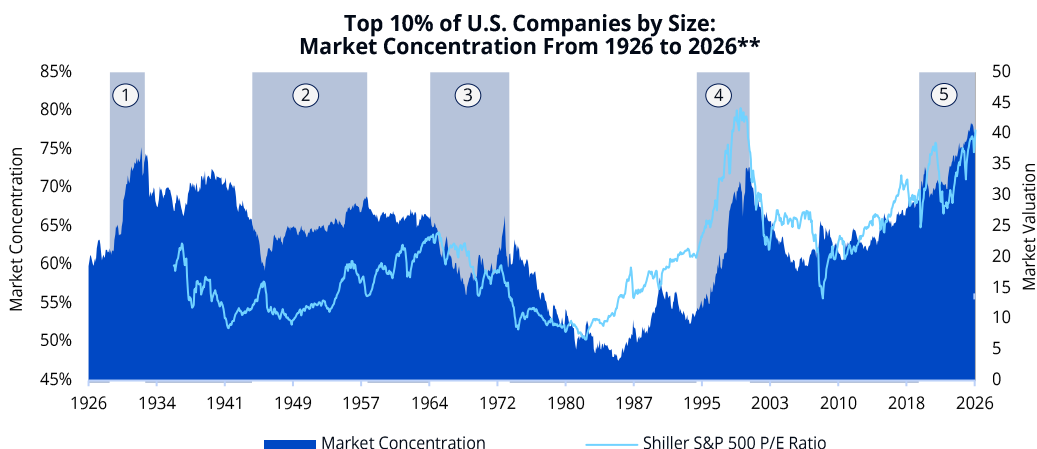
U.S. Equity Investors at Risk

Today's elevated valuations and extreme concentration levels have historically been associated with weaker long-term U.S. returns.

- Only 2% of historical valuations have been higher than today's level
- The average 10-year forward return has been -1.1%



*Source: Morningstar and www.shillerdata.com. Market valuation is represented by the Shiller P/E ratio and is using monthly data from March 1936 to June 2016. Forward 10-year returns are represented by the S&P 500 Index and is using monthly data from March 1946 to June 2016. Each dot is a single starting point in history. It shows how expensive U.S. large-company stocks were in that month (measured by the Shiller P/E ratio) and what the S&P 500 Index actually returned, on average per year, over the 10 years that followed. Because each dot needs a full 10 years of subsequent returns, the most recent dot is from 2016; the dotted line marks today's valuation at 40.9x for comparison. The dots trend downward, indicating that higher starting valuations were historically followed by lower 10-year returns.



- 1 = Great Depression (1929-1932)
- 2 = Post-WWII Expansion (1945-1957)
- 3 = Nifty Fifty (1965-1973)
- 4 = Dot-Com Bubble (1995-2000)
- 5 = "Magnificent Seven" Era (2020-)

**Source: Kenneth French Data Library (portfolios formed on size) and www.shillerdata.com. Market concentration represents the value of the top decile of companies based on size divided by the entire value of the market and is as of May 31, 2026. Market valuation is represented by the Shiller S&P 500 P/E ratio.

Small-Cap Stocks Are Experiencing Historically Rare Underperformance

History shows that when small-caps lag by this magnitude, subsequent rebounds have delivered meaningful and durable outperformance.



Sources: Kenneth French Data Library and Morningstar. Past performance does not guarantee future results. Data represents rolling 10-year excess returns from June of 1936 to May 2026.

	Small Cap Trailing 10-Year Underperformance*	Duration of Rebound	Annualized Return (Small vs. Large)	Growth of \$100 (Small vs. Large)	Starting Large-Cap P/E Ratio
1	-4.4%	12.5 years	20.3% vs. 10.0%	\$1,026 vs. \$343	18.2x (Near Post WWII Peak)
2	-8.5%	11.2 years	10.0% vs. 0.4%	\$284 vs. \$109	41.4x (Near Dot-Com Peak)
3	-7.2%	?	?	?	36.1x (Magnificent Seven)

Sources: Kenneth French Data Library, Morningstar and www.shillerdata.com.

Note: Small-Cap Stocks represent the bottom 3 deciles of companies based on market cap and Large-Cap Stocks represent the top 3 deciles of companies based on market cap. *Small-Cap Stocks' 10-year annualized return minus large-cap stocks' 10-year annualized return.

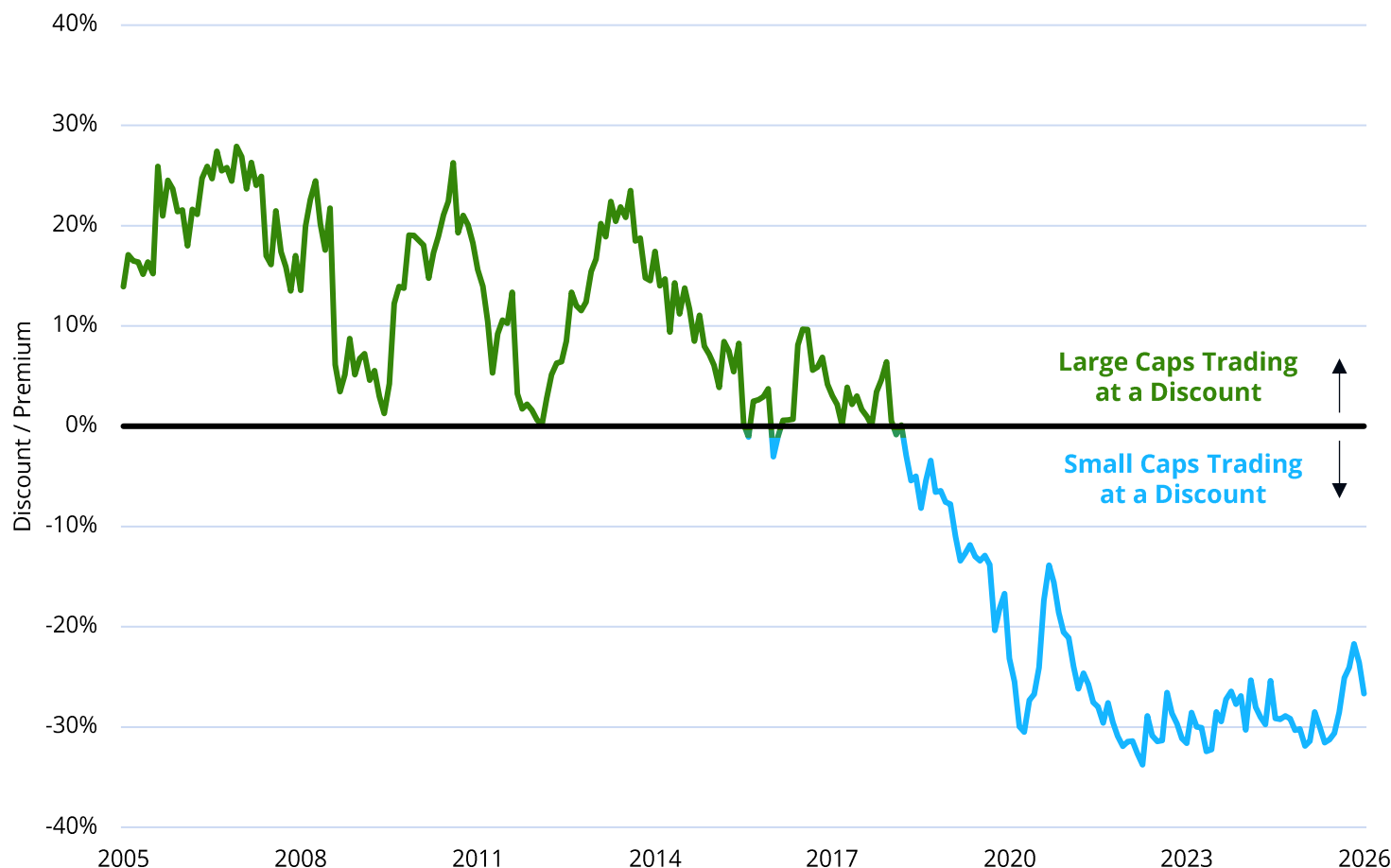
Significance for Investors

Staying anchored to large-caps may cause investors to miss a rare, generational opportunity. Thoughtful diversification may enhance long-term return potential and help manage concentration risk.

Small-Cap Stocks Present a Compelling Entry Opportunity

The valuation gap between large- and small-cap stocks remains near historically wide levels.

Small Cap Equities Are Trading At Historically Wide Discounts (June 2005 to June 2026)



Source: American Beacon, FactSet.

Note: The premium/discount is determined by the Russell 2000 Index forward fiscal one-year estimates divided by the Russell 1000 Index forward fiscal one-year estimates.

Significance for Investors

Large-cap investors are paying a premium for growth, while small-cap stocks offer overlooked value and underappreciated growth potential. History suggests such gaps often signal turning points.

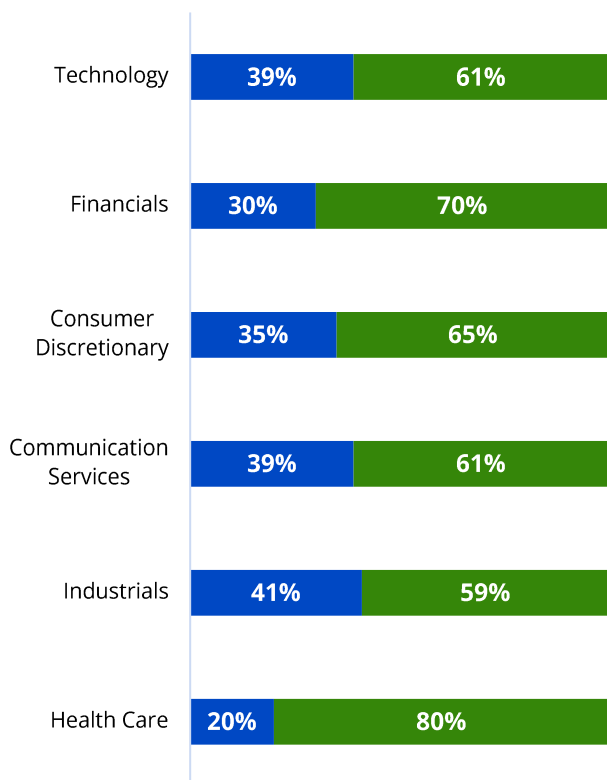
Expanding the Opportunity Set

The expansive small-cap universe offers investors broader diversification and access to innovative, underfollowed, and often overlooked opportunities.

As shown in the charts below, small-cap stocks represent a significantly wider universe of companies than large-caps, while large-cap sector exposure is increasingly dominated by a small number of top holdings.

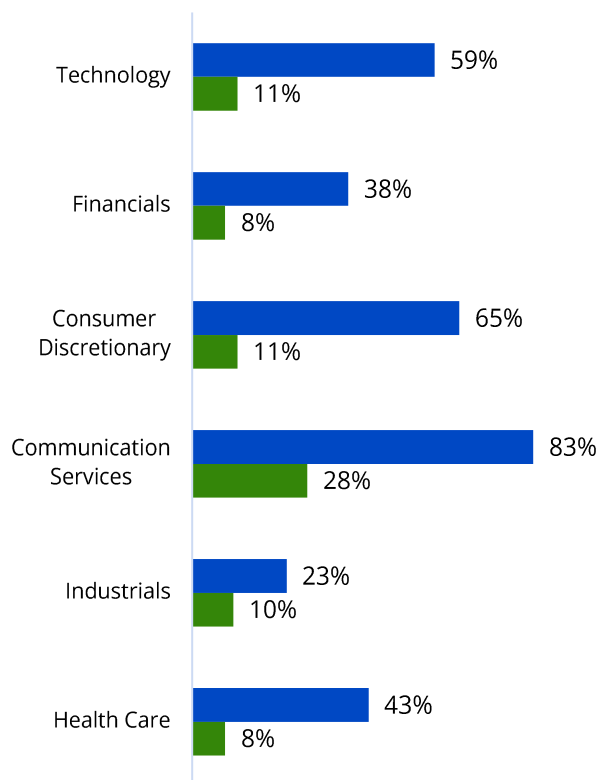
Percent of Total Market Opportunity Set

■ Large Cap ■ Small Cap



Concentration Within Top 5 Holdings

■ Large Caps ■ Small Caps



Source: American Beacon, FactSet as of June 30, 2026.

Note: Large-cap stocks are represented by the Russell 1000 Index and small-cap stocks are represented by the Russell 2000 Index.

Significance for Investors

The expanded small-cap opportunity set not only diversifies portfolios but also increases the likelihood of discovering tomorrow's market leaders early.

Past performance does not guarantee future results.

Investing in **small-capitalization stocks** may involve greater volatility and lower liquidity than larger company stocks.

GLOSSARY

Alpha: A measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of a fund and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark is a fund's alpha.

Annualized Return: The annualized return is the geometric mean of the returns with respect to one year.

Correlation: A statistical measure of how two securities move in relation to each other.

Magnificent Seven: This is a term for seven of the most dominant and influential technology-focused companies in the U.S. stock market, known for their substantial market capitalization and rapid growth. The stocks that make up the Magnificent Seven are: Alphabet (GOOGL, GOOG): Parent company of Google and YouTube, focused on search, advertising, and cloud computing. Amazon (AMZN): E-commerce giant with a dominant cloud computing platform (AWS) and streaming services (Prime). Apple (AAPL): A leader in consumer electronics (iPhone, iPad, Mac) and services (Apple Music, App Store). Meta Platforms (META): The social media behemoth that owns Facebook, Instagram, and WhatsApp, and is investing heavily in the metaverse. Microsoft (MSFT): A major software provider, cloud computing leader (Azure), and owner of LinkedIn and Xbox. Nvidia (NVDA): A key player in the artificial intelligence (AI) boom due to its dominance in graphics processing units (GPUs) essential for AI and data centers. Tesla (TSLA): The leading manufacturer of electric vehicles (EVs) and a key player in renewable energy solutions.

Nifty 50 (NSEI): In the United States, the term Nifty 50 was an informal designation for a group of roughly 50 large-cap stocks on the New York Stock Exchange in the 1960s and 1970s that were widely regarded as solid buy and hold growth stocks, or "blue-chip" stocks.

Non-U.S. Domiciled: Any company or entity whose primary base of operations is not in the United States.

Price-to-Earnings Ratio ("P/E Ratio"): Current share price of a stock divided by its earnings per share.

Shiller P/E Ratio (CAPE ratio): A valuation measure that uses real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.

Valuation: The process of determining the value of an asset or company. Stock analysts determine the value of a company based on current and future earnings, the market value of the company's assets and the balance sheet. A company with a high price-to-earnings ratio is said to have a high valuation or be highly valued. Bond analysts determine the value of a bond based on projections of future interest rates, and they use their valuation to determine whether a bond should be bought or sold at its current price.

Yield: The annual return on an investment, expressed as a percentage of the price. For stocks, yield is the annual dividend divided by the purchase price, also known as a dividend yield. For bonds, it is the coupon rate divided by the market price, called current yield.

Diversification does not assure a profit nor protect against loss. The Russell 1000® Index measures the performance of the large-cap segment of the US equity universe.

The Russell 1000 Index is a subset of the Russell 3000® Index which is designed to represent approximately 98% of the investable US equity market. It includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are included.

The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index which is designed to represent approximately 98% of the investable US equity market. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

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