Kayne Anderson Rudnick Investment Management

Investment Perspectives

March 2026

The Case for U.S. Small-Mid Caps

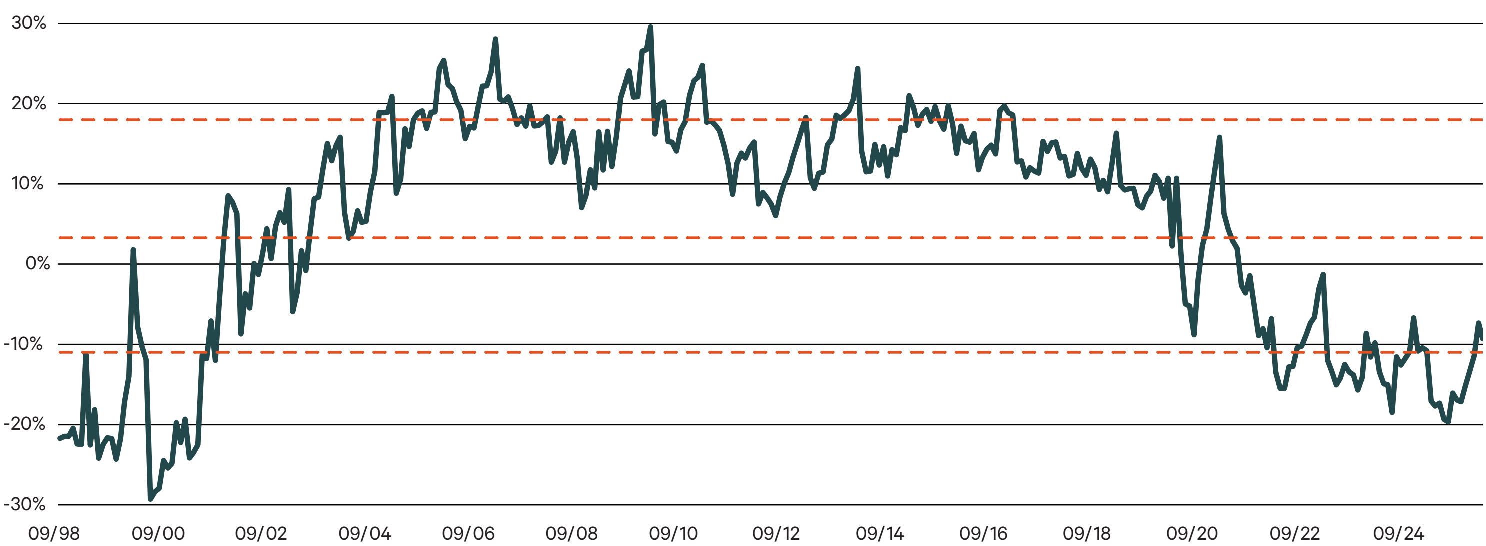
U.S. Large Cap Versus U.S. Small-Mid Cap Valuation Gap

U.S. large-cap stocks have now outperformed small- and mid-cap stocks for more than a decade. Differences in performance between them have been driven by fundamental composition. Large caps have benefitted from a higher concentration of businesses with superior earnings growth as well as multiple expansion.

While this period of relative outperformance by U.S. large caps has provided attractive returns to investors, it has also brought increased expectations. As charted below, valuation of small-mid cap companies relative to large caps (S&P 600 vs. S&P 500) has swung from a greater than one standard deviation premium at the end of the lost decade in 2010 to a greater than one standard deviation discount, the lowest it's been since the late 1990s.

FIGURE 1: SMALL-MID FORWARD P/E PREMIUM/DISCOUNT

Russell 2500™ Index vs. Russell 1000® Index Price-to-Earnings Ratio, FY2

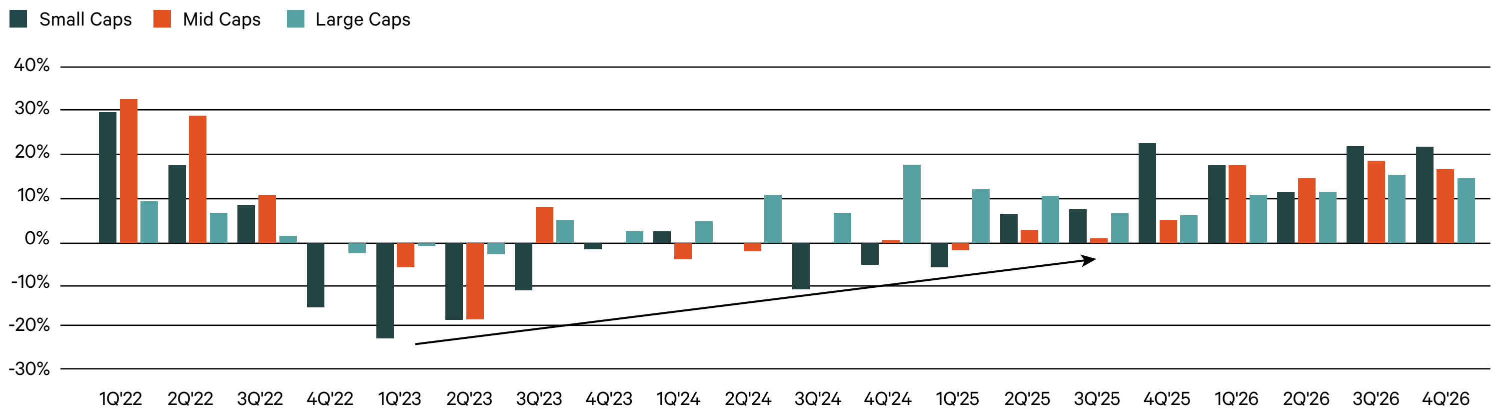


Data is as of March 31, 2026. Source: FactSet. Please see the end of this paper for information regarding the indices. The indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. ***Past performance is no guarantee of future results.***

2026 Earnings Estimates Favor U.S. Small and Mid Caps

When looking at future earnings estimates in the chart below, it is noteworthy that small caps (S&P 600) and mid caps (S&P 400) are expected to overtake larger caps (S&P 500) with faster earnings growth through 2026. This would represent a marked change from the past few years and may be the catalyst for outperformance.

FIGURE 2: EARNINGS GROWTH ESTIMATES FOR SMALL, MID AND LARGE CAP STOCKS

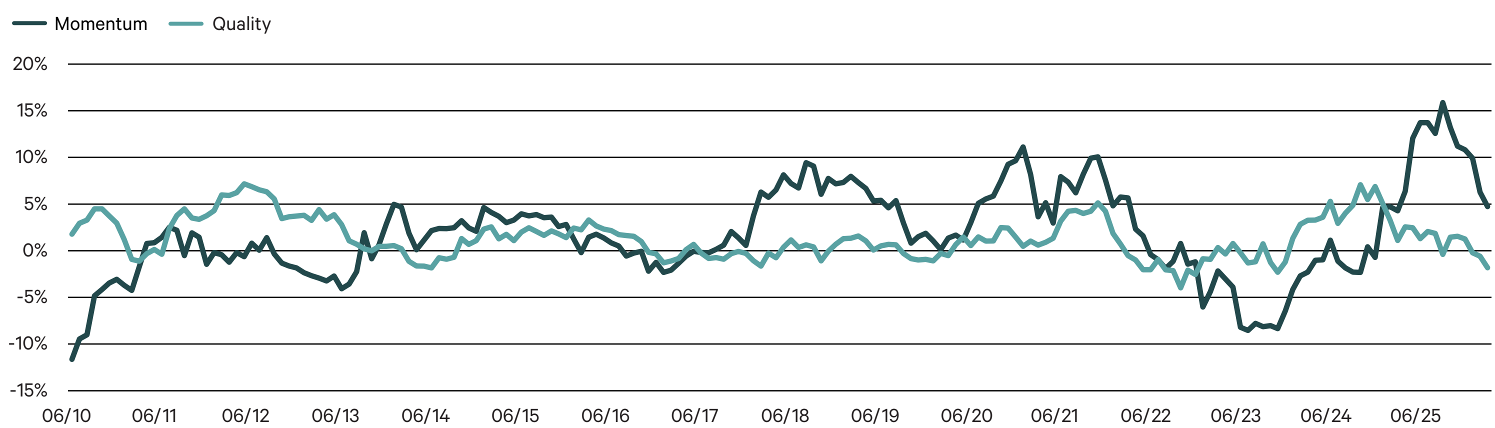


Data as of December 2, 2025. Source: FactSet, BofA U.S. Equity & U.S. Quant Strategy. Please see the end of this paper for information regarding the indices. The indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. ***Past performance is no guarantee of future results.***

Recent Momentum Versus Quality Factor Performance Now Favors High Quality

We have observed increased investor interest in lower quality and non profitable small and mid cap companies during recent market rallies. This pattern is not unusual and typically occurs during periods of rising risk appetite, when improving sentiment and liquidity lead investors to seek higher beta, momentum driven exposure. Importantly, when momentum meaningfully outpaces quality, it often reflects a late stage shift in investor behavior that can leave fundamentally strong companies relatively overlooked, setting up more attractive conditions for long term quality investors. Recently, the return differential between momentum and quality stocks has been both abrupt and of a higher magnitude. As shown in Figure 3, large and mid cap momentum stocks have outperformed quality over the past two years by the widest margin since the style indices were created, and a similar pattern has also emerged in the small-cap universe, where momentum has likewise outperformed quality.

FIGURE 3: ROLLING 2-YEAR EXCESS RETURNS VS. MORNINGSTAR U.S. LARGE-MID TARGET MARKET EXPOSURE



Data as of March 31, 2026. Source: FactSet and Morningstar. Please see the end of this paper for information regarding the indices. The indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. ***Past performance is no guarantee of future results.***

These phases—sometimes referred to as “junk rallies”—can produce strong short term returns, but they have been historically difficult to sustain without a corresponding improvement in underlying fundamentals. From our perspective, such periods often reinforce the importance of discipline and provide opportunities to reposition portfolios toward higher quality businesses rather than participate in speculative excess.

The Case for Investing in Quality Small-Mid Caps

Large cap indices currently include a higher concentration of profitable, well capitalized businesses with characteristics that do align closely with our quality criteria but with a current catalyst: potential value creation from AI.

By contrast, U.S. small mid cap indices contain a much broader mix of companies. The top 10 Russell 2500 Index companies represent only 6.3% of the universe, unlike the S&P 500 at 36.5%. While arguably more diverse, the Russell 2500 Index also includes a substantial number of companies with lower profitability, higher leverage, and/or inconsistent earnings.

However, high quality small-mid companies do exist, and when identified, we believe they can offer compelling opportunities. These businesses often operate in specialized niches, generate strong returns on capital, and benefit from less efficient pricing due to limited analyst coverage. In our view, this makes small caps an area where active, quality focused research is especially valuable, even if the broader index faces headwinds.

Thus, you can gain exposure to compelling, competitive investment opportunities, with meaningful earnings growth with diversification from the concentrated return nature of the larger indices.

Notice in Figure 4 how the characteristics of the KAR Small-Mid Cap Core strategy present a return on equity and earnings growth meaningfully greater than the index, while having less balance sheet risk.

FIGURE 4: KAR SMALL-MID CAP CORE PORTFOLIO CHARACTERISTICS

As of March 31, 2026

	KAR Small-Mid Cap Core	Russell 2500™ Index
Quality		
Return on Equity—Past 5 Years	24.0%	12.7%
Debt/EBITDA*	1.0 x	2.1 x
Earnings Variability—Past 10 Years	36.2%	81.7%
Growth		
Earnings Per Share Growth—Past 5 Years	10.8%	11.7%
Earnings Per Share Growth—Past 10 Years	14.5%	10.1%
Dividend Per Share Growth—Past 5 Years	16.4%	9.7%
Dividend Per Share Growth—Past 10 Years	9.2%	6.3%
Capital Generation—{ROE x (1-Payout)}	18.9%	10.1%
Value		
P/E Ratio—Trailing 12 Months	26.8 x	34.4 x
Dividend Yield†	0.9%	1.3%
Free Cash Flow Yield‡	4.2%	3.1%
Market Characteristics		
$ Weighted Average Market Cap—3-Year Average	$14.8 B	$7.8 B
Largest Market Cap—3-Year Average	$37.0 B	$37.3 B

Data as of March 31, 2026. Source: FactSet Research Systems and BNY Mellon. The statistics presented above are based on a representative portfolio. Actual results may vary. Other principal consultant firms may use different algorithms to calculate selected statistics. Estimates are based on certain assumptions and historical information. Please see the end of this paper for information regarding the index. The index is unmanaged, its returns do not reflect any fees, expenses or sales charges, and it is not available for direct investment. Returns may be affected by currency fluctuations. ***Past performance is no guarantee of future results.***

**KAR utilizes the interquartile method when calculating Debt/EBITDA. The interquartile method excludes outliers from an aggregate statistic such as weighted average. The interquartile method does not assume that data from the top or bottom of the distribution are outliers—only the extreme ends are excluded—and that it can be applied consistently as a quantitative method for most fundamental characteristics. Debt/EBITDA utilizes net debt for the calculation.*

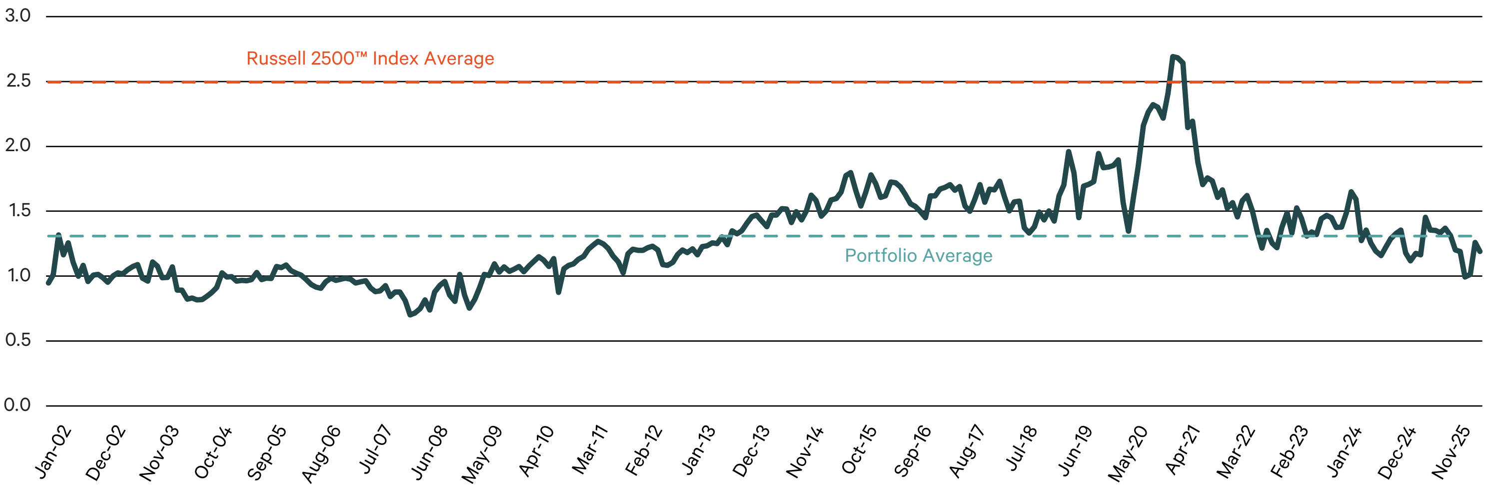
†Dividend yield is a financial ratio that shows how much companies have paid out in dividends in the most recent year relative to their stock price at the end of such year. Dividend yield is being shown here as a characteristic of the stocks held in the portfolio and not to infer how the stocks have or will perform, as dividends are not the only component of the portfolio's performance. Dividends are subject to change from year-to-year, and the portfolio's dividend yield could be lower or higher in future years.

‡Free cash flow data is as of December 31, 2025. Prices are as of March 31, 2026. Excludes financials.

In Conclusion

As illustrated in the following graph, when comparing KAR's Small-Mid Core strategy's price-to- earnings ratio (P/E) to its longer run earnings per share (EPS) growth rate, it is notable that it is currently trading in line with its inception-to-date average and below that of the benchmark.

FIGURE 5: SMALL-MID CAP CORE PORTFOLIO PRICE/EARNINGS-TO-GROWTH RATIO



Data as of March 31, 2026. Source: FactSet Research Systems and BNY Mellon. The statistics presented above are based on a representative portfolio. Actual results may vary. Other principal consultant firms may use different algorithms to calculate selected statistics. Estimates are based on certain assumptions and historical information. Please see the end of this paper for information regarding the index. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment. Returns may be affected by currency fluctuations. ***Past performance is no guarantee of future results.***

We continue to believe that quality-focused U.S. small-mid cap equities should be part of investors' portfolio allocation. Given today's market dynamics, we believe this segment warrants increased attention from long term investors.

Index Definitions: The Russell 2500™ Index *is a free float-adjusted market capitalization-weighted index of the 2,500 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies.* ***The Russell 1000® Index*** *is a free float-adjusted market capitalization-weighted index of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies.* ***The Morningstar U.S. Target Market Exposure*** *measures the performance of large- and mid-cap stocks in the U.S., representing the top 85% of the investable universe by float-adjusted market capitalization.* ***The Morningstar U.S. Quality Factor Index*** *is designed to provide efficient, strong exposure to the quality factor, as defined by the Morningstar Risk Model. This is measured as the equally weighted z-score of a company's profitability (trailing 12-month return on equity) and the z-score of its financial leverage (trailing 12-month debt/capital).* ***The Morningstar U.S. Momentum Factor Index*** *is designed to provide efficient, strong exposure to the momentum factor based on returns in local currency. This is measured as the trailing 12-month return, excluding the most recent month, minus the local risk-free rate.* ***The S&P 500® Index*** *is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested.* ***The S&P Mid Cap 400®*** *provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500®, is designed to measure the performance of 400 mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment. The index is calculated on a total return basis with dividends reinvested.* ***The S&P SmallCap 600®*** *seeks to measure the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable. The index is calculated on a total return basis with dividends reinvested. The indices are unmanaged, their returns do not reflect any fees, expenses or sales charges, and they are not available for direct investment.*