

Overview

The Bloomberg U.S. 2000 Total Return Index returned 2.41% in 4Q25, continuing its momentum for the year and surpassing the previous late-November 2024 peak. The key driver of index returns in the quarter was the healthcare sector (+18.9%), specifically biotechnology, which roared (+29%), while most other sectors were flat or down. The rest of the market was mixed, amid mixed economic and consumer data and rising trade tensions. GDP growth slowed sharply, employment gains disappointed, and consumer spending showed signs of deceleration following the robust pace seen earlier in the year. In credit markets, the Bloomberg US High Yield Index gained 1.31%; spreads were flat and remained near all-time lows, while yields fell 17 bps. The Federal Reserve continued to ease rates, enacting two 25-bps cuts in October and December to the current range of 3.50-3.75%, while the 10-year Treasury was flat at around 4.17%. Small-cap stocks were generally in line with large caps, but micro-caps lagged. Within the small-cap index, Health Care continued to lead, while Consumer Discretionary, Consumer Staples, and Information Technology lagged.

Small to Mid Cap Equity

The Penn SMID Cap strategy returned -0.52% during 4Q25, underperforming its benchmark, the Bloomberg U.S. 2500 Total Return Index, by 2.62%, and delivered 13.46% for the year, outperforming by 2.62%. The top contributing sectors to performance were Energy, Financials, and Real Estate while top detracting sectors were Health Care, Consumer Discretionary, and Industrials. Largest contributing positions in the quarter included 1) Lumentum Holdings (LITE), an optical equipment provider, demonstrated the resilience of AI infrastructure themes as the company reached near-term financial targets with tier-one partners and new product launches, benefiting from the expanding TAM for optical networking equipment in datacenter connectivity, 2) Alphatec Holdings (ATEC), a spine-focused medical device company, reported very positive 3Q results including significant beats on top and bottom lines with raises to 4Q and FY25 guidance and improved free cash flow inflection, and 3) Lumen Technologies (LUMN) a fiber-based network provider, captured multiple hyperscaler data center connectivity deals as AI demand continued to drive infrastructure buildout despite broader market weakness. Largest position detractors included 1) TG Therapeutics (TGTX), a commercial biopharma focused on multiple sclerosis, continued to languish as strong Briumvi growth failed to meet demanding street expectations while large competitors aggressively defended market share, creating a

negative feedback loop with elevated short interest at 17%, 2) Leonardo DRS (DRS), a defense equipment manufacturer, faced pressure from government shutdown fears, CEO transition execution risk, and temporary margin pressure from germanium shortage dynamics despite maintaining a solid longer-term outlook for core defense products, and 3) Itron Inc. (ITRN), a metering equipment and grid software manufacturer, suffered negative stock reaction from a lull in hardware orders and declining book-to-bill ratios despite posting decent 3Q results.

Smaller Company Equity

The Penn Smaller Companies strategy returned 0.72% during 4Q25, underperforming its benchmark, the Bloomberg U.S. 2000 Total Return Index, by 1.7%, and delivered 14.79% for the whole year, outperforming by 3.73%. The top contributing sectors to performance were Communication Services, Consumer Discretionary, and Energy, while the top detracting sectors were Health Care, Materials, and Financials. Most prominent contributing positions in the quarter included 1) Applied Optoelectronics (AAOI), an optical equipment provider, successfully ramped 800G and 1.6T pluggable transceivers for AI datacenter connections with commitments from major hyperscalers visible through 2026 and beyond, demonstrating resilience despite broader tech sector weakness, 2) EW Scripps-A (SSP), a television broadcaster, rallied on Sinclair's acquisition offer at a significant premium to pre-announcement levels, providing near-term downside protection and upside from deal completion, and 3) Realreal Inc. (REAL), an online consignment marketplace for luxury goods, benefited from strong consumer trends and proved more resilient than consumer discretionary peers amid macro headwinds. Largest position detractors included 1) Sable Offshore (SOC), an exploration and production company focused on offshore development, dealt with significant delays in restarting its Canadian operations caused by activist and regulatory pressures, creating timing uncertainty around cash flow generation and balance sheet improvement, 2) Aspen Aerogels (ASPN), a thermal barrier materials provider, continued to underperform as EV sales languished post government subsidy expiration with major automakers reducing future EV production outlooks creating multi-year earnings headwinds, and 3) Innoviz Technologies (INVZ), a LiDAR sensor provider, was dinged on the broad-based tech selloff late in the year though management retained conviction in several looming autonomous vehicle partnerships and new sensor launches.

Small Cap Equity

The Penn Small Cap strategy returned -0.88% during 4Q25, underperforming its benchmark, the Bloomberg U.S. 2000 Total Return Index, by -3.29% and delivered 16.11% total return for the year, outperforming by 5.05%. The top contributing sectors to performance were Communication Services, Energy, and Real Estate, while the top detracting sectors were Health Care, Materials, and Information Technology. Most prominent contributing positions in the quarter included 1) The RealReal (REAL), an on-line consignment marketplace for luxury goods, beat earnings expectation due to strong consumer demand trends, 2) Applied Optoelectronics (AAOI), an optical equipment provider, is successfully ramping 800G and 1.6T pluggable transceivers that increase network speeds for AI datacenters with one and possibly two large hyperscalers in 2026 and beyond, and 3) EW Scripps (SSP), a TV broadcaster, received a takeover offer at a significant premium. Largest position detractors included 1) TG Therapeutics (TGTX), a commercial biopharma co. focused on multiple sclerosis, sales guidance did not meet demanding consensus expectations. At the same time, competition in their drug class intensifies, 2) Waystar (WAY), a revenue cycle management software platform for healthcare providers, was dragged down with the broader software group due to premium valuation despite a powerful quarterly result, as well as a releveraging the balance sheet for an expensive acquisition 3) Radnet (RDNT), an owner/operator of outpatient diagnostic imaging centers and related AI enabled tech, offer mixed quarterly results in the face of a premium valuation followed up by a short report questioning the legitimacy of the AI transformation story.

Outlook

Market conditions in 4Q have normalized from the elevated momentum earlier in 2025, with investor focus shifting to the durability of corporate earnings growth, the future path of interest rate policy and oversight, and the resolution of trade policy uncertainties. The favorable credit market environment, characterized by tight spreads, ready access to capital at reasonable rates, and a lower Fed Funds Rate, should continue to support refinancing activities and corporate investment. The excitement around AI continues, with massive, debt-fueled capital expenditures from companies like Oracle and Meta; however, some skepticism has arisen regarding questionable structures, covenants, leverage, and more, leading to a meaningful widening of CDS spreads against these issuers. Market volatility measures such as the VIX (equities) and MOVE (credit) remain subdued, indicating investor confidence.

Solid economic growth, increased corporate confidence, and favorable credit market conditions have historically been tailwinds for Penn's equity strategies. Our companies generally benefit from deleveraging and the ability to refinance debt at favorable rates. Smaller companies have a higher share of floating-rate debt, making falling rates a tailwind for earnings. M&A activity has also been prevalent within our portfolios as a deleveraged company tends to be an attractive acquisition candidate. Despite the recent outperformance of smaller companies, valuations of profitable, smaller companies still appear attractive relative to large-cap stocks, trading near historical relative lows. Small-cap earnings growth turned positive earlier in 2025 and is now positive on an LTM basis, marking the first time since 4Q 2022 (pre-rate hiking). The small-cap index is expected to deliver nearly 3x the EPS growth of large caps in 2026, driven by stronger sales growth and improved margins. We continue to believe small-cap stocks represent a compelling long-term risk/reward and will continue to use our fully integrated credit and equity research process to identify attractively valued companies that are improving their capital structures for the benefit of shareholders.

Penn Capital Products Net Performance (%) – as of Dec 31, 2025	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inc.	Inc. Date
Small to Mid Cap Equity	-0.67	13.64	13.64	10.85	5.18	8.67	9.24	Dec-02
<i>Bloomberg 2500 Index</i>	<i>1.84</i>	<i>10.84</i>	<i>10.84</i>	<i>13.48</i>	<i>7.11</i>	<i>10.27</i>	<i>11.17</i>	
Small Cap Equity	-1.17	14.85	14.85	12.62	8.83	10.40	11.87	Dec-93
<i>Bloomberg 2000 Index</i>	<i>2.41</i>	<i>11.06</i>	<i>11.06</i>	<i>13.32</i>	<i>6.64</i>	<i>10.00</i>	<i>10.31</i>	
Smaller Company Equity	0.28	14.69	14.69	14.82	11.91	17.00	16.23	Dec-11
<i>Bloomberg 2000 Index</i>	<i>2.41</i>	<i>11.06</i>	<i>11.06</i>	<i>13.32</i>	<i>6.64</i>	<i>10.00</i>	<i>11.10</i>	
Micro Cap Equity	-3.72	8.66	8.66	3.06	0.12	6.32	7.46	Aug-06
<i>Bloomberg Microcap Index</i>	<i>1.01</i>	<i>12.73</i>	<i>12.73</i>	<i>9.45</i>	<i>3.39</i>	<i>8.40</i>	<i>7.27</i>	
Defensive Short Duration High Income	1.76	7.88	7.88	7.85	4.91	4.48	4.08	Jan-13
<i>ICE BofA 1-3 Year BB US Cash Pay High Yield Index TR</i>	<i>1.58</i>	<i>7.22</i>	<i>7.22</i>	<i>7.58</i>	<i>4.50</i>	<i>4.98</i>	<i>4.47</i>	
Defensive High Yield	1.63	8.35	8.35	9.24	4.08	5.19	6.39	Dec-93
<i>ICE BofA BB-B US Non-Distressed High Yield Index TR USD</i>	<i>1.62</i>	<i>9.00</i>	<i>9.00</i>	<i>9.29</i>	<i>4.12</i>	<i>5.87</i>	-	
Opportunistic High Yield	1.86	8.59	8.59	9.80	4.22	6.05	6.88	Dec-93
<i>ICE BofA US HY Constrained Index</i>	<i>1.35</i>	<i>8.50</i>	<i>8.50</i>	<i>10.02</i>	<i>4.50</i>	<i>6.43</i>	-	

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Specialists in Capital Structure Investing®

At Penn Capital, we believe that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, we've found that managing bond portfolios makes us better equity managers, and vice versa.

Employing a fully integrated credit and equity research process, we focus on non-investment grade companies in the micro to mid-capitalization range, where we can take advantage of inefficient security pricing.

We are a boutique investment management firm based in Philadelphia, PA. We forge our own ideas, we respect hard work, and we are committed to our clients, our staff and our community.

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A copy of Penn Capital's current written disclosure statement discussing our advisory services and fees is available upon request.