PENN CAPITAL

Overview

The Bloomberg U.S. 2000 Total Return Index advanced 20.97% in 2Q26, delivering its strongest quarterly performance in recent memory and lifting year-to-date returns to 23.03%. The quarter began on a cautious note, as geopolitical tensions stemming from the U.S.-Israel conflict with Iran weighed on investor confidence, disrupted energy markets, and created intermittent volatility across equity and credit markets. As the quarter progressed, however, risk appetite rebounded sharply, fueled by resilient corporate earnings, broadening optimism around artificial intelligence-driven capital investment, and an easing of the most acute geopolitical fears. The Federal Reserve, now under the leadership of new Chairman Kevin Warsh, voted unanimously at its June meeting to hold the federal funds rate steady at 3.50%–3.75% — a range unchanged since December 2025 — though the updated dot plot signaled that a rate hike may be forthcoming later in 2026 if inflation, partly driven by the Iran war, remains elevated. The 10-year Treasury yield moved higher by approximately 15 basis points over the quarter, closing near 4.47%. University of Michigan Consumer Sentiment slipped to 49.5 at quarter-end, reflecting a more cautious household backdrop despite surging equity prices.

Small to Mid Cap Equity

The Small to Mid Cap strategy returned 22.98% in 2Q26, outperforming its benchmark, the Bloomberg U.S. 2500 Total Return Index, by 6.34%. Year-to-date through June 30, the strategy has returned 22.01%, outperforming the benchmark by 2.95%. The top contributing sectors to relative performance were Industrials, Real Estate, and Discretionary, while the primary detracting sectors were Energy, Communication Services, and Materials.

The largest contributing positions during the quarter included: 1) Ouster Inc., a digital LiDAR provider, which launched its REV8 sensor — the world's first color LiDAR product — and is gaining traction with global Fortune 500 industrial and smart infrastructure companies, including Amazon, for AI-enabled warehouse automation; 2) ACM Research, a wafer fab equipment provider, whose cleaning equipment is seeing strong order flow from Chinese customers building out their domestic AI ecosystem as well as from global foundries for advanced packaging, growing revenue approximately 30% year-over-year; and 3) RXO Inc., a freight brokerage platform operator, which is demonstrating meaningful operating leverage at the beginning of what appears to be a multi-year freight upcycle while benefiting from the scale and efficiency of its large national broker network. The largest position detractors included: 1) Calix Inc., a broadband equipment provider, which is experiencing near-term memory margin pressure in the first half of 2026 — headwinds that should subside into 2027 as the company continues to build out its subscriber base on its agentic broadband platform; 2) Camtek Ltd., a wafer fab equipment provider, whose stock ran into its earnings release on an elevated valuation multiple — the company did beat and raise expectations, and the position was added to on the pullback; and 3) Amentum Holdings, a professional services company providing solutions to governmental and energy market customers, whose shares underperformed despite solid earnings growth and continued deleveraging, as nuclear opportunities take longer to develop, defense spending has rotated toward weapons systems, and government shutdown concerns persisted.

Smaller Company Equity

The Smaller Company strategy returned 29.76% in 2Q26, outperforming its benchmark, the Bloomberg U.S. 2000 Total Return Index, by 8.79%. Year-to-date through June 30, the strategy has returned 31.01%, outperforming the benchmark by 7.98%. The top contributing sectors to relative performance were Technology, Consumer Discretionary, and Industrials, while the primary detracting sectors were Communication Services, Energy, and Materials.

The largest contributing positions during the quarter included: 1) Ouster Inc., a digital LiDAR provider, which launched its REV8 sensor — the world's first color LiDAR product — and is rapidly gaining commercial traction with global Fortune 500 industrial and smart infrastructure customers, including Amazon for AI-enabled warehouse automation; 2) ACM Research, a wafer fab equipment provider, which is seeing robust order momentum from Chinese customers building out their AI ecosystem as well as from global foundries for advanced packaging equipment, growing top-line revenue approximately 30% year-over-year; 3) Whitefiber Inc., a data center co-location provider, whose backlog is rapidly expanding as it secures hosting agreements with large, investment-grade AI counterparties in its purpose-built facilities; and 4) Wolfspeed Inc., a power semiconductor producer, whose high-quality silicon carbide (SiC) products are gaining traction in high-powered AI data center rack applications under a new and improved management team with deep expertise in the analog and power semiconductor market. The largest position detractors included: 1) Artivion Inc., an aortic arch medtech company, which faced three simultaneous headwinds during the quarter — Middle East war-related dampening of EMEA volumes, a supplier disruption, and slower-than-expected placements of its newly launched device as hospital IRBs proved a more difficult regulatory hurdle than anticipated; 2) Calix Inc., a broadband equipment provider, which experienced near-term memory margin pressure in the first half of 2026, expected to subside into 2027 as the company continues to grow its subscriber base on its agentic broadband platform; and 3) E.W. Scripps, a television broadcaster, which was pressured by fears that M&A activity within the broadcast industry could be further delayed as state attorneys general pursued actions to block a peer merger.

Small Cap Equity

The Small Cap strategy returned 24.56% net in 2Q26, outperforming its benchmark, the Bloomberg U.S. 2000 Total Return Index, by 3.59%. Year-to-date through June 30, the strategy has returned 27.87%, outperforming the benchmark by 4.84%. The top contributing sectors to relative performance were Technology, Consumer Discretionary, and Health Care, while the primary detracting sectors were Energy, Communication Services, and Materials.

The largest contributing positions during the quarter included: 1) Ouster Inc., a digital LiDAR provider, which launched the REV8 sensor — the first ever color LiDAR sensor — and is gaining meaningful traction with global Fortune 500 industrial and smart infrastructure customers, including Amazon, for AI-enabled warehouse automation; 2) ACM Research, a wafer fab equipment provider, which is seeing strong orders for its cleaning equipment from Chinese customers building out their AI ecosystem, as well as from global foundries for advanced packaging equipment, and is growing revenue approximately 30% year-over-year; and 3) RXO Inc., a freight brokerage platform operator, which is proving its operating leverage at the beginning of a potential multi-year freight upcycle while benefiting from its large, scalable broker network. The largest position detractors included: 1) Calix Inc., a broadband equipment provider, which is experiencing near-term memory margin pressure in the first half of 2026 — headwinds expected to subside into 2027 as it continues to grow its subscriber base on its agentic broadband platform; 2) Amentum Holdings, a professional services company focused on governmental and energy market solutions, whose shares underperformed despite solid earnings growth and continued deleveraging, as nuclear opportunities take longer to develop, government spending has shifted toward weapons systems, and fears around volatile government shutdowns lingered; and 3) E.W. Scripps, a television broadcaster, whose shares were pressured by fears that ongoing M&A activity in the industry could be further delayed as state attorneys general pursued actions to block a merger between industry peers.

Outlook

As equity markets enter the second half of 2026, the investment backdrop is shaped by a complex interplay of structural market forces and evolving macroeconomic risks. On the constructive side, small cap valuations — even after the strong 2Q26 performance — remain compelling relative to large caps on a historical basis. The Russell 2000 (ex-biopharma) trades at approximately a 10% discount to the S&P 500 on a forward P/E basis, compared to a historical norm of a roughly 10% premium — a spread of approximately 20 percentage points that represents one of the cheapest relative readings in 50 years, per Furey Research Partners. On a price-to-book basis, small caps trade at a roughly 57% discount to large caps, and at a 44% discount on enterprise value-to-free cash flow. Importantly, this valuation discount persists even as small cap earnings growth is expected to exceed that of large caps in the year ahead. The credit environment continues to support corporate refinancing and capital structure management. Our portfolio companies generally benefit from a deleveraged balance sheet profile and the ability to refinance debt at what we see as favorable rates, and given smaller companies' larger proportion of floating rate debt, we believe this creates a stronger tailwind when and if the Fed eases.

On monetary policy, Chairman Warsh has adopted a data-dependent stance. He recently indicated that inflation risks have come down over his first four weeks, citing declining inflation expectations in both surveys and bond markets, and suggesting that the Iran-war-related spike in energy prices may have peaked as a peace agreement took hold. Penn's base case is that the Fed remains on hold as inflation moderates — a constructive backdrop for smaller companies with greater floating rate debt exposure. Elevated tariff-related costs and geopolitical uncertainty remain risks to watch, and important upcoming economic events will be the July 28–29 FOMC meeting and July 30th PCE month over month report.

Despite these crosscurrents, Penn Capital remains constructive on the fundamental outlook for small cap equities, supported by a corporate deleveraging, an improving M&A environment that have historically benefited our portfolios, and the expectation that AI-related capital investment will continue to generate upside to expectations across technology, industrials, and healthcare. We will continue to leverage our integrated credit and equity research process that seeks to identify attractively valued companies improving their capital structures for the benefit of shareholders.

Penn Capital Products Net Performance (%) – as of June 30, 2026	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inc.	Inc. Date
Small to Mid Cap Equity	22.98	22.01	30.80	15.54	6.32	10.77	9.96	Dec-02
Bloomberg 2500 Index	*16.64*	*19.06*	*32.39*	*17.07*	*7.39*	*11.73*	*11.75*	
Small Cap Equity	24.56	27.87	41.05	19.03	8.26	13.17	12.53	Dec-93
Bloomberg 2000 Index	*20.97*	*23.03*	*40.92*	*18.49*	*7.11*	*11.96*	*10.85*	
Smaller Company Equity	29.76	31.01	47.96	22.27	10.36	20.04	17.81	Dec-11
Bloomberg 2000 Index	*20.97*	*23.03*	*40.92*	*18.49*	*7.11*	*11.96*	*12.29*	
Micro Cap Equity	18.85	14.18	20.25	6.35	-3.68	7.67	7.99	Aug-06
Bloomberg Microcap Index	*18.44*	*16.39*	*39.21*	*14.37*	*-0.54*	*10.25*	*7.91*	
Defensive Short Duration High Income	1.97	2.10	5.70	7.29	4.82	4.39	4.08	Jan-13
ICE BofA 1-3 Year BB US Cash Pay High Yield Index TR	*1.76*	*1.95*	*5.18*	*7.02*	*4.42*	*4.67*	*4.46*	
Defensive High Yield	2.39	1.82	5.53	8.14	3.86	4.90	6.35	Dec-93
ICE BofA BB-B US Non-Distressed High Yield Index TR USD	*2.44*	*2.04*	*6.09*	*8.38*	*3.96*	*5.45*	-	
Opportunistic High Yield	2.60	1.82	5.91	8.60	3.66	5.65	6.83	Dec-93
ICE BofA US HY Constrained Index	*2.45*	*1.89*	*5.74*	*8.78*	*4.13*	*5.69*	-	

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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.

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Penn Capital Management
Schuylkill Yards | 3025 JFK Boulevard, Suite 270 | Philadelphia, PA 19104
215.302.1500 |www.penncapital.com