PENN CAPITAL

Overview

The second quarter was notably/meaningfully strong for smaller-cap companies, with performance robust from start to finish. Enthusiasm that had been tempered into the end of the first quarter by Middle East–related uncertainty quickly reversed, as markets opened the quarter with a powerful risk-on tone and largely sustained it throughout. As oil prices peaked and investors began to anticipate easing tensions in key shipping lanes, equities rallied broadly, but technology was the clear standout. Small-cap names leveraged to the AI infrastructure and data center build-out saw share prices move sharply higher, with many “picks and shovels” beneficiaries of the AI cycle posting outsized gains. After more than a year of strong performance, questions around the rationality and durability of the AI trade became more vocal; nonetheless, data center demand continued to grow dramatically over the period, providing fundamental support to the move.

One notable shift during the quarter was the relative underperformance of the largest AI spenders—particularly the major webscale platforms—compared with their supply chain. As investors increasingly scrutinized the return on massive capital expenditure programs, these mega-cap buyers lagged while component, equipment, and infrastructure providers continued to outperform. This dynamic drove small caps to outpace large caps by a wide margin over the quarter, with smaller, more focused beneficiaries of AI-related capex capturing a disproportionate share of the upside.

At the same time, falling oil prices following a ceasefire in the Iran conflict weighed on energy stocks, which had entered the quarter on strong momentum. Energy underperformed as crude retraced much of its war-driven spike, while consumer stocks began to show some early signs of life but still lagged many cyclicals and growth sectors after being hit hardest into the conflict. We see this as a developing opportunity: as gasoline prices continue to normalize and the summer driving season concludes, we believe lower fuel costs should provide a growing tailwind to consumer discretionary and select staples heading into year-end.

Micro Cap Equity

Our Micro Cap Equity strategy outperformed its benchmark, the Bloomberg Micro Cap Index, during the second quarter, driven primarily by strength in Real Estate, Consumer Discretionary, and Industrials. Within Real Estate, recently initiated positions in hotel and lodging companies performed notably/meaningfully well as World Cup-related demand pushed room rates higher and business travel showed signs of sustained recovery. In Consumer Discretionary, our overweight exposure to retailers and restaurants benefited from improving sentiment as a ceasefire became more likely, easing pressure on consumers through declining oil prices. Within Industrials, a sole-source supplier to the aerospace and defense sector expanded capacity significantly, supported by anticipated increases in demand for components used in Patriot missile systems following inventory drawdowns during the Iran conflict.

Performance was negatively impacted by Utilities, Information Technology, and Materials. Utilities lagged as rising interest rates and higher oil prices intensified inflation concerns, weighing on this rate-sensitive sector. In Information Technology, our underexposure to highly speculative, pre-revenue companies detracted as these names rallied on expectations of future AI-driven growth that has yet to materialize. We expect continued volatility in this segment, as much of the anticipated growth is likely deferred into future periods. Within Materials, a silicon metals manufacturer underperformed due to persistent competitive pressures and the absence of expected EU tariffs that were anticipated to restrict emerging market supply.

Small Cap Value

The Small Cap Value Equity strategy outperformed its benchmark, the Bloomberg 2000 Value Index, during the second quarter, led by contributions from Consumer Discretionary, Industrials, and Energy. Within Consumer Discretionary, an overweight position in retailers and restaurants benefited from improving consumer sentiment as a ceasefire became more likely, easing pressure through lower oil prices. In Industrials, a sole-source supplier to the aerospace and defense market expanded capacity significantly in anticipation of increased demand for components used in Patriot missile systems following inventory depletion during the Iran conflict. Within Energy, a leading provider of oilfield tools to the

Middle East performed well, supported by expectations for increased capital spending to rebuild damaged oil production infrastructure following the war.

Performance was negatively impacted by Information Technology, Utilities, and Healthcare. In Information Technology, our underexposure to AI-linked hardware manufacturers weighed on results as the segment outperformed. Utilities lagged amid rising interest rates and higher oil prices, which heightened inflation concerns and pressured this rate-sensitive sector. Within Healthcare, underexposure to pharmaceutical companies detracted from performance as M&A activity accelerated across the sector during the quarter.

Outlook

Geopolitical risk remains elevated, and the ceasefire framework is widely viewed as fragile. In response, China has been drawing down substantial domestic stockpiles to reduce current oil purchases, helping push prices back toward pre-conflict levels. This has eased headline inflation expectations at the margin, though core inflation measures have remained relatively firm, leaving the Federal Reserve in a deliberative stance on its policy path.

From a macro perspective, the market has been buoyed by rising expectations for long-duration spending on the electrical grid and data center infrastructure. The largest cloud and webscale companies continue to direct incremental capex dollars into these areas, providing strong order visibility for the ecosystem of power equipment, cooling, semiconductors, and networking providers. Paradoxically, equity performance for many of these webscalers has been muted, as expanding capex budgets invite investor scrutiny around long-term returns on invested capital and free cash flow trajectories. By contrast, equipment suppliers and other direct beneficiaries of AI-related infrastructure spending performed very well in the quarter. Given their sensitivity to capital spending plans, we are watching any signs of moderation in webscale capex intentions closely, as a shift in spending could have important valuation implications across the semiconductor, communications equipment, and broader technology complex.

Looking forward, the consumer complex may be increasingly well positioned if inflation expectations continue to drift lower. A sustained moderation in inflation would reduce pressure on the Fed to consider renewed rate hikes into year-end, and any transition back toward a more easing-biased policy stance would likely benefit rate-sensitive areas of the market most—particularly consumer, smaller-cap cyclicals, and domestically oriented businesses. In that environment, we would expect quality small caps with strong balance sheets and direct exposure to improving real disposable income to be notable beneficiaries.

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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