Transcript of Asset TV Small Cap Video Masterclass with Mark Roach, Nathan Moser and Chris Parker

Hello and welcome to this Asset TV Small Caps Masterclass. Joining us today, we have Mark Roach, director of Small and Micro Cap Equities at CS McKee and lead portfolio manager of the North Square Small Cap Value Fund at North Square Investments, Nathan Moser, senior portfolio manager at Impax Asset Management and Chris Parker, senior portfolio manager of Thrivent Small Cap Value ETF at Thrivent Asset Management.

(00:00:39):

Well, it's great to have everyone with us today. Kicking us off here, Chris, why do you think that investors should be paying more attention to small caps in today's markets?

Chris Parker (00:00:50):

First and foremost, I would say that having exposure to small caps within the context of a broader investment allocation approach is a good idea. As for why small caps should be garnering some additional attention in the current market environment, let's start with the current operating backdrop. Small cap companies are often more representative of the overall economy and overall broader domestic economic activity. And while earnings performance of large cap companies has rightfully received a substantial amount of attention recently, there are some clear signs that earnings performance for the overall economy and for small caps specifically is improving.

(00:01:32):

After experiencing declines in 2023 and 2024, revenue and earnings growth in small caps both turned positive last year and accelerated through 2025 and into 2026. In fact, if we exclude the comparison issues during the pandemic, the first quarter of 2026 was actually the best earnings environment for small caps since 2018.

(00:01:56):

Another sign of broadening operating momentum, for example, is the recent improvements in the manufacturer's Purchasing Managers' Index, or the PMI, which has moved above 50 for the past four months. And that's indicative of a broadly improving domestic industrial economy and comes after nearly four years of contraction. So right now we have an operating environment that's improving and that's coupled with small cap equities trading at a wider than typical discount to large cap on several key valuation metrics that we evaluate. Based on recent data, small cap valuations relative to large caps are trading at a 15 to 20% discount to a 30 year average of a mix of metrics such as PE ratio, free cash flow yield and enterprise value to EBITDA. And in prior periods when we've had small cap performance operating performance improving and valuations attractive, this has generally led to favorable returns for the group.

(00:03:02):

So we view those as a number of reasons why we believe small cap equities should get some incremental focus in today's markets.

Jenna Dagenhart (00:03:12):

Turning to you, Nathan, why do you think the case for small caps is more compelling today than it has been in recent years?

Nathan Moser (00:03:20):

And I think it comes down to three key points. After a very difficult period of underperformance, I believe small caps are under owned. When we look at small caps as a percentage of the total equity market capitalization of the market, they represent approximately 4.5%, which is well below their long-term average of 8%. Second, valuation, which was alluded to previously. When we look at relative valuations versus large cap, the S&P 600 Index trades very close to 25 year lows relative to the S&P 500 Index. So very attractive valuation. And then lastly, when I think about small caps and what they offer investors, they offer very important diversification benefits. Large caps are increasingly driven by the artificial intelligence or AI trade. We see market concentration at levels that are higher than those witnessed during the internet bubble. And so small caps really let our investors and our clients give them the opportunity to stay invested in markets, but to diversify and to broaden their exposure to other areas of the US economy.

Jenna Dagenhart (00:04:40):

And Mark, in 2025, many investors characterize small cap gains as a junk rally driven by lower quality companies. Given that higher quality small caps have outperformed year to date, does this suggest the leadership is becoming more fundamental and sustainable?

Mark Roach (00:04:59):

Yes. Thanks for having us here. In 2025, the stuff that led didn't have earnings, but it had a story. The real question is what happens after a run like that hits. And so the way we see it is take every stock trading at 10 times sales, the speculative end of the market and add it up. We only hit levels like that twice dotcom bubble, which is around $6 trillion and the COVID craze right around 15 trillion. So both times those names got cut roughly a half on the way down and today close to 30 trillion is what we're seeing right now. So we're not testing the old extremes, it's a double. And so we live through the meme stocks and the dotcom bubble, but these stocks run rallies about we were down about a thousand basis points then got beat up pretty good. But this next two years we were up 2000 basis points over the next two years as it unwound.

Average Annual Total Returns as of June 30, 2026

	Latest Quarter	Year to Date	1 Year	3 Years	5 Years	10 Years	Since Inception*
Class I	15.16%	23.00%	36.20%	15.67%	10.53%	10.41%	8.52%
Investor Class Shares	15.11%	22.86%	35.86%	15.37%	10.26%	10.14%	9.92%
Russell 3000 Total Return Index	15.44%	10.88%	22.82%	17.86%	20.36%	12.31%	15.06%
Russell 2000 Value Total Return Index	17.19%	22.99%	43.01%	18.73%	8.23%	10.89%	7.97%

* Inception date for Class I is 8/22/2007, Investor Class is 12/31/2003. Index inception date returns are matched to Class I shares. The Fund has adopted the historical performance of the Foundry Partners Small Cap Value Fund (the "Predecessor Fund"), a former series of Valued Advisers Trust, as a result of a reorganization consummated after the close of business on April 25, 2025 ("Reorganization"), in which the Fund acquired all of the assets, subject to the liabilities, of the Predecessor Fund. The performance information presented above for periods prior to the Reorganization reflects the performance of the Predecessor Fund. At the time of the Reorganization, the Fund and the Predecessor Fund had substantially similar investment strategies. Prior to the Reorganization, the Fund was a "shell" fund with no assets and had not yet commenced operations. The Predecessor Fund had two share classes: Investor Class shares and Institutional Class shares. In the Reorganization, the holders of the Investor Class shares and Institutional Class shares of the Predecessor Fund received Investor Class shares and Class I shares, respectively, of the Fund.

Call 855-551-5521 or visit northsquareinvest.com for the most recent month-end performance results. Fund facts are as of 3/31/26 unless otherwise stated. Current performance may be lower or higher than the performance data quoted. The performance data quoted represents past performance, which is no guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Performance would have been lower without expense limitations in effect.

Gross Ratio Class I:	1.05%
Gross Ratio Investor Class:	1.30%
Net Ratio Class I:	1.05%
Goss Ratio Investor Class:	1.30%

The expense ratios are as shown in the Fund's most recent prospectus. The difference between gross and net operating expenses reflects contractual fee waivers and/or expense reimbursements in place until September 30, 2027. Please see the Fund's prospectus for more details.

(00:06:01):

Those periods hurt while you're in them, but when it runs out of gas, our quality focus generally does well. And one of the things we asked ourselves was, what about our process? So what question do we want to have? Does our quant front end actually help us when we're picking stocks? And so right now if you just throw a dart and pick the stock in the Russell 2000 Value, you would have a 46.2% chance of landing a winner. That's worse than a coin toss. If you run it through our value momentum and quality front end and that jumps to 53.5% so we've got better than even odds.

(00:06:55):

But here's the real story, really it's about severity, big moves up or down and that to us means 50% down or 50% up. So on the upside, the Russell 2000 Value has a positive severity of something around 10.1%. And I'll be honest, we give a little bit back on here. We slipped to 9.3%. So we have a 9.3% chance of getting something up 50% or more. But when we look at the downside for the 2000 value, you get a 9.6% chance of owning a name that falls more than 50%. With our VMQ (Value Momentum Quality)screen, it's just 3.7%. So that trade we make every single day, we get our fair share of the upside, but we cut the disasters by more than half and that's what compounds. The money you don't lose in drawdowns is the money that still is working for you. Avoiding blowups matters a lot more as much as finding winners.

Jenna Dagenhart (00:07:54):

Sticking with value, Chris, at Thrivent Asset Management, you manage a Thrivent Small Cap Value ETF. Why do you think value might be of interest to investors right now?

Chris Parker (00:08:05):

We think it's a really interesting time for value and as Mark alluded to an extent for a quality approach to value in particular. So for our strategy, we look to buy sound or improving businesses led by capable and well aligned management teams when they're trading at a substantial discount to our estimate of intrinsic value and when expectations and sentiment are low versus our forecasts. So we're focused on identifying durable high quality companies with demonstrated earnings power and cash flow generation and an ability to generate return on invested capital.

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And sometimes those present themselves as opportunities when companies are going through temporary cyclical or company specific setbacks. Sometimes it's instances of concerns about changes in short term earnings power. We're seeing, I think, some of those in the current environment. At other times, quite frankly, it's companies that are demonstrating improved structural earnings power and growth potential and the market is slow to fully realize that and incorporate those into share prices.

(00:09:22):

And in our mind, periods of either tremendous fear in some cases or often tremendous optimism that's focused into very narrow areas of the market can create opportunities for our approach to value investing. And if we think about the current market environment, many investors are quite narrowly focused on a few areas that specifically tie into artificial intelligence and the winners from artificial intelligence, building models, building out data centers, et cetera, and are willing to pay what we think are very high prices for those companies. And a lot of everything else, quite frankly, is being ignored a little bit. However, many of the companies that are being ignored or neglected are actually performing quite well.

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As we've talked about, the domestic economy is accelerating, small cap earnings growth is accelerating and in many cases, those are companies that are using AI to make their businesses more efficient, more profitable, improve their growth potential, or underappreciated or unanticipated beneficiaries of aspects like artificial intelligence. And investors are able to purchase those companies that are growing earnings, improving growth rates at quite compelling valuations. And so we think that setup is very positive for a quality approach to value investing.

Jenna Dagenhart (00:10:57):

Nathan, valuations have been a key part of your thesis. How attractive are small caps today relative to large caps?

Nathan Moser (00:11:05):

I think they're quite attractive. Obviously valuation's a bit more of an art than a science, but when we look at the absolute valuations, while they have increased a touch over the past year as small caps have outperformed large, the relative valuation, as I mentioned before, is incredibly attractive and that really sets the stage for what we expect to be a multi-year long-term outperformance period. And so this market environment we're in today has the look and the feel of the late 1990s. When we look back at that period, which was the last time we saw a relative valuation this attractive, small caps went on a four-year run of outperformance that was greater than 80% versus large. And that was despite having a recession, having the events of 9/11 and having a war in the Middle East. And so I think when you come back to it, the starting point, what investors pay today is incredibly important when you think about the return potential. And today's market is just giving investors that opportunity to take advantage of what, again, we think will be a multi-year run.

Jenna Dagenhart (00:12:20):

Now, Mark, why could small cap stocks benefit if market leadership broadens beyond mega cap growth?

Mark Roach (00:12:28):

Great question. I think because the broadening is the trade, right? So if you go back to 1984, whenever the average stock starts beating the cap weighted index, small caps tend to lead. So mega cap's concentration has been the thing holding us back. So when that unwinds, it flips to a tailwind. And honestly, broadening is when our job gets easier, there's more dispersion, more mispricing to pick through and we run about a 91% active share. So you're getting the real thing, not just the closet index that owns all the junk.

Jenna Dagenhart (00:13:11):

And moving on to you, Chris, what are some of the common mistakes investors make with small cap investing?

Chris Parker (00:13:19):

Very good question, Jenna. We think one of the mistakes that investors make is thinking about small cap equities as a somewhat homogeneous group of companies and not paying attention to the quality of the businesses that they're investing in. Depending on the point in time, about a quarter to a third of small cap companies, as measured by the Russell 2000 Index are not profitable and not generating free cash flow and a similar size cohort lacks a demonstrated track record of earning in excess of their cost of capital. So they don't create economic value over time.

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That group of companies has historically faced some tough sledding when it comes to generating returns for investors over time. And in fact, small cap earners have generated annual returns that are about four and a half percentage points higher than non-earners. So that in and of itself is a great argument in our mind for active management in small caps versus using index. Additionally, quite frankly, we think that investors don't evaluate risk reward at an individual stock level appropriately in small cap. Individual small cap equities are more volatile than large cap and characteristics such as business quality and management quality and capital structure matter a great deal there, as does really explicitly understanding downside risk and really thinking about the range of outcomes that can occur for individual securities.

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I think one of the key aspects for our investment process for Thrivent Small Cap Value ETF is that we do explicitly focus on understanding that distribution of outcomes for individual securities, really looking at that range of potential returns when we look at investments and not just the upside, because the upside for many small cap companies can look pretty compelling, but if you're not balancing that against risk factors, you're not really getting a complete understanding of what your probabilistically weighted returns are likely to be.

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Similarly, we think that small cap investing can be more subject to value trap risk. Where the starting point on valuation for an individual company might be enticing to an investor, but the business itself might be deteriorating or lack of catalyst or lack fundamental improvement that will eventually lead investors to pay attention and cause the shares to increase in value. And so having that as a key component of an approach to small cap is fairly important in our view.

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We also believe that there's a misperception that small caps are a place where you want to hop into and hop out of depending on the macro economic environment or other macro factors. Those factors can certainly help, but the reality is that when you focus on profitable cash generative companies that grow earnings power over time and often you can find those trading at quite substantial discounts in the small cap arena. And in many cases, those eventually turn into high quality mid caps. If you have a patient, quality through the cycle approach to investing in small caps, you can potentially capitalize on the opportunities created in that investment universe that you might miss if you hop into and hop out of the asset class depending on your view on the macro economy or other factors.

Jenna Dagenhart (00:17:00):

Spending a little bit more time on investor sentiment, Nathan, it still seems somewhat muted. How does that influence your outlook?

Nathan Moser (00:17:08):

Yeah, so I definitely agree that it's muted towards the overall small cap asset class. That said, I am seeing pockets of exuberance in the lower quality, more speculative stocks. In fact, we've seen low quality lead high quality going back for more than a year. That's noted by sort of the performance between the Russell 2000 Index, which tends to be lower quality and the S&P 600 Index, which favors companies that are more profitable and have higher return profiles.

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And so just to put some numbers on it, if we go back to April of last year when the market bottomed, the Russell 2000 Index at lower quality cohort of stocks has outperformed the high quality cohort by about 8%. From my perspective as a quality investor, I look at periods like this as fairly short live. When we've seen low quality leadership in the past, they tend to be very sharp and sudden. We've seen them as short as a quarter or two and as long as a year or so, but we expect that quality trade will re-exert itself in the coming quarters ahead.

Jenna Dagenhart (00:18:22):

Mark, in markets increasingly driven by sentiment and narratives, how do you incorporate behavioral or gain theory considerations into small cap investing and why is that so important? We know it can have a huge impact.

Mark Roach (00:18:36):

Yeah. So we think about four behavioral levers working at once. So we have value is fear and greed, momentum is recency bias, and the fourth, the narrative, is the game theory piece. I mean, I think it's the one that I should probably walk through because it's where a lot of our edge really lives. So the core idea is information moves through the market or the narrative moves through the market in a sequence. It goes in four stages. First, narrative shifts the way the media frames a story. That's the earliest signal. Then you get a second behavioral follows. People start acting on the new story. You see it in search data and spending and most importantly, you see it how investors position their portfolios.

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And then third is the fundamentals confirm it, revenue and margins catch up. And only then this fourth piece comes in together, which is the price, finally re-rating because price doesn't move until enough investors are forced to change their view. So that's where we can see the bias. More important is we track what the market believes and we can see that with natural language processing and we can actually identify which sort of bias we're seeing in the marketplace at any given time.

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And so I can give you a good example. So the loudest moves in the market that have the least belief underneath them, it's no surprise, it's tech, it's up the most. But the conviction behind it is flat and it's starting to fade and we can see that happening, but we're probably maybe one or two or three quarters ahead of that. And so that strong belief in the market is sitting in names that haven't moved yet. So utilities where the long-term story is completely re-rated, but the price is still pinned down by rates. That gap between what people are buying and what they actually believe is exactly where we look for alpha and it's invisible to a screen. So you really don't have a choice. Yo have to dig into the natural language processing on all the news and it can really give you a good edge.

Jenna Dagenhart (00:20:47):

Chris, how do valuations and earnings play a role in how you review assets for Thrivent Small Cap Value ETF?

Chris Parker (00:20:56):

For us, valuation and really more importantly, the idea of substantial undervaluation and a large margin of safety. That's the north star for our investment process. It's not the only component, but that's the starting point. And when we think about valuation, we're focused on free cashflow. That focus is primarily driven by the belief that the value of a business over time is ultimately determined by the free cash flow that it's able to generate over time, but it's also supported by the empirical evidence that exists that free cash flow generative companies, especially in the small cap universe and those with attractive free cash flow yields have tended to outperform over time. But for small cap specifically, when we're thinking about the idea of margin of safety, we're not just thinking about the potential return or how cheap an asset might be relative to the midpoint in terms of the potential outcomes.

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We're also very much thinking about that range of foreseeable outcomes and looking to purchase shares when we're forecasting substantially greater upside than downside. So think about that as highly asymmetric risk return or the adage of heads, I win a lot, tails I lose a little. And the wider the range of outcomes for our process, the greater discount we're going to seek when we're thinking about when to purchase shares and similarly how we size positions.

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But, being undervalued is only a part of the investment process. We're clearly looking for businesses where we're forecasting improvement in financial results. Obviously undervalued, but with deteriorating fundamentals is not a particularly good place to focus. And even if the shares look cheap, that's not a place that we're going to spend our time given our belief that the likelihood of underperformance there is elevated. And so in particular, we're looking for companies that we think have the potential for sustainable structural improvements in growth and in profitability as those are the opportunities for substantial positive re-rating and those are investments that have the potential for substantial outperformance.

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We also actually look for companies that grow value over time. We think that in small cap in particular, that's an important point. Good companies that are cheap can stay cheap for extended periods of time even when operating results are okay and thus patience is often very key to capitalizing on mispricing. It might seem unusual for a value investor to have a growth component to their investment process, but if a business isn't growing value over time, we think that the longer you have to wait for the undervaluation to be realized, the lower your annualized returns. And we think that patience in a long-term view is important and one of our competitive advantages in investing.

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And so by focusing on companies that meet our other criteria but that are also growing value over time, that does allow us to be more patient, take a longer term view, seek out things that we think are legitimately meaningfully mispriced. And we think this aspect of our investment process is especially important when it comes to small cap investing and small cap value investing.

Jenna Dagenhart (00:24:32):

Mark, why do you believe small cap value stocks continue to offer inefficiencies for active managers in today's increasingly algorithmic and information rich markets?

Mark Roach (00:24:44):

Yeah. So I think the algorithms made large caps efficient, not necessarily small caps. I mean, down at the bottom of the market coverage is thin and if you just buy the index, you're obviously buying the unprofitable right along with everything else. The thing for us is our edge was never about having better information. It's about behavior. Markets are really good at pricing in human biases and we built the process to take advantage of devices. The quant screen is just, what, we talked about, the VMQ, is the cost of entry. Everybody's got one. And so the edge is three decades of knowing the difference between a stock that's cheap for a reason and one that's temporarily hated. That's the part a screen can't do.

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But I will say the advent of technology, there is a lot of new powerful ways to be efficient and capture trades based on what the market believes and you have to really look for it. So I think there's a real powerful system that we use, which is just natural language processing on all the news, whether it's from China, whatever, it's all getting fed into us and what the market is actually thinking. It's a real powerful source of alpha.

Jenna Dagenhart (00:26:01):

Nathan, anything you'd like to add to that before we move on to the next question?

Nathan Moser (00:26:06):

I think it's quite interesting to do that work from a natural language processing approach. I guess my question would be, how does it consider market structure changes? I think that's an area that's quite interesting as the market has evolved over the last couple decades. Do you think the efficiency of that approach still holds merit?

Mark Roach (00:26:31):

Absolutely. And I guess for me, I can give a couple examples right back in the dotcom bubble, I was reading 10-Ks and 10-Qs and again, if I wasn't picking the right ones, I was lost. If I miss the 10 bagger and I only get a two bagger, that means something. And so right now what we can see is exactly. So fast forward, we do the great financial crisis, same thing, we're just doing all the same work. In 2016, it became very powerful and that's because ChatGPT and some of these other things were coming around, probably closer to 2020, but we started looking at natural language processing and I was coding a bunch of it.

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But to keep it short, one of the things we did was, I mean, there's a couple of them. One, inflation is transitory. We took all of our earnings calls, put them into a natural language processing and 78% of all of our calls on the Russell 2000, 70% of the time they were talking about raising prices. That was it. So we knew that this was not transitory. Then you go fast forward to the first part of 2026 where we were looking at the K economy and we saw that with many of our tools and what we also found was that, hey, the consumer's in not a good spot, but everybody was saying the consumer's going to come back, they're going to start spending money, spending money and they never did in the first quarter.

(00:28:02):

Now they've done a little bit better recently and we saw that as well, but here's ... We talked about the technology. The technology was the same thing. We saw that as well. It's a great way to understand where the regimes are changing and where possible trades are. It doesn't mean you're going to get the answer right. It just means it's a tool that helps us identify where there might be a bias in the marketplace. And if we're right, again, it's still, we're not quants. We have a quant front end, everybody's got that to kind of drill down everything and then it just comes down to us saying, "Hey, let's look at the narratives and see what's happening right now."

Jenna Dagenhart (00:28:43):

And Mark mentioned inflation, which made me think of this. Nathan, how are you positioning the portfolio in today's macro environment, including geopolitical and inflation risks? Because we're still hearing a lot about inflation and the risk there.

Nathan Moser (00:28:59):

Yeah. So in terms of our positioning, we've been taking profits in some of those companies where we think valuations have become less attractive and redeploying. So our approach is not value, it's not growth, it's a core approach to small cap investing. So we're willing to pay out for high quality companies. We're willing to position the portfolio in those companies that are growing quickly, but we don't want to overpay for those. And so what we've seen in some of our holdings is they've gotten to levels where we think they're at full and fair valuations. In the short term, our expectation is that markets could be volatile. So as you mentioned, geopolitics, inflation, there are other concerns around what's going to happen with AI displacing folks from an employment perspective markets a bit over its key. So in the short term, we could see some volatility and as active managers, we look at that volatility as an opportunity to take advantage go and put money to work.

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Maybe one last point specific to the geopolitical and inflation concerns, our expectation at Impax is that these settle down in the coming months and that will serve as a key catalyst for small caps to outperform. The way I look at it is if we get a resolution in Iran, you'll see energy prices come down that will lower the inflationary pressure with the combination of the economy slowing likely in 2027, we'll see the Fed able to lower interest rates. All of those will be quite supportive to small cap.

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So while the market may be choppy here in the near term, I think it's key for investors to remain positive on smaller companies over the long term.

Jenna Dagenhart (00:30:49):

And you mentioned Fed policy. Chris, how does the level of interest rates impact small cap stocks?

Chris Parker (00:30:57):

Sure. So interest rates are one of obviously many factors that influence the performance of equities overall and small cap equities. I would echo Nathan's point that those influences are typically short term in nature, so we're not talking about longer term factors. For small cap equities in particular, that impact from interest rates tends to come through two primary transmission mechanisms.

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So first, small cap companies do tend to have a tighter linkage to changes in the domestic economy and domestic economic activity than many large caps. So they have a higher beta to the economy to the extent that interest rates rise to the point that it slows economic activity. So that would be the Fed taking fairly aggressive action to constrain inflation in this particular point. I mean, that can cause revenue growth and earnings growth for small caps to slow more than large caps for a period of time. We do, I think like Nathan mentioned, we view those more as temporary slowdowns and we think more about the long run growth and earnings power for small caps and in particular small cap earners as being very competitive.

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Secondly, small cap companies do tend to have as a group a higher degree of financial leverage. And so in some cases that debt is also short term and oftentimes floating in nature. So when you do have interest rates that increase by a noteworthy amount, that interest burden obviously increases and does adversely impact earnings growth for small caps. So we're at a pretty interesting environment, I think, from the perspective of interest rates. We've seen an acceleration in inflation due in part to energy prices and impacts from the conflict in the Middle East, some other factors as well. We also do have a new Federal Reserve chair and so that sort of a change in leadership, if you will, can inject some uncertainty into markets. I think we're seeing that.

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But we try to remain very cognizant of the idea that short term impacts such as the direction of interest rates and sell offs or volatility that that can create are realistically more opportunities to take advantage of the dispersion and the dislocations that that can create for individual securities. And we tend to view those more as times to take positions that are going to generate excess return and generate alpha for our investors.

Jenna Dagenhart (00:33:51):

Mark, how could Federal Reserve policy influence small cap valuations and performance over the next 12 to 24 months?

Mark Roach (00:33:59):

Yeah. So the rate cut tailwind everybody penciled in for this year, it's not going to happen. The Fed's on hold, the markets are holding up, inflation is sticky and so is the job market. And so the next move is more likely up and down. But that's exactly why this is a stock pickers market and not an index market. So I really think that we don't necessarily need it as a way to make alpha here, but I think that the reason that small caps are so rate sensitive in the first place is that again, what we've talked about is the 40% of a Russell that carries floating rate debt and they're not making any money. Those are the names that need cuts to survive. We don't own them. Sure, will they cuts help? Perhaps.

(00:34:52):

But that might be in terms of the narrative that I'm seeing, that might be something that the market doesn't like because they think inflation is going to be here for a little bit longer. But you've got the consumer that is not spending a lot of money anymore, they're in a K economy. So there's a lot to kind of walk through and I think if the Fed makes a mistake on rates going up or rates going down, it's going to be tricky and I think they stay put for a much longer period of time. I think that's going to be good for us as stock pickers.

Jenna Dagenhart (00:35:29):

And looking at the full picture, Nathan, what role should small caps play in portfolios today and how should advisors approach them?

Nathan Moser (00:35:39):

Yeah, again, I think the role they play is as a diversifier. So you can lower potential risk by spreading your bets outside of areas of the market that have become crowded. And so I would encourage folks to think more broadly, and that can be done down market cap. It can be done looking outside the United States, obviously our preference is down market cap where we just need valuations that are too attractive to ignore. So from an advisor standpoint, when you've had portfolios and large caps perform as well as they have, you're likely overweight relative to traditional asset allocation metrics. And so as you rebalance, it's important to think about those areas that the market is not paying attention to because increasingly it's our view that they will pay attention to those and they can move quite fast.

Jenna Dagenhart (00:36:30):

Mark, what do you believe the current macroeconomic environment is favorable for small cap stocks moving forward?

Mark Roach (00:36:38):

I think there's three things and, for us, I don't think we need the Fed. First valuation, small caps are trading at around 18 times earnings versus 22 to 24 of the S&P 500. That's about as wide as gap as we've seen. Second, earnings are inflecting. Small Cap Quality Index is projected to grow earnings around 21% this year. And third, the fiscal piece, the new tax law that kicked in, full expensing on equipment and research and development, which is aimed right at the capital heavy small caps. So if I'm talking about rates, I know it's the elephant in room. We don't need cuts. The Feds on hold if anything for the next move is probably a hike, not a cut if they're going to do something this year. But for us, that's not a problem. It's a filter. I mean, the companies that need lower rates to survive are levered in losing money, we don't own those. And so to play this, our hand, what we look for is strong balance sheets anyway, so that's going to help us with picking stocks.

Jenna Dagenhart (00:37:40):

Nathan, what would you say are the key risks that could impact the small cap outlook?

Nathan Moser (00:37:45):

Yeah. So I think the key risk to remember for folks is that small caps are exposed to the domestic economy. So to the extent that you fear that we're going to enter a recession, that would be a key concern and would likely lead to the underperformance for the asset class. And so when I think through potential shocks to the system, you have to start with energy. Markets expect that there will be a resolution in the Middle East. If that assumption is incorrect and we see a surge in energy prices, it'd have to be a meaningful surge, but it's always possible. You could see a real growth impact to the US as well as the global economy. So I think recession risk in that scenario would increase.

(00:38:34):

The other issue that's getting a little bit less discussion these days, just given with all the noise in markets is around employment. Obviously AI is changing the world just like the internet did. There is the potential and again, I don't know if it's the base case, but there is the potential that we could see a period of higher unemployment and potentially significantly higher unemployment, which could lead to a recession as well. So that's something to monitor.

(00:39:03):

Again, when investors start to talk about these issues, they find their way into valuations. So there is a greater than 0% chance that we have some negative event, but if your valuation at your starting point is cheap enough, it's low enough, then that the odds are skewed in your favor. And again, as quality investors, if you're buying companies with good balance sheets that are generating strong and predictable free cashflow that have solid management teams, you should be able to weather any near term volatility or near term concerns.

Jenna Dagenhart (00:39:37):

And Mark, why should advisors consider increasing small cap exposure now rather than waiting? What are the biggest risks remaining on the sidelines?

Mark Roach (00:39:47):

I think because you almost never get cheap price and the catalyst at the same time and right now you've got both without needing the Fed like we talked about earlier. And so the trouble with waiting is that small caps turn fast, so they're not going to wait for anybody. And it's obvious you don't want to miss that first leg. And honestly, the real risk of sitting on the sideline isn't missing a rate cut, it's sitting in expensive large cap concentration with pretty high earnings and PEs, while the cheapest, fastest growing part of the market re-rates without you. And if the market ride gets bumpy on the way, our downside captures about 73% versus the benchmark. And as I said before, not blowing up matters just as much as picking winners.

Jenna Dagenhart (00:40:38):

And Nathan, you emphasize a quality approach. How do you define quality within the small cap universe and why is it especially important now?

Nathan Moser (00:40:48):

Yeah. So as I mentioned before, quality is, a lot of folks have sort of different definitions, the way I think about it is breaking it down into a couple core pieces. So you start with the balance sheet. It's important for investors and for companies to have balance sheets that can fund their future growth. I think it was mentioned earlier in this conversation when times get tough, access to capital tends to be cut off first for small cap.

(00:41:20):

So our approach at Impax is to invest in companies that have that strong balance sheet and the ability to withstand any volatility. The second thing is really around free cashflow generation. Again, a lot of small cap companies don't have positive free cashflow. Those that do have options to create shareholder value. You can use that free cashflow to invest in your business, you can use that free cash flow to acquire other companies, or if your stock is too cheap, you can repurchase those shares. So we are quite attracted to companies that have strong and predictable free cashflow.

(00:41:59):

And then lastly, the management teams are incredibly important. At large cap companies, you have several, if not dozens of senior members of the management team that are driving the performance of a company. For smaller companies, it really comes down to just a handful of key individuals. So our preference is for those management teams that understand the short-term needs of Wall Street, so that's setting realistic expectations, but those teams that are focused on really driving long-term shareholder returns. At Impax, we care deeply about sustainability. And so we are attracted to those management teams that understand the risk and the opportunities related to sustainability and we try to position our portfolio to benefit from those.

Jenna Dagenhart (00:42:52):

And Nathan, going back to you, small caps are a very diverse asset class that goes without saying, how do you differentiate between high quality businesses and the rest of the market?

Nathan Moser (00:43:05):

Yeah, it's a wonderful place to be an investor. They're not only diverse, but there's so many of them. There's more than 2,000 plus companies that we could potentially invest in. And so that creates the opportunity for those that are willing to look for the hidden gems amongst the thousands of companies. Our process incorporates a combination of proprietary tools, which helps us narrow that investible universe so that the team and I can really focus our diligence or our research efforts. These tools include the analysis of a company's financial attributes. We spend a lot of time considering their competitive positioning. We're quite attracted to companies that have a product or service that can grow regardless of the economy. And as I mentioned before, we're looking for those companies that are in industries that have sustainability related tailwinds.

(00:44:05):

Our approach is quite concentrated. So we're running 50 to 75 companies. And so that allows us to really get to know our companies well, to know the management teams, to make sure that they're well aligned with us as investors. But importantly, by running a concentrated strategy, it allows us to be very selective with ideas as they work through our process. We're more likely to throw an idea out and not invest in a company than we are when we start the process. So again, it's a wonderful opportunity set for active managers with a disciplined approach and we think it creates the opportunity for long-term risk adjusted returns.

Jenna Dagenhart (00:44:48):

And Chris, with your fund being a small cap value fund, how do you avoid value traps?

Chris Parker (00:44:54):

Sure. I think one of the other participants talked about avoiding large losses is particularly important in terms of generating attractive outcomes for investors in small cap value asset class. There are a number of different pieces of our process that are really designed to help us avoid value traps. To me, the first thing is the focus on quality, the focus on companies that have free cash flow generation, have a demonstrated track record of earnings power, have a demonstrated track record over time of generating an excessive cost of capital. That does give you a sense that there's something positive in terms of what you're starting with. If you're looking at a company with those attributes that's maybe in the midst of some challenges or in the midst of some question marks, if you will, about long-term positioning, which is often where we find value traps.

(00:45:58):

Beyond that, the first component, quite frankly, is the degree of due diligence that we perform. We do run a concentrated portfolio, it tends to be 50 to 60 names. And so we do spend a lot of time digging into the companies that we're dealing with to understand what's going on at a very deep level of the business, the industry, what are the factors that maybe are creating challenges, that are creating uncertainties, to understand the plan that the management team might have in place to address those and does it squarely focus on the areas where there are challenges and then also what's the background and the capabilities of the management team to execute that plan?

(00:46:47):

I would echo Nathan's point that in small cap, understanding the management teams that you're investing in is a hugely important factor. The dispersion in terms of quality of management teams and capability to execute is quite wide in the space. So in particular, when we're looking at challenged businesses, that aspect is especially important. I think one of the other aspects, at least of our process is we're looking for improving businesses. And so as it relates to companies that are potentially going through turnarounds, we try to be pretty patient and we're willing to wait until we see clear signs of progress in terms of key aspects of that turnaround. There is enough inefficiency in the small cap space that if you've done the due diligence and you've done the work and you understand what the management team is trying to execute and what the KPIs are, that you will be able to notice those in many cases and see that there's actual turn that's occurring and mitigate the substantial risk of loss and capitalize on those types of opportunities.

(00:48:07):

And then I would just also go back to the idea of within our approach to valuation and to undervaluation, we really do try to drill down into what adverse scenarios look like and what those look like in terms of the valuation of the business if things do go wrong to give us a much clearer sense of how much bad news potentially is priced into some of these potential turnarounds or companies that are facing challenges so that we can calibrate the idea of when things are starting to improve with how much is priced in and make a really informed decision as it relates to those types of investments.

Jenna Dagenhart (00:48:54):

And Mark, how significant is today's valuation gap between small caps and large caps and what opportunity does it create for investors?

Mark Roach (00:49:04):

I mean, I do think that small caps ... And we've talked about this over the course of this podcast. And so yes, I think the valuation smart caps are trading around 18 times versus 22 to 24. We talked about that good, strong earnings growth coming in. So I think the next couple of years, I agree we are going to see a small cap revolution that might last more than two years. It'd be the first time since probably the dotcom bubble when we finally saw that it could be something that long. That was probably about three years, but nonetheless, I think the outlook for small caps are good.

Jenna Dagenhart (00:49:51):

Nathan, where specifically are you finding the most compelling opportunities across small caps?

Nathan Moser (00:49:57):

Yeah. So we're seeing real opportunities within the healthcare sector. Healthcare is from a sector perspective, very similar to small caps. It's had several years of underperformance versus the market. As a result, there's this compelling valuation opportunities. I, when I meet with clients, tell them that we are finding more interesting healthcare companies to invest in, then we have room for them within the portfolio. And so drilling down a level where we're most excited is around biotech and medical devices. These are areas that are really offering investors strong potential growth and also solving some unmet clinical needs, so benefiting society as well. Outside of healthcare, we like the financial sector. We have strong exposure to the asset managers, which have benefited from strong and robust capital markets, but we really are finding that the banks have been a bit left behind in this market that's been focused on technology and everything AI related.

(00:51:08):

So what's about the banks is they're not only cheap, but they're going to benefit from deregulation. They're going to benefit from increased merger and acquisition activity. They are beneficiaries of a stable economy. And what they offer investors is reasonable return expectations with very modest risk. So if you think about it from a risk adjusted perspective, investing in banks provides a diversified portfolio of some ballasts. And so those are a couple areas that we're quite excited by.

Jenna Dagenhart (00:51:45):

Mark, we touched a little bit on this earlier, but how might small cap companies benefit from the growth of artificial intelligence even if they aren't building the AI models themselves?

Mark Roach (00:51:56):

Yeah. I mean, obviously it's the big guys that are building it, but I think the productivity gains, I think those are going to go to the companies using it. So for us, it's something that we would call a self-help story. So AI shows up as fatter margins and better productivity and our narrative work points us right at them. The picks and shovel names, industrials, utilities, communication services where you can see belief and price climbing together on something real. We're not necessarily buying chip makers. We did have a couple in the beginning of the year, but as good value managers, we were trimming them up as they were going up 50, 60, 80, 100%.

(00:52:42):

So we're not making some big AI bet. Our process just keeps surfacing these as margin stories. And these are the types of stocks that we call potential compounders and those are stocks that we want to have in our portfolio for two, three, four, five years. We've seen several of those over the time of running money since 1995 and those are fun to have in your portfolio for sure.

Jenna Dagenhart (00:53:09):

Certainly. And Nathan, innovation is a theme that comes through in your process. How are you seeing that play out across sectors beyond traditional technology?

Nathan Moser (00:53:18):

Yeah. So AI has definitely captured the attention of investors and we see in the market on a daily basis that companies exposed to that theme are really seeing very strong growth and very strong share prices. We're taking the approach of looking forward and trying to figure out where the puck is going. And so I think investors will increasingly look for companies that are leveraging that technology to improve their business or the creation of new companies and industry.

(00:53:51):

And so one of those areas, and I alluded to this before, was biotech. Biotech is using AI, especially at early stage drug discovery companies. They're using it to help improve the success rate of new compounds and that has a real potential to change these business models. The drug discovery process and the clinical research that is needed to take a compound through all the levels of testing and through to potential FDA approval can be many years. To the extent that we can shorten that through the use of AI or we can increase the hit rate can change the return outcomes for these businesses.

(00:54:36):

And then one other area that we have exposure to within the portfolio is around autonomous driving. That touches a few companies within the portfolio, but again, wouldn't be possible without the increases in technology related to compute and AI. So again, I guess the key point would be at some point the market will move beyond those companies building out the models and infrastructure towards those companies and those industries using the technology to improve their business.

Jenna Dagenhart (00:55:07):

Nathan ... Or Mark, rather, anything you'd like to add to that?

Mark Roach (00:55:12):

No, it's great. We've done something similar. We took a look at healthcare and we first found that it was very difficult to pick stocks in small cap land for biotech and pharmaceuticals with drugs, but we also went and looked at a couple ways to create alpha there. And so we've been building some models and we're testing them now. So to be continued, I guess, is where we're at, but it's been very promising. We've put a couple in and they've worked and one didn't. And so we're still tweaking it a little bit here and there.

Chris Parker (00:55:53):

Jenna, if I can join the point that Nathan was making in terms of we're starting to move beyond the idea of first order AI winners and second order AI winners into those who are going to be applying AI to their businesses with the idea of higher quality, better managed companies across the small cap universe, that's the cohort that the management team is more likely to adopt more quickly, we believe, some of those tools has a better capability and ability to then drive those into their business and understand how to utilize those strategically to improve efficiency, to improve competitive position and will oftentimes have the cashflow and the earnings capability to invest in that if needed to expand their competitive moat or to expand the competitive gap relative to some of their peers.

(00:57:00):

And right now we're not at a point, I don't think, where the market is really focusing on those types of opportunities. They're not quite as flashy or as interesting, but to Nathan and Mark's point, eventually that will unlock improved earnings power for the companies that are more effectively able to utilize that. And that's where we're spending a lot of time in terms of allocating our research effort and allocating some of our capital within the portfolio.

Jenna Dagenhart (00:57:33):

Certainly. And I guess summing up our discussion today, Mark, if you had one minute to make the case for small caps in 2026, what would be the three strongest reasons to own the asset class today?

Mark Roach (00:57:49):

I think it's pretty simple. They're cheap, widest valuation gap in quite some time. The growth that we saw are going to see this year and that you don't really want to be buying the index because you're going to be left behind with the 40% of those stocks being junk and non-earners.

Jenna Dagenhart (00:58:09):

Nathan, anything you'd add to that if you had to sum up the case for small caps in 2026?

Nathan Moser (00:58:16):

Yeah, I would add that they are still very much under owned by the investing public. And if you look at the available market cap to invest in, it's quite small. So just one statistic maybe the entire Russell 2000 Index is less than the market cap of the largest company in the Mag Seven. And so to the extent that investors start to rotate and move down market cap, small caps have the ability to effectively levitate. And so our advice to clients and to listeners has been that you want to start moving ahead of that. It's very hard from a behavioral perspective to chase. We've had one year of outperformance of small versus large. Surprisingly, some of our clients and prospects are not aware of that. The media has not been focused on small, but we think if a couple things go right here that small caps could have a significant move on a relative basis. So we're advising folks to really start to look at their allocation to the asset class.

Jenna Dagenhart (00:59:26):

And before we let you all go, I want to go around and gather some final thoughts. That was a really great statistic you threw in there, Nathan. Mark, any stats or final thoughts or final words you'd like to leave with our viewers today?

Mark Roach (00:59:41):

No, I think we've got a strong setup. So our VMQ gets us on second base, we have a great hitting average of getting on base. And then for us, it's all about finding the biases in the market and taking advantage of them. And I think there's a lot ... Of opportunity with that natural language processing to really help drive alpha. It's that, it's the self-help stuff, it's margin expansions. I think it's going to be an exciting time to be a small cap manager.

Jenna Dagenhart (01:00:14):

And incorporating the behavioral finance, as you mentioned earlier.

Mark Roach (01:00:17):

Yes, absolutely. So yeah, behavioral finance is really what it's all about for us. It's funny because when we started seeing this data, it wasn't just like a couple hundred basis points of alpha. It was 1,000 basis points, 2,000 basis points. I mean, once you get those things right and you see it, you just can't un-see it.

Jenna Dagenhart (01:00:40):

It is. Nathan, I'll give you the final word today.

Nathan Moser (01:00:46):

Yeah. So just for advisors that have watched this, I think we've had a pretty robust discussion about the reasons to invest in the asset class. I think maybe making it very simplistic for folks. I think of owning small caps in a portfolio makes sense from a diversification standpoint. So when we look at the market with its significant concentration, that represents potential risk. Very hard to know when that trade unwinds, but as an advisor who's managing assets for your clients, I think it's important to make sure that portfolios are broadly diversified. And what's nice about small caps is it enables you to achieve that diversification. There are more exciting companies outside of AI related fields to investigate. Big active managers have that ability to find those exciting companies. And so I would agree with the previous sentiment, you want to be an active manager in small cap. The index is low quality by definition and those managers that have the skill and the ability to add alpha are the ones where you should be looking to allocate.

Jenna Dagenhart (01:01:55):

Well, Mark, Chris, Nathan, thank you all very much for being with us today and thank you to everyone out there watching.

(01:02:00):

Once again, I was joined by Mark Roach, director of Small and Micro Cap Equities at CS McKee and lead portfolio manager of the North Square Small Cap Value Fund at North Square Investments. Nathan Moser, senior portfolio manager at Impax Asset Management and Chris Parker, senior portfolio manager of Thrivent Small Cap Value ETF at Thrivent Asset Management. And I'm your host, Jenna Dagenhart with Asset TV.

Principal Risks of Investing, North Square Small Cap Value Fund: Risk is inherent in all investing, including an investment in the Fund. An investment in the Fund involves risk, including the following principal risks, among others: Market Risk, Equity Risk, Value-Oriented Investment Strategies Risk, Management and Strategy Risk, Small-Cap-Sized Company Risk, Foreign Investment Risk, Valuation Risk, Sector Focus Risk (Financials Sector and Industrials Sector), Preferred Securities Risk, Convertible Securities Risk, Fixed Income Securities Risk, High Portfolio Turnover Risk, Cybersecurity Risk, and Reliance on Technology Risk Summary descriptions of these and other principal risks of investing in the Fund are set forth in the Fund’s prospectus. Before you decide whether to invest in the Fund, carefully consider these risk factors associated with investing in the Fund, which may cause investors to lose money. There can be no assurance that the Fund will achieve its investment objective. An investment in the Fund is not a deposit of a bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Please see the Fund’s prospectus for additional risk disclosures.

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Diversification does not assure a profit, nor does it protect against a loss.

Definitions of terms used in this podcast:

Earnings growth is the percentage increase in a company's net income (profit) over a specific period.

The **Purchasing Managers' Index (PMI)** is an economic indicator that assesses the business environment by surveying purchasing managers at private-sector companies about their expectations for orders, production, employment, and supplier deliveries.

The **price-to-earnings (P/E) ratio** measures a company's share price relative to its earnings per share (EPS). Often referred to as the price or earnings multiple, the P/E ratio helps assess the relative value of a company's stock.

Free cash flow yield (FCF) is a valuation metric that measures the cash a company generates relative to its share price. Calculated as FCF per share divided by the current share price, it indicates the percentage of an investment that is returned as free cash flow each year. Free cash flow is the cash a company has left over after paying for its operating expenses and capital expenditures—investments in physical assets like property and equipment. It is the true discretionary cash available to pay dividends, reduce debt, or to reinvest in the company.

Enterprise value to EBITDA (more commonly referred to by the acronym EV/EBITDA) is a popular valuation multiple used to determine the fair market value of a company. By contrast to the more widely available P/E ratio (price-earnings ratio) it includes debt as part of the value of the company in the numerator and excludes costs such as the need to replace depreciating plant, interest on debt, and taxes owed from the earnings or denominator.

The **S&P 600** (Standard & Poor's 600) is a stock market index maintained by S&P Dow Jones Indices that tracks the performance of 600 small-sized U.S. companies. Constituents of the Index typically have a market capitalization between $1.2 billion and $8 billion at the time of inclusion

The **S&P 500** (Standard & Poor's 500) is a stock market index weighted by market capitalization that is made up of 500 of the largest public companies in the United States. Covering approximately 80% of the total U.S. equity market value, it is widely considered the premier benchmark for the broader American economy.

A **basis point** (often called a "bip" or "bps") is a standard unit of measurement used in finance to express percentage changes in interest rates, bond yields, and investment fees.

The **Russell 2000® Index** is a stock market index that measures the performance of approximately 2,000 small-cap U.S. companies. The Russell 2000 represents the smallest two-thirds of the broader Russell 3000 Index and serves as a primary benchmark for tracking the health of smaller, domestically-focused American businesses.

The **Russell 2000® Value Index** is a prominent U.S. stock market index that tracks the performance of 2,000 smaller companies in the broader Russell 3000 Index, offering a comprehensive view of the small-cap sector. It is not possible to invest directly in an index.

The **Russell 3000® Total Return Index**, the Fund's primary regulatory benchmark index, measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equities.

Value Momentum Quality (VMQ) is a factor-based quantitative strategy combining three primary investment styles in an effort to identify market-beating stocks.

Active Share measures how much a mutual fund's portfolio deviates from its benchmark index. High Active Share indicates divergent holdings from the benchmark, suggesting active management.

Alpha represents the excess return of an investment strategy compared to its benchmark index, after accounting for risk.

The **margin of safety** is a tenet of investing by which an investor purchases securities only if they're trading below their intrinsic values by a certain amount.

a "**K**-shaped **economy**" in which higher-income households experience faster growth in spending than lower-income households.

Beta is an indicator of the price volatility of a stock or other asset in comparison with the broader market. Beta suggests the level of risk that an investor takes on in buying the stock. The higher the beta number, the higher the risk.

A "**Small Cap Quality Index**" such as is a financial benchmark designed to track smaller companies that exhibit strong fundamentals, robust balance sheets, and consistent profitability, rather than just market size. A classic example is considered to be the MSCI USA Small-Cap Quality Index. This index tracks US companies with market values below a few billion dollars that meet strict "quality" metrics: low debt-to-equity, consistently high returns on equity (ROE), and stable year-over-year earnings

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