



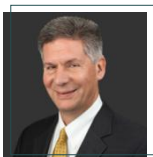
# EMERALD DIVERSIFIED SMALL CAP GROWTH

## CORRECTION IS HEALTHY

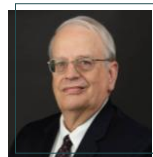
**THE MARKET ENTERED 2026** with significant momentum. Domestic economic growth was running above trend and fourth quarter corporate earnings and initial guidance for 2026 were broadly better than expected. Equity market returns as a result were broadening, reflecting growing confidence that economic momentum was set to continue as the benefits of the One Big Beautiful Bill—rising capital expenditures, consumer tax refunds, deregulation, lower interest rates, waning tariff pressures and rising productivity were coalescing to provide tailwinds to economic growth. Optimism abounded as represented by the AAI Investor Sentiment Survey, a measure of investment sentiment, which reached a 1-year high in Bullish sentiment at 49.5% for the week ended January 14, 2026. Peak bullishness in investor sentiment coincided with peak market returns, with the S&P 500 and Russell 2000 gaining +2% and nearly +10% at their respective peaks in late January. This euphoria proved short lived, as fears of AI disintermediation, tariff restructuring, private credit default risk, and broadening systemic risk to the banking system all served to undermine confidence. Ultimately, it was the conflict in Iran, the subsequent closure of the Strait of Hormuz, surging oil and gas prices, and a dramatic reversal in treasury yields that drove a surge in equity and bond market volatility and forced a significant

### KEY POINTS:

- ***The Emerald Small Cap Diversified Growth portfolio successfully navigated the volatility of the first quarter, posting solid relative performance results and outpacing the Russell 2000 Growth Benchmark.***
- ***Stock selection was at the foundation of the outperformance, as those companies with strong secular tailwinds demonstrated resilience amidst a more challenging and volatile market backdrop.***
- ***At the sector level, the portfolio benefitted from strong relative performance within the industrial, technology, and telecommunications sectors. Partially offsetting this strength was relative underperformance within the cyclical and more rate sensitive areas of the portfolio including the financials, energy, consumer discretionary, consumer staples and healthcare sectors.***
- ***As we enter 2026 the portfolio currently holds the largest active exposures in the technology, financial, and consumer discretionary sectors.***



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degrossing in equities. March was by far the worst month of the quarter, with broad market returns falling well into negative territory with the Russell 1000 (-4.97%), Russell 2000 (-5.00%), and Russell 3000 (-4.97%) each posting mid-single-digit negative returns for the month. While we hesitate to call a mid-single-digit decline a victory, we believe the Russell 2000's relative resilience in March is particularly noteworthy given all the headwinds outlined above. Performance for the full first quarter of 2026 was similarly a standout, with the Russell 2000 (+0.88%) total return substantially outpacing that of the Russell 1000 (-4.18%). The broadening of the market was evident, with the Russell Microcap (+1.49%), Russell 2500 (+2.04%), and Russell Midcap (+1.29%) each outperforming the Russell 1000.

From a style perspective, the value indices of the Russell outperformed by a wide margin across all market capitalizations, driven in part by rising oil prices and the strong performance of the U.S. energy sector. Within the Russell 2000, the Value Index gained +4.96%, while the Growth Index declined by -2.81%. The energy sector of the Russell 2000 Value gained +35.34% and contributed more than 240 basis points to the benchmark return, according to FactSet. Conversely, within the Russell 2000 Growth benchmark, the energy sector gained a strong but more modest +26.53%, contributing +81 basis points to the index's total return. While absolute energy sector exposure and performance certainly had an impact to return amongst the styles, sector returns across the Russell 2000 Growth Index broadly lagged their value counterpart, with the exception of the telecommunications and basic materials sectors.

Specific to the Russell 2000 Growth, strength within the energy sector was complemented by gains in telecommunications (+11.71%), basic materials (+10.83%), and industrials (+4.01%). Conversely, the technology sector (-13.51%) saw pronounced weakness, as did sectors more sensitive to interest rates and credit fears, including utilities (-14.32%), healthcare (-6.44%), and financials (-5.90%), all of which were meaningful laggards.

There are also notable trends when examining the distribution of returns by characteristics/factors. According to an April 1,

2026 report from Steve DeSanctis, Equity Strategist at Jefferies, companies with market capitalizations above \$1 billion (+32 bps), and those in the highest ROE quintiles (quintile 1: +78 bps, quintile 2: +157 bps, quintile 3: +168 bps), led the way, demonstrating solid relative outperformance to the benchmark overall. In contrast, companies with the highest sales growth (-367 bps), highest Beta (-488 bps), and non-earners (-474 bps) lagged. That said, trends beneath the surface and amongst the cohorts of these characteristics remain bifurcated, lacking any clear trend and/or bias.

## PORTFOLIO REVIEW

The Emerald Small Cap Diversified Growth portfolio successfully navigated the volatility of the first quarter, posting solid relative performance results and outpacing the Russell 2000 Growth Benchmark. Although the absolute return for the portfolio was modestly negative, the portfolio outpaced the Russell 2000 Growth Index, which declined -2.80% for the period. Stock selection was at the foundation of the outperformance, as those companies with strong secular tailwinds demonstrated resilience amidst a more challenging and volatile market backdrop. At the sector level, the portfolio benefitted from strong relative performance within the industrial, technology, and telecommunications sectors. Partially offsetting this strength was relative underperformance within the cyclical and more rate sensitive areas of the portfolio including the financials, energy, consumer discretionary, consumer staples and healthcare sectors.

The industrials sector was the portfolio's largest positive contributor to return for the first quarter. Those companies with exposure to the commercial aerospace supply chain, both maintenance & repair and new build, the data center infrastructure buildout, and growing investment in power infrastructure were the largest contributors to the portfolio's performance. At the industry level, the portfolio experienced relative outperformance within the aerospace, building: climate control, engineering and contracting, diversified industrials, and construction industries.



Stock selection within the technology sector was a key driver of the portfolio's relative outperformance for the quarter. Companies benefitting from the AI infrastructure buildout, defense-related capital spending, and an accelerating semiconductor capital investment cycle provided a thematic tailwind, with the electronic components, computer services, and production technology industries delivering the largest positive contributions to return. The portfolio's relative underweight position to the software industry and positive stock selection also contributed positively to performance.

Emerald's portfolio benefited from its exposure to the telecommunications sector, particularly within the telecommunications equipment industry, as artificial intelligence-driven capital expenditures provided a strong boost to companies supplying lasers and optical components for telecom and datacenter applications.

Partially offsetting the positive contributors to portfolio performance outlined above, was stock selection driven underperformance within the financials, energy, consumer discretionary, consumer staples and healthcare sectors.

The financial sector was the portfolio's largest source of relative underperformance as stock selection within the bank, investment services, consumer lending and insurance industries weighed on relative performance. The parabolic move in treasury yields, rising private credit concerns, AI-disintermediation and surging oil and gas prices weighed heavily on the financial sector and Emerald's more growth-oriented holdings. This was similarly true within the consumer discretionary sector, where stock selection within the restaurant, household equipment, household furnishings and diversified retail industries detracted from performance.

Emerald's holding and positioning within the energy sector also detracted from performance. The energy sector of the Russell 2000 Growth Index posted extraordinarily strong performance, gaining +26.53% reflecting the surge in oil prices and the potential for persistent intermediate term supply disruptions. Given the significance of the move and sizeable outperformance to the balance of the index,

Emerald's underweight position and stock selection proved to be a headwind to portfolio performance.

The healthcare sector of the portfolio also faced challenges, primarily as a result of stock selection within the pharmaceuticals, medical services, and medical equipment industries.

As we enter 2026 the portfolio currently holds the largest active exposures in the technology, financial, and consumer discretionary sectors. Thoughts on those sectors and other notable areas of exposure are highlighted below.

- The technology sector, as of quarter-end, was the portfolio's largest relative overweight position. The composition of the sector exposure remains diversified with holdings within the semiconductor, production technology, electronic components, computer services, software and consumer digital services industries. Of these, the semiconductor, electronic components and production technology industries represent the largest absolute weights. Portfolio positioning continues to evolve as the opportunity set changes and while the portfolio remains overweight the semiconductor industry, the largest relative overweight positions are now held within the production technology and electronic components industries. Within the production technology industry we have increased the portfolio's exposure to semiconductor capital equipment companies positioned to benefit from the meaningful upward revisions to capex plans from the prominent memory and foundry/logic vendors. The portfolio also remains overweight the electronic component and semiconductor industries with an emphasis on companies participating in the growth in AI infrastructure, defense modernization and replenishment, and RFID, as well as those companies positioned to take advantage of a broader cyclical recovery in the industrial and consumer end markets. Further, although sentiment surrounding software stocks continues to be pressured by



concerns over AI-disintermediation and the commoditization of point solutions, middleware and subscale platforms, we remain focused on niche opportunities within cybersecurity, and vertical software where domain expertise, first-party data, and the ability to build embedded workflows create defensible positions over time.

- Emerald continues to hold an overweight position in the financial sector driven by holdings within the banking, insurance, asset management, investment services and consumer lending industries. The portfolio has the largest nominal exposure to the banking industry. We are particularly optimistic regarding the outlook for the banking industry. In 2025, the number of U.S. bank M&A deal announcements reached 182 deals announced, up about 37% from the 133 announced in 2024, and the highest annual total since 2021, according to data from S&P Global Market Intelligence. We expect announcement momentum to continue through 2026, resulting in multiple expansion across the industry. At the same time, we believe greater than expected loan growth, a positive sloping yield curve resulting in further rate cuts from the Federal Reserve, and an easing regulatory burden will have positive implications for earnings growth and bank stock performance.
- The portfolio also ended the quarter with an overweight position in the consumer discretionary sector. Exposure to the consumer sector has grown in recent quarters, reflecting an expanding opportunity set across airlines, apparel, auto, casinos, consumer electronics, home furnishings, retail, entertainment, restaurants and recreational services. While the recent surge in oil and gas prices and the upward pressure on treasury yields has pressured the sector, we believe the consumer will ultimately prove, yet again, more resilient than feared and remain optimistic regarding the

idiosyncratic opportunity for each of the individual holdings that comprise the sector exposure.

- The healthcare sector represents a large nominal exposure within the portfolio, although the portfolio was underweight relative to the benchmark as of quarter-end. At the industry level, the portfolio currently holds the largest active exposures within the pharmaceuticals industry and the largest nominal exposure within the biotechnology industry. Approximately 50% of the portfolio's therapeutics exposure is in companies that are generating revenue, down from a peak of 80% in the past quarters. Within the medical device and diagnostic companies, we remain focused on the innovators that are driving growth through accelerating utilization and market share gains, and that are profitable or approaching profitability with a strong balance sheet. As we look forward, we are encouraged that financing has been readily accessible for companies within the biotechnology and pharmaceutical industries that are achieving clinical success and presenting quality clinical data. M&A of biotech companies continues as the top 25 pharma companies will have ~47% of their 2025 revenue expected to face generic competition by 2030. Small cap biotech is the drug innovation engine and pharma has enough firepower to acquire the entire small cap biotech universe. Q1-26 was strong but unremarkable from a total dollar value of biotech M&A which would annualize to \$300B for public and private companies combined. This would be the second highest year and come in just short of the all-time record \$328B set in 2019. More importantly, there were 19 M&A transactions with >\$1B upfront in Q1-26. We believe this is a continuation of the trend where 2025 saw a record 35 such transactions. The previous record was 21 biotech M&A transactions >\$1B. We believe that the pharmaceutical companies are likely to continue along this path, looking to pursue a larger number of bolt-on transactions which we believe will provide a



favorable tailwind to the small capitalization biotechnology industry and Emerald's small cap biotechnology exposure.

- The industrials sector is now the portfolio's largest absolute exposure, although the portfolio remains underweight at quarter-end. At the industry level the portfolio's largest overweight is in the defense industry. We believe the portfolio's defense holdings are well positioned to benefit from initiatives to replenish and modernize the global defense industrial base. Investment levels are set to accelerate both domestically and globally. Beyond defense, the portfolio also has exposure to the aerospace industry which continues to benefit from elevated maintenance and repair spending on the existing commercial fleet and the acceleration in new build activity. In addition to the above, the portfolio is also positioned to benefit from the secular investment themes in the AI datacenter buildout, power generation and distribution, reshoring, and advanced manufacturing.

## MARKET OUTLOOK

2026 The pause that refreshes? The strong start to 2026 was interrupted by the building wall of worry (AI disintermediation, private credit risk) and ultimately the conflict in Iran. The tail risk from the closure of the Strait of Hormuz and the residual effect from closed or damaged energy facilities is meaningful. Oil prices are surging and gas prices have breached \$4 per gallon nationally, a historical consumer pain point. The repercussions of the closure of the Strait and surging energy prices are far-reaching and have the market sketching scenarios ranging from a growth shock to stagflation. Consequently, recession probabilities and treasury yields have simultaneously moved higher. At the same time and at least for the time being, high frequency economic indicators have been demonstrating resilience (employment, retail sales, ISM surveys), the Bloomberg Economic Surprise Index is at the highest level in the last year, and earnings estimates have in aggregate been moving higher. As a matter of fact, S&P 500

earnings for the first quarter are expected to grow by ~12% year over year, which is the highest estimate heading into a quarterly earnings season since 2021, according to Peter Oppenheimer at Goldman Sachs. We believe the outlook for corporate earnings growth, the underlying resiliency in economic growth, and the strong secular spending trends in AI, power infrastructure, defense, reshoring, etc. have helped to insulate the market in the face of this very present tail risk to growth. The duration of the conflict remains the largest swing factor, and while the recent announcement of a ceasefire from the Administration sparked a meaningful rally in equities and a selloff in oil and treasury yields, the situation remains fluid and as such the path to a full resolution and a durable reopening of the Strait of Hormuz remains uncertain.

While we acknowledge the risk to growth, and the probability of some residual overhang from the damage done in the Middle East, resolution and/or durable deescalation is still a possibility. As a result and given the path of the economy and corporate earnings growth pre-conflict, it is difficult to get overly bearish. In that regard, we remain of the belief that we are in the early stages of the earnings upcycle for small caps. The flywheel of innovation is in motion, and we believe that both the simultaneous broadening and deepening of multiple secular growth investment opportunities is driving a broad-based acceleration in investment. Artificial intelligence investment is crossing the adoption chasm and AI adjacent themes are proliferating. The reindustrialization of the U.S. economy, datacenter, defense, semiconductors, and broader initiatives to reshore aspects of the supply chain, including critical minerals, are driving a meaningful acceleration in the demand for construction and engineering services and power generation, which is catalyzing a simultaneous acceleration of investment in domestic power infrastructure. At the same time, initiatives to modernize the defense industrial base and rebuild depleted stockpiles are expanding globally. Investments in space/aerospace also appear to be gaining steam. We also continue to see noteworthy opportunities within the longer duration components of the healthcare sector, specifically in biotechnology and medical devices where innovation has continued unabated. Similarly, we believe the multiplier effect from the secular growth opportunities noted above should also



have positive implications for the more cyclically exposed companies within the financial, consumer discretionary and broader industrial sectors. The opportunity set is broad and expanding and that is reflected in Emerald's sector and industry positioning.

Further we continue to believe that the One Big Beautiful Bill (rising capital expenditures, consumer tax refunds), deregulation, waning tariff pressures and rising productivity are poised to provide incremental upside to current forecasts for economic growth. Consumer balance sheets remain in good shape in aggregate, as do corporate balance sheets, and money supply is expanding at a mid-single digit pace. Small capitalization stocks are particularly well positioned to benefit from these factors. We believe the relative resiliency of the Russell 2000 despite surging treasury yields, and heightened market volatility is a testament to the improving earnings outlook. Small cap valuations also remain attractive. The relative valuation of the Russell 2000 to the Russell 1000 currently hovering in the 27<sup>th</sup> percentile, with the Russell 2000 continuing to trade at a double-digit discount to the Russell 1000 on a trailing P/E (non-negative), price to book and price to sales basis, according to an April 6, 2026 report from Steve DeSanctis at Jefferies.

Risks to this narrative are numerous. A "tweet a day" is unlikely to take the volatility away as there remains a high degree of uncertainty related to the duration of the conflict in Iran, the ultimate outcome, and the potential implications to the cost of energy and economic growth. Tariffs also remain a source of uncertainty. In the aftermath of the Supreme Court's revoking of the IEEPA related tariffs, the Administration is scrambling to recreate the IEEPA tariff structure through other available provisions, including Section 301 country specific investigations. While the market generally believes the highwater mark for tariff rates is behind us, there continues to be a risk that the country specific investigations could lead to higher rates in at least some instances. Further, the Federal Reserve's path for interest rates and the market's implied path has continued to be a source of market volatility. In addition, Kevin Warsh is slated to assume the role of Federal Reserve Chair later this year and while Mr. Warsh is well known, the

transition in leadership brings with it its own unique set of potential challenges. The market also remains on high alert for any sign of deterioration in the credit markets, particularly private credit, which has been an area of significant growth over the last few years. 2026 is also a midterm election year. Historically, mid-term election years, particularly in and around the election, have proven more challenging than not.

Emerald as always remains focused on controlling the controllables and utilizing our fundamental bottom-up research process to identify the best growth opportunities within the small capitalization universe.

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