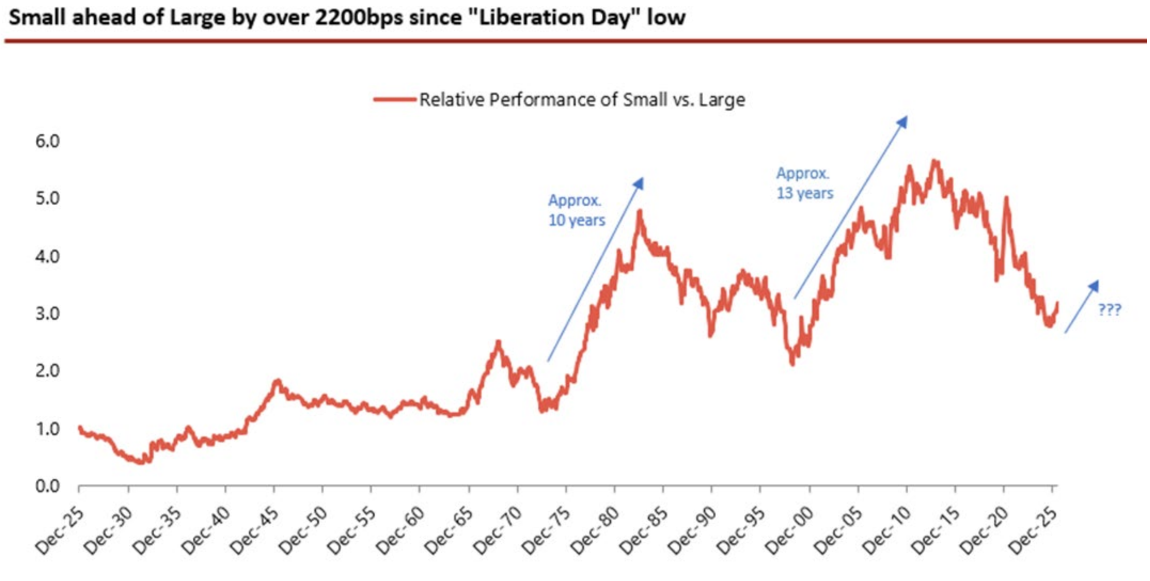
CRM 2Q 2026 Market Commentary

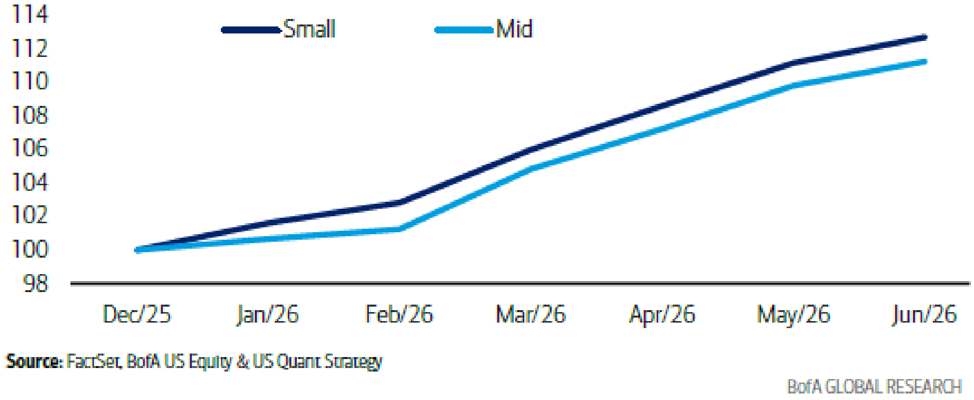
Following the market pullback in March during the onset of the U.S./Iran war, the U.S. equity markets rebounded strongly in the second quarter. Small cap stocks enjoyed their 3rd best second quarter performance ever (according to Jefferies Research), with the Russell 2000 Index gaining 21%, well outpacing the 10% return from the S&P 500 Index. This continued the first quarter trend of small caps outperforming large caps. Growth stocks topped the leaderboard this quarter, with gains from Information Technology, particularly semiconductor and semi-cap equipment makers, as the artificial intelligence (AI) capex boom continued to outpace expectations. We also had healthy returns from cyclical stocks such as Consumer Discretionary and Industrials as energy prices retreated from the war spike, while the Institute for Supply Management (ISM) Manufacturing Index registered over 50 each month this year (indicating that the U.S. manufacturing industry is in an expansion phase). Earnings expectations were also revised higher during the period due to both stronger top and bottom-line growth. We witnessed one of the most robust capital markets issuance periods this quarter, capped off by the largest IPO ever by funds raised from SpaceX. However, not all indicators were flashing green as Kevin Warsh was sworn in as the new Fed Chair in May and faced a changing and uncertain interest rate and inflation outlook compared to the beginning of the year. We expect the focus for investors in the second half of 2026 to be whether the outlook for earnings continues to improve and whether the market can broaden further towards more of the Main Street economy. We remain constructive on small and mid-cap stocks from both a fundamental and valuation perspective, even after their healthy recent performance. History has shown that we may be on the cusp of a new multi-year upcycle for this group relative to large caps (see chart below).



Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

One of the more encouraging developments during the quarter was the continued improvement in the outlook for earnings growth. While the mega-cap companies' earnings forecast, particularly the Magnificent 7 companies, has been well documented, small and mid-cap companies' earnings growth have accelerated this year after the earnings recession they experienced in 2022-2024. We believe the headwinds of higher interest rates and inflation are or will reverse and become tailwinds for small and mid-cap companies. This broadening of earnings momentum has helped reinforce investor confidence that the expansion remains intact, even as monetary policy expectations and geopolitics have been volatile.

Consensus NTM EPS expectations (indexed to 100 at start of year)
for S&P 600 and S&P 400 through June 2026



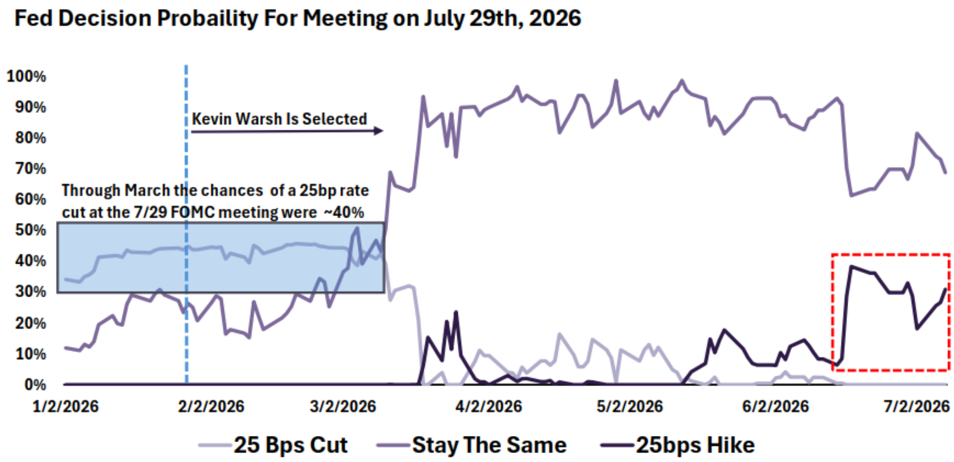
Equity market leadership during the second quarter was shaped by the acceleration in AI-related capital expenditures. Semiconductor manufacturers and semiconductor capital equipment companies emerged as clear beneficiaries, as hyperscalers continued to invest aggressively in compute capacity, advanced chips, and supporting infrastructure. In addition, Consumer Discretionary and Industrial stocks rallied this quarter as the spike in energy prices subsided and the economy remained resilient. We believe the recent improvement in the ISM Manufacturing Index is supportive of domestic oriented companies, which tend to be small and mid-caps, that have been neglected by investors over the past few years, and presents pent-up performance that will carry the market forward.

Recent Improvement In ISM Manufacturing Is Supportive Of Small Caps

Note: The RBC US Equity Strategy team does not authorize the reproduction of its published charts and is not able to share their underlying data due to license restrictions with our vendors.
Source: RBC US Equity Strategy, Bloomberg, Russell, S&P, latest available data as of 6/24/26

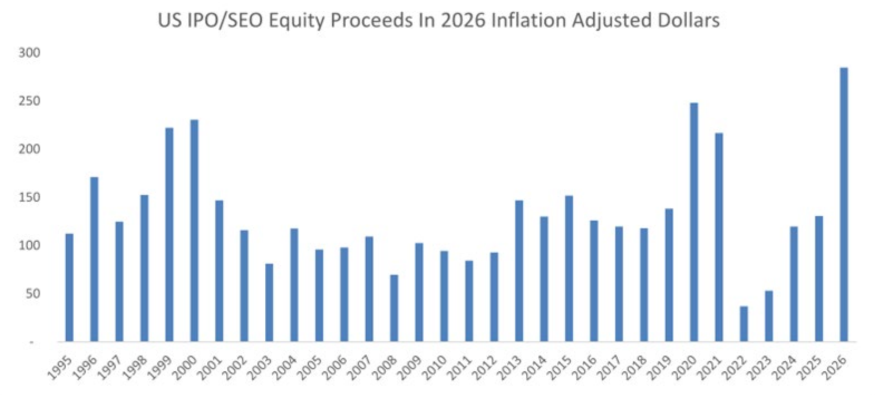
Geopolitical risk moderated during the quarter as positive progress was made toward reopening the Strait of Hormuz. While the memorandum of understanding (MOU) between the U.S. and Iran fell short of a comprehensive or permanent solution, it represented a meaningful step toward reducing near-term energy supply risks and alleviating worst-case scenarios priced in earlier this year. Oil markets responded constructively, and broader risk assets benefited as investors recalibrated probabilities around global growth disruptions. While we are hopeful that the U.S. and Iran can arrive at a more permanent agreement in the future, we must be pragmatic in assuming there will be slippage in compliance and this cease-fire will be challenged. Thus, we remain mindful of the continued geopolitical risks and their impact on capital markets and economies.

Monetary policy was another focus area during the quarter following the swearing in of the new Federal Reserve Chair, Kevin Warsh. Early optimism around two prospective rate cuts in 2026 at the beginning of the year gave way to a reassessment as inflation proved more persistent than expected. By June 30th, the market had shifted to the possibility of two rate hikes this year (nearly a 100-bps swing in tightening sentiment from earlier this year). While this repricing introduced volatility across interest-rate-sensitive assets, it did not break the underlying strength of the U.S. economy. The conversation this quarter was also about what Kevin Warsh will do differently than his predecessor. We didn't have to wait long. At his first Federal Reserve Open Market Committee (FOMC) meeting, Mr. Warsh dramatically cut the length of the FOMC statement, removed forward guidance, and discussed the establishment of five new task forces to examine the Fed's actions around: communications, balance sheet policy, data inputs, productivity/jobs, and inflation frameworks. We should get the findings from these task forces by year-end. We believe one of the more consequential actions from the task forces findings could be a more meaningful shrinkage of the Fed's balance sheet. This could be coupled with an interest rate easing strategy to blunt the impact of tighter market liquidity. The belief is the Fed has relied too heavily on its balance sheet and too little on interest rate cuts as its primary monetary policy tool. The view is that the Fed balance sheet is more supportive of Wall Street and asset prices while Fed rate cuts are more supportive of Main Street. An environment of lower interest rates but less liquidity could be highly constructive for active managers investing in small and mid-cap stocks, given down cap companies are more tied to bank interest rates than capital market pricing, and non-earnings companies, which we tend not to own, will be penalized by lower market liquidity.



Source: Truist Securities Research and CME Group

Capital markets activity was robust during the second quarter, highlighted by large initial public offerings. The SpaceX IPO was one of the most talked about new issuances given its scale and importance for private companies potentially approaching public markets. In addition, expectations are building around future IPOs from leading artificial intelligence platforms, including OpenAI and Anthropic. The anticipated size and strategic importance of these offerings signal a reopening of the IPO market, suggesting improving risk appetite after a prolonged period of muted issuance.



Source: U.S. Federal Reserve, Raymond James research

The annual reconstitution of the U.S. Russell indices was another notable event that occurred late in the quarter but will have a lasting impact on future quarters. There was a meaningful reduction in the allocation to the Technology sector for the down cap, value indices as well as a shift to less momentum stocks. In addition, small-cap indices became incrementally cheaper on a valuation basis, while large-cap indices became more expensive. This mechanical shift has meaningful implications for forward returns, particularly given the already wide valuation dispersion between large-cap and small-cap equities.

Russell 2000 Valuations

	Trailing P/E (Non-Negative)	Forward P/E	Price to Book	Price to Cash Flow*	Price to Sales	P/E to Growth
New Index	18.6	21.9	2.25	20.7	1.97	2.11
Old Index	18.8	26.0	2.18	20.3	1.90	2.26
Difference	**-0.2**	**-4.1**	**0.1**	**0.5**	**0.1**	**-0.1**
% Difference	**-1.1%**	**-15.8%**	**3.2%**	**2.3%**	**3.7%**	**-6.6%**

Russell 1000 Valuations

	Trailing P/E (Non-Negative)	Forward P/E	Price to Book	Price to Cash Flow*	Price to Sales	P/E to Growth
New Index	25.0	23.3	3.86	15.3	3.00	2.44
Old Index	24.4	22.6	3.53	14.8	2.79	2.41
Difference	**0.6**	**0.7**	**0.3**	**0.5**	**0.2**	**0.0**
% Difference	**2.3%**	**3.0%**	**9.3%**	**3.5%**	**7.8%**	**1.3%**

Source: FactSet; FTSE Russell; Jefferies

As we move into the second half of 2026, we believe markets will remain sensitive to policy signals and geopolitical developments but increasingly anchored by earnings fundamentals. Improving small and mid-cap profitability and positive economic indicators point towards a broadening opportunity set. While higher interest rates may challenge weaker balance sheets, they also reinforce the importance of stock selection. In our view, the combination of resilient and improving earnings growth, attractive relative valuations in small and mid-caps, and tailwinds such as onshoring, the One Big Beautiful Bill (OBBB) stimulus, and de-regulation creates a constructive environment for fundamentally driven equity strategies despite ongoing macro uncertainty. We continue to see significant opportunities today to own businesses that are undergoing change and are neglected by the market that have strong balance sheets and cash flow generation, and where we believe we are paying very little for an earnings recovery when it does materialize. We leave you with this interesting table from Jefferies Research (see below). Over the last 100 years, once the market has rotated from large cap leadership to small cap leadership, small caps tend to outperform large caps by over 14% annualized on average over the next 5 years.

Small Underperformance Cycle		**Small Caps**		**Large Caps**		**Relative Performance**		**1Yr Subs Relative Perf**		**3Yr Subs Relative Perf**		**5Yr Subs Relative Perf**	
Period	**Length (Y)**	**Cumul.**	**Ann.**	**Cumul.**	**Ann.**	**Cumul.**	**Ann.**	**Cumul.**	**Ann.**	**Cumul.**	**Ann.**	**Cumul.**	**Ann.**
Jan. 1926 to May 1932	6.3	-81.8	-23.6	-52.6	-11.1	-61.6	-14.0	111.1	111.1	136.8	33.3	309.4	32.6
Feb. 1937 to June 1939	2.3	-48.1	-24.5	-27.7	-13.0	-28.2	-13.2	-0.2	-0.2	-7.7	-2.6	57.4	9.5
May 1946 to June 1949	3.1	-35.4	-13.2	-12.6	-4.3	-26.1	-9.3	32.8	32.8	106.3	27.3	170.6	22.0
Dec. 1968 to Dec. 1973	5.0	-41.5	-10.2	11.8	2.3	-47.7	-12.2	-27.5	-27.5	19.0	6.0	15.7	3.0
July 1983 to Oct. 1990	7.3	35.9	4.3	149.3	13.4	-45.5	-8.0	32.7	32.7	65.9	18.4	119.0	17.0
Feb. 1994 to Mar. 1999	5.1	79.1	12.1	219.0	25.6	-43.9	-10.7	21.8	21.8	-11.3	-3.9	-10.3	-2.1
Feb. 2014 to Jan. 2016	1.9	-14.4	-7.8	7.3	3.7	-20.2	-11.1	21.0	21.0	51.1	14.8	124.9	17.6
Dec. 2016 to 4/8/25	**8.3**	**43.0**	**4.4**	**158.1**	**12.1**	**-44.6**	**-6.9**	**?**	**?**	**?**	**?**	**?**	**?**
Average	**4.9**	**-7.9**	**-7.3**	**56.6**	**3.6**	**-39.7**	**-10.7**	**27.4**	**27.4**	**51.4**	**13.3**	**112.4**	**14.2**

Note: The performance was calculated (or Derived) based on data from CRSP cap-weighted database.

Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; NBER; FTSE Russell; Jefferies.