

Q2 2026 Quarterly Commentary

By Nathan Fredrick, CFA
Performance Summary

The Micro Opportunities strategy underperformed the Russell Microcap Index in the second quarter. The benchmark advanced sharply in one of the most speculative risk-on quarters micro caps have seen in years, and while the strategy posted a solidly positive absolute result, our quality discipline kept us well behind the index. Over the trailing twelve months the strategy has also lagged the benchmark. We are never satisfied trailing the index, and we address the specific drivers, and the actions we took in response, throughout this letter.

Market Context

The quarter was defined by two forces pulling in the same direction: an accelerating artificial intelligence buildout and a persistent geopolitical supply shock. The AI trade broadened rather than faded, and nowhere was that more visible than at the smallest end of the market, where technology stocks surged to roughly 20% of the Russell Microcap Index by quarter end, up from the mid-teens just weeks earlier. Meanwhile, the disruption in the Strait of Hormuz kept crude and refined product markets dislocated for much of the quarter before progress in peace negotiations in mid-June sent oil prices sharply lower and began pulling curtailed supply back into commodity markets, a reversal that directly affected several of our holdings and trades discussed below.

Beneath the surface, the micro-cap rally carried a distinctly speculative character. The strongest returns in the benchmark came from categories we avoid by design: pre-revenue biotechnology, crypto-adjacent names, and unproven artificial intelligence narratives. Quarters like this one are the cost of those quality thresholds, and we accept that trade-off deliberately. Our job is to own profitable, durable, well-managed small businesses at sensible prices, not to chase whatever the market happens to reward in a given quarter.

Sector Highlights

Industrials was our best-performing sector and the portfolio's only meaningfully positive relative contributor. We carry roughly a quarter of the portfolio in industrials, well above the benchmark's mid-teens weight, and our industrials holdings rose sharply, led by Mayville Engineering, Heartland Express, and Douglas

Dynamics. Energy also added relative value, as our underweight helped in a quarter when benchmark energy stocks declined following the mid-June oil reversal.

Information technology was by far the largest relative drag. The benchmark's technology stocks surged in aggregate during the quarter, and our structural underweight of mid-single-digit exposure against a benchmark weight approaching 20% cost us from an allocation standpoint. Health care selection also hurt: the benchmark's health care cohort, led by speculative biotechnology, rallied hard while our profitable, revenue-generating health care holdings declined modestly. Our large consumer staples overweight, a source of stability in most environments, was a headwind in a strongly risk-on tape, and materials selection detracted as our nitrogen and uranium exposure gave back prior gains.

Top Contributors

Mayville Engineering Company (MEC)

Mayville Engineering, the Wisconsin-based metal fabrication and manufacturing solutions provider, was the portfolio's largest contributor as shares gained approximately 109% during the quarter. The company's trucking, agriculture, and military end markets began to inflect at the same time as investors rediscovered domestic manufacturing capacity as a scarce asset and management moved into data center rack fabrication. With the stock more than doubling, we trimmed the position in stages during the quarter, consistent with our sizing discipline in names that have run sharply.

Red Violet (RDVT)

Red Violet, a data analytics and identity intelligence provider, gained approximately 84%. The company's proprietary identity graph continues to take share in fraud prevention and investigative workflows, and it is one of the rare profitable, founder-driven software businesses available at the micro-cap end of the market. It remains a top-five holding. Red Violet continues to onboard customers at record levels which is a good leading indicator of future sales growth. Management is also integrating AI in product development. In contrast to most other software companies, the market sees AI as a tailwind rather than a headwind for them.

Top Detractors

LSB Industries (LXU)

LSB Industries, the nitrogen products producer, declined approximately 28% and was the portfolio's largest detractor. We originally owned LSB for its leverage to the disrupted global nitrogen supply, a thesis that worked well while the Middle East conflict kept capacity offline. When peace negotiations progressed in mid-June, curtailed supply began returning to the market, and the shares sold off. We think the move to the downside is an overreaction and LXU will benefit from the disruption. We also think the market is missing the significant free cash flow they will generate over the near and mid-term.

Uranium Royalty (UROY)

Uranium Royalty sold off with the other material names. There was no fundamental news that should have caused the decline. They diversified their royalty base to include commodities outside of uranium, which should make the business model more stable over the long term. Other uranium stocks have also done poorly even though uranium spot prices have been stable.

Portfolio Changes

New Positions and Additions

We added **Lifeway Foods (LWAY)** in April, the dominant U.S. producer of kefir. Lifeway reported record quarterly sales of \$63 million, up 37% and driven by volume rather than price, with gross margin expanding meaningfully on favorable milk costs, and a major plant expansion remains on track for completion by year end. We discuss LWAY in depth later in the letter.

We also initiated **Strattec Security (STRT)** in April. Strattec makes vehicle access and security hardware, and a new management team is driving margin expansion and customer diversification from a depressed base. During the quarter the chief executive and chief financial officers each purchased meaningful amounts of stock in the open market, the kind of cluster insider buying we view as a strong signal at an undemanding valuation.

We owned **Zevia (ZVIA)** briefly during the quarter, and the episode is worth describing because it illustrates our sell discipline. We purchased the position in early May as fundamentals inflected, with the company moving from roughly \$20 million of annual losses toward positive

EBITDA under a chief executive whose leadership was central to our thesis. When she resigned unexpectedly in mid-June, we stayed true to our thesis, which stated plainly that we would sell if she left. We honored that commitment and exited the position at a modest gain. We subsequently met her successor, whose experience includes a key role in Celsius's (CELH) rise, an old micro holding that subsequently turned into a midcap. Zevia remains on our watch list.

Late in the quarter, we added to two existing positions. We increased CRA International (CRAI), the litigation and economic consulting firm, where results should improve as the company laps a first-quarter compensation reset and where we believe the stock has been unfairly lumped in with consulting names that will not benefit from artificial intelligence. We also increased Allot (ALLT), the network intelligence and security software provider, following a substantial buyback announcement, an addition that also modestly raised our technology exposure, which this quarter demonstrated was too thin.

Reductions and Sales

Several sales reflected valuation and sizing discipline. We trimmed iRadimed (IRMD) in early May: the position had grown beyond 5% of the portfolio, near-term earnings comparisons are demanding, and the valuation was extended, though the fundamental story remains intact as the company's new IV pump configurations carry list prices more than double the prior generation. We trimmed Mama's Creations (MAMA) in May for similar reasons: after a strong run the stock carried a premium multiple for a food company facing tougher comparisons, even as distribution wins at Walmart and Target continue to expand its footprint. We trimmed Mayville Engineering in stages as described above.

Notable Holdings and Themes

Lifeway Foods (LWAY) is the largest producer and marketer of kefir in the United States. Kefir is a tart, tangy cultured milk rich in probiotics, protein, calcium, and vitamin D, with roots in Eastern Europe dating back generations. Lifeway was the first company to introduce kefir to U.S. consumers on a commercial scale and dominates the market. Lifeway has an exclusive blend of kefir cultures containing 12 live and active probiotics and its core kefir line offers variations including traditional, organic, grass fed, lactose free, and collagen added. Additionally, Lifeway is extending its brand into adjacent categories, including Probugs kefir pouches for kids, farmer cheese, a high protein and creatine line, a new

probiotic butter, and a licensing agreement for probiotic dog kibble under the Open Farm brand.

The kefir category today is benefitting from durable consumer trends including increased awareness of gut health, high protein diets, and a widespread shift to better-for-you food. The company distributes through more than 25,000 retail locations across 48 states, with strong relationships with many of the top mass retailers in the country. Lifeway is taking advantage of these trends through marketing and the roll out of smaller 3 and 8 oz size bottles to drive trial and consumer awareness. As evidence of the category gaining consumer awareness, kefir was specifically named in the updated 2026 food pyramid guidelines, which cited it as a fermented food supportive of a healthy microbiome.

The primary overhang on the stock, a multi-year governance dispute and multiple bids from Danone, were recently resolved. With that distraction behind it, management's focus has shifted to execution. Lifeway is currently undergoing an approximately \$50 million expansion of its Waukesha, WI manufacturing facility which will roughly double the plant's capacity. Lifeway also remains underpenetrated at Costco, leaving room for continued distribution gains. Management's 2027 EBITDA guidance of \$47–\$50 million highlights a significant margin expansion opportunity as the Waukesha facility ramps up and sustained sales growth drives operating leverage.

Lifeway has mid- to high-teens sales growth and an improving free cash flow trajectory, reaching breakeven in 2026 and inflecting to positive the following year. We believe this supports the case for a higher valuation multiple. Category leading, health and wellness CPG names have been acquired in recent years at a mean of 3.4x EV/Sales and 17.8x EV/EBITDA, including Pepsico's acquisitions of Siete Foods and Poppi, Flowers Foods' purchase of Simple Mills, and Celsius Holdings' acquisition of Alani Nu. We believe this supports the case for a higher multiple over time and acts as a useful reference point for where a leading brand in the space could be valued. As of writing, LWAY trades at significantly lower multiples than the companies mentioned above.

Lifeway's products are built around health and wellness, from kefir's naturally high probiotic, bioavailable protein, and calcium content to formulations that are up to 99% lactose free. All Lifeway Kefir bottles are 100% recyclable and BPA free, and the company's certified organic products are non-GMO, with conventional lines independently verified non-GMO by Eurofins. Since

2006, Lifeway has procured more than 87,000 MWh of Green-e certified renewable energy credits, avoiding an estimated 34,506 metric tons of CO₂e, equivalent to the emissions avoided by not burning 191 railcars of coal. On the sourcing side, the company's Farmer Pledged Milk program ensures all milk comes from cows raised without artificial hormones or antibiotics, and Lifeway encourages its supplying farmers and cooperatives to adopt enhanced animal welfare practices.

Outlook

Heading into the second quarter, we found ourselves navigating the immediate aftermath of the energy and materials shock discussed in our prior letter. As we noted at the time, the escalation of tensions in the Middle East had introduced meaningful uncertainty into the microcap outlook, and we responded by repositioning the portfolio toward more defensive ground. Implicit in that decision was a key risk: that returning to a more constructive stance would require, at minimum, a slowing in the rate of bad news, if not outright improvement on the ground.

That improvement arrived faster than we anticipated. The announcement of a ceasefire, followed by the signing of a memorandum of understanding, triggered a sharp reversal in sentiment even though little had fundamentally changed in the region itself. Oil prices and several materials prices retraced a significant portion of their earlier gains. In hindsight, the resolution may have been simpler than the market's initial reaction implied: most economies carried sufficient strategic reserves to absorb the shock, and the consumer, bolstered by stronger year-over-year tax refunds, proved more resilient than we had modeled in our Q1 outlook.

As a result, we enter the current period less bearish on the consumer than we were three months ago; a meaningful consideration for a microcap portfolio, where consumer- and financials-oriented names make up a substantial share of the opportunity set and had been among the areas we expected to see a delayed recovery. At the same time, the market has begun to unwind a portion of the artificial intelligence trade that dominated leadership earlier in the year. While we believe that trade has run considerably, we continue to see durable value in the picks-and-shovels businesses that sit underneath it. These include smaller infrastructure and enabling technology providers with staying power independent of any single cycle. We are considering adding to our technology weighting after this pull back in the stocks.

We are overweight to consumer staples, which offer a way to maintain some consumer exposure while retaining a defensive posture. Separately, the broad-based sell-off in consumer discretionary names since the onset of the conflict has created what we view as attractive entry points in select businesses whose long-term fundamentals remain intact. An area where the relative valuation gap for smaller companies versus their large-cap peers, a theme we highlighted entering the year, looks especially compelling.

Healthcare represents another area of incremental portfolio activity. Biotech has been a persistent outperformer within the sector, a dynamic that has been difficult to keep pace with given our concentration in medical technology names, which have lagged. This gap is particularly pronounced in the microcap space, where many of the smaller medtech businesses we favor for their durable competitive advantages have not yet participated in the move. We are increasingly seeing signs of a broader rotation into the sector as a whole, and we intend to position the portfolio to benefit from that shift over the coming quarter.

On energy, we believe the recent sell-off has overshot to the downside relative to the underlying fundamentals in the Middle East, which have not meaningfully changed. We see potential value emerging as the group stabilizes, though we would prefer greater clarity, and for valuations to more fully reflect a resetting reality, before committing additional capital.

Taken together, we would characterize our stance as cautiously optimistic. As some of the more speculative

artificial intelligence-related trades continue to unwind, we anticipate a rotation into higher-quality, smaller businesses that lagged the broader market earlier in the year. A dynamic we believe plays directly to the strength of our core investment philosophy and to the relative valuation opportunity we see across the microcap universe today.

Closing Remarks

Quarters like this one test the patience that quality investing requires, and we appreciate yours. At the microcap end of the market, the temptation to abandon discipline is strongest exactly when speculation is being rewarded most, and we will not do it. Our process of owning superior businesses with superior management teams at attractive valuations has been the source of our long-term results, and we believe it will be again when the current speculative leadership inevitably narrows. We do not take the responsibility of managing your capital lightly and we are grateful for your trust and confidence.



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(Disclosures and strategy largest contributors and detractors on next page).

**Micro Opportunities Strategy
 Largest Contributors and Detractors — Q2 2026**

5 Best - Absolute Contribution

Ticker	Company	Avg. Weight	Contribution
MEC	Mayville Engineering Company, Inc.	2.78%	2.00%
RDVT	Red Violet, Inc.	2.93%	1.91%
TILE	Interface, Inc.	2.94%	1.16%
HTLD	Heartland Express, Inc.	3.01%	1.13%
FSBC	Five Star Bancorp	3.50%	0.99%

5 Worst - Absolute Contribution

Ticker	Company	Avg. Weight	Contribution
LXU	LSB Industries, Inc.	2.49%	-0.82%
UROY	Uranium Royalty Corp.	3.09%	-0.69%
LMAT	LeMaitre Vascular, Inc.	3.75%	-0.52%
PWP	Perella Weinberg Partners Class A	2.59%	-0.26%
CRAI	CRA International, Inc.	1.78%	-0.24%

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