Equities in Focus

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Small-Caps: But Wait; There Is More

Smaller-cap companies have continued their winning ways, handily outperforming many other stock market indices year-to-date. This has led some to question if the train has left the station regarding adding to small-caps. We believe further upside exists given where they sit within the AI narrative that is driving stock market action, their earnings power and a still-healthy economy.

Key Takeaways

1. **The Stealthy Leaders**
   Amid all the AI headlines, small-caps have steadily outperformed many other indices.
2. **Improving Earnings and an Effective Diversifier**
   Earnings estimates are ranking higher and may be less over-indexed to the AI trade versus large-caps.
3. **A Solid Manufacturing Backdrop and Less Crowded**
   An expanding economy and a historically small market footprint leaves room for continued participation.

Strong Returns and Earnings Range

Small-cap equities have continued to strongly outpace many popular market benchmarks year-to-date (*Display 1*). These strong returns have been supported by an earnings recovery, along with a sector profile that transcends AI themes.

After lagging S&P 500 earnings growth and especially those of the Magnificent Seven stocks, consensus estimates have small-caps leading the pack (*Display 2*). And their sector exposures may also help investors diversify the source of those earnings. *Display 3* shows that AI build-out sectors represent about 17% of the Russell 2000 versus nearly half of the S&P 500. Conversely, sectors more closely connected to the broader US economy represent a larger portion of the Russell 2000 compared to the S&P 500. Small-caps are not an anti-AI allocation but may offer a viable source of diversification from the many battleground issues developing around the AI trade.

Economic and Headroom Expansion

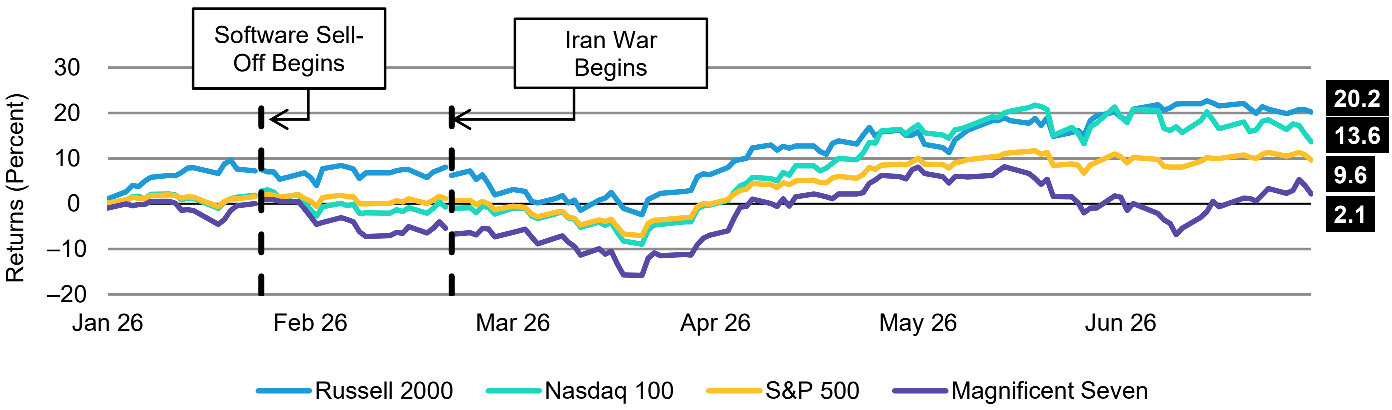
Indeed, small-caps offer a way to participate in more of the economy, and the economy is doing fine. Plus, their forward P/E ratios have been meaningfully correlated to manufacturing activity (*Display 4*). The ISM Manufacturing Purchasing Managers' Index reached 53.3 in June, its sixth consecutive month above 50 and a level associated with expansion. Meanwhile, the Russell 2000 represents only about 5.5% of the S&P 500's market value (*Display 5*), still well below its longer-term footprint, which argues for measurable rerating potential.

Our View

Small-caps remain cyclical, rate-sensitive and highly dependent on company selection. But after years of being overlooked, the case is no longer simply "they are cheap." Earnings are improving, leadership is broadening, and economic support remains, which provides a sound glide path to allocate with intent in this asset class.

To learn more about AB's equity investment solutions and to access other market insights, visit [Equity Investments | AB](#).

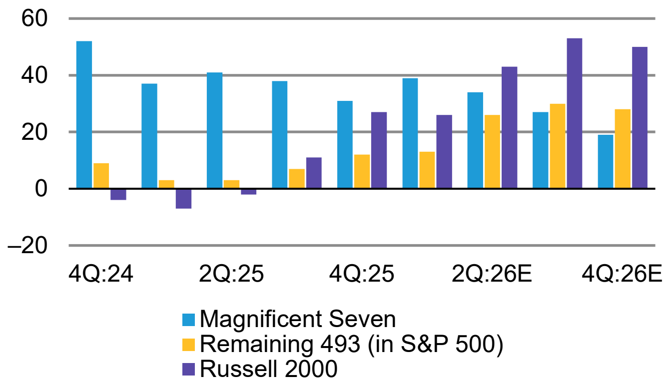
Display 1: Small-Caps Continue to Perform Well, Despite Bumps in the Road



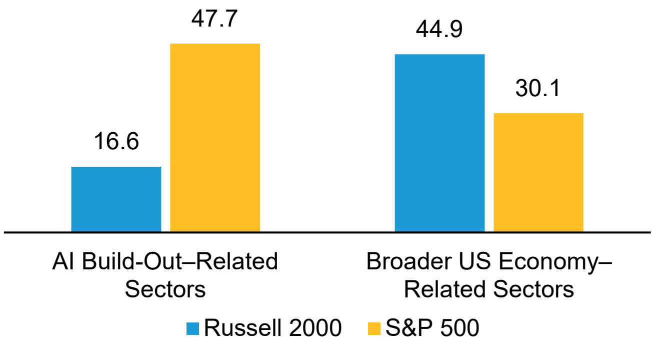
Past performance does not guarantee future results.
Returns in US dollars. An investor cannot invest directly in an index, and its performance does not reflect the performance of any AB portfolio. The unmanaged index does not reflect the fees and expenses associated with the active management of a portfolio.
As of July 17, 2026
Source: Bloomberg, FTSE Russell, Nasdaq, S&P and AB

Strong Earnings Recovery and Profit Opportunities Beyond AI

Display 2: Year-over-Year Change in EPS
Percent

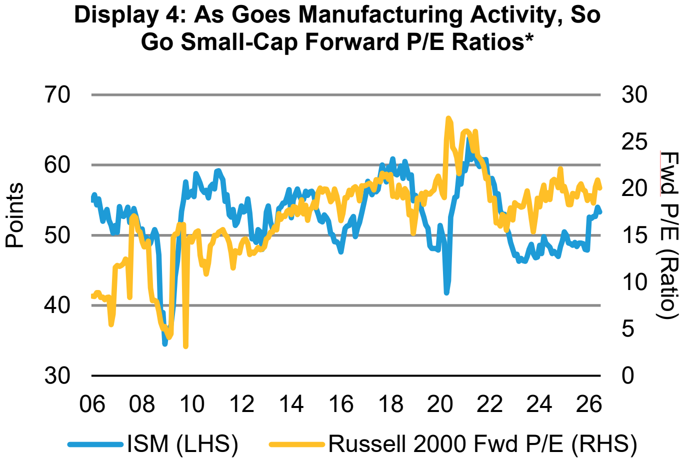


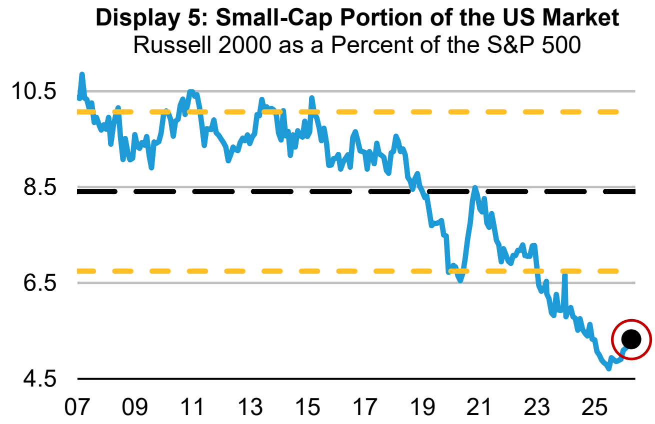
Display 3: Exposure to AI by Sector*
Percent



Past performance and current analysis do not guarantee future results.
*AI build-out–related sectors include technology and communication services; broader US economy–related sectors include consumer discretionary, financials, industrials and consumer staples; S&P 500 AI build-out–related sectors include Amazon.
As of June 30, 2026
Source: Bloomberg, FactSet, FTSE Russell, Strategas Research Partners, consensus estimates and AB

One-Two Punch: Manufacturing Strength and Ample Capacity to Advance Relative to the Broad Market





Past performance, historical analysis and current forecasts do not guarantee future results.
*Using forward 24-month estimates
Left display as of June 30, 2026; right display as of June 26, 2026
Source: BofA, Bloomberg, FactSet, FTSE Russell, Haver Analytics, ISM and S&P