

The Small-Cap Inflection is Here Why Quality Could Forge the Path Ahead

We believe the stage is set for a shift toward small-cap leadership, with high-quality stocks best positioned to lead the way.

- 1 Pro-Growth Policies and Easing Regulation**
Several pro-growth policies are supporting an improving environment for U.S. businesses, which could disproportionately benefit smaller-cap companies.
- 2 The AI Infrastructure Buildout Powering a Durable Supply Chain**
A wave of AI infrastructure spending is benefitting small caps through a vast and durable supply chain.
- 3 Attractive Relative Valuations and Strong Prospective Growth**
With relative valuations near multi-decade lows and growth prospects improving, small caps have the potential to deliver strong prospective returns.
- 4 The Case for Quality in Small Caps**
While unprofitable companies typically lead initially during small-cap rebounds, we believe sustainable returns belong to high-quality small-cap companies.
- 5 Built for the Long Term**
Small caps have historically weathered periods of market volatility and ultimately delivered strong long-term performance.

Active Management Edge

William Blair's Small Cap Growth Fund has offered a compelling combination of strong relative performance and risk-adjusted returns over time, driven by our rigorous bottom-up research process, which seeks to identify high-quality growth companies and capitalize on market inefficiencies.

Author:

U.S. Growth and Core Equity Portfolio Specialist Team

Introduction

Despite generating solid absolute returns over the past several years, U.S. small-cap companies have lagged their large-cap counterparts. While relative valuations have remained attractive for an extended period, a lack of fundamental catalysts has failed to incite durable earnings growth for the asset class.

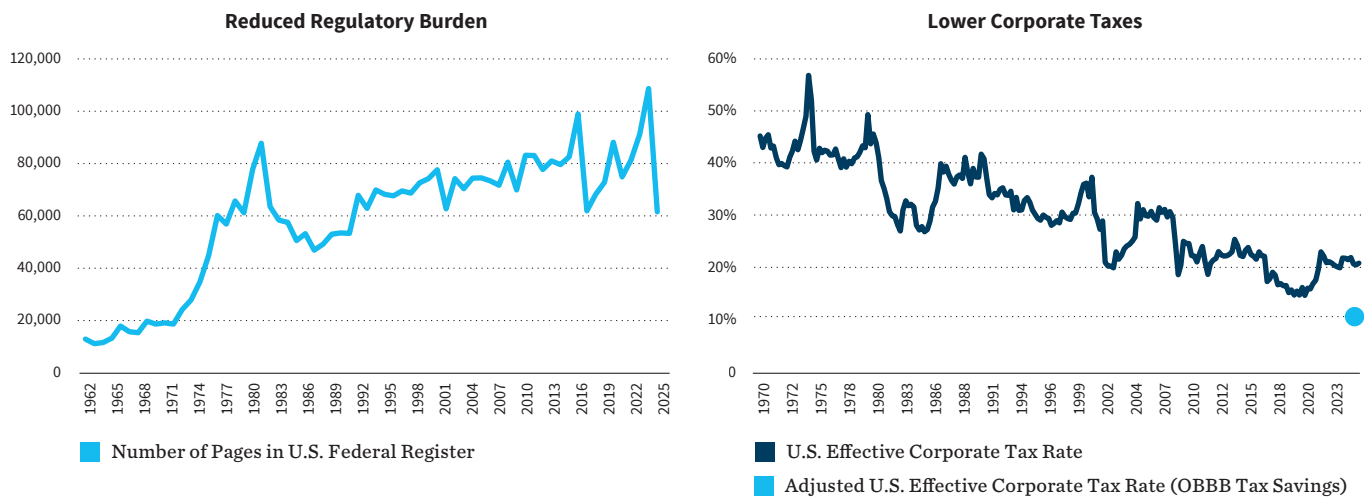
However, since the “Liberation Pause” on April 9, 2025, small-cap earnings projections have inflected higher. This fundamental pivot—catalyzed by a decisive shift in market sentiment and supported by the pro-growth measures of the current administration—has propelled the Russell 2000 Index to a 44% surge, outperforming the S&P 500 Index by 11% through March 2026. With easing regulations and the AI infrastructure buildout providing a sustainable secular tailwind, we remain constructive on the asset class and believe that the long-awaited earnings rebound among smaller-cap stocks will materialize and drive favorable relative returns for the asset class.

1. Pro-Growth Policies and Easing Regulation

Several factors are expected to improve the environment for small-cap companies. These include a reduced regulatory burden, lower corporate tax rates, and new domestic manufacturing incentives accompanied by favorable capital expenditure write-offs, which are expected to accelerate innovation and drive sustained growth across the U.S. market. These dynamics can be especially advantageous for smaller-cap stocks, which we believe are positioned to benefit disproportionately from these structural changes.

EXHIBIT 1

Improving Business Backdrop in the United States

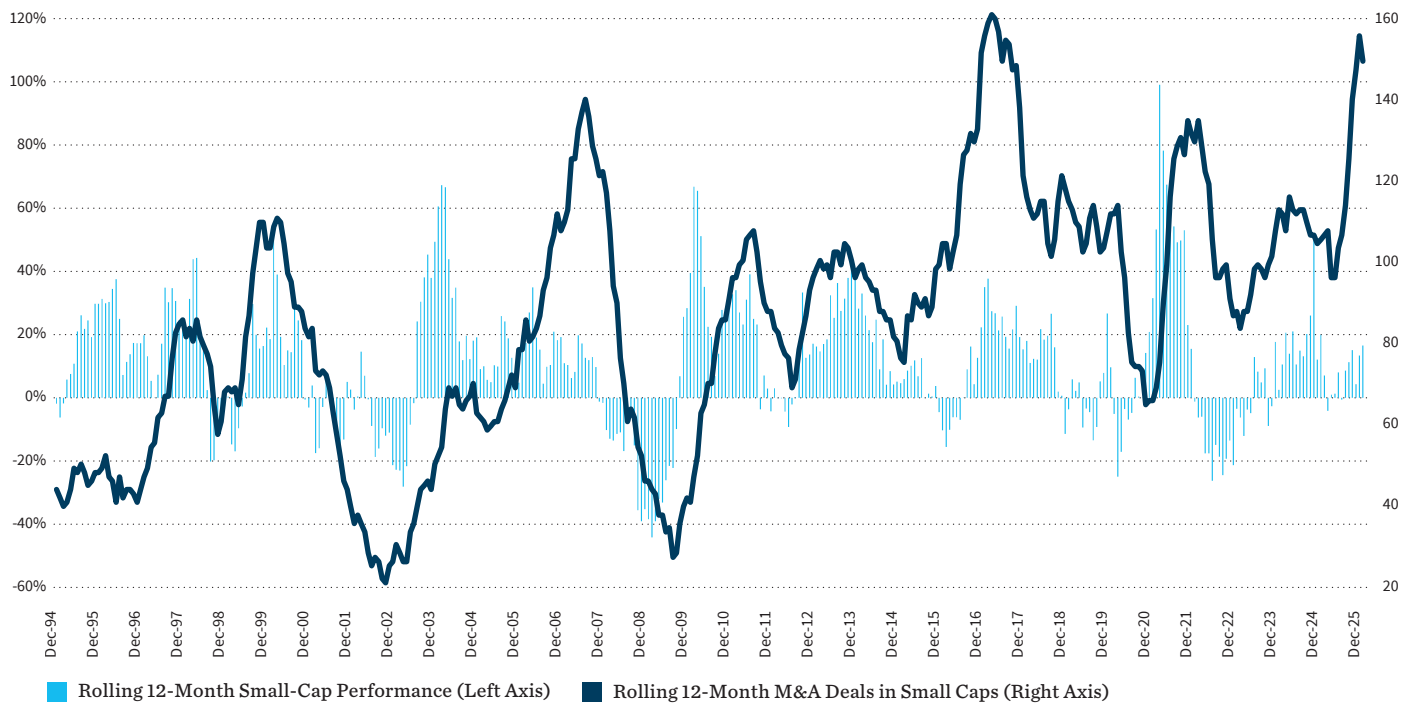


Sources: U.S. Federal Register, Piper Sandler, and William Blair. Reduced regulatory burden as of December 2025 and lower corporate taxes as of July 2025. OBBB tax savings refers to tax reductions created by the One Big Beautiful Bill (OBBB).

In conjunction with pro-growth policy shifts, a less onerous regulatory environment under the current administration has induced more favorable conditions for merger and acquisition (M&A) activity. Years of regulatory constraints have fueled a significant backlog of deal-making demand. Attractively valued, quality-oriented small-cap firms are prime targets for large-cap leaders looking to deploy strong balance sheets into their next phase of growth. Over the past year, M&A activity has risen to levels above long-term averages. Historically, periods of heightened M&A activity have been associated with outperformance in the small-cap equity market.

EXHIBIT 2

M&A Activity and Small-Cap Performance



Sources: FactSet, Bloomberg, FTSE Russell, Jefferies, and William Blair, as of January 31, 2026. Small-cap equities are represented by the Russell 2000 Index. See last page for index definitions. Past performance is not indicative of future returns. A direct investment in an unmanaged index is not possible.

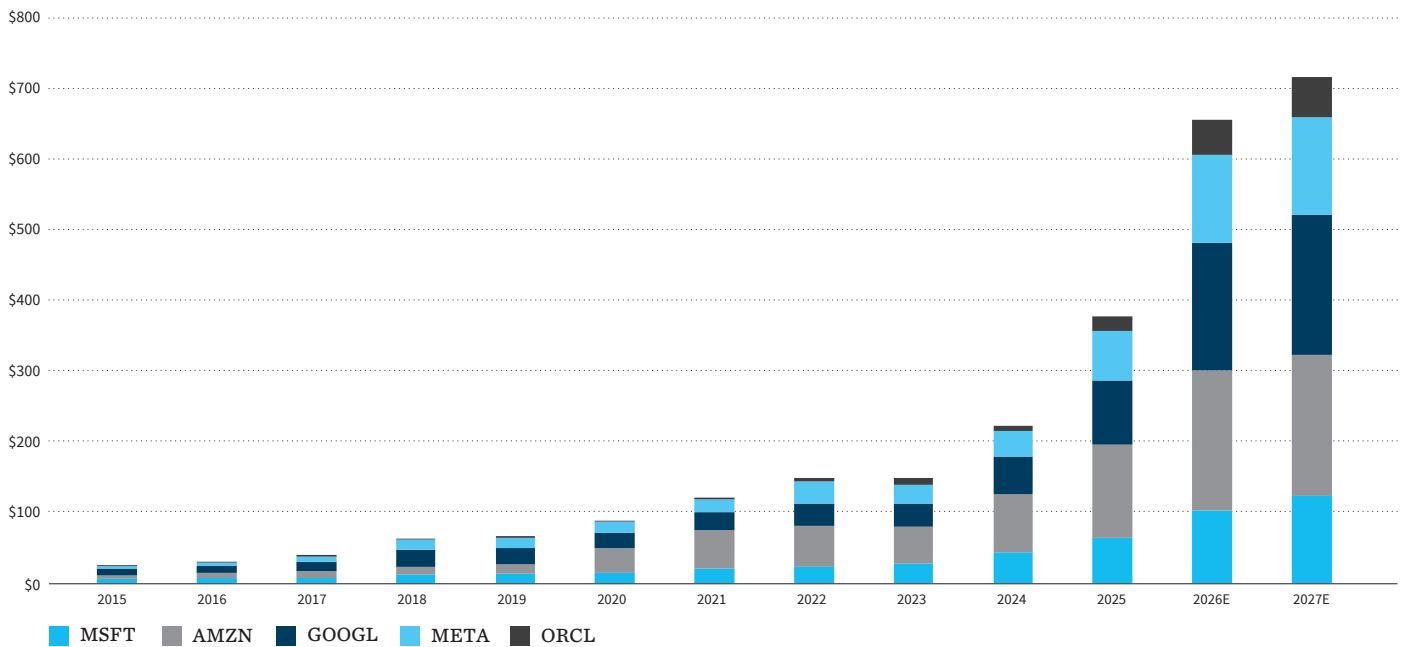
2. The AI Infrastructure Buildout Powering a Durable Supply Chain

We believe smaller-cap companies are well positioned to benefit from the substantial capital that several mega-cap technology firms have invested in building infrastructure related to AI.

Large hyperscalers, or companies that operate large data centers—such as Microsoft, Amazon, Alphabet, Meta, and Oracle—have committed significant resources to developing the infrastructure to help drive AI-related applications. In 2025, these hyperscalers spent nearly \$380 billion on capital expenditures (capex), an increase of more than 65% year-over-year. Over the next two years, they are projected to spend approximately \$700 billion per year to fund the AI buildout.

EXHIBIT 3

Hyperscaler Capex Spend (In Billions)



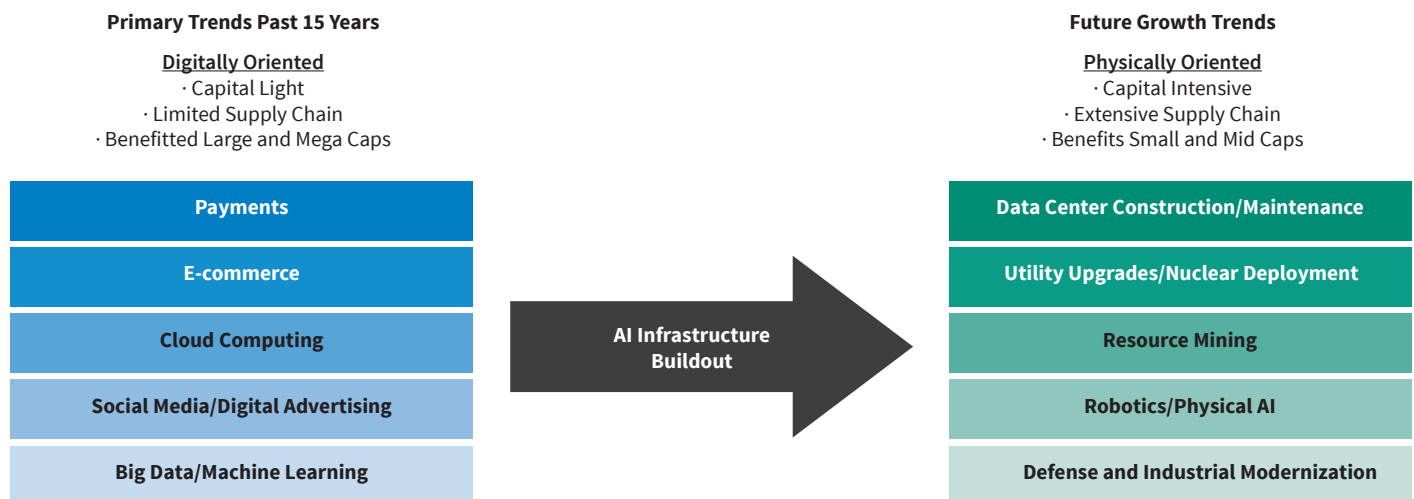
Sources: FactSet and William Blair, as of February 21, 2026.

We believe sustained capex from major hyperscalers should forge durable revenue streams for many smaller-cap companies, marking a departure from the capital-light, digitally oriented trends of the last fifteen years. While large- and mega-cap companies tremendously benefitted from past secular trends like e-commerce, cloud software, and digital payments, the AI infrastructure buildout is powering a pervasive supply chain that disproportionately rewards smaller companies involved in verticals such as utility upgrades, resource mining, and data center construction and maintenance. Many of the companies in our portfolio have exposure to these growing end-markets and represent the “picks and shovels” of this secular movement.

As the AI landscape shifts from the initial infrastructure build stage to new revenue-generating opportunities, we believe smaller companies can capitalize on demand from new AI-driven products and services, further positioning themselves to take advantage of durable growth opportunities. Moreover, the adoption of rapidly evolving AI tools should bolster productivity, allowing smaller firms to scale their capabilities and expand their margin profiles.

EXHIBIT 4

Small Caps: Investing in the Physical Buildout



Source: William Blair, as of February 28, 2026.

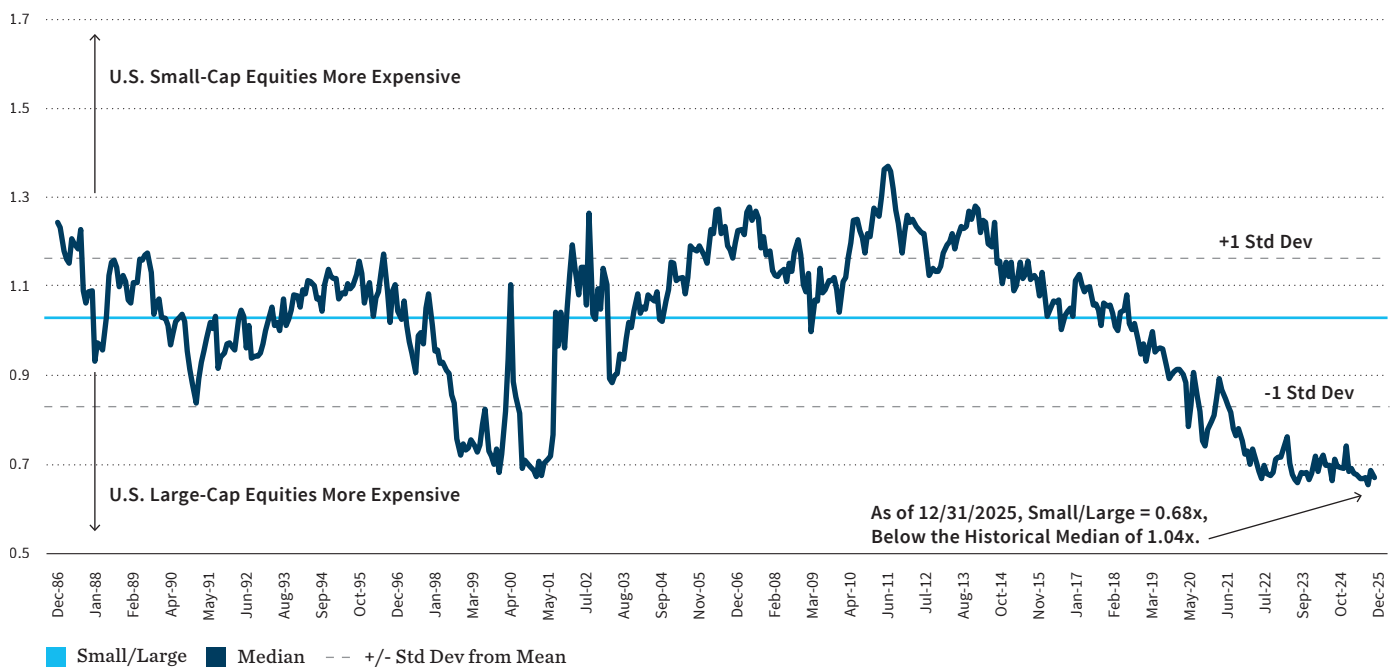
3. Attractive Relative Valuations and Strong Prospective Growth

Small-cap stocks have historically commanded a slight premium over large-cap stocks, reflecting the higher growth and return potential typically associated with investing in smaller companies.

Over the past decade, the relative decline in small-cap valuations compared to large-cap valuations can be attributed to several factors, including subdued economic growth and slower earnings growth for small caps compared to large caps in recent years. In contrast, the strong performance of large-cap indices has been significantly influenced by a small number of digitally oriented mega-cap stocks that have shown substantial acceleration in earnings and free-cash-flow growth, thereby boosting their valuations.

EXHIBIT 5

Relative Forward P/E Ratio: Small Caps vs. Large Caps

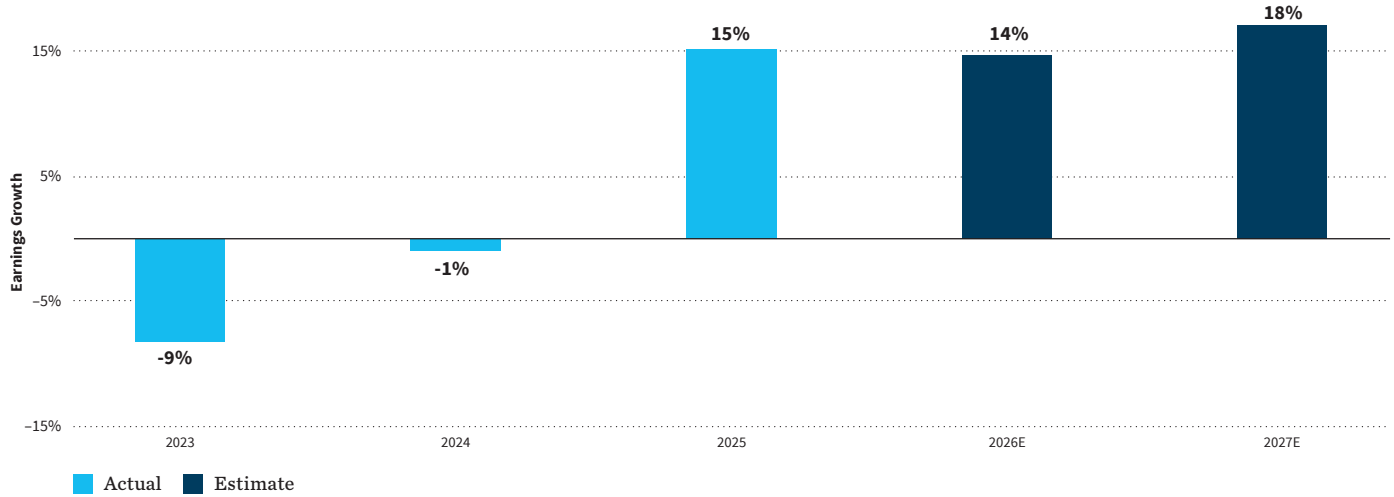


Sources: Bank of America Merrill Lynch and William Blair, as of December 31, 2025. Valuation methodology excludes unprofitable companies. Small-cap equities are represented by the Russell 2000 Index; large-cap equities are represented by the Russell Top 200 Index. See back page for index definitions. A direct investment in an unmanaged index is not possible.

Beyond the primary catalysts already noted, we believe small caps—which experienced an earnings recession in 2023 and 2024—could deliver robust earnings growth over the coming years. Given that small-cap performance has historically been correlated with earnings growth, we see a compelling trajectory for the asset class in coming years.

EXHIBIT 6

Small Caps Poised for Robust Earnings Growth



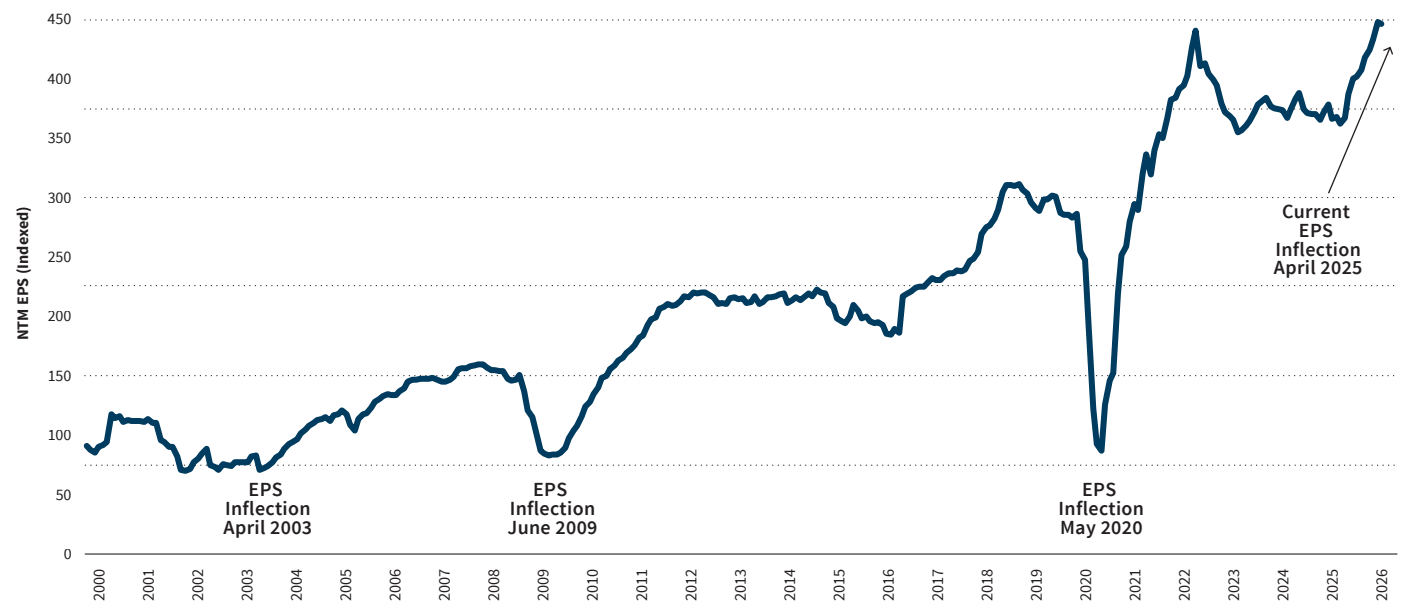
Sources: FactSet and William Blair, as of February 28, 2026. Small-cap equities are represented by the S&P 600 Index. See last page for index definitions. A direct investment in an unmanaged index is not possible. E refers to estimated.

4. The Case for Quality Within Small Caps

The initial stages of earnings inflections and concurrent market recoveries in small caps are typically driven by a rebound in low-quality, unprofitable, speculative companies. Mirroring past cycles, the sharp rally following the April 2025 bear-market bottom was led by these types of low-quality firms.

EXHIBIT 7

Earnings Inflections and Concurrent Market Recoveries

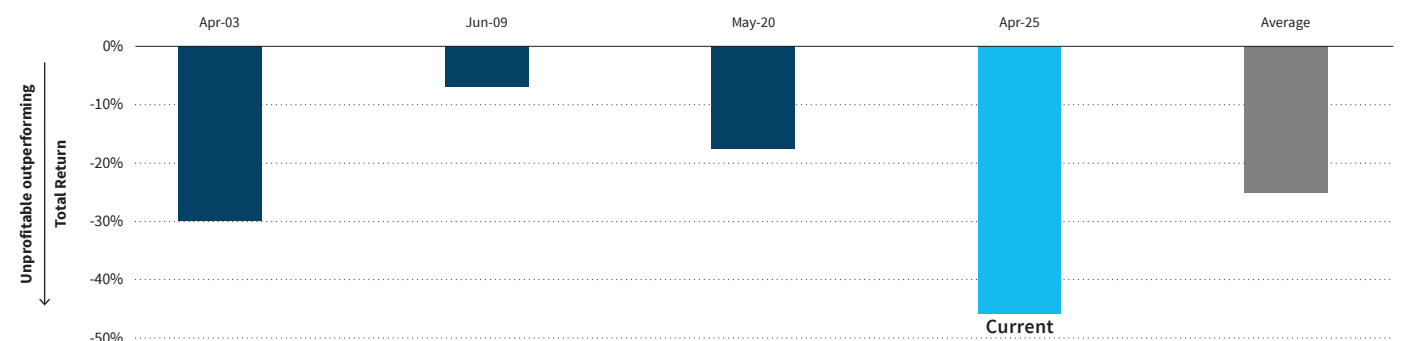


Sources: Factset and William Blair, as of January 31, 2026. NTM EPS refers to next 12 months earnings per share. Small-cap equities are represented by the Russell 2000 Index. See last page for index definitions. A direct investment in an unmanaged index is not possible.

For example, unprofitable stocks have historically outperformed in the six months following an earnings inflection.

EXHIBIT 8

Russell 2000 Index Six-Month Return Post Earnings Inflection (Profitable Minus Unprofitable Stocks)



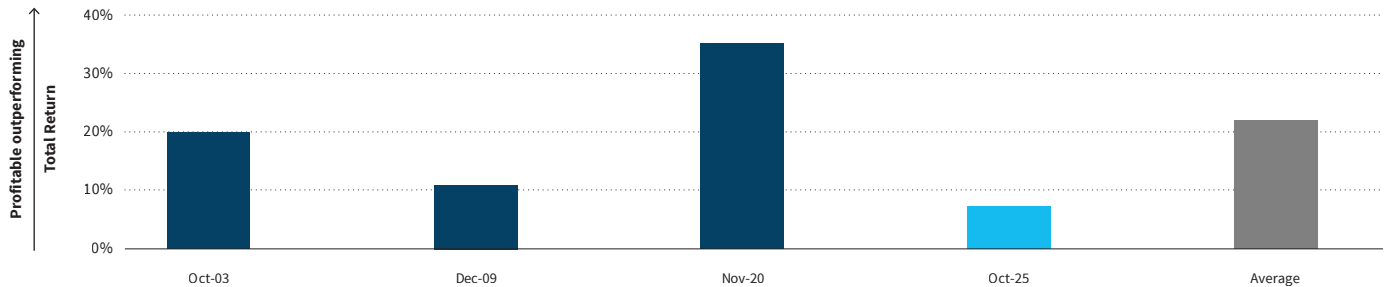
Sources: FactSet and William Blair, as of January 31, 2026. See last page for index definitions. Past performance is not indicative of future returns. A direct investment in an unmanaged index is not possible.

However, as the cycle matures and the initial speculation period subsides, the market typically pivots and rewards profitable small caps with more durability.

Importantly, sustained leadership within the small-cap universe belongs to high-quality companies that have markedly outperformed lower-quality companies over time. Because a company’s value is fundamentally the present value of its future cash flows, we prioritize firms that generate real shareholder returns. We believe these are the types of companies built to lead over the long run.

EXHIBIT 9

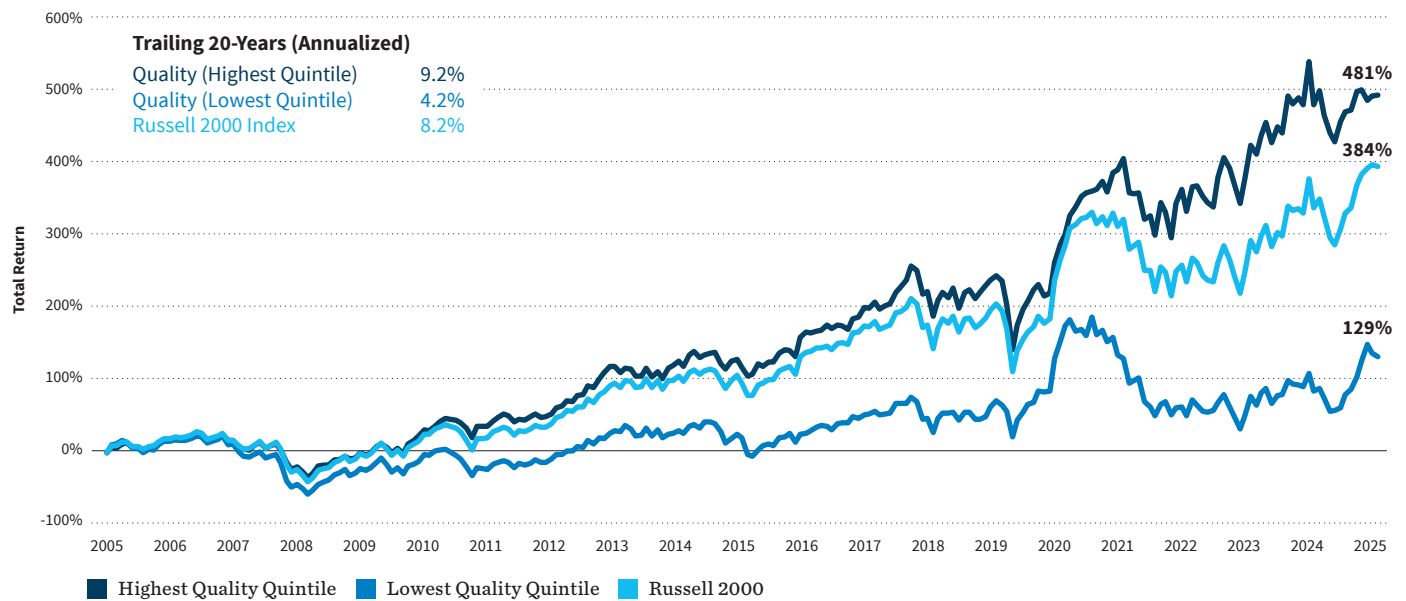
Russell 2000 Index: One-Year Forward Return After Initial Six-Month EPS Inflection
(Profitable Minus Unprofitable Stocks)



Sources: FactSet and William Blair, as of January 31, 2026. Three months have elapsed in the current 1-year forward return cycle. See last page for index definitions. **Past performance is not indicative of future returns.** A direct investment in an unmanaged index is not possible.

EXHIBIT 10

Long-Term Outperformance of Quality Among Small Caps



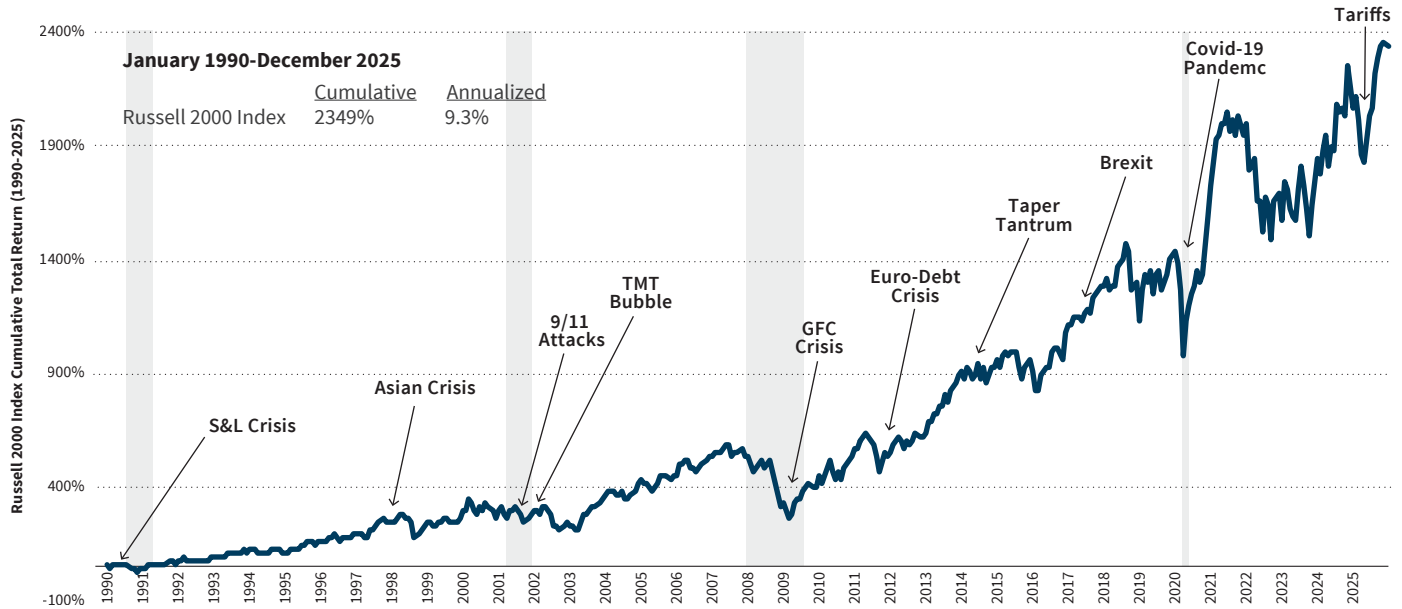
Sources: FactSet and William Blair, as of December 31, 2025. **Past performance is not indicative of future returns.** WB Quality measures sustainable value creation, earnings quality, and financial strength using cash flow return on invested capital (CF ROIC), CF accruals, and net debt/EBITDA. Small-cap equities are represented by the Russell 2000 Index. See last page for index definitions. A direct investment in an unmanaged index is not possible.

5. Small Caps: Built for the Long-Term

Over the past 36 years, and in the face of several calamitous events (including the collapse of the tech bubble, the global financial crisis, and the COVID-19 pandemic), the Russell 2000 Index has generated a cumulative return of more than 2,300%, compounding at an annual rate of 9.3%. Throughout the period, investors were forced to navigate temporary market setbacks but were rewarded for their patience with strong long-term returns.

EXHIBIT 11

Taking the Long-Term Perspective in Small Caps



Sources: FactSet and William Blair, as of December 31, 2025. **Past performance is not indicative of future returns.** A National Bureau of Economic Research (NBER) recession refers to a recession officially identified by the NBER, the organization responsible for determining the start and end dates of U.S. business cycles. Small-cap equities are represented by the Russell 2000 Index. See last page for index definitions. A direct investment in an unmanaged index is not possible.

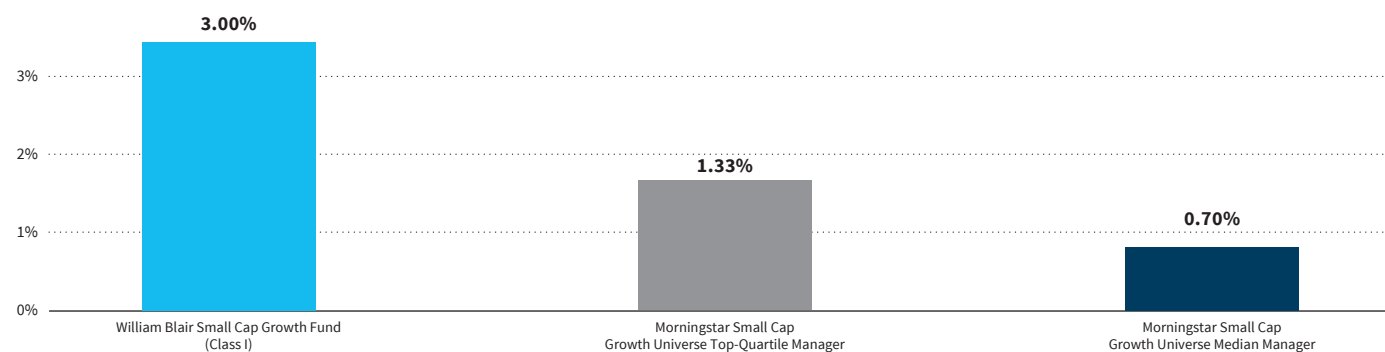
Active Management Edge

Small caps have historically been a fertile ground in which to generate excess returns over time. In general, they have less analyst coverage and are more prone to market inefficiencies. Active managers can thus leverage in-depth research to identify undervalued or mispriced opportunities in the small-cap space.

William Blair's Small Cap Growth Fund is driven by our comprehensive, bottom-up research approach. The strategy focuses on identifying quality growth companies and capitalizing on market inefficiencies. Three key characteristics often differentiate the strategy from other small-cap growth managers: (1) greater valuation sensitivity while still maintaining growth in line with or exceeding the Russell 2000 Growth Index; (2) a bias toward smaller market caps; and (3) a contrarian bias. This fundamental approach has delivered a compelling mix of strong relative performance and superior risk-adjusted returns over time.

EXHIBIT 12

Small-Cap Growth Active Manager Excess Return vs. Russell 2000 Growth Index (25-Year Period Ending 3/31/26)



Sources: FactSet and William Blair, as of March 31, 2026. **Past performance is not indicative of future returns.** A direct investment in an unmanaged index is not possible.

ANNUALIZED PERFORMANCE (AS OF MARCH 31, 2026)

	1-Year	3-Year	5-Year	10-Year
William Blair Small Cap Growth Fund (Class I)	13.80%	9.67%	3.01%	12.41%
Russell 2000 Growth Index	23.58%	12.27%	1.62%	9.79%

Expense ratio: gross, 1.12%; net, 0.99%. The Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund operating expenses until 4/30/26. **Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month-end performance information, please call +1 800 742 7272, or visit our website at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Class I shares are available only to investors who meet certain eligibility requirements.** The benchmark shown represents the Fund's performance benchmark, which is different from the Fund's regulatory benchmark. The Fund's regulatory benchmark is the Russell 3000 Index and is included in the Fund's prospectus. The Fund's prospectus can be found here. Morningstar Ranking: Morningstar Percentile Rankings are based on the Fund's total return (excluding sales charge) relative to all the funds in the same Morningstar category, where 1 is the highest and 100 is the lowest percentile rank. Ratings and rankings are one measure of performance. Some of our Funds have experienced negative performance for the time periods shown. For the most current performance, please visit williamblairfunds.com.

Conclusion

The investment landscape for small-cap equities is evolving, with several positive factors contributing to what we believe is an increasingly favorable environment. Importantly, the current administration's focus on pro-U.S. policies, coupled with a less restrictive regulatory backdrop that may spur increased M&A, will likely enable quality growth companies to serve as the primary beneficiaries. Furthermore, sustained demand from AI infrastructure spending should serve as a powerful catalyst for many small-cap companies involved in the buildout. Combined with attractive relative valuations, we believe these dynamics present a compelling opportunity for investors to consider small caps as part of a diversified investment strategy.

Important Disclosures

Please carefully consider the Fund's investment objectives, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus and summary prospectus, which you may obtain by calling 1-800-742-7272. Read the prospectus and summary prospectus carefully before investing. Investing includes the risk of loss.

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Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. Investing in small-capitalization companies involves special risks, including higher volatility and lower liquidity. Small-cap stocks are also more sensitive to purchase/sale transactions and changes in the issuer's financial condition. Different investment styles may shift in and out of favor depending on market conditions.

Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result. Investments focused in the United States will have greater exposure to the market, political and economic risks of that country than if it was more diversified across a number of countries. Diversification does not ensure against loss. Past performance is not indicative of future returns.

References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security.

The **Russell Top 200 Index** is an unmanaged index registered to Russell/Mellon. It measures the performance of the 200 largest companies in the Russell 3000 Index. It is a capitalization-weighted index as calculated by Russell on a total return basis with dividends reinvested. The **Russell 2000 Index** is an unmanaged index registered to Russell/Mellon. It measures the performance of the 2,000 smallest companies in the Russell 3000 Index. It is a capitalization-weighted index as calculated by Russell on a total return basis with dividends reinvested. The **Russell 2000 Growth Index** measures the performance of Russell 2000 companies with above average price-to-book ratios and forecasted growth rates. The **S&P 500 Index** is a capitalization-weighted index designed to measure the performance of approximately 500 large-cap U.S. publicly traded companies. It is widely considered a benchmark indicator of the overall U.S. stock market and economy. The **S&P 600 Index** is designed to track the small-cap market segment. Indices are unmanaged and do not incur fees or expenses. A direct investment in an unmanaged index is not possible.

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