

Small/Mid Cap Strategy Year Ahead

2026 Year Ahead: Small caps, big recovery

Small Cap

5 bullish themes for small caps in the year ahead

Small caps faced numerous challenges entering '25, from tariff/Fed uncertainty to a still-elusive EPS recovery. But after turning more constructive in August, we are bullish on small caps in 2026, expecting small caps to outperform mid and large caps.

- 1) **Earnings to drive outperformance.** The long-awaited profits rebound is here (with support from positive guidance): consensus expects +18% EPS growth for small caps vs. 16% for mid and 13% for large in '26, where history suggests small caps typically lead in backdrops of accelerating and better-than-large-cap profits growth. Revisions have also shifted more favorably for small vs. mid.
- 2) **Fed continues to cut:** Our economists expect three more rate cuts between now and the end of next year, helping to mitigate refinancing risks.
- 3) **Capex cycle benefits small caps:** Small cap sales growth (which is still tepid) has been highly correlated to US capex growth – and we are bullish on capex in 2026.
- 4) **Potential for lower tariffs & deregulation:** Tariff-related uncertainty plagued small caps in early '25, but potential relief (exemptions, IEEPA challenges) would be most positive for small caps given their thinner margins. Deregulation would also be bullish: smaller caps face greater burdens from regulatory compliance.
- 5) **Favorable positioning & valuation, shifting flows:** Multi-cap managers are very underweight small caps vs. overweight mid and mega caps, and small caps are still the cheapest part of the market and have begun to see momentum in inflows.

Key risks include manufacturing failing to recover or the onset of a credit cycle.

New swing factors: rise of retail...AI...return of M&A/IPOs

We explore key themes impacting small caps, including 1) the rise of retail trading - which has coincided with better index returns but increased index concentration; 2) AI (rising proportion of small caps discussing both AI investment & AI boosting productivity – and the companies mentioning AI most frequently offer less-stretched valuations and higher consensus long-term growth in small vs. large) and 3) implications of a pick-up in M&A and IPOs, which have picked up to their highest levels since '21 (also see our [M&A deep-dive report](#) and [Big Picture M&A outlook video](#) with our analysts).

Styles, sectors, themes: SMID investor's roadmap to '26

We continue to favor Value over Growth, where Value typically leads in profit recoveries and Fed cutting cycles and is historically cheap vs. Growth. We would fade the rally in micro caps, the most expensive segment of small, but neutralize our prior preference for quality (other factors likely to matter more, and owning a mix of high and low quality stocks makes sense based on valuations, positioning and the profits backdrop). We like capex beneficiaries, which are still trading at reasonable valuations. As for sectors, Financials continues to rank best in our small & mid cap quant work (cheap, favorable revision trends, seeing productivity growth) - but we're watching credit. Plus: a look at what happened in '25 (where you're not alone: ~90% of small cap funds underperformed).

Trading ideas and investment strategies discussed herein may give rise to significant risk and are not suitable for all investors. Investors should have experience in relevant markets and the financial resources to absorb any losses arising from applying these ideas or strategies.

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Refer to important disclosures on page 56 to 58.

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Timestamp: 02 December 2025 03:05AM EST

02 December 2025

Small/Mid Cap Research
United States



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2026 SMID Cap Year Ahead

Small caps faced numerous challenges entering '25, from tariff/Fed uncertainty to a still-elusive EPS recovery. But after turning more constructive in August, we are bullish on small caps in 2026, expecting small caps to outperform mid and large caps.

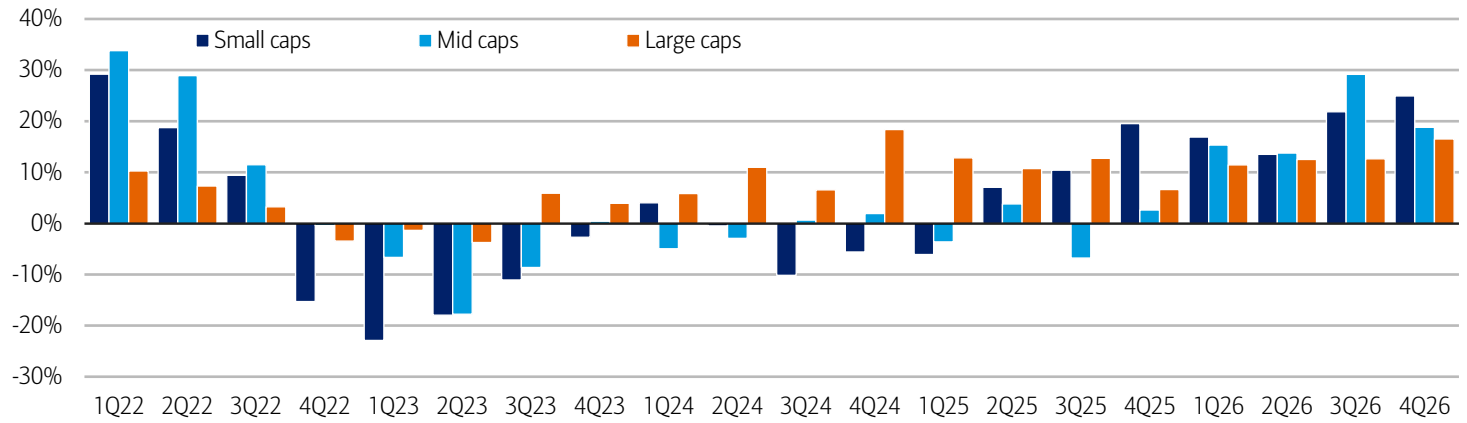
Earnings outperformance should drive small caps to lead

Stronger & accelerating profits growth for small vs. large suggests small leads

Small caps have historically outperformed by 9ppt, on average, in backdrops where small caps profits growth outpaced large cap profits growth and were accelerating, as consensus expects for 2026 (S&P 600 EPS +19% vs. S&P 500 EPS +13% (and S&P 400 EPS +15%). Small caps outperformed large caps 75% of the time in these backdrops over the last ~25 years.

Exhibit 1: Small cap earnings growth now positive, expected to eclipse large cap earnings growth in 2H25 and 2026

S&P 600, S&P 400 & S&P 500 y/y qtrly EPS growth (1Q22-4Q26 consensus)



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 2: Most sectors expected to see a pick-up in earnings growth in '26 across small/mid/large

S&P 600 (small), S&P 400 (mid), S&P 500 (large) consensus earnings growth based on current constituents

Sector	2024			2025E			2026E		
	Small	Mid	Large	Small	Mid	Large	Small	Mid	Large
Cons. Disc.	-12%	-4%	17%	-7%	-2%	5%	21%	9%	12%
Staples	23%	66%	4%	3%	5%	0%	0%	16%	7%
Energy	-33%	-18%	-22%	-18%	-5%	-8%	12%	18%	11%
Financials	1%	5%	17%	15%	13%	14%	14%	13%	10%
Health Care	72%	11%	4%	-9%	1%	12%	32%	20%	9%
Industrials	11%	0%	2%	14%	-1%	5%	12%	15%	15%
Tech	-27%	11%	22%	67%	19%	23%	18%	19%	23%
Materials	-14%	-15%	-5%	-14%	-7%	0%	31%	41%	20%
Real Estate	5%	2%	3%	3%	10%	5%	5%	4%	7%
Comm. Svcs.	-65%	2%	31%	-47%	-68%	20%	165%	193%	16%
Utilities	8%	15%	19%	-3%	-1%	6%	5%	21%	10%
Index	-5%	2%	12%	6%	4%	12%	17%	15%	14%

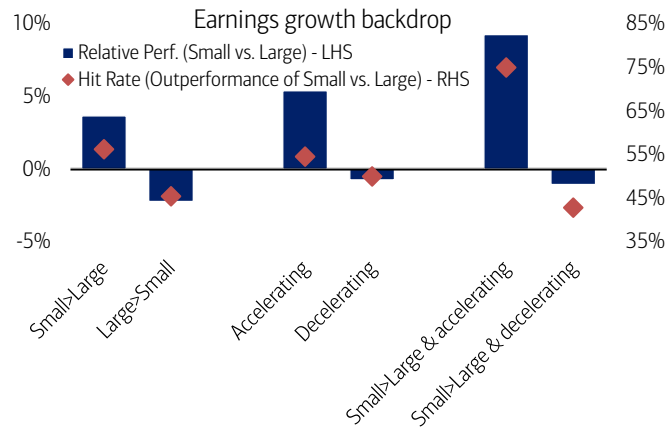
Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 3: In years where small cap profits growth is outpacing large cap profits growth and accelerating, small caps have outperformed 75% of the time and by an avg. of 9ppt

S&P 600 vs. S&P 500 annual profits growth backdrop and relative performance of small vs. large (1999-now)

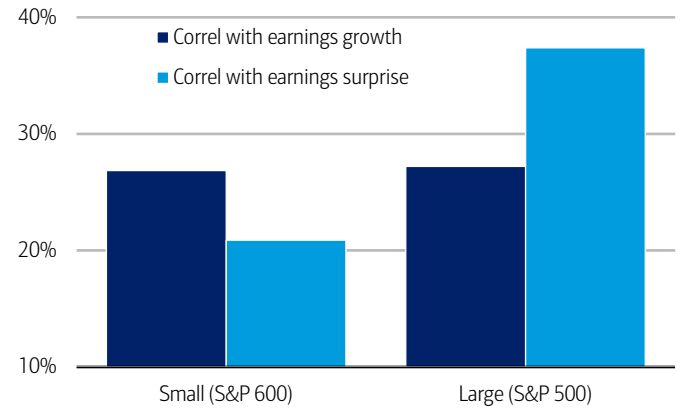


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 4: Growth has been more correlated with small cap performance than surprise (the opposite of in large caps)

Correlation of YoY earnings growth vs. yearly performance and earnings surprise vs. yearly performance (1998-present)

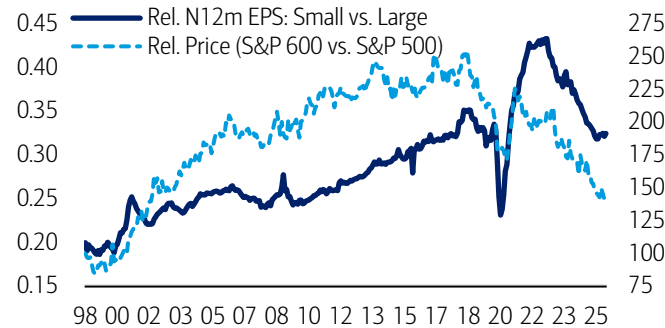


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 5: Price vs. EPS: Underperformance of small vs. large caps post-COVID (since mid 2021) has come amid fundamental (earnings) underperformance since late 2022

Relative N12m consensus EPS: S&P 600 vs. S&P 500 (1998-11/2025)

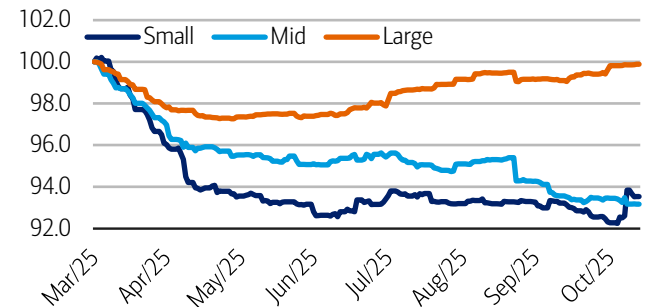


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 6: After estimates bottomed post the Liberation Day cuts, small and large cap index EPS estimates for 2026 have been rising while mid cap estimates have continued to fall

Consensus 2026 earnings expectations by S&P index (indexed to 100 on 3/31/25 through 11/2025)

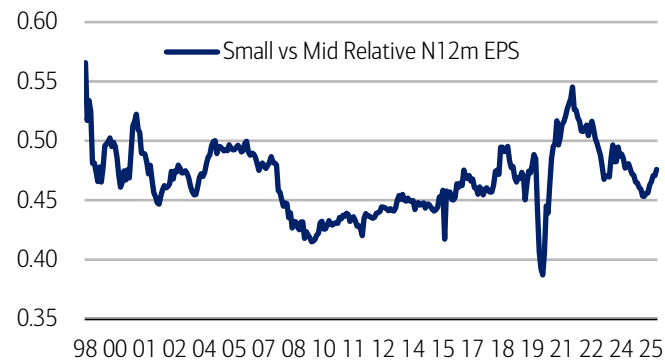


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 7: Relative EPS also inflecting for small vs. mid caps...

Relative N12m consensus EPS: S&P 600 vs. S&P 500 (1998-11/30/2025)

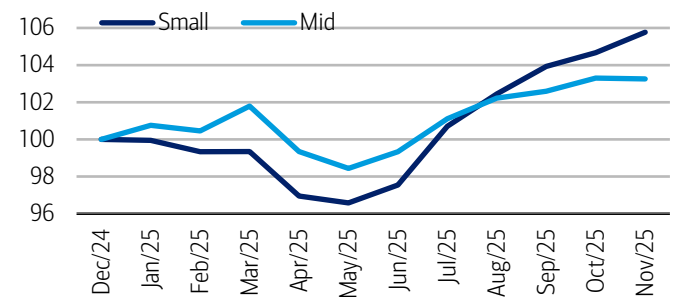


Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 8:after mid caps had previously seen better revision trends for most of this year, but revisions now picking up for small caps

Consensus N12m EPS for S&P 600 vs. S&P 400, 12/2024-11/2025 (indexed to 100 at start of period)



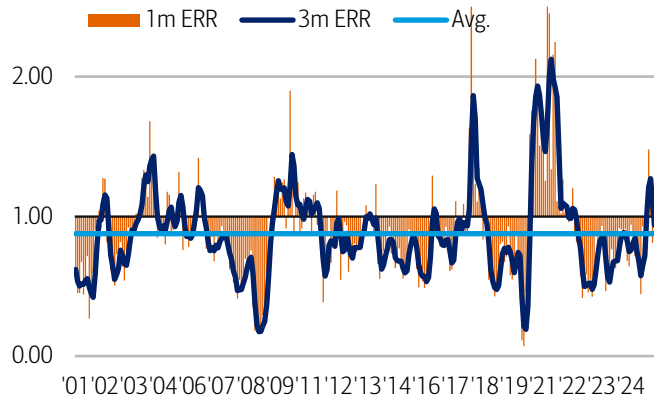
Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 9: Small caps' 3m ratio of positive vs. negative EPS revisions currently above average at 0.94x but slowing, though the 1m ratio improved to 0.97x from 0.81x

S&P 600 earnings revision ratio, 2001-11/30/25

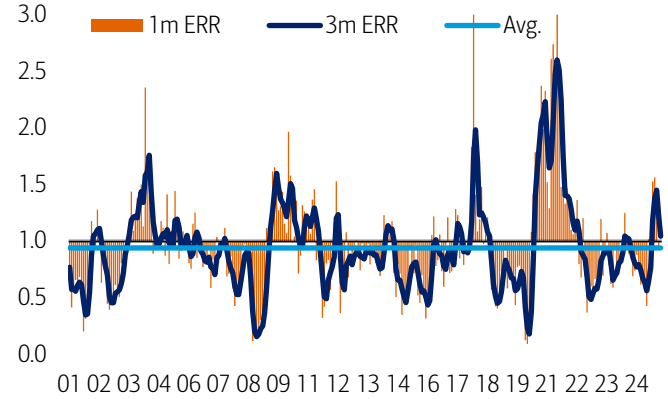


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 10: Mid caps' 3m earnings revision ratio also suggests more positive than negative revisions (1.04x) but slowing, though the 1m ratio improved to 0.99x from 0.94x

S&P 400 earnings revision ratio, 2001-11/30/25

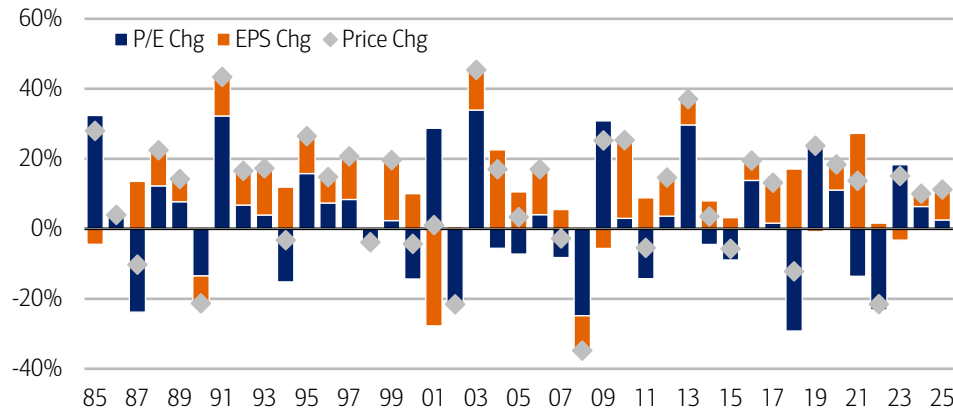


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 11: Earnings drove returns in 2025 (with a little multiple expansion) – we expect earnings continue to drive returns in 206

Russell 2000 price performance decomposition by year, 1985-2025 YTD (as of 10/31/25)



Source: FactSet, BofA US Equity & US Quant Strategy

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Profits backdrop matters more for small vs. large than GDP backdrop

The best environment for equities historically has been in backdrops of accelerating EPS growth. The combination of accelerating EPS growth and accelerating GDP growth has actually seen similar median returns in small caps to a backdrop of EPS growth with decelerating GDP growth, but decelerating EPS growth regardless of the GDP backdrop has been seen much weaker absolute and relative returns.



Exhibit 12: Accelerating profits backdrops have been the best environments for small caps, even if GDP slowing

Small cap YoY performance based on EPS and GDP growth backdrops (1950-4Q24)

Small cap returns	Accelerating EPS growth		Decelerating EPS growth	
	Decel. GDP	Accel. GDP	Decel. GDP	Accel. GDP
% occurrence	13.1%	35.0%	40.4%	11.4%
Avg. return	18.8%	15.8%	8.6%	14.5%
Median return	17.3%	17.3%	9.0%	16.3%
Hit rate	87.2%	76.0%	62.5%	82.4%

Note: Corporate profits backdrop based on S&P 500 EPS growth. Returns based on Russell 2000 from 1979-present; source for historical returns prior to 1979: CRSP®, Center for Research in Security Prices. Graduate School of Business, The University of Chicago. Used with permission. All rights reserved. www.crsp.uchicago.edu Performance has been calculated by BofA US Equity & Quant Strategy.

Source: Bloomberg, CRSP, BofA US Equity & US Quant Strategy

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Exhibit 13: Profits backdrop has mattered more than GDP backdrop for small vs. large cap returns

Small vs. large cap relative YoY performance based on EPS and GDP growth backdrops (1950-4Q24)

Small vs. large returns	Accelerating EPS growth		Decelerating EPS growth	
	Decel. GDP	Accel. GDP	Decel. GDP	Accel. GDP
% occurrence	13.1%	35.0%	40.4%	11.4%
Avg. return	5.5%	5.4%	2.8%	2.6%
Median return	4.7%	3.9%	1.5%	0.5%
Hit rate	61.5%	64.4%	53.3%	52.9%

Note: Corporate profits backdrop based on S&P 500 EPS growth. Based on Russell 2000 from 1979-present for small caps and S&P 500 for full history for large caps; source for historical small cap returns prior to 1979: CRSP®, Center for Research in Security Prices. Graduate School of Business, The University of Chicago. Used with permission. All rights reserved. www.crsp.uchicago.edu Performance has been calculated by BofA US Equity & Quant Strategy.

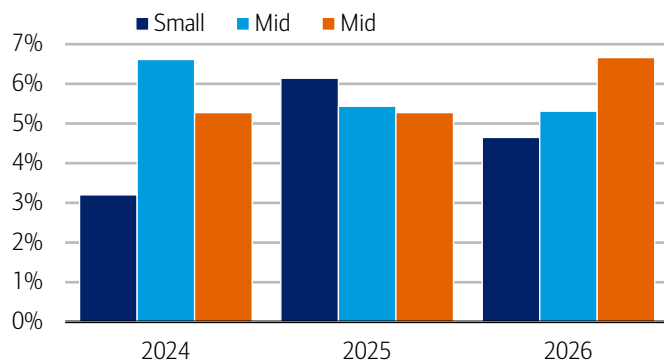
Source: Bloomberg, CRSP, BofA US Equity & US Quant Strategy

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Sales growth tepid, but improving

Exhibit 14: Sales growth expected to pick up for small caps over the next few quarters but slow in 2H26, leading to slower 2026 growth vs. 2025 (and below large cap sales growth in 2026)

S&P 600 vs. S&P 400 vs. S&P 500 consensus sales growth

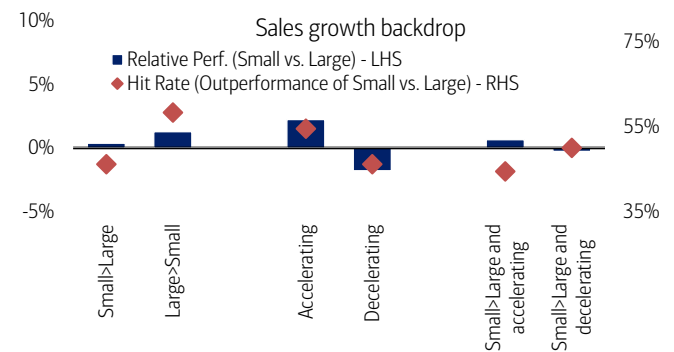


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 15: But historically, limited differentiation in relative returns based on relative sales growth scenarios (relative earnings backdrop has mattered more)

S&P 600 vs. S&P 500 annual profits growth backdrop and relative performance of small vs. large (1999-now)

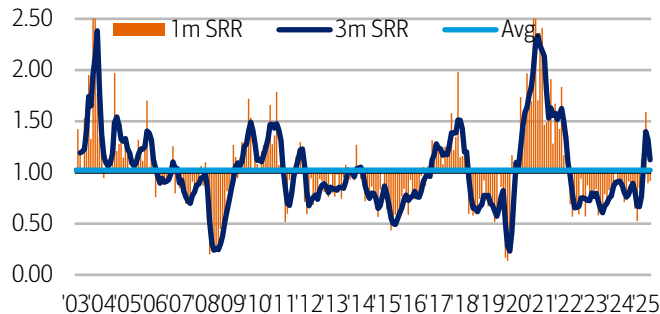


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 16: More positive than negative sales revisions for small caps over the last three months (1.02) but pace of upward revisions slowed

S&P 600 sales revision ratio, 2001-10/31/25

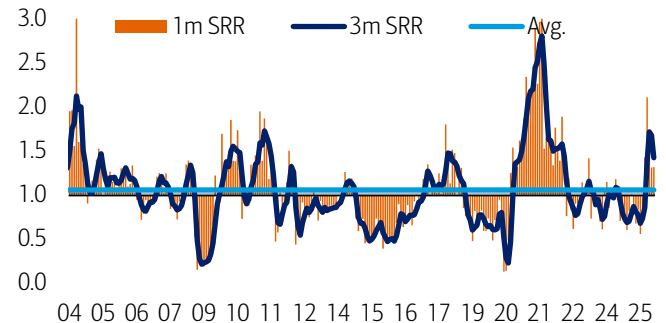


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 17: Mid caps' 3m sales revision ratio is 1.4x, with the pace of positive revisions slowing in Oct.

S&P 400 sales revision ratio, 2001-10/31/25



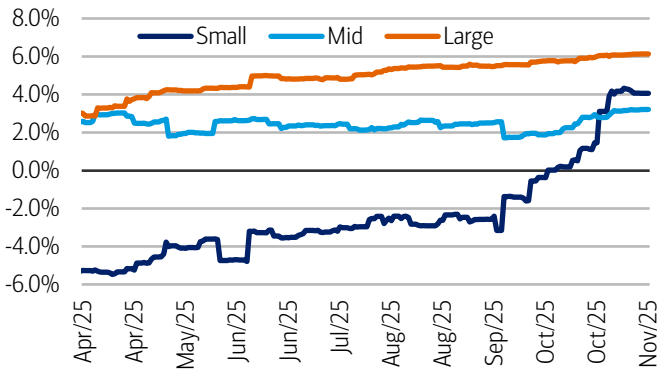
Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 18: Small cap sales seeing strong recent revisions, narrowing gap with expected growth for large caps (and outpacing mid caps)

Consensus 2026 sales growth for S&P 600 (small), S&P 400 (mid) and S&P 500 (large), Mar. 2025-present



Source: FactSet, BofA US Equity & US Quant Strategy

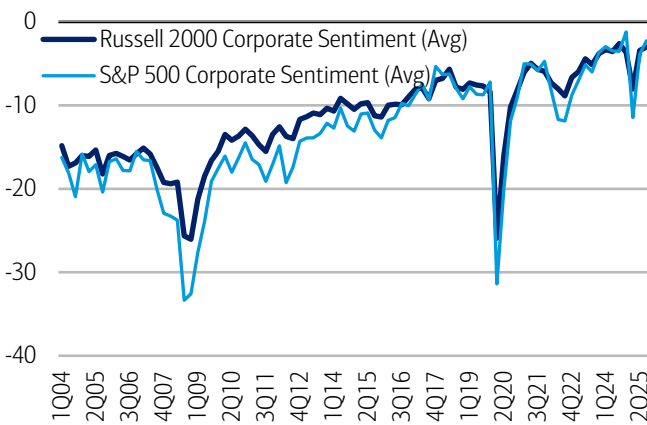
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Corporate sentiment incrementally weaker but guidance is strong

Corporate sentiment on earnings calls has improved for large caps so far this earnings season, but deteriorated slightly for small caps despite strong guidance. Meanwhile, actual earnings guidance has been very strong, with management guiding above consensus 1.4x as much as below over the last three months (and a similar guidance ratio in mid caps).

Exhibit 19: Corporate sentiment improved for large caps vs was flattish for small caps relative to last quarter

Avg. sentiment score for reported Russell 2000 and S&P 500 companies 4Q04-3Q25 (as of 11/7/25)

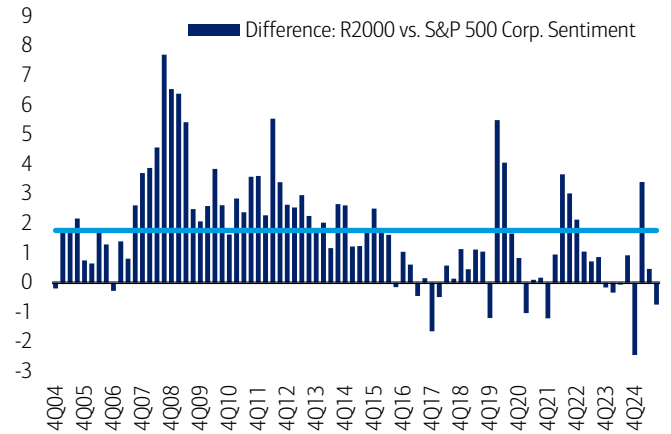


Source: FactSet, BofA Global Research

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Exhibit 20: Spread in corporate sentiment scores on earnings calls for small vs. large caps is tracking below history

Avg. sentiment score for reported Russell 2000 companies vs. the same for S&P 500 companies, 4Q04-2Q25 (as of 11/7/25)



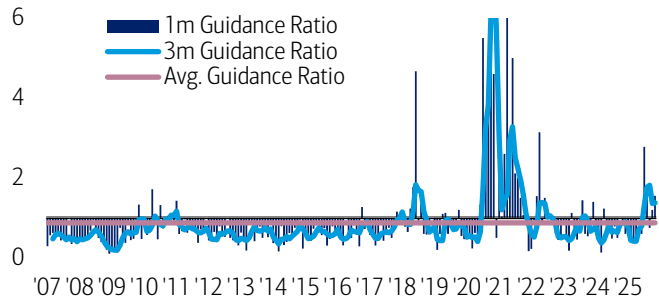
Source: FactSet, BofA Global Research

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Exhibit 21: Small cap 3m earnings guidance ratio of 1.4x is above avg. of 0.9x; 1.6x for 1m ratio

S&P 600 management guidance ratio (# above- vs. below-consensus) as of 11/30/25

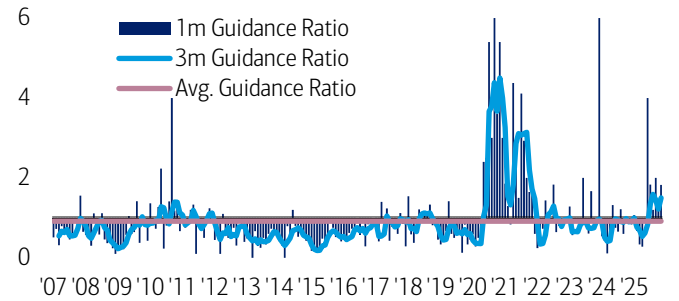


Source: Bloomberg, BofA US Equity & US Quant Strategy

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Exhibit 22: Mid cap 3m earnings guidance ratio of 1.4x is above avg. of 0.9x; 1.7x for 1m ratio

S&P 400 management guidance ratio (# above- vs. below-consensus) as of 11/30/25



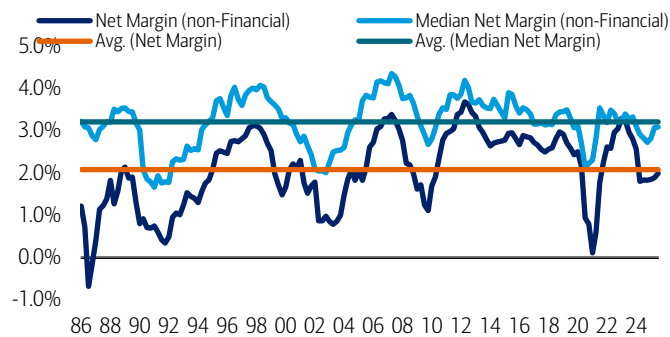
Source: Bloomberg, BofA US Equity & US Quant Strategy

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Margins improving off lows; decently resilient during the recent EPS recession

Exhibit 23: Small cap margins compressed during the earnings recession but have recovered back close to historical average levels

Russell 2000 non-financial net margins (trailing 12m), aggregate and median, 1986-3Q25

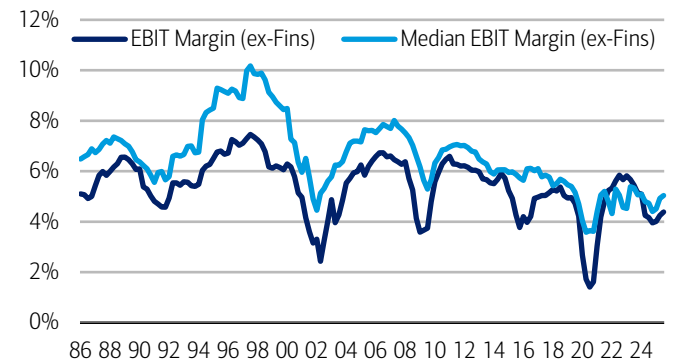


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 24: Small cap operating margins have also been recovering

Russell 2000 non-financial EBIT margins (trailing 12m), aggregate and median, 1986-3Q25



Source: FactSet, BofA US Equity & US Quant Strategy

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Credit commentary: so far, no broad-based issues

Reporting is close to wrapping up for banks, and our read on credit commentary from SMID banks has been stable to mixed, with many reporting stable or improving credit conditions while several increased reserves conservatively or saw an uptick in charge-offs. Aside from any disclosed exposures to Tricolor, First Brands etc, Commercial Real Estate (CRE) remained an area of concern cited by a few banks. But overall, more of the credit headlines occurred early in earnings season (e.g. Zion).

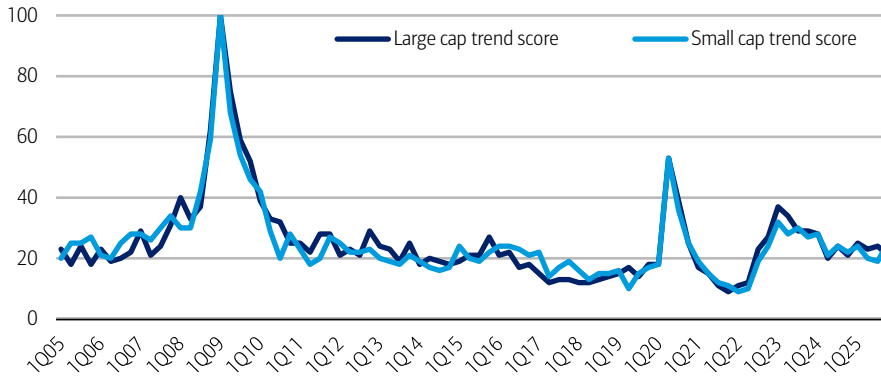
Layoffs have ticked up for small caps but remain below 2023 levels

Layoff announcements for small caps have so far ticked up q/q but are still below 2023-earnings recession levels. They saw a slightly bigger tick-up in trend in layoff announcements sequentially relative to large caps, but the overall trend score is similar.



Exhibit 25: Small caps have seen a sequential uptick in layoff announcements, but still well below the last uptick we saw during the 2023 earnings recession

Trend score in layoff announcements (100=peak) in small vs large caps, 2005-3Q25 earnings season as of 11/20/25



Source: AlphaSense, BofA Global Research

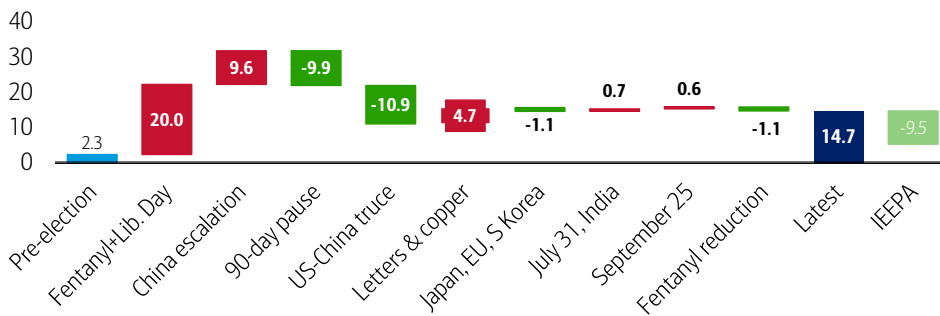
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Lower tariffs would also be a relative benefit to SMID

A recent [expert call on the IEEPA tariff hearings \(recap\)](#) hosted by our economists suggested a 70-80% likelihood that IEEPA (International Economic Emergency Powers Act) tariffs would be reversed – where small caps would be relative beneficiaries given their thinner margins have put their earnings most at risk from tariffs. The caveat is that the administration would likely use other trade authorities to enact tariffs (e.g. Section 232, 301, 122) but our economists believe effective tariff rates would still settle a few percentage points below current levels. Small caps have been the most at risk from tariffs given their thinner margins, where our worst case estimate is a ~14% hit to operating earnings (vs. an ~8% hit for mid caps). If the Supreme Court upholds the IEEPA tariffs, they would expect trade uncertainty to dissipate as the administration prioritizes trade deals over new tariff announcements going into the midterms (see [US Econ Year Ahead](#)).

Exhibit 26: After a period of volatility, our economists estimate the effective tariff rate stands at 14.7%, of which 9.5ppt (~65%) is due to IEEPA actions

Evolution of theoretical US effective tariff rate (%)



Source: BofA Global Research, Haver. Note: 90-day pause includes the electronics exemption. US-China truce includes UK deal. July 31, India includes Vietnam and Indonesia deals. IEEPA ruling assumes fentanyl/reciprocal tariffs are deemed invalid and trade deals are reneged upon

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Exhibit 27: Worst case for small caps: we estimate a ~14% hit to operating earnings from tariffs assuming companies bear the full cost
 Impact to Russell 2000 operating income using BofA Econ's estimates of US effective tariff rates (31% China, 5% Canada/Mexico, 15% RoW) and an incremental 10% retaliatory rate from China

		% passed through pricing					
		0%	20%	40%	60%	80%	100%
% hit to foreign sales	0.0%	(11%)	(8%)	(6%)	(4%)	(2%)	(0%)
	-0.5%	(13%)	(11%)	(9%)	(7%)	(5%)	(3%)
	-1.0%	(16%)	(14%)	(12%)	(10%)	(8%)	(6%)
	-1.5%	(19%)	(17%)	(15%)	(13%)	(11%)	(9%)
	-2.0%	(22%)	(20%)	(18%)	(16%)	(14%)	(11%)
	-2.5%	(25%)	(23%)	(21%)	(18%)	(16%)	(14%)

Source: FactSet, BEA, BofA US Equity & US Quant Strategy. Note: Effective rate for China based on incremental rate of slightly less than 30% (accounting for exemptions) + 11% (2024 effective rate). Effective rate for Canada/Mexico based on current rates and USMCA exemptions. Rate for ROW based on recent trade deals with conservative assumptions.

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Exhibit 28: Worst case for mid caps: we estimate an ~8% hit to operating earnings from tariffs assuming companies bear the full cost
 Impact to S&P 400 operating income using BofA Econ's estimates of US effective tariff rates (31% China, 5% Canada/Mexico, 15% RoW) and an incremental 10% retaliatory rate from China

		% passed through pricing					
		0%	20%	40%	60%	80%	100%
% hit to foreign sales	0.0%	(5%)	(4%)	(3%)	(2%)	(1%)	0%
	-0.5%	(7%)	(6%)	(5%)	(4%)	(3%)	(2%)
	-1.0%	(8%)	(7%)	(6%)	(5%)	(4%)	(3%)
	-1.5%	(10%)	(9%)	(8%)	(7%)	(6%)	(5%)
	-2.0%	(11%)	(10%)	(9%)	(8%)	(7%)	(6%)
	-2.5%	(13%)	(12%)	(11%)	(10%)	(9%)	(8%)

Source: FactSet, BEA, BofA US Equity & US Quant Strategy. Note: Effective rate for China based on incremental rate of slightly less than 30% (accounting for exemptions) + 11% (2024 effective rate). Effective rate for Canada/Mexico based on current rates and USMCA exemptions. Rate for ROW based on recent trade deals with conservative assumptions.

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Another risk from tariffs if they do not drift downward is that more of the hit from tariffs may be felt in subsequent quarters. Small cap companies built up inventory throughout this year and had ~75 days sales inventory as of August when reciprocal tariffs went into effect, suggesting companies used up that inventory in October.

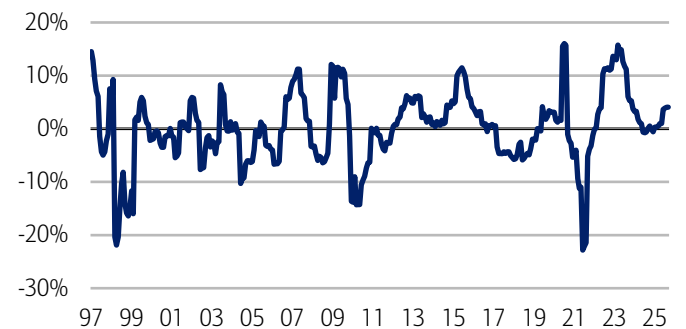
Exhibit 29: Days sales of inventory (DSI) was 74 days for the Russell 2000 as of the start or earnings season and was a similar level in Aug.
 Russell 2000 days sales of inventory (1997-3Q25)



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 30: Russell 2000 companies built up inventory ahead of and as tariffs began
 Russell 2000 YoY change in days sales of inventory (1997-3Q25)



Source: FactSet, BofA US Equity & US Quant Strategy

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Mixed tariff commentary on recent earnings calls

Small caps had ~70 days of inventory when the Aug. reciprocal tariffs went into effect, suggesting a risk there could be an uptick in tariff impacts felt in 4Q (though Trump's meeting with President Xi and the reduction in fentanyl tariffs provides some offset). Our parsing of tariff commentary on SMID earnings calls so far shows that some are already experiencing a hit with similar impact in subsequent quarters (e.g. Sweetgreen), while some companies expect a heavier impact in subsequent quarters (e.g. Levi Strauss). Meanwhile, others have noted successful pass-through of pricing/anticipated fully mitigation (e.g. [Fortune Brands](#), [Five Below](#)). Some have shifted capacity out of China (e.g. Allbirds to Vietnam).

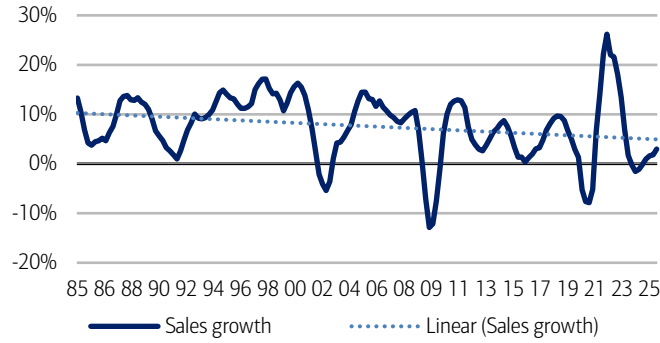
Capex cycle should benefit small cap sales

We're bullish on a US capex cycle (and capex>consumption), driven by refurbishment of aging infrastructure, hyperscale capex, reshoring, automation, etc (see [Equity Strategy Year Ahead](#)). Our work suggests that small cap sales growth is highly correlated to US capex growth (more so than for large caps), suggesting these stocks will be the biggest beneficiaries of a capex cycle. Small cap sales growth has trended downward historically in tandem with a shrinking proportion of companies' cash flow spent on capex, suggesting secular tailwinds to the sales recovery beyond the recent cyclical pick-up.



Exhibit 31: Small caps' trailing sales growth improving but over history has trended lower...

Trailing 12m sales growth (YoY) for Russell 2000, 1985-3Q25

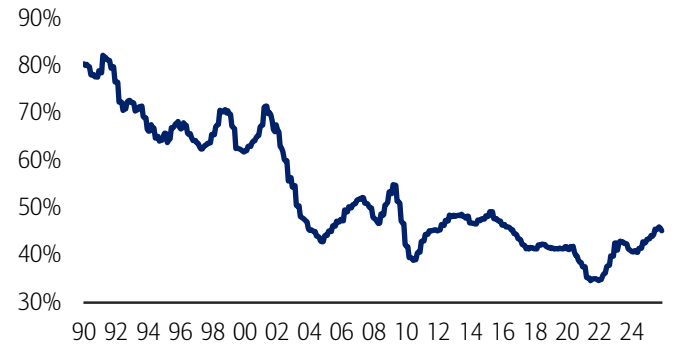


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 32: ...While capex as a share of corporates' operating cash flow has also trended lower over time, but finally picking up

Trailing 12m capex by S&P 500 companies as a % of operating cash flow, 1990-11/2025

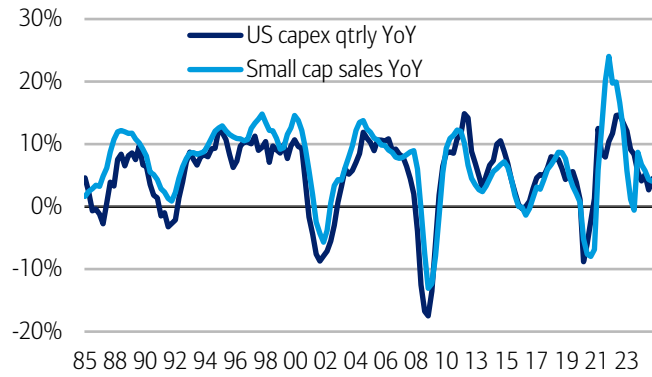


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 33: Small cap sales growth has been highly quarterly with US capex growth...

US qtrly. YoY capex growth vs. Russell 2000 YoY sales growth, 1986-2Q25

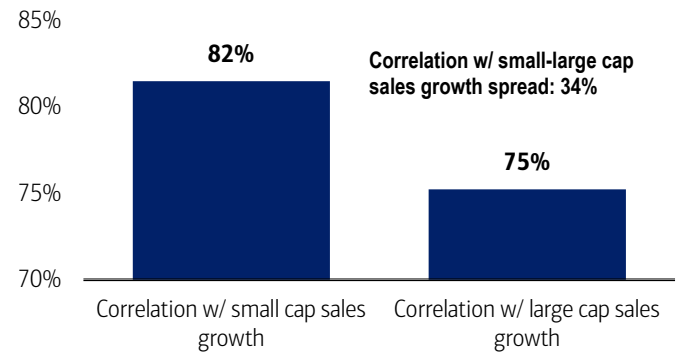


Source: FactSet, Haver Analytics, BofA US Equity & US Quant Strategy

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Exhibit 34: ...with a higher correlation (82%) than with large caps' sales growth (75%)

Correlation of US qtrly. YoY capex growth vs. Russell 2000 YoY sales growth and S&P 500 YoY sales growth, 1986-2Q25



Source: FactSet, Haver Analytics, BofA US Equity & US Quant Strategy

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Exhibit 35: Small caps most sensitive to capex are trading at reasonable valuations

Median P/E ratios of top 50 S&P 600 stocks) with the highest sensitivity to the three components of US private non-residential fixed investment, 1986-2024 (statistically significant only)

	P/E	P/E ex-nonearners
S&P 600 stocks most sensitive to US equipment spending (median)	13.7	15.1
S&P 600 stocks most sensitive to US structures spending (median)	13.6	13.1
S&P 600 stocks most sensitive to US IPP spending (median)	14.4	14.0

Source: FactSet, Haver Analytics, BofA US Equity & US Quant Strategy

Note: See our last [SMID Cap Theme Screens](#) for details - screens are based on a multivariable regression from 1986-2024, with YoY sales growth as the dependent variable, YoY growth in nominal GDP as the first independent variable, and YoY growth in each of the non-residential fixed investment components above as the second independent variable. We included only stocks with at least 10 years of data that have statistically significant betas at the 95% confidence level

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Deregulation would be bullish as well

According to a 2023 study by the National Association of Manufacturers¹ and prior studies they cite on regulatory costs among firms of various sizes, regulatory compliance costs disproportionately impact smaller firms. They note that firms with <50 employees incur regulatory costs of \$14,700 per employee per year, 20% greater than large firms of 100+ employees (\$12,200), with 50-99 employee firms incurring \$13,800 per employee. While <15% of Russell 2000 companies would be small firms by this definition, the skew of regulatory costs by firm size suggests they should see greater margin benefit from reducing regulatory costs.

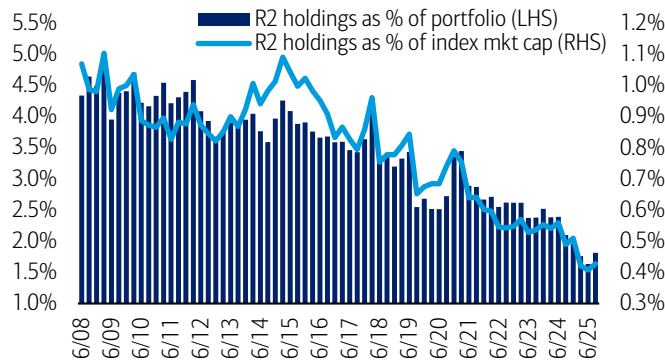
Positioning/flows supportive

Small caps very neglected, but starting to see strong flow momentum

Small caps have been reduced to the lowest weights in multi-cap managers portfolios in our post-GFC (Global Financial Crisis) data history, where managers are ~60% underweight the size segment relative to its weight in the market. Mid and mega caps, meanwhile are very overweight. On flows, our BofA equity client flow trends suggest clients are finally buying small cap single stocks this year, and with buying of small cap equities extending across client groups, most notably a big pick-up in hedge fund inflows the last few months.

Exhibit 36: Small caps make up just 1.8% of multi-cap managers' portfolios, just off of lows hit a quarter ago (based on data since 2008)

Multi-cap managers' holdings of Russell 2000 stocks as a percentage of total portfolio holdings and as a percent of Russell 2000 market cap, 2Q08-3Q25



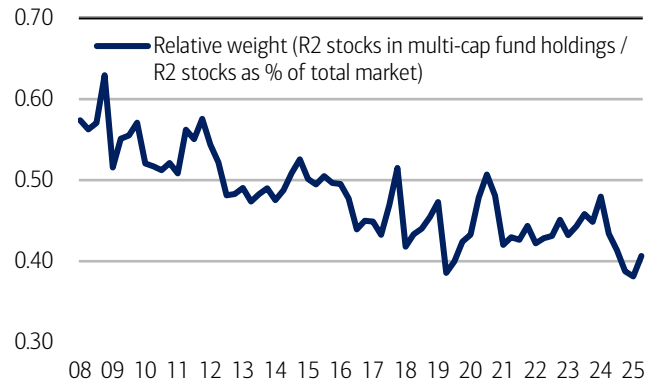
Note: Based on fund universe as of 2025 and historical holdings of those funds from 2008-now

Source: Lipper, FactSet, BofA US Equity & US Quant Strategy

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Exhibit 37: Multi-cap managers are ~60% underweight small caps

Relative weight of Russell 2000 stocks in multi-cap managers' holdings (relative to Russell 2000 stocks' weight in Russell 3000), 2Q08-3Q25



Note: Based on fund universe as of 2025 and historical holdings of those funds from 2008-now

Source: Lipper, FactSet, BofA US Equity & US Quant Strategy

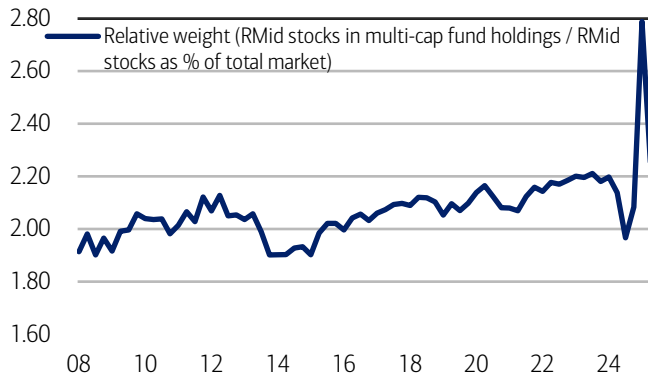
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¹ Crain, Nicole V. and Crain, W. Mark: "The Cost of Federal Regulation to the U.S. Economy, Manufacturing and Small Business", National Association of Manufacturers, October 2023 (<https://nam.org/wp-content/uploads/2023/11/NAM-3731-Crains-Study-R3-V2-FIN.pdf>).



Exhibit 38: Multi-cap funds' relative weight in mid caps shot up to record highs this year

Relative weight of Russell MidCap stocks in multi-cap fund holdings (vs. Russell MidCap stocks weight in Russell 2000), 2008-3Q25

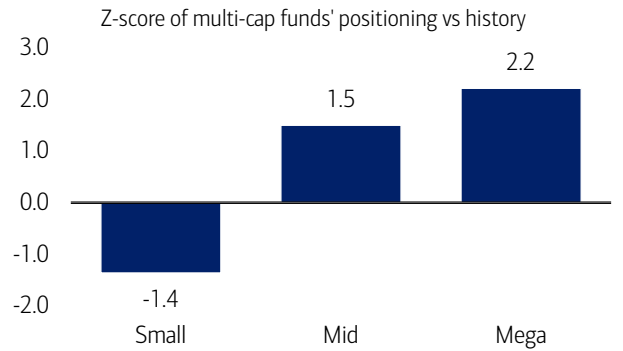


Note: Based on fund universe as of 2025 and historical holdings of those funds from 2008-now
Source: Lipper, FactSet, BofA US Equity & US Quant Strategy

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Exhibit 39: Multi-cap managers are very underweight small caps relative to history vs. very overweight mid & mega caps vs. history

Z-score of multi-cap funds' relative weight in Russell 2000, Russell MidCap and Russell Top 200 (mega cap) stocks vs. history since 2008 (as of 3Q25)

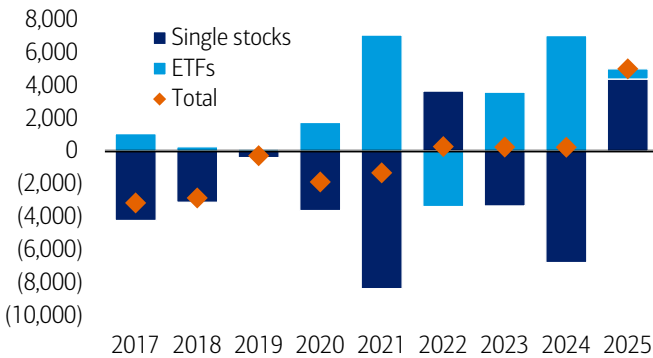


Note: Based on fund universe as of 2025 and historical holdings of those funds from 2008-now
Source: Lipper, FactSet, BofA US Equity & US Quant Strategy

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Exhibit 40: Small caps have finally begun to see single stock buying by clients this year after selling most of the last eight years

Net buying/selling of small/micro cap single stocks and ETFs by BofA Securities equity clients, \$mn, 2017-YTD 2025t

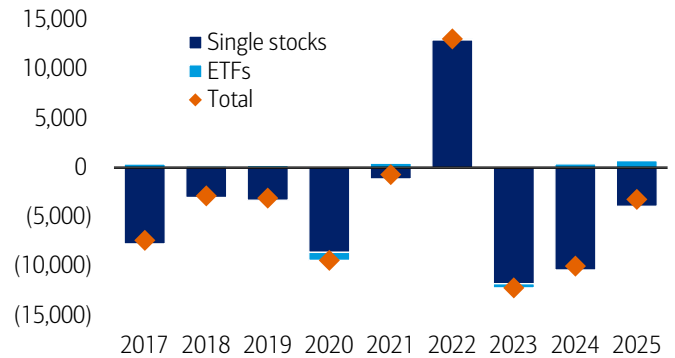


Source: BofA Securities

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Exhibit 41: Mid caps have seen ETF inflows YTD but have not yet seen the same interest or momentum in single stock inflows

Net buying/selling of mid cap single stocks and ETFs by BofA Securities equity clients, \$mn, 2017-YTD 2025t

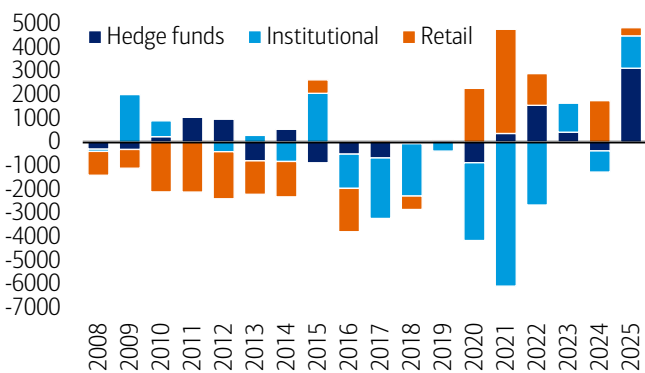


Source: BofA Securities

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Exhibit 42: Momentum in small cap flows YTD – with big inflows from hedge funds in recent months

Net buying/selling of small/micro caps by BofA client group, \$mn, 2008-now

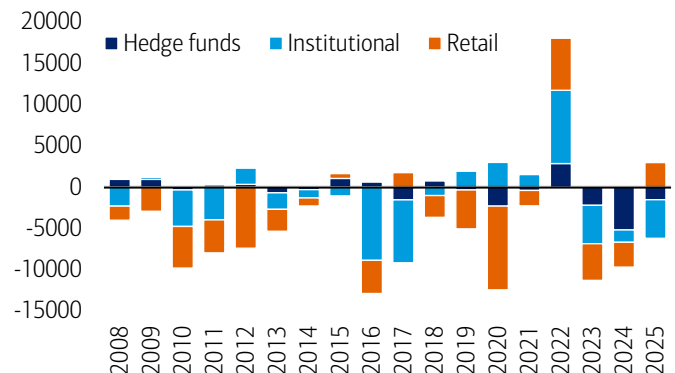


Source: BofA Securities

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Exhibit 43: Mid caps have not seen the same interest from hedge funds or institutional clients as small caps this year

Net buying/selling of mid caps by BofA client group, \$mn, 2008-now



Source: BofA Securities

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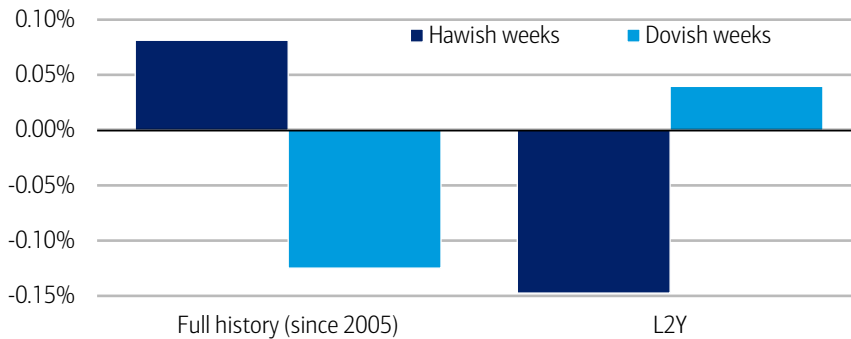
Fed cuts help mitigate refinancing risk

Fed cuts are likely to help support outperformance of small caps given their increased rate-sensitivity and elevated refinancing risk. Over the past two years, Russell 2000 has underperformed when rate cut expectations were pushed out vs. outperformed when pulled forward, the opposite was true during dovish/hawkish Fed weeks historically.

Nearly half of debt is short-term or floating rate, with more debt coming due over the next several years. We estimate the cumulative impact Russell 2000 non-Financial operating earnings over the next five years from higher interest expense (assuming 3 cuts next year which both BofA and consensus expect) is a 32% hit relative to 2024 operating earnings, but all of that hit is in 2027-29. Each further 25bp cut reduces the cumulative hit by another ~2ppt. Both consensus and BofA economists expect 3 cuts next year. Credit tightening would be a risk; every 50bp rise/fall in high yield spreads is also a ~2ppt hit/benefit. Our Credit Strategists expect very modest tightening in HY spreads to 250bp (not far above current levels).

Exhibit 44: Over the last two years, Russell 2000 has underperformed during “hawkish” Fed weeks/when cuts pushed out

Relatively performance of Russell 2000 vs. Russell 1000 in weeks where the N12m Fed funds rate expectation was increased (hawkish) vs. decreased (dovish), last two years vs. historically since 2005

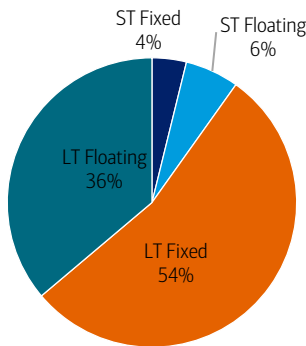


Source: Bloomberg, BofA US Equity & US Quant Strategy

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Exhibit 45: Over 45% of small cap debt is short-term or floating rate

Russell 2000 (ex-Financials) debt profile (as of 4/2025)

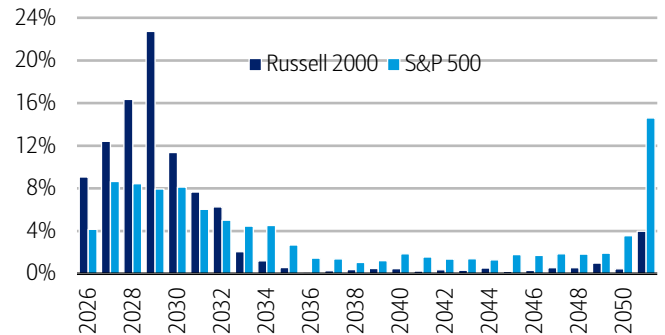


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 46: Bulk of small cap debt maturing between now and 2029

% of long-term fixed rate debt maturing by year, S&P 500 vs Russell 2000, 2025-2051+



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 47: We estimate a cumulative 32% impact to operating earnings over 5yrs from refinancing risk (assuming BofA forecast of 75bp of further cuts between now and 2026)...every further 25bp in rate cuts is another ~2ppt benefit

Russell 2000 ex-Financials: cumulative EBIT hit in 2025-29 from increase in net interest expense (assuming BofA Fed base case vs. no rate cuts)

Sector	Cumulative 5yr impact (assuming BofA forecasts)	
	for cuts	No further cuts
Consumer Discretionary	-12%	-15%
Materials	-11%	-14%
Consumer Staples	-12%	-14%
Industrials	-15%	-20%
Utilities	-12%	-16%
Energy	-20%	-23%
Information Technology	-26%	-26%
Russell 2000 ex. Fins	-32%	-37%
Real Estate	-48%	-60%
Communication Services	-73%	-87%
Health Care	NM	NM

Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

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Exhibit 48: Real Estate and Communication Services have among the greatest refinancing risk within small caps

Cumulative change in net interest expense vs. 2024 (% of '24 EBIT) for Russell 2000 non-Financials as of each year 2025-2029 (assumes BofA Economics forecast of 3 more 25bp cuts between now and 2026)

Sector	Change in net interest exp. vs. 2024 (% of 2024 EBIT)				
	2025	2026	2027	2028	2029
Comm. Svcs.	(21%)	(19%)	2%	31%	73%
Cons. Disc.	(1%)	(0%)	3%	7%	12%
Staples	(2%)	(4%)	(2%)	3%	12%
Energy	1%	1%	4%	11%	20%
Health Care	NM	NM	NM	NM	NM
Industrials	(3%)	(5%)	(1%)	6%	15%
Tech	2%	9%	14%	18%	26%
Materials	(0%)	(2%)	(1%)	3%	11%
Real Estate	(7%)	(3%)	10%	30%	48%
Utilities	(1%)	(1%)	2%	8%	12%
Russell 2000 ex. Fins	(2%)	(1%)	7%	18%	32%
ex. Fins & Utilities	(2%)	(0%)	7%	19%	33%

Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

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Table 1: Weighted avg. maturity of Russell 2000 debt = 3-4yrs

Russell 2000 ex-Financials debt: % long-term fixed & wtd. avg. maturity

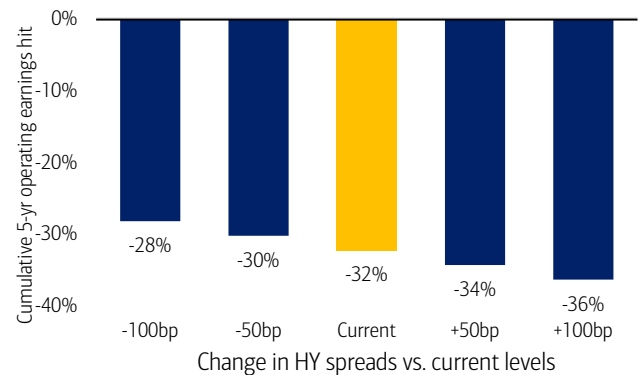
Sector	% of debt that is L/T	Wtd. Avg. Debt Maturity
	Fixed	
Utilities	78%	12.5
Energy	65%	3.7
Comm. Services	63%	3.7
Tech	58%	2.6
Real Estate	55%	3.0
Russell 2000	54%	3.6
Materials	49%	2.4
Health Care	46%	2.1
Cons. Disc.	47%	2.8
Staples	45%	1.9
Industrials	43%	3.2

Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 49: Every +/-50bp in High Yield (HY) spreads is another ~2ppt hit/benefit to the cumulative impact to net interest expensive as a % of operating earnings

Cumulative 5yr (2025-29) % increase in net interest expense (as a % of 2024 operating earnings) for Russell 2000 ex-Fins. based on HY spread scenarios



Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

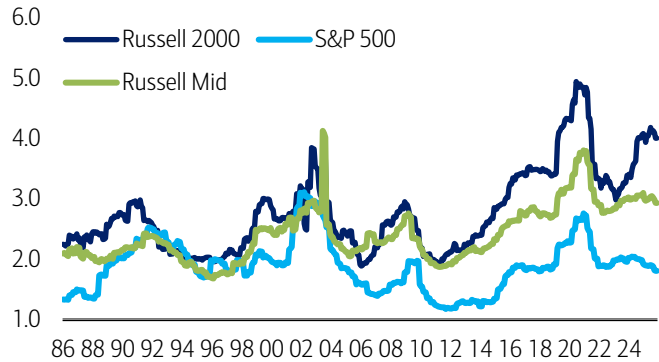
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The state of small & mid cap balance sheets

Exhibit 50: Small cap leverage at 4x, down from COVID peaks but still near historic highs

Russell 2000, Russell MidCap and S&P 500 (ex-Financials) Net Debt/EBITDA (1986-11/2025)

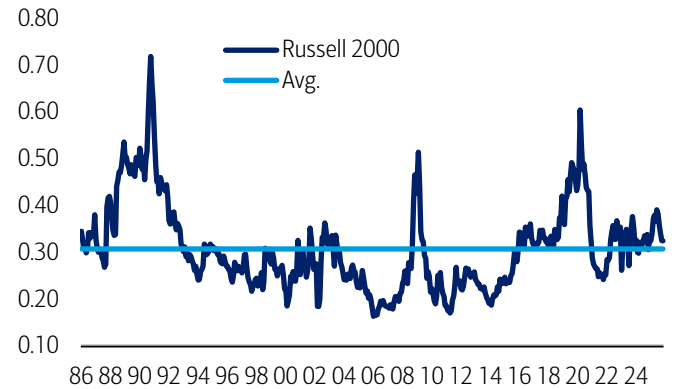


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 51: Net Debt to Market Cap at 0.32x slightly above the avg. of 0.31x

Russell 2000 ex-Financials Net Debt to Market Cap ratio 1986-11/2025

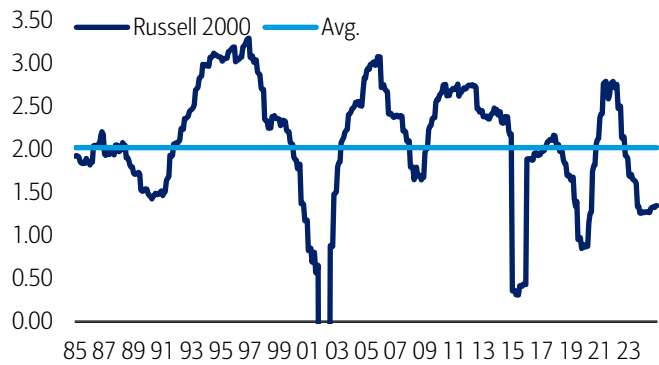


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 52: Interest coverage of 1.3x is below the avg. of 2.0x after being in an earnings recession for the past several years

Russell 2000 ex-Financials interest coverage ratio 1986-11/2025

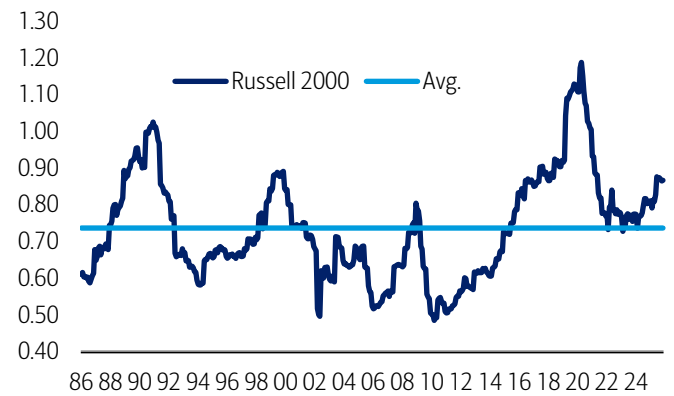


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 53: Net Debt/Equity at 0.87x is above avg. of 0.74x

Russell 2000 ex-Financials Net Debt to Equity 1986-11/2025

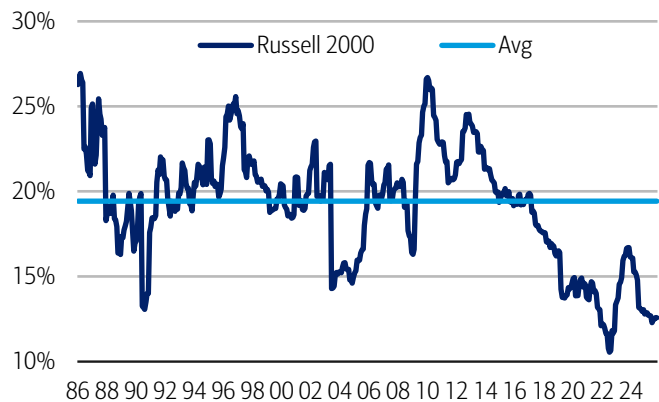


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 54: Small caps' Operating Cash Flow to Debt at 13% is below avg of 19%

Russell 2000 non-Financials Operating Cash Flow to Debt 1986-11/2025

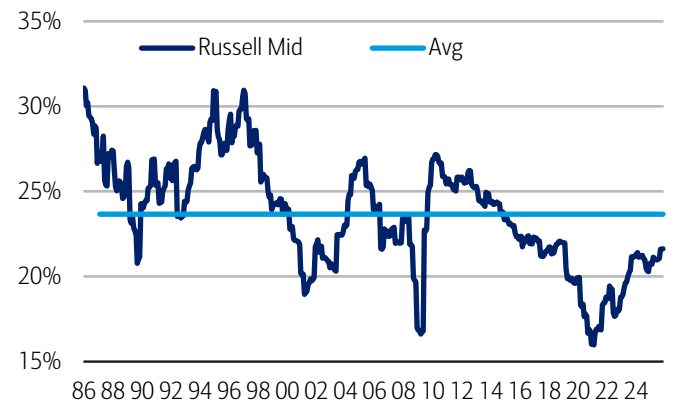


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 55: Mid caps' Net Cash Flow to Debt at 22% is slightly below the average of 24%

Russell MidCap non-Financials Operating Cash Flow to Debt 1986-11/2025



Source: FactSet, BofA US Equity & US Quant Strategy

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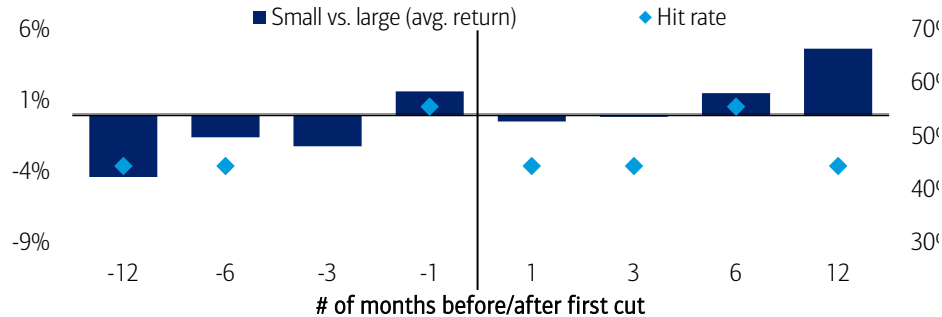


Fed cuts and size performance: historical perspective charts

Relative performance of small caps during Fed easing cycles has been mixed – small caps have typically outperformed in the 6-12 months after the first cut, but have slightly underperformed during the full cutting cycle – except if considering the cutting cycles that coincided with US recessions, where small caps outperformed, on average (and in ~60% of those instances, vs. a hit rate of only 40% during all easing cycles) - Exhibit 57. But given refinancing risk and the increased sensitivity of the Russell to rate expectations, we believe cuts should be more positive than historically for returns.

Exhibit 57: Small caps have typically outperformed large caps in the 6 months after the first rate cut, but have underperformed in the initial months, and had mixed performance over 12m (positive avg. relative returns but >50% outperformance rate)

Small vs. large cap relative returns in the 1/3/6/12 mos. before and after the first Fed rate cut since 1974



Source: Fama French data library, Haver Analytics, BofA US Equity & US Quant Strategy

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Exhibit 58: Small caps have typically outperformed during Fed cutting cycles that occurred around economic recessions, with more mixed performance in ones that didn't coincide with recessions

Absolute and relative performance of small caps during historical Fed rate cutting cycles since 1974

First cut	Last cut	# of mos	Econ recession?	Small Cap absolute performance						Full easing cycle Annualized	Relative Performance: Small vs. Large caps							
				Prior to first rate cut			Following first rate cut:				Prior to first rate cut			Following first rate cut:			Full easing cycle Annualized	
				-12m	-6m	-3m	+3m	+6m	+12m		-12m	-6m	-3m	+3m	+6m	+12m		
7/31/1974	4/30/1975	9	1	-24%	-20%	-14%	-7%	6%	39%	33%	3%	-3%	0%	1%	11%	27%	20%	
4/30/1980	6/30/1980	2	1	7%	4%	-15%	24%	43%	61%	101%	2%	1%	-9%	8%	22%	36%	46%	
1/31/1981	12/31/1982	23	1	22%	16%	2%	11%	8%	-5%	10%	10%	9%	1%	8%	7%	3%	5%	
10/2/1984	8/19/1986	23		-11%	2%	4%	-2%	11%	9%	18%	-10%	-4%	-3%	-5%	0%	-4%	-6%	
10/19/1987	2/10/1988	4		-2%	-17%	-20%	-7%	6%	11%	-14%	4%	4%	7%	-19%	-9%	-13%	-68%	
6/5/1989	9/4/1992	39	1	20%	20%	10%	3%	-2%	-1%	3%	-1%	4%	0%	-7%	-11%	-15%	-5%	
7/6/1995	11/17/1998	40		19%	16%	10%	5%	11%	19%	10%	-5%	-5%	1%	0%	-1%	0%	-14%	
1/3/2001	6/25/2003	30	1	1%	-8%	-4%	-12%	3%	2%	-4%	5%	1%	3%	6%	11%	16%	9%	
9/18/2007	12/16/2008	15	1	11%	0%	-4%	-8%	-18%	-16%	-34%	-4%	-6%	-4%	-4%	-3%	8%	0%	
8/1/2019	3/15/2020	7	1	-7%	3%	-4%	1%	7%	-5%	-33%	-12%	-6%	-4%	-2%	-4%	-15%	-20%	
Avg.				19	4%	2%	-4%	1%	7%	11%	9%	-1%	0%	-1%	-1%	2%	4%	-3%
Avg. (recessions only)				18	4%	2%	-4%	2%	7%	11%	11%	0%	0%	-2%	2%	5%	8%	8%
Median				19	4%	2%	-4%	0%	7%	6%	6%	1%	-1%	0%	-1%	-1%	1%	-3%
Hit Rate					60%	60%	40%	50%	80%	60%	60%	50%	50%	40%	50%	50%	50%	40%
Hit Rate (recessions only)					71%	57%	29%	57%	71%	43%	57%	57%	57%	29%	57%	57%	71%	57%

Source: BofA US Equity & Quant Strategy, Bloomberg (for Russell 2000 small cap returns in all cycles post-1975 and S&P 500 large cap index returns in all cycles) Haver Analytics, Source of historical returns for small caps in 1974-75 cycle: CRSP®, Center for Research in Security Prices, Graduate School of Business, The University of Chicago. Used with permission. All rights reserved. www.crsp.uchicago.edu Performance has been calculated by BofA US Equity & Quant Strategy

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What works in small when the Fed cuts: Quality/Size>Risk, Value>Growth, Mo'

Below we highlight Russell 2000 factor group performance during Fed cutting cycles historically (since 1989), both in the initial 12m after the first cut and during the full cutting cycle. Overall, Value factors have typically outperformed Growth factors, Momentum has led, Quality has outperformed, and Risk has lagged. Cash return factors have also typically fared well, and larger stocks within small caps typically outperformed smaller stocks.



Exhibit 59: Value>Growth, Quality>Risk, Momentum outperformed within small caps during Fed cuts

Avg. relative performance of Russell 2000 factor groups (top quintile vs. equal-weighted index) during Fed cutting cycles since 1989

Top Quintile vs. Index	Avg. Return		Hit Rate	
	12m after 1st cut	Full cutting cycle	12m after 1st cut	Full cutting cycle
	Momentum	6%	5%	80%
Valuation	5%	3%	60%	60%
Quality	5%	4%	100%	80%
Cash Deployment	4%	5%	60%	80%
Liquidity	3%	1%	60%	40%
Size (Mkt Cap)	2%	2%	80%	60%
Growth	0%	-1%	40%	40%
Leverage	-1%	-3%	60%	0%
Risk	-8%	-9%	20%	0%

Note: Hit rate=% of periods in which style outperformed the equal-weighted Russell 2000. For definitions of our factors, see the Appendix. Back-tested performance is hypothetical in nature and reflects application of the screen and is not intended to be indicative of future performance. Back-tested performance here is the average relative performance of Russell 2000 factor groups during Fed cutting cycles since 1989, based on top quintile factors of the Russell 2000.

Source: FactSet financial data and analytics, BofA US Equity & US Quant Strategy

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Exhibit 60: Long-short return spreads were most positive for Momentum, Quality, Value within small caps during Fed cuts

Avg. relative performance of Russell 2000 long-short factor groups (Quintile1-Quintile5) in the 3/6/12m after first Fed cut since 1989

Q1-Q5	Avg. Return		Hit Rate	
	12m after 1st cut	Full cutting cycle	12m after 1st cut	Full cutting cycle
	Momentum	17%	16%	100%
Quality	13%	14%	80%	80%
Valuation	11%	11%	80%	80%
Size (Mkt Cap)	10%	9%	100%	100%
Liquidity	8%	5%	60%	80%
Cash Deployment	6%	7%	80%	80%
Growth	5%	5%	60%	100%
Leverage	2%	0%	80%	80%
Risk	-14%	-17%	20%	0%

Note: Hit rate=% of periods in which style outperformed the equal-weighted Russell 2000. For definitions of our factors, see the Appendix. Back-tested performance is hypothetical in nature and reflects application of the screen and is not intended to be indicative of future performance. Back-tested performance here is the average relative performance of Russell 2000 factor groups during Fed cutting cycles since 1989, based on top quintile factors of the Russell 2000.

Source: FactSet, BofA US Equity & Quant Strategy

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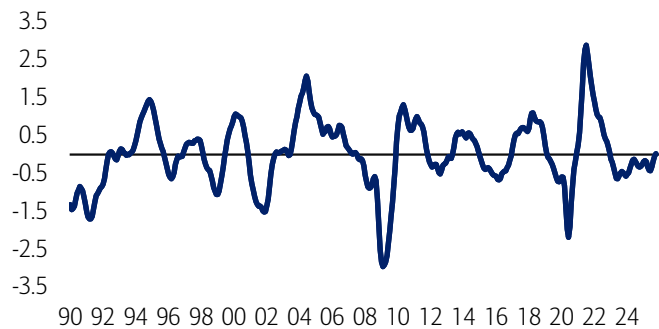
Regime backdrop currently favorable for small vs. large...

...but continued “macro muddle” suggests less of a clear signal vs history

Our US Regime Indicator – a four-phase macro indicator to determine where we are in the cycle – has been improving since mid-summer, current in the “Recovery” phase after two years of macro muddle. Recoveries have been the best phase for small caps relative to large caps, where small caps have outperformed ~75% of the time by ~8ppt on average. Small caps have still typically slightly outperformed, on average, if we were to move to mid-cycle, though the hit rate of our performance has been closer to a coin flip. Small caps have historically underperformed in Downturns, a risk if we were to slip back to that regime. But overall, the indicator has been in a “macro muddle” for over two years, bouncing back and forth between Downturn and Recovery, less of a clear signal than historically.

Exhibit 61: US Regime Indicator has improved since July, currently in “Recovery”

US Regime Indicator, 1990-10/2025

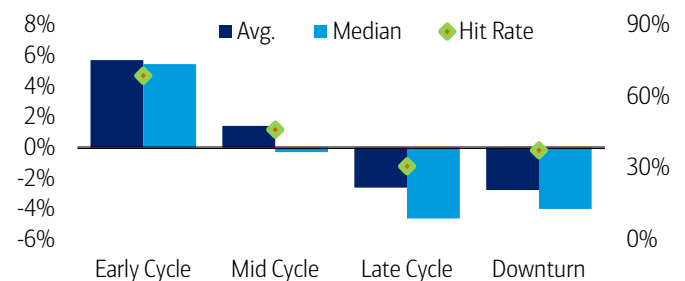


Source: BofA US Equity & Quant Strategy, LSEG Data & Analytics, ICE Data Indices, LLC, ISM Federal Reserve, BLS. See Appendix for Methodology. Disclaimer: The indicator identified as US Regime Indicator above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This indicator was not created to act as a benchmark.

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Exhibit 62: Small caps have historically underperformed large caps in Downturns and outperformed in Early Cycle/Recovery phases

Average and median relative performance of small vs. large caps during the four phases of our US Regime Indicator (since 1970)



Note: Based on Russell indices for from 1979-present; source for historical returns prior to 1979: CRSP®, Center for Research in Security Prices. Graduate School of Business, The University of Chicago. Used with permission. All rights reserved. www.crsp.uchicago.edu Performance has been calculated by BofA US Equity & Quant Strategy. For details on our US Regime Indicator, please see the discussion earlier in this report as well as the Appendix for methodology. Past performance is not necessarily a guide to future performance. Source: BofA US Equity & Quant Strategy, CRSP, Bloomberg

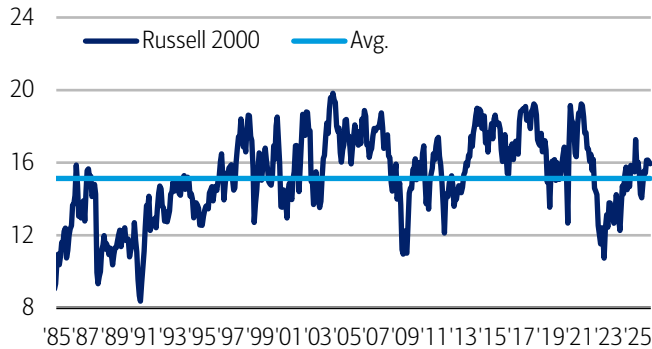
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Valuations: nothing's cheap, but small is cheap vs. large...

Exhibit 63: Small cap forward P/E of 16x is slightly above long-term avg. of 15x

Russell 2000 Forward P/E, 1985-11/30/2025

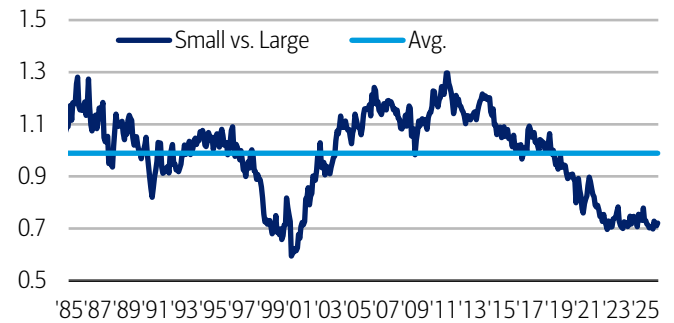


BofA US Equity & Quant Strategy, FactSet

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Exhibit 64: Small caps remain historically cheap vs large caps: relative forward P/E of 0.72x is below the historic avg. of 0.99x and has been trending around ~0.7x since 2022

Russell 2000 Forward P/E, 1985-11/30/2025

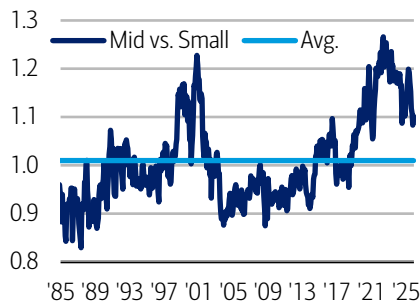


BofA US Equity & Quant Strategy, FactSet

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Exhibit 65: Relative P/E of mid vs. small caps at 1.10x remains above average of 1.01x

Relative Forward P/E of Russell Midcap vs Russell 2000, 1985-11/30/2025

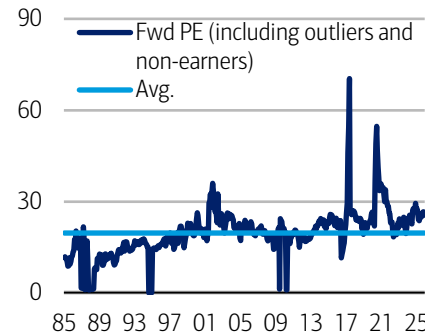


BofA US Equity & Quant Strategy, FactSet

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Exhibit 66: Small cap forward P/E including non-earners of 25x is above avg. of 22x

Russell 2000 Forward P/E (including outliers & non-earners), 1985-11/30/2025

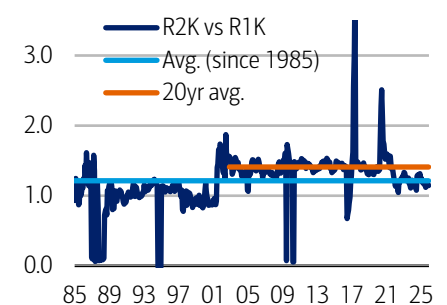


BofA US Equity & Quant Strategy, FactSet

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Exhibit 67: Rel. fwd. P/E of small vs large including outliers & non-earners (1.14x) is below L/T avg. of 1.21x & 20yr avg. of 1.41x

Russell 2000 Forward P/E (including outliers & non-earners), 1985-11/30/2025



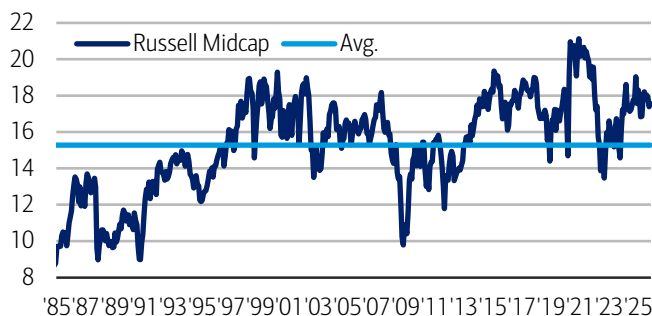
BofA US Equity & Quant Strategy, FactSet

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...and mid caps are very cheap vs. mega caps

Exhibit 68: Mid-caps continue to trade above the long-term avg. (18x vs. 15x avg)

Russell Midcap Forward P/E, 1985-11/30/2025

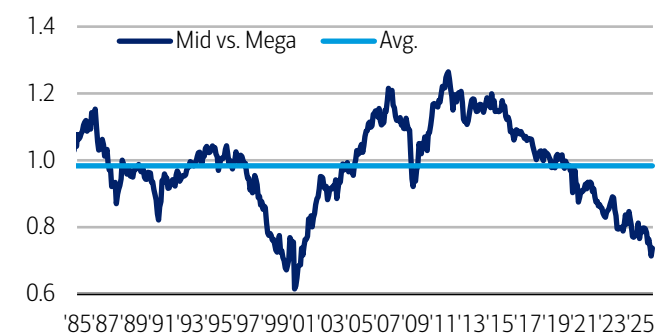


BofA US Equity & Quant Strategy, FactSet

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Exhibit 69: Mid-caps remain the most inexpensive vs mega caps in ~25 years (relative forward P/E 0.74x vs. 0.98x avg)

Relative Forward P/E of Russell Midcap vs Russell Top 200, 1985-11/30/2025



BofA US Equity & Quant Strategy, FactSet

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Key risks to constructive small cap view

If manufacturing doesn't continue to recover...

The ISM is the #1 most correlated macro indicator with small vs. large cap relative performance historically. YoY improvement in the ISM has historically been correlated with improving small vs. large cap relative performance YoY. But the ISM has now been bouncing around in the high 40s range since earlier this year and macro indicators correlated with the ISM have been mixed (Exhibit 72-Exhibit 73), suggesting uncertainty around timing/sustainability of the manufacturing recovery. This could suggest a stall in outperformance if the recent trend continues – or risks if manufacturing were to deteriorate. But easing rate pressures so far suggest the ISM should recover back into expansionary territory this year, based on the historical leading relationship between the 10yr yield and the ISM (Exhibit 71).

Exhibit 70: PMIs, leading indicators & consumer sentiment are most positively correlated macro indicators with small vs. large performance; VIX, financial conditions, credit conditions and credit spreads are the most negatively correlated

Historical absolute & relative perf. correlations of Russell 2000 vs. macro variables since 1979 (or longest available history as noted), ranked from most positive to most negative correlations with relative returns

Indicator	Rel. Perf. (R2 vs. R1)	Absolute Perf. (R2)	Data since	R1 Absolute Perf.
	Correlation	Correlation		Correlation
ISM Mfg.	0.40	0.55	12/31/1979	0.45
OECD Leading Indicator	0.36	0.69	12/31/1979	0.65
ISM Non-Mfg	0.33	0.66	7/31/1998	0.58
US Markit PMI	0.32	0.71	5/31/2008	0.71
UMich Consumer Sentiment	0.30	0.50	12/31/1979	0.42
CRB Index	0.29	0.34	12/31/1979	0.25
Housing starts	0.25	0.45	12/31/1979	0.43
NFIB Small Biz Optimism	0.21	0.48	1/31/1987	0.44
Conf Board Consumer Confidence	0.20	0.47	12/31/1979	0.50
WTI Oil	0.18	0.22	12/31/1979	0.19
10yr Tsy Yld	0.14	0.00	12/31/1979	-0.03
US Dollar Index (DXY)	0.14	-0.04	12/31/1979	-0.09
Nominal US GDP	0.12	0.25	12/31/1979	0.24
Yield Curve (10yr-2yr)	0.11	0.01	12/31/1979	-0.09
CPI	0.09	0.05	12/31/1979	0.02
2yr Tsy Yld	0.06	-0.01	12/31/1979	0.02
Real 10yr yld	0.04	-0.13	1/31/2004	-0.15
OECD GDP	0.02	0.23	12/31/1979	0.27
Industrial Production	0.00	0.14	12/31/1979	0.22
Fed Funds Rate (effective)	-0.01	0.05	12/31/1979	0.12
Unemployment Rate	-0.01	-0.18	12/31/1979	-0.31
Real US GDP	-0.04	0.24	12/31/1979	0.33
Conference Board Coincident Indicators	-0.08	0.24	12/31/1979	0.43
MOVE Index	-0.09	-0.35	4/30/1989	-0.25
Inflation Exp (5yr)	-0.11	0.01	4/30/1991	0.09
Inflation Exp (1yr)	-0.12	-0.01	12/31/1979	0.12
Initial Jobless Claims	-0.12	-0.16	12/31/1979	-0.11
IG Credit Spreads	-0.22	-0.62	12/31/1997	-0.50
SLOOS - Net % tightening (Small firms)	-0.23	-0.43	6/30/1991	-0.37
SLOOS - Net % tightening (Lg/Mid-size firms)	-0.30	-0.46	6/30/1991	-0.37
HY Credit Spreads	-0.30	-0.72	12/31/1997	-0.57
Financial Conditions (Chicago Fed)	-0.31	-0.51	12/31/1979	-0.66
VIX Index	-0.31	-0.52	1/31/1991	-0.24

Source: Haver, ICE Data Indices, LLC, Bloomberg, BofA US Equity & Quant Strategy

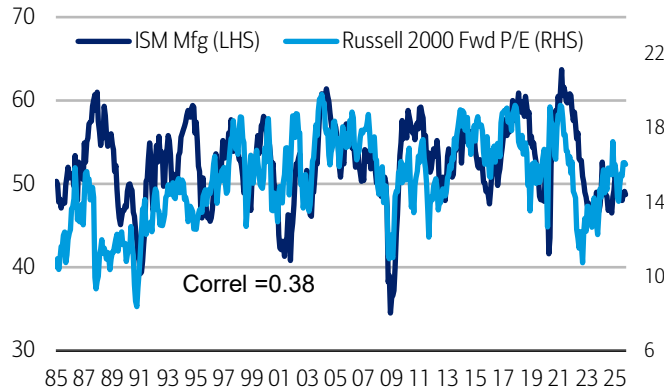
Note: based on monthly perf. for all indicators except SLOOS (Senior Loan Officer Opinion Survey) and GDP which are qtrly. All analysis since the inception of the Russell indices in 1979, or whenever the macro indicator became available

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Exhibit 71: Small cap valuations correlated with ISM (38% correlation since 1985), pricing in ISM of 57 as of October month-end (vs current level of 49)

Russell 2000 Fwd P/E (LHS) vs ISM Mfg. Index (RHS), 1985-10/31/25

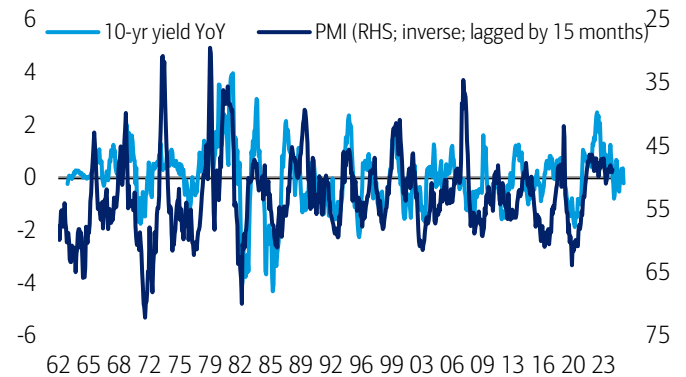


Source: Haver Analytics, FactSet, BofA US Equity & Quant Strategy

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Exhibit 72: Easing rate pressure typically translates to a pickup in manufacturing, suggesting ISM should recovery into expansionary territory (low 50s) this year based on the historical relationship

10-yr yield YoY vs. ISM Manufacturing PMI with a 15-mo. lag (1962-10/2025)

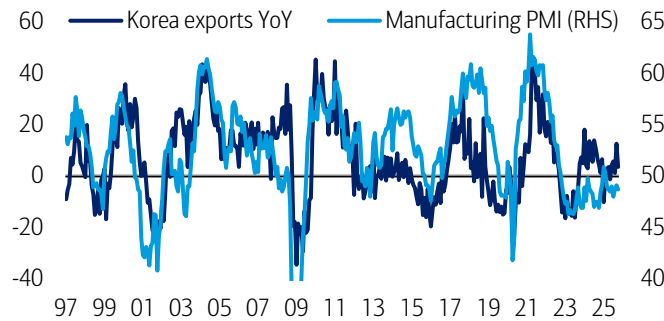


Source: BofA US Equity & Quant Strategy, Bloomberg

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Exhibit 73: Korea exports, which are correlated with ISM, are currently up slightly YoY but have been volatility in recent months

Korea exports YoY vs. ISM Manufacturing PMI (1997-10/31/25)

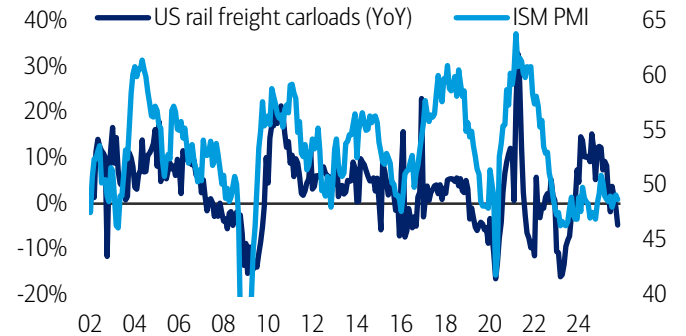


Source: Bloomberg, BofA US Equity & Quant Strategy

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Exhibit 74: Rail freight carloads correlated with ISM; carloads' YoY trend has recently deteriorated into negative territory

US rail freight carloads YoY vs. ISM Manufacturing PMI (2002-10/2025)



Source: Bloomberg, BofA US Equity & Quant Strategy

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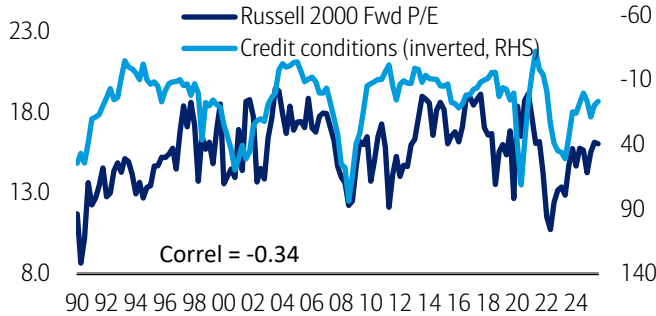
...or if credit or financial conditions deteriorate

Credit conditions and credit spreads are among the most negatively correlated indicators with small cap relative performance (wider spreads/tightening conditions are negatives). Credit Strategy Neha Khoda expects just a modest widening of spreads in 2026 (to 350bp) with default rates staying low (see [HY/Loan Strategy Year Ahead](#)). She expects better total returns in high yield credit (+5.8%) than investment grade (+4.9%).

Here we also add US Financial Conditions to our checklist of macro indicators, which we find is also among the most negatively correlated. Here, financial conditions have remained supportive (looser YoY), with the index on a downward trend since early 2023. This index contains >100 measures of financial activity across money markets, equity markets, debt markets and both the traditional and “shadow” banking systems, per the Chicago Fed., and includes many of the indicators we track above (e.g. VIX, Fed Funds, credit conditions, credit spreads, yield curve, etc.) as components.



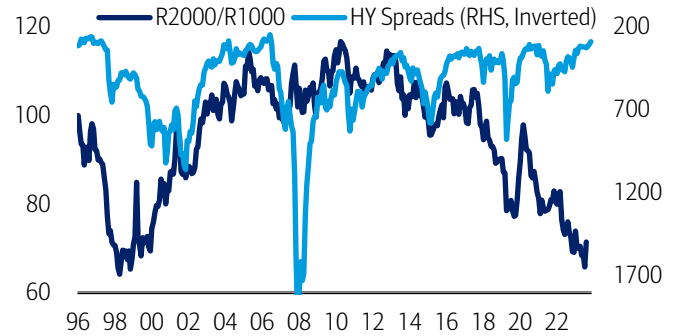
Exhibit 75: Small cap P/E also correlated (~34% correl) with credit conditions, discounting further easing in the SLOOS (net % tightening (loosening) implied by current P/E of 16x = -6% vs. latest value of 7%)
 Russell 2000 Fwd P/E (LHS) vs Senior Loan Officer Opinion Survey (SLOOS) net % tightening loans (RHS, inverted), 1990-10/31/25



Source: Haver Analytics, FactSet, BofA US Equity & Quant Strategy

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Exhibit 76: Small vs. large cap performance negatively correlated with HY spreads (but has diverged since late 2022)
 HY Spreads (RHS, Inverted) vs. Russell 2000/Russell 1000 relative performance from 12/31/1996-Present



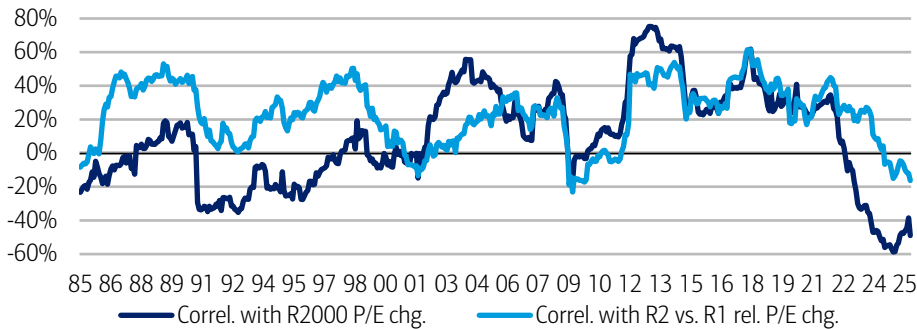
Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

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Watching interest rates, but peak is likely behind us

Our Rates strategists forecast the 10year Treasury yield to rise just slightly to 4.25% in 2026 (also their forecast for 2027). A bigger rise in rates would be a key risk: the correlation between small cap valuations and changes in interest rates is now the most negative in history (after flipping negative in 2022, and the correlation with small vs. large caps’ relative P/E is the most negative in over a decade (Exhibit 76).

Exhibit 77: Small cap valuations are more negatively correlated with changes in 10yr yields than ever
 Rolling 3-year correlation of monthly changes in the 10yr Tsy. yield. Vs. monthly changes in the forward P/E ratio for the Russell 2000 and the relative P/E for Russell 2000 vs. Russell 1000 (1985-10/2025)



Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

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Volatility could be another swing factor

One of the other most negatively correlated factors with small vs. large cap relative performance besides credit conditions/spreads is volatility. While fading policy/macro uncertainty and less tariff uncertainty could suggest lower market volatility than what we saw in early 2025, our Equity Derivatives team, meanwhile sees the case for volatility to stay supported: they believe AI is building toward a larger bubble, with history suggesting that volatility rises as bubbles build (see [Equity Derivatives Year Ahead](#)).



Themes & hot topics

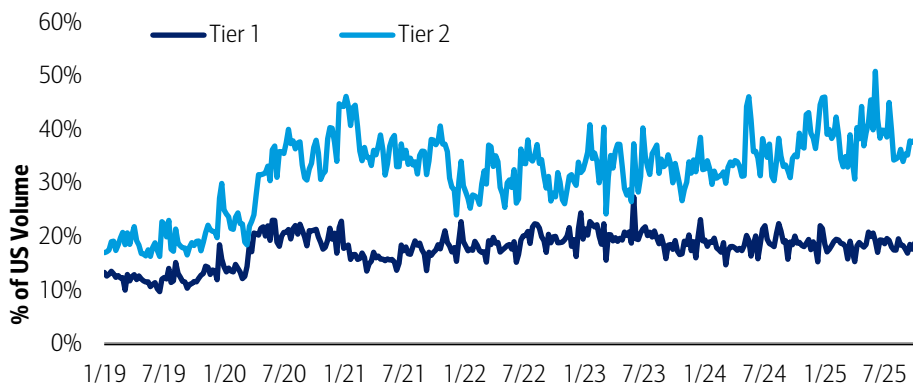
Implications of the rise of retail trading

Retail is now 30-40% of small cap volumes

Retail investor participation in the US equity market has been elevated in recent years, initially seeing a jump during 2020, helped by high savings rates, COVID/work-from-home, stimulus, and the rise of platforms like Reddit and brokers like Robinhood. While some of the factors that have contributed to a COVID-era rise in retail trading have somewhat reversed, like return-to-work and peak stimulus, retail investor participation in small caps has risen again since 2023, averaging 35-40% over that period (currently 35%). Large cap retail participation is 20% today. This compares to ~10% for small caps and ~20% for large caps pre-COVID in 2019. Post-COVID, we've found that small caps have historically outperformed large caps in periods of elevated retail trading (and underperformed in periods of low retail trading).

Exhibit 78: Retail participation makes up ~20% of large cap and ~35% of small cap volumes

Retail participation (Tier 1 = large, Tier 2 = small) as a % of US volumes, 2019-Sept 2025



Source: FINRA OTC Transparency Data and BofA Securities Methodology

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Exhibit 79: Small caps have seen better average returns in periods of elevated retail activity

Average 3m return and hit rate of small outperforming large during periods of high/low (more than/less than one standard deviation above avg.) retail trading volume in small caps post-COVID (4/2020-present)

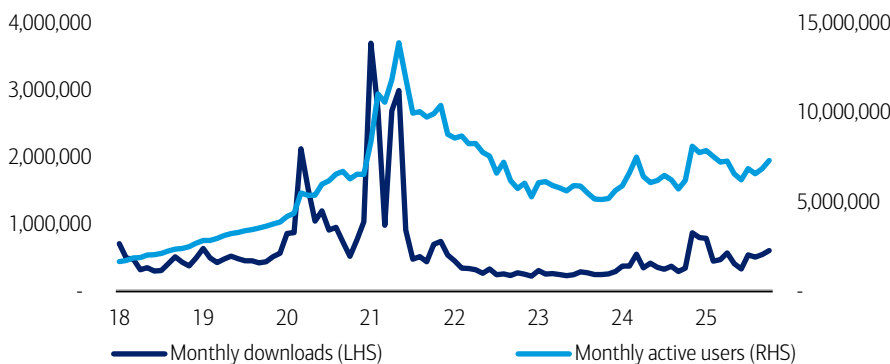
	Avg. 3m return	Hit rate of small outperforming large
High retail activity	2.3%	42%
Low retail activity	-3.3%	27%

Source: FINRA OTC Transparency Data and BofA Securities Methodology, Bloomberg, BofA US Equity & US Quant Strategy

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Exhibit 80: Robinhood activity has increased since June (though remains well below 2021 levels)

Robinhood monthly downloads and monthly active users (avg. of daily), 2018-10/2025



Source: SensorTower, BofA US Equity & US Quant Strategy

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Rising concentration risk within the Russell 2000...

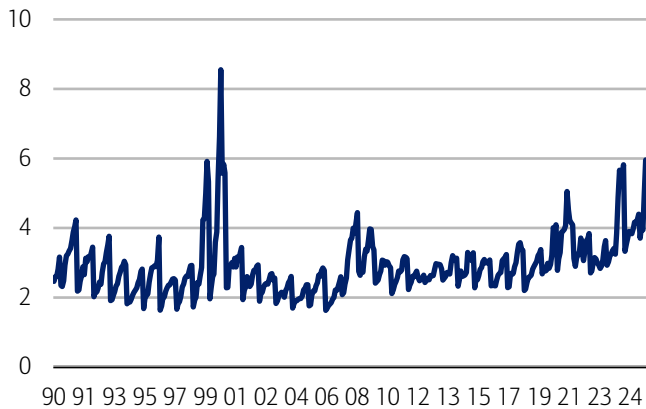
...which has challenged small cap active managers

Concentration within the Russell 2000 has risen post-COVID in tandem with higher retail activity, where some stocks that have been the focus of retail activity have grown to among the largest weights in the SMID indices at their highs. However, there is still less concentration risk in the SMID indices vs. in the large cap benchmarks. For example, the 10 largest stocks in the Russell 2000 only comprise ~6% of the index today. But they can still have a large impact on returns, where YTD the top 10 stocks contributed nearly 3ppt of the Russell 2000 index' 8% YTD return (as analyzed on 11/14). Outperformance of a narrow group of stocks in tandem with low quality/micro cap leadership YTD have contributed to a tough year for small cap fund managers (only 15% have outperformed).

Russell's move to a twice-a-year rebalance next year (June & Dec.) can help mitigate some of the concentration issues, where stocks won't "hang around" as long if they've become mid/large caps – which has also been one contributing factor to the outperformance of the Russell 2000 vs. S&P 600 over the past three years (see: "Hot topic: S&P 600 vs. Russell 2000 indices" section in this [SMID valuations note](#)). But with the second rebalance not until December 2026, it will still be a year (Jun 2025-June 2026) between the last and next rebalance, suggesting Russell 2000 could continue to lead S&P if similar dynamics persist in 2026.

Exhibit 81: Concentration in Russell 2000 has increased: top 10 stocks currently 6% of index (highest since tech Bubble peak of 8-9%)

Top 10 stocks weight in Russell 2000 by month (1990-10/2025)

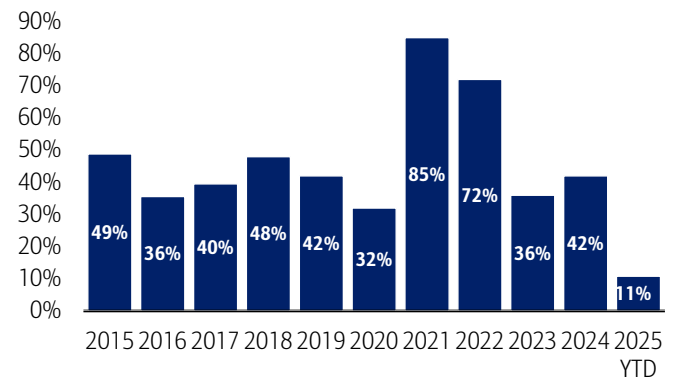


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 82: Only 15% of small cap managers were outperforming their Russell benchmark YTD as of 3Q

% of small cap active funds beating their Russell benchmark, 2015-2025 YTD as of 3Q25



Source: Lipper, BofA US Equity & US Quant Strategy

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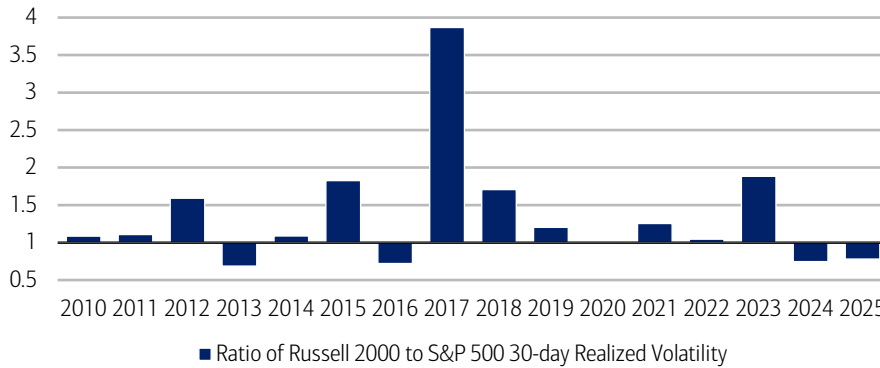
But so far, not created outsized average relative volatility for small caps

Realized volatility for small caps on average over the course of 2021 (when retail/"meme stock" activity first picked up post-COVID) was only modestly higher than for large caps – and years of recent pick-ups in activity (2024 and 2025) have seen lower average volatility for small caps vs. large caps. Interestingly, small caps have also seen lower average realized volatility vs. large caps in many recent years of market stress, including COVID, Brexit and the Taper Tantrum. We have highlighted rising liquidity risks to the S&P 500 in our Equity Strategy work – where asset allocations like pension funds now have a barbell of passive and private (suggesting more forced selling of liquid S&P 500 passive vehicles during periods of stress).



Exhibit 83: Small caps have seen lower realized volatility than large caps in recent years of market stress like 2020 (COVID), 2016 (Brexit), 2013 (Taper Tantrum) & YTD 2025 (tariffs), and also in years of elevated retail/meme stock activity ('24/'25) and only modestly higher in '21

Ratio of Russell 2000 to S&P 500 30-day Realized Volatility (Avg. by year, 2010-2025 as of 11/21/25)



Source: Bloomberg, BofA US Equity & US Quant Strategy

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Today vs. Tech Bubble: some key differences

Speculation: outperformance of unprofitable stocks is less extreme today

Within small caps, low quality stocks have outperformed high quality stocks since the start of 2Q this year. Typically low quality rallies are short lived, but there were several periods of longer (~1yr+) low quality leadership in small: leading into the Tech Bubble, the early 2000's recovery, post-GFC & post-COVID. The relative performance of earners vs. non-earners since the end of March (-42ppt as of 10/31) is about half the length of the low quality cycles we saw post-GFC/COVID and into the Tech Bubble (14-18 months. It is also lesser in magnitude (-75-90ppt during COVID/GFC and -236ppt into the Tech Bubble, though already greater in magnitude vs. the post-COVID/GFC low quality rallies once annualized). Health Care has been a key contributor to recent low quality outperformance, where 40% of non-earners today are in Health Care. As for the Tech Bubble, that period was accompanied by a significant IPO boom in non-profitable stocks. The risk: low quality stocks could have further to run if parallels to the Tech Bubble continue, one reason we have neutralized our preference for Quality.

Exhibit 84: Earners (quality) have underperformed non-earners (low quality) within small caps since the start of 2Q...typically they lead over time but lagged following COVID/GFC as well as during the tech bubble

Cumulative relative price performance of Russell 2000 earners (positive trailing profits) vs. non-earners, rebalanced monthly, 12/1988-10/2025

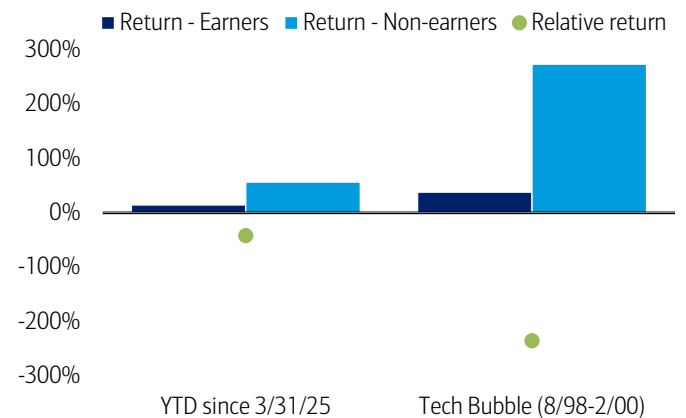


Source: FactSet, BofA US Equity & US Quant Strategy. Note: Back-tested performance is hypothetical in nature and reflects application of the screen and is not intended to be indicative of future performance

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Exhibit 85: Underperformance of high quality relative to low quality was more extreme during the tech bubble

Returns of Earners vs. Non-Earners in the Russell 2000, Tech bubble vs. Now



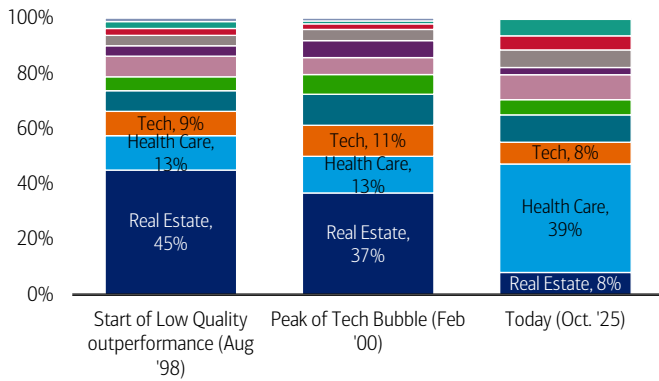
Source: FactSet, BofA US Equity & US Quant Strategy.

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Exhibit 86: Health Care has been the biggest share of non-profitable stocks today (was Real Estate during tech bubble)

Russell 2000 non-earners: today vs. Tech Bubble



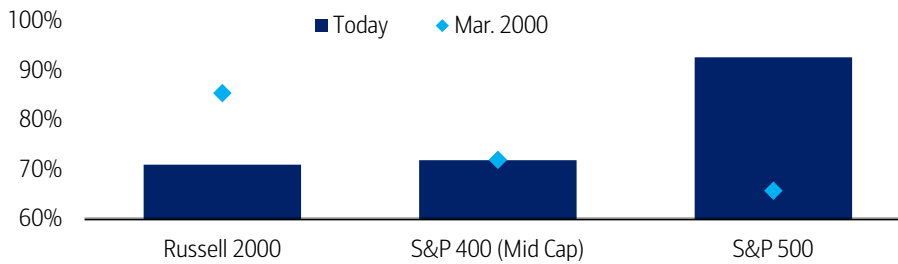
Source: FactSet, BofA US Equity & US Quant Strategy

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Russell 2000 ≠ Nasdaq

Exhibit 87: Another difference: Russell 2000 is the least-correlated benchmark with the Nasdaq today vs. the most correlated benchmark with the Nasdaq during the tech bubble

Avg. trailing three-year pairwise correlations of Russell 2000, Russell MidCap and S&P 500 with the Nasdaq (1996-10/2025), current vs. March 2000



Source: Bloomberg, FactSet, BofA US Equity & US Quant Strategy

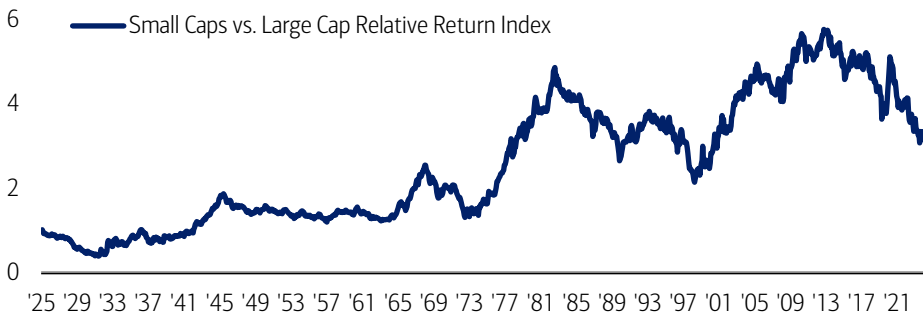
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Parallels: cheap relative valuations, subsequent outperformance

Similar to leading into the Tech Bubble, small caps have suffered a multi-year stretch of underperformance, where relative P/E ratios of small vs. large caps today are the lowest since the Tech Bubble (see Valuations section). Following the Tech Bubble, small caps enjoyed nearly a decade of outperformance vs. large caps.

Exhibit 88: Small caps have underperformed for a decade; rel. perf. cycles typically last 6-10 years

Cumulative relative performance of US small caps vs. US large caps, 1925-9/30/2025



Note: source for historical returns: CRSP®, Center for Research in Security Prices, Graduate School of Business, The University of Chicago. Used with permission. All rights reserved. www.crsp.uchicago.edu Performance has been calculated by BofA US Equity & Quant Strategy.

Source: Bloomberg, CRSP, BofA US Equity & US Quant Strategy

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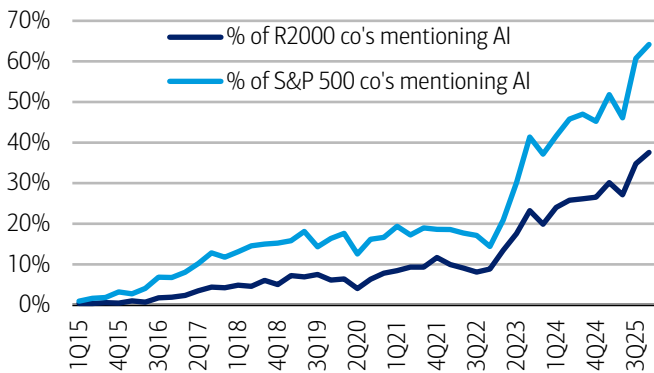
AI is a small cap story, too

AI remains a bigger theme for large caps, but we have still seen a big jump in the number of small caps talking about, investing in and benefitting from AI. 40% of small caps mentioned AI on calls this quarter, with ~20% mentioning AI investment and ~12% mentioning AI as a productivity boost. Small caps still have catch-up relative to large caps, but a lot to gain if they're able to reduce costs and enhance productivity given small caps' thin margins and greater labor intensity (highest employee/sales ratio of the three size segments).

Additionally, the companies talking about AI the most (based on number of mentions per company as of their latest earnings call) actually skew more toward the small cap range.

Exhibit 89: 40% of small caps talking about AI on earnings calls, double vs. two years ago

% of Russell 2000 companies vs. % of S&P 500 companies mentioning AI on earnings calls (1Q15-now as of 3Q25 earnings season)

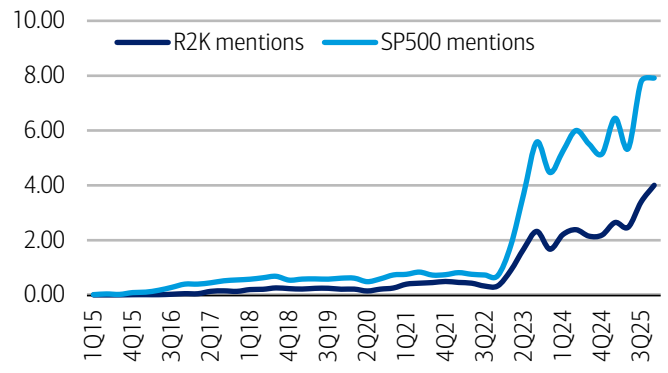


Source: FactSet, AlphaSense, BofA Global Research

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Exhibit 90: Number of AI mentions per company by small caps also continues to increase (higher but flat-lined for large caps this quarter)

of AI mentions per company on Russell 2000 vs. S&P 500 earnings calls, 1Q15-now (as of 3Q25 earnings season)

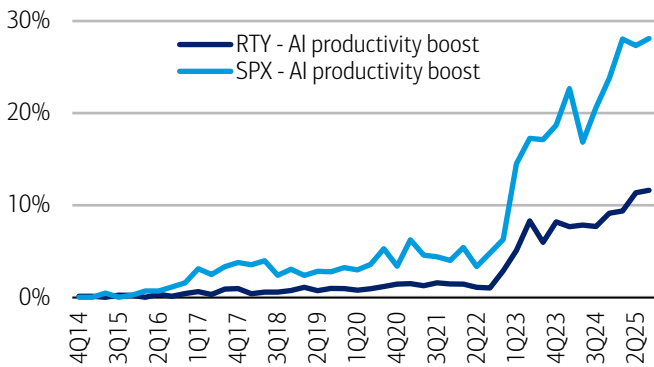


Source: FactSet, AlphaSense, BofA Global Research

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Exhibit 91: ~12% of small caps (and ~28% of large caps) are mentioning AI in the context of boosting productivity

% of earnings/guidance/other documents mentioning AI boosting productivity: Russell vs. S&P 500 (1Q15-now as of 3Q25 earnings season)

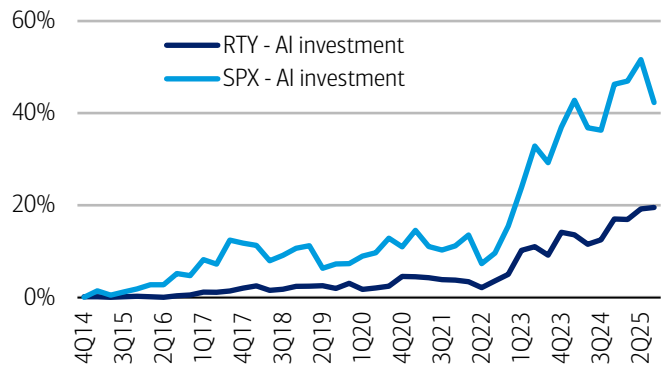


Source: FactSet, AlphaSense, BofA Global Research

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Exhibit 92: ~20% of small caps and ~45% of large caps mentioning AI investment on earnings calls

% of earnings/guidance/other documents mentioning AI investment: Russell vs. S&P 500 (1Q15-now as of 3Q25 earnings season)



Source: FactSet, AlphaSense, BofA Global Research

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Exhibit 93: The companies mentioning AI at least 30 times on their latest earnings call skew more toward small than large

Characteristics of companies with at least 30 AI mentions/co. of on latest earnings call (3Q or 2Q 2025)

30 or more AI mentions/company

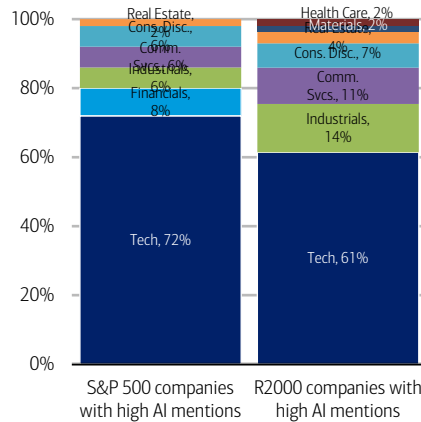
# of companies	164
Avg. Mkt. Cap	137,710
Median Mkt. Cap	5,828
% on Russell 2000	35%
% on S&P 500	30%
% on Russell MidCap*	17%
Non-index co's	18%

Source: FactSet, BofA US Equity & US Quant Strategy
 Note: % of Russell MidCap excludes any mid cap companies on S&P 500

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Exhibit 94: Companies most frequently mentioning AI outside of Tech skew toward Financials in large caps vs. Industrials in small

Sector breakdown: S&P 500 and Russell 2000 co's mentioning AI >30x on latest earnings call



Source: FactSet, BofA US Equity & US Quant Strategy
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Exhibit 95: The cheapest and highest expected growth companies with the most AI mentions are small caps

Valuations and Consensus LTG of companies mentioning AI at least 30x on latest earnings call

	Median P/E	Median P/S	Consensus LTG
Overall	21.7	3.6	12.2
R2000 co's	19.5	2.7	18.5
S&P 500 co's	24.8	5.6	11.4
RMid co's	23.0	4.2	13.3
Non-index co's	15.9	1.7	6.6

Source: FactSet, BofA US Equity & US Quant Strategy
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M&A pick-up could benefit parts of SMID

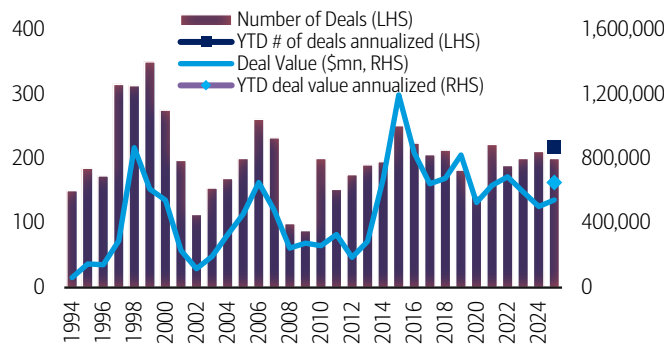
For more, including color from our fundamental analysts on the M&A backdrop/outlook, see: [What's the deal with M&A? \(07 Nov. 2025\)](#).

On track for best M&A year since '21 if pace continues

US M&A activity has been solid this year (and typically picks up after election years following the removal of policy uncertainty): deals YTD through Oct. are just 5% below last year's levels, which annualized (if the pace continues) would suggest the best year for M&A since 2021. Aggregate deal value has been tracking above last year's levels but below levels in 2021-23 and the ~5 years prior to COVID, suggesting a continued tilt toward smaller deals. This is also evident in Russell 2000 and non-index stocks dominating deals (~60% and ~33% of the YTD total, respectively) vs. still-scarce mega cap deals (1%) and a decline in share of mid cap deals (7%, vs. ~15% most recent years).

Chart 1: US M&A activity YTD tracking 5% below 2024 levels, on track for best year since 2021 (if pace continues) when annualized

US M&A activity (deal count and aggregate deal value in \$mn), 1994-YTD 2024 (as of 10/27/25)

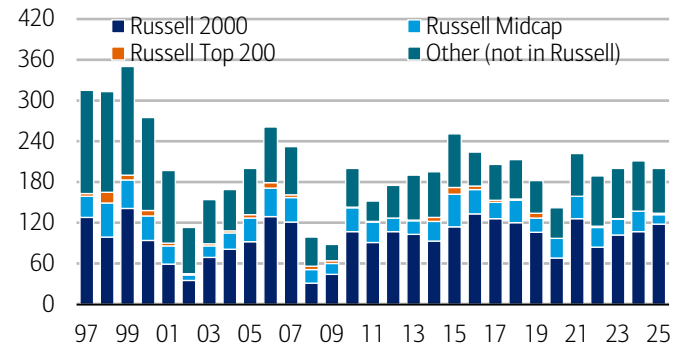


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 96: M&A deals chiefly in small caps, especially in recent years; still few mega-cap deals

of deals by size segment (based on Russell 3000 deals, 1997-2025 YTD as of 10/27/25)



Source: FactSet, BofA US Equity & US Quant Strategy

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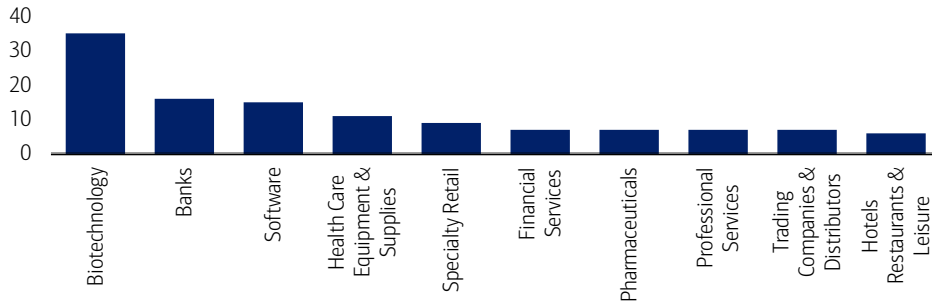


M&A YTD has been led by Biotech, Banks, Software

Health Care has dominated deal activity this year, with M&A deals tracking at a record high for Health Care in our data history since 1997. Nearly one-third of deals YTD have been in Health Care (a record share), with about half of those deals in Biotech (top industry for deals YTD). Financials has so far seen a resurgence YTD driven by Banks (the #2 industry for YTD deal activity), with Financials, Tech and Industrials each comprising 13-14% of YTD deals.

Exhibit 97: Busiest sectors for deal activity YTD have been Biotech, Banks and Software

Number of US M&A deals by GICS sector of target in 2025 YTD (as of 10/27/25)

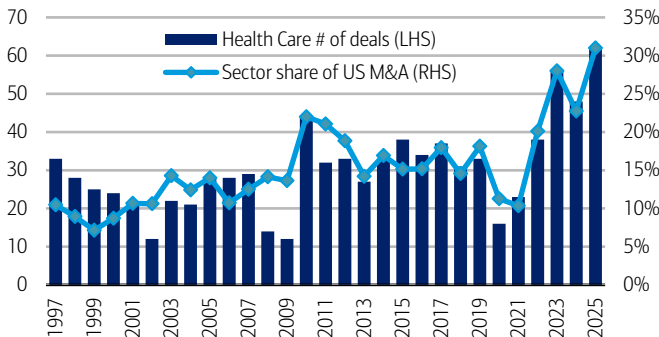


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 98: Health Care M&A activity at record highs

Health Care M&A deal count and share of total US M&A (1997-10/27/25)

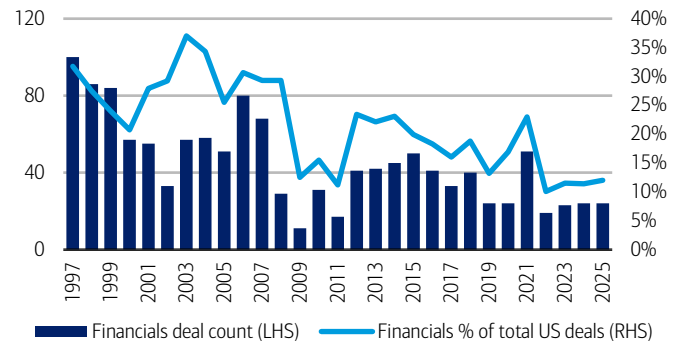


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 99: Financials M&A activity has continued to slowly rise for the third consecutive year, helped by Banks M&A this year

Financials M&A deal count and share of total US deal count, 1997-10/27/25



Source: FactSet, BofA US Equity & US Quant Strategy

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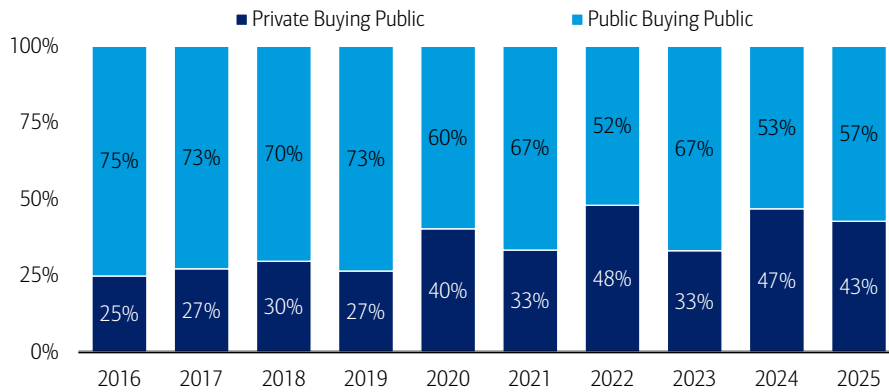
But more take-privates

Take-privates have been a historically large (>40%) share of deals over the last few years, particularly as interest rates have increased since '22. As we noted in [Relative Value Cheat Sheet: There's a new value investor in town](#), private investors are funding more opportunities in public equities that reflect marks to a higher rates/inflation backdrop. Take-privates have been most prevalent in Cons. Disc. and Comm. Services YTD (65% and 73% of deals in each YTD), followed by Tech (44%). LBO activity also remains elevated. Tightening credit conditions would pose risk to both.



Exhibit 100: Take privates remain elevated relative to most of the past decade (~45% of deals both this year and last year)

Share of US M&A deal count by category, 2016-YTD 2025 (as of 10/27/25)



Source: FactSet, BofA US Equity & US Quant Strategy

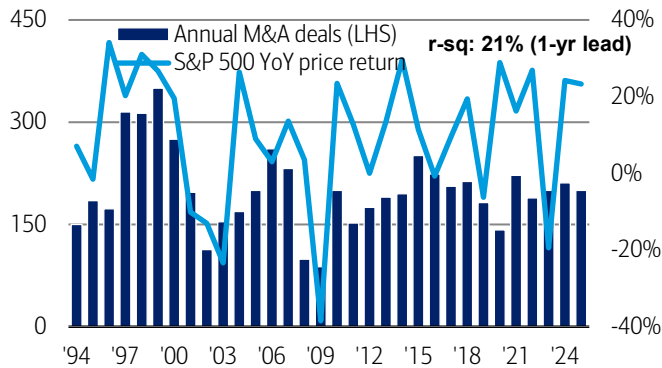
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Macro case for M&A generally supportive...

...but watching credit conditions and growth

Exhibit 101: Strong recent market returns bode well for M&A

S&P 500 YoY price return (one-year lead) vs number of annual US M&A deals; last data point is 2025 YTD price return, 1994-YTD 2025

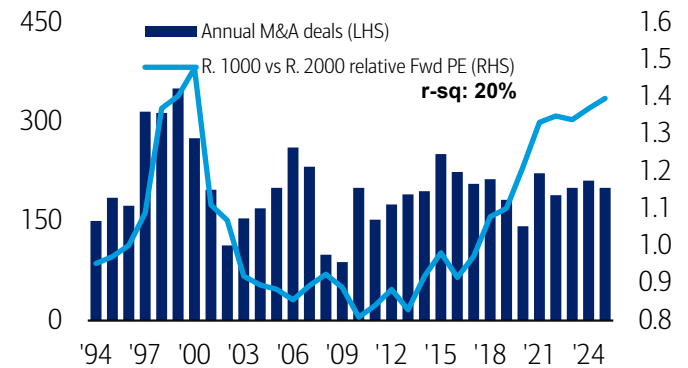


Source: FactSet, Bloomberg, BofA US Equity & US Quant Strategy

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Chart 2: Attractive valuations of small vs. large caps supports M&A

Rel. Fwd PE of Russell 1000/Russell 2000 vs # of annual US M&A deals, 1994-2025 YTD (M&A as of 10/27/25, valuations as of 9/30/25)

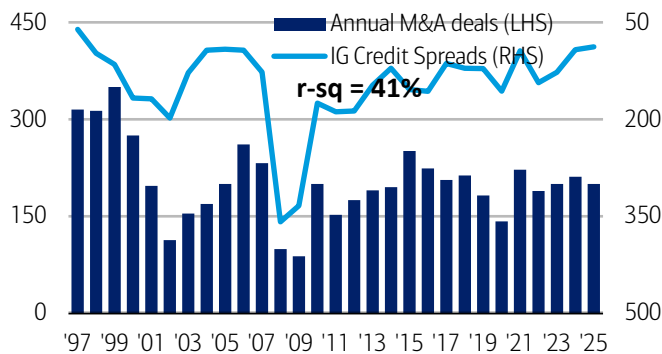


Source: BofA US Equity & US Quant Strategy, FactSet

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Exhibit 102: M&A activity has an inverse relationship with IG spreads

Avg. annual inverse IG Credit Spreads vs # of annual US M&A deals, 1994-2025 YTD (M&A as of 10/27/25, IG spreads as of 9/30/25)

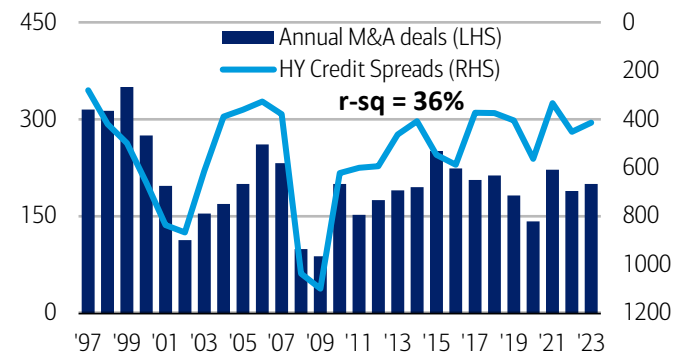


Source: BofA US Equity & US Quant Strategy, FactSet

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Exhibit 103: It is also the same case for the inverse HY credit spreads

Avg. annual inverse HY Credit Spreads vs # of annual US M&A deals, 1994-2025 YTD (M&A as of 10/27/25, HY spreads as of 9/30/25)



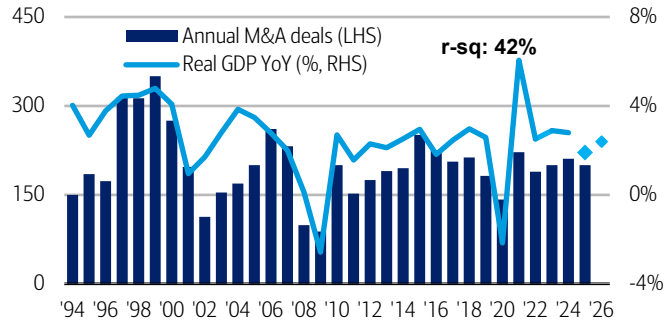
Source: BofA US Equity & US Quant Strategy, FactSet

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Chart 3: M&A is cyclical: pick-up (slowdown) in GDP growth correlated with pick-up (slowdown) in activity

Real GDP growth (Y/Y) vs # of annual US M&A deals 1994-2024 (dots=BofA GDP forecasts for '25/'26)

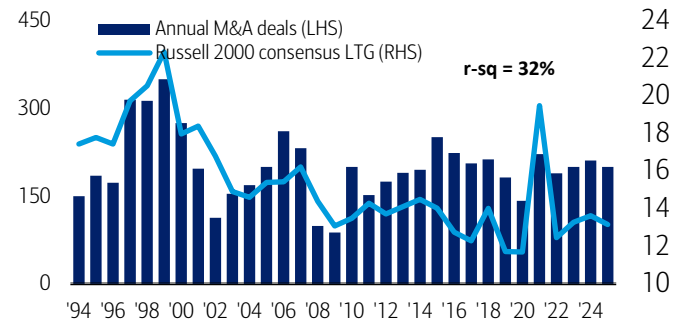


Source: BofA US Equity & US Quant Strategy, FactSet, Mergerstat, BEA

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Chart 4: Long-term growth expectations for small caps are well below what they were in the 90s/early 2000s

Russell 2000 consensus long-term growth vs. # of annual US M&A deals, 1994-YTD 2025 YTD (M&A as of 10/27/25, consensus LTG as of 9/30/25)



Source: BofA US Equity & US Quant Strategy, FactSet

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Who benefits? Small cap targets, big acquirers, select small cap sectors

While it's logical that a pick-up in M&A can boost small caps (often targets), small cap have underperformed more than outperformed in years of above-average M&A activity – likely as M&A pick-ups have coincided with times when small caps have rallied and valuations are stretched. The current backdrop could be different, as small caps are historically cheap vs. large and have suffered a massive 10yr underperformance cycle. Small cap targets have seen historically-strong outperformance YTD (+26ppt vs. the index the day post-announcement) as well as over the last several years. Given the increasing scarcity of high secular growth small caps, large cap acquirers buying growth have also outperformed post-announcement in recent years (see M&A report linked earlier in this section).

Certain small cap sectors have consistently outperformed during heavy M&A years. Health Care, Tech and Utilities have all seen better performance (based on median relative returns) in years of above-average M&A activity than years of below-average deal activity; Tech and Utilities along with Staples have also seen a greater hit rate of outperformance in years of above-average M&A activity.

Exhibit 104: Small caps have actually lagged large caps during heavy M&A years...

Years of above-average M&A activity by deal count and Russell 2000 vs. Russell 1000 performance, 1997-2024

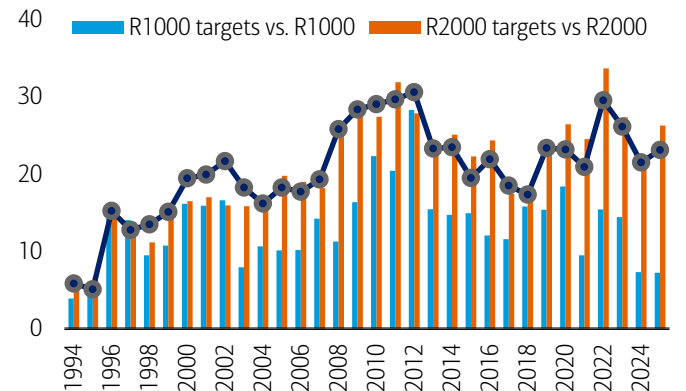
Year	# of deals	R2000	R1000	Small vs. Large
1997	315	21%	31%	-10%
1998	313	-4%	25%	-29%
1999	350	20%	19%	0%
2000	275	-4%	-9%	5%
2006	261	17%	13%	4%
2007	232	-3%	4%	-7%
2015	251	-6%	-1%	-5%
2016	224	19%	10%	10%
2017	206	13%	19%	-6%
2018	213	-12%	-7%	-6%
2021	222	14%	25%	-11%
2024	211	10%	23%	-13%
Avg:		7%	13%	-6%
Median:		12%	16%	-6%
Hit Rate:		58%	75%	33%

Source: FactSet/Mergerstat, BofA US Equity & US Quant Strategy

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Exhibit 105: Historically strong outperformance of small cap M&A targets in recent years (including 1-day outperformance of +26ppt vs. the Russell 2000 YTD)

Relative one-day performance of US M&A targets vs. Russell indices following deal announcements, 1994-2024 YTD (deals as of 10/27/25)



Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 106: Health Care, Tech and Utilities tend to see better performance in active M&A years (and Staples has seen a better hit rate of outperformance)

Relative performance and hit rates of Russell 2000 sectors vs. the index in above-average (heavy) vs. below-average (light) M&A years by deal activity (1997-2025 YTD through 10/27/25)

	Median Rel. Perf.		Hit Rate Heavy M&A Years
	Heavy M&A Years	Light M&A Years	
Health Care	3%	1%	57%
Tech	6%	0%	71%
Cons. Disc.	-4%	2%	30%
Staples	6%	7%	80%
Energy	-16%	4%	18%
Financials	-2%	2%	33%
Industrials	6%	5%	69%
Materials	0%	1%	45%
Real Estate	-3%	6%	30%
Utilities	7%	-4%	80%
Comm. Svcs.	-3%	-4%	50%

Source: FactSet/Mergerstat, BofA US Equity & US Quant Strategy

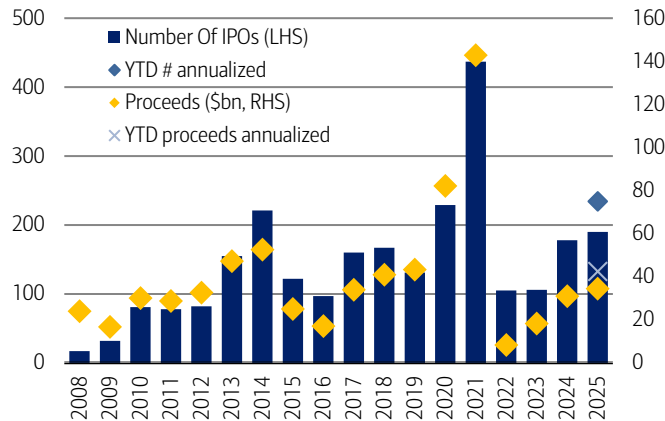
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IPOs continue to recover; best year since '21

After the IPO boom of 2020-21 (and subsequent drop-off in 2022-23), deal activity has been recovering, with 190 IPOs on major US exchanges YTD through Oct. (per FactSet data), up from 178 last year, on track for the busiest year since 2021. Total deal proceeds have also increased to their highest level since 2021, though the average deal size (\$1.1bn) was down from \$1.2bn and \$1.5bn the previous two years. Based on data from Dealogic (which extends back to 2008 but based just on US companies by business nationality that have IPO'd), IPO activity is tracking well below the 90s and mid 2000s levels. SPACs IPOs (blank check companies) have picked up again YTD, still well below activity during the 2020-21 IPO boom, but the highest share of IPOs since then at nearly 60% of US IPOs (vs. 30-35% the prior two years).

Exhibit 107: IPO activity continues to pick up from 2022 lows; 2025 annualized activity suggests further accelerating vs. 2024

Number of IPOs and IPO Proceeds (\$bn; based on IPOs of companies on major US exchanges; excludes SPACs), 2008-2025 YTD (as of 10/2025)

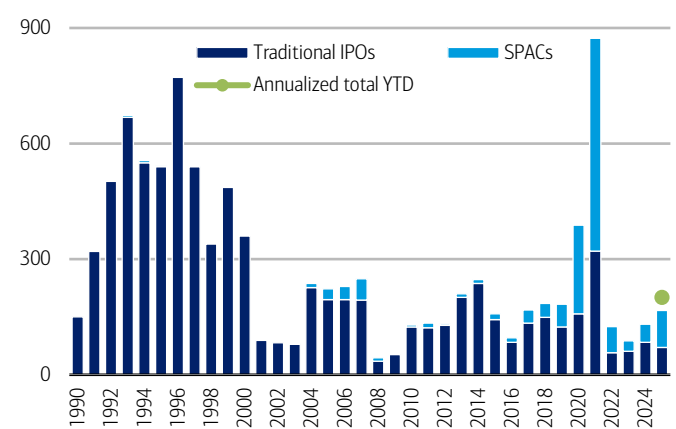


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 108: Considering US companies that have IPO'd this year, SPACs have risen to nearly 60% of the total, the highest since 2021

Number of US IPOs based on IPOs of US-only companies by business nationality, SPAC vs. non-SPAC, 2008-2025 YTD (as of 10/2025)



Source: Dealogic, BofA US Equity & US Quant Strategy

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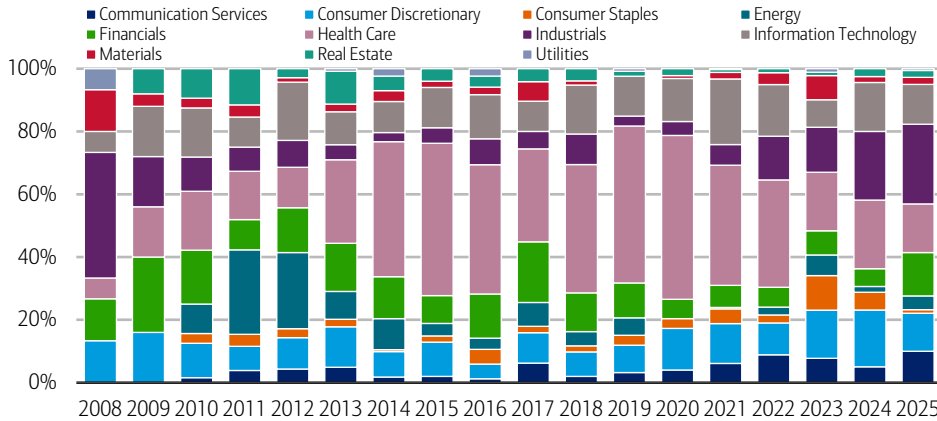
IPO activity broadening out across sectors

Health Care was the biggest share of IPOs the last five years since the 2020-21 IPO boom, but activity has broadened out across sectors this year, with Industrials, Health Care, Financials and Tech the busiest sectors.



Exhibit 109: Industrials, Health Care, Financials & Tech have been busiest IPO sectors YTD, with IPO activity more diversified across sectors relative to the last 5 years

IPOs on major US exchanges: breakdown by sector, 2008-YTD 2025 (As of 10/2025)



Source: FactSet, BofA US Equity & US Quant Strategy

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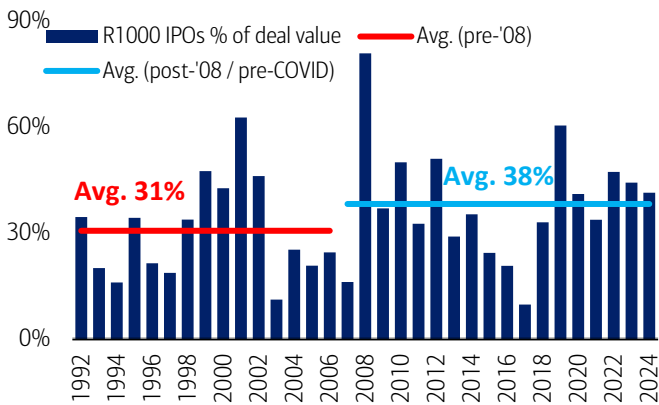
But companies staying private longer, leading to fewer/less growthy small caps

As companies stay private longer, IPOs are debuting larger: 38% of IPOs since 2008 have debuted on the Russell 1000 large cap index vs. 31% from the early 90s through the GFC (Exhibit 109). The average market cap of an IPO has risen to record highs, though still below Tech Bubble levels as a % of Russell 2000 market cap. Many small cap investors we speak with complain that many of the “attractive” small cap IPOs that do come out also get acquired right away. Amid fewer IPOs, the median age of small caps has risen and the long-term growth expectations of small caps have declined relative to history.

Deregulation and the lowering of costs for public companies could shift activity back to more IPOs, though private markets are expected to continue to grow (see our Thematic team’s recent [private primer](#)).

Exhibit 110: Stocks debuting larger: % of IPOs debuting on the Russell 1000 within 1-2 years has been higher post-08 than pre-08

Russell 1000 IPOs % of total deal value within 1-2 years post-launch, '92-'24



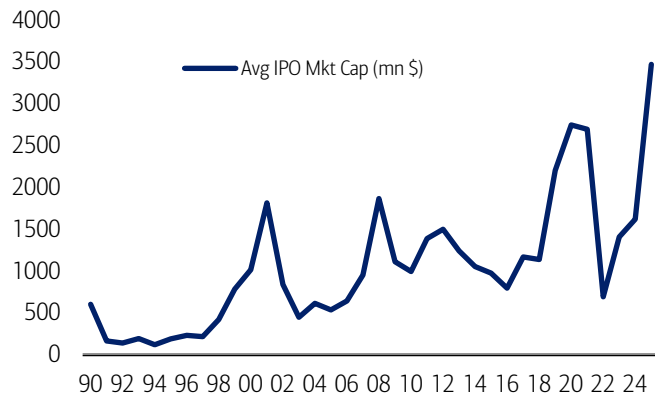
Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 111: The average IPO market cap has accelerated since '22, reaching all-time highs in '25

Avg IPO (ex-SPAC) market cap, 1990-2025 YTD (as of 10/2025)

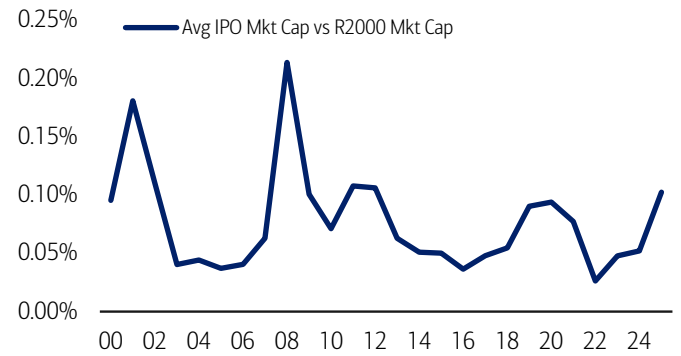


Source: Dealogic, US Equity & Quant Strategy

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Exhibit 112: However, the average IPO market cap as a percent of the Russell 2000 market cap is still below what it was back in '01 and '08

Avg IPO (ex-SPAC) market cap vs Russell 2000 market cap, 1990-2025 YTD (as of 10/2025)

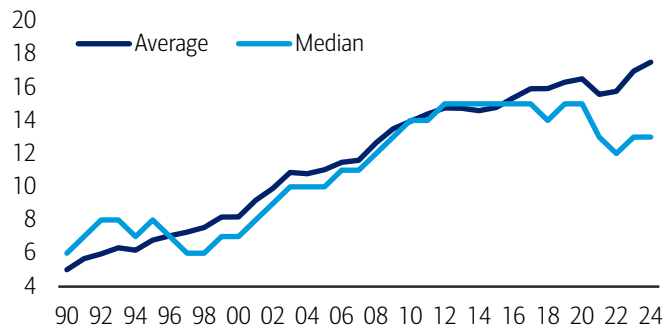


Source: Dealogic, US Equity & Quant Strategy

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Exhibit 113: The median small cap has been public for 13yrs – down from 15yrs prior to the IPO/SPAC boom, but 2x 90s/early 00s levels

Average and median age of Russell 2000 companies since their first trade date as public companies (1990-2024)



Source: FactSet, BofA US Equity & Quant Strategy. Note: first trade date history available since 1972. Companies that went public prior to 1972 excluded from the full analysis.

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Exhibit 114: Long-term growth expectations for small caps have declined from >20% in the late 90s to just 13% today

Russell 2000 median consensus Long-Term Growth (LTG) rate, 1994-2024



Source: FactSet, BofA US Equity & Quant Strategy

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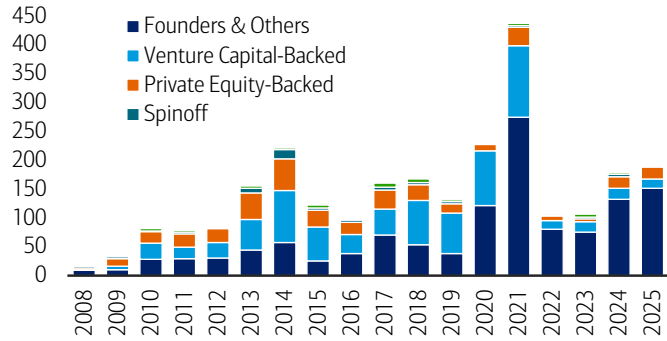
Slight pick-up in private equity backed deals, but still low

After comprising >50% of IPOs most years post-GFC, private equity (PE) and venture capital (VC) backed deals have shrunk to a minority of IPO activity since 2020 (11% since 2024 and 5-7% the three years prior). PE funds have had a challenging several years: according to Preqin, private equity fundraising has declined for four consecutive years through 2024. With a build-up of dry powder and not many exits, our Banks team had expected M&A and IPO activity could pick up this year (see report: [Banks Year Ahead](#)). PE firms may have had more incentive/demand to bring companies public the last two years after the dearth of deals in 2022-23/demand from investors for deals, and more retail money has been flowing into private capital. Lower interest rates have also been a positive, while inflation has picked up again.



Exhibit 115: Founder-led IPOs have comprised >50% of deals since 2020...

IPOs on major US exchanges: deal count by IPO type from 2008-2025 YTD (as of 10/2025)

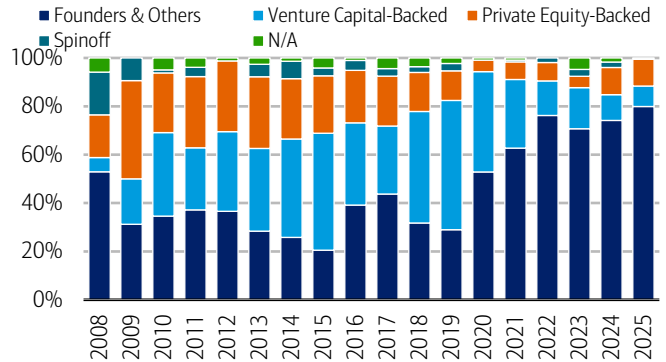


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 116: ...while private equity and venture capital backed deals have not been as prevalent, but have risen in share since 2024

IPOs on major US exchanges: deal type as a % of total deal count by year from 2008-2025 YTD (as of 10/2025)



Source: FactSet, BofA US Equity & US Quant Strategy

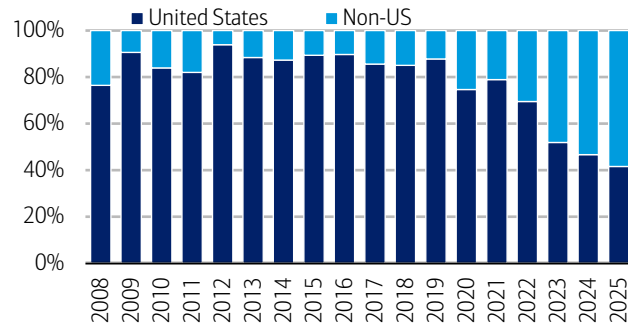
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More than half of US IPOs are now non-US stocks

Over the last five years, we have seen an increasing proportion of US IPOs that are non-US stocks, including a record nearly 60% this year. Companies outside the US have been attracted to the potential for high valuation, better liquidity, and/or more robust comps than may be offered in their home markets, particularly for smaller companies.

Exhibit 117: IPOs in the US: record share of non-US companies

Proportion of US vs non-US co's going public in the US, 2008-2025 YTD

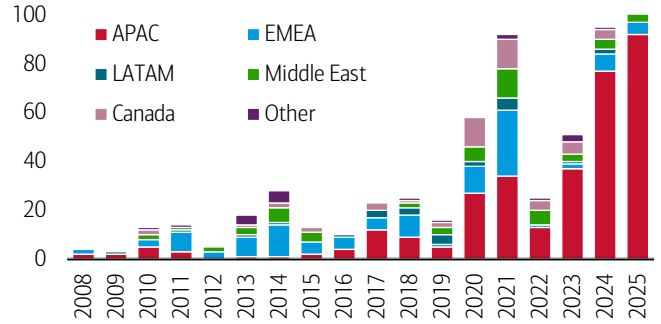


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 118: Non-US IPOs in the US chiefly from APAC in recent years

Non-US IPOs in the US: # of deals by year by region (2008-2025 YTD)

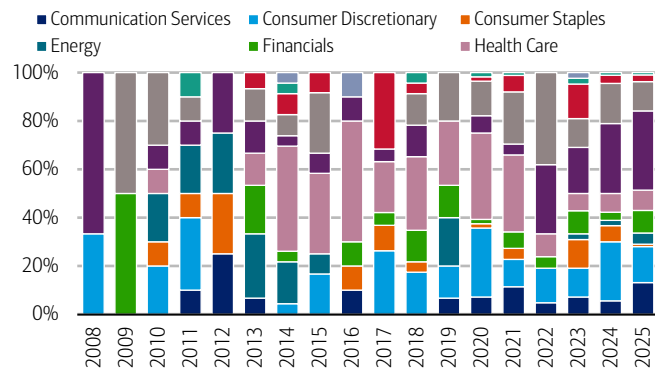


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 119: Non-US IPOs in the US have generally been diversified across sectors (with Industrials the largest share since 2024)...

Sector composition: non-US stocks which went public in the US (2008-2025 YTD as of 10/2025)

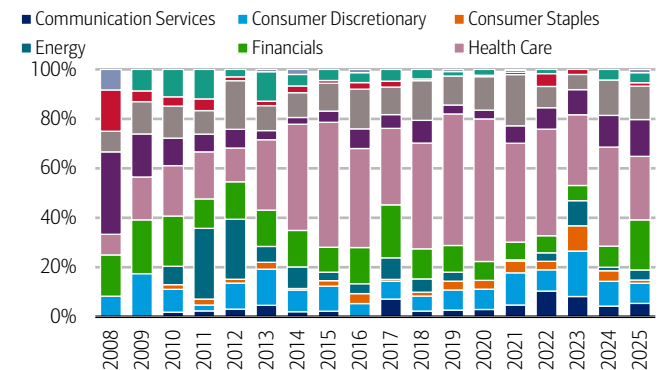


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 120: ...while US stock IPOs within the US have been most concentrated in Health Care

Sector composition: US stocks which went public in the US (2008-2025 YTD as of 10/2025)



Source: FactSet, BofA US Equity & US Quant Strategy

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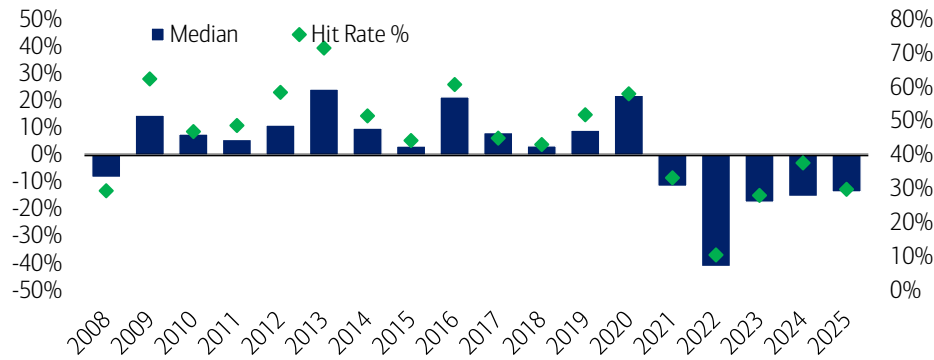
But IPOs are still underperforming

Historically, IPOs have historically tended to outperform over the short-term (1-3 months) vs. more mixed medium-term performance and underperformance over 3-5 years. But since the IPO boom of 2020-21 (which saw a boom in low quality/non-profitable IPOs), IPOs have underperformed even in the initial months post IPO.

Overall since the '20/'21 IPO boom (which saw a record proportion of non-earner IPOs), there has been a focus on quality/profitability, helping to explain overall IPO underperformance amid a declining but still-elevated proportion of non-earner IPOs, and within IPOs, outperformance of earners vs. non-earners. Performance has been more mixed within IPOs amid this year's low quality leadership: earners have outperformed non-earners over the subsequent 3m but lagged over 1m and 6m periods.

Exhibit 121: IPOs typically outperform short-term (3mos post offering) but following the IPO bubble of '20-'21, the median IPO is still seeing negative returns

Median historical; 3 month performance of US IPOs (excludes SPACs) from 2008-2025 YTD (through Oct.)



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 122: Most IPOs underperformed in 2025

Performance of US IPOs (excl. SPACs) in 2025 YTD (through Oct.) vs history since '08 (subsequent 1,3,6,12-mos.)

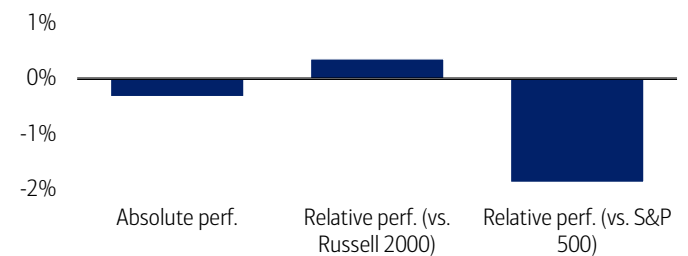
	Absolute perf.				Relative perf. (vs. Russell 2000)			
	1m	3m	6m	12m	1m	3m	6m	12m
2025								
Median	0%	-14%	-32%		0%	-16%	-43%	
Hit Rate	47%	30%	12%		48%	31%	10%	0%
Historical median	4%	4%	-3%	-11%	4%	1%	-8%	-16%
Historical hit rate	59%	54%	47%	43%	59%	52%	44%	39%

Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 123: In 2025, IPOs have performed in-line with the Russell 2000 over the subsequent monthly but have lagged the S&P 500

Median 1m performance of US IPOs in 2025 YTD (through Oct. 2025) vs. Russell 2000 and S&P 500



Source: FactSet, BofA US Equity & US Quant Strategy

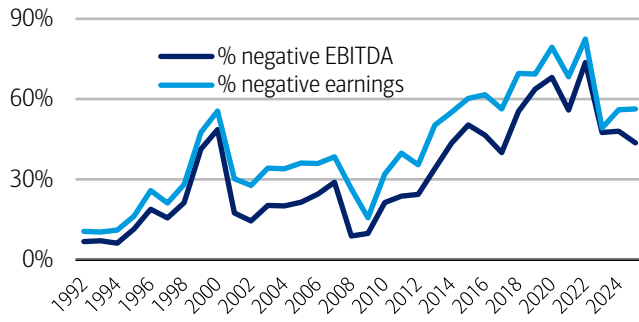
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One shift: 2025 saw slightly better reception to low quality IPOs amid a backdrop of risk-on/low quality outperformance within small caps. Non-earner IPOs YTD have outperformed earner IPOs over the subsequent 1m and 6m, though have still lagged over 3m.



Exhibit 124: 56% of IPOs in 2025 had negative earnings vs 70-80% of IPOs in 2020-2022 (but still similar to Tech Bubble highs)

% of US-IPOs (ex-SPACs) with negative earnings & negative EBITDA (1992-2025)



Source: Dealogic, FactSet, US Equity & Quant Strategy

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Exhibit 125: Since 2021, profitable IPOs (stocks with earnings) have outperformed unprofitable IPOs (stocks with negative earnings), though YTD has been more mixed to positive for nonearner IPOs

Relative median performance of profitable vs. unprofitable (negative earnings) IPOs, 2019-2025

	1M	3M	6M	12M
2019	-12%	-3%	-23%	-67%
2020	-39%	-47%	-45%	-21%
2021	0%	19%	24%	23%
2022	27%	35%	30%	41%
2023	29%	48%	42%	11%
2024	7%	-9%	10%	10%
2025	-3%	2%	-15%	

Source: FactSet, BofA US Equity & US Quant Strategy

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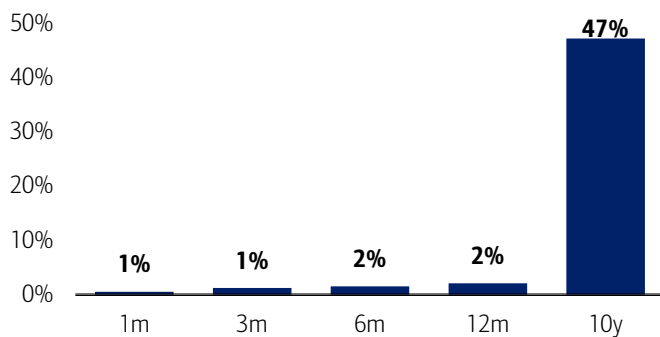
Long-term view: Small > mid > large

Our work suggests that valuation tends to be a poor short-term timing indicator, but it matters much more for long-term (10-year) returns. This also applies when looking at the relationship between relative small vs large cap valuations and subsequent relative returns, particularly at extremes.

As of month-end, multiples suggest 9% annualized returns for small caps over the next 10 years vs 1% annualized returns for large caps, based on the historical regression of P/E vs subsequent returns for the Russell 2000 and Russell 1000 indices. The relative forward P/E of the Russell 2000 vs Russell 1000 also suggests that small caps could outperform large caps over the next 10 years (by 3ppt a year based on the relative multiple, Exhibit 126). For the Russell MidCap, multiples as of month-end suggest 6% annualized 10yr returns.

Exhibit 126: Valuations have the highest explanatory power over the long-term, explaining half of the variability in small vs. large cap returns over 10yrs vs. 2% or less over 1m, 3m, 6m or 12m periods

R² of relative forward P/E vs subsequent return spread over various time horizons (since 1985): Russell 2000 vs Russell 1000, as of 11/30/2025

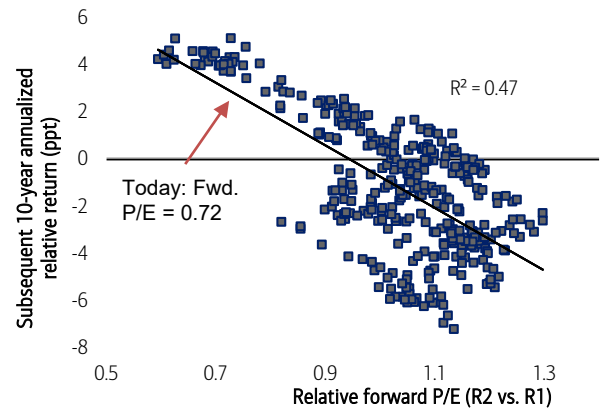


Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling returns differential. Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 127: Relative fwd. P/E of 0.72x for small vs. large caps suggests that small caps could outperform large caps over the next ten years

Relationship between relative fwd. P/E of Russell 2000 vs Russell 1000 and subsequent 10yr annualized relative returns, 1985 – 11/30/2025



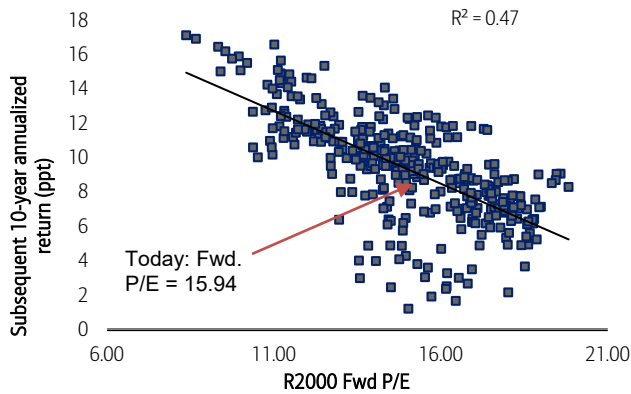
Note: Represents the relationship between the relative forward PE for the Russell 2000 vs the Russell 1000 (since 1979) and subsequent rolling 10-year annualized returns differential.

Source: BofA US Equity & Quant Strategy, FactSet

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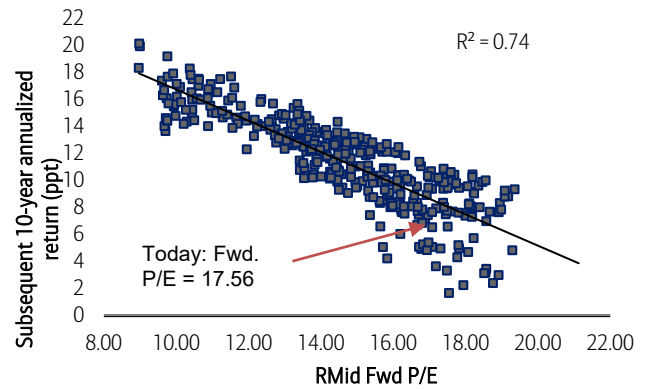
Exhibit 128: The absolute forward P/E of 15.9z for the Russell 2000 as of month-end suggests 9% annualized 10yr returns as of month-end
 Russell 2000 forward P/E vs subsequent ten-year annualized returns, 1985-present (as of 10/31/25)



Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 129: The absolute forward P/E of 17.6x for the Russell MidCap suggests 6% annualized ten-year returns as of month-end
 Russell MidCap forward P/E vs subsequent ten-year annualized returns, 1985-present (as of 10/31/25)



Source: BofA US Equity & Quant Strategy, FactSet

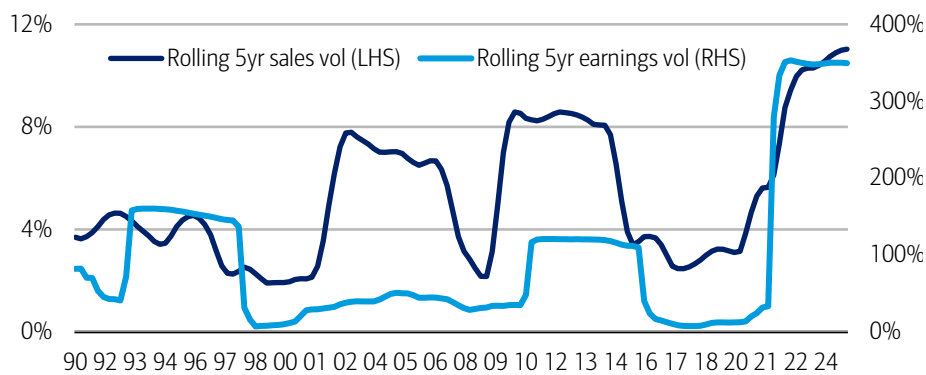
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But risk premium may not fall as low as history

The spread between +9% annualized projected returns for the Russell 2000 vs. flattish returns for the Russell 1000 may not be as dramatic as valuations suggest, given shifts in the composition of small and large caps relative to history. A reversion to 80s/90s levels in the small cap risk premium may be unlikely, in our view: sales and earnings volatility have risen, quality has deteriorated (secular decline in ROE, secular rise in non-earners), leverage has increased and expected long-term growth prospects for small caps have been lower, on average. Our work on the S&P 500 suggests the opposite has been true: the S&P has grown higher quality and less levered versus history

Exhibit 130: Sales volatility has consistently risen; more earnings volatility in recent years

Russell 2000 5-year earnings and sales volatility, 1990-2024 (Rolling 5yr standard deviation of LTM sales growth and LTM earnings growth)



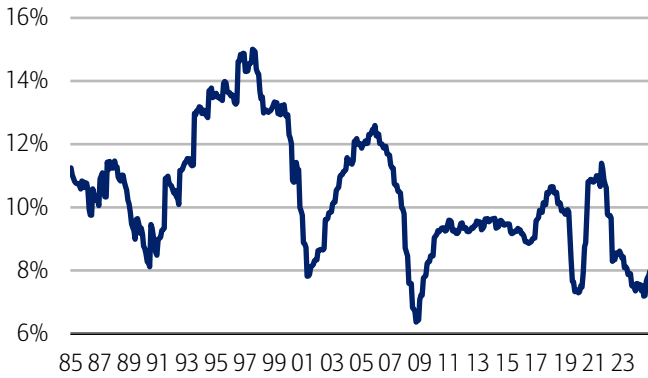
Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 131: ROE for Russell 2000 has trended lower over time

Russell 2000 median ROE, 1985-10/2025

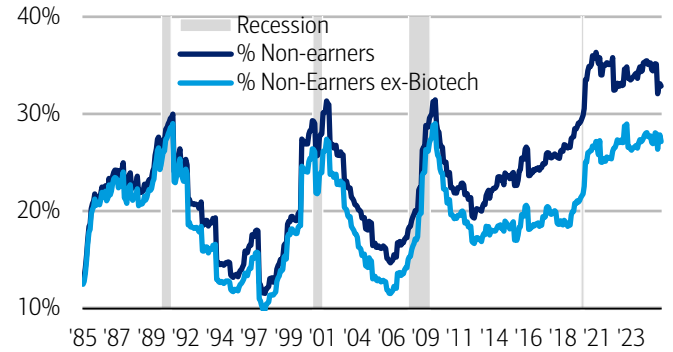


Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 132: 33% Russell 2000 stocks are non-earners, down from recent peaks but still near historic highs

% of Russell 2000 stocks that are non-earners, 1985-10/31/25

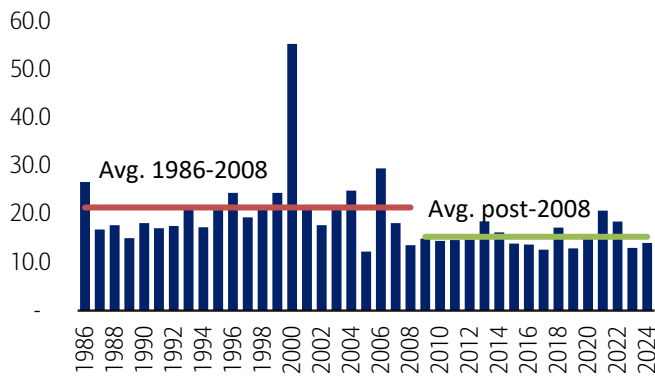


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 133: Long-term growth expectations for small caps are lower

Consensus LTG (3-5yr growth estimate) for Russell 2000 ex-Fins, 1986-2024

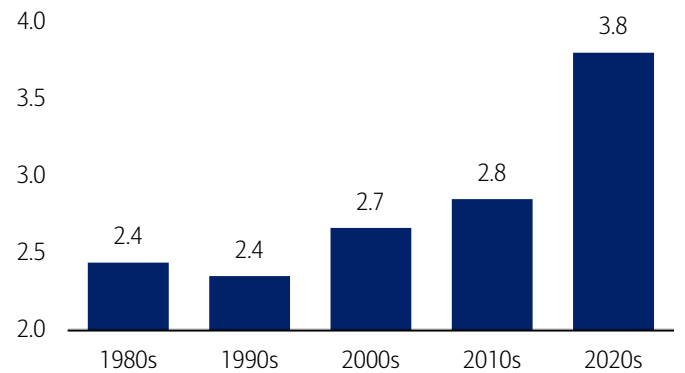


Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 134: Small caps have grown more levered

Avg. net debt/EBITDA for Russell 2000 ex Financials by decade (1985-now)

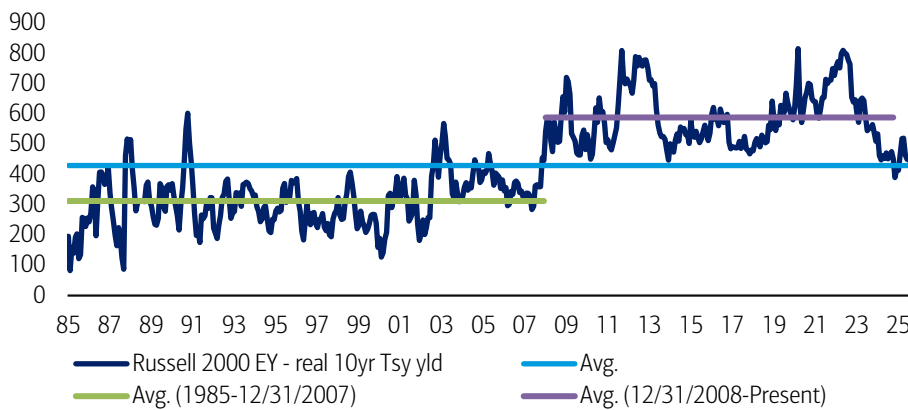


Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 135: Small cap equity risk premium in-line with historical avg. (but below post-GFC avg.)

Russell 2000 forward earnings yield – real 10-year Treasury yield (1985-10/31/2025)



Source: FactSet, Haver Analytics, BofA US Equity & US Quant Strategy

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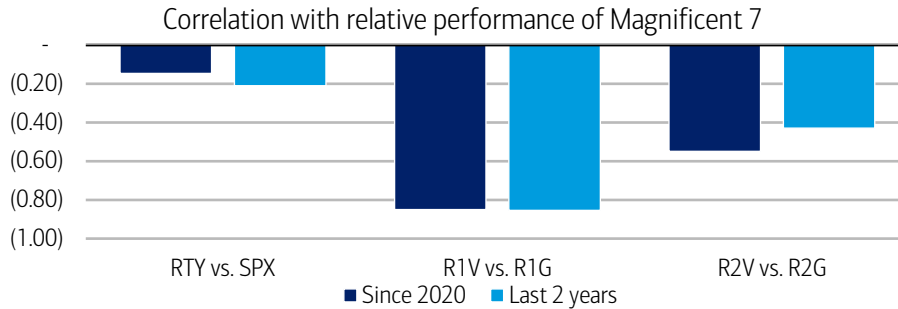
The SMID cap investor's guide to 2026

Value > Growth

We favor Value over Growth within SMID caps for 2026. Value has historically outperformed in accelerating profits backdrops as well as Fed easing cycles, and if the market broadens beyond the Magnificent 7 (where those stocks underperform the index), periods of Mag 7 underperformance in recent years have coincided with Value outperformance vs. Growth. Value is also historically cheap vs. Growth across metrics.

Exhibit 136: If market broadens and Mag 7 underperforms the S&P 500, this has been correlated with Value outperforming growth in both small and large caps

Correlation since 2020 and over last two years of Magnificent 7 relative performance vs. S&P 500 and various index pairs' relative performance (Russell 2000 vs. S&P 500, Russell 1000 Value vs. Russell 1000 Growth, Russell 2000 Value vs. Russell 2000 Growth)

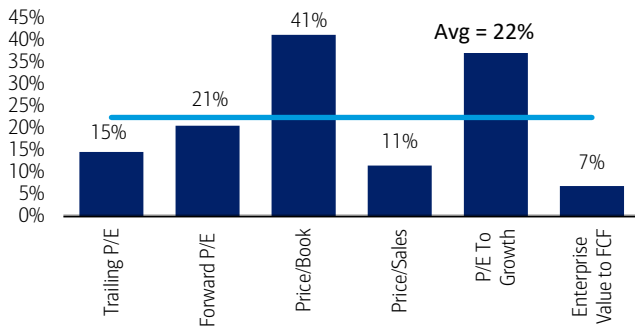


Source: Bloomberg, BofA US Equity & US Quant Strategy

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Exhibit 137: Small cap Growth is historically expensive vs Value on all 6 metrics we track (by an avg. of 22%)

Relative premium (discount) to the historical average multiple for Russell 2000 Growth vs Russell 2000 Value on Trailing and Fwd. P/E, Price/Book, Price/Sales, PEG and EV/FCF (1985-11/30/2025)

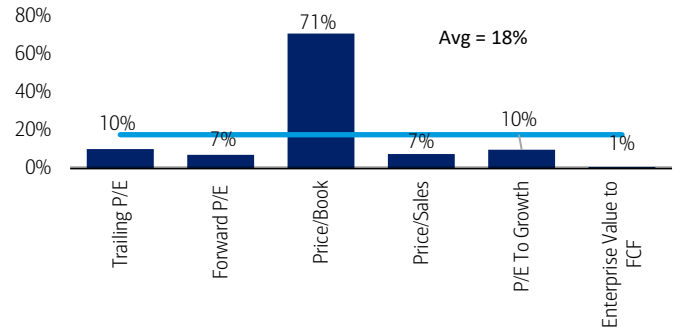


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 138: Mid cap Growth is historically expensive vs Value on all of the metrics we track (by an avg. of 18%)

Relative premium (discount) to the historical average multiple for Russell MidCap Growth vs Russell MidCap Value on Trailing and Fwd. P/E, Price/Book, Price/Sales, PEG and EV/FCF (1985-11/30/2025)



Source: FactSet, BofA US Equity & US Quant Strategy

BofA GLOBAL RESEARCH

Exhibit 139: Profits cycle accelerations positive for Value vs. Growth, particularly within small caps

Avg. annualized quarterly performance of Growth vs. Value (based on Fama French data) in periods of accelerating vs. decelerating corporate profits, 1925-present

	Small Value	Small Growth	Relative	Large Value	Large Growth	Relative
Accelerating Profits	24%	14%	10%	19%	14%	5%
Decelerating Profits	14%	12%	2%	12%	10%	2%

Source: FactSet, Fama French (https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html), BofA US Equity & US Quant Strategy

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Exhibit 140: Profits cycle has mattered more for small cap Value vs. Growth than macro factors

R-squared of Russell 2000 Value vs. Growth YoY performance vs. profits cycle and vs. top 10 most correlated macro factors (since 1979 except where noted)

Russell 2000 Value vs. Russell 2000 Growth YoY Perf. versus:	R-squared
Russell 2000 trailing YoY profits (since 1985)	24.8%
S&P 600 trailing YoY EPS (since 2003)	4.9%
Avg. of top 10 most correlated macro factors	2.8%

Source: Haver Analytics, Bloomberg FactSet, BofA US Equity & US Quant Strategy

Note: Top 10 most correlated macro factors include: positive: Unemployment Rate, WTI, ISM Mfg, ISM Non-Mfg, Fed Funds, Initial Jobless Claims, negative: Real 10yr Yield, DXY (USD), Conference Board Coincident Indicators,, Industrial Production. All since 1979 except ISM Non-Mfg. since 1998 and Real 10 yr since 2004.

BofA GLOBAL RESEARCH

Neutralizing our prior preference for Quality

Own a mix of high and low

Low quality has outperformed since the spring, but not nearly as much as it did during the Tech Bubble (see Today vs. Tech Bubble section earlier). High vs. low quality performance has historically been mixed during prior profits recoveries, suggesting Value>Growth may matter more, but low quality more frequently outperformed. The valuation backdrop for high vs. low quality is mixed: non-earners have re-related relative to earners since the summer, while earners have generally re-rated since the profits recession, where the relative multiple on sales of earners vs. non-earners is now in-line with history. High ROIC stocks look relatively inexpensive vs. history while low ROIC stocks look stretched (but below recent peaks). And positioning suggests that while managers lessened their underweight in low quality since a year ago, they are still very underweight. High Quality historically outperforms in Fed cutting cycles, but lags if manufacturing (PMI) recovers.

Other factors (including Value>Growth) are likely to matter more than Quality – owning both high and low quality stocks makes sense, where stock selection is likely to matter (and our analysts cover ~1,000 US small and mid caps).

Exhibit 141: Mixed results for Quality based on the profits cycle (but over shorter history on S&P profits, low quality outperformed when profits accelerate)

Relative performance of high vs. low quality quintiles of Russell 2000 (based on average of Quality factors we track) based on phase of small cap profits cycle

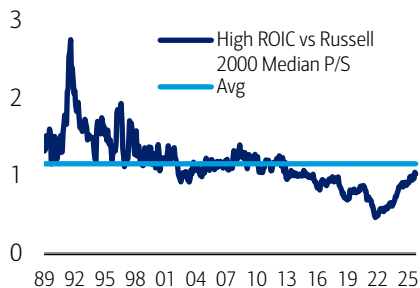
	Russell 2000 qtrly YoY profits (since 1986)		S&P 600 qtrly YoY profits (since 2002)	
	Accelerating small cap profits	Decelerating small cap profits	Accelerating small cap profits	Decelerating small cap profits
Relative Perf.: High vs. Low Quality	1.4%	1.5%	-0.6%	1.7%
% of times High Quality outperformed Low Quality	60%	59%	45%	65%

Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 142: The relative valuation of high ROIC small caps vs the index is slightly below average

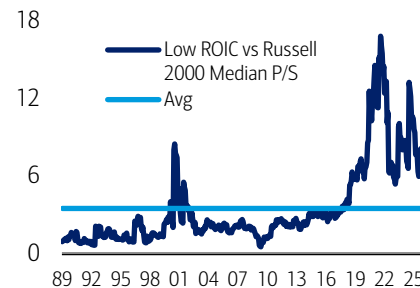
Relative median Price/Sales of top quintile ROIC small caps vs Russell 2000 1989-11/2025



Source: FactSet, BofA US Equity & US Quant Strategy
BofA GLOBAL RESEARCH

Exhibit 143: While the relative valuation of low ROIC small caps vs the index is above average

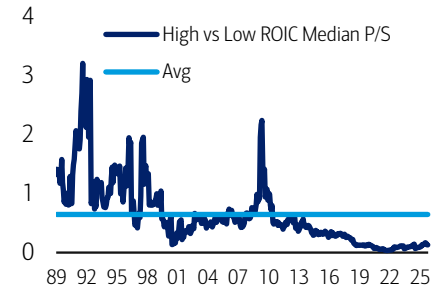
Relative median Price/Sales of bottom quintile ROIC small caps vs Russell 2000 1989-11/2025



Source: FactSet, BofA US Equity & US Quant Strategy
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Exhibit 144: High ROIC small caps remain inexpensive vs low ROIC small caps

Relative median Price/Sales of top quintile ROIC small caps vs bottom quintile ROIC small caps 1989-11/2025

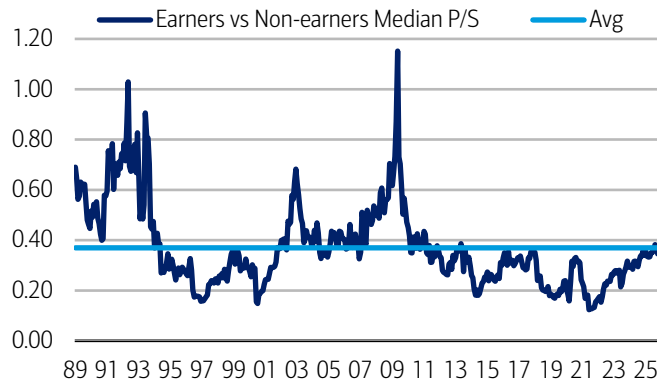


Source: FactSet, BofA US Equity & US Quant Strategy
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Exhibit 145: Relative valuation of earners vs. non-earners on Price/Sales is essentially in-line with history

Relative median Price/Sales of Russell 2000 earners vs. non-earners (1989-11/2025)

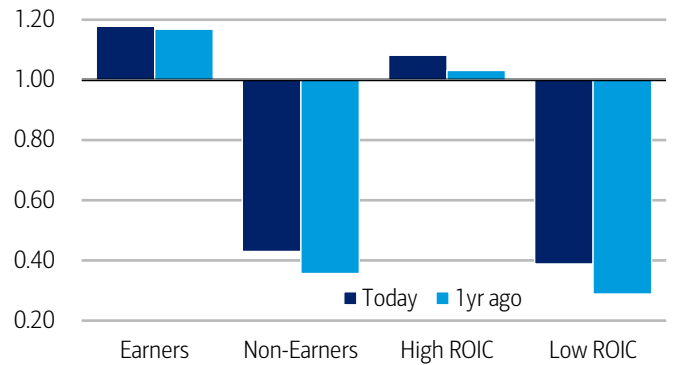


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 146: Small cap active managers have been overweight high quality, underweight low quality

Small cap active managers' relative weight (vs. Russell 2000 index weight) in Russell 2000 earners, non-earners, High ROIC quintile, and Low ROIC quintile today vs. a year ago



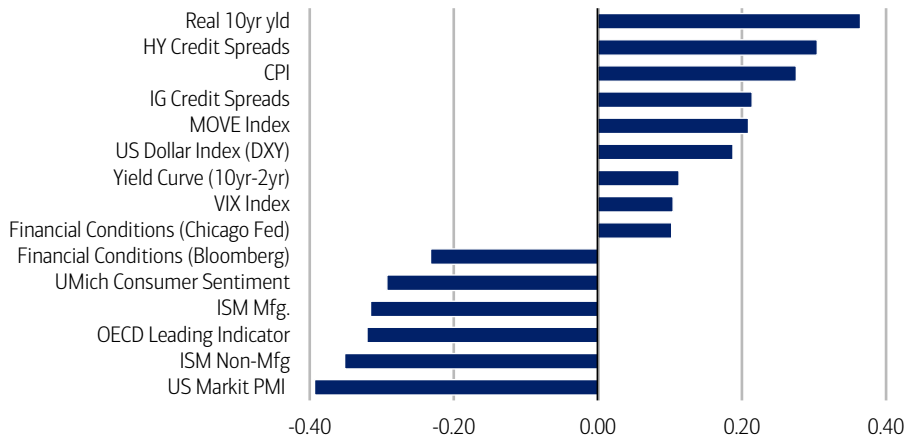
Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 147: If PMIs and consumer sentiment improve, low quality typically leads high quality, which the opposite is true if real 10yr yields, CPI or credit spreads increase

Top 15 macro factors with most positive or most negative historical correlations with high vs. low quality returns (based on avg. of Earners/NonEarners and High/Low ROIC YoY returns (1989-present except since '90 for Financial Conditions, '97 for credit spreads, '08 for Markit PMI, '98 for ISM Non-Mfg., '04 for Real 10yr)

Historical correlation with High vs. Low Quality Performance



Source: Haver Analytics, Bloomberg, FactSet, BofA US Equity & US Quant Strategy

BofA GLOBAL RESEARCH

Fade micro caps: focus on “small” but not “smallest”

Micro caps have outperformed since 2Q, helped by short-covering (where stocks with high short interest have outperformed), low quality outperformance (where ~60% of micro caps are non-earners) and “meme stock” trading (see earlier section on individual/retail investors). Micro caps have seen significant re-rating this year and have become the most expensive part of small caps, trading ~80% above avg. on Price/Sales and >20% above avg. on Price/Book. Recently, microcaps have sold off from their peak in mid-Oct, and we have seen micro cap stock outflows in our [Client Flows \(report\)](#) most recent weeks. We think the rally looks long in the tooth.



Exhibit 148: Smallest size quintile of the Russell 2000 is the most expensive (absolute and vs. history),

Median valuation (on price/sales and price/book) of Russell 2000 by size quintile (1986-10/2025) Note: Based on non-Financials for Price/Sales, full index for Price/Book

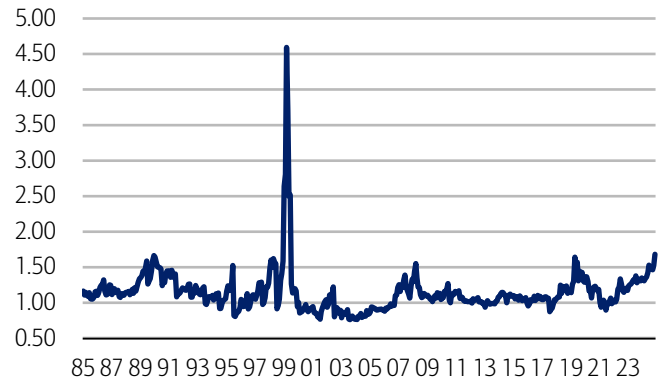
Size Quintile	Price/Sales			Price/Book		
	Curr ent	LT Avg.	% above (below) history	Current	LT Avg.	% above (below) history
1 (Largest)	1.3	1.4	-8%	1.3	1.7	-25%
2	1.6	1.3	18%	1.4	1.8	-19%
3	1.6	1.4	18%	1.7	1.9	-13%
4	2.0	1.4	37%	2.2	2.1	5%
5 (Smallest)	3.2	1.8	78%	3.0	2.5	22%
Q5 vs. Universe	1.7	1.1	47%	1.6	1.2	27%
Q5 vs. Q1	2.5	1.6	60%	2.3	1.5	55%

Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 149: Relative Price/Sales of micro caps vs. universe are the highest since the Tech Bubble

Relative median Price/Sales of smallest quintile of Russell 2000 by market cap vs. index, 1985-10/31/25



Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 150: Smallest stocks within the Russell 2000 are the lowest quality: only ~40% are expected to be profitable over N12m vs. >80% of stocks in the largest size quintile

% earners vs. non-earners by size quintile within the Russell 2000 based on consensus N12m EPS

Size Quintile	# stocks	Earners	Non-Earners (or N/A)
1 (Largest)	304	84%	16%
2	307	78%	22%
3	305	64%	36%
4	301	55%	45%
5 (Smallest)	310	40%	60%

Source: FactSet, BofA US Equity & US Quant Strategy

BofA GLOBAL RESEARCH

Sectors: Financials ranks best

Heading into 2026, **Financials** continues to rank highest in our quant work within both small and mid caps, where it's cheap, has among the strongest revision trends, and ranks well on BofA analyst upgrades relative to downgrades. Financials are also one area of the Russell seeing productivity growth – real sales per employee has been improving despite declining for the overall Russell 2000 amid higher rates and more non-earner/"zombie" companies that can drag down productivity (Exhibit 152). M&A has also picked up in the sector. But we continue to monitor the credit backdrop for further risks to SMID Banks. **Consumer Staples** ranks more favorably than **Consumer Discretionary** in both our small and mid cap quant work, and we recently shifted to a preference for Staples over Discretionary in our large cap sector views.

While not historically cheap, **Tech** stocks have seen among the strongest revision trends in small and mid – and small Tech looks historically cheap vs. mid cap Tech.

Communication Services also ranks well in both size segments. **Health Care** ranks better in mid than small, but has moved up toward middle of the pack in small. M&A helps sentiment, risks to high-growth stocks from higher rates have diminished, revision trends have improved, and small cap managers are broadly underweight vs. history. **Real Estate** is in the middle of the pack and our analysts see a bullish backdrop in '26 ([REITs Year Ahead](#)).

Industrials ranks worst in our small cap work. **Energy** continues to screen as a value trap in small, where together with **Materials** and **Utilities** has seen among the weakest recent revision trends.



Exhibit 151: Small caps: Financials rank highest, Industrials lowest
Small cap quantitative sector ranks (11=highest, 1=lowest) as of 11/30/2025

Sector	Combined Rank (highest to lowest)	Valuation Rank	Revisions Rank	Momentum Rank	BofA Sentiment Rank
Financials	11	8	9	8	7
Consumer Staples	10	8	11	2	10
Communication Services	9	11	8	1	7
Materials	8	4	1	10	11
Information Technology	7	5	10	5	5
Energy	6	10	2	3	9
Utilities	5	1	3	11	8
Health Care	4	3	7	9	3
Real Estate	3	7	6	6	2
Consumer Discretionary	2	6	4	4	4
Industrials	1	2	5	7	1

Source: BofA US Equity & Quant Strategy, FactSet. For full details on our sector ranks, see: [Small/Mid-Cap Valuations: Earnings improvement driving returns 11 November 2025](#)

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Exhibit 152: Mid Caps: Financials rank highest, Consumer Discretionary lowest
Mid cap quantitative sector ranks (11=highest, 1=lowest) as of 11/30/2025

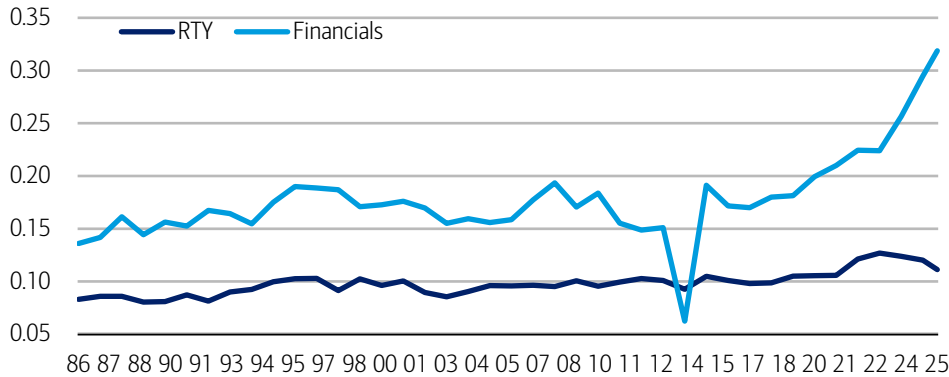
Sector	Combined Rank (highest to lowest)	Valuation Rank	Revisions Rank	Momentum Rank	BofA Sentiment Rank
Financials	10	9	8	7	11
Health Care	10	8	9	10	8
Communication Services	9	6	11	5	10
Energy	8	11	3	8	6
Industrials	7	2	6	9	7
Utilities	6	1	5	11	6
Real Estate	4	5	7	6	3
Information Technology	4	3	10	4	4
Consumer Staples	3	10	4	2	2
Materials	2	6	1	1	9
Consumer Discretionary	1	4	2	3	1

Source: BofA US Equity & Quant Strategy, FactSet. For full details on our sector ranks, see: [Small/Mid-Cap Valuations: Earnings improvement driving returns 11 November 2025](#)

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Exhibit 153: Small cap Financials are seeing productivity growth

Real sales per employee (\$mn of 1986 dollars), Russell 2000 Financials vs. Russell 2000 index (1986-3Q25)t



Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 154: In small, Financials, Tech, Health Care and Real Estate have the best combination of positive or close to positive EPS and sales revision ratios on both a 1m and 3m basis

S&P 600 1m and 3m earnings and sales revision ratios (# positive vs. negative) as of 11/30/25

Sector	3m ERR	1m ERR	3m SRR	1m SRR
Cons. Staples	1.22	1.13	0.38	0.50
Tech	1.18	1.14	1.20	1.22
Financials	1.17	1.15	1.16	0.92
Comm. Svcs.	1.05	1.11	0.24	0.36
Health Care	0.99	1.15	0.99	1.33
Real Estate	0.98	1.05	2.19	1.69
Industrials	0.86	1.11	0.87	1.18
S&P 600	0.94	0.97	0.96	1.05
Cons. Disc.	0.83	0.84	1.01	1.20
Energy	0.63	0.50	0.67	1.00
Materials	0.50	0.53	0.64	0.50
Utilities	0.64	0.29	0.47	0.50

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 155: In mid, Real Estate, Tech & Health Care have the best combo of positive EPS & sales revisions on a 1m & 3m basis

S&P 400 1m and 3m earnings and sales revision ratios (# positive vs. negative) as of 11/30/25

Sector	3m ERR	1m ERR	3m SRR	1m SRR
Comm. Svcs.	3.00	5.00	0.88	2.00
Technology	1.63	1.60	2.21	1.50
Health Care	1.49	1.67	1.15	1.91
Real Estate	1.21	1.00	2.46	1.00
Energy	0.77	2.00	0.89	2.00
Industrials	1.09	1.25	1.21	1.25
Financials	1.26	0.93	1.52	0.79
S&P 400	1.04	0.99	1.22	1.07
Utilities	1.05	0.63	1.07	1.40
Discretionary	0.71	0.49	1.04	0.93
Staples	0.92	0.80	0.67	0.42
Materials	0.38	0.35	0.47	0.44

Source: BofA US Equity & Quant Strategy, FactSet

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In small, Financials, Communication Services and Consumer Discretionary look cheap vs. history and cheap vs. large cap peers across metrics, but the latter two screen as value traps in our tactical quant work. Tech is expensive vs. history, but is cheap vs. large cap peers and ranks well in our quant work.

Exhibit 156: Relative median valuations for Russell 2000 sectors versus the benchmark
as of 11/30/2025

	Relative (vs R2000) median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
Russell 2000	1.13	1.94	1.93	16.8	13.5	21.42	1.04	1.64	2.00	17.5	14.6	21.48	9%	18%	-3%	-4%	-8%	0%
Comm Svcs	0.76	0.50	0.94	0.99	1.02	0.71	1.23	0.89	1.30	1.31	1.34	1.09	-38%	-44%	-28%	-25%	-24%	-35%
Discretionary	0.84	0.39	1.04	1.00	0.98	0.98	0.91	0.46	1.01	0.98	0.96	0.95	-8%	-16%	3%	1%	2%	3%
Energy	2.17	0.58	0.62	1.01	0.98	0.80	1.07	1.19	0.87	1.03	1.02	0.93	102%	-51%	-28%	-2%	-4%	-14%
Financials	0.74	1.03	0.58	0.75	0.72	N/A	1.14	1.31	0.68	0.78	0.81	N/A	-35%	-22%	-14%	-4%	-12%	N/A
Health Care	1.99	3.86	2.13	1.51	1.61	1.12	1.01	2.90	1.69	1.50	1.35	1.27	97%	33%	25%	1%	20%	-12%
Industrials	1.08	0.62	1.18	1.34	1.27	1.02	1.01	0.53	1.02	1.04	1.02	0.97	7%	17%	15%	28%	24%	5%
Materials	0.79	0.61	1.01	1.47	0.97	1.41	1.13	0.52	0.92	0.97	0.92	1.00	-30%	17%	10%	52%	5%	42%
Real Estate	2.81	1.76	0.61	0.70	0.84	0.69	1.89	2.30	0.77	0.75	0.81	0.80	49%	-24%	-21%	-6%	3%	-14%
Staples	1.38	0.32	0.94	1.32	0.96	0.98	1.23	0.43	1.09	1.07	1.11	1.11	13%	-26%	-14%	23%	-14%	-11%
Technology	1.13	1.58	2.02	1.86	1.48	0.91	0.98	1.31	1.25	1.44	1.25	1.03	16%	21%	61%	29%	18%	-12%
Utilities	2.58	1.30	0.98	1.23	1.34	1.80	2.82	0.85	0.84	0.94	0.99	1.14	-8%	53%	17%	31%	36%	57%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.
Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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Exhibit 157: Relative median valuations for the Russell 2000 vs Russell 1000 sectors
as of 11/30/2025

	Relative median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
R. 2000/R. 1000	0.66	0.70	0.55	0.7	0.8	0.79	0.79	0.90	0.78	1.0	1.0	0.87	-16%	-22%	-29%	-25%	-24%	-10%
Comm Svcs	0.55	0.39	0.61	0.71	0.63	0.68	0.88	0.72	0.93	1.05	1.05	0.92	-37%	-46%	-35%	-32%	-40%	-26%
Discretionary	0.49	0.37	0.32	0.73	0.71	0.76	0.84	0.65	0.66	0.93	0.90	0.80	-42%	-43%	-52%	-21%	-21%	-5%
Energy	1.88	0.63	0.64	0.98	1.03	0.86	0.78	0.99	0.82	1.00	0.99	0.77	142%	-36%	-22%	-2%	3%	12%
Financials	0.96	0.90	0.56	0.86	0.85	N/A	1.03	1.11	0.90	1.01	1.02	N/A	-7%	-19%	-38%	-15%	-16%	N/A
Health Care	1.25	1.72	0.83	0.87	1.21	1.01	0.89	1.68	0.87	1.09	1.17	1.01	41%	2%	-4%	-21%	3%	0%
Industrials	0.62	0.45	0.46	0.83	0.82	0.77	0.81	0.68	0.71	0.96	0.98	0.83	-24%	-33%	-35%	-14%	-16%	-8%
Materials	0.52	0.82	0.76	1.12	0.83	0.96	0.78	0.73	0.73	0.93	0.93	0.80	-34%	13%	4%	20%	-10%	19%
Real Estate	0.86	0.47	0.55	0.77	0.76	0.55	0.90	0.73	0.72	0.85	0.85	0.75	-5%	-36%	-23%	-9%	-11%	-27%
Staples	0.50	0.48	0.56	1.03	0.81	0.85	0.79	0.55	0.57	0.97	1.02	0.85	-37%	-12%	-2%	7%	-21%	0%
Technology	0.75	0.51	0.60	0.91	0.82	0.65	0.86	0.73	0.72	0.97	0.99	0.91	-12%	-30%	-16%	-5%	-17%	-28%
Utilities	1.11	0.79	0.86	0.98	0.93	0.79	1.04	0.91	1.01	1.08	1.07	0.95	8%	-13%	-15%	-9%	-13%	-17%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.
Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

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In mid caps, Financials also looks cheap vs. history in and screens well in our quant work; the same is true of Materials.



Exhibit 158: Relative median valuations for Russell Midcap sectors versus the benchmark

as of 11/30/25

	Relative (vs benchmark) median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
Russell Midcap	1.61	2.45	3.05	21.6	16.6	25.50	1.29	1.69	2.57	18.9	15.4	23.90	25%	45%	19%	14%	8%	7%
Comm Svcs	1.00	1.02	0.91	1.00	1.35	0.86	1.19	1.29	1.25	1.20	1.29	1.02	-16%	-21%	-28%	-17%	4%	-16%
Discretionary	1.05	0.73	1.69	1.00	1.00	1.03	0.86	0.69	1.27	0.99	1.01	1.00	22%	6%	33%	1%	-1%	3%
Staples	1.85	0.43	1.02	0.94	0.93	0.94	1.26	0.56	1.35	1.08	1.08	1.10	47%	-22%	-24%	-13%	-13%	-15%
Energy	0.68	0.73	0.54	0.85	0.76	0.78	1.03	1.09	0.86	1.11	1.09	1.17	-34%	-33%	-38%	-23%	-31%	-33%
Financials	0.52	0.89	0.60	0.65	0.66	N/A	0.91	1.10	0.66	0.74	0.79	N/A	-43%	-20%	-9%	-13%	-17%	N/A
Health Care	1.12	1.75	1.51	1.42	1.09	0.93	0.96	1.57	1.46	1.37	1.20	1.18	17%	12%	3%	3%	-9%	-21%
Industrials	1.08	0.99	1.48	1.25	1.22	1.05	1.00	0.74	1.15	1.09	1.05	1.00	8%	34%	28%	15%	16%	5%
Materials	1.01	0.50	0.65	0.93	0.86	1.15	1.14	0.64	1.00	0.99	0.95	1.06	-11%	-22%	-35%	-6%	-10%	9%
Real Estate	2.30	2.75	0.70	0.69	0.87	N/A	1.78	3.04	0.78	0.81	0.93	N/A	29%	-10%	-11%	-14%	-6%	N/A
Technology	0.96	1.99	1.51	1.33	1.29	1.04	0.89	1.62	1.38	1.45	1.27	1.04	8%	23%	10%	-8%	2%	0%
Utilities	1.57	1.26	0.74	0.97	1.16	1.73	2.12	0.86	0.67	0.82	0.92	1.51	-26%	47%	10%	18%	25%	15%

*Trailing and forward P/E excludes negative earners; **EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: Data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

Most mid cap sectors look historically expensive vs. small cap peers, but Energy and Materials look like relative value in mid caps. Health Care also look relatively cheap in mid on half of metrics we track.

Exhibit 159: Relative median valuations for the Russell Midcap vs Russell 2000 sectors

as of 11/30/2025

	Relative median valuation						Long-term median (since 1985)						% difference from long-term median					
	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**	PEG	P/Sales	P/BV	Trail P/E*	Fwd P/E*	EV/FCF**
R. Mid/R. 2000	1.42	1.26	1.58	1.28	1.23	1.19	1.23	1.06	1.24	1.02	1.01	1.12	15%	19%	27%	26%	22%	6%
Comm Svcs	1.87	2.55	1.53	1.30	1.62	1.43	1.23	1.39	1.12	0.99	1.03	1.05	52%	84%	36%	30%	57%	37%
Discretionary	1.79	2.37	2.56	1.28	1.25	1.25	1.18	1.51	1.48	1.06	1.09	1.21	51%	57%	73%	21%	15%	4%
Staples	1.91	1.72	1.72	0.92	1.21	1.13	1.21	1.44	1.48	1.03	0.96	1.14	57%	19%	16%	-11%	26%	-1%
Energy	0.45	1.59	1.36	1.08	0.95	1.16	1.19	1.07	1.22	1.09	1.08	1.33	-62%	48%	11%	0%	-12%	-13%
Financials	1.00	1.09	1.62	1.10	1.12	N/A	0.99	0.93	1.10	0.99	0.99	N/A	2%	17%	48%	11%	14%	N/A
Health Care	0.80	0.57	1.13	1.20	0.84	0.99	1.12	0.53	1.07	0.95	0.89	1.03	-28%	8%	5%	27%	-6%	-5%
Industrials	1.42	2.01	1.99	1.20	1.18	1.23	1.21	1.39	1.38	1.05	1.03	1.17	18%	44%	43%	14%	15%	5%
Materials	1.84	1.03	1.02	0.81	1.09	0.97	1.27	1.34	1.32	1.03	1.07	1.21	45%	-23%	-23%	-21%	2%	-20%
Real Estate	1.17	1.97	1.79	1.26	1.28	N/A	1.10	1.33	1.34	1.15	1.15	N/A	6%	48%	34%	9%	11%	N/A
Technology	1.21	1.59	1.19	0.92	1.08	1.37	1.14	1.32	1.31	1.05	1.01	1.11	6%	21%	-9%	-13%	7%	23%
Utilities	0.87	1.22	1.18	1.01	1.06	1.14	0.96	1.07	0.99	0.93	0.94	1.03	-10%	14%	20%	9%	13%	11%

* Trailing and forward P/E excludes negative earners; ** EV/FCF excludes Financials and Real Estate as well as companies with negative free cash flow.

Note: NA values due to negative median, data since 1985 except for Real Estate (since 2001). FFO is used instead of EPS for REITs.

Source: BofA US Equity & Quant Strategy, FactSet

What's crowded vs. neglected

Exhibit 160: Mid and small cap fund manager positioning in sectors as of Nov. 2025 and vs. history

History for sectors since 2016 or since 2018 for Comm. Services, ranked descending by an average rank of relative weights in fund holdings and positioning z-scores vs. history across small and mid cap fund types

Sector	Rel Wgt. in Fund Holdings			Z-score vs. history			Rel Wgt. in Fund Holdings			Z-score vs. history		
	MCC	MCG	MCV	MCC	MCG	MCV	SCC	SCG	SCV	SCC	SCG	SCV
Materials	1.33	NM	1.02	1.2	NM	(0.6)	1.26	0.69	2.03	(1.0)	(1.2)	0.9
Industrials	1.14	1.01	0.96	0.4	(1.3)	(0.8)	1.24	1.22	1.52	(0.6)	1.4	0.5
Consumer Staples	1.02	1.15	0.85	(1.3)	2.7	(1.9)	1.48	1.07	1.47	3.1	0.1	0.7
Financials	1.14	1.41	1.20	(0.6)	(0.3)	0.6	1.18	0.99	0.96	(0.1)	(1.8)	1.5
Information Technology	1.00	1.16	1.11	0.7	1.9	0.2	0.87	1.05	1.12	(0.4)	(0.4)	(1.1)
Consumer Discretionary	1.02	0.69	1.12	(0.3)	(1.7)	0.2	1.20	1.27	0.96	2.3	3.6	(1.6)
Real Estate	0.92	1.79	0.62	0.3	1.3	(0.1)	0.88	0.64	0.59	0.1	(0.4)	0.2



Exhibit 160: Mid and small cap fund manager positioning in sectors as of Nov. 2025 and vs. history

History for sectors since 2016 or since 2018 for Comm. Services, ranked descending by an average rank of relative weights in fund holdings and positioning z-scores vs. history across small and mid cap fund types

Sector	Rel Wgt. in Fund Holdings			Z-score vs. history			Rel Wgt. in Fund Holdings			Z-score vs. history		
	MCC	MCG	MCV	MCC	MCG	MCV	SCC	SCG	SCV	SCC	SCG	SCV
Energy	0.86	0.82	1.04	(0.7)	(0.1)	(0.5)	0.93	0.77	0.96	(0.4)	(0.8)	(0.2)
Health Care	0.91	0.92	1.26	(0.1)	(1.6)	(0.3)	0.64	0.82	0.64	0.4	(0.4)	(0.5)
Utilities	0.72	0.70	0.77	(0.4)	(0.8)	0.4	0.82	1.29	0.66	(0.7)	0.3	0.2
Communication Services	0.35	0.79	0.61	(2.0)	(0.1)	(2.4)	0.67	0.52	0.53	(0.9)	(2.1)	(0.9)

Source: BofA US Equity & Quant Strategy, FactSet

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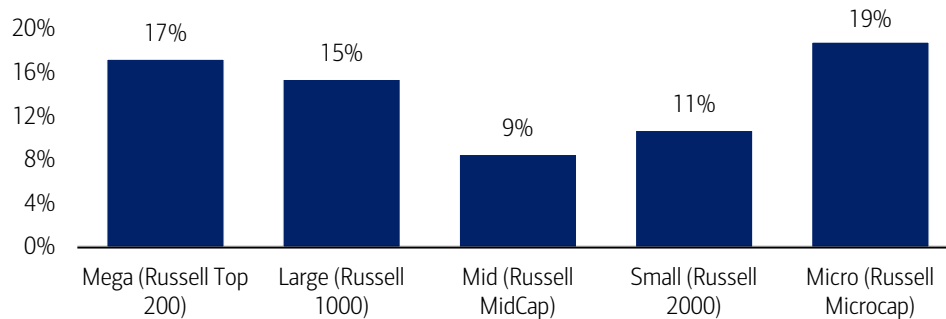
2025 in review: performance explained

A year for mega & micro

YTD leadership (as of 11/25/25) has been a barbell of the biggest and smallest stocks: mega caps (Russell Top 200 +16) and micro caps (Russell Microcap +19%). Optimism over Tech/AI (where continued upside earnings surprises pushed out the broadening theme to '26) supported mega caps, while risk-on/low quality leadership since 2Q accompanied by a resurgence in "meme stock" activity and an increase in retail trading supported micro caps. Small and mid caps were +11%/+8%, respectively.

Exhibit 161: Barbell of mega cap and micro cap outperformance YTD

YTD performance by Russell size index (as of 11/24/25)



Source: Bloomberg, BofA US Equity & US Quant Strategy

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What we got right: small vs. mid cap relative calls

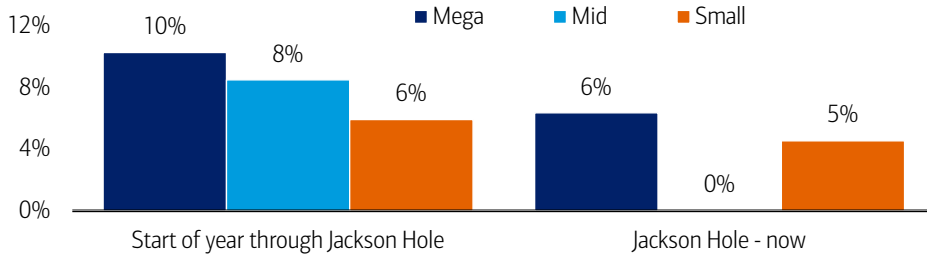
In our [SMID Cap 2025 Year Ahead](#), we highlighted a preference for mid >small caps as well as for mid>mega caps. Our preference for mid within SMID was despite consensus bullishness on small caps post-election, where our views were that 1) profits tend to drive returns more than politics (and the small cap profits recovery was still elusive while mid caps were seeing better revisions/trends), 2) refinancing risk reemerged for small caps amid pushed-out prospects for Fed cuts amid sticky inflation, better data and the Republican sweep, and 3) risk that policies that would be most negative for small cap profits would be frontloaded (e.g. tariffs/tightening of immigration policies).

In Aug., following Fed Chair Powell’s Jackson Hole speech, we shifted to a preference for small>mid within SMID, expecting small caps to outperform both mid and mega given three shifts: 1) Fed cuts restarting imminently, 2) EPS recovery finally materializing for small caps plus positive revisions/guidance (in tandem with trends starting to weaken for mid caps) and 3) a shift to “Recovery” in our US Regime Indicator (best phase for small caps). Mid caps outperformed small caps by 2ppt from January until Jackson Hole, and then small caps outperformed mid caps by 5ppt from Jackson Hole until today.



Exhibit 162: Mid led small prior to Jackson Hole while small has outperformed since. Mega led in both.

YTD returns until Jackson Hole (8/22/25) vs. post Jackson Hole (through 12/1/25): Russell Top 200, Russell MidCap, Russell 2000



Source: Bloomberg, BofA US Equity & US Quant Strategy

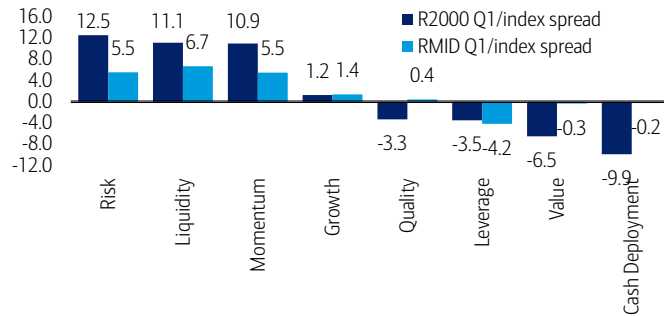
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Vs. what we got wrong: mega led small & mid, low quality led in SMID...

Despite getting the small vs. mid relative calls right, we underestimated the strength in mega caps as the AI theme continued, where mega caps leading both size segments in both periods. Additionally, within SMID, low quality outperformed high quality by 22ppt (despite similar performance of the two groups in mid caps), and Growth outperformed Value, helped by the leadership of Health Care and Tech stocks (many of which are Growth/unprofitable) as well as a resurgence in “meme stock” trading.

Exhibit 163: Risk led, Growth outperformed, Value and Quality underperformed within small caps YTD

YTD long factor total returns (in ppt) within the Russell 2000 (dark blue bars) and Russell Midcap (light blue bars), as of 10/31/2025

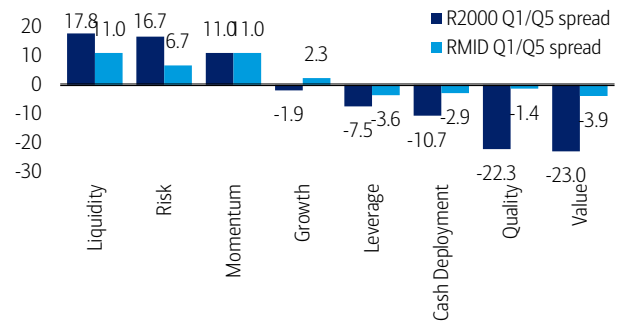


Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 164: High Quality stocks outperformed Low Quality stocks by 22ppt in small caps YTD (vs. performed more similarly in mid caps)

YTD top-bottom quintile total returns (in ppt) within the Russell 2000 (dark blue bars) and Russell Midcap (light blue bars), as of 10/31/2025.



Source: FactSet, BofA US Equity & US Quant Strategy

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...and the micro cap rally has persisted longer than expected

Since the summer we have noted the rally looked long in the tooth. Micro caps have outperformed since 2Q, helped by short-covering (where stocks with high short interest have outperformed), low quality outperformance (where ~60% of micro caps are non-earners) and “meme stock” trading (see earlier section on individual/retail investors). Micro caps have seen significant re-rating this year and have become the most expensive part of small caps, trading ~80% above avg. on Price/Sales and >20% above avg. on Price/Book. Recently, microcaps have sold off from their peak in mid-Oct, and we have seen micro cap stock outflows in our [Client Flows \(report\)](#) most recent weeks.

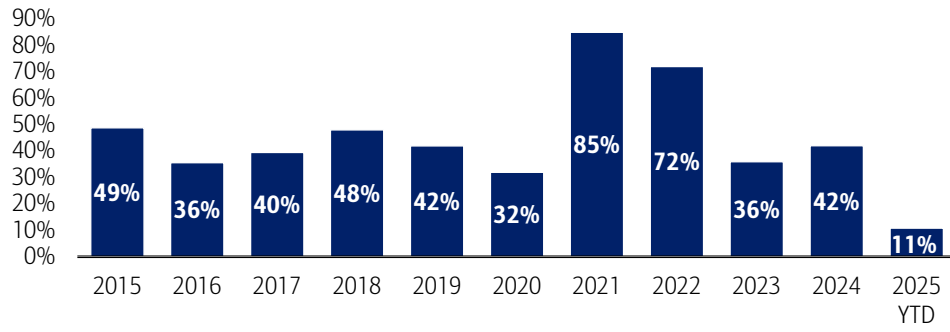
...leading to a tough year for small cap active managers

The outperformance of low quality and micro caps has led to the worst year in at least a decade for small cap active funds (who tend to tilt up in quality/cap vs. their benchmark), of which only 11% have outperformed YTD as of 10/2025.



Exhibit 165: Tough year? You're not alone: only 11% of small cap active funds have outperformed YTD

% of small cap active managers outperforming their Russell benchmark YTD (as of 10/25)



Source: Lipper, BofA US Equity & US Quant Strategy

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Appendix

Methodology – small cap quantitative sector ranks

Our small cap quantitative sectors ranks, first introduced in our [Small Cap Outlook report](#) (5 August 2018), rank sectors from highest to lowest based on an average of four factors: valuation, estimate revisions, price momentum, and BofA analyst sentiment.

1. Valuation: Relative EV/FCF, Fwd P/E and P/S vs history

We compute the median relative multiple for each Russell 2000 sector (vs the Russell 2000 median multiple) as of month-end and calculate how far above/below it is from its long-term median (since 1994). We do this on enterprise value (EV)/free cash flow (FCF), historically the best Value factor for selecting stocks within small caps, along with Forward P/E (the most generally applicable metric across sectors) and Price/Sales (to account for sectors that have negative earnings or FCF or for which FCF is not a meaningful metric). We compute the overall valuation rank by ranking sectors based on an average of their EV/FCF, Forward P/E, and Price/Sales ranks or as many of the three that are available/applicable. (Note: companies with negative FCF or earnings are excluded from the median calculations. For P/E, funds from operations (FFO) is used for real estate investment trusts (REITs). Financials and REITs are excluded from the EV/FCF ranks).

2. Fundamentals: Estimate revision ratios

We rank sectors from highest to lowest based on their three-month earnings estimate revision ratio (number of consensus estimates revised up vs number revised down within each sector each month, computed over a three-month period as of the latest month-end on the S&P 600 universe). Of the Growth factors we track within the Russell 2000, our work suggests that estimate revision factors are the best stock-selection factors.

3. Momentum: Change in the 200-day moving average

We rank sectors from highest to lowest based on the median one-month change in the 200-day moving average for the stocks in that sector as of the latest month-end, where this has historically been the best stock-selection measure among the momentum factors that we track within the Russell 2000 index.

4. BofA analyst sentiment: proportion of ratings upgrades-downgrades

Our work suggests that our BofA Global Research analysts' rating changes within the Russell 2000 are correlated with subsequent performance, particularly over the short term, and that this was true across nearly all sectors over each subsequent time period shown in the chart above. This was particularly true of ratings downgrades, and correlations were higher for our analysts' ratings changes than for the mean consensus analyst ratings change. We thus rank sectors from highest to lowest by the net proportion of BofA fundamental analyst ratings upgrades less downgrades (rolling three-month sum) as of the latest month-end.

Methodology – mid cap quantitative sector ranks

We use the same methodology to generate quantitative sector ranks for mid caps, based on the same four categories:

1. Valuation: Relative EV/FCF, Fwd P/E and P/S vs history

Similar to in small caps, we compute the median relative multiple for each Russell MidCap sector (vs the Russell MidCap index median multiple) as of month-end and calculate how far above/below it is from its long-term median (since 1994). We do this on enterprise value (EV)/free cash flow (FCF), Forward P/E and Price/Sales. We compute the overall valuation rank by ranking sectors based on an average of their EV/FCF, Forward P/E, and Price/Sales ranks or as many of the three that are available/applicable. (Note: companies with negative FCF or earnings are excluded from the median calculations. For P/E, funds from operations (FFO) is used for real estate investment trusts (REITs). Financials and REITs are excluded from the EV/FCF ranks).



2. Fundamentals: Estimate revision ratios

Similar to in small caps, we rank mid cap sectors from highest to lowest based on their three-month earnings estimate revision ratio (number of consensus estimates revised up vs number revised down within each sector each month, computed over a three-month period as of the latest month-end on the S&P 400 universe).

3. Momentum: Change in the 200-day moving average

Similar to in small caps, we rank sectors from highest to lowest based on the median one-month change in the 200-day moving average for the stocks in that sector as of the latest month-end, where this has historically been the best stock-selection measure among the momentum factors that we track within the Russell MidCap index.

4. BofA analyst sentiment: proportion of ratings upgrades-downgrades

Similar to in small caps, we rank sectors from highest to lowest by the net proportion of BofA fundamental analyst ratings upgrades less downgrades (rolling three-month sum) as of the latest month-end, here based on the Russell MidCap universe

Methodology: US Regime Indicator

Inputs include the following eight macroeconomic or top-down variables:

- **Earnings Revision ratio:** The ratio between the number of companies in the S&P 500 for which Thomson Financial consensus earnings estimates have been raised versus those that have been lowered. Rising = improving economic cycle.
- **ISM PMI:** ISM PMI Institute for Supply Management Manufacturing Purchasing Managers Index, represented as the Z-Score. The index monitors activity reported by 300 supply management professionals. Above 50 indicates economic expansion.
- **Inflation:** The 12-month change in the BofA Inflation Composite (see methodology), represented a Z-Score. Rising inflation indicates improvement.
- **GDP Forecast:** The next 12-month US GDP growth forecast from the Federal Reserve Bank of Philadelphia Survey, represented as a Z-Score.
- **LEI index:** The 12-month change in the Conference Board US Leading Index of Ten Economic Indicators represented as a Z-Score. Rising = improving.
- **US Capacity Utilization:** The 12-month change in US capacity utilization, represented as a Z-score. The capacity utilization rate indicates the percentage of total economic capacity currently used. Rising capacity utilization implies improving economic conditions. Rising capacity utilization suggests expansion and potential inflationary pressure.
- **10-yr US Treasury Bond Yield:** The 12-month change in the bond yield, represented as the Z-Score. Rising yields indicate improving economic conditions.
- **High Yield corp. bond spread:** The 12-month change in the credit spread of the ICE BofA US High Yield Index, represented as a Z-score. Falling = improving.

Using the phases identified by the US Regime Indicator, we assess performance of broad style categories using the following factors based on top decile S&P 500 stocks; see our “Quantitative Profiles” monthly publication for full factor definitions). Our analysis on small caps in the context of our regime indicator analyzes style group performance in the context of each regime as above, based on the style categories (top and bottom quintile of stocks in the Russell 2000) defined in our monthly “Small/Mid Cap Factors: A PM’s Guide” publication; see these reports for full details.



For the historic period from January 1970 to December 1989, the US Regime Indicator was based on the available inputs listed above, which were:

- 1/70 to 1/82: 5 inputs: Inflation, 10-yr US Treasury Bond Yield, ISM PMI, Leading Economic Indicators index, US Capacity Utilization;
- 2/82 to 3/88: 6 inputs: all of the above plus GDP Forecast;
- 4/88 to 4/89: 7 inputs: all of the above plus the High Yield corporate bond credit spread;
- 5/89 to 12/89: all 8 inputs: all of the above plus the Earnings Revision Ratio.

Performance of sizes/styles during regimes prior to January 1990 could be impacted by the more limited set of factors used to determine regimes, different definitions for Growth, Value and Size (where we use Fama-French performance data for the 1970-1989 period vs. performance of our S&P 500 top/bottom decile factors over the original history of our indicator from 1990-present), as well as the different macro backdrop in the earlier period marked by high inflation.

Earnings Revision Ratios Methodology

Beginning in April 1986 (and January 2006 for Real Estate), we calculate the ratio between the number of companies in the S&P 500 for which Thomson Financial consensus earnings estimates have been raised versus those that have been lowered. We apply the same calculation to the S&P 500 GICS Sectors (where we use FFO for REITs within Real Estate). One-month revision ratios are computed as the number of companies for which estimates this month are higher than they were last month, divided by the number of companies for which estimates this month are *lower* than they were last month. For example, within a particular subgroup of the market, if consensus estimates have increased for 5 companies and have decreased for 10, the estimate revision ratio will be 0.5 (5 divided by 10).

The three-month revision ratio is similarly defined as the total number of earnings estimate increases divided by total number of earnings estimate decreases during the last *three* months. For example, in February 2002, the three-month revision ratio is computed as the total number of companies with increased monthly estimates, divided by the total number of companies with decreased estimates throughout December 2001, January 2002, and February 2002.

We similarly calculate the S&P 600 (small cap) earnings revision ratios (one-month and three-month) by the same methodology, with data beginning in February 2001.

For earnings/sales estimates, we look at the change in the FY1 estimate (current unreported year) if there's more than 120 days between the current date and the company's fiscal year-end date, otherwise we look at the change in the FY2 estimate (next unreported year).

Guidance Ratios Methodology

Earnings guidance: We track the number of instances of above- vs. below-consensus management guidance for earnings over the last three months for S&P 500 companies. If a company issues changes to its outlook more than once in a one-month period, we incorporate all instances of guidance into our aggregate number. The ratio also includes all instances of above- or below-consensus earnings guidance issued by a company (for example, if they issue both quarterly and annual guidance). The one-month and three-month revision ratios are calculated as they are for estimate revision ratios. The data source is Bloomberg. For companies that provide both GAAP and Operating guidance, or for REITs that provide both EPS and FFO guidance, we remove one data point if both data points provide the same guidance direction, otherwise both data points are used.



Factor Definitions

Valuation Factors

Book/Price (Q1=highest): Common equity per share divided by price.

EBITDA/EV (Q1=highest): LTM (last 12 months) earnings before interest, taxes, depreciation and amortization divided by Enterprise Value (market cap + preferred stock + short term debt + long term debt + minority interest – cash). Financials are excluded.

Free Cash Flow Yield (Q1=highest): (LTM cash flow from operations – LTM capital expenditures) divided by market cap. Financials and Equity REITs are excluded.

Free Cash Flow/EV (Q1=highest): (LTM cash flow from operations – LTM capital expenditures) divided by Enterprise Value (market cap + preferred stock + short-term debt + long-term debt + minority interest – cash). Financials and Equity REITs are excluded.

Cash Flow/Price (CFO/P) (Q1=highest): LTM cash flow from operations divided by price. Financials and Equity REITs are excluded.

Forward E/P (Q1=highest): I/B/E/S FY1 EPS divided by price. FFO is used instead of EPS for Equity REITs.

Trailing E/P (Q1=highest): LTM EPS excluding extraordinary items divided by price. FFO is used instead of EPS for Equity REITs.

Sales/Price (Q1=highest): LTM sales per share divided by price. Financials are excluded.

Sales/EV (Q1=highest): LTM sales divided by enterprise value (market cap + preferred stock + short-term debt + long-term debt + minority interest – cash). Financials are excluded.

GARP (Growth at a Reasonable Price) Factors

Trailing EG/P (inverse of PEG) (Q1=highest): I/B/E/S long-term growth rate estimate divided by Trailing Earnings/Price.

Forward EG/P (inverse of PEG) (Q1=highest): I/B/E/S long-term growth rate estimate divided by Forward Earnings/Price.

Quality Factors

Return on Equity (ROE) (Q1=highest): LTM net income before extraordinary items divided by the one-year average of total stockholders' equity. Equity REITs are excluded.

ROE 1 year change (Q1=highest): 12 month change in ROE. Equity REITs are excluded.

Return on Assets (ROA) (Q1=highest): LTM net income before extraordinary items divided by the one-year average of total assets. Equity REITs are excluded.

Cash Flow ROIC (Cash flow return on invested capital) (Q1=highest): LTM cash flow from operations divided by invested capital (average common equity + average preferred equity + average long-term debt + average minority accumulated interest). Financials and Equity REITs are excluded.

Return on Invested Capital (ROIC) (Q1=highest): LTM net income before extraordinary items divided by the one-year average of total invested capital. Equity REITs are excluded.

Free Cash Flow Return on Assets (FCF ROA) (Q1=highest): (LTM cash flow from operations – LTM capital expenditures) divided by one-year average assets. Financials and Equity REITs are excluded.



Earners/Non-earners (Q1=earners, Q5=non-earners): Earners are stocks that have a positive forward (FY1) P/E; Non-earners are stocks with a negative forward (FY1) P/E. FFO is considered instead of EPS for Equity REITs.

Momentum Factors

Price to 200-Day Moving Average (Q1=highest): Ratio of the month-end closing price to the average closing price over the last 200 days.

1 Month Change in the 200-Day Moving Average (Q1=highest): The 1-month change in the 200-day moving average.

5-week/30-week Moving Average (Q1=highest): The ratio of the average daily closing price over the last five weeks vs. that over 30 weeks.

10-week/40-week Moving Average (Q1=highest): The ratio of the average daily closing price over the last ten weeks vs. that over 40 weeks.

30-week/75-week Moving Average (Q1=highest): The ratio of the average daily closing price over the last 30 weeks vs. that over 75 weeks.

12-Month Price Change (Q1=highest): The change in the current price from 12 months ago.

9-Month Price Change (Q1=highest): The change in the current price from 9 months ago.

3-Month Price Change (Q1=highest): The change in the current price from 3 months ago.

Average 12-month Price Return & 1-month Price Return: (Q1=highest): Equal-weighted rank of stocks by (1) highest the price return over the last 12 months; and (2) the highest price return over the last one month.

Average 12-month Price Return & 1-month Price Reversal (Q1=highest): Equal-weighted rank of stocks by (1) the highest price return over the last 12 months; and (2) the lowest price return over the last one month.

Growth Factors

IBES Mean LT Growth (Q1=highest): The mean estimate of I/B/E/S forecasted long-term growth rates.

EPS Estimate Revision (Q1=highest): The difference between the I/B/E/S FY1 EPS estimate that that of three months ago divided by the absolute value of the I/B/E/S FY1 EPS estimate as of three months ago. FFO is used instead of EPS for Equity REITs.

Estimate Diffusion (Q1=highest): Calculated using a three-month weighted-average of the change in the number of up estimates minus the down estimates divided by the total numbers of estimates for FY1. The most recent change in estimates received a weighting of 50%, the change from two months earlier was weighted at 30%, and the change from three months ago was allocated 20%. A company had to have at least two analysts covering it. FFO is used instead of EPS for Equity REITs.

Earnings Surprise (Q1=highest): The standardized unexpected earnings (SUE) score as determined by I/B/E/S, which is calculated by subtracting the mean earnings estimate by the actual reported earnings and then dividing that figure by the standard deviation of estimates. A company must have at least two analysts covering it to be included. FFO is used instead of EPS for Equity REITs.

Sales Growth Trailing 5 Year (Q1=highest): 5-year growth rate of trailing annual sales.

EPS Growth Trailing 5 Year (Q1=highest): 5-year growth rate of trailing annual diluted EPS. FFO is used instead of EPS for Equity REITs.



YoY Change in Trailing EPS (Q1=highest): Change in LTM EPS before extraordinary items from 4 quarters earlier LTM EPS before extraordinary items. FFO is used instead of EPS for Equity REITs.

FY1 EPS Growth (Q1=highest): Change in the FY1 EPS estimate versus the prior year actual (FY0) EPS. FFO is used instead of EPS for Equity REITs.

Operating Margin (Q1=highest): LTM operating income divided by LTM sales. Financials and Equity REITs are excluded.

Operating Margin Expansion (Q1=highest): 12-month change in operating margin. Financials and Equity REITs are excluded.

Risk Factors

EPS Variability (5-year) (Q1=highest): The degree of variability in quarterly EPS over the past five years. FFO is used instead of EPS for Equity REITs.

EPS Estimate Dispersion (FY2) (Q1=highest): The coefficient of variation among I/B/E/S FY2 EPS estimates (standard deviation of estimates divided by mean estimate). A stock must have at least two estimates available to be considered. FFO is used instead of EPS for Equity REITs.

Price Volatility (1yr) (Q1=highest): The standard deviation of the daily price change measured during the last year.

Beta (5yr) (Q1=highest): The regression coefficient from regressing monthly price returns against the returns of the S&P 500 over 60 months. Beta is a measure of non-diversifiable risk.

Liquidity Factors

3-Month Average Daily Volume (Q1=highest): The average daily trading volume over the prior three months.

3-Month Average Daily Dollar Volume (Q1=highest): The average daily trading dollar volume (volume times price) over the prior three months.

1-Month Trading Volume (Cumulative) (Q1=highest): The cumulative trading volume over the past month.

Market Cap (Q1=highest): The month-end market capitalization.

Leverage Factors

Net Debt/Equity (Q1=highest): The total debt minus cash & short-term investments divided by total common equity. Financials are excluded.

Net Debt/Market Cap (Q1=highest): The total debt minus cash & short-term investments divided by total market capitalization. Financials are excluded.

Net Debt/EBITDA (Q1=highest): The total debt minus cash & short-term investments divided by operating EBITDA. Financials and companies with negative EBITDA are excluded.

Net Debt/EBITDA Adjusted (Q1=highest): The total debt minus cash & short-term investments divided by adjusted EBITDA (operating EBITDA + Unusual Expenses). Financials and companies with negative adjusted EBITDA are excluded.

Cash Deployment Factors

Dividend Growth (Q1=highest): The year-over-year growth between trailing four-quarter total common dividends as of the latest month-end and trailing four-quarter total common dividends as of 12 months ago.



Dividend Payers/Non-payer (Q1=Payers, Q5=Non-payers): Stocks that pay a dividend (based on the trailing 12-month dividend yield) are considered payers; stocks that don't pay a dividend are considered non-payers.

Dividend Yield (Payers only) (Q1=highest): Indicated dividend rate dividend by price. Companies that do not pay a dividend are excluded.

Share Repurchase (Q1=largest decrease in shares): Year-over-year change in shares outstanding.

Miscellaneous Factors

Price (Q1=highest): The month-end closing price.

Analyst Coverage (Q1=highest): The number of available I/B/E/S FY1 earnings estimates submitted by analysts.

Short Interest Ratio (Days to Cover) (Q1=highest): The number of shares held short divided by the average daily trading volume. It can be interpreted as the number of days it would take short sellers to cover the short position.

Short Interest 12M z-score (Q1=highest): The z-score of the most recent number of shares shorted vs. the last 12 months history.

Foreign Exposure (Q1=highest): The ratio of foreign sales to total sales

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R1}
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Underperform	N/A	≥ 20%

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