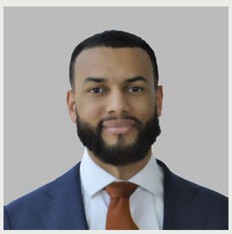
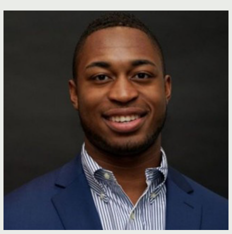
Thoughts from the desk: Small Companies

Wellington Management™



Cody Ampomah, CFA
Vice President, Equity Research Analyst of small companies



Isaiah Mathieu
Investment Analyst of Small Companies

Summary

2026 has featured a pronounced rotation away from the service and intangible economy to real assets and the physical economy. We believe this marks a sharp reversal from the early 2020s where software, digitization, and its enablers were the primary drivers of the market. This shift has been driven by a combination of cyclical and structural factors. Taken together, these dynamics are driving market leadership toward businesses that provide real-world capacity, supply chain resilience, and hard-to-replace assets.

At a high level, this shift reinforces our preference for companies levered to scarce assets, businesses with durable and defensive moats, and a selective view on models being actively disrupted by AI.

The Bigger Picture

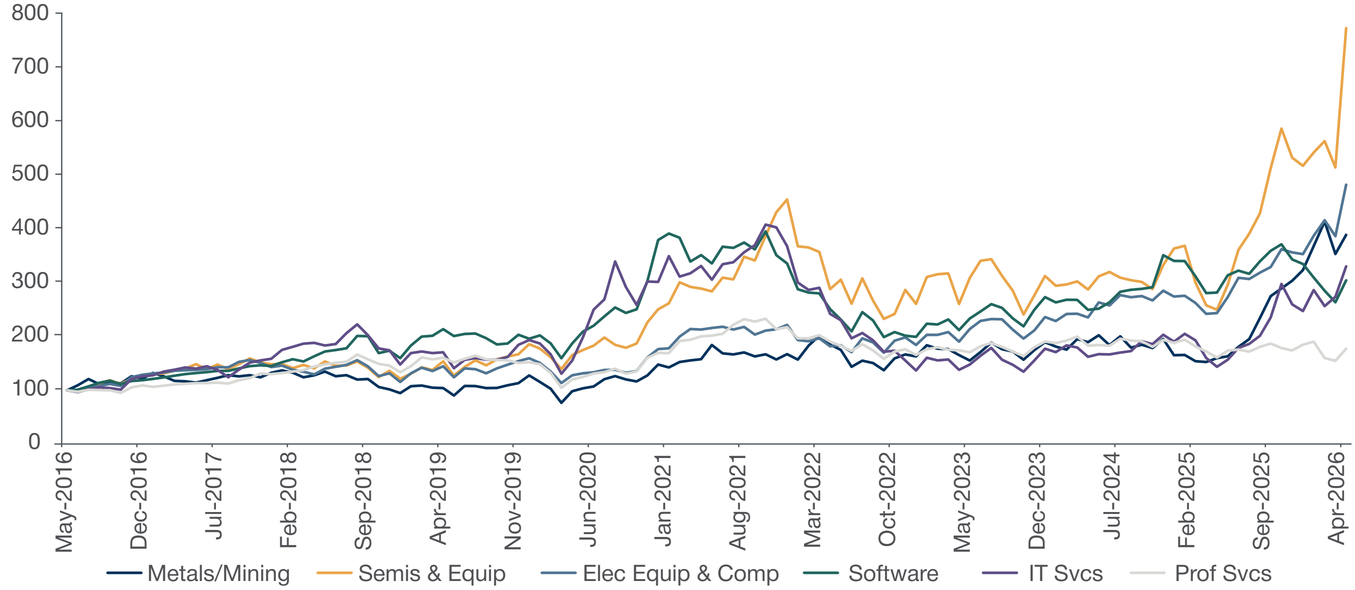
Part of this shift is cyclical. Economic data suggest that the industrial economy is beginning to recover, following years of stagnation and inventory digestion. This favors companies who are levered to infrastructure buildout and the industrial economy. Unlike a typical cyclical recovery, today's backdrop is being shaped by several concurrent structural shifts.

A key factor is the reshaping of global supply chains with tariffs accelerating these decisions. The US collected roughly $195 billion[1] in tariff revenue in FY2025, and businesses are increasingly focused on mitigating the impact of rapidly evolving policy decisions. These shifts are elevating the value of having domestic capacity, particularly for assets that have meaningful legal, labor, and capital barriers to build.

AI is also playing a key role in reshaping the economy in multiple ways. The most visible impact has been emerging supply constraints. GPU shortages have caught many of the headlines, but capacity constraints have broadened. For example, the pricing of DRAM – memory critical to phones, data centers, and beyond – has more than doubled[2] due AI demand. This extends to craft labor, power generation, electric distribution, among other markets.

At the same time, the market is repricing service and software businesses. Software alone has lost ~$160 billion[3] in value since its peak last year. There is concern that these businesses' moats may not be indefensible as previously believed. We think there is reasonable basis for these concerns. After all, a software companies' most prized asset is typically its code base – and competitive products can now be built at a fraction of the time and cost using AI coding assistants. As a result, we are underwriting these business models with greater scrutiny and sensitivity in these industries.

Real asset vs. intangible asset stock performance



Source: FactSet, Wellington Management | Chart shows indexed performance of selected Russell 2000 industries based on 12-month forward earnings estimates. Industries shown: Metals & Mining, Semis & Equip, Electronic Equip & Comp, Software, IT Services, and Professional Services. Data are based on current industry constituents as of 30 April 2026 and indexed back 10 years to 30 April 2016.| For illustrative purposes only. Not representative of an actual investment. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. | **Past Index or Third Party performance does not predict future returns.** | Chart data: 30 April 2016 to 30 April 2026.

Thematic ideas

- **Global copper miner**: owns and operates copper mining facilities. we expected continued scarcity for copper, which remains critical to moving the world toward electrification. more importantly, the company is bringing on new capacity at a time when there is a global deficit in copper due to disruptions at key suppliers.

- **Digital manufacturer**: digital network of machine shops for prototype and production parts. this could be easily mistaken for an easily disrupted software company. however, its moat is its network effect, and specifically its network of buyers and sellers who depend on its platform to bring products to market.

Bottom line

The market appears to be transitioning from a regime that rewarded asset-light business models to one that rewards physical scarcity. Meanwhile, there will be selective opportunities to find durable business models at a discount amid the market rotation. As that transition unfolds, we believe the best opportunities will come from distinguishing between businesses that merely looked durable in the prior regime and those that can compound through this one.

Source 1: Congressional Budget Office, “CBO’s Updated Projections of the Budgetary Effects of Tariffs as of November 15, 2025,” 20 November 2025; USAFacts, based on U.S. Treasury data. CBO noted that tariffs changed frequently throughout 2025 and estimated that tariff increases implemented from January 6 to November 15, 2025 would reduce primary deficits by $2.5 trillion over 2025–2035, excluding macroeconomic effects. USAFacts reported $194.9 billion in FY2025 customs dutieS.

Source 2: TrendForce, “Memory Price Outlook for 1Q26 Sharply Upgraded; QoQ Increases of All Product Categories to Hit Record Highs,” 2 February 2026. TrendForce cited persistent AI and data center demand as worsening the global memory supply/demand imbalance and projected PC DRAM prices to increase by more than 100% quarter over quarter in 1Q26.

Source 3: FactSet, Wellington Management. iShares Expanded Tech-Software Sector ETF (IGV) used as a proxy for software businesses. Estimate reflects the change in aggregate market capitalization of IGV constituents from the 2025 peak to 30 April 2026, in USD. For illustrative purposes only. Not representative of an actual investment. Past performance does not predict future returns. | **Past Index or Third Party performance does not predict future returns**.

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