

Principal Aligned

Year-end review

JANUARY 2026

It was a year of two different markets, before and after the announced tariff-rate “pause” on April 9. Right before that announcement, the S&P 500’s year-to-date return was -15%. But the pause kicked off a rally that brought the index back to record highs by mid-year. From the April 8 lows through year-end, the S&P 500 returned 40%.

The rally was led by more speculative companies. Stocks in the vicinity of the AI story soared. “Quality” finished the year as the worst performing factor, and strategies like ours that invest in higher-quality companies felt the effect. Both MidCap and Blue Chip underperformed last year, with all the weakness occurring from April 9 through year-end. This write-up will include our perspective on that performance and our reasoning for changes we made. We’ll finish with examples of how companies are growing intrinsic value, which is always the basis for our confidence as we look ahead.

Historical perspective

We’ve been through stretches like this before. We’re not traders – we’re owners of a set of companies that share certain traits, like competitive moats, owner-operator leaders, and reasonable valuations. It’s a process that for nearly 26 years has worked – performance of the representative account, a U.S. mutual fund, beat all other mid-cap funds since its inception¹. But while it has worked over time, it doesn’t work every time – not in every kind of market, or every single year.

The stretch from April 9 through year-end is the kind of market – up 30%+, led by the riskiest companies - where we’ve historically lagged. Which makes sense. The market takes on different moods, and when it’s giddy with excitement is when our kind of company isn’t as popular. The steadily compounding, lower-risk, sometimes rather boring businesses we prefer become less attractive.

But our companies tend to regain their appeal when the market’s mood is less exuberant. When it’s cautious, or downright scared. This shows up clearly in MidCap’s track record. This table (right) analyzes every 12-month period since inception, on a rolling monthly basis. Almost 300 different 12-month stretches. We’ve lagged in fast-rising markets. We’ve done well through lower-returning environments. This pattern has worked over time because the less-than-stellar markets are much more common.

Rolling 12-month returns, since inception²

1-year index returns	Number of periods	Batting average ³	Average excess return (gross) ⁴	Average excess return (net) ⁴
<10%	125	84.8%	5.06	4.62
10-20%	93	67.7%	2.30	1.76
20-30%	44	50.0%	0.41	-0.17
>30%	36	16.7%	-4.15	-4.79

versus Russell MidCap Index

As of 31 December 2025. Source: eVestment. ²The Inception date is 1 April 2000. ³Batting average is the percentage of periods where the strategy outperformed the index. ⁴The average excess return is the average return of the strategy relative to the index.

MidCap – 2025 performance

MidCap’s biggest detractors last year were Copart, Brown & Brown, and KKR. We’ve held each company for several years, and they remain high-conviction, top-15 holdings as of year-end.

Copart has the largest online auction for salvage vehicles. Last year they faced headwinds to volume growth that we’re confident are temporary. There were fewer auto insurance claims last year – not because of fewer accidents, but because drivers have become less covered by insurance after two years of rates spiking. We don’t view this shift as permanent; rates have plateaued, and the long-term trend has been more coverage, not less. Copart continued to manage the business well. Operating cash flow per share still grew double digits. They’re investing in promising areas of future growth. We bought more shares.

Brown & Brown is one of the nation’s largest insurance brokers. Last year property insurance rates softened, which weighed on the growth rates of brokers. Their business model is taking a cut of the premium paid, so the direction of pricing has a direct impact. Insurance pricing goes through cycles, but more important is that Brown & Brown remains well positioned in this fragmented industry. They’ll have opportunities to continue making attractive acquisitions, with an owner-operator in Powell Brown who we believe knows what to look for. We added to our position last year.

¹Source: Morningstar. The mutual fund (1 share) has a shorter track record than the strategy (less than 25 years). Since inception of 1 March 2001. As of December 31, 2025 among the 184 Mid-Cap Value, Mid-Cap Growth and Mid-Cap Blend category funds that consistently have been categorized as a mid-cap fund throughout the period.

KKR is an alternative asset manager with nearly \$600 billion of fee-earning assets. The shares of nearly all the public alternatives companies declined last year, based on worries that slow monetization of existing investments will put the clamps on fundraising. KKR still had a good year, raising over \$100 billion of new capital. We believe KKR will continue delivering for their investors – and that they’ll be rewarded with more to manage. They’re still in the early days of growing the assets they’ll eventually invest for individuals and to support insurance products. KKR remains one of the strategy’s top holdings.

Zooming out a level, the weakest sector was Technology. The prevailing narratives around AI winners and losers mostly cut against us last year. We didn’t own the huge gainers, like Western Digital, SanDisk, Ciena, or Lumentum (each up >300% from April 9 through year-end). These companies are clearly levered to the AI trade. However, the reason we’re not shareholders is not because of a bearish AI view. It’s that even if AI spending continues to climb, these companies have little to defend themselves against the forces of capitalism. They were in the right place at the right time. But others will want in, and the barriers to entry just aren’t large enough.

Our Technology holdings are mostly software businesses, and there the story took hold that AI will lead to their demise. Either customers will use AI to build their own solutions, or AI-native startups will run laps around the incumbents. We think the worry is way overdone. It mistakes what makes these businesses special; making the software has never been the hard part. But being entrenched with customers – seeing their pain points, the new features that would be useful – that’s valuable. For companies like Constellation and Tyler Tech and Roper, the likely effect of AI is to make their products better and businesses more profitable, but last year their shares declined on the fears.

Turning to what had better performance, MidCap’s top contributors were HEICO, Brookfield, and Perimeter Solutions. Owner-operators are at the helm of each company, and their strong results last year were the outcome of years of sound long-term decisions and execution.

HEICO makes thousands of airplane parts, and they’re by far the largest of their kind. They’re purely an aftermarket supplier, usually competing against the original part that was designed into the aircraft. It’s a tough business to get started in; all else equal, aircraft owners want the original part when it’s time to replace. But all is not equal. HEICO’s product quality and reliability have gradually won the industry over, and their scale and breadth of products enables them to offer much better prices. HEICO saves their large customers (e.g. airlines) millions of dollars. These customers love HEICO and want to do more business – and there’s a long runway for that.

Top relative contributors	Sector
HEICO	Industrials
Brookfield Corporation	Financials
Perimeter Solutions	Materials
Top relative detractors	Sector
Copart	Industrials
Brown & Brown	Financials
KKR	Financials

Brookfield was an exception to the weak performance of alternatives managers last year. Like KKR, they had another outstanding year of fundraising (>\$100 billion of new capital). And they continue to innovate. They launched more new strategies in the last year than their total number of strategies 10 years ago. 70% of their fee revenue comes from products and strategies launched in the last decade. As an example, their expertise puts them in unique position for the AI buildout; it’s a combination of real estate, infrastructure, and power, all of which Brookfield is good at.

Perimeter Solutions was a smaller weight, but it had a big year. They make Phos-Chek – a fire-retardant dropped from airplanes to contain wildfires. It’s a monopoly with a deep moat. In recent years a competitor tried to market a different retardant, but it proved corrosive to aircraft and in 2024 was taken off the Forest Service’s list of qualified products. Perimeter’s financial results were strong throughout 2025, and towards the end of the year they signed a major long-term contract with the USDA that reaffirms their role for years to come.

At the sector level, MidCap was helped by avoiding some weaker areas like Staples and Energy and REITs. The Real Estate sector boosted relative performance the most. Our largest holding there is CBRE, a broker and services firm that had strong performance. Transactions in commercial real estate have started to recover. CBRE was on their front foot through the low point of the cycle, aggressive in their efforts to bring on premier brokers from other firms. They’re now even more advantaged as the cycle turns in their favor.

MidCap – What we did

We mostly bought more of companies we already owned last year – which is usually the case when we’re out of favor. Here we’ll highlight the biggest changes over the back half of the year (our first half purchases were covered in the mid-year review).

Topping the list is Live Nation. The company is sometimes a punching bag – who likes paying those extra Ticketmaster fees? But they understand their role as a useful punching bag, taking the hits for their main customer, the artists. Live Nation pockets a small fraction of those fees. They have additional ways of making money, like promoting the concerts, sponsorships, advertising, and owning venues. This means Live Nation can offer artists the best terms for a tour. They’re a crucial part of the entire concert ecosystem. People increasingly prefer unique experiences over more stuff – and Live Nation is in great position to make more of those experiences possible.

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Next is Ashtead, better known by their brand: Sunbelt Rentals. The name will formally change in '26 when the company moves its listing from the UK to the US. Sunbelt is the second-largest equipment rental company in the US. They're set to be a winner as this industry further consolidates. Customers want scale and breadth of expertise – and partnering with Sunbelt is clearly better for them than owning equipment. They have a CEO who understands the benefits of empowering frontline employees and giving them incentives to act like owners.

To fund these purchases, we had a mix of trims and full sales. Brookfield was the biggest trim, followed by Hilton and HEICO – all big weights with strong performance, so trimming kept position sizes in check.

Top purchases	Sector	Purchased (%)
Live Nation	Consumer Discretionary	+1.0
Ashtead Group	Industrials	+0.5
CBRE Group	Real Estate	+0.3
Top sales	Sector	Sold (%)
Brookfield Corp	Financials	-1.2
Gartner	Information Technology	-0.9
Vail Resorts	Consumer Discretionary	-0.6

Gartner, Vail Resorts, and Progressive were the largest positions fully sold. Progressive had been slowly trimmed for the last two years, as its market cap grew clearly into large-cap territory. With Gartner and Vail, there are just better businesses with less risk for us to invest in. Gartner's growth slowed last year. What concerned us most was their decision to slow down hiring in their sales force. It's a change in their playbook and signals less confidence. Vail still has the best resorts, but Alterra's become a worthy competitor. We'd rather own more advantaged businesses with better opportunities to deploy capital.

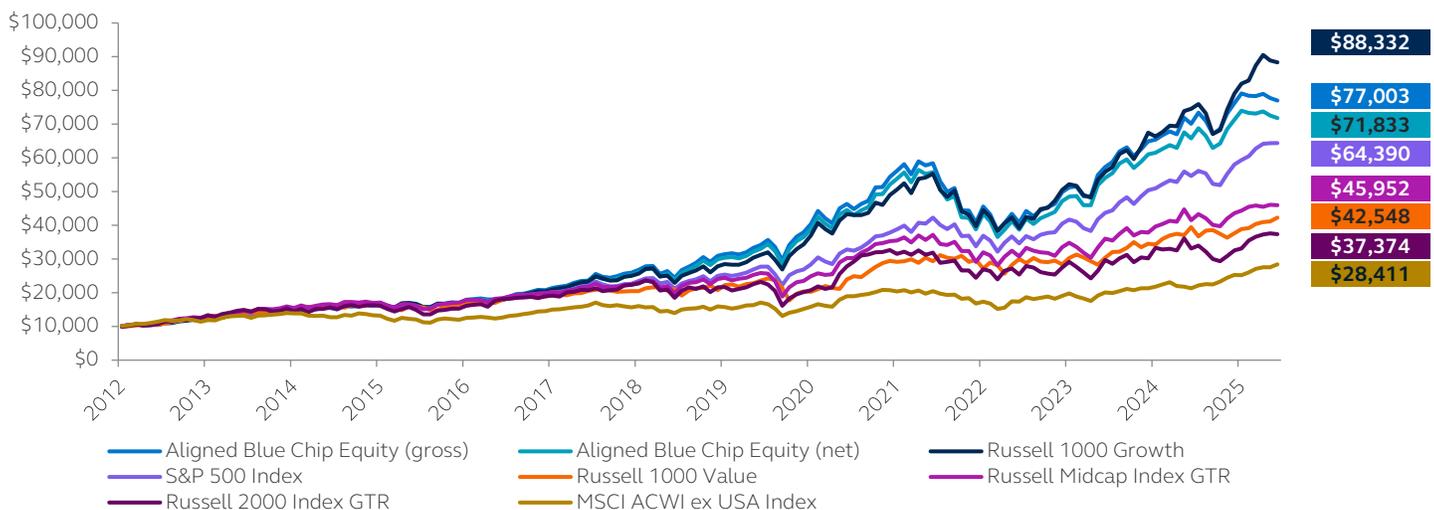
Other notable additions included companies mentioned in the performance section. We've steadily increased the weight of CBRE over the last couple years, seeing an opportunity as they took advantage through the real estate cycle. It's now a top-10 position. We added more to our software holdings: Constellation and Tyler Tech, as well as AppFolio and Topicus and CCC Intelligent Solutions. We saw the weakness in insurance brokers like Brown & Brown and AJ Gallagher as a long-term opportunity. With quality so out of favor last year, there was a lot we were excited to buy.

Blue Chip – 2025 performance

It's become a familiar story for large-cap managers. Blue Chip had strong absolute performance – up double digits – but trailed its main index, the Russell 1000 Growth, with the top relative detractors being holdings that had stellar performance. The companies – this time NVIDIA and Alphabet – were bigger weights in the index. NVIDIA averaged a 12% weight in the Russell 1000 Growth. It contributed about a quarter of the index's return.

We understand if that's a story that's getting old. It's frustrating for all involved – including us. The stubborn fact is that concentration is risky, but when it works it beats everything (see chart below since Blue Chip's inception in 2012). Eight stocks that are all correlated to the same thing making up almost 60% of an index is an outrageous amount of risk. But to this point, it's worked – to the tune of 18%/yr for the last decade.

Blue Chip Equity composite performance since inception (1 July 2012)



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Being active against that index over the last decade has been, well, nearly impossible. Looking at large-growth funds as of Sep 30, the funds that achieved 10-year outperformance – not a long list – had a median active share of only 40%. Hats off to them.

But the question, as always, is what to do going forward. One change approved for Blue Chip in 2025 was moving its status to non-diversified. This removes the “5/25” rule, where positions with >5% weight cannot sum to more than 25% of the strategy. Many large-growth funds have made this change. Index funds don’t have the restriction; the index’s weight in >5% positions is closer to 50%. Understandably, many investors now view 5/25 as an unnecessary tying of fund managers’ hands, at least in this category against this index.

This change is not about becoming a benchmark-hugging manager. We still don’t own any shares of the index’s 2nd largest weight, for example (Apple, 11%). But it’s a positive move that frees us to own more of our best ideas – whether or not they happen to be large index weights. Since the status officially changed in July, some of our biggest purchases were in our top positions.

To touch briefly on those relative detractors, NVIDIA and Alphabet had important roles in advancing AI last year. “Reasoning” models were the big unlock that improved AI’s ability and accuracy. These systems use multi-step structured logic, essentially “thinking” their way through problems, rather than just pattern matching. This “thinking” is impressive, but it also requires a ton of compute. AI already consumed a lot of power, but these reasoning models took it to another level – for the foreseeable future, power will be the bottleneck to solve around. And when that’s the case, it makes sense for data center builders to keep paying up for the very best solution that can do the most with a given amount of power: NVIDIA’s platform.

Top relative contributors	Sector
Apple	Information Technology
Netflix	Communication Services
ServiceNow	Information Technology
Top relative detractors	Sector
NVIDIA	Information Technology
Alphabet	Communication Services
Copart	Industrials

Alphabet stumbled out of the gate when the AI race kicked off in earnest three years ago, but they’re not stumbling anymore. Their Search business, thanks in part to “AI Mode” that was unveiled last year, has so far been resilient to the threat from answer engines. And their own competitor in that arena, Gemini, has been catching on. They’ve got their own TPU-based infrastructure, a fast-growing cloud business, one of the best models, and the resources of a company that made over \$100 billion in net income last year. They’ve always had the potential, and the ChatGPT threat forced the urgency. Last year the market turned its attention away from the threat and toward the vast potential opportunity.

Beyond the index concentration, the story is similar – in some cases, the same – to what was covered in MidCap’s section. The tough year for high-quality was felt in Blue Chip as well. Three of the next largest detractors are “overlap” positions, companies owned in both portfolios and that were covered above: Copart, KKR and Roper. Like MidCap, Technology was the sector that detracted most, where we didn’t own some of the big winners (e.g. Palantir). Our holdings like Cadence Design – an AI beneficiary, but in a less exciting way – had positive performance but didn’t keep up.

On the contributing side, Blue Chip also benefitted from not owning some laggards. The biggest was Apple, whose single-digit performance trailed. The benchmark also has some larger software companies that felt the AI-related fears: ServiceNow, Adobe, and Salesforce all fell more than 20%.

Netflix continued to shine, at least through the first half of the year. We trimmed our position back then, so its fourth quarter weakness had less bite. The evidence keeps mounting that Netflix’s platform makes hits possible on a scale that doesn’t exist elsewhere. It’s hard to imagine K-Pop Demon Hunters becoming the same kind of phenomenon, or something like Suits becoming relevant years after initially airing – without Netflix. When you have a platform that enables that kind of upside for content, it’s logical to want to own the content. Through this lens, it makes sense that Netflix sees a lot of value in owning the Warner Brothers library and studios.

Amphenol had a huge year. They make connectors – tens of thousands of different kinds of connectors, from the most basic (e.g. the USB-C cable that charges your phone) to the most mission-critical, where speed and reliability are essential (e.g. enabling power and data to move within a data center). Business surged last year, with a boost from the AI buildout. They’re in a great position for the growth in all forms of electronics going forward.

Schwab helped as well with a year of strong earnings growth. The cash-sorting headwinds of a couple years ago are now in the rearview mirror. Meanwhile, Schwab has been deepening its moat. They’ve integrated TD Ameritrade, giving them more scale. Their flywheel of attracting more assets by keeping costs low is in full motion. Total client assets were nearing \$12 trillion as of year-end. Six years ago, that number was closer to \$4 trillion.

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Blue Chip – What we did

Blue Chip's biggest back-half changes were made possible by the change to non-diversified status. Our top three purchases were to holdings that are now above 5%: Microsoft, Brookfield, and NVIDIA.

For a company already so large, Microsoft has so much to pursue. Their cloud unit Azure grew revenue at a mid-30's percentage last year, and we're likely only in the middle innings of cloud migration. Their Office / 365 business, with products like Excel that are now 40 years old, still grew at a mid-teens pace. Millions of enterprises critically depend on Microsoft – a sturdy recurring revenue base, and perhaps the best possible starting point for integrating and monetizing AI advances.

Brookfield has become even better as it's gotten bigger, which is saying something for a company that's compounded at 18%/yr since Bruce Flatt took over in 2002. They're still thought of as just a real estate investor, but it's much more than that. They own and operate assets that make up the backbone of the global economy, which now includes the infrastructure that enables AI. We believe they can compound earnings at a high rate for many more years.

Top purchases	Sector	Purchased (%)
NVIDIA	Information Technology	+5.7
Microsoft	Information Technology	+2.0
Brookfield Corp	Financials	+1.3

Top sales	Sector	Sold (%)
Progressive	Financials	-2.4
Thermo Fisher	Health Care	-1.9
Hilton Worldwide	Consumer Discretionary	-1.7

NVIDIA's been the clear winner of the initial AI arms race, as model-trainers desperately try to get ahead. What's been less clear is whether NVIDIA's dominance would extend to inference, the day-to-day usage of AI. Last year's breakthrough with reasoning models plays to NVIDIA's strengths. With power the bottleneck, NVIDIA's platform will make sense even for many cost-conscious buyers thinking hard about tradeoffs. The range of outcomes, in our view, has narrowed.

To fund these purchases, we trimmed some recent strong performers like Hilton and Schwab, and we fully sold Progressive and Thermo Fisher. Progressive was simply about valuation; they'd been in a sweet spot

for a couple years, growing fast as inflation caused customers to shop around and some competitors to retrench. But the market had started to price in that abnormal rate of growth longer-term.

Like MidCap, the weak backdrop for our kind of company meant there were several companies we were eager to buy. Other incremental purchases included TransDigm, Cadence, Danaher, and Constellation Software, to name a few.

Looking ahead

Stories move stocks, but only for a little while. Over any longer stretch of time, it's the earnings that count. It's best not to get caught in the noise. For 26 years, we haven't had a market "outlook" story to tell. Over time, all that matters is whether we're right about our companies' ability to compound earning power. So, that's where we focus. Below are a few examples of why we're confident in the future.

Live Nation is accelerating its Venue Nation strategy, acquiring and developing concert venues globally. These investments could add nearly 30 million annual fans over the next five years, and returns have already exceeded their 20% target. Owning venues allows Live Nation to pair its promoted tours with its properties, creating a powerful flywheel—fans attending shows in owned venues are three times more profitable than those in third-party locations. The recent acquisition of Paris La Défense Arena, Europe's largest indoor venue, underscores the scale and ambition of this strategy.

O'Reilly continues to expand its store and distribution network, paving the way for more market share gains in a fragmented industry. They recently opened their first large distribution center in the Northeast, where O'Reilly has fewer stores. This distribution center is the foundation for more stores in the region, where they're likely to quickly pick up market share. O'Reilly is also growing its newer businesses in Mexico and Canada, where there is a long runway to grow at attractive returns.

Hyatt brought Playa Hotels & Resorts into their network last year, which adds to their already strong portfolio of resort hotels. These are hard to replicate assets and Hyatt secured multi-decade management agreements. This novel structure – Hyatt acquired the resorts, and then sold the real estate and signed long-term management agreements – is in line with their strategy to be asset-light. Over the last decade Hyatt has generated over \$5 billion from selling owned hotels. Their hotel network has meanwhile doubled to 1,500 properties, as Hyatt continues to attract owners to its system.

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Simon Wilson was appointed CEO of Markel Insurance last March, and he has several initiatives to improve the underwriting at Markel. He's focused on improving profitability and reorganizing in a way that provides more clarity, decentralization, and accountability. Since these adjustments, we have begun to see Markel improve its underwriting performance in its core US business. Simon previously led Markel's International Insurance operations very successfully. We look forward to seeing additional improvement in Markel's results throughout 2026 and beyond.

Perimeter Solutions announced a historic five-year agreement with the US Department of Agriculture. We believe this agreement expands the company's revenue base and makes it less seasonal. Perimeter Solutions also announced an agreement to acquire Medical Manufacturing Technologies (MMT). This is the company's first significant acquisition since its owner-operator leaders (people we respect in Nick Howley and Will Thorndike and Haitham Khouri) took over in 2021. We look forward to seeing them apply their value-creation operating principles to a newly acquired business.

Amphenol built on their long track record of value-creating M&A with the announced acquisition of Commscope's Connectivity and Cable Solutions (CCS) business for \$10.5 billion. This expands Amphenol's presence in the fast-growing AI market and brings additional new end markets for Amphenol to serve. We're excited to see growth and margins at CCS improve under Amphenol's ownership.

Veeva Systems had a productive year. They successfully transitioned their first top-20 pharma customers to Veeva's new CRM software platform, continued to grow their clinical and R&D software products, and released their first AI agent products. We expect Veeva to build on these achievements in 2026 and believe the essential nature of their software in a highly regulated industry, their customer intimacy, and founder-led culture will lead to more profitable growth in the years ahead.

MSCI's custom index business saw rising demand, as investors want more personalized solutions based on MSCI's standards and data. MSCI also launched two new private market solutions – an area where many desire more transparency and consistency. These are smaller businesses today, but they're promising areas of future growth.

Formula One will welcome more partners next year, with new teams from Cadillac and Audi and a new media partner in Apple. Competition within the sport continues to increase, which accelerates their flywheel by making races more exciting, drawing in more fans, and attracting more sponsorship interest. They also acquired MotoGP last year, which is essentially the F1 of motorcycle racing.

We could go on, but hopefully the point has been made. Markets can get excited about the next big thing, and last year's examples included hopes for quantum computing and nuclear energy and rare earths mining. But over time it's far better, in our view, to invest in advantaged businesses making real moves that can earn attractive returns without taking big risks. We believe we're owners of such companies, and that's what makes us excited about 2026 and the years beyond.

Thank you for your continued investment in our strategies. We appreciate the confidence and trust you have placed in us. – Aligned Investors

Composite performance (%)	3M	1YR	3YR	5YR	10YR	20YR
MidCap Equity (gross)	-3.97%	2.27%	16.12%	8.86%	13.17%	12.12%
Russell Midcap Index	0.16%	10.60%	14.34%	8.67%	11.00%	9.49%
MidCap Equity (net)	-4.11%	1.65%	15.44%	8.21%	12.58%	11.58%

Composite performance (%)	3M	1YR	3YR	5YR	10YR	Performance start (1 July 2012)
Blue Chip Equity (gross)	-1.67%	9.88%	23.64%	10.68%	16.57%	16.31%
Russell 1000 Growth Index	1.12%	18.56%	31.12%	15.31%	18.11%	17.49%
S&P 500 Index	2.66%	17.88%	22.98%	14.42%	14.81%	14.78%
Blue Chip Equity (net)	-1.82%	9.22%	22.92%	10.03%	15.96%	15.71%

As of 31 December 2025. Returns over one year are annualized. Past performance is not a reliable indicator of future return.

Risk considerations

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