

January 20, 2026

Dear Clients and Partners:

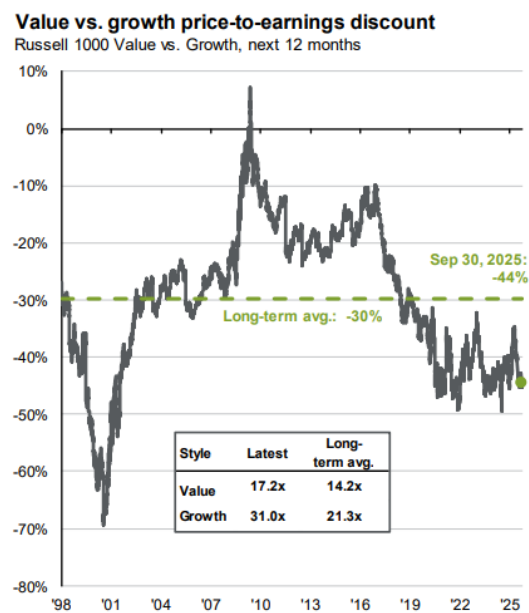
Despite many scary news items (including what was at one point effectively a full Chinese trade embargo) 2025 came in strong. Below are the results through September 2025 and for the full year of 2025:

Through September 30, 2025				Full Year 2025			
	Value	Blend	Growth		Value	Blend	Growth
Large	11.7%	14.8%	17.2%	Large	15.9%	17.9%	18.6%
Mid	9.5%	10.4%	12.8%	Mid	11.0%	10.6%	8.7%
Small	9.0%	10.4%	11.7%	Small	12.6%	12.8%	13.0%

Q425 was the quarter for Value. This makes sense given how stretched Growth was versus Value. In our last letter we specifically called this out as the discount of Value vs. Growth got very extreme. This is what we said:

Across the rest of the market, mid and small caps did participate as did Value but to a lesser extent. Interestingly, Value is once again trading towards the lowest end of its recent range vs. Growth. A few notes related to the chart to the right:

- Value will almost always trade at a lower multiple than Growth given the overall growth and margin profile of the businesses (think Proctor and Gamble vs. Microsoft)
- Historically the valuation discount is around 30% less vs. 44% today
- Both Value at 17x earnings and Growth at 31x earnings are above their long-term averages. Growth is significantly above, reflecting (i) the fact that the Growth businesses of today are far better than the historical average and (ii) significantly above average expected earnings growth from AI development



- *We would note that towards the bottom of this range there is generally at least a period of Value outperformance*

Q4 was indeed a period of Value outperformance. Interestingly, Large Cap still had the best quarter due to Large Cap Value having the best quarter. Where we saw the biggest struggle was Mid Cap Growth. Mid Cap Growth is generally where a lot of software companies sit. Software has been hit very hard by the rise of the AI trade. Even looking at the Large Cap Tech companies this is clear. Here is a list of some of the largest US pure software companies (i.e., not the hyperscalers like MSFT, GOOG, AMZN, ORCL) and the percentage they are off their all-time highs:

- Salesforce – 35%
- ServiceNow – 42%
- Adobe – 52%
- Autodesk- 18%

If we broaden this to Mid Cap the figures look worse and this is with markets at all-time highs. We've talked a lot about AI. Does this mean that the pure software companies are in real trouble?

Software and AI

In the short and intermediate term we do not believe so. As we've discussed in prior letters we tend to default to the Bill Gates quote of "we tend to overestimate what we can do in five years and underestimate what we can do in 10 years". Most likely, the software companies, especially the biggest ones with the most resources, will find a way to make the AI work for them.

Wall Street analysts don't run businesses. We do and we would note a few things:

- It is unbelievably disruptive to rip out a piece of software. The price savings have to be extreme
- Change management (i.e., getting people to buy into the new software) is very challenging
- You have to reach a point that either the customer service is so bad and/or the price is so high that you are willing to potentially lose employees over it to make a change
- Large corporations move very slowly and ripping out one of those products is likely low on the "to-do" list for CEOs. "We saved \$100M on technology upgrades" is not as compelling to the market as "we found \$200M of new revenue"

So, net-net we think that the software companies will likely re-rate higher after a period of under-performance. Currently, the market isn't sure how to think about their revenue models going forward. Most of these companies charge on a per seat basis, but if AI allows customers to do significantly more with each seat license, then customers likely don't need as many seats. Investors are therefore thinking that all of these companies will then see substantial revenue contraction as the number of seats contract. As some companies like ServiceNow and Salesforce are already starting to show, they can actually upsell quite a bit of their AI services which, even if there is contraction in the number of seats, will continue to provide revenue growth and profit margin expansion. If you think about it from an end consumer value perspective, being able to do more with less (including less people) is more valuable to a business and therefore they are likely to pay more for it.

We saw the same thing back in the early 2010s when companies like Microsoft and Adobe evolved from a one-time upfront licensing fee to a monthly SaaS model. Analysts didn't know how to think about the revenue and profits in the out years as the licensing fee provided more upfront revenue at higher margin but was lumpier around product releases. Due to the uncertainty, the stocks sold off hard, the revenue models eventually became clear as the SaaS revenue overtook the license fee revenue and the stocks then took off. We expect we are in a similar painful period of discovery for software stocks right now, but the future may be brighter than what is currently reflected in the prices.

Is the AI Trade Over

No. But the Q4 winners rotated. A lot happened so a brief recap:

- OpenAI essentially accidentally revealed their plan to potentially have the government backstop some loans via a panel discussion comment from the CFO. The market began to doubt that they can execute the plan (ORCL sell off, Semi underperformance)
- Anthropic released Claude Code which serious software developers are raving about (see the software discussion previously this was a part of that sell-off)
- Google released the newest Gemini and it performed above and beyond ChatGPT (GOOG massively outperformed everything after that)

It is worth noting that for the first half of 2025 everyone assumed that GOOG had lost. Since April lows GOOG is up 133%. This is the second largest company in the world, moving 133% in about 8 months. Now, the narrative is that TPUs (GOOG) might just dominate vs. GPUs (NVDA, AMD, etc.). Needless to say things change very quickly in the AI space. What is likely to come next?

For starters, we don't think anyone is slowing down. Claude Code is proof that specific applications have massive total addressable markets (TAM) with profits. OpenAI is certainly now in "prove it" stage. They should have their first products trained by Blackwell NVDA chips out in the next six months. This is likely to be a meaningful jump forward. After that will come the Rubin chips next year which is likely an even bigger jump. Google is certainly not going to be sitting on their hands and MSFT / AMZN will be investing aggressively to support everyone.

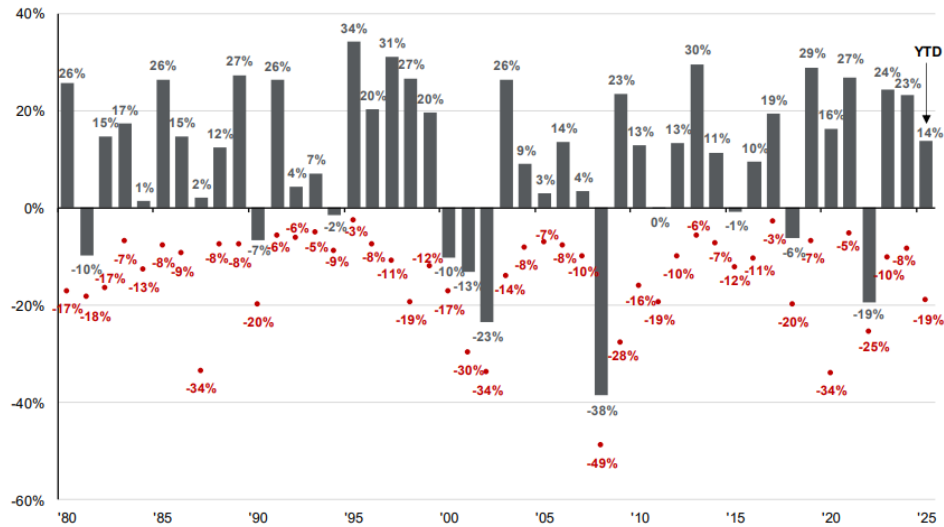
So, no, we do not believe the AI trade is over just as we do not believe the large software businesses are dead. Who wins (or said more accurately is perceived to be ahead) is likely to flip flop for a long time to come. But the spending that backs the AI trade is unlikely to slow materially.

We'll finish this portion of the letter with our last quarter's ending on the AI trade:

Our opinion on this has been made repeatedly: we think the technology is very real. The timing and the magnitude are unknown, but it is coming. We would also note if we have a "bubble" the market is likely going significantly higher. That doesn't mean it is going to be a straight line however. The below shows annual returns (black line) and largest annual drawdown in red:

S&P 500 intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.1%, annual returns were positive in 34 of 45 years



Big Business

Following up on the theme of the largest businesses discussed in the software section, it is fun to look back at the largest businesses of each decade:

Top 10 companies by decade

GTM U.S. 10

Top 10 S&P 500 companies by market capitalization

Percent of S&P 500 market capitalization as of the first day of the indicated year



Source: Bloomberg, Standard & Poor's, J.P. Morgan Asset Management.
Companies are organized from highest weight at the bottom to lowest weight at the top. Past performance is no guarantee of future results.
Guide to the Markets – U.S. Data are as of December 31, 2025.

J.P.Morgan
ASSET MANAGEMENT

There are a few really interesting things to gather from this:

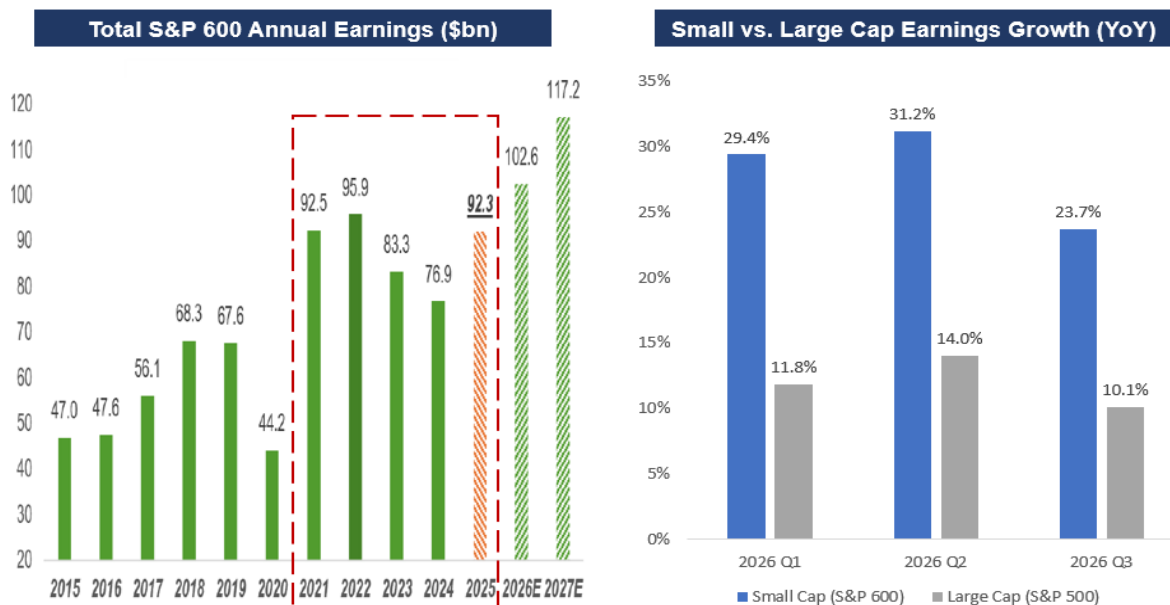
- Every single one of these businesses is still around today although Kodak is a shell of itself and is always listed as the poster child for being disrupted
- Two of them had to go bankrupt (Kodak & GM) and then come back
- Another few went basically bankrupt (C, BAC and AIG) but were bailed out
- A few of them have been carved up (Dupont & GE, AT&T - this is a different AT&T than what is public today)
- Some of them merged together (we don't think we'll be seeing any of the 2025 merged together anytime soon)
- Only two of them basically changed their business model entirely (IBM & MSFT)
- Typically around 20% was the cap where the top 10 businesses were in terms of the % of the S&P 500. Now we are at 40%
- Not a single company from 40 years ago is still in the top 10 today (Exxon is close at number 13) but worth only 1/12 of the largest)
- However; looking at where the largest companies from 10 years ago are today there isn't quite as much change as it appears:
 - AAPL (3rd largest now)
 - XOM (13th)
 - MSFT (4th)
 - JNJ (15th)
 - BRK (9th)
 - WFC (27th)
 - GE (combined with the spin-offs close to top 10)
 - PG (25th)
 - JPM (10th)
 - CVX (34th)
- We won't bore you with the same math as 20 years but most of them are close to the largest today

In other words, things don't change quite as much as one would think. Most companies remain but the largest companies in terms of the top 10 change radically every 10 years and the size changes significantly as well. This is also one of the reasons that the S&P 500 is such a great index. It buys more of the best businesses and it removes the ones that fall out. You essentially always own the most of the best businesses.

Increasing Small Cap Exposure

For those in our ETF and mutual fund portfolios, we have been underweight small caps for many years. This is because large cap earnings growth and quality has been substantially higher than small caps for a long time. As you can see below, in just the past four years, for example, small cap earnings have effectively been flat, and the small cap equity index has largely followed suit. However, you'll notice in your accounts that the last quarter we increased small cap exposure for the first time in a long time. This is because small cap earnings are now set to grow at rates over twice that of large caps over the next three quarters and should have meaningful earnings growth for the next two years. This is primarily due to accelerating economic growth, lower interest rates (small cap companies have more debt so benefit more from lower interest rates) and strengthening industrial end markets where small caps are more heavily concentrated (less tech than large caps).

In addition, we have launched an individual stocks strategy for small caps using the same fundamental framework to select the highest quality growing businesses that we use for our Compounders strategy, simply applied to companies with \$1B-\$8B market caps.



Source: Zacks Investment Research, Inc.

Conclusion

The same stocks do not always lead every single quarter. Many sectors and sub-sectors will fall in and out of grace. Continuing to own the best businesses over the long haul is a fantastic way to make good returns and let the best businesses do the work for us.

As always, we are available at your convenience.

Regards,
Your Fortis Team

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