

# L2 MIDCAP SELECT STRATEGY

Portfolio Manager Commentary as of September 30, 2025

## Q3 2025 STRATEGY PERFORMANCE:

The Russell Midcap ETF and S&P500 Midcap ETF gained 5.33% and 5.52% for the quarter, respectively, while the L2 Midcap Select Strategy rose 9.16%<sup>1</sup> net. Since inception in March 2021, the L2 Midcap Select Strategy is up 81.82%, more than double the returns of both benchmarks.

## MARKET OVERVIEW: QUICK SUMMARY

Large Cap Growth led the way higher in Q3 again, up 10.43%, Large Cap Core rose 7.92%, and Large Cap Value rose a respectable 5.29%.<sup>2</sup> Midcap, as measured by both the S&P Midcap (SPMD) and the Russell Midcap (IWR) benchmarks rose 5.52% and 5.33% respectively.<sup>3</sup>

The importance of building a financial plan with your Advisor - and sticking to it - has never been more important in our view. Rarely has the market given investors such a brutal reminder that trying to time markets around macro news is a fool's game. From the start of the year through April 8th, most US benchmarks were down between -15% and -20%; the one exception being the Large Cap Value ETF which fell "only" -10%.

From that low, the primary US Large and Midcap ETF benchmarks have exploded higher. Large Growth ripping nearly +34%, Large Core and Midcap rising well over 20% each, and Large Value jumping nearly 17%. The nature of this post April 8th rally has been decidedly "risk on."

Investors piled into speculative low-quality, high volatility, and already expensive blue-chip tech stocks.<sup>4</sup> To drive the point home we note that the average return of stocks of companies that **lose money** was +29% in the quarter vs. profitable companies rising only 7.9% on average.<sup>5</sup> At the sector level, only Tech and Communication Services beat the benchmark by any material amount with nearly every other sector lagging.<sup>6</sup>

## THE AI MANIA IS IN FULL SWING

The L2 team would be remiss if we did not provide our Advisors with some comments about where we are in the AI hype-cycle. By every metric we are aware of, the mania around AI looks as precarious and foolish as any bubble seen in our careers. In 1980 McKinsey forecast there would be less than 1 million cell phone users by the year 2000. Turned out they were a tad light. By 1999, there were 900,000 people adopting cell phones...every three days. By 2000 there were 109 million cell phones in use.<sup>7</sup>

1 Returns represent the L2 US Midcap Select Composite Strategy

2 As defined by the Russell 1000 Large Growth ETF "IWF", Russell 1000 Core ETF "IWB", and the Russell Large Value ETF "IWD"

3 As defined by the Russell Midcap ETF "IWR" vs. the S&P 400 Midcap ETF "SPMD"

4 The Financial Times, There's Value in Value Stocks;

5 Facet Q3 Commentary

6 Bloomberg Attribution of IWB, the Russell 1000 Core ETF's Q3 returns; note: Consumer Discretionary did rise 8.8% in the quarter vs the benchmark's 8% gain, but every other sector lagged

7 "McKinsey & Co Isn't All Roses", Andrew Ross Sorkin at the NYT, 2013 and "Cutting the Cord" in The Economist, Oct 7th, 1999

Last year McKinsey forecast that AI will generate up to \$48 trillion in revenue by 2040 – a number ~50% larger than US GDP. Less frequently cited is their report's comments that this revenue "...could generate \$2 - \$6 trillion in profit by 2040."<sup>8</sup> So their bullish forecast for the technology maps out to 12.5% profit margins.

For context, market darling Nvidia's net profit margins over the last 12 months tallied to an extraordinary 52.5%. So even in the case of an economic boom unlike anything the world has seen, we should expect margins to fall. Why? The reasons are clear.

As Bain & Co. explains in their 5th annual Global Technology Report, the world is currently short \$800 billion in revenues to profitably fund the AI data centers needed by 2030. And that shortfall is not for lack of optimism. That number includes vast savings from AI that have yet to materialize.<sup>9</sup>

The market is now awash in the stories that clearly lay-out the circular nature of the vendor financing that has become ubiquitous to the AI narrative. The sheer size of the **announced** deals makes the shenanigans of Nortel Networks, WorldCom and others from the dot.com bubble look minuscule by comparison.<sup>10</sup> What's different this time you ask?

Private equity and private credit would be our answer. In a brief and brilliant article by Bloomberg's [Sridhar Natarajan](#) and [Allison McNeely](#), they explain that there are now 19,000 private equity funds. That's 5,000 more PE funds than there are McDonalds.<sup>11</sup>

When there is an ocean of capital held by managers that don't get paid unless they put the money "to work" what do you think happens? They allocate the capital and start taking fees. The article goes on to cite none other than Brookfield, Blackstone, Carlyle, and Apollo as **all being bullish** on investing in AI data centers. We've cobbled together two quotes from article we think are telling:

*"Data centers are a great place to be positioned...you're not picking like which specific application within AI is going to be the winner....the explosive growth in [private investments in data centers] and the opportunity to structure tailor-made financing options is raising investor hopes that they can lock in lucrative returns without being bogged down by the gyrations in public markets."*

Figuring out exactly how much private equity and credit sponsors have pledged to the various data-centers being built is not easy. But reading two articles from The Economist, Credit markets look increasingly dangerous and *The murky economics of the data-centre investment boom is helpful*. Why?

The articles document that credit spreads are tighter today than in either 2021 or 2007 – both periods where credit peaked and subsequently suffered severe losses. Equally insightful is how, contrary to the claims of the private sponsors that they can "lock in lucrative returns", the arrival of money-losing firms like OpenAI, CoreWeave and other GPU rental firms has increased the demand for credit while seriously undermining the quality of the borrowers.

We share all of this because our strategies have benefitted significantly from the AI hype cycle. Yet we would highlight our recent [exit in Oracle](#) as well as our just published [bull-note on Cisco](#) as examples of how active

8 McKinsey, The next big arenas of competition, October 23, 2024

9 "\$2 trillion in new revenue needed to fund AI's scaling trend", Bain & Co, September 23, 2025

10 "Circular Financing: Does Nvidia's \$110B Bet Echo the Telecom Bubble?", Thomas Tunguz, Theory Ventures

11 "Crazy, Right?": More PE Funds Than McDonald's Signals Pressure, Bloomberg News

managers can keep your clients involved without chasing low-quality narrative stocks with terrible fundamentals.

While illiquid private investment vehicles do eliminate the gyrations in public markets, that is, in our mind, at your expense. As the stunning collapse of Tricolor and First Brands has shown us, the opaque, high-fee, world of private equity and credit is equally if not more vulnerable to fraud than listed companies that must follow rigorous disclosure.

**If you are working with a financial advisor none of this should matter.** The typical client of the Financial Advisors we work with is 1) properly diversified, 2) has risk exposure that is suitable to their tolerance and 3) understands that investing is a long horizon endeavor. Specifically, one that, done systematically, transfers wealth from the emotional and impatient to the patient, diversified, and disciplined.

**L2 would like to thank the Advisors we are selective in working with for bringing this caliber of individual to us.** The L2 team recently declined offers to be platformed on some of the largest wealth advisory platforms in the country. We'd rather work fervently to win **with and for** those independent souls who put their clients' interests ahead of their own.

Over the last 15 years, L2 has spent significant money and time ensuring our boutique asset-management firm stuck to the facts and followed the processes that have proven out over centuries. In return we, and our investors, have benefitted from this discipline with benchmark beating returns in eight of our nine strategies.

Aside from a willingness to persist in periods when we look foolish, the most important thing we have done is remain relentless in reminding our investors that **the stocks we buy on your behalf represent partial ownership in very real, well capitalized, and well-run companies.**

This may seem obvious to some. But the endless marketing blitzes from the big-money management complex hailing bloated index funds, or naïve factor ETFs, has effectively disintermediated most investors' cognitive affinity for understanding what they own. Instead, investors are fed an ever-changing menu of "wrappers" that make increasingly tenuous performance and volatility claims (in our view).

Below we show some fundamentals of the stocks in your Midcap Strategy (top row) vs. the benchmark Russell Midcap ETF (second row). In our view, this is pretty simple. The application of our evidence derived, rules based, active management process has assembled a portfolio of stocks that have higher quality characteristics yet trade at discounts to the benchmark.

|                    | FCF/EV* | P/S  | P/E   | Fwd P/E | ROE | Total Yield | 3 Yr Grth | 36m Beta |
|--------------------|---------|------|-------|---------|-----|-------------|-----------|----------|
| MidCap Strategy    | 3.6%    | 1.8x | 20.1x | 18.4x   | 25% | 3%          | 46%       | 1.14     |
| S&P400 ETF         | 3.2%    | 1.4x | 24.7x | 17.6x   | 16% | 3%          | 36%       | 1.23     |
| Russell MidCap ETF | 2.8%    | 1.7x | 28.1x | 18.9x   | 16% | 3%          | 36%       | 1.21     |

Source: L2 Asset Management, LLC; Data from 9/30/2025; \*ex financials

## CONTRIBUTORS & DETRACTORS:

**Comfort Systems USA, Inc. (FIX)** supplied our investors with another impressive gain in the third quarter of 2025, surging 54% on the heels of the stock's truly outstanding Q2 results. While we trimmed our position in August to take some gains off the table, we believe the stock has room to move higher as the company is following a disciplined strategy while pursuing AI-related growth opportunities.

Although FIX is trading at a high valuation multiple, earnings are expected to grow almost 59% for the full year, having increased 74.6% YoY in Q2.<sup>12</sup> The company has generated positive free cash flow for the past 26+ years, has raised its dividend for 13 years in a row, and its cash balance is growing even after making substantial share repurchases in the first half of the year.<sup>13</sup>

Although FIX is trading at a high valuation multiple based on trailing earnings, we believe the company's outlook, based on its expected earnings growth and backlog, justify that view.

FIX's market cap is now above the minimum threshold for inclusion in the S&P 500, and while we are certainly not predicting it will join that benchmark any time soon, it is no longer outside the realm of possibility. Combined with strong cashflow, solid profitability, and a return on equity that hit 40% last quarter, we believe the stock can move higher.

**Affiliated Managers Group, Inc. (AMG)** produced a 21% return for its shareholders this quarter, making a solid contributors to the Midcap strategy. We believe the stock has room to move higher as it appears to be somewhat unappreciated compared to similar firms in the space.

Affiliated Managers Group, Inc. acts as a strategic partner and long-term investor in a group of roughly 40 independently operated investment firms that offer a range of investment strategies and services to mutual funds, and institutional, high net worth, and retail investors. They cover a wide range of developed and emerging market equity strategies, private markets and liquid alternatives, and multi-asset and fixed income products. Formed in 1993, AMG is based in West Palm Beach, Florida.

Owning stock in AMG offers a way to invest in a diverse "portfolio" of independent investment firms. These affiliates cover a wide range of asset classes through their investment strategies, which means AMG's revenues and profits do not depend on the ups and downs of a single market or the popularity of a particular type of strategy. AMG's affiliates maintain autonomy and retain significant direct equity ownership in their individual firms, so incentives are properly aligned (they have "skin in the game").

In terms of organic growth, the second quarter of 2025 was AMG's strongest quarter in 12 years, largely due to growth in private markets and liquid alternatives, which are increasingly popular among high net worth investors seeking tax-aware solutions.<sup>14</sup> Total alternative AUM increased by 20% in the first half of 2025, including a record \$33 billion in net inflows. AUM also increases when it adds new affiliates, and the first half of 2025 has been one of the most active periods of new investment activity in AMG's history.

In Q2 2025, fee-related earnings grew 4% year-over-year, led by higher AUM due to positive investment performance and organic growth in alternative strategies. This was partly offset by outflows from fundamental equity strategies. AMG is trading at a low valuation multiple relative to its peers. Given its positive outlook we believe the stock has meaningful upside potential in the near- to intermediate-term.

**Kinsale Capital Group, Inc. (KNSL)**, a specialty insurance company, tumbled 12% in Q3 2025, detracting from our Mid-cap strategy. Despite this pullback, we maintain a positive view of the company and the stock.

Kinsale, which was founded in 2009 and is headquartered in Richmond, VA, focuses exclusively on Excess and Surplus (E&S) insurance and is the largest "pure play" E&S insurer in the U.S. E&S insurance covers high-risk or

12 <https://seekingalpha.com/symbol/FIX/earnings>

13 <https://seekingalpha.com/symbol/FIX/cash-flow-statement>, and <https://seekingalpha.com/symbol/FIX/income-statement>.

14 <https://ir.amg.com/static-files/6c3b6732-46ce-4915-8976-390bff916e7f>

niche exposures that do not fit into a standard insurer's book of business.

To ensure quality and consistency, Kinsale controls its own underwriting process rather than delegating authority to agents or brokers. It also manages claims in-house, which management believes leads to better outcomes and a higher degree of accuracy in setting reserves. This discipline shows in Kinsale's financial results, as revenue in Q3 2025 grew 22% year-over-year while net income grew by 45%.

E&S policies typically command relatively high premiums to cover the unusual risks involved, and this market now represents almost 10% of insurance premiums in the U.S. This has nearly doubled since 2017, and Fitch Ratings sees room for that to climb to 12% in the coming years.<sup>15</sup>

Kinsale's financials are strong, including revenue growth, earnings growth, return on capital, and healthy reserves. Perhaps the main reason for the sell-off this quarter is that KNSL is still trading at a fairly high multiple relative to the P&C industry overall, after huge run-ups in 2023 and 2024. However, comparing Kinsale's valuation multiple to that of the typical P&C insurer is not particularly meaningful and we think the stock can deliver solid returns going forward.

**Chewy, Inc. (CHWY)**, the leading online pet products retailer, slipped 5% this quarter, after a 31% gain in Q2, detracting from our Mid-cap strategy. The underlying reasons for establishing the position in CHWY remain intact and we believe the stock has greater upside potential after this recent pull-back.

Chewy is a 100% e-commerce business that offers pet food, treats, supplies, and medications in the U.S. through retail websites and mobile apps. While CHWY competes with big online and bricks-and-mortar retailers (think Amazon and Walmart), they are generalists while Chewy is exclusively focused on pet products. Its platform is designed to make it easy for pet owners to find and order what they need/want, with an extensive product inventory for each pet species. Those broader retailers' sites cannot easily replicate what Chewy offers and do not command the same degree of customer loyalty among devoted pet owners.

As we noted when we added the name, millennials and Gen Zers now dominate the pet-owning demographic, and in general these consumers prioritize wellness, seek unique experiences, and are digital-first shoppers. Many buy specialty products for their critters – global pet accessories sales alone are expected to nearly double between 2025 and 2034.<sup>16</sup> Going beyond food, toys, and grooming, growth is also coming from "non-traditional" products such as (and we're not making this up) pet probiotics, pet wipes, and pet toothpaste.<sup>17</sup>

Net income in Q2 dropped 79% year-over-year, mainly due to a large non-recurring tax benefit that boosted results last year. This may have been the root cause of the stock's decline in Q3, which we view as an overreaction as operating income increased 117% YoY, indicating healthy growth in the company's core business. Trading at a modest price-to-sales ratio, we see the recent decline in the stock as providing runway for CHWY to move higher.

15 <https://beinsure.com/news/us-es-insurance-premiums-hit-117bn/#:~:text=Fitch%20Ratings%20says%20the%20US,auto%2C%20and%20medical%20professional%20liability>

16 <https://www.gminsights.com/industry-analysis/pet-accessories-market>

17 <https://explodingtopics.com/blog/pet-industry-trends>

## CONCLUSION:

We continue to follow the data which tells us that the current market backdrop characterized by historically high concentration coupled with bloated valuations will create substantial tailwinds for our evidence-based, process driven investment methods. This is particularly true of our Value, Midcap, and Dividend & Income strategies.

Our biggest concern would be the return of a wildly speculative environment like 2020 which could temporarily inhibit the returns we believe are inevitable.

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Performance results presented in this material is not indicative of future results. The total net performance of L2's portfolios is available upon request.

## INDEX DEFINITIONS

**Russell Midcap ETF (IWR):** iShares Russell Mid-Cap ETF is an exchange-traded fund incorporated in the USA. The Fund seeks investment results that correspond to the performance of the Russell Midcap Index. The Index is a capitalization-weighted index consisting of the 800 smallest companies in the Russell 1000 Index. This ETF replicates the Index using an optimized strategy.

**S&P MidCap 400 ETF (SPMD):** SPDR Portfolio S&P 400 Mid Cap seeks to provide investment results that, before fees and expenses, correspond generally to the total return performance of the S&P MidCap 400 Index.