

# L2 MIDCAP SELECT STRATEGY

Portfolio Manager Commentary as of December 31, 2025

## Q4 2025 STRATEGY PERFORMANCE:

The Russell Midcap ETF and S&P500 Midcap ETF gained 0.12% and 1.63% for the quarter, respectively, while the L2 Midcap Select Strategy rose 2.26%<sup>1</sup> net. 2025 was another stellar year for the Midcap strategy (11.44% vs. 10.37% and 7.42% for the respective benchmarks). Since inception in March 2021, the L2 Midcap Select Strategy is up 85.89%, more than double the returns of both benchmarks.

## MARKET OVERVIEW: QUICK SUMMARY

Large Cap Value led the way higher in Q4 up 3.82%, Large Cap Core rose 2.48%, and Large Cap Growth rose 1.15%.<sup>2</sup> Midcap, as measured by both the S&P Midcap (SPMD) and the Russell Midcap (IWR) benchmarks rose 1.63% and 0.12% respectively.<sup>3</sup>

This quarter delivered something of a reprieve from an intense period of speculative behavior by market participants, although low-quality stocks continued to outperform their high-quality peers. Our Q3 2025 commentary used ARKK to highlight the extent of this risk-seeking behavior. From January 1st to September 30th, ARKK rose +52% while the Large Core ETF (IWB) rose 14% and Large Value (IWD) returned 11%. We also noted that from April 8th (the low point of the “Liberation Day”-induced market decline) through September 30th, the ARKK ETF rose an incredible 113%, despite its preference for exorbitantly priced stocks of loss-making companies.

Q4 saw what we hope is the beginning of a genuine shift in risk attitudes, as ARKK fell -10.87% for the quarter. If investors start paying more attention to fundamentals and valuations, which drive long-run returns, 2026 could be a terrific year for L2’s Active Strategies. Regardless of which “flavor”—from our Dividend & Income to our Large Cap Growth offerings—a return to basic investment principles could make our benchmark leading performance since inception, even better.

When many investors are in a speculative frenzy it’s difficult for high conviction, low-turnover, valuation- and quality-aware, concentrated strategies like ours to shine. Yet such periods set the stage for significant return potential based on fundamentals, as the mania wanes and sanity and cash flows prevail. We have seen this repeatedly in the past, most recently in 2022. As a reminder the ARKK ETF lost -67.0% in 2022 while the market was down -18.1%. Today, as in 2021, we continue to believe our stable of actively managed products – which have fared surprisingly well in this speculative environment – have their best days ahead of them.

**While this recent phase of nonsensical speculative behavior has lasted much longer than the data suggests it should, that indicates the consequences will be that much more painful for those who have jumped on the speculation bandwagon. Without exception, the story is always the same: expensive, loss-making, and low-quality stocks fall while more rationally priced, quality stocks with decent to excellent growth profiles outperform.**

<sup>1</sup> Returns represent the L2 US Midcap Select Composite Strategy

<sup>2</sup> As defined by the Russell 1000 Large Growth ETF “IWF”, Russell 1000 Core ETF “IWB”, and the Russell Large Value ETF “IWD”

<sup>3</sup> As defined by the Russell Midcap ETF “IWR” vs. the S&P 400 Midcap ETF “SPMD”

At a macro level: Wealthy households are keeping the U.S. economy humming, along with enormous levels of capital expenditures to support the AI buildout. Those two sources of spending accounted for over 2/3rds of Q3 2025 GDP growth.<sup>4</sup> It's no big secret that one of the main reasons the U.S. economy has been able to absorb the shock of tariffs (which, as a result of various exemptions are much lower than the "headline" numbers that caused widespread recession fears last April) is that the wealthy keep spending. This creates a positive feedback loop, as spending supports corporate profit margins, which has boosted stock prices, making wealthy households wealthier, which leads to more spending. The top 10% of earners now account for almost half of all consumer spending in the U.S.).<sup>5</sup>

We believe a corollary of this has been the outsized concentration in a few well-known tech stocks that dominate index funds. The same folks driving spending are also cycling into index funds.<sup>6</sup> The good news is that, by definition, there is a large cohort of high-quality, blue-chip equities trading at discounts last seen at the peak of the dot.com bubble. Evidence-based, benchmark-aware active management processes like ours have done well despite these headwinds. Even better, the data suggests our best days may lie ahead.

Below we show some fundamentals of the stocks in your Midcap Strategy (top row) vs. the benchmark S&P400 ETF & Russell Midcap ETF (second row & third 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 equal to cheaper valuations than the benchmarks.

	FCF/EV*	P/S	P/E	Fwd P/E	ROE	Total Yield	3 Yr Sales	
							Grth	36m Beta
MidCap Strategy	3.4%	1.8x	18.1x	17.2x	25%	4%	46%	0.97
S&P400 ETF	3.4%	1.5x	27.9x	17.1x	14%	3%	33%	1.24
Russell MidCap ETF	3.1%	1.6x	27.5x	18.2x	17%	3%	33%	1.23

Source: L2 Asset Management, LLC; Data from 12/31/2025; \*ex financials

## CONTRIBUTORS & DETRACTORS:

After a shaky start in the first part of last year, shares of retailer **Abercrombie & Fitch Co. (ANF)** stabilized and then surged when the company reported its most recent quarterly results (Q3 of its fiscal year). The stock rose 47% over the fourth quarter of 2025, making a strong contribution to our Midcap strategy. We think ANF is undervalued and likely to rise further.

Starting in 2014, a new CEO and a major rebranding effort helped ANF regain popularity within its target market; still, in the apparel business it is always a battle to stay relevant. In its most recent results ANF reported its 12th consecutive quarter of growth, with sales rising 7% to a record high. Net sales and operating margin were both at the high end of the company's guidance and earnings per share beat expectations, while inventory levels were in line with forecasts.<sup>7</sup> Further, the company expects sales to grow 6%-7% in the coming year.<sup>8</sup>

4 "Wealthy Consumers Keep Economy Humming", Wall Street Journal, 12/26/2025, p. A2

5 Ibid.

6 <https://awealthofcommonsense.com/2025/02/the-top-10/>

7 <https://seekingalpha.com/article/4847513-bercrombie-and-fitch-co-anf-q3-2026-earnings-call-transcript>

8 Ibid.

Despite this positive momentum, investors do not seem to fully appreciate ANF, as the stock is still trading at a below-average P/E multiple. This alone gives the stock room to move higher. In addition, short interest as a percent of total float is fairly high, at almost 13%. Assuming the stock price moves higher based on positive fundamentals, short covering would give it an additional boost. Management has been aggressively buying back stock, totaling 9% of shares outstanding at the beginning of the year through FY Q3, (they know a bargain when they see one?), providing additional support. With its large cash balance, more share repurchases are likely. Given all of this, we expect ANF to move higher.

Shares in the **New York Times (NYT)** rose 21% in the fourth quarter of 2025, making a strong contribution to the Midcap strategy. While the shift away from paper and ink toward digital journalism killed off many newspapers, a handful have figured out how to flourish and the NY Times is clearly one of them. Despite its high valuation multiple, we think the stock can continue to deliver for investors.

The New York Times newspaper, highly respected around the world, has been around for 175 years. As noted above, NYT has found a way to thrive in the digital age. Digital subscription revenue grew 21% from Q2 2022 to Q1 2025,<sup>9</sup> and paid subscribers grew 31.5%.<sup>10</sup> This topline growth has translated into earnings-per-share over the past three years of 25.7% (CAGR). In sum, the company has identified ways to profitably expand its reach. Supporting its stock price, it has been paying out at least 50% of its free cash flow to shareholders through a combination of dividends, which have increased in each of the past seven years,<sup>11</sup> and share repurchases.<sup>12</sup>

The elephant in the room is AI. Last May, NYT signed a deal with Amazon for at least \$20 million per year that allows its content to be used in short answers delivered via Amazon products such as Alexa, and for AI training purposes.<sup>13</sup> Will that cannibalize the Times' core business? We don't think so. If legitimate news sources ceased to exist, AI chatbots would be forced to use what has happened in the past to fabricate stories about what is happening today (much the same can be said for social media).

Why do we think NYT's stock price has room to move higher, even at a high valuation multiple? We can't say it any better than the company's CEO who, in presenting the company's Q3 2025 results, said, "*We have world-class journalism and a portfolio of leading lifestyle products in giant spaces... [Our products] are so valuable that people seek them out by name, form habits and make room for them in their daily lives.*"<sup>14</sup> We think that tells a solid story for investors.

**Chewy, Inc. (CHWY)**, an e-commerce platform that sells 130,000 types of pet products, supplies and prescriptions, detracted from returns falling 18% this quarter. At its core, CHWY is a free cash-flowing, debt-free company with a dominant and growing market share in an industry that is not only gaining customers each year, but also one in which each customer increases his/her spending annually. Furthermore, the pet care industry has demonstrated resilience across economic cycles because of the essential, repeat nature of a pet's needs. In addition, CHWY has a world-class fulfillment network that is essentially fully built out.<sup>15</sup> CHWY can cost efficiently ship products

9 <https://www.statista.com/statistics/279835/new-york-times-media-groups-quarterly-circulation-revenue/?srsltid=AfmBOoq3GJvOFD39yZ51rtLdFpRoS6XjSUtJ4vW5h86xeFwULotDYia0>

10 <https://www.statista.com/statistics/1424757/new-york-times-digital-subscribers-by-type/?srsltid=AfmBOoqzGtoT4VsmxK3880CtBdtQkg-UkFJHo0gC1hMgFcodSC6wNFkc>

11 <https://www.dividend.com/stocks/communications/media/publishing-broadcasting/nyt-the-new-york-times-company/>

12 <https://seekingalpha.com/article/4838211-the-new-york-times-company-nyt-q3-2025-earnings-call-transcript>

13 <https://www.wsj.com/business/media/amazon-to-pay-new-york-times-at-least-20-million-a-year-in-ai-deal-66db8503>

14 <https://seekingalpha.com/article/4838211-the-new-york-times-company-nyt-q3-2025-earnings-call-transcript>

15 Chewy, Inc. 3Q FY 2025 earnings conference call transcript, December 10, 2025.

to more than 80% of the U.S. population overnight and nearly 100% in two days.<sup>16</sup> All this implies that as CHWY continues to grow, more of its revenue will fall to its bottom line as the business scales and the incremental cost of filling customer orders declines.

CHWY's gross margin has increased 300 basis points (bp) since FY 2021: 29.6% over the most recently reported twelve months compared with 26.6% in FY 2021. (CHWY's fiscal year ends approximately one month after the end of the corresponding calendar year. For example, FY 2021 ended on January 30, 2022.) Interestingly, CHWY's gross margin when the stock reached its all-time high of \$119 in February 2021 was only about 25.5%.<sup>17</sup>

Based on analysts' consensus FY 2026 earnings estimate for CHWY of \$1.56,<sup>18</sup> the stock trades at a forward P/E ratio of around 21.5x, or a ~10% discount to the S&P 500. CHWY trades at an even sharper discount to the broad stock market on the basis of its enterprise value (EV)-to-adjusted EBITDA ratio. Since CHWY both has better growth prospects and carries lower risk than the average stock, the stock deserves to trade at a marked premium to the broad market.

Consistent with its sales growth profile and sequential increases in its adjusted EBITDA, CHWY's operating and free cash flow have jumped over the last few years. More specifically, the company generated \$487 million in free cash flow over the twelve months ended November 2, 2025, up from \$343 million in FY 2023 and \$119 million in FY 2022.<sup>19</sup>

When we aggregate these data points, a reasonable intermediate price target for CHWY stock is around \$40. Such a CHWY stock price would equate to a slight P/E premium, but still a discounted EV-to-EBITDA ratio to the S&P 500. Such upside potential is the chief reason CHWY is a central holding in our portfolio.

**AAON, Inc. (AAON)** detracted from our Midcap strategy, declining 18% in the fourth quarter of 2025. It has been a challenging year for the stock, but we believe it can recover based on data center-driven demand for its products and services.

The company has confronted a number of challenges over the past year that appear to have tainted investor sentiment toward the stock. These included a technology transition that led the company to suspend new orders for various products. That hurt sales and margins, rattling investors. While unwelcome, this setback most likely pushed out sales to later quarters rather than causing the company to forfeit that revenue entirely.

The boom in data center construction clearly benefits the BASX unit, which provides air handling, liquid cooling, and cleanroom environments for data centers and their related cleanrooms. While BASX represents a fairly small percentage of AAON's total sales, it has been experiencing substantial growth for the past three years. In the company's most recent earnings call, the CEO announced the BASX unit's backlog, driven by growth in the data center market, rose \$896.8 million, up 119.5% from a year ago and 43.9% from the prior quarter. The company is adding nearly 800,000 square feet of manufacturing capacity, with large-scale production expected to come online shortly that should support meaningful BASX growth in 2026. The AAON brand also experienced substantial sequential sales growth of 28.1%, driven by over 20% production increases.<sup>20</sup>

---

16 Chewy, Inc. FY 2024 10-K.

17 Chewy, Inc. 3Q FY 2025 10-Q; Chewy, Inc. FY 2024 and FY 2022 10-Ks.

18 Yahoo Finance.

19 Chewy, Inc. 3Q FY 2025 10-Q; Chewy, Inc. FY 2024 and FY 2022 10-Ks.

20 [https://seekingalpha.com/news/4518351-aaon-anticipates-mid-teens-sales-growth-and-28-percent-28\\_5-percent-gross-margin-for-2025-as](https://seekingalpha.com/news/4518351-aaon-anticipates-mid-teens-sales-growth-and-28-percent-28_5-percent-gross-margin-for-2025-as)

We remain focused on AAON's growth outlook, which we think is compelling. Management appears to be confident in its sales forecast, based on demand growth, backlogs, particularly for BASX, which is playing a bigger role in the company's overall outlook, and the ability to hold price increases. We expect to see increased EPS in Q1 2026 and beyond that will provide the basis for a boost in the company's share price.

## **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.

## DISCLAIMERS

L2 Asset Management, LLC (“L2”) is a registered investment adviser with the United States Securities and Exchange Commission in accordance with the Investment Advisers Act of 1940.

The information, data, analyses, and opinions presented herein (a) do not constitute investment advice, (b) are provided solely for informational purposes and therefore are not, individually or collectively, an offer to buy or sell a security, (c) are not warranted to be correct, complete or accurate, and (d) are subject to change without notice. L2 shall not be responsible for any trading decisions, damages, or other losses resulting from, or related to, the information, data, analyses or opinions or their use. L2 may render no investment advice unless a client service agreement is in place.

L2 and its affiliates do not provide tax, legal, or accounting advice. This material is not intended to provide, and should not be relied on for tax, legal, or accounting advice. You should consult your tax, legal, and accounting advisors before engaging in any transaction. Investing involves risk and possible loss of principal capital.

Nothing herein shall limit or restrict the right of L2 to perform investment management or advisory services for any other persons or entities. Furthermore, nothing herein shall limit or restrict L2 from buying, selling, or trading securities or other investments for their own accounts or for the accounts of their clients. L2 may at any time have, acquire, increase, decrease, or dispose of the securities or other investments referenced in this publication. L2 shall have no obligation to recommend securities or investments in this publication as a result of its investment activities for its own accounts or for the accounts of their clients.

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

**iShares Russell Micro-Cap ETF (IWC):** iShares Micro-Cap ETF is an exchange-trade fund. The ETF tracks the performance of the Russell Microcap Index, which includes companies with market capitalizations typically below the threshold of the Russell 2000 Index.

**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.