

# L2 MIDCAP SELECT STRATEGY

Portfolio Manager Commentary as of March 31, 2026

## Q1 2026 STRATEGY PERFORMANCE:

The Russell Midcap ETF and S&P500 Midcap ETF gained 1.27% and 2.58% for the quarter, respectively, while the L2 Midcap Select Strategy rose 4.56%<sup>1</sup> net. In a quarter characterized by extreme volatility, we are happy with the performance of the strategy. For those that have spoken with us or seen us present, our team continues to pound the table on the overlooked “blue-chips on the make” we are finding in the Midcap universe. Since inception in March 2021, the L2 Midcap Select Strategy is up almost 95%, more than double the returns of both benchmarks.

## MARKET OVERVIEW: QUICK SUMMARY

Large Cap Value and Midcap benchmark ETFs delivered modest but positive returns in Q1 2026 of 1.97% and 1.27%, respectively, due to their relatively large exposures to the Energy sector. In contrast, with much smaller weights in Energy and big losses in Information Technology stocks, Large Cap Core declined -4.29% and Growth, which has almost no Energy stocks, tumbled -9.83%.<sup>2</sup>

As these returns show, this quarter, or more specifically, the final month of the quarter, was all about Energy, as disruptions in oil supplies due to the war in Iran dominated markets. Energy stocks delivered a whopping 39% return, on average, depending upon the benchmark. The Materials sector also benefitted (think petrochemical and fertilizer makers). While the upturn in Energy stocks is understandable, returns of this magnitude suggest that investors expect high oil prices to stick around for a while.

On the flip side, Consumer Discretionary and Financials suffered, for the same reason: unease about how long high oil prices will persist. Consumers were already pinched by inflation and high-income households that had been holding up spending are taking a hit in their stock portfolios, which may lead them to pull back. Supporting this view, Consumer Staples rallied. The Fed is now unlikely to cut rates until late in 2026, if then, hurting the outlook for bank lending.

Growth stories were clearly out of favor this quarter, with investors apparently questioning whether massive spending on the AI buildout will pay off. Morgan Stanley estimates nearly \$3 trillion of AI-related infrastructure investment will be made globally by 2028, with more than 80% of that spending still to come.<sup>3</sup> If every working-age adult on earth paid \$20 per month to use AI, it would take over three years to recoup that \$3 trillion. A Bloomberg columnist observed that “AI is both an object of speculative excess and a source of genuine existential risk.”<sup>4</sup> All of the Mag 7 stocks declined this quarter, even though not all of them are betting the farm on AI build-outs.

At a macro level: Even without the spike in oil prices, it’s hard to argue that the Fed should cut interest rates. Inflation measured by the Personal Consumption Expenditures index, the Producer Price Index, and other inflation

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1 Returns represent the L2 US Midcap Select Composite Strategy

2 As defined by the Russell Large Value ETF “IWD”, the Russell Midcap ETF “IWR”, the Russell 1000 Core ETF “IWB”, and the Russell 1000 Large Growth ETF “IWF”.

3 <https://www.morganstanley.com/insights/articles/ai-market-trends-institute-2026#:~:text=Morgan%20Stanley%20Research%20estimates%20that,earnings%20and%20capital%20markets%20activity>

4 <https://www.bloomberg.com/news/newsletters/2026-03-11/one-chart-captures-the-great-contradiction-in-markets-right-now>

measures have been heading in the wrong direction. Some of this could be tariff-driven, but services inflation, which has been moving higher, is not. And despite the not irrational concern that AI will eliminate large numbers of jobs in the not-too-distant future, that hasn't happened yet. Hiring is far from robust, but unemployment is holding steady.

The good news is that there has been significant dispersion in the returns of the individual stocks that comprise broad market indices. To us, that indicates opportunities to identify high-quality companies whose prices do not fully reflect their earnings outlook. With all of the recent upheaval and big daily swings, we stay focused on what our models tell us. We rarely make changes based on headlines; we adjust when our models pick up on persistent signals of the underlying causes of market moves.

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	3.2%	1.8x	16.7x	16.9x	24%	5%	45%	1.01
S&P400 ETF	3.4%	1.5x	24.9x	16.5x	15%	4%	29%	1.19
Russell MidCap ETF	3.1%	1.6x	28.3x	17.5x	17%	3%	29%	1.15

Source: L2 Asset Management, LLC; Data from 3/31/2026; \*ex financials

## CONTRIBUTORS & DETRACTORS:

**Valaris, Limited (VAL)** was a major contributor in Q1 2026, rising roughly 95%, with the move driven less by higher oil prices than by Transocean's agreement to acquire the company. Announced on February 9, the deal represented about a 32% premium to Valaris' February 6 closing price and would leave Valaris holders owning roughly 47% of the combined company. Because shareholders will receive a fixed number of Transocean shares, VAL will likely trade in line with RIG until the transaction is expected to close in the second half of 2026. Even before the announcement, Valaris had been performing well, underscoring that companies we view as attractive investments can also become attractive acquisition candidates.

**IPG Photonics Corp. (IPGP)** was another strong contributor, returning 60% in Q1 2026 after reporting better-than-expected Q4 2025 revenue growth. The company's fiber lasers remain critical components in industrial systems, and recent strength came from stabilizing industrial demand, solid semiconductor applications, and expansion beyond materials processing, with non-materials applications now roughly 14% of revenue. We are also encouraged by newer opportunities in counter-drone systems and medical technology, which broaden IPG's growth runway while management continues to emphasize product quality, market leadership, and cost discipline. With analysts projecting strong earnings growth over the next two years, we continue to see upside in the shares.

**Chewy, Inc. (CHWY)** detracted in the quarter, falling 18%, but we continue to view the selloff as an overreaction. The company occupies a differentiated niche as a pure-play online pet retailer, benefiting from largely non-discretionary pet spending, a focused assortment, a major fulfillment network, and customer service that supports strong loyalty. More than 80% of revenue comes from quasi-subscription products, and Chewy also operates the #1 pet pharmacy in the country by scale, giving the business recurring-revenue characteristics that generalist

competitors may struggle to match. While revenue and net income have been flat recently, analysts expect earnings per share to grow by more than 20% in FY2027, and we believe the pullback has improved the stock's upside potential.

**Abercrombie & Fitch Co. (ANF)** gave back some of its strong Q4 2025 gains in Q1 2026, but we still view the shares as undervalued. The turnaround remains intact, with 12 consecutive quarters of growth and recent results showing sales up 7% to a record high, earnings ahead of expectations, and operating margin at the high end of guidance. Hollister continues to stand out, with 16% sales growth in fiscal Q3, while improving average unit revenue suggests the Abercrombie brand still has pricing power even as it laps tougher comparisons. With management guiding to 6%-7% sales growth, the stock still trading at a below-average earnings multiple, and buybacks already totaling roughly 9% of beginning-of-year shares outstanding through fiscal Q3, we continue to see further upside.

## **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.

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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.