January 20, 2026

Dear clients and friends,

Re: LCM Annual Letter December 31, 2025

In LCM's eighteenth annual letter I will discuss the markets in 2025, review our results and provide a brief analysis of our current portfolio.

Year in Review

The defining narrative in markets last year was the reconfiguration of global trade policy by the US administration. After the US "Liberation Day" tariff launch in April, the animal spirits seemed to awaken, and money began to flow into the most speculative corners of the stock market. By late summer, a list of market leaders read like a list of investments a prudent investor would seek to avoid. Among the biggest gainers were the most shorted stocks, unprofitable technology companies, meme stocks, quantum computing stocks, and Bitcoin related stocks. By year end some of the boom fizzled but overall it was a huge move for speculative stocks.

The US market continues to be driven by technology and euphoria about artificial intelligence. Alongside high and rising valuations, the race to win at AI and cloud computing is causing capital intensity to increase at the largest technology companies, which is a substantial degradation of earnings quality versus the "capital light" business models that existed in technology 20 years ago. This worrisome trend may have been overlooked due to the industry convention of using EBITDA as a yardstick to approximate profits, which unlike earnings does not account for capital spending.[1] The US stock market is very concentrated, with the ten largest companies representing 39% of the value of the whole S&P 500, eclipsing the previous high of 34% for the ten largest companies at the end of the Nifty Fifty[2] period in 1972. The influence of mega-caps on index returns can be seen by comparing the return of the S&P 500 which was up 17.9% (up 12.4% in Canadian dollars), to the return of the Equal Weighted S&P 1500 Index[3] which was up only 7.9% (up 2.3% in Canadian dollars). Thus, without the heavy influence of the largest stocks, the *average* stock in the US returned just under 8% last year.

In Canada, the resurgence of gold after a long slumber propelled the Canadian stock market to one of its best years. Gold tends to do well under the threat of inflation, but not if interest rates increase substantially, thus in hindsight conditions were perfect. A bar of gold pays no income to its owner, so it tends to be viewed less as a 'store of value' if higher interest can be earned elsewhere. For a portfolio manager, it is exceptionally difficult to time when to buy gold, and even tougher to know when to sell. And sell you must at some point, as the long-run returns from gold have been terrible compared to investments in growing, high return-on-capital businesses.

As we mentioned in last year's letter, there are many signs of overenthusiasm in capital markets. Valuations are stretched by just about any metric you choose. For example the Shiller P/E ratio on the S&P 500 Index ended the year at 40.4 times earnings, above the peak valuations of 1929[4], and just below the all-time peaks reached in the 2000 internet bubble. A boom in private credit seems to have delayed a broader downturn in levered private equity, and retail participation in the stock market continues apace. These factors signal caution. The main risk that LCM is concerned with is losing money. From LCM's perspective, the only response to a frothy bull market is to ensure we maintain our discipline by insisting on a margin of safety in our investments. While having a disciplined approach may seem to hold you back from time to time (particularly in hot markets), it is a key component to avoiding permanent capital loss.

In terms of portfolio activity, we sold one quarter of our largest position this spring due to concerns about a short-term cyclical peak in profits. LCM also eliminated the remainder of a small position beset with tariffs having already sold three quarters of it at much higher prices in 2021. We identified and purchased shares in one new idea, a global company based in Europe, which we discuss more near the end of this letter. LCM ended the year invested in nine companies diversified across eight industries and was conservatively positioned with roughly a third of the portfolio in cash.

<u>Results</u>[5]

Last year we earned a total portfolio return of 1.9%. We have said in every letter that with a short list of positions, sometimes it will feel like the action is passing us by, and 2025 was one of those years. We will discuss the drivers of last year's results in more detail in the next section.

Including 2025, over the past five years LCM has earned 14.7% per year, accomplishing our primary goal to earn in excess of 7% per year. A simple average of the Canadian and US stock market has returned 16.1% per year in Canadian dollars over this same five-year period, and the Equal Weighted S&P 1500 Index is up 10.5% annually over this period (up 9.0% per year in US dollars).

Since it was founded in 2008, LCM has earned a cumulative total return of 770.5% or 13.2% per year on an annualized basis. In other words, $1 invested at LCM when we opened our doors before the financial crisis in mid-2008 is worth roughly 8.7x that amount today. We have accomplished our long-term goal to earn in excess of 7% annually, and LCM has beaten a simple average of the Canadian and US stock market by 2.2% per year. We are pleased with these long-term results and view them as a product of our patient and disciplined approach.

<u>A closer look at our largest positions</u>

Rather than discuss a principle of investing in this year's discussion section, I thought it would be useful to provide some context for why some of our positions did not perform at pace with the market in 2025. As 100% of my investable net worth is invested in the same portfolio as all LCM clients, this is the question I feel is most pressing and is likely to be yours as well.

Three of LCM's largest holdings each experienced operational or industry-related setbacks in 2025, and none generated positive share performance during the year. As we do not publicly promote or disclose specific investments, we will refer to these holdings generically as Company A, B and C.

Company A was initially purchased during the pandemic in 2020. Since that time, the share price has appreciated approximately 4.1x (times), and we have not sold any portion of our position. The company is currently undertaking a significant expansion, and recent results have trailed industry forecasts due to a series of operational "teething issues" somewhat typical of projects of this scale. We have spent considerable effort assessing these challenges, including directly engaging with management, visiting the operations, and discussing the issues with competitors and industry experts.

The management team has an excellent reputation and strong historical track record of capital allocation. LCM's assessment is that the current difficulties are temporary and will be resolved well within our investment horizon. Notably, there has been broad-based insider buying by senior management in recent months, which we view as an encouraging signal. Successful expansion into adjacent products or geographies takes time, and results should be evaluated over years rather than quarters. This reinforces why we encourage clients to commit capital to LCM with a minimum five-year time horizon, to ensure clients reap the benefits of long-term fundamental growth in the businesses we own. At current prices, Company A trades at what we believe is an exceptionally attractive valuation, and we estimate prospective total returns in excess of 20% annually over the next three years.

Company B faced an industry-related headwind rather than anything company specific. Research we conducted on its competitive landscape led us to conclude earlier in the year that profits in Company B's industry were at a short-term cyclical peak. Accordingly, this spring we sold one quarter of this position near the highs, realizing gains of up to 16.2x our initial purchase price from 2010. As anticipated, cyclical pressures emerged later in the year and the share price declined roughly 20% from our sale price. The remaining position therefore detracted from portfolio performance in 2025. Over the past fifteen years, Company B has been a powerhouse of organic growth, growing earnings approximately 11.5x. LCM's analysis continues to indicate that it possesses a superior business model and is well positioned to gain share in a growing industry. While near-term earnings growth will likely be flat as cyclical pressures play out, the medium-term outlook remains compelling. We expect this position to generate annual returns in the mid-teens over time.

Company C is working through a period of adjustment related to tariffs. This was the first stock LCM purchased for clients in August 2008. By 2017, we had sold substantially all of this position at gains of up to 12.7x our initial purchase price. During this nine-year period of ownership, earnings per share rose roughly 6 fold, or 22% per year largely due to self-funded, organic growth initiatives. We began rebuilding the position in 2021, at prices approximately 40% below the highs at which we sold in 2017. More recently, tariff-related uncertainty has delayed customer orders and constrained near-term growth. We expect an adjustment period of one to two years as the industry adapts. Beyond that, we believe the company is uniquely positioned to resume strong earnings growth through the deployment of capital into high-return organic initiatives. While valuation is compelling, the timing of growth is somewhat uncertain, leading us to calculate a wider range of prospective returns ranging from 11% to 17% per year over a three-year horizon.

As noted, all three companies declined modestly in price during 2025. The products and services that these three companies provide will be in demand by society for the next several decades regardless of whatever happens in artificial intelligence or global geopolitics. These companies are each leaders in their respective industries with above average profit margins and returns on incremental capital in excess of 20% after tax. All three have conservative balance sheets and clear, self-funded paths to significant organic earnings and free cash flow growth over the next three to five years. Collectively, they trade at an average P/E ratio of 12 times trailing earnings – this is certainly compelling value in absolute terms and particularly attractive relative to the current expensive stock market environment. Under a range of reasonable scenarios, LCM's calculations of prospective annual total returns across these holdings range from 11% to 26% per year over the next three to five years. There are, of course, no guarantees in business. Just as these businesses did not perform in 2025, there is no certainty they will perform in 2026. Nevertheless, we continue to believe that owning conservatively financed, growing, high-quality businesses with strong returns on capital and purchased at attractive valuations remains the most reliable way to protect and grow capital over the long term.

A new opportunity set for LCM

Last year LCM identified and invested in a global company squarely within our circle of competence, purchasing shares at a compelling valuation of less than 10 times prospective earnings. This company has an attractive business model, offers an exciting long-term growth trajectory, a great balance sheet and an excellent board of directors. What is unique about this investment for LCM is that we purchased the shares directly on a European stock exchange, after determining how to custody these shares within our clients' US dollar cash accounts. From a foreign exchange risk perspective, this is economically no different than investing in American Depositary Receipts, a strategy LCM has employed since inception to get exposure to attractively priced international companies. The only practical difference is that it occasionally requires yours truly to get up in the middle of the night to coordinate transactions with our trader in London. While we don't intend to deviate from our focused approach, the ability to selectively invest directly in Europe means having more securities to study and meaningfully expands our opportunity set. This is especially exciting at a time when European equities tend to be a lot cheaper than their North American counterparts.

What can clients expect going forward?

It is important to remember that LCM does not own the market and generally, our holdings are not significant components of the index. The valuations of our holdings are attractive; the business models and balance sheets of our holdings are strong and in lieu of buying investments with no margin of safety, we hold a cash position. In every letter we caution that losses on an annual basis are unavoidable from time to time. Given that owning shares in a company is analogous to being a part owner of a business, and just as no business owner can expect to increase their net worth in a straight upward line, neither can an investor in stocks. Taking a long-term perspective is the best advice to help maximize the long-run returns for our capital.

I wish you all the best for 2026. If you have any questions, please call me at 604-558-0070.

Sincerely,

Daniel Lewin CFA
President

1 Take Microsoft for example which is owned by 90% of US Equity funds. I hate EBITDA as a metric for valuing businesses, largely due to my concern that the DA, or Depreciation and Amortization, is not profit but actually estimates a real and significant cost called 'maintenance capital expenditure' that must be paid to keep the lights on and the machinery in the factory running. However, if you go back two decades to 2005, Microsoft's early software focused business model really defied conventional business economics, with very little DA and very little maintenance capital spending. In fact in 2005, the DA expense calculated was very similar to total capital expenditure, and this totaled only 2.2% of revenue and 4.6% of EBITDA. So valuing MSFT on 2005 EBITDA might not be the worst sin as the DA was de minimis. In fact, the book

Capitalism Without Capital written in 2017 by Haskel and Westlake, with a plug on the inside cover from Bill Gates himself outlines just how a software business like MSFT in 2005 didn't need much in the way of factories or warehouses to create and distribute software. Fast forward two decades to 2025, and last year MSFT spent an enormous amount of capital ($65 billion) on buying warehouses and filling them with servers to build out the cloud and trying to be first to win at AI. Last year, DA at MSFT was 9.9% of revenue and in fact MSFT spent 179% of that estimate, or 41% of EBITDA. Imagine the absurdity of paying a multiple of EBITDA, thinking it was profit, and then realizing 41% of it needed to be spent to keep up with competitors in your business. This level of capital intensity is similar to Exxon – and oil production and refining is one of the most capital-intensive businesses there is. Most concerning for those who own mainstream mutual funds and index funds is that, despite the increase in required capital spending, MSFT trades at an even higher multiple of EBITDA today than in 2005 (21x now vs 14x). In comparison, Exxon trades at 8x EBITDA. This worrisome increase in capital intensity and degradation of earnings quality has occurred at most of the largest technology companies in the market. For reference using P/E multiples, which I think are closer to reality than EBITDA, MSFT trades at 34x trailing earnings today versus 24x in 2005 when it was a smaller company with higher growth prospects.

2 The Nifty Fifty period was discussed in LCM's 2023 Annual Letter.

3 The Equal Weighted S&P 1500 Index is an average of the returns of the 500 largest companies (the S&P 500), the next 400 medium sized companies (the S&P 400) and the smallest 600 (the S&P 600). Because the weights of the largest companies are so considerable, their performance tends to drown out the smaller companies' performance in a market cap weighted index. For instance, even though it included 1000 more medium and small companies, in 2025 the market cap weighted S&P 1500 earned 17.0% - very close to the S&P 500 return of 17.9% because the largest stocks contribute so much to the totals. This compares with the aforementioned Equal Weighted S&P 1500 Index total return of 7.9%.

4 The LCM holiday book this year was 1929 by Andrew Ross Sorkin. If you did not receive a copy of this book and would like one please let us know and we will send one off.

5 All stated returns are gross of fees. We take pride in ensuring that our fees are fair and reasonable for the service LCM provides. If you would like a copy of LCM's Investment Management Agreement that outlines our fees and services in more detail please contact us. Returns for LCM are from a representative account as all client assets are held on a segregated basis. Small differences will occur between accounts due to rounding and the timing of cash flows. The S&P TSX Composite Total Return Index is used to represent the Canadian stock market returns, and has returned 7.8% per year over the seventeen and a half years ended December 31, 2025. The S&P 500 Total Return Index translated into Canadian dollars is used to represent the U.S. stock market returns, and this index has earned 14.1% per year in Canadian dollar terms over this same period. In US dollars the S&P 500 has risen 12.2% per year. Thus LCM's total portfolio return of 13.2% per year has beaten a simple average of the Canadian and U.S. Stock Markets by 2.2% per year since inception. "Since inception" refers to the seventeen-and-a-half-year period from June 30, 2008 to December 31, 2025.