ARISTOTLE
CAPITAL MANAGEMENT

“MAY YOU LIVE IN INTERESTING TIMES”

Source: AI generated image - Google Nano Banana 2. Content created solely by AI cannot by copyrighted. Edited with Adobe software.

While the Western world often references the ironic phrase, “May you live in interesting times,” the actual, centuries-old Chinese proverb is far more direct: “Better to be a dog in times of tranquility than a human in times of chaos.” It is a phrase rooted in irony, because “interesting” times are inevitably periods of heightened anxiety, structural shifts, and intense noise. It is a blunt reminder that periods of rapid change and structural upheaval inherently demand immense resilience.

Today’s economic landscape perfectly embodies this paradox. We are operating in highly interesting times, characterized by rapid technological breakthroughs and market exuberance on one hand, and underlying macroeconomic tensions and shifting global alliances on the other. This environment tests the emotional fortitude of every market participant. Ultimately, the question facing us today is not whether this underlying uncertainty will persist, but how we choose to respond to it: with discipline or speculation, patience or reaction, perspective or fear.

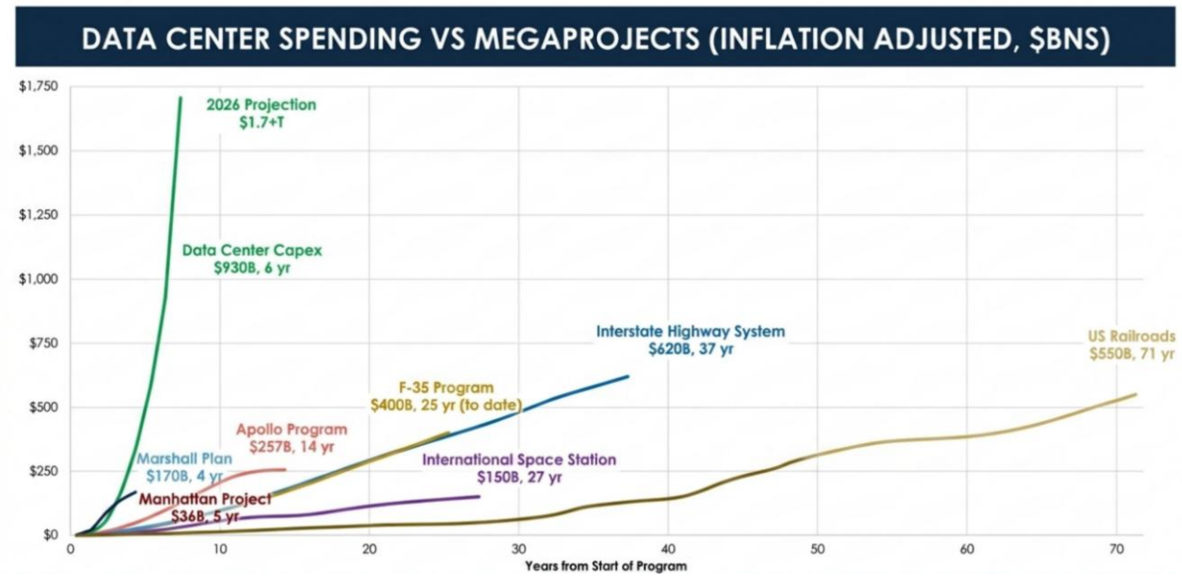
Our view on today’s environment

We view recent relative underperformance of Aristotle Capital equity strategies as a reflection of a narrative-driven market and a temporary disconnect between price and value. We take full accountability for challenging performance and continue to challenge our assumptions daily; however, we remain disciplined and will not chase short-term momentum.

While the potential of a new AI-driven world should not be underestimated, the herd appears to be stampeding into the mercurial fog of exuberance. As capital rotates out of resilient, predictable franchises to fund crowded market themes, it has created a headwind for our strategy—and potentially a long-term opportunity for our investors. We are eagerly accumulating what we consider durable-quality companies at what we see as highly attractive valuations.

The Scale of the Firehose – from processing units to memory chips

In the U.S., there are roughly 4,000 existing data centers with almost 3,000 more under construction. Total hyperscaler investment over the prior seven years will exceed $1.7 trillion by the end of this year, a magnitude and pace that has no historical precedent. Between one-half and two-thirds of the spend is being channeled directly to server rack systems; namely short-lived technology assets like processors and memory that have an economic useful life of three-to-five years. A stark contrast to the U.S. Railroad build-out that is still powering our economy and connecting the nation for decades.



Source: Company reports, Federal Highway Administration (FHWA), National Aeronautics and Space Administration (NASA), Congressional Research Service (CRS), U.S. Government Accountability Office (GAO), Brookings

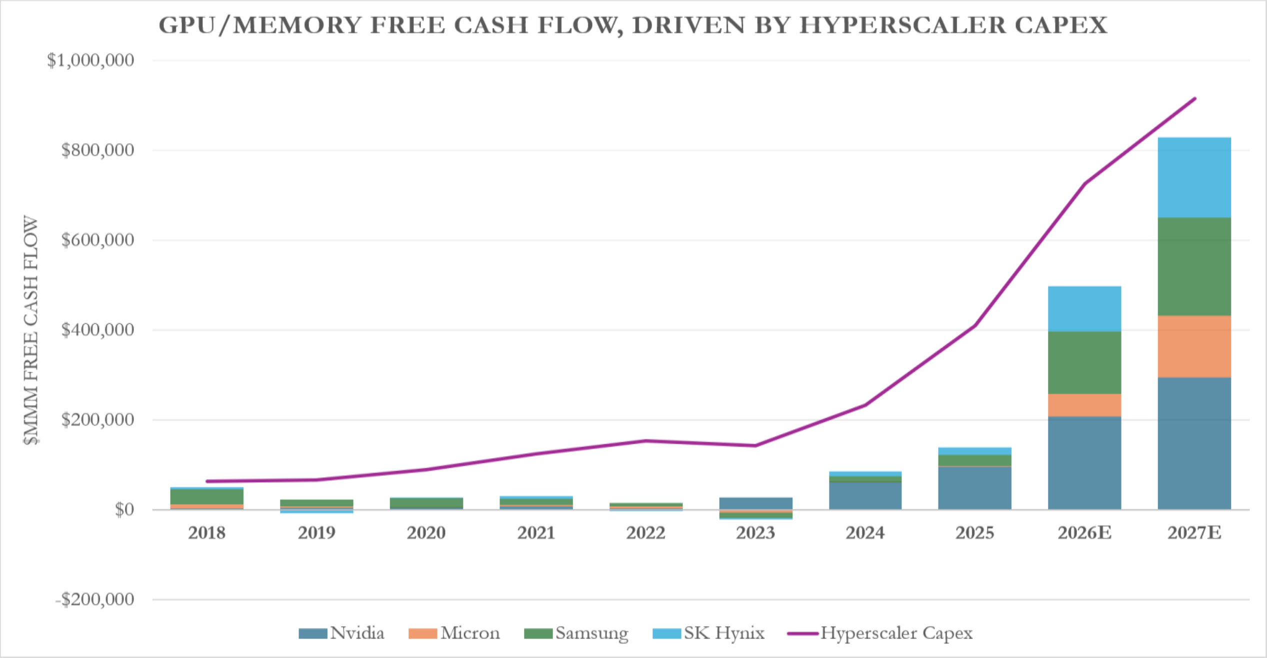
This capital has been frantically chasing scarcity within the AI value chain, forced from one narrow bottleneck to another:

- For the first two years of this cycle, Nvidia stood directly in front of the firehose, absorbing a point-blank blast of capital that took pre-tax cash flow from $8 billion in 2023 to an estimated $250 billion in 2026.
- By late 2025, the market realized millions of GPUs being purchased by hyperscalers would create a concurrent **demand wave for memory hardware** that the global manufacturing base could not possibly fill. Compute power was scaling exponentially but memory capacity was hitting a wall.
- By early 2026, the memory oligopoly (Samsung, SK Hynix, and Micron) announced that they were completely sold out for the year. **Without memory, hundreds of billions spent on GPUs would sit idle**.

Consider very recent history: Just two years ago the same memory industry was trapped in the depths of a devastating global chip glut, where average selling prices for mainstream DDR4 memory sat at a cyclical floor of $0.20 per Gigabyte.

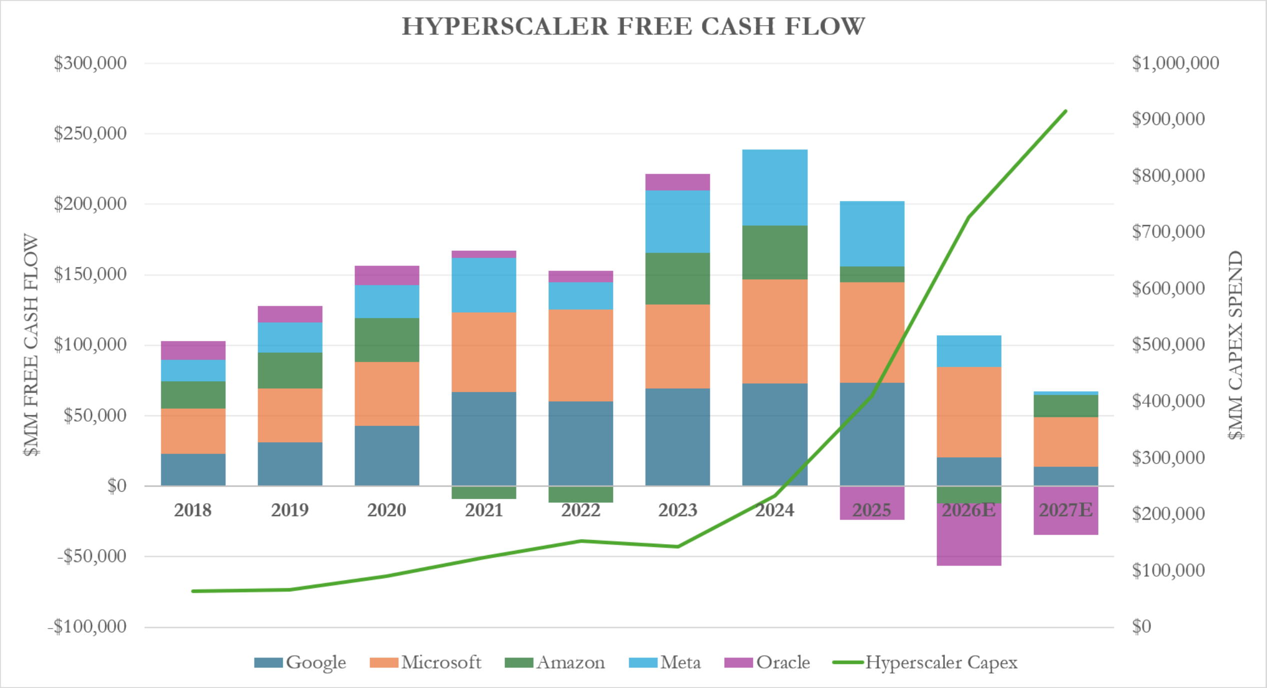
Today, demand at any cost has converged with extremely tight short-term supply, driving prices up 600% to $1.40 per Gigabyte. Given the immense operating leverage inherent in semiconductor manufacturing, almost all these incremental proceeds dropped to the bottom line… for the time being.

After collectively earning less than $10 billion in free cash flow in 2023, the memory oligopoly is forecast to generate nearly **$500 billion in free cash flow in 2026**. No example is more illustrative of this transient windfall than SanDisk. At the time of its spin-out from Western Digital in early 2025, its consensus forecast pre-tax cash flow for 2026 stood at $1 billion; as of May 2026, the current forecast has been revised upward to $32 billion.



Source: Bloomberg, Company filings

The transfer of cash flow from hyperscalers to compute and memory companies hit an inflection point this spring when a number of hyperscalers came to capital markets with massive debt and equity raises: Alphabet ($85 billion), Oracle ($50 billion), and Meta ($30 billion). If some of the most profitable companies in history have chosen not to (or cannot) fund these expenses organically, we believe it is reasonable for one to ask questions. Is the magnitude and duration of the spend justified? Are token compute costs too low? If so, is compute demand overstated? What is normal?



Source: Bloomberg, Company filings

Unsurprisingly, the primary driver of returns for both the Russell 1000 Value and the MSCI ACWI indices were companies on the receiving end of the massive capital spend. The top-10 contributors represented 57% and 49% of the return for the Russell 1000 Value (887 companies) and MSCI ACWI (2,408 companies) indices, respectively.

Russell 1000 Value	Average Weight	YTD Return	Contribution
Micron	1.88%	297%	3.11%
Intel	0.99%	257%	1.41%
SanDisk	0.41%	781%	0.87%
Applied Materials	0.68%	145%	0.70%
AMD	0.62%	144%	0.68%
Caterpillar	0.97%	75%	0.58%
Cisco	1.13%	54%	0.55%
Marvell Technology	0.33%	214%	0.48%
Western Digital	0.38%	241%	0.48%
Johnson & Johnson	1.75%	26%	0.43%
Top-10 Contributors	9.15%	182%	9.29%
Other-877	90.85%	8%	6.97%
Total Return (YTD thru 6/30/2026)			**16.26%**

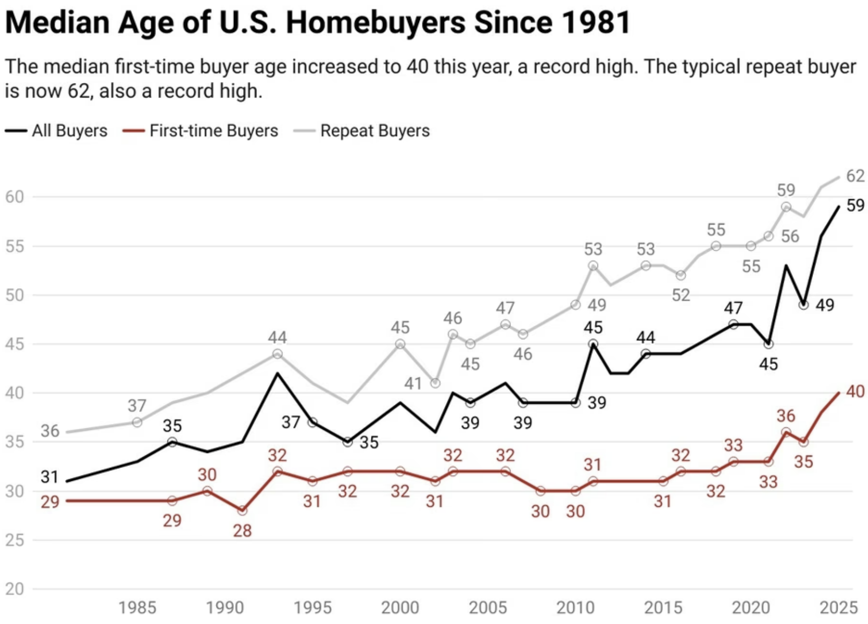
MSCI ACWI	Average Weight	YTD Return	Contribution
Micron	0.65%	301%	1.02%
SK Hynix	0.49%	280%	0.72%
TSMC	1.61%	54%	0.70%
Samsung Electronics	0.72%	160%	0.67%
AMD	0.51%	152%	0.57%
Alphabet	3.68%	13%	0.48%
Intel	0.33%	257%	0.47%
Applied Materials	0.32%	171%	0.37%
Lam Research	0.34%	140%	0.33%
ASML Holdings	0.59%	71%	0.32%
Top-10 Contributors	9.24%	96%	5.65%
Other-2,398	90.76%	7%	5.95%
Total Return (YTD thru 6/30/2026)			**11.60%**

Source: Factset

K-shaped: Wall Street asset owners and Main Street consumers

The massive capital explosion is dragging a narrow swath of the industrial economy along with it; benefiting independent power producers, gas turbine manufacturers, copper miners, and specialized HVAC providers. However, most businesses sit outside this AI data center infrastructure ecosystem, and many are struggling.

Indeed, the broader construction industry is weathering their most difficult operating environment since the Global Financial Crisis. High interest rates have frozen the housing market, dropping turnover to its lowest level since the early 1990s. The stagnation has pushed the average age of a U.S. home to an all-time high age of 44 years old, while the average age of the first-time homebuyer has climbed to an unprecedented 40 years old – up from 31 as recently as 2016.

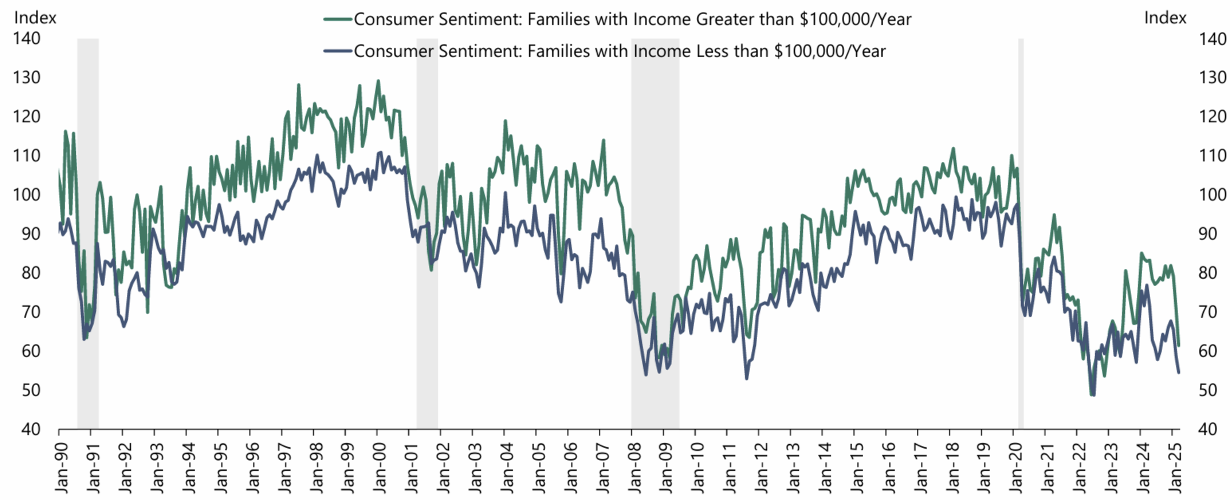


Source: National Associate of Realtors as of November 4, 2025

Simultaneously, broader corporate fundamentals are flashing clear warning signs of eroding consumer health. The post-pandemic era of easy, pricing-led growth for consumer companies is officially over. Brands have lost their blanket pricing power and are shifting aggressively toward localized discounting and product overhauls to protect volumes.

Outliers still exist, as we have seen with **Procter & Gamble**, where consumers are pinching pennies on basic household goods but remain willing to pay a premium if the product delivers a clear upgraded utility. Across the board, consumers are flatly rejecting products that offer no distinct value proposition.

Consumer sentiment declining across income groups



Source: University of Michigan, Haver Analytics, Apollo Chief Economist, March 16, 2025

This deep macroeconomic disconnect is reflected in consumer sentiment, depicted above. The May 2026 update was even more dire when the University of Michigan Consumer Sentiment Index collapsed to a record low of 44.8 (recognize this is likely *transitory* given war, oil prices, etc.). At the same moment, the S&P 500 marched to a new all-time high. There is no precedent for this environment; we have never witnessed a gap so fundamentally wide between Wall Street asset inflation and Main Street consumer economic reality. *Interesting times.*

Whither Quality? Three Archetypes

When we explain that our investment process starts with "quality," a client often balks, "what active manager *doesn't* seek high quality?" Fair point. But like beauty, quality is in the eye of the beholder.

While market participants are familiar with distinct flavors of value investing (Deep Value, Intrinsic Value, and Relative Value), many treat "Quality" as a uniform, static monolith. To provide a more nuanced framework for this environment, we propose three core archetypes of Quality across our investment universe: **Transient**, **Conventional**, **Durable**.

Notably, we see a widening fundamental chasm driving a severe performance divergence across this wide-ranging Quality universe.

Transient Quality companies are currently exhibiting extraordinary, *cyclical* scarcity-driven fundamentals that mimic *structural* quality characteristics, including pricing power, margin expansion, and high returns on capital. In these environments, customers double- and triple-order products to secure supply because the cost of downtime far outweighs the incremental cost of the product. Wall Street routinely mistakes these peak earnings for permanent, structural economics. This is what people mean when they compare today's highfliers to 1999, "Today there are real earnings behind these companies! This time it's different!" However, there is no cartel. Scarcity inevitably vanishes as a massive, high-capex supply wave collides with demand as prices collapse. Boom, bust. While these cycles may offer short-term trading opportunities, and *as there is nothing so disturbing to one's well-being and judgment as to see a friend get rich quick,* we recognize that our edge lies elsewhere. Obviously, we do not typically invest in Transient Quality because market timing (i.e., when to get out) is everything. When we do, we invest in companies we believe can be owned for the long-term through many market cycles.

Re-read the section above on the "Scale of the Firehose" with "Transient Quality" in mind.

We believe **Conventional Quality** companies, characterized by strong brands, deep consumer loyalty, and dominant market shares, represent the most perplexing archetype today. Digital advertising, ecommerce penetration, higher quality private labels, and low barriers to entry have broken the historical virtuous cycle in traditional Consumer Packaged Goods. A parallel degradation is occurring among some legacy Enterprise Software companies, where seat-based subscription models are exposed to the AI efficiency paradox and potential technological disruption. These franchises still possess incumbency advantages, ecosystem lock-in, and irreplaceable data sets, but they are not as structurally resilient as they once were. We think those that evolve and adapt will thrive. Those that do not will go the way of Kodak, Blockbuster, and BlackBerry.

And then there are **Durable Quality** businesses. While we pragmatically invest across all three quality archetypes, we are most energized by Durable Quality's long-term compounding potential. Durable scarcity represents what we believe to be an enduring, structural moat, enabled by such qualities as geology, irreplaceable infrastructure assets, product scarcity, essentiality, or stringent local regulation. Its hallmark is the ability to raise prices ahead of inflation for sustained periods without impairing volume. Hermès and Ferrari are the ultimate consumer expressions of this idea: their scarcity is behavioral, deliberate, and self-reinforcing. Our pursuit of these characteristics has led us to our largest active overweight in Materials, a sector not conventionally associated with "quality." **Martin Marietta**, expanded upon below, perfectly illustrates this thesis.

By maintaining our pragmatic quality-value discipline and fishing in the quiet pond of Durable Quality that our deeper value or benchmark-oriented peers typically avoid, we look forward to compounding investor capital through this historic market cycle.

Durable Quality Example: Martin Marietta[1]

Aggregates (crushed stone, sand, and gravel) is one of the best businesses in the world, in our view. How can a capital-intensive, undifferentiated commodity product selling for a mere 1.2 cents per pound be so profoundly "moated?" The answer lies in geology and physics, which combine to create a legally protected regional oligopoly selling an irreplaceable, essential product by the ton. Humanity will always require rock to build roads, bridges, runways, and foundations. The core business model, "turning big rocks into little rocks," cannot be disrupted.

While aggregates are cheap at the source, moving rock is prohibitively expensive. Trucking costs double the delivered cost every 50 miles, forcing contractors to buy from the closest permitted quarry. This geographic capture grants producers tremendous pricing power. Barriers to entry are practically insurmountable. One cannot simply buy land and start blasting. Strict zoning, NIMBYism, and environmental reviews often take more than ten years to clear. Local communities are rarely eager to permit multiple quarries. Consequently, Martin Marietta's 281 operational quarries are irreplaceable assets that have driven 4.5% annualized pricing power over the last 20 years. This durability was proven during the Global Financial Crisis, when aggregates increased price despite volume declines.

Unlike many technology or legacy industrials, we believe aggregates face limited threat of obsolescence, while baseline demand remains stable. Martin Marietta's diversified end markets reinforce this durability: public infrastructure (~37%) complements cyclical non-residential (~35%) and residential (~20%) demand. Long-term tailwinds include rebuilding America's aging infrastructure, an eventual housing recovery, and domestic re-shoring. Martin Marietta also possesses a strategic footprint across the fastest-growing inland industrial hubs. It commands the Texas triangle (Dallas, Houston,

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[1] Investment example discussion is not intended to present a complete analysis of the security, other material risks and considerations may apply. See important disclosures at the end of this document.

and San Antonio), with dense quarry clusters throughout the Midwest industrial base. This deliberate consolidation has given MLM #1 or #2 market share in over 90% of its geographies.

Management has also avoided chasing expensive acquisitions, preserving flexibility to act at cycle troughs. That discipline enabled smart asset swaps, the acquisition of Texas Industries with limited bidding competition, and recent opportunistic transactions including Lehigh-Hanson West Coast assets, Blue Water, and Quikrete. The current Cash Flow Return on Enterprise Value (our own determination of free cash flow yield), just shy of 6%, understates MLM's runway as normalized volume and earnings power remain materially higher than headline levels. Catalysts include margin synergies from recent acquisitions, a structural "value over volume" pricing strategy, and continued in-market expansion where competitors cannot permit new reserves.

Finally, the U.S. manufacturing build-out represents a massive incremental demand shock. Semiconductor plants and AI data centers require expansive footprints, logistics roads, and vibration-resistant foundations. Because these megaprojects must source rock locally, they create powerful demand shocks inside MLM's permitted quarry monopolies, supporting volume security and compounding pricing power independent of the residential cycle.

Final Thoughts

Taken together, we believe our recent underperformance reflects a market rewarding a narrow set of AI infrastructure beneficiaries whose earnings, *while real in the moment*, are in our view being valued as more durable than they may ultimately prove to be. At the same time, many resilient businesses tied to the broader economy have been overlooked as investors crowd into scarcity-driven themes.

We are not dismissing AI, nor are we waiting passively for the market to change. We are using this dislocation to upgrade the portfolio toward what we believe are Durable Quality businesses, purchased at valuations that may better reflect normalized fundamentals. In periods like this, discipline can feel uncomfortable, but history suggests that prices and fundamentals eventually reconnect. Our objective is to ensure that when they do, our clients own businesses with the durability, pricing power, and compounding potential to create value well beyond the current cycle.

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