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Quarterly Commentary

4th Quarter 2025

Diversification Deception

"Diversification is the only free lunch in investing."

– Harry Markowitz, 1990 Nobel Memorial Prize in Economic Sciences

Diversification is a hallmark characteristic underpinning the “Modern Portfolio Theory” introduced in the 1950s by Harry Markowitz, the economist whose research on the theory would earn him a Nobel Prize. Diversification was introduced by Markowitz as a risk-management concept. His theory defined “risk” as variability of portfolio returns and he demonstrated that adding a stock of a company that was uncorrelated with the existing portfolio would reduce the risk (i.e. variability of portfolio returns) without reducing the expected return of the portfolio.

We described Markowitz’ Modern Portfolio Theory in our 2nd Quarter 2014 Commentary as “a cat with 999 lives” and we have explained at length in prior commentaries (see those from 1Q23, 2Q14 or 2Q07) why we disagree with much of his theory. While we do not believe that diversification should be pursued merely for diversification’s sake, we do find diversification to be a portfolio management tool that can mitigate the unanticipated risks that every stock investor faces. Diversification via a differentiated portfolio dilutes company-specific or “idiosyncratic” risks that could include the impending loss of a patent, a management team that is cooking the books, or a factory built on a fault line. For example, if you only own Pfizer stock, your portfolio returns are fully exposed to the specific risks associated with Pfizer.

That said, there is a cost to diversification because it also dilutes the impact of unexpected or underappreciated company-specific positive outcomes. This dilution of good outcomes is sometimes referred to as “diworsification.” Such a positive outcome could be a portfolio holding that develops a new low-cost mining technology or discovers a cure for a disease. If your research leads you to believe that a company’s competitive advantage is not fully reflected in its stock price, you want to be able to benefit from the fruits of your research by owning an

overweight position in that company. Consequently, you want enough exposure to a company so that it has the potential to make a sizable impact on returns when positive things happen but not so much exposure that a negative outcome would cause permanent damage.

Though diversification is meant to be a risk management technique, it has morphed into a concept often “sold” by many in the investment management industry as the chief consideration an investor should use to make investment decisions. We think the “complexity” sold by Wall Street as “diversification” often turns out to be a mere mirage. Frequently, clients are not truly getting exposure to different industries and cash flow streams, which is the type of diversification we value. We continue to be surprised by the amount of assets that are invested in highly complex strategies involving dozens of exchange traded funds (ETFs) and mutual funds under the guise of “diversification” when a simple analysis of the underlying holdings reveals extreme concentrations in the same speculatively valued technology companies as exist in the major U.S. indices.

Just last month we had the opportunity to review an equity portfolio managed by a large, highly-regarded institution. This portfolio contained 13 different individual stocks, 12 unique mutual funds and 10 different ETFs, mostly by the same underlying sponsors but with fancy-sounding and “diverse” names. Among the products owned was a “Growth ETF” and a “Global Equity ETF” and a “Core Equity ETF” and a “Global Growth Equity ETF” and a “Dividend Growers ETF” and a “Total Stock Market ETF.” (Yes, those were the literal names.) One might think that a portfolio with this many different baskets of stocks would be highly diversified, but upon closer inspection the 10 largest consolidated stock exposures accounted for 39.2% of the portfolio’s equity exposure, matching the 39.2% for the S&P 500. Five of the largest 10 company exposures were not even owned individually and merely made the top 10 from the incremental concentrations of ownership across the ETFs and mutual funds. The overlap was not apparent on the statement but was only revealed by our analysis (see Chart 1.) Eight of the portfolio’s 10 largest positions were also in the S&P 500’s top 10 positions. Additionally, the portfolio’s largest position had a weighting of over 10% while the largest member of the S&P 500 accounted for little more than 7% of the index! Most importantly, the weighted average price to earnings (P/E) ratio of the portfolio’s 10 largest stock positions was over 50x, only dropping to 45x when excluding the stock with the highest P/E. We would consider it diversification deception when “diversity” of more than 20 funds and products ends up with highly concentrated individual company exposures in one sector (technology), particularly when these companies are trading at very extreme valuation levels.

Chart 1: Overlap of Stocks Across 22 Mutual Funds & ETFs

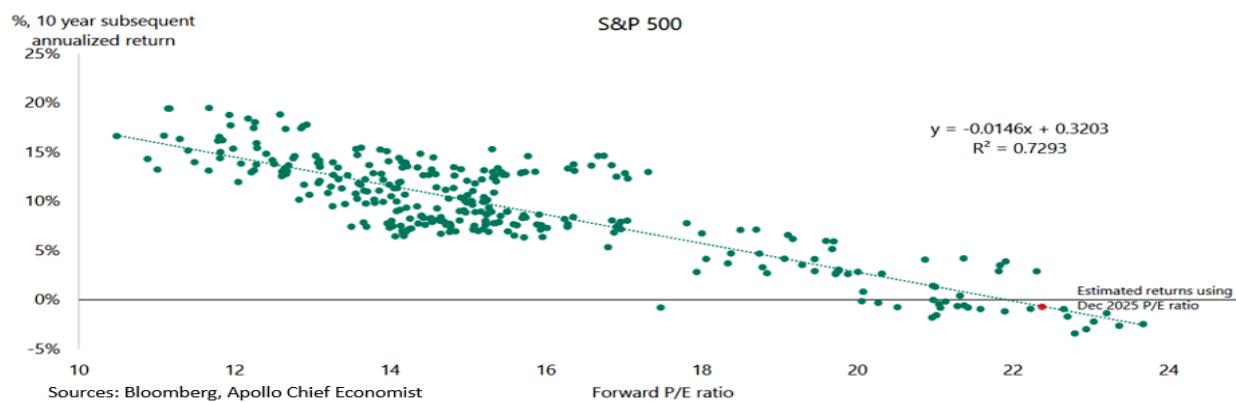
Company	Ticker	Appearances
Microsoft Corp.	MSFT	19
Broadcom Inc.	AVGO	19
Nvidia Corp.	NVDA	14
Meta Platforms, Inc.	META	13
Alphabet Inc.	GOOG	12
Taiwan Semiconductor Manufacturing Co.	TSMC	12
Amazon.com Inc.	AMZN	10
Apple Inc.	AAPL	10
Eli Lilly & Company	LLY	8
RTX Corporation	RTX	7

In contrast, we believe our portfolios have sufficient diversity of underlying exposure to benefit from the premise of reducing idiosyncratic risk (by limiting single-name or large sector positions) while maintaining significant enough position sizes to be rewarded for our research work. This balance was evident in the makeup of our 2025 performance. Our equity composite outperformed both the broad market (represented by the S&P 500 Index) and the Russell 1000 Value Index in 2025 despite value underperforming the broad index. Our outperformance of the value index was not because we have veered from value, but instead because we had overweight exposure to undervalued areas of opportunity that are not fully reflected in the value index. International stock indices outperformed US stock indices in 2025, and we wrote extensively in our second quarter commentary about how valuation expansion in US domiciled stocks over the last 15 years had gradually resulted in an increase in our weighting to internationally-domiciled stocks. This overweight exposure to internationally-domiciled companies continued to benefit our composite throughout the remainder of 2025. In fact, seven of the top 10 contributors to our composite's 2025 return were domiciled outside the United States. (As a reminder, just because a company is domiciled outside the US does not mean they are not doing the bulk of their business here in the US, which is the case for most all of our foreign-domiciled companies.) Gold mining businesses were by far the largest contributor to our 2025 returns, accounting for approximately 40% of our equity return during the year. In contrast, the Russell 1000 Value Index only contains one gold mining company **Newmont Mining (NYSE:NEM)**, which ended the year with a 0.37% weighting in the index even after strong performance during the year. The rest of the largest contributions to our composite portfolio return came from a variety of other sectors such as Financials, contributing around 20% of the return; Energy contributing around 10% of the return; and Consumer Staples and Healthcare, which each contributed around 6% of the full-year 2025 composite return.

Because we do believe that some level of diversity of exposure to different industries and economic drivers of cash flow streams is very prudent, the diversity of our portfolio today contributes to our optimism regarding our portfolio's future return prospects. The companies we have been able to add to our clients' portfolios in the last few years belong to many different sectors and industries – Consumer Staples, Chemicals, Beverages, Communication Services, Life Insurance, Aerospace, Pharmaceuticals. Though we like the varied exposures our stock selections have created, diversity alone is not the primary reason we remain so optimistic about our clients' portfolios going into 2026. Instead, it is the continued discounted valuation levels of the businesses we own that excites us most. This is because we believe that history is very clear that valuation is by far the most important determinant of future returns.

Chart 2 below reveals the very high predictive power of valuation on future returns. The dot plot lays out the relationship between valuation (forward P/E) and future returns (annualized return for the subsequent 10 years). The dotted line represents the correlation between valuation and future returns. It is clear that the relationship is inverse such that future returns tend to decrease as forward P/E increases. Based on the green line and the S&P 500's forward P/E at the beginning of December 2025 (see the red dot in the lower right side of the dot plot), S&P 500's annualized returns for the next decade are not likely to be very high. This relationship between valuation and future returns leads us to intentionally avoid stocks with aggressively high valuations.

Chart 2: S&P 500 Forward P/E Ratio vs Subsequent 10-year Annualized Returns



In addition to being the best indicator of future returns, we also believe valuation is another very good tool for portfolio risk management. We look for companies where we believe the valuation reflects most of what could go wrong and little of what could go right. This is a basic tenet of value investing. High valuations are often driven by high expectations – and the higher the expectations, the harder it is for companies to live up to them. Contrast that with low valuations – the lower the valuation, the lower the expectations and the easier it is for companies to surpass them. There will always be exceptions, but valuation discipline increases your odds of an upside surprise when everyone is expecting negative news.

This brings us back to the state of our portfolios going into 2026. If the conclusion from Chart 2 above is that, on average, stocks with low valuations tend to experience above average returns going forward, prospects for our stocks remain attractive. Clients will know that 2025 was a very good year for our composite equity performance on both an absolute and relative basis. Often, stock valuations will be inflated after a year of high returns. However, what excites us most about the future is that this outperformance was achieved in 2025 not because of inflated valuation levels but instead because of earnings and cash flow growth within our portfolio. Chart 3 (on the following page) shows that our composite portfolio became even more attractive based on P/E, price to free cash flow (P/FCF) and enterprise value to EBITDA (EV/EBITDA) valuations. Furthermore, our composite portfolio continues to trade at

valuation levels that are much more attractive than the broad market as represented by the S&P 500. Additionally, our clients enjoy a dividend yield that is more than double the index yield, pulling forward more of our expected return to nearer-term cash flows. Our composite's debt to equity ratio remains at half that of the index, which should provide balance sheet durability during hard times. While we are much happier having a diverse set of undervalued businesses to own versus a single sector of undervalued businesses, it is the undervalued nature of the businesses we own that contributes most to our continued optimism in our portfolio even after a very strong 2025.

Chart 3: Valuation Levels at Beginning and End of 2025: FRM Composite versus the S&P 500

Valuation Levels	FRM Composite			S&P 500 Index		
	12/31/24	12/31/25	%Change	12/31/24	12/31/25	%Change
Price to Earnings (P/E)	16.2	15.6	-3.7%	26.8	28.6	6.7%
Price to Book Value (P/BV)	1.4	1.7	21.4%	5.1	5.3	3.9%
Price to Free Cash Flow (P/FCF)	15.3	15.0	-2.0%	35.4	39.2	10.7%
Price to Sales (P/S)	1.15	1.39	20.9%	3.00	3.28	9.3%
Enterprise Value to EBITDA* (EV/EBITDA)	10.1	8.6	-15.0%	16.6	17.7	6.6%
Dividend Yield	2.96%	2.85%	-3.7%	1.51%	1.18%	-21.9%
Debt/Equity	61%	59%	-3.3%	122%	119%	-2.5%

*Enterprise Value is Stock Market Capitalization plus Net Debt and EBITDA is Earnings before Interest, Taxes, Depreciation and Amortization

Gold Bubble or Not

The per ounce price of gold ended 2024 at \$2,624.26, peaking at \$4,550.15 on 12/26/25 and ending the year up 64.5% at \$4,317.63. Most gold mining stocks outperformed the metal price. For our equity composite, gold miners were responsible for about 40% of total returns. When a price move like this happens, there is often a concern that a bubble has formed. As reported in Chart 4, the FRM Equity Composite began the year with a 7.93% weighting in gold mining stocks comprised of **Agnico Eagle Mines (NYSE: AEM)**, **Barrick Mining (NYSE: B)** and **Newmont Corp. (NYSE: NEM)**. By early September, their weighting had grown to 12.33%. At that time, we trimmed our gold miner exposure to 10.87%. By mid-September, the weighting was 11.26% and we trimmed it back to 10.29%. In the first full week of the new year, our gold miner weighting had reached 12.25%, which we trimmed to 10.22%. We did not take these actions for fear that a bubble had formed in gold or gold miners. The profit taking was a risk management strategy. Given the strong performance in gold miners relative to most other portfolio holdings, we did not want to become too overweight. Our interest in avoiding overconcentration stems from our acknowledgement of the risk management benefits of some

Chart 4: FRM Composite Gold Miner Position Changes

	Beginning Gold Miner Weighting	\$ Value Sold as % of Total Investment in Gold Miners	Change in Gold Miner Weighting (Percentage Points)	Ending Gold Miner Weighting
12/31/24	7.93%	NA	NA	7.93%
09/05/25	12.33%	-11.84%	-1.46 ppt	10.87%
09/18/25	11.26%	-8.58%	-0.97 ppt	10.29%
01/06/26	12.25%	-16.58%	-2.03 ppt	10.22%

level of diversification, as we discussed at length above. Our trimming of our gold miner exposures should demonstrate our incremental and disciplined approach to portfolio management.

While gold and gold miners could experience periodic price declines, we do not believe either are in bubble territory. After we address the probability of a current gold bubble, we will discuss whether it is likely that the gold miner equities are currently in a bubble.

Commodity bubbles burst due to a large increase in supply or a sudden decrease in demand. Although bubbles will continue until market participants recognize the reality of the situation, the primary causes of commodity bubbles bursting are the emergence of a supply glut or sudden demand destruction. A large increase in mine production (supply glut) would not be a likely source of downward pressure on gold prices. According to the World Gold Council, global 2024 gold production (full year 2025 data has not been published yet) was a record 3,661 metric tonnes (mt), which only amounts to 1.38% of the estimated 216,265 mt of above-ground gold (see Chart 5 for sources of above-ground gold excluding current production).

Massive new mine discoveries could raise concern that future production might overwhelm demand causing gold prices to fall in anticipation of a *future* supply glut, as opposed to a current supply glut. However, new large gold discoveries have been growing smaller in number and size. According to S&P Global, during the five years ended 2024, there were only five gold discoveries that had reserves, resources and past production of over 2 million ounces. Overall, gold miners added 4,261 mt (FYI, 1 mt = 32,150.7 troy ounces) of gold to reserves and resources through new discoveries during the five-year period for an annual average of 852.2 mt well under 3,601 mt average annual production rate for the same five years. Also, new mines can take a decade or longer to navigate through environmental, social and regulatory issues such as water permits, reclamation plan approvals and negotiations regarding community and economic development issues. After these issues are settled, the mine must be built, which can take several more years until commercial production begins. While there are mines that have progressed far into the permitting and development process, the production potential for these mines is known and expected. Furthermore, with new discoveries failing to replace production, a sudden increase in reserves does not seem to be a likely source of a supply glut.

Second-hand jewelry sales may increase during recessions, but most people only sell their jewelry when they are in dire need of cash. So, we do not think second-hand jewelry sales would cause a supply glut. Additionally, recessions often occur during turbulent economic times, and demand for gold tends to increase during economic turbulence due to gold being the flight to safety asset of choice for many investors.

Chart 5: Total Known Gold (end-2024)

Total Above-Ground Gold (end-2024)		
	Metric Tonnes	
1. Jewelry	97,149	44.9%
2. Bars & Coins (incl. ETFs)	48,634	22.5%
3. Central Banks	37,755	17.5%
4. Other	32,727	15.1%
Total above-ground	216,265	100.0%

Total Underground Gold (end-2024)		
	Metric Tonnes	
5. Reserves	54,770	29.3%
6. Resources	132,110	70.7%
Total underground	186,880	100.0%

Source: World Gold Council, Metals Focus

That leaves gold selling by central banks and/or owners of bars, coins, gold-backed ETFs or gold-backed cryptocurrency as the remaining candidates for being a source of a future gold supply glut. Working our way backward through this list, cryptocurrency platform Tether hired several of HSBC's senior gold traders and has become the largest non-sovereign buyer of gold accumulating 116 metric tons (mt) for supporting its gold-backed digital currency, Tether Gold (XAU \ddagger). We expect the success of Tether's gold-backed products to attract crypto competitors which will add to global gold demand. We would consider ETF liquidations to be a short-term threat of oversupply given that ETFs are more liquid and are more susceptible to being used for speculative purposes. However, gold-backed ETF gold holdings total 3,968 mt which is not much more than one year of global mine production. In the case of owners of physical bars and coins, their motivation primarily stems from a desire to hedge against inflation or a desire for a safe asset in which to ride out turbulent times. Given the flagrant deficit spending by nearly every major government in the world, we do not see gold sales by bar and coin owners as a source for a future supply glut.

Meanwhile, central banks have been aggressively adding to their gold reserves buying over 1,000 mt in each of the previous three years (see Chart 6) compared to an average of 512 mt for the preceding decade. If the trend continues, central banks will soon hold more gold than US treasuries in their foreign reserves (see Chart 7).

Chart 6: Central Bank Reported Gold Purchases

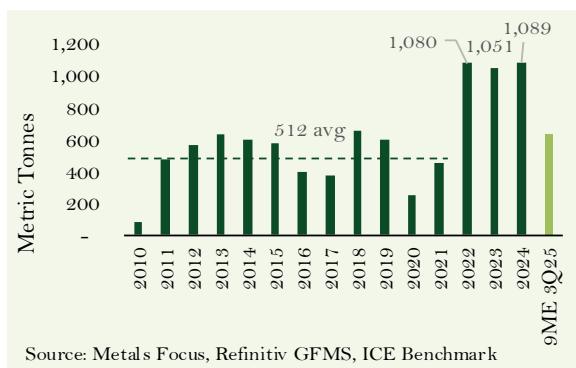


Chart 7: Central Bank Holdings of Gold & US Treasuries



Central bank demand for gold is increasing around the world. BRICS nations (Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Indonesia, Iran, and the UAE) are buying gold to assuage their concerns about U.S. dollar trade hegemony, but would still need to purchase 16,484 mt to increase their current foreign reserve gold exposure of 14.5% to match the 53.4% ratio of the G7 countries. Additionally, the BRICS nations have developed the infrastructure to settle all trade between members using a new instrument that is 40% backed by gold, potentially adding significant new demand. Furthermore, China is expanding its gold vault network to compete with the London Bullion Market Association (LBMA) and reduce China's dollar dependence. China is also rumored to be changing their liquidity designations to make

gold substitutable for US Treasuries as collateral in repo markets. Finally, Russia is considering banning gold bar exports to deter capital flight and retain its strategic resources.

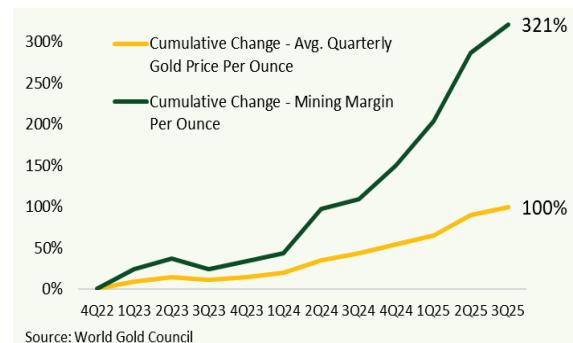
All the factors laid out in the previous three pages lead us to believe that, although the price of gold could experience near-term pullbacks, its rise over the last couple years is not indicative of a bubble. So, if the metal is not likely in a bubble, we need to consider whether gold miners are in bubble territory.

We would be concerned if the primary driving force behind last year's gold miner returns was a dramatic expansion in valuation instead of improving fundamentals. However, gold miner fundamentals have improved significantly. As an industry subject to great indifference over the past decade, miners had to become especially attentive to expenses given that capital was not freely flowing into the industry. Consequently, mining margin expansion per ounce of gold greatly outpaced the rise in gold prices (see Chart 8). Although the trailing 12-month P/E ratios for all three miners have increased, the trailing earnings were generated by a much lower average realized gold price versus the current gold price. If we use expected earnings based on today's gold price, all three miners have lower valuations compared to the end of 2024 and more cash than debt on their balance sheets. At the current gold price, we expect over 20% growth in earnings per share and free cash flow for all three miners. Given that we do not consider gold, the metal, to be in bubble territory, we continue to purchase gold miners for new clients at conservative multiples of expected earnings and free cash flows. For existing clients, we will continue to own gold miners at their current valuations; however, we may periodically trim these positions if we deem their weightings within the portfolio to be too large.

2025 Milestones

2025 was a very rewarding and eventful year for our clients and our firm. Our equity composite surpassed 35 years of existence in September and finished the year with our fifth-best annual performance over that time period. (For reference, the S&P 500 only had its 16th best year in our 35-year history.) The year started off with a leadership and ownership transition that had been in the works for many years. Greg Hartz and Mark Millsap had the foresight to hire the next generation of our investment team well in advance of any intentions of scaling back, beginning with Zach Riley and Chris Fleischmann in 2008 and Meredith Moll in 2015. They methodically involved the second generation in portfolio management and client relationships for over a decade before finally handing over the reins to own and manage the business earlier this year. We laugh at how few clients read our full announcement given how many "how is retirement?!" questions Greg and Mark fielded in 2025! Stealing a line from Mark Twain, Greg

Chart 8: Gold Miners Profits Outpace the Price of Gold



and Mark have spent the year saying “The reports of my retirement have been greatly exaggerated!” They both remain active full-time employees, though with a bit more spring in their steps given they no longer have to worry about firm management matters such as regulatory compliance or technology decisions and thus get to focus exclusively on researching companies and meeting with clients, which are by far the most enjoyable aspects of our business. Though they are committed to remaining full-time through at least 2027, we hope they choose to stick around long after that in whatever capacity they desire. Their mentorship has been priceless, and we look forward to continuing to benefit from their wisdom in the future.

The year was also a big one for family additions. We started off the year with Mark’s eldest son Gray Millsap and his wife Mallory welcoming their second daughter Monroe Gray Millsap, born on January 29 and weighing in at eight pounds four ounces. The whole Millsap crew was elated at Monroe’s arrival, and it was a particular blessing given that Mark’s mom Sallie passed peacefully in June at age 96. No one was happier than Sallie at the arrival of her 13th great grandchild! Our newest hire (2024) George Sellers and his wife Savannah also welcomed their second child, a little girl named Alice Sellers born September 12 weighing seven pounds and twelve ounces and measuring 19.5 inches long. George and Savannah seem to be adjusting well to a larger family size and big brother William (13 months old at Alice’s birth) is so far having little trouble sharing Mom and Dad’s attention. And though it didn’t technically happen in 2025, we can’t miss disclosing the arrival of Camden Davis Riley, born to Taylor and Zach Riley on January 4, 2026 weighing eight pounds six ounces and measuring 20.5 inches long. Baby Camden is named after his much-beloved uncle George Camden Riley (Zach’s youngest brother) who died in early 2025 after a hard-fought cancer battle. Baby Cam doesn’t yet realize what a welcome blessing he is for the entire Riley family.

This was also a big year for educational milestones by FRM offspring. Our team christened two new aspiring speech-language pathologists: Trina Boyd’s daughter, Tia Boyd, and Abby McKelvy’s daughter, Maddy McKelvy. Tia graduated Magna Cum Laude from the University of Arkansas at Little Rock with a Bachelor of Science in Communication Sciences and Disorders, a Bachelor of Arts in World Languages (Spanish), and a Certificate of Proficiency in Spanish. Tia is currently working as a Speech Language Pathology Assistant and plans to enroll in graduate school in the fall of 2026 to study to become a Speech Language Pathologist. Abby’s daughter Maddy also graduated in May, Summa Cum Laude with a Bachelor of Science in Communication Sciences and Disorders at the University of Arkansas at Fayetteville. Maddy is now working on her Master of Science in Speech-Language Pathology at UCA. Last but not least, Chris Fleischmann’s youngest son Ian graduated from Catholic High School here in Little Rock. He promptly headed to the University of Arkansas and is studying Art. Chris and Karen seem to be adjusting well to empty nesting and we are expecting Chris to write a verified hit with all of the extra time he can devote to his songwriting hobby.

We had an unexpected departure this summer when Lauren Sanders decided to retire from her accounting career to focus on her other job(s) of raising two kids and overseeing some personal family businesses. Lauren joined our firm in 2010 and steadily advanced throughout her time here, overseeing our portfolio accounting and reporting work, assuming most of Gail O'Donnell's duties when she retired in 2021 and being promoted to Controller in 2022. Lauren was a joy to work with, and we have missed her friendly demeanor around the office. We were grateful that she gave us several months to transition her responsibilities internally, and we commend Trina Boyd, Stephanie Hills, Abby McKelvy and George Sellers for agreeably assuming her job responsibilities as she transitioned out.

We mentioned last quarter that we had begun the process of upgrading our portfolio accounting system. After an extensive search process we have selected a provider and will begin implementing the new system in 2026. We look forward to improved efficiencies and capabilities on this new system. Once again, we welcome any requests or feedback from you as we revamp our client statements and annual presentations. We want to be presenting the information that our clients find valuable.

We are as grateful as ever for our FRM "family" of loyal clients whom we are honored to serve every day. Thank you for entrusting us with the job of helping you steward your assets. For those of you who have not been by our offices in a while, let 2026 be the year. We would be very proud to reintroduce you to our entire team, and we are always delighted for our group to be reminded of what great clients we are privileged to serve. May 2026 bring you and yours good health and much joy and prosperity.

Disclosure

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