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Poplar Forest Team Quarterly Commentary

J. Dale Harvey
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Dear Partner,

I have long loved going to the beach. There is something about the ocean – its immensity perhaps, or the rhythm of the tides and the sound of crashing waves – that brings me peace. From a distance, the ocean can resemble a beautiful still pool of blue, but up close, we see constant churning. The ocean seems like an apt metaphor for the stock market this year. For the first two months of the year, the market looked fairly calm, yet underneath the surface, there was extreme churning driven by investor worries about the impact of Artificial Intelligence, cracks in private credit lending, and more generalized concerns about recession given weak job creation. And then came the war with Iran.

One of our jobs as stewards of your wealth is akin to that of a lifeguard. At Tocqueville, we are constantly watching the water with the goal of keeping your funds out of rip currents that could imperil your long-term investment goals. We believe that our focus on normalized earnings and free cash flow is particularly important when seas are roiling or unsettled. While the S&P 500 has fallen to start the year, our investment process has provided downside protection, and we remain excited about the potential of the companies in which we are invested. The underlying churning, meanwhile, continues to unearth attractive new investment opportunities that we believe can improve the risk/reward characteristics of the Poplar Forest portfolios; we added one new investment while liquidating another during the first quarter.

The Iran War Rogue Wave

Rogue waves are swells that are more than twice the size of regular waves and they can occur even when seas appear calm. When the Trump administration started positioning naval and air assets in the Middle East, investors began to prepare for choppy seas. Even so, the consensus believed that any conflict would be short-lived. With the clash now in its fifth week and with damage exceeding expectations, investors have been faced with the reality of Iran's response to this massive bombing campaign. The Iranian Regime views the attack as an existential threat and has responded accordingly. They aim to make the conflict too expensive for the U.S. and its allies. They believe that if the costs grow too high, the President will back down and the regime will survive. Closing the Strait of Hormuz has long been a Regime threat and now they have followed through on it, sending oil to more than \$100 a barrel. With this critical shipping lane closed, the impact on global economies, especially those in Asia, is significant.

For long-term investors, how this conflict gets resolved may be more important than short-term oil prices. If the regime survives, then we probably go back to the status quo of Iran being a sanctioned country. The Strait of Hormuz may be reopened, but investors are likely to assume higher normalized oil prices on concerns that it could be closed again in the future. It will take years to repair the damage that we've already seen, and companies will likely adjust supply chains to more expensive, but more secure, sources of materials. Relative to other countries, the U.S. economy may face fewer costs from these adjustments, but this outcome hurts everyone. This scenario is rapidly being reflected in stock prices on the belief that President Trump will back down before "finishing the job."

A more bullish scenario is one in which the current regime is replaced by a government more friendly to the West. Sanctions could be dropped, and oil prices would likely follow. If a new Iran were friendly with its neighbors, then we could even see a long-elusive peace in the Middle East that would pay massive dividends to the global economy. Getting to such an end point could involve more short-term pain in hopes of long-term gain. If Iran ultimately gets sanctions relief, perhaps in exchange for promises to not build a nuclear weapon, then global oil supplies could surge in coming years. With Venezuela now free to expand output, the addition of a recovery in Iranian production could drive oil prices well below pre-war levels.

In the intermediate term, lower oil prices would be good for the economy in that they would reduce inflation risks. The President has long talked of lower oil prices, not higher, so we have a hard time envisioning a war strategy that forces us to live with high prices for much longer. Given that, oil price risk feels more downwardly skewed at a time when oil company stock prices have reached all-time high levels. With prospective returns for our oil company investments now well below our 15% three-year hurdle rate (based on normalized earnings), we have reduced our energy investments as we see better risk-adjusted returns in other sectors.

Will Artificial Intelligence Create a Tsunami of Job Losses?

Prior to the war in Iran, the big market debate concerned the impact of AI on white collar jobs. There has been ample reporting about the accelerating capabilities of AI for a few months now, but in late February, Citrini Research published a futuristic think piece that suggested that AI-driven white collar jobs losses would send the economy into a depression. Software jobs will supposedly be the first to go as new AI tools replace human coding. Software stocks, long market leaders, have been deemed losers and in the wake of Citrini's report, their share prices fell dramatically on worries about creative destruction. The Citrini report was entertaining reading, but I'm reminded that history is replete with examples of misguided economic tsunami warnings.

"Consider thou what the invention could do to my poor subjects. It would assuredly bring to them ruin by depriving them of employment, thus making them beggars." – Queen Elizabeth I

When the Queen wrote this more than four hundred years ago, she was responding (negatively) to a 1589 patent request for a "stocking frame" knitting machine. What happened next? The machine helped turn the textile industry into the largest employer in England.

Fast forward three-plus centuries, to a time when mainframe computers began entering offices. A group of Nobel laureates and scientists (The Ad Hoc Committee on the Triple Revolution) warned President Lyndon B. Johnson:

"The cybernation revolution has been brought about by the combination of the computer and the automated self-regulating machine. This... is as decisively different from the industrial revolution as that was from the agricultural revolution... The promises of jobs are a cruel and dangerous hoax." — 1964 Report to the President

President Johnson responded by creating a "Commission on Automation," but the massive job loss never arrived. Instead, the "computer revolution" created the largest expansion of the middle class and the service economy in human history.

At Tocqueville, we don't have our head in the sand with respect to AI. In fact, we have found it to be a helpful tool that has increased the efficiency of our investment research efforts. (And yes, I used Google Gemini to find the quotes you just read.)

Instead of accepting the most negative view, we fundamentally believe that AI will be a productivity enhancer for society that will allow new companies to thrive. While some incumbent technology businesses will have to go head-to-head with this new competition, others may be more insulated. In this area, our research seeks to understand what competitive moats companies have in managing these evolving challenges. Our work led us to make an initial investment in a provider of payroll processing services that may well ride a wave of new business startups facilitated by AI in coming years. This company's stock declined more than 35% over the last year despite estimated earnings growth of 10% for the company's year ending in May 2026. The business generates attractive free cash flow and returns most of it to shareholders through dividend payments which provide a current dividend yield of roughly 4.6%.

The Private Credit Undertow

Just as fears of creative destruction led to a massive selloff in software stocks, lenders to software companies have also gotten scared. This is particularly the case in "Private Credit" – lending not from well-established banks or the bond market, but from pools of private funds that have promised their investors enhanced returns in exchange for more limited liquidity. Unfortunately, in recent weeks we've seen the major private credit firms activate "redemption gates," effectively telling investors they must stay in the water even if they'd prefer to get out and dry off.

"After all, you only find out who is swimming naked when the tide goes out."
– Warren Buffett, 1992

After years of rapid expansion, the \$2 trillion private debt market is facing its first true test. The evolving private credit narrative is a bit like a classic "undertow" in that it is largely invisible from the surface, but still

powerful enough to drain liquidity when the tide turns. At Tocqueville, our focus on public equities with strong credit profiles helps ensure we won't be embarrassed at low tide.

While the prospect of investors asking for their money back may raise concerns about a negative credit cycle, we believe the reality will prove less damaging than some investors fear. As a headline from a recent Morgan Stanley research report put it: "Risks in Private Credit – Significant, but Not Systemic," meaning the problem can be contained without pushing the economy into recession. Looking at our portfolio, our financial sector investments are all well capitalized and have low-to-no exposure to the problem loans plaguing Private Credit today.

The Ebbing Tide of a Weak Job Market

With the War, AI, and Private Credit attracting so much attention, I think the rest of the economy, where most of life happens, has gotten less attention than it deserves. This was supposed to be a year of accelerating growth as we passed the one-year anniversary of tariffs and as the stimulus from the One Big Beautiful Bill kicked in. Can't you just hear the Beach Boys singing "Good, good, good, good vibrations!"

Instead of sunshine, however, we've had some cloudy weather to start the year. While layoffs, a leading indicator of economic activity, have remained tempered, job growth has been anemic – we're in a low-fire, low-hire environment. And as I've said, there is a growing worry that the War will tip us into economic contraction. Many parts of the economy have been dealing with recession-like conditions for a couple of years now, but an official recession has been avoided because the massive spending in the tech sector has carried the day. If anything, we've begun to see glimmers of sun through the clouds as the industrial economy has begun to pick up.

We aren't the only ones who are noticing signs of improvement. At their March meeting, the Federal Reserve released its updated Summary of Economic Projections (SEP). The primary takeaway being slightly higher expectations for both economic growth and inflation for 2026, largely reflecting the resilience of the economy. The Fed noted both upside and downside risks to their dual mandates regarding maximum employment and stable prices. But the bottom line was no change in interest rates. Investors came into the year expecting three cuts in 2026, and now we may only get one. I think that in addition to the war, higher than expected interest rates are having a negative impact on the stock market.

Our team has never claimed to have an edge when it comes to macroeconomic forecasting, but we do pay particular attention to the leading economic indicators because they have historically been good weather forecasting tools. Those indicators were turning up before the war started and we are hopeful that this progress won't get washed out. Furthermore, earnings estimates have also been trending higher, not lower, and we don't typically see big layoff announcements when profits are growing.

While the probability of a formal recession remains a point of debate on Wall Street, we manage your capital as if one is always a possibility at some point in the next three-to-five years. This doesn't mean we stop swimming with a company just because it has downside potential in a recession, but we want to ensure that

we are being more than adequately compensated for that risk. Prioritizing companies with healthy free cash flow and solid balance sheets provides a margin of safety if the threat of economic lightning forces us out of the water.

Our Commitment to You

Despite the many cross currents in the market this year, stocks have been buoyed more than I expected. Given all that's going on, I would not have been surprised to see stocks sell off much more than the recent 8% decline from pre-war price highs. Perhaps investors have gotten trained to expect big, blustery positioning by the President to be followed by a rapid de-escalation. If that is the case, the conflict could be over any day now, but if not, a more serious market dislocation could occur if the conflict drags on. Unfortunately, there is no way to know in advance which outcome we'll face.

Amidst the relatively mild selloff in stocks, investors have been reallocating their equities (so called sector rotation). For example, money has shifted away from businesses that may be hurt by increased AI competition and into "HALO" stocks: companies with **Hard Assets** and **Low Obsolescence** risk. High oil prices have helped energy stocks but hurt travel companies. Investors have also sought the safety of electric utilities that typically hold up well in recession while abandoning financials service stocks that would be hurt. It has been a lot to keep up with, but we love the work!

A lifeguard's job is often boring right up until the moment it isn't. Much of our work involves the quiet, disciplined "scanning" of regulatory filings, discounted cash flow models, and industry trends to ensure your capital is positioned for long-term growth and capital preservation. Thank you for your continued trust in our process. If the current "flags" on the beach have you concerned, or if you'd like to do a "deep dive" into any of our holdings, the door to the lifeguard station is always open.

And don't forget your sunscreen!



J. Dale Harvey
March 31, 2026

DISCLOSURES

Value stocks typically are less volatile than growth stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice. Fund holdings and sector allocations are subject to change and should not be considered recommendations to buy or sell any security.

Index performance is not indicative of a fund's performance. Past performance does not guarantee future results. Earnings growth is not a measure of the Fund's future performance.

Forward Earnings: A company's projected profits for a future period, typically the next 12 months.

Free Cash Flow: The money a company has left over after paying its operating expenses (OpEx) and capital expenditures (CapEx). The more free cash flow a company has, the more it can allocate to dividends, paying down debt, and growth opportunities.

Gross Domestic Product (GDP): The total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

Normalized Earnings: Normalized earnings are adjusted to remove the effects of seasonality, revenue, and expenses that are unusual or one-time influences. Normalized earnings help business owners, financial analysts, and other stakeholders understand a company's true earnings from its normal operations.

PCE (Personal Consumption Expenditures): A monthly index that reflects the changes in the prices of goods and services purchased by consumers in the United States.

Price/Earnings (P/E) Ratio: The current market price of a company share divided by the earnings per share of the company. **Return on capital:** A metric that investors often use to evaluate the profitability of an investment or to compare returns across multiple investments.

Russell 1000 Value Index: A U.S. stock market index that tracks the largest 1,000 stocks in the Russell 3000 Index, which represent about 93% of the total market capitalization of that index.

S&P 500 Index: Is a market value weighted index consisting of 500 stocks chosen for market size, liquidity and industry group representation. The Index is unmanaged, and one cannot invest directly in the Index.