BALLAST
ASSET MANAGEMENT

For the third quarter of 2026, BAM's strategy returned -4.2% gross and -4.5% net of fees versus -4.9% for the Russell 2000 Value. Year-to-date through September 30th, the portfolio returned approximately 10.4% gross and 9.6% net versus 17.0% for the index.

Performance	Yearly Returns						Annualized Returns*				
	2021	2022	2023	2024	2025	YTD	3Y	5Y	7Y	10Y	Incept.
Ballast Portfolio[1] Gross	41.8%	-13.3%	18.6%	14.7%	8.3%	10.4%	14.1%	8.2%	13.3%	12.3%	12.4%
Ballast Portfolio[1] Net	40.4%	-14.2%	17.4%	13.5%	7.2%	9.6%	13.0%	7.1%	12.1%	11.2%	11.3%
Russell 2000 Value[2]	28.2%	-14.5%	14.6%	8.1%	12.6%	17.0%	17.9%	7.8%	10.7%	9.4%	10.2%
Alpha** (net of fees)	12.2%	0.3%	2.8%	5.4%	-5.4%	-7.3%	-7.1%	-0.9%	2.6%	3.7%	2.6%

* Annualized 3Y, 5Y, 7Y, 10Y and since inception (performance start date of 10/01/15) returns reported through 9/30/26.
** Presented geometrically as the annualized cumulative excess return after fees.

The third quarter interrupted what had been a powerful run for small caps. After a historic first half, the Russell 2000 Value fell 4.9% in the quarter. Leadership swung back toward mega-cap, AI-centric names, as rising interest rates tightened financial conditions. While both the portfolio and the Russell 2000 Value declined in absolute terms, we outperformed the index on a price basis, falling -4.5% versus -4.9% for the Russell 2000 Value. Our holdings continued to execute well and performed meaningfully better than the broader index on a fundamental basis.

On an adjusted EPS basis, 70.5% of portfolio companies with consensus estimates either met or beat expectations (4 of our companies, or 8%, have not yet reported Q3 earnings.) This compares with 66.5% for the Russell 2000 Value according to Bloomberg. Our companies earned a 15.5% ROE over the last 12 months, compared with just 1.2% for the index. Even more impressive, our companies generated those returns with much less leverage: 70% debt-to-equity and 1.0x net debt to EBITDA, versus 110% and 5.1x for the Russell 2000 Value. Our stocks are also cheaper, trading at 13.3x forward earnings against 21.9x for the index. Notably, Bloomberg consensus earnings imply nearly 20% ROE for our companies over the next 12 months compared to approximately 9% for the Russell 2000 Value on a median basis — and just 0.5% on a weighted-average basis. This matters because stocks should not outperform the underlying returns to the businesses once they have closed the discount to intrinsic value.

Our process and people have not changed. The businesses we own are compounding real economic value faster than the index, starting from a cheaper base, with stronger balance sheets and durable competitive positions to ensure staying power. Just as it has for the last 20+ years of managing this strategy, we are confident our returns will mean revert as their business fundamentals become reflected in the stock prices.

The Election

We prefer not to discuss politics, but the dramatic shift in the balance of power makes it unavoidable, mainly because it raises the risk of new regulation on the artificial intelligence (AI) infrastructure buildout. According to Peterson Institute, private non-residential fixed investment as a percent of GDP increased about 100bps to 15% of GDP as of 3Q26. Excluding the AI build-

out, which contributed 250bps, all other investment fell 100bps.[1] Through third quarter 2026, the top five hyperscalers (Amazon, Alphabet, Microsoft, Meta, and Oracle) capex totaled $560 billion, roughly 2.3% of YTD GDP. Guidance indicates another $240–280 to come over the balance of this year, and analysts routinely cite $1,000+ next. We see this as a material risk for the AI "picks and shovels" companies. As we have noted in previous letters, most of our AI exposure depends on long-term use of the technology, not on the infrastructure buildout. That positioning hurt us in the first half of the year. We believe it will become a strong tailwind as productivity gains begin to outweigh the buildout story.

Unfortunately, at this summer's Russell reconstitution, many of the best performing "pinch point" companies, such as semiconductors and memory, left the index because they had grown too large or too expensive. That kept some of the mean reversion we would otherwise have expected from showing up in our relative performance. As the old saying goes, it is better to be lucky than good, and this time we were unlucky. Even so, we remain convinced of two things. Our positions in companies that benefit from AI's long-term structural changes should more than offset short-term spikes in companies whose revenue and earnings profiles are inflated by the buildout. And those companies are unlikely to sustain anything close to their current results once the buildout mania fades.

Why quality small cap value makes sense for 2027.

Small cap value stocks are cheaper and expected to grow earnings faster than large caps in 2027. They are less exposed to deglobalization and can diversify the risk posed by AI concentration in large caps. Although quality has lagged in small caps for the last 18 months or so, it remains an important part of reducing the risk of permanent losses. We believe Ballast's long-term CAGRs are nearly as much a function of consistently controlling risk to avoid the negative asymmetry of losses as they are of identifying quality companies at good values.

As we explain below, opaque, illiquid leverage is mounting across the capital market. Private credit and AI financing can enable extreme leverage. At the same time, global M1 is growing slower than the economy, removing liquidity, and increasing refinancing risk. Private credit discipline has measurably deteriorated,[2] while managers' discretion with valuation marks may understate the degree of performance deterioration.

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[1] https://www.piie.com/blogs/realtime-economics/2026/ai-booms-two-engines

[2] Share of direct-lending investment income from PIK more than doubled since 2018, reaching 8.8% in late 2025 (Vanguard). Lincoln International: loans with any PIK rose from ~7% (Q4 2021) to ~11% (2025–26); "bad PIK" (added after origination) rose from ~2–2.5% to ~6%. Overall private-credit covenant-lite was 21% of deals in 2025 (up from 4% in 2023), with the vast majority concentrated among larger borrowers (Proskauer: 91% of cov-lite deals had EBITDA ≥$50m). For mega-deals (debt >$500m), sources cite ~50–55%. Data from Moody's in 2023 showed only ~7% of private-credit loans >$500m were covenant lite. Fitch's trailing 12-month U.S. Private Credit Default Rate (already inclusive of soft events such as interest deferrals, PIK introductions, and stressed maturity extensions) stood at a record 6.3% through Q3 2026 and 6.2% through October.

Small Cap Value is Cheaper and with more growth than Large Cap in 2027[3].

- The Russell 2000 Value (RUJ) trades at 19.5x trailing EPS and 18.8x 2026 consensus, cheaper than the S&P 500 (SPX) at 23.3x trailing EPS and 20.7x 2026 consensus.
- Consensus projects RUJ EPS will grow 28% in 2027, nearly twice as fast as the 15% consensus expects for SPX.
- RUJ's has less than 5.5% weight in its top ten names, less than AAPL, MSFT and NVDA individually. The S&P 500's top ten weight is about 37%.
- We believe small caps are underweighted in most portfolios and probably more under-researched than ever, fertile hunting ground for mispriced quality companies.

Quality mitigates index construction problems.

- RUJ has much weaker fundamentals than the S&P 500 (3x higher margins and a 6x ROE advantage despite about half as much leverage).
- Indexes constructed with naïve value proxies are likely broken. The classic Book/Market misses intangible assets important to valuation, which results in a bias toward low quality.
- The small value quality opportunity set varies but is usually around 200-250 stocks. (Quality definitions vary, but at a minimum need to include the ability to self-finance in tight credit markets.)
- The characteristics of BAM's portfolio are consistently comparable to or better than either large caps or private equity companies, which are 4x more leveraged and higher multiple.[4]

Small caps benefit from debt-fueled AI spending stimulus.

- Small caps tend to outperform as the economy accelerates, and the economy tends to grow faster when debt growth is higher.
- Recent economic data suggest the economy is indeed picking up steam. If sustained, the upturn in job and productivity growth could help real wages catch up without driving inflation or pressuring corporate margins.
- The $650b of AI debt raised this year[5] has a stimulative effect that we believe is similar to the stimulus from debt-financed federal spending or rapid mortgage debt growth in the early 2000s.
- Street analysts anticipate AI will need $1tr of funding in 2027 and similar in following years. Retained earnings and equity raises will cover part, but AI companies will still need to borrow massive amounts.

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[3] All data points in this section are sourced from Bloomberg, Nov 2026.

[4] PitchBook (Q3 2026 Global M&A Report): Sponsors in North America and Europe paid a median 11.5x EBITDA as of ~Sep 2026. According to Bloomberg as of 10/31/26, S&P 500 EV/EBITDA was 15.4x, the Russell 2000 Value was 10.0x and Ballast's portfolio weighted average was 5.8x.

[5] International Monetary Fund, Global Financial Stability Report, October 2026 (Chapter 1). Also summarized in contemporary reporting, e.g.,

Quality mitigates small cap value's interest rate and credit risk exposures.

- A typical company in RUJ has significant floating-rate and short-term borrowing in its capital stack. If rates increase, it quickly hits earnings.
- The Fed's tightening bias, sticky inflation and expectations anchoring higher, put upward pressure on nominal interest rates.
- AI capital spending and federal deficits may also pressure real rates, especially if deglobalization reduces foreign lending into the US more than the domestic savings rate can increase.
- If credit tightens enough, default and refinancing risk can crush the equity value of leveraged small cap value companies. We believe low quality's run the last couple years is at least partly a function the distress premium collapsing, leaving only one direction for major changers.
- Market wide leverage increases the likelihood credit will tighten materially. A disorderly unwind risks a credit crunch that would be catastrophic for levered small caps.

Systemic Leverage is likely far higher than record numbers indicate.

- Elevated trade book leverage is clearly visible in the $1.5t of margin loans and $3.9t prime brokers have lent to hedge funds.[6] Stocks can work as collateral when the market is rising. If share prices fall faster than the market can absorb forced-selling for margin calls, selling drives more price declines triggering more forced selling, and so on.
- The amount of leverage in private credit and AI is obscured by complexity and privacy. The deepest risk is contagion if a large entity is leveraged to levels that brought down Continental Illinois and triggered the S&L crisis in the 1980s, LTCM in the 1990s, mortgage credit unwind in the 2000s, MF Global in the 2010s and Archegos in 2021.
- AI leverage is sustainable as long as the weakest links meet revenue and profits projections. Off-balance sheet financing makes it hard to see come of the leverage. The bigger problem is the complex, mutually dependent exposures among a relatively small number of banks, insurers, private credit, and private equity funds. If OpenAI or Anthropic debt needs restructuring, or the market's estimate of the value of NVDA's vendor financing declines, it could cascade.
- Circular financing's leverage potential extends beyond AI to leverage stacking across at least four tiers: banks, private credit, private equity, and insurers. The 6-8x leverage of a typical PE portfolio company could easily be stacked to 14x multiplying fund-level borrowing, GP NAV loans (growing rapidly), and bank-to-fund lending. With intentional effort, 20x or might be possible.

[6] "Margin Call Risk Is Rising as Liquidity Tightens," Simon White, Bloomberg, 11/03/2026.

- The largest players operate as investors, borrowers, and lenders, potentially creating hidden balance sheet interdependence increasing the risk a small problem could trigger a cascade of contagion.
- Because private credit loans are not publicly traded, fund managers can mask problem loans with "mark to magical thinking" for a while. However, if any important PC backed entities fail, illiquidity and opacity would also amplify counterparty risk aversion. At a minimum, credit would get extremely tight, and full-blown freeze-up is not out of the question, in our view.

AI and Circular Financing

Nvidia's vendor financing sits behind invest in, guarantee, or backstop customers (OpenAI, Anthropic, neoclouds) that then buy the suppliers' chips or cloud capacity. The IMF's October 2026 GFSR flagged 14 disclosed deals linking ~$300 billion equity and $650 billion debt to $1.4 trillion in future revenue commitments—roughly 5× equity for each dollar of promised spend.[7]

Bankruptcy-remote SPVs and similar structures for GPU and data-center financing keep debt off parent balance sheets, which obscures the higher effective leverage. While not labeled debt, the economic obligations remain—via long-term leases, residual-value guarantees, take-or-pay contracts, and contingent support—even when GAAP keeps them off the books until leases commence. Moody's estimated the top five hyperscalers held $662 billion in signed-but-not-commenced data-center lease commitments (113% of their combined adjusted debt) as of end-2025; broader off-balance-sheet AI commitments across major players are now estimated in the trillions.

Banks, Private Credit and Private Equity

Bank lending to non-banks surpasses $1 trillion.[8] Fund financing has grown rapidly as private equity exits slowed (distributions ~13–15% of NAV vs. ~25% historically) to $1.0tr or as much as $1.5tr by some estimates.[9] Historically, banks offered low-cost subscription lines (secured by LP commitments) and now offer some senior NAV/hybrid facilities, enabling PE funds to bridge capital calls, smooth cash flows, and maintain deal certainty, while avoiding forced asset sales. Private credit has grown by filling gaps where banks face regulatory or risk constraints and with

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[7] International Monetary Fund, Global Financial Stability Report, October 2026 (Chapter 1). Also summarized in contemporary reporting, e.g., The Next Web, "IMF warns $1.4tn in circular AI deals could deepen a market correction," 13 October 2026.

[8] Oxane Partners, "Bank-Fund Convergence: Why Banks Never Left Private Credit," September 2026. https://www.oxanepartners.com/blogs/bank-fund-convergence

[9] "how private credit is redrawing the fund finance map," June 2026. https://app.termgrid.com/article/how-private-credit-is-redrawing-the-fund-finance-map/

"innovative" products like more flexible, higher-leverage NAV loans.[10] In our experience, Wall Street often uses innovation as a synonym for risky.

Leverage stacks when NAV facilities add fund-level debt atop already-levered portfolio companies ("leverage on leverage"), while a bank provides back-leverage to private credit funds that in turn finance PE vehicles or assets—multi-layer exposure with limited transparency.[11]

Extreme Leverage Is Not Compatible with Stability

- **1980s**: S&L crisis and Continental Illinois failure (1984), high-risk leveraged lending.
- **1990s**: LTCM's ~25–30:1 fixed-income arbitrage positions required a Fed-coordinated private rescue after the 1998 Russian default.
- **2000s**: Mortgage credit unwind (subprime/structured credit, 2007–08) took down highly leveraged players including Bear Stearns, Lehman, AIG and others.
- **2010s**: MF Global's 2011 collapse tied to leveraged European sovereign bets.
- **2021**: Archegos used total-return swaps across multiple prime brokers for highly concentrated equity exposure (roughly 5–13× leverage). Margin calls triggered a rapid unwind and >$10 billion in bank losses.

The common thread is opaque or concentrated leverage that looks manageable in aggregate but can force fire sales and transmit losses when a large player is stressed.

Performance Attribution

Stock selection was strongest in Financials. Even though we were well underweight the sector, it added about 2 percentage points of relative return. Selection was also strong in Information Technology and Industrials. Our largest contributors for the quarter were Climb Global Solutions (+38.4%), Paysign (+64.6%), RCM Technologies (+44.1%), SPS Commerce (+44.2%) and Natural Resource Partners (+12.9%), our largest position. MiniMed (+24.9%), Kosmos Energy (+20.4%) and Capital Bancorp (+12.4%) also added meaningfully. The largest detractors were Bel Fuse (–26.7%), Turning Point Brands (–30.7%), Terex (–27.2%) and Collegium Pharmaceutical (–39.7%). Weak selection in Materials, led by Ecovyst (–21.0%), and in Consumer Staples gave back part of our gains. So did Energy, where Solaris Energy Infrastructure (–11.4%) fell with the broader AI sell-off, while the sector rallied.

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[10] Investec, "Fund Finance: Beyond the headline rate," November 2026. https://www.investec.com/en_gb/focus/private-equity-trends/2026/pe-trends-fund-solutions.html, he Middle Market, "When Private Credit Replaces the Exit," August 2026. https://www.themiddlemarket.com/news-analysis/when-private-credit-replaces-the-exit

[11] Financial Times, "How banks fuel the private credit boom," December 2025. https://www.ft.com/content/535b3d0c-429c-4e67-a73d-3513e4e730d8. Financial Times Interactive, "How private equity tangled banks in a web of debt," July 2024. https://ig.ft.com/private-equity

From an allocation perspective, most of the benefit came from our overweight in Energy, the benchmark's best-performing sector. Our underweights in Real Estate and Consumer Discretionary and our lack of Utilities exposure also helped. Those gains were partly offset by overweights in Industrials and Information Technology, which both lagged. Our underweight in Health Care also hurt since it was one of only two sectors in the index to rise.

Top Contributors	Ticker	Avg Weight	Total Return	CTR (bps)
CLIMB GLOBAL SOLUTIONS INC	CLMB	3.74%	38.41%	120
PAYSIGN INC	PAYS	2.00%	64.59%	94
RCM TECHNOLOGIES INC	RCMT	1.79%	44.10%	65
SPS COMMERCE INC	SPS	1.63%	44.20%	55
NATURAL RESOURCE PARTNERS LP	NRP	4.42%	12.91%	50

Top Detractors	Ticker	Avg Weight	Total Return	CTR (bps)
BEL FUSE INC-CL B	BELFB	1.95%	-26.68%	-78
TURNING POINT BRANDS INC	TPG	2.06%	-30.71%	-68
TEREX CORP	TEX	2.13%	-27.16%	-65
COLLEGIUM PHARMACEUTICAL INC	COLL	1.31%	-39.72%	-62
GPGI INC	GPGI	2.03%	-25.10%	-57

We remain available to discuss any aspect of the portfolio or our thinking in greater detail.

Regards,

Ballast Asset Management

Important Notes and Disclosures

The investment decisions we make for clients' accounts are subject to various market, economic, and other risks, and there is no guarantee that those investment decisions will always be profitable. Clients are reminded that investing in any security entails risk of loss, which they should be willing to bear. The past performance of the firm or its principal is no guarantee of future results.

Some information contained in this communication was obtained from third-party sources. While these sources are believed to be accurate, that information has not been independently verified.

[1]Account returns are presented both gross and net of management fees. All account returns are net of transaction costs and gross of non-reclaimable withholdings taxes, if any, and reflect the reinvestment of dividends and other earnings. Monthly composite returns are calculated by weighting each account's monthly return by its relative market value. All returns are expressed in US dollars. **Past performance does not guarantee future results.**

The gross performance results presented do not reflect the deduction of investment advisory fees. Actual returns will be reduced by such advisory fees and other expenses as described in the individual contract and, where applicable, Form ADV Part 2A.

Net performance results do not reflect the deduction of investment advisory fees actually charged to the accounts in the composite but do reflect the deduction of a model investment advisory fee of 1.00%, which is the maximum advisory fee rate in effect for the respective time period. Actual advisory fees may vary among clients invested in the strategy. Returns for each client will be reduced by such fees and expenses as described in the individual contract and, where applicable, in Form ADV Part 2A.

[2]The Russell 2000 Value Index measures the performance of the smallcap value segment of the US equity universe includes those Russell 2000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 years) growth and lower sales per share historical growth (5 years).

Indices are shown for informational and comparative purposes only. An Index is unmanaged, does not reflect transaction costs, management fees, or other expenses (which would reduce returns), and cannot be purchased directly. An Index's composition may differ materially from how a portfolio is constructed – including holdings, guidelines, restrictions, sectors, correlations, concentrations, volatility, and tracking error, all of which may change over time – and no representation is made that any portfolio will track or reflect any Index shown.

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Ballast Asset Management, LP claims compliance with the Global Investment Performance Standards (GIPS®) and has been independently verified for the period October 1, 2015 through December 31, 2020. Verification assesses whether (1) the firm has complied with all of the composite construction requirements of the GIPS Standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS Standards. The verification report is available upon request. Verification does not ensure the accuracy of any specific composite presentation. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. A GIPS composite report can be obtained by calling 469-502-3652.

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