



Q1 2026

April 24th, 2026

Maintaining an Elevated Cash Position

In Q4 2025, we ended our letter by noting that cash had become the largest position in the portfolio. The first quarter of 2026 was the first negative quarter for the S&P 500 since Q1 2025's tariff shock. The S&P fell 4.3%. The Nasdaq Composite fell 7%. The "Magnificent 7" also turned negative; Microsoft alone accounted for roughly 1/4th of the S&P's drawdown. The equal-weight S&P outperformed the cap-weighted index by about 5%; it's becoming a stock-pickers' market. While we do not attempt to time the market, we note that when markets start to ignore growing risks in the economy, and valuations are high (on average), we opt for more defensive positioning. The most speculative asset, Bitcoin, fell 22.6%, and FINRA margin debt hit \$1.28 trillion in January.

We have described this setup in each of the last two letters. We did not predict a selloff, and we are not predicting one now. What we did was act on our valuation discipline: we sold our position in Alibaba, Fannie Mae common, BMW & Mercedes-Benz, trimmed Corning, and closed our position in Tri Pointe Homes due to the announced sale of the business. By and large, with these proceeds, we let cash build.

While one quarter is noise, our goal is to explain what "defensive positioning" actually means for a long-only equity investor, because the word gets thrown around in ways that lose its meaning. Defensive does not mean bearish. It does not mean "in cash, waiting for a crash." It means we are unwilling to own things at prices that require everything to go right.

What Defensive Means in 2026

A position in cash has an opportunity cost. The 10-year Treasury yields 4.38% as of quarter-end. The S&P's long-run real return is roughly 7%. If the next five years return to the long-run average, holding cash costs us meaningful compounding. This is the case critics of cash always make, and it is a fair one.

One input affects everyone: the price of oil. It raises costs directly at the pump, tightens supply when the Iran war takes refiners offline, and drives up the price of any transported goods. Higher gas prices fuel inflation and hit already stretched lower-income consumers hardest. The ongoing conflict has all but eliminated the prospect of interest rate cuts until ships can safely pass through the Strait of Hormuz. While markets often climb a "wall of worry," investors seem to be betting on a near-term resolution. If that hope proves misplaced, we could face product shortages, higher prices, and eventually a pullback in demand.

One of our biggest concerns was the political pressure to cut rates against a backdrop of what appeared to be an inflationary (or disinflationary) environment, without fully

understanding the risks that cuts would pose to the long end of the curve. The good news is that this risk now appears to be minimal, and the prospect of rate hikes is increasingly likely. If the administration's goal is to make housing more affordable, these events may help their cause, even if, on the surface, higher long-term rates today temporarily make homes less affordable.

The selloff in software was another notable development during the quarter, with the S&P Software Index declining 22.5% in Q1 as valuations reset sharply across the group. After a prolonged period of multiple expansion, during which many high-quality software businesses traded at 10x–15x forward revenue at the peak, investors have begun to question the durability of growth, the sustainability of elevated margins, and the magnitude of incremental demand tied to AI-related spending.

Our portfolios largely avoided this move because we held minimal direct exposure to software companies. That positioning proved beneficial as selling pressure hit both high-quality compounders (or those perceived as such) and more speculative names alike. Within the group, several companies we previously covered saw steep declines: Blackbaud fell ~35% in the quarter, UiPath dropped 30%, Verisk declined 16%, and Gartner fell 36%. (Note, we do not own any of these names, but they are on our watchlist)

For Verisk and Gartner, the key question has shifted. Investors once asked whether their data was proprietary and mission-critical; now they ask whether ChatGPT can deliver a comparable answer at a fraction of the cost. At the same time, companies increasingly generate insights in-house using their own data, reducing the need to outsource. Internally, we continue to develop programs that improve our process and research capabilities; one can only assume others with deep pockets are doing the same.

As stated in past letters, we believe 2025 was the year of understanding what AI is and how it can help. 2026 is the year of implementation. One aspect that may be underappreciated is that the tech industry, and specifically software companies, rely heavily on stock-based compensation. When the stock is up and to the right, drawdowns are temporary, employees feel rich and excited to come to work. When those options are far out of the money and practically worthless, do they look to leave and get a fresh package? Or do companies issue more stock to retain talent? A \$100k option package when the stock is at \$100 vs the stock at \$50 requires 2x the dilution. In what we considered to be egregious add-backs of real costs, and dilution that year after year was a drag to our "owners' earnings," is potentially going to get worse. Or this is the nirvana situation for software companies. When employees leave, and companies replace them with AI, firms avoid severance costs. Morale often holds steady or even improves if remaining employees gain more control over their work. Management teams also sidestep the headlines and backlash associated with overt job cuts, even when AI effectively drives the same outcome.

We have not deployed capital into software names, but we typically find opportunities when correlations converge to one, and investors deem entire sectors uninvestable. We expect any investment in software or technology to be volatile. Headlines drive the short-term narrative as markets work to assess each business's terminal value risk.

Our cash position provides yield, optionality, and a payoff profile that remains negatively correlated with both the portfolio and the broader market. We do not try to call tops or bottoms, and we respect the power of momentum. Bargains do not appear when conditions look perfect, and sentiment turns universally positive.

We will redeploy capital under the same conditions that have always guided us: when securities trade at prices that require only ordinary outcomes to generate acceptable returns. Baxter at \$17 and Perrigo at \$15 qualified.

Portfolio Performance (Q1)

Winners	Performance	Losers	Performance
GLW	55.60%	PRGO	-21%
SPHR	23.50%		
CALY	18.90%		

Q1 Winners

Corning (GLW)

Corning continued to do what we described in our Q3 2025 letter. On January 27, Corning and Meta announced a multi-year agreement worth up to \$6 billion for optical fiber, cable, and connectivity for U.S. AI data centers, anchored at the Hickory, North Carolina, plant that Corning says will become the world's largest fiber-optic cable facility. The stock jumped 16% on the news. The next day, on its Q4 2025 earnings call, management raised the Springboard plan's incremental annualized sales target to \$11 billion by end-2028 (from \$8 billion), with \$5.75 billion now at "high confidence" by end-2026 (from \$4 billion). Core EPS grew 26% year over year in Q4 to \$0.72. Free cash flow for the full year nearly doubled versus 2023.

On virtually every metric that matters, Corning executed. On the one metric that worries us, the valuation. At quarter-end levels, Corning trades in the mid-60s on TTM core EPS, versus the ~36x we flagged in Q3 when the stock was ~\$80. The company is meaningfully better than it was six months ago. It is not twice as good. We are not wholesale sellers of Corning; the multi-year setup around AI-driven fiber demand remains real, and management has executed. But we are keeping portfolio and risk management at the forefront of our process. Balance a business firing on all cylinders with a stock that's projecting many years of growing demand. We note that while Corning is a great business, it's still a manufacturing company (of sorts), and therefore, while their end markets are growing at exponential rates, Corning's ROIC is not one that will ever approach 50%+ as it requires significant capital to build their facilities. Thus,

while other capital-light compounders at times can justify very high multiples as all FCF can go towards buybacks, Corning must balance growth/maintenance capex and capital returns.

Sphere Entertainment (SPHR)

Sphere's operating results continue to surprise us to the upside. On January 19, The Wizard of Oz crossed 2 million tickets sold and more than \$260 million in ticket revenue; by late February, cumulative ticket revenue had moved toward \$290 million, and management announced an "enhanced 2.0" version of the show for later in 2026 with new scenes and 4D effects. The December quarter delivered \$308 million of revenue and \$33 million of adjusted operating income. Per-show Sphere revenue was up mid-single digits year over year.

On January 18, Sphere, the State of Maryland, Prince George's County, and Peterson Companies announced their intent to develop the first smaller-scale Sphere at National Harbor near Washington, D.C., with 6,000 seats, a 16K x 16K LED interior, roughly \$200 million in state, local, and private incentives, and a projected \$1 billion in annual economic impact. Management stated they can handle several more concurrent projects. This is exactly the monetization path we described in Q4. If the company licenses its technology and know-how to enable smaller-format Spheres at a fraction of the Las Vegas cost, and collects franchise fees without deploying additional capital, the business shifts from a single expensive venue in Las Vegas to a more valuable content-and-royalty model. The stock has had an extraordinary run off the 2025 low, but we remain bullish on the underlying trajectory.

The future of entertainment continues to run through Sphere. Additionally, traffic in Las Vegas has been declining for the last few years as fewer international travelers visit. Despite this, the Las Vegas Sphere has had no trouble selling tickets. Should traffic rebound, we could see demand accelerate, the opposite of what most expect.

Callaway (CALY)

Our Q4 letter introduced the thesis: MODG's sale of its 60% stake in Topgolf was the catalyst for transitioning from a levered conglomerate to a clean, pure-play golf OEM. On January 1, the sale closed, and Leonard Green & Partners paid a \$1.1 billion valuation for Topgolf, generating roughly \$770 million in net proceeds to Callaway. On January 16, the ticker changed from MODG to CALY. Management used \$1.0 billion of those proceeds to retire its Term Loan B; the balance sheet now carries approximately \$680 million of cash against \$480 million of gross debt. The board authorized a \$200 million share repurchase.

At quarter-end levels, we estimate the stock trades at ~12x 2027e earnings and expect management to continue paying down debt and repurchasing shares. The previously complex story is now in the past, and the go-forward is much easier to underwrite. Golf + buybacks.

Q1 Laggard

Perrigo (PRGO)

Perrigo was our biggest loser in 2025 at -46%, and the pain continued into Q1. On February 26, Perrigo reported Q4 2025 results, missed EPS, recorded a \$1.3 billion goodwill impairment, and guided 2026 "All-In" adjusted EPS to \$2.00–\$2.30, down from 2025's \$2.75. Infant formula revenue fell 25% in the fourth quarter, driven by weakness in the Good Start contract-manufacturing arrangement; the segment contributed roughly \$21 million in negative operating income. Layer in continued OTC destocking, and the market treated the print as a thesis-breaking event. The stock fell to \$9.81 on March 11, roughly a 35% drawdown from year-end.

We added to Perrigo during the quarter.

What was once viewed as a cyclical headwind now appears more structural, as the infant formula business has struggled to regain market share and shelf space. On November 5, 2025, the company launched a formal strategic review of the \$360 million infant formula business. We view this as prudent, given that regaining shelf space would require additional capital that the company does not have. The dermacosmetics divestiture is expected to close in Q2 2026, with proceeds earmarked for debt paydown. Management has announced an additional \$80–\$100 million in annual cost savings on top of the existing \$320 million Project Energize program, along with a 7% workforce reduction.

One reason we added to the position is that the stock's distressed valuation could trigger two outcomes. First, it may attract an activist investor seeking to further simplify the business. Second, through the ongoing strategic review of the infant formula segment, we see an increasing likelihood that the company will put the entire business up for sale. PRGO has paid a dividend for 23 consecutive years; we believe the company is more likely to sell itself than to cut the dividend.

The stock trades at approximately 4.8x forward earnings, 8.6x EV/EBITDA, and 0.4x sales. Free cash flow conversion should improve from here as severance payments wind down. Excluding the problem businesses, we estimate the core OTC/self-care franchise can generate \$2.50+ of EPS in a few years. Assuming zero value for infant formula, which the market appears to, the remaining business trades at roughly 5x earnings, with optionality from deleveraging, sale proceeds, and eventual mean reversion in the OTC destocking cycle. That is not a valuation for a permanently impaired business. That is a valuation for a business where the market has decided the bad outcomes are the only outcomes.

While we added to the position, it remains on the smaller side of our core holdings, balancing what has been a more challenging path than we initially expected with what we view as a business near its bottom. Our willingness to add on weakness rests on the thesis that this is a fixable balance-sheet and portfolio problem, not a franchise in secular decline.

New Position Baxter International (BAX)

We initiated a position in Baxter during the quarter in the high teens.

Baxter spun off its kidney care business as Vantive, closing the sale to Carlyle on January 31, 2025, for approximately \$3.8 billion gross and \$3.3–\$3.4 billion net of taxes. The RemainCo is a focused hospital-products company generating roughly \$11.2 billion in 2025 revenue across three segments: Medical Products & Therapies (IV solutions, infusion pumps including Novum IQ, nutrition, and drug delivery, roughly half of sales); Healthcare Systems & Technologies (smart beds, patient monitoring, and Hillrom-era capital equipment); and Pharmaceuticals (injectable generics and compounding). The North Cove, North Carolina, facility supplies about 60% of U.S. IV solutions and was damaged by Hurricane Helene in late 2024, with production recovery continuing to weigh on margins into 2026.

In 2025, Baxter issued a voluntary recall of certain Novum IQ infusion pumps due to potential safety and performance issues. The company has not yet quantified the financial impact, but the recall adds near-term pressure through remediation costs and some disruption to customer adoption, reinforcing the broader operational challenges it is working through.

Our thesis:

- Valuation. Baxter trades near 11x forward earnings on what we believe are well below normalized levels.
- Margin trajectory. The 2026 operating margin guide of 13–14% reflects the compounding of Hurricane Helene recovery costs, tariff absorption, and unfavorable mix. Normalized margins sit closer to the high teens. New CEO Andrew Hider (started September 2025) is introducing a lean-manufacturing operating system called "Baxter GPS." We expect an investor day or capital-markets event within 12 months to formalize a 100–200 bp margin-expansion roadmap.
- Management upgrade. Hider is a ten-year Danaher alumnus who most recently ran ATS Corporation, where he drove significant value creation, with revenue roughly doubling and shares more than tripling during his tenure from 2017 to 2024. A Danaher Business System operator now leading a sub-scale medtech with a depressed multiple and portfolio-simplification optionality is the archetypal setup that works over three to five years. He has already introduced the Baxter Growth & Performance (GPS) system, a company-wide operating framework focused on continuous improvement. Cutting the dividend early removes one of the more painful overhangs, and we view it as appropriate.
- Portfolio diversification to a less economically sensitive business.

The biggest risk is that Baxter is not simply experiencing a temporary earnings reset, but owns a portfolio of lower-quality assets that may be structurally losing share. The Novum IQ infusion pump issue is the clearest example. Baxter initiated voluntary corrections in

2025, the FDA classified them as Class I recalls, and the company has a ship and installation hold in the U.S. and Canada that remains ongoing. Reuters also reported the recall was linked to 79 injuries and 2 deaths, with shipment holds expected to remain in place throughout 2026.

The IV solutions business also may not fully snap back to prior demand levels. Fluid conservation practices adopted after Hurricane Helene have become embedded in clinical practice and are expected to continue reducing IV solutions demand. In other words, some portion of the hurricane disruption may have pulled forward a more permanent change in customer behavior.

Leverage remains another constraint. The dividend cut was necessary, but it also reinforces that the balance sheet leaves limited room for error. If the pump issues take longer to resolve, if IV solutions demand remains below historical levels, or if Healthcare Systems & Technologies continues to underperform, deleveraging could take longer than expected. The bear case is that Baxter is not just a trough-margin story, but a company with weaker competitive positions than the historical multiple implied. That is the risk we are underwriting. At our purchase price, we believe the valuation compensates us for those risks.

Other Portfolio Activity

We also added to **Weyerhaeuser (WY)** during the quarter. Our Q4 letter argued that softwood lumber was nearing the end of a three-plus-year downturn: Canadian supply continues to come offline (West Fraser permanently closed four mills in Q4 2025; Canfor shut Polar and suspended Houston); Canadian producers now face combined landed duties of 45.16%; and inventories are lean across the channel. Lumber prices moved higher through the quarter, and January 2026 housing starts surprised to the upside at 1.487 million SAAR. The GreenFirst-type illiquid lumber exposure we discussed in Q4 gave us a view; Weyerhaeuser gives us the liquid way to express it, along with 10.4 million acres of timberland, an investment-grade balance sheet, a REIT structure, and a 2030 plan targeting \$1.5 billion of incremental adjusted EBITDA.

We exited **Tri Pointe Homes (TPH)** during the quarter. On February 13, Sumitomo Forestry announced a definitive agreement to acquire TPH for \$47.00 per share in cash, a roughly 29% premium to the prior close and above Tri Pointe's all-time closing high. The deal values the company at approximately \$4.3 billion, requires no financing, and is expected to close in Q2 2026. This outcome represents exactly what we seek when we invest in a well-run homebuilder.

We exited **Alibaba (BABA)** during the quarter. During the quarter, we exited our Alibaba position after a roughly two-year holding period. We initially purchased the stock near the peak of U.S.-China relationship tensions, when we believed the market was underappreciating the value of Alibaba's cloud and emerging AI capabilities.

Over our holding period, two things changed. First, the market began to recognize Alibaba's positioning in AI and cloud infrastructure. Second, geopolitical tensions between the U.S. and China moderated, removing a key overhang on the stock.

As the thesis evolved, so did the capital allocation profile. Alibaba transitioned from a business generating significant free cash flow, returning capital through dividends and buybacks, to one prioritizing heavy reinvestment to fund its AI buildout. While we continue to see the strategic rationale, we were not comfortable underwriting the return on this incremental capital at the scale required.

Closing

We spend a lot of time in these letters talking about process. The reason is that the process is the only thing in our control. We cannot control multiple expansions in names we do not own. We cannot control the speed at which Sumitomo Forestry decides to buy a homebuilder. We cannot control the timing of a lumber cycle inflection. What we can control is the quality of our research, the discipline of our sizing, and our willingness to act when prices get where we want them and to sit when they don't. Q1 rewarded the latter. We suspect the rest of 2026 will reward the former.

We are grateful, as always, for the trust you place in us.

Portfolio Top 5 Holdings

At the end of the quarter, our top 5 positions were Cash, NVDA, GLW, BKRIF, and HCC.

Regards,



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