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ELM RIDGE

“Propellerheads”

Fourth Quarter Report • December 31, 2025

“Graham and Dodd investors are people who place a very high value on having the last laugh. In exchange for the privilege, they have missed out on a lot of laughs in between.”

– Michael Lewis, *The New New Thing*, 2000.

ELM RIDGE	4TH QUARTER	2025	2024	2023	2022	INCEPTION-TO-DATE ANNUALIZED
NET PERFORMANCE	7.8%	9.4%	-5.6%	-15.4%	48.6%	5.7%
GROSS LONG CONTRIBUTION	9%	20%	1%	7%	15%	11%
GROSS SHORT CONTRIBUTION	-1%	-9%	-6%	-21%	25%	-5%
AVERAGE NET EXPOSURE	19%	13%	43%	26%	23%	18%
S&P 500	2.7%	17.9%	25.0%	26.3%	-18.1%	8.1%

We had a pretty good quarter and an encouraging year. But if you really want to put all your eggs in the all-that-has-been-good-will-stay-so-interest-rates-are-coming-down-again-credit-issues-have-not-surfaced-and-will-not basket, you can read this for a few YouTube clips and move on. The S&P has been compounding at about 15% since the end of the 2008 Financial Collapse, the first twelve of those years supported by the Fed and the last three appearing to indicate that we could eventually power through as rates adjusted. The fact that we have consistently run net exposures less than 30% was always going to hurt during this period, as was our value orientation when the Russell 1000 Value Index trailed its growth counterpart by a more than 600 percentage points. Stir in our disastrous early foray into energy and you now have the recipe for WeSuck.

Although Elm Ridge has a long way to go to make up for the 2010s, our dismal decade, we’ve more than held our own since rates bottomed in the summer of 2020. Zigging when the market zags and vice versa,¹ we’ve compounded at 18%, with the 27% rate from the long side (v 17% for the S&P), more than making up for our efforts to short a continued bull market – and despite value stocks continuing to lag.²

¹ Who knows which one means up.

² The Russell Value’s posting a 14% annual return during that period compared to the 19% posted by its Growth counterpart. .

Green Shoots

“There will be growth in the spring.”
–Chauncey Gardner, *Being There*, 1979³

While we’re still waiting for a big, concerted move upward in value, we’ve had enough green shoots to keep us in the game. First, our hard-hit financials: AerCap (AER); Citigroup (C); and OneMain (OMF); began to climb the wall of worry, with an average return of 170% (about 2x the S&P) over the past three years, and yet they still sell at just over half the market’s multiple on the normalized earnings we use for valuation.⁴

Moreover, the three have been big stocks (currently 15% of capital) for us because we were able to balance their vulnerability to a credit downturn with an even bigger short position in some regional banks and life insurance companies. These, we thought, had more risks in their loan and investment books than would have been evidenced during the benign environment supported by interest rate repression. While, to this point, they have avoided large losses, the market is beginning to join our concern and our shorts here have lagged the S&P by about 50% over the same 3-year period.

Meanwhile, a few of our low-priced industrials seem to have awakened as well. Alcoa (AA), GM and Mittal Steel (MT) have shrugged off tariff concerns to return more than 60% on average this past year, with another similar sized move needed to get them to our calculations of fair value.

On the other hand, we must acknowledge that Lyondell (LYB), another stock we pitched in our first quarter letter, with an 8% dividend yield, has tumbled such that it now sports a 13% one. We are now in the middle of the longest and deepest polyethylene (plastics⁵) down cycle in modern history,⁶ with about a quarter of world capacity at risk of closure. At current levels, we understand that, even with its low-cost position, the company can barely generate enough cash to support its dividend (although it does have a year’s worth in the bank) and that the analyst community and most professional investors are pushing management to cut it. While they continue to tout the fact that they have increased the payout for 14 straight years, we think that if they did cut, the stock would most likely rise, since professionals would no longer need to worry about being embarrassed (a sin way worse than leaving money on the table). Even some of the skeptics admit that, at this price, LYB could return over 30% annually to shareholders over the cycle.

History Repeating?

*The word is about, there's something evolving,
Whatever may come, the world keeps revolving...
They say the next big thing is here,
That the revolution's near,
But to me it seems quite clear
That's it's all just a little bit of history repeating.*

The newspapers shout a new style is growing,

³ <https://www.youtube.com/watch?v=VietO5mmJcl>

⁴ We have calculated a price/normalized (mid-cycle) earnings measure 4-5 years out for the 1,000 or so stocks we track in our universe and it is the primary measure we use to value them.

⁵ <https://www.youtube.com/watch?v=eaCHH5D74Fs>

⁶ So says our good friend ChatGPT.

*But it don't know if it's coming or going,
There is fashion, there is fad
Some is good, some is bad
And the joke rather sad,
That it's all just a little bit of History repeating.
–Propellerheads, 1997⁷*

*“Lengthy, uninterrupted booms, like the one in the 1920s, produce a collective delusion. Optimism becomes a drug, or a religion, or some combination of both. Propelled along by a culture of hot tips, one-of-a-kind deals, killer sales pitches, and irresistible slogans, people lose their ability to calculate risk and distinguish between good ideas and bad ones.”
–Andrew Ross Sorkin⁸*

*“The only thing new in the world is the history you don't know.”
–Harry Truman*

Recent performance is just a sideshow. We're looking for regime change, as prolonged supranormal returns in credit sensitive assets (growth stocks, debt, housing and “alternatives⁹”) sew the seeds of its undoing. As Howard Marks argues in a recent memo, “Cockroaches in the Coal Mine”¹⁰ (a worthwhile read for anyone interested in investing):

The key observation is that good times lead to complacency, risk tolerance and carelessness, as people bid aggressively for assets and compete to make loans. And then the bad times expose the results of that carelessness, as investments that were entered into without an adequate investigation and margin for error fail to hold up in a hostile environment.

The tidal wave of funds thrown at alternative managers has left a situation where it is now estimated that the “unregulated shadow banking system” controls \$70 trillion, with 50% of financial assets touched by unregulated entities – as one observer noted in pointing to the paralleled growth of the trust banks into the Panic of 1907.¹¹ These sums have to bid up asset prices and facilitate more risk. While we acknowledge Marks' admonition that the recent string of troubling news in credit land (e.g., some high-profile defaults and frauds) need not portend any new systemic problem, we agree that the current starting point should make any investor leery.

So you can ignore the *Financial Times* (12/30/25) headline “Private equity firms sell assets to themselves at a record rate” (while also selling minority stakes at unprecedented levels.¹²) Don't worry about the Financial Stability Board and IMF's concerns about the quality of Private Credit – now comprising more than 1/3 of North American insurance company investment portfolios.¹³ While reported loan default rates are still low, S&P now monitors the growing number of “selective defaults” where loans are “cured” by adding interest to the value of the loan (so called Payment-in-Kind, or PIK loans) in lieu of cash payments, with the adjusted default rate now up to 4.6%.¹⁴ So what if the share of private credit loans sporting PIK features, has quadrupled to nearly 20% over the last three years¹⁵ and

⁷ https://www.youtube.com/watch?v=nC2pgcagyRk&list=RDnC2pgcagyRk&start_radio=1

⁸ *1929: Inside the Greatest Crash in Wall Street History--and How It Shattered a Nation*, Andrew Ross Sorkin.

⁹ Typically a more levered but illiquid version of the preceding.

¹⁰ <https://www.oaktreecapital.com/insights/memo/cockroaches-in-the-coal-mine>

¹¹ “Marc Rubinstein on the Hidden Fault Lines in Modern Finance”, *Institutional Investor*, 12/16/25.

¹² *Wall Street Journal*, 12/24/25.

¹³ *Bloomberg News*, 12/19/25 and *Institutional Investor*, 11/21/25. The FSB is an international organization formed in 2009 to monitor the global financial system

¹⁴ “Private Credit Hysteria Will Get Very Real Soon,” Paul J. Davies, *Bloomberg Opinion*, 12/1/25.

¹⁵ JP Morgan, 11/25/25.

Goldman Sachs Asset Management estimates that 15% of private credit borrowers aren't generating enough operating cash to cover interest costs.¹⁶

We think the supportive landscape for credit and all things risky has helped fuel for the market's love affair with AI and other growth (e.g. "compounder") stocks. But the AI story would have engendered excesses all by its lonesome. To quote Marks again:

There's a consistent history of transformational technologies, generating excessive enthusiasm and investment, resulting in more infrastructure than is needed and asset prices that prove to have been too high. The excesses accelerate the adoption of the technology in a way that wouldn't occur in their absence. The common word for these excesses is "bubbles."¹⁷

One AI start-up just raised a mere \$2b at a \$10b valuation (and just a couple of months later is looking at a \$50b number), and yet the company has not released a product nor told its investors what it is trying to build. Said one investor (who we gather still ponied up some dough) "it was the most absurd pitch meeting, ... we're doing an AI company with the best AI people, but we can't answer any questions."¹⁸ We get it. "I could I tell you, but then I'd have to kill you."¹⁹ When Nvidia reportedly agreed to spend \$20b (or 40x forecasted revenue) for privately held Groq, Sheetal noted that "it's only \$20b." Of course, that makes Groq worth more than all but 8 names in our long portfolio, including a couple who pay their shareholders more in dividends than Groq has sales.

We all should be grateful for the legions of investors who ended up losing their shirts supporting the initial frantic buildouts of railroad, radio, and internet infrastructure – before subsequent generations built profitable businesses with that scaffolding. We don't doubt that, in due time, AI has the potential to provide a huge boon to economic output. I hope to live long enough to give thanks to those now chasing the dream, who will have so selflessly sacrificed their wealth in support of what promises to be another game-changing technology.

So it need not concern us that while GPU chips are reportedly in shortage, compute prices have fallen by a third since April.²⁰ Circular deals in the AI world (I'll invest or agree to back X hundreds of billions of your AI build out in return for a commensurate purchase of my chips or services, thereby creating revenue out of thin air) have become so commonplace that no one bats an eyelash. We should cheer those investors and tech companies willing to throw billions at anything AI since a mere mention of it is likely to send their stocks and holdings higher. Isn't it nice that a couple of private credit lenders report that borrowers are now asking for more than 100% of the build out cost for new data centers.²¹ But commitments are now soaring to such a degree that players are once again forced to turn to special purpose financing vehicles (SPVs, designed to keep debt off balance sheets), that helped hide risk in 2008 – as Meta just did with its proposed new data center.²²

We'll defer to Marks one more time:

While the parallels to past bubbles are inescapable, believers in the technology will argue that "this time is different." Those four words are heard in virtually every bubble... On the other hand, Sir John Templeton,

¹⁶ "Investment Outlook 2026" Goldman Sachs Asset Management.

¹⁷ <https://www.oaktreecapital.com/insights/memo/is-it-a-bubble>

¹⁸ <https://www.derekthompson.org/p/this-is-how-the-ai-bubble-will-pop>

¹⁹ <https://www.youtube.com/shorts/Bu4BH-V10Yk>

²⁰ "How much does AI rhyme with Shale," *The Carlyle Compass*, 11/25/25.

²¹ *Bloomberg News*, "AI Data Center Boom Sparks Fears of Glut Amid Lending Frenzy," 12/12/25

²² "Meta Announces Joint Venture with Funds Managed by Blue Owl Capital to Develop Hyperion Data Center" press release 10/21/25.

who in 1987 drew my attention to those four words, was quick to point out that 20% of the time things really are different. **But on the third hand, it must be borne in mind that behavior based on the belief that it's different is what causes it not to be different!** (his emphasis).

...AI is currently the subject of great enthusiasm. If that enthusiasm doesn't produce a bubble conforming to the historical pattern, that will be a first.²³

You can read history or watch South Park's "Margaritaville."²⁴ Your call.

We recognize that none of the above need spell game over – and if it did, the game would have already ended. But it is interesting that both Apollo and Nvidia felt sufficient pressure to publish detailed rebuttals to some of the most visible critiques. At first blush, their responses do sound convincing. For example: public credit is also illiquid; insurance companies list their individual investments but banks don't; levered lending has recorded limited loss rates over the past 15 years; NVDA's cash *payments* to customers have been insignificant; NVDA customers may be losing money but they are pursuing a great opportunity; and the fact that 5-year old chips are still running indicates that they are depreciating them correctly. But they are attacking straw men. We accept that levered lending ought to perform well in an era of benign credit. While public credit may have its issues, the fact that a \$2b loan marked was marked by Blackstone, Apollo and KKR at 82, 77 and 91 respectively²⁵ doesn't instill confidence in the private kind. Our issue with NVDA is with its commitments, not what it has paid out thus far. And the fact that 5-year-old GPUs are still running doesn't mean that they are worth more than a smidge of what they originally cost.

We do recognize that a severe market dislocation would take our stocks with it... at first. But investors passing on our holdings have been fearing a possible upcoming recession for almost all the past 15 years. We too are wary and have focused our long book on those companies with the balance sheet and low-cost position to weather any hit from decreased demand – and can thus take advantage of any temporary dips to buy back even more of their overlooked shares. If the buy-growth-at-any-price strategy does falter, investors would probably once again look to real cash-generating support that ultimately underpins stock prices (as was the case in 2000 and 2022 when our longs posted rather attractive returns while beating the S&P by 50 and 35 points respectively).

While we're finally seeing some shots across the bow of the Good Times Supertanker,²⁶ it could well hold its course for some time. True, there is **no record of positive returns over the following 10 -years** when the S&P's P/E has reached current levels (see chart on the next page), but there could always be a first. That's not a bet we want to take. Cue up the Propellerheads.

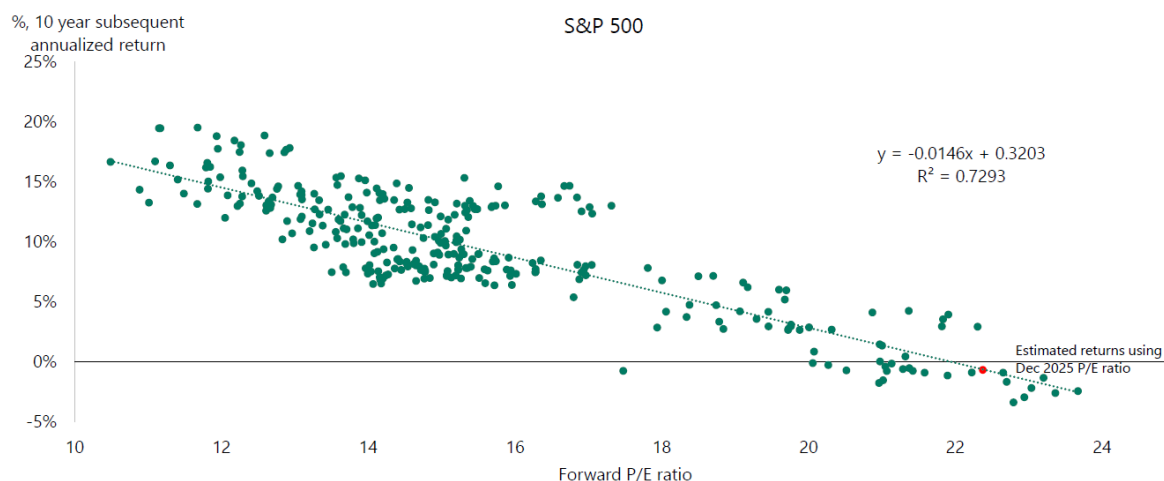
²³ Oaktree, "Is it a bubble?" Op Cit.

²⁴ <https://www.youtube.com/watch?v=2Yrr0Or8O-E> and <https://www.youtube.com/watch?v=OtpwAg0KTeA>

²⁵ *Bloomberg News*, 11/13/25

²⁶ From Abby Cohen's famous 1998 contention that the United States market and economy is "like a supertanker. We're not the fastest ship. We're not the prettiest ship. But it's very hard to knock us off course."

S&P 500 forward P/E ratio vs subsequent 10-year annualized returns



Sources: Bloomberg, Apollo Chief Economist

DISCLOSURES AND NOTES TO PERFORMANCE

Past performance should not be construed as an indicator of future performance. Inception is January 2000.

(a) The performance figures are estimates and unaudited. (b) All returns presented are calculated on a time weighted, total return basis (include all dividends, interest, accrued income, realized and unrealized gains and losses and commissions). Gross Returns do not reflect the deduction of a 1.5% management fee, applicable fund expenses, or a 20% performance allocation. Net Returns include dividends, net interest, and reflect the deduction of a 1.5% management fee plus applicable fund expenses; they are also net of a 20% performance allocation, if applicable; (c) These returns are not GIPS compliant. These returns are not AIMR compliant as they represent only the performance of the Series A, Class 1 shares. Individual investor returns may vary due to several factors, which include but are not limited to: the timing of subscriptions and redemptions; differences in fee structures; individual investor account high water marks, and differences in tax treatment. Because of certain governmental regulations, not all accounts are New Issue eligible. New Issues contributed approximately 9.6% gross to the performance figures presented for the year 2000, 0.6% gross for the year 2001, 0.09% gross for the year 2002, 0.48% gross for the year 2003, 0.47% gross for the year 2004, 0.30% gross for the year 2005, 0.17% gross for the year 2006, 0.24% gross for the year 2007, 0.03% gross for the year 2008, 0.01% gross for the year 2009, 0.03% gross for the year 2010, 0.05% gross for the year 2011, 0.00% gross for the year 2012; 0.05% gross for the year 2013; 0.05% gross for 2014; 0.01% gross for 2015 and 0.00% thereafter; (e) All performance figures are before-tax returns. Actual after-tax returns depend on an investor's individual tax situation and may differ from those above. (f) All historical performance and exposure statistics reported in this letter prior to October 1, 2001 refer to Elm Ridge Value Partners, L.P., a 3(c)1 limited partnership. (g) All S&P 500 performance percentages are shown with dividends reinvested. The S&P 500 has not been selected to represent an appropriate benchmark to compare Elm Ridge Management's performance, but rather is disclosed to allow for comparison of Elm Ridge Management's performance to that of a well-known and widely recognized index and is not intended to imply that the fund's portfolio is comparable to this index either in composition or elementary risk. The S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies chosen with respect to market size, liquidity, and industry. The index is calculated on a total return basis with dividends reinvested. (h) The Form 13F that is filed on a quarterly basis by Elm Ridge contains the required details concerning our portfolio.

Where indicated, select performance results included in this document are hypothetical returns which have been compiled by Elm Ridge Management. Hypothetical performance results may have inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. One of the limitations of hypothetical performance results is that they are prepared with the benefit of hindsight. There are numerous other

factors related to the markets in general or to the implementation of any specific trading strategy which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results. Any hypothetical performance results do not include the reinvestment of dividends, interest, and capital gains, and do not reflect the deduction of Elm Ridge Management's investment advisory fees. Thus, actual return will be reduced by the advisory fees and any other expenses which may be incurred in the management of the fund. All investments involve risk including the loss of principal. Cumulative and annualized returns are shown. Cumulative returns represent the amount, including all interest or dividends and capital gains received on an investment over a period, usually expressed as a percentage of the amount invested. Annualized returns represent the increase in value of an investment, expressed as a percentage per year. Contribution figures are estimated and may not sum due to rounding and compounding effects. Estimated Gross Long and Short Contributions are calculated independently by compounding the respective monthly returns. This material has been prepared or is distributed solely for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy.