BANYAN CAPITAL MANAGEMENT

January 16, 2026

Dear Client,

Banyan's equity composite gained 10.1% in 2025 versus the S&P 500's gain of 17.9%. Since the start of 2019, when yours truly officially took the helm, we have compounded at 13.3% per year versus 17.3% for the S&P 500. Details on our equity composite can be found here.

In other news, please join us in congratulating Bill Knorr. He became a partner at Banyan effective January 1st. Bill has done a great job since joining us in 2024. He passed the final CFA exam a few months ago and is now a CFA Charterholder. Bill has also improved our operations, investment process, and client service. We are fortunate to have him. Congrats, Bill!

Lastly, please visit our recently updated website at www.banyancapital.com. Mr. White Creative did a great job. The website is not, however, in final condition. Many of our past publications, including client letters, are not yet online. They soon will be. I am to blame for the delay.

Marvelous Markets

Markets are marvelous. These emergent processes aggregate vast amounts of data, much of which is conflicting, into a single price. The price then pulses through the economy as a signal, and people respond to the price signal out of self-interest. A rising price, for instance, says something is dearer. In response, we consume less of the thing to economize and produce more of the thing to profit. No grand authority tells us to. We just do as we wish. As Adam Smith put it,

> "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantage."[1]
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> \- *The Wealth of Nations*

How amazing is that? We all want a better life. Markets tell us how to get it. We must serve others, moreover, and we do so out of self-love, not charity. Rarely do we even grasp our role in the greater scheme. We simply follow local price signals to profit like ants following pheromone trails to food. We are, as Adam Smith observed, "led by an invisible hand to promote an end which was no part of [our] intention."[2] That end, of course, is the public good. It is our neighbors who benefit most.

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[1] Adam Smith, *An Inquiry into The Nature and Causes of The Wealth of Nations*, MetaLibri (2007; Originally 1776), pp. 16.

[2] *Id.* at 349.

Were Adam Smith alive today, his awe would surely extend to stock markets. Ours does. They amplify the more fundamental signals emanating from product markets. If bread becomes dearer, for example, then so, too, do bakeries. Perhaps returns on capital rise to 30% from 10%. This alone gets bakers to reinvest in their businesses. The entrepreneurial response is amplified, however, if the stock market is certain faster growth and higher profits are sustainable for bakeries.

To reflect its certainty, the stock market may, for instance, pay $20 for a dollar of bakery earnings now instead of the $10 it paid before. This is a powerful signal. A new dollar employed by a bakery now creates $6 of stock market value whereas it created $1 before.[3] Capital will flood, not trickle, into the business. More bakeries crop up, which means more bread. Consumers benefit, but bakers suffer. Thus, a better future for bakers is threatened by the market's certainty in it.

This simple example illustrates the Herculean task stock markets face. Bread is perishable, but a bakery, like all businesses, is perpetual. Those who own its stock have a claim to its future value, but the endless future can take many paths. The stock market must consider each path and weigh its odds. Price itself, moreover, can alter the future, as illustrated by the bakery example. For a going concern, in fact, value can never be known. It can only be estimated within a range.

Stock markets handle this difficult task remarkably well. Most stock prices lie in the belly of their value range. There are exceptions, however. Foresight is limited, people are emotional, and the weight of consensus is heavy. Prices can thus be pushed to extremes that reach, or even breach, the outer edges of a stock's value range. These "edge cases" are rich in opportunity.

In an edge case, the stock market implies a single future is all but *certain*, not just *probable*, and that future must be either very good or very bad to push a stock's price to the edge. Yet, certainty is rare in business, and it skews the risk-reward in favor of contrarians. A contrarian's losses should be modest if the future unfolds as markets expect; it is already priced in with certainty. A contrarian can profit, on the other hand, if the future unfolds along one of the many unexpected paths.

Warren Buffett, in fact, credits his success to edge cases. They are the one-foot hurdles he seeks:

> "To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers. . . . [I]t is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult."[4]
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> \- Berkshire Letter (1989)

Phinia (PHIN), for example, was an edge case when we first bought it. It is an auto parts supplier focused on internal-combustion engine (or "ICE") powertrains. PHIN sells to automakers and the aftermarket. It is profitable, with little debt, and has a money-minded CEO, Brady Ericson. Better

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[3] Stock Market Value of Dollar Invested = Return on Investment x Earnings Multiple, whereas:

a. Before Bread Became Dear | Stock Market Value of Dollar Invested = 10% x 10 = $1; and
b. After Bread Became Dear | Stock Market Value of Dollar Invested = 30% x 20 = $6.

[4] Warren Buffett, Letter to Shareholders, Berkshire Hathaway (1989), *available at*: https://www.berkshirehathaway.com/letters/1989.html.

yet, we bought PHIN after it was spun out of a much larger firm, BorgWarner (or "BWA"), at the height of electric vehicle (or "EV") euphoria in July of 2023. This created ideal conditions for us.

Market euphoria, by definition, implies an extreme future is all but certain. Stock prices therefore reflected certainty in an all-EV future at the time. BWA responded by very publicly announcing its transition to EVs. Spinning out much of its ICE business as PHIN followed. We were immediately interested. An all-EV future seemed far from certain, even unlikely, to us. Few shared our opinion. In fact, PHIN's competitors were, like BWA, exiting the ICE business to adapt to an all-EV future.

At spin, moreover, PHIN was worth roughly 10% of BWA's value, which meant investors with a 5% position in BWA had a 0.5% position in PHIN post-spin. We figured most would sell PHIN without doing the work. This was confirmed when I visited PHIN's CEO in Detroit. Not a single other analyst had come to see him. The reason was obvious. PHIN was small, new, and in the ICE business. So, why care? The ICE business was clearly headed for extinction, after all.

But we did the work and had a contrarian opinion. An all-EV future seemed like a fantasy to us. At $26.75 per share, which is where PHIN traded, we saw a great risk-reward proposition. It offered an owner earnings yield of roughly 20%. The potential gain was large if EV penetration disappointed, we figured, but our risk of loss was modest since an all-EV future was already priced in. This proved correct. With an all-EV future now unlikely, PHIN's stock price is above $70.

In short, markets are marvelous. They show us the way to a better life and make us serve others to get there. Markets are not perfect, however, especially stock markets. Certainty too often creeps in and pushes prices to extremes. We like these edge cases. They offer contrarians a low-risk way to profit from uncertainty. For Buffett and lesser mortals like us, clearing these one-foot hurdles is an easier way to ***build permanent wealth***. Certainty, on the other hand, is too rare to bet on.

Sincerely,

Drew Estes, CFA, JD
Portfolio Manager