April 13, 2022

Memo to clients and friends:

Re: Q1 Review

In our letter written early this year, we noted that 2021 had been a boomer for the stock market but that we were somewhat skeptical on how 2022 would turn out. At least so far, our skepticism has been warranted as all of the Q1 index numbers shown below are in negative territory.

An old stock market saying states that, "as goes January, so goes the year," and January stock market returns were negative, though this does not mean that 2022 will be a disaster. We are looking for lots of volatility but we have no forecast on what the final verdict will be, though stocks will likely give up some of the unusually high returns earned over the past three years.

Benchmark Index Total Returns	Quarter Ending 3/31/2022
Lipper Balanced Fund Index	-5.00%
S&P Dividend Aristocrats	-3.00%
S&P 500 Stock Index	-4.60%
Russell 1000 Value Index	-0.70%
3-month US Treas. Bill	0.03%
S&P-7-10-Year-US Treas. Bond Index	-6.47%
S&P U.S. Gov & Corporate 30 Year Bond Index	-11.07%

The first quarter of 2022 provided both hope and anxiety. As the stock market was very close to its all-time high at the end of last year and we could all see storm clouds boiling up, it is not surprising that we ended up with negative results. But it could have been a lot worse. From the beginning of the year through the beginning of March the stock market declined over ten percent. However, after the decline it moved sharply higher in a short time frame, recovering about half the ground lost to close out the quarter.

Our accounts performed about as we thought they would. Our stocks held up very well through the bottom of the decline (as they are structured to do) but then lagged the market through the upswing and ended the quarter with market competitive results.

Looking ahead through the balance of the year, we fully expect periods of negative returns. However, as you all know, we invest for the long-term and think in terms of three to five years as a reasonable holding period to judge how we are doing relative to your specific needs and objectives. This includes not just performance but also dealing with changes along the way – making sure cash is available when required and capital gains subject to tax are only realized when we have something better to buy on an after-tax basis. As time passes and expectations and needs change, we fully expect that your portfolio will also need to change.

From a long-term perspective, declining markets often provide considerable opportunity for improving portfolio holdings and structure with a reduced tax impact. Volatility may make us nervous and uncomfortable but it often leads to price distortions in both directions facilitating the ability to "buy low and sell high".

The economic picture through the rest of this year and into next, doesn't look great. We all know that the inflation rate has risen dramatically and that the Federal Reserve Bank has begun to take steps to bring it under control. Interest rates are now rising and likely to continue to do so at least through the end of this year. And wages, though also rising, have not kept up with inflation, meaning that many are losing ground in terms of what a dollar will buy.

Ever since the end of the credit crisis back in 2008-2009, the Fed has been buying in treasury and mortgage-backed securities. These are paid for by simply crediting the seller (mostly banks and brokers) with the amount due. This is the modern equivalent of "printing money". This was warranted after 2008-2009 mortgage crisis and again as COVID appeared, forcing a near shut down of much economic activity. Under those conditions, the last thing the economy needed was tight money so the spigot was turned on high to be sure plenty of money was available to both facilitate recovery but also to fund the various COVID stimulus programs created by Congress and the administration. But, in our view, the last stimulus package and its funding by the Fed were both unnecessary.

Even before the last stimulus a year ago, it was becoming clear that the economy was recovering from the COVID shutdowns but the money spigot remained wide open. As inflation began to rise it was said to be "transitory" due to the difficulties caused by COVID of getting goods delivered from overseas and to stores (so-called supply chain disruptions). But inflation has almost never been transitory in the sense that it eventually just goes away. Action must be taken and inflation is almost always "sticky" because higher priced raw materials and other inputs tend to work their way through everything we produce and sell. This can create an inflationary feedback loop that circles around and around within the economy.

Because it got out of hand, the Fed now has no choice but to slow things down to the point that demand comes back in line with available supply to break the inflationary spiral. Just as the Fed added dollars to the economy through quantitative easing (buying securities to create more money) it now needs to sell those same securities to pull money back from the economy. Less money leads to higher interest rates.

This is further pushed along by declaring that the "Federal funds rate" will be increasing. The Federal funds rate is the interest rate the Fed and commercial banks charge each other as those institutions short of funds on a given day borrow from those with a surplus. In either case, higher interest rates

mean higher costs to finance both consumer goods (like autos) and business expansion. The ultimate result is slower growth.

The problem this creates, is that it is almost impossible for the Fed to get it just right as they go through this process. Tighter monetary policy acts only with a considerable lag in the time it takes to work its way through the economy. The result of this it that there is no quick fix to inflation and the Fed usually overshoots when tightening creating a recession with all that portends on its own.

While COVID and the reactions of both the Federal government (overdoing the stimulus packages) and the Federal Reserve (creating too much money through easy credit) were the main causes of the inflation we are now experiencing, there are always other factors as well. At the top of everyone's list today is the war in Ukraine. The human tragedy aside, defense spending on wars always complicates things. On one hand, it is stimulative as the defense goods used need to be replaced and that is good for many manufacturers. However, wars are also hugely disruptive to international trade, creating more friction within many of the non-U.S. economies that, today, are already under pressure as, like us they are also just starting to recover from COVID which caused similar inflationary pressures.

In addition, China has declared a zero tolerance for the newest strain of COVID and that has resulted in many shutdowns there that are still going on. That will further exacerbate the supply chain problems and resultant shortages that we all have been reading about.

So, what do we do about portfolio investments? The answer is that, while we are not cavalier about recession and the potential for a real bear market, we believe we are in reasonably good shape to weather whatever storm may appear. As mentioned above, our portfolios held up very well in the January/February decline earlier this year and we would expect the same result if the market should decline further as a result of a real recession. And given our long-term investment holding periods we would fully expect our portfolios to be worth more five years from now in comparison with today. Corporate dividends and earnings will be higher as recession fades and, once again, the end of the financial world will not occur, though many will probably call for it before we get to the other side of whatever happens next.

Top 20 Holdings

This quarter saw a much wider range of returns among our top holdings than we have seen in a while, giving rise once again to the phrase, "It is a market of stocks, not a stock market." Especially when the market is trending lower, individual stocks do not necessarily move up or down at the same pace as the market and some winners are easily found.

For the first three months of the year agricultural commodities trading company ***Archer-Daniels-Midland*** led the group, returning nearly 35% for the quarter alone. Year over year it is up 65%. The company started out strong due to inflation concerns, and it ended strong as the Russia-Ukraine conflict raised grain prices, pushing earnings higher. Biopharmaceutical company ***AbbVie*** and energy pipeline ***Enterprise Products Partners*** also had a very strong quarter, each returning over 20%.

On the other end of the spectrum a few of last year's winners took a breather over the last few months. Retailer ***Lowes*** was our worst performer, down just over 20% from its phenomenal highs. There doesn't seem to be anything "wrong" with the company. Sales and guidance were both better than expected, so it looks like investors have been taking profits and locking in last year's gains of over 60%. Semiconductor maker ***Qualcomm*** and industrial products and equipment maker ***Illinois Toolworks*** were our other worst performers, each down 14-15% for the quarter. Fundamentally these companies remain strong, and we intend to continue to hold them (and will add to them if the price is right).

This quarter saw more turnover in our Top 20 Holdings than we have seen in a while. Our current top 20 holdings are as follows:

AbbVie Inc.	Fastenal Company
Ameriprise Financial	Illinois Tool Works Inc.
Amgen Inc.	Leggett & Platt, Inc,
Archer Daniels Midland	Lowe's Companies, Inc.
Bank of New York Mellon Corp.	Merck & Company, Inc.
Cardinal Health Inc.	Microsoft Corporation
Caterpillar, Inc.	Polaris Industries Inc.
Cisco Systems, Inc.	Qualcomm Inc.
Comcast Corporation	SPDR Technology Sector ETF
Enterprise Products Partners L.P.	United Parcel Service, Inc.

Pharmaceutical (and Covid vaccine maker) ***Pfizer*** was replaced by drug distributor ***Cardinal Health*** based on performance (Pfizer up so we sold some – Cardinal down so we bought some). We also began selling ***Starbucks*** and ***3M*** over the quarter. Most of the proceeds were used for purchases of ***Comcast*** and additions to ***Leggett & Platt***.

Starbucks has been an incredible company which we first purchased in 2018 after a rapidly rising dividend put it on our radar screen. Until recently Starbucks had exceeded expectations, though recent events knocked the stock from its high and put it on our sell list. With Starbucks locations largely saturating the USA, much of the company's growth is coming from abroad and particularly from China. China's COVID policy has been responsible for shutting down stores, and we anticipate this will continue for some time. In addition, Starbucks employees have been making pushes to unionize across the U.S. with a NYC store the most recent. The result will probably be higher costs. Interestingly, Starbucks has tended to have one of the better reputations in the retail/service sector for treating its employees well. With labor shortages occurring across the US in addition to ongoing inflation, we would not be surprised

to see a push for unions across various sectors of the economy in coming years. After some debate we decided to largely lock in our gains from Starbucks and move on to another company.

3M has been a disappointing performer since we've held it. Sales for the fourth quarter were relatively flat, while costs are being pressured due to inflation, leading to somewhat disappointing results at a time when many other companies are breaking previous records. There were some very well-known risks swirling around 3M before we purchased shares, mainly litigation risk due to 3M's prior production of chemicals containing PFAS (per- and polyfluoroalkyl substances). These are sometimes referred to as "forever chemicals" due to their persistence in the environment. They can be found in a variety of substances from the foam used in fire extinguishers to the coatings for nonstick skillets. We believe the very widely publicized PFAS risks are likely overblown, which is why we originally purchased it. However, with the fundamentals looking a bit less bright we felt comfortable booking a small loss and moving on to higher quality companies without litigation issues.

On the buy side, ***Comcast*** is a new purchase for clients that we have not held in the past. Its Cable Communications segment (high speed internet, pay TV, and voice) makes up over half of revenues, with the rest coming from NBCUniversal (owns NBC and other networks, Universal Studios, Dreamworks, and Universal Studios theme parks) and British satellite tv broadcaster Sky. The stock price has not moved much over the past five years, while earnings, cash flow and dividends are all up substantially and in spite of a reputation for relatively poor cable service. With a dividend yield around 2.25% and a strong financial rating as well as rising earnings over the next several years, Comcast is a relatively stable company that we believe is worth considerably more that its current price.

Leggett & Platt is a company we have owned off and on over the last several years. The company primarily manufactures bedding products (foam, springs, adjustable beds), and it also makes furniture, flooring, textiles, and specialized products such as hydraulic cylinders. Recent declines in the stock price have put it on our radar once again, and we have been adding to our holdings. With a 4.75% dividend yield we are willing to be patient and give the stock price time to recover. Leggett & Platt has raised the dividend for 50 consecutive years, quite a feat for a relatively cyclical company and an indication of strong interest in shareholder value added. And although the businesses they are in do not appear to be very exciting, the company holds about 1500 patents on their manufacturing processes so they are a lot more sophisticated than would appear from just a glance at their end products.

Separate from our Top 20, we have received questions from a number of you about a litigation notice on Teva Pharmaceuticals, a company that we sold a number of years ago. They are a generic drug company that was caught up in the many lawsuits relating to the production or distribution of opioids. Many of these suits are now being settled and previous owners are being contacted relative to possible inclusion in the settlement class.

Our experience with these recoveries is that the process is onerous and long and generally results in a very small payout of cash to the former shareholders (The lawyers always do well). We do have the records necessary for those who want to respond but, personally, we have decided not to for our own portfolios. Should a settlement offer come up on other securities where the payout looks more lucrative, we will let you know.

Looking to the future, in spite of what could be a rougher road ahead, we do not plan to take any dramatic action either with respect to the percentage of assets you have invested in common stocks or the individual holdings in our portfolios. Quality is something we are particularly careful about when buying new holdings and quality is what will carry us through should a worse than expected recession happen this year or next.

With the passage of time, there will always be a few issues we have fundamental questions about but not very many. This is why our holding periods for individual equities averages about five years. In addition, for taxable accounts, we are particularly conscious of the capital gains created along the way and the tax liability that results. Buying high quality companies at what we believe are below average prices and holding them for a number of years has long been one of the secrets to building wealth and we plan to continue to apply that philosophy.

As always, we welcome any questions or comments this letter may raise.

With kind regards,

Loudon Investment Management LLC

DML/ELS/JJS/LRO