July 17, 2023

Dear Clients and Friends:

Re: Q2 Investment Review

Since the beginning of this year, the S&P 500 stock index has done extremely well in contrast to the terrible performance, top to bottom, that occurred in 2022. All of our benchmarks have shown "good" performance so far in 2023.

Benchmark Index Total Returns	Quarter Ending 6/30/2023	Year to date 6/30/2023
Lipper Balanced Fund Index	3.20%	7.60%
S&P Dividend Aristocrats	3.98%	5.86%
S&P 500 Stock Index	8.74%	16.89%
Russell 1000 Value Index	4.09%	5.14%
3-Month US Treas. Bill Index	1.19%	2.29%
S&P 7-10-Year-US Treas. Bond Index	-1.84%	2.01%
S&P U.S. Gov & Corporate 30 Year Bond Index	-2.43%	4.07%

In fact, the equity indexes have done so well that most are now considered to be back in "bull market" territory given that they are all up 20% from their lows reached near the end of last year. However, as you can see above, there is a very wide discrepancy between the S&P 500 Index return and those of the other two common stock indexes. As the S&P has generally been thought to be the most representative of "market" performance, this is a subject worth a review.

In our last quarterly letter, we reviewed the four different indexes we use for comparative purposes and the different ways they are calculated. The importance of the methodology is clear in the numbers above with the S&P 500 more than 10 percentage points above the other two common stock comparisons. So how has the total stock market really done?

The S&P 500 is generally considered a widely "diversified" index. In fact, much investment theory is based on that assumption. While that may have been true in the past and may again be true in the future, that view is subject to considerable challenge today.

The reason is that only nine of the 504 stocks currently in the index (about 1.8% of the index by number) count for 30% of the performance weighting. This is because of the way the S&P 500 is calculated (capitalization weighted) - the largest companies count the most and these companies (such as Apple, NVIDA, Microsoft, Berkshire Hathaway etc.) are very large indeed. Due mainly to the advancement of technology and their prospective earnings growth, they are currently among the most favored stocks in the stock market, and we would contend, the most overvalued. Stock prices have moved well ahead of reported fundamental progress. In contrast, if we look at the average performance of all the stocks in the index (equal weighted), the return from the same group of 504 stocks would only be about 6.9% this year rather than the 16.9% for the index as reported above.

The Dividend Aristocrats Index (also equal weighted) is probably the best direct comparison with our own quality, value and dividend-oriented selection process and it too has lagged the S&P 500 this year. But quite recently it had matched the S&P 500 returns over the past five years. Like us the dividend aristocrats typically do best when the S&P is in decline as was the case last year.

For this year, at least, the largest technology companies are the winners. But, over time, performance differences such as these tend to dissipate. We have seen this before. We don't think the stock market has changed so much that it won't happen again. With valuations for these stocks mostly through the roof, some will inevitably become underperformers even as earnings continue to increase and in aggregate, the group will probably produce no more than average performance over the next five years. If we were indexing today, we would much prefer to use the equal weighted S&P to deemphasize these stocks.

Trouble with the Money Supply?

Money, of course, is what we use to buy things. Economists give it a number of formal definitions but the one most focused on is called M2. Growth in our money supply promotes and supports growth in the economy, both in the U.S. and globally.

One of the prime causes of the Great Depression in the 1930s was the reduction of the money supply in keeping with the economic theories of the time. In contrast, the Great Recession of 2008-2009 was partially cured by flooding the economic system with more money than it needed to make sure there was no shortage of money to impede recovery. That worked. So far so good.

Our concern in the 2010-2020 era was, as reported in our letters, that the money supply continued growing too fast. In fact, we would contend that the rapid growth in money forced by the Federal Reserve caused the extreme top in the stock market in late 2021. Money not used in the "real" economy ends up in the financial markets and that is why interest rates went to zero and one of the reasons the stock market went through the roof.

The arrival of COVID slowed the economy and any restraints on money supply growth were removed to offset economic downturn. Stimulus programs were then implemented to get the economy moving again. Because the economy slowed, excess money growth had no major economic impact though it did

push the financial markets higher. However, eventually the stimulus programs funded with borrowed money went too far. The result was too much demand and that inevitably creates inflation.

If we fast forward to today the situation is very different. The money supply has been tightened which is why interest rates have gone up. This was done to control the inflation caused by the recovery along with the presence of too rapid growth in money. But has this effort gone too far? Despite the optimistic views readily available today, we have concerns.

Recently the money supply has done something we haven't seen since the Great Depression that began some ninety years ago. Over the past year M2 actually contracted with the supply today now down close to a trillion dollars since it peaked in July of 2022. While there have been brief declines in the quantity of money within a given year, we haven't seen a twelve-month contraction for a long time.

The only comparable experiences of money supply contraction came in and before the 1930s so they are not fully relevant today. Hopefully since then, the Federal Reserve has since gained a lot of knowledge of how the economy works and what the response should be. But an actual decline in the money supply has happened so infrequently that we need to pay attention. We also know that the Federal Reserve does make mistakes.

The one thing we know for sure is that a reduction in available money is not good for either economic growth or the stock market. Just as a growing money supply supports economic expansion, a contraction is like pouring sand into the gears of growth.

6/30/2023 LIM Top Holdings

ABBV	AbbVie Inc.	ITW	Illinois Tool Works Inc
AMP	Ameriprise Financial	LOW	Lowes Companies Inc
AMGN	Amgen Inc	MSFT	Microsoft Corporation
ADM	Archer Daniels Midland	PII	Polaris Industries Inc.
CAT	Caterpillar Inc	QCOM	Qualcomm Inc.
CSCO	Cisco Systems Inc	XLK	SPDR Technology Sector ETF
CMCSA	Comcast Corporation	SWK	Stanley Black & Decker
DLR	Digital Realty Trust Inc	TGT	Target Corporation
EPD	Enterprise Products Partners LP	TROW	T Rowe Price Group
FAST	Fastenal Company	TFC	Truist Financial Corp

During the last quarter Digital Realty Trust and Truist Financial Corp replaced Leggett & Platt and Merck on our top twenty list.

Truist was formed in 2019 when BB&T (a former LIM holding) and SunTrust Banks combined, making what is now the sixth largest bank in the US based on assets. Truist stock slid down earlier this year in sympathy with the failure of Silicon Valley Bank (SVB), then again in May with the collapse of First Republic Bank. At its low this year the stock had lost over 50% of its value.

This was the point where we began to get really excited about high quality regional banks, including both Truist and US Bancorp. In a panic, the market was bidding down the prices of all the regional banks indiscriminately, failing to account much for quality. We saw a great opportunity here and began adding shares of Truist and USB to all client portfolios. Truist and USB shares have both recovered a bit since the low point as the banking-related panic has begun to abate. As with all the large banks, Truist passed its 2023 stress test, and the 6.5% dividend yield (which was over 7% when most purchases were completed) should remain stable for the foreseeable future.

The addition of Truist to portfolios highlights our contrarian nature, as we actively look for companies that are out of favor but with strong prospects over the long run. We cannot say for certain whether the banking panic is finally over. With at least a few more interest rate increases likely for the near future as well as a possible recession on the horizon, banks will probably remain under pressure for a little while longer. But that doesn't mean that high quality banks like Truist will face the doom and gloom that many investors seem to fear. By the time it is clear the banking panic was overdone it is likely that the stocks will already be well into their recovery, which is why we often buy while the news is negative.

Long-time holding Digital Realty is another company we have been actively adding to in recent months. Digital Realty is a real estate investment trust (REIT) that owns and manages technology related properties. Its properties consist of data centers, with nearly half of its properties outside the United States. These data centers make up much of the backbone of cloud computing, and the company looks poised to benefit from the explosive growth in artificial intelligence. Meanwhile the stock was pulled down along with other REITs as interest rates moved higher. Real estate companies tend to rely heavily on debt, and many will struggle to refinance old debt and will need to take on debt at higher interest rates in order to fund new deals. While Digital Realty is not immune, it has an extremely strong balance sheet. Its debt is mostly fixed at an average rate of 2.8%, and most of the debt is long term. Also, as an international player, Digital Realty has access to capital markets outside the US and can search around for the most attractive rates. Over the last decade Digital Realty has been a company we are thrilled to own at the right price, and we were excited when it came back down to "buy" prices. With a dividend yield close to 5% this is a company where we can sit back and earn a reasonable return while we wait for the stock to recover.

Some of our recent purchases in companies like Truist and Digital Realty were funded by sales of pharmaceutical Merck. Most of our shares in Merck were purchased around two years ago, and they have been a stellar performer. This especially held true in 2022 when it was one of our best performers, returning around 40% in a year when the market was down substantially. It just goes to show that there are nearly always opportunities even when the stock market is declining. Since then, Merck stock has generally stalled, and we do not see any great catalyst on the horizon even though their cancer drug Keytruda is proving to be a blockbuster and increasingly is finding new cancer applications. Feeling

lukewarm about Merck for the foreseeable future, we have sold many of our outstanding shares in order to take advantage of some better buying opportunities like Truist and Digital Realty.

On the other end of the spectrum, it looks like we were too early in our initial purchases of Leggett & Platt, and this is a holding that will require more patience than Merck. This is a case of a cheap stock getting cheaper. The company, which makes engineered components for furniture, among other products, has moved out of our top twenty list due mostly to poor performance. It is down slightly year to date while most of other stocks have gone up.

In addition, we have sold shares in order to make use of the tax loss in taxable accounts where gains had previously been realized though we may buy it back at an appropriate time. Leggett & Platt has an advantage over competitors because it is a dominant company in a fragmented industry. In cases where a smaller competitor begins to achieve a large market share Leggett has had the ability to acquire them. Additionally, Leggett benefits from an extensive patent portfolio covering its metallurgical and process technology in the manufacture of springs used in other products. This helps it maintain profitability even when the economy is in decline. Leggett is a cyclical company, but it is also a very high- quality company that has raised the dividend for each of the last 50 years, making it a “Dividend King”. While we wait for better times, we are currently comforted by a 6% dividend yield, a level we have not seen in the stock since the Great Recession in 2008-2009.

So what comes next and what do we do?

As usual, we tread lightly. Fundamentally we like all of the stocks above though as always, some are better priced today than others. Longer-term the group as a whole should serve us well. Our questions relate much more to the general economic outlook.

For some time, we have been talking about the probability of recession as we recover from the COVID lockdowns. So far recession hasn’t happened and the consensus view today seems to be that if we have one at all, it will be mild. The consensus for the stock market is also very positive.

While we find these views reasonable based on the totality of what we can see today, it is what we can’t see that generally creates problems. The recent contraction in the money supply may or may not prove significant but it is disturbing as it is nearly unprecedented. We have seen very little written about it though it could prove important. It could indicate a deeper recession than is now being predicted and all that goes with such an event.

Just as we believe that part of the run in the stock market over the past decade was fueled by too much money, an economic or stock market contraction can be caused by too little. Once economic contractions start, they can be difficult to stop and often last longer than one would think. Given all that is going on in the world today, geopolitically as well as economically, we may be in an entirely new ballgame.

Having noted the above, we do not plan to change our approach. It is long-term and strategic in nature and specifically tied to the long-term objectives of each of our clients. And we affirm this knowing it may become uncomfortable in shorter periods of time when we are out of phase with the overall stock market.

The best offset to short-term stock market or economic uncertainties is to emphasize high quality holdings operating stable businesses that are selling at realistic stock prices. Unhappy surprises are fewer with these kinds of companies. And while these stocks may not rise as fast as the "market" in the short run, they also tend to hold up better during declines, at least this is what our investment experience suggests.

Since the Great Depression we have been through 27 Bear markets that on average have lasted 286 days or something over nine months, just about what happened in 2022. But the 27 Bull markets that followed lasted over 1000 days or about 2 years and nine months. We respect past experiences and these numbers are why we emphasize the strategic rather than the short-term.

Given all of the above, it wouldn't surprise us if we see a substantive stock market decline in the next year, though we can never predict when it might start. But it would surprise us if it breached the lows reached only six months ago. In other words, by definition, we would still be in a bull market and our accounts will be managed on that assumption.

Sincerely,

Loudon Investment Management LLC

DML/ELS/JJS/LRO