October 13, 2025

Dear Clients and Friends:

Re: Q3 Investment Review

During the third quarter of this year the stock market again pushed its way to new all-time highs, once again led by technology-related stocks. The Technology Sector alone returned over 11% while, at the other end of the spectrum, the much more reasonably priced Consumer Staples Sector showed negative stock market results. The war for investment dollars between technology and everything else continues.

Benchmark Index Total Returns	Year to date Ending 9/30/2025	Quarter Ending 9/30/2025
Lipper Balanced Fund Index	10.98%	4.69%
S&P Dividend Aristocrats	5.46%	2.97%
S&P 500 Stock Index	14.83%	8.12%
Russell 1000 Value Index	11.65%	5.33%
3-month US Treas. Bill Index	3.25%	1.12%
S&P U.S. Aggregate Bond Index	5.96%	2.00%

Will history repeat itself?

"History Doesn't Repeat Itself, but it Often Rhymes."
-Mark Twain

In 1999 the S&P 500 rose over 20% despite the fact that over half of the stocks in the index fell for the year. Gains that year were driven by the final stretch of the Internet boom and Y2K preparations. As a result of the S&P 500 top holdings driving returns, the top ten companies in the index grew to constitute about 40% of the overall value. The top ten holdings at that time included (by size): Microsoft, General Electric, Cisco Systems, ExxonMobil, Intel, Lucent Technologies, IBM, America Online, and Citigroup. What happened next was dramatic to say the least. Five of the top ten companies eventually fell 80% or more from their highs and never fully recovered (of those, Lucent and AOL merged into other companies and eventually became almost irrelevant). Citgroup, Walmart, ExxonMobil, and perhaps surprisingly IBM, fared the best throughout the dot com bust, though all have lagged the S&P 500 returns over the last 25 years. Of the top ten companies from 1999, only one, Microsoft, eventually thrived after the initial Internet bust, and it remains a top ten holding in the S&P 500 and our portfolios today.

Why do we take the time to look back to what happened over 25 years ago? Because today the market finds itself in a similar situation in which the top ten companies of the S&P 500 index are driving market returns, by being up an average of about 22% for the first nine months of the year (NVIDIA and Broadcom are currently leading the way). Those top ten holdings now include: NVIDIA, Microsoft (our largest holding), Apple, Amazon, Meta Platforms, Broadcom, Alphabet (Google), Tesla, Berkshire Hathaway, and JPMorgan Chase. These top ten holdings have once again grown to make up over 40% of the total S&P 500 Index, and many of the remaining stocks in the index (about a third) have negative total returns year to date. This time around the story is generally all about Artificial Intelligence (AI) rather than the Internet, but much of the story rings similar. Currently many analysts believe that the runway for growth in AI is practically infinite while others believe AI is already in a bubble. To date the biggest advantage of AI is that it is helping companies across all industries become more efficient. These are real gains that should not be underestimated. That said, it remains to be determined whether many of these companies will ultimately prove to be worth the hype.

We believe that current valuations for the market may be stretched, at least for certain segments of the market such as AI. The average Price to Earnings Ratio (P/E) of the current top ten holdings in the S&P 500 stands at 59 which is an extremely high number historically. The overall PE for the Index is only about 23 times this year's expected earnings, which is also high historically. We aren't necessarily convinced AI is a bubble… yet. But there are many signs that continued high growth will be necessary to justify current valuations, and we do see several stocks that are priced for perfection. As a result, it wouldn't take much to knock many of these companies down a notch or two. And it may be only a matter of time before some kind of shock hits the economy, probably from somewhere we least expect. With technology driving growth as it did in the late '90's, only time will tell if we are due for a correction and whether it might look anything like the correction we saw in 2000.

One advantage we have today is that funding for unprofitable businesses is substantially limited when compared with the dotcom bubble. Many of the biggest and fastest growing AI companies are generating plenty of cash. This should help to protect stock prices in the event the market turns.

While we do hold a few of the companies mentioned above as they are generally terrific businesses, overall we are substantially underweight these top ten holdings relative to the market indexes. With so much of the focus on AI many other sectors of the market have been greatly ignored over the past year.

This is where we tend to focus our energy as we look for what is likely to be successful over the next several years. Certain industries including healthcare, real estate, financials, consumer stocks and energy have all lagged the market over the past year, and these are the areas where we are more likely to find some great bargains, especially as interest rates begin to come down. For example, T-Mobile and NextEra Energy are two stocks that are cheap by all of our standard measures, and we believe that they have bright futures as we look ahead (more on those two stocks in our top holdings section). For this reason, we don't hit the panic button when it looks like valuations for "the market" may be stretched.

Government shutdown and tariffs make for a busy start to the fourth quarter

As we started to write this letter, the Federal Government shut down for the first time since 2019 as Republicans and Democrats continue to blame each other for the general disfunction in Washington. Democrats demand that Congress revisit Obamacare subsidies and Medicaid cuts from the recent Trump spending bill, while at least some Republicans indicate they will be happy to negotiate, but only *after* Democrats sign a continuing resolution to keep the government going a few more months. Sigh.

Hopefully the two sides will have come to a resolution before this letter goes out, though it would not surprise us if negotiations take a while. The last government shutdown lasted 35 days and was the longest on record. Markets have had almost no reaction to this most recent government freeze, and we aren't convinced the chaos works in anyone's favor politically. From a portfolio standpoint the government shutdown has had almost no impact on our investments. However, this could change if the shutdown is dragged out for a long period of time.

Meanwhile the tariff story remains generally messy. Recently implemented tariffs include 10% on lumber and timber, 25% on upholstered wooden furniture, and 100% on some branded pharmaceuticals. Potential tariffs on semiconductors remain uncertain, and there is a more recent threat of 100% tariffs on movies.

A recent study out of Yale indicated that the actual average effective tariff was likely a little over 10% over the summer vs. 2.4% at the beginning of the year. This is lower than many individual stated rates as companies figure out ways to avoid paying full fare. And continually moving announcements about what new tariffs may be implemented only add to the confusion about what this all means.

According to the US Treasury, the government has collected over $200 billion in tariff revenue for 2025 through September. At this rate the income collected from tariffs is a line item that could begin to make at least a small dent in the US's reliance on deficit spending, a potential bright spot in the tariff story. The piece of the puzzle that is less clear is who ultimately bears the costs. Will consumers, foreign nations, large companies, or a combination of all three of these ultimately pay for the tariffs through either higher prices or lower profits? So far there is little to indicate that consumers are bearing the burden, though this is more likely to change the longer the tariffs last.

It appears that the tariff story has only just started, and we believe that many are likely to stick around for the long term. Companies and countries willing to make a deal are likely to fare better, such as Pfizer's recent announcement of TrumpRx, a site where cash customers can buy its drugs for a substantial discount. Pfizer also pledged a $70 billion investment in US manufacturing, research and development. In return Pfizer was granted a three-year reprieve on the newly announced pharmaceutical tariffs, and the company's stock soared on the news. We believe we will see more deals like this in the fourth quarter. In the meantime, the impact of tariffs remains murky.

The most important question for the future is whether the large revenues being generated that help offset deficit spending will be worth the inflationary impact as the costs work their way through the system? The answer to this requires more time, but so far, the economic impact has been much less than was predicted by most economists.

Widely Held Stocks

Over the past quarter, as usual, there has been little turnover in the Top Twenty list.
This is largely due to our long-term investment perspective, for our largest holdings in particular. Our objective is not just to produce competitive returns but also to minimize capital gains taxes from an overly active trading orientation.

9/30/2025 Top Holdings

ABBV	AbbVie Inc	JPM	JPMorgan Chase & Co
ABT	Abbott Laboratories	LNC	Lincoln National Corp
AMT	American Tower Corp	LOW	Lowes Companies Inc
CAT	Caterpillar Inc	MSFT	Microsoft Corporation
CSCO	Cisco Systems Inc	NEE	NextEra Energy, Inc
DLR	Digital Realty Trust Inc	QCOM	Qualcomm Inc.
EPD	Enterprise Products Partners	TFC	Truist Financial Corp
FAST	Fastenal Company	TMUS	T-Mobile US, Inc
G	Genpact Limited	TSM	Taiwan Semiconductor
ITW	Illinois Tool Works Inc	XLK	SPDR Technology Sector ETF

But turnover is rarely zero. Last quarter continued buying of **T-Mobile** and **Next Era Energy** pushed them up the list and into the top twenty. At the same time, we have been selling **Ameriprise Financial**. AMP has been a highly successful stock and as a result it had become an oversized holding in many accounts. Its reduction was mostly to bring it back in line with a more typical sized holding.

Novo Nordisk also fell off the list because of a stock price cliff following an earnings report. We believe the problems are temporary so we have done no fundamental net selling, though some changes in holdings occurred short-term for tax reasons. You will recall that Novo along with Eli Lilly are the leaders in the new highly effective weight loss drugs.

T-Mobile is one of the big three (along with ATT and Verizon) in the mobile phone business. However, unlike the other two with their wireline business, it is much more a high quality “pure play” on mobile activity.

The company has firmly established itself as a major leader in the U.S. telecom industry by leveraging a unique combination of network superiority, aggressive value-based pricing, and a customer-centric brand identity. Its most significant competitive advantage stems from its 5G network leadership, largely due to the wireless spectrum assets gained from a merger with Sprint several years ago. T-Mobile now operates the largest and fastest 5G network in the country, often providing superior speeds in urban and suburban areas, which has been a powerful tool for customer acquisition and market share growth.

T-Mobile built its competitive position through its famous "Un-carrier" movement, which was fundamentally a strategy to disrupt traditional industry pain points and differentiate itself on customer value and experience. Key components of this strategy include the elimination of traditional long-term contracts and the introduction of transparent, simplified pricing. Furthermore, T-Mobile heavily relies on value-added benefits and "customer-centric perks," such as the inclusion of streaming services like Netflix and Apple TV+, free in-flight Wi-Fi, and free international data roaming in over 215 countries, which significantly contrast with the more traditional, domestic service-focused offerings of its competitors. These perks, bundled under programs like "Magenta Status," enhance customer loyalty and satisfaction.

Given all of this, it is surprising that it is not selling at a higher price. Past and expected future earnings growth are expected to be in the 15-20% range yet its valuation is well below other companies growing at similar rates, though it does sell at a substantial premium to ATT and Verizon. Cash generation is high so we see little need for outside financing unless they decide to make additional acquisitions.

NextEra Energy's competitive advantages come from a unique and highly successful dual-business strategy, combining the stability of a regulated electric utility with the growth potential of a leading clean energy developer. This structure provides the company with several significant and durable advantages over its peers.

The foundation of NextEra's strength is its dual-business model. This consists of:

1. Florida Power & Light (FPL): A rate-regulated electric utility that provides stable, predictable earnings by recovering costs and earning a regulated return on its infrastructure investments in Florida. Florida is generally considered a return friendly state. This reliable cash flow provides defensive stability to the overall enterprise. Also, due to periodically large weather events, their infrastructure is in good shape.

2. Their other subsidiary is NextEra Energy Resources (NEER): The world's largest generator of renewable energy from wind and sun, and a world leader in battery storage. NEER operates under long-term contracts, offering significant growth and scalability across North America, aligning the company with the secular trend of clean energy transition.

The record of growth in both earnings and cash flow has been very good and, although they may slow somewhat in the future, are still expected to remain well above average providing the underlying fundamentals for future returns in excess of 10% annually. But the stock is also historically undervalued so there could be a further boost from an upward push on valuation. This is a relatively low risk, high quality business combination making the returns even more attractive than the numbers alone would suggest. We would expect the stock to prove especially attractive in the event of a market correction.

Summary

There is always something changing in the factors influencing the valuation of common stocks. The boom in AI is now well into year four or five but that doesn't mean it is over. On one side, the current situation appears to be much more supported by underlying fundamentals when compared to the dotcom boom in 1999. Having said that, however, a substantive correction can occur at any time, even within the context of an ongoing bull market. In fact, this happened in 2022 when a number of Tech stocks, as well as the S&P 500 Index produced negative returns.

Typically, the pressure on investment advisors to change their approach when performance lags the market is greatest at market tops just as the bubble pops and long held more moderately priced good companies come back into favor. Thanks to all of you, we have not faced such pressures to change our stripes. Hopefully, communications like this have helped all of us stay the course even when it requires more patience than is typical.

It is important to remember that there have been long periods of time in the past when our approach has outperformed the market and technology in particular. This has been especially true at the bottom of a declining stock market when all of us feel uncomfortable.

Our remedy for this has always been to structure portfolios toward companies such as NextEra or T-Mobile that should do well over time, regardless of the aggregate market returns. We think that today is a very good time to stick to our underlying philosophy and wait for the market to come back to us.

Sincerely,

Loudon Investment Management LLC

ELS/DML/JJS/LRO