LOUDON
INVESTMENT MANAGEMENT

July 15,2026

Dear Clients and Friends:

The S&P 500 Stock Index in the second quarter came roaring back, producing a return of nearly 15% and once again led by tech, artificial intelligence (AI) in particular. Meanwhile other equity indexes, without the same technology weighting, were left behind. You may also note below that the bond market has pretty much stood still since the beginning of the year – this is often a good back drop for equity gains.

Benchmark Index Total Returns	YTD Ending 6/30/2026	Quarter Ending 6/30/2026
Lipper Balanced Fund Index	6.36%	7.64%
S&P Dividend Aristocrats	9.31%	6.72%
S&P 500 Stock Index	10.21%	15.20%
Russell 1000 Value Index	16.26%	13.87%
3-month US Treas. Bill Index	1.77%	0.90%
S&P U.S. Aggregate Bond Index	0.85%	0.80%

More of the Same?

During the first quarter, there was some evidence that the market was broadening out in terms of the different sectors that were participating in the advance. Nearly everything except the high-tech sector did reasonably well. This reversed over the past three months as technology and AI stocks once again pushed the S&P 500 well ahead of the other major indexes. The technology sector rose over fifty percent from late March to early June and now makes up 38% of the entire stock market, weighted by market value. The popularity of these stocks not only pushed them higher but also held back many other sectors, as the money to buy tech often came from the sales of stocks in other sectors.

We also had the sense that stocks with poor performance were almost indiscriminately sold to make mid-year portfolio reports look better, a practice that we believe ultimately leads to a performance penalty.

Despite this rush back to previous winners, when stock prices rise faster than the underlying earnings of the companies going up, unreasonably high valuations or earnings disappointments eventually put a cap on further increases. This may be the case for a number these of stocks today.

Recently purchased NVIDIA, discussed further in the next section, is the opposite. Over much of last year the stock price did not go up while earnings growth never much slowed down. The same happened with Microsoft, our largest single holding. In fact, we added a few shares in Microsoft where we thought the portfolio participation was not large enough. In our opinion Microsoft is currently one of the best tech stocks when risk as well as potential return are taken into account.

Also interesting over the past quarter is what didn't seem to faze the market, including the war in Iran and the attendant rise in energy prices due to the blockade of the Strait of Hormuz. While consumer attitudes began to sour with rising energy prices, the economy and the stock market continued to move higher. It is this disconnect that often leads people to believe that the stock market is crazy.

Ultimately it is earnings that move stock prices, and recent earnings for most companies involved with increasingly sophisticated technology have been nothing short of spectacular. Going back to NVIDIA, the stock price had been flat from July '25 through the end of March when we began to take a closer look. At the same time, this year's earnings and cash flow are expected to nearly double this year and rise another 30 to 50% in 2027. With this kind of growth, it doesn't take long for high earnings valuations to decline rapidly from very high to average. This has happened with enough stocks to drive the S&P Index to record levels with disturbing regularity. Just because the stock prices have gone up a lot doesn't automatically mean they must go down if earnings keep pace.

Top Holdings

While it feels like we were fairly active in trading this quarter, there was just one change in our top twenty holdings. Our first ever widespread purchases in NVIDIA took shape, and as a result NVIDIA replaced Digital Realty Trust on our top holdings list.

06/30/2026 Top Holdings

ABBV	AbbVie, Inc.	MSFT	Microsoft Corp.
CAT	Caterpillar, Inc.	NEE	NextEra Energy, Inc.
CSCO	Cisco Systems, Inc.	NVDA	NVIDIA Corp.
EPD	Enterprise Products Partners LP	O	Realty Income Corp.
FAST	Fastenal Co.	QCOM	QUALCOMM, Inc.
G	Genpact Ltd.	TFC	Truist Financial Corp.
ITW	Illinois Tool Works Inc.	TMUS	T-Mobile US, Inc.
JPM	JPMorgan Chase & Co.	TSM	Taiwan Semiconductor Manufacturing Co
LNC	Lincoln National Corp.	USB	U.S. Bancorp
LOW	Lowe's Companies, Inc.	XLK	State Street Technology Select Sector ETF

Long-term holding Digital Realty, first purchased in 2013, is a real estate investment trust (REIT) that develops and manages over 300 data centers all over the world. Data centers have made front page news quite a bit over the last year or two, mainly due to their consumption of power as well as the vast amounts of water needed to help keep the equipment cool, which has resulted in a lot of local resistance against building new facilities. Despite the challenges, the demand for technology-related properties does not appear to be slowing down, at least not yet. Meanwhile Digital Realty has built, owned, and managed many data centers over the last few decades and has always been a best-in-class company.

The outlook for Digital Realty is generally bright, as we expect revenues and cash flow to grow in the high single digits over the next several years. The balance sheet is solid with relatively low debt for a real estate investment. The 2.8% dividend yield is low for a REIT, but substantially higher than the stock market. Our main concern is that the dividend has not been raised since 2023, something we generally don't like to see. In a larger context this is understandable, as there have been tremendous investment opportunities in recent years that are likely to be a very good use of the company's excess cash. Nevertheless, we would prefer to see the company returning more cash to shareholders over time.

There is not much else to report on Digital Realty, as we did not actively buy or sell shares over the quarter, and it only moves off the list due to active purchases of NVIDIA. The stock has been a solid performer both short and long-term – year to date it is up a bit more than the S&P though all of the gain came in the first quarter of the year, with the second quarter coming in flat. The stock appears about fairly valued right now, so we are keeping an eye on it, though unless we have other concerns we usually hold stocks until they become "grossly overvalued" by our own metrics. Digital Realty is not there yet.

More exciting than Digital Realty is our purchase in NVIDIA, a company that is nearly always front page center in the investment community these days. NVIDIA designs and sells computer graphics processors, chipsets, and related software, with about 90% of its revenues coming from data centers. It is truly a best-in-class company. The stock is up over 850% over the last five years which has catapulted it to becoming the largest company in the world by stock market value, the first publicly traded company to surpass a $5 trillion valuation though its current valuation is lower. Despite it being unusual for us to purchase such a high growth company, as we took a closer look at the fundamentals, we liked what we saw.

Operationally, NVIDIA's growth in recent years has been stellar. For the first quarter, revenues were up 20% over the previous three months, and earnings were up over 130% year-over-year. Given the sheer size of NVIDIA, one would think that the rate of growth must surely slow down (and eventually we are sure that it will). But that time does not appear to be coming soon, as the CEO recently reported that growth is increasing at an accelerated pace. The opportunity is massive, with NVIDIA predicting $3 trillion to $4 trillion in annual AI spending by 2030.

With relatively low capital spending for a firm of its size and minimal debt, NVIDIA is basically a cash flow machine, and so we began to look at where all that cash was going. The company recently increased its quarterly dividend from $.01 to $.25 per share which is what initially caught our eye. The current yield of around .5% is well below our typical investment and lower than the overall market, but there is plenty of runway for growth and we hope to see the dividend continue to go up from current levels. NVIDIA has also been making substantial investments in other AI-related companies, and it added an $80 billion stock-buyback program. We generally prefer cash in hand (dividends) over stock buybacks, but this is a case where some level of stock buybacks makes sense, as it should help to stabilize the stock price over time, as the price can be more volatile from day to day as compared with our typical holding.

NVIDIA stock has fallen over 15% since its mid-May high of $236. The current price sits around $205, and the one year return is only slightly ahead of the S&P 500. The stock currently trades at around 23 times forward earnings which we believe is cheap when you consider it is a company where we can reasonably pencil in growth of 20% or more over the next several years without too much difficulty. If this growth should materialize then we have no doubt that the stock will eventually prove to be a bargain at current prices, although of course there are no guarantees.

As with any company, NVIDIA stock is not without risk. Most recently investors are worried about geopolitics in the AI space, particularly opportunities in China which may be limited by the Chinese government. It is this specific concern that has put recent pressure on the stock. Additionally, NVIDIA's largest customers are big tech (Microsoft, Amazon, Alphabet, Meta and Oracle to name a few). It is estimated that roughly 85% of NVIDIA's total data center revenue comes from just six major customers. This makes it susceptible to a slowdown in capital spending by any one of those firms. And if we were to see a broader economic slowdown, we expect that all of its major customers would likely be impacted.

Like the dawn of the Internet, there is no question that AI is changing and will continue to change how businesses operate across the world. The ultimate success of AI will depend on whether its use translates into higher sales and efficiencies for the companies that are using it. Only time will tell whether AI is worth all the hype. Unlike the Internet boom and subsequent bust of the late 1990's and early 2000's which were fueled by companies burning through cash, NVIDIA is a firm that has reinvented the wheel regarding AI while generating substantial revenues and cash flows every step of the way. Its largest customers are also extremely profitable. There is always a chance, or perhaps an inevitability, that the demand will start to dry up sooner or later. The semiconductor industry is notoriously cyclical over time. Although we don't see any signs of a slowdown right now, there is always a chance that could change quickly, particularly in the event of macroeconomic headwinds or a major recession.

But on the whole, we believe the market is underpricing the growth opportunities still available for NVIDIA. Trading at a close to the market multiple makes the stock "grossly undervalued" by our metrics given well above growth potential in both earnings and dividends. Put another way, even if NVDIA were to slightly underperform all expectations, we believe that the value is quite reasonable at current prices.

An Economic Conundrum

We recently came across an article in Reuters that pointed out that the US economy has not had a "real" recession since mid-2009, an incredible 17-year run. Technically the pandemic recession of 2020 was real. But it was caused by a deliberate shutdown to contain Covid-19 rather than a cyclical downturn, and it was heavily offset by government support which led to a V-shaped slump and recovery. In economic terms, Covid was barely a blip on the radar as we look back at the stock market today. That is an incredible run. Even better, the US economy continues to prosper. First quarter earnings for the S&P 500 were up more than 20% over the previous year on revenue gains of more than 10%, and growth is expected to accelerate through the rest of 2026. Nearly 80% of S&P 500 companies exceeded expectations on both earnings and revenues. Even better, recent gains in the stock market have been more spread out and less dominated by the top ten holdings, which feels to us like a good thing and a healthy return to normal, especially as smaller companies historically tend to have a greater capacity to grow quickly.

And yet as the US economy by all measures continues to chug along, many people, especially young families and recent college grads, feel like they have been left behind. Rents are high (at least in the

areas where young workers presumably prefer to live), starter homes seem out of reach, and the job market is increasingly difficult to navigate. Many are concerned that Gen Y and Gen Z may be the first generations to be worse off than their parents, and there is some evidence for this. About 90% of children born in the 1940's earned more than their parents. For those born in the 1980's the number is closer to 50%. Meanwhile the median age of a first-time home buyer has climbed from 31 in 1981 to over 40 years old today. We don't have any great insight into the disconnect between our typical measures of economic growth that tend to benefit most, and the feeling that this recent prosperity is leaving many young adults behind, but it is something we plan to pay attention to in the coming months and years. Our hope is that time will help to soothe out many of these discrepancies as interest rates continue to come down and baby boomers continue to retire.

Conclusion

Looking ahead and with all humility (recognizing that economic forecasts tend to be wrong at least as often as they are right), we see fairly bright days through the end of the year. We expect that stock prices will continue to react very strongly to earnings announcements, both positively and negatively. Stocks as a whole are already pricing in a higher rate of growth, so even small shortfalls could be swiftly punished by investors even if the news is seemingly "good". It would not surprise us if the market in general does not do much in the second half of the year, as much of the good news seems like it is already priced in. Meanwhile, we generally don't mind a bit of turbulence in the market as it often leads to buying opportunities.

Sincerely,

Loudon Investment Management, LLC

ELS, JSS, DML, LRO