LOUDON
INVESTMENT MANAGEMENT

October 14, 2026

Dear Clients and Friends:

In general, equity performance moderated over the last quarter versus Q2. The first two months of the quarter favored our dividend-oriented portfolios but over the past month the low or no yield technology stocks once again took charge, largely in reaction to increased interest rates announced in mid-September. The total return of the Dividend Aristocrats compared with the S&P 500 (shown below) illustrates the penalty for having limited technology exposure even within a group of otherwise high-quality dividend growers. As has usually been the case, our equity returns were better than most of the dividend rich indexes.

Benchmark Index Total Returns	YTD Ending 9/30/2026	Quarter Ending 9/30/2026
Lipper Balanced Fund Index	5.26%	-1.03%
S&P Dividend Aristocrats	5.86%	-3.16%
S&P 500 Stock Index	12.75%	2.30%
Russell 1000 Value Index	19.27%	2.59%
3-month US Treas. Bill Index	2.72%	0.91%
S&P U.S. Aggregate Bond Index	-2.31%	-3.13%

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair."

- ***Charles Dickens A Tale of two Cities***

The Best of Times: The average S&P 500 stock returned about 9.8% so far this year while the S&P 500 Index which is weighted by market cap returned almost 3% more. Looking back over five years, the spread is even more dramatic, with the equal weight index returning around 50% versus 90% for the cap weighted index. In both cases equities have done well, but this discrepancy does show how the largest companies in the S&P 500 continue to dominate with higher returns.

The Worst of Times: Bonds on the other hand have not done well this year. The Treasury sector did especially poorly with the yield on many maturities as well as mortgage rates recently rising to levels not seen in twenty years or more. Bond prices fall as interest rates increase, and this impact is greater the longer the maturity. On the bright side we can now find a one-year treasury with a yield to maturity (expected return from interest and price appreciation) of 4.6%, which is a lot more reasonable than the close to zero percent rates that dominated for a long time. However, it does also mean that the equity tailwind of falling rates is now clearly behind us.

Usually increasing interest rates lead to a decline in common stocks. But this time around earnings in tech stocks have been so strong that they have overcome the drag of rising rates. And as tech now represents almost 40% of the S&P 500, that index is no longer nearly as diversified nor representative of the average company as it has been in the past. There are currently twelve US stocks with total market values of over $1 trillion each, but only two (Eli Lilly and Berkshire Hathaway) are not intimately involved in technology. It wasn't too long ago there were no stocks this large. It has clearly been the very best of times for advanced technology and artificial intelligence.

But bonds are a different story. As a result of ongoing and seemingly intractable Federal deficits, gross U.S. debt now exceeds $40 trillion and grew $2 trillion over the past fiscal year alone. Although the various well publicized (and much moaned about) cuts in spending because of DOGE appear large, they barely make a dent in the continuing requirements from Medicare and Social Security. It is projected that in just six years under current law, Social Security payouts will need to be cut 22% if nothing is done.

Although the amount of Federal debt outstanding has been jawboned forever, it is only in the past several decades or so that our national debt has really become a major problem. In 2001 Federal debt was less than 32% of gross domestic product (the value of all the goods and services produced in the U.S.). Today it is over 100%. Interest on the debt is now larger than the funds spent on any other category other than Social Security and Medicare. It is estimated that in the last fiscal year the Federal government spent about $7.4 trillion while bringing in only $5.4 trillion even with strong economic growth improving inflows.

Despite this the stock market continues to move higher, and the U.S. dollar is still considered the benchmark currency for the world. This is presumably due to our continuing growth, entrepreneurial spirit and leadership in many areas of technology. Can this last forever? Given the fickleness of Congress, continued growth in the economy and some restraint in spending are the only apparent solutions. Raising tax rates could also help in theory, but politicians tend to forget that increasing taxes both slows growth and will influence behavior as rational individuals will try to avoid paying more. Only time will tell if the politicians are willing to step up to the plate as this cannot continue indefinitely. For the time being it is difficult to foresee what kind of problems may arise if the credit rating of the U.S. should again falter as it has already been reduced one notch from AAA.

As you all know, we focus on high-quality dividend paying stocks with good prospects for future growth and reasonable valuations. Our objective is to participate in rising markets but avoid the major declines when stocks go down. We have no plans to change this objective regardless of the fact that over the past four years of the bull market we have lagged the S&P 500. As noted above, we have done a much better job of providing returns above dividend-oriented benchmarks. And despite the length of the market rise, it is worth remembering that over the past fifty years, whenever a bull market has gone up

for four years in a row, it has continued to rise in the fifth. We do not expect the next year to be an exception.

Top Twenty Holdings

During the third quarter we were not particularly active in trading. As a result, our top twenty holdings are unchanged from the most recent quarter.

09/30/2026 Top Holdings

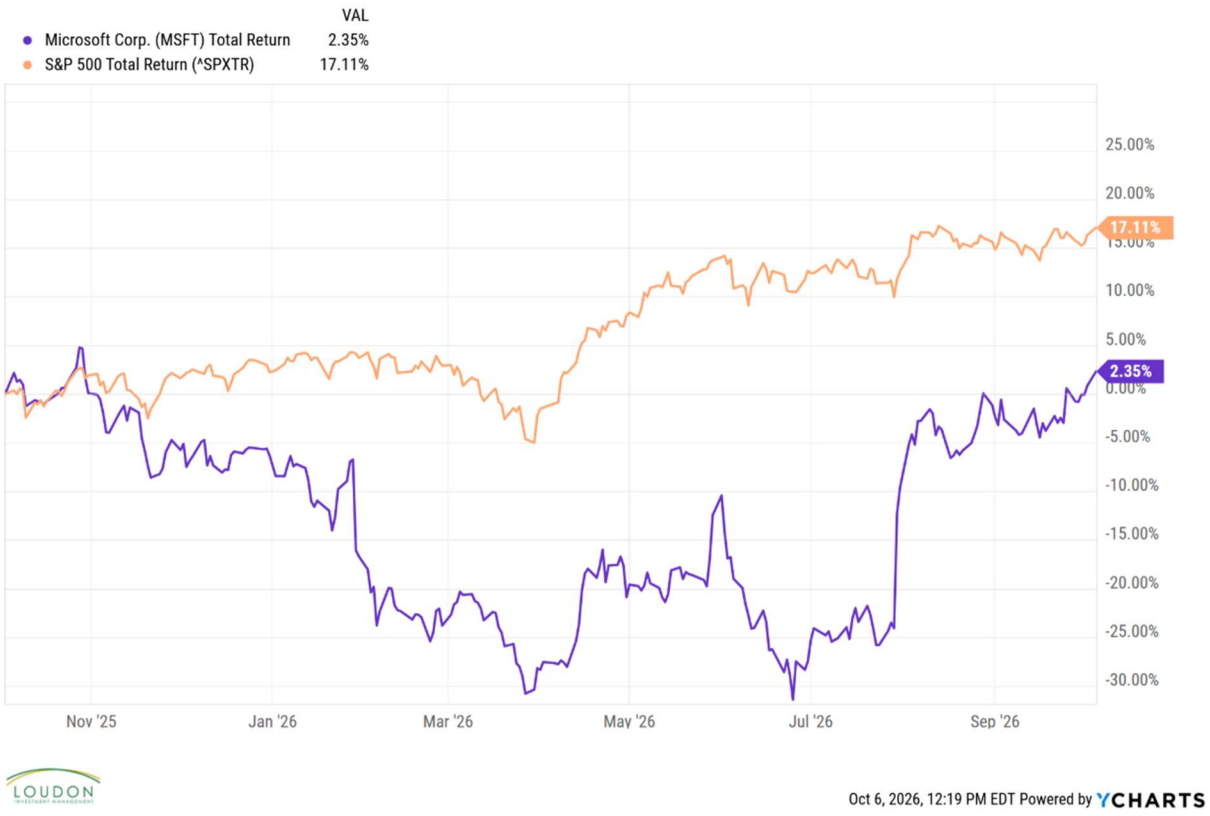
ABBV	AbbVie, Inc.	MSFT	Microsoft Corp.
CAT	Caterpillar, Inc.	NEE	NextEra Energy, Inc.
CSCO	Cisco Systems, Inc.	NVDA	NVIDIA Corp.
EPD	Enterprise Products Partners LP	O	Realty Income Corp.
FAST	Fastenal Co.	QCOM	QUALCOMM, Inc.
G	Genpact Ltd.	TFC	Truist Financial Corp.
ITW	Illinois Tool Works Inc.	TMUS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

One company that has had a particularly interesting year is our largest holding, Microsoft, which we initially purchased in early 2013. At that time the company was focused on technology for Windows, PC's and Servers, with the bulk of its revenues from Windows and Desktop Office licenses. We purchased the stock soon after a decline in price caused the dividend yield to first hit 2%. This brought it into our range for consideration at the time. Back then we did not know exactly what the future would hold for Microsoft, but we did believe that we were buying a best-in-class company with solid growth prospects at a historically reasonable price. Founder and company Chairman Bill Gates had already proven himself a titan in the tech industry, and we believed that Microsoft was likely to eventually come out on top despite fears at the time that its long run of growth might be substantially slowing down.

As the best companies do, over the last decade Microsoft has reinvented itself. The company's cloud business (primarily Azure) now makes up the bulk of revenues. And in today's fast-paced world Microsoft is undergoing yet another transition as it is still in the early stages of implementing Artificial Intelligence (AI) through its Microsoft 365 CoPilot (a new line of PCs) as well as substantial investments in OpenAI.

Over the last decade Microsoft's performance has dwarfed the market, with the stock providing a total return of over 925% compared with the S&P 500 return over the same period of around 325%. Yet despite its incredible success, the price of Microsoft has been quite volatile recently, and the stock price has lagged the market over the last year. From late 2025 through the first half of 2026 investors grew weary that Microsoft (and other tech companies) were overspending on AI and that it might take too long for these investments to ultimately pay off. Then in late July Microsoft earnings easily beat analyst

expectations proving that, at least for the time being, the fears were unwarranted. The subsequent movement in the stock price can be seen on the chart below:



As you should know by now, we are not short-term traders. We tend to agree with Warren Buffett that the best stock is one you can buy and hold forever, and most of our stock analysis is oriented toward this end. If we can buy high-quality companies with historic and future fundamental returns (income growth plus dividend yield) of 10% or higher, price returns to investors generally tend to take care of themselves. And if we can buy them when they are at low prices rather than high, future returns will eventually be even better.

For this reason, we try not to worry too much about the day to day or month to month ups and downs for any one stock. Even for a company like Microsoft the swings in the price can be fast and furious in either direction. Eventually the fundamentals may change for Microsoft, but for now the future continues to look bright. It is directly because of its long-term success that Microsoft has grown to be our largest holding.

The Anatomy of a Sale

Since its initial purchase, our only major sales of Microsoft have been for the purpose of trimming back the position when it has grown too large in accounts. We start to pay more attention when stocks grow to over 5% of a portfolio, as that is generally a sign that the stock has performed well relative to other holdings. At this point we often let a stock continue to run so long as the fundamentals still look good. When a stock is between 5%-10% of a portfolio we consider trimming it back depending on the

circumstances, and on the very rare occasion when a stock grows to over 10% of a portfolio we automatically trim the holding regardless of our feelings about the company or future performance.

Microsoft is not the only company to which these rules apply. It is not by chance that all of our largest holdings have been our best performers over the long term. AbbVie, Taiwan Semiconductor, Cisco and Caterpillar are all long-term success stories that we have needed to trim back from time to time.

Yet any sales of these companies also come with a significant tax bite when held in a taxable account. Long-term capital gains are typically 15%-20% for taxable accounts (depending on the stockholder's income), and many states also take a piece of the profits as well. We consider it a good problem to have when a holding has been such a success that it has grown too large in accounts, or when we decide we want to lock in some of the gains after a stock has had a strong run. But selling even a portion of the holding in any of the companies mentioned above can potentially lead to a high tax bill.

As a result, the math gets a little more complicated than simply swapping shares of one company into shares of another company that we believe will perform better. For a trade to be worthwhile we also need to clear the tax hurdle, meaning the swap only makes sense if the company purchased outperforms the original stock by more than the taxes that will be due. And making that back only gets us back to even. For a company like Microsoft with an extremely low-cost basis, that tax hurdle is a lot higher than it would be for stocks we haven't owned for nearly as long.

Nevertheless, we do have some tools at our disposal that can help to minimize the tax bite when selling our winners. One benefit of our long-term orientation is that stocks held for over a year are taxed at a lower rate than short-term holdings. Additionally, we do have some control in how and when we realize gains. We may choose to sell at an off-peak time, particularly if whatever we want to purchase with the proceeds is down more than what we are selling. It may seem counter-intuitive to choose to sell when a stock is off its peak price, but lower gains mean lower taxes if what we are buying is also down in price. Alternatively, we may choose to spread out the taxable gains over two years or sell a stock that is at a loss to partially offset the gains. Lastly, for those clients who hold both a taxable account as well as tax deferred accounts like IRA's, we typically sell the stock out of the IRA first to avoid the immediate tax impact.

Putting it all together we find that deciding when to sell a stock and determining how much to sell can be even more complicated than deciding what and how much to buy. When it comes to the tax piece of the equation, our main goal is to avoid any big surprises at the end of the year and to minimize the taxes as best as we can for clients. Taxes are unavoidable, but you should expect to hear from us in a year when the tax hit may be above normal, and we can always provide an update at any time during the year.

What Comes Next?

As we have said in the past, a stock market that has been going up for some time doesn't necessarily have to fall. Artificial Intelligence and all that implies represent a new era and will continue to develop and grow in its application, some good and some bad, regardless of how nervous it may make us. It should continue to drive the economy forward for years.

Future positive returns from stocks all depend on continued growth in the economy and earnings, which current developments suggest are continuing. Though the economy and the world have issues, this is almost always the case. Economic growth has been and continues to be strong. With the recent

change in the Chair of the Federal Reserve Bank, for whom inflation is a priority, we can hopefully get price increases under control. If that happens, we could have more clear sailing ahead.

Sincerely,

Loudon Investment Management LLC

ELS,DML,JJS,LRO