



Newsletter

SMEAD US VALUE — 2ND QUARTER 2026 (6/30/2026)

Diversification Circa 2026

Most of the studies we've seen argue that 90% of the benefit of diversification comes by the 20th common stock. In our discipline, based on our eight criteria for common stock selection, we own 25-30 names. Halfway through this year, you can see the benefit of our diverse group of common stocks and also see that our eight criteria for stock selection began to shine like our long-term record indicates it has in the past.

First, a quick review of our eight criteria for stock selection as seen below:

Required over entire holding period

- Meets an economic need
- Strong competitive advantage (wide moats or barriers to entry)
- Long history of profitability and strong operating metrics
- Generates high levels of free cash flow
- Available at a low price in relation to intrinsic value

Favored, but not required

- Management's history of shareholder friendliness
- Strong balance sheet
- Strong insider ownership (Preferably with recent purchases)

We attempt to find meritorious companies that are purchased when they are out of favor. We then let them succeed for long holding periods because the multi-year winners tend to create the most alpha over the long term.

Second, we stay inside our circle of competency. Charlie Munger said, "Envy is a really stupid sin because it's the only one you could never possibly have any fun at!" We have virtually no competitive advantage in predicting technology trends. We have purchased and owned tech companies in the past when they fell deeply out of favor and they fit our eight criteria. However, it had nothing to do with predicting anything similar to what venture capitalists try to figure out.

Third, we show a lot of courage over time by having what is called high active share at 96%. What this means to our shareholders who are outside of the investment industry is that our portfolio only overlaps with the S&P 500 Index by 4%. Therefore, there will be times when the

index is doing well relative to us, and there will be times when we're doing much better than the index. Thankfully, having high active share has worked in our favor over the last 15 years.

Fourth, the passive S&P 500 Index no longer offers diversification. Recently, 45% of the index was in technology/AI stocks. Jack Bogle, the Father of Indexing at Vanguard, is probably rolling over in his grave. The low cost is still there, but much of the diversification has been eliminated by the massive technology stock bull market.

Fifth, we lean toward repeat customer businesses. In the early years of the fund, we bought broken growth stocks like Starbucks, Disney and eBay in 2009. We liked their addicted customer bases. In 2020, we saw commodity prices at 220-year lows relative to stock prices. We bought oil stocks because they have the same repeat customer factor working in their favor. We remain heavily invested in these oil stocks because they offer great value relative to the stock market and are hugely underrepresented in the passive S&P 500 Index with a 3.1% position.

Lastly, our portfolio has avoided the popular and expensive excitement while offering the same kind of relative/absolute value that built our track record. Oil prices are down to \$70 per barrel, but our companies can make marvelous profits with their shareholder-friendly use of massive free cash flows. Shoppers seem to like our mall REITs and wide variety of consumer discretionary stocks. The irony is that the COVID-19 shutdowns in 2020 gave us the chance to buy into these companies, and the rewards just keep coming.

We have no idea when the intense popularity of today's futuristic and extremely expensive stocks will end. However, we are working every day with the goal of future success while sticking to our discipline. We are very excited about the coming years and thank our investors for their faithful ownership.

Play The Long Game,

Bill Smead
Lead Portfolio Manager

Cole Smead, CFA
Co-Portfolio Manager



Invest With Us Today!

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The recent growth in the stock market has helped to produce short-term returns for some asset classes that are not typical and may not continue in the future. Margin of safety is the difference between the intrinsic value of a stock and its market price. The price-earnings ratio (P/E Ratio or P/E Multiple) measures a company's current share price relative to its per-share earnings. Alpha is a measure of performance on a risk-adjusted basis. Beta is a measure of the volatility of a security or a portfolio in comparison to the market. Growth investing is focused on the growth of an investor's capital. Leverage is using borrowed money to increase the potential return of an investment. Momentum is the rate of acceleration of a security's price or volume. The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. Profit margin is calculated by dividing net profits by net sales. Quality is assessed based on soft (e.g. management credibility) and hard criteria (e.g. balance sheet stability). Value is an investment tactic where stocks are selected which appear to trade for less than their intrinsic values. The dividend yield is the ratio of a company's annual dividend compared to its share price.

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