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Southeast Asset Advisors, LLC

Investment Management & Consulting

Thomasville – Atlanta – Tallahassee – Mobile – Charleston

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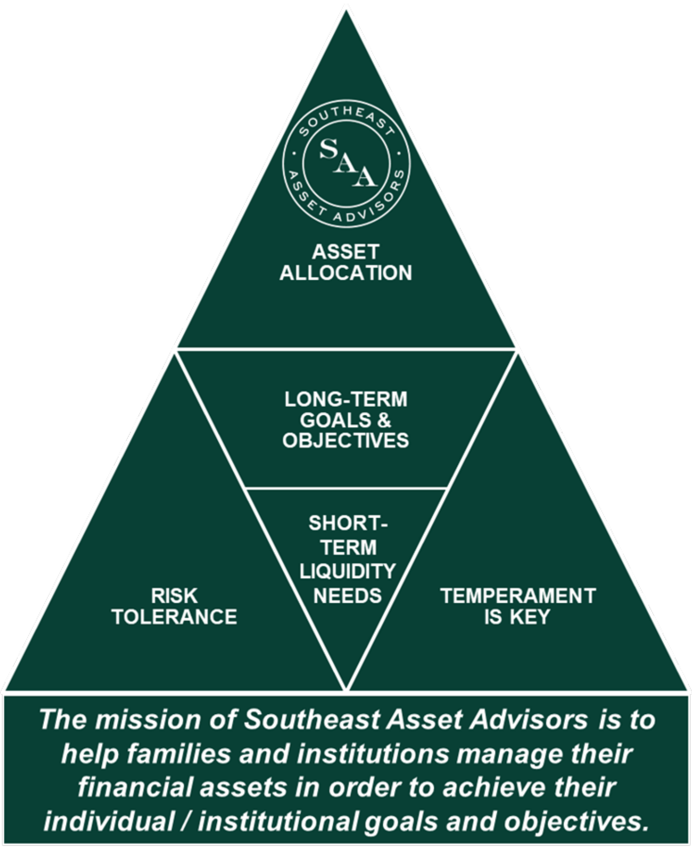
The Margin of Safety Quarterly [1]

July 2026



SOUTHEAST ASSET ADVISORS

WE STRIVE TO PROTECT AND GROW OUR CLIENTS' CAPITAL OVER THE LONG TERM BY:

1) Focusing on individual client goals and objectives.
2) Having the proper asset allocation to reflect each client's tolerance for volatility (i.e., temperament).
3) Stress testing short-term liquidity needs.
4) Investing with a value orientation and utilizing managers who understand the intrinsic value of a business and margin of safety along with passive strategies as appropriate.
5) Rebalancing portfolio holdings/managers when appropriate to take advantage of underpriced and to avoid overpriced assets based on the client's profile of asset allocation ranges.

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[1] <u>Margin of Safety (MOS)</u>: Many investing greats have said these are the most important three words in investing. We agree and call our quarterly letter accordingly. MOS is key in determining anything with variables occurring in the future, i.e., price to future value, all future outcomes, etc. Its magic is that the higher your MOS, the smaller your edge needs to be to have a favorable outcome.

TO: Clients and Friends
FROM: SAA Managing Directors
RE: 2nd Quarter 2026 Commentary
DATE: July 2026

Market Review

For the quarter ending June 30, 2026, financial markets, as valued by quoted market prices, generated strong returns across most asset classes supported by strong corporate earnings. We are in a continued boom period, as investor enthusiasm for generation AI and related companies for the quarter and year-to-date lead the way. For us many questions remain about returns on massive AI infrastructure spending, etc.

	June 30, 2026	
	QTR	YTD
S&P 500	~15.2%	~10.2%
S&P 500 Equal Weighted	~10.9%	~11.1%
S&P Mid Cap	~14.5%	~17.3%
S&P Small Cap	~19.7%	~23.9%
S&P Growth	~21.9%	~12.0%
S&P Value	~8.0%	~8.0%
MSCI EAFE	~11.1%	~9.8%
Bloomberg Agg Bond	~0.7%	~0.6%

The bond market, as measured by the Bloomberg Agg Bond Index, had small positive returns as the market adjusted to new Fed leadership and ongoing uncertainty surrounding inflation.

We continue to keep bond allocations in the short duration range and avoid long or even intermediate duration maturity.

Investor attention is increasingly focused on the evolving artificial intelligence landscape as it appears at least currently a disregard for the current Iran and US conflict and the possibility of a longer-term wider war.

The successful public debut of SpaceX (SPCX) and reported plans for future public offerings by OpenAI and Anthropic have the potential to attract substantial capital flows as it appears a momentum market and optimism rules the day. We also expect increased market volatility, as investors continue to evaluate returns of massive capex invested in AI infrastructure as well as the many geopolitical risks. Mr. Market is not sure of the effects AI will have on many businesses. Who will be the winners and who will be the losers? AI will destroy some businesses and will change most of them in ways that are difficult to predict. The market is also unsure of the return on invested capital (ROIC) of the spending. The pendulum swings in this environment where AI unknowns generate both euphoria and questions.

Q2 Index Return Drivers

While the strong returns generated by most major equity indices during the first half of 2026 may suggest a broad-based market advance, a closer examination of the underlying contributors tells a more nuanced story.

Across the S&P 500, S&P MidCap 400, S&P SmallCap 600, and MSCI EAFE indices, a significant portion of returns came from companies tied directly or indirectly to artificial intelligence infrastructure spending. Semiconductor manufacturers, semiconductor equipment providers, data-center operators, networking companies, optical component manufacturers, electrical infrastructure suppliers, and other businesses supporting the AI ecosystem were among the largest contributors to index performance.

In the S&P 500, many of the largest contributors included companies such as Micron, NVIDIA, AMD, Intel, Broadcom, Applied Materials, Lam Research, Alphabet, Arista Networks, Vertiv, Equinix, Corning, Cisco, and others tied to AI-related compute, storage, networking, software, and data-center infrastructure. Even though the Index contains 500 companies spanning many industries, a relatively small group of AI-related beneficiaries accounted for a meaningful share of total index performance.

A similar pattern emerged in the S&P MidCap 400 and S&P SmallCap 600 indices. Many of the strongest-performing constituents were companies supplying optical networking equipment, semiconductor manufacturing tools, electronic components, power management systems, testing equipment, and other technologies essential to expanding AI infrastructure. These results suggest that AI-related spending has influenced market returns well beyond the largest technology companies that typically receive the most investor attention.

The trend was also evident internationally. Within the MSCI EAFE Index, some of the largest contributors included ASML, Tokyo Electron, Infineon, Advantest, ASM International, BE Semiconductor Industries, Renesas Electronics, Siemens Energy, Schneider Electric, and other companies involved in semiconductor manufacturing, industrial automation, electrification, and power infrastructure. These companies occupy important positions in the global supply chain supporting AI development and deployment.

The picture becomes even more compelling when the analysis is expanded to include companies positioned to benefit from increased electricity demand, power generation, grid modernization, and energy infrastructure investment associated with data-center growth. Utilities, power equipment suppliers, industrial electrification companies, energy infrastructure operators, and select energy producers were also meaningful contributors to returns across several indices.

This does not imply that all strong-performing companies were AI-related, nor does it suggest that future returns will necessarily follow the same pattern. However, it does highlight an important observation for investors: headline index returns may overstate the degree of diversification in the drivers of market performance. While market leadership broadened during the second quarter, many of the largest contributors across multiple asset classes and market capitalizations ultimately traced back to a common theme—the substantial capital being invested in artificial intelligence infrastructure and the businesses that support it.

As value-oriented investors, we believe it is important to look beyond index-level returns and understand what is actually driving performance. Doing so helps explain why diversified portfolios may at times perform differently than a benchmark. This reminds us that strong index returns do not necessarily mean that all areas of the market are advancing equally.

The difficult question is how long today's environment can persist? Will AI chips remain near monopoly status a decade from now? Will historically cyclical industries such as memory, semiconductors, and computers continue to enjoy shortages and unusually high profit margins? Or will we eventually look back on today's profitability as a cyclical peak? Perhaps these businesses have permanently changed, much as when Apple rose above the boom-bust cycles of the consumer electronics industry. Or maybe this resembles oil shocks when crude reached $150 per barrel, and many argued that $200 would be the new norm.

We cannot answer some of these questions with any degree of certainty.

Sentiment Pendulum Swings in a Momentum Market

We believe this momentum market is highly influenced by traders. It appears to us few market participants consider valuation as a north star with an anchor of margin of safety. It seems all crystal balls are focused on the future of AI events, the war, midterm elections, and inflation/interest rates. The earnings are truly amazing in many companies. The numerous supply constraints across the AI ecosystem have delayed the already massive AI buildout, postponing answers to many of the industry's most important unknowns. We see a competitive race in AI compute between the US and China. China is rapidly catching up to the US in AI and does not have the limitation on data center permits, the power limitations, and the security restrictions that exist in the US.

Asset Allocation Thoughts

We remain committed to diversification while maintaining exposure to AI companies that we think have the earnings and leadership to navigate the uncertain path forward. The S&P is still concentrated at over ~40% to large cap AI and related stocks and over ~50% weighted if counting other suppliers and power provides to data centers. Market volatility is likely to increase as investors continue to contend with unusually wide uncertainty surrounding AI's long-term outcomes.

We hope that you enjoy the rest of your Summer. Please call us if your goals or objectives have changed or if you would like to meet with us.

Thank you for your confidence.

Your SAA Team

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*"In the short run, the market is a voting machine
but in the long run it is a weighing machine."*

- Ben Graham

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*"Thinking is to humans as swimming is to cats;
they can do it, but they'd prefer not to."*

- Daniel Kahneman

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"Semiconductors have always been cyclical and secular."

- Li Lu

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"If there's literally one thing, one trait that you want that's going to allow you to accumulate wealth, it's the lack of FOMO, particularly in modern markets that can get so crazy with social media and Reddit and Twitter and everything."

- Morgan Housel