

QUARTERLY LETTER

“Price stability is not an end in itself. But it is a precondition to sustained growth and prosperity.” – Paul Volcker, Federal Reserve Chair, 1979–1987

Nearly forty years after Paul Volcker left the Federal Reserve, his legacy as an inflation fighter endures. Early in his tenure, the Fed raised interest rates to restrain inflation and restore price stability. These actions took political courage and helped establish the foundation for a long period of economic growth and prosperity.

The Federal Reserve’s new Chair, Kevin Warsh, appears to share Volcker’s convictions. A recurring theme in Warsh’s public remarks has been a commitment to restoring and maintaining price stability. Like Volcker, he appears willing to accept tighter monetary policy when necessary to bring inflation back to the Fed’s objective.

In this letter, we examine recent inflation trends and three forces that complicate the Fed’s pursuit of price stability in the near term: energy prices, fiscal policy, and artificial intelligence (AI) infrastructure spending. We then consider what moderating inflation could mean for financial markets and the broader U.S. economy.

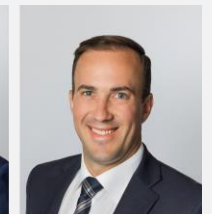
Recent Inflation Trends

The cumulative effect of inflation is easy to underestimate. Based on annual Consumer Price Index (CPI) data, a basket of goods that cost \$100 in 2016 would cost more than \$136 today. That increase reflects average annual inflation of approximately 3.1% over the period, compared with the Federal Reserve’s objective of 2%. The gap may appear modest in any given year, but over time compounding can meaningfully erode purchasing power.

As the chart on the following page illustrates, annual inflation has fallen considerably from its June 2022 peak of more than 9%. Yet the decline has stalled *above* the Fed’s objective, and recent readings show renewed upward pressure.

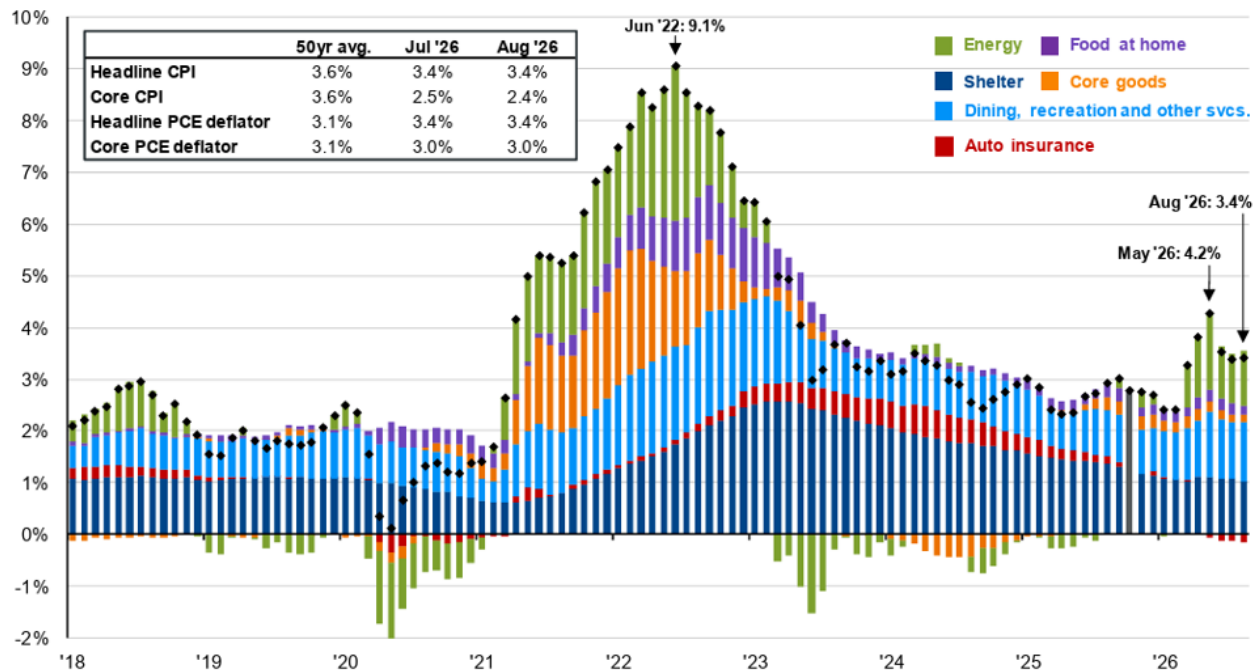
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Contributors to headline CPI inflation

Contribution to year-over-year % change in CPI, non-seasonally adjusted



Energy Prices

Since the start of the year, oil prices have increased by over 60% as investors have priced in a reduction in supply globally stemming from the Iran War. This has had a trickle-down effect across the global economy, with prices rising due to higher input costs. While the Iran War was initially believed to be a short conflict, a resolution is proving to be more complicated. Extended hostilities in Iran complicate matters for the Federal Reserve as inflation is likely to stay higher for longer under that scenario. Conversely, a durable peace agreement would provide welcome relief for the Federal Reserve and their goal of price stability.

Fiscal Policy

When looking back at the inflationary surge of 2021 and 2022, massive COVID-19 fiscal stimulus to the tune of \$4.6 trillion played a significant role. The cumulative fiscal response was equivalent to a substantial share of 2020 GDP and supported demand at a time when pandemic-related disruptions constrained the economy's productive capacity. This aggressive fiscal response contributed to the inflationary surge, particularly as consumer demand rebounded faster than supply chains could recover. Today, fiscal policy remains expansionary in the face of full employment and an economy that by most measures is performing admirably.

Looking ahead, government spending restraint would likely be welcomed by the bond market and could aid in lowering inflation expectations.

AI Infrastructure Spending

Spending on AI infrastructure is estimated at roughly \$600 billion to \$700 billion in the United States alone in 2026. Although AI's long-term productivity benefits may ultimately be disinflationary, the infrastructure buildout is creating inflationary pressure in the *near term*. An extraordinary amount of capital is competing for a finite supply of construction labor, engineering services, power equipment, semiconductors, and electricity. If AI infrastructure spending is approaching its peak rate of growth, however, these pressures could gradually subside in the years ahead.

Financial Markets and Price Stability

The forces currently influencing inflation are not entirely within the Federal Reserve's control. The Fed cannot end a war, determine fiscal policy, or build the power generation required by the AI economy. That said, Kevin Warsh's prioritization of price stability is an important component of continued U.S. economic vitality.

Sustained growth and economic prosperity are the aims of any healthy economy. Over time, moderate and predictable inflation encourages investment, supports economic planning, and creates a more favorable environment for financial markets.

Quarterly Performance Update

During the third quarter of 2026, the Alley Company Dividend Portfolio modestly outperformed the Russell 1000 Value Index.

For the year-to-date period through September 2026, the portfolio's underperformance relative to the Russell 1000 Value Index is considerably influenced by companies the portfolio does not own. For example, semiconductor, disk-drive, and other AI-related stocks have contributed an estimated 12.2 percentage points to the benchmark's return (the bulk of which occurred during the first half of the year, prior to Russell's reconstitution of its index). Many of these companies either do not pay a dividend, have a very low dividend, or do not meet our quality standards for inclusion in the portfolio.

Top and bottom performing sectors in the Russell 1000 Value Index during the quarter are displayed in the table below. (+) and (-) symbols indicate the Alley Company Dividend Portfolio being overweight or underweight the sector relative to the benchmark weighting. Our sector weightings are driven by our bottom-up fundamental research process, rather than any top-down sector rotation approach.

Top Performing Sectors	Bottom Performing Sectors
Energy (+)	Utilities (+)
Technology (-)	Industrials (+)
Communication Services (+)	Real Estate (+)

From an individual holdings perspective in the third quarter, top contributors to and detractors from performance were:

Top Contributors	Top Detractors
Phillips 66 (PSX)	The Home Depot (HD)
Microsoft (MSFT)	Cisco Systems Inc (CSCO)
Chevron (CVX)	WEC Energy Group (WEC)

Q3 2026 Review of Portfolio Changes

Trims: Capital One Financial (COF), Phillips 66 (PSX)

Adds: CME Group (CME), Microsoft (MSFT), RTX Corp. (RTX)

During the quarter, we sold our position in Carlisle Companies (CSL) and used the proceeds to increase the portfolio's position in Microsoft (MSFT). Although CSL's operating results have been satisfactory, its exposure to interest-rate-sensitive commercial and residential construction markets presents an ongoing headwind. Meanwhile, MSFT's fundamentals continue to be robust, and the decline in its share price and valuation created an attractive opportunity to add to our long-term position.

Dividend Announcements

Dividend announcements among Alley Company Dividend Portfolio holdings during the calendar year are below:

Q1 2026		Q2 2026	
Company	Dividend Change	Company	Dividend Change
Arthur J. Gallagher (AJG)	+8%	Apple (AAPL)	+4%
BlackRock (BLK)	+10%	Ameriprise (AMP)	+6%
CME Group Inc. (CME)	+20%	Alphabet (GOOGL)	+5%
Chevron (CVX)	+4%	Paychex (PAYX)	+10%
Cisco Systems (CSCO)	+2%	Procter & Gamble (PG)	+3%
Eaton (ETN)	+6%	Parker Hannifin (PH)	+11%
Home Depot (HD)	+1%	Home Depot (HD)	+1%
Hershey (HSY)	+6%	RTX Corporation (RTX)	+7%
NextEra Energy (NEE)	+10%		
Prologis (PLD)	+6%		
Phillips 66 (PSX)	+6%		
Verizon Communications (VZ)	+4%		

Q3 2026	
Company	Dividend Change
ASML Holding NV (ASML)	+18%
Duke Energy Corp (DUK)	+2%
Intuit (INTU)	+15%
JPMorgan Chase (JPM)	+10%
Morgan Stanley (MS)	+15%
Microsoft (MSFT)	+8%
Philip Morris International (PM)	+9%
Union Pacific Corp (UNP)	+3%
US Bancorp (USB)	+4%

Alley Company Dividend Portfolio

The investment philosophy of the Alley Company Dividend Portfolio focuses on striking the balance between attractive absolute dividend yield and strong dividend growth underpinned by solid company fundamentals of our portfolio holdings. We employ a bottom-up, research-driven process focused on fundamental analysis of our portfolio holdings.

ALLEY COMPANY

Alley Company is a boutique investment management firm that is dedicated to operating a discernible and disciplined investment philosophy and generating superior risk-adjusted investment returns. Alley Company was originally founded in 1998 and in 2006 established the Alley Company Dividend Portfolio to capitalize on investment opportunities in quality companies with strong dividend-paying cultures.



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