

Talbot Financial – Second Quarter 2023 Review

Please find attached your Talbot Financial second quarter 2023 portfolio review to supplement your monthly account statements available from Schwab. The report provides a performance summary of your investment portfolio compared to the S&P 500 Total Return Index (“Index”), Talbot Financial’s benchmark, and lists your investment portfolio holdings by industry sector.

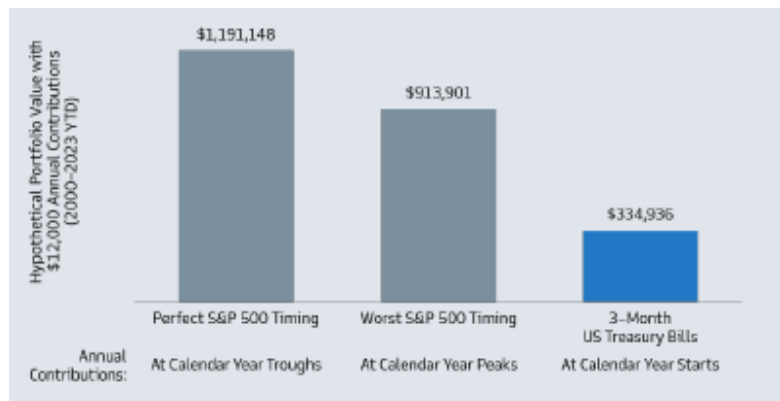
Investment Review

The stock market was resilient during the first half of 2023, with the Index rising 8.7% for the second quarter and 16.9% for the year-to-date period. The strength of the rebound from 2022 was driven by several factors, including continued U.S. economic growth, robust financial results from companies across several industries, broadly held views that interest rates are near a peak and inflation is subsiding, and the further realization that the era of Artificial Intelligence (AI) is just beginning. The top performing industry sectors for the quarter and first half of the year were Technology, Communications Services and Consumer Discretionary. Within each sector, there was strength from those companies leveraged to Generative AI.

Last quarter we reviewed Generative AI and how it is at the earliest stage of growth. Now we will take a closer look at how the companies you own in your investment portfolio will benefit from Generative AI. In summary, our perspective is that Generative AI has applications in three areas:

- The first is for consumer uses like enhanced search. Microsoft and Google are the two leaders in this space. Microsoft is leveraging ChatGPT and Google has developed their own technology (Bard). This area of AI is receiving most of the press coverage, but we also believe it will be the smallest contributory to the growth of the companies over the long run.
- The second area includes firms building out the infrastructure to scale AI. Your investment portfolio has material a weight in this area through the following companies:
 - Nvidia: provides the chips that empower AI.
 - Microsoft, Alphabet (Google), and Amazon: provide the platforms to deliver and utilize AI’s capabilities, as well as cloud storage.
 - Salesforce, Adobe and ServiceNow: distribute AI services to their clients through their respective platforms.
 - Applied Materials and Synopsis: provide the tools for semiconductor companies to design and build more advanced chips to power AI.
- The third area is Enterprise usage, or how corporations throughout the world use AI to increase productivity and enhance scalability. We believe this category will be the largest over time. However, it is also the hardest to quantify. That said, every company we invest in will eventually use Generative AI to streamline supply chains, improve delivery, manage costs and improve efficiency, leading to improved operating profits.

The sharp positive turnaround in the stock market this year is a reminder of how important it is to focus on the long-term and remain fully invested. One of our core investment strategies is to stay in the market, versus attempting to time the market. This is a relevant point today because the rise in interest rates over the last year has made “holding” cash appear as a good alternative to owning equities. A recent study by Goldman Sachs suggests otherwise. Below is a table showing the returns from investing \$12,000 per year since the year 2000 under three different scenarios.



- Scenario 1 assumes an investment of \$12,000 per year made with perfect timing, or at the low point for the market in each year. The total value in this scenario was \$1.9 million after the 23 ½ years.
- Scenario 2 assumes an investment of \$12,000 per year made with the worst timing, or at the highest point in the market each year. The total value of this scenario was \$0.9 million after the 23 ½ years.
- Scenario 3 assumes an investment of \$12,000 per year is held in cash. The total value of this scenario was \$0.3 million after the 23 ½ years.

The takeaway from the above analysis is investing in equities over the long-term resulted in returns about three-times better than cash, even when the timing of making the investments was poor. Importantly, having sufficient cash set aside for near-term spending needs is prudent and essential.

We welcome the opportunity to review your portfolio in person, by phone or on a Zoom conference. Please feel free to contact us for a review, or to answer any questions you may have about your portfolio.

Sincerely,

Talbot Financial, LLC

www.talbotfinancial.com