

## Talbot Financial – Third Quarter 2023 Review

In this time of vile terrorist attacks in Israel, our hearts go out to all those tragically affected by the ongoing violence. We hope for a swift resolution that brings peace and stability to the region.

### Investment Review

Please find attached your Talbot Financial third 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.

The Index declined 3.3% for the third quarter but remains up 13.1% for the year-to-date period ending September 30, 2023. The three investment themes we reviewed last quarter all remain intact: the U.S. economy continues to expand, large U.S. companies are reporting solid earnings growth, and inflation has slowed. The only perspective that has shifted more recently is a view that interest rates may potentially stay higher for longer, based on comments from Federal Reserve Chairman Jerome Powell.

When interest rates rise, or stay higher for longer, the cost of borrowing increases. When borrowing costs rise, corporate profits are reduced. Lower profits then translate to decreased valuations, and stock prices face headwinds. This interest rate effect is most pronounced on companies with higher levels of debt. Conversely, companies with lower debt ratios or no debt, strong balance sheets and healthy cash flows are less susceptible to higher interest rates.

A key tenant of our investment strategy is to own high-quality companies with strong balance sheets and cash flows. Thereby making them less vulnerable to rising interest rates. The following table illustrates the strength of the balance sheets of the companies in the Talbot Financial Composite Portfolio, comprised of client accounts managed for over five-years, versus the Index:

	Net Debt/ Total Capital	Net Debt/ EBITDA
<b>Talbot Financial Composite Portfolio</b>	<b>17.5%</b>	<b>0.7</b>
<b>S&amp;P 500 Index</b>	<b>34.8%</b>	<b>1.6</b>

The ratio of Net Debt/Total Capital is a measure of financial leverage. The lower ratio of 17.5% for the Talbot Financial Composite Portfolio means the companies in the typical client investment portfolio have roughly half the amount of debt leverage as compared to the Index.

The second metric, Net Debt/EBITDA, represents Net Debt divided by EBITDA (earnings before interest, taxes, depreciation, and amortization), a measure of profitability. Again, a lower figure is favorable. The Talbot Financial Composite Portfolio figure of 0.7 highlights that the companies

in the typical client portfolio have far less debt relative to their respective cash flows, as compared to the Index. In other words, the 0.7 figure means the companies in your portfolio could pay off all their debt in about six-months simply through net cash flows. Not a likely scenario, yet a very good indicator of the strength of their respective balance sheets.

Costco Wholesale Co. (ticker symbol: COST), a portfolio holding, provides a good example of our focus on balance sheet strength. The table below shows Costco's cash balance and long-term debt:

<b>(\$ in millions)</b>	<b>Cash</b>	<b>Long-Term Debt</b>	<b>Net Debt</b>
Costco	\$ 13,708	\$ 9,004	\$ (4,704)

As you can see, Costco's balance sheet has more cash than long-term debt, meaning the amount of net debt is negative.

In closing, it is in times of turmoil like the crisis in the Middle East that we reflect on our own lives. We appreciate you placing your trust and confidence in us to support your financial objectives.

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](http://www.talbotfinancial.com)