

## Talbot Financial – Fourth Quarter 2023 Review

Please find attached your Talbot Financial fourth 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

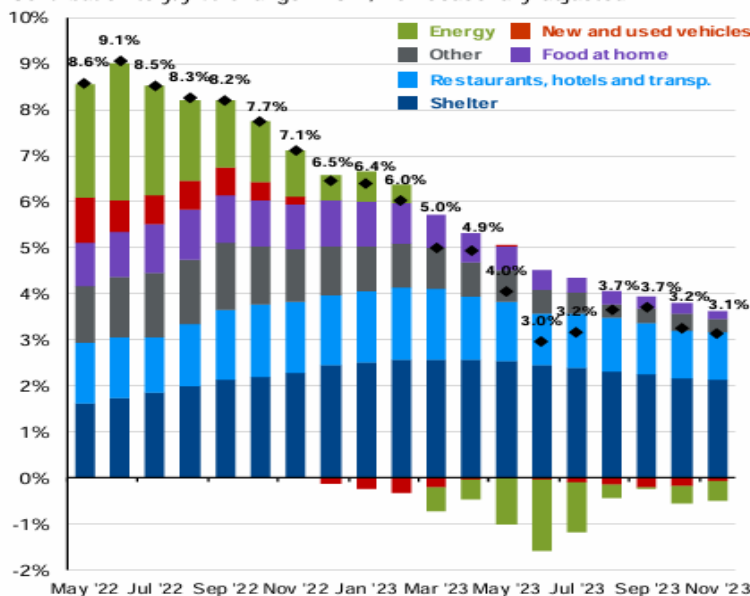
2023 was a favorable year for the equity markets, as represented by a 26.3% increase in the Index. A somewhat remarkable result set against the backdrop of the fastest pace of Federal Reserve rate increases in 40-years, a regional banking crisis and an escalating war in the Middle East. In our view, it demonstrates the resiliency of the of the broader U.S. financial system and the sustainable competitive advantages of large industry leading companies.

Performance was led by the Technology and Communications industry sectors, driven by the continued expansion of artificial intelligence (AI). Conversely, interest rate sensitive sectors, specifically Utilities and Energy, were the performance laggards. Talbot Financial clients’ investment portfolios, as compared to the Index, are overweight Technology, underweight Energy, and have no exposure to the Utilities sector.

Our perspective is that the material decrease in inflation was the largest driver to the strong equity returns for the year. The chart below depicts the Consumer Price Index (CPI), a primary measure of inflation, by its different components. After peaking at 9.1% in May 2022, the CPI consistently declined over the following 18-months. The November 2023 CPI figure was 3.1%.

#### Contributors to headline CPI inflation

Contribution to y/y % change in CPI, non-seasonally adjusted



Lower inflation is historically good for stock market returns because it is typically accompanied by lower short-term interest rates.

Looking forward into 2024, we forecast five fundamental reasons to remain confident about our portfolio of companies, including strong earnings expectations, an increased likelihood of lower interest rates, a solid labor market, continued growth of AI, and a high level on investible cash sitting in money market funds.

1. After only growing at 2% in 2023, earnings for the S&P 500 Index are projected to grow at almost 12% in 2024. Strong earnings growth is historically a driver of stock returns.
2. Interest rates are expected to decline. The Federal Reserve has a dual mandate of managing inflation and employment. As previously stated, inflation declined from 9.1% to 3.1% over the previous 18-months and is now near the target level. At the same time, unemployment remains essentially unchanged at 3.7% versus 3.6% one year ago. Thus, the Federal Reserve has done its job of lowering inflation while keeping unemployment low. Maintaining higher interest rates risks pushing unemployment higher and driving the economy into recession; and therefore, it is likely interest rates will decrease.
3. The labor force remains robust. This is important because employment and wages drive consumer spending. Consumer spending accounts for almost two-thirds of U.S. Gross Domestic Product.
4. Significant investments into AI in 2023 will begin to show greater benefits in 2024 and the years ahead. AI will generate substantial productivity gains and other benefits across the companies in the investment portfolio.
5. Higher interest rates drove a surge in money market fund assets to almost \$6 trillion at year-end 2023, an all-time high. History suggests that as interest rates decline, cash moves out of money market funds and into other asset classes, predominantly equities.

In summary, the U.S. economy is on solid footing and the backdrop for favorable equity returns over the long-term remains intact.

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)