Talbot Financial – Fourth Quarter 2024 Review

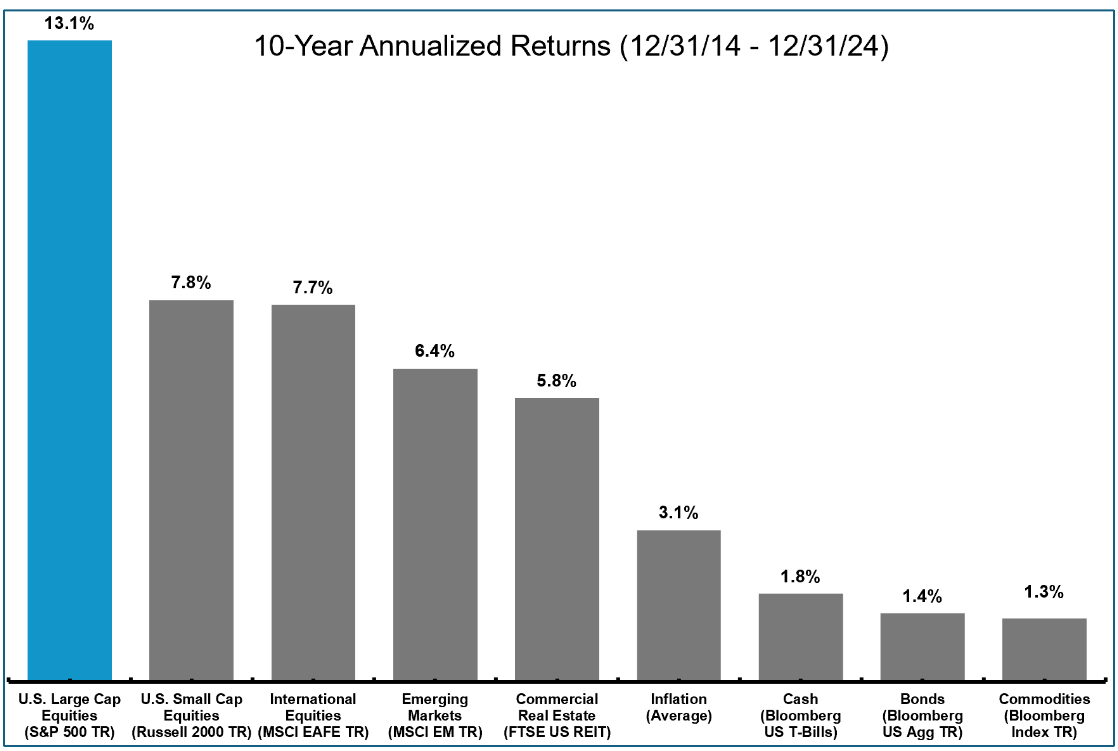
Our hearts go out to all those tragically affected by the Los Angeles area fires. We have made personal donations through Talbot Financial to the American Red Cross to support people who have been impacted by the fires. We are grateful for the tireless efforts of the first responders.

Investment Review

Please find attached your Talbot Financial Fourth quarter 2024 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.

2024 was the second consecutive year of strong growth in the equity markets with the Index increasing over 25% for the year. The return was driven by continued strength in the economy, slowing inflation, and an Artificial Intelligence (AI) fueled rally in a select number of technology stocks. 10 of 11 industry sectors within the Index posted positive returns for the year, with the exception being Basic Materials. The best performing sectors were Technology, Communications and Consumer Discretionary. The underlying theme driving performance in these three sectors was exposure to AI, including companies such as Nvidia, Apple, Amazon and Microsoft.

The cumulative return of the Index during the past two years is over 55%. Furthermore, Large-Cap U.S. based companies (i.e., the S&P 500 Index) have led the way in returns over the last 10-years as represented in the table below.



As a result of our fundamental research-driven investment process, the holdings in Talbot Financial client portfolios are mostly comprised of stocks from the S&P 500 Index. Our focus is on identifying about 50 of the companies in the Index, diversified across the 11 industry sectors, that have the following characteristics:

1. **Exceptional balance sheets**. Strong balance sheets are important because they help companies survive economic downturns, help secure funding, and lower overall borrowing costs.

2. **Strong and sustainable cash flows.** High levels of cash flow mean a company has a steady stream of cash that not only covers expenses, but can also fund growth, manage debt, and mitigate exposure to potential economic downturns.

3. **Possess wide economic moats around their businesses.** An economic moat is a sustainable competitive advantage over its competitors, making it difficult to take away market share. Moats can come in many different forms, including strong brands, cost leadership, intellectual property, or high switching costs.

4. **Extensive global revenue streams from geographic diversification.** Approximately 60% of revenues of companies in the Index is derived from within the U.S. The remaining 40% of revenue is generated from sales from other countries.

5. **U.S. GAAP accounting standards.** This helps ensure that financial statements are prepared consistently over time and provide a material level of transparency to investors.

Importantly, we do not own all 500 stocks in the Index. We further examine each factor above to build a portfolio of what we consider to be the highest quality companies within the Index. Costco is one such example.

Costco is one of the world's largest retailers with over $250 billion in annual revenue, and exhibits the characteristics mentioned above:

- Balance Sheet Strength: $11.1 billion in cash and $9.5 billion in debt, meaning they have more cash than debt on their balance sheet.

- Strong Cash Flows: Generates over $6 billion per year of Free Cash Flow. This excess cash flow is used for reinvestment into the company, dividends and stock buybacks.

- Wide Economic Moat: Numerous moats protecting its business, including purchasing power for low cost leadership and loyal members. The select number of items available allows Costco to buy in bulk and offer the lowest prices. A fee membership program further supports lower prices and helps control theft by monitoring entry to and exit from the warehouses.

In summary, the characteristics above are why we own our companies for the long-term, but also why we are comfortable holding them through bouts of market volatility in the short-term.

As always, 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