

Talbot Financial – Third Quarter 2024 Review

Please find attached your Talbot Financial third 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.

Investment Review

The Index increased 5.9% for the third quarter and is up 22.1% through the first nine-months of 2024. Strength was broad based with eight of 11 industry sectors outperforming the Index for the quarter, led by Utilities, Real Estate, Industrial and Financials.

The outlook for Artificial Intelligence (AI) related stocks remains strong, although returns were bifurcated during the first nine-months of the year. Semiconductor companies providing the building blocks of the AI infrastructure were the top performing stocks for the year-to-date period. Software companies, which we believe will be the biggest winners in AI over the longer term, lagged semiconductor companies over the same period. As the AI infrastructure matures, we believe the next leg of growth will be the layering of software applications to increase productivity and drive sustained growth across all industries in corporate America.

Economic Outlook

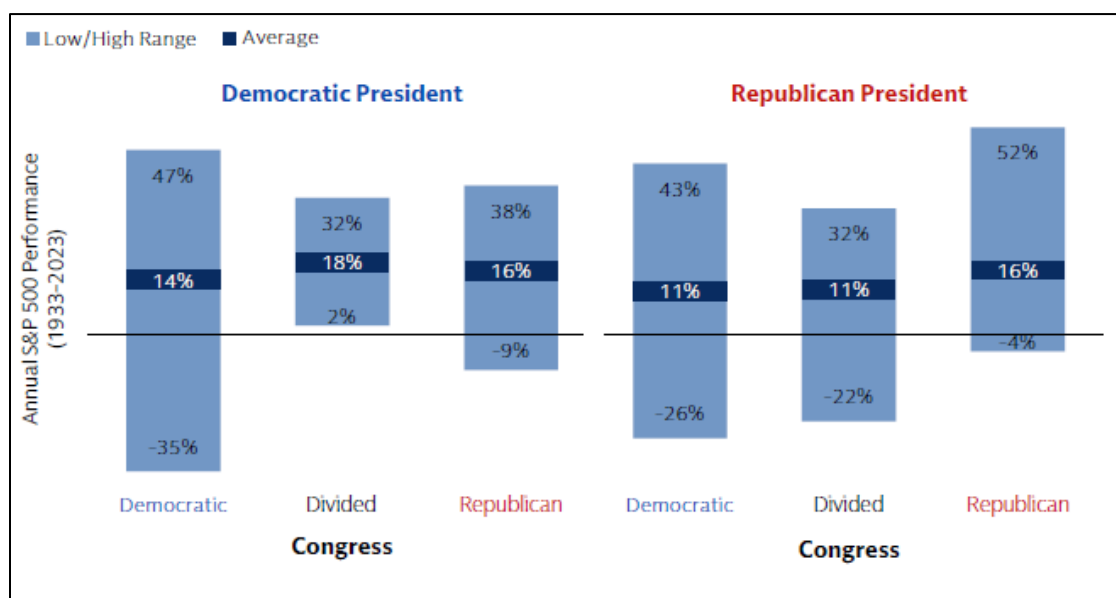
Our view is the U.S. economy is stable, and the risk of a recession remains low. Real Gross Domestic Product (GDP), or the total value of all goods and services produced within the U.S., is tracking at 3% through the first nine-months of the year. Consumer spending, which produces two-thirds of GDP, is growing at 2%-3%. Inflation, as measured by the Consumer Price Index (CPI), has stabilized at 2.5%. Lastly, the unemployment rate of 4.1% signifies a healthy job market. Specific to a recession, we track seven different recessionary indicators: the yield curve, manufacturing activity, inflation, job growth, housing activity, credit performance, and company earnings. Six of the indicators are improving, indicating the risk of recession is low.

Impact of Presidential Elections and Interest Rate Cuts on Long-Term Equity Market Returns

Two near-term events could affect stock market returns, the upcoming presidential election and the Federal Reserve’s cuts in interest rates.

Presidential elections create uncertainty associated with the potential consequences of economic policy changes. Equity markets do not like uncertainty; and therefore, volatility historically increases around elections. However, history has shown that regardless of political outcome, volatility quickly subsided, and equity prices moved higher. Below is a table showing stock market returns based on presidential party affiliations. The table, provided by Goldman Sachs, shows the annualized returns of the S&P 500 Index under the

six different combinations of presidential and congressional parties. Note that the equity markets averaged about mid-teen digit returns across all combinations of President and Congress regimes.



The following quote from a Morningstar research report sums it up best: “Markets are driven by earnings and cash flow, and politics move into the background pretty quickly.”

Last month the Federal Reserve announced a half percentage point cut in the Federal Funds Rate, ending a cycle of interest rate increases that started in March of 2022. Federal Reserve Chairman Powell suggested further interest rate cuts in the coming months and quarters. History has shown a strong correlation between decreasing interest rates and higher stock prices. The old adage “don’t fight the Fed” intuitively makes sense as lower interest rates benefit both corporate and personal borrowing, leading to a more robust economy. An improving economy typically leads to higher corporate cash flows and earnings, which drive stock prices over time. Below is a table with data provided by JP Morgan showing the relationship between declining interest rates and the subsequent two-year return of the S&P 500 Index over the previous six interest rate cut cycles.

Two - Year S&P 500 Return from start of Rate Cut Cycle		
Year	Recession	2 - Year Return
1984	N	40%
1989	N	18%
1995	N	70%
2001	Y	-35%
2007	Y	-30%
2019	N	55%
Average:		20%
Average, ex recession:		46%

Over the last six rate cuts, the S&P 500 Index averaged a 20% return in the two years immediately after the initial rate cut. Further, in years with no recession, the returns were

substantially higher. In summary, interest rate cuts have historically had a favorable impact on equity market returns.

Specific to Talbot Financial portfolio companies, our outlook remains optimistic given their strengthening balance sheets, improving cash flows, and increasing competitive advantages.

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