Talbot Financial – Second Quarter 2021 Review

Please find attached your Talbot Financial second quarter 2021 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 post-pandemic economic recovery continued in the second quarter. The forecast for economic growth in the second quarter is about 10%, as measured by Gross Domestic Product (GDP). This represents an acceleration from first quarter GDP growth of 6.4%, and a sharp contrast to a 3.5% decline in GDP in 2020. Consensus estimates suggest the economy will grow between 6% - 7% this year, meaning the shorter-term rate of economic growth has likely peaked.

A strong economic recovery was reflected in the performance of large company U.S. stocks in the second quarter, with an Index return of 8.5%. For the year-to-date period, the Index increased 15.2%. Second quarter industry sector leadership was broad based across the Technology, Real Estate and Communication Services sectors. This is in contrast with the first quarter, when performance was led by sectors most correlated to an economic rebound, including Energy, Financials and Industrials.

The financial news media is reporting that the swift economic recovery may lead to high inflation. Increased prices on goods and services make it abundantly clear we are already experiencing some inflationary pressures. However, our view is that inflation will be moderate over the next few years and ultimately be beneficial to your investment portfolio.

Our basis for this investment perspective is threefold. First, we believe most of the recent inflation spike is transitory and not sustainable. Second, a moderate level of inflation has historically been favorable for stocks. And finally, the stocks you own in your Talbot Financial investment portfolio are well positioned for an environment of increased levels of inflation.

Much of the recent inflationary pressure has been driven by supply chain constraints and wage pressures, both of which we believe are short-term in nature. The economic shutdown last year caused unprecedented closures of businesses and a global freeze of product distribution logistics. The result was a massive contraction across supply chains. These "shocks" to the global supply network are now evident in the form of price increases for items such as new and used cars, airline tickets, furniture and many commodities. The good news is evidence is mounting that these bottlenecks are opening back up. For example, port congestion is easing, many commodity prices have begun to fall, and semiconductor supply should begin to improve by year-end.

Inflation is also seeing pressure from wage increases, the underlying cause of which is a lack of labor participation. Two primary factors are the issue: the lack of child-care options for working parents and enhanced unemployment benefits. Both headwinds should ease in September as children go back to school and the enhanced level of federal unemployment benefits expire. As the workforce expands, wage pressures should subside. For these reasons, we believe much of the supply chain and wage pressure constraints are temporary and will be mitigated in the last half of this year.

Furthermore, some level of moderate inflation is good for companies as it allows them to raise prices. History supports this point as illustrated in the table below with the returns of the S&P 500 during five periods of rising inflation since 1998.

S&P 500 Performance During Periods of Inflation*						
Index	**4/30/1998 - 4/30/2000**	**6/30/2002 - 9/30/2005**	**10/31/2006 - 7/31/2008**	**7/31/2009 - 9/30/2011**	**4/30/2015 - 7/31/2018**	**Average**
S & P 500	15.8%	8.8%	-2.7%	9.0%	12.0%	8.6%
*Return Figures are Annualized						

As you can see from the chart, equity returns were positive in four of the five periods of rising inflation and the average return was about 9% annualized.

The final reason we feel a moderate level of inflation will be favorable for your investment portfolio over the long run is because you own stock in industry leaders with strong balance sheets. Historical data has shown that companies that grow, while also maintaining a high dividend, tend to perform well during inflationary periods. A focus on consistent growth of earnings and the dividend is a cornerstone of our investment philosophy. In fact, over 60% of the companies in our Talbot Financial target portfolio pay a dividend greater than the Index. In addition, we believe the technology companies you own have developed sustainable competitive advantages, thereby having the ability to raise prices.

In summary, the economy is on sound footing and the outlook for investing in equites remains favorable.

Our office in Bellevue is fully open and we would welcome the opportunity to review your portfolio in person, by phone or on a Zoom conference. Please contact us for a review, or to answer any questions you may have about your portfolio.

Sincerely,

Talbot Financial, LLC

www.talbotfinancial.com