

Talbot Financial – First Quarter 2026 Review

During this time of conflict in the Middle East, our thoughts are with all those affected by the ongoing conflict. We hope for peace and a lasting resolution.

Investment Review

Please find attached your Talbot Financial First Quarter 2026 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 increased market volatility during the first quarter of 2026 was driven by an AI-induced pullback in technology stocks, the Supreme Court’s reversal of executive branch tariff powers, and the war in Iran. As a result of these headwinds, the Index declined 4.3% during the period. Performance leadership came from commodity-sensitive sectors, with the Energy and Basic Materials sectors among the strongest performers.

The sharp rise in oil prices introduced near-term economic and market volatility, but we believe its long-term implications are limited. From an economic perspective, an energy shock typically produces a short-term rise in prices as higher energy costs pass through to businesses and consumers. However, these pressures self-correct as supply adjusts, demand normalizes, and inflationary pressures subside. From a financial markets perspective, energy shocks often prompt a rotation toward energy stocks and away from high-quality companies with durable competitive advantages and secular long-duration growth profiles. This dynamic is evident in the equity markets today.

For example, Microsoft, a core holding in Talbot Financial clients’ portfolios, saw its weakest quarterly stock performance since the 2008 financial crisis, even as the company reported roughly 17% year-over-year growth in revenue and operating income in its most recent quarter. The rotation towards energy stocks contributed to the decline in Microsoft’s share price, but the predominant reason was the potential impact of AI on Microsoft’s core business operations. Our perspective is that Microsoft has strategically positioned itself as a leader in AI innovation.

We believe Microsoft is gaining significantly from advances in AI, thanks to its ownership of key platforms like Azure, Office, Windows, and enterprise identity services, foundations where AI is developed and implemented daily. Rather than being overtaken by technological change, Microsoft is harnessing AI to create valuable, widely used services, further reinforcing its business model and increasing customer dependence on its ecosystem.

Furthermore, Microsoft is undertaking this transition while maintaining the high-quality financial metrics that meet our investment criteria. The company's AAA rated balance sheet, a distinction shared by only one other S&P 500 constituent, reflects minimal leverage and deep liquidity and will support elevated AI and cloud infrastructure investments without compromising capital returns.

Microsoft's ability to generate high margin cash flow remains a core strength as high recurring revenue from Office 365, Windows, and Azure support durable profitability. This cash flow further supports AI infrastructure investment.

The company continues to accelerate innovation across businesses as it embeds AI throughout its product ecosystem, including Azure, Office, Dynamics, security, and developer tools. These advancements place the company at the forefront of AI integration and strengthen its competitive advantage within the industry.

In our view, Microsoft's combination of financial strength, innovation leadership, and sustainable competitive advantages support attractive long-term growth. While near-term market rotations may periodically pressure the stock, we continue to view Microsoft as a foundational core holding for long-term investment portfolios.

Lastly, near-term market rotations are why we diversify portfolios across nine different economic industry sectors. This has the benefit of counterbalancing a sector that is out of favor with sectors that are in favor.

We 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