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Fourth Quarter 2022 Commentary

Dear Clients,

Please find enclosed your December 31, 2022 Investment Reports.

While 2022 was a tough year for diversified investors, the fourth quarter provided some relief as returns were positive across the major asset classes. For the quarter, US Large Cap Stocks returned 6.7% and US Bonds returned 1.9%. International stocks (both developed and emerging) showed strong returns for the quarter as the US dollar weakened over the quarter for the first time since 2020.

2022 was a year that saw the unexpectedly rapid reversal of loose monetary policy by central banks (as they raised short term interest rates and ended their accommodative purchases of private sector assets). As we mentioned in our last quarterly letter, rising interest rates have a negative impact on the discounted present value of future cash flows. Accordingly, asset prices fell, sometimes in precipitous fashion. 2022 saw the greatest number of trading days (about 25%) where the stock market was down 1% or more since the Global Financial Crisis (2008). 2022 also produced the worst return performance for a U.S. 60% stock and 40% bond portfolio since the 1930's.

The fourth quarter of 2022 also saw the capitulation of many formerly high-flying, headline-grabbing investment stories. Tesla, a darling of all things possible in the green revolution, was down over 53% for the quarter. Massive fraud came to the surface in the crypto markets, albeit with limited surprise given that US and other global regulators had turned a blind eye to enforcing time tested best practices for investor safety (like requiring accurate disclosures of significant financial information for securities and market exchanges).

Benchmark Returns

	Last Quarter	Last Twelve Months	Last Five Years
US Large Cap Stocks	6.7%	-19.9%	9.6%
US Mid Cap Stocks	9.0%	-18.7%	7.3%
US Small Cap Stocks	8.0%	-17.6%	5.9%
Developed International Stocks	17.3%	-14.5%	1.5%
Emerging Market Stocks	9.7%	-20.1%	-1.4%
US Bonds	1.9%	-13.0%	0.0%
Global Bonds	4.5%	-16.2%	-1.7%

Data source: YCharts. Past performance does not guarantee future results. It is not possible to invest directly in an index. Last five years data is annualized. Indexes in table are:
US Large Cap Stocks: CRSP US Mega Cap TR
US Mid Cap Stocks: CRSP US Mid Cap TR
US Small Cap Stocks: CRSP US Small Cap TR
Developed International Stocks: MSCI EAFE NTR
Emerging Market Stocks: MSCI Emerging Markets NTR
US Bonds: Bloomberg US Aggregate TR
Global Bonds: Bloomberg Global Aggregate TR

As we look forward to 2023, the specter of a coming recession is obviously on everyone's mind. One time-tested and oft-cited indicator, an inverted yield curve (when short term safe investments yield more than long term safe investments), is signaling a likely recession.

In the US stock market, most of the 2022 decline was the result of lower price to earnings multiples (or as said in an analogous way, an increase in the discount rate of future earnings). Actual 2022 stock earnings themselves grew positively year over year (believe it or not). Will 2023 finally bring the feared decline in earnings? That question is justifiably on investors' minds.

That same fear that exists for stocks extends to the housing market (both in the US and globally). According to Dow Jones, mortgage rates rose more rapidly in 2022 than any other year in on record. Could we see a large drop in housing prices (a sector that is such an important economic

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engine of many developed economies)? It is tough to see how the increased costs of borrowing do not negatively impact prices, but we would add that there are buffers against housing price drops in the US that were not in place during the Global Financial Crisis (e.g., US consumer balance sheets are stronger and there are fewer adjustable-rate mortgages in the system).

One area of the market that feels more right sized after a rough year is government bonds. In the US, positive expected real government bond yields are available across all investment horizons. Outside of the US, negative-yielding debt (meaning you would lock in a loss if you bought a bond and held it to maturity) has receded from a peak of about $18 trillion dollars in bonds in 2020 to almost zero negative-yielding debt today.

As far as near-term predictions go (near term meaning 2023), there is a long history of Wall Street consensus estimates for one year forward returns on the stock market. As you might guess, the results versus the predictions are all over the map, reinforcing the difficulty for even the "experts" to predict where the stock market will be a year hence. We bring the topic up here, not so that you will place any faith in a particular 2023 prediction, but to note that the dispersion of Wall Street predictions this new year is the widest it has been since the Global Financial Crisis. Wide dispersion in "expert" guesses indicates that there are perhaps more uncertainties in the mix for the coming year than usual.

Internationally, China looks set to scrap its futile efforts to control an endemic virus thereby (potentially) returning the world's second largest economy to normal business activity, which would be a net positive to global output. Additionally, we sense that the world economy has come to "live with" war in Ukraine (much like it did with the long war in Afghanistan), and news of rockets and death do not seem to shock markets as much as they did at the outset. The status quo of continued fighting appears priced into 2023 global output expectations. If the war were to spiral across borders, that would have very serious negative market implications, but the more likely path of surprise might be a positive boost to markets from the result of a yet unannounced resolution to the conflict. Finally, and interestingly, for the first time in the 21st century, there will be no major regularly scheduled elections in G7 countries the coming year (the G7 is seven of the most economically important democratic countries in the world: the US, UK, Germany, France, Italy, Canada, and Japan); no major elections imply less political anxiety for markets.

Here in the US, we are seeing the inflationary impact of the COVID-19 economic rescue policies swing back in pendulum-like fashion. In 2022, "M2", which is a measure of money supply, contracted on a year over year basis for the first time in United States history (after increasing by a record amount in 2020). How far the inflation pendulum swings back is very much a key open question for investors. Part of the uncertainty is determining at what point the government (through either monetary or fiscal policy) will be tempted to intervene in the swinging pendulum. Twenty-first century political activity has demonstrated that government policy makers (Republicans and Democrats alike) have little desire to allow economic markets to swing freely. We therefore will be waiting, like all other investors, to see what the Federal Reserve chooses to do in 2023. And we, like other forecasters, must humbly allow for the unanticipated impact of yet foreseen rescue packages that may be conjured in Washington, Beijing, or Brussels.

What is one to do when there are so many variables in play? You may have heard us say "keep the ball in the fairway" or, like a physician, recommend first to "do no harm." We warn against extreme positioning in your investment portfolios because it is akin to saying one knows exactly when the unexpected good things and bad things will come around the corner of life. Yes, we want to help you maintain a portfolio that has sufficient ballast to weather inevitable economic storms, but we also want to help you be optimistic enough to put out to sea so that you may reach the brighter shores on which we all aspire to be.

We remain sincerely grateful for your continued trust in us to serve you, and we wish you and your families a fulfilling year ahead.

Leavell Investment Management, Inc.

Please advise us if you would like copies of our annual Securities & Exchange Commission Disclosure Brochure (Form ADV), a Prospectus for The Government Street Funds or a record of how your proxy statements were voted.