Fourth Quarter 2023 Commentary

Dear Clients,

Please find enclosed your Fourth Quarter 2023 Investment Reports.

Most investment assets appreciated in the fourth quarter of 2023, marking a strong reversal from the prior quarter. Among broad stock indexes, U.S. Small Cap Stocks led with a 13.4% total return. Other broad stock indexes also posted strong results for the quarter; even the laggard of the group, Emerging Market Stocks, posted 7.9% total return for the quarter. For the year, all major categories of stocks posted robust positive returns (see table below).

Benchmark Returns

	Last Quarter	Last Twelve Months	Last Five Years
U.S. Large Cap Stocks	11.9%	29.7%	16.2%
U.S. Mid Cap Stocks	12.3%	16.0%	12.7%
U.S. Small Cap Stocks	13.4%	18.1%	11.7%
Developed International Stocks	10.4%	18.2%	8.2%
Emerging Market Stocks	7.9%	9.8%	3.7%
U.S. Bonds	6.8%	5.5%	1.1%
Global Bonds	8.1%	5.7%	-0.3%

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

The quarter also featured strong returns for broad bond indexes, with U.S. Bonds up 6.8%. For the year, U.S. Bonds produced a positive total return of 5.5%, bouncing back from two consecutive years of negative performance. One could reasonably argue, with the aid of hindsight, that the chief forces driving the overall market rally in bonds and stocks for the quarter were the easing of inflationary indicators, and the related Federal Reserve's forward guidance on the path of interest rates for 2024. During the quarter, the 10 Year U.S. Treasury bond yield, a closely watched long-term interest rate, hit a 15+ year high at 5% before dropping by more than 20% in yield and closing the quarter below 4%. The revised financial expectations that drove such a dramatic reversal in this long-term interest rate also boosted most other global asset prices.

The strong final quarter of the year cemented a surprisingly attractive 2023 full calendar year for diversified investors. Recall that when we wrote this same letter last year, we noted that "the specter of a coming recession" was on every investor's mind. That gloomy specter never fully materialized, and stock and bond market performance responded accordingly. Against the backdrop of a widely predicted 2023 recessionary storm that never came, might we dare to ask what is in store for 2024?

In the aptly named book "Fortune Tellers", Walter Friedman recounts "the story of American's first economic forecasters." Men such as Roger Babson, John Moody, and Irving Fisher competed to legitimize the art of economic forecasting, following in the wake of early twentieth century "prophets" and "astrologers" such as Evangeline Adams, who counted financial elite, even J.P. Morgan himself, among her clients. Was this past epoch which blended pundit prophecies and economic forecasting all that different from ours today? A New York Times quote from the turn of that century teasingly noted, "Wall Street laughs at [prophecies], but it always reads them closely." Perhaps even in our modern era, we find ourselves eagerly consuming suspiciously specific tales of the future which conform to our already personally developed suspicions.

There is however an alternative to narrowly estimating what the future will hold. Indeed, the modern-day market forecasts we would encourage clients to run furthest from are specific estimates. For example, despite the intuition that one is more likely to predict the combined total points in a college football game than the precise score, the largest participants in our industry continue to happily publicize one year future precise scores ("price targets") for the S&P 500. For some reason, we humans seem to conflate the precision of a forecast with its accuracy. Would it not be more prudent to consider ranges or conditions rather than specific outcomes?

Leavell's belief in diversified investment portfolios ties into similar reasoning. Clairvoyance is difficult. And it is especially difficult the more people who are participating. When young, we might have gathered around to guess what number between 1 and 100 our friend had in their mind. It did not take long to appreciate that the more friends who were playing, the more difficult it was to be the closest guesser.

Picking a single successful stock will clearly produce a higher winning return than choosing a diversified index that owns that same stock. The problem is that only one investor gets to win. The point being: lottery tickets are a bad idea. Narrow year-end market forecasts are the same.

As the new year arrives, a more constructive exercise for 2024 might be to ponder the range of future market outcomes. We want investors to ask themselves: under what circumstances would they be a forced seller of investments, either because of financial needs or psychological pressure?

If you would not be a forced seller in most scenarios you can imagine, then your asset allocation between risky and safe assets is likely healthy. However, if you plan to sell stocks if there is a [fill in the calamity of your choice], then your asset allocation may need to be revisited.

Recently there was a runway-based plane crash in Japan between a commercial airliner and a coast guard plane. It was a tragedy that no one wanted to see, especially as five Japanese coast guard members lost their lives. However, it was also a testament to "good" forecasting. Good forecasting is admitting that we do not know when or where the next crash will take place, but rather committing to learn from past events. In reporting on the event, CNN noted that Japan Airlines had been party to the deadliest single-aircraft accident in history which killed 520 people in 1985. As part of creating a culture of safety and learning from past events, the airline keeps the wreckage of that tragedy on display at their headquarters for all employees to see. In the recent 2024 crash, all 379 of their Airbus A350 passengers were able to evacuate the plane to safety. Many news stories noted the various safety improvements that have come as a result of learning from past events.

As we look towards what we hope will be a prosperous new year for all our clients, let us take a moment to check our safety belts. And while we do not want to trivialize the immense gap between the value of protecting human life and protecting wealth, we can learn from this example in the airline industry. The best way to make our way through 2024 is not to offer you a precise but low probability story of where GDP growth or the S&P 500 will be at the end of the coming year, but rather to make sure your portfolio is designed to weather the *unexpected* deviations from its planned trajectory. We encourage you to engage in conversations with your Leavell Investment Counselor so that we can continue to serve you well.

As always, we remain grateful for your trust.

Leavell Investment Management, Inc.