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First Quarter 2025 Commentary

Dear Clients,

Please find enclosed your First Quarter 2025 Investment Reports.

Developed International Stocks led the way for the quarter ended March 31, 2025, up +6.9%. Emerging Market Stocks also showed positive returns (+2.9%). U.S. Bonds were up a solid +2.8% for the quarter, and Global Bonds followed closely with a positive +2.6%. For the first time since the third quarter of 2023, U.S. Large Cap Stocks were negative for the quarter, down -5.0%. U.S. Mid Cap Stocks were more resilient (-1.6%) than their large cap brethren, but U.S. Small Cap Stocks suffered more (-7.4%).

Benchmark Returns

	Last Quarter	Last Twelve Months	Last Five Years (annualized)
U.S. Large Cap Stocks	-5.0%	9.1%	19.0%
U.S. Mid Cap Stocks	-1.6%	5.2%	16.2%
U.S. Small Cap Stocks	-7.4%	-1.6%	15.6%
Developed International Stocks	6.9%	4.9%	11.8%
Emerging Market Stocks	2.9%	8.1%	7.9%
U.S. Bonds	2.8%	4.9%	-0.4%
Global Bonds	2.6%	3.0%	-1.4%

Data source: YCharts (get.ycharts.com/disclosure/). 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

Even with the setback of the first quarter, United States stocks are up a remarkable amount by historical standards over the past five years (see the far-right column in the table above). Let us reflect upon that observation as we turn towards current market conditions.

As a reminder, stocks are securities that endow their owners with the right to collect future profits from the company that issued the security. The value of the security is therefore related to the expected future profits of the company *and* what others will pay for the right to those future profits. Investors describe these two separate forces that create stock prices as fundamentals and investor sentiment. One force, fundamentals, is rooted in economics. The other force, investor sentiment, is rooted in human behavior. Both forces can move independently. For example, if a company announces that it has invented a new battery technology that increases the driving range for electric cars, we might expect improved profit expectations to drive the price of the stock higher. Similarly with investor sentiment, if investors are flush with new unexpected income, they may become increasingly inclined to speculate on a stock that has produced lucrative returns for their neighbor.

Stock markets tend to notch their best performance when both fundamentals and investor sentiment become self-reinforcing. Over the past five years, this has been the case. Stock fundamentals have indeed been strong, as companies have developed some remarkable productivity enhancing (and profit enhancing) inventions, from artificial intelligence to weight loss drugs. Investor sentiment has also been positive as government support (derived from increased deficits) boosted many salaries beyond what would have otherwise been expected emerging from a global pandemic. With fatter than expected wallets and plenty of investing success stories to be shared around the water cooler, positive investor sentiment has been abundant.

This first week in April, both forces abruptly reversed course. On the fundamental side, the specter of tariff impacts on profits looms large. Many of the goods Americans purchase are manufactured along an intricately linked global supply chain. The 2020 pandemic and the related supply shortages highlighted the complex nature of just how many countries take part in manufacturing the car in your driveway or the phone in your pocket. Tariffs will impact these global supply chains, and companies are racing to figure out the best way to respond. This new friction threatens corporate profits and raises the previously simmering odds of a 2025 recession.

On the side of investor sentiment, there has been a proverbial race to the exits this first week in April. As much as greed is a force that can drive markets up, fear is equally potent and often materializes with rapid onset. Investor sentiment has also not been helped by the fact that approximately half of all Americans have a recent political loss fresh on their minds and likely did not enter 2025 with a buoyant disposition.

Beyond U.S. investors, there are also global investors, and their psychology matters as well. When a country consumes more than it produces, it pays for that excess consumption by issuing IOU's (liabilities). Many financial pundits focus on the fact that foreign nations have been buying our treasury securities as IOU's (and thereby enabling our fiscal deficit). However, treasury securities are not the only liability that foreigners have purchased to satisfy the IOU's from the U.S. According to the United States Department of the Treasury, foreign investors own more than 20 percent of *all* outstanding U.S. securities. That means foreigners own not just government treasuries (about 33 percent), but also corporate bonds (about 27 percent) and corporate stocks (about 18 percent). Needless to say, foreign investor sentiment may not be as constructive today as it was before the recent announcements of tariffs, reduction in foreign aid, and reduction in foreign military support. Additionally, as a simple economic accounting identity, it is worth noting that if the U.S. purchases fewer foreign goods in the future, foreigners will, on net, need to purchase fewer U.S. securities.

Investment commentaries such as this one are a curious collection. They fall into roughly three types: those that recount the past, those that predict the future, and those that focus on the principles of investing. The letters that focus on the past tend to be the longest in length and the most detailed. We try to limit such commentary because we know our clients are well informed about current events. The reason historical commentary letters are often the longest is because it is easiest to sound intelligent in hindsight. However, a quarter is often not enough distance to fully digest the impact of the past on the future. In fact, true hindsight often takes decades. For example, nobody today studies World War I without thinking about its linkages to World War II; a perspective that was unavailable to a December 1918 quarter-end newsletter.

Another type of commentary is prediction based. It is our observation that most of these commentaries come in the form of newsletters where the author has little skin in the game, rather than from investment managers. Roger Federer, the famous tennis player, recounted that he won 80% of the single matches he ever played, but only 54% of the points over the course of those matches. We have said it before: we are not clairvoyant. We seek to win all the matches we play, but markets are at least as tough as Federer's opponents, and aces in market predictions are rare. You win in markets like Federer won in tennis: by long-term persistence in tight matches.

That leads us to our style of investment commentary and the one that we believe is most useful for our clients. Our goal is that in uncertain markets, just as in upbeat markets, you remain focused on investment principles. Is your time horizon and your asset allocation appropriately matched? Is your portfolio appropriately diversified? Is your financial situation organized to your satisfaction? We doubt that the angst often engendered by the evening news will change between now and our next letter, but we remain always available to visit with you one-on-one so that you may have confidence in your financial plan.

Leavell Investment Management, Inc.

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