MILL CREEK CAPITAL ADVISORS

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Q3 2024 Outlook

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01 July 2024

Election Insights '24

By Michael Crook, Chief Investment Officer

We are now four months from the 2024 US presidential election. This publication kicks off our Election Insights series that will continue through the end of the year. During that time, we'll publish a variety of content and Livestreams with expert guests that focuses on how the eventual outcome could impact the economy, markets, and estate planning.

Economists use the terms positive analysis to refer to objective, evidence-based statements, and normative analysis to refer to prescriptive, value-based statements. This quarterly commentary – as will all of our Election Insights coverage – offers what we intend to be viewed as purely positive analysis about the election: important upcoming dates, a look at the economic indicators that have some predictive power for the eventual outcome, current polling numbers in battleground states, and forecasts from prediction markets.

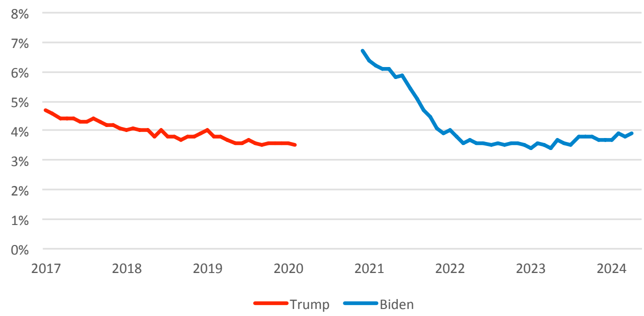
When we started working on this article in early June, we knew that first presidential debate would occur right before our publication date and that we might have to make a few minor updates right before publication. However, we didn't seriously anticipate that President Biden's performance would be awful enough to create a crisis moment within the Democratic Party.

Many observers are now wondering if Biden will be replaced as the Democratic Party's nominee. While the probability of that occurring is certainly higher today than it was a week ago, there are no smoke-filled rooms where influential party members determine the candidate. Biden won 99% of the pledged delegates via state primaries and he is the only person that can make the decision to release those delegates. For now, Biden remains the likely Democratic nominee and this article examines the current state of the contest through that lens.

Economic Backdrop

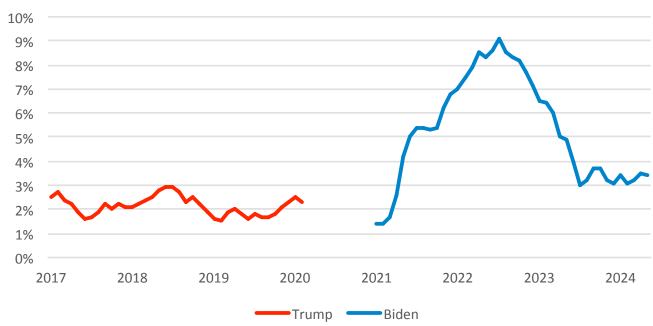
The US's strong labor market (Fig. 1) and solid economic growth would historically favor the incumbent, President Biden, but sticky inflation (Fig. 2) and falling real wages (Fig. 3) offset those advantages. At this juncture, the national economic data doesn't point to a clear advantage for Biden or Trump, but the Misery Index (Fig. 4), a

Fig. 1: The US unemployment rate remains below 4%



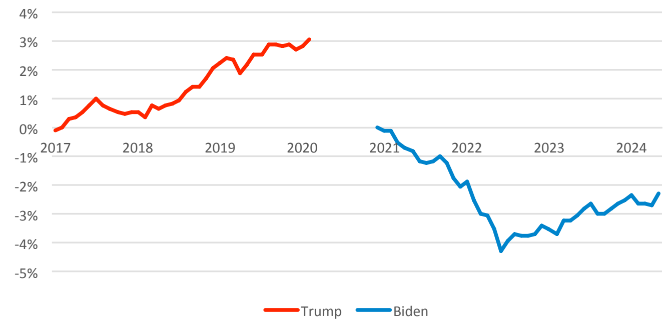
Source: Bloomberg, Mill Creek.

Fig. 2: Inflation (CPI) is stuck above 3%



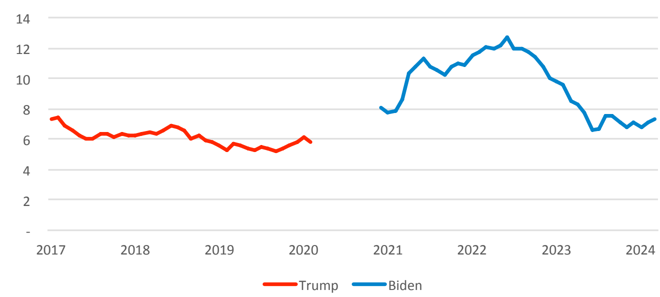
Source: Bloomberg, Mill Creek.

Fig. 3: Inflation-adjusted income growth has been negative for Biden's first term



Source: Bloomberg, Mill Creek. Lines show cumulative real income growth.

Fig. 4: The "Misery Index" remains elevated



Source: Bloomberg, Mill Creek.

combination of the unemployment rate and the inflation rate, remains slightly elevated relative to Trump's pre-COVID economic environment. Further declines in inflation would benefit Biden presuming it doesn't coincide with job losses.

Consumer sentiment (Fig. 5) remains highly polarized based on political affiliation, but it is worth noting that sentiment remains subdued across the board and is much lower for independents today than during the Trump presidency, which could be important in swing states.

While manufacturing is a small part of the US economy, it might end up being a factor in Pennsylvania, Wisconsin, and Michigan. The Institute of Supply Management (ISM) produces a measure of manufacturing activity known as the Manufacturing Purchasing Managers' Index (PMI). An index level above 50 indicates manufacturing is expanding, whereas an index level below 50 indicates a contraction in manufacturing. Manufacturing has been contracting since mid-2022 but has recently shown signs of recovery (Fig. 6).

In totality, we don't believe the current economic situation gives either candidate a clear advantage. Unemployment is near all-time lows, so Biden's economic prospects are heavily tied to inflation. Trump has the most to gain from worsening economic conditions or a resurgence in inflation.

Current Polling

We provide polling (as of 6/30/2024) as a reference point for the current state of the race (Fig. 7). Many observers don't believe polls are predictive until later in the cycle, and these results do not yet include any post-debate polls.

There are also active political prediction (i.e., betting) markets, which (academically[1]) are considered more accurate predictors of outcomes than polling. However, political betting markets are illegal in the US, which limits the ability of US residents to participate.

The largest online prediction market is Polymarket, a decentralized prediction platform that operates on the Ethereum blockchain. Approximately $200 million has been bet on the US election outcome through Polymarket. PredictIt is another online prediction market that is owned and operated by Victoria University of Wellington in New Zealand. PredictIt only trades a few thousand dollars of volume in the US presidential market, on average, per day.

Conclusion

Economic data has yet to break in a direction that is conclusively favorable to either candidate and consumer

[1] https://repository.arizona.edu/handle/10150/666656

sentiment remains heavily biased with political affiliation. While current polling and prediction markets favor a Trump victory, we are too far from the election to have strong conviction in the outcome. Perhaps more importantly, the policy agenda of the president will be heavily predicated on the makeup of Congress. Odds favor the Republicans to take back a slight majority in the Senate, but the composition of the House remains very uncertain.

Therefore, it is too early to begin positioning portfolios for a particular outcome (see our Perspective). At this time we'd focus more on estate and tax planning considerations, like the possibility that the estate and gift tax exemption will fall back to pre-Tax Cuts and Jobs Act level of $5 million, adjusted for inflation, at the end of 2025. The consumer sentiment chart (Fig. 5) is also worth pondering. We've experienced historically good labor market conditions under both Trump and Biden and equity markets produced double-digit growth for both presidents. Allowing political partisanship to drive our economic and market perspective is rarely a recipe for success.

Important Dates

Week of July 8: Trump is likely to announce his running mate.

July 15–18: Republican National Convention in Milwaukee, Wisconsin. Wisconsin is one of the seven battleground states that will likely determine the election outcome.

August 13: Vice Presidential Debate

August 19–22: Democratic National Convention in Chicago, Illinois. Organizers are worried about protests and potential violence in what might feel like a modern-day replay of the 1968 Democratic National Convention.

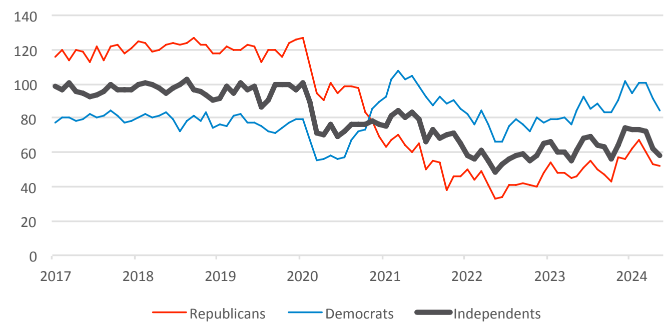
September 2: Generally considered to be the beginning of the final leg of the campaign and when polling numbers become more predictive for the election outcome.

September 17–18: Final Federal Open Market Committee (FOMC) meeting before the election. While we believe the Fed to be an apolitical institution, some observers are likely to interpret their actions as political.

September 20: Early voting begins in Minnesota, South Dakota, and Virginia. Most states begin early voting sometime in October.

November 5: Election Day

Fig. 5: Consumer sentiment remains subdued



Source: Bloomberg, Mill Creek.

Fig. 6: ISM Manufacturing PMI

Source: Bloomberg, Mill Creek.

Fig. 7: Current polling averages, Biden v. Trump

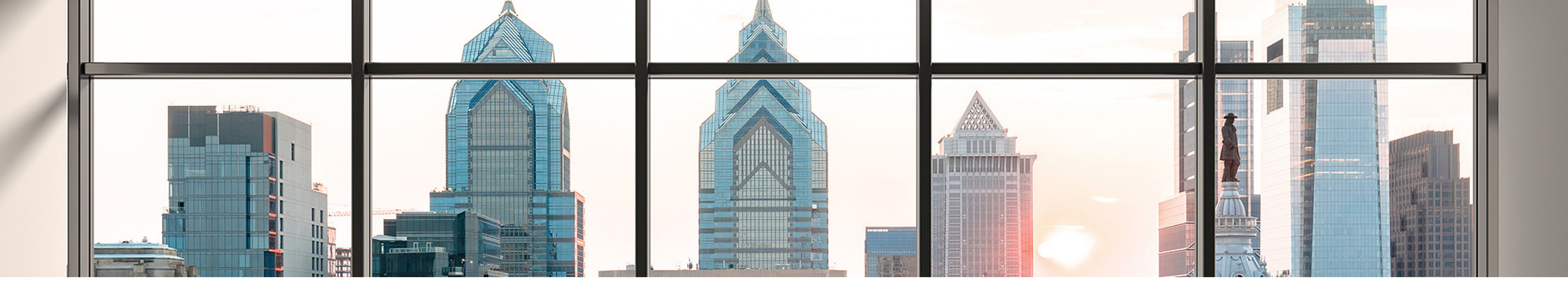
	Electoral Votes	538 (ABC News)	RealClear-Politics
National	270	-0.7%	-1.9%
Arizona	11	-4.3%	-5.6%
Georgia	16	-5.8%	-4.0%
Michigan	15	-0.8%	-0.5%
Nevada	6	-3.2%	-2.8%
North Carolina	16	-6.6%	-6.7%
Pennsylvania	19	-1.4%	-2.8%
Wisconsin	10	-0.2%	Tie

Source: Bloomberg, Mill Creek.

Fig. 8: Prediction market odds (Likelihood to win)

	Polymarket	PredictIt
Biden	22%	37%
Trump	64%	57%

Source: Bloomberg, Mill Creek.



House View Summary

Our Tactical Preferences

	Underweight	Neutral	Overweight
Cash		=	
Municipal Fixed Income	–		
State/Local GO	–		
Lease			+
Transportation	–		
Higher Education		=	
Health Care			+
Duration		=	
Taxable Fixed Income	–		
Corporate			+
Government	–		
Securitized			+
Duration		=	
Public Equity		=	
US Large-Cap			+
US Mid- and Small-Cap			+
US Growth		=	
US Value		=	
International Developed	–		
Emerging Markets	–		
Private Assets			
Private Debt			+
Private Equity			+

Our Perspective

1. The US economy is experiencing a soft landing. Inflation has moderated significantly and economic growth has moderated back to the pre-COVID trend.
2. The US labor market, in particular, remains quite strong.
3. The Fed will likely reduce the fed funds target (cash rates) sometime in 2024, but the cuts won't be significant unless the economy falls into recession.
4. Interest rate–sensitive countries, including Australia, Canada, Norway, Sweden, and the UK, remain weak links in global growth.
5. We are underweight fixed income and expect headwinds for bonds as Fed rate cut expectations prove to be excessive.
6. Within fixed income, we are neutral duration and believe it is prudent to maintain high credit quality.
7. US equity valuations, particularly in the mega-cap growth space, remain elevated. Small-cap US equities are trading at the largest discount to large-cap in 30 years.
8. We are overweight US equities, overweight US small-cap equities, and underweight the rest of the world.
9. We are overweight private credit and private equity.

Second Quarter 2024: Market Review

- US inflation has ranged from 2.5-3% annualized rate over the last 3-6 months.
- The US labor market remains strong but showed signs of cooling in Q2, with slower job creation and some layoffs in interest rate-sensitive sectors.
- The Atlanta Fed's GDP Now measure is tracking at 3% GDP growth for Q2. Private forecasters are closer to 2% growth. The first official estimate will be released in a month.
- A policy rate cut from the Federal Reserve is likely in play for September or November if economic data continues to trend in the current direction.
- The European Central Bank made the first of what could be multiple policy rate cuts this year.
- China continues to experience weak domestic demand and deflationary pressures and would like to cut interest rates, but has hesitated to do so in order to not put depreciation pressure on the renminbi.
- The Case-Shiller National House Price Index was up 6.3% year-over-year in April and residential housing inventory remains well below normal levels.
- Interest rates rose modestly over the balance of the quarter, creating headwinds for bond returns.
- Global equities rose 2.9%. US growth continues to outperform, whereas US small and mid-cap equities lagged. Emerging market equities also had a good quarter.

Index Returns	Q2 2024	2024 YTD	2023	2022	2021	2020	1 Year	3 Years	5 Years	10 Years
Global Equities	2.9%	11.3%	22.2%	-18.4%	18.5%	16.3%	19.4%	5.4%	10.8%	8.4%
US Equities	3.2%	13.6%	26.0%	-19.2%	25.7%	20.9%	23.1%	8.1%	14.1%	12.1%
Large Cap US	3.6%	14.2%	26.5%	-19.1%	26.5%	21.0%	23.9%	8.7%	14.6%	12.5%
Mid Cap US	-3.3%	5.0%	17.2%	-17.3%	22.6%	17.1%	12.9%	2.4%	9.5%	9.0%
Small Cap US	-3.3%	1.7%	16.9%	-20.4%	14.8%	20.0%	10.1%	-2.6%	6.9%	7.0%
US Growth	7.8%	19.9%	41.2%	-29.0%	25.8%	38.3%	32.2%	10.3%	18.5%	15.8%
US Value	-2.3%	6.2%	11.7%	-8.0%	25.4%	2.9%	12.9%	5.1%	8.9%	8.1%
Int'l Developed Equities	-0.4%	5.3%	18.2%	-14.5%	11.3%	7.8%	11.5%	2.9%	6.5%	4.3%
Emerging Market Equities	5.0%	7.5%	9.8%	-20.1%	-2.5%	18.3%	12.5%	-5.1%	3.1%	2.8%
US Taxable Bond Market	0.1%	-0.7%	5.5%	-13.0%	-1.5%	7.5%	2.6%	-3.0%	-0.2%	1.3%
US Municipal Bond Market	-0.4%	-0.8%	4.6%	-4.8%	0.5%	4.2%	2.3%	-0.4%	1.0%	1.8%
Diversified Commodities	2.9%	5.1%	-7.9%	16.1%	27.1%	-3.1%	5.0%	5.7%	7.2%	-1.3%
Hedge Funds	1.9%	6.9%	7.8%	-6.9%	9.7%	9.5%	11.5%	2.5%	5.7%	4.2%

Index Returns (as of Dec 31, 2023)	2023	2022	2021	2020	1 Year	3 Years	5 Years	10 Years
Global Equities	22.2%	-18.4%	18.5%	16.3%	22.2%	5.7%	11.7%	7.9%
Private Equity	8.4%	-1.6%	45.7%	21.8%	8.4%	15.8%	17.1%	15.4%
US Taxable Bond Market	5.5%	-13.0%	-1.5%	7.5%	5.5%	-3.3%	1.1%	1.8%
Private Credit	11.5%	4.7%	16.5%	2.0%	11.5%	10.8%	8.4%	8.3%

Key Rates (as of stated date)	Jun-2024	Dec-2023	Dec-2022	Dec-2021	Dec-2020	Dec-2019	Dec-2018	Dec-2017	Dec-2016	Dec-2015
US 10-Year Treasury	4.4%	3.9%	3.9%	1.5%	0.9%	1.9%	2.7%	2.4%	2.4%	2.3%
Barclays Aggregate Bond Index	5.0%	4.5%	4.7%	1.8%	1.1%	2.3%	3.3%	2.7%	2.6%	2.6%
BBarc Muni 1-10 Yr Blend (1-12) Index	3.4%	2.8%	3.0%	0.7%	0.6%	1.4%	2.2%	2.0%	2.1%	1.6%

Source: Bloomberg, Mill Creek. Returns for periods greater than one year are annualized. Index rates are yield to worst. As of June 30, 2024 unless otherwise stated. Indices used to represent periodic capital markets returns include: MSCI ACWI (Global equities), Russell 3000 (US equities), Russell 1000 (Large Cap US), Russell Mid Cap US (Mid Cap US), Russell 2000 (Small Cap US), Russell 3000 Growth (US Growth), Russell 3000 Value (US Value), MSCI EAFE (International Developed), MSCI Emerging Markets Index (Emerging Markets Equities), Bloomberg Aggregate Bond Index (US Taxable Bonds), Bloomberg 1–10 Year Municipal Bond Index (US Municipal Bonds), HFRX Global Hedge Fund Index (Hedge Funds), Bloomberg Commodity Index TR (Diversified Commodities), Pitchbook Buyout PE Index (Private Equity), and Pitchbook Private Debt Index (Private Credit).

The historical index performance results are provided exclusively for comparison purposes over various time periods only. It is not possible to invest directly in an index. Index performance does not reflect any management fees, transaction costs, or other expenses that would be incurred by a portfolio or fund, or transactions in fund shares. Such fees, expenses, and commissions would reduce returns. It should not be assumed that any account holdings will correspond directly to any comparative index reflected herein. Data as of June 30, 2024.

Inflation Metrics Explained

By Michael LoCasale, Vice President

Halfway through the year, US inflation has proved persistent relative to where expectations sat at the start of 2024. This has had far-reaching consequences for the economy and capital markets, most notably causing projections for monetary policy easing to be walked back significantly. With inflation unlikely to fade from center stage over the coming months, we thought it would be helpful to provide a refresher on some of the more popular measures of inflation.

CPI vs. PCE

The two most well-known measures of inflation are the Consumer Price Index (CPI) and the Personal Consumption Expenditures Index (PCE). CPI is produced by the Bureau of Labor Statistics (BLS) and calculates the average change in out-of-pocket expenses paid by urban consumers for a basket of goods and services. PCE is calculated by the Bureau of Economic Analysis (BEA), and measures the average change in *actual* expenses for urban *and* rural consumers, as well as payments made on their behalf. Notably, PCE includes the price of all medical goods and services purchased by employer-provided insurance as well as public programs such as Medicare and Medicaid, in addition to nonprofit expenses on behalf of households.

Due to the significant discrepancy in scope between the two measures, their underlying components can differ dramatically. As shown in Fig. 1, CPI has over twice the weight to housing-related goods and services compared to PCE, while PCE has a much higher emphasis on medical, financial, and insurance expenses. These differences can, at times, account for notable differences in readings between the two measures. However, over longer periods, CPI and PCE should generally produce similar results, with CPI historically running about 0.5% higher than PCE, on average.

The compositions shown above certainly do not reflect the breakdown of spending for any one individual consumer, particularly those at either end of the wealth spectrum. Rather, they represent the breakdown of spending for the *average* consumer, when viewing the economy in aggregate.

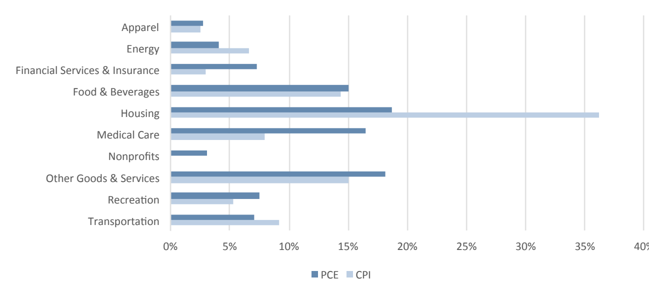
Variations of Inflation Measures

To further understand inflation, there are several variations of CPI and PCE, with the most well known being headline, core, supercore, and trimmed mean.

- **Headline:** comprises all components shown above, including food and energy, the prices of which can be particularly volatile.
- **Core:** excludes food and energy, in order to focus on components whose prices tend to be "stickier," or less susceptible to price changes.
- **Supercore:** removes housing from core inflation.
- **Trimmed mean:** strips out the fastest- and slowest-growing prices, to reduce statistical "noise."

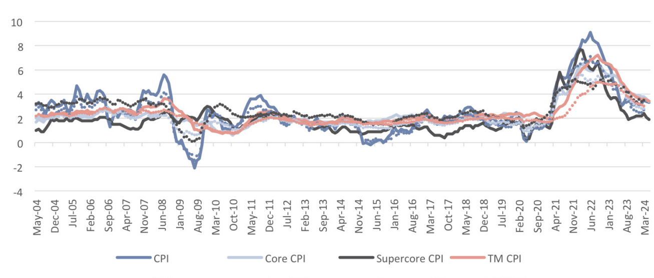
These variations can be used in combination to understand the general inflationary pressures within the economy, and they are all telling the same story: that inflation has cooled noticeably from the 2021 and 2022 (Fig. 2) highs, remains elevated relative to the Fed's long-run target of 2%, and could require months or even years of patience from the Fed and households to get back to 2%.

Fig. 1: Index components



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Mill Creek.

Fig. 2: Year-over-year inflation (%)



Source: Bloomberg, Mill Creek.

Mid-Year Financial Planning Checklist for Private Clients

As we reach mid-year 2024, the financial landscape has experienced significant equity market gains, with many equity market indices hitting record highs. Now is an excellent time to reassess financial strategies. Here are the key areas we are focusing on with our clients to ensure their plans align with their goals and objectives:

1. **Rebalancing Investment Portfolios:**

- [ ] Given this year's market performance, portfolios may need to be rebalanced back to target allocations to maintain alignment with your objectives and risk tolerance.

2. **Managing Short-Term Cash Needs:**

- [ ] Now is an opportune time to raise cash from investment portfolios by selling overweight positions or taking your Required Minimum Distributions where appropriate.

3. **Long-Term Needs and Risk Management:**

- [ ] Revisit liquidity needs to ensure sufficient fixed income and diversification to weather potential market volatility.
- [ ] Invest excess cash is in high-yield savings accounts and pay down any high-interest liabilities.

4. **Optimizing 2024 Contributions and Gifts:**

- [ ] Optimize IRA and employer-sponsored retirement plan contributions.
- [ ] Leverage increased annual gift limits to maximize lifetime gifting (details in Fig. 1).
- [ ] Review charitable giving strategies, such as donating appreciated assets, bunching charitable gifts, and utilizing Qualified Charitable Distributions (QCDs) for clients over the age of 70.5. As a reminder, the QCD limit has increased from $100,000 to $105,000 in 2024.

5. **Updating Estate Plans and Reviewing Beneficiaries:**

- [ ] Review any changes in your family or financial situation and prepare for the expiration of the Tax Cuts and Jobs Act provisions in 2025.
- [ ] Ensure beneficiary designations on retirement accounts and other financial documents align with current wishes.

By addressing these key areas, we help our clients ensure their financial plans remain aligned with their long-term goals and objectives. For a detailed checklist of 2024 financial planning items, please refer to Fig. 1.

Fig. 1: Important Tax Planning Thresholds (2024)

Retirement	2024
401(k), 403(b), 457 limits	$23,000
Catch-up contributions (age 50+)	$7,500
IRA contribution	$7,000
IRA catch-up contribution	$1,000
Limit on annual additions to Defined Contribution plan (for example, SEP IRA)	$69,000
Limit on annual additons to Defined Benefit plan	$275,000
Estate and gift tax	**2024**
Annual gift exclusion	$18,000
Estate and GST exemption amount	$13,610,000

Private Equity in 2024: Resilient Growth Amid Market Challenges

By Andrew Murray, Managing Director of Private Equity

This quarter's commentary focuses on what has happened thus far in 2024 based on two observable data points:

1) Capital formation in private equity

2) Earnings growth in the middle market

These data points illustrate a market that remains both substantial and resilient across various dimensions. While the rise in interest rates has undoubtedly compressed purchase multiples and put pressure on highly levered transactions financed with floating-rate debt, the overall industry and environment remain attractive to new investors.

Capital Formation

Private equity fundraising data is a key indicator of investor willingness to make long-term commitments. In the first quarter of 2024, investors showed a remarkable appetite with over 100 funds raising $156 billion—a 16% increase over the five-year first-quarter average (Fig. 1). Despite the uncertainty of a US election year and significant geopolitical instability in Europe, fundraising remained strong in both regions, highlighting the abundant opportunities for skilled PE managers.

The only major caveat to this trend is the rise of the "megafund." Funds with over $5 billion in commitments garnered their largest share of the overall market in the past decade. Allocators are signaling trust in the oldest, most well-established managers with the greatest share of their allocations, leaving less room for smaller emerging firms.

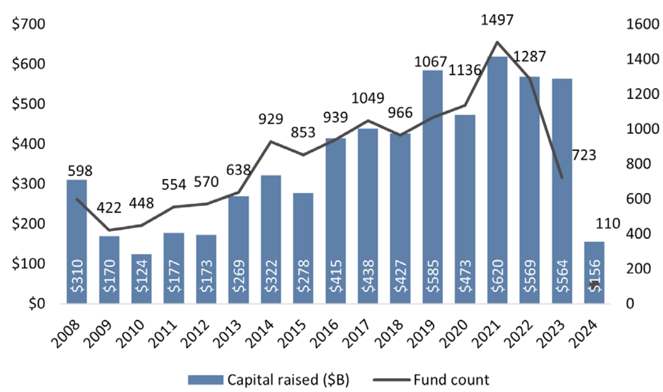
Earnings Momentum

By definition, measuring quarterly sales and earnings metrics across an industry with the word "private" in its name makes any sort of holistic summary of operational performance challenging. Nonetheless, the Golub Capital Altman Index provides a reasonable barometer for operating performance across a diversified sample of private equity–backed companies.[1]

The recent data and long-term trends in the report indicate healthy growth for companies in the lower middle market and support the rationale for new allocations to the asset class (Fig. 2). Double-digit earnings growth in the first two months of the year highlights the health of companies in the lower middle market and their ability to navigate many of the labor and inflationary challenges facing the economy.

Fig. 1: Private equity fundraising is off to a strong start in 2024

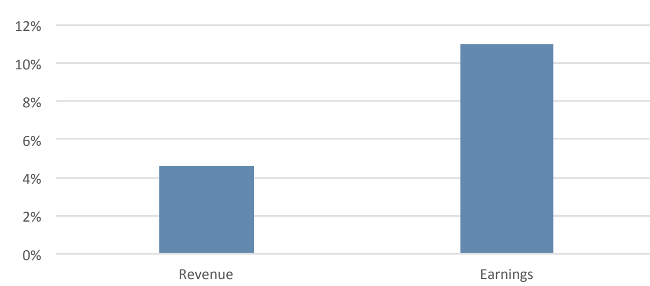
PE fundraising activity by vintage year



Source: PitchBook, Mill Creek. *YTD as of 3/31/24.

Fig. 2: Revenue and earnings in the middle market remain strong

Revenue and earnings growth in the Golub Capital Altman Index



Source: Golub Capital Middle Market Report, Mill Creek. Data as of March 31, 2024.

[1] The Golub Capital Middle Market Report analyzes the results of the Golub Capital Altman Index ("GCAI"), which measures the median revenue and earnings growth of approximately 110–150 privately owned companies in the Golub Capital loan portfolio for the first two months of each calendar quarter. It compares these results to the financial performance of well-known market indexes, including the S&P 500 and S&P SmallCap 600. The GCAI is produced by Golub Capital in collaboration with credit expert Dr. Edward I. Altman.

Around Mill Creek

Firm highlights, milestones, events, and resources

First Annual Pickleball Tournament

In May, we kicked off our first annual pickleball tournament at Valley Forge Military Academy & College. It was a fantastic day full of sportsmanship and camaraderie. Huge congratulations to **Pat Burke** and **Michael LoCasale** for taking home the championship. We're already looking forward to next year's event!

In case you missed it…

Family Wealth Dynamics: Navigating Generational Transitions & Governance Strategies

Tune in to hear **Katie Poole**, Principal and Investment Officer at Mill Creek, and **Lisa Beattie Frelinghuysen**, Senior Advisor at Banyan Global, explore the complexities of family governance and decision-making and offer valuable insights on engaging the next generation as they step into positions of power. Watch it here.

New hires

Welcome aboard to our newest team members.

Michael McDermott, Client Experience Manager

Dhruvi Dangar, Co-op

PUBLICATION DETAILS

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Certain statements set forth in this commentary constitute "forward-looking statements." All such forward-looking statements involve risks and uncertainties, and there can be no assurance that the forward-looking statements included in this commentary will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as representations or warranties of MCCA and that the forward-looking statements will be achieved in any specified time frame, if at all.

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