MILL CREEK CAPITAL ADVISORS

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Q2 2025 Outlook

CONTENTS

01 April 2025

The Wait-and-See Economy

By Michael Crook, Chief Investment Officer

We enter the second quarter of 2025 with a constructive but less optimistic economic outlook for the US. While leading indicators for the US economy point to continued growth, the outlook is increasingly clouded by high levels of uncertainty around economic policy and geopolitics.

President Donald Trump came into office with investors focused on his pro-growth policies — namely tax reform, energy production, and deregulation. The first two months of his administration made it clear the focus would equally be tariffs and deportations — policies viewed by the market as anti-growth.

Our investment positioning can be described as optimistically cautious. We expect global stocks to outperform bonds over the balance of 2025, but believe diversifiers like private credit, private equity, and private real estate are increasingly vital for portfolio health and resilience. US large-cap growth — and the Magnificent 7 in particular — remains the frothiest part of the global equity market and therefore the most at risk from continued headwinds.

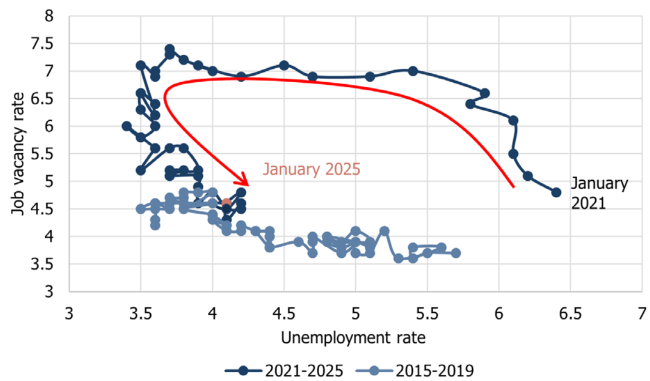
Economic normalization

The post-COVID labor market was characterized by high vacancies and low unemployment (Fig. 1, next page). The relationship between job vacancies and unemployment has returned to the same levels we saw between 2015 and 2019, which is to say the balance of negotiating power between employers and employees is no longer fully on the side of job seekers.

Inflation has also largely normalized. Yes, the Fed's preferred gauge of inflation[1] remains above 2% (Fig. 2, next page), but inflation has never flatlined at exactly 2% for an extended period. We're closer to 2% today than we have been 85% of the time over the last 25 years. We expect them to remain in a "hold" position until they are forced into another hiking or easing cycle.

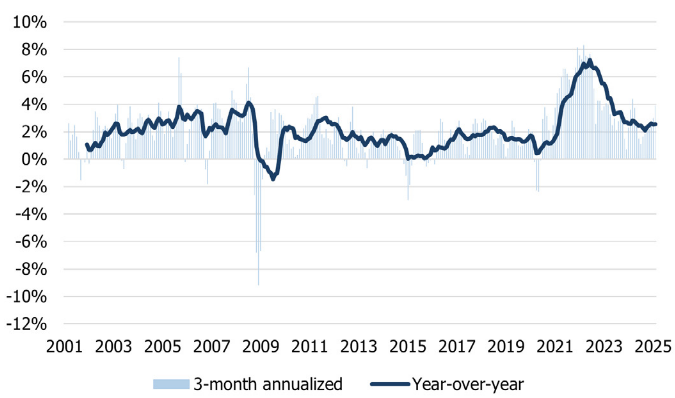
[1] Personal Consumption Expenditures Price Index

Fig. 1: Labor market tightness has dissipated



Source: Bloomberg, Mill Creek. As of 3/31/25.

Fig. 2: Inflation...close enough for government work (PCE Price Index)



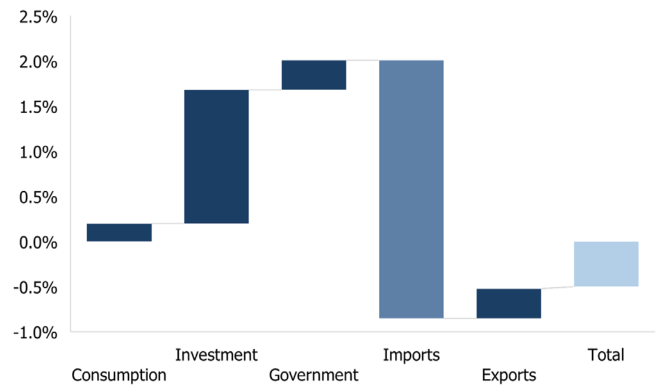
Source: Bloomberg, Mill Creek. As of 3/31/25.

But are we headed into a recession?

When the first estimate for Q1 2025 GDP growth is released on April 30, it is likely to be a negative number. It will be important for investors to look past that negative data point and understand that it was mainly driven by a surge of imports ahead of potential tariffs. We're likely to see an equal and opposite bounce-back effect in Q2 or Q3.

The GDP accounting identity is GDP = C + I + G + (EX – IM), where C is personal consumption, I is private investment, G is government consumption, and (EX – IM) is exports minus imports. The Department of Government Efficiency (DOGE) has yet to make a meaningful dent in government spending, and personal consumption and private investment remain healthy. Net exports, on the other hand, are estimated to detract 3.5% from GDP for Q1, thus pulling the overall GDP growth number into negative territory (Fig. 3).

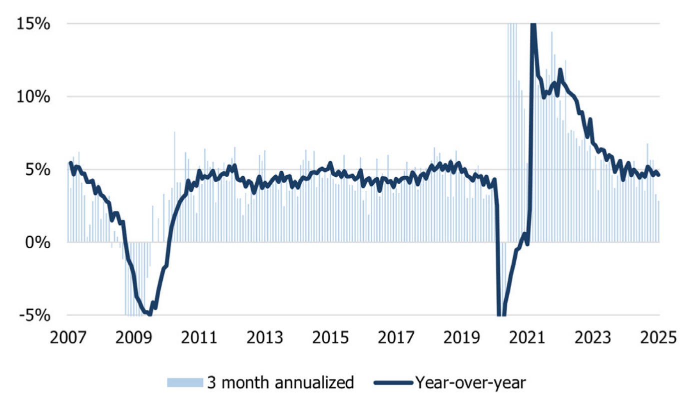
Fig. 3: Imports were a drag on Q1 GDP growth (Atlanta Fed GDPNow)



Source: Bloomberg, Mill Creek. As of 3/31/25.

Aggregate income growth (the total amount of income all Americans are taking home each week), which should be roughly equal to GDP growth, provides an easy way to look through current GDP distortions. Aggregate income (Fig. 4) continues to grow at 4–5% year-over-year, but has slowed in recent months.

Fig. 4: US Index of Aggregate Weekly Payrolls

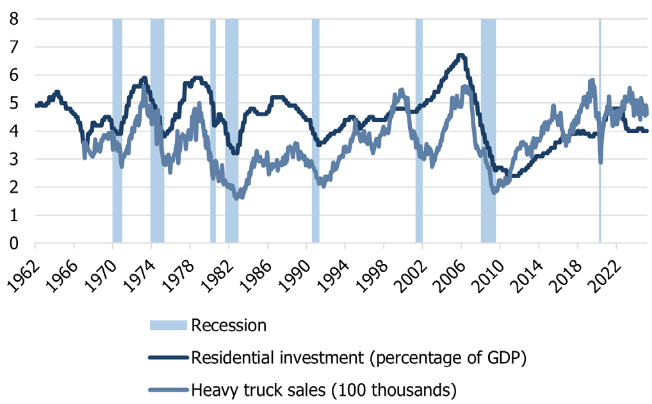


Source: Bloomberg, Mill Creek. As of 3/31/25.

The US economy is slowing but healthy. The same can be said about the US equity market. In 2024, Q4 S&P 500 earnings were 17% higher year-over-year with 5% revenue growth.

Leading indicators, like residential investment and heavy truck sales, also signal that it's too early to be worried about recession (Fig. 5).

Fig. 5: Leading indicators point to continued growth

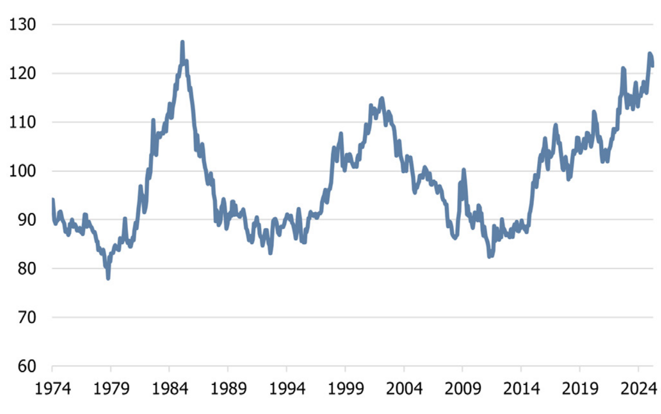


Source: Bloomberg, Mill Creek. As of 3/31/25.

Wither the dollar?

The dollar has declined roughly 6% since President Trump took office, which sounds meaningful but is inconsequential from a longer-term perspective (Fig. 6). The dollar is strong for many reasons, but its status as the world's safe-haven reserve currency creates constant demand for the dollar and dollar assets. A too-strong dollar makes US exports more expensive for foreign consumers and US imports cheaper for domestic consumers.

Fig. 6: US Trade-Weighted Dollar Index



Source: Bloomberg, Mill Creek. As of 3/28/25.

As we discussed in February, President Trump's top economic advisors would like to see a weaker dollar while maintaining the safe-haven role of the dollar in world affairs. In 1985, President Ronald Reagan orchestrated the Plaza Accord (named after the NYC hotel where the agreement was signed), which resulted in the deliberate weakening of the dollar relative to the currencies of our major trading partners.

We are uncertain as to whether President Trump will try to pull off an equivalent "Mar-a-Lago Accord," as his advisor Stephen Miran has called it, but the dollar also faces headwinds from our fiscal situation. High real economic growth has stabilized our current debt-to-GDP ratio, but a slowdown or actual recession would be very challenging to work through without austerity measures like Europe faced after 2008. The muddle-through approach requires lower real interest rates, which is likely to lead to a weaker dollar.

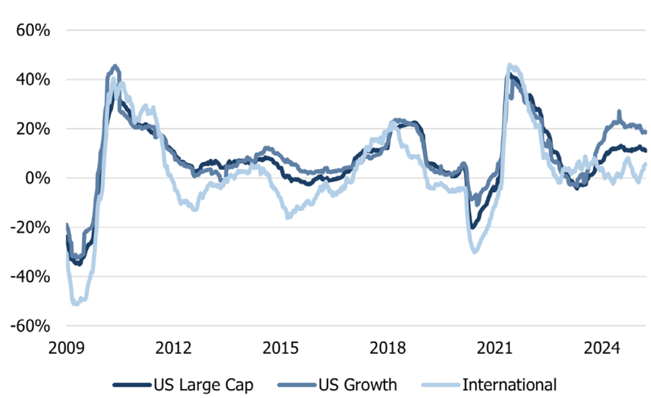
Is American (corporate) exceptionalism over?

American exceptionalism is a loaded phrase. Here, we simply use it to refer to (1) the persistent outperformance of US financial markets, and (2) the high valuations that US financial assets have been able to achieve versus their international counterparts.

As we've described above, the US economy is slowing but healthy. The same can be said about the US equity market. In 2024, Q4 S&P 500 earnings were 17% higher year-over-year with 5% revenue growth.

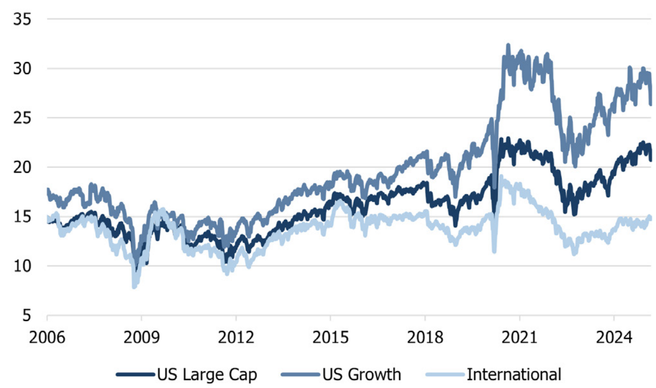
However, continued policy uncertainty will weigh on markets—particularly if lack of clarity around tariffs results in a pullback in business investment and consumer spending. Twelve-month forward earnings expectations are significantly higher for US equities (Fig. 7), which already trade at a higher premium (Fig. 8, next page), than other parts of the world. Expectations are particularly high for US mega-cap growth.

Fig. 7: US growth equities have a high earnings hurdle (12-month forward earnings growth)



Source: Bloomberg, Mill Creek. As of 3/28/25.

Fig. 8: US growth equities trade at “exceptional” valuations (12-month forward P/E)

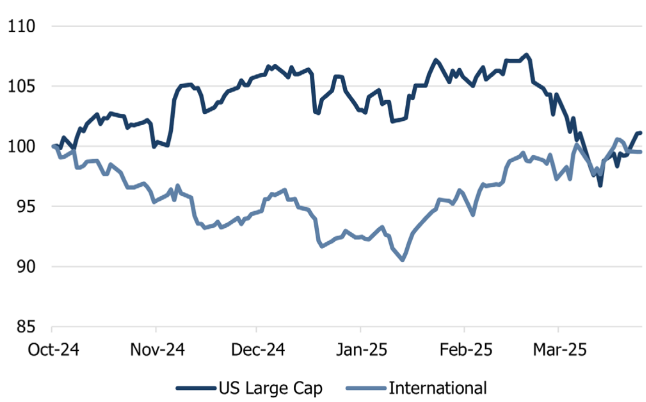


Source: Bloomberg, Mill Creek. As of 3/28/25.

Whether due to damage from tariff concerns, disruptive technological advancements like DeepSeek, or a recognition that current expectations are simply excessive, US mega-cap growth remains overvalued relative to other parts of the equity market.

Nevertheless, we believe it is wrong to say that the March swoon in equity markets impacted US growth or the Magnificent 7 more than other parts of the market. Virtually every equity market—and submarket (e.g., the Magnificent 7)—reverted back to the level they were at in early October when President Trump became the front-runner in prediction markets (Fig. 9). Markets priced in optimism, and have priced it back out for now, and we’d caution against reading more into it at the moment.

Fig. 9: Stock markets are back to last fall’s levels



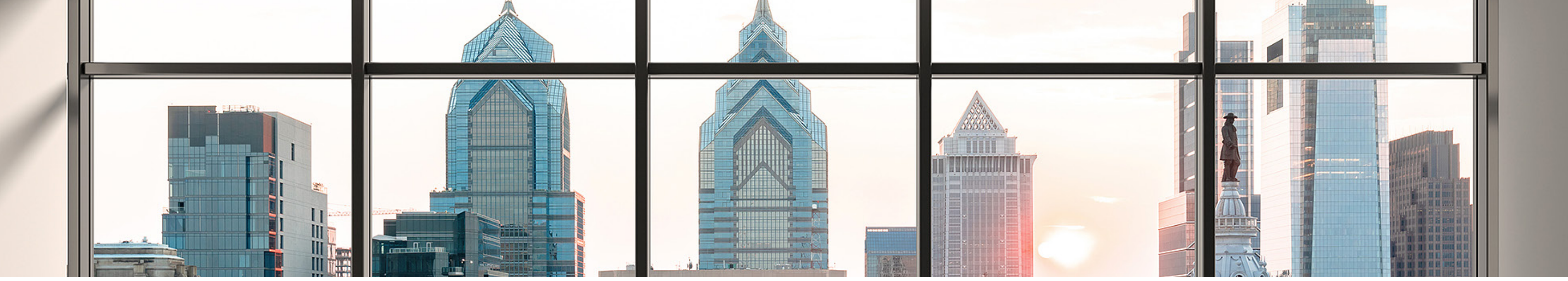
Bloomberg, Mill Creek. As of 3/28/25.

Asset allocation

Attempting to time the market based on policy announcements coming out of Washington is a fool’s errand.

The recent pullback in equities provides an opportunity for investors who are underweight public equities, but we do not believe the sell-off has been sufficient to overweight equities within a balanced portfolio.

Our focus continues to be on finding investments that we believe offer compelling risk-adjusted returns for investors who are resilient to the whims of politicians and the emotions of market participants. In addition to private equity (see p. 10) and private credit (see p. 8), our investment committee recently approved a value-add private real estate strategy (see p. 7) that we believe is particularly timely in the current environment, will be accretive to portfolio performance, and will continue to help us diversify out of public stocks and bonds without sacrificing returns.



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			+
Private Real Estate			+

Our Perspective

1. Policy uncertainty continues to weigh on the US economy. Consumer sentiment has deteriorated, inflation expectations are rising, and corporate capital expenditure plans have been pulled back.
2. Even so, US economic growth remains solid. Aggregate income growth remains above 4% and we haven't seen a deterioration in two of the best leading indicators — residential investment and heavy truck sales.
3. Inflation remains stubbornly above the Fed's target, but we expect the Fed to continue with a wait-and-see approach until growth deteriorates or inflation heads higher.
4. Within fixed income, we are neutral duration and believe it is prudent to maintain high credit quality.
5. US equity valuations, particularly in the mega-cap growth space, remain elevated. International and US small cap are more reasonably valued.
6. The correlation between stocks and bonds remains very high, making diversifiers increasingly important.
7. We are overweight alternative income strategies versus traditional fixed income.
8. We are overweight private equity and private real estate versus the rest of the portfolio.

First Quarter 2025: Market Review

- Trade news dominated headlines during the quarter, as investors scrambled to assess the impact that ever-evolving tariff proposals may have on the capital markets.
- The Federal Reserve kept its policy rate steady at a range of 4.25%–4.5%. The central bank expects to cut rates twice during the remainder of 2025, while markets are pricing in three to four cuts.
- US economic growth is expected to slow in Q1, with consensus estimates projecting GDP growth in the range of 1%–2%, down from 2.3% at the end of 2024.
- Personal Consumption Expenditures (PCE) inflation has remained steady over recent months, at roughly 2.5% year-over-year.
- Likewise, the labor market remains on solid footing, with the most recent unemployment rate of 4.1% largely unchanged over the past six months.
- Uncertainty around global trade caused geographic equity performance to vary dramatically, with foreign markets significantly outperforming domestic.
- Traditional fixed income posted a positive return as rates declined overall.

Index Returns (as of Mar. 31, 2025)	Q1 2025	2024	2023	2022	2021	2020	1 Year	3 Years	5 Years	10 Years
Global Equities	-1.3%	17.5%	22.2%	-18.4%	18.5%	16.3%	7.2%	6.9%	15.2%	8.8%
US Equities	-4.7%	23.8%	26.0%	-19.2%	25.7%	20.9%	7.2%	8.2%	18.2%	11.8%
Large Cap US	-4.5%	24.5%	26.5%	-19.1%	26.5%	21.0%	7.8%	8.7%	18.5%	12.2%
Mid Cap US	-3.4%	15.3%	17.2%	-17.3%	22.6%	17.1%	2.6%	4.6%	16.3%	8.8%
Small Cap US	-9.5%	11.5%	16.9%	-20.4%	14.8%	20.0%	-4.0%	0.5%	13.3%	6.3%
US Growth	-10.0%	32.5%	41.2%	-29.0%	25.8%	38.3%	7.2%	9.6%	19.6%	14.5%
US Value	1.6%	14.0%	11.7%	-8.0%	25.4%	2.9%	6.7%	6.3%	16.1%	8.6%
Int'l Developed Equities	6.9%	3.8%	18.2%	-14.5%	11.3%	7.8%	4.9%	6.1%	11.8%	5.4%
Emerging Market Equities	2.9%	7.5%	9.8%	-20.1%	-2.5%	18.3%	8.1%	1.4%	7.9%	3.7%
US Taxable Bond Market	2.8%	1.3%	5.5%	-13.0%	-1.5%	7.5%	4.9%	0.5%	-0.4%	1.5%
US Municipal Bond Market	0.7%	0.9%	4.6%	-4.8%	0.5%	4.2%	2.0%	2.0%	1.3%	1.8%
Diversified Commodities	8.9%	5.4%	-7.9%	16.1%	27.1%	-3.1%	12.3%	-0.8%	14.5%	2.8%
Hedge Funds	0.7%	11.1%	7.8%	-6.9%	9.7%	9.5%	6.7%	4.5%	8.7%	4.3%

Index Returns (as of Sept. 30, 2024)	2024 YTD	2023	2022	2021	2020	1 Year	3 Years	5 Years	10 Years
Global Equities	18.7%	22.2%	-18.4%	18.5%	16.3%	31.8%	8.1%	12.2%	9.4%
Private Equity	5.3%	8.2%	-0.3%	36.1%	20.3%	9.4%	6.4%	14.0%	13.5%
US Taxable Bond Market	4.4%	5.5%	-13.0%	-1.5%	7.5%	11.6%	-1.4%	0.3%	1.8%
Private Credit	9.2%	8.6%	1.4%	18.2%	2.8%	10.6%	7.4%	8.1%	7.5%

Key Rates (as of stated date)	Mar-2025	Dec-2024	Dec-2022	Dec-2021	Dec-2020	Dec-2019	Dec-2018	Dec-2017	Dec-2016	Dec-2015
US 10-Year Treasury	4.2%	4.6%	3.9%	1.5%	0.9%	1.9%	2.7%	2.4%	2.4%	2.3%
Barclays Aggregate Bond Index	4.6%	4.9%	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	3.3%	3.4%	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 03/31/2025 unless otherwside 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), Bloomberg Buyout PE Index (Private Equity), and Bloomberg Private Debt Index (Private Credit).

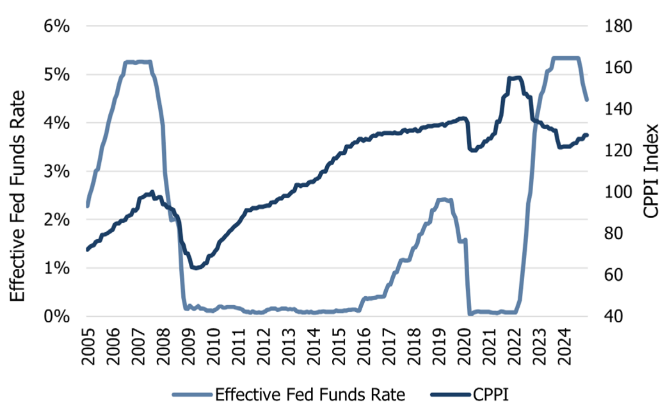
The historical index performance results are provided exclusively for comparison purposes over various time periods only. It is not possible to invest directly in an index. Index performance does not reflect any management fees, transaction costs, or other expenses that would be incurred by a portfolio 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 March 31, 2025.

Why Now Is a Prime Time for Private Real Estate

By Sam McFall, Managing Director, Investment Strategy

The Fed's zero interest rate policy inflated asset values including commercial real estate after the global financial crisis (GFC) of 2007–2009, ultimately stoking inflation and forcing the Fed to embark on one of the fastest and largest rate-hiking cycles in recent memory. In 2022, risk assets from growth stocks to commercial real estate saw their prices reset the most post-GFC outside of the COVID shock of 2020. While the rise in short-term interest rates (and cap rates) triggered a valuation reset, fundamentals including net operating income (NOI) growth were steadily improving, thus creating one of the most attractive entry points for private real estate in nearly 20 years. With real estate values about 18% below their most recent peak according to data from the Green Street Commercial Property Price Index (CPPI), we believe it is an opportune time to initiate or add exposure to value-add private real estate within a multi-asset class portfolio (Fig. 1).

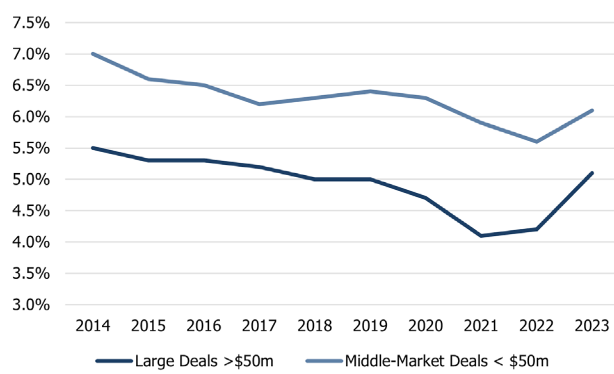
Fig. 1: CPPI relative to changes in short-term interest rates



Source: Bloomberg, GCM Grosvenor, Green Street, Mill Creek. As of 12/31/24.

Not all private real estate is created equally, and we believe the most attractive risk-reward today is in middle-market (less than $50 million) real estate. The middle market is appealing for a multitude of reasons including: 1) greater liquidity as nearly 95% of all transactions occur in deals less than $50 million; 2) more fragmentation and greater operational inefficiencies; and 3) less competition from the larger institutional allocators and REITs. Relative to larger deals, middle-market deals have consistently traded at an average premium of about 100 basis points thus offering significantly more return potential than that found in larger deals over $50 million (Fig. 2).

Fig. 2: Median cap rate by deal size in commercial real estate



Source: CoStar, GCM Grosvenor, Mill Creek. As of 12/31/23.

Within the middle market, we specifically like value-add investments which typically require some sort of repositioning and/or development in order to maximize value and return. We are targeting exposure to niche or adjacent property types, which are specialized assets such as affordable workforce housing, outdoor storage for trucks and heavy equipment, and office-to-multifamily conversions, to name a few. In addition to attractive potential returns, specialized properties typically offer: 1) strong fundamentals, 2) lower entry prices, and 3) higher yield potential versus the traditional property types and large trophy assets held by core and core-plus investors.

Market pundits have long warned of the potential consequences that would ensue following an extended period of ultra-accommodative monetary policy. It surprised few when the Fed had to reverse course and begin one of the most aggressive tightening cycles in decades. From March 2022 through July 2023, the Fed raised interest rates 11 times, totaling 500 basis points. While the market drawdown and valuation reset was a painful experience for many investors, it ultimately created one of the best buying opportunities in decades. We believe that the current valuation levels, attractive fundamentals, and return potential for value-add, middle-market private real estate make it one of the most favorable asset classes to deploy fresh capital into today.

Private Credit: An Evolving Market

By Nora Pickens, Partner, Investment Strategy

Corporate borrowers have enjoyed solid performance for quite some time, but early signs of stress are now emerging within this otherwise supportive backdrop. Default rates in both public and private markets have been rising, especially among issuers with floating-rate debt. Currently, the spread between leveraged loans (floating-rate) and high-yield bonds (fixed-rate) is near a record high—reflecting more so the impact of the Federal Reserve's tightening cycle rather than fundamental deterioration of the underlying businesses (Fig. 1).

Fig. 1: High-yield bond default rate – leveraged loan default rate

Source: JPMorgan, Mill Creek. As of 12/31/24.

Companies that locked in low-cost, fixed-rate debt were able to boost margins by growing revenues without incurring additional interest expenses. In contrast, those relying on floating-rate debt face mounting pressure—especially if they took on aggressive leverage before rates began climbing. To be clear, the graph above highlights public corporate loans with 5-7 year maturities which we don't hold in our private income portfolio (our floating rate debt is mostly 1-2 year duration asset backed securities that have already refinanced in the higher interest rate environment successfully). Nevertheless, it's still a trend worth exploring. A recent bankruptcy by Zips Car Wash, a subscription car wash company financed by a handful of private creditors, is an example of how some business models are starting to crack. According to their Chapter 11 filing:

- **High Leverage:** Zips carried $654 million in first-lien, senior secured debt against $303 million in annual revenue (!), leaving little room for error.
- **Rising Interest Expense:** The company's interest costs jumped from $59 million to $93 million in just one year.
- **Competitive Underwriting:** Although exact details are unknown, at least four large institutional lenders were involved—likely competing against each other to close the deal.
- **Amend and Extend:** Zips executed 25 amendments over the life of the loan before filing for bankruptcy, underscoring the increasingly dire situation and repeated efforts to keep the business afloat.

We by no means assume our portfolio will experience zero defaults. Our underwriting and return assumptions always incorporate an expected loss rate over a full market cycle. However, a key part of our research process is ensuring we're playing in the "right sandbox" and receive adequate compensation for the risks we take. In the more competitive upper- and middle-market segments of private credit, intense competition often erodes terms and pricing, making it vulnerable to subpar returns.

This trend is confirmed by performance data. The Cliffwater Direct Lending Index (CDLI) Unlevered Net of Fees Index tracks unlevered returns of private US middle-market corporate loans (direct lending) and provides the best "apples to apples" comparison to public market returns. We find that while direct lending has outperformed the liquid loan market over the trailing 3, 5, and 10 years, the delta has narrowed by nearly 100 basis points since 2013 (Fig. 2). This is despite a 75bps drop in management and administrative fees over that period. It's also worth noting that this data does not span a major credit crisis or extended stress environment. Given current pricing trends, we wouldn't be surprised if this area of the private

Fig. 2. Historical total return summary

	Total return			
	Trailing 3 Yrs	Trailing 5 Yrs	Trailing 10 Yrs	ITD
Direct Lending (net of fee)	7.47%	7.21%	6.55%	6.74%
Public Leveraged Loans	6.47%	5.74%	4.86%	4.77%
Difference	***1.00%***	***1.47%***	***1.69%***	***1.97%***

Source: Cliffwater, Bloomberg, Mill Creek. Annualized returns through 9/30/24, inception to date as of 6/30/2013.

credit market underperforms public markets in the next downturn.

While we don't hold any upper-middle-market corporate deals, we do have exposure to what we term "quasi asset-backed/corporate" loans. These loans finance cash-flow-light/asset-heavy transactions. Often, borrowers require short-term capital to bridge a known liquidity event. Collateral can come in the form of cash-flowing businesses but is augmented by other sources like liquid stock portfolios, real estate, or equipment. This provides multiple uncorrelated levers for principal recovery in the event of a default.

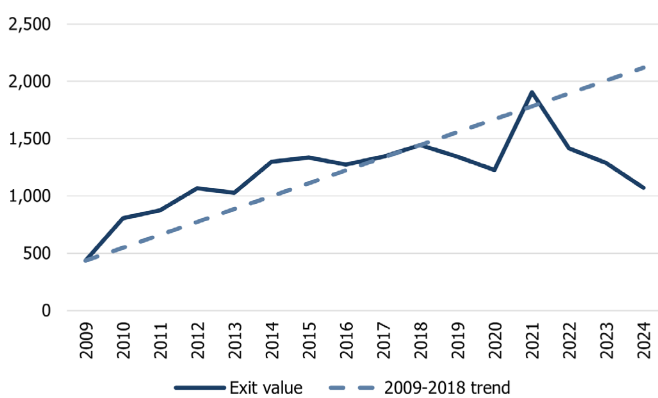
When lending against cash flows, our managers generally cap leverage at around 3.0x and require monthly reporting to verify underwriting assumptions. Additional protections can include fixed charge coverage ratios, board observation rights, minimum guarantor net worth, minimum liquidity, and excess cash flow sweeps. Moreover, because these loans are bilateral, our managers maintain frequent communication with borrowers, enabling them to promptly address any emerging issues. We continue to pursue these tightly structured deals for our private income portfolio because 1) they've experienced comparatively less spread tightening than other segments of the debt market; 2) terms have not undergone the same deterioration observed elsewhere; and 3) they address a lending gap that banks remain hesitant to fill. Taken together, these factors provide a more attractive return profile when accounting for default and recovery rates across both private and public debt.

Bump or slump?

By Michael Crook, Chief Investment Officer;
Andrew Murray, Managing Director, Private Equity; and
Daniel Bradley, Associate Director, Alternative Investments

Private equity investors came into 2025 optimistic about the prospects for an uptick in corporate activity, which would boost returns and facilitate distributions out of aging funds. With the first two months of 2025 behind us in private equity markets, the early verdict is…unclear. That is to say, many of the positive expectations surrounding the exit environment for private equity-backed companies have yet to materialize and the uncertainty weighing on public markets is also hampering deal volume in private markets.

Fig. 1: Exit volumes have fallen below trend (US PE exit activity, billions)



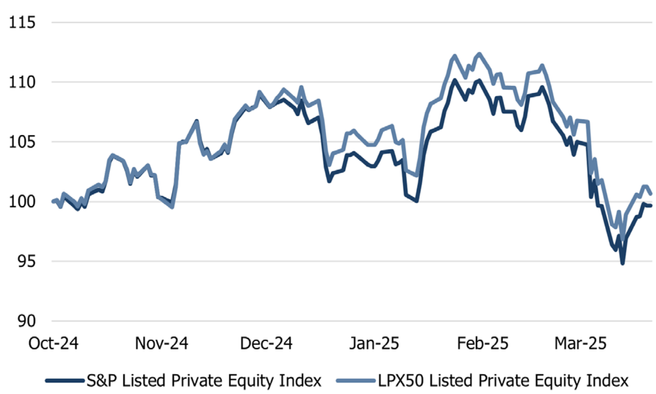
Source: PitchBook, Mill Creek. As of 12/31/24.

Private equity funds have struggled to return assets back to investors at a reasonable pace over the last few years (Fig. 1). Private equity general partners are quick to point to a generally diminished environment for corporate activity as the key reason they have been unable to exit companies at target valuations. They are correct regarding the data. Merger and acquisition volume ranged between \$5–6 trillion per year from 2015 to 2019, fell to \$4.5 trillion in 2020, and then jumped to \$6.7 trillion in 2021. 2022 to 2024 volumes were closer to \$4 trillion.

However, low deal activity is a characteristic of the environment, not the cause of the environment. Investors should ask why has deal volume been so low. Deals will happen to the extent that buyers and sellers can agree on a price.

First, regulation could be to blame. An overly burdensome regulatory environment can hamper dealmaking and some general partners certainly point a finger at the Biden administration's regulatory choices as a headwind to exits. This consideration is difficult to quantify, but the euphoria priced into private equity firms' stock prices after President Trump became the odds-on favorite to win the presidency (Fig. 2) is one indication that investors expected fewer regulatory constraints. High policy uncertainty post-inauguration has returned those stock prices back to earth.

Fig. 2: Bump and then slump (Listed PE Price Index)

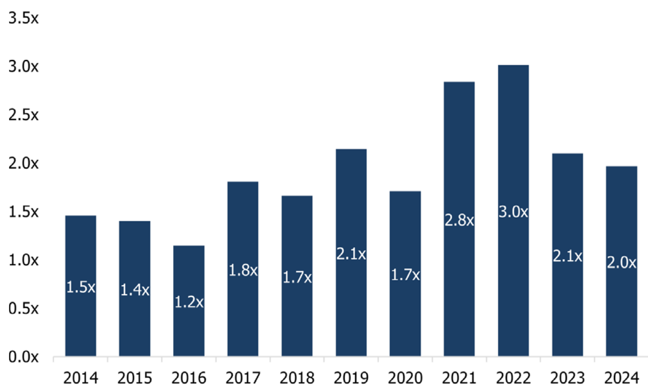


Source: Bloomberg, Mill Creek. As of 3/21/25.

However, we don't believe regulation was the primary cause of limited exits for private equity funds. We believe many general partners simply paid too much for companies in 2021 and 2022 and now cannot sell them for prices that show a reasonable return on capital.

Median enterprise value/revenue, which averaged 1.6x from 2014 to 2019, jumped to 2.8x and 3x in 2021 and 2022, respectively (Fig. 3, next page). Valuations have come down since then and private equity firms haven't been able to grow earnings enough to offset those declines. For example, if the valuation of a company drops from 3x to 2x, the equity in the company has declined 33.3% in value. Increasing revenue by 50% would get the valuation back to the purchase price, but revenue would have to increase by 200% to create a 2x multiple (100% return) on the investment, which is at the lower end of what many private equity firms are targeting.

Fig. 3: Private equity multiples were too high in 2021 and 2022



Source: Pitchbook, Mill Creek. As of 12/31/24.

In sum, the math is very challenging for those investments to show a decent return. Since funds that were putting money to work in 2021 and 2022 generally have at least 4 years remaining in their terms, general partners can sit on their positions until they are forced sellers or the market gives them a better exit opportunity. To our credit, we skipped the 2021 vintage year and most of 2022 due to the high valuations that were apparent in the market at the time.

What's next?

The private equity industry remains healthy overall from a capital formation standpoint but will need to unclog this logjam of aging capital before entering another period of broad-based rapid growth. We continue to see reasonable exit activity and distributions within our funds, but they are not entirely immune from industry-wide trends.

As the need for liquidity intensifies, there's been an increase in what's known as "GP-led secondaries" or "continuation funds." These are vehicles where a general partner sells one or more companies into a new fund with a new set of limited partners. It allows the fund manager to reset the clock and continue owning the company even though the term on the original fund ran out. In 2019, there were nine such transactions globally. Last year there were 89 transactions that encompassed over $70 billion of market value.[1]

Limited partners are also turning to the secondaries market to gain liquidity. There are a number of private equity firms that raise capital to buy fund interests from limited partners. The volume in 2024 was approximately $89 billion, an increase from $54 billion in 2019.

Opportunities for investors

We've participated in a few GP-led secondaries over the last 18 months and will continue to do so when the underwriting of the asset is compelling and fits our objectives. General partners also face headwinds for fundraising, which has created additional coinvestment opportunities for us. Coinvestments are direct investments in a company made alongside a fund manager but outside of the fund.

A desire for liquidity has also led to substantial LP-led secondaries supply hitting the market. Our outlook for those investments is mixed at best since the advent of retail-facing "evergreen" private equity funds has simultaneously created substantial demand in the secondaries market. Evergreen funds must invest capital as it is received or face cash drag in their returns. This makes them relatively price insensitive, particularly since they generally target lower returns than traditional closed-end private funds. Positions that would have sold at a 50% discount a few years ago are now getting bids at 90% of net asset value (NAV), since those evergreen funds can immediately write up the position to the fund's stated NAV for an 11% return without having to find a buyer at that price.

There's a saying in investing that you get credit for selling, not buying. By marking positions to NAV when they are purchased, evergreen funds are giving themselves credit for buying regardless of the fair-market value of the asset. We wouldn't throw the baby out with the bathwater, but investors should be very selective in choosing a partner in the secondaries market at this time.

We maintain the view that consistent allocations to private equity is a suitable strategy for long-term investors to generate a premium to public markets, but doing so requires a focused, institutional grade approach to achieve those objectives. Our primary focus remains on US lower-middle-market buyouts, early-stage venture capital and sector-focused strategies which represent the deepest opportunity set in terms of both companies and high-quality managers. Examples from recent activity include financial services/fintech, healthcare IT, and critical infrastructure services.

[1] https://www.secondariesinvestor.com/secondaries-volume-hits-record-high-of-160bn-evercore/.

PUBLICATION DETAILS

Investment Strategy Group

Michael Crook, Chief Investment Officer
Nora Pickens, Partner
Sam McFall, Managing Director
Andrew Murray, Managing Director
Michael LoCasale, Director
Daniel Bradley, Associate Director

Project management and editing

Rachel Hassett, Associate Director

Report design

George Stilabower (www.stilabower.com)

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