BESSEMER TRUST

Quarterly Investment Perspective

Glass Half Full at Half Term

Holly H. MacDonald
Chief Investment Officer

Executive Summary

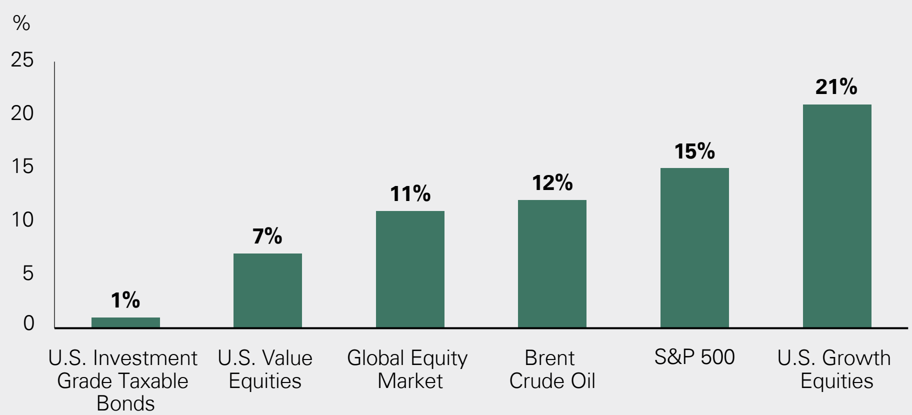
- **The first half of 2024 proved to be strong for risk markets. Slower growth and inflation moving, also slowly, to the Fed's target are constructive for equities. Although risks remain, we view the glass as half full as we reach half term.**
- **In addition to exploring some nuances of the growth and inflation stories, we provide our views on the geopolitical and political backdrop and the reasons why the U.S. markets should be resilient in the face of these challenges. We also provide an update on private markets, which are increasingly relevant as companies stay private longer.**
- **We maintain a modest overweight to equities, with a focus on the U.S. and higher quality companies. Our key overweight sectors are industrials, healthcare, and technology. We recommend including private assets in portfolios for qualified clients. Rates at high levels and continued dispersion in markets also bode well for the hedge funds with whom we partner.**

Despite a few notable bumps in the road, it has been a strong first half of the year for risk markets. U.S. growth equities have led the market to reach new all-time highs, with weakness in April eclipsed by strength in the first quarter and June (Exhibit 1). Robust earnings from the largest companies in the world and early signs of the power of artificial intelligence to push profits even higher allowed equity markets to look through the potential headwind of significantly fewer Federal Reserve eases this year (one to two) than priced at the end of 2023 (six to seven). The macroeconomic narrative has been in flux week to week, with higher first quarter inflation prints worrisome to some investors.

Overall, our view has not changed substantially from what we outlined in our year-ahead outlook in early January. Somewhat slower growth and inflation moving to the Fed's target, albeit slowly, are a constructive backdrop for equities, where we have recommended overweight positioning while allowing our bond allocation to take on its historically defensive role in portfolios. Taking a step back from the numerous individual data points we analyze, the important trends in growth and inflation are so far playing out as expected (Exhibit 2). Although risks remain, we view the glass as half full as we reach half term.

Exhibit 1: 2024 Year-to-Date Asset Class Performance

Key Takeaway: It has been a strong start to the year for equities, with growth stocks leading markets to record highs.

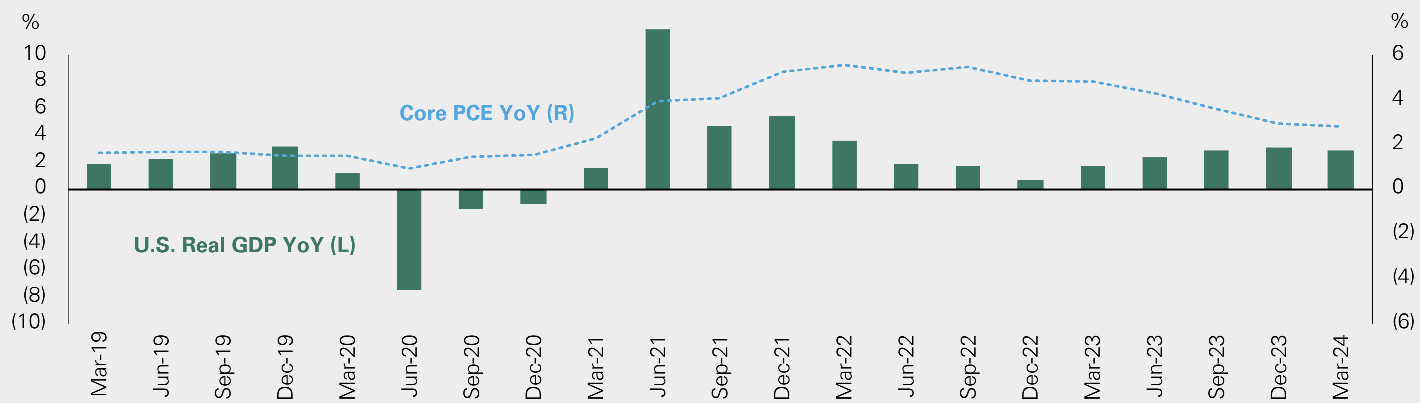


As of June 28, 2024, aside from Brent crude oil, which is as of June 24, 2024. Returns look at total return of each asset class where applicable. The asset class performance is measured using the following indices: Value Equities (Russell 1000 Value), Growth Equities (Russell 1000 Growth), Global Equity Market (MSCI AC World IMI), U.S. Investment Grade Taxable Bonds (ICE BofA 1-10 Year AAA-A U.S. Corporate and Government Index).

Source: Bloomberg, EIA

Exhibit 2: U.S. Real GDP YoY vs. Core PCE YoY

Key Takeaway: Growth and inflation are edging lower.



As of March 31, 2024.

Source: Bloomberg, Bureau of Economic Analysis

In this Quarterly Investment Perspective, we discuss what we think are some interesting nuances of the growth and inflation stories that are not covered as widely in the usual financial discourse.

We start, though, with our views on the geopolitical and political backdrop. In addition to the ongoing wars in Ukraine and the Middle East, along with an increasingly tense dynamic with China, elections in half of the world's democracies are already causing volatility in international markets, with disparate reactions to results in Mexico and India and continued uncertainty in France and the U.K. as snap parliamentary elections lie ahead. We discuss reasons why the U.S. markets have been and are likely to be more resilient in the face of these challenges and our own elections this fall.

Finally, we provide an update on private markets, which are increasingly relevant as companies stay private longer. The combination of massive inflows to the private space, disruption to markets in 2022 including higher interest rates, and yet a steady flow of compelling opportunities has made for a dynamic backdrop. Dispersion in private markets bodes well for our active managers in the space, and we expect the opportunity set to continue growing in the coming years.

Our recommended overweight to equities, a focus on the U.S., and high-quality tilts in equity portfolios have worked well so far in 2024, with a representative Balanced Growth portfolio up 8.5% year to date versus its benchmark at 7.3%. We have rotated individual positions within equities throughout the year, and our key overweight sectors are industrials, healthcare, and technology.

Our overall positioning is related to our view on the macroeconomic backdrop noted above, but some of our key investment themes have relatively little to do with the growth and inflation mix in the economy. There are secular tailwinds due to themes such as increased spending on defense, aerospace, and cybersecurity; artificial intelligence is in its early innings, in our view, and some of the large suppliers are likely to maintain dominant positions as the use cases grow; and related to energy transition, nearshoring and onshoring, and public and private support for a resurgence in capital expenditures, we expect infrastructure spending to persist (Exhibit 3).

In total, we are comfortable both with our modest overweight to equities and including private assets in portfolios for qualified clients. Rates at high levels and

Exhibit 3: Key Equity Investment Themes

Key Takeaway: Secular investment themes in portfolios can be additive regardless of the macroeconomic environment.

Defense, Aerospace, & Cybersecurity	Artificial Intelligence	Infrastructure Spending
NG Northrop Grumman	Microsoft Azure	United Rentals
Howmet Aerospace	NVIDIA	Eaton Powering Business Worldwide
Fortinet	Google Cloud Platform	Quanta

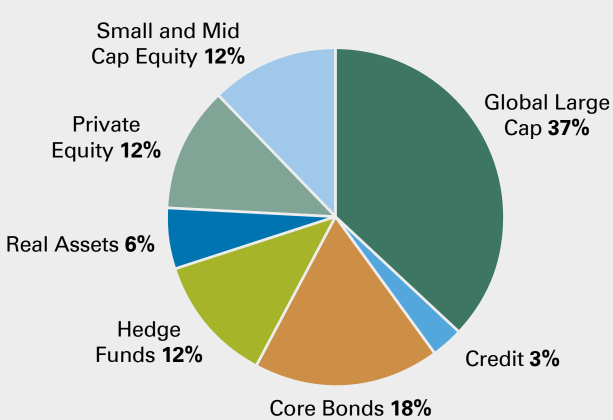
As of June 30, 2024.

Source: Bessemer Trust

continued dispersion in markets also bode well for the hedge funds with whom we partner, while the asset class also provides additional diversification in portfolios (Exhibit 4).

Exhibit 4: Balanced Growth 70/30 With Alternatives Asset Allocation

Key Takeaway: We maintain a modest overweight to stocks relative to bonds while continuing to target quality companies that can grow earnings as the economy slows.



As of June 30, 2024.

Source: Bessemer Trust

Geopolitics and Politics: U.S. More Insulated Than Others as Uncertainty Increases

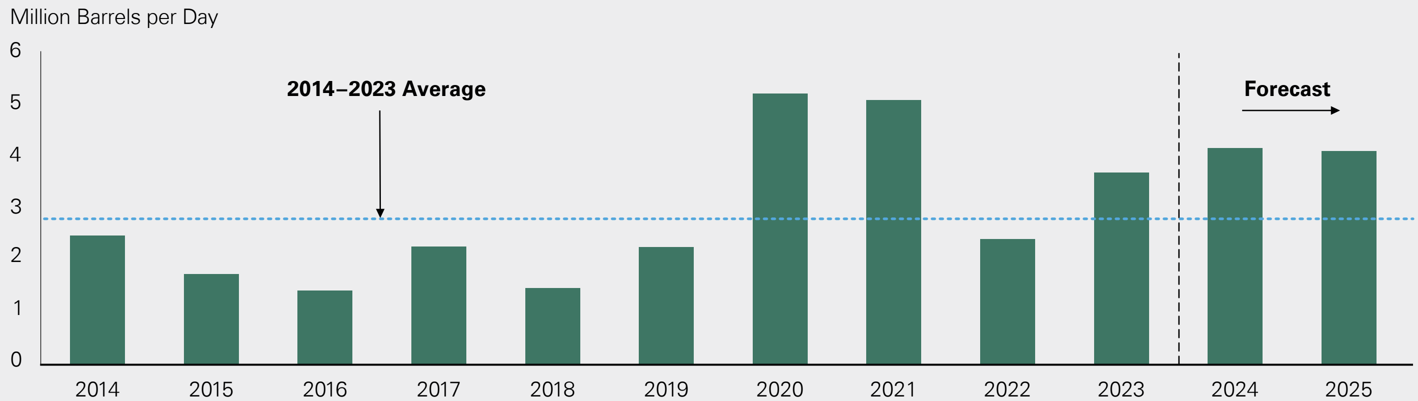
The geopolitical backdrop has continued to deteriorate this year, with the silver lining being that U.S. markets have been resilient in the face of increased risks and the U.S. dollar benefiting from its safe haven status. We expect non-U.S. markets to be more vulnerable as wars remain far from resolved and elections unfold.

Wars in Ukraine and the Middle East dominate headlines, and simmering tension with China in the South China Sea are heating up in the background. Perhaps most worrisome from the U.S. perspective are the tenuous connections among adversaries, including but not limited to Russia forging ties with North Korea and selling oil to China in non-U.S. currency, and Iran accelerating enrichment of near-weapons-grade uranium. Indeed, the "axis of evil" that President George W. Bush coined is more a reality now than it has been in recent decades.

Given this dynamic, it might seem surprising that risk markets have edged higher. We attribute U.S. market strength largely to macroeconomic resilience, the Federal Reserve's ability to ease when needed given better inflation dynamics versus 2022 and 2023, and

Exhibit 5: OPEC Surplus Crude Oil Production Capacity

Key Takeaway: Despite geopolitical tensions, volatility in oil prices has been more contained, in part due to above-average spare production capacity.



As of May 31, 2024. 2014–2023 average is 2.8 million barrels per day.

Source: U.S. Energy Information Administration, Short-Term Energy Outlook, May 2024

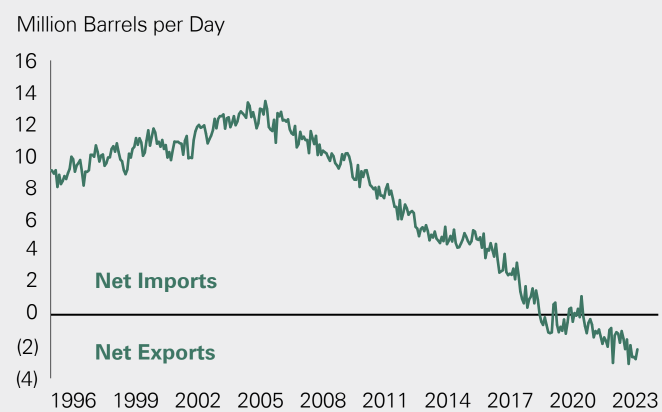
importantly, changes in the supply and demand of key commodities. One of the main transmission mechanisms of geopolitical issues to markets is higher energy prices, which can weigh on consumption — a key component of U.S. growth — and can also push up inflation expectations. However, global oil markets are currently seeing greater supply than demand (Exhibit 5). Equally important is that the swing producer of oil is Saudi Arabia, still a strong ally of the U.S. by most measures. And, of course, the U.S. supply backdrop has shifted notably in recent years, with crude oil exports now joined by larger production and exports of natural gas following Russia's invasion of Ukraine (Exhibit 6).

While the increased tensions have not affected our overall asset allocation, they have led to a keener focus from our portfolio teams on the companies that will do well in this environment, supporting our holdings in the defense, cybersecurity, and infrastructure areas as mentioned in the section above. The same can be said for our U.S. overweight, which has continued to be beneficial year to date: Insulation from geopolitical events and recent election turmoil in France and Mexico and, to a lesser extent, India have allowed investors in U.S. markets to focus on artificial intelligence and other positive trends. The question is whether this dynamic can persist as we approach our own election.

Having navigated many presidential elections, our approach has been to understand which policy differences between candidates are likely to be enacted in either scenario and to evaluate which will

Exhibit 6: U.S. Crude Oil and Liquid Fuel Total Liquid Net Imports

Key Takeaway: The increase in domestic oil and gas production has helped insulate the U.S. from spillover effects of escalating conflicts abroad.



As of May 31, 2024.

Source: Bloomberg

matter most for markets. While the two presumptive candidates this time are quite different from one another in terms of style, there is surprising symmetry on key policy issues relevant for markets.

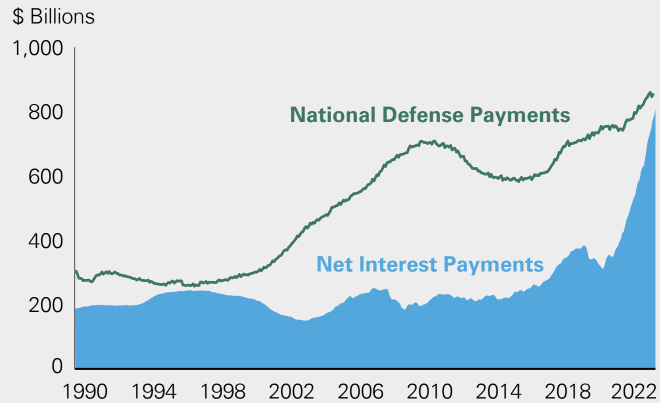
Both former President Trump and President Biden pursued an expansionary fiscal policy, held a strong stance on China, and were generally supportive of U.S. technology companies despite stern rhetoric at various junctions. While Trump has suggested he would roll back Biden's most recent stimulus policies, we think it is unlikely that meaningful funding agreed to under the Inflation Reduction Act would be unwound. Projects are underway, and many are in Republican districts. It seems other policy initiatives would be a higher priority.

We acknowledge key differences in the areas of immigration, healthcare, and energy. These will matter for specific sector investments and holdings. We provided our early thoughts on these topics in "Politics, Policy, and Markets: Short- and Long-Term Implications." As long as there is a decisive resolution to the election, however, we anticipate the outcome will matter less to overall risk appetite and more to these individual sectors.

One shift we are monitoring for 2025 and beyond is the difficulty for either Trump or Biden to continue to pursue an expansionary fiscal policy. The deficit has been growing significantly but has been more of a secondary political issue in recent years as the pandemic and wars have led to bipartisan support for additional spending. As tax cuts expire in 2025 and either nominee would be in the first year of a new term in 2025, we anticipate more difficult debates related to spending and taxation. The trillions of dollars of national debt are hard to fathom, and the resilience of the U.S. dollar as other countries have faltered in numerous ways has made this issue less front and center. However, as interest payments on the debt are set to eclipse total U.S. spending on national defense, we think the issue will become harder to ignore (Exhibit 7). As we get more certainty as to the power dynamics in D.C. next year, this will be a key area of our research, though we maintain our view that while the current U.S. debt trajectory is not sustainable, it is unlikely to pose an immediate problem for markets, particularly as demand for U.S. Treasuries should persist given the U.S. dollar's safe haven status.

Exhibit 7: U.S. Government Defense and Net Interest Spending (12-Month Rolling Sum)

Key Takeaway: As interest rates have risen, government net interest costs have caught up to defense spending and contributed to the rise in government debt.



As of April 30, 2024.

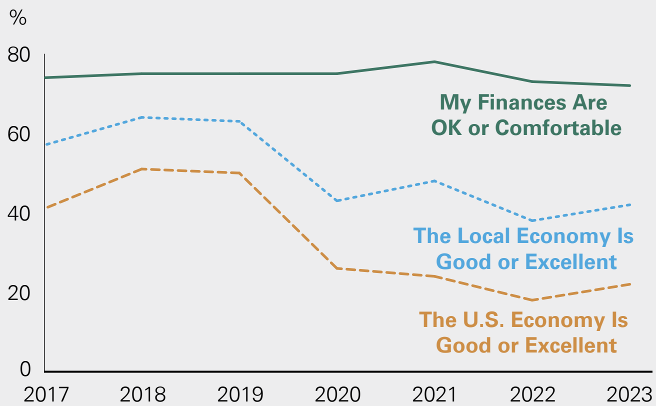
Source: Bloomberg, U.S. Treasury

A secondary question for us is which outcome is more likely. We are unlikely to have an edge in forecasting the winner of the presidential election but rely on strategic partners who have the expertise to share perspectives beyond the headlines generated by an increasingly polarized and sensationalist press:

- There is uncertainty in the Democratic ticket following the first presidential debate and a notable chance that President Biden steps down as the party's nominee.
- Our base case has been a split Congress, but we believe the probability of a red wave has increased following the first presidential debate.
- Republicans are likely to win the Senate given a favorable map of seats up for reelection.
- Meanwhile, Democrats appear to have a slight edge in the House based on details of local races, though we acknowledge that the House may follow the presidential vote given the recent trend of decreased split-ticket voting.

Exhibit 8: Survey Results From Americans on How the Economy Is Doing

Key Takeaway: The perception of economic conditions from Americans varies depending on which situation they are asked about.



As of December 31, 2023.

Source: Bloomberg, U.S. Federal Reserve

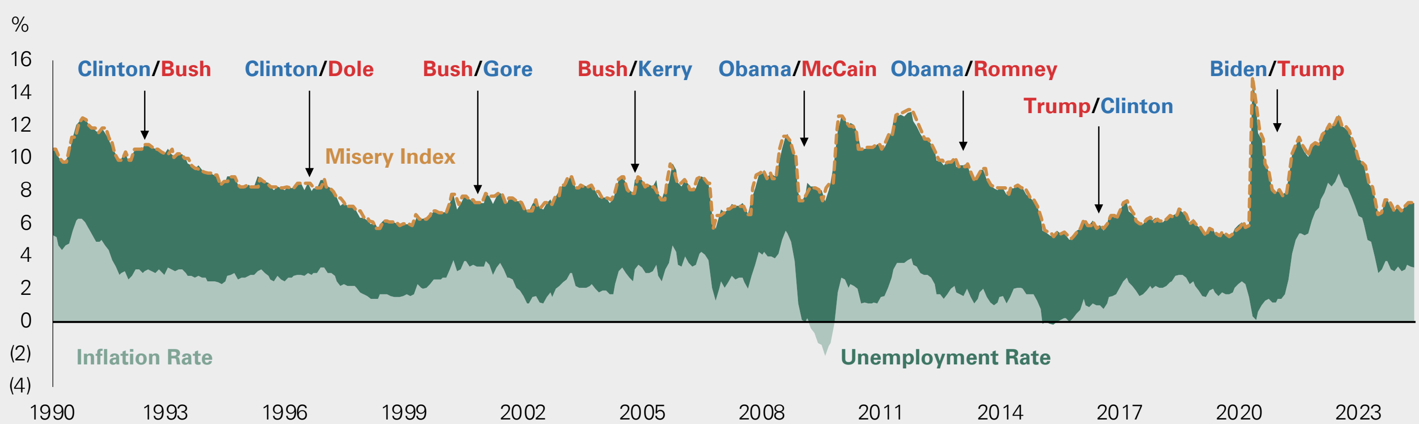
As for the presidential election, it could be decided by about 100,000 voters in a handful of states. We offer the basic observation that "it's the economy, stupid," and how voters experience the economy in the coming months is quite important. It is indeed more about this *experience* than objective economic measures, in our view. For example, while many Americans feel OK about their specific situation, most do not think the economy is on a positive trajectory (Exhibit 8). The closest thing we have seen that is an objective determinant ahead of elections is the "misery index," which measures the combination of inflation and unemployment over time. Strategas notes that gains in this series in the last year of a president's term have not boded well for reelection, and the index is currently teetering around the crucial level for President Biden (Exhibit 9). There is much more to come from us on these topics, in many forums, in the coming months.

Inflation and Growth: Perspectives on Each as They Inch Lower

Taking a step back regarding the macroeconomic backdrop, our hypothesis that both inflation and growth would move lower over the course of the year so far is playing out. At various points in the first half of 2024, higher inflation prints raised concerns of a potential resurgence. While prices are high and experienced differently, we are confident that a broad resurgence in inflation

Exhibit 9: "Misery Index" (Inflation + Unemployment Rate) and Presidential Elections

Key Takeaway: The combination of inflation and unemployment rising in the last year of an incumbent's term has made reelection difficult.

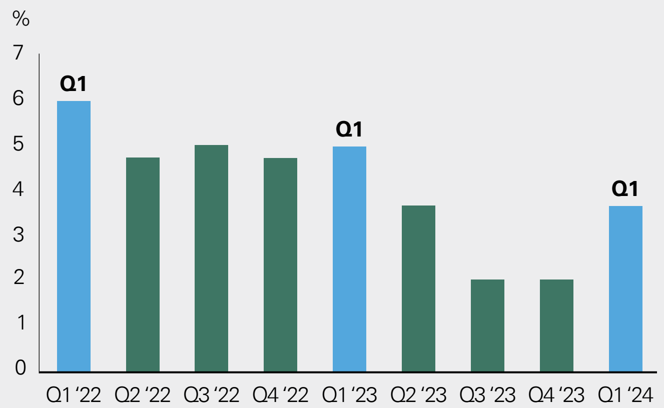


As of May 31, 2024. Red represents a Republican candidate, and blue represents a Democratic candidate. The winner is listed first.

Source: Bloomberg, Bureau of Economic Analysis, Bureau of Labor Statistics, Strategas, 270towin

Exhibit 10: U.S. Core PCE Price Index (Annualized QoQ Growth)

Key Takeaway: Following the pandemic, seasonal factors have, in part, led to higher inflation in the first quarter relative to the remaining quarters of the same year.



As of March 31, 2024. The blue shading denotes the first quarter of each year. Core PCE is represented by the price component of the GDP report.

Source: Bloomberg, Bureau of Economic Analysis

is unlikely absent a meaningful, unexpected shock. Higher inflation prints in the first quarter were largely attributable to flawed seasonal adjustments coming out of the pandemic. As shown in Exhibit 10, seasonal adjustments have led to relatively high inflation prints in the first quarter during recent years.

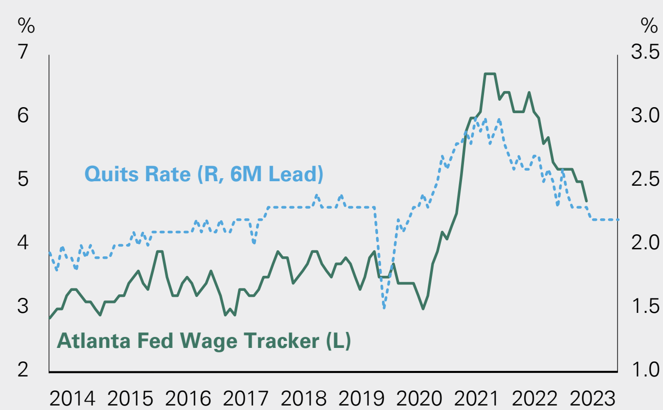
With respect to other aspects of the inflation debate, we note that shelter prices, which make up about 18% of core PCE, have now been declining on an annual basis since May 2023. This data remains quite lagged to reality with more timely data showing that rents in most of the country are down 12.6 percentage points from the peak in February 2022. Goods prices have not been a meaningful contributor to overall inflation for some time and have entered deflation territory in recent months, while the decline in service price inflation has been bumpy. A closer look at the specific subsectors that have shown recent increases in inflation suggests that such increases should be short-lived. Depressed activity in areas such as the auto space indicates that one-offs related to auto insurance costs, for example, will not last long.

Bigger picture, the employment backdrop in the economy is the most important factor for services inflation, and there is meaningful softening in the labor market. We prefer to look at indicators such as the quits rate, which tends to lead wages (Exhibit 11). Employment data has been volatile with monthly nonfarm payrolls indicating a still strong labor market, while the household survey, which likely does not capture the recent immigration trends, has pointed to a weaker labor market. However, nonfarm payrolls for the last year have been revised downward, consistent with a slowing economy.

With inflation risks fading, we are increasingly attuned to data that are indicating a slowing growth backdrop. First-quarter GDP came in weaker than expected, with some usually accurate sell-side firms' estimates being nearly two percentage points too high. The data was revised down further to show growth of just 1.4%, and subsequent activity data has shown a similar pullback from prior quarters. In this highly unusual economic cycle following the onset of the pandemic, there have been notable swings in consumption and a huge influence from

Exhibit 11: Quits Rate vs. Wages

Key Takeaway: Forward-looking indicators, such as the quits rate, currently point to additional loosening in the labor market, which should subsequently reduce wage pressures.

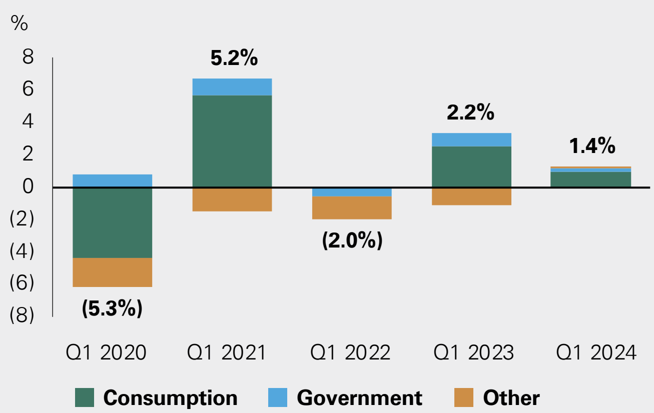


As of April 30, 2024.

Source: Bloomberg, Bureau of Economic Analysis, Federal Reserve

Exhibit 12: Contributions to First-Quarter GDP Growth (2020–2024)

Key Takeaway: Since the pandemic, GDP growth has largely been driven by consumption and government spending.



As of June 30, 2024.

Source: Bloomberg, Bureau of Economic Analysis

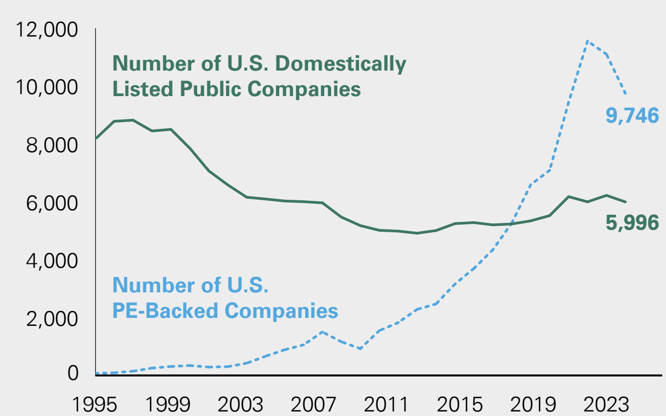
government spending (Exhibit 12). While government spending contracted in early 2022 following the pandemic surge, it was surprisingly robust last year. It is likely to remain positive in this election year but should fall short of last year's level. As noted above, it will be difficult to sustain such spending following the election regardless of the party in power. Meanwhile, consumption, which surged following the initial collapse in the pandemic, is now starting to wane more visibly as wage growth declines. As we have discussed in other publications, there are important nuances, with higher-income groups, who are seeing the glass as half full, benefiting from robust equity markets and home prices, continuing to spend at elevated levels while lower-income consumers, who are seeing the glass as half empty, have largely spent COVID savings and are feeling higher prices more acutely. Overall, we expect growth to continue to slow and the Fed to respond with moderate easing starting this year.

Private Markets: Return to Normal Yielding Opportunities

Private markets in recent years have been a good example of an area that can be seen as a glass half full or half empty. This has been a part of the market that increasingly cannot be overlooked with many more private equity-backed companies than publicly listed domestic companies in the market today (Exhibit 13). The returns of preeminent managers in private markets have outpaced public markets over the past 20 years, but the skew between the best and average managers is significant, with the top quartile returning 18.8% and the average returning 10.7% with the bottom quartile returning 3.1%. As new entrants flooded the market in 2021, 2022 saw spectacular losses from some notable crossover investors while strong incumbents were able to provide some protection versus more volatile public markets. As public markets have recovered, the private managers' marks are largely lagging but appear poised to increase in the coming months.

Exhibit 13: Private Equity-Backed Companies vs. Publicly Listed Companies

Key Takeaway: There has been a significant reduction in the number of publicly listed stocks, while private equity-backed companies are on the rise.

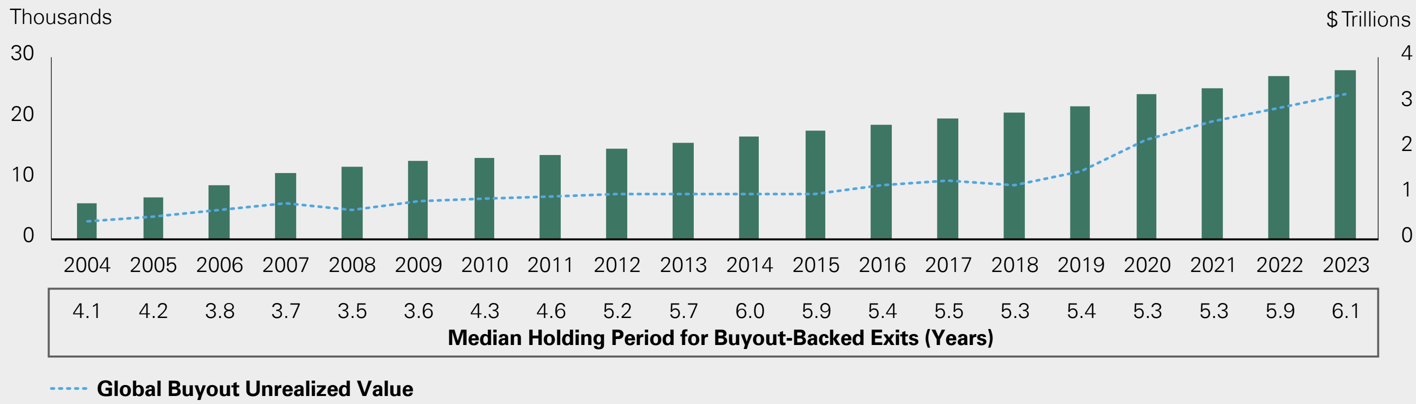


As of December 31, 2023.

Source: PitchBook, Strategas, World Federation of Exchanges

Exhibit 14: Record High Number of Aging, Unrealized Private Equity-Held Companies

Key Takeaway: The backlog of buyout-backed companies continues to build due to the lack of exit activity, reaching a record high.



As of December 31, 2023. Blue dotted line corresponds to the right vertical axis. Green bars represent the number of companies and correspond to the left vertical axis.

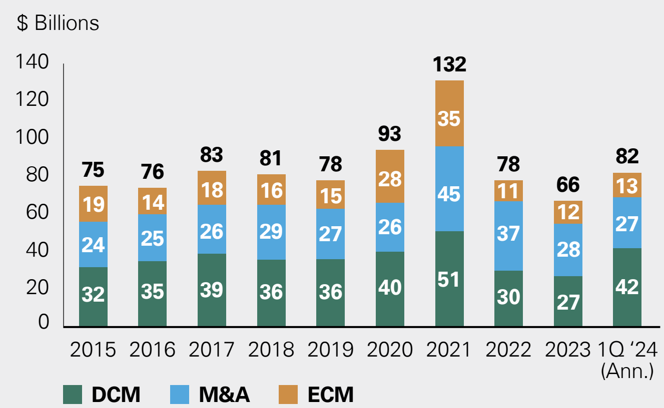
Source: Bain 2024 Private Equity Report, PitchBook

One area of recent concern where we are seeing some incremental progress is exits. Return of cash flow as private companies are sold is the true mark of success of an investment. Such exits have been fewer and farther between in recent years, with higher rates and uncertain sentiment slowing activity in IPO markets, in particular. This has led to the current situation of a record number of aging, unrealized PE-backed companies (Exhibit 14).

That said, in recent months, we have seen tangible signs of improvement. Investment banking fees related to capital markets activity picked up in the first quarter and are on pace to post their first year of increases since 2021 (Exhibit 15). In our Fifth Avenue Private Equity program, we have seen notable exits via IPO, strategic M&A, and structured exits. We expect our long-term historic distribution patterns to reassert themselves. An investor who has invested steadily in our program is experiencing a self-funding dynamic in their portfolio with strong cash flows and returns in excess of those of public markets over the last 10 years.

Exhibit 15: Investment Banking Fees Related to Capital Markets Activity

Key Takeaway: Following a period where elevated interest rates have constrained transactions, capital markets activity is beginning to pick up from low levels.



As of March 31, 2024. Data compiles investment bank activity across the industry, including large and small banks that have investment banking businesses and report to Dealogic. Data for 2024 represents the annualized rate from the first quarter.

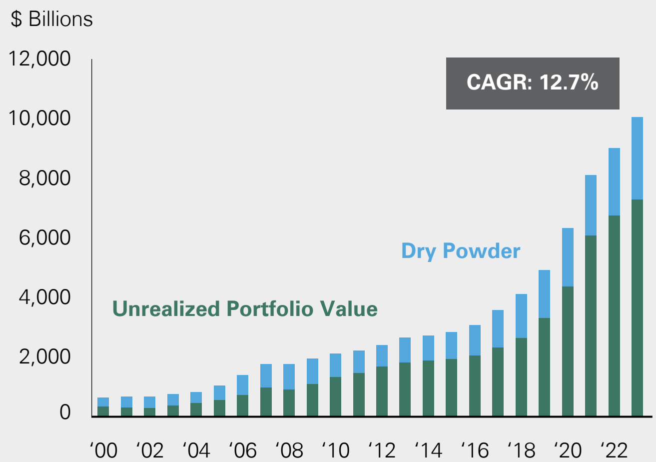
Source: Dealogic, Evercore ISI Research

What has not changed is the growth in private markets as an asset class and interest from investors to increase allocations. Growth rates have surpassed 12% in the past 20 years, and more than half of investors responding to a broad McKinsey study have stated they are likely to increase allocations over the next three years (Exhibits 16 and 17). We note that potential increases were especially notable to infrastructure and private debt, areas of focus for our programs in the past two years. We look forward to remaining active participants, working with top private managers, to deliver compelling opportunities for our clients.

With acknowledgment to Investment Strategist Madeline Simone for her work on the analytics in this document.

Exhibit 16: Private Equity Assets Under Management (2000–2023)

Key Takeaway: Private equity assets under management have grown 12.7% per year since 2000.

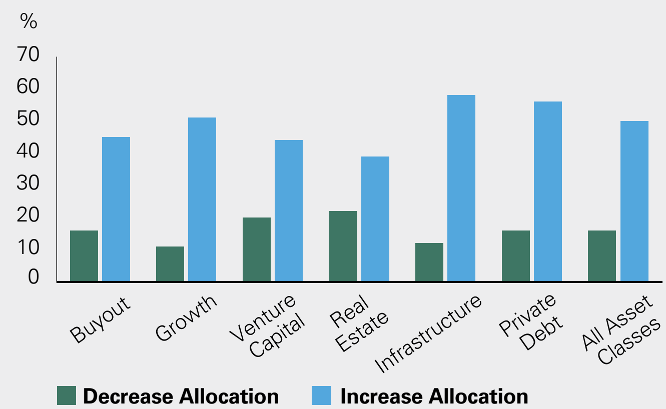


As of December 31, 2023.

Source: Prequin, Strategas

Exhibit 17: Expected Change in Funding to Various Asset Classes Over the Next Three Years From Institutional Investors

Key Takeaway: Over the coming years, asset allocations towards private markets are likely to grow.



As of December 31, 2023. McKinsey asset management survey on institutional investor asset allocation preferences.

Source: McKinsey & Company

Parting Thoughts

Thank you for reading our latest Quarterly Investment Perspective. As always, we will continue to monitor economic and market trends and provide our latest thinking in written communications, videos, and interactive forums. We welcome your engagement. Please contact your client advisor with any questions you may have.

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