Mills Wealth Market Update Q3 - 2023

Summer just won't go away, but I think Fall is finally sneaking into North Texas. On the weekends I smell barbecue cooking at the Southlake Dragon high school football tailgates & the same goes for the college pregame tailgates on Saturdays (and the post-game parties afterwards.) Wyoming is 4 and 1 and when I talk to my daughter, Alli who is a senior there or Emily, one of our talented young planners, they are hoarse on Mondays from screaming at the weekend's game. Fun times!

Mike Mills
Managing Partner
CFP, CLU, CFS

SECTION I – AROUND THE MILLS WEALTH OFFICE
SECTION II – QUARTERLY MARKET REVIEW
SECTION III – THOUGHTS ON THE ECONOMY
SECTION IV – INVESTMENT PORTFOLIO THOUGHTS
SECION V – PICTURES WORTH LOOKING AT

Around the Mills Wealth Office

I think one of the most important things I can discuss in this update would be to introduce our two new employees. In the last month and a half, we have had two new employees join our firm. We are excited to introduce Helen Esomo and Lena Melugin. Please read Helen's and Lena's Biographies by clicking the link on their names. I cannot tell you how proud I am of the team of people we have put together to steward you toward your goals sooner and safer, hopefully with more confidence than before you met us. I'm so proud that these talented women have joined our existing team. This is the first time we have more women in the company than men, and we are extremely proud of that. As you probably know, finance is an industry dominated by men, so we are deeply honored to have FOUR incredible women working on your plan. Each of them has come with a very different journey to our firm. Truthfully, all our team members have come from different paths and everyone on our team brings incredible depth of experience, from Big 4 tax, to marketing, to a trust Company, a large insurance company, and a large independent brokerage, we have an amazing pool of talent all unified by the belief that "Best is Best".

Quarterly Market Review

The 3rd quarter was the first quarter this year that saw all markets decline. Global Real Estate was the biggest loser of the quarter at -6.49% followed by International Developed Stocks at -4.10%, the US Stock Market at -3.25%, surprisingly followed by the US Bond Market at -3.23%. Bringing up the rear was the Emerging Stock Market at -2.93% and the Global Bond Market at -0.78%. The good news is that all of these markets have been up over the past 1, 5, and 10 years. To see more, click here.

Thoughts on the Economy

Like the Texas heat, economic activity for the first part of the 3rd quarter ran hot helping to lift rebounding equity prices, especially in Tech companies and the Magnificent 7 up until late July. Investor sentiment seemed focused on robust consumer spending, most likely from full employment, rising wages, and the left-over effects of covid stimulus. As I strolled around our local shopping area, I noticed lines nearly out the door for stores like Lululemon, Apple, and Tesla. If you judged the economy by store traffic and airport lines, it is easy to see Americans are still feverishly spending money.

Mills Wealth Market Update Q3 - 2023

Even though there is still some high consumer demand, raising interest rates, like most Fed tools, can take a while to work as higher rates reverberate through the economy until they eventually have the desired policy effects (like slowing down economic activity.)

Many of the portfolio managers & analysts that I follow believe consumers are beginning to run out of "spending rope" – the result of pent-up demand spending after covid and from the extra cost associated with inflation and higher borrowing. More bearish analysts believe the speed and magnitude the interest rate increases (the steepest in US history), combined with the declining credit quality of both individual consumers and corporate borrowers, have increased the probabilities of additional negative shocks to the economy that could show up in market prices.

I think the million-dollar question is, **will the US avoid a recession?...** or **will higher rates reduce inflation while also harming employment or breaking the economy?** Jim Grant, the legendary publisher to hedge funds and author of Grant's Interest Rate Observer, believes investors need to accept interest rates will be higher for longer. This perception finally worked its way into market prices midway through September as equity markets finally cooled off the last 2 weeks of September (unlike the Texas heat). In addition to a small drop in equity prices, the yield curve change shape. Below I will spend extra time explaining why this shape changing will affect how your portfolio is positioned and is a tipping point that we have been waiting for to make a change our to defensive assets.

For most of the 3rd quarter, sentiment was overly optimistic, however as data continued to come in, it was clear the economy was still running "hot" several percent ahead of the inflation target set by the Fed. Then on a dime, investors switched to a more pessimistic view triggered by changing interest rate assumptions. For the beginning half of the 3rd quarter, market rates assumed the Fed would begin cutting rates in late 2023 or early 2024. Long-term rates were in the low 4%'s until stronger economic activity, budget uncertainty, reshoring some supply chains finally caused a rapid reversal that sent long-term rates up to above 5% on the 30- year bond. This massive move in price on long bonds caused the yield curve to change shape from highly inverted at the beginning of the quarter (inverted means short-term rates pay investors more than long-term interest rates) to a flatter curve where rates are similar for short, intermediate, and long-term debt. (Normally yield curves slope up to the right most of the time as investors demand higher rates for loaning over longer time periods).

This change in the interest rate yield curve has caused MWA to begin to shift what we own in our defensive portfolios. While rates have been rising, we have owned very short-term bonds which have had the highest interest rates, but as rates begin to top out, we will begin to shift the length of the bonds we own longer to more intermediate durations because longer bonds can provide equities more protection when rates eventually fall, (This often occurs when economic conditions weaken).

Investment Portfolio Thoughts

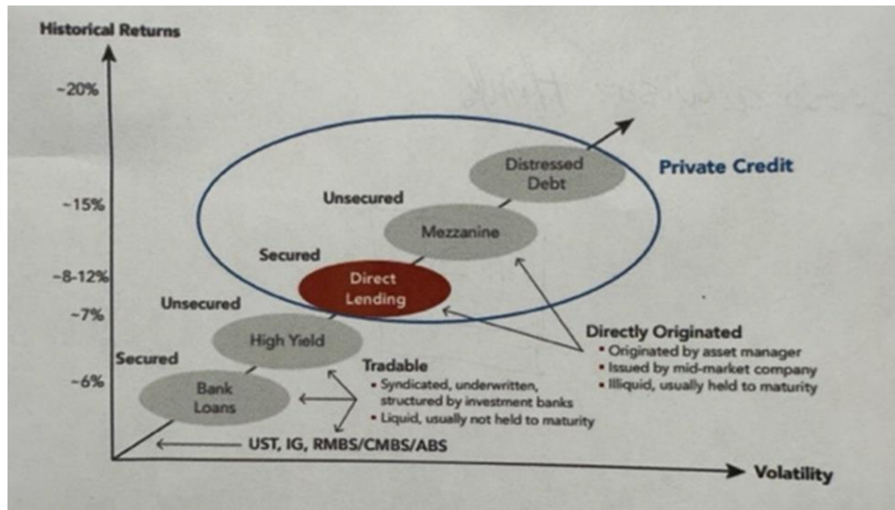
FIXED INCOME FINALLY LOOKS YUMMY: For the first time in many years, I think many types of fixed income (bonds) look attractive as a stand-alone investment opportunity, not just an equity hedge or a portfolio risk reduction tool.

TERM: Bonds work like a seesaw: when interest rates rise, bond values fall, the longer the bonds, the bigger the decline. Conversely, when rates fall, bonds rise, and longer bonds rise more than shorter-term bonds. Timing interest rates is not a job I want to sign up for, but when bond rates begin to exceed our financial plan's minimum goal, I believe it is time to begin buying longer, high-quality bonds that will profit if rates eventually fall (usually caused from an economic shock, deflation, market declines, etc.) Because our clients eventually plan to spend some of the money we hold inside portfolios, we always try to keep a portion of the portfolio in shorter-term bonds. In order to get to our desired intermediate term duration, we therefore must barbell some of the portfolio (owning a portion in short-term bonds, and a

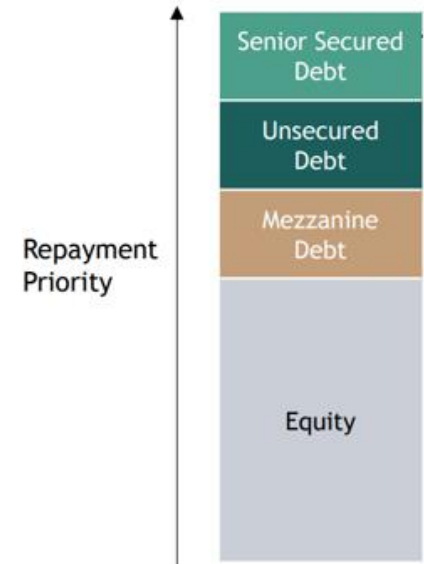
Mills Wealth Market Update Q3 - 2023

few longer dated bonds which allows us to get our overall portfolio to 5-7 years long. The rest of the portfolio will be in intermediate duration fixed income. We will typically ease into this change in strategy, making several trades.

CREDIT: Most of the bonds we own in our portfolios are held to protect equities. However, as rates have risen and economic conditions have tightened, banks have had to pull back from some types of lending. Institutional money managers have met this need by raising investment funds to fulfill this unmet demand. **One of the asset classes we have been evaluating adding to some portfolios is called Private Credit.** Private Credit is similar to bonds, but the notes have higher yields, and the credit terms now seem to favor the funds more than the borrowers. We have met with several top teams in this space, and with portfolio yields surpassing 10% for 1st lien assets, we believe Private Credit issued by disciplined underwriters in today's high yielding marketplace will likely produce returns above what can be earned on many types of equity. Like all fixed income, the lower the quality the more you can expect defaults, especially if economic conditions continue to tighten. We think the sweet spot in the bond/private credit market is in secured 1st lien contracts with a 10% yield because even if there are a few defaults, full cycle returns should still exceed our objectives.



If you look at the picture above, this image does a great job of illustrating how Private Credit's returns and volatility may compare to other types of syndicated debt. In the figure to the right, you can see that the secured private credit we are looking at sits near the top of the capital stack, so recoveries in the event of a default should be very high. Secured Private Credit offers investors higher quality than high yield unsecured tradable debt, which I rarely own in portfolios (I usually own equities instead).



Private Credit is different than bonds because there is an illiquidity premium built into its returns. Private Credit loans are usually held for the entire term of the note, and they are not traded around like bonds. Borrowers like Private Credit, especially if M&A is involved, because borrowers can get quicker decisions with less red tape, albeit at higher interest rates.

We think that for investment time horizons of 3-10 years, the Private Credit asset class should provide an attractive investment for long-term risk tolerance investors, especially when compared to US Large Growth stocks that have been bid up and are trading near long-term highs in their range of valuations. In the picture below, you can see the equity risk premium has fallen. This means investors are not being paid very much extra for the risk of owning equities when compared to owning bonds.

For investors choosing between owning large US stocks, which have posted a decade long streak with above average returns, to credit risk bonds at 9-12%

yields, we think switching some funds to private credit with a prominent value manager specializing in this space makes sense at these yields. Additionally, because private credit is secured and higher in the credit stack, if the economy slows, we think returns on private credit probably exceed US equities in most scenarios, especially pretax.

What are the negatives from buying Private Credit now instead of equities?
I think if something causes risk assets to sell off, Private Credit would not be immune, although I expect secured Private Credit would hold up much better than equities. Because Private Credit is held to maturity and is difficult to sell or transfer in the middle of the loan, Private Credit funds are owned through a different structure called ***Interval Funds*** that has partial liquidity (this is needed to protect investor returns in case too many investors wanted out at the same time). The biggest disadvantage to owning Private Credit is that if you want to sell the entire position and everyone else in the fund also wanted to sell, sales would be gated and taken pro-rata. The interval fund structure that allows partial liquidity to investors is not noticeable if most investors buy and hold, but if there is a race for the door, it could take a while to get out completely as investors would need loans to mature or new investors to enter. Because the high yields on Private Credit's notes are about 10% net of fees and spread across hundreds of companies, and the loans are secured by assets, I still think it is likely the portfolio would perform well over the next 3-7 years even if there was a temporary decline in price or a widening in note spreads or a temporary race for the door. Like most investments, there could be some volatility in prices, but we expect much lower volatility than equities and probably higher rates of return when compared to Large US stocks. We are still deciding what size this position will make up in our various portfolios. If you have any questions or thoughts on this subject, please reach out and we can give you more detailed thoughts on this decision or can discuss the specifics of your portfolio.

High Yield Municipal Debt:
Another asset we are beginning to add into select portfolios is a higher yielding municipal income fund from the industry's low-cost provider. Currently this fund pays over 4.5% tax free (nearly 7% tax equivalent yield), and has an expense ratio of only 1/10 of 1 %. About 80% of the portfolio is in investment grade municipal assets and 20% in higher yielding municipal projects. Because of the increase in longer-term rates and because credit is being paid a premium, we think this investment is also very attractive to high tax bracket investors and should produce strong returns with some volatility as rates move around.

The changing shape of the yield curve appears to indicate we are getting to the end of the rate hiking cycle and now is probably the time to start increasing portfolio's duration. It is possible we will be a little early in this change in allocation, but if viewed over the longer term (like funding your goals of education, retirement, etc.), I think now is a great time to make these portfolio shifts.

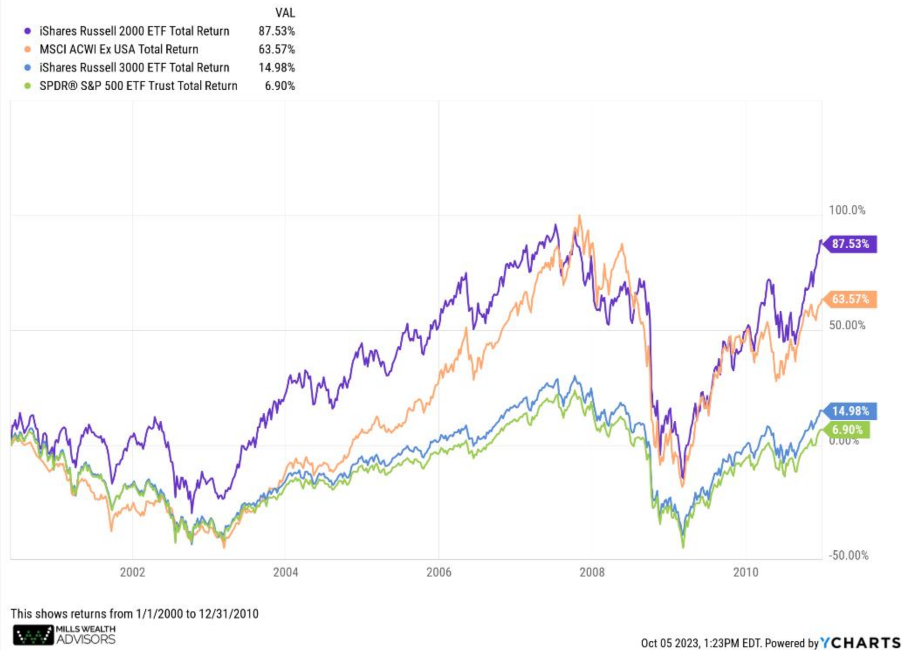
Housing prices:
Many clients have asked our thoughts on housing since it usually represents a large portion of client portfolios. Since the Financial Crisis, many US markets have been faced with a continuous shortage of new homes. "The estimates

of how large the shortage is varies widely. For example, a June 2023 report by Zillow put the estimated shortage at 4.3 million homes" (1)

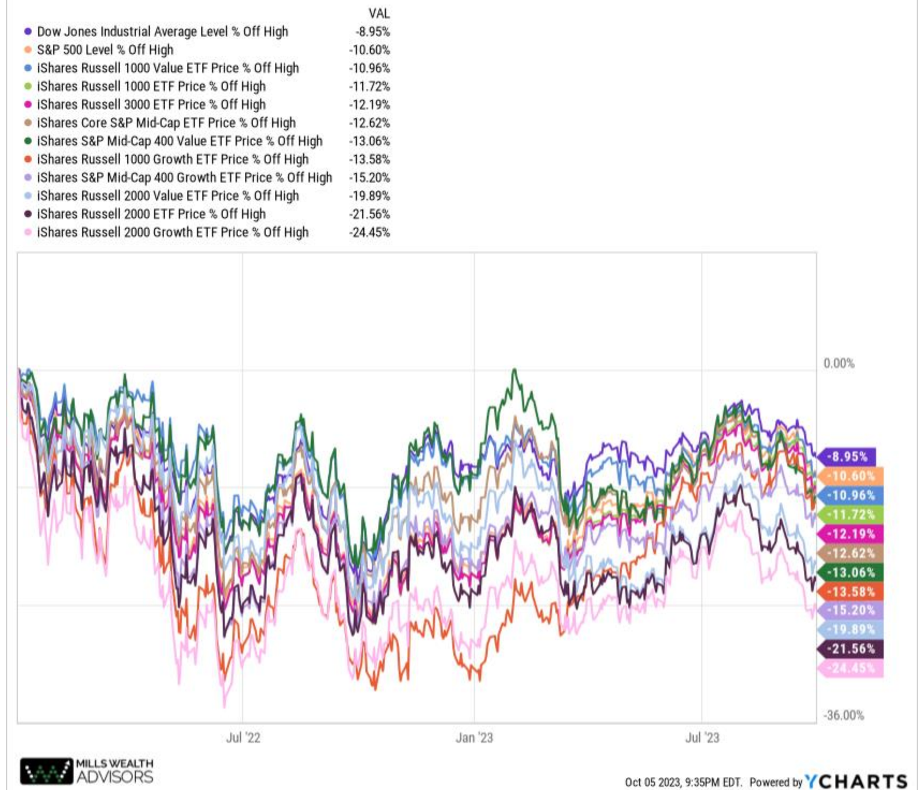
Another factor leading to a reduced supply comes from the fact that many homeowners are effectively trapped in their current home because they now have a below-market interest rate. "61% of all outstanding mortgages have an interest rate below 4%, including 23% that are below 3%" (1). Now that current mortgage rates are over 7%, most homeowners will not put their home up for sale or change homes because their mortgages are not transferable. Changing from their current home to a new home at higher rates would change their cost considerably. The resulting lack of supply leads to bidding wars, pushing prices up even higher." (1) **It should be noted that we are not overly supplied like we were in the great Financial Crisis. Homebuilding should continue to offer decent returns on capital.** If you are looking to buy a house, we believe prices are unlikely to fall significantly with this supply/demand backdrop.

Mills Wealth Market Update Q3 - 2023

Pictures Worth Looking at

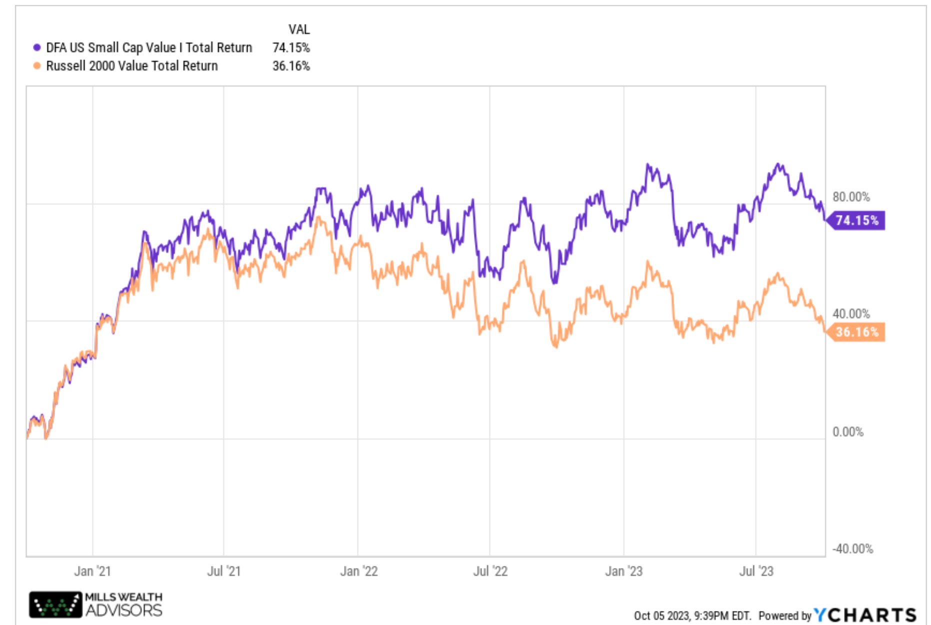


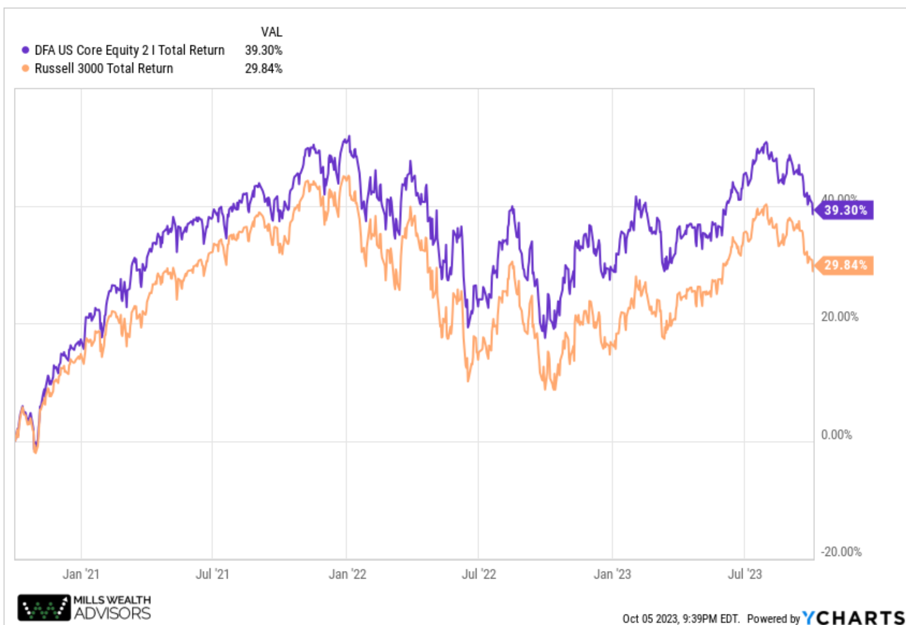
How a diversified portfolio helped returns in the 2000s.

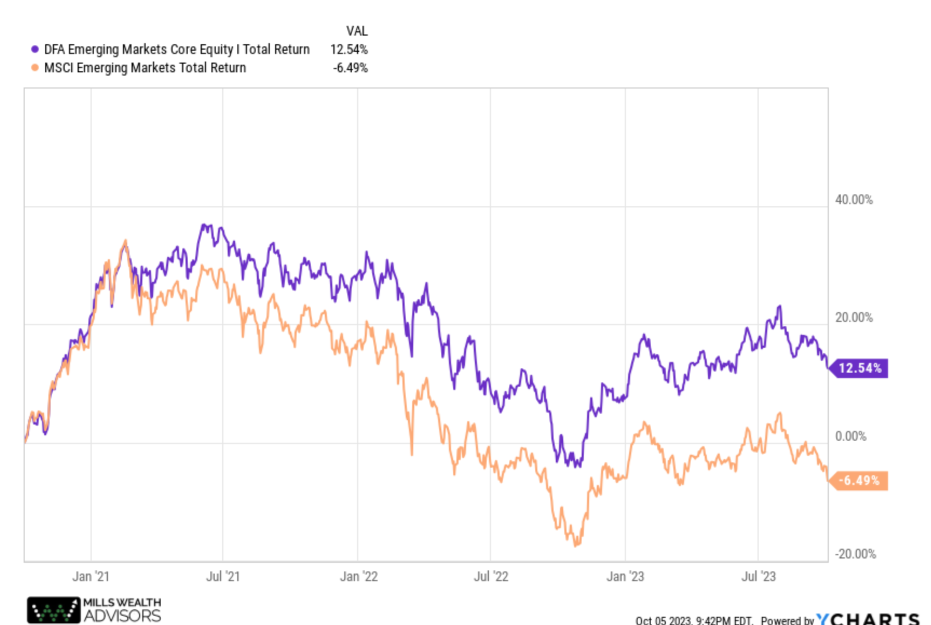


US Indices off their most recent highs.

Mills Wealth Market Update Q3 - 2023







Dimensional Funds have outperformed their benchmarks.

Mills Wealth Market Update Q3 - 2023

Bloomberg US Aggregate Bond Index: Longest Drawdowns (Monthly Data, 1976 - 2023)			
Start of Drawdown	End of Drawdown	# Months	Max Drawdown During Period (Monthly)
Aug-20	?	38	-17.2%
Jul-80	Oct-81	16	-9.0%
May-13	Apr-14	12	-3.7%
Aug-16	Jul-17	12	-3.3%
Feb-94	Jan-95	12	-5.1%
Mar-87	Nov-87	9	-4.9%
Aug-79	Apr-80	9	-12.7%
Apr-08	Nov-08	8	-3.8%
Feb-96	Sep-96	8	-3.2%
Jun-03	Nov-03	6	-3.6%
Feb-84	Jun-84	5	-4.9%
May-83	Aug-83	4	-3.5%

Current bond market is worst bond market since 1976.

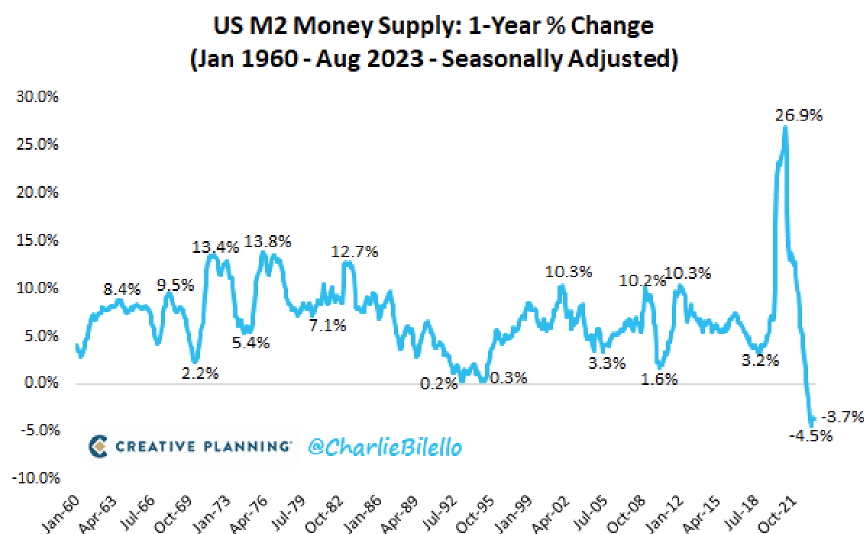
Global Currencies: 10-Year % Change vs. The US Dollar (G20 Currencies Highlighted)

Currency	Ticker	10-Yr % Ch	Currency	Ticker	10-Yr % Ch	Currency	Ticker	10-Yr % Ch	Currency	Ticker	10-Yr % Ch
Venezuelan Bolivar	VEF	-99.9998%	Mongolian Tughrik	MNT	-53.4%	Malaysian Ringgit	MYR	-31.3%	Macedonian Denar	MKD	-22.0%
Sudanese Pound	SDG	-99.3%	Colombian Peso	COP	-53.2%	Mauritian Rupee	MUR	-30.5%	Guinean Franc	GNF	-21.1%
Syrian Pound	SYP	-99.1%	Malagasy Ariary	MGA	-50.5%	Romanian Leu	RON	-30.5%	South Korean Won	KRW	-20.8%
Argentine Peso	ARS	-98.3%	Tunisian Dinar	TND	-48.5%	Bangladeshi Taka	BDT	-29.4%	Moroccan Dirham	MAD	-19.9%
Turkish Lira	TRY	-92.6%	Namibian Dollar	NAD	-47.6%	Polish Zloty	PLN	-29.1%	Fijian Dollar	FJD	-18.6%
Surinamese Dollar	SRD	-91.5%	Basotho Loti	LSL	-47.6%	Afghan Afghani	AFN	-29.0%	Turkmenistani Manat	TMT	-18.4%
Angolan Kwanza	AOA	-88.2%	Swazi Lilangeni	SZL	-47.6%	Papua New Guinean Kina	PGK	-28.8%	Czech Koruna	CZK	-17.9%
North Korean Won	KPW	-85.9%	South African Rand	ZAR	-47.6%	Moldovan Leu	MDL	-28.6%	Honduran Lempira	HNL	-17.5%
Uzbekistani Som	UZS	-82.4%	Burundian Franc	BIF	-45.9%	New Zealand Dollar	NZD	-28.3%	Samoan Tala	WST	-16.2%
Ghanaian Cedi	GHS	-81.3%	Gambian Dalasi	GMD	-45.7%	Peruvian Sol	PEN	-26.9%	Chinese Yuan Renminbi	CNY	-16.2%
Sierra Leonean Leone	SLL	-81.0%	Rwandan Franc	RWF	-45.3%	Indonesian Rupiah	IDR	-26.3%	Solomon Islander Dollar	SBD	-16.1%
Nigerian Naira	NGN	-79.5%	Kyrgyzstani Som	KGS	-45.1%	Mexican Peso	MXN	-25.7%	Thai Baht	THB	-14.6%
Ukrainian Hryvnia	UAH	-77.9%	Chilean Peso	CLP	-44.6%	Nepalese Rupee	NPR	-25.6%	Yemeni Rial	YER	-14.2%
Egyptian Pound	EGP	-77.7%	Norwegian Krone	NOK	-44.2%	Dominican Peso	DOP	-25.0%	Vietnamese Dong	VND	-13.2%
Libyan Dinar	LYD	-74.5%	Uruguayan Peso	UYU	-43.9%	British Pound	GBP	-24.8%	Icelandic Krona	ISK	-12.1%
Kazakhstani Tenge	KZT	-67.9%	Swedish Krona	SEK	-41.9%	Tongan Pa'anga	TOP	-24.7%	Iraqi Dinar	IQD	-11.1%
Haitian Gourde	HTG	-67.6%	Kenyan Shilling	KES	-41.4%	Bhutanese Ngultrum	BTN	-24.7%	Singapore Dollar	SGD	-8.5%
Russian Ruble	RUB	-66.7%	Iranian Rial	IRR	-41.0%	Indian Rupee	INR	-24.7%	Bruneian Dollar	BND	-8.5%
Malawian Kwacha	MWK	-66.4%	Hungarian Forint	HUF	-41.0%	Serbian Dinar	RSD	-24.0%	Kuwaiti Dinar	KWD	-8.4%
Ethiopian Birr	ETB	-65.8%	Algerian Dinar	DZD	-40.2%	Philippine Peso	PHP	-23.9%	Israeli Shekel	ILS	-7.5%
Pakistani Rupee	PKR	-63.6%	Paraguayan Guarani	PYG	-39.0%	Canadian Dollar	CAD	-23.8%	Costa Rican Colon	CRC	-5.7%
Congolese Franc	CDF	-63.4%	Georgian Lari	GEL	-37.9%	Cape Verdean Escudo	CVE	-23.5%	Trinidadian Dollar	TTD	-5.1%
Lao Kip	LAK	-61.1%	Botswana Pula	BWP	-37.2%	Euro	EUR	-22.4%	Guyanese Dollar	GYD	-2.9%
Sri Lankan Rupee	LKR	-59.3%	Tanzanian Shilling	TZS	-35.9%	Comorian Franc	KMF	-22.4%	Belizean Dollar	BZD	-1.9%
Liberian Dollar	LRD	-57.9%	Japanese Yen	JPY	-34.3%	Central African CFA Franc	XAF	-22.4%	Swiss Franc	CHF	-1.6%
Tajikistani Somoni	TJS	-56.6%	Jamaican Dollar	JMD	-33.6%	Bosnian Convertible Mark	BAM	-22.4%			
Brazilian Real	BRL	-55.4%	Nicaraguan Cordoba	NIO	-32.0%	CFP Franc	XPF	-22.4%			
Azerbaijan Manat	AZN	-53.9%	Australian Dollar	AUD	-31.7%	Bulgarian Lev	BGN	-22.4%			
Burmese Kyat	MMK	-53.6%	Tuvaluan Dollar	TVD	-31.7%	Danish Krone	DKK	-22.3%			
Mozambican Metical	MZN	-53.4%	Ugandan Shilling	UGX	-31.6%	Ni-Vanuatu Vatu	VUV	-22.1%			

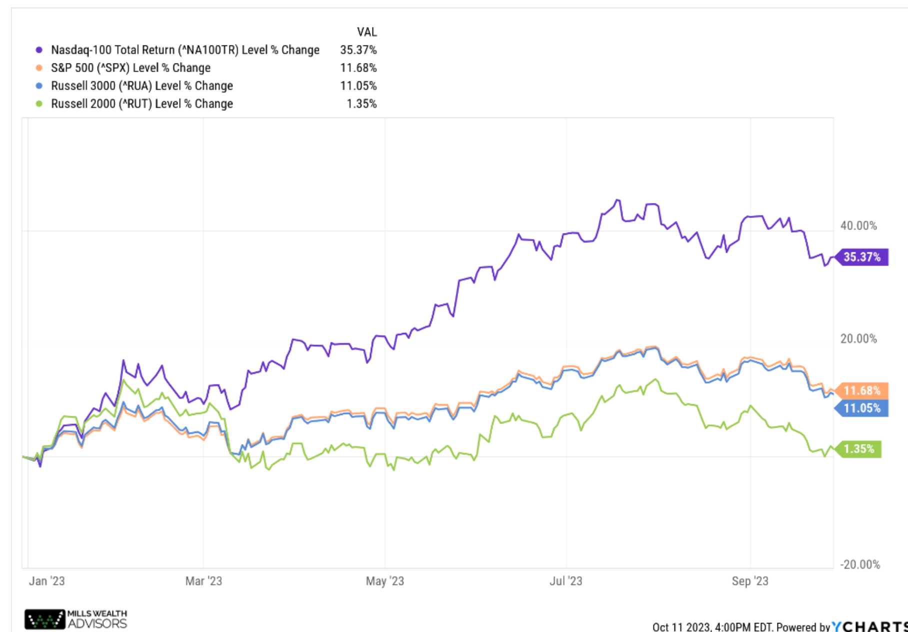
Note: Data as of 9/27/23 via XE.com

CREATIVE PLANNING @CharlieBilello

Every currency has depreciated against the dollar going back to 2013.



Money Supply increased due to COVID Stimulus but has slightly lowered since.



Returns across American companies are drastically different.