KKR

Insights

14.3

Global
Macro Trends
June 2024

Opportunity Knocks

Mid-Year Outlook for 2024 Executive Summary

Contents

This note is an executive summary of our Mid-Year Outlook for 2024 available on www.KKR.com or by clicking here. We encourage interested readers to reach out to your KKR Relationship Manager for additional information.

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Opportunity Knocks

Mid-Year Outlook for 2024

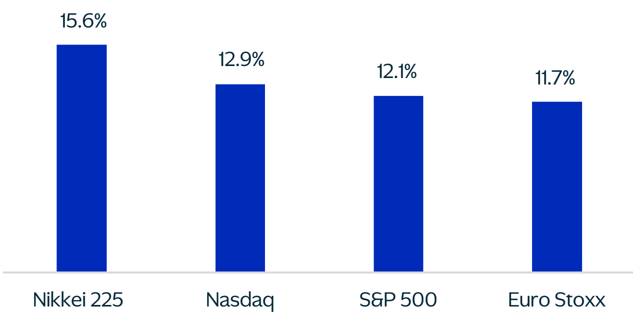
Despite intensifying political uncertainty, heightened geopolitical tensions, and volatile commodity prices, we continue to see compelling investment opportunities across the global macro landscape. Accelerating AI demand for electricity, reorientation of global supply chains, improving labor productivity, and retirement security all represent important macro themes behind which to invest. We also remain really encouraged by the technical backdrop, as net issuance of Equities and Credit remains well below trend. However, it is definitely not business as usual in the world of macro and asset allocation, as our *Regime Change* thesis requires a different approach to portfolio management. To build upon this view, we have done more analysis to underscore the value of adding more non-traditional assets to one's portfolio. Indeed, unlike in the past, today's volatility in portfolios is being driven by stock-bond correlation, not by single asset volatility. Importantly, most of today's CIOs have not invested in this type of environment. In terms of areas to lean in, we think that the current vintage will be a strong one for Private Equity, especially opportunities linked to value creation by operational improvement and/or corporate carve-outs. Meanwhile, we continue to pound the table on many parts of Real Assets, including Real Estate Credit, Infrastructure, and Asset-Based Finance. Finally, we see a lot of potential in Opportunistic Credit and Capital Solutions. On the risk side, we believe higher rates – especially if productivity should tail off – are a more challenging scenario than lower rates and slower earnings. We are also keeping an eye on employment trends. Our bottom line: *Opportunity Knocks*, as we still think the current economic cycle has further to run, a backdrop that should accrue to the benefit of long-term investors, especially ones who have dry powder to lean into the inevitable periodic dislocations that are likely to occur during a *Regime Change*.

> A pessimist complains about the noise when opportunity knocks.
>
> — **Oscar Wilde**, Irish poet and playwright

We are often asked, especially heading into the second half of 2024, if we still believe that the glass is half full for global allocators when it comes to deployment opportunities, particularly in an environment of heightened complexity, 'sticky' inflation, and higher for longer interest rates. (See *Glass Half Full Outlook for 2024*). With an uncertain presidential election around the corner in the United States, and many other important elections taking place across the world, there is certainly a lot to consider. On the more cautious side, equity markets are now nicely higher, and credit spreads are now sharply tighter since late December 2023 when we laid out our thesis that investors might regret looking at the glass as half empty. In fact, our KKR proprietary market-implied default model suggests HY spreads are pricing in about a two percent default rate today, compared with about three percent at the beginning of the year and a historical average of 5.7%.

Exhibit 1: Equity Markets Have Withstood Substantial Volatility to Enjoy Glass Half Full Returns and Then Some in the 1H24...

Equity Performance Across Regions, YTD Performance

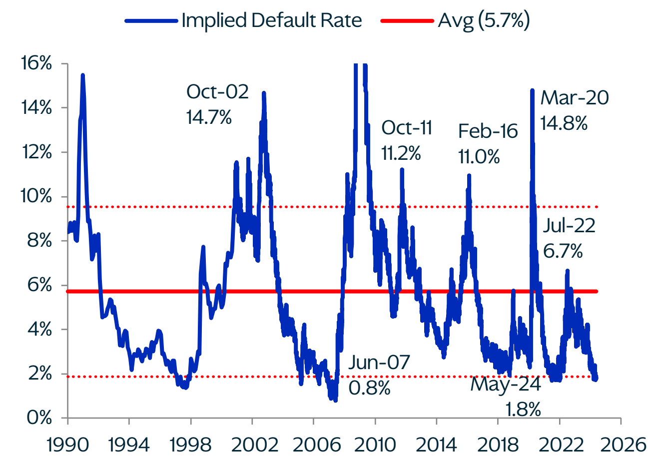


Data as at June 7, 2024. Source: Bloomberg.

Indeed, unlike in the past, today's volatility in portfolios is being driven by stock-bond correlation, not by single asset volatility.

Exhibit 2: ...While Investors Have Also Gotten More Optimistic About the Outlook for Credit, High Yield in Particular

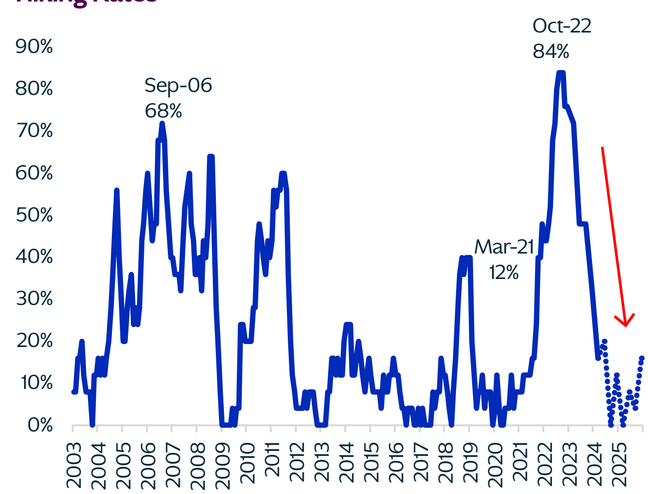
U.S. High Yield Implied Default Rate, %



Data as at May 24, 2024. Source: Bloomberg.

Exhibit 3: Risk Assets Have Responded Favorably to the Idea That There Will Be Fewer Tightenings and More Easings

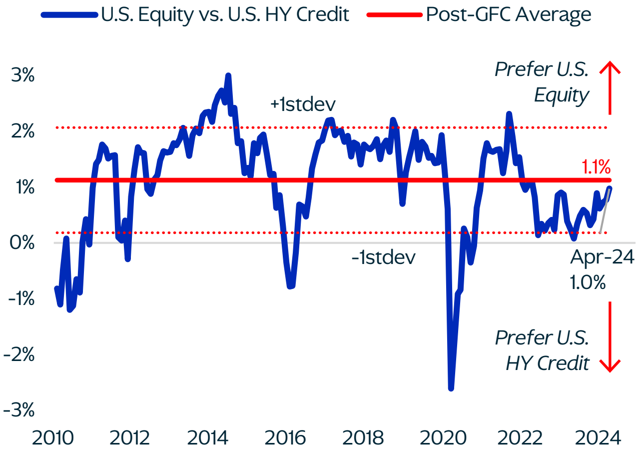
Consensus Forecast: % of Global Central Banks Hiking Rates



Hiking rates is defined as an increase in rates over the past three months. Data for U.S., JP, CN, AU, CA, E2, NZ, NO, SE, GB, JP, CH, IN, ID, KR, PH, TW, TH, VN, BR, CL, ZA, TR, IL, CZ, HU, PL. Data as at May 31, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 4: Overall, Our Models Still Favor Credit, But Now Only at the Margin

Relative Value: Equities vs. Credit, Internal Rate of Return for Equities vs. HY YTW



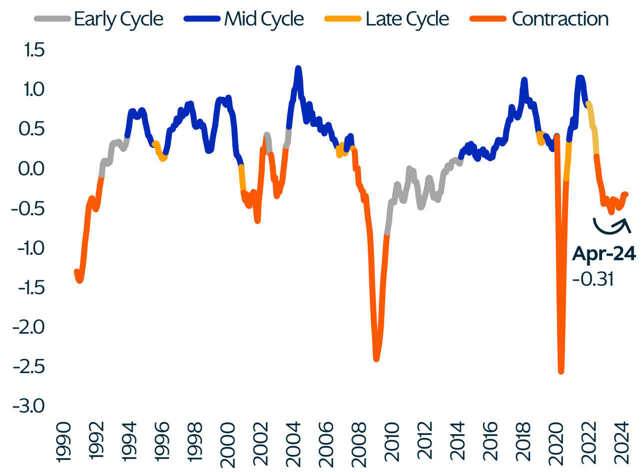
Data as at May 24, 2024. Source: Bloomberg.

However, perhaps more important for long-term investors, there are a lot of political and social crosscurrents that are increasingly bleeding their way into markets. Not surprisingly, the introduction of social media into our political process has created more discord. This type of disruption is like other post-industrial revolutions where technological change ushered in periods of social and political unrest. As our colleague Ken Mehlman explains, just as the invention of the printing press around 1440 introduced years of political, religious, social, and scientific disruption, the combination of the Internet and social media is a 'Gutenberg 2' moment that has produced and portends similar disturbances.

At the same time, complicated issues around immigration and inequality are also driving tense debates across the Western world that increasingly seem to push the left and right further apart. See Section IV, question #3 for a full discussion, but the upcoming U.S. presidential election only increases our conviction that policy from either a Trump or a Biden administration is likely to maintain an inflationary bent (which further heightens discord), given the threat of tariffs and the need for security spending, contributing to an increasing 'normalization' of wider than usual deficits. Finally, great power rivalries around the globe have intensified notably in recent quarters. As such, investors should expect more barriers to trade and capital flows in the coming years under almost all scenarios. Key to our collective thinking is that the intensifying focus on 'homeland economics' is a post-COVID, post-Ukraine global phenomenon that is likely to continue almost regardless of electoral outcomes in most countries.

Exhibit 5: After Two Years of Being in Late Cycle and Contraction, Our Proprietary KKR Cycle Indicator Is About to Move Into Its Early Cycle Phase

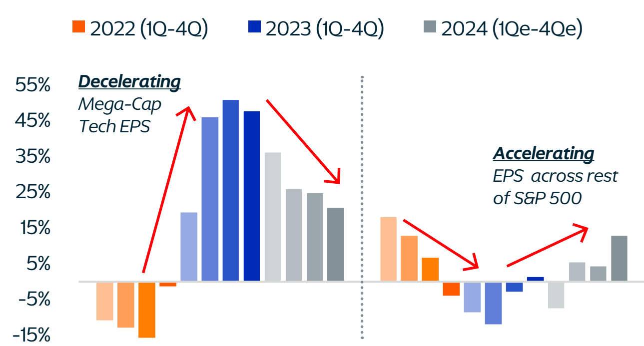
KKR Cycle Indicator (1990-Present, Z-Score)



Data as at April 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 6: We Think Earnings Growth Is Set to Broaden Beyond Mega Cap Technology and Become More Balanced in Coming Quarters, Driven by Positive Operating Leverage and Margin Growth in Other Sectors

S&P 500 EPS Growth Disaggregation



Data as at April 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

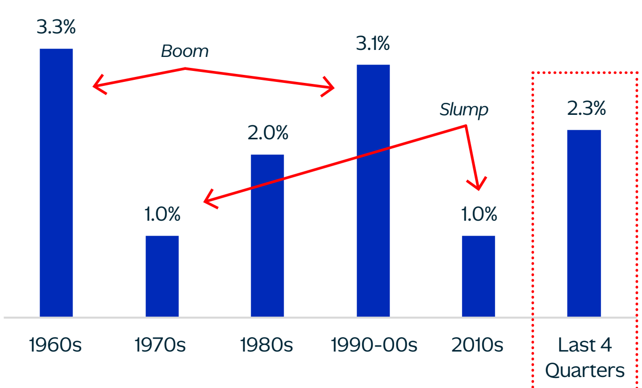
Exhibit 7: Long Periods of Equity Outperformance Have Been Driven by Productivity and/or Central Bank Intervention...

Productivity vs. Equity Markets		Labor Productivity, %QoQ, SAAR	S&P 500 Average Annual Return	Average U.S. Budget Deficit as a % of Nominal GDP	Average Fed Balance Sheet as a % of Nominal GDP
High Productivity Period	1960s	3.3%	8.4%	-1.0%	5.4%
	1990s-2000s	3.1%	8.8%	-0.8%	6.0%
Low Productivity Period	1970s	1.0%	-0.9%	-2.3%	6.4%
	2010s	1.0%	11.8%	-4.8%	20.9%
All Periods	1958-2018	2.1%	7.20%	-2.6%	8.3%
Today	4Q22-1Q24	2.2%	8.5%	-5.7%	29.8%

Note: 1960s and 90s-00s are the 'high' productivity growth (>3%) periods, referring to 1958-1968 and 1995-2005, respectively. 1970s and 2010s are the 'low' productivity growth (<1.0%) periods, referring to 1973-1979 and 2010-2019, respectively. Data as at April 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 8: ...As We Look Forward, Our Thesis Is That Productivity Is Again Set to Reaccelerate, Which Would Be Quite Positive for Capital Markets

U.S. Annual Labor Productivity Growth, %



Note: 1960s refers to 1958-68; 1990s-00s refers to 1995-05; 1970s refer to 1973-79; 2010s refer to 2010-19; 1980s refers to 1980-88. Data as at March 31, 2024. Source: Bloomberg, Federal Reserve Bank of San Francisco.

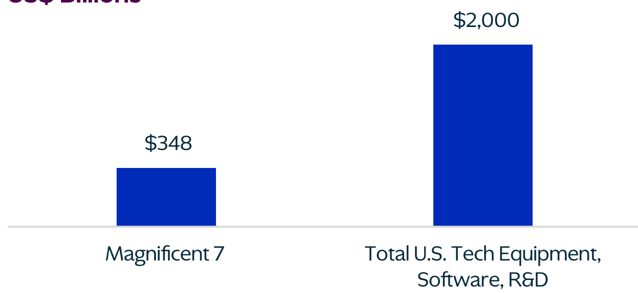
On the positive side of the ledger, growth and earnings – as our models have been suggesting for some time – are all performing better than the consensus expected in a higher nominal GDP growth environment. True, the U.S. consumer is not driving massive demand growth the way he or she was post-COVID, but unemployment has stayed low *(Exhibit 10)*, inventories are in check, and housing activity is stabilizing. Also, we have seen a massive capex cycle being led by the Technology sector *(Exhibit 9)*. Our view is that, similar to the Internet boom in the 1990s (and the corresponding period of solid economic growth leading up to 2000), the AI boom will drive a sustained period of higher capex before it is actually reflected in corporate profitability results. Implicit in what we are saying, though, is that the recent ongoing surge in productivity has actually occurred *before* AI benefits have been realized at scale, further underscoring our view that the corporate sector could enjoy a longer-tailed profitability renaissance. Importantly, though, unlike the dot-com bubble 20+ years ago, the companies financing this spending this cycle have bullet proof balance sheets, lower costs of capital, and a more consolidated market.

As we look ahead, we also want to signal another positive: Corporate earnings growth is beginning to broaden beyond just the Technology sector. One can see this in *Exhibit 6*. We think this increased breadth should create a more balanced tone within the liquid Equity markets. In addition, the technical picture remains quite compelling, with a lack of both *net* equity and corporate debt issuance (*Exhibit 11*), which generally bodes well for returns (*Exhibit 12*), especially in Private Equity.

Our view is that, similar to the Internet boom in the 1990s (and the corresponding period of solid economic growth leading up to 2000), the AI boom will drive a sustained period of higher capex before it is actually reflected in corporate profitability results.

Exhibit 9: The Magnificent 7 Reinvests 61% of Their Operating Free Cash Flow Back Into Capex and R&D. They Now Also Account for Almost 20% of Total Capex

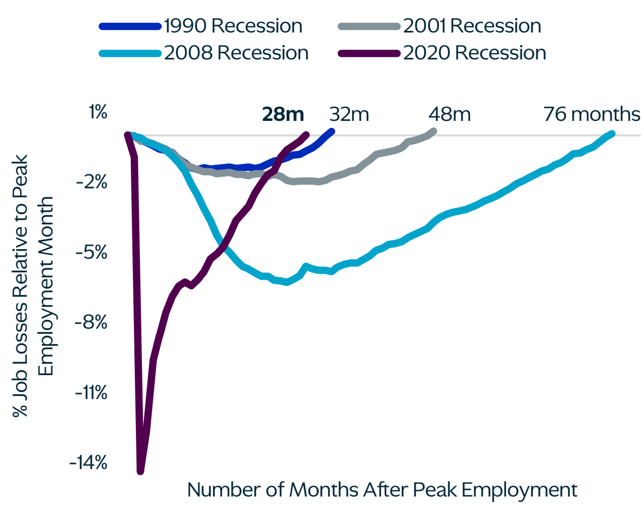
2024 Capex by Tech Magnificent 7 Compared to Total for U.S. Tech Equipment, Software, and R&D, US$ Billions



Data as at May 20, 2024. Source: Goldman Sachs.

Exhibit 10: We Think the Jobs Environment Is Much More Akin to the 1990s Than Post-GFC

Historic U.S. Job Losses and Recovery Trajectories

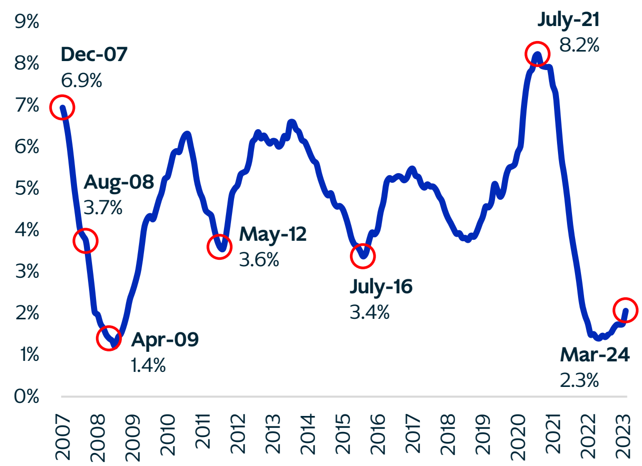


Data as at December 31, 2023. Source: U.S. Bureau of Labor Statistics, Haver Analytics.

At the same time, we think that many investors are still actually underweight their target allocations, including holding too much Cash at a time when most central banks have finished raising rates (*Exhibit 3*). Our proprietary survey work within the Family Office (see Loud and Clear) and Insurance (see No Turning Back) segments supports this view, while money market/cash balances in the individual investor market are also quite high relative to trend.

Exhibit 11: Our Liquidity Indicator Is Still Recovering From Near-Trough Levels

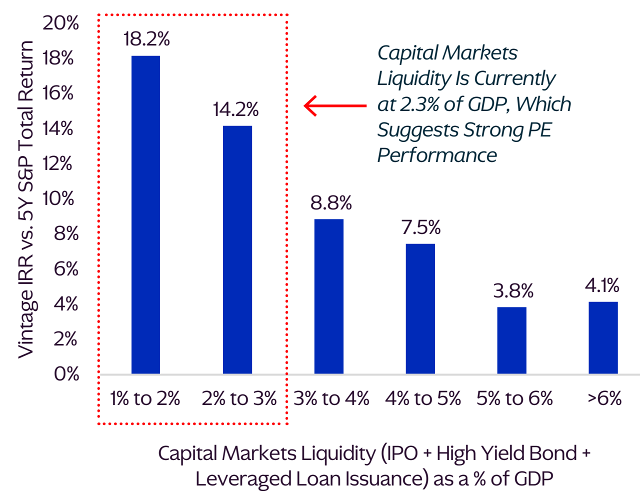
Capital Markets Liquidity Trailing 12 Months as a % of GDP (IPO, HY Bond, Leveraged Loan Issuance)



Data as at March 31, 2024. Source: Preqin, Bank of America, Bloomberg , KKR Global Macro & Asset Allocation analysis.

Exhibit 12: Private Equity Tends to Outperform Public Markets in Low Liquidity Environments

Private Equity Outperformance Across Liquidity Regimes, 1997-2023

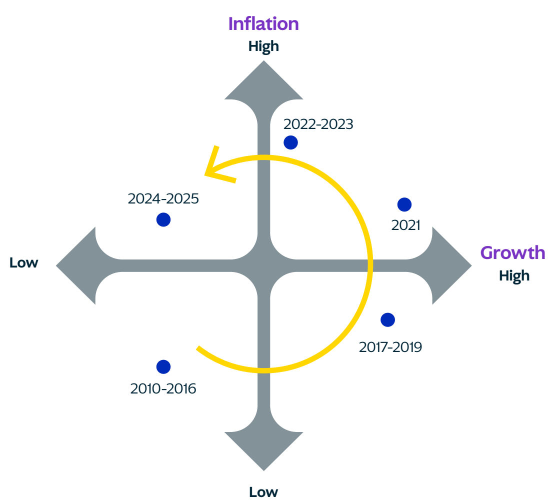


PE returns from Preqin on a 5-year forward returns from 1997 - 2019 basis. Data as at December 31, 2023. Source: Preqin, Bank of America, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Against this unique macroeconomic backdrop, however, we continue to argue that as investors we are experiencing a *Regime Change*. There remain four pillars to our original thesis: ongoing fiscal stimulus, heightened geopolitics, a messy energy transition, and stickier wages (driven largely by a shortage of skilled workers). If we are right, then global allocators and macro investors need to view their portfolios through a different lens. In particular, we think that more diversification across asset classes as well as less dependence on global sovereign bonds is warranted, especially given correlations between stocks and bonds have turned decidedly positive (*Exhibit 14*).

Exhibit 13: While Inflation Should Continue to Cool, We Don't Think It Will Return to Previous Levels. As a Result, We Maintain Our Regime Change Thesis

Low and High Growth and Inflation Regimes



Data as at June 14, 2024. Source: KKR Global Macro & Asset Allocation analysis.

So, where do we land as we look ahead to the second half of the year and into 2025 and beyond?

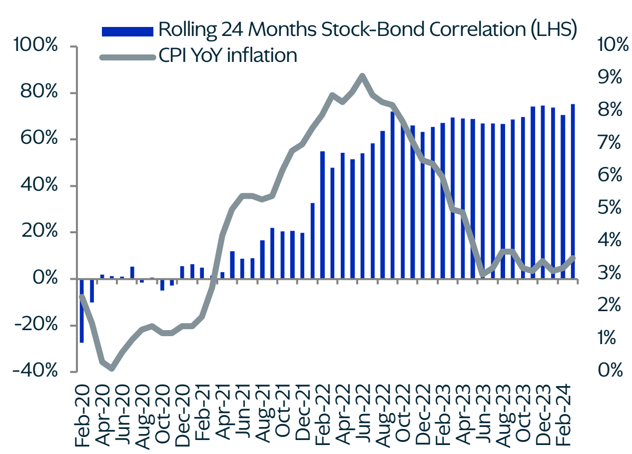
Most importantly, we retain our optimistic viewpoint for the following four reasons:

1. **We think that we have entered a structurally higher level of productivity in the United States, a backdrop that we believe will benefit capital markets globally**. We were not around for the 1960s, but the surge in productivity that followed tech investment in the 1990s is likely an apt parallel, we believe. Importantly, this increase in productivity will at least partially offset some of our concerns about wider deficits in the near-term. As we detail below in Section II, we are also raising our long-term run rate for U.S. GDP to two percent from 1.5%, signaling a structural improvement in growth that we believe warrants investor attention.

2. **We think that central banks, especially the Bank of Japan and the U.S. Federal Reserve, have adopted policies that are actually not that restrictive from a historical perspective**. For one thing, the Fed and other central banks' steady states for balance sheets are still plump relative to history (*Exhibit 15*). If we are right that U.S. real rates peak at two percent in the coming quarters and decline below one percent over time (note: we forecast one Fed cut in 2024 and an additional four in 2025), then this Fed tightening cycle will have been a fairly mild one by historical standards. One can see this in *Exhibit 16,* which shows that, if our forecasts are correct, the real fed funds rate will not spend a very long time in truly restrictive territory this cycle (i.e., at or above the level of potential GDP growth).

Exhibit 14: Despite Inflation Falling on a Cyclical Basis, the 'New' Positive Relationship Between Stocks and Bonds Remains Strong

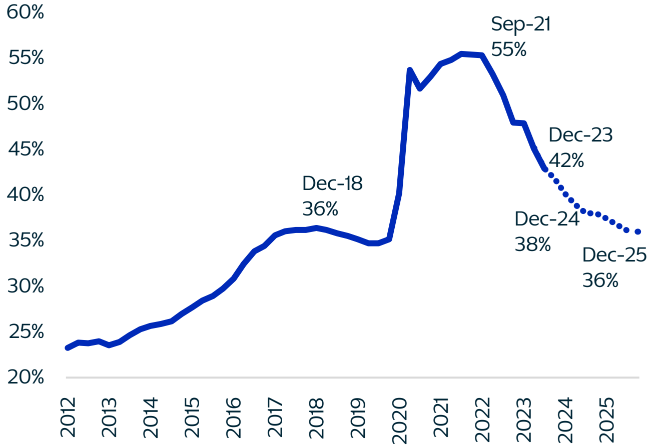
U.S. Stock-Bond Correlation and U.S. CPI, %



Data as at March 31, 2024. Source: Bloomberg, KKR GBR analysis.

Exhibit 15: Despite Record Tightening at the Front End, Central Bank Balance Sheets Will Remain Plump With Assets

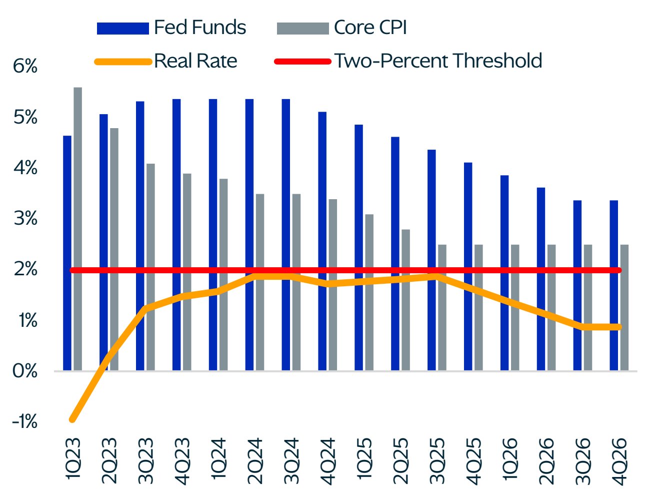
G4 Central Bank Balance Sheets as % of GDP, Dollar-Weighted



G4 = Federal Reserve, the ECB, the Bank of England, and the Bank of Japan. Data as at September 30, 2023. Source: Haver Analytics, national central banks and statistical agencies, KKR Global Macro & Asset Allocation analysis.

Exhibit 16: We Think The Fed Will Bring Real Rates to Two Percent This Cycle, But No Higher

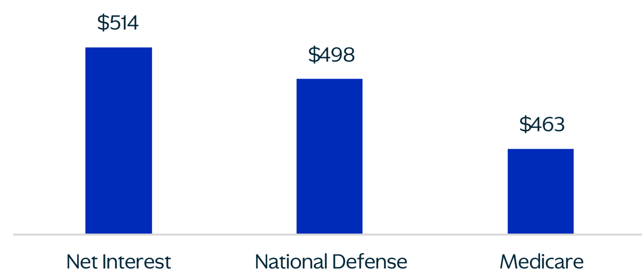
GMAA Base Case: Real Rates



Data as at June 12, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 17: Annual Spending on the U.S. Debt Service Burden Is Now More Than Spending on National Defense or Medicare, and More Than the U.S. Spends on Veterans, Education, and Transportation Combined

Overall Spending, US$ Billions



Data as at April 30, 2024. Source: CBO.

Traditional Macro Relationships Are No Longer Behaving the Same as in the Past	
1	Japan is experiencing inflation, while China has disinflationary headwinds.
2	U.S. Treasuries and the Japanese yen are no longer the ‘risk-off’ assets of choice. They are, in fact, driving much of the volatility in the capital markets during periods of uncertainty.
3	European growth is coming from the periphery, not the core, this cycle.
4	The interest rate easing cycle has started in Europe, not in the U.S., for the first time.
5	We have actually raised our long-term forecast for U.S. GDP growth, despite an inverted yield curve and a low savings rate. In the past, these two macro variables were recession signals.
6	It is the government, not the consumer or corporates, that is most leveraged this cycle.

At the same time, we think that many investors are still actually underweight their target allocations, including holding too much Cash at a time when most central banks have finished raising rates.

3. **Third, we think that the employment market holds up better this cycle.** Some of our optimism is actually driven by demographics, especially given the exit that we have seen of aged 55+ workers from the workforce since the onset of COVID. While we do expect immigration in the U.S. to create more slack in some sectors, we think this is a positive development for growth as unemployment from excess supply feels very different from the 'typical' cyclical dynamics of over-hiring and layoffs.

Exhibit 18: The U.S. Has Been Able to Grow Its Workforce Through Demographic Growth; Meanwhile, Europe and Japan Have Offset Aging Populations by Improving Participation Rates. Looking Ahead, We Think That Aging Demographics Will Require a Rethink of Both Workforce Participation and Immigration

Contributions to Workforce Growth, Millions

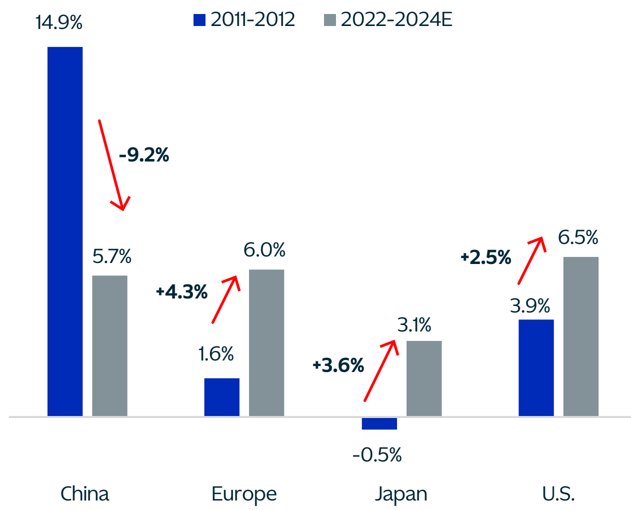
	U.S.	Europe	Japan
1Q2010 Workforce	**153.7**	**159.8**	**65.7**
Demographics	**11.3**	**-3.0**	**-3.4**
Change in Participation	**2.7**	**14.8**	**7.0**
Change in Prime-Age Male Participation	-0.3	0.1	0.0
Change in Prime-Age Female Participation	1.3	3.0	2.7
Change in 55-64 Participation	0.5	9.6	2.0
Change in 65+ Participation	1.2	2.2	2.3
4Q23 Workforce	**167.8**	**171.5**	**69.4**

Europe data based on the 'Euro-Area 19' subset of E.U. members. Latest available data as at December 31, 2023. Source: U.S. Bureau of Labor Statistics, Eurostat, Japan Statistics Bureau.

4. **Finally, consistent with our *Regime Change* thesis, and because we are mostly living in a higher nominal GDP environment,** we retain our conviction that a hard landing is not in the cards. The most cyclical areas of the global economy already dipped in 2022-23 and are now improving from below-trend levels. We are becoming more constructive around the potential for cyclical wage dynamics, as well as structural considerations related to technology and automation, to drive higher and faster nominal GDP growth globally.

Exhibit 19: Besides China, Most Economies Are Experiencing Higher Nominal GDP This Cycle

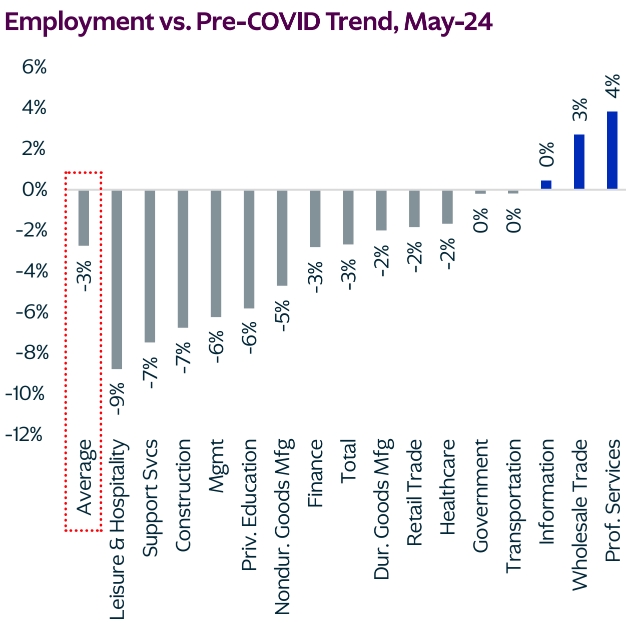
Annual Nominal GDP Growth, %



2024 are KKR GMAA estimates. Data as at May 31, 2024. Source: China National Bureau of Statistics, Statistical Office of the European Union, Cabinet Office of Japan, U.S. Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

Against this unique macroeconomic backdrop, however, we continue to argue that as investors we are experiencing a *Regime Change*. There remain four pillars to our original thesis: ongoing fiscal stimulus, heightened geopolitics, a messy energy transition, and stickier wages (driven largely by a shortage of skilled workers).

Exhibit 20: Pent-Up Demand in Key Pandemic-Affected Services Sectors Continues to Fuel Above-Average Job Growth in the U.S.



Pre-COVID trend based on linear extrapolation of 2014-19. Data as at May 31, 2024. Source: U.S. Bureau of Economic Affairs, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

As our colleague Ken Mehlman explains, just as the invention of the printing press around 1440 introduced years of political, religious, social, and scientific disruption, the combination of the Internet and social media is a 'Gutenberg 2' moment that has produced and portends similar disturbances.

However, while our longer-term thesis remains largely intact, we are constantly refining and evolving our convictions. To this end, we wanted to highlight what's changed since December and why we think adding more ballast to portfolios is warranted, particularly given the optimism being priced by markets during an asynchronous cycle where some sectors are slowing more quickly and inflation remains too sticky. So, as part of the next chapter of our *Regime Change* framework, we note the following:

What Is Changing or Being Amplified Since Our Outlook for 2024?

1

Increasing Importance of Non-Correlated Assets

After two major deep dive surveys across the Family Office and Insurance universes, we have even greater conviction in our thesis around owning more non-correlated assets. Key to our thinking is that, in a world where the efficient frontier for expected returns is now flatter, the importance of diversification increases. As a result, CIOs need more diversifiers in their portfolios so that they do not get whipsawed, especially when short-term performance can be quite volatile. One can see this in *Exhibit 27*. If we are right, then our insight has significant implications for allocators, particularly CIOs who have embraced long-duration bonds and/or VC on the equity side, or that do not believe in linear deployment.

2

Portfolio Volatility Is Increasing Because of the Changing Relationship Between Stocks and Bonds, Not an Increase in Single-Asset Volatility

There is another important influence to consider as well. Specifically, given all the movement around interest rates these days, the changing nature of government bonds in a portfolio, and greater use of concentrated ETFs by market participants (e.g., 40% of the High Yield market is now daily liquidity), the volatility of most benchmarks we track is surging to the upside, which increases the risk that a portfolio allocation change can be made at the wrong time. Some great work by Racim Allouani and Rachel Li suggests that today's heightened portfolio volatility is actually driven more by stock/bond correlation than by a surge in single-asset volatility, which was typically the case pre-COVID. This new reality is a big deal as it adds risk to a typical 60/40 portfolio, and it speaks to our view that we are indeed in a *Regime Change* when it comes to portfolio construction.

3

We Are More Focused On the Positive Path of Productivity, Especially in the U.S.

Given increasing debt loads amidst larger government deficits, we are now extremely focused on the one catalyst that is best equipped to keep stagflation at bay: Productivity. As we detail in *Exhibits 7* and *49*, the best decades of equity performance are usually linked to periods of strong productivity gains. Against today's backdrop of stickier wages, we think that strong productivity will be needed to allow corporate margins to hold. Were productivity to slip, we likely would take a more defensive stance on risk assets, a reality that is new to our macro thinking in 2024.

4

The Mismatch Between Energy Supply and Demand Is More Pronounced

The mismatch between energy demand and energy supply seems even bigger than our previously bullish view. Demand is once again rising on electrification trends for EVs and heat pumps and the explosive growth in energy-intensive users such as data centers, semi fabs, EV battery plants, and steel mills. In the U.S., for example, overall electricity demand is poised to grow 2.4% annually, compared to essentially zero in prior years. We believe as much as one-third of this growth could come from data centers, and that data centers could account for 7-10% percent of total electricity demand in the next few years, compared to two to three percent at the end of 2023. While demand is increasing, our work shows that most developed market economies don't have the infrastructure in place to meet this need. Moreover, a lot of the power demand is not where the power supply is currently located. We view this current set-up as a major opportunity for investors, especially on the Infrastructure side.

5

A Broadening of Earnings Growth Across Sectors and Geographies

As we show in *Exhibit 76*, we have raised our 2024 and 2025 S&P 500 EPS forecasts to $250 and $270, respectively. What is changing in our data is that corporate earnings growth is set to broaden beyond mega-cap

Tech in coming quarters. We think this shift will represent more balance in the equity markets, and as a result, we are raising our 2024 target to 5,700 from 5,400 previously, which is roughly 10% above the 'top-down' consensus estimate of 5,172. Our 2025 target of 6,130 implies about 13% of upside from today's level of around 5,414. Meanwhile, in Europe, we think the economy is bottoming at a time when most investors are underweight the region. Stronger tourism, rebounding sentiment, and an increase in real wages (at last) will lead to a perkier consumer in the coming quarters. As part of this improvement in growth, the services economy is accelerating nicely. Additionally, the end of quantitative easing breathed life back into, and produced strong returns for, the financial services sector. We expect this trend to continue as valuations normalize.

6

More Sustained Deficits Amid Election Volatility Reinforces Our Regime Change Thesis

Regardless of the electoral outcome, the 2024 U.S. election is likely to further strengthen our *Regime Change* thesis. Though actual fiscal policy under Biden or Trump is not likely to loosen much given the expiration of some 2017 tax cuts or the imposition of tariffs, we continue to think that under either administration the deficit will stabilize at historically wide levels. As a result, we think Treasury term premium will stabilize at wider levels, too – which will make it harder for bonds to rally the way they did in past cycles. That said, there are also several policy proposals that could skew inflationary under a second Trump presidency, including writing stimulus checks for households, deporting undocumented immigrants (which would aggravate labor shortages), cutting off Iranian and Venezuelan oil, and potentially pressing for a more dovish Fed.

7

The Labor Supply and Demand Mismatch Could Create Unprecedented Demand for Worker Retraining

We think the U.S. labor force is in the early innings of an inflow of about four million additional potential workers amidst a record surge in immigration. However, our best guess is that limited formal skills training means the overwhelming majority of these workers will be competing to fill a small portion (perhaps about two million) of the 8.1 million open jobs in the U.S. As a result, we think the opportunity set for worker retraining may be as large as it has ever been, in part because there will be a lot of pressure to bring unemployed workers from low-skilled sectors (where we expect more of a labor glut in some cases) into high-skilled jobs left open by COVID-era retirements.

So, while we certainly believe in the opportunity set and our glass half full perspective, we do want to acknowledge that we are entering a volatile period in the second half of 2024 at a time when spreads are already very tight. To be sure, we are not signaling a more sustained bearish tilt the way we did in 2022 (see Walk, Don't Run). Rather – if we could steal a page from our Outlook for 2023: Keep It Simple – now is not a time to get over-extended when it comes to leverage or liquidity. The current environment, we believe, is more akin to the Oscar Wilde quote when he says that, "A pessimist complains about the noise when opportunity knocks." Said differently, if *Opportunity Knocks* in the form of a capital markets draw-down linked to election uncertainty, then you should have your portfolio in position to 'answer the door.' Don't just be the 'pessimist', particularly when many of today's macroeconomic headwinds can be overcome through a combination of thoughtful asset allocation and directed thematic investing.

Six Areas Where We Differ From Consensus

#1: Bumpy, But Faster Growth

Across all regions, we are again more bullish on growth than the consensus. In the U.S., stronger assumptions around both job growth and productivity lead us to raise our 2024 forecast to 2.5%, 10 basis points ahead of the consensus, and our 2025 forecast at 2.0%, 20 basis points above consensus. More importantly, we have raised our long-term forecast for U.S. structural GDP growth to two percent from 1.5% in the past. In Europe, data surprises are no longer lagging the U.S. as economic momentum turns positive. We are increasing our 2024 GDP growth forecast to 0.8% from 0.5% versus a consensus estimate of 0.7%. For 2025, our growth forecast is 1.4%, the same as consensus. We think growth in China is bottoming and likely in the early recovery stage. Our 2024 forecast is at 5.0% versus 4.7% at the beginning of the year and a consensus of 4.9%, while 2025 is at 4.6%, 10 basis points above consensus. In Japan, we forecast 0.6% GDP growth in 2024 and 1.2% in 2025, 20 basis points and 10 basis points above consensus, respectively.

#2: We Are Not as Worried About a Lower U.S. Savings Rate Signaling an Over-Extended Consumer This Cycle

While we do think U.S. consumer spending will slow in coming quarters, we are not seeing the type of imbalances that were observed in the run-up to past recessions. Specifically, although savings rates today are at the lowest levels since the GFC (currently around four percent, versus two to three percent in 2005-2006), we think this simple comparison doesn't account for the increase in the 65+ population over the last two decades (17% today versus around 12% prior to the GFC). Personal savings rates become sharply negative once households retire, meaning aging demographics likely explain some of the savings pullback. In fact, our estimates suggest that the 'neutral' savings rate has actually fallen to around 5.6%, down from 9-10% in the mid-2000s, implying that savings rates today are just 100-200 basis points below 'normal', while the savings rates that prevailed before the GFC were actually 700-800 basis points too low. Therefore, while we do expect some retrenchment, households do not look nearly as overspent as they have in the lead-up to past downturns.

#3: Bigger Regional Differences in Interest Rates. In the U.S., What's the Rush?

In the U.S., we are above consensus on interest rates this year as part of our higher for longer thesis. We see the Fed cutting rates just once this year, to 5.125% (which puts our forecasts about 25 basis points above market forwards) before falling to 4.125% in 2025 (also about 25 basis points above market pricing). For the U.S. 10-year, we stick to our forecast of 4.25% for year-end 2024 and four percent for year-end 2025, which remains a bit more hawkish than consensus of 4.2% for 2024 and 3.9% for 2025. In Europe, we have the bund at 2.6% for end-2024 (above consensus of 2.2%) and 2.8% in end-2025 (also above consensus of 2.2%). We think sustained higher inflation volatility means a return to a longer-term average term premium of approximately 50 basis points, leading to a long-term bund yield target of approximately 3.0%. In China, by comparison, we are actually below consensus for the 10-year for both 2024 and 2025 at 2.2% vs. 2.4%, and 2.0% vs. 2.4%, respectively. Against this backdrop, we think FX volatility will remain elevated and will serve as an important source of information for markets alongside the yield on government bonds.

#4: Better EPS, Driven By Higher Margins

We believe the cycle has further room to run, with margin expansion (as opposed to multiple re-rating) powering the next leg of the recovery. Our 2024 S&P 500 price target of 5,700 remains 10% above the 'top-down' consensus estimate of 5,172. For 2025, our target of 6,130 implies about 13% of upside from today's level of around 5,414. For 2024 and 2025 EPS, our targets are $250 and $270, versus the top-down consensus of $240 and $253, respectively. Our framework linking real GDP growth and unit labor costs to operating margins points to 20-30 basis points of margin expansion this year and next so long as labor productivity stays supportive.

#5: Oil – $80 is the New $60

We expect oil prices to settle in the mid-$70-80s range in 2024 amid slower global demand and better global supply. Longer term, though, we still think '$80 is the new $60.' As such, our longer-term forecasts remain well above futures, which continue to embed prices falling to the mid-$60-70s in 2025 and beyond.

#6: Where Could We Be Wrong?

Our base view is that there is an asymmetric risk for the economy and markets if rates go higher versus lower. We still see six percent short rates as somewhat of a tipping point, given this level limits operating cash flow for most levered entities as well as encourages more deposit flight from traditional financial intermediaries. Also, because policymakers did not remove as much stimulus from the markets this cycle, we continue to caution that the currency markets could be a source of unexpected stress for investors to consider in their portfolios. Finally, an extreme spike in unemployment, which is not our base case (as we think unemployment stays lower this cycle) would likely be unsettling for both our thesis and the markets, we believe.

What does all this mean from a macro and asset allocation standpoint?

In the classic 1975 Steven Spielberg film *Jaws*, Chief Brody, played by Roy Scheider, proclaims – after internalizing the size and power of the shark – "you're gonna need a bigger boat" to Captain Quint, who was played by Robert Shaw. Brody's important epiphany was that traditional shark-catching techniques were no longer effective, and as a result, a different approach was warranted. Like Chief Brody, this is how we view asset and security selection in the current macro landscape: another approach is warranted. This viewpoint, since the onset of COVID, served as the backbone of our now well-established *Regime Change* thesis.

As we look ahead, we still have high conviction in this framework, and if anything, we now think that the longer-term implications of our prior work may be even more profound than we had previously understood. We do not make these comments lightly, and to this end, we think that there are several key action items for portfolio managers and CIOs to consider. They are as follows:

1. **First, we remain of the mindset that a *Regime Change* (*Exhibits 13* and *14*) has occurred that requires a different type of portfolio, including more collateral-based cash flows, more upfront yield, and more linkage to the higher nominal GDP environment in which we are operating (*Exhibit 19*)**. Importantly, it also means that safe haven assets like government bonds and traditional currency hedges like JPY won't work as well this cycle. If there is good news, it is that our own internal work is showing that wages, which we view as a proxy for sticky services inflation, are moderating from peak levels, though KKR's portfolio company CEOs still see a higher resting heart rate for wages and inflation this cycle.
2. **Second, given flatter expected returns than in the past, we now think more focus on diversification is warranted**. As we detail in *Exhibit 21*, the five-year forward median return across asset classes we forecast is 80 basis points lower than what we saw over the last five years. That said, we also see more ways to win in this cycle across a wider swath of asset classes. This viewpoint is in direct conflict with what worked before COVID, when concentrating one's assets in long-duration equities (e.g., VC) and fixed income (e.g., long-duration Investment Grade Debt) easily bested the benefits of constructing a more diversified portfolio. If we are right then CIOs, similar to what we learned from our *proprietary insurance survey*, should broaden their exposure and own more non-traditional assets that are less correlated. In addition, allocators will likely need to be more opportunistic to deploy when asset classes, regions and/or sectors periodically fall out of favor.

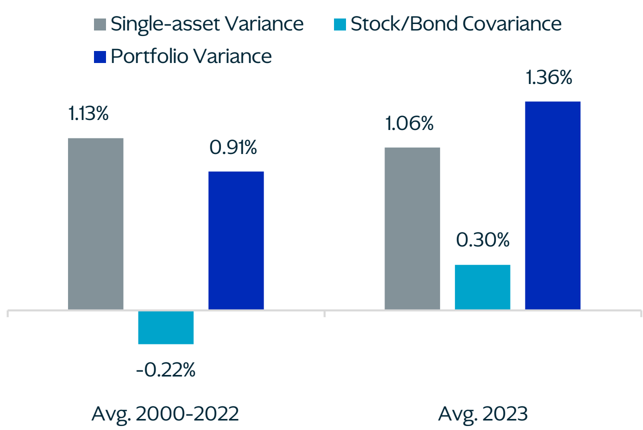
Exhibit 21: Given Flatter Returns, We Think a More Diversified Portfolio Will Perform Better in the Future

Private Market Expected Returns, %

Data as at April 30, 2024. Source: Bloomberg, BofA, Cambridge Associates, Green Street, KKR Global Macro & Asset Allocation analysis.

Exhibit 22: The Recent Heightened Portfolio Volatility Is More Correlation Driven Than Single-Asset Volatility Driven. This Backdrop Means That CIOs Need to Find More Assets That Bring Down Overall Portfolio Variance

60/40 Portfolio Variance Decomposition — Rolling 3-Year



Data as at December 5, 2023. Source: Bloomberg, BofA, Cambridge Associates, Green Street, KKR Global Macro & Asset Allocation analysis.

3. **Third, in our new regime framework, we expect heightened volatility around the fundamental relationship between stocks and bond assets, which have become more correlated. As a result, traditional benchmarks are likely to demonstrate more volatility than in the past**. Somewhat ironically, our colleague Chris Sheldon likens the current state of affairs in the global capital markets to self-inflicted wounds, as investors' desire for greater liquidity increases volatility given so much of the fixed income market is actually now in equity linked, daily liquidity credit vehicles. One can see this in *Exhibit 22*, which shows that the increase in stock/bond covariance is leading to higher overall portfolio variance. Importantly, this outcome is occurring despite single asset variance actually declining. Our bottom line: Allocators should consider a shift towards assets that help overcome this increasing correlation between stocks and bonds. Greater communication with boards and end constituents is also likely becoming more important. Otherwise, there is now heightened risk that boards encourage CIOs and their teams to tamp down on certain single asset class allocations at precisely the wrong time, which ultimately could further dent cumulative performance in a world where the investment community is already starting with lower expected forward returns.

Our bottom line: Allocators should consider a shift towards assets that help overcome this increasing correlation between stocks and bonds. Greater communication with boards and end constituents is also likely becoming more important. Otherwise, there is now heightened risk that boards encourage CIOs and their teams to tamp down on certain single asset class allocations at precisely the wrong time, which ultimately could further dent cumulative performance in a world where the investment community is already starting with lower expected forward returns.

SECTION I

Asset Allocation and Key Themes

Picks and Pans

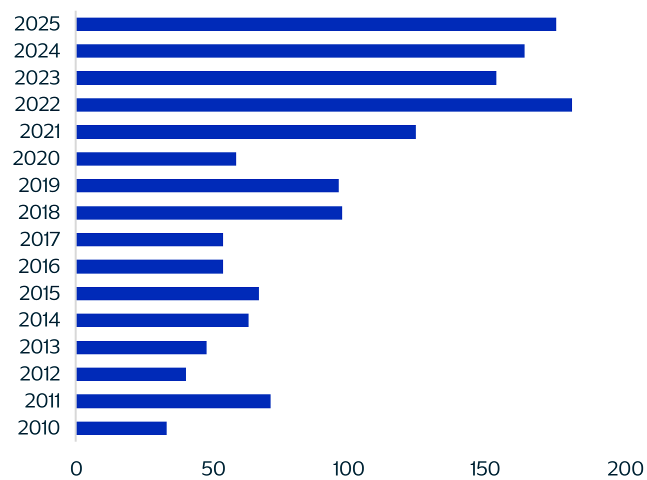
Against the current macroeconomic setting, we offer our updated Picks and Pans for investors to consider:

▲ Public Company Buyouts of Themselves (NEW)

We are seeing a growing number of public companies that are essentially taking themselves private through better capital allocation, including aggressive buyback programs. A good example, we believe, is the home building sector. We are also seeing this type of corporate reform behavior in the U.S. home improvement sector as well as in parts of the industrial and energy sectors. In our view, many executives in this area are de-emphasizing the cyclical components of their businesses to create more sustainable companies with greater visibility of earnings and returns. As a result, we think that not only solid buyback activity but also a lower cost of capital could drive valuations materially higher at many of these companies than the consensus now thinks.

Exhibit 23: Europe Has Historically Done More Dividends and Fewer Buybacks, But That Is Changing

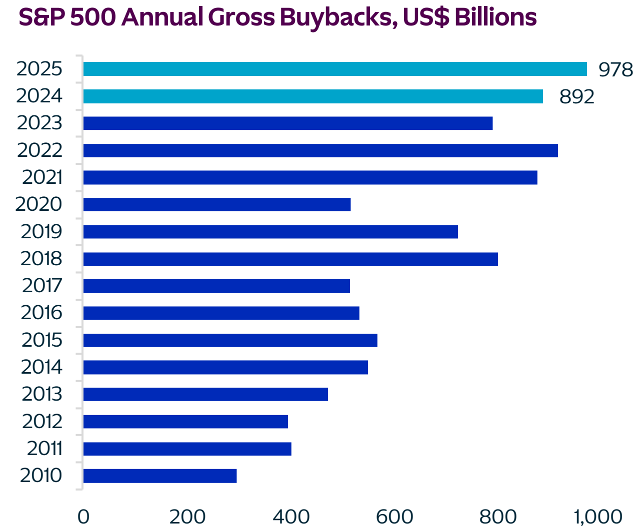
Euro Stoxx 600 ex-Financials Gross Buybacks, € Billions and GS Estimates



Data as at April 24, 2024. Source: Goldman Sachs.

We are of the view that all-in yields are likely near peak levels, as cooling inflation will give the Fed more conviction on interest rate cuts and easing financial conditions.

Exhibit 24: U.S. Buybacks Have Been Driven by Solid Earnings Growth and Tech Stocks, Contributing Mightily to the Lack of Supply



Data as at March 31, 2024. Source: S&P, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

▲ CLO Liabilities (NEW)

We are of the view that all-in yields are likely near peak levels, as cooling inflation will give the Fed more conviction on interest rate cuts and easing financial conditions. While we still like Loans, our preference is to play this idea through higher-quality CLO tranches, as diversification benefits and credit enhancement matter more in an environment where idiosyncratic risks are elevated (particularly when it comes to refinancing). We also think that CLOs fit into our higher for longer thesis on rates relative to pre-COVID.

▲ Biotechnology (NEW)

We think the recent drawdown in biotech stocks is likely overstated when one compares it to how the rest of the equity market has performed. Just consider that the Nasdaq biotech index is down about 19% from its 2021 peaks, while the S&P 500 has actually *climbed* about 19% over the same period. Nonetheless, we continue to think biotech remains one of the most compelling secular growth stories in the market, backed by aging populations, increased technological investment, and the fact that a lot of weaker startups have struggled to raise capital/IPO in recent years. Our bottom line: We are turning more bullish on the sector, particularly when one accounts for the fact that valuations in price-to-book terms are now hovering near the lowest levels since the GFC.

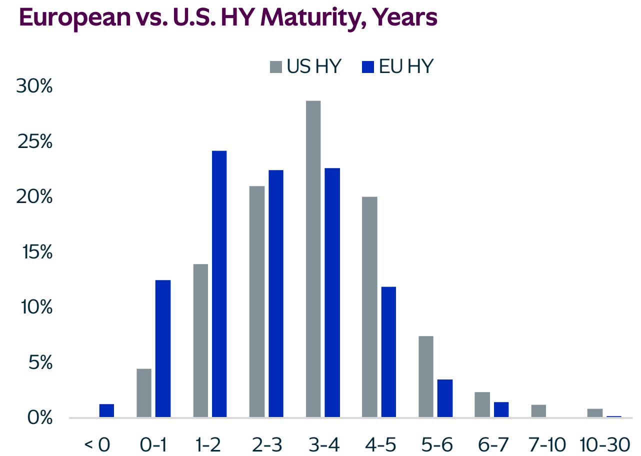
▲ USD EM Corporate Debt (NEW)

While we remain bullish on the growth trajectory for emerging markets, we continue to think that EM Public Equity markets may not be the best way to play this theme, as they are often overweight state-backed enterprises that do not prioritize returning profits to shareholders. By contrast, we like opportunities in the private markets to work alongside local partners to align with key growth themes, as well as opportunities in the public debt markets (particularly as EM default rates are often lower than those for U.S. corporates). At present, we especially like the relative value opportunities in EM Debt to lend to some of the same quasi-governmental enterprises that drag on EM index returns, as these companies carry more protection than typical corporates while offering excess spread relative to their inherent risk.

▲ Short Duration European Credit (NEW)

Not only does European HY screen 'cheap' to U.S. HY on a spread basis, but we believe historical levels suggest there is more opportunity for high quality senior secured assets to tighten relative to the U.S. Importantly, European HY maturities tend to be shorter, and against this backdrop, we expect fully 35-40% of European HY to mature by the end of 2026. Taken together with ECB rate cuts, this reality offers near-term takeout opportunities for bonds that still have convexity. Moreover, in many instances across Europe, we think that there is some compelling convexity that remains, particularly for any issuers that will try to use future rate cuts as an opportunity to address existing short-term debt.

Exhibit 25: Fully 35-40% of Euro HY Is Maturing by the End of 2026. We See This Refinancing Opportunity as Significant



Data as at April 30, 2024. Source: Bloomberg.

▲ Japan (REPEAT)

We continue to remain constructive on the investing environment in Japan and believe that an economic reawakening is in progress. We see a transition underway in the coming years from the post-COVID, pent-up, demand-driven recovery to a second phase, fueled by real income growth. Capital expenditures remain elevated, which is critical to boosting productivity to offset not only the increase in wages but also the price increases in food and oil. We take comfort that corporate reforms, especially around listed companies, continue to gain momentum under Prime Minister Kishida. We also still see opportunities in corporate carve-outs and significant value in direct public to privates, as we believe the opportunity for operational value creation is meaningful. That said, we do expect the yen to remain weaker for longer and highly volatile, likely only strengthening once the Fed begins its easing campaign. Against this backdrop, we think sound hedging and portfolio construction is only becoming more important.

▲ 365 Day Lending, Including Fund Financing (REPEAT)

If we are right that the Fed cuts rates more gradually than markets expect, then the carry offered by the front end of the curve is going to be an important driver of performance in 2024. We are particularly interested in term subscription lines as an opportunity to receive above-market compensation for exposure to high-quality counterparties in a space where regional banks have pulled back on new lending. Today, a sub-line with less than a 365-day maturity generally yields SOFR +200-250 basis points, which we think could be attractive as a Cash plus surrogate with low default potential. Importantly, this opportunity screens well from a cyclical risk standpoint, as banks are beginning to move back into this market which could tighten pricing in the next few quarters.

▲ U.S. Leveraged Loans Refinancing Wave (NEW)

Similar to what we are saying about European High Yield, we think the wave of refinancing for leveraged loans will continue, driving better total returns for discounted Leveraged Loans nearing maturity. All told, year-to-date through May, U.S. Leveraged Loan issuance stood at $550 billion, of which fully $198 billion (36%) was driven by refinancing activity. We look for this theme to continue in coming quarters as spreads across risk assets have continued to compress. As our colleague Chris Sheldon's recent credit letter suggests, sponsors and issuers are looking to reprice and refinance existing debt, which will continue to provide tailwinds for the asset class and will likely drive spread compression absent new M&A.

Exhibit 26: We Believe Reinsurance Capital Solutions Can – in Certain Situations – Provide Meaningful Diversification, Reduced Volatility, and Enhanced Performance...

Asset	Model Portfolio (Weighting or Ratio)	Alternative 1	Alternative 2	Alternative 3	Alternative 4
Equities	60%	60%	55%	55%	50%
Bonds	40%	35%	40%	35%	30%
Insurance Assets	0%	5%	5%	10%	20%
Annualized Return	5.4%	6.3%	5.8%	6.6%	7.9%
Volatility	13.2%	12.9%	12.3%	12.0%	10.8%
Return Risk Ratio	0.41x	0.48x	0.47x	0.55x	0.73x
	Difference in Basis Points				
	Model Portfolio (Weighting or Ratio)	Alternative 1	Alternative 2	Alternative 3	Alternative 4
Annualized Return	5.4%	+90	+39	+129	+257
Volatility	13.2%	-27	-92	-120	-239
Return Risk Ratio	0.41x	+0.08x	+0.06x	+0.15x	+0.33x

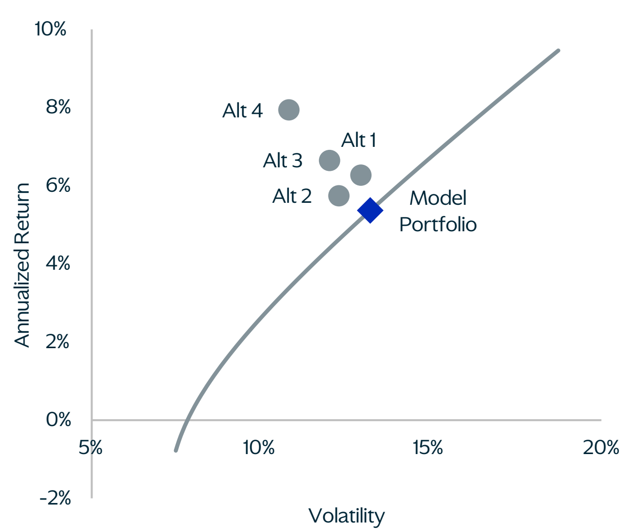
Equities: MSCI ACWI Gross Total Return USD Index; Bonds: Bloomberg Global-Aggregate Total Return Index; Alternative Portfolio: Reinsurance transactions. Data from 1Q18 to 1Q24. Source: KKR GBR analysis.

▲ Reinsurance Capital Solutions (NEW)

A continuing refrain we heard from our recent survey work was the growing desire to own longer duration, compounding-oriented assets with tax-efficient attributes, especially for family offices/high net worth investors. Importantly, we believe participating in reinsurance transactions (or what we call insurance as an asset class) can be an effective complement to yield-oriented asset classes such as Private Credit and/or Asset-Based Finance. At the same time, the high return on capital attributes of this asset class also enable allocators to play 'offense' with their portfolios. The market potential for insurance as an asset class is quite sizeable, as we increasingly see that a growing number of insurers are looking for partners to reinsure block transactions, or actually exit lines of business. Beyond stable returns and solid yield characteristics, the asset class's low correlation to other more traditional fixed income products is quite compelling if our 'bigger boat' thesis is accurate.

Exhibit 27: ...Which Is In Line With Our Diversification Thesis for Portfolio Construction

Various Reinsurance Transaction Portfolios Volatility and Annualized Return vs. a Traditional 60/40



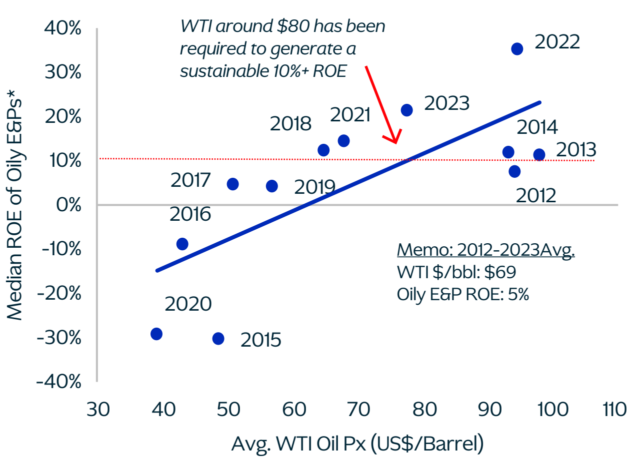
Equities: MSCI ACWI Gross Total Return USD Index; Bonds: Bloomberg Global-Aggregate Total Return Index; Alternative Portfolio: Reinsurance transactions. Data from 1Q18 to 1Q24. Source: KKR GBR analysis.

▲ Out Year Oil Prices (REPEAT)

We expect oil prices to moderate to the mid $70-80 range amid slower global demand and better global supply next year. Longer term, we still think '$80 is the new $60.' Shale is still the key source of longer-term global supply growth, and producers continue to demonstrate a disinclination to grow supply unless prices center at least around $80. This forecast remains well above futures, which continue to embed prices falling to $60-70 in 2025 and beyond.

Exhibit 28: If We Are Correct That Shale Producers Are Now Focused On Generating Attractive FCF and ROEs, We Think Around $80 Is the Long-term Price Level Required to Achieve Those Aspirations

Median ROE of Oily E&Ps vs. Avg. WTI Price



* Median of COP, EOG, PXD, OXY, FANG, APA, PDCE, MGY, MUR, DEN, CIVI, CRC, SM, CDEV, TALO. Data as at December 31, 2023. Source: Bloomberg.

▲ Opportunistic Credit (REPEAT)

This 'Pick' has multiple threads to it. For starters, we see significant value in opportunistic liquid Credit vehicles that can nimbly 'toggle' allocations across High Yield, Levered Loans, and Structured Credit as well as between sectors and themes, particularly as a repricing of spreads and the risk-free rate create select pockets of relative value.

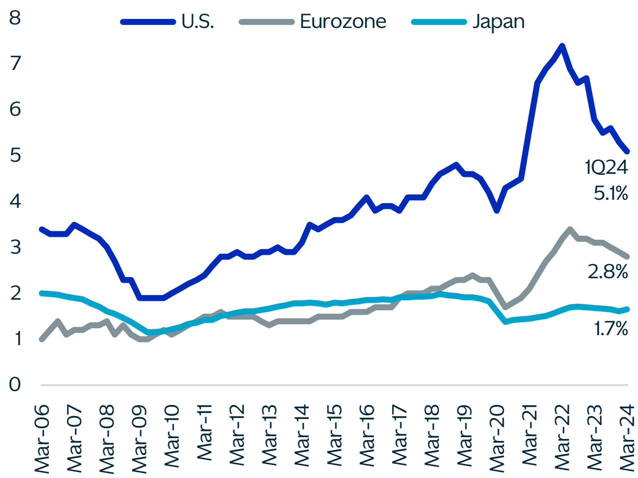
We also think that wider dispersions within Credit asset classes, often driven by indiscriminate ETF buying and/or selling, are creating substantial opportunities that were not available in the past. At the same time, we are seeing some really attractive relative valuation in the bucket we call Capital Solutions Credit to fund acquisitions and/or major capital expenditures including domestic re-shoring initiatives. In particular, it definitely feels to us like there is an upward 'kink' in the efficient frontier that is providing investors in products like Convertible Bonds and Preferred Securities the ability to enjoy some attractive equity upside participation but also retain some downside protection at limited additional costs. Finally, Asia Credit also remains an area of growing interest from investors, as this more nascent market faces less competition from more traditional players.

▲ Worker Retraining (NEW)

The latest CBO figures imply that total U.S. immigration may be roughly 5.5 million people *higher* over 2023-2027 than previously expected (or more than double what the CBO's previous forecasts for run-rate immigration had assumed). While that should help alleviate labor scarcity, given there are some 8.1 million open jobs in the U.S., the bad news is that the majority of new workers will be qualified for only about two million of these open positions. Thus, we think there is a massive economic opportunity to invest in better worker training that can help move many workers into higher-skill job openings across manufacturing, logistics, nursing, etc., that have been left open as a result of baby boomer retirements or growing needs. Against this backdrop, a rethinking in approach may be warranted. Areas where we see opportunity could include: 1) shifting job requirements from a credentials first model to a skills first model. Importantly, we believe this will optimize ROI in education and training and also lead to more employable people; 2) reliance on certificates to confirm training of people in areas of specific need and employment relevance; 3) a skills first model that allows workers and employers to understand skills adjacency, facilitating the upskilling of existing workers whose jobs have some overlap with or even all of, the skills needed; and 4) expansion of hybrid platform models that provide online credentialing paired with personalized coaching.

Exhibit 29: U.S. Worker Turnover Rates Are Much Higher Than Those in Other Developed Countries

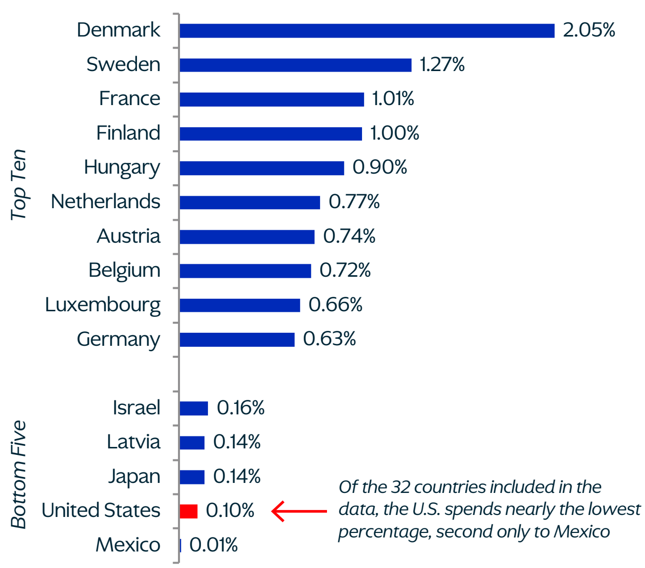
Quarterly Job Vacancy Rates by Country, %



Data as at March 31, 2024. Source: U.S. Bureau of Labor Statistics, Eurostat, Bank of Japan, Haver Analytics.

Exhibit 30: The U.S. Spends Less On Worker Retraining Than 31 Out of 32 OECD Countries Studied

Public Expenditures on Assistance and Retraining for Unemployed Workers in Top Developed Economies as a % of GDP



Data as at December 31, 2022. Source: U.S. Department of Commerce.

▲ Multifamily Real Estate (New)

For some time now, we have been advocating an overweight to Real Estate Credit. We now see good value on the equity side, too. Key to our thinking: U.S. rental vacancies are at their lowest levels in about 40 years (except for the pandemic), while run-rate household formation will likely run at a higher rate than rental units can be delivered given the pullback in building starts. Importantly, we think the recent surge in U.S. immigration will only add to these imbalances, as it could potentially double the number of households formed over the next three years. Finally, we think market technicals are becoming more bullish, too, including signs that cap rates have now started to peak (as more transactions are taking place between buyers and sellers) as well as tighter spreads for RE lending (including the CMBS market). So, while we are not yet ready to 'run' when it comes to RE allocations, we think owning some existing multifamily in strategic geographies could be quite fortuitous, particularly in cases where replacement costs are near or above asset values.

▼ Fade Fed Rate Cuts When the Market Gets Euphoric (REPEAT)

If we are right that we are in a higher nominal GDP environment with increased levels of productivity, then the neutral rate for Fed Funds likely stays higher this cycle. As such, we do not share the consensus view of two or so rate cuts this year. Rather, we stick to our view that inflation is on a cooler path but will not return to the Fed's target range of two percent. Therefore, we would use periods of dovish euphoria to hedge out interest rate risks (like the opportunity set that was presented to investors during the banking crisis of 2023).

▼ Low-Cost Consumer Discretionary (REPEAT)

As we have written before, younger and lower-income U.S. consumers have been the most exposed to inflation this cycle, which is weighing on available spending. Moreover, a lot of inflation today is in 'must-have' categories like food, housing, etc., which is taking wallet share from discretionary spending on 'nice-to-have' budget items like restaurants or recreational goods. Finally, we think the composition of low-income demand is likely shifting away from categories like fast-casual dining as a surge in immigration leads to more competition for both employment and low-cost housing. Against this backdrop, although the consumer in aggregate has mostly recovered from the inflation shock of 2022, we remain cautious about the outlook for nonessential spending among this cohort.

▼ FX Risks (NEW)

We think the asynchronous experiences of major world economies around inflation and growth will create more volatility in both interest rates and currencies, particularly in cases where countries face tradeoffs between the long-term effects of higher bond yields on budgets versus the impact of weaker currencies on trade balances. To see this, one can consider the divergent experiences of the U.S. and Japan in recent years: U.S. bonds have become quite cheap, while its currency has strengthened sharply. Japanese bonds remain expensive, which should help government deficits, but its currency is at 30-year lows. There are also crosscurrents from geopolitics, including reserve balances and FX interventions, to consider. Our bottom line: betting on currency returns is likely a poor risk/reward for most investors right now, which is why we prefer FX hedge benefits for USD investors to potential currency upside in most cases.

Key Themes

We also think that leaning into themes that serve as foils to today's uncertain landscape is critical. To this end, we are enthusiastic about the following investment trends:

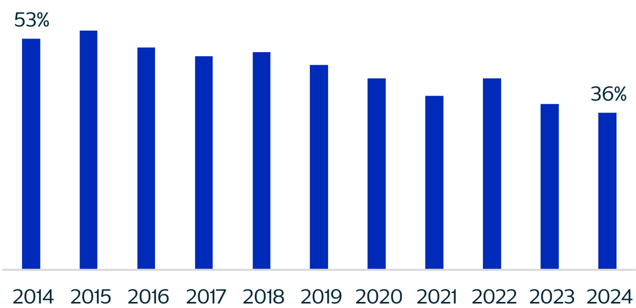
1

Buying Complexity, Selling Simplicity in the Equity Markets

While we still favor simplicity in Credit markets, we are seeing some interesting opportunities around complexity in the Equity markets. In addition to direct public-to-private transactions, we believe that corporate carve-outs are amongst the most attractive ways to find devalued and underappreciated companies in bifurcated markets — markets that too often seem to eschew complexity in favor of simplicity at almost all costs. In particular, we still believe the opportunity set to acquire high-quality carve-outs across PE, Infrastructure, and Energy remains outsized in today's markets. In our view, it would not be unreasonable, for example, to expect corporate carve-outs in large markets like the U.S. and Japan to account for a third or more of total deal volume during the next 12-24 months. Importantly, prices for these types of transactions tend to be much more attractive than regular way private-to-private transactions, and the operational upside has also generally been more significant than regular way Private Equity transactions.

Exhibit 31: The Industrials Sector Is Becoming Much More Fragmented

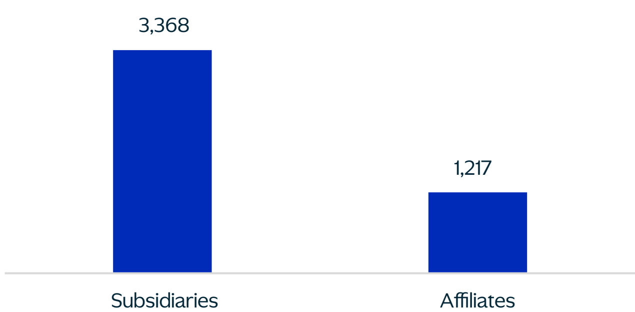
Top 10 Largest Industrials as a % of S&P Industrials by Market Cap



Data as at May 31, 2024. Source: Factset, Melius Research.

Exhibit 32: We Expect Divestments in Japan's Corporate Carve-Out Arena to Continue

Top Five Select Japan Conglomerates Number of Subsidiaries and Affiliates



Subsidiaries refer to subsidiaries with consolidated financial statements. Affiliates refer to unconsolidated subsidiaries. Data as at March 31, 2022. Source: Company disclosures, KKR Global Macro & Asset Allocation analysis.

> Just consider that the projected increase in AI electricity demand is roughly equivalent to adding 24 million homes (or 16% of total housing stock) to the grid.

2

Collateral-Based Cash Flows

Our research continues to show that many individual and institutional investors are still underweight Real Assets, especially Infrastructure and Energy, at a time when the need for inflation protection in portfolios remains high. Moreover, if we are right about the AI-electricity demand that we are forecasting, then the opportunity set to own growthier Infrastructure assets, especially around data centers, logistics, etc., is quite compelling, we believe. Just consider that the projected increase in AI electricity demand is roughly equivalent to adding 24 million homes (or 16% of total housing stock) to the grid. Finally, as we show below, the benefits of using Real Assets, especially Infrastructure, Real Estate Credit, Asset-Based Finance, and certain commodity investments, to increase portfolio diversification dovetail nicely with our current macro view about the need to find more diversifiers in one's portfolios. One can see this in *Exhibits 33* and *34*, respectively.

Exhibit 33: We Think More CIOs May Need to Focus on the Diversification Benefits of Non-Traditional Asset Classes, Particularly Infrastructure

Asset Class Correlations, Quarterly, Using Last 12 Months Total Return From 2012-2023

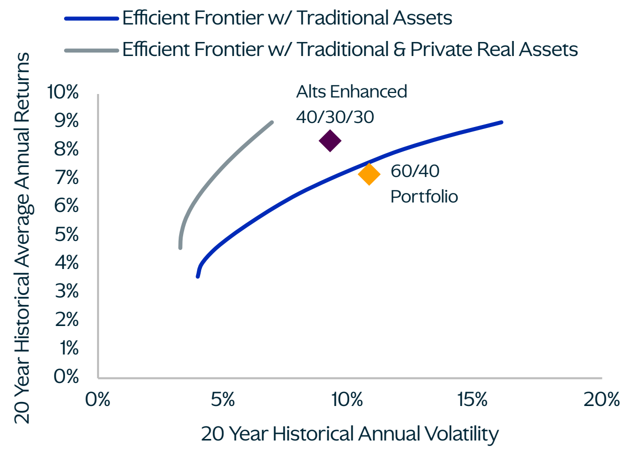
	IG	RMBS	CMBS	Public Equities	Structured Credit	Private Equity	Private Credit	RE Equity	Infra
IG	100%								
RMBS	92%	100%							
CMBS	96%	91%	100%						
Public Equities	50%	28%	44%	100%					
Structured Credit	35%	6%	34%	70%	100%				
Private Equity	29%	12%	28%	84%	49%	100%			
Private Credit	7%	-17%	5%	78%	75%	76%	100%		
RE Equity	-20%	-19%	-17%	33%	12%	52%	55%	100%	
Infra	-3%	-19%	-6%	46%	21%	63%	55%	54%	100%

Data as at September 30, 2023. Source: Cambridge Associates, JP Morgan, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Meanwhile, within Credit, we favor Real Estate Credit and Asset-Based Finance as a play on our *Regime Change* thesis. Even with inflation cooling and the Fed approaching an easing campaign, we still think 'higher for longer' will remain in play. As a result, we see a potential upward re-rating of structured products that are being used to finance Real Assets such as houses, aircraft, renewable power assets, and warehouses. Importantly, these products also have a degree of inflation linkage, given they are backed by hard assets that tend to rise in value with consumer prices, and they often have floating coupons that may benefit lenders during periods of higher rates.

Exhibit 34: Regime Change: We Think That There Is a Need to Shift One's Asset Allocation Mix Towards More Investments Linked to Nominal GDP

20 Year Average Annual Returns and Volatility of Real Assets and 60/40 Portfolios



Efficient frontier calculated using quarterly total returns over the last 20 years ending in March 2023. Traditional asset efficient frontier constructed using the MSCI World Index for Global Equities, the Bloomberg Global Aggregate Treasury Index for Global Government Bonds, the iShares TIPS Bond ETF for TIPS, and the Bloomberg Global Aggregate Corporate Index and Bloomberg Global High Yield Index for Global IG and HY Corporates. Efficient frontier with traditional and Private Real Assets uses all of those indices, plus the MSCI U.S. REIT Index for Global REITS, Commodities proxied using the S&P GSCI Spot Index, Global Private Infrastructure is proxied using the Burgiss Global Infrastructure Index, Private Real Estate proxied using the Burgiss Global Real Estate Index, and the Giliberto Levy Commercial Mortgage Index for Private Real Estate Debt. Data as at March 31, 2023. Source: Bloomberg, Burgiss, Giliberto Levy, KKR Global Macro, Balance Sheet & Risk analysis.

3

Productivity

We continue to believe that corporations will need to focus on automation and productivity to offset skills mismatches and labor shortages in certain instances. In our view, many of the most influential technological trends, including automation and digitalization that were in place before the pandemic have now only accelerated, especially on the industrial side of the economy. We think that the recent uplifts in productivity are not anomalies but instead are closely linked to a resurgence in capital investment that began around 2014. To date, the most advanced efforts have been heavily concentrated in the manufacturing industry, which in the United States accounts for less than 10% of total employment but nearly 90% of all robot installations. However, the playbook is starting to shift, as the aging population makes it harder to fill junior roles in service industries; we believe this trend will only accelerate as automation increases in fields like retail, leisure and hospitality, and healthcare. We are also very bullish on trends in worker retraining. Using data and educational techniques to improve student/employee skills to better match the demand by corporations for labor will be a mega-theme, we believe. No doubt, automation and productivity are emerging as some of the most compelling mega-themes this cycle, in our view, and at times have accounted for about 20-25% of our deal teams' PE activity since the pandemic.

We are also very bullish on trends in worker retraining. Using data and educational techniques to improve student/employee skills to better match the demand by corporations for labor will be a mega-theme, we believe.

Exhibit 35: Overall, Higher Wages Should Lead to Productivity Growth Over Time, Particularly for Skilled Positions

Wage Inflation vs. Labor Productivity in U.S. Manufacturing, %

Data as at April 30, 2024. Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

4

Security of Everything

We remain the maximum bullish on this theme. Against a background of rising geopolitical tensions, cyberattacks, and shifting global supply chains, CEOs around the world tell us that they want to know that they have resiliency when it comes to key inputs such as energy, data, transportation, and pharmaceuticals. In particular, we think that regulators and executives in the financial services industry feel strongly that cyber protection spending should accelerate more meaningfully, especially after the 2023 hack of the Treasury market. This theme also ties into rising temperatures around the world. Companies will need to ensure the security of storage, power, and transportation, and with government spending initiatives/tax incentives like the Inflation Reduction Act (IRA) in the U.S., a lot more government support will be targeted at the intersection of climate and supply chains. We also think that the defense industry will continue to benefit mightily from this theme.

5

Intra-Asia

Multiple trips to Asia since the onset of COVID confirmed for us that a meaningful transition is occurring: Asia is becoming more Asia-centric, with increased trade within the region rather than simply with developed markets in the West. Already, the share of Asian trade with regional partners (versus with the West) has increased massively to 58% in 2021 from 46% in 1990. We believe that more market share gains are likely, particularly when one considers that intra-Europe trade stood at 69% in 2021. All told, we think that intra-Asian trade could hit 65-70% in the next five to seven years.

Key areas on which we are focused include transportation assets, subsea cables, security, data/data centers, and energy transmission. Importantly, local banks are taking more of the local market share as part of this build-out. Before the Global Financial Crisis, Western financial firms accounted for two-thirds of the region's overseas lending. Today, by comparison, local Asian banks, led by China, Japan, and Singaporean entities, account for more than half.

We also see more countries in the region participating in and robustly benefiting from the Asia global growth engine. Frances Lim believes that India and Southeast Asia in particular stand to benefit from the ongoing changes. In addition to favorable demographics, more multinational companies are expanding their footprints beyond China, which remains an important influence too. This building of resiliency into supply chains has led to opportunities in data centers, logistics, and lower-cost manufacturing in the region.

6

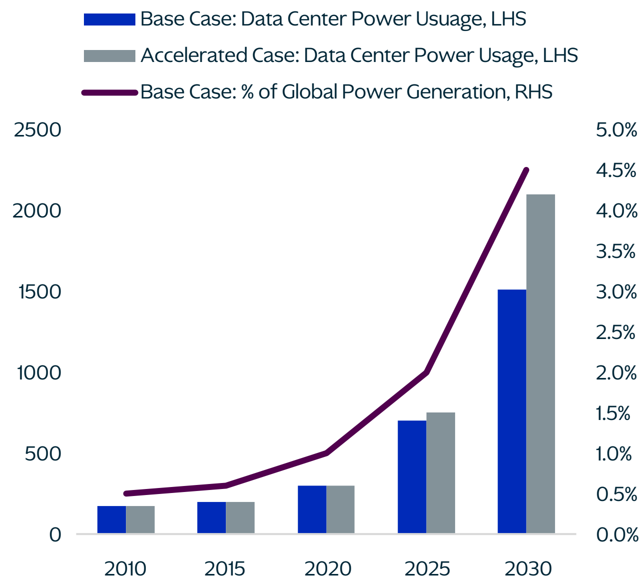
Intersection of AI and Energy Supply

In recent months we spent a substantial amount of time with internal and external constituents digging into whether we have the power supply to handle all the bullish demand sentiment we are now seeing. Our conclusion is that the constraint is on the supply side, not on the demand side, and that this mismatch will be one of the biggest investment stories over the next few years across North America, Europe, and Asia. All told, our best estimate is that power demand in the U.S. will increase at a CAGR of 2.0-2.5% over the next five years, compared to zero for the past five years. As this growth accelerates, data centers alone are expected to account for 7-10% of total energy demand by 2029, compared to two to three percent today. If we are right, then billions of dollars will be required across natural gas, renewables, transmission, and other forms of infrastructure. As part of our thesis, we expect energy efficiency, including cooling procedures, to become a significant area of growth. A recent trip to Spain in early June to drill down on this topic not only reinforced our conviction about the growing demand side of the equation, but also the emerging bottleneck in production that will need to be met in Europe through more supply of renewables as well as additional grid upgrades.

All told, our best estimate is that power demand in the U.S. will increase at a CAGR of 2.0-2.5% over the next five years.

Exhibit 36: By 2030, Data Centers Could Account for 4.5% of Global Energy Power Generation

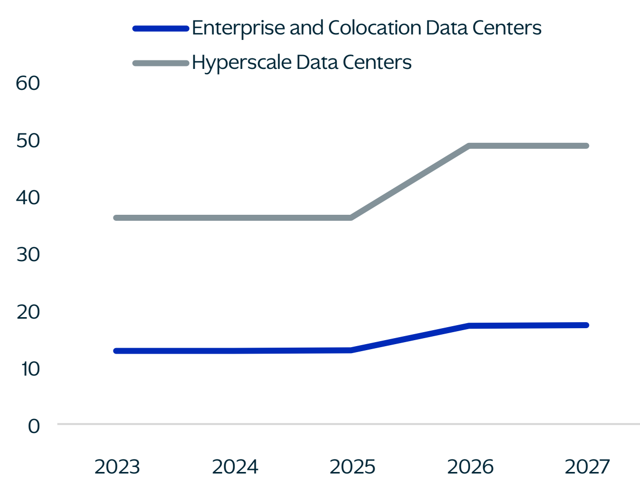
Global Data Center Power Usage Per Year, TWh



Data as at March 31, 2024. Source: SemiAnalysis.

Exhibit 37: Hyperscalers, Which Are the Biggest and Fastest Growing Part of the Market, Require More Energy, Racks, and Cooling Systems

Rack Density, KW/Rack



Data as at March 31, 2024. Source: JLL.

7

Demographic Challenges to Retirement Security

While we believe productivity is in the early stages of an upcycle, we also remain cautious that productivity growth will not be enough to offset the negative impact of a rapidly aging global labor force. Recall that the dependency ratio, or the ratio of the 65+ population relative to the working-age population, rose from 18% in 1990 to 30% in 2020 and is expected to rise to 37% by the end of the decade. Said differently, the working-age population is peaking in many parts of the world, while the base of older workers they need to support is growing rapidly. Increased fertility efforts will be required. This challenging demographic landscape will also further incentivize governments and corporations to encourage more domestic savings, including annuities and other tax-deferred savings vehicles in the developed markets. In the emerging markets like India, by comparison, we expect the government to introduce new programs that help shift individuals out of gold and real estate into more traditional capital markets savings vehicles.

Exhibit 38: Wealth and Retirement Savings Are Now Greatly Skewed Towards Older Demographics. We Think These Types of Imbalances Will Capture the Interest of Governments Regarding Retirement Security

Household Assets by Age Group, US$ Trillions and % of Total

	Assets, US$ Trillions		As a % of Total Assets	
Age	**2023**	**2001**	**2023**	**2001**
55 and Older	$114	$26	69%	51%
40-54	$37	$19	22%	37%
Under 40	$15	$6	9%	12%

Data as at December 31, 2023. Source: Federal Reserve.

At the same time, existing savings will need to be restructured and/or reorganized, we believe. For starters, just consider that the sizeable wave of retirements experienced in the U.S. and other economies in recent years was linked to financial security that elderly workers enjoyed from rising housing prices, especially post COVID. However, elevated housing prices, combined with structural housing shortages in developed markets, mean that workers will increasingly need to seek alternative vehicles for wealth accumulation going forward. All told, in the U.S. for example, the percentage of total assets owned by the aged 55+ age cohort has grown from 51% in 2001 to 69% in 2023 driven in part by a 4x increase in Real Estate assets during that time. One can see this in *Exhibit 38*.

In our view, homeowners will now need to diversify their holdings to create more balanced retirement plans. At the same time non-homeowners, many of whom have had to dedicate more of their current income to cover rental costs, will need to find ways to create 'catch-up savings', given that they have not benefitted from the home asset price appreciation. In our view, neither task (i.e., diversification of assets by homeowners as well as much needed catch-up savings for non-homeowners) will be that easy to accomplish without utilization of more professional advice and government incentives.

Our final point on retirement security is that we think there will be a blurring between national security and economic security. Simply stated, we expect a greater number of politicians to encourage citizens to keep their savings at home. Indeed, a recent speech by President Macron, for example, identified that Europe is challenged by not having an integrated financial system to ensure that savings are funding innovation and private investment on the continent. Rather, he cited an estimate of €300 billion flowing to U.S. Treasuries, which in his view helped fuel American, rather than European, growth. This vocal viewpoint – frankly – did not come as a total surprise to us, as to some degree, many political leaders want to lower their cost of capital and reduce dependence on foreign flows, especially in countries that run large deficits. As such, we have seen a notable increase in tax-deferred savings accounts that – in addition to the demographic headwinds that countries face – help limit some of the anxiety around running large deficits and/or depending on other countries to fund their growth.

Overall, though, our message to CIOs is that we have entered the next chapter of our *Regime Change* thesis. Flatter expected returns allow CIOs to use their risk budgets to build more diversification, especially among assets that have low correlation with each other and can provide more balance during periods of volatility. Beyond lower expected returns, what has changed is that the volatility in today's market is being driven by stock-bond correlation, not by single asset volatility. Against this *Regime Change*, we continue to advocate that a new approach to asset allocation is warranted.

In terms of risks, we continue to think that higher rates (especially if productivity tails off), not lower rates amidst slowing earnings, is the greater risk. As such, we still value some floating rate debt in the portfolio as well as more assets linked to nominal GDP than in the past.

Overall, our message is that, despite all the potential headwinds facing our society, our markets, and our economies, now is not the time to be a pessimist, especially when *Opportunity Knocks*. We still see some compelling opportunities, especially for allocators of long-term capital, and as such, we would use any dislocations to increase exposures to longer-term secular themes, including the Security of Everything, Collateral-Based Cash Flows, Productivity, and Intra-Asia Trade.

Maybe more importantly, though, is that we see productivity in the United States ticking higher, which is a more bullish, structural tailwind than we had previously been anticipating – and one on which we think investors should focus.

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