KKR

Insights

13.5

Global Macro Trends
December 2023

Glass Half Full

Outlook for 2024

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Henry H. McVey
Head of Global Macro & Asset Allocation, CIO of KKR Balance Sheet
henry.mcvey@kkr.com

David McNellis
david.mcnellis@kkr.com

Frances Lim
frances.lim@kkr.com

Aidan Corcoran
aidan.corcoran@kkr.com

Paula Campbell Roberts
paula.campbellroberts@kkr.com

Racim Allouani
racim.allouani@kkr.com

Changchun Hua
changchun.hua@kkr.com

Kristopher Novell
kristopher.novell@kkr.com

Brian Leung
brian.leung@kkr.com

Deepali Bhargava
deepali.bhargava@kkr.com

Rebecca Ramsey
rebecca.ramsey@kkr.com

Bola Okunade
bola.okunade@kkr.com

Patrycja Koszykowska
patrycja.koszykowska@kkr.com

Thibaud Monmirel
thibaud.monmirel@kkr.com

Asim Ali
asim.ali@kkr.com

Ezra Max
ezra.max@kkr.com

Miguel Montoya
miguel.montoya@kkr.com

Patrick Holt
patrick.holt@kkr.com

Allen Liu
allen.liu@kkr.com

Glass Half Full

Outlook for 2024

We view 2024 as an important transition year in our *Regime Change* thesis. Specifically, for the first time since the onset of COVID-19, we are finally forecasting below consensus inflation for much of the next 12 months. As a result, tactical investors may want to position their portfolios to take advantage of this temporary disinflationary impulse. That said, our longer-term thesis about a 'higher resting heart rate' for inflation this cycle remains robust. Specifically, the four key pillars of our *Regime Change* thesis – a sizeable fiscal impulse, sticky labor costs, a messy energy transition, and a fundamental restructuring of global supply chains – all argue for a different approach to asset allocation, we believe, including a meaningful reduction in the role government bonds can play in a diversified global portfolio. Meanwhile, as we peer around the corner today towards what tomorrow might look like, we still see the push and pull of loose fiscal policy versus tight monetary policy, which are working against one another to heighten volatility as well as increase dispersions against a backdrop of rising geopolitical tensions. The capital markets are not immune to this tug-of-war mentality either, as corporate net issuance remains lackluster versus a flood of supply in the government debt markets. Against this increasingly complex backdrop, we think that all global allocators will need a 'glass half full' approach that encourages them to direct capital towards investment themes that not only have attractive growth characteristics but also serve as foils to some of the current obstacles to what was once a more synchronized and well-integrated global economy. The areas where we have the highest conviction thematically as we enter 2024 include our Security of Everything thesis, Digitalization, Industrial Automation, Intra-Asia Connectivity, and Global Infrastructure.

> A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty.
>
> — **Winston Churchill**, Former Prime Minister of the United Kingdom

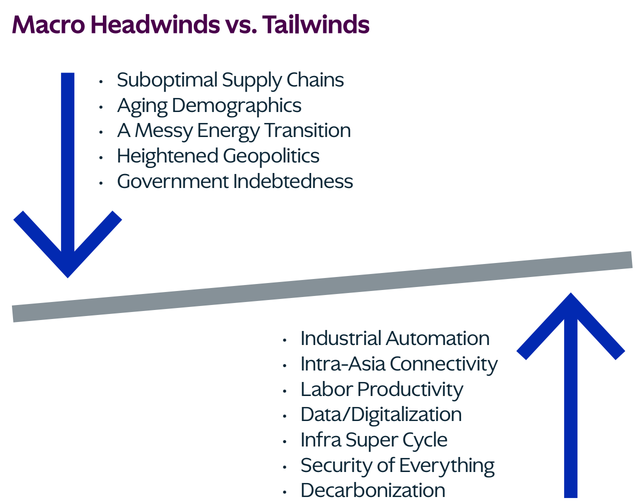
When we wrote our 2023 Outlook, our lead-in was "Despite all the uncertainty across today's global capital markets, we are poised to enter 2023 with a more constructive tilt, especially on many parts of Credit." **Fast forward 12 months, and as we describe below, we continue to maintain our constructive tilt and suggest that one should view the investing landscape with a 'glass half full' lens**.

Indeed, we want to reiterate again this year that for those allocators who want to roll up their sleeves and do some digging, there is still a massive amount of dispersion – the lion's share of which has been caused by macroeconomic uncertainty – within and across asset classes/regions that can be harnessed to create substantial value for long-term investors (*Exhibit 11*).

Importantly, though, we still think that too many people are locked into the paradigm that the S&P 500 is trading at lofty headline valuations and the U.S. economy is topping out and headed for a hard landing. As a result, they are sitting idle, as they feel there is little to no value in the market beyond Cash (i.e., despite a strong year in risk assets, there is still a record $5.6 trillion of assets in money market accounts). We just do not see it that way, especially in the core investing businesses that KKR oversees. For starters, outside of the S&P 500's 'Magnificent 7 or 12' (depending on your grouping preference), we think there are some very compelling Equity stories, especially ones that need capital to grow or reposition their businesses. Consistent with this view, the public-to-private and carve-out opportunities that exist today weren't available four to seven years ago, in our view. Meanwhile, Liquid Credit still looks cheap (especially relative to pension and insurance liabilities), and many parts of the Infrastructure sector where we traffic remain in a secular bull market on a global basis. Finally, between ongoing periodic dislocations as well as a growing number of required refinancings, there are a lot of capital solutions opportunities across Asset-Based Finance and Opportunistic Credit that earn an appealing coupon with some equity upside as well in many instances.

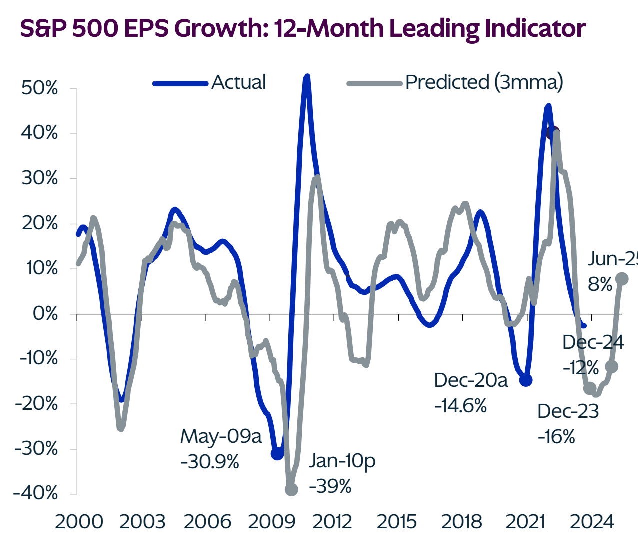
From our perch at KKR, we also believe that the opportunity set to invest behind some of the biggest mega-themes we have seen in years keeps the 'glass half full' for global allocators. Importantly, many of the investment opportunities we are highlighting also serve as compelling investment hedges and/or foils to some of the ails in the global economy these days (*Exhibit 1*). Hence, the famous Winston Churchill quote "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty" has become our 2024 mantra.

Exhibit 1: While We Fully Acknowledge Some Global Macro Headwinds, Our Travels Continue to Uncover Some Powerful 'Glass Half Full' Themes to Invest Behind



Data as at November 30, 2023. Source: KKR Global Macro and Asset Allocation analysis.

Exhibit 2: Our Earnings Leading Indicator Has Bottomed and Is Now Suggesting Profits Will Mend

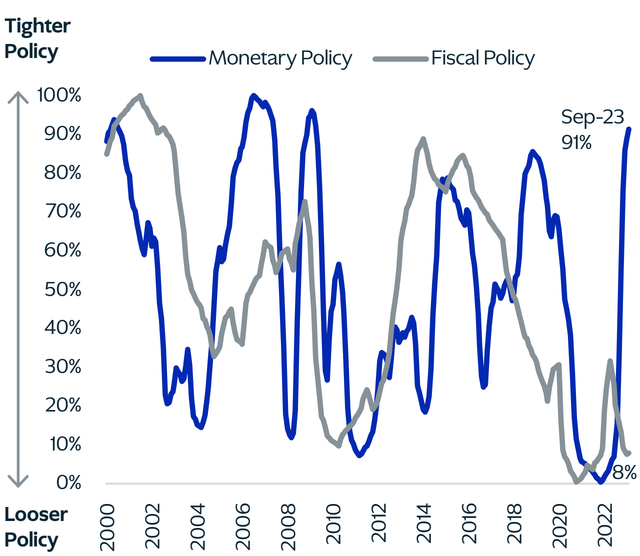


The Earnings Growth Leading Indicator (EGLI) is a statistical synthesis of seven important leading indicators to S&P 500 Earnings per share. Henry McVey and team developed the model in early 2006. Data as at November 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

As we reflect on the past 12 months, there is little question that 2023 has been a roller coaster ride, especially given the 'conundrum' we are seeing where a strong fiscal impulse is at odds with extreme monetary tightening (*Exhibit 3*). One macro hedge fund portfolio manager, Scott Bessent, described it as a race car driver who has one foot on the pedal (i.e., fiscal policy) and – at the same time – another foot on the brake (monetary policy). Against these competing influences, we saw the collapse of several prominent banks in the spring, which created fears of a deflationary, deleveraging cycle. However, this macro shock only proved to be a head fake for investors worried about an economic collapse, as the narrative shifted by the fall to one of higher GDP growth and surging long-end rates, despite the lingering effects of Russia's war in Ukraine and rising geopolitical tensions in the Middle East. Finally, heading into year-end, markets have snapped back in the opposite direction, betting on an aggressive series of Fed cuts and driving bond yields sharply lower.

Exhibit 3: Stimulus Conundrum: Today the Fiscal Impulse Is the Gas Pedal, Whereas Monetary Policy Is the Brake

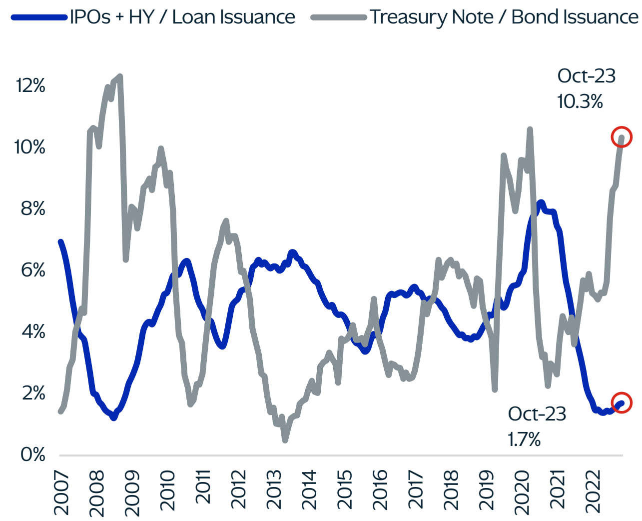
Fiscal and Monetary Policy as %ile of Historical Range



Monetary tightness measures the difference between real fed funds and potential GDP growth. Fiscal tightness measures the difference between the budget deficit and U.S. output gap as a % of GDP. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 4: Capital Markets Conundrum: Net Issuance Has Contracted Massively, Except When It Comes to Government Bonds

Capital Markets Liquidity, Trailing Twelve Months, as a % of GDP



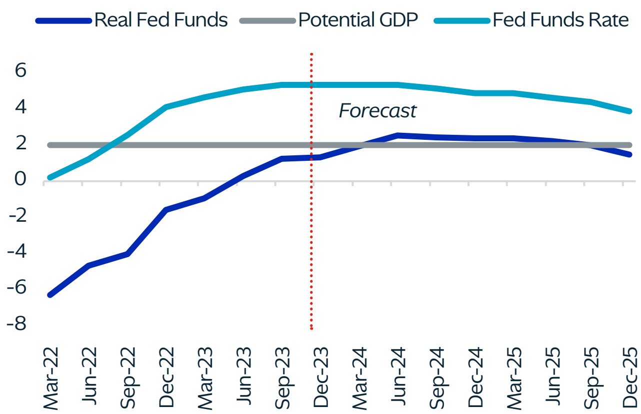
Data as at October 31, 2023. Source: Bloomberg.

During all of these ups and downs, we at KKR continued to subscribe to our Regime Change playbook (see *Regime Change: Enhancing the Traditional Portfolio*). To review, our thesis rests on four pillars – sticky labor costs, heightened geopolitics, a messy energy transition, and overheated fiscal impulses – that suggest there will be a 'higher resting heart rate' for inflation this cycle. This backdrop requires, we believe, a dramatic shift in one's asset allocation towards assets more linked to nominal GDP, not to over-indebted financial assets like government bonds linked to the low inflation, low growth world we are leaving.

We think there are some very compelling Equity stories, especially ones that need capital to grow or reposition their businesses.

Exhibit 5: Real Rates Will Tighten in 2024, Despite Lower Inflation. This Backdrop Is Why the Fed Can Ease (But Not as Much as the Market Now Thinks)

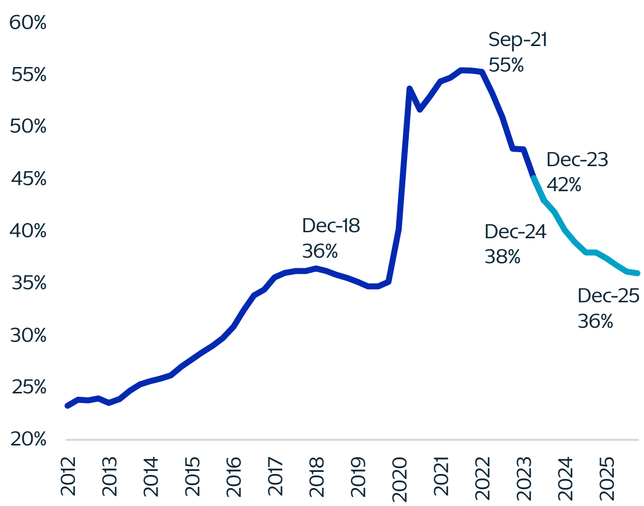
GMAA Projection: Real Rates vs. Potential GDP, %



Data as at November 15, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 6: Despite Record Tightening at the Front End, Central Bank Balance Sheets Will Remain Plump With Assets for Quite Some Time

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

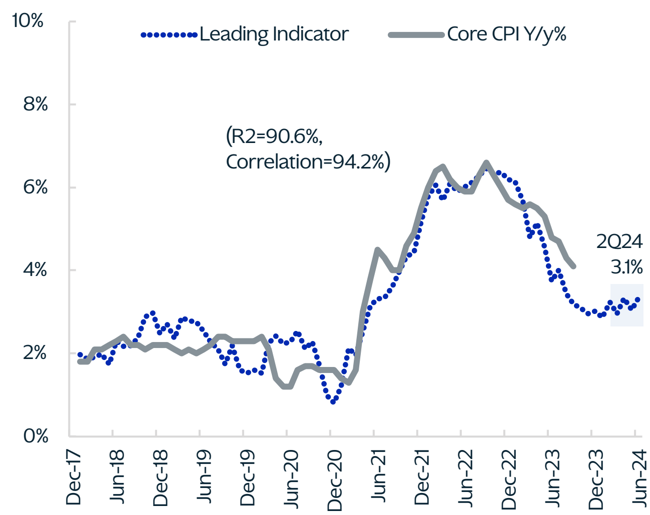


G4 = Federal Reserve, the ECB, the Bank of England and the Bank of Japan. Data as at September 30, 2023. Source: Haver Analytics, national central banks and statistical agencies, KKR Global Macro & Asset Allocation analysis.

To date, our Regime Change approach to asset allocation, including being short duration, owning collateral, and being higher up in the capital structure, has served us well. In fact, it has largely been a one-way trade in our favor. **However, buyer beware in 2024: Next year will be different for two reasons. For starters, we are uniformly above consensus on growth (except in Europe) and uniformly below consensus on inflation (except in Japan). Also, rate of change matters, and our models are suggesting lower year-over-year inflation prints for at least the first six months of 2024 (*Exhibit 7*).** Moreover, we think that in 2024 nominal growth will likely slow (we actually have a mild recession in the second half of the year in our base forecast), and goods inflation could be negative, as we show in *Exhibit 8*. Meanwhile, unemployment will tick up, we believe, and long rates should rally a little further as the Fed finally cuts rates at the short end. **So, our punch line is that, from a tactical perspective, fixed income instruments may continue to benefit from a disinflationary impulse in the first half of 2024, which could be compelling for short-term investors in the U.S.**

Exhibit 7: Our CPI Model Begins to Flatten Out Around Mid-Year 2024

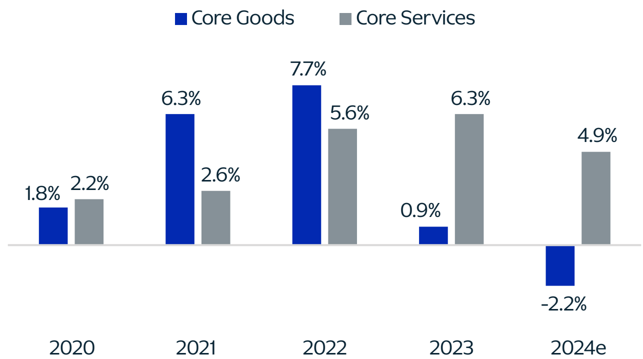
Core CPI Leading Indicator, %



Model calculated on monthly basis to better reflect latest CPI inflation trends. Data as at November 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 8: Core Goods Will Be Deflationary in 2024, While Core Services Will Begin to Come Off the Boil

Core Goods and Services Inflation, 2020-2024e



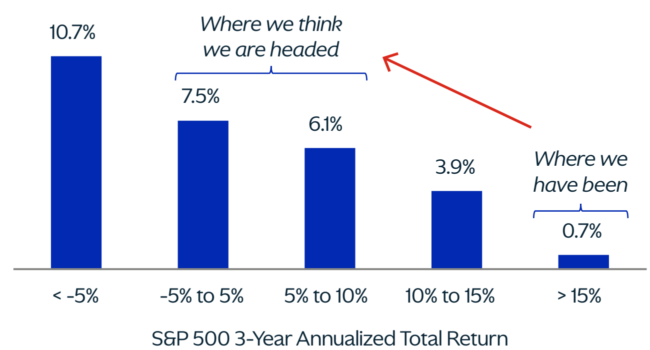
Data as at December 12, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

However, we see this positioning in inflation trends as temporary, and we do not want to confuse the cyclical with the secular. For long-term investors, we still believe that there will be a 'higher resting heart rate' for inflation this cycle, compliments of the supply side factors driving our Regime Change thesis, which warrants a different approach to macro and asset allocation, including overweight positions in collateral-based cash flows such as Infrastructure, Energy, Asset-Based Finance, and Real Estate Credit.

Meanwhile, within the equity side of the traditional 60/40, we also think that control-based Private Equity investing can likely play a bigger and more important role in helping to generate higher returns in a world where our overall expected returns have fallen (see Section IV where we address expected returns as well as *Regime Change: The Role of Private Equity in the 'Traditional' Portfolio*). Key to our thinking is that, despite a higher cost of capital, owning control positions with operational improvement opportunities can best the performance of a passive index by a good margin if our macroeconomic fore-casts are correct. Indeed, history is on our side; as *Exhibit 9* shows, the value of the illiquidity premium has increased when public markets have reverted towards more modest levels of return. The time to be bearish on Private Equity is not today; rather, it was actually in late 2021 and early 2022, when we believe several growth-oriented PE investors over-deployed their capital relative to trend amidst record low rates (and did not hedge in many instances).

Exhibit 9: The Excess Return of Private Equity Is Greatest When Public Equity Market Volatility Is Highest. We Link These Better Results in Private Equity in Tougher Markets to Operational Improvements and Better Entry Prices

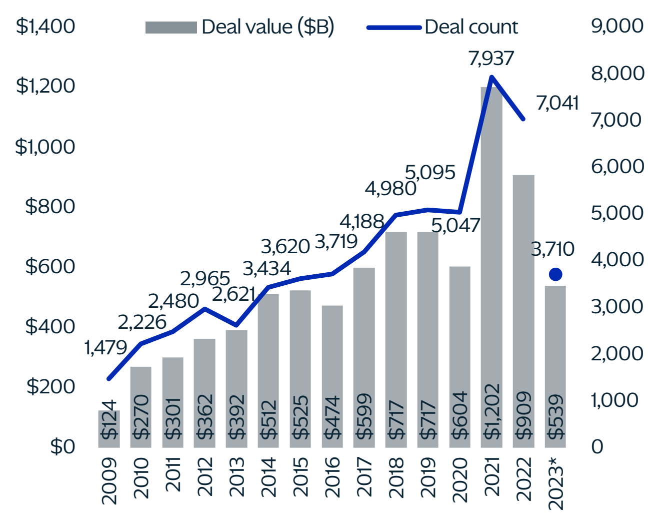
Average 3-Year Annualized Excess Total Return of U.S. Private Equity Relative to S&P 500 Across Public Market Return Regimes



Data as at November 30, 2022. Source: Cambridge Associates, Pitchbook, KKR Global Macro & Asset Allocation analysis.

Exhibit 10: Deployment Pacing in Private Equity Matters a Lot. The Time to Be Cautious Was in the Second Half of 2022, Not 2024, in Our View

U.S. Buyout Deal Activity, US$ Billions and Deal Count

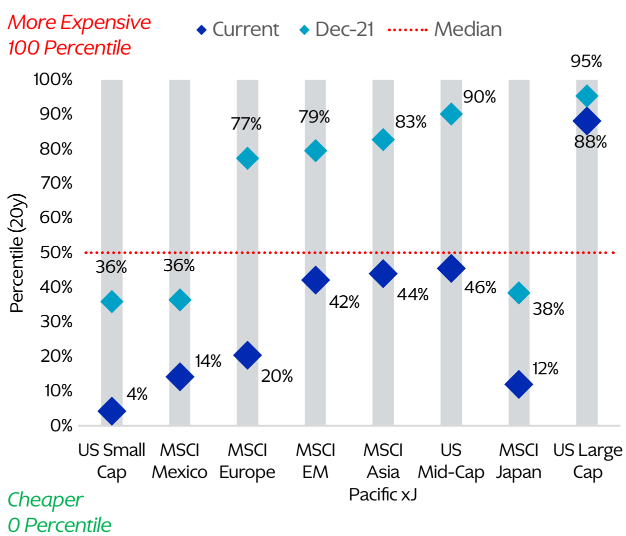


Note: Private Credit is represented by the Cliffwater Direct Lending Index. High Yield is represented by the ICE BofA U.S. High Yield Index. Senior Bank Loans are represented by the S&P/LSTA Leveraged Loan Index. U.S. Treasuries are represented by the ICE BofAML 10-year U.S. Treasury Index, CLO AAA, CLO BBB, CLO BB refers to the Palmer Square Indices. Data as at November 30, 2023. Source: Bloomberg, Cliffwater, Cambridge Associates.

Finally, we really like flexible capital in the Credit markets. Yields are at attractive levels in absolute terms, the quality of the debt in large liquid markets like High Yield is higher, and periodic dislocations are creating ample opportunities to lean in and out of various Credit products. Moreover, as economic growth slows, dispersions tend to increase within and across asset classes, a backdrop that tends to favor more flexible capital than the past regime where QE 'artificially suppressed' the rate of interest.

Exhibit 11: Excluding Large Cap Growth, Both Dispersions as Well as Absolute Valuations Remain Compelling Across Many Parts of the Global Equity Markets

Cross-Asset Valuation Percentiles, Relative to 20-Years Average, %

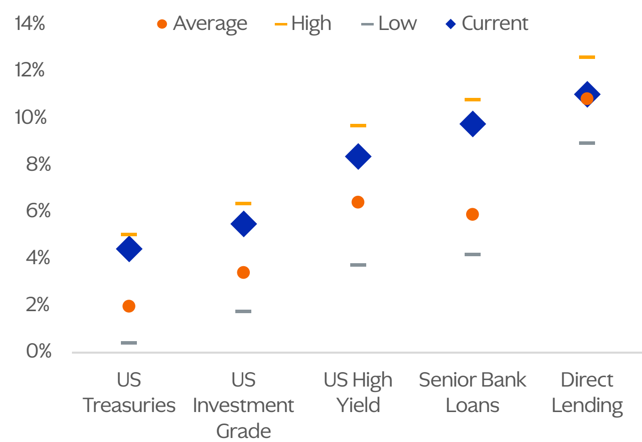


Notes: Equity indices refer to NTM P/E. Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, S&P, MSCI, KKR Global Macro & Asset Allocation analysis.

We also keep in mind that, even amid the recent rally in bonds, the stock/bond correlation has remained quite elevated.

Exhibit 12: There Are Multiple Parts of Credit That Appear Attractive Today for Total Return-Oriented Investors

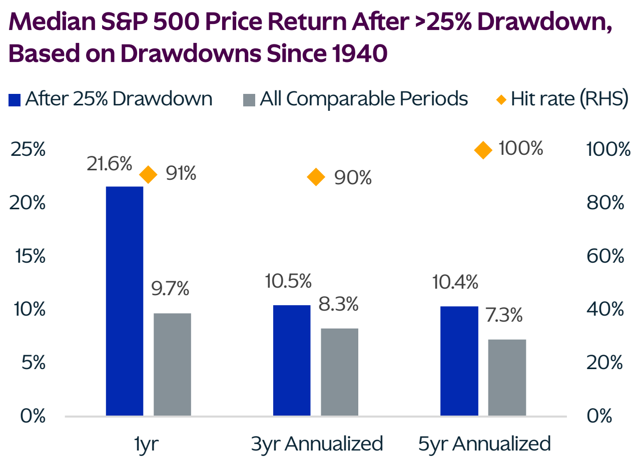
Yield to Maturity, Last 10 Years



Note: Private Credit is represented by the Cliffwater Direct Lending Index. High Yield is represented by the ICE BofA U.S. High Yield Index. Senior Bank Loans are represented by the S&P/LSTA Leveraged Loan Index. U.S. Treasuries are represented by the ICE BofAML 10-year U.S. Treasury Index, CLO AAA, CLO BBB, CLO BB refers to the Palmer Square Indices. Data as at November 30, 2023. Source: Bloomberg, Cliffwater, Cambridge Associates.

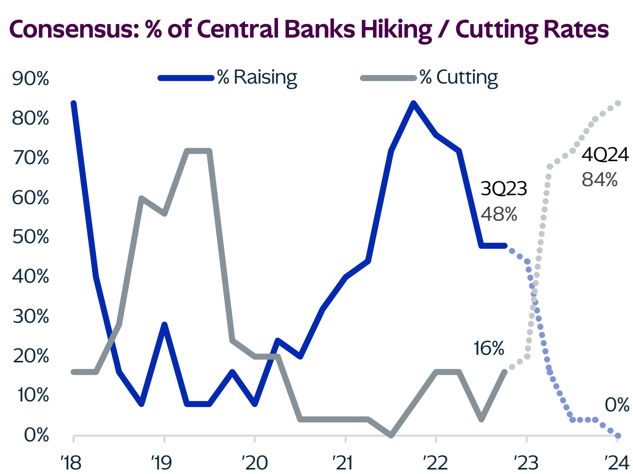
By comparison, we remain long-term cautious on the role of 'risk-free' government bonds in diversified portfolios to serve as reliable shock absorbers. If we are right, then we think that the '40%' segment of the 60/40 portfolio probably contains too much government debt. As a result, we think investors who are following this allocation plan may want to use any cyclical rally from today's levels to lighten up. The reality is that governments, more so than corporations and individuals, are now more heavily indebted. Moreover, there is – compliments of sizeable deficits – still a lot of supply coming to market at a time when the Fed and most of the banks in its network own trillions of dollars of bonds that have unrealized losses. As such, if bond prices do rally more than we expect, then these interested parties become natural sellers, we believe. We also keep in mind that, even amid the recent rally in bonds, the stock/bond correlation has remained quite elevated, validating our thesis that bonds are not portfolio shock absorbers in the regime we envision.

Exhibit 13: We Are Now Only 14 Months Into a Bull Market Recovery Since the Lows in October 2022. We Believe in Staying the Course



Data as at October 31, 2023. Source. Bloomberg.

Exhibit 14: Central Bank Tightening Should Be Less of an Issue in 2024



Hiking / cutting rates defined as an increase in rates over the past three months. Data for US, JP, CN, AU, CA, EZ, NZ, NO, SE, GB, JP, CH, IN, ID, KR, PH, TW, TH, VN, BR, CL, ZA, TR, IL, CZ, HU, PL. Data as at November 4, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Where do we go from here? Our punch line is that, despite all the crosscurrents swirling around us, we are still taking a 'glass half full' approach to our risk tolerance as we think about global macro and asset allocation preferences for 2024. So, although a lot of optimism is now in the price, we remain focused on the following tailwinds:

1

We still think that the bear market in Equities actually ended in October 2022, and while there are plenty of considerations, returns tend to be above average after a 25% decline in the S&P 500. One can see this in *Exhibit 13*. It is more than history being on our side. What continues to be different is that **central bank balance sheets are still near record levels, which allows them to act as important shock absorbers during periods of stress**. As a result, there is still a lot of money in the system, despite money supply growth being negative in many parts of the world. **We think this bullish reality is still largely underappreciated by market participants and helping to support asset prices**. One can see this in *Exhibit 6*, which shows that there is still a much bigger cushion relative to prior cycles.

2

As we detail below, **we think earnings for the cycle already bottomed in 2Q23**, despite our forecast for significantly slower nominal GDP in 2024. See our questions section, but our work shows EPS can increase as nominal GDP cools. Consistent with this view, our KKR Cycle Indicator (*Exhibit 30*) suggests that we will next move from contraction to early cycle recovery (albeit with some bumps along the way), which we view positively.

3

Outside of government bonds, **new issuance supply remains near record lows**. As a result, the **technical bid for parts of Credit and Equities remains compelling**. To be sure, we worry about certain refinancings, but consumers have termed out their debt (especially prime consumers with mortgages) while Private Credit has become a more viable solution for many corporate borrowers. Perhaps most importantly, the lion's share of the maturity wall for corporate debt has now been pushed out towards 2025-2026 and the bulk of debt maturing in the near-term tends to be higher grade (e.g., the market with the greatest near-term maturity need outside of IG is European HY, which is dominated by senior BB).

4

We also think central banks are closer to the end of the tightening campaign. Consistent with this view, we think that **bond prices have troughed for the near-term**. The disinflationary impulse of 2024 will only help our thesis short term, although we do not think bonds will rally as much as they have in past cycles.

5

Finally, our 'glass half full' approach to investing this cycle also applies to our thematic tilts (and importantly, we think these themes win in a disinflationary *or* a reflationary environment). Despite a lot of consternation and handwringing amongst investors, rising geopolitical and macroeconomic headwinds are actually creating significant opportunities for allocators willing to invest behind the solutions to the challenges that are plaguing the global economy. Though not exhaustive, *Exhibit 1* identifies some of the areas where we are finding significant and compelling opportunities that require billions of dollars of capital investment to overcome new macroeconomic and geopolitical headwinds that were not persistent during the prior decade.

Finally, our 'glass half full' approach to investing this cycle also applies to our thematic tilts (and importantly, we think these themes win in a disinflationary or a reflationary environment). Despite a lot of consternation and handwringing amongst investors, rising geopolitical and macroeconomic headwinds are actually creating significant opportunities for allocators willing to invest behind the solutions to the challenges that are plaguing the global economy.

WHERE WE DIFFER FROM CONSENSUS

Growth	Outside of Europe, we are above consensus for GDP growth in every region in 2024. Key to our thinking is that fiscal spending will remain more resilient and have a bigger multiplier effect than the consensus thinks. We also think that labor hoarding and ongoing fixed investment will lead to a lower unemployment rate this cycle across many developed markets. Finally, in markets like the U.S., traditional recessionary drivers such as capex spending, housing activity, and inventories are still recovering after bottoming this year.
Inflation	Besides Japan, we are below consensus for inflation in 2024. This viewpoint represents an important near-term change in our thinking relative to expectations across Europe, the U.S. and China.
Interest Rates	We remain largely in the higher for longer camp for longer-term rates, given our view on a higher resting rate for inflation this cycle. In the U.S., for example, our 10-year forecast for 2024 is four percent, compared to consensus of 3.75%. Meanwhile, we expect the Fed to cut three times in 2024, compared to four for the consensus. In Europe, we see yields finishing 2024 at 2.6%, and 2025 at 2.8%, compared to a consensus of 2.3% and 2.25%, respectively.
EPS/ Margins	The earnings recession is behind us, as net margins have already declined for five straight quarters. In fact, on an ex-energy basis year-over-year, EPS was already back in growth territory in 2Q23. Confirming this view, our Earnings Growth Lead Indicator has inflected higher after troughing in 2023. That said, we are not as bullish as the consensus. Specifically, we expect six percent year-over-year EPS growth ($235 per share) in 2024 while the bottom-up consensus is much more robust at 11% year-over-year ($246 per share).
Oil	We expect oil prices to settle in the mid-$70-80 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 mid-$60-70 in 2025 and beyond.
USD	We see the dollar as more range-bound in the near term, as we see fewer Fed cuts than the consensus. Thereafter, despite secular headwinds, we expect only a gradual depreciation of the U.S. dollar as growth, inflation, and rates continue to be higher for longer.

Longer-term, however, we do think that this cycle is different; we reflect this conviction in the table below, which highlights eight historical macroeconomic inconsistencies that we believe will prevail going forward:

WHAT'S DIFFERENT THIS CYCLE

1. Asia

Japan is experiencing inflation, while China is flirting with deflation

2. Europe

The periphery of Europe, including once maligned Greece, is outperforming traditional economic stalwarts like Germany

3. Leverage

It is the government, not the consumer, that is over-leveraged this cycle

4. Real Rates

Real rates (Fed Funds - Core CPI) are still rising as inflation moderates

5. Inflation

Demand is cooling in the near term, but supply constraints around housing, labor, supply chains, and commodities mean inflation will settle at a 'higher resting heart rate' this cycle

6. Growth

Nominal GDP will slow materially in 2024, but earnings growth will likely re-accelerate

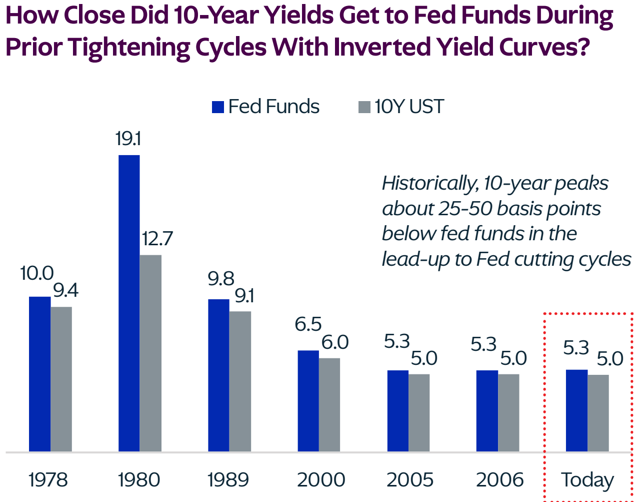
7. Shock Absorbers

Traditional safe-haven assets such as the dollar, yen, and U.S. Treasuries are not rallying consistently during risk-off periods

8. Less Bust

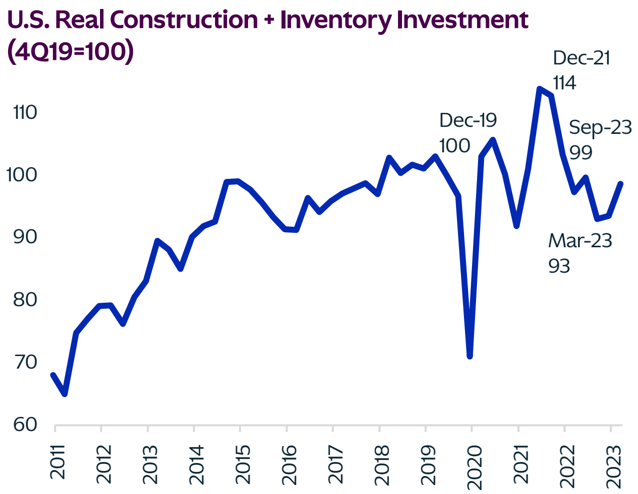
Housing is bottoming and inventories are not overbuilt, which is why there will be 'Less Bust' this economic cycle, Meanwhile, despite record tightening at the front end, central bank balance sheets are helping to contain financial stress

Exhibit 15: Using History as Our Guide, We Still Think U.S. 10-Year Yields Peaked in October



Data as at October 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 16: Recessions Are Typically Caused by Excessive Housing and Inventory Issues. That Backdrop Does Not Look Likely This Cycle



Data as at September 30, 2023. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Despite our 'glass half full' thesis for 2024, please don't view our position as cavalier. Having secured my first job on Wall Street back when the banking system was still licking its wounds post the Savings and Loan (S&L) crisis in the 1990s, I want to fully acknowledge the current macroeconomic backdrop is as complex as we have seen in decades. Make no mistake: While we do not ascribe to the hard landing scenario, this environment is not goldilocks the way certain 'soft-landing' bulls are signaling. We think that central banks will counsel patience after seeing financial conditions ease as rapidly as they did in November. At the same time, a lot more of our optimism around growth is now in the price, meaning some of the more compelling bargains we have highlighted over the past few months have now dissipated.

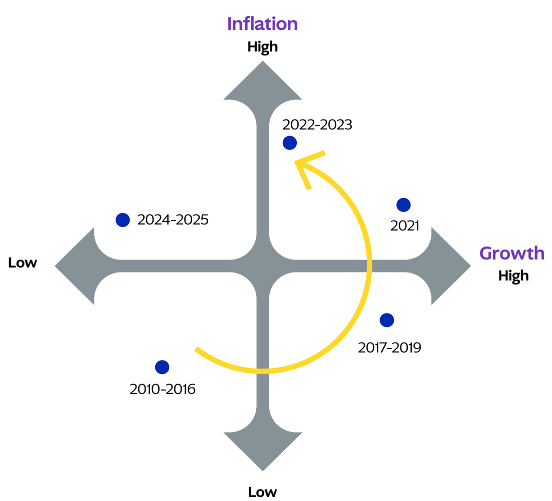
So, stay calm: capital market volatility is the friend of patient, long-term capital. Also, avoid the temptation to stretch. For example, now is not the time to get long the equity of zombie companies, add another turn of leverage to acquisition financing, or go max long on duration because you *can*, in our view. We still advocate for allocators to 'Keep It Simple', a signature phrase from our 2023 Outlook. In terms of what we worry about (i.e., the global 'glass half empty'), we think that refinancing risk, especially for beaten-down Real Estate assets and certain parts of Credit, will reveal that higher rates are having a direct impact on cash flows that could be redistributed back to investors.

Second, geopolitics remains an increasingly hard-to-predict influence that could derail growth and/or markets. In particular, 2024 is a major election year, which, as history has shown, can lead to political dysfunction and more. Further, we still think labor costs – whether it is through higher wages or business interruption – could dent profitability more than some investors are willing to acknowledge. Simply stated, we need a productivity boom to offset the wage increases we envision. If not, central banks may not be able to ease as abruptly as many investors hope.

Finally, as we detailed earlier regarding what we see as different this cycle, this market is one where we cannot 'just' rely on models. As investors, we must venture out and visit and get 'local' with clients, executives, and counterparts. Case in point: Anyone who primarily relied on the path of the ISM in 2023 – which is usually a good indicator of the direction of the S&P 500 – was being too pessimistic. What such investors missed was the technology mega-trend of Artificial Intelligence, an important driver of growth. They also likely failed to notice the multiplier effect of fiscal stimulus that was being pumped into the system. So, against this backdrop, our strong view is that history can only serve as a guide. This cycle is not typical, and it requires a more 'hands-on' and creative approach to investing for allocators, especially those who need to make regional tilts and/or find relative value up and down the capital structure.

Exhibit 17: While 2024 Should Be a Lower Inflation Environment, We Believe a Regime Change Has Occurred

Low and High Growth and Inflation Regimes

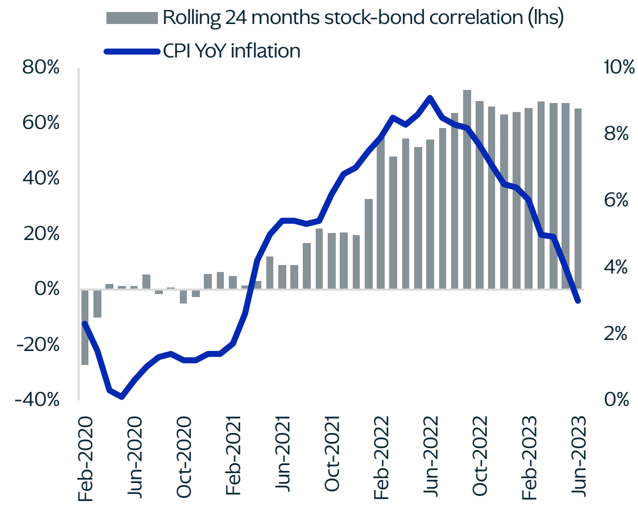


Data as at November 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Further, we still think labor costs – whether it is through higher wages or business interruption – could dent profitability more than some investors are willing to acknowledge. Simply stated, we need a productivity boom to offset the wage increases we envision.

Exhibit 18: Despite Inflation Falling on a Cyclical Basis, the 'New' Positive Relationship Between Stocks and Bonds Remains Strong

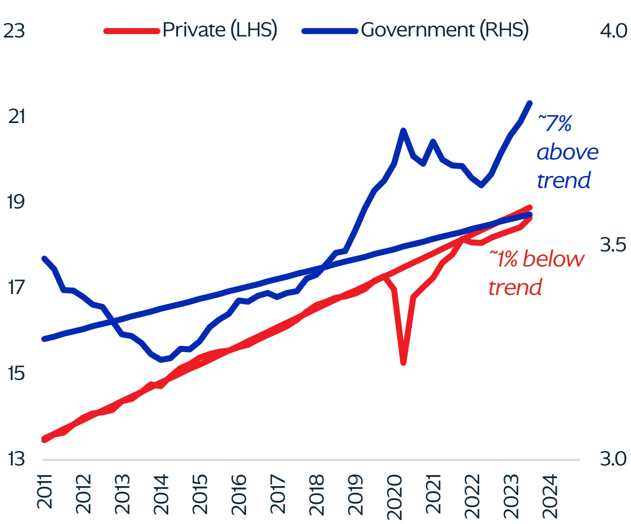
U.S. Stock-Bond Correlation and U.S. CPI, %



Note: Stocks refers to the S&P 500 and Bonds refers to the 10-year Treasury Yield. Data as at September 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

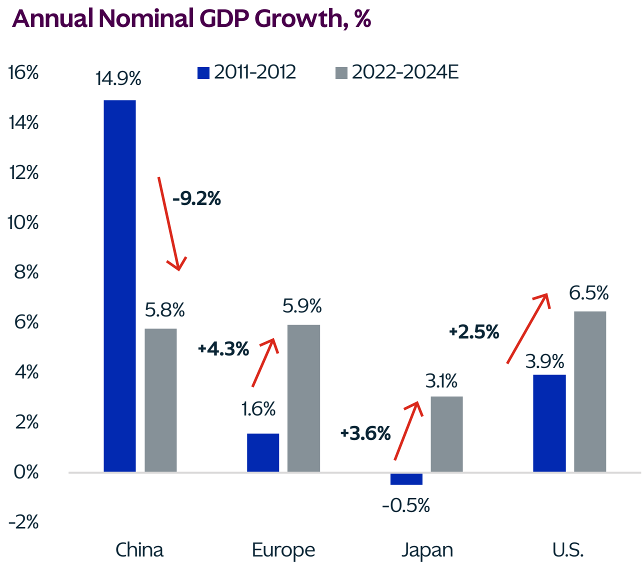
Exhibit 19: The Fiscal Impulse Remains Outsized Relative to Prior Cycles, Providing an Important Buffer to Growth

Real GDP vs. 2011-2019 Trend, US$ Trillions



Data as at November 30, 2023. Source: Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

Exhibit 20: Besides China, Most Economies Are Experiencing Higher Nominal GDP This Cycle



2023 and 2024 are KKR GMAA estimates. Data as at October 31, 2023. Source: China National Bureau of Statistics, Statistical Office of the European Union, Cabinet Office of Japan, Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

Anyone who primarily relied on the path of the ISM in 2023 – which is usually a good indicator of the direction of the S&P 500 – was being too pessimistic. What such investors missed was the technology mega-trend of Artificial Intelligence, an important driver of growth. They also likely failed to notice the multiplier effect of fiscal stimulus that was being pumped into the system.

SECTION I

Asset Allocation and Key Themes

Picks and Pans

▲ Japan (REPEAT)

Our multiple trips to Tokyo this year made Frances Lim and me still constructive on the investing environment. The good news is that capital expenditures are accelerating, which is critical to boosting productivity to offset not only the increase in wages but also the price increases in food and oil. We also take comfort that corporate reforms, especially around listed companies, are gaining further momentum under Prime Minister Kishida. We continue to see opportunities in corporate carve-outs. We also see significant value in direct public to privates, as we believe the opportunity for operational value creation is meaningful.

▲ Cyber Security (NEW)

We believe that even more spending will be needed in the area of cyber. The 'bad actors' continue to improve their techniques, with an estimated 72% of firms with annual revenues over five billion attacked in the past 12 months. As a result, we think that both governments and corporations need to respond to this growing challenge. If there was one sector on which to focus, we think that it would be on traditional financial services, including banking, trading, settlement, and wires.

▲ Collateral-Based Cash Flows (REPEAT)

Our research continues to show that many individual and institutional investors are *still* underweight Real Assets, especially Infrastructure and Energy, during a time when the need for inflation protection in portfolios remains high. We are also encouraged that investors are 'expanding' the definition of infrastructure to include more operational improvement stories. We really like having this additional value creation lever in a high and/or rising rate environment.

Meanwhile, within Credit, we favor 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. Structured products as part of this investment strategy often finance certain traditional Infrastructure and Real Estate assets like aircraft, renewable power assets, and warehouses. 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 often have floating coupons that may benefit lenders during periods of higher rates.

▲ 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.

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.

▲ More 'Balanced' Approach to Duration (NEW)

We are not all-in on duration, as we continue to think that long-term borrowing by governments is driving up the risk-free cost of capital. Nonetheless, we do think that there is clear value in investors' ability to lock in cash-like yields at the long end of the curve, as inverted yield curves do not last forever and have historically resolved through bull, not bear steepening. Against that backdrop, we think investors will want to consider trimming their overweight to floating rates as we head into 2024. We actually think a similar logic applies across the risk spectrum, which is why we have been calling for a more balanced approach to High Yield versus Loans, as well.

▲ 365 Days and Less Lending, Including Sub-Lines (NEW)

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 sublines 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.

▲ Energy Infrastructure Related to AI (NEW)

While most investors are focused on the semiconductor angle of the current AI boom, we have been spending more time focusing on the energy demand surge needed to train AI models. The reality is that, in many instances, existing infrastructure is insufficient to meet the demand required. Against this backdrop, we are bullish on critical energy transmission assets, data centers, and cooling technologies.

▲ Opportunistic Credit (REPEAT)

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. The absolute returns of these types of vehicles today are competitive with Public Equities in many instances, yet, there is likely less volatility, and one is higher up in the capital structure. Meanwhile, in Private Credit markets, we are seeing some attractive relative valuation in areas of Asset-Based Finance as well as in Capital Solutions Credit to fund an acquisition and/or a major capital expenditure, including domestic re-shoring initiatives.

▲ Residential Mortgages (NEW)

The technical picture of banks originating fewer mortgages as well as the Fed selling its book of mortgages is leading to indiscriminate selling at times. This is despite, in many instances, an improvement in quality; we think prime consumers will actually hold up fairly well this cycle. We find this backdrop quite compelling and would use any weakness to accumulate positions, especially for investors who have fixed liabilities (pension funds, insurance companies, etc.)

▼ Fade Inverted Yield Curves (NEW)

We think that structural pressures in the treasury market (including a glut of supply and lack of foreign interest in USTs) will keep bonds from rallying as much as they typically have when the Fed starts cutting rates. Our term premium model suggests that 10-year yields currently reflect a lot of structural factors, many of which are unlikely to be resolved in the near term, including wider deficits, lower savings rates, positive stock-bond correlations, etc. Meanwhile, at the short end of the curve, we think that the Fed will have the flexibility to cut several times in 2024 (albeit less than the market thinks), which should help steepen the curve as a whole.

▼ Office Real Estate (REPEAT)

With prevailing Office cap rates around 150 basis points higher than those for multifamily or data centers, we still do not think that Office CRE investors are being appropriately compensated for the uncertain path of operating income at a time when occupancy is still falling and sublet space is still rolling off. By contrast, we think there are some emerging opportunities in less-cyclical sectors like Data Centers, Industrials, and Single-Family Rentals, which offer wider average cap rates than they did in 2021-2022.

▼ Cuspy Credit and Non-Control Positions in Equities (NEW TWIST ON REPEAT)

We are entering an environment where slower nominal growth is relieving pressure on bond yields and helping to encourage more capital markets activity. However, there are likely still too many weak companies with weak capital structures that will need to refinance in the next several quarters. Similar to last year's outlook, our view is to 'Keep It Simple' and not stretch on the quality front in 2024. The incremental yield pick-up in the lowest rated unsecured High Yield, for example, is just not worth it, in our view. Against this backdrop, we think the difference between control and non-control positions will get magnified materially in 2024, as demanding equity multiples require more focus on operational improvement and the ability to retool companies' capital structures, even as borrowing markets thaw.

▼ Non-Core U.S. Consumer (NEW)

See Question #4 below for details, but younger and lower-income U.S. consumers have been the most exposed to inflation this cycle and are increasingly relying on credit cards and loans to make ends meet. By contrast, a lot of 'core' U.S. consumers (including homeowners) are still in decent shape, as fixed-rate mortgages, a manageable overall debt burden, and a solid 'stock' of excess savings help support spending. Against that backdrop, we think a lot of the slowdown in consumer spending and an uptick in consumer distress this cycle will, unfortunately, be concentrated in lower-income households, especially if we are right that the labor market is finally starting to slow.

▼ Unsecured Credit (NEW)

Our data suggest a tiering of consumer obligations with consumers focusing on must-haves, such as paying their mortgages and cell phone bills but skimping on their nice to haves, such as unsecured loans. Importantly, our base case is that there will be lower than normal unemployment this cycle (we are using a 110-basis point increase, compared to 300-400 basis points, on average, in prior cycles). However, even with a more favorable backdrop relative to prior cycles, we believe that some lenders got too aggressive during the post-COVID spending euphoria. As we enter 2024, some of this lax underwriting will come home to roost, especially where there is no direct claim on the collateral.

▼ Regional Banks (REPEAT)

While we think regulators are highly invested in the viability of the regional banking system, we still think that regional banks may be forced to pay up for deposits at a time when they are already facing significant losses on their RE lending books. At the same time, we think regulatory pressures are leading banks to find ways to reduce their risk-weighted assets, leading to a broad array of asset and portfolio changes. While we don't think these forces will be enough to inspire a full scale S&L-style meltdown, we do think that distress in the system will remain elevated while higher borrowing costs 'pinch' net income margins.

▼ Fed Rate Cuts (NEW)

We do not share the view priced in forward markets that the Fed will cut almost six times in 2024. Remember that the Fed wants to hold real rates at or above two percent until inflation returns to target on a sustainable basis. If we're right that inflation only falls to the mid-two percent range next year, then a nominal rate near four percent would be too accommodative in real terms.

Key Themes

In terms of key themes, we note the following:

1

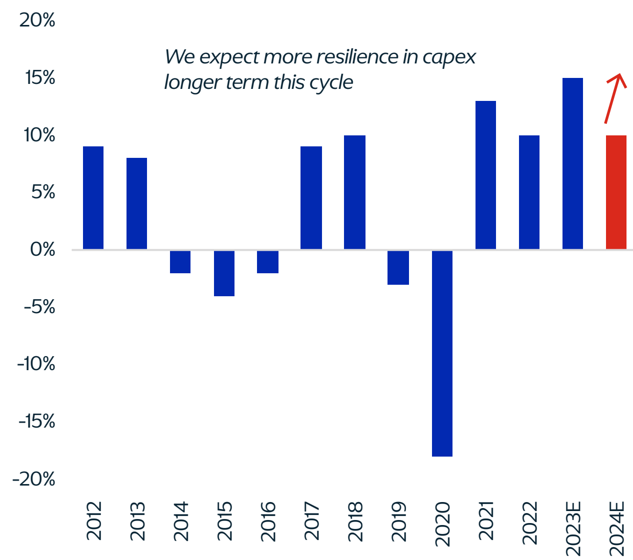
Industrial Automation

One of the mega themes that bubbled up during our 2023 travels, especially in Asia this fall, was the emergence of an industrial automation cycle. In Japan, for example, capital expenditures are hitting record highs (*Exhibit 22*), as companies search for new ways to drive productivity. These investments will be critical in a higher nominal GDP world where labor costs and other rising inputs could otherwise pressure margins. We heard a similar story in China and Germany where companies are trying to use technology and automation to deliver more efficiency and productivity in a world where demographics and cross-border connectivity are becoming more challenged. To this end, we favor software plays, as one example, that can help warehouses become more efficient at storing goods and/or using less energy, or industrial automation efforts that retool old manufacturing processes to make them more globally competitive. We also like mission critical, highly engineered, and application-specific products that have high cost of failure, but account for a small percent of total product cost (e.g., flow control. testing/inspection/ certification equipment).

Companies are trying to use technology and automation to deliver more efficiency and productivity in a world where demographics and crossborder connectivity are becoming more challenged.

Exhibit 21: Many Factors From AI and ESG Spend to Reshoring to Past Underinvestment to CHIPS Act/IRA Stimulus Are Contributing to the Uptick in Current Capex Spend

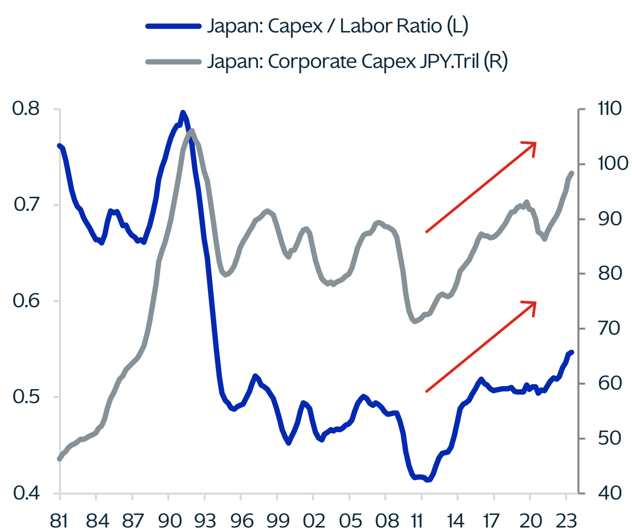
Multi-Industry Capex % Change Y/y Median, %



Data as at September 30, 2023. Source: Melius Research.

Exhibit 22: Japan Corporate ROE Has Been Robust, Supporting Higher Corporate Capex, Especially When Labor Shortage Gets Worse

Japan: Corporate Capex



Data as at June 30, 2023. Source: Bloomberg.

2

Security of Everything

We remain the maximum bullish on this theme. Against a backdrop of rising geopolitical tensions, cyber-attacks, 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 recent events in 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 IRA, a lot more government support will be targeted at the intersection of climate and supply chains.

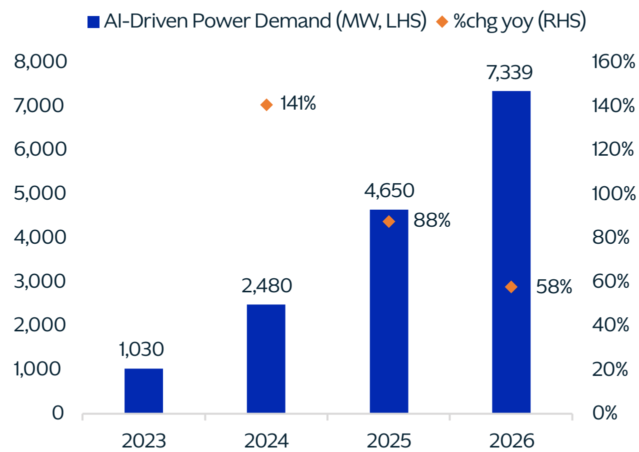
Exhibit 23: Cybersecurity Has Become a Major Risk Surrounding Generative AI Models

Biggest AI-Related Risks U.S. Executives Are Currently Facing, % of Respondents

n=500. Data as at February 28, 2023. Source: Bank of America, Baker McKenzie, Insider Intelligence.

Exhibit 24: AI Workflows Are More Computational Intensive and Server Racks Use More Energy, Which Will Drive Power Demand

AI-Driven Data Center Demand, Megawatts



Data as at June 30, 2023. Source: Evercore Research.

3

Intra-Asia Connectivity

Our three visits to Asia in 2023 confirmed for us that this time is different, and a meaningful transition is well under way: Asia is becoming more Asia centric as more trade occurs within the region 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. Key areas on which we are focused include transportation assets, sub-sea 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 (GFC), 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 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.

4

Labor Productivity/Work Force Development

Corporations will need to focus on automation and productivity gains. Periods of labor scarcity have historically been opportunities for greater automation. In terms of key offsets, our team at KKR is particularly focused on technological advancements that can have an impact on productivity. Specifically, many of the important technological trends, including automation and digitalization, that were already in place before the pandemic have now only accelerated. 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. Using history as our guide, we believe that the recent uplifts in productivity 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 have already seen robots cleaning floors at Heathrow and clearing dishes in Japan and think this trend will accelerate as automation increases in fields like retail, leisure and hospitality, and healthcare. No doubt, automation and productivity are emerging mega-themes, in our view, and at times have accounted for about 20-25% of our deal teams' PE activity since the pandemic.

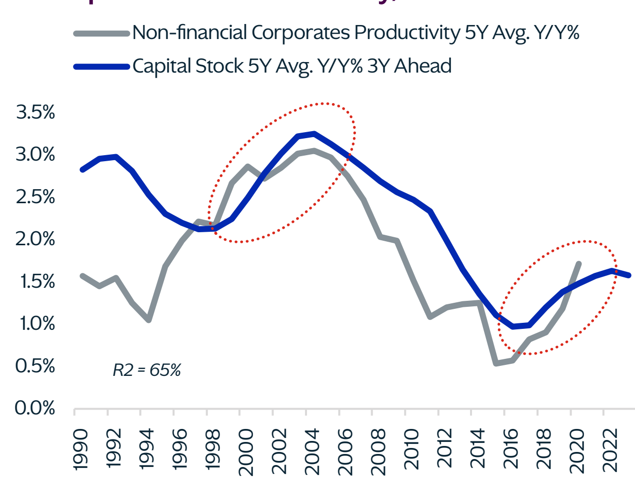
Exhibit 25: Wage Gains Have Historically Led to Periods of Rising Productivity

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

Data as at May 31, 2022. Source: BofA Quantitative Research.

Exhibit 26: Capital Investment Leads to Productivity Gains. The Last Major Wave of Capital Investment Occurred in the 1990s and Another Is Currently Underway, We Believe

U.S. Capital Stock vs. Productivity, %



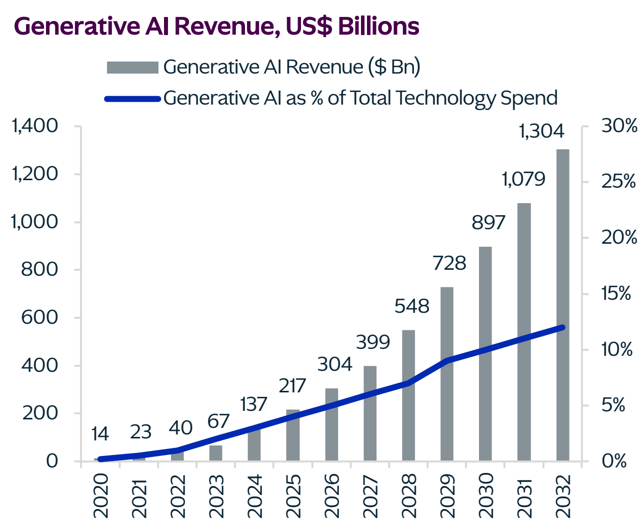
Data as at December 31, 2021. Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Cornerstone Research, Haver Analytics.

5

Artificial Intelligence

The AI investment opportunity set is massive (some estimates suggest Generative AI revenues may exceed USD one trillion per annum within a decade), but we favor a more nuanced approach to start. Specifically, while direct plays on AI tech development are quite compelling, they are also quite expensive. By contrast, we think a number of non-direct plays on AI, including data center capex, semiconductor manufacturing, power transmission, and distribution will likely also undergo massive investment cycles stemming from the need to develop the underlying infrastructure.

Exhibit 27: Spending on Generative AI Looks Set to Explode in the Coming Years



Data as at June 2, 2023. Source: Bloomberg, International Data Corporation.

Consider that the proliferation of AI work streams also comes at a time when hyperscale operators, which represent roughly half of data center capex, are already dealing with significant backlogs, rising lead times, and higher construction costs. In other words, we believe it will be difficult to quickly scale data center infrastructure to meet the rising demand for computing capacity. All told, some estimates suggest that the servers used in model training and inference could consume an additional 2.5 gigawatts of data center annually by 2024, which represents an increase of 10 – 15% to the current 19-gigawatts TAM (*Exhibit 24*). In addition to higher overall data center demand, we think there will be more focus on power distribution going forward, too: The additional power demand created by AI is related to the fact that AI workstreams are more computationally intensive. It is estimated that the energy density per server rack is ten to thirty times higher for AI servers than for general-purpose cloud computing, meaning each square foot of data center space will require much more power than it did previously. This higher power consumption will further accelerate the transition from air cooling to liquid cooling in data centers, as well, we believe.

However, from a macro perspective, we are less convinced that the productivity-enhancing capabilities of GAI will be enough to offset the impact of demographic headwinds and structural labor shortages on wages. In our view, there are several 'gating factors' that may impede the widespread adoption and implementation of GAI in displacing high-skill service positions including an increasingly complex cybersecurity threat landscape, concerns over data privacy, an uncertain regulatory environment, labor disputes, and shortages of high-end computing capacity. So, while we are believers in the long-term potential of AI, we think that some of the most compelling opportunities in this space may exist outside of mega-cap software companies, and instead have to do with addressing the physical infrastructure bottlenecks and large amount of investment that needs to happen, including building out the 'backbone' of physical infrastructure before GAI can scale.

So, while we are believers in the long-term potential of AI, we think that some of the most compelling opportunities in this space may exist outside of mega-cap software companies.

6

Decarbonization

Decarbonization will remain an important investment theme, but we continue to believe that there are two sides to the Energy Transition 'coin' that an investor must consider. Key to our thinking is that during this transition, there will need to be more investment going back into traditional energy sources such as oil and gas. From our perch, we are also very bullish on the brown-to-green transition across existing corporate and government platforms. These opportunities are the large-scale ones that will allow big sectors of the global economy to become more energy efficient. The last two decades of growth in decarbonization efforts were generally asset-light, driven mainly by advances in software and technology. Those advances, which supported digitalization and services, will still be required to continue fueling growth. However, the climate investing required to really make a difference at scale is likely much more asset-heavy in nature. This reality is largely linked to the requirements for decarbonizing the traditional power generation, property, transportation, and industrial sectors, as well as for upgrading existing global supply chains, buildings, and data centers for sustainability. This reality will be challenging for regulators, many of whom will face a real conundrum between trying to provide the lowest cost to the end consumer in a high inflationary environment balanced against the goals of bolstering the grid for decarbonization and ensuring environmental impact remains low. Clearly these two objectives can be at odds with each other at times, and as a result, regulatory risk remains elevated. Finally, the rise of AI as well as other shifts in new forms of energy will require the footprint of energy distribution to be reworked. This reconfiguration represents a major opportunity for both Infrastructure and parts of Private Equity, we believe.

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SECTION II

Global / Regional Economic Outlooks

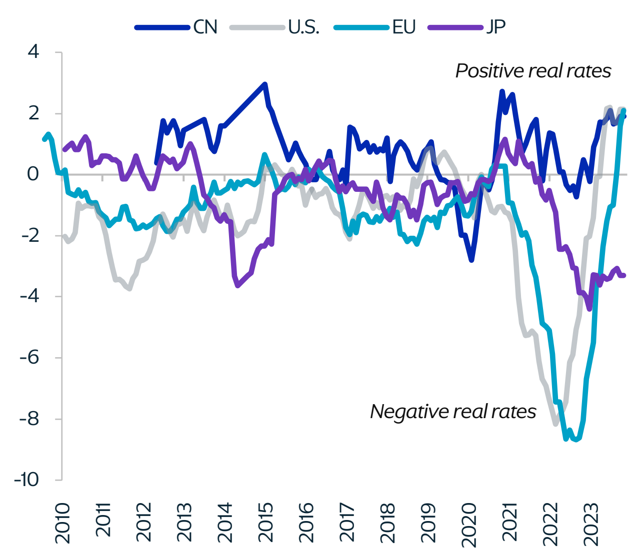
In my multiple decades of traveling around the world, I can't remember a time when economic growth was so asynchronous. Just consider the latest trip that Aidan Corcoran and I took to the Continent. What did we learn? Germany, one of the usual 'powerhouses' of global trade, has been hit by the one-two punch of higher energy costs and a weakened China. Recent changes in the fiscal situation, including a 60-billion-euro reduction to the Climate and Transformation Fund that had been earmarked for industrial modernization and green energy programs, are also likely to hurt growth. Meanwhile, China is flirting with deflation and sluggish consumption; high relative real rates have not helped, though it does feel like more stimulus is on the way.

However, other parts of the world are still growing nicely. For example, multiple visits to Japan this year reinforced our view that the country is finally exiting deflation and as we show in *Exhibit 29*, it actually will have a level of nominal GDP growth slightly exceeding the U.S. despite short-term rates in Japan being negative versus more than five percent in the U.S.

So, where are we headed? Though COVID-style stimulus packages are no longer on the table, we do sense that most elected officials are maintaining strong fiscal stimulus flows ahead of some important election periods in many of the major economies, including the United States. At the same time, however, their respective central bank counterparts have been pumping the brakes in an effort to prevent too much money from chasing too few goods. Macro manager and friend Scott Bessent likens the situation to a Formula I race where the driver is stepping on both the gas (fiscal) and the brake (monetary) at the same time. We agree and believe this backdrop dovetails with our strong belief that this environment requires a new approach to asset allocation (see *Regime Change: Enhancing the 'Traditional Portfolio*).

Exhibit 28: The Wide Divergence in Real Rates Around the Globe Speaks to the Asynchronous Nature of This Recovery So Far

Real Interest Rate in Major Economies, %



Note: Real interest rate is measured here as 10-year government bond yield – headline CPI inflation. Data as at November 30, 2023. Source: WIND, KKR Global Macro & Asset Allocation analysis.

Exhibit 29: Our Forecasts Reflect the Asynchronous Recovery Happening in the Global Economy

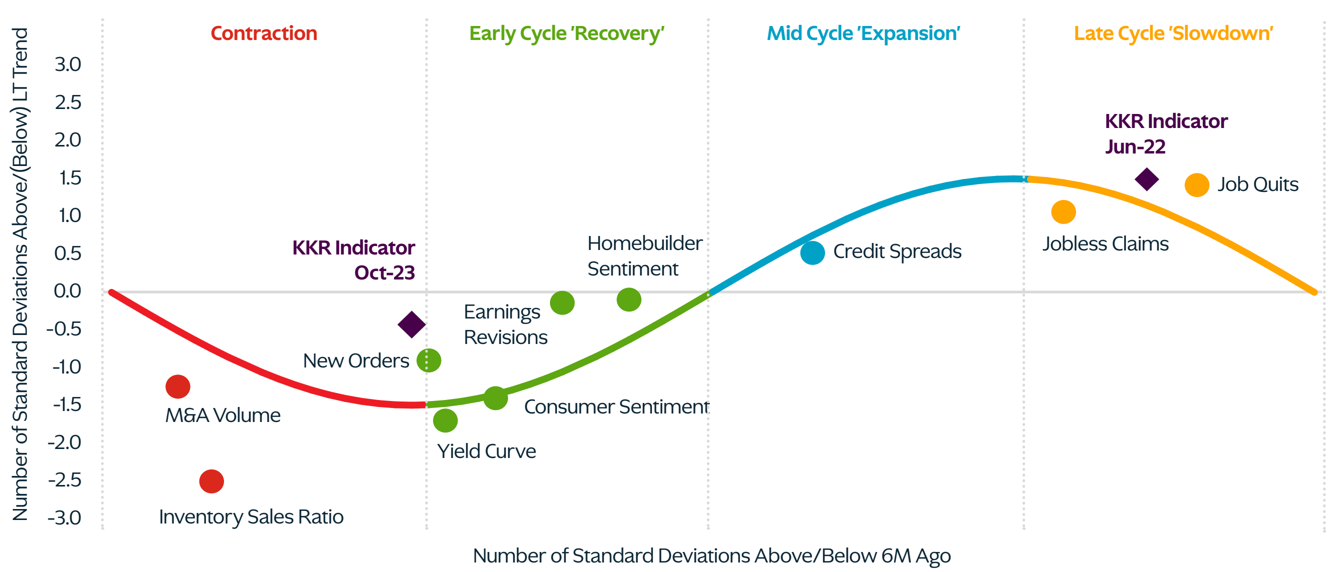
	2024e Real GDP Growth		2024e Inflation		2025e Real GDP Growth		2025e Inflation	
	GMAA New	Bloomberg Consensus	GMAA New	Bloomberg Consensus	GMAA New	Bloomberg Consensus	GMAA New	Bloomberg Consensus
U.S.	**1.5%**	1.3%	**2.6%**	2.7%	**1.8%**	1.4%	**2.5%**	2.3%
Euro Area	**0.5%**	0.6%	**2.4%**	2.7%	**1.4%**	1.5%	**2.0%**	2.1%
China	**4.7%**	4.5%	**1.4%**	1.7%	**4.5%**	4.4%	**1.8%**	1.9%
Japan	**1.4%**	1.0%	**2.7%**	2.1%	1.0%	1.0%	**2.0%**	1.5%

Data as at November 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

If we are right that globalization has more 'sand in its gears' this cycle, it likely means a more nuanced view of global investing, including adding even more reinforcements to the global/local model that global financial institutions like KKR have been embracing for some time. The old model, which our former colleague Stephen Roach of Morgan Stanley first accurately outlined in the 1990s, whereby the U.S. consumer buys cheap goods from emerging markets (and in return, central banks of producer countries buy U.S. Treasuries) in a coordinated global fashion with low inflation was an easy one for most allocators to invest behind; unfortunately, that backdrop is unlikely to re-occur anytime soon. With its disappearance, so too go many of the benefits of investing in a global synchronized recovery.

Looking forward, while we still expect investment themes to track globally, we believe a much more localized, nuanced approach will be required. There are also likely to be more periods when parts of the world/economy are growing, and – at the same time – parts of the world contracting. For instance, our forecasts reflect above-average nominal growth for the U.S. and Japan, while Europe and China remain more downbeat. Meanwhile, we continue to think Services still outperform Goods in the near term in most developed markets, while within China, we see a division between 'old economy' sectors like Real Estate and Tech, which are experiencing a downturn, and new growth drivers including industrial automation. As a result, we all probably need to get more comfortable with the notion of a rolling recovery or a rolling recession, which is exactly what our model is telling us. One can see this in *Exhibit 30.*

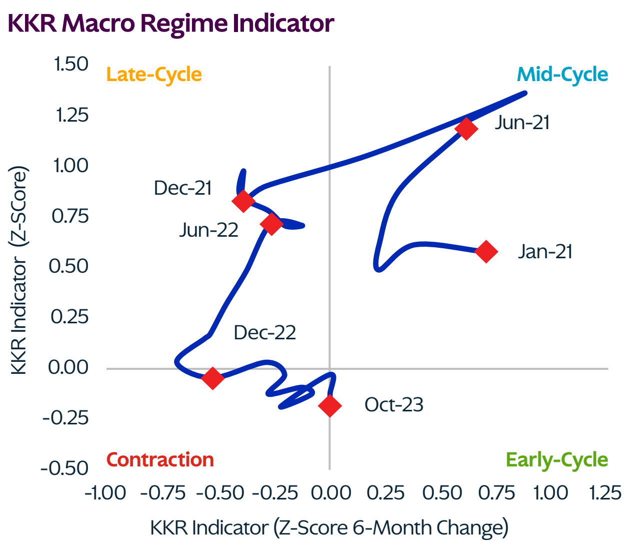
Exhibit 30: Today, the 10 Subcomponents of Our Cycle Indicator Are Unusually Asynchronous and Spread Across All Four Phases of the Business Cycle



Data as at October 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

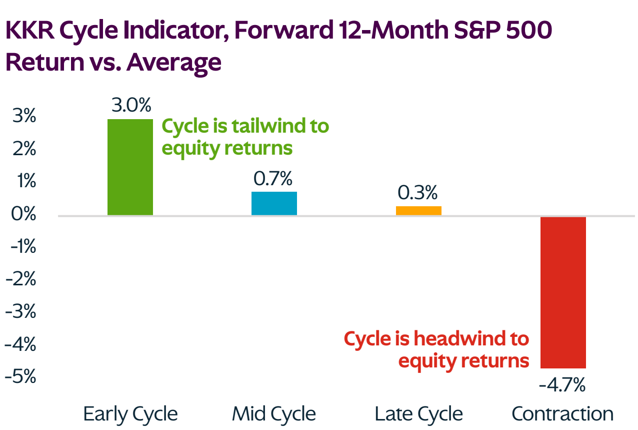
Importantly, our 'glass half full' thesis does rely on the markets moving towards an Early Cycle Recovery versus getting stuck in Contraction (the quadrant where returns usually lag the most) in 2024. Key variables on which we are focused include a less inverted yield curve, more positive earnings revisions, and an eventual pick-up in M&A activity.

Exhibit 31: Our KKR Macro Indicator Is Straddling Contraction and Early Cycle. We See It Headed to Early Cycle Over Time



Data as at October 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 32: Performance During Early Cycle Far Exceeds the Contraction Phase



Data as at October 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 33: Our Probability Weighted Forecasts Still Tilt Towards Higher Growth and Stickier Inflation

	KKR GMAA Real GDP Forecast, %			KKR GMAA Inflation Forecast, %		
	Base	Low	High	Base	Low	High
U.S.						
2024e	1.5%	-1.0%	3.0%	2.6%	2.0%	4.5%
2025e	1.8%	1.5%	2.0%	2.5%	2.0%	3.0%
Euro Area						
2024e	0.5%	0.0%	1.4%	2.4%	1.7%	3.0%
2025e	1.4%	0.3%	1.9%	2.0%	1.4%	3.0%
China						
2024e	4.7%	4.2%	5.2%	1.4%	0.8%	2.0%
2025e	4.5%	4.0%	5.0%	1.8%	1.2%	2.5%
Japan						
2024e	1.4%	0.8%	2.0%	2.7%	2.0%	3.3%
2025e	1.0%	0.5%	1.5%	2.0%	1.5%	2.5%

In the U.S. for 2023 and 2024 we assign a probability of 60% for the base case, 20% for the bear case, and 20% for the bull case. In Europe we assign the downside 20th percentile and the bull case 80th percentile. In China for 2024 and 2025, we assign a probability of 60% for the base case, 20% for the low case, and 20% for the high case. In Japan for 2024 and 2025, we assign a probability of 65% for the base case, 15% for the low case, and 20% for the high case. Data as at November 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

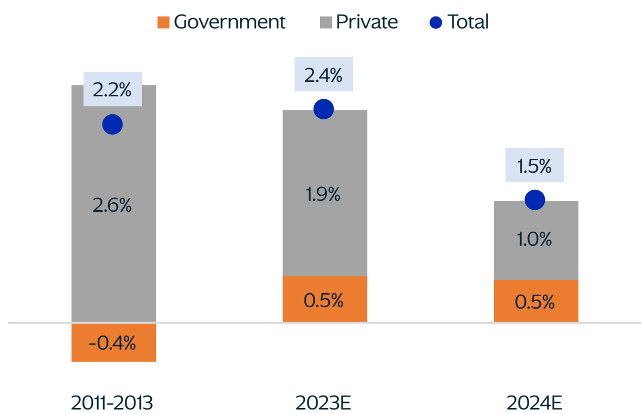
U.S. GDP

Forecasts: Dave McNellis believes that U.S. GDP growth will fall to 1.5% in 2024 from 2.4% in 2023, before ticking up to 1.8% in 2025. Our growth forecast for both years is well below the 2015-2019 average of 2.5% and continues to embed a mild recession playing out in the second half of next year (something we have been talking about since we first outlined our 'Less Boom, Less Bust' thesis in our Midyear Outlook). Importantly, though, our 2024 GDP forecast remains above the consensus estimate of +1.3%.

Commentary: We have often been asked why we retain our optimistic bent on U.S. growth, given that real rates are on track to rise further into positive territory next year, while consumer spending is running above trend amidst very low unemployment and savings rates that seem to leave little room for improvement. No doubt, we agree with the consensus that these dynamics will likely push the U.S. into a downturn. For our money, however, three ballasts will help the U.S. economy avoid the 'left tail' of a prolonged and serious recession. We note the following:

Exhibit 34: The Government Has Moved From Being a Deterrent to a Driver of GDP Growth This Cycle

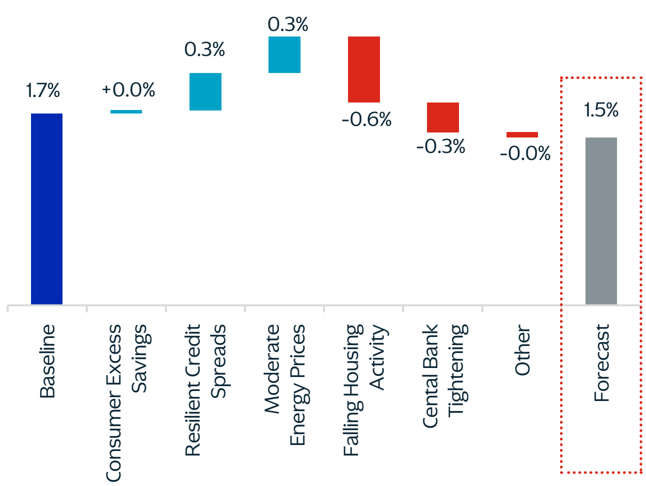
Contributions to U.S. GDP Growth, %



Data as at November 30, 2023. Source: Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

Exhibit 35: Credit Spreads Have Not Blown Out This Cycle, Which Has Helped to Offset the Drag From Slowing Housing Activity

Elements of 2024 U.S. GDP Indicator, %

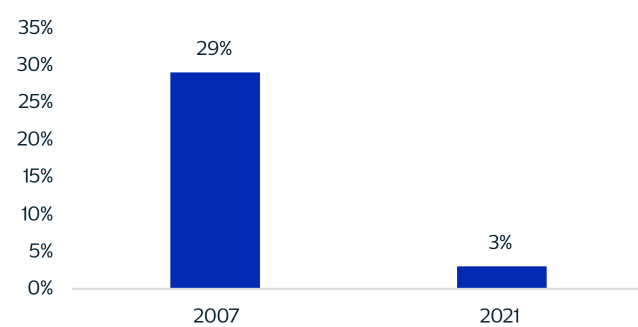


Our GDP leading indicator is a combination of eight macro inputs that in combination we think have significant explanatory power regarding the U.S. growth outlook. Data as at November 13, 2023. Source: Federal Reserve, U.S. Bureau of Labor Statistics, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Reason #1: Borrowers are still insulated from the impact of higher rates. For starters, remember that about 14 million borrowers refinanced their mortgages during the pandemic, which has helped alleviate pressure on interest coverage ratios. One can see this in *Exhibit 37*, which shows that – while new mortgage contract rates have surged from around four percent in 2019 to nearly eight percent today – the average interest rate paid by consumers has *fallen* over the same period to 3.7% from 3.9%. It's not just households who have done a good job controlling their interest expense this cycle, however: bond duration has extended meaningfully, and we think about 40% of floating-rate exposure by leveraged loan borrowers is actually hedged to maturity. Against this backdrop, we continue to think that the transmission of monetary tightening will be both more lagged and more muted than in past tightening cycles.

Exhibit 36: There Are a Lot More Fixed-Rate Mortgages Today Than There Were in the Lead-Up to the GFC

Adjustable-Rate Mortgages as % of All Outstanding Residential Mortgages

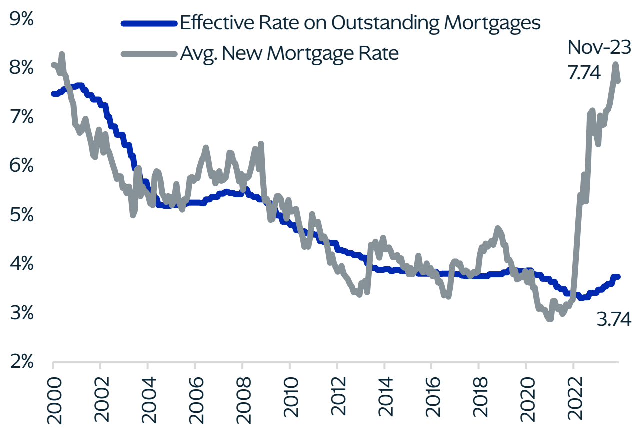


Data as at December 31, 2021. Source: BofA, KKR Global Macro & Asset Allocation analysis.

For starters, remember that about 14 million borrowers refinanced their mortgages during the pandemic, which has helped alleviate pressure on interest coverage ratios.

Exhibit 37: While New Mortgage Rates Have Surged, the Average Existing Mortgage Rate Is Actually Still Lower Than It Was in 2019

Mortgage Rate, %



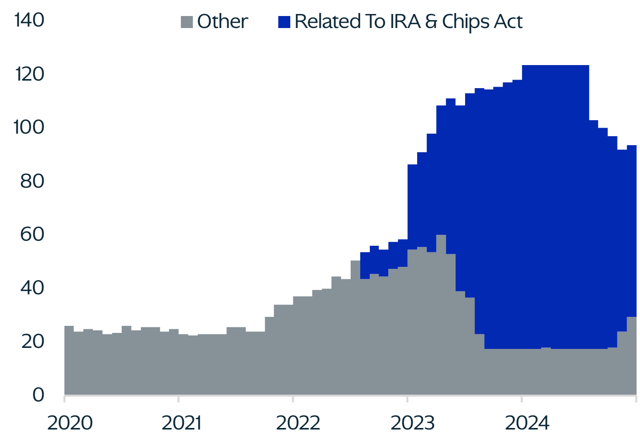
Data as at November 20, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Reason #2: There is an unprecedented amount of fiscal support this cycle. Government spending continued to surge in 2023, with support for both households (including, e.g., tweaks to student loan Income-Driven Repayment plans, which will mean about $475 billion in additional stimulus) and businesses (including IRA, CHIPS, and IIJA money that is still being deployed). Although the growth in government spending is weakening at the margins, these programs mean that the actual *level* of real government outlays (i.e., spending including transfer payments, which are not counted in GDP calculations) is still running more than 25% above trend, which is quite remarkable considering total employment is now about 3.5 million higher than it was pre-pandemic. One can see how unusual this backdrop is in *Exhibit 39*.

Investment across inventories and construction, which typically account for over 100% of the GDP slowdown during U.S. recessions, actually bottomed earlier this year and is currently recovering.

Exhibit 38: The Fiscal Impulse From the IRA and CHIPS Acts Is Running Near Peak Levels, But It Will Have a Long Tail

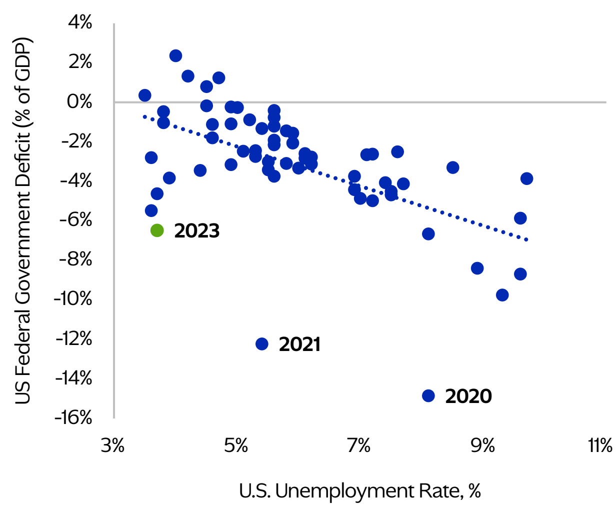
Construction Spending on Manufacturing Facilities, Computer, Electronic, and Transportation Equipment, US$ Billions, SAAR



Data as at October 31, 2023. Source: U.S. Bureau of Economic Affairs, CBO, Goldman Sachs, UBS, Numis Research.

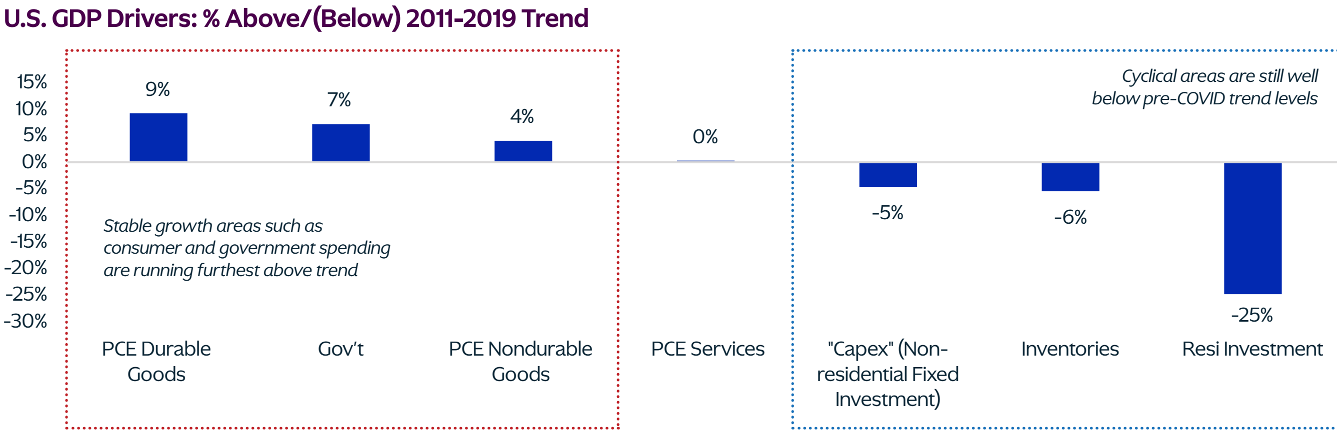
Exhibit 39: We Are Far Removed From the Typical Relationship Between Unemployment and the Deficit

U.S. Federal Government Deficit vs. Unemployment Rate



Data as at October 31, 2023. Source: Bloomberg.

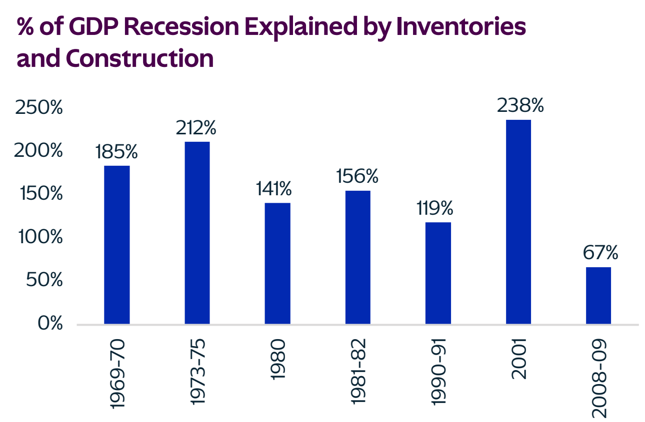
Exhibit 40: Many Cyclical Areas of the Economy Are Actually Running Below Trend, Which Bodes Well for Growth Not Collapsing



Data as at September 30, 2023. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Reason #3: "It is hard to get hurt falling out of a basement window." This may be our most important observation as we head into 2024. Investment across inventories and construction, which typically account for over 100% of the GDP slowdown during U.S. recessions, *actually bottomed earlier this year and is currently recovering (Exhibits 40* and *41)*. While our forecasts continue to embed a slowdown in these categories (driven in part by slower consumer spending and Fed tightening), we think it is hard to get very bad outcomes from a starting point where inventories are not overbuilt, housing has already had its worst year since the depths of the GFC, and capex is running approximately 30% below its pre-pandemic trend.

Exhibit 41: Consistently, Across Cycles, Inventory and Construction Capex Contractions Have Driven the Great Bulk of Recessionary Downturns



Recession periods examined: 3Q69-2Q70, 4Q73-1Q75, 1Q80-3Q80, 3Q81-1Q82, 3Q90-1Q91, 2Q01-4Q01, 2Q08-2Q09. Data as at November 10, 2023. Source: U.S. Bureau of Economic Affairs, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

So, our punch line is that the big surprise for investors may be that growth merely slows, but it does not collapse this cycle. Indeed, as we have recounted, we just don't see the same level of risk for a sustained downturn in the U.S. economy this cycle, as many of the 'riskiest' parts of the economy will perform much better than they have in past recessions. On the other hand, we do think that for some areas of the U.S. economy – Consumer Goods in particular – this downturn may feel worse than headline GDP numbers might suggest.

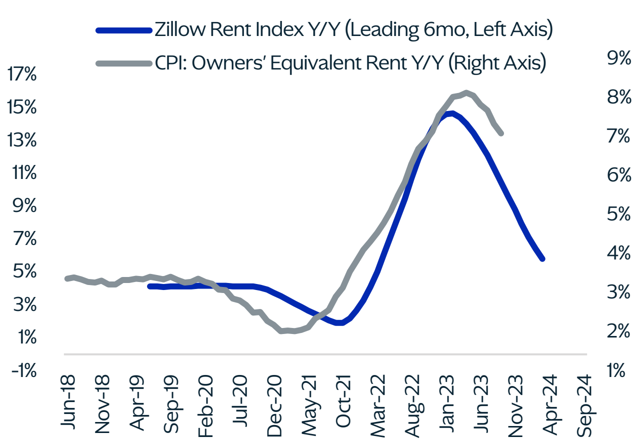
U.S. INFLATION

Forecasts: We continue to expect further progress on U.S. inflation in the near term, with CPI falling to 2.6% in 2024 from 4.2% this year. By comparison, consensus has CPI at 2.7% in 2024. Although our call for lower inflation versus consensus and higher GDP growth may appear counterintuitive, our key observation is that growth will remain stronger on the corporate side of the economy next year. By contrast, we think consumer spending will actually slow at the margins, particularly if we are right that unemployment rises next year.

Commentary: In terms of specific contributions to 2024 inflation, Dave McNellis and Ezra Max think that Shelter inflation, which accounts for about one-third of overall CPI, will continue to slow next year as the official BLS inflation measures start to 'catch down' to the disinflation seen in actual rents. One can see this in *Exhibit 42*. At the same time, we think that Core Goods prices have started to roll over, which should continue in 2024 as consumers pull back on Goods spending. Finally, although we think that labor-sensitive 'Supercore' inflation (i.e., Core Services inflation ex-Housing) will remain well above its pre-COVID run-rate, our models suggest that slowing job growth should be enough for the Fed to finally bring this 'focus metric' below three percent on a year-over-year basis by the middle of next year *(Exhibit 43)*.

Exhibit 42: Unlike the Past Few Years, Rental Disinflation Should Be an Attractive Inflation Tailwind in 2024

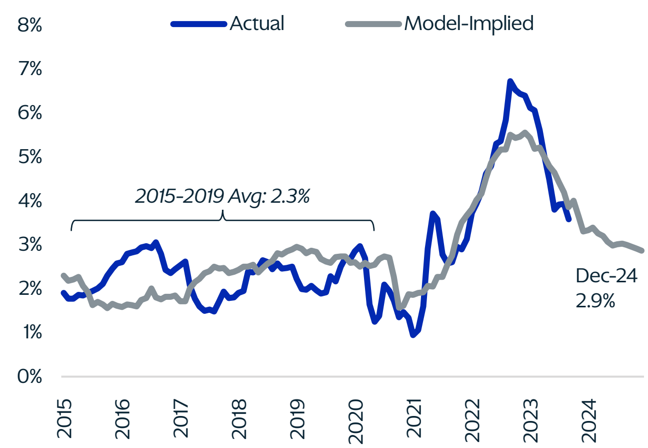
Zillow Rent Index vs. Owners' Equivalent Rent, Y/y %



Data as at November 30, 2023. Source: Bloomberg, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 43: We See Supercore Inflation Cooling Next Year, Although the Fed Will Struggle to Bring it Back Under Three Percent, We Believe

%Y/y Supercore Inflation



Data as at November 30, 2023. Source: Bloomberg, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

The good news for markets in the near term, as we detail below, is that bringing inflation back towards the mid-two percent range should encourage the Fed to cut rates next year and in 2025, as it greatly diminishes the 'right tail' risk for central banks of a world where inflationary trends have been well in excess of central bank targets for several years.

In terms of specific contributions to 2024 inflation, Dave McNellis and Ezra Max think that shelter inflation, which accounts for about one-third of overall CPI, will continue to slow next year as the official BLS inflation measures start to 'catch down' to the disinflation seen in actual rents.

Exhibit 44: Core Goods and Shelter Disinflation Help in 2024-2025, But Supercore Remains a Problem

KKR GMAA U.S. CPI FORECAST DETAILS										
	3Q23a	4Q23e	1Q24e	2Q24e	3Q24e	4Q24e	Full-Year 2022	Full-Year 2023e	Full-Year 2024e	Full-Year 2025e
Headline CPI	**3.6%**	**3.2%**	**2.8%**	**2.8%**	**2.5%**	**2.4%**	**8.0%**	**4.1%**	**2.6%**	**2.5%**
Energy (7%)	-5.5%	-4.5%	-3.9%	0.5%	-2.6%	-0.7%	25.4%	-4.7%	-1.7%	7.5%
Food (13%)	4.3%	3.0%	2.4%	2.7%	2.7%	2.6%	9.9%	5.8%	2.6%	0.5%
Core CPI (8%)	**4.4%**	**3.9%**	**3.4%**	**3.0%**	**2.9%**	**2.7%**	**6.2%**	**4.8%**	**3.0%**	**2.4%**
Core Goods (21%)	**0.4%**	**-0.1%**	**-0.7%**	**-2.5%**	**-2.8%**	**-2.8%**	**7.7%**	**0.9%**	**-2.2%**	**0.1%**
Vehicles (8%)	-1.0%	-0.6%	0.3%	-2.4%	-2.8%	-3.2%	12.4%	-0.4%	-2.0%	-0.5%
Other Core Goods (13%)	1.4%	0.3%	-1.4%	-2.5%	-2.8%	-2.6%	4.7%	1.7%	-2.3%	0.5%
Core Services (59%)	**5.9%**	**5.4%**	**4.9%**	**4.9%**	**4.9%**	**4.6%**	**5.6%**	**6.3%**	**4.9%**	**3.3%**
Shelter (34%)	7.4%	6.7%	5.8%	5.3%	4.9%	4.4%	5.8%	7.6%	5.1%	3.5%
Medical (6%)	-2.1%	-1.2%	1.6%	3.9%	5.8%	6.2%	4.3%	-0.3%	4.4%	2.8%
Education (2%)	3.0%	2.4%	2.0%	1.8%	1.6%	1.8%	2.7%	3.1%	1.8%	2.8%
Other Core Services (17%)	6.6%	6.1%	5.0%	4.9%	5.0%	4.9%	6.4%	6.8%	5.0%	3.2%

Data as at December 12, 2023. Source: U.S. Bureau of Economic Analysis, Bloomberg, Haver Analytics.

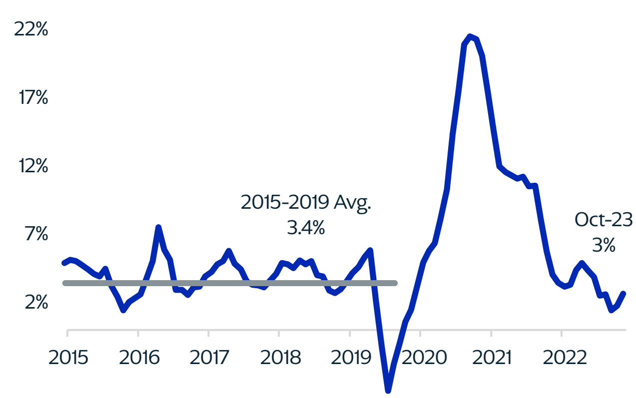
Looking at the longer term, we do continue to think that the Fed will struggle to achieve two-percent inflation on a sustainable basis in coming years, as the supply of critical commodities, labor, and housing remains constrained at a time when the stock of liquidity in the economy is still very elevated. Against that backdrop, we continue to think that inflation will ultimately settle in the mid-two percent range from 2025 onward, up from around two percent in 2015-2019.

To see why cooler near-term inflation does not automatically mean the Fed can bring CPI back to its target, consider each of the major CPI 'food groups' identified by Chair Powell (Housing, Core Goods, and 'Supercore' Services Ex-Housing).

Reason #1: Housing disinflation may peak in 2024-2025. The rental market is currently absorbing a glut of new supply, and sponsors are prioritizing lease-up and cash flow over long-term pricing (leading to steeper discounts for new rentals). However, we do not expect this dynamic to continue indefinitely. Indeed, as *Exhibit 46* shows, rental supply is on track to fall from record highs in 2024 back towards post-GFC levels in 2025 and 2026, as a tougher financing environment limits new construction. Meanwhile, our call for a structurally lower unemployment rate this cycle suggests that demand for rental housing will remain elevated at a time when millennials are continuing to form new households (*Exhibits 46 and 47*). All told, though we do not think rental inflation will rise towards anything like the levels seen in 2021 and 2022, we do expect rent growth to return to levels in line with or above the pre-COVID average.

Exhibit 45: Housing Supply Is Finally Allowing Rental Prices to Moderate...

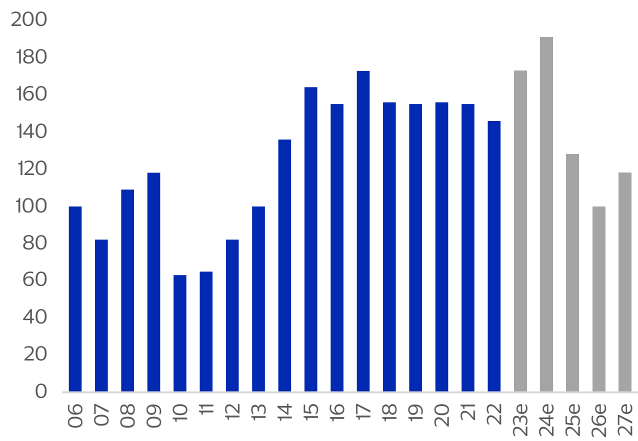
Zillow Rental Inflation, 3-Month Moving Average, % Annualized



Shown on a seasonally adjusted basis. Data as at October 31, 2023. Source: Bloomberg, Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 46: ...But This Effect May Reverse in 2026 and Beyond

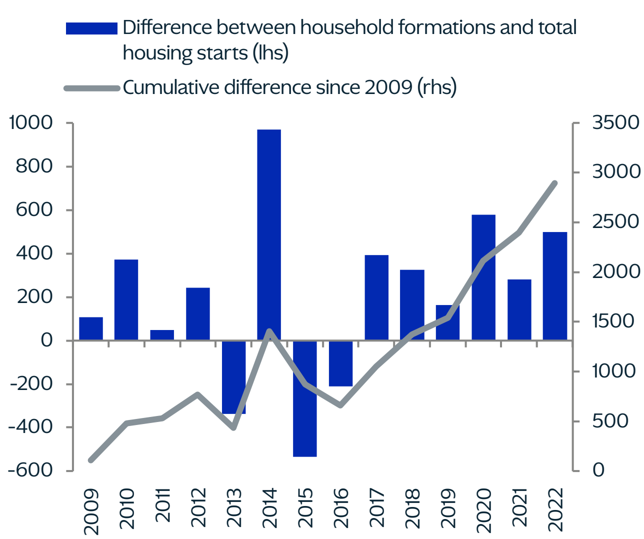
U.S. Multi-Family New Supply in Top 50 Markets, Index, 2006=100



Data as at September 30, 2023. Source: Green Street, KKR Global Macro & Asset Allocation analysis.

Exhibit 47: On the Demand Side, We Think Household Formation Will Continue to Accelerate

Gap Between U.S. Household Formation and Housing Starts, Thousands



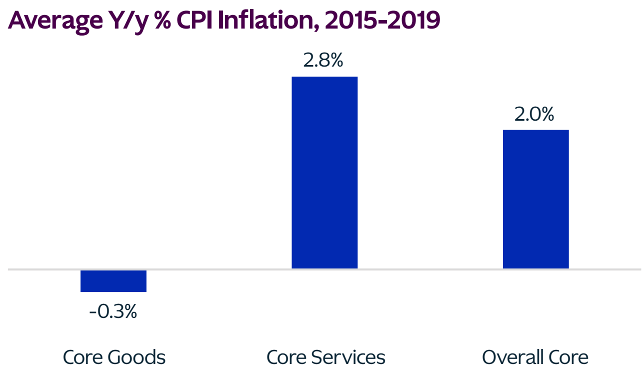
Data as at December 31, 2022. Source: U.S. Bureau of Labor Statistics, Haver Analytics, KKR GBR estimates.

Reason #2: Goods deflation may not continue indefinitely. Our forecasts embed that Core Goods prices continue falling in the near term, before stabilizing with very low levels of inflation (for instance, we see Core Goods prices growing just +0.1% Y/y in 2025). Although this backdrop sounds constructive for the Fed, it is actually far *more* inflationary than the world of 2015-2019, when globalized trade flows and falling commodity prices meant that consumer goods prices fell every year. One can see this in *Exhibit* 48, which shows that Core Goods deflation was an essential offset to Core Services inflation in the years leading up to the pandemic. On balance, we believe that this transition could add about 10-20 basis points to average annual inflation.

Reason #3: We think 'Supercore' inflation will remain 'sticky' this cycle amidst higher wage growth. As we have written for some time, we believe wages are on track to rise faster than overall inflation over a multi-year period as workers recoup lost real income. One can see this in *Exhibit* 49. Consequently, we think that input costs will remain high for non-Housing Services, which will continue to put upward pressure on 'Supercore' inflation at a time when consumers are still shifting demand from Goods towards Services (that is the key reason our models show 'Supercore' inflation getting 'stuck' around three percent next year). Against that backdrop, we continue to think that 'Supercore' inflation will ultimately settle at a higher level than the low-mid two percent run-rate that prevailed before COVID.

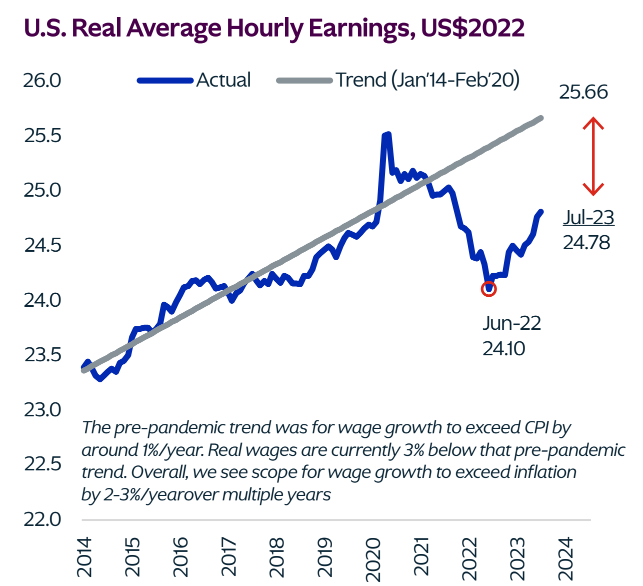
Although this backdrop sounds constructive for the Fed, it is actually far more inflationary than the world of 2015-2019, when globalized trade flows and falling commodity prices meant that consumer prices fell every year.

Exhibit 48: The Fed Achieved Its Inflation Mandate Pre-Pandemic in Part Because Globalization Was Driving Down Consumer Goods Prices. We Are No Longer Sure That Goods Will Stay Permanently Deflated



Data from 1984 - 2023. Data as at September 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 49: We Think Wages Continue to Be Inflationary on Net, as Unemployment Remains Low



Data as at September 30, 2023. Source: Greenstreet, Bloomberg, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

So, when we look at inflation in its entirety, our bottom line is that near-term inflation trends may give the Fed room to cut rates, but there are still longer-term *supply side* constraints including a shortage of housing, deglobalization, and a lack of workers that will be hard to address through central bank policy alone over the longer term.

EUROPE GDP

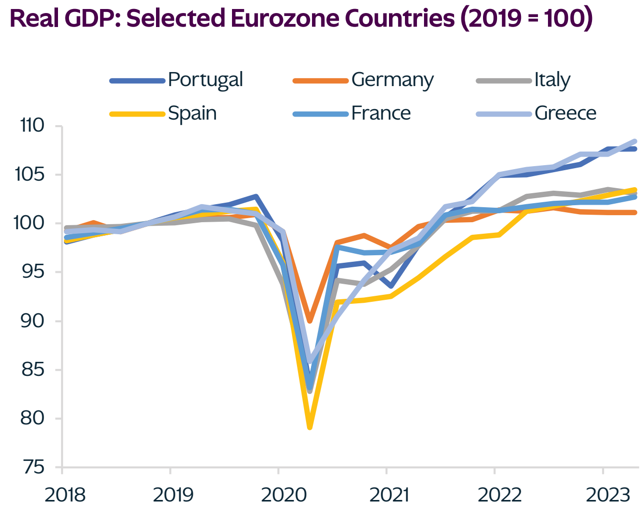
Forecasts: We think Eurozone GDP growth will likely remain muted at just 50 basis points in 2024 in our base case, compared to consensus forecast of 60 basis points, before accelerating to 1.4% in 2025 versus a consensus of 1.5%. Despite the headline growth number, 2024 will feel very different to 2023, as momentum is likely to build as we move through the year, aided by an expected pivot in ECB policy.

Commentary: We look for 2024 to see a continuation of the sluggish growth momentum seen in 2023. Key to our thinking is that the headwinds of fiscal consolidation are again starting to blow, most notably in the form of the recent ruling by the German constitutional court that the country's expenditure plans (to redirect COVID-related monies) were illegal, necessitating meaningful spending cuts. Meanwhile, while we expect a dovish pivot from the ECB, with four rate cuts in 2024, monetary policy will still be a drag on growth in 2024, due to the lags in policy transmission. On the positive side, the risk of a very negative outcome is relatively limited, despite several years of lackluster growth, due to strong household savings and limited household debt. To put it another way, expectations in Europe have been downbeat for so long that it is hard to get a meaningful downside surprise relative to consensus.

On the positive side, the risk of a very negative outcome is relatively limited, despite several years of lackluster growth, due to strong household savings and limited household debt.

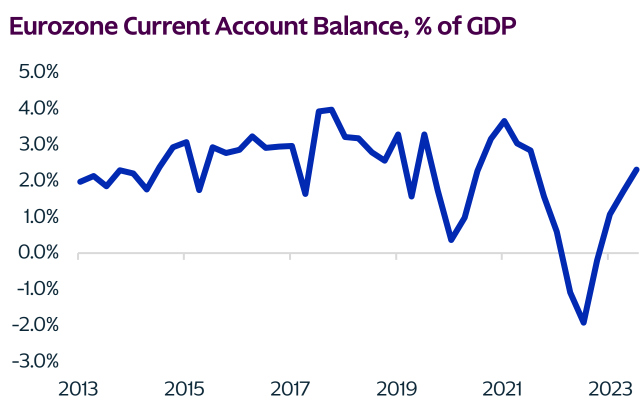
Importantly, every cycle is different, and there are some key nuances that we wanted to flag for investors. They are as follows:

Exhibit 50: The Periphery Has Led the European Recovery During This Cycle



Data as at September 30, 2023. Source: Eurostat.

Exhibit 51: The Current Account Balance Has Turned Sharply Positive, Almost Back to Long Term Averages

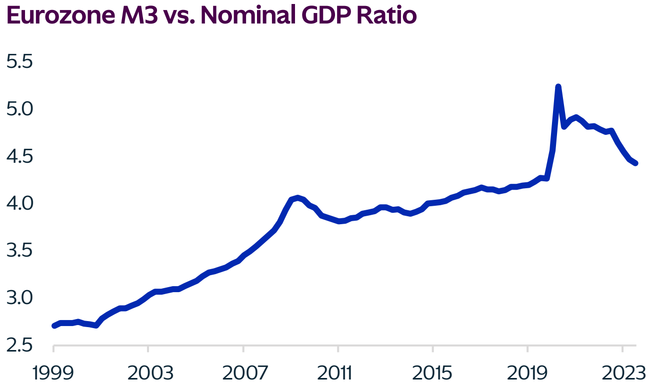


3Q23 GDP has been estimated. Data as at September 30, 2023.
Source: ECB, Eurostat.

- **Southern European states have actually been more resilient than the 'Core' this cycle.** Countries most affected by the Eurozone crisis underwent their painful deleveraging over the last decade, leaving household and corporate balance sheets in countries like Greece, Portugal, and Italy in better shape. In addition, these Southern European states were beneficiaries of post-COVID revenge spending over the last 12 months, particularly in the summer tourist season, and continue to be major beneficiaries of the NextGenEU fiscal disbursements. As a result, they have seen healthy economic growth despite the drain in liquidity from ECB rate hikes and balance sheet reductions.
- **Liquidity is getting tighter, but the stock of liquidity is still fairly supportive.** It's important to realize that the tight liquidity we are seeing in risk markets is a feature, not a bug, of the current monetary policy regime. True, inflation has fallen sharply, giving the ECB room to make a dovish pivot in 2024, but we think it will take over a year to reach a neutral policy stance once it starts cutting rates (which we think will be in the first half of 2024). That said, while liquidity has been tight on a year-over-year basis, it's important to keep sight of the level of liquidity in the system, which remains very meaningful and a source of support for asset prices.
- **Most of the recent increase in rates is permanent.** Investors need to realize that the period of ultra-low rates was an aberration, and what we have now is much closer to normality. Just look at the ten-year inflation-linked bund: it has just barely returned to positive territory. A normal market environment would see investors demanding a positive real interest rate as a matter of course.

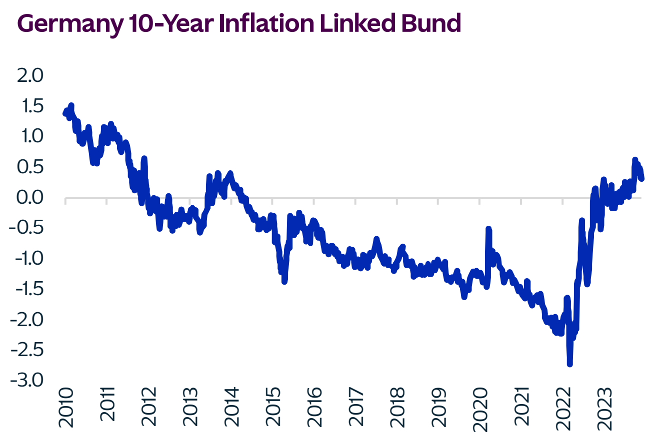
Countries most affected by the Eurozone crisis underwent their painful deleveraging over the last decade, leaving household and corporate balance sheets in countries like Greece, Portugal, and Italy in better shape.

Exhibit 52: Liquidity in Terms of Money (M3) to Nominal GDP Remains at Robust Levels



3Q23 GDP has been estimated. Data as at September 30, 2023.
Source: ECB, Eurostat.

Exhibit 53: Real Bond Yields in Europe Just Recently Turned Positive for the First Time Since 2014



Data as at November 30, 2023. Source: Bloomberg.

Our punchline is that an anemic headline economic recovery for the EU is masked by a dispersion of outcomes between the core and periphery, but we expect the lagged impact of monetary policy tightness to bite even the healthier Eurozone economies in the coming quarters. The good news is that across corporates and households, we generally do not see pockets of excess leverage, with the risk mostly being concentrated in governments. Aside from leverage in Nordic real estate, this remains the key source of systemic risk in Europe and we are carefully monitoring fiscal policy developments in Italy, the UK, and Belgium. There remains no clear growth engine for the Eurozone, but the risks appear generally well-managed, leaving the overall short-term outlook still muted.

EUROPE INFLATION

Forecasts: We think Eurozone inflation will fall to 2.4% in 2024 and 2.0% in 2025, compared to a consensus of 2.7% and 2.1%.

Commentary: We see a faster deceleration of headline inflation than consensus expects. This is driven by our view of strong disinflation coming from manufacturers, overall continued sluggish demand in the near term, and limited persistence in the pass-through of recent high inflation into wages. Taking each in turn:

- **Manufacturing Disinflation** We continue to believe that the inventory overhang will be a meaningful disinflationary force in the coming months. Despite a very rapid fall in manufacturers' pricing, the mountain of inventory has so far barely fallen. We see this in the MSCI Europe inventory levels and we also hear it from logistics players and companies to whom we speak.
- **Weak Demand** We think a meaningful upward inflection in consumer spending is still a few quarters away. More importantly, consumer demand has been weak now for several years, so some catch-up spending is overdue and would likely not prove inflationary.

We see a faster deceleration of headline inflation than consensus expects. This is driven by our view of strong disinflation coming from manufacturers, overall continued sluggish demand in the near term, and limited persistence in the pass-through of recent high inflation into wages.

- **Tame Wage Inflation** While ECB President Lagarde has said she would need to see the wage agreements in the first half of next year before pronouncing on the knock-on impact of inflation on wages, we think the signs point to relatively limited pass-through. Indeed, Eurozone workers have seen meaningful erosion of their wages in real terms in recent years, and current data points to a deceleration in wage inflation that is coming surprisingly rapidly, given the normal lags in wage setting. This is key to our thinking that an initial rate cut from the ECB is a possibility as early as the first half of 2024.

Exhibit 54: Inventories In Europe Remain Very Elevated

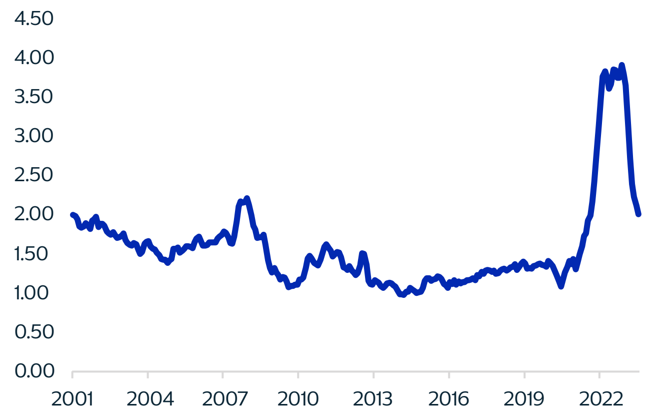
MSCI Europe Inventory as a % of Annual Sales

Data as at September 30, 2023. Source: Morgan Stanley Research.

Most of the recent increase in rates is permanent. Investors need to realize that the period of ultra-low rates was an aberration, and what we have now is much closer to normality.

Exhibit 55: Persistent Core Inflation as Estimated by the ECB Is Now at Two Percent...

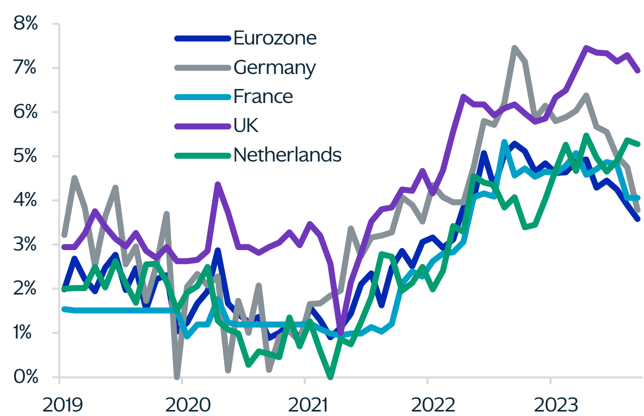
ECB: Eurozone HICP Persistent and Common Component of Inflation (PCCI), Core, %



Data as at September 30, 2023. Source: ECB.

Exhibit 56: ...But Wage Growth Remains Sticky in Many Areas of Europe

Indeed Wage Tracker: Posted Wage Growth, Y/y %



Data as at September 30, 2023. Source: Indeed.

ASIA OVERVIEW

Given we operate eight offices across Asia and are active in both developed and developing countries, Frances Lim, who heads Asia macro for KKR, and her colleagues can take a broad-based approach to the region. What is clear from their macro work and our on the ground visits is that Asia is increasingly operating in a divergent/asynchronous manner relative to the rest of the developed world.

Importantly, despite China's slowdown, overall regional growth in Asia is still running at twice the pace of the U.S. and Europe. One can see this in *Exhibit 57*. Meanwhile, we are seeing rapid structural changes occurring across India, Japan, and China, which are leading to improved physical and technological infrastructure able to support longer-term growth. Moreover, low real yields are helping and should also be positive for valuations.

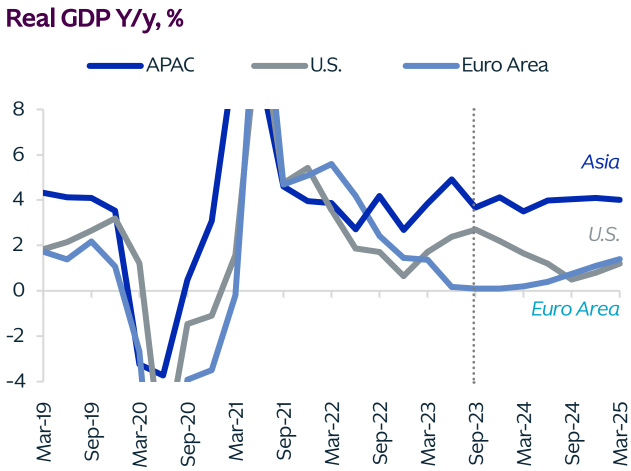
KEY BIG PICTURE ASIA TAKEAWAYS

1. China's economy will continue its weak recovery, though we think stronger fiscal and monetary stimulus will make 2024 a better year for growth and stability. Maybe more important, the country is continuing to rebalance its economy towards 'new China' growth engines such as decarbonization and industrial automation/digitalization which account for 20 percent or more of the economy, helping to offset much of the slowdown in fixed investment, including housing.
2. Japan exits its multi-decade-long period of deflation, with the support of a weak yen, corporate sector reform, and a tight labor market. We think that it is different this time, including a greater focus on shareholder value, rising wages, and increased capital expenditures.
3. India should remain on a strong growth trajectory, amid a reform-driven structural transformation as well as a turn in the investment cycle after a decade-long stagnation. After reaching seven-plus percent growth in 2023, GDP growth is likely to moderate slightly in 2024. Importantly, we see both improving exports and increased fixed investment as leading to differentiated long-term performance in India.
4. Across Asia, we still see some 'scarring', or structural slowing, of the consumer post the pandemic. This reality is likely most evident in low-income households in China. Wages, incomes, and savings of low-to-middle-income households were most affected by lockdowns, as pandemic restrictions limited access to jobs, there were no cash handouts (relative to developed markets), and consumers had to dip into their savings. Moreover, many small businesses did not survive the pandemic-driven slowdown. Consumers are now rebuilding their savings and their confidence, but this process will take time. Meanwhile, mid-to-high-income households were less affected, and as a result, they fared better, and were willing to spend more on outdoor activities, travel, and healthy choices.
5. Geopolitical risks remain an overhang across the region, and as such necessitate an added risk premium when thinking about returns. Aligning with long-term government objectives, particularly in China, remains important.

Bottom line: Asia continues to march to a different beat from an economic standpoint to both Europe and North America. Within the region, we remain most excited by the structural reforms we see in Japan and India as well as the economic rebalancing that is starting to occur in China. Importantly, when the Fed pivots, both lower interest rates and a weaker U.S. dollar could become a further tailwind to growth in a region that is already tracking well above what we see across most developed economies, especially in the West.

So, not only are we seeing an asynchronous cycle globally, but we are also seeing major divergences within Asia. One can see this in *Exhibit 58*. For example, after a robust 2021, export-based economies like Korea, Taiwan, and Singapore are now at the bottom of the semiconductor cycle and economic cycle. Meanwhile, after a tough 2023, Vietnam is now recovering from an anticorruption sweep and property market correction. On the other hand, once strong domestic demand-related economies like India and the Philippines are now beginning to see growth come off peak levels, and as a result, should continue to see growth slow through the course of 2024 as the impact of higher inflation and rates filters through their economies.

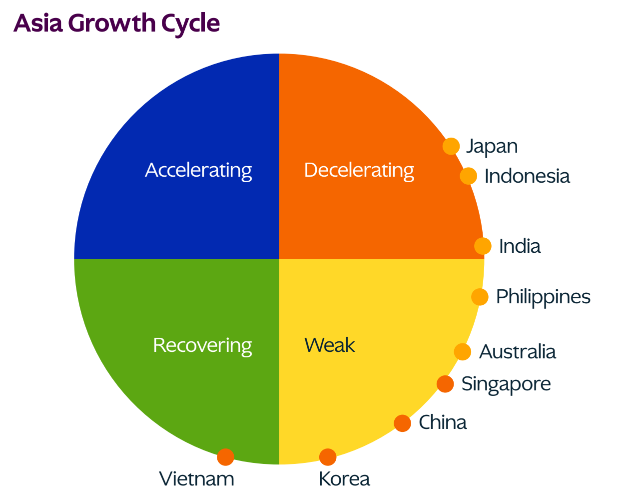
Exhibit 57: Rotating Drivers of Growth Keep Asia Running At Twice the Pace of the U.S. and Europe...



Data as at November 30, 2023. KKR GMAA estimates for U.S., Euro Area, China, IMF estimates for other Asia Pacific countries, nominal GDP weighted. Source: Haver Analytics, IMF, KKR Global Macro & Asset Allocation analysis.

Longer-term, we think that some really important shifts in the Chinese economy warrant investor attention.

Exhibit 58: ...Despite a Cyclical Slowdown in Several Economies in the Region



Data as at November 13, 2023. Source: KKR Global Macro & Asset Allocation analysis.

CHINA GDP

Forecasts: In general, we are more bullish than the consensus on growth, and as we discuss later, we have more moderate expectations on inflation. Specifically, we look for China Real GDP growth in 2024 of 4.7%, slightly above consensus of 4.5%. Our base case assigns a 60% probability to this outcome. Our bull case for 2024 Real GDP growth is 5.2% (20% assigned probability); the bear case is 4.2% (20% assigned probability). For 2025, we look for growth to fall slightly to 4.5%, 10 basis points above consensus of 4.4%.

Commentary: In the near term, China's economy will continue its weak recovery with the help of both supportive fiscal and monetary policies. All told, we estimate that total government initiatives could add 60 basis points to GDP in 2024. While we do think that growth may have bottomed, many traditional parts of the economy will likely continue to struggle. Housing, which accounts for almost 20% of the economy, continues to face headwinds, including both too many houses and too many developers. The government clearly acknowledges this challenge, and as a result, it is changing policies to be more accommodative, including recent policy changes to allow lower down payments for first-time home buyers as well as more bank credit support for developers.

KEY CHINA GDP TAKEAWAYS

Growth: Even with growth in the 4.5-4.7% range for 2024 and 2025, China is leading most of the developed world in growth. Changchun Hua and Frances Lim are more bullish than the consensus as China continues the rebalancing of its economy away from real estate towards industrial automation, decarbonization, and consumption upgrades.

Transforming the Economy: As the government pivots to a 'new China', driven by industrial digitalization and the energy transition, the country is ceding low-cost manufacturing to other countries in Asia. Already, China leads the world in the installation of industrial robots by nearly eight-fold, and we see more gains ahead.

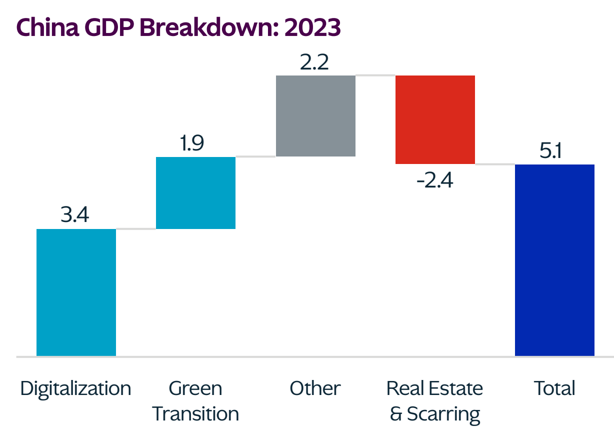
Housing: The oversupply of housing relative to demand remains a major headwind. High levels of housing inventory, which we think total 5-50 million, as well as some much-needed consolidation in the real estate development sector, suggest that any residential real estate recovery will take quite some time to unfold.

Consumer Behavior: There is still a 'scarring' effect from zero-COVID policy; at the same time, the housing market downturn is denting growth as well as impacting consumer behavior, with household deposits still well above trend and excess savings at decade highs.

Self-Sufficiency, Despite Restrictions: As the government pivots to a 'new China' driven by industrial digitalization and the energy transition, China's self-sufficiency is on the rise. China is already capable of producing 40% of its semiconductors need, and its wafer fab capacity installation will be more than the sum of Taiwan and North America by 2024. Looking ahead, we see more internalization of the economy.

Longer-term, we think that some really important shifts in the Chinese economy warrant investor attention. See our recent *Thoughts From the Road - Asia*, but we believe that global investors may not fully understand how much China's economy is undergoing a substantial change. Indeed, before COVID, a lot of market capitalization was created in China by entrepreneurs who leveraged technology to create an improvement in the consumer's experience, including online shopping, social media, and consumption upgrades. Today, by comparison, the new growth drivers of the Chinese economy are industrial digitalization and the energy transition. They both are growing as much as 40% year-over-year, and each sector represents about 10% of the Chinese economy. Importantly, China has a competitive cost and resource advantage across both these areas, and we think that they will look to increase their competitive advantage, especially in the EV sector. As such, our base view is that – over time – investors will talk more about these drivers than they will about housing and exports, both of which we think have peaked in absolute terms and as underpinnings to the China growth story.

Exhibit 59: A New Economy: China's Green and Digital Economy Will Soon Fully Offset the Slowdown in Fixed Investment, Including a Saturated Housing Market



Note: 'Green transition' is based on green finance and transition investment studies from Beijing Institute of Finance and Sustainability as well as as reported by BNEF. 'Digital economy' added value is as reported by CAICT, including added value of the information industry and added value that the information industry brings to other industries. The drag of real estate is estimated by the KKR GMAA team with an IO table and includes the real estate industry itself and the industry's impact on upstream and downstream. Data as at November 30, 2023. Source: Beijing Institute of Finance and Sustainability. China National Bureau of Statistics, BNEF, CAICT, KKR Global Macro & Asset Allocation analysis.

Exhibit 60: We Continue to See Strong Growth From China's New Economy. We Believe Policy Easing Will Help Mitigate Drags from Real Estate and Negative Wealth Effects

Note: 'Green transition' is based on green finance and transition investment studies from Beijing Institute of Finance and Sustainability, as well as as reported by BNEF. 'Digital economy' added value is as reported by CAICT, including added value of the information industry and added value that the information industry brings to other industries. The drag of real estate is estimated by the KKR GMAA team with an IO table and includes the real estate industry itself and the industry's impact on upstream and downstream. Data as at November 30, 2023. Source: Beijing Institute of Finance and Sustainability. China National Bureau of Statistics, BNEF, CAICT, KKR Global Macro & Asset Allocation analysis.

CHINA INFLATION

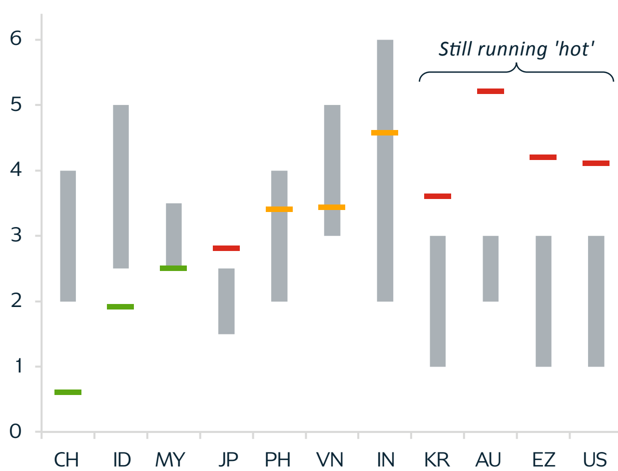
Forecasts: On the inflation front, we look for inflation to reach 1.4% in 2024, compared to 0.2% in 2023 and a consensus view of 1.7%. For 2025, our base case is for inflation to hit 1.8%, just below a consensus of 1.9%.

Commentary: As 2023 comes to an end, China is still flirting with deflation, a backdrop that reflects both weak demand from housing market correction / scarring effects and less supply distortions. Looking ahead, however, China's inflation may normalize somewhat as the supply side fades away (hence some upside risk from higher oil and food prices) and policy easing effects take hold.

Exhibit 61: Inflation in Many Parts of Asia is Close to Target, But China Remains Near Deflationary Levels

Data as at November 30, 2023. Nominal GDP weighted. Source: National statistical agencies, central banks, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 62: Inflation Is at or Below Target in Asia. As Such, Asia's Central Banks Do Not Need to Fight Inflation



Data as at November 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

JAPAN GDP GROWTH

Forecasts: We expect Real GDP growth in Japan of 1.4% in 2024, compared to consensus of one percent. In 2025, we anticipate growth to fall to one percent, in line with consensus.

Commentary: Even though Frances Lim and Changchun Hua believe Real GDP growth will likely decelerate in 2024, we think Japan will still outperform consensus expectations. Our work suggests that consumption will be supported by an increase in real disposable incomes. Specifically, we believe 2024 consumption will be helped by the recently rolled-out tax cuts, faster wage growth (possibly from 2.3% in 2023 to 2.7% in 2024) and continued improvement in inbound tourism (still only at 84% of 2019 levels).

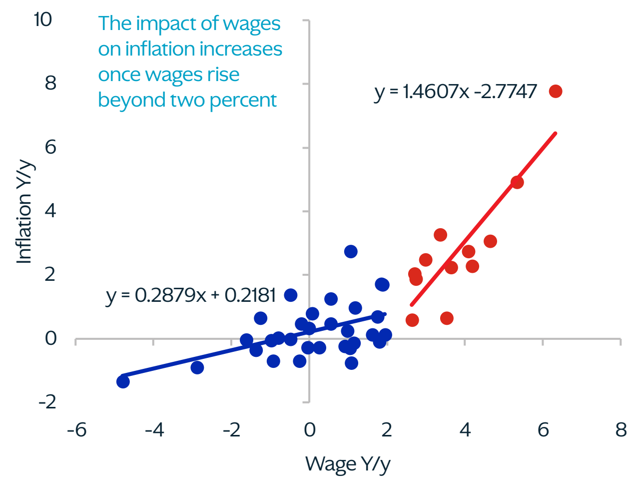
JAPAN INFLATION

Forecasts: We expect inflation in Japan to rise to 2.7% in 2024, compared to consensus of 2.1% percent. In 2025, we anticipate inflation to cool to around two percent, higher than consensus of 1.5%.

Commentary: We think that Japan is exiting deflation for the first time in decades, which means it is one of the few countries in the developed world whose stock market is benefitting from our thesis about a 'higher resting heart rate' for inflation. Labor shortages, sticky services inflation, and tightening monetary policy are all driving this increase. Wages are up in Japan as demographic headwinds shrink labor supply. This reality, we believe, is why more automation, especially in the corporate sector, is inevitable. With inflation running around 2.5%, this backdrop means that we will see sustainable negative real yields. So, our bottom line is that, despite some softness in the depth of the market, now is a good time to be an issuer relative to where we think rates are headed in Japan. It also means that in order to earn an adequate return on a real basis as Japan exits deflation, both individual and corporate savers, especially deposit holders, will have to find alternative investments to Cash..

Exhibit 63: Tight Labor Markets Are Helping to Put More Upward Pressure on Japan Inflation

Japan Wage-Inflation Spiral, 1980-2022



Data as at December 31, 2022. Source: Japan Ministry of Health, Labor & Welfare, Japan Ministry of Internal Affairs and Communications, Haver Analytics.

We think that Japan is exiting deflation for the first time in decades, which means it is one of the few countries in the developed world whose stock market is benefitting from our thesis about a higher resting heart rate for inflation. Labor shortages, sticky services inflation, and tightening monetary policy are all driving this increase.

SECTION III

Capital Markets

S&P 500

Our colleague Brian Leung, who is a director on the KKR Global Macro & Asset Allocation team, is looking for positive, albeit below-average, returns for the U.S. equity markets in 2024. Amidst the macro crosscurrents, we see another six percent upside for U.S. equities to 5,010 in 2024 under our base case and would lean into any market dips to accelerate deployment. Fundamentally, we see a relatively constructive macro backdrop unfolding given continued disinflation, Fed cuts, slower growth but no severe recession, and a sideways to down outlook for both the U.S. dollar and crude oil. Even so, many parts of shorter-duration Credit are now offering competitive returns. Within Equities, our primary focus is on cash flowing companies where growth is solid and refinancing risk is low. We are more capitalization-agnostic today than in the past, and by region, we now feel more inclined to lean further into international stocks, including both high quality Emerging Markets and other focus markets such as Japan.

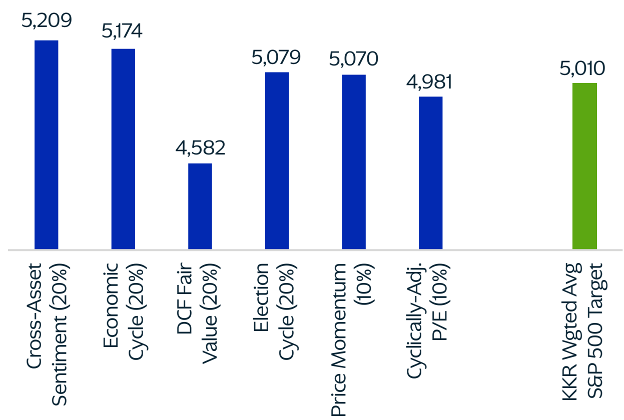
During the 'offseason', Brian and the team revamped our forecasting framework to incorporate signals from investor sentiment, the economic cycle, the election cycle, price momentum, and valuations to complement our traditional discounted cash flow analysis. In our mind, the P/E ratio ultimately measures what 'price' investors are willing to pay for a unit of 'earnings', which by definition is a broad-based confluence of fundamentals, risk appetite, sentiment/positioning, and views on the economy and the political environment. To this end, we have broadened our analysis to include multiple new inputs, which we detail below and summarize in *Exhibit 64*.

- **Sentiment/Positioning:** Our gauge of cross-asset sentiment is nowhere near a crowded extreme even after the rally from October lows. Instead, it is still improving from benign levels, which is historically a bullish setup for equities over the subsequent 12 months. A more direct gauge of net exposure across active mutual funds, L/S hedge funds, CTAs, volatility-targeting, and risk parity funds also suggests positioning is not an impediment to further gains.
- **Economic Cycle:** While our Cycle indicator is currently in 'macro purgatory' straddling the 'Contraction' and 'Recovery' phases, we have increasing conviction that it will keep moving away from 'Contraction' towards 'Recovery' next year. The transition will likely be bumpy, but if we are right, then the macro backdrop goes from being a headwind to a tailwind for equity markets.
- **Technicals/Seasonality**: Even though we are not technicians, it would be remiss to ignore the powerful seasonality of the four-year Presidential election cycle. Simply put, based on 24 cycles since 1928, average equity returns during years three and four tend to be more than double those of years one and two (*Exhibit 65*). The probability of positive returns is also meaningfully higher in years three and four, as the party in office is likely more incentivized to shore up the economy as re-election nears.

We are more capitalization-agnostic today than in the past, and by region, we now feel more inclined to lean further into international stocks, including both high quality Emerging Markets and other focus markets such as Japan.

Exhibit 64: We Expect the S&P 500 to Reach 5,010 by Year-End 2024, Based on Our Revamped Framework Incorporating Signals from Sentiment, the Economic Cycle, DCF Modeling, the Election Cycle, Price Momentum and Valuations

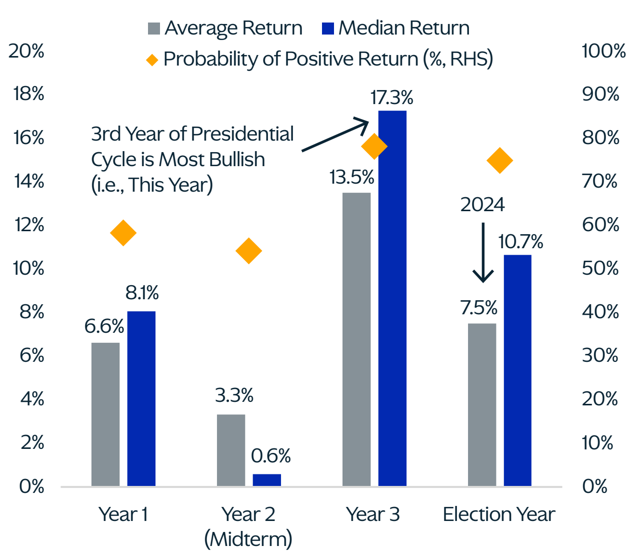
S&P 500 Base Case 2024 Price Target: Weighted Average of Six Frameworks



Data as at December 14, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 65: During Year Four of the Presidential Election Cycle, the S&P 500 Tends to Be Up 75% of the Time With Average Returns of 7.5%, Based on Data From 24 Cycles Since 1928

S&P 500 Returns and U.S. Election Cycles, Based on Election Cycles Since 1928

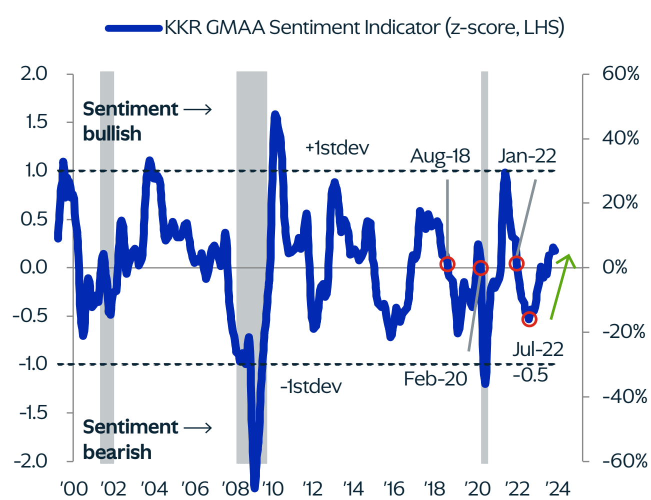


Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Importantly, our KKR cross-asset class sentiment indicator, which tracks around 30 metrics across equities, credit, FX, commodities, and positioning, suggests current sentiment remains positive and improving (see *Exhibit 66*). Historically, this combination is an attractive setup for risk assets, as equities tend to return +10% on average with a greater than 80% hit rate over the subsequent 12 months. The key drivers in the model that suggest it is too early to take profits include a) still-low levels of risk-taking across speculator traders and mutual funds; b) benign credit spreads and lack of funding stress; and c) subdued rates volatility and FX options skew. In terms of what we are watching, the indicator would flash a more guarded, defensive signal once sentiment reverses and heads to more negative territory (e.g., January 2022, February 2020, August 2018).

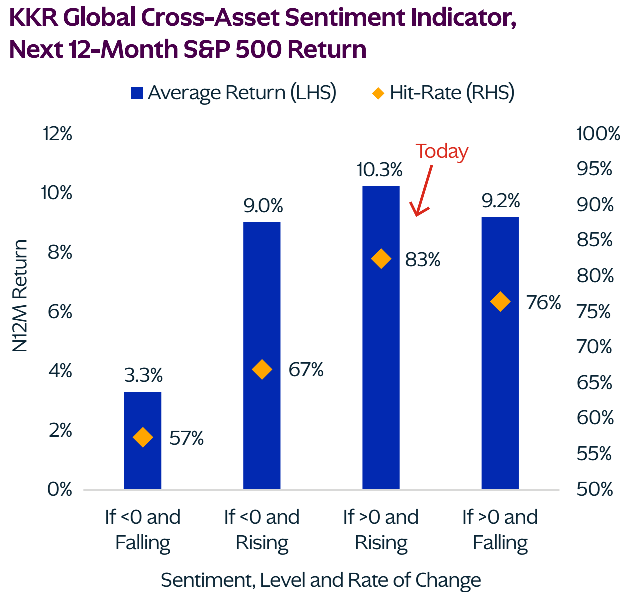
Exhibit 66: Our Measure of Cross-Asset Sentiment Is Still Improving From Benign Levels and Nowhere Near a Crowded Extreme

Cross-Asset Sentiment and Market Returns, %



Note: Indicator comprises around 30 components across equities, credit, FX and commodities, and positioning. Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 67: This Backdrop Tends to Have Bullish Implications for Equities Over the Next 12 Months (+10% on Average With >80% Hit Rate)



Note: Based on monthly analysis since 1999. Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

As in past years, we asked Brian to run a scenario analysis to help us think through a potential roadmap for 2024. Informed by this work, our roadmap for Equities is detailed below in our Base, Bull, and Bear scenarios.

Our Base Case (60% probability): We assume U.S. nominal GDP growth decelerates to about 4 percent from six to seven percent this year, but there is no severe downturn. While we still embed a mild, technical recession in the second half of 2024, markets likely view that as an outcome not dissimilar to a 'soft-landing' with a few negative GDP quarters mixed in. The combination of an EPS recovery (about four percent top-line growth plus a modest approximate two percent margin expansion), supportive sentiment/positioning, and stabilizing bond yields, drives the S&P 500 to 5,010 by end-2024 (19.6x NTM P/E), underpinned once again by larger-cap growth stocks (*Exhibit 68*).

Exhibit 68: S&P 500 Price Target Base/Bear/Bull Scenarios: Our Base Case Calls for Six Percent Price Returns. Our Bull Case Is Mid-Teens Returns While Our Bear Case Is Approximately Seven Percent Downside

S&P 500 Price Target Scenarios

	Base (60% Prob)	Bear (20% Prob)	Bull (20% Prob)	Weighted Average	*Bottom-Up Consensus*	*Top-Down Consensus*
Current = 4,725						
2024 Year-End Target	**5,010**	**4,400**	**5,310**	**4,948**	***n/a***	***4,704***
P/E on 2025 EPS	19.6x	19.1x	20.0x			
2025 Year-End Target	**5,310**	**n/a**	**n/a**	**n/a**	***n/a***	***n/a***
P/E on 2026 EPS	19.6x	n/a	n/a			
2022a EPS	$220	$220	$220	$220	*$220*	*$220*
2023e EPS	$222	$215	$226	$221	*$222*	*$222*
2024e EPS	$235	$204	$251	$232	*$246*	*$230*
2025e EPS	$255	$231	$266	$252	*n/a*	*$250*
2026e EPS	$271	$236	$290	$268	*n/a*	*n/a*

Note: Forecasts assume S&P 500 ends 2023 at ~4,725. Data as at December 14, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

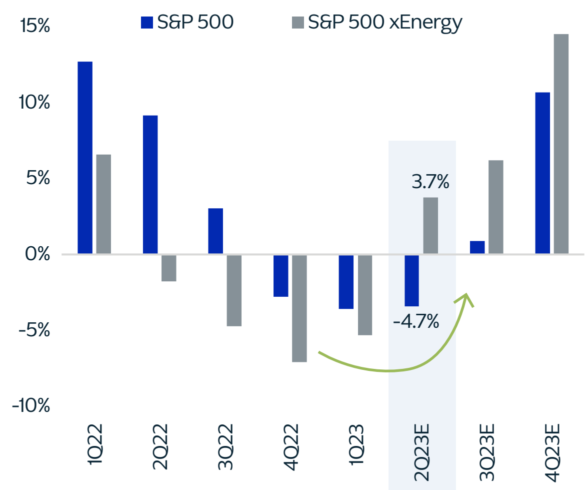
Key to our thinking in our base view are the following assumptions:

1. **On EPS:** We expect six percent year-over-year growth in 2024 to $235 per share from $222 per share this year. Importantly, though, the earnings recession is now behind us, we believe, as net margins have already declined for five straight quarters and our Earnings Growth Lead Indicator has inflected higher after troughing in 2023. In fact, on an ex-energy basis, EPS was already back in growth territory in 2Q23 *(Exhibit 69). Even* so, we think the bottom-up consensus expectation of 11% EPS growth (to $246 per share) is too rosy, as it implies margins snap back towards prior highs amidst slowing economic growth, resilient wages, and a higher-for-longer rate environment (*Exhibit 70*). Remember that benign globalization had been a significant tailwind to S&P 500 net margins, with lower cost of goods sold (China labor arbitrage/outsourcing) and lower taxes (tax arbitrage) accounting for fully around 70% of the margin improvement over the past 20-25 years *(Exhibit 71)*. Going forward, we expect the

combination of deglobalization (e.g., re-shoring), higher interest expense, and potential partial reversion of 2017 corporate tax cuts, to weigh on incremental margin expansion.

Exhibit 69: On an Ex-Energy Basis, EPS Already Inflected Back into Growth Territory in 2Q23

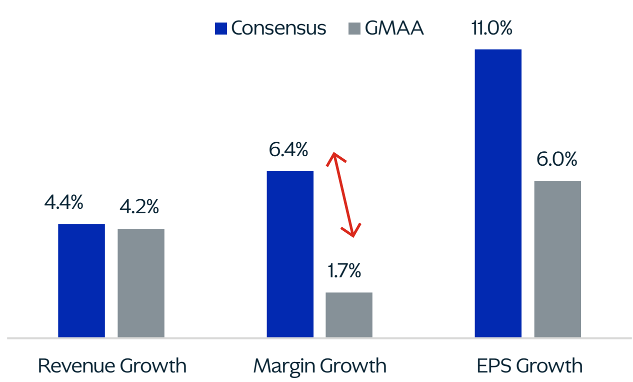
S&P 500 EPS by Quarter (Consensus)



Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 70: We Have Similar Top-Line Growth Expectations as Consensus for 2024; Where We Differ Is Degree of Margin Recovery

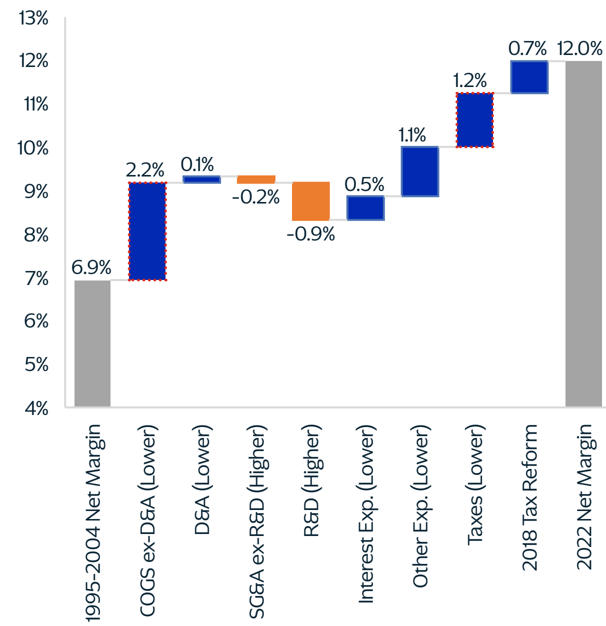
S&P 500 2024 EPS Growth Estimate, %



Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 71: Margins Have Increased Steadily in Recent Decades. We Now Think Incremental Margin Expansion Will Be Harder to Come By

2022 Net Margin (ex-Financials) Expansion vs 1995-2004 Levels

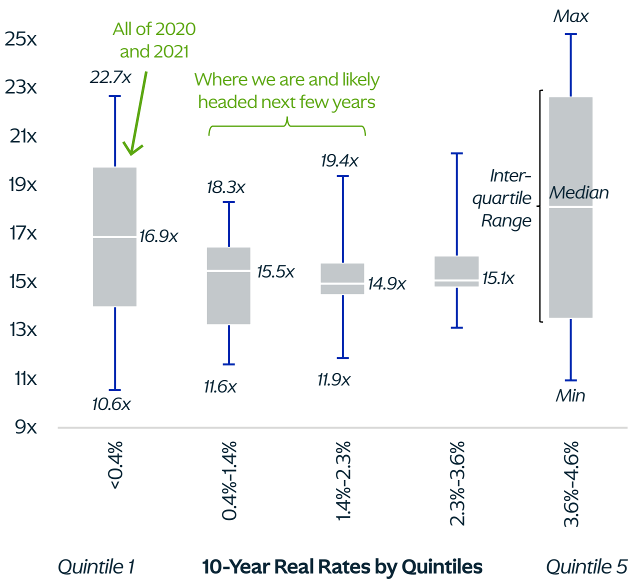


Data as at November 30, 2023. Source: Bloomberg, BofAML Global Research, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

While we still embed a mild, technical recession in the second half of 2024, markets likely view that as an outcome not dissimilar to a 'soft-landing' with a few negative GDP quarters mixed in.

Exhibit 72: If 10-Year Real Rates Stay in the 1.5-2.5% Zip Code, Our Base Case P/E of About 19.6x Is Consistent With Equities Trading at the High End of the Range

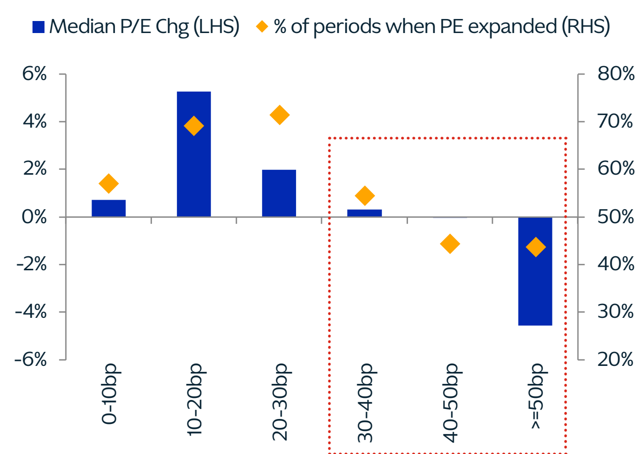
S&P 500 NTM P/E Across 10yr U.S. Real Rates, Quarterly Data, 1990-Present



Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 73: It Is Not So Much the Level of Real Rates, But the Rate of Change That Typically Hurts Equity Multiples

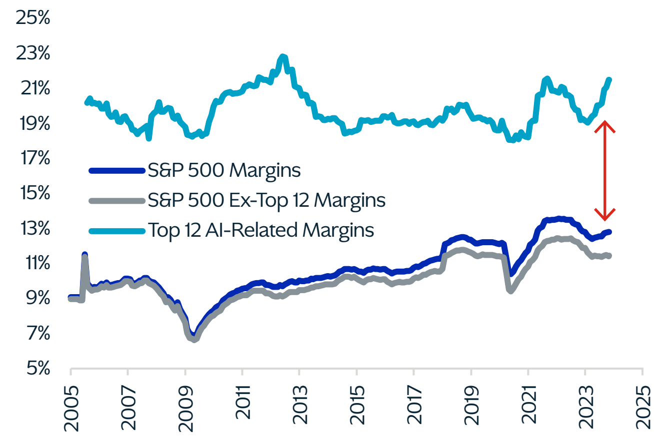
Rising Real 10-Year Rates vs. PE Multiples, 1982-2023



Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 74: Mega-Cap Tech / AI Stocks – Which Have Structurally Higher Margins – Make Up Roughly One-Third of the Index Today, Up From Just About 10% Ten Years Ago

S&P 500 Net Margin Decomposition



Data as at November 30, 2023. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

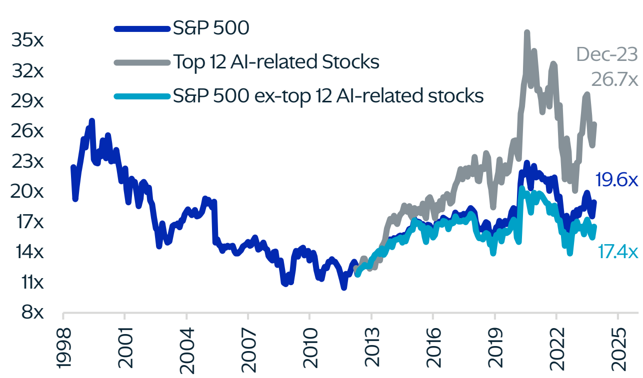
2. **On Valuations:** We assume S&P 500 NTM P/E trades at around 19.6x, which is effectively flat versus where we are today, though admittedly elevated relative to the higher real rates environment (1.5-2.5%) that we are envisioning (*Exhibit 72*). However, while equity multiples typically struggle during disorderly surges in real rates, we argue that they largely adjust to a higher level of real rates over time (*Exhibit 73*). Moreover, shifting index composition towards higher P/E sectors over time is biasing valuations higher, in our view. We also think the significant size of central bank balance sheets is positively impacting valuations in today's environment relative to history. Separately, just consider that mega-cap tech / AI stocks – which have structurally higher margins – make up roughly one-third of the index today, up from just around 10% ten years ago (*Exhibit 74*). So, when we pull it all together, we do believe that some premium relative to history is likely warranted. Moreover, as we peer around the corner into 2025, our base is that multiples will stay high as the U.S. recovers from the mild technical recession in 2024, coupled with an improvement in U.S. real GDP growth from 1.5% in 2024 to 1.8% in 2025.

3. We also spent some time decomposing the S&P 500's multiple to understand what the average is telling us.

What we learned is that, while 19.6x NTM P/E multiple is on the high side, the headline number does mask the divergence between the top 12 mega-cap AI-related stocks at 26.7x and the rest of the 488 stocks at 17.4x. At 17.4x, the rest of the stock market is trading just above its 10-year average (*Exhibit 75*). Said differently, the median stock in the S&P 500 is not priced for perfection and has re-rating potential so long as the economy sidesteps a deep, prolonged downturn. Meanwhile, the growth for the top 12 S&P 500 stocks for 2024 is still robust at about 20%, compared to around 25% in 2023. Against this backdrop of growth and steady margins again next year, we think the potential for large-cap technology stocks to maintain their valuation is high.

Exhibit 75: The Headline Valuation for the S&P 500 Masks the Divergence Between Elevated Valuations for the Top 12 Mega-Cap Tech / AI-Related Stocks Versus More Reasonable Valuations for the Rest of the Index

S&P 500 NTM P/E Decomposition



Note: AI-related stocks include Apple, Microsoft, Amazon, Nvidia, Google, Meta, Tesla, Broadcom, AMD, Salesforce, Netflix and Oracle. data as at December 14, 2023. Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

We also augment our base case with probabilistic bear and bull cases to account for a broader range of outcomes:

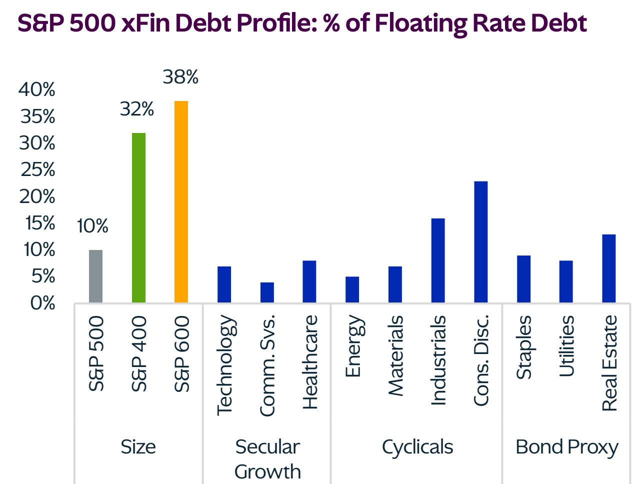
Our Bear Case (20% probability) Lagged impact of tightening leads to widespread credit contraction, triggering higher layoffs in cyclical sectors (e.g., construction, manufacturing, business services, etc.) and another lurch lower in the housing market. The U.S. economy falls into a garden-variety recession, which causes EPS to fall another 5% in 2024. Sentiment/Positioning is of little help as the equity risk premium jumps to discount the economic downturn. The S&P 500 slumps towards 4,400 by end-2024 (19.1x NTM P/E).

Our Bull Case (20% probability) The Fed achieves the proverbial soft-landing, where inflation converges back to the target without breaking the labor market. Fiscal stimulus has more than offset tighter monetary conditions as the U.S. economy has become less rate-sensitive than before, thanks to locked-in mortgage rates and wealth effects with household net worth at all-time highs. Corporate margins – aided by AI tailwinds – snap back towards prior highs with EPS growing about 11% in 2024 per consensus expectations. The S&P 500 rallies to new highs of around 5,310 by end-2024 (20.0x NTM P/E).

On the sector/style debate, we prefer to play for further equity upside via quality stocks with decent growth and strong free cash flow conversion (e.g., those with high ROE, high-interest coverage, and high profitability/FCF) given a still uncertain macro backdrop with decelerating GDP growth. Despite looking quite cheap on a relative basis versus large cap stocks, we do not yet have conviction that all small- and mid-cap stocks can sustainably outperform over the next 12 months especially absent a strong and broad-based cyclical economic recovery (which is not our base case). That said, for long-term investors as well as Private Equity players, we do see a lot of value, especially in operationally intensive sectors such as Industrials.

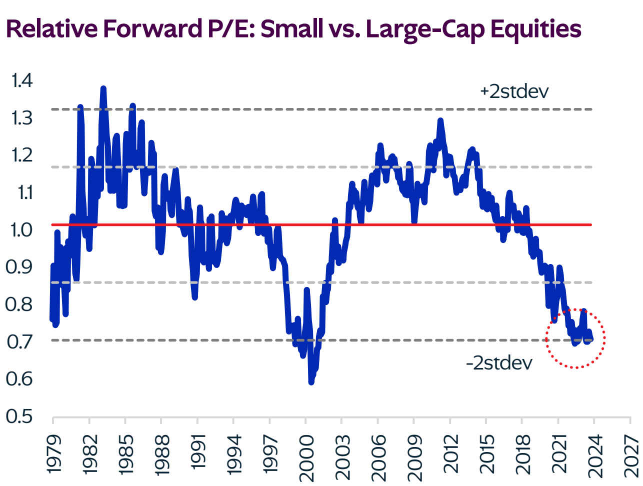
Our bottom line is that Equities, as measured by the S&P 500, represent modest value in today's market. Our base case price return target of six percent (approximately 7.5% total return) is solid in a vacuum, but not as compelling when one accounts for the broader opportunity set. Relatively elevated starting valuations limit the upside potential: consider that U.S. High Yield Credit now offers around 650 basis points of yield pick-up relative to the S&P 500 dividend yield, which is the highest differential since 2009; even U.S. Investment Grade Credit is offering 390 basis points of yield premium. As such, we continue to think Credit looks more attractive than Public Equities, especially on a risk-adjusted basis.

Exhibit 76: Small-Cap Has Close to a 40% Floating-Rate Debt Exposure, Compared to Just 10% for the S&P 500



Data as at November 30, 2023. Source: Bloomberg, JPMorgan Global Research.

Exhibit 77: Small Cap Stocks Are Technically Cheap, But We are Focused Primarily on the Ones With Strong Free Cash Flow and Limited Refinancing Risk



Data as at November 30, 2023. Source: BofA Global Research, Factset.

GLOBAL INTEREST RATES

Our regional forecasts suggest that short rates in the U.S. and Europe will fall next year as inflation cools, which should bring some relief to capital markets. Meanwhile, although we see Japan rates rising further, we think that the Bank of Japan will opt for a 'patient' approach to tightening, especially if lower global rates relieve some of the pressure on the Yen. All told, we think that at times 2024 will feel like a return to the 'old regime' of stable and falling rates, including government bonds holding their recent rally in Europe and the U.S. (as we outline below, we see the potential for bond yields to remain below our near-term forecasts for parts of next year).

That said, our instinct remains that things are not going back to the way they were. Specifically, more aggressive fiscal spending (particularly in the U.S.), supply-driven inflation from labor, housing, and commodities, and a fracturing geopolitical landscape all point to a higher cost of debt across developed markets this cycle. Against that backdrop, our long-term bond yield forecasts remain above consensus – and well above the pre-COVID 'norm' – in every market we track.

Exhibit 78: For 2024 and 2025, We Are Considering a Range of Outcomes, Highlighting the Asynchronous Nature of Capital Markets

KKR GMAA 10-Year Interest Rate Forecast and Probability, %			
	Base	**Low**	**High**
U.S.	**60%**	**20%**	**20%**
2024e	4.0%	3.0%	5.0%
2025e	4.0%	2.5%	5.0%
Euro Area	**60%**	**20%**	**20%**
2024e	2.6%	1.75%	3.25%
2025e	2.8%	1.75%	3.75%
China	**60%**	**20%**	**20%**
2024e	2.6%	2.4%	2.8%
2025e	2.5%	2.3%	2.7%
Japan	**65%**	**15%**	**20%**
2024e	1.25%	.65%	1.75%
2025e	1.5%	.65%	2.0%

Data as at November 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Against that backdrop, our long-term bond yield forecasts remain above consensus – and well above the pre-COVID 'norm' – in every market we track..

U.S. INTEREST RATES

FORECASTS: On the short end of the curve, there are no changes to our forecasts. Specifically, we continue to feel good about our call for fed funds to fall from 5.375% currently to 4.625% at YE 2024 and 3.875% at YE 2025, before falling to 3.125% over the longer term. By contrast, the consensus is calling for the Fed to cut rates to the 4.375% range in 2024 and the 3.375% range in 2025.

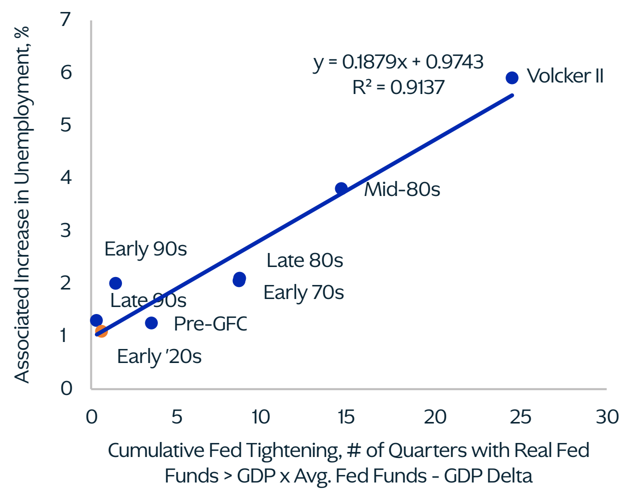
At the long end of the curve, we continue to see a divergence between tactical tailwinds and structural headwinds (including a wider term premium). Reflecting this divergence, we are taking down our 2024 10-year forecast to 4.0%, from 4.25% previously, and think bond yields could remain below this level in the coming quarters. Meanwhile, we are *raising* our bond yield forecasts for 2025 and beyond to 4.0% from 3.5% previously. The consensus is more bullish throughout our forecast period, expecting 10-year yields to fall more dramatically to 3.75% at year-end 2024 and 3.6% in 2025, before stabilizing in the mid-three percent range over the longer term.

COMMENTARY: Our optimistic take on growth assumes the Fed will not feel as much pressure to meet its full employment mandate next year, and we think policymakers remain wary of the potential for resurgent inflation across goods, housing, and labor over the longer term. Against that backdrop, we believe the Fed's primary focus in the near term will be preventing real rates (i.e., fed funds less Core CPI) from rising to levels that could threaten growth. As one can see in *Exhibit 79*, our best guess is that the 'speed limit' for real rates this cycle is the level of potential GDP growth in the economy – currently around two percent –which would imply at least three Fed cuts next year followed by a further three cuts in 2025.

That said, we also see a roughly 20% chance that growth reaccelerates (i.e., potential GDP growth is higher than we now think) and the Fed holds rates higher to deal with inflation, and an approximate 20% chance that the Fed cuts faster than what is currently priced into markets if growth deteriorates/something goes 'bump' in the financial system. One can see these estimates in *Exhibit 81*.

Exhibit 79: Potential GDP Has Historically Acted as a 'Speed Limit' for Fed Tightening Campaigns

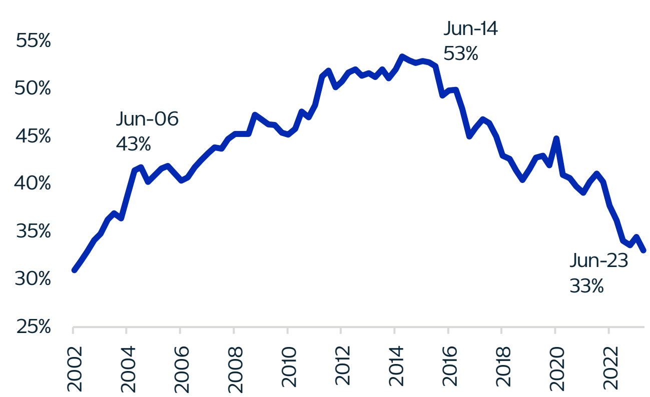
Real Fed Funds vs. Potential GDP and Unemployment



Note: Associated increase in unemployment defined as median unemployment rate in 2Y following real rates > potential GDP vs. initial unemployment rate. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

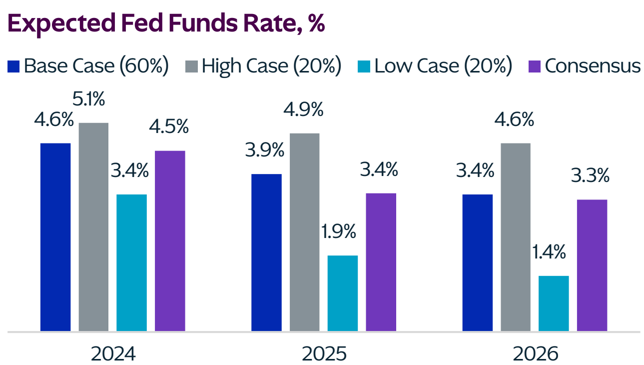
Exhibit 80: Foreign Buyers Helped Contain Government Borrowing Costs in Recent Years; That Trend Is Now Reversing, We Believe

Foreign Ownership as % of Privately-Held Treasury Debt



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

Exhibit 81: Our Fed Funds Rates Forecasts Remain Above Consensus

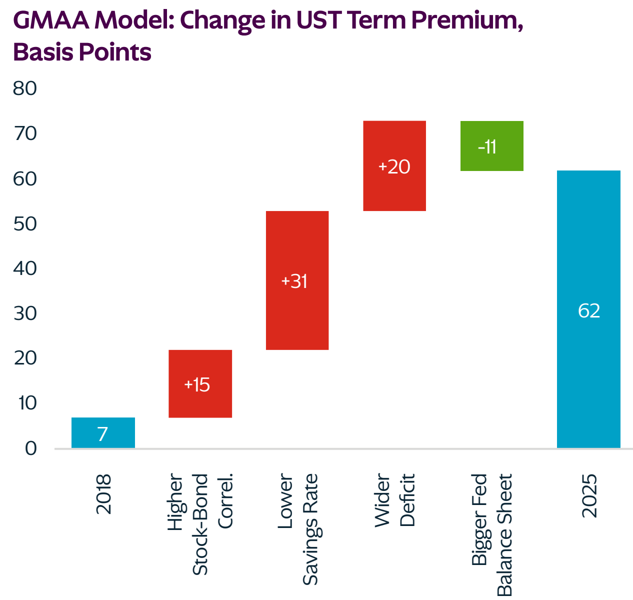


Data as at December 6, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Meanwhile, in terms of treasury yields, we have long held the view that a positive stock-bond correlation, wider fiscal deficits, a shrinking Fed balance sheet, and less of a savings 'glut' increases the term premium that investors demand to hold longer-term bonds. We now have more confidence that these effects will persist for some time, as the federal deficit has stabilized at *minus six percent* of GDP, uptake at the Fed's Bank Term Funding Program facility has reversed, and structurally lower savings rates make it harder for the U.S. to fund its deficit. As one can see in *Exhibit 82*, we estimate that these factors collectively add about +60 basis points to 10-year Treasury yields, which is why we remain above consensus in our outlook for longer-term treasury yields.

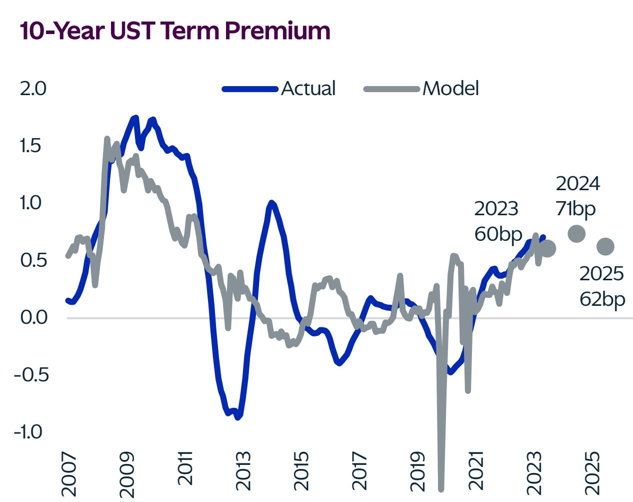
Meanwhile, in terms of treasury yields, we have long held the view that a positive stock-bond correlation, wider fiscal deficits, a shrinking Fed balance sheet, and less of a savings 'glut' increases the term premium that investors demand to hold longer-term bonds.

Exhibit 82: Our Model Suggests Positive Stock-Bond Correlations, Wider Fiscal Deficits, a Flat Fed Balance Sheet, and Lower Savings Rates Will Keep Term Premia Elevated in Coming Years



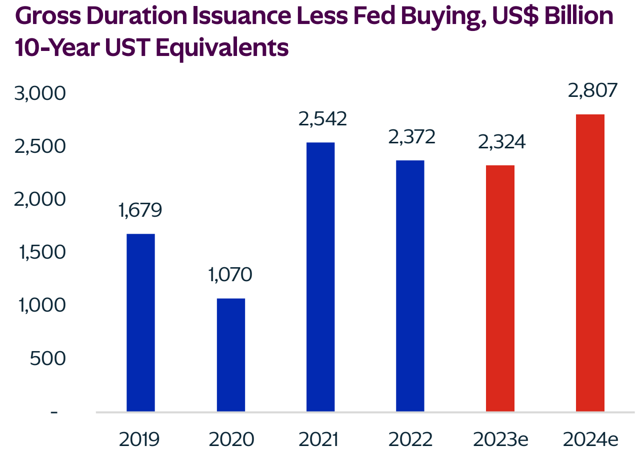
Term premium model based on Fed balance sheet as a % of GDP, rolling stock-bond correlation, level of short rates, and fiscal deficit. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 83: All Told, Our Forecasts Suggest Term Premium Will Stay Higher Than in Past Downturns



Term premium model based on Fed balance sheet as a % of GDP, rolling stock-bond correlation, level of short rates, and fiscal deficit. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 84: Net Issuance Should Accelerate Heading Into 2024

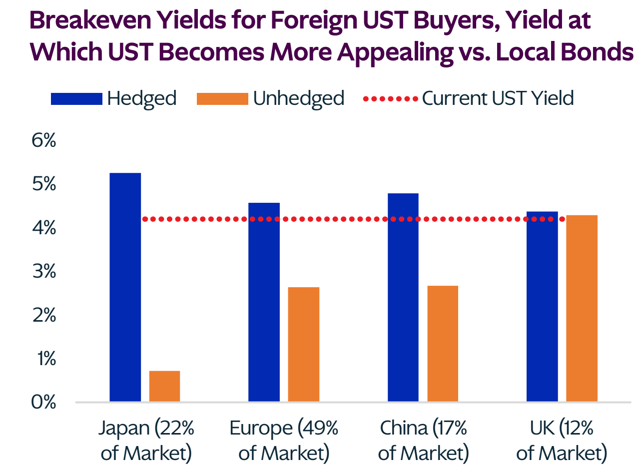


Data as at November 21, 2023. Source: J.P. Morgan.

Don't get us wrong, though: on a tactical basis, Fed easing could help sustain bond yields below four percent in the near term. Rather, our point is that a lot of portfolios may still be overweight government bonds at a time when the treasury market has undergone a structural change. Namely, **foreign investors likely no longer want to hold as many Treasury notes/bonds**, as hedging costs make U.S. Treasuries less appealing than local instruments for most countries while geopolitics limit Chinese appetite for longer-term U.S. debt. At the same time, **we continue to think that commercial banks have now stepped back from the market** in a more permanent way, particularly as they wait to see the impact of new capital requirements. All told, these shifts will make the Treasury market more price-sensitive at the margins, which we think will help set a 'floor' for how low yields can go this cycle.

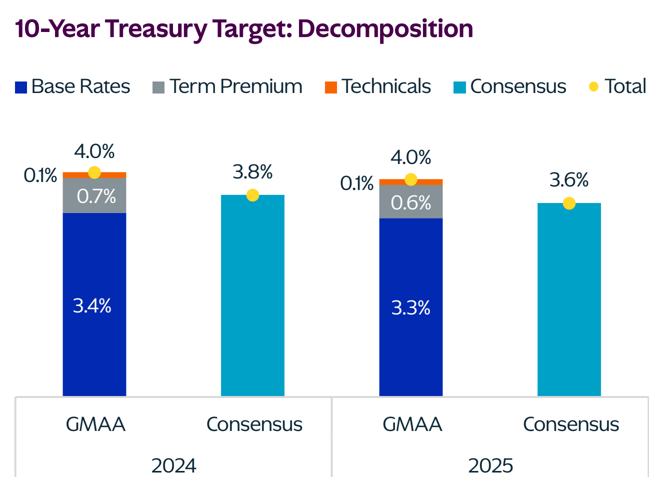
Rather, our point is that a lot of portfolios may still be overweight government bonds at a time when the treasury market has undergone a structural change.

Exhibit 85: Foreign Buyers Still Don't Want U.S. Debt Amidst Higher Domestic Yields and Elevated FX Hedging Costs, Though USTs Are Becoming More Competitive



Data as at December 1, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 86: We Think Higher Term Premia Are Now a Structural Feature of This Cycle



Data as at November 3, 2023. Source: KKR Global Macro & Asset Allocation analysis.

EUROPE INTEREST RATES

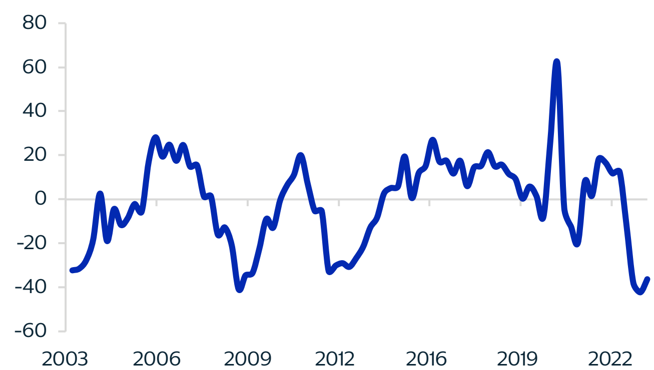
Forecasts: Our base case calls for four 25 basis point rate cuts by the ECB in 2024, taking the depo rate to three percent by year-end from four percent in 2023, followed by another two 25 basis points cuts in 2025 (with risks skewed to a more accelerated pace of cuts). If this happens, then the ECB's main policy rate, the deposit rate, would decline to our assumed neutral rate of 2.5% by the end of 2025, with some risk that the ECB overshoots and cuts to two percent. KKR's forecasts compare to the consensus forecasts of 3.2% and 2.7% at end-2024 and end-2025, respectively. For the 10-year bund, we think it will finish 2024 at 2.6%, and 2025 at 2.8%, compared to consensus of 2.3% and 2.25%, respectively.

Commentary: The key issue for investors to consider is whether the Eurozone is set to return to a positive term premium at the ten-year point or not. Meanwhile, the consensus view is that the 10-year bund will finish 2025 at 2.25%, fully 55 basis points below our expectations. The key points driving our view of a return to a positive term premium are:

- **Eurozone Demand Will Recover, Driving Rates Up** We believe the current period of weak demand in Europe is mainly a cyclical phenomenon and not permanent. Once activity returns to healthier levels, there should be an increased demand for capital, keeping rates higher and driving a positive term premium. Weak activity on the corporate side is shown quite dramatically in the ECB survey data, while consumers have for their part also shunned spending and instead driven their savings up.
- **Quantitative Tightening** The ECB's balance sheet continues to carry almost five trillion of QE holdings built up through the new Pandemic Emergency Purchase Program as well as prior programs. Against this backdrop, we believe any material decline in the 10-year bund rate below 2.5% (where we peg the ECB's neutral depo rate), could be viewed by the Governing Council as an open invitation to accelerate Quantitative Tightening, limiting the potential for rates to rally.
- **Attractive Investment Opportunities** We also see numerous attractive investment opportunities, which we believe should tempt capital away from low-risk government debt markets once risk sentiment recovers. Key to our thinking, for example, is that the gap between the earnings yield on the MSCI Europe versus the corresponding market-cap weighted government bond yield is now four percent, compared to just 355 basis points in Spring 2021 and a gap of just 40 basis points today in the U.S. Meanwhile, the trillions that are needed to address climate change, defense spending, and supply chain security, among other themes, will also put upward pressure on rates as investors face multiple demands for their capital, we believe.

Exhibit 87: Bank Lending Has Already Fallen Dramatically in Europe. As a Result, We Actually Foresee a Recovery From These Depressed Levels

ECB Bank Lending Survey: Corporate Loan Demand, Previous 3 Months

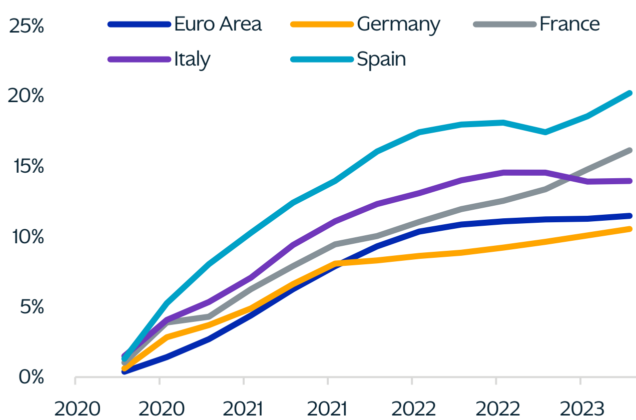


Data as at September 30, 2023. Source: ECB.

> The gap between the earnings yield on the MSCI Europe versus the corresponding market-cap weighted government bond yield is now four percent, compared to just 355 basis points in Spring 2021 and a gap of just 40 basis points today in the U.S.

Exhibit 88: European Consumers Still Have a Buffer of Excess Savings, Even in Real Terms

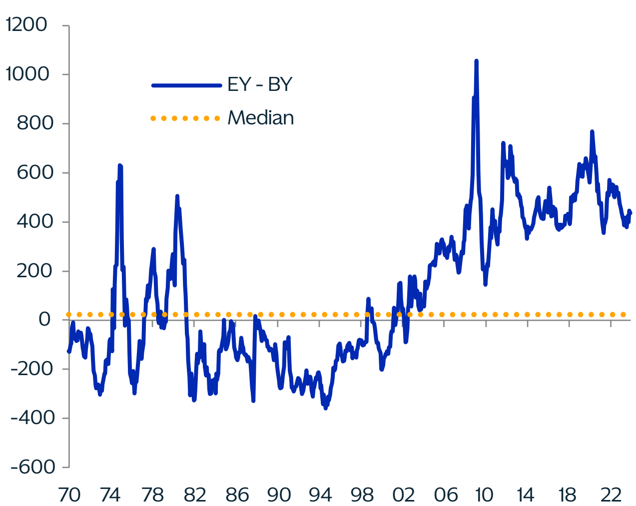
Real Excess Savings, % of 2019 Real Income



Data as at September 30, 2023. Source: ECB.

Exhibit 89: Equities Still Appear Attractive Relative to Government Bonds in Europe

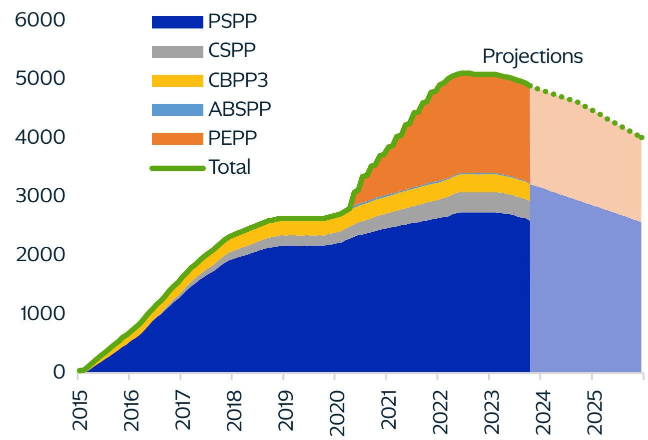
MSCI Europe Earnings Yield vs. Market Cap Weighted Bond Yield



Data as at November 22, 2023. Source: MSCI, Bloomberg, Morgan Stanley Research.

Exhibit 90: ECB Balance Sheet Contraction Should Continue for the Foreseeable Future

ECB Holdings - Asset Purchase Programes, € Billions



Note: PSPP (Public Sector Purchase Program), CSPP (Corporate Sector Purchase Program), CBPP3 (Covered Bonds Purchase Program 3), ABSPP (Asset-Backed Securities Purchase Program), PEPP (Pandemic Emergency Purchase Program). Data as at October 31, 2023. Source: ECB, KKR Global Macro & Asset Allocation analysis.

JAPAN INTEREST RATES

Forecast: We expect the BoJ to follow a more cautious path than other DM central banks when it comes to normalizing interest rate policy. Specifically, our forecasts show short rates moving from negative 10 basis points today to around 10 basis points next year, before gradually rising to 30 basis points over the longer run, which is roughly in line with the market consensus. In terms of bond yields, we see the 10-year JGB rising to 1.25% next year and 1.5% in 2025, versus consensus of one percent and 1.2%.

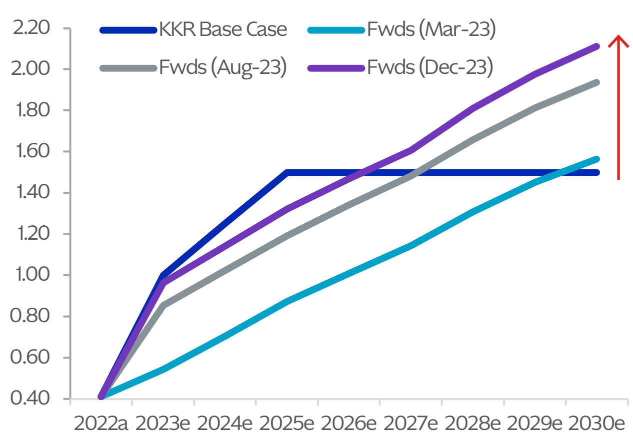
Commentary: Our base case embeds that the Bank of Japan will exit negative interest rate policy in one of the upcoming meetings, but no later than April of 2024, and then proceed more gradually into positive territory. Key to our thinking is that we now believe Japan is exiting deflation on a structural basis, which is a sea-change from the last twenty years. One can see this in *Exhibit 92*, which shows that unemployment in Japan has now fallen to levels that have historically coincided with sharp increases in wage growth and inflation.

The market has started catching up with our view *(Exhibit 91)*, but there still may be some upside to yields, especially as we think QT will proceed at a rate of about 20 trillion yen per year. With that said, we do not think JGB yields will run away, as we have seen in the U.S. and U.K. this cycle. The ownership base for Japan's debt is primarily domestic; by comparison, Japan and China are often among the largest owners of U.S. Treasuries. Moreover, the Japanese government seems attentive to the risks of supplying too much duration to markets, and as a result, we don't think it will tolerate a huge, uncontrolled surge upward in real rates.

What are the upside and downside risks to our forecasts? If inflation and growth continue to beat expectations, the BoJ may start tightening policy faster than we expect (taking policy rates towards 60-70 basis points in 2024) while accelerating QT. We assign roughly an approximate 20% chance to this scenario. Meanwhile, we see roughly a 15% chance that Japan keeps policy looser, a scenario where bond yields would remain below one percent amidst a return to slower growth and inflation.

Exhibit 91: The Capital Markets Are Now Pricing in Some Upside to Yields

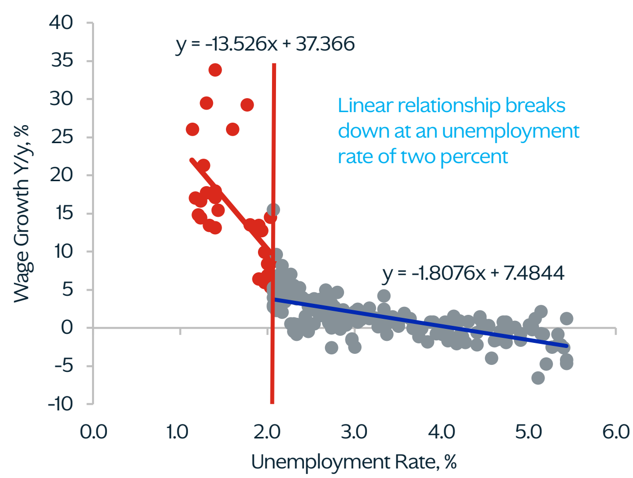
JGB 10-Year Forecasts and Forwards, %



Data as at December 8, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 92: Tight Labor Markets Are Helping to Put More Upward Pressure on Japan Inflation

Japan: Unemployment Rate vs. Wage Growth, 1Q 1971 - 1Q 2023



Data as at November 30, 2023. Source: KKR Global Macro & Asset allocation analysis.

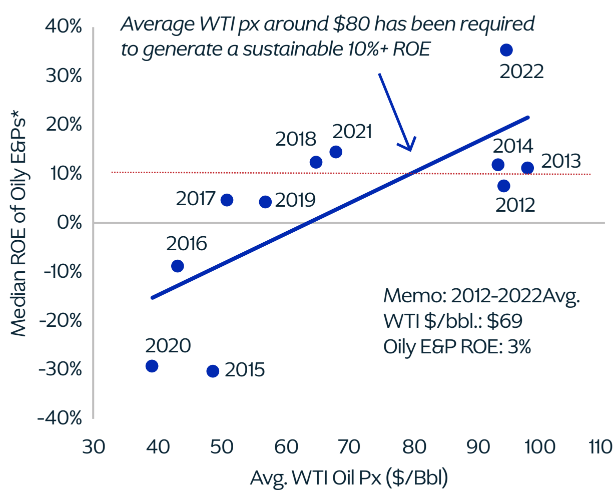
Our base case embeds that the Bank of Japan will exit negative interest rate policy in one of the upcoming meetings, but no later than April of 2024, and then proceed more gradually into positive territory. Key to our thinking is that we now believe Japan is exiting deflation on a structural basis, which is a sea-change from the last twenty years.

OIL

Forecasts: We continue to forecast that '$80 is the new $60' as a midpoint for WTI oil prices in coming years. If we are correct that shale producers are now focused on generating attractive free cash flow and return on equity, we believe that a long-term price level of around $80 is required to achieve those aspirations. This level is above futures pricing of $68 per barrel in 2025 and $66 per barrel in 2026.

Exhibit 93: In a World Where Shale Producers Are Disciplined About Return on Capital, We Think WTI Prices Are Likely to Average Around $80 Over the Longer Term

Median ROE of Oily E&Ps vs. Average WTI Oil Price, US$ Billions per Barrel and %



Median of COP, EOG, PXD, OXY, FANG, APA, PDCE, MGY, MUR, DEN, CIVI, CRC, SM, CDEV, TALO. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

That said, we do think prices may center closer to the mid-$70s in 2024 (i.e., somewhat below average relative to an $80 long-term run-rate). The key driver is our expectation that the global supply/demand balance will flirt with a modest surplus in the first half of 2024 even after the approximate 0.9 million barrels per day of additional OPEC+ 'voluntary' cuts for 1Q24. The combination of a) decelerating global demand growth from a weaker China growth impulse and muted OECD expectations; and b) stronger-than-expected non-OPEC, non-Russia supply growth (e.g., Canada, Brazil, Guyana, etc.), would likely leave little room for OPEC to boost production, keeping its spare capacity (more than four million barrels per day) high and thus capping the oil market upside.

Exhibit 94: Our Bet Is That Consensus Is Too Pessimistic About Oil Prices in the 2025-2027 Period and That the Curve Will Likely Re-Rate Higher

	GMAA Base Case vs. Futures					High/Low Scenarios	
				Δ Latest vs. Aug-23			
	KKR GMAA Dec-23	WTI Futures Dec-23	KKR GMAA vs Futures Dec-23	KKR GMAA	Futures	KKR GMAA High Case	KKR GMAA Low Case
2020a	**39**	**39**	N/A	N/A	N/A	39	39
2021a	**68**	**68**	N/A	N/A	N/A	68	68
2022a	**95**	**95**	N/A	N/A	N/A	95	95
2023e	**78**	**78**	**-1**	**-3**	**-4**	85	75
2024e	**75**	**73**	**2**	**2**	**-5**	125	65
2025e	**80**	**68**	**12**	**0**	**-5**	80	60
2026e	**80**	**66**	**14**	**0**	**-4**	100	70
2027e	**80**	**64**	**16**	**0**	**-2**	100	70

Data as at December 7,, 2023. Source: Bloomberg, U.S. Bureau of Labor Statistics, Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

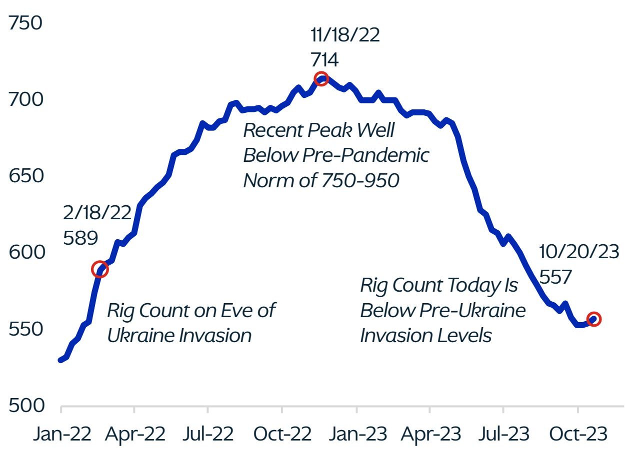
Commentary: In terms of why we hold a differentiated view in the out years for oil, we tend to focus on what we call the 'three C's' at KKR. They are as follows:

- **Shale Consolidation**: In an oil price environment like the current one, we think shale production growth today is approximately half of what one would have expected pre-pandemic. Multiple factors are driving E&P management to lean cautiously on capex plans, including long-term demand uncertainty, regulatory overhang, and a market that continues to incentivize cash flows over production growth. Exxon/Pioneer and Chevron/Hess have been two recent marquee examples of the energy consolidation trend.
- **Production Costs**: The PPI for oil and gas drilling has increased more than 20% since 2019, yet long-dated oil futures prices remain in the $60-70 range, where they centered in the 2017-19 era.

- **OPEC Control of Incremental Supply:** Modest growth of U.S. Shale production leaves OPEC in the driver's seat of incremental global supply. OPEC has demonstrated a preferred price range of $70-100, with interventions most likely to occur outside those bounds.

Exhibit 95: U.S. Shale Oil Is No Longer the Marginal Arbiter of Global Oil Supply and Price

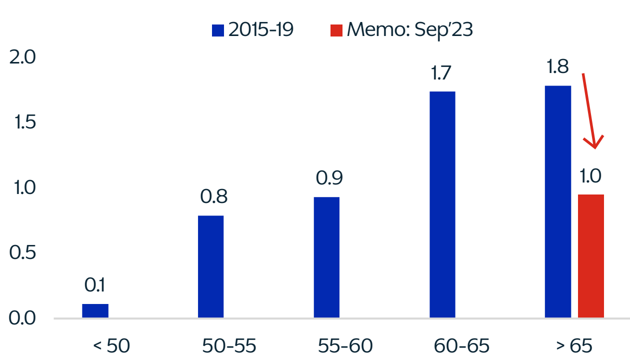
U.S. Horizontal Rig Count



Data as at October 27, 2023. Source: Baker Hughes, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 96: U.S. Production Growth Continues to Run Well Below Historic Norms Relative to the Current Price Environment

Average U.S. Crude Oil Supply Growth in Various WTI Price Ranges*, Millions of Barrels per Day

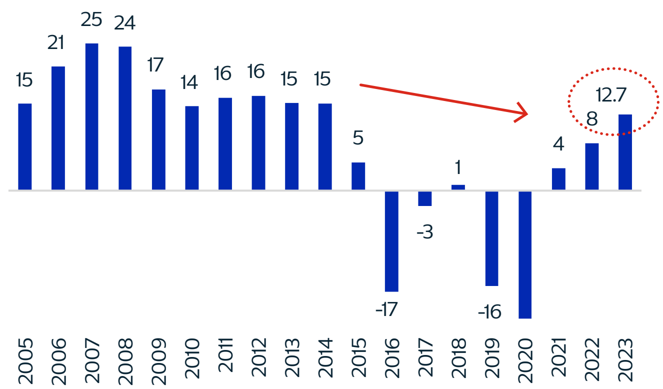


* Price leading supply growth by six months

Data as at October 31, 2023. Source: Energy Intelligence, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 97: We Expect Production Costs to Remain Elevated, as Oil Service Companies Have Significant Pricing Power and Further Scope to Expand Margins

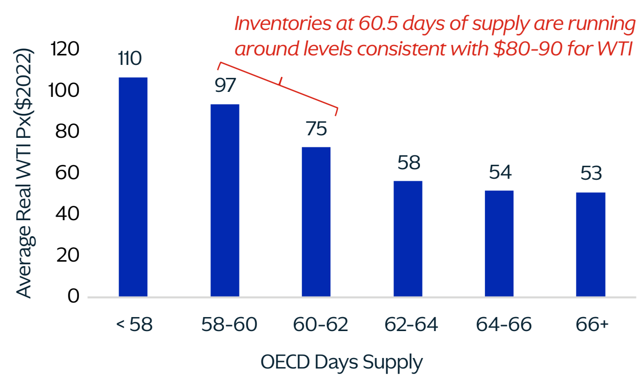
S&P 1500 Energy Equipment & Services Industry Operating Margin, %



Data as at October 31. 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 98: The Low Absolute Level of OECD Oil Inventories Today Continues to Point to WTI Prices in the $80-90 Range

Oil Prices vs. Days of Supply



Data as at October 31. 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

We continue to forecast that '$80 is the new $60' as a midpoint for WTI oil prices in coming years.

CURRENCY

As 2023 unfolded, stronger growth and our higher for longer thesis for inflation and rates have supported the dollar, even in the face of mounting deficits. Indeed, since we published our Midyear Outlook in June, the USD has been essentially flat.

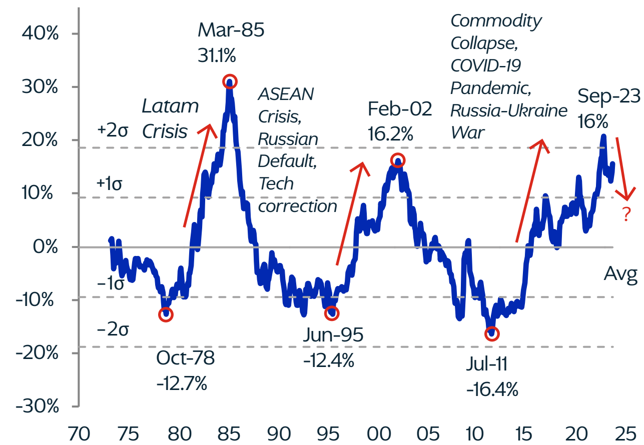
So where do we go from here? In the near term, we see scope for USD to continue moving in a sideways pattern as U.S. rates and growth remain more attractive vs. other major economies (particularly if we are right that the Fed opts for a more hawkish path compared to the ECB and BoJ). While we think this dynamic may soften at the margins next year, we do not expect to see a meaningful depreciation in the dollar until growth in the U.S. slows more decisively and employment levels start to come down.

Thereafter, we maintain our view that structural headwinds will weigh on the dollar including elevated valuations, de-dollarization of trade flows, and the lagged impact of large fiscal deficits (which help boost rates/growth in the near-term but tend to lead to a weaker USD over time). Said differently, the dollar is benefitting from very high rates and surprisingly strong growth; as this situation normalizes, we expect more 'structural' concerns, including heightened geopolitics, to increasingly come to the fore.

In terms of key currency crosses to watch, we continue to think that JPY looks especially appealing this cycle. Indeed, our colleagues Frances Lim and Changchun Hua estimate that JPY could strengthen materially in coming years as rate differentials narrow and Japan structurally exits deflation. At the same time, we still look for further appreciation in the Euro back towards 1.15 or higher in 2024, and we still like some of the higher carry EM markets, especially those that have their fiscal houses in order.

Exhibit 99: We Look for the USD to Hold Firm Until Growth Slows and Unemployment Ticks Up. Thereafter, We Think the U.S. Dollar Could Retreat Meaningfully

Real Broad Trade - Weighted U.S. Dollar REER: % Over (Under) Valued



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

> In terms of key currency crosses to watch, we continue to think that JPY looks especially appealing this cycle. Indeed, our colleagues Frances Lim and Changchun Hua estimate that JPY could strengthen materially in coming years as rate differentials narrow and Japan structurally exits deflation.

SECTION IV

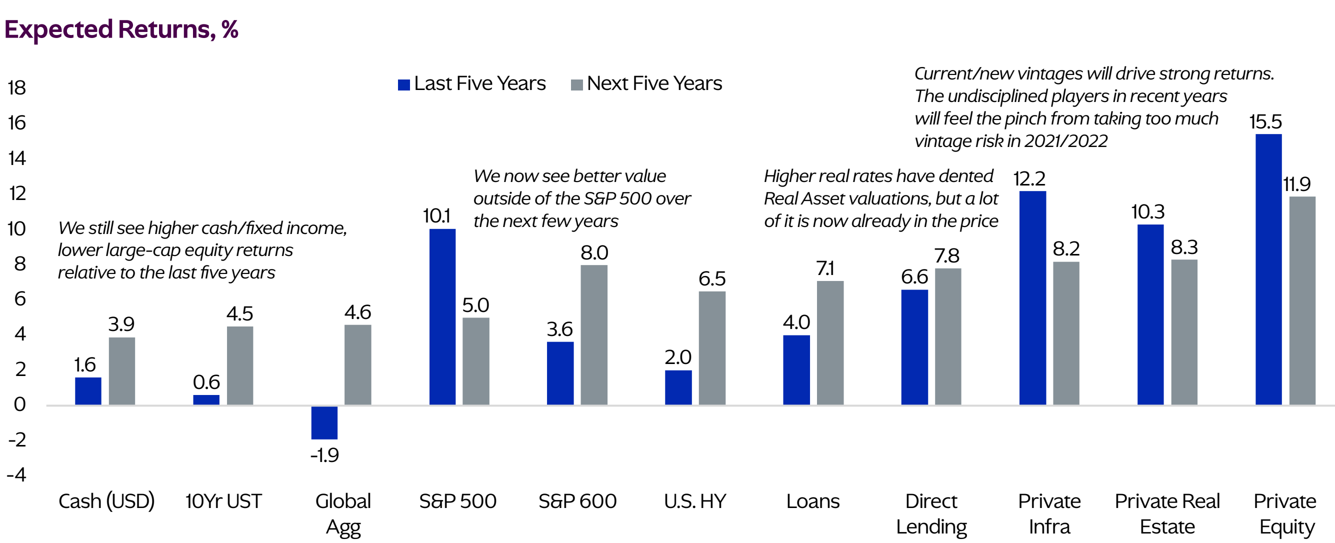
Frequently Asked Questions

QUESTION NO. 1

How are you thinking about expected returns?

Given our team's focus on asset allocation – including the approximate $26 billion of capital we manage on the firm's balance sheet – we have spent a lot of time pressure-testing our assumptions around expected returns across asset classes. See below for our key takeaways, but the bottom line is that we are in a year of 'transition' within our Regime Change thesis. Specifically, the public markets are still adjusting to an environment of higher-for-longer rates, and parts of the next twelve months will feel like a typical downturn (including a potential fixed-income rally). At the same time, however, private asset valuations have now compressed quite a bit in recent quarters, earnings likely bottomed this year, and the potential to create value through operational improvement is significant, in our view. As such, we firmly believe that investors who pull back on deployment today will miss out on some very compelling vintages. Against this backdrop, we think now is still a time to 'Keep It Simple', with more of a bias towards quality and less need to stretch on risk, while still deploying thematically.

Exhibit 100: We Continue to Think That Returns Will Look Different Relative to the Past Five Years



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

Exhibit 101: How Our Forecasts Have Changed

Asset Class	Next 5 Years Return, %, Nov-23	Next 5 Years Return, %, Aug-23	Delta, Basis Points	Key Dynamics	Comments
Cash (USD)	3.9%	3.7%	+20	We see slower Fed cuts in 2024 versus the consensus view	We think that Cash can act as an important diversifier, especially for allocators who are using more Alternatives this cycle
10Y UST	4.5%	5.0%	-50	We see UST yields staying higher for longer	We advocate leaning into duration only selectively, as bonds may not rally as much this cycle
Global Agg	4.6%	4.8%	-20	Closely linked to UST forecast, but a more supportive backdrop vs. Treasurys	We think it makes more sense to lend to corporates vs. over-indebted governments this cycle
S&P 500	5.0%	5.1%	-10	Top-12 AI-related stocks have helped lift index-level valuations	Limited upside to multiples; we favor cash-flowing equities with strong EPS outlook
U.S. HY	6.5%	6.3%	+20	More confidence that yields are compensating investors for default risk	We think that HY performs better this cycle, given more collateral and higher ratings
U.S. Loans	7.1%	6.8%	+30	Wider spread and higher average SOFR	We are constructive on loans, but think the best way to gain exposure to this space currently may be through high-quality CLO liabilities
Direct Lending	7.8%	8.3%	-50	Competition has narrowed spreads modestly	Illiquidity premium + lower losses = outperformance, but cost of capital is normalizing
Private Infra	8.2%	8.2%	-	The asset class has proved to be an effective inflation hedge	We remain constructive as a play on our collateral-based cash flow thesis
Private Real Estate	8.3%	8.5%	-20	Roughly parallel shift in entry/exit cap rates	Cap rate widening has not been even across sectors
Private Equity	11.9%	11.9%	-	Current/new vintages will drive returns, but more of a drag from undisciplined PE investments made during 'go-go' years	This is a good time to have a control position in equities

Data as at November 30, 2023. Source: Bloomberg, BofA, Cambridge Associates, Greenstreet, KKR Global Macro & Asset Allocation analysis.

- **We continue to think that this is a good time to be a lender…**No doubt, higher risk-free rates mean that investors can now be well compensated for sitting higher in the capital structure. One can see this in *Exhibit 103*, which shows that HY yields now exceed S&P 500 dividend yields by one of the widest margin since 2009. Importantly, we are not forecasting a sharp widening of credit spreads this cycle; a key to our thinking is that defaults will not experience a 'full' spike as in past downturns, as the quality of High Yield has improved significantly.

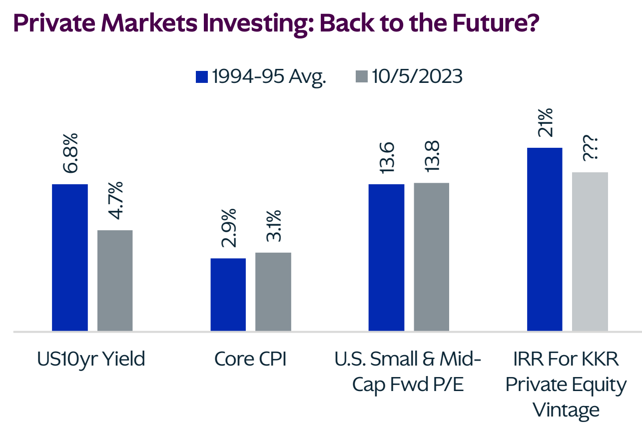
- **Within one's credit portfolio, we think this may be the time to pursue more balance between fixed vs. floating assets.** To be sure, we also still like cash as an uncorrelated asset class, but we think it makes sense to add some duration, too, as there is a compelling opportunity to lock in cash-like yields over a multiyear period.

- **Within private markets, the cost of capital has started to normalize.** The excess return earned on Private Credit is still quite compelling (in general, we think private credit outperforms HY and Loans by about +100 basis points or more over the next five years), but we do acknowledge that we are starting to see more competition, which is leading to spread compression in certain instances. Hence, we maintain a preference to overweight areas such as Asset-Based Finance, Structured Credit, and even parts of Real Estate Credit. Meanwhile, private market valuations now look more reasonable compared to public markets. As we detail below, we think that the market is currently underestimating the opportunity to create operational improvements, especially in carve-out and bolt-on acquisitions.

- **Today is not necessarily a good time to buy passive, non-control positions in Equities.** As we show in *Exhibit 100*, we think the most disappointing asset class for investors this cycle may actually be large public companies that are exposed to slower growth. Meanwhile, there are a lot of smaller cash flowing companies in the S&P 600 that are trading at deeply discounted valuations at a time when market breadth is set to improve. This backdrop is one of the reasons we look for more public-to-private transactions in 2024.
- **We still see a world of higher real rates, but certain parts of real asset prices have largely discounted this with more attractive entry points for Real Estate and Infrastructure.** Cap rates and infrastructure price/book have improved meaningfully in recent months, and now in some instances are at levels that can offset the long-term impact of higher real bond yields, we believe. Within Infrastructure, we are most focused on opportunities to create core-type assets linked to our major themes (digitalization, the energy transition, and security of everything). Within Real Estate, meanwhile, we think there is a lot investors can do without going too far out on the risk spectrum (e.g., today is not the time to make a big bet on return-to-office), as cap rates have widened in a lot of thematic and stable sectors like housing and industrials/warehouses.

The impact of Fed tightening on existing PE deals may be both gentler and more gradual than many today fear, with pain largely being concentrated in companies that took on too much leverage when rates were at zero and did not hedge out their floating-rate exposure.

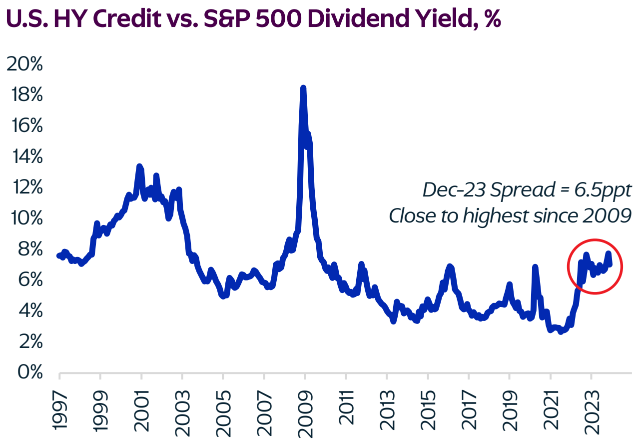
Exhibit 102: We Have Often Seen Very Strong PE Vintages in High-Rate Environments



Note: October 5 represents annualized rate over April-August (latest four months for CPI. Small/Mid-Cap is aggregate of S&P 400 (Mid-Cap) and S&P 600 (Small-Cap). 1994-95 represents average IRR for 1993 Fund (23.6%) and 1996 Fund (18.0%). Data as at October 5, 2023. Source: Bloomberg, Cambridge Associates, KKR Global Macro & Asset Allocation analysis.

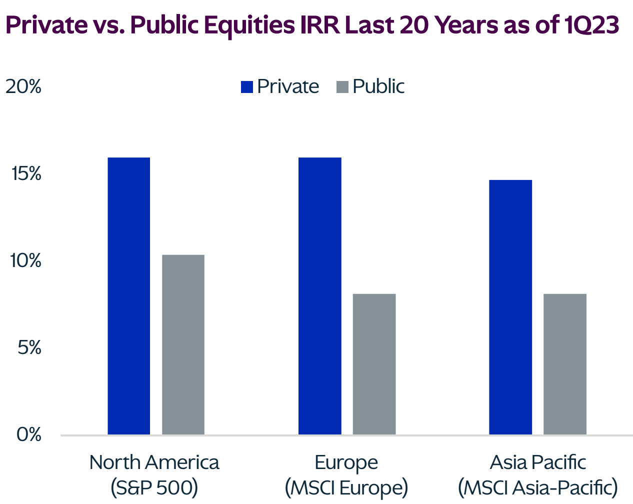
Interestingly, out of all the asset classes we cover, we have gotten the most questions on Private Equity, and specifically, whether we think the 'model' for investing in this strategy will still work in an environment of higher rates. No doubt, we do believe that the current macroeconomic landscape will require a different playbook relative to what worked over 2010-2019. We think this reality has the potential to surprise investors who 'grew up' investing in an environment of stable and falling rates. However, as we detail below, we are likely more optimistic than the consensus about the outlook for Private Equity, despite interest rates at today's levels. Key to our thinking: sponsors have become more thoughtful about leverage, the headroom for operational improvement is quite attractive these days, and 'patient capital' is in high demand in an era where IPO markets are no longer receptive to unproven growth names. In our view, we are in an environment where late-stage startups are struggling to secure funding while IPO markets are only open for successful and thematic businesses with a proven track record. We think PE can thrive as a source of 'patient capital' in this market, helping to bridge the gap for cash-flowing businesses that have room for operational improvement.

Exhibit 103: For Liquid Investors, a Tactical Overweight to Credit Relative to Equities Makes Sense to Us



Data as at December 6, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 104: Across Geographies, Private Equity Returns Tend to Exceed Public Equity Returns

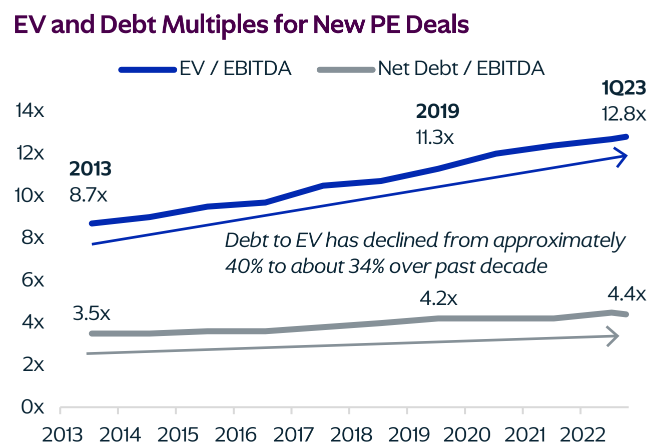


Note: Public Equities IRR is calculated as a modified public market equivalent (mPME), which is defined as the returns that an investor would achieve by deploying the PE cash flows into public equity markets. Data as at September 30, 2022. Source: Cambridge Associates, Bain, Bloomberg, KKR Portfolio Construction analysis.

To this end, we think that investors need to break the debate down into three areas of analysis:

Capital Structure: The equity cushion in most of the recent deals is actually much higher than in the past. For example, in 2013, debt as a percentage of total capital structures reached about 40%. Today, by comparison, that percentage is closer to 30%. In addition, sponsors have become more sophisticated about 'smoothing out' the impact of Fed policy decisions: consider that maturities on debt structures have been materially extended from around 6.6 years for the average HY borrower in 2019 to nearly 8 years as of 2023, while a larger share (perhaps about 40%) of loan borrowers have hedged floating-rate interest exposure. Against that backdrop, we think that the impact of Fed tightening on existing PE deals may be both gentler and more gradual than many today fear, with pain largely being concentrated in companies that took on too much leverage when rates were at zero and did not hedge out their floating-rate exposure.

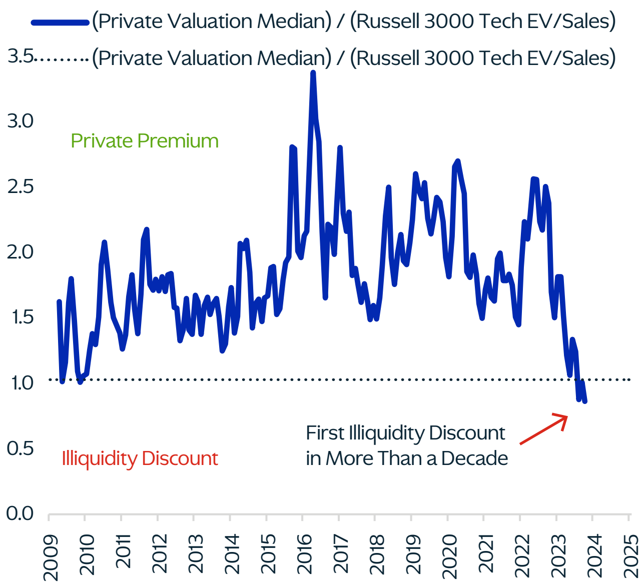
Exhibit 105: While Prices Did Increase, Managers Have Been More Disciplined About Leverage This Cycle



Data as at March 31, 2023. Source: Burgiss.

Exhibit 106: We Are Starting to See an Illiquidity Discount Emerge in Private Markets, a Backdrop Which Is Consistent With Our Vintage Analysis

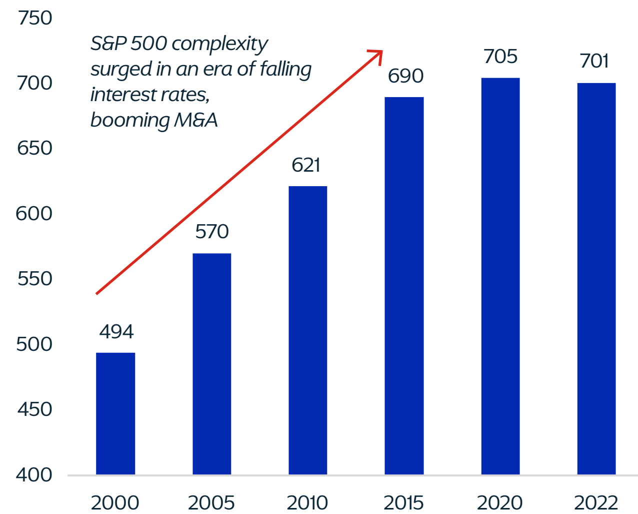
VC and PE Median Valuation/Sales of Completed Transactions vs Public EV/Sales (x)



1.0 equals parity and differentiates between premium and discount. Data as at October 31, 2023. Source: Bloomberg, Pitchbook, Morgan Stanley.

Exhibit 107: Public Companies Have Become More Complex, Which Is Why We Are Seeing More Carve-Outs Occur

Number of Subsidiaries per S&P 500 Company



Data as at December 31, 2022. Source: Factset.

Value Creation: The other offset to higher rates is that the private equity industry is not sitting still. The math is quite simple. Companies need to create enough value through operational improvements, acquisitions, and strategic changes to more than offset the decline in cash flow from higher rates and/or a higher cost of capital. So, the more levers one has to pull, the better the opportunity is.

Against that backdrop, we think PE companies may have a strategic advantage over larger firms in the public markets, which in many cases have become too complex, with a growing number of undermanaged subsidiaries that cannot justify the current cost of capital. One can see this in *Exhibit 107*. In our view, the potential opportunity set for PE-led carve-out transactions among public conglomerates is quite significant this cycle.

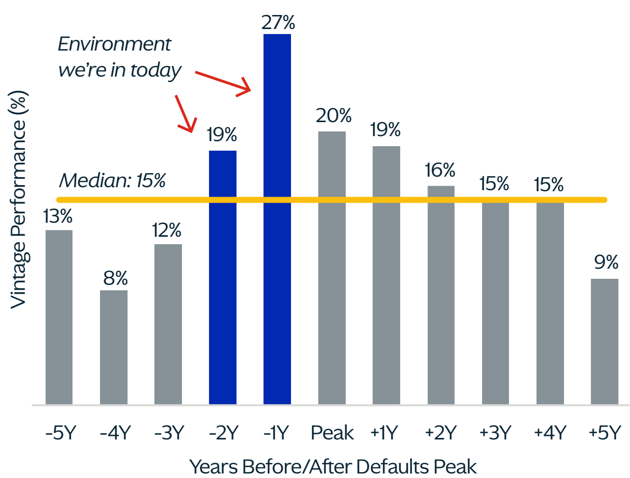
Exit Multiples: This area is the one we think deserves the most scrutiny. Our simple math indicates that exit multiples should fall – in theory and all else being equal – as rates have increased. However, we also note that public markets have been willing to pay higher multiples for companies that are big, thematic, and 'simple' rather than complex. On the other end of the spectrum, there are a lot of VC-backed firms that cannot find the capital needed to scale and are raising at lower multiples. That 'gap' offers a lot of potential for PE as a source of 'patient capital' that can partner with management teams to drive operational efficiency and create profitable companies that can command higher multiples in public markets.

Our bottom line: With both interest rates and prices starting to normalize, we think existing PE vintages may hold up better than many investors currently expect. Maybe more importantly, we believe current vintages will ultimately deliver strong performance, as history should be on our side. Indeed, as we show in *Exhibit 108*, de-leveraging cycles are often productive times to be deploying capital. Moreover, dislocations around rates can often create opportunities, which is what we saw during the bond market sell-off in 1994 (probably the most similar historical comparison to today).

Overall, though, as we show in *Exhibit 100* in our expected returns discussion, we do believe we are entering a lower return world where the coupon on fixed income can serve as an important driver of overall total returns, which was certainly not the case over the past decade. Against this backdrop, we want more operational improvement stories, especially across Private Equity; we want to favor capital structures that have plenty of equity cushion when considering a preferred, convertible, or convertible preferred. Finally, we continue to advocate for collateral-based cash flows that are linked to nominal GDP growth. Within this universe, Real Estate Credit, Infrastructure, and Asset-Based Finance appear quite interesting to us.

Exhibit 108: Deleveraging Cycles Have Coincided With Some of the Best PE Vintages

Median Net IRR for PE Vintages Raised During Default Cycles, 1987-2014



Data as at March 31, 2023. Source: Federal Reserve Board, Preqin, KKR Global Macro & Asset Allocation analysis.

The current environment is a supportive one for multi-asset credit portfolios with an ability to toggle between different asset classes as the macroeconomic environment continues to evolve.

QUESTION NO. 2

Given the substantial pullback in bank lending, where do you see relative value in Credit?

Similar to what we laid out in our 2023 Outlook, we remain bullish on Credit. Last year we felt – on the margin – that Private Credit had an edge in terms of risk-adjusted return. This year, by comparison, we think one's approach should be much more nuanced. Key to our thinking is that, as we show in *Exhibit 111,* the dispersion of returns across many Credit strategies has narrowed meaningfully.

Not surprisingly, against that backdrop, we think the current environment is a supportive one for multi-asset credit portfolios with an ability to toggle between different asset classes as the macroeconomic environment continues to evolve. To this end, we want to provide more details on how our Portfolio Construction team is thinking about relative value across the three main 'buckets' of credit that we focus on (HY, Loans, and Private Credit).

- **Within Private Credit, we think Asset-Based Lending is becoming more compelling.** While Direct Lending is feeling a little more competitive these days, there is still a shortage of capital in sectors traditionally dominated by smaller banks, including asset-backed consumer loans and commercial real estate lending. This backdrop is a positive one for Asset-Based Finance. Importantly, our high-level view is that defaults, rather than recovery rates, will likely be the main driver of credit losses this cycle. As such, owning some collateral could prove to be fortuitous in the macroeconomic environment we envision.
- **We think many parts of High Yield are starting to become more competitive versus Levered Loans.** As we indicated earlier, we are of the view that all-in yields are likely near peak levels, as cooling inflation means the Fed will be more inclined to cut rates in response to economic weakness and/or financial stress. Perhaps more importantly, although spreads still appear somewhat narrow in HY, they look increasingly competitive versus Loans *(Exhibit 112)*, especially when one recognizes that there are a lot of deeply discounted

HY bonds that will likely be redeemed one plus years before maturity. Finally, we continue to emphasize that the quality of the HY universe has improved materially versus past cycles, which should help reduce the chance of a severe default cycle. One can see this in *Exhibit 109*, which shows a significant improvement in the percentage of secured securities. Specifically, about half of new issue HY is now secured, up from just 20-30% before the pandemic.

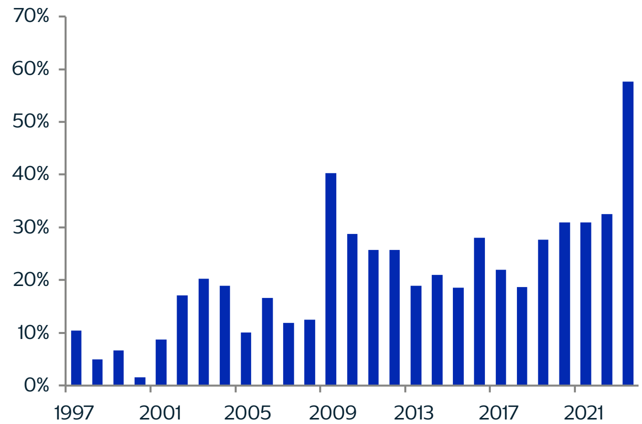
- **To be clear, we still like Loans, but our preference is to play this idea through CLOs, which we think offer compelling value.** We still think the best way to express our 'Keep It Simple' view is likely through higher-quality CLO tranches, as diversification benefits and credit enhancement matter more in a late-cycle environment where idiosyncratic risks are elevated (particularly when it comes to refinancing).

Pulling it all together, our basic view is that the next twelve months will offer pockets of opportunity across credit assets, including a chance to supplement superior returns in Private Credit with a 'liquid sleeve' for portfolios if refinancings slow and maturities extend. Importantly, however, higher risk-free rates mean that this is a time to 'Keep It Simple', which is why we generally like staying higher in the capital structure, having stronger protections in the event of a default, and taking advantage in certain instances of convexity in HY.

Pulling it all together, our basic view is that the next twelve months will offer pockets of opportunity across credit assets, including a chance to supplement superior returns in Private Credit with a 'liquid sleeve' for portfolios if refinancings slow and maturities extend.

Exhibit 109: The Quality of the High Yield Universe Has Improved Meaningfully in Recent Years

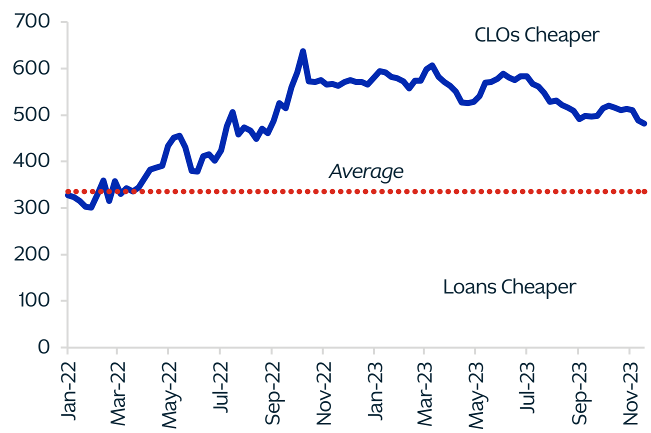
Secured % of New Issue



Data as at November 28, 2023. Source: BofA Global Research.

Exhibit 110: We Still Like Loans, But Think the Diversification Benefits of CLOs Make Them More Attractive Right Now

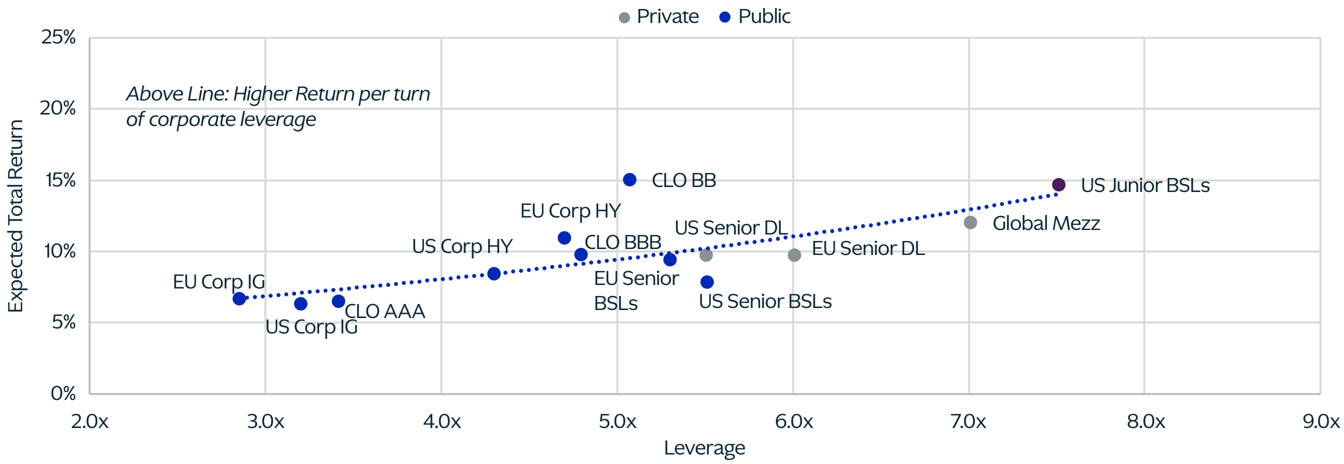
Spread Differential: U.S. CLO BB Minus LLI BB, Basis Points



LT average computed since 2012. Data as at November 24, 2023. Source: LCD, GBR analysis.

Exhibit 111: We Actually Think Leveraged Credit May Offer a Competitive Risk/Reward Versus Direct Lending at This Point in the Cycle

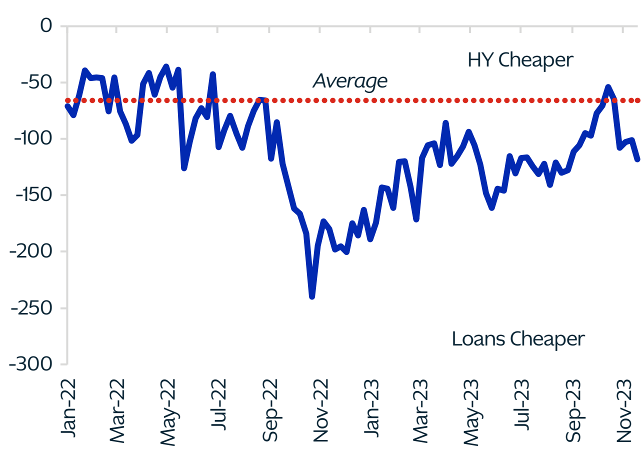
Credit Strategies - Expected Total Return vs. Leverage



Note: In contrast to five-year expected returns shown above, our credit strategies model shows returns over the lifetime of an investment. Data as at November 30, 2023. Source: LCD, KKR GBR analysis.

Exhibit 112: HY Is Starting to Approach Fair Value Versus Loans, Particularly When One Accounts for Discounted Prices

Spread Differential: U.S. HY B Minus LLI B, Basis Points



LT average computed since 2012. Data as at November 24, 2023. Source: LCD, GBR analysis.

QUESTION NO. 3

What is your outlook for margins, particularly as nominal GDP growth is slowing?

Given our call for earnings to recover while nominal GDP continues to slow, we wanted to provide some historical context for how these key economic indicators tend to correlate with each other:

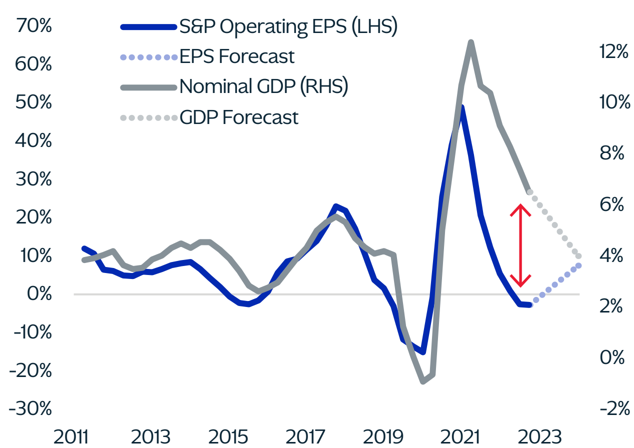
Point #1: It is not unusual for GDP to trough after EPS, which is what we believe will occur this cycle... To support our point, we looked at seven cyclical troughs in earnings going back to 1979 and found that, on average, GDP does continue to slow after troughs in earnings. Looking at the details, nominal GDP slowed post the EPS trough in four of the seven instances we considered, including 1991, 2001, 2009, and 2016. In those instances, the GDP trough lagged the EPS trough by 2.5 quarters on average, and nominal GDP growth slowed by an average of 66 basis points following the EPS trough. On the other hand, in 1982, 1998, and 2020, GDP improved alongside the recovery in earnings.

Some general characteristics of cycles where GDP growth troughs after EPS:

- GDP troughing after EPS has been a feature of more recent cycles. It has happened every downturn since 2001, barring only 2020, which of course was a very unusual cycle.
- GDP troughing after EPS seems more likely in cycles where USD is at a cyclical peak (e.g., 2001). The strong USD pressures EPS and is an indicator that the U.S. domestic environment is stronger than the foreign environment (which is a relative headwind for SPX EPS, given its substantial foreign sales exposure.)

Exhibit 113: It Is Not Unusual for GDP to Trough After EPS, Which Is What We Believe Will Occur This Cycle

Operating EPS vs. Nominal GDP, Trailing Twelve Months, % Change, Y/y

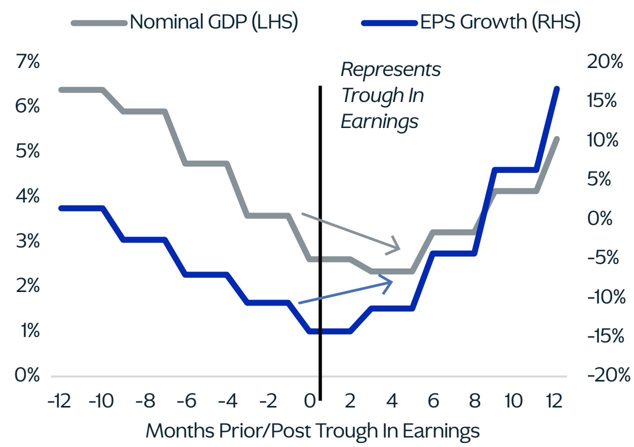


Data as at September 30, 2023. Source: Bloomberg.

GDP troughing after EPS seems more likely in cycles where USD is at a cyclical peak (e.g., 2001).

Exhibit 114: Nominal GDP Typically Slows for Another 2.5 Quarters Following a Bottom in Earnings

Nominal GDP Growth, % Change, Y/y, Following Bottom in Earnings



Periods considered in the analysis include Dec 1982, Sep 1991, Dec 1998, Dec 2001, March 2009, June 2016, Dec 2020

Data as at September 30, 2023. Source: Bloomberg.

Point #2: ...That said, the magnitude of the lag and divergence we are proposing this cycle is admittedly outsized. Of the seven prior cycles we studied, the maximum time lag between EPS versus GDP troughs was about nine months. The maximum deceleration in nominal GDP following EPS troughs was 2.5 percentage points in 2009. By comparison, the sort of slowdown we're proposing this cycle is much more pronounced, with fully 12 months between troughs, and fully 3.4 percentage points of nominal GDP deceleration following the EPS trough in 2Q23.

Point #3: One reason we are proposing an unusual path for earnings and GDP this cycle is because it's already had a very unusual beginning. What we're suggesting is the normalization of a divergence that opened in 2022 (*Exhibit 113*), when earnings growth decelerated significantly (to 2.3% from 32.2% due to margin contraction) while nominal GDP remained strong (falling slightly to 9.1% from 10.7%). We think it makes sense that earnings can hook back up while nominal GDP slows in 2024, given this recent divergence (*Exhibit 114*). Put differently, we think that there will be a broad opportunity set of public companies that can grow earnings in 2024. As such, a slowing nominal GDP growth environment is not necessarily as much of an impediment to an earnings recovery, in our view.

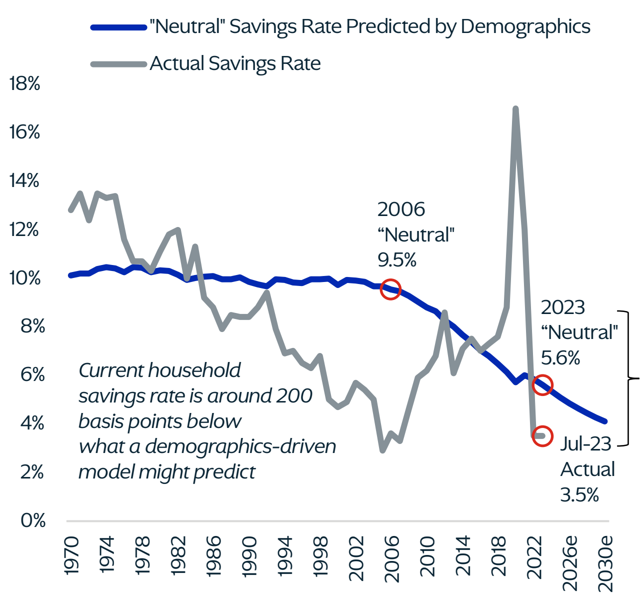
QUESTION NO. 4

How are you thinking about the U.S. consumer?

As we describe in our economic update section above, we do think that U.S. consumer spending will slow heading into 2024. Key to our thinking is that the drawdown of COVID-era 'excess' savings *(Exhibit 117)* and a softer labor market will leave U.S. households more susceptible to growth shocks at a time when financial conditions are still tightening, resulting in a mild downturn and a higher unemployment rate. We also see other incremental headwinds to growth heading into year-end, including student loan repayments (although we think the impact on aggregate consumer spending should be fairly modest) and a drop in real fiscal transfers.

Exhibit 115: In Aggregate, Consumer Spending Is Not as Stretched as One Might Think

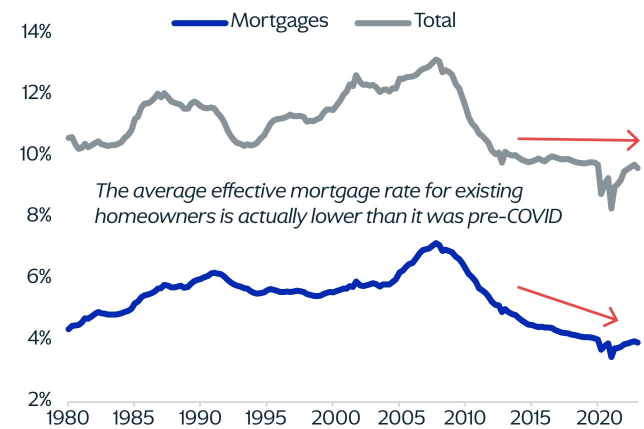
Aging Demographics Are Pushing Down the 'Neutral' Savings Rate



"Neutral" savings rate is the weighted average predicted by the mix of households by age. Source: KKR GMAA analysis of findings from "Lifecycle Patterns of Saving and Wealth Accumulation." Feiveson & Sabelhaus. Federal Reserve Board, 2019.Data as at November 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Exhibit 116: Homeowners' Interest Coverage Ratios Remain Quite Manageable

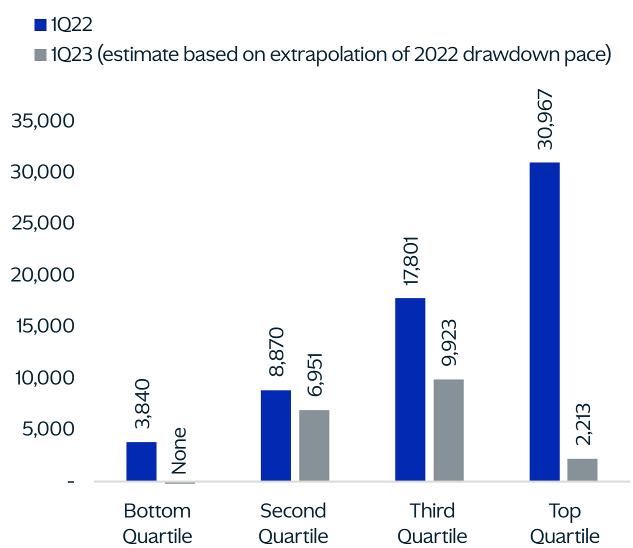
Debt Service Costs as % of Disposable Income



Data as at March 31, 2023. Source: Federal Reserve Board.

Exhibit 117: Depleted Consumer Savings Support Our Call for a Downturn in 2024, and Will Weigh on Household Spending at All Levels

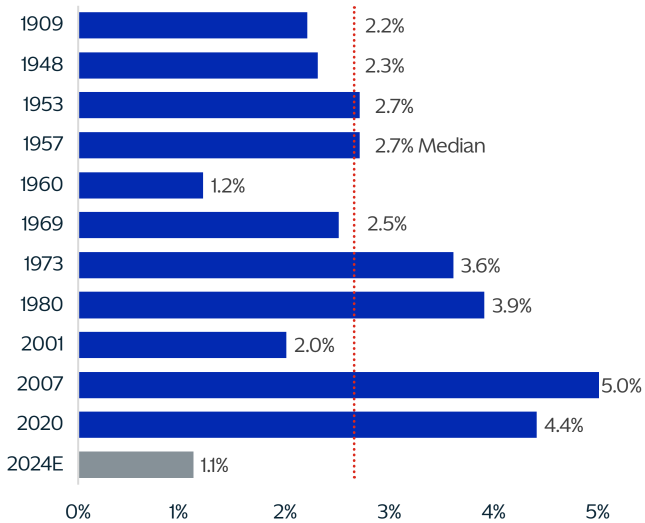
Excess Savings Per Household By Income Quartile ($)



Data as at March 31, 2023. Source: Federal Reserve, KKR Global Macro & Asset Allocation analysis.

Exhibit 118: However, Despite Our Recession Call, We Do Not Think Unemployment Will Surge This Cycle

Full-Year Change in U.S. Unemployment Rate from Trough to Peak, %

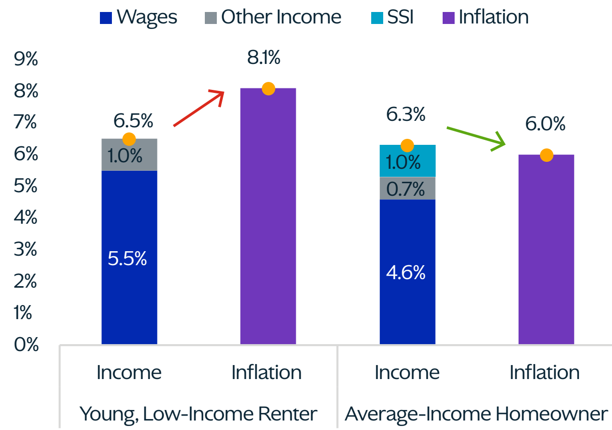


Data as at August 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

That said, we do not expect an especially severe cycle when it comes to consumer spending, with growth slowing to the low single-digit range from three percent currently. Top of mind for us is the fact that total U.S. employment is still running about two to three percent below trend (with a lot of job growth coming from non-cyclical industries like Healthcare and Government, as shown in *Exhibit 120*), which should help keep a lid on jobless rates. In fact, our forecasts have unemployment rising just +110 basis points this cycle on a full-year basis, versus +270 basis points in a 'typical' recession *(Exhibit 118)*. Moreover, while current consumer savings rates are probably too low at approximately four percent, we do not see them returning to the seven to eight percent range that prevailed pre-COVID. Instead, our demographic models point to a sustainable 'neutral' savings rate in the five to six percent range *(Exhibit 115)*. Our bottom line is that while we will very likely see more normalization from today's starting point of very high spending and very high employment, the pullback may not be as harsh as in past cycles.

Exhibit 119: The Worst Declines in Real Incomes Have Been for Renters Who Do Not Receive Social Security

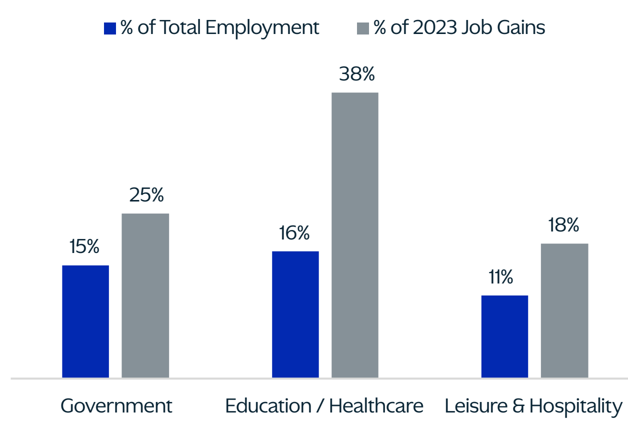
Income and Inflation Growth in 2022



LH column inflation: CPI reweighted to cons. basket for 1st quintile households, with entire shelter expense (27% of basket) attributed only to rent (6.4% inflation in 2022). RH column inflation: CPI reweighted to cons. basket for 3rd quintile households, with shelter expense (34% of basket) attributed to fixed mortgage payments (0% growth in 2022). LH column income mix: under-25 consumer income mix (88% wages, 0% SSI, 12% other). RH column income mix: median-income consumer income mix (73%/18%/9%). Income growth rates: 6.3% low-end wage growth, 6.2% median wage growth (per BLS), 5.7% growth, 8% other income growth. Data as of December 31, 2022. Source: U.S. Bureau of Economic Affairs, U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 120: Over 75% of Job Growth Is Coming from Just Three Sectors This Cycle

Share of Employment and Job Growth by Sector

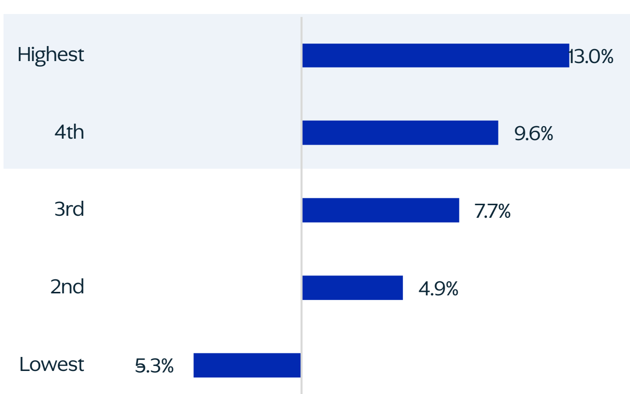


Data as at November 30, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

We think high-income consumers will be a particular source of strength. First, these consumers have been the largest beneficiaries of higher asset values, which makes a big difference if we are right that housing and equities do not give up their gains in the near term. Second, despite higher mortgage rates, the reality is that most homeowners are paying an effective mortgage rate that is *lower* than it was before COVID (whereas renters have seen shelter costs rise +20% over the same period). As a result, many high-income consumers are seeing their net interest spread improve, not decline, in a rising rate environment. Finally, we think that the biggest change to labor market dynamics at the margin may actually be in lower-paying industries, which have so far been insulated from layoffs as employers have backfilled jobs. The good news for the economy as a whole is that high-end consumer spending tends to be the strongest indicator for aggregate consumer spending, given the fact that households earning $100,000 or more per year typically account for about two-thirds of all spending in the U.S.

Exhibit 121: We Think Asset Prices Will Continue to Support High-End Spending

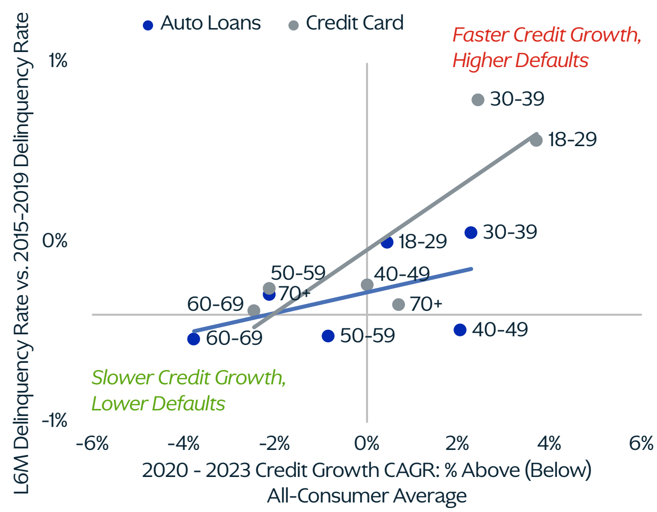
Net Worth: % Above (Below) Pre-COVID Trend by Quintile of Household Income



Data as at 1Q23. Source: Federal Reserve Board, KKR Global Macro & Asset Allocation analysis.

Exhibit 122: Credit Box Expansion May Have Led Younger Consumers to Take on Too Much Debt This Cycle

Post-Pandemic Credit Growth and Change in Delinquencies by Product and Age

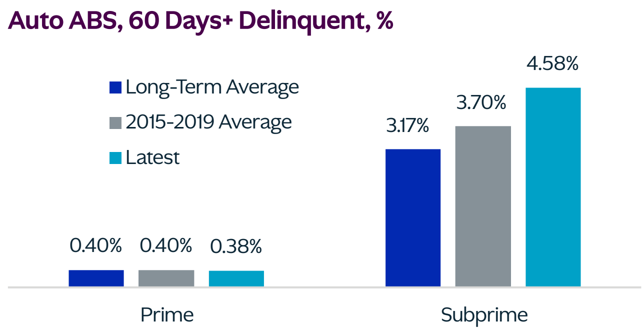


Data as at December 31, 2022. Source: Federal Reserve Board, KKR Global Macro & Asset Allocation analysis.

Unfortunately, younger and lower-income consumers are in a much tougher spot this cycle. As we have been highlighting for some time, these households have been exposed to more severe inflationary shocks, particularly when it comes to rent prices and the cost of essentials like energy and food. One can see this in *Exhibit 119*, which shows that – despite higher wage growth at the low end – better non-wage income and lower inflation mean that real incomes have risen faster for high-income consumers. As a result, we see more signs that near-prime consumers are tapping credit lines to meet spending needs. On balance, we think some households in this category may be over-levered amidst rising rates. Consider the fact that defaults for subprime card and auto borrowers are already *above* pre-pandemic levels, despite some of the lowest unemployment rates in fifty years. Looking ahead, we think that the impact of rising layoffs in low-wage industries may produce more severe outcomes for non-prime consumer credits, resulting in a further pullback in spending.

Pulling it all together, our bottom line is that aggregate consumer spending should hold up decently well this cycle, especially if we are right that hiring will not drop off as much as it does in a 'typical' recession. However, we are likely to see an unusually wide divergence between 'core' and 'noncore' consumers this cycle, particularly when it comes to consumer credit. Against that backdrop, we double down on our view that there is good sense in Keeping It Simple across the credit complex.

Exhibit 123: We Think Low-Income Consumers May Be Overleveraged, Especially If We Are Right that Employment Is in the Process of Slowing



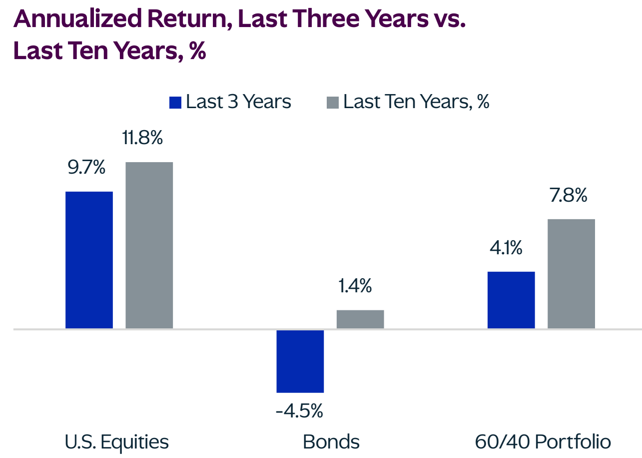
Data as at July 31, 2023. Source: Morgan Stanley, KKR Global Macro & Asset Allocation analysis.

QUESTION NO. 5

How do you feel about asset allocation, specifically your 'Regime Change' thesis now that rates are coming down?

Coming out of COVID we began writing about a 'Regime Change', where four secular drivers – labor shortages, outsized fiscal impulses, rising geopolitics, and a messy energy transition – would warrant a new approach to portfolio construction. Behind these four drivers, a fundamental change in the traditional relationship between stocks and bonds (where bond prices rise when stock prices fall) occurred. Simply stated, post-COVID this relationship broke down. With nearly three years of negative bond performance, our thesis actually played out faster and more severely than we originally imagined. Although the last few weeks have seen this move reverse, the stock/bond correlation has remained quite elevated, validating our thesis that bonds are not portfolio shock absorbers in the regime we envision.

Exhibit 124: The Performance of the 60/40 Is Not Achieving the Same Results in the 'New Regime'



Monthly returns from the S&P 500 for US Equities and from Bloomberg Barclays Aggregate for U.S. Bonds. 60/40 Portfolio constructed assuming monthly rebalancing. Data as at November 30, 2022. Source: Bloomberg.

Looking forward, we have often been asked whether the behavior of stocks and bonds will revert to historic norms as price growth cools. If you are a mean-reversion deflationist, you surely take comfort in the massive drop-off in money supply growth. You also likely feel good that goods inflation is plummeting, and rental incomes are cooling too. Moreover, as we showed in *Exhibit 7*, our inflation model is pointing towards lower inflation through the summer of 2024.

For our money, there are four key areas that we are watching in 2024 (three of which argue for stickier inflation and one, the Energy Transition, that could trend more disinflationary), to determine if our thesis remains sound, including:

1. **These Days, Elections Tend to Encourage More Fiscal Spending:** When I joined KKR in 2011, it was all about fiscal austerity, with Europe being ground zero for budget reductions. Today, by comparison, we see both left- and right-leaning politicians using government programs to woo their voter bases. As our colleague Ken Mehlman has suggested, 2024 will also be a 'year of elections' – in the U.S., the EU, the U.K., India, Indonesia, and Taiwan. These elections will occur in a time of rising populism/institutional distrust, geopolitical rivalry, and rising inflation. We see several forces at work, all of which support our Regime

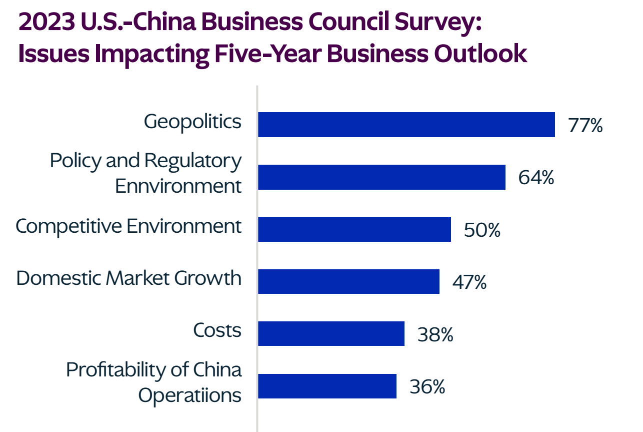
Change thesis. First, we think there will likely be a call by many for increasing 'homeland economic policies' to subsidize independent domestic and friendly nation manufacturing (think like-minded blocs) and supply chains for critical sectors such as semiconductors, AI, advanced computing, pharma, and green energy. Second, we believe scrutiny of foreign and outbound investments that share know-how for these critical sectors with rival nations will continue to be an area of focus and may increase. Third, we believe security spending—including both cyber and conventional defense —will also rise. Finally, sensitivity and controls around supply chains, dual-use technologies, infrastructure, and data will only gain in importance, which likely will support more spending linked to our Security of Everything thesis.

2. **Geopolitics Wise – Unfortunately – It Feels Like We Have Entered a More Structural Bear Market of Political Tensions**. Even before the recent tragic events in Israel/Gaza, geopolitical tensions continued to drive increased spending on more resilient infrastructure to offset uneven supply chains. Looking at the bigger picture, it feels to us at KKR that the democratization effects of trade many envisioned post the creation of the WTO in 1995 are now to be replaced by 'like-minded blocs' rather than global markets. We do not make these statements lightly; ultimately, we think geopolitical uncertainty could meaningfully change energy policy, defense spending, supply chains, and even consumption patterns. Further, the desire to prevent mutual economic and technological dependence between the industrialized democracies and China could accelerate and intensify. Consistent with this view, we think that the definition of 'security' for governments and corporates extends beyond the military playing field to include data, search, payments, communications, and healthcare. Indeed, the 2023 U.S.-China Business Council Survey suggests that geopolitics is the single largest issue weighing down business sentiment over the long term. CEOs believe that industrial policies aimed at developing domestic innovation and national champions are giving rise to worries over lost market share, not just in China, but globally as well. U.S. companies are undertaking a range of business strategies to ensure continued access to the China market, including continuing the China plus one strategy and developing separate supply chains for each segment of their businesses. The U.S.-China Business Council believes that, in some instances, "localizing more production, services, or intellectual property in China" does help. Companies also understand the importance of being aligned with government priorities and are withdrawing from certain sectors that are viewed as national priorities. Being aligned with the government in China is a prerequisite for success in our view.

3. **From a Labor Force Availability Perspective, We Continue to See More Strains Ahead**. We continue to see poor demographics, unexpectedly high childcare costs, and a general lack of worker re-training still leading to sticky wages. We also think that real wages, which have been lagging badly since COVID, are now on track to increase meaningfully. Consider that the pre-pandemic trend was for wage growth to exceed CPI by about one percent per year and that real wages are now about three percent below that pre-pandemic trend. As one can see in *Exhibit 49*, the potential for wages to play 'catch-up' in coming years has significant implications for both inflation and monetary policy, we believe.

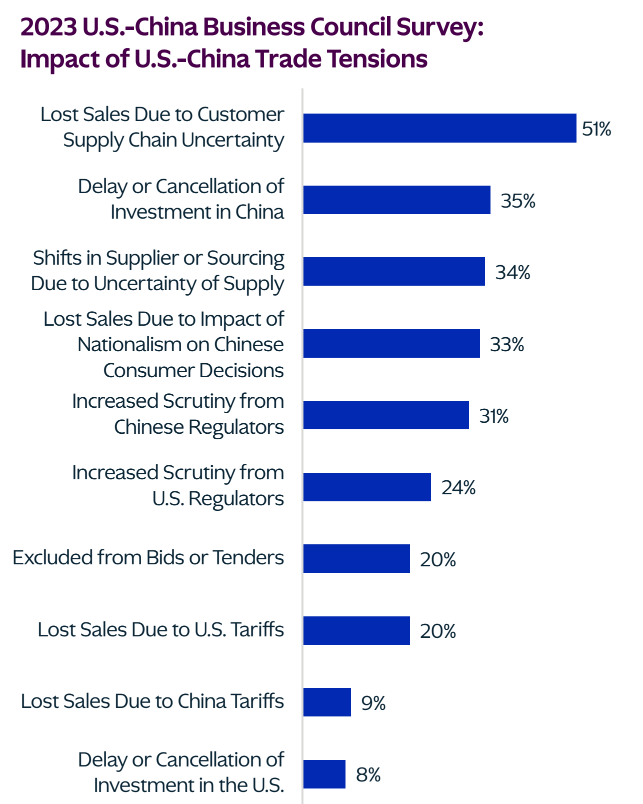
Consistent with this view, we think that the definition of 'security' for governments and corporates extends beyond the military playing field to include data, search, payments, communications, and healthcare.

Exhibit 125: Nearly 80% of U.S. Companies Doing Business in China Have Been Impacted by Geopolitical Tensions



Data as at September 30, 2023. Source: U.S.-China Business Council 2023 Survey.

Exhibit 126: 34% of Businesses in China Have Changed Their Own Suppliers to Mitigate Uncertainty



Data as at September 30, 2023. Source: U.S.-China Business Council 2023 Survey.

4. **The Energy Transition Remains Messy; Could It Be Becoming More Deflationary Than Inflationary, Given the Massive Supply Response We Have Seen of Late?** Somewhat surprisingly, the energy transition is the one area where we feel the least conviction about our higher-for-longer inflation thesis. Recent visits to major markets like the United States and China show that public-private partnerships are leading to more capacity in many instances. At the same time, key commodity inputs like lithium have fallen by 60% or more. That said, given all the focus on decarbonization, the traditional energy industry is under-investing in the capex required to lower oil and natural gas prices while a global renewable energy strategy takes hold. Meanwhile, demand for AI is leading to a huge surge in demand for energy in places where energy production and/or distribution is not sufficient to meet demand. So, while we do worry about the energy transition shifting from an inflationary force to a deflationary one, we are not yet ready to make that call.

Exhibit 127: U.S. Businesses Understand the Importance of Being Aligned With the Government to Do Business in China

Data as at September 30, 2023. Source: U.S.-China Business Council 2023 Survey.

Exhibit 128: In Recent Years, the U.S. Has Been Able to Grow Its Workforce Because of a Major Demographic Tailwind. However, This Benefit Is Now Poised to Reverse. Meanwhile, Europe and Japan Have Offset Significant Demographic Headwinds by Improving Participation Rates

Contributions to Workforce Growth, Millions)			
	U.S.	Europe	Japan
4Q10 Workforce	**153.7**	**157.9**	**65.7**
Demographics	**9.6**	**-3.2**	**-3.2**
Change in Participation	**1.4**	**12.7**	**6.8**
Change in Prime-Age Male Participation	-0.6	-0.1	0.0
Change in Prime-Age Female Participation	0.7	2.3	2.6
Change in 55-64 Participation	0.1	8.6	1.8
Change in 65+ Participation	1.2	1.8	2.4
4Q22 Workforce	**164.7**	**167.3**	**69.4**

Europe data based on the 'Euro-Area 19' subset of E.U. members. 4Q22 uses latest data available in Japan and Europe. Data as at January 10, 2023. Source: U.S. Bureau of Labor Statistics, Eurostat, Japan Statistics Bureau.

Against this backdrop, our base case is to stay the course on our longer-term thesis, despite some near-term disinflationary tailwinds in the first half of 2024. In particular, we want to remain firmly overweight collateral-based cash flows. From our vantage point, the 'cost' of staying long real assets, especially Infrastructure, Asset-Based Finance, and Real Estate Credit, is really quite low. Key to our thinking is that history may repeat itself where, similar to the 1970s and early 1980s, inflation cycles come and go several times. As such, having some extra collateral-based cash flows in the portfolio can add significant value, especially if one remembers the decline of the Nifty 50s in the 1973-74 bear market.

Meanwhile, if inflation does subside and begins to run consistently below the Fed's target (not our base view), the value of the outsized income streams that Real Assets are currently generating will lead to a significant increase in net asset value in a lower rate environment. We also continue to favor operational improvement stories in Private Equity, and growing EPS and dividend-yielding Public Equities. By comparison, we want to not get over-extended on duration and/or be long spicy Credits lower down in the capital structure.

That said, given all the focus on decarbonization, the traditional energy industry is under-investing in the capex required to lower oil and natural gas prices, while a global renewable energy strategy takes hold. Meanwhile, demand for AI is leading to a huge surge in demand for energy in places where energy production and/or distribution is not sufficient to meet demand. So, while we do worry about the energy transition shifting from an inflationary force to a deflationary one, we are not yet ready to make that call.

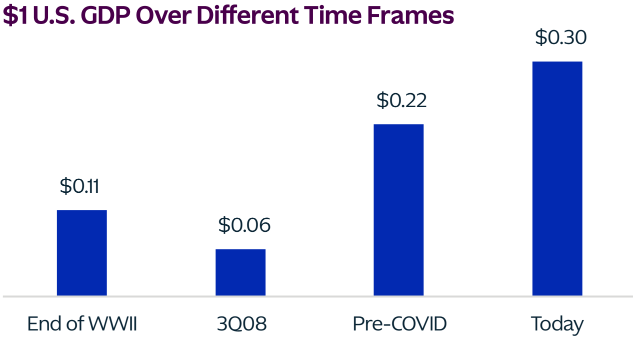
SECTION V

Conclusion

No doubt, there are a lot of macro headwinds swirling around the global economy. Slowing growth, rising geopolitics, and higher interest rates should all be factored into one's macro and asset allocation outlook. The good news, though, is that there are some structural tailwinds that one can invest behind this cycle that actually benefit from some of these areas of concern. For example, our security of everything thesis is a direct play on companies wanting to build more resiliency into their supply chains. Cyber, re-shoring, and redundancy planning will all benefit mightily. Meanwhile, more challenging demographics are leading to a boom in automation and digitalization, especially in the industrial sector. Decarbonization in the energy arena is also leading to opportunities in both the old economy (e.g., oil and gas) as well as the new economy energy sector, including battery storage. Demand for data also continues to explode, and the inability to get the right amount of energy to the right locations at the right time will also require capital investment.

Exhibit 129: The Size of the Fed Balance Sheet Exceeds War Time and Post-GFC

Comparison of Amount on Fed Balance Sheet per $1 U.S. GDP Over Different Time Frames

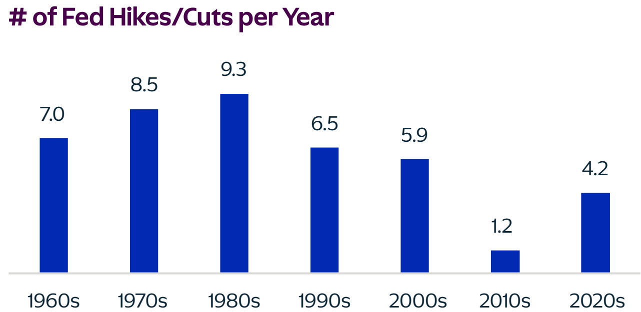


Data as at November 22, 2023. Source: Goldman Sachs Investment Research.

Importantly, there is still a lot of stimulus in the system that can act as a shock absorber. Indeed, as *Exhibit 129* shows, the Fed's balance sheet, despite all the tightening of late, is still significantly larger than in prior cycles. Against this backdrop, we expect the Fed to remain more active this cycle versus the prior decade, which is what we show in *Exhibit 130*.

The good news, though, is that there are some structural tailwinds that one can invest behind this cycle that actually benefit from some of these areas of concern. For example, our security of everything thesis is a direct play on companies wanting to build more resiliency into their supply chains. Cyber, re-shoring, and redundancy planning will all benefit mightily. Meanwhile, more challenging demographics are leading to a boom in automation and digitalization, especially in the industrial sector.

Exhibit 130: Even With the Fed Potentially Cutting and Inflation Cooling, the Higher for Longer Regime Will Continue



Data as at November 22, 2023. Source: U.S. Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

So, while we agree that the next part of the Regime Change cycle could be harder and more volatile than in the past, we remain optimistic, especially for investors who are willing to adapt to the current environment. In particular, as we have outlined in this outlook piece, there are some major secular investment themes, especially for allocators who embrace our Regime Change playbook for asset allocation, to make above-average returns this cycle. The key, we believe, will be to approach today's capital markets with a 'glass half full' lens by allocating to investment themes that actually serve as foils to some of the crosscurrents that are currently serving as headwinds to what was once a synchronized and well-integrated global economy. Amongst the areas where we remain the most constructive are our Security of Everything thesis, Digitalization, Industrial Automation, and Global Infrastructure.

So, while we agree that the next part of the Regime Change cycle could be harder and more volatile than in the past, we remain optimistic, especially for investors who are willing to adapt to the current environment. In particular, as we have outlined in this outlook piece, there are some major secular investment themes, especially for allocators who embrace our Regime Change thesis playbook for asset allocation, to make above-average returns this cycle.

Important Information

KKR

Kohlberg Kravis Roberts & Co. L.P.
30 Hudson Yards
New York, New York 10001
+ 1 (212) 750.8300
www.kkr.com