

KKR

# Insights

14.6

Global  
Macro Trends  
December 2024

# Glass Still Half Full

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Outlook for 2025

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# Glass Still Half Full

## Outlook for 2025

Without question, we are living in extraordinary times, where perspectives on the world vary dramatically. On the one hand, rising GDP-per-capita in many countries, significant advancements in healthcare, and incredible technological discoveries all represent meaningful positive momentum. In addition, soaring asset prices have materially boosted net worth, especially for those heavily invested in the S&P 500 and housing. At the same time, however, a contrasting narrative emerges for many global citizens, especially those adversely impacted by inflation and/or military conflicts. Governments across the globe are grappling with ballooning deficits amidst the need for huge investments in infrastructure, security, workforce development, and supply chain needs. Many nations face increasingly complex demographic shifts as well as political discontent with the ‘establishment’, driven by a ‘revolt of the public’ against established institutions by digitally empowered citizens. Moreover, for those not invested in the equity or housing markets, a stark divide between the ‘haves’ and ‘have-nots’ has contributed to record levels of inequality. At the same time, the traditional distinction between economic and national security has become increasingly blurred, as we transition from a period of benign globalization to one of heightened geopolitical tensions. Yet, despite all these cross currents, our investment outlook for 2025 still tilts positive. So, leveraging a refrain from our 2024 Outlook, our 2025 mantra remains that the Glass is Half Full. To be sure, investors should expect lower returns and more volatility along the way than in 2024. Still, stronger U.S. productivity, easy financial conditions, robust nominal earnings growth, and lack of net issuance, give us confidence that not only is the cycle not over but more gains for investors could lie ahead in 2025. Equally as important, we still see several mega investment themes that we believe will require trillions of dollars of private capital over the next 10 years to fulfill their destiny. Against this backdrop, we think the potential for investors who ascribe to our top-down *Regime Change* macro thesis to generate above-average returns is still compelling.

It was the best of times, it was the worst of times.

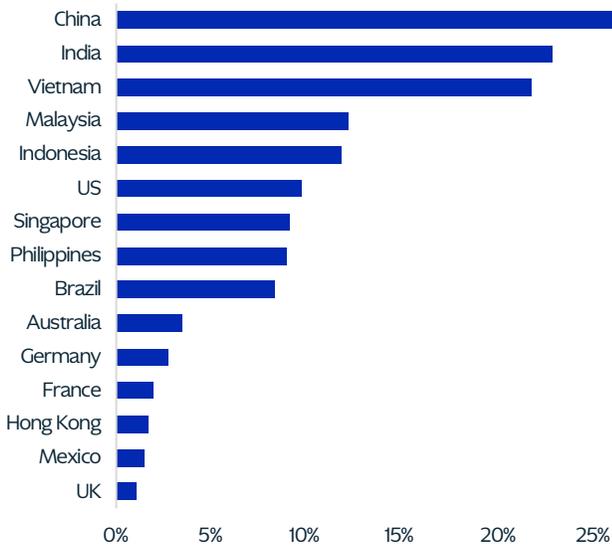
— Charles Dickens, English novelist, journalist, short story writer and social critic

I don't recall much from my high school English class at St. Christopher's School in Richmond, Virginia, but I do remember reading *A Tale of Two Cities* by Charles Dickens. It certainly made an impression on me. The contrasts between 'light' versus 'darkness' and 'hope' versus 'despair' ultimately reveal that things are often not as they seem.

Fast forward a few decades, and today's world dovetails with that backdrop. On the positive side of the ledger, we live in a time of extraordinary societal advancements. Healthcare has improved drastically around the globe; we now clearly see more tangible evidence that AI will lead to another positive inflection point in the technology/productivity cycle, and both life expectancy and GDP-per-capita are rising rapidly in many emerging economies.

**Exhibit 1: The World Is Still Urbanizing, Supporting GDP-per-Capita Growth**

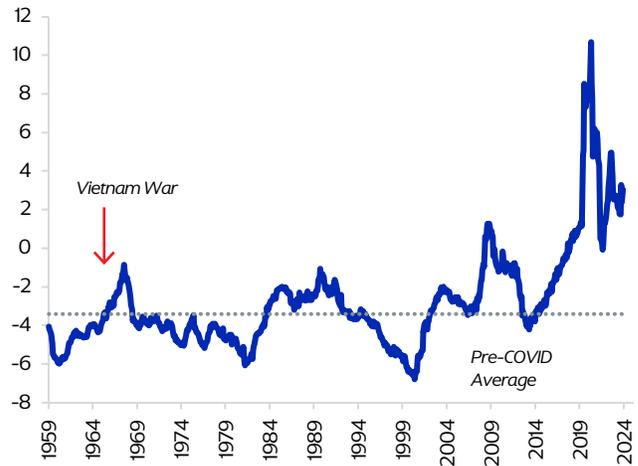
**Change in GDP Per Capita, 2019 - 2024 %**



GDP per Capita: PPP, constant 2021 international US\$. Data as at May 22, 2024. Source: IMF, KKR Global Macro & Asset Allocation analysis.

**Exhibit 2: Beyond Surging Productivity, Heavy Fiscal Impulses and Low Unemployment Are the Two Key Attributes, We Believe, That Are Defining This Cycle**

**Difference Between Federal Budget Deficit, as a % of GDP and Unemployment Rate, PPT**



Data as at September 30, 2024. Source: Goldman Sachs.

It has also been a time of rising asset prices for many investors, especially those who overweighted the S&P 500 in their portfolios. All told, by the end of 2023, the Federal Reserve estimated aggregate household net worth in the United States had ballooned to a record \$160+ trillion, driven primarily by robust housing and stock markets. By most headline metrics, things have never been better.

Looking ahead, we still see more 'light' than 'darkness'; hence, our call to view the Glass Still Half Full in 2025. However, we do want to emphasize that higher valuations, more positive sentiment, and rising estimates may lead to a year of more modest returns, especially relative to 2023 and 2024.

Most Important Things to Know	
<b>Asynchronous Recovery</b>	We now live in a world where the ECB is cutting earlier and faster than the Fed this cycle, a sequencing that has never occurred before. Meanwhile, in Asia, the Bank of Japan is raising rates. At the same time, China needs to create internal demand to offset deflationary trends and a major deleveraging cycle reminiscent of 2008 in the United States. Japan's 30-year bonds now yield more than China's, while in Europe, once maligned Greece now has bond yields that are essentially on par with those of France.
<b>A Higher Bar</b>	Unlike the past two years, the more aggressive GDP and EPS growth estimates for the U.S. to start the year will challenge and set a higher bar for an 'upside surprise' in 2025 ( <i>Exhibit 30</i> ). Additionally, this Fed cycle will likely be less dovish than previous ones. So, look for large domestic-oriented economies, such as the U.S. and India, services-based economies like Spain, and corporate reform-minded economies, such as Japan, to outperform. In this context, we think earnings growth now matters more than multiple expansion.
<b>Currency Markets Are an Achilles' Heel</b>	Most investors are now focused on a surging 10-year yield. By comparison, we are more focused on currency volatility. Tariff wars and big fiscal imbalances can create volatility shocks that differ from recent cycles.
<b>Oil</b>	For the first time in years, we are below consensus on our near-term outlook. Specifically, our 2025-26 forecasts of \$65 per barrel are now modestly below futures pricing. However, our longer-term 2027-28 estimates of \$70-75 per barrel remain comfortably above futures at around \$64 per barrel. In the bigger picture, as AI scales, we believe energy security will become even more entwined with national security. See Key Themes for full details.
<b>Productivity Holds the Key</b>	U.S. productivity is surging, elevating both earnings and growth. Until this slows, we think the cycle will continue. When it does slow, however, the downturn will be faster and more significant than the consensus believes.
<b>Regime Change Thesis Intact</b>	Recent election outcomes around the world put an exclamation point on our <i>Regime Change</i> thesis, which is driven by bigger deficits, heightened geopolitics, a messy energy transition, and stickier U.S. inflation (including a tilt towards protecting jobs rather than throttling PCE from current levels in 2025). Our top-down framework suggests flatter returns, which will likely require a different playbook for capital deployment.
<b>New Growth Drivers Amidst Heightened Global Competition</b>	We envision a blurring of economics and national security across all regions, likely encouraging political leaders to develop ways to expand investment, including increased savings, more private sector involvement, and a focus on driving down the cost of capital. As part of this transition, we see key growth markets emerging in India, the Middle East, and other parts of Southeast Asia. As a result, we think Intra-Asia trade will continue to accelerate.

Yet, under the surface, things are not quite as good as they seem, as significant imbalances exist. For starters, consider that the aforementioned surge in net worth has largely been concentrated in the hands of a few, with adults aged 55+ now controlling 69% of total household assets in the U.S., up sharply from about 50% in 2001. One can see this in *Exhibits 8* and *39*, which underscore the benefits of long-tail QE on asset price appreciation for those asset owners who were fortunate enough to own stocks and houses during the past two decades. All told, through 2023, this 55+ age group in the U.S. has enjoyed an \$88 trillion, or 335% increase in household assets, since 2001. This figure also captures 77% of the total overall increase in household assets during this period by all cohorts. By comparison, the under-40 population's share actually fell from 12% to nine percent of total assets during

the same time period, while the 40-54-year-old cohort saw its market share fall to 22% from 37% during the same period.

There is also a clear 'have' versus 'have not' bifurcation in equity markets, with the significant outperformance of the S&P 500 relative to its international peers being more pronounced of late than during either the Nifty Fifty or Dot-com periods. One can see the extremity of this delta in *Exhibit 3*. So, beyond the outperformance of the S&P 500, there is also the reality that only a small percentage of people actually own stocks that delivered that outperformance. In fact, in the U.S., for example, the most recent Federal Reserve consumer survey suggests that only 21% of U.S. households owned stocks directly in 2022.

**Exhibit 3:** The U.S. Equity Story Has Been a Dominant Global Story, Driven by Productivity, a Trend We Expect to Persist in 2025

**Relative Performance of U.S. Equities vs. Global Equities**



Data as at November 15, 2024. Source: MSCI, Bloomberg.

**Exhibit 4:** Unlike in the Past, Consumers and Corporations Are Not Overleveraged This Cycle. Rather, It Is the Government That Has Excess Leverage

**Debt-to-Income Ratio**



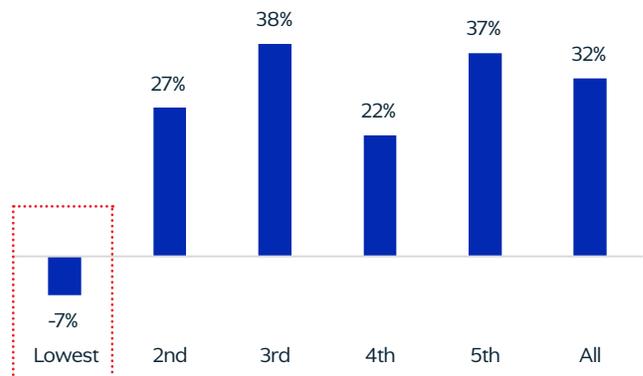
Income is defined as: For consumers total personal income (before tax or interest expense); for corporates it is EBITDA; for government it is total revenue. Data as at September 30, 2024. Source: BofA, KKR Global Macro & Asset Allocation analysis.

In a similar vein, consumer cash balances at Bank of America, which we find to be a good proxy for the U.S. consumer, also tell a worrisome story. *Exhibit 5* shows consumers with the lowest cash balances have

experienced a seven percent decline in their savings since 2019. In contrast, the average cash balances of the bank's entire customer base have increased by fully 32% during the same period, with the wealthiest banking clients seeing even greater gains at 37%. Importantly, this is not just a U.S. phenomenon. As illustrated in *Exhibits 6* and *7*, the age cohort indeed plays a role. Still, the reality is that an increasingly smaller number of people are holding a greater share of total global financial assets. One can see the disparity starkly in *Exhibit 7*, as it reveals that only 58 million people, or just 1.5% of the world's total population, control \$192 trillion, nearly 48% of global wealth.

**Exhibit 5:** Cash Balances Are Not Uniformly Up, as the Lowest Income Americans Have Felt the Pinch of Inflation

**Deposit and Money Market Balances by Quintile: % Change Since 2019**

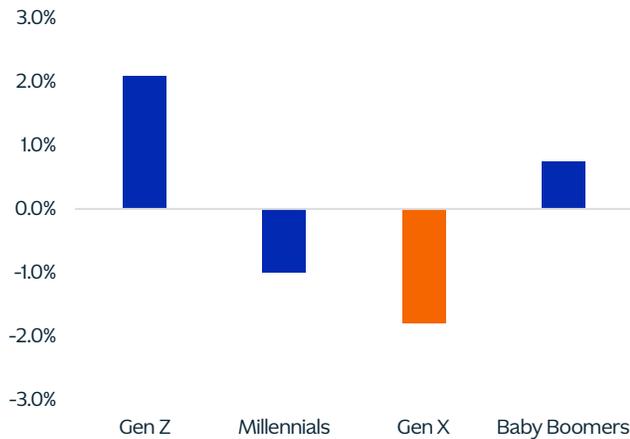


Data as at June 30, 2024. Source: Federal Reserve, KKR Global Macro & Asset Allocation analysis.

These types of 'light' versus 'darkness' debates are also reflected in our macro data, which is why we stick to our thesis on the asynchronous global recovery - characterized by rolling recoveries and rolling recessions within and across economies.

**Exhibit 6:** We Are Seeing Different Spending Patterns Amidst an Asynchronous Recovery

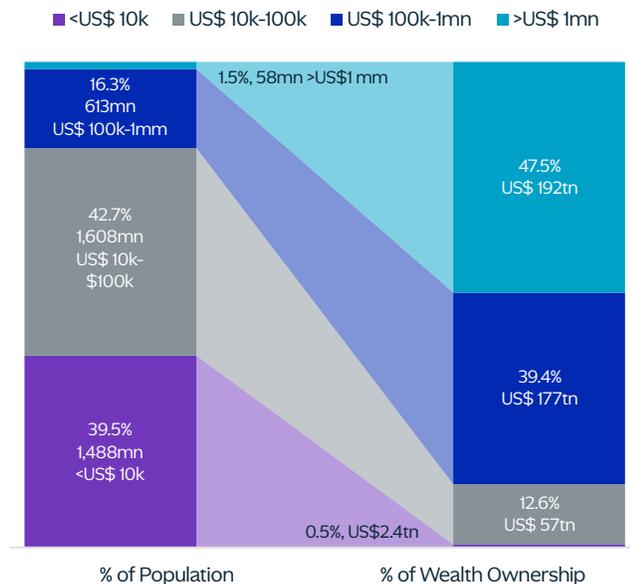
**Discretionary Card Spending per Household by Generation, YTD, %**



Data as at September 30, 2024. Source: Bank of America.

**Exhibit 7:** Inequality Is a Global Phenomenon. Consider That Just 1.5% of the Population Has Accumulated 47.5% of Global Wealth

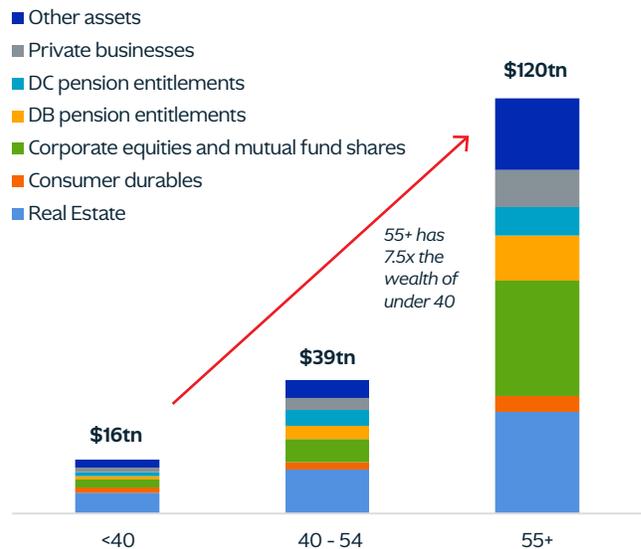
**World Inequality: Comparison of Population Share by Income Cohort and by Asset Ownership**



Data as at February 28, 2024. Source: UBS Global Wealth Databook 2024.

**Exhibit 8:** The Lion's Share of Net Worth Is Now Owned by Investors Who Are Aged 55+

**Major Assets on Household Balance Sheets by Age, US\$ Trillion**



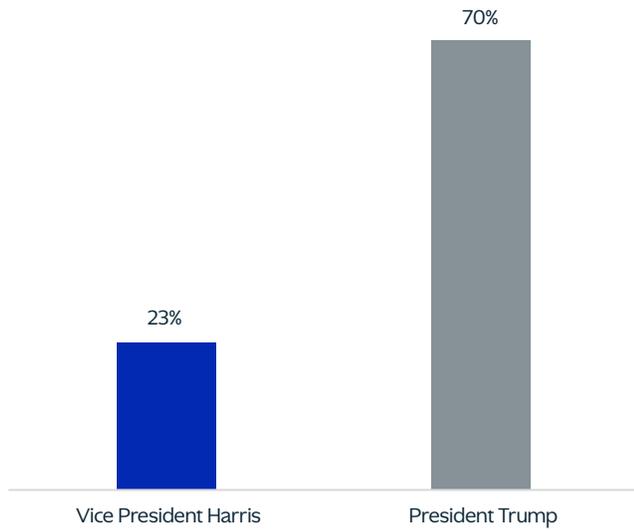
Other assets include checking accounts, money market accounts, and prepaid debit cards. Data as at June 30, 2024. Source: Federal Reserve Distributional Financial Accounts.

So, to many individuals around the world, 'darkness' and 'despair' are more appropriate adjectives to describe their current reality. This perspective is certainly true in the U.S., where in the presidential election, cost of living concerns, mainly linked to inflation, reinforced voters' desire for change. This helped elect President Trump, the first time a previously elected President, who had lost reelection, has made a comeback in more than a century (*Exhibits 9 and 10.*)

There is also a clear 'have' versus 'have not' bifurcation in equity markets, with the significant outperformance of the S&P 500 relative to its international peers being more pronounced of late than during either the Nifty Fifty or Dot-com periods.

**Exhibit 9:** American Voters View President Trump as an Agent of Change

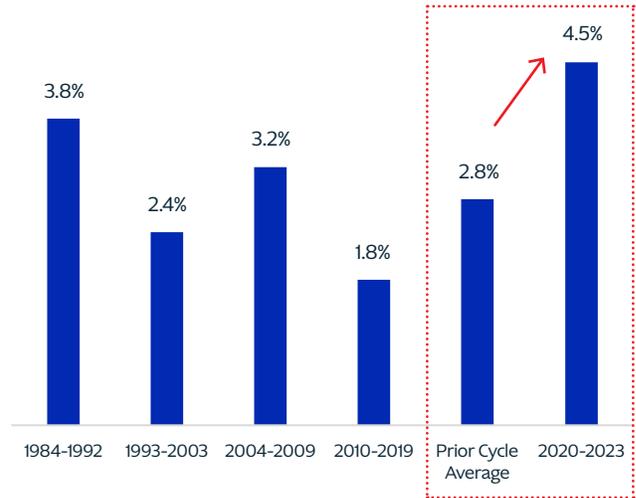
**NBC Exit Poll: Who Do I View as the 'Change' Candidate?**



Data as at November 8, 2024. Source: NBC Exit Polls.

**Exhibit 11:** Headline Inflation Has Been 60% Higher Post Pandemic Than in Prior Cycles

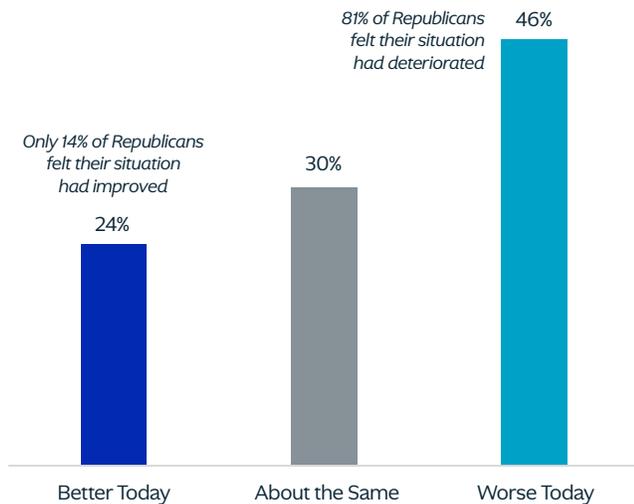
**U.S. Headline Inflation by Economic Cycle, Annualized, %**



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

**Exhibit 10:** We Link This to Growing Economic Dissatisfaction, Particularly Amongst Working Class Households

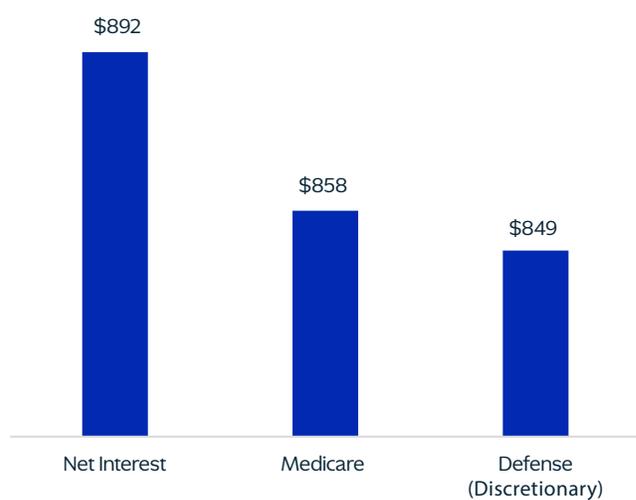
**NBC Exit Poll: Compared to Four Years Ago, Your Family's Financial Situation, %**



Data as at November 8, 2024. Source: NBC Exit Polls.

**Exhibit 12:** Annual Spending on the U.S. Debt Service Burden Is Now More Than Spending on National Defense or Medicare and More Than U.S. Spending on Veterans, Education, and Transportation Combined

**CBO 2024 FY Budget Projections, US\$ Billions**



Data as at June 30, 2024. Source: Congressional Budget Office.

Looking at the big picture, as Ken Mehlman and I discussed following the U.S. election (see *2024 U.S. Election: Focus on the Forest, Not the Trees*), recent events around the world have put an exclamation point on the major secular changes we at KKR have been focused on. These include more government spending, more competitive and volatile geopolitics, a messy energy transition, and sticky, uneven inflationary trends. From our perspective, these four drivers continue to form the foundation of what we have been describing as a *Regime Change* for investors since the onset of COVID (see *Regime Change: Enhancing the 'Traditional' Portfolio*).

As we look ahead, we believe President Trump's vision for America likely involves promoting faster growth and addressing significant deficits through reduced regulation and tax cuts. This vision also emphasizes more of a focus on economic independence, including resilient supply chains and increased local energy production from traditional sources, particularly in light of the surging energy demands driven by AI—an important focus of President Trump's new team. Balancing growth, deregulation, and enacting tariffs will all need to be considered against the potential for reaccelerating inflation amid larger interest expense outlays and an expanding economic divide by cohort, we believe.

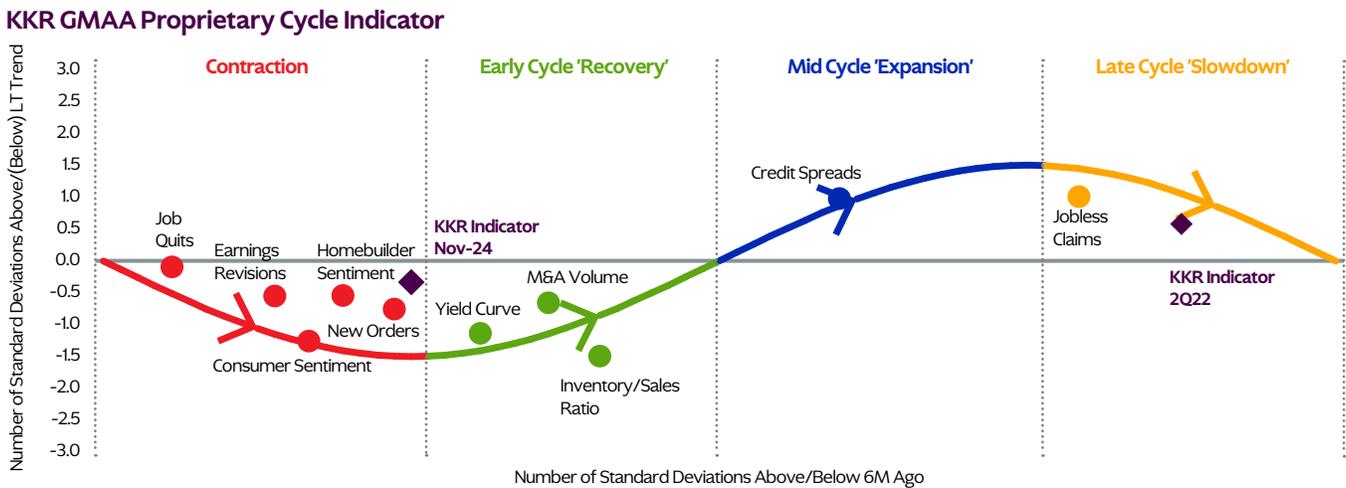
Meanwhile, in Europe, Germany is experiencing a major slowdown in growth, while bond vigilantes in the U.K. and France are trying to rein in heavy government spending. In fact, battles over fiscal spending to promote growth contributed to the collapse of existing governments and triggered elections in Germany and France. At the same time, the situation in China also warrants investor attention. We believe that China's shift in its manufacturing approach—moving away from consumer goods, which defined its role as the world's manufacturer when it joined the WTO in 2001, and instead focusing on industrial automation and the green economy—is creating a challenging environment for corporations invested in these sectors. This situation resembles the difficulties faced by traditional manufacturers at the beginning of the century. In other words, industrial manufacturers today are experiencing a sense of uncertainty akin to what the consumer manufacturing sector in the U.S. and Europe encountered after 2001. If there is any good news on this

front, one could argue that this additional excess capacity is more deflationary than recessionary.

Not surprisingly, these types of 'light' versus 'darkness' debates are also reflected in our macro data, which is why we stick to our thesis on the asynchronous global recovery—characterized by rolling recoveries and rolling recessions within and across economies. This ongoing reality is illustrated in our cycle indicator model in *Exhibit 13*. Moreover, as detailed below in our Global/Regional Economic Forecasts in SECTION II, we are forecasting uneven global growth again in 2025. Specifically, we are raising our U.S. forecast for GDP to 2.5% from 2.3% previously, versus a consensus of 2.1%, while we are lowering our China 2025 GDP forecast to 4.4% from 4.6%, versus a consensus of 4.5%. For Europe, we maintain our forecast of 0.8%, 40 basis points below consensus of 1.2%. Without question, our global economic outlook is undeniably bifurcated between domestic-led economies, like the U.S. and India versus traditional export nations.

Balancing growth, deregulation, potential restrictions on immigration, and enacting tariffs will all need to be considered against the potential for reaccelerating inflation amid larger interest expense outlays and an expanding economic divide by cohort, we believe.

**Exhibit 13:** The 10 Subcomponents of Our Cycle Indicator Are Unusually Asynchronous and Spread Across All Four Phases of the Business Cycle



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

Yet, amidst all these handwringing concerns, we have consistently been of the mindset that 'light' would triumph over 'darkness' across the global capital markets for investors, particularly following the S&P 500's 25% correction in 2022. To review our perspective, our cautious *Walk, Don't Run* message in 2022 (a year when global central banks raised rates and equity markets swooned) gave way to *Keep It Simple* in 2023 and then *Glass Half Full* in 2024. Looking ahead, we still see more 'light' than 'darkness'; hence, our call to view the *Glass Still Half Full* in 2025. However, we do want to emphasize that higher valuations, more positive sentiment, and rising estimates may lead to a year of more modest returns, especially relative to 2023 and 2024.

So, while the bar is undoubtedly higher, **we remain positive on risk assets again in 2025 for the following five reasons:**

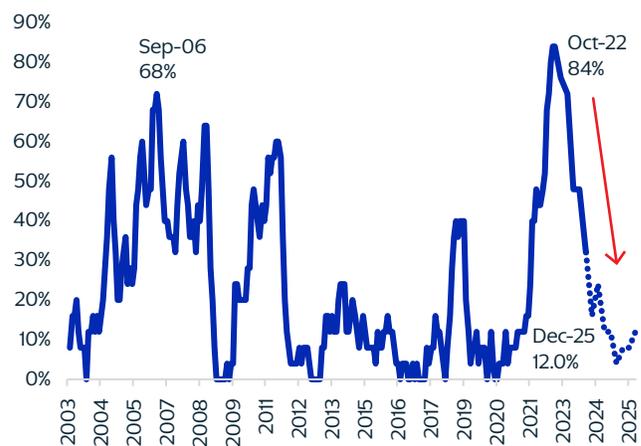
**Point #1: Central bank easing is usually positive for markets unless there is a recession (not our base case).**

As shown in *Exhibit 14*, headwinds from global central bank tightening have given way to central bank easing. Here in the U.S., we certainly do not see the Fed in ultra-easing mode, but the global landscape, especially in China and Europe, is turning more positive on interest rates. Not surprisingly, such a backdrop is usually quite constructive for risk assets. In fact, unless we foresee a recession

(definitely not our base case in the likely higher nominal GDP environment under President Trump), markets generally trend higher. One can see this in *Exhibit 15*.

**Exhibit 14:** Risk Assets Are Responding Favorably to the Idea of Fewer Tightenings and More Easings

**Percentage of Top 25 Central Banks Hiking**



Hiking/cutting rates defined as a change in rates over the past three months. Data for U.S., JP, CN, AU, CA, E2, NZ, NO, SE, GB, JP, CH, IN, ID, KR, PH, TW, TH, VN, BR, CL, ZA, TR, IL, CZ, HU, PL. Data as at September 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 15: S&P 500 Performance Has Been Very Strong of Late, But It is Actually Not Unprecedented Relative to History**

Historical S&P 500 Performance Following >25% Market Crashes									
Date of			No. of Months From		Decline	Subsequent Annualized Price Return			
Market Peak	25% Decline	Market Trough	Market Peak to 25% Decline	25% Decline to Market Trough	Peak-to-Trough	1-year	2-year	3-year	5-year
Nov-40	Dec-41	Apr-42	13.2	4.3	(34%)	14%	17%	16%	12%
May-46	Oct-46	Oct-46	4.3	0.0	(27%)	4%	5%	3%	10%
Dec-61	Jun-62	Jun-62	6.3	0.2	(28%)	31%	23%	17%	12%
Nov-68	Apr-70	May-70	16.9	1.0	(36%)	28%	15%	10%	1%
Jan-73	Aug-74	Oct-74	19.1	1.6	(48%)	12%	17%	8%	7%
Nov-80	Aug-82	Aug-82	20.2	0.2	(27%)	54%	24%	22%	25%
Aug-87	Oct-87	Oct-87	1.8	0.0	(33%)	24%	23%	11%	13%
Mar-00	Mar-01	Jul-02	11.9	16.1	(48%)	1%	(12%)	(1%)	3%
Oct-07	Sep-08	Nov-08	11.3	2.1	(52%)	(8%)	(1%)	2%	8%
Feb-20	Mar-20	Mar-20	0.7	0.4	(34%)	59%	30%	16%	n/a
Jan-22	Oct-22	Oct-22	9.3	0.0	(25%)	22%	27%	n/a	n/a
<b>Average</b>			<b>10.6</b>	<b>2.6</b>	<b>(37%)</b>	<b>20%</b>	<b>13%</b>	<b>10%</b>	<b>10%</b>
<b>Median</b>			<b>11.6</b>	<b>0.7</b>	<b>(34%)</b>	<b>19%</b>	<b>17%</b>	<b>10%</b>	<b>10%</b>

Data as at October 31, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 16: We Don't See a Recession, So the Path of Least Resistance Is Likely Higher Again in 2025**

**S&P 500 Returns Around the Start of Fed Cutting Cycles**



Data as at November 29, 2024. Source: Datastream, Worldscope, Goldman Sachs Global Investment Research.

That said, we do want to acknowledge that we are trending ahead of schedule in terms of market performance. *Exhibit 15* shows that following strong gains in 2023 and 2024, two-year annualized performance stands at 27%, 1000 basis points above the median return for the same period. While not unprecedented relative to history, the S&P 500's performance suggests future gains may be more measured (especially given that we do not envision significant multiple expansion in 2025). Hence, our belief that a 'higher bar' is now required.

While we retain a pro-risk appetite, we do want to moderate our stance a bit relative to prior years, as start of the year expectations are both higher and more realistic.

**Point #2: The technical backdrop for risk assets remains quite favorable.** Almost all the questions we receive these days on the macro front revolve around fundamental topics like earnings and GDP growth. Yet, one of the most powerful forces we have witnessed on the markets since COVID is the influence of positive market technical forces. In addition to the coordinated central bank easing we mentioned above, we also see a notable lack of supply as a potentially underappreciated tailwind to market performance. There are four areas to consider:

- First, as illustrated in *Exhibit 17*, net issuance (which we measure as total proceeds from IPOs, Levered Loans, and High Yield issuance as a percentage of GDP over the last 12 months) is at 3.1%, down from a peak of 8.2% in summer 2021.
- Second, *Exhibit 18* shows that U.S. buybacks are poised to remain robust for the S&P 500 in 2025. Over the past decade, net buybacks have contributed approximately one percent to earnings per share annually. Looking ahead, we anticipate gross buybacks will increase by around 15% year-over-year in 2025, reaching approximately \$1 trillion.
- Third, money market balances are at plump levels, reaching \$6.5 trillion in October compared to \$4.8 trillion at the start of 2020 (*Exhibit 19*). As rates decline globally, we think that individual savers, especially those focused on long-term retirement savings, will need to transition these monies into higher returns products, including Alternatives.
- Finally, although central bank balances are smaller today than during the pandemic's peak, they remain significant compared to pre-COVID levels, as shown in *Exhibit 20*.

**Exhibit 17: Capital Markets Conundrum: Net Issuance Has Contracted Massively, Except When It Comes to Government Bonds**

**Capital Markets Liquidity (TTM) as a % of GDP, (IPO, HY Bond, Leveraged Loan Issuance)**



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

**Exhibit 18: We Expect More Than One Trillion Dollars in Buybacks in 2025, Further Supporting Our Bullish Technical View**

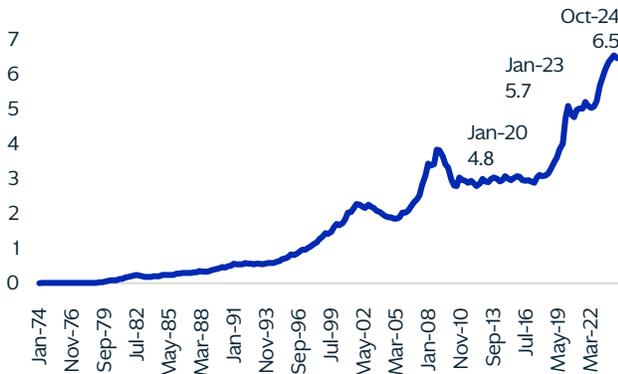
**S&P 500 Net Buybacks, %**



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

**Exhibit 19:** There Is Still a Wall of Cash On the Sidelines. Money Funds in the U.S. Have Risen by Nearly \$3.5 Trillion Over the Last Decade

**Total Financial Assets: U.S. Money Market Funds, US\$ Trillion**



Data as at October 16, 2024. Source: ICI, FRED.

**Exhibit 20:** Despite Record Tightenings, Central Bank Balance Sheets Are Only Back to Pre-COVID Levels

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



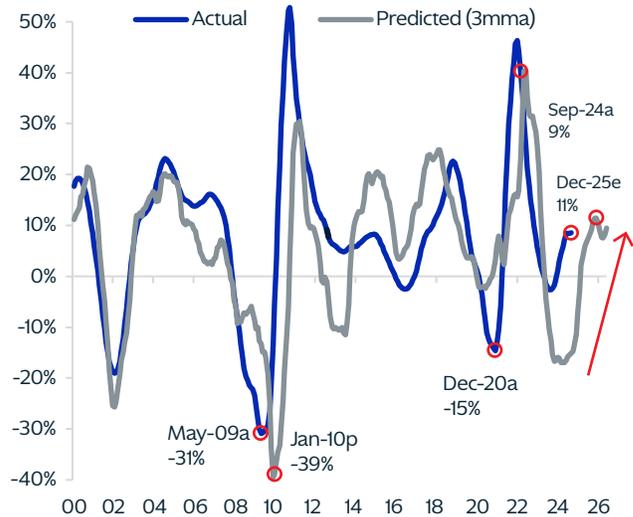
G4 = Federal Reserve, the ECB, the Bank of England and the Bank of Japan. Data as at September 30, 2024. Source: Haver Analytics, national central banks and statistical agencies, KKR Global Macro & Asset Allocation analysis.

**Point #3:** Our Earnings Growth Lead Indicator (EGLI) is inflecting upward, encouraging us to raise our 2025 EPS again.

As shown in Exhibits 21 and 22, our proprietary Earnings Growth Leading Indicator, or EGLI, is signaling an improvement in earnings growth heading into 2025. This signal is important, and as we detail in SECTION III, we are now using an estimate of \$273 for 2025, which implies an 11% year-over-year growth. Our estimate also compares favorably to a 'top-down' consensus of \$266 for EPS in 2025, which implies about 10% year-over-year growth. Key drivers of the model include less drag from central bank tightening, falling commodity prices, and favorable credit spreads. One can see these details in Exhibit 22.

**Exhibit 21:** Our Earnings Growth Leading Indicator Inflects Higher Over Coming Quarters...

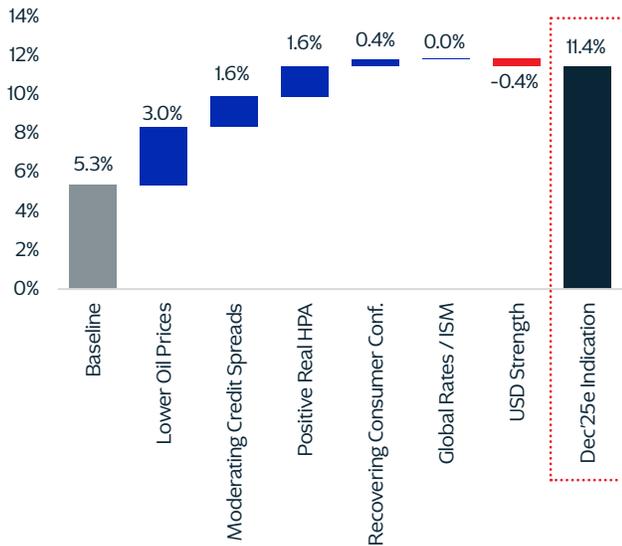
**S&P 500 EPS Growth: 12-Month Leading Indicator**



Our S&P 500 Earnings Growth Leading Indicator ('EGLI') is a combination of seven macro inputs that together we think have significant explanatory power regarding the S&P 500 EPS growth outlook. Data as at December 10, 2024. Source: National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 22: ...Powered by Fading Headwinds From Central Bank Tightening and Elevated Commodity Prices**

**Contributions to Dec-25e S&P 500 EPS Growth Forecast**



Our S&P 500 Earnings Growth Leading Indicator ('EGLI') is a combination of seven macro inputs that together we think have significant explanatory power regarding the S&P 500 EPS growth outlook. Data as at December 10, 2024. Source: National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Point #4: Productivity gains serve as an important driver of both the economy and earnings, especially in the United States.** Our base view is that productivity began to strengthen in the second half of the prior decade, but heavier reliance on automation and digitalization throughout COVID accelerated this momentum. **All told, we are forecasting GDP-per-employee to grow 1.3% in 2025 versus consensus of 1.0%.** Importantly, we believe that the current surge in productivity has already occurred even before the potential benefits of AI have been fully realized. Unlike last year, though, we are starting to see some advantages from AI at the portfolio company level, which boosts our baseline confidence in our productivity-led GDP thesis (and remember, we only forecast job growth to average 125,000 per month in 2025, compared to 175,000 per month in 2024). Moreover, unlike the dot-com bubble two decades ago, the companies driving today's spending possess strong balance sheets and lower capital costs, and operate in a more consolidated market.

**Exhibit 23: Stronger Labor Productivity Is the 'Secret Sauce' to Extending the Business Cycle as Well as Partially Offsetting Higher Deficits, We Believe**

**U.S. Labor Productivity Growth, %**

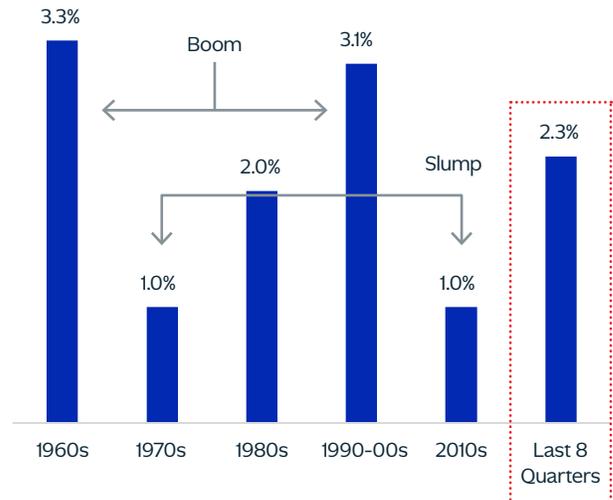
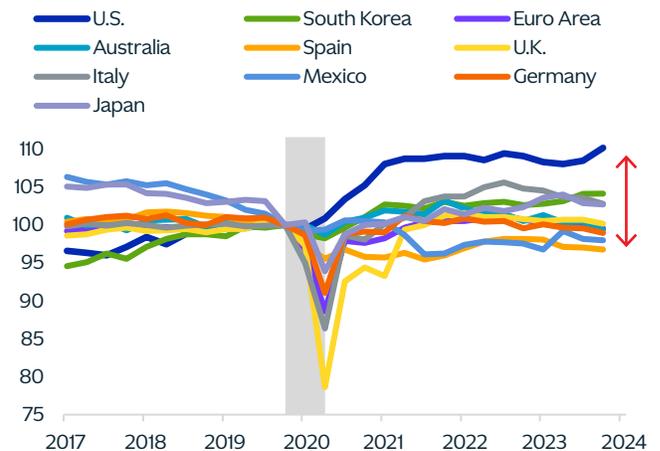


Chart refers to real output/hours worked. 1960s refers to 1959-68; 1990s-00s refers to 1995-05; 1970s refers to 1973-79; 2010s refers to 2010-19; 1980s refers to 1980-88. Data as at September 30, 2024. Source: Bloomberg, Federal Reserve Bank of San Francisco.

**Exhibit 24: U.S. Productivity Is Significantly Outpacing the Rest of the World Since COVID**

**Productivity Across Major Economies, Output Per Worker, 4Q19=100**



Data as at September 30, 2024. Source: Bloomberg, U.S. Bureau of Economic Affairs, EY Parthenon, KKR Global Macro & Asset Allocation analysis.

**Point #5: Time is on our side, as we are just 26 months into a bull market.** While we acknowledge that the current bull market is ahead of schedule regarding appreciation, we still see its duration as compelling. *Exhibit 25* shows we are just over two years into the recovery, compared to an average of around 5.5 years. Importantly, we think the current bull market has legs, as we do not foresee the necessity for either a major consumer or corporate deleveraging - two important macro factors that often choke off bull markets.

**Exhibit 25: We Are Just 26 Months Into a Bull Market, in Our View. On Average, Since 1949, the Bull Markets Have Lasted 5.5 Years**

S&P 500 Bear Market Troughs to Bull Market Peaks			
Bear Market Trough	Bull Market Peak	% Gain	# of Years
6/13/1949	8/2/1956	267%	7.1
10/22/1957	12/12/1961	86%	4.1
6/26/1962	2/9/1966	80%	3.6
10/7/1966	11/29/1968	48%	2.1
5/26/1970	1/11/1973	74%	2.6
10/3/1974	11/28/1980	126%	6.2
8/12/1982	8/25/1987	229%	5.0
12/4/1987	3/24/2000	582%	12.3
10/9/2002	10/9/2007	102%	5.0
3/9/2009	2/19/2020	401%	11.0
3/23/2020	1/3/2022	114%	1.8
10/12/2022	11/30/2024*	69%	2.1
	<b>Average</b>	<b>192%</b>	<b>5.5</b>
	<b>Median</b>	<b>114%</b>	<b>5.0</b>

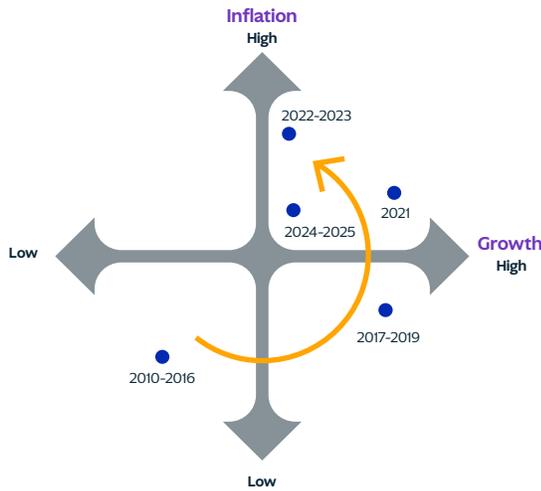
\*Bull market is still ongoing. Data as at November 30, 2024. Source: Bloomberg.

As previously mentioned, we continue to advocate that investors think differently about their asset allocation strategies, especially given the higher nominal GDP environment in the United States. Specifically, our *Regime Change* thesis focuses on four key inputs (bigger deficits, heightened geopolitics, a messy energy transition, and stickier services inflation) that we think necessitate a new approach to traditional asset allocation strategies for investors. In particular, we note the following:

1. **We expect flatter returns and increased allocations to non-correlated assets in portfolios.** The five-year forward median return across asset classes we forecast is fully 180 basis points lower than what we saw over the last five years (meaning there will be less differentiation between the best- and worst-performing assets in a portfolio, on average). At the same time, 'old' portfolio correlations are breaking down, so asset allocation - not single asset volatility - has a much bigger impact on overall portfolio volatility. Our message is to seek out - all else being equal - uncorrelated assets. Manager selection will also matter more, especially in Credit.
2. **We believe investors should have more linkages to nominal GDP.** Given a higher resting heart rate for inflation this cycle (including a perceived pivot by the Fed to an increasing focus on job creation rather than inflation submission in 2025), we think investors should own more cash-flowing assets linked to nominal GDP. This includes building flexibility across mandates and carefully considering duration. As such, we strongly believe that an overweight to modestly leveraged Infrastructure and certain Real Estate investments with yield is prudent for adding ballast to one's portfolio. We are also quite constructive on Asset-Based Finance, which provides numerous shorter duration opportunities with good cash flowing characteristics and sound collateral.
3. **Own more assets where you control your destiny.** In a world where trade barriers are increasing, we suggest tilting portfolios towards domestic consumption stories. We also favor more control situations, especially in the private markets, where operational improvements or strategic consolidation can, at times, drive robust profit growth, especially in Private Equity. Finally, we continue to favor political changes that drive corporate reforms, hence our optimism around investing in Japan. Still, as the convergence and blurring of the lines between national and economic security gains momentum, we expect to see more policies that encourage domestic savings, higher profits, and a lower cost of capital.

**Exhibit 26:** As We Exit a Low Growth, Tight Fiscal, and Loose Monetary Environment, We Think That a Regime Change Is Occurring

**Low and High Growth and Inflation Regimes**



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

**Exhibit 27:** Despite Inflation Falling on a Cyclical Basis, the ‘New’ Positive Relationship Between Stocks and Bonds Remains Strong

**U.S. Stock-Bond Correlation vs. CPI**



Model retrained monthly to better reflect latest CPI inflation trends. Data as at November 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 28:** Forward-Looking Expected Range of Outcomes Will Be Narrower, We Believe

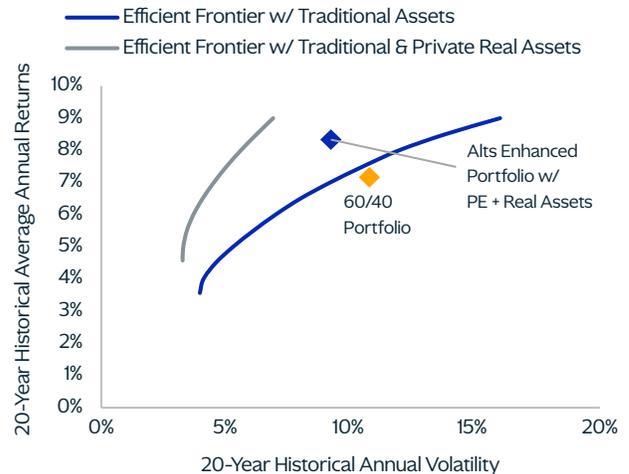
**Expected Return Range of Outcomes, %**



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

**Exhibit 29:** Our *Regime Change* Thesis Suggests That Allocators Need to Think Differently About Asset Allocation

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



Data as at June 30, 2023. Source: KKR Global Macro, Balance Sheet & Risk analysis.

What could we go wrong? In our view, there are three risks where investors need to be laser focused. They are as follows:

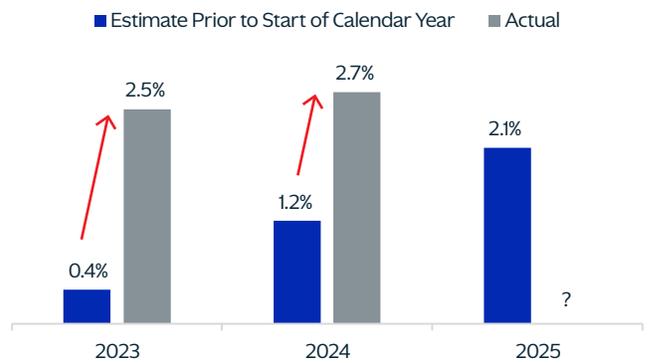
- Interest Rate Surprises.** The interplay of big deficits, faster cyclical growth, and slower productivity could lead to a rapid and surprising increase in interest rates, especially at the long end of the curve. From what we can tell, the consensus firmly believes that global rates are headed lower amidst a downturn in global growth. However, if growth and inflation reaccelerate under President Trump and the Fed needs to tilt more actively hawkish, especially if the Fed needs to again tighten aggressively at the short end of the curve, it could materially dent sectors like Private Credit, Real Estate, Insurance Surrenders, and Large-Cap Growth stocks and could be quite problematic for many sectors of the economy.
- Disappointing Earnings from the Magnificent Seven on a sustained basis.** To date, earnings from the Mag7 have consistently exceeded expectations. Against this backdrop, momentum as a factor in the U.S. equity market has appreciated fully 42% year-to-date, compared to less than 17% for Value and Dividend factors over the same period, according to Bloomberg. However, if top line and net income growth were to slow more than expected, we believe the premium valuation that these stocks enjoy, as well as the 'halo effect' that the Mag7 has had on many other names in the index, would be destabilizing for markets.
- Negative Currency Market Reactions.** Heightened trade barriers, indebtedness, and geopolitical tensions could unsettle currency markets. If we believe that 1994-2000 is the correct analogy for the cycle that is unfolding (which we do), then we also need to stay focused on currencies. Following the rate increase of 1994 (which we equate to 2022), the market rallied nicely for the next few years as productivity and earnings came through. However, things became unsettled in 1998, as a combination of currency unwinds and excess leverage led to a short and sharp market correction that investors were underestimating. Against this backdrop, we are watching both the dollar and EM currencies, especially given higher leverage and the need/want of some countries to adjust their currencies to improve their competitive positioning.

Said differently, a competitive devaluation is not out of the question during the next four years.

**While we retain a pro-risk appetite, we do want to moderate our stance a bit relative to prior years, as start of the year expectations are both higher and more realistic.** Indeed, after two years of missing the top-down narrative quite badly, many economic forecasters now better understand the benefits of productivity and government stimulus. As such, they are boosting their year-ahead forecasts. One can see this in *Exhibit 30*, which shows that 2025 starting expectations for GDP growth are now materially higher than in either 2023 or 2024. Capital markets sentiment is also more optimistic, and we think that investors can no longer rely on tighter credit spreads. All told, our High Yield default monitor now suggests a default rate of around 1.5%, compared to a historical average of 5.6%. Meanwhile, in Equities, trading multiples also, in our view, seem to incorporate a fair amount of optimism.

**Exhibit 30: The Potential for an Upside Surprise to GDP Estimates in 2025 Is Now Lower...**

**Bloomberg Consensus: U.S. Real GDP Growth Estimates**

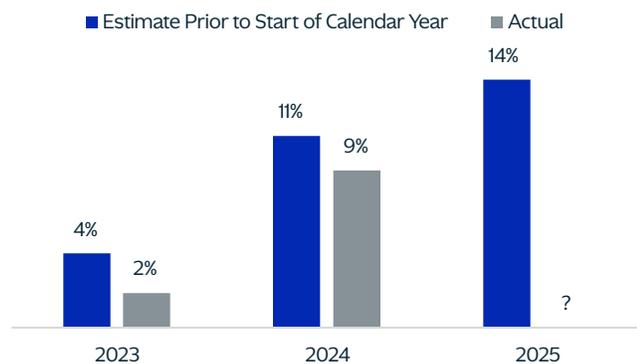


Data as at November 15, 2024. Source: Bloomberg.

All told, we are forecasting GDP-per-employee to grow 1.3% in 2025 versus consensus of one percent.

**Exhibit 31: ...As Sell-Side Analysts Have Boosted Their EPS Forecasts, Which Makes It More Difficult**

**Bottom-Up Consensus: S&P 500 EPS Growth Estimates**



Data as at November 15, 2024. Source: Bloomberg, S&P.

**Our bottom line:** Though the bar is now higher to achieve strong absolute returns in 2025, we believe that ‘The Glass is Still Half Full’. Against this backdrop, though, we encourage investors to focus on:

- **Owning more assets that benefit from faster than expected earnings growth relative to the already high expectations.**
- **Prioritizing investments in countries where there is active corporate reform, improving productivity, and better return on capital** (see SECTION I for details).
- **Capturing tailwinds from one or more of our underappreciated mega investment themes** (again, see SECTION I) **or positive market technical forces.**

Key Market Calls	
<b>Above Consensus Growth In the U.S.</b>	We expect 2.5% GDP growth in the U.S. during 2025, 40 basis points above consensus. Meanwhile, we assume 11% year-over-year S&P 500 EPS growth in 2025, which implies an above-consensus EPS of \$273 per share (versus the ‘top-down’ consensus estimate of \$266 per share.)
<b>Below Consensus Growth in Europe and China</b>	We assume Eurozone 2025 GDP growth of 0.8%, which is 40 basis points below consensus. Meanwhile, in China we expect 4.4% growth, compared to the consensus of 4.5%.
<b>Higher SPX Target</b>	We maintain a ‘Glass Half Full’ posture for U.S. Equities, expecting the S&P 500 to reach around 6,850 in 2025 versus a top-down consensus of 6,359.
<b>No Surge Higher in Rates, But Entering a Period of Steeper Yield Curves</b>	We assume the Fed cuts twice in 2025, compared to consensus expectations of three cuts. On the long end, we move our 10-year target to a range of 4.25% to 4.5% for 2025 (versus consensus of 4.1%) to account for tariff-related pressures as well as policy stance uncertainty in 2025.
<b>Above Consensus Inflation in the U.S., But Below in Most Other Economies</b>	In the U.S., we think inflation will have a higher resting rate than the consensus thinks. We forecast inflation of 2.6% in 2025 versus consensus of 2.4%. Embedded in our forecast is that tariffs boost inflation by 30 basis points in 2025. Separately, in Europe and China, we think inflation will continue to cool. We are at 1.9% for Euro Area inflation in 2025, versus consensus of 2.0%. In China, we are 30 basis points below consensus at 0.9% for 2025.
<b>Oil</b>	Our forecasts for 2025-26, at \$65 per barrel, are now slightly below current futures prices. In contrast, our longer-term projections for 2027-28, at \$70-75 per barrel, are well above the futures price of approximately \$64 per barrel.

SECTION I

# Key Themes and Asset Allocation

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

## 1

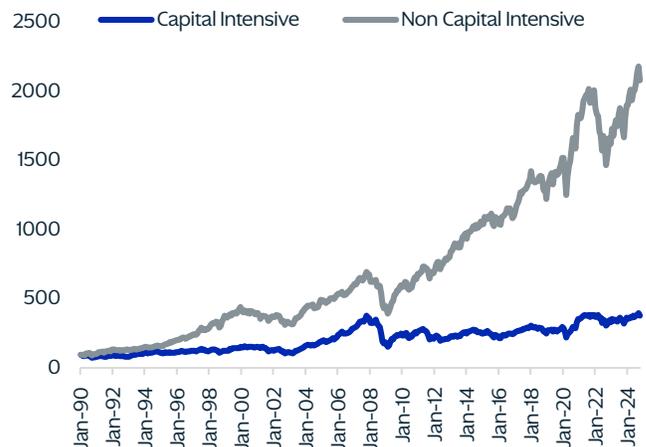
### Improved Capital Efficiency

We see a mega trend emerging as more companies shift from capital heavy to capital light. *Exhibit 32* shows the materiality of this transition in equity performance, and it is significant. In a series of compelling transactions we are tracking closely, a growing number of public companies are essentially taking themselves private through better capital allocation, including aggressive buyback programs. They are also selling off capital heavy parts of their businesses, including divestitures and securitizations. Many executives are deemphasizing their businesses’ cyclical or lower-returning components to create more sustainable companies with greater visibility of earnings and returns. Not surprisingly, this transition began to accelerate after the bank deleveraging cycle in 2008, but it has gained both speed and breadth since the demise of Silicon Valley Bank. While we are indeed enamored of the multiple lift that capital light companies enjoy, we learned in 2024 that there may be an even bigger opportunity for credit providers to make a compelling economic rent by providing the ‘off ramp’ for the assets being sold. Credit card receivables, houses, non-performing loans, real

estate, facilities, and equipment are all being financed by the Asset-Based Finance market, a trend we now see accelerating. Already, this market opportunity has reached trillions of dollars, and we are now seeing it expand into other markets, such as insurance liabilities. Importantly, as we have detailed in our relative value question in SECTION IV, we think that the return per unit of risk in the Asset-Based Finance market is currently quite attractive relative to other parts of Credit.

**Exhibit 32: Non-Capital-Intensive Companies Are Breaking Out. We Like Both the Equity Being Converted Towards Capital Light As Well As the Financing Opportunity Linked to Assets Being Sold**

**World Capital vs. Non-Capital-Intensive Companies, USD Price Return Indexed to 100 in January 1990**



Capital intensity based on: Assets/Employee, Asset/Net Income, and Capex/Net Income. Data as at October 31, 2024. Source: Goldman Sachs.

# 2

## Private Sector Market Share Gainers

During our recent discussions in Washington, D.C. about the implications of the U.S. election ‘Red Sweep’, it became clear that the combination of rising deficits and the desire for ‘less’ government will lead to the private sector having a more significant future role in key growth markets. Areas such as digital infrastructure, space exploration, retirement savings, and defense are likely to see outcomes shaped by increased private investment. In many instances, projects that require capital intensity until they fully ramp could be in better hands under private ownership. Private owners are also likely to be more focused on deadlines and ROIC, so these opportunities could be good ones to pursue, we believe. Meanwhile, in the case of retirement security, the private sector will need to address the growing gaps in government support, particularly as many plans fall short of covering living costs, or if governments struggle to meet financial obligations. Importantly, we heard similar commentary on visits to France and Spain too, with heavy debt burdens encouraging private market participants to assume responsibility in many of these same aforementioned industries.

# 3

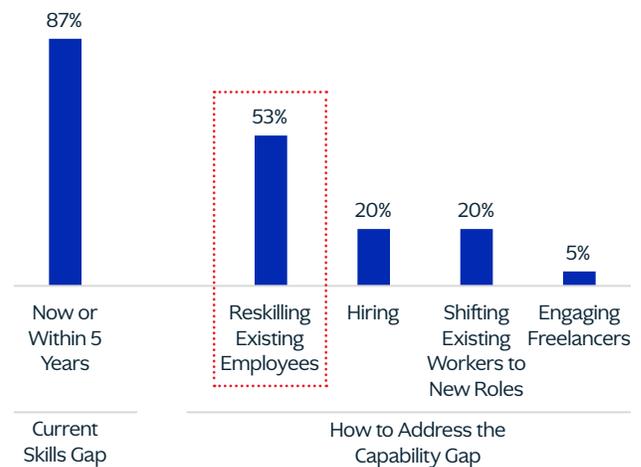
## Worker Retraining/Productivity

We think the opportunity set for lifelong learning and worker retraining may be as large as it has ever been for several reasons. In a world where technology is shifting the competitive landscape rapidly, we see increasing numbers of workers needing more training or retraining more often to compete. Learning loss and educational disengagement have remained high among younger Americans since COVID, creating a need for ‘education completion’ and ‘career-ready skills’ efforts. Finally, the retirement of the huge baby boom generation has reduced the supply of available workers. Going forward,

there will be a lot of pressure to bring unemployed/ underemployed workers from lower-skilled sectors, as well as workers potentially disrupted by AI and technology, into higher-skilled jobs left open by pandemic-era retirements. Demand for recognizing the skill adjacencies between professions and connecting workers with platforms that can identify and offer upskilling for sectors where employer skill needs are changing, will increase. Against a backdrop of enhanced skills requirements and stickier wages, we think strong productivity will be needed to allow corporate margins to hold. Morgan Stanley estimates that net immigration will decline from a peak of 3.3 million in 2023 to 2.9 million in 2024, 1.0 million in 2025, and 0.5 million in 2026. We agree. So, going forward, we see investment opportunities in areas such as labor market analytics, job search tools, skills-based training (on- and off-line), and productivity ‘enhancers’ including workflow tools and automation.

**Exhibit 33:** 87% of Companies Worldwide Have or Expect to Have Workforce Skills Gaps Within Five Years

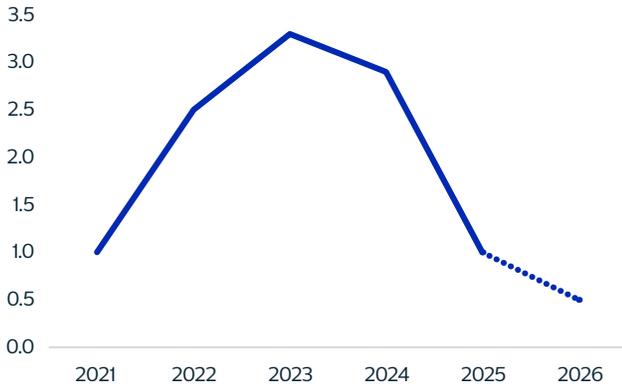
**McKinsey Survey On Expected Skills Gap Within Companies, %**



1,216 global survey participants representing the full range of regions, industries, company sizes, functional specialties, and tenures. Data as at January 8, 2021. Source: McKinsey Global Institute.

**Exhibit 34: Net Immigration Declines Will Require Productivity Enhancements**

**Net U.S. Immigration, Millions**



Data as at November 22, 2024. Source: Morgan Stanley Research Estimates.

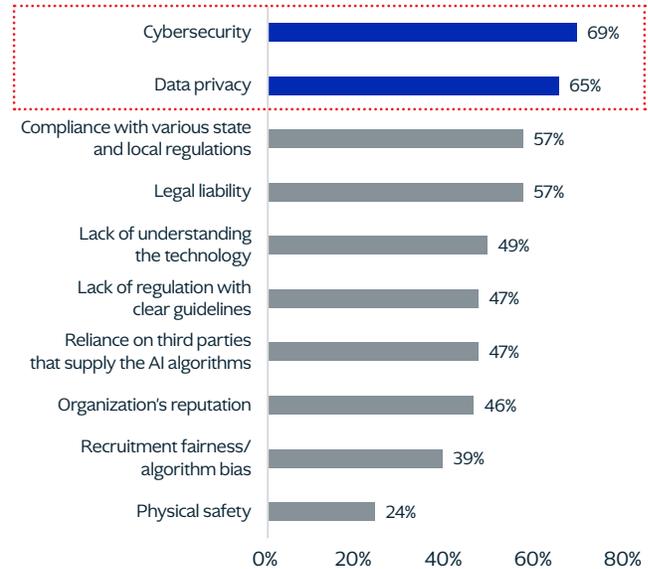
4

**Security of Everything**

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

**Exhibit 35: Our Security of Everything Thesis Underscores Our View That Companies, As Well As Individuals, Will Need to Spend More on Cyber and Data Privacy**

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

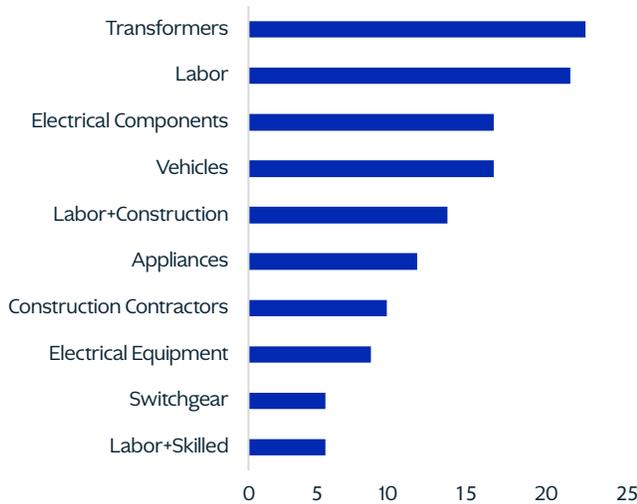


Data as at February 28, 2024. Source: Bank of America, Baker McKenzie, Insider Intelligence.

During our recent discussions in Washington, D.C. about the implications of the U.S. election ‘Red Sweep’, it became clear that the combination of rising deficits and the desire for ‘less’ government will lead to the private sector having a more significant future role in key growth markets.

**Exhibit 36:** Supply and Demand for Industrial Equipment Is Out of Balance Due to Underinvestment, the Energy Transition, and Weather

**Supply Shortages in ISM Subsectors, Number of Months in the Last 2 Years**



Data as at October 31, 2024. Source: U.S. Census Bureau.

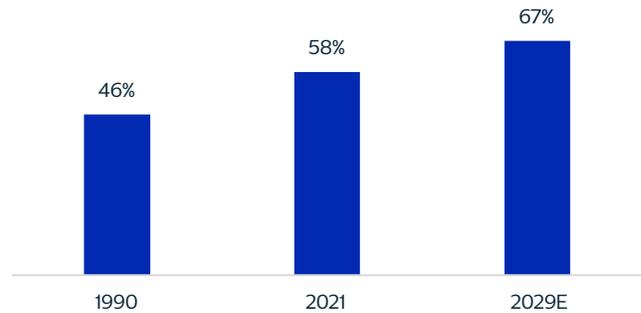
# 5

## Intra-Asia

Repeated trips to Asia in both 2023 and 2024 confirmed for us that a meaningful transition is occurring: Asia is becoming more Asia-centric, with increased trade within the region rather than simply with developed markets in the West. Already, the share of Asian trade with regional partners (versus with the West) has increased massively to 58% in 2021 from 46% in 1990. We believe that more market share gains are likely, particularly when one considers that intra-Europe trade stood at 69% in 2021. All told, we think that intra-Asian trade could hit 65-70% in the next five to seven years, especially as the United States pivots away from traditional alliances and values-based diplomacy towards 'America First' policies in a region home to very trade-dependent economies.

**Exhibit 37:** In 1990, Just 46% of Asian Trade Took Place Within Asia; By 2021, That Figure Had Reached 58%

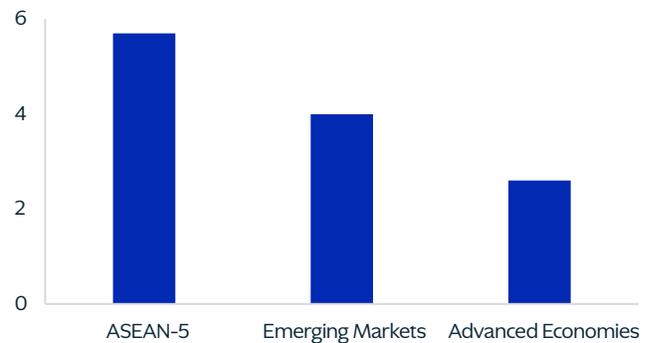
**% of Trade That Is Within Asia**



Data as at December 31, 2023. Source: The Economist.

**Exhibit 38:** Rising Asian Consumption Also Makes Local Markets More Attractive

**Volume of Imports, Average Annual % Increase, 2023-2027**



ASEAN-5 equals Indonesia, Malaysia, Philippines, Singapore, and Thailand. Data as at September 30, 2023. Source: The Economist.

Key areas on which we are focused include transportation assets, subsea cables, security, data/data centers, and energy transmission. Importantly, local banks are taking more of the local market share as part of this build-out. Before the Global Financial Crisis, Western financial firms accounted for two-thirds of the region's overseas lending. Today, by comparison, local Asian banks, led by China, Japan, and Singaporean entities, account for more than half. We also look for significant growth in non-bank lending, including both Liquid Credit and Private Credit, as this theme gains further momentum across Asia.

We also see more countries in the region participating in and robustly benefiting from the Asia global growth engine. Our colleague Changchun Hua believes that India and Southeast Asia in particular (e.g., Philippines, Indonesia, Vietnam, etc.) 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. The building of resiliency into supply chains has led to opportunities in data centers, logistics, and lower-cost manufacturing in the region.

# 6

## Demographic Challenges to Retirement Security

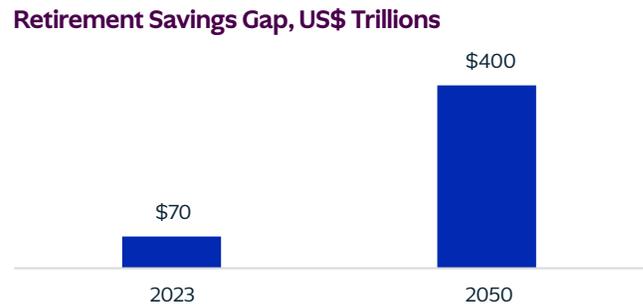
We are bullish on domestic retirement savings, especially as more and more governments begin to appreciate the importance of keeping local flows in their own markets. We note that the U.S. dependency ratio, or the ratio of the 65+ population relative to the working-age population, rose from 18% in 1990 to 30% in 2020 and is expected to rise to 37% by the end of the decade. As a result, the working-age population is peaking in many parts of the world, while the base of older workers they need to support is growing rapidly. To address this challenging demographic landscape, increased efforts in fertility will likely be necessary. This situation should also motivate governments and corporations to promote greater domestic savings, including annuities and other tax-deferred savings options in developed markets. Japan's NISA program is an excellent example of the type of structures that we expect to see rolled out across the global economy in the coming quarters. Meanwhile, in emerging markets like India, by comparison, we expect to see governments introduce new programs that help shift individuals out of gold and real estate into more traditional capital markets savings vehicles.

**Exhibit 39:** Individuals 55+ Have Captured Essentially All of the Increase in Household Assets Starting After the GFC

Household Assets by Age Group, US\$ Trillions and % of Total						
Age	Assets, US\$ Trillions			As a % of Total Assets		
	2001	2007	2023	2001	2007	2023
55 and Older	\$26	\$44	\$114	51%	57%	69%
40-54	\$19	\$26	\$37	37%	33%	22%
Under 40	\$6	\$8	\$15	12%	10%	9%

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

**Exhibit 40:** The Global Retirement Savings Gap Is Expected to Reach \$400 Trillion by 2050



Data as at December 31, 2023. Source: World Economic Forum.

At the same time, we believe existing savings will need to be restructured and reorganized. For starters, just consider that a sizeable wave of retirements experienced in the U.S. and other economies in recent years was linked to the financial security that elderly workers enjoyed from rising housing prices, especially post-COVID. However, elevated housing prices, combined with structural housing shortages in developed markets, means that workers will increasingly need to seek alternative vehicles for wealth accumulation going forward. All told, in the U.S. for example, the percentage of total assets owned by the aged 55+ age cohort has grown from 51% in 2001 to 69% in 2023, driven in part by a 4x increase in Real Estate assets. One can see this in *Exhibit 39*.

We think that homeowners will now need to diversify their holdings to create more balanced retirement plans. At the same time, non-homeowners, many of whom have had to dedicate more of their current incomes to cover rental costs, and also have not benefitted from the home asset-price appreciation, will need to find ways

to create ‘catch-up savings’. In our view, neither task (i.e., diversification of assets by homeowners or much needed catch-up savings for non-homeowners) will be that easy to accomplish without government incentives and professional advice.

Our final point on retirement security: we expect a greater number of politicians globally to encourage citizens to keep their savings at home, as increasingly economic security converges with national security interests. Indeed, a recent speech by President Macron highlighted the challenges faced by Europe in not having an integrated financial system that can ensure that savings are funding innovation and private investment on the Continent. He noted specifically an estimated €300 billion flowing to U.S. Treasuries, which he believes helps fuel American, rather than European, growth. This vocal viewpoint – frankly – did not come as a total surprise to us, as to some degree, most political leaders want to lower their cost of capital and reduce dependence on foreign flows, especially in countries with large deficits. As such, we have seen a notable increase in tax-deferred savings accounts that – in addition to the demographic headwinds that countries face – can somewhat help limit the anxieties around running large deficits and reliance on foreign funding for growth.

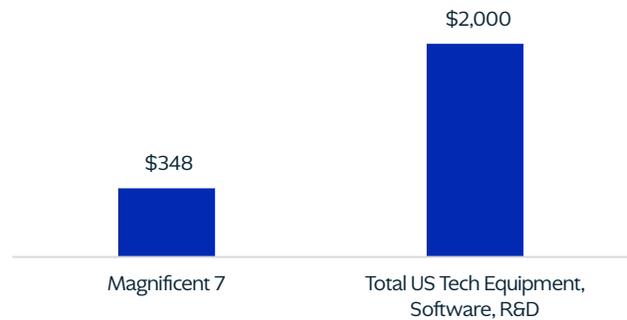
# 7

## AI/Energy Infrastructure

As we have traveled around the world and talked to various CEOs about AI, we have come to a few important investment conclusions about the required infrastructure. For starters, the lion’s share of the ‘Magnificent 7’ view AI as an opportunity but also as an ‘existential threat’. To this end, we think that they will continue to spend at a surprisingly strong rate for the next few years. Already, as we show in *Exhibit 41*, their Capex and R&D spending has increased to nearly 20% of total U.S. Tech spend, compared to only 3.6% in 2011. The good news, though, is that Capex intensity is not so outsized that we think there is the potential for these companies to pull back in the coming quarters. One can see this in *Exhibit 42*.

**Exhibit 41:** The Magnificent 7 Reinvests 61% of Operating Free Cash Flow Back Into Capex and R&D. They Are Spending at a Scale Equivalent to Nearly 20% of Total U.S. Tech Capex, a Trend We Expect to Continue in 2025

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



Data as at September 30, 2024. Source: Goldman Sachs, U.S. Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

**Exhibit 42:** While the Absolute Dollars Spent Today Are Massive Relative to Past Cycles, Capex Intensity (Relative to Sales) Does Not Look Outsized

**U.S. Hyperscaler Capex Intensity: Capex/Sales**



Hyperscalers refer to MSFT, AMZN, GOOGL, META and ORCL. Data as at November 30, 2024. Source: Company data, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Importantly, most of these companies run with negative net debt and they continue to show strong top line growth and healthy margins. As a result, we view this backdrop differently than what we saw during the telecom/technology bust of 2001. Our second point is that we expect more global expansion linked to AI in the coming

years, especially in Asia. *Exhibit 43* shows that Asia's data center footprint is a fraction of the U.S. footprint. We expect this to change.

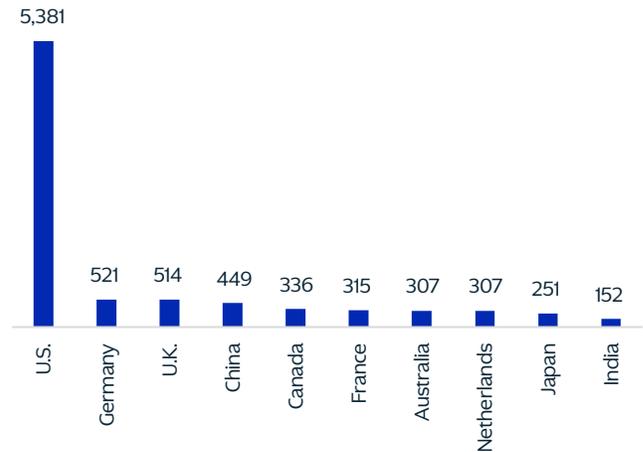
Our third point is that, for AI to scale, massive investment in the picks and shovels, as well as the energy infrastructure needed to support growth, will be required. *Our recent trip to D.C. in early December only reinforced our view that part of the Trump administration's plan is to further deregulate energy production, transportation, and transmission to make America 'energy safe/independent' during this period of extraordinary change in the technology industry.* Permitting reform will also be critical. All told, our estimates suggest that soaring demand for data centers to support artificial intelligence and cloud computing will boost global spending in the sector to at least \$250 billion a year. At KKR, that is where we are leaning in, including companies that can deliver energy efficiently as well as cooling procedures for data centers. We also want to own the 'pipes' that can get power from its origin to where there is demand. To date, much of the incremental renewable power sources that have been built are often too cyclical (think wind or solar) or not in the right location to power the demand that is required. Therein lies the opportunity, we believe.

Meanwhile, if we are right that electricity prices will increase to reflect this growing demand that we are envisioning (e.g., the Commonwealth of Virginia already funnels 25% of its energy production towards AI-related activities), then investments in energy efficiency should gain momentum too. Consistent with this view, we favor software plays, as one example, that can help warehouses become more efficient at storing goods and using less energy, or industrial automation efforts that retool old manufacturing processes to make them more globally competitive.

We also want to own the 'pipes' that can get power from its origin to where there is demand.

**Exhibit 43: The Opportunity for Data Center Growth in the Rest of the World Is Still Quite Substantial**

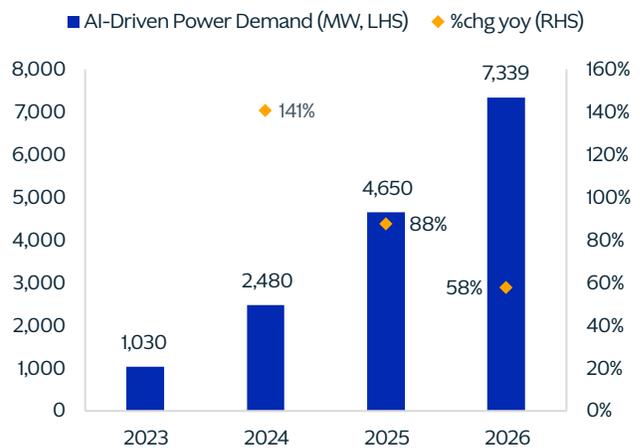
**Number of Data Centers**



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

**Exhibit 44: AI Workflow Requires More Computation Intensity, While Server Racks Use More Energy, Both of Which Will Drive Power Demand**

**AI-Driven Data Center Demand, Megawatts**



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

# Picks And Pans

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

## ▲ Industrial Companies Focused On Safety And Testing (New)

As a thematic investment, we favor industrial company investments that specialize in aspects of fire safety, mass notification, and testing and measurement. We like this area of the global industrials sector for several reasons. For starters, many of these types of investments are regulated by a perpetually evolving framework of safety codes enforced at multiple levels of jurisdiction, not only mandating installation at each new building, but often requiring replacements and upgrades post-inspection. Test equipment is necessary to understand and validate material attributes such as structural integrity, surface protection, and estimates of barrier and air properties. Investing in industrial companies as a thematic strategy allows investors to tap into technological advancements, supply chain resiliency, and sustainability initiatives that should benefit from long-term growth and add resilience to portfolios.

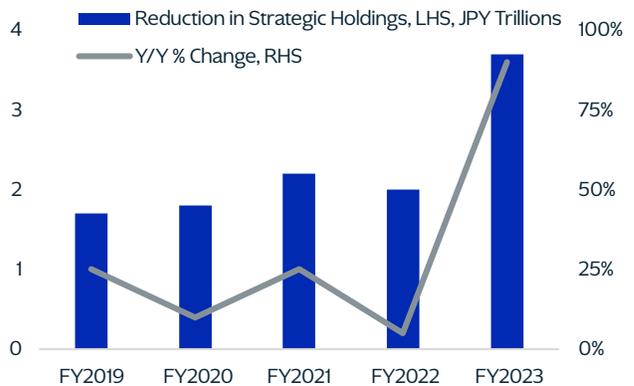
## ▲ Japan With A Focus On Intercompany Holdings (New)

We recently went back to Japan where we discovered another compelling investment idea beyond corporate carve-outs and public-to-privates: There is an accelerating unwind of Japanese strategic holdings within the corporate sector, a backdrop that is encouraging a wave of stock buybacks like Toyota's recent tender offer. This buyback activity comes amidst a governance push by the Tokyo Stock Exchange to encourage major corporations to dismantle their cross-shareholdings. In

the past, such mutual holdings have been viewed as a means to strengthen business relationships in Japan. However, the reality is that these tangled structures can lead to weakened oversight, shielding management from shareholder accountability. Not surprisingly, given all the focus on improving shareholder returns in Japan, many of these cross-company holdings are now being unwound, which allows these corporates to reacquire shares at generally accretive levels. At the same time, Japan's Financial Services Agency has also intervened by introducing new disclosure guidelines, which are making it more challenging for companies to shift their holdings from strategic to pure investment status. As a result, hesitant shareholders are coming under more scrutiny. So, our key takeaway from our most recent Japan trip is that the ongoing unwinding of these holdings is creating a virtuous cycle by releasing dormant capital, thus enabling sellers to focus on growth while allowing buyers to improve their return on equity.

**Exhibit 45:** There Has Been \$30 Billion of Reductions in Japanese Strategic Holdings Year-to-Date

### Japan Corporate Unwinds

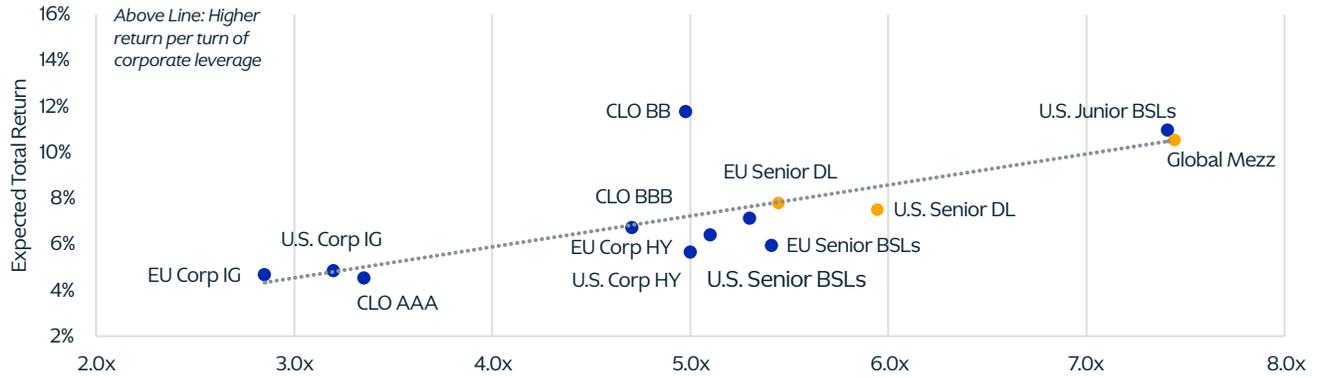


Data as at September 30, 2024. Source: Goldman Sachs Investment Research.

Meanwhile, we heavily favor Asset-Based Finance as a play on our Regime Change thesis within the Credit markets.

**Exhibit 46: CLO BB Securities Offer a Higher Return per Unit of Leverage**

**Expected Total Return vs. Leverage, %**



Data as at September 30, 2024. Source: Bloomberg, LCD.

Overall, we are still constructive on the investing environment in Japan and believe that an economic reawakening is in progress. Specifically, we see a transition underway in the coming years from the post-COVID, pent-up, demand-driven recovery, to a second phase fueled by real income growth. Capital expenditures remain elevated, which is critical to boosting productivity to offset not only wage increases, but also price increases in food and energy. We also still see opportunities in corporate carve-outs and significant value in direct public to privates, as we believe the opportunity for operational value creation is meaningful. That said, the new opportunities we learned about during our visit, such as the acceleration in the disposition of inter-company holdings, feel intriguing to us. We note that sell-side firms such as Goldman Sachs offer baskets that allow investors to play this part of the corporate reform story efficiently.

**▲ CLO Liabilities (Repeat)**

As we detail later in our ‘Questions’ section, relative value is harder to find in the Credit markets these days. Consistent with this view, we believe that all-in yields are likely near peak levels, as cooling inflation will give the Fed more conviction on interest rate cuts and easing financial conditions. While we still like Loans at a headline level, our preference today is to play this idea through higher-quality CLO tranches, as diversification benefits and credit enhancement matter more in an environment where

idiosyncratic risks are elevated (particularly when it comes to refinancing). We also think that CLOs fit into our higher for longer thesis on rates relative to pre-COVID. In terms of specific CLO Liabilities, we think the BB sleeve looks particularly attractive (*Exhibit 46*).

**▲ Biotechnology (Repeat)**

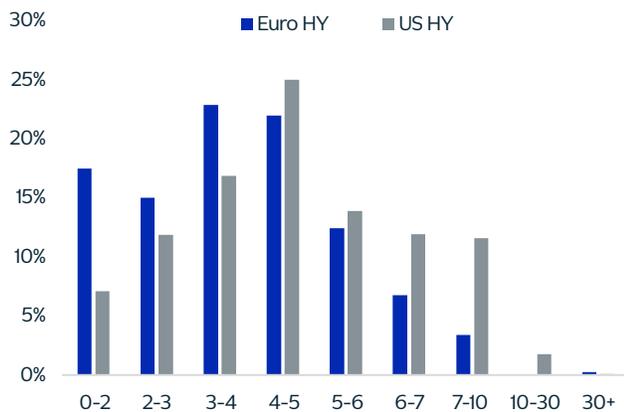
We think the drawdown in biotech stocks is likely overstated when one compares it to how the rest of the equity market has performed. Just consider that the Nasdaq biotech index is down about 19% from its 2021 peaks, while the S&P 500 has actually *climbed* about 19% over the same period. Nonetheless, we continue to think biotech remains one of the most compelling secular growth stories in the market, backed as it is by increased technological investment and aging populations, and the fact that many weaker startups have struggled to raise capital/IPO in recent years. While concerns about the direction of healthcare have given some investors pause, we think the ‘reshoring’ of biotechnology and the growing appreciation that biotechnology is a critical industry for national defense, will more than offset those concerns in 2025. Our bottom line: We are turning more bullish on the sector, particularly when one accounts for the fact that valuations in price-to-book terms are now hovering near the lowest levels since the GFC.

## ▲ Short Duration European Credit/Capital Solutions (New)

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

**Exhibit 47:** Fully 55% of Euro HY Are Maturing Over the Next Three to Four Years. We See This Refinancing Opportunity as Significant

### HY Maturity Wall, %



Data as at October 31, 2024. Source: Bloomberg.

## ▲ Collateral-Based Cash Flows (Repeat)

Our research continues to show that many individual and institutional investors are *still* underweight Real Assets, especially Infrastructure, Asset-Based Finance, Real Estate Credit, and certain parts of Energy, during a time when the need for inflation protection in portfolios remains high. These products also have a degree of inflation linkage, given they are 1) either 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 rising rates (e.g., Asset-Based Finance), or 2) they have pricing escalators/contracted revenues that are longer-term in nature.

While most investors are focused on the semiconductor angle of the current AI boom, we have been spending more time studying the energy demand surge needed to power these models. The reality is, 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.

Meanwhile, we heavily favor Asset-Based Finance as a play on our Regime Change thesis within the Credit markets. The market opportunity is significant, as lending in this asset class now approaches \$6 trillion or more, which is multiples the size of High Yield, Levered Loans, and/or Direct Lending. See *Exhibit 46* for details, but the spread to other forms of Credit in terms of potential absolute return in the Asset-Based Finance market now appears quite compelling. Even with inflation cooling and the Fed embarking on an easing campaign, we still think ‘higher for longer’ will remain in play.

## ▲ Uranium (New)

We think nuclear energy demand will only continue accelerating as more countries acknowledge its critical role in addressing climate change by facilitating the transition to greener energy sources. As such, we are using Uranium as a pick to signal that we want some form of exposure to this growing growth idea. To grasp the scale of adoption, over 30 governments are collaborating with the IAEA to

incorporate nuclear power into their energy strategies. Currently, over 60 new reactors are under construction worldwide, and 300 more are in the planning/proposed phase. So, the heightened interest in nuclear power across the globe should bolster the bullish outlook for Uranium, which is currently facing a significant structural supply deficit. China's increased usage due to its atomic energy build out could tighten the market even further, particularly as this critical mineral becomes even more intertwined in great power competition. China is committing \$440 billion to the construction of 150 new reactors, which will add 150 gigawatts (GW) of capacity over the next 15 years. This expansion surpasses the total nuclear capacity built worldwide in the past 35 years.

## ▲ Secular Compounders Outside The Magnificent Seven (New)

Between 2017 and 2023 a group of growth-oriented secular compounders outside of the Tech sector consistently outperformed the broader equity market. More recently, the AI-driven rally has seen the 'Magnificent 7' (and the index, given their size) inflect upwards, leaving the non-Tech compounders behind (*Exhibit 48*). These secular compounders now trade at a historic 55% discount on NTM price-earnings relative to the broader market (*Exhibit 49*). At these prices, particularly given the risks of increasing market concentration in the Mag7, we think it would be opportune to return to these secular compounders, which still maintain their moats and ability to reinvest capital at attractive returns.

So, our key takeaway from our most recent Japan trip is that the ongoing unwinding of these holdings is creating a virtuous cycle by releasing dormant capital.

**Exhibit 48:** Secular Compounders (Ex Tech) Have Recently Fallen Behind the Market. We Would Buy the Dip

**Global Equity Compounders, ex-Tech, Total Returns vs. MSCI AC World**



Data as at October 25, 2024. Source: Datastream, STOXX, Goldman Sachs Global Investment Research.

**Exhibit 49:** These Compounders Are Now Historically Cheap On Forward Price-to-Earnings Relative to the Market

**Global Equity Compounders, ex-Tech, 12-Month Forward Price-Earnings vs. MSCI AC World**



Data as at October 25, 2024. Source: Datastream, STOXX, Goldman Sachs Global Investment Research.

## ▲ Models Transitioning To Capital Light (New)

As mentioned in the Key Themes segment, we see a mega trend emerging as more companies shift from capital heavy to capital light. A growing number of public companies are essentially taking themselves private through better capital allocation, including aggressive buyback programs. They are also selling off capital heavy parts of their businesses, including divestitures and securitizations, to raise fresh capital to complete these repurchases. Not surprisingly, many executives are deemphasizing their businesses' cyclical components to create more sustainable companies with greater visibility of earnings and returns. To this end, we think the opportunity to either buy the equity of the companies transitioning towards more of a capital light model or to buy the assets off these companies as they transition is quite compelling.

## ▼ Near Term Oil Prices (New)

See SECTION III on the Capital Markets for specific details, but we anticipate a challenging supply and demand landscape in 2025. Global tariffs could strengthen the U.S. dollar and dampen global oil demand growth, potentially extending the market surplus and delaying a rebound in oil prices. Consequently, our WTI forecasts for 2025-26 are slightly below current futures pricing, and our 2025 forecast is the first time we have been below consensus in years. Nonetheless, we remain optimistic about the longer-term outlook for crude oil in 2027-28. This outlook is driven by prolonged lower oil prices that may suppress supply while stimulating demand, as well as upward pressures from geopolitical instability, a sometimes chaotic energy transition, and a more disciplined approach to return on invested capital from both OPEC and non-OPEC producers.

## ▼ Low-Cost Consumer Discretionary (Repeat)

As we have noted previously, younger and lower-income U.S. consumers have been the most exposed to inflation this cycle, which is weighing on available spending. Moreover, a lot of inflation today is in 'must-have' categories like food, housing, etc., taking wallet share from discretionary spending on 'nice-to-have' budget items like restaurants or recreational goods. Finally, we think the composition of low-income demand is likely shifting away from categories like fast-casual dining, as a surge in immigration leads to more competition for both employment and low-cost housing. Against this backdrop, although the consumer in aggregate has mostly recovered from the inflation shock of 2022, we remain cautious about the outlook for nonessential spending among this cohort. Top of mind for us as well is that low-cost, low-margin retail products where China has a high share of manufacturing will be particularly exposed to the impact of higher tariffs; low-income consumers have seen limited real wage gains in recent years and may be faster to pull back on 'nice-to-have' categories in the Goods space.

## ▼ FX Risks

We think markets are undervaluing the risk of meaningful volatility in the currency markets in 2025. Just consider that implied volatility for major currency pairs is now lower than before the pandemic, despite higher implied volatility for U.S. rates. Said differently, the market is betting that interest rate differentials will remain relatively well-contained as global central banks and the Fed confront similar economic conditions. We disagree and continue to see this as an 'asynchronous' economic cycle, particularly now that the threat of a more aggressive tariff policy risks raising inflation for the U.S. (as an importer) while hurting growth for exporters like Europe and China. More broadly, increasing economic frictions between major countries have historically led to less coordination in currency markets, which raises the chance of large swings in FX. Our bottom line is that this is *not* the time to take a lot of excess exposure risk on FX, as it may prove to be the dominant story of 2025 the way that bond market volatility was the dominant story of 2023-24.

## ▼ Cuspy Credit and Non-Control Positions In Equities (New)

We are entering an environment where slower nominal growth limits pressure on bond yields and helps to encourage more capital markets activity. However, there are likely still too many weak companies with anemic capital structures that will need to refinance in the next several quarters. Similar to our 2023 Outlook, our view is to 'Keep it Simple' and not stretch on the quality front in 2025. In our view, the incremental yield pick-up in the lowest rated unsecured High Yield, for example, is just not worth it. Against this backdrop, we think the difference between control and non-control positions will magnify materially in 2025, as demanding equity multiples require greater focus on operational improvement and the ability to retool companies' capital structures, even as borrowing markets thaw.

## ▼ Unsecured Consumer Credit (New)

Our data suggest a tiering of consumer obligations with non-prime 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 150-basis point increase, compared to 300-400 basis points, on average, in prior cycles). However, even with a more favorable backdrop relative to previous cycles, we believe that some lenders became too lax in their underwritings during the post-COVID spending euphoria. As we enter 2025, some of this lax underwriting will come home to roost, especially where there is no direct claim on the collateral.

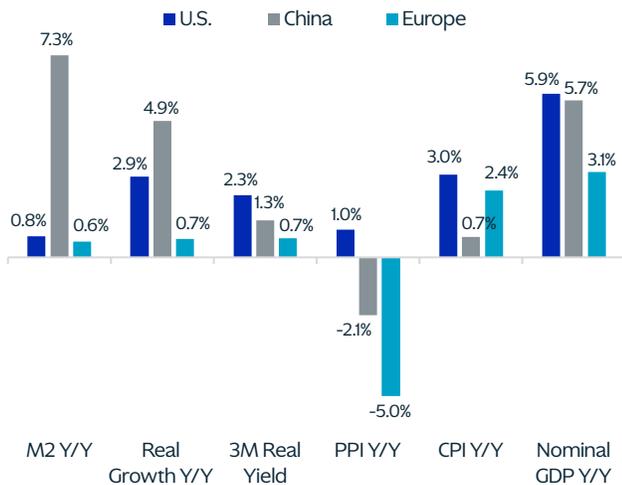
Against this backdrop, we think the difference between control and non-control positions will magnify materially in 2025, as demanding equity multiples require greater focus on operational improvement and the ability to retool companies' capital structures, even as borrowing markets thaw.

SECTION II

# Global / Regional Economic Forecasts

**Exhibit 50:** The Wide Variance Across Key Economic Indicators...

**Key Economic Indicators, %**



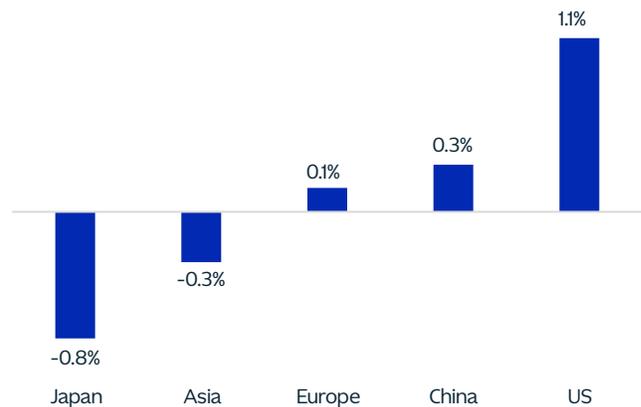
Real yield calculated as 3M rate - Latest Y/y CPI inflation. Data as at November 26, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Recent visits to China and the European continent, as well as travel around the United States, reinforced our view that the U.S. productivity story is the shining star in what is an otherwise dimmer universe of global economic growth. To be sure, India continues to chug along at a strong clip, and we also felt pockets of cyclical upswing during our recent trip to Southeast Asia. Still, our overall message is one of disjointed and more sluggish global growth, one that is likely to get amplified with the introduction of more assertive tariffs by President Trump. So, our bottom line as we enter 2025, is that we continue to have heightened

conviction about the asynchronous global recovery we have been forecasting this cycle.

**Exhibit 51:** ...Speaks to the Asynchronous Nature of This Recovery

**2024 Consensus GDP Revisions, %**



Data as at November 26, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

So, our bottom line as we enter 2025, is that we continue to have heightened conviction about the asynchronous global recovery we have been forecasting this cycle.

**Exhibit 52: We Are Above Consensus in the United States for Growth, But Below Everywhere Else in the World**

	2025e Real GDP Growth		2025e Inflation		2026e Real GDP Growth		2026e Inflation	
	GMAA	Bloomberg	GMAA	Bloomberg	GMAA	Bloomberg	GMAA	Bloomberg
	New	Consensus	New	Consensus	New	Consensus	New	Consensus
<b>U.S.</b>	2.5%	2.1%	2.6%	2.4%	2.0%	2.0%	2.8%	2.5%
<b>Euro Area</b>	0.8%	1.2%	1.9%	2.0%	1.2%	1.3%	2.2%	2.0%
<b>China</b>	4.4%	4.5%	0.9%	1.2%	4.1%	4.1%	1.0%	1.2%
<b>Japan</b>	1.0%	1.2%	2.0%	2.0%	0.8%	0.9%	1.5%	1.7%

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

**Exhibit 53: Our U.S. Forecasts Have an Upside Skew, But We See a Downside Skew in Many Other Countries**

	KKR GMAA Real GDP Forecast and Probability, %			KKR GMAA Inflation Forecast and Probability, %		
	Base	Low	High	Base	Low	High
<b>U.S.</b>						
2025e	2.5%	1.5%	3.0%	2.6%	2.5%	4.0%
2026e	2.0%	1.0%	2.5%	2.8%	2.0%	3.5%
<b>Euro Area</b>						
2025e	0.8%	0.3%	1.5%	1.9%	1.4%	2.5%
2026e	1.2%	0.7%	1.6%	2.2%	1.6%	2.7%
<b>China</b>						
2025e	4.4%	3.9%	4.8%	0.9%	0.4%	1.4%
2026e	4.1%	3.6%	4.6%	1.0%	0.5%	1.5%
<b>Japan</b>						
2025e	1.0%	0.5%	1.5%	2.0%	1.5%	2.5%
2026e	0.8%	0.3%	1.3%	1.5%	1.0%	2.0%

In the U.S. for 2025 and 2026, we assign a probability of 50% for the base case, 35% for the bear case, and 15% for the bull case. In Europe we assign the downside 20th percentile and the bull case 80th percentile. In China and Japan for 2025 and 2026, we assign a probability of 55% for the base case, 30% for the low case, and 15% for the high case. Data as at December 15, 2024. Source: KKR Global Macro & Asset Allocation analysis.

## U.S. GDP

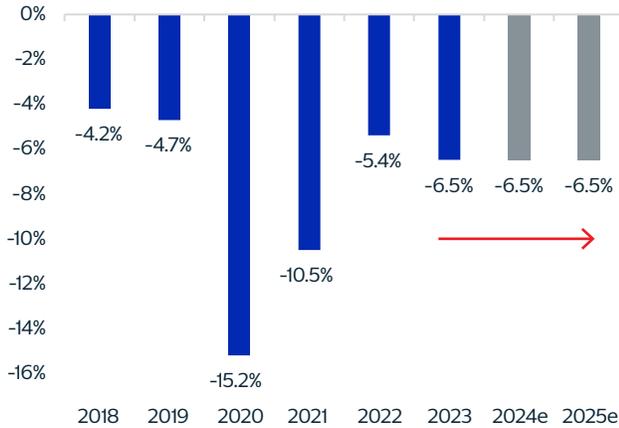
**Forecasts:** Despite the threat tariffs can pose to the economy, we are, in fact, revising our 2025 GDP outlook upward modestly to 2.5% from 2.3% previously, which puts us notably above the consensus for 2025 (currently at 2.1%). For 2026, we forecast two percent growth, which is in line with consensus. Although our 2025 fundamental forecast is +40 basis points above consensus, our quantitative models (which do not capture the impact of tariff policy) are even more bullish at +2.9%. Specifically,

ignoring tariffs, our models indicate that ample credit availability and strong wealth effects will help prop up GDP in 2025-26, partially offset by a modest drag from the impact of elevated mortgage rates on housing market activity.

Importantly, though, we emphasize that while higher tariffs do generally lower GDP in aggregate (including via headwinds to real consumer spending, capex, and typically exports too, given how tariffs promote stronger FX and invite retaliation from trade partners), there are important offsets to consider, including lower import volumes (remember that imports are a negative input into GDP) and slightly easier fiscal policy (given that tariff revenue will likely help finance tax cuts). See *Exhibit 55* for details of our specific projections on where tariff policy is headed, but our best estimate is that - on net - new tariffs will subtract a combined 40 basis points from U.S. GDP in 2025. One can see an analysis of the GDP impacts in *Exhibit 57*. We also assume that tariffs boost inflation by 60 basis points over two years, or about 30 basis points in 2025 (*Exhibit 56*). Importantly, in his first term President Trump showed that he could use tariffs for strategic purposes, enhancing the U.S. negotiating position with other nations, reducing trade imbalances and achieving security objectives. In such a world, tariffs are often a temporary means to an end. Also, Trump 1.0 smartly proved that the U.S. could effectively impose tariffs in sectors where there were replacements available from other markets.

**Exhibit 54:** No Significant Fiscal Retrenchment Expected in 2025

**U.S. Budget Balance, as a % of Nominal GDP**



Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 55:** We Forecast That President Trump Will Use a Tiering System Again to Implement Tariffs

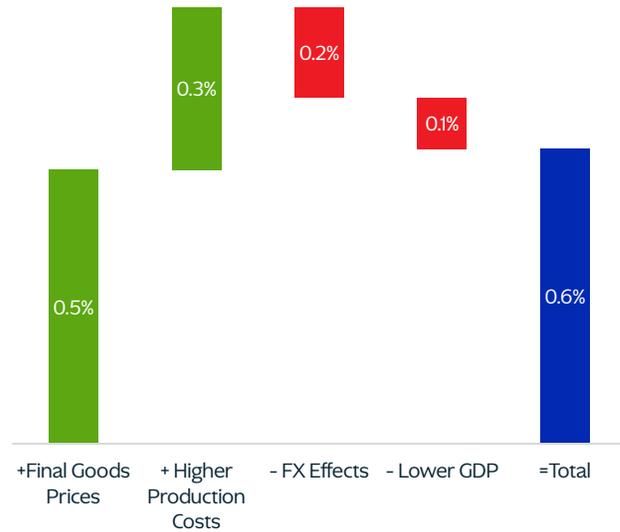
List	Coverage	Amount US\$bn	Current Tariff	Incremental Tariff	Possible Final Tariff	Legal Authority
China	List 1/2	40	25%	60%	85%	Sec. 301 (Unfair Trading Practices)
	List 3	120	25%	35%	60%	
	List 4a	90	7.5%	10%	17.5%	
	List 4b	200	0%	5%	5%	
Select Global Import Tariff (Mexico, Germany)	Broad Coverage	2,650	2.7%	5%	7.7%	Combination of 122, 201, 232, IEEPA
<b>Total</b>			<b>3.8%</b>	<b>7.0%</b>	<b>10.8%</b>	

Data as at November 15, 2024. Source: Haver Analytics, Goldman Sachs Research, KKR Global Macro & Asset Allocation analysis.

‘It is [still] hard to get hurt falling out of a basement window.’

**Exhibit 56:** On Balance, Tariffs May Boost Headline PCE by Approximately 60 Basis Points Over Two Years

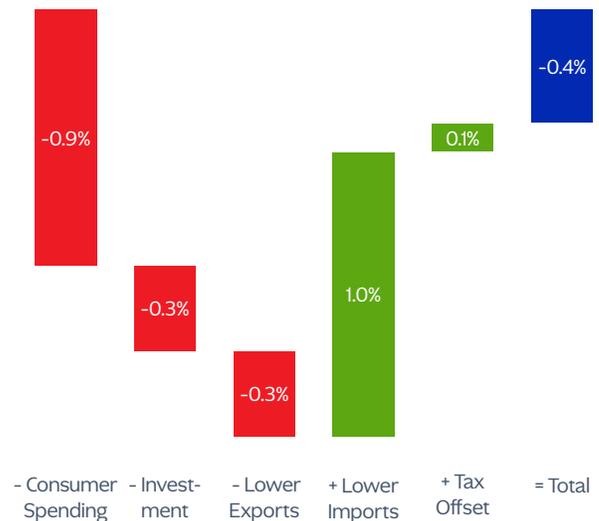
**Tariff Impact On Price Levels**



Data as at November 15, 2024. Source: KKR Global Macro & Asset Allocation analysis.

**Exhibit 57:** Current Tariff Proposals Do Not Materially Dent Our GDP Forecasts

**Tariff Impact on GDP**



Data as at November 15, 2024. Source: KKR Global Macro & Asset Allocation analysis.

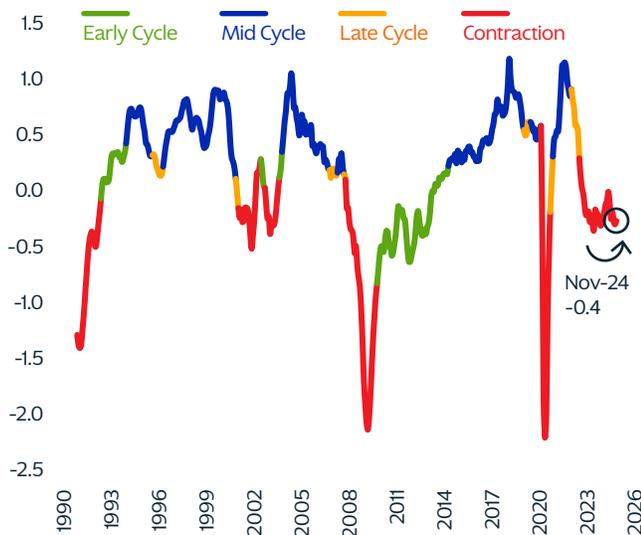
**Commentary:**

There are four key areas of positive tailwinds that we believe will support our above-consensus outlook for GDP growth. They are as follows:

**Point #1: “It is [still] hard to get hurt falling out of a basement window.”** Construction spending and inventory investment – the most cyclical areas of the economy – are now running well below trend, as they have already been under pressure over the last few years. We focus on these areas because they typically see abrupt declines during recessions, actually accounting for more than 100% of the net peak-to-trough GDP downturn in most cycles. One can see this in *Exhibit 59*.

**Exhibit 58:** Our U.S. Cycle Indicator Has Been in Contraction Since 2022, But Is Now Inching Back Towards ‘Early Cycle’ Territory

**KKR Cycle Indicator, 1990-Present, Z-Score**

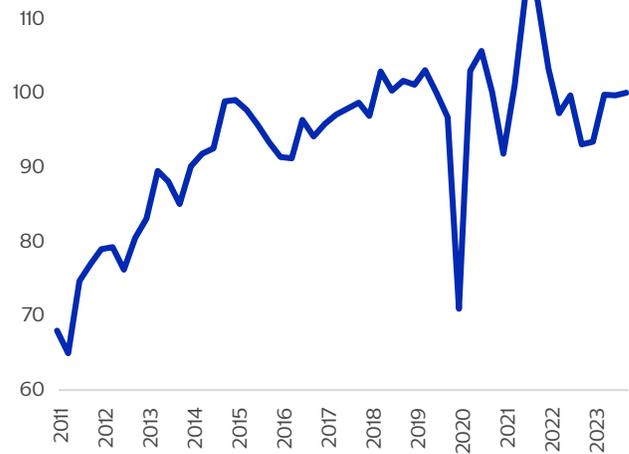


Data as at November 30, 2024. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Finally, we note that the ‘Mag7’ has reached a scale where the ‘micro’ of these companies has taken on ‘macro’ resonance.

**Exhibit 59:** Recessions Are Typically Caused by Housing and Inventory Issues. That Backdrop Does Not Look Likely This Cycle

**Real Construction + Inventory Investment (4Q19=100)**

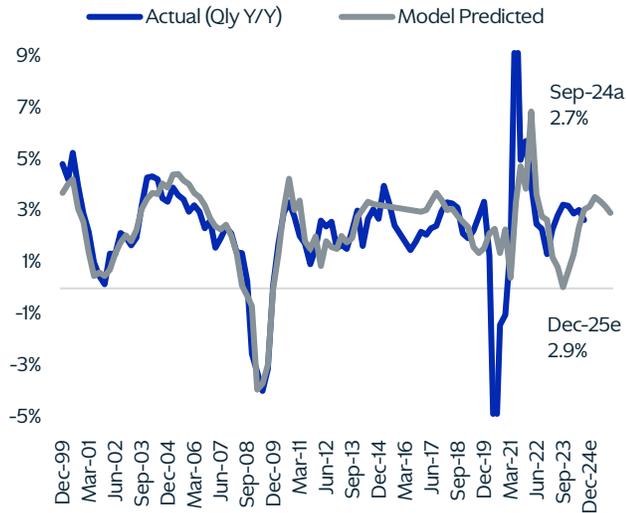


Data as at September 30, 2024. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

More broadly, as we show in *Exhibit 58*, our cycle indicator has been in contraction for more than two years now. Importantly, though, we are optimistic that as we transition through 2025, the model will progress towards ‘early cycle’ territory. Consumer confidence and M&A activity improvements should act as important spurs as impulses from lower Fed rates and declining political uncertainty start flowing through the economy. Finally, we note that the Magnificent Seven have reached a scale where the ‘micro’ of these companies has taken on ‘macro’ resonance. All told, the Magnificent Seven Capex now spends on a scale equivalent to almost 20% of total U.S. spending on equipment Capex, R&D, and software IP. Importantly, the Magnificent Seven is growing expenditures in these areas by 15% to 20% annually. We have seen ‘fingerprints’ of these sector trends in recent GDP data, which showed, for example, equipment Capex growing at an annualized rate of over 10% in recent quarters, a trend that our macro team believes can persist into 2025.

**Exhibit 60: Our GDP Leading Indicator—Which Does Not Incorporate Tariffs—Points to Continued Near Three Percent Growth Going Forward...**

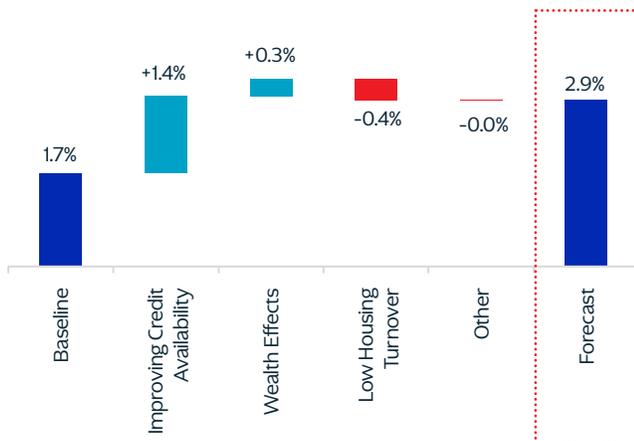
**U.S. Real GDP Leading Indicator, %**



Our GDP leading indicator is a combination of eight macro inputs that together we think have significant explanatory power regarding the U.S. growth outlook. Data as at November 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 61: ...Fueled by Improving Credit Conditions and Wealth Effects**

**Elements of 2025 GDP Indicator, %**



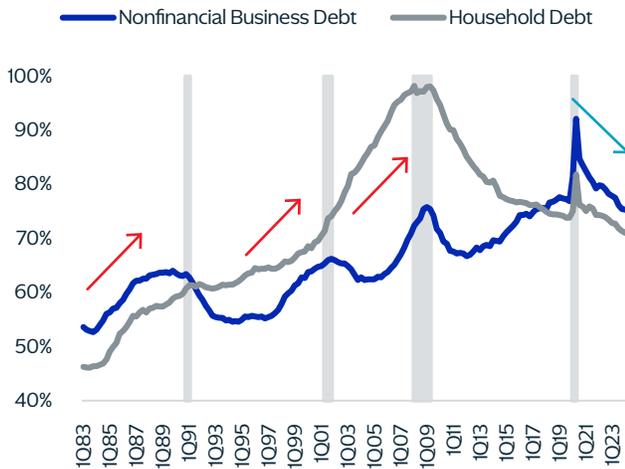
Our GDP leading indicator is a combination of eight macro inputs that together we think have significant explanatory power regarding the U.S. growth outlook. Data as at November 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Point #2: The credit cycle could accelerate:** As we showed earlier in *Exhibit 14*, we are beginning a global easing cycle. To be sure, we still ascribe to our higher resting heart rate for inflation thesis, but we do think central banks will get absolute rates lower, especially outside of the U.S. As such, we expect more lending to take place as both consumers and corporations look to move beyond refinancings as a result of more pro-growth capital formation. Deregulation and more M&A should help fuel faster growth under a new Trump administration. Looking ahead, there are several areas where we expect a rebound in lending capacity. For starters, we think that traditional issuance outside of Investment Grade is poised to accelerate. Second, lower absolute rates should help drive more mortgage origination for consumers, while a stabilizing CRE equity cycle should help bring more refinancing activity to real estate lending. Third, we expect further expansion of the Asset-Based Finance market, a viewpoint that dovetails with our thesis about more companies becoming capital light (see Key Themes section). Finally, we expect more mergers and acquisitions, though we do also think that corporations will rely more heavily on their stock prices today than in the past.

**Point #3: Consumers are in good shape and will continue to spend:** Overall, debt-to-GDP levels for both households—and even businesses—are now below where they were in 2019. Even consumer credit card and auto debt—which are areas that have not experienced the same sort of deleveraging that mortgage debt has in the post-GFC era—are nonetheless showing aggregate debt-to-income ratios that are essentially in line with longer-term trends (*Exhibit 63*). Granted—as noted in our unsecured credit ‘pan’ above—elevated debt service costs are continuing to place strains on subprime borrowers exposed to variable-rate liabilities. Regardless, our core message is that there has not been any notable borrowing binge among households, and as a result, we are not expecting any major pullbacks related to widespread consumer deleveraging.

**Exhibit 62: U.S. Corporate and Consumer Leverage Ratios Have Actually Declined Versus Pre-Pandemic Levels**

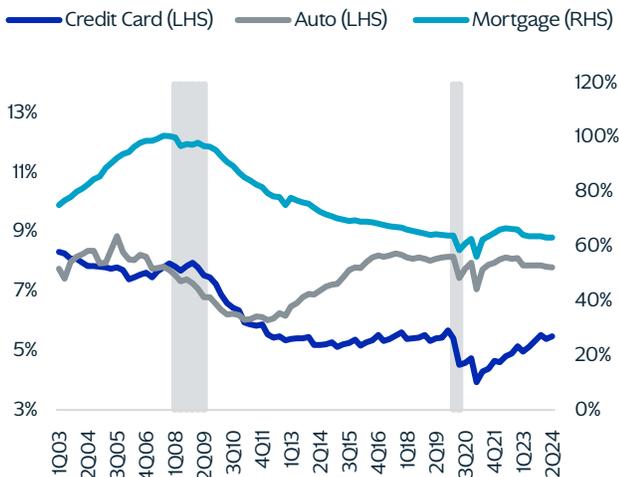
**U.S. Private Sector Leverage as a % of GDP**



Gray shading denotes recessionary quarters. Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Economic Affairs, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 63: Even Though Credit Card Debt Has Increased Back Above Pre-COVID Levels, Both Mortgage Debt and Auto Loans as a Percentage of Disposable Income Have Decreased in Recent Years**

**Credit Card and Auto Debt as a % of Disposable Income**



Data as at June 30, 2024. Source: Haver Analytics, Federal Reserve Board.

Meanwhile, though the current U.S. household savings rate of around five percent may seem low compared to the norm of around 10% that prevailed in the 1980s-90s and even during parts of the post-GFC era, we do not believe current trends represent an over-extension of consumer spending. Importantly, the true 'neutral' savings rate today is much lower than it was in earlier eras, courtesy of aging demographics. Consider lifecycle savings behavior: individuals tend to save substantially until reaching retirement. As workers move into retirement, they generally begin spending more than they earn, which is now the case for the large cohort of Baby Boomers who have recently moved into their late 60s and 70s. Taking these mass retirements into account, our analysis suggests that the true 'neutral' expected savings rate for the country today is right around its current level of about five percent (*Exhibit 139*).

Undoubtedly, there are still pockets of stress among consumers, and the implementation of tariffs may prompt more consumer caution, particularly among lower-income households. However, our bigger-picture view is that consumers - in broad terms - have passed the test of post-pandemic inflation and have largely reined in spending and leverage sufficiently to offset today's higher costs. At the same time, although job growth is slowing (we assume 125,000 net gains per month on average in 2025, versus around 160,000 in 2024), we do not think it is going to collapse. Perhaps more importantly, wage growth trends remain quite supportive for workers, with average hourly earnings in September-November 2024 (latest data) growing at the fastest monthly average rate in almost a year and helping boost post-pandemic cumulative real wages into positive territory for middle-income households (*Exhibit 64*). In our view, labor hoarding continues to limit the 'tail risk' of severe layoffs and wage deflation. In turn, we think that continued moderate labor turnover trends should bolster consumer sentiment. Our bottom line: the consumer is starting today from what looks like a point of equilibrium regarding spending, savings, and labor turnover behavior. As such, while we still expect some slowing in consumer spending over the course of 2025, we do not think it will be enough to offset strength in other parts of the economy.

**Exhibit 64:** Post-Pandemic Real Income Growth Only Recently Turned Positive for Lower-Income Households and Remains Far Behind the Real Gains of Upper Income Tiers

**Cumulative Income vs. Inflation Growth Since 2021**



Compares typical inflation rate for 3rd decile and 8th decile consumers as reported in the Consumer Expenditure Survey. Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Point #4: U.S. productivity is a major differentiator:** If there is a notable tension in the analysis above, it is that we are expecting U.S. growth to remain robust in 2025 (+2.5% GDP), even as we are expecting job growth to slow (+125k/month). For this backdrop to play out as we describe, we need productivity trends to remain robust. To that end, we see three key points to consider. First, we think our ‘Regime Change’ thesis of a hotter post-COVID economy is conducive to productivity gains. The historical pattern is clear: when labor becomes scarce, and wage inflation rises, productivity tends to increase a couple of years later (*Exhibit 65*). We believe a similar pattern is playing out today.

Second, technology diffusion continues to exert an important influence on the economy. Much of this stems from advancements made during the pandemic, including surging cloud and virtualization investment, which we see as ongoing tailwinds to worker productivity. Additionally, AI is now finally beginning to play a role, which is not something we signaled last year. Beyond what we are starting to see in our portfolio companies, a recent survey by Mor-

gan Stanley showed that around 90% of the businesses surveyed are seeing ROI on AI-related initiatives meeting or exceeding expectations, particularly in areas like call center operations and salesforce efficiency.

**Exhibit 65:** U.S. Labor Productivity Growth Is Breaking Out

**Labor Productivity, Real Output Per Hour**



Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Our bottom line: the consumer is starting today from what looks like a point of equilibrium regarding spending, savings, and labor turnover behavior. As such, while we still expect some slowing in consumer spending over the course of 2025, we do not think it will be enough to offset strength in other parts of the economy.

**Exhibit 66: Full Employment As Well As New Highs in Prime-Age Labor Force Participation Promote Greater Expansion of Real Output Per Hour Worked**

**Prime-Age Employment vs. Labor Productivity Growth, 4Q86 to 3Q24, Excludes Recessions**

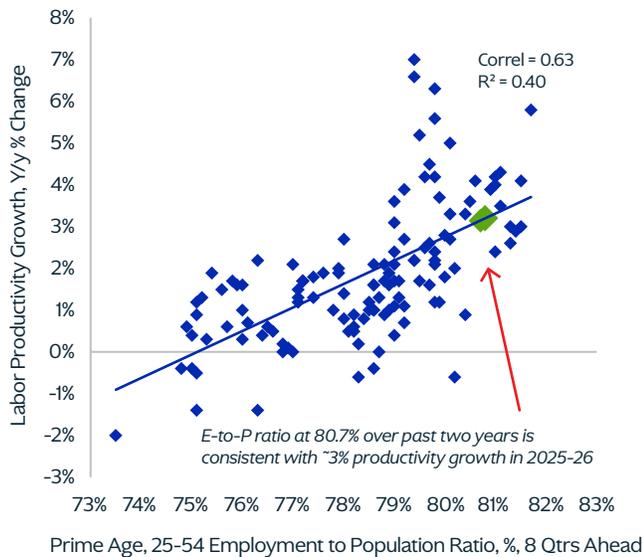


Chart refers to real output/hours worked. Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, Haver Analytics, Employ America, KKR Global Macro & Asset Allocation analysis.

Third, fiscal policy has been a significant enabler of productivity gains. Government programs such as the IJA, CHIP Act, and IRA have led to a private manufacturing boom (though the pace has slowed). Instead of crowding out the private sector, we believe that strategic industrial policy helped companies overcome initial hurdle rates, as the private sector became more confident that the government was there to backstop final demand. As discussed, we believe fiscal policy remains expansionary. The deficit isn't contracting, particularly concerning CHIPS and IRA spending, which — while no longer surging — still should support net growth. For instance, companies will now need to spend on equipment to outfit the new facilities they have built.

**Exhibit 67: The Post-COVID Period Has Been Reminiscent of the 1960s and 1990s**

**Decomposition of U.S. Labor Productivity Growth, %**

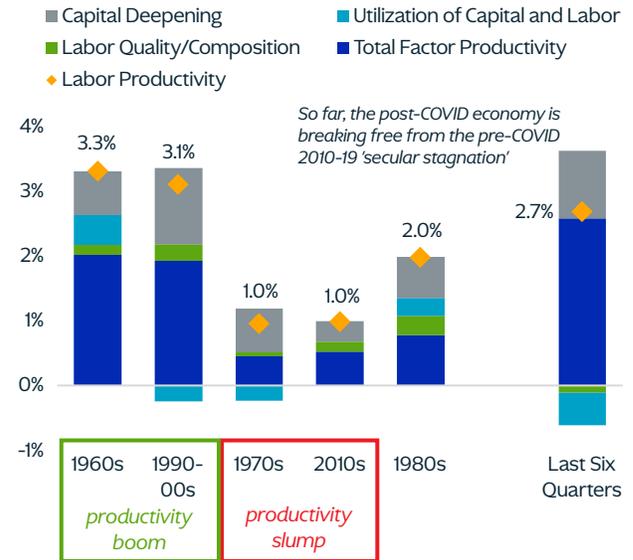


Chart refers to real output/hours worked. Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Our bottom line on productivity: if you look beneath the surface of our growth expectations, productivity is the key driver of our differentiated view. Our job growth forecasts are slightly below consensus, but we believe the growth of GDP-per-employee is now running at a higher run-rate. Against this backdrop, we expect the U.S. to outperform from a growth perspective.

Instead of crowding out the private sector, we believe that strategic industrial policy helped companies overcome initial hurdle rates, as the private sector became more confident that the government was there to backstop final demand.

## U.S. Inflation

**Forecasts:** We think core inflation may be ‘stuck’ around current levels next year, as faster goods inflation offsets a cooling labor market. Our U.S. CPI forecasts are 2.6% for 2025 and 2.8% for 2026, both above the consensus of 2.4% and 2.5%, respectively. Importantly though, we think a lot of the acceleration in Core CPI that we have embedded in our forecast will ultimately be driven by one-off increases in the level of prices (rather than the structural rate of inflation), particularly as services inflation appears to be moderating.

There is no change to our view that the new ‘resting heart rate’ of inflation is around 2.5% versus 1.5% in the pre-pandemic era. What’s new in our thinking is that tariffs will present moderately hawkish risks to inflation in 2025 and 1H26, which will introduce more uncertainty for the Fed.

**Commentary:** Over the past two years, we have often written about a divergence between ‘sticky’ services categories (where inflation was at risk of becoming embedded during 2022-2023) and goods categories (which have been in a deflationary cycle after surging during the pandemic). Looking ahead to 2025-2026, we expect a partial reversal of this trend: on the one hand, goods prices are on track to pick up materially as a result of more aggressive tariff policy; on the other, services disinflation should continue across both housing and labor. See below for details, but on balance, these trends give us confidence that while parts of CPI will accelerate next year, we will not see the type of broad-based reacceleration that would push the Fed to hike again.

**While our inflation model is trending lower, tariffs could present a one-off shock to goods inflation.** Our core inflation models - which do not yet anticipate the impact of future policy changes, including tariffs - still indicate that slowing housing inflation, better ‘lagged’ COVID-era inflation, and a slowing labor market will lead to cooler inflation next year (*Exhibit 68*).

Nonetheless, we want to be clear: the potential increase in goods inflation that we expect from the Trump administration tariffs could be significant, particularly in the near term. As we mentioned earlier, we estimate +30 basis points to Core CPI per annum in 2025-26 owing to tariff policy, which we envision playing out as a one-off price shock in 2025 that will fully drop out of year-over-year comparisons by late 2027.

This view incorporates 60-85% tariffs on ‘List 1-3’ China goods, 5-20% tariffs on ‘List 4’ China goods, and an average incremental five percent increase in tariffs on goods from the rest of the world (five percent being a rough simplified average of what we expect to be diverse initiatives across sectors and geographies). All told, these changes imply an approximate seven percent increase in the effective tariff rate from around three percent today to a little over 10% by the end of next year, which would put tariffs at the highest level going back to at least the early 1960s. What keeps us from being even more hawkish on the outlook for goods prices is that we think the incoming administration will be incentivized to limit the impact of higher prices on American households following an election where the cost of living became a central campaign issue. As a result, we think tariff categories will be at the least somewhat targeted, with policy exceptions in categories where substitution is especially difficult.

**Exhibit 68:** Our Core CPI Leading Indicator Shows Core CPI ‘Stuck’ Around Three Percent in the Near Term...

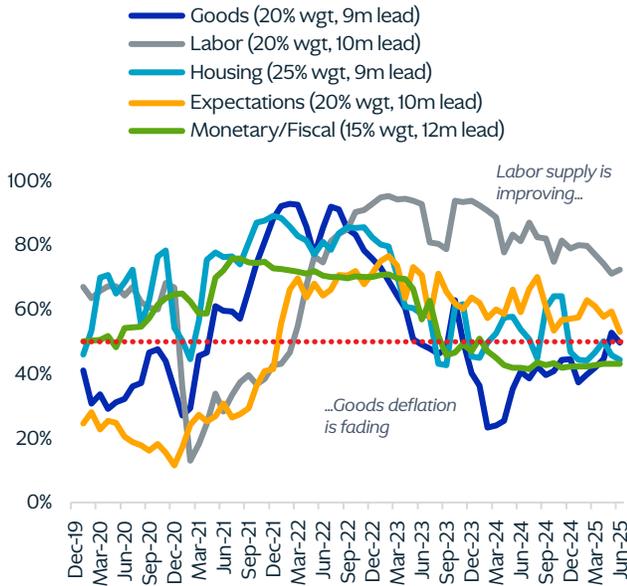
### Core CPI Leading Indicator



Model refit monthly to ensure that forward-looking projections reflect most relevant inflation drivers. Data as at October 31, 2024. Source: Bloomberg, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 69: ...As Goods Reflation Offsets a Cooler Labor Market**

**Leading Inflation Dashboard Components**



Data as at October 31, 2024. Source: Bloomberg, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**We believe the new administration’s deportation policies will not spur a significant and sustained increase in ‘sticky’ labor inflation.** While President Trump’s policies will have a large impact on goods inflation, we are less concerned about the risks of a tighter labor market from higher deportations. Specifically, we would emphasize that it is hard to envision the U.S. experiencing the type of labor inflation that occurred following 2020–2021 when some 2.5 million people had left the labor force because of the pandemic. There were almost two job openings per unemployed worker (remember that reaching that ratio today would require about six to seven million people to exit the labor force).

To test this thesis, we looked at four sectors of the labor market with the highest concentration of undocumented workers and ran a conservative estimate that about seven percent of the current undocumented workforce in these sectors would be deported. Nationally, across the undocumented population in the U.S., an approximate seven percent deportation rate for undocumented immigrants would correspond to roughly 750,000 to one million deportations or three to four times the highest

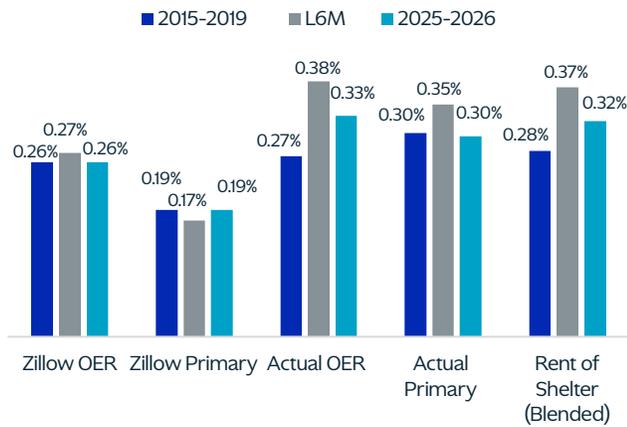
level on record (which occurred during the GFC when labor demand was especially low). Even under these draconian assumptions, job openings would still remain at or below 2023 levels in most of these sectors (with the notable exception of Administrative Services). One can see this in *Exhibit 71*. Said differently, while we do expect some upward pressure on wages because of deportations and the potential for more significant labor stress within certain hard-hit geographies/industries, it is tough to envision a broad-based increase in labor inflation so long as the economy is not short of workers in the aggregate.

**Meanwhile, housing inflation is finally starting to stabilize.** Housing inflation, the largest component of CPI, appears to be stabilizing around four percent annually, as both government rent measures (which tend to lag real-time rent measures such as Zillow) and market rents are settling into a more stable trajectory. All told, we think monthly CPI inflation for both OER and primary rent will average around 30 basis points in 2025, slightly below today’s levels and slightly above levels that predominated before the pandemic. Amidst significant uncertainty around tariffs (and to a lesser extent Supercore inflation), the more stable outlook for shelter inflation is a key offset which should help prevent inflation from becoming unglued next year.

We believe the new administration’s deportation policies will not spur a significant and sustained increase in ‘sticky’ labor inflation. While President Trump’s policies will have a large impact on goods inflation, we are less concerned about the risks of a tighter labor market from higher deportations.

**Exhibit 70: Overall, We Think Rent Inflation Will Average Approximately 30 Basis Points (Blended) Going Forward, Not Far From Today’s Levels**

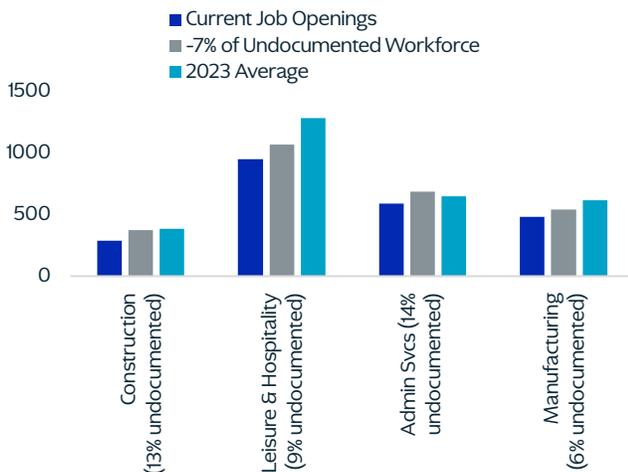
**OER and Primary Rent Inflation**



Data assumes 50/50 blend of SFR and Multifamily for Zillow Primary Rent equivalent index and 90/10 blend for Zillow OER equivalent. Data as at October 31, 2024. Source: Bloomberg, Haver Analytics, U.S. Bureau of Labor Statistics, Zillow, KKR Global Macro & Asset Allocation analysis.

**Exhibit 71: We Do Not Think That Trump Administration Policies Will Spur Significant Labor Inflation at the Aggregate Level**

**Potential Impact of Deportations on Sectors with a Large Undocumented Workforce**



Admin services assume 2x temp help services job share held by undocumented workers. -7% based on 4x the highest ever interior deportation year (250k in 2008) applied to a base of 13M immigrants, applied evenly across the board. Data as at October 31, 2024. Source: Bloomberg, Pew, EconoFact.

**Finally, we think insurance categories - which have been a key input into ‘Supercore’ inflation - will continue to stabilize from high levels.** ‘Supercore’ inflation (i.e., Services less Shelter inflation) has certainly been volatile, but we see it moderating more in 2025. Key to our thinking is that a large part of the inflationary impulse, auto-related categories (which surged in 2023-2024 following the spike in vehicle prices during the pandemic), is now poised to behave somewhat better. All told, auto insurance/maintenance categories are running at a +14% average annual increase over 2023-2024, while all other Supercore categories are averaging closer to two percent.

However, as we look ahead, our premise is that maintenance and insurance costs have now fully caught up to the increase in auto prices since 2019, which makes us feel better that the ‘fever’ is breaking for these categories (e.g., auto insurance has averaged +0.6% for the three months through October months, versus +1.1% for the last 12 months). No doubt, uncertainty remains elevated in this part of the economy, but we think Supercore inflation is ultimately on track to converge to the three to four percent range, higher than the Fed would like but well below the six to eight percent range that prevailed in late 2023/early 2024.

**Inflation bottom line: Sticky but not out of control is the most likely scenario.** If we are right, the good news is that, despite higher goods prices and pockets of labor scarcity in select industries, government policies are unlikely to provoke the kind of broad-based, ‘sticky’ inflation across housing and labor that rattled policymakers and markets in 2022-2023. As a result, we see a limited risk that the Fed will need to hike again. However, we think inflation stays at a ‘higher resting heart rate’ this cycle, a reality that potential trade wars will only exacerbate. Moreover, we expect inflation uncertainty to remain high, given that President Trump will likely use tariffs as an ongoing negotiating tool in the coming quarters, all of which contributes to our call for more gradual Fed easing.

However, we think inflation stays at a ‘higher resting heart rate’ this cycle, a reality that potential trade wars will only exacerbate.

## Exhibit 72: Pulling It All Together, We Estimate Core Inflation Runs in the Three Percent Range in 2025-26 Before Settling Closer to 2.5% Longer Term

KKR GMAA U.S. CPI FORECAST DETAIL									
	4Q24e	1Q25e	2Q25e	3Q25e	4Q25e	Full-Year 2023	Full-Year 2024e	Full-Year 2025e	Full-Year 2026e
<b>Headline CPI</b>	<b>2.7%</b>	<b>2.4%</b>	<b>2.4%</b>	<b>2.9%</b>	<b>2.9%</b>	<b>4.1%</b>	<b>2.9%</b>	<b>2.6%</b>	<b>2.8%</b>
Energy (7%)	-3.9%	-4.6%	-4.7%	-1.2%	1.0%	-4.8%	-1.5%	-2.4%	4.0%
Food (13%)	2.3%	2.4%	2.8%	2.9%	2.8%	5.8%	2.3%	2.7%	2.0%
<b>Core CPI (80%)</b>	<b>3.3%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.2%</b>	<b>3.0%</b>	<b>4.8%</b>	<b>3.4%</b>	<b>3.0%</b>	<b>2.8%</b>
<b>Core Goods (18%)</b>	<b>-0.8%</b>	<b>0.0%</b>	<b>0.7%</b>	<b>1.8%</b>	<b>2.0%</b>	<b>0.9%</b>	<b>-1.1%</b>	<b>1.1%</b>	<b>0.7%</b>
Vehicles (6%)	-1.9%	0.1%	1.8%	3.9%	2.9%	-0.4%	-2.4%	2.2%	1.0%
Other Core Goods (12%)	-0.1%	0.0%	0.2%	0.7%	1.6%	1.7%	-0.4%	0.6%	0.6%
<b>Core Services (62%)</b>	<b>4.6%</b>	<b>3.9%</b>	<b>3.6%</b>	<b>3.6%</b>	<b>3.3%</b>	<b>6.3%</b>	<b>5.0%</b>	<b>3.6%</b>	<b>3.6%</b>
Shelter (35%)	4.8%	4.3%	3.9%	3.6%	3.5%	7.5%	5.4%	3.8%	4.0%
Medical (7%)	3.7%	3.3%	3.2%	4.0%	3.8%	-0.4%	2.8%	3.6%	3.0%
Education (3%)	4.0%	4.1%	4.2%	4.1%	3.7%	3.1%	3.1%	4.0%	3.5%
Other Core Services (18%)	4.6%	3.3%	3.1%	3.1%	2.8%	6.8%	5.3%	3.1%	3.0%

Data as at November 30, 2024. Source: Bloomberg, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

## Euro Area GDP

**Forecast:** Our colleague Aidan Corcoran, alongside his team of Bola Okunade and Asim Ali, are projecting GDP growth of 0.8% and 1.2% in 2025 and 2026, 40 basis points and 10 basis points below consensus, respectively, relative to 0.8% growth in 2024. This continuation of below-trend growth at the Eurozone level masks increasing divergence between the sluggish manufacturing/export-driven core of Germany (30% of Eurozone GDP) and the more robust services/tourism-driven periphery of Spain and Portugal – with the contrast especially sharpened with the overhang of U.S. tariffs.

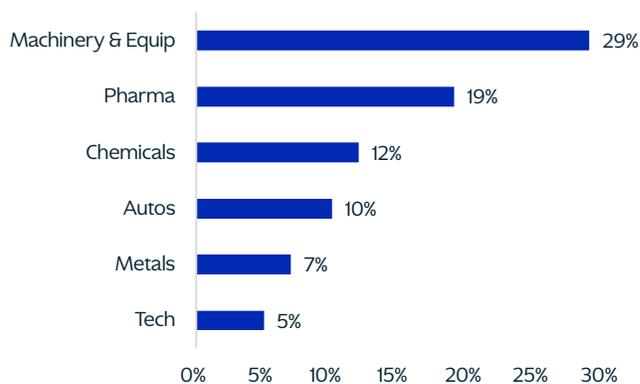
**Commentary:** More than almost any region, Europe appears to be in the ‘crosshairs’ of an increasingly complex and more segregated economy, especially supply chains – as trade flows are reordered. We note the following:

- Manufacturing in the eye of the storm:** Trade ties between Europe and the U.S. have actually been deepening in recent years. In 2023, for example, the U.S. was the EU’s largest export destination at 20%. As such, key sectors like machinery, pharmaceuticals, and automobiles will all face challenges from potential tariffs – compounded by China’s exporting of its overcapacity. At the same time, Europe has also

become particularly reliant on U.S. LNG, accounting for 20% of total gas imports in the region of late. Moreover, despite greater connectivity with U.S. production, Europe still faces high electricity costs compared to its global peers, as gas remains the marginal price-setter.

## Exhibit 73: 70% of EU Goods Exports to the U.S. Come From Four Sectors

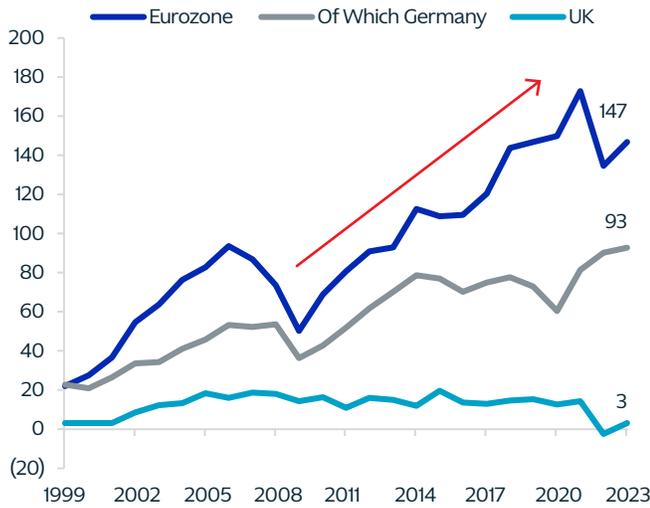
### Top USD Sector Shares of EU Exports to the U.S., %



Data as at December 31, 2023. Source: United Nations, Goldman Sachs Investment Research.

**Exhibit 74: Europe Will Need to Contend With the U.S. Becoming a Combative Trade Partner**

**Annual Goods Trade Balance With the U.S., US\$ Billions**



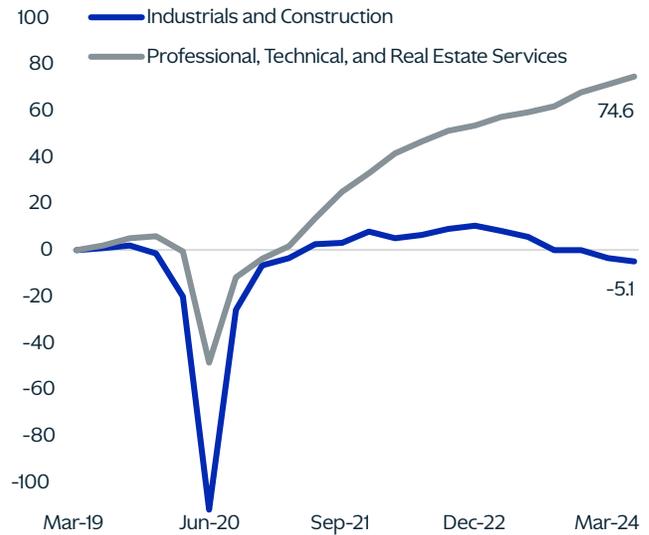
Data as at September 30, 2024. Source: Eurostat.

- German elections come at a difficult time:** Olaf Scholz's three-party coalition collapsed 12 hours after Trump's election, partly over disagreements on how to contend with this economic backdrop. Snap elections are scheduled for February 2025, and the results will help set the legislative agenda on how both Germany and the EU grapple with economic stagnation and structural reform.

We do see some potential upside to growth from the implementation of some of the reforms in the Draghi report, as well as effective deployment of fiscal firepower, particularly around capital markets union, the joint issuance of debt, and investment in productivity-boosting infrastructure.

**Exhibit 75: Services Are Increasingly Driving the European Economy**

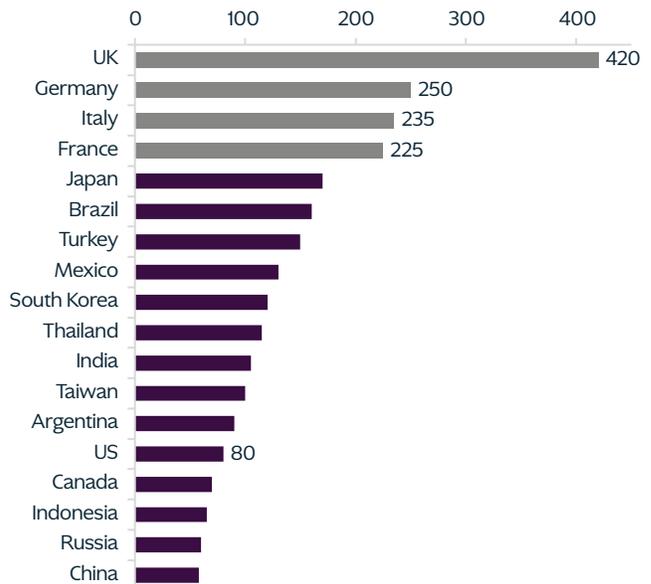
**Eurozone Sectoral Real Value Add, Change Since 1Q19, €Billions**



Data as at September 30, 2024. Source: Eurostat.

**Exhibit 76: Europe Has a Stark Disadvantage in Energy Costs**

**2023 Average Electricity Prices for Industrial Users, US\$/MWh**



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

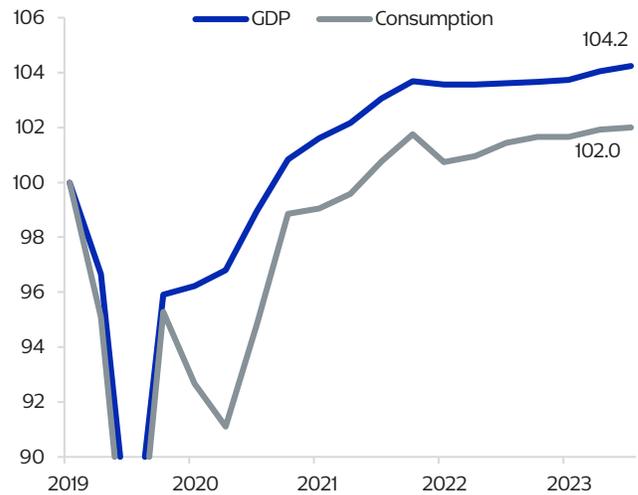
- Greater need for defense spending:** Pressures from the incoming U.S. administration are creating a need for increased European defense spending in order to continue support for Ukraine and also reduce historic reliance on U.S. military cover in the region. While European NATO countries are expected to (approximately) meet their two percent targets in aggregate, upward pressure on spending is all but certain to continue. Part of the concern around defense spending from a European perspective revolves around already large deficits as well as the need for more domestic consumption in the region (see next point).
- Households are not spending their excess savings:** While consumer confidence has slowly picked up, it remains below pre-pandemic levels, with low-income cohorts, in particular, lagging. Against this backdrop, domestic consumption still remains subdued, with cautious spending patterns persisting and savings intentions hitting record highs. If there is good news, it is that declines in the real return on cash should stimulate spending. Also, the labor market continues to be a bright spot, with tightness continuing to support strong nominal wage growth, particularly in the U.K.

Should Europe take a business-as-usual approach to the exogenous shocks it faces, we expect growth to continue at its current sub-trend clip. However, Europe has in the past shown an ability to come together during crises to push for greater policy integration. Therefore, we do see some potential upside to growth from the implementation of some of the reforms in the Draghi report, as well as effective deployment of fiscal firepower, particularly around capital markets union, the joint issuance of debt, and investment in productivity-boosting infrastructure.

While European NATO countries are expected to (approximately) meet their two percent targets in aggregate, upward pressure on spending is all but certain to continue.

**Exhibit 77: European Consumption Has Edged Up to Just Two Percent Above 2019 Levels, Which Is Half the Growth Rate of GDP**

**Eurozone Consumption vs. GDP, Since 4Q19**



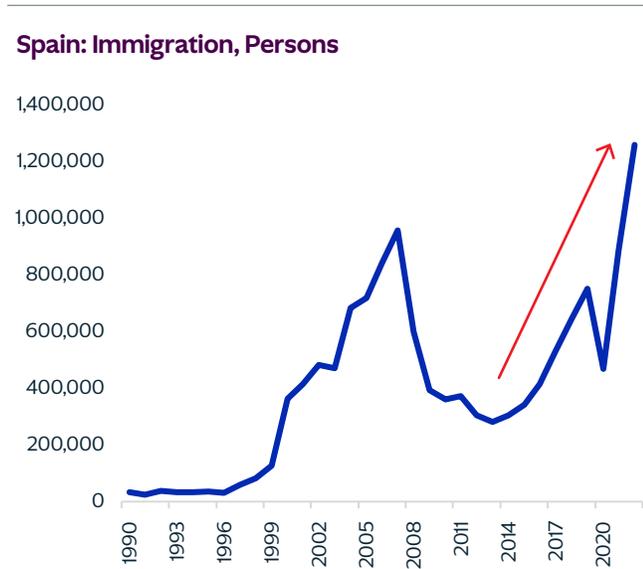
Data as at 3Q24. Source: Eurostat.

**Countries like Spain and the U.K. have a partial buffer against global trade headwinds.** Spain's economy has benefited from a service and tourism-driven model as tourist arrivals in 2024 outpaced 2023 and pre-COVID levels by 10 to 15%. On the demographics side, significant immigration from South America has facilitated population growth, particularly due to shared language and cultural similarities, which have eased integration. While this influx has also contributed to rising housing prices, this partly reflects the structurally weak housing supply since the GFC. Notably, Spain has successfully reduced consumer debt over two decades, establishing a strong foundation for growth. At the start of 2024, consensus estimates called for Spanish GDP growth to be at 1.4%; it then proceeded to more than double to three percent as the year progressed, notably outgrowing the U.S.

Turning to the U.K., it shares similar positive demographic trends with ongoing immigration expected to contribute to a growing workforce over the next 25 years, contrasting with anticipated declines in key Eurozone countries. On the trade side, services should remain outside the purview of potential tariffs. The U.K. is increasingly geared towards services exports, now accounting for 55% of exports, with the U.K. the second largest global exporter of services in

absolute terms. That said, the U.K. faces some notable domestic headwinds – particularly elevated fiscal debt amid stubbornly high wage inflation. Indeed, high wage inflation could keep upward pressure on interest rates, further limiting fiscal space and potentially leading to further fiscal austerity.

**Exhibit 78:** Record High Immigration Flows, Largely Driven by Latin America, Have Bolstered the Labor Force and Fueled Consumer Demand in Spain

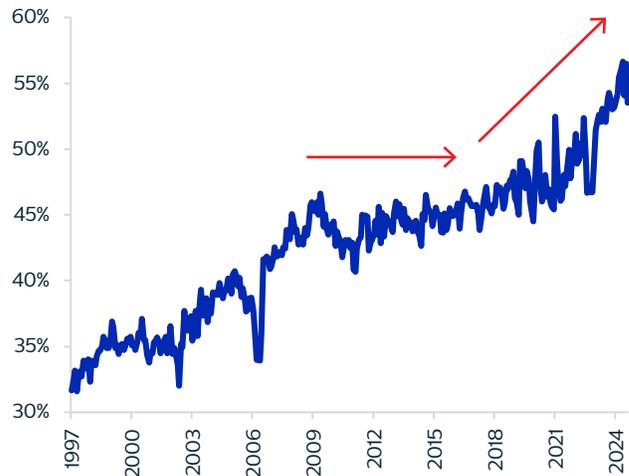


Data as at December 31, 2023. Source: Eurostat.

Even if the U.S. were to unilaterally act on tariffs by 1H25 (the most accelerated timeline) and if the EU responds immediately, it will take time for the newly elevated goods prices to feed into the consumer basket, pushing some of the inflationary impact into 2026.

**Exhibit 79:** The U.K.'s Services Share of Exports Continues to Grow, and It is the Second Largest Exporter of Services Globally

**U.K. Services Share of Exports, %**



Data as at October 31, 2024. Source: ONS.

**Euro Area Inflation**

**Forecast:** We forecast inflation at 1.9% and 2.2% in 2025 and 2026, relative to consensus forecasts of 2.0% in both years.

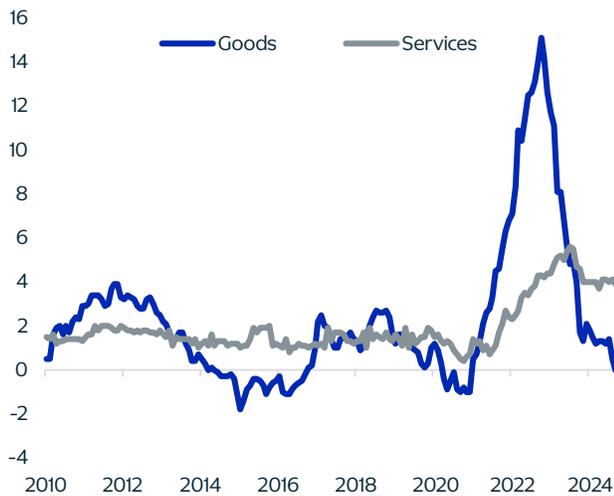
**Commentary:** We see a slightly faster deceleration of headline inflation than consensus expects in 2025, driven by the soggy economic backdrop and a still-shaken consumer, picking up to slightly above target in 2026 as tit-for-tat tariffs and rolling supply disruptions bite.

- **Energy deflation to continue:** The unexpectedly softer backdrop for energy inflation led to the market persistently overestimating inflation over the past 12 months, a trend that we think can persist – albeit more modestly – in 2025.
- **Fading expectations of a strong consumption recovery:** Services inflation remains elevated, driven by still sticky wages, but given the consumer remains reluctant to spend, we do not see this reality as enough to hold inflation above target next year – particularly given the hit to demand from a potential trade war with the U.S.

- Impact from any EU tariff response will take time:** Even if the U.S. were to unilaterally act on tariffs by 1H25 (the most accelerated timeline) and if the EU were to respond immediately, it would take time for the newly elevated goods prices to feed into the consumer basket, pushing some of the inflationary impact into 2026. Meanwhile, the impact on sentiment and aggregate demand will work in the opposite direction.

**Exhibit 80:** We Believe Europe’s Inflation Normalization Will Persist in 2025, Despite Potential Tariffs

**Eurozone Inflation, Y/y % Change**



Data as at September 30, 2024. Source: Eurostat.

Changchun Hua and Allen Liu believe that both external and internal forces will challenge China’s resilience in 2025-26.

**Exhibit 81:** After a Year of Inflation Coming Below Expectations, the Market Has Finally Recalibrated

**Eurozone Inflation Surprises**



Data as at October 31, 2024. Source: Citi, Bloomberg.

**China GDP**

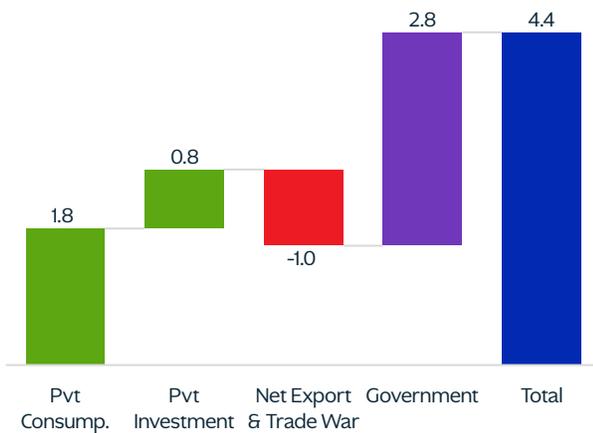
**Forecasts:** We are lowering our 2025 growth forecast to 4.4% from 4.6% previously, below both the market consensus of 4.5% and the likely government growth target of 4.5-5.0%. For 2026, we project a growth rate of 4.1%, in line with consensus. Our scenario analyses indicate that the tariff war could potentially reduce China’s GDP growth by 80 to 200 basis points, with risks leaning towards the downside. While we are encouraged by the government’s commitment to supporting the economy, we believe President Xi’s initiatives may not fully mitigate the remaining challenges. Continued lackluster consumption, driven by a consumer base inclined to save, and a still-recovering housing market, are likely to pose ongoing obstacles to economic growth in the near term.

**Commentary:** Changchun Hua and Allen Liu believe that both external and internal forces will challenge China’s resilience in 2025-26. Importantly, the significant external pressures from the tariff war could be compounded by sizeable internal issues, including the cautious behavior of consumers. While we expect the augmented government deficit may rise from this year’s RMB9 trillion (or 6.8% of GDP) to RMB12 trillion (or 8.9% of GDP), with potential upside surprises, we question whether it will go far enough. Specifically, the machinery and electrical

appliances sector, the area expected to be most impacted by tariffs, is unlikely to benefit due to the government’s non-prioritization of investment in this area. Perhaps more importantly, restoring consumer confidence will be difficult, given the weak economic and job market outlook. We do, however, expect less drag as a result of the housing market correction.

**Exhibit 82:** Despite Outsized Policy Stimulus, the Tariff War Is Likely to Place a Drag On China’s GDP Growth

**China GDP Growth by Expenditure, 2025**

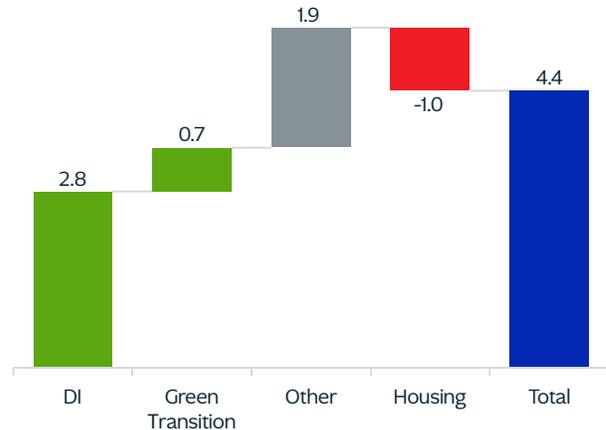


Data as at November 28, 2024. Source: China National Bureau of Statistics, Wind, KKR Global Macro & Asset Allocation analysis.

Despite President-elect Trump’s announcement of an incremental 10% tariff on all Chinese goods, we believe his second term may continue the selective and targeted tariff increase strategy.

**Exhibit 83:** Elevated Policy Easing May Substantially Relieve the Drag from Housing. The Overall Message, Though, Is That New Drivers of the Chinese Economy, Including Digital Industrialization Are Becoming More Influential

**China GDP Breakdown by Sector, 2025**



‘Digital Industrialization’ is as reported by CAICT, including added value of the information industry and added value that the information industry brings to other industries. ‘Green Transition’ is based on green finance and transition investment studies from the Beijing Institute of Finance and Sustainability. 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 28, 2024. Source: Beijing Institute of Finance and Sustainability, China National Bureau of Statistics, BNEF, CAICT, KKR Global Macro & Asset Allocation analysis.

How are we thinking about economic growth in China?

**Point #1: The potential for a trade war 2.0 poses significant downward pressure on China’s exports and growth.** In 2024, net exports contributed 1.2 percentage points to GDP growth, with the U.S. as a significant trading partner, accounting for 15% of China’s total exports. However, exports may become a major drag in the coming years. To illustrate the possible impact of tariffs, we consider the following three scenarios:

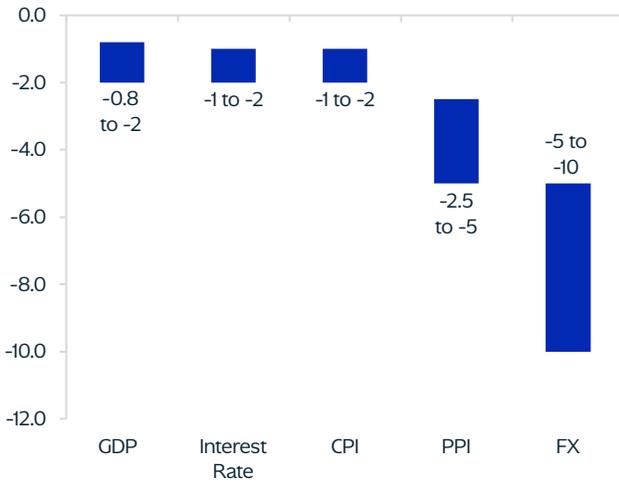
- **Base scenario (65% odds):** Despite President-elect Trump’s announcement of an incremental 10% tariff on all Chinese goods, we believe his second term may continue a selective and targeted tariff increase strategy. This would result in a 16% tariff hike, bringing the overall average to around 35%, compared to 19% prior to his election victory.
- **Risk scenario (30% odds):** There is a risk that the U.S. may revoke China’s Permanent Normal Trade Relations,

which grants Most Favored Nation status. If this occurs, it will result in an average 36% tariff hike on *all Chinese goods*.

- **Extreme scenario (5% odds):** The new administration imposes a sweeping 60% tariff on Chinese goods, as President Trump suggested during his campaign.

**Exhibit 84:** Impact of the Tariff War: Slower Growth, Falling Inflation, Lower Rates, and a Weaker CNY

**Possible Impact of Tariff Hike on China, %**



Data as at November 28, 2024. Source: KKR Global Macro & Asset Allocation analysis.

As we assess the effect of Trump administration policies on the Chinese economy, we expect the machinery, electrical, and transportation equipment sectors across China to be most impacted. Key export categories from China to the U.S. include consumer electronics, textiles and clothing, chemicals, and base metals. In 2023, consumer electronics exports—primarily smartphones and computers—reached \$435 billion. Of this \$435 billion, 22% was directed to the U.S., accounting for 41% of total U.S. imports in this category. The second-largest export sector, textiles and clothing, totaled \$404 billion, with 17% going to the U.S. market, representing 28% of total U.S. imports for these goods. Based on our tariff assumptions and the estimated elasticity of each category, we expect construction and traditional machinery, traditional electrical equipment (excluding electronics), and transportation equipment to be most affected.

**Exhibit 85:** China’s Major Export Products to the U.S. Include Consumer Electronics, Textiles and Clothing, Chemicals, and Base Metals

**China and U.S. Import/Export Relationship, US\$ Billions**

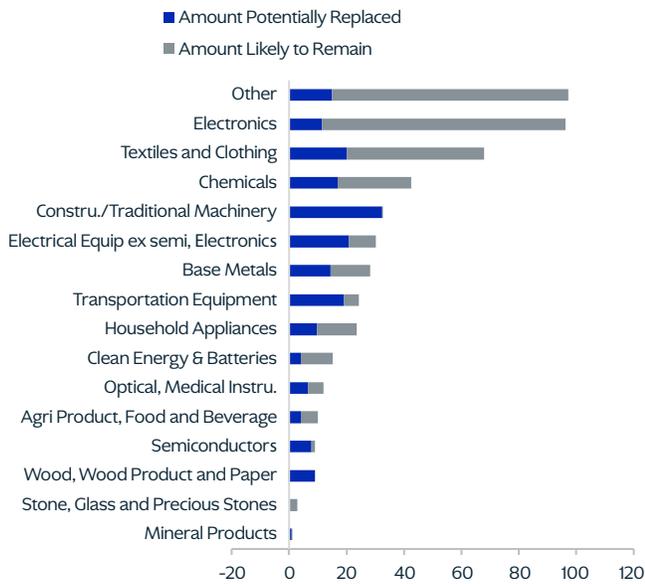
Sector	China Total Exports, 2023	China Exports to the U.S., 2023	U.S. % of China Exports, 2023	China % of U.S. Imports, 2023
Consumer Electronics	435	96	22%	41%
Textiles and Clothing	404	68	17%	28%
Other	395	97	25%	26%
Chemicals	362	42	12%	10%
Base Metals	268	28	11%	15%
Transportation Equip	265	24	9%	4%
Constru./Trad. Machinery	260	33	13%	15%
Elec Equip ex Semi, Electronics	232	30	13%	17%
Semiconductors	201	9	4%	9%
Home Appliances	124	24	19%	26%
Clean Energy & Batteries	118	15	13%	31%
Agri Products, Food and Beverage	97	10	10%	3%
Optical/Medical Instru.	69	12	17%	10%
Mineral Products	68	1	2%	0%
Wood, Wood Product and Paper	51	9	17%	14%
Stone, Glass and Precious Stones	31	3	9%	2%
<b>Total</b>	<b>3380</b>	<b>501</b>	<b>15%</b>	<b>14%</b>

China’s exports to the U.S. based on China Custom Bureau and U.S. imports from China based on USITC. Data as at December 31, 2023. Source: UN Comtrade, China Custom, USITC, KKR Global Macro & Asset Allocation analysis.

As we assess the effect of Trump administration policies on the Chinese economy, we expect the machinery, electrical, and transportation equipment sectors across China to be most impacted.

**Exhibit 86:** Around 38% of China’s Exports to the U.S. Could Be Substituted, with Machinery, Electrical, and Transportation Equipment Most at Risk

**Trump 2.0 Tariffs: Replacements for Chinese Exports, US\$ Billions**



Data as at December 31, 2023. Source: UN Comtrade, China Custom Bureau, USITC, KKR Global Macro & Asset Allocation analysis.

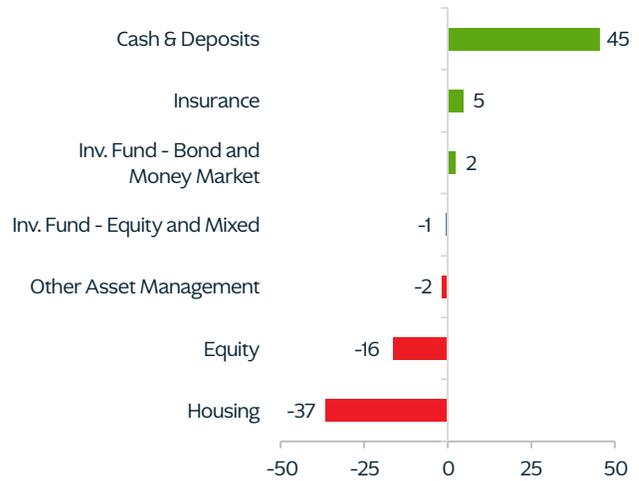
**Point #2: We think domestic consumption will not compensate for the decline in exports, especially given the pressures on household balance sheets and low consumer confidence from a sluggish job market.**

Two years post-COVID, consumption expenditures in China have not returned to normal, and savings are still increasing. We estimate that the propensity to spend has declined and remains low due to slower income growth (37%), an uncertain future income outlook (31%), and the negative wealth effect (32%).

**Point #3: The housing market is beginning to show some positive signs, but it will likely remain a drag on growth in 2025.** Inventory levels are declining due to a significant drop in housing starts, and there has been a rebound in transactions following the policy shift in September. However, inventory levels remain high, and it takes three to four years to digest fully, indicating room for further price declines. We believe it will take about a year or more for the market to stabilize.

**Exhibit 87:** Chinese Households Have Seen Significant Falls in Their Holdings of Risk Assets and Gains in Their Cash Holdings Since 2021

**Change in Household Assets, 2021 to 1H24, Trillions of RMB**

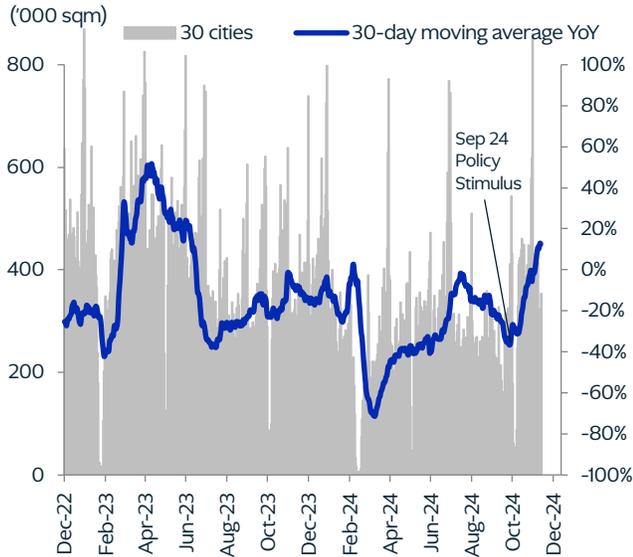


Data as at June 30, 2024. Source: Chinese Academy of Social Sciences, China National Bureau of Statistics, China Ministry of Housing and Urban-Rural Development, Asset Management Association of China, State Financial Supervision and Administration Bureau, Wind, KKR Global Macro & Asset Allocation analysis.

Two years post-COVID, consumption expenditures in China have not returned to normal, and savings are still increasing. We estimate that the propensity to spend has declined and remains low due to slower income growth, an uncertain future income outlook, and the negative wealth effect.

**Exhibit 88:** Housing Transactions Have Somewhat Recovered After Recent Policy Stimulus...

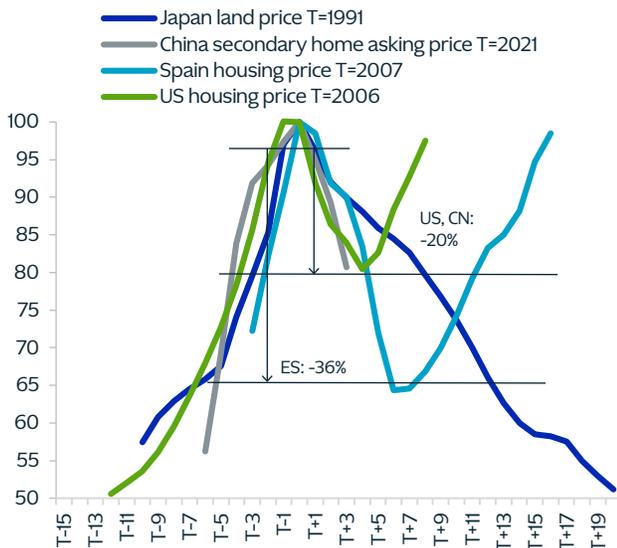
**30 Cities Daily Primary Residential Sales**



Data as at November 15, 2024. Source: China National Bureau of Statistics, Wind, Haver Analytics, UBS, KKR Global Macro & Asset Allocation analysis.

**Exhibit 89:** ...However, Further Housing Price Corrections Are Likely Needed

**Housing/Land Prices**



Data as at October 31, 2024. Source: China National Bureau of Statistics, Wind, Haver Analytics, UBS, KKR Global Macro & Asset Allocation analysis.

**Point #4: We are encouraged that the Chinese government has prioritized supporting the economy, but government efforts are unlikely to fully offset all the difficulties that remain, in our view.** Since September 2024, we have seen several key measures, including monetary policy easing, using the fiscal budget to address local government hidden debt, direct government purchases of home inventory, and providing PBoC swap lines for equity purchases. The December Politburo meeting and Central Economic Work Conference also reaffirmed the shift in policy priorities, using language such as ‘moderate easing’ of monetary policy (a change for the first time since the GFC), ‘forcefully boosting consumption’ and ‘extraordinary counter-cyclical policies’; sending the strongest signal in over a decade. Looking ahead to 2025, we expect the augmented fiscal deficit to rise from 6.8% of GDP this year to about nine percent, which would mean an additional RMB3 trillion in government spending to bolster the economy.

However, there is a notable sectoral mismatch between the policy stimulus and the most affected sectors of the economy, diminishing its impact. Overall, we think it will be difficult for the policy stimulus to fully counteract both external shocks and weak domestic demand, making achieving the government’s growth target challenging.

Overall, we think it will be difficult for the policy stimulus to fully counteract both external shocks and weak domestic demand, making achieving the government’s growth target challenging.

**Exhibit 90:** China Has Also Been Shifting Its Policy Priorities Towards Minimizing Risk and Promoting Growth

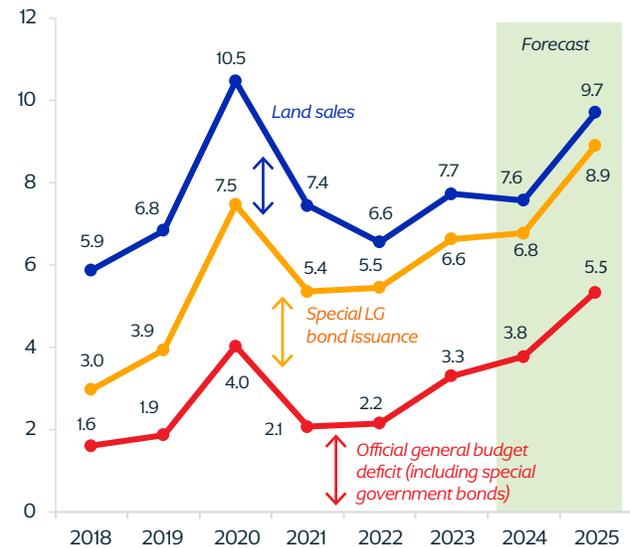
Policy Areas	Policy Content	Actual or Potential Size of Stimulus
Monetary	Policy rate	7d reverse repo 20bp cut; MLF 30bp cut; likely another 50-100bps in 2025
	Reserve Requirement Ratio	50bp cut; likely another 50bp in 2025
Fiscal	Local hidden debt swap program	RMB12trn for 2025-29
	Augmented government deficit ratio	6.8% for 2024 likely up to 8.9% for 2025
Housing	Home purchase restrictions	
	Mortgage rates	50bp cut for existing mortgages
	Destocking: idle land buyback and existing homes for affordable housing	Likely RMB4-5trn for 25-27
	Old town renovation	1.5mn units for now, with 1mn units monetization
Consumption	Replacement demand subsidies for auto/appliance	RMB300bn
	Social welfare system for the 200mn migrant workers	Possible RMB2-3trn
	Fiscal subsidies for students and low-income households	RMB50bn
Banking and capital markets	Bank sector: Recapitalization	Possible RMB1-2trn
	PBoC swap line to provide liquidity for equity purchase	RMB500bn via swap line

Data as at November 15, 2024. Source: China National Bureau of Statistics, PBoC, IMF, WIND, KKR Global Macro & Asset Allocation analysis.

2025 is a pivotal year in China as it reorients its fiscal and monetary policies in the face of both external and domestic challenges.

**Exhibit 91:** We Are Anticipating the Introduction of a Larger Fiscal Package

**Augmented Fiscal 'Deficit' as a % of GDP**



Data as at November 15, 2024. Source: KKR Global Macro & Asset Allocation analysis.

**Bottom Line:** 2025 is a pivotal year in China as it reorients its fiscal and monetary policies in the face of both external and domestic challenges. In our view, risks skew to the downside due to a worsened external environment during President Trump's second term, coupled with complex structural domestic issues, including the housing correction, under-pressure household balance sheets, and overcapacity.

**China Inflation**

**Forecasts:** Deflationary pressures in China are proving to be more severe than anticipated. We are revising our 2025 inflation forecast down to 0.9% from 1.0%, lower than the market consensus of 1.2%. We are also changing our 2026 forecast to 1.0% from 1.3% previously and below consensus of 1.2%.

**Commentary:** There is considerable deflationary pressure on China's economy. The 'old economy', which includes sectors like housing, construction and steel, continues to experience weak demand. In contrast, the 'new economy', including electric vehicles and green transition sectors, is suffering from overcapacity, as production levels for many key products have exceeded demand. Tariffs will likely worsen this situation, potentially leading to more severe price wars in the coming years.

## Japan GDP

**Forecasts: For 2025, we are revising Japan's GDP growth to one percent, down from the previous estimate of 1.2% (in line with consensus).** In 2026, we anticipate growth will slow to 0.8%, below the consensus of 0.9%. This downward revision is mainly driven by increased external uncertainties, including tariffs on Japanese exports and the possibility of heightened tensions resulting from a tariff conflict between the U.S. and China.

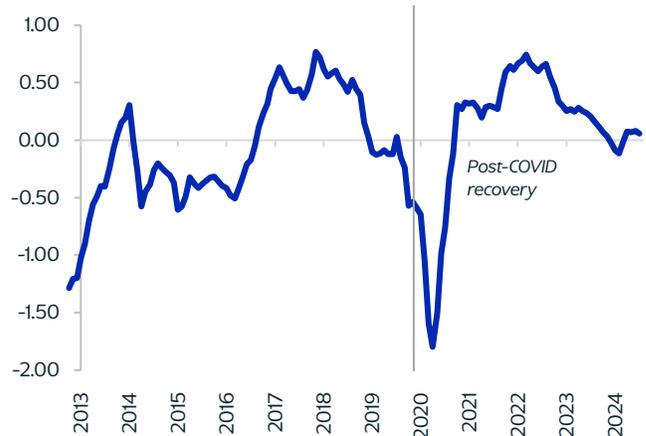
**Commentary:** Growth in 2024 has fallen short of our initial expectations due to persistent inflation and fiscal consolidation. Nevertheless, we believe that a recovery is still possible as our outlook on corporate reform in Japan and the virtuous cycle between real income growth and consumption recovery remains largely intact. Maybe more importantly, long-term productivity increases should help drive growth despite lackluster population growth. All told, given the surge in nominal capital expenditures, we anticipate labor productivity to gradually increase from the current range of 0.5-0.7% to around one percent over the next decade.

We see several themes driving this transformation. First, wage increases spurred by nationwide labor shortages are fueling an automation capex cycle aimed at reducing costs. Moreover, broad corporate governance reforms since 2013 have strengthened the roles of institutional investors and independent board members, leading to greater risk-taking by corporate management and boosting M&A activity. Finally, heightened geopolitical tensions are prompting multinational corporations to shift parts of their supply chains to friendlier shores, reinforcing the virtuous cycle of capex and productivity.

That said, external uncertainties, including the tensions from tariffs and increased competition with China, lead us to forecast a slightly smaller recovery than initially anticipated. Japanese machinery and electrical appliance manufacturers may gain some advantage by replacing Chinese manufacturers as suppliers to the U.S. market. However, we do not expect this will occur on a large scale. Moreover, Japanese exporters may encounter weaker demand from China and heightened competition from Chinese exporters in non-U.S. markets.

**Exhibit 92: Japan's Cyclical Economic Slowdown Appears to Be Bottoming Out...**

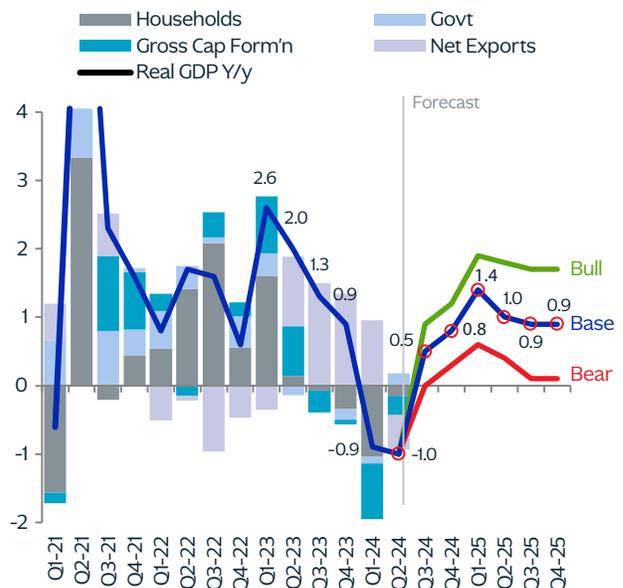
**Japan Economic Cycle, %**



Economic cycle is based on PMI, retail sales, home prices, exports, unemployment rate, bank credit and equity prices. Data as at September 30, 2024. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 93: ...But Persistent Inflation and Fiscal Consolidation Moderated the Magnitude of the Recovery in 2024**

**Japan: Quarterly Real GDP, Y/y, %**



Data as at November 15, 2024. Source: Cabinet Office of Japan, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**What do we think you need to know?**

**Point #1: High inflation, particularly in food and energy, has negatively affected consumer confidence among older Japanese cohorts.** This reality is especially challenging for the aging population, many of whom have less disposable income to manage rising prices. As Japan’s population ages, aggregate household income and consumption are expected to decrease. All told, we estimate that household income typically declines by 30% at partial retirement (ages 60-70) and another 30% upon full retirement (aged 70+). The adverse effects of this demographic shift are likely to become more pronounced after 2027 when the population of the current 50-60 years of age cohort begins to decline, and the decrease in household formation solidifies.

**Point #2: However, we retain high confidence about real wage and income growth, as nominal wage increases continue to be robust amid easing inflation,** which is favorable for a consumption recovery. We anticipate that the 2025 Shunto wage negotiations will see a further boost to wages. The Japanese Trade Union Confederation (Rengo) advocates for an overall wage increase of five percent or more, with a target of six percent or higher for small- and medium-sized enterprises. This momentum follows the most significant pay hike in 33 years, implemented by Japanese companies earlier in 2024. In our view, these developments demonstrate a strong commitment to enhancing wages and supporting economic recovery, which could help real consumption return to pre-COVID levels.

However, we retain high confidence about real wage and income growth in Japan, as nominal wage increases continue to be robust amid easing inflation, which is favorable for a consumption recovery.

**Exhibit 94: The Sustained Real Wage Growth of 2024 Will Likely Continue in 2025...**

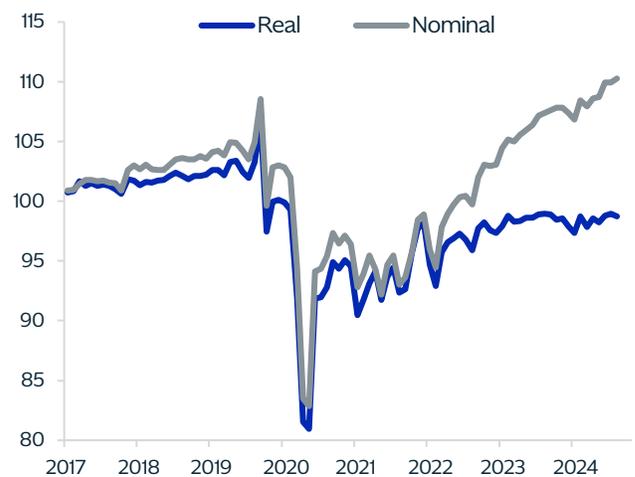
**Japan Wage Growth, Y/y %**



Data as at August 31, 2024. Source: Ministry of Health, Labor and Welfare Japan, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

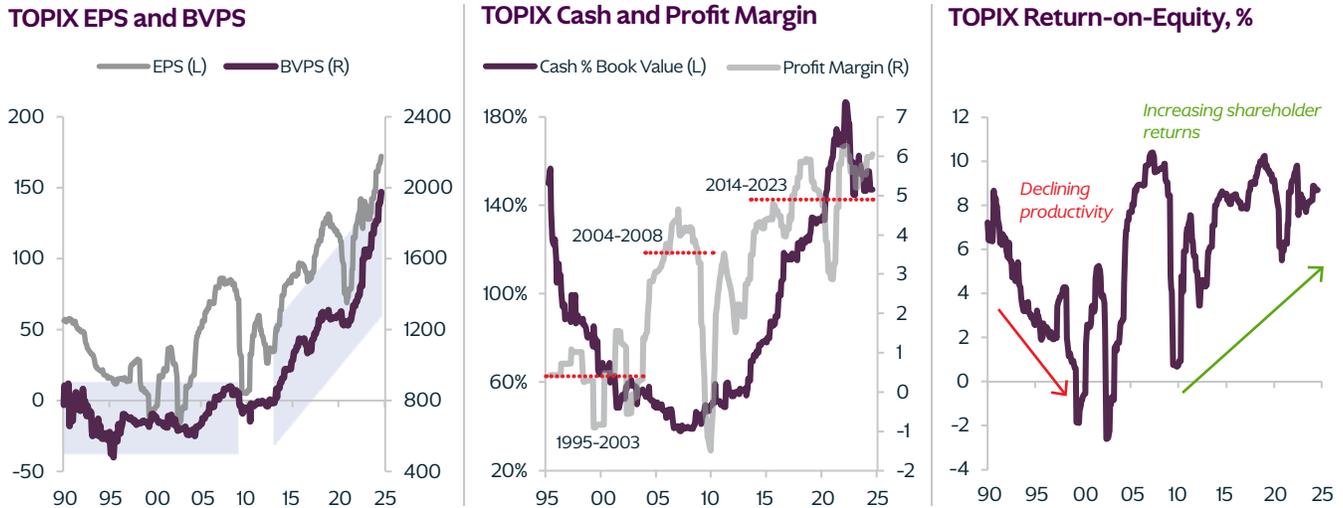
**Exhibit 95: ...Which Should Be an Important Driver of a Recovery in Consumption in Japan**

**Consumption Activity Index**



Data as at September 30, 2024. Source: Ministry of Health, Labor and Welfare Japan, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 96: Japanese Equities Are Showing Positive Trends in Margins and Return on Equity**



EPS is earnings per share; BVPS is book value per share. Data as at August 31, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Point #3: Our main narrative for Japan—one focused on corporate governance reform and productivity enhancement—is still intact.** In recent years, corporate governance reforms have gained momentum. Initiated during the Abe administration, these reforms aimed to increase the number of independent directors on boards, empower shareholders—especially institutional investors—and establish compensation structures that incentivize senior management to embrace risk. This marks a shift away from traditional low pay and conservative business strategies. These changes have led to increased merger and acquisition activity and higher profits among larger-cap companies in the Japanese equity market. Notably, the unwinding of corporate strategic holdings in Japan reached 3.7 trillion JPY in 2023, representing a 90% increase. Trends for 2024 suggest that this momentum will continue.

Importantly, the Private Equity sector in Japan is experiencing a significant renaissance, which we believe will further boost corporate productivity and support public markets. The focus of corporate governance reform is shifting towards unwinding cross-shareholdings, expected to improve capital efficiency, increase transparency, enhance accountability, and foster greater competition. Positive trends are already visible, as the market capitalization of companies undergoing these

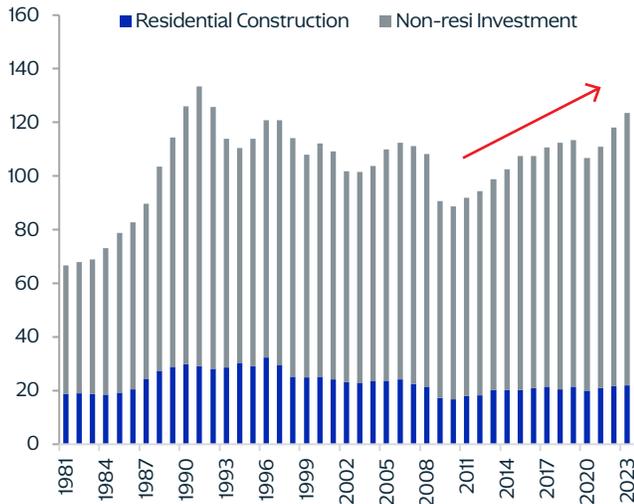
reforms has decreased while foreign ownership has increased.

In addition to corporate governance reforms, the Japanese government has introduced various policies to enhance productivity, such as promoting research and development, encouraging digital transformation, and improving labor market flexibility. These initiatives are designed to foster a more dynamic and competitive economic environment. Furthermore, regional policies that enhance productivity in local economies have played a crucial role in reducing regional disparities and supporting overall economic growth. While we do not anticipate dramatic shifts in growth, we expect productivity to rise from the current 0.5% to between 0.8% and 1.0% over the next decade, reflecting the positive trends within the economy.

Importantly, the Private Equity sector in Japan is experiencing a significant renaissance.

**Exhibit 97: Rising Private Capex Spending Should Help to Lift Productivity...**

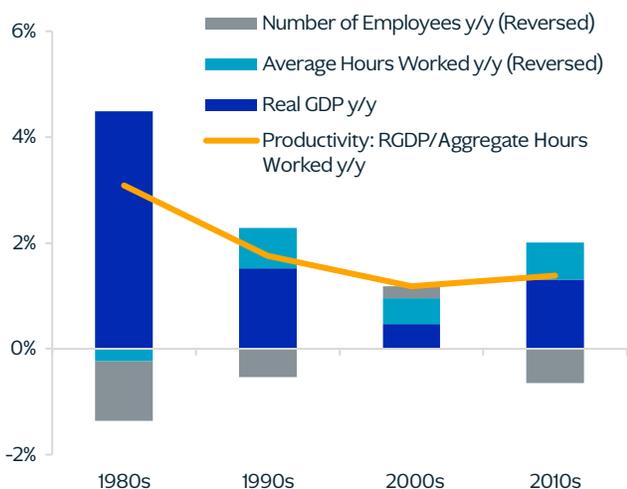
**Private Capex, Trillion JPY**



Data as at December 31, 2023. Source: Ministry of Finance Japan, Cabinet Office of Japan, OECD, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 98: ...Which Will Be Needed to Offset a Declining Labor Force**

**Japan Labor Productivity, Y/y %**

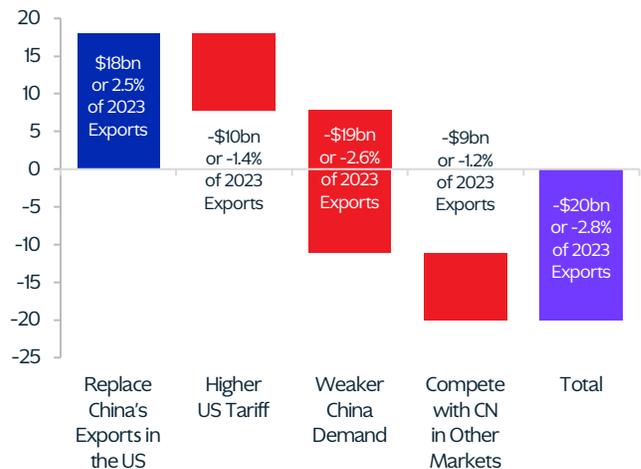


Data as at December 31, 2023. Source: Ministry of Finance Japan, Cabinet Office of Japan, OECD, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Point #4: Japan may also face challenges from potential U.S. tariff increases. At the same time, strengthening demand from China is impacting its competitive edge in key industries.** While Japan and Korea might seem poised to benefit from the Sino-U.S. tariff war, potential gains are primarily limited to sectors such as office machines, construction machinery, and auto parts, with overall gains from replacing China's exports to the U.S. estimated at up to \$18 billion. However, these gains will likely be more than offset by higher U.S. tariffs, weaker China demand, and increased competition in non-U.S. markets, potentially resulting in negative net gains.

**Exhibit 99: Japan Will Likely Also Feel the Impact of The Tariffs, Especially as China Reacts to U.S. Sanctions**

**Illustrative Estimate of the Impact of the Trade War on Japan Exports, US\$ Billions**



Data as at November 27, 2024. Source: UN Comtrade, KKR Global Macro & Asset Allocation analysis.

**Point #5: On the policy front, fiscal consolidation remains a priority, with the fiscal deficit decreasing from 5.2% of GDP last year to 4.1% this year.** We expect further modest falls in the fiscal deficit ratio over the next two years. We note the risk of a 'stalling' of this consolidation if growth disappoints and also in light of the government's recently approved \$92 billion supplementary budget.

**Bottom Line:** While Japan's recovery may be slower than many had hoped, a capex recovery and corporate governance reform should help to support the next leg

of recovery in 2025. Corporate governance reforms have led to a revival in market earnings. However, we do not view the market as overheated because of reasonable valuation metrics, high cash reserves, and manageable leverage, all of which support the continued attractiveness of Japanese public equity markets for potential take-privates and spin-offs.

### Japan Inflation

**Forecast:** We maintain our 2025 CPI inflation forecast at two percent, aligning with the market consensus, easing a bit from our 2024 estimate of 2.5%. For 2026, we think inflation will fall to 1.5%, below the consensus of 1.7%.

**Commentary:** We have long argued that Japan has successfully exited deflation, with wage increases supporting core inflation. However, we foresee inflation easing in 2025, primarily due to a potential decline in energy prices and easing of supply chain disruptions. True, prolonged weakness of the yen could exert some inflationary pressure. But overall we anticipate an easing but stable inflationary environment, reflecting a balanced economic outlook for Japan.

The focus of corporate governance reform is shifting towards unwinding cross-shareholdings, expected to improve capital efficiency, increase transparency, enhance accountability, and foster greater competition.

## SECTION III

# Capital Markets

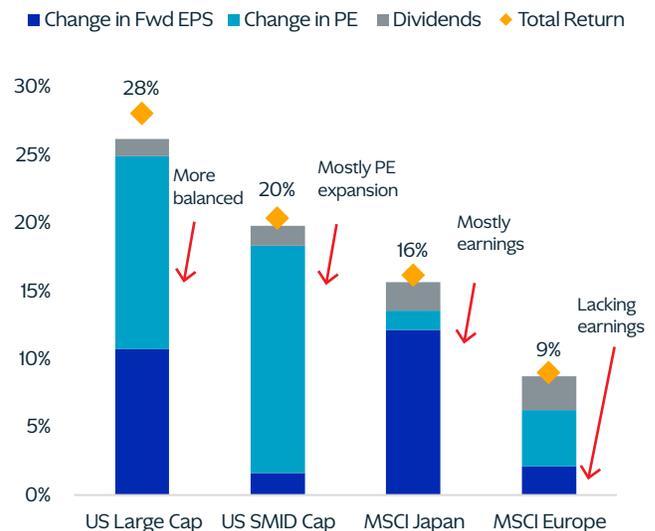
### S&P 500

**Forecasts:** Our colleague Brian Leung now expects the S&P 500 to reach 6,850 in 2025 and approximately 7,500 in 2026, which implies a more than 20% upside from current levels over the next two years. On EPS, he is calling for 11% year-over-year growth in 2025, which implies an above-consensus EPS of \$273 per share (versus the ‘top-down’ consensus estimate of \$266 per share). For 2026, Brian sees EPS at \$300 per share, which is in line with the consensus. From a valuation perspective, our 2025-26 outlook assumes equity multiples re-rate modestly to 23.0-23.5x forward earnings, up from current levels of about 22.5x. Key to our thinking is that greater earnings growth outside of the Magnificent Seven slightly lifts the overall multiple investors are willing to pay for the index in 2025 (*Exhibits 105, 106, and 113*)

**Commentary:** With the help of higher trough margins, strong buybacks, and differentiated productivity, the U.S. market remains the global standout, having rallied fully 60% in two years (*Exhibits 100 and 101*). Despite this recent string of strong performance, Brian Leung maintains a ‘Glass Half Full’ posture for U.S. Equities, expecting the S&P 500 to reach around 6,850 in 2025 and approximately 7,500 in 2026. To be sure, we expect plenty of volatility, consolidations, and drawdowns along the way to our 2025-26 price targets. However, we believe that it is still too early to turn bearish on U.S. Equities. Instead, we suggest investors become a little more diversified and balanced in 2025. Specifically, we believe that a broadening of earnings in 2025 suggests that investors complement their mega-cap Tech/AI holdings with more cyclical exposure, such as the S&P 500 equal-weighted index and select small and mid-cap stock indexes.

**Exhibit 100: S&P 500 2024 YTD Returns Have Been Fairly Balanced, Driven by Both Earnings Growth and Multiple Expansion**

#### Total Return Decomposition, 2024 YTD

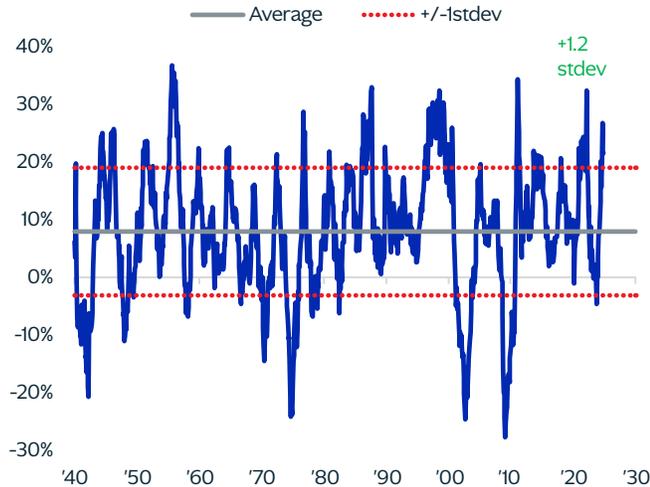


Data as at November 30, 2024. Source: Bloomberg, MSCI, KKR Global Macro & Asset Allocation analysis.

However, we believe that it is still too early to turn bearish on U.S. Equities. Instead, we suggest investors become a little more diversified and balanced in 2025.

**Exhibit 101:** Given S&P 500 Returns Are Tracking So Strongly Relative to Trend, It is Now Paramount That Our Productivity Thesis Holds to Maintain This Outperformance

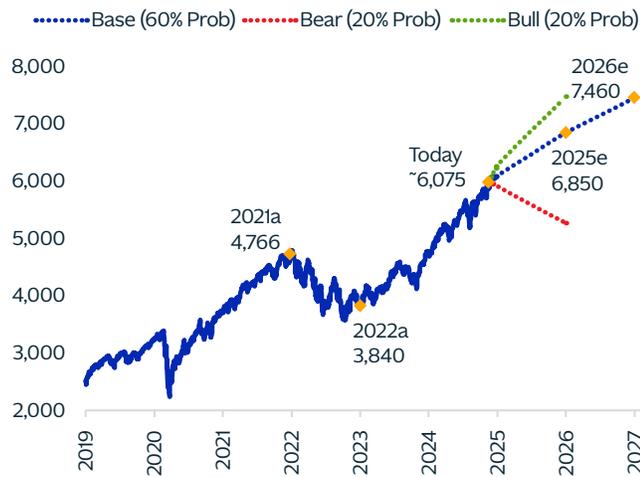
**Rolling 2-Year Annualized S&P 500 Price Return**



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

**Exhibit 102:** We Expect the S&P 500 to Reach Around 6,850 in 2025 and Approximately 7,500 in 2026

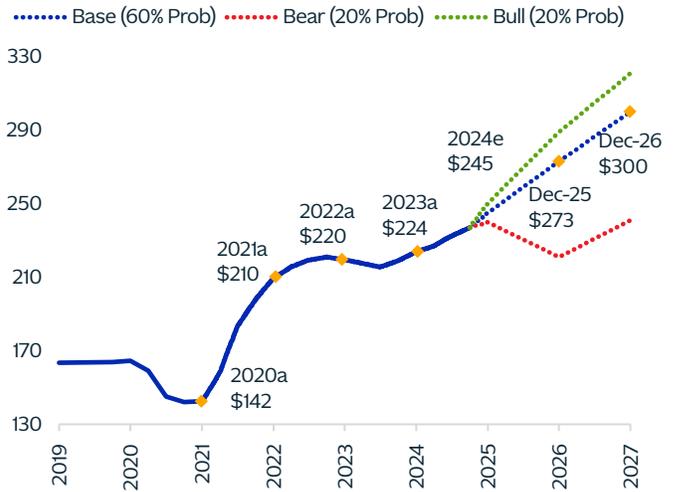
**S&P 500 Price Target, Base/Bear/Bull Cases**



Data as at December 5, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Exhibit 103:** Our Base Case Assumes S&P 500 EPS Reaches \$273 per Share in 2025 and \$300 per Share in 2026

**S&P 500 EPS, US\$/Share, Base/Bear/Bull Cases**



Data as at December 5, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Our Base Case (60% probability):** Consistent with the view espoused in our Mid-Year Outlook, we see the ingredients for a more durable economic cycle. There is no ‘hard landing;’ the Fed is cutting into a profits upcycle, productivity growth is staying above-trend, energy prices are benign, the aggregate consumer is still in good shape, and there are early signs of a positive inflection in cyclical areas of the economy. Deregulation and potential tax cuts are tailwinds offset by headwinds from lower immigration and from global tariffs. We expect corporate earnings to increase by 11% in 2025, with higher nominal GDP and margin expansion powering the next leg of the recovery. Despite stretched valuations, we see the S&P 500 reaching approximately 6,850 by end-2025 and around 7,500 by end-2026, more than 20% upside from the current level (Exhibit 104).

**Exhibit 104:** Our Forecasts Reflect What We Believe Is a More Durable Economic Cycle

S&P 500 Price Target Scenarios						
	Base (60% Prob)	Bear (20% Prob)	Bull (20% Prob)	Weighted Average	Bottom-Up Consensus	Top-Down Consensus
<b>2025 Year-End Target</b>	<b>6,850</b>	<b>5,270</b>	<b>7,480</b>	<b>6,660</b>	<i>n/a</i>	<b>6,359</b>
P/E on 2026 EPS	22.9x	21.9x	23.3x			
<b>2026 Year-End Target</b>	<b>7,460</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
P/E on 2027 EPS	23.3x	n/a	n/a			
2023a EPS	\$224	\$224	\$224	\$224	\$224	\$224
2024e EPS	\$245	\$240	\$250	\$245	\$242	\$242
2025e EPS	\$273	\$221	\$289	\$266	\$275	\$266
2026e EPS	\$300	\$241	\$321	\$292	<i>n/a</i>	\$300
2027e EPS	\$321	\$250	\$351	\$312	<i>n/a</i>	<i>n/a</i>

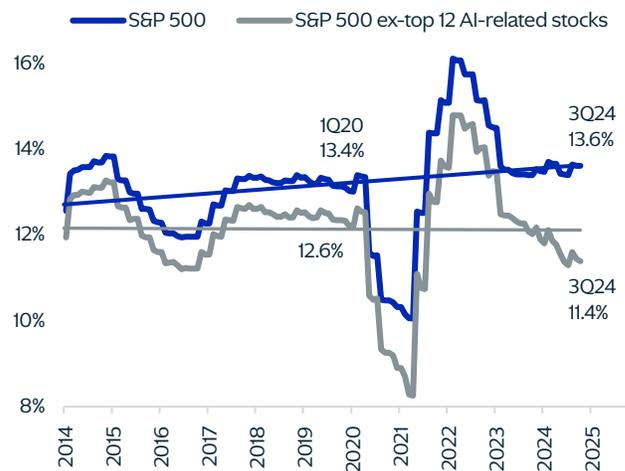
S&P 500 trading at 6,075 on December 5, 2024. Data as at December 5, 2024. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**On EPS: We are calling for 11% year-over-year EPS growth in 2025, which implies an above-consensus EPS of \$273 per share (versus the ‘top-down’ consensus estimate of \$266 per share).** Importantly, growth should continue to broaden in coming quarters, going from relatively narrow Tech/AI leadership in 2024 to a more balanced picture in 2025. Outside of the top 12 mega-cap Tech/AI stocks, operating margins are actually still below pre-COVID levels (*Exhibits 105 and 106*). Given the combination of above-potential GDP growth, strong labor productivity, and deregulation, we see ample room for improvement. Our regression-based Earnings Growth Lead Indicator has also inflected higher due to fading rate hikes, lower oil prices, resilient home prices, and tighter credit spreads, raising our conviction on the sustained earnings upcycle. For 2026, we preliminarily expect EPS to increase 10% to \$300 per share, which is in line with the ‘top-down’ consensus of around \$300 per share.

**We continue to view the revival in labor productivity growth as the ‘secret sauce’ to a more durable earnings recovery, as it raises potential GDP and facilitates higher non-inflationary growth.** Businesses can invest more without overheating the economy and pay workers higher wages without degrading margins, so long as better productivity keeps unit labor costs contained (*Exhibits 107 and 108*). This backdrop is a ‘Regime Change’ from the post-GFC ‘secular stagnation’, when productivity slumped to multi-decade lows on the back of tepid aggregate demand, tame inflation, and low rates.

**Exhibit 105:** S&P 500 Operating Margins Outside of the Top 12 Tech/AI Stocks Are Actually Still Running Below Pre-COVID Levels...

**S&P 500 EBIT Margin Disaggregation, %**



Data as at October 31, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

Importantly, growth should continue to broaden in coming quarters, going from relatively narrow Tech/AI leadership in 2024 to a more balanced picture in 2025.

**Exhibit 106:** ...But We See Broadening Sector Contributions in 2025, Which Should Support Both Growth and Valuations Outside of the Magnificent Seven

**S&P 500 EPS Growth Disaggregation, %**



Data as at October 31, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Exhibit 107:** We Expect Margin Expansion Ahead for the S&P 500 So Long as Unit Labor Costs Stay Subdued Amidst Higher Labor Productivity

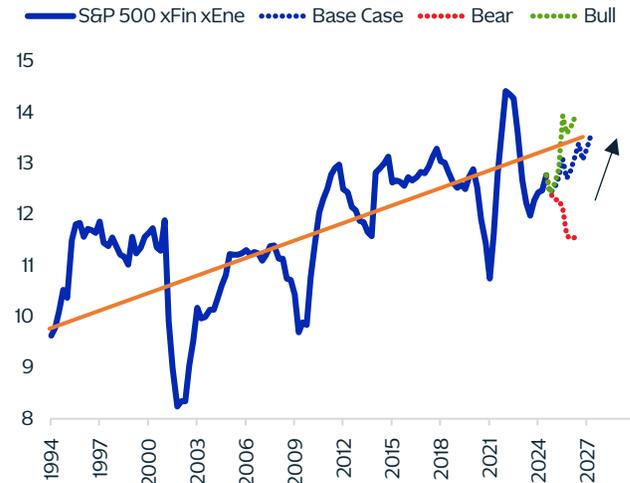
**S&P 500 xFin xEne EBIT Margin**



Data as at October 31, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Exhibit 108:** S&P 500 Margins Have Ample Room to Move Higher Over the Next Two Years

**S&P 500 xFin xEne EBIT Margin, 2025-26 Forecast**



Data as at October 31, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Valuations: Our 2025-26 outlook assumes equity multiples re-rate modestly to 23.0-23.5x forward earnings, up from current levels of about 22.5x.** Headline equity valuations are unquestionably extended, even on an ex-top 12 mega-cap Tech/AI stocks basis. However, the S&P 500 at around 22.5x today is actually below the 2021 peak of approximately 23x and well below the 1999 Tech bubble peak of about 25x (*Exhibit 109*). And even though the current implied equity risk premium (4.1%) is near the lowest level since the GFC, it remains significantly above the euphoric 2.1% on offer during the height of the 1999-2000 Tech bubble (*Exhibit 110*). From our perch, the S&P 500 is a fundamentally higher-quality index today (versus 10-20 years ago), with higher margins, lower net leverage, better-rated constituents, and a sector composition that tilts asset-lite (more cash flow generative), thanks to the dominance of Technology and Communications Services (*Exhibit 111*), all of which support higher valuations.

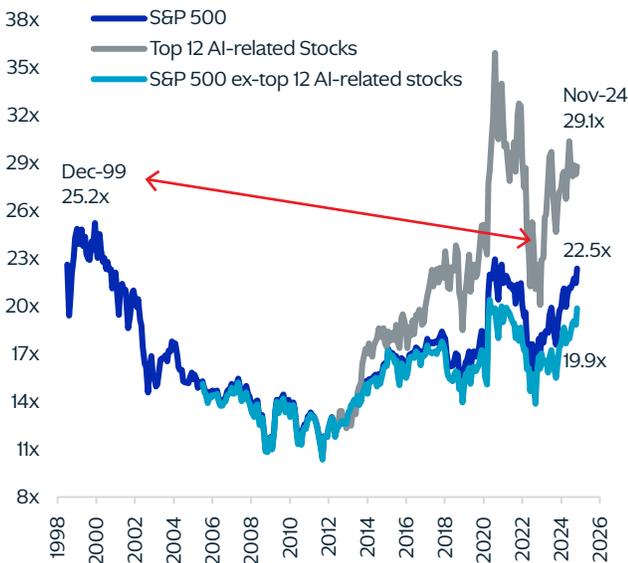
Finally, we would note that valuations are a notoriously poor 1- to 3-year forward market-timing tool, as rich valuations can stay rich absent a catalyst (*Exhibit 112*). Key downside catalysts include a) a disorderly surge in 10-year bond yields on the back of larger deficits and inflation reacceleration; b) 'Mag7' growth disappointing lofty expectations; and c) a more punitive than expected tariffs

Finally, we would note that valuations are a notoriously poor 1- to 3-year forward market-timing tool, as rich valuations can stay rich absent a catalyst (*Exhibit 112*). Key downside catalysts include a) a disorderly surge in 10-year bond yields on the back of larger deficits and inflation reacceleration; b) 'Mag7' growth disappointing lofty expectations; and c) a more punitive than expected tariffs

regime driving global growth downgrades. We are very much attuned to downside risks today, but do not assume they play out under our base case at this juncture.

**Exhibit 109:** Even On an ex-Top 12 AI/Mega-Cap Tech Stocks Basis, S&P 500 Valuations Are Extended Today at 19.9x

**S&P 500 NTM P/E Decomposition**

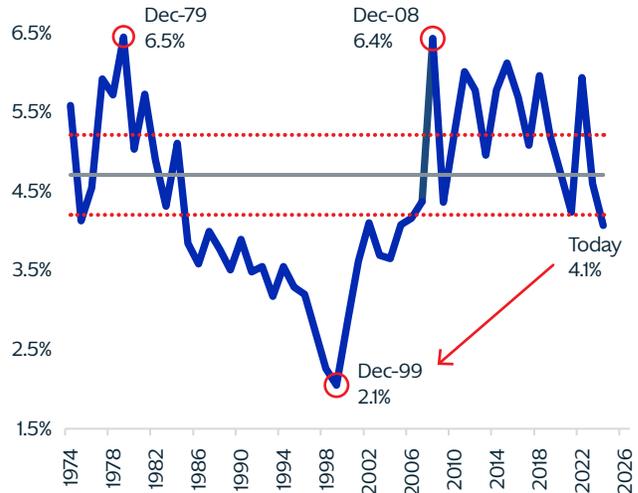


AI-related stocks include Apple, Microsoft, Amazon, Nvidia, Google, Meta, Tesla, Broadcom, AMD, Salesforce, Netflix, and Oracle. Data as at November 30, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

Headline equity valuations are unquestionably extended, even on an ex-top 12 mega-cap Tech/AI stocks basis. However, the S&P 500 at around 22.5x today is actually below the 2021 peak of approximately 23x and well below the 1999 Tech bubble peak of about 25x.

**Exhibit 110:** The Implied Equity Risk Premium On Offer Is Near the Lowest Level Since the GFC. But It Is Nowhere Near 1999-2000 Levels of Irrational Exuberance

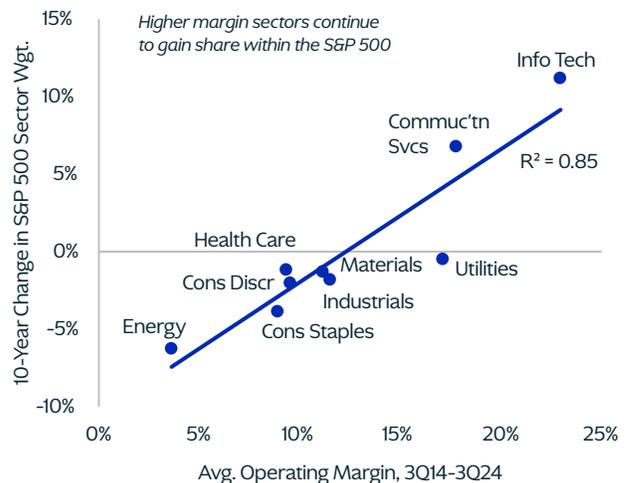
**Market-Implied Equity Risk Premium, Since 1974 xTech Bubble**



Data as at November 30, 2024. Source: S&P, NYU Professor Aswath Damodaran, KKR Global Macro & Asset Allocation analysis.

**Exhibit 111:** The S&P 500 Has Become a Higher Quality Index, With Higher Margins, Lower Asset Intensity, Lower Cyclical, and Less Leverage Than Before

**S&P 500: Sector Weights vs. Operating Margin**



Data as at October 31, 2024. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

**Exhibit 112: Equity Valuations Can Remain Extended (>20x) for Long Periods of Time**

**# of Months to S&P 500 Peak After NTM P/E >20x**



Data as at November 30, 2024. Source: Bloomberg, S&P, Evercore ISI, KKR Global Macro & Asset Allocation analysis.

**Our Bear Case (20% probability):** Mega-cap Tech/AI earnings disappoint, housing activity remains in a deep freeze given record unaffordability, and continued labor market slowing gives way to increased layoffs. The Trump administration leans into the stagflationary components of lower immigration, full-fledged tariffs, and Fed meddling, with little offset from deregulation and new fiscal impulse. With the 10-year bond yield and inflation expectations getting unmoored, the Fed is forced to hike rates again in 2025, and earnings decline on a Y/y basis. The S&P 500 ends the year at about 5,270 (-13% downside from the current level).

**Our Bull Case (20% probability):** A productivity boom drives a ‘goldilocks’ environment of strong real GDP growth, continued disinflation, and benign financial conditions. The Trump administration prioritizes pro-growth policies (deregulation and tax cuts) but scales back the stagflationary portions (immigration and tariffs). Both mega-cap Tech/AI stocks and cyclical/reflationary names propel the S&P 500 to new highs of approximately 7,480 by end-2025 (about 23% upside from current levels).

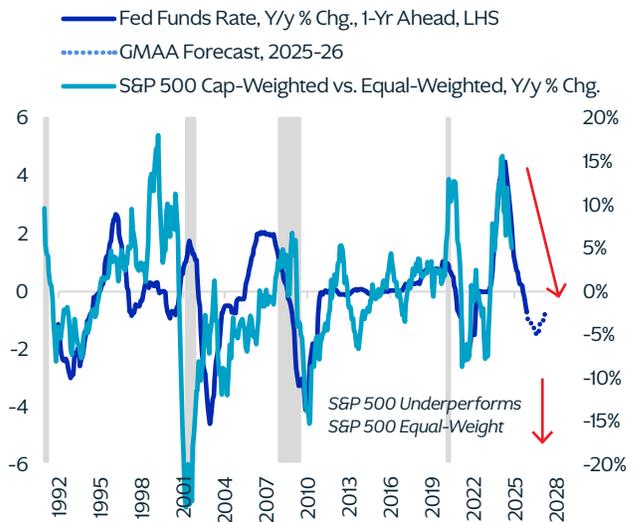
**Our Bottom Line: We think this cycle has more room to run. The supportive macro environment suggests it is simply too early to turn bearish on risk assets.**

Even so, as a hedge against rich large-cap valuations, we recommend adopting a more balanced exposure to U.S. equities by adding to the S&P 500 equal-weighted index

and select small and mid-cap stocks (*Exhibit 113*). We prefer to play a broadening rally by focusing on small and mid-cap names that rank favorably on Quality (ROE or ROIC) and Profitability (free cash flow yield) (*Exhibit 114*). Last but not least, investors should take advantage of favorable market conditions to monetize where possible in 2025.

**Exhibit 113: Fed Easing Cycles Tend to Correlate With S&P 500 Equal-Weight Outperforming the S&P 500**

**‘Breadth’ Outperforms With Fed Cutting Cycle**



Data as at October 31, 2024. Source: Bloomberg, SG Research, S&P, KKR Global Macro & Asset Allocation analysis.

We continue to view the revival in labor productivity growth as the ‘secret sauce’ to a more durable earnings recovery, as it raises potential GDP and facilitates higher non-inflationary growth.

**Exhibit 114: Not All SMID-Cap Stocks Are Created Equal. Profitable and High-Quality Names Are the Safer Way to Play a Broadening Rally**

**U.S. Small Cap Factor Return, Sector Neutral, %**



Data as at October 31, 2024. Source: Piper Sandler Research, S&P, KKR Global Macro & Asset Allocation analysis.

**U.S. Interest Rates**

**FORECAST:** On the short end of the curve, we are sticking to our post-election view that ‘neutral’ for the Fed this cycle is around 3.375% (or about 75-100 basis points above Core CPI). However, a positive shock to inflation from tariffs will discourage the Fed from moving too quickly in 2025-26. **As a result, we now see the Fed cutting rates twice in 2025 and twice in 2026 versus our prior expectation of four cuts in 2025.** Consensus expectations are for approximately three cuts in 2025 and none in 2026.

Said differently, we think the Fed will continue targeting one percent real rates (around where we think they are currently) and adjust nominal rates accordingly. On the long end, we raise our 10-year target to 4.25-4.5% for 2025 (versus consensus of 4.1%) to account for tariff-related rates and inflation uncertainty next year (which feeds into term premium in our Treasury yield model). Still, we keep our 2026 target at four percent (in line with consensus). Longer-term, we continue to see the 10-year trading at four percent, reflecting our view that the long end of the curve does not become ‘unglued’ as both deficits and inflation will ultimately stabilize at elevated levels.

**COMMENTARY:** As mentioned earlier, we now expect the Fed Funds rate to reach 3.875% by the end of 2025. This forecast embeds that the Fed will seek to keep real rates near end-2024 levels by holding nominal rates unchanged in the low-mid four percent range for much of 2025.

Specifically, our forecast implies that real rates should hover around one percent through the end of 2025 and into 2026, as the Fed aims to avoid any additional monetary stimulus that could exacerbate inflation while recognizing that real rates are still in moderately restrictive territory. Recall that real rates relative to real GDP growth, which is the appropriate measure for assessing how restrictive monetary policy actually is, are at the most restrictive levels since the 1990s. The Fed has made it clear that maintaining one percent real rates across the yield curve is their target for this cycle, which so far has been a level that avoided overly tightening and stifling growth. We think this remains their framework/guiding light as they navigate substantial inflation uncertainty.

**Exhibit 115: We Still See a Higher for Longer Interest Rate Environment, Except in China, Relative to Pre-COVID**

	KKR GMAA 10-Year Interest Rate Forecast and Probability, %		
	Base	Low	High
<b>U.S.</b>	<b>60%</b>	<b>20%</b>	<b>20%</b>
2025e	4.25-4.5%	2.5%	5.0%
2026e	4.0%	2.5%	5.0%
<b>Euro Area</b>	<b>60%</b>	<b>20%</b>	<b>20%</b>
2025e	2.5%	1.6%	3.1%
2026e	2.75%	1.8%	3.3%
<b>China</b>	<b>55%</b>	<b>30%</b>	<b>15%</b>
2025e	1.5%	1.2%	1.8%
2026e	1.2%	0.9%	1.5%
<b>Japan</b>	<b>55%</b>	<b>30%</b>	<b>15%</b>
2025e	1.35%	1.1%	1.5%
2026e	1.45%	1.2%	1.6%

Data as at December 15, 2024. Source: KKR Global Macro & Asset Allocation analysis.

**On the long end of the curve, we’ve fielded a lot of questions about whether our 10-year forecasts of 4.25-4.5% in 2025 - and four percent for the longer term - are too low for the current environment or too high relative to history.** We don’t think so, and here’s why. Recall that our approach has been to decompose Treasury yields into short rates and the ‘term premium’, or the additional yield investors require for holding long-term bonds. For starters, our forecasts for short rates over the next ten years are not moving much. Meanwhile, our model for market term premium actually suggests that markets are already pricing the impact of wide deficits and high inflation uncertainty (*Exhibits 118 and 119*).

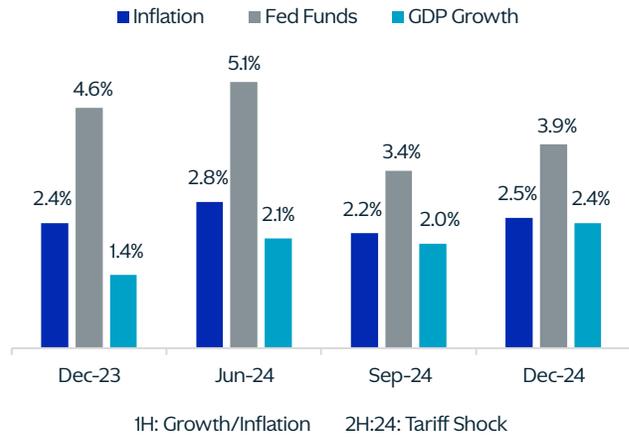
Meanwhile, savings rates, Fed balance sheet policy, and the deficit are all on a comparatively stable path, in our view. We think the most surprising of these points may be around deficits: We do not expect any material further federal deficit-widening in the second Trump administration. Said differently, we think any fiscal expansion above and beyond the extension of expiring TCJA tax provisions is likely to be ‘paid for’ via tariffs and DOGE-related spending cuts.

Pulling all of these factors together, our fundamental model for 10-year Treasury yields would actually point to ‘fair value’ of around 4.25% for both 2024 and 2025 (*Exhibit 120*). With that said, we think some of the unique tail risks around government policy will continue to trouble markets in 2025, which suggests that investors should demand a higher yield for holding long-term government bonds. As such, we see market technicals pushing 10-year yields into the 4.25-4.5% range in 2025 before yields settle on a longer-term resting rate of four percent.

We think any fiscal expansion above and beyond the extension of expiring TCJA tax provisions is likely to be ‘paid for’ via tariffs and DOGE-related spending cuts.

**Exhibit 116: FOMC Reaction Function From 1H24 Suggests They Will Seek to Match Increases in Core Inflation With the Move in Nominal Rates**

**Year Ahead FOMC Projections**



Data shows hypothetical FOMC projections assuming our estimated tariff impacts are fully known to FOMC in Dec-24. For 1H24, year-ahead refers to 2024 estimates; for 2H24, year-ahead refers to 2025 estimates. Data as at November 13, 2024. Source: Federal Reserve Board, KKR Global Macro & Asset Allocation analysis.

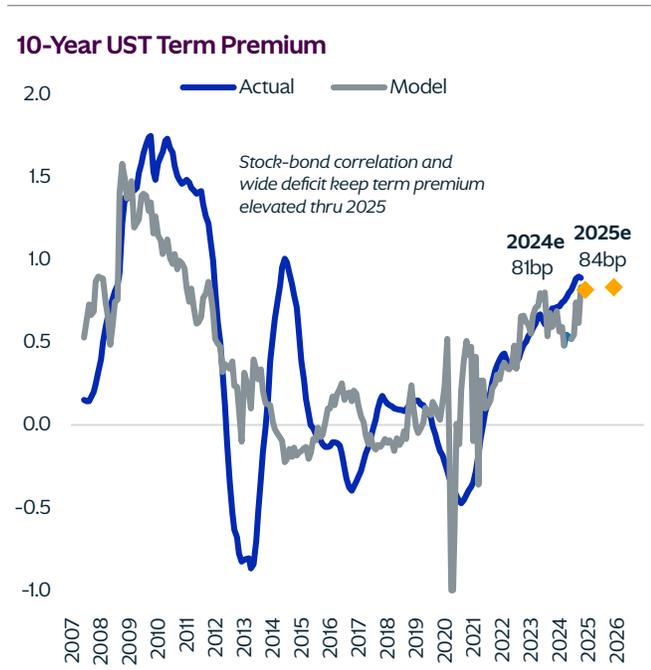
**Exhibit 117: Market Pricing Implies That the Fed Is Already Below ‘Neutral’ in Real Terms, Which Feels Too Hawkish to Us**

**Market Pricing for Real Rates, %**



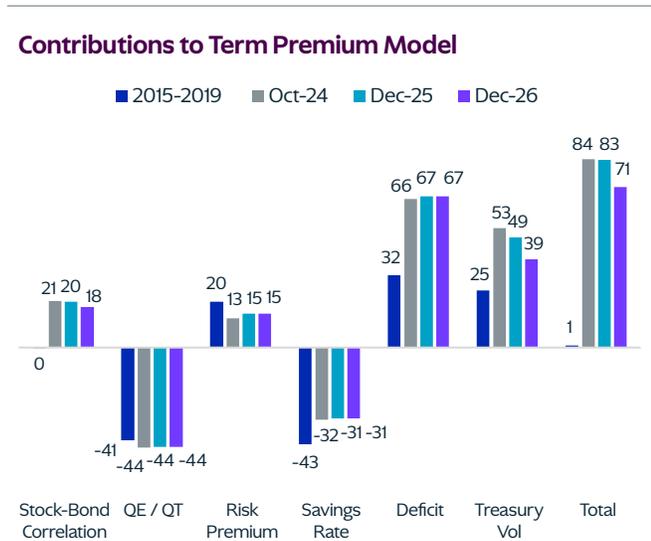
Forward rates are based on 5-year breakeven and SOFR forwards. Nov-24 assumes October CPI in line with Bloomberg consensus. Data as at November 7, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 118: Term Premium Model Implies Elevated But Stable Term Premium in Coming Years**



Data shown on a year-end basis. Data as at November 14, 2024.  
Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 119: Looking Beneath the Hood, Treasury Volatility Is the Key Diver of Higher Yields in Our Model**



Data as at October 31, 2024. Source: Bloomberg, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

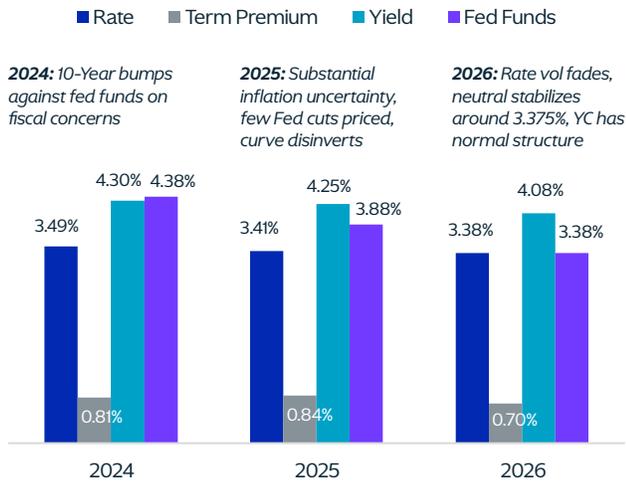
With that said, we do see more upside for bond yields in 2025 if the Fed actually resumes hiking, tariffs are more inflationary than we expect, and/or if deficits actually widen meaningfully (none of which are in our base case). Amidst all of this uncertainty, though, we retain our bias that now is not the time for big bets on duration. So long as the Fed is determined to ease (or at least not about to hike rates), it is difficult to envision the 10-year yield rising back towards five percent. Achieving such levels would require the 10-year yield to exceed the Fed Funds rate due to bear steepening, something that has not occurred over the past 50 years except when markets believe the Fed has already reached the neutral rate. Our baseline remains that the Fed is going to continue slowly lowering nominal rates, which will help keep a lid on 10-year yields. Moreover, foreign buyers have been willing to buy Treasuries when hedged yield differentials approach zero - which would be implied by 10-year yields in the 4.5-4.75% range.

What could go wrong with this thesis? First, if policymakers and markets begin to see a serious risk of a broad-based reacceleration in inflation (not our base case), then the 'ceiling' provided by fed funds would no longer be a consideration, and the 10-year yield could retest 2023 highs around five percent. Moreover, this scenario would increase foreign buyers' hedging costs, which would limit their willingness to buy U.S. debt. The other scenario worth considering is on the fiscal side. So far, we have not seen the appetite or political momentum for wider primary deficits, but a big increase in issuance at the long end of the curve could potentially push 10-year Treasury yields beyond the 4.5-4.75% band. Until these risks start to fade (likely by mid-late 2025), our preference is to avoid being overconfident that bond yields will rally the way they did over the summer/fall of 2024.

Specifically, our forecast implies that real rates should hover around one percent through the end of 2025 and into 2026, as the Fed aims to avoid any additional monetary stimulus.

**Exhibit 120:** Our Fundamental Treasury Yield Model Points to 4.25% Yields in 2024 and 4.5% Yields in 2025. However, We Think Market Technicals Will Push Yields Higher in 2025, Towards 4.5%

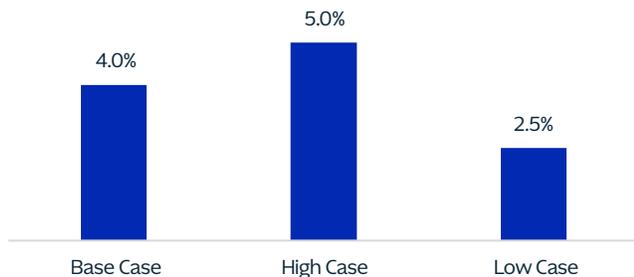
**10-Year Treasury Fundamental Model, %**



Data shown on a year-end basis. Data as at November 14, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 121:** Given Low Odds of Substantial Further Hikes, Our 10-Year Forecast Still Skews to the Downside

**Long-Term: 10-Year UST Forecast, %**



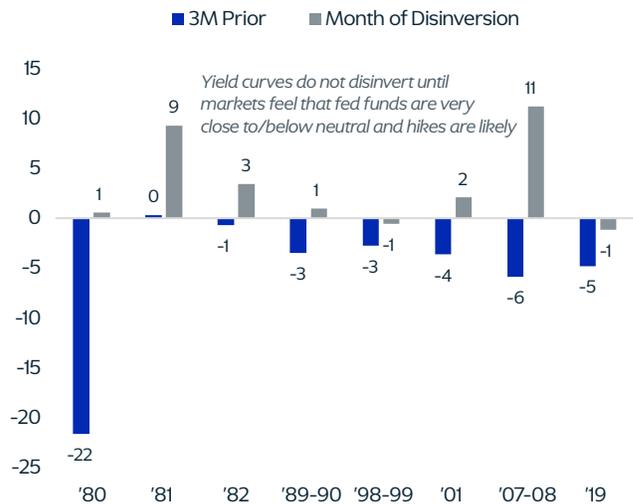
Data as at October 31, 2024. Source: Bloomberg, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

In summary, as we look ahead to next year, there remains considerable uncertainty regarding the tariff situation. Our base case is that the Fed will be easing – not tightening – in 2025, making it unlikely for the yield curve to become unglued. In the worst-case scenario, core inflation could remain at this year’s levels into 2025, which might compel the Fed to raise rates twice from where we are today and push treasury yields back towards five percent.

This situation would hinge on the assumption that labor inflation worsens amidst strong growth, tariffs double from our base case, and shelter inflation unexpectedly accelerates, despite current trends. This combination seems unlikely, but amidst substantial uncertainty, we think investors will want more compensation for holding duration until more clarity emerges on government policy and inflation.

**Exhibit 122:** The 10-Year Has Not Traditionally Moved Above 4.5% Unless the Fed Is (Plausibly) Finished Cutting

**# of Expected Fed Hikes (Cuts) During Yield Curve Disinversions**



Data shows major yield curve disinversions from 1980 – 2024. Data on a monthly basis. Data as at October 14, 2024. KKR Global Macro & Asset Allocation analysis.

As we look ahead to next year, there remains considerable uncertainty regarding the tariff situation. Our base case is that the Fed will be easing – not tightening – in 2025, making it unlikely for the yield curve to become unglued.

### Euro Area Interest Rates

**Forecast:** On rates, we call for a terminal rate of two percent for the short end in 2025 before rising to our long term neutral of 2.5% in 2026. We maintain our above consensus bund yield target of 2.5% in 2025 and 2.75% in 2026, versus a consensus of 2.3% and 2.28%, respectively. However, given the geopolitical challenges, we do acknowledge that there are downside risks to both the base rate and the ten-year rate, which may ultimately require some monetary accommodation.

**Commentary:** As headline inflation has fallen faster than expected over 2024, the ECB has been given more room to turn its attention to the downside risks to Eurozone growth and inflation. We believe the challenging backdrop for GDP will allow the ECB to cut the deposit rate below neutral in 2025, returning the economy to trend growth rates by 2026. Unlike in the U.S. and the U.K., where front loaded fiscal loosening has challenged short end yields, Eurozone rates have remained anchored to the downside. At the long end, we think the continued shrinking of the ECB balance sheet and demand for longer term capital to restructure the economy, will push long term yields up from current levels, maintaining a positive term premium of 25 to 50 basis points.

**The return of dealmaking:** Europe has already started to see a long-awaited pickup in M&A. Moreover, cycle-adjusted valuations in Europe are increasingly attractive relative to the rest of the world (13x P/E discount to the U.S.) and as capital market liquidity picks up, we expect to see a continuation of this trend. With a combination of cheap assets and an attractive funding currency given falling short end yields, we think foreign pools of capital will be increasingly interested in picking up earnings-accretive assets in Europe.

No doubt, geopolitics is reshaping supply chains, causing redundancies that contribute to inflation as the world becomes less globally integrated.

**Exhibit 123:** Near-Term Inflation and Front-Loaded Fiscal Concerns Have Pushed Up the Short End in the U.S. and the U.K., But Not in Germany/the Eurozone

#### 2-Year Government Bond Yields, %



Data as at November 13, 2024. Source: Bloomberg.

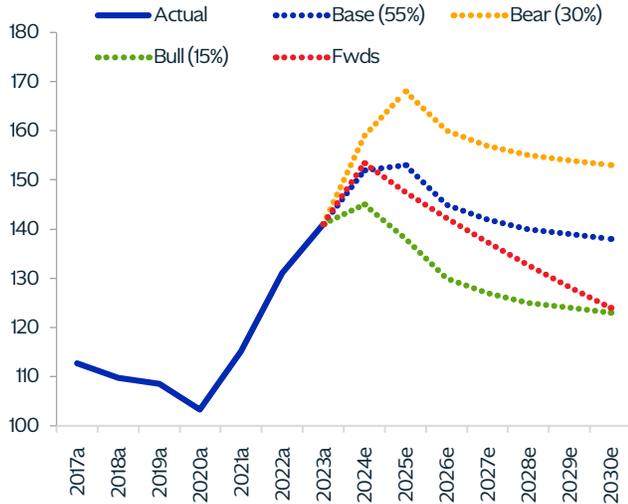
### Japan Interest Rates

We maintain our call of further interest rate policy normalization, with a hike roughly every six months. In terms of specifics, our terminal rate assumption for 2025 is 0.75%, compared to market consensus of 0.7%. For 2026, our terminal rate forecast is one percent versus market consensus of 0.9%. On the long end of the curve, we expect the 10-year to reach 1.35% in 2025 and 1.45% in 2026, compared to a consensus of 1.37% and 1.54%, respectively.

We also want to underscore that interest rate differentials account for 95% of JPY movements. In the past year, JPY trading has increasingly been influenced by U.S. interest rate trends and expectations. Our U.S. team anticipates the U.S. 10-year government yield to reach 4.25% for 2024-25, up from the previous four percent, driven by the likely trade war and other inflationary policies. Consequently, the JPY may weaken further to 153 in 2025, compared to our earlier projection of 145.

**Exhibit 124:** We Expect USDJPY to Remain Weak at 152 in 2024 and 153 in 2025

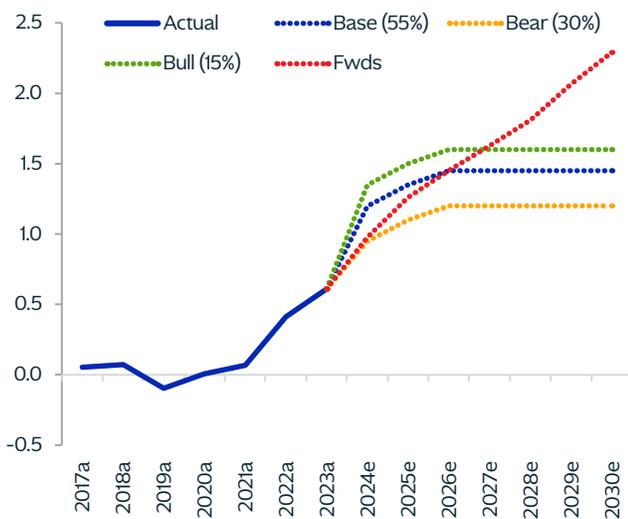
**Currency Exchange Rate, Actual and Forecast: USDJPY**



Data as at November 14, 2024. Source: Bank of Japan, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 125:** We Expect the 10-Year Government Bond Yield to Reach 1.35% in 2025 and 1.45% in 2026

**JGB 10-Year Yield, %**



Data as at November 15, 2024. Source: Bank of Japan, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 126:** Japan's Long-Term Borrowing Costs Are Now Greater Than China's

**Long-Term Borrowing Costs: 30-Year Bonds, %**



Data as at December 3, 2024. Source: Bloomberg.

**Oil**

**Forecasts:** We are lowering our average WTI oil price forecasts for 2025-27, following the tariffs-related downgrades to our Asia/China and Eurozone GDP growth estimates. Regarding specifics, our 2025-26 forecasts move down to \$65 per barrel (from \$68 and \$75 previously), while our 2027 forecast falls to \$70 per barrel (from \$80 previously). The combination of a stronger U.S. dollar and weaker global oil demand growth likely means looser supply/demand fundamentals for longer, postponing the recovery in oil prices. Relative to consensus, our 2025-26 forecasts are now modestly below futures pricing, but our longer-term 2027-28 forecasts of \$70-75 per barrel remain comfortably above futures at approximately \$64 per barrel.

The combination of a stronger U.S. dollar and weaker global oil demand growth likely means looser supply/demand fundamentals for longer.

**Exhibit 127: We Are Lowering Our Average WTI Oil Price Forecasts for 2025-27, Following the Tariffs-Related Downgrades to Our Asia/China and Eurozone GDP Growth Estimates**

	GMAA Base Case vs. Futures			High/Low Scenarios		Memo: Oct-24 Forecasts	
	KKR GMAA	WTI Futures	KKR GMAA vs. Futures	KKR GMAA	KKR GMAA	KKR GMAA	WTI Futures
	Nov'24	Nov'24	Nov'24	High Case	Low Case	Oct'24	Oct'24
2021a	68	68	n/a	68	68	n/a	n/a
2022a	95	95	n/a	95	95	n/a	n/a
2023a	78	78	n/a	78	78	n/a	n/a
2024e	76	76	0	78	74	76	77
2025e	65	68	-3	90	55	68	72
2026e	65	66	-1	90	55	75	70
2027e	70	64	6	100	60	80	68
2028e	75	64	11	100	65	n/a	n/a

Forecasts represent full-year average price expectations. Data as at November 25, 2024. Prior as at October 11, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Commentary: We continue to see a challenging supply/demand backdrop in 2025.**

Robust Americas supply growth (e.g., Brazil, Guyana, and Canada), structural headwinds slowing Chinese gasoline and diesel demand growth, and continued technological improvements and efficiency gains out of the Permian, leave little room for OPEC+ to unwind voluntary cuts into an oversupplied environment, in our view (*Exhibit 128*).

- Global Demand Remains Tepid:** Global oil demand growth has surprised on the downside this year owing largely to China. China's accelerated shift to New Energy Vehicles (including LNG trucks) is at least partly structural and strategic. The pivot to electrification and gas helps with decarbonization goals, lowers domestic pollution, and improves national security insofar as it reduces the need to import oil from Saudi Arabia and Russia. Incremental countercyclical fiscal stimulus could stabilize demand, but we see no quick fixes here, especially with elevated tariff policy uncertainty looming over China/Asia and European growth.
- U.S. Supply:** While Shale capital discipline and geological constraints have weighed on rig counts and well production, we have underestimated the continued technological improvements and efficiency gains out of the Permian Basin. All told drilling and completion efficiency gains have cut down the total average time from rig to production by roughly one-third relative to 2019. Accelerated building shifts the mix of wells to

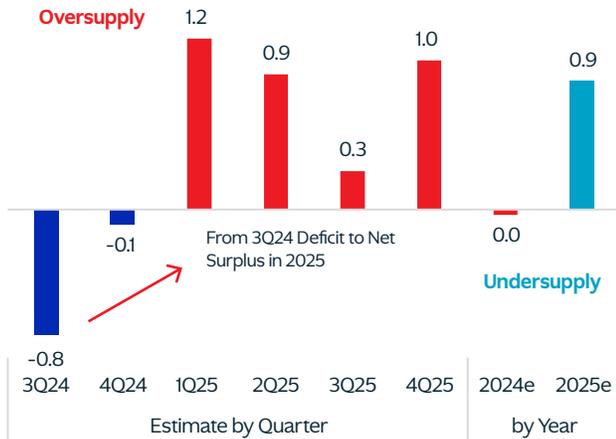
newer and more productive ones, helping to offset the slowing production of mature wells.

- Other Supply Within the Americas:** At the same time, Americas supply growth is set to accelerate in 2025 and 2026 thanks to continued growth in Canada and the price-inelastic production ramp up at new FPSOs (floating production, storage, and offloading) in Brazil and Guyana. The problem for OPEC+ is that supply growth from the Americas alone is likely to match, if not exceed, total global demand growth next year.

All told, drilling and completion efficiency gains have cut down the total average time from rig to production by roughly one-third relative to 2019. Accelerated building shifts the mix of wells to newer and more productive ones, helping to offset the slowing production of mature wells.

**Exhibit 128:** While Spot Conditions Remain Somewhat Tight in 4Q24, Supply/Demand Balances Are Set for Chunky Inventory Builds in 2025

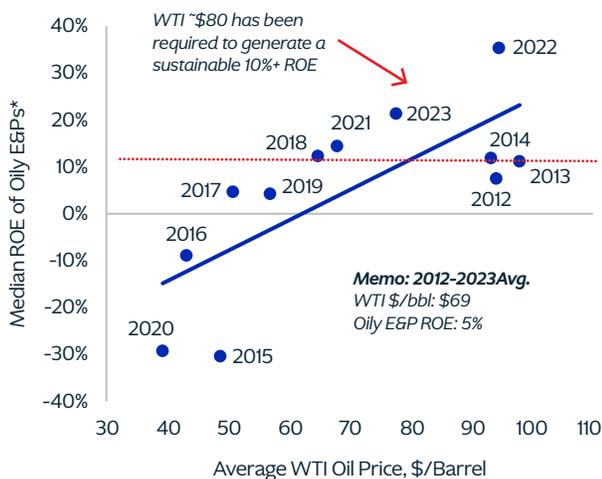
**Global Supply Surplus/Deficit, Millions of Barrels per Day, Consensus Estimates**



Consensus includes Evercore, MS, JPM, S&P, Piper Sandler, UBS, GS, BofAML, Citi, RBC, and Jefferies. Data as at October 31, 2024. Source: Broker Research, KKR Global Macro & Asset Allocation analysis. .

**Exhibit 129:** In a World Where Shale Producers Are Disciplined About Return On Capital, We Still Think WTI Prices Are Likely to Average Around \$75-80 Over the Longer Term

**Median ROE of Oily E&Ps vs. Average WTI Price**



\*Median of COP, EOG, PXD, OXY, FANG, APA, PDCE, MGY, MUR, DEN, CIVI, CRC, SM, CDEV, TALO. Data as at September 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**In our view, U.S. election implications boil down to the prioritization and interaction of President Trump’s policies on Iran, Venezuela, Russia, and global tariffs. Acknowledging the crosscurrents, we think his policies will ultimately contribute to a looser supply/demand balance, which aligns with our more guarded outlook for oil prices over the next two years.**

- **In terms of upside risk**, the return to a maximal sanctions regime on Iran and Venezuela would reduce their oil exports and revenue, which would help tighten the supply/demand backdrop in 2025. We estimate that as much as 1.5-2.0 million barrels per day of Iranian and Venezuelan exports could be at risk, though there are mitigants given that core OPEC+ holds more than five million barrels per day of spare capacity and over 90% of Iranian barrels go to private, independent Chinese refineries that are harder for the U.S. to track and sanction.
- **On the downside**, a swift Russia/Ukraine peace settlement could lead to sanctions relief, eventually paving the way for increased Russian oil exports and higher production growth (as much as 1.0-1.5 million barrels per day). In addition, the threat of global tariffs has already led to downgrades to our Asia/China and Eurozone GDP estimates, which would weigh on global oil demand growth all else being equal.
- We are actually less worried about the administration’s plan to boost domestic oil production via deregulation and tax cuts significantly. ExxonMobil’s head of upstream recently noted “I don’t think we’re going to see anybody in the drill, baby, drill mode. I really don’t.” Opening up more federal lands and slashing EPA regulations on methane emissions may help on the margin. However, E&P producers will not simply ramp up production if it means selling barrels into an oversupplied market at a lower price. This aligns with our thinking that producers remain laser-focused on shareholder returns and that production levels will be – as they always are – driven by market forces such as supply/demand, price/costs, geology, and technological advancements. In any case, near-term U.S. production is not really at stake, as any new project sanctioning would take several years before adding to volumes.

**Longer-term, however, we are still more constructive than the consensus (Exhibit 127). Consistent with this view, we continue to see the ‘Three C’s’ underpinning the macro backdrop for energy:**

1. **Shale Consolidation:** Today’s shale production growth rates are less than half of what one would have expected pre-pandemic in an oil price environment like the current one. Producers are committed to capital discipline; prioritizing shareholder return and free cash flows over volume growth (Exhibit 129). The wave of consolidation by larger players (roughly 70% of total production is controlled by public producers today) should also reduce pro-cyclical drilling by smaller privates.
2. **OPEC Control of Incremental Supply:** More inelastic shale reaction function leaves OPEC in the driver’s seat of incremental global supply. We believe core OPEC continues to prioritize market stability over market share, even as the group is angling to unwind voluntary cuts in coming months. In addition, Saudi Arabia’s fiscal breakeven has increased on a structural basis to \$90–\$100 per barrel, given the higher pace of spending on Vision 2030 mega-projects, which incentivizes higher oil prices.
3. **Durable Consumption:** We think the durability of demand from emerging markets and petrochemicals can offset declines in gasoline demand from developed markets and China. Global oil demand can continue to increase over the next decade, underpinned by continued growth from EM/Asia (rising GDP per capita), petrochemicals (Naphtha/LPG), and jet fuel (limited scalable substitution options). The Trump administration’s potential rollbacks of EPA rules on methane emissions and fuel efficiency standards and cuts to EV, wind, and solar tax credits, could also push out the peak in long-term fossil fuel demand.

**Bottom line: Pulling the pieces together, we continue to see a challenging supply/demand backdrop in 2025. Global tariffs, by potentially strengthening the U.S. dollar and dampening global oil demand growth, will likely prolong the market glut and delay the recovery in oil prices. As such, our 2025-26 WTI forecasts are actually modestly below futures pricing.**

**However, we maintain our more constructive longer-term (2027-28) outlook on crude oil. Key to our thinking: lower oil prices for longer crowding-out supply and boosting demand, the upward pressures emanating from unsettled geopolitics, an at-times messy energy transition, and the structurally higher ROIC discipline we are seeing from OPEC and non-OPEC producers alike.**

Yet, growing global demand for energy sources, especially as AI accelerates, likely means that demand will outstrip supply in the near term. It also means that power supply to AI will become a national security agenda for the U.S., China, and other leading global powers.

## SECTION IV

# Frequently Asked Questions

## ● QUESTION NO. 1

### Why is KKR still bullish on its Regime Change thesis?

Unlike the period following the Global Financial Crisis where low growth and low inflation were the norm, in 2021 we entered a new global macro regime, characterized by higher inflation and rate bias, that has limited the traditional role of bonds in portfolios as 'conventional diversifiers' given the increased correlation between stocks and bonds, which we believe will continue to be driven by an elevated level of inflation volatility. Meanwhile, the results of the recent U.S. election and President Trump's policy proposals have only reinforced our macroeconomic framework, putting an exclamation point on major global secular trends causing elevated price volatility. As such, we still believe our *Regime Change* thesis continues to have significant implications for both growth and investing, and note the following factors that drive us to this conclusion:

#### 1. **More aggressive fiscal spending than in the past.**

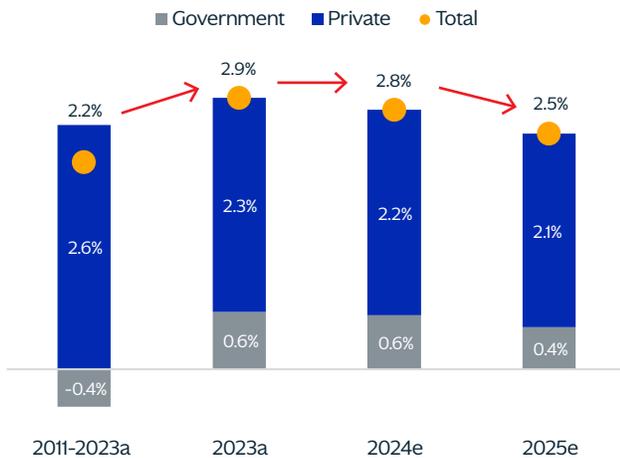
While COVID-style stimulus packages are off the table, many elected officials still advocate for strong fiscal stimulus during key election periods in major economies. When I joined KKR in 2011, the focus was on fiscal austerity, particularly in Europe. Today, by comparison, we see politicians on both the left and right using government programs to woo their voter bases. All told, U.S. debt-to-GDP has increased to

123.3% in 2024 from 104.6% in 2015. At the same time, we look for the U.S. deficit to reach -6.5% in 2025 compared to -2.4% in 2015. Our recent conversations in Washington, D.C. have led us to believe that President Trump will try to curb the deficit on the margin (e.g., roll back loan forgiveness and shave the IRA down on the margin), **but there is not much a sitting President can do without reducing fixed expenses such as Medicare and Social Security.** However, the U.S. is not alone, as we have seen budgets and balances deteriorate in other key markets such as France and the United Kingdom, and we expect more of the same. We anticipate calls for increased 'homeland economic policies' to support domestic manufacturing and supply chains for critical sectors such as Semiconductors, AI, Pharmaceuticals, and Green Energy. Further, scrutiny of foreign and outbound investments that share technology with rival nations will likely intensify. We also foresee a rise in security spending, encompassing both cyber and conventional defense. Finally, sensitivity and controls around supply chains, dual-use technologies, infrastructure, and data will only gain in importance, likely supporting more spending linked to our *Security of Everything* thesis.

We have increased our focus on collateral-based cash flows backed by hard assets, such as in Infrastructure, Real Estate, and Asset-Based Finance.

**Exhibit 130:** The Government Has Moved From Being a Deterrent to Being a Stable Driver of GDP Growth This Cycle

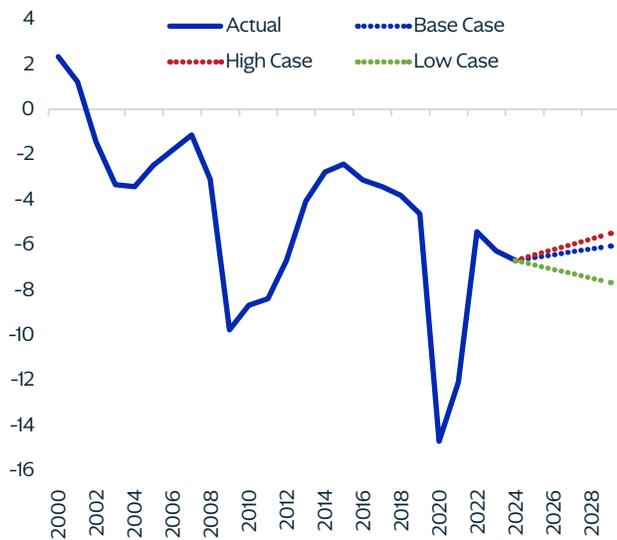
**Contributions to GDP Growth, %**



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

**Exhibit 131:** All Told, We Think the Deficit Will Continue to Stabilize at Around -6% to -7% of GDP in Coming Years

**U.S. Federal Budget Deficit, as a % of GDP**



Data as at November 12, 2024. Source: CBO, Cornerstone, Goldman Sachs, Veda Research, KKR Global Macro & Asset Allocation analysis.

**Exhibit 132:** A Lot of Political Capital Will Be Needed to Extend Current Tax Cuts, Limiting the Scope for New Stimulus

**Estimated Annual Deficit Impact from Trump Policy Proposals, US\$ Billions**

Proposal	Current Law	Current Policy	Likelihood
Individual TCJA	380	0	100%
Business TCJA	95	80	100%
Expand Child Tax Credit	20	20	10%
SALT Cap at 20k 5-Year	15	15	75%
IRA Rollback	-50	-50	100%
Student Loan Rollback	-40	-10	100%
Lower Corporate Tax Rate to 18%	30	30	25%
15% Made in America	21	21	20%
15% Corp Rate	24	24	15%
Partial SSI, Overtime Exempt	19	19	20%
Exempt Tips	12	12	33%
Baseline Tariffs	0	-240	60%
Further Tariffs	0	-120	15%
<b>Baseline</b>	<b>421</b>	<b>-106</b>	
<b>Hardline, Tariffs</b>	<b>526</b>	<b>-199</b>	
<b>Hardline, No Tariffs</b>	<b>526</b>	<b>161</b>	

Data as at November 12, 2024. Source: Cornerstone, Goldman Sachs, Veda Research, KKR Global Macro & Asset Allocation analysis.

2. **Heightened geopolitics.** No doubt, geopolitics is reshaping supply chains, causing redundancies that contribute to inflation as the world becomes less globally integrated. Tariffs worsen these challenges, leading major companies to duplicate supply chains to mitigate geopolitical risks rather than focusing solely on manufacturing costs. According to a report by the Reshoring Initiative, since 2010, the U.S. has reshored two million jobs, which is only 40% of the cumulative jobs lost due to offshoring. In 2022 and 2023, over 630,000 jobs returned to the U.S., marking the highest two-year figure on record. Annualized projections for 2024 indicate that more than 200,000 additional jobs will be reshored. Notably, it took 11 years to reshore the first million jobs, but only three years to approach the second million. Looking at the bigger picture, it feels to us at KKR that the democratization effects of trade many envisioned after the creation of the WTO in 1995 are now to be replaced by 'likeminded blocs' rather than global markets. Ultimately, we think geopolitical

uncertainty could meaningfully change energy policy, defense spending, supply chains, and even consumption patterns. Moreover, the push to reduce economic and technological dependence between industrialized democracies and China may 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, natural resources, and healthcare.

**3. Stickier inflation, including services-based inflation.**

As we showed in *Exhibit 68*, we still see inflation finding a ‘higher resting rate’ this cycle. The main drivers continue to be services (*Exhibit 133*) as well as some sticky areas of goods, including areas likely to be impacted by tariffs. To be sure, we are not forecasting a return of inflation towards the eight to nine percent seen in 2022, but our big picture is still one of sticky inflation, hindered by challenging demographics, unexpectedly high childcare costs, and a general lack of worker retraining. Importantly, our recent portfolio company survey work confirms these trends, as we see wage growth accelerating again in 2025.

**4. A messy energy transition.** President Trump’s re-election further underscores our view that the energy transition will not be a smooth one. Policies between parties on this topic remain divided, and appetites for renewables relative to traditional fuels differs by country and region. Yet, growing global demand for energy sources, especially as AI accelerates, likely means that demand will outstrip supply in the near term. It also means that power supply to AI will become a national security agenda for the U.S., China, and other leading global powers. Without question, this backdrop will create more volatility and uncertainty, both of which are likely to affect inflationary patterns. Despite this reality, many old economy sectors, including traditional commodity producers and manufacturers, have recently been starved of capital, despite the stark reality that they still play critical roles in the greening of the global economy. Remember that less than 20% of the total global energy supply today is linked to clean energy sources.

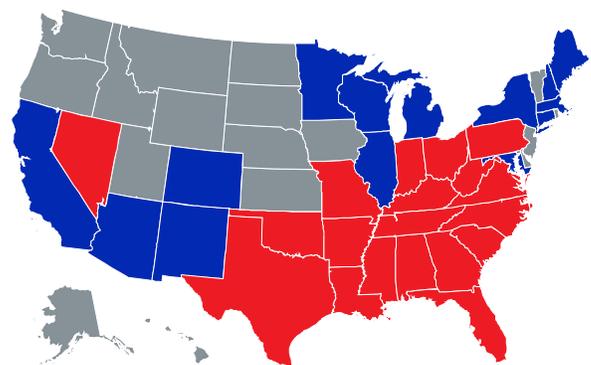
**Exhibit 133: Services and Goods Sectors Are Experiencing Very Different Outcomes**



Data as at November 30, 2024. Source: U.S. Bureau of Labor Statistics, Haver Analytics.

**Exhibit 134: 80% of IRA Investments Are in Republican States...**

**Investment Under IRA, Announced**



Data as at July 31, 2024. Source: J.P. Morgan Research.

**Exhibit 135: ...Which Is Why We Think a Full Repeal Is Unlikely**

Components of IRA Supported by Trump Policies	
Gas Power	Positive: Withdraws EPA Power Plant Rules
Oil & Gas Production	Positive: Market forces main driver, but some boost from additional leasing
Alt. Fuels/ Hydrogen	Positive: Hydrogen tax credit rules likely eased
CCUS	Positive: Republicans have historically supported, but specific policies uncertain
Nuclear	Positive: Republicans have historically supported
Manufacturing & Supply Chain	Mixed: Tariff plans present mixed risk depending on company specific supply chains
Onshore Renewables	Mixed: Likely to stay cost competitive, but Trump pulls back some pro-renewables regulation
Electric Vehicles	Negative: Downside risk from changes to EPA rules; IRA EV tax credits may be modified
Offshore Wind	Negative: May use executive actions similar to Trump 1.0

Data as at July 31, 2024. Source: J.P. Morgan Research.

If we are correct, then what does this all mean for investing? In an environment where higher for longer inflation and interest rates are likely amidst a Regime Change, our advice is to consider the following from an asset allocation perspective:

- 1. We have increased our focus on collateral-based cash flows backed by hard assets, such as Infrastructure, Real Estate, and Asset-Based Finance.** In general, the assets backing these income streams can keep pace with inflation, either contractually or in the ability to pass through costs, which is one of the core drivers of the outperformance of many Real Assets in this investing regime. Downside protection characteristics of Infrastructure assets become even more appealing when one considers that the asset class also offers the potential to earn outsized returns due to exposure to sticky long-term mega-trends.
- 2. It also means that Cash and shorter-term Credit can play a bigger part in portfolios, especially where there are flat yield curves and active refinancings.** Given our view that the risk-free rate - not credit spreads - will be the more volatile input in a higher nominal GDP environment, we think that there is real opportunity to earn excess returns relative to one's liability without taking a lot of duration risk. Refinancings and convertible preferred securities are two of our favorites.

- 3. We think owning more control equity positions works well under our Regime Change thesis.** In particular, we favor corporate carve-outs, especially those that have a sizeable operational improvement angle. Outside of the U.S., we think that the potential for Private Equity to outperform Public Equities, especially in Europe and many markets in Asia, is considerable. Public valuations are generally attractive, while the potential to improve productivity at many of these companies remains outsized. Finally, as we mentioned earlier, we favor more active management of capital, including companies that are using Private Equity as a vehicle to transition from capital heavy to capital light models.

**QUESTION NO. 2:**

**How is the U.S. consumer doing?**

One of the most frequently asked questions we receive, both internally and externally, revolves around the health of the U.S. consumer, and in particular, if there are early signs of 'fatigue'. **Our bottom line is that the all-important U.S. consumer is not as 'spent out' as many perceive.**

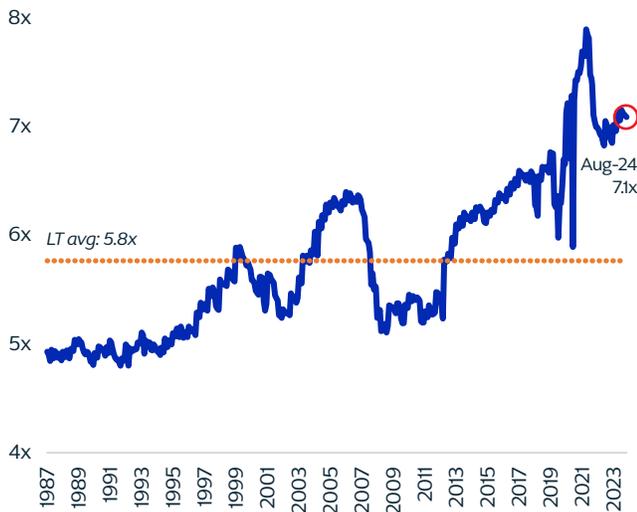
In fact, several factors are contributing to aggregate consumer resilience: the labor market has remained resilient (*Exhibit 144*) and real incomes have continued growing, particularly as inflation for essential items such as food and shelter, has finally begun moderating. Also important has been the wealth effect of resilient housing prices for the two-thirds of U.S. households who are homeowners. Critically, home prices have continued appreciating modestly, as uplift from limited existing home supply has offset pressures from elevated financing costs.

Zooming out even more broadly, one of the key positives we see for the consumer is that **household balance sheets are quite healthy in aggregate, which we observe both in terms of asset values (*Exhibit 136*) and debt burdens (*Exhibit 62*).** To be sure, balance sheet wealth is significantly concentrated in the upper reaches of the income spectrum. Furthermore, as discussed in more detail below, lower-income households have faced more 'effective' inflation, partially due to their relatively elevated exposure to variable-rate consumer liabilities such as

credit card debt. Importantly, however, these households have not been on a borrowing binge. In fact, outstanding principal balances for consumer debt categories, including credit cards and auto loans, are running quite close to subdued pre-pandemic levels relative to disposable income (*Exhibit 137*). Overall, as Dave McNellis's work showed in the U.S. economic section above, it is the government, not the consumer or the corporate sector, that is most leveraged this cycle (*Exhibit 4*).

**Exhibit 136:** Relative to Disposable Income, Household Net Worth Remains Near Historic Highs

**Net Worth to Disposable Income**

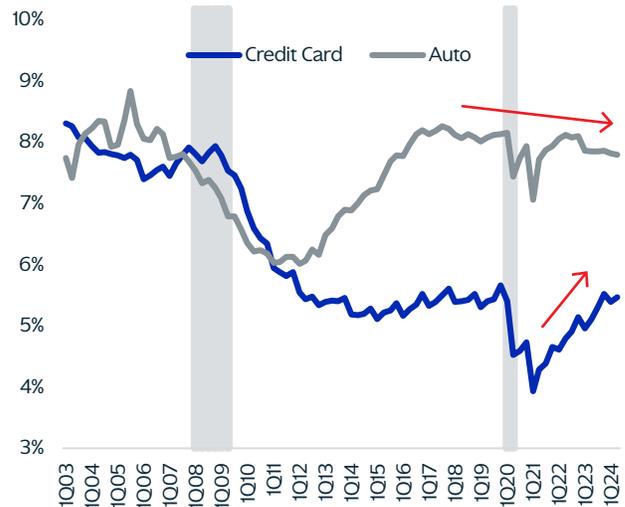


Data as at October 31, 2024. Source: Bloomberg, Federal Reserve, KKR Global Macro & Asset Allocation analysis.

Revisions to government estimates last September revealed the savings rate to be running at a significantly more sustainable run-rate in the four to five percent range, versus earlier, concerningly low, estimates in the two to three percent range.

**Exhibit 137:** Outstanding Household Debt Levels Remain Fairly Subdued Relative to Disposable Incomes

**Credit Card and Auto Debt as a % of Disposable Income**

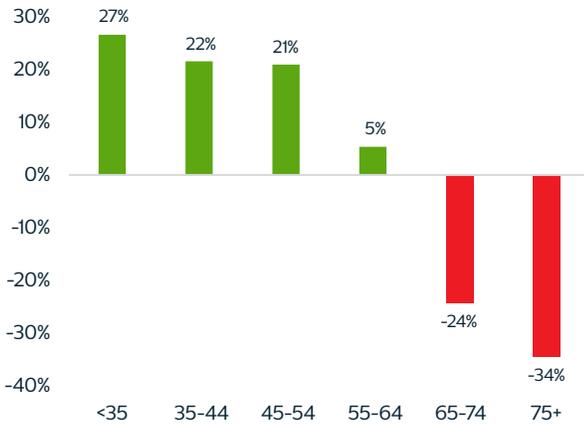


Gray shading denotes recessionary quarters. Data as at September 30, 2024. Source: Federal Reserve, U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

What other key indicators are we monitoring relating to consumer health? Beyond the cost-of-living and balance sheet measures mentioned above, the household savings rate is an indicator we watch for the sustainability of spending patterns. **Critically, revisions to government estimates released last September revealed the savings rate to be running at what we view as a significantly more sustainable run-rate in the four to five percent range, versus earlier, concerningly low, estimates in the two to three percent range.** Maybe even more importantly, stronger-than-previously-estimated income growth was the prime driver of the improvement in the savings rate, indicating that household earning power remains robust. Granted, a four to five percent savings rate still looks quite low relative to longer-term historical norms that often ran closer to the 10% range. However, as we illustrate in *Exhibits 138* and *139*, graying demographics actually explain much of the structural decline in savings rates over time.

**Exhibit 138:** Lifecycle Savings Behavior Suggests the Average Savings Rate Should Come Down as the U.S. Population Ages

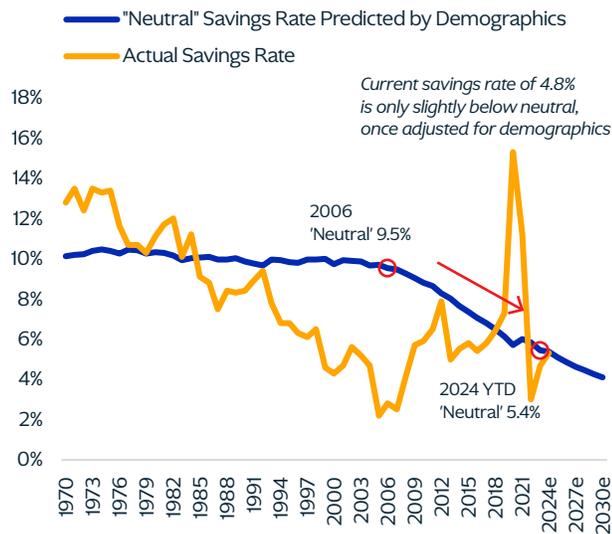
**Average Household Savings Rate, Segmented by Head-of-Household Age**



A neutral savings rate is the weighted average predicted by the mix of households by age. Source: KKR Global Macro & Asset Allocation analysis of findings from “Lifecycle Patterns of Saving and Wealth Accumulation.” Feiveson and Sabelhaus (2019). Federal Reserve Board.

**Exhibit 139:** We Find That the Savings Rate Is Right Around What a Demographic-Driven Model Would Suggest

**Savings Rates: Actual vs. Demographics-Predicted**

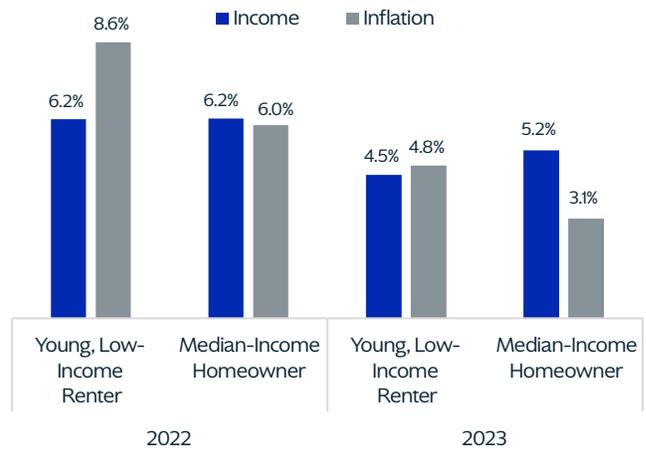


Neutral savings rate is the weighted average predicted by the mix of households by age. 2024 YTD represents Q1 and Q2 2024 average. Source: KKR Global Macro & Asset Allocation analysis of findings from “Lifecycle Patterns of Saving and Wealth Accumulation.” Feiveson and Sabelhaus (2019). Federal Reserve Board.

**While the health of the U.S. consumer is solid in aggregate, we do want to flag that there is a clear bifurcation in the data.** Without question, younger and lower-income U.S. consumers have been most exposed to inflation this cycle, weighing on available spending. Moreover, a lot of inflation today is in ‘must-have’ categories like food, housing, etc., which is taking wallet share from discretionary spending on ‘nice-to-have’ budget items like restaurants or recreational goods. Consider that a Bloomberg survey revealed approximately 45% of people ages 18 to 29 live at home, an 80-year high. This is why we remain relatively cautious about this cohort’s outlook for nonessential spending. One piece of incremental good news on this front is that, while essentials inflation remains comparatively elevated, it is starting to move lower (*Exhibit 142*).

**Exhibit 140:** Low-Income Renters Have Borne the Brunt of Inflation

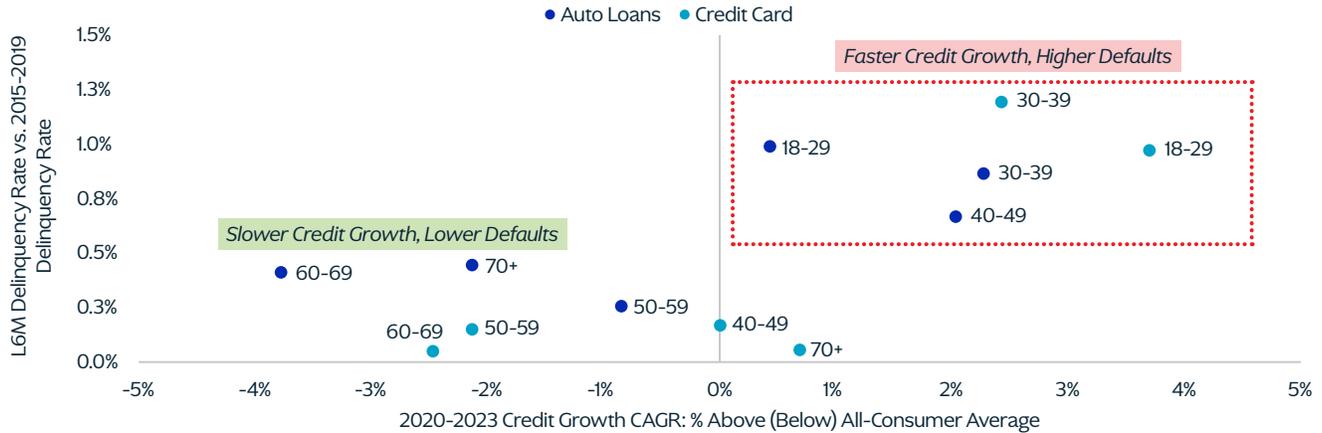
**Income and Inflation Growth, %**



Inflation data excludes the impact of OER, which does not flow through to homeowners’ consumption costs. Young, low-income renter data based on under-25 income mix, and spending habits for renters earning ~\$35k/year. Median-income homeowner data based on median-income (~\$60k/year) income mix, and average inflation rate assuming flat shelter costs due to fixed-rate mortgages. Data as at December 31, 2023. Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Haver Analytics.

**Exhibit 141:** Upticks in Credit/Auto Defaults This Cycle Have Been Driven by Younger Borrowers, Who Saw Borrowing Increase at a Disproportionate Rate During the Pandemic

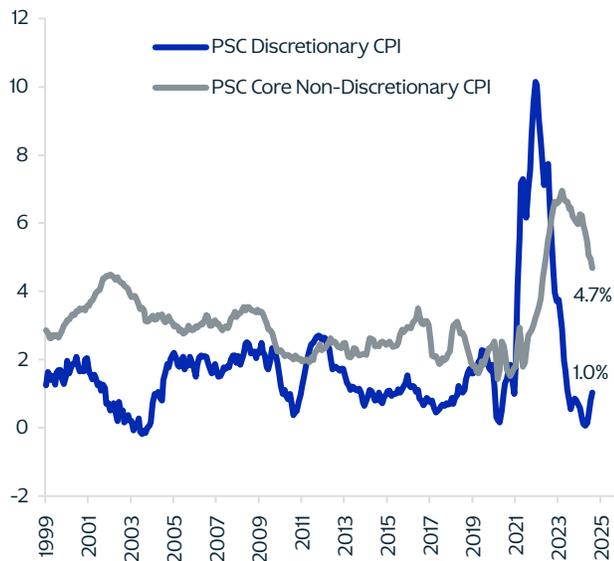
**Post-Pandemic Credit Growth and Change in Delinquencies by Product and Age**



Data as at October 31, 2024. Source: Bloomberg, Federal Reserve, KKR Global Macro & Asset Allocation analysis.

**Exhibit 142:** Costs of Essentials Continue to Rise, While Those for Discretionary Items Remain Better Contained

**PSC Discretionary and Core Non-Discretionary CPI Models, SA, Y/y%**

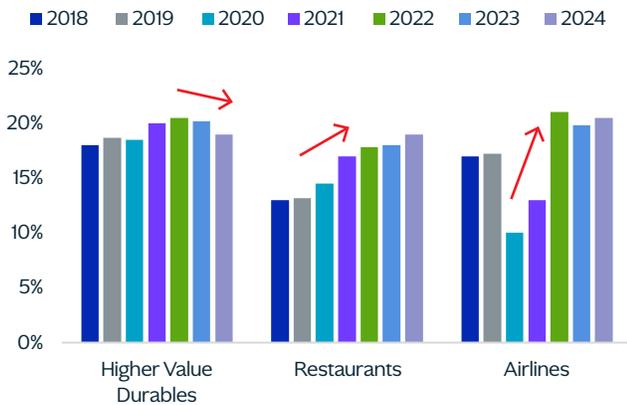


Core non-discretionary index includes Medical Care Commodities, Rent, Hospital Services, Auto Maintenance, Insurance and Fees, Childcare, Telecom/Internet Service, Personal Care Goods and Services, Legal Services, Funeral Expenses, Financial Services, and Pet Services. All other categories are included in the Discretionary index. Data as at October 31, 2024. Source: PSC.

Importantly, high-income consumers have seen home prices and stock portfolio values rise in both real and nominal terms since the pandemic. In the second quarter of 2024, the total value of owner-occupied real estate reached \$48.2 trillion, up \$1.8 trillion from the previous quarter and \$3.5 trillion from 2023. Remarkably, this value is more than double what it was a decade ago when it averaged between \$20 and \$22 trillion. Benefits of home ownership mainly skew to higher-income consumers who tend to own homes, whereas lower-income consumers tend to rent. Said differently, home ownership has become one of the most striking determinants of wealth status — likely more important than employment status — coming out of the pandemic. Homeowners’ equity is at its highest level since the 1950s, providing a potential upside to confidence in spending. Meanwhile, U.S. households’ stock portfolio values increased by nearly \$8 trillion in 2024. These equity market benefits have overwhelmingly gone to high-end consumers. On the liabilities side, inflation has lowered debt servicing costs on existing mortgages, with the average mortgage payment falling from 7.2% of disposable income at the onset of the GFC to just 3.8% today. These shifts have allowed high-end consumers to build cash balances despite paying higher prices for their homes.

**Exhibit 143:** The Preference for Experiences Over Things (Especially More Expensive Durable Purchases) Still Holds, Particularly in a Higher Inflation Environment

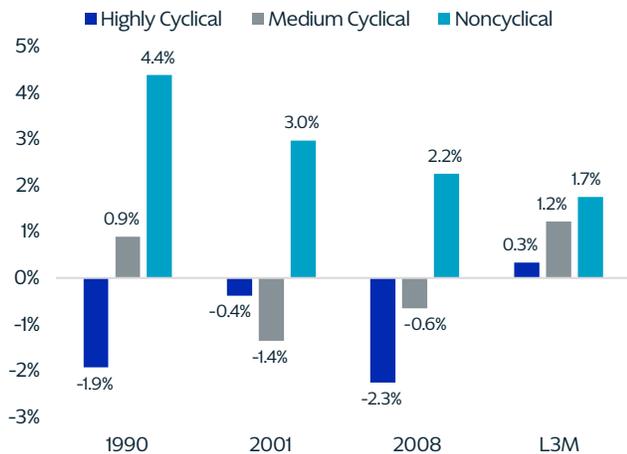
**Share of Spending on Higher-Value Goods vs. Select Experiences, %**



Data as at October 31, 2024. Source: Bank of America internal data.

**Exhibit 144:** Employment Dynamic Across Cyclical Sectors Does Not Paint the Picture of a Labor Market Entering Into a Recession

**L3M Annualized Job Growth 3M Prior to Recession by Industry Type**



Highly cyclical includes construction, manufacturing, and tech/publishing. Medium cyclical includes wholesale trade, transportation, and other. Noncyclical includes finance, education/healthcare, leisure/hospitality, and government. Data as at September 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**What does all this mean for investing?** Overall, we think that consumers will stay active in 2025, especially if we are right that employment stays solid. Wages too should hang in there. We note that fully 81% of respondents in our latest Americas Chief Human Resource Officer survey indicated that headcount for 2025 should grow or remain the same. Further, compensation growth was expected to run around 4%, which remains well above the pre-pandemic run rate of employment cost growth in the U.S. (2.7% on average in 2017-19).

Against this backdrop, we think there are several key trends for allocators of capital to consider. First, as indicated above, services spending trends remain generally more robust than goods spending trends. One way we like investing against this theme is via scalable consumer services providers, particularly those that cater to a growing demand for ‘do-it-for-me’ solutions. Another key services theme is the hospitality, travel and leisure sector, which remains resurgent. Separately, we like investing against our ‘Security of Everything’ theme. In the consumer space, one way to play this is via B2B business models that help brands manufacture and distribute efficiently amid an ongoing proliferation of Stock Keeping Units (SKUs). The continued growth of e-commerce is one of the key accelerants. In addition, we continue to focus on beauty, health, and wellness as ‘new essentials’ in the post-pandemic world, reflecting changing consumer priorities. Finally, the South and Midwest renaissance, driven by initiatives like CHIPS and the IRA, along with geopolitical shifts favoring onshoring, has led to a significant increase in regional manufacturing and construction. Notably, credit card spending in these areas has risen by 25% compared to the 2019 average, outpacing growth in the West and Northeast.

**QUESTION NO. 3**

**What are KKR’s latest thoughts on expected returns this cycle?**

In our latest update on expected returns across asset classes, our key takeaway remains that investors are still facing a ‘flatter’ set of expected returns, underscoring our view that the performance differences between various

assets are narrowing in the new investing regime we envision. All told, the five-year forward median return across asset classes we forecast is 180 basis points lower than what we saw over the last five years. Further, the differentiation between best and worst performing asset classes is now 770 basis points, versus 800 basis points in our 2024 Outlook (that was a peak over the last five years). At the same time, investors are experiencing lower returns while historical correlations among assets are changing, making asset allocation a more crucial factor for overall portfolio volatility than the volatility of individual assets. Finally, as *Exhibit 145* shows, asset classes such as Real Estate Equity now appear to have some ‘catch up’ return potential during the next five years, in our view.

See *Exhibit 145* below for full details, but our main takeaways are as follows:

1. **Flatter efficient frontier:** With margins up, interest rates higher as compared to the pre-pandemic average, and trading multiples elevated, there is now a tighter band between what one can earn from short-duration assets such as Credit, versus longer-duration assets like Equities. Moreover, given less central bank intervention (which favors long duration assets), the return differential between the best-and worst-performing assets in a portfolio is now less stark than in the previous five years, underscoring our strong view that portfolio diversification is even more important.
2. **Real Assets, including Infrastructure and now Real Estate Equity, screen as attractive:** As we detail below, we think that the cash flows from Real Assets become more appealing in an environment of higher nominal GDP growth. That thesis has been the backbone of our decision to overweight collateral-based cash flows in recent years. In particular, we continue to think that Real Assets, especially Infrastructure, Real Estate, and Asset-Based Finance, should be a more significant part of investors’ portfolios. Because of their collateral, these hard assets also can act as important ‘shock absorbers’ if we are right that stocks and bonds will continue to sell off together (i.e., are now positively correlated) or if economic growth slows more than expected.
3. **Fixed income returns should be higher on a go-forward basis:** Higher projected Credit returns reflect, first and foremost, the math of higher coupons in a world

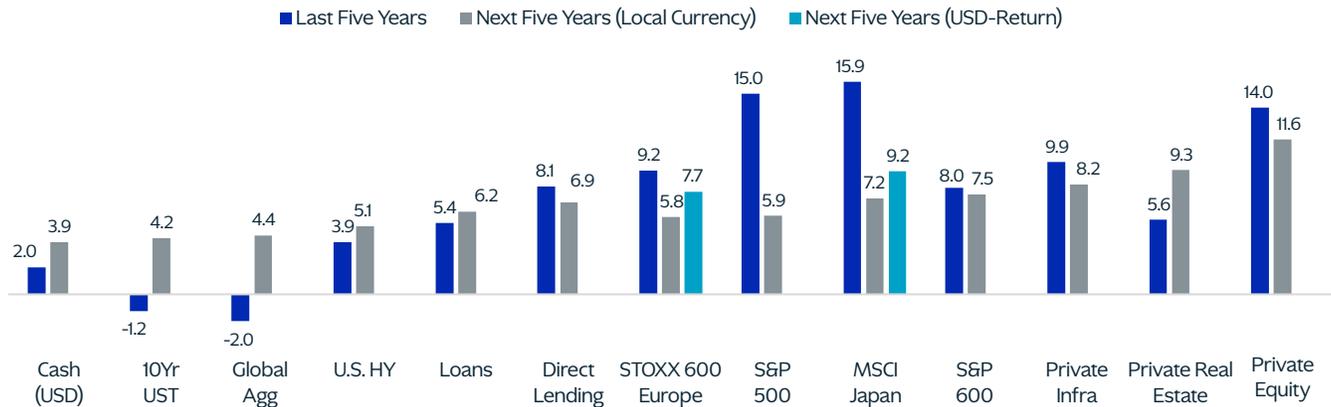
where we think U.S. government bond yields settle near four percent. This viewpoint is consistent with our view that we will have a higher nominal GDP environment if we are correct about our ‘higher resting heart rate’ thesis. To be sure, while corporate defaults are likely to be higher this cycle than pre-pandemic, the combination of higher nominal GDP growth and the fact that companies having termed out their debt during the pandemic, should help keep credit losses relatively tame compared to past cycles, we believe. Meanwhile, though we think Credit spreads may widen modestly in 2025, a sharp move would probably require a drastic slowdown in growth. This scenario, we believe, would provoke a dovish pivot in Fed policy, too. Said differently, we assign a small probability to an outcome in which spreads widen and risk-free rates stay really high in 2025, especially given that our GDP model appears to be accelerating.

4. **Large-cap U.S. Equity returns are likely to be lower:** Over the next five years, the S&P 500 can be expected to return around six percent, compared to 15% during the past few years. Of the forward return we are forecasting, the dividend yield alone gets us to more than one percent, while earnings growth fully drives the rest of the total return. Importantly, we look for the multiple on the S&P 500 to slightly compress over the next five years, compared to a nearly 40% increase during the prior five-year period. While we do not discount the secular trend around digitalization and artificial intelligence that has driven the Magnificent Seven in recent years, we think that the growthier part of the market, including Large-Cap Equities such as the Magnificent Seven, are unlikely to have further multiple expansion from here on a five-year forward basis.

Our bottom line is that credit valuations are probably closer to ‘fair’ versus ‘rich’, despite what headline metrics would indicate.

**Exhibit 145: We Continue to Think That Returns Will Look Different Relative to the Past Five Years**

**Expected Returns, %**



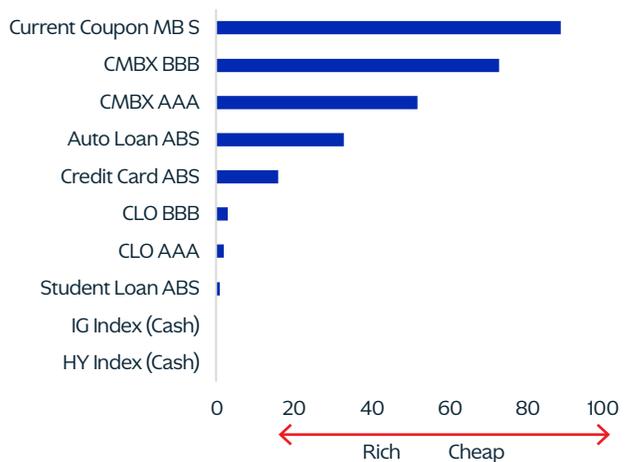
For private asset classes (Private Credit, Private Infra, Private Real Estate, and Private Equity) returns are representative of the median manager return net of Fee/Carry. Local currency returns shown. Last 5 Year return from June 30, 2019 to June 30, 2024 for consistency across asset classes. Data as at October 15, 2024. Source: Bloomberg, BofA, Cambridge Associates, Green Street, KKR Global Macro & Asset Allocation analysis.

**5. Private Equity remains the highest expected returning asset class:** Private Equity continues to be the asset class with the highest return potential – especially on a go forward basis amidst pressures on Public Equities driven by elevated valuations, higher inflation volatility, and higher interest rates. We have seen a solid acceleration in deployment activity and monetization amid an increase in overall activity across global capital markets. Given the rate of uncertainty, value creation and exposure to critical secular trends have become even more important. If there is additional good news for the asset class, we look for a material surge in deal related activity across the corporate and private sectors in 2025, especially as a new administration pushes more of a deregulatory agenda.

a ‘technical’ bid for absolute yield, as well as a resilient economic recovery. More broadly, spreads have tightened across most parts of the credit complex.

**Exhibit 146: The Absolute Level of Yields, Not Just Spread Level, Suggests That There Is Still Value in the Market in a Higher Nominal GDP Environment**

**Spread Percentiles, Post 2010 to Current**



Data as at November 30, 2024. Source: Goldman Sachs Investment Research.

**QUESTION NO. 4**

**Where does KKR see relative value in Liquid Credit?**

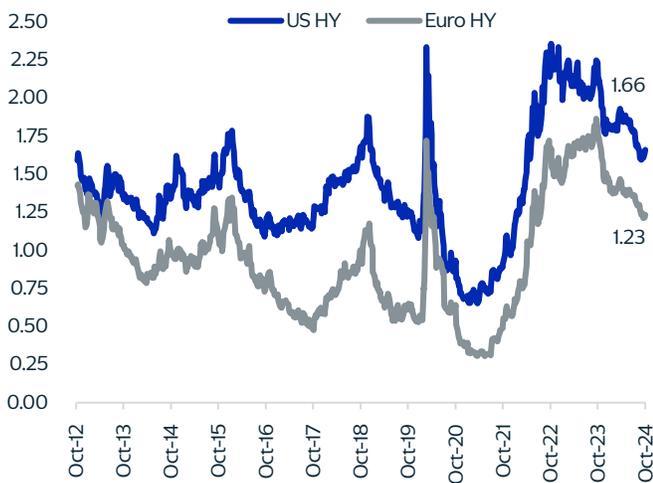
No doubt, spreads have tightened significantly since we wrote our 2024 Outlook, which has made it a harder environment to realize absolute value in credit. Just consider that high-yield OAS is now 50-100 basis points tighter than it was in December 2023, driven by both

With that said, we also think that investors need to focus on absolute yield, given where the risk-free rate is relative to history, as well as the cost of liabilities. One can see this in *Exhibits 145* and *146*. Against this backdrop, we still think there are some interesting pockets of relative value which investors should consider.

- Beyond factoring in some benefit for a higher absolute level of interest rates amidst a higher nominal GDP environment, an investor also needs to factor in the reality that **the quality of credit markets has broadly improved**. In fact, while nominal U.S. High Yield spreads are tighter than they were pre-GFC and only about 30 basis points wider than they were pre-Dot-com, **on a leverage-adjusted basis, spreads were actually at similar levels to today as recently as 2019**. In Europe, meanwhile, spreads were actually tighter in 2017, 2019, and 2021 than they are today using the same metric. Not surprisingly, we are particularly focused on opportunities in Europe where refinancing will continue to result in early take-outs as a short-duration strategy, especially if we can earn additional currency carry from hedging back into U.S. dollars.

**Exhibit 147: U.S. High Yield Appears More Fairly Valued When Leverage Levels Are Incorporated Into the Analysis**

**HY YTW per Turn of Leverage, %**



YTW=yield to worst. Data as at October 31, 2024. Source: BofA Global Research, LCD/Pitchbook.

**Exhibit 148: The Yields in Euro Floating Rate Debt Also Appear Attractive**

**Broadly Syndicated Loans YTM Per Turn of Leverage, %**



YTM=yield to maturity. Data as at October 31, 2024. Source: BofA Global Research, LCD/Pitchbook.

- **Beyond fixed rate securities like High Yield, we actually think the opportunity spread looks even richer for floating rate debt**, including BSLs (*Exhibit 148*). Indeed, leverage-adjusted spreads are actually wider for BSLs than they are for U.S. High Yield and are actually in line with pre-COVID levels. That backdrop makes us feel better in an environment where the Fed is cutting (not hiking) and nominal growth remains robust (versus the more 'normal' levels that prevailed pre-COVID). Finally, we like the technical bid for loans at a time when there is very little net supply and the bid from CLOs remains robust.
- **On the CLO front, we continue to prefer more junior tranches of the CLO stack (select BB tranches are amongst our favorite)**, which continue to offer wide spreads relative to 'look-through' leverage. From our vantage point at KKR, we think that CLOs are well-suited for investors willing to take some drawdown risk, and for buy-and-hold investors, as we continue to view fundamental credit risks as quite remote for CLO 2.0 (consider that defaults for this cohort are typically less than 50 basis points annualized, while spreads are currently around 600 basis points or more).

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Our bottom line is that credit valuations are probably closer to 'fair' versus 'rich', despite what headline metrics would indicate. Key to our thinking is that leverage levels as well as the absolute level of rates do matter, especially in a higher nominal GDP environment. Within the credit complex, we prefer floating rate asset classes, especially structured products which have shown resilience in past crises. Looking at the big picture, our thesis aligns with our broader call that there is likely more value in floating-rate assets at a time when the outlook calls for less of a rally for duration and a slower pace of Fed rate cuts. Finally, we continue to think that this remains an environment for 'credit picking', including the ability to toggle between credit asset classes, especially across High Yield, Bank Loans, and Structured Products.

We are also encouraged by the technical market picture. In addition to tightening financial conditions and falling earnings, bear markets usually occur when the market's supply has both grown in size and deteriorated in quality. Today, by comparison, we see neither.

## SECTION V

# Key Conclusions

As we peer around the corner today on what tomorrow might look like, we are encouraged by what we see in many markets. Said differently, despite heightened uncertainty, we see the *Glass Still Half Full*. Within Credit, for example, we think that the absolute levels of rates matter more than many investors may currently suspect. So, while we are nervous about credit spreads on a relative basis, our view that stronger nominal GDP lies ahead is an important tailwind for minimizing defaults and downgrades in the current cycle, especially relative to the low growth, low inflation environment that defined the pre-COVID period.

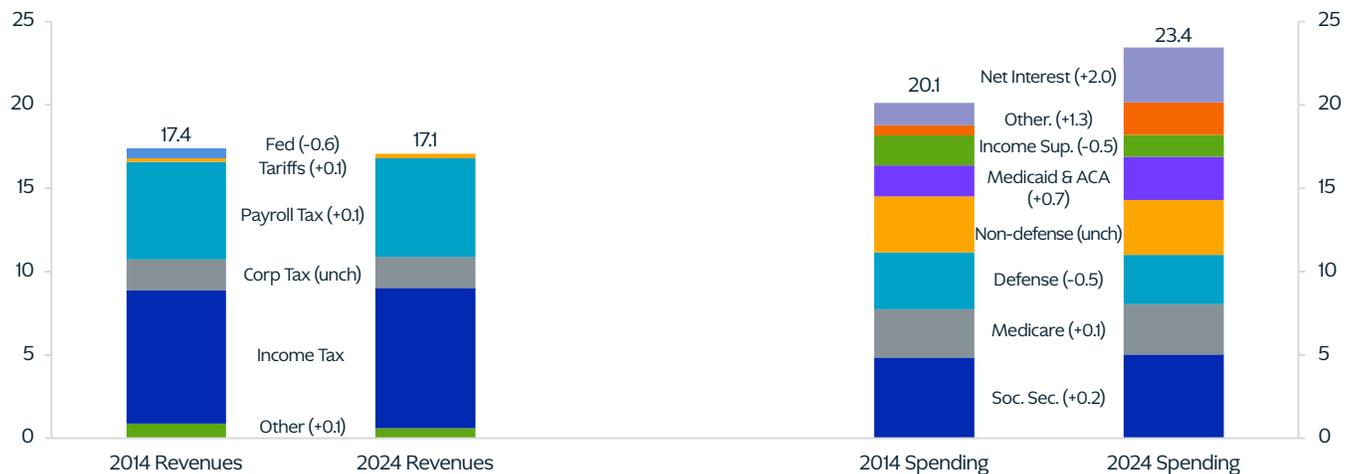
Meanwhile, on the Equity side of the house, we see stronger nominal EPS growth in 2025, especially in the U.S. Within Equities, we heavily favor domestic consumption

stories (think the U.S. and India), corporate reform stories (think Japan), and/or services-based countries (think Spain). We also believe that a broadening of earnings, especially in the U.S., will be good for market breadth across most major equity indexes.

To be sure, both bigger deficits, as we show in *Exhibit 149*, and heightened geopolitics suggest that greater diversification, especially towards non-correlated assets, will be required in the *Regime Change* we are envisioning. Another important mitigant to today's more complicated environment is the potential to invest around some of the compelling mega-themes that we have identified in this piece. While not exhaustive, this list includes the following:

**Exhibit 149:** Similar to Its Global Peers, the U.S. Has a Spending Overrun – Not Necessarily a Revenue Problem

**Changes in Composition of U.S. Government Revenues and Spending FY2014 to FY2024 as a % of GDP**



Data as at September 30, 2024. Source: Goldman Sachs Investment Research.

1

Capital Heavy to  
Capital Light Models

2

Improving Worker  
Productivity/  
Worker Retraining

3

Security of  
Everything,  
Including Reshoring  
and Resiliency  
Efforts

4

AI-driven  
Energy Demand  
Creating Unique  
Energy Supply  
Opportunities

5

Collateral-Based  
Cash Flows That  
Yield and Are  
Levered to Nominal  
GDP

We are also encouraged by the technical market picture. In addition to tightening financial conditions and falling earnings, bear markets usually occur when the market's supply has both grown in size and deteriorated in quality. Today, by comparison, we see neither. Overall net issuance of corporate debt and IPOs remains quite modest relative to history.

If there is a potential area of concern in our base case forecast, it is that expectations are now much higher. Specifically, whereas in the past two years GDP growth estimates by the sell-side were less than one percent, the 2025 estimate for growth is now well above two percent. A similar reality has also occurred in the Equity market, as more and more strategists have finally raised their forecasts for both earnings and valuation as we head into 2025. Also, we are not as sanguine about a major Fed cutting cycle in 2025. So, the *bar is higher* for investors to enjoy an upside surprise, we believe.

That said, given all the aforementioned favorable tailwinds, we still retain our *Glass Half Full* mentality heading into 2025. What is different for next year, however, lies in our

approach to capital allocation. Specifically, for allocators of capital, **our central message is that overall returns are compressing at this point in the cycle, which means that alpha from manager selection and the need for diversification of assets will increase materially in the global macroeconomic environment we are envisioning.** Against this backdrop, we think the role of Alternatives, including Private Equity, Infrastructure, Real Estate, and Credit, as well as short duration Liquid Credit and Cash – at the expense of Government Bonds – becomes much more important. We also think that more non-correlated assets will be required to serve as 'shock absorbers' against the inevitable bouts of volatility that are likely to occur in a world of sizeable budget deficits, heightened geopolitics, a messy energy transition, and sticky inflation. Therein lies the opportunity in the Regime Change that we believe is unfolding.

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