KKR

Insights

15.2

Global Macro Trends
May 2025

The Art of Learning

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The Art of Learning

With a whirlwind of recent developments — post-U.S. election tax debates, ‘Liberation Day’, and travels both abroad and at home in early May—we think it makes sense to update what we have been learning, especially as it relates to our *Regime Change* thesis. One learning involves the role of international bonds, including investors’ increased desire to own more non-U.S. fixed income, alongside more private market Alternatives, that can help to further diversify a portfolio. Another key area where we have increased our knowledge involves the U.S. dollar’s valuation relative to history. With a weakening dollar, local currency liabilities have the potential to become a more severe drag on performance than we and many investors were expecting prior to April 2nd. Meanwhile, on tariffs, we’ve updated our ‘post-bargaining plausible case’ by incorporating what we’ve learned from the recent China and U.K. negotiations. Our new baseline suggests a 15% effective tariff rate (down from 18%), which we see as the most likely steady state. This new steady state also improves our GDP growth outlooks for the United States, Europe and China. Finally, another area we are now watching more closely as part of the tariffs conversation is the relative importance of goods vs. services to the U.S. economy. Our estimates actually suggest that the gross profitability of U.S. services exports currently surpasses the ‘lost profits’ on goods that the U.S. imports instead of manufacturing domestically. This learning, coupled with the potential for further dollar weakness, has impacted the way we are thinking about the ‘America First’ agenda.

> Learning is like sailing against the current; if you don’t advance, you will be driven back.
>
> — **Chinese proverb**

When Ken Mehlman and I wrote about the outcome of the U.S. election last November (see *2024 Election: Focus on the Forest, Not the Trees*), we noted that from a macro and asset allocation perspective the 2024 'Red Sweep' only added further fuel to KKR's *Regime Change* thesis, first laid out to investors as we exited COVID. To review, the thesis underscores our view that this time is different, including the way investors need to think about asset allocation, including the role of bonds. Specifically, we think that government bonds will not be able to fulfill their role as portfolio 'shock absorbers' this cycle. As a reminder, our top-down *Regime Change* thesis framework is driven by four factors: heightened geopolitical competition, bigger fiscal deficits (which is consistent with the latest U.S. debt downgrade by Moody's to Aa1 from Aaa on May 16th), a messy energy transition, and stickier inflation. Importantly, the world we are describing represents a major shift from the low growth, low inflation, tight fiscal and loose monetary policy framework that dominated much of the last two decades, especially the 2010-2016 period. One can see this in *Exhibit 2*.

Of the factors mentioned above, the geopolitical factor has been the most amplified of late. As my colleagues General (Retired) David Petraeus and Vance Serchuk remind me often, we have moved from an era of benign globalization to one of great power competition. Increasingly in this world, politics is driving economics, and there is a blurring of capital markets policy and national security policy as cross border barriers to the flow of capital, data, technology, and people rise. Seen through this lens, key milestones such as Brexit and now 'Liberation Day' represent just the latest 'textbook' examples of the convergence that the KKR Global Institute has been suggesting for some time.

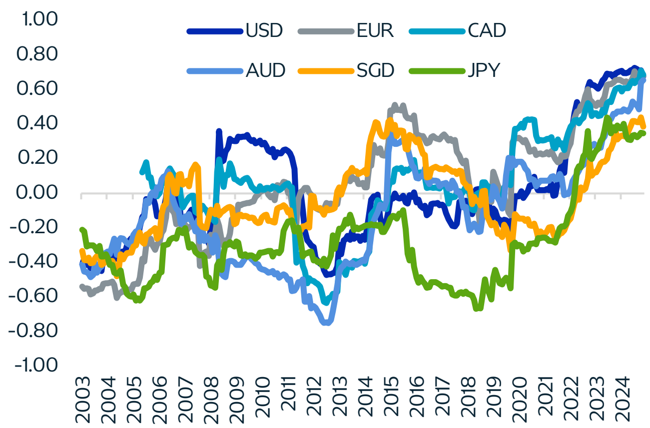
However, there is a new variable affecting our *Regime Change* thesis that we believe warrants investor attention. It centers on the introduction of a potentially structurally weaker dollar, alongside our longstanding view that the correlation between stocks and bonds is moving from negative to positive this cycle. Indeed, as we saw upon the April 2nd 'Liberation Day' announcement and then again when President Trump sparred with Federal Reserve head Jerome Powell later that month, the unsettling triumvirate of 1) the U.S. dollar depreciating; 2) Equities selling off; and 3) bond prices declining all *at the same time,* wreaked havoc on markets, challenging *two* fundamental underpinnings of modern-day asset allocation theory. The picture is as follows:

1. **During risk off days, government bonds are no longer fulfilling their role as the 'shock-absorbers' in a traditional portfolio**. As such, there is now an ongoing clear and present danger for global allocators who bought into the idea that when stocks sell off, bonds will always rally. Importantly, this significant break down in asset allocation theory is occurring not only in the U.S. but also across most other global developed markets. One can see this in *Exhibit 1*.
2. **While bonds and stocks were selling off together, the U.S. dollar was also weakening**. As a result, there has been a growing fear that, because of dollar weakness, local currency liabilities have the potential to become a more severe drag on performance than expected, especially during turbulent days in the market. CIOs and their boards are seeing their offensive assets such as stocks and defensive assets such as government bonds both decline in value at the same time that their local currency liabilities, which they traditionally have not hedged, increase in value too. This unsettling outcome is occurring at a time when most global retirement plans are overweight U.S. assets relative to their benchmarks.

During risk off days, government bonds are no longer fulfilling their role as the 'shock-absorbers' in a traditional portfolio. As such, there is now an ongoing clear and present danger for global allocators who bought into the idea that when stocks sell off, bonds will always rally.

Exhibit 1: With the U.S. Leading the Pack, Long-Term Correlation Levels Between Stocks and Bonds Have Increased Across Most Countries

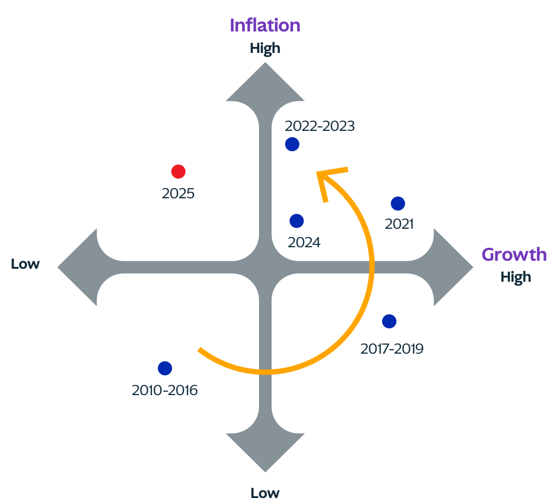
Rolling 36-month Local Stock/Bond Correlation



Correlation matrices are based on monthly returns. Local bond market performance for the U.S., Europe, the U.K., Canada, Singapore, and Japan is represented by unhedged local currency Bloomberg Aggregate indices. Australian bond market performance is represented by Bloomberg AusBond Composite 0+ Yr Index. Local stock market performance is represented by S&P 500 Index for the U.S. and unhedged MSCI Country Indices for the rest. Data as at December 31, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: Regime Change: We Continue to Argue That This Time Is Different

Low and High Growth and Inflation Regimes



Data as at April 5, 2025. Source: KKR Global Macro & Asset Allocation analysis.

There is also the consideration that the government is trying to narrow the goods segment of the trade deficit without first narrowing the fiscal deficit. The associated slowdown that we are also seeing in the large and notably more profitable services sector surplus, which we discuss below in more detail *(Exhibit 14)*, is likely a contributing influence as well.

Beyond the aforementioned portfolio construction questions that have come up in our discussions with global CIOs, boards, politicians, and investors, recent trips to the United Kingdom and to Los Angeles to participate in Michael Milken's annual conference, elicited a slew of other questions from business executives and investors seeking guidance. Further, partial tariff relief has arrived faster than we anticipated post April 2nd in the form of preliminary China and U.K. trade deals.

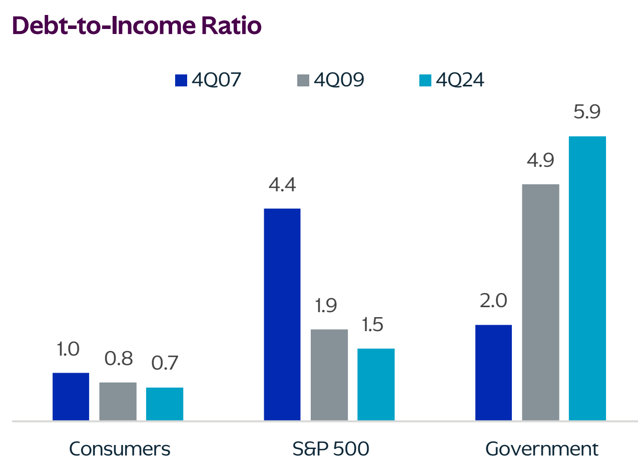
To this end, we are using this latest *Insights* note to not only flag some of the most topical questions but also to detail our views (given the points highlighted above) on the way we are approaching asset allocation in the current environment. See below for details, but our summary views on the most asked questions are as follows:

1. **While not a game changer, partial tariff relief has arrived a little faster than anticipated. What has changed in your thinking?** Dave McNellis, Brian Leung, and Miguel Montoya have updated their 'post-bargaining plausible case' for tariffs to incorporate learnings from the China and U.K. deals. Overall, we now think a 15% post-bargaining effective tariff rate (ETR), down from our previous assumption of 18%, seems the most likely steady state. A few key observations: The decline in China tariffs is certainly helpful, although perhaps not the needle mover for our base case as one might initially think. Keep in mind that President Trump had already carved out exemptions for major categories like computers, electronics, and smartphones, so reducing the assumed tariff rate on other items doesn't have as much impact as it might seem. That said, the post-bargaining ETR for China now decreases to 30%, compared to our prior estimate of 37%. The U.K. deal also brought some positive news, introducing the possibility of flexibility on 232 sector tariffs. We had previously assumed no exemptions to the 25% tariffs on autos and steel/aluminum aside from USMCA exemptions. Now we

assume that roughly 50% of auto import volumes and 10% of steel and aluminum volumes might eventually be exempted down to the 10% 'base' tariff rate. The lowering of our post-bargaining ETR to 15% from 18%, combined with the earlier-than-anticipated arrival of partial tariff relief, both support an improved outlook for GDP. As a result, we are moving our U.S. Real GDP growth estimate for 2025 up to a 1-2% range from the previous 0.5-1.5%. Meanwhile, in Europe, we are awaiting the outcome of negotiations with the European Union. That said, Aidan Corcoran suggests that a positive outcome, similar to what happened with the U.K. and China, could impact growth slightly. As such, he is increasing his European GDP estimate to 0.7% from 0.6% in 2025. Finally, Changchun Hua suggests that if the situation holds, the impact on China's GDP falls from negative 240 basis points to 'just' negative 90 basis points. The need for rate cuts and RMB depreciation also will be less urgent than we initially thought, and as such, our China Real GDP growth outlook for 2025 increases to 4.8% from 4.3%.

2. **Why are you not more bearish on earnings growth, given the magnitude of the supply shock?** Unlike the downturn in 2007, which was driven by both bank and consumer deleveraging, surging oil prices, and sharply wider credit spreads, this potential downturn is a policy-induced one, which does not share those same attributes. In fact, oil prices are going down, credit spreads are only modestly wider (and remember credit spreads have been the most coincident indicator in our long-standing Earnings Growth Leading Indicator or EGLI model). One can see this in *Exhibit 8*. Further, banks are flush with cash, and global policy rates are heading lower. So, as we detail below, we do think that corporate earnings growth will moderate sharply, but our EGLI *(Exhibit 9)* will not turn negative the way it did during other major periods of uncertainty, unless there is an unanticipated policy mistake around the deficit widening further and/or the independence of the Fed is becoming impaired. That's the good news. The potentially bad news for investors is that the initial communication of the 'Liberation Day' game plan as well as the recent introduction of DeepSeek by Chinese entrepreneurs, has increased uncertainty – uncertainty that will likely dent the premium valuation that U.S. Equities and U.S. credit spreads enjoyed prior to April 2nd, especially as we see 1) further blurring between economics and national security amongst governments around the world; and 2) global allocators repositioning their portfolios to gain more diversification outside of the United States. Finally, as we show below, the desire to reduce America's goods deficit actually may come at the expense of its sizeable and profitable services surplus. See *Exhibit 14* for details, but some insightful work done by my colleague Dave McNellis shows that services have a higher return on capital and are likely a better way to harness the U.S.'s comparative advantage on a sustainable basis.

Exhibit 3: Unlike in the Past, Consumers and Corporations Are Not Overleveraged

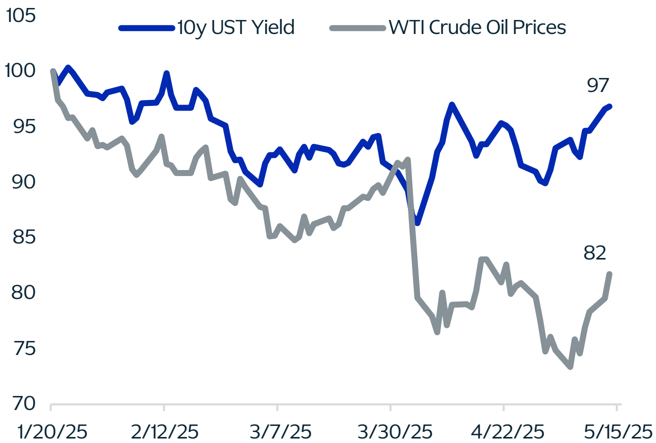


Income is defined as: For consumers total personal income (before tax or interest expense); for corporates it is EBITDA; for government it is total revenue. Debt is defined as: For consumers it is total debt; for corporates net debt; for government it is total debt held by the public. Data as at December 31, 2024. Source: BofA, KKR Global Macro & Asset Allocation analysis.

We do think that corporate earnings growth will moderate sharply, but our EGLI will not turn negative the way it did during other major periods of uncertainty.

Exhibit 4: Since the Inauguration, Both Oil and the 10-Year Yield Have Declined, With Oil Providing Meaningful Tailwinds

Treasury Yield and Oil Price Change, Indexed at 100 to January 20, 2025



Data as at May 13, 2025. Source: Bloomberg.

3. **Could currency policy ultimately be a more effective vehicle for improving U.S. competitiveness, especially relative to reciprocal tariffs on goods?** As history has shown, following the Plaza Accord in 1985 and the Dot.com bust in 2000, one of the most potent levers used to increase American competitiveness was allowing for a renormalization of the U.S. dollar's trading level. According to our models, one of which we show in *Exhibit 15*, the USD is likely around +15% rich relative to its theoretical fair value, making it the third most expensive level since the 1980s. In this context, we think a change in the trading level of the U.S. dollar — likely driven by a strategic asset allocation repositioning by global investors, or even by some foreign governments allowing gradual appreciation of their currencies as a tacit condition of tariff relief — could actually bolster competitiveness far more effectively than imposing heavy reciprocal tariffs on the U.S.'s closest trading partners and military allies. Importantly, we are not arguing for an uncontrolled devaluation. Rather, we believe that if the dollar were just to relinquish some of the elevated valuation it has accrued since the onset of COVID in a 'mean reversion' trade, it could stabilize at a level that would significantly enhance U.S. competitiveness in the global export arena. Bottom line: Over time we favor more market-based forces to create competitive export advantages relative to imposing fluctuating reciprocal tariffs which we think can dent capital investment/productivity by creating more uncertainty.

4. **For investors who are considering selling down their overweights in U.S. financial assets, what should they know?** Many CIOs are considering moving assets out of the United States towards other parts of the world. While the theory behind this shift is understandable, the practicality of the execution is difficult. The U.S. equity market, for example, is nearly twice the size of Europe, Japan, and India, combined. Moreover, many U.S. companies are large, liquid names that have low leverage and solid earnings growth. Their returns on capital are often higher too. However, on the fixed income side, we do see some room for improvement through greater diversification. Key to our thinking is that, if our *Regime Change* thesis continues to play out the way we think it will, the traditional role of U.S. government bonds in many global portfolios will become more diminished. The reality is that the U.S. government is burdened with a large fiscal deficit and high leverage, and its bonds are likely over-owned by many global investors who have benefitted from both positive interest rate differentials and a strong U.S. dollar. Recall that many portfolios have relied heavily on the 60/40 model, comprising 60% Equities and 40% bonds, with a significant portion allocated to U.S. Treasuries. See below for more detail, but we asked our colleague Rachel Li for an analysis that explored the impact of adding international bonds into the traditional 60/40. Her findings indicated that local bonds could indeed provide the additional diversification that, these days, U.S. government bonds might struggle to deliver. Moreover, when combined with private assets such as Private Equity as well as Infrastructure and Asset-Based Finance, the potential benefits to returns and to risk management were substantial. One can see this in *Exhibit 19*.

5. **Are strong, positive market technical forces helping to offset shaky economic trends?** Investing is more than just understanding the fundamentals. The technical picture matters too. Our punchline remains that tariffs represent a supply shock that has dampened demand, prompting us to consider more

limited growth prospects of 1-2% U.S. GDP growth in 2025 versus our quantitative model's projection of 2.9% (ex-tariffs). That's the bad news. The good news is that the technical backdrop is still quite compelling, and becoming more optimistic. The S&P 500 is poised to buy back over $1 trillion of stock, money market balances are high, and net issuance, as we describe below, is near historic lows *(Exhibits 28* and *29)*.

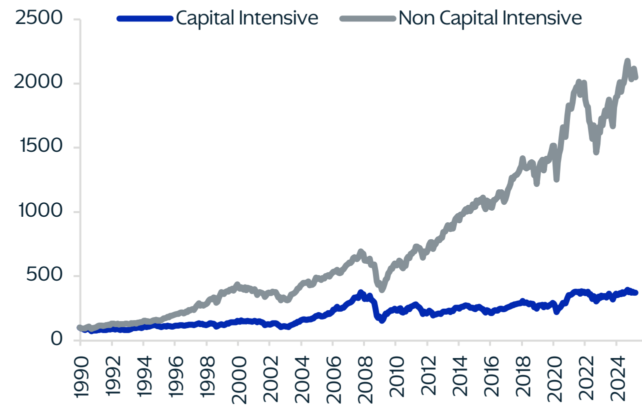
Looking at the big picture, we think that today's market is one where we will need to 'make our own luck.' On the positive side of the ledger, we do believe that the fat left tail risk, which includes a falling dollar, rising interest rates, and a weakening equity market (i.e., what investors experienced in the aftermath of 'Liberation Day') has been – through trial and error – mitigated.

That said, as we mentioned above, the introduction of DeepSeek by Chinese innovators and the abrupt roll-out of 'Liberation Day', suggest that valuations are now likely capped relative to the prior period of U.S. exceptionalism. Moreover, as we signaled earlier (and we detail below), we think the role of U.S. bonds in many portfolios will come under question, especially in a world where the U.S. overtly pursues an 'America First' agenda. Importantly, this transition towards more regional and country emphasis is happening at a time when current accounts are beginning to normalize faster than fiscal accounts are being shrunk, a backdrop which makes us want to think differently about "risk free" rates.

From an asset allocation perspective, we like control positions in Private Equity, especially those with operational improvement stories. Meanwhile, in Credit, we favor focusing on market dispersions and securities higher up the capital structure, and we think Real Estate Credit and growth Infra in the Real Assets space are attractive. From a country perspective, we favor Japan, India, and Germany, alongside an equal-weighted approach to the S&P 500 (versus the market capitalization weighted approach in the past). From a thematic perspective, we remain bullish on our major investment themes, including the Security of Everything, Capital Heavy to Capital Light, Productivity/Worker Retraining, Collateral-Based Cash Flows, and Intra-Asia Trade.

Exhibit 5: Non-Capital Intensive Companies Have Broken Out to the Upside. We Like Both the Equity Being Converted Towards Capital Light As Well As the Financing of the Assets Being Sold

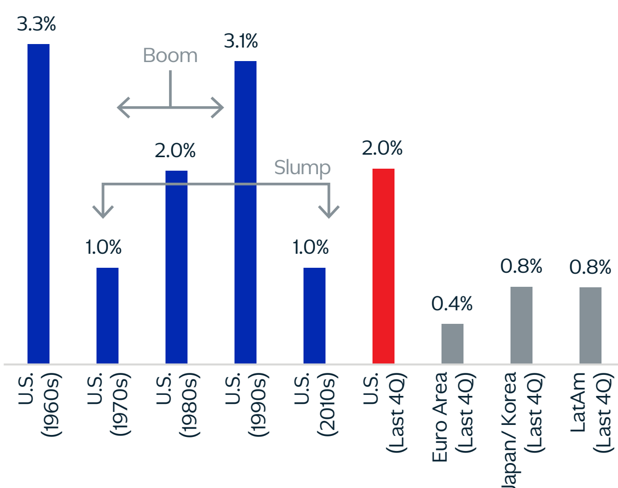
World Capital vs. Non-Capital Intensive, USD Price Return Indexed to 100 in January 1990



Capital intensity based on: Assets/Employee, Asset/Net Income, and Capex/Net Income. Data as at March 31, 2025. Source: Goldman Sachs.

Exhibit 6: The U.S. Will Need to Maintain Its Productivity Edge to Avoid Some Form of Stagflation

Labor Productivity Growth (%QoQ, SAAR)



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. U.S. based on real output/hours worked; rest of world based on real output/employed persons; LatAm refers to a simple average of Mexico, Brazil, Chile, Colombia and Peru. Data as at December 31, 2024. Source: Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Most Asked Questions

QUESTION NO. 1

While not a game changer, partial tariff relief has arrived faster than you were anticipating. What has changed in your thinking?

Dave McNellis, Brian Leung, and Miguel Montoya have updated their 'post-bargaining plausible case' for tariffs to incorporate learnings from the China and the U.K. deals. Overall, we believe the most likely steady state for executives and investors to incorporate as their base case is a 15% post-bargaining effective tariff rate, down from our previous forecast assumptions of 18% and the 'Liberation Day' roll-out of 26%.

In terms of specific details to consider, the decline in China tariffs is certainly helpful, although perhaps not as significant a game-changer for our base case as one might initially think. Keep in mind that President Trump had already carved out exemptions for major categories like computers, electronics, and smartphones. So, reducing the assumed tariff rate on other items doesn't have as much impact as it might seem. That said, the post-bargaining ETR for China does fall on the margin to 30%, compared to 37% in our old forecast.

Meanwhile, the U.K. deal also brought some positive news, introducing the possibility of flexibility on 232 sector tariffs. We had previously assumed no exemptions to the 25% tariffs on autos and steel/aluminum, aside from USMCA exemptions. Now, we're assuming some exemptions—roughly 50% of auto import volumes and 10% of steel and aluminum volumes might eventually be exempted. The lowering of our post-bargaining ETR to 15% from 18%, combined with the earlier-than-anticipated arrival of partial tariff relief, both support an improved outlook for GDP.

Against this backdrop, we are moving our U.S. Real GDP growth estimate for 2025 up to a 1-2% range from the previous 0.5-1.5%. In Europe, we are still awaiting the outcome of negotiations with the European Union. That said, Aidan Corcoran suggests that a positive outcome, similar to what happened with the U.K. and China, could impact growth by a further 10 basis points in 2025, to 0.7% from 0.6%. Finally, Changchun Hua suggests that if the current situation holds, the impact on China's GDP will be significantly less than we previously estimated down from -240 basis points to just -90 basis points. The need for rate cuts and RMB depreciation will be less urgent than we initially thought, and as such, our China Real GDP growth outlook for 2025 increases from 4.3% to around 4.8%.

As my colleagues General (Retired) David Petraeus and Vance Serchuk remind me often, we have moved from an era of benign globalization to one of great power competition. Increasingly in this world, politics is driving economics, and there is a blurring of capital markets policy and national security policy. Seen through this lens, key milestones such as Brexit and now 'Liberation Day' represent just the latest 'textbook' examples of the convergence that the KKR Global Institute has been suggesting for some time.

Exhibit 7: We Are Modestly Revising Our Effective Tariff Rate to 15%, Down From 18% Previously. The Decline in China Tariffs Is Helpful, Albeit Perhaps Not As Much of a Needle-Mover for Our Base Case As One Might Think

Category	2024 Imports ($bn)	Prior Tariff Rate (pre-Election)	ETR Increase			Final ETR		
			Liberation Day	Original Post-Bargaining Plausible Case*	Current Case**	Liberation Day	Original Post-Bargaining Plausible Case*	Current Case**
IEEPA / Reciprocal Tariffs (Excluding Critical Imports)								
EU	384	2%	20%	10%	10%	22%	12%	12%
Mexico	506	2%	19%	10%	10%	21%	12%	12%
China	300	14%	54%	37%	30%	68%	51%	44%
Canada	413	2%	20%	10%	10%	23%	13%	12%
Japan	90	2%	23%	12%	10%	25%	14%	12%
Rest of World	840	3%	19%	12%	10%	22%	15%	13%
Total IEEPA ETR	**2,532**	**3%**	**25%**	**15%**	**13%**	**29%**	**19%**	**17%**
Section 232 Tariffs (Critical Imports)								
Autos	269	0%	25%	25%	18%	25%	25%	18%
Energy (Oil & Gas)	176	0%	0%	0%	0%	0%	0%	0%
Steel/Aluminum	57	5%	20%	20%	18%	25%	25%	23%
Other Critical Imports	531	2%	10%	10%	10%	12%	12%	12%
Total 232 ETR	**1,034**	**0%**	**13%**	**13%**	**11%**	**14%**	**14%**	**12%**
Total Imports	**3,267**	**3%**	**22%**	**15%**	**12.1%**	**26%**	**18%**	**15%**
China	**439**	**14%**	**48%**	**33%**	**24%**	**62%**	**47%**	**38%**
Rest of World	**2,829**	**2%**	**18%**	**12%**	**10.2%**	**20%**	**13%**	**12%**

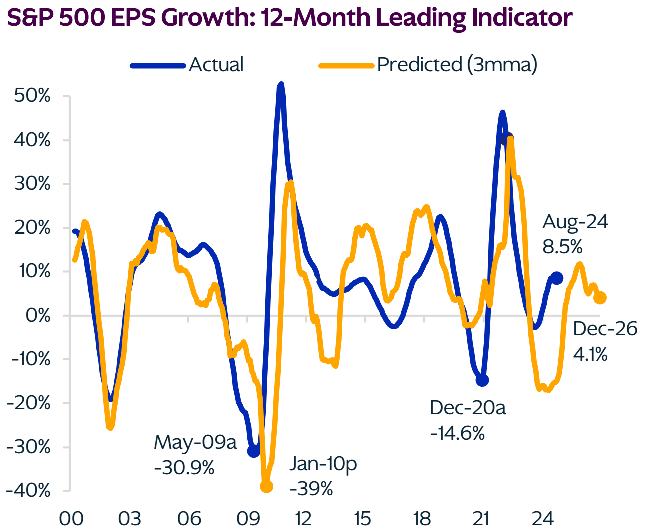
*Original Post-Bargaining Plausible Case: assumed ~50% of announced reciprocal tariff rate, Canada/Mexico 50%/38% of imports are USMCA compliant which will be tariffed at a lower 12.5% rate. We assumed carve outs for critical imports (no stacking); **Current Case reflects latest announcements including 30% China rate, we further assume that 50% of Section 232 auto tariffs are ultimately negotiated lower to 10%, 10% of Steel tariffs get carved out; Critical Imports include autos, energy, copper, pharmaceuticals, semiconductors, lumber, batteries, semiconductors and electronics, food. Data as at May 12, 2025. Source: KKR Global Macro & Asset Allocation analysis.

QUESTION NO. 2

Why are you not more bearish on earnings growth given the magnitude of the supply shock?

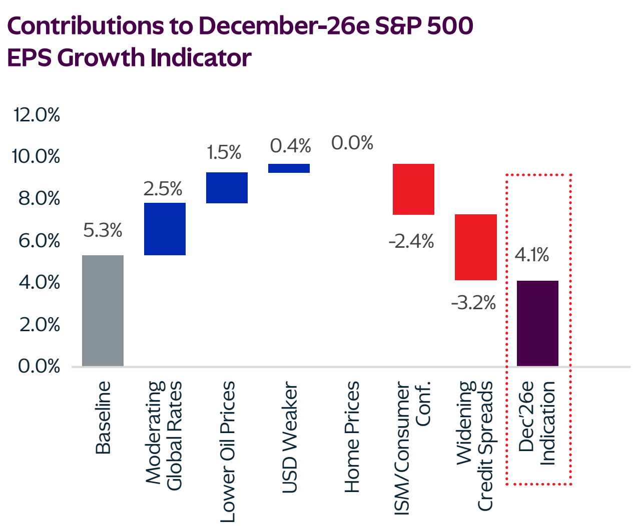
While we have reduced our tariff forecast to 15% from 18%, 15% is still a huge jump from a 4% tariff rate pre-election; moreover, uncertainty breeds apathy when it comes to potential investment spending and deal activity. Not surprisingly, we are being asked by multiple clients why we are still forecasting positive EPS growth. For starters, we think the current administration now better understands the threatening mix for the capital markets of a weaker dollar, falling equities, and rising bond yields. As such, we think policy considerations to prevent this left fat tail are now in place, which is positive for risk premiums and growth. Second, as we show in *Exhibit 9*, lower oil prices, lower interest rates, and a weakening dollar are all acting as important tailwinds to keep growth positive, albeit down substantially from the 11% that our model predicted before DOGE and 'Liberation Day' were implemented. Evidence is mounting that the soft spots may take longer to surface, so we may need to factor in more GDP durability in 2Q25 and possibly more cracks in 2H25. No doubt, stresses from China tariffs are real, but we think it will take until back-to-school, and then especially the holiday season, to become truly acute. Food inflation, however, should remain well-contained, which is a partial offset, we believe.

Exhibit 8: Unlike 2007 and 2020, Our Earnings Growth Leading Indicator Is Not Yet Calling for Negative Growth...



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 April 5, 2025. Source: National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 9: ...Because of the Benefits of Lower Oil Prices, a Weaker USD, and Moderating Global Rates

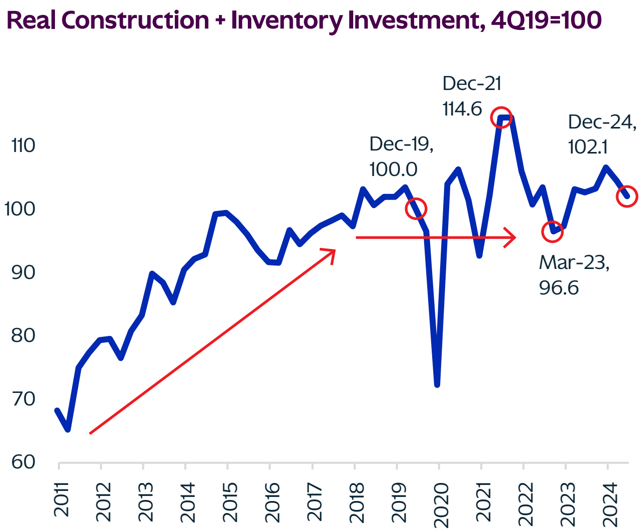


Our S&P 500 Earnings Growth Leading Indicator ('EGLI') is a combination of seven macro inputs that together we think have significant explanatory power regarding the S&P 500 EPS growth outlook. Data as at April 5, 2025. Source: National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

There is also some reality that several parts of the economy were already at stall speed entering 2025, a time when markets were much more optimistic about growth. Consider that U.S. ISM has been in 'contraction' territory for 28 of the past 30 months. Now, production and export orders have fallen to their lowest levels since May 2020 because of the tariff uncertainty disruption across the manufacturing complex. Moreover, both inventories and residential real estate activity, which we view as important proxies for cyclical activity, have been subdued for quite some time. One can see this in *Exhibit 10*. My colleague Dave McNellis reminds me that inventory investment and construction capex typically account for more than 100% of the net declines in GDP during U.S. recessions, so cyclical risks are greatest when spending in these areas is running at above-trend levels. Today, the opposite is true: inventory investment and construction capex have been at below-trend levels from a cyclical perspective since 2022, due to headwinds from both Fed hikes and post-pandemic supply chain normalization. While our forecasts continue to embed malaise in cyclical capex (driven in part by slower consumer spending and a very moderate pace of Fed cuts compared to market expectations of Fed easing), we think it is hard to get very bad outcomes from a starting point where inventories are not overbuilt, and housing starts have already fallen 20% from 2022 peak levels. Though the capex cycle has been massive, it has been led by the Tech sector. Importantly, though, unlike the dot-com bubble 20+ years ago, the companies financing the spending this cycle have bullet proof balance sheets, lower costs of capital, and a more consolidated market. Another point to consider is that private sector leverage is quite low relative to prior periods. One can see this in *Exhibit 11*. The good news is that across corporates and households, we generally do not see pockets of excess leverage, with the risk mostly being concentrated in governments.

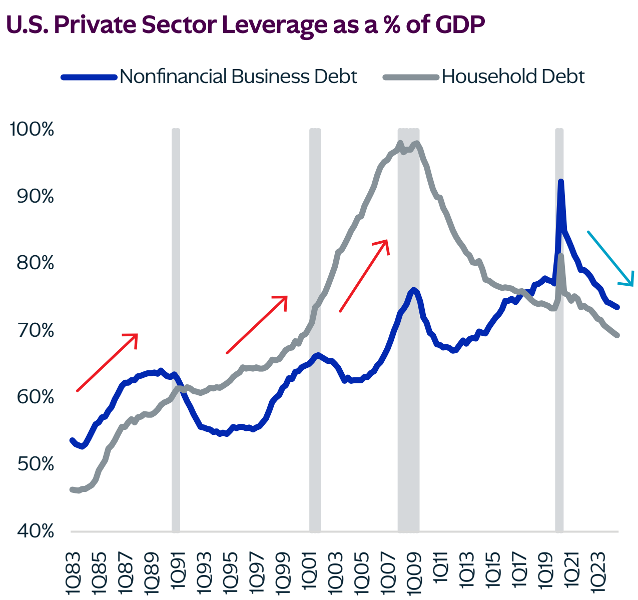
The good news is that across corporates and households, we generally do not see pockets of excess leverage.

Exhibit 10: True Economic Hard Landings Are Usually Caused by Housing and Inventory Issues. This Cycle Has Not Been Marked by Excesses in Those Areas



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

Exhibit 11: Importantly, Business and Consumer Leverage Levels Have Also Not Increased This Cycle, Which Helps Buffer Against an Outsized Default Cycle



Gray shading denotes recessionary quarters. Data as at March 5, 2025. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

What will we be watching for in the coming months? There are two things to keep a close eye on, we believe. First is AI capex, which has been outsized this cycle. Were this too slow (not our base case), then we would turn more cautious on growth. One can see the importance of AI spending by the Magnificent 7 in *Exhibit 12*. Importantly, S&P 500 Tech sector capex and R&D spending are not that elevated relative to cash flows. This is in sharp contrast to the pre-2000 era, when capex and R&D spending reached an unsustainable 140% of cash flows, compared to 'just' approximately 65% in 2024.

Exhibit 12: Magnificent Seven Capex + R&D Spending Is Now Running Near the Equivalent of Almost 29% of Total U.S. Tech-Related Equipment and Intellectual Property Investment

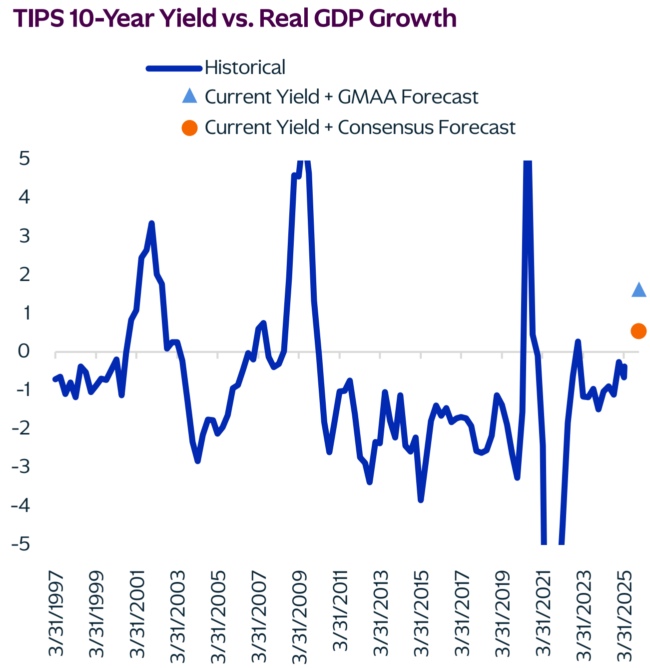
Magnificent 7 Capex and R&D Spending, Y/y

	Mag. 7 Capex + R&D ($mn)	%Chg. Y/y	R&D ($mn)	Capex ($mn)
2011	34,438		21,647	12,792
2012	48,796	42%	27,909	20,887
2013	58,619	20%	32,417	26,202
2014	76,908	31%	42,037	34,871
2015	89,158	16%	52,205	36,953
2016	106,589	20%	61,055	45,534
2017	132,613	24%	76,237	56,376
2018	178,117	34%	94,790	83,327
2019	194,603	9%	114,484	80,119
2020	241,680	24%	133,564	108,116
2021	310,817	29%	165,434	145,383
2022	384,757	24%	212,745	172,012
2023	406,579	6%	239,601	166,978
2024	515,224	27%	262,308	252,916
2025e	613,015	19%	286,474	326,541

2025e is Bloomberg consensus for Magnificent 7. Data as at February 7, 2025. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Importantly, S&P 500 Tech sector capex and R&D spending are not that elevated relative to cash flows.

Exhibit 13: We Do Not Think the U.S. Can Sustain 5%+ 10-Year Yields in the Growth Environment We Envision



Data as at April 15, 2025. Source: Bloomberg, KKR Global Macro & Asset analysis.

Separately, we are watching longer-term real rates. Indeed, while near-term inflation expectations are high, longer-term inflation expectations have fallen from a peak of 2.47% in mid-February. As such, long-term real rates are becoming more restrictive *(Exhibit 13)*, which is why we believe President Trump is so attentive to the level of interest rates. As mentioned, we had been forecasting fewer cuts than the market consensus in 2025 (we assume two whereas the market was pricing in 3-4 cuts in recent weeks, before aligning with our view), but we do believe that Chair Powell and his team would be wise to consider reducing QT selling of Treasuries to zero from $5 billion per month, to foster more accommodative financial conditions generally, including via helping to control long-end yields and promoting the gradual USD depreciation we espouse.

Finally, another area we are watching closely as part of the tariffs conversation is the goods vs. services trade. Importantly, work done by Dave McNellis suggests that U.S. services net exports are actually more valuable than goods net imports. Indeed, *Exhibit 14* below reflects KKR's estimates of the gross profits associated with major industries in the goods deficit and services surplus. Unsurprisingly, industries involved in the goods deficit tend to be low margin with low ROIC. In fact, when you subtract cost of goods sold from the total trade value, we estimate that the gross profitability of U.S. services exports is actually more valuable than the 'lost profits' on goods that the U.S. imports rather than manufacturing. Our bottom line: Distinct from President Trump's assertion that the U.S. has been getting 'ripped off' from global trade, we think the facts paint a more nuanced picture, in which U.S. businesses have outsourced the production of low-margin goods to help facilitate activity in relatively more profitable and productive areas. Importantly, businesses have created this profitability and efficiency uplift while still fostering the broad-based benefits of the full-employment economy that the U.S. enjoys today. Given the importance of the services sector to overall growth (something that we think many economists and politicians may be underestimating), we would become more concerned about earnings growth if negotiations on goods were to lead to a worse than expected contraction in the United States' strong services sector.

Separately, we are watching longer-term real rates. Indeed, while near-term inflation expectations are high, longer term inflation expectations have fallen from a peak of 2.47% in mid-February. As such, long term real rates are becoming more restrictive, which is why we believe President Trump is so attentive to the level of interest rates.

Exhibit 14: Services Exports Are Actually More Valuable Than Goods Imports On a Gross Profit Basis

	U.S. Net Exports, $bn	Gained/ (Missed) Gross Profits, $bn	Industry Gross Profit Margin	Industry ROIC
Key Trade Deficit Industries - Goods, 2024				
Capital Goods	-317	-87	28%	9%
Autos	-306	-45	15%	5%
Electronics	-417	-28	7%	7%
Total	**-1,040**	**-160**	**15%**	**7%**
Key Trade Surplus Industries - Services, 2024				
Travel & Leisure	37	26	69%	11%
Financial Services	130	84	65%	14%
Business Services	111	37	33%	10%
Use of IP	86	54	63%	17%
Total	**364**	**200**	**55%**	**13%**

Industry gross margin and ROIC proxies: Capital Goods: S&P 1500 Capital Goods; Autos: S&P 1500 Autos & Components; Electronics: S&P Global 1200 Electronics Manufacturing Services (no U.S.-specific index available); Travel & Leisure: S&P 1500 Hotels, Resorts & Cruise Lines; Financial Services: S&P 1500 Diversified Financial Services; Business Services: S&P 1500 Commercial & Professional Services; Use of IP: S&P 1500 Software & Services. Data as at May 6, 2025. Source: U.S. Census Bureau, S&P, Bloomberg, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

QUESTION NO. 3

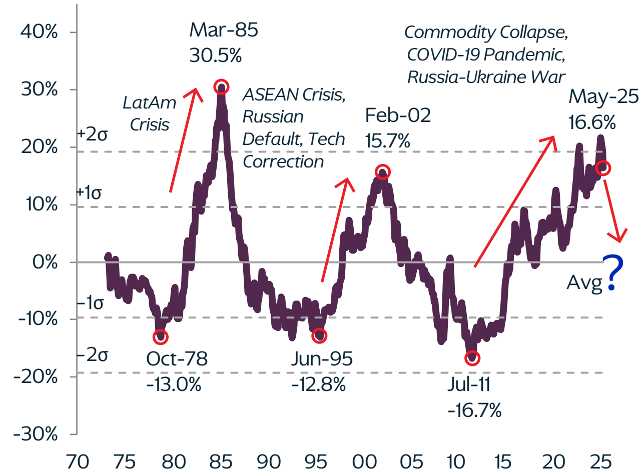
Could currency policy ultimately be a more effective vehicle for improving U.S. competitiveness, especially relative to reciprocal tariffs?

While we expect the tariff negotiations to remain fluid, we now envision a steady state, with a foundational 10% base rate across many countries, as well as flexible reciprocal tariffs and select sector-specific levies across autos, steel, semiconductors, pharmaceuticals, and critical minerals. All told, these considerations take our average aggregate tariff assumption up to 15% (including a post-bargaining ETR for China of 30% vs. 37% previously).

Importantly, though, we do wonder whether tariffs on goods is the most effective way to improve American competitiveness and profitability. As we discussed above *(Exhibit 14)*, we think more work needs to be done around extending America's competitive advantage in higher-profitability, higher-return services sectors of the economy. We think leaning into the services economy is a boon not just for business but also for workers, as services account for fully 84% of U.S. private sector employment. Also crucial is that services jobs pay more per hour on average than manufacturing jobs do ($36 per hour on average for services, vs. $35 for manufacturing), which belies the common perception that manufacturing jobs are a singular pathway to financial security. Finally, we note that the services sector provides steadier employment (during the GFC, private services employment fell just 5%, vs. a staggering 22% drop in goods production jobs) and is much faster growing (private services jobs are up +6% since 2019, vs. +3% for goods production).

Exhibit 15: We Are Exiting a Period of U.S. Exceptionalism Dollar-Wise

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

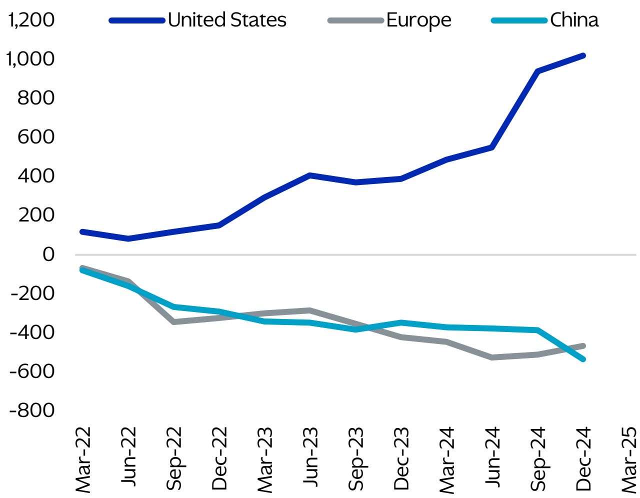


Data as at May 19, 2025. Source: Bloomberg.

We think more work needs to be done around extending America's competitive advantage in services sectors.

Exhibit 16: Until Recently, Foreign Buyers Represented a Huge Support System for U.S. Assets

Cumulative Cross Border Flows by Region, US$ Billions



Data as at April 17, 2025. Source: IMF, Bloomberg, Goldman Sachs.

We also think more time should be spent on U.S. currency policy. As illustrated in *Exhibit 15*, our analysis indicates that the dollar is currently overvalued by approximately 15-20%, placing it among the highest levels recorded in recent history. Indeed, since 1970, when Fed data begins, there have only been two periods when the trade-weighted U.S. dollar reached a 15% overvaluation on a trade-weighted basis: once in the mid-1980s and again in the early 2000s. The first time this happened in September 1983, the dollar appreciated for a further 1.5 years before entering a roughly decade-long bear market sparked by the Plaza Accord. Meanwhile, in February 2002, the dollar peaked just above 15%, marking the start of another approximately 10-year bear market, with the dollar ultimately slipping to around 13% below fair value.

What makes the current period stand out is that since the dollar hit the +15% overvaluation mark in early 2022 and has since been oscillating within a volatile range for nearly three years. Comparing and contrasting periods of overvaluation, one finds the following:

- **Mid-1980s:** The dollar hit 15% overvaluation in September 1983. It continued to appreciate sharply for another 1.5 years, reaching 30% overvaluation before embarking on a roughly 10-year bear market, ultimately falling to around 12% below fair value.
- **Early 2000s:** The dollar reached 15% overvaluation in January 2002, peaking about a month later. This marked the start of another decade-long bear market, with the dollar eventually drifting to approximately 13% below fair value.
- **Present:** The dollar crossed the 15% overvaluation threshold in early-2022 and has maintained this elevated range for nearly three years.

History suggests that in the short term, capital inflows can keep supporting the dollar—much like the 1980s. However, our view going forward aligns more with the early 2000s analogy. Specifically, we think we are now seeing the tail end of a period characterized by exceptional U.S. returns, large equity inflows, and U.S. assets commanding outsized shares of global portfolios. Granted, there are notable differences in the backdrop today, including that oil is not in a bull market as it was in the 2000s, and Chinese growth is not as ascendant as it was in the 2000s. Those were important aggravating factors to the earlier USD bear market. So, we do not expect the next downcycle to be as rapid or pronounced as it was 20-odd years ago, but ultimately, we do think history indicates that the dollar is likely to revert to trading at a discount on a real effective exchange rate basis—or below 'par,' one might say—over a decade-long horizon.

To be sure, any decline of the U.S. dollar may diminish the buying power of those who hold it, but it also brings about several favorable outcomes. One notable impact is that it enhances the competitiveness of American manufacturing companies, potentially leading to job creation within the country. In addition, a slightly weaker dollar facilitates easier debt repayment for countries and businesses with dollar-denominated debts. Finally, stronger non-dollar currencies may help energize non-U.S. consumers via increased purchasing power. This should help relieve the mighty U.S. consumer from some of its longstanding burden of driving outsized shares of global growth.

Finally, stronger non-dollar currencies may help energize non-U.S. consumers via increased purchasing power.

QUESTION NO. 4

For investors who are considering selling down their overweight in U.S. financial assets, what should they know?

Undoubtedly, 'Liberation Day' has been a catalyst for engaging in serious conversations with global investors and their boards about diversifying beyond the U.S. capital markets. Truth be told, many investors have probably enjoyed an unsustainable run of excess U.S. returns (e.g., the SPX was up 20%+ for two years in a row). However, it is not just a return to normalcy on the asset side for global investors who are overweight U.S. assets. 'Liberation Day' also abruptly reminded CIOs and their boards that their liabilities are denominated in local currency.

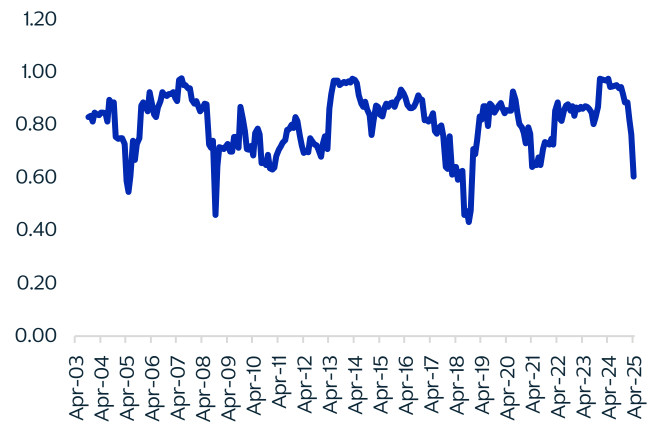
So, when the U.S. experienced the trifecta of a weaker dollar, falling equities and rising rates, it set off risk alarm bells that forced everyone from sovereign wealth funds to family offices to not only de-risk but also to look for ways to reduce their overweights to U.S. assets.

As we showed earlier in *Exhibit 1*, what is clear to us is that correlations, on both a short- and long-term basis, are changing towards a potentially more unfavorable mix for multi-asset class investors. This reality likely means that allocators will need to think differently about their asset allocations. In particular, we are very focused on the role of bonds. While stocks and bonds are becoming more correlated, we also noticed that the correlation between non-U.S. and U.S. bond markets have declined sharply. We link today's lower correlations to some combination of asynchronous monetary policies, inflation and growth gaps, and U.S. fiscal uncertainties.

Against this backdrop, we think that for investors who want to add more downside protection to their portfolios, one possible solution is to move some portion of their 60/40 portfolio into global bonds at the expense of U.S. bonds. *Exhibit 17* shows that U.S. bonds and global bonds are becoming less correlated. We think the potential to periodically find international bonds that behave quite differently to U.S. Treasuries in investor portfolios is rising.

Exhibit 17: U.S. and Global Bond Correlations Have Been Declining, As the U.S. Embraces More of an 'America First' Policy

Rolling 12-Month Correlation Between Global Agg Ex. U.S. and U.S. Agg Hedged to Home Currency



Rolling correlations are calculated on monthly returns. Non-U.S. bond market performance is represented by hedged Bloomberg Global Aggregate ex-U.S. Indices. U.S. bond market performance is represented by hedged Bloomberg U.S. Agg index. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

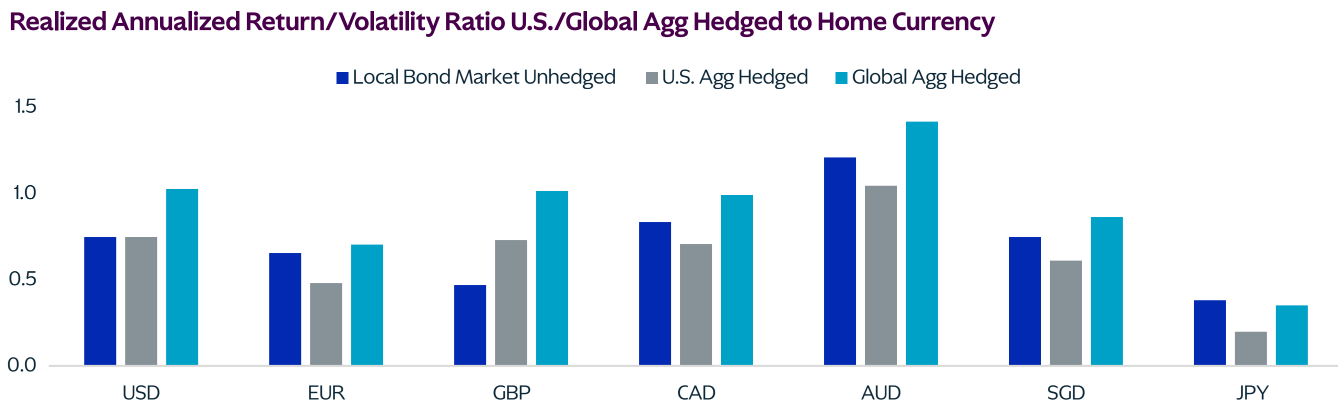
Exhibit 18: Most Local Bonds Have Modest Correlations to Each Other and to the U.S. Bond Market, Suggesting Diversification Benefits Could Be Achieved Over the Long Term

Global Bond Correlations, Monthly

	US-Agg	EuroAgg	SterlingAgg	CanadaAgg	AusBond	SingaporeAgg	JapanAgg
US-Agg	1.00	0.74	0.74	0.83	0.67	0.71	0.44
EuroAgg	0.74	1.00	0.74	0.72	0.68	0.58	0.45
SterlingAgg	0.74	0.74	1.00	0.72	0.65	0.58	0.43
CanadaAgg	0.83	0.72	0.72	1.00	0.68	0.61	0.45
AusBond	0.67	0.68	0.65	0.68	1.00	0.60	0.43
SingaporeAgg	0.71	0.58	0.58	0.61	0.60	1.00	0.38
JapanAgg	0.44	0.45	0.43	0.45	0.43	0.38	1.00

Correlation matrices are based on monthly returns over the period from November 2002 to April 2025. Local bond market performance for U.S., Europe, UK, Canada, Singapore, and Japan is represented by unhedged local currency Bloomberg Aggregate indices. Australian bond market performance is represented by Bloomberg AusBond Composite 0+ Yr Index. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 19: Historically, We Note That Global Bond Markets Have Generated Higher Risk-Adjusted Returns On a Hedged Basis Than Both Domestic and U.S. Bond Markets, Driven by Both Slightly Higher Return and Lower Volatility

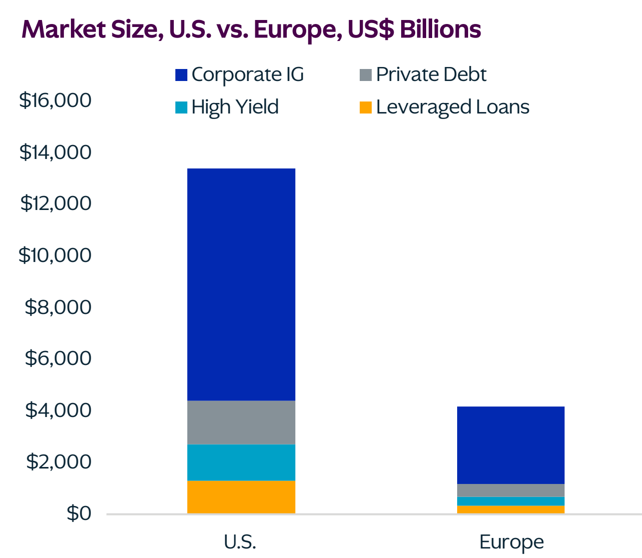


Realized annualized returns and volatility are calculated from monthly returns over the period from February 2004 to April 2025. Local bond market performance for the U.S., Europe, the U.K., Canada, Singapore, and Japan is represented by unhedged local currency Bloomberg Aggregate indices. Australian bond market performance is represented by Bloomberg AusBond Composite 0+ Yr Index. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

That said, for those looking to diversify outside of the U.S., we are more inclined to swap out of bonds than stocks. To this end, we did want to flag a few considerations, especially for large pools of capital. They are as follows:

1. The U.S. Equity market is 2x the size of Japan, Europe, and India *combined*. So, the transaction/friction costs of moving assets globally should be considered carefully.
2. The U.S. leveraged loan market is estimated to be around $1.4 trillion, highlighting the vast liquidity within the American financial landscape. By comparison, the European market is less than one-fourth the size at $323 billion.
3. The size of the High Yield market in the U.S. is $1.4 trillion, compared to approximately $358 billion in Europe.
4. The size of the U.S. Corporate IG market is approximately $9 trillion, while Europe is one-third the size at around $3 trillion.
5. The U.S. private debt market (which includes Direct Lending, Distressed, Junior Mezzanine, and Fund of Funds) is estimated to be approximately $1.7 trillion, illustrating the depth and breadth of Private Credit opportunities in the U.S. In contrast, Europe's private debt market size is approximately $500 billion.

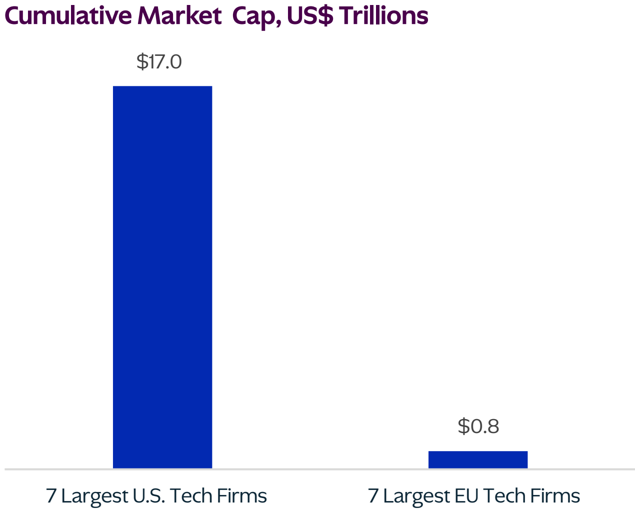
Exhibit 20: While We are Now Forecasting Higher Expected Returns in Europe, The U.S. Market Still Has Greater Liquidity



Data as at April 30, 2025. Source: Bloomberg.

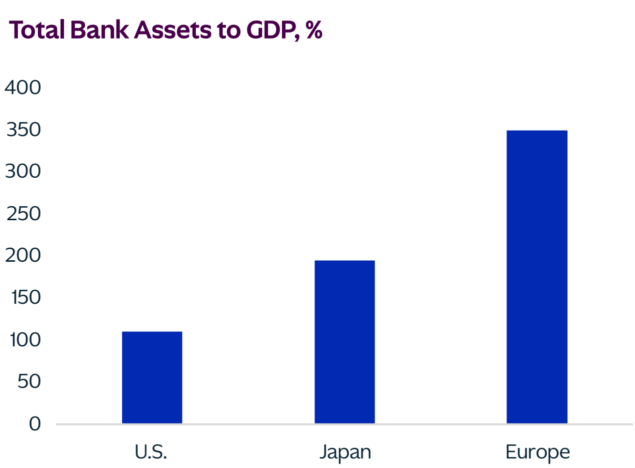
Correlations are changing towards a potentially more unfavorable mix for multi-asset class investors.

Exhibit 21: U.S. Tech Firms Are Large and Liquid. In Europe, by Comparison, the Tech Sector is Smaller and Has Less of a Global Reach



Data as at April 30, 2025. Source: Bloomberg.

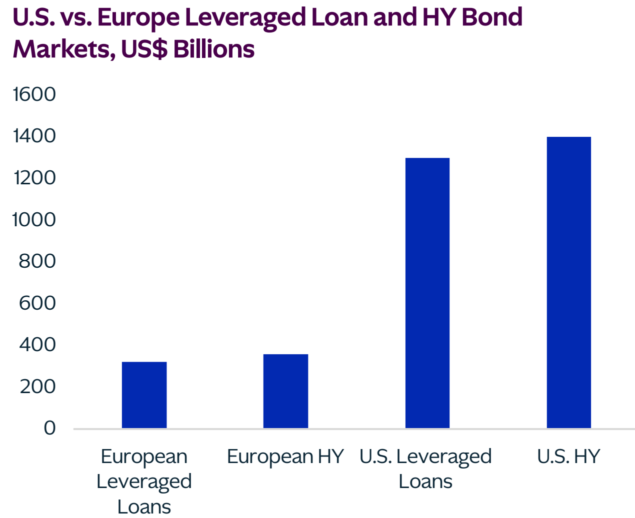
Exhibit 22: European Bank Assets to GDP Are Around 3x the U.S. Level



Data as at April 30, 2025. Source: Bloomberg.

We feel that Infrastructure and Asset-Based Finance can play a valuable role in helping to diversify global portfolios.

Exhibit 23: The U.S. Credit Market is Nearly 4x the Size of Europe's

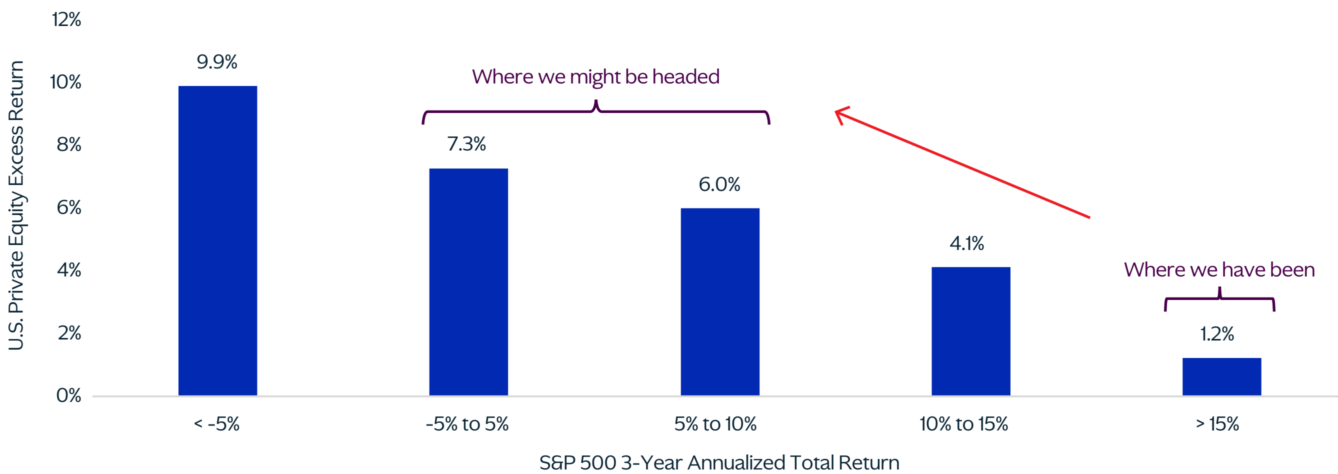


Data as at April 30, 2025. Source: Bloomberg.

So, our bottom line in the liquid markets is that some further diversification away from U.S. Treasuries may make sense at this point in our *Regime Change* thesis. Maybe more importantly, though, is that regardless of where one comes down on diversification strategies for liquid securities, we feel strongly that Private Alternatives—particularly Infrastructure and Asset-Based Finance—can play a valuable role in helping to diversify global portfolios these days, especially for investors seeking to enhance inflation protection and better align with inflation-linked liabilities. To review, since 2022, we have argued that Real Assets and collateral-based cash flows could help enhance the returns of the traditional 60/40 portfolio by providing more upfront yield and enhanced inflation protection. Central to this thesis has been that liquid government bond portfolios, which in the past have traditionally served as shock absorbers or diversifiers, could no longer fulfill this purpose in the *Regime Change* we envisioned. It is not only the conduct of bonds post 'Liberation Day.' This view has been reinforced by the behavior of the bond market in both 2022 and 2023, as examples, driven by sticky services inflation, Japan exiting Yield Curve Control, and Fitch's downgrade of U.S. debt. Most importantly, these asset classes have provided solid upfront yields along with attractive returns during a period marked by the highest inflation and interest rate increases in the past 50 years.

Exhibit 24: The Private Equity Illiquidity Premium Actually Outperforms Public Markets in Less Robust Equity Markets

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



Data reflects actual pooled horizon return, net of fees, expenses and carried interest. For funds formed between 1986-2024. Data as at December 31, 2024. Source: Cambridge Associates Benchmark Statistics, KKR Global Macro & Asset Allocation analysis.

We also think Private Equity, especially deals linked to operational improvement stories, can drive not only performance but also non-correlated inputs into a diversified portfolio. We have often cited the need for investors to own more assets where you control your own destiny. In a world where trade barriers are increasing, we 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. We think owning more control equity positions also 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 these companies remains outsized. Finally, 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. In our view, 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.

How should one think about asset allocation if an investor wants to diversify outside of a traditional U.S.-dominated 60/40 portfolio? Given the number of times we have been asked this question since 'Liberation Day', we asked Rachel Li on our KKR Solutions team to run a few scenario analyses to underscore the benefits of both global bonds relative to U.S. Treasuries as well as the addition of Private Alternatives into portfolios. As one can see in *Exhibit 26,* there is an incremental benefit on a risk-adjusted return basis of replacing half of the U.S. bond allocation with international bonds. While this improvement may appear marginal on a historic basis, we believe it's set to be more pronounced going forward due to the increasing correlation of stocks and bonds globally along with the mismatch of local liabilities. Regardless, we believe that we have entered an environment where CIOs and boards need to spend more time thinking about non-correlated diversifiers in their portfolios *(Exhibit 25)*.

Exhibit 25: Non-Correlation Only Increases in Importance in the Environment We Envision

Asset Class Correlations, Quarterly From 2004-2024

	Public Fixed Income	Public Equities	Asset-Based Finance	Direct Lending	Junior Debt	Private Opportu-nistic Credit	Real Estate Credit	RE Value-Add & Opp	Buyout	Growth	Venture	Global Infra	Reinsurance (Net Equity Proxy)
Public Fixed Income	-	0.3	0.1	0.0	0.2	0.0	0.4	0.0	0.3	0.2	0.1	0.2	0.3
Public Equities	0.3	-	0.5	0.7	0.7	0.7	0.3	0.4	0.8	0.8	0.5	0.6	0.7
Asset-Based Finance	0.1	0.5	-	0.7	0.7	0.7	0.2	0.6	0.7	0.5	0.4	0.5	0.5
Direct Lending	0.0	0.7	0.7	-	0.8	0.7	0.4	0.5	0.7	0.7	0.5	0.5	0.6
Junior Debt	0.2	0.7	0.7	0.8	-	0.8	0.3	0.7	0.9	0.8	0.6	0.8	0.6
Private Opportunistic Credit	0.0	0.7	0.7	0.7	0.8	-	0.3	0.6	0.8	0.7	0.4	0.6	0.6
Real Estate Credit	0.4	0.3	0.2	0.4	0.3	0.3	-	0.2	0.3	0.4	0.2	0.2	0.4
RE Value-Add & Opp	0.0	0.4	0.6	0.5	0.7	0.6	0.2	-	0.7	0.6	0.5	0.7	0.1
Buyout	0.3	0.8	0.7	0.7	0.9	0.8	0.3	0.7	-	0.9	0.7	0.8	0.6
Growth	0.2	0.8	0.5	0.7	0.8	0.7	0.4	0.6	0.9	-	0.8	0.7	0.6
Venture	0.1	0.5	0.4	0.5	0.6	0.4	0.2	0.5	0.7	0.8	-	0.4	0.4
Global Infra	0.2	0.6	0.5	0.5	0.8	0.6	0.2	0.7	0.8	0.7	0.4	-	0.4
Reinsurance (Net Equity Proxy)	0.3	0.7	0.5	0.6	0.6	0.6	0.4	0.1	0.6	0.6	0.4	0.4	-

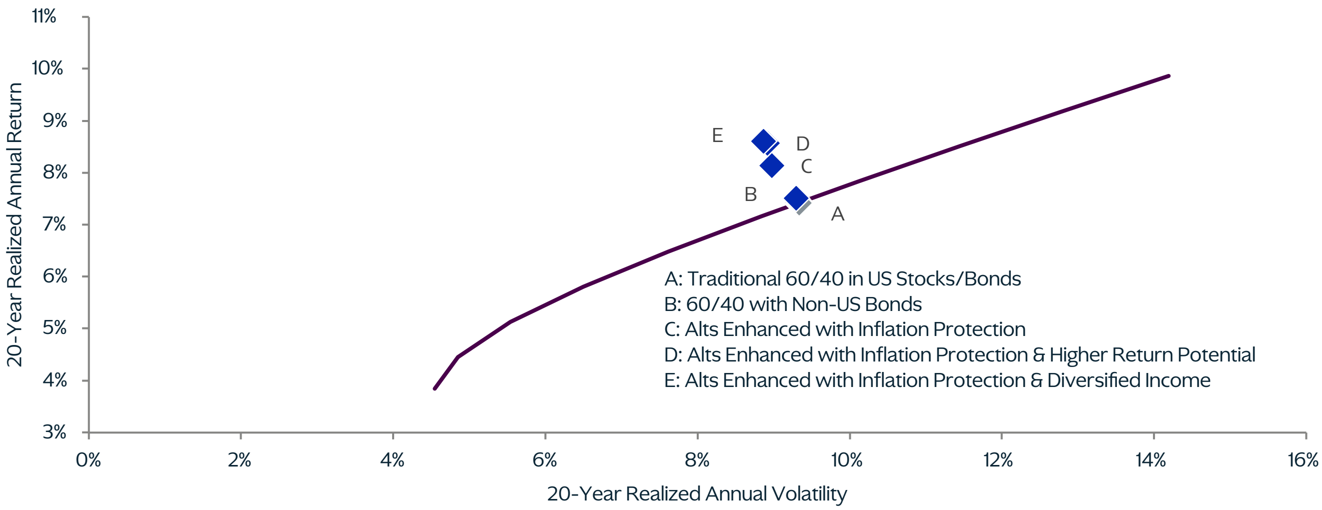
Correlations are calculated with quarterly returns between September 30, 2004 and June 30, 2024. Each asset class is modeled as follows: Public Fixed Income (Bloomberg Global-Aggregate Total Return Index Value Unhedged USD), Public Equities (MSCI World Index), Asset-Based Finance (KKR Private Credit ABF composite investments post January 1, 2017 is shown for illustrative purposes only to depict the possible diversification benefits of non-traditional asset classes), Direct Lending (Cliffwater Direct Lending Index), Junior Debt (Burgiss Private Debt/Mezz), Private Opportunistic Credit (Burgiss Private Debt/Generalist), Real Estate Credit (Gilberto-Levy Level I Index), Real Estate Value-Add & Opp (Burgiss Real Estate Index: Value-Add/Opportunistic), Global Infrastructure (Burgiss Infrastructure Index), Buyout (Cambridge Buyout), Growth (Cambridge Growth Equity), Venture (Cambridge Venture Capital). Reinsurance (KKR proxy post 2016 is shown for illustrative purposes only to depict the possible diversification benefits of non-traditional asset classes). Source: Bloomberg, Cambridge, Burgiss, Gilberto-Levy, Cliffwater, KKR Global Macro & Asset Allocation analysis.

Maybe more importantly, for investors with an appetite to take on illiquidity risk by investing in private markets, we suggest four options to better capture the diversification benefits of enhancing a 60/40 portfolio, while also enhancing inflation protection, return and growth potential. As *Exhibit 26* shows, there is a meaningful benefit to performance by adding Infrastructure and Asset-Based Finance (Portfolio C) as well as Infrastructure, Asset-Based Finance, and Private Equity to a portfolio (Portfolio D). Given the importance of non-correlation in a volatile world, we have also included portfolios that diversify further into Real Estate Credit and Insurance as an asset class. One can see this in Portfolio E.

There is an incremental benefit on a risk-adjusted return basis of replacing half of the U.S. bond allocation with international bonds. While this improvement may appear marginal on a historic basis, we believe it's set to be more pronounced going forward.

Exhibit 26: Our Work Shows That Alternatives May Offer Diversification Benefits in Global Portfolios While Potentially Enhancing Returns

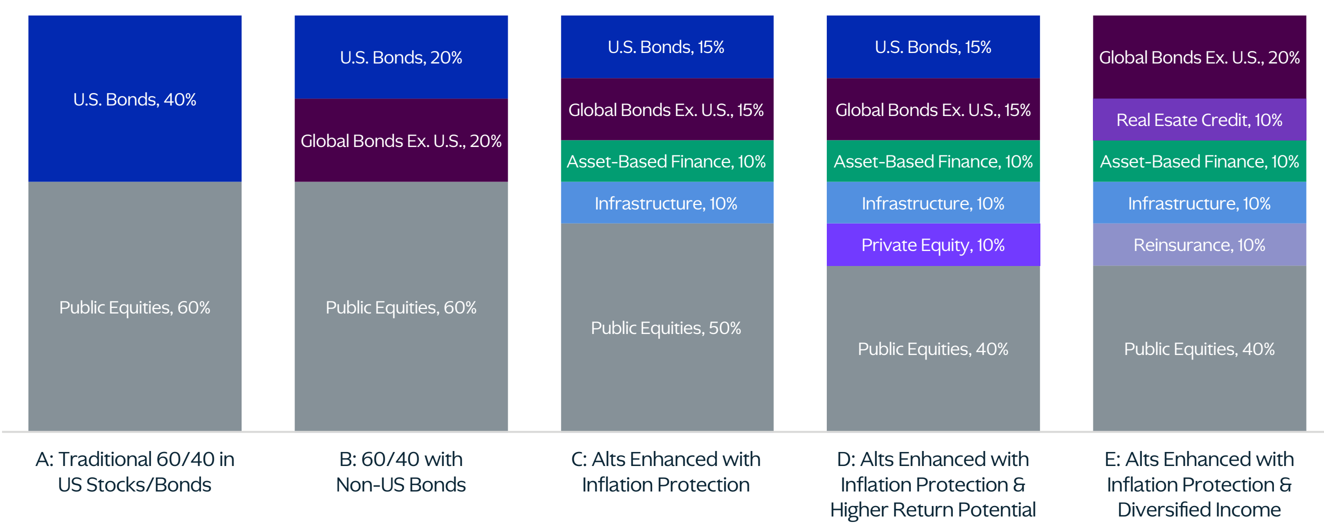
20-Year Annual Returns and Volatility of Various 60/40 Portfolios, %



Realized annualized returns are calculated from quarterly returns and volatilities are calculated using annual total returns from 2004 to 2024 to partially correct for the downward bias for private market proxy volatility. Proxies are defined as follows: U.S. Stocks: S&P 500 Index; U.S. Bonds: U.S. Aggregate; Global Bonds ex U.S.: Global Aggregated ex U.S. Hedged in USD; Infrastructure: Burgiss Infrastructure Index; Private Equity: Cambridge Buyout Index; Asset-Based Finance: KKR Private Credit ABF composite investments post January 1, 2017, backfilled with Burgiss Private Credit Index. Real Estate Credit: Gilberto-Levy Level I Index. Reinsurance: KKR proxy post 2016 is shown for illustrative purposes only to depict the possible diversification benefits of non-traditional asset classes. Source: Bloomberg, Burgiss, KKR Global Macro & Asset Allocation analysis.

Exhibit 27: We Think the Addition of Private Markets to Asset Allocation Enhances Inflation Protection and Return

Traditional 60/40 and 60/40 with Alternatives Portfolios



Data as at May 15, 2025. Source: KKR Global Macro & Asset Allocation analysis.

Our bottom line is that we think we are at an inflection point for asset allocation, especially for international investors who have overweighted U.S. assets, including too much exposure to U.S. Treasuries and U.S. large cap growth stocks (the two most common refrains we have been hearing). As our analysis in *Exhibit 26* shows, we believe there is a significant opportunity to enhance performance without taking on a lot more risk. Indeed, we think shifting one's allocation away from the traditional 60/40 of U.S. stocks and bonds could not only boost returns, but also lower overall portfolio risk in many instances if done properly. Offsets to consider include the aforementioned size of markets, liquidity, and duration considerations.

QUESTION NO. 5

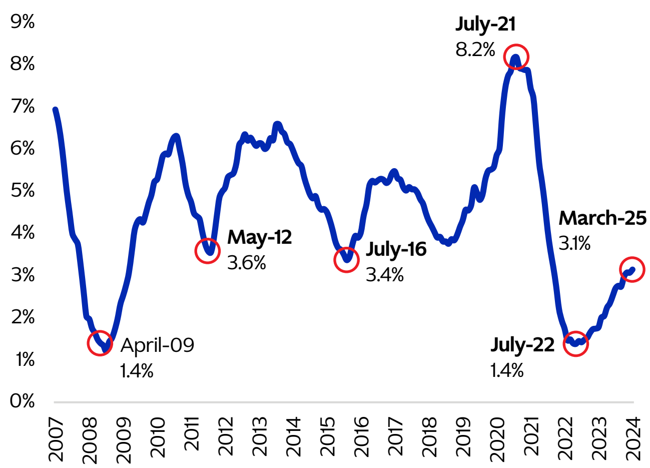
Are strong, positive technical influences in the markets helping to offset shaky economic trends?

While our models and our conversations with CEOs both point towards slowing growth and uncertain capex spending on the fundamental side, our technical work shows an extremely favorable backdrop. Just consider the following:

1. **As we show in *Exhibit 28*, net issuance of IPOs, Levered Loans, and High Yield are at levels not seen since the recovery from the Great Financial Crisis**. Importantly, this backdrop is occurring at a time when many CIOs, especially at insurance companies, are starved of product. Moreover, lack of issuance is occurring at a time when U.S. companies are projected by Goldman Sachs to be buying back another one trillion dollars or more of their own stock.
2. **While less product is available, sizeable Cash positions are also building**. One can see this in *Exhibit 29*, which shows that cash balances now total around $7 trillion. With the rise in interest rates, Cash became an attractive alternative to bonds, particularly as it offered high rates of uncorrelated returns. With the expectation that the Fed will resume its easing campaign over the near term, we believe that the opportunity cost of losing out on compounding of capital may far outweigh the decrease in volatility, particularly in a higher for longer inflationary environment.
3. **Sentiment is poor, which we view as a contra-indicator**. One can see this in *Exhibit 30*. If as investors we are supposed to 'sell greed and buy fear', then the current set-up does appear quite interesting, we believe.

Exhibit 28: Our Liquidity Indicator Is Still Recovering From Near-Trough Levels

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

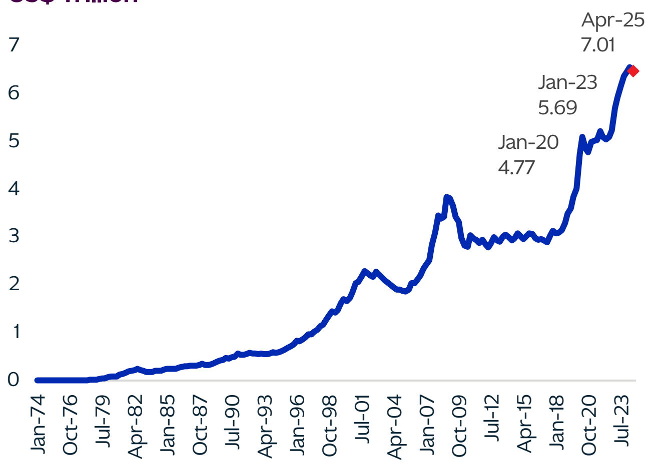


Data as at March 31, 2025. Source: Preqin, Bank of America, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Net issuance of IPOs, Levered Loans, and High Yield are at levels not seen since the recovery from the Great Financial Crisis.

Exhibit 29: There Is Still a Wall of Cash. Money Funds in the U.S. Have Risen by Nearly $3.5 Trillion Over the Last Decade

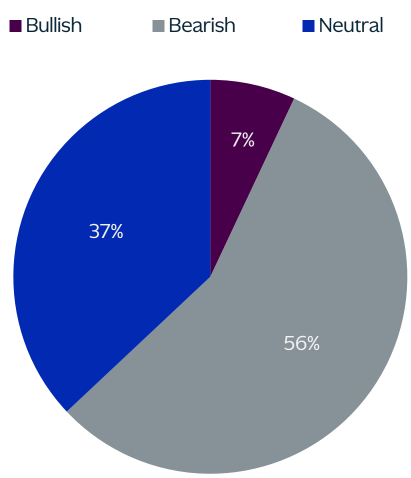
Total Financial Assets: U.S. Money Market Funds, US$ Trillion



Data as at April 10, 2025. Source: ICI, FRED.

Exhibit 30: Investor Mood Is Still Decidedly Bearish

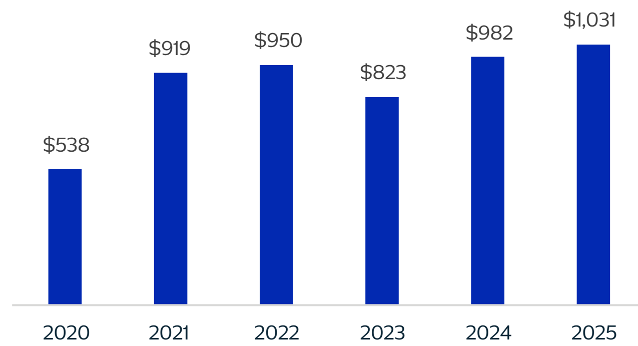
Barrons Big Money Poll: Client Perspectives on the S&P 500



Data as at May 2, 2025. Source: Barrons.

Exhibit 31: Buybacks Have Increased Approximately 25% from 2023

GS Forecasts for Aggregate S&P 500 Share Buybacks, US$



Data as at May 5, 2025. Source: Goldman Sachs Investment Research.

As trade and capital flows become less fluid across geographies we likely will be living in a world where the fundamentals are only mediocre. However, the technical picture is actually quite compelling, which means that the opportunity set for investors, especially those with a long-term horizon, may be much better than the consensus currently thinks.

We likely will be living in a world where the fundamentals are only mediocre as trade and capital flows become less fluid across geographies. However, the technical picture is actually quite compelling.

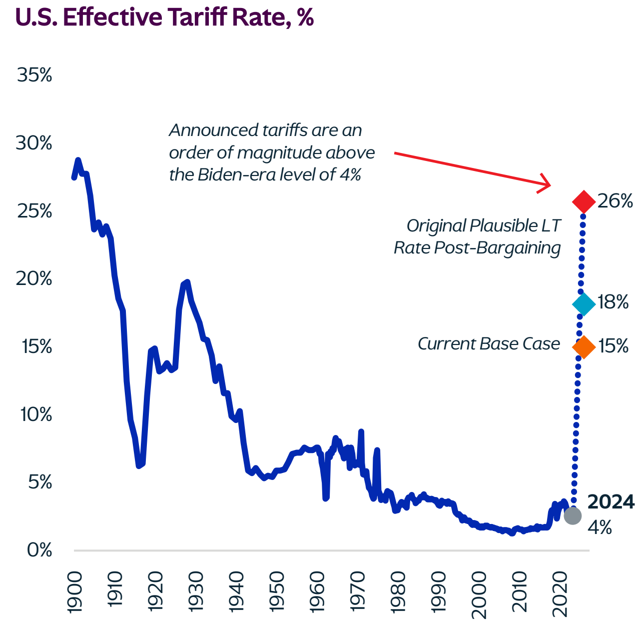
Conclusion

The aftermath of 'Liberation Day' has created new questions for investors, particularly in regard to learnings around portfolio construction and our *Regime Change* thesis. My travels in the U.S., China, and Europe increasingly connect me to some of the most thoughtful allocators in our industry. Our discussions are typically centered on five main areas:

First, headwinds from tariffs decreased somewhat sooner than we originally anticipated. Work done by Dave McNellis, Brian Leung, and Miguel Montoya suggests a projected steady-state post-bargaining effective tariff rate of around 15%, down from 18%. While tariff reductions in China are beneficial, their impact is limited due to existing exemptions on key categories, leading to an updated China ETR of 30%, from 37%. These developments support a more optimistic GDP outlook, with U.S. growth for 2025 now expected in the 1-2% range, up from 0.5-1.5%. In Europe, we forecast a slightly more positive outlook for GDP growth in 2025, raising our estimate to 0.7% from 0.6%. For China, the GDP impact of tariffs is now less severe, improving from -240 to -90 basis points, reducing the urgency for rate cuts and RMB depreciation, and increasing Changchun Hua's 2025 growth forecast to 4.8% from 4.3%.

Headwinds from tariffs decreased somewhat sooner than we originally anticipated. Work done by Dave McNellis, Brian Leung, and Miguel Montoya suggests a projected steady-state post-bargaining effective tariff rate of around 15%, down from 18%.

Exhibit 32: Our Current Tariff Base Case Declines to 15% From 18%



Forecasts reflect peak U.S. average tariff rate of 26%, which moderates to 15% based upon current negotiations. Data as at May 14, 2025. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Second, unlike the 2007 downturn, which was driven by bank and consumer deleveraging, surging oil prices, and sharply wider credit spreads, the current potential downturn is policy-induced and lacks these attributes. Oil prices are decreasing, credit spreads are only modestly wider, banks are flush with cash, and global rates are trending lower. While we anticipate a sharp moderation in corporate earnings growth, our EGLI model suggests it won't turn negative as it did during past crises unless there is an unexpected policy mistake, such as further deficit widening or a Fed whose independence is compromised. This is the good news.

However, the introduction of 'Liberation Day' and of DeepSeek has no doubt heightened uncertainty, potentially reducing the premium valuation of U.S. equities and credit spreads enjoyed before April 2nd. This uncertainty is compounded by the increasing overlap between economics and national security amongst global governments and the shift by global allocators to diversify their portfolios beyond the United States.

Third, we believe that the U.S. dollar could be a formidable tool in enhancing U.S. competitiveness. Historical precedents, such as the Plaza Accord in 1985 and the Dot. com bust in 2000, demonstrate that adjusting the U.S. dollar's trading level has been a powerful method for boosting American competitive advantage. Our models suggest the USD is currently about 15% overvalued, marking its third highest level since the 1980s. As such, we believe that a strategic adjustment in the dollar's trading level, driven by—amongst other things—global investors' increased desire to diversify their holdings outside of the U.S., could enhance America's competitiveness more effectively than imposing tariffs on key trading partners and allies. Moreover, coupled with our learnings about the relative profitability of services over goods (*Exhibit 14*), we think that maintaining a broad-based economic footprint may be a better formula for elevating total U.S. competitiveness versus the current agenda of imposing tariffs in areas where America does not need to build comparative advantage.

Fourth, we think it's crucial to understand the challenges of reallocating assets globally. The U.S. equity market is nearly twice the size of Europe, Japan, and India combined, with many large, liquid companies showing strong earnings growth. However, in fixed income, there's room for improvement. If our *Regime Change* thesis continues to unfold as expected, the traditional role of U.S. government bonds may diminish due to the country's fiscal deficit and high leverage. Many portfolios have relied on the 60/40 model, heavily weighted towards U.S. Treasuries. Our analysis suggests that incorporating international bonds into this model offers diversification benefits that U.S. government bonds may struggle to provide. Combining these changes on the liquid side with private assets like Infrastructure, Private Equity, Asset-Based Finance, Real Estate Credit, and Insurance could enhance returns and risk management.

Finally, while tariffs have created a supply shock, the technical backdrop remains compelling. The S&P 500 is set to buy back over $1 trillion in stock, money market balances are high, and net issuance is near historic lows. A similar dynamic is playing out on the share repurchase front in Europe, and the total is even higher if one includes public-to-private transactions. However, a recent poll shows that top money managers are more bearish than they've been in nearly three decades, with only 26% seeing bright market prospects.

Our bottom line: In today's market, we must 'make our own luck.' The risks of a falling dollar, rising interest rates, and a weakening equity market have been mitigated, but new developments like 'Liberation Day' and DeepSeek suggest valuations may be capped compared to previous periods of U.S. exceptionalism. Against this backdrop, we favor control positions in Private Equity, particularly those with operational improvement stories, focus on market dispersions and higher capital structure securities in Credit, and find Real Estate Credit and growth Infrastructure in Real Assets attractive. We also think non-correlated, yielding asset classes such as Insurance can potentially be additive as well. By country, we prefer Japan, India, and Germany, alongside an equal-weighted approach to the S&P 500. We remain bullish on our investment themes including the Security of Everything, Capital Heavy to Capital Light, Productivity/Worker Retraining, Collateral-Based Cash Flows, and Intra-Asia Trade.

Against this backdrop, we favor control positions in Private Equity with operational improvement stories, focus on market dispersions and higher capital structure securities in Credit, and find Real Estate Credit and growth Infrastructure in Real Assets attractive. We also think non-correlated, yielding asset classes such as Insurance can potentially be additive as well.

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