INSIGHTS

GLOBAL MACRO TRENDS

VOLUME 10.1 • JANUARY 2020

Play Your Game

KKR GLOBAL INSTITUTE

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Play Your Game

Given the heightened "noise" around geopolitics and macroeconomic uncertainties, our strong suggestion is to play heavily to one's strengths in today's markets. All of us at KKR see a clear path forward to leverage the distinct areas of investment and operational expertise that we have developed as a firm during the last 44 years to "control our own game," including when and where we deploy capital on behalf of our limited partners. At the moment, we feel strongly that global central banks' decisions to hold nominal interest rates below nominal GDP at this point in the cycle means that almost all investors should overweight collateral-backed assets with upfront cash flow. Second, given the huge bifurcations now present across most major market indices, we think that there is a significant amount of value in the "middle" part of the market that does not face 1) the fancy valuations that the top decile of the market now embeds or 2) the structural headwinds – largely innovation driven – that the bottom decile of the market must now endure. Security selection that favors investments with improving cash flow generation/conversion will now be rewarded handsomely, in our opinion. Third, we think that we are now entering the decade of the Asian millennial, and given his and her preferences for Experiences Over Things, significant capital should be allocated to this investment theme in the coming years. Fourth, we remain bullish on cash-flow compounding stories that have built competitive moats around their businesses, including the ability to be a price setter. Finally, we want to overweight investment vehicles that can lean into the periodic dislocations that we think are increasingly headed our way during this new decade. If we are right, then we believe these aforementioned five top-down themes will be prerequisites for success for investors who may otherwise be swayed by headline risks or events that they can't control. Remember: Investing isn't about beating others at their game. It's about controlling yourself at your own game.

"Investing isn't about beating others at their game. It's about controlling yourself at your own game."

BENJAMIN GRAHAM
AMERICAN INVESTOR, ECONOMIST, AND PROFESSOR

Section I: Introduction

Without a doubt, 2019 was a year to remember; the question, though, is for what? On the one hand, the glass half empty community may want to point to the record level of global consternation, especially around issues linked to Brexit, the Middle East, Hong Kong, and the U.S.-China trade war. On the other hand, the glass half full community might remember it as the year that the U.S. Congress had its most diverse set of representatives, including the most women,[1] or that unemployment reached a record low across several major economies, including those of the United States and Germany, or that both the S&P 500 and Nasdaq had their best performance years since 2013.

Regardless of which viewpoint you embrace, there is no doubt that we are living in times that require both a sound understanding of the past and a heightened conviction about where we are headed in the future. The good news for KKR and its partners is that over its 44 year history, the firm has *not* built its investment franchise by, as Benjamin Graham so eloquently pointed out, trying to "beat others at their game." Rather, KKR remains committed to doing what we do best: Leveraging all our global resources to deploy capital effectively in a way that is unique to the culture of the firm, almost irrespective of the macroeconomic and/or geopolitical environment. As the performance results have borne out since Henry R. Kravis and George R. Roberts founded KKR with their original partner Jerome Kohlberg in 1976, a continually innovative approach to "controlling our own game" has served us well, particularly in recent years as we have expanded across businesses and geographies.

Within our world of Global Macro, Balance Sheet, and Risk Analytics (GBR) at KKR, one of our ongoing responsibilities is to "control our own game" on the macro outlook by working with our colleagues across the various investment teams to be thoughtful around long-term investment opportunities/risks, pacing, leverage/funding, and portfolio construction. As part of this process, the GBR team holds an annual December offsite to update our long-term forecasts for all the major asset classes within the global capital markets (*Exhibit 21*). We undertake this exercise to bring together all the various viewpoints across not only our team but also across the entire firm to create an integrated, holistic view of investment opportunities and trends that we can seek to "control" across geographies, products, and capital structures. Not surprisingly, we also weave important client discussions into our thinking. This year, those client inputs were especially influential, given heightened questions of late around the direction of trade/globalization, splintering of traditional political parties, and negative interest rates. As one might guess, our most recent GBR investment roundtable in December 2019 certainly involved some hotly debated topics. However, coming out of our meetings, we all agreed on several key inputs that KKR, alongside our investment partners, likely can "control" to be effective in the environment we anticipate. The primary questions raised – and more importantly, the summary of our answers – are as follows:

1. **Should we prepare for a change in market leadership, or will 2020 be just more of the same?** Our answers are yes and no. Yes, investors should begin to brace for change; no, 2020 will not be more of the same. Unlike at the start of prior years, we now feel that both the benefits of Quantitative Easing (QE) and the Fourth Industrial Revolution – the two big mega trends that have defined where capital has flowed in the current cycle – are now more accurately priced into many of today's market "winners." In U.S. Equities, for example, the top quintile of S&P 500 stocks, which we view as a reasonable proxy for the winners in this segment of the market, now trade at their most expensive level since the Tech Bubble of 2000 (*Exhibit 1*). Meanwhile, as the same chart shows, the least expensive stocks now trade at their cheapest levels in several decades. On the Credit side, it is a similar story of the Haves and Have Nots. All told, we note that 86% of the High Yield market, excluding the top quintile of issues by yield (which represent just 14% of the market by weight), yields only 4.6% on average. Our analysis does *not* mean that the "winners" can't still do well as long-term holdings (particularly on the equity side), but the point is that the consensus has largely caught up to our thinking on the era of low rates and technological change – and what it means for return on capital across business models – that my colleague Ken Mehlman and I have been describing for some time. As such, the winners' ability to compound at the same rate of return is now likely more challenging, given that these companies are now not only bigger but also they are starting from a much higher valuation point (*Exhibit 82*), we believe. The good news is that, as we describe below in detail, we still see a lot of value in the "great unloved," or the middle part of the market that actually looks attractively priced against today's low interest rate backdrop, particularly if significant operational improvement can be implemented.

2. **Will Value outperform Growth?** Though we do expect market leadership to broaden, the world we are describing does not mean that *all* Value strategies will outperform *all* Growth ones. There are just too many broken business models in the Value indexes. That said, as we mentioned earlier, we do think that drivers of market performance across both Equities and Credit shift in 2020 to beyond just long-duration bonds, quality/defensive securities, and growth assets. *If our thesis is right, then we are now headed "back to the future," as the new regime we envision will again be about real cash flow generation/conversion at the asset level, particularly relative to one's financing cost*. Meanwhile, momentum strategies (i.e., what has worked will keep working) and certain passive strategies could begin to lag somewhat in 2020, particularly those stocks with elevated valuations and a narrowing variant perception about their future prospects. Consistent with this view, heady metrics in the private markets like adjusted TAM, or total addressable market, and adjusted EBITDA could

1 Data as at February 9, 2019. Source: Pew Research Center.

"We are now headed 'back to the future,' as the new regime we envision will again be about real cash flow generation/conversion at the asset level, particularly relative to one's financing cost."

all face much more intense investor scrutiny, we believe. On the sovereign income side, we expect the benefits of negative interest, particularly deposit rates, to be more forcefully called into question in 2020 and beyond. We also expect investors to begin to better appreciate that central bankers are apt to let inflation run above their targets. If we are right about these two changes in central bankers' thinking, then longer duration sovereign debt might not be the star performer it was during the prior decade.

3. **Will bond yields go higher or lower in 2020?** We see bonds stuck in a trading range, but our U.S. inflation indicator tells us that deflation risks, at least in the U.S., are being overstated by bond bulls. See our U.S. GDP outlook in Section II as well as our Interest Rate outlook in Section III for further details, but our models have the yield curve steepening in 2020. We also think that the dollar is in the process of peaking, which is an important new input. Our dollar view is consistent with our belief that the Federal Reserve actually ends up cutting rates one more time this year to encourage more fixed investment spending in the U.S. (*Exhibit 32*). Meanwhile, outside the U.S., we still see more disinflationary forces at work, which likely means downward pressure on overall global nominal GDP (*Exhibit 19*). If we are right, then owning hard assets with upfront cash flow backed by worthy collateral could be one of the biggest asset allocation calls of the next five years.

4. **Will the United States continue to outperform its global peers again in 2020?** We think the U.S. ends its reign as the dominant equity market in 2020. Non-U.S. markets are now cheap enough that, even with their flawed compositions (which is why we prefer Private Equity to Public Equity outside the U.S.; see below for details), they warrant investor attention for at least a cyclical "catch-up trade." Also, central bank liquidity trends are now generally more in favor of international markets. This view too represents a modest change in our thinking relative to 2019, but we do acknowledge that international companies need to deliver higher incremental returns on capital than they have in recent years. Longer term, however, we remain of the mindset that the U.S. equity market will still outperform many global indices because of the S&P 500's overweight skew to global trends, including healthcare innovation, technological change, and business services.

5. **How much risk should we have in the portfolio at this point in the cycle?** While we are still risk seeking in terms of our portfolio construction, we are not leaning into markets like last January. Said differently, if last January's risk tolerance ranking was an eight or nine out of 10 on a sliding scale (with 10 being maximum long risk and one being the maximum defensive positioning), we are probably closer to a six to seven to start 2020. Our more measured stance reflects the reality that prices have already moved up at a time when we do not see a huge upside surprise to either growth or central bank liquidity. We also want some dry powder to be able to lean in during periods of turbulence. That said, we do want to highlight that any periodic market dislocations that we envision in 2020 are unlikely to lead to a damaging feedback loop to the broader economy, which is why we do not forecast a 2008-type event this year, or probably – for that matter – this cycle. Against this sort of backdrop, we think a top-down macro overlay that is focused on long-tail investment themes as well as tactical shifts will serve investors well in the lower return, higher volatility environment we envision for the next several years.

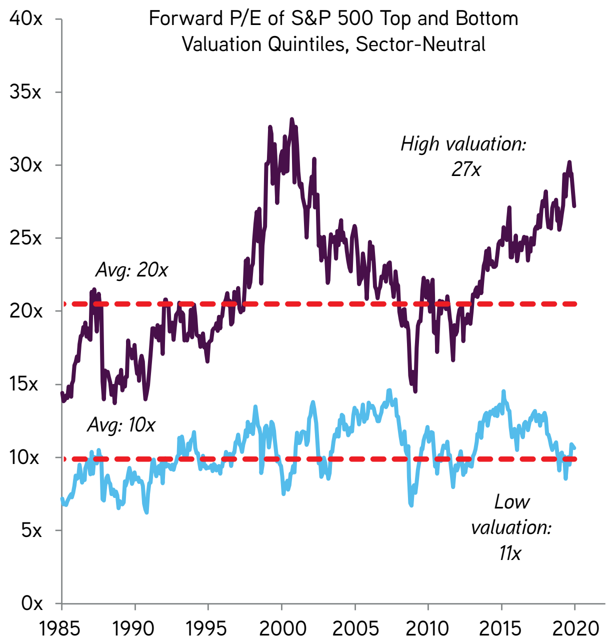
6. **Where should we lean in and lean out from an asset allocation perspective?** See below for more details, including our new "Picks and Pans" section, to better understand our best ideas on asset allocation, portfolio construction, and hedging. The Picks and Pans section has been designed to replace our former target asset allocation table. Why did we make this change? We have shifted our format starting with this note because 1) we believe that there is no single "correct" asset allocation for all the various constituents that KKR now services on a global basis; and 2) we think we are most effective using our top-down, thematic framework for helping investors decide where to lean in and lean out relative to their own benchmarks, not ours.

7. **What do your asset allocation models say about U.S. Equity, Credit, and Rates in terms of relative value for 2020?** Markets appear near-term overbought, but *our longer-term models still suggest that there is still an upward bias to risk assets in 2020*, driven by accommodative central banks, low inflation, modest earnings growth, and continuity (i.e., strong performance often begets strong performance the next year). Indeed, potential market headwinds, including a more discerning IPO market (*Exhibit 131*), an increase in missed EBITDA targets by levered buyouts (*Exhibit 125*), and higher valuations (*Exhibit 73*), are not enough to topple the positive trends we envision in 2020. Against this backdrop, we see Equities offering about the same value as Credit, both of which we favor over sovereign debt. This relative viewpoint to favor risk assets, including both Credit and Equities, should not be all that controversial, given 1) the negative term premium still present in most government bonds (*Exhibit 64*); and 2) the current earnings cycle has not fully run its course. However, given the massive bifurcations within many markets (*Exhibits 81* and *82* for Equities and *Exhibit 120* for Credit), the risk-on versus risk-off decision will not be the real story of 2020, in our view. Rather, it will be about relative value within the overall market for risk assets. From our perch, we think that the lowest quality parts of the Equity and Credit markets will likely stay cheap in 2020, while the high quality stuff will likely stay fully priced. So, we are focused more on the unloved "middle" part of the market, where there is 1) the ability to buy decent cash flow at reasonable prices; and 2) the potential for notable multiple expansion or spread compression based on a variant perception relative to the consensus surrounding key issues such as growth, returns, and business model sustainability. In our opinion, this will be the real story of 2020. At the moment, we like certain beat-up Loans in the B-rated space, and we also like BB, BBB, and AAA liabilities in the CLO space (with BB being our favorite). In Equities, we like high free cash flow stories, particularly those with rising EPS growth and dividend growth (see our Secret Sauce framework below). Finally, we remain overweight Alternatives — across Equity, Credit, and Real Assets — all of which we believe are capable of earning an illiquidity premium that currently appears above average. See below for more details.

Obviously, there are no easy answers to the aforementioned questions. However, we do want to use this *Insights* note to try to tackle these issues in detail as well as to lay out our top down framework for 2020. Overall, the key message from our team is that the capital markets backdrop looks quite different to us today than it did at the beginning of last year. To review, at this time last January when we published our *Outlook* for 2019 (see *The Game Has Changed*; January 2019), essentially both our Equity and Credit models suggested that the global capital markets were pricing in some form of a recession. Against this backdrop, we boosted our U.S. Public Equity allocation by 400 basis points to overweight to capture some of the upside we saw at the time. In doing so, we amped up the risk tolerance of the portfolio.

EXHIBIT 1

A Winner's Curse Is Developing, as Great Companies with Competitive Advantage Have Become Much More Expensive...



Note: Purple is top quintile; blue is bottom quintile. Data as at December 6, 2019. Source: Compustat, I/B/E/S, Goldman Sachs Global Investment Research.

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Non-U.S. markets are now cheap enough that, even with their flawed compositions (which is why we prefer Private Equity to Public Equity outside the U.S.), they warrant investor attention for at least a cyclical 'catch-up trade.'

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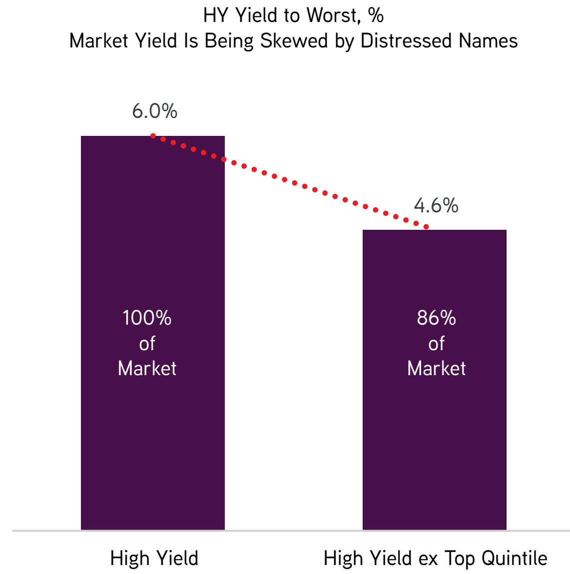
EXHIBIT 2

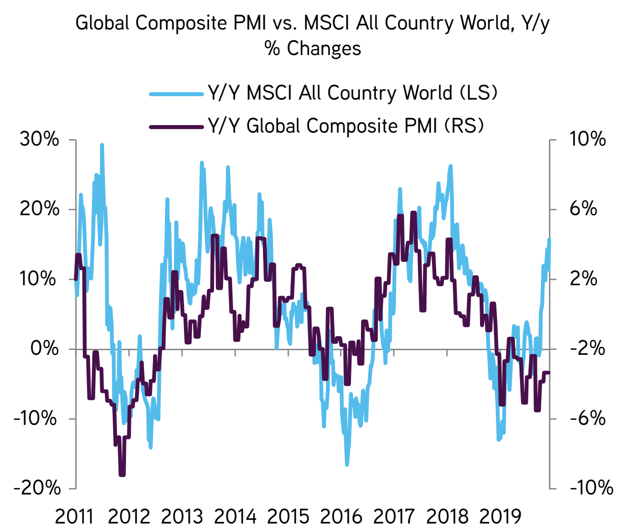
...A Similar Dynamic Is Playing Out in the High Yield Markets as Well



Data as at September 30, 2019. Source: KKR Credit Analysis, ICE BofAML.

EXHIBIT 3

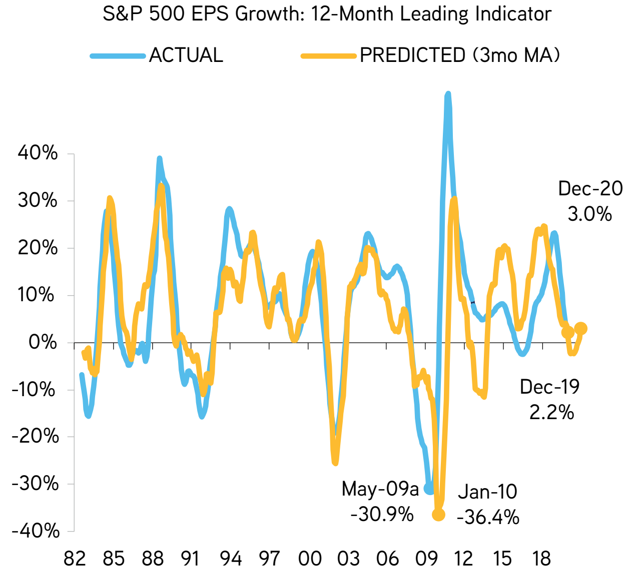
PMIs Could Very Well Be Bottoming, but Equities Currently Have Already Priced in a Big Rebound



Data as at November 30, 2019. Source: Morgan Stanley Research, Markit, IMF, National Sources.

EXHIBIT 4

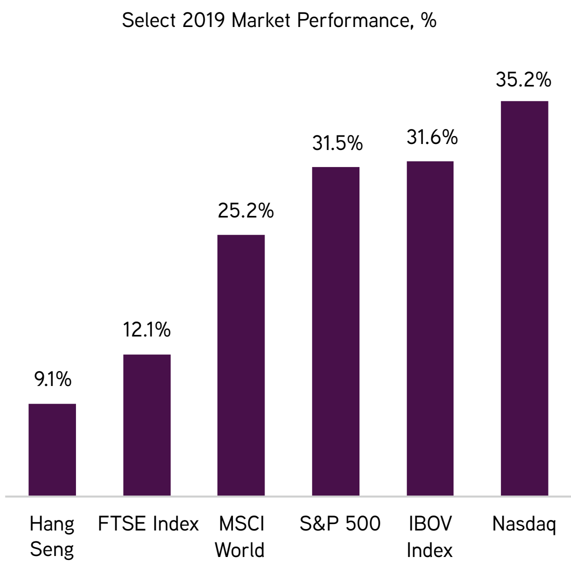
Our Earnings Growth Leading Indicator (EGLI) Points to a Bottoming of Growth in the First Half of 2020, But We Only See a Mild Recovery Thereafter



Our Earnings Growth Leading Indicator is a combination of seven macro inputs that in combination we think have significant explanatory power regarding the S&P 500 EPS growth outlook. Data as at December 31, 2019. Source: Federal Reserve, Bureau of Labor Statistics, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 5

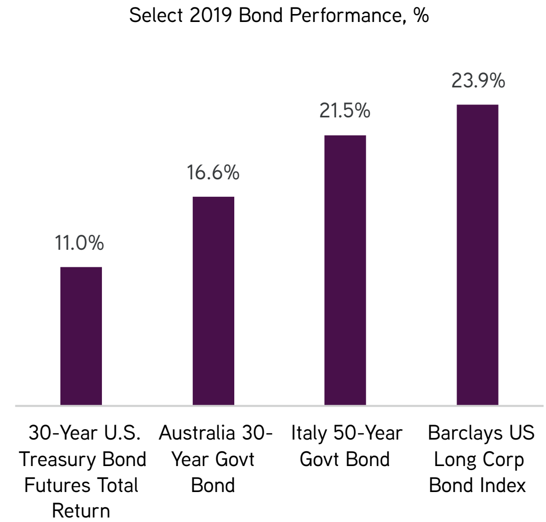
Being Long Growth Has Trumped Everything Else in Equity Land...



Data as at December 31, 2019. Source: Bloomberg.

EXHIBIT 6

...Meanwhile, Across Fixed Income It Has Paid Handsomely to Get Long Duration



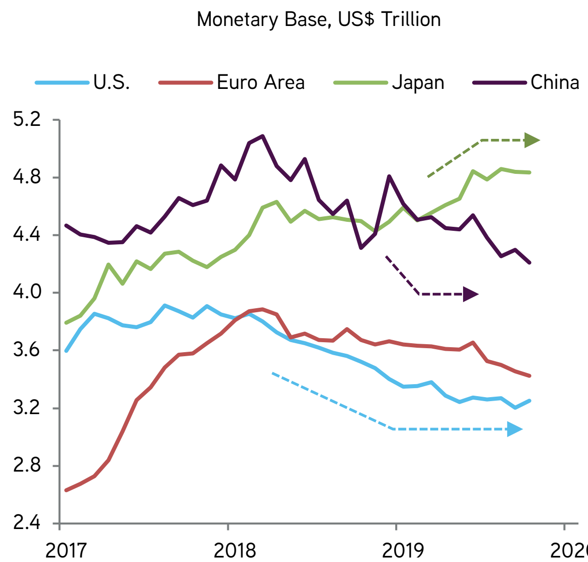
Data as at December 31, 2019. Source: Bloomberg.

Today, we see the global capital markets through a different lens — one that is certainly less rose colored than the ones we were wearing last year. Indeed, unlike last January, we now think that the U.S. stock market has already priced in a robust economic recovery in the first half of 2020. By comparison, our predictive earnings model (*Exhibit 4*) suggests only a modest recovery occurring by the second half of this year. We also think that there may not be enough political risk priced into the U.S. market at current valuations, and believe the private growth markets still need to unwind further.

However, unlike the slowdowns of 2008, 2012, and 2016, credit conditions did not unravel during the recent economic turbulence that occurred in the second half of 2019 (when we essentially had a global manufacturing recession). In fact, during this period global central banks not only supplied ample liquidity to the market again but also expanded their balance sheets. These initiatives have, in turn, helped to suppress bond yields and support credit, leaving financial conditions today as favorable as they have been since the beginning of the prior decade, according to the investment bank Goldman Sachs. Renewed financial easing *is an important input in our thinking because* it ought to be a net positive both for economic growth and risk asset performance in the near-term.

EXHIBIT 7

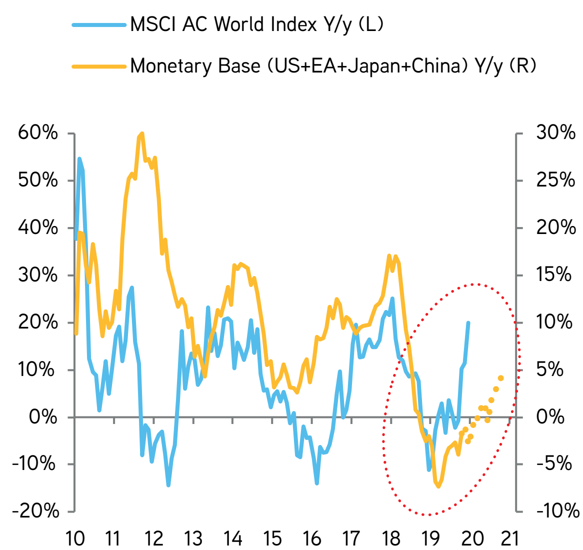
Money Supply Growth Had Slowed Beginning in 2018, but….



Data as at November 30, 2019. Source: Federal Reserve Board, European Central Bank, Bank of Japan, People's Bank of China, Haver Analytics.

EXHIBIT 8

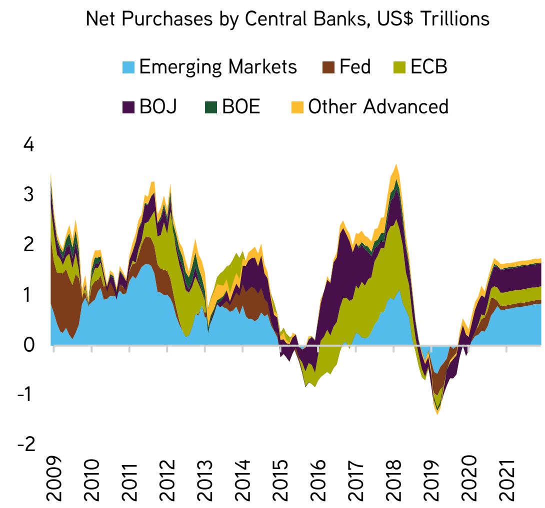
…We Now See It Accelerating Again in 2020



Data as at November 30, 2019. Source: Federal Reserve Board, European Central Bank, Bank of Japan, People's Bank of China, Haver Analytics.

EXHIBIT 9

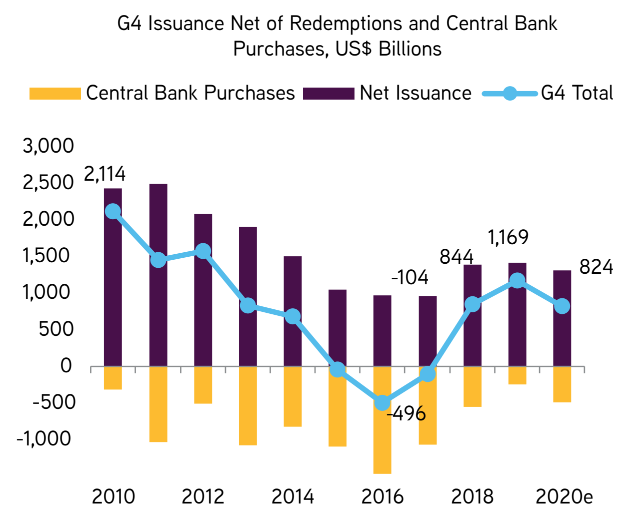
Central Bank Balance Sheets Are Again Expanding…



Data as at December 17, 2019. Source: Fulcrum.

EXHIBIT 10

…Which Should Keep Net Issuance at Manageable Levels



Note: G4 = Europe, the U.K., Japan, U.S. Data as at November 30, 2019. Source: Morgan Stanley.

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Despite mounting headwinds, our call is certainly not to head to the sidelines and wait for a major pullback.

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Key Macro Themes for 2020

So, what are investors to do? Despite mounting headwinds, our call is certainly not to head to the sidelines and wait for a major pullback. As we show in *Exhibits 7* and *8*, we forecast global liquidity to continue to improve consistently in 2020 at a time when our research shows that many individual investors and endowments are not yet at their target risk levels. Central bank balance sheets too should increase again (*Exhibits 9* and *10*). Moreover, while the cycle is running long in duration, the risk premium relative to the risk-free rate on quite a few asset classes, including Equities, is still attractive in many areas of the global markets. One can see this in *Exhibit 75*, which shows that the current earnings yield on U.S. stocks is just only now back to the historical average relative to the current yield on the 10-year U.S. Treasury.

Maybe more important than our near-term valuation work, though, is that – by leveraging our top-down thematic approach to investing – we are still finding a lot of interesting opportunities at the micro level to pursue for clients across both asset classes and geographies. See below for full details (Section IV), but our key macro investment themes for 2020 are as follows:

Theme #1: Complexity 2.0. In past years we have argued that corporate carve-outs are amongst the most attractive ways to find "diamonds in the rough" in bifurcated markets – markets that seem to eschew complexity in favor of simplicity at almost all cost. Importantly, we still believe the opportunity set to acquire high quality carve-outs across PE, Infrastructure, and Energy remains outsized. However, given such wide bifurcations in many of the markets where KKR traffics globally, we now want to be even more aggressive in our pursuit of complexity. In jeweler's parlance, we are using this 2020 outlook to shift our focus beyond just under-valued "diamonds in the rough" to include the occasional "hidden pearl" trading at a fraction of its intrinsic value. Hence, we made the decision to call this theme Complexity 2.0. In many instances our global investment teams, especially our distressed credit markets effort, are increasingly uncovering beaten-up, stand-alone assets where the payback period could be just three years, compared to five to 10 years for many of our traditional businesses at KKR. So, our call to arms in 2020 is for portfolio managers across all our businesses to not only buy great companies at good prices but also for them to consider more middle of the pack businesses that are trading at significant discounts to intrinsic value. And if we are right that market breadth expands in 2020, this theme could be an important one for all global investors who are looking for both relative value as well as attractive upside versus downside skew this year.

Theme #2: Asian Millennial: Consumption Upgrade. We have long spotlighted the global trend towards *Experiences Over Things*, but this year we want to allocate additional dollars to vehicles that are capturing the explosion in buying power that is being unleashed in Asia. By way of background, there are now a total of 826 million millennials in Asia, compared to 67 million in the United States. Because of this segment's heft, total consumption in Asia actually passed that of Europe in 2011, and it is poised to exceed the U.S. by 2022. How should one invest behind this theme? See Section IV for more details, but personal financial services, healthcare services, wellness/beauty, healthier foods, and food safety should all be major long-term beneficiaries of the environment we are envisioning. We also anticipate continued demand for China and other Asian tigers to tackle air, water, and soil pollution, likely creating opportunities for companies that address these issues. Importantly, though, the Asian consumer in both developed and developing markets is becoming increasingly sophisticated, which is leading to a more demanding customer who uses technology to drive value, selects aspirational brands over standardized ones, and comparison shops more often than in the past. So, as we detail below, we think fully understanding the influences of education and technology on today's Asian consumer are now prerequisites for investors who pursue this theme.

Theme #3: Yearn for Yield Continues; Own More Collateral-Based Assets. In a world where central bankers are holding nominal interest rates below nominal GDP, we think CIOs should be increasing their allocations to collateral-based assets with upfront cash flow. Indeed, we see reinvestment risk as one of the greatest challenges that most CIOs now face in a world of increasingly sluggish nominal GDP growth. And if we were positive on this thesis earlier in the year, our most recent trip to India in the fourth quarter of 2019 definitely elevated our conviction that there is a secular shift in global growth occurring, and as such, there should be a commensurate shift in one's asset allocation targets. Importantly, this risk is coming during a period that we previously identified as *The Uncomfortable Truth* (see our April 2019 *Insights* for full details), which we defined as record low interest rates amidst bulging deficits and soaring debt loads. Our advice then as well as now is to own more cash-flowing assets linked to nominal GDP and build more flexibility across mandates. Importantly, despite our view that inflation will remain low in the medium term, we respect that the "Authorities" are trying to shrink existing debt loads by holding nominal interest rates below nominal GDP. As such, we believe strongly that an overweight to modestly leveraged Infrastructure and certain Real Estate investments with yield is prudent to add some ballast to one's portfolio. We are also quite constructive on Asset-Based Finance, which continues to provide us with lots of shorter duration opportunities with good cash flowing characteristics and sound collateral.

> **"So, our call to arms in 2020 is for portfolio managers across all our businesses to not only buy great companies at good prices but also for them to consider more middle of the pack businesses that are trading at significant discounts to intrinsic value."**

Theme #4: Cash Flow Compounders. With China's nominal GDP falling from 36.0% year-over-year growth in 1994 to a record low of 6.7% in 2016 (and it is still not far above this level today), overall global nominal GDP growth has suffered mightily.[2] This decline makes sense to us, as these days, China typically accounts for one-third of total global growth. As we look ahead, we still do not expect a rebound any time soon, as the OECD projects that China's nominal GDP growth will fall further towards just 5.9% by 2030. Against this backdrop, the percentage of companies in the MSCI All Country World Index that are poised to grow eight percent or more has fallen sharply to 26% in 2019 from more than 40% during the 2000 – 2001 period. So, our view is to find the companies that have established cash flowing business models where there are identified economies of scale that result in material improvements in cash flow and book value as these businesses grow in size. We also think that these companies should have well-identified sources of support for those cash flows, including access to growing end markets, clear economies of scale in production or distribution, brand loyalty, and defensible margins. Our recent conversations with some of the foremost central bankers around the world lead us to believe that *pricing power will become a distinguishing feature in the lower nominal GDP environment we envision during the next three to five years*. By comparison, we are quite cautious on companies that cannot generate positive cash flow, especially certain unprofitable IPO candidates, and we look for their cost of capital to rise meaningfully into 2020. In terms of where to invest behind our favorable outlook on secular growth stories, we currently favor several regional themes over global ones, including U.S. business services, European logistics, Asian travel, and U.S. automation.

Theme #5: Lean Into Dislocation/Dispersions. In our humble opinion, we are likely to encounter more volatility in the quarters ahead – even if we do not have a major sustained drawdown like 2008. There are several influences that drive our thinking. First, the political noise in the U.S. is likely to heat up materially during the next 10 months. Outside of the U.S., recent events in the Middle East serve as a stark reminder that global tensions, especially those linked to national security, will continue to flare. Second, while central banks have turned the spigots back on, we have exited the glory days that defined Quantitative Easing at its extreme during the 2014-2018 period. So, excess liquidity cannot heal as many wounds and will not likely be as long-lasting this time round. One need only to track the performance of the CCC market in 2019 to appreciate that there is a new world order. In High Yield, for example, 2019 was the first time that the HY Index returned more than 10% where CCC was not the leadership area of the market. Or we can look at the CLO market, where many managers have begun to sell their B loans to increase cushion for future downgrades. Given CLOs comprise 55-60% of the $1.2 trillion loan market and approximately 70% of CLO assets are in single B's, there has been a substantial network effect in the market. Third, we think that corporate margins have peaked, and given some of the sizeable uptick in leverage in recent years, the potential for markets to get disjointed is significant. Fourth, we think that significant adjustments to EBITDA have overstated the earnings power of many companies that we track. Not surprisingly, the capital markets are starting to try to separate the wheat from the chaff. Consistent with this backdrop, our research shows that dispersions across many equity and debt markets have spiked – a backdrop that we believe allows investors to buy attractive cash-flowing assets at reasonable valuations at this late point in the capital markets cycle. At the moment, we are playing this macro theme through our Opportunistic Credit and Distressed/Special Situations allocations, but we do believe it is constructive for Equity Hedge Fund managers as well (something we have not said for years).

2 Data as at December 31, 2016. Source: China Bureau of National Statistics, Haver Analytics.

Asset Allocation: Picks and Pans for 2020

As in past years, we think it is important to link the macro to the micro. Ultimately, key to any sound macro overlay is to drive those conclusions down to the asset class and/or security level. However, as the breadth of our investor base at KKR has increased significantly in recent years, we no longer think having a single target benchmark makes sense. So, we are moving towards a strategy in our semi-annual publications of highlighting Picks and Pans, where – almost irrespective of benchmark – we would be leaning in and leaning out. To this end, we suggest the following Picks and Pans:

We Would Overweight 'Spicy' (But Not Too Spicy) Local Government Bonds in Certain Countries with High Real Rates. While we remain cautious on Argentina or Turkey (see below), we do like some of the medium 'spicy' local debt in countries such as Vietnam, the Philippines, and Mexico. One can see this in *Exhibit 71* below, but in these markets we think that that inflation trends could be ebbing at a time when real rates are still high. There is also the potential for interest rate cuts. In Mexico, for example, we are forecasting up to 75 basis points of total interest rate easing this year. To this end, we like local currency debt in the short- to medium-term part of the curve, and we also like cash flowing assets like Real Estate and/or Infrastructure where cap rates may be too high. Indeed, in a world of over $11 trillion of negative rates, the value of the real coupon in markets like Vietnam, the Philippines, and Mexico could be substantially revalued upward if our case for the global economy is correct.

We Would Overweight Allocations to Environmental, Social, and Governance Investments (ESG). This theme is not new at KKR, but we do want to use our 2020 outlook to highlight our growing focus on investing in companies whose core business model addresses critical global challenges. Consistent with this view we have been spending an increasing amount of time with our Impact co-portfolio managers and colleagues Ken Mehlman and Robert Antablin. As a result, we enter 2020 with an intensifying focus on increasing allocations to investments aligned with global Sustainable Development Goals (SDGs).

Many of these investments dovetail directly with macro themes we've highlighted before. For example, recent trips to India and China again emphasized a focus on renewables, food safety, environmental safety, and waste management, as middle class populations focus on concerns linked to quality of life, the environment, and worker safety. Other rising macro themes include workforce development, as global companies, universities, and cities address the Fourth Industrial Revolution's unprecedented technological disruption. Similarly, climate change is producing historic rain events, which harms water quality via storm water runoff. Overall, the global backdrop that we are describing leads us to look across all KKR's investment platforms to partner with companies that mitigate climate change, enhance resilient development, protect water quality, manage waste responsibly, and enhance learning and workforce development.

We also continue to integrate the consideration of relevant ESG issues into the governance, value creation and risk management efforts of all of the investments we make. By helping to implement strategies at our portfolio companies that – among other things – optimize environmental footprints, promote diversity and inclusion, create better employee-executive alignment, emphasize good governance and enhance supply chains, we are supporting their efforts to improve and protect value. We believe the combination of the aforementioned macro trends, plus radical transparency driven by the Internet and social media, make investments in solutions for and the broader consideration of ESG issues in our investment decisions key for value creation. Plus, managing material ESG issues well likely impacts performance versus peers. As a result, "doing well by doing good" remains a growing investment theme at KKR in 2020.

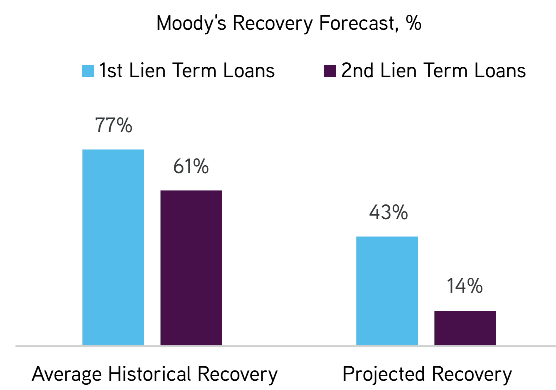
We Would Overweight Collateral-Based Assets with Cash Flow: Infrastructure, Subordinated Real Estate Credit, and Recurring Origination Platforms. Consistent with our thesis of how to respond when governments around the world hold nominal interest rates below nominal GDP (*Exhibit 116*), we think that CIOs should own – in size – cash flowing collateral with upfront yield, including Infrastructure, Subordinated Real Estate Credit, and Real Estate Equity. We are also fond of some of our platforms in Credit where we originate paper backed by collateral that provides cash flow from day one. We hold these assets in high regard because of their ability to perform in a variety of environments. On the one hand, in the event the global economy slows more than expected, we believe collateral-based assets will be even more attractive in such a downside scenario. On the other hand, in the event growth reaccelerates more than forecast (and there is actually some inflation in the system), inflation-based step-ups in pricing schemes as well as increases in the value of nominal GDP and the underlying assets should create value for investors.

We Would Underweight Many Parts of Later Stage Venture Capital/ Early Stage Growth. Our belief is that the WeWork situation was not a "one-off" occurrence. Rather, we see a growing number of Venture Capital/early stage Growth investments that we think may have difficulty funding in 2020. While TAM, or total addressable market, is an interesting statistic, it does not guarantee a company will convert its customers into a cash flowing business model. In the "back to the future" environment we envision, cash flow conversion will again become king. From what we can observe, there are still too many companies with high fixed costs and less marginal revenue dollar per purchase that are being funded, and in 2020 we believe that a more skeptical investment community will expose some of these flaws, particularly as unprofitable private growth companies try to access the public markets. So, similar to last year, we would stay underweight this part of the market.

We Would Overweight Opportunistic Liquid Credit, CLO Liabilities, and Certain Bank Loans. Consistent with our macro theme to lean into dislocation and buy 'spicy' debt (but not too 'spicy'), our suggestion is to pursue a strategy of accumulating positions in credit yielding instruments where prices reflect some of the current market uncertainty while avoiding the tails. For example, CLO managers, which now control 60% or more of the loan market, are often forced to sell names when they begin to worry about their weighted average rating factor, or WARF. These technical gyrations often create opportunities to scoop up some decent credits at attractive prices. Over-collateralization tests within the CLO market are also creating opportunities in the B segment of the market. No doubt, security selection matters, but we are finding good businesses trading at attractive prices with limited maturities. In particular, we like secured first lien loan risk versus a super-tight High Yield market. We also like BB CLO Liabilities for many of the same reasons. On the equity side, we are seeing similar opportunities, given the immense bifurcations that have been created. See Section II for more details. From a product perspective, we remain big fans of the opportunistic credit mandates as a strategy because they provide investors with the ability to toggle across Loans, Structured Products, and High Yields as the market ebbs and flows.

EXHIBIT 11

Given Loose Underwriting Standards, the Importance of Real Cash Flow Is Going Up in the Macroeconomic Environment We Are Envisioning



Data as at August 16, 2018. Source: *Convergence of Bonds and Loans Sets State for Worse Recovery in the Next Downturn*, Moody's Investors Service.

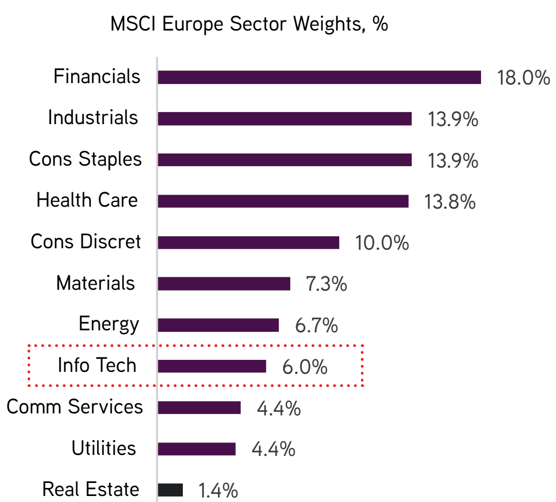
> **"Importantly, though, the Asian consumer in both developed and developing markets is becoming increasingly sophisticated, which is leading to a more demanding customer who uses technology to drive value, selects aspirational brands over standardized ones, and comparison shops more often than in the past."**

We Would Remain Long Global Housing as a Theme in the Developed Markets. As we detail below, we remain constructive on household formation and home improvement stories. Besides an uptick in demand (*Exhibit 36*), our basic thesis is that what led to the last crisis (an abundance of subprime mortgages and oversupply of housing) are not concerns at present. Limited availability of credit in the housing arena has also prevented growth from rebounding too sharply in many markets. Finally, the sector will continue to be an attractive macro hedge this cycle, because housing related activity tends to improve when overall economic growth slows and interest rates fall.

We Would Overweight International Private Equity Strategies. While we are not convinced that European public equity markets can consistently outperform the U.S. and Asia, we believe that European Private Equity can outperform its public benchmark. Key to our thinking is that Europe's public markets are compositionally flawed, which creates a significant opportunity for European Private Equity to win through sound portfolio construction. Public markets in Europe are overweight Financials and underweight Technology. This mismatch creates an incredibly attractive arbitrage for private equity managers. Second, we continue to believe that underachieving multinationals in Europe are going to shed their non-core subsidiaries. Already, we have seen Airbus, Nestle, and Unilever sell major subsidiaries to Private Equity. As the industry data has suggested, Private Equity is much better positioned to navigate these complex situations and deliver upon operational improvement stories that the public markets cannot match in terms of value creation, in our view. Finally, while the public markets do not reflect it, we continue to believe that one of the most efficient ways for PE to best the aggregate public indexes is to get long innovation. Logistics, consumer experiences, and payments all represent key areas where we think that Private Equity can gain attractive exposure to growth segments of the region relative to what is offered in the public markets.

EXHIBIT 12

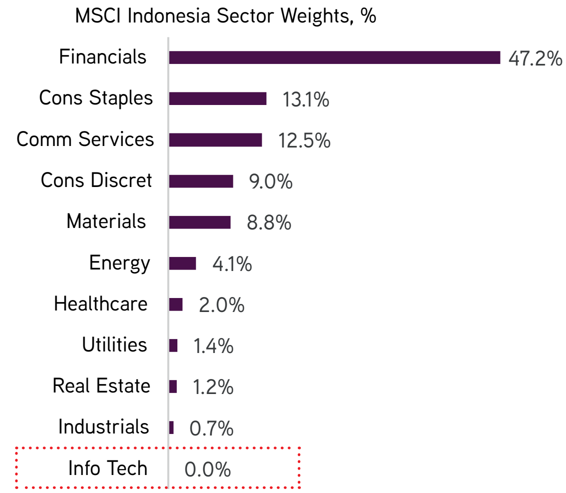
Europe Public Market Indices Are Heavily Overweight Financials and Underweight Technology



Data as at December 31, 2019. Source: MSCI.

EXHIBIT 13

It's a Similar Story in Indonesia, Which Has No Tech Exposure in the Public Market Index



Data as at December 31, 2019. Source: MSCI.

Asia too represents a major opportunity for Private Equity to handily outperform Public Equity indexes (i.e., increase the value of the illiquidity premium). In Indonesia, for example, there are literally no public companies in the technology space. Meanwhile, traditional financial services accounts for fully half of the total market capitalization of a country that is experiencing a significant increase in its GDP per capita. Moreover, the index is not actually that representative of the consumption upgrade story that we see in areas such as healthcare services, environmental services, and travel/leisure.

We Would Own More of Our 'Secret Sauce' Stocks in 2020. One of our longest-held macro themes (See our *Insights* note from December 2011 entitled *Brave New World, Yearning for Yield*), which we term "Brave New World," is that there has been a major demographic shift in investor preference — one that would drive individuals and institutions toward investments that could deliver both yield and growth. Importantly, in our Secret Sauce analysis we frame equity "yield" as a growing dividend yield — not just a high, stable one. In addition, the aspect of growth we address in our Secret Sauce analysis is growth via an improving return on capital, not merely growth acquired at any price. Our bottom line: In the macroeconomic environment we envision for the next five years, we would lean into stocks that meet our Secret Sauce criteria, which is predicated on the view that in addition to rising payout ratios, investors should also screen for strong free cash flow growth and rising ROE.

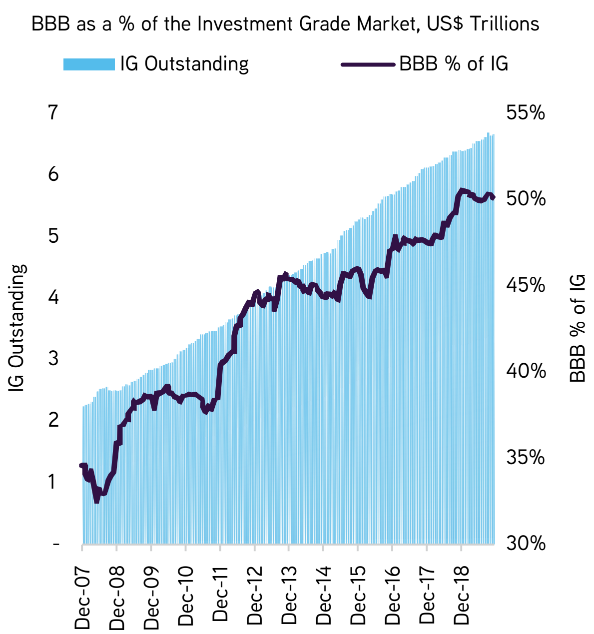
In Currencies, We Would Own JPY, EUR, and GBP Relative to the U.S. Dollar, Which We Think Is Peaking. On JPY, we like the defensive characteristics of this currency, and we think that it appears attractive relative to the U.S. dollar, particularly if we are right that the Federal Reserve eases again in 2020. Meanwhile, we think that the Eurozone will not be as bad in 2020, and as such, its currency could see some improvement from already attractive levels. Finally, despite its recent bounce, we think the GBP is likely still oversold. With the negative fat tail agenda off the table, we think the currency – and some of the assets it supports in the United Kingdom – are still worth investing behind.

We Would Overweight Short Duration U.S. Government Bonds Relative to Developed Market Peers. While we are forecasting some economic reacceleration in second half of 2020 growth, we still believe that U.S. short duration represents good value in absolute terms, particularly relative to its global peers. It also serves as an attractive diversifier for large global portfolios.

We Would Underweight Areas of Excess Credit Creation: Unsecured Consumer Credit, Subprime Card Loans, and BBB Investment Grade Debt. While we are not forecasting a recession in 2020, we do expect to see continued deterioration in areas of the credit market where there have been excesses. In particular, in recent years unsecured consumer credit and subprime card loans have enjoyed lax underwriting standards. We now expect some of the poor decision-making that underpinned outsized growth in these markets to bubble up in 2020. On the other hand, BBB Investment Grade debt is coming off a stellar year as a play on investors extending duration. Given its elevated duration and low yields at current levels, we would shift to more of an underweight position. All told, BBBs are now an unprecedented 50.1% of the IG market, with a quarter in just two sectors - Energy (15.4%) and Healthcare (10.5%) – both of which are volatile and heavily hinged on policy. Against this backdrop, we think that the macroeconomic and geopolitical environment, including heightened regulation, could trigger a wave of 'fallen angels,' or Investment Grade credit falling back into the high yield category over the next 12-18 months.

EXHIBIT 14

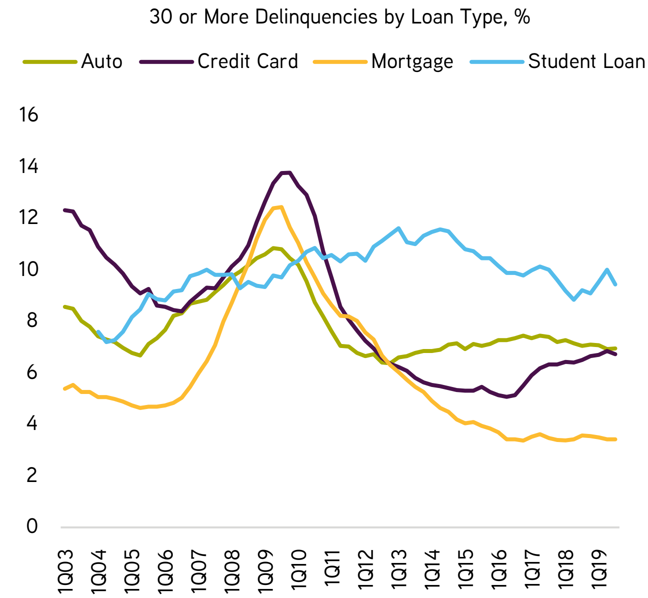
BBB's Are Now 50% of the Investment Grade Market, and 25% of Them Are in Highly Volatile Energy and Healthcare Sectors



Data as at December 31, 2019. Source: Bloomberg.

EXHIBIT 15

Consumer Delinquency Rates Have Not Trended Back Towards GFC Levels, Signaling the Consumer Is Not Over-Levering



Data as at September 30, 2019. Source: Federal Reserve Bank of NY, Haver Analytics.

We Continue to Be Cautious on Turkey Within the Emerging Markets Arena. Similar to last year, we continue to think that Turkish assets will remain under pressure, and as such, we would pair them up with other EM assets that have greater stability.

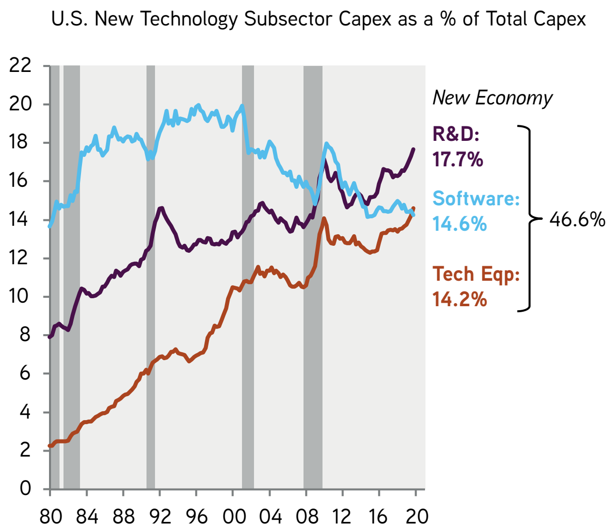
While we have used our Picks and Pans section to give specific details regarding high conviction investment ideas, the most important take-away for this year we believe is that the "winners" in this new decade will be associated with – regardless of asset class or geography – improving cash flow generation and cash flow conversion. 2020 will also be about breadth, and it will be about global opportunities. It will also be a year where the riches of investing go to allocators who can look up and down capital structures for value, price compare across geographies, and find relative attractiveness between public and private market opportunities. Implicit in what we are saying is that cash flow, cash flow conversion, book value growth, and return on capital all matter much more than in the past. On the other hand, shaky capital structures and immature growth companies that lack scalability will face significant funding issues, as investors tighten their purse strings on more speculative investments, particularly relative to the past five years.

Investment Considerations/Risks

In terms of major macro risks that could dent the outlook we are forecasting, we see several to consider (and please see Section V for full details, including hedges). First, our data shows that – outside of required technology spending — we have not yet seen a sustained rebound in CEO/CFO intentions to pursue capital expenditures. This reality flies in the face of most Wall Street opinions that 1) capital expenditures will snap back in 2020; and 2) consensus earnings will rally 11% in 2020, because of an expected rebound in cyclical items like traditional capital goods investments. Given how much asset allocators depend on earnings growth to justify their risk posture these days (i.e., the lion's share of tactical investors are overweight stocks at the expense of sovereign debt because of the earnings yield arbitrage), we will be watching this area closely.

EXHIBIT 16

New Economy Capex Has Become Almost Half of Total Capital Expenditures in the United States...



Data as at September 30, 2019. Source: Cornerstone Macro.

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Our recent conversations with some of the foremost central bankers around the world lead us to believe that pricing power will become a distinguishing feature in the lower nominal GDP environment we envision during the next three to five years.

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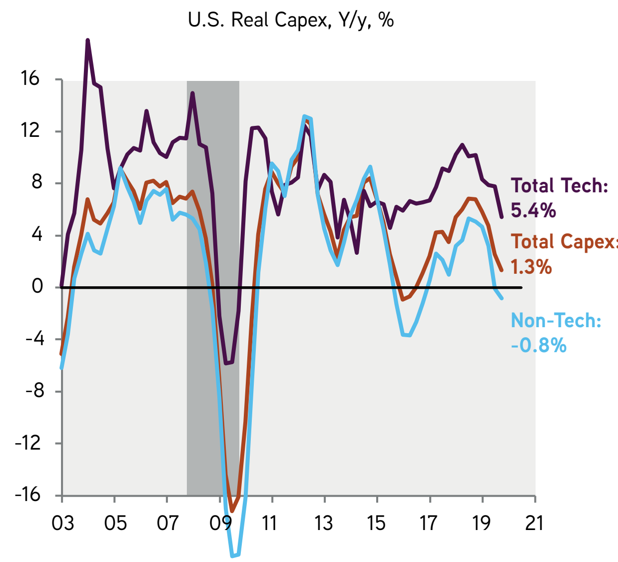
EXHIBIT 17

...Which Has Helped to Offset the Capex Decline Linked to Trade Tensions and a Manufacturing Recession



Data as at September 30, 2019. Source: Cornerstone Macro.

Second, followers of our work will know that we have been proponents of the bifurcated economy thesis (*Exhibit 37*). Specifically, we have been arguing that the current manufacturing recession would not corrode the strength in services that we have been seeing. We still feel confident in this view (and we actually think global manufacturing PMIs are bottoming), but as we describe below, our recession model is suggesting that the corporate sector is more vulnerable than it appears at first glance. See Section V for more details.

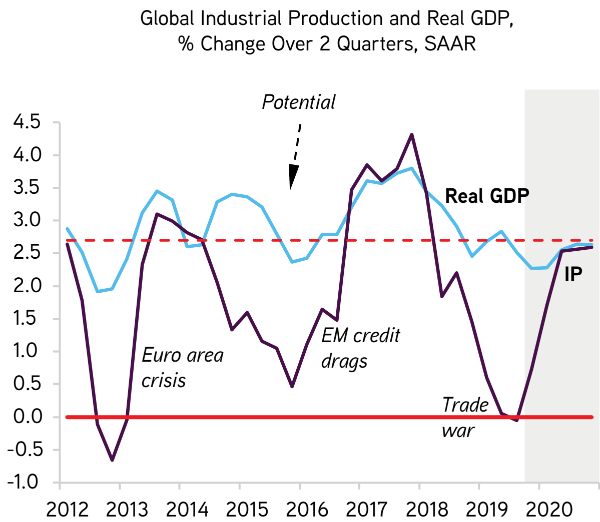
Third, political risk should not be overlooked. It can't be perfectly calculated like a P/E ratio or a dividend yield, but its opaqueness does not mean it should be ignored. Indeed, 2019 was a year of heightened global travel for KKR's GBR team, and collectively, we cannot remember a time in recent history where there has been so much consternation or geopolitical strife. Importantly, this is occurring during robust economic growth. As part of this viewpoint, we continue to believe that a Fourth Industrial Revolution – amongst other forces at work – is creating worker displacement that is not likely to dissipate any time soon. This, along with the radical transparency of the Internet, is challenging the reputation of all institutions, including industry. As such, we see a much higher threat of heightened scrutiny and potential re-regulation across many industries than in the past. Meanwhile, as we describe below in significant detail in Section V with some help from our colleagues Ken Mehlman and Travers Garvin, we are not sure who will win the U.S. presidential election, but our base case is predicated on the view that neither party sweeps the House, the Senate, *and* the Presidency.

Finally, our base view is that, while there is a Phase I agreement on trade issues such as soybean purchases and financial services liberalization in China, there will not be a resolution on key issues such as cybersecurity, artificial intelligence, and/or cloud. Also, as the rollout of 5G accelerates in 2020, we expect its rollout to represent a major battleground between the East and the West. In general, we think that

President Trump will continue to use tariffs across Asia and Europe in the foreseeable future; in particular, we expect some acceleration of tariffs into autos during 2020. See Section II for more details.

EXHIBIT 18

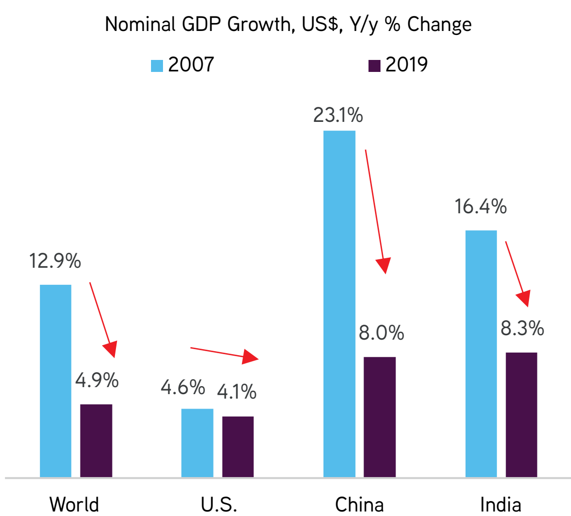
We Expect More Rolling Recessions to Occur Rather Than One Large 2008-Type Event



Data as at November 26, 2019. Source: JP Morgan.

EXHIBIT 19

We Believe That Investors Are Underestimating How Much Nominal GDP Has Slowed in Recent Years



Note: China and India in local currency. Data as at November 21, 2019. Source: IMFWEO, respective national statistical agencies.

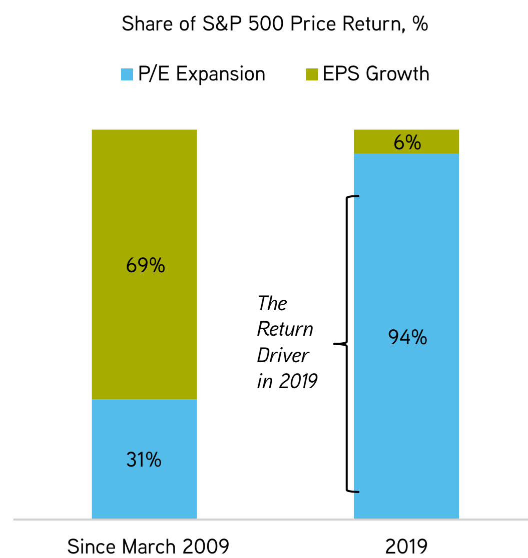
Expected Returns/Summary Thoughts

Looking at the bigger picture, we think that 2020 is another year where it becomes increasingly clear that we remain in a world of sustained low nominal GDP growth. One can see the magnitude of the decline since 2007 in *Exhibit 19*. In particular, the chart really brings to life the slowdown we are seeing in the Asian tigers (e.g., China and India). Given how important these countries are to global growth (remember China alone accounts for one-third of global growth), this shift in trajectory is quite significant. Indeed, global growth trends are now so anemic that it reminds us of the old saying, "it is hard to hurt yourself falling out of the basement window."

Somewhat ironically, an economic backdrop that fails to create a global synchronized recovery could again be a good one for global capital markets. Interest rates remain so low that – as long as earnings and the dollar do not fall off a cliff (which we don't think they will) – global asset allocators will be forced to again allocate to risk assets. That said, there will be wobbles along the way, and we probably should prepare for more mini-cycles (*Exhibit 18*) rather than something akin to 2001 or 2008. Also, as we show in *Exhibit 20*, there is now less scope for multiple expansion from current levels relative to 2019. If we are right (and we think we are), then outsized performance in 2020 will be primarily linked to improving return on capital and/or improving an asset's capital conversion (*Exhibit 22*).

EXHIBIT 20

P/E Expansion Drove Returns Much More in 2019 Than in Prior Years of This Bull Market



Data as at December 31, 2019. Source: Factset, Goldman Sachs.

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We are highly confident that European Private Equity can outperform its public benchmark in its region.

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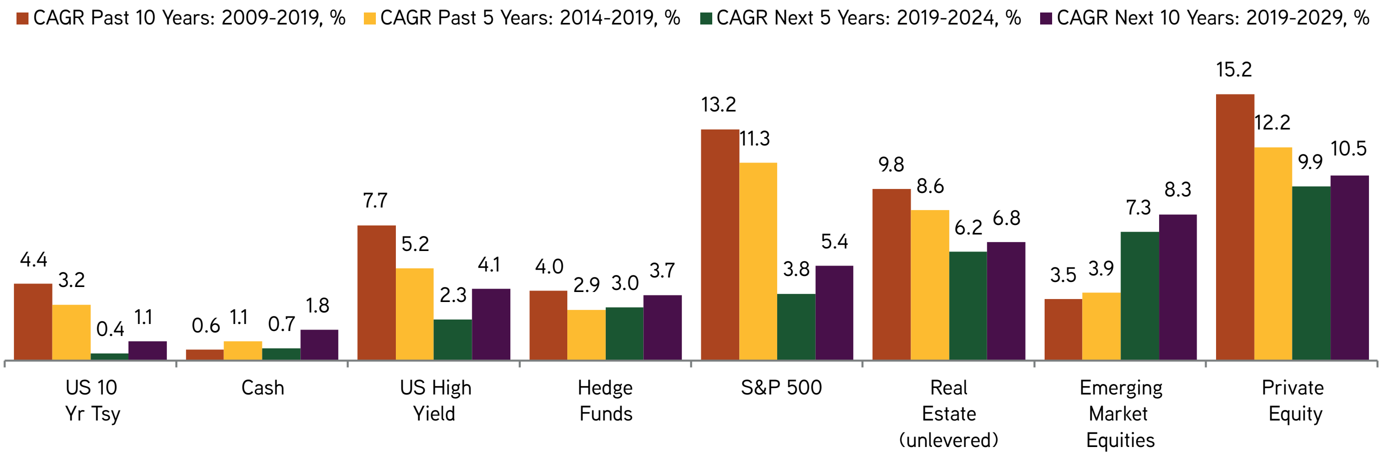
EXHIBIT 21

We Now Anticipate More Modest Forward-Looking Returns Across Many Asset Classes

Past and Future Expected Returns by Asset Class, CAGR, %

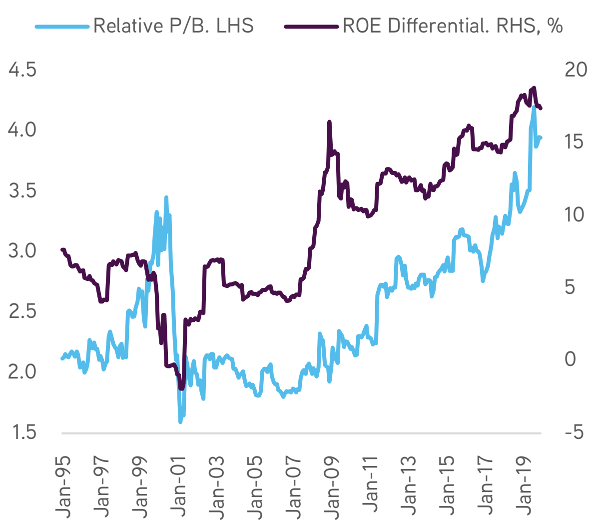


Data as at October 25, 2019. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 22

Finding Improving Return on Capital and Cash Flow Conversion Stories Hold the Key to 2020, We Believe

Russell Growth vs. Value



Data as at December 31, 2019. Source: Bloomberg.

Section II: Macro Basics

In the following section, we describe in detail several key macroeconomic considerations where we think CIOs should have a view.

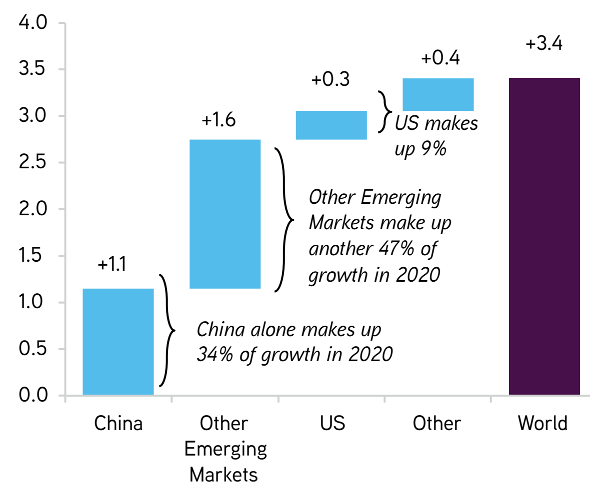
Global GDP

Our base view is that the global economy will continue to bump along in 2020. Importantly, though, as we first detailed in our *Wisdom in Curiosity* piece, our predictive macro models are pointing towards an upward bias in the second half of the year for the United States. We also expect Europe to rebound slightly from the depressed levels witnessed in the third quarter of 2019. European economies, with their relatively greater degree of connectivity and trade-related dependence upon China, stand to benefit from easier comparisons in key markets like autos as well as some easing of global trade tensions (remember approximately 46% of gross GDP in Europe is linked to exports). Within the emerging markets, however, we still expect nominal GDP growth to remain at fairly depressed levels. In particular, we expect continued softness in the large Asian economies such as China and India, both of which are now running at nominal GDP rates well below investor expectations (*Exhibit 19*).

EXHIBIT 23

EM Countries Are Expected to Account for More than Three-Quarters of Total Global Growth in 2019

2020 Real Global GDP Growth, %



Data as at October 15, 2019. Source: IMFWEO, Haver Analytics.

EXHIBIT 24

We Expect Overall Slow Global GDP Growth this Year, Albeit with Some Reacceleration in the Second Half of 2020

2020 GROWTH & INFLATION BASE CASE ESTIMATES

	GMAA TARGET REAL GDP GROWTH	BLOOMBERG CONSENSUS REAL GDP GROWTH	KKR GMAA TARGET INFLATION	BLOOMBERG CONSENSUS INFLATION
U.S.	1.9%	1.8%	2.2%	2.1%
Euro Area	1.1%	1.0%	1.3%	1.2%
China	5.8%	5.9%	3.3%	3.1%
Mexico	0.9%	1.1%	3.5%	3.4%

GDP = Gross Domestic Product. Bloomberg consensus estimates as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis.

To be sure, trade remains a wildcard in our global forecast, despite the announcement of a Phase I trade agreement in December 2019. Indeed, informed by a series of high level meetings in Asia, Europe, and the United States, we remain committed to our thesis that global trade as a percentage of GDP is in secular decline (*Exhibit 27*). Our latest thinking on the current trade conundrum is as follows:

- **The framework for U.S.-China trade negotiations has changed, in our view**. Indeed, both President Donald J. Trump and President Xi Jinping are now being forced to acknowledge (and as the December 2019 agreement made clear) that there will be no one-time "big bang deal"; rather, we are headed towards a series of mini-deals. Why is this happening? Our view is that cybersecurity, artificial intelligence, and cloud computing will permanently remain outside of current trade negotiations, which means most of the recent trade negotiations exclude some of the most important, long-term strategic issues the two countries now face. In fact, our belief is that these tech-related issues will now be included only in national security and diplomatic discussions. Said differently, trade negotiators from China and the U.S. are now kicking the most important "can" down the road because of lack of agreement on what have become critical national defense topics. In our view, such tactics allow both sides to claim "victory," and it clears the way for a near-term agreement. However, the lack of progress on core structural issues does not address critical long-term questions of fair play and competitiveness, and as such, investors should look for a much more gradual approach to resolution in the coming quarters.

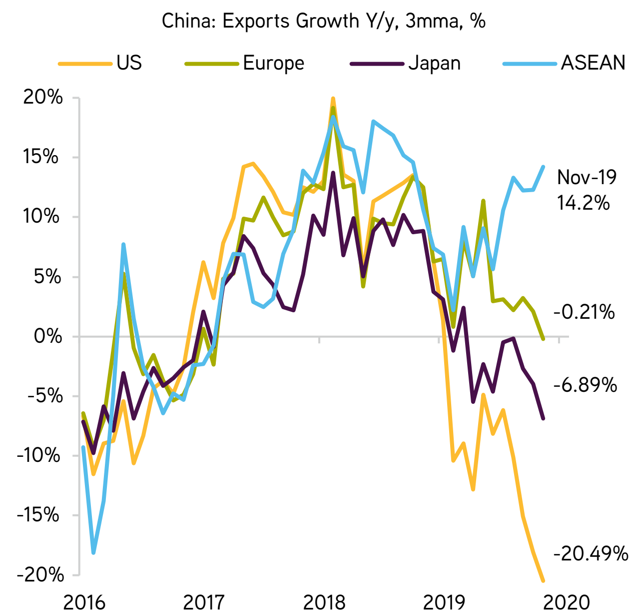
- **Our view is that both the U.S. administration and the Chinese government now acknowledge that alignment in more traditional industries such as agriculture and financial services is achievable; however, we believe investors should likely prepare for dual standards in key strategic areas such as 5G, Search, etc.** Somewhat ironically, by implementing the trade wars, the U.S. is accelerating China's desire to insource key initiatives, especially in technology. Already, exports as a percentage of GDP in China are at 16.5%, compared to 36% a decade ago and 12% in the United States. The goal, we believe, is for the government to help drive China's export level from 16.5% down to the 12.0% where the U.S. now resides (bringing China close to a full domestic consumption economy). If we are right, then many critical industries in China will rely less on foreign imports, particularly those from the United States.

- **Perhaps most importantly, we have left most of our meetings with U.S. government officials throughout 2019 with the belief that tariffs will now be part of American foreign policy for quite some time**. To be sure, tariffs are blunt instruments, but they represent a sea change in foreign policy, one that we believe both Democrats and Republicans can support. Importantly, they signal the arrival of American economic nationalism. We also want to underscore that we expect tariff policies to expand into other regions, including Europe, in the near future.

- **Mexico is fast emerging as a winner in the trade war**. Our view is that the current administration's take on Mexico is changing for the better, and as such, Mexico is now viewed by U.S. policymakers as a more important trading partner than when we first started to dig into trade as a macro theme. Recent passage of the United States Mexico Canada Agreement (USMCA) will only accelerate this trend, we believe.

EXHIBIT 25

China Has Tried to Offset Weakness in Exports to the U.S. by Accelerating Export Growth to its ASEAN Peers

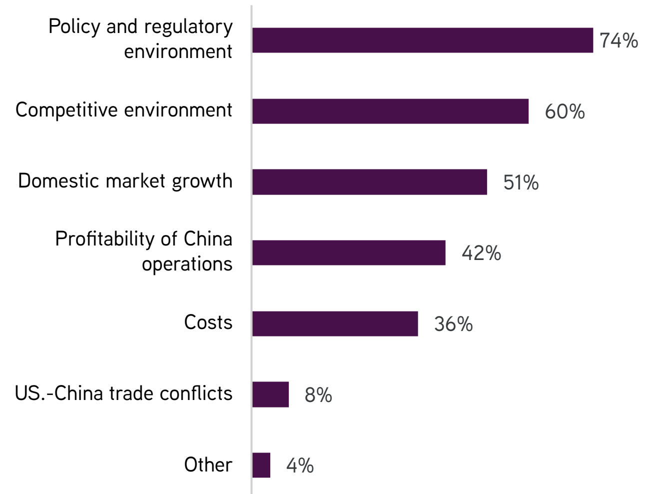


Data as at November 30, 2019. Source: China National Bureau of Statistics, Haver Analytics.

EXHIBIT 26

Longer-Term Policy and Regulatory Concerns Dwarf All Other Concerns, Including Trade

Issues Impacting Five-Year Outlook, U.S.-China Business Council Survey, 2019



Source: 2019 U.S.-China Business Council Survey.

In summary, we think that some of the near-term excitement about a trade deal needs to be tempered. To be sure, the United States and China need each other for economic reasons as it relates to basic goods and services, and as we detail below, the recent improvement in tone regarding trade negotiations does help our 2020 GDP forecast in the U.S. However, as we are seeing play out in Internet Search and 5G, many key offerings for consumers and corporations are becoming national security issues. Longer-term, dual standards and bifurcated supply chains will act as sand in the gears of global growth.

For investors who own businesses in China or invest in China, we think understanding the trend towards insourcing in key areas such as semiconductors, robotics, and artificial intelligence as well as rule of law trends linked to acquisitions, permitting, and approvals will be of paramount importance. Overall, though, our view remains unchanged that global trade as a percentage of GDP peaked in 2008, and as such, we are now dealing with a new global framework when thinking through trends in nominal GDP, supply chains, and profits.

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In fact, our belief is that tech-related issues will now be included only in national security and diplomatic discussions with China.

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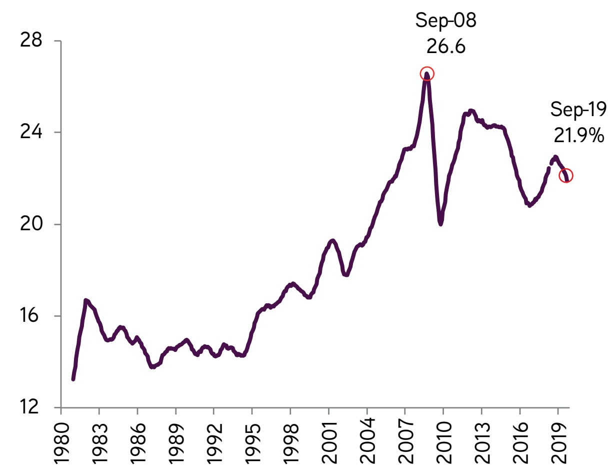
EXHIBIT 27

Trade as a Percentage of Global GDP Peaked Several Years Ago

Global Merchandise Exports as a % of Global GDP



Data as at September 30, 2019. Source: IMFWEO, Haver Analytics.

EXHIBIT 28

Cross-Border Capital Flow Trends, a Traditional Proxy for Globalization, Are Reversing as Protectionism Ramps Upwards

Global Cross Border Bank Lending as a % of GDP

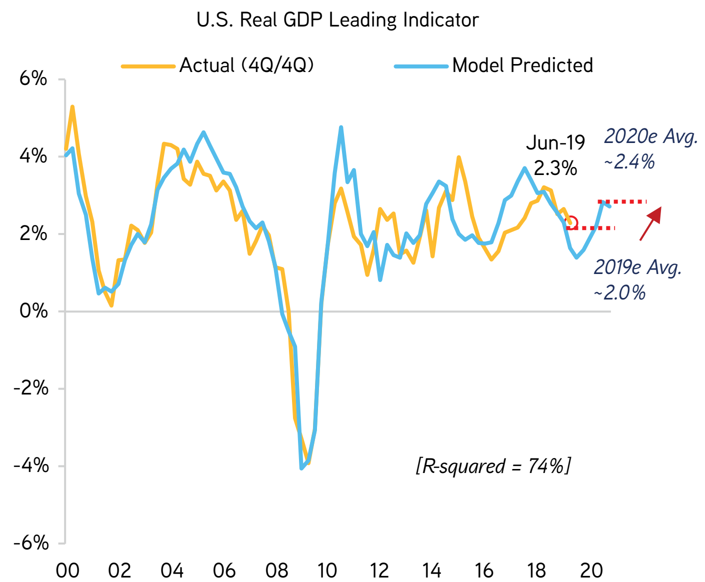
Data as at May 31, 2019. Source: BofA Merrill Lynch, Bloomberg.

U.S. Economic Outlook

We are now using a U.S. GDP forecast of 1.9%, up from 1.3% as of our last official update in October. Our 2020 outlook continues to represent a slowing from 2.4% in 2019e. On a bottom-up basis, our forecast assumes investment spending growth falls below one percent, the slowest level so far this cycle. One can see this in *Exhibit 32*. We do, however, think consumption spending remains relatively resilient at around 2.3%, down only slightly from 2.6% in 2019e. Moreover, we believe overall GDP trends begin to accelerate sequentially starting in the second half of 2020.

EXHIBIT 29

Our Quantitative GDP Indicator Continues to Point to an Upturn in 2H20...



Our GDP leading indicator is a combination of eight macro inputs that in combination we think have significant explanatory power regarding the U.S. growth outlook. Data as at December 31, 2019. Source: Federal Reserve, Bureau of Labor Statistics, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro & Asset Allocation analysis.

In terms of our specific assumptions regarding the trade war, the Phase I deal announced in December was broadly in line with our long-held assumptions. One can see this in *Exhibit 30*, which now assumes a 30 basis point *direct* drag from tariffs, which is down just 10 basis points from our prior estimate of 40 basis points. Where we do get a bit more optimistic relative to our prior expectations is that the basic rules of the road for trade are becoming clearer, which should help reduce *indirect* trade-related uncertainty and potential abrupt tightening of financial conditions. As a result, we now forecast just a 20 basis point drag from trade uncertainty and related tightening financial conditions in 2020, compared to 75 basis points in our last forecast update in October 2019. One can see this in *Exhibit 31*.

However, even with this improvement in indirect trade-related issues, our fixed investment forecast remains extremely weak again in 2020 (*Exhibit 32*). To date, many of the CEOs with whom we speak feel better about issues related to trade, but they still are not ready to spend aggressively on major capital expenditures until after the election in November 2020.

EXHIBIT 30

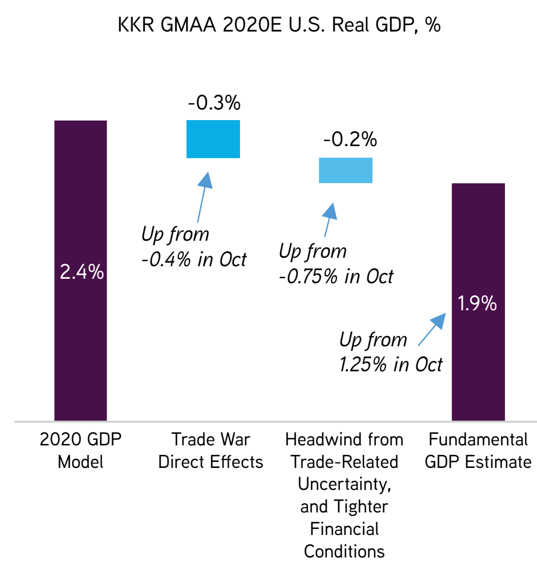
We Have Updated Our 2020 GDP Forecast to Reflect a Smaller Direct Impact on Growth from Tariffs

	2020E U.S. GDP IMPACT		
	PRIOR ASSUMPTIONS (SEP'19)	CURRENT ASSUMPTIONS (DEC'19)	COMMENT
List 1-2 Tariffs ($50bn @ 25%)	-0.02%	-0.02%	*Previously assumed 30% tariff rate*
List 3 Tariffs ($200 billion @ 25%)	-0.19%	-0.16%	*Previously assumed 30% tariff rate*
List 4A Tariffs ($112 billion @ 7.5%)	-0.12%	-0.06%	*Previously assumed 15% tariff rate*
List 4B Tariffs ($160 billion *Threatened* @ 15%)	0.00%	0.00%	*Continue to assume these are not implemented*
Autos: Tariffs on selected high-tech vehicle components	-0.05%	-0.05%	*Assumes autos & Europe become a focus of tariff threats in 2020*
Total	**-0.4%**	**-0.3%**	

e = KKR GMAA estimates. Data as at December 13, 2019. Source: USTR, Bureau of Economic Analysis, Census Bureau, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 31

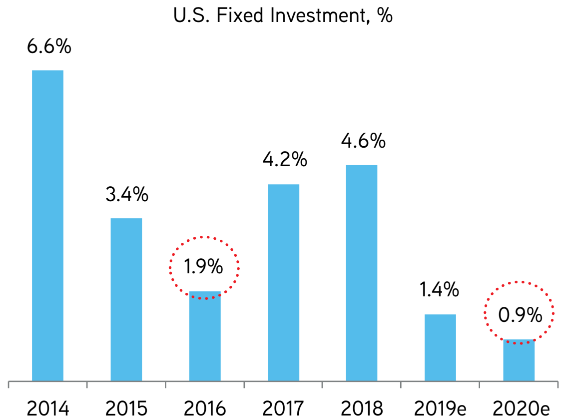
A More Constructive Tone on Trade Also Helps to Reduce the Indirect Impacts from Trade on Our GDP Forecast



e = KKR GMAA estimates. Data as at December 13, 2019. Source: USTR, Bureau of Economic Analysis, Census Bureau, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 32

2019 Was a Weak Year for Investment Spending. We Expect More of the Same in 2020

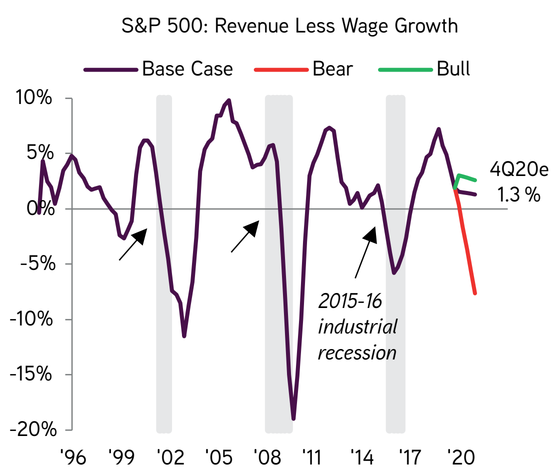


Data as at December 13, 2019. Source: Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

From a job growth perspective, we expect monthly non-farm payrolls to average around 130,000 in 2020, down from closer to 180,000 in 2019. Implicit in what we are forecasting is our strong belief that healthcare, education, leisure/hospitality and professional services jobs, which now account for around 70% of total job growth, maintain some momentum in 2020. On the other hand, we do not see Manufacturing or Retail rebounding as part of the cyclical upswing we are forecasting.

EXHIBIT 33

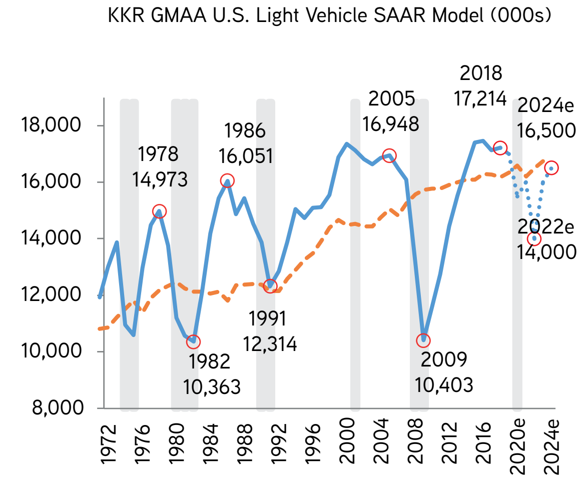
We Believe That Slowing Growth Amidst Higher Wages Will Become a Headwind to Margins in 2019



Data as at December 31, 2019. Source: Bloomberg.

EXHIBIT 34

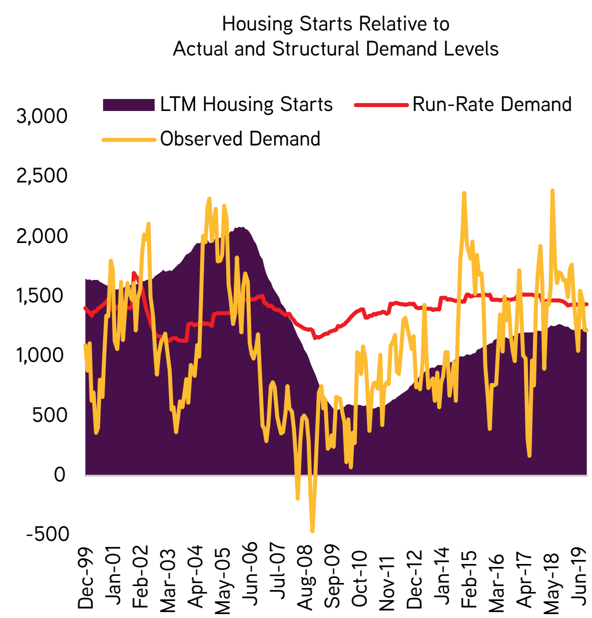
Cyclical Areas of the Economy Such as Autos Are Indicating We Are Late Cycle



Data as at December 13, 2019. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 35

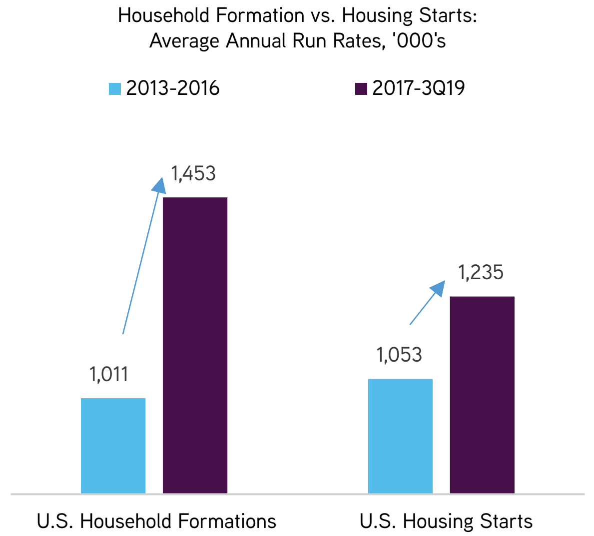
U.S. Housing Starts Are Still Below True Structural Demand...



Data as at September 30, 2019. Source: Bureau of Economic Analysis, Haver Analytics.

EXHIBIT 36

...At a Time When Quarterly Household Formations Remain Robust

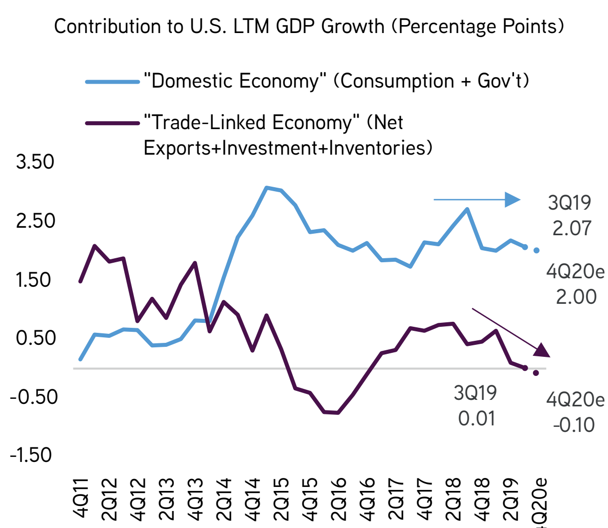


Data as at September 30, 2019. Source: Census Bureau, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Looking at the big picture, the world we are describing looks a lot like a two-tiered economy that never reaches maximum potential nor faces a major sustained slowdown. It also implies decent growth in consumption and services-related activity, but we do not see much improvement in fixed investment and exports. One can see this in *Exhibit 37*. Under this construct, the U.S. does not have the nasty recession that some of the bears want to believe will happen. On the other hand, the U.S. economy never snaps back and sustains strong growth the way some of the sell-side bulls are forecasting. If we are right, then the potential is for mini-cycles (e.g., 2011, 2016, 2019) to occur more often versus a "big bang" downturn like 2001 or 2008.

EXHIBIT 37

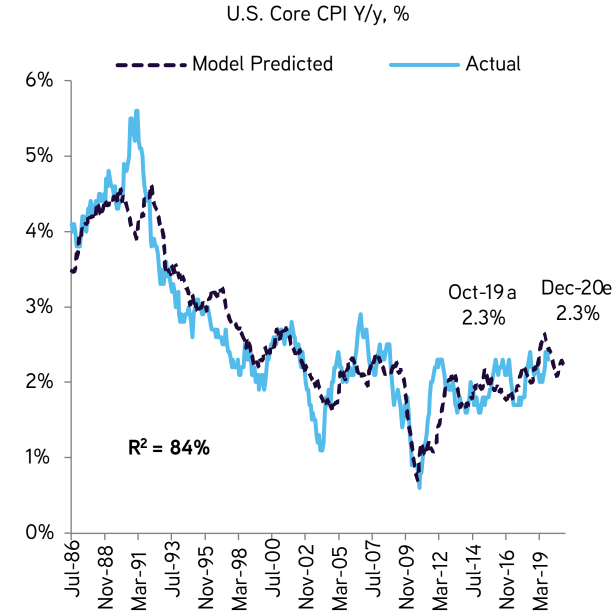
Weakness in the Trade-Linked Economy Is Being Offset by Fiscal Spending and Consumption



Data as at December 13, 2019. Source: BEA, Haver Analytics.

EXHIBIT 38

Our Core CPI Model Continues to Chop Around in the Low Two Percent Range. A Stronger USD Has Been a Drag on the Model, While Continued Low Unemployment Acts As an Uplift



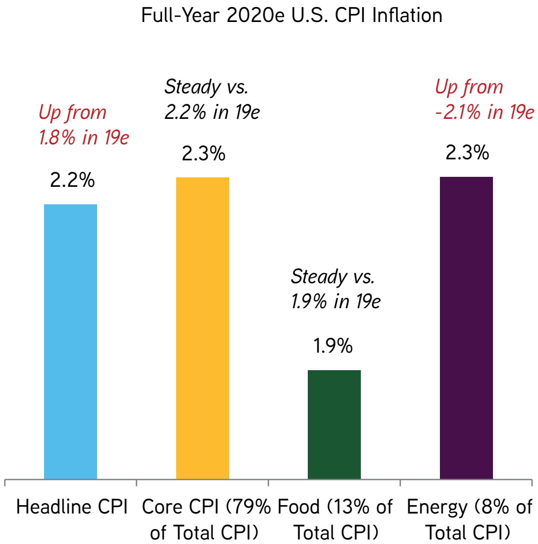
e = Estimated, as per KKR GMAA model. Data as at December 31, 2019. Source: Bureau of Labor Statistics, CBO, Census Bureau, Federal Reserve, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

"So, our primary message is that we expect a mild up-tick in inflation in 2020, including a reacceleration in headline CPI back above two percent. This outcome is what the Federal Reserve wants, and as such, we do not think this implies a more hawkish stance from the Fed."

On the inflation front, we think that investors may be underestimating the recent rebound in the data we are seeing. Indeed, all major measures of U.S. inflation — including wages, core CPI, and core PCE — crept quietly higher in the second quarter of 2019 and are now running near the high end of the range for this cycle. Tariffs may be creating some transitory uplift in inflation, but we think there is also a more fundamental increase due to little available slack in either labor or housing markets.

EXHIBIT 39

Rising Energy Prices in the U.S. Should Promote Higher Headline CPI in 2020



Data as at December 31, 2019. Bloomberg, KKR Global Macro & Asset Allocation analysis.

As we detail in *Exhibit 39*, we forecast headline inflation of 2.2% in 2020, compared to 1.8% in 2019. Looking beneath the surface, we anticipate core CPI to hit 2.3%, up slightly from 2.2% in 2019, and we look for Food, which is 13% of CPI, to again grow 1.9% year-over-year in 2020. Finally, we model out that Energy, which is eight percent of headline CPI, increases notably to 2.3% after being a 2.1% drag on CPI in 2019.

So, our primary message is that we expect a mild up-tick in inflation in 2020, including a reacceleration in headline CPI back above two percent. This outcome is what the Federal Reserve wants, and as such, we do *not* think this implies a more hawkish stance from the Fed. In fact, as we explain in more detail in our Interest Rates section below (see Section III), we actually see scope for the Fed to cut one more time in 2020, which we envision as a response to a potential transient tightening of financial conditions at some point this year, amid frustratingly slow GDP growth and well-controlled inflation.

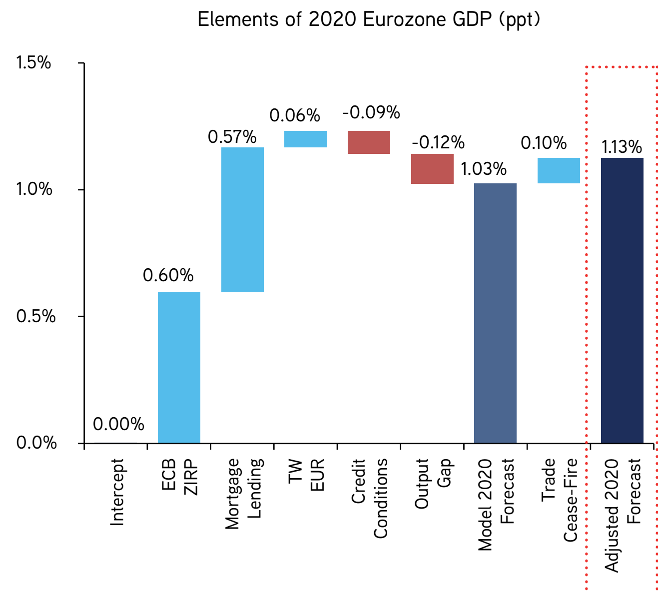
European Economic Outlook

Turning to Europe, my colleague Aidan Corcoran looks for Eurozone GDP to remain stuck in low gear in 2020, with our model pointing to a mere 1.1% growth for the year *(Exhibit 40)*. Key to Aidan's thinking is that credit is still not flowing freely, and the output gap is also failing to support growth. On the positive side, ECB Zero Interest Rate Policy (ZIRP) remains a material support, as does the housing market.

We expect a similarly tepid outcome on the inflation side, with our model pointing to a weak print of just 1.3% in 2020 *(Exhibit 41)*, despite a meaningful contribution from disposable income growth. The flipside of weak inflation is that, in real terms, consumers will feel more spending power – a fact that is underscored by the divergence between wage growth and inflation *(Exhibit 42)*. This gap is at a twenty-year high, supporting the European consumer just when support is most needed; it should also help to offset the pervasive weakness we see in the industrial sector.

EXHIBIT 40

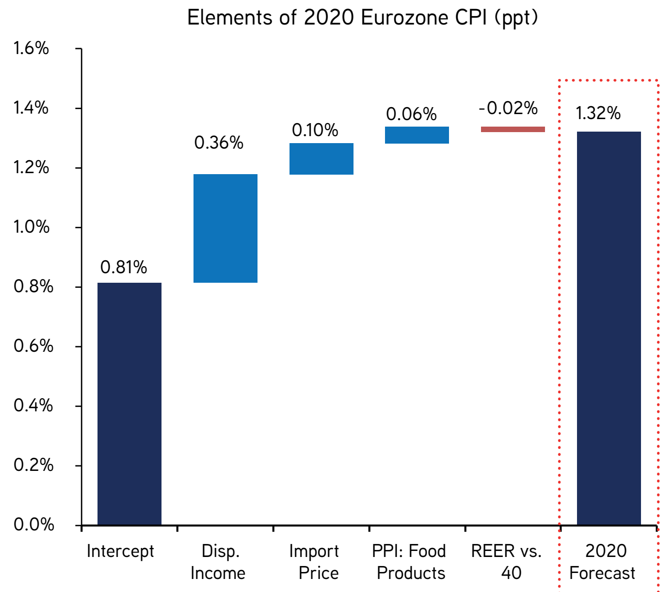
Our Model Points to Continued Tepid GDP Growth in 2020, Despite Some Easing of Trade Tensions



Note: We have taken TW EUR vs. 40 as the TW EUR in the regression. Intercept is the sum of the intercept and the lagged dependent variable terms. Trade cease-fire is assumed to be a 10bps positive impact on the Eurozone GDP as a result of the trade war easing. Data as at December 15, 2019. Source: Bloomberg, Eurostat, European Central Bank, European Commission, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 41

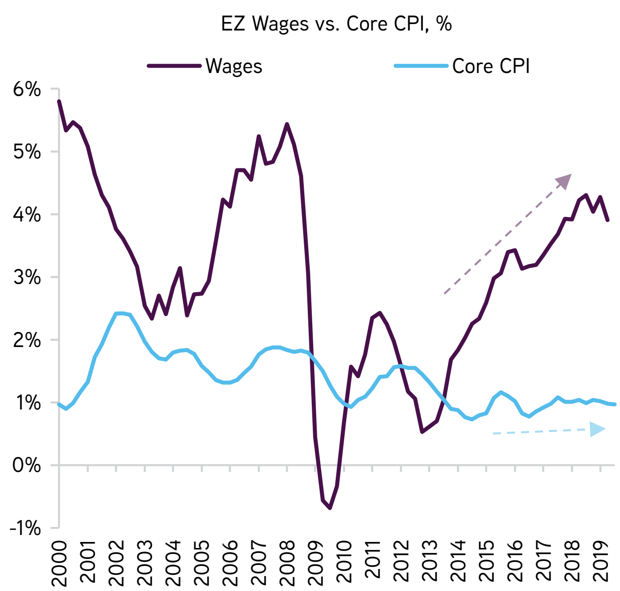
We Believe Eurozone CPI Will Continue to Fall Well Short of the ECB's Target of Close to Two Percent, Despite Support from Disposable Income Growth



Note: Intercept is the sum of the intercept and the lagged dependent variable terms; 40 is our base reference level for the REER. Data as at December 15, 2019. Source: Bloomberg, Eurostat, European Central Bank, European Commission, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 42

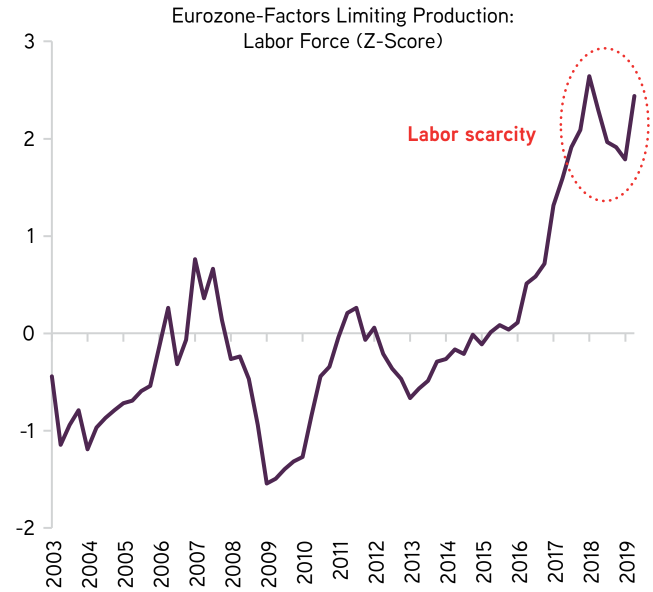
Wage Growth Is Running Well in Excess of Core Inflation, Supporting Disposable Income



Data as at November 30, 2019. Source: Eurostat.

EXHIBIT 43

The Number of CEOs Citing a Tight Labor Market as a Limit to Production Is Around All-Time Highs



Data as at November 30, 2019. Source: Eurostat.

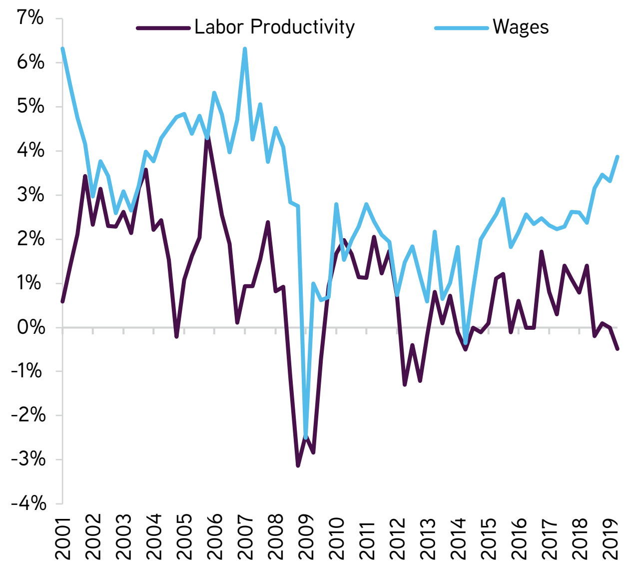
Stepping back from the disappointing headline GDP number we expect in 2020, we believe this backdrop could actually be a somewhat compelling environment for thoughtful investors. Indeed, consumers are benefitting from high real wage growth at a time when sub-trend GDP growth decreases the likelihood of a sharp downturn in GDP. Meanwhile, anxiety about the European economy is keeping some global investors on the sidelines. This mismatch in expectations versus reality is opening up, we believe, some really interesting investment opportunities in the following areas: secular growers (e.g., software and innovation companies), carve-outs with operational upside, and complex cross-border stories.

To be sure, there remain some significant risks for investors to navigate. Brexit is set to enter the difficult stage of negotiating future trade arrangements, and the U.K.'s economy is poised to flirt with recessionary conditions in some sectors, we believe. Importantly, the United Kingdom is not alone. Politics across the continent has become more polarized and divisive, and the European industrial sector continues to face meaningful trade uncertainty. In particular, German exports will likely never succeed in decoupling from the overall trade backdrop – the links are just too deep *(Exhibit 46)*. Finally, we expect more heated debate on climate change in Europe. Indeed, at the EU level, the agenda is increasingly being cast through the lens of climate change action, with proposals for the EU Green Deal to span from energy to fiscal and monetary policies.

EXHIBIT 44

Rising Wages in the UK Are Not Sustainable, Unless Productivity Growth Corrects Upwards

U.K. Wages vs. Productivity, Y/y, %

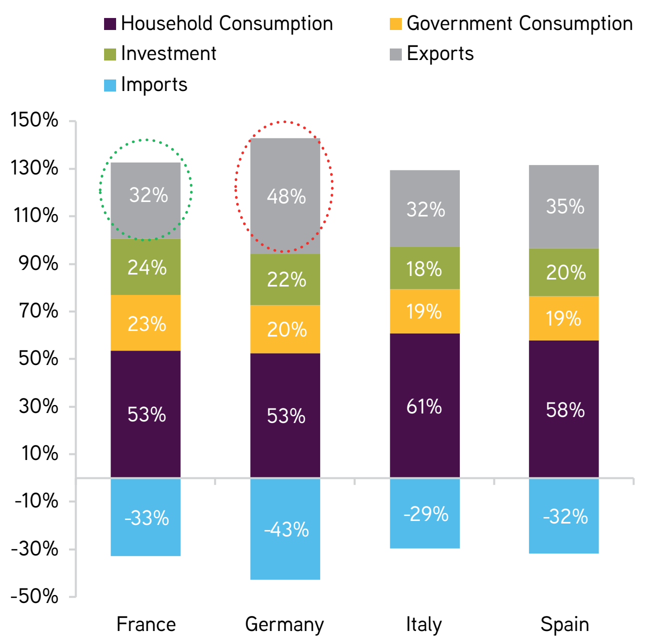


Data as at October 31, 2019. Source: Office of National Statistics, Haver Analytics.

EXHIBIT 45

Lower Dependence on Trade Than Germany Is Insulating France from Global Headwinds

Share of Real GDP, % of Total

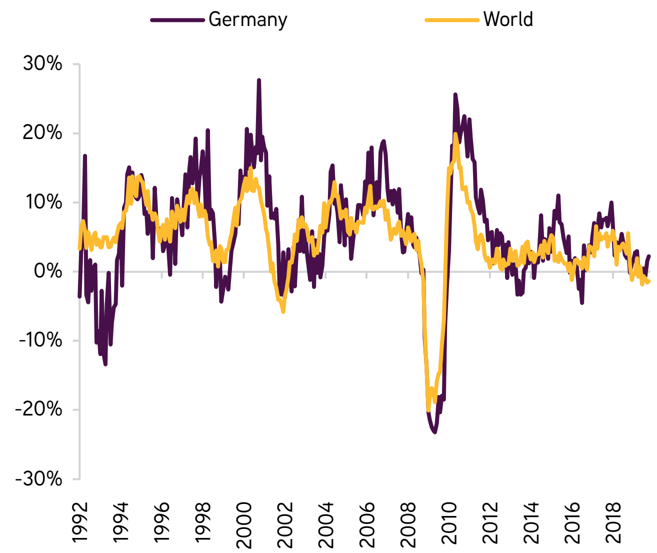


Data as at September 30, 2019. Source: Eurostat.

EXHIBIT 46

German Exports Growth Remains Highly Dependent on the Overall World Trade Backdrop

Germany vs. World Exports, Y/y, %

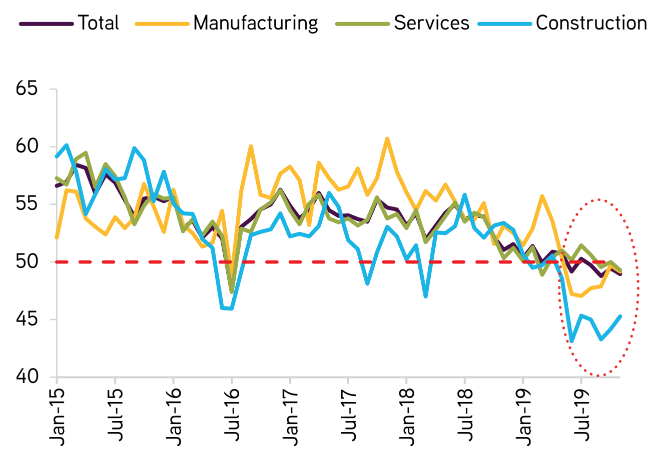


Data as at October 31, 2019. Source: Deutsche Bundesbank, Netherlands Bureau for Economic Policy Analysis.

EXHIBIT 47

The UK Economy Has Slowed Dramatically Across All Key Sectors

U.K. Purchasing Managers Survey (50+=Expansion)



Data as at November 30, 2019. Source: IHS Markit.

"

This mismatch in expectations versus reality is opening up, we believe, some really interesting investment opportunities.

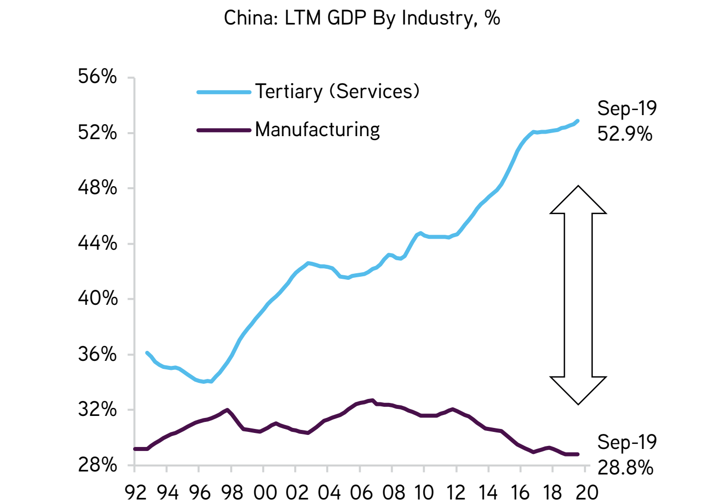
"

China Economic Outlook

My colleague Frances Lim expects China growth to stabilize in 2020, as the biggest negative thrust from the trade tariffs pass. At the same time, she also expects the positive influences of both monetary and fiscal stimulus to fully take effect. That's the good news. The bad news is that the secular trend of slowing growth will continue as the economy continues to mature, and as a result, we expect 2020 real GDP growth of 5.8% with an average inflation rate of 3.3% year-over-year.

EXHIBIT 48

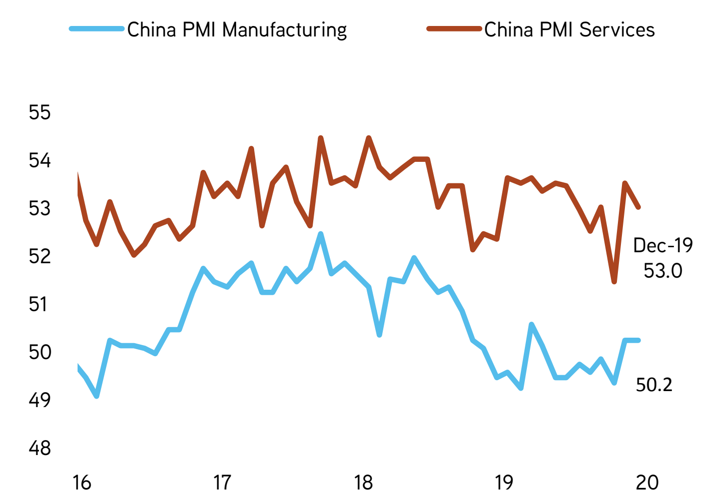
While China Is Still the World's Manufacturing Powerhouse, It Is Actually a Services Economy…



Data as at 3Q19. Source: China National Bureau of Statistics, Haver Analytics.

EXHIBIT 49

…and China's PMIs Remains Well Above 50

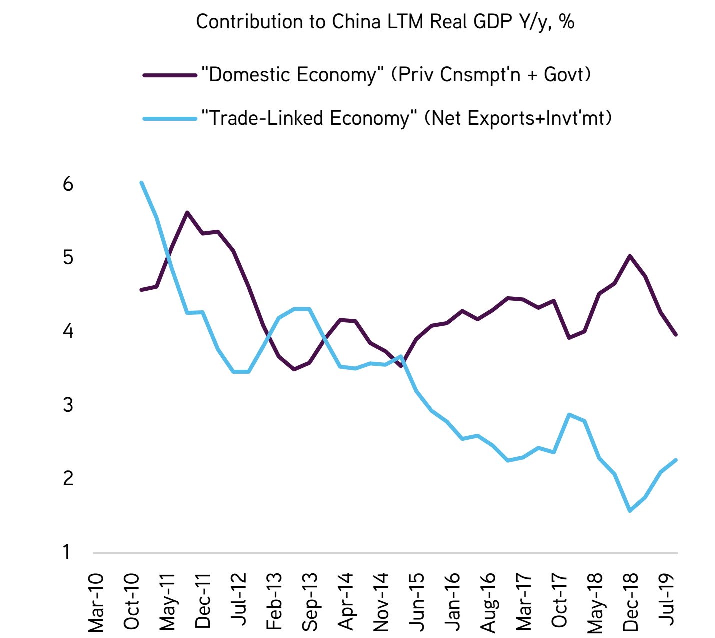


Data as at December 31, 2019. Source: China National Bureau of Statistics, Haver Analytics.

Embedded in our GDP forecast of 5.8% are the following assumptions. First, while sentiment will continue to ebb and flow with U.S.-China tensions, we do believe that we have passed the height of direct year-over-year GDP implications from the U.S.-China trade war on the local economy. Second, we do not see a major one-time stimulus in 2020. One can see this in *Exhibit 51*. Rather, we continue to see a series of small measures to keep GDP in a tight range, including more cuts in the Reserve Ratio Requirement (RRR). The reality, as Frances often points out to me, is that China is now largely a services-based economy — and the services sector in China is still running at nominal growth of nine percent year-over-year. So, given the secular growth we see in the services segment of the economy, we do not expect a large, one-time stimulus package in 2020.

EXHIBIT 50

Similar to the United States, China Now Runs a More Bifurcated Economy

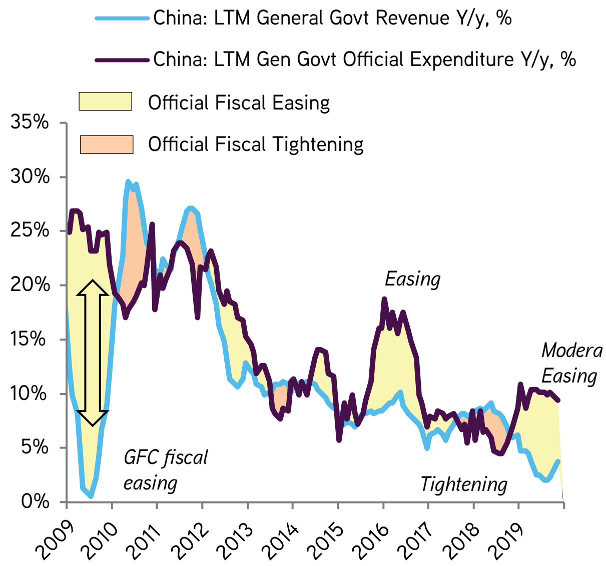


Data as at September 30, 2019. Source: China National Bureau of Statistics, Haver Analytics.

"While sentiment will continue to ebb and flow with U.S.-China tensions, we do believe that we have passed the height of direct year-over-year GDP implications from the U.S.-China trade war on the local economy."

EXHIBIT 51

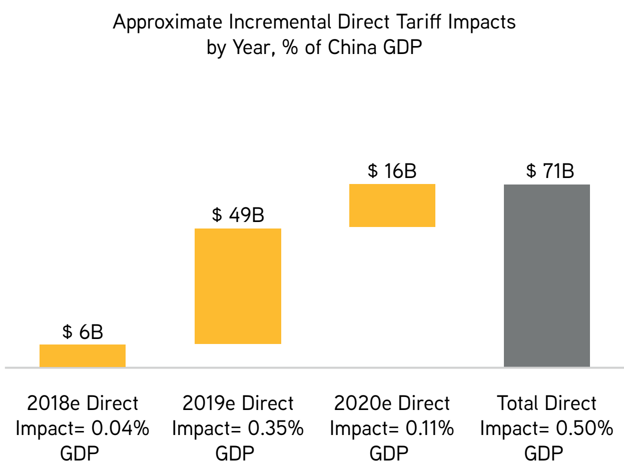
Our Base Case for 2020 Real GDP Is 5.8%. Consistent With This View, We Continue to See a Series of Small Stimulus Measures to Keep GDP on Track Versus a One-Time Surge in Government-Backed Support



Data as at November 30, 2019. Source: China National Bureau of Statistics, Haver Analytics.

EXHIBIT 52

The Good News Is That the Phase I Deal Should Take Some Pressure Off the Direct Impact on 2020 Growth in China

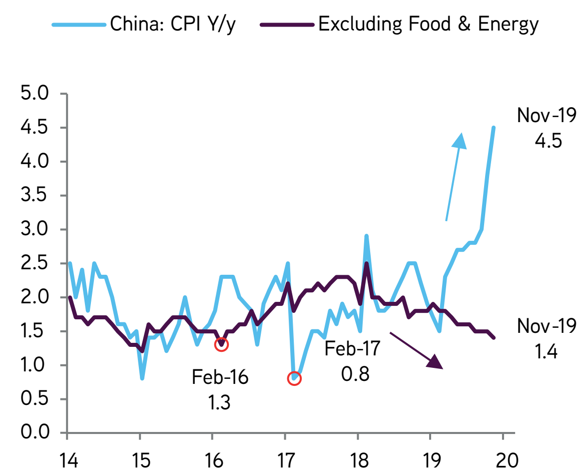


Phase I tariffs not implemented include the tariff increase from 25% to 30% on $250B of exports, the tariff of 15% instead of 7.5% on $112B of exports, and the $15% tariff on the remaining $165B of exports. *Assuming China Nominal GDP of US$14.2 trillion in 2019. Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation estimates.

On the inflation front, Frances suggests that headline CPI will likely remain elevated, particularly in the first half of 2020; at the same time, she believes core inflation will remain lackluster throughout the year. What is driving the differential in the two measures of inflation (i.e., what makes headline go up so much more than core)? The impact of pork prices on headline inflation. Indeed, over the past year, China's hog population has fallen by 185 million or 43% due to the African swine fever virus, which has led to a 136% increase in pork prices – a key driver of headline consumer inflation. Maybe more importantly, there is currently no vaccine for the virus, and because it is estimated to take at least 20 months to replace stock, supply will likely not normalize until late 2021. As a result, we now think headline inflation will average 3.3% in 2020, while core inflation, which is being held down by excess capacity and increased competition, will remain at just 1.5% year-over-year.

EXHIBIT 53

We Expect the Divergence of Headline and Core Inflation to Continue Into 2020...

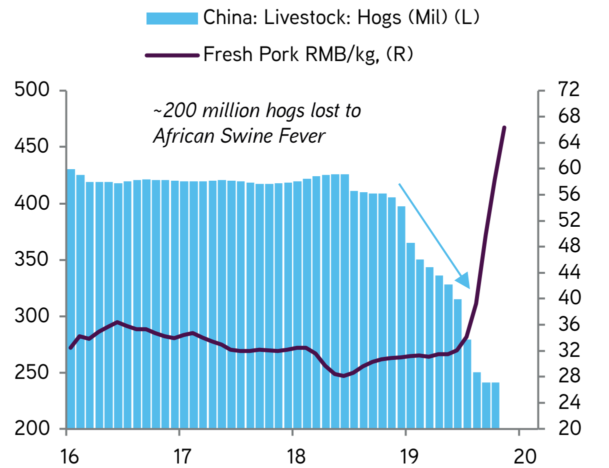


Data as at November 30, 2019, Source: China National Bureau of Statistics, Haver Analytics.

> **"For investors who own businesses in China or invest in China, we think understanding the trend towards insourcing in key areas such as semiconductors, robotics, and AI as well as rule of law trends linked to acquisitions, permitting, and approvals will be of paramount importance."**

EXHIBIT 54

...Driven by Record Low Hog Supply and Elevated Pork Prices



Data as at November 30, 2019, Source: China Ministry of Agriculture, China Price Monitoring Center, NDRC, Haver Analytics.

Finally, we believe that – on a tactical basis – the currency will fluctuate around seven for 2020. More strategically, though, we think that it will continue to serve as the relief valve for any escalation in the U.S.-China trade war. Importantly, though, the China export story – and its long-term currency positioning – is actually much broader than just the relationship with the United States. Indeed, as we show in *Exhibit 55*, China's export machine is still gaining share in the global export market, despite losing share in the United States. Key areas of increase, according to Frances' work, are both Europe and Asia.

EXHIBIT 55

The Trade War Has Not Derailed China's Export Story

Data as at October 31, 2019. Source: China National Bureau of Statistics, Haver Analytics.

Mexico Economic Outlook

My colleague Brian Leung expects a modest growth recovery in Mexico during 2020, driven by less-restrictive monetary policy, stronger real wage gains, and easier base effects. The recently announced National Infrastructure Plan (PNI) – financed by private capital totaling $43 billion across 147 projects – is a step in the right direction, as it shows that Andrés Manuel López Obrador (AMLO) is willing to lean on private investment to help reignite growth.

However, the bigger picture story in Mexico is that the country remains dogged by the ongoing decline in investment, elevated policy uncertainty, and tight financial conditions. We also worry about the risk of fiscal slippage, especially if tax revenue disappoints and Pemex requires larger-than-expected financial assistance to turn around its crude production. As such, we expect 2020 real GDP growth of just 0.9%, which is up from approximately 0.1% in 2019, but below consensus expectations of 1.1%.

On the inflation front, we expect headline inflation to average 3.5% this year, which is above consensus expectations of 3.4%, but down from 3.7% in 2019. While headline inflation has decreased significantly, Mexico's core inflation has remained uncomfortably sticky at 3.6% – due in part to higher unit labor costs. This increase makes sense, as our data suggests that wage growth has been outpacing productivity growth (note that the minimum wage increases by another 20% this year). Even so, both headline and core inflation are now broadly well-anchored, in our view, which should allow the central bank to gradually ease policy.

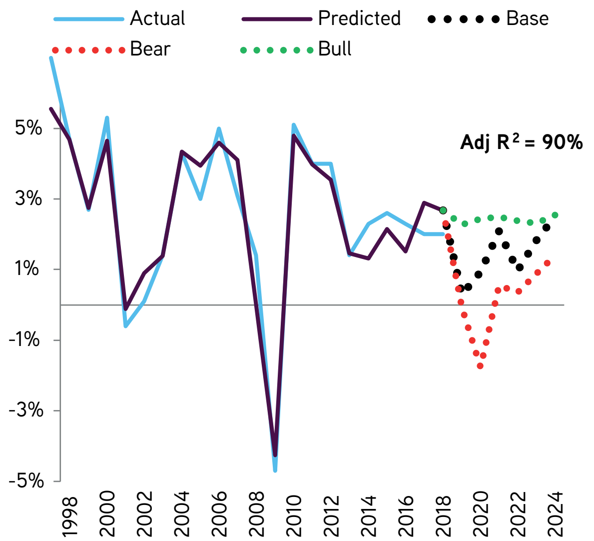
In terms of specifics on the Mexican central bank, our base case calls for another 75 basis points of rate cuts in 2020, bringing the policy rate down to 6.5% from 7.25% today (remember Banxico estimates the "neutral" rate is 4.8%-6.4%, so we still have some wiggle room). However, we do not expect a "big bang" when it comes to rate cuts, as the size and speed of the easing cycle will ultimately be dictated by the interplay between a persistently negative output gap on the one hand and concerns about financial stability, peso depreciation and stubborn core inflation on the other.

"However, the bigger picture story in Mexico is that the country remains dogged by the ongoing decline in investment, elevated policy uncertainty, and tight financial conditions."

EXHIBIT 56

We Expect Mexico Real GDP to Grow Approximately 0.9% in 2020, Which Is Below the Trailing Five-Year Average of 1.8% and Below the Consensus of 1.1%

Mexico Real GDP Growth, Y/y % Change

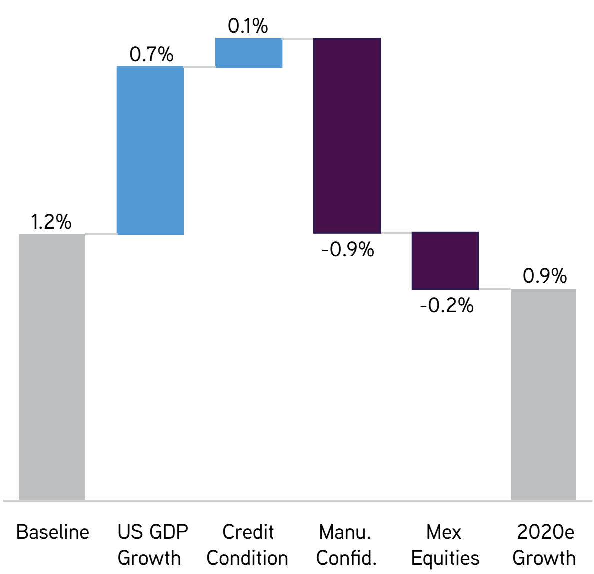


Data as at December 3, 2019. Source: Banxico, INEGI, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 57

Tailwinds from U.S. GDP Help, but Weak Business Investment and Industrial Production Are Notable Drags on Our Mexican GDP Model

Components of Mexico Real GDP Growth Model

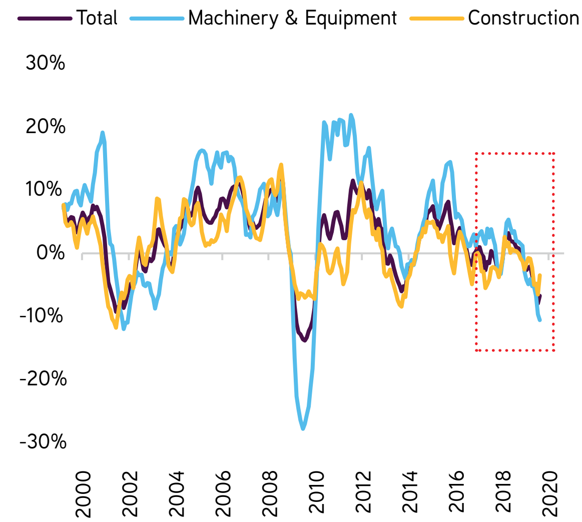


Data as at December 3, 2019. Source: Banxico, INEGI, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 58

Investment Has Been the Major Laggard in Recent Years... but It Has Really Collapsed Over the Past 12 Months

Mexico Gross Capital Formation, 3-Month Moving Average, Y/y % Change)

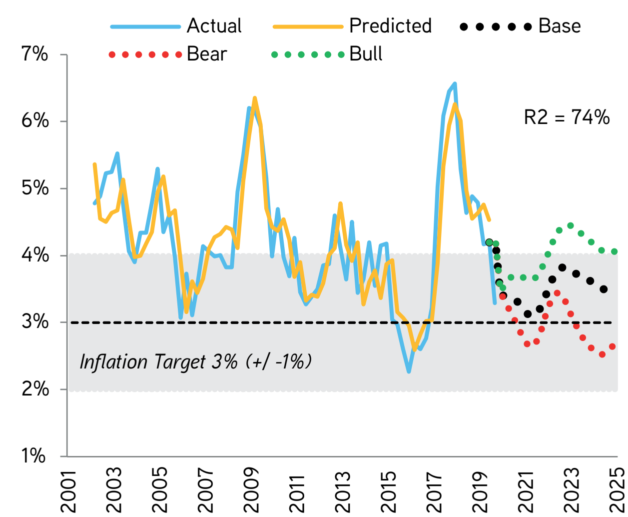


Data as at December 3, 2019. Source: Banxico, INEGI, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 59

We Expect Headline Inflation to Average 3.5% in 2020e, Just Above Consensus Expectations of 3.4% but Down from 3.7% in 2019

Mexico Headline CPI, Y/y % Change

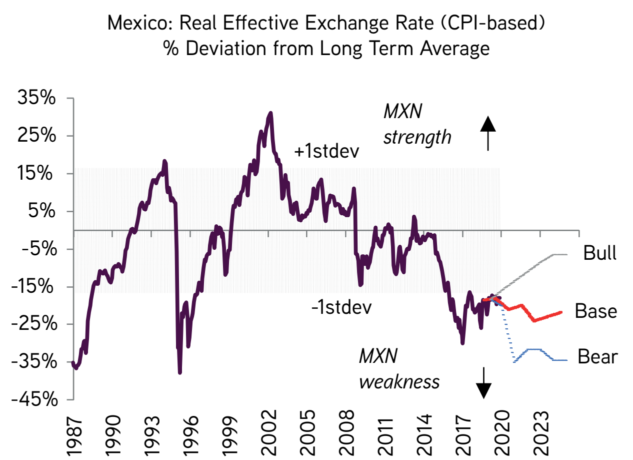


Note: 2020-2025 are estimates. Data as at December 3, 2019. Source: Banxico, INEGI, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

On the currency front, we expect the Mexican peso to depreciate by approximately 2.7% per annum over the next five years, which is better than the 4.7% implied by forward curves. Key to our thinking is that Mexico has the highest real rate (4.3%) among major EM countries and the currency still looks undervalued in real effective exchange rate terms. That said, we maintain a bearish bias over the medium term owing to Mexico's weaker growth prospects, long-term productivity slowdown, deteriorating governance and insecurity, credit downgrade risks, and the expectation that the high carry today will be gradually eroded as the central bank eases policy.

EXHIBIT 60

The Mexican Peso Is Already Trading One Standard Deviation Below Its Long-Term Average in Real Effective Exchange Rate Terms



Note: 2020-2023 are estimates. Data as at November 30, 2019. Source: Bloomberg, Haver Analytics, Banxico, INEGI, KKR Global Macro & Asset Allocation analysis.

Our bottom line: We expect Mexico to muddle through and growth to again remain below potential. However, given where real rates are, we see several interest rate cuts ahead in 2020. This backdrop fuels our asset allocation desire to own local securities with outsized yield.

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Specifically, we now just look for one cut in 2020 on the heels of our U.S. GDP upgrade to 1.9% this year, compared to our 'old' forecast of 1.3%. Previously, we had been forecasting two further Fed cuts, with fed funds ending the year at 1.125% (i.e., down 125 basis points from peak).

"

We also expect assets in the Real Estate and Infrastructure arenas to perform well in the Mexican public markets; as such, we would suggest increasing one's target allocations, particularly at these seemingly depressed levels. On the other hand, we remain more cautious on capital expenditures as well as overall growth stories, given the complicated political backdrop the country still faces.

Section III: Key Macro Inputs

Interest Rates

As we thought more about the economic backdrop we are describing in the U.S. for 2020, we decided to trim our Fed easing call. Specifically, we now just look for one cut in 2020 on the heels of our U.S. GDP upgrade to 1.9% this year, compared to our "old" forecast of 1.3%. Previously, we had been forecasting two further Fed cuts, with fed funds ending the year at 1.125% (i.e., down 125 basis points from peak). As the investment community is aware, the Federal Open Market Committee (FOMC) held rates unchanged in December 2019, and it continued to suggest via its 'dots plot' that rates could remain on hold throughout 2020. We are a little more conservative than the Fed because 1) our view on capex growth is likely more pessimistic, especially outside of spending on technology; 2) we believe that the "trade war" will remain part of American foreign policy for years to come, which will likely restrain overall fixed investment spending more than expected; and 3) we remain concerned about slowing nominal GDP in places like China and India. Also, as we show below in *Exhibit 61*, the Fed often continues cutting – for insurance reasons – even when the market thinks the central bank is done.

EXHIBIT 61

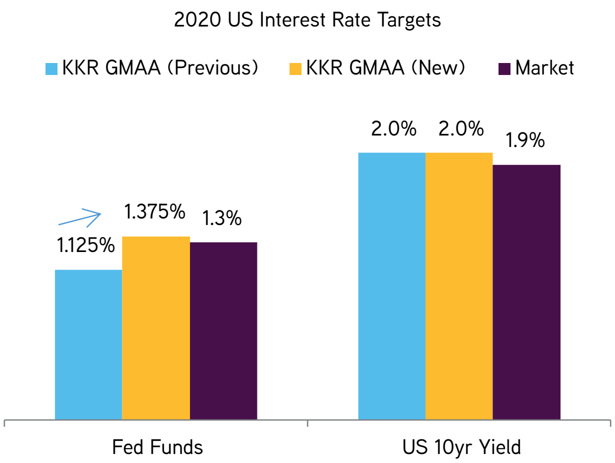
The Fed Often Continues Cutting Even After the Market Thinks It Is Finished

	2YR YIELD - FED FUNDS TARGET (BASIS PTS)	12MO FWD CHANGE IN FED FUNDS TARGET (BASIS PTS)	MONTHS UNTIL OFFICIAL ONSET OF NEXT RECESSION
Jan-90	3	-150	7
Feb-96	19	0	N/A
Feb-99	38	100	N/A
May-01	22	-225	0
Apr-08	29	-187.5	0
Dec-19	**1**	**???**	**???**

Data as at December 11, 2019. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 62

We Move to Just One Fed Cut Expected in 2020; Meanwhile, Our 10-Year Yield Target Remains 2.0%



Data as at December 11, 2019. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

On the other end of the spectrum (i.e., the risk the Fed raises rates), we want to flag that Chairman Powell endorsed the idea that the FOMC is unlikely to raise rates until inflation is running reliably above two percent. This directive from Powell is a big deal because we have not seen inflation run above the Fed's target this whole cycle. He also lowered the natural rate of employment, which suggests that he and his central bank colleagues believe that we can add more jobs without inflation picking up.

In terms of 10-year yields, we now expect they could trade around two percent in 2020. This view is consistent with what we have been signaling to both internal and external constituents. One can see this in *Exhibit 66*. *Therefore, our call continues to be that rates will stay lower for longer, and as a result, reinvestment risk will ensure that more money migrates into Alternative products that can deliver on the value of their illiquidity premium.* That said, we do think that there is some small scope for the term premium to turn less negative in 2020. As we show in *Exhibit 64*, our forecast is that the term premium ends the year at minus 75 basis points, up from minus 114 basis points in August of 2019.

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Our call continues to be that rates will stay lower for longer, and as a result, reinvestment risk will ensure that more money migrates into Alternative products that can deliver on the value of their illiquidity premium.

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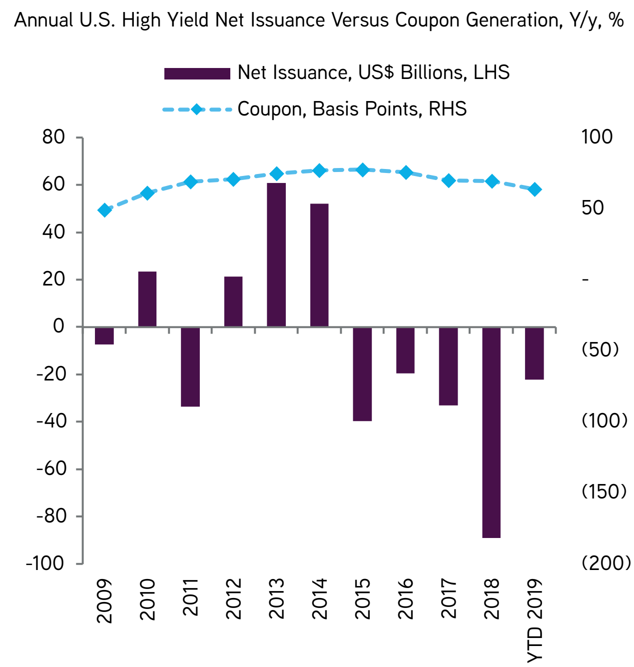
EXHIBIT 63

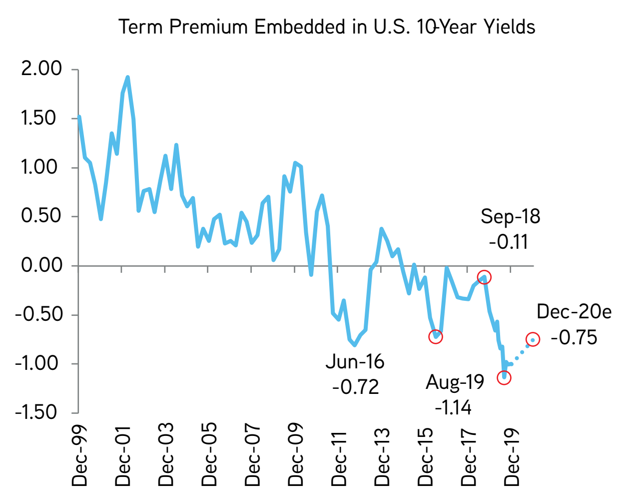
As U.S. High Yield Matures, Coupons Are Trending Downward Along with Supply at Maturity



Net issuance is the sum of Calls/Tenders, Maturities, Defaults, Rising Stars, New Issues, Fallen Angels. Data as at November 30, 2019. Source: KKR Credit, LPSA.

EXHIBIT 64

We See Scope for Some Term Premium Recovery

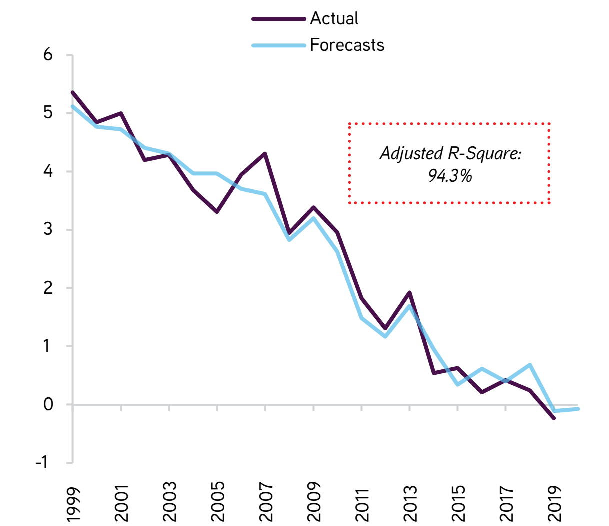


Historic data based on Kim and Wright model published by U.S. Federal Reserve. Current data as at December 31, 2019. Source: Bloomberg.

In Europe, we expect the ten-year bund yield to remain range-bound between zero at the high end and minus 50 basis points at the low end. Interestingly, our quantitative model, which is at the high end of this range, is forecasting minus 11 basis points. However, we believe the bund will likely finish 2020 closer to the mid-point of this range.

EXHIBIT 65

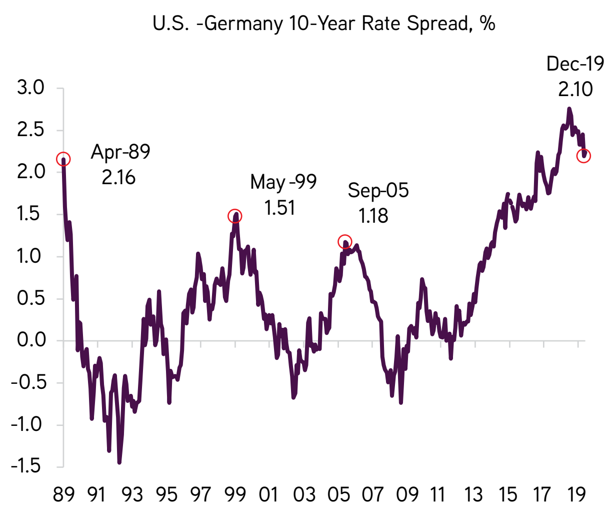
We Expect the Yield on the German Bund to Remain Range Bound Around Zero in 2020



Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis, Bloomberg.

EXHIBIT 66

We Expect U.S. Yields to Remain Linked to German Bunds



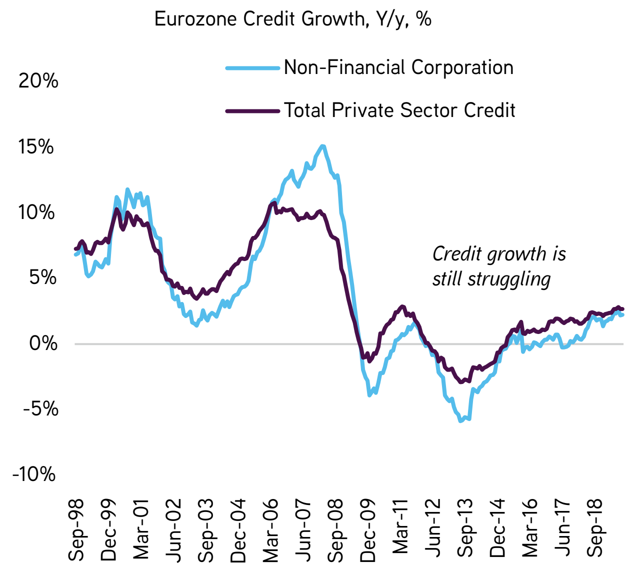
Data as at December 31, 2019. Source: Bloomberg.

There are two inputs that drive our thinking. The first is that Eurozone credit growth today remains disappointing, despite years of extreme policy accommodation from the ECB. Indeed, we have approached the point where reasonable people can debate if we have passed the ECB's "reversal rate." This level is the rate beyond which further rate cuts actually tighten monetary conditions – whether by impeding the banking system, by harming savers, or by general confidence effects. We fully acknowledge that we cannot pinpoint the "reversal rate" with a high degree of accuracy, but in our view, the ECB is right on the cusp. Against this backdrop, policy effectiveness is now being called into question, and as a result, we think it is highly unlikely there will be quick recovery for inflation, the economy, or the bund yield.

The second observation is simply that deleveraging is a long, painful process. In the Eurozone, the public sector is still deleveraging (rightly or wrongly), while the non-financial corporate sector is treading water (*Exhibit 68*). True, households have mostly finished deleveraging, but the aggregate picture remains one of a highly indebted economy. Nominal GDP growth, the traditional cure for excessive leverage, is of limited help in such a cycle. With significant deleveraging still taking place, we believe the bund will likely stay pinned close to where it is for a sustained period.

EXHIBIT 67

Eurozone Credit Growth Remains Disappointing, in Spite of Extremely Low Rates

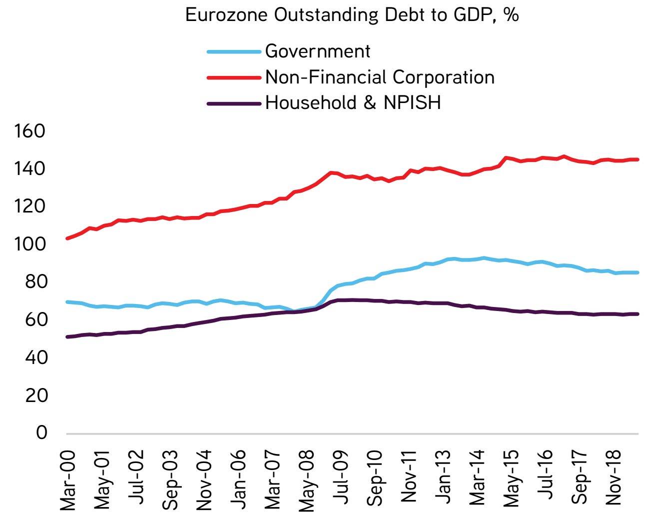


Data as at November 30, 2019. Source: ECB, Haver Analytics.

"The second observation is simply that deleveraging is a long, painful process. In the Eurozone, the public sector is still deleveraging (rightly or wrongly), while the non-financial corporate sector is treading water."

EXHIBIT 68

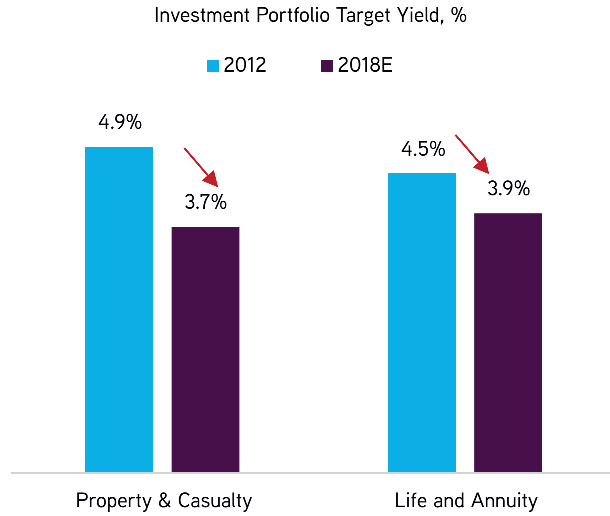
In the Face of Structurally Slowing Growth, Europe Has Also Chosen to Deleverage



Data as at September 30, 2019. Source: Statistical Office of the European Communities, Haver Analytics.

EXHIBIT 69

Portfolio Yields Across the Insurance Industry Have Fallen in Recent Years



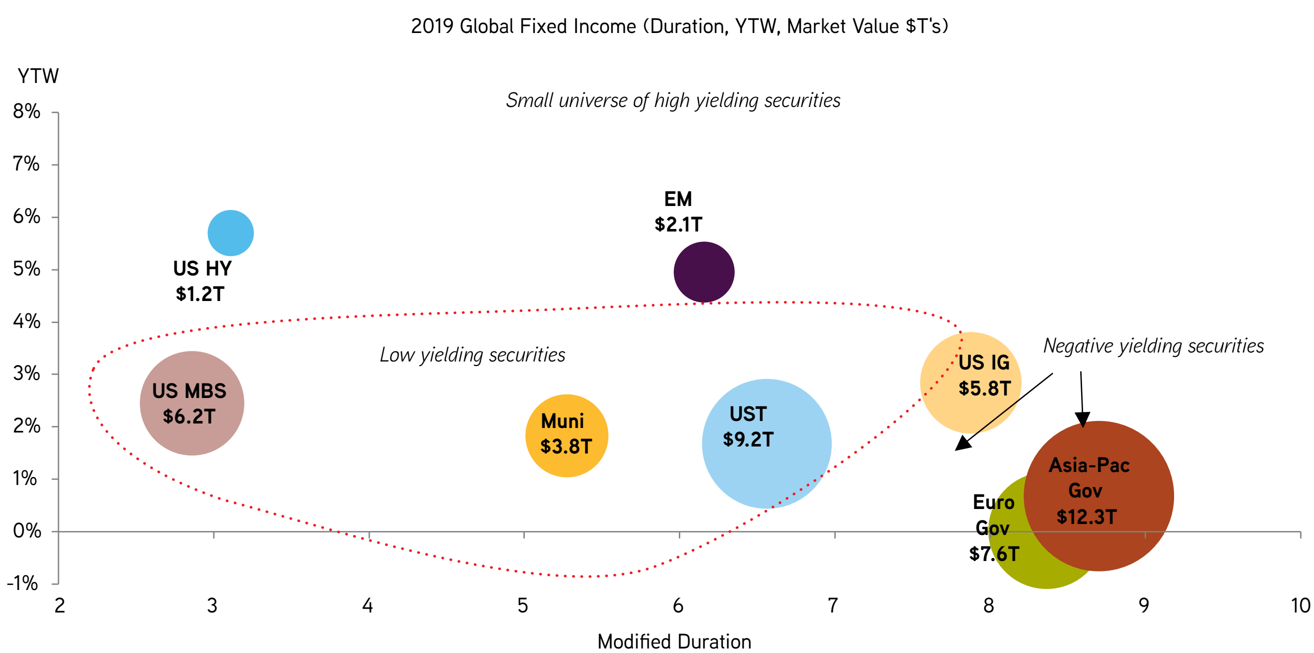
Data as at May 2018 Source: KKR 2018 Insurance Survey.

What does all this mean for investors? Our base view is that a world of low nominal rates amidst sluggish global economic growth suggests reinvestment risk is a serious concern for investors. In particular, we think that insurance companies – as we show in *Exhibit 69* – face a major headwind on their ability to generate outcomes for savers. That said, insurance companies are not alone, and we now think that all savers, including both individuals and institutions, will need to find additional ways to supplement their traditional income streams.

How serious is the problem? Well, as we show in *Exhibit 70*, nearly 24% of the $48.3 trillion global fixed income market is negative yielding these days. Moreover, of the securities that do have positive yield, most are quite skinny. For example, when we adjust the U.S. High Yield and exclude the bottom quintile, the rest of the market is only yielding four percent. My colleague Aidan Corcoran sees even more pressure in the European High Yield market. In fact, he recently discussed a "High Yield" deal with the GBR team that came to market at a 75 basis point absolute spread.

EXHIBIT 70

Nearly 24% ($11.3 Trillion) of the $48.3 Trillion Global Fixed Income Market Is Negative Yielding Securities

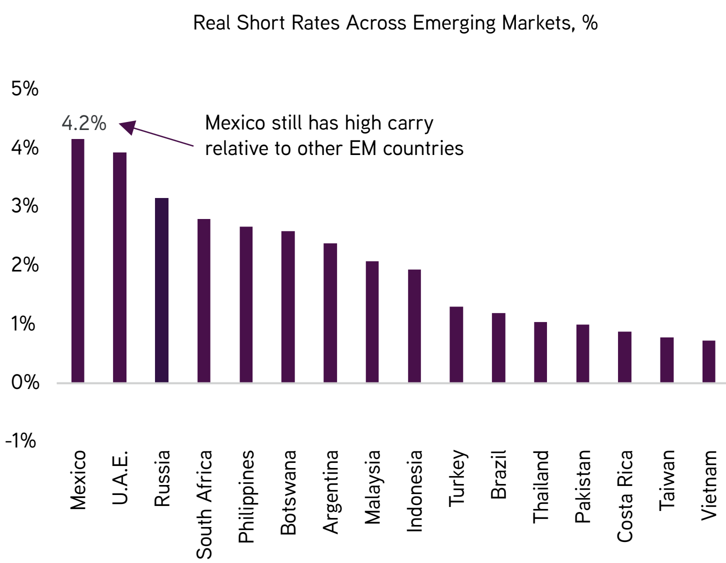


Data as at December 31, 2019. Source: Bloomberg.

Not surprisingly (and as we detail below in the section on macro themes), we have migrated the portfolio more towards the private markets, especially hard assets that have upfront cash flow yield. These securities generally offer much better returns than what is available in the traditional CUSIP market, and they are often backed by collateral that should help in the event of a default. Separately, we also like some of the 'spicy' local currency that one can buy in markets with above average real rates. One can see this in *Exhibit 71*. To this end, we favor domestic bonds in markets such as Mexico (where we expect 75 basis points of easing in 2020), the Philippines, Vietnam, and India these days. Our work shows that owning higher real rate securities in an environment of slowing nominal GDP, particularly if the dollar becomes less well bid, makes a lot of sense.

EXHIBIT 71

High Carry and Real Rates Are Creating an Interesting Opportunity to Own Some Spicy EM Local Debt, We Believe



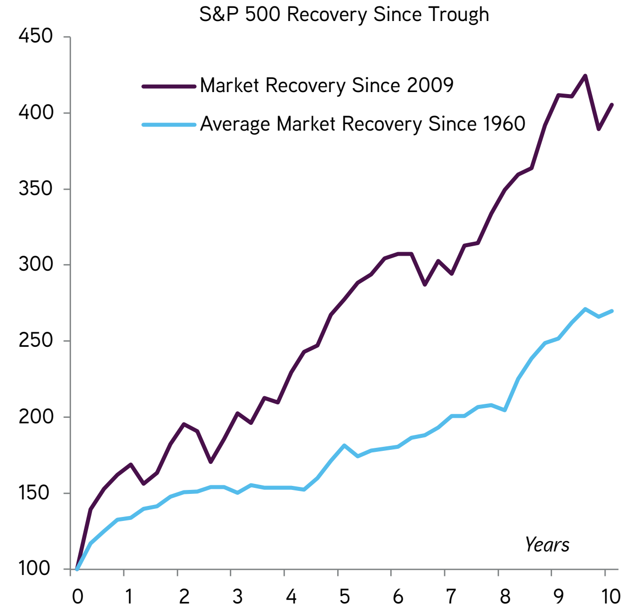
Note: REER = Real Effective Exchange Rate. Data as at December 3, 2019. Source: Banxico, INEGI, Bloomberg, Haver Analytics.

Outlook for U.S. Equities

When discussing the outlook for stocks, many investors with whom we speak indicate to us that U.S. stocks are expensive. On the surface, we tend to agree. One can see in *Exhibits 72* and *73* that we have had a long bull run, and as a result, most traditional valuation metrics suggest we are stretched. This viewpoint resonates with us, but we also think that investors must adjust for a few important variables to get a more complete picture. For starters, we believe that an investor should incorporate the absolute level of interest rates. Indeed, despite a rolling 10-year return that is almost one standard deviation above its historical average (*Exhibit 74*), the earnings yield on stocks is now just back to the historical average. One can see this in *Exhibit 75*, which leads us to believe that stocks – all else being equal – can grind higher before reaching unsustainable levels.

EXHIBIT 72

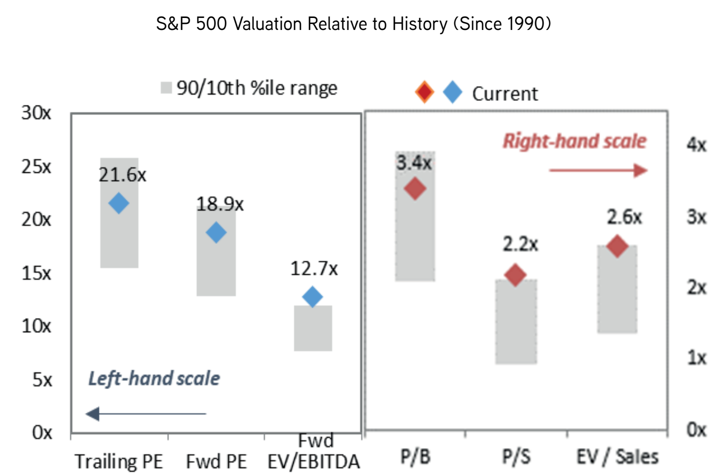
This Financial Recovery Has Been Unusually Strong...



Data as at December 13, 2019. Source: Datastream, Goldman Sachs.

EXHIBIT 73

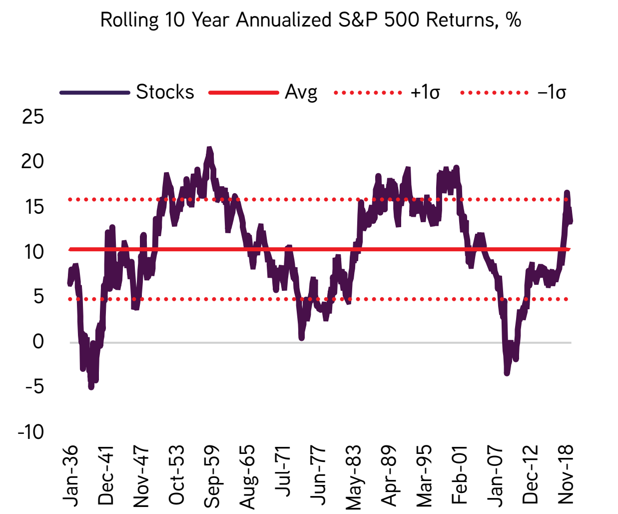
...Which Has Boosted Many Valuation Metrics Near the Top of the Ranges Relative to History



Data as at November 30, 2019. Source: Bloomberg, S&P.

EXHIBIT 74

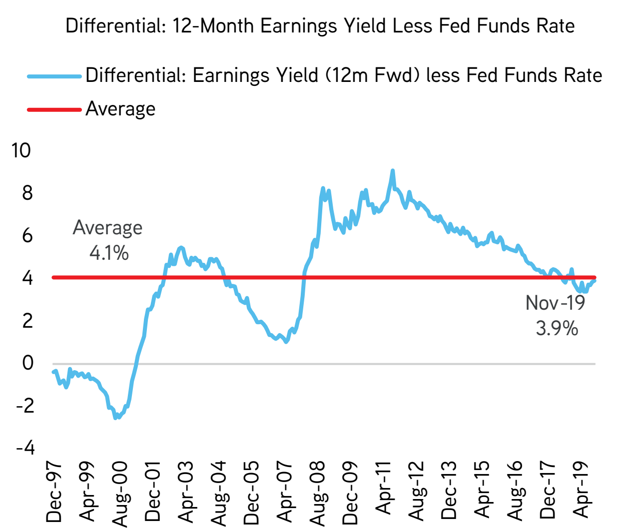
Rolling Annualized Returns for the S&P 500 Are Nearly at One Standard Deviation Above Their Long-Term Average



Data as at December 31, 2019. Source://www.econ.yale.edu/~shiller/, Bloomberg.

EXHIBIT 75

However, the Earnings Yield Arbitrage Relative to the Risk-Free Rate Is Still Only Just Back to Its Historical Average

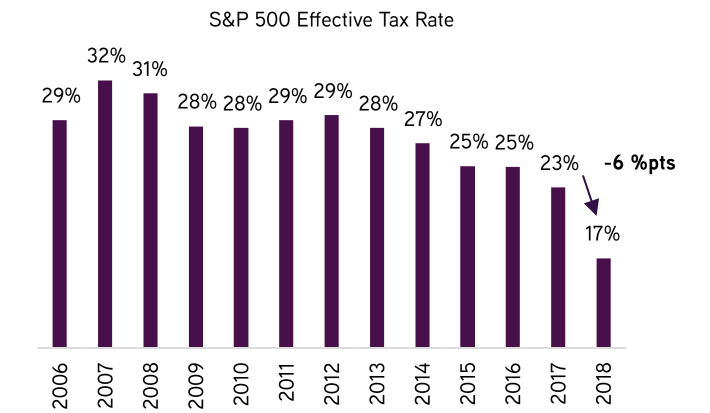


Data as November 30, 2019. Source: Bloomberg.

Second, my colleague Dave McNellis has done some interesting work to show that both a lower tax rate and compositional changes in the S&P 500's sector weightings suggest a higher steady state valuation than more traditional metrics might imply. Indeed, as we show in *Exhibit 76*, the tax rate on the S&P 500 has fallen fully 600 basis points, which has helped to raise net income as a percentage of EBITDA (*Exhibit 77*). This change in profitability is important because we estimate that it boosts EV/EBITDA valuations by at least eight percent, and we have not boosted the P/E ratio in our example (which one could argue should be done too).

EXHIBIT 76

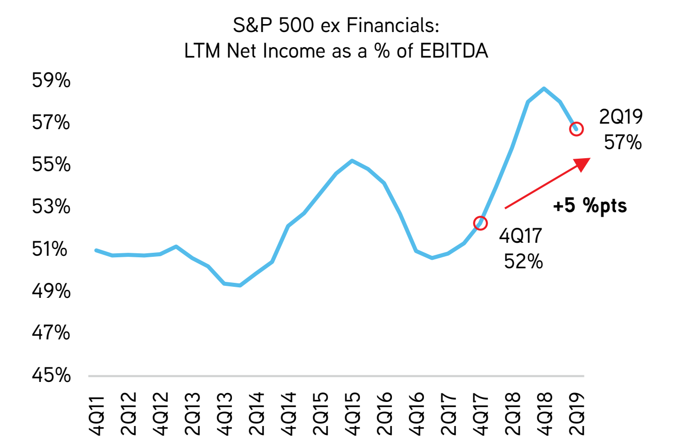
2017 Tax Reform Lowered S&P 500 Effective Tax Rate by Six Percentage Points...



Data as October 11, 2019. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 77

...Which in Turn Helped Raise Net Income Relative to EBITDA by Approximately Five Percentage Points



Data as October 11, 2019. Source: KKR Global Macro & Asset Allocation analysis.

Moreover, as we show in *Exhibit 79*, the market's shift increasingly towards higher growth, higher profitability sectors such as Technology – at the expense of sectors like Energy – needs to be considered as well. Pulling all the pieces together, we do see some potential for market valuations to drift a bit lower in coming years, and bake this into our underwriting activities around the firm. As *Exhibit 80* shows, however, current trading levels are only about 2.5 turns of EBITDA above pre-GFC levels once properly adjusted for sector mix and tax, which does not seem terribly outsized given the significant decline in interest rates over the intervening years (e.g., a U.S. 10-year yield of around 1.8-1.9% currently, versus. 4.5-5% in 2006).

EXHIBIT 78

We Estimate Tax Reform Raised 'Fair Value' Market EV/EBITDA by Approximately Eight Percent

	PRE TAX REFORM	POST TAX REFORM	*CHANGE*
EBITDA	100	100	
Net Income	52	57	
Mkt Cap @ Constant P/E	880	965	
Net Debt	200	200	
Implied Enterprise Value	1,080	1,165	
Net Income % of EBITDA	52%	57%	*10%*
EV/EBITDA	10.8	11.7	*8%*
P/E	16.9	16.9	*0%*

Our model assumes the following: 1) constant EBITDA of $100, 2) constant net debt of 2x EBITDA, constant P/E of 16.9x, 4)pre-tax reform EV/EBITDA of 10.8x, 5) net income as a % of EBITDA rises to 57% post tax reform from 52% pre- tax reform. Data as at September 27, 2019. Source: BofAML, Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 79

The S&P 500 Is Increasingly Dominated by Higher-Valuation Sectors, Including TMT, Health Care, and Real Estate

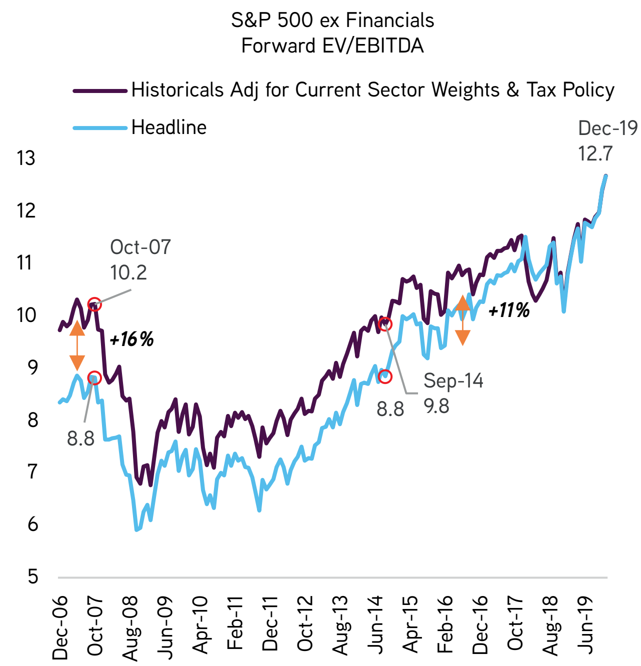
Contribution S&P 500 (ex-Financials EBITDA)

	DEC'06	DEC'19	'MARKET SHARE' CHANGE (% PTS)	MEMO: FORWARD EV/EBITDA
Tech	12%	19%	6.9%	14.6
Comms Svcs	8%	15%	6.5%	10.4
HlthCr	11%	15%	4.3%	12.7
Real Estate	1%	2%	1.2%	20.9
Utilities	6%	6%	-0.4%	12.5
Materials	5%	4%	-1.1%	10.9
Industrials	13%	11%	-2.1%	11.8
Cons Disc	13%	11%	-2.4%	13.4
Cons Stpls	10%	8%	-2.5%	14.2
Energy	20%	10%	-10.4%	7.3
TOTAL	**100%**	**100%**	**0.0%**	**12.4**

Data as at December 31, 2019. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 80

Adjusting Historical EV/EBITDAs to Reflect Current Tax Policy and Sector Mix Raises Valuations Substantially



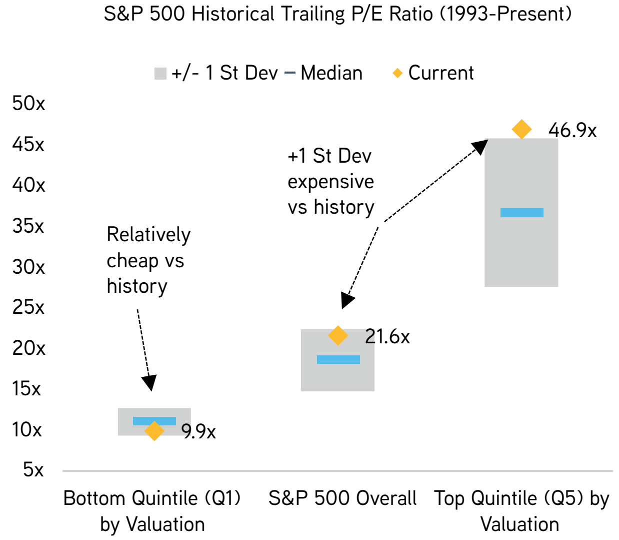
Data as at December 31, 2019. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation analysis.

The third point to keep in mind is that there is not one "market." As we show below in *Exhibits 81* and *82,* the current S&P 500 is extremely bifurcated. These bifurcations are bullish because they are creating a significant opportunity for managers who are willing to dig deep to understand the complexities of why a company may no longer be in the top quintile of the market, yet may still have sound long-term fundamentals, including potential for faster growth and higher returns. Indeed, a key initiative for us in 2020 will be to find companies where return on capital has the potential to increase; yet, this upside potential is not priced into the security at current valuation levels.

"That said, insurance companies are not alone, and we now think that all savers, including both individuals and institutions, will need to find additional ways to supplement their traditional income streams."

EXHIBIT 81

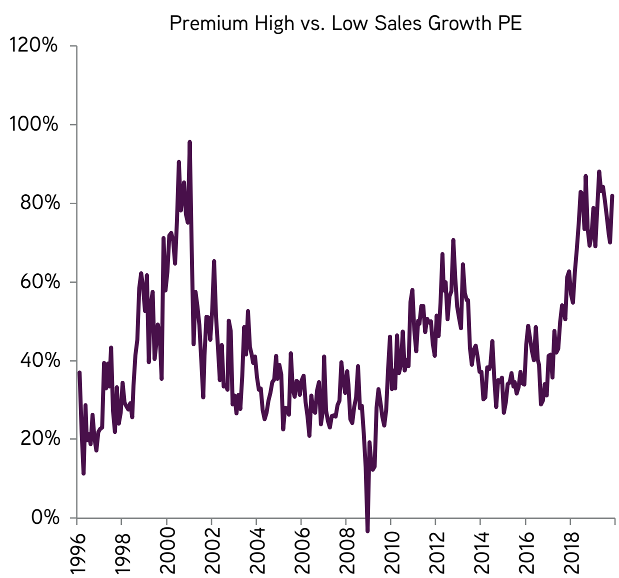
Because of Significant Market Bifurcations, There Is the Opportunity to Buy Complexity at a Discount and Sell Simplicity at a Premium



Analysis based on quarterly data since 2004 and excludes companies with negative earnings. Data as at December 31, 2019. Source: Bloomberg, S&P 500, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 82

High Growth Stocks Now Trade on Their Highest Premium to Low Growth Stocks Since 2000



Data as at November 30, 2019. Source: IBES, Datastream, Goldman Sachs Global Investment Research.

So, what is our bottom line on where the headline index, as measured by the S&P 500, should trade? Our base view for the S&P 500 is the following:

Earnings Per Share For the S&P 500, we assume that earnings-per-share grows by roughly five percent in 2020 to $173 per share from $164 in 2019. This forecast is slightly ahead of our quantitative model's output of 3.1% (*Exhibit 83*), but we think buybacks, which the model does not naturally pick up, will provide an additional tailwind again in 2020 of one to two percent. Our forecast of five percent compares to the consensus forecast of 9.0% growth in 2020, or $178 per share. My colleague Frances Lim, who helped oversee our earnings work this year, believes that the cyclical component of the sell-side consensus is too optimistic, particularly in areas such as Energy, Materials, and Industrials. Hence, we use a more conservative number relative to the consensus.

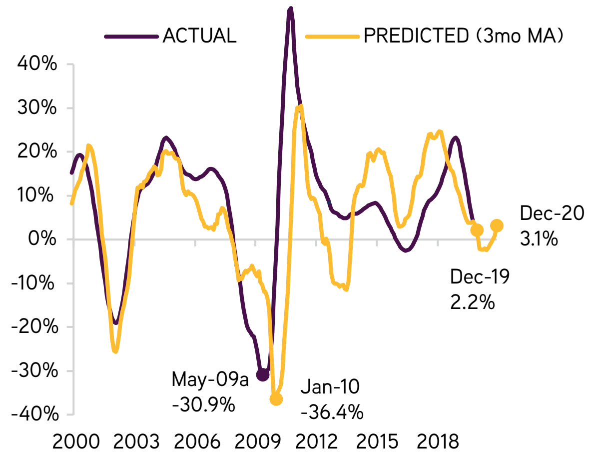
Target Multiple For the target multiple, we are using a range of 17.9x-18.7x for 2020; in 2019, by comparison, the S&P 500 traded in a range from 16.6x to 19.8x, with a median of 17.9x. Our model for forecasting the multiple for 2020 relies on key macro variables that we track for stocks, including the level of the 10-year yield, the unemployment rate, and oil. Not surprisingly, given that many of our inputs are now more balanced versus the more positive tilt they embedded throughout much of 2019, we no longer look for any further *aggregate* multiple expansion in 2020. In fact, we think the multiple could contract a little from December 2019's peak level of nearly 20.0x towards our target range of 17.9x-18.7x.

Dividend Yield The current dividend yield on the S&P 500 is approximately 1.9%. We expect dividends to essentially grow in line with EPS growth next year.

Total Return Forecast So, when we bring it all together, our forecast for U.S. Equities comes in just north of two percent (five percent EPS growth plus two percent dividend yield less five percent of multiple compression), with a range from minus three percent to plus eight percent, including the dividend yield. One can see this in *Exhibit 88*. As we mentioned before, though, headline levels for indexes like the S&P 500 can be misleading, given the bifurcations. So, we think selectivity will be key to true value creation, particularly as it relates to return on capital and related multiple expansion. From a relative value perspective, the equity returns we are forecasting are certainly less compelling relative to what we can find in segments of the Liquid Loan market or the CLO liability market. They are also well below what we are uncovering in many parts of the private markets. Given these discrepancies, our overall asset allocation preferences generally tilt towards 1) dislocated parts of the global Equity and Credit markets where we have a variant perception versus consensus on earnings and/or valuation; 2) improving return on capital stories where we expect operational improvements to boost returns and cash flow conversions; 3) investments that dovetail with our long-tailed macro themes in Section IV.

EXHIBIT 83

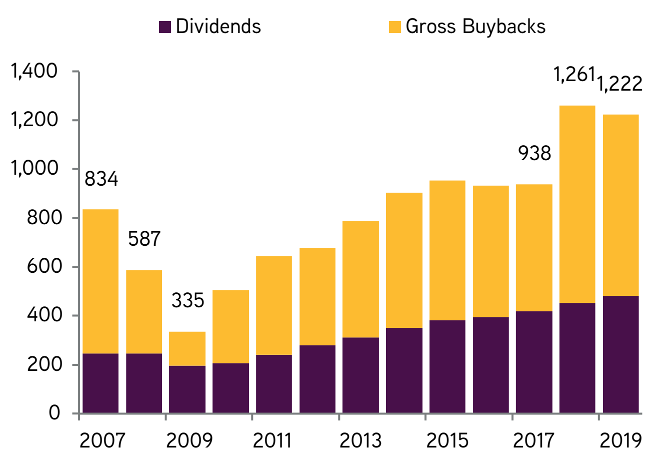
Our Earnings Growth Leading Indicator Suggests Low Single Digit Growth



Data as at December 10, 2019. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 84

We Are Tracking About $1.2 Trillion in Buybacks Annually



Data as at November 30, 2019. Source: S&P.

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There is not one 'market,' as the current S&P 500 is extremely bifurcated.

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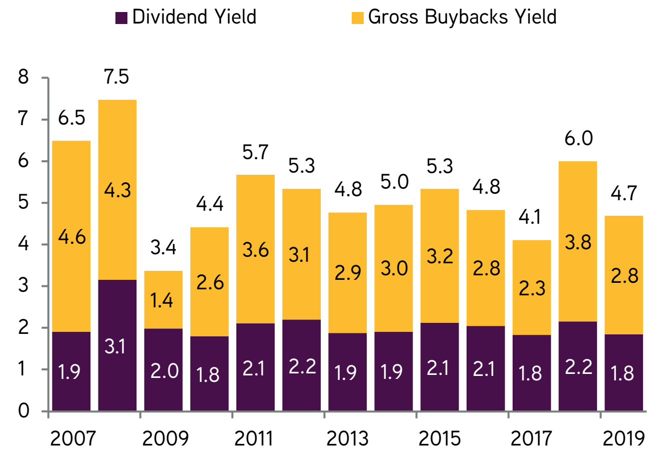
EXHIBIT 85

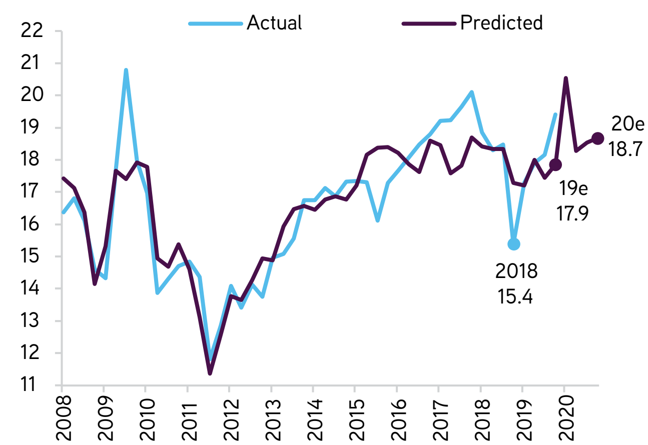
Buybacks and Dividend Growth Give Ballast to the S&P 500



Data as at November 30, 2019. Source: S&P.

EXHIBIT 86

We Think the Market Can Sustain a 17.9x-18.7x Multiple in 2020, Given Low Rates, Unemployment, and Oil Prices



Multivariate model based on a data between 1Q08-4Q18 and incorporating S&P 500 earnings growth, the US 10-year Treasury yield, unemployment rate, and oil prices. Data as at December 10, 2019. Source: S&P, Bloomberg.

EXHIBIT 87

We Are Using $173 in Earnings and a Peak Multiple of Almost 19x in 2020, Which Represents a Touch of Multiple Compression Relative to 2019

S&P PRICE INDEX AT VARIOUS P/E AND EPS LEVELS

P/E EPS	17.2X	17.7X	18.2X	18.7X	19.2X	19.7X	20.2X
$157	2,704	2,783	2,861	2,940	3,018	3,097	3,175
$161	2,773	2,854	2,934	3,015	3,095	3,176	3,256
$165	2,842	2,925	3,007	3,090	3,172	3,255	3,337
$169	2,911	2,995	3,080	3,164	3,249	3,333	3,418
$173	2,980	3,066	3,153	3,239	3,326	3,412	3,499
$177	3,049	3,137	3,226	3,314	3,403	3,491	3,580
$181	3,118	3,208	3,299	3,389	3,480	3,570	3,661
$185	3,186	3,279	3,371	3,464	3,556	3,649	3,741
$189	3,255	3,350	3,444	3,539	3,633	3,728	3,822

Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 88

Given Such a Strong Close to 2019, Our 2020 Forecast Now Implies We Are Close to Fair Value

S&P TOTAL RETURN AT VARIOUS P/E AND EPS Y/Y LEVELS

P/E EPS	17.2X	17.7X	18.2X	18.7X	19.2X	19.7X	20.2X
$157	-14.6%	-12.1%	-9.7%	-7.2%	-4.7%	-2.2%	0.2%
$161	-12.4%	-9.9%	-7.4%	-4.8%	-2.3%	0.3%	2.8%
$165	-10.3%	-7.7%	-5.1%	-2.5%	0.1%	2.7%	5.4%
$169	-8.1%	-5.4%	-2.8%	-0.1%	2.6%	5.2%	7.9%
$173	-5.9%	-3.2%	-0.5%	2.3%	5.0%	7.7%	10.5%
$177	-3.7%	-1.0%	1.8%	4.6%	7.4%	10.2%	13.0%
$181	-1.6%	1.3%	4.1%	7.0%	9.9%	12.7%	15.6%
$185	0.6%	3.5%	6.4%	9.4%	12.3%	15.2%	18.1%
$189	2.8%	5.8%	8.7%	11.7%	14.7%	17.7%	20.7%

Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis.

DM versus EM Debate

As we mentioned in our introduction and similar to what we said last year, our work continues to show that Emerging Market equities are in an elongated process of bottoming. One can see this in *Exhibit 91*. However, also similar to last year, *the signal is modest at best, and as such, we continue to advocate selectivity*.

EXHIBIT 89

We Recommend Selective Engagement with EM Markets

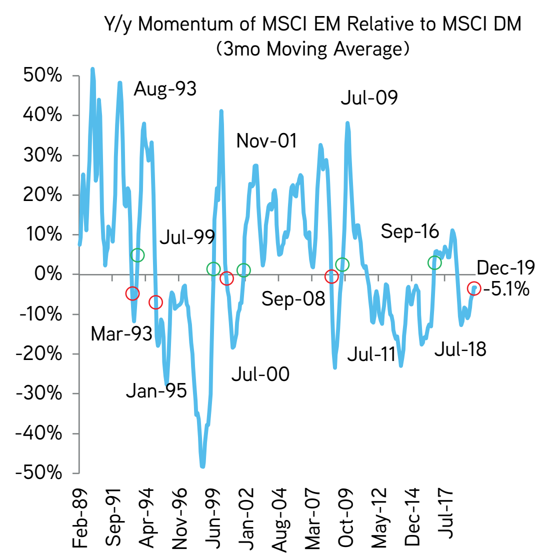
	"RULE OF THE ROAD"	MAY '15	JAN '16	AUG '16	MAY '17	SEP '17	JUN '18	DEC '18	DEC '19
1	Buy When ROE Is Stable or Rising	↔	↔	↔	↗	↗	↗	↗	↔
2	Valuation: It's Not Different This Time	↔	↗	↗	↗	↔	↔	↔	↔
3	EM FX Follows EM Equities	↘	↘	↔	↔	↗	↔	↗	↗
4	Commodities Correlation in EM is High	↔	↔	↔	↔	↔	↗	↔	↔
5	Momentum Matters in EM Equities	↘	↘	↗	↔	↗	↔	↘	↔

Overall: We continue to recommend selective engagement with EM. Currencies look fairly washed out and stock market momentum is starting to stabilize. That said, fundamentals in many instances do not yet look compelling, given continuing overhangs from the trade war. In particular, commodity demand and corporate margin trends both look weak.

Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 90

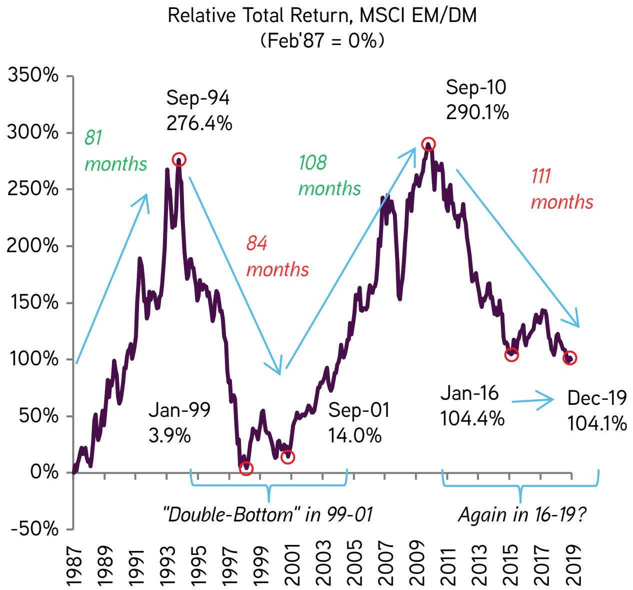
Relative Momentum in EM Is Starting to Stabilize...



Data as at December 31, 2019. Source: MSCI, Bloomberg, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 91

...and EM Stocks Continue to 'Bounce Along the Bottom' Relative to DM



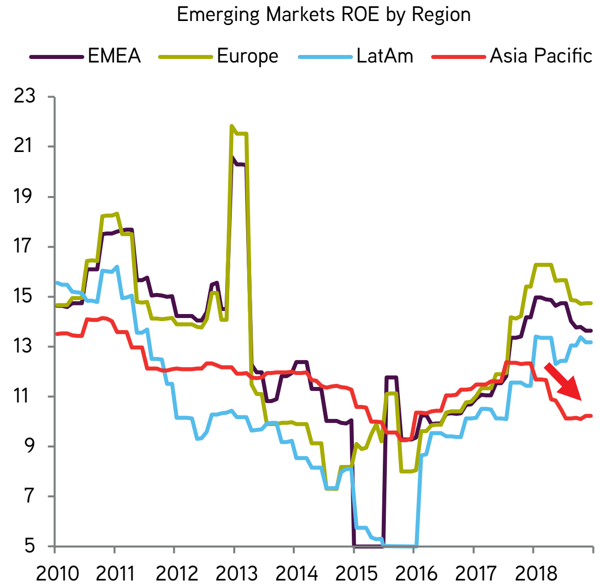
Data as at December 31, 2019. Source: MSCI, Bloomberg, KKR Global Macro & Asset Allocation analysis.

A major issue that we see, which we show in *Exhibits 92* and *93*, respectively, is that emerging market ROEs are not rebounding in the way many investors would hope. Our recent travels to India and China suggest a more structural decline in returns, as intensifying competition and excess capacity seem to be at play. Traditional technology returns are also being adversely impacted in key markets such as Korea, which also is acting as a drag on returns.

"A major issue that we see is that emerging market ROEs are not rebounding in the way many investors would hope. Our recent travels to India and China suggest a more structural decline in returns, as intensifying competition and excess capacity seem to be at play."

EXHIBIT 92

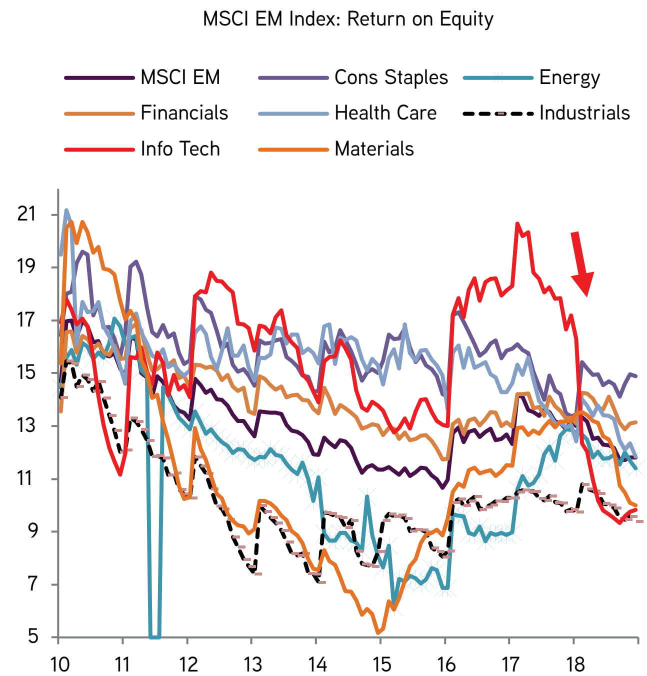
EM ROE Has Fallen Sharply in Recent Quarters...



Data as at December 31, 2019. Source: MSCI, Bloomberg, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 93

...Driven in Particular by Weakness in the Asian Tech and Materials Sectors



Data as at December 31, 2019. Source: MSCI, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Our bigger picture conclusion is that, while we are increasingly positive on EM relative to DM securities, we – and the investors with whom we speak – may be missing the forest for the trees. Specifically, many EM Public Equity indexes are – at best – often just a crude tool for getting exposure to the outsized growth that we see in emerging Asia and Latin America. By comparison, many of the Private Equity funds that we are helping to structure through our asset allocation work at KKR are trying to gain meaningful exposure to the important industries that are actually driving rising GDP-per-capita in large economies like Brazil, Mexico, China, India, and Indonesia. Given this backdrop, we think that the illiquidity premium one can earn in Asia and parts of Latin America these days may be increasing structurally during the next five to 10 years. If we are right, then the lion's share of global CIOs, particularly in the pension community, will need to rethink their traditional allocation to Public Equities. Otherwise, they risk leaving some outsized returns on the table at a time when we think that the performance of the traditional 60/40 liquid stock-bond allocation will drop meaningfully on a go-forward basis.

Oil Outlook

Despite fairly lackluster GDP growth, there certainly has been no shortage of volatility in the oil markets of late. Indeed, recent events in Iraq highlight the uncertainty associated with making bold predictions – either up or down – for oil prices. That said, we are in the business of making forecasts, and in doing so, we try to incorporate both fundamental drivers as well as potential geopolitical considerations. To this end, we note the following. First, as we show in *Exhibit 94*, the near-term demand backdrop remains weak in absolute terms. However, it is becoming more supportive at the margin. Indeed, for the first time in 1.5 years, we see demand trends actually beginning to stabilize, and as a result, we are now essentially in-line with consensus in our outlook versus our prior stance of being more pessimistic.

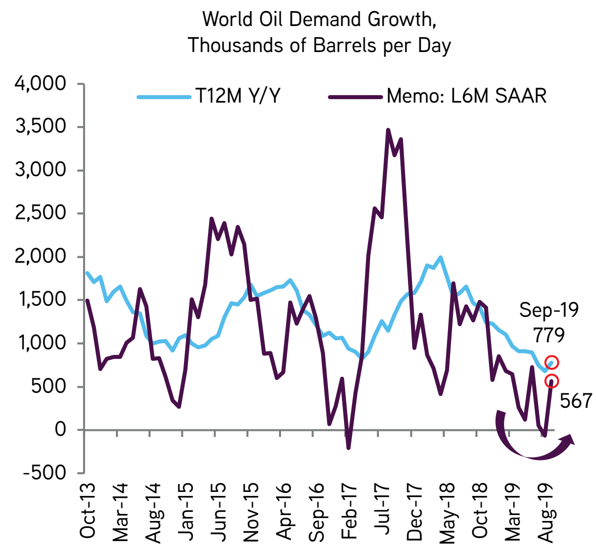
So, even under our guarded global growth outlook (e.g., 2020 U.S. GDP of just 1.9%), we feel better. In fact, our model now calls for oil demand to improve to approximately one million barrels per day in 2020 from approximately 0.8 million barrels per day in 2019. The lagged effect of lower prices in 2019, IMO 2020 (a slashing of marine sector sulphur emissions in international waters), and China economic stimulus are key positives that should help stabilize trends, we believe.

Our second consideration is production, and on the U.S. production side, our base view is that the backdrop is also becoming more supportive at the margin. The U.S. shale productivity surge finally seems to be moderating. The annualized rate of production growth has fallen from a recent peak of over two million barrels per day in late 2018 down to around one million barrels per day. Tight financing conditions, accelerating base declines, and peaking lateral-length adjusted production rates all seem to be contributing to the moderating shale story.

On the other hand, we *do* see non-OPEC ex.-U.S. production as a key risk factor in coming quarters. Specifically, key forecasters we watch and respect (e.g., IHS, Goldman Sachs) are calling for non-OPEC ex.-U.S. supply to surge by fully one million barrels per day in 2020 (i.e., on its own, enough to meet global demand growth). New midstream availability in Canada and new offshore project streaming in Norway and Brazil are key drivers. There is significant debate in the market as to whether this conventional supply surge persists beyond 2020, so this will be a key area of further due diligence for us in coming months. For now, though, we operate under an assumption that non-OPEC production could surprise on the upside.

EXHIBIT 94

Global Demand Growth Is Very Weak, but We Finally See It Stabilizing. IMO 2020, China Stimulus, and Lower Prices Offer Supports Heading into 2020



Data as at December 3, 2019. Source: IEA, Energy Intelligence, IHS, Haver Analytics, Bloomberg, KKR Global Macro & Asset Allocation analysis.

The third consideration is geopolitical. As we outline in *Exhibit 95*, an extreme disruption could push WTI prices towards the $75-80 range, or about 50% above the two-year forward price. This outcome would actually be in-line with history. However, given that Iran-U.S. tensions do not appear to be spiraling out of control, we think a trading range of around $60, which embeds some premium – but not one as extreme as the 1990 or 2003 flare-ups – is likely closer to the merited risk premium that is warranted in the first half of 2020.

Importantly, this backdrop is happening at a time when publicly traded energy equities are still trading near the low end of their past 15 year range. Hence, the current backdrop seems like an interesting environment for investing in producing assets where one can hedge early year production at today's attractive near-term prices, while benefitting down the road from new acreage development. Longer term, though, we are increasingly of the mindset that terminal values could be challenged, given shifts in investor sentiment and ongoing regulatory changes.

EXHIBIT 95

Significant Oil Supply Disruptions Can Push Spot Prices to About 50% Above the Two-Year Forward Curve. Under an Extreme Case in 2020, That Could Equate to a $75-80 WTI Price. However, We Are More Sanguine, Thinking $60-$65 per Barrel Makes Sense in 2020

DATE	EVENT	ANNUALIZED RATE OF INVENTORY DRAW (IN DAYS OF INVENTORY)	OIL SPOT PRICE, % ABOVE 2-YEAR FORWARD PRICE
Sep-90	First Gulf War Outbreak	-10.4	82%
Mar-96	Surging Demand (around 3-4% per year)	-12.2	19%
Feb-03	Iraq War Outbreak	-8.6	53%
	Average		**51%**

Data as at December 3, 2019. Source: IEA, Energy Intelligence, IHS, Haver Analytics, Bloomberg, KKR Global Macro & Asset Allocation analysis.

So what is our bottom line? We think there will be attractive opportunities to put money to work in the Energy Real Assets sector in 2020. As outlined above, non-OPEC supply is accelerating, which may serve to keep dated oil futures under pressure. At the same time, however, we think spot prices this year may reflect an ongoing premium due to the threat of continued Iran-driven supply disruptions (similar to what we saw in Saudi Arabia in September 2019).

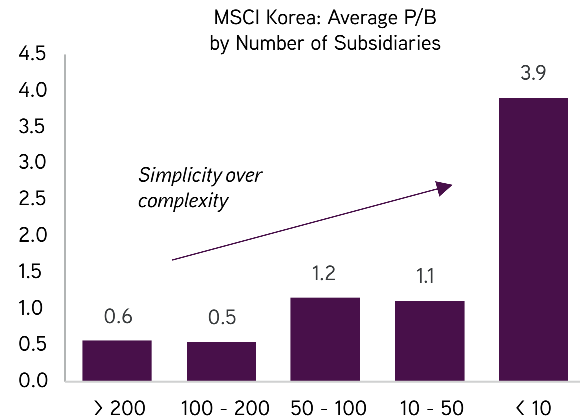
Section IV: Key Themes

In the following section, we update our thoughts on our core macro themes.

Theme #1: Buy Complexity 2.0 During the past eight years, we have been intently focused on buying into complexity. It started in 2011 when an investor could harness macro fears to buy high quality companies at discounted prices where there was upside leverage to the trading multiple. From 2014-2019, as multiples expanded, we focused investors on corporate complexity, with a particular emphasis on corporate carve-outs. Importantly, as we show in *Exhibits 96* and *97*, the macro backdrop for this strategy remains compelling from both a valuation and an activity standpoint.

EXHIBIT 96

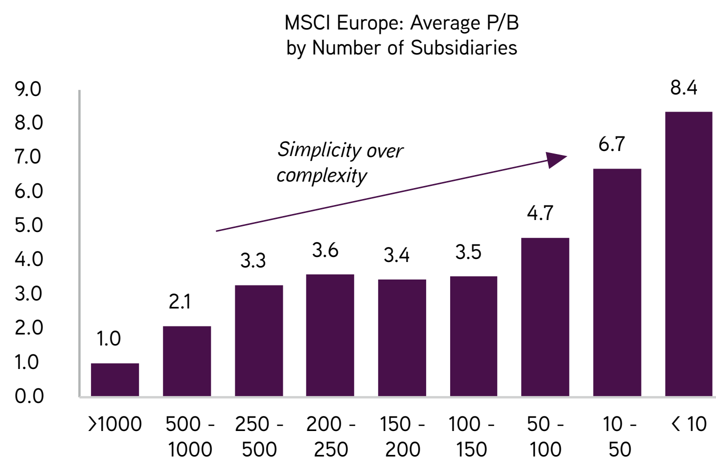
Valuations and Return on Equity Are Generally Lower for Complex Corporate Structures in Mature Asian Markets Like Korea. We View This as an Opportunity to Create Value



Sum may not add up due to rounding. Data as at December 2, 2019. Source: MSCI, Factset Global, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 97

A Similar Story Holds True in Europe. As Such, We Continue to Advocate Buying Complexity Where There Is the Potential to Create Simplicity Through Operational Improvements

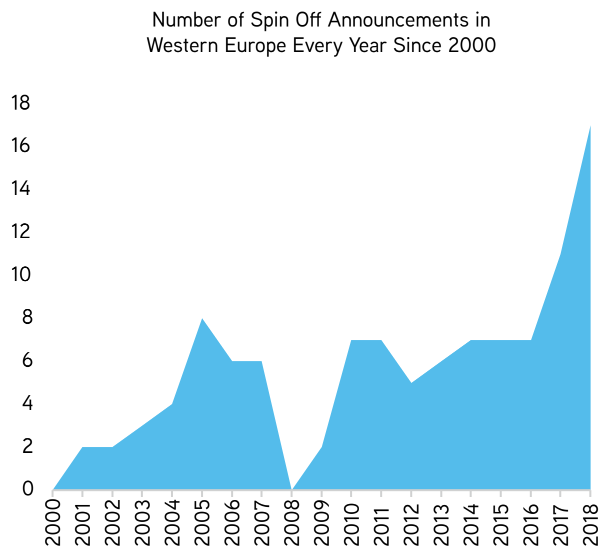


Data as at December 2, 2019. Source: Capital IQ.

Why are carve-outs becoming so much more pervasive? We see several forces at work. First, many global conglomerates – particularly those with lots of non-core subsidiaries – now trade at a discount, not a premium to net asset value. One can see this in *Exhibits 96* and *97*, respectively. So, their cost of capital is now a liability, not an asset, as return profiles have deteriorated. Second, local competition, particularly in Asia, is getting much better, and as a result, multinational subsidiaries now need better management and focus to remain competitive (*Exhibit 99*). Third, activist investors are

EXHIBIT 98

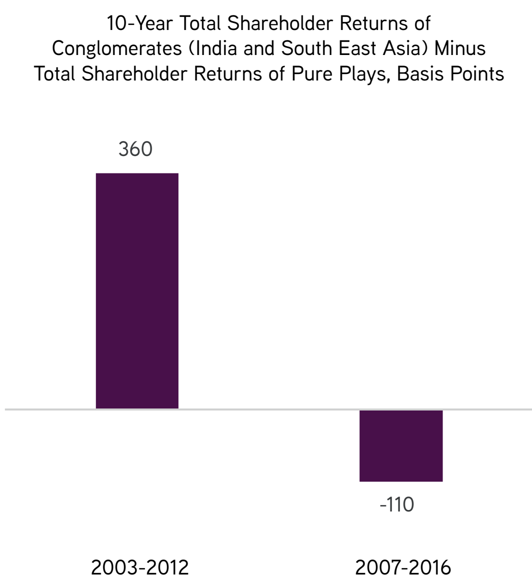
Spin-Offs in Europe Are Rising as Complexity Benefits Wane



Data as at December 31, 2018. Morgan Stanley Research, Euromonitor.

EXHIBIT 99

Asian Conglomerates Are Losing Their Competitive Advantages, Which Likely Means More Divestitures



Data as at September 30, 2019. Source: Capital IQ.

serving as an important catalyst to highlight the deficiencies in large, global footprints that were for the most part ignored during the reign of the imperial CEO during the late 1990s and early 2000s (think Citi, AIG, etc.).

While our penchant for carve-outs remains a core theme, we now believe that — consistent with our heavy emphasis this year on cash flow conversion — our preference has expanded to now include not only high quality companies trading at a discount but also mediocre companies where the market is pricing in something akin to Armageddon when it comes to cash flow generation. Said differently, a business that is a melting iceberg can still be a good investment as long as an investor gets an adequate return on their investment before the iceberg melts. Again, investing is all about having a variant perception relative to investor expectations and being right about the fundamentals – or actually creating improvements to a business that drive the fundamentals well beyond what the consensus thought was possible.

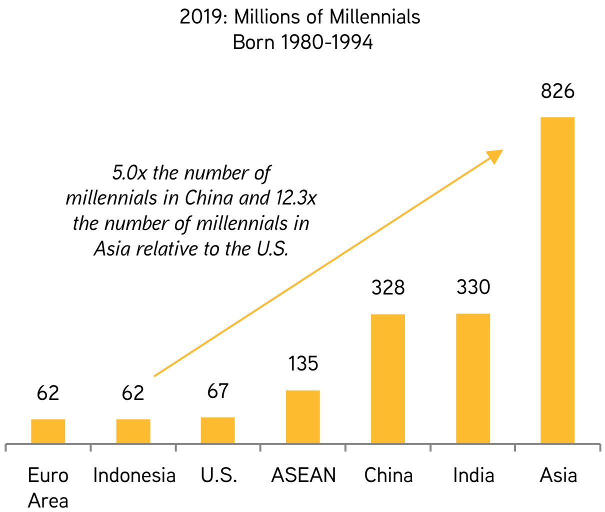
No doubt, this strategy will require a little more courage from KKR and its investors. However, given how beaten up some parts of the market are and the shift towards quantitative trading/passive investments (which tend to be more momentum driven), the ability to buy unloved cash flows at extremely discounted prices is quite compelling, in our view. The key, we believe, will be having a more optimistic view about the company's return on capital relative to consensus expectations, not just the direction of the return. This nuance is a small but important one in the investment climate we think we are entering.

Theme #2: Experiences Over Things Version 2.0, with a Focus on Asia We continue to be bullish on our Experiences Over Things thesis. In particular, we remain constructive on travel, leisure, wellness, and entertainment. However, there are larger forces at work that now cause us to continually refine our outlook to stay ahead of consumer preferences. Indeed, as detailed by a recent piece from the Council on Foreign Relations (see *The Work Ahead: Machines, Skills, and U.S. Leadership in the Twenty-First Century*), we are increasingly struck by how fast overall consumer behavior patterns are changing. Some of this change is related to technology (e.g., e-commerce), some of this change is related to demographics (e.g., the rise of the millennials), and some is related to educational pursuits.

"While our penchant for carve-outs remains a core theme, we now believe that — consistent with our heavy emphasis this year on cash flow conversion — our preference has expanded to now include not only high quality companies trading at a discount but also mediocre companies where the market is pricing in something akin to Armageddon when it comes to cash flow generation."

EXHIBIT 100

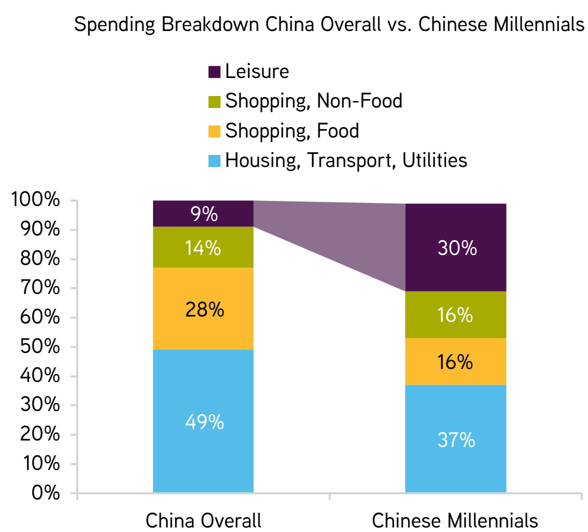
With More than 6x as Many Millennials in Asia than in the U.S. and Europe Combined, the Asian Millennial Will Reshape the Global Consumer Market



Asia includes China, India, Japan, Hong Kong, Korea, and ASEAN (Indonesia, Malaysia, Philippines, Thailand, Singapore, Vietnam). Data as at October 9, 2019. Source: United Nations World Population Prospects, Haver Analytics.

EXHIBIT 101

Chinese Millennials Save Less and Allocate Three Times More of Their Income to Leisure



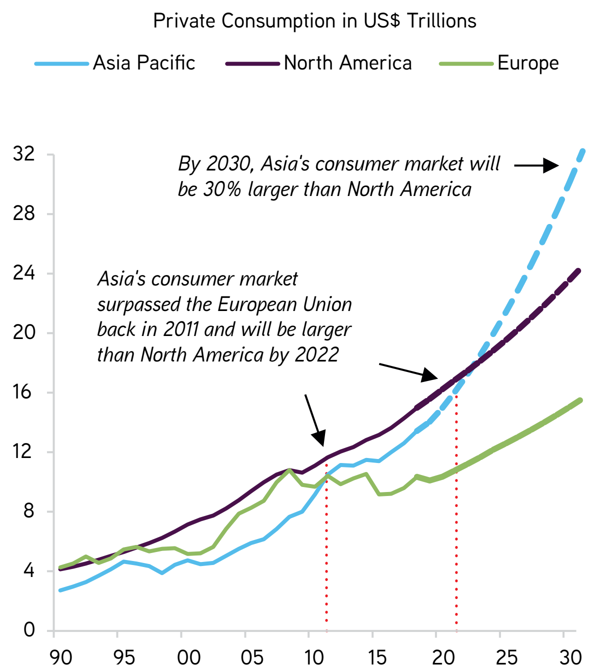
Data as at December 31, 2016. Source: Goldman Sachs Global Investment Research.

Importantly, though, we want to use 2020 to emphasize our Experiences Over Things thesis in Asia. As we detailed in the introduction and show below in *Exhibits 102* and *103*, the opportunity set at the macro level is massive. By way of background, of the total 826 million millennials in Asia, Frances estimates that fully 40%, or 328 million, are today in China. India is now on par at 330 million, and Indonesia and other South East Asia peers are gaining ground too.

However, it is more than just the macro forces that impress us. Indeed, recent trips to India and China underscore for us how good the management teams at a micro level have become. They have truly embraced a mindset of creative destruction, and in industries such as financial technology, healthcare services, environmental services, and travel and leisure, these executives are willing to rethink traditional business models to deliver a better outcome for consumers. This reality is particularly true for companies that are exposed to the consumption upgrade cycle, many of which do not have to restructure legacy processes to be more in touch with their end-user.

EXHIBIT 102

In Asia, Consumption Growth Trumps Investment Growth

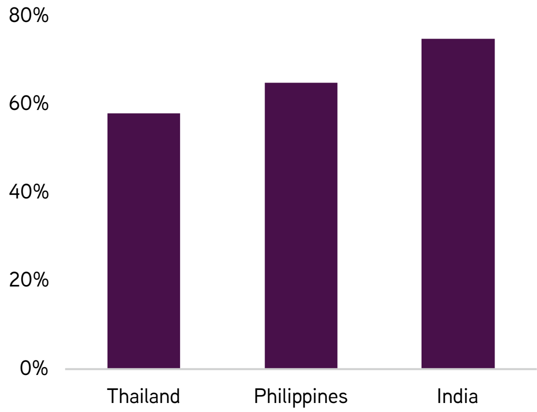


Asia includes China, Hong Kong, Taiwan, India, Japan, Korea. Data as at October 9, 2019. Source: IMF, World Bank, National Statistical Agencies, Haver Analytics.

> "By way of background, of the total 826 million millennials in Asia, fully 40%, or 328 million, are today in China. India is now on par at 330 million, and Indonesia and other South East Asia peers are gaining ground too."

EXHIBIT 103

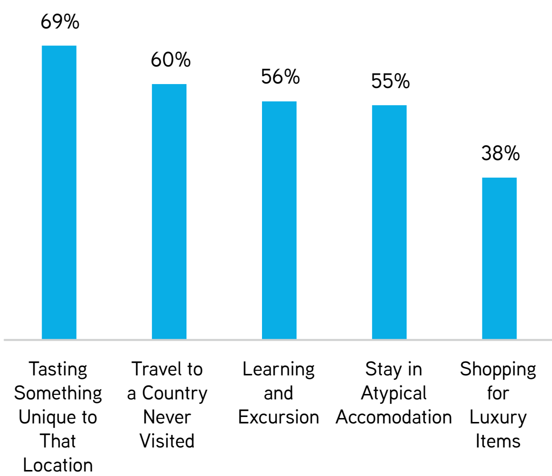
Asia Millennials Are Seeking Experiences Over Things



Data as at September 30, 2019. Source: Euromonitor Survey.

EXHIBIT 104

Chinese Millennials Prefer the Unique Experience Over the Luxury Item

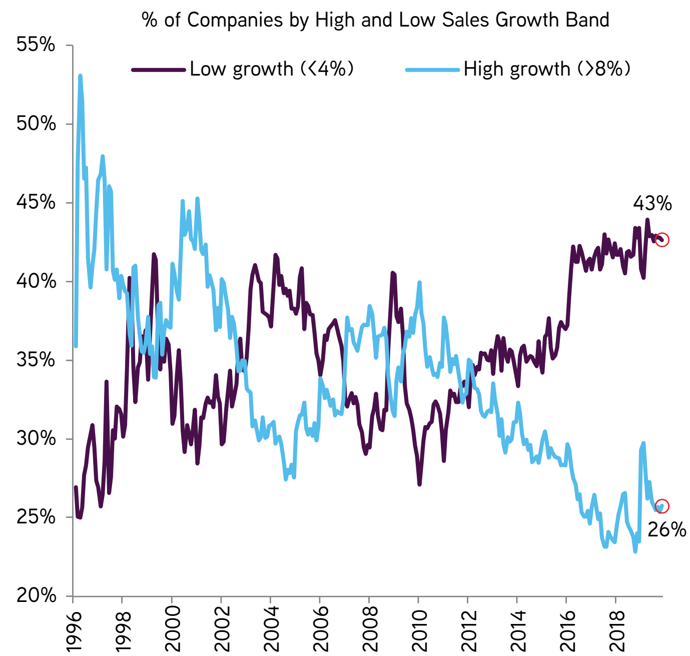


Data as at July 26, 2018. Source: TTG Asia, Hotels.com.

Theme #3: Own Some Secular Growth Winners That Are Cash Flow Compounders Amidst Slowing Nominal GDP As we mentioned earlier, there has been a notable deceleration in China's nominal growth rate (*Exhibit 19*) in recent years. At the same time, disruptive forces, particularly in the Technology, Healthcare, and Financial Services Technology sectors, are creating something akin to an industrial revolution that we have not seen since the 1870s. Against this backdrop of a slowing China and increasing disruption across several key industries, we have seen the percentage of companies with top-line growth of eight percent or more decline to 26% of the MSCI All Country World Index, compared to 45% in 2000/2001. One can see this in *Exhibit 105*.

EXHIBIT 105

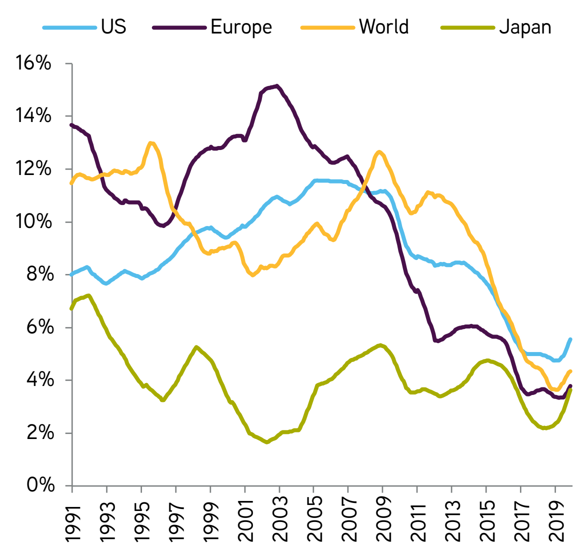
Very Few Companies Generate Top-Line Growth These Days



Data as at December 6, 2019. Source: Datastream, I/B/E/S, Goldman Sachs.

EXHIBIT 106

Top-Line Growth Has Been Falling Along with Nominal GDP Growth

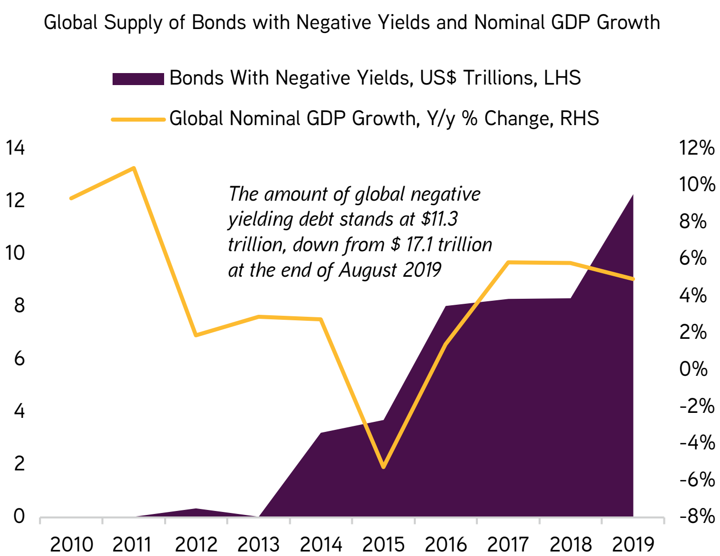


Data as at October 31, 2019. Source: Datastream, Worldscope, Goldman Sachs.

We believe that many of these structural growers now enjoy not only a cheaper cost of capital but are increasingly benefitting from a network effect that allows them to gain greater operating leverage than their peers. In many instances, we are witnessing fast-moving corporate "winners" taking market share while maintaining pricing, and as such, the outlook is quite bright, we believe. Key markets like cybersecurity and value-added payment systems are obvious examples of this new world order playing out, but we also believe that this "winner take all approach" is occurring in logistics, defense electronics, and even food and healthcare delivery platforms that we see in Asia. Importantly, though, we probably would avoid or own smaller positions in some of the high-profile growth companies in areas where anti-monopoly or anti-competitive behavior is being espoused by elected officials in Europe and the United States.

EXHIBIT 107

Negative Interest Rates Have Not Helped to Improve Growth in Nominal GDP. In This Type of Slowing Environment, Cash Flow Compounding Becomes More Valuable



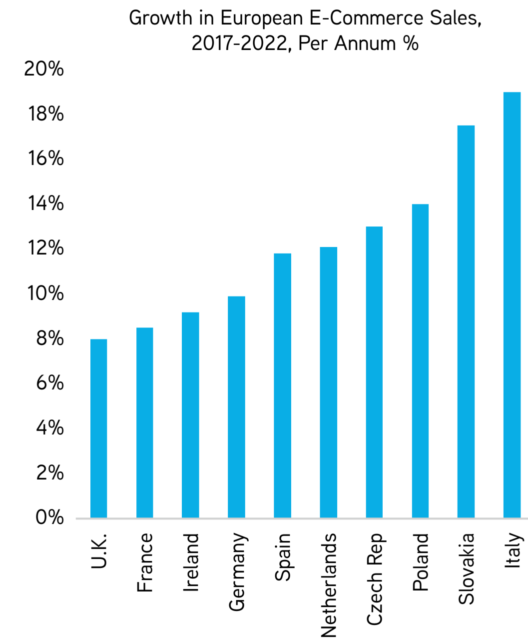
Data as at December 31, 2019. Source: Bloomberg, IMF, Haver Analytics.

At the moment, we actually are seeing better value in the public markets, particularly relative to many private markets, in countries such as China and even in the United States. *Implicit in what we are saying is that we believe that some private company valuations have run too far, too fast to be supported through initial public offerings the way some of the Venture Capital and Growth communities may have hoped.* Hence, we maintain our more cautious stance on early stage Growth financings as part of our Picks and Pans this year (see Section I for details).

Ultimately, we believe that the poor performance of several recent IPOs in the Growth arena supports our view that cash flow matters. To be sure, we are not back to 1999, but we do believe that several of the recent investment rounds in the Private Growth markets have been at speculative levels. As such, investors should avoid where possible business models that are predicated on low marginal revenue economics amidst continued high fixed costs. We also believe that estimates around the total addressable market have been exaggerated in certain instances. Importantly, though, we view recent disappointment in performance as a long-term opportunity, and accordingly, we do expect to shift our significant underweight in Private Growth back to an equal weight or overweight as leading investors in the sector are forced to acknowledge that some of their valuation metrics have gotten too robust.

EXHIBIT 108

The Need for New Supply Hubs and Digitization of Supply Chains Will Continue to Drive Demand and Efficiency in European Logistics as E-Commerce Grows

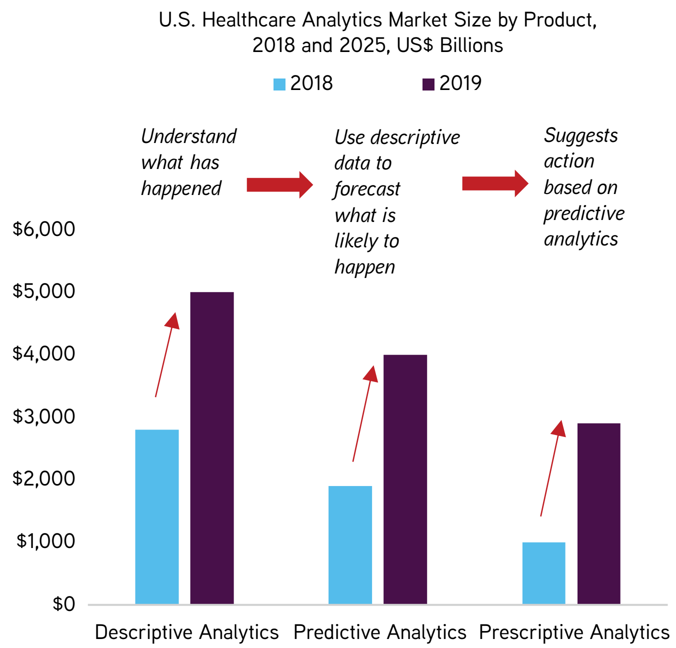


Data as at December 31, 2018. Source: CBRE, Euromonitor.

"At the moment, we actually are seeing better value in the public markets, particularly relative to many private markets, in countries such as China and even in the United States. Implicit in what we are saying is that we believe that some private company valuations have run too far, too fast to be supported through initial public offerings the way some of the Venture Capital and Growth communities may have hoped."

EXHIBIT 109

We Are Bullish on Growth in Analytics Across a Variety of Sectors



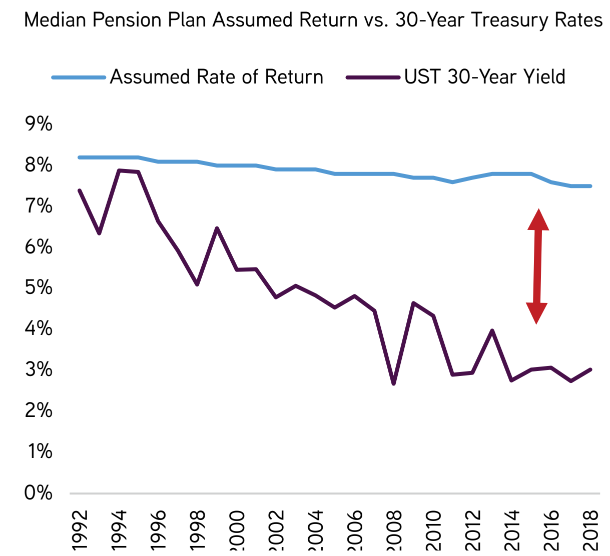
Data as at November 2018. Source: IDC. https://www.seagate.com/files/www-content/our-story/trends/files/idc-seagate-dataage-whitepaper.pdf

Theme #4: Increase Exposure to Collateral-Based Assets with Up-front Cash Flow As we mentioned earlier, we think that reinvestment risk remains one of the biggest concerns in the market today, and as such, we are constantly looking for creative strategies to satisfy the ongoing "Yearn for Yield" that we continue to forecast. The much hoped for rebound in interest rates after the end of Quantitative Easing never occurred, and barring a collapse in the dollar, we do not see global rates moving materially higher during the next few years. Not surprisingly, given this backdrop, many yield-oriented allocators of capital have been consistently moving away from low-yielding BBB securities (*Exhibit 111*) into a wide spectrum of Alternative investments, a trend we expect to continue. The reality is that, in a low nominal GDP environment with falling expected returns, the value of the illiquidity premium increases materially, we believe.

"The much hoped for rebound in interest rates after the end of QE never occurred, and barring a collapse in the dollar, we do not see global rates moving materially higher during the next few years."

EXHIBIT 110

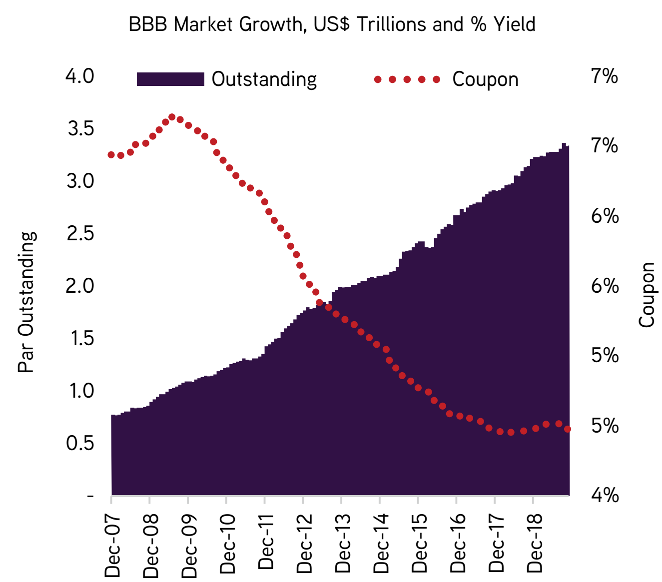
Given Declining Bond Yields, U.S. State Pension Plans Likely Need to Consider Alternative Investment Strategies



Data as at December 31, 2018. Source: The Pew Charitable Trust.

EXHIBIT 111

The Coupon on BBB-Rated Has Shrunk Dramatically. At the Same Time, the Par Value of These Securities Has Grown Immensely



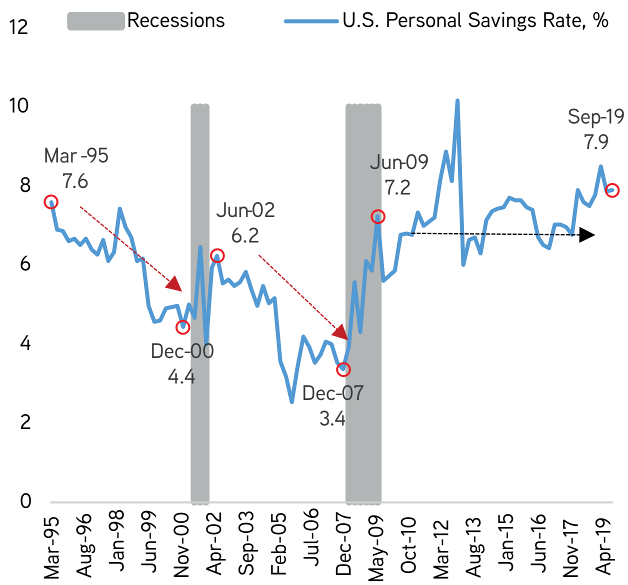
Data as at December 31, 2019. Source: Bloomberg.

So, what is driving rates so low? Beyond a strong technical backdrop from the central banks, there are several factors to consider, we believe, on why rates may stay lower for longer. First, we think that there are demographic and socioeconomic influences that are leading to lower rates. We note a strong "Yearn for Yield" evident among U.S. consumers, who continue to sock away savings at a heady rate relative to the current advanced state of the economic cycle. We can quantify this trend in several of the emerging markets where we invest, but our data in the U.S. is fairly compelling. One can see this in *Exhibit 115*. There also has been a sizeable uptick in global reserves (*Exhibit 114*). These increases are important because central banks are looking for safe homes for their assets, particularly if they feel comfortable with the local currency.

We also believe that there is lingering consumer caution in the post-GFC era (*Exhibit 112*); in fact, the savings rate today in the United States at 7.9% is higher than it was coming out of downturn in June 2009, when it was 7.2%. There are also the structural savings needs of an aging society to consider. Our research shows that the savings rate for individuals aged 55 years and older is now a chunky 13%, which is significant given that this demographic controls much of the current wealth in the United States. One can see this in *Exhibit 113*.

EXHIBIT 112

In an Unusual Break from Recent History, Savings Rates Have Not Declined This Cycle



Data as at September 30, 2019. Source: Bureau of Economic Analysis, NBER, KKR Global Macro & Asset Allocation analysis.

"

We note a strong 'Yearn for Yield' evident among U.S. consumers, who continue to sock away savings at a heady rate relative to the current advanced state of the economic cycle.

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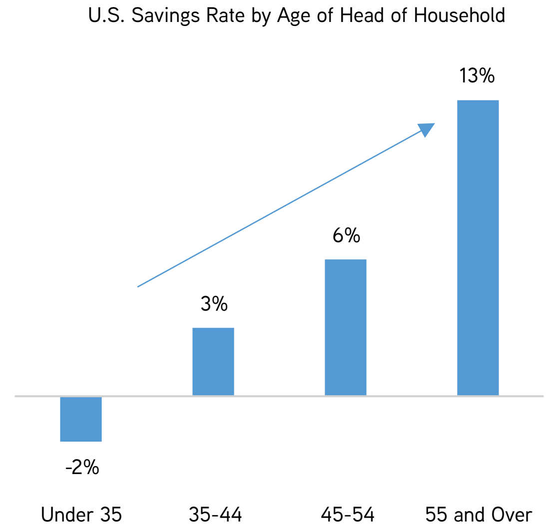
EXHIBIT 113

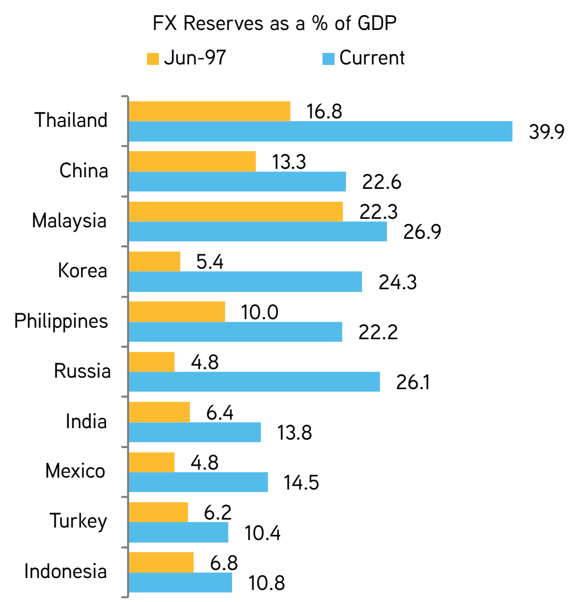
Aging Demographics Explain, in Part, the Surprising Persistence of High Savings Rates



Data as at 2013. Source: Moody's Analytics analysis of 2013 Federal Reserve data.

EXHIBIT 114

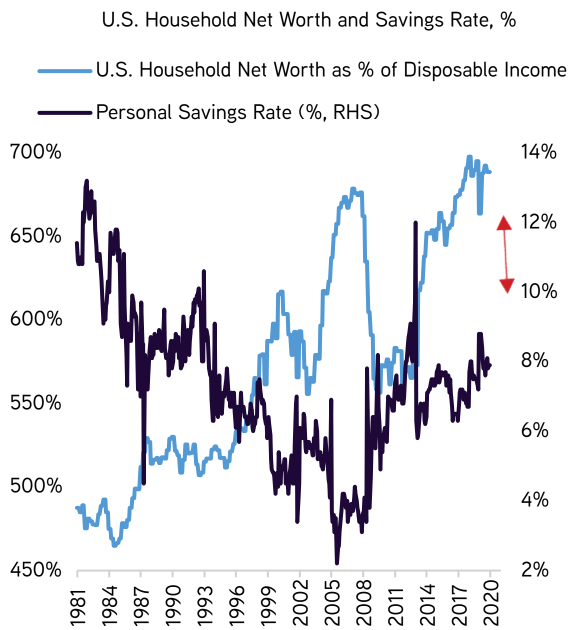
The War Chest of Foreign Currency Reserves Is Increasingly Finding Its Way Into Fixed Income Securities, Which Is Further Depressing Yields



Data as at November 30, 2019. Source: Respective national statistical agencies, Haver Analytics.

EXHIBIT 115

U.S. Households Are Not Spending Relative to Their Net Worth This Cycle



Data as at December 31, 2019. Source: Bloomberg.

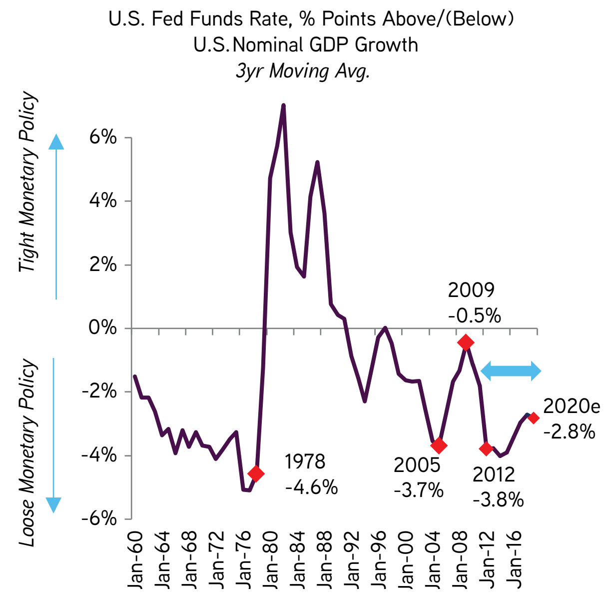
Against this backdrop, we feel strongly that investors should try to own more hard assets with yield linked to nominal GDP growth. For example, in both Europe and the United States we are finding compelling opportunities in the Asset-Based Finance arena to provide attractive short-term, real estate-backed bridge loans to qualified buyers in stable markets. In our view, these types of investments provide not only collateral in what is likely a late cycle environment but also produce upfront cash flows with plenty of equity cushion. We also like the moat-like features of owning servicing agents because they control the quality of deal flow, their continuity provides the ability to lean in and out, and they often have some operational improvement story to their existence. Finally, many of the platforms with which we are now working are providing important offerings – especially housing-related platforms – to local communities across Asia, Europe, and the Americas.

We are also constructive on Real Estate and Infrastructure assets, particularly cash flowing ones in Asia. For example, in India there are a host of promoters with over-leveraged capital structures who will likely need external partners in areas such as transmission lines, renewables, and hospitals. We would also consider leaning into office space in India. In Europe, we think both Real Estate and Infrastructure appear attractive relative to the risk free rate, and as such, we think there is actually room for cap rates to compress. Within the United States, we like the midstream space, Subordinated Real Estate Credit, and Real Estate, particularly in cities with favorable business demographics (e.g., Seattle).

Finally, we are bullish on our thesis to own collateral assets for defensive reasons. Specifically, assets linked to nominal GDP also provide inflation protection and macro ballast in an environment where we know that the "Authorities" are running policies that are quite aggressive. Specifically, as we show in *Exhibit 116*, holding nominal interest rates below nominal GDP is an effort to not only inspire growth but also to defease the substantial debt liabilities that have been accumulated during the last decade since the GFC.

EXHIBIT 116

The Government Has Focused on Stimulating Nominal GDP Through Monetary Policy. This Strategy Makes Us Want to Overweight Cash Flowing Assets with Upfront Yield

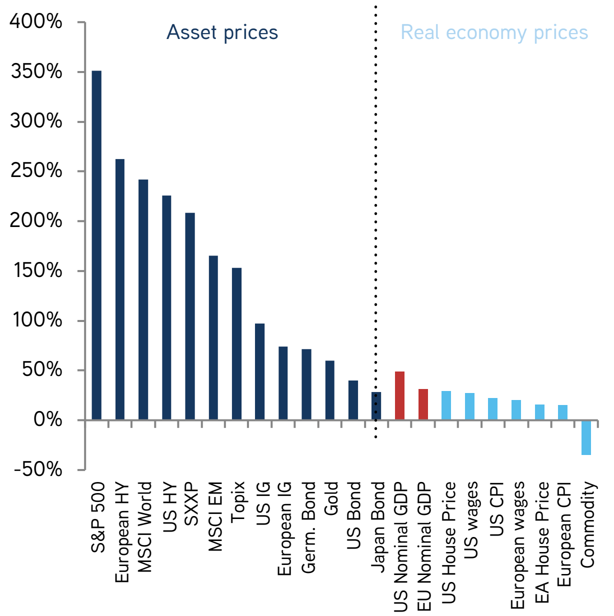


Data as December 31. 2019. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

> "Finally, we are bullish on our thesis to own collateral assets for defensive reasons. Specifically, assets linked to nominal GDP also provide inflation protection and macro ballast in an environment where we know that the 'Authorities' are running policies that are quite aggressive."

EXHIBIT 117

Financial Assets Have Been the Star Performer of Late. Going Forward, We Want to Own More Assets Linked to Nominal GDP



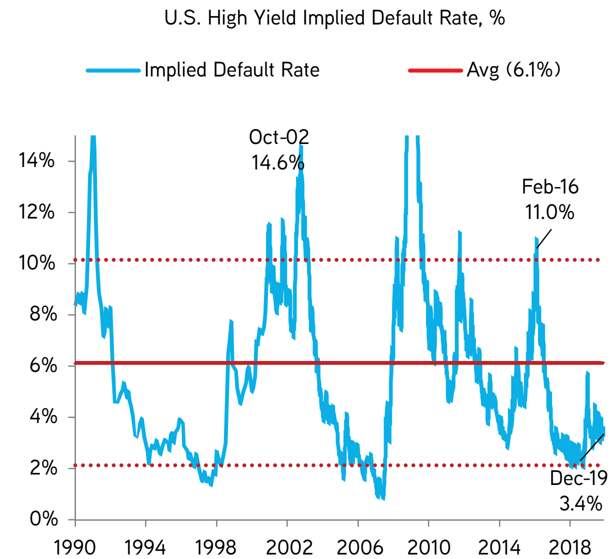
Data as at December 31, 2019. Source: Goldman Sachs.

Overall, we think that this theme is amongst the most important that we are identifying in this year's *Outlook*, and we would pursue this strategy across both regions and asset classes, including Real Estate, Asset-Based Finance, and Infrastructure. Beyond the collateral and upfront yield, we think this strategy can outperform in both a low and high inflation environment. To be sure, investors should not over-leverage these assets, but the flexibility of these asset classes in an uncertain environment is quite valuable, we believe.

Theme #5: Buy Dislocation/Dispersions As we described in our April 2019 *Insights* note *The Uncomfortable Truth*, we are living in an odd time characterized by low interest rates, sluggish global GDP growth, and rising geopolitical tensions. Against this backdrop, we expect above average periodic dislocations across the capital markets versus a massive, "one-time" 2008-like downturn. Already, as we show in *Exhibit 118*, our implied default model has hit recessionary levels several times since 2009, despite the reality that we have not yet had a technical recession in the United States. We regard this backdrop as an *opportunity* because it confirms our strong view that assets are consistently being mispriced when investors lose faith in central bank liquidity and/or economic growth. Both January 2016 and fourth quarter of 2018 are excellent examples where nimble investors could buy high quality securities, including both Debt and Equities, at attractive prices.

EXHIBIT 118

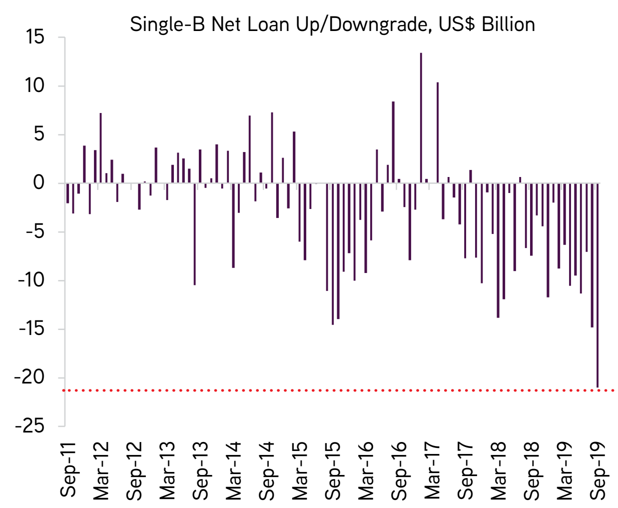
Our Implied Default Rate Has Hit Recessionary Levels Several Times, Despite the Reality That We Have Not Yet Had a Technical Recession in the United States. We View These Overreactions as an Opportunity to Lean In



Note: Our model assumes the long-term average realized default rate is 4% and the recovery rate is 40%. Data as at December 31, 2019. Source: ICE BofAML Bond Indices, S&P Global Ratings.

EXHIBIT 119

At $21 Billion, September Had the Most Single B Net Downgrades in Several Years



Data as at October 4, 2019. Source: Credit Suisse, Bloomberg.

Equally as important as the opportunity set that periodic dislocations provide, though, are the significant variations we are seeing across and within the global capital markets. To this end, we note that *Exhibit 120* serves an effective dashboard for highlighting some of these mismatches in the U.S. credit markets.

EXHIBIT 120

We See Some Substantial Bifurcations in Credit That Warrant Investor Attention

AS AT 12/31/19	CURRENT SPREAD*	1-YEAR PERCENTILE	3-YEAR PERCENTILE	5-YEAR PERCENTILE
HY Index	360	3.4%	30.5%	18.3%
BL Index	436	50.8%	76.8	46.1%
BBB IG Index	130	2.7%	8.30	5.1%
HY BB	202	4.6%	4.7%	2.8%
BL BB	276	3.4%	28.8%	17.3%
HY B	356	0.8%	13.4%	8.0%
BL B	451	16.9%	61.0%	36.6%
HY CCC	1008	61.1%	85.8%	61.5%
BL CCC	1219	61.0%	87.0%	65.2%

*Current Spread is in basis points. Data as at December 31, 2019.
Source: Bloomberg.

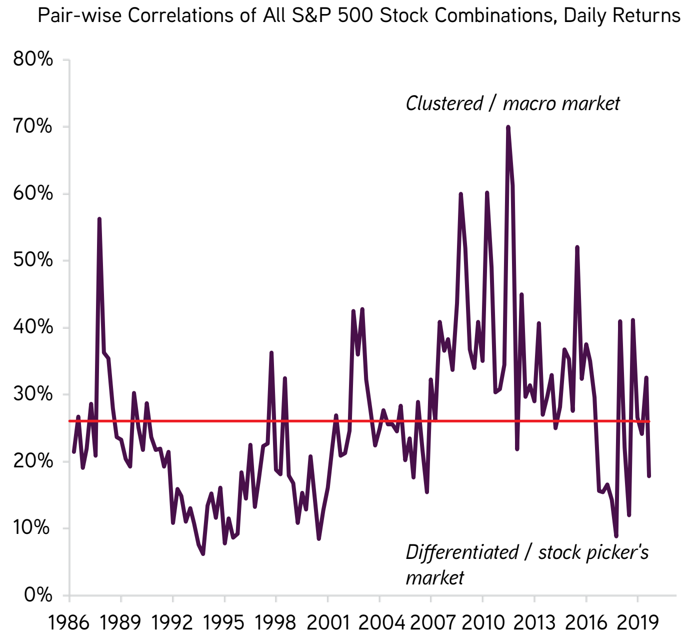
For example, B-rated Bank Loans are trading at the 61st percentile on a three-year basis; at the same time, B-rated High Yield securities are trading tight at the 13th percentile over the same period. A similar scenario is playing out in the equity markets as well. One can see, for example, in both *Exhibit 121* and *Exhibit 122* that correlation and dispersions are becoming much more favorable, a trend we expect to continue.

This improving backdrop means that there is a compelling ability to earn outsized returns, as 1) misunderstood credits are pulled to par; and 2) misunderstood equities are re-rated upward, as their earnings power becomes more apparent. Against this backdrop, we believe that hedge funds, adept credit pickers, and concentrated long-only strategies should perform well.

> **"We regard this backdrop as an opportunity because it confirms our strong view that assets are consistently being mispriced when investors lose faith in central bank liquidity and/or economic growth."**

EXHIBIT 121

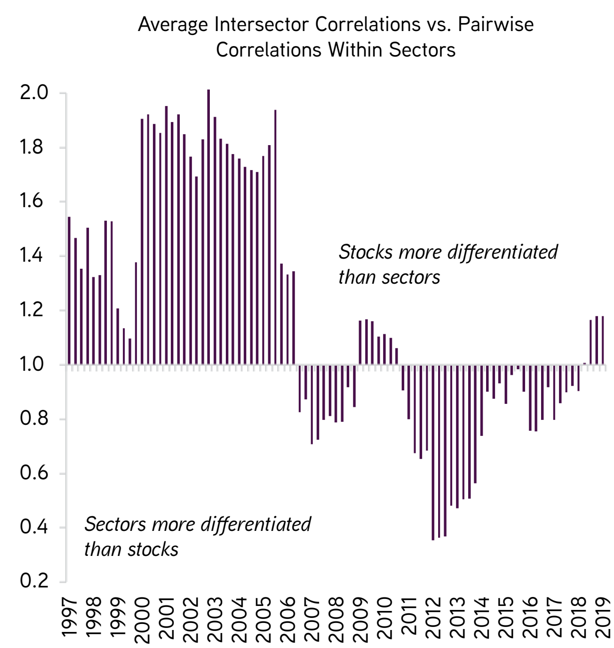
As the Tailwind from Quantitative Easing Slows, the Macro Environment for Micro Activity Should Improve



Data as at November 30, 2019. Source: BofA Merrill Lynch U.S. Equity & Quantitative Strategy.

EXHIBIT 122

Dispersions Are Now Just Starting to Widen. This Shift Is Bullish for Security Selection



Data as at December 31, 2019. Source: BofA Merrill Lynch U.S. Equity & Quantitative Strategy.

Section V: Investment Considerations/Risks

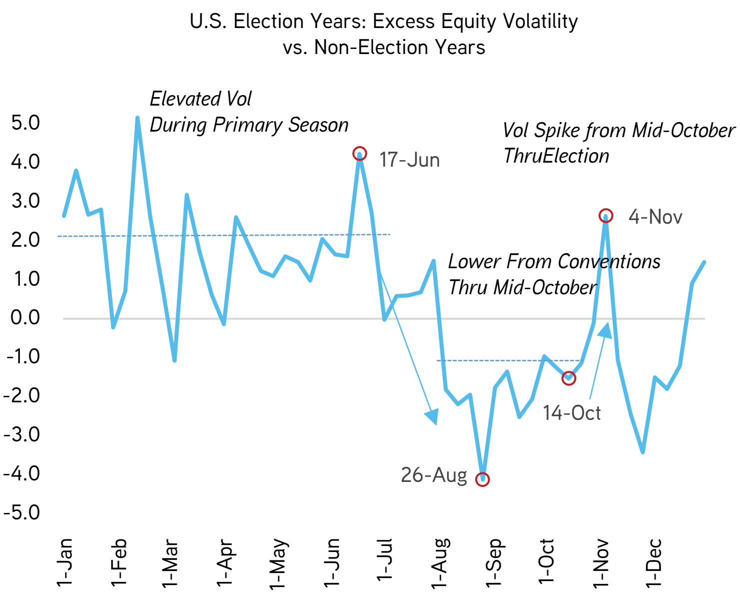
In the following section we identify risks in 2020 and beyond that we believe global asset allocators and macro investors need to consider.

Risk #1: 2020 Elections in the U.S.

Some of the most important events for global investors will be the 2020 U.S. elections for the Presidency, the House of Representatives, and one-third of the U.S. Senate. There are also some important state elections on which to focus. While all presidential elections are important, 2020 could be particularly consequential, as both a referendum on President Trump's disruptive leadership and a harbinger of future direction for U.S. policy and politics.

EXHIBIT 123

Our Research Shows That Volatility Linked to Presidential Elections Tends to Moderate from the Conventions Through October



Note: Analysis of median equity index volatility during election years vs. non-election years from 1988-2019 (i.e., eight election years and 24 non-election years). Based on OEX Volatility (VXO) prior to 1990, and SPX Volatility (VIX) thereafter. Source: CBOE, Bloomberg, KKR Global Macro & Asset Allocation analysis.

As populism and polarization have grown, increasingly ideological and angry voters have been attracted to leaders who emphasize our collective differences – versus other, more consensus focused politicians during the recent past. President Trump did not create this dynamic, but he is particularly adept at highlighting and exploiting divisions, and his presidency has accelerated this trend. In fact, under President Trump's leadership, many Republicans have repositioned themselves to embrace more divisive rhetoric.

Moreover, this divisiveness is combined with increased Republican hesitation about free trade and globalization and reduced ardor for limited government and entitlement reform. A Trump victory could make some of this repositioning more durable within the GOP. A tough talking, big spending, tariff wielding, "America First" GOP emphasizes quite different fiscal, monetary and regulatory policies than policies of Reagan, Bush, McCain and Romney. A Trump loss, by contrast, would likely produce a lengthy period of self-reflection and a battle for the Republican soul.

Once repelled by President Trump, many Democratic leaders actually now mimic parts of his divisive style. While the Democratic House majority was won by moderates in suburban districts, there is currently considerable energy on the party's more ideological left wing. This spring, for example, Democrats will choose between center left leaders like former Vice President Biden, Senator Klobuchar, Mayors Bloomberg and Buttigieg versus more ideological leaders like Senators Warren and Sanders. The outcome of this contest will most likely help determine the Democrats' future.

The historical context for this election is also important to keep in mind. Since 2015, insurgent candidates have won overwhelmingly across the world. This trend goes back further in the U.S. where, over the past 20 years, U.S. voters have increasingly voted against incumbents in favor of opposition parties. President Trump was elected as the ultimate insurgent, but today he is the incumbent. He will benefit most from a strong economy (since 1924, the only incumbent President's defeated for re-election faced a recession in the two years prior to the vote). Recent tensions with Iran could help the President as historically Americans rally around their Commander in Chief during times of global crisis. Focus on Iran could also reduce coverage of and miniaturize impeachment proceedings against President Trump. Also, the power of any sitting President to set policy, build his party machine and make news is not to be underestimated, particularly when coupled with a unified GOP and President Trump's remarkably effective communications and marketing skills.

On the other hand, President Trump, who has never achieved a 50% approval rating, has also mobilized and unified his critics. Remember the Trump GOP machine has lost many elections in 2017, 2018 and 2019. Consistent with the backdrop of a more politically charged environment, the 2018 midterms saw the highest eligible voter turnout in 104 years, and many of the 2019 off-year elections also produced historic turnout. Hence, our view is that President Trump will have more difficulty winning the popular vote. However, we all know that American Presidents are elected by the Electoral College, which means fewer than 10% of eligible voters in seven states — Florida, Michigan, Minnesota, North Carolina, Pennsylvania, Wisconsin, and Arizona — will select the next President of the United States. Within those states, pay particular attention to white working class men and suburban female voters.

U.S. Senate elections will also be important as the closely divided Senate will have a critical voice on new policy. The GOP's four seat majority is potentially in peril, as several Republicans in Democratic leaning states face serious challengers. Prediction markets may underestimate this possibility, in our opinion.

While headlines in 2020 will primarily focus on Presidential politics, smart investors should keep their eyes on legislative and regulatory trends. Where to focus? Already, we note the remarkable and somewhat underappreciated flurry of year-end negotiating and legislating in 2019. Specifically, Congress funded the Federal government through October 2020. Agreement appears to have been reached on the North American trade deal. Congress also passed their Defense bill (NDAA) and a variety of "tax extenders." Politically, these successes shows parties can still work together, even in hyper-polarized times plus an impeachment. Practically, this flurry of 2019 accomplishments means fewer 2020 political "cliffs" driven by must-pass deadlines.

In terms of a thumbnail sketch of the 2020 legislative agenda, we expect Impeachment to be wrapped up by late January or early February. Then, we should see consideration of USMCA. It's unclear whether Congress will get to consensus, but investors should also watch for: 1) action surrounding transportation or a smaller infrastructure bill; 2) significant focus on healthcare; and 3) a steady backbeat of Federal judge confirmations. With the recent conservative electoral gains in the U.K. and Brexit, we also recommend investors watch for quick movement to begin U.K./U.S. trade negotiations.

In 2020, investors should also watch for high political *theater* from both parties. From the Democrats, investors should anticipate: "show trial" hearings for disfavored industries (such as Big Tech, Big Pharma, and Wall Street); legislative proposals featuring populist themes; criticism of wealth and finance; and vocal labor unions and boisterous rallies. On the Republican side, Trump thrives on a "reality TV" atmosphere and running against the political system. This is likely smart politics as nine of the last 11 Presidential contests were won by the candidate with fewer years as a Washington politician. Watch for policy initiatives that rally the President's base: renewed emphasis on immigration and the "wall"; anti-terror programs to keep the country safe; high profile boasts versus international leaders abroad, ad hominem attacks on Democrats back home; and boisterous rallies.

In the end, Democrats will seek to make the next 10 months a referendum on President Trump. Republicans will seek to frame the race as a choice between "socialism" and the more extreme positions of the left versus free enterprise and "America First." Both will embrace a populist posture against the "status quo" and Washington. Short-term investors should take caution in making broad bets on the direction of politics and policy. Longer term investors should look past next year's noise and recognize the continued populist streak defining both political parties and what that means for individual industries and investment.

Risk #2: Earnings Disappoint, Including Technology

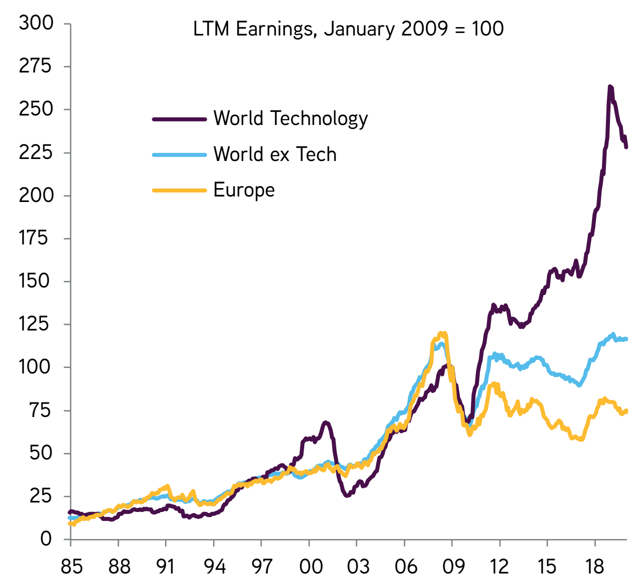
While technology has clearly been the earnings driver this cycle, we are beginning to wonder whether we as investors have all gotten too dependent on its success. Indeed, as we show in *Exhibit 124*, earnings from the Technology sector have accounted for 100% of the total increase in global EPS since the recovery began in 2009. Without question, it has created a lot of dependence on one sector in the global economy to carry us when other more cyclical sectors have faltered (think Energy or Retail).

This outsized contribution also has – of late – led to some excesses in valuation, corporate behavior, and growth assumptions. Said differently, we are not surprised by the "We" fall-out; in fact, we expect more issues in 2020 when investors come to realize that many companies in the later-stage Venture Capital and early stage Growth markets will not turn cash-flow positive. This viewpoint is significant because it means some CIOs, many of whom have strong performance based on unrealized gains, will now see their performance deteriorate.

Meanwhile, on the Credit side, we are increasingly concerned that there have been a lot of adjustments to EBITDA in areas such as software and services that could come under scrutiny in 2020. The risk, we believe, is that projected earnings do not materialize because assumptions by strategic acquirers and/or private equity are just too aggressive.

EXHIBIT 124

For Years Tech Earnings Have Outstripped Overall Earnings on a Global Basis. This Trend Now Appears to Be, On the Margin, Reversing

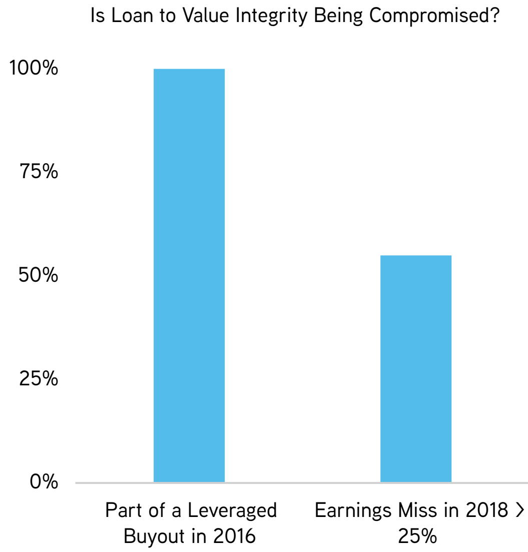


Data as at December 3, 2019. Source: Worldscope, Datastream, Goldman Sachs Global Investment Research.

"While technology has clearly been the earnings driver this cycle, we are beginning to wonder whether we as investors have all gotten too dependent on its success. Indeed, earnings from this sector have accounted for 100% of the total increase in global EPS since 2009."

EXHIBIT 125

Aggressive Add-Backs to Earnings Are Now Creating Problems for Certain LBOs



Data as at December 5, 2019. Source: Goldman Sachs, Bloomberg.

We also fear that, given Technology's recent successes, there will be more regulatory scrutiny of the sector. Europe is clearly leading the global charge around control of data and privacy issues, but the United States appears to be gaining momentum. Already, in July of last year, we saw the Department of Justice escalate its scrutiny of big technology companies by announcing a new antitrust probe. In our view, this announcement was not an aberration; rather, we view it as the beginning of a more concerted effort to make sure these companies are not too big and not too powerful.

Bigger picture, the message is clear: A lot of the shift towards risk assets has occurred because earnings, Technology in particular, have generally been strong the last 10 years. So, that trend needs to continue for the existing asset allocation that most investors have embraced in recent years to succeed. The good news is that our models still suggest decent earnings growth, including for Technology, and relatively low inflation (remember oil spikes amidst tightening financial conditions is what stymies markets, and as such, the potential for a major sustained downturn is limited, we believe).

So as we think about our 2020 forecasts, sustained disappointing EPS growth relative to expectations would be a downside risk at almost any juncture in a market cycle. However, in our estimation, that risk will be heightened in 2020, given the way that 2019 performance results played out. Specifically, after several years of EPS growth supporting market returns alongside PE expansion, essentially all of the 2019 market return has been driven by multiple expansion.

Hence, we think broad-based hedges may make sense to protect against our EPS models being too optimistic at a time when credit spreads are tight and index level multiples appear high in many instances. For those who want an outright hedge against the concerns we are voicing as part of one's target asset allocation, our colleague Phil Kim suggests a rolling program of three-month payer swaptions or payer spreads on CDX IG. For example, at current post crisis tights in spread and lows in volatility, a 3-Month Expiry, Long 25 - Short 10 Delta Payer Swaption has a 15.5x Max Gross Payout with a breakeven of 61.5[3].

Risk #3: Where We Are in the Cycle/Recession Risks

While we did not have a technical recession in 2019, our models were right to highlight that there was an elevated risk of a slowdown. Indeed, much like the 2015/2016 time period, real investment spending growth turned negative (on a sequential basis) last year. Today, by comparison, our earnings and GDP models are suggesting that there could be a rebound in 2020. However, our proprietary recessionary model still suggests that we are in a fragile period. Specifically, Paula Roberts and Nishant Kachawa, who help oversee our recession model, point to low corporate interest coverage and tightening loan standards across both commercial and consumer segments of the market.

EXHIBIT 126

Market Performances Following Long Stretches of Consecutive Performance Are Usually Choppy

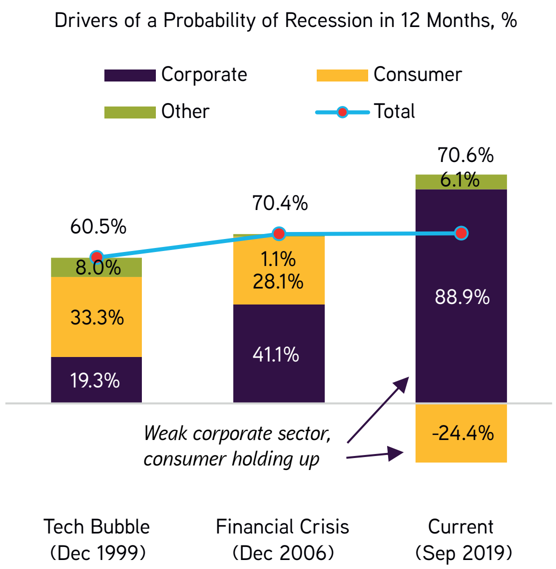
# OF CONSECUTIVE YEARS OF POSITIVE RETURNS	START	END	CUMULATIVE RETURN	CAGR
3	1954	1956	113%	28.7%
3	1963	1965	61%	17.1%
3	1970	1972	41%	12.2%
3	1978	1980	67%	18.7%
4	1942	1945	146%	25.2%
4	1958	1961	104%	19.5%
5	2003	2007	83%	12.8%
6	1947	1952	154%	16.8%
8	1982	1989	299%	18.9%
9	1991	1999	450%	20.9%
9	2009	2017	259%	15.3%
			Avg. CAGR	18.7%

Data as at December 31, 2017. Source://www.econ.yale.edu/~shiller/, Bloomberg.

3 Data as at 12/17/19, CDX IG: Long 60 Strike / Short 80 Strike Payer Spread vs. Spot Reference: 46.5, 3/18/2020 Expiry

EXHIBIT 127

The Consumer Is Currently Acting as an Overall Buffer in Our Recession Model



Data as at December 31, 2019. Source: KKR Global Macro & Asset Allocation analysis.

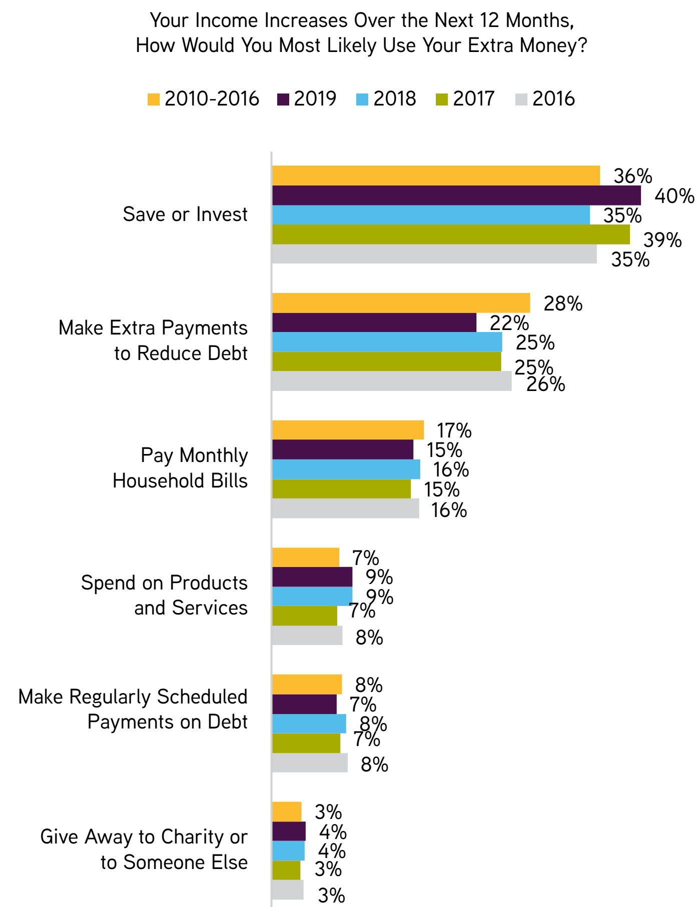
We certainly are watching our model, given its heightened level of concern on a gross basis. However, as the model also suggests, the consumer's overall health appears in good shape. One can see this in *Exhibit 127*. We also take some comfort from our friend and veteran ISI consumer analyst Greg Melich's recent survey which shows that consumers want to save more than spend on goods or even pay down debt (i.e., which would imply they are potentially over-levered). One can see that in *Exhibit 128*. An uptick in consumer savings — while it will may slow overall growth relative to potential — definitely reduces the likelihood of a sudden stop in consumer spending owing to a credit freeze, as experienced in the 2008 recession.

Risk #4: Significant Dollar Depreciation Would Be an Issue for Global Markets

We have made the call that the U.S. dollar will stop its structural ascent in 2020. We do not see it falling out of bed, but we do think a little softness will help with our thesis about broadening the performance of global equity markets (i.e., not just the U.S. doing well). However, were the dollar to face more significant pressure than we are forecasting, it could be fairly destabilizing for global capital markets. The reality is that, as we show in *Exhibit 130*, the world is long U.S. dollars across both traded assets and financial assets.

EXHIBIT 128

Consumers Are Saving More and Paying Down Debt Rather Than Over-Leveraging Themselves



Data as at December 2019. Source: Evercore ISI Survey.

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Political risk should not be overlooked. It can't be perfectly calculated like a P/E ratio or a dividend yield, but its opaqueness does not mean it should be ignored. Indeed, 2019 was a year of heightened global travel for KKR's GBR team, and collectively, we cannot remember a time in recent history where there has been so much consternation or geopolitical strife.

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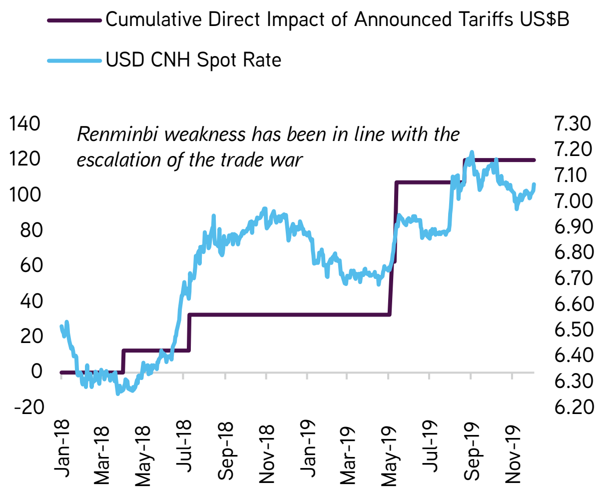
EXHIBIT 129

If the Trade War Intensifies More Than Expected, We Would Expect Further Weakness in the RMB

Direct Impact of Tariffs and Renminbi Weakness, USD Billions and RMB

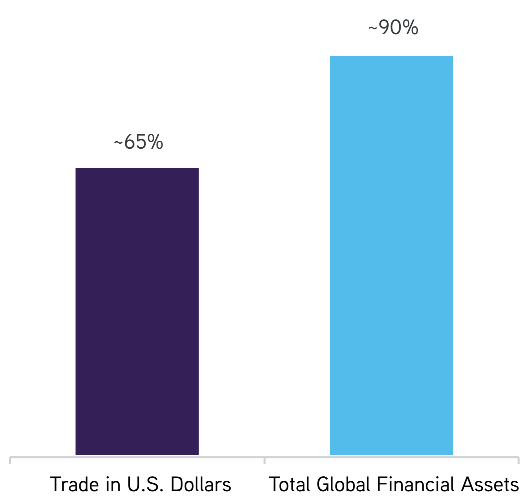


Data as at December 2, 2019. Source: Bloomberg.

EXHIBIT 130

The Global Investment and Trade Communities Are Now Heavily Overweight U.S. Assets

Trade and Financial Assets in USD, %



Data as at October 11, 2019. Source: SLJ Research, BIS.

What could create further weakness in the dollar? Trade tensions could reignite, the Federal Reserve could lose credibility, or growth might be much weaker than expected after the election. The consequences of any of these scenarios would be significant because it would likely lead to higher inflation and higher bond yields, neither of which the capital markets are set up to handle. It may likely also cause a major outflow from the U.S. credit markets, which have been major beneficiaries of foreign flows, Asian ones in particular.

We do not see this scenario as our base case, but we do believe our decision to ramp up our international exposure to Public Equities and Private Equity is prudent. In addition, we think our decision to aggressively own collateral-based assets with upfront cash flow and pricing power is probably the most effective hedge that exists.

Section VI: Conclusion

"The pessimist complains about the wind, the optimist expects it to change, the leader adjusts the sails." - William Arthur Ward

As we look ahead in 2020, there is both the strategic and the tactical to consider. On the strategic, we note the following insights that we believe are required to Play Your Game:

1. We continue to think we are in a low growth, low inflation environment on a global basis. In this environment, nominal GDP growth will remain subdued in most countries where we invest.

2. We think that liquidity will remain ample. Central banks are not going to grow their monetary base the way they did during the 2014-2017 period, but they are not going to let a second half of 2018 event occur again either.

3. We think that the earnings yield on stocks will remain above the risk-free rate in most countries. This viewpoint means that risk assets are likely to remain well-bid.

Overall, the environment we are describing is an attractive one for risk assets. However, many asset classes now reflect some of these attractive macro factors. As such, we think that a thoughtful top-down approach that leverages our key macro themes is warranted. To this end, asset allocators and macro managers should consider – amongst other things – the following tactical tilts:

1. We continue to think the ability to arbitrage Public Equity markets through the use of Private Equity is quite significant right now in both Europe and Asia. Hence, we advocate that CIOs swap more Public Equity monies to Private Equity when it comes to overall international allocations.

2. In the low nominal growth environment we envision, owning hard assets with cash flow is a prerequisite for success. As such, we currently favor Infrastructure, Real Estate, Subordinated Real Estate Credit, and Credit platforms that originate hard asset loans backed by collateral.

3. Given the rising importance of wellness, environmental safety, food safety, climate change, etc., we favor an increasing allocation to ESG-related investments.

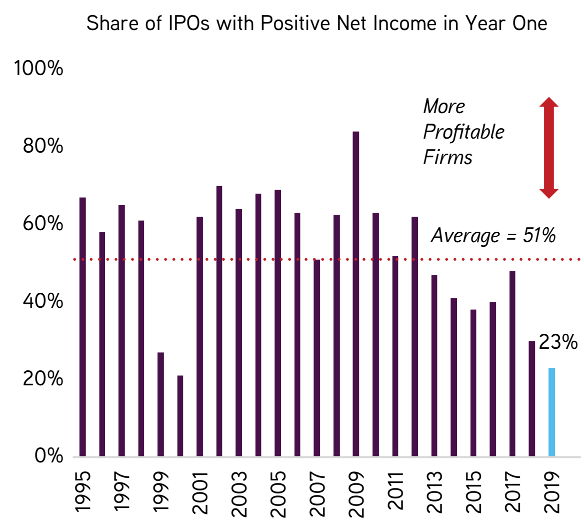
4. Within Equities and Credit, we think that the importance of cash flow is going up. As such, all our strategies are tilted towards cash flow generation, including our "Secret Sauce" framework. We also want to own cash flow compounders with strong moats around their businesses that will seek to help sustain rising returns on capital.

5. Given rising geopolitical concerns as well as unorthodox monetary policy, we expect more periodic dislocations. To this end, we tilt heavily towards investment vehicles that have flexibility, including distressed and opportunistic credit mandates, and Hedge Funds.

No doubt, there are risks to our outlook, and as such, we have highlighted a variety of hedges and market considerations that investors should review in detail. Above all, though, the best advice we can give our readers is to take a step back and dust off many of your old valuation and accounting books. The new reality that we will face this year will likely benefit those investors who will go forward by actually going "back to the future" and focusing on where actual free cash flow – not just the promise of it – is undervalued relative to expectations. And in doing so, we believe that investors will be in the best position to be able to Play Your Own Game in 2020 and beyond.

EXHIBIT 131

The IPO Market in 2019 Reflected a Move Away From Flow Generation Capabilities. We Think This Trend Is Poised to Reverse Course in 2020



Data as at December 31, 2019. Source: Goldman Sachs.

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