

The Art of Learning

In Brief

Global Macro Trends | May 2025



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With a whirlwind of recent developments—post-U.S. election tax debates, ‘Liberation Day’, and travels both abroad and at home in early May—it makes sense to update what we have been learning at KKR, especially as it relates to our *Regime Change* thesis. Overall, we view the current market environment as one that presents compelling opportunities for investors who are willing to harness the uncertainty to their advantage. Read more in our latest Insights note: *The Art of Learning*.

Learning is like sailing against the current;
if you don't advance, you will be driven back.

— Chinese proverb

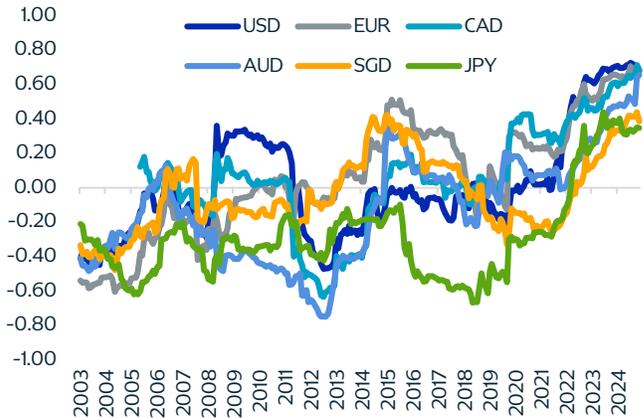
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Government bonds are no longer fulfilling their role as the ‘shock-absorbers’ in a traditional 60/40 portfolio.

Globally, investors may want to own more non-U.S. fixed income, alongside more private market Alternatives, to better diversify a portfolio. We believe there are incremental benefits on a risk adjusted basis of adding a combination of global bonds relative to U.S. Treasuries to enhance diversification and reduce portfolio correlations. Combining these assets on the liquid side with private assets like Infrastructure, Private Equity, Asset-Based Finance, and Real Estate Credit could enhance returns and risk management.

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

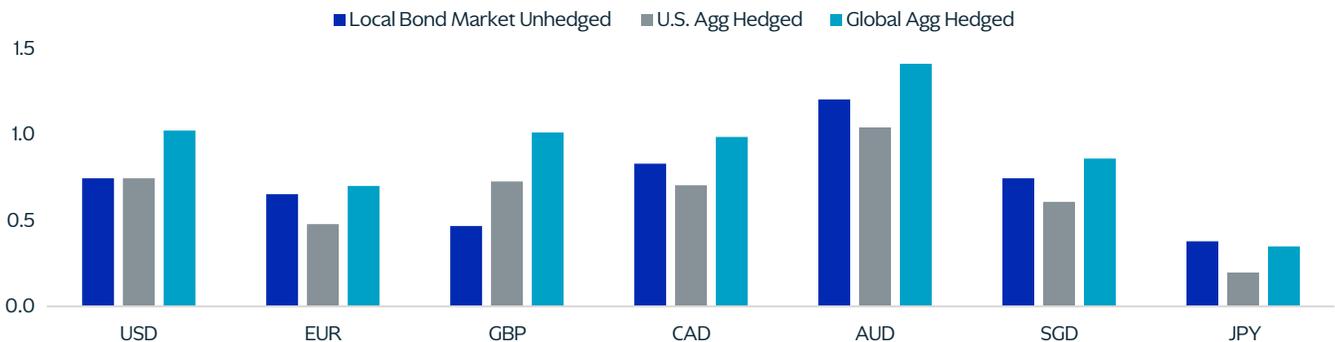
Rolling 36-month Local Stock/Bond Correlation



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

Exhibit 2: Historically, Global Bond Markets Have Generated Higher Risk-Adjusted Returns On a Hedged Basis, Driven by Slightly Higher Return and Lower Volatility

Realized Annualized Return/Volatility Ratio U.S./Global Agg Hedged to Home Currency



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

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The U.S. dollar is weakening at the same time global bonds and equities are selling off, a new wrinkle in our *Regime Change* thesis.

Another key area where we have increased our knowledge involves the U.S. dollar's valuation relative to history. With a weakening dollar, local currency liabilities have the potential to become a more severe drag on performance than we and many investors were expecting prior to April 2nd. We think investors need to spend more time thinking through non-correlated diversifiers to add to portfolios, particularly when so many investors are overweight U.S. Equities and Treasuries. We favor Asset-Based Finance, Infrastructure and Private Equity for diversification, income, and capital appreciation benefits.

Exhibit 3: Non-Correlation Only Increases in Importance in the Environment We Envision

Asset Class Correlations, Quarterly From 2004-2024

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

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

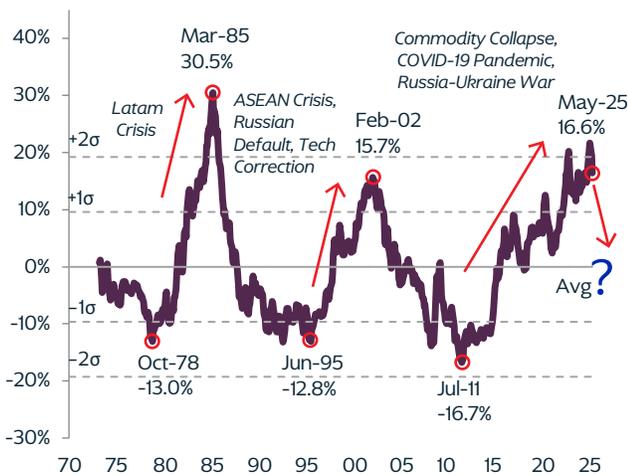
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The U.S. dollar could be a more effective tool than reciprocal tariffs.

On the flip side, we think that some mean reversion in the U.S. dollar could be more successful in improving America’s manufacturing prowess than imposing elevated reciprocal tariffs. Our models currently show that the U.S. dollar is about 15% over-valued, its third highest level since the 1980s. We advocate for a controlled adjustment rather than a drastic devaluation, aiming for a dollar valuation that would significantly improve U.S. competitiveness in global exports.

Exhibit 4: We Are Exiting a Period of U.S. Exceptionalism Dollar-Wise

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



Data as at May 15, 2025. Source: Bloomberg.

Our new baseline suggests a 15% effective tariff rate (down from 18%), which we see as the most likely steady state.

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Partial tariff relief has arrived a little faster than anticipated.

We’ve updated our ‘post-bargaining plausible case’ by incorporating what we’ve learned from the recent China and U.K. negotiations. Our new baseline suggests a 15% effective tariff rate (down from 18%), which we see as the most likely steady state. The decline in China tariffs is certainly helpful, although perhaps not as significant a game-changer for our base case as one might initially think. President Trump had already carved out exemptions for major categories like computers, electronics, and smartphones, so, reducing the assumed tariff rate on other items doesn’t have as much impact as it might seem. That said, the post-bargaining ETR for China does fall on the margin to 30%, compared to 37% in our old forecast.

Exhibit 5: Our Current Tariff Base Case Declines to 15% From 18%

U.S. Effective Tariff Rate, %



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

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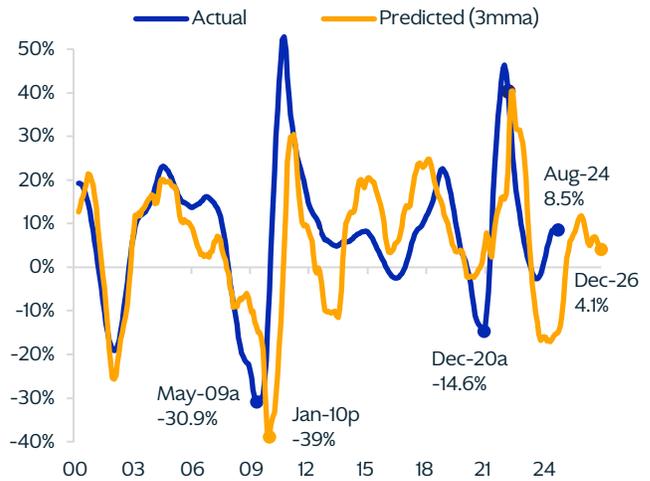
The new tariff steady state improves our GDP growth outlooks for the United States, Europe and China.

Beyond our modest GDP revisions, our Earnings Growth Leading Indicator continues to show positive growth, despite heightened uncertainty. Lower oil prices, a decline in global interest rates, and only modestly wider credit spreads keep us more optimistic than many bears. These developments support a more positive GDP outlook, with U.S. growth for 2025 now expected in the 1-2% range, up from 0.5-1.5%. In Europe, we forecast a slightly more positive outlook for GDP growth in 2025, raising our estimate to 0.7% from 0.6%. For China, the GDP impact of tariffs is now less severe, improving from -240 to -90 basis points, reducing the urgency for rate cuts and RMB depreciation, and increasing Changchun Hua's 2025 growth forecast to 4.8% from 4.3%.

Lower oil prices, a decline in global interest rates, and only modestly wider credit spreads keep us more optimistic than many bears.

Exhibit 6: Unlike 2007 and 2020, Our Earnings Growth Leading Indicator Is Not Yet Calling for Negative Growth...

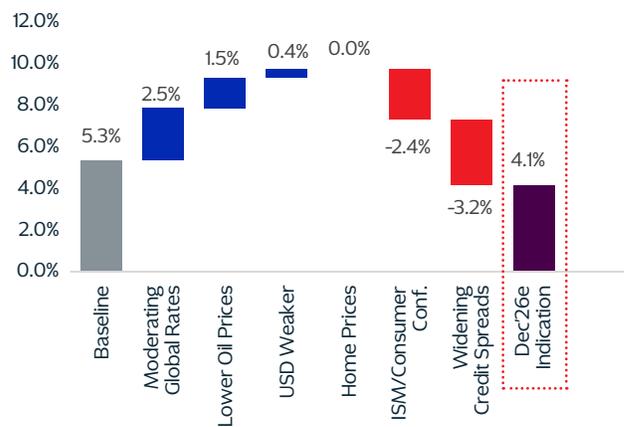
S&P 500 EPS Growth: 12-Month Leading Indicator



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

Exhibit 7: ...Because of the Benefits of Lower Low Oil Prices, a Weaker USD, and Moderating Global Rates

Contributions to December-26e S&P 500 EPS Growth Indicator



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

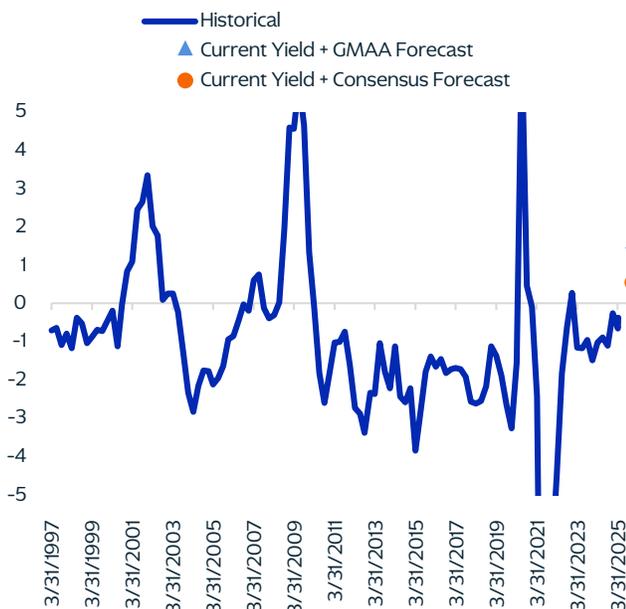
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We are watching longer term real rates.

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

Exhibit 8: We Do Not Think the U.S. Can Sustain 5%+ 10-Year Yields in the Growth Environment We Envision

TIPS 10-Year Yield vs. Real GDP Growth



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

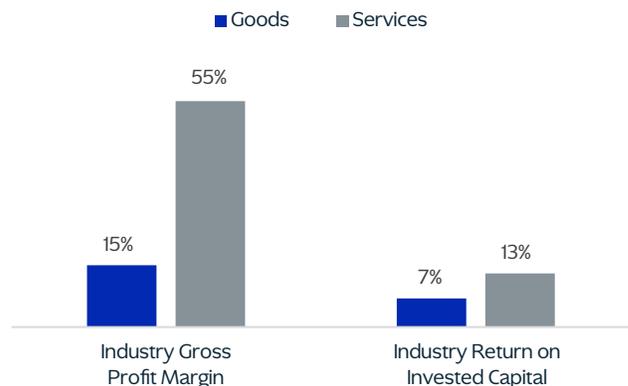
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The relative importance of goods vs. services to the U.S. economy is misunderstood.

Our estimates actually suggest that the gross profitability of U.S. services exports currently surpasses the ‘lost profits’ on goods that the U.S. imports instead of manufacturing domestically. This learning, coupled with the potential for further dollar weakness, has impacted the way we are thinking about the ‘America First’ agenda. We think leaning into the services economy is a boon not just for business but also for workers, as services account for fully 84% of U.S. private sector employment. Also crucial is that services jobs pay more per hour on average than manufacturing jobs do (\$36 per hour on average for services, vs. \$35 for manufacturing), which belies the common perception that manufacturing jobs are a singular pathway to financial security.

Exhibit 9: Services Exports Are Actually More Valuable Than Goods Imports On a Gross Profit Basis

Trade Deficit and Surplus Margins and ROIC, %



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

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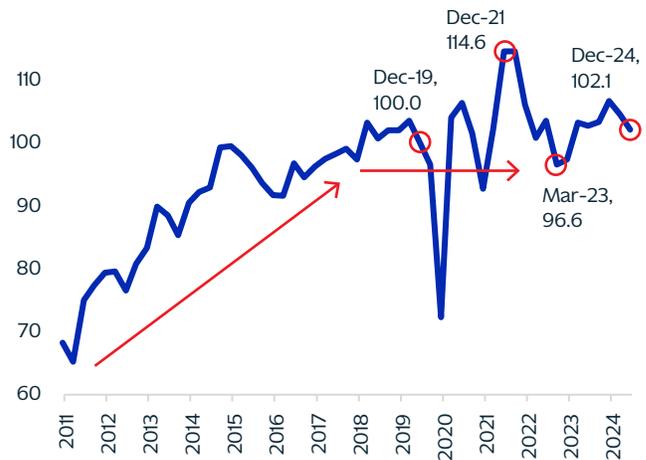
Despite only mediocre fundamental growth, the technical picture for the global capital markets, especially in the United States, remains extremely compelling.

No doubt, tariffs have created a supply shock, but the technical backdrop remains compelling. The S&P 500 is set to buy back over \$1 trillion in stock, money market balances are high, and net issuance is near historic lows. We think this means that the opportunity set for investors, especially those with a long-term horizon, may be much better than the consensus currently thinks. Inventory investment and construction capex typically account for more than 100% of the net declines in GDP during U.S. recessions, so cyclical risks are greatest when spending in these areas is running at above-trend levels. Today, the opposite is true: inventory investment and construction capex have been at below-trend levels from a cyclical perspective since 2022, due to headwinds from both Fed hikes and post-pandemic supply chain normalization. As a result, we think that Credit will perform better this cycle, and despite increased volatility, we still see the path of least resistance for the global capital markets, particularly international markets, as higher than lower.

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

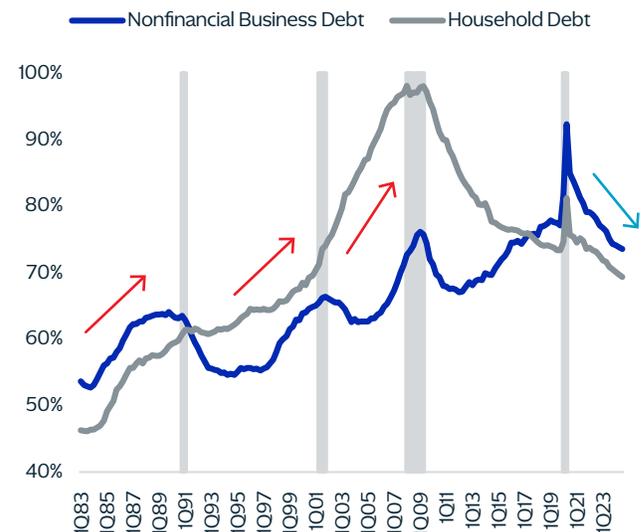
Real Construction + Inventory Investment, 4Q19=100



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

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

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



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

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But perhaps what's just as crucial is what remains unchanged.

From an asset allocation standpoint, we still favor control positions in Private Equity—especially those with operational upside stories that can also provide non-correlated inputs into a diversified portfolio and at times, drive robust profit growth. Outside of the U.S., we think that the potential for Private Equity to outperform Public Equities, especially in Europe and many markets in Asia, is considerable. Public valuations are generally attractive, while the potential to improve productivity at these companies remains outsized. Finally, we favor more active management of capital, including companies that are using Private Equity as a vehicle to transition from capital heavy to capital light models. In our view, the difference between control and non-control positions will magnify materially in 2025, as demanding equity multiples require greater focus on operational improvement and the ability to retool companies' capital structures, even as borrowing markets thaw. In Credit, our focus is on market dispersions and securities higher up the capital structure. Real Estate Credit and growth Infra within Real Assets continue to look attractive.

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Exhibit 12: The Private Equity Illiquidity Premium Actually Outperforms Public Markets in Less Robust Equity Markets

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



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

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Our mega investment themes remain intact.

We continue to favor the Security of Everything, Capital Heavy to Capital Light, Productivity & Worker Retraining, Collateral-Based Cash Flows, and Intra-Asia Trade. And in today's markets, we believe the key is to 'make our own luck.'

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