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A New Foundation for Global Wealth

Rebuilding Portfolios for the New Regime

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SECTION I

Introduction

In nearly a decade, total global assets under management (AUM) have grown 118%, from $57.8 trillion in 2012 to $125.9 trillion in 2021, while over the same period (*Exhibit 1*) global private capital AUM has grown over 300%. As a result, private asset classes now represent 7.8% of global AUM, up from 4.2% in 2021.[1] Notably, at the end of 2022, individuals represented only 16%[2] of total private capital AUM, in significant contrast to their 50% representation of global AUM. Nevertheless, some analysts[3] expect a potential shift in market share over the next ten years as **individuals increasingly look to private markets** following a period of elevated volatility, and changes in the investing landscape that have led to a Regime Change[4], including:

- **Tectonic Shifts** in the global geopolitical and macro environment. These structural shifts are putting pressure on the traditional 60/40 portfolio and driving the ongoing elevated correlation between stocks and bonds. Amid the resulting -18% performance in 2022, individual investors are increasingly seeking solutions to meet their needs for better diversification and returns.
- **A shrinking and more concentrated opportunity set in the public company universe**. The number of firms listed on public exchanges has shrunk by ~30% over the past 40 years. As examples, there are 50% fewer public companies in the United States, 35% fewer in the United Kingdom, and 13% fewer in India[5]. In addition, the stability of future returns in equity markets may be at risk amid the concentration of technology stocks. Tapping into Private Markets may broaden the investable universe and unlock return potential for investors, as an increasing portion of value creation and return generation is taking place prior to companies going public.
- **Expanded access for individual investors**. Until recently, Private Markets investing for individuals has largely been limited to the highest end of the wealth scale due to structural barriers including regulation, minimum ticket size and liquidity constraints. Globally, the average individual allocation to Private Markets Alternatives sat at roughly 3% at the end of 2022[6] versus nearly 40% for many US endowments[7]. Since then, innovative fund structures and technology solutions, including the introduction of evergreen vehicles for Private Equity and Infrastructure with lower minimum requirements, have broadened access. Moreover, this evolution is occurring as many retiring baby boomers or career switchers are moving their retirement savings out of defined contribution plans or other employer-sponsored plans such as 401(k)s into individual retirement accounts (IRAs).[8] IRAs allow for much greater individual investor control of investment decisions, including investing in Private Markets.[9]

Importantly, there is no cookie cutter approach to Private Markets investing as goals vary by age, sources of income, life circumstance and a myriad of other personal considerations. In this piece, we share our proprietary models for integrating Private Alternatives to achieve three primary investor objectives:

1. **Generate Income:** We believe incorporating Private Credit, Private Infrastructure and Private Real Estate can increase the income potential of the portfolio while maintaining substantial levels of liquidity. As detailed in

1 Bain, McKinsey, KKR Global Macro, Balance Sheet and Risk analysis.
2 "Why Private Equity Is Targeting Individual Investors", Bain & Co, February 27, 2023.
3 Bain, McKinsey, KKR GBR analysis. "Why Private Equity," Bain & Co.
4 Our colleagues Henry McVey and Racim Allouani have written a series on the new macroeconomic regime characterized by higher inflation, higher nominal interest rates, and lower real economic growth relative to long-term averages. In the series, the authors describe the need for institutional investors to rethink portfolio construction in the new regime. See "Regime Change: Enhancing the 'Traditional' Portfolio", "Regime Change: The Role of Private Equity in the 'Traditional' Portfolio", "Regime Change: The Changing Role of Private Real Assets in the 'Traditional' Portfolio", "Regime Change: The Benefits of Private Credit in the 'Traditional' Portfolio" for full details. No representation is made that the trends depicted or described will continue.
5 Data available as of 2019. World Bank.

6 Cerulli Associates.
7 2022 NACUBO-TIAA Study of Endowments.
8 Cerulli Associates, https://www.cerulli.com/press-releases/ira-assets-reach-nearly-14-trillion.
9 Prudential, https://www.prudential.com/financial-education/ira-vs-401k.

Exhibit 10, with a 30% combined allocation to private Alternatives[10], the "Generate Income" model portfolio would have yielded 5.7% annually versus 4.1% for the 60/40 portfolio.

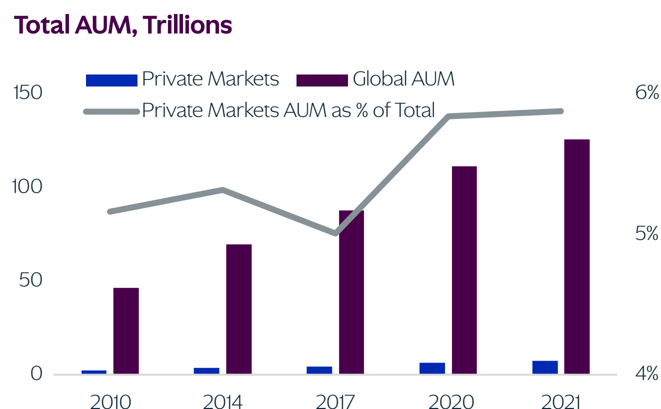
2. **Preserve Capital:** Incorporating Private Credit and Private Infrastructure into a portfolio can provide downside protection[11] and enhance inflation hedging benefits. Versus the 60/40 portfolio, our "Preserve Capital" portfolio would have lowered the standard deviation from 13.5% to 11.1%, increasing the certainty on the future value of the portfolio, given the tighter range of outcomes.

3. **Boost Return:** Incorporating Private Equity may significantly boost the performance potential of the portfolio, resulting in an additional 1.1 percentage points of return, from 9.1% to 10.2%, on a compound annual growth basis. One hundred dollars invested in the "Boost Return" portfolio in 2010 would be worth $343 today, versus $283 in the 60/40 portfolio.

Finally, **understanding cash management is critical to successful implementation**. Herein we share a framework for liquidity management involving two important steps — segmenting illiquid and liquid assets and mapping Private Markets investment funding and harvesting expectations. Underlying Private Markets assets are illiquid, i.e., not easily converted into cash. As a result, each portfolio should be separated into illiquid, comprising the private alternatives allocation, versus liquid assets, which would include cash or "liquid wealth" to fund near-term cash flow needs, such as those to fund lifestyle expenses or significant withdrawals. Thereafter, understanding expectations for the pace and level of funding versus harvesting investments by asset class e.g., whether a "J-curve" exists, will aid overall liquidity management.

Exhibit 1: The Rise in Allocation to Alternatives

Total AUM, Trillions



Data as of December 31, 2021. Source: McKinsey.

Importantly, there is no cookie cutter approach to Private Markets investing as goals vary by age, sources of income, life circumstance and a myriad of other personal considerations.

10 See *Regime Change: Enhancing the 'Traditional' Portfolio* for more information.

11 Downside protection is no guarantee against future losses.

SECTION II

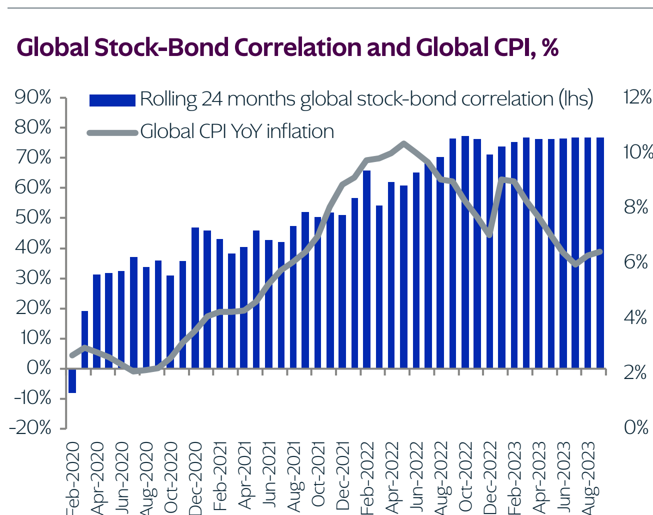
Tectonic Shifts Creating a New Macro Regime

In contrast to the post Global Financial Crisis (GFC) period where low growth and low inflation were the norm, beginning in 2021 we entered a new global regime with a higher inflation and therefore higher rate bias, which has impacted portfolio performance. In this environment, the correlation between stocks and bonds has increased, reducing the benefit of conventional diversification.

In 2022, the traditional 60/40 portfolio returned -18% as both stocks and bonds underperformed. Global equities contracted -19.5% in 2022 and global bond values declined nearly -16.2% over that period.[12] Rising input and borrowing costs put pressure on corporate margins causing elevated market volatility in 2022, which affected company stock performance. Concurrently, on the back of higher inflation, higher interest rates led to a decrease in the value of long duration, inflation-sensitive fixed rate bonds.

Exhibit 2: Globally, the Relationship Between Stocks and Bonds Is Changing in this Inflationary Environment

Global Stock-Bond Correlation and Global CPI, %

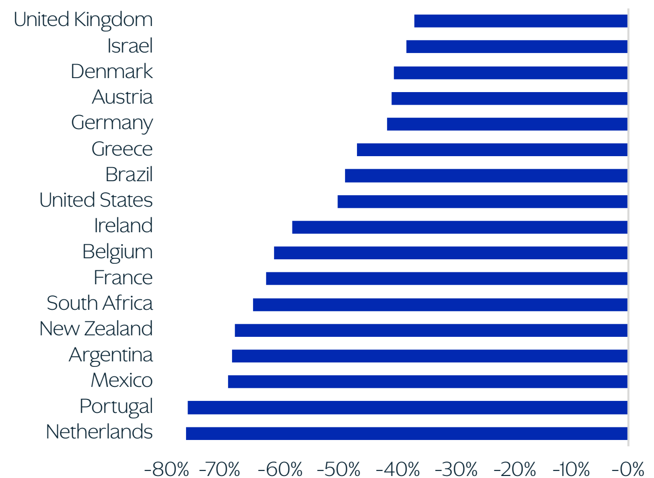


Data as of September 2023. Source: Bloomberg.

12 Bloomberg. KKR Global Macro, Balance Sheet and Risk analysis.

Exhibit 3: There Has Been a Decline in the Number of Publicly Listed Companies

Global Publicly Listed Companies and Peak-to-Trough Decline % Change: 1980-2019



Data as of December 31, 2019. Source: World Bank.

After a disappointing 2022 for stocks and bonds, and for the 60/40 portfolio, 2023 seemingly provided the stage for a recovery in the S&P 500. But the reality is that fewer than 10 stocks concentrated in software, tech and semiconductors drove roughly 75% of the performance in the first six months of the year. Excluding those 10 stocks, the S&P 500 has returned only 1.2% year to date. Both the underperformannce and outperformance of the S&P 500 has come to be dominated by only a handful of large technology companies, and this high level of performance concentration may challenge the stability of future returns. Indeed, the S&P 500 has been on a run; but that may have more to do with AI/tech optimism than real economic growth.

To be sure, our work suggests that going forward it will be difficult to replicate the ~8% returns historically generated

by 60/40 portfolios by investing in Public Markets alone. The historical performance of the 60/40 portfolio has primarily relied on multiple expansion and a low cost of financing in the stock component of the benchmark and on falling interest rates as well as stable inflation in the bond component. Large-cap Public Equities returns may be lower than they have been in recent history as higher input costs challenge earnings growth and higher interest rates constrain multiple expansion. On the other hand, while we expect future fixed income returns to be above historical averages amid higher rates, increased inflation volatility may erode the value of future bond cash flows.

The Tectonic Shifts underpinning the higher inflation bias and the challenges facing Public Equities markets are likely to persist, driving the importance of obtaining diversification, income and return elsewhere. These structural shifts include:

- **Acceleration of the energy transition:** Catalyzed by the COVID-19 pandemic and Russia's invasion of Ukraine, energy independence and sustainability have become increasingly critical priorities. As nations increase focus on adopting clean energy sources — which history suggests will be a multi-decade long transition requiring trillions of dollars — the cost of a wide array of green commodities (e.g., lithium, nickel) and rare earth minerals will remain elevated as demand for these scarce materials is likely to exceed supply.
- **Shift from "benign globalization" to "great power competition"**: The race between China and the U.S. as well as greater competition between nations — including between partners — is resulting in increased supply chain redundancy and focus on securitization across a wide array of strategic industries.[13]
- **Demographics, migration and labor shortages**: Slowing growth in the working age population has negatively impacted the global economic growth outlook. Further, the undersupply of labor and housing will likely sustain higher wage and shelter costs.
- **Short term impact of AI investment**: While technology tends to be deflationary in the long term, the development of AI in the short term is, we believe, inflationary due to the quantum of energy, labor, semiconductors, data centers, and other critical resources necessary for AI to scale.

To be sure, our work suggests that going forward it will be difficult to replicate the ~8% returns historically generated by 60/40 portfolios by investing in Public Markets alone. The historical performance of the 60/40 portfolio has primarily relied on multiple expansion and a low cost of financing in the stock component of the benchmark and on falling interest rates as well as stable inflation in the bond component.

13 General (Ret.) David Petraeus and Vance Serchuk.

SECTION III

Opportunities in Private Markets

1

Overview

In the low real growth, high inflation, higher rate macro regime we believe we are in, most asset classes—public or private—may experience slower returns, but private asset classes could fare better given the possible excess returns over public markets, inflation hedging and volatility dampening benefits inherent in many of the asset classes.

Historically, Private Equity has generated an average excess return of 430 basis points versus Public Equities.[14] The excess return over public markets or the "**illiquidity premium**" derives from the ability to improve a company or asset through active involvement. In contrast to passive ownership in Public Markets, having a direct ownership stake in a private company allows sponsors to improve business operations or better align employees and management, for example, which historically has driven significant value creation. Long term investments also create tax advantages by avoiding short term capital gains tax incurred when selling assets held for less than a year.

Portfolio diversification can increase returns without increasing risk, we believe. We have noted that the elevated correlation between stocks and bonds may translate into a reduced benefit from diversification in the 60/40 portfolio as bonds are not providing their traditional shock absorption benefit. Incorporating less correlated assets into one's portfolio allows investors to reduce portfolio-level risk.

Finally, tapping into Private Markets may significantly **broaden the opportunity set**. An increasing portion of value creation and return generation now occurs within privately held companies as 85% of US companies with revenue over $100 million are private, according to Bain & Co. In fact, in the US., the number of Private Equity-backed companies has exceeded publicly held companies since 2012. Today, Private Equity is an established alternative for capital raising in lieu of going public. Remaining private can lessen the regulatory burden on companies and allow for a greater focus on long-term value creation plans, as opposed to the quarterly demands of the public markets.

2

Comparison of the Role of Different Private Markets Asset Classes in a Portfolio

While all Private Markets asset classes may benefit from an illiquidity premium, each asset class exhibits different return, yield, inflation hedging and downside protection benefits.[15]

Private Equity can offer comparatively high returns while Real Assets and Private Credit can provide more downside protection or preservation of capital[16]. Indeed, Private Credit and Infrastructure have historically experienced shallow drawdowns and fast recovery periods, along with strong income generation that can buffer possible valuation drawdowns. Real Assets like Real Estate and Infrastructure provide purchasing power protection due to

14 KKR *Regime Change: The Role of Private Equity in the 'Traditional' Portfolio*.

15 Downside protection is no guarantee against future losses.

16 *Ibid.15.*

Exhibit 4: Select "Foundational" Private Markets Alternative Asset Classes

Overview of Key Alternative Asset Classes

	Private Equity	Private Credit	Private Real Estate	Private Infrastructure
High-Level Description	Invest in private companies and seek to create value by improving business operations and/or expanding into new businesses.	Lend to companies with greater control and lender protections (but less liquidity) than available in public markets and receive regular income driven by loan repayments.	Invest in or lend to commercial properties including apartments and industrial facilities, and benefit from capital appreciation and income generation.	Invest in essential physical assets in sectors such as transportation, telecommunications or power where cash flow may be contracted or regulated.

Data as of October 31, 2023. Source: KKR GBR analysis.

the valuation tie with replacement costs, and infrastructure assets specifically often include contracts explicitly linked to inflation. Notwithstanding their defensive attributes, these asset classes generally retain the ability to achieve upside potential if operators boost the profitability of the underlying asset, especially in sectors that may benefit from sustainable, long-term industry tailwinds.

Overview of Key Alternative Asset Classes

Incorporating these asset classes to further diversify a portfolio comprising Public Equities and fixed income may enable investors to better withstand potential declines in Public Equities markets and offer more ways to win. Today, Public Equities are exhibiting a high correlation across asset classes except Private Real Estate Equity. Private Credit and Private Infrastructure also exhibit a low correlation to Bonds.

At KKR, considering this new macroeconomic backdrop, we have increased our focus on collateral-based cash flows backed by hard assets, such as in Infrastructure, Real Estate, and Asset-Based Finance. These income streams, or the assets backing them, generally are able to keep pace with inflation, either contractually or via pricing power, which is one of the core drivers of the outperformance of many Real Assets in the new regime.

Exhibit 5: 12 Quarter Correlation Matrix

Rolling 12 Quarter Correlation Matrix	Public Equities	Bonds	Private Infrastructure	Private Credit	Private Equity	Private Real Estate Equity	Private Real Estate Credit
Public Equities							
Bonds							
Private Infrastructure							
Private Credit							
Private Equity							
Private Real Estate Equity							
Private Real Estate Credit							

Public Equities refers to the S&P 500, Bonds refers to the Global-Aggregate, Private Equity refers to Cambridge Associates Benchmark, Private Credit refers to the Cliffwater Direct Lending Index, Private Real Estate Equity refers to Green Street U.S. Commercial Real Estate, Private Real Estate Credit refers to Giliberto-Levy Commercial Mortgage Performance Index, and Private Infrastructure refers to Cambridge Associates Private Benchmarks. Green = Low (-0.50 to 0.50), Yellow = Moderate (0.50 to 0.75), and Red = High (0.75 to 1.00) Correlation. Data from March 31, 2020 to December 31, 2022. Source: Cambridge, Bloomberg, Giliberto-Levy, KKR GBR analysis.

Here is where we see opportunities within each Private Markets asset class:

Credit:

- We expect **Private Credit** returns to be higher over the next five years relative to the last five years, benefiting from the elevated policy rate and the credit-constrained environment where traditional bank lenders have pulled back from the market. Many Private Credit asset classes are offering yields above their 10-year averages, but a focus on quality, especially at this stage of the cycle, is paramount.
- **Private Credit** — which may include **Direct Lending and Asset-Based Finance** — can offer compelling yield with an element of downside protection and diversification compared to traditional asset classes. As we near the mild downturn we anticipate, Asset-Based Finance may become increasingly attractive given the asset backing and inflation hedging features.

Private Infrastructure:

- Private Infrastructure may offer **potential downside protection** via exposure to essential assets, but also **significant alpha generation potential** through exposure to secular and thematic tailwinds like digitalization and decarbonization. Infrastructure provides both current income and strong inflation hedging characteristics due to the tendency for contracts at the asset level to have embedded inflation escalators.
- While some Private Infrastructure assets can be more bond-like in generating predictable cash flows, a similar playbook to that of Private Equity can increasingly also be applied here to grow the value of the underlying assets and contribute to possible outperformance over Public Infrastructure returns. Importantly, not all infrastructure is the same and, as a result, assets that require substantial construction or development in GDP-sensitive or volatile areas warrant additional diligence.

Private Equity:

- Private Equity has historically been among the **top returning private asset classes**. Sponsors invest in private companies and seek to create value by improving business operations and/or expanding into new businesses.
- Going forward, given lower expected Public Equities market returns, the illiquidity premium is likely to become even more valuable. Further, Private Equity's excess returns over Public Equities tends to be greatest when public market volatility is highest. As a result, the current capital market dislocation may present significant opportunities.

Private Real Estate:

- Private Real Estate has been a strong performer in recent years, as logistics, warehouses, and muti-family have all performed well. However, in the current "lender's market," for example, **Private Real Estate Credit** also appears attractive, as it is offering almost equity-like returns with lower levels of risk due to its seniority in the capital structure. Tighter capital standards, unrealized losses and higher loan loss reserve requirements are forcing financial institutions to hold more capital and issue fewer loans, which has provided an opportunity for non-bank lenders to fill the gap.
- **Private Real Estate Equity** has historically outperformed in times of elevated inflation. Particularly as interest rates normalize, Private Real Estate Equity has the ability to deliver **inflation hedging, diversification, and tax benefits,** e.g., depreciation and other charges can offset taxable returns. Further, given expectations for slower real GDP growth, real estate allows investors to gain exposure to long-term secular trends such as digitalization or demographics, for the prospect of earning GDP+ returns.
- While fundamentals in many sub-sectors of Real Estate outside of non-Prime Office remain strong, the Logistics and Housing sub-sectors in particular are starting to look increasingly attractive relative to traditional asset classes given the repricing experienced over the past 12 months.

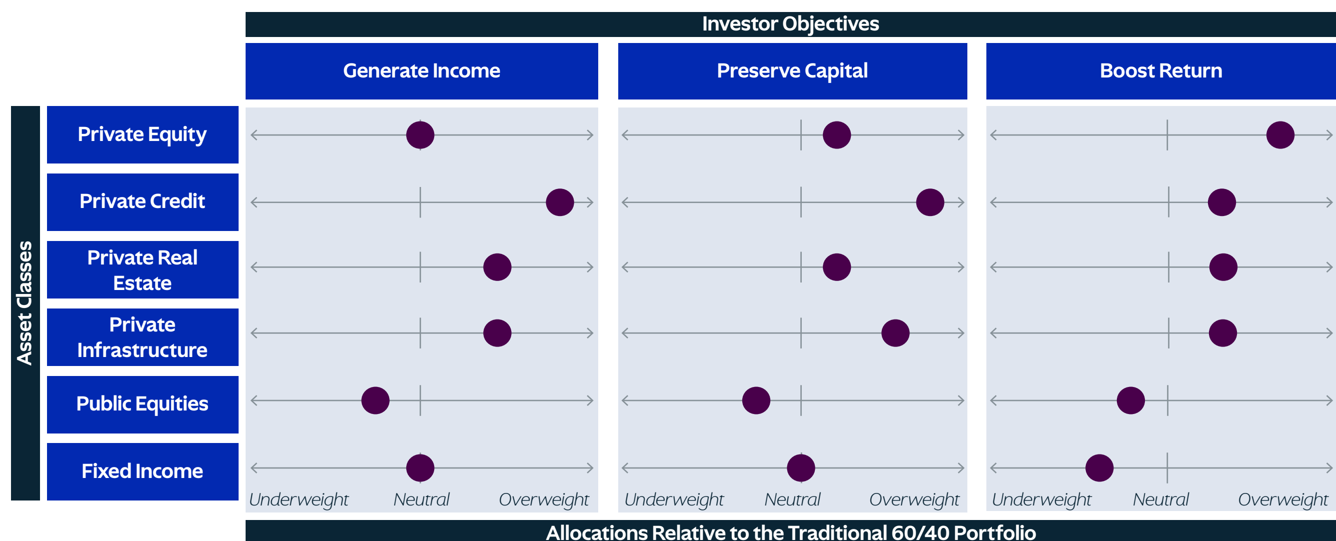
SECTION IV

How to Construct a Diversified Portfolio with Private Alternatives

Today, many individual portfolios still resemble the traditional 60/40 asset allocation, but investors are increasingly looking for guidance on how to enhance their portfolios with Alternatives. Recognizing that investors have diverse core objectives varying by factors such as age, sources of wealth, and life circumstances, we have developed three model portfolios informed by our discussions with Financial Advisors, private bankers and CIOs globally.[17] The three models are:

1. **Generate Income:** Increase the income potential, relative to the 60/40 portfolio, while maintaining reasonable levels of liquidity.
2. **Preserve Capital:** Increase stability of returns while providing inflation hedging benefits.
3. **Boost Return:** Enhance total return potential through the cycle.

Exhibit 6: Potential Asset Allocation "Tilts" Relative to the 60/40 Based on Investor Objectives



Note: Allocation tilts shown are relative to an existing 60/40 Portfolio consisting of 60% Public Equities and 40% Fixed Income. Optimization analysis performed using the S&P 500 for Public Equities, the Bloomberg Global Aggregate for Fixed Income, the Cambridge Associates Private Benchmarks for Private Equity, the Cliffwater Direct Lending Index for Private Credit, the Cambridge Associates Global Infrastructure Benchmark for Private Infrastructure, and the Cambridge Associates Real Estate Index for Private Real Estate. Data as of October 31, 2023. Source: Bloomberg, Cambridge, KKR GBR analysis. No specific KKR products referenced.

17 There are no guarantees investment objectives will be achieved or materialized.

Background On Our Quantitative Approach to Developing Model Portfolios

We approached the formulation of our asset allocation models via Monte Carlo simulation[18], which allowed us to test a range of scenarios to determine which portfolio allocations would most likely achieve each stated objective. We calibrated the model using (i) actual historical returns, (ii) historical asset class volatility, and (iii) historical correlations amongst asset classes.

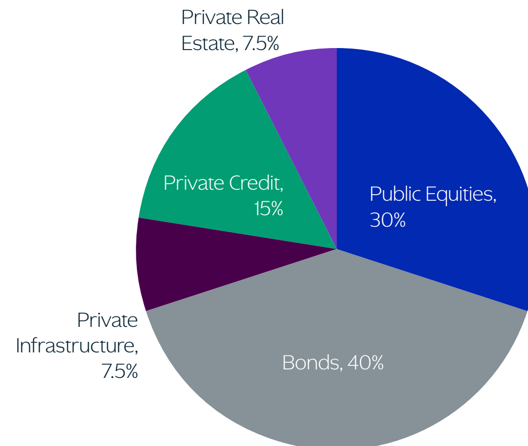
Across investment objectives, and consistent with the framework introduced in our KKR note Regime Change: Enhancing The 'Traditional' Portfolio, our work suggests that increasing the Private Markets allocation to 10-30% can significantly improve results for individuals comfortable with giving up substantial liquidity. We back tested the portfolios across a variety of metrics (*Exhibit 10*) and they each achieved the stated objective and outperformed the traditional 60/40 portfolio.

#1: Generate Income

The "Generate Income" portfolio is designed to increase yield while maintaining greater access to liquidity. To meet this income objective, investors can reallocate from the Public Equities tranche to more yield-oriented Alternative asset classes while maintaining a substantial Bond allocation. Within Alternatives, the high Private Credit allocation generally can provide predictable and attractive streams of cash flow. Private Credit encompasses distinct sub-asset classes such as Direct Lending and Asset-Based Finance where structures, terms, and opportunities vary. It is similarly the case in the other yield-contributing Alternatives allocations in this portfolio, Private Real Estate and Private Infrastructure, which offer exposure to collateral-based cash flows, both high up in the capital structure as a lender or on the equity side as an owner.

Exhibit 7: KKR's Generate Income Portfolio Allocation[19]

Alts Enhanced - Generate Income



Data as of October 31, 2023. Source: KKR GBR analysis.

#2: Preserve Capital

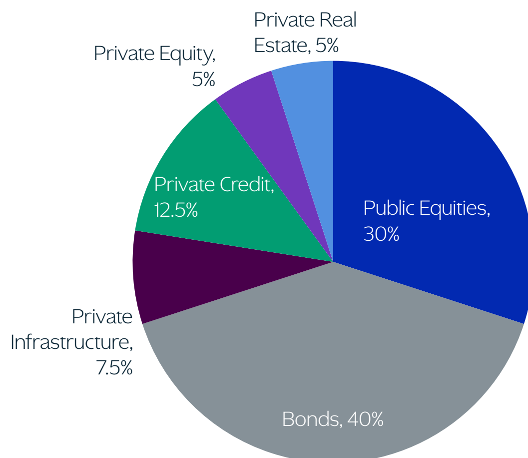
The "Preserve Capital" portfolio is designed to enhance capital preservation by decreasing the volatility of returns and protecting capital from inflation's corrosive effects. Private Credit and Private Infrastructure, which tend to exhibit low volatility, shallow drawdowns, and reliable inflation hedging characteristics, are the core elements of this portfolio.

Private Infrastructure assets typically provide essential functions with high entry barriers, so their values may be less exposed to fluctuations. Private Credit has historically proven relatively resilient to market downturns due to the senior secured nature of private loans and the equity subordination. Both asset classes are also better protected from inflation pressures via the inflation linkage embedded in Private Infrastructure contracts or the floating rate nature of private loans or collateral-based cash flows available in parts of Private Credit. Altogether, this is a relatively low volatility portfolio (*Exhibit 10*) designed to protect the "nest-egg" but with enough upside to outpace the effects of inflation.

18 Monte Carlo simulation is a quantitative modeling approach that uses repeated sampling to determine the probability of an event occurring.

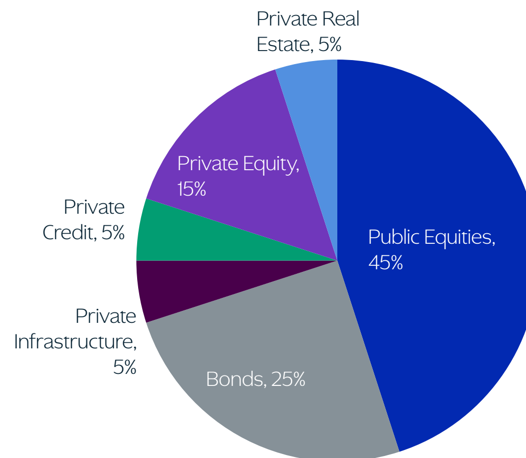
19 Allocations are shown for illustrative purposes only and should not be viewed as a solicitation of any KKR sponsored product or investment.

Exhibit 8: KKR's Preserve Capital Portfolio Allocation[20]



Data as of October 31, 2023. Source: KKR GBR analysis.

Exhibit 9: KKR's Boost Return Portfolio Allocation[22]



Data as of October 31, 2023. Source: KKR GBR analysis.

#3: Boost Return

The "Boost Return" portfolio is designed with the principal goal of increasing returns while benefiting from diversification. Supported by value creation through operational improvement, as well as alignment of interests, Private Equity returns have historically outperformed Public Equities by 430 basis points[21].

It is important to note that the tradeoff of liquidity versus return is apparent in all the model portfolios but perhaps best exemplified here. Specifically, there is a material and persistent return premium that can be harvested by taking on incremental illiquidity. With that said, there is some offset, as the income distributions from the Private Credit, Private Infrastructure, and Private Real Estate Equity buckets, combined with the inherent dividends and coupons from the 70% allocation to traditional liquid public equities and bonds, provides a liquidity cushion.

In *Exhibit 10*, we have shared the results of our back test of each portfolio across a variety of metrics. Most notably, for all of the portfolios that include Alternatives, the risk-adjusted return (measured by the return per unit of risk) outperformed the traditional 60/40 portfolio in both high and low inflation environments. Informed by quantitative and historical analysis, each portfolio achieved its objective given the selection and weighting to each asset class but, also because of the power of diversification. The benefits of aggregating assets with low correlations cannot be overstated; and with rising correlations between stocks and bonds, Alternatives perform a crucial diversifying function.

Supported by value creation through operational improvement, as well as alignment of interests, Private Equity returns have historically outperformed Public Equities by 430 basis points.

20 *Ibid. 19.*

21 KKR *Regime Change: The Role of Private Equity in the 'Traditional' Portfolio.*

22 Allocations are shown for illustrative purposes only and should not be viewed as a solicitation of any KKR sponsored product or investment.

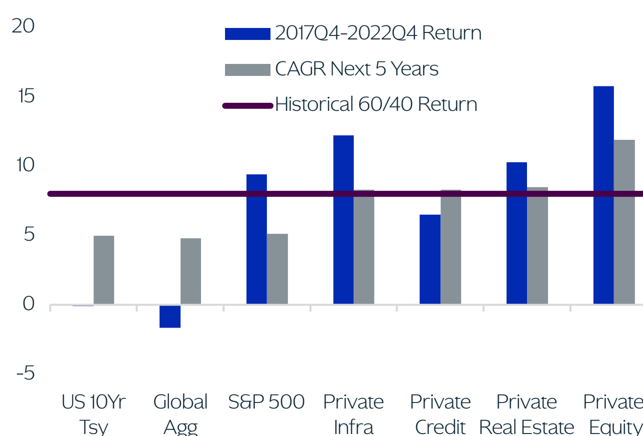
Exhibit 10: KKR's 'By the Numbers' Model Portfolio Metrics

All Periods by Portfolio	Return	Volatility	Return per Unit of Risk	Δ vs. 60/40	% Liquid Asset	Cash Yield
Generate Income	8.7%	10.8%	0.81	0.14	70%	5.7%
Preserve Capital	9.0%	11.1%	0.81	0.14	70%	5.4%
Boost Return	10.2%	14.0%	0.73	0.06	70%	3.9%
60 / 40	9.1%	13.5%	0.67		100%	4.1%
High Inflation						
Generate Income	9.7%	10.8%	0.90	0.19	70%	6.4%
Preserve Capital	10.2%	11.1%	0.92	0.20	70%	6.0%
Boost Return	11.9%	13.6%	0.87	0.15	70%	4.4%
60 / 40	9.5%	13.2%	0.72		100%	4.9%
Low Inflation						
Generate Income	7.7%	10.4%	0.75	0.16	70%	4.5%
Preserve Capital	7.9%	10.7%	0.74	0.15	70%	4.1%
Boost Return	8.8%	14.7%	0.60	0.01	70%	3.0%
60 / 40	8.2%	14.0%	0.59		100%	2.6%

Note: High Inflation is defined as annual CPI > 2.5% and Low Inflation is defined as annual CPI < 2.5%. Portfolio returns and volatility modeled using annual total returns from 1971 to 2022 for the S&P 500, from 1997 to 2022 for Private Real Estate, from 2004 to 2022 for Private Infrastructure, from 1974 to 2022 for Bonds, from 1997 to 2022 for Private Equity, and from 2005 to 2022 for Private Credit. Assumes continuous rebalancing of the portfolios. U.S. Equities modeled using the S&P 500 Index. Bonds modeled using the Bloomberg US Agg. Private Real Estate modeled using the Cambridge Associates Real Estate Index. Private Infrastructure modeled using the Cambridge Associates Infrastructure Index. Private Equity modeled using the Cambridge Associates Private Equity Index. Private Credit modeled using the Cliffwater Direct Lending Index. Cash yields modeled using annual data from 1970 to 2022 for Public Equity, from 1976 to 2022 for Bonds, 2000 to 2022 for Private Real Estate, 1990 to 2022 for Private Infrastructure, 1994 to 2022 for Private Equities, and 2005 to 2022 for Private Credit. Public Equities using S&P 500 12M gross dividend yield, Private Equity proxied using S&P Small Cap 12M gross dividend yield, Private Infrastructure proxied using S&P Infrastructure 12M gross dividend yield from 2006 onwards and 1990-2006 back filled using S&P Utilities, Public Credit based on Bloomberg US Agg yield to worst, Private Credit using Cliffwater Direct Lending Index Income Return, Private Real Estate based on Green Street All-sector Equal-weighted cap rate. Source: Cambridge Associates, Green Street, Bloomberg, NCREIF, KKR GBR analysis.

The "Generate Income" portfolio produced a high cash yield, even relative to portfolios with higher allocations to illiquid assets. The "Preserve Capital" portfolio exhibited comparatively low volatility and strong risk-adjusted returns. Finally, the "Boost Return" portfolio blew the other portfolios out of the water across time periods in terms of return all while doing so with less volatility than the 60/40 portfolio.

Exhibit 11: KKR Expected Returns Framework



Data as of October 31, 2023. Source: Bloomberg, Cambridge, KKR GBR analysis.

Importantly, based on our KKR forecasted expected asset class returns (*Exhibit 11*), we expect Public Equities returns in particular to moderate relative to the previous five years given the Regime Change[23]. On the other hand, Public and Private Credit returns should increase given higher risk-free rates – all else being equal. However, amid the elevated correlation between stocks and bonds – which we expect to persist driven by Tectonic Shifts, bonds may not play the crucial shock absorption role going forward. Investors may need to rely on other sources, including Private Markets Alternatives to achieve diversification and reduce volatility.

Importantly, based on our KKR forecasted expected asset class returns, we expect Public Equities returns in particular to moderate relative to the previous five years given the Regime Change.

23 KKR *Regime Change: The Role of Private Equity in the 'Traditional' Portfolio*.

SECTION V

Evolution of Private Markets

Until recently, Private Markets investing has largely been limited to the highest end of the wealth scale due to structural barriers including regulation, lack of access, economics, and liquidity constraints. Today, by comparison, innovative fund structures and technology solutions, including the introduction of evergreen vehicles, have broadened access.

Regulation: The new frontier for global wealth is propelled not just by this new macroeconomic regime, but also by a supportive regulatory and technological backdrop. In recent years, regulatory changes around the world have allowed fund managers to offer new private wealth solutions. For example, in 2020, the U.S. Securities and Exchange Commission expanded the definition of "accredited investor"[24] beyond wealth-based criteria to include individuals with sufficient "knowledge and expertise" about a potential investment. Across the pond, the European Long-Term Investment Fund or the Long-Term Asset Fund in the UK are structures that result in easier access to private asset classes for individual investors. Simultaneously, new FinTech tools and partnerships have been fast entering the market, resulting in customized solutions for individual investors that seek to offer holistic portfolio analytics, reporting, and streamlined distribution.

Product innovation: We see three main vehicles for individuals to gain access to Private Alternatives, each with different liquidity characteristics:

1. **Drawdown funds**: *closed-end* funds, which require investor commitments at inception, call capital from investors periodically over an *investment period* — typically 3-5 years — to invest in deals and then distribute proceeds back to investors following realizations, during the ~5-7 year *harvesting period*. Eligible investors are "qualified purchasers" holding investment portfolios with a value of $5 million or more.
2. **Evergreen or semi-liquid vehicles**: *open-end* structures are typically continuously available and priced daily or monthly at their *net asset value*. Investors can redeem a portion of the invested capital, typically limited to 5% at the total vehicle level, on a quarterly basis. Eligible investors are "accredited" i.e., have a single income greater than $200,000 or have a joint income with a spouse greater than $300,000.
3. **Listed vehicles**: traded vehicles such as REITs for Private Real Estate and Business Development Companies (BDCs) for Direct Lending which have illiquid underlying assets within a publicly traded wrapper. As such, these vehicles can sell shares on the open market with daily liquidity, though they are subject to market forces and prices are highly correlated with equity prices. There are no eligibility requirements for listed vehicles.

However, amid the elevated correlation between stocks and bonds — which we expect to persist driven by 'Tectonic Shifts', bonds may not play the crucial shock absorption role going forward. Investors may need to rely on other sources, including Private Markets Alternatives to achieve diversification and reduce volatility.

24 https://www.ecfr.gov/current/title-17/chapter-II/part-230#230.501

SECTION VI

Managing Illiquidity and Semi-Liquidity

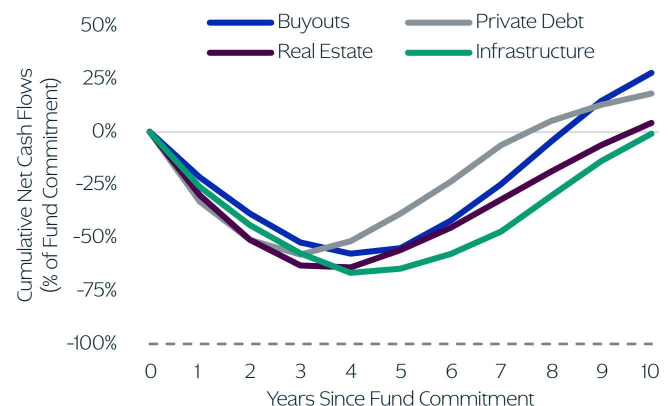
As more individuals lean into Private Markets investing, understanding how to manage the inherent liquidity constraints is critical. To be sure, the underlying Private Markets assets are illiquid, i.e., not easily converted into cash. Importantly then, each portfolio should be separated into illiquid, comprising the private alternatives allocation, versus liquid assets, which would include cash or "liquid wealth" to fund near-term cash flow needs, such as those to fund lifestyle expenses or significant withdrawals. Interestingly, once an institutional or individual investor goes through the exercise of modeling their cash flow needs, they most often find that they have *overestimated* liquidity needs.

Managing Cash Flow When Investing in a Drawdown (Illiquid) Vehicle

Investing in drawdown vehicles typically requires the most planning as investors must reserve liquidity to fund capital calls during the investment period and be ready to reinvest capital when returned by the General Partner (GP) during the distribution period. Notably, the deployment and distribution profile of drawdown funds varies by asset class. A Private Credit drawdown fund will typically draw capital over ~3 years and return most proceeds over the following ~3 years; those periods are generally longer for Private Equity and Infrastructure. That said, committing to a typical Private Equity drawdown fund does not mean that the total commitment amount will be locked up for the entire fund term (typically ~10 years). In early years, a portion of this commitment will be "called" each year, leaving the remainder "uncalled" until further capital calls are issued. Thereafter, proceeds are distributed upon exit of the underlying investments during the distribution phase. Investors should retain capital in liquid form to meet capital calls, whose magnitude and timing can be uncertain and vary fund to fund. During the distribution phase, capital is gradually returned to investors and can be considered "liquid" again. Finally, by its term, the fund would have typically returned most of the original capital plus investment returns.

Exhibit 12: Typical Cash Flow Profile for Private Strategy Drawdown Vehicles

Typical Net Cash Flows as a % of Fund Commitment



Data as of October 31, 2023. Source: KKR Portfolio Construction analysis.

Managing Cash Flow When Investing in an Evergreen (Semi-Liquid) Vehicle

In a semi-liquid structure, the investor may invest the entire target commitment into an existing vehicle on day 1. There is no "investment period" or "distribution period" as the vehicle is continuously invested though providing limited liquidity. Typically, those funds offer a maximum 5% of NAV liquidity per quarter (or ~20% per year), generally after some period of lock up. That said, available liquidity could be higher if other investors do not redeem, or could be lower if the manager decides to increase restrictions. Further, investors should note that there are tax incentives and

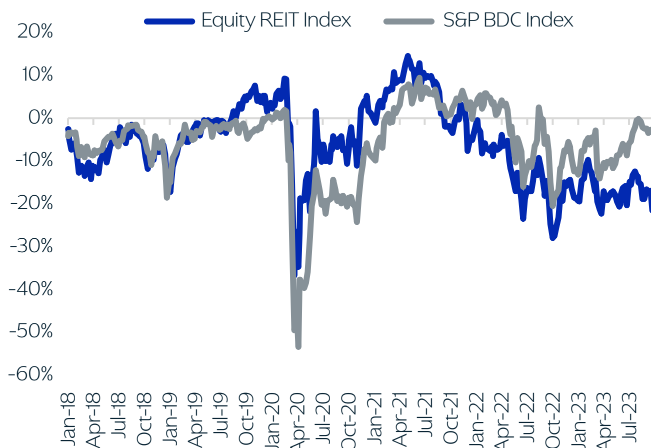
capital appreciation benefits from remaining invested for a longer period.

Managing Cash Flow When Investing in a Traded Vehicle

Traded vehicles offer the most liquidity as shares can be sold in the open market, but they also have the most uncertainty as to the value of the shares sold. Investments in publicly traded vehicles such as traded REITs or traded BDCs can be liquidated at any time. However, in a down market, the trading price can fall significantly below the true or assessed value of the assets (the so-called "discount to NAV") and the investor seeking liquidity in those times may take a significant reduction, thereby eroding the benefit of investing in private assets in the first place.

Exhibit 13: Historical Discount-to-NAV for Publicly Traded Private Assets Vehicles

Publicly Traded Private Equity REIT and S&P BDC Vehicles, Discount to NAV



Data as of October 31, 2023. Source: Bloomberg, KKR Portfolio Construction analysis.

Dividend or Income Distributions

All three classes of vehicles — drawdown, evergreen and traded, may also offer supplemental liquidity via dividend or income distributions in select share classes. As such, even in more illiquid structures, underlying assets may offer incremental liquidity, which should be understood as part of a comprehensive cash management program.

Importantly then, each portfolio should be separated into illiquid, comprising the private alternatives allocation, versus liquid assets, which would include cash or 'liquid wealth' to fund near-term cash flow needs, such as those to fund lifestyle expenses or significant withdrawals. Interestingly, once an institutional or individual investor goes through the exercise of modeling their cash flow needs, they most often find that they have overestimated liquidity needs.

SECTION VII

Conclusion

Over the next decade, amidst the Tectonic Shifts upholding the new macro regime, leaning into Private Markets to achieve investment objectives will become only more salient, we believe. Especially for investors who are new to Private Markets investing, working with a trusted financial advisor or private banker to understand the relative value between Public and Private Markets, as well as the benefits and risks of each Private Markets asset class, is essential to optimize asset allocation in the current macroeconomic and geopolitical environment.

Specifically, there is a material and persistent return premium that can be harvested by taking on incremental illiquidity.

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