KKR

# Insights

14.1 Global Macro Trends February 2024

# Loud and Clear

KKR 2023 Family Capital Survey

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**Henry H. McVey**
Head of Global Macro
& Asset Allocation,
CIO of KKR Balance Sheet
henry.mcvey@kkr.com

**Rebecca J. Ramsey**
rebecca.ramsey@kkr.com

**Ezra Max**
ezra.max@kkr.com



**Special Thanks To:**

**Blake Shorthouse**
blake.shorthouse@kkr.com

**Jeff Schachter**
jeff.schachter@kkr.com

**Monica Mandelli**
monica.mandelli@kkr.com

**Lester Lim**
lester.lim@kkr.com

**Harald Duerr**

**Mohamed Attar**

**Markus Egloff**

**Zachary Burke**

**Alice Chung**

**Alice Bush**

**Jacqueline Zhang**

**Nicolas Mira**

**Gio Onate**

**Hattie Pettit**

**Rachel Li**

**Yifan Zhao**

**Drew Golicz**

**Thibaud Monmirel**

**Sarah Overlander**

**Daniel Remondi**

# Loud and Clear

## KKR 2023 Family Capital Survey

At a time of record low activity across the global capital markets, many allocators have been sitting on the sidelines of late, particularly regarding private investments. However, this positioning is not what we are hearing from leading CIOs in the KKR family office network. Indeed, many CIOs who participated in this year's KKR survey of family offices told us that they plan to increase – not decrease – exposure to Alternatives in 2024. Their rationale: They understand the role the illiquidity premium can play in compounding capital in a tax efficient manner to build wealth for future generations. Importantly, this year's CIOs are most focused on increasing exposure to Private Credit, Infrastructure, and Private Equity. To fund these investments, they intend to reduce Public Equities and Cash. We also learned from our survey work that many of these family offices are in major growth mode, adding investment, risk management, and product expertise; at the same time, they are also looking to partner with the 'right' GPs across regions and sectors where they may not have as much in-house knowledge. From a strategic perspective, what came through 'Loud and Clear' was a desire to leverage their long-term focus and operating expertise to build competitive advantage versus more passive pools of capital across the global capital markets. Interestingly, as our survey shows, there are significant differences that have emerged between older, more established offices, which have leaned heavily into Alternatives such as Private Equity, and 'younger' ones, which are in a more exploratory phase of their global asset allocation. Finally, our survey and subsequent conversations lead us to believe that, while this group of CIOs is in a great position to play offense in today's market, there is still more that they can do from a portfolio construction perspective to improve their return per unit of risk.

> Go as far as you can see; when you get there, you'll be able to see farther.
>
> — **John Pierpont Morgan**, American financier and investment banker

One of my favorite Anthony Bourdain quotes observes that "Travel changes you. As you move through this life and this world you change things slightly, you leave marks behind, however small. And in return, life — and travel — leaves marks on you." I feel that way about the privilege of travel as it relates to my job at KKR. To be sure, I may not have eaten baby clams in Vietnam like the late Mr. Bourdain, but I do get to spend time learning and strategizing with some of the most interesting and engaging CIOs in the business.

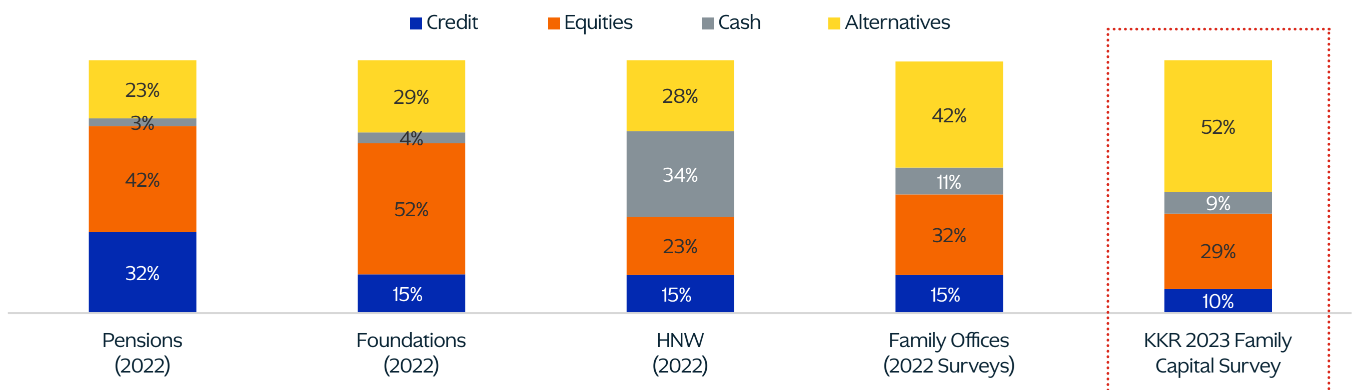
Indeed, after too many years of Zoom calls because of the pandemic, I really hit the road in 2023, making three trips to Europe and three to Asia as well as crisscrossing the United States several times during the year. It was during this travel that I had the good fortune to have more than a few lunches and dinners with CIOs from several of the world's leading family offices. We spoke about a wide variety of topics, including asset allocation and business intentions. It was quite clear from our conversations that these individuals viewed their roles not solely as family office CIOs, but also as leaders of global investment organizations, with many now representing complex family holding companies and/or endowments and healthcare plans too. Said differently, these CIOs are not simply caretakers for pockets of wealth; rather, great numbers of them now run very large, complex, and quite sophisticated pools of money that compete with other thoughtful allocators of capital from around the world.

So, as we were tallying the results from our third KKR Family Capital survey, which we conducted in December of 2023, those conversations began to take on new meaning for me. **What seems most important to many CIOs today – and this came through 'Loud and Clear' during my travels – is their desire to leverage their longer-term focus as well as their owner/operator mentality to create a sustainable competitive advantage in investing versus more traditional passive investors**, many of which are hampered by the need to offer higher near-term payout ratios and/or are more constrained in their ability to lean into dislocation.

**So, at a time when other allocators are pulling back from private allocations, this group's intention is to actually increase exposure to private market investments again in 2024 to further take advantage of the illiquidity premium across a variety of Alternative asset classes (at the expense of Cash and Public Equities)**. One can see this in *Exhibit 3*. As one seasoned CIO said, "Now is an interesting time to play offense, given that many others need liquidity, and we don't. We are particularly keen on going direct, for example, in sectors where we have owned businesses in the past. At the same time, we increasingly want to partner with GPs in areas where we may not have regional expertise or industry expertise to further build out our portfolio."

**Exhibit 1:** Family Offices Are Generally Long-Term Focused, Leveraging a Heavy Allocation to Alternatives to Deliver Outsized Returns

**Asset Allocation as a % of AUM**




Alternatives include Private Equity, Private Credit, VC/Growth, Hedge Funds, Real Estate, Infrastructure, and operating businesses. Data as at January 31, 2024. Source: Willis Towers Watson, CommonFund, Capgemini, Average of Global Family Office Surveys, KKR 2023 Family Capital Survey.

These organizations are also in major growth mode, including adding investment, risk management, and product and sector expertise. They are achieving this by both partnering with the 'right' GPs on larger transactions as well as internalizing certain investing roles.

The other big takeaway from my engagement with CIOs and our survey work was just how similar the asset allocation objectives of KKR's Balance Sheet are to those of individual family offices seeking to create long-term value. Specifically, the CIOs we surveyed are mostly focused on compounding their capital in a tax efficient manner. **Indeed, fully 93% of respondents cited growing assets for future generations as a focus for their portfolios.** By comparison, 44% cited a focus on capital preservation, with just 35% focused on generating income to meet the needs of current generations *(Exhibit 5)*.

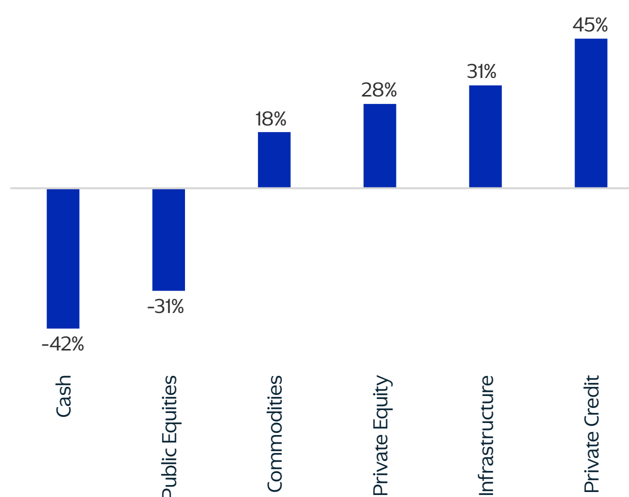
**Exhibit 2:** Family Offices Are Still Heavy Users of Alternatives, But Their Focus Has Shifted More Towards Real Assets of Late

| KKR Family Capital Survey Comparisons | 2017 | 2020 | 2023 |
|---|---|---|---|
| **Public Equities** | 29% | 31% | 29% |
| **Liquid Credit** | 9% | 10% | 10% |
| **PE/VC** | 24% | 27% | 27% |
| **Private Credit** | 6% | 4% | 4% |
| **Hedge Funds** | 12% | 6% | 6% |
| **Real Assets** | 11% | 13% | 15% |
| **Cash** | 10% | 9% | 9% |

Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

The largest KKR Balance Sheet allocation – similar to what we heard from our family office counterparts – is linked to private investments that are longer duration, compounding-oriented, and with tax efficient attributes.

**Exhibit 3:** CIOs Are Generally Looking to Increase Illiquidity in 2024 Across Private Credit, Infrastructure, and Private Equity

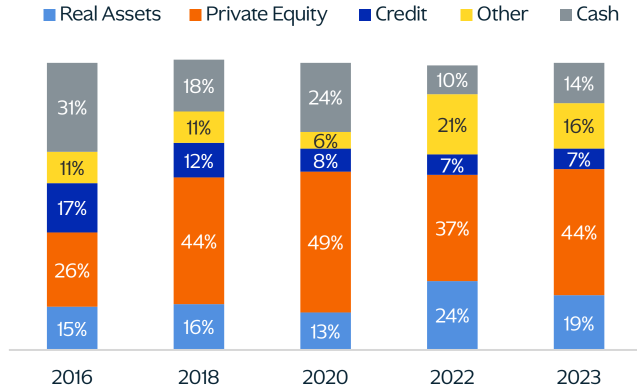



Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

Consistent with this compounding viewpoint, the largest KKR Balance Sheet allocation – similar to what we heard from our family office counterparts – is linked to private investments that are longer duration, compounding-oriented, and with tax efficient attributes. So, excluding investments intended to expand our business from a strategic standpoint (our insurance holdings, hedge fund GP interests, and our Japan Real Estate investment or J-REIT), fully 83% was invested in private assets at the end of last year, with 52% allocated to Private Equity (including Core PE). Similarly, the CIOs we surveyed had an average of 52% allocated to Alternatives, with half of the total in Private Equity-like investments (including Growth) to better harness the illiquidity premium. They also told us they intend to hold the investments for longer while retaining higher Cash balances than traditional allocators to act as a buffer (see *Exhibits 2* and *5*). As a result (and without giving up overall net returns), this 'barbell' strategy leaves them room to play 'offense' during dislocations, as when KKR acquired a 63% stake in the Global Atlantic insurance company during the summer of 2020.

**Exhibit 4:** Over Time We Have Allocated More of the Capital On KKR's Balance Sheet to Compounding Investments

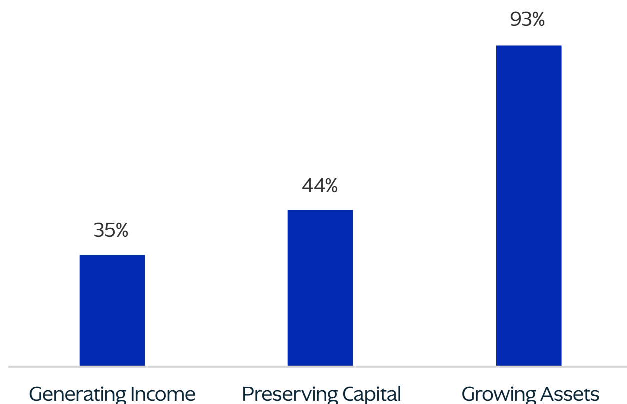
**KKR Balance Sheet Asset Allocation Over Time, Before Completion of the Global Atlantic Acquisition, %**




Other includes Hedge Funds, insurance stakes, our capital markets business, and structured secondaries. Data as at December 31, 2023. Source: KKR Balance Sheet.

**Exhibit 5:** Compared to Other Allocators, Family Offices Tend to Be Almost Singularly Focused on Compounding Capital

**KKR 2023 Family Capital Survey: Primary Focus of Family Office, Multiple Answers Allowed, %**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

At the same time, as we describe in more detail below, both KKR and its family office clients have created more inflation protection in the portfolio in recent years, especially through investments in areas like Real Estate, Infrastructure, Real Estate Credit, and Asset-Based Finance. Also, similar to KKR, family offices have opportunistically taken advantage of key trends, such as disruption of supply chains and the increased global focus on the 'security of everything' by leaning into logistics, warehouses, cell towers, and data centers to deploy capital.

The KKR Balance Sheet probably differs most from our family office survey respondents in the following three areas: First, our commitment to Asia is quite different. All told, our exposure to Asia has increased to 17% at the end of 2023 from just eight percent in 2016 and 10% in 2020. By comparison, our family office CIOs indicated that they typically have 10% or less of their portfolios in Asia, mostly through fund commitments. As a firm, we are continuing our ongoing push into Asia that began in 2005 across Credit, Infrastructure, Real Estate, and Private Equity as we are strong believers in the growth potential of the region. We also supplemented our strong organic growth in Asia with a major real estate acquisition in Japan in 2022. We think expanding our presence in Japan coupled with increasing our investing presence beyond Private Equity to also include Private Credit and Infrastructure in Greater Asia explains the lion's share of the large delta in our allocation percentages.

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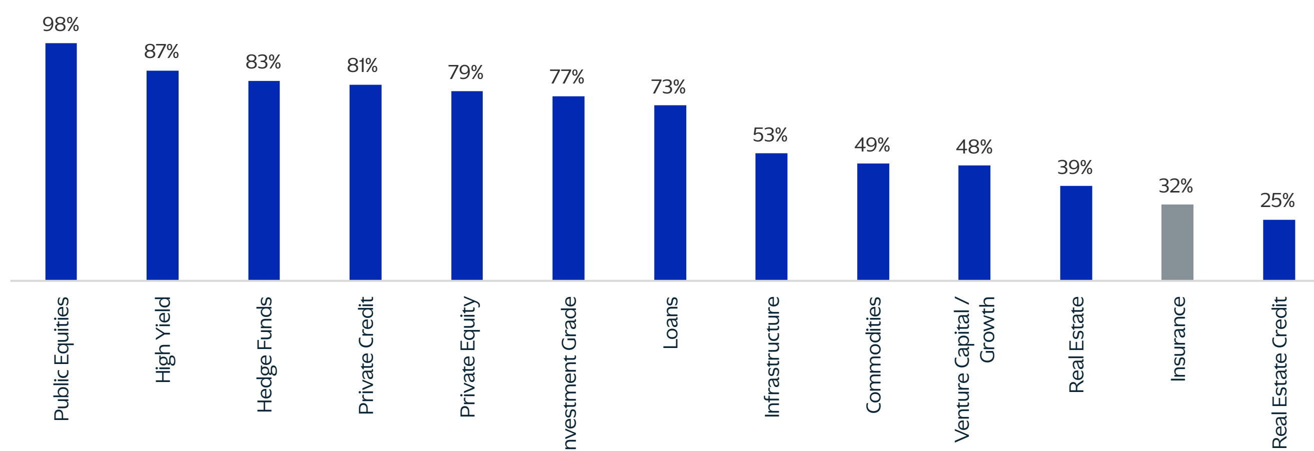
**Exhibit 6:** Similar to the KKR Balance Sheet, Family Offices Are Increasingly Using Private Market Allocations, Including Insurance, to Both Boost Returns and/or Act as a Source of Diversification

**Correlation to 60/40 Portfolio by Asset Class, %**




Note: 60/40 Benchmark comprises Public Equities and IG Credit. Data as at December 31, 2023. Source: KKR GBR Analysis.

Second, with KKR's 2023 100% acquisition of Global Atlantic, we now have a much bigger allocation to the insurance sector. Why does this matter? Many of the family offices we surveyed have investments in art or family operating businesses. We now have exposure to an 'operating business' in the form of non-correlated insurance assets matched against similar duration liabilities, which now totals about a fifth of our balance sheet, up from just 10% a few years ago. In particular, we like the fact that insurance assets tend to offer similar return on equity to comparable Equity investments while producing much less correlation/volatility than many other asset classes (*Exhibit 6*). Moreover, when asset class returns for the next five years appear more compressed than in the past, as Frances Lim's capital markets assumptions suggest (see *Outlook for 2024 Glass Half Full,* page 57), then as one leading CIO in the U.S. told us, "what really matters is the diversification and volatility benefit that one asset class might offer versus another." Against this backdrop, we were not surprised to learn that several family offices have already been leaning into insurance in a variety of ways as part of their portfolio diversification strategy.

Third, KKR today derives the majority of its hedge fund exposure through its ownership stake in Marshall Wace. Previously, we had tried to incubate several strategies, but we found that Marshall Wace proved a better partner for us in this area. While family offices have overall reduced their Hedge Fund exposure since 2017, today much of their allocation is in the more traditional LP/GP structure.

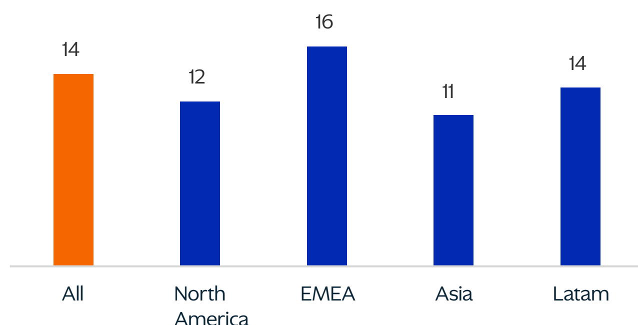
Beyond the synergies with the KKR Balance Sheet, what else did we learn from our survey and what are the current trends worth highlighting to all types of global investors? See below for full details, but our punch line is as follows:

- **The trend towards using more Alternatives in the average family office portfolio remains intact, with fully 52% of average assets allocated to Alternatives, up 200 basis points from 2020**. To be sure, we fully acknowledge that KKR's family office network is likely biased towards a larger share of Alternatives than others who partner with the same cohort (external estimates place the industry average around 40-50% Alternatives). However, as our survey of CIO intentions suggests (*Exhibits 3* and *27*), we actually think this percentage could drift higher by another few hundred basis points over the next few years as Public Equities and Cash are reduced.
- **Within Alternatives, however, there appears to be diversification across asset classes, including a significant jump in Real Assets, which includes Real Estate, Infrastructure, and Commodities**. All told, Real Assets jumped more than 200 basis points in 2023 to

a sizeable 15% of average total assets, compared to 13% in 2020 and just 11% in 2017. This increase largely makes sense to us, given 1) many CIOs were underweight inflation hedges heading into COVID; 2) many had not held any positions in Infrastructure as an asset class until recently; and 3) a surprisingly large number of family offices accumulated positions in oil and gas equities when traditional allocators, including certain pensions and endowments, exited the asset class on environmental and governance considerations. Many CIOs suggested that though they were believers in decarbonization and concerned about climate change, the facts remain that the energy transition will be "a marathon and not a sprint as these assets will be needed for at least the next 20 years." Overall, though (and as we detail below), several CIOs now feel a little over-exposed to Real Estate, and as such, are looking to offload some positions, especially developmental projects and/or those with substantial refinancing risk during the 2025/2026 period.

**Exhibit 7:** The Average Family Office in Our Survey Has Been in Existence for More Than a Decade

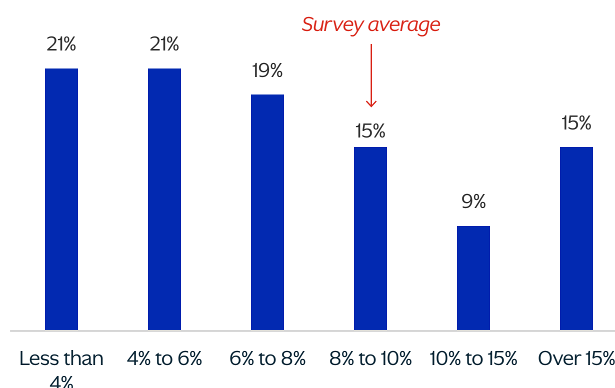
**KKR 2023 Family Capital Survey: Average Age of Family Office, Years**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

**Exhibit 8:** Nearly One Quarter of Our Survey Respondents Hold More Than 10% in Cash

**KKR 2023 Family Capital Survey: Share of Cash Holdings, %**




Data as at January 31, 2023. Source: KKR 2023 Family Capital Survey.

- **Cash positions are still quite high at nine percent, and as such, we continue to think that many investors are still under-risked for today's markets.** We note that the average cash position for 'fully scaled' family offices (i.e., those founded five or more years ago) is a bit lower at around six percent, which we think provides a better estimate for 'true' run-rate cash balances. That said, beneath the surface many allocators are sitting on huge sums of cash, **with nearly one quarter of survey respondents holding 10% or more**. Interestingly, though, this total is actually down from 2020 when 45% of our survey respondents had 10% or more in Cash in their portfolios. While some family offices keep higher reserves to provide ballast to near-term obligations or even their operating businesses, for the others we worry that they are waiting too long for the 'perfect pitch' before deploying. See the introduction in our *Outlook for 2024 Glass Half Full*, but history suggests that markets tend to have a strong run over the five to seven years following a drawdown of the magnitude experienced in 2022, even when nominal GDP is slowing.
- **In terms of intentions for 2024, our survey shows that CIOs plan to allocate more to Private Credit (first choice), to Infrastructure (second choice), and to Private Equity (third choice).** One can see the details in *Exhibit 3*. On the other end of the spectrum, CIOs intend

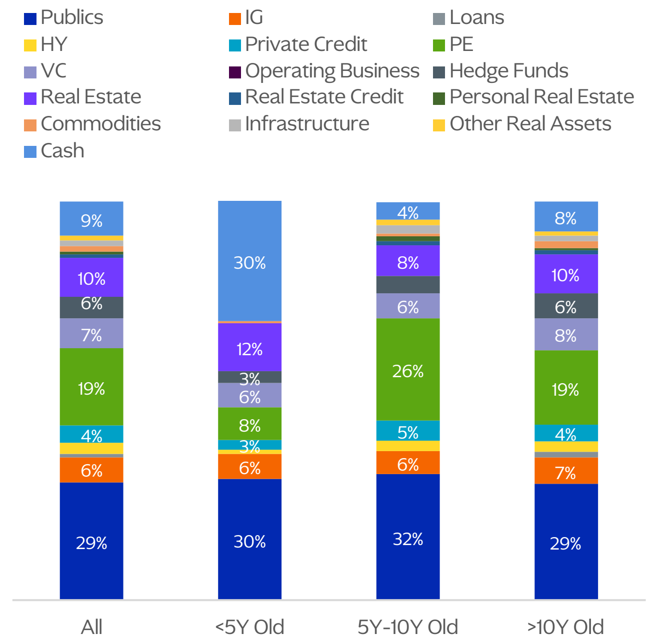
to liquidate Cash and Public Equities to fund these new positions. By country, CIOs suggested increasing allocations to Japan, Korea, and India at the expense of China. Interestingly, however, their views on increasing renewable allocations versus owning more traditional oil and gas investments were more balanced than we might have anticipated.

- **We continue to see a notable asset allocation bifurcation between family offices set up within the last five years and family offices that had already scaled before COVID.** For example, we found a meaningful divergence in the approach to Hedge Funds, with an approximate 300 basis point differential between older and younger family offices. Cash balances, as one might expect, also differed meaningfully for family offices less than five years old at about 30% of AUM versus around six percent for the more mature offices. In addition, although Real Estate Equity allocations were fairly similar regardless of family office tenure at around 8-12%, there was a four hundred basis point differential in strategies like Commodities, Other Real Assets, and Infrastructure between the more established family offices and those less than five years old. *The biggest outlier, however, was Private Equity, as older family offices hold between 19% and 26% in Private Equity, compared to just eight percent for those less than five years old.*

Cash positions are still quite high at nine percent, and as such, we continue to think that many investors are still under-risked for today's markets.

**Exhibit 9:** Asset Allocation Looks Very Different for More Tenured Family Offices

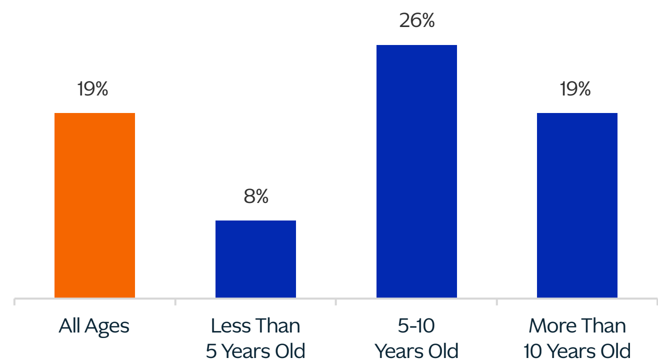
**KKR 2023 Family Capital Survey: Detailed Asset Allocation by Age of Family Office, %**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

**Exhibit 10:** Family Offices Tend to Increase Their Allocations to Private Equity Over Time

**KKR 2023 Family Capital Survey: Allocations to Private Equity, %**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

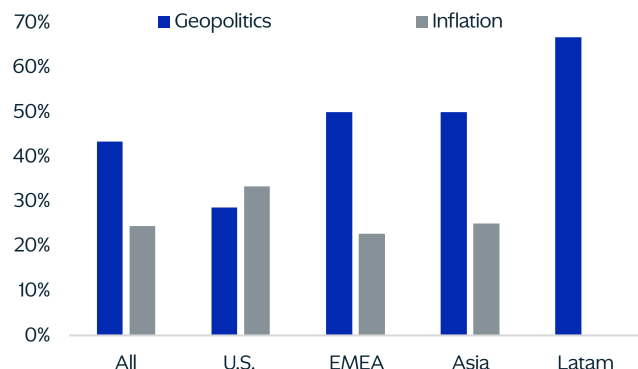
- **Regional differences were more stark than in previous surveys.** For example, U.S. family offices had a surprisingly low allocation to traditional Private Equity (12% of total AUM in leveraged buyouts), compared to 20-25% for Latin America, Asia, and Europe. That said, U.S. firms allocate four to seven percent more to VC/Growth investing, so their net exposure to total Private Equity, including Buyout and more Growth-oriented strategies is actually not that far off the global average. As we show in *Exhibit 24*, they also own more Public Equities than EMEA, Asia, and Latin America. Meanwhile, family offices in Asia remain heavily allocated to Real Estate (21%, compared to 11% or less in other regions). Importantly, though, our conversations with CIOs in Asia indicated a desire to reduce Real Estate positions given that the structural decline in interest rates may now be over.

We also surveyed our participants on bigger picture topics like investment themes, risks, structure, etc. We note the following:

- **From a thematic perspective (see *Outlook for 2024 Glass Half Full*), many CIOs are definitely aligned with some of the big mega themes we have been investing behind as a firm**. Specifically, there is a growing recognition that our thesis on the modernization of the industrial sector, including automation and digitalization, has significant momentum. In addition, we heard about cyber and AI, especially in sectors where there is a lot of data (e.g., Healthcare) and/or where a family office has a specific industry viewpoint on how AI may change the course or direction of the operating business. CIOs are also importing this theme in house to provide overlays to make their offices more efficient. Finally, a large number of CIOs who interact with their families' operating businesses cited an increase in the cost of goods sold, labor shortages, and higher wage growth, and the challenges of passing through these costs responsibly. So, without question, these operators are open to investing behind advancements that can improve productivity and/or drive cost-related efficiencies.
- **We heard from a lot of CIOs who are going against the grain to find value-based private market opportunities.** For example, several large family offices are increasing their weighting to oil and gas investment opportunities. They are interested in both Public Equities as well as private investment in this area, convinced that forced selling by other investors exiting the sector is creating a tremendous opportunity to buy cheap cash flow at very reasonable valuations. We also heard similar stories around the industrial sector, especially in situations where the company might need more capital to grow. One smart CIO we spoke with is focused on finding opportunities in the 'less sexy' areas outside of growth, including lower middle market companies that have had to haircut their valuation aspirations as they have struggled to raise capital.
- **Geopolitics is eclipsing inflation as the main concern for family office CIOs.** Across the family offices we surveyed, more than 40% of respondents identified geopolitics as the single most important risk today, versus about 25% who were more focused on inflation (interestingly, though, among U.S. family offices, views were more evenly split). Indeed, we think that family offices outside of the U.S. have tended to have a heightened awareness of geopolitical tensions due to the increase in regional tensions and pressure points globally, although our conversations suggest that concern is rising among investors regardless of geography.

**Exhibit 11:** Geopolitical Concerns Are Most Pronounced in Asia, While the U.S. Is Still Concerned About Inflation

**KKR 2023 Family Capital Survey: What Is the Primary Risk to Markets Today?**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

- **Overall, CIOs are spending much more time on asset allocation and portfolio rebalancing than in the past**. One can see this in *Exhibit 12*. This viewpoint makes sense for several reasons. First, many family office CIOs are taking into account the breadth of activities of the families they work for, and these additional exposures take time to incorporate into their asset allocation work. Second, as we indicated earlier, many likely have too much Cash and too many Public Equities, and there is a significant desire to rebalance. The huge growth in the family cash flows from either liquidations, dividends, or annual cash flow generation from an operating business makes this consideration an important one. Third, as more of the family offices mature, they tend to want to do more in illiquid investments. In particular, more family offices, especially in Europe – similar to what we are doing with our Strategic Holdings segment at KKR – want to retain high quality, secular compounding businesses for longer and in more size than in the past. Tenured CIOs that utilize more structured asset allocation strategies in Asia also consistently cited increasing private markets allocations as a priority. Finally, as concerns around geopolitics and inflation have increased, so too has the desire to add more ballast through collateral-based cash flows, including Infrastructure and Asset-Based Finance/Real Estate Credit, to protect their portfolios.

**Exhibit 12:** Getting the Asset Allocation Right in Today's Environment Is the Number One Focus of CIOs Today

| KKR 2023 Family Capital Survey: Where Are You Focusing Most of Your Investment Efforts for The Next 12-18 Months? | Rank 1 | Rank 2 |
|---|---|---|
| Asset allocation / portfolio rebalancing | 53% | 14% |
| Opportunistic or strategic investments | 25% | 29% |
| Investments into new strategies | 11% | 11% |
| Re-ups into existing relationships | 11% | 29% |
| Public markets | 0% | 17% |

Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

- **This focus on asset allocation makes sense, given our analytical work on efficient frontiers suggests that some CIOs could do more to earn a better return per unit of risk by making slight adjustments to their asset allocations**. See *Exhibit 26* for details, but we think some potential changes, including a reduction in Public Equity and Real Estate allocations, combined with an increase in Infrastructure, Real Estate Credit, and PE strategies could create more efficient portfolios over time. From a regional perspective, we also think there are meaningful opportunities in Asia to rebalance away from the large overweight to Real Estate Equity. See below for more details.

- **Meanwhile, while the majority of individuals with whom we spoke represented successful business operators, slightly more than 50% of them today still own a family business.** Perhaps more strikingly, such businesses only accounted for roughly seven percent of combined assets, on average, for these families. Given that the average family office in our survey is more than a decade old, we were not totally surprised, though the percentage of non-business owners was higher than we were expecting. That said, business owners' industry knowledge has not gone idle as most CIOs indicated that their preference, as one respondent explained, was "to invest in sectors where knowledge can be levered from the operating business" and that they were "interested in allocating to similar lines of business." Overall, we sense that families without operating businesses are also trying to gain more exposure to this space through other means (e.g., for family offices without an operating business, PE allocations are on average about eight percentage points higher). We tend to agree, as we think the difference between control and non-control equity positions will be magnified in an environment where the cost of capital has increased. We heard from numerous CIOs that they wanted to take more long duration control positions via partnering with the 'right' GPs rather than participating in large club deals as minority partners.

- **There is some growing concern that more internal resources are required to support both the growth in assets under management as well as the push to diversify across more asset classes, including co-investments**. All told, average assets under management in our survey universe have grown around 50% over the last five years to an estimated $3.3 billion from roughly $2.4 billion in 2018 for offices that have been operating for five years or more, while headcount has risen just 10% or less. We heard of

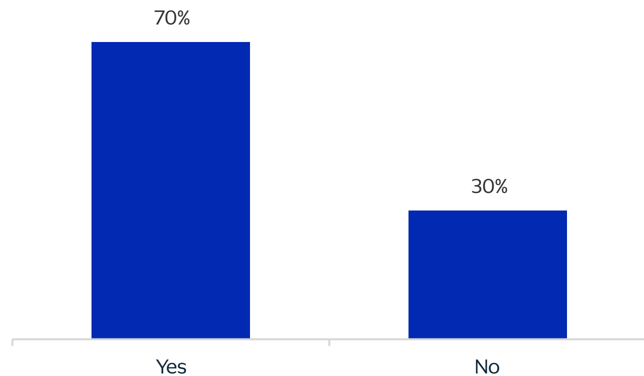
similar situations when we did our last Endowment and Foundation survey in 2022, and our take remains the same: more infrastructure is required to support these pools of capital, especially those that are diversifying away from a primary operating business over time towards more of a formal asset allocation model. Not surprisingly, a large percentage of family offices are looking to enhance their technology, legal and compliance, and operations infrastructure (*Exhibit 13*).

**Our Bottom Line: We hear the message 'Loud and Clear' that this segment of the market is changing – and for the better – as family offices try to leverage their owner/operating mentality and long-term focus to create competitive advantage in a rapidly changing marketplace**. For starters, as we mentioned above, the average assets under management have increased fully 50% since the last time we did our survey to over three billion dollars. More importantly, these investors are diversifying across asset classes, and as they mature, they are better at harnessing the value of the illiquidity premium to compound capital. They are also using better hedging techniques and increasing both their desire and ability to lean into dislocations. We view this repositioning as the development of an important competitive advantage.

Our Bottom Line: We hear the message 'Loud and Clear' that this segment of the market is changing – and for the better – as family offices try to leverage their owner/operating mentality and long-term focus to create competitive advantage in a rapidly changing marketplace.

**Exhibit 13:** CIOs Are Highly Focused On Driving Better Outcomes via Enhanced Performance Analytics

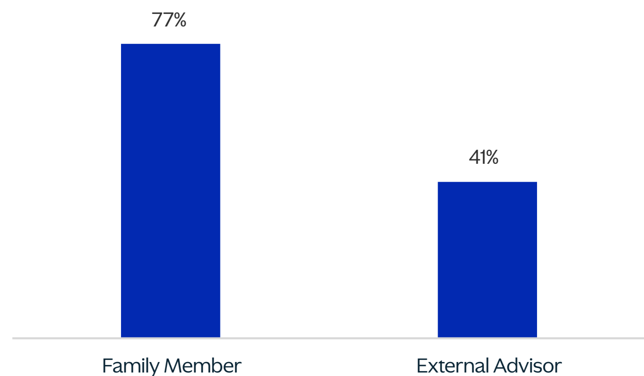
**KKR 2023 Family Capital Survey: Are You Looking to Enhance Performance Analytics?**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

**Exhibit 14:** Family Members Still Dominate the Lion's Share of Investment Committees

**KKR 2023 Family Capital Survey: Which of These Representatives Do You Have On Your Investment Committee?**

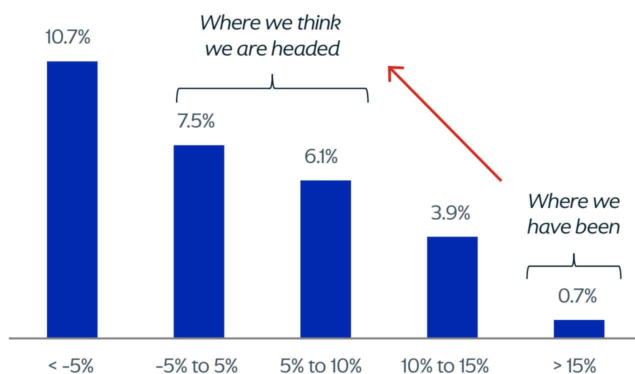



Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

However, as we detail in this survey report, more investment in internal infrastructure and processes is still required. In particular, greater attention needs to be paid to measuring performance, risk-adjusted returns, and correlations. We also think more consistency around deployment, especially to Private Equity, is required, even when monetization activity slows. Indeed, if we have learned something at KKR through our 47-year history, it is the value of consistent deployment in both up – and more importantly down – markets (*Exhibits 15* and *16*). Finally, from a business model perspective, several family offices may have over-stepped in their desire to go direct in certain asset classes (e.g., Real Estate development, Venture Capital) during the run-up in equity markets in 2021, and as such, they are repositioning their businesses to optimize areas such as co-investments, international expansion, and portfolio construction.

**Exhibit 15:** The Excess Return of Private Equity Is Greatest When Public Equity Market Volatility Is Highest. We Link These Results to the Capacity for Operational Improvement and Value Creation

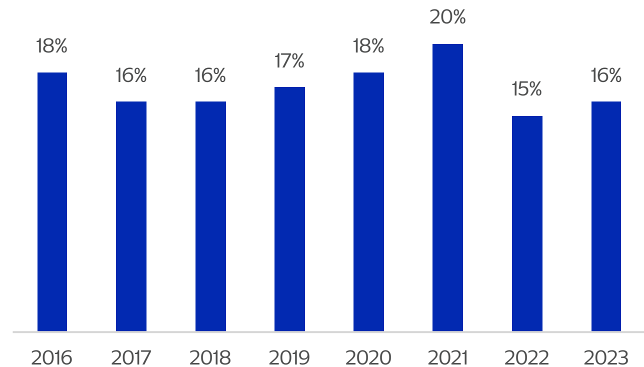
**Average 3-Year Annualized Excess Total Return of U.S. Private Equity Relative to S&P 500 Across Public Market Return Regimes**




Data as at November 30, 2022. Source: Cambridge Associates, Pitchbook, KKR Global Macro & Asset Allocation analysis.

**Exhibit 16:** We Find That a Key to Generating Solid Returns in the Alternative Arena is Staying Focused on Linear Deployment in Both Good and Bad Markets

**KKR Annual Private Equity Deployment as a % of All Actively Deploying Funds**




Actively deploying funds defined as funds that are still deploying non-reserve capital. Data as at December 31, 2023. Source: KKR GBR analysis.

In particular, greater attention needs to be paid to measuring performance, risk-adjusted returns, and correlations. We also think more consistency around deployment, especially to Private Equity, is required, even when monetization activity slows.

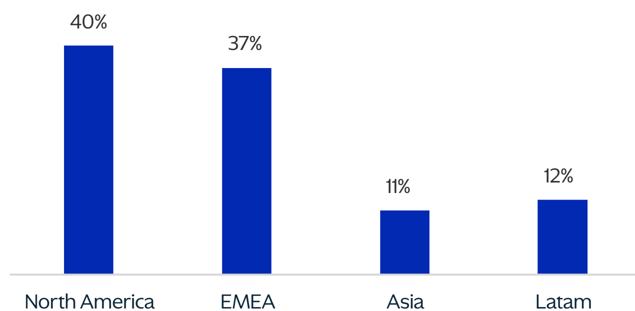
## SECTION I

# Who did we survey?

**Who did we interview and how does that compare to our prior surveys?** We directly surveyed more than 75 CIOs, and equally as important, spoke with a hefty percentage in "CIO to CIO' conversations. When we conducted our first survey of family offices back in 2017, 80% of our participants were in the United States; today, by comparison, that percentage has dropped to 40%, as our relationships with family offices in Europe, Asia, and Latin America have grown meaningfully. All told, EMEA CIOs accounted for 37% of the 2023 survey, while Asia and Latin America were at 11% and 12% respectively.

**Exhibit 17:** 60% of This Year's Survey Participants Participants Are Now Outside of the U.S.

**KKR 2023 Family Capital Survey by Region, %**

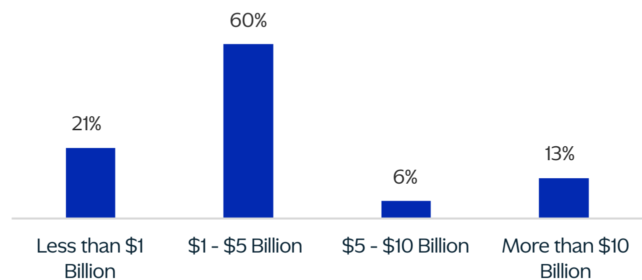



Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

In terms of size, the average pool of assets for our survey was over three billion dollars, with 60% of our CIOs overseeing $1-$5 billion in assets. This total is up from both 2020 and 2017, where 51% and 41% of respondents managed assets in this range, respectively. Finally, 19% of current survey participants have at least $5 billion in assets, while 21% of CIOs oversee less than one billion.

**Exhibit 18:** Nearly 20% of Survey Respondents Manage Over $5 Billion

**KKR 2023 Family Capital Survey: Assets Under Management, %**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

In terms of age, the average family office has been in existence for 14 years, some are quite newly formed, but others were created before the 1970s. The EMEA region has the most tenured offices, with an average age of 16 years, compared to 14 years in Latam, 12 years in North America, and 11 years in Asia.

Beyond the formal survey we sent out to more than 350 CIOs (with around 25% responding), we also engaged with more than 20 CIOs in detailed conversations about key macro and asset allocation trends. Several of these were fourth and fifth generation family offices so we had many discussions on how the approach to investing and asset allocation has changed over time. The synergies to our evolution at KKR were very apparent, particularly as we discussed the expansion into new sectors, asset classes, and regions, e.g., when we scaled into Asia or moved into the Credit space back in the early 2000s. We also discussed our approach to KKR's Balance Sheet, and why we have focused on compounding capital while maintaining discipline on returns per unit of risk.

## SECTION II

# What has changed?

One of the things most exciting about these surveys is discovering the incremental shifts between asset classes and then tying that to what this says about the broader investing environment. The CIOs who participated in our survey have maintained a similar overweight to private versus public assets over the past six years, shifting between Listed Equities and Alternatives by a few hundred basis points *(Exhibit 20)*, with Alternatives holding steady at just over half of AUM (compared to one quarter to one third of AUM for many of the other pools of capital with whom we partner, as we discuss in the next section). Consistent with this shift, we repeatedly heard CIOs mentioning their intent to be longer-term equity owners 1) where there was greater potential to influence outcomes in a tax efficient manner; and 2) given the continued value and stability of the private markets' illiquidity premium.

What has changed, however, is the mix of these assets, with more emphasis on Real Assets as a source of inflation protection during the last several years, including more dedicated deployment towards select Real Estate sectors like data centers, logistics, and warehouses that capture important post-pandemic investing themes. See below for details, but this rotation has been funded by a pullback in Hedge Fund allocations since 2017, along with a decision to slow down deployment to new Private Equity funds.

**More Real Assets, Especially Real Estate.** All told, the average allocation to Real Assets (which we define as Real Estate Equity and Credit, Personal Real Estate, Commodities, Infrastructure, and Other Real Assets such as timber/artwork) increased by 200 basis points since our last survey in 2020, entirely driven by Real Estate Equity on a net basis. Interestingly, while KKR's Balance Sheet too has increased its Real Estate Equity in size during the last five years, we have also focused on scaling our Infrastructure weightings – something that family offices really have not done historically. As a result, family office clients have generally committed about six to seven times as much capital to Real Estate strategies as they committed to Infrastructure in recent years. By contrast, on KKR's Balance Sheet, that same deployment ratio is less than two-to-one. Given an increasing focus on inflation protection as well as geopolitics, however, we were encouraged to see that more CIOs are shifting their focus somewhat and do intend to allocate more to Infrastructure in coming quarters.

What has changed, however, is the mix of these assets, with more emphasis on Real Assets as a source of inflation protection during the last several years, including more dedicated deployment towards select Real Estate sectors like data centers, logistics, and warehouses that capture important post-pandemic investing themes.

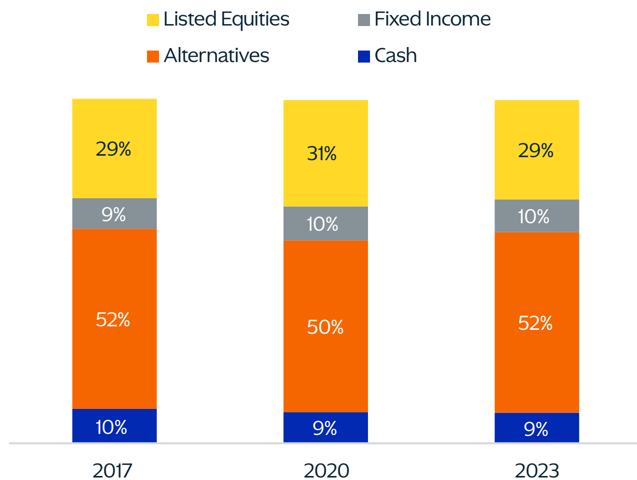
**Exhibit 19:** We Think Now Is Not the Time to Scale Back on Private Equity

| KKR 2023 Family Capital Survey: Asset Allocation | | |
|---|---|---|
| | 2020 | 2023 |
| **Public Equities** | 31% | 29% |
| **Investment Grade** | 6% | 6% |
| **Loans** | 1% | 1% |
| **High Yield** | 3% | 3% |
| **Private Credit** | 4% | 4% |
| **Private Equity** | 22% | 19% |
| **Venture Capital** | 5% | 7% |
| **Hedge Funds** | 6% | 6% |
| **Real Estate** | 7% | 10% |
| **Real Estate Credit** | 2% | 1% |
| **Personal Real Estate** | 2% | 1% |
| **Commodities** | 1% | 1% |
| **Infrastructure** | 1% | 1% |
| **Other Real Assets** | | 1% |
| **Cash** | 9% | 9% |

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

**Exhibit 20:** Families Offices Typically Hold the Majority of Their Assets in Private Investments

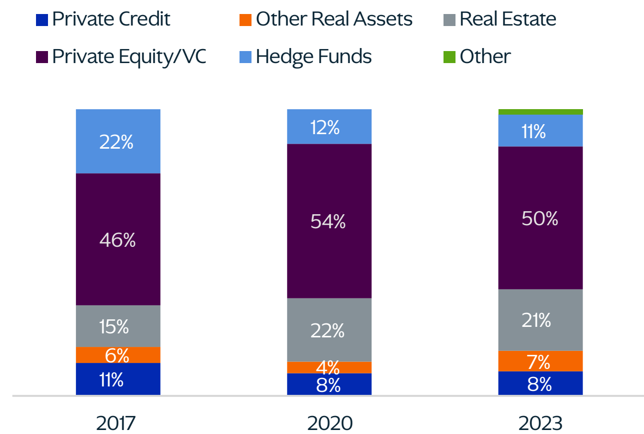
**KKR 2023 Family Capital Survey: Broad Asset Allocation, 2017-2023**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

**Exhibit 21:** Private Equity/Venture Capital Remains the Largest Allocation, But Real Assets Have Been Gaining Share in Recent Years

**KKR 2023 Family Capital Survey: Broad Asset Allocation as a % of Total Allocation to Alternatives, 2017 -2023**

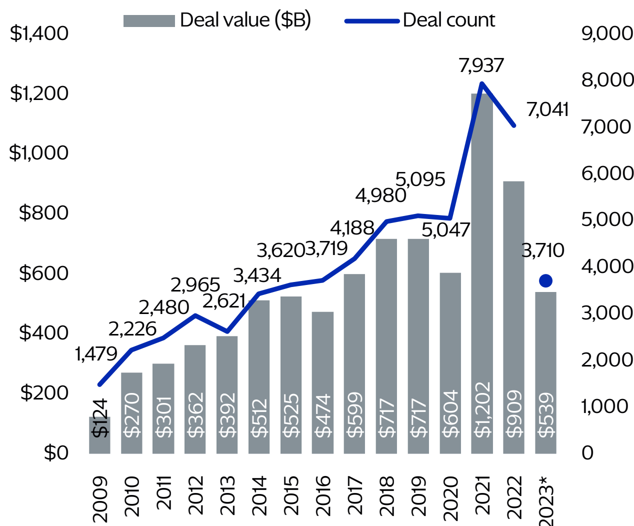



Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

**CIOs Are Now Revisiting If They Pulled Back From PE at the Wrong Time.** In certain instances we believe that the pivot towards Real Assets, which jumped in aggregate by 200 basis points to 15% since our last survey, and Venture Capital, which jumped by two hundred basis points to seven percent from five percent during the same period, has been funded partially by a pullback in Private Equity. All told, PE allocations fell to 19% in 2023 from 22% in 2020. One can see a summary of all the changes in asset allocation in *Exhibit 19*.

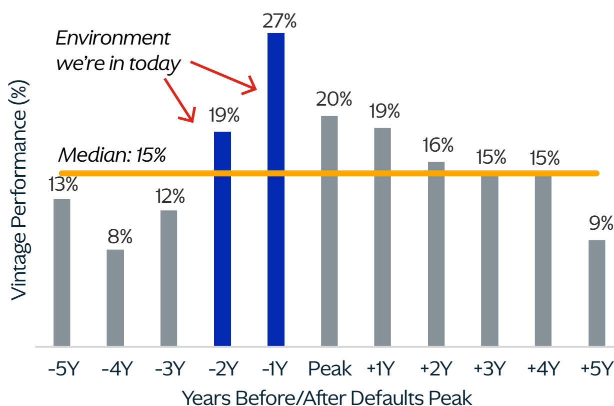
Based on our follow-up conversations, a potential risk, we believe, is that some investors may have pulled back on allocating to Private Equity at precisely the wrong time. Indeed, as *Exhibit 15* shows, PE vintages deployed during capital market dislocations (such as that experienced since the Fed started raising rates) have been among the best performing historically. The good news as outlined below is that many investors are now starting to lean against this trend, with a net 25% of respondents planning to increase their allocation to Private Equity in 2024. Also, as we detailed in our *Outlook for 2024* note, we are more optimistic that realizations have bottomed and are headed higher during the 2024-2025 period.

**Exhibit 22:** Deployment Pacing in Private Equity Matters a Lot. The Time to Be Cautious Was in the Second Half of 2021 and 2022, Not 2024, in Our View




Data as at November 30, 2023. Source: Pitchbook.

**Exhibit 23:** Deleveraging Cycles Have Coincided With Some of the Best PE Vintages




Data as at March 31, 2023. Source: Federal Reserve Board, Preqin, KKR Global Macro & Asset Allocation analysis.

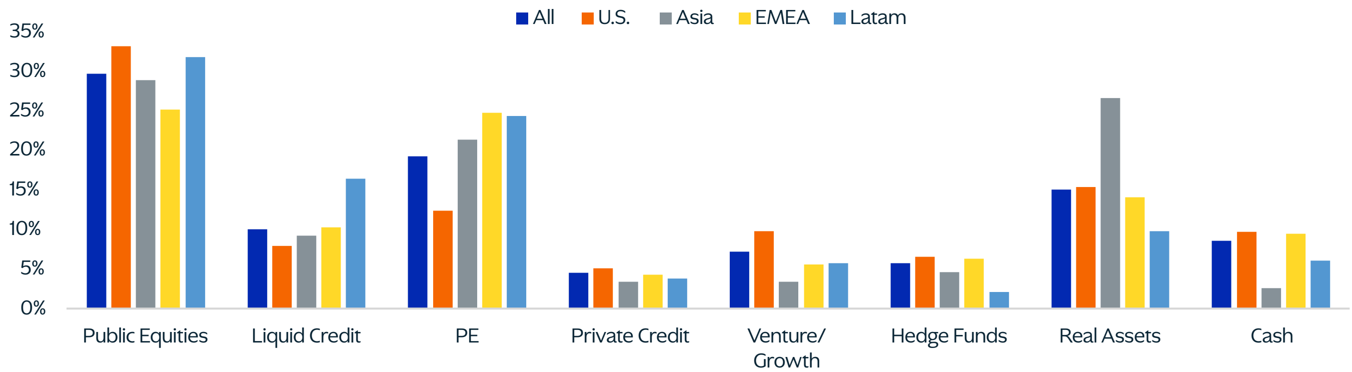
**Hedge Fund Allocations Are Stabilizing at Much Lower Levels.** Hedge Funds have stabilized at around six percent of AUM in recent years, or about 12% of Alternatives investments, which is about half the level seen when we conducted our first Family Office survey in 2017. Even though the post-COVID environment has been challenging for Hedge Funds, and many CIOs suggested that their tax inefficiencies were causing them to reallocate elsewhere, some survey respondents cited them as compelling vehicles for structured credit, to play select macro themes, or to diversify the overall portfolio in certain instances.

**Regional Preferences Were Large This Time**. From a regional perspective, there are a few distinct differences between family offices' approaches to asset allocation that are worthy of investor attention. For starters, family offices in North America tend to be over-indexed to Public Equities and VC and under-indexed to PE compared to their regional peers. All told the average U.S. office held about 33% of its AUM in Public Equities, compared to 32% in Latam, 29% for Asia, and 25% for EMEA. Meanwhile, U.S. offices held about 10% of their AUM in Venture/Growth investments, versus three to six percent in other geographies. Interestingly (and much to our surprise), on the traditional Private Equity front, Asia, EMEA, and Latam family offices allocated about 20-25% of AUM to Private Equity, while U.S. family offices held just 12% of their AUM in this strategy. However, as the intentions segment in our survey illustrates, many CIOs in the U.S. intend to boost their allocations again in 2024.

Within EMEA, our data suggests that these family offices are the heaviest users of Private Equity. One can see this in *Exhibit 24*, which shows European PE allocations at 25%. They are also longer-term focused, with the average European family office underweighting Public Equities to 'pay' for their overweight in Private Equity. As part of their Private Equity programs, an increasing number are holding on to high quality positions for longer. This strategy is quite consistent with our approach to our Core PE program, which centers on buying and holding high cash flowing businesses with compelling simple unit economics.

**Exhibit 24:** U.S. Family Offices Tend to Be Overweight Growth-Oriented Public/Private Investments, While Those in Asia Have Leaned into Real Assets

**KKR 2023 Family Capital Survey: Regional Allocation by Asset Class, % of AUM**



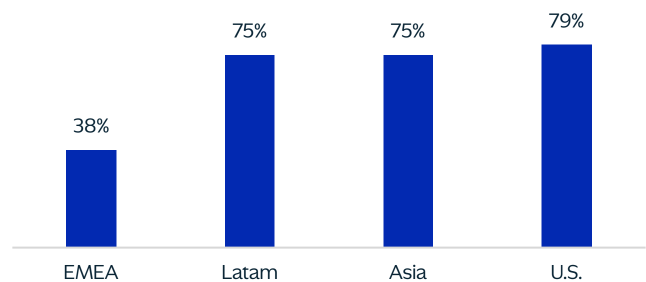

Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

Meanwhile, given the increase in KKR's family office business in Asia, we spent extra time in this survey learning more about how assets are allocated in this region. What we found is that Asia is unique in that the average family office holds a much larger position in Real Assets, especially Real Estate. Indeed, at 27% of AUM, Asian family offices' Real Assets position is more than 1,000 basis points higher than what we see in North America, EMEA, or Latam. Importantly, the vast majority of this exposure is coming from Real Estate. In fact, Infrastructure accounts for less than one percent of Asian family offices' AUM today, which is amongst the lowest of the regions we surveyed. So, all told, our survey suggested that Real Estate allocations in Asia are running at 21%, compared to 12% in EMEA, 11% in the U.S., and just seven percent in Latam. If there is good news, though, we increasingly heard a strong desire to increase exposure to other Real Assets, especially Infrastructure, across the various regions, including from CIOs in Asia.

Finally, we found it notable that Asian family offices tended to underweight Cash relative to CIOs in the other regions. Specifically, Cash accounts for just about three percent of AUM among Asian family offices, versus ten percent or more for the 'average' family office in other regions. Some of this could be because of the low returns on Cash in countries like Japan, but we actually think that CIOs in Asia do rely more on liquid securities, fixed income in particular, when they need Cash than in other parts of the world. 75% of our respondents from Asia also had access to a credit line to manage liquidity needs.

**Exhibit 25:** European Family Offices Are More Conservative When It Comes to Using Credit Lines for Liquidity Management

**KKR 2023 Family Capital Survey: Do You Have a Line of Credit to Borrow Against?**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

Indeed, at 27% of AUM, Asian family offices' Real Assets position is more than 1,000 basis points higher than what we see in North America, EMEA, or Latam.

## SECTION III

# Asset allocation and returns

As we described earlier, we think that family offices enjoy a distinct mandate when it comes to asset allocation, including more flexibility to withstand downdrafts, a higher tolerance for illiquidity, and less of a requirement to generate near-term yield for income. Against that backdrop, it makes sense to us that family offices and KKR's Balance Sheet have made a conscious decision to overweight Alternative assets compared to the other allocators outlined in *Exhibit 1,* above.

However, we wanted to learn more about whether further improvements could be made. To this end, we spent some time with our Portfolio Construction team to understand how these allocation decisions are impacting performance compared to other major pools of capital. Importantly, we chose to exclude the impact of manager and security selection from this exercise (i.e., we assumed returns in each asset class were similar to those for an 'average' manager or an index benchmark), which means that the efficient frontier of possible returns is likely lower than what most CIOs actually tend to deliver.

One can see the results of our analysis in *Exhibit 26*, which shows that a higher allocation to Alternatives is — by design — allowing family offices to deliver better risk-adjusted performance than many pensions or endowments and foundations. That's the good news for our family office CIO universe. In particular, we note that an overweight to illiquid strategies should allow family offices in our survey — all else being equal — to outperform their peers who have less exposure to Alternatives by approximately 600 basis points, with only a marginal increase in volatility. Moreover, anticipated asset allocation shifts in 2024 from our intentions survey (including a rotation from Public Equity to Private Equity and from Real Estate Equity to Real Estate Credit and Infrastructure, as outlined in the next section below) should further help improve performance per unit of risk.

Nonetheless, our analysis does suggest that – directionally – there is still likely more work that family offices can do to move their returns and risk 'up and to the left' in order to deliver superior performance in the macroeconomic environment we envision *(Exhibit 15)*. For starters, although the CIOs in our survey plan to commit about 21% of AUM to Private Equity by the end of 2024, we think they may still want to consider shifting even more of their 'risk budget' from listed stocks to PE strategies, especially tax-efficient, long duration ones, in coming years. Importantly, to complement this increase in illiquidity, we fully support the way most fully scaled CIOs are currently approaching asset allocation via a 'barbell' approach of holding a relatively high Cash balance and a large position in liquid credit to offset an overweight to illiquid strategies.

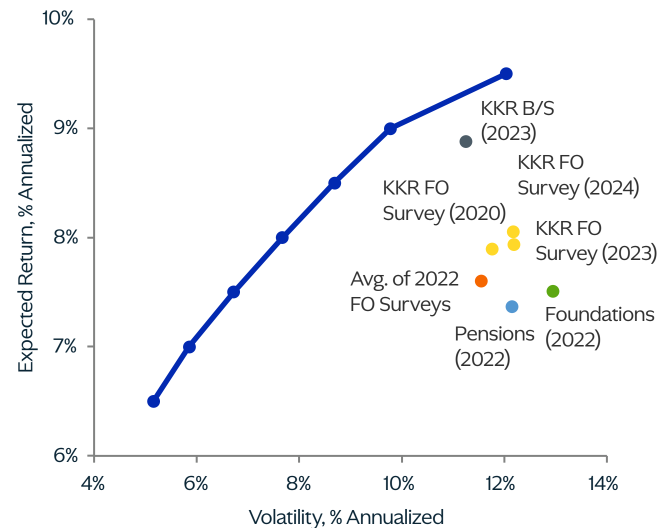
A higher allocation to Alternatives is — by design — allowing family offices to deliver better risk-adjusted performance than many Pensions or Endowments and Foundations.

We also think there is meaningful room to rebalance family offices' Real Assets portfolios, including smaller allocations to Real Estate Equity (particularly in Asia) and increased weightings to Real Estate Credit and Infrastructure. In addition, beyond the size of one's overall Real Estate Equity allocation, we also think there is an argument for many CIOs to reassess the mix of RE assets they are holding, particularly given the opportunity to add more distressed/recovery assets over the next 12-24 months as valuations and opportunities within the space begin to increase. If implemented, these shifts would represent more alignment on asset allocation with the more 'traditional' part of KKR's Balance Sheet, where we have chosen to overweight Private Equity, Infrastructure, Real Estate Credit, and Energy Transition assets.

Finally, after our discussions with some CIOs, we also left feeling that there is a growing appetite to align more with what we are doing at a strategic level. For example, several family offices are already buying and reworking blocs of insurance liabilities as well as participating in side-car investments and joint ventures, all businesses we have moved more aggressively into at KKR in recent years as part of our overall insurance footprint. Beyond the recurring payout/yield component and the more tax-efficient nature of these assets, there is also the diversification element. Indeed, as we show in *Exhibit 6*, many insurance assets tend to have a low correlation with most parts of liquid markets. At the same time, certain family offices have funded hedge fund start-ups, and in doing so, gained access to a portion of GP economics (receiving fee income in addition to the return performance). To be sure, marriages like these are not to be entered into lightly. However, if a CIO can find the right partner along the way, the upside can be significant.

**Exhibit 26:** Some Willingness to Maintain a More Illiquid Balance Sheet Has Helped KKR and Many Family Offices Deliver Strong Risk-Adjusted Returns Over Time

**KKR 2023 Family Capital Survey: Efficient Frontier by Allocator, %**




Data uses KKR capital market assumptions for expected returns and desmoothed volatility for private asset classes. Constraints on asset classes and strategy mix based on min/max allocations observed in our survey, +/-20% tolerance. Data as at December 31, 2023. Source: Bloomberg, Cambridge, GBR Analysis.

In addition, beyond the size of one's overall Real Estate Equity allocation, we also think there is an argument for many CIOs to reassess the mix of RE assets they are holding, particularly given the opportunity to add more distressed/recovery assets over the next 12-24 months as valuations and opportunities within the space begin to increase.

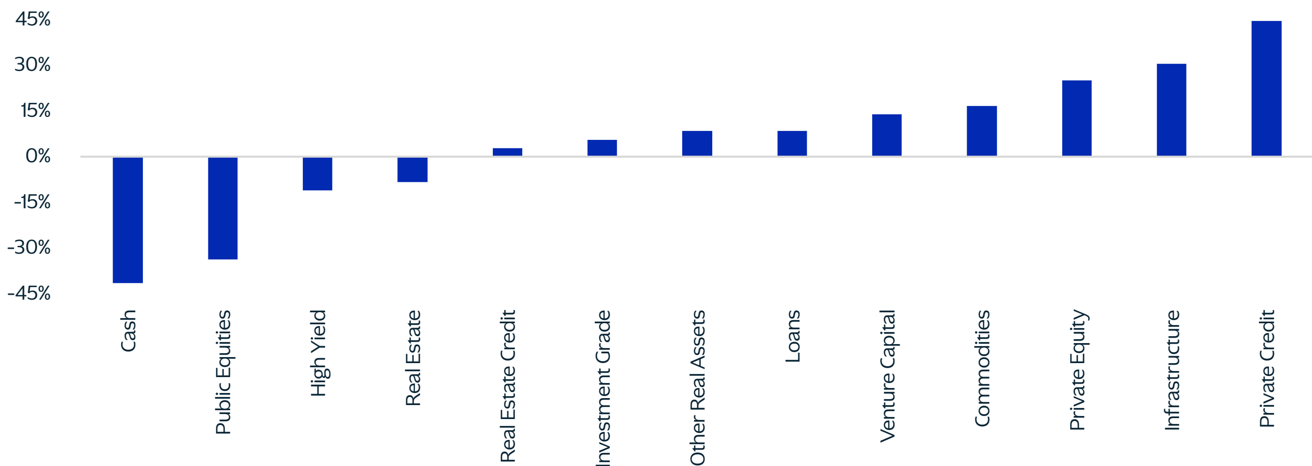
## SECTION IV

# Opportunities and concerns

**Where do CIOs intend to allocate?**

We asked the CIOs in our survey where they intend to allocate more/less capital in 2024, which one can see in the diffusion index shown in *Exhibit 27*. Notably, a net majority of CIOs suggested that Private Credit would likely be their future asset class of choice. We too view Private Credit as an attractive asset class, particularly in times of dislocation when the ability to pivot quickly and be nimble is rewarded. What we learned from our conversations was that many CIOs are now finally making a tactical wager that they can use Private Credit to exceed their hurdle rates, many of which are in the 10% plus range. The demise of both Signature Bank and Silicon Valley Bank, hung loans at the money center banks, and higher capital charges have all created an interesting backdrop for private lenders. Previously, in 2020, the absolute rate of return on the asset class did not qualify on an unlevered basis for many of our survey respondents.

**Exhibit 27:** CIOs Intend to Further Boost Returns by Reducing Cash and Public Equity Allocations While Reinvesting Further Into Alternatives




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

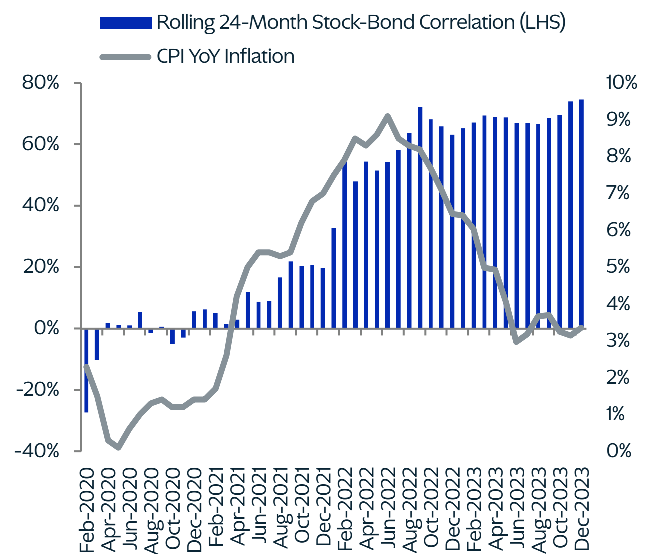
That said, multiple CIOs stated they were perplexed about the 'sudden' attraction of Private Credit among their peer group. They indicated that they have been allocating meaningfully to the asset class for several years, and as such, they are now a little more concerned that all the hype around the asset class may make it more competitive on a cyclical basis. Maybe more importantly, many of these same CIOs still believe that Private Equity, not Private Credit, is the best way to efficiently compound capital over a longer-term horizon.

Interestingly, we heard more from CIOs who are allocating Private Credit capital beyond the U.S. and Europe to include growthier markets such as Asia. Their logic: As Private Equity, Growth Equity, and Capital Solutions all come of age in the region (e.g., more corporate carve-outs, more control deals, and more de-leveraging stories), they think this tilt will lead to better pricing and terms — and less competition from established players.

For our nickel, despite more capital flowing into the space, we remain constructive on many parts of Credit. Traditional banks now face more regulation and capital charges, and we think that Basel III could lead to even higher capital charges at many traditional financial institutions. At present, we see value in Opportunistic Liquid Credit as well as Mezzanine as deal activity begins to pick up. However, we are probably most interested in Asset-Based Finance within Private Credit these days. Key to our thinking is that there is hard collateral backing these loans, which we think will accrue to an investors benefit if we are right about a longer-term, higher resting heart rate for inflation. Moreover, this area is attracting much less capital these days than Direct Lending, which might serve Asset-Based Finance well on the relative pricing front.

The other big area of interest was Infrastructure, which ranked number two in our intentions' survey. Having now done this survey three times, the increase in intention to allocate to Infrastructure is representative of two larger market trends. First, we think more CIOs around the world, including family office CIOs, are appreciating the merits that Infrastructure can bring to a portfolio, including inflation protection and yield. Second, given that today's Infrastructure (think data centers, logistics, and transportation assets) is often more growthy than traditional infrastructure (think airports and toll roads), we are seeing increasing numbers of CIOs swap out of Public Equities or other higher returning asset classes to create room for allocations. From a thematic perspective, our family office CIOs also appreciate that our 'security of everything' thesis positions this asset class as a way to respond to heightened geopolitical tensions and shifting supply chains.

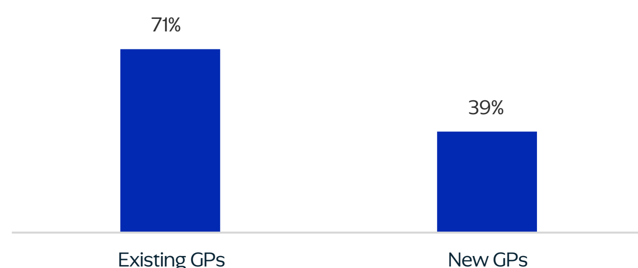
**Exhibit 28:** Real Assets Have Become a More Important Diversifier, As the Correlation Between Stocks and Bonds Has Changed Since COVID




Note: Stocks refer to the S&P 500 and Bonds refer to the 10-year Treasury Yield. Data as at December 31, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Third on the intentions to buy list was Private Equity. Overall, there was a continued desire to increase allocations to Private Equity (which really came through in our CIO conversations, in particular), but intentions were dampened a bit by a slower realization cycle of late. When we spoke to CIOs, they again reinforced the importance of co-investments to supplement their fund commitments. All told, as we show in *Exhibit 29*, most CIOs are looking for a more complete package that extends beyond traditional fund commitments. Beyond the co-investment business, we find family capital commitments to be meaningful partners alongside the KKR Balance Sheet across a variety of activities, including seeding new businesses as well as getting larger in key investments.

**Exhibit 29:** CIOs Place a Premium on Co-invest Opportunities




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

At the opposite end of the spectrum, most CIOs were likely going to fund new investments with Public Equities. Our conversations indicated that there was more of a large-cap U.S. bias to sell, which makes sense to us, given the notable appreciation of late. Also, as we show in our expected returns forecast, we now forecast lower returns in this asset class on a go-forward basis.

Cash is the other asset CIOs are really looking to trim. This viewpoint dovetails with our view that rates have likely peaked, and as a result, there are likely better opportunities elsewhere. We think it's important to note that many family offices utilize Cash from their operating business to fund operations and provide distributions to the family members. As mentioned above, many CIOs are also using lines of credit, Liquid Credit, and ETFs as backfills for Cash.

Meanwhile, there were a mix of assets in third place to 'sell', including Real Estate, and High Yield, which make sense to us in today's environment. The intention to sell Real Estate also supports our view that Real Estate Equity has further to go before the asset class rebounds in unison. That said, as our colleague Ralph Rosenberg, who heads global Real Estate at KKR, and I have been discussing, we are starting to see some interesting situations where forced sellers are creating attractive entry prices for opportunistic equity capital, especially owners who can create operational improvements.

**Where are family offices not in synch with each other?**

Clearly there is a lot of ongoing debate around China. Not surprisingly, most CIOs acknowledged that they were shifting allocations within Asia away from China/HK towards India and Japan. Against this backdrop, we expect direct China exposure in many family office allocations to fall closer to two to five percent from 9-11% previously. Our take: Sentiment is really negative, and we think investors might want to consider the benefits of a call spread option strategy to maintain some exposure if they are reducing their direct cash exposures to Public Equities in China at current valuations.

There was also a big split in regard to Energy. Many CIOs, especially in Europe, want to ramp up exposure to Climate and Energy Transition funds. Asian CIOs also mentioned that they were being encouraged to align family offices with the operating companies' socially responsible investing mandates. Sustainability is clearly a huge directive within these regions. Not surprisingly, they have little to no interest in traditional energy assets. By comparison, in the U.S. and Latin America, there was increasing interest in owning more traditional energy assets, including pipelines, LNG, and natural gas production. Cheap valuations, strong cash flows, and negative sentiment have several CIOs thinking that the sector is washed out and ready for a bigger, more sustainable rebound, as the shift towards renewables takes longer than the consensus now thinks.

Clearly there is a lot of ongoing debate around China. Not surprisingly, most CIOs acknowledged that they were shifting allocations within Asia away from China/HK towards India and Japan.

The third area of discussion was around how to access the Credit opportunity. Some CIOs feel strongly, as our intention survey suggests, that they should ramp exposure to Private Credit. Others, by comparison, think that there is more value in the Liquid Credit markets, especially with managers who can toggle between High Yield, Levered Loans, and Structured Credit; within the private markets, they favor Asset-Based Finance and Mezzanine/Capital Solutions.

Finally, there is definitely debate about whether to invest in more 'development' areas such as Real Estate construction and early stage Growth/Venture Capital. Some families had poor performance after rates surged in 2022, and as a result, they are pivoting to own private investments with more visible cash flows. On the other hand, there is still a solid contingency that view 2022 as an aberration, more than a trend. Our take: Given our view that we will have a higher resting heart rate for inflation (and hence, a higher equilibrium for short rates), moving forward, we are in the camp of those who are pivoting their portfolios towards more cash flowing investments.

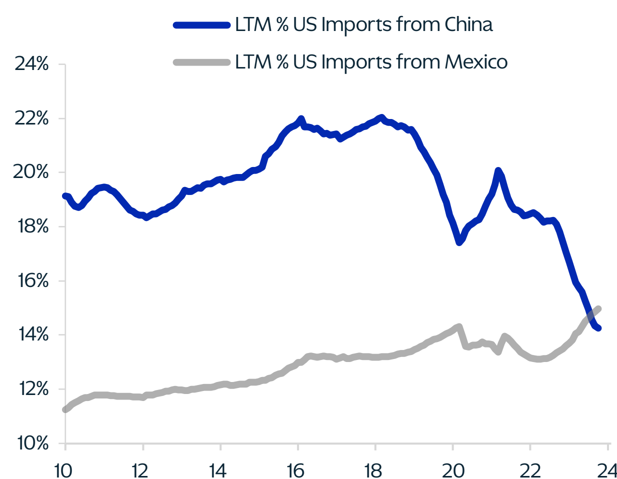
**Our family office CIOs are interested in similar themes to KKR.**

Not surprisingly, our CIO universe and KKR are investing behind very similar thematic tilts. As one CIO told us, his office "will dedicate more effort to finding long-term, secular themes where we can make sizeable investments with significant capital appreciation targets." To this end, we thought we would highlight the areas where there was the greatest amount of overlap as well as provide some additional color on how CIOs might approach the opportunity set.

**Security of Everything:** Without question, CIOs are looking to find investment ideas that can serve as foils to the increasing geopolitical tensions they are sensing these days. We agree, and we think this shift towards investing behind 'resiliency' ideas began during COVID and has only been reinforced by Russia's attack on Ukraine, the conflict in the Middle East, and the activity in the Red Sea. Against this backdrop, the security of energy, communications, healthcare, and data is not only an economic priority but a geopolitical one as well. There is also likely more turmoil ahead. Indeed, as our colleagues Vance Serchuk and General (Ret.) David Petraeus suggest, the democratization effects of trade many envisioned post the creation of the WTO in 1995 may now be replaced by 'like-minded blocks' rather than global markets. This trend played out rapidly in Europe, with a reinvigorated NATO, and rapidly changing energy policy, defense spending, supply chains, and even consumption patterns.

Importantly, the desire to be economically and technologically independent means that the definition of 'security' for governments and corporates extends beyond the military playing field to include data, search, payments, communications, and healthcare. Companies will need to ensure the security of storage, power, and transportation, and with government spending initiatives/ tax incentives like the IRA, a lot more government support will be targeted at the intersection of climate and supply chains. Against this backdrop, we expect more CIOs in the family office channel to prioritize key sectors such as cyber, data security, logistics, and supply chain management technology. One CIO said it quite well when he shared that a top concern is the "increased need for cybersecurity and the increasing probability that it disrupts geopolitical relationships."

**Exhibit 30:** The Shifting of Supply Chains Is Creating Opportunities Across Real Estate, Infrastructure, and Private Equity

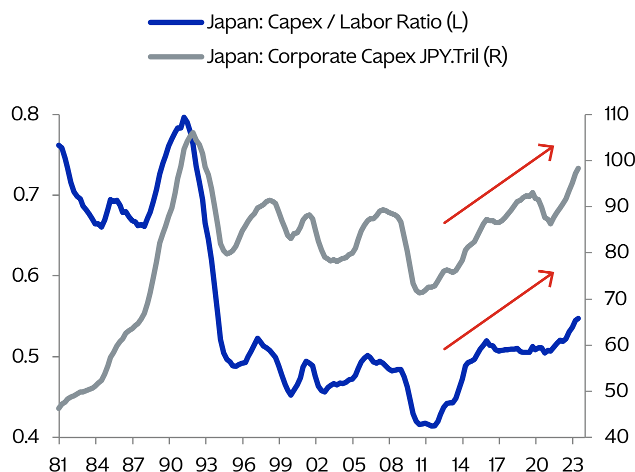



Data as at October 31, 2023. Source: U.S. Census Bureau.

**Industrial Automation:** One theme that continued to bubble up during our CIO calls was the opportunity in what one CIO called the "more mundane, less sexy" parts of the market, including helping industrial companies reposition themselves in this new era of global competition. To review, this theme has been bubbling up during recent travels, and especially in Asia last fall. In Japan, for example, capital expenditures are hitting record highs, as companies search for new ways to drive productivity. These investments will be critical in a higher nominal GDP world where labor costs and other rising inputs could otherwise pressure margins. We heard similar stories in China and Germany where companies are trying to use technology and automation to deliver more efficiency and productivity in a world where demographics and cross border connectivity are becoming more challenged. To this end, we favor software plays, as one example, that can help warehouses become more efficient at storing goods and/or using less energy, or industrial automation efforts that retool old manufacturing processes to make them more globally competitive. We also like mission critical, highly engineered, and application-specific products that have a high cost of failure, but account for a small percent of total product cost (e.g., flow control testing/inspection/certification equipment).

**Exhibit 31:** Japan Corporate ROE Has Been Improving, Supporting Higher Corporate Capex, Especially Amidst Persistent Labor Scarcity

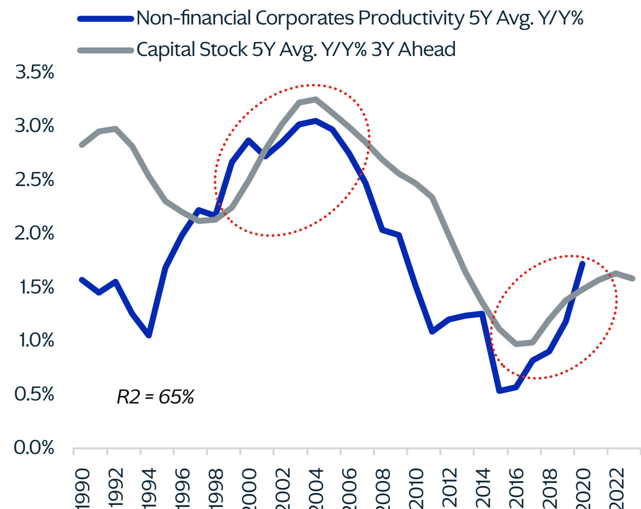
**Japan: Corporate Capex**




Data as at November 30, 2023. Source: KKR Global Macro & Asset Allocation analysis.

**Exhibit 32:** Capital Investment Leads to Productivity Gains. The Last Major Wave of Capital Investment Occurred in the 1990s and Another Is Currently Underway, We Believe

**U.S. Capital Stock vs. Productivity, %**




Data as at December 31, 2021. Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Cornerstone Research, Haver Analytics.

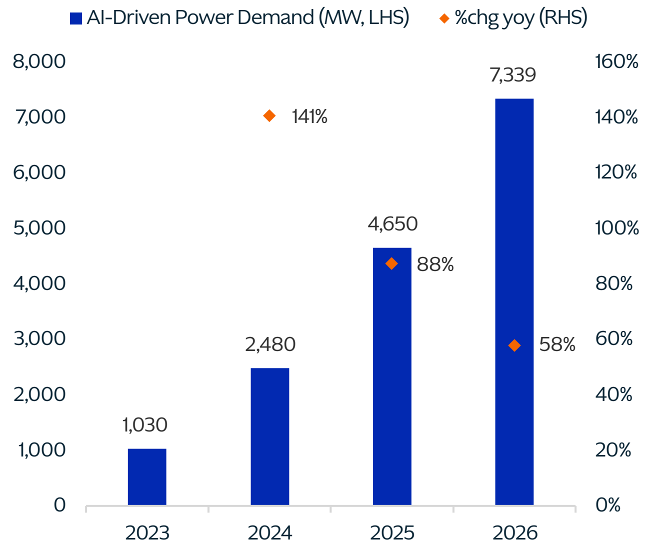
One theme that continued to bubble up during our CIO calls was the opportunity in what one CIO called the 'more mundane, less sexy' parts of the market, including helping industrial companies reposition themselves in this new era of global competition.

**Artificial Intelligence:** The AI investment opportunity set is massive (some estimates suggest Generative AI revenues may exceed USD one trillion per annum within a decade), but we and many of the CIOs with whom we spoke favor a more nuanced approach to start. Specifically, while direct plays on AI tech development are quite compelling, they are also quite expensive. By contrast, we think a number of non-direct plays, including data center capex, semiconductor manufacturing, power transmission and distribution, will likely also undergo massive investment cycles stemming from the need to develop the underlying infrastructure and energy consumption (*Exhibit 34*).

Consider that the proliferation of AI work streams also comes at a time when hyperscale operators, which represent roughly half of data center capex, are already dealing with significant backlogs, rising lead times, and higher construction costs. In other words, we believe it will be difficult to quickly scale data center infrastructure to meet the rising demand for computing capacity. The additional power demand created by AI is related to the fact that AI workstreams are more computationally intensive. It is estimated that the energy density per server rack is ten to thirty times higher for AI servers than for general-purpose cloud computing, meaning each square foot of data center space will require much more power than it did previously. This higher power consumption will further accelerate the transition from air cooling to liquid cooling in data centers, as well, we believe.

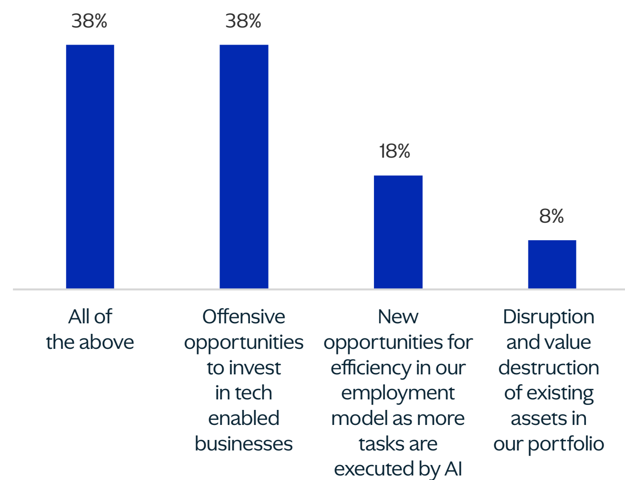
Without question, CIOs are looking to find investment ideas that can serve as foils to the increasing geopolitical tensions they are sensing these days.

**Exhibit 33:** AI Workflows Are More Computation Intensive and Server Racks Use More Energy, Which Will Drive Power Demand




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

**Exhibit 34:** Family Offices Want to Capture the Transformative Nature of AI, But Also Recognize the Potential for Value Destruction



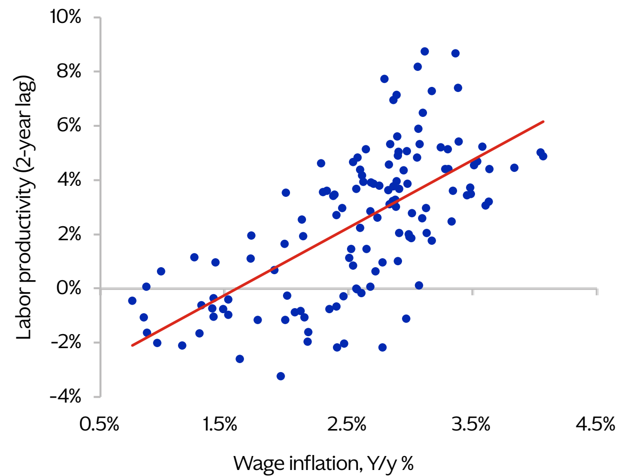

Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

As mentioned earlier, we support the idea of using family operating businesses to gain insights on investing behind AI. Already, family offices are making significant inroads investing in AI ideas using proprietary data across their industrial fleets, healthcare networks, and salesforces.

**Labor Productivity/Workforce Development:** For more than 50% of our survey respondents that owned an operating business as well as those who are overweight Private Equity, labor costs, and productivity enhancements are key issues that are driving allocation decisions across multiple asset classes, including Private Equity. Why? As CIOs look to understand operating business cash flows and challenges, they often seek investments that can enhance operations or find solutions for challenges. This aligns with what we are seeing in KKR portfolio companies and with investors globally as corporations focus on automation and productivity gains to offset challenging demographics and tight labor markets. Our work suggests that periods of labor scarcity have historically been opportunities for greater automation; we are particularly focused on technological advancements that can have an impact on productivity. Specifically, many of the important technological trends, including automation and digitalization, that were already in place before the pandemic have now only accelerated. We are also very bullish on trends in worker retraining. Using data and educational techniques to improve student/employee skills to better match the demand by corporations for labor will be a mega-theme, we believe. Using history as our guide, we believe that the recent uplifts in productivity are closely linked to a resurgence in capital investment that began around 2014. To date, the most advanced efforts have been heavily concentrated in the manufacturing industry, which in the United States accounts for less than 10% of total employment but nearly 90% of all robot installations. However, the playbook is starting to shift, as the aging population makes it harder to fill junior roles in service industries. We have already seen robots cleaning floors at Heathrow and clearing dishes in Japan and think this trend will accelerate as automation increases in fields like retail, leisure and hospitality, and healthcare. No doubt, automation and productivity are emerging mega-themes, in our view, and at times have accounted for about 20-25% of our deal teams' PE activity since the pandemic.

**Exhibit 35:** Wage Gains Have Historically Led to Periods of Rising Productivity

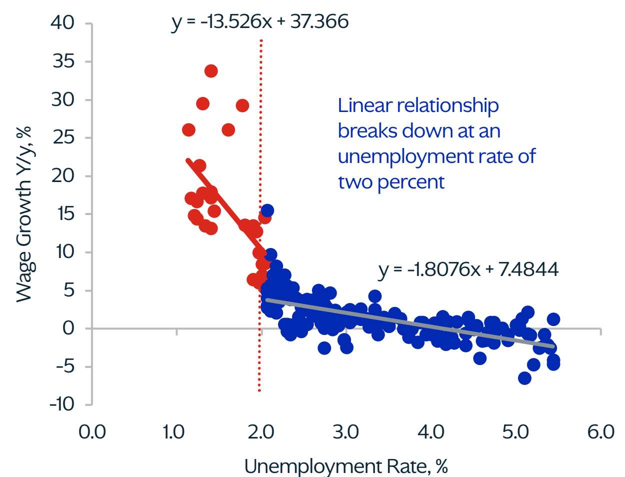
**Wage Inflation vs. Labor Productivity in U.S. Manufacturing, %**




Data as October 31, 2023. Source: U.S. Census Bureau.

**Exhibit 36:** Tight Labor Markets Are Helping to Put More Upward Pressure on Japan Inflation

**Japan: Unemployment Rate vs. Wage Growth, 1Q 1971 - 1Q 2023**




Data as at November 30, 2023. Source: KKR Global Macro & Asset allocation analysis.

## SECTION V

# Conclusion

We chose '**Loud and Clear**' as our title for this year's KKR family office survey to reflect the high conviction we felt from the CIOs we surveyed and interviewed. That said (and similar to KKR's Balance Sheet), it is clear they feel empowered to leverage their competitive advantages as active owners of businesses as well as their patient capital focus to try to generate superior returns for their constituents. We believe our survey captured not only the growth opportunities ahead, but also some of the challenges they face as they try to scale their businesses to the next level, including headcount constraints, large, concentrated positions, and – at times – differing views from the matriarchs and patriarchs who employ them.

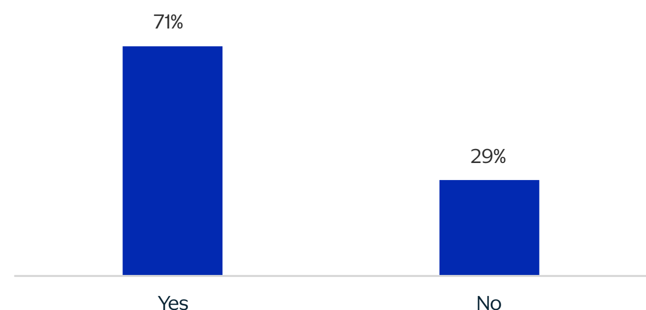
This survey also reaffirmed our strong belief that no one model works for all family offices. That said (and similar to KKR's Balance Sheet), the CIOs we surveyed are almost all longer-term focused, and committed to harnessing the illiquidity premium as well as being positioned to lean into dislocations. However, how they size their investments across asset classes and regions is still quite varied. For sure, this industry is not a mature one. Moreover, in Section III, where we discuss areas where family offices are not in synch, is an important reminder to us that there are multiple paths to success in this marketplace, especially given the freedom embedded in many of the mandates we reviewed with our survey participants.

That said, as we showed with our efficient frontier analysis in *Exhibit 26*, we do think that many CIOs could consider making tweaks to their portfolios that might boost their return per unit of risk. In particular, we think that there is an opportunity set to add more to Infrastructure, Real Estate Credit, and Private Equity. We also think that, while there is a greater focus on performance measurement and compensation, even more could be done in this area, especially as these organizations scale up further.

Looking ahead, we at KKR are excited to find more ways to partner with these CIOs as they seek GPs who can provide sourcing, co-invest flow, and asset allocation expertise in areas where they do not intend to internalize their investment process. No doubt, the road ahead is a complicated one for anyone who allocates capital in today's world, but our 2024 survey confirms our strong belief that this group of CIOs is well positioned to be at the winner's table at the end of this cycle if they are 'Loud and Clear' about playing to the embedded strengths we have been championing in this group since we wrote our first KKR Family Office Survey back in 2017.

**Exhibit 37:** As Family Offices Have Matured, Performance Has Become More Aligned With the Overall Portfolio's Performance

**KKR 2023 Family Capital Survey: Do You Align Compensation of Investment Teams to Performance of the Investment Portfolio at the Portfolio Level?**




Data as at January 31, 2024. Source: KKR 2023 Family Capital Survey.

We do think that many CIOs could consider making tweaks to their portfolios that might boost their return per unit of risk.

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**Kohlberg Kravis Roberts & Co. L.P.**
30 Hudson Yards
New York, New York 10001
+ 1 (212) 750.8300
**www.kkr.com**