KKR

December 2023 Market Review

KKR Credit & Markets

2024: A Credit Vintage to Remember?

Written by:

Christopher A. Sheldon
Partner and Co-Head
Credit & Markets

Rory O'Farrell
Director,
Client & Partner Group

Key Themes

In this letter, we'll focus on the opportunities in both private and liquid credit markets.

01

Market Risk: The Elephant in the Room

02

Fixed vs. Floating Rates in a Changing Monetary Environment

03

The Non-Corporate Side of Private Credit Monetary Environment

Executive Summary

In 2024, we think the conditions are ripe among the most attractive new vintages and opportunities in some time across the credit spectrum, including private and publicly traded credit. Lenders should continue to benefit from relatively scarce capital conditions to reach high-quality borrowers on attractive terms. Asset buyers, on the other hand, are likely to engage in more transactions as valuations come down, and the transactions are likely to be less reliant on leverage. It's also important to remember that not all private debt is corporate. Asset-based finance offers important, diversifying exposure to non-corporate cash flows, and both the asset class and the opportunities it offers are growing as banks continue to pull back on collateral-based lending.

However, there is also fear in the market. This largely concerns existing portfolios, and we believe it is in some ways legitimate. We expect further deterioration in corporate fundamentals as businesses continue to adjust to a higher-for-longer interest rate and inflation environment. However, we do not foresee a collapse or a sweep of defaults in either public or private credit markets, nor do we see the trend toward financing in private markets completely reversing as syndicated markets thaw. Private credit has a place in the market now, and it will continue to. As we have said before, we believe public and private credit markets are likely to coexist, rather than supplant one another. We think there will be a strong bifurcation and increasing dispersion between lenders who balanced risk in the good times by lending to high-quality, larger companies with resilient business models and capital structures and those who did the opposite.

Fears about deteriorating fundamentals are also a major issue for public credit markets, but here again, we see worry overshadowing a view of the available opportunity. As conviction on the future path of interest rates builds and inflation wanes, duration is starting to become more interesting again. We are starting to shift our allocation toward high yield bonds, an asset class that has derisked in important ways over the last decade and may offer different opportunities than many investors expect.

Introduction

2023 was a year of paralyzing unease in credit markets and beyond. As inflation spiraled and the U.S. Federal Reserve, European Central Bank (ECB) and other international central banks sent interest rates soaring to try to tame it, many old assumptions about the cost and availability of capital came up for reconsideration. Transactions and the pace of investment slowed as everyone waited to see what would become of interest rates. Capital was at a premium, and private lenders with deep pools and flexible capital had the opportunity to lend to high-quality businesses on advantageous terms. Likewise, in public markets, periods of dislocation with low prices, high spreads and high yields created attractive entry points for credit investors in 2023.

The accepted wisdom now is that interest rates will remain higher for longer in the United States and Europe. In the United States, there is also more consensus around the idea that the Fed's rate hikes are having their desired effect; slowing the economy and tamping down inflation. In our last market review, we wrote about how this increased clarity was encouraging a modest pickup in capital markets activity. Heading into 2024, we still see signs that activity is picking up in certain corners of the market, but there is by no means a stampede to deploy and transact. Clarity has not yet translated into conviction. Most investors and allocators have not experienced a prolonged period of high interest rates and structural inflation before and do not have a playbook or tool kit to fall back on.

What's left is a different kind of fear. The old fear centered around whether central banks could tame inflation without engineering a hard landing. The new fear is whether existing borrowers are still creditworthy in a new macroeconomic reality, or whether we stand on the precipice of a rush of defaults. Many investors are waiting to see what the answer is, loathe to deploy capital just before a default wave hits. A similar line of thinking holds true for private equity and other private asset classes: Can the deals of yesteryear still work with higher rates?

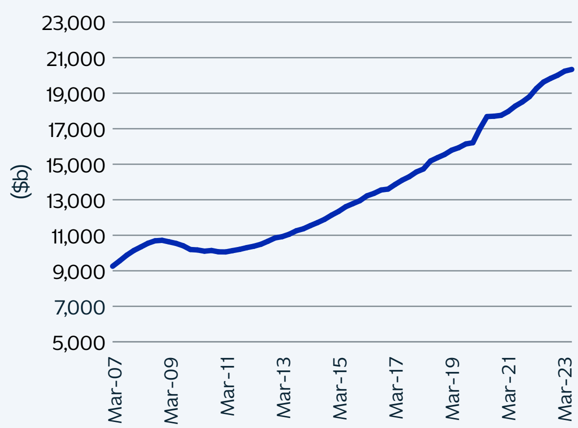
We often hear about the new market fear in six points:

---

1. Corporate debt levels have doubled since the Global Financial Crisis (Exhibit 1).
2. Interest rates are rising, which will put pressure on corporate profit margins as input costs rise. It's likely that a growing number of companies will have trouble either refinancing or paying their debts.
3. More and more corporate borrowing has taken place in private markets. Most of that debt is floating rate, meaning that the debt burden has increased significantly as rates have risen. Risks building in the asset class may be opaque and difficult to predict.
4. The cost of debt in leveraged buyouts has become more expensive, which in turn makes the math on these transactions more difficult for private equity sponsors.
5. Much has been made of the so-called golden age for private credit. A significant amount of dry powder has been raised in the $1.4 trillion asset class. As more and more lenders seek to deploy that capital, some worry that competition will erode lending standards and compress spreads.
6. If fundamentals are challenged, staying in senior secured debt seems like a more prudent option than venturing into subordinated or sub-investment grade debt.

EXHIBIT 1

US Nonfinancial Corporate Debt



Source: U.S. Federal Reserve as of September 8, 2023.

We agree generally with the facts of this argument, but we disagree that a universal reckoning is coming either for private credit or private equity. (The two are interlinked, as private credit is often used to finance private equity transactions.) Instead, we foresee a period in which the dispersion among outcomes is increasingly stark, with the potential for some very strong vintages for many private asset classes next year and the years immediately following. In this market review, we'll share our perspective on risk in the credit markets, discuss the timing of a pivot to fixed-rate over floating-rate debt, and explore how non-corporate credit exposure can serve as a hedge against corporate borrowers.

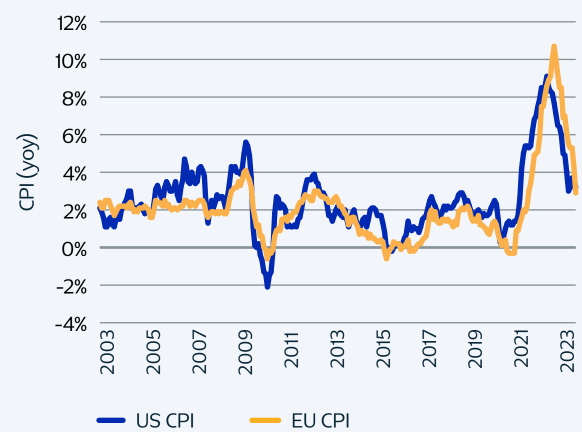
Market Risk: The Elephant in the Room

The first two-and-a-half points of the market fear argument—highly leveraged companies, particularly those with floating-rate debt, potentially running into trouble making debt service payments—are fundamentally about inflation and interest rates. These are also the two metrics that dominated the market's thinking about risk across asset classes, but particularly in credit, in 2023.

We think the worst may be over, or soon will be, when it comes to inflation and interest rates. Inflation has been steadily declining all year in Europe and the United States (Exhibit 2). Particularly noteworthy, according to our Global Macro & Asset Allocation team, is that goods prices have fallen steadily as supply chains untangle COVID-era snarls and consumer demand normalizes. We agree with their view that the Federal Reserve is likely on hold for the next few months, that the United States will enter a mild recession as early as mid-2024, that the central bank may make modest rate cuts in 2024 (likely in the second half of the year) and that these cuts will not change the higher-for-longer interest rate environment. The European Central Bank, could begin easing as soon as the second quarter of 2024.

EXHIBIT 2

Consumer Prices in the US and Europe



Source: Bloomberg, KKR Credit Analysis as of October 31, 2023.

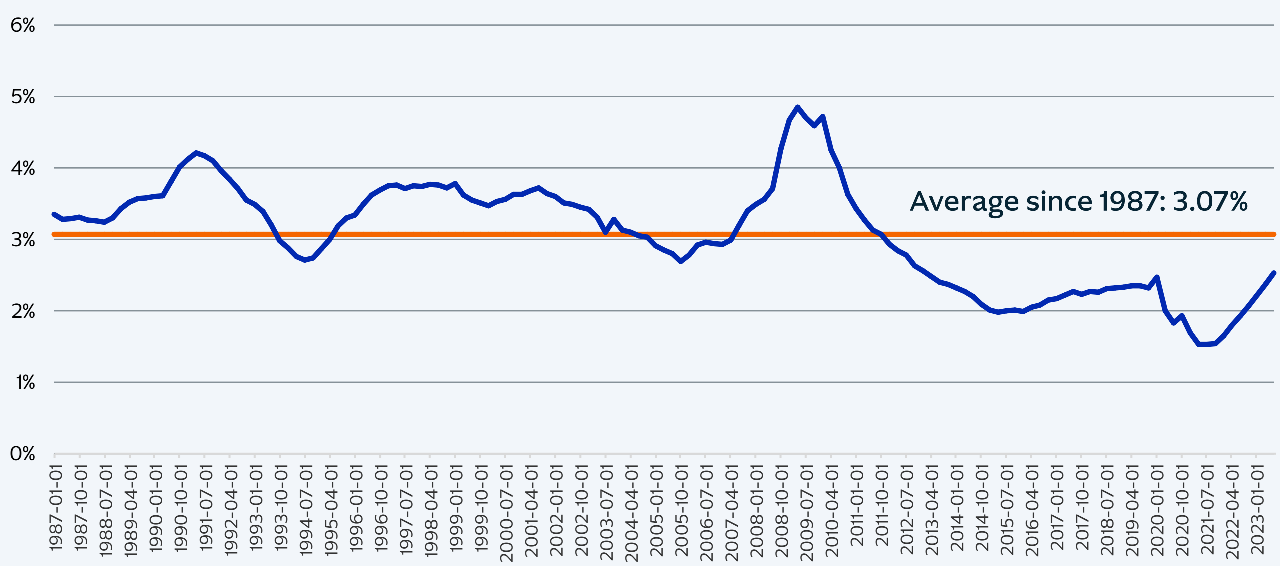
However, both inflation and rates are likely to settle out at a "higher resting heart rate" compared to the pre-COVID markets investors have grown used to. Our macro team predicts that the U.S. consumer price index (CPI) will come to 2.6% in 2024 and above 2.5% in 2025 and beyond. Ten-year Treasury bond yields, which ran up sharply in the fall of 2023, should also come down to 4.25% by the end of 2024. The team believes there is a new, higher premium to hold U.S. Treasuries due to the overwhelming fiscal debt load.

What does it all mean for corporate borrowers and the public and private credit markets? In our experience, market-destabilizing selloffs occur when there is widespread forced selling. Though some banks were forced to sell assets in the wake of the March 2023 bank failures and there is some pressure on regional banks to shed loan portfolios to improve their capital positions, we have not seen investors engage in the kind of forced selling that occurred either during the Global Financial Crisis or the beginning of the pandemic. On the other end of the spectrum, consumer loan delinquencies have ticked up, but at 2.53% are below the average of 3.07% since 1987 (Exhibit 3). What we see in most asset classes, including real estate, is motivated selling, rather than true forced selling. There is, no doubt, a settling-out of asset prices taking place, but we do not see it as a dramatic selloff. We compared the current stance of many allocators in [our June 2023 Market Review] to the Samuel Beckett play, "Waiting for Godot." If Godot is a bottoming-out similar in scale to that of the Global Financial Crisis, we think allocators, too, may be waiting for something that never comes.

On the other hand, corporate fundamentals have deteriorated and will likely continue to do so. Almost as powerful as higher rates is the expectation of higher rates, which feeds into corporate capital expenditure and budgeting decisions across sectors and industries.

EXHIBIT 3

Consumer Loan Delinquencies on Commercial Bank Loans



Source: Board of Governors of the Federal Reserve System (US) as of June 30, 2023.

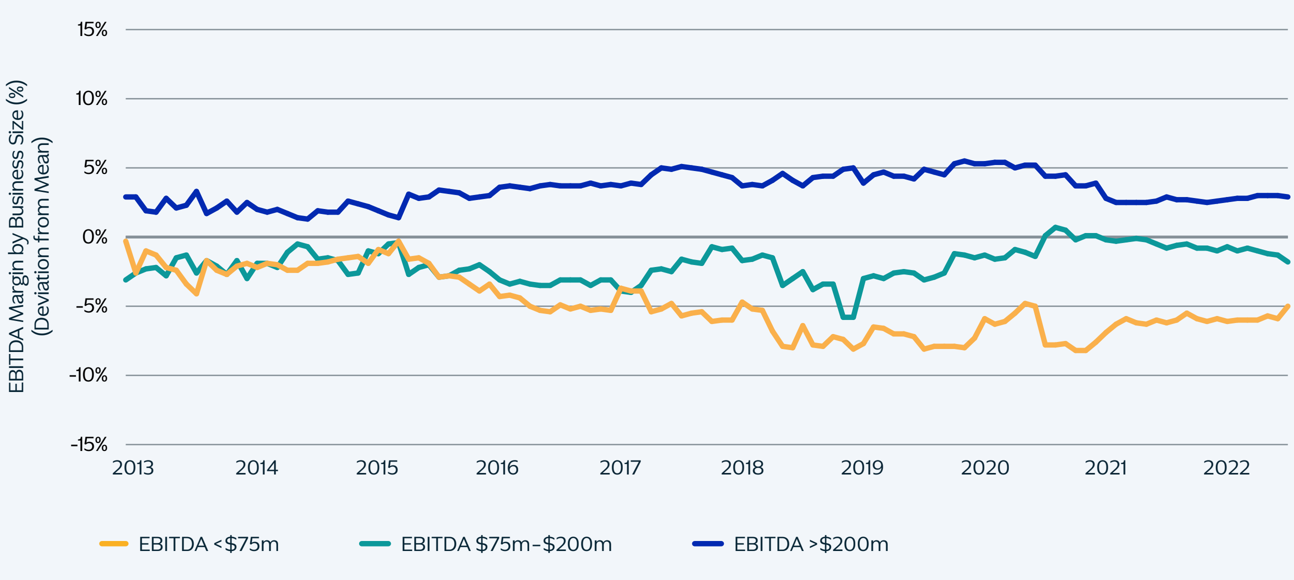
Let's look closer, starting with public markets, where we have the most data. Defaults have ticked up, but are still relatively muted. The JPMorgan US High Yield Bond Index default rate over the last 12 months was 1.2% as of September 30, up from 0.8% at the end of 2022. The US Leveraged Loan Index default rate was 2.3%, up from 1.0% over the same period.

However, as we will note in the next section, we think [high yield bond markets have gotten much less risky]() over the past decade. In addition, companies have been very active in trying to manage their debt maturities. While many leveraged loans had relatively short-dated debt, issuers have proactively refinanced or completed amend-and-extend agreements to deal with upcoming maturities. As we have noted in prior reviews, amend-and-extend deals have been a particularly active segment of market activity in the second half of 2023.

Now to point 2.5 of the six-point fear argument: the potential for opaque systemic risks building in private credit markets. It's true that private markets are private, and therefore, we don't have reliable, broad market data for them. We fully expect that defaults in private credit will increase, just as they have in liquid markets, and in fact that they will potentially increase *more* than in liquid markets. We have consistently focused on lending to the upper end of the middle-market and have seen opportunities to lend to companies with larger EBITDAs since the pandemic. However, a good portion of the increase in overall private lending that has occurred over the last several years has been in the smaller end of the middle market. Our data has shown that smaller companies have a more difficult time navigating difficult market conditions and may have fewer places to turn to borrow or refinance than larger companies (Exhibit 4).

EXHIBIT 4

Smaller Companies' Profit Margins Were More Volatile and More Negative over the Last 10 Years



Source: KKR Credit as of June 30, 2023.

However, there is a flip side to the private-is-private idea. Workouts in private credit often remain private, too, making it difficult in some cases to pinpoint whether a default has occurred or been avoided. Private borrowers may negotiate with their lenders for a combination of more time to pay, a lower interest rate or the ability to make payments in kind to exchange some interest-paying debt for equity in the company without anyone being the wiser. In the past, troubled loans were the bread-and-butter business for distressed buyers and funds, but we think this is changing. The more established incumbency of large private credit providers that can negotiate and resource workouts, as well as the increasing role of flexible capital solutions, may make it more difficult in our view for distressed buyers and funds to access troubled loans. Smaller private lenders that do not have the resources to negotiate solutions could be in trouble, but what we see ahead is a bifurcation in outcomes rather than an implosion of the entire asset class.

We think bifurcation will be a consistent theme in 2024. Lenders that have focused on larger businesses with strong market positions will in our view perform better than those that have taken on more risk either on leverage levels or by lending to smaller, less proven businesses.

We would also point out that there is a difference between the bifurcation we expect in existing private loan portfolios from pre-pandemic vintages and the nature of both the current opportunity and the opportunity going forward. Inflation has been a topic of conversation among top asset managers for nearly four years now, ever since the pandemic introduced true scarcity to advanced economies that had little experience with it and a flush of stimulus followed, particularly in the United States. In fact, pandemic inflation was a slow-moving train the likes of which we had never seen before. Top managers knew inflation was coming and were actively managing portfolios against it for nearly two years before it began showing up in economic data.

Regardless, we feel confident that lenders are paying more attention than they did in 2019 to the stability of profit margins and how vulnerable a company's business model and profits are to inflation and rising rates. The accumulated knowledge about how inflation affects corporate credit dynamics can potentially give private lenders a better sense of the risk that rates and inflation pose to deals under consideration.

Market activity will also have an important effect on private credit in 2024. The lack of available debt capital has been a theme across all markets in 2023. The pullback in bank lending, CLO formation, high yield bond and leveraged loan issuance, and IPOs created a situation in which private debt was in extremely high demand. That made for a lender-friendly market with more protective covenants and more attractive terms, but also reduced the number of leveraged buyouts and other kinds of deals that private credit has traditionally funded.

As we noted last quarter, we are starting to see signs of a thaw in several parts of the market. Back in May 2023, we noted that syndicated markets were starting to open, but only for issuers with relatively large equity cushions and high ratings. That activity remained relatively strong in September but slowed in October on concerns about both the path of interest rates and the tragic geopolitical developments in Israel and Gaza. However, we predicted in May that selective syndicated markets reopening would create demand for private junior debt as an alternative source of funding. We have seen that bearing fruit in our own pipeline.

While overall leveraged buyout transaction activity remains below the post-pandemic highs, we have been seeing more demand for acquisition financing in our private credit business. In the first part of the year, transaction activity was weighted toward public-to-private transactions and corporate carve-outs. Starting in September, we also began to see more sponsor-to-sponsor transactions and non-sponsor activity involving refinancing or businesses that either chose to seize a moment of relative stability or simply couldn't wait any longer.

Which brings us to the fourth point in the six-point fear argument, about whether or not the math of leveraged buyouts still works in the new environment. Private equity has come under scrutiny in recent months, largely due to the difficulty of exiting investments in an environment in which sellers and buyers still have some room between them on valuations and financing is much more difficult than usual. However, there has also been some concern about whether private equity relies too much on leverage levels that won't work in a higher-for-longer environment.

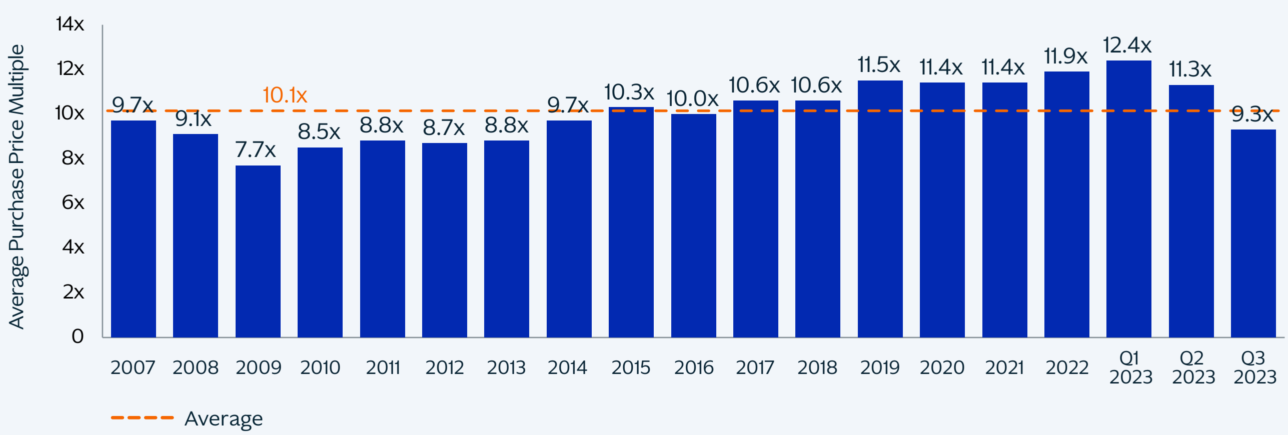
From where we sit as a lender, we would not be surprised if debt-financed rollups and private-to-private transactions remained challenging in 2024 and beyond. However, we note that in carveouts and public-to-private transactions, the distinct potential for private equity investors to add incremental value to overlooked assets is a major part of the value proposition. These types of transactions do not require as much leverage to succeed, nor do they rely on multiple expansion. Instead, they succeed when teams can find and acquire assets where they can use their expertise to create value. As earnings continue to come under pressure from higher-for-longer rates and sticky inflation, we expect that more companies will look to either look to sell non-core assets in a carveout or seek capital solutions.

We at KKR have also seen in our own business that value creation is the key element in achieving returns. In our American Private Equity platform, revenue and EBITDA growth outpaced the S&P 500 between 2017 and 2022 (15% vs. 8% and 14% vs. 8%, respectively).[1] There is no guarantee that this kind of fundamental outperformance will continue; however, the point is that private equity is not always just about leverage ratios.

As sellers capitulate, we expect high quality assets to be available at attractive prices in all kinds of private equity transactions, including real estate and infrastructure. Indeed, our Private Equity team notes that leveraged buyout multiples in the United States continue to normalize, with the average purchase price multiples declining from a high of 12.4x in the first quarter of the year to 9.3x, below the average of 10.1x since 2007 (Exhibit 5). Multiples have not adjusted uniformly, however, underscoring the importance of broad exposure.

EXHIBIT 5

US LBO Multiples



EBITDA is adjusted for cost savings and synergies. Source: American Investment Council, "2023-Q3 AIC Trends Report"

1. As of December 31, 2022. Includes all unrealized and partially realized KKR Americas Private Equity Investments.

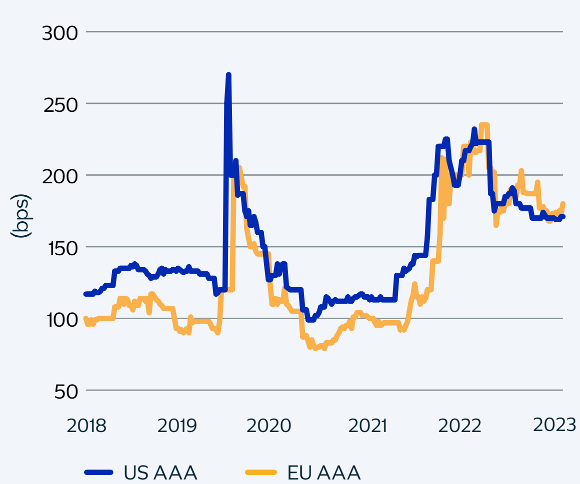
As a method to finance leveraged buyouts, we see loan issuance as an important harbinger of the path of credit markets. Loan issuance not only gives a sense of the appetite for corporate transactions but are also critical to the function of the CLO markets. U.S. leveraged loan issuance picked up in September 2023 and has generally been higher than in 2022, but still much lower than pre-pandemic norms. (In both the U.S. and Europe, high yield bond issuance has picked up faster than loan issuance.)

Our Leveraged Credit team notes that demand for CLO paper is coming back, particularly for AAA, the backbone of any CLO capital structure. Exhibit 6 illustrates the movement in AAA tranches of new issue deals. Prices are tightening, albeit off a lower volume level. CLO creation is intrinsically linked with new loan issuance, and tightening CLO liabilities helps one side of the CLO arbitrage equation. On the other side, widening asset spreads on new issue loans remains a key data point that we focus on.

Elsewhere in the capital markets we find it notable that three IPOs worth more than $500 million took place in the United States. Aftermarket performance in some of those deals and in a few European IPOs was challenging. As in syndicated markets, investors are looking for relative safety in larger companies with either existing profits or a credible path to profitability.

EXHIBIT 6

New Issue AAA CLO Spreads



Source: BofA Research, European and US CLO AAA New Issue Spreads, as of October 27, 2023. US AAA Spreads data refers to the weekly average of top-tier CLO managers' priced deals, while EU AAA Spreads is the weekly average of all priced deals.

The two remaining arguments in the six-point fear argument is that there is overexuberance about private credit, which could lead to lenders competing away their premiums and protections, and that staying only in senior, secured debt is the best course of action in this market environment.

It's true that we have observed spreads tightening lately and more intense competition due to the relatively small number of deals in the market. As markets open, however, the number of deals will increase, too. More managers will be looking to lend capital, but they will have more opportunities to do so. Likewise, the challenges banks face, which we talk more about later, are not going away. The need for flexible, bespoke, and certain capital will likely outstrip the supply for quite some time, in our view. We also foresee that competition will be most intense around smaller deals, while the much smaller number of players with large pools of capital should make competition less intense around larger transactions.

Finally, when it comes to assessing the potential for junior debt versus senior debt, we think it's important to look not only at the position in the capital structure, but also the sector the company is in, who the private equity sponsor is, the specific economics, the size of the company, the amount of equity under the junior debt, and a number of other factors. In other words, not all junior debt is the same. Meanwhile, subordinated debt of relatively large companies with large equity cushions may represent a compelling risk-adjusted return, particularly to typical equity allocators.

The credit opportunity in 2023 was compelling, and we expect the opportunities to build in 2024 as the market opens. In our view, there is the potential for a good vintage across many private asset classes, with the caveat that the old rising tide of low interest rates and easy money will no longer be there to lift all boats. Deep relationships, access to capital, and value creation will all be important. With interest rates at their current elevated levels, the relative risk-adjusted return in private credit looks particularly compelling.

Fixed vs. Floating Rates in a Changing Monetary Environment

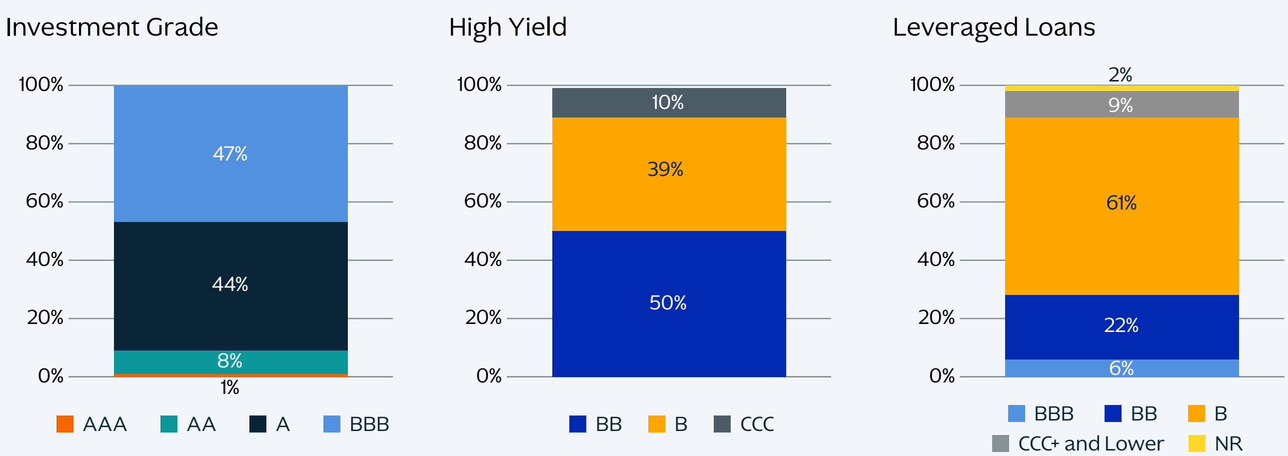
For now, market chatter has seemed to focus on hidden risk in corporate credit markets as a result of the higher-for-longer phenomenon, but we think it's just as important to look at how opportunities are shifting in this new reality. If the most intense stage of the Fed's tightening campaign is over and rates have plateaued at relatively high levels, locking in current yields in fixed-rate debt starts to become more attractive. Our Leveraged Credit team recently explained that they are increasing exposure to duration by buying high yield bonds, while also maintaining an overweight to floating-rate debt (leveraged loans and CLO debt).

We have argued before that high yield bonds are less risky than they appear—nearly half the market in both the U.S. and Europe is rated BB, the top of the scale for leveraged credit, and 60% of new issue high yield bonds are secured. Nearly half of the investment grade universe is rated BBB, just one step away from high yield, meaning there are plenty of credits in the border zone between the two classifications. In leveraged loans, the proportions are quite different (Exhibit 7). High yield bonds also tend to have call protection that prevents borrowers from refinancing at a lower rate for a given period, allowing investors to lock in higher rates. Second, high yield bond prices have more room to rise compared to loans at a time when the path of interest rates is not likely to produce a boost as significant as it has in the past for investors in floating-rate debt.

We do not think, however, that the time is right for a full-blown pivot into fixed-rate debt. Inflation in the United States seems to be flattening out, but it is still high relative to post-Global Financial Crisis history and structural trends support higher inflation going forward (as our colleague Henry McVey, Head of the Global Macro, Balance Sheet and Risk team and CIO of the KKR Balance Sheet, has written about with colleagues multiple times, notably here on the forces keeping labor markets tight). The time to *start* adding duration is now, but whether to continue and how quickly depends on what happens next.

EXHIBIT 7

Composition by Rating of Public Credit Markets



Source: Bloomberg and ICE Index Platform as of November 10, 2023. Investment Grade Index breakdown by rating is based on the BAML Corporate US Corp Master Index (C0A0); High Yield Index breakdown by rating is based on the US High Yield Master II Index (H0A0), Leveraged Loan Index breakdown by rating is based on the Morningstar LSTA Leveraged Loans Index. Percentages may not add to 100% due to rounding.

The Non-Corporate Side of Private Credit

We are optimistic about the ability to find interesting deals in the world of corporate credit next year, both in private and leveraged markets. However, we are also seeing an increasing interest in diversifying exposure to corporate credit with asset-based finance. Asset-based finance offers the potential to invest in a wide variety of financial assets and hard assets that throw off recurring or consistent cash flows. The collateral that underlies loans in this arena can consist of consumer finance assets (mortgages, auto finance), hard assets (aircraft leasing), commercial finance (equipment leases), and contractual cash flows. As a result of the variety in the types of loans available, as well as the hundreds or even thousands of individual loans underlying every portfolio investment, correlations with other asset classes, including corporate credit, are relatively low (Exhibit 8).

The asset-based finance asset class could grow from $5.2 trillion to $7.7 trillion by 2027, by our estimates, in large part because of a pullback by banks in funding these kinds of collateralized loans. That pullback only accelerated as interest rates rose and questions about the asset-liability mismatch between short-term deposits and long-term debt obligations became more apparent with the collapse of Silicon Valley Bank, Signature Bank, and First Republic earlier this year.

EXHIBIT 8

Correlations Among ABF and Other Major Asset Classes

	Global Private Credit	Global Private Equity	U.S. Loans	U.S. High Yield	Global Infrastructure	Global Real Estate	KKR ABF
Global Private Credit	—	0.93	0.86	0.82	0.84	0.73	0.71
Global Private Equity	0.93	—	0.79	0.83	0.79	0.70	0.68
U.S. Loans	0.86	0.79	—	0.93	0.68	0.49	0.64
U.S. High Yield	0.82	0.83	0.93	—	0.67	0.44	0.56
Global Infrastructure	0.84	0.79	0.68	0.67	—	0.77	0.52
Global Real Estate	0.73	0.70	0.49	0.44	0.77	—	0.71
KKR ABF	0.71	0.68	0.64	0.56	0.52	0.71	—
Average Correlation	0.81	0.79	0.73	0.71	0.71	0.64	0.64

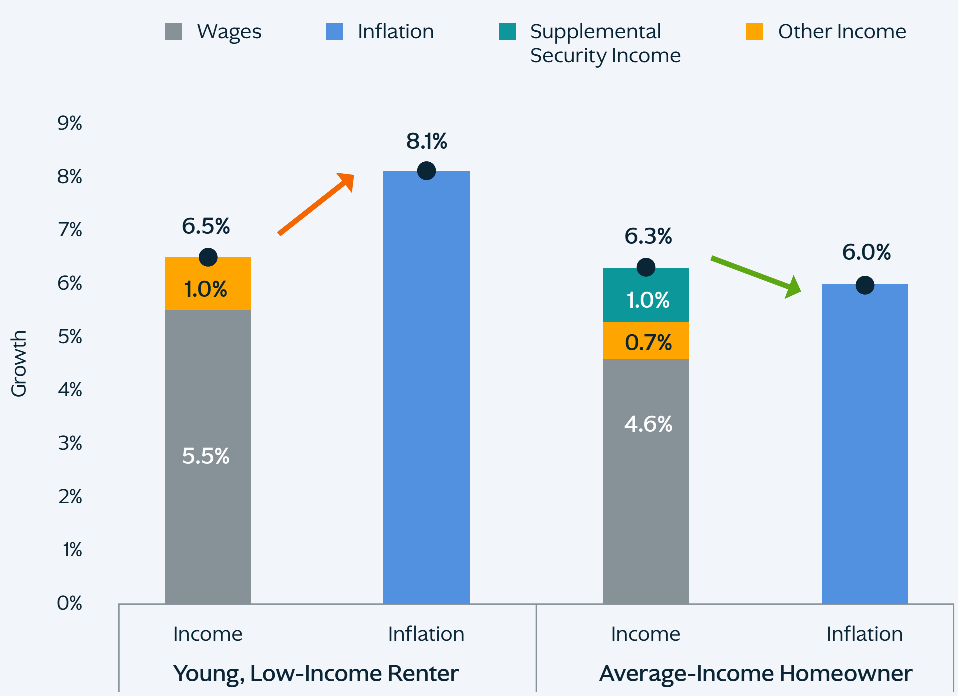
Note: The table above reflects the correlation between market movements (which may be positive or negative)of the asset classes represented in the table from the period commencing July 1, 2017, up to and including March 31, 2023 based on the irrespective gross returns during this period (for example, a correlation of "1" between asset classes would indicate that market movements of both asset classes (whether positive or negative) during the period were identical). Data as at September 30, 2022. Gross performance of each asset class is based on gross returns of the following indices. Global Private Equity (Cambridge Private Equity Index), Global Real Estate (Cambridge Real Estate Index), Global Infrastructure (Cambridge Infrastructure Index), Global Private Credit (Cambridge Private Credit Index), US High Yield (ICE BofA US High Yield Index), US Loans (Morningstar LSTA US Leveraged Loan TRUSD), KKRABF (KKR Private Credit ABF Composite, investments originated post January 1, 2017). See "Important Information" for additional detail about the use of indices. Historic market trends are not reliable indicators of actual future market behavior including future correlations of any asset classes referred to above. Diversification does not guarantee returns or capital preservation.

In the United States, regional banks are under particular pressure to sell loan portfolios due to more stringent capital requirements, but we are also seeing larger banks looking to shed these sorts of assets on attractive terms. Banks are struggling to attract deposits, with money market accounts paying higher interest rates. Given their long-duration books, which include unrealized losses, they cannot move fast enough to increase the yields they offer depositors. We expect banks to continue to optimize their balance sheets by selling high-quality assets, creating an opportunity for private asset-based finance.

As in other areas of our private credit business, we are focused primarily on high-quality borrowers and collateral. In the consumer segment, for example, our Asset-Based Finance team has drawn a sharp distinction between prime borrowers and lower-income borrowers, as the former has been far less affected by rising interest rates. Even something as simple as being a homeowner with a low mortgage rate locked in, compared to a renter who may have seen large increases in housing costs lately, can make a big difference in available cash (Exhibit 9). Our team has also been staying out of the segments that are most challenged by inflation and favoring investments with a high level of current income, rather than capital appreciation potential. These loss-prevention measures are key to achieving strong risk-adjusted returns.

EXHIBIT 9

Income and Inflation Growth in 2022 for a Young, Low-Income Renter vs. a Homeowner with an Average Income



Young, Low-Income Renter

Left-hand column income mix: Under-25 consumer income mix (88% wages, 0% SSI, 12% other).

Left-hand column inflation: CPI reweighted to cons. Basket for 1st quintile households, with entire shelter expense (27% of basket) attributed only to rent (6.4% inflation in 2022).

Average-Income Homeowner

Right-hand column income mix: Median-income consumer income mix (73%/18%/9%).

Right-hand column inflation: CPI reweighted to cons. Basket for 3rd quintile households, with shelter expense (34% of basket) attributed to fixed mortgage payments (0% growth in 2022).

Income growth rates: 6.3% low-end wage growth, 6.2% median wage growth (per BLS), 5.7% growth, 8% other income growth.

Data as at December 31, 2022. Source: BEA, BLS, KKR GMAA.

Conclusion

We've been writing for the last 18 months about fear, uncertainty, and paralysis in the financial markets and capital markets. Now that inflation and interest rates, the twin flames that stoked these fears, seem to be settling out at a higher rate than the market is used to, there is a new fear about the viability of corporate financing math and whether companies can sustain revenues and profit margins in a higher-for-longer environment.

As valuations between sellers and buyers continue to converge, we may continue to see headlines about problems in pre-pandemic vintages across private markets. But we think that investors who are waiting for their Global Financial Crisis moment of rock-bottom valuations may be disappointed. There will certainly be some forced selling in certain places, but for the most part, we expect these sales to be idiosyncratic rather than systemic. Nor do we see a wave of defaults coming for borrowers.

Looking ahead to 2024 and beyond, we think the opportunity for attractive vintages is exciting. There will be discounts on high-quality assets for equity buyers, and from a lender's perspective, banks are still providing far less capital than they once were, while capital markets seem to be slowly reopening, albeit in a jerky, one-step-forward-two-steps-back pattern. The need for financing is acute for many companies, which should continue to support better terms and documentation, while higher-for-longer interest rates support attractive yields.

This is new to many investors; thus, there is no handy playbook on the shelf to address the current moment, but experiences and past cycles do offer clues for what to do and where to look. One thing the Global Financial Crisis taught us is that when investors are paralyzed by fear, they often overlook opportunity. And the opportunity cost of this oversight can be very painful, indeed.

Christopher A. Sheldon

Bob and Carl Discuss Their Vintages

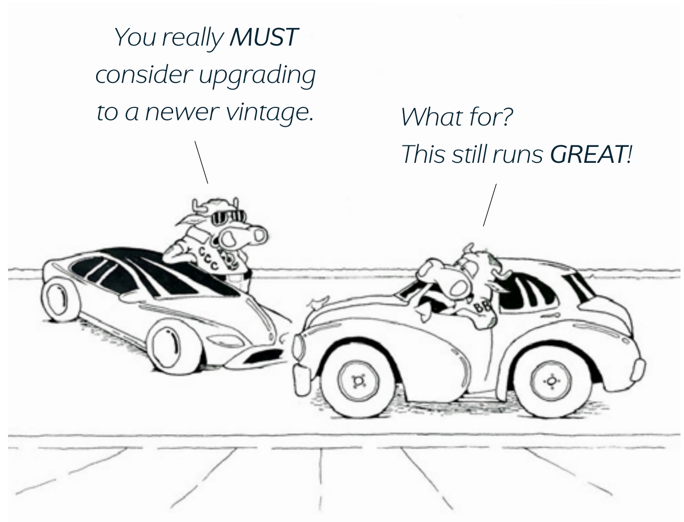


Illustration by: Jerry Capria, KKR Credit.

Disclaimer

Disclaimer The views expressed in this material are the personal views of Christopher A. Sheldon, Rory O'Farrell, and the Credit & Markets Team of Kohlberg Kravis Roberts & Co. L.P. (together with its affiliates, "KKR") and do not necessarily reflect the views of KKR itself. The views expressed reflect the current views of Mr. Sheldon, Mr. O'Farrell and the Credit & Markets Team as of the date hereof and neither Mr. Sheldon, Mr. O'Farrell and Credit & Markets Team nor KKR undertakes to advise you of any changes in the views expressed herein. In addition, the views expressed do not necessarily reflect the opinions of any investment professional at KKR, and may not be reflected in the strategies and products that KKR offers. KKR and its affiliates may have positions or engage in securities transactions that are not consistent with the information and views expressed in this material. This material has been prepared solely for informational purposes. The information contained herein is only as current as of the date indicated, and may be superseded by subsequent market events or for other reasons. Charts and graphs provided herein are for illustrative purposes only. The information in this material has been developed internally and/or obtained from sources believed to be reliable; however, neither KKR nor Mr. Sheldon, Mr. O'Farrell and the Credit & Markets Team guarantees the accuracy, adequacy or completeness of such information. Nothing contained herein constitutes investment, legal, tax or other advice nor is it to be relied on in making an investment or other decision. There can be no assurance that an investment strategy will be successful. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such. This material should not be viewed as a current or past recommendation or a solicitation of an offer to buy or sell any securities or to adopt any investment strategy. The information in this material may contain projections or other forward-looking statements regarding future events, targets, forecasts or expectations regarding the strategies described herein, and is only current as of the date indicated. There is no assurance that such events or targets will be achieved, and may be significantly different from that shown here. The information in this material, including statements concerning financial market trends, is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. Performance of all cited indices is calculated on a total return basis with dividends reinvested. The indices do not include any expenses, fees or charges and are unmanaged and should not be considered investments. The investment strategy and themes discussed herein may be unsuitable for investors depending on their specific investment objectives and financial situation. Please note that changes in the rate of exchange of a currency may affect the value, price or income of an investment adversely. Participation of, and discussions with, KKR private markets personnel, KKR Capital Markets and KKR Capstone personnel, Senior Advisors, Industry Advisors and, if applicable, RPM and other Technical Consultants, in KKR Credit's investment activities is subject to applicable law and inside information barrier policies and procedures, which can limit or restrict the involvement of, and discussions with, such personnel in certain circumstances and the ability of KKR Credit to leverage such integration with KKR.

KKR

Kohlberg Kravis Roberts & Co. L.P.
30 Hudson Yards
New York, New York 10001
212-750-8300
www.kkr.com