KKR

Insights

14.2

Global
Macro Trends
April 2024

No Turning Back

KKR 2024 Insurance Survey

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No Turning Back

KKR 2024 Insurance Survey

At the time of our last insurance survey in 2021, there were fully $15 trillion in aggregate assets with negative interest rates. Today, by comparison, there are literally none, as interest rates have spiked in record fashion across the global capital markets, especially in the United States. The good news is that insurance CIOs have navigated these wild swings gracefully through thoughtful asset allocation and risk management. Now, against a backdrop of higher interest rates, these CIOs have built pools of highly liquid assets that can deliver overall returns in support of loss reserves when they write new business (which most want to do more of). Moreover, the most recent investing environment has created a mentality shift where CIOs now can focus on leveraging both liquid and illiquid allocations to build more resilient, 'all-weather' portfolios. As a result, CIOs have proven not only that they can compound capital at above-average rates, but that they can also achieve important diversification benefits and provide a 'fatter' set of expected returns. Hence, the clear message we drew from our 2024 insurance survey participants is that there is 'no going back' to more traditional approaches to asset allocation, ones that had more of a singular focus on Liquid Credit. Indeed, having become more comfortable with the diversification and return enhancements that non-traditional investments can achieve, many CIOs are looking for opportunities to selectively allocate more to these areas. In particular, fully 64% of CIOs in our survey envision the Alternatives segment of non-traditional asset classes driving overall portfolio returns going forward.

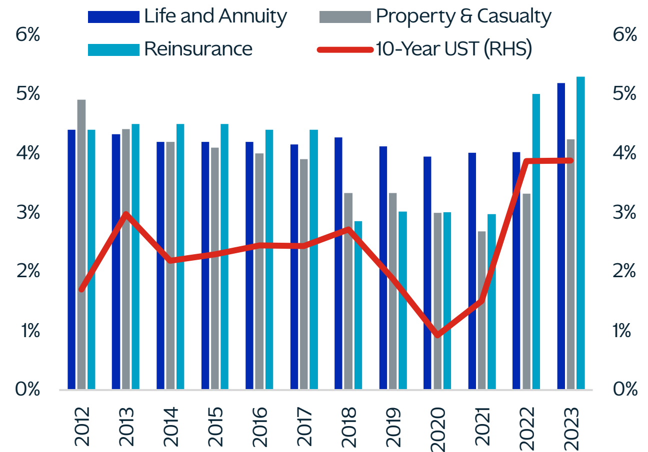
> If you are going to achieve excellence in big things, you develop the habit in little matters. Excellence is not an exception, it is a prevailing attitude.
>
> — **Colin Luther Powell**, American politician, statesman, diplomat, and United States Army officer

For those keeping score, our last insurance survey was published in October 2021, the second year of the pandemic. Beyond the human tragedy linked to COVID, at the time we – as investors – were wrestling with an unprecedented macroeconomic environment characterized by record low interest rates, ballooning fiscal deficits, and rising geopolitical tensions. Thus, I introduced that 2021 survey with a question — stealing a quote from The Godfather — "How did things ever get so far?" Indeed, those were trying times for insurers as the monetary 'Authorities' experimented with quantitative easing policies that significantly disadvantaged savers, especially those who relied on annual interest income for retirement security.

However, when we fast forward to today, the environment feels quite different. Interest rates are higher, pricing is generally firmer, and demand for insurance is stronger across most product categories, especially annuities and certain parts of Property & Casualty. **Indeed, as one very seasoned, savvy CIO suggested to me, the "last 12 years have been abnormal, today is normal."** In particular, global central banks have facilitated a sharp move away from negative rates. To put this in context, the last time we did this survey there were $15 trillion of negative-yielding assets in aggregate. Today, by comparison, that number is zero, and C-suite executives across the insurance complex with whom we engaged believe that it is possible for insurers to achieve higher yielding risk-adjusted returns that are safe and in alignment with the financial strength these executives wish to have for their companies.

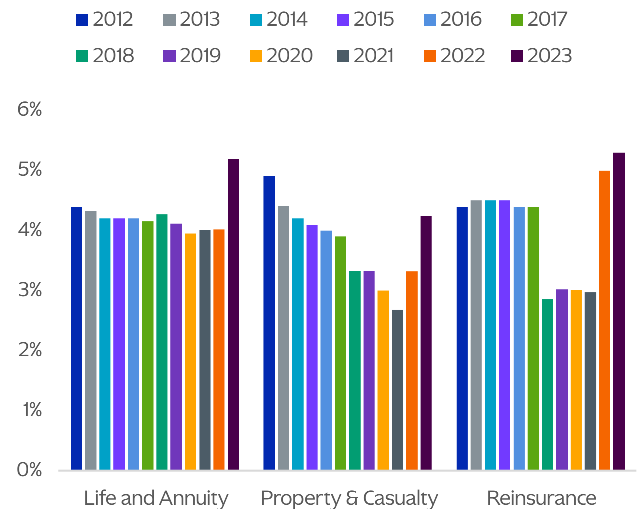
> Indeed, as one very seasoned, savvy CIO suggested to me, the 'last 12 years have been abnormal, today is normal.'

Exhibit 1: Target Yields in Our Insurance Universe Show 'A Return to Normalcy'...



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

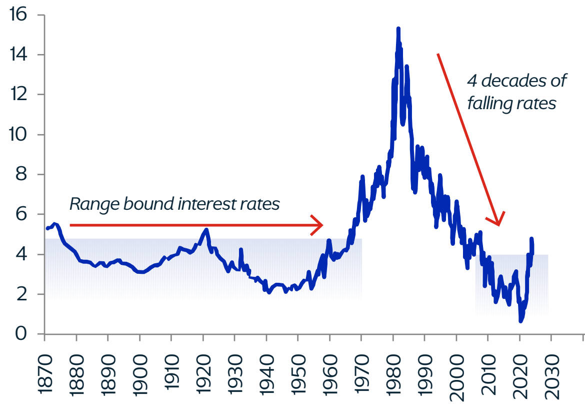
Exhibit 2: ...Across All the Various Segments of Insurance



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 3: Interest Rates Heading Back to the Future…

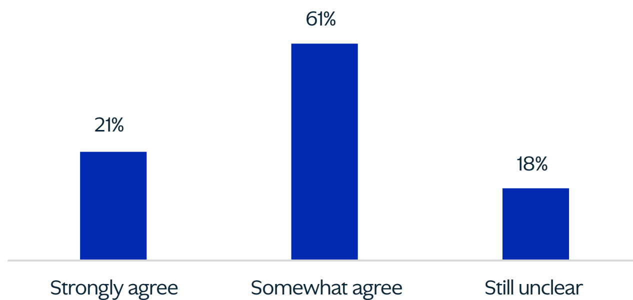
U.S. Long Term Government Yield, %



Data as at January 31, 2024. Source: Shiller Data, Federal Reserve Board, U.S. Treasury, Haver, KKR Global Macro & Asset Allocation analysis.

Exhibit 4: …Which Is Consistent With Our CIOs' Views That Inflation Has Reset Higher in This New Regime

KKR 2024 Insurance Survey: Have U.S. Inflation Rates Reset Higher On a Structural Basis Relative to the Pre-pandemic Trend?

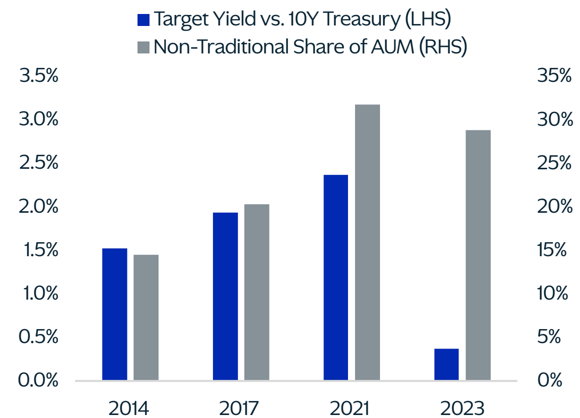


Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

As a result, many CIOs expressed that, for the first time in over a decade, they now have a pool of highly liquid assets that can deliver yields in support of loss reserves when they write new business. Investment Grade debt allocations, for example, have surged back to 56.6% of total assets from 48.5% in 2021 *(Exhibit 6)*. At the same time, because of the portfolio ballast that has been added, CIOs can also focus on leveraging their increased illiquid allocations to compound capital with above average portfolio returns as well as achieve the diversification benefits provided by Private Equity, Infrastructure, and Private Credit in an insurance portfolio (*Exhibit 35*).

Exhibit 5: Unconventional Monetary Policy Accelerated an Existing Rotation Towards Alternatives, But That Trend Has Not Reversed as Rates Increased

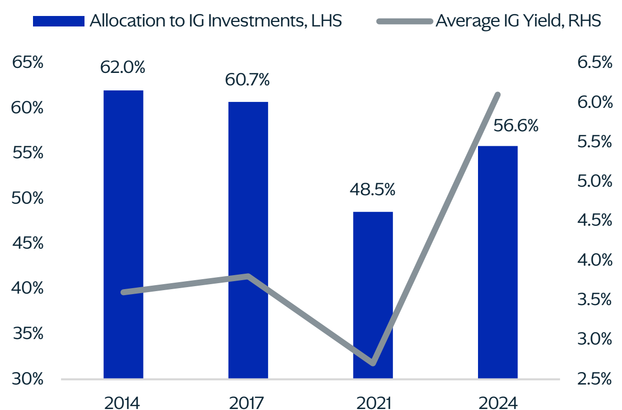
KKR 2024 Insurance Survey: Alternative Allocation and Target Spread, %



Data as at March 31, 2024. Source: Bloomberg, KKR 2024 Insurance Survey.

Exhibit 6: The Move Towards Alternatives Is Happening in Parallel With a Rebound in Liquid, High Quality Investment Grade Debt

KKR 2024 Insurance Survey: Allocation to Investment Grade Investments and Average Investment Grade Yield, %



Data as at April 22, 2024. Source: Bloomberg, KKR 2024 Insurance Survey.

Importantly, though, despite more normal interest rates, there is likely "no going back" to 2017 targets on the asset allocation front, as one CIO told us. One can see this in *Exhibit 5*, which shows that insurers' allocations to non-traditional assets have stayed elevated over the past two years (declining by only about three percent, and still about 50% larger than they were in 2017), despite some 21 Fed rate hikes over the same period. The reality is that, having successfully weathered the aftershocks of a global pandemic that at first brought negative interest rates and then was followed by an epic tightening campaign during inflation's 'transitory' period, CIOs are now more comfortable embracing both complexity and illiquidity. Indeed, CIOs in the survey indicated that their private portfolio returns – despite higher capital charges in many instances, have consistently rewarded effective "structuring, complexity and illiquidity" in both low- and high-rate environments.

Consistent with this view, from a macroeconomic and portfolio construction perspective, the insurance CIOs we spoke with agree with our thesis that a 'Regime Change' is underway (see our initial report in the Regime Change series from May 2022) which means more of an "all-weather portfolio is now required." As a result, they now feel that they must "construct portfolios that can deliver resiliency, which may mean *not* optimizing for the last 10 basis points on an efficient frontier curve." The good news is that, with current forward returns more compressed across asset classes (and exacerbated by an inverted yield curve), these investment professionals are placing a premium on assets that help to further diversify their existing portfolios. As one leading CIO told us, the "efficient frontier has become much flatter."

From a competitive perspective (and as we detailed in our *Dream Big* piece in 2021) the big are getting bigger, and they are leveraging their increasing prowess to have more dynamic pricing of liabilities, which in turn allows them to lean into dislocations more intelligently on the asset side. As a result, expertise across investment management, portfolio construction, and technology has become a prerequisite for success across both the Life and Annuity and Property & Casualty sectors. As we detail below, we see this trend only accelerating, and it is extending into creating even more sales and distribution advantages as well. Finally, size and scale really matter, especially from a control perspective. Recent consolidation activity is allowing larger firms to own more origination platforms, which permits these scale players to drive better terms on new investments, structures, workouts and syndications.

What's Changed Since Our Last Survey

1

The Zero Interest Rate Policy that defined the investing environment during our 2021 survey period has massively reversed course. This reality has significant implications for all insurers' views on growth, risk management, and comes back to sourcing.

2

Despite higher rates, CIOs now want to create portfolios — utilizing both liquid and illiquid investments — that are more "all-weather" in nature.

From a competitive perspective the big are getting bigger, and they are leveraging their increasing prowess to have more dynamic pricing of liabilities, which in turn allows them to lean into dislocations more intelligently on the asset side.

3

Performance success of non-traditional asset classes such as Structured Credit, Private Equity, and Infrastructure have shifted CIOs' views on blended expected returns, capital charges, and operational/technological investment.

4

Against a backdrop of more condensed forward returns across all asset classes, CIOs are now more focused on the benefits of non-correlated assets.

5

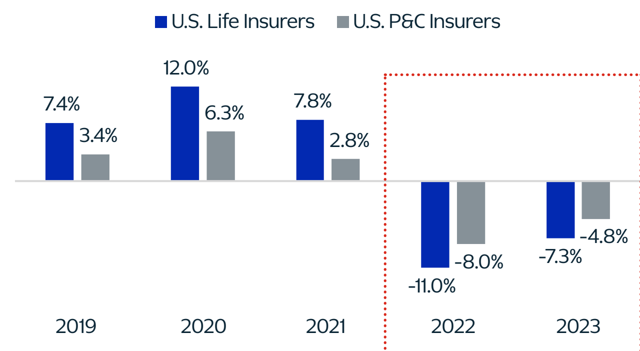
Scale increasingly begets scale and insurers are leveraging their size and partnerships to lean into periods of dislocation and access new markets and asset classes.

At the same time, as we describe below, there are some important headwinds worth considering. For starters, billions of dollars of unrealized gains in 2020 have turned into billions of dollars of unrealized losses, as rates around the world reset higher in recent quarters. These changes in risk-free rates were the main driver of the year-over-year changes seen in *Exhibit 7*, especially for long duration life portfolios (credit spreads were a secondary factor). As such, the penalty linked to a default or downgrade has increased materially, especially if rates were to tick back up and it becomes harder for certain capital-constrained insurers to restructure existing blocks of assets on their balance sheets. Meanwhile, many insurers are going more global, and this effort requires the ability to transfer one's culture and risk management practices overseas in a thoughtful way. Moreover, our experience is that it can be challenging to access non-traditional investments in scale in new geographies, particularly in cases where an 'authentically local' view is required.

In addition, competition, especially in the Life and Annuity arena, has increased at a time when scale begets scale. At the same time, operating budgets are expanding. Technological prowess, the ability to harness dislocations to write new business at more attractive terms, and differentiated product origination across the global capital markets have all become important differentiators to remain competitive.

Exhibit 7: Insurance CIOs Have Had to Invest Across a Variety of Interest Rate Environments in Recent Years, Which Has Made Asset Allocation Even More Important

Unrealized Gain/Loss of Bond Portfolios: Last 5 Years, %



Data as at December 31, 2023. Source: KKR Insurance Solutions.

Looking at the big picture: Conducting one-on-one interviews with multiple CIOs from around the world morphed into discussions about how we could work more closely as true partners. Indeed, having acquired the remaining 37% of Global Atlantic that we did not own in the fourth quarter of 2023, KKR entered 2024 as a 100% owner/operator of a leading Life and Annuity company. Founded in 1976, KKR has a long history of adding value to and building scale across our investments. With the Global Atlantic transaction, we now feel like we are in a unique position, especially given our origination and distribution footprint, to not only improve our breadth and reach but also to do so in a collaborative way alongside other insurance companies who also want to think differently about asset allocation in a world where the macroeconomic and geopolitical backdrops look quite different relative to the prior two decades.

SECTION I

Where Did We Get Our Data?

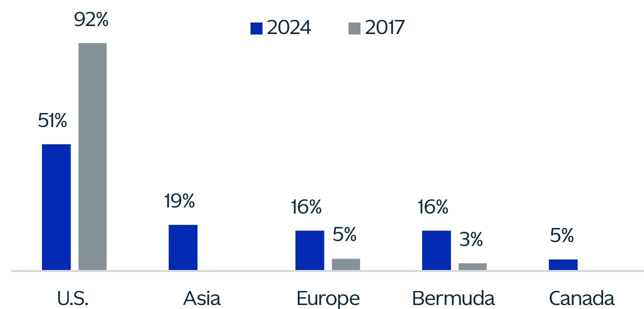
This year, we took a multi-pronged approach. We surveyed nearly 50 insurance companies and CIOs, supplemented by select follow-up conversations, and then hosted a small, more intimate half-day CIO event for 20 CIO relationships alongside our co-CEO Scott Nuttall and Craig Lee, who heads our Insurance and Strategic Finance effort at KKR. All told, our survey respondents, alongside these event attendees, oversee more than $8 trillion in assets, which is double the investable assets represented in our initial 2017 survey.

About half of the survey respondents and event participants this year were based in the U.S., compared to more than 90% in 2017. Meanwhile, Asia and Europe accounted for 35%, compared to 26% in 2021 and only a handful in 2017. This actually provides a window into the expanding footprint of our insurance asset management business, conveying the importance we place on this cohort at KKR.

Against a backdrop of more condensed forward returns across all asset classes, CIOs are now more focused on the benefits of non-correlated assets.

Exhibit 8: Our Survey Is More International Than in Years Past, Reflecting the Expansion of Our Insurance Franchise

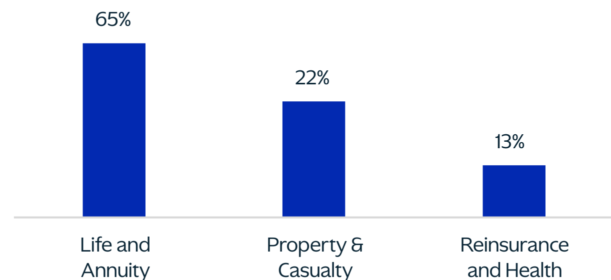
KKR 2024 Insurance Survey: Where Are Your Headquarters?



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 9: This Year's Respondents Skew More Towards Life and Annuity

KKR 2024 Insurance Survey: What Is Your Primary Business Line?

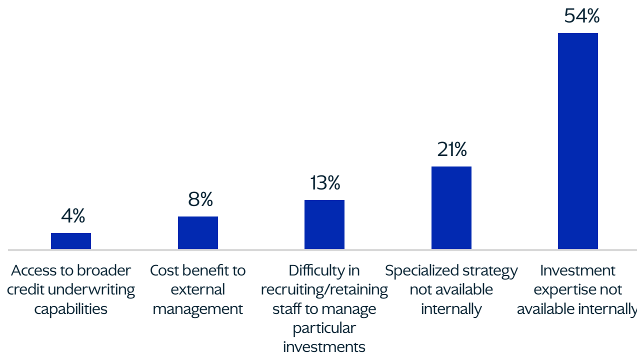


Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 10: We've Captured Formal Responses As Well As Informal Insights from CIOs Who Manage Roughly $8 Trillion in AUM via Our Survey and Onsite Insurance Conference

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 11: Insurance Companies Are Outsourcing Certain Investment Functions



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

In terms of specific asset classes, our survey respondents indicated that their top choices for new investments include Private Credit, Private Equity, and Infrastructure. Of the three, Infrastructure may have the greatest opportunity set to gain market share, we believe.

SECTION II

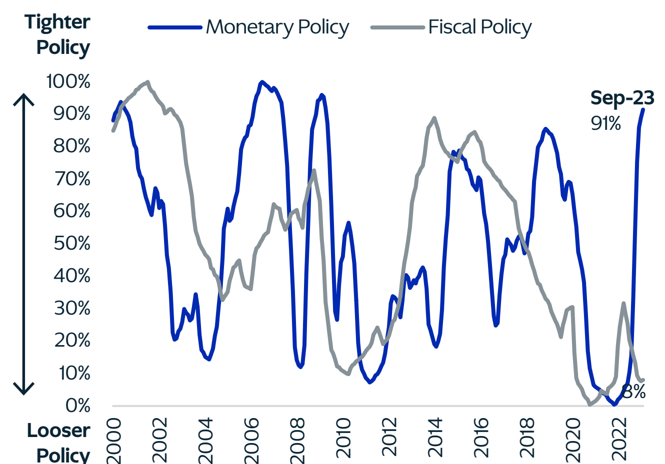
Big Ideas on Which to Focus

A 'Regime Change' Has Occurred, Which Has Substantial Implications for Asset Allocation. In conducting our follow-up meetings, it became clear to us that we were often talking to like-minded investors when it comes to the outlook for inflation. Indeed, as I have written about extensively in our *Regime Change* series of papers with my colleague Racim Allouani (see Insights on KKR.com for our four-part series), we see four structural drivers to our thesis. First, we have shifted from a world of tight fiscal and loose monetary policy towards one of loose fiscal and tight monetary policy. One can see this in *Exhibit 12*. On a go-forward basis, our analysis at KKR suggests that rates are likely to settle at higher nominal levels than markets were 'used to' before the pandemic, while fiscal deficits will likely remain very wide by historical standards for the U.S. at around six percent of GDP.

Second, the world now faces a more difficult geopolitical footprint alongside increased complexity. Supply chains have moved from 'just in time' to 'just in case', a backdrop that lowers efficiency and increases costs, particularly as reliance on economic partnerships with like-minded blocs gains importance. Third, poor demographics in the U.S., China, Japan, and Germany, for example, are leading to greater wage payments to highly skilled/technical workers in areas such as welding, plumbing, and for services employees, especially in healthcare and leisure. Essentially, the cost of everything rises, which makes pricing, particularly in the Property & Casualty space, even more critical.

Exhibit 12: Stimulus Conundrum: Today the Fiscal Impulse Is the Gas Pedal, Whereas the Monetary Impulse Is the Brake

Fiscal and Monetary Policy as %ile of Historical Range

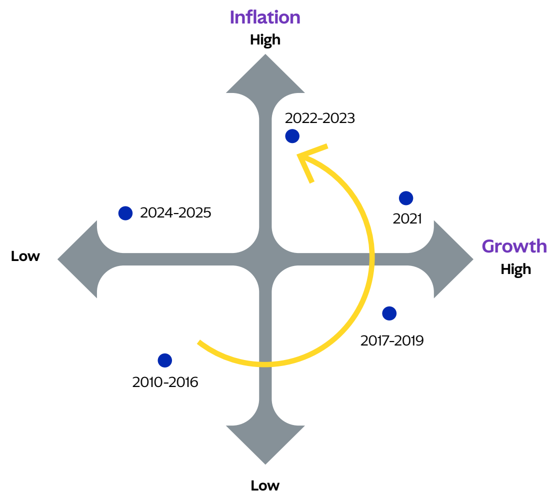


Monetary tightness measures the difference between real fed funds and potential GDP growth. Fiscal tightness measures the difference between the budget deficit and the U.S. output gap as a % of GDP. Data as at September 30, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

On a go-forward basis, our analysis at KKR suggests that rates are likely to settle at higher nominal levels than markets were 'used to' prior to the pandemic.

Exhibit 13: While 2024 Should Show Some Moderation in Inflation, We Believe a 'Regime Change' Has Occurred

Low and High Growth and Inflation Regimes



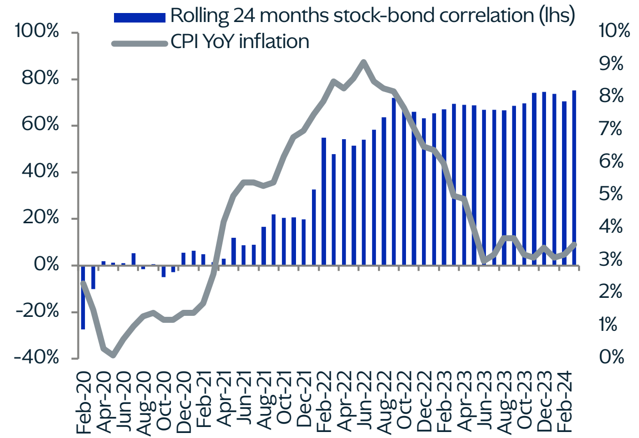
Data as at December 31, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Finally, as in past periods of energy transition (e.g., the U.S. Industrial Revolution), the current evolution from more traditional sources is and will be messy. For one, we estimate a deficiency in existing capital expenditures that will keep longer-duration oil prices higher for longer. At the same time, many of the hard-to-find minerals required in renewables continue to demonstrate volatile price swings. Moreover, the lion's share of the processing for these inputs is now overwhelmingly in China, which again will put a strain on global supply chains at times and could fuel geopolitical tensions over access to critical inputs.

Insurance companies just want their investment managers to own more high-quality fixed income instruments, and/or non-traditional assets that can match or exceed their liabilities with as little risk of default as possible.

Exhibit 14: The Relationship Between Stocks and Bonds Has Changed, Which We Think Is Having a Material Impact on Asset Allocation

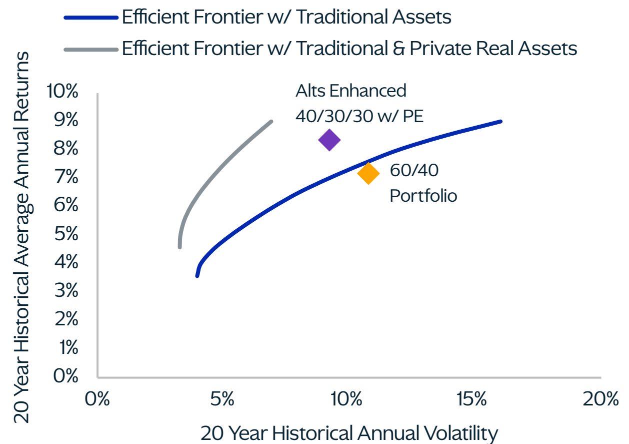
Rolling 24-Month Stock-Bond Correlation and Y/y U.S. CPI, %



Note: Stocks refer to the S&P 500 and Bonds refer to the 10-Year Treasury Yield. Data as at March 31, 2024. Source: KKR GBR analysis.

Exhibit 15: In a Higher Nominal GDP Environment, We Think That There Is a Need to Shift One's Asset Allocation Mix

20 Year Average Annual Returns and Volatility of Real Assets and 60/40 Portfolios



Example pension liabilities and asset portfolio. Analysis models the example pension liabilities as a short position in a bond with coupon payments over 50 years that escalate annually. Surplus excess returns and surplus risk are estimated as the difference in returns between an underfunded portfolio and the modeled pension liabilities. Data as at June 30, 2023. Source: KKR Global Macro, Balance Sheet & Risk analysis.

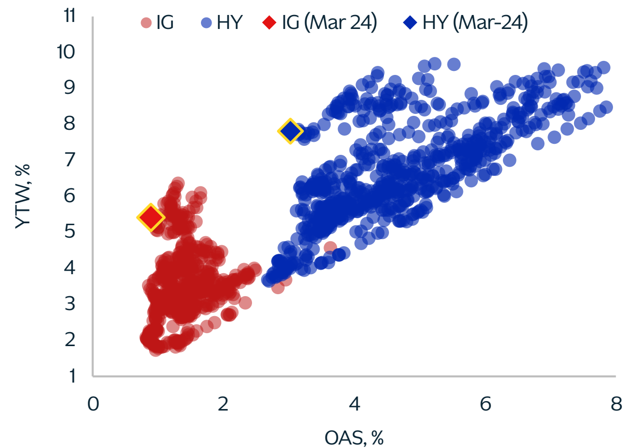
Against that backdrop, we think more investors will want to look for new assets that can serve as effective hedges against periods of both higher inflation and higher interest rates. Not surprisingly, Infrastructure Debt and Infrastructure Equity, Real Estate Credit, and Asset-Based Finance were all cited in our survey as compelling vehicles to play this theme.

More insurers are sending a signal to all investors that it is the absolute level of rates, not the spread over SOFR or Treasuries, that may matter the most. Key to our thinking is the fact that risk-free yields have reset faster than insurers' cost of funds in many cases, which means that the spread on insurer liabilities is less of a concern than it was in 2021-2022 *(Exhibit 16)*. This viewpoint is important for two reasons. First, it suggests that those allocators simply waiting for spreads to return to historical norms may not be given the opportunity to participate in today's credit markets in size if they take their eyes off the 'action,' which is the risk-free rate. Key trigger points are likely six percent in Investment Grade and eight to nine percent in High Yield. Second, because insurers can achieve a lot of their target returns in the liquid markets these days, the investment managers who serve them should know that, as we like to say, a "B grade is an A, and a C is an F." Said differently, insurance companies just want their investment managers to own more high-quality fixed income instruments, and/or non-traditional assets that can match or exceed their liabilities with as little risk of default as possible. They also want more diversification and lower correlation across and between products. Importantly, this comment is not just aimed in the direction of the Public Markets; it includes the Private Markets too, especially across Direct Lending, Asset-Based Finance, and Real Estate Credit.

Against that backdrop, we think more investors will want to look for new assets that can serve as effective hedges against periods of both higher inflation and higher interest rates.

Exhibit 16: Despite Tight Spreads, All-In Yields Are About as Attractive as They Have Been in 10 Years

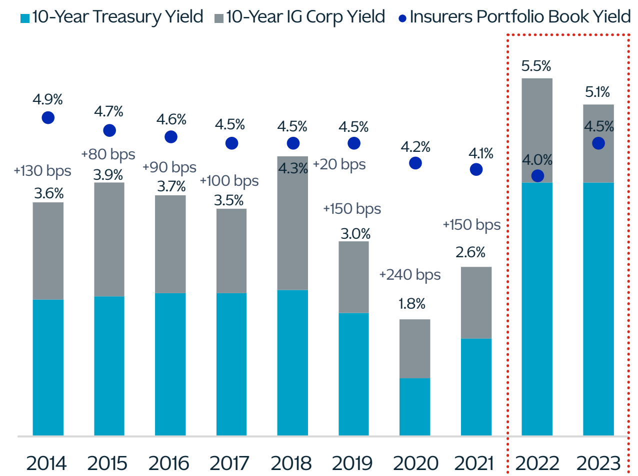
Yield vs. Spread for U.S. Corporate Bonds (Weekly, 2010 -Present)



Data as at March 18, 2024. Source: Bloomberg.

Exhibit 17: In 2022, Insurers' Reinvestment Rates Shifted to Exceed Portfolio Book Yield

U.S. Life Insurance Book Yield vs. IG Corporate Reinvestment Rates, %



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

Nonetheless, despite higher risk-free rates around the world, CIOs are now more comfortable engaging in discussions about non-traditional asset classes, including Alternatives. This reality is in sync with our 'No Turning Back' thesis that grew in large part from our CIO conversations during this year's survey. To review, the challenge of generating sufficient spread in 2020-2021 pushed a lot of CIOs to think more creatively about their portfolios, adding more illiquid investments to achieve their target yields. Against this backdrop, we were not surprised that the share of non-traditional investments surged by nearly 1,200 basis points from about 20% of AUM in 2017 to nearly 32% in 2021. What has been more interesting from our perspective is that over the last three years, despite Fed hikes and much higher risk-free rates, that total has only retreated slightly to 29%.

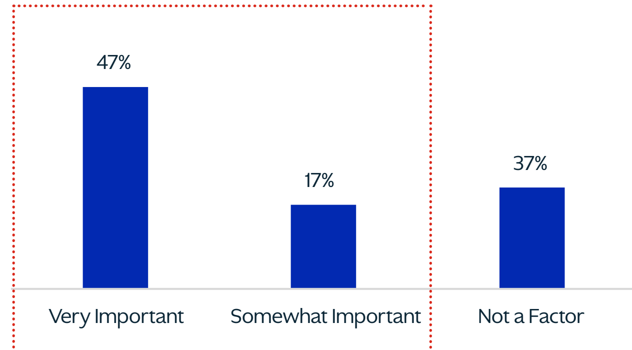
As the title of our report indicates, our frank assessment, which was consistently reinforced by our CIO survey and discussions, is that things are not going back to the way they were. **Indeed, having become more comfortable with the diversification and return enhancement from illiquid investments, more CIOs are looking for opportunities to selectively add to this allocation (fully 64% of the CIOs in our survey continue to envision Alternatives driving portfolio returns going forward)**, which is quite remarkable in the current rate environment.

In terms of specific asset classes, our survey respondents indicated that their top choices for new investments include Private Credit, Private Equity, and Infrastructure. Of the three, Infrastructure may have the greatest opportunity set to gain market share, we believe, given it is only about two percent of most portfolios as well as having some positive tailwinds from less onerous capital charges. Also, there is an increased desire by many insurers to own some longer-duration assets with current yield and effective inflation protection, especially if rates should decline again at some point.

Today, however, our base view at KKR remains that disinflation is taking longer to play out than the consensus once expected.

Exhibit 18: Despite Higher Rates, Alternatives Are Still Poised to Represent a Meaningful Proportion of Overall Portfolio Allocations

KKR 2024 Insurance Survey: How Important of a Role Will Alternative Investments Play In Driving Returns of Your Portfolio Going Forward



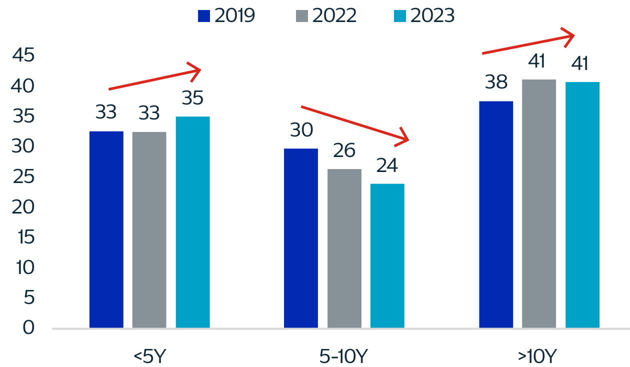
Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

When it comes to the outlook for duration, the trend is no longer your friend. To their credit (no pun intended), the CIOs we surveyed got short duration ahead of the Fed's epic rate tightening cycle. As one CIO suggested, the industry largely shortened duration of their assets as short rates rose and the yield curve inverted. At the same time, CIOs, especially on the Property & Casualty side, saw inflation in their businesses, and they used these insights to increase prices during the Fed's hiking cycle.

Today, however, our base view at KKR remains that disinflation is taking longer to play out than the consensus once expected. Our forecasts now suggest that the Fed will hold rates at current levels through year end. For what it is worth, earlier in the year CIOs did not expect a drastic fall in rates, with nearly one third predicting two or fewer Fed cuts this year. At that time, the consensus was at three to four cuts, down from a peak of six to seven.

Exhibit 19: Insurance Companies Have Moved Out of the Belly of the Curve Towards the Front End

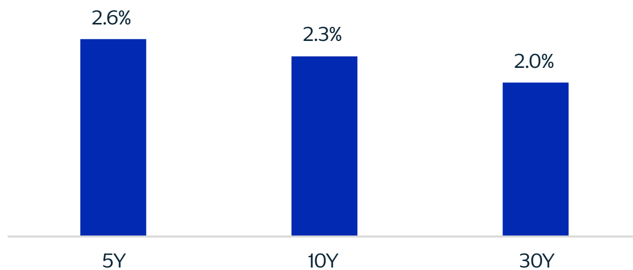
Bond Maturity Distribution: U.S. Life Insurers, % of Total



Data as at December 31, 2023. Source: KKR Insurance Solutions.

Exhibit 20: These Shifts Have Served Policy Holders and Investors Quite Well in Recent Years

Change in U.S. Treasury Yields Since 2019, %



Data as at February 28, 2024. Source: Bloomberg.

Economies of scale matter even more today. Scale has allowed insurers to build a competitive advantage when it comes to origination. Origination prowess is minimizing credit risk in many instances, which allows certain insurers to be more efficient with their capital. Scale enables investment in technology, which leads to better portfolio construction and risk analytics. It also allows the home office to be more coordinated with its sales force, which ultimately allows better pricing when sourcing liabilities. Large insurers are also gaining a competitive advantage when it comes to relative value across more public and private asset classes. Not surprisingly, this added advantage is encouraging CIOs to comparison shop more frequently across both asset classes and geographies, and it is leading traditional insurers to be able to extend their market share both organically and through acquisitions across large businesses such as retail annuities, pension-risk transfer assets/liabilities, and closed blocks.

Without question, non-correlated asset classes have gained importance in the minds of our CIOs. If we are right in our view that 1) the resting neutral rate for Fed funds is now higher; 2) traditional government bonds can't diversify as much as they did in the past; and 3) overall returns have compressed now that we have exited a low rate, loose monetary, tight fiscal environment, then the value of a non-correlated asset in one's portfolio increases materially. Indeed, where asset class returns for the next five years appear more subdued than in the past, as Frances Lim's capital markets assumptions suggest (see Outlook for 2024 Glass Half Full, page 57), as one leading CIO in the U.S. told us, "the diversification across issuers, sectors, and asset classes all help to mitigate idiosyncratic risk while the diversification across asset classes helps mitigate systematic risk."

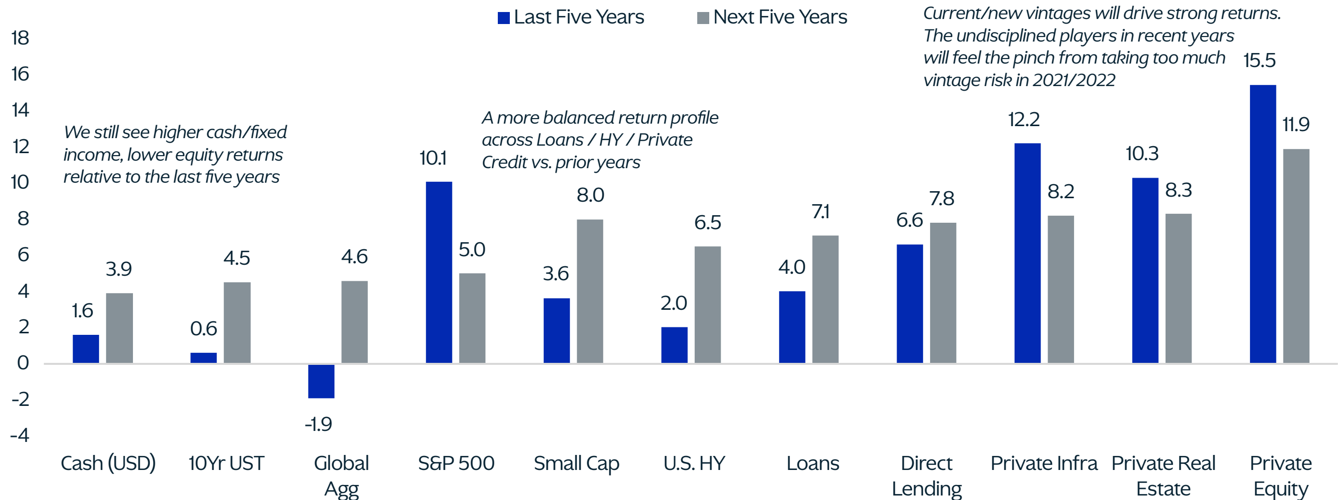
Exhibit 21: We Think More CIOs Are Focusing on the Diversification Benefits of Non-Traditional Assets in an Insurance Portfolio

Asset Class Correlations, Quarterly, Using L12M Total Return From 2012-2023

	IG	RMBS	CMBS	Public Equities	Structured Credit	Private Equity	Private Credit	RE Equity	Infra
IG	100%								
RMBS	92%	100%							
CMBS	96%	91%	100%						
Public Equities	50%	28%	44%	100%					
Structured Credit	35%	6%	34%	70%	100%				
Private Equity	29%	12%	28%	84%	49%	100%			
Private Credit	7%	-17%	5%	78%	75%	76%	100%		
RE Equity	-20%	-19%	-17%	33%	12%	52%	55%	100%	
Infra	-3%	-19%	-6%	46%	21%	63%	55%	54%	100%

Data as at September 30, 2023. Source: Cambridge Associates, JP Morgan, Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 22: Forward Returns Are Now More Compressed Across Asset Classes, Which We Think Increases the Importance of Non-Correlated Assets



Data as at December 5, 2023. Source: Bloomberg, BofA, Cambridge Associates, Green Street, KKR Global Macro & Asset Allocation analysis.

A local presence is now warranted in many instances. With the huge spike in rates, more and more CIOs have been growing their sovereign books to match off against their liabilities. All told, these positions have increased in some instances to 20-25%, up 10% or more since 2021. We heard this message around a shift in positioning in both the United Kingdom and parts of Asia. Moreover, as more and more insurers have increased their onshore exposure in emerging markets such as China, Indonesia, and Brazil, they have done it through sovereign debt. Somewhat ironically, though, in a market like Vietnam (which is not rated investment grade), insurers have delved into local Private Credit to construct the credit profiles that they are seeking.

A local presence is now warranted in many instances. With the huge spike in rates, more and more CIOs have been growing their sovereign books to match off against their liabilities. All told, these positions have increased in some instances to 20-25%, up 10% or more since 2021.

SECTION III

Key Asset Allocation Conclusions

The trend in allocations towards Private Markets at the expense of Cash and Public Equities continues. All told, Domestic Equities have fallen to 4.0% from 4.2% in 2021 and a peak of 7.2% in 2017. International Equities have fallen to 0.5%, from 1.4% in 2021 and 1.9% in 2017. By comparison, the trend in Private Equity is quite different, with those we surveyed indicating an increase in their allocations of nearly two percent since 2017. All told, Private Equity has increased to 4.1% in 2024 from 3.2% in 2021 and 2.4% in 2017. This increase may sound like a small change in percentage terms, but on the base of the eight trillion in assets under management that we reviewed, it represents a reallocation from 2017 of about $100-150 billion. The shift was particularly notable for the Property & Casualty community, which has historically held a much larger share of their AUM in Public Equities. All told, Public Equity allocations within the P&C companies we surveyed fell 600 basis points from 10.9% in 2017 to just over 4.9% in 2024, while Private Equity rose from two percent in 2017 to 5.2% in 2024, a 320 basis point increase. Importantly, though, we think this shift in investment priorities makes a lot of sense, as our capital market expectations imply that typical ROE for P&C insurers' PE investments is perhaps 10-20% higher than that for Public Equities.

With the rise in interest rates, there has been an impressive snapback in allocations to Investment Grade debt. All told, this percentage of total AUM has increased to 56.6% from 48.5% in 2021. Given the recent move in rates, this 810 basis point rise makes sense to us. Interestingly, though interest rates are higher today than in 2017, Investment Grade allocations actually have not rebounded to their peak level of 60.7% during that period. As one leading CIO told us, "The investment period surrounding COVID taught me to think differently about asset allocation."

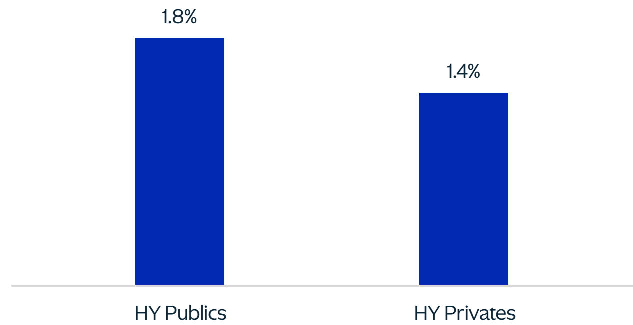
Within Non-Traditional Investments, which total 28.9% in this year's survey versus 31.8% in 2021 and 20.3% in 2017, Structured Credit has been a long-term winner, especially in the U.S. Indeed, Structured Credit now totals 8.3% of portfolios in 2024, compared to a more modest 5.9% in 2017. CLO Debt, Asset-Based Finance, and other structures that can be traded, now offer competitive yields compared to straightforward corporate bonds, and these structures have held up quite well in the 15 years following the GFC from a loss perspective. As a result, our survey work showed an increased confidence in this asset class. By region, U.S. insurers are heavy allocators at 12.5%, while Asia and Europe are much smaller at between one and three percent. **Meanwhile, Private Credit allocations have dipped, as CIOs have used the increase in rates to shift their portfolios back into more liquid products.** As a result, Private Credit allocations fell back to 2017's level of around 5.3% after jumping during the 2021 zero interest rate policy period, when allocations spiked to 7.7% of insurer portfolios.

Interestingly, though, this downshift in the Private Credit allocation is not because the product is producing disappointing returns. In fact, the CIOs in our survey were clear: **81% use Private Credit to increase yield**, and as we will discuss in detail below, Private Credit ranks number one in terms of intentions to buy on a go-forward basis. Moreover, we continue to think many insurance portfolios – which are especially sensitive to impairments and downgrades – have appreciated the lower default profile that Private Credit has demonstrated over time *(Exhibits 23 and 24)*. There is no doubt that disciplined underwriting

and key structural provisions have also played an important role. Some work by our colleague Scott Jeffreys, who heads KKR's Insurance Analytics effort, shows that losses in Alternatives relative to public markets were less severe for insurers over the last five years.

Exhibit 23: Losses for Private Credit Tend to Be Lower for Both High Yield...

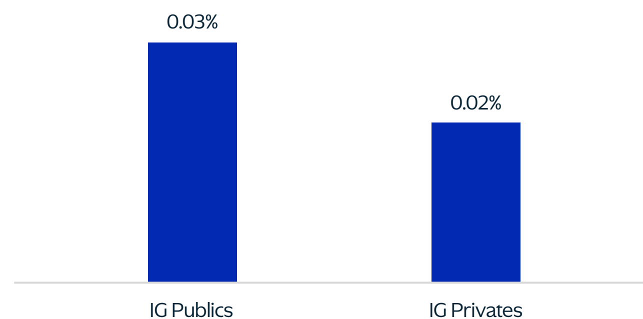
U.S. Life Insurance Impairment Rates: Public vs. Private Hight Yield Credit, 5 Year Average, %



Data as at December 31, 2023. Source: KKR Insurance Solutions.

Exhibit 24: ...and Investment Grade

U.S. Life Insurance Impairment Rates: Public vs. Private IG Credit, 5-Year Average, %



Data as at December 31, 2023. Source: KKR Insurance Solutions.

However, our survey CIOs did flag a few things for us. First, the yield on IG during the Fed hiking campaign became in the words of one allocator "a no-brainer". U.S. CIOs also bought high quality European paper and supplemented local currency returns with a positive euro carry to boost performance. Second, the Private Credit space now feels more crowded, with one CIO telling us "the lines are long" for quality Private Credit managers "and we don't like to queue." Against this backdrop, more CIOs have pivoted towards Asset-Based Finance in several instances. Our takeaway was that they like the downside protection that is built into ABS structures as a complement to Direct Lending, especially as banks sell more collateralized assets off their balance sheets in bulk.

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Exhibit 25: Our Survey Respondents Have Structurally Embraced Non-Traditional Investments While Also Taking Advantage of the Recent Spike in Risk-Free Rates to Buy More Investment Grade Debt

	2017	2021	2024	Change 2021 to 2024
Total Liquid Equities	9.1%	5.5%	4.5%	-1.0%
Domestic Equities	7.2%	4.2%	4.0%	-0.2%
International Equities	1.9%	1.4%	0.5%	-0.9%
Total Liquid Fixed Income	66.8%	56.3%	61.5%	5.2%
IG Fixed Income	60.7%	48.5%	56.6%	8.1%
Non-IG Fixed Income (Bank Loans & HY)	6.1%	7.8%	4.9%	-2.9%
Total Non-Traditional Investments	20.3%	31.8%	28.9%	-2.9%
Structured Credit (CLO, CBO, etc.)	5.9%	9.2%	8.3%	-0.9%
Private Credit	5.6%	7.7%	5.3%	-2.4%
Private Equity	2.4%	3.2%	4.1%	0.9%
Hedge Funds	0.5%	0.5%	0.4%	-0.1%
Real Estate Equity	1.5%	2.7%	1.8%	-0.9%
Real Estate Credit	3.7%	5.9%	6.4%	0.5%
Commodities/Energy	0.4%	0.1%	0.4%	0.3%
Infrastructure	0.4%	2.4%	2.3%	-0.1%
Total Cash/Other	3.8%	6.4%	5.1%	-1.3%
Cash	2.7%	4.9%	4.1%	-0.8%
Other	1.1%	1.5%	1.1%	-0.4%

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Real Estate: It's finally getting more interesting in the equity sleeve of Real Estate. With Real Estate Equity values down and bank lending constrained, Real Estate Equity allocations dipped 90 basis points to 1.8% in 2024, while Real Estate Credit allocations increased to 6.4% from 5.9% in 2021 and a paltry 3.7% in 2017. These numbers are not likely to jump a huge amount in the near-term, as we believe further provisioning will be required to create a cushion to absorb headwinds in the office sector. That said, as we detail below, CIOs believe that prices are approaching levels on the equity side where the asset class "is now much more interesting to us."

Not surprisingly, CIOs from Life and Annuity, Property & Casualty, and Reinsurance & Health all have different asset allocation priorities. Within the Life and Annuity space, CIOs leaned even more heavily into Structured Credit than the averages for all insurance companies in our survey. All told, their Structured Credit allocations reached 8.9% in 2024, about 60 basis points higher than the average survey respondent's. Real Estate Credit, too, is another area of differentiation, with Life and Annuity insurers allocating 7.4% to the asset class, 100 basis points more than the average of all respondents. Meanwhile, with the Property & Casualty segment, our data shows that they hold 110 basis points more than the average in Private Equity (5.2% vs. 4.1%), 40 basis points more than the average in Public Equities (4.9% vs. 4.5%) and 70 basis points more in Bank Loans & HY (5.6% vs. 4.9%).

Exhibit 26: Private Markets Investing in Asia Is Less Mature...

Allocations to Non-Traditional Investments				
	Average	U.S.	Europe	Asia
Structured Credit	8.3%	12.5%	3.3%	0.2%
Private Credit	5.3%	4.4%	8.9%	1.7%
Private Equity	4.1%	5.2%	1.9%	2.6%
Hedge Funds	0.4%	0.3%	0.3%	0.2%
Real Estate Equity	1.8%	1.5%	2.5%	2.0%
Real Estate Credit	6.4%	7.0%	5.9%	6.9%
Commodities/Energy	0.4%	0.2%	0.6%	0.3%
Infrastructure	2.3%	1.9%	3.0%	3.5%

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 27: ...While Variances by Type of Insurer Are Meaningful

Allocations to Non-Traditional Investments				
	Average	Life	P&C	Other
Structured Credit	8.3%	8.9%	6.9%	4.4%
Private Credit	5.3%	4.7%	5.5%	6.1%
Private Equity	4.1%	2.8%	5.2%	3.2%
Hedge Funds	0.4%	0.0%	0.5%	1.1%
Real Estate Equity	1.8%	1.3%	2.8%	0.5%
Real Estate Credit	6.4%	7.4%	3.6%	11.8%
Commodities/Energy	0.4%	0.2%	0.5%	1.1%
Infrastructure	2.3%	1.9%	2.3%	5.2%

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Within Life and Annuity, CIOs leaned even more heavily into Structured Credit than the averages for all types of insurance.

SECTION IV

Regulatory Considerations

Though insurance regulatory and rating-agency capital models are ever-evolving, in 2024 insurers are confronted with a unique situation where most global frameworks are undergoing significant change at the same time. In our conversations, many CIOs cited these proposed changes as likely necessitating shifts in asset allocation. This could lead to a potential repositioning of billions of dollars in insurance assets over time.

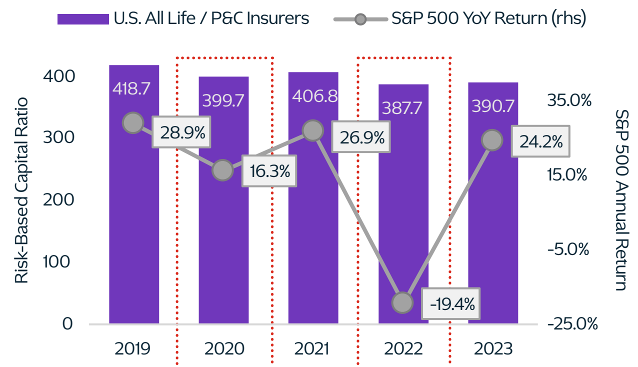
While many of the impending changes are intended to promote global consistency, each regulatory framework is still, or will likely be, nuanced. Many global insurers are subject to multiple regulatory regimes and therefore have a complex balancing act in designing asset allocation strategies that are capital efficient across multiple capital models. This balancing act is made even more complicated for insurers by the fact that many of these changes have yet to be finalized, so ongoing capital optimization is being done with a level of uncertainty.

Despite such challenges, insurance balance sheets continue to demonstrate resilience in the face of significant operating events like COVID and market downturns. The industry also continues to maintain strong capitalization levels, reflected by stable Risk-Based Capital Ratios (RBC) through time *(Exhibit 28)*.

Insurance asset allocations *have* become inherently more complex, due in large part to a prolonged period of low reinvestment rates and the need to supplement yield with Alternatives, including Private Credit and Structured Products. That said, increased diversification across asset classes does not always mean more risk. Many insurance CIO's have successfully evolved their investment programs with increased sophistication and a broadened asset allocation toolkit to achieve these outcomes, while also maintaining their risk budgets by enhancing investment risk models to prudently evaluate new asset class strategies.

Exhibit 28: Insurance Balance Sheets Continue to Demonstrate Resilience

U.S. RBC Ratios vs. Equity Market: Last 5 Years



Data as at March 31, 2024. Source: KKR Insurance Solutions.

Though capital levels have been resilient, and the risk profiles of insurers are strong on a historic basis, regulators continue to have an increased focus on asset risk. In the U.S., for example, the National Association of Insurance Commissioners (NAIC) has multiple, concurrent workstreams specifically related to increased oversight of structured products and over reliance on rating agency ratings. To drill down further in this area, Scott Jeffreys detailed the following considerations:

#1: Regulatory capital frameworks are becoming more consistent globally: As mentioned earlier, many regulatory changes are happening concurrently to promote greater global consistency. For certain jurisdictions, like Asia Pacific, the focus is now on adopting a principles-based framework that is similar in style to Europe's Solvency II model. Bermuda also continues to strengthen its investment oversight and regulatory regime.

Exhibit 29: More Alignment Among Global Insurers

Regulatory Capital Model	Impact to Insurers' Investment Portfolios
EU / UK Solvency II Capital	Solvency II reforms intended to ease the capital burden for many insurers and enable them to take on more risk and/or increase allocations to illiquid credit Further incentivizes insurance capital to invest in longer duration assets that can boost the economy
APAC Regulatory Capital	New 'principles-based' capital frameworks, like Solvency II, are being implemented across APAC countries, which will increase insurers' focus on ALM in setting asset allocation strategies
Bermuda Solvency Capital	Stricter eligibility requirements for reserve-backing assets; potentially higher capital charges for Structured Products, 'hard-to-sell' assets, and below investment grade securities Overall greater alignment with Solvency II

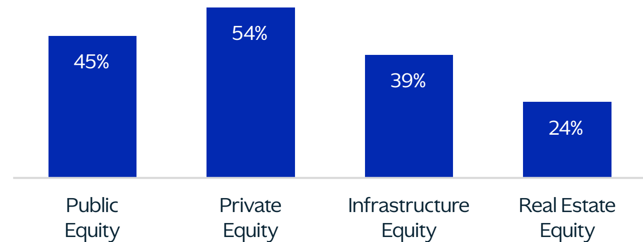
Data as at March 31, 2024. Source: KKR Insurance Solutions.

#2: Rating agency capital changes may encourage insurers to focus on asset classes with improved capital efficiency: In November 2023, S&P's new capital adequacy criteria for all global insurers went into effect. For those insurers where S&P capital is the binding constraint in determining asset allocation, the new criteria will be impactful to investment strategy.

In S&P's new model, Infrastructure equity now has a lower capital charge relative to Private Equity and Public Equity. This reduction is a recognition of Infrastructure's lower historical volatility and is consistent with other regulatory frameworks such as Solvency II. As *Exhibit 30* suggests, Infrastructure investments made by insurers in regions where a similar capital benefit has been afforded have grown considerably, notably in Europe.

Exhibit 30: Capital Charges for Infra Are Now Less Than Public and Private Equity

S&P Capital Charge Comparison for U.S. Equity (99.8% Confidence Level, 'Substantial Stress')



Data as at March 31, 2024. Source: KKR Insurance Solutions.

Fixed Income asset charges are no longer determined by credit rating alone; instead, they will vary more based on category. For ratings below AA, Structured Products (Category 4) generally receive the most punitive capital treatment. For lower rated bonds and loans, the capital charge differences can be significant between categories of the same rating. For example, **senior secured High Yield (Category 1) incurs nearly half of the required capital as does senior unsecured High Yield (Category 2)**. This model change is due to the consistently higher credit recoveries for senior secured. We think **insurers who optimize their investments for S&P capital are now likely to favor asset classes with this benefit**, such as senior Direct Lending, Bank Loans, or senior secured High Yield bonds.

Though capital levels have been resilient, and the risk profiles of insurers are strong on a historic basis, regulators continue to have an increased focus on asset risk.

Exhibit 31: Assets Will Now Be Grouped Into Four Distinct Categories…

Category 1	Government-related, infrastructure debt, **senior secured** bonds / loans
Category 2	**Senior unsecured** bonds / loans
Category 3	**Subordinated** bonds / loans and preferred stock
Category 4	**Structured Finance,** including non-agency RMBS, CMBS, CLOs, CDOs & ABS

Data as at March 31, 2024. Source: KKR Insurance Solutions.

Exhibit 32: …With Capital Now Also Dependent Upon Rating Cohort and Bond Tenor

Credit Risk Charges for Bonds and Loans: 99.8% Confidence Level

More than 1 but less than or equal to 5 years

	Category 1	Category 2	Category 3	Category 4
AAA	0.12	0.22	0.28	0.12
AA	0.29	0.54	0.71	0.37
A	0.53	0.98	1.28	1.38
BBB	1.08	2.00	2.61	2.61
BB	**2.97**	**5.52**	**7.22**	**9.84**
B	5.84	10.85	14.19	20.75
CCC to C	28.82	53.53	70.00	86.47
D/SD	38.00	67.00	86.00	100.00

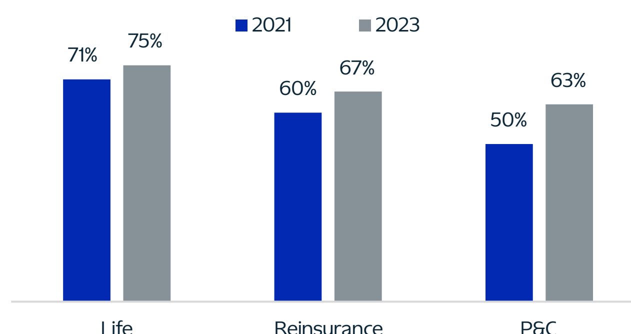
Data as at March 31, 2024. Source: KKR Insurance Solutions.

So, despite the move towards more illiquid investments, our view is that CIOs will need to continue to work hand in hand with regulators to ensure continuity and adherence to regulatory requirements. As we suggested earlier, the view among our survey and conference participants is that there is 'no going back' regarding the use of non-traditional investments. Said differently, many CIOs with whom we spoke have now determined that the risk/reward balance of layering additional complexity to achieve income appreciation is highly value added to portfolios.

So, despite the move towards more illiquid investments, our view is that CIOs will need to continue to work hand in hand with regulators to ensure continuity and adherence to regulatory requirements.

Exhibit 33: The Insurers in Our Survey Continue to Favor Income vs. Price Appreciation as a Driver of Investment Returns

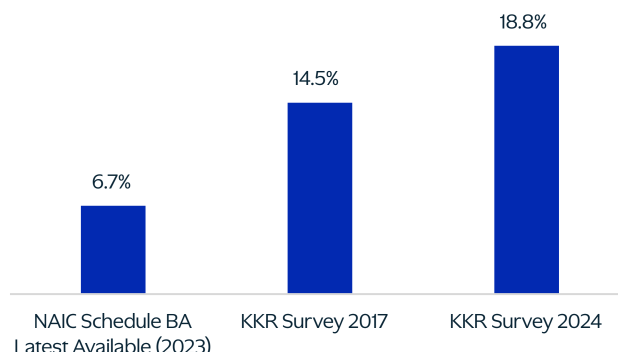
% Reporting Income as Most Important Driver of Returns



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 34: KKR Clients Have a Higher Degree of Comfort Scaling Alternatives

Allocation to Alternatives, %



Schedule BA assets include Private Equity, Hedge Funds, Commodities/Energy, Private Credit, and Infrastructure. NAIC data as at December 31, 2023. Survey data as at March 31, 2024. Source: NAIC, KKR 2017 and 2024 Insurance Surveys.

SECTION V

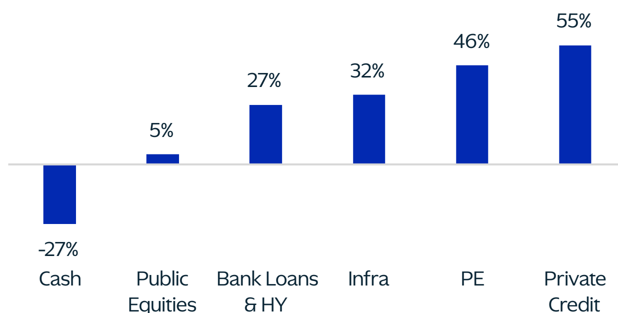
Where Are We Headed?

Despite having navigated a tricky environment where billions of dollars of unrealized gains have turned into billions of dollars of unrealized losses, CIOs still want to aggressively reposition their books of business. They see the opportunity that higher yields provide, and they are now more comfortable diversifying outside of corporate bonds and public equities. As we indicated at the outset, given the 'Regime Change' that many believe we are in, there is 'No Turning Back' from an asset allocation/ portfolio positioning perspective.

Interestingly, at the top of the list – despite insurers having pulled back their allocations a bit as rates spiked – is Private Credit. One can see this in *Exhibit 35*.

Exhibit 35: Investor Intentions Are Clearly Headed Towards Higher Allocations to Private Markets

KKR 2024 Insurance Survey: Net % of Survey Respondents Planning to Increase (Decrease) Allocations in 2024



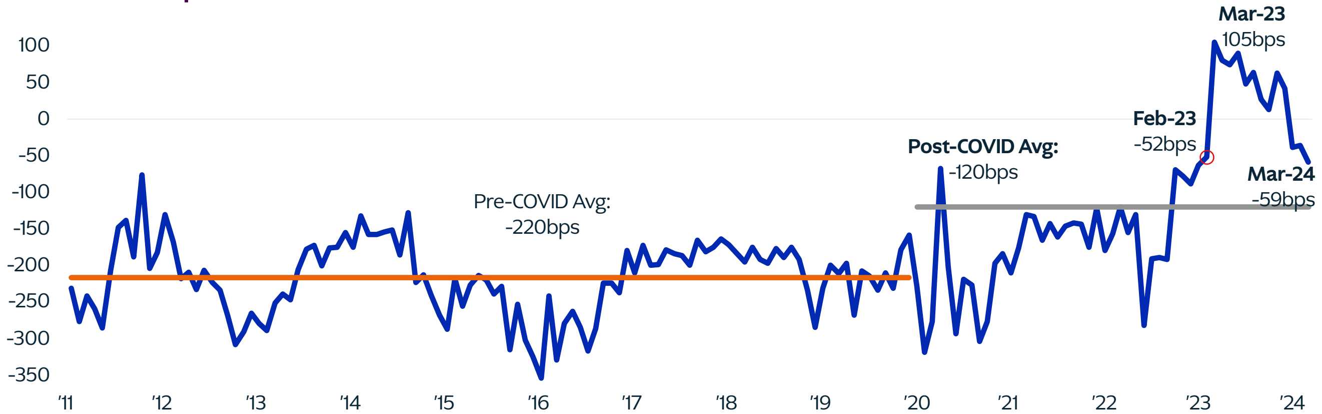
Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Despite these positive intentions, allocations won't surge overnight, we believe. CIOs suggest the lines are (too) long in some cases and though most agree they want to do more in this area, pacing and partnering with the right manager matters. As one CIO summarized well on behalf of most of our survey participants, "Private Credit…is on my list for 2024. I want to do more."

Meanwhile, as *Exhibit 35* also shows, more and more CIOs are again turning to Private Equity, despite its higher capital charges, to boost portfolio returns. The diversification benefits and extra returns were cited by multiple participants, particularly when compared to public markets. The asset class is also viewed as less volatile. One CIO expressed that, while challenges persist in the VC and Private Equity spaces due to higher rates and sluggish exits, "this backdrop should create some opportunities for recent vintages," and as a result, they are leaning in on new commitments.

There is also growing interest in Infrastructure, especially given it proved to be one of the best inflation hedges during the 2020-2023 period. Capital charges are certainly a consideration (though, as we indicated above in *Exhibit 30*, they are getting better and are lower than Equities), but our survey work and – more importantly – our follow up conversations led us to believe that Infrastructure will become an asset class of choice over the next few years, especially for insurers who are writing long-tail liabilities. One CIO really summed up the infrastructure opportunity well: "The benefits of Infrastructure as an asset class sync up with our focus. It provides a longer-term investment horizon that can support longer liabilities, provides diversification from credit risk, and typically has lower defaults, given its critical nature. That said, it is far from perfect. Capital charges matter, and the transactions are generally complex and require investment specialization."

Exhibit 36: CMBS New Issue Spreads Remain Very Wide Relative to History



Data as at April 20, 2024. Source: Bloomberg.

Interestingly, while Real Estate Equity and Credit did not show up in our formal intentions survey, it was certainly an area of high interest in our face-to-face meetings and when we analyzed the data by insurer type. Life and Annuity insurers listed Real Estate Credit as number four on their list for increases in 2025. Indeed, CIOs are thinking about the potential for being Real Estate lenders at a time when banks are definitely pulling back from the sector. Interestingly, though, while banks don't want to lend directly on Real Estate, they are willing to lend to funds that invest in Real Estate. An added benefit is that lenders can increasingly ask their equity counterparts to lower the leverage against these assets and still maintain attractive lending spreads. One CIO suggested that Real Estate can be "a mixed bag, with opportunities in digital infrastructure, but expect continued challenges in retail, office, and pockets of multi-family." Given this backdrop, a lot of the CIOs we spoke with emphasized the importance of careful underwriting that allows investors to capture the wider risk premia that currently exist in the CMBS market *(Exhibit 36)* without being exposed to severe idiosyncratic risks of, for example, deals where sponsors are unwilling to make the sort of capital investment needed to attract and retain tenants in competitive markets.

On the equity side of Real Estate, we are also seeing an acceleration in interest, albeit off a very low base. "The next six to 12 months should finally be a good time to lean in. We finally are seeing value." The ability to tranche assets across Real Estate is also helping with capital charges. Not everyone, however, is that constructive. As one CIO told me, "This work out is going to take longer; and there is still more provisioning to be done before we get interested."

Meanwhile, more and more CIOs are again turning to Private Equity, despite its higher capital charges, to boost portfolio returns. The diversification benefits and extra returns were cited by multiple participants, particularly when compared to public markets. The asset class is also viewed as less volatile.

SECTION VI

Big Topics of Discussion

Beyond spending time on portfolio details, we also were able to engage on several important macroeconomic and geopolitical topics. Key takeaways are as follows:

TOPIC A: What is the risk of a recession?

As we dug into concerns for CIOs, one subject remained top of mind: the risk of a recession. I think many of these sophisticated thinkers struggled with the amount of debt on government balance sheets, Fed behavior, overexuberance in equity markets and a challenged commercial real estate sector. As one thoughtful CIO explained, "Recession is the ultimate fear, and the other risks are just potential exogenous risk factors that could trigger a recession." As we wrote about in our Outlook for 2024 Glass Half Full, three ballasts will likely help us avoid a prolonged and serious recession. Here is our thinking:

Point #1: Household and Corporate borrowers are still largely insulated from the impact of higher rates. For starters, remember that fully 14 million mortgage borrowers, or 26% of homeowners, refinanced their mortgages during the pandemic, which has clearly helped alleviate pressure on interest coverage ratios. While new mortgage contract rates have surged from a low of under three percent in 2020-2021 to a peak of around eight percent last fall and currently remain over seven percent, the average interest rate paid by consumers has actually fallen from 3.9% in late 2019 to 3.8% today. It's not just households that have done a good job controlling their interest expense this cycle. In addition, corporate bond duration has extended meaningfully, and we think about 40% of floating-rate exposure of leveraged loan borrowers is hedged to maturity. So, against this backdrop, we continue to think that the transmission of monetary tightening will be both more lagged and more muted than in past tightening cycles.

Exhibit 37: Most CIOs Feel They Are Highly Exposed to Credit Risk

KKR Insurance Survey: Top Three Investment Risks		
	2024	2021
1	Credit Default Risk	Duration/Interest Rate Risk
2	Equity Risk	Asset Liability Mismanagement
3	Asset Liability Mismanagement	Credit Default Risk
3	Real Estate Risk	Credit Mitigation Risk
5	Credit Migration Risk	Equity Risk

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Exhibit 38: The Economy, Geopolitics and the Election Are Also Top Concerns

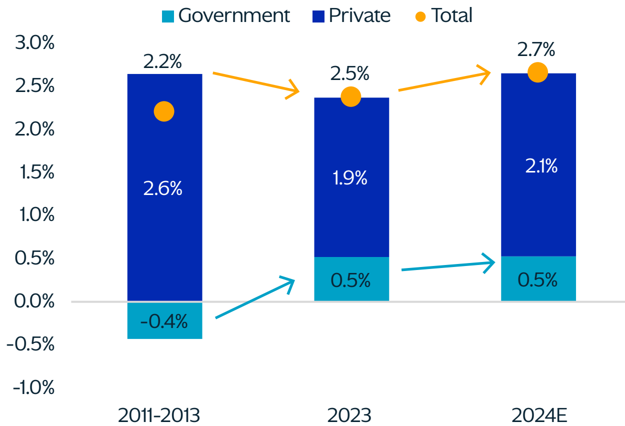
KKR Insurance Survey: Top Concerns		
	2024	2021
1	Recession	Inflation/Deflation
2	Inflation	Monetary Policy
3	Geopolitics	End of Cycle
4	Election	Recession
5	Cybersecurity	Foreign Exchange Risk

Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

Point #2: There is an unprecedented amount of fiscal support this cycle. Government spending continued to surge in 2023, with provisions for both consumers and businesses. Although the growth in government spending is softening at the margins, the absolute level of real government outlays is still running more than 25% above pre-pandemic trend levels. Said differently, the U.S. is still running a recession-fighting fiscal strategy at a time when the business cycle is well underway.

Exhibit 39: The Government Has Moved From Being a Deterrent to Being a Driver of GDP Growth This Cycle

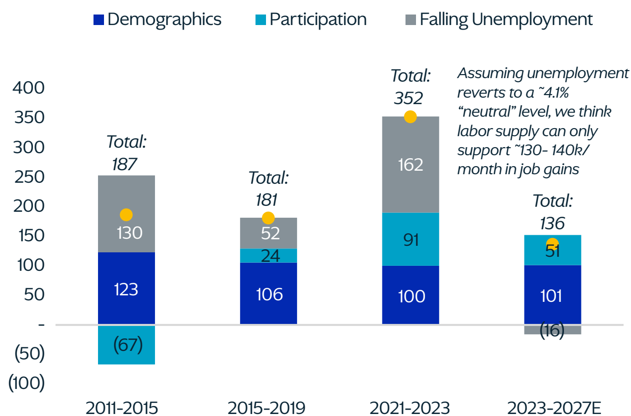
Contributions to GDP Growth



Data as at February 13, 2024. Source: U.S. Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

Exhibit 40: We Think the Neutral Employment Rate Is Only Around 125-150,000 Jobs

Potential Monthly Job Growth (000s)



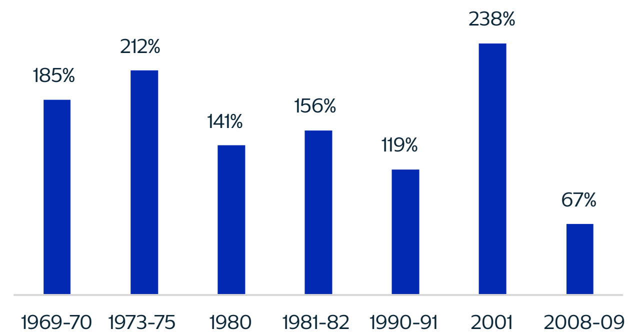
Data as at December 31, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Point #3: The U.S economy: "It is hard to get hurt falling out of a basement window." This may be our most important observation on the economic front as we move through 2024: the most cyclical areas of the U.S. economy, including Inventory and Construction Investment, are still running at around mid-cycle, not late-cycle, levels.

Looking ahead, our forecasts do embed some moderation in certain cyclical areas of the economy, but growth is resilient, even more so than we anticipated at the beginning of the year. Importantly, we believe this trend will continue into 2025.

Exhibit 41: Consistently, Across Cycles, Inventory and Construction Capex Contractions Have Driven the Great Bulk of Recessionary Downturns

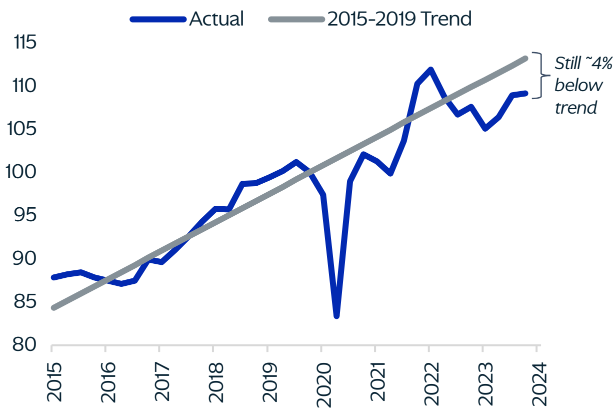
% of GDP Recession Explained by Inventories and Construction



Recession periods examined: 3Q69-2Q70, 4Q73-1Q75, 1Q80-3Q80, 3Q81-1Q82, 3Q90-1Q91, 2Q01-4Q01, 2Q08-2Q09. Data as at November 10, 2023. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

This may be our most important observation on the economic front as we move through 2024: the most cyclical areas of the U.S. economy, including Inventory and Construction Investment, are still running at around mid-cycle, not late-cycle, levels.

Exhibit 42: Importantly, Investment in These Categories Is Still Recovering from the Pandemic



Data as at December 31, 2023. Source: U.S. Bureau of Economic Analysis, KKR Global Macro & Asset Allocation analysis.

TOPIC B: Geopolitical complexity

A constant refrain we heard in our CIO conversations concerned the heightened state of geopolitical risks—many of which could have unpredictable financial market impacts. As one CIO suggested, "Middle East, Ukraine/Russia, Taiwan/China just to name the big ones....Geopolitics is number one by far." We think this new environment will likely be a more challenging one for global growth, as trade relationships are no longer determined by economic efficiencies but instead by geopolitical orientations. While there is no good hedge against this development, we continue to like investments linked to our Security of Everything thesis, including Infrastructure/logistics networks that benefit from the reorientation of global supply chains, as well as businesses that can help ensure the security of data, healthcare, and energy. We also heard from several CIOs, especially in the Property & Casualty arena, who were buying more Commodities and Infrastructure.

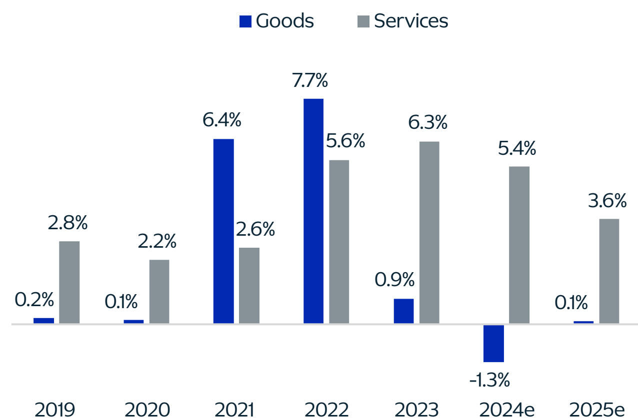
TOPIC C: How are we thinking about the path of inflation in the near term?

In our CIO conversations, one message came through loud and clear: The easy part of the cycle is behind us. When the Fed was tightening and inflation was far above target, the rate markets were trending higher, and as a result, CIOs could comfortably run a duration gap while being sure they would have enough yield to meet their liabilities. Today, however, the outlook is much 'foggier,' as monetary transition is upon us. Against this backdrop, volatility remains elevated, as there can be a lot of overreactions and over analysis by market participants with each new piece of data.

Exhibit 43: The Markets Have Continued to Whipsaw Around Fed Rate Cut Expectations

Data as March 8, 2024. Source: Bloomberg.

Exhibit 44: Services Inflation Continues to Be the Major Driver of Overall U.S. Inflation



Data as at March 31, 2024. Source: U.S. Bureau of Labor Statistics, Haver Analytics.

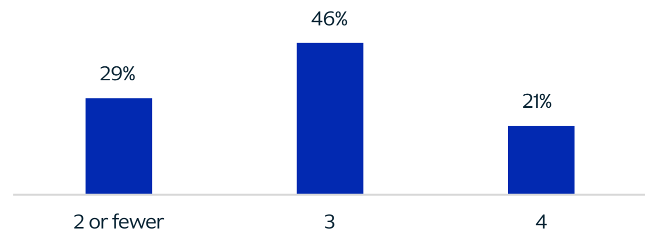
For our money, we continue to believe that investors have spent this cycle being too optimistic about the Fed cutting rates into an illusory moderation of nominal growth, cooling of inflation, and/or tightening of fiscal policy. We believe disinflation is taking longer than anticipated to play out and therefore we have no cuts in our Fed forecast for 2024, versus consensus and forward market expectations of one to two cuts beginning in the fall. Perhaps more importantly, though, we think that over the long term, both nominal growth and nominal interest rates are likely to run at higher levels this cycle compared to the 2010-2019 regime, particularly in the U.S. Key drivers include a shortage of workers and housing, heightened geopolitics, a messy transition towards green/domestic manufacturing, and wider fiscal deficits. All told, we envision a world where the 'resting rate' for core inflation settles around 2.5%, which would be above the Fed's target of two percent, and well above the pre-pandemic norm closer to 1.5%. Maybe even more importantly, we think this more unsettled inflation environment implies that U.S. 10-year yields likely do not run sustainably below four percent in coming years.

All of these crosscurrents come during an election year where some form of trade restriction is almost certainly on the docket for the next administration, whether merely tweaks to the de minimis import level, which would mostly impact low-cost imports, or more ambitious across-the-board tariffs of 10% or more. If we're right that the trend is towards more protectionism, then one of the key global tailwinds for disinflation over 2010-2019 may be turning into a headwind.

Against this backdrop, we think global central banks may be slower to cut rates than many investors currently anticipate amid difficulties in bringing Supercore, Housing, and Goods inflation towards target simultaneously. This is why we believe investors will continue to favor upfront recurring yields and assets with defendable margins as well as longer-dated assets to match liability duration. We think this is a huge part of our CIOs' desire to begin implementing strategies around long-term compounding of capital, as well as their 'barbell' positioning on the yield curve currently.

Exhibit 45: Nearly a Third of Our Respondents Expect Two or Fewer Fed Cuts

KKR 2024 Insurance Survey: How Many Fed Cuts Do You Expect This Year?



Data as at March 31, 2024. Source: KKR 2024 Insurance Survey.

TOPIC D: How do you approach currency hedging?

One of the many reasons why I look forward to these surveys is the insights I gain from best-in-class CIOs. The topic of hedging was one such example. Many insurers that we spoke with shared that their risk management policies dictated that, for every non-U.S. policy written, a local currency asset must be purchased to manage asset-liability matching. Unhedged foreign investments used to support USD liabilities could result in the erosion of fixed income returns due to adverse FX movements over the asset's life. This strategy helps explain the large portfolio of international assets on insurers' books, in some cases up to one third of assets. Sovereigns are clearly an asset class utilized by many global insurers, particularly in Asia.

Other CIOs utilize a robust program of hedging risk assets. One CIO shared that in order "to mitigate overseas investment risks, we utilize FX swaps and maintain hedging ratio at 100% level". Finally, it is straightforward for insurers to apply certain accounting standards to support both economic and accounting friendly hedge strategies for FX. This allows for the use of cross currency swaps and FX forwards to mitigate FX and interest rate differential risk to create a portfolio of synthetic U.S. dollar assets.

SECTION VII

Key Themes

While many CIOs are focused on managing the day-to-day gyrations that come with any levered portfolio of interest rate sensitive assets, they are also hugely focused on the long-term as well. In particular, we spent a lot of time discussing some of the mega investment themes behind which they are investing their portfolios. To this end, we thought we would highlight a few that came through in our survey and/or follow up meetings.

Collateral-Based Cash Flows

While collateral-based cash flows are not a new theme for us, we now think we are entering a 'new frontier', certainly according to the CIOs with whom we spoke. Specifically, they are looking for more ways to gain access to not only traditional investments such as Real Estate Credit and Equity but also newer areas such as Asset-Based Finance and Infrastructure. On the former, we know a fair amount about this business through our Global Atlantic holdings and, similar to our CIOs, we like the defensive nature of this asset class, the above average yield, and the benefit that proprietary origination offers. Importantly, in line with our thesis that "a B is an A" in this environment, many CIOs are actually allocating more to what they call High Grade Asset-Based Finance, which is just a more conservative version of the standard product.

On the Infrastructure front, CIOs like that revenues are often tied to the level of inflation. They also like the yield and diversification that the asset class provides. Further, many of the investments in this arena tie into some of the big mega themes we are all pursuing, including data, data storage, logistics, and energy infrastructure. Moreover, because of the long-tail nature of the asset class, many Life and Annuity insurers feel that they can do more to write some longer-tail liabilities, including the pension risk transfer business, by leveraging this asset class.

AI/The Digitalization of Everything

In our last survey, we noted that "Technology driven innovation in data management, distribution, underwriting and pricing, processing of claims, and modeling for valuation, projections, and risk management will all need to be upgraded and updated." Based on our conversations with CIOs for this survey, the digitalization of insurance companies continues. However, AI has only accelerated the speed of the transformation, particularly regarding the automation of repeatable processes and optimization of claims and other forms of client engagement. We think this will continue to be an area of investment and growth for insurers, particularly as demographics become even more challenging across most of the developed world and aging populations seek enhanced user experiences.

As insurers have scaled assets and geographies, investments in technology have led to improvements in portfolio construction and risk analytics. This in turn has improved liability pricing and coordination with salesforces. Large insurers are also gaining a competitive advantage when it comes to relative value across more public and private asset classes. Not surprisingly, this added advantage is encouraging CIOs to comparison shop more frequently across both asset classes and geographies, and it is leading traditional insurers to be able to extend their market share both organically and through acquisition across large businesses such as retail annuities, pension-risk transfer assets/liabilities, and closed blocks. One CIO suggested that understanding whether AI fundamentally pressures business models, rather than providing automation-led enhancements, is a key consideration in investing, particularly in Private Credit.

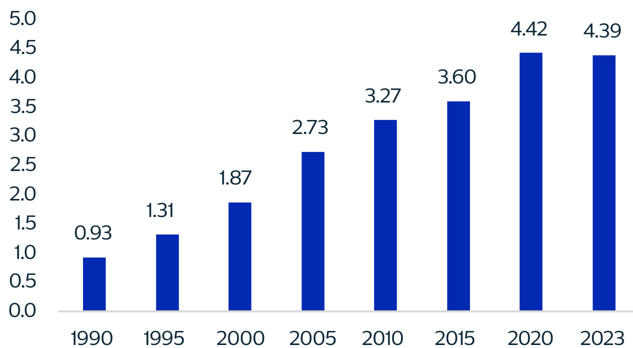
Productivity

One topic that continued to surface in our CIO conversations was the need for more productivity gains, particularly as continued wage growth is keeping inflation elevated. Our work has shown that periods of labor scarcity have historically been opportunities for greater automation. Many of these trends were already in place before the pandemic and have now only accelerated, we believe.

Importantly, insurers themselves are also focused on productivity within their businesses as it relates to technology, product offerings, issuance, underwriting, and distribution. As one can see in *Exhibit 46* below, assets per employee have risen sharply in the insurance sector in recent years. To achieve maximum benefits at this scale, more productivity is required. Productivity is also necessary to offset wage growth, which has accelerated across many industries (including insurance) since COVID.

Exhibit 46: Productivity Is a Priority for the Insurance Sector, Too, Where AUM Has Risen Sharply

U.S. Insurance: AUM per Employee, US$ Million



Data as at December 31, 2023. Source: KKR Global Macro & Asset Allocation analysis.

Exhibit 47: Wage Gains Have Historically Led to Periods of Rising Productivity

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

Data as at May 31, 2022. Source: BofA Quantitative Research.

Importantly, insurers themselves are also focused on productivity within their own businesses as it relates to technology, product offerings, issuance, underwriting, and distribution.

SECTION VIII

Conclusion

As we wrapped up our KKR CIO insurance conference and survey, it only reinforced for us that we are in a new regime. Indeed, according to our CIOs, "there is no turning back." Some of this change is linked to the macroeconomic environment. In particular, most CIOs are bracing for a higher resting heart rate for inflation and interest rates. They also expect the geopolitical environment to remain much more complicated going forward.

However, the other big underpinning of our 'No Turning Back' thesis is that our insurance CIOs also believe that they have entered a new regime for asset allocation. As we mentioned earlier, these investment executives want more, as one CIO cited "all-weather portfolios." And it is not just about adding Alternatives to the mix. Rather, they want to include investments that are not as correlated, and overall, they want to construct portfolios that can endure all types of shocks. The good news is that, with the rise in interest rates, they can do this much more easily than in the past. Indeed, to most of the CIOs with whom we interacted, it feels like the insurance industry has entered a good environment when it comes to investing the capital associated with new business wins.

Looking ahead, we also sense that there will be more focus on scaling what one can do well and shuttering existing businesses where an insurance company cannot build and sustain a competitive advantage. Against this backdrop, we expect to see more consolidation and sales of large non-core blocks. Finding the right partners to scale, particularly outside the U.S. or in asset classes where expertise or access matter, is also of importance.

Further, the number of CIOs that cited their intention to increase allocations to Private Credit sent two clear signals about overall asset allocation in the insurance sector, in our view. First, a lack of desire by traditional banks to lend these days has increased private lending opportunities across multiple asset classes for insurers. This reality has led to the expansion of insurers' `private credit toolkit' to include a broader universe beyond just traditional Private Credit. CLO liabilities, Asset-Based Finance, Real Estate Credit, and Infrastructure Debt all likely will be considered, especially as CIOs strive to create less correlation to the direction of interest rates. Second, because of this broader investing toolkit, we expect to see much more focus on relative value across both private and public securities in a world where the macro has shown that it can change so dramatically in just a 12-month period.

In conclusion, CIOs in the insurance industry now face both significant opportunities and challenges in a more volatile interest rate environment. So, what worked before the pandemic most likely will not be as effective in the 'Regime Change' that we believe is underway. As a result, CIOs are increasingly embracing the notion that there will be 'No Turning Back' when it comes to creating all-purpose portfolios that can thrive in this new macroeconomic environment that we now all find ourselves navigating on a global basis.

As a result, CIOs are increasingly embracing the notion that there will be 'No Turning Back' when it comes to creating all-purpose portfolios that can thrive in this new macroeconomic environment that we now all find ourselves navigating on a global basis.

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