

# INSIGHTS

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## The Wisdom of Compounding Capital





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# The Wisdom of Compounding Capital

Ultra High Net Worth investors have increasingly become more influential leaders in the global asset management industry, leveraging a more sizeable base of assets under management to participate in more complex transactions, all while broadening their global reach. In an effort to better understand this growth opportunity, we recently engaged with around 50 CIOs from leading Ultra High Net Worth family offices with whom KKR does business. Most families with whom we spoke are also led by self-made entrepreneurs, which dovetails closely with the way founders Henry R. Kravis and George R. Roberts have been building KKR for the last forty five years. Their investment profiles also mesh well with KKR and its balance sheet heavy strategy, given the Ultra HNW's focus on capital appreciation as well as their commitment to a long-term investment horizon via private investments. While underlying fundamentals are robust in this sector of the market, many CIOs are looking to further refine their business models. In particular, many executives are still searching for ways to bolster their asset allocation platforms, including broader diversification, better performance measurement, and improved sourcing. As we look ahead, we think the 'wisdom' of these initiatives – coupled with the long-term nature of their capital bases – will serve them well in the macroeconomic environment we now envision.

**Knowledge comes, but wisdom lingers.**

**ALFRED LORD TENNYSON**  
ENGLISH POET BORN 1809

In May 2017 we penned our first detailed report on the outlook for the Ultra High Net Worth market, which we titled *The Ultra High Net Worth Investor: Coming of Age*. Since then, this group of allocators, which the industry technically defines as having \$30 million or more in investable assets (though slightly more than 70% of the ones who participated in our KKR study in 2020 typically oversee multiple billions), have gone well beyond ‘coming of age.’ Rather, they are flourishing as influential leaders in the global asset management industry. As part of this expansion, these allocators are leveraging a more sizeable base of assets under management to do more complex transactions, extending their reach more globally, and leaning more aggressively into dislocations. They also have had the ‘wisdom’ in recent years to add more depth to their investment teams, to focus more on gaining greater operational expertise, and to embrace more sophisticated asset allocation techniques and modeling. As part of this maturation process, these allocators have also sharpened their investment opinions in certain areas. We note the following key takeaways from our survey:

- 1. Ultra High Net Worth families remain heavy users of a variety of Alternatives.** See below for full details (*Exhibits 12 and 13*), but families that have over one billion in assets under management have from 51-54% of their total assets in some type of Alternative product, for example, compared to ‘just’ 44% for family offices who oversee less than one billion dollars and 23% for more traditional pension funds.
- 2. Leading CIOs in the Ultra High Net Worth sector are moving more towards longer duration, compounding-oriented private investments.** Indeed, while the illiquidity premium remains an important competitive advantage that Ultra HNW investors can exploit across multiple products, there appears to be an increased realization that private funds that are focused on multiples of money may be more attractive than IRR-focused funds for tax sensitive accounts. All told, nearly 70% of survey respondents cited growth of their capital (i.e., compounding) as the primary objective of their investment portfolio (*Exhibit 2*), while only 17% cited need for income. This viewpoint also underscores our belief that wealthy families like the benefits of being equity owners in businesses that can compound capital over time in a tax efficient manner.
- 3. Consistent with this view, one of the biggest shifts in our data since 2017 is an increase in Private Equity allocations.** All told, total PE allocations, which we define to include Control (e.g., a family business), Buyouts, and Growth/Venture Capital (though actual allocations to VC came in quite low), increased fully 300 basis points in 2020 to 27% of total assets under management from 24% three years ago. When we peeled back the onion on the data, we found that larger and longer tenured family offices were the key drivers of the increase in Private Equity allocations. See below for further details.
- 4. Not surprisingly, given how much the equity markets have appreciated in recent years, some Alternative products, particularly those with more income or more hedged positions, did not gain market share this cycle.** In fact, allocations to Hedge Funds dropped 600 basis points to 6% from nearly 12% in 2017, while Private Credit dipped to 4% from 6%.

- 5. Cash balances remain high at around 9%, but that is not the ‘story’.** The real story around cash management is in the disparity of how CIOs in this channel manage their Cash positions. On the one hand, some family offices are now holding 25-30% of their portfolios in Cash. On the other hand, some have zero Cash and periodically use borrowing facilities to meet capital calls and/or payouts. We are not in the zero Cash bucket, but 30% seems extremely high to us, particularly in a world of heavily negative real rates across most developed economies. If there is good news from our perspective, our survey shows the percentage of family offices holding 15% or more in Cash did drop from 34% in 2017 to 23% in 2020. Details below.
- 6. However, the strategy of overweighting Alternatives and Cash in size has still led to strong performance – and with lower volatility – relative to other segments of the investment management industry in recent years.** One can see this in *Exhibit 5*. However, as we describe below, all macro and asset allocation professionals, including Ultra High Net Worth families, will face more subdued headline returns in the investment climate that we think we are entering. As such, both top-down allocation strategies as well as manager/security selection will grow in importance. See Section III for more details.
- 7. In terms of big opportunities, family offices are becoming more thematically driven and actually align with many of the key investing themes we are pursuing at KKR.** Specifically, relative to 2017, there is more attention being paid to finding diversification within new verticals – not just in their own area of operating expertise (e.g., not just industrial experts investing their excess family cash flow in industrial assets). Key themes on which to focus include corporate carve-outs, the global rise of the millennial, Asia as a growth destination, and secular growth stories in healthcare/technology. This approach towards more thematic investing also ties well with the greater focus on compounding capital than in the past.
- 8. Most CIOs of family offices are increasingly focused on free cash flow and free cash flow conversion.** Not surprisingly, they are doing less in early stage Venture Capital, which is often more conceptual in nature, and more in Growth Equity and PE than some endowments with whom we speak, despite a clear focus on innovation and technological change. Growth investments are also becoming a bigger part of their overall Private Equity portfolios (*Exhibit 29*).
- 9. Interestingly, geopolitical concerns rank number one – ahead of rising interest and/or inflation – as the investment risk most cited in our survey.** Digging deeper, U.S.-China tensions are currently the clear area of concern. In fact, 70% of those surveyed who mentioned geopolitical tensions specifically cited the emergence of a U.S.-China cold war as a threat to global capital markets. Rising rates is also an area of concern, though the lion’s share of CIOs do not see that as a near-term reality. We agree.

That said, there is still room to grow and improve their competitive positioning, we believe. If we had to nudge our friends in the Ultra High Net Worth community to consider some additional tools to institutionalize their business, there would be a few things to consider. They are as follows:

- 1. Many Ultra HNW investors, particularly family offices, have too much local bias in portfolios.** On the liquid side, huge concentrated positions in businesses these family know well still dominate some of the portfolios. Many CIOs acknowledge this shortcoming, and as such, over time we expect more CIOs to work with their sponsors to lower their overall concentration in local investments, particularly family-run operating companies and/or large concentrated public positions. Meanwhile, on the private side, there is still probably not enough geographic diversification, in our view. Having dealt with this issue ourselves as part of our balance sheet diversification strategy at KKR, we think a more formal 'game plan' may be needed, particularly to gain exposure to complex regions such as Asia.
- 2. We think that there is the potential to consider some Infrastructure, or other forms of collateral-based assets, in their portfolios.** Whereas KKR's balance sheet already holds four percent in Infrastructure investments (with an intent to grow this position), our clients' portfolios essentially hold zero, according to our survey results. In fact, only one client out of all those who submitted responses mentioned Infrastructure as a source for improving yield; by comparison, Real Estate, another Real Asset with similar characteristics in many instances, garnered the greatest amount of CIO interest when asked the same question (*Exhibit 22*). Many CIOs told us that Infrastructure does not appear to be an obvious investment allocation for earning the double digit returns they are seeking. Our view, which we describe in more detail below, is more optimistic – not only from a return perspective, but also as a way to potentially gain greater ESG exposure, which we think will become a distinct area of focus for all investors. Also, we are seeing a surge in Infrastructure deployment opportunities, as supply chains shift to regional from global at a time when services are now eclipsing goods, and growth in the digital world is outpacing the physical one.
- 3. Reinvestment risk is growing.** As mentioned earlier, Cash balances remain quite elevated relative to any other asset pool that we monitor on a global basis. Importantly, given that lots of families are seeing realizations spike from many areas of their private portfolios, reinvestment risk has increased, and as such, should be addressed more systematically, we believe. Said differently, we think that many CIOs in the Ultra HNW category may need to be even more aggressive around formalizing deployment schedules, including bigger re-ups, to prevent a cash bulge from occurring across many plans. They may also need to extend duration in longer-tail products such as Infrastructure and/or Core Private Equity (i.e., longer duration PE).
- 4. There is still improvement needed in measuring success and fine-tuning the investment processes.** While we fully acknowledge that flexibility, particularly the ability to lean into dislocations, is a significant competitive advantage for this group, we see a need for better communication and agreement on what a structured and consistent asset allocation 'game plan' looks like in these organizations. In particular, events like the sale of a company or initial public offering are leading to unnaturally high Cash balances that can take too much time to get redeployed. Consistently measuring whether security selection and/or asset allocation tilts create value over time is likely an important next step for most organizations that are already adhering to a targeted asset allocation format.

Also, greater transparency towards process and the relationship the family plays in setting the asset allocation targets as well as implementation tactics probably would behoove everyone involved, including CIOs, families, and finance/operations.

Overall, though, the road ahead for families with whom KKR does business appears quite attractive, we believe. This segment of the market has the capital to be a meaningful partner in important, sizeable deals; they can move quickly (i.e., often investing in first time funds and/or during periods of uncertainty); and their permanence of capital provides both stability and flexibility when many in the industry are more constrained. Against this backdrop, most CIOs with whom we spoke want to maintain or even increase their risk profile (*Exhibit 1*).

#### EXHIBIT 1

Besides the EMEA Region, Most CIOs Intend to Maintain or Increase Risk Budgets in 2021

#### KKR 2020 FAMILY OFFICE SURVEY: ARE YOU PLANNING TO INCREASE, DECREASE OR MAINTAIN THE OVERALL RISK IN YOUR INVESTMENT PORTFOLIO IN THE NEXT 12 MONTHS?

	MAINTAIN	INCREASE	DECREASE
GLOBAL	59%	34%	7%
AMERICAS	52%	38%	10%
EMEA	61%	0%	39%
ASIA PACIFIC	46%	54%	0%

Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

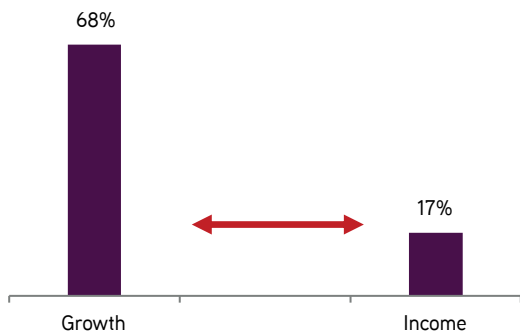
**As part of this expansion, these allocators are leveraging a more sizeable base of assets under management to do more complex transactions, extending their reach more globally, and leaning more aggressively into dislocations. They also have had the 'wisdom' in recent years to add more depth to their investment teams, to focus more on gaining greater operational expertise, and to embrace more sophisticated asset allocation techniques and modeling.**



EXHIBIT 2

Nearly 70% of the Survey Respondents Mentioned Growth as the Focus of the Investment Portfolio

% of Total Survey Respondents Who Mentioned the Following Key Words as a Purpose of the Investment Portfolio, Multiple Responses Allowed

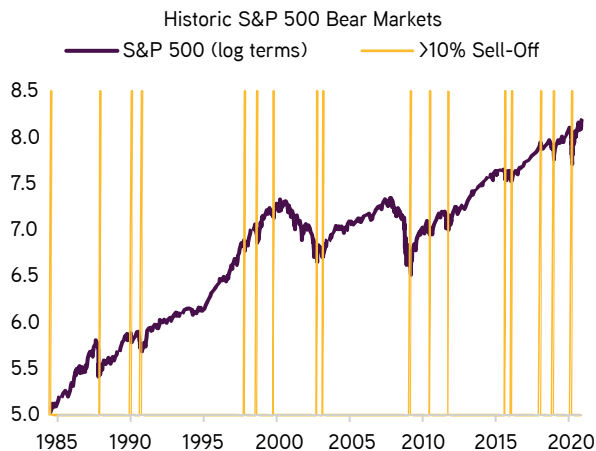


Data as at December 31, 2020. Source: KKR 2020 Family Office Surveys and KKR Global Macro & Asset Allocation analysis.

Importantly, this risk tolerant mentality is occurring at a time when macro conditions appear supportive of their more flexible approach. Specifically, as we show in *Exhibit 3*, markets are becoming dislocated more often than in the past. Meanwhile, our strong belief at KKR is that we remain in an important period of innovation for the global economy. As such, the opportunity for Ultra HNW families and other allocators to also put more capital behind structural winners that can take market share *and* improve profits is quite unique (*Exhibit 4*).

EXHIBIT 3

Increasing Market Volatility Is Leading to More Opportunities

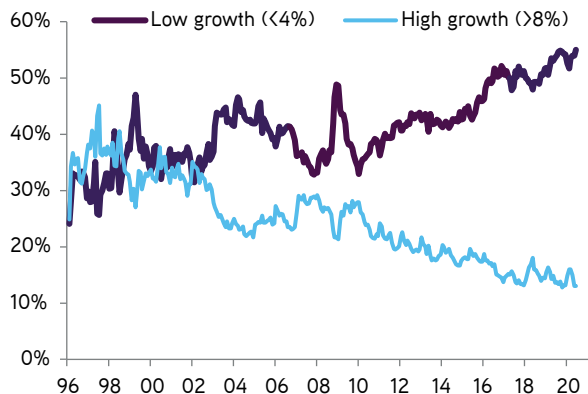


Data as at November 30, 2020. Source: Bloomberg.

EXHIBIT 4

The Number of Companies That Can Structurally Grow Has Slowed, Which Reinforces Our View About the Importance of Long-Term Thematic Investing

MSCI World Consensus FY3 Sales Growth % of Companies by Growth Bank



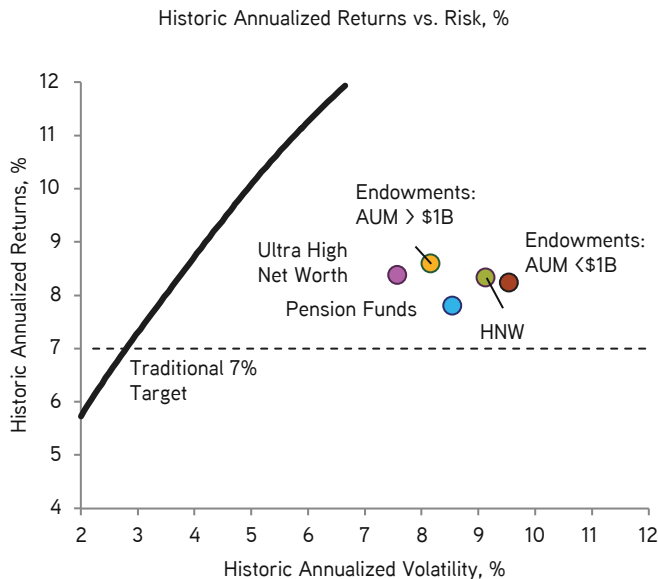
Data as at September 30, 2020. Source: Datastream, I/B/E/S, Goldman Sachs Global Investment Research.

While the past five years have indeed been volatile when one considers the commodity correction, the U.S.-China trade war, and the coronavirus pandemic, the entire asset allocation community, including Ultra High Net Worth investors, HNW investors, pensions, and endowments have managed to achieve respectable returns (*Exhibit 5*). The key difference, in our view, was in the volatility profile. Though the Ultra HNW community is perceived to be more risk taking than, for example, the pension community, its volatility profile actually ended up being lower – largely due to its barbell approach of higher allocations to Cash and Alternatives at the expense of Public Equities and Bonds. Looking ahead (and as we describe in Section III), we believe that future returns will be more challenging, supporting our view that both superior asset allocation and manager/security selection will be required.

**Though the Ultra HNW community is perceived to be more risk taking than, for example, the pension community, its volatility profile actually ended up being lower – largely due to its barbell approach of higher allocations to Cash and Alternatives at the expense of Public Equities and Bonds.**

EXHIBIT 5

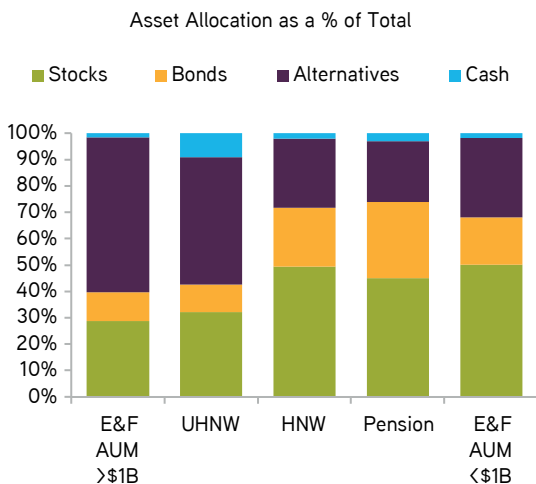
In Recent Years, Ultra HNW CIOs Delivered Both Competitive Performance and Lower Volatility



Historic = estimated past 5 year annualized return using historic benchmark returns and the current asset allocation. Data as at December 31, 2020. Source: KKR 2020 HNW Survey, BNY Mellon Endowments and Foundations Performance and Asset Allocation Study 2020, Towers Watson Global Pensions Asset Study 2020, HNW represents the averages of published target asset allocation recommendations for a moderate portfolio from investment management divisions of leading investment banks, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 6

A Key Driver to the Strong Returns Was a Barbell Approach of Heavy Alternatives and Heavy Cash



Data as at December 31, 2020. Source: KKR 2020 HNW Survey, BNY Mellon Endowments and Foundations Performance and Asset Allocation Study 2020, Towers Watson Global Pensions Asset Study 2020, HNW represents the averages of published target asset allocation recommendations for a moderate portfolio from investment management divisions of leading investment banks, KKR Global Macro & Asset Allocation analysis.

SECTION I

With whom did we speak?

While KKR is actively engaged with building relationships across all segments of the market, we recently did a deep-dive into one specialized subset of investors. Specifically, over the past few months, we engaged with around 50 CIOs from leading Ultra High Net Worth families with whom KKR does business. What was the make-up of the clients with whom we spoke? To review, the industry standard is to classify Ultra High Net Worth as over US\$30 million in assets, although the average CIO in our survey oversees between one and five billion U.S. dollars. As mentioned earlier, these relationships mesh well with KKR and its balance sheet heavy strategy, particularly given the focus on long-term capital appreciation. Further, most families with whom we spoke are also led by self-made entrepreneurs, which dovetails well with the way founders Henry R. Kravis and George R. Roberts have been building KKR for the last forty five years.

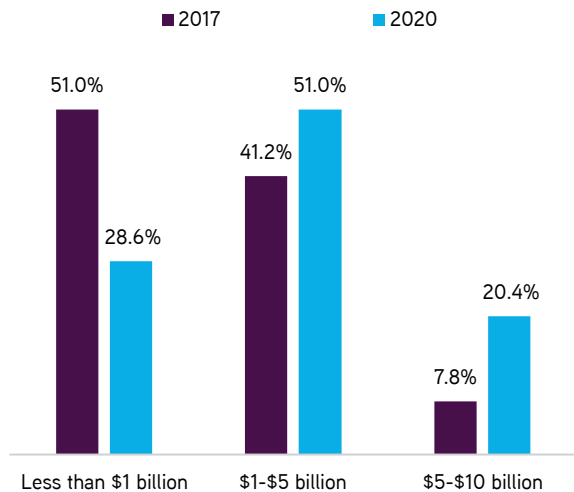
As Exhibit 7 and 8 show, there are some notable changes in those we surveyed in 2020 versus in 2017. First, Europe, Latin America, Asia and the Middle East were much more influential this time, making up 57% of our responses. In 2017, these constituencies accounted for just 20% of the total. This shift in mix is very important because it injects a broader array of inputs – and styles for that matter – into our survey, including asset allocation and deployment preferences. However, it also means that there are no perfect apples-to-apples comparisons relative to our 2017 survey. Second, the size of assets under management has grown materially. As mentioned earlier, more than 70% of participants now manage more than one billion dollars, suggesting AUMs on par with mature endowments and certain pensions. As one might expect, the infrastructure and expertise required to tilt more global, to delve into new asset classes, and to invest in size outside of funds (i.e., directly or through co-investments) is much more prevalent in these larger organizations.

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EXHIBIT 7

In 2020, One of Every Five Respondents Manages More Than Five Billion in Assets...

KKR Family Office Survey:  
Assets Under Management in US\$, 2017 vs. 2020

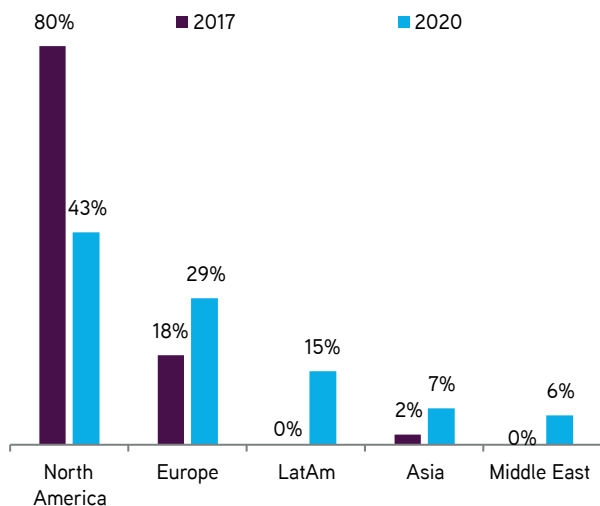


Data as at December 31, 2020. Source: KKR 2017 and 2020 Family Office Surveys..

EXHIBIT 8

...And We've Broadened the Scope of the Survey to Extend Beyond North America

KKR Family Office Survey:  
Participation by Region, 2017 vs. 2020, %



Data as at December 31, 2020. Source: KKR 2017 and 2020 Family Office Surveys.

A key finding from our survey is that Ultra HNW CIOs are predisposed to use Alternatives more heavily. Specifically, they tend to run with around 50% in Alternatives, compared to the 20-30% range reported by other types of Ultra High Net Worth surveys we have seen. Consistent with this view, our survey respondents skew more towards Private Equity than other asset managers in the industry.

Beyond the formal survey that we sent out to these individuals, we also engaged around half the participating CIOs in detailed conversations about key macro and asset allocations trends. These conversations also focused on KKR's sizeable balance sheet and the detailed asset allocation strategy we have been pursuing since the Firm cut its dividend in early 2016. All told, KKR's book value has increased 67% since that time, and it has been able to retain an additional \$4 billion of incremental capital to invest – amongst other things – in its funds. Not surprisingly, we felt immediate synergies with these family offices as many also have sophisticated strategies that generally align with the investment objectives we are trying to achieve at KKR. Indeed, in almost all instances this connection led to a candid, solicitous two-way dialogue on the opportunities and risks that come from trying to compound long-term capital in a thoughtful risk-adjusted way.

Importantly, we do not believe that there is only one approach to managing a large, sophisticated family office. There is not. In fact, there are growing bifurcations on how to tackle the opportunity set. Some Ultra HNW families are adding internal resources to grow their infrastructure in order to allocate less to funds and target more capital for direct investments. Their logic is to develop (or acquire) industry expertise that can then be leveraged to source more deals and create more opportunities.

Other quite large family offices are scaling nicely by 'sticking to their knitting.' Specifically, they retain a small staff, focus primarily on funds versus co-invests, and adhere to a structured allocation game plan. In almost all these instances, outside influence from the wealth creator was limited, asset allocation and performance goals were clearly defined, and there was a strong penchant for cash flowing businesses (i.e., very little Venture Capital in the portfolio). Not surprisingly, these family offices are laser focused on building like and trust relationships with alternatives managers that can source deals in areas of interest and view these partnerships of paramount importance.

So, as we look ahead, our base view is that there are multiple models which can be successful. The key, in our view, is knowing one's core competencies and then creating an investment environment that can execute upon and leverage these strengths. Importantly, though, as we mentioned at the outset, there probably needs to be less intervention from the families once a course has been charted. In addition, there should be more measurement for and consistency of approach to defining success. Most CIOs appear to be shooting for double digit returns over time, but – as mentioned earlier – there do appear to be a few blind spots around concentrations and risk-adjusted returns.

**Importantly, we do not believe that there is only one approach to managing a large, sophisticated family office.**

# What has changed in Ultra HNW portfolios?

As the allocation and portfolio construction ‘geeks’ at KKR, we often get excited by a 50-100 basis point annual shift between the major food groups like stocks to bonds, or bonds to cash, or fixed income to equities. So, one can imagine the surprise when Rebecca Ramsey, Frances Lim, and I tallied up the responses to this most recent survey. As we show below in *Exhibit 9*, we found some significant reallocations in our latest survey when compared to 2017: Hedge Funds lost 600 basis points of market share, while Private Equity and Real Estate each jumped 300 basis points.

To be sure, there are clearly multiple forces at work that could influence market share gains and losses, including appreciation, hedging, inflows, changes in sample size, liquidations, etc. However, our conversations with leading CIOs reinforced that both the downsizing and upsizing we saw was intentional. In particular, we repeatedly heard CIOs mentioning their intent to be longer-term equity owners where 1) there was greater potential to influence outcomes in a tax efficient manner; and 2) the opportunity to take advantage of the illiquidity premium in today’s low rate environment was more sizeable. This reduction also dovetails with Frances’s 2017 Ultra HNW survey work, which uncovered the inefficiency of such large Hedge Fund allocations in her portfolio optimization (see our 2017 report [The Ultra High Net Worth Investor: Coming of Age](#)).

**EXHIBIT 9**

There Have Been Meaningful Shifts Upward in Private Equity and Real Estate at the Expense of Hedge Funds and Private Credit Since 2017

KKR FAMILY OFFICE SURVEY ASSET ALLOCATION COMPARISON:			
ASSET CLASS	2017	2020	CHANGE
LISTED EQUITIES	29%	31%	+2%
FIXED INCOME	9%	10%	+1%
PRIVATE CREDIT	6%	4%	-2%
PRIVATE EQUITY	24%	27%	+3%
HEDGE FUNDS	12%	6%	-6%
REAL ESTATE	8%	11%	+3%
OTHER REAL ASSETS	3%	2%	-1%
CASH	10%	9%	-1%

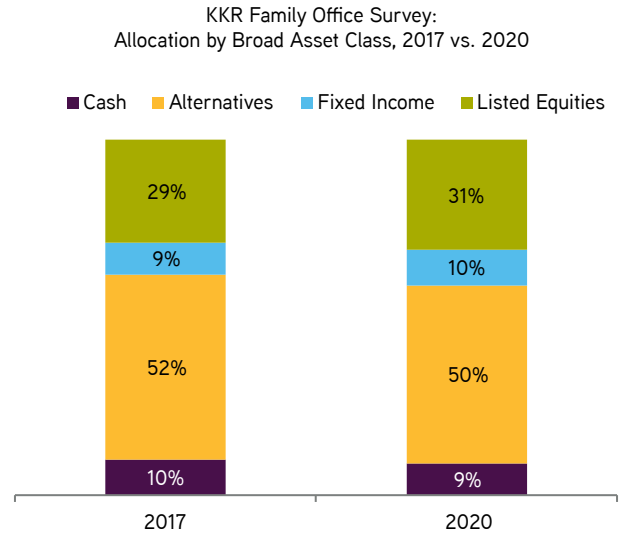
Note: May not equal 100% due to rounding. Data as at December 31, 2020. Source: KKR 2017 and 2020 Family Office Surveys.

In terms of broad allocation trends, we also found the data interesting as to what it means for overall allocation to Alternative asset classes. As *Exhibit 10* shows, allocations to Alternatives actually fell to 50%

of the total in 2020, compared to 52% of the total in 2017. While the pivot away from Hedge Funds and Private Credit by many CIOs was a factor, we attribute the lion’s share of the decline to the significant appreciation in Public Equities and Fixed Income – compliments of lower rates and more Quantitative Easing – versus a concerted bias to reduce Alternative allocations.

**EXHIBIT 10**

The Bull Market in Public Equities Has Boosted Allocations. However, Alternatives Remain the ‘Go To’ Asset Class of Choice in Our Survey



Note that we have removed Private Credit from Fixed Income in 2017 and added it back to the Alternatives allocation for consistency of approach. This change adjusts the previously reported Fixed Income percentage of total from 15% to 9% and the Alternatives percentage of total allocation from 46% to 52%. Data as at December 31, 2020. Source: KKR 2017 and 2020 Family Office Surveys.

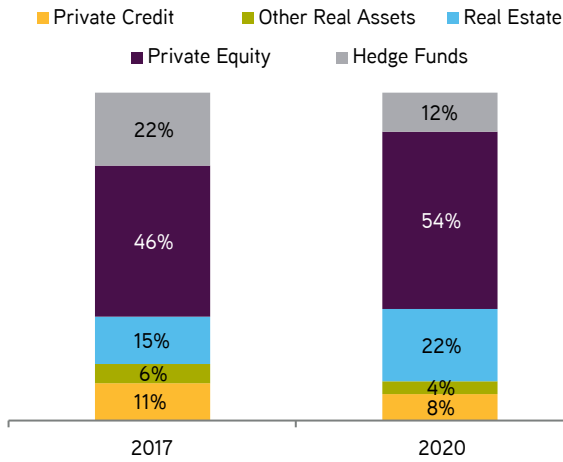
**In particular, amongst the family offices with whom we spoke, Private Equity had clearly gained in appeal. Better tax efficiencies, greater control, and more assurance with the asset class were all cited as important catalysts for change. Because of this significant bump to Private Equity, the asset class moved from 46% of the total Alternatives weighting in 2017 to 54%, or well over half of the total Alternatives allocation in this latest survey.**



EXHIBIT 11

There Have Been Meaningful Shifts Upward in Private Equity and Real Estate at the Expense of Hedge Funds and Private Credit Since 2017

KKR Family Office Survey: Allocation to Alternatives as a % of Total, 2017 vs. 2020



Note that in 2017 Real Estate and Other Real Assets were combined, totaling 23% of the total allocation to Alternatives. However, given more robust reporting details, we are now listing them separately for clearer comparisons to 2020 data. The addition of Private Credit to Alternatives as noted in *Exhibit 10* impacted overall weightings such that Hedge Funds decreased to 22% from 23%, Private Equity decreased to 46% from 53%, Real Assets changed from 23% to 15% for Real Estate and 6% to Other Real Assets. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

Within Alternatives, however, there were obvious shifts in mindset that happened between 2017 and 2020. In particular, amongst the family offices with whom we spoke, Private Equity had clearly gained in appeal. Better tax efficiencies, greater control, and more assurance with the asset class were all cited as important catalysts for change. Because of this significant bump to Private Equity, the asset class moved from 46% of the total Alternatives weighting in 2017 to 54%, or well over half of the total Alternatives allocation in this latest survey.

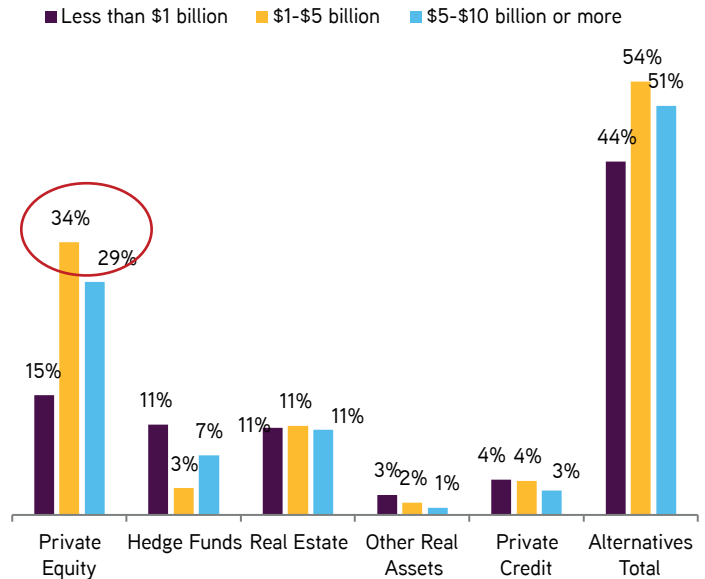
Importantly, both the size of the plan and seasoning of the program mattered for Private Equity allocations. Specifically, as we show in *Exhibit 13*, when assets under management are less than one billion, the allocation to Private Equity is about 34% of the total Alternatives allocation; however, as assets under management increase, so too does the allocation to Private Equity as a percentage of the total Alternatives bucket — to between 57-63%. In many instances CIOs are selling Hedge Funds to fund this increase in weightings to Private Equity (*Exhibit 13*).

**The date of formation of the family office also plays a role, as older family offices tend to favor heavier allocations to Private Equity.**

EXHIBIT 12

As Family Offices Scale in Size, They Tend to Allocate More to Private Equity...

KKR 2020 Family Office Survey: Actual Allocation to Alternatives Based on Assets Under Management, %

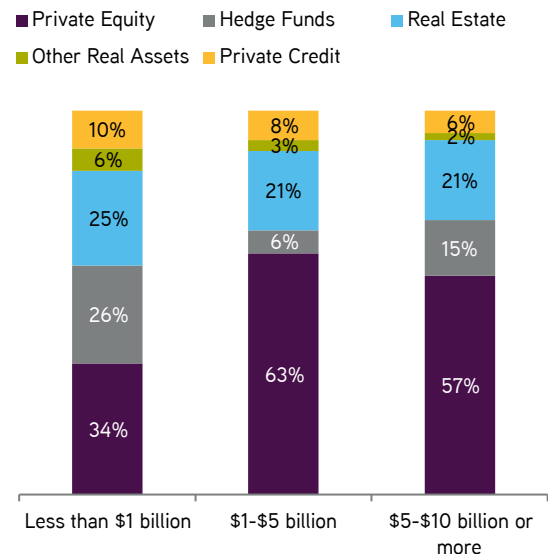


Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

EXHIBIT 13

...Which Ultimately Has Created Some Notable Shifts in Asset Allocation

KKR 2020 Family Office Survey: Allocation Within Alternatives as a % of Total Based on Assets Under Management

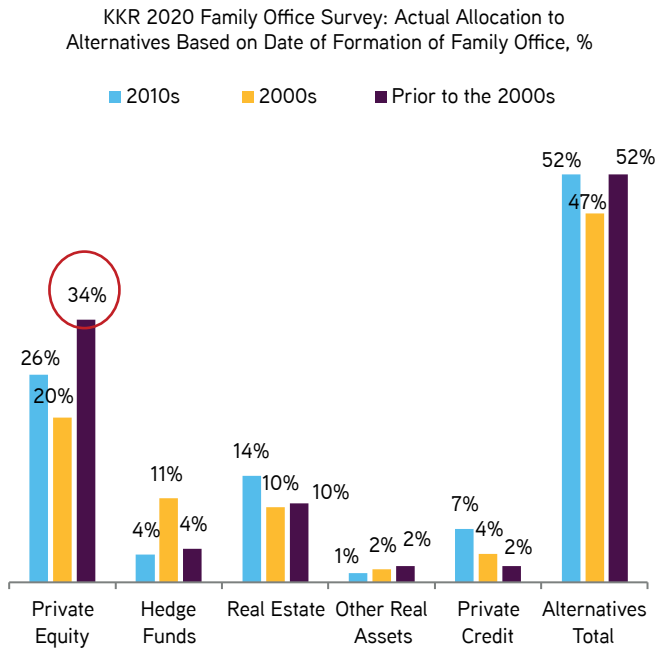


Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

The date of formation of the family office also plays a role, as older family offices tend to favor heavier allocations to Private Equity. One can see this in *Exhibits 14* and *15*, respectively. Our conversations with CIOs suggested that an increased comfort develops after a program is up and running, which often incentivizes larger and more global allocations. Relationships mature, so like and trust builds over time and leads to consideration of multiple product offerings. Also, we think tax efficiency tends to be more top of mind with older and larger organizations.

**EXHIBIT 14**

**As Family Offices Mature, They Rely More on Private Equity...**



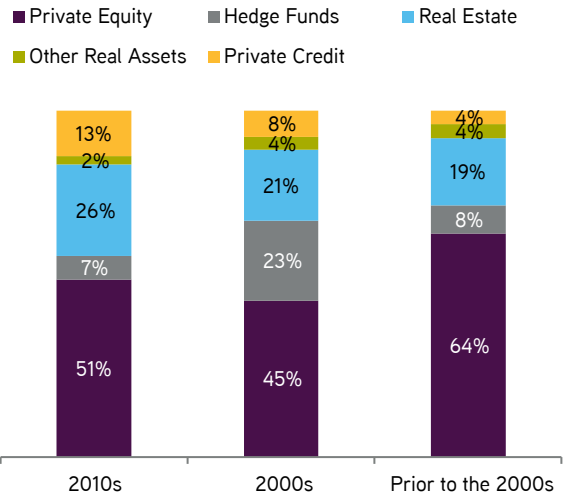
Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

**Interestingly, while our data shows that Private Equity allocations increased as assets under management grew, allocations to controlled businesses (e.g., family run businesses) remained a prominent part of Private Equity allocation almost regardless of size.**

**EXHIBIT 15**

**...and Less on Other Forms of Alternatives Such as Hedge Funds, Real Estate, and Private Credit**

KKR 2020 Family Office Survey: Allocations to Private Equity as a % of Total Based on Date of Formation of Family Office



Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

Interestingly, while our data shows that Private Equity allocations increased as assets under management grew, allocations to controlled businesses (e.g., family run businesses) remained a prominent part of Private Equity allocation almost regardless of size. One can see this in *Exhibit 18*. This trend makes sense to us, as many family offices represent CEOs where their business necessitates ownership of direct equity, while focusing on compounding capital and minimizing taxes.

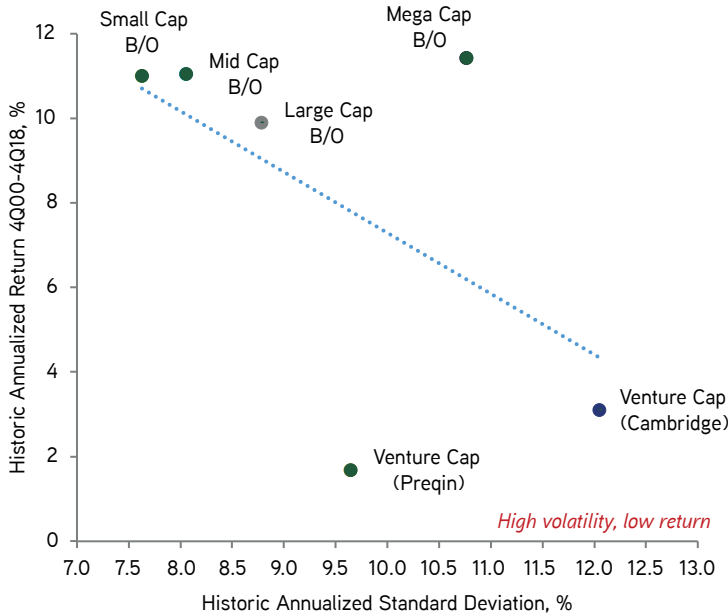
Separately, Growth and Venture Capital investing has become more prominent in larger family offices. Interestingly, though, almost all of the increase we detected came from successful Growth investing, not a big uptick in VC allocations. The reality is that cash flow matters much more to these families than the endowments with whom we speak. Also, access to top managers in this space has been difficult. We do not make this statement lightly, as our research on Venture Capital reinforces our view that it is a truly superb asset class *only* if one can gain access to the best managers. Otherwise, its overall Sharpe ratio is actually not that compelling for most investors relative to Private Equity and even Public Equities (*Exhibit 16*).

EXHIBIT 16

While Top Tier Venture Capital Firms Have Performed Exceedingly Well, the Average VC Firm Has Not Delivered Stellar Risk-Adjusted Returns Relative to Buyouts

Low volatility, high return

High volatility, high return

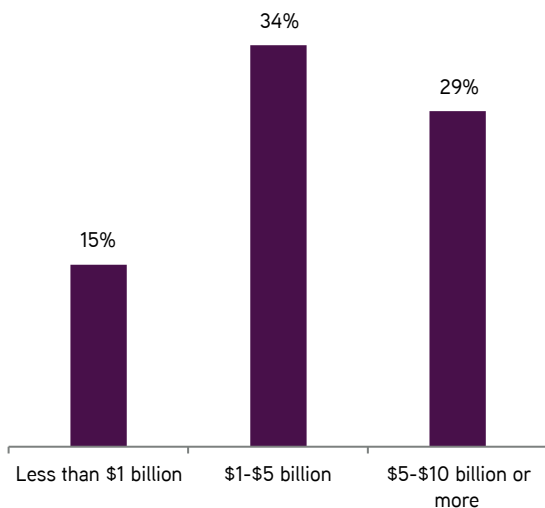


Based on horizon pooled returns net of fees, expenses and carried interest. Data as at December 31, 2018. Source: Cambridge Associates, KKR Global Macro & Asset Allocation analysis.

EXHIBIT 17

As Family Offices Scale, They Tend to Add More to Private Equity

KKR 2020 Family Office Survey: Allocations to Private Equity Based on Assets Under Management, %



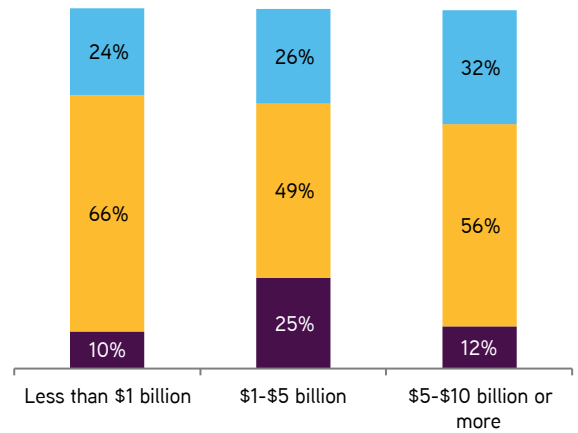
Note: Not exact due to rounding. Data as at December 31, 2020. KKR 2020 Family Office Survey.

EXHIBIT 18

Larger Family Offices Have Added to Their Growth Portfolios in Recent Years

KKR 2020 Family Office Survey: Allocations to Private Equity as a % of Total Based on Assets Under Management

Venture Capital and Growth Buyout Controlled Business

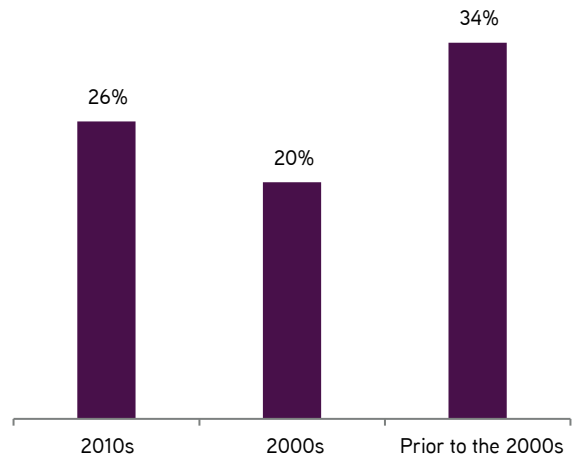


Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 19

Overall, Private Equity Allocations Remain Significant, But...

KKR 2020 Family Office Survey: Actual Allocations to Private Equity Based on Date of Formation of Family Office, %

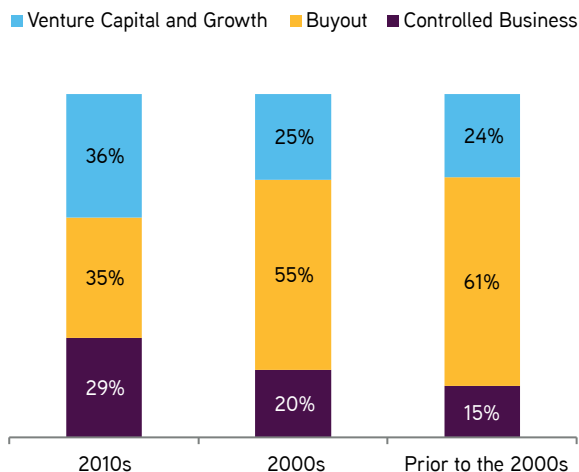


Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

**The reality is that cash flow matters much more to these families than the endowments with whom we speak.**

### ...Newer Family Offices Have Tilted More Towards Growth Funds

KKR 2020 Family Office Survey: Allocations to Private Equity as a % of Total Based on Date of Formation of Family Office



Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

Separately, allocations to Real Estate also enjoyed a hefty increase, jumping to 11% in 2020 from 8% in 2017. As a percentage of total allocation to Alternatives, Real Estate increased 22% in 2020, up from 15% in 2017. According to many CIOs with whom we spoke, this increase was linked not only to the yearn for yield on collateralized assets in such a low rate environment, but also to the diversification benefits of Real Assets in de-risking some of the volatility inherent in other parts of the portfolio, notably Public and Private Equity.

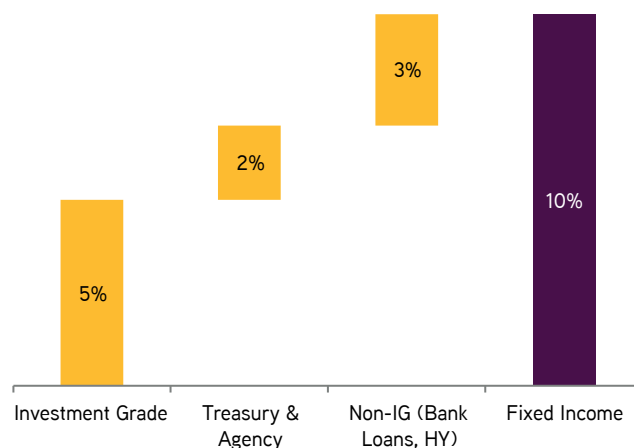
By comparison, the market share of Other Real Assets declined to 2% in 2020 from 3% in 2017. As a result, its weighting as a percentage of total allocations to Alternatives declined to 4% from 6%. While a few commodity bulls do remain, many with whom we spoke had thrown in the towel on the Energy sector and were mainly looking to consolidate positions and/or exit poor investments. Meanwhile, as mentioned earlier, no one has really had any appetite – thus far – to consider Infrastructure as a yield-oriented ESG play.

Outside of Alternatives, we also spent time analyzing the data around the more traditional asset classes. Our findings are as follows:

**Fixed Income** As expected, Ultra High Net Worth families tend to have smaller allocations to Fixed Income. In this most recent survey (unlike in 2017) we were able to drill down and get more granular data. What we learned was that our CIOs have about 5%, or 50% of their total 10% allocation to Fixed Income in Investment Grade debt. Meanwhile, they hold about 2%, or 20% of their total Fixed Income portfolio in Sovereign Debt (e.g., Treasuries, Bunds, etc.). Finally, they keep about 3%, or 30% of their total Fixed Income allocation in Non-Investment Grade bonds like High Yield.

### Fixed Income Tilts Towards Investment Grade, Followed by Bank Loans and High Yield

KKR 2020 Family Office Survey: Allocations to Fixed Income by Sub-Asset Class, %



Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

### Real Estate Was the Asset Class That Was Utilized Most Often in the Hunt for Yield

KKR FAMILY OFFICE SURVEY 2020: WHICH OF THE FOLLOWING ASSET CLASSES HAVE YOU PRIMARILY USED TO INCREASE YIELDS OVER THE LAST THREE YEARS?

RANKING	ASSET CLASS
1	REAL ESTATE
2	PRIVATE CREDIT
3	BUYOUTS
4	DIVIDEND YIELDING EQUITIES
5	BANK LOANS AND HIGH YIELD

Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

**Separately, Growth and Venture Capital investing has become more prominent in larger family offices. Interestingly, though, almost all of the increase we detected came from successful Growth investing, not a big uptick in VC allocations.**

Importantly, having small Fixed Income allocations does not mean that Ultra High Net Worth investors are not interested in yield. Rather, they just seem to be finding income in other areas. As we show in *Exhibit 22*, CIOs suggested that they are now using Real Estate (particularly when not all the income is taxed as ordinary income), Private Credit, and dividend yielding Equities as a substitute for traditional Fixed Income. This strategy actually makes a lot of sense to us, given these investments are more linked to nominal GDP growth. In addition, they also provide greater inflation protection than traditional fixed income offerings.

**Public Equities** As *Exhibit 9* shows, Public Equities remained a substantial part of the overall asset allocation for the family offices we surveyed. Specifically, Public Equities accounted for 31% of the total allocation in 2020, compared to 29% in the 2017 survey. We find this increase unsurprising, given that global equity markets – as measured by the MSCI All World – appreciated a sizeable 69% between the two surveys. What is more surprising to us, though, is that some family offices still have such substantial allocations towards Public Equities. In fact, our data suggests that 32% of survey respondents have 40% or more in Public Equities, while nearly 15% have 60% or greater in just this one asset class.

Though we do not have all the required data streams to measure it perfectly, our conversations with these top chief investment officers led us to believe a large portion of the Public Equity positions are highly concentrated – often the result of initial public offerings, private companies being sold to larger, public competitors, and/or a preference for secular compounders that happen to be public.

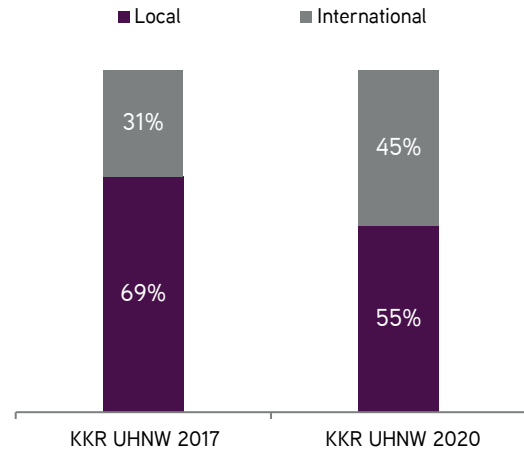
Interestingly, though, as we show in *Exhibit 23*, there has been some movement to diversify away from local markets since our last survey. We are encouraged by this trend, though we still think that there is more work to be done, particularly in some of the accounts that follow less strict asset allocation guidelines. We also note that, as we show in *Exhibit 24*, the older, more established offices have – not surprisingly – had more time to diversify their portfolios away from the U.S., including large concentrated positions.

**CIOs suggested that they are now using Real Estate (particularly when not all the income is taxed as ordinary income), Private Credit, and dividend yielding Equities as a substitute for traditional Fixed Income. This strategy actually makes a lot of sense to us, given these investments are more linked to nominal GDP growth.**

EXHIBIT 23

While Diversification Has Improved, Our Survey Respondents Are Still Heavily Indexed to Their Local Markets

KKR Family Office Survey: Public Equities Breakdown as a % of Total Listed Equities

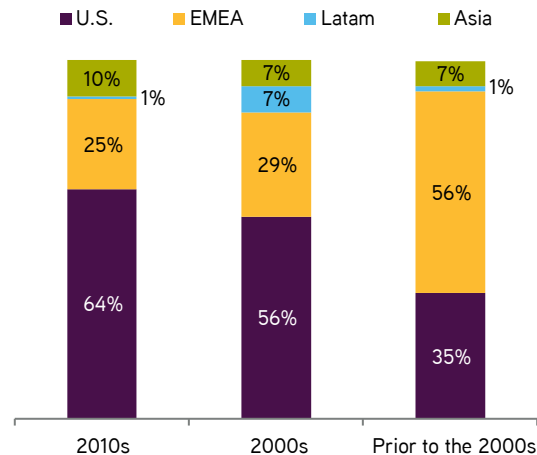


Local is defined as equity market of family office location if the family office invests in Public Equities. Data as at November 30, 2020. Source: KKR 2017 and 2020 Family Office Surveys and KKR Global Macro & Asset Allocation analysis.

EXHIBIT 24

Older Family Offices Appear to Have Less Exposure to U.S. Public Equities

KKR 2020 Family Office Survey: Regional Public Equities Allocation as a % of Total



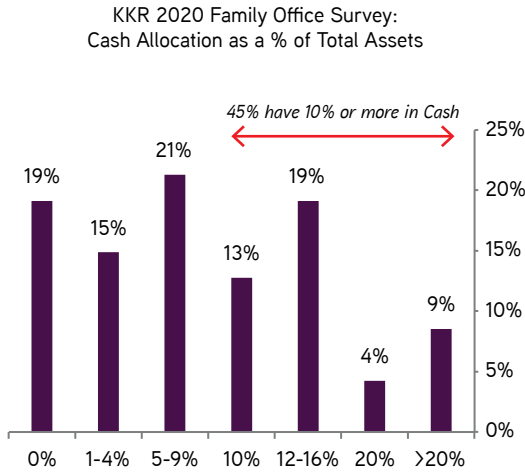
Note: Not exact due to rounding Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.



**Cash** Average cash balances declined, dropping to 9% in 2020 from 10% in 2017. More importantly, in our view, is that some of the 'fat tails' relating to cash balances have also declined. In our 2017 Ultra HNW survey, for example, 34% of the respondents held 15% or more in Cash (with 20% holding 20% or more). By comparison, the number of family offices holding 15% or more in Cash in 2020 declined to 23%, with only 13% holding 20% or more, a significant decline in three years. We also learned that 45% of respondents had 10% or more in Cash, down from 56% in 2017.

**EXHIBIT 25**

**KKR Ultra HNW Clients Have a Large Portion of Their Assets in Cash**



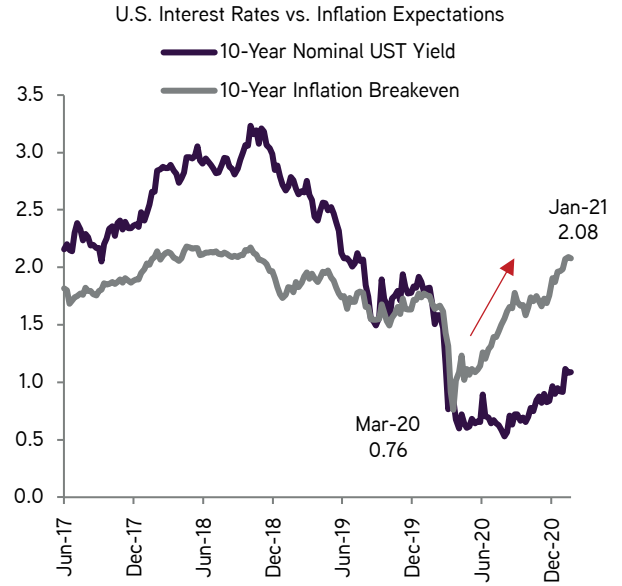
Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

Why are the cash balances generally so high? Some CIOs suggested that they were enjoying the benefits of repayments or prepayments. Others have been beneficiaries of profit windfalls as a result of businesses being sold or merged. However, there were also a meaningful contingency of respondents that wrestled with current valuations, slowing deployment, and others who simply couldn't put the money to work fast enough with the sizeable cash flow being allocated to them on a quarterly basis. To be certain, each program is different, but given such low returns on Cash these days at a time when governments around the world appear to be striving intently to boost inflation, our view is that more time and attention needs to be focused on this area of the portfolio.

**Some family offices still have such substantial allocations towards Public Equities. In fact, our data suggests that 32% of survey respondents have 40% or more in Public Equities, while nearly 15% have 60% or greater in just this one asset class.**

**EXHIBIT 26**

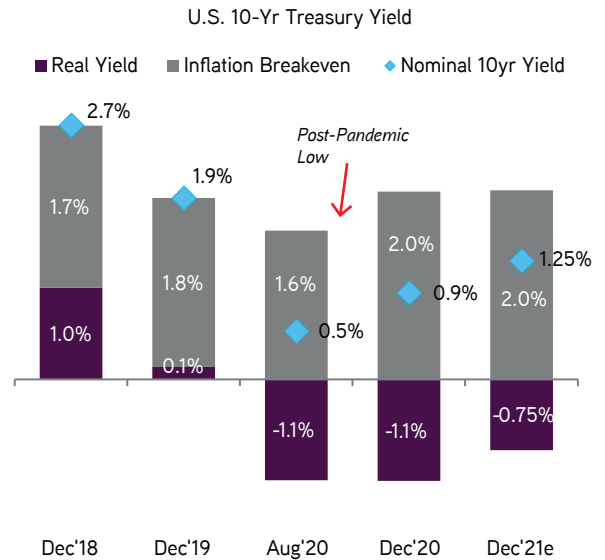
**Higher Inflation Expectations Means the Penalty For Owning Cash Has Increased**



Data as at January 21, 2021. Source: Bloomberg.

**EXHIBIT 27**

**Record Stimulus by the Federal Reserve and Treasury Are Finally Lifting Inflation Expectations**



Data as at December 8, 2020. Source: Bloomberg.

**Family Owned Businesses** In 2020, we learned that only 5% of the families surveyed considered the family operating business as part of their Private Equity allocation. In 2017, although our sample size was more U.S.-centric, we estimated that around 20% of those surveyed owned a family business in their local market. We are the first to acknowledge that these comparisons are tough to make, as many of our conversations and data indicated large public equity holdings in the family enterprise. Hence, our take-away remains that there are often many layers of exposure to the local, family businesses and organi-

zations that run through family offices – some of which may not be fully reflected in the asset allocation game plans we reviewed.

To be clear, we are not in the camp that suggests CIOs should hurriedly sell family businesses just to diversify their holdings. Rather, we are arguing that they are an important risk input that should be clearly factored into diversification targets, risk levels, and return goals – an approach that we do not think is *consistently* embraced by this community of investors.

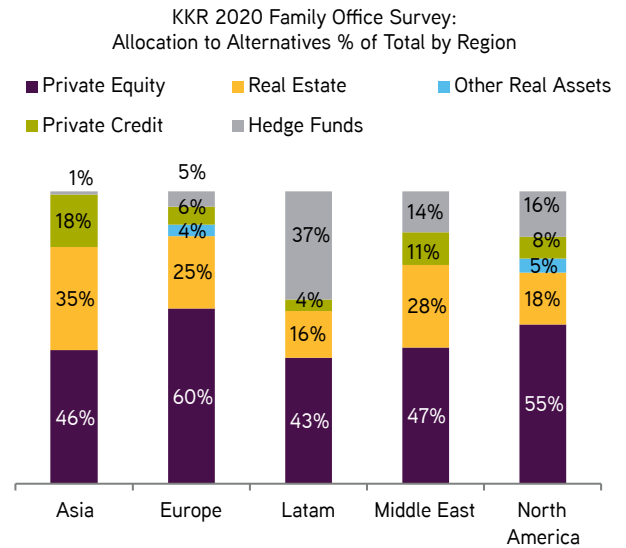
**Regional Insights** In terms of additional regional insights, there were quite a few. One caveat, however, is that sample size was small in some regions, so we tried to focus on the areas with the most robust data and the most significant allocations. To this end, we note the following:

- As one might expect with investment plans that are funded by extremely wealthy entrepreneurs, there are significant regional biases. In Europe, family offices are heavily overweight their local regions, with nearly 40% of the survey respondents allocating 80-100% of total public equity allocations to EMEA stocks. A similar story holds true in the U.S., with nearly 25% of the survey respondents allocating 80% or more of their public equity allocations to U.S. stocks.
- Allocations to Real Estate in Europe rose 100 basis points (from 12% to 13% between 2017 and 2020), compared to a 300 basis point increase for all regions (to 11% in 2020, from 8% in 2017). CIOs suggested to us that European family offices tend to lean into Real Estate a bit more due to the overall attractiveness relative to bonds and equities, particularly given the negative interest rate environment.
- The United States and Europe remain the largest buyers of Private Equity as a percentage of total Alternative allocations at 55% and 60%, respectively. One can see this in *Exhibit 28*.
- As *Exhibit 29* shows, Asia remains the most heavily overweight region for Controlled businesses with family linkages with nearly 80% of Private Equity investments falling into this category. By comparison, Europe is overweight more traditional Buyout Private Equity, while North America has a more balanced mix amongst Control, Buyouts, and Venture Capital and Growth.

**By comparison, the number of family offices holding 15% or more in Cash in 2020 declined to 23%, with only 13% holding 20% or more, a significant decline in three years.**

**EXHIBIT 28**

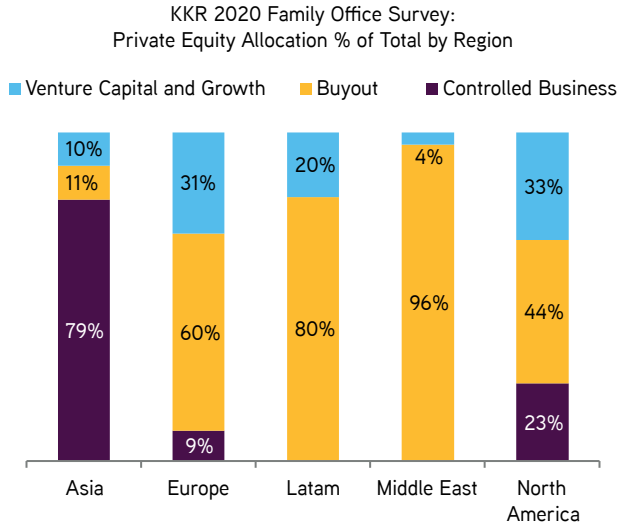
From a Regional Perspective, Asia Is Overweight Real Estate and Private Credit, While Latam Favors Hedge Funds



Data as at December 31, 2020. Source: KKR 2020 Family Office Survey.

**EXHIBIT 29**

We Think the Sizeable Weighting to the Family Controlled Businesses in Asia Ultimately Will Decrease During the Wealth Transfer to the Next Generation



Note: Not exact due to rounding. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

## How does the Ultra HNW asset allocation compare to other players in the market and what does it mean for returns?

As *Exhibit 30* shows, Ultra High Net Worth investors have an asset allocation approach that differs meaningfully from other asset allocators with whom KKR does business, with a heavy reliance on private investments at the expense of listed stocks and bonds being the most notable. We attribute this differentiated positioning to both the absolute size of their capital base as well as the fact that most of our Ultra High Net Worth clients do not have large fixed payout ratios. As such, they have the flexibility to be more singularly focused on capital appreciation rather than preservation. Accordingly, they are increasingly eager to use non-traditional strategies, including direct private investments, to try and generate outsized, idiosyncratic returns. Within their Alternative allocations, they tend to be much bigger in four areas: Private Equity, Real Estate, Hedge Funds, and Direct Lending. Their most comparable peer in terms of reliance on Alternatives would be the endowment community. Specifically in 2020, Ultra HNW allocation to Alternatives was 50%, just 1% above endowments, but fully 27% above global pensions and 24% above High Net Worth families.

As one might expect, the large allocation to Alternatives by Ultra High Net Worth investors translates into lower allocations towards other more traditional assets. For example, our Ultra HNW respondents allocate about 31% of their portfolios to Public Equities, which is meaningfully lower than the 35-50% that pensions, endowments, and HNW individuals typically target.

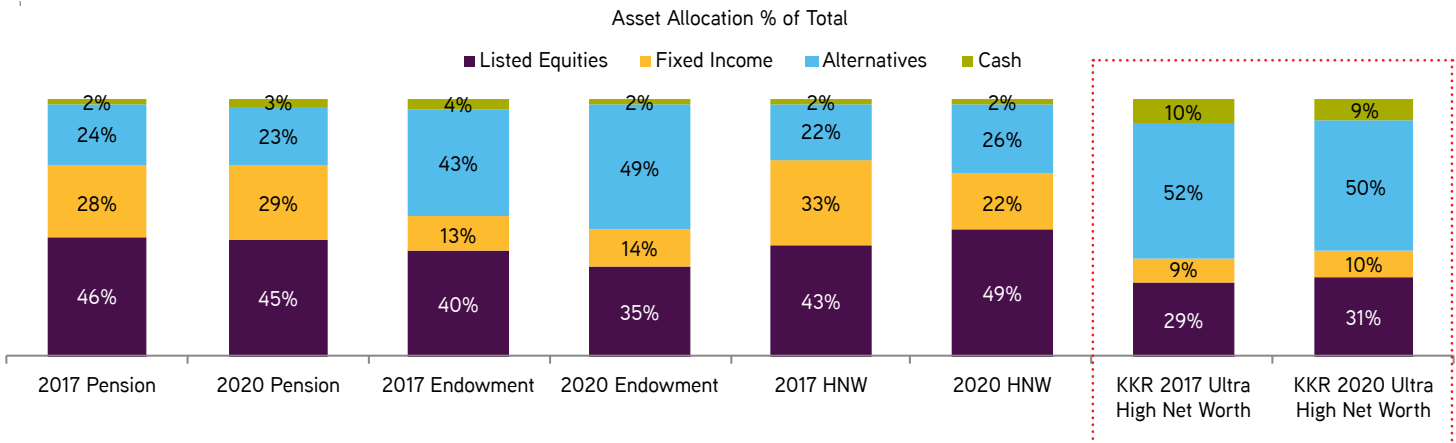
Another key point of differentiation is in regards to the use of Fixed Income. Traditional pensions continue to lean more heavily into this asset class, with nearly 30% of total portfolio allocations dedicated to Fixed Income. As one might guess, we link this heavy allocation to contractual payments guaranteed to beneficiaries of these plans. By comparison – and at the other end of the spectrum – Ultra High Net Worth investors, many of whom have limited contracted annual payments of size, have just 10% of their portfolios in this asset class.

So, what do all these asset allocation strategies imply for forward risk-adjusted returns and what would we suggest as potential tweaks to the Ultra HNW investor’s strategy? Proprietary work done by my colleague Frances Lim suggests that most allocators of capital, including Ultra High Net Worth families, now face a lower return profile over the next five years. One can see this in *Exhibits 31* and *32*, respectively. To begin with, the current environment is one of very high Public Equity valuations, particularly in U.S. Equities. At the same time, many allocators – compliments of robust capital markets in recent years – now have above average allocation of stocks in their overall their portfolios.

If there is a silver lining to generally full valuations as measured by the S&P 500, it is that we are very constructive on active management relative to passive, index based returns. In our view, the alpha potential across many public equity markets should be able to offset some of the beta contraction that Frances is forecasting. Also, from a regional standpoint, the outlook for International Equities appears more compelling than large capitalization U.S. Equities, as starting valuations are lower at a time when the U.S. dollar is weakening. Finally, we believe that the outlook for small cap stocks appears much more attractive than large caps. Key to our thinking is that the pandemic has disproportionately impacted small-to-medium enterprises (SMEs) more than large cap companies. However, historic comparisons suggest that performance of small caps relative to large caps tends to be strong coming off a trough, which is exactly where we think we are in this recovery cycle (*Exhibit 33*).

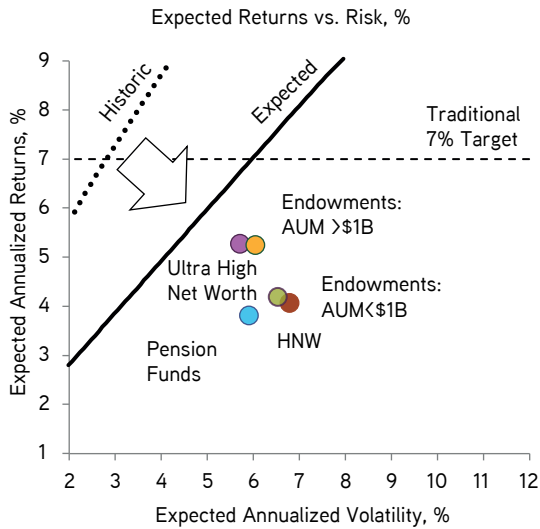
EXHIBIT 30

Because of Their Heavy Allocation to Private Equity, Ultra High Net Investors Continue to Be the Heaviest Users of Alternative Products Across the Pools of Liquidity We Studied



Note: Not exact due to rounding. Data December 31, 2020. Source: Willis Towers Watson, Bank of NY/Mellon, HNW represents the averages of published target asset allocation recommendations for a moderate portfolio from investment management divisions of leading investment banks, KKR 2017 and 2020 Family Office Survey.

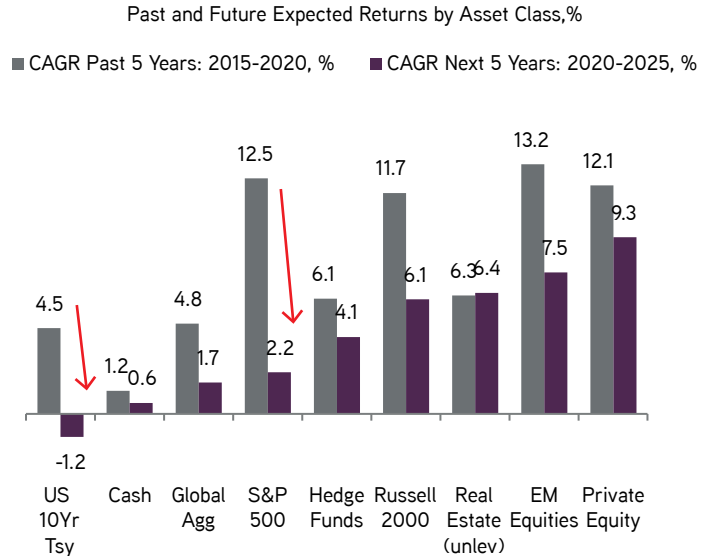
Future Returns Will Be Far Different From Historic Returns, Particularly for Those Who Do Not Adjust Their Asset Allocation...



Expected = estimated next 5 year return using KKR expected returns and current asset allocation. Data as at December 31, 2020. Source: KKR 2020 HNW Survey, BNY Mellon Endowments and Foundations Performance and Asset Allocation Study 2020, Towers Watson Global Pensions Asset Study 2020, HNW represents the averages of published target asset allocation recommendations for a moderate portfolio from investment management divisions of leading investment banks, expected returns estimated by KKR GMAA, KKR Global Macro & Asset Allocation analysis.

**Ultra High Net Worth investors have an asset allocation approach that differs meaningfully from other asset allocators with whom KKR does business, with a heavy reliance on private investments at the expense of listed stocks and bonds being the most notable. They have the flexibility to be more singularly focused on capital appreciation rather than preservation. Accordingly, they are increasingly eager to use non-traditional strategies, including direct private investments, to try and generate outsized, idiosyncratic returns.**

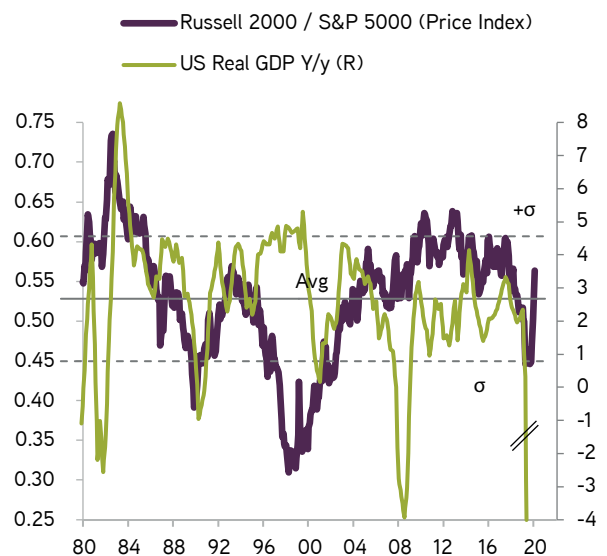
...As Future Equity and Bond Return Will Be Much More Challenging Than in the Past



Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

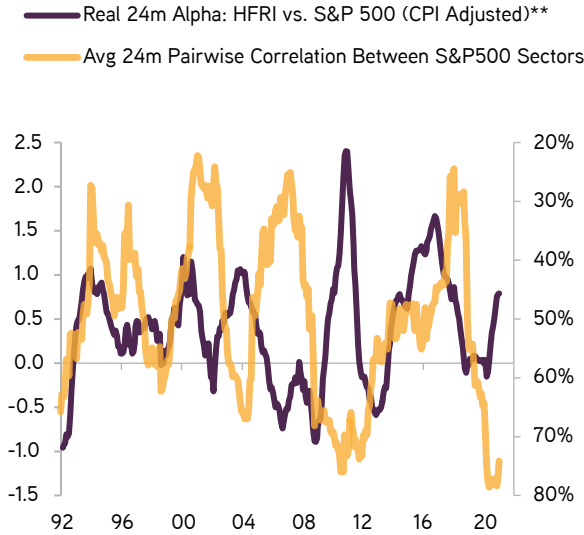
Meanwhile, the bond market provides its own challenges to asset allocators, as yields are at record lows. Compliments of heavy central bank intervention and record fiscal stimulus, breakeven inflation expectations are also rising in many instances, including the United States. Hence, in several scenarios we can envision, future returns for bonds could turn negative as interest rates rise over the next five years, with little yield to offset the duration impact.

If History Is Any Guide, Small Cap Stocks Are Likely to Outperform Off the Trough



Data as at December 31, 2020. Source: Bloomberg, Bureau of Economic Analysis, Haver.

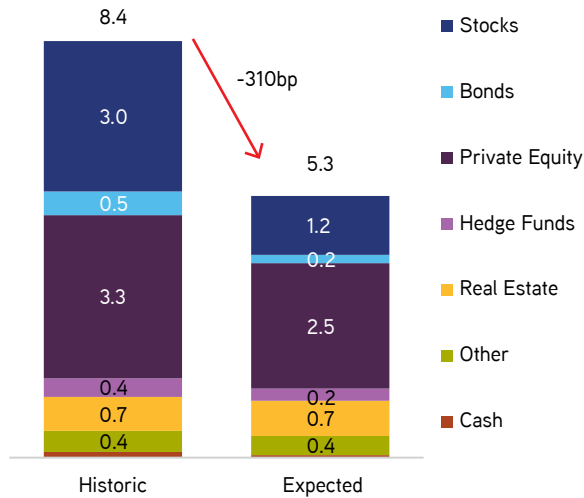
Hedge Fund Alpha Tends to Rise As Dispersion Across Stocks and Sectors Declines



Data as at December 31, 2020. \*\* HFRI returns inflation adjusted, and re-centered. Source: S&P, Bloomberg, KKR Global Macro & Asset Allocation analysis.

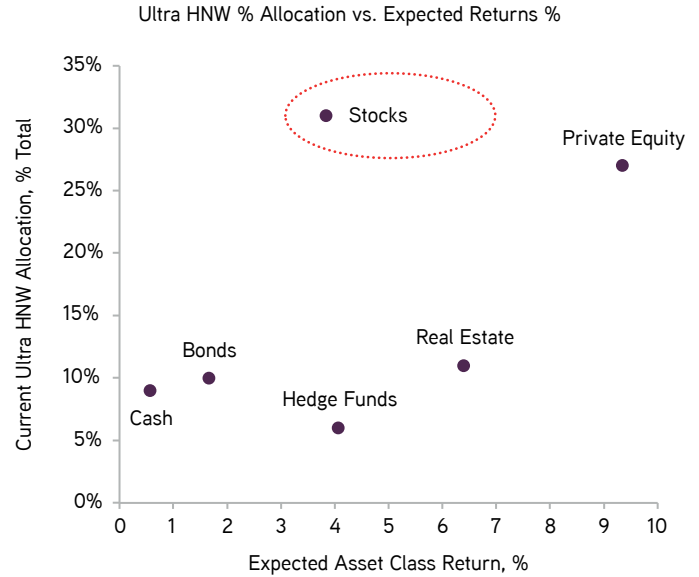
Ultra HNW Investors Have Less Exposure to Traditional Asset Classes; However, Exposure to Listed Equities and Liquid Fixed Income Could Be a Drag on Future Returns

Ultra HNW Expected Return Based on Current Allocation, and Historic vs. Expected Return, %



Note: Historic = estimated past 5 year annualized return using historic benchmark returns and the current asset allocation; Expected = estimated next 5 year return using KKR expected returns and current asset allocation. Assumed "Other" is an equal weighted mix of Real Estate, Private Equity, Infrastructure, and Hedge Funds. Data as at December 31, 2020. Source: KKR 2020 HNW Survey, KKR Global Macro & Asset Allocation analysis.

The Mismatch In Allocation Is in the Outsized Stock Allocation Relative to Expected Returns



Note: KKR expected returns over the next 5 years. Data as at December 31, 2020. Source: KKR 2020 HNW Survey, KKR Global Macro & Asset Allocation analysis.

So, against this backdrop of high multiples and low rates, we – unsurprisingly – see next five year returns lower across almost all asset classes that we track. However, we expect a pretty notable dispersion amongst forward looking returns. For example, U.S. large cap Equities could see an 82% decline in expected returns to 2.2% from 12.5% over the previous five years, while global bond returns could decline 65% to 1.7% from 4.8%. However, not all five year outlooks show this much reversal as there are still what we view are a solid, core group of asset classes that could likely return above five percent each year, including U.S. Small Caps, Emerging Market Public Equities, Real Estate and Private Equity.

**So, against this backdrop of high multiples and low rates, we – unsurprisingly – see next five year returns lower across almost all asset classes that we track. However, we expect a pretty notable dispersion amongst forward looking returns.**



So, unless Ultra HNW allocations evolve to respond to the new environment that we envision, returns could fall 310 basis points to 5% annually in the five years ahead (*Exhibit 35*). While this decline might seem severe, the Ultra HNW community is actually better positioned at the aggregate level relative to many other players in the market. For example, Frances' work suggests that pension funds could see a 400 basis point drag to returns, while endowments below \$1 billion could see a 420 basis point fall – largely due to their outsized allocations to listed Public Equities at 45% relative to Ultra HNW at 31%.

**EXHIBIT 37**

In Terms of Asset Classes, Large Cap Stocks and Bonds Could See the Largest Decline in Returns

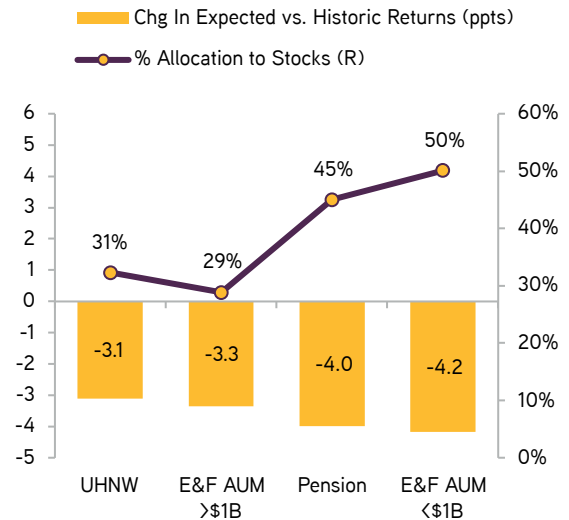
	HISTORIC ANNUALIZED RETURNS	NEXT 5 YEAR EXPECTED RETURNS	% CHANGE
S&P 500	12.5	2.2	-82%
BONDS	4.8	1.7	-65%
CASH	1.2	0.6	-52%
RUSSELL 2000	11.7	6.1	-48%
EM EQUITIES	13.2	7.5	-43%
HEDGE FUNDS	6.1	4.1	-33%
PRIVATE EQUITY	12.1	9.3	-23%
REAL ESTATE	6.3	6.4	2%

Historic = estimated past 5 year annualized return using historic benchmark returns and the current asset allocation; Expected = estimated next 5 year return using KKR expected returns and current asset allocation. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

**If there is a silver lining to generally full valuations as measured by the S&P 500, it is that we are very constructive on active management relative to passive, index based returns. In our view, the alpha potential across many public equity markets should be able to offset some of the beta contraction we are forecasting.**

**EXHIBIT 38**

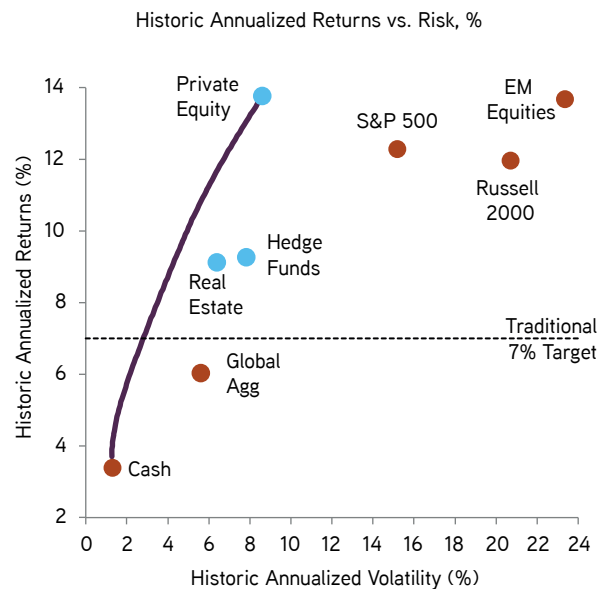
The Hit to Future Returns, Given Current Allocations, Is Likely Less Severe for the Ultra HNW Due to Lower Allocation to Listed Equities



Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

**EXHIBIT 39**

Historic Returns Across Most Asset Classes Have Been Quite Robust, But...

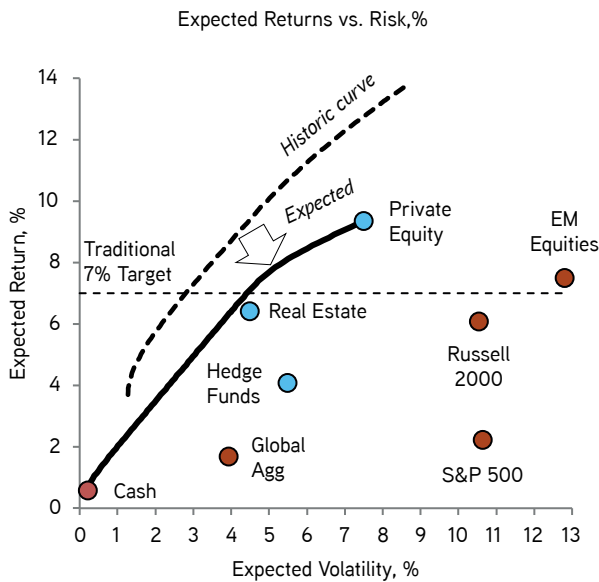


Note: From 1Q86 to 4Q20 where data is available, deemphasizing 2008 and 2009 returns at one-third the weight due to the extreme volatility and wide range of performance, which skewed results. Using MSCI AC World Gross USD for Listed Equities; Barclays Global Agg Total Return Index Unhedged USD for Fixed Income; Cambridge Associates Global Private Equity for Private Equity; HFRI Fund Weighted Composite Index for Hedge Funds; and Barclays US T-Bills 3-6 Months Unhedged USD for Cash. Source: Bloomberg, MSCI, Cambridge Associates, KKR Global Macro & Asset Allocation analysis.

To mitigate these potential declines in earnings power, we think that there will likely need to be an even more substantial upward allocation towards higher returning asset classes, including Private Equity, Real Estate, Emerging Market Equities, and Small Cap Equities. One can see this in *Exhibit 40*. Meanwhile, as bonds are now less effective as a diversifier, we expect increased use of more creative vehicles for generating diversification, particularly Hedge Funds, which should do well amidst wide dispersions. Also, income producing asset classes such as Real Estate and Infrastructure should also gain performance momentum, we believe. Finally, as mentioned earlier, we think that a shift towards active management, international Public Equities (both developed and developing) and Small Cap Equities should help bolster returns.

**EXHIBIT 40**

...Future Returns Are Likely to Be More Modest



Note: Historic return equals past five years; Expected return equals next five years. Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

**To mitigate these potential declines in earnings power, we think that there will likely need to be an even more substantial upward allocation towards higher returning asset classes, including Private Equity, Real Estate, Emerging Market Equities, and Small Cap Equities.**

**SECTION IV**

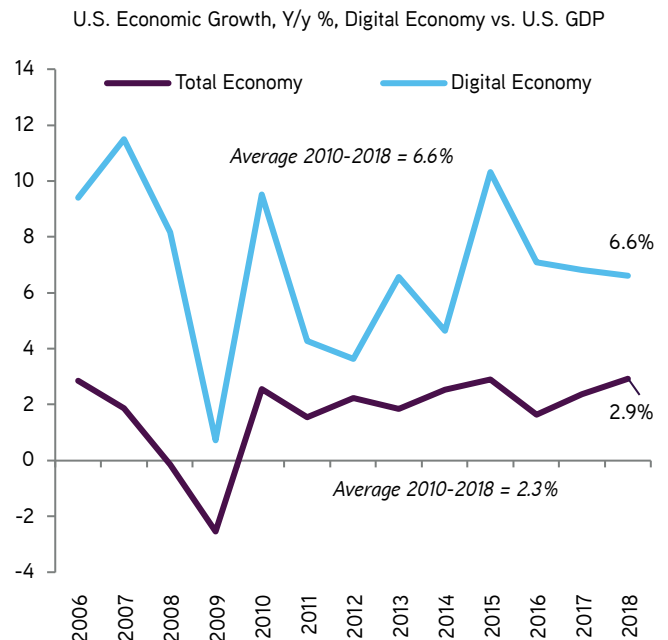
**Where do they see opportunity and what are areas of concern?**

*"I skate to where the puck is going, not where it has been."* Wayne Gretzky, the Great One

As we mentioned earlier, Ultra HNW families are dedicating more time and attention to finding "where the puck is going". Larger capital bases now make it harder to deploy in niche strategies, and as such, more CIOs are increasingly using top-down themes to gain an edge. Notably, many of the areas where "the puck is headed" are not represented within major benchmark indices. Consistent with this shift in strategy, most of our conversations about investing themes were focused on big ideas, including corporate carve-outs, the impact of millennials across all regions, Asia as a growth destination, and secular growth stories in Healthcare/Technology. Readers of our work know that at KKR we too share similar optimism about many of these themes, particularly around investing behind secular compounders (*Exhibit 41*) and the rise for the global millennial (*Exhibit 42*). It was clear to us that thematic investments also served the purpose of helping to bypass staffing issues, aided in filling gaps in expertise or knowledge, and/or helped with positioning one's portfolio for long-term trends outside of traditional fund vehicles.

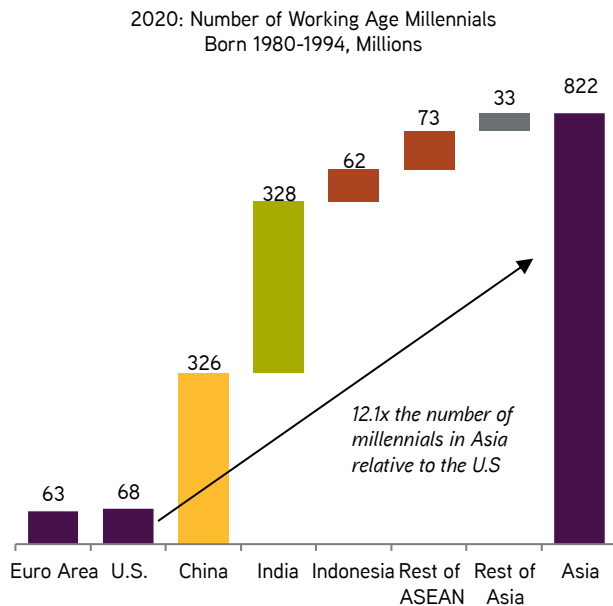
**EXHIBIT 41**

Digitalization Has Become a Key Driver of Economic Growth



Data as at August 31, 2020. Source: Bureau of Economic Analysis, Cornerstone Macro.

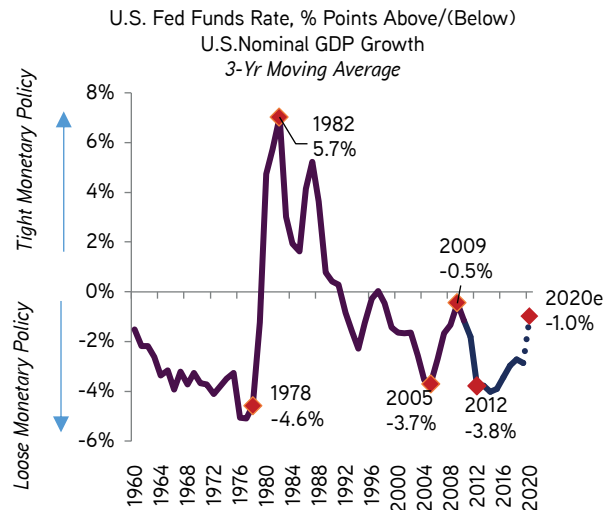
With More than 6x As Many Millennials in Asia than in U.S. and Europe Combined, the Asian Millennial Will Reshape the Global Consumer Market



Data as at October 13, 2020. Asia includes China, India, Japan, Hong Kong, Korea, and ASEAN (Indonesia, Malaysia, Philippines, Thailand, Singapore, and Vietnam). Source: United Nations World Population Prospects, Haver Analytics.

That said, there were areas of divergence. Specifically, given the current backdrop of low rates and high money supply growth, we are probably more bullish on collateral based cash flows as a steady liquidity buffer than the CIOs with whom we spoke. One can see the significance of the macro set-up in *Exhibit 43*, which shows we have entered an unusual time where central bankers are holding nominal interest rates well below nominal GDP to try to inspire some inflation. As such, we are distinctly more overweight collateral-based cash flows (e.g., Infrastructure, Asset Based Finance, parts of Real Estate) than many of the family offices with whom we engaged. Importantly, we do not think that products like Infrastructure have to be stodgy and low return. In fact, we have found a lot of opportunity in areas such as fiber infrastructure, which we view as a direct play on growth in data, and alternative energy and water. We also believe that the Infra space is increasingly utilizing innovation and technology for ESG type investments that meet the goals and objectives we are striving to support within our portfolio construction framework.

The Strategy to Reflate Is Based on Holding Nominal Interest Rates Below Nominal GDP



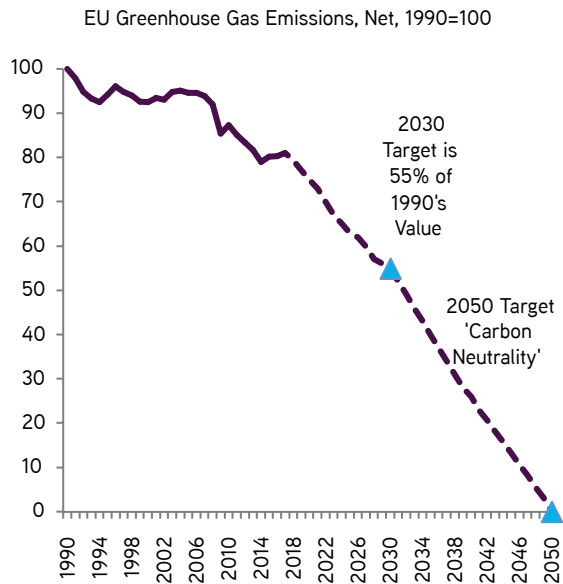
Data as at September 30, 2020. Source: BEA, Federal Reserve, Haver Analytics.

So, it feels like there is more opportunity to increase investments that back ESG initiatives than what surfaced in our survey, we believe. When asked, some CIOs mentioned it was an area of focus, but several still see it more as an emerging opportunity than a mainstream one. That said (and in line with the progress on the Paris Agreement), European CIOs were definitely the most eager amongst the bunch to invest behind ESG-related ideas. Meanwhile, in other regions, we do believe sustainable investing is being approached through greater interest in and focus on Growth investing, particularly as it relates to saving resources and improving efficiency and productivity.

**Importantly, we do not think that products like Infrastructure have to be stodgy and low return. In fact, we have found a lot of opportunity in areas such as fiber infrastructure, which we view as a direct play on growth in data, and alternative energy and water.**

EXHIBIT 44

Europe Is Working Towards Broader 2030 and 2050 ESG Targets



Data as at July 31, 2020. Source: Eurostat.

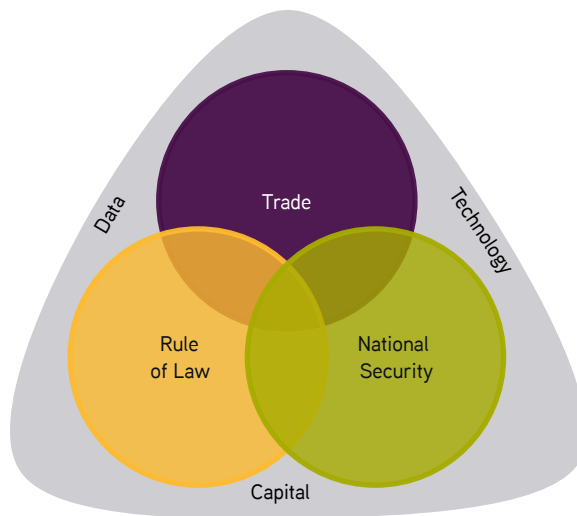
Interestingly, when it comes to market concerns, CIOs indicated that there were plenty of issues to worry about – despite their overall positive bias towards risk assets. An increase in social tensions globally, leading to heightened levels of uncertainty, was a definite worry of the CIOs with whom we spoke. They were also concerned about being overly biased towards the U.S. if its global economic leadership position is diminished. Also, as *Exhibit 50* shows, CIOs responding to our survey shared similar long-term concerns around the U.S.-China relationship and the retreat from globalization that the CEOs who participated in the recent U.S.-China Business Council study expressed. We don't disagree, given the blurring of lines between traditional trade, rule of law, technology, supply chains and national security (*Exhibit 45*). Yet, while we do believe that a 'new' cold war between the United States and China is unfolding, we also want to suggest that this relationship is likely to look quite different from the U.S.-Russia relationship during the 1947-1991 period. Key

**CIOs responding to our survey shared similar long-term concerns around the U.S.-China relationship and the retreat from globalization that the CEOs who participated in the recent U.S.-China Business Council study expressed.**

to our thinking is the fact that the U.S. and China are much more tied together economically than during prior periods of super-power confrontation (*Exhibit 47*).

EXHIBIT 45

National Security Is Now Bundled With Rule of Law and Trade Negotiations

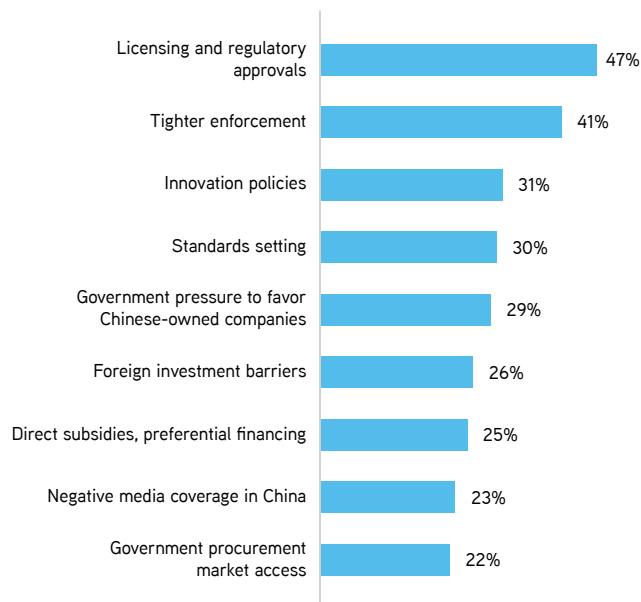


Data as October 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

EXHIBIT 46

Global Multinationals Are Having a Harder Time Navigating the Business Environment in China

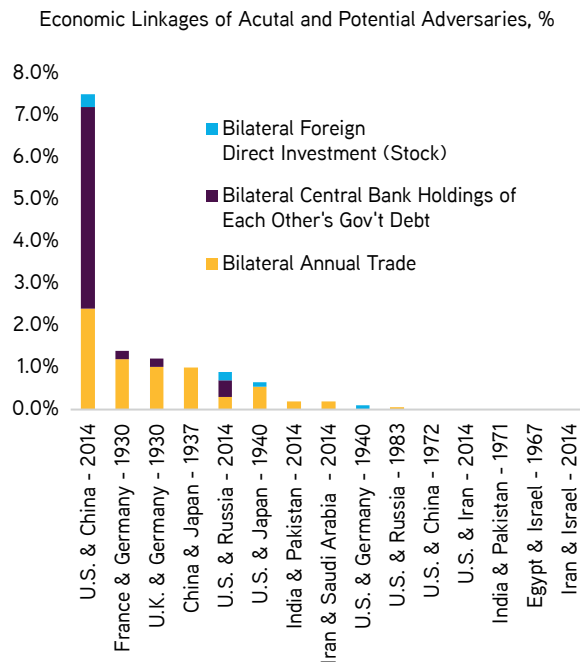
What Are the Most Important Concerns of Operating in China These Days?



Data as at June 30, 2019. Source: U.S.-China Business Council Member Survey.

EXHIBIT 47

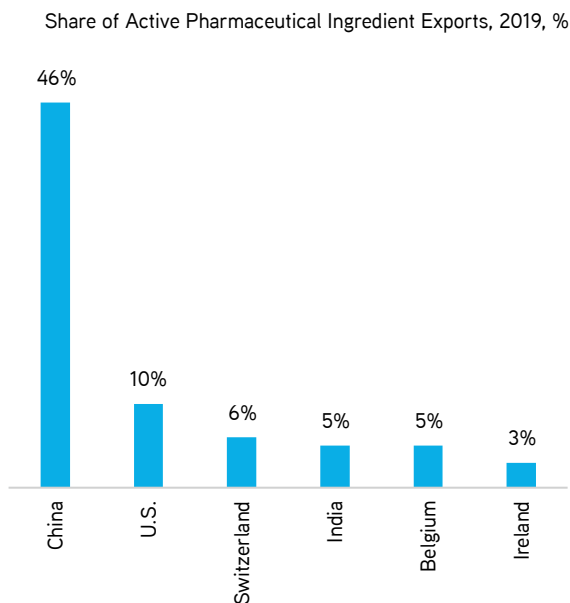
The U.S. and China Currently Have Much Deeper Economic Linkages Than Many Traditional Adversaries Throughout History



Data as at December 31, 2016. Source: JPM Asset Management, UNCTAD, World Bank, UN, U.S. Treasury, Baribieri/Keshk COW Trade data, U.S. Trade Representative Office, Setser (CFR), Bank of England, St. Louis Fed, Eichengreen (Berkeley), Howson (Princeton), East-West Center, O'Neill (CNA), Ritschi (LSE) Accominotti (LSE), Wilkins (FIU), Villa (CEPII).

EXHIBIT 48

However, Supply Chains in Key Areas Such As Pharmaceutical Production Are Now Being Viewed As National Security Issues



Data as at December 31, 2019. Source: Goldman Sachs.

So, where do we go from here and how to play it? Our base view is that the U.S. will stay tough on China under a Biden administration. However, we do expect some differences with the previous administration. First, we believe that President Biden may trade some of former President Trump's tariffs for other concessions from China, such as in regards to climate change. The reality is that the tariffs are unpopular in both countries, and former President Trump's trade policies have not prevented China from actually growing its market share in exports.

Second, we think that President Biden will likely pursue a coalition of the willing strategy, trying to foster a better rapport across not only the public and private sectors within the United States, but between the U.S. and its global counterparts as well. Also, expect less noise from a President Biden Administration than from former President Trump's.

If we are right about our China worldview, then the best way to hedge is to get long our intensifying domestication theme (see *2021 Outlook: Another Voice*). Defensive currencies such as the yen also likely make sense. Finally, our bias remains to embrace capital structures that can withstand a more unsettled geopolitical environment than in the past.

EXHIBIT 49

Geopolitical Risk and Cycle/Recession Risk Is Also Top of Mind for Many

KKR 2020 FAMILY OFFICE SURVEY: WHAT MACRO RISK FACTOR CONCERNS YOU FOR 2020 AND BEYOND?

RANKING	RISK FACTOR
1	GEOPOLITICAL
2	END OF CYCLE / POTENTIAL RECESSION
3	INFLATION/DEFLATION
4	IRRATIONAL EXUBERANCE
4	BONDS NO LONGER BEING A PORTFOLIO SHOCK ABSORBER IN TIMES OF HEIGHTENED VOLATILITY

Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

**Our base view is that the U.S. will stay tough on China under a Biden administration. However, we do expect some differences with the previous administration.**



The Trade War and Retreat from Globalization Were Viewed As Most Impactful Post 2020

KKR 2020 FAMILY OFFICE SURVEY: WHAT GEOPOLITICAL ISSUES POTENTIALLY HAVE THE BIGGEST IMPACT FOR YOU IN 2020 AND BEYOND?

IMPACTFUL?	YES	NO
U.S. / CHINA TRADE WAR (COLD WAR)	59%	41%
RETREAT FROM GLOBALIZATION	50%	50%
U.S. PRESIDENTIAL ELECTION	30%	70%
TECHNOLOGY AND SUPPLY CHAINS AS NATIONAL SECURITY ISSUES	23%	77%

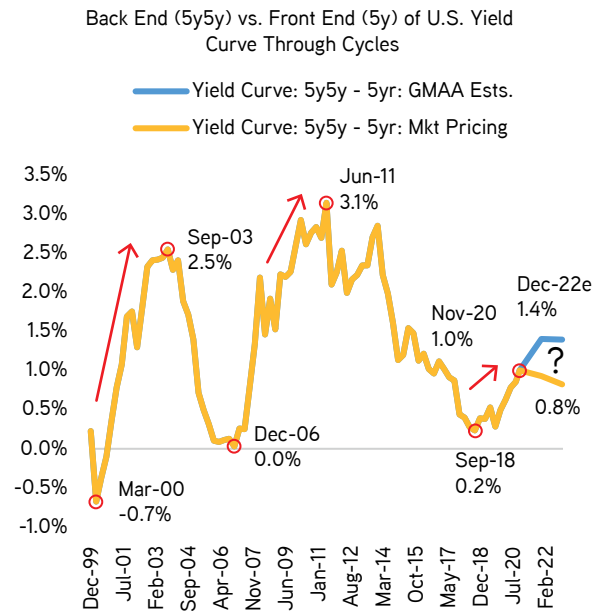
Data as at December 31, 2020. Source: KKR Global Macro & Asset Allocation analysis.

Separately, we heard a lot of concern around currency risks and high valuations. On the former, we are strongly of the view that the dollar will eventually resume weakening. If we are right, then risk of unintended principal loss could be a real issue that CIOs may need to spend more time on. Without question, currency hedging takes time and resources, but it can add or detract a lot of value. Just consider that nearly one third of all long-term EM Equity returns come from currency.

On the latter risk (i.e., valuations), our dialogues with leading CIOs underscore the importance of adjusting for and having a view on the direction of interest rates. As we show in *Exhibit 51*, we do think rates will increase modestly over the next few years. We also concur that the consensus is too sanguine about the potential for this increase (*Exhibit 52*). However, we do not see a spike occurring in rates, which gives us greater conviction to believe in further upside to equity prices in the near-term. In fact, as we detailed in our 2021 Outlook, we see fair value for the S&P 500 of around 4,100 in 2021, driven not only by strong earnings growth but also by our belief that low rates will provide a tailwind for keeping trading multiples at elevated levels again in 2021. Maybe more importantly, the potential for the Russell 2000 and International Equities, including Emerging Markets, appears quite compelling during the next 12-24 months, we believe.

**Maybe more importantly, the potential for the Russell 2000 and International Equities, including Emerging Markets, appears quite compelling during the next 12-24 months, we believe.**

We Expect More Curve Steepening Than What Is Currently Priced In



e = KKR Global Macro & Asset Allocation estimates. Data as at November 30, 2020. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Pulling the Pieces Together, We Target a U.S. 10-year Yield of 1.25% in 2021 and 1.50% in 2022

	MARKET PRICING			GMAA ESTIMATES		
JAN-21A	1.03%	0.41%	1.70%	1.03%	0.41%	1.70%
DEC-21E	1.23%	0.66%	1.70%	1.25%	0.70%	2.00%
DEC-22E	1.43%	0.93%	1.70%	1.50%	0.85%	2.25%

e = KKR Global Macro & Asset Allocation estimates. Data as at January 27, 2021. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

While it did not show up in the survey results, our conversations with CIOs around Real Estate underscored that family offices were adversely impacted by the onset of COVID-19. Remember, allocations to Real Estate shifted substantially to 11% in 2020 from 8% in 2017. Our impression is that managing Real Estate directly, particularly outside of one's own market, has proved to be more difficult than expected for some family offices. As such, we expect the majority of the family offices with whom we spoke to move more towards a fund and co-invest model and/or potentially trim back this heightened allocation.

## Conclusion

*I got tired of playing other people's songs.* Gregory LeNoir Allman

Similar to legendary musician Gregg Allman, the Ultra High Net Worth families in our survey no longer want to take a back seat or passive role in managing the future of their 'business.' Rather, they too want to craft their own narrative by executing their own playbook in the investment management industry. In particular, their CIOs are using both their investment prowess and increased buying power in the market to create differentiated outcomes. In our view, this is not an aberration, but the beginning of a secular trend.

A key point of differentiation for this subset of the market is the combination of their long-term assets *and* their limited liability set. Indeed, in a world where low rates have ballooned the value of future liabilities, this skew of long-duration assets relative to short-term liabilities is a distinguishing feature. Not surprisingly, it is reflected in CIOs' heavy allocation to Alternatives, particularly multiple forms of Private Equity.

However, there is more work to be done, particularly around diversification of portfolios, within the Ultra High Net Worth segment of the market. We also think that more processes and measurement needs to be put in place at several of the family offices with whom we spoke for our survey. Sourcing too will become even more valuable, particularly as distributions accelerate the way we think they will for many family offices over the next three to five years.

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Overall, though, while we do look for absolute returns to fall across this segment of the market at the aggregate level, we believe that thoughtful asset allocation as well as effective manager/security selection can lead to differentiated outcomes for the Ultra High Net Worth investor. We also think that the nimbleness and creativity of the CIOs with whom we spoke will serve them well in the macro-economic environment we believe we are entering. In the end, those who compound their capital most effectively are best poised to succeed. Indeed, as Benjamin Franklin so aptly suggested "Money makes money. And the money that money makes, makes money."



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