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QUARTERLY INVESTMENT PERSPECTIVES: **Q4 2023**

Third Quarter Review

The stock market was quiet for most of the summer until hitting a pocket of volatility in September, with the S&P 500 falling (4.77%) over the last month. The large cap index ended the quarter down (3.27%), but remains in positive territory YTD, with a total return of 13.07%. Mid and small cap stocks experienced greater volatility than large caps, falling (5.02%) and (5.89%) respectively, during the quarter. Total returns for mid and small cap stocks have lagged their large cap brethren this year, with the Russell Mid Cap index returning 3.91% and the Russell 2000 index of small cap companies returning 2.54%. Large caps have benefitted uniquely from the returns of a select few companies – Nvidia and Tesla, which make up about 5% of the S&P 500 index, have returned 201% and 112%, respectively. Other AI centric stocks, such as Google, Amazon, and AMD, have all returned over 50% this year. It is not so much that small and mid cap stocks have experienced major setbacks this year relative to large cap stocks, they just have not been as much of a benefactor of the artificial intelligence awakening that has occurred.

Fixed income returns remain challenged as volatility in the yield curve persisted. While short-term rates have gradually moved higher as the Fed has hiked rates to 5.5%, intermediate and long-term rates have jumped. The Ten-Year Treasury yield has moved from 3.88% to start the year to 4.59% to end the third quarter. Over the quarter, the Barclays US Aggregate Index fell (3.23%) and is now down (1.21%), YTD. Longer maturity bonds have not only failed to protect investors from volatility in the equity markets, but they have also contributed to downside returns as yields have risen. Despite the volatility in intermediate and long maturity bond markets, we have seen increasing opportunities within the fixed income space as rates have risen, particularly in the short-term maturity part of the market. Short-term Treasuries and areas of corporate credit have been positive this year and are poised to deliver attractive returns over the next year with yields at 5.5%.

In summary, the first three quarters of the year have been positive for stocks and negative for bonds, with more recent volatility in both bond and stock markets being driven by rising yields. Investors are weighing the balance of the Federal Reserve keeping rates higher for longer, rather than hiking rates and then immediately cutting them. While inflation pressures have eased, the economy has remained resilient. Generally, this is a good thing, but it does mean inflation may remain sticky and as a result, the Fed will have to keep rates elevated in order to avoid a rebound in inflation readings.

Investment Market	Q3 - 2023	YTD 2023
U.S. Large Cap Stocks	-3.3%	13.1%
U.S. Mid Cap Stocks	-4.7%	3.9%
U.S. Small Cap Stocks	-5.1%	2.5%
International Developed Stocks	-4.1%	7.1%
Emerging Market Stocks	-2.9%	1.8%
Barclays US Aggregate Bond	-3.2%	-1.2%
Barclays Global Aggregate Bond	-4.0%	-3.2%

Sources: Eaton Vance, as of 9/30/2023

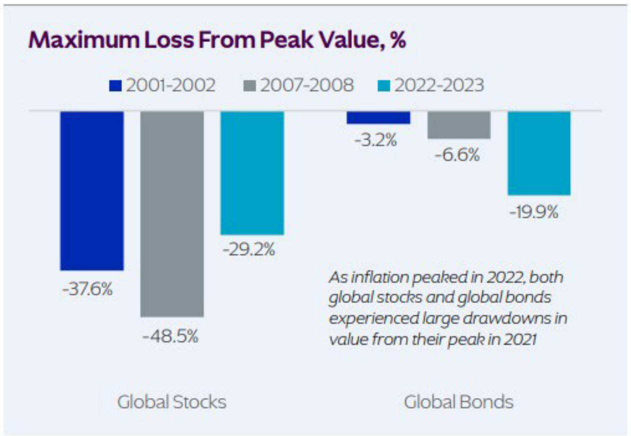
MARKET REVIEW AND OUTLOOK

Bonds Have Not Been a Buffer

Historical data would illustrate that when the stock market experiences a downturn, bonds usually provide a shelter from the storm. In 2008, when the S&P 500 fell (37%), the Barclays US Aggregate Bond index (the Agg) was up 8%. In 2000, at the start of the tech bubble, the S&P 500 fell (9%) while the Aggregate Bond index rose 11.6%. The next two years, from 2001 to 2002, the S&P 500 fell a cumulative (32%). Conversely, the Aggregate Bond index rose 21%. During these recent "risk-off" periods for stocks, bonds not only avoided the drawdown that equities experienced, but they also offered substantial positive returns. Over the last three years, however, bonds have been nothing but a detractor to portfolio returns. According to KKR, the Barclays Agg index has experienced a 19.9% drawdown over the last two years. This represents the worst drawdown on record for the index.

Adding bonds has historically provided stability but during the most recent cycle that has not been the case. The primary reason for this is the fact that the Federal Reserve held rates at zero for a decade after the 2008 financial crisis. Bonds in the current cycle offered minimal coupon return, with significant price risk if the Fed raised aggressively, which is what they did over the last year and a half, going from 0.0% to 5.5%. At the start of previous periods of market volatility (2001 and 2007), the Ten-Year Treasury yielded 5.12% and 4.71%. By comparison, at the start of 2022, the Ten-Year Treasury yielded just 1.52%.
Bonds have been a bust the last two years, but will they still be a detriment to portfolio returns going forward? History tells us that they will not be. In fact, bonds are likely to provide a favorable return to portfolios regardless of what stocks do in the coming year. No matter what the Fed does, we know that a One-Year Treasury will return 5.5% and a Two-Year Treasury will return 5.03% to investors over the next year. If the Fed is done hiking rates, which many assume them to be, intermediate term bonds are poised to provide strong returns based on historical data.

EXHIBIT 21: Historically, Adding Bonds to a Portfolio Would Have Provided Stability Amid Market Turmoil; However, During the Most Recent Cycle That Has Not Been the Case



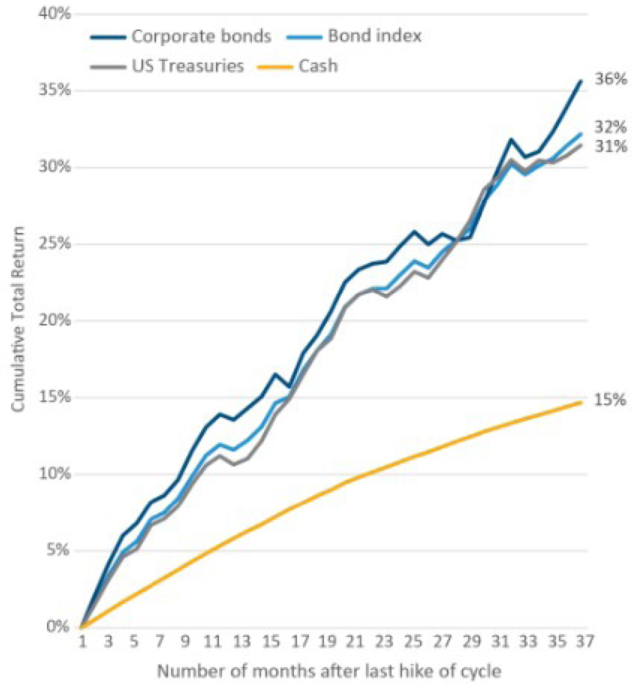
Global stocks proxied using the MSCI World Index, Global Bonds proxied using the Bloomberg Global Aggregate Bond Index. Maximum drawdowns that each index experienced within 3 periods, 12/31/2000 to 12/31/2022, 6/30/2007 to 12/31/2009, and 12/31/2021 - 3/31/2023. Data as at March 31, 2023. Source: Bloomberg, Global Macro, Balance Sheet & Risk analysis.

MARKET REVIEW AND OUTLOOK

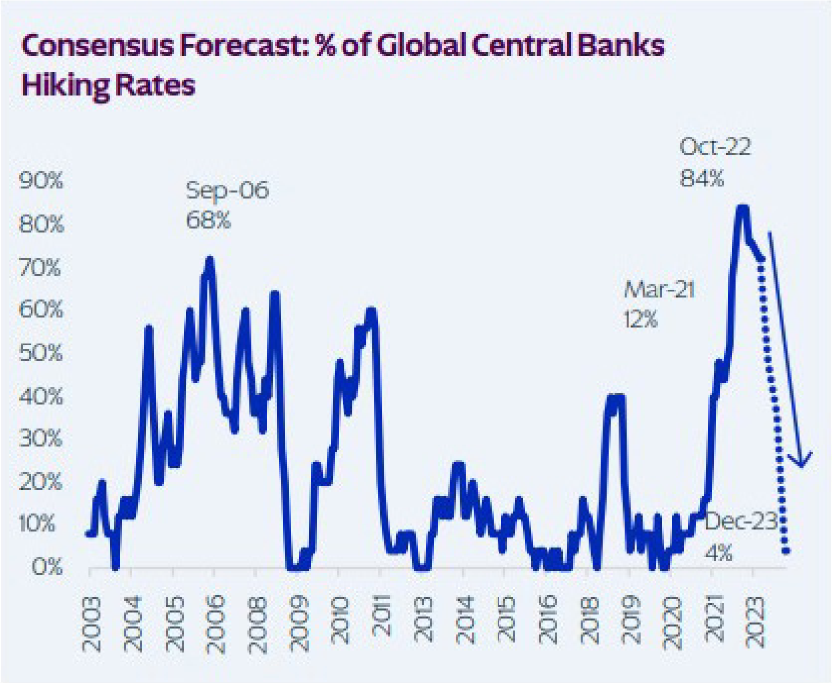
On average, the three year returns for Treasuries and corporate bonds have been over 30% after the Federal Reserve finished their rate hiking cycle. With current yields around 5% and the majority of rate hiking pressure behind us, we are positive on bonds as a portfolio contributor over the next three years. If the economy moves into a recession, they will likely offer price returns above their coupon as the Federal Reserve moves towards cutting rates, which benefits bond prices.

Bond Returns Have Exceeded Cash Returns When the Starting Point Was the *Last* Interest-Rate Hike

Three-year cumulative return after last hike for bond, corporate, Treasury, and cash indices



Note: Each data series represents the cumulative monthly return for three years since the last hike of each tightening cycle.



'Hiking' defined as an increase in the policy rate over the last three months. Uses Bloomberg consensus forecast for top 25 global central banks excluding the Federal Reserve. Data as at May 29, 2023. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

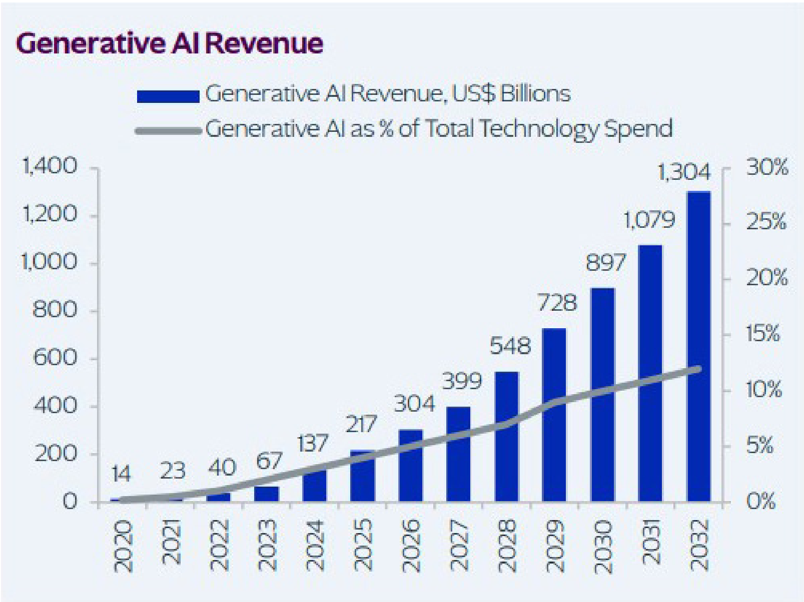
While 83% of global central banks were hiking rates in 2022, just 4% are expected to hike rates at the end of 2023.

MARKET REVIEW AND OUTLOOK

Artificial Intelligence Remains Front and Center

A key driver of equity market returns this year has been the accelerated adoption of artificial intelligence. During the most recent earnings reporting period, AI was mentioned nearly 4x, on average, in a sampling of earnings calls across the S&P 500. That compares with just 0.5x a year ago, a sevenfold increase. While some companies are certainly trying to hitch their wagon to AI hype, the widespread adoption and use cases for the new technology are undeniable. Bloomberg currently estimates that total generative AI revenue will hit $67 billion this year and register around 2.5% of total technology spending. Next year, that revenue number is expected to double to $137 billion.

By 2032, total generative AI revenue is expected to increase to $1.3 trillion dollars and account for over 10% of total technology spending. McKinsey estimates the impact could be even higher, projecting that AI could add the equivalent of $2.6 trillion to $4.4 trillion, annually to the global economy. By comparison the United Kingdom's entire GDP in 2021 was $3.1 trillion. McKinsey notes that four main areas of business - customer operations, marketing and sales, software engineering, and research and development—could account for approximately 75 percent of the total annual value from generative AI use cases. Specifically in life sciences, they note how AI models can generate candidate molecules and accelerate the process of developing new drugs and materials. Whereas the current drug R&D process is a pass-fail funnel process that is highly inefficient given the number of compounds that need initial testing, AI can help more efficiently identify the most promising compounds so that there are fewer starting points in order to achieve the same number of leads.



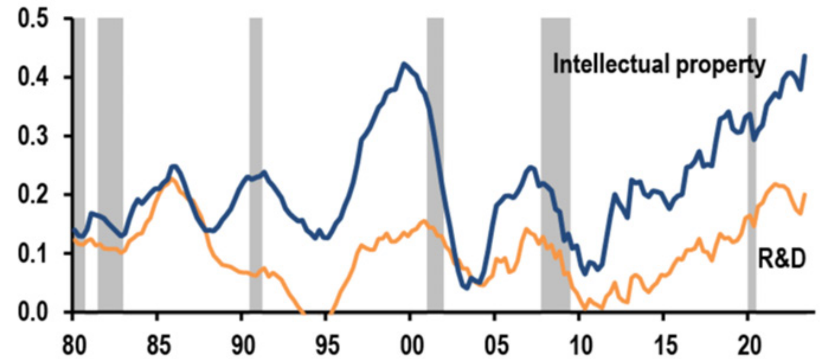
Data as at June 2, 2023. Source: Bloomberg, International Data Corporation.

A more detailed example can help show the benefit of AI within the pharma pipeline. MIT's Technology Review highlighted an older patient with an aggressive form of blood cancer that was resisting treatment from common cancer drugs. Doctors took a small sample of tissue from the patient, then using robotic automation and machine learning models, were able to expose the tissue to hundreds of drug combinations to see what worked most effectively. Instead of putting the patient through multiple months long courses of chemotherapy, automation and machine learning allowed them to carry out an exhaustive search within a very short window of time that effectively treated the patient's cancer.

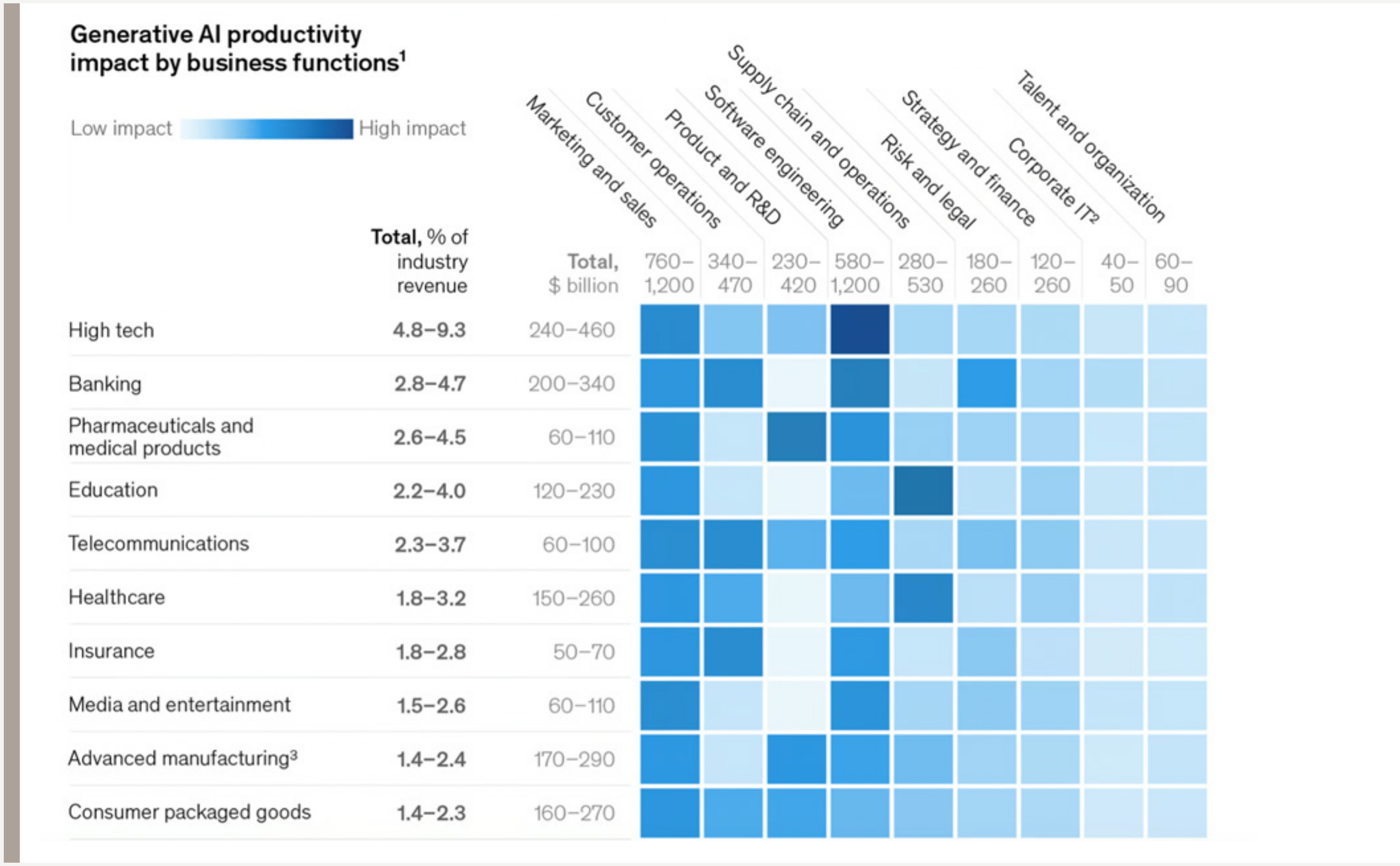
To be certain, the acceleration of artificial intelligence usage has caused concern from both private and public communities. Elon Musk, Sam Altman (the founder of ChatGPT) and others have called for greater scrutiny over how AI is incorporated into everyday life. Left unchecked, there are clearly significant potential problems with AI and thus it is deserving of some moderating as it emerges from infancy. New technology has a history of looking like a threat before widespread adoption occurs and the potential, beneficial use cases are fully fleshed out. Skepticism abounded at the rollout of the internet, and yet today we couldn't imagine life without it. We continue to explore the potential investment implications of artificial intelligence, including its applications within technology companies and as well as areas like biotechnology, that could see not only increased revenue and margin expansion from more efficient, rapid drug development, but also benefit from mergers and acquisitions as larger pharma companies invest in the sector to enhance their pipeline.

Figure 3: Contributions to US GDP growth

%-pt contribution, moving average over 12 quarters



Source: BEA, J.P. Morgan



High tech, banking, and pharmaceutical sectors are poised to see the greatest impact from artificial intelligence.

Chart via McKinsey

MARKET REVIEW AND OUTLOOK

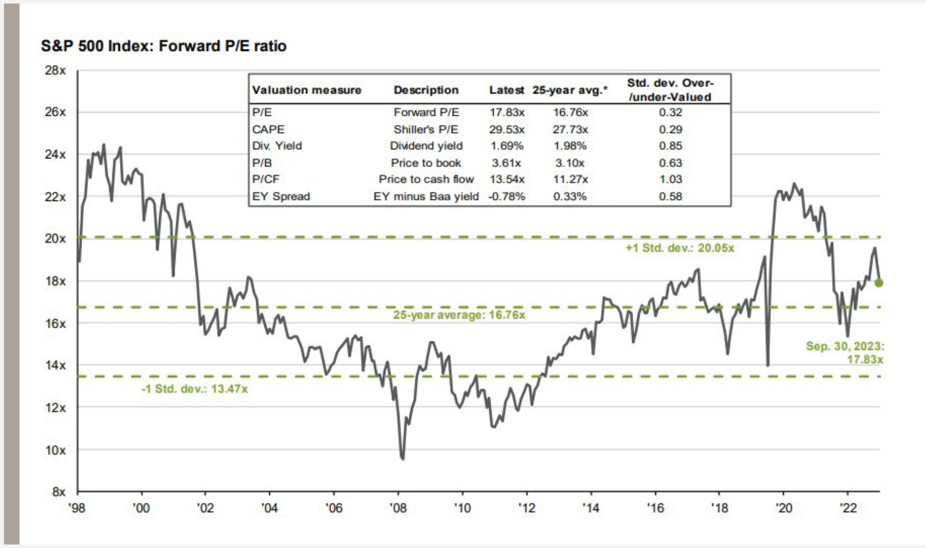
Alternative Assets Under Consideration

Over the last three years, both stocks and bonds have experienced considerable volatility. From the third quarter of 2020 to the present, the Barclays US Aggregate Bond index has fallen (-14.96%). The S&P 500 has gained 34% but it sustained a 24% drawdown last year. Between bonds delivering negative returns, to stocks experiencing their worst calendar year since 2008, investors have had a bumpy ride to navigate and must weigh the balance of return outlooks going forward. As asset allocators, we are constantly weighing the balance of risk and return as we seek to optimize portfolios for each client's short-term financial needs and long-term goals.

As we outlined earlier in our commentary on the bond market, return prospects for fixed income investments are significantly better than they were three years ago when the Federal Reserve had interest rates at zero. U.S. Treasury yields offer near zero risk with a return between 4.5% to 5.5% for bonds held to maturity. Investment grade corporate bonds yield 6.48%, while high yield corporate bonds yield 9.20%. While volatility has been elevated over the last two years, the fixed income portion of an investor's portfolio is offering the best return prospects in over a decade.

Where the question remains is how we reduce risk while maintaining favorable return prospects. Equities have been volatile over the past year but have bounced back in 2023. While the price returns this year have been welcome, it has put the S&P 500's valuation back into above average levels.

A modestly overvalued equity market does not signal an imminent downturn in stocks; however, an above average valuation does tend to correlate with below average long-term returns. With that in mind, we have continued to explore alternative investment allocations within the portfolio as a means of both return enhancement and risk mitigation.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	17.83x	16.76x	0.32
CAPE	Shiller's P/E	29.53x	27.73x	0.29
Div. Yield	Dividend yield	1.69%	1.98%	0.85
P/B	Price to book	3.61x	3.10x	0.63
P/CF	Price to cash flow	13.54x	11.27x	1.03
EY Spread	EY minus Baa yield	-0.78%	0.33%	0.58

Chart via JP Morgan

MARKET REVIEW AND OUTLOOK

KKR has illustrated a variety of asset classes, from cash, to bonds, to stocks, next to a variety of private asset classes such as infrastructure, credit, real estate, and private equity. While projected returns in fixed income have moved higher, projected returns in large cap stocks (as measured by the S&P 500) have moved lower. For clients who have owned private credit and real estate, the benefits of both lower volatility and positive returns that have not been correlated to the equity or bond market have been a beneficial experience.

As we continue to assess private investment markets relative to public investment markets, the following criteria are top of mind:

(1) Liquidity terms: Private investments often require capital to be committed or locked up for a defined period of time. This has benefits as it allows the investment manager to find mispriced securities that are not as closely analyzed by the bigger pool of public market investors and prevents rapid inflows and outflows of money from creating undue volatility within the underlying asset. The downside is that if an investor needs to access their money for a given reason within the lockup period, they must source their funds from elsewhere or pay a penalty fee for redeeming out of the private investment. In analyzing the liquidity of a private investment, we tend to prioritize shorter-term lock up periods for committed capital, while balancing the need for a manager to optimize their cash flows to make the best investments.

(2) Costs: Private investments often carry higher fees than public investments. The traditional model is for a management fee of 2.00% and a performance fee, charged on positive returns, of 20%. By comparison, a Schwab US Large Cap ETF (SCHX) has a fee of

Note: Capital markets assumptions are average across all quartiles annualized total returns. Forecasts represent five-year annualized total return expectations. 'Last five years' through 4Q22 due to limited data availability. For private asset classes (Private Credit, Private Infra, Private Real Estate, and Private Equity), returns are net of Fee/Carry. Note that we have altered our Private Credit methodology to exclude fund-level leverage, which has lowered total return on a go-forward basis. Data as at May 31, 2023. Source: Cambridge Associates, Bloomberg, KKR Global Macro, Balance Sheet and Risk analysis.

0.03%. In analyzing the costs of a private investment, we prioritize a manager who is both competitive on their costs and has a history of demonstrating the ability to generate returns that exceed their cost premium relative to public markets. Top quartile alternative asset managers have historically proven outsized returns and reduced volatility are worth paying higher fees.

(3) Efficiency of the underlying market: as we look at private investments, we favor managers who operate in markets with significant inefficiencies. An example of this is private credit, where the manager is making loans to small- and mid-size businesses who are growing, but don't yet have access to the wide pools of capital that are available to companies with $500 billion in market capitalization. These less efficient areas of the credit market allow investors to have access to greater return streams, while still holding a senior secured credit investment that is backed by a strong balance sheet and cash flows.

MARKET REVIEW AND OUTLOOK

As we continue to tactically manage portfolios, we both acknowledge that traditional stocks and bonds have stood the test of time over many decades and should continue to serve investors well over the long-term. We also recognize the need to adapt to what the current market environment is telling us, which is that an elevated inflation environment, with high interest rates, and stocks at above average valuations is here to stay.

Cheap stocks, rates at zero, and the days of muted inflation do not seem to be coming back any time soon. As a result, we believe it is prudent to explore all the potential options, public and private, that are available to our clients, while maintaining the principles that we have always adhered to when investing – keeping the costs low, aligning with excellent stewards of capital, and taking the least risk possible while trying to meet our client’s return goals.

MARKET REVIEW AND OUTLOOK

Closing Thoughts

Volatility entered back into the stock market during the third quarter, as September brought about a sell-off in both stocks and bonds as intermediate and long-term Treasury yields rose. The prospect of economic growth remaining strong, and inflation being stickier than once thought has brought about a reset in expectations regarding how the Fed will proceed from here. While it was originally assumed that the Fed would cut rates in the back half of this year, that expectation has been pushed out to 2024. It seems we are in a "higher for longer" environment as it relates to interest rates.

While this type of environment is good for savers and those with adequate capital, higher interest rate environments can cause greater pressure on loan markets, consumer balance sheets, and the value of assets, including stocks. This is one of the reasons why, despite positive earnings growth and an economy which has continued to avoid recession, the stock markets fell during the quarter.

As we navigate the rest of the year, we will continue to manage both the short-term risks and the long-term opportunities that have been presented. We believe artificial intelligence remains an intriguing long-term storyline for investing and continue to explore ways in which this will manifest itself in different sectors. We are also continuing to explore areas within private markets for potential investment opportunities that will help investors better manage their balance of risk and return in a tactically diversified portfolio. As always, we thank you for your confidence and look forward to speaking with you soon as it relates to your financial plan.

DISCLOSURES

All data as of 9/30/23 via Bloomberg, Eaton Vance, St Louis Federal Reserve JP Morgan, the Wall Street Journal, and Bloomberg.