

KKR

# Insights

14.5

Global  
Macro Trends  
November 2024

# 2024 U.S. Election

Focus on the Forest, Not the Trees

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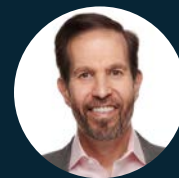
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# 2024 U.S. Election

## Focus on the Forest, Not the Trees

For nine out of the last ten elections, the American people have voted for change. We are in a generational era of political disruption which has accelerated since COVID, challenging incumbent parties around the world. President Trump and the GOP's ability to seize the mantle of change is essential to understanding their historic victory on November 5. Indeed, when responding to exit polls, more than 70% of voters associated incoming President Trump with bringing change, while only 23% did so for outgoing Vice President Harris. What will this change look like for individual investors and institutional allocators of capital, as well as for ordinary citizens in the U.S. and abroad? Without question, now is the time to focus on the forest, not the trees. At KKR, we believe strongly that the next administration will continue to fuel the drivers of our 'Regime Change' thesis from 2021 when the world began to experience a new type of more insular, more fiscally driven asynchronous global recovery. In fact, from our vantage point, last week's election results merely put an exclamation point on the major secular changes happening globally, including more government spending, more competitive and volatile geopolitics, a messy energy transition, and sticky and more uneven inflationary trends that we as a firm have been emphasizing for years. Consistent with this view, we think President Trump's vision for America likely involves faster growth and the tackling of big deficits through less regulation and tax cuts. We also think he will continue the transition away from benign globalization, using a more assertive approach to great power competition

and security concerns. As such, owning more Equity, Infrastructure, Real Estate, and Credit assets linked to nominal domestic GDP growth will become more important to portfolios. We also expect to see more volatility surrounding a steeper yield curve in reaction to the election, given President Trump's policy instincts around, for example, tariffs and immigration. That said, KKR's macro team does not see the long end becoming unglued, as U.S. productivity is surging, and the technical picture remains quite favorable for now. By comparison, Europe and Asia will likely face a combination of both challenges and opportunities, many of which will no doubt be based on what President Donald J. Trump refers to as 'the art of the deal.' Deregulation, too, will likely be a tailwind, potentially fueling M&A and other forms of capital markets activity. Against this backdrop, we believe the implications for asset allocation and portfolio construction are profound. Our bottom line: We retain our pro-risk assets stance heading into 2025, leveraging our key global investment themes amidst heightened thoughtfulness around portfolio construction, including a greater focus on pacing, sector concentration, operational expertise, and financial leverage.

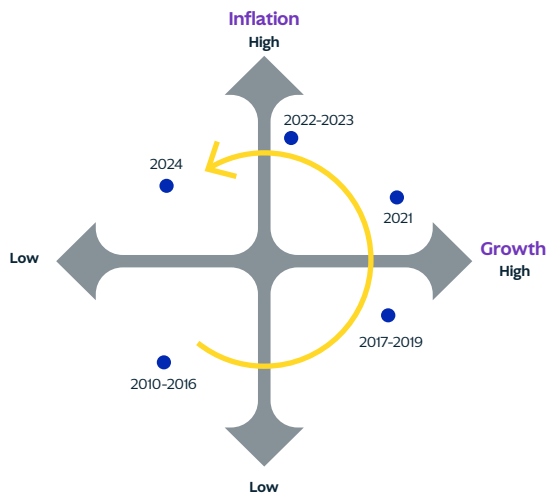
You can't depend on  
your eyes when your  
imagination is out of focus.

— Mark Twain, American writer

At times during one’s career, stepping back and trying to see the forest through the trees is essential. Now, we think, is one of those times. This presidential election cycle is the fourth in which we have partnered to relay what we believe are the most important conclusions. Though each cycle has been different, President Trump’s victory was driven by two ongoing powerful forces that warrant investor attention: an intense dissatisfaction with the status quo, a phenomenon affecting incumbent parties around the world, and the continuation of a political realignment along educational lines that began in the U.S. with the 2016 election and has continued to expand. Also, American voters have demanded change and ‘sent them packing’ in every election since the Global Financial Crisis, except in 2012 when President Obama was reelected.

**Exhibit 1:** Regime Change: We Have Exited a Low Growth, Low Inflation and Tight Fiscal Environment For Something Quite Different, Including a Higher Resting Heart Rate for Inflation and Rates

**Low and High Growth and Inflation Regimes**



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

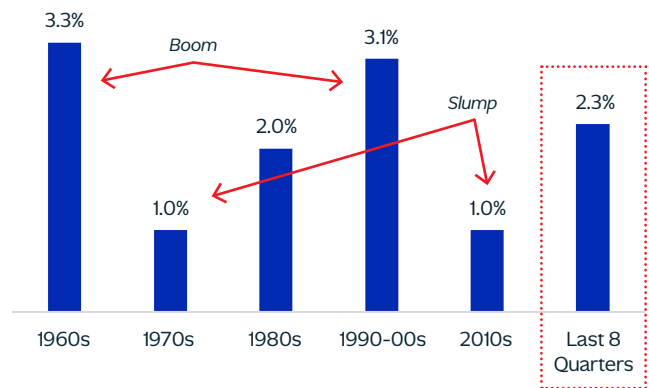
From a macroeconomic and asset allocation perspective, the ‘Red Sweep’ in the U.S. Presidential election is hugely significant, but it actually does not alter our existing macroeconomic framework that much. Rather, it just adds further fuel to our ‘Regime Change’ hypothesis, which we first laid out to investors when we exited COVID. Our thesis is marked by a ‘higher resting heart rate’ for

inflation, nominal GDP, and interest rates. Core drivers of this framework still include 1) persistent fiscal deficits, 2) supply chain shifts amid heightened geopolitics, 3) an at-times messy energy transition, and 4) structural labor scarcity amidst challenged demographics. What’s different this time is that the potential for deregulation and merger activity (*Exhibit 4*) in key sectors will likely be an incredibly important trend during the next four years.

**We see President Trump’s election greatly emphasizing the significance of these four factors.** To be sure, we don’t think we are going back to the June 2022 nine percent inflation environment anytime soon, but we believe a higher neutral rate and volatility around that rate, due to periodic bouts of inflation and other supply shocks, are likely.

**Exhibit 2:** Stronger Labor Productivity Is the ‘Secret Sauce’ to Extending the Business Cycle As Well As Partially Offsetting Higher Deficits

**U.S. Annual Labor Productivity Growth, %**



Note: 1960s refer to 1959–68; 1990s–00s refer to 1995–05; 1970s refer to 1973–79; 2010s refer to 2010–19; 1980s refer to 1980–88. Data as at September 30, 2024. Source: Bloomberg, Federal Reserve Bank of San Francisco.

In short, voters were willing to risk more political chaos in the hopes that President Trump might reduce the disorder of high prices, rising crime, illegal immigration, and wars in Europe and the Middle East.

**Exhibit 3: Our Liquidity Indicator Is Still Recovering From Near-Trough Levels. We View This Bullishly**

**Capital Markets Liquidity (TTM) as a % of GDP (IPO, HY Bond, leveraged Loan Issuance)**



Data as at October 31, 2024. Source: Preqin, Bank of America, Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 4: We Think M&A Activity Will Be a Beneficiary of Deregulation**

**M&A Volume (TTM) as a % Of GDP**



Data as at October 31, 2024. Source: Bloomberg.

**See below for details, but we are only making modest changes to our GDP and rates forecasts.** Specifically, post the election results, we are nudging up our neutral rate for Fed Funds to 3.375% from 3.125%. Key to our thinking is that the potential drag on GDP growth from tariffs is fairly manageable, on the order of 0.25-0.50 percentage points spread out over a few years, whereas the CPI uplift could be around 0.5-1.0 percentage points on a one-time basis, we believe. Remember that the U.S. is a large consumer economy. Meanwhile, we lower our European GDP growth forecast for 2025 to 0.8% from 1.1% previously, compared to consensus of 1.2%. As in previous years, we will provide a full forecast summary update in our Outlook for 2025 note, which we plan to publish in mid-December 2024. **A key area where we intend to spend more time is the currency markets.** An America-First presidential policy likely means a stronger dollar, especially relative to countries that have larger trading deficits with the U.S. At a minimum, we expect a material elevation in currency volatility as trade policies are re-negotiated (*Exhibit 14*). Finally, as we detail below in our scenario analysis work, we think that the implications for China could be material over time, given that country’s ongoing dependence on both fixed investment and exports.

**Against this backdrop, however, there are significant implications for both portfolio positioning and asset allocation that investors should consider.** From a portfolio perspective, President Trump’s vision for America is one of faster growth, lower taxes, and less regulation amidst a more competitive world. In this macroeconomic environment, the government – not the consumer or corporate sector – has excess leverage. As such, owning more assets linked to nominal GDP rather than directly to government debt could be one of the biggest shifts for CIOs to consider. Indeed, as we show in *Exhibit 1*, we have left the lower left quadrant of low growth and low inflation and have entered – likely on a more sustained basis – the top half of the chart, including periods of higher growth and inflation. If we are right, then a fundamental reshaping of asset allocation drivers will unfold, we believe.

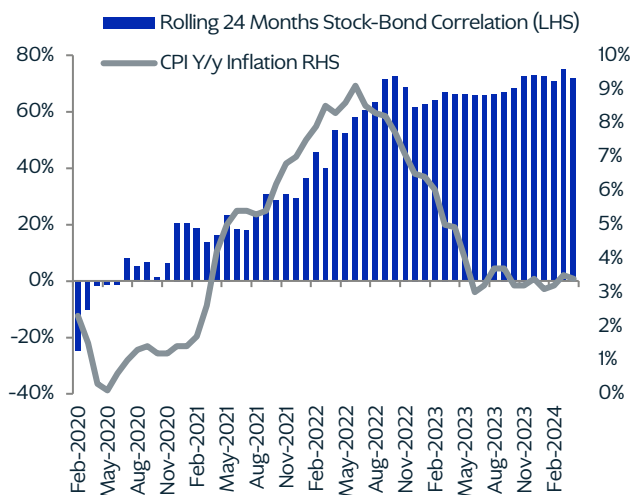
**Exhibit 5: CIOs Will Need to Increasingly Focus on the Benefits of Diversification Amidst What We Believe Is a Regime Change for Asset Allocation**

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

Note: Analysis using EEM, VNQ, MDY, SPSM, SPY, EFA, TIP, AGG, DJP, BIL, CDLI, SPW, Cambridge Associates Private Equity, Real Estate, and Infrastructure. Private Equity, Private Real Estate, and Private Infrastructure are Net Returns to LPs. Private Credit is a gross unlevered return. 60 /40 represented by 60% SPY and 40% AGG. Data as at 3Q23. Source: Cambridge Associates, Bloomberg.

**Exhibit 6: Despite Inflation Falling on a Cyclical Basis, the 'New' Positive Relationship Between Stocks and Bonds Remains Strong. This Reality Is a Major Development for Global Allocators**

**U.S. Stock-Bond Correlation and U.S. CPI, %**



Model retrained on a monthly basis to better reflect latest CPI inflation trends. Data as at June 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Given all the uncertainty, why do we not want to take a more conservative positioning stance? In addition to decent fundamentals, there are two reasons:**

- First, the U.S. is enjoying a productivity boom that we have not seen since the 1990s. If there were an analogy on which to focus, it would be the 1994-1996 period. In today's world, 2022 was 1994, a period marked by higher rates and an unsettled fixed income market. 1994/1995 also marked 15 straight months of the ISM Manufacturing being below 50, yet there was no recession. In today's world, similarly, we have had 23 out of 24 months of ISM Manufacturing prints with no recession. Again, productivity has been key to preventing an economic downturn, reaching 2.2% q/q annualized in 3Q24 and fully 2.8% over the last four quarters.
- Second, we think the technical picture remains extremely favorable. As we show in *Exhibit 3*, net issuance of IPOs, Levered Loans, and High Yield is still running way below trend, a favorable backdrop for higher prices that is being exacerbated by a record amount of money sitting on the sidelines as well as plump central bank balance sheets that are still serving as an important volatility damper. Meanwhile, on the equity side, the S&P 500 is on track to repurchase \$1 trillion in stock in both 2024 and 2025. While European buybacks are not as robust, they should still reach \$400 billion or more over the next 12 months. To be sure, more supply will come to market as deal activity picks up, but today's levels of M&A reflect minimal animal spirits (*Exhibit 4*).

**The biggest risk is clearly higher rates, which dampen valuations, housing activity, and consumer spending.** In our view, this risk is asymmetric relative to lower rates because higher rates slow activity and shake suspect capital structures, while lower rates encourage growth and accelerate refinancings. So, for those who can hedge, this area is the one to hedge, if we are right about President Trump's pro-growth policies.

Where do we go from here? **We remain constructive on risk assets, and as such, are most focused on near-term implications for interest rates and FX:**

- We are still figuring out all the details from a sector perspective, **but Financials, Real Estate, Defense, Oil Services and certain pockets of the Energy complex, should all perform well.** We also expect a lot more M&A. On the cautionary side, a higher nominal GDP environment leads to higher financing costs for both buyers of autos and houses. Companies dependent on the full IRA tax credit across EV, wind, and solar may also be challenged though we believe a full repeal is unlikely. We are also watching healthcare closely, but do not anticipate a major overhaul of any retiree benefits or drug prescription programs.
- **Movements of the U.S. 10-year yield towards 4.5% are an appropriate reaction to a Trump victory, in our view, given his reflationary policy instincts around growth, tariffs, and immigration. That said, the macro team does not see the long end becoming unglued.** Remember that voters handed Trump a significant mandate to control inflation, which we think will ultimately limit appetite for blowout deficit-widening. More likely is that the TCJA is extended for some period of time, but tariffs and partial IRA repeals will substantially offset President Trump's ambitions around further new tax and spending initiatives.
- **Other key macro markets where we expect meaningful election-related differentiation include China, Mexico, and Japan.** President Trump's tariff threats pose further downside FX risks for China, Europe, and Mexico in particular. For Japan, by comparison, there is potential for further JPY weakness if U.S. 10-year yields continue to rise, but - overall - we also see persistent structural tailwinds for investing from ongoing structural reforms.

**What is our bottom line?** From an investment perspective, we continue to subscribe to our *Regime Change* thesis, which means that portfolios are likely out of position for the current environment. Overall, the government, not the consumer or the corporate sector, is likely over-levered this cycle. As such, we want to diversify away from these holdings, including owning more private assets that can harness the illiquidity

premium in a less correlated fashion. Meanwhile, from an economic perspective, we now argue more intently for an asynchronous global recovery, one that is defined by both rolling recoveries (e.g., services today) and rolling recessions (e.g., the goods economy today).

Within this world, we see several key investment themes on which to focus:

# 1

## Own More Non-Correlated Assets.

Against this unique macroeconomic backdrop, we continue to argue global allocators and macro investors need to view their portfolios through a different lens. In particular, we think that more diversification across asset classes and less dependence on global sovereign bonds is warranted, especially given that correlations between stocks and bonds have turned decidedly positive. As detailed in our [Mid-Year Outlook for 2024: Opportunity Knocks](#), we are now entering a flatter expected return profile across more assets, increasing the importance of non-correlation in the typical portfolio.

# 2

## Capital Heavy to Capital Light.

We see a mega trend emerging as more companies shift from capital heavy to capital light. A growing number of public companies are essentially taking themselves private through better capital allocation, including aggressive buyback programs. They are also selling off capital heavy parts of their businesses, including divestitures and securitizations, to raise fresh capital to complete these repurchases. Not surprisingly, many executives are de-emphasizing the cyclical components of their businesses to create more sustainable companies with greater visibility of earnings and returns.

## 3

### Worker Retraining/Worker Productivity.

We think the opportunity set for lifelong learning and worker retraining may be as large as it has ever been for several reasons. Among younger Americans, learning loss and educational disengagement have remained high since COVID. Going forward there will be a lot of pressure to bring unemployed workers from low-skilled sectors as well as workers potentially disrupted by AI and technology into higher-skilled jobs left open by pandemic-era retirements. There will also be demand for recognizing the skill adjacencies between professions, connecting workers with platforms that can identify and offer upskilling for sectors where employee skill needs change. Further, against today's backdrop of stickier wages, we think strong productivity will be needed to allow corporate margins to hold.

## 4

### Security of Everything.

We remain the maximum bullish on this theme. Against a backdrop of rising geopolitical tensions, cyberattacks, and shifting global supply chains, CEOs worldwide tell us that they want to know that they have *resiliency* when it comes to critical inputs such as energy, data, transportation, and pharmaceuticals. We also think that the defense industry will continue to benefit mightily from this theme.

We think the opportunity set for lifelong learning and worker retraining may be as large as it has ever been for several reasons.

## 5

### Collateral-Based Cash Flows.

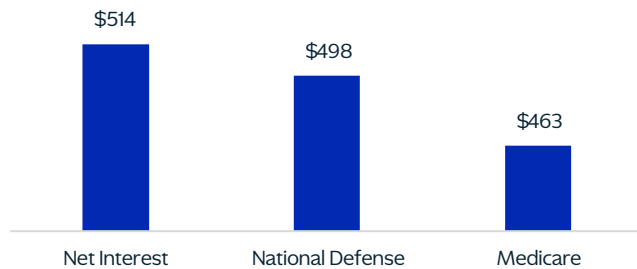
Our client conversations suggest many investors are still underweight Real Assets, especially Infrastructure and Energy, at a time when the need for inflation protection in portfolios remains high. Moreover, if we are right about the AI-electricity demand that we are forecasting, then the opportunity set to own growthier Infrastructure assets, especially around data centers, logistics, etc., is quite compelling, we believe.

**Overall, while we are not going back to a World War II-style 'guns and butter' debate per se, we may see a return of the global bond market 'vigilantes.'** In the 1980s and recently in the U.K. during the administration of former Prime Minister Liz Truss, a group of market participants challenged government overreach on deficits by punishing government bond prices when politicians were seen to have over-stepped their boundaries. Today, our message that a faster nominal GDP environment does not lead to a lower debt burden should give us all pause, especially in terms of portfolio positioning. From our vantage point at KKR, the U.S. has been running policies that are 'different this time' relative to the low growth, low inflation, globally interdependent economies, and tight fiscal environments that defined the 2000-2019 period. In the current environment, we expect our asynchronous global recovery economic thesis of rolling recoveries and rolling recessions to gain more acceptance from investors. As it does, it likely will have significant long-term implications for asset allocation. Hence, we encourage investors to take a step back from the market's day-to-day and consider the longer-term implications of what a second term under President Trump could mean in the context of our *Regime Change* thesis. We first examine the current political landscape, then review implications by region.



**Exhibit 7: Annual Spending on the U.S. Debt Service Burden Is Now More Than Spending on National Defense or Medicare, and More Than the U.S. Spending on Veterans, Education, and Transportation Combined**

**Overall Spending, US\$ Billions**



Data as at April 30, 2024. Source: CBO.

An America-First presidential policy likely means a stronger dollar, especially relative to countries that have larger trading deficits with the U.S. At a minimum, we expect a material elevation in currency volatility as trade policies are re-negotiated.

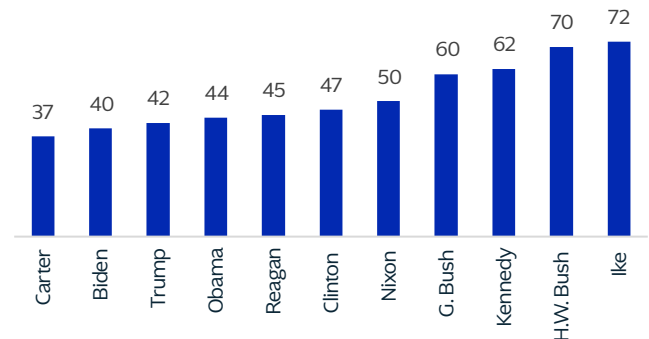
## SECTION I

# The U.S. Political Landscape and the ‘Change’ Election

On November 5th President Trump won reelection, powered by public desire to upend the status quo and by dissatisfaction with the Biden/Harris administration. President Trump is the first U.S. President in over a century to win two non-consecutive terms, an almost unprecedented personal and political comeback. This marks the ninth time in the last ten U.S. elections that Americans have chosen a new path forward, ousting both parties from power in successive elections since President Obama was reelected in 2012. This trend of incumbent party losses is also a pattern playing out around the globe. Importantly, President Trump was viewed by more voters as the change candidate, and we think this is why he won the election. Only two sitting vice presidents have been elected President, both serving under very popular presidents with widespread public satisfaction. In contrast, by his third year in office, President Biden was the second least popular U.S. President in more than 70 years. On election day, his approval rating was an anemic 40%; only 32% of voters held positive views on the economy, with just 26% believing the country was on the right track. According to exit polls, 70% of voters associated President Trump with change versus 23% for Vice President Harris.

**Exhibit 8:** President Biden Had the Second Worst Approval Rating of a Sitting President in His Third Year Since the 1950s

## Third Year of Presidency Incumbent Approval Rating, %

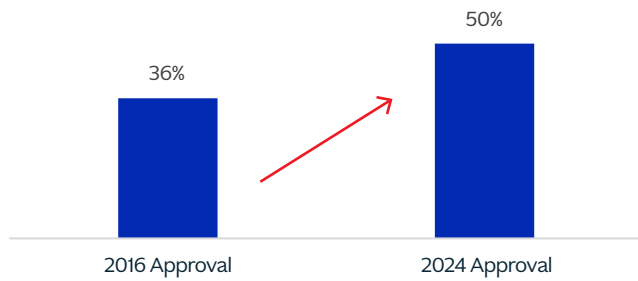


Data as at September 30, 2024. Source: Gallup.

Importantly, President Trump was viewed by more voters as the change candidate, and we think this is why he won the election.

**Exhibit 9: The American Viewpoint on President Trump Changed Post His First Term...**

**Approval Rating for Donald Trump 2016 vs. 2024**



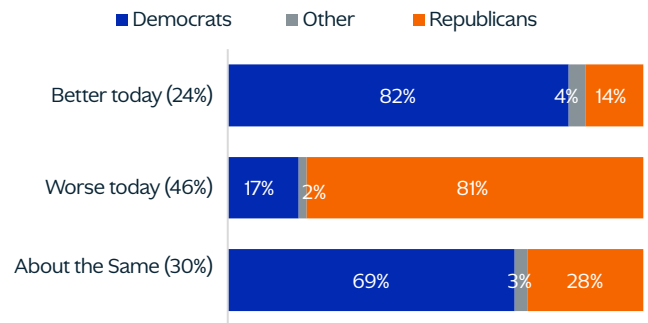
Data as at September 30, 2024. Source: Gallup.

Vice President Harris tried to re-frame the election as a referendum on President Trump, whose challenge to the 2020 election and chaotic approach concerned many voters. The Vice President also hoped to capitalize on concerns about the Supreme Court’s overturning of Roe v. Wade. While voters do express concerns about President Trump’s demeanor and consistency, many also remember his first term as a time of relative peace and prosperity. Consider that President Trump’s approval rating in 2024 is nearly 15 points higher than when he was elected in 2016;

voters consistently told pollsters their families were better off during the Trump administration than Biden/Harris. In short, voters were willing to risk more political chaos in the hopes that President Trump might reduce the disorder of high prices, rising crime, illegal immigration, and wars in Europe and the Middle East.

**Exhibit 10: ...We Link This to Growing Economic Dissatisfaction**

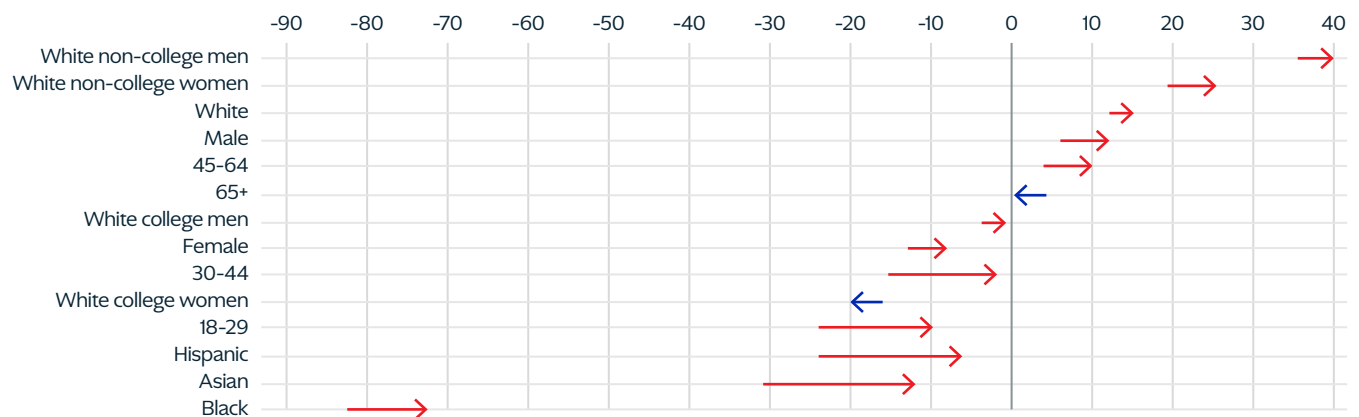
**Compared to Four Years Ago, Is Your Family's Financial Situation:**



Data as at November 8, 2024. Source: NBC Exit Polls.

**Exhibit 11: President Trump Has Increased His Support Broadly Across the Electorate Since 2020**

**Republican Margin Over Democrats, Change Since 2020 by Demographic Group %**



Red signifies shifts among Republicans. Blue signifies shifts among Democrats. Data as at September 30, 2024. Source: Financial Times, Catalist, Edison Research.

President Trump was the first Republican winner of the popular vote victory in 20 years. He improved upon his 2020 performance across nearly every demographic, increasing his share of the vote in 92% of the counties in the U.S. Notably, President Trump expanded his base of support beyond white non-college voters to include significant gains amongst Hispanics, Asian Americans, and African Americans. By election day, he had assembled the most diverse Republican coalition in many years. Importantly, this coalition also grew in 2020, a year in which President Trump's overall performance did not grow across the electorate. President Trump's ability to assemble this multi-racial working-class majority shouldn't be underestimated both in its importance for the current election and in light of the President's and GOP leaders' desire to cement it in the future. This presents long term political advantages in the electoral college and in representation in the U.S. Senate. Democratic leaders recognize this achievement as a threat to their own future; we expect that both parties' competition for these voters will influence policy priorities on both sides of the aisle moving forward. In [Party of the People](#), Patrick Ruffini, a smart pollster, goes deeper into this phenomenon, which he anticipated more than a year before the election.

So, what do we anticipate will happen in 2025? We believe the overarching goal of the new administration will likely be to maximize legislative wins in the first 100 days of President Trump's term. Many believe Republicans failed to achieve this in his first term when Congress took too long to move key pieces of legislation and allowed itself to get bogged down by unnecessary fights. Here's what we think you need to know:

---

# 1

## Senate

Republicans will have a 53-seat majority, which is significant because it allows them to win victories even while potentially losing one or two colleagues' support. What is notable is the number of Democratic incumbents who lost their seats including Sherrod Brown in Ohio, John Tester from Montana, and Bob Casey in Pennsylvania.

---

# 2

## House

Control of the House is now the most important factor in the legislative outlook for 2025, and Congressional Republicans have spent much of this year planning for the potential for unified control of the White House and the Congress. Republicans appear to have the slight upper hand, though the majority may be quite small. While a small GOP majority would suggest a disputatious caucus to manage, Speaker Mike Johnson has been a deft leader and with the help of President Trump can impose even more discipline.

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# 3

## Personnel

In politics, it is often said that 'personnel is policy.' President Trump's 2016 election surprised many of his supporters, including Republican congressional leaders. Therefore, his cabinet and top advisors were mostly traditional GOP and business leaders, with much of the agenda (particularly the more conventional policy objectives starting with tax relief) being driven by Speaker Paul Ryan and Senate GOP leader Mitch McConnell. This time, Trump's leadership of the party—both in terms of politics and policy—is stronger. The agenda for the coming administration is being steered by President Trump and his allies at organizations such as the America First Policy Institute in coordination with Republican Congressional leaders. In terms of key personnel, President Trump is again likely to recruit a mix of conventional highly credentialed business leaders with more ideological supporters of his America First agenda. His selection of campaign manager Susie Wiles as the first woman chief of staff in U.S. history with bipartisan respect for her professionalism and smarts, as well as her clear loyalty to the President, is a good example of the type of effective leader he will seek.

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# 4

## Executive Actions

President Trump can also keep campaign promises through executive action. Watch for a possible return to his first term immigration policies, including potential new deportations and a reversal of Biden-era actions. He may use his authority to promote government efficiency and focus on changes to civil service rules and other related items. Tariffs will also be a key focal point for executive action; see more detail below.

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# 5

## Extension of 2017 Tax Cuts

Congressional Republicans view sending an extension of the 2017 tax cuts to President Trump's desk as a centerpiece of their 2025 legislative agenda. Assuming there is a unified GOP government, Republicans intend to again use the budget reconciliation process to move a tax bill. While the core components of the tax bill will be extending the expiring provisions of the 2017 law, new initiatives such as 'no tax on tips' and perennially challenging issues like the SALT limitation and the pass-through deduction, will also be in play. Changes to some of the energy provisions of the IRA will also be a core element of the bill (although full repeal of the IRA is unlikely). Congressional Republicans plan to pass a budget resolution (the first step in the budget reconciliation process) early next year that will include reconciliation instructions for a future tax bill. However, the resolution will also likely include instructions for other key priorities like immigration funding and energy. It may also include instructions on healthcare, possibly the largest source of potential spending cuts. Timing-wise, Congressional Republican tax writers want to move quickly on a tax reconciliation bill, potentially setting up a final vote within the key 'first hundred days' time frame of April 2025,

or by early summer. Doing so will require them to build consensus for the tax provisions potentially as part of a larger reconciliation bill and potentially at a time when Congress is also dealing with the debt limit and federal spending. History would suggest the fourth quarter of next year is the most probable window for passage.

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# 6

## Discretionary Spending

Congressional Republicans will also have to navigate extensions of federal discretionary spending programs and the debt limit. There may be a desire to 'clear the decks' on both issues before the end of this year in the lame duck session. However, it is unlikely that Congressional Democrats, including Senate Majority Leader Chuck Schumer, would agree with this approach, or what they would demand in exchange. If not, federal spending and the debt limit will become the two major legislative cliffs Congress will need to navigate next year.

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# 7

## Oversight

Congressional leaders will likely use their oversight power to advance broader agendas. This could include oversight of perceived regulatory excess and weaponization or 'lawfare' by government bureaucracies. This new Republican majority is also more populist, in some cases more skeptical of business, and could exercise their oversight of some business activities e.g., tech platforms content moderation practices that critics allege reflect ideological bias.

# 8

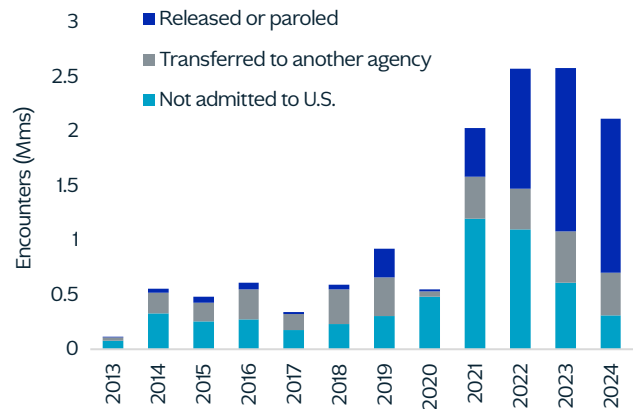
## Regulatory

President Trump is likely to make significant changes across agencies including the U.S. Treasury, the Department of Justice, the Department of Energy, the SEC, the FTC, CFPB, etc. If past is prologue, many of his appointees are likely to embrace a deregulatory agenda to promote economic growth. The SEC may move away from priorities like the ESG rule for investment advisors and climate disclosure. One trend to be mindful of is that international and U.S. state regulators may become more aggressive to counter what they see as a lack of regulation by a Trump administration. Similarly, as in the last Trump presidency, some stakeholders may pressure businesses to make voluntary commitments in climate related areas in response to a less aggressive policy agenda. We expect the Trump administration and Congress to use their joint powers to reverse and roll back a number of Biden administration regulatory proposals. This includes the use of the Congressional Review Act, executive orders, and agency actions. Both the Trump administration and Congress may use last year's repeal of the Chevron doctrine to curb or reverse rulemaking that they believe lacks Congressional authority.

If past is prologue, many of his appointees are likely to embrace a deregulatory agenda to promote economic growth.

**Exhibit 12: A Much Higher Percentage of Captured Immigrants Are Being Released for Parole Than at Any Other Time in History**

### Border Interactions Are Increasingly Resulting in Release



Note: 2024 Immigration levels are annualized based on data from January 2024. Source: Federal Reserve Bank of Dallas, Department of Homeland Security, KKR Global Macro & Asset Allocation analysis.

## SECTION II

# Geopolitical Implications

Although President Trump is sure to bring significant changes in both policies and style to the White House, we think that, with respect to geopolitics, it is important to recognize that there are also likely to be key points of continuity. As under President Biden and during President Trump's first term, great power competition is likely to remain the overarching framework for global geopolitics, with particular weighting around U.S.-China rivalry. U.S. policy themes around industrial policy, control over critical and emerging technologies, the robust and creative use of export controls, sanctions, tariffs, and other instruments of economic policy and statecraft, and the expansion and modernization of America's defense and industrial technology base are likely to continue if not accelerate under Trump 2.0. While the Biden administration generally (albeit not consistently) sought to develop collective and collaborative approaches on these topics with allies and partners, the Trump administration is likely to be more assertive in expressing its preferences and tolerant of confrontation with America's historic friends.

As in other areas of policymaking, the foreign and national security approaches of the second Trump administration are likely to be shaped by the individuals selected by President-elect Trump for key jobs. Unlike the Biden administration, whose national security team was as a general rule ideologically cohesive and tight knit, a Trump administration may incorporate several individuals with diverse and contrasting views about the world and America's place in it, with President Trump serving as the ultimate arbiter. This is likely to result at times in less predictable policies, especially in areas where the internal disagreements are sharpest. In the case of China, for

example, the Biden administrations put in place export controls, outbound investment screening, and other trade and technology policies that generally prioritized U.S. national security considerations, building on the work begun during the second half of the first Trump administration. We think it is likely that this will prove the basic direction of travel under the second Trump administration, but also see the potential for a more transactional approach that balances national security calculations with mercantilist and other considerations.

Finally, as under Trump 1.0 and Biden, Trump 2.0 is likely to see a continuing push by allies and partners to reduce their historic dependence on the United States, to develop their own independent capabilities, and to deepen their coordination and cooperation with each other, coupled with a recognition that full independence or autonomy from Washington is impossible.

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More broadly, as noted earlier, there is likely to be a recurring 'art of the deal' theme in President Trump's approach to the world—with a push to resolve or at least attenuate the wars in Ukraine and the Middle East, restart diplomacy with North Korea, expand the Abraham Accords between Israel and its Arab neighbors, and rebalance trade relations with major nations on terms perceived by Trump as more favorable to the United States. As always in foreign policy, the devil will be in the details, and it remains to be seen how successful these peace-broker and powerbroker efforts will be. President Trump is also likely to continue to pursue a personalized diplomacy that was evident in his first term and already during the transition, in which he relies on his own direct interactions with individual leaders more than an interagency process.

Finally, as under Trump 1.0 and Biden, Trump 2.0 is likely to see a continuing push by allies and partners to reduce their historic dependence on the United States, to develop their own independent capabilities, and to deepen their coordination and cooperation with each other, coupled with a recognition that full independence or autonomy from Washington is impossible. In the case of Europe and Japan, for example, this will mean further acceleration of their defense and security spending and modernization. We also note in this context that the theme of intensifying geopolitical rivalry—in the Asia-Pacific between China and other major regional powers, on the one hand, and between Russia and the Europeans on the other—will persist regardless of choices in Washington, as Beijing and Moscow each challenge the regional status quo in ways that unsettle most of their neighbors.



## SECTION III

# Regional Implications of Increased Tariffs

## United States: Targeted and Strategic

**The Matter of Tariffs:** Big picture, we take President Trump's tariff threats seriously but not literally. The total incremental tariffs on China will likely be considerably less than the 60% he has threatened, with most of the blunt force hitting 'List 1-3' items that are less consumer-facing and that have more readily available substitutes. Other global tariffs are likely to be selective, not a blanket 10% across the globe. Recall that for all the 'noise', the tariff approach President Trump implemented in his first administration was quite strategic and legalistic. We expect broad elements of this to continue, with smart tariffs used to target specific trade imbalances and security threats, rather than as a blanket global 'piggy bank.'

### How could President Trump approach tariffs in a strategic and targeted manner?

- On his first day in office, President Trump could declare **China in violation of the Phase I trade agreement**. This initiative would trigger a dispute resolution mechanism with deadlines continuing into the spring. The ultimate result could be that President Trump declares punitive tariffs on China for non-compliance, and China responds by withdrawing from the agreement. **Importantly, the earliest that any new China tariffs would go into effect is probably spring 2025.**
- **15% 'balance of payment authority' surcharges on countries with 'serious' trade imbalances are a risk for European autos.** Trump can impose tariffs of up to

15% on countries he deems as having threatening trade imbalances with the U.S. (*Exhibit 14*), so even traditional trading partners, such as the German auto industry, could be threatened.

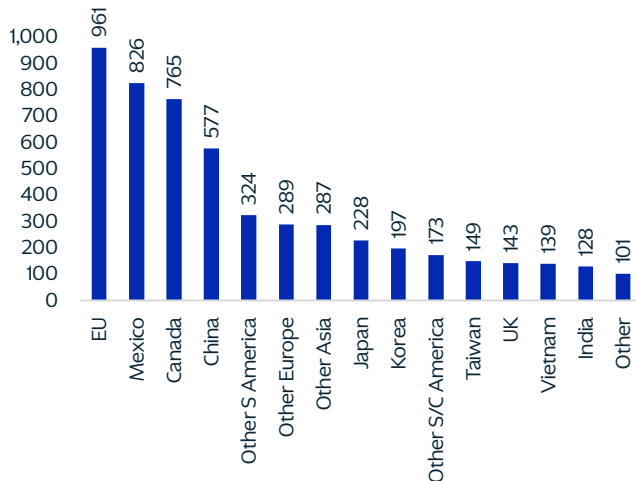
- **IEEPA used as leverage to get Mexico to seal their side of the border.** The International Emergency Economic Powers Act (IEEPA) gives the President broad authority to use tariffs as a national security tool. He could threaten (or temporarily place) broad tariffs on Mexico as leverage to get them to take a more aggressive approach to border enforcement. He could use the same authority to place tariffs on Chinese and other foreign autos exported via Mexico. More broadly, Trump is likely to target Chinese exports that are being effectively transshipped through third countries like Mexico and Vietnam, especially when this activity is driving up a U.S. trade deficit with these countries.
- **High risk that Section 232 tariffs on steel and aluminum snap back on April 1, 2025.** Steel and aluminum tariffs are under a suspension that lasts until March 31, 2025. We think there is a heightened risk that President Trump will allow them to snap back into place.

**How might other countries retaliate? We are most on guard about retaliation as it pertains to** agriculture and commodity products, petrochemicals (where China has overcapacity), and autos. Besides pro-rata tariff hikes, China could strike back via a) import controls by directing state-owned enterprises to stop or significantly curtail purchases from the U.S.; b) export controls on critical supply chain items such as rare earth metals and large-

scale batteries; and/or c) targeted sanctions on persons/companies through fines, investment/travel restrictions, etc. Specifically, we are also watching for ways in which U.S. digital platforms (e.g., Amazon, Netflix, etc.) could potentially be punished via regulation. However, this risk is mitigated in our view by the fact that China has already walled most of these platforms off. Beijing is also likely to try to woo U.S. allies and partners in Europe and Asia that are also threatened by Trump administration tariffs with more favorable and generous trade policies—maneuvering in the hope that China can make ‘America First’ into ‘America Alone.’ It remains to be seen how dexterous Beijing proves in such efforts or how effectively the Trump administration moves to counter them.

**Exhibit 13: The Largest U.S. Trading Partners (Exports and Imports) Are the European Union, Mexico, Canada, and China**

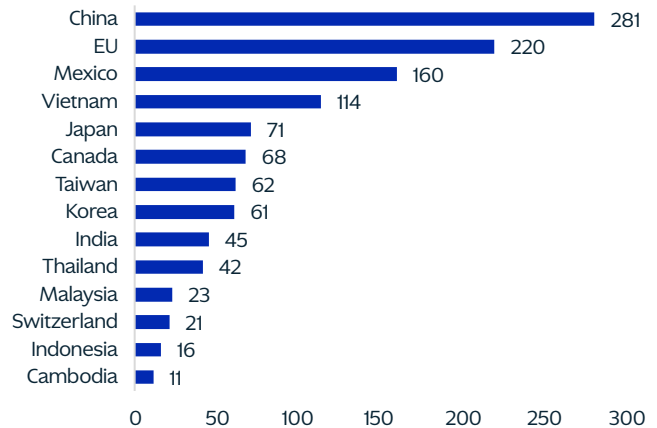
**U.S. Largest Trading Partners, Exports + Imports, US\$ Billions, TTM**



Other South America = South America excluding Argentina, Brazil, Chile, Colombia, Venezuela. Other Europe = Europe excluding EU, Russia, Norway, Switzerland, the U.K. Other Asia = Australia, Indonesia, Malaysia, Philippines, Hong Kong, Singapore, Pacific Rim. Data as at August 31, 2024. Source: U.S. Census Bureau.

**Exhibit 14: Countries With Large Bilateral Goods Trade Surpluses Versus the U.S. Are Now More at Risk of Tariffs**

**Bilateral Goods Trade Surplus with the U.S., US\$ Billions, LTM**



Note: Trading Partners With >\$10 billion in LTM Goods Trade Surplus with the U.S. Data as at August 31, 2024. Source: Census Bureau, KKR Global Macro & Asset Allocation analysis.

**What does this all mean for growth, inflation, and rates?**

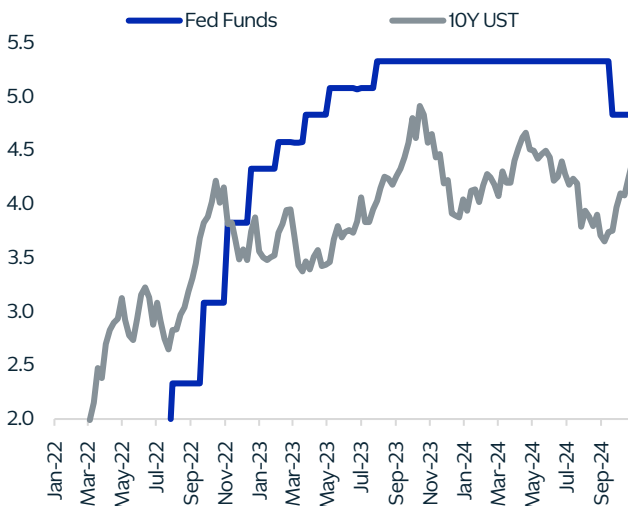
Though we are still trying to understand all the elements of President Trump’s second term trade policy, no one component is causing us to revisit our growth and inflation forecasts just yet. Unlike in other geographies, our view is that the tariffs in the U.S. are intended to fund other fiscal ambitions, so any tariff ‘drag’ will be substantially offset by tax relief and fiscal spending. Our preliminary work suggests that the potential drag on GDP growth is fairly manageable on the order of 0.25-0.50 percentage points spread out over a few years, whereas the CPI uplift is around 0.5-1.0 percentage points on a one-time basis, we believe.

With growth and inflation effects canceling each other out to some extent, we think implications are more neutral for rates than deeply hawkish. The Fed lowered rates by 25 basis points to 4.625% in November, which was in line with market expectations. In his public comments, **Chair Powell seemed determined to stay the course on monetary policy, with continued near-term cuts (despite elevated nominal growth). He was forceful in his commentary about not yielding to political pressure for a lower terminal rate (despite President Trump’s reelection).** On balance, we stick to our forecast for one

more rate cut in 2024 and four more rate cuts in 2025. For 2026 and beyond, we now see the Fed holding policy at 3.375%, versus our previous expectation of one further cut to 3.125%, reflecting the potential inflationary pressures we see resulting from a second Trump presidency. We believe that the long end of the yield curve does not become unglued and keep our 10-year Treasury yield target at 4.25% this year and 4.0% longer term.

**Exhibit 15:** Remember that the 10-Year Cannot Rise Above 4.5-4.75% Without the Yield Curve Normalizing

**10-Year UST and Fed Funds Rate, %**

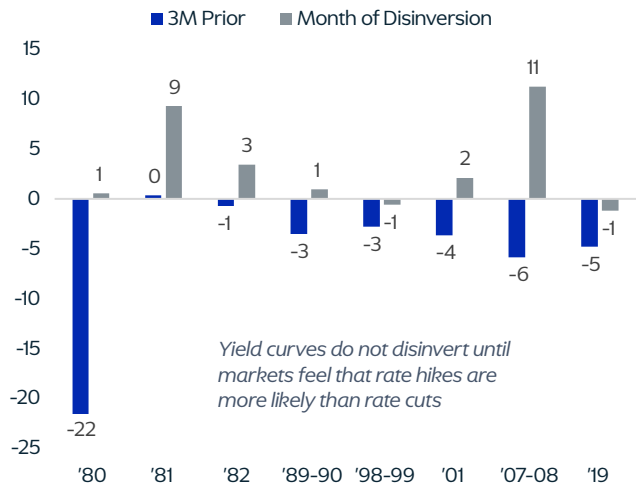


Data as at November 4, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

With growth and inflation effects canceling each other out to some extent, we think implications are more neutral for rates than deeply hawkish.

**Exhibit 16:** We Do Not Think Normalization Can Happen Until the Fed Is (Nearly) Done Cutting Rates

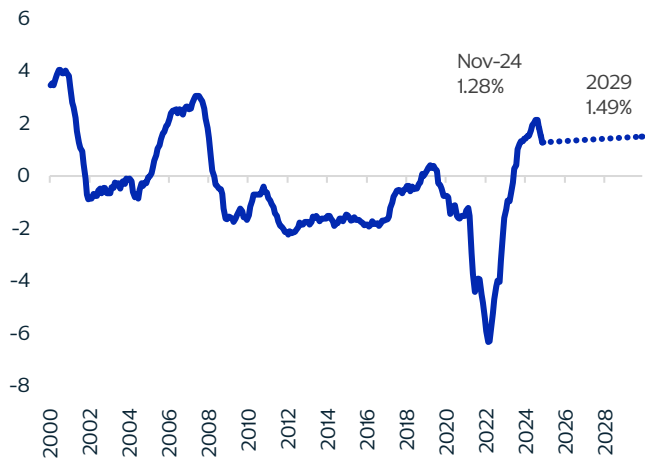
**# of Expected Fed Hikes (Cuts) During Yield Curve Disinversion**



Shows expected total Fed cuts over next two years. Prior to 2019, # of fed cuts based on implied pricing from Treasury markets. Data as at November 4, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 17:** Market Pricing Implies that The Fed Is Already Below 'Neutral' in Real Terms, Which Feels Too Hawkish to Us

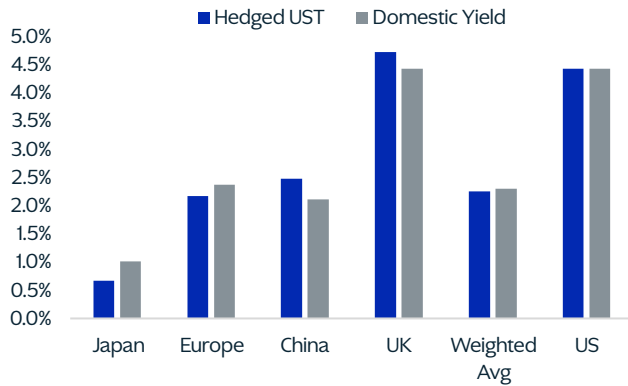
**Real Rates over Time, %**



Forward rates are based on 5-year breakeven and SOFR forwards. Nov-24 assumes October CPI in line with Bloomberg consensus. Data as at November 7, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 18:** This Constraint Suggests the 10-Year Cannot Rise Beyond 4.75% Without Foreign Yields Rising, Too

**Domestic Yield vs. Hedged UST Yield by Market, %**



Uses 2-year hedge cost by currency, weighted by long-term U.S. bond ownership. Data as at November 7, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

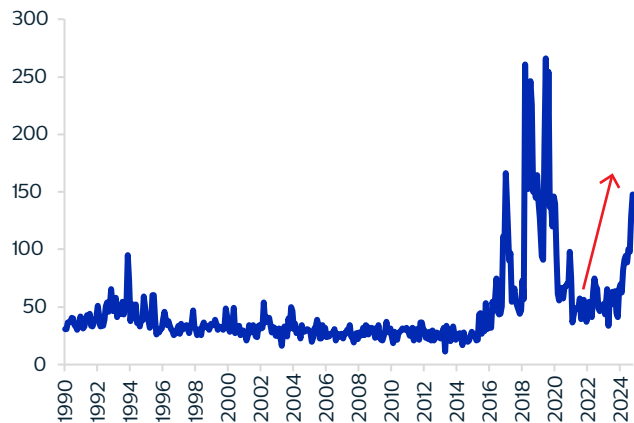
Recall that for all the ‘noise’, the tariff approach President Trump implemented in his first administration was quite strategic and legalistic.

## Europe: Near Term Stagflationary Concerns

In Europe, the U.S. presidential election result has introduced a new set of geopolitical and economic uncertainties. With President Trump’s return to the presidential seat, shifts in trade, defense, and energy policy loom large, each with distinct implications for European markets and economic stability. Export-reliant Europe would be particularly vulnerable to sweeping Trump tariffs, triggering a potential near-term stagflationary shock. The longer-term impact will depend on the degree to which Europe can come together in the face of this challenge and implement elements of the recent Draghi [plan](#). We see six key areas of focus:

**Exhibit 19:** Uncertainty Around U.S. Trade Policy Has Intensified

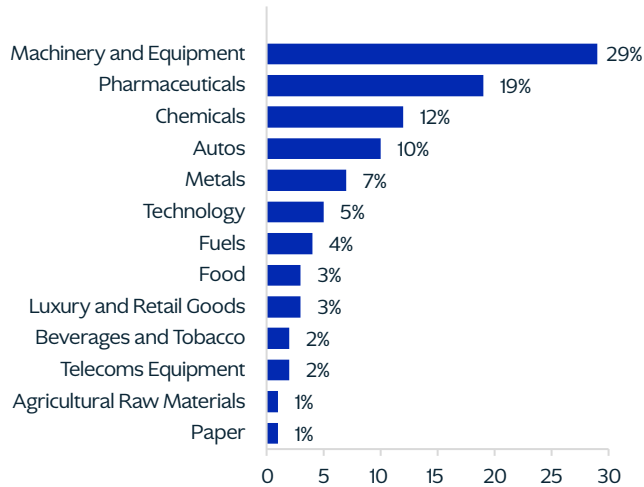
**U.S. Trade Policy Uncertainty**



Data as at October 31, 2024. Source: Matteo Iacoviello.

## Exhibit 20: Broad Based Tariffs Are Likely to Impact Europe's High Value Manufacturing Industries Disproportionately

### EU Exports to the U.S., % of Total Exports to the U.S.



Data as at December 31, 2023. Source: Eurostat.

# 1

## Tariffs

Top of mind for Europe are the across-the-board trade tariffs threatened by President Trump, where Europe's goods trade surplus with the U.S. leaves it especially vulnerable. Though it seems unlikely, if President Trump implements his proposed unilateral 10% tariffs, certain European sectors - most notably chemicals and Germany's automotive industry - could be severely impacted. There is also the risk that displaced Chinese exports would also be redirected towards Europe, intensifying competition and further straining profit margins in key industries. Analysis from the German Economic Institute estimates that a new trade war could cost Germany - which is also now contending with the collapse of its government - €180 billion over President Trump's four-year team. Conversely, services-focused economies like the U.K. and Spain are less impacted by goods tariffs than their manufacturing-heavy peers but will still be impacted. Finally, we do think it is important

to note that, as the United States puts in place a first-of-its-kind outbound investment screening regime geared at China, there is a possibility that Europe could adopt a similar mechanism to complement its existing inbound investment screening regimes, which have themselves expanded significantly in recent years.

# 2

## Growth

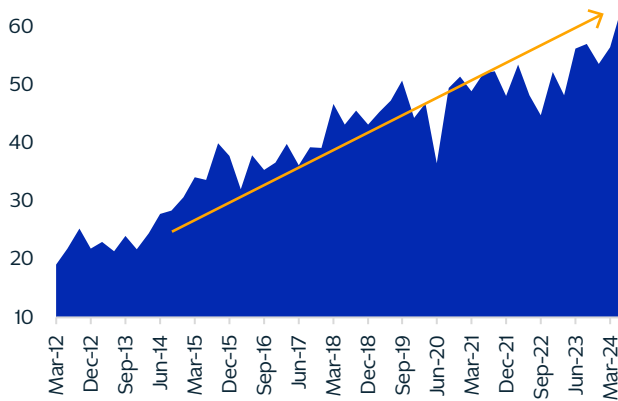
At the outset, Europe is likely to retaliate to any potential changes in U.S. tariffs before serious negotiations can take place. We see increased trade policy uncertainty amplifying the direct tariff impact as companies delay investment and hiring, further dragging on European growth. We anticipate that the bulk of the impact will be felt in 2025 and cut our GDP forecasts by 30 basis points to 0.80%. Further risk lies in increased U.S. borrowing exerting upward pressure on long term real interest rates and tightening financial conditions against a weakening economy.

Yet, as with any challenge, there are also meaningful opportunities. Specifically, Europe could adopt some of the key structural changes advocated by Draghi in his recent [report](#) on European competitiveness, such as reinforcing industrial resilience and reducing dependency on external markets. By advancing efforts to consolidate critical industries and strengthen its own supply chains, Europe can better shield itself from the volatility of U.S. led trade shifts, laying the groundwork for longer term resilience and growth.

This shift means that Europe, which has long relied on the U.S. for military cover, will need to significantly increase its defense spending.

**Exhibit 21:** Europe’s Significant Trade Surplus With the U.S. May Soon Face Renewed Scrutiny

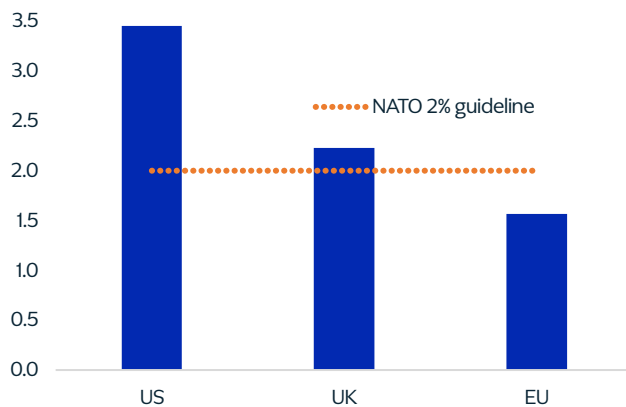
**EU Goods Trade Balance with the U.S., Quarterly, EUR Billions**



Data as at June 30, 2024. Source: Eurostat.

**Exhibit 22:** In 2022, the EU’s Average Military Expenditure as a Share of GDP Was About 0.4 Percentage Points Below NATO’s Guideline

**Military Expenditure, % of GDP, 2022**



Data as at December 31, 2022. Source: The World Bank.

# 3

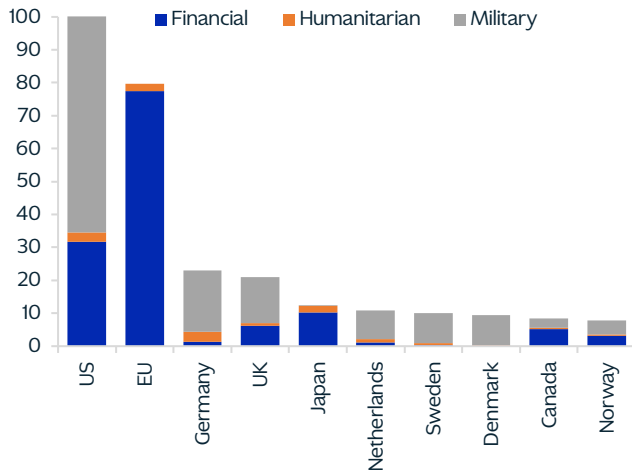
## Defense

The economic outlook is compounded by geopolitics as President Trump’s rhetoric on Ukraine and NATO implies a potential retraction of U.S. support and less certainty around U.S. security guarantees in almost all scenarios. This shift means that Europe, which has long relied on the U.S. for military cover, will need to significantly increase its defense spending. Already several European leaders have stated that the target of two percent of GDP dedicated to military spending, established in 2014, is unrealistically low and that Europe must ramp up military production – a dynamic that has already been accelerating since the 2022 Russian invasion of Ukraine as well as a theme that the Trump administration will champion. Europe needs to balance these new security demands against existing pressures from an aging population, the green transition and investing in innovation driven economic goals. With defense spending having a generally low growth multiplier for Europe due to the import content, increased military outlays will increase fiscal pressure on already strained government budgets, particularly for countries like Italy and France with already high debt-to-GDP levels. On the other hand, this crisis poses a unique collective threat to the EU, offering a critical opportunity to accelerate discussions around the issuance of joint debt.

By advancing efforts to consolidate critical industries and strengthen its own supply chains, Europe can better shield itself from the volatility of U.S. led trade shifts, laying the groundwork for longer term resilience and growth.

**Exhibit 23: Withdrawal of U.S. Support for Ukraine Would Leave a Huge Funding Gap**

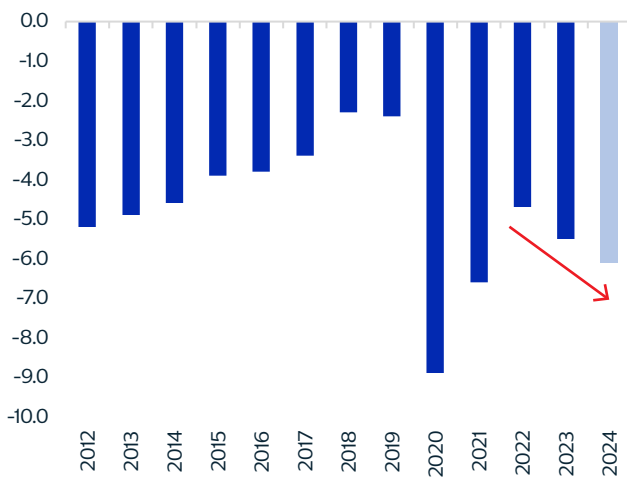
**Bilateral Commitments to Ukraine, €Billions, 24 Jan 2022 - 31 Aug 2024**



Data as at August 31, 2024. Source: Kiel Institute for the World Economy.

**Exhibit 24: France Has Consistently Fallen Short of Deficit Targets. Government Projections Indicate that Its Budget Deficit will Rise to 6.1% of GDP in 2024**

**France: Budget Balance, % of GDP**



Data as at June 30, 2024. Source: Eurostat, French Government.

# 4

## Climate Change and Clean Tech

European companies are global leaders in renewables and clean energy and some of the listed players have been beneficiaries of the U.S. IRA in receiving tax incentives for U.S.-bound capital investment. As noted earlier, while President Trump and the new GOP majority are unlikely to do a wholesale roll-back of the IRA given the concentration of capex and jobs in red states, changes to local content rules might remove the 40% tax credit from some of the large projects the European renewables developers had already committed to. This risk saw the European renewables equity index fall by 9.5% on the day the Trump victory was announced, compared to a 0.6% fall for the broader index. It's important to note, however, that European-focused clean energy players are not affected by this risk.

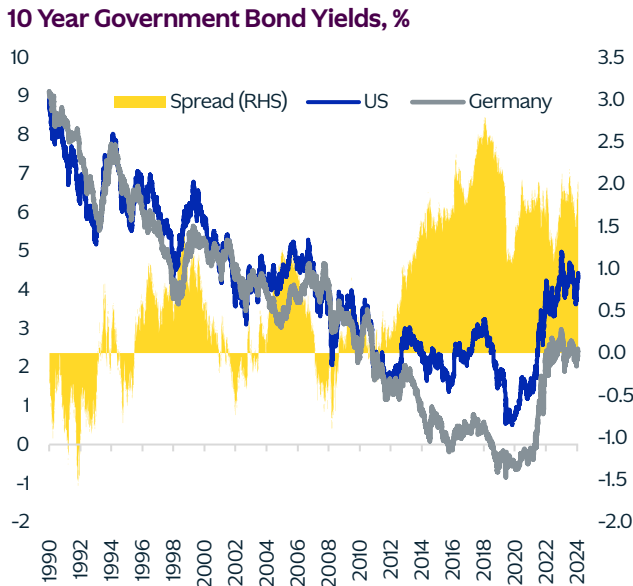
# 5

## Inflation

Tit for tat tariffs have a mixed impact on European inflation, with U.S. tariffs cutting demand and retaliatory tariffs restricting supply in the economy. In the near-term, we think this results in a small increase in inflationary pressure as the market adjusts. In the longer term if restrictive tariffs are maintained we believe the economy runs a larger output gap and this puts more downside pressure on inflation.

Overall, while we are not going back to a World War II-style 'guns and butter' debate per se, we may see a return of the global bond market 'vigilantes.'

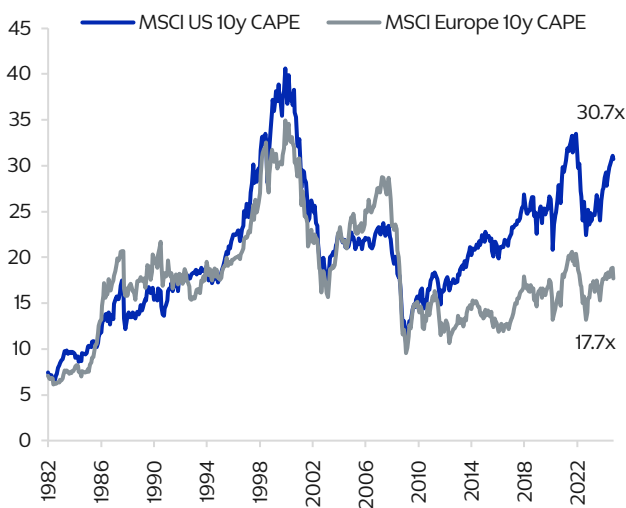
**Exhibit 25: We Could See Further Widening in Rate Differentials Between the U.S. and Europe**



Data as at November 7, 2024. Source: Bloomberg.

**Exhibit 26: European Public Markets Trade at a 13 Point Discount to the U.S. On Cyclically Adjusted Earnings**

**U.S. vs. Europe Cyclically Adjusted Price-Earnings**



Data as at October 31, 2024. Source: Barclays Research, LSEG Data & Analytics, IBES.

# 6 Rates

The ECB faces a delicate balance as it navigates the inflationary pressures and weakened growth outlook likely to be brought on by the U.S. election. While price stability remains the ECB’s primary mandate, its policy approach is not isolated from the broader economic conditions that are now facing heightened strain. As downside risks to European growth intensify, we see an increasing possibility of more aggressive ECB easing in the near term below neutral, even at the expense of tolerating short term inflation. We think this policy response opens up more downside to the euro potentially reaching parity with the dollar.

**Our bottom line for Europe: The U.S. election and the fall of the German coalition have important implications for asset allocation in Europe. Key points where investors need to focus:**

- **Watch Europe’s response:** Europe will respond to the expected challenge posed by tariffs and reduced defense support, potentially by adopting elements of the Draghi plan. Snap elections in Germany, where changing electoral math could drive momentum for lifting debt limits and bolstering investment, could help to position Europe for strengthened autonomy and growth.
- **Cautious on cyclicals:** Caution is warranted on cyclicals and exporters – key trade surplus sectors with the U.S. include machinery, chemicals, autos, and pharmaceuticals. We modestly cut our Eurozone growth forecast for GDP in 2025 to 0.8%.
- **Stay long the U.K. and the periphery:** We have increasing conviction on the U.K. and the Eurozone periphery, as both are favorably positioned given their greater dependence on services versus goods both domestically and in exports.
- **Exploit the public market valuation overhang:** Valuations are likely to remain attractive in Europe. Some previously expensive sectors (cleantech), for example, have seen valuations take a fall and are worth monitoring.



- Security of Everything: U.S. trade tariffs, following the return of Russia as a major security threat to the continent, underscore the core of our ‘Security of Everything’ thesis – to include the urgent need for resilient, secure supply chains along with increased security spending around critical infrastructure, cybersecurity, energy, data, and the broader digital economy – as trade flows are reordered. Focus on opportunities in sectors driving reshoring, supply chain innovation, and critical infrastructure. While many are familiar with this idea, not everyone realizes how deep this investment thesis goes. We are seeing live opportunities in areas as diverse as:
  - Critical minerals – recycling and circularity
  - Building sovereign cloud solutions
  - Cross border mergers of European defense champions/ supply chain players
  - Digital connectivity infrastructure (fiber, towers, satellites)
  - Decarbonization of hard to abate sectors (including transportation, which has an important geopolitical component given Europe’s energy importer status)
  - Infrastructure services space (design, engineering, installation, repair of electrical grids, fiber network, water treatment, and protection of undersea cables)
  - Addressing the skills gaps to deliver against all of these opportunities

As Draghi pointed out in his report, large private capital investment will be needed to make progress on all key European priorities, with the U.S. election providing greater urgency.

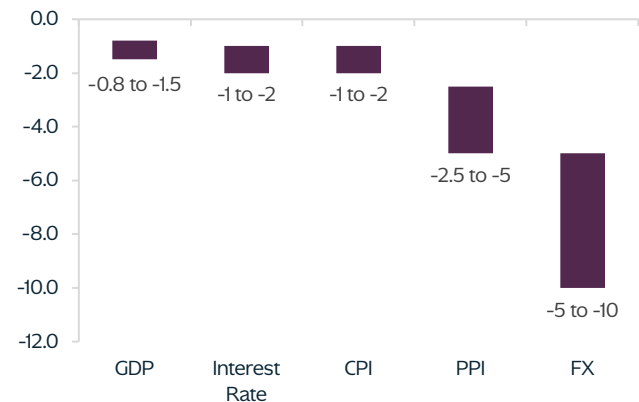
Focus on opportunities in sectors driving reshoring, supply chain innovation, and critical infrastructure.

## China: The Epicenter

As we highlighted before, we take the tariff war seriously but not literally, as we do think tariffs will be strategic and legalistic. Therefore, this section considers a few scenarios to illustrate possible negative impacts from tariffs. In the worst case (a blanket 60% tariff on all Chinese goods), we estimate China’s exports to the U.S. could be reduced by 75%, potentially lowering China’s GDP growth rate by around 1.5 percentage points. This would also exert significant downward pressure on both PPI and CPI. Consequently, China’s interest rates may need to be cut further, potentially approaching zero, and the CNY may face substantial depreciation pressure, possibly breaking 7.5 against the U.S. dollar. In response, the Chinese government will likely need to implement additional stimulus measures, possibly around RMB 3-5 trillion, on top of what has already been announced.

**Exhibit 27:** Impact of the Tariff War: Slower Growth, Falling Inflation, Lower Rates, and a Weaker CNY

**Illustrative Impact of Tariff Hike on China, %**



Note: The range estimate reflects the best and worst outcomes of our three scenarios listed below. Data as at November 7, 2024. Source: KKR Global Macro & Asset Allocation analysis.

**Exhibit 28:** The CNY Depreciated by 14% Amid the 2018-20 US-China Tariff War

**USDCNY vs. Tariff**



Data as at March 7, 2021. Source: PIIE, Bloomberg, KKR Global Macro & Asset Allocation analysis.

In 2018, during President Trump’s first term in office, he initiated a trade war with China starting with a 25% tariff on products in Lists 1 and 2, covering \$34 billion and \$15 billion worth of machinery and electronics, respectively. In September 2018, he imposed a 10% tariff on \$200 billion worth of goods in List 3 which was subsequently increased to 25% in May 2019. A 15% tariff on List 4A, mainly consumer goods, took effect in September 2019 and was reduced to 7.5% in February 2020. Tariffs on List 4B, valued at \$160 billion, have yet to take effect.

The tariff war significantly impacted trade between China and the U.S. The average tariff on Chinese goods rose to 19.3%, up from the original 3.4%. Consequently, U.S. imports from China decreased by 20% between 2018 and 2023, particularly for products subject to higher tariffs. In 2018, these items accounted for 61% of U.S. imports from China, but this share declined to 47% by 2023.

Chinese manufacturers may have mitigated the impact by re-exporting goods to the U.S. through ASEAN members and countries like Mexico.

**Exhibit 29:** The Average Tariff On Chinese Goods Rose to 19.3% From 3.4% Post-Tariff War

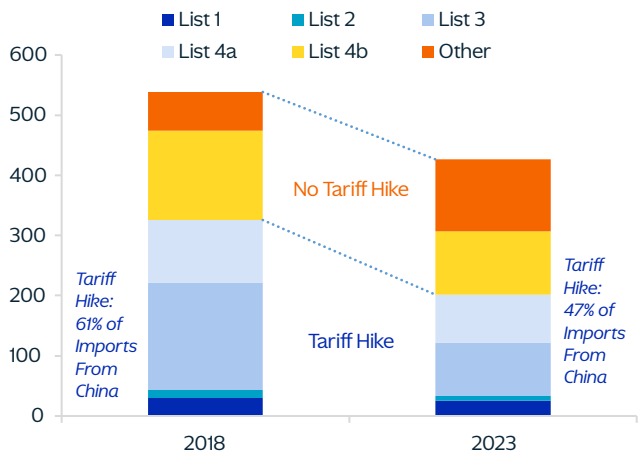
**U.S. Tariff Rates on Chinese Products, %**



Data as at December 31, 2023. Source: PIIE.

**Exhibit 30:** U.S. Data Shows Significant Reduction in Chinese Imports of Affected Products Due to Tariffs

**Impact of Tariff Hikes on US Imports from China, US\$ Billions**



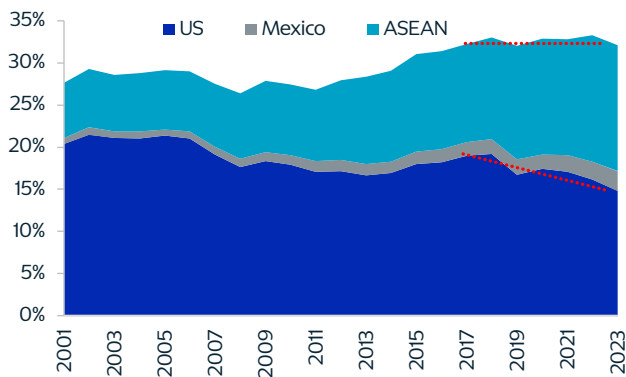
Data as at December 31, 2023. Source: USITC, KKR Global Macro & Asset Allocation analysis.

Chinese manufacturers may have mitigated the impact by re-exporting goods to the U.S. through ASEAN members and countries like Mexico. While China’s direct exports to the U.S. have declined, evidence suggests a significant share is being rerouted. The share of U.S. imports from China dropped from 21% in 2018 to 14% in 2023, but this

loss has been offset by increased imports from ASEAN and Mexico, keeping the combined share stable at around 40%. Similarly, while China's direct exports to the U.S. have decreased, its exports to the U.S., Mexico, and ASEAN have remained relatively flat.

**Exhibit 31:** Though China's Exports to the U.S. Have Come Down, Together the U.S., ASEAN, and Mexico Remain Stable

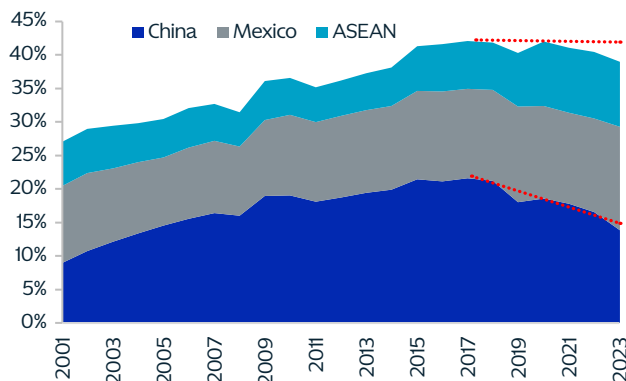
**China Exports to the U.S., Mexico and ASEAN, % of China Total Exports, 2018-2023**



Data as at December 31, 2023. Source: China General Administration of Customs, KKR Global Macro & Asset Allocation analysis.

**Exhibit 32:** Imports From China Have Also Declined, but the Combined Markets Remain Stable. We Think This Signifies a 'Rerouting' by China

**U.S. Imports From China, Mexico and ASEAN, % of U.S. Total Imports**



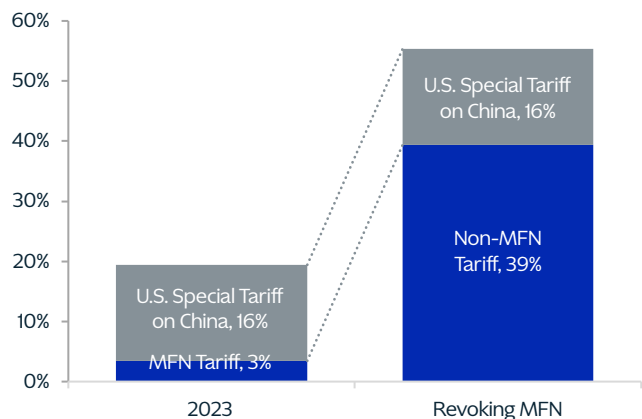
Data as at December 31, 2023. Source: USITC, KKR Global Macro & Asset Allocation analysis.

It's too early to predict the outcome of this round of the tariff war, but we can consider three scenarios for analysis:

- **Scenario I:** Removing China from the U.S.'s Most Favored Nation (MFN) status. Currently, MFN countries face an average tariff of three percent, while non-MFN countries face an average tariff of 39%. With the existing 16% additional tariff on China, **the overall tariff could rise to 55%**. Currently, only Belarus, Russia, Cuba, and North Korea are excluded from MFN status.
- **Scenario II:** Similar to what happened during President Trump's first term, he may selectively increase tariffs based on the four previous lists to minimize the negative impact on U.S. inflation. This could result in an **overall tariff on China of 35%**.
- **Scenario III:** A 60% tariff will be imposed on Chinese goods, as promised during the election campaign.

**Exhibit 33:** Scenario I: Revoking China's Most Favored Nation Status Could Lead to an Average 55% Tariff on Chinese Goods

**Revoking China's Most Favored Nation Status, %**



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

**Exhibit 34:** Scenario II: Post-Tariff War, \$250 Billion in Non-Consumer Goods Face 60% Tariff, While Consumer Goods Average 35% Penalties

Tariff Scenarios: Current, Possible Incremental and Final				
Coverage	Amount (\$bn)	Current Tariff	Possible Incremental Tariff	Possible Final Tariff
List 1-2	50	25%	35%	60%
List 3	200	25%	35%	60%
List 4a	112	7.5%	18%	25%
List 4b	160	0	10%	10%

Data as at December 31, 2023. Source: Office of the United States Trade Representative, USITC, KKR Global Macro & Asset Allocation analysis.

We estimate that the U.S. import elasticities for the four lists from the previous tariff war ranged from 1.7 to 2.2, with product-specific elasticities ranging from 1.5 to 4.2 (averaging 1.9). We think the reroute share may be halved due to a more stringent check (i.e., down from previous estimate of 50-60% to 30%).

With these assumptions, here are the key impacts of the possible tariff war:

- **Scenario I:** A 55% tariff could lead to a 70% reduction in China's exports to the U.S. and a 10.6% decrease in China's total exports. With 30% of products being re-exported to the U.S. through third countries, the overall impact on China's total exports would be a 7.4% decline.
- **Scenario II:** Selective tariff increases based on the current list would result in an overall 35% tariff on Chinese goods. This would cause a 30% drop in China's exports to the U.S., leading to only a 3% reduction in China's total exports after accounting for re-exports.
- **Scenario III:** A blanket 60% tariff would cut China's exports to the U.S. by 75%, resulting in an 11.3% decrease in China's total exports. With 30% of exports redirected, the total reduction in China's exports could be 8%.

Europe and Asia will likely face a combination of both challenges and opportunities, many of which will no doubt be based on 'the art of the deal.'

**Exhibit 35:** U.S. Tariff War Could Reduce China's Direct Exports to the U.S. by 30-75%, Based on Tariff List Assumptions, in Certain Scenarios

Scenario	Total U.S. Tariff on China	Impact on China Exports to U.S.	Direct Impact on Total China Exports	Assume Re-export through ASEAN, Mexico, etc.	Impact on Total China Exports Considering Re-export
<b>Current</b>	<b>19.3%</b>				
Scenario I: Revoking China's Most Favored Nation Status	55% (36% hike from current level)	-70%	-10.6%	30%	-7.4%
Scenario II: Selective Tariff Hike	35% (16% hike from current level)	-30%	-4.6%		-3.2%
Scenario III: Overall Tariff Hike to 60%	60% (41% hike from current level)	-75%	-11.3%		-7.9%

Calculated with Armington elasticity from A. Soderbery (2015), Estimating import supply and demand elasticities: analysis and implications, Journal of International Economics. Data as at December 31, 2023. Source: Office of the United States Trade Representative, USITC, KKR Global Macro & Asset Allocation analysis.

## APAC (Ex-China): A Balancing Act

President Trump's tariff policy is likely to trigger global protectionism, which generally has a negative impact on the Asia-Pacific (APAC) region, especially for export-oriented economies. The enactment of universal tariffs and resultant lower demand from China could impact advanced APAC economies such as Korea, Japan, and Australia by 0.6-1.1 percentage points in the aforementioned worst scenario. In contrast, India and ASEAN countries are likely to be less impacted due to their limited exposure to the U.S. and China. APAC countries' ability to absorb supply chain shifts from China and become substitute suppliers to the U.S. market without becoming targets themselves are also important offsetting considerations.

The deflationary and disinflationary trends in the region are likely to lead to lower interest rates and weaker local currencies. We expect most economies in the region to continue their cycle of rate cuts, while the Bank of Japan

may raise rates more gradually and to a lesser extent than previously anticipated. A stronger U.S. dollar is expected to exert downward pressure on regional currencies, particularly the Chinese yuan (CNY). This depreciation of the CNY, coupled with significant interest rate differentials, may also impact the Korean won (KRW), Japanese yen (JPY), and Australian dollar (AUD), leading to further depreciation pressures.

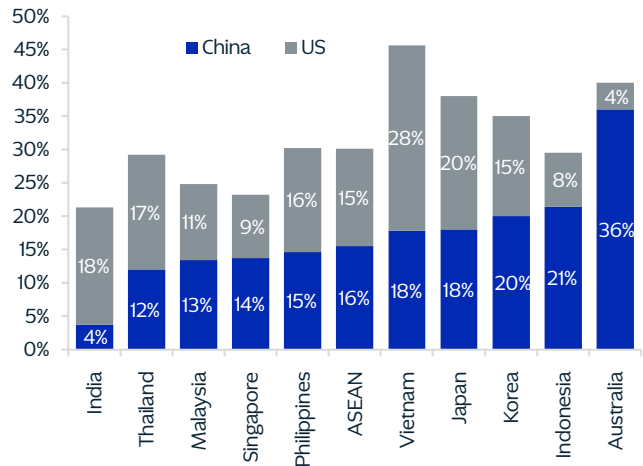
In terms of exposure to the G2 economies (China and the U.S.), we can group the region into two categories:

- Relatively Low Exposure:** This group of countries may experience less negative impact from the U.S.-China tariff war. India has the least exposure to the G2, with four percent of its exports going to China and 18% to the U.S. Most ASEAN members, such as Thailand, Malaysia, Singapore, the Philippines, and Indonesia, have around 30% combined exposure to the G2. Some of these countries are starting to benefit from China's supply chain shifts and have become suppliers to the U.S. It remains to be seen if they can maintain this balancing act or will be targeted themselves by U.S. tariffs.
- Relatively High Exposure:** This group of countries may face larger negative impacts. Australia's main issue is its high exposure to China. Japan and Korea could be affected by both U.S. tariffs *and* reduced demand from China. Vietnam is an interesting case, as it has the highest exposure to the G2 but is also a popular destination for Chinese companies relocating their operations. Overall, Vietnam's impact could be relatively muted unless it becomes a target of U.S. sanctions.

Taking all this into account, a scenario involving a 10% universal tariff and 60% tariff on Chinese goods would negatively affect the three Northeast Asian economies the most: China (-1.5%), Korea (-1.1%), and Japan (-0.7%). However, the impact on most of ASEAN and India is expected to be less severe. For example, the benefits from supply chain reallocation may more than offset the negative impacts of higher U.S. tariffs and lower Chinese demand in Malaysia and India. Australia is likely to see a 0.6 percentage point cut to its GDP growth, primarily due to its high exposure to China. Given its role as a major trade center, Singapore may suffer a bit from reduced global trade.

**Exhibit 36: G2 Exposure: Higher in Advanced APAC Economies (Japan, Korea, Australia)...**

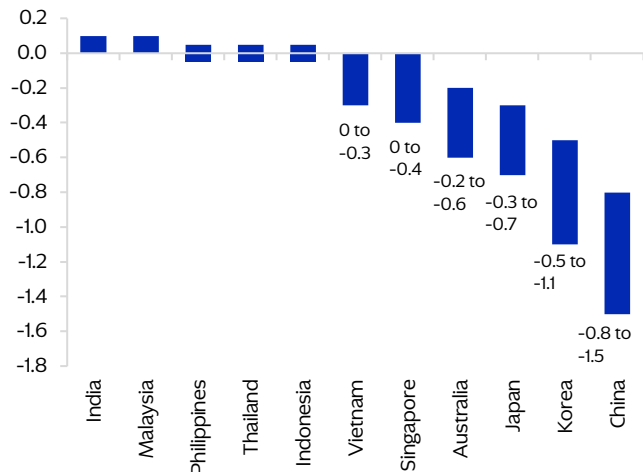
**Share of Exports to the U.S. and China in Countries' Total Exports**



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

**Exhibit 37: ...and Lower in India and ASEAN**

**Illustrative Impact of U.S. Tariffs on APAC GDP Growth by Country, %**



The range estimate reflects the best and worst outcomes of our three scenarios. Data as at November 7, 2024. Source: KKR Global Macro & Asset Allocation analysis.

**Exhibit 38:** High Exposure to China in Most APAC Economies, Except India and the Philippines

	Exports to China, % GDP	Share of tourist arrivals from China, %	Non-food commodity exports, % total exports	China outward FDI, % recipient countries' GDP	Currency, correlation coefficient
	12m to July 2024	2023	2023	2023	Since 2021
Australia	7.3	7.5	76.6	0.16	0.79
Singapore	13.3	10	15.8	1.66	0.16
Malaysia	10.2	7.3	18.9	0.39	0.78
Thailand	6.6	12.5	10.5	0.26	0.27
Korea	6.9	18.4	10.1	0.03	0.71
Indonesia	4.2	6.7	33.9	0.35	0.67
Japan	3.1	9.7	5.1	0.01	0.53
India	0.5	0.2	23.4	-0.01	0.67
Philippines	2.1	4.8	8.6	0.07	0.73

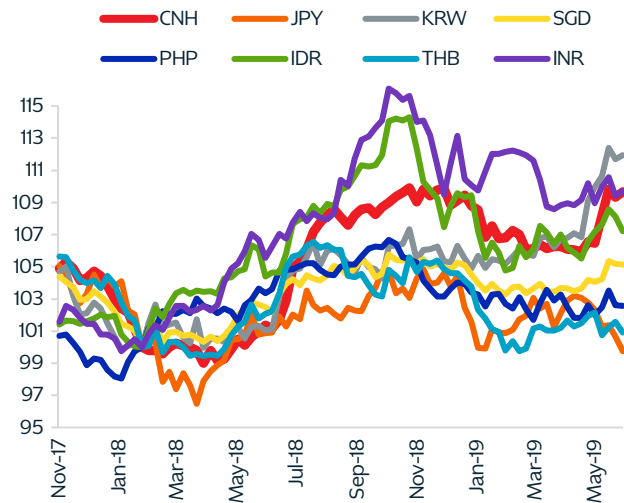
Data as at July 31, 2024. Source: Nomura, UN Comtrade, China General Administration of Customs, CEIC, KKR Global Macro & Asset Allocation analysis.

In terms of the impact on regional currencies, we anticipate general depreciation pressure. This is driven by two main factors. First, an increase in U.S. inflation and a reduced U.S. current account deficit may bolster the strength of the dollar. Second, the substantial depreciation pressure on the CNY is likely to have a spillover effect on regional currencies, particularly the Korean won and Japanese yen.

We expect most economies in the region to continue their cycle of rate cuts, while the Bank of Japan may raise rates more gradually and to a lesser extent than previously anticipated.

**Exhibit 39:** During the 2018-19 Sino-U.S. Trade War, There Were Synchronized Movements of CNY and Most APAC Currencies

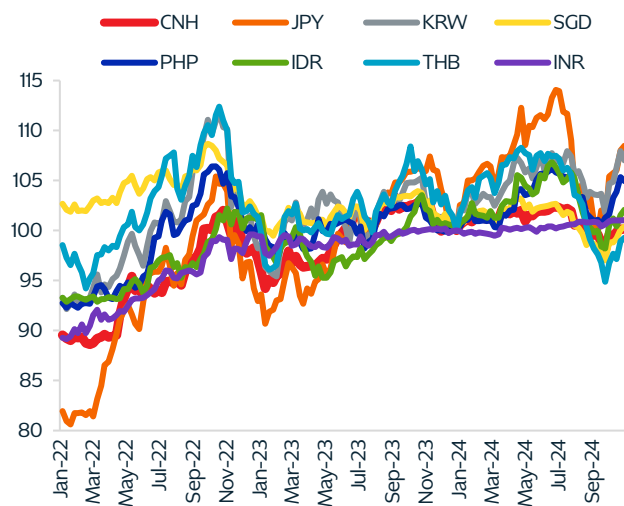
**Asia Currencies vs. USD, Jan 2018=100**



Data as at June 7, 2019. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 40:** All Regional Currencies Depreciated Against the U.S. Dollar After the 2024 U.S. Election

**Asia Currencies vs. USD, Dec 2023=100**



Data as at November 7, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

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## SECTION IV

# Conclusion

While we acknowledge that it is still early days and there are several moving pieces, we do think there are some important conclusions for investors to digest. We note the following:

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# 1

**Donald J. Trump's administration will encourage a more pro-growth, higher nominal GDP environment.**

An 'America First' agenda will further amplify our view about an asynchronous global recovery. A focus on American interests could overshadow, in some instances international cooperation. To this end, we look for more rolling recoveries and rolling recessions.

---

# 2

**We subscribe to the thesis that the world has transitioned from an era of benign globalization, where countries saw their relations in win-win terms, to one of great power competition, where the assumptions are more often zero-sum.**

U.S.-China rivalry is one of the principal engines for this shift, but not the only one: China's rivalry with its major

Asian neighbors, Russian revisionist ambitions against Europe, and conflict in the Middle East also entrench the trend. A second Trump administration is likely to be less predictable and more transactional than the last four years under Joe Biden. Still, areas of continuity are equally important and include erosion of free trade, more interventionist government policies around trade and investment on both national security and populist grounds, and secular spending growth around the 'security of everything,' as governments and companies try to build resilience in a less stable and certain world, to include the restructuring of global supply chains onto a more geopolitically rationalized basis.

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# 3

**A higher resting heart rate for growth and inflation suggests investors should allocate more capital to collateral-based cash flows linked to nominal GDP.**

A societal risk, however, is that rising asset prices create further income equality if real wages do not catch up.

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# 4

Net issuance as well as M&A activity are at extremely low levels, and as such, they both should rebound.

We look for a material surge in deal related activity across the corporate and private sectors in 2025. We think more pro-cyclical policies alongside accommodative capital markets could fuel a meaningful capex and M&A cycle.

---

# 5

The most important variable we are watching is U.S. productivity.

It is key to growth and profitability, and it is required to offset higher inflation and bigger deficits. Importantly, though, the recent ongoing surge in productivity (+2.3% over the last eight quarters) has actually occurred before AI benefits have been realized at scale, further underscoring our view that the corporate sector could enjoy a longer-tailed profitability renaissance.

**Bottom line:** So, as we peer around the corner today on what tomorrow might look like, our strong advice is to focus on the forest, not the trees. Without question, there will be the temptation to over-trade the daily news, as there is likely to be a lot of interesting – but non-substantial – crosscurrents and rhetoric that do not actually change the narrative of the next four years. By comparison, there will be some material events that occur along the way that warrant investor attention, which is why we continue to rely so heavily on our top-down frameworks, including our *Regime Change* approach. No one can predict the future, but there are portfolio tilts, many of which we have identified in this piece, that should help better insulate

portfolios in what we believe could be one of the most dynamic times across the global capital markets in recent history.

Importantly, though, the recent ongoing surge in productivity (+2.3% over the last eight quarters) has actually occurred before AI benefits have been realized at scale, further underscoring our view that the corporate sector could enjoy a longer-tailed profitability renaissance.



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