

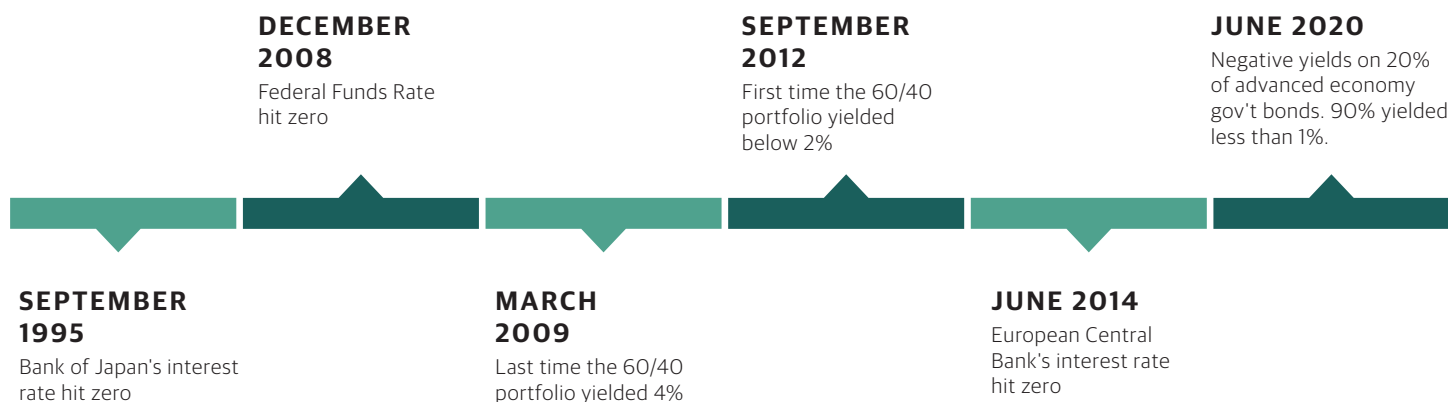
PRIVATE WEALTH SOLUTIONS

Income: A Scarce Resource

The challenge of finding attractive income sources in a low-yield world has increased to a degree perhaps unfathomable a decade ago.

Income-oriented investors seeking to adapt to this new world should understand that (i) historically, low-rate environments have tended to be remarkably persistent;¹ (ii) many income-oriented portfolios today bear substantial depletion risk;² and (iii) alternative sources found in private markets may be part of the answer for yield-starved investors.

FIGURE 1: Milestones on the Path to Zero/Near-Zero Interest Rates



Source: Federal Reserve Bank of St. Louis, 2020. Morningstar and Bloomberg, as of June 30, 2020. Reuters, 2019.

I. The Stubborn Persistence of Near-Zero Interest Rates

Several factors have driven interest rates near zero in developed economies, including accommodative monetary policy after the Global Financial and COVID crises. In the U.S., markets expect that strong economic growth and high inflation will lead the Federal Reserve to hike its policy rate by the end of 2022, though it would take several months, if not years, for rates to near pre-COVID levels. In Japan and the Euro-zone, interest

rates will likely remain lower for longer due to continued central bank support and demographic trends. These include aging populations, which tend to save more and therefore bid up the prices of income-generating assets and suppress those assets' yields. Over the longer term, an older population in the U.S. is also likely to result in structurally lower inflation and rates.

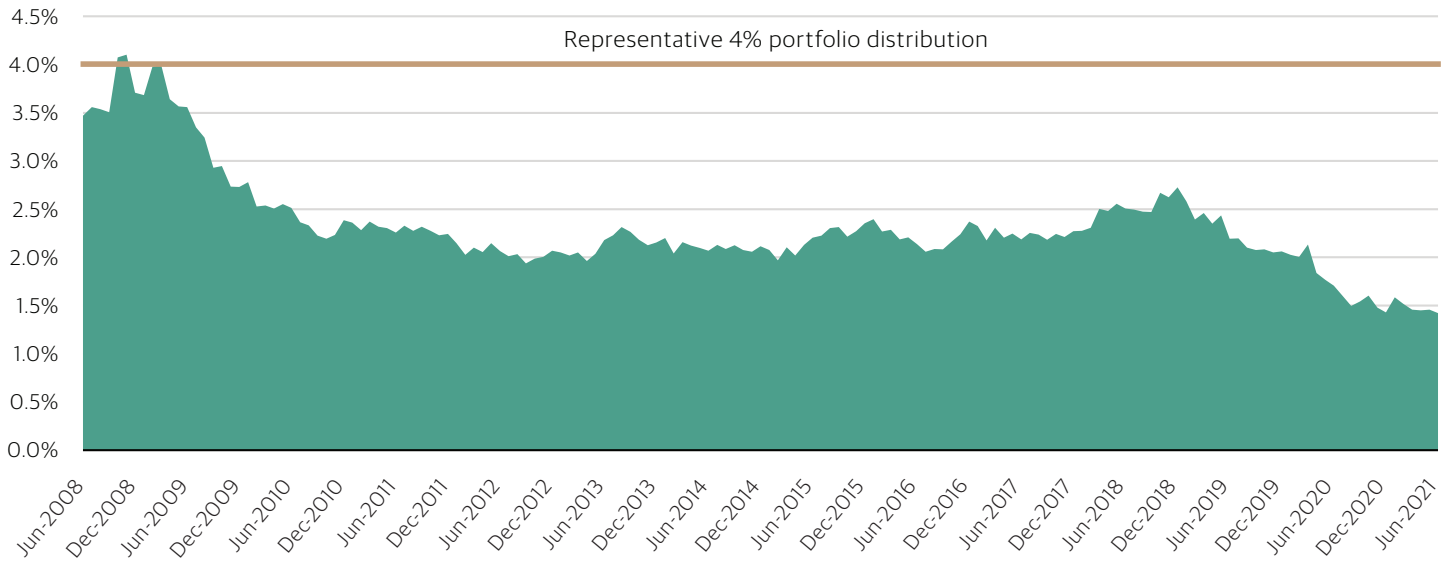
1. Source: Based on publicly available policy benchmark and interest rate data in Europe and Japan, 1995-2020.

2. Source: Alliance for Lifetime Income, "Americans are Confronted by a Looming Retirement Income Shortfall," July 2019.

3. Source: Board of Governors of the Federal Reserve System, 2020.

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FIGURE 2: Annualized 60/40 Portfolio Yield from 2008 to 2021



Source: Bloomberg, Morningstar, as of June 30, 2021. Hypothetical portfolio allocated 60% to the S&P 500 Index, 40% to the Bloomberg U.S. Aggregate Bond Index. The yield on the traditional 60/40 portfolio was calculated using the S&P 500 Index dividend yield and the annualized Bloomberg U.S. Aggregate Index yield. Portfolio yields are shown from June 2008 to June 2021.

II. Significant Portfolio Depletion Risk

Accordingly, in our view many income-oriented portfolios today may face substantial depletion risk. That is, we believe portfolios may be at risk of being exhausted or permanently impaired while their owners are still living and/or still face financial obligations that they intend to meet with portfolio income.

The sheer math when comparing the yield of a traditional 60/40 portfolio today—which is 1.4% as of 6/30/2021—versus a representative portfolio distribution of, say, 4% a decade ago is daunting. Yields on the 10-Year Treasury, AAA-rated corporate bonds and municipal bonds (Figure 3) stand anywhere from a

fraction to less than half their levels a decade ago, when the first of the Boomer cohort began to retire. Investors who require a 4% distribution face the possibility of withdrawing money at perhaps twice the rate that portfolio yields can supply it, forcing those investors to rely on market appreciation and/or drawing down capital to meet their anticipated living needs.

This may be particularly risky at a time of heightened market volatility. Sharp drops in asset value in our opinion only serve to heighten depletion risk, since the withdrawal of a fixed percentage after a market decline all else holding equal represents a larger relative percentage of the total portfolio.

FIGURE 3: Yields When the First Boomer Retired (2010) vs. Yields Today



Source: Bloomberg, Morningstar, as of June 2021.

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III. Potential Solution: Introducing Alternative Sources of Income

Income-oriented investors today may want to revisit private market alternatives as a potential solution for their yield challenges. In particular, portfolios with private credit and private real estate allocations compared to a traditional portfolio (Figure 4) may offer greater yield potential and a higher likelihood of closing the above-discussed income gap.

In the hypothetical portfolios presented on this page, investors in the dominant asset classes today face yields which may be below their targets—in some cases, half the traditional yield target of 4%.

Allocating just a portion of the same portfolio to asset classes such as private real estate and private credit may bring significant potential yield enhancement. In the hypothetical illustration here, the portfolio yield rises to 3.4% from 1.4%.

We see private real estate as a compelling portfolio holding, one with attractive total return potential, a considerable portion of which may be delivered in the form of income. Private credit in our view is primarily a source of high income potential, and also warrants consideration as a long-term portfolio holding.

As a trade-off of investing in private market alternatives, capital is often locked up for specified periods. This means investors must plan around the lack of liquidity of the investment. In practice, this often means investors must source liquidity from other parts of their portfolios. For some investors, a semi-liquid investment structure may represent a middle ground between liquid and illiquid investments.

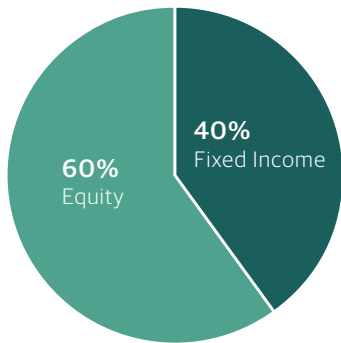
FIGURE 4

Traditional 60/40 Portfolio

1.4%
Annualized
Yield

8.5%
Annualized
Return

9.9%
Annualized
Volatility

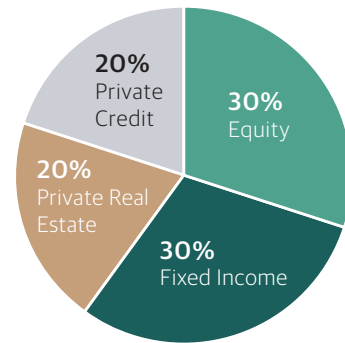


Portfolio with Private Market Alternatives Allocation

3.4%
Annualized
Yield

8.0%
Annualized
Return

5.9%
Annualized
Volatility



Source: Morningstar, Bloomberg, Cliffwater, as of June 30, 2021.

The yield on the traditional 60/40 portfolio was calculated using the S&P 500 dividend yield and the annualized Bloomberg U.S. Aggregate Bond yield. The yield on the portfolio with a private market alternatives allocation was calculated using the S&P 500 dividend yield, the annualized Bloomberg U.S. Aggregate yield, the annualized quarterly income for the Cliffwater Direct Lending Index and the annualized quarterly income for the NCREIF ODCE Index. There can be no assurance that any Blackstone fund or investment will achieve its objectives or avoid substantial losses, or that alternative investments will generate higher yields than other investments. Annualized yields as of June 30, 2021. Annualized returns and volatility are based on the quarterly returns over the 15-year period from July 2006 to June 2021.

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