THINKING BEYOND THE CYCLE
By Jason M. Thomas

After a decade of robust returns, uninterrupted global economic growth (despite some regional stumbles), and a seemingly inexorable rise in valuations across virtually all asset classes, investors have become focused on the endgame. Questions regarding the timing of this cycle’s inevitable turn for the worse are certainly worth pondering, but they are hardly the only ones worth asking, nor are they likely to prove to be the most consequential to portfolio performance. Instead, it is the secular decline in expected returns – rooted in the rise of global savings relative to investment demand – that poses the greatest risk to investors.

Financial capital is no longer the finite resource it once was. Modern businesses generate more cash than they can reinvest. The rise of “hyperscalers,” “virtual companies,” and asset-light business models has resulted in a structural surplus of liquidity that bids up the price of existing assets and pushes real financing costs to zero. High returns over the past decade partly reflect asset prices’ one-time adjustment to this shift. Now that this process has run its course, those returns are largely in the rearview mirror.

If investors are to avoid the looming diminution in returns, they will need to adopt a secular, rather than cyclical, orientation to their thinking and investment strategy. This means that rather than assume a defensive posture in anticipation of a downturn, investors should think beyond the cycle and increase their exposure to the scarce resources, demand drivers, and investment strategies most likely to generate persistent returns over the next decade or more.

Today, human capital is the finite resource that constrains the growth of businesses: managerial talent, creativity, professional networks, and the capacity to manage complex situations and execute in circumstances that others cannot. Human capital not only offers the prospect of faster growth, but also uncorrelated returns from the specific actions undertaken to unlock value. Only by identifying businesses and partners rich in human capital can investors hope to generate incremental returns necessary to offset the decline in the equilibrium return on savings.

Investors seeking persistent returns through the next downturn should also weight portfolio exposures towards sectors that exhibit less dependence on global GDP growth and strategies that offer uncorrelated risk profiles. This means focusing on assets whose cash flows depend more on demographics and structural changes in the economy than aggregate demand growth, and investment strategies with countercyclical properties and longer holding periods.

The decline in expected returns has made life difficult for savers, but this is not due to a conspiracy among central banks or temporary forces likely to dissipate in the next few years. Instead, it reflects a structural change in the global economy that has increased the amount of cash chasing investment opportunities of all types. Investors shouldn’t delude themselves into thinking a downturn won’t come, but obsessive focus on its timing distracts attention from the steps necessary to ensure recent returns persist through the next cycle and beyond.

Calm But Not Complacent – Contextualizing the Next Downturn

Timing recessions is notoriously difficult. Downturns almost necessarily involve some unforeseen shock that destabilizes the system. This unpredictability makes market-timing strategies unprofitable. Increased cash holdings introduce a drag on returns that can only be offset if investors are right about the timing and magnitude of the market correction and eventual rebound. Even worse, obsessive focus on “getting out” at the top to beat these long odds often leads to indiscriminate selling of the sort that boosts returns for other investors by allowing them to deploy additional capital at more advantageous prices during market hiccups.

While cyclical fears tend to increase with the length of the expansion, the magnitude of the eventual downturn does not. The depth and duration of recessions instead depend on the size of the capacity overhang that develops during the expansion (Figure 1). Large imbalances can manifest themselves in a relatively short period, as between 2002 and 2007 in the U.S. when the stock of commercial mortgages doubled, builders constructed five million more single-family homes than were necessary to meet household demand, and the average loan-to-value ratio on mortgaged properties rose by 20 percentage points. Timing the spark that ended that cycle was much less important than recognizing the potential scale of the inferno that could result.

FIGURE 1

GDP Growth Over the Next Two Years is Inversely Related to Measures of Excess Capacity in Credit, Real Estate & Corporate Capex

2 Carlyle analysis; Federal Reserve Flow of Funds Accounts, B. 103 and L. 217.
3 Carlyle Analysis of BEA Data, April 2019.
Despite the lengthy expansion, there are few obvious signs today of excess capacity on a comparable scale (Figure 2). The modest GDP growth in advanced economies over the past decade can be traced directly to weakness in capital spending and credit growth. Construction activity has remained near recession levels in the U.S. and Europe, while household indebtedness has declined well below pre-crisis levels. Real estate developers have been remarkably circumspect, with commercial development spending failing to rise with valuations for the first time on record (Figure 3). After a decade of conservatism, CEOs today invoke “late-cycle” concerns to rationalize even more risk aversion (Figure 4).

The Bigger Risk is the Decline in Expected Returns...

While the available evidence counsels against a defensive posture, both because of an inability to time the downturn and the absence of obvious excesses that would merit a high degree of caution, this is hardly the time for complacency. Expected returns have declined significantly over the past several years, introducing the risk that portfolio balances in five and ten years’ time will fall well short of targets.

The cyclical recovery from the Global Financial Crisis combined with the secular decline in interest rates to produce a decade of strong returns on the back of rising valuations (+40%) and
expanding operating margins (+3 percentage points). This process has largely run its course. If we assume that sales continue at their current pace (i.e. no recession) but margins, interest rates, and multiples slowly revert to their pre-crisis averages, the expected return on stocks would be close to 4% in nominal constant-currency terms (including dividends) over the next five years (Figure 5). Perhaps high valuations, low financing costs, and wide operating margins may prove to be a more enduring feature of the investment environment, but it is hard to imagine future returns from further improvements across any of these dimensions.

...Originating from the Rise of Corporate Savings and Asset-Light Business Models

While unconventional monetary policy has been blamed for the drop in bond yields and corresponding rise in valuations across asset classes, it is important to disentangle cause and effect. Central banks have simply responded to fundamentals. Expected returns are low because financial capital is no longer the finite resource it once was.

For a large and growing share of businesses, internally-generated cash flow is more than sufficient to cover all desired capital spending. In fact, these corporate cash flow surpluses have grown so large that the (nonfinancial) corporate sector has not only become self-financing, on the whole, but has actually shifted from being a net borrower from the rest of the economy to a net lender (Table 1).

### TABLE 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating Cash Flow (Net of R&amp;D)</th>
<th>Gross Investment (Capex)</th>
<th>Borrowing (-) or Lending (+)</th>
<th>As a % of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>2,216.60</td>
<td>2,094.10</td>
<td>$121.90</td>
<td>1.2%</td>
</tr>
<tr>
<td>2008</td>
<td>1,348.50</td>
<td>1,433.30</td>
<td>-$84.80</td>
<td>-1.2%</td>
</tr>
<tr>
<td>1999</td>
<td>914.30</td>
<td>1,020.60</td>
<td>-$106.30</td>
<td>-2.0%</td>
</tr>
<tr>
<td>1990</td>
<td>491.30</td>
<td>530.90</td>
<td>-$39.60</td>
<td>-1.2%</td>
</tr>
<tr>
<td>1980</td>
<td>274.60</td>
<td>310.60</td>
<td>-$36.00</td>
<td>-2.2%</td>
</tr>
<tr>
<td>1974</td>
<td>126.40</td>
<td>146.00</td>
<td>-$19.60</td>
<td>-2.3%</td>
</tr>
</tbody>
</table>

This turns our traditional understanding of the economy’s capital development on its head. Forty years ago, the largest companies were industrial businesses—GM, Exxon, Ford, GE, IBM, Chevron, Westinghouse, among others—that could not scale production without external capital. When current output consumed existing capacity, these businesses would tap the savings of households, pensions, trusts, insurers, and other pools of capital to build the new factories, buy the new equipment, and hire the new workers necessary to increase production. These investments increased the economy-wide stock of assets, and the income they generated became the coupons, dividends, and capital gains that constituted investors’ returns.

Today, intangible assets—ideas, content, design platforms, software, proprietary technology, brand, business methods, etc.—account for over 80% of economy-wide enterprise value, up from just 20% forty years ago (Figure 6). These assets introduce a scalability that allows virtually infinite revenue growth without much, if any, incremental investment. For many of today’s largest and most profitable businesses, the old resource constraints not only no longer apply but are not even intelligible as concepts. What is the capacity utilization of Facebook? What is the physical depreciation rate of WeChat? What is the inventory turnover ratio of Windows 10?

As shown in Table 2, the ten largest (by market cap) U.S.-listed businesses today generate roughly 2.5x as much operating income (Ebit) as they reinvest in the business. Only two of the companies are net borrowers: ExxonMobil, an “old economy” company whose cash flow relations provide a guide to how things worked in the past; and Amazon, whose aggressive expansion strategy necessitated significant capital outlays that should decline in relation to income in the future. The other eight companies—including two based in China—generated 3.5x as much internal cash from operations as they reinvested in the business over the past five years, after accounting for all R&D spending and related intellectual property production.

### TABLE 2

<table>
<thead>
<tr>
<th>Company</th>
<th>Operating Income (USD Thousands)</th>
<th>Capital Expenditures (USD Thousands)</th>
<th>Internal Cash/Capex Coverage Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apple</td>
<td>65,874,000</td>
<td>12,436,250</td>
<td>5.30x</td>
</tr>
<tr>
<td>Microsoft</td>
<td>30,510,000</td>
<td>8,512,000</td>
<td>3.58x</td>
</tr>
<tr>
<td>Berkshire Hathaway</td>
<td>27,427,750</td>
<td>13,820,250</td>
<td>1.98x</td>
</tr>
<tr>
<td>Alphabet (Google)</td>
<td>25,837,500</td>
<td>14,621,250</td>
<td>1.77x</td>
</tr>
<tr>
<td>Johnson &amp; Johnson</td>
<td>20,141,000</td>
<td>3,409,500</td>
<td>5.91x</td>
</tr>
<tr>
<td>Facebook</td>
<td>15,942,000</td>
<td>6,915,500</td>
<td>2.31x</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>13,646,000</td>
<td>19,407,250</td>
<td>0.70x</td>
</tr>
<tr>
<td>Tencent</td>
<td>8,954,771</td>
<td>1,690,452</td>
<td>5.30x</td>
</tr>
<tr>
<td>Alibaba</td>
<td>6,638,383</td>
<td>2,542,691</td>
<td>2.61x</td>
</tr>
<tr>
<td>Amazon</td>
<td>5,736,500</td>
<td>9,643,250</td>
<td>0.59x</td>
</tr>
</tbody>
</table>

*Weighted Average 2.4x

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The AUM is estimated based on the cash position of Apple as of 12/31/2018.

Bloomberg, Ocean Tomo, April 2018.

Carlyle Analysis; BEA; Integrated Macroeconomic Accounts of the U.S.

Braeburn Capital, “Apple should shrink its finance arm before it goes bananas,” The Economist.


14 Braeburn Capital, “Apple should shrink its finance arm before it goes bananas,” The Economist.

The AUM is estimated based on the cash position of Apple as of 12/31/2018.

With no need for external capital and more internal cash than they could plausibly spend, the corporate sector builds larger and larger cash positions, repurchases stock, boosts dividends, and even lends to other businesses through asset management subsidiaries. Since the Global Financial Crisis, share repurchases have exceeded new equity issuance by roughly $4 trillion in the U.S. alone (Figure 7), while Apple has become one of the largest market-based lenders in the world, with an asset management subsidiary with more than $250 billion under management.

By no means is this phenomenon restricted to megacap companies or the technology and health care sectors. Over the past decade, a new generation of “asset-light” or “virtual” businesses has emerged that has redefined the boundaries of the firm by focusing on core competencies and outsourcing much else, including productive capacity (plant, equipment, staffing) through contract manufacturing. Rather than a cost arbitrage, this new generation of outsourcing reflects the greater degree of specialization made possible by digitization, globalization in services, and longer and more competitive value chains. The most profitable and fastest growing “manufacturers” have become sophisticated, lightly-staffed design platforms capable of orchestrating complex, cross-border production processes for precision equipment, apparel, electronics, and other goods.

Today’s Relevant Constraint is Human Rather than Financial Capital

While businesses may not need money from financial intermediaries, they still need their help. Today, human capital is the finite resource that binds the growth of businesses and commands high returns, and this is as true for “virtual” companies as it is for large industrial firms with billions of dollars’ worth of physical assets. While the structural excess of corporate savings over investment has depressed equilibrium return on passive saving, the return on human capital has never been higher.

Human capital refers to managerial talent, creativity, professional networks, and, perhaps most importantly, the experiential knowledge gained from years devoted to building better businesses. The great business managers are not infinitely replicable; neither are the creative geniuses that invent products that we didn’t know we needed or thought technically possible; but neither is the practical knowledge of product market dynamics and operations that has been accumulated over decades inside of certain businesses and investment firms. In each case, there is a finiteness, a binding constraint. Some have it, others do not, and returns have come to depend on its accumulation and deployment.

For instance, businesses with the human capital necessary to develop innovative products may lack the skills necessary to successfully commercialize them, which generally requires experience in the industry, customer and market knowledge, branding and communication, distribution, and close relationships with key actors. Likewise, businesses with products dominant in a given market may lack the skills and relationships necessary to expand globally, which often requires linguistic, cultural, and social capital. There is also a transformational form of human capital often used to reorient and reposition businesses. The great business managers are not infinitely precocious; but neither are the creative geniuses that invent products that we didn’t know we need or thought technically replicable; neither are the creative geniuses that invent products that we didn’t know we need or thought technically possible, but neither is the practical knowledge of product market dynamics and operations that has been accumulated over decades inside of certain businesses and investment firms.

Multiple intelligences: The theory in practice


12 Bloomberg, Ocean Tomo, April 2018.

13 Carlyle Analysis; BEA; Integrated Macroeconomic Accounts of the U.S.

14 Braeburn Capital, “Apple should shrink its finance arm before it goes bananas,” The Economist.


The Ascendance of Private Capital Dovetails with this Structural Shift

In many ways, these structural changes have made it the best and worst time for private capital. On the one hand, few businesses are looking for capital underwritten to 20% annual returns, and those who do likely have something wrong with them. The simple act of finding deals no longer commands the returns it once did. But, on the other hand, current conditions are especially propitious for those private capital firms with the replicable growth strategies, CEO networks, and global platforms that can help companies accelerate growth or change directions.

When financial capital was the binding constraint, businesses pursued public listings to obtain the lowest-cost capital available to scale their business. Today, entrepreneurs, founders, and management teams increasingly prefer to partner with global private investment firms in pursuit of human capital. Identifying deficiencies is not always easy; possessing the professional network, market knowledge, and resources necessary to remedy them is even harder. Just as certain types of human capital accumulate more quickly in areas with more skilled workers and a common focus,21 other types grow most efficiently inside of global investment firms with integrated networks of professionals that have devoted their lifetimes to building better businesses.

Investors have responded by dramatically increasing their allocations to private capital to participate in this process. Over the past decade, “active management” has come to be synonymous with private equity, as ETFs and passive strategies account for a larger share of sophisticated investors’ stock portfolios, and “stock picking” has been replaced by direct ownership and control through private markets.

Ironically, some have labeled the exponential growth in the private equity industry’s assets under management (AUM) and dry powder as a “bubble.”22 These observers see massive capital flows into the industry but fail to perceive the profound structural changes that have led to a more-than-proportion- al increase in companies seeking private capital. In fact, the number of public companies in the U.S. has dropped by 53% from its peak, a decline similar to that observed in many other economies (Table 3) and the mirror image of the rise of private equity-backed companies (Figure 8). When controlling for company size and financial market development, overall listing propensity has declined by roughly two-thirds over the past 40 years.23

The universe of public companies is not just smaller in number; its composition has shifted towards businesses that tend to be substantially older, larger, and more mature than was the case 10-to-20 years ago. Delistings due to mergers, buyouts, and bankruptcies have not been offset by new Initial Public Offerings (IPOs), which have declined by 75% in the U.S. since the late-1990s. As yesterday’s “growth stocks” migrate to private portfolios, Duke Professor Elizabeth de Fontenay cautions, “the public stock market is quickly becoming a holding pen for massive, sleepy corporations.”24

<table>
<thead>
<tr>
<th>TABLE 3</th>
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</thead>
<tbody>
<tr>
<td><strong>Decline in the Number of Publicly-Listed Companies</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Peak</td>
<td>End of 2017*</td>
<td>Decline</td>
</tr>
<tr>
<td>Netherlands</td>
<td>392</td>
<td>102</td>
</tr>
<tr>
<td>Mexico</td>
<td>390</td>
<td>141</td>
</tr>
<tr>
<td>South Africa</td>
<td>754</td>
<td>294</td>
</tr>
<tr>
<td>France</td>
<td>1185</td>
<td>465</td>
</tr>
<tr>
<td>US</td>
<td>7322</td>
<td>3439</td>
</tr>
<tr>
<td>Brazil</td>
<td>592</td>
<td>335</td>
</tr>
<tr>
<td>UK</td>
<td>2913</td>
<td>1858</td>
</tr>
<tr>
<td>Israel</td>
<td>664</td>
<td>431</td>
</tr>
<tr>
<td>Germany</td>
<td>761</td>
<td>450</td>
</tr>
<tr>
<td>Switzerland</td>
<td>289</td>
<td>228</td>
</tr>
</tbody>
</table>

*Four-Year Average

<table>
<thead>
<tr>
<th>FIGURE 8</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth in Private Companies Mirrors Fall in Public Listings</strong></td>
<td></td>
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</tbody>
</table>

With little prospect for additional multiple or margin expansion, portfolio-wide returns over the next 5-to-10 years will depend more on growth. And as growth gravitates to private portfolios, investors will need to adjust allocations to reflect current realities rather than those that prevailed a decade ago.

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23. Carlyle Analysis. While listings in some Asian economies continue to grow due to faster new firm formation, the pace has slowed dramatically and the number of listed companies globally has declined steadily over the past five years. Godge, C. et al. (2018), “Eclipse of the public corporation or eclipse of the public markets?” ECGI Working Paper No. 547.
25. WDI Database, February 2019
Portfolio Construction Still Looms Large
a. Structural Rather than Cyclical Demand Growth

While excess returns over the secular horizon will largely accrue to human rather than financial capital, the cyclical sensitivity of a portfolio’s return profile will still depend on the composition of the underlying assets. Investors should not be spooked by the prospect of a downturn, but they also should not pretend one will not occur either. At this point in the cycle, investors should increase exposure to sectors that exhibit less dependence on global GDP growth.

Table 4 reports the statistical dependence between the cash flows of eight industries with GDP. The first two columns measure the correlation between the industry’s aggregate sales and operating earnings with GDP, while the next two measure the “beta” or sensitivity of industry cash flows to a given change in GDP (a 1% drop in nominal GDP has been associated with a 5.66% drop in financial services industry revenues, for example).

As is obvious from the table, the aggregated cash flows in the health care sector have evolved independently from GDP over the past 25 years. That’s largely because health expenditures tend to be a function of demographics and the long-run convergence in living standards fostered by globalization (Figure 11). Health care tends to be the rare sector whose cash flows are both “low-beta” and fast-growing, with largely idiosyncratic risks stemming from changes in public policy and therapeutic breakthroughs. For Asian economies that are growing old at the same time that they are growing rich, health expenditures are likely to grow significantly faster than the broader economy.

Indeed, the cyclical sensitivity of the returns on a specific investment often has much more to do with the strategy, or value creation proposition, than industry or geography.
The other low-beta sector, “consumer staples,” is best conceived as a geographic rather than sectoral strategy. Traditionally viewed as a “defensive sector” involving expenditures that consumers in advanced economies are loathe to cut from their budgets, this category really captures consumer spending that tends to accumulate through time rather than vary over the cycle or in response to interest rates. On this basis, it is the rise of the Asian consumer—especially in China—that best captures this persistence.

While Chinese consumption slowed in 2018 in response to the intensifying trade dispute with the United States—an idiosyncratic political shock—the medium-term outlook remains extremely favorable. While rising household income growth will account for the bulk of the increase, generationally shifts in savings rates and attitudes towards debt should make large contributions as well. China’s national savings rate remains more than 10 percentage points above Korean levels and nearly 20 percentage points above that of Japan. At the same time, Chinese household indebtedness stands at barely half of Korean levels and 20% below those of households in Malaysia and Thailand. These disparities should narrow over the next decade, particularly given the shift in the macroeconomic framework away from exports and investment towards growth centered on consumption, services, and advanced industries.

If Chinese consumption follows the path of the Japanese, Korean, and Taiwanese economies at similar per capita income levels, household spending should rise from 38% to 55% of GDP over the next 15–20 years. The difference is that with 1.3 billion people and a starting GDP in excess of $13 trillion, the rise of the Chinese consumer is likely to have a far greater impact on global economies and investment portfolios. If broader GDP expands at a 6% real rate over the next decade, consumer spending would advance by more than 8%, on average, or growth of nearly $400 billion per year in 2019 terms.

The cyclical sensitivity of each asset in a portfolio depends on a number of factors that extend well beyond its location and industry categorization. While health care sector revenues typically exhibit little dependence on GDP, sometimes policy risks are correlated with the economic cycle, such as when public insurance cutbacks occur during economic downturns. And while a negative economic shock generally depresses demand for energy, these effects tend to be concentrated in “upstream” sectors, with shipping, pipelines, refining and electricity transmission and distribution largely unaffected. Long-term structural change in energy consumption should also ensure that demand for battery technology and renewables grows steadily through any recession.

Indeed, the cyclical sensitivity of the returns on a specific investment often has much more to do with the strategy, or value creation proposition, than industry or geography. For example, carving out a subsidiary or division from its corporate parent and turning it into a standalone business is a complex process that involves significant execution risks. A new management team needs to be assembled; accounting, sales, legal, and product development functions often need to be established or reinvented; the ownership of physical and intellectual property must be disentangled and valued appropriately; and an entirely new corporate culture and strategy needs to be conceived and transmitted throughout the business. And all of this needs to occur without any material cost overruns or loss of revenues.

Similar execution risks are evident in infrastructure, where coordination with political leaders, labor unions, and other stakeholders often adds another layer of complexity to the project. The returns to redeveloping airports, dredging ports, building pipelines, and transitioning electricity generation to renewable sources all involve multidimensional optimization problems inside of fixed budget and time constraints. Real estate renovation or redevelopment often involves similar risks.

as the details of the projects have to match the precise tastes of the target business or household demographic without cost or time overruns. Energy investments often involve similarly complex political dynamics and increasingly depend on the diffusion of technology to boost the productivity of existing fields.

In each of these cases, the investment may succeed or fail across any of these dimensions, but that success or failure has nothing to do with the returns on the S&P 500 or any other index of global assets. Such execution risks provide uncorrelated returns that depend on the human capital of the financial sponsor, its CEO networks, and other partners. The more complex the undertaking, the smaller the pool of potential rivals and higher the expected returns on the requisite human capital.

c. Diversifying Risk Through Time: Longer Duration and Countercyclical Deployment

Cyclical variation in returns is not just about economic fundamentals, but also the predictable movements in multiples and financial conditions. At cyclical peaks, risk premia tend to be low, credit spreads narrow, and asset price multiples reach levels that leave little-to-no margin for error. Returns on investments made during these periods could disappoint even if the business, or cash flows from the asset, perform according to plan.

However, the practical importance of such financial market volatility depends on the holding period. For example, the return on an investment held for one month is entirely explained by its cash flow performance; fundamentals are all that matter. Empirical estimates of the relationship between these two extremes reveal that multiple contraction declines nonlinearly with the expected holding period. An asset held for 10 years assumes 60% less multiple contraction risk than one held for three years (Figure 14).

![FIGURE 14](image)

**Risk of Multiple Contraction Declines Nonlinearly with Holding Period**

Risk Reduction from Extending Duration

Asset Held 3 Months: Return Mostly Attributable to Market Volatility

Asset Held 20 Years: Return Almost Entirely from Fundamentals

Cyclical risks could be further diversified through opportunistic or countercyclical credit strategies that deploy capital during periods of heightened volatility. Empirical evidence reveals that credit (loans and bonds) absorbs a disproportionate share of the decline in enterprise value during market downturns relative to its seniority in the capital structure. During these episodes, the market price of loans and bonds drops below its “intrinsic” value, which means that above-average returns on credit often become a necessary condition for non-negative returns on equity. This is not simply dollar-cost-averaging, but the active exploitation of capital structure arbitrage opportunities that allow investors to simultaneously increase expected returns and downside protection. By scaling up capital deployment during these periods, investors can boost cumulative returns and diversify market exposure through time.

### Conclusion

Investors should be calm but not complacent. The looming end of the current cycle is not as material a risk to portfolio performance as the secular decline in expected returns. Financial capital is not the scarce resource it once was; the rise of the “virtual” company and structural surplus of corporate savings have depressed equilibrium returns to savers. Today, it is human capital that relaxes constraints on growth and generates outsized returns for investors.

Rather than worry about when this cycle will end, investors should focus on the steps required to ensure that the strong portfolio performance of the past several years persists through to the next cycle and beyond. To that end, investors should: (1) seek investment partners rich in human capital, with replicable growth strategies, CEO networks, and global platforms; (2) increase exposure to secular rather than cyclical growth drivers, such as health care expenditures and household consumption in China; (3) focus on strategies that generate returns from uncorrelated execution risks; and (4) diversify market risks over time through investment strategies that pursue longer holding periods and countercyclical capital deployment.

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33 Carlyle Analysis of S&P Capital IQ Data, June 2018.

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