Blackstone

The Connection

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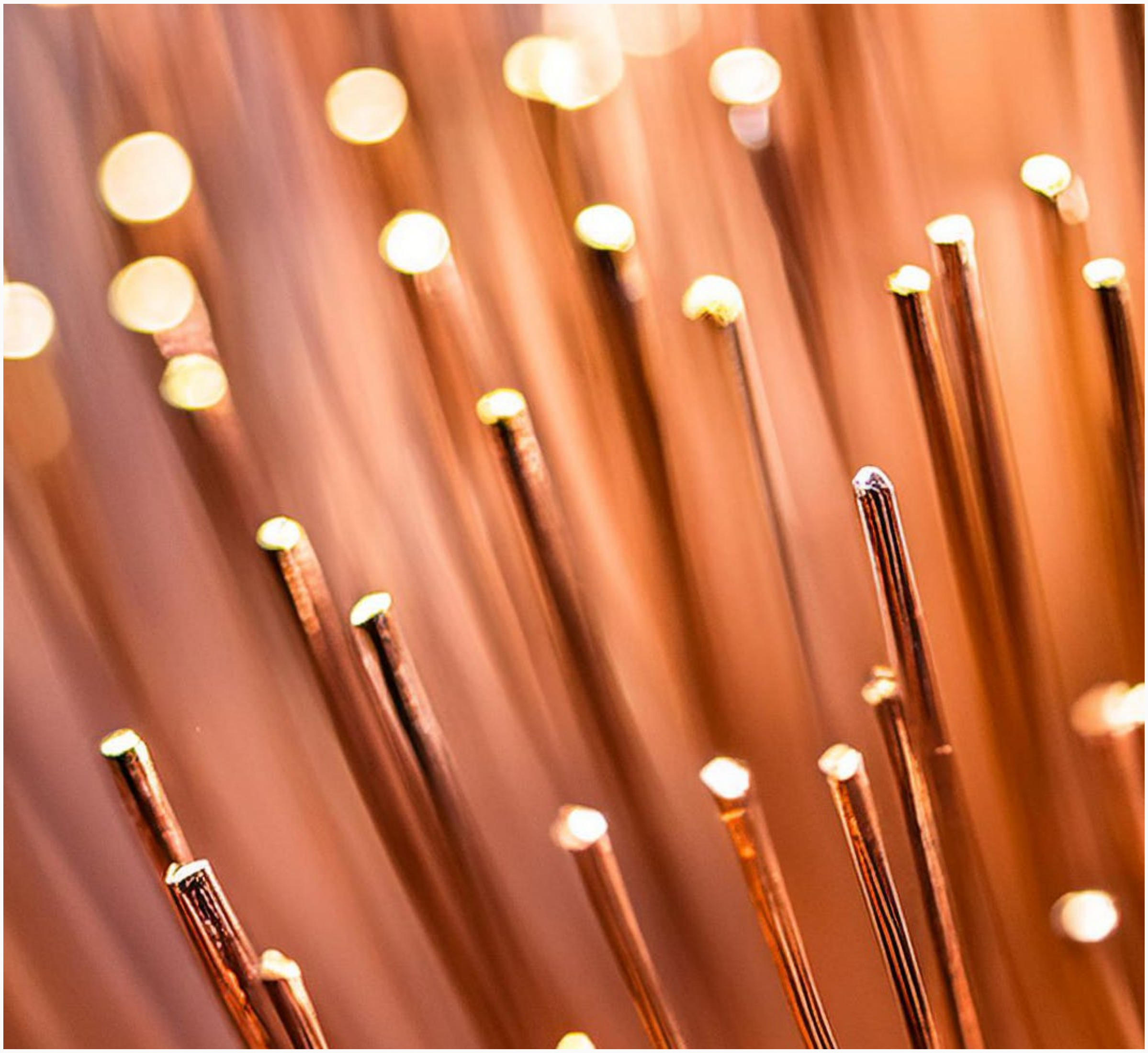


SPRING 2025

Disasters Have a Way of Not Happening

The surprising tariff announcement on April 2 sent US and global financial markets into full defense mode. Risk assets sold off, while so-called safe havens like the US dollar and Treasuries failed to offer protection. Volatility spiked to levels not seen since the depths of COVID and before that the Global Financial Crisis. Now, the strain on the global economy is becoming more evident. Exactly how much remains to be seen.

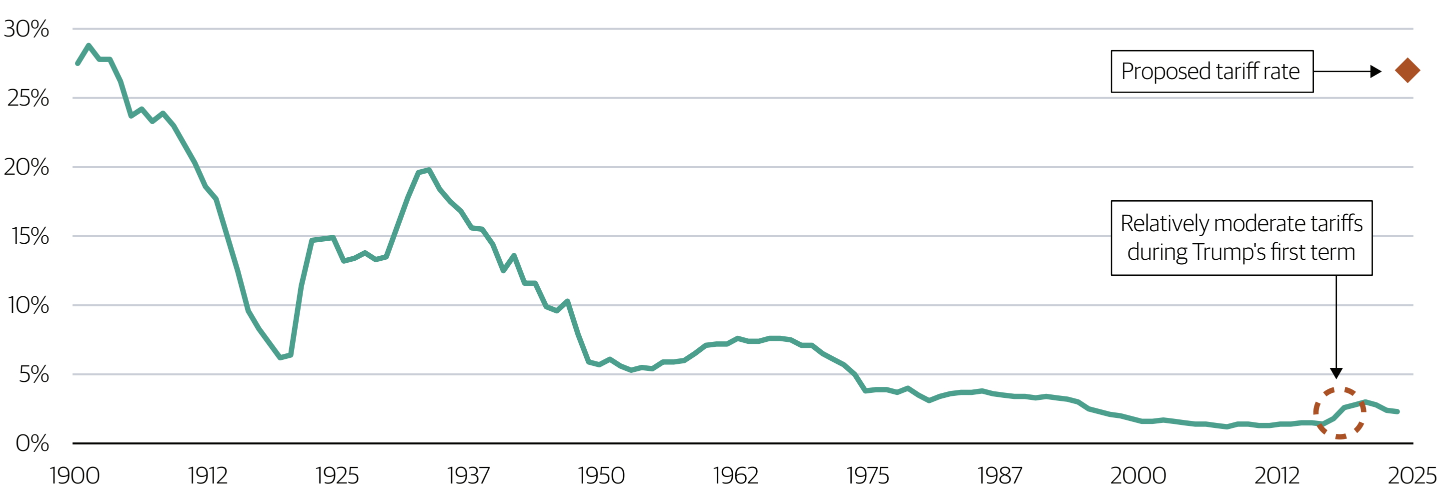
While we note the many risks that these tariffs bring—economic slowdown, inflation, recession, greater volatility, longer-term uncertainty—we can also be clear-eyed about what can go right for investors.

This edition of *The Connection* doesn't ignore what's going wrong. But as my former partner and mentor Byron Wien often reminded us, "disasters have a way of not happening." I'm not offering false optimism. Conditions on the ground are clearly more challenging than they were just a few weeks ago, forcing investors to navigate first-, second-, and third-order effects of tariff uncertainty. That said, nothing is predetermined—things may get worse, or they may not. Either way, I believe that history can be a guide, and it suggests that during periods of dislocation, opportunities often emerge for those willing to look.

A Negative Feedback Loop

Economic growth in the United States was solid, but already slowing before the tariff shock, albeit from above-trend levels. In 2023, GDP grew a robust 2.9%. That pace cooled slightly to 2.8% in 2024, and early forecasts for 2025 were closer to 2.4%. Manageable, certainly, especially with strong balance sheets and low unemployment. But the deceleration was underway. Soft data, such as household sentiment and small business confidence, was slipping. Even hard data like retail sales showed cracks forming.

Figure 1: US Effective Tariff Rate



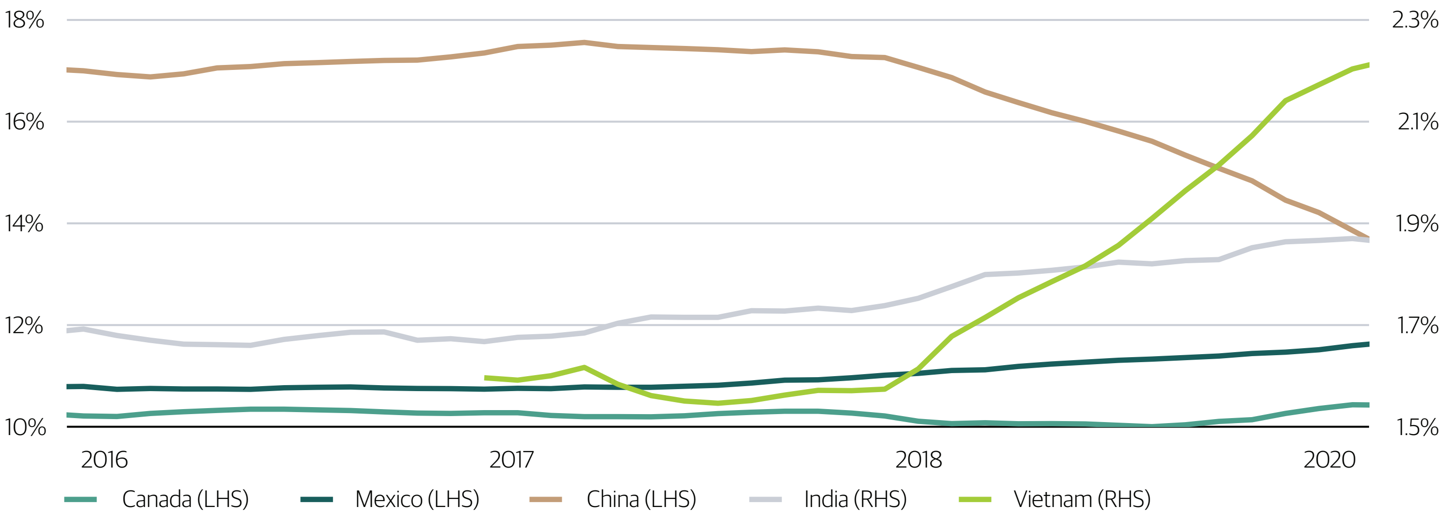
Source: US International Trade Commission (12/31/2024), Yale Budget Lab (4/9/2025) and Bloomberg. The proposed tariff rate is measured pre-substitution. Assuming there are no shifts in the import shares of different countries, the 2025 tariffs to date are the equivalent of a 24.6 percentage point increase in the US average effective tariff rate. This increase would bring the overall US average effective tariff rate to 27%, the highest since 1903. This assumes imports from China remain at 14% of total US imports, consistent with their 2024 share, and that the newly announced 125% tariff applies to a specific subset of goods from China. The "reciprocal" tariff rates announced on April 2 and effective April 9 have been suspended for 90 days. During this period, a 10% minimum tariff applies universally to the countries and product categories covered in the April 2 announcement, excluding China. For China, the April 2 reciprocal tariff increases to 125%, and when combined with the existing 20% IEEPA tariff, results in a maximum rate of 145% on the April 2 base. For commodities excluded from the April 2 announcement but subject to existing tariffs (e.g., steel, aluminum, automobiles), a 45% rate applies. For other carve-outs like lumber, pharmaceuticals, and semiconductors, the current applicable rate is 20%.

Then came the April 2 announcement. The consensus had been for something closer to Trump 1.0 tariffs—headline-grabbing, but ultimately diluted through exemptions. In 2018, tariffs were imposed on many goods, but many more were carved out through negotiation and industry influence. The effective rates paid by companies rose only modestly.

Global trade didn't contract as many feared. Instead, trade routes adjusted and supply chains reorganized. China lost market share, but Mexico, Canada, Vietnam, and India stepped in. The disruption was more surgical than systemic, at least until COVID.

Figure 2: US Imports by Country

(share of total; seasonally adjusted, 12-month moving average)



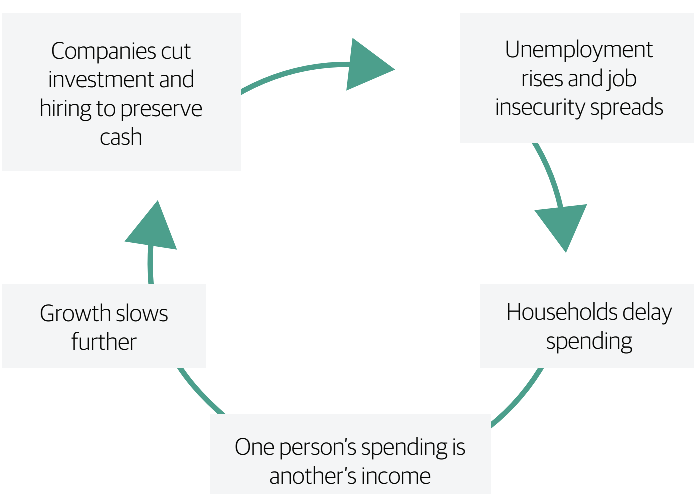
Source: US Census Bureau and Macrobond, as of 2/28/2020.

Trump 2.0 tariffs feel different. If implemented as proposed, Trump 2.0 tariffs would represent some of the most aggressive trade restrictions since the Smoot-Hawley Tariff Act in the 1930s. Even if tariffs are negotiated down, which seems likely, the uncertainty alone is proving disruptive. Uncertainty is a tariff in its own right—and for now, it's being priced as a costly one.

The early signals are unmistakable. Business confidence is deteriorating amid growing uncertainty. The latest NFIB Small Business Optimism Index has fallen to levels seen only during the COVID recession and the Global Financial Crisis. Households are feeling the same unease, taking the University of Michigan Consumer Sentiment down to multi-decade lows.

Forward indicators, including new orders, shipments, and CapEx plans, are softening. This earnings season, an above-average number of companies pulled their forward guidance. Conversations in boardrooms are shifting from growth to defense.

Figure 3: Negative Feedback Loop



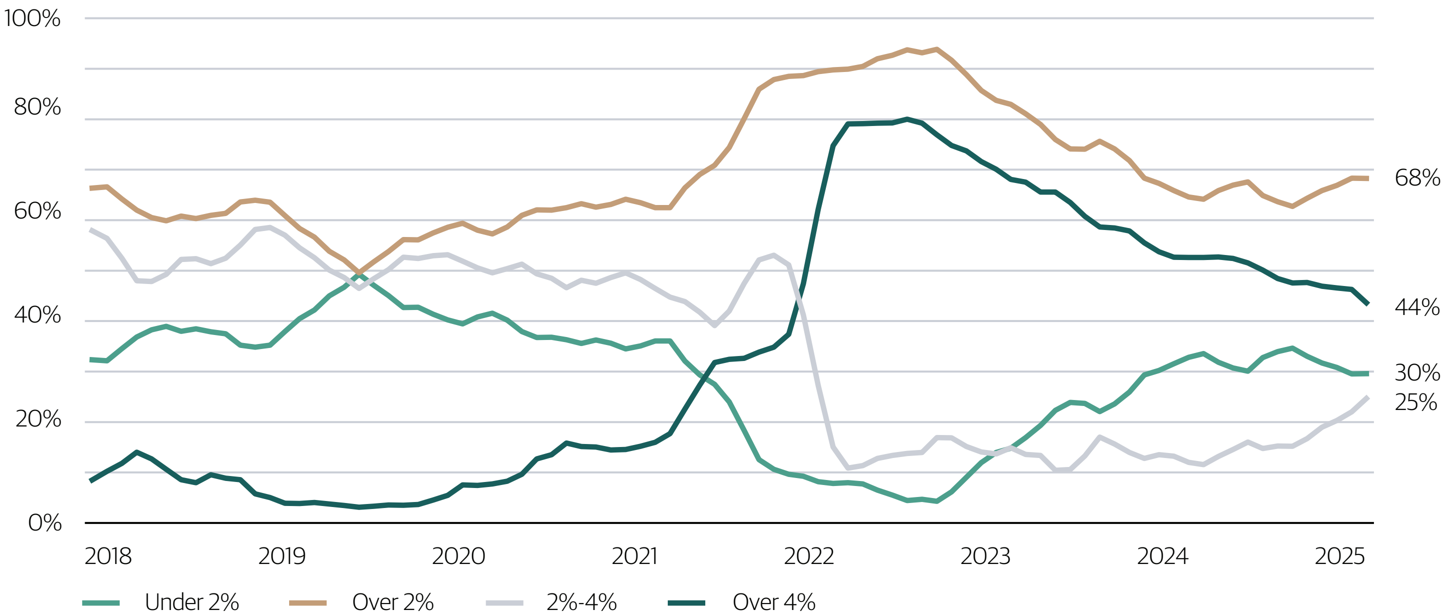
Add it all up, and the risk of a negative feedback loop is rising.

Once a loop like this one sets in, it becomes self-reinforcing. Breaking it requires either a decisive shift in monetary policy or a meaningful fiscal response. Right now, neither looks imminent. Monitoring signals like the Challenger Job Cut Announcements and initial jobless claims will be important to determine if this feedback loop is beginning. While federal job cuts have appeared in the Challenger Job Cut Announcements, private industry layoffs announcements remain low, as do initial jobless claims.

Inflation Is a Risk

To make matters worse, there is a possibility that some parts of the inflation basket may rise even as others decline. Easing shelter costs should offer some relief in the months ahead. However, as tariffs take effect, higher prices are likely for core goods, which account for almost a fifth of the overall index. Textbooks might call tariffs a one-time price adjustment, but the real world is messier. As input costs cascade through supply chains, pricing power could become contagious. Historically, import prices show one of the strongest correlations to CPI.

Figure 4: US CPI Diffusion Index



Source: US Bureau of Labor Statistics and Bloomberg, as of 3/31/2025. Represents the share of total CPI components with rising prices on an annual basis, indicating the breadth of inflation.

For now, the Federal Reserve appears more focused on labor markets than trade policy. Fed officials recognize the risk of a negative spiral but have yet to act preemptively. So why wait? The logic is tactical: acting now would risk depleting their ammunition too early. But hesitation carries its own cost—the longer they wait, the greater the odds that they'll have to do more, not less, and the less likely a soft landing becomes. Watching closely, of course, are the markets, which currently reflect the possibility of four rate cuts in 2025.

Disasters Have a Way of Not Happening

In any period of uncertainty, it's worth stepping back from the barrage of bad news and assessing the longer-term fundamentals. That's especially true when stress is high—when reaction becomes reflex and knee-jerk decisions can lock in damage that might have been avoided.

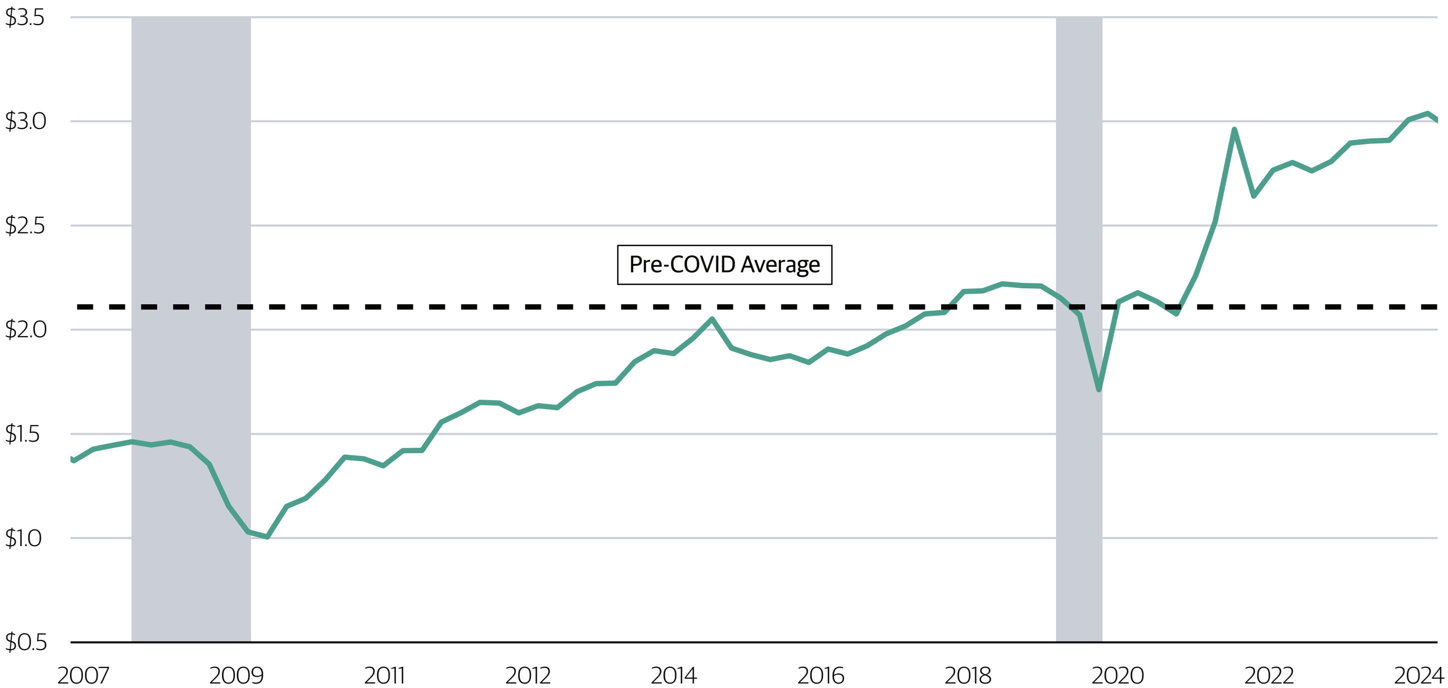
As mentioned earlier, there's still a lot we don't know about these tariffs, including what industries will be targeted or spared, how much pass-through will occur, and how long the measures will last. While we await more clarity, we can find perspective in what we do know and what it tells us: The road ahead may be uneven, but it's not uncharted, and it's far from hopeless.

The US economy is like a tree—it just grows. Over the long run, economic growth is simply the sum of changes in the working-age population and productivity, and the US has the best demographics in the developed world and benefits from one of the strongest productivity stories anywhere.[1] Its natural trajectory is toward growth, not contraction. Most estimates of long-run potential sit between 1.8% and 2.0%, and in my view, the current investment and productivity cycle offers upside to that range.

Investment, or future productivity, has been running nearly 50% higher since 2018 than the pre-COVID average.

1. Source: US Bureau of Labor Statistics, International Comparison of Annual Labor Force Statistics, as of 1/21/2025.

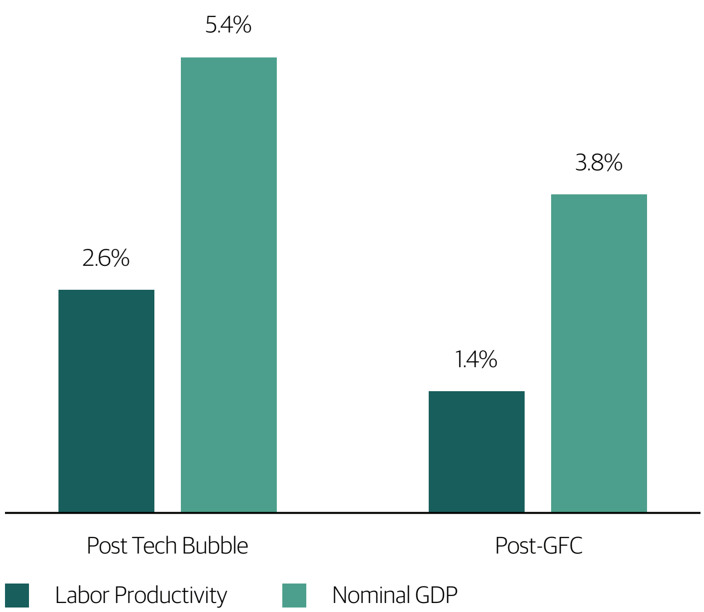
Figure 5: Nonfinancial Corporate Business Total Capital Expenditures
(USD in trillions)



Source: US Federal Reserve and Bloomberg, as of 12/31/2024.

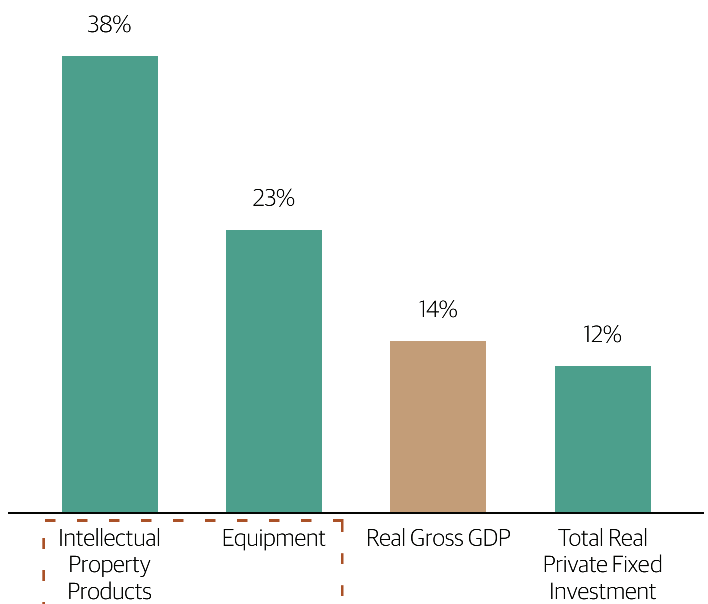
Much of that surge followed a structural labor shift. After the Global Financial Crisis, the unemployment rate peaked near 10%, and it took nearly a decade, until 2018, for it to fall to 4%. At that level, labor tightness drove wage pressures, and companies responded by investing in efficiency and automation. That was before the current wave of AI investment even began. Considering the scale and scope of these investments, the US may be on the cusp of productivity gains similar to those that followed the 1990s tech revolution.

Figure 6: 10-year Average Labor Productivity and Nominal GDP
(YoY%; seasonally adjusted)



Source: Bloomberg, US Bureau of Economic Analysis, as of 12/31/2023. Labor Productivity represents non-farm business sector labor productivity. Post-Tech Bubble is from 3/31/2002 to 9/30/2007. Post-GFC is from 9/30/2009 to 9/30/2019.

Figure 7: US Real GDP and Real Private Fixed Investment
(4Q24 versus 4Q19 percentage change)



Source: US Bureau of Economic Analysis, as of 12/31/2024. Intellectual Property Products represent non-residential related investment. Equipment represents both residential and non-residential.

The US enters this period of uncertainty from a position of relative strength. Sentiment has clearly deteriorated, but fundamentals haven't cracked, especially when it comes to household and corporate balance sheets, which are in solid shape. In fact, many of the traditional warning signs of recession aren't flashing red at all.

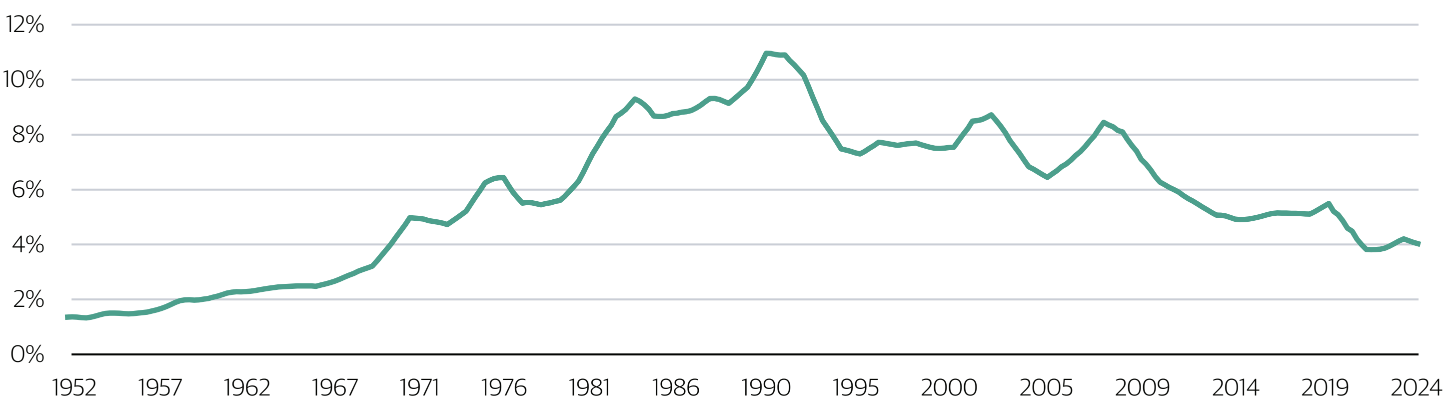
Start with the corporate sector. While the impacts from current market volatility and economic uncertainty remain to be seen, portfolio company data has thus far shown healthy revenues, strong margins, and CEOs who, while cautious, remain confident in their ability to manage through the noise.[2,3] At the same time, we're not seeing signs of real stress beneath the surface. One of the earliest indicators of real corporate stress is when gross interest expense rises as a percentage of revenue, forcing companies to slash investment or cut labor costs. But that's not what we're seeing. Gross interest expense as a share of revenue remains near historic lows. Also, financing remains accessible. Most firms, especially large ones, locked in low-cost capital when they had the chance and are now benefiting from that prudence.

The household picture is similarly resilient. Net worth is at an all-time high. Unemployment, at 4.1%, remains historically low. Jobless claims are stable. Perhaps most important, household debt service burdens are still below pre-COVID levels. Households don't just spend out of income, they spend out of wealth. And with wealth up, spending power is stronger than the macro narrative might suggest.

Also, credit is still flowing. The Fed has already cut rates by 100 basis points since September 2024, and globally, this is shaping up to be the most coordinated rate-cutting cycle since the Global Financial Crisis. Money supply growth, which had turned negative in 2023, is now back in positive territory. Credit creation is the lifeblood of the economy and, for now, that blood is circulating.

Figure 8: US Corporate Gross Interest Payments as a Percentage of Revenue

(4-quarter moving average)



Source: US Federal Reserve, as of 9/30/2024.

What Can Investors Do? See the Opportunity

Portfolio diversification isn't broken, but it's being severely tested. The traditional 60/40 portfolio already proved less reliable after the volatility of 2022 and 2023. A long period of negative correlation between stocks and bonds broke down as inflation and interest rates surged in 2022. Where investors once relied on bonds to provide ballast to equity volatility, both asset classes declined together.

That positive correlation persisted into 2023, as both stocks and bonds recovered, and it remained positive through most of 2024. Now, in the face of a sharp, policy-induced risk-off move, the usual safe havens aren't behaving as expected. The U.S. dollar has swung wildly to a two-year low, and demand for 10-year Treasuries has been weak, pushing yields higher. Investors aren't just repricing assets, they're rethinking assumptions, and that's much harder to reverse.

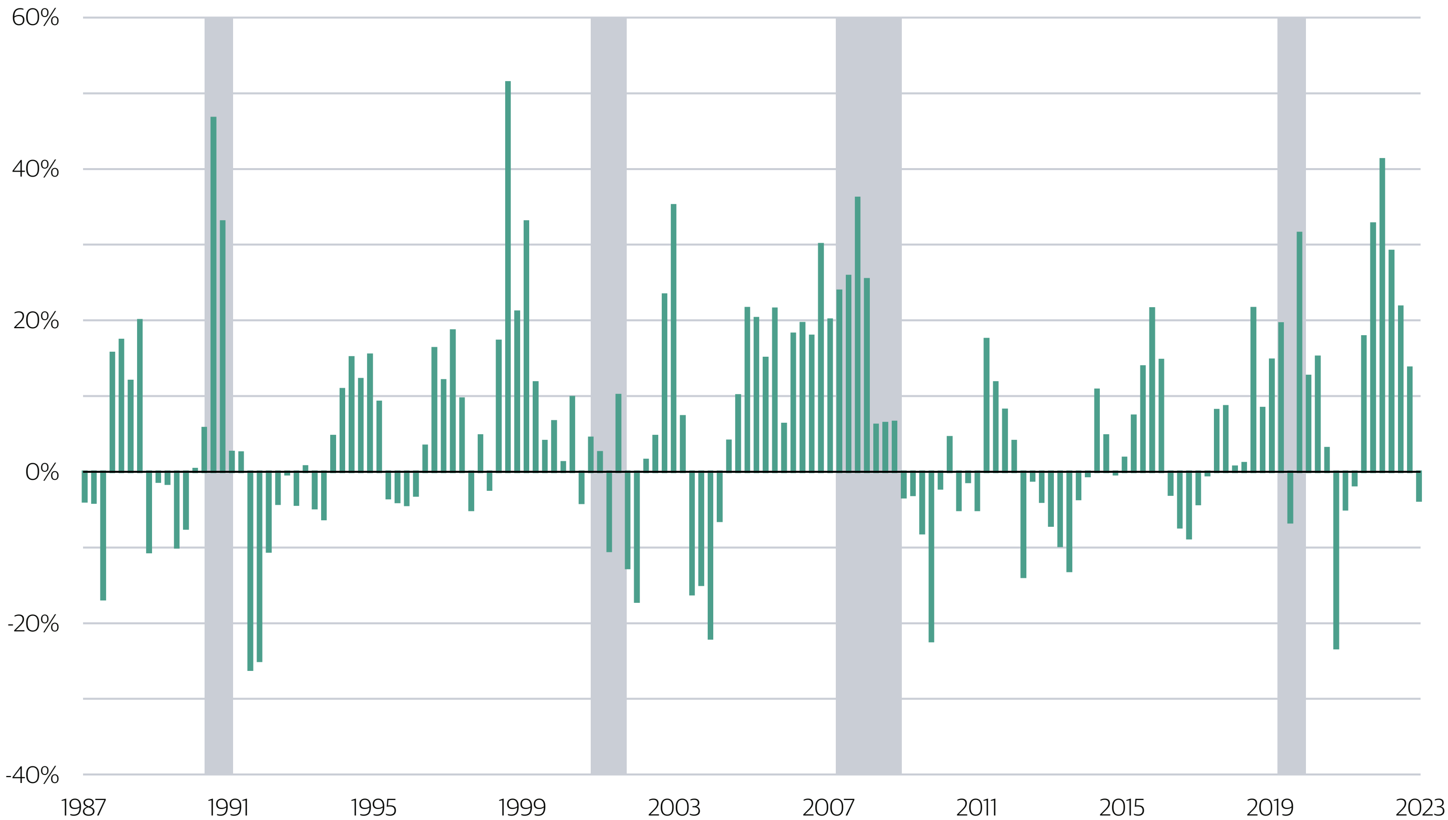
2. The Blackstone CEO survey referred to herein is a survey of a subset of portfolio company CEOs. For 1Q25, the survey reflects responses from 92 Blackstone portfolio companies (56 US CEOs) largely within Blackstone's private equity and credit businesses (the "CEO Survey"). Note that survey composition varies from quarter to quarter. The CEO Survey was initiated on 3/11/2025, and closed 3/24/2025. The responding portfolio companies are not necessarily a representative sample of companies across Blackstone's portfolio and the views expressed do not necessarily reflect the views of Blackstone. The views expressed reflect the responding CEOs' views as of the date of their responses, and Blackstone does not undertake any responsibility to advise you of any changes in such views. References to "CEO" or "CEOs" herein refer to respondents to the 1Q25 Blackstone CEO survey.

3. Portfolio company data reflects corporate private equity operating companies as of 3/31/2025. Excludes select public investments, select Energy investments, select FIG investments, certain new investments, investments where YoY growth rates are not comparable due to divestures and certain other companies for which timely forecasts are unavailable.

But periods like this one don't just reveal stress, they also reveal opportunity. Uncertainty breeds volatility, and volatility creates dislocation, which is precisely when long-term investors typically lean in. That's where private markets come in—not just for their historical resilience when public markets falter, but for their long-run return potential. Historically, some of the best private market vintages have emerged in the aftermath of economic shocks. When capital is scarce, pricing improves. When public markets are in retreat, private markets step in with resilience.

Private equity has a long track record of outperforming during downturns. Over the past several decades, private equity returns relative to the Russell 2000 tend to be strongest when public markets are weakest. During the Tech Bubble, the Global Financial Crisis, and other stress periods, private equity consistently delivered above-market returns. The average outperformance across recessionary downturns? 8.3 percentage points when public markets were down greater than 10%. That's not marginal alpha—that's compounding power.

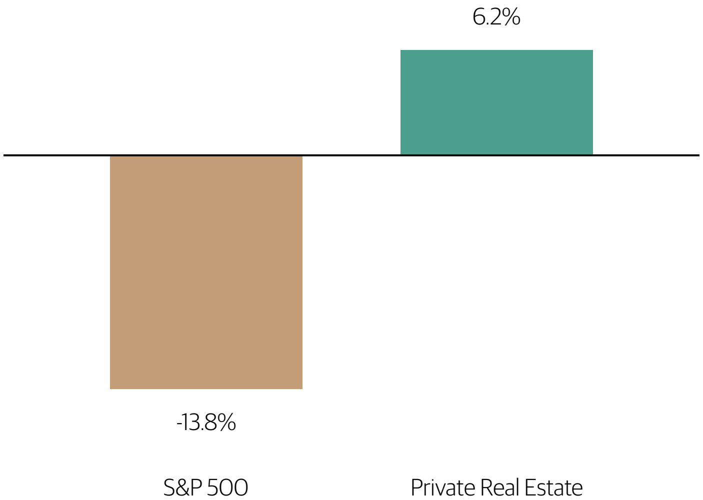
Figure 9: Relative Outperformance of Private Equity Versus Russell 2000 mPME



Recession	Annualized Private Equity Performance Relative to Russell 2000
Early 90s	2.8%
Tech Bubble	5.4%
Great Financial Crisis	4.6%
COVID-19	-3.6%
Average	**2.3%**

Source: Blackstone Investment Strategy Calculations, Cambridge Associates and Bloomberg, as of June 30, 2023. Private Equity is measured using the Cambridge Associates US Private Equity Index. Russell 2000 performance is shown as Modified Public Market Equivalent (mPME) which is a public market equivalent methodology developed in-house by Cambridge Associates. The methodology provides a consistent means to effect a performance comparison between a private investment and public alternative. The relative performance is measured as a ratio of returns over 12 months rolling period. Grey shaded areas represent NBER defined recessions. We calculate the relative performance as a ratio and annualize it assuming continuous compounding. The table looks at the following periods: "Early 90s" recession figures are based on calculations from September 1989 to December 1991; "Tech Bubble" figures are based on calculations from March 2000 to September 2002; "Great Financial Crisis" figures are based on calculations from December 2006 to March 2010; "COVID-19" figures are based on calculations from December 2018 to March 2021.

Figure 10: S&P 500 Versus Private Real Estate During S&P 500 Declines
(average annual total return)



Source: S&P and NFI-ODCE Index, as of December 31, 2024. Covers annual total returns during S&P drawdowns since 1980 (1981, 1990, 2000, 2001, 2002, 2008, 2018 and 2022).

Private real estate tells a similar story. During the eight calendar years since 1980 when the S&P 500 posted negative returns, private real estate delivered an average return of +6.2%, while the S&P fell by nearly -14%. With low correlations to public equities and a negative correlation to investment grade bonds, private real estate has provided a powerful source of diversification when it was needed most.

It's not just about performance, it's also about repositioning. In today's market, where traditional diversification is breaking down and liquidity is still available, now may be the time to consider rebalancing toward private assets: equity, real estate, credit, and infrastructure. These aren't panic moves—they're strategic reallocations that could position portfolios for long-term durability.

In the section that follows, my colleague Mike Forman, Senior Managing Director in our Real Estate group, discusses one of the most compelling stories playing out in real time: the intersection of infrastructure, power, and digital transformation in Blackstone's data center business.

This lens offers a different angle, but the message is consistent: Uncertainty doesn't have to mean paralysis. With focus, patience, and a willingness to lean into change, investors can find real opportunities, even now. In moments of dislocation, history rewards the investor who tunes out the noise and keeps their head.

Cutting Through the Noise: The Long-Term Case for Data Centers

Mike Forman
Senior Managing Director, Blackstone Real Estate

These days, headlines about data centers are everywhere—Deepseek, Stargate, and reports of leasing slowdowns, to name a few. For investors, it's essential to look beyond short-term volatility and focus on long-term fundamentals. I believe digitalization of the economy, including the AI revolution, is a megatrend that supports strong long-term demand for data centers.

Secular Demand Growth

For the past 30 years, the economy has been rapidly digitalizing, and we're still in the early innings. The share of GDP attributed to the information technology sector has more than tripled over the last 25 years but remains at just 8%.[4] As technology usage grows, the increased computing and storage requirements fuel demand for data centers. Said differently, the cloud does not live in the clouds! We've seen a long trend of robust growth in data center demand as cloud computing and content creation have boomed, and, more recently, as AI has begun to take off.

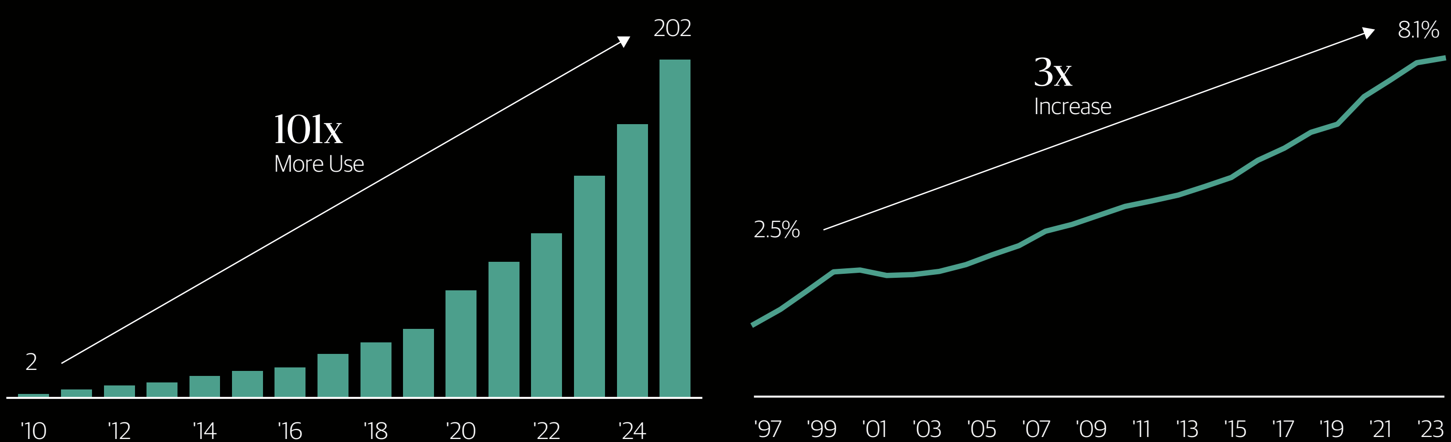
AI adoption is still in its infancy. Early adopters of AI, such as software engineers, showcase its potential—over 25% of all new code at Google is now generated by AI and engineers using AI are 26% more productive.[5,6] Yet more broadly, AI has barely begun to be integrated into our lives, the technology we interact with, and the economy. Today, just 1%-5% of work hours are assisted by AI.[7] This is changing rapidly, particularly as AI models become more capable and reliable. For example, this year, we are beginning to see the first examples of AI "agents," which upgrade capabilities from do-it-yourself tools (e.g., generating vacation itineraries) to white-glove services (e.g., actually booking your trip).

The potential for AI is enormous. I expect it will become embedded into everything—enterprise processes, scientific discovery, medical advances, manufacturing, and robotics. Each of these use cases will require significant increases in computing power compared to today.

Figure 1: Digitalization is driving the economy[8]

Data Created and Stored (zettabytes)

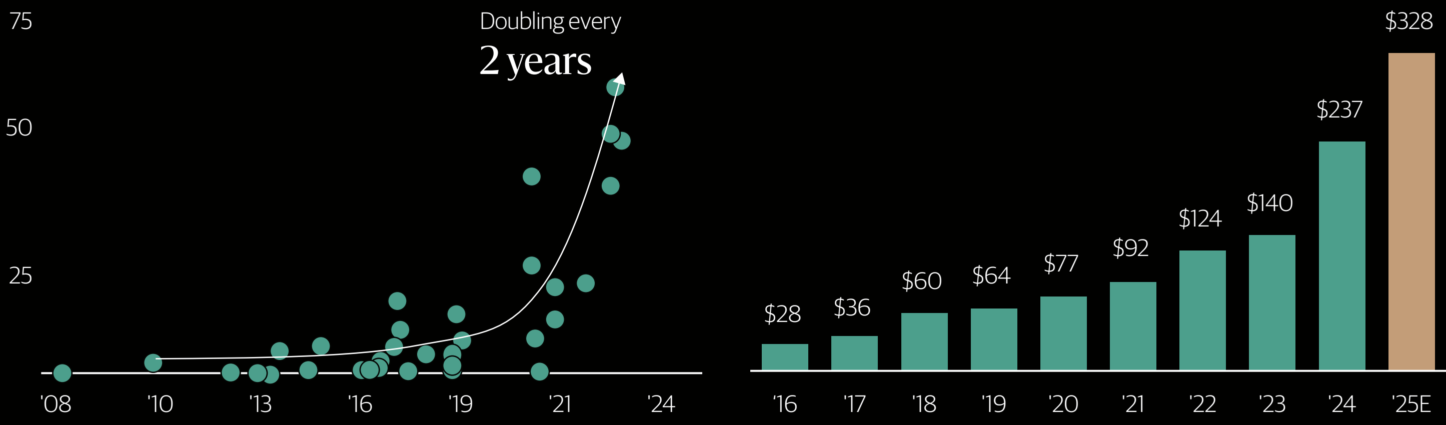
IT Sector Contribution to the Economy (% of GDP)



4. Bureau of Economic Analysis, as of March 2025.
5. Google Q3 2024 Earnings Call, as of October 2024.
6. Cui, Zheyuan and Demirer, Mert and Jaffe, Sonia and Musolff, Leon and Peng, Sida and Salz, Tobias, The Effects of Generative AI on High-Skilled Work: Evidence from Three Field Experiments with Software Developers (2/10/2025). Available at SSRN: https://ssrn.com/abstract=4945566 or http://dx.doi.org/10.2139/ssrn.4945566.
7. Federal Reserve Bank of St. Louis, as of February 2025.
8. IDC, as of May 2024; Bureau of Economic Analysis, as of March 2025.

Figure 2: Efficiency gains have spurred massive investment in computing[9]

Compute Efficency (billions of calculations per $) | Hyperscaler CapEx ($ in billions)



Computing Efficiency Gains

AI is not only becoming more powerful but also more efficient, as illustrated by DeepSeek earlier this year. For example, the cost to access equivalent-intelligence AI models has declined by 99% over the past two years.[10] These efficiency gains have introduced volatility in public markets, but they also highlight the rapid pace of technological advancement.

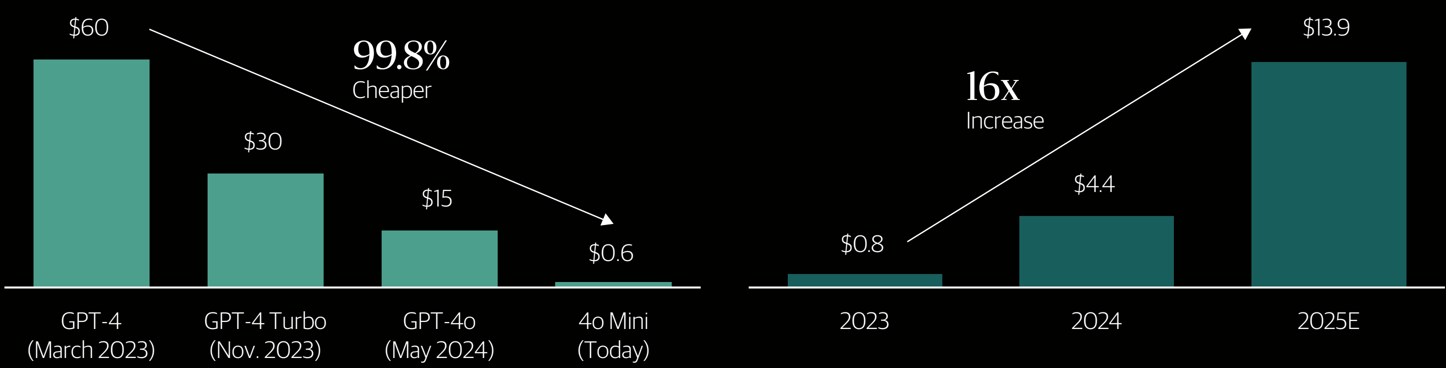
Counterintuitively, efficiency gains have been the propellant of digitalization. Compute has been getting exponentially more efficient in terms of both cost and energy—computations per dollar of IT investment and per watt have been doubling every two to three years for many decades.[11] On top of this, innovation in software has doubled the number of tasks which can be completed per unit of compute every year.[12] Despite these gains, IT spend and compute power usage have not gone down, but rather have increased dramatically, as these efficiency gains create new capabilities and unlock new use cases.

We are seeing a similar trend within the AI space. As capabilities improve and costs come down, usage is exploding—usage of leading AI platforms is up 4x year-over-year, and OpenAI now has over 600 million monthly active users.[13] Revenues are also growing rapidly, with 2025F revenues for AI model providers up 16x since 2023 and 3x year-over-year to $14 billion.

This phenomenon, known as Jevon's Paradox, explains why efficiency gains often lead to greater resource consumption. It's a dynamic we've seen throughout history, from lightbulbs to transportation. Digitalization is the megatrend of our lifetime.

Figure 3: AI revenues have increased rapidly as cost to use models has declined[14]

Cost to Access AI Models ($ per million tokens) | AI Model Revenue ($ in billions)



9. Hobbahn et al. "Trends in Machine Learning Hardware", Epoch AI, Morgan Stanley Equity Research, Public Reporting as of July 2024.
10. OpenAI, Wayback Machine, as of April 2025.
11. Greenmantle, as of July 2024.
12. Danny Hernandez, Tom B. Brown, Measuring the Algorithmic Efficiency of Neural Networks. Available at: https://doi.org/10.48550/arXiv.2005.04305.
13. Similarweb, Reuters, as of April 2025.
14. OpenAI, Wayback Machine, as of April 2025. Revenue data includes OpenAI, Anthropic, Character.ai based on availability (comprises 90% of total web visits for LLMs). CNBC, New York Times, The Information as of 4Q24. "$ per million tokens" represents the cost to access one million tokens through OpenAI's API.

Downside Protected Growth Opportunity

Technological innovation will continue at a rapid pace, and it remains to be seen where exactly value will ultimately accrue in the AI ecosystem. However, with data centers, we are investing in the "picks and shovels" of the digital economy, and are well positioned if we believe that long-term demand for compute is going up.

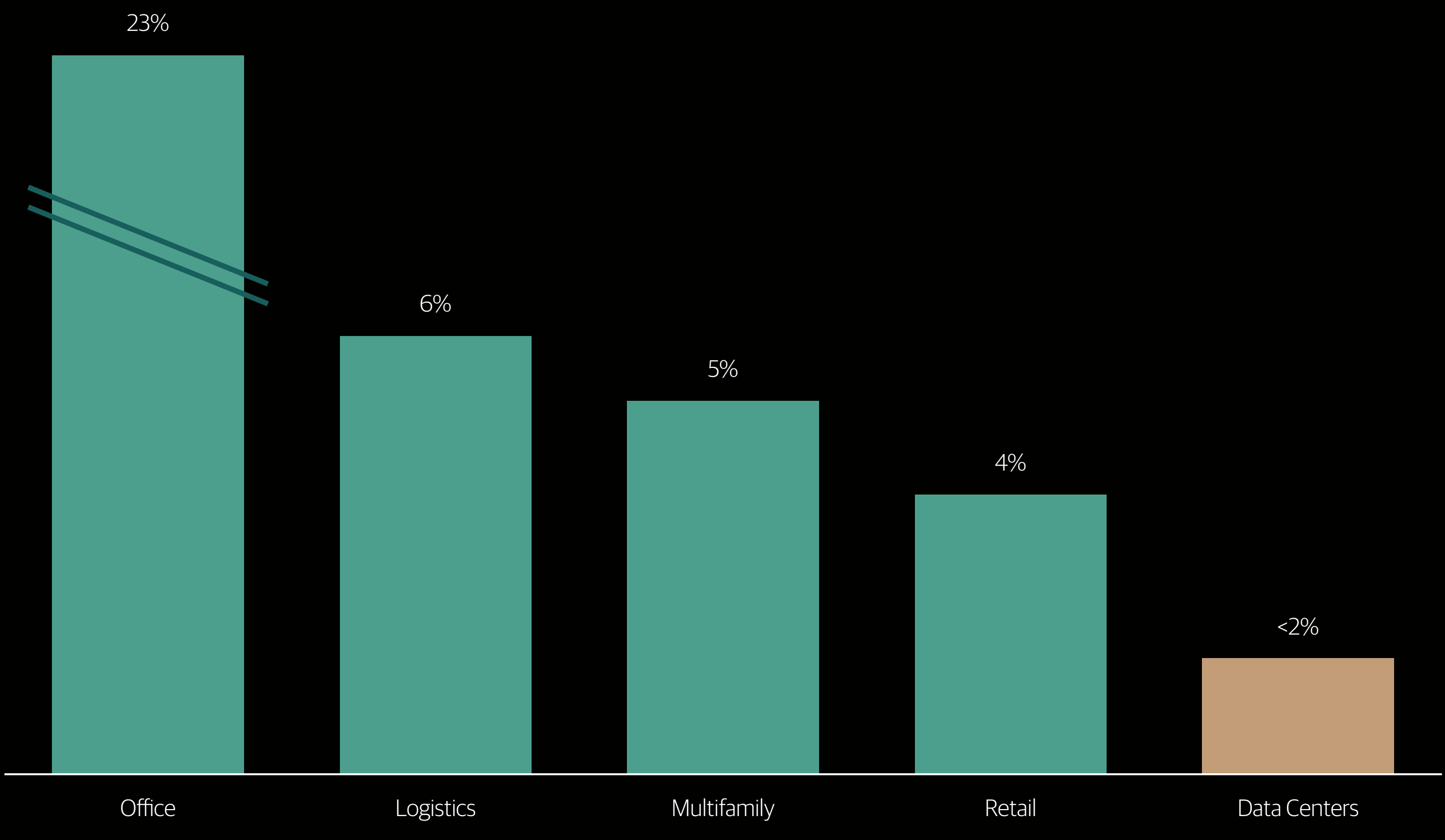
Capital markets volatility may lead to periods of slower growth, and we have seen this happen before. Our current leasing pipeline is as large as it's ever been, but we continue to be disciplined in our approach and structure our investments to minimize downside in the event demand slows. For example, we typically only build or lend to data centers after securing pre-leases with investment-grade counterparties on long-duration contracts. This means we are protected against short-term shifts in demand and can play the long game.

Supply Constraints: A Competitive Advantage

As data center owners, we benefit from significant barriers to new supply. Vacancy rates across the U.S. are below 2%,[15] tighter than any other sector we invest in. This does not appear to be changing anytime soon—there is almost no speculative construction in the industry given the capital intensity of each project. As we are seeing real time in our businesses, it's becoming harder every day to build new data centers.

Power is a major bottleneck to delivering new capacity. After 25 years of flat electricity demand, the US is experiencing a surge in demand from data centers, electric vehicles, electrified heating systems, and re-shoring of manufacturing.[16] The power grid has not been able to keep up, and wait times for new grid connections have increased to 7-10 years in key data center markets.[17] Blackstone is investing heavily in new generation and transmission infrastructure, but upgrading and modernizing the grid takes decades—not months or years. We have been able to procure power at scale by leveraging our 20+ years of experience investing in energy markets and the highly capable teams at our portfolio companies, but most new entrants to the space lack this expertise.

Figure 4: Data center vacancy is lower than other asset classes[18]



15. DCH, as of December 2024.
16. GridStrategies, as of December 2024.
17. Blackstone proprietary data.
18. As of 12/31/2024. Office, retail: CoStar. Retail Reflects all retail. Logistics: CBRE. Multifamily: RealPage Market Analytics. Data Centers: datacenterHawk.

Beyond power, developers continue to experience supply chain constraints, labor shortages, and increased regulatory and permitting challenges. Amidst this backdrop, operational execution is crucial, and we are wary of the many "fly-by-night" operators who seem to have emerged overnight. When investors ask us what we worry about the most, operational execution is at the top of the list. We are focused on investing behind best-in-class platforms, including our portfolio companies QTS, AirTrunk and Lumina, and our joint venture partner Digital Realty. Many of these platforms have proven track records spanning multiple decades.

Capital has also become a more important differentiator, as these campuses often require billions of dollars to build. Blackstone's financial resources combined with high-quality operators is a winning formula.

What's Next for Blackstone?

Today, Blackstone manages an $85 billion global data center platform with a powered land bank that can support over $125 billion of future growth.[19] We have built the largest and fastest-growing data center business in the world in partnership with incredibly talented teams at our portfolio companies. For years, we have been planting the seeds for future growth and we are now positioning ourselves for continued leadership over the long term.

Beyond our equity investments, we have also built a leading digital infrastructure lending platform, and are focused on investing at scale across the entire capital stack. Our conviction and access to capital enable us to unlock unique opportunities and provide differentiated solutions across the digital infrastructure ecosystem.

19. Represents total enterprise value, including future buildout of pre-leased capacity.

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