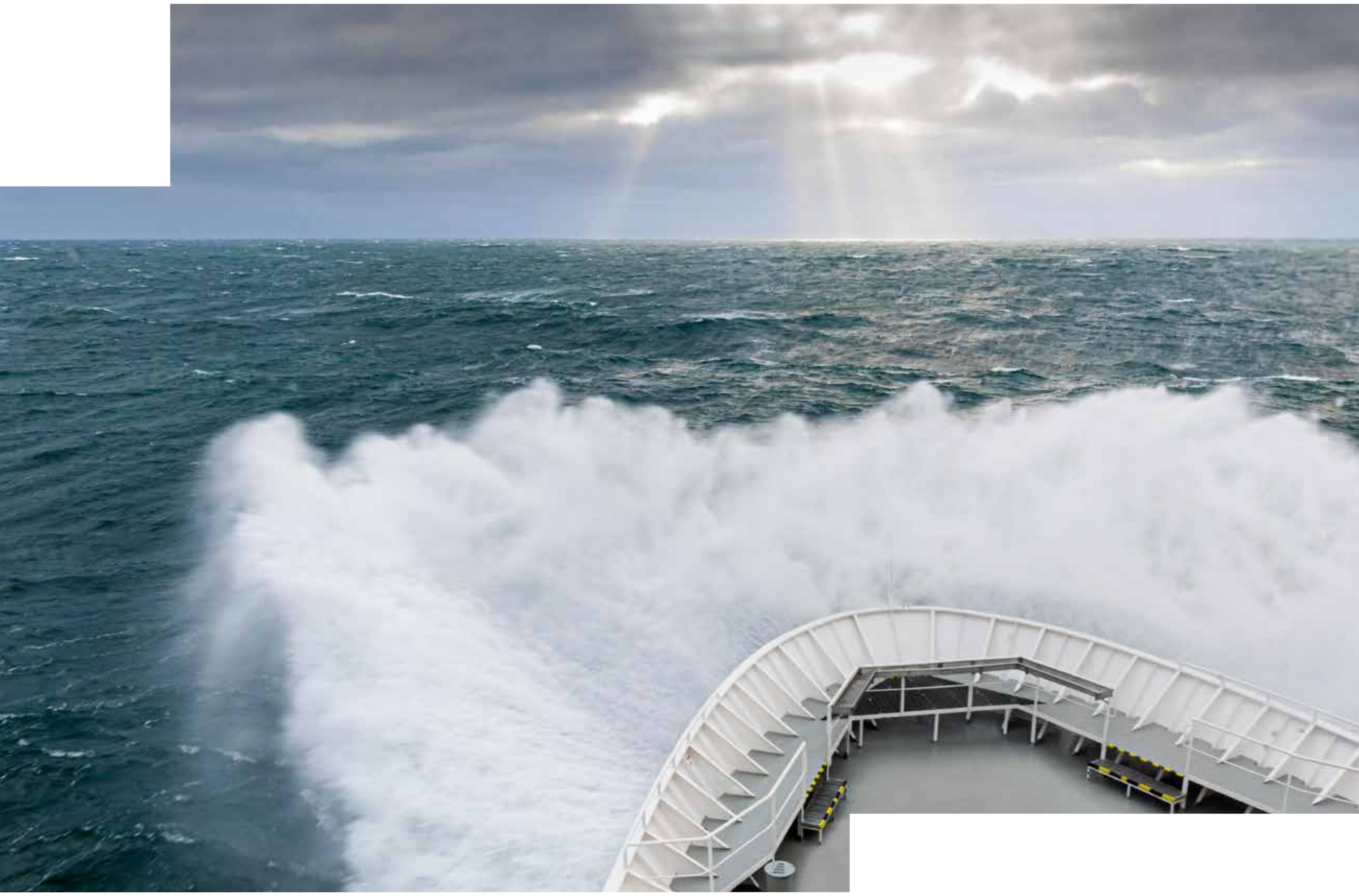
Investment Outlook 2021



Living forward.

Living forward.

Content

From my perspective

Thomas Gottstein
CEO Credit Suisse Group AG

It is my pleasure to present our Investment Outlook 2021. This past year was unlike any other, with the COVID-19 pandemic leading to severe recessions, high unemployment and volatile swings in financial markets.

So what is in store for 2021? Of course, the safety of our communities and citizens remains the highest priority. It is clear that our health and the performance of our economies go hand in hand. Much will depend on progress toward a vaccine and other efforts to mitigate the health crisis.

We generally see conditions for a continued recovery in global activity in 2021 amid strong fiscal and monetary stimulus, accelerated technological innovation and investments in carbon mitigation.

However, uncertainties abound, from geopolitics and de-globalization to the effects of lower-for-longer interest rates across asset classes. The very narrow margins in the recent US elections underscored hardening political divisions that may complicate the policy response to the pandemic.

Our economists, financial analysts and strategists have worked tirelessly across regions to help investors and entrepreneurs navigate these rapidly evolving global challenges, while putting sustainability at the core of our House View. It provides the analytic foundation for our role as a leading wealth manager with strong global investment banking capabilities.

The fruits of these efforts are reflected in our Investment Outlook, fittingly titled "Living forward." It offers our key views on how markets and economies will evolve in the year ahead. I am confident that you will find it a valuable resource as you seek opportunities in these uncertain times.

I extend to you my best wishes for a healthy and prosperous 2021.

Thomas Gottstein

Dear reader

Living forward.

Michael Strobaek
Global Chief Investment Officer

As human beings, we have a need to understand our lives by looking back at the past. But the 19th century Danish philosopher Soren Kierkegaard said we should not forget about the future.

Once our world emerges from the shadow of the COVID-19 pandemic, it will only be natural for us to "live backwards" as we examine how this challenging period affected our lives. As individuals, we can all recall how it felt to see our cities empty out as the world went into lockdown, as well as our worries about what would happen to our families and friends. What is for sure is that none of us will ever forget that 2020 was the year when we were all confronted with a global pandemic of a deadly virus.

The crisis was also an extraordinary experience for investors as it pushed the global economy into its deepest recession since World War II. Equity markets plunged in late February and March, then rallied strongly in the subsequent months thanks to unprecedented support from central banks and governments.

This publication is not about the past, however, but looks ahead at what we expect will shape investments and markets in the new year. Investment conditions are tighter and the search for yield and returns has become trickier. Now is the time when increased discipline is needed to overcome our natural bias to look to the past for guidance. Sound judgement grounded in a rigorous analysis of the present combined with perseverance in pursuing an investment thesis can make investing highly rewarding, as we demonstrated during the height of the crisis, when we decided to go against the tide and began buying equities in late March.

As we move forward, the pandemic will continue to occupy us in 2021. Governments will have new COVID-19 outbreaks to battle, and will need to distribute a vaccine to their population once it becomes available. Additionally, people and businesses will need to adapt to what we believe will be permanent changes in the way we work, learn and live.

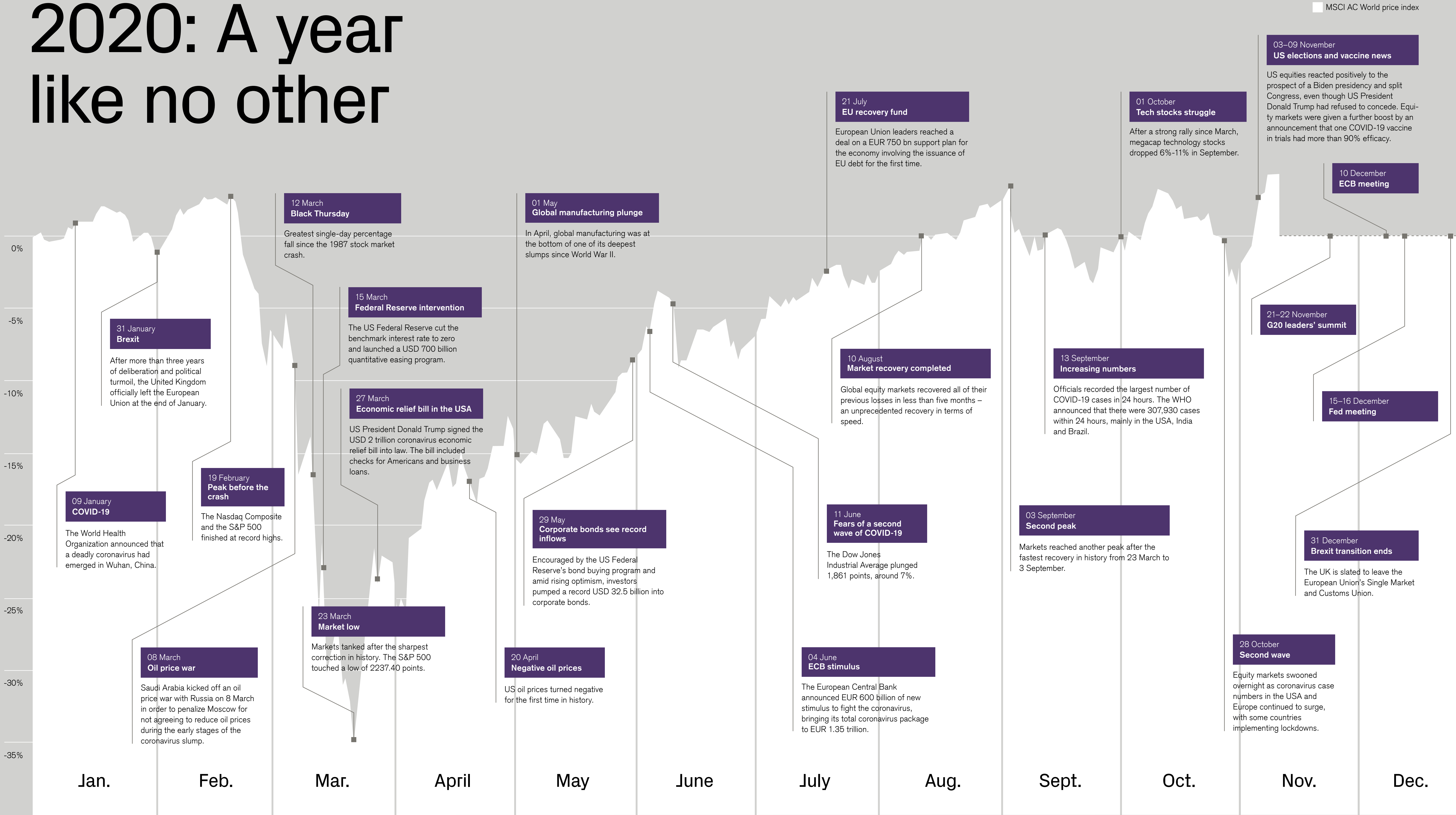
Finally, while economic growth should normalize after the pandemic-induced shock in 2020, there are risks that still need to be monitored carefully. In the following pages, we explore the outlook for the different asset classes and the global economy in 2021.

Beyond all the unprecedented events of the year we are leaving behind, a far greater challenge awaits as capital shifts to addressing the environmental and societal trends that the pandemic has catalyzed. Over the past 18 years, Credit Suisse has been very active in the area of sustainable and impact investing. We believe investors have a clear role to play in the transition to a more balanced and sustainable world. This will require a shift in mindset and approach, which is already underway as investors call for closer alignment of purpose and profit when deploying their investment capital.

We strive to be in a position to help our clients accelerate these trends. Our major initiatives in this area include the Supertrends, our long-term investment themes that focus on societal change, such as Millennials' values and Climate change – Decarbonizing the economy. We have also launched funds targeting some of the United Nations' Sustainable Development Goals.

Enabling our clients to invest with sustainability and impact in mind is among our bank's top priorities going forward, and you will continue to hear more about our efforts on this front as we put it at the heart of our investment offering. I am sure that the year 2020 will be a defining moment in our lives, and I reflect upon a quote from the Danish philosopher Soren Kierkegaard in which he says life can only be understood backwards, but it must be lived forwards.

2020: A year like no other



Global economy

Pandenomics: After the shock

The year 2020 has been like no other. The global lockdown during the first wave of the COVID-19 pandemic triggered the strongest economic contraction in modern history. Most economies recovered sharply thereafter, but a second wave of COVID-19 set the economy back again. Yet growth should accelerate gradually in 2021 without triggering a troubling rise in inflation or interest rates, despite much higher government debt.

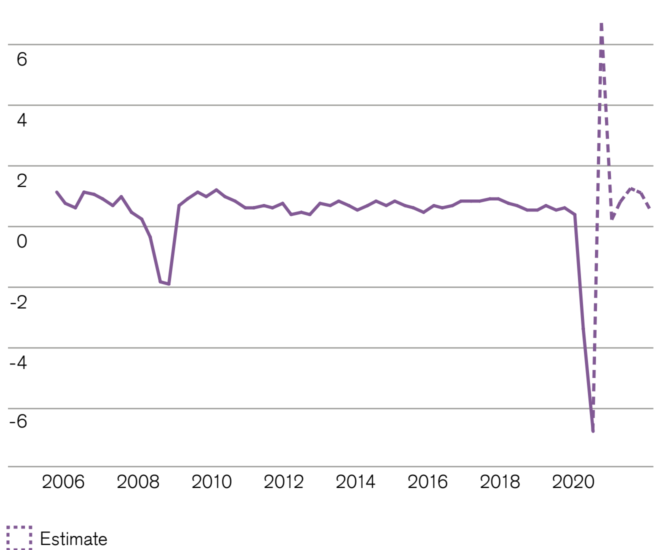
"Shock and awe"
Due to the lockdown of the global economy, 2020 will go down as a historic year with a truly unique economic trajectory. The deepest quarterly global gross domestic product (GDP) contraction on record in Q2 was followed by the sharpest quarterly rebound on record the following quarter, as the lockdown restrictions were eased and fiscal and monetary stimulus kicked in. Yet, when the COVID-19 pandemic threatened to get out of control, policymakers around the world used a "shock and awe" tactic to deal with the economic fallout from this public health crisis.

What was different this time? In a "normal" downturn, the cyclical parts of the economy like construction typically contract, while the service part of the economy fares better. But this time around, the shock affected cyclical manufacturing sectors and the service economy simultaneously, leading to extreme swings in economic activity. This is rare.

In the USA, the service sector has contracted only three times in the past seventy years: in 1973, 2008 and 2020. During the 2020 recession, cyclical sectors slowed as the economic closure of entire countries disrupted supply chains. In the service economy, several sectors came to a standstill during the quarantines, as "normal" operations suddenly became unsafe for clients and staff amid the pandemic (e.g. running a hair salon or a restaurant). This also explains the sharp rebound in economic activity once lockdown restrictions were lifted, as supply chains were restored and previously closed businesses re-opened with new COVID-19 safety restrictions. Massive fiscal and monetary stimulus provided additional support for the recovery.

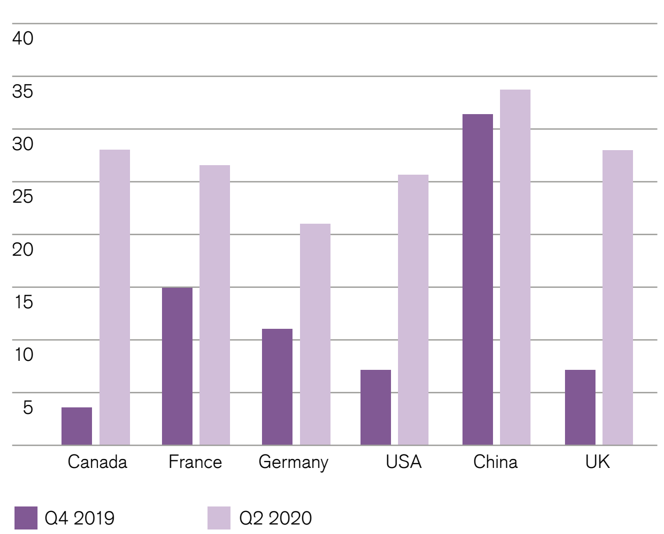
Another unusual macroeconomic feature of the 2020 recession was the simultaneous increase of savings ratios in the USA, Europe and Asia. Fiscal and social support programs supported household income during the lockdowns, leading to much better consumer spending than would otherwise have occurred. But because service spending (as opposed to physical goods spending) was constrained by social distancing, households were able to save at high rates too. As a result, household balance sheets improved, an unusual situation in a recession. Further spending improvement is likely if rising hours and falling unemployment continues, and a switch back to service spending will occur once the pandemic ends.

Return to "normal"
Global real GDP growth (QoQ in %)



Last data point 30/06/2020
Source Bloomberg, Credit Suisse

Households are saving more
Household savings rate (in %)



Last data point 30/06/2020
Source Haver Analytics, Credit Suisse

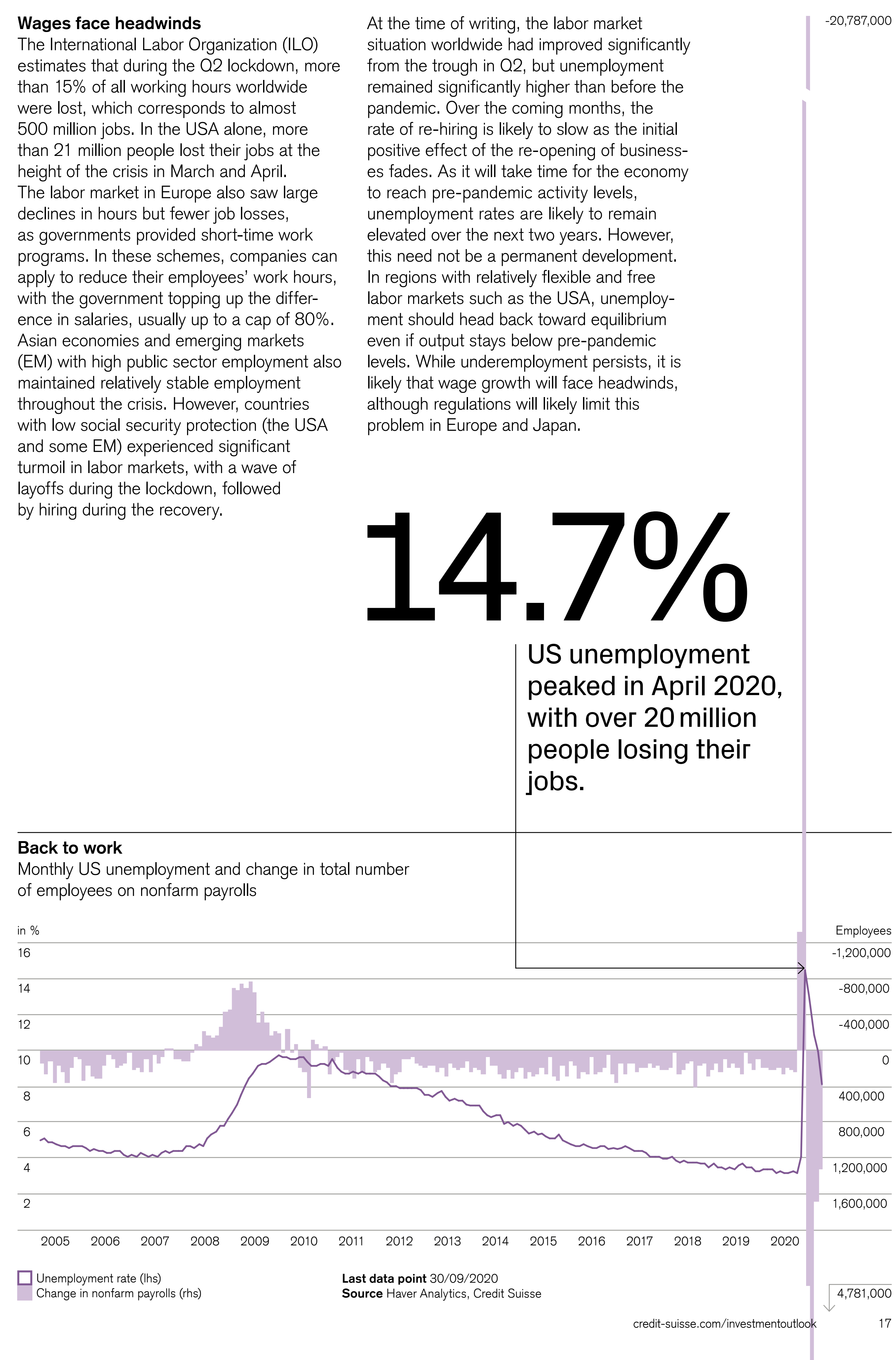
Wages face headwinds
The International Labor Organization (ILO) estimates that during the Q2 lockdown, more than 15% of all working hours worldwide were lost, which corresponds to almost 500 million jobs. In the USA alone, more than 21 million people lost their jobs at the height of the crisis in March and April. The labor market in Europe also saw large declines in hours but fewer job losses, as governments provided short-time work programs. In these schemes, companies can apply to reduce their employees' work hours, with the government topping up the difference in salaries, usually up to a cap of 80%. Asian economies and emerging markets (EM) with high public sector employment also maintained relatively stable employment throughout the crisis. However, countries with low social security protection (the USA and some EM) experienced significant turmoil in labor markets, with a wave of layoffs during the lockdown, followed by hiring during the recovery.

At the time of writing, the labor market situation worldwide had improved significantly from the trough in Q2, but unemployment remained significantly higher than before the pandemic. Over the coming months, the rate of re-hiring is likely to slow as the initial positive effect of the re-opening of businesses fades. As it will take time for the economy to reach pre-pandemic activity levels, unemployment rates are likely to remain elevated over the next two years. However, this need not be a permanent development. In regions with relatively flexible and free labor markets such as the USA, unemployment should head back toward equilibrium even if output stays below pre-pandemic levels. While underemployment persists, it is likely that wage growth will face headwinds, although regulations will likely limit this problem in Europe and Japan.

14.7%

US unemployment peaked in April 2020, with over 20 million people losing their jobs.

Back to work
Monthly US unemployment and change in total number of employees on nonfarm payrolls



Last data point 30/09/2020
Source Haver Analytics, Credit Suisse

Creative destruction and productivity

A shock like the COVID-19 pandemic also influences productivity. One measure of this is the growth of labor productivity, i.e. real GDP growth minus real growth in hours worked. During the pandemic, labor productivity jumped as hours worked fell more than output. As employees return to their jobs, however, this should reverse and productivity growth could slow. Still, productivity is always very volatile over short time periods. In the longer term, the pandemic could enhance productivity, at least in a number of sectors.

> “ Central banks have become much more open to adopt unorthodox monetary policy measures.

The lockdown has created plenty of disruption, which will likely boost new business models such as online medicine and new ways of working. There will be short-term costs to these disruptions, but emerging business models can generate efficiencies in the long run, especially if companies and governments invest in the right areas, such as digital infrastructure.

Central banks on hold

With wages under pressure and/or – depending on the region – unemployment levels rising, inflation looks set to remain subdued. We expect global inflation of 2.3% in 2021 – lower than the pre-pandemic level of 2.5% in 2019. In the USA, we expect inflation of 2.0% in 2021 versus 1.0% for the Eurozone and 2.5% for China. These low inflation numbers mean that central banks will be in no hurry to raise interest rates. During the lockdown, the US Federal Reserve (Fed) joined other major central banks in cutting rates to around zero, and they re-launched or extended major asset purchase programs. Their objective was to depress real interest rates further in order to support the economic recovery. We do not expect any of the major central banks to hike interest rates in 2021, and most likely well beyond. In fact, we could even see an increase in asset purchases if growth falters or if inflation fails to rise.

Fog over fiscal future

While the effects of the pandemic should help keep inflation in check in 2021, the long-term consequences of the crisis on inflation are less clear. Over time, ballooning budget deficits and public debt are likely. This destabilization of public finances can lead to inflation, but only if central banks are ineffective or inactive in responding to future inflation pressure. This could happen, for example, if central banks succumb to outside pressures or if they begin to allow concerns over government debt service to influence their rate decisions. This is a risk case for the post COVID-19 period. We cannot exclude the possibility that central banks are pressured into financing overly ambitious fiscal programs.

Central banks could also simply respond too late or weakly to accelerating inflation. Yet the Fed's shift toward average inflation targeting does not limit its ability to respond quickly to a rapid overshoot in inflation. In Europe, the constitution of the European Central Bank (ECB) renders this especially unlikely. In countries with high public debt, fighting inflation becomes more difficult for central banks than fighting deflation. This is because inflation makes it easier to manage a high debt burden while deflation makes it more difficult to do so.

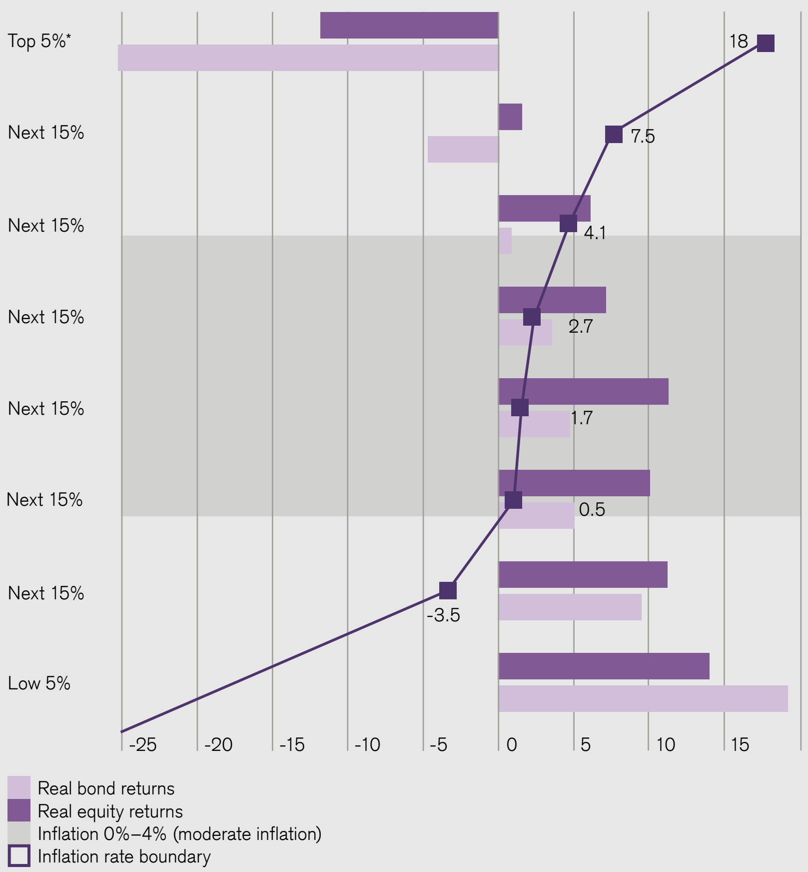
Central banks have thus become much more open and eager to adopt unorthodox monetary policy measures such as quantitative easing, negative interest rates or yield curve control to avoid deflation than to tighten monetary policy in the face of rising inflation when the economy is weak. This puts central banks in a delicate position to fulfill their mandates. For now, it is too early to assess such tail risks, but investors should stay attentive to the sustainability of public finances.

Inflation holds the fate of financial assets

For financial assets and investors, it is key to determine which inflation regime will prevail in coming years. For most developed countries and emerging markets, 0%–4% headline inflation is a moderate inflation regime. In such a regime, equities tend to outperform bonds. In high inflation regimes (typically when headline inflation is above 7.5%), equities stop producing positive total returns while bonds tend to perform negatively. In deflation regimes (negative headline inflation), bonds outperform stocks.

Real bond and equity returns vs. inflation rates

Rate of return/inflation (in %, 1900–2019)



* Percentiles of inflation across 2516 country-years; bond and equity returns in same year

Last data point 31/12/2019

Source Elroy Dimson, Paul Marsh, and Mike Staunton, DMS dataset. Not to be reproduced without express written permission from the authors.

The debt legacy

Many countries implemented fiscal stimulus measures amounting to 10% of GDP or more during the crisis. By the end of 2020, the ratio of government debt to GDP in the USA will rise above 130 %, according to International Monetary Fund (IMF) data, and to more than 160% for Italy and more than 260% for Japan. Although policymakers will be increasingly concerned about rising debt, pressure to provide additional fiscal stimulus will increase if economies fail to fully recover. In the USA, additional stimulus will be limited in size given the Democrats' failure to achieve decisive majorities in Congress.

Additional stimulus measures of the magnitude of 2020 are quite unlikely, however, given the expected recovery of the world economy and the low probability of further full COVID-19 lockdowns. Whatever the trajectory of the global economy, high government debt will remain a challenge for policymakers going forward. So long as interest rates remain at or close to their current lows, debt will remain sustainable. However, governments will be constrained in fighting any future recession and, more importantly, financing growth-enhancing expenditures. High debt is thus likely to be one of the lasting burdensome legacies of COVID-19.

Protectionism to persist

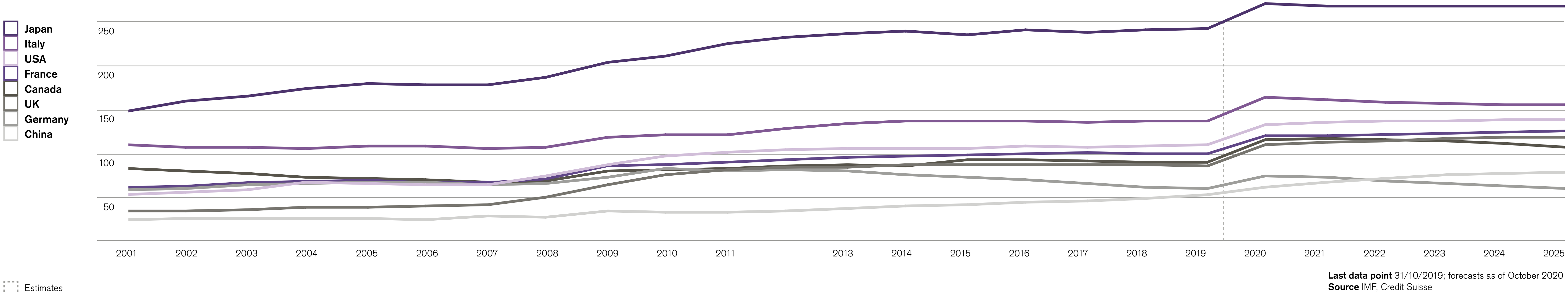
Over the past 20 years, China has gone from producing roughly 5% of worldwide industrial output to 30%, while the USA's share has fallen from 25% to 18%, according to our estimates. Many western politicians have pledged to boost local export and manufacturing capacity and jobs, but doing this on such a scale that could lead to a rapid rebound in the US or European share of global production is highly unlikely. However, trade barriers and frictions that have increased since 2016 are likely to persist. While tariffs are unlikely to increase between Western economies – in fact, a trade deal between the USA and EU is in the making – tensions over technology and investment are likely to remain in place or may worsen. In response, China is currently making significant investments in the semiconductor industry to reduce its dependence on other less friendly trading partners. This could lead to a duplication of supply chains. Protectionist tendencies may also increase in the area of pharmaceuticals, with lobby groups trying to suggest that the COVID-19 crisis proves the need to produce strategic supplies nationally. A much better approach would be to ensure, via multilateral or bilateral treaties, that diversified global supplies are available in a future health crisis.

US elections: Limited leeway for President-elect Biden

While Joe Biden won the US presidency, the Democrats' room for maneuver will remain limited given their failure to achieve decisive majorities in Congress. The USA is therefore unlikely to see significant changes in tax policy, while added expenditures in areas such as the "green" economy will also be limited. Changes in health care legislation or regulation will also remain limited. However, the tone from the White House is likely to shift markedly.

Price tag of a pandemic

General government debt (% GDP)



Last data point 31/10/2019; forecasts as of October 2020
Source IMF, Credit Suisse

So long status quo

Crises often become a transformative force. While some developments turn out to be temporary, others prevail long after the crisis is over. As we take stock of the COVID-19 pandemic, we identify several long-lasting consequences.

The rapid spread of COVID-19 in early 2020 caught most of the world by surprise and turned the global economy upside down. The pandemic made us aware that contagious diseases can still threaten society as a whole and that such outbreaks are in fact by-products of human progress. All along history, however, health crises have helped to drive scientific and social innovation, shaping the paths of future economic development. We believe that the current health crisis will be no exception.

Yet, rather than being a complete game-changer, COVID-19 has accelerated existing trends. The digitalization of everyday life, the trend toward more flexible work arrangements, the deceleration of globalization, the weakening of multilateralism, the expansion of the state or the vulnerability of cities – all of these developments were already underway prior to the virus outbreak.

The speed at which these trends are now progressing challenges human capacity to keep pace. Legislation is lagging behind in several areas, from data protection to labor laws, and governments, just like companies, have to strengthen their resilience by adopting more sustainable economic paradigms.

Acting now with a view to the world after COVID-19 can help minimize the likelihood of another pandemic-driven global crisis. It can also provide an opportunity to address issues that have undermined growth and prosperity in the last few decades.

Trends to watch

1 **Inflation tail risks:** The benign inflation regime of past decades will persist in the medium term, but deflation and inflation tail risks have grown.

2 **Multilateralism 2.0:** Multilateralism is either reset and reformed or will cede to multi-polarism as a result of US-China interactions.

3 **Democracy/Autocracy:** Both can fail or thrive in a pandemic as crisis management, state capacity and citizens' trust matter more than political systems. Both will continue to co-exist.

4 **Big state:** Governments' expanded powers will outlast the crisis, initiating desirable changes but also increasing the risk of undermining market dynamics and individual responsibility.

5 **Nearshoring:** Globalization will not reverse but slow further, with more emphasis on regional diversification, nearshoring of production and resilience rather than cost efficiency.

6 **Surveillance:** Surveillance and personal data collection now enable states and companies to become information empires. Comprehensive privacy protection is crucial.

7 **Work:** Remote work is here to stay, fostering an even broader flexibilization and new standards in the world of work.

8 **Education:** Lifelong learning will become a key part of everyone's life to create an adaptable workforce and develop skills that stress human advantage over machines.

9 **Inequality:** Inequality will remain a great focus and possibly initiate more redistributive taxes, triggering people and capital flows in response.

10 **Decentralization:** Cities will survive but adapt, leaving room for more regional decentralization and a renaissance of small towns in the developed world.

Regional outlook

Going into 2021, the growth picture differs across regions. As the world economy still struggles with the coronavirus pandemic, some countries are further ahead in the recovery process. On top of the COVID-19 crisis, some countries have additional political challenges to address in the year ahead.

USA
A gradual recovery from the second wave

Growth is likely to be above potential (the growth rate that can be sustained over the long term) as the USA stages a multi-year recovery from the pandemic. We expect a similar level of inflation in 2021 as in prior years, but both deflation and inflation tail risks have grown.

Government and external debt, which have swelled due to policies to address the fallout from the COVID-19 crisis, may prove to be destabilizing forces over time. In terms of the quarterly growth profile, we are likely to see a gradual acceleration after a renewed setback in Q4 2020. Even under the new Democratic administration, we are unlikely to see much of an improvement in the relationship with China. Changes in taxation will be limited, as will increases in spending on "green" infrastructure.

Latin America
Growth diverges

Mexico's long-term growth prospects appear to be worsening as President Andres Manuel Lopez Obrador maintains an antagonistic stance toward the private sector. Global risk appetite has driven the stability of local financial markets, but remains at risk given the financial fragility of heavily indebted and state-owned oil company Pemex. In contrast to the deteriorating growth outlook in Mexico, the decline of interest rates in Brazil could allow the economy to grow faster and bolster confidence in the sustainability of the public debt. For this to occur, however, President Jair Bolsonaro will need to show strong political ability to carry out fiscal reforms.

UK
Life after the EU

The UK's departure from the European Union's Single Market and Customs Union is likely to impose long-term costs (e.g. for trade barriers and bureaucracy) and slow the country's recovery from the COVID-19 pandemic. The expiration of the transition period at the end of 2020 will thus be an additional shock for the UK economy – with or without a trade deal, in our view. Furthermore, there is the potential for long-term damage if the UK government withdraws fiscal support prematurely.

Eurozone
Pandemic strengthens ties

European countries reopened their economies earlier than the USA and were therefore a bit ahead in terms of the economic recovery. As Europe is hit by a second wave of COVID-19, we are seeing a renewed setback. However, once the pandemic subsides the Eurozone appears poised to grow above potential, especially as fiscal policies have successfully mitigated much of the damage lockdowns would have inflicted on businesses and jobs. However, government finances are stretched in several key countries like Italy, and investment demand is soft. Challenging demographic trends (i.e. an aging population) pose an additional headwind to growth potential. A successful long-term recovery from the COVID-19 crisis will depend on further effective fiscal and political integration. The creation of the EU recovery fund was a step in the right direction, in our view.

China
Benefits from a head start

China is ahead of most other countries when it comes to recovery from the pandemic. It was the first country to impose lockdowns and the first to lift them. By now, Chinese industrial production has recuperated most of the lost ground, and China will be the only major economy to post a positive growth rate for 2020 (we expect real GDP growth of 2.2%). The course of the recovery from here on will be more reliant on a rebound in employment, which continues to face challenges (the travel and entertainment sectors are still reluctant to hire). Further out, we anticipate three key policy categories to be emphasized in the next five-year plan: technology advancement, labor productivity and land reform. The authorities aim to engineer a smooth deceleration to GDP growth as the economy matures and the potential comes down accordingly, and to proactively counteract any forces that would decouple China from the global economy.

Switzerland
Holding up

The coronavirus crisis also badly hit the Swiss economy, which held up better than others for three reasons. First, lockdown measures were not as strict as for example in Italy or Spain, as construction or manufacturing sites, for example, were not closed nationwide. Second, measures to mitigate the fallout from the crisis were very timely and effective: short-time working and COVID-19 loans had a positive impact right from the beginning of the crisis. Third, Switzerland has a relatively advantageous industry sector breakdown, with a high proportion of value creation coming from pharma, chemicals and other sectors (including commodities trading, banking and insurance) that were not directly affected by the restrictions or that even saw demand increase due to COVID-19. Going forward, however, the pace of recovery is likely to be similar to that of Switzerland's main trading partners.

Japan
Innovation to the rescue

Marginally positive real GDP growth should be achievable in 2021, as demographic headwinds are offset by stable productivity gains thanks to continued technological innovation. Nevertheless, persistent but mild disinflation, along with low nominal interest rates, is likely to continue to pose a threat to the banking industry, forcing it to undergo major consolidation.

Main asset classes

Credit continues to shine

In 2021, core government bonds' gains will be meager, while emerging market hard currency bonds remain appealing. In credit, investment grade offers a good risk/reward. In high yield bonds, we see select opportunities to enhance returns in the lower-rated credit segments.

With short-dated yields likely to remain anchored at low levels by central bank policy, we do not expect long-term yields to rise strongly in 2021. Nevertheless, we see a moderate steepening of government yield curves as the most likely scenario in 2021, driven by the ongoing economic recovery and central banks' objective to raise inflation expectations.

The US Federal Reserve (Fed) made an important change to its long-term strategy in Q3 2020, introducing a policy approach of average inflation targeting in which a potential inflation overshoot would be tolerated to make up for earlier below-target inflation outcomes. The framework should allow the Fed greater flexibility in its policy choices in order to lift inflation expectations, thereby helping term premiums (the excess yield for holding long-term vs. short-term bonds) to rise from depressed levels.

Moreover, while central banks' accommodative stance and ongoing bond purchases to support the recovery have kept fixed income volatility low in 2020, we think volatility could see some normalization in 2021 together with increased inflation tolerance by central banks, along with higher debt and fiscal deficits. With our expectation of a moderate rise in long-term yields, we believe that nominal core government bond returns should remain close to zero or negative in the next 12 months.

Inflation-linked bonds' edge over nominal bonds

In 2020, inflation numbers fell sharply in response to the economic contraction and the drop in commodity prices. In light of the ongoing economic recovery, major economies' inflation rates are expected to show some normalization in 2021, though likely only reaching 2.0% in the USA and 1.0% in the Eurozone, the latter being significantly below the target of the European Central Bank (ECB). However, central banks' potential tolerance for higher inflation should help stabilize and lift long-term inflation expectations, eventually exceeding recent historical averages. Inflation-linked bonds (ILBs) – which provide compensation for rising inflation – would benefit from such a rise in inflation expectations, unlike bonds. When adjusted for duration differences, we therefore think that ILBs offer a better return prospect than respective nominal government bonds.

Look for yield in emerging market bonds

Yields of emerging market hard currency bonds (EM HC) have fallen markedly since the COVID-19 induced sell-off. Nevertheless, spreads have remained above previous lows, albeit in part due to the declining underlying US government bond yield. Record high market positioning and a narrower scope for policy support going forward is moderating the return outlook.

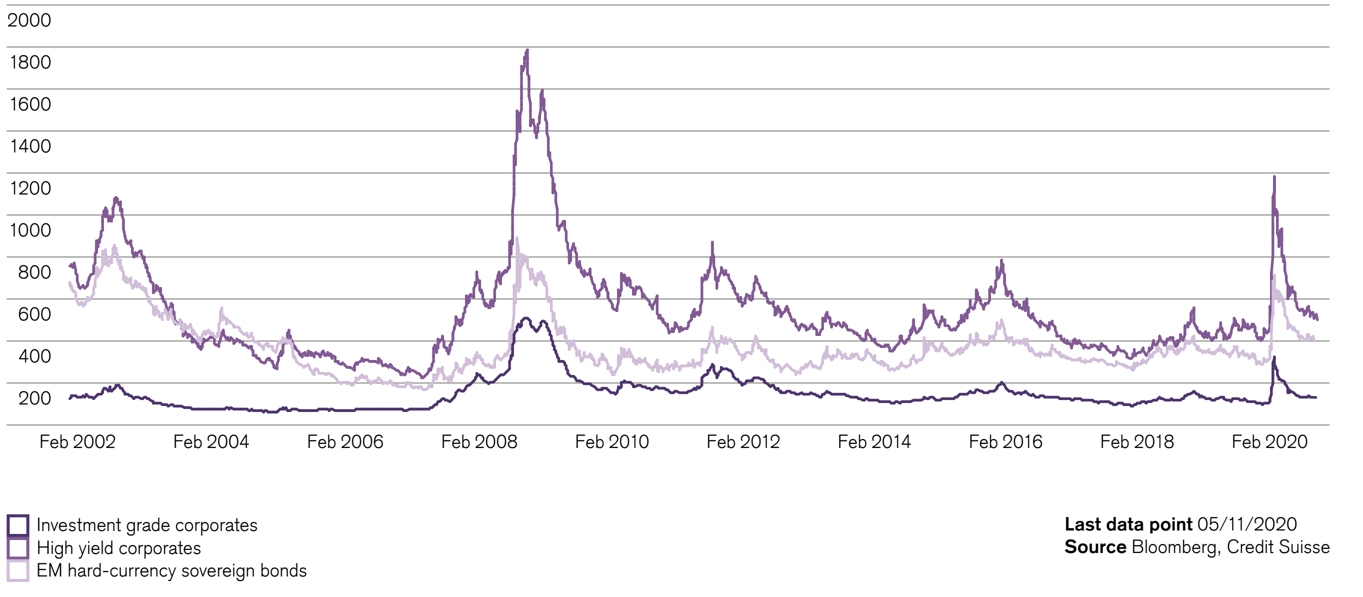
Notwithstanding the more stable global growth environment, many EM countries will still have to deal with the impact of the lockdowns following the initial COVID-19 shock, in particular the need to reverse some of the monetary and fiscal stimulus deployed in response to the crisis. On the other hand, the potential increase in cyclical revenues after the rebound in economic activity this year, together with some fiscal tightening and stronger external balances, would suggest a slower pace of debt supply going forward.

IG remains in demand

Most investment grade (IG) corporate bond segments delivered a positive return in 2020, supported by falling government bond yields as well as supportive monetary and fiscal policies. Nonetheless, credit spreads have widened since the beginning of the year. Against the backdrop of a gradual recovery of the global economy, we expect central banks and governments globally to retain the very supportive monetary and fiscal policies, especially the credit facility to purchase IG corporate bonds directly, which should support further spread tightening in the new year. As we expect long-term government bond yields to only slowly normalize, IG credit should continue to perform. With spreads for the high-grade segment having further room to tighten, we expect global IG to deliver a mid-single-digit return over the next 12 months. In our view, investors should favor good quality corporate bonds over nominal government bonds due to continued strong central bank support, not only in Europe but also in the USA. For diversification, we think that IG EM corporate bonds in USD offer an attractive yield pickup for investors looking for diversification.

We think that in the absence of additional shocks and in light of persistently low global interest rates, EM HC debt remains an important source for enhancing returns within fixed income. For the overall EM HC index that we track, we forecast a return of 4.4% by end 2021. More defensive investors might prefer to invest only in IG government bonds, even though this lowers the return outlook. After a large number of sovereign credit downgrades in 2020, we foresee a more stable environment in 2021 as we move further away from the initial COVID-19 shock and after several debt restructurings in high yield. Within major EM countries, the political agenda in 2021 is not particularly busy and may help limit specific risks. There are legislative elections scheduled in Russia and Mexico and municipal elections in South Africa.

Spreads have some tightening potential left
In basis points



Last data point 05/11/2020
Source Bloomberg, Credit Suisse

HY spreads: Room to tighten
At the time of writing, rating agency Moody's expects global high yield (HY) credit default rates to peak in Q1 2021. With risk sentiment improving alongside a projected economic recovery in 2021, we expect that a further moderate spread tightening in HY corporates is likely. Within HY, single-B rated bonds still offer attractive spread cushions compared to more defensive segments.

> “ESG bonds are likely to remain relatively well supported.

We anticipate that global HY should deliver 4.4% returns by the end of 2021. Given the prospect of a COVID-19 vaccine, consumer discretionary sectors such as airlines and gaming are likely to recover. Even though corporate leverage increased in the energy and metals sectors throughout 2020, current yields appear sufficient to compensate for default risks as we go into 2021, especially against the backdrop of ongoing central bank support. Similarly, while European sub-financials might face higher risks in terms of rising non-performing loan provisions, the strengthened bank balance sheets and fiscal support have largely reduced European banks' funding stress. We expect European sub-financial bonds' performance to be in line with HY bonds in 2021.

Benefits of ESG focus
We believe investors can benefit from two aspects when it comes to environmental, social and governance (ESG) corporates in 2021. Firstly, a corporate bond portfolio that takes into account ESG criteria might be less affected by corporate defaults and credit rating downgrades over a long-term horizon. Secondly, with the benefits of ESG screening increasingly acknowledged by investors and, in turn, translated into higher ESG allocations and inflows, we expect ESG bond prices to remain relatively well supported.

Equities still drive returns

Equities offer attractive return prospects as we move into 2021. The broad political backdrop should remain supportive given very loose monetary policies globally and continued fiscal support. The earnings slump in 2020 due to the pandemic should prove to be transitory. Consensus forecasts for global equities imply that 2021 earnings will exceed the 2019 level, which should support equities over the course of the year.

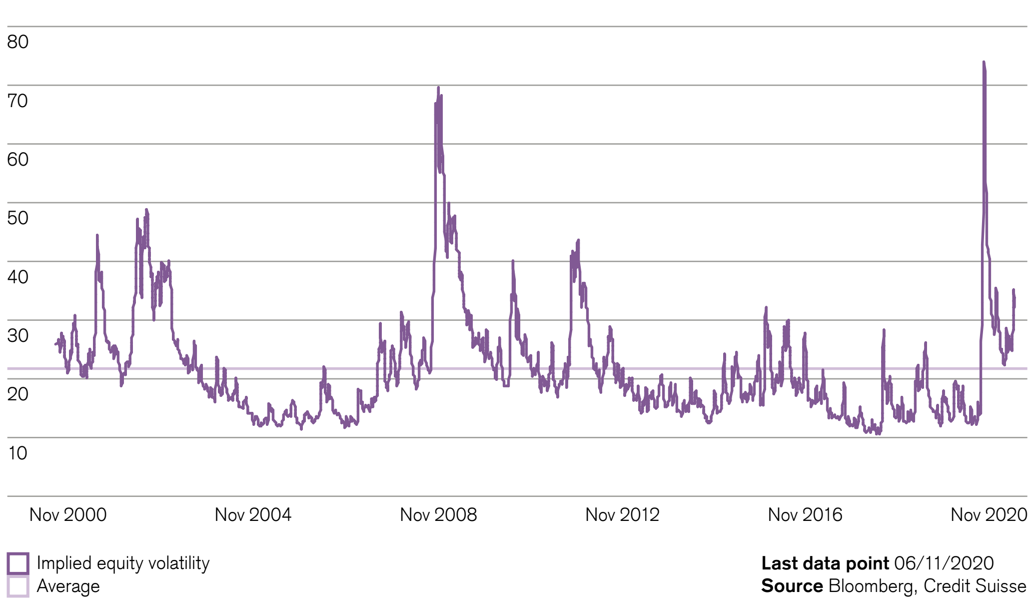
Don't be put off by high valuations

On traditional valuation metrics such as the price-to-earnings ratio, equity market valuation appears elevated compared to longer-term historical averages. On the one hand, we believe this is driven by the ultra-low or even negative yield environment, especially in inflation-adjusted terms. On the other hand, the fast and forceful interventions by policy makers, most importantly the US Federal Reserve (Fed), in response to the COVID-19 pandemic helped bring investors' risk aversion down, allowing for the sharp market recovery in late spring 2020. In 2021, policy support should remain in place to curtail risk aversion. Besides the risk of a credit crisis, we think that concerns over a late-cycle overheating have been pushed further out due to the pandemic-induced recession and policy makers' increased inflation tolerance. As central banks continue to curtail those tail risks, risk premia might even decline further as the economic environment continues to stabilize over the course of 2021, which would underpin higher valuation ratios compared to the historical record.

When comparing relative attractiveness across asset classes, which ultimately steers a substantial part of investment flows, equity markets continue to look quite attractive. Since the beginning of 2020, real bond yields in the USA have declined by over 100 basis points, outpacing the decline in earnings yields (inverse of the price-earnings ratio), thus supporting higher valuation multiples.

Room to move lower

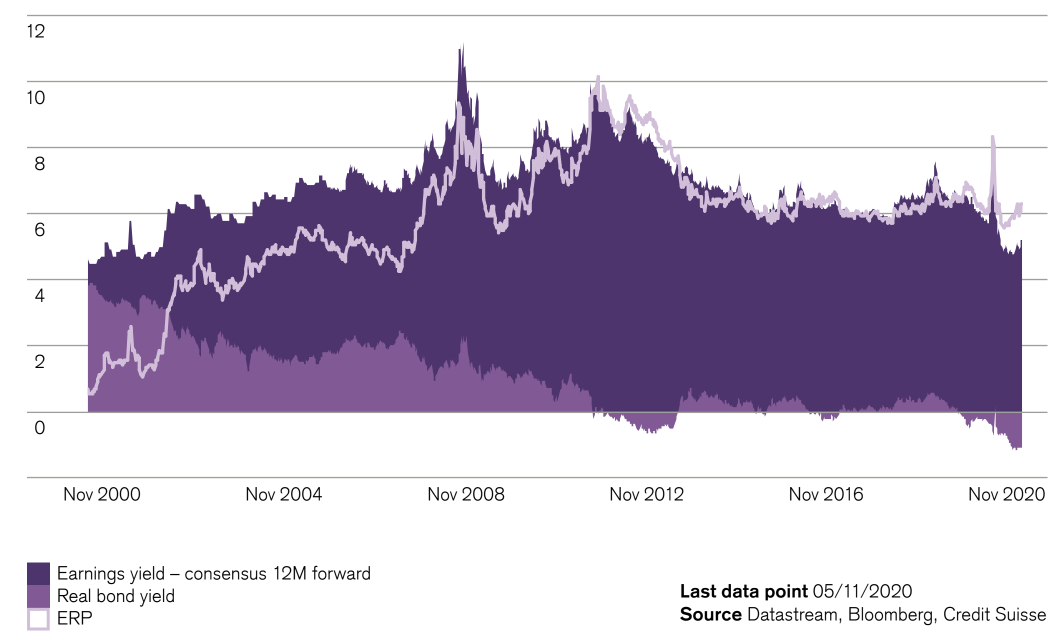
CBOE S&P 500 Volatility Index expected market volatility as reflected by traded options



Last data point 06/11/2020
Source Bloomberg, Credit Suisse

Risk has its rewards

MSCI World – Earnings yield vs. real bond yield (in %)



Last data point 05/11/2020
Source Datastream, Bloomberg, Credit Suisse

Currently the difference between the earnings yield and the real bond yield as a measure for the equity risk premium (ERP) is higher than the long-term average, suggesting that equities offer an attractive excess return over bonds. We acknowledge that in an uncertain environment, the ERP should be elevated, as investors demand a higher premium for holding risky assets. Nonetheless, as economies recover and growth returns, these concerns should ease over time.

Catching the cyclical rebound

On a regional level, the differences in sector composition will matter most, in our view. Particularly the share of secular growth industries (e.g. technology-related companies) versus cyclical industries (e.g. financials) is expected to drive much of the regional return differential in 2021.

The COVID-19 pandemic has accelerated the trend of disruption, which will continue to be a strong and powerful force. E-commerce and online shopping will increasingly replace traditional retail stores, favoring warehouses over malls. Remote working setups deploying cloud computing, data security, wireless networks and video communication tools should continue to make office space less attractive, while increasing the appeal of suburban housing. Furthermore, online education is increasingly replacing traditional in-person training, while telemedicine offers an affordable and quick alternative to doctor visits.

We continue to find attractive market segments that have the potential to disrupt and therefore have room to expand market share and profit margins, including technology-related industries and healthcare. We also see potential in materials, including construction materials, based on solid demand for commodities, a strong housing market and potentially more construction activity, especially in residential housing.

The disrupted parts of the economy, however, are likely to lose market share and their margins will come under pressure. Typical examples are brick-and-mortar retailers or print media. We also expect ongoing structural headwinds in the traditional energy and financial sectors.

After some temporary cooling, we expect economic momentum to reaccelerate in 2021, which would then allow investors to position themselves in cyclical sectors, such as travel and hospitality or automotive.

What’s in style for 2021?

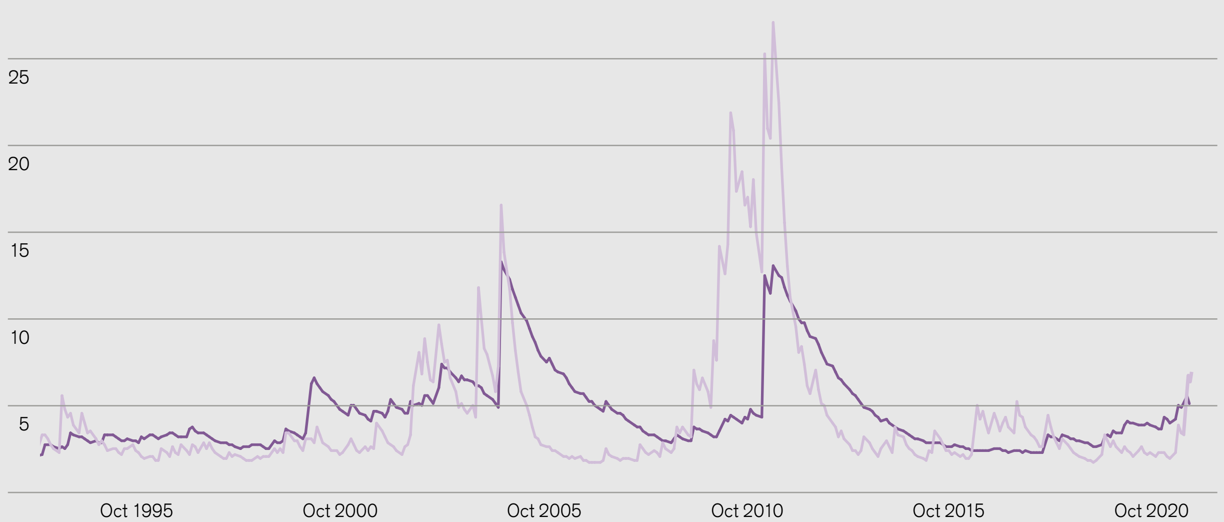
In 2020, we witnessed a strong divergence in returns between growth and value stocks. Going into 2021, we believe that value stocks have the potential to catch up, though the timing of such a rebound is not quite clear. In a typical economic expansion where gross domestic product (GDP) grows above potential and monetary policy is expansionary, an investment tilt toward value and small-cap stocks should eventually trump growth and large caps.

The adverse shocks stemming from the global COVID-19 pandemic have nonetheless accelerated factors for which growth is well positioned. This includes the ability to meet the shift in demand caused by decreased mobility, social distancing and remote working and learning. At the same time, relevant parts of value face structural challenges, such as car companies struggling with CO_2 emissions.

The same is true for financials, with the lower-for-longer yield environment leading to margin erosion, and for energy, where decreasing appetite for fossil fuels and environmental issues are headwinds for stock prices. Heading into 2021, we prefer to maintain a small growth tilt, but expect to see periods when value stocks could outperform.

Note: Value stocks are stocks that stand out by their low valuation relative to their fundamentals (e.g. earnings, dividends or sales). They often have high dividend yields and tend to be sensitive to the business cycle. Growth stocks are stocks of companies with substantial growth prospects that retain most of their accrued earnings in order to finance growth.

A tale of two strategies
Earnings volatility of growth and value (in %)



Earnings volatility: Growth
Earnings volatility: Value

Last data point 31/10/2020
Source Datastream, Credit Suisse

ESG here to stay

Sustainability has become increasingly important for investors. So much so that it has become mainstream. For the first time in its 15-year history, the World Economic Forum’s Global Risks Report 2020 exclusively listed environmental concerns as the top global risks by likelihood, as well as for the majority of risks by impact. Awareness of environmental, social and governance (ESG) factors is rising, as illustrated by the increase in online search engine queries. Assets under management adhering to ESG standards are growing rapidly, putting greater pressure on listed companies to align business models and practices with ESG standards. Furthermore, fiduciary duties are gradually adapting to include sustainable investment principles, as regulators are increasingly demanding the consideration of ESG criteria.

> “Sustainability has become increasingly important for investors.

Benefits for investors include more protection against prominent governance incidents, resilient ESG performance, along with the soft factor of doing good. We believe this trend will continue, leading to further demand and support for sustainable investments.

Eurozone has the advantage

The Eurozone could outperform the USA over the course of 2021, as earnings offer catch-up potential and should benefit disproportionally from the economic recovery due to their cyclical sensitivity. The earnings cushion provided by the resilient and stable growth-related industries (e.g. technology) during the COVID-19 crisis was less pronounced in Europe.

In addition, various regulatory measures regarding dividend payments, introduced during the crisis to ensure sufficient capital buffers in the insurance and financial industries, are likely to be phased out in Europe as economic stability resumes. This would increase the attractiveness of high dividend paying strategies, which tend to be more relevant for European equity markets. We currently calculate a relative valuation advantage for the Eurozone of close to 10%, which we expect to close over time.

Swiss quality

Swiss equities are of a defensive quality and therefore have a resilient earnings profile due to the strong concentration in the healthcare and consumer staples sectors, which account for more than half of the MSCI Switzerland index. During the pandemic-driven downturn, the Swiss market benefited from its defensive qualities. However, Swiss equities went on to lag the strong rebound due to this defensiveness and a relatively low share of technology-related businesses. Following the rally, we believe that the substantial share of global market leaders with high-quality products offers attractive earnings prospects for the Swiss market. Solid and, most importantly, stable dividends are another argument in favor of Swiss equities, especially at a time when investors are searching for income generating assets due to low bond yields. As an export-oriented economy, the strength of the CHF due to its safe-haven status has been a drag on performance in the past. However, we expect this drag to lessen for 2021, as the continued global economic recovery should reduce the appeal of the CHF as a safe-haven currency.

202

potential COVID-19 vaccines currently being developed.

Vaccine: The X-factor

Some 202 potential COVID-19 vaccines were being developed and tested globally, with 47 in human trials, according to the World Health Organization's 3 November draft landscape of COVID-19 candidate vaccines. In November 2020, one particular vaccine reported encouraging phase 3 study news, likely leading to widespread vaccinations by mid-2021. This is remarkable, as typical vaccine development takes years, not months.

There are several questions linked to a vaccine, including its duration of protection, but also its safety and public acceptance. In addition, the availability of a vaccine and speed of production, along with the logistics in terms of global distribution are key in order to understand how quickly the world could return to "normal." There is also the issue of near-term capacity, especially for poorer regions.

Nevertheless, any credible confirmation that an effective vaccine is available for wider distribution – and despite all the mentioned issues – would likely be positive for broader equities and overall risk sentiment. Indeed, equity markets already appear to anticipate such positive news based on results from ongoing vaccine trials and approval processes. In such a case, we expect that the sectors that have been most negatively affected by COVID-19, including travel, leisure and hospitality, could see a recovery. We would also expect to see a quick rotation within equities from "stay-at-home" equities and growth stocks into value and cyclical stocks, driven by positive earnings revisions and the potential for a valuation re-rating. Regionally, we expect tourism dependent and cyclical equity markets to begin to catch up in such a scenario after a protracted underperformance throughout 2020 (e.g. in the Eurozone).

UK – Brexit uncertainty keeps us sidelined
Since the Brexit vote in 2016, UK equities have underperformed global equities meaningfully, leading to a significant de-rating and a historically low valuation multiple compared to world equities. More recently, UK equities have experienced inferior earnings and sharper dividend cuts than global equities due to the UK market's high exposure to the financial and energy sectors, which were substantially affected by the COVID-19-related lockdown. Valuation ratios and high-dividend yields indicate attractiveness, however the economic outlook remains clouded due to uncertainties related to the UK's pending departure from the European Single Market under Brexit. Nevertheless, currency developments could help cushion the blow. UK equities have a strong inverse correlation to the GBP due to the high share of earnings generated outside the country. We believe that a weak GBP, in combination with the attractive equities valuation, could help offset the hit to growth if Brexit uncertainty continues and there are additional COVID-19 outbreaks in the UK. Additional fiscal and monetary stimulus could also support the economy and domestic stocks in the near term.

Emerging markets: Asia stands out
Emerging market (EM) equities are dominated by Asia, which accounts for approximately 80% of the global EM market capitalization. Asia has significant exposure to the so-called "new economy" industries and we therefore see a number of structural trends that support Asian equities, such as digitalization, the cloud and artificial intelligence.

We expect Asian equities to deliver attractive returns in 2021 given the current containment of COVID-19 in large parts of the region and the ongoing robust economic recovery in China. As valuations appear to have already largely priced in good economic prospects, a continued recovery in earnings will be key to drive the market higher. The broader economic recovery and strong growth from the technology segment should prove supportive for earnings.

Foreign investors are likely to focus on EM Asia as they hunt for superior growth opportunities. The COVID-19 pandemic more severely affected the other two EM regions, Eastern Europe, Middle East and Africa (EEMEA), as well as Latin America. The fundamental backdrop is therefore weaker for those two regions compared to EM Asia.

However, equity prices have corrected due to the pandemic, leading to the potential for outperformance should concerns related to COVID-19 abate, for example through a globally distributed vaccine. Easy monetary policy and a weaker USD should prove beneficial for EM equities. One key risk for EM equities in 2021 remains the US-China trade dispute and the potential for further escalation.

USD set to lose further ground

We expect further USD declines in 2021 on the back of improving global growth, a deteriorating US real yield advantage and the widening of fiscal and external deficits. The EUR and JPY should benefit from this trend. We believe the CNY will also gain, supported by portfolio flows.

So far this year, the USD has lost ground against other major developed market (DM) currencies. In the face of what we expect to be an ongoing global recovery in 2021, we think the USD should continue to lose ground. The very accommodative US Federal Reserve (Fed) has erased the USD's interest rate (or carry) advantage, and the prospect of poor US fiscal and external balances should further weigh on the USD. The Fed's adoption of a new policy framework, including average-inflation targeting, increases the risks of higher long-term inflation expectations. With the Fed unlikely to raise policy rates for the next 2-3 years, hence preventing sharp moves in nominal yields, US real yields risk moving even lower. This should further weigh on the USD. An extended second wave of COVID-19 infections over the winter months could, however, create some market volatility and enable the USD to gain ground temporarily due to its safe-haven status.

Rosier outlook for EUR
Political risks to the EUR have receded with the comprehensive European Union (EU) recovery fund. Despite some widening in the fiscal deficit, the EU's structural external balances (3% surplus on average over the last five years) are sound and superior to those of the USA. Moreover, in a world of worsening public finances, we think that the new EU-wide bond creates a tool to promote EU convergence and should boost the availability of attractive safe liquid assets. This could also help the EUR. With EUR valuations still attractive, we expect EUR/USD to reach 1.25 at the end of 2021.

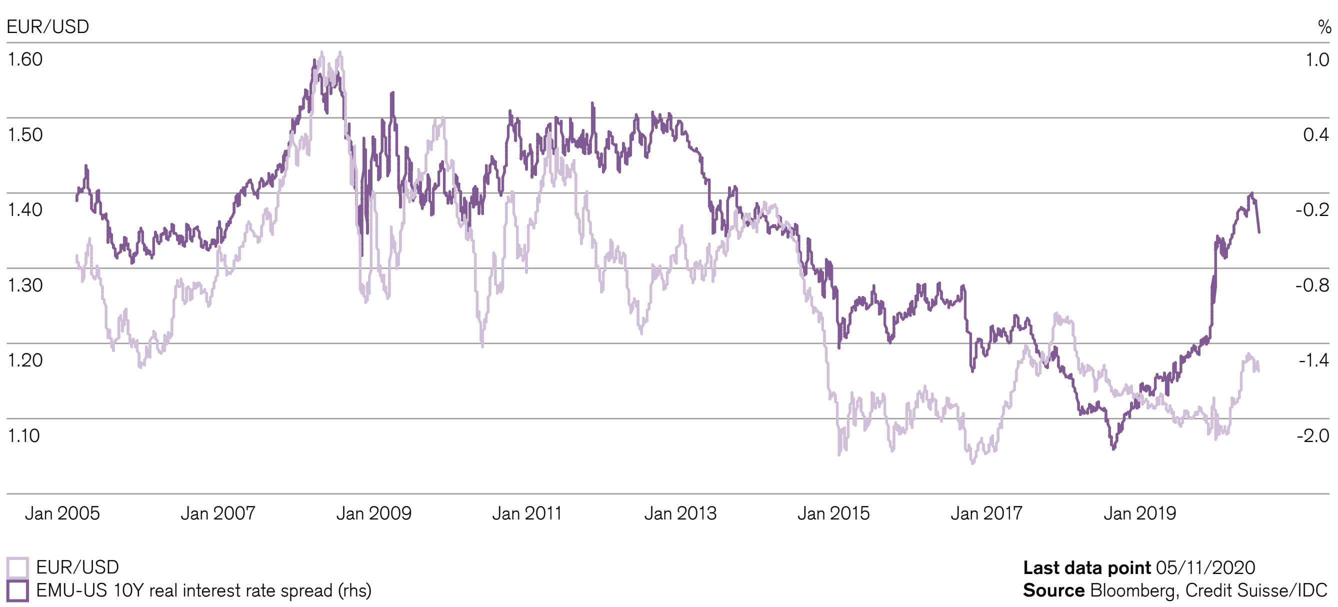
JPY, GBP undervalued vs. USD
The JPY has an improved outlook as US interest rates converged with those of Japan and, in fact, turned even lower on a real basis. The JPY remains undervalued against the USD, while Japan's structural current account surplus and strong international investment positions support the currency. We forecast a modest GBP appreciation next year, as uncertainty on the political and the monetary policy side should diminish and allow the market to refocus on the GBP's cheap valuation, especially against the USD.

CHF likely to soften
Short-term uncertainties related to the geopolitical situation and COVID-19 may keep the CHF supported up to the end of 2020. Still, the Swiss National Bank is likely to prevent the CHF from appreciating by intervening in the foreign exchange market if needed. In 2021, we expect the CHF to depreciate modestly against the EUR thanks to the improved outlook for the global economy and the largely overvalued CHF.

EM currencies should gain ground
With the USD likely to extend its weakness, the fundamental outlook for emerging market (EM) currencies should improve in 2021. While we believe that economic activity in EM should remain subdued in the short term considering the residual effects of the COVID-19 shock and uncertainty about the need for additional measures to deal with the virus, we also expect the economic recovery in EM to slightly outperform the US in 2021. We would expect a lower degree of policy support as fiscal measures are partially reversed and EM central banks become less accommodative after inflation bottomed in Q3. As global interest rates remain persistently low, potential rate hikes in EM could give some support to EM currencies, as long as such hikes are not seen as undermining real activity. Against this backdrop, we would expect some degree of differentiation across currencies.

In Asia, China's current account surpluses should decline and eventually turn into a deficit, with the economic rebalancing structurally favoring consumption and lower savings over the longer term. However, net portfolio flows should remain strong into 2021. China offers more attractive interest rates compared to global core bond yields, while equity flows may also be positive given the recovery of China's economy and the associated path of earnings growth. All in all, we anticipate some CNY appreciation next year and forecast USD/CNY at 6.32 in 12 months. This should support most other Asian currencies against the USD. In particular, we expect the KRW to benefit as South Korea has a strong current account surplus and has brought COVID-19 under control.

More than meets the eye
Relative real interest rates not fully reflected in EUR/USD

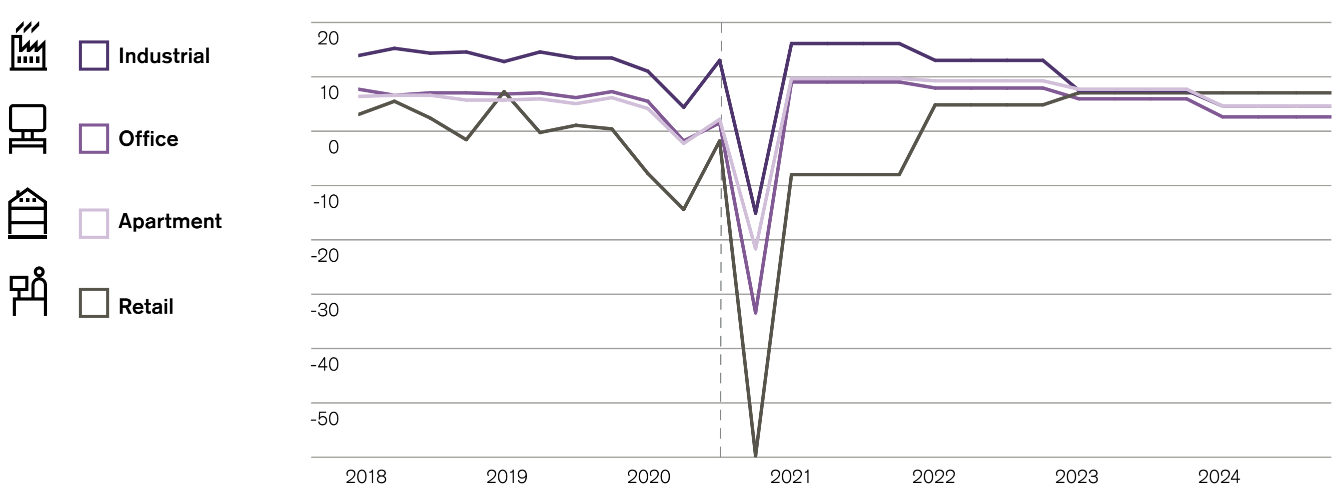


Last data point 05/11/2020
Source Bloomberg, Credit Suisse/IDC

Shifting to the post-pandemic world

The economic recovery and low interest-rate environment should be favorable for real estate investments in 2021, even though COVID-19 represents an ongoing challenge for certain market segments. We favor sectors underpinned by structural growth such as industrial and logistics real estate.

Industrial/logistics outperformance set to continue
Total return forecasts across US commercial real estate sectors



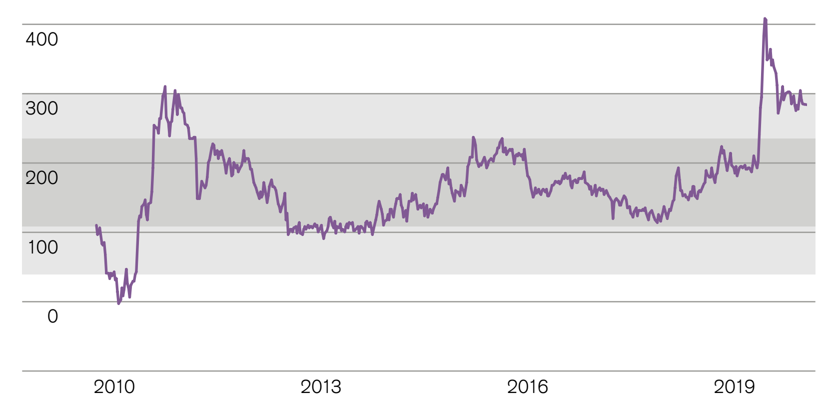
Last data point 30/09/2020; forecast until 31/12/2024
Source Datastream, NCREIF, PMA, Credit Suisse

The projected environment for 2021 – a continuing economic recovery combined with historically low interest rates – is favorable for real estate in general. With valuations in listed markets still below pre COVID-19 levels, we expect the asset class to deliver positive, mid-single-digit returns in 2021. The outbreak of COVID-19 and ensuing lockdowns affected the various segments of the real estate market very differently. Whereas accelerated growth in e-commerce and the trend toward working from home are likely to also negatively affect demand for retail and office space in 2021, logistics and industrial real estate continue to be among the major beneficiaries of the crisis due to increased demand from online retailers. In addition, data centers and communication towers benefit from rising data usage as employers enable their staff to work from home. As a result, applying a sectoral view has become even more important when investing in real estate.

Prefer US listed real estate
We currently favor listed over direct real estate due to more compelling valuations. Within listed real estate, we prefer the US market, which has a higher exposure to logistics and data centers, as well as to defensive sectors such as self-storage. In the UK, listed real estate companies are trading at a large discount to net asset values (NAVs), but the outlook will ultimately depend on how the Brexit transition evolves. Eurozone real estate is a defensive market due to its 70% exposure to the German residential market, which continues to be supported by structural undersupply and would benefit from the likely abolition of the rental freeze in Berlin in 2021. Swiss real estate funds should remain supported by the low rate environment and high exposure to the residential market. However, already rich valuations are likely to limit further price upside in 2021. Investors should expect a distribution yield of about 2.5%.

Direct real estate: Not out of the woods
While share prices of listed real estate companies react quickly to market news, valuations in direct markets lag due to their appraisal-based nature. We therefore believe that property values in direct markets are likely to correct further as we move into 2021, especially in structurally challenged sectors such as office and retail. We prefer core strategies that invest in a diversified portfolio of good quality and centrally located properties, as well as strategies with a higher exposure to the industrial and residential sectors given their more defensive nature. We also believe that strategies focusing on sustainability (e.g. green building practices) and societal trends (e.g. redesign of office buildings offering greater personal space, recreational areas, etc.) will benefit in the long term.

Recovery and rates support real estate
Spread between real estate dividend yield and 10-year government bond yields (in bp)



MSCI Real Estate World dividend yield spread*
Average +/-1 standard deviation
Average +/-2 standard deviation

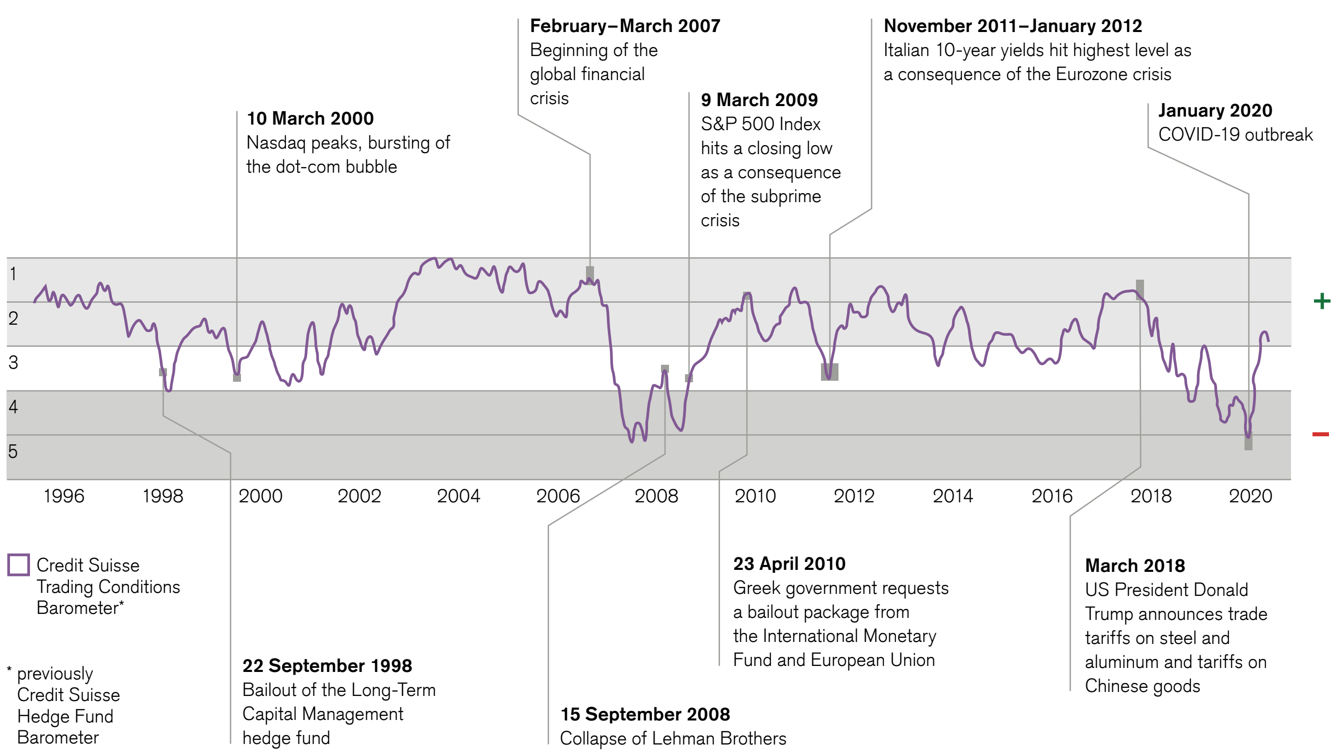
Last data point 02/11/2020
Source Datastream, Bloomberg, Credit Suisse

* Spread between 12-month forward dividend yield on MSCI World real estate and weighted 10-year government bond yields (according to index country weights)

Better trading conditions for hedge funds

We expect hedge funds (HFs) to deliver low single-digit returns, with volatility comparable to that of investment grade (IG) bonds in the USA and UK. As such, we believe that HFs are viable alternatives to stabilize portfolios. Although trading conditions for HFs are set to improve going into 2021, due diligence remains critical.

Credit Suisse Trading Conditions Barometer* suggests improved market conditions compared to 2020
Scorecard based on Purchasing Managers' Indices, liquidity conditions, volatility and systemic risks



\+ Hedge funds typically outperform safe-haven assets
\+ Conditions supportive of cyclical strategies

– Hedge funds typically outperform risky assets
– Conditions supportive of defensive strategies

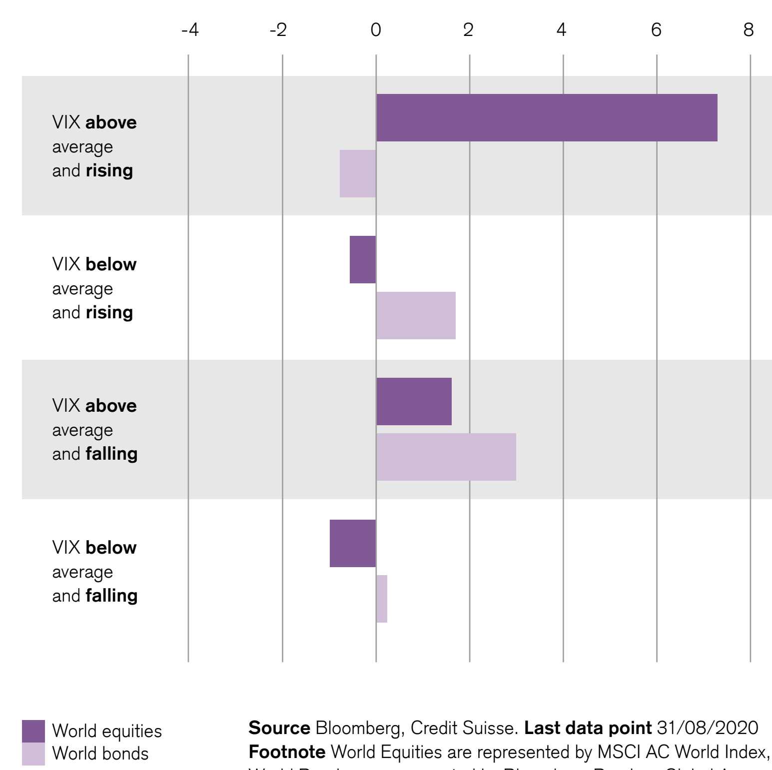
Last data point 25/09/2020
Source Bloomberg, Credit Suisse

Most HF indices registered just under a third of the decline experienced in equity markets during the COVID-19 sell-off in Q1 2020, with performance dispersion among managers widening significantly during the crisis. While growth and liquidity sensitive strategies suffered from a disruption in market functioning due to a significant deterioration in market liquidity, defensive strategies were able to limit declines to the low single digits. Participation in the subsequent rebound has been in line with historical trends and, on aggregate, hedge funds have fulfilled their role of portfolio stabilizers, delivering a small positive performance in the first nine months of 2020. Although HF returns have been on a declining trend in recent years, we expect them to stabilize at low single-digit levels as the economic recovery continues and trading conditions improve. Importantly, we expect hedge fund volatility to be comparable to IG bonds in the USA or UK, making them a viable alternative in helping to balance risk and return in multi-asset portfolios. In contrast, government bonds face negative total return prospects, while other options to improve portfolio stability are either more illiquid (e.g. infrastructure) or may be too complex to be implemented by private investors (e.g. option overlay strategies). Recent surveys have shown that investor interest in HFs is growing, including one conducted by Preqin in H2 2020.

Conducive environment in 2021
HFs are set to enter 2021 amid more favorable conditions than in 2020. First, the COVID-19 crisis has led to a fundamental change in the outlook for several sectors. For example, it has increased healthcare spending and acted as a catalyst for positive technology trends that are likely to persist, while other sectors such as consumer discretionary will only experience a gradual recovery. Such divergences led to a conducive environment for stock picking and relative value trades. Second, we expect elevated market volatility to persist with increased trading ranges, which should help increase returns of tactically oriented HFs with skilled managers. Finally, relative value strategies can benefit from higher carry in non-traditional but fundamentally stable markets, such as mortgage-backed securities or consumer loans. Central bank asset purchases should guarantee smooth market functioning, thereby reducing liquidity risks. We think that a well-selected basket of HFs diversified across styles offers a good balance between expected return and risk, supported by the economic recovery and an improved opportunity set post the COVID-19 shock. As dispersion among managers and strategies has been wide, specialized due diligence is critical.

With sustainability and environmental, social and governance (ESG) compliance gaining more prominence in security selection and performance, managers with a robust ESG screening framework may fare better. While a fund of funds approach should enable portfolio diversification and stability for risk averse investors, a more targeted approach with allocations to top-performing managers holds merit for more risk tolerant investors to enhance return prospects.

Hedge funds tend to fare better amid uncertainty
Excess returns of hedge funds over equities and bonds (in %)

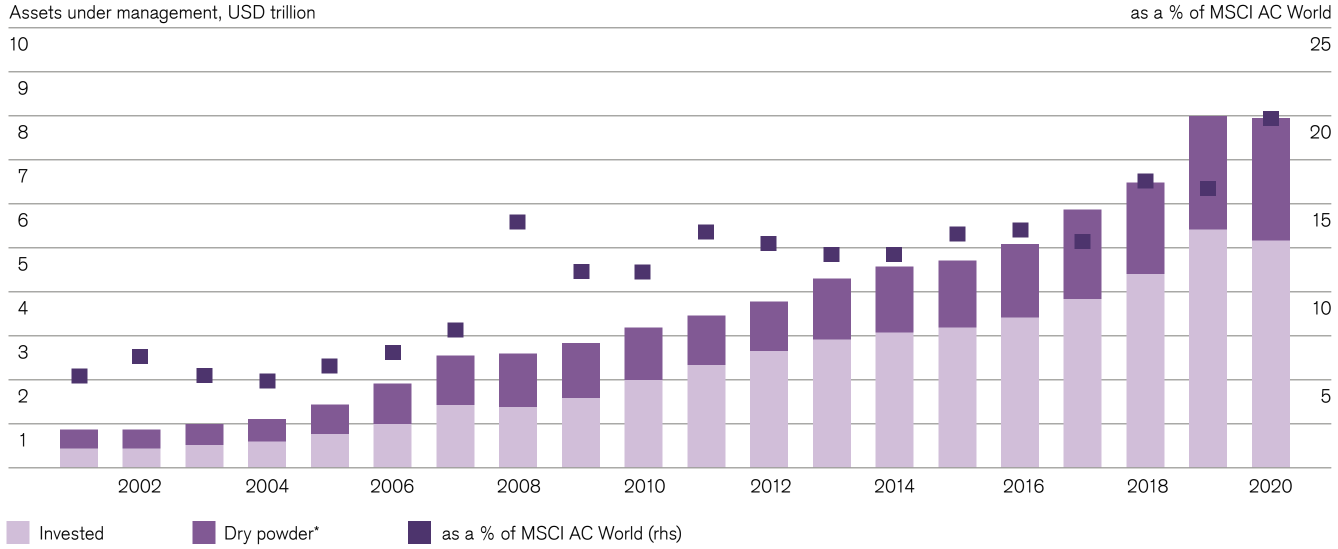


Source Bloomberg, Credit Suisse. **Last data point** 31/08/2020
Footnote World Equities are represented by MSCI AC World Index, World Bonds are represented by Bloomberg Barclays Global Agg index. Next 6M median excess returns since 2000. VIX measures S&P 500 30-day options-implied volatility.

Long-term rewards

Patient private equity (PE) investors with access to best-in-class managers should be able to achieve an attractive excess return over public markets. As PE requires a long-term commitment, we note the importance of a measured approach with well-diversified investments over the cycle. Sound due diligence and access to top managers with proven track records are key success factors.

In demand: PE's popularity intensifies deal competition
Private equity assets under management

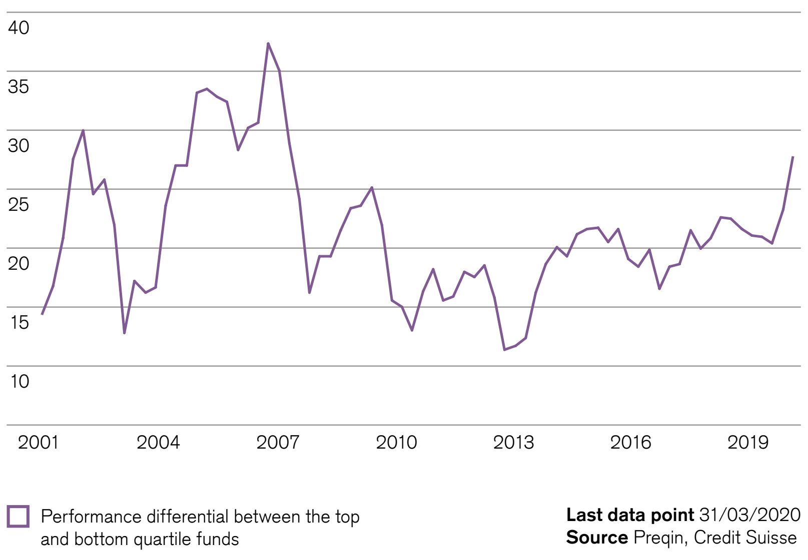


* Dry powder – committed but not invested capital

Last data point 31/03/2020
Source Preqin, Credit Suisse

The COVID-19 shock led to an initial slump in PE investment activity, but it increased the upside potential for venture and growth investments by creating disruption and incentivizing innovation in traditional sectors. It also presented distressed PE vehicles with a broader set of sectors, as previously healthy companies in areas such as travel, dining, and leisure saw a drop in cash flows. Moreover, portfolio rebalancing following the COVID-19 shock should open up previously inaccessible opportunities for funds in the PE secondary market (so-called secondaries). Traditional PE valuation metrics indicate some improvement in the pricing of PE deals, also compared with public markets. Overall, this should underpin the expected long-term excess return of PE over public markets, rewarding a long-term commitment of funds.

Not all funds are created equal
Performance differential between the top and bottom quartile PE funds (% YoY)



Last data point 31/03/2020
Source Preqin, Credit Suisse

Leverage ticking up
In the COVID-19 environment, PE companies increasingly used cheap credit for liquidity and investment purposes. The financial leverage on new buyout transactions rose sharply, according to Preqin, a provider of data for alternative assets. Although this requires attention, we do not perceive it as a concern for the industry yet, for three reasons. First, the larger proportion of debt used is senior compared with developments before the 2008 global financial crisis. Second, the industry is now better versed in risk and liquidity management, as evident in lower return volatility, as established managers hold a growing amount of capital. Third, buyouts, the most leveraged PE strategy today, account for about 27% of assets under management in private markets (40% in 2008/09). Finally, Refinitiv LPC's latest Middle Market Lender Outlook shows a more conservative stance from lenders. Therefore, we think that the risk of an excess use of leverage should be contained.

Track record counts
The COVID-19 crisis led to a temporary rise in investor concerns with regard to PE, but it did not diminish demand for the asset class. Following the shock, US regulators allowed US retirement plans to invest in buyout firms, and banks to take stakes in venture capital funds. The increasing popularity of PE leads to more transparency and intensifies competition for deals. We think that PE managers with a solid track record, deal sourcing and client base should continue to outperform the overall market. Over the long term, we believe that well-diversified PE exposure to managers and across strategies, vintages and geographies should be preferred for private investors to achieve an excess return over public equities. We also highlight impact investing, as the PE industry is well positioned to express a long-term view on topics like climate change and education, while allowing for diversification when actively seeking to increase value.

Market rebalancing continues

Commodities witnessed a turbulent 2020. Gold reached new all-time highs while cyclical markets hit deep crisis troughs from which they were still recovering at the time of writing. Going into 2021, we think the backdrop should stay conducive for real assets and commodities in particular.

In 2021, a continued economic recovery should lift physical demand for commodities. Extreme monetary and fiscal policies may finally spur higher inflation expectations and weigh on the USD, which would be broadly supportive for commodities. We prefer diversified exposure including both cyclical segments, i.e. energy and base metals, as well as precious metals, as we might see risk sentiment swing considerably along the way.

> “We would not be surprised to see new all-time highs in gold.

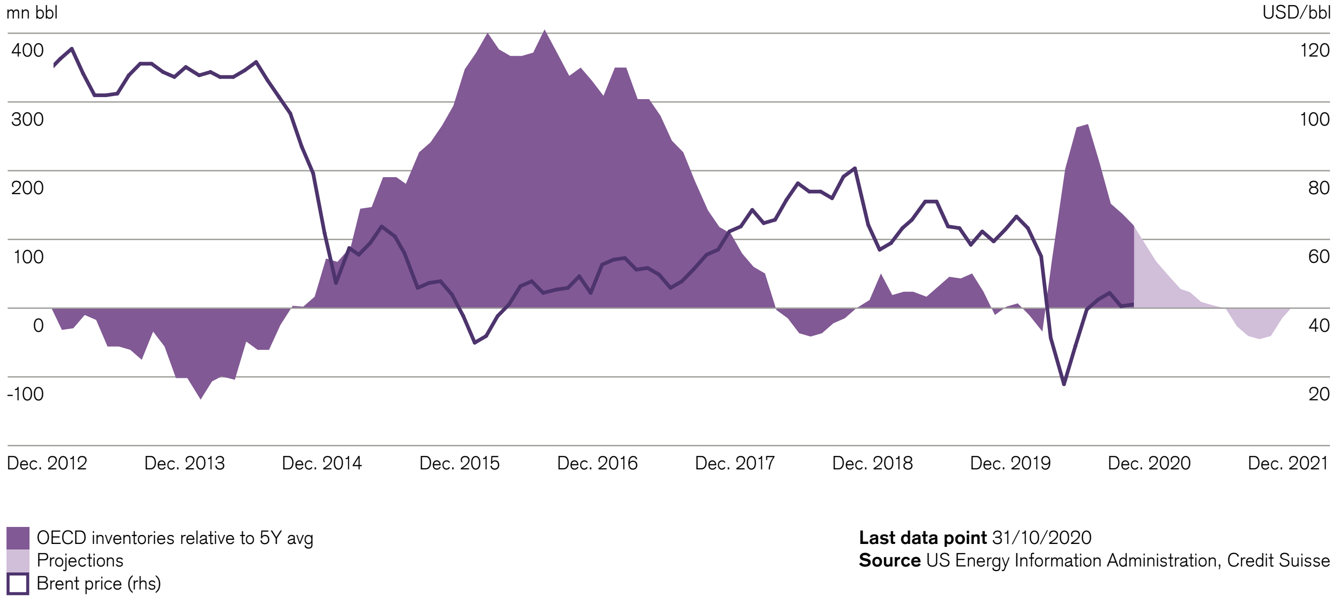
Oil demand outpacing supply
In terms of commodity-specific dynamics, demand for most commodities including oil has yet to recover to pre COVID-19 levels and is unlikely to do so in 2021. However, the crisis has left considerable capital expenditure holes and caused new projects to be deferred or even scrapped altogether, leaving supply more constrained than demand. As a consequence, large inventories that accumulated during the most acute shock phase are projected to normalize, which should ultimately lift spot prices and lead to flattening forward curves.

Oil in particular has some more room to catch up toward and potentially above equilibrium levels (which we see at around USD 50 a barrel), in our view, as inventory normalization is under way but takes time. Yet, we would stress that a prerequisite for this positive view on the energy complex is that members of the Organization of the Petroleum Exporting Countries and its allies, also known as OPEC+, continue to comply with pledged supply cuts. At the same time, we would not be surprised to see new all-time highs in gold, especially if US real yields drifted even deeper into negative territory.

Keep an eye on inflation
While inflationary pressures have remained muted and are not a major concern near-term, the inflation discussion deserves some attention in light of current policy measures and rising debt burdens. In this context, we note that a broad basket of commodities, including gold, provided a good inflation hedge in the past. For effective shelter, investors should be exposed to elements that spur inflation, e.g. energy and agriculture prices among others, while gold reacts positively to higher price levels if central bank actions are seen as causing an inflation overshoot.

What the risks are
The main risk to a positive commodities view would come from a much weaker than expected growth environment, which could be caused by renewed lockdowns triggered by a negative development of the COVID-19 pandemic. Conversely, rapid vaccine success could accelerate the rebalancing processes. Trade disputes and tariffs can also weigh on activity and commodity demand, as we saw in 2019.

After the storm: Oil inventories expected to normalize



Last data point 31/10/2020
Source US Energy Information Administration, Credit Suisse

Pushing for change

The global COVID-19 pandemic has underpinned the relevance of our Supertrends

For many of us, the COVID-19 pandemic brought our lives almost to a standstill, and in doing so has altered the way we live, work and learn. This poses a significant challenge for governments in terms of how they manage these evolving economic and societal trends. We believe that our long-term Supertrends thematic framework is well positioned to capture many of these upcoming changes. Indeed, we see developments in 2020 as an accelerator for many of our themes rather than a temporary phenomenon, and each of our Supertrends has proven to be solidly positioned in this challenging environment.

Setting the trend

When looking at our “Anxious societies – Inclusive capitalism” Supertrend, for example, we find that popular frustration has shifted more toward issues at home, in particular inequalities, rather than being focused on perceived outside threats and a move toward protectionism. The coronavirus pandemic has shown, if anything, that the real emerging threats are global and require multilateral cooperation, as well as individual protection. The subthemes “Affordability,” “Employment” and “Personal Security” perfectly capture today’s challenges for governments, as well as opportunities for the private sector.

We launched our “Infrastructure – Closing the gap” Supertrend back in 2017 in light of the looming global infrastructure gap, which is expected to total an estimated USD 15 trillion by 2040. Various fiscal stimulus packages announced during the worldwide economic lockdown have targeted infrastructure investments, including the European Union’s EUR 750 billion recovery plan, which includes spending to accelerate the region’s green and digital transformations. Hence, the pandemic could spark an uptick in investments rather than a postponement, in our view.

Our “Technology at the service of humans” Supertrend is particularly well placed, as it touches upon the type of flexibility suddenly required in terms of living and working in the COVID-19 era. The coronavirus quarantines have accelerated the relevance of each of the existing subthemes, leading to a permanent rather than temporary increase of e-commerce, demand for cloud infrastructure, online media consumption and artificial intelligence services, among others. Digitalization, automation and connectivity will remain crucial in the years to come as trends such as home office, remote medical care, online shopping, cashless payments, home schooling and entertainment have risen to new levels of growth in terms of usage and sales this year.

The coronavirus pandemic has also put the elderly in the spotlight given that this cohort is among the most vulnerable to COVID-19. The race to find an effective vaccine has sharpened the focus on the pharmaceutical sector, which is further accelerating the relevance of our “Silver economy – Investing for population aging” Supertrend. While the relevance of the therapeutics and devices subthemes has increased during the pandemic, so too have the care and facilities subthemes as the COVID-19 crisis has underscored the importance of expanding the number of hospitals and facilities for the elderly in coming years.

Sustainability: At the heart of societal trends

On the other side of the demographic tree, the focus of Millennials is toward technology and sustainability. New ways of learning through home schooling and a further acceleration in the consumption of subscription-based service such as Netflix, Spotify and others were among the core trends during the pandemic. In addition, this Supertrend has focused on sustainability since its inception, and we have applied a strict environmental, social and governance (ESG) screening for single stocks, as this generation is highly conscious of the environment, as well as social and governance issues.

The Millennials and Generation Z cohorts have pushed for and driven a more sustainable way of doing business. So much so that we believed a tipping point had been reached with respect to the responses of broader society including governments, consumers and companies to climate change. We hence introduced in 2020 a new sixth Supertrend: "Climate change – Decarbonizing the economy." Greenhouse gas emissions (GHG) are the main contributor to global warming, and experts forecast a material increase in the incidence of severe floods, droughts, fires and storms the greater the warming is. Under the 2015 Paris Agreement, countries agreed that emissions needed "to peak as soon as possible" and said they would follow up with reductions in order to achieve carbon neutrality (balance between emissions and removals) between 2050 and 2100.

We believe there is an investment case to be made around the companies that contribute most effectively to the transition to a less carbon-intensive world economy. The economic shutdown caused by the COVID-19 outbreak has reduced GHG emissions substantially in certain regions, which clearly signals what could be achieved in the future. The key sectors that our "Climate change" Supertrend focuses on are power generation and fossil energy sources, transportation, and agriculture/food production, as these are responsible for the bulk of man-made carbon emissions.

Generating alpha

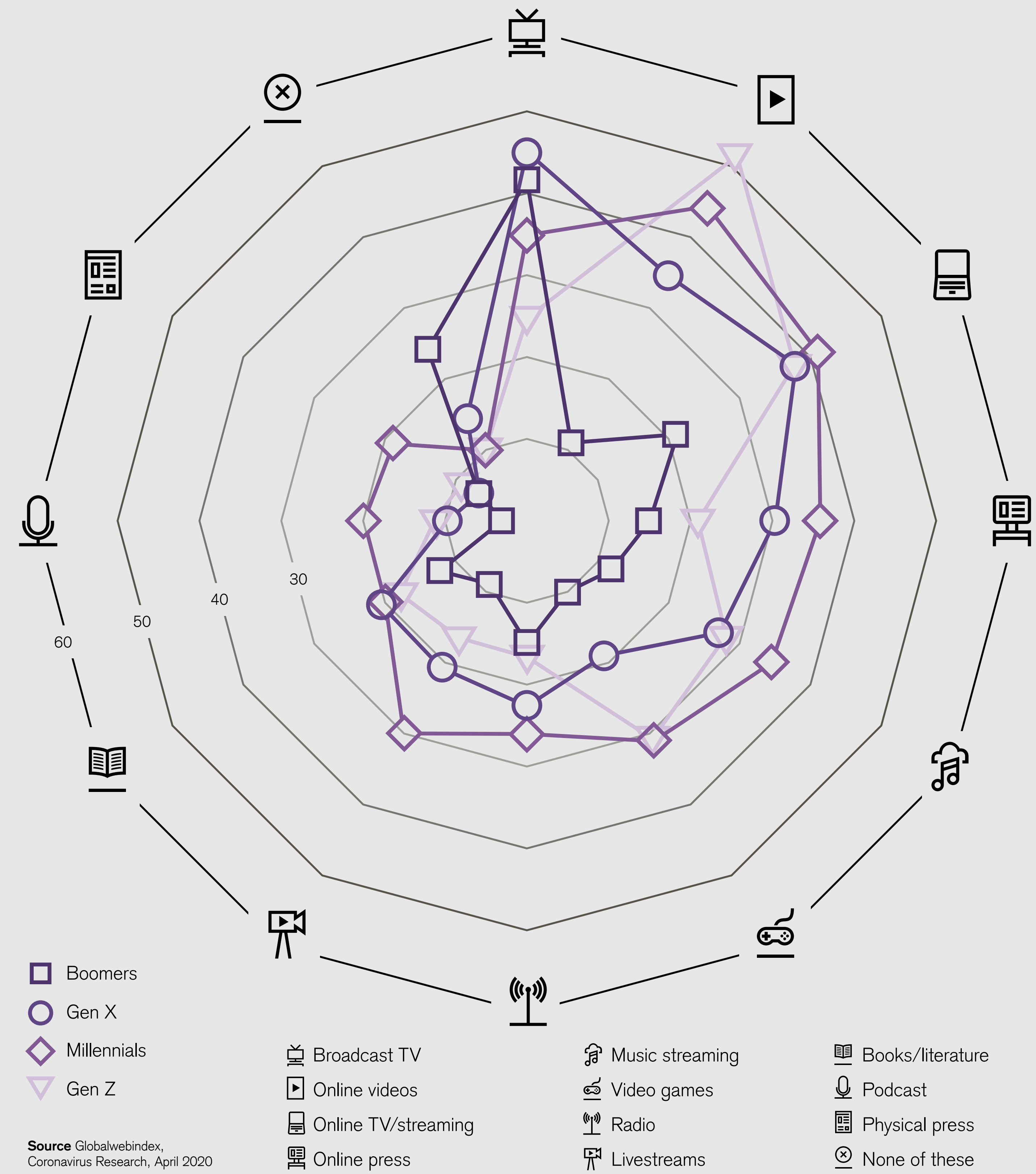
Credit Suisse Supertrends focus on long-term societal trends for investors with a multi-year investment horizon. Our sector equity analysts have identified key trends and the stock selection benefits from their deep expertise in the sector and knowledge with regard to the specific companies. Given its tailor-made building block system, active selection is a key pillar for our thematic framework.

With around 25-40 single stocks per Supertrend, our approach offers a good degree of diversification with the ultimate aim to generate significant alpha over the long-term thanks to a deep bottom-up single stock analysis. Furthermore, each Supertrend's clear thematic focus ensures a meaningful difference from broader equity market indices. We have also made sure that each Supertrend includes a sensible combination of cyclical and defensive companies applying a barbell strategy of index heavyweights and selected small cap pure play companies. As such, diversification and risk management are top priorities in the construction of our Supertrends. The aim is to protect investors from idiosyncratic single company events or temporary headwinds in an industry, region or currency.

Find out more:
credit-suisse.com/supertrends

Shifting media consumption amid pandemic

% of people who say they have started consuming or are consuming more of the following media channels since the COVID-19 outbreak.



Source Globalwebindex, Coronavirus Research, April 2020

Investment strategy 2021

Where to turn for yield

The U-turn of the US Federal Reserve (Fed), from trying to normalize interest rates to guiding for zero rates for years to come, best illustrates the new policy paradigm that is relevant when devising investment strategies. What should investors consider? We take a look.

The forceful monetary policy reactions to the COVID-19 pandemic showed that, as long as inflation stays within central banks' comfort zone, policymakers will do, in the famous words of former European Central Bank President Mario Draghi, "whatever it takes" to avoid a crisis. Thus, we think that the likelihood of an imminent crisis, due to either a deflationary threat or near-term overheating, has diminished significantly. As for risks of overheating in particular, inflation is unlikely to become a concern for markets any time soon, not least because the Fed, in its new policy framework, has signaled a greater tolerance when it comes to allowing inflation to overshoot. Policymakers in Western countries are likely to prefer such a scenario as it would, among other things, help them deal with rising public debt burdens.

All roads lead to equities
This policy setting suggests it is important for investors to ensure that portfolios have sufficient exposure to real assets. After all, high quality nominal assets promise only very meager – in most cases negative – real returns since central banks have pushed yields to low levels. With central banks continuing to look for ways to curtail risks, risk aversion and thus equity risk premia still have room to fall, which is likely to add to performance over the medium term. As economies stabilize further after the pandemic-related shock, investors looking to preserve real wealth and meet long-term obligations will be highly incentivized to invest a significant share of portfolios in equities.

Portfolio airbags
Low bond yields and falling yield volatility have created doubts about whether government bonds still provide an attractive means of diversifying large cyclical, i.e. equity-related risks in portfolios. Given the dire return outlook for bonds, should those bonds continue to play a role in multi-asset portfolios? The Fed has dampened expectations that its policy rate might go negative. Yet, should deflation loom, we think all options will be on the table, including driving yields far into negative territory, which in turn would help to push prices up further. We therefore believe that it still makes sense to invest a certain share of a multi-asset portfolio in government bonds. Investors who are more concerned about high inflation should consider holding a larger allocation to inflation-linked or real government bonds.

However, we think that investors should also look for alternatives to adjust risks in multi-asset portfolios, especially if equity exposure is raised to increase return prospects. One way to add protection is to engage in hedging strategies using derivative markets, which should be actively managed over time as the costs of hedging and hedging needs change. Another way to add protection is to take market positions, which should provide strong positive performances during equity market downturns and flat to low returns otherwise. This again requires active management, but can help to buffer sharp equity market downturns, as our experience shows.

Bringing diversity to portfolios
Adding more asset classes remains a way to improve the trade-off between risk and return. Given low interest rates and a recovering economy, real estate should continue to offer attractive returns while providing a more income-oriented component. Investing part of equities in private markets provides another way to increase longer-term return prospects. Investing in longer-term themes such as those we identify in our Supertrends framework can also help raise portfolios' longer-term return profile.

Further enhancing return prospects
In this context, investing according to environmental, social and governance (ESG) criteria is an important trend, in our view, that allows investors to direct portfolios toward projects that prioritize sustainability and good governance, which we believe are important for sustainability in performance as well. Within fixed income portfolios, taking credit exposure is a way to enhance return prospects to preserve wealth. Credit spreads are still somewhat higher than before the crisis and suggest an overall attractive return outlook. A bias toward higher-quality segments still appears warranted, as the fallout from the pandemic is expected to lead to rising default rates in the lower-quality credit segments in the first half of 2021.

Forecasts

> Inflation is unlikely to become a concern for markets any time soon.

We expect that the global economy should grow by 4.1% in 2021 as demand continues to recover following the recession in 2020. With policy rates set to remain at or below zero in all major developed economies, equity markets should continue to provide attractive returns. In fixed income, returns on core government bonds will be meager at best, while credit exposure provides opportunities to enhance returns.

Forecasts for growth and inflation

Real GDP (y/y %)

	2019	2020E*	2021E*
Global	**2.6**	**-3.7**	**4.1**
United States	2.2	-3.6	4.2
Canada	1.5	-5.2	6.0
Eurozone	**1.3**	**-7.6**	**4.6**
Germany	0.6	-6.0	4.0
Italy	0.3	-9.1	5.1
France	1.5	-9.4	6.5
Spain	2.0	-11.7	5.7
United Kingdom	1.3	-11.8	4.5
Switzerland	1.1	-4.0	3.5
Japan	**0.7**	**-5.0**	**1.5**
Australia	2.0	-6.0	5.0
China	**6.1**	**2.2**	**7.1**
India (fiscal year)	6.8	4.2	-9.0
Brazil	1.2	-4.8	4.1
Russia	1.3	-4.0	2.7

Inflation (annual avg. y/y %)

	2019	2020E*	2021E*
Global	**2.5**	**1.8**	**2.3**
United States	1.8	1.2	2.0
Canada	2.0	0.6	1.3
Eurozone	**1.2**	**0.3**	**1.0**
Germany	1.4	0.4	1.4
Italy	0.6	-0.2	0.5
France	1.3	0.5	0.7
Spain	0.8	-0.2	0.8
United Kingdom	1.8	0.9	1.4
Switzerland	0.4	-0.7	0.3
Japan	**0.6**	**-0.2**	**0.1**
Australia	1.7	0.4	1.5
China	**2.9**	**2.7**	**2.5**
India (fiscal year)	3.4	4.7	5.7
Brazil	3.7	3.0	3.7
Russia	4.4	3.3	3.6

* E: estimate

Last data point 13/11/2020
Source Thomson Reuters Datastream, Haver Analytics, Credit Suisse

Note: Historical and/or projected performance indications and financial market scenarios are not reliable indicators of current or future performance.

Financial market performance/forecasts

Equities*	2020 YTD performance on 12 November 2020	2021 expected total returns
US equities	13.07%	7.40%
EMU equities	-4.85%	9.10%
Swiss equities	1.04%	7.10%
UK equities	-14.80%	8.40%
Japanese equities	3.54%	6.80%
Emerging market equities	10.79%	8.90%

Bond yields	Close on 12 November 2020	End-2021 forecast
10-year US Treasury yield	0.93%	1.30%
10-year German Bund yield	-0.51%	-0.30%
10-year Swiss Eidgenossen yield	-0.43%	-0.30%

Credit	2020 YTD performance on 12 November 2020	2021 expected total returns
Global investment grade bonds**	6.06%	3.50%
Global high yield bonds**	3.70%	4.40%
Emerging market HC bonds***	2.20%	4.40%

Currencies & commodities	Close on 12 November 2020	End-2021 forecast
EUR/USD	1.18	1.25
USD/CHF	0.92	0.88
EUR/CHF	1.08	1.10
USD/JPY	105	100
GBP/USD	1.32	1.35
USD/CNY	6.62	6.32
Gold (USD/oz)	1870	2200
WTI (USD/bbl)	42	52

* Performance and expected returns are total return including dividends. Markets refer to MSCI country/regional indices in local currency. Performance of the periods 12/11/2015–12/11/2020 for those indices in chronological order are: MSCI USA: 7.8%, 21.8%, 7.4%, 15.9%, 18.5%. MSCI EMU: -4.8%, 24.2%, -6.9%, 17.1%, -4%. MSCI Switzerland: -6.1%, 20.5%, 1.9%, 19.1%, 4%. MSCI UK: 13.3%, 14.5%, -1%, 8.6%, -12.5%. MSCI Japan: -12.6%, 31.6%, -4.6%, 6.1%, 4.3%. MSCI EM: 4.9%, 32.3%, -8.6%, 12.8%, 16%
** Barclays Global Investment Grade Corporate and Global High Yield index
*** JP Morgan EMBIG Div. (sovereign index)

Last data point 13/11/2020
Source Bloomberg, Datastream, Credit Suisse

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