

## Index Solutions

### Investing in Fixed Income: Indexed Products to face the Low Interest Rate Environment

Newsletter No. 12



In this newsletter, we are pleased to explore with you alternatives to invest in the fixed income space effectively, even with the current low interest rates.

Among the different options, we will focus on index funds replicating **corporate, emerging market and short-term maturity bond indices**.

As a result of current demographic trends, emerging markets are increasingly driving global growth. In response to growing demand, last November we launched the first indexed fund for institutional investors replicating an emerging market debt index: the **CSIF Bond Emerging Markets Index Blue**.

Finally, the current low interest rates' environment carries a significant risk of corrections in the bond market over the medium term. Our **CSIFs for indices with short-term maturities** are the right instrument to reduce the duration of a portfolio significantly.

We hope you enjoy the newsletter.

  
Dr. Valerio Schmitz-Esser

  
Dr. Philipp Kellerhals



**“As perfect as the original”:  
Credit Suisse Index Funds**

Investors are facing major challenges this year striving to achieve target returns. Following last May increase in yields, some investors are anticipating a further movement in government bond yields over the coming months, as the first rate hike is imminent in the US.

This newsletter focuses on two key questions: which bond segments still offer attractive yields with acceptable risk levels in the current low interest rate environment? And how can investors use **indexed funds** to invest in these segments while minimizing costs?

### Corporate bonds boost income

Investments in government bonds remain unattractive as public deficits remain high. By contrast, the financial crisis has made the private sector leaner and sleeker. Corporate bonds with a higher yield offer attractive income potential.

Within the foreign corporate bond segment, the **CSIF Bond Global Corporate ex CHF Index Blue** offers investors a broadly diversified fund with over 820 issuers from 47 different countries. Another similar option is the **CSIF Bond Corporate EUR Index**, which contains around 290 issuers from 28 countries. Both funds invest exclusively in investment grade bonds with ratings of BBB– and above. Currency-hedged share classes are available to protect against currency risk.

Last but not least, the new **CSIF Switzerland Bond Index Corporate Blue** is our first index fund invested exclusively in corporate bonds issued in Swiss francs. With an average rating between A+ and A, the fund currently offers a yield of 0.35%.



Issuer origin is well diversified, with 43% of issuers from Switzerland and 57% from other countries.

Index funds for corporate bonds	OAD in years	YTM in %
CSIF Bond Global Corporate ex CHF Index Blue	6.45	2.40
CSIF Bond Global Corporate ex CHF 1–5Y Index Blue (NEW)	2.74	1.50
CSIF Bond Corporate EUR Index	5.04	0.89
CSIF Switzerland Bond Index Corporate Blue (NEW)	4.67	0.35

OAD: option-adjusted duration; YTM: yield to maturity  
 Sources: Credit Suisse, Barclays Point as at March 31, 2015

Index funds for core investments	OAD in years	YTM in %
CSIF Switzerland Bond Index AAA-BBB Blue	7.02	0.14
CSIF Switzerland Bond Index AAA-AA Blue	7.88	0.02
CSIF Bond Global Aggregate ex CHF Index	6.45	1.44
CSIF Bond World ex CH Index Blue	7.42	0.91

OAD: option-adjusted duration; YTM: yield to maturity  
 Sources: Credit Suisse, Barclays Point as at March 31, 2015

## Emerging markets: strong economic growth and low sovereign debt levels

Several signals suggest that globally diversified portfolios should include investments in emerging markets. Demographic trends and improvements in productivity have turned emerging markets into growth drivers. According to the International Monetary Fund, emerging markets overtook industrialized countries in terms of **economic output** as early as 2013. Differences among the sovereign debt of emerging and developed countries have increased recently. Industrialized countries have lost a lot of **fiscal strength**, while emerging markets have gained in strength. This phenomenon is reflected in **credit ratings**, particularly for emerging markets that issue bonds in US dollars, where the average bond rating is now investment grade. As a result, the asset class has evolved from a high yield niche market into a fully integrated segment in the global bond market.

## Emerging markets: hard currency bonds

The J.P. Morgan EMBI Global Diversified Index

The **CSIF Bond Emerging Markets Index Blue** replicates the **J.P. Morgan EMBI Global Diversified Index**. The index contains government bonds and quasi sovereign bonds with different credit ratings and is diversified across the Africa, Asia, Europe, Latin America and Middle East regions. Global volumes in this market segment stand at USD 700 bn.

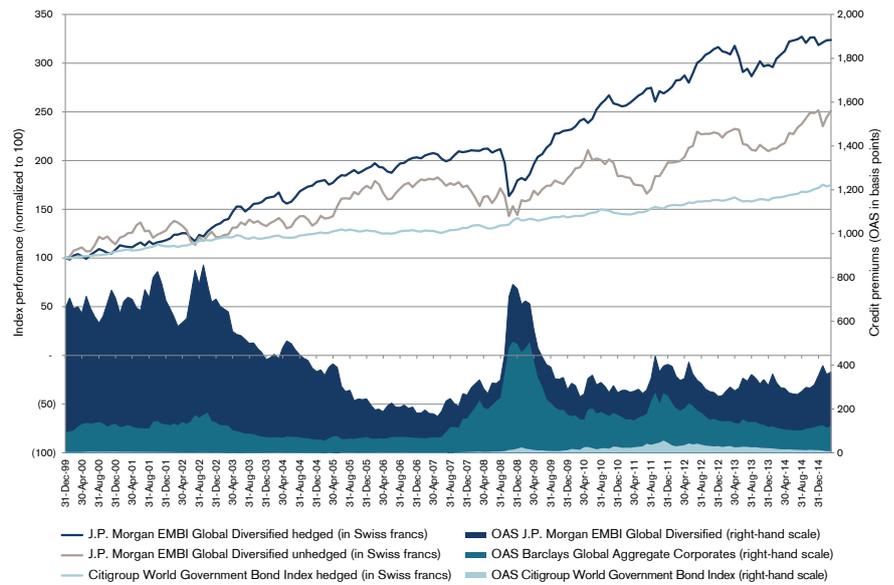
The J.P. Morgan EMBI Global Diversified Index caps the weighting for countries with high issue volumes. This characteristic enables **better diversification** and, during 2014 volatile market conditions with the crisis in Venezuela and geopolitical unrest in Russia and Ukraine, made the index significantly outperform its market cap weighted peer (J.P. Morgan EMBI Global).

The J.P. Morgan EMBI Global Diversified Index is ideal for investors looking for broad diversification combined with **low index volatility**. This fund also includes a currency-hedged share class.

## Significantly higher yields

The chart below compares J.P. Morgan EMBI Global Diversified index performance and credit spreads with other global bond indices. Annualized yields and volatility in the currency-hedged and unhedged index were higher than for the Citigroup World Government Bond Index hedged during last 15 years.

### Index yields and credit spreads from January 2000 to March 2015



OAS: Option-adjusted Spread

Sources: Credit Suisse, Barclays, Citigroup and J.P. Morgan as at March 31, 2015

Historical performance indications and financial market scenarios are not reliable indicators of current or future performance. Performance indications do not consider commissions, fees and other charges, including commissions levied at subscription and/or redemption.

Over the analyzed period, the monthly index loss has only reached double digits once, during the financial crisis: the unhedged index dropped 12.5% in October 2008 with a three-month recovery period. The currency-hedged index fell 17% with a six-month recovery period. Credit spreads have remained stable ever since. The credit spreads for emerging market bonds in hard currencies are currently around three times as high as those of global corporate bonds (Barclays Global Aggregate Corporates).



## Emerging Markets: Indexed investments

Indexed investment strategies are particularly attractive for broad portfolio diversification and efficient cost structure. The **CSIF Bond Emerging Markets Index Blue** currently comprises 415 securities from 124 issuers (index: 470 securities and 127 issuers). The efficient cost structure is not only reflected in the low total expense ratio (TER), but also in the overall transaction costs, as indexed funds have very low turnover.

Emerging market debt	OAD in years	YTM in %
CSIF Bond Emerging Markets Index Blue	7.26	5.86

OAD: option-adjusted duration; YTM: yield to maturity  
 Sources: Credit Suisse, Barclays Point as at March 31, 2015

A solid index strategy reflects the risks and returns of the index. If investors still have doubt on the feasibility and opportunity of Indexed investments in Emerging Markets, by comparing the performance of active emerging market bond funds, we find that active funds underperformed versus the benchmark over a three- and five-year period by 87% and 64% respectively (Standard & Poor's indices versus active score-card, June 2014).

## Shorter duration

**Reducing duration** is one way of decreasing interest rate risk in the current low yields environment. Duration is reduced, for example, by **limiting maturity to between one and five years** within the index. As the yield curve is still very flat, the opportunity costs of reducing duration are relatively low.

Credit Suisse manages **four indexed funds** with short duration:

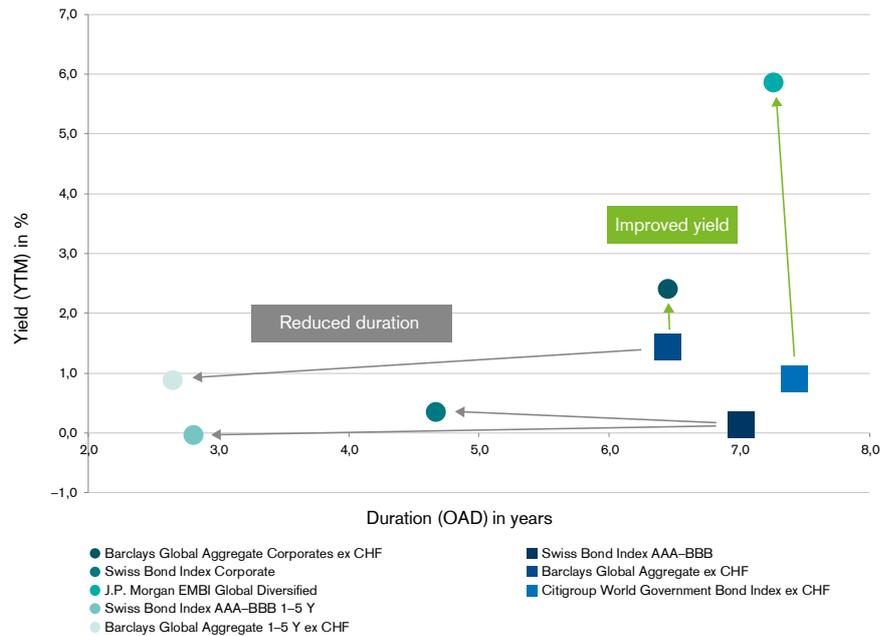
Short duration	OAD in years	YTM in %
CSIF Switzerland Bond Index AAA-BBB 1-5Y Blue	2.81	-0.04
CSIF Bond World ex CHF Fiscal Strength 1-5Y Index Blue	2.62	0.69
CSIF Bond Global Aggregate ex CHF 1-5Y Index Blue	2.65	0.88
CSIF Bond Global Corporate ex CHF 1-5Y Index Blue ( <b>NEW</b> )	2.74	1.50

OAD: option-adjusted duration; YTM: yield to maturity  
 Sources: Credit Suisse, Barclays Point as at March 31, 2015

## Summary

Investing in corporate and emerging market bonds, as **yield drivers**, will also improve portfolio diversification. They offer broader credit risk premiums and more attractive yields than standard investment grade bonds.

If yields remain close to record-low levels, the opportunity costs associated with reducing duration will be low. **Reducing duration** by approximately 50% will improve investment safety in your bond portfolio, even if interest rates begin to rise. The chart below shows global yields against duration for the various different options.



Sources: Credit Suisse, Barclays Point as at March 31, 2015

The option of hedging currency risk is key for investments in global bonds. We offer currency-hedged share classes for all of the funds described in this newsletter.

### Your contacts

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## Appendix

Indexed bond funds	Benchmark	Issue fees in % <sup>1</sup>	Redemption fees in % <sup>1</sup>	Cutoff	Settlement	Total assets in CHF m as at 22.06.2015
CSIF Switzerland Bond Index AAA-BBB Blue <sup>2</sup>	Swiss Bond Index AAA-BBB	0.50	0.00	14:00	D+2	6,325
CSIF Switzerland Bond Index AAA-AA Blue <sup>2</sup>	Swiss Bond Index AAA-AA	0.50	0.00	14:00	D+2	2,393
CSIF Switzerland Bond Index Corporate Blue	Swiss Bond Index Corporate	0.50	0.00	14:00	D+2	53
CSIF Switzerland Bond Index AAA-BBB 1-5Y Blue <sup>2</sup>	Swiss Bond Index AAA-BBB 1-5Y	0.45	0.00	14:00	D+2	1,191
CSIF Bond Global Aggregate ex CHF Index	Barclays Global Aggregate ex CHF	0.22	0.02	15:00	D+3	2,077
CSIF Bond World ex CH Index Blue <sup>2</sup>	Citigroup World Government Bond Index World ex CHF	0.09	0.02	15:00	D+3	2,295
CSIF Bond Global Corporate ex CHF Index Blue <sup>2</sup>	Barclays Global Aggregate Corporates ex CHF	0.40	0.00	15:00	D+3	1,145
CSIF Bond Corporate EUR Index	Barclays Euro-Aggregate Corporates Bond Index	0.30	0.00	14:00	D+2	121
CSIF Bond Emerging Markets Index Blue <sup>2</sup>	J.P. Morgan EMBI Global Diversified	0.60	0.00	15:00	D+3	305
CSIF Bond Global Aggregate ex CHF 1-5Y Index Blue <sup>2</sup>	Barclays Global Aggregate ex CHF 1-5Y	0.18	0.02	15:00	D+3	173
CSIF Bond World ex CHF Fiscal Strength 1-5Y Index Blue <sup>2</sup>	Barclays Global Treasury ex CHF Fiscal Strength 1-5Y	0.09	0.02	15:00	D+3	268
CSIF Bond Global Corporate ex CHF 1-5Y Index Blue	Barclays Global Aggregate Corporates ex CHF 1-5Y	0.40	0.00	15:00	D+3	<b>NEW</b>

<sup>1</sup> Anti-dilution levy: The spread between the subscription and redemption price is credited fully to the fund and serves the sole purpose of covering the transaction costs. This procedure ensures that the existing clients of the investment fund do not have to bear the costs of the client initiating the transaction.

<sup>2</sup> Subfunds that include the "Blue" suffix may not engage in any securities lending.

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

Source: Credit Suisse as at June 22, 2015

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