

Index Solutions

Strategy Indices: Still Doing Well

Newsletter No. 13



In October 2014, Credit Suisse expanded its range of funds replicating strategy indices. Since then, investors have been wondering whether individual strategies have lived up to the promises of past performance.

With this in mind, we would like to examine how the individual strategies have performed during the turbulent year that was 2015.

What we can say is that the period under review – from October 2014 to December 2015 – was a good time to be invested in the strategies.

We hope you enjoy the newsletter.

D. Valerio Schmitz-Esser

Dr. Valerio Schmitz-Esser
Head Index Solutions

S. Elmenhorst

Stephan Elmenhorst
Head Balanced & Strategy Indexing



**Perfect Replication:
Credit Suisse Index Funds**

MSCI World ex CH Minimum Volatility Index

The MSCI World ex CH Minimum Volatility Index represents the global equity universe with the lowest volatility, as calculated using the MSCI Barra factor model. The index portfolio contains 294 securities (as at December 31, 2015) and is constructed by applying minimum-variance optimization to the MSCI World ex CH universe, the parent index. Additional optimization criteria limit the weightings of individual securities and prevent excessive turnover rates.

Both the low beta (compared to the parent index) and the focus on equities with low security-specific risks help to reduce index volatility. Historically, MSCI World ex CH Minimum Volatility Index returns have tended to outperform the parent index when the equity market is weak (see figure 1.1).

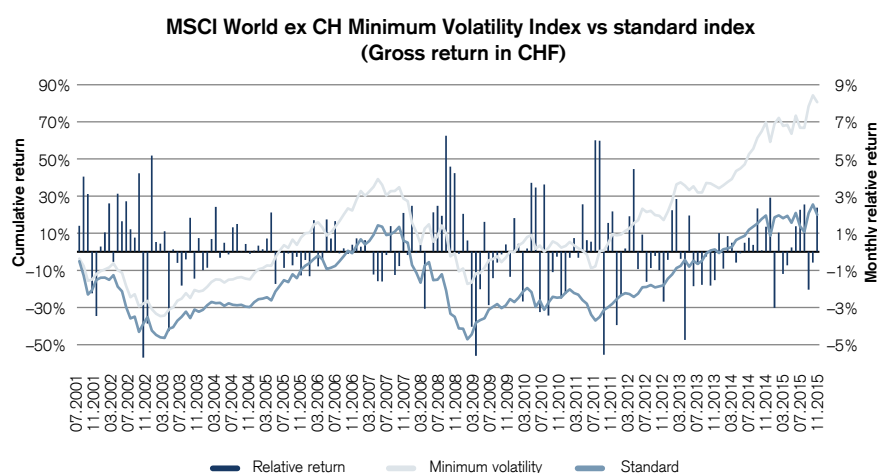


Figure 1.1 (Period: 29.06.2001 to 31.12.2015)

Returns remained on-trend in 2015. As predicted by past performance, the minimum volatility strategy significantly outperformed the market-weighted parent index during the general market downtrend in January. The strategy did not do as well during the bounceback in February, although absolute returns remained clearly positive (+6.13 %).

The same pattern was observed during the market turbulence in the third quarter of 2015, when minimum volatility proved the better strategy, outperforming the parent index every month (see Appendix, figure 1.2).

MSCI World ex CH Quality Index

The MSCI World ex CH Quality Index contains the top 300 equities from the parent index, as determined by the MSCI quality factor. The quality factor identifies growth stocks with a relatively high return on equity and low debt-to-equity ratio compared with the market as a whole. The result is a portfolio of companies notable for their stable business models and competitive edge. Historically, the MSCI World ex CH Quality Index has outperformed the parent index during recovery phases and at the end of upturns when volatility is rising (see figure 2.1).

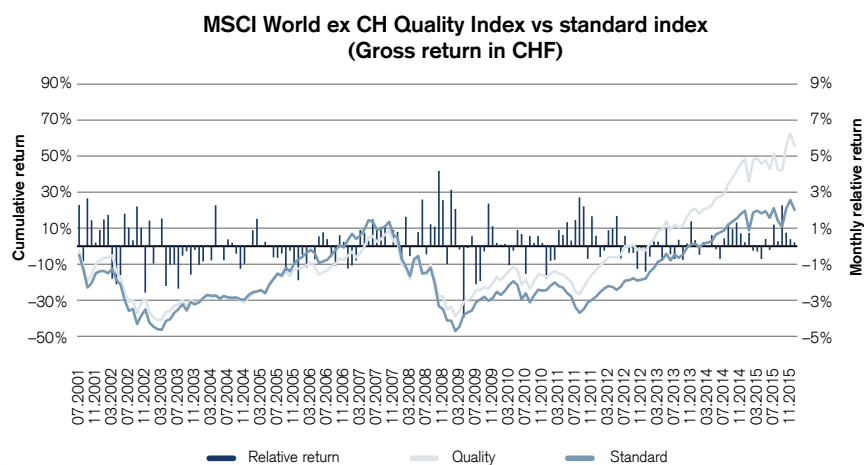


Figure 2.1 (Period: 29.06.2001 to 31.12.2015)



This pattern was also apparent in 2015, when the MSCI World ex CH Quality Index posted significantly higher returns than the parent index in January and the third quarter (see Appendix, figure 2.2).

MSCI World ex CH Value Weighted Index

The weighting model used in the MSCI World ex CH Value Weighted Index is based on fundamental criteria and draws on key financial figures from the balance sheet and income statement. The MSCI World ex CH Value Weighted Index contains all the companies that appear in the MSCI World ex CH parent index and offers the greatest number of investment opportunities out of all the strategies under review, together with the lowest turnover rates and lowest tracking error versus the parent index. The upshot is a broadly diversified portfolio, which is invested in less expensive (value) stocks and smaller companies (size) than the parent index.

Historically, the MSCI World ex CH Value Weighted Index has performed particularly well during the transition from a recovery phase to a stable uptrend (see figure 3.1).

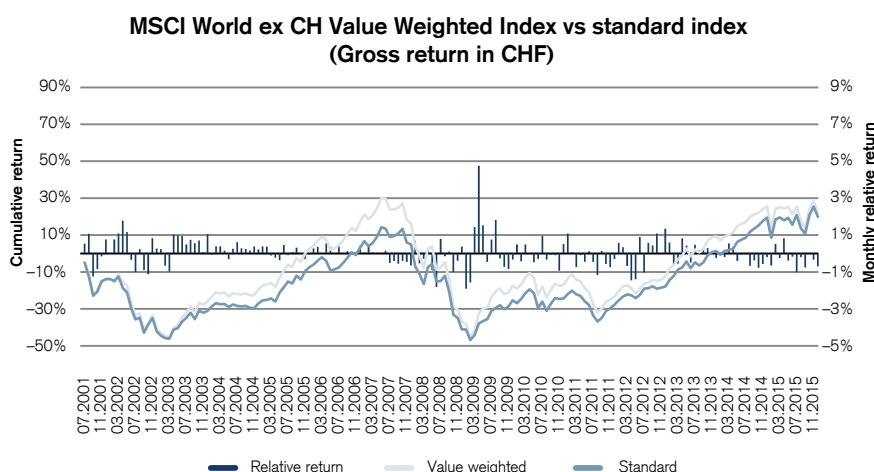


Figure 3.1 (Period: 29.06.2001 to 31.12.2015)

As expected, the fundamental strategy has underperformed the market as a whole over the course of the year (see Appendix, figure 3.2), which has been dominated by a volatile sideways movement.

MSCI World ex CH Quality Mix Index

The MSCI World ex CH Quality Mix Index is an equally weighted combination of the three mentioned strategy indices. The strong inverse correlation between the relative returns from the quality and value-weighted strategies is a good reason for having an equal weighting in order to generate stable returns that outperform the MSCI World ex CH Index. The inclusion of the minimum volatility strategy significantly improves stability during periods of pronounced market corrections (see figure 4.1).

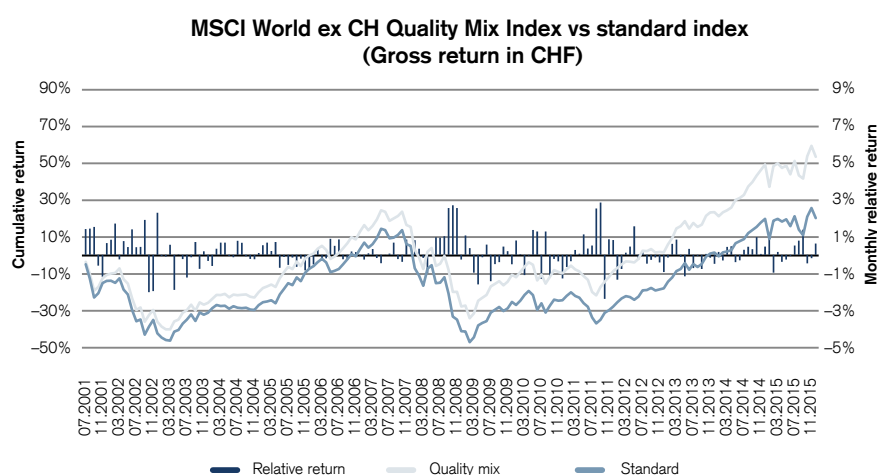


Figure 4.1 (Period: 29.06.2001 to 31.12.2015)

This weighting strategy continued to perform well in 2015, as the combination of the individual strategies provided broad diversification and a harmonious whole in the form of stable, less volatile above-index returns (see Appendix, figure 4.2).

Conclusion

We have extended our range of strategy index funds to allow investors to make targeted improvements to their portfolio's **risk/return profile** and thereby enhance **risk-budget** management, identify **factor returns** or simply generate a **stable outperformance**. The chart below shows the historical returns for the individual strategies and combinations versus the MSCI World ex CH parent index (figures 5.1 and 5.2, gross returns in Swiss francs).

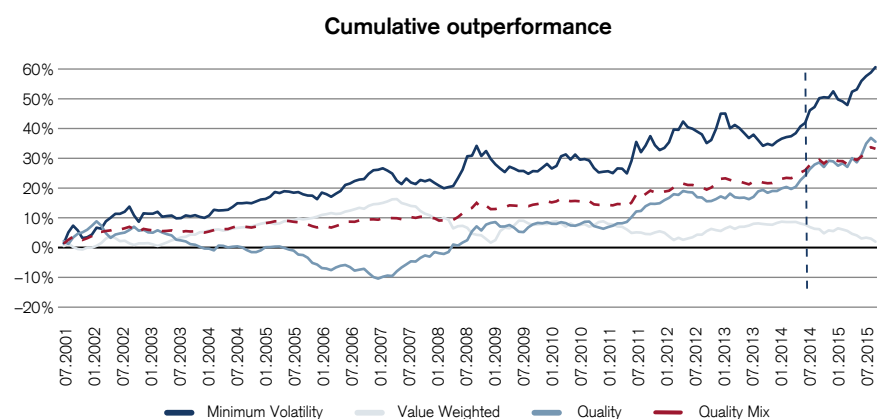


Figure 5.1 (Period: 29.06.2001 to 31.12.2015)

Alternative strategy weightings	Minimum volatility	Value weighted	Quality	Quality mix	Standard
Annual return	10.17%	-0.10%	8.43%	6.12%	3.55%
Ex-post volatility	13.97%	18.96%	18.45%	16.90%	18.39%
Risk/return ratio	0.73	-0.01	0.46	0.36	0.19

Figure 5.2, data since the launch of our strategy funds (Period: 31.10.2014 to 31.12.2015)

Risk/return profile

Over the last fourteen months, the risk/return ratios for the MSCI World ex CH Quality Index, MSCI World ex CH Minimum Volatility Index and MSCI World ex CH Quality Mix Index were considerably higher than for the capital-market-weighted MSCI World ex CH Index. The returns were therefore consistent with the long-term analyses and in line with expectations.

Factor returns

With an absolute return of 10.17% since the end of October 2014, the minimum volatility strategy outperformed the standard index by 6.62%. The bulk of the outperformance was generated between July and September, which were difficult months for equities markets (see Appendix, figure 1.2). The quality/growth strategy also performed well, posting an absolute return of 8.43%. The fundamental approach was the only strategy to lag behind the market weighting, recording an absolute return of -0.10%. It should be noted that the inverse correlation between the outperformances of the value weighted and quality strategies persisted during the period.

Risk budget

With volatility at 13.97% since the end of October 2014 (parent index: 18.39%), the inclusion of the MSCI World ex CH Minimum Volatility Index allowed us to reduce risk considerably, or increase equity-market exposure, yet without increasing overall risk.

Stable outperformance

Over the last fourteen months, the equally weighted combination of all three strategies (quality mix) posted a consistent outperformance. The clear inverse correlation observed in the past between the outperformances of the value weighted and quality strategies was still apparent.

In addition to the returns described above, the MSCI World ex CH Quality Mix Index was boosted by the minimum volatility strategy. And the validity of the strategy remains unimpacted by the timing of investment.

Wider Investor Eligibility for 10 Credit Suisse Institutional Funds

With combined assets of more than CHF 66 billion (as at 31.12.2015), Credit Suisse Institutional Funds (CSIF) are one of the largest Umbrella under Swiss law. Until now, these investment funds were only open to qualified investors as defined in Article 10 paras. 3 to 4 CISA. Due to growing interest in index funds from private investors, we have decided to apply for approval for a new umbrella fund, Credit Suisse Index Fund (CH), to the Swiss Financial Market Supervisory Authority (FINMA). The funds under this umbrella will be therefore accessible to all investors.

Assuming FINMA gives its consent, nine CSIF sub-funds will be transferred from the existing umbrella fund for qualified investors to the new umbrella. These include the three equity index funds on the SPI, SMI, and SPI Extra, as well as the six CHF bond index funds on the SBI AAA-BBB and its sub-indices. Assuming FINMA gives its consent, CSIF II Gold will also be converted into a publicly accessible fund. There will be no change for already invested qualified investors. In particular, the proven anti-dilution provision, possibility of making contributions in kind, and structure of the share classes will remain unchanged. Existing investors will not incur any costs as a result of the widening of investor eligibility.

Tax efficiency through our indexed Luxembourg funds

In most countries, interest and dividend payments from securities are subject to withholding tax. The scope for exemptions and refunds varies depending on the underlying investment's target country and the fund domicile. In some target countries, Swiss investment funds are finally subject to higher taxation than funds domiciled in other countries.

In an effort to provide the most tax-efficient solution for investors, from now on selected Swiss funds of funds will invest in Luxembourg target funds in addition to Swiss funds. Unlike Swiss investment funds, Luxembourg-based SICAV funds can be exempted from withholding tax on certain interest and dividend payments, notably in Spain, Italy and France. The following five CSIF funds of funds will be able to hold both Swiss and Luxembourg-based target funds in future:

CSIF III World ex CH Index – Pension Fund

CSIF World ex CH Index

CSIF Europe Index

CSIF Europe ex CH Index

CSIF Bond World ex CH Index Blue

In order to avoid transaction costs, the target allocation of Luxembourg funds will be built up using cash inflows. The process is expected to take a few months. The table below shows the anticipated tax savings and cost benefits once the target quota has been reached. The predicted tax benefits for all five funds exceed the expected costs, meaning that the predicted returns for all five funds will increase by between 1 and 5 basis points per annum.

Fund of funds	Target allocation of Luxembourg funds in the fund of funds index	Tax benefits from Luxembourg target funds	Cost (TER) of Luxembourg target funds	Weighted tax benefits from Luxembourg target funds	Weighted cost (TER) of Luxembourg target funds	Total benefit to fund of funds
CSIF III World ex CH Index – Pension Fund	12.11%	0.114%	0.0225%	0.0138%	0.0027%	0.0110%
CSIF World ex CH Index	12.11%	0.114%	0.0225%	0.0138%	0.0027%	0.0110%
CSIF Europe Index	46.96%	0.114%	0.0225%	0.0533%	0.0106%	0.0428%
CSIF Europe ex CH Index	54.86%	0.114%	0.0225%	0.0623%	0.0123%	0.0500%
CSIF Bond World ex CH Index Blue	31.63%	0.189%	0.0225%	0.0598%	0.0071%	0.0527%

Source: Credit Suisse. Data as at 31.10.15

Your contacts

For further information, please contact your relationship manager or our index mandates product specialists:

Tel.: +41 44 334 41 41

E-mail: index.solutions@credit-suisse.com

Appendix: Performances of individual strategy indices between October 2014 and December 2015

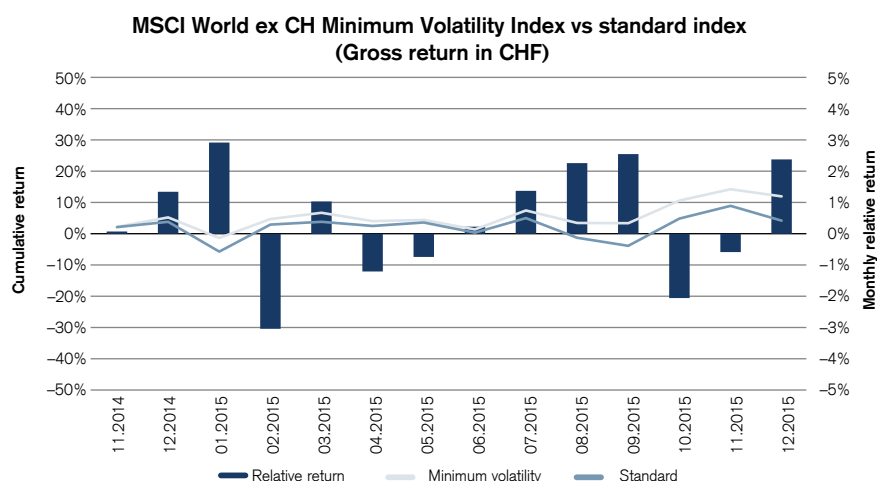


Figure 1.2 (Period: 31.10.2014 to 31.12.2015)

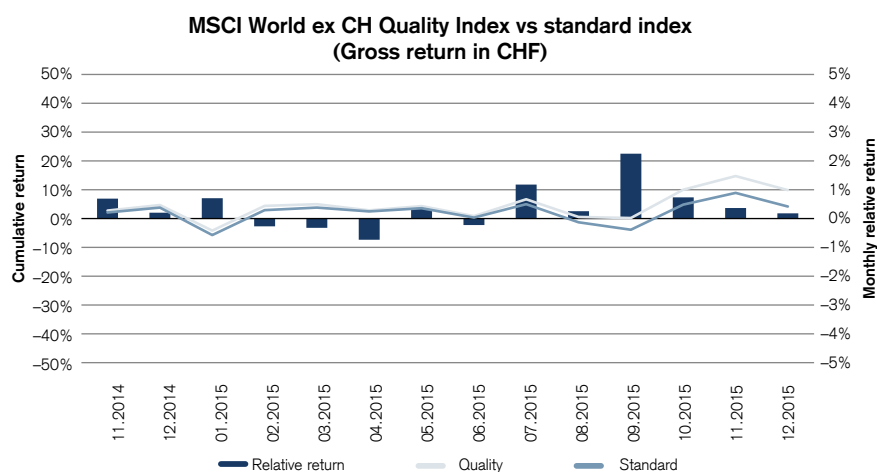


Figure 2.2 (Period: 31.10.2014 to 31.12.2015)

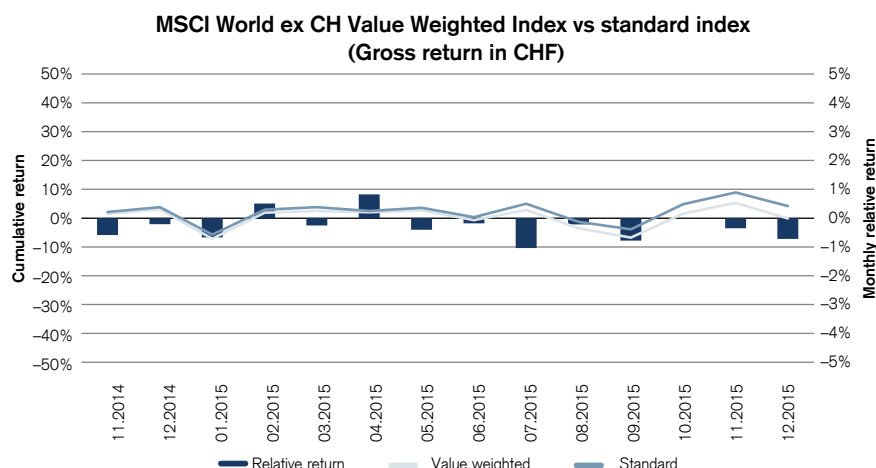


Figure 3.2 (Period: 31.10.2014 to 31.12.2015)

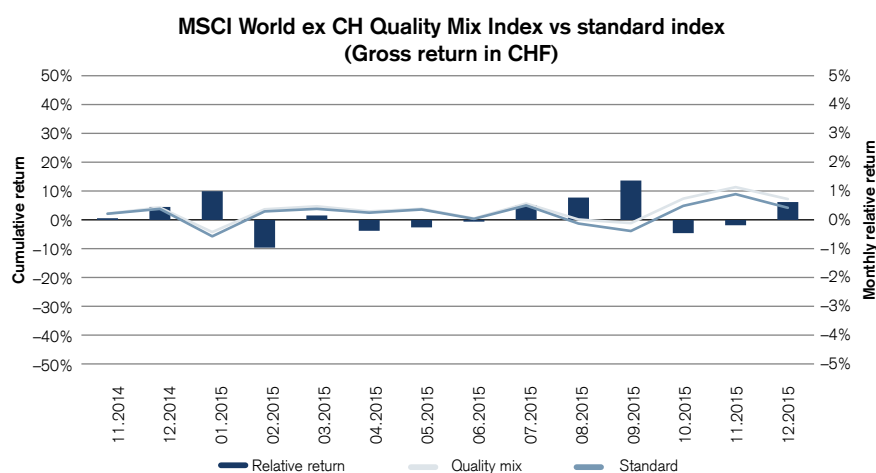


Figure 4.2 (Period: 31.10.2014 to 31.12.2015)

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