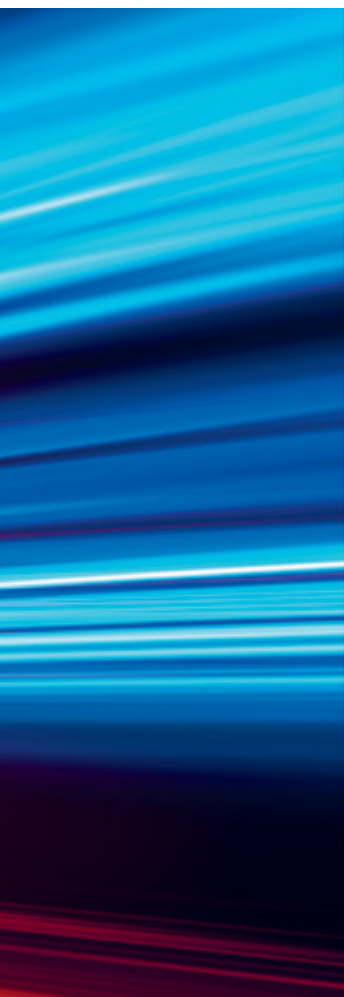


Investment Outlook 2022



The great transition.

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The great transition.



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From my perspective



Thomas Gottstein
CEO Credit Suisse Group AG

Over the past years, and particularly in 2021, we have seen the critical importance of protecting the planet as well as small businesses, employees and those most vulnerable in our societies. Looking ahead to 2022, banks like Credit Suisse continue to play an important role in supporting their clients through the economic recovery in a post-pandemic world.

As you will read in the pages ahead, we believe that the post-pandemic normalization will be different from past crises. Logistics network issues and disruptions should gradually be resolved, however, helping to alleviate inflation in some categories of goods.

Yet we will likely see significant structural challenges over the next decade and beyond, including continued aging populations and the shift to a lower carbon footprint. We are, in other words, at the beginning of a great transition.

Our new strategic vision for Credit Suisse underscores our commitment to accelerating this change with differentiated innovation, operating with agility and building growth for businesses, investors and entrepreneurs. In this context, our Credit Suisse House View is essential in that it anchors the advice and investment insights as well as attractive investment solutions we bring to our wealth management clients globally.

I wish you a healthy and prosperous 2022.

Thomas Gottstein

Dear reader

The great transition



Michael Strobaek
Global Chief Investment Officer

The year ahead is going to see the start of a meaningful economic and financial transition. A transition not just to a post-COVID reality, but also to more normal monetary policy, and to more moderate returns on financial markets. Importantly, it is also a transition to a stronger focus on sustainability, as the world moves toward net zero emissions.

Two years since the coronavirus first emerged, the world is still looking for an exit from the pandemic. Indeed, the past year has been marked by important steps toward normalization – including the rollout of vaccination campaigns and related loosening and, indeed, elimination of restrictions in many parts of the world – as well as setbacks, as the spread of the Delta variant slowed the pace of economic recovery in some regions. Though COVID-19 now seems more under control, some parts of the global economy such as labor markets have yet to recover fully. Looking at the year ahead, we believe global growth should remain solid, driven by many of the same factors that supported the recovery in 2021.

From an investor's point of view, 2021 has proven to be rewarding, with equity markets again generating double-digit returns. Earnings growth has been strong, with MSCI AC World earnings even surpassing pre-pandemic highs. We believe that earnings should remain the key driver of equity returns in the year ahead, enabling equities to deliver sound, though somewhat lower, single-digit returns. Since fixed income as an asset class continues to deliver only meager returns, we believe investors should look to investment strategies that follow non-traditional patterns to diversify their opportunity set further.

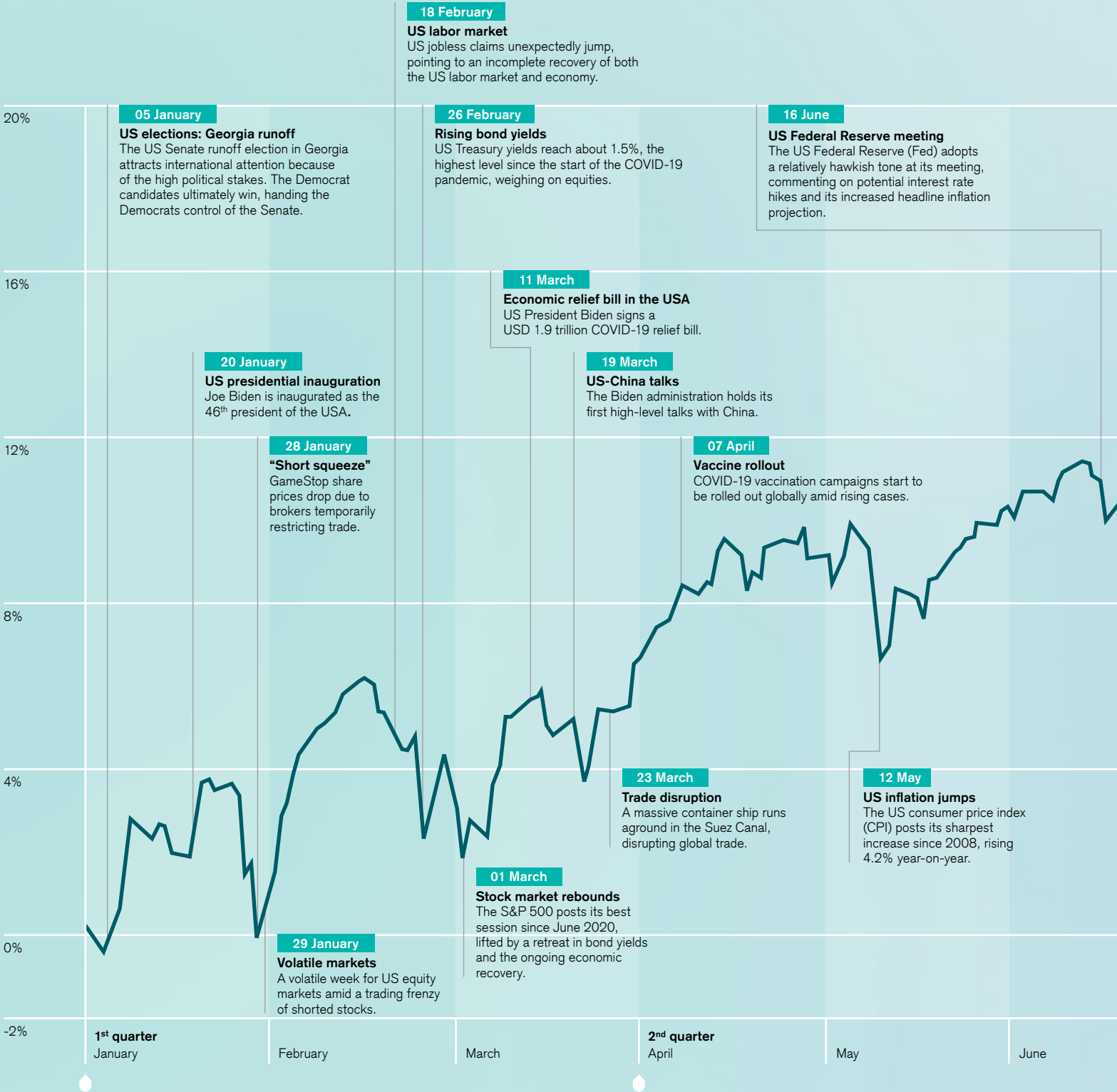
In the pages ahead, we not only look at the opportunities and risks investors may encounter in 2022. We also touch upon the increased focus on environmental, social and governance (ESG) topics that we expect to continue to influence companies and the investment outlook in 2022. In this context, we highlight key ESG trends that investors should follow in 2022. After all, we remain convinced that they have a clear role to play in the transition to a more balanced and sustainable world.

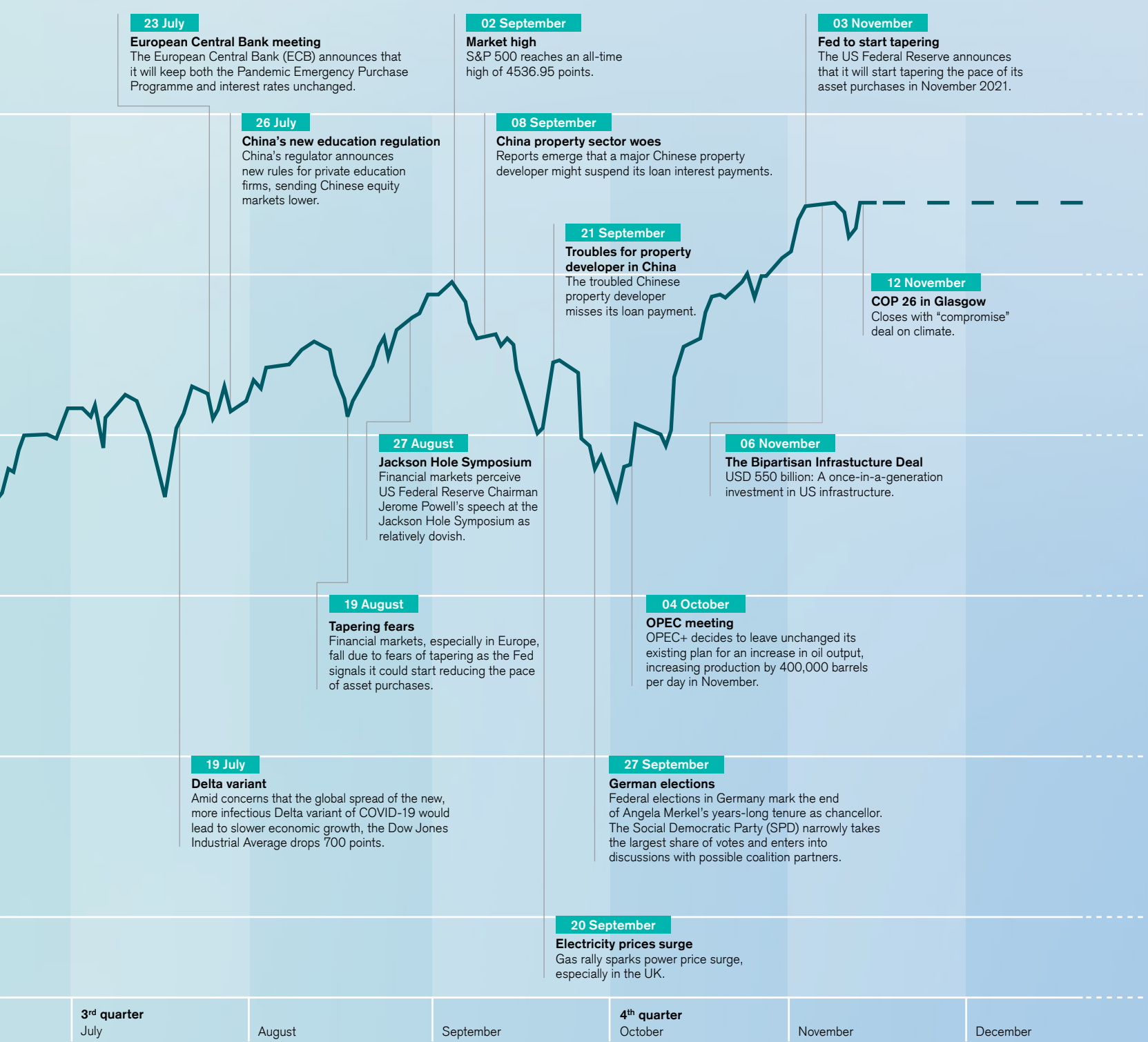
This is where our long-term investment themes, the Supertrends, come in. Earlier this year, we paired some of the subthemes we capture in our Supertrends with the United Nations' 17 Sustainable Development Goals (SDGs). In our view, the global pandemic has heightened the importance of the SDGs in that they can serve as a guiding principle for future economic activity and development, as well as government cooperation and international relations. It is vital that we recognize this guiding principle also as investors.

As we all continue the great transition going into 2022, I hope our insights and guidance provide an essential compass for your road ahead.

Michael Strobaek

2021: Looking for the exit from the pandemic





MSCI AC World price index

23 July**European Central Bank meeting**

The European Central Bank (ECB) announces that it will keep both the Pandemic Emergency Purchase Programme and interest rates unchanged.

26 July**China's new education regulation**

China's regulator announces new rules for private education firms, sending Chinese equity markets lower.

02 September**Market high**

S&P 500 reaches an all-time high of 4536.95 points.

08 September**China property sector woes**

Reports emerge that a major Chinese property developer might suspend its loan interest payments.

21 September**Troubles for property developer in China**

The troubled Chinese property developer misses its loan payment.

03 November**Fed to start tapering**

The US Federal Reserve announces that it will start tapering the pace of its asset purchases in November 2021.

12 November**COP 26 in Glasgow**

Closes with "compromise" deal on climate.

27 August**Jackson Hole Symposium**

Financial markets perceive US Federal Reserve Chairman Jerome Powell's speech at the Jackson Hole Symposium as relatively dovish.

06 November**The Bipartisan Infrastructure Deal**

USD 550 billion: A once-in-a-generation investment in US infrastructure.

19 August**Tapering fears**

Financial markets, especially in Europe, fall due to fears of tapering as the Fed signals it could start reducing the pace of asset purchases.

04 October**OPEC meeting**

OPEC+ decides to leave unchanged its existing plan for an increase in oil output, increasing production by 400,000 barrels per day in November.

19 July**Delta variant**

Amid concerns that the global spread of the new, more infectious Delta variant of COVID-19 would lead to slower economic growth, the Dow Jones Industrial Average drops 700 points.

27 September**German elections**

Federal elections in Germany mark the end of Angela Merkel's years-long tenure as chancellor. The Social Democratic Party (SPD) narrowly takes the largest share of votes and enters into discussions with possible coalition partners.

20 September**Electricity prices surge**

Gas rally sparks power price surge, especially in the UK.

3rd quarter
July

August

September

4th quarter
October

November

December

Credit Suisse House View in short



Economic growth

Global economic growth looks set to be above trend again in 2022. As social distancing rules are relaxed further, consumption of services such as restaurants or travel should pick up, supporting the services part of the economy. Strong goods demand should result in a pickup in production once supply chain problems start to ease. As a result, industrial production looks set to increase as well.



Fixed income

Government bond yields will likely deliver negative returns in 2022. In credit, low spreads – both in investment grade and high yield – will barely compensate for the risks that come with higher yields. In general, we prefer to avoid duration risk. We favor Eurozone inflation-linked bonds and prefer senior loans due to their floating rate characteristics.



Inflation

In 2022, inflation should normalize from the elevated numbers of 2021, though it will likely remain above pre-pandemic levels. The steep price increases that immediately followed the COVID-19 lockdowns will fall out of inflation calculations (fading base effects) and supply chain problems should also ease – resulting in gradually declining inflation pressures as the year 2022 progresses.



Equities

We foresee attractive returns from global equities in 2022 with earnings remaining the key driver. We expect equity segments that lagged the global recovery from the pandemic shock to emerge as bright spots alongside industries that benefit from secular growth trends.



Interest rates

Given the ongoing economic recovery, both the European Central Bank (ECB) and the US Federal Reserve (Fed) are likely to reduce their asset purchases as 2022 progresses, with the Fed moving faster than the ECB. We expect the Fed to start hiking rates in late 2022, but we expect the ECB to keep rates unchanged. Monetary policy should stay unchanged in Japan and Switzerland during this period. In the UK, where inflation is a bit stickier than in the rest of Europe, we expect the Bank of England to start hiking rates in December 2021, followed by two more hikes in 2022. We also expect rate hikes in certain emerging markets, including Brazil.



Foreign exchange

The USD should be supported by the Fed's policy normalization path, particularly against the CHF and JPY. EUR/USD should remain soft in early 2022, but later stabilize as Eurozone fundamentals improve. Emerging market currencies should witness more differentiation in terms of performance, with the RUB supported by domestic rates, while the CNY will likely be range bound as policy risks persist.



Commodities

Demand within cyclical sectors is set to remain firm, but supply should improve and ease some of the shortages in physical spot markets. Energy markets are likely to face high volatility through the winter months, but this should moderate further into 2022. The price of carbon will stay a key topic, while gold may be vulnerable as policy normalization begins.



Real estate

We expect real estate investments to deliver positive mid-single-digit returns, benefiting from the historically low interest rate environment, as well as the continuing economic recovery. We favor sectors underpinned by secular growth drivers including logistics real estate, as pandemic-driven structural shifts persist.



Private markets and hedge funds

The economic backdrop remains supportive for private markets, while investment conditions are more competitive. We highlight opportunities underpinned by secular growth and market dislocations. In hedge funds, market conditions are likely to stay supportive for lower market-beta strategies and yield alternative investments.






Global economy

Transition in progress





The global pandemic is not yet over but vaccinations have helped bring back some normality to everyday life. Although the rapid spread of the COVID-19 Delta variant slowed the pace of economic normalization in some places in 2021, the recovery should continue in 2022 with expected above-potential growth in global gross domestic product (GDP). That said, the post-pandemic normalization will be different from past crises. A recession like no other will bring a unique recovery. In summary, there is much more to learn about the pandemic economy in the coming quarters.

The last two years have been extraordinary – not only for humanity but also for the global economy. Despite the fact that the COVID-19 pandemic now appears more under control thanks to vaccination programs, parts of the global economy, e.g. labor markets, have yet to stage a full recovery. Business as usual remains unusual – and will stay so for the foreseeable future.

When COVID-19 evolved into a global pandemic in 2020, the ensuing lockdowns sent the global economy into the steepest recession on record. This unprecedented shock led to extraordinary fiscal and monetary support, which helped to trigger a sharp recovery. However, the size of the economic shock resulted in unrecognizable data and a “data fog,” which made it difficult to interpret and even more difficult to forecast, leading to a wide dispersion in views among investors. In the USA, labor market statistics like initial jobless claims rose to levels previously unthinkable, while in financial markets, oil prices briefly turned negative, to name just two examples.

The recovery from the crisis continued into 2021, driven by strong stimulus effects and pent-up demand. Inflation rose as well – in part due to so-called base effects, i.e. the data fog issues, as well as ongoing supply chain issues, i.e. shortages of goods ranging from computer chips to softwood lumber that were caused by COVID-19 related closures of factories and ports. Toward the end of 2021, some central banks had enough confidence in the economic recovery to start reducing some of the emergency stimulus by slowing down asset purchases (tapering). In 2022, we expect a reduction in the data fog as economic activity further normalizes. However, not all features of the pandemic economy will be transitory. In our view, the coming year will be more “normal” than 2021, but with plenty of special factors still at work. We believe that the economy that will ultimately emerge from this crisis will be profoundly different from 2019, with the most important changes likely to be unrelated to the pandemic.

Find out more



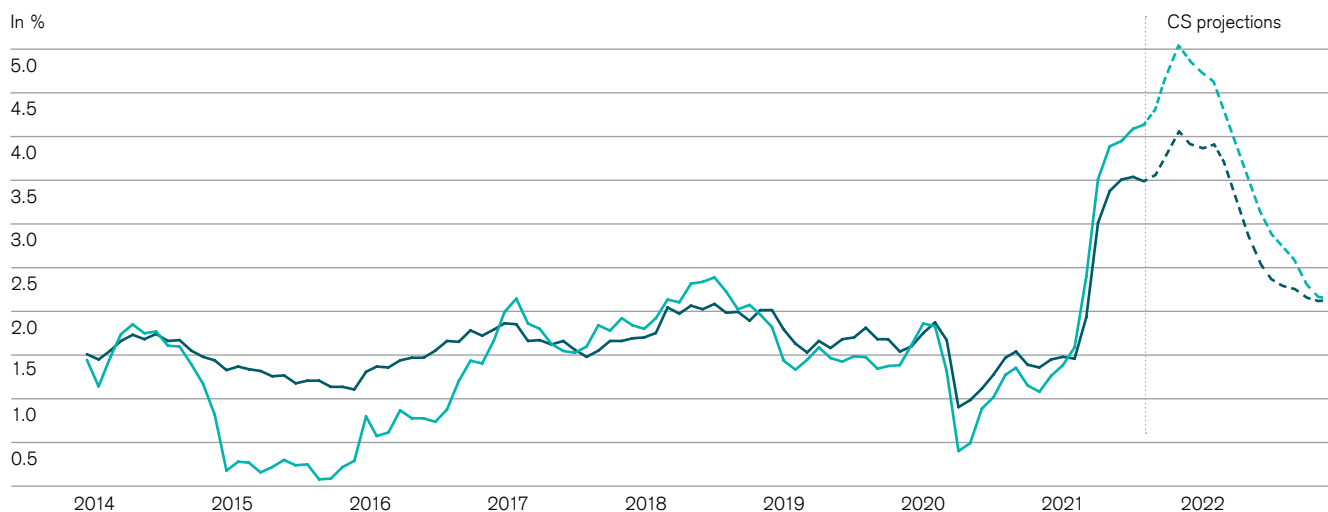
Solid growth despite supply chain challenges

In terms of economic growth, 2022 looks set to be a good year, driven by the same factors that already supported the economic recovery in 2021: solid demand, a still supportive fiscal and monetary policy environment and the continued relaxation of COVID-19 related restrictions that will help industries such as tourism and travel. We expect the global economy to grow by 4.3% in real terms in 2022. This is less than the 5.8% we expect for 2021 but higher than the growth rate before the pandemic. For example, the global economy grew by 2.7% in 2019.

Global industrial production (IP) looks set to improve. The unprecedented boom in goods spending during the recovery has been fueled by diverted income that would have usually gone into services but did not due to COVID-19 restrictions on sectors such as tourism and restaurants, sufficient stimulus to lift disposable income despite falling labor income, and unusually high demand for some goods such as electronics. During the 2020 recession, IP fell more than total goods demand, and production always lagged behind consumption throughout the recovery.

As a result, inventories throughout the global economy have been drawn down. Some of these shortfalls in production are related to COVID-19 measures and are likely to improve as restrictions are lifted. Others look set to persist in 2022, particularly those that require new business investments (i.e. factories) to ramp up production such as computer chips. Labor shortage issues, such as the lack of truck drivers that is causing problems in the UK, will likely remain a challenge in the coming year. Overall, however, we expect supply chain issues to be less of an acute problem in 2022 than in 2021.

While IP is one side of the recovery story, the larger part of the global economy consists of services. Services spending has not fully recovered because social distancing continues to affect many sectors, including restaurants and tourism. Alongside the overall recovery of the economy, services clearly improved in 2021 and we think the recovery is likely to continue in 2022 as more restrictions are lifted. We therefore expect services to grow faster than the overall economy in 2022. The good growth prospects for both IP and services mean that the global economy should be able to digest the gradual withdrawal of emergency fiscal stimulus (e.g. special unemployment benefits or furlough schemes) and central bank support.

US inflation – Fading base effects at work

Core PCE YoY
Headline PCE YoY

Last data point 09/2021
Source BEA, Credit Suisse

Inflation: Leveling off but still elevated

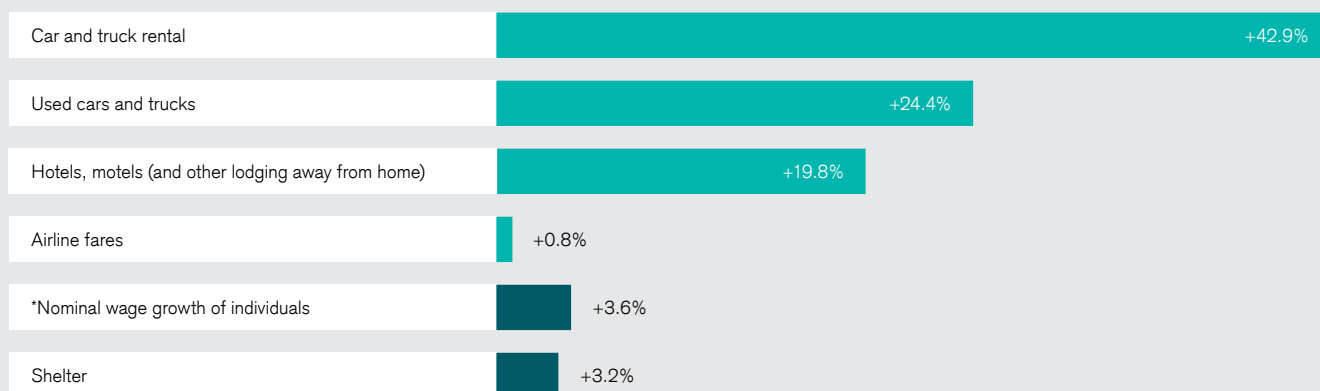
The acceleration of inflation was one of the key themes of 2021. The pandemic initially acted as a strong deflationary shock. Many prices initially fell (e.g. West Texas Intermediate crude futures briefly turned negative for the first time in history in April 2020). Fearing a deflationary spiral and depression-like conditions similar to the 1930s, policymakers reacted swiftly and forcefully, ushering in monetary and fiscal stimulus of unprecedented size. These reflationary policies helped to put the economy back on track. In turn, the strong goods demand coupled with pandemic disruptions that overwhelmed many supply chains have led to sharp increases in core goods inflation. We estimate that global inflation rates – being a measure of the change in prices – increased by 3.5% in 2021.

The rate of change in price levels should start to peak going forward. This is because much of the initial recovery in prices is now behind us (i.e. base effects are fading), while there should be fewer supply chain disruptions ahead. However, other factors will likely prevent inflation rates from falling all the way back to pre-pandemic levels. One of these factors is the tightness of labor markets. The economic recovery in 2021 helped to bring back many jobs, and unemployment rates in many countries are close to levels prior to the pandemic. With the expected recovery in the services economy in 2022, we think the labor market could quickly become tight, with demographics exacerbating the issue in many countries. In fact, we already see labor shortages in everything from bus and truck drivers to substitute teachers and restaurant workers. Tight labor markets should improve the bargaining power of workers in wage negotiations. Consequently, while we expect inflation to decline as the year 2022 progresses, this should ensure that the annual average rate of inflation stays elevated at 3.7%. In 2019, global inflation stood at 2.5%.

Inflation makes a comeback

While we expect that the recent surge in inflation will prove a largely transitory event, it could prove stickier in some categories in the longer term, namely shelter and wages.

US Consumer Price Index: September 2020–September 2021 *September 2021 – 12-month moving averages of median wage growth, hourly data



■ Inflation is likely temporary

■ Inflation could be longer lasting

Source US Bureau of Labor Statistics; Federal Reserve Bank of Atlanta

To hike or not to hike?

With inflation in many regions likely to remain above central banks' targets in 2022 (we forecast, for example, inflation rates of 4.5% for the USA and 2.8% for the Eurozone), one of the key questions will be how central banks will respond. During the pandemic, all of the major central banks implemented significant asset purchasing programs (quantitative easing) to supply financial markets with ample liquidity and keep financial conditions supportive for the economic recovery. We believe that many central banks will start reducing their asset purchases before they turn to hiking interest rates. Indeed, several central banks, including the US Federal Reserve (Fed) started to do just that in late 2021. In their communications, central banks have made it clear that any reduction in their asset purchase programs will depend on the economic data, and they will carry it out in a way that will not threaten the economic recovery. High (but falling) core inflation and strong progress toward full employment in 2022, amid market expectations of imminent tightening, is likely to deliver one rate hike from the Fed by the end of 2022. In the Eurozone, the European Central Bank (ECB) is likely to end its Pandemic Emergency Purchase Programme (PEPP) in June 2022, in our view, but it should continue to buy assets throughout the year through more conventional programs. The situation is slightly different in the UK. In the UK, where inflation is a bit stickier than in the rest of Europe, we expect the Bank of England to start hiking rates in December 2021, followed by two more increases in 2022. In summary, we will likely see some rate hikes in selected countries, but we expect the Fed to only hike once while the ECB sticks to reducing asset purchases and leaves interest rates unchanged for the time being.

The impact on financial markets

As inflation rates level off, and central banks reduce asset purchases and increase rates, real interest rates (nominal interest rates minus inflation) could rise in 2022. Rising real interest rates usually mean that financial market returns (notably bond returns) will likely be lower, while financial market volatility is usually higher. Rising real interest rates also negatively affect the ability of governments and households to service their debt, which is why central banks will closely monitor this development and make sure it remains manageable.

Overall, we believe that 2022 will be a year of recovery and transition from the pandemic. Growth looks set to stay quite robust and labor markets should tighten. A slight increase in real interest rates and ongoing – although less severe – supply chain problems are risks that could lead to financial market volatility and need to be carefully monitored by policymakers and investors alike. Nevertheless, it is very likely that 2022 will be a much more normal year than 2020 and 2021. That said, longer-term factors such as climate change, shifting demographics and new technologies mean that we will be transitioning toward something new in the post-COVID world. Overall, 2022 will mark the start of a transition to the post-COVID decade.

The post-COVID decade

In many respects, the COVID-19 pandemic was an unprecedented shock to the global economy that led global policymakers and businesses into uncharted waters. While many elements of this shock (e.g. the lockdowns) are clearly temporary, others (e.g. the substantially increased levels of government debt) look set to be of a longer-lasting nature. At the same time, important trends such as climate change and shifting demographics have reached a level of urgency that could very well result in a permanent change of the current economic order.

So what could the new “normalized” post-pandemic world economy look like? In our view, the future will be shaped by new factors including: shifting demographics; more state capitalism; expensive problems like the energy transition; and new disruptive technologies. In terms of demographics, we have now reached a situation where the working age population in most parts of the world except Africa is stagnating as populations age. This should lead to tighter labor markets, providing workers with more bargaining power that could lead to increased wage growth. As a result, companies are likely to step up investments in automation and other measures to boost labor productivity.

Looking at the labor market in more detail, many middle class jobs in developed markets have vanished over the last 20 years, while there has been a simultaneous increase in both high- and low-paying jobs. This has led to an increase in wealth and income inequalities, which governments are likely to address by redistributing income through new taxes or new regulations. We already see this trend today in China, where the government has adopted a set of new “common prosperity” policies, effectively changing priorities from a growth-first mindset toward one of increased equality. We see similar developments in developed countries including the USA, which could lead to increased state capitalism, i.e. government involvement in business.

Additionally, policymakers will have to deal with “expensive problems.” An aging population’s rising health expenses, the energy transition toward renewables and developed countries’ long overdue infrastructure overhaul are just a few of the most pressing examples. All these topics require substantial investments at a time when government budgets are already under pressure. Worryingly for governments, strained budgets could also limit their ability to smooth out future economic downturns.

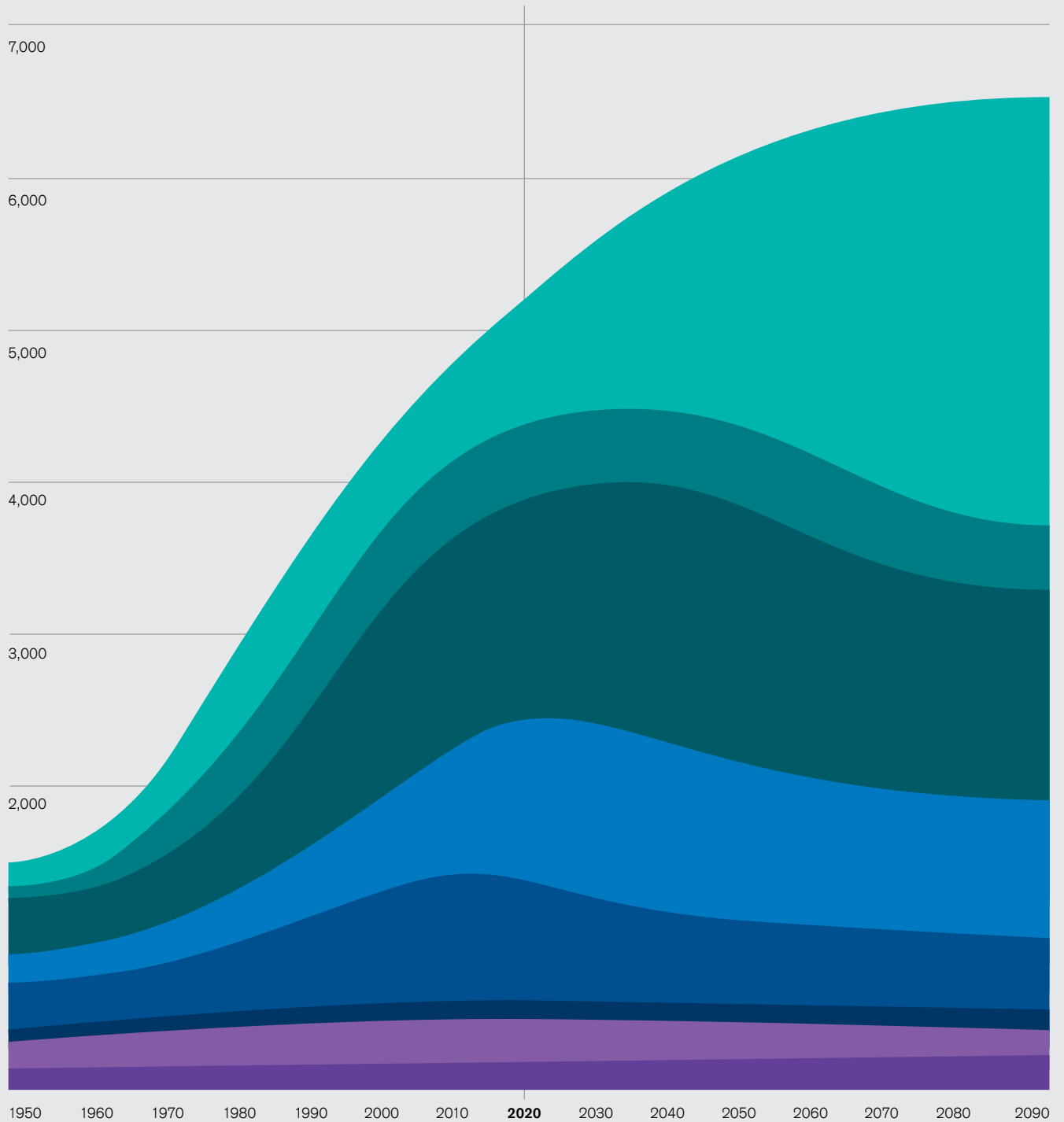
If there is good news, it is likely on the technological frontier. New technologies such as quantum computing or Blockchain applications could help to address some of these problems while simultaneously putting pressure on traditional business models. For example, Blockchain technology could revolutionize payment systems, as well as banking and wealth management.

Overall, we think the “normalized” post-pandemic world will be one where economic growth will be more erratic and volatile but not necessarily lower or higher than before. We expect a return of the economic boom-bust cycles of the past. We are likely to see an unwinding of liberal policies such as free trade and low corporate taxes. Instead, new regulations and taxes and increased income redistribution could lead to a less steady business climate and add to the economic volatility. As a result, inflation is likely to be higher than it was over the past 20 years, but hyperinflation seems unlikely. Investments in climate measures, automation, infrastructure and new technologies could lead to a meaningful increase in labor productivity but also to increased government debt. Banks are likely to help finance government deficits by holding more government bonds. At the same time, Blockchain technology and central bank digital currencies are likely to transform the financial industry to its core. In terms of political developments, the rivalry between the USA and China looks set to stay firmly in place, while the political divide in Western Economies could deepen further. In summary, the next decade will be marked by the end of the “Great Moderation” of recent decades, with 2022 being the year where the first developments become visible.

“ We expect a return of the economic boom-bust cycles of the past.

Demographics – No easy fix for labor shortages

Working age population in millions by region



North America
Europe

Other developed markets
China

India
Rest of Asia

Latin America
Africa

Regions in focus

USA

Find out more



Shifting to a lower gear

We expect real GDP growth of 3.8% in 2022, but a halting services rebound and ongoing supply chain issues are complicating the final stages of the pandemic recovery. Inflation is expected to slow to 4.5% after an extreme spike earlier in 2021, but risks remain to the upside.

Global supply chain shocks could lead to more strength in goods prices in the near term, and lead indicators for shelter inflation have picked up significantly. The Fed is beginning to gradually remove accommodative policies. Tapering of asset purchases will begin in mid-November 2021 and continue into the middle of next year. High (but falling) core inflation and strong progress toward full employment in 2022, amid

market expectations of imminent tightening, is likely to deliver one rate hike from the Fed by the end of next year. In terms of politics, the Biden administration's infrastructure package will support growth in 2022. There could also be renewed political gridlock ahead if Democrats lose the midterm elections in 2022.

Latin America



Losing steam

We project that real GDP in Latin America will grow at an annual average rate of 1.8% in 2022 following 6.4% growth in 2021. While this represents a significant slowdown, growth remains above pre-pandemic levels of 0.7% in 2019.

We forecast annual regional inflation at 10.3% in 2022, with higher commodity prices, supply-side bottlenecks and FX pass-through being the main drivers. As of late September 2021, approximately 60% of the population in the countries under our coverage had received at least one COVID-19 vaccine dose.

Generally, growth rates look set to diverge across the region: Colombia, Peru and Mexico should exhibit the strongest growth rates, while Brazil looks set to lag the region due to strong monetary tightening and the uncertain political outlook.

UK



Bank of England on track to hike rates twice in 2022

The UK recovered at an impressive pace in 2021, as the quick vaccine rollout allowed for most pandemic restrictions to be eased. However, there are signs that growth is losing momentum. We expect real GDP growth of 5.0% in 2022 versus 7.0% in 2021. Some of this slowdown was expected as the initial boost from the reopening fades. However, labor shortages and supply bottlenecks are also causing a loss of momentum in the

recovery, along with a record rise in firms' costs. While some factors causing labor shortages like COVID-19 self-isolation rules should unwind, Brexit could lead to a permanent decline in the labor supply. While demand should continue to be supported by the reopening of the economy and the high share of consumer savings, we think that higher inflation, the end of the furlough scheme in September 2021 and the withdrawal of other fiscal support measures are likely to weigh on consumer and business spending. Inflation is expected to remain above

target due to rising energy and food prices, higher goods prices due to supply bottlenecks, rising services prices due to the reopening and the reversal of value-added tax cuts. Given the persistence of above-target inflation and the Bank of England's hawkish rhetoric of late, we expect the BoE to start hiking rates in December 2021, followed by two more increases in 2022.

Switzerland

Find out more



Supply issues slow the recovery

Leading indicators continue to point to solid growth in the coming months, while a decline in the unemployment rate should support consumer spending. Furthermore, elevated domestic demand for goods will now likely persist for longer than we had previously forecast as a result of various supply delays.

Consequently, we do not anticipate that demand for goods will flatten meaningfully until mid-2022. However, there could then be quite a steep slump due to the future threat of saturation and the possible destocking on the part of companies. As is the case in most economies, consumer price inflation accelerated over the summer.

However, it remained well within the Swiss National Bank's definition of price stability. As a result, we expect the SNB to maintain its expansionary monetary policy. We forecast real GDP growth of 2.5% in 2022 versus 3.5% in 2021, while inflation should remain unchanged in 2022.



Find out more

Eurozone

Same, but different

A successful vaccination program appears to have contained the health crisis in the Eurozone. The economy has reopened and is growing quickly but continues to lag developments in the USA. Supply chain problems are restraining industrial output, which we expect to surge once those issues are resolved.

In the meantime, they are causing a sharp rise in headline and core inflation. The ECB should pare back its asset purchase program in the coming months. Sustained high inflation and looser fiscal policies could lead to hawkish guidance on rates beyond next year.

In terms of politics, the formation of what is expected to be a center-left led government in Germany may support making the EU Recovery Fund a permanent fiscal mechanism. So there is scope for a material step forward in European integration next year.



Japan

A fresh start?

Japan went through a leadership change in 2021, and the new cabinet has quickly started to work on a new stimulus package to support the economic recovery. This stimulus package could come into effect as soon as January 2022. We anticipate the total size of the package will likely amount to JPY 20–30 trillion, including provisions for future use. Small businesses in the services sector, low-income households,

medical and pharmaceutical industries, agriculture and fishery industries, the tourism industry and local governments with weak financial positions will be the main targets of subsidies and credit enhancing measures. Money will also be set aside for aid to the renewable energy sector and nuclear power generation. The majority of measures to be included in the supplementary budget will be extensions and expansions of existing ones, which lack fresh

ideas to boost demand. Another area of focus after the leadership change will be national security and defense. The geopolitical environment surrounding the country is changing rapidly, and the new government may decide to increase fiscal spending on national security substantially. We forecast real GDP growth of 1.7% in 2022 from 2.0% in 2021, and inflation of 0.5% in 2022 versus -0.2% in 2021.



Find out more

China

Common prosperity and net-zero emissions

For most of 2021, China saw a strong recovery in growth before experiencing a renewed slowdown due to problems in the real estate sector as well as regulatory change and policy reforms. Authorities aim to gain regulatory oversight and control of the most valuable assets of key growth sectors. The real estate market is among the targeted sectors. While we did not anticipate that one of China's largest property developers would face possible default, we do not see a crisis in the real estate market over the next 6–12 months.

The Chinese authorities have already reacted to the solvency risks in the property market to prevent wider contagion. In the long run, however, demographic trends will likely apply downward pressure on housing prices, which could fall faster than expected. In terms of consumption, we expect the household consumption recovery to lag behind, weighed down by the recent regulations and the fact that households' debt service ratio is already at the high end – around 32%, based on our estimates.

Inflation pressure is building in China on the producer price index (PPI) front but the passthrough to the consumer price index has been limited. Finally, China has unveiled an ambitious net-zero emission target by 2060. We expect it to have a very limited (negative) impact on 2021 GDP, while the medium-term impact depends on authorities' chosen strategies (e.g. whether they choose to reform electricity prices or allow sustainable energy to be used alongside the current energy infrastructure), which could either boost or weigh on growth.

Australia: Continuing recovery

The evolution of the labor and housing markets holds the key to the broader outlook for the Australian economy. Australia's international borders closed in early 2020, causing a sharp drop in the growth rate of the population. This is set to reverse, lifting the supply of labor and giving demand for housing a further boost.

Australia swiftly returned employment to its pre-pandemic level following the 2020 lockdowns. We expect a similar recovery as restrictions ease following the latest COVID-19 outbreaks. Resilience in business confidence is reflected in healthy hiring intentions. Businesses are not only looking beyond the lockdown and expecting consumption to rebound, they are also looking through the negative demand impact caused by stagnant population growth. That is one side of a two-sided coin. The other side tells us there will not be a step up in job gains as borders reopen. That is, the positive outcomes for the labor market have been front-loaded in this cycle. This means the unemployment

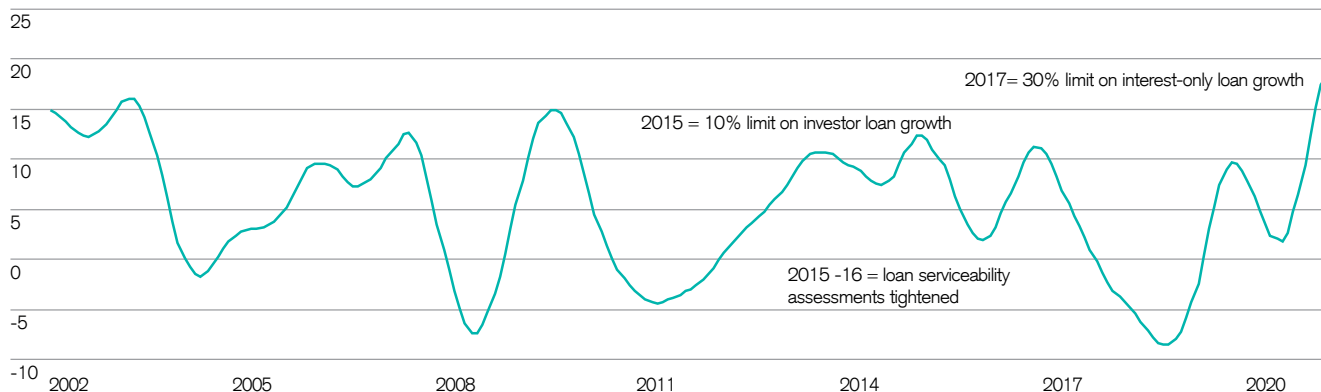
rate is very likely to remain above what the Reserve Bank of Australia (RBA) considers the threshold for lifting the cash rate until 2023 at the earliest.

How to cool the housing market?

Demand for housing is surging and propelling house prices higher. While this is the result of low borrowing rates, it is not a higher cash rate that will cool the market. Instead, macro and micro-prudential measures will be called upon to restrain lending. This has already begun. From past experience, we know that a few interventions are needed before lending comes under control, but when that happens, it has a knock-on effect on overall household consumption, via the wealth effect. This is another reason to expect the cash rate to remain at 0.1% for longer than many expect – other levers of policy will be working to restrict economic activity.

In summary, we can expect the Australian economy to continue recovering in 2022, but at a more moderate and sustainable pace.

House Prices y/y %



China: Course correcting toward new strategic objectives

After a year marked by regulatory intervention in numerous industries, we see potential for some relief for China's beleaguered corporations come 2022. The annual Two Sessions meeting in March might provide a suitable occasion for China's policymakers to signal a slowing of the pace of reforms. Thereafter, corporations might be given some leeway to adapt to the new policy environment and priorities. More expansionary policy steps after the Two Sessions meeting are also possible, as economic growth could decelerate below trend. We expect China's GDP to grow 6.1% in 2022, with inflation at 2.2% for the year.

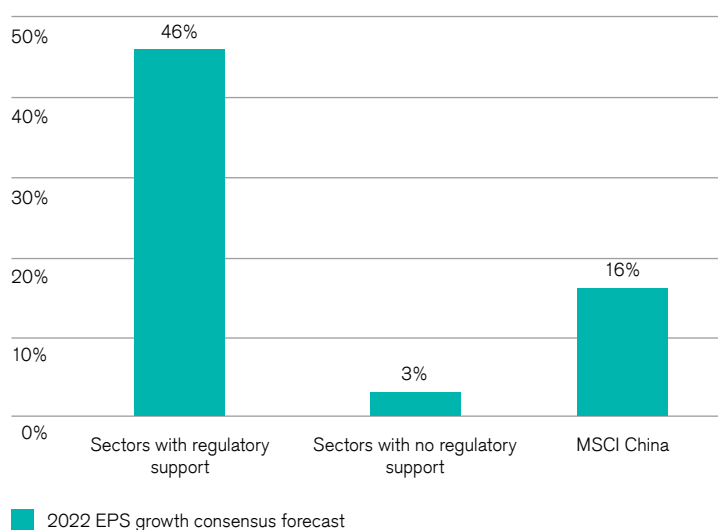
Such a gradual ebbing of regulatory uncertainty could also lead to a decline in the currently elevated equity risk premium. We continue to favor strategically important industries and sectors that stand to benefit from the redirection of the regulatory environment. These include technology, advanced manufacturing (e.g. artificial intelligence and semiconductor companies), internet, electric vehicle and renewable energy.

The real estate sector, which constitutes almost 30% of China's GDP, is likely to remain under pressure in 2022, albeit less intensely than in 2021. Deleveraging could be slowed to avoid systemic risk. In this difficult environment, investors in high yield credit of China's real estate sector should focus strictly on higher credit quality issuers. We see better opportunities in high yield names in the industrial and commodity sectors, as they should enjoy improved cash flows as a result of elevated commodity prices and local government spending on infrastructure going into H1 2022.

CNY likely to stay relatively stable

The CNY is likely to continue to enjoy support from China's strong merchandise trade surplus, along with foreign direct inflows and recovering portfolio inflows – driven by the global economic recovery and a more forgiving policy and regulatory environment, respectively. Yet, CNY strength is likely to be constrained by recovering competition from other production centers and a gradual resumption of tourism outflows. Overall, we expect China to maintain a healthy current account and a relatively stable currency.

Expect sectors with regulatory support to deliver strong earnings growth



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

Last data point 27/10/2021
Source Bloomberg, Credit Suisse

Japan's corporate sector likely to benefit from global recovery

The stereotype of Japan as a perennial growth laggard raises the potential that the market might be somewhat late in factoring in the corporate sector's strong links to the global economic recovery. This might lead to a period of dissonance, where Japanese corporate earnings are excessively discounted and companies' stocks undervalued.

We expect the global economy to continue to recover in 2022, albeit with regional differences. The likely normalization of supply chains should accelerate the recovery of manufacturing, allowing inventory restocking and capital expenditure to support growth.

Not all sectors are equal

Japan's exporters are mostly manufacturers – specifically of capital and production goods – and will thus likely be able to benefit from this recovery. Those that can rely on their market dominance and enjoy priority as supply chains recover should be able to achieve faster growth. As such, focus on

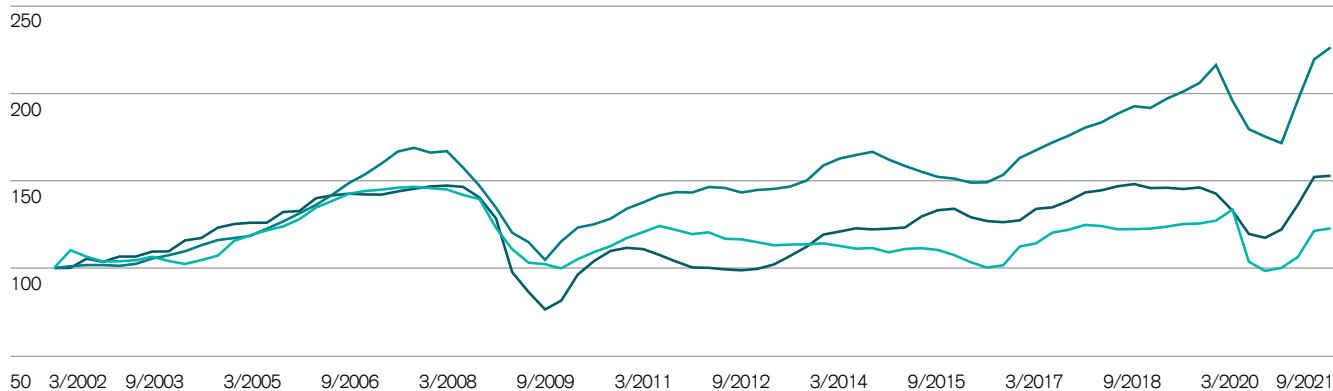
specific sector exposure should be an integral part of investing in Japanese equities.

Consumption key to recovery

Meanwhile, consumption might turn out to be a key support for a domestic economic recovery. The new government of Prime Minister Fumio Kishida has elevated income distribution and sustainable consumption as key growth engines. Where traditional fiscal spending has not been effective in boosting consumption sustainably, longer-term policies like reversing the long-declining share of corporate profits allocated to salaries might prove more successful. Politically, the House of Councillors election scheduled for July 2022 will be seen as important for solidifying the new government's power and thus likely help accelerate the implementation of these policies.

A structural rise in disposable incomes should combine with an aging population to put consumption on a sustained recovery. Additionally, a recovery in foreign tourism should prove supportive for the services and leisure-related sectors.

Corporate Earning (12M EBITDA, 100=March 2002), Japan link to global cycle



Southern comfort: Reopening on the way

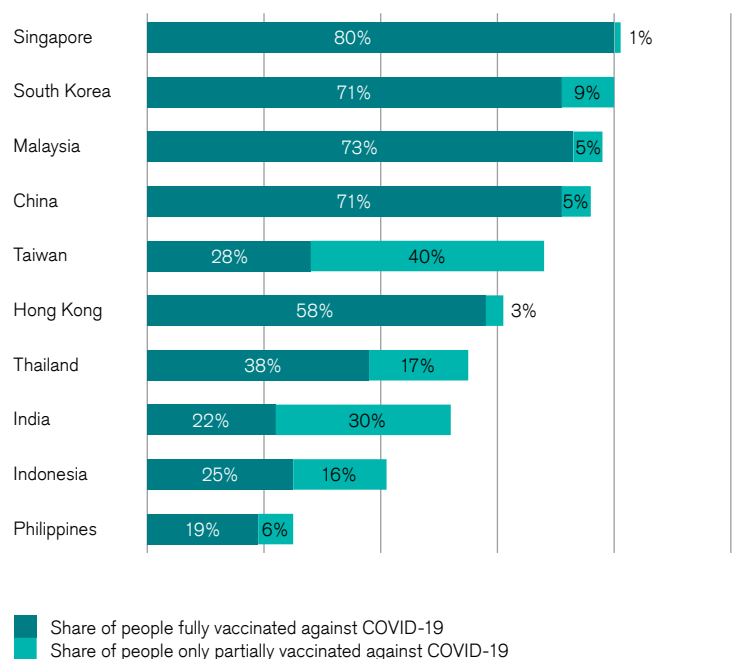
Asia's reopening baton has passed from North to South as Southeast Asia (SEA) emerges from its COVID-induced malaise. The gathering pace of the vaccination rollout is allowing SEA to gain a firmer footing on the path to recovery. But these are early days still and we prefer to wait for upgrades to earnings projections before repositioning for a more sustained outperformance. Still, the signs are hopeful.

In what might be a prelude of things to come, Asia's equity markets in 2021 – especially in H2 – reversed the relative regional performance of 2020, as SEA markets significantly outperformed China's equities. The key difference for SEA is its newly adopted approach of “living with COVID,” which reduces the risk of episodic lockdowns. New COVID-19 cases in most SEA countries are on a downward trend as governments have been accelerating their vaccination programs.

SEA countries are targeting full inoculation for at least 70% of their population by February 2022, which will further reduce the risks of severe lockdowns and allow the economies, and possibly even inward tourism, to recover more quickly. SEA is now relaxing movement restrictions internally and, tentatively, even externally, facilitating the staggered return of services activity, and a release of pent-up demand for goods. We expect the real GDP growth in ASEAN-6 (including Vietnam) to accelerate to 5.6% in 2022 from 3.6% this year.

Nevertheless, despite the brightening economic outlook and receding pandemic, we bide our time and stay neutral on regional equities for now. The missing piece in SEA's post-pandemic recovery story is the absence of a robust earnings recovery – analysts have revised lower their 2022 earnings estimates over the past three months partly due to the absence of large-scale stimulus packages. In our view, investors should wait for signs of earnings recovery before aggressively adding exposure to the region.

Share of people vaccinated against COVID-19



Last data point 26/10/2021

Source Ourworldindata.org, Credit Suisse

Pandemic sharpens investors' focus on sustainability

The increased focus on environmental, social and governance (ESG) themes in 2021 will continue to influence both companies and the investment outlook in 2022. Shareholders, employees, regulators and ESG activists are holding companies to account, and this engagement shows no signs of abating. We summarize key ESG trends that investors should follow in 2022.

1. Climate change and biodiversity loss – An end to business as usual

Many investors will have heard of the Conference of the Parties (COP) 26, the United Nations' climate summit that was held in Glasgow in November 2021. Fewer investors will be familiar with the COP 15, the two-part UN biodiversity summit, which kicked off in October 2021 and is slated to finish (COVID-19 permitting) in May 2022. The outcome of these two COPs will be to set the environmental agenda for the years to come. While metrics like a carbon footprint for climate change are now widely reported, investors are still struggling to find meaningful metrics by which to compare companies on the more complex subject of biodiversity. As a result, the onus is on companies to demonstrate how their businesses are adapting to this new reality. Food and agriculture companies, which sit at the intersection between climate change and biodiversity loss, are likely to experience the greatest scrutiny.

Yet even in the absence of meaningful government action on the climate front to date, investors should expect an end to business as usual. In 2022, levels of carbon dioxide emissions in the atmosphere are expected to reach a dangerous milestone: a 50% increase compared to pre-industrial levels.¹ At the same time, ecosystems are now losing species at rates not seen since previous mass extinction events, and are currently estimated to be between 100 and 1000 times greater than pre-human levels.² On a global scale, these changes pose material risks for companies and investors in terms of disrupted supply chains, lower crop yields and greater food price volatility. Investors should thus seek out companies that are able to manage these risks, as they are likely to outperform in the long term.

Solutions that address the twin crises of climate change and biodiversity loss could lead to a potentially unprecedented investment opportunity. From climate-smart and regenerative agriculture to alternative proteins and reduced food waste, investing in nature-positive solutions could create USD 10 trillion in new business opportunities while delivering up to 37% of greenhouse gas (GHG) emission reductions by 2030, according to a 2020 article on the World Economic Forum website: *How investing in nature can help tackle the biodiversity and climate crises*.

¹ Met Office: Atmospheric CO₂ now hitting 50% higher than pre-industrial levels, (Carbon Brief, 2021).

² Extinctions during human era one thousand times more than before, (ScienceDaily, 2014).

³ Cybercrime To Cost The World \$10.5 Trillion Annually by 2025, (Cybercrime Magazine, 2020).

⁴ Cybercrime To Cost The World \$10.5 Trillion Annually by 2025, (Cybercrime Magazine, 2020).

⁵ Gartner Forecasts Worldwide Security and Risk Management Spending to Exceed \$150 Billion in 2021, (Gartner, 2021).

2. Labor markets – Protecting gig workers' rights

The gig economy ranges from low-skilled, routine work right through to highly-skilled workers, and also includes those working in creative and digital industries, education (EdTech) and, more recently, healthcare professionals. At the more skilled end of the spectrum, competition is fierce and employers have to pay competitive rates to secure the skills they need for business-critical projects or to fill shifts. Done the right way, the online freelance economy matches talent to labor gaps, provides transparency and brings certainty that skills are fairly rewarded for workers who are in high demand. Women have increasingly turned to the gig workforce for income during the pandemic. This is because they were over-represented in industries that were hit hard by the crisis including hospitality and services, or they were forced to give up stable jobs to care for children or other dependents. While gig jobs provide flexibility and opportunities for marginalized workers, the wages in lower-skilled work are often low and unstable and there is a lack of employment protection.

Gig platform companies have generally entered highly regulated markets. By engaging in regulatory arbitrage through the misclassification of workers as independent contractors to circumvent employment law, low-skilled gig workers may be paid less than the minimum wage, and costs such as insurance and capital expenses may be borne by the worker. Moreover, these gig workers may lack standard protections, such as paid sick leave, holiday pay and pension/superannuation. Many jurisdictions are introducing regulation to protect gig workers with the aim of building a more balanced relationship between the gig platforms and their workers. Legal and regulatory pressures on the platform business model will likely continue through 2022, with some companies responding better than others to the evolving gig environment.

Investors can stay ahead by taking a proactive stance on robust human rights and improved disclosure on workplace policies and practices, which contribute to creating long-term value and reducing liability, reputational and operational risks, in our view. In addition to emerging areas such as EdTech, investment opportunities span technologies that stand to benefit from an increasingly flexible working environment, with cloud, enterprise SaaS (Software as a Service) and cybersecurity providing exposure to the gig economy. The gig economy ecosystem also includes new mitigation opportunities for investors, such as insurtech products that offer innovative short-term, pay-as-you-go insurance solutions for gig workers. Adjacent technologies including innovative payment networks can increase financial accessibility for the underbanked and pay workers immediately instead of forcing them to wait for weeks for their paycheck, helping to improve gig workers' standard of living.

3. The digital paradox – COVID crisis a catalyst for opportunities and challenges

While the speed of the recent digital transformation to enable business continuity, remote working and automation is likely to continue in 2022, digital security will be a high priority as many sectors, including education, healthcare, commerce, manufacturing and entertainment, are transformed by a digital-first approach.

As the world emerges from the COVID-19 crisis, however, digital experts are in combat with a pandemic of a different kind. Cybercrime is predicted to inflict damages of USD 6 trn globally in 2021 from lost productivity, damage and destruction of personal and financial data and theft of intellectual property³. With reputational harm and ransomware attacks becoming more prolific and expensive, damages are forecast to reach USD 10.5 trn⁴ in 2025. Breaches and recent ransomware attacks in diverse sectors have highlighted the risk of poorly secured infrastructure. Awareness is growing and spending on cyber resiliency will continue into 2022 given the risks that firms must manage in this area.

Although cybersecurity has been typically regarded as a technological issue since it protects systems, networks, software and data, cyber vulnerabilities are considered to be an existential business risk that investors should not ignore and it is managed within ESG as part of the "S" dimension.

Cybersecurity is becoming an increasingly high legislative priority; in the USA, there is now bipartisan commitment for legislation to improve cyber incident reporting and for funding for infrastructure projects. In the European Union, the new Cybersecurity Strategy calls for state-of-the-art cyber defense capabilities to combat cyberattacks across the region.

Leading companies in this area know that cybersecurity is both a business and a technical issue and build cybersecurity into their business products, services and processes. The best-performing companies have already increased their focus on cyber-risk management, skills and infrastructure throughout the organization, including supply chains, and other companies will follow. Investors should consider a company's cybersecurity preparedness as a part of their investment decision, as companies that can manage these risks are more likely to outperform over the long term.

Such developments should drive investment opportunities that arise through new and incremental business for the cybersecurity ecosystem. These include the adoption of a zero-trust approach, which requires all users both inside and outside the organization's network to be authenticated, authorized and continuously validated before being granted (or keeping access) to applications and data, as well as embedded hardware authentication and behavioral analytics. Moreover, the increasing demand for cloud-based services across most industry verticals is also a major driver for the cloud security market, the fastest growing segment.⁵ Further opportunities involve leading vendors focused on assuring cybersecurity hygiene down their hardware and software supply chain and throughout their own operations, as well as the next generation of cyber-experienced professionals that are emerging as entrepreneurs from sectors such as financial services, and governments that drive innovative start-ups.

Find out more





Historical

- ↗ More sustainable production
- ↗ More sustainable consumption

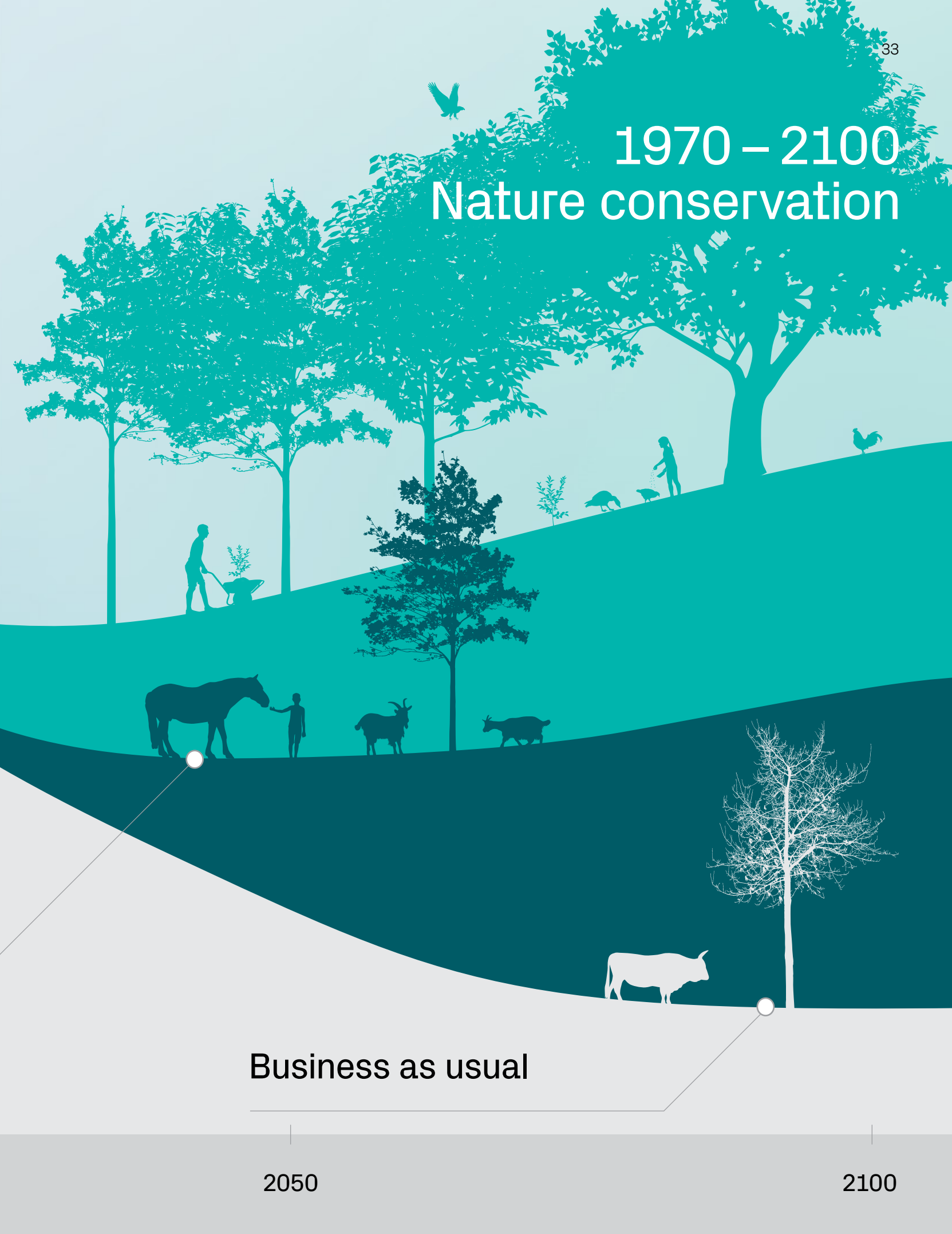
↗ Increased conservation efforts

Source Adam Islaam | International Institute for Applied Systems Analysis (IIASA); Credit Suisse

1970

2010

1970 – 2100 Nature conservation



Business as usual

2050

2100





Main asset classes

Beware of duration risk within fixed income

Government bond yields will likely move higher on the back of economic growth momentum and policy normalization in 2022. As inflation rates slow, we no longer expect US inflation-linked bonds (ILBs) to outperform nominal bonds, though there is room for Eurozone ILBs to do so. We do not anticipate a strong performance for either global investment grade or high yield, while emerging market hard currency bond fundamentals will likely be less supportive. An interesting alternative to high-yielding credit in developed markets is global senior loans, which offer attractive relative valuations.

The decades-long bond bull market

10-year US Treasury yield, in %



Last data point 22/10/2021
Source Refinitiv, Credit Suisse

Developed markets:

Government bonds remain unattractive

In developed markets, the focus in the coming year will be on central banks and the prospects for the unwinding of quantitative easing (QE) and policy normalization. Some central banks have already started raising interest rates, with Norway and New Zealand leading the way, and markets expect other countries to follow. We expect the US Federal Reserve (Fed) to hike rates once in 2022, followed by another four hikes in 2023. Overall, government bond yields should grind higher on the back of economic growth momentum and policy normalization.

Eurozone ILBs could outperform

Inflation expectations in the Eurozone are still at levels below the target of the European Central Bank (ECB), and a further rise is possible in early 2022. This suggests that Eurozone ILBs may have some potential to outperform compared to nominal government bonds. Within the Eurozone, ECB and European Union fiscal support continues to help peripheral countries, and government bond spreads like the BTP (Italy)/Bund (Germany) may further narrow if the Eurozone fiscal union progresses. In contrast, current inflation expectations in the USA reflect the view that inflation rates will slow down in 2022 toward the Fed's 2% target. In this scenario, rising nominal yields would primarily be driven by real yield increases. As such, US ILBs would no longer outperform nominal bonds as they did in 2021.

Dim outlook for corporate bond returns

We do not anticipate a strong performance for either global investment grade (IG) or high yield (HY). The containment of the pandemic and ongoing recovery of the global economy could support risk appetite at the same time as the Fed moves toward normalization. However, the latter could have a negative impact on credit market performance due to higher treasury rates. In our view, the current low spreads in IG and HY suggest that credit performance will be constrained by rising core government bond yields. Moreover, a relatively flat credit curve points to a potential normalization of credit risk premiums back to their long-term average (i.e. a rise in spreads relative to treasuries). Overall, we favor a short duration positioning into 2022.

Sovereign emerging market hard currency (EM HC) bonds lose appeal

We think EM HC bond fundamentals should be less supportive in 2022, as external balances are unlikely to improve further and many EM countries have significantly increased their fiscal spending following the COVID-19 shock, leading to an increase in government debt. Higher refinancing needs will likely put upside pressure on rates because the market will require a higher premium to buy EM debt. Additionally, with the Fed tapering in the near term and moving toward raising rates further out, the return outlook for EM HC sovereign bonds is set to become more challenging. Overall, current spreads do not look attractive enough to compensate investors for rising rates volatility and the risk/reward for EM HC bonds has thus deteriorated.

At the regional level, we expect low single-digit returns from Asian HC bonds in 2022. Spreads are likely to remain stable, as Asian sovereign fundamentals have been resilient thanks to strong policy support amid the pandemic. Indeed, Asia's FX reserves and current account balances have improved, while external debt to GDP has seen only a modest rise. As for the rest of EM, rising US yields and lower carry limit total return potential. Within Asia, we have a preference for China. Its lower duration profile is likely to limit downside risks stemming from rising US Treasury yields and relative valuations are cheap after accounting for its healthier debt fundamentals. China has one of the lowest external debt-to-GDP ratios, and its current account balances have continued to improve over the past two years.

In EM, some economic growth moderation, combined with more expensive onshore refinancing conditions, could limit improvements in both EM corporate default rates and performance in 2022. With global government bond yields likely to trend higher, we prefer to position for the short-duration segment in EM corporate bonds. Moreover, the combination of higher interest rates and still soft labor markets in EM could keep wages contained in 2022, which could lead to lower demand and reduced implied revenues for EM corporates. This will likely translate into deteriorating fundamentals, such as leverage and interest coverage ratios over time. We are relatively cautious and prefer to position defensively for short-duration EM credit, favoring segments that offer a balanced risk/reward between value and default rates, such as Asian crossover credit with solid credit fundamentals. In summary, while the outlook for EM sovereign and corporate bonds is mixed, the wider spread compared to developed market government bonds could lead to some selective opportunities.

Prefer senior loans

An interesting alternative to high-yielding credit in developed markets is global senior loans (see page 35 for details). They offer attractive relative valuations and should benefit from a higher government bond-yield environment, low expected default rates and rising rating upgrades in 2022.

Indeed, rating upgrades for global senior loans are outpacing downgrades at the fastest pace since Q2 2012 due to several factors: accommodative lending conditions for lower-rated issuers; and the reopening of economies, which paves the way for favorable rating actions. We anticipate that this trend will continue, especially in cyclical sectors such as electronics and chemicals.

What are senior loans?

Senior loans are the floating rate debt (the part of debt where the interest rates are set to a floating benchmark) of companies that have below IG ratings, and/or have a high level of contracted or outstanding debt. They are issued to support companies that are borrowing to make acquisitions, spend on large capital expansions, refinance and/or increase existing debt, or make one-time dividend payments to shareholders. The market perceives these loans to be more risky given uncertainties regarding the stability of such businesses, and thus requires a higher return in the form of fees and the loan spread.

Senior loans typically represent a first lien secured

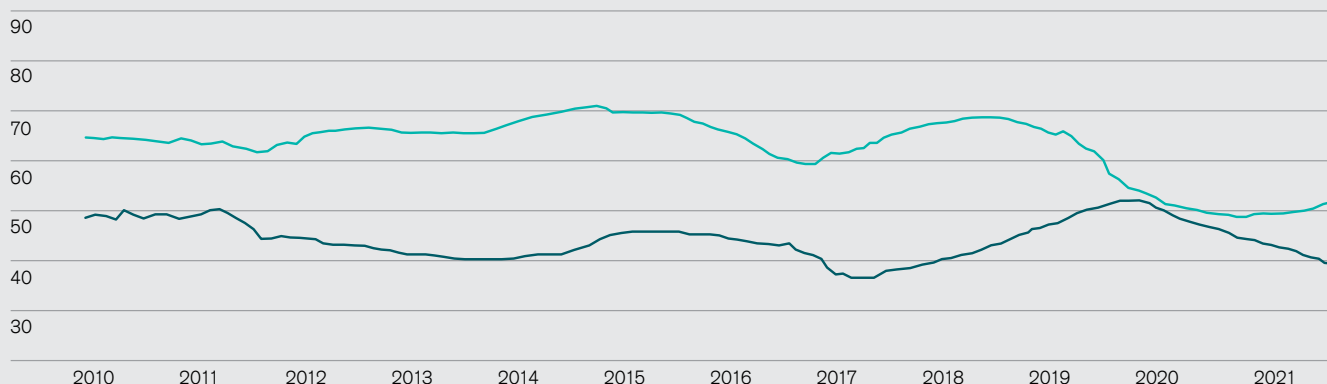
on a company's assets in the case of a bankruptcy. As a result, if a company becomes distressed and declares bankruptcy, senior loans are typically the first in line to be repaid before bondholders and shareholders. Although there is no guarantee that the amount of collateral will be sufficient to pay off a borrower's loan in full, the fact that senior loans are secured by collateral has historically translated into significantly higher recoveries on defaulted loans in comparison to recoveries on defaulted high yield bonds (see chart below).

Senior loans are set up using a written contract (the credit agreement), which governs the manner in which funds are extended to the borrower and sets the interest rate to be paid by the borrower. It also imposes significant limitations on a borrower's business operations – measures that are designed to enhance the ability to repay lenders.

Senior loans have higher recovery rates vs. high yield bonds

If an issuer defaults, how much an investor would recover of their investment for senior loans versus high yield bonds

Per USD 100 Par



☐ US high yield bonds (senior unsecured)
☐ US senior loan, 1st lien

Measured by debt prices which are taken immediately prior to distressed exchanges or 30 days after non-distressed exchange defaults, 3-year average.

Last data point 30/09/2021
Source Moody's, Credit Suisse

Technical analysis corner: Bond yield trends in 2022

Our technical analysts believe that global bond yields are set to move higher during 2022, based on two key technical factors: the potential for large technical bases across global bond markets; and our assessment that the momentum behind the move higher in yields is picking up again following the summer 2021 bond rally.

US bond yields headed higher

The US 10-year bond yield started to rise again toward the end of Q3 after an earlier surge in 2021. This means that a three-year technical base may be forming, which would have significant negative implications for government bonds in 2022, in our view. The key yield level that defines this base is seen at 1.70%, and if a weekly close above here can be achieved, which is our base case, we believe this would provide the platform for a more significant rise in yields during 2022. The next key yield levels to watch for the US 10-year bond yield during 2022 are seen at 1.965%/2.00%, then 2.145%/2.16%. The size of the base suggests that we could even move beyond these levels later in 2022. Reinforcing the move higher in bond yields is the reacceleration of multiple medium-term indicators, including the moving average convergence divergence (MACD) momentum indicator, which measures trend strength. Our own proprietary momentum indicators, which are based on adjusted moving averages and total return momentum, among other factors, have also remained consistently bearish on global treasuries since Q1 2021 and continue to warn of deteriorating momentum as we head toward 2022.

In the USA, 10-year US inflation breakevens (market-implied forecasts for inflation) are unlikely to move significantly beyond major long levels at 273/278 bp, in our view, which are the record price highs from 2005 and 2012. We thus believe that rising real yields will eventually drive most of the move higher in US nominal yields. This expectation is based on our view that the US 5-year real yield may be in the process of constructing a potential “double bottom” base. This technical pattern occurs after two successive lows appear at the same level, and in this case would be confirmed above -1.445%. If this “double bottom” base can be established, it would confirm a more significant pricing higher of US real yields, in our view.

In summary, momentum indicators and technical pattern analysis suggest that we will see a significant rise in US bond and real yields during 2022, which should lead to weak total returns for government bonds as an asset class.

“ Momentum indicators and technical pattern analysis suggest that we will see a significant rise in US bond and real yields during 2022.

UK bonds lead the way

Within core developed markets, UK bond yields have led the way higher during 2021, and the 10-year maturity has already confirmed an equivalent multi-year base following a break above long-term yield resistance levels earlier in 2021. Medium-term momentum is seen even stronger from here, albeit far from oversold levels. From a technical perspective, we see scope for 10-year UK bond yields to rise toward their 2018 high of 1.75% during the course of 2022, with interim levels seen at 1.375%/1.39%. The 10-year German bond yield would also complete a similar structure with a move above -.075%/-0.05%, suggesting 2022 is set to see a global yield repricing.

European inflation expectations have driven the rise in European yields during 2021 after surging throughout the year, with the German 10-year breakeven breaking out of a six-year range earlier in the year. This marked a regime-changing breakout from a technical perspective, however the market is already at the next major resistance levels at 192 bp/194.5 bp, with scope for some further limited upside to the psychologically important 200 bp level, where we would expect European inflation expectations to hold up better than the US in a high level range.

European inflation linked bonds (ILBs) and their US counterparts have started to diverge, with European inflation expectations rising faster than US ones. In terms of technical analysis, this divergence represents a large top and reversal in relative inflation expectations between the two regions and we expect this new trend to persist into 2022.

In summary, fixed income investors should also expect weak total returns from European and UK government bonds during 2022, with the technical outlook suggesting ample scope for yields to rise further.

Earnings to drive equities

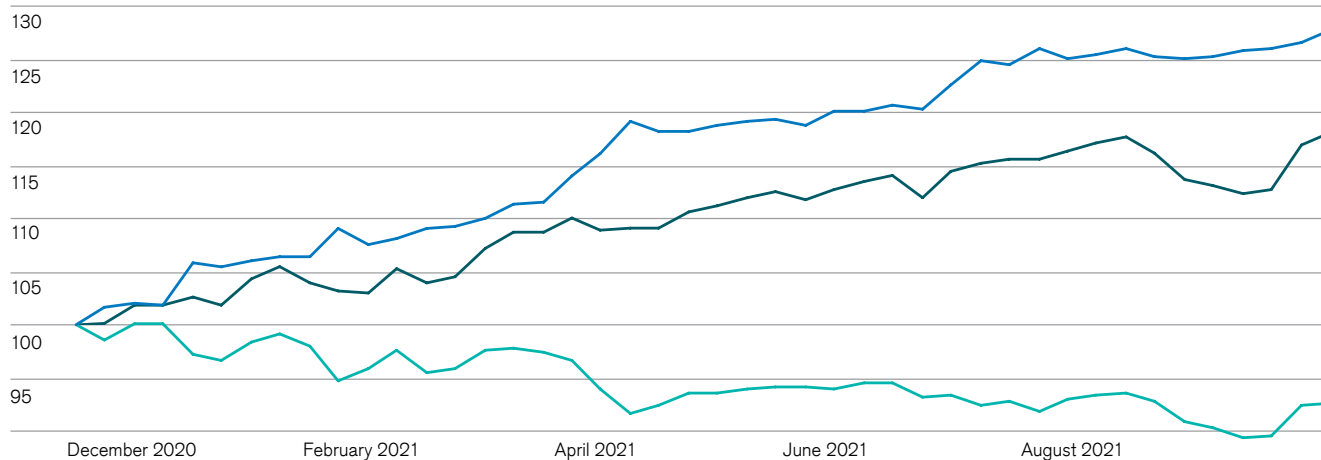
We expect earnings to be the key driver of equity returns in 2022. In line with our earnings expectations, we expect high single-digit equity returns in 2022 compared to double-digit returns in 2021. Other tailwinds for this asset class going forward include the ongoing economic recovery, and the “there is no alternative” (TINA) argument for equities.

“Pricing power” a key topic

The past year has been a rewarding one for global equity investors as most equity markets and regions generated impressive returns. Earnings growth has been very robust, with MSCI AC World earnings surpassing pre-pandemic highs in 2021. This has driven strong equity returns in 2021, though the price-to-earnings (P/E) ratio declined as levels were already elevated and investors anticipated that the extraordinary fiscal and monetary support of the COVID-19 era would begin to fade (see chart).

Looking ahead to 2022, we expect a year of “normalization.” Economic growth is expected to normalize in 2022, with the recovery continuing, albeit at a slower speed and tilted toward the first half of 2022. Household balance sheets remain in good shape. We also expect earnings to normalize in 2022 after the significant boost ushered in by the unprecedented fiscal and monetary stimulus, and a very volatile period during the initial stages of the COVID-19 pandemic.

The E (earnings) outpaces the P (prices)



■ MSCI World
■ 12-month forward P/E
■ 12-month forward earnings

Note: Return attribution indexed to 100 as of 31/12/2020

Last data point 28/10/2021
 Source Refinitiv, Credit Suisse

Consensus forecasts imply earnings growth in the high single digits for 2022, which is close to long-term averages. In our view, the constructive macroeconomic environment should support revenue growth. We expect margins to remain at solid levels. Nevertheless, potential headwinds include rising input costs due to greater demand and the widening producer price index vs. consumer price index gap, which gives companies less room to pass on rising costs to the consumer. “Pricing power” will thus become an important topic for equity investors in 2022, i.e. companies that can pass on the rising input costs to consumers will fare better than those with low pricing power. We expect high single-digit equity returns in 2022 compared to double-digit returns in 2021.

Little room for re-rating

Even though traditional valuations (i.e. P/E multiples) declined in 2021, they remain at elevated levels compared to longer-term historical averages. We see little room for re-rating (i.e. higher P/E multiples), as we expect that financial conditions, including interest rates, will become somewhat tighter in 2022 due to rising real yields. We expect the US Federal Reserve (Fed) to start tapering asset purchases in mid-November, and to complete this process by mid-2022.

Key risks for global equities in 2022

There are a number of risks for global equities in 2022. One risk to earnings (i.e. margins) is rising input costs, for example for commodities or wages. Another related risk is further disruptions in supply chains, a factor that started to weigh on some companies' profitability in the second half of 2021. Inflation was also a risk for this asset class in 2021, although most market participants expect that the current elevated inflation levels will be transitory. However, stickier-than-expected inflation could lead to tighter monetary conditions and increase the risk of a policy error – both of which would be headwinds for global equities. Additionally, we believe there is less room going forward for fiscal stimulus, which has been a supportive element for equities during the COVID-19 crisis. This is because governments will likely wind down their unprecedented fiscal policy, and there could also be policy gridlock following the US midterm elections. A COVID-19 comeback due to new mutations that make current vaccines less effective is another risk worth flagging. China also remains a potential risk for global equities, e.g. due to a slowing economy and the risk of further regulatory headwinds as we saw in several sectors in 2021. Finally, there are several elections to keep an eye on in 2022, namely the US midterms and the presidential elections in France and Brazil.

MSCI AC World earnings growth – Earnings per share (EPS) growth expected to normalize in 2022

6.4% EPS growth - compound annual growth rate (CAGR) (2010–19)

-11.9% EPS growth 2020

48.8% estimated EPS growth 2021

7.6% estimated EPS growth 2022

Sector outlook

Consumer discretionary: Consumer services preferred

One sector we expect to do well in 2022 is consumer services, which provides exposure to restaurants, hotels and leisure companies. The sector has lagged others as lockdowns and other restrictions delayed the reopening of dining and leisure facilities. We view this as an attractive opportunity, as we expect services spending/consumption to be a bright spot in 2022. Consumption trends remain supportive on the back of the pent-up demand for services, an improving labor market and robust household balance sheets.

Financials: Higher interest rates provide boost

Financials, and banks in particular, are among the key beneficiaries when yields and interest rate expectations rise. Increased distributions to shareholders via dividends or buybacks pose another tailwind for financials, in our view. The sector's valuation remains attractive and the earnings picture is constructive.

IT: Rising real yields a headwind

The IT sector benefits from secular growth trends. Within IT, we expect software and services to do well as the industry group has a superior earnings outlook and sturdy cash flow generation. Our expectations for rising real yields is a headwind for the sector as a whole. In general, this sector has attractive market segments that have the potential to disrupt and thus have room to expand market share and profit margins (see pages 56–57 for a description of our Supertrends long-term thematic investments), including technology-related industries.

Communication services: Growth, valuation challenges ahead

The earnings outlook for communication services is in line with global equities. The technology/interactive media component of the sector offers attractive growth but is richly valued, while the telecom sector offers good value but the growth component is lagging. Furthermore, regulatory issues and potentially higher taxes remain a key risk and could have a severe impact, though the magnitude of such changes is hard to assess.

Utilities: Under pressure

Utilities lagged the global equity benchmark (MSCI World) in 2021, and is not among our preferred sectors going into 2022. While earnings expectations for 2022 have improved, the sector experienced an earnings decline in 2021 and macro headwinds (e.g. higher rates/yields) are set to intensify as central banks prepare to unwind some of their monetary stimulus measures.

Energy: Full recovery from pandemic impact

The energy sector posted the strongest earnings recovery in 2021, with earnings growth expected to increase by over 100% from the start of the year. Looking at 2022, earnings are set to stage a full recovery from the pandemic impact and are projected to be 5% higher than 2019 levels (pre-pandemic), according to consensus estimates. Despite attractive fundamentals and high dividend yields as oil prices recover and cash flow stabilizes, structural headwinds from the energy transition, as well as environmental, social and governance (ESG) concerns remain.

>100%

Increase in earnings growth expected in energy sector in 2021

Healthcare: Challenging conditions in the short term

Healthcare earnings growth and price performance lagged global equities in 2021. Consensus earnings expectations are still below broader global equities and relative momentum is also weak. At the same time, long-term growth drivers like better healthcare access in emerging markets, high operating leverage, low input costs and an aging population remain intact. Nevertheless, the increase in yields due to the on-going recovery of the global economy poses a risk to this defensive sector.

Materials: Growth drivers remain in place

We expect materials to deliver attractive returns in 2022 due to above-trend global growth and the role of some metals in the transition to more sustainable production and consumption (e.g. electric vehicles). We expect earnings growth to normalize in 2022 as base effects fade and global growth moderates from the 2021 highs, though the sector's long-term structural growth drivers remain in place.

Equity styles: Several potential standouts in 2022

For equity styles, 2021 did not display any clear trends. At the time of writing, only quality and value gained (slightly) compared to the MSCI World Index. To some extent, this is a testament to the uncertainty, varied economic impact and "foggy data" caused by the global pandemic as the world absorbed and adjusted to the shock. Going into 2022, we expect that the growth style in the USA will see renewed support, along with small caps globally. On the other hand, we continue to expect that the value style will do well in Europe. Our views are supported by a constructive economic outlook, with purchasing managers' indices (PMIs) expected to be expansionary along our forecast horizon. Additionally, the majority of a broad set of US indicators continues to support a constructive macroeconomic environment.

Industrials: Outlook brighter as world moves toward normalization

Industrials is the most economically-sensitive sector to global manufacturing and industrial production. Going into 2022, we expect the global supply chain pressures to moderate as we move into a "normalized" world. The sector stands to benefit from the reacceleration in global industrial production momentum as current inventory levels are very low.

Regional outlook

United States of America



Politics and Fed in focus

The outlook for US equities is key for our broader equity outlook as the USA accounts for 60% of the MSCI AC World – the global equity benchmark. We expect that monetary policy and politics will be important drivers of US equities in 2022. The equity bull market could face a speed bump relating to tapering, but will likely continue its upward trend, in our view.

Another potential headwind for US equities is tighter monetary policy and our expectations for rising real yields. In terms of political events, the US midterm elections in November 2022 will be in focus. The Democrats face the possibility of losing their (slight) majority in one or both chambers, which could result in policy gridlock. We therefore expect less fiscal spending after the US midterm elections.

Despite these headwinds, we have a constructive outlook for US equities. The solid earnings outlook and still benign financial conditions should support US equities. In addition, the US equity market has significant exposure to the tech sector and can therefore benefit from secular growth trends.

Eurozone



Continued recovery

Going into 2022, the economic outlook for the Eurozone remains constructive. As highlighted above, we expect earnings to be the key driver for global equities, and this is also true for the Eurozone. The consensus earnings forecast for the Eurozone is among the highest in the major developed markets, supporting our constructive outlook on Eurozone equities.

We see the biggest upside potential in markets that have lagged during the post-pandemic recovery. In terms of politics, the presidential elections in France will be in focus. A victory for a euroskeptic president would be a risk for European integration. It will also be interesting to see if the eventual coalition that governs Germany will push for additional fiscal spending and further European integration, which would be supportive of European assets.

Developments in China are also important for Eurozone equities, in particular for French (e.g. luxury goods companies) and German (e.g. car manufacturers) equity markets.

Switzerland



Currency in focus

Due to its significant exposure to the healthcare and consumer staples sectors, the Swiss equity market is seen as a defensive market. This defensiveness can be a headwind or tailwind, depending on the market environment.

In 2021, which was marked by the huge earnings recovery and cyclical markets, Swiss equities lagged the broader equity benchmark (MSCI World). As 2022 is the year of “normalization,” we expect Swiss equities to perform in line with the equity benchmark. An important driver for Swiss equities is the

currency, as a stronger CHF acts as a headwind for the export-oriented Swiss equity market. We believe the Swiss National Bank will keep a lid on the CHF in the coming year (see page 46).

United Kingdom



Tackling post-Brexit challenges

The UK posted the strongest earnings recovery in developed markets in 2021. Estimated earnings per share (EPS) for UK equities for 2022 should show a complete recovery from the pandemic, and are 4% higher than the 2019 EPS (pre-pandemic), according to consensus estimates. Despite this positive trend, however, UK equities have underperformed global equities since 2019.

This performance has extended the already significant de-rating (i.e. decline in P/E multiples) due to Brexit, and the market now trades at a historically low valuation multiple. Going forward, the UK heavyweight sectors that were disproportionately impacted by lockdown measures should be a major beneficiary of the “reopening” trade.

UK equity indices also have a lower exposure to the IT sector and a higher weighting in terms of financials versus the MSCI World, which should act as a tailwind in a rising yield environment. We expect UK equities to perform well in 2022, fueled by earnings growth as well as some higher valuation multiples. A high dividend yield of around 4% should also prove supportive for total returns.



Japan

Bright outlook

Japanese equities lagged in H1 2021 due to the delayed rollout of COVID-19 vaccinations and continued pandemic restrictions. However, Japan caught up with its developed market peers in terms of both vaccinations and equity

market performance in H2 2021, as political changes paved the way for a new administration and potential stimulus. Looking ahead, we expect Japanese equities to deliver attractive returns in 2022, as the Japanese economy fully reopens and drives domestic consumption,

exports pick up with the easing of supply chain pressures and strong external demand, while the outlook is for attractive earnings growth, more buybacks and supportive policy – both monetary and fiscal.



Emerging markets Asia

Double-digit earnings growth ahead

Asian equities have been under acute pressure in 2021 due to China's growth deceleration, increased regulation for technology stocks and the fate of a large (troubled) property developer in China. However, we expect Chinese growth to stabilize in 2022 and the economy to grow by 6.1%, as monetary and fiscal policies become less restrictive.

Simultaneously, the worst impact of the regulatory crackdown on technology stocks appears to be over, reducing a key risk for the market. Prospects of a recovery in China and still healthy growth in developed markets bode well for regional earnings, which should grow by double digits in 2022. With the containment of COVID-19, South East Asian economies should also experience a meaningful economic and earnings recovery.

Finally, the shortage of semiconductors should continue to support growth momentum for the technology hardware sector. In conclusion, given expectations of an improvement in the underlying fundamentals, we believe Asian equities are poised to deliver attractive returns in 2022.



Latin America

Ready to turn the corner

After a weak performance in 2021, we expect Latin America (Latam) equities to deliver attractive absolute returns in 2022, accompanied by additional volatility amid heightened political noise. Latam equities are expected to benefit from strong global economic growth and a favorable composition toward cyclical sectors such as financials and materials, which together represent over 45% of the weighting in the MSCI EM Latin America.

As central banks across the region continue to tighten rates, financials are the prime beneficiaries of rising rates and yields while higher commodity prices also bode well for the region's growth prospects. A high dividend yield of around 5% is also supportive for total returns of Latam equities.

However, with seven countries in Latam heading to the polls, including Brazil, we expect that political and regulatory developments will likely remain key risks for the region.



Eastern Europe, Middle East and Africa

Financials, energy should bolster equity returns

After a stellar performance in 2021, driven by the solid earnings recovery on the back of the reopening of the global economy, we continue to expect Eastern Europe, Middle East and Africa (EEMEA) equities to deliver attractive returns in 2022, albeit at a moderate pace.

We anticipate EEMEA earnings growth to normalize in 2022 as favorable base effects fade. However, we still expect high single-digit earnings growth, in line with the EM benchmark (MSCI Emerging Markets Index). Financials, the biggest sector (around 40% of the weighting in the MSCI EEMEA), are expected to be the prime beneficiary of rising rates and yields.

High energy prices would be another favorable factor for regional economies, especially the Middle East and Russia, improving their fiscal picture and finances. As such, we expect EEMEA equities to remain attractive in 2022 and deliver absolute returns in line with EM equities.

Tapering – A speed bump or brake for the equity bull market?

Tapering refers to a reduction in asset purchases by a central bank. Tapering occurs when central bank economic stimulus policies begin to wind down. It is not a balance sheet reduction as central banks will continue to provide stimulus to the economy but at a slower pace. As markets grow used to this support, impending tapering announcements can lead to market downturns, referred to as “taper tantrums.” The Fed announced a tapering of its asset purchases at its November 2021 meeting. US asset purchases increased the size of the Fed’s balance sheet to 37.5% of GDP from 19.2% of GDP in February 2020. In contrast, the same ratio increased to 69.2% from 39.2% in the Eurozone and to 132.8% from 104.7% in Japan. This excess liquidity coupled with low interest rates initially helped to calm equity markets following the COVID-induced shocks, and later fueled the strong rally in stocks.

The 2013 taper tantrum

On 22 May 2013, then Fed chair Ben Bernanke announced the tapering of the Fed’s asset purchase program, which led to an immediate spike in bond yields and a drop in equities. This change was limited to the reduction in the pace of asset purchases – the paring of the balance sheet only started in 2015. One month after the May 2013 announcement, developed market and emerging market equities were down by -7% and -10%, respectively.

Over the next 12 months, global equities recovered with a return of 13%, with the USA and Eurozone driving the positive performance. In another instance of monetary tightening, the Fed began to reduce its balance sheet in 2018, which at the time stood at USD 4.5 trillion. For the next 20 consecutive months, the Fed reduced the size of assets on its balance sheet by around USD 700 billion, with an average reduction of about USD 35 billion a month. Global equities declined by -4% over the following 12 months (from the end of January 2018), with the Eurozone, Japan and emerging markets the key laggards.

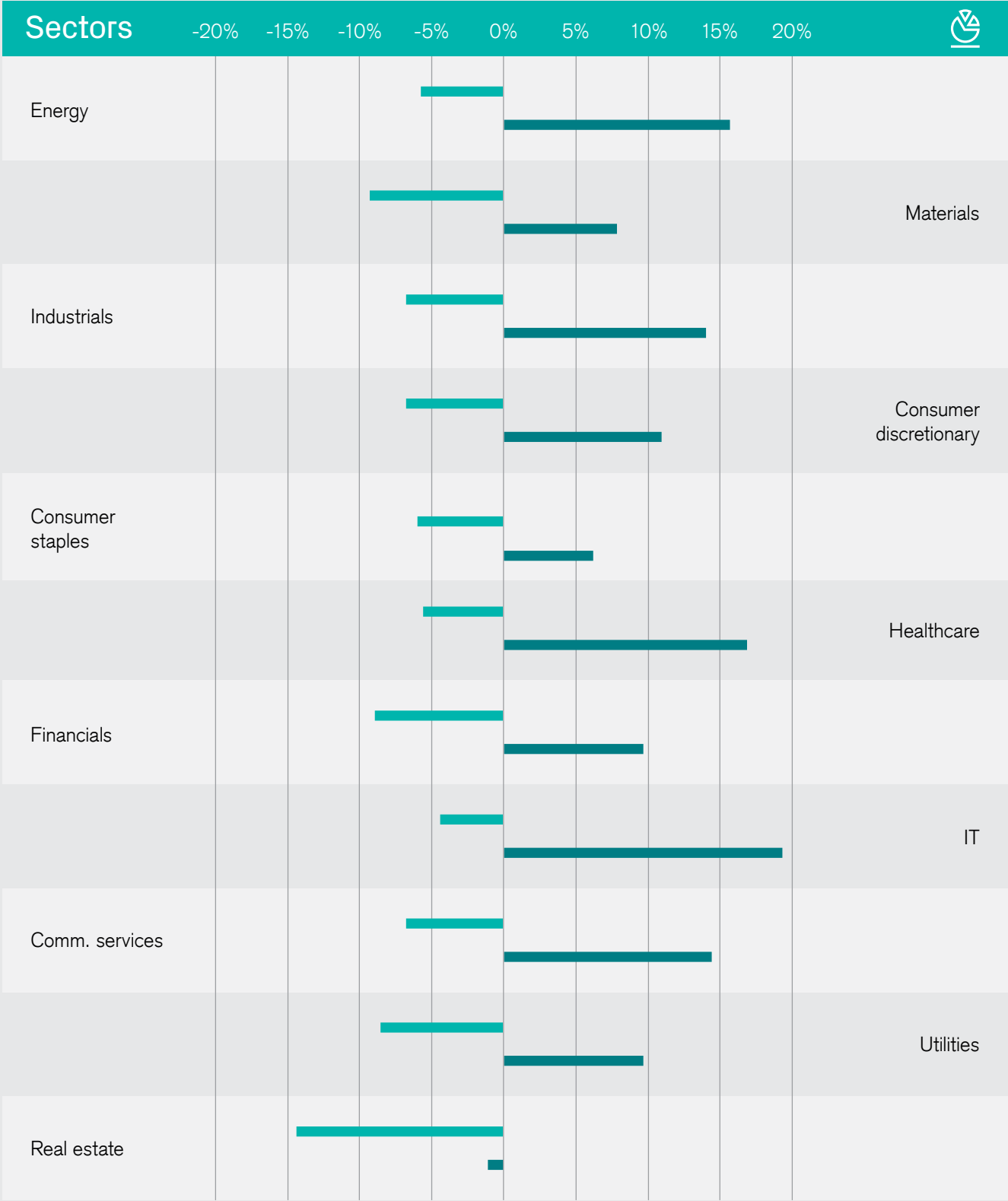
What could be different this time?

We think the fundamentals are somewhat better this time around to absorb any tapering shock. The real yield this time around is even lower at -0.86% vs. -0.25% back in 2013. Lower yields have driven up valuation multiples: the 12-month forward P/E is now much higher than in 2013, while the forward earnings growth rate is higher. Labor conditions are also better, with the current US unemployment rate at 4.6% vs. 7.5% in 2013. Moreover, in the past four Fed rate-hiking cycles, global equity markets corrected but then recovered with a slightly positive return over a one-year period. In our view, an equity correction due to tapering could provide a buying opportunity for investors.

“ An equity correction due to tapering could provide a buying opportunity for investors.

What tapering could hold in store for equity investors in 2022

Performance of sectors after 2013 tapering announcement



1 M
12 M

2013 tapering is as of 22/05/2013,
as per the Fed announcement date.

Last data point 27/09/2021
Source Bloomberg, Refinitiv, Credit Suisse

USD supported by rate advantage

Going into 2022, the currencies that are expected to be in favor are those that can benefit from their central banks' gradual move toward normalization. This transition phase may also prove supportive for more cyclical currencies, such as commodity currencies.

USD could strengthen against CHF/JPY

The USD will see its fortunes predominantly determined by the US Federal Reserve's policy normalization path relative to other economies, and the ongoing economic recovery at the global and regional level. Currencies with low yields and subdued inflationary paths might face headwinds going into 2022. From this perspective, both the JPY and the CHF might be vulnerable to declines in 2022. Regarding the CHF, the Swiss National Bank (SNB) is likely to maintain its active FX policy in which it intervenes in the FX market to weaken the CHF if needed. This should keep a lid on the currency and prevent any sustained strengthening that would add disinflationary pressure to a persistently low domestic inflation environment.

EUR initially weak in 2022

With the Fed out front in terms of the tapering (i.e. reduction) of asset purchases, the EUR might start 2022 rather softly vs. the USD. However, while the European Central Bank (ECB) has struck a cautious and patient tone with respect to policy normalization, inflation should accelerate further going into next year. This will potentially leave FX markets vulnerable to an earlier re-pricing of policy normalization. Economic fundamentals remain more solid within the Eurozone vs. the USA, in particular in terms of external balances and from a fiscal deficit perspective. Moreover, the prospect of European fiscal integration, supported by Germany's new governing coalition, could provide some added impetus for the EUR on a medium-term basis. A stabilization and recovery in the EUR could follow later in 2022. But this outcome depends on how long the Eurozone inflation surge lasts, as well as the ECB's ability to bring forward policy normalization relative to current market expectations.

More support for CAD, NOK, NZD

With several central banks entering policy normalization territory in 2022, rotating FX positions during the year may be important. For example, entering long currencies (i.e. those that are expected to go higher) when the central bank outlook becomes more supportive due to an improved economic outlook. Higher-beta (i.e. more cyclical) currencies, in particular commodity-related currencies, should do well within the G10 if, as we anticipate, fundamentals keep pace and local central bank support remains in place in early 2022. Commodity currencies have so far lagged commodity prices and the improvement in the related terms of trade (the ratio of export prices vs. import prices). As we move into 2022, however, it is more likely that both cyclical activity and policy normalization combine, so that currencies should re-correlate with an improvement in the terms of trade, providing support for the CAD, NOK and NZD specifically. In contrast, the AUD stands out as the higher-beta currency most at risk due to China's slowdown. In summary, we believe valuations and the FX impact on inflation, as well as financial conditions, should limit the extent to which currencies can rally in 2022.

TRY, BRL weak spots; RUB strong performer

The outlook for emerging market (EM) FX in 2022 is less supportive compared to 2021. Concerns about EM growth moderation related to COVID-19 have receded, as further lockdowns seem unlikely going forward given vaccination programs. However, China's growth outlook remains a key risk for next year.

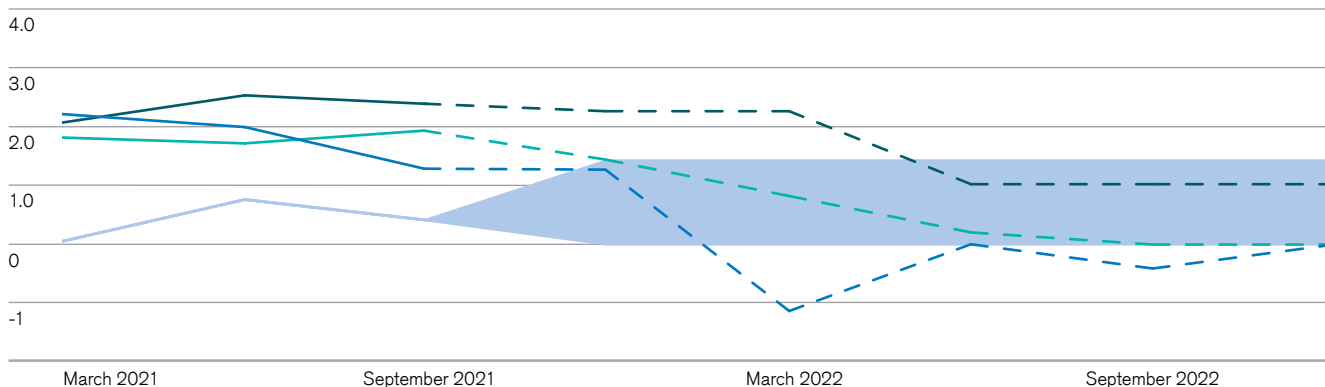
EM central banks have been proactive in dealing with rising inflation in 2021, and monetary policy has been a supportive buffer for EM FX in general. We expect that the hiking cycle will, however, slow in 2022 and come to an end in countries that have front-loaded monetary tightening (e.g. Mexico). While EM FX carry has risen, it has hovered around the historical average since 2010. Additionally, EM real rates will likely struggle to reach positive territory as inflation across EM continues to rise. In Latin America and Eastern Europe, Middle East and Africa (EEMEA), inflationary pressures remain. Support from a dovish Fed is also likely to diminish next year as we move closer toward US policy rate normalization. The relative carry advantage is thus unlikely to increase much further. In light of the shifting Fed stance, differentiation across currencies will remain key. Even though EM countries are generally in a better position now than they were in 2013 during the "taper tantrum," some fragile spots remain. Most EM countries eased fiscal policy to deal with the COVID-19 crisis, which has led to overall wider fiscal deficits and higher government debt across EM. In that regard, Brazil and Turkey stand out as the weakest spots. On the other hand, currencies with solid fundamentals and high carry should continue to benefit. Here we especially see the RUB as a strong performer within EM.

Stable or softer CNY

A fairly flat or weaker USD trajectory would be needed for Asian currencies to broadly remain stable or even strengthen against the USD. Aside from that, a significant regional issue will be China's growth outlook, with a key determinant being the government's ability to resolve the recent property sector stress, as well as the duration of the regulatory regime uncertainty. We think that the regulatory situation might start to stabilize in 2022, potentially leading to an improvement in portfolio flows in the second half of the year. Overall, the uncertainties mentioned above might weigh on China's economic growth so that the People's Bank of China (PBoC) might preemptively allow for a more stable or even softer CNY through the first half of 2022.

Central bank normalization paths will affect currencies in 2022

Financial asset purchases in % of annualized GDP



ECB
BoE
Fed
SNB*

* Assumption for the SNB: Foreign currency purchases between 0 and the average of the purchases estimated for the period between February 2015 and May 2016.

Last data point Q3 2021
Source Credit Suisse, Refinitiv Datastream

Exploiting structural trends in real estate

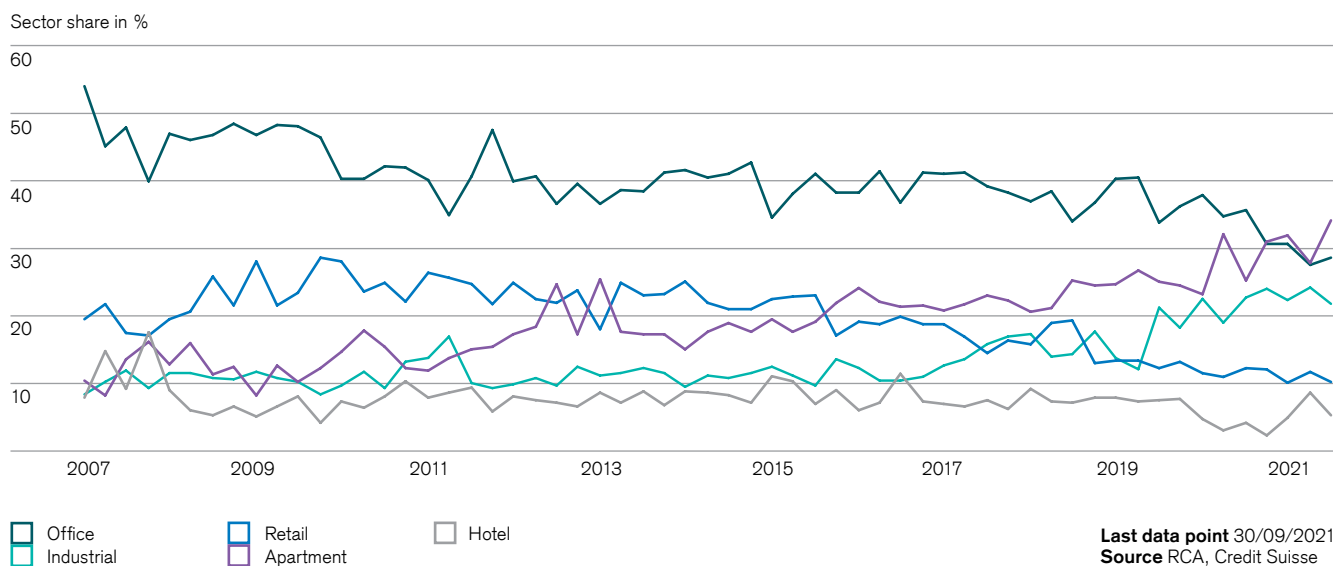
Historically low interest rates and the ongoing economic recovery should be supportive of real estate investments in 2022. That said, pandemic-driven structural shifts persist and we continue to favor sectors underpinned by secular growth drivers, such as logistics real estate.

With interest rates expected to rise modestly and the global economic recovery set to continue, the environment remains supportive for real estate investments. However, the pandemic has accelerated preexisting structural trends, and we believe that real estate markets will need to adjust further in 2022 in order to reflect changing consumer behavior and tenant needs. Accelerated growth in e-commerce, digitalization and working from home (WFH) should continue to benefit sectors such as logistics, data centers and communication towers, while further challenging

the outlook for office and retail space. Listed real estate companies are well positioned for the ongoing market shifts: more than half are exposed to the aforementioned factors and enjoy strong underlying growth (e.g. logistics) or sectors that service basic human needs and thus are less dependent on the business cycle (e.g. residential and self-storage). Overall, we expect listed real estate markets to deliver positive mid-single-digit returns in 2022.

Apartment and industrial assets increasingly sought-after

Global commercial real estate transactions, sector share as % of total volume



Listed real estate:**Favorable outlook for the USA and the UK**

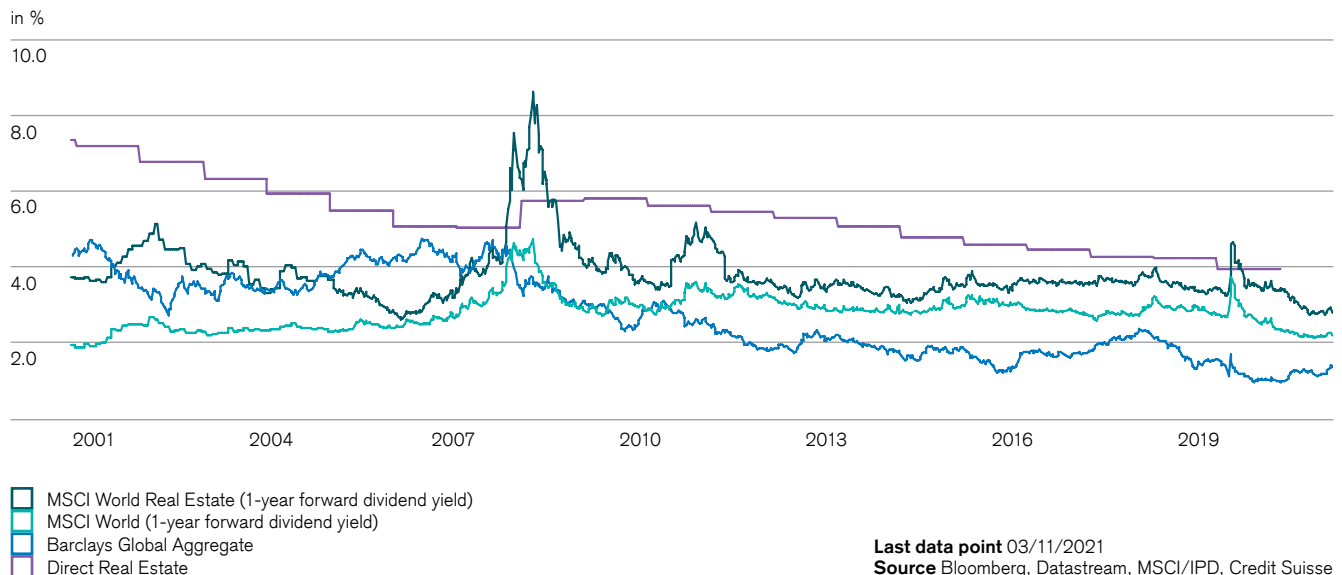
Within listed real estate, the outlook for the US market is favorable due to its higher exposure to sectors underpinned by strong structural growth. Similarly, UK listed real estate should benefit from its exposure to the logistics segment, which is the highest within the real estate benchmark. UK real estate companies should also be lifted by a strong recovery in the London office market, supported by moderate supply and improved investor sentiment as the Brexit uncertainty has dissipated. Although the German residential market (approx. 70% of Eurozone listed real estate) remains structurally undersupplied, potentially tighter regulation presents a headwind. Valuation of Swiss real estate funds is elevated, but the continued low rate environment and improving momentum in the Swiss rental apartment market are supportive.

Direct real estate: Logistics still favored

Investors have adjusted their preferences to the post-pandemic world with apartments overtaking offices, and industrials climbing to new highs in terms of investment volumes. Going forward, we expect property values in the retail sector to fall further due to the growing popularity of e-commerce. The projected economic recovery is generally supportive of the office sector, but continued WFH discussions will likely result in a reduction in demand for office space. However, we believe that such a reduction will be mostly concentrated in lower quality assets and we thus prefer good quality and centrally located investments. We also highlight environmental, social and governance (ESG) credentials, which are increasingly important for tenants and easier to achieve in newer property investments. The outlook remains favorable for logistics assets, as e-commerce continues to drive demand for warehouses and distribution centers, as well as residential assets, especially in regions with low supply and inventory levels.

Real estate continues to provide a relatively high yield

Yield in % across different asset classes



Last data point 03/11/2021

Source Bloomberg, Datastream, MSCI/IPD, Credit Suisse

Yield/income alternatives with hedge funds

As tailwinds for cyclical strategies abate, we prefer lower market-beta hedge fund strategies and yield alternative investments.

We expect modest returns next year that are close to the long-term average. Due diligence and manager selection are key.

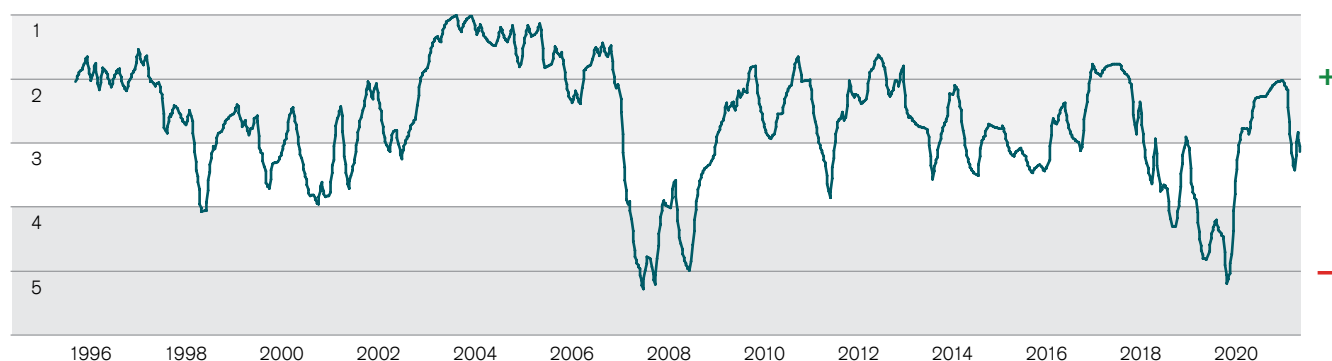
Positive on lower market-beta strategies

A positive economic backdrop, unprecedented levels of liquidity and regional price dispersion supported hedge fund (HF) performance (trailing 12-month ending Q3 2021), with cyclical strategies benefiting the most. The high single-digit performance was one of the best since the global financial crisis. While systemic risks remain moderate, our Trading Conditions Barometer indicates that tailwinds for cyclical strategies have abated.

We thus expect hedge fund returns to moderate to near mid-single digits. We also prefer strategies that are less sensitive to equity and credit beta, such as opportunistic long/short equity, diversified macro and corporate arbitrage. Managers of such strategies should benefit from higher volatility and cross-asset market movements arising from a potential rise in long-term yields and the US Federal Reserve's expected tapering.

Our Trading Conditions Barometer has turned neutral

Scorecard based on Purchasing Managers' Indices, liquidity conditions, volatility and systemic risks



□ Credit Suisse Trading Conditions Barometer*

* previously Credit Suisse Hedge Fund Barometer

- + 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 05/11/2021

Source Bloomberg, Datastream, Credit Suisse/IDC

Yield alternatives

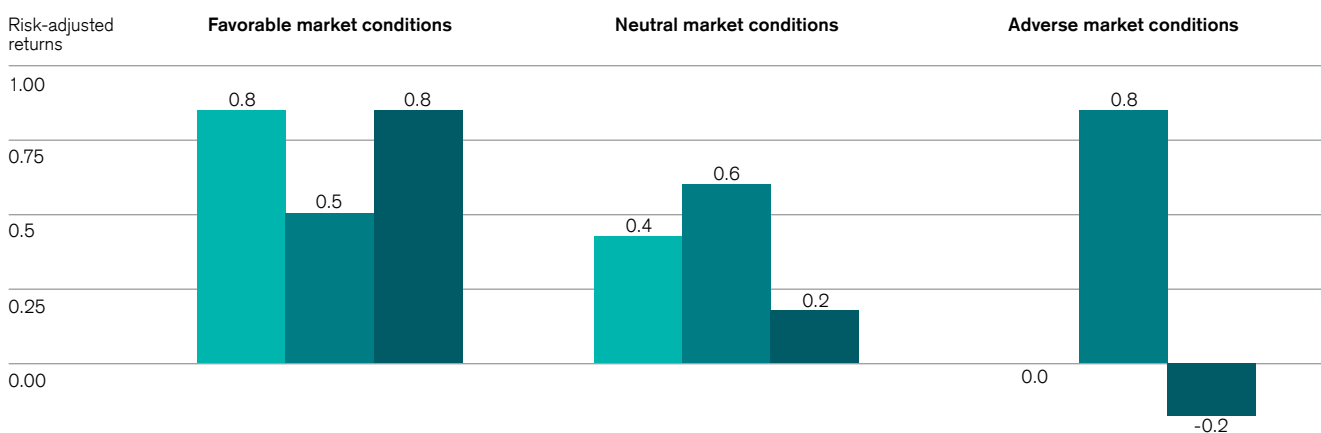
Going into 2022, we also see a supportive market backdrop for strategies that seek to generate income from alternative assets, such as private infrastructure, real estate and consumer loans. In our view, an increase in fiscal spending across most developed countries with a particular focus on reductions in their carbon footprint should lead to stable market conditions for related infrastructure assets. Additionally, strong household balance sheets, underpinned by an above-average savings rate and improving employment levels and wages, should lead to a stable backdrop for the private real estate and consumer loan sectors. Thus, private alternative asset strategies offer income-generating opportunities, in particular considering the still historically low levels of yields offered in public markets. But investors have to be mindful of issuer and sector concentration risks in private markets, which can be mitigated by investing in well-diversified fund solutions.

Due diligence and manager selection are key

HFs historically tended to outperform equities on a risk-adjusted basis when our Trading Conditions Barometer indicated a neutral regime. Active managers typically benefited from exploiting mispricing opportunities due to bouts of volatility typically associated with the neutral regime. HFs have also managed to limit their volatility to the near mid-single digits, helping to reduce overall portfolio volatility in a multi-asset context. Going forward, the investment environment looks more challenging than in 2021; we expect an increase in the performance differential between the best- and worst-performing managers. We thus continue to highlight the importance of investing with experienced managers, with thorough due diligence and fund selection processes in place.

Risk-adjusted returns* of hedge funds versus equities and bonds

Ratio (returns/volatility)



Hedge funds represented by Credit Suisse Hedge Fund Index; global equities by MSCI AC World Index; global bonds by Bloomberg Barclays Global Aggregate Index (unhedged)

■ Hedge funds
■ Global equities
■ Global bonds

* Next 6M median returns between 1997–2021 divided by volatility; market regimes defined by the Trading Conditions Barometer

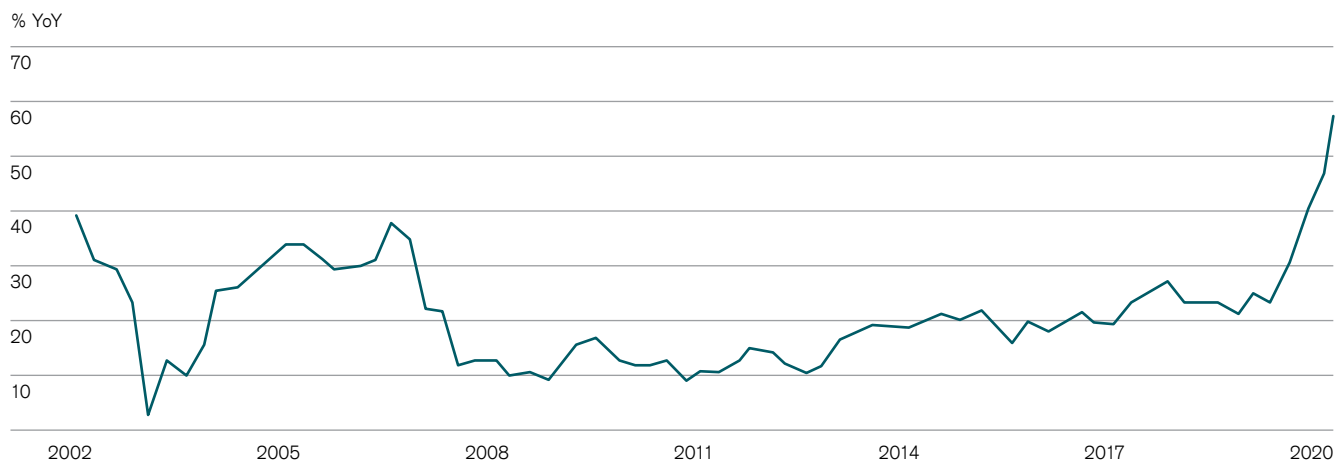
Last data point 31/10/2021
Source Credit Suisse, Bloomberg

Venture capital opportunities in finance, healthcare and education

The economic backdrop remains supportive for private markets, but investment conditions are more competitive going into 2022. While we expect private markets to deliver below long-term average returns, there are still opportunities underpinned by secular growth and market dislocations. Sound due diligence and portfolio approach are key factors for success.

Top funds are outperforming their peers by an increasing margin

The performance difference between top and bottom quartile funds



□ The difference between top and bottom quartile fund

Last data point 31/03/2021
Source Preqin, Credit Suisse

The backdrop is more challenging

The positive economic backdrop and relatively modest interest rate rises remain supportive for this asset class. But higher valuations and record levels of dry powder have created more challenging investment conditions, which are likely to persist going forward. Additionally, the COVID-19 pandemic has exacerbated the consolidation of the industry, with large funds becoming even bigger and challenging investment conditions for smaller and less established managers. We thus expect a large divergence between the top and bottom quartile funds to persist. In such an environment, we expect private markets to deliver high but below long-term average returns. Our projections reflect an average fund performance, but the historically larger gap of about 20% p.a. between the top- and bottom-performing funds underscores the importance of fund selection and due diligence.

Opportunities for strategies with limited leverage

In an environment where inflationary pressures and rising long-term benchmark yields pose a risk, we highlight strategies with high growth but limited leverage, such as venture capital (VC) and growth capital. The COVID-19 pandemic has accelerated a shift toward technology adoption, thereby creating an unprecedented pool of opportunities across a spectrum of sectors including finance, healthcare and education.

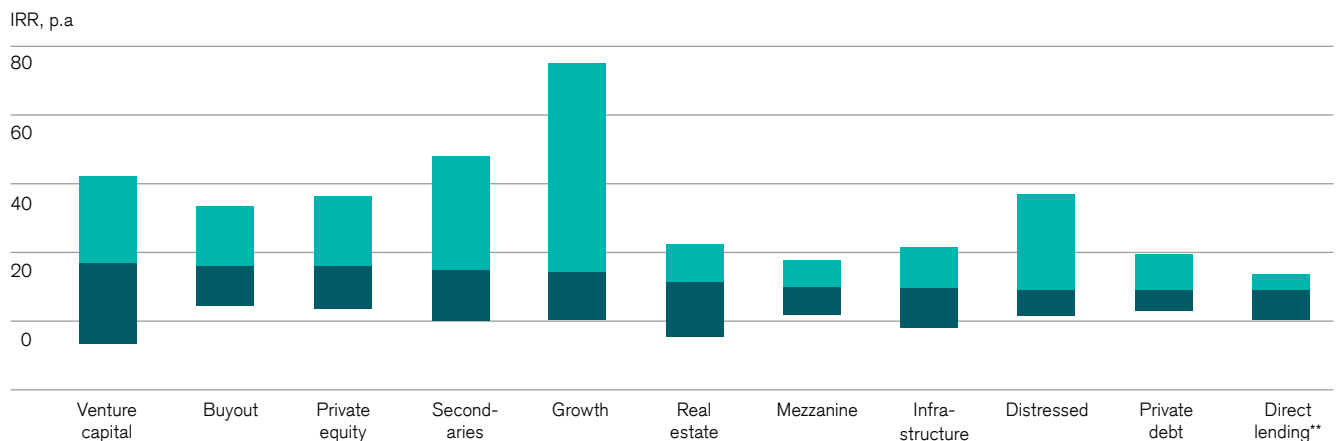
The fast pace of innovation, rapid decision-making and readily available capital make VC funds well positioned to exploit such long-term trends. We also highlight the rising importance of the life sciences sector, also supported by secular growth drivers such as aging societies and improving affordability in developing nations over the long term. Finally, secondary managers can help exploit market dislocations amid bouts of volatility in 2022.

Portfolio approach is key

Private markets cannot be timed but continuous allocation with experienced managers throughout the cycle forms the basis of a systematic construction of a resilient portfolio. The core portfolio returns (buyouts, core real assets, senior debt) can be enhanced by adding higher growth strategies (venture and growth capital) in order to capture an economic upswing, while market dislocation strategies (secondaries and distressed) should help limit the downside as the opportunity set for such funds emerges as a result of financial distress (either widespread or localized). Overall, a well-diversified private equity exposure is required for stabilizing cash flows in order to achieve steady excess returns over public equity. The importance of diversification, manager selection and due diligence should be at the forefront of the investment process after addressing individual client objectives and requirements.

Private markets offer very different return profiles, providing a good basis for a well-diversified exposure

Private markets dispersion of returns*, ranked by median return



Top quartile range
Bottom quartile range

* Annual net IRRs based on vintage years 2004–2018

** Data used 2008–2018

Last data point 31/12/2018
Source Preqin, Credit Suisse

Favor cyclicals in commodities

As we head into 2022, the demand environment for commodities is set to remain supportive given expectations for continued above-average global industrial production growth and restocking needs. That said, some moderation is likely.

Commodities performance has been very strong throughout 2021 amid continued pressure on physical commodity markets, as reopening demand overwhelmed supply and drove down inventories. As we head into 2022, the demand environment is set to remain supportive given expectations for continued above-average global industrial production growth and restocking needs. That said, some moderation is likely and the intensity of growth is set to ease when services instead of goods drive economic activity. Supply is also catching up in various segments, removing some pressure on physical markets. In this environment, return prospects should stay positive but spot contributions may be smaller.

Favor cyclicals vs. defensives

Robust growth and the prospect of gradually less supportive central bank policy should favor cyclical over defensive commodities. Gold could become more vulnerable if and when real yields shift upward, reinforcing our recommendation to look for downside protection – ideally into eventual price bounces. Among cyclicals, decarbonization efforts should lift medium-term demand prospects for base metals, even if we may see tactical swings and periods of surplus dynamics along the way. We expect oil prices to stay supported, as demand has further room to catch up but supply competition could increase as more non-OPEC volumes return. Hence, spot prices may moderate somewhat as 2022 progresses, with performance mostly driven by roll yields. Gas and power could remain a source of volatility, at least until we reach the end of winter. In carbon markets, we see scope for prices to consolidate following the massive gains of late, but the longer-term direction of travel should stay upward if policymakers were to not only step up climate ambitions but also move ahead with implementation.

Still a good inflation hedge

In a portfolio context, commodities exposure where investors have strategic allocations provides diversification and an effective hedge against inflation surprises. However, we would look for more active curve management as currently backwardated curves may no longer steepen but instead normalize to some extent. On the sector and individual market level, relative value considerations may become more relevant again, and we would look for yield-enhancing and/or volatility-selling opportunities.

Risk scenarios

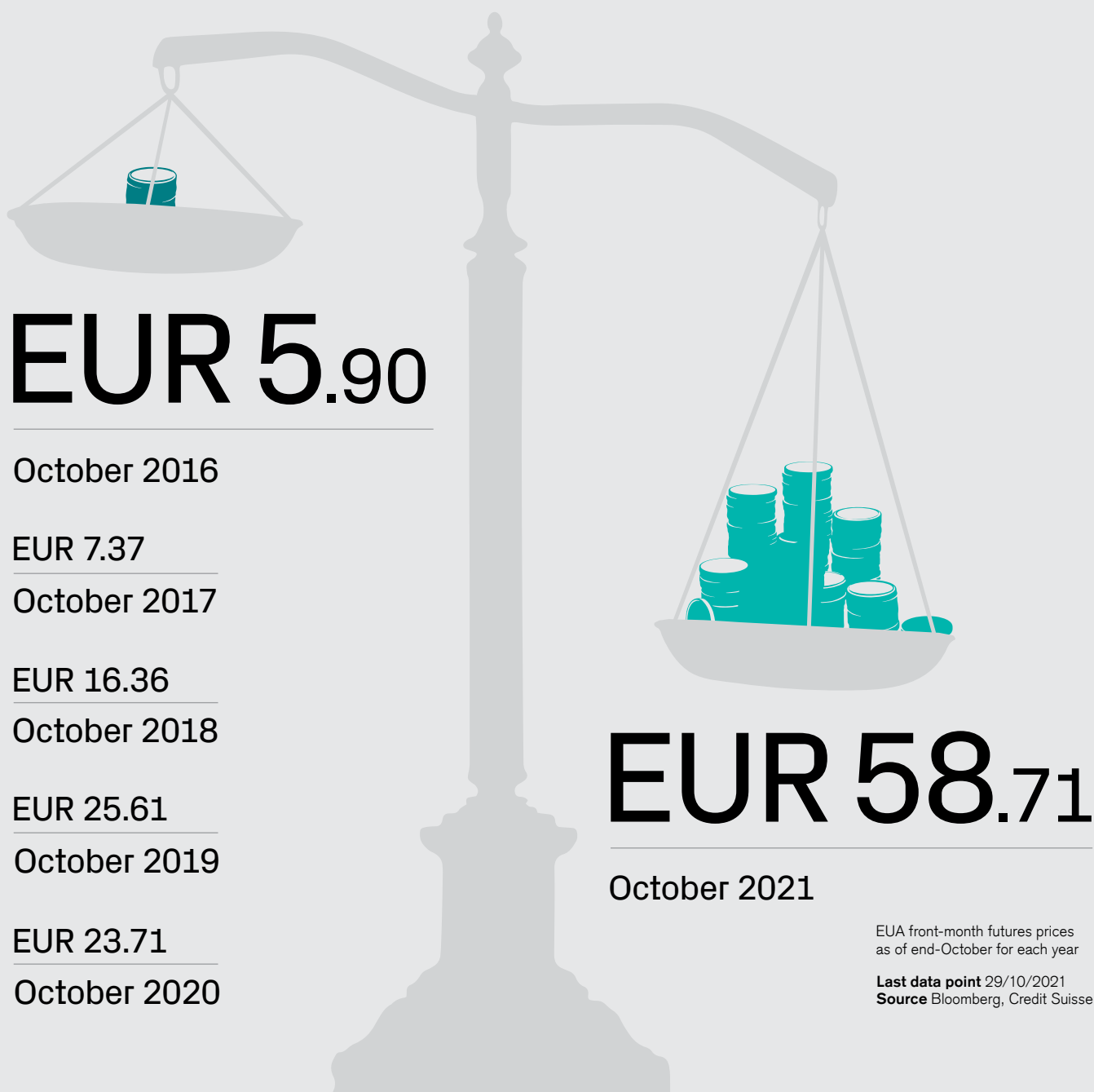
Risks and uncertainties are plentiful at any moment, but top of mind right now are increased tail risks in power markets, driven by tightness in gas that has spilled over into related segments. Current supply buffers are unusually low across regions, sparking fears of insufficient winter supply if there was a cold spell, prompting markets to price in a significant risk premium. Uncertainty is exceptionally high at the moment. Eventually, the situation should resolve itself, but the fear is that this may not happen before spring arrives. In any case, the energy transition is a big challenge (and opportunity) that may bring increased volatility, at least in the first phase. Cooling Chinese property markets, which are a major driver of raw materials demand, constitute a longer-term concern. That said, this risk might be offset by infrastructure investment and demand growth linked to decarbonization efforts.

Carbon prices and the climate

Carbon markets set prices for CO₂ emissions, and are considered a key tool in combating climate change. Various regional initiatives are expanding globally, while the European Union's Emissions Trading System (ETS) is the world's largest and most liquid cap-and-trade scheme. Policymakers hand out and auction emission allowances, which are freely tradable and reduced over time, to participating firms. Prices are determined by policy (supply side) and industrial activity, as well as by relative energy prices (demand side).

The equilibrium is set by the marginal abatement cost to reduce a ton of carbon. Rising prices incentivize efficiency gains among both producers and consumers. Investors also play an important role by providing liquidity, enhancing the effective risk transfer between market participants and helping fund research efforts. Carbon exposure is also increasingly relevant from an environmental, social and governance (ESG) perspective, as carbon offsets can be used to address the "E" aspect of investments.

The costs of 1 MT CO₂



Supertrends in the post-COVID era

Thematic funds are a rapidly expanding niche that has evolved in recent decades from targeted sector and sub-sector investments. The growing interest in thematic investments perhaps lies in the very nature of the disruptive times in which we live today: rapid technological advances, demographics and the climate change challenge are shaking up old business models and creating new ones. Traditional diversification along geographies or sectors may not fully capture this transformation. By diversifying through themes, investors can better capture the long-term trends that are ushering in change.

Our long-term investment themes, the Supertrends, cover six key societal developments that we are convinced will lead to business and investment opportunities. Four years after their initial launch, we have paired some of our Supertrends subthemes with the United Nations' 17 Sustainable Development Goals (SDGs). We believe that the global coronavirus pandemic has heightened the importance of the SDGs in that they can serve as a guiding principle for future economic activity and development, as well as government cooperation and international relations.

A recent acceleration in global efforts to fight climate change through sustainability-related infrastructure investments serves as a good example of how investment opportunities can be paired with the SDGs. It is important to note that this mapping should be viewed as a compass rather than a formal guideline, as there is no universally accepted definition of what constitutes an SDG-aligned investment.

Higher growth through lower emissions

Political leaders around the world are intensifying their sustainability focus and taking measures to achieve ambitious greenhouse gas (GHG) emission targets, with “net zero” being the new magic number. Our Climate change and Infrastructure Supertrends are well positioned to benefit from this political momentum and planned investments over the decades to come, in our view. The Climate change Supertrend focuses on the decarbonization of economic activity, a development that impacts life on land and below water and contributes to healthy communities. Beyond electricity generation, transport and energy transition, we believe that the food revolution will not only make us healthier but will substantially reduce CO₂ emissions worldwide. Meanwhile, the Infrastructure Supertrend’s core themes are energy and water (infrastructure), but also include the infrastructure required to facilitate the movement of people and goods through safe and efficient transportation. The subthemes in both of these trends are reflected in some of the UN SDGs, such as industry, innovation and infrastructure, decent work and economic growth and responsible consumption and production.

Finding a (better) social balance

The Anxious societies Supertrend addresses better equality of opportunities, with a focus on the affordability of essential human needs such as housing, education, healthcare and personal security, and the issue of decent employment amid changing labor markets. During the COVID-19 pandemic, popular frustration continued to center on domestic “pain points.” Job security due to economic challenges and changes, the rising cost of education, increasing healthcare expenses, as well as personal and public safety are among the top concerns – and priorities – for many individuals around the globe. We see interesting investment opportunities in companies that address these challenges and provide solutions to lowering the costs of basic services, in other words employers that have a solid score on the “social” aspect of environmental, social and governance (ESG) are also in focus. These topics touch on several UN SDGs, including decent work and economic growth, reduced inequalities and sustainable cities and communities.

Living healthier and longer

We expect both the elderly and the younger generations covered in our Silver economy and Millennials Supertrends, respectively, to continue to drive change ahead. The aging global population inevitably increases the need for medical solutions for health conditions associated with old age and the related healthcare costs and coverage, especially as this trend increasingly impacts emerging markets. In terms of the younger demographic, Millennials are pioneering a healthier kind of consumption. After shaking up shopping and advertising habits, we believe they will next disrupt the finance sector, a focus this year in our Digital natives subtheme. Sustainability and responsible consumption should continue to thrive thanks to the younger generation’s influence. These subthemes can be linked to several of the UN SDGs including good health and well-being, gender equality and decent work and economic growth.

Can’t touch this

Technology is at the heart of many advances toward the UN SDGs. Indeed, the subthemes in our Technology Supertrend are reflected in many of the SDGs, ranging from peace, justice and strong institutions to sustainable cities and communities. We believe that the next frontier will be the “touchless economy,” as the removal of physical interaction in human communication, life and work has accelerated dramatically during the COVID-19 pandemic. We expect that touchless user interfaces and interconnected multi-devices and applications will increasingly enable interaction via voice assistants, while biometric authentication functionality based on voice or image recognition could provide personalized services for users at work or at home.

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Investment strategy 2022

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Investment strategies for 2022

Central banks and their assessment of economic conditions will likely be front and center once again in shaping investment strategies in 2022. As COVID-19 moves from pandemic to endemic, an inflation threat has superseded the deflation worries that loomed in the early days of the crisis. Disrupted supply chains are one contributing factor, and they may remain challenged in coming quarters and keep upward pressure on consumer prices. Nevertheless, central banks will likely pursue a slow and gradual normalization of monetary policies, as they are of the view that the current spike in inflation should be transitory.

We expect the US Federal Reserve (Fed) to start hiking rates in late 2022, followed by four additional hikes in 2023. The Fed's introduction of a more symmetric inflation targeting approach and the acceptance of a temporary overshoot provide further support for a measured path to normalization, which could help to reduce the pressure from rising public debt burdens and ultimately contribute to the economic recovery.



“ Central banks and their assessment of economic conditions will likely be front and center once again.

The inflation factor

We forecast global inflation of 3.7% in 2022, with broad disparity across countries. This scenario implies that a higher-than-normal cash allocation within portfolios should be avoided, as purchasing power could fade quickly. The same applies in general to nominal assets such as bonds, where a fixed interest is paid and the invested amount is paid back at face value at maturity without adjusting for inflation. The outlook is brighter for those financial assets that behave positively with rising inflation (i.e. real assets). Take equities, where the price of a stock reflects future earnings expectations. Rising inflation stems from the fact that companies can raise prices for their products/services, boosting their profitability. Our global nominal gross domestic product (GDP) growth forecast (an estimate of real GDP plus inflation) of 8% in 2022 allows for plenty of revenue and earnings growth potential, helping to offset any inflationary pressure. Nonetheless, rising government bond yields will likely become a headwind for equity valuations eventually, especially if real yields turn higher and cross into positive territory again, though we do not think that this will occur in 2022. Equity sectors and segments that are aligned with strong structural growth drivers, including those identified in our Super-trends thematic framework, can help offset the impact of inflation.

Core bond returns limited

This normalization of monetary policies will kick off with a gradual reduction of fixed income asset purchases by central banks, which, together with the broadening economic recovery, should pave the way for interest rates to grind higher. Rising yields would negatively impact bond prices, and the current low income from bonds combined with tight credit spreads would offer little compensation. Our return expectations for government and corporate bonds is thus limited. Nevertheless, we believe that there should be an allocation to core bonds within multi-asset portfolios for risk mitigation purposes (i.e. bonds' shock absorbing qualities), though their actual return contribution may be minimal.

Stay diversified

When approaching portfolio risk management, the key is to seek out assets with return profiles that depend on different factors. These diversification effects can be further improved with investment strategies that follow non-traditional patterns. For example, there are hedge fund strategies that can go both long and short equities to expand their opportunity set. Finding investment strategies to compensate for low investment income from bonds is a difficult task. Dividend-focused equity strategies, with an emphasis on companies with sound balance sheets and strong cash flow production, or return-enhancing equity option strategies can be interesting alternatives, as are non-core bonds if widening spreads were to offer an opportunity. Real estate is another approach, as the ongoing economic recovery is supportive. Private equity also offers an opportunity to boost a portfolio's return profile amid ongoing market dislocations and the continuing economic recovery. However, private equity is only suitable for those investors who can tolerate greater illiquidity than with traditional investments.

Forecasts

We expect the global economy to grow by 4.3% in real terms in 2022. This is less than the 5.8% we expect for 2021 but higher than the growth rate before the pandemic. In equities, we expect high single-digit returns in 2022 compared to double-digit returns in 2021. Government bond yields will likely move higher on the back of economic growth momentum and policy normalization in 2022.

Forecasts for growth and inflation

Real GDP (y/y %)

	2020	2021E*	2022E*
Global	-3.4	5.8	4.3
United States	-3.4	5.5	3.8
Canada	-5.3	4.7	4.8
Eurozone	-6.5	5.3	4.2
Germany	-4.9	2.7	3.7
Italy	-8.9	6.5	4.5
France	-8.0	6.5	4.6
Spain	-10.8	6.9	5.8
United Kingdom	-9.7	7.0	5.0
Switzerland	-2.4	3.5	2.5
Japan	-4.7	2.0	1.7
Australia	-2.4	3.4	4.1
China	2.3	8.1	6.1
India (fiscal year)	-7.0	8.7	7.7
Brazil	-4.1	4.8	-0.5
Russia	-3.0	4.5	2.4

Inflation (annual avg. y/y %)

	2020	2021E*	2022E*
Global	1.9	3.5	3.7
United States	1.2	4.7	4.5
Canada	0.7	3.2	3.4
Eurozone	0.3	2.4	2.8
Germany	0.4	3.2	2.9
Italy	-0.1	2.1	2.7
France	0.5	2.2	2.7
Spain	-0.3	2.1	2.7
United Kingdom	0.9	2.3	3.7
Switzerland	-0.7	0.5	0.5
Japan	-0.1	-0.2	0.5
Australia	0.9	2.6	2.6
China	2.5	0.9	2.2
India (fiscal year)	6.6	5.3	5.2
Brazil	3.2	8.2	8.1
Russia	3.4	6.6	5.6

* E: estimate

Last data point 15/11/2021

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*	2021 YTD performance on 15 November 2021	2022 expected total returns	Credit	2021 YTD performance on 15 November 2021	2022 expected total returns
US equities	25.5%	6.7%	Global investment grade bonds**	-1.11%	0.70%
EMU equities	24.9%	7.2%	Global high yield bonds**	3.44%	1.10%
Swiss equities	21.1%	6.3%	Emerging market HC bonds***	-1.40%	1.20%
UK equities	18.5%	7.7%			
Japanese equities	16.5%	6.9%			
Emerging market equities	3.7%	7.3%			
Bond yields	Close on 15 November 2021	End-2022 forecast	Currencies & commodities	Close on 15 November 2021	End-2022 forecast
10-year US Treasury yield	1.60%	2.00%	EUR/USD	1.13	1.17
10-year German Bund yield	-0.25%	0.10%	USD/CHF	0.93	0.94
10-year Swiss Eidgenossen yield	-0.14%	0.10%	EUR/CHF	1.05	1.10
			USD/JPY	114.5	116
			GBP/USD	1.34	1.40
			USD/CNY	6.39	6.38
			Gold (USD/oz)	1862	1600
			WTI (USD/bbl)	80	70

* Performance and expected returns are total return including dividends. Markets refer to MSCI country / regional indices in local currency. Performance of the periods. 12/11/2016 – 12/11/2021 for those indices in chronological order are: MSCI USA: 21.8%, 7.4%, 15.9%, 18.5%, 34.7%. MSCI EMU: 24.2%, -6.9%, 17.1%, -4.0%, 30.1%. MSCI Switzerland: 20.5%, 1.9%, 19.1%, 4.0%, 23.5%. MSCI UK: 14.5%, -1.0%, 8.6%, -12.5%, 20.7%. MSCI Japan: 31.6%, -4.6%, 6.1%, 4.3%, 22.2%. MSCI EM: 32.3%, -8.6%, 12.8%, 16.0%, 11.8%.

** Barclays Global Investment Grade Corporate and Global High Yield index

*** JP Morgan EMBIG Div. (sovereign index)

Last data point 15/11/2021

Source Bloomberg, Datastream, Credit Suisse

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