CREDIT SUISSE

Investment Outlook 2017

Conflicts of Generations

Investment Outlook 2017

Tidjane Thiam, CEO Credit Suisse Group AG

From my perspective

It is my pleasure to present to you the 2017 edition of our Investment Outlook. Every year, this publication synthesizes some of our bank's best investment-related analysis.

Many of our clients are telling us that they feel it is becoming increasingly difficult to make well-founded investment decisions, in spite of the abundance and ever-increasing accessibility of information. A clear reason for this is that one traditional source of investment returns, the yield on bonds, has become extremely scarce. A possibly more profound reason is that the forces influencing our economic, social, political and ecological realities are becoming increasingly complex, polarized and potentially disruptive.

A number of these issues are addressed in our 2017 Outlook under the headline "Conflicts of Generations." In 2016, we once again witnessed bouts of militant extremism and shifts in the political landscape which seem to reverse a multi-decade trend toward increased political and economic integration and liberalization. Meanwhile, financial stresses on governments and corporations continue to mount. The challenge of funding rising pension liabilities for an aging population amid historically low interest rates is one such stress. In addition, rapid technological advances are changing the way we live and work, producing winners as well as losers.

The application of technology-driven innovations such as big data and robotics to healthcare, communication, finance and many other areas presents us with enormous opportunities to enhance productivity, to generate investment returns and to ultimately raise incomes and improve wellbeing. Identifying such opportunities is a key task for our bank's expert community. The history of Credit Suisse is one of providing financial expertise and funding to entrepreneurs, one of actively promoting and supporting innovation, transformational change and economic development. This began for us with the financing and development of Switzerland's rail transportation system 150 years ago, a key driver of the country's subsequent economic success. We are determined to continue along that path.

I hope you find this report insightful and useful when thinking about your investment strategy for 2017 and beyond.

I wish you a successful and prosperous year.

Tidjane Thiam

“The history of Credit Suisse is one of providing financial expertise and funding to entrepreneurs, one of actively promoting and supporting innovation, transformational change and economic development.”

Tidjane Thiam

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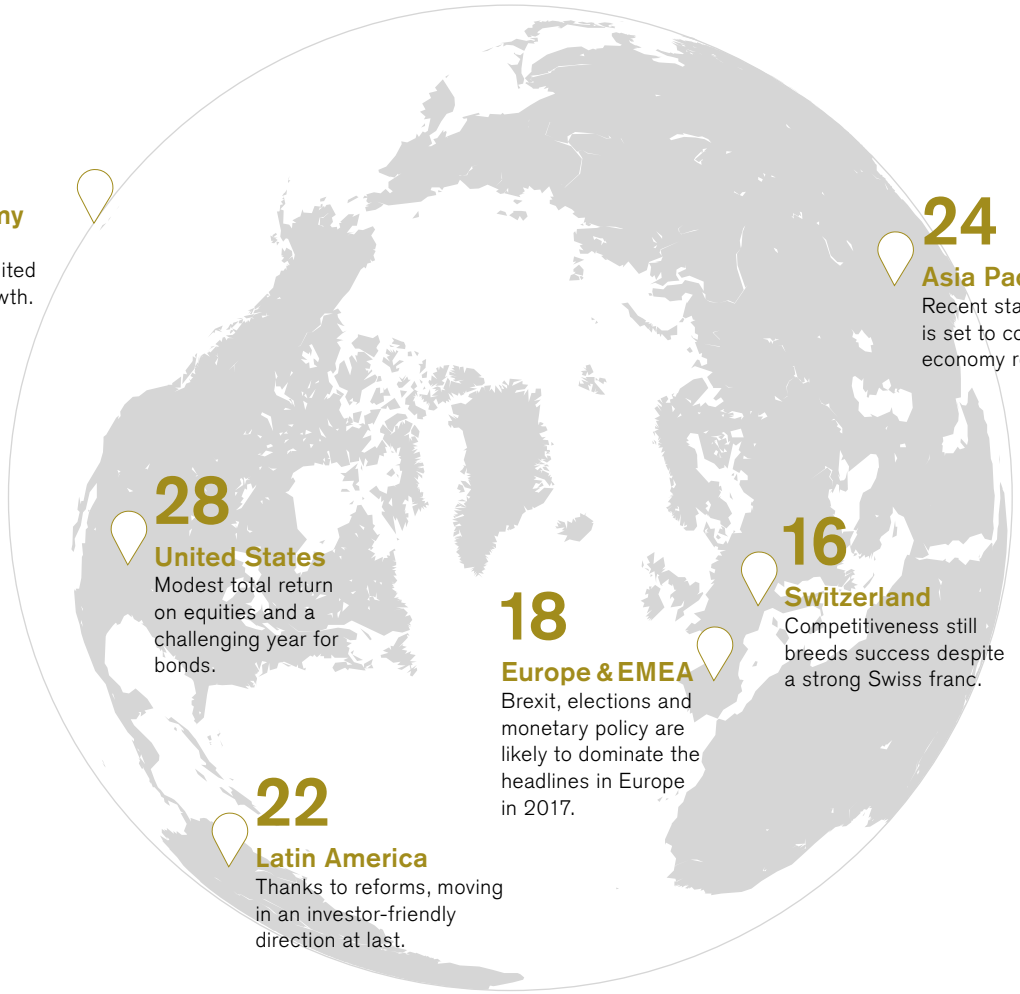
Global and Regional Outlook

The investment environment in 2016 was mixed, characterized by uneven global growth and political events such as Brexit and the US elections. The gradual repair of the global economy and greater political clarity in the USA should allow investors to seize opportunities in 2017.



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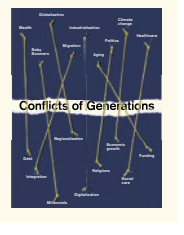
Conflicts of Generations

Globalization, technology, migration and inequalities are increasingly polarizing and creating the potential for disruptions as well as politically-driven change for the better or worse. Increased attention will likely be paid to how the associated risks can be managed and how investors can contribute to de-escalating these issues.



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Summary of the conference "Conflicts of Generations," held in Zurich, Switzerland, in September 2016.

More information
For more information, please visit credit-suisse.com/investmentoutlook

Michael Strobaek, Global Chief Investment Officer

Why perspective matters

Individuals alone do not generally trigger macroeconomic trends, policies or financial market reactions. Thus when creating an economic and financial outlook, economists and financial experts typically work in a detached, methodical and theoretical manner, looking at things in aggregate and ignoring the details of individual human actions and emotions.

Increasing collective power of individual human actions

In most years, such an approach appears warranted. But for 2017, the general context seems to demand more attention to what drives individuals to join political movements, to not only vote but actually contribute to setting or resetting policies in a way that can be positive or negative for the economy and financial markets. For example, it is noteworthy that the populist movements and governments in Latin America that emerged from the hardships of the emerging market crisis of the 1990s are now on their way out. New governments, more reformist and emancipated from any particular doctrine, have come to power, and with the support of democratic majorities are bringing back collective trust in private sector entrepreneurship at the heart of their economies and societies. At the same time, in many developed economies, the adversities resulting from the financial and European debt crisis, exacerbated more recently by the challenges of mass migration from countries at war, are seeing democratically backed populist forces gaining ground where the establishment has failed to take the necessary action to respond to people's daily problems and frustrations.

Polarizations and conflicts at the heart of the debate

Considering this backdrop, it is important to recognize and articulate the issues at stake and identify the risks and opportunities they entail. In a recent internal investment conference on the topic of "Conflicts of Generations," we reflected upon today's polarizations and conflicts that could end a multigenerational socioeconomic period of peace. In the insert to this Investment Outlook, we present key takeaways and conclusions of the conference, which featured Credit Suisse investment professionals and thought-leaders. We assess how these conflicts affect our thinking about the key trends, opportunities and risks in 2017. Our Investment Outlook and the investment ideas we present draw heavily from our conclusions. Investors, like citizens in their everyday life, exert influence with their investment decisions and thus express trust – or lack thereof – in companies, sectors and sovereigns. We thus believe that investors have an important role to play in contributing to solutions, and so do we as a bank, with the support we provide and with our expertise, services and products. For example, a number of our high conviction investment themes for 2017 can contribute to solving the yield challenge faced by many long-term institutional and private investors, while at the same time focusing on sectors that are powerful productivity enhancers and job creators.

An assertive outlook

Much of what we present here is the fruit of the thought leadership we combine in our expert teams. We hope that you, our esteemed client, will find our work interesting and relevant and will enjoy reading our thoughts. ■

“Investors, like citizens in their everyday life, exert influence with their investment decisions and thus express trust – or lack thereof – in companies, sectors and sovereigns.”

Michael Strobaek

Review 2016
Political fractures – resilient markets

11 February 2016

European financial stocks under selling pressure

General uncertainty over the health of the leading European banks and Italian banks' non-performing loans take a toll on financial equities.

7 January 2016

Shortest trading day in China

On 7 January, the Shanghai Composite Index experienced its shortest trading day in history by closing down 7% just 30 minutes after the market opened.

11 February 2016

Oil hits multi-year low

Fears over a lack of storage capacity caused US crude futures to plummet to USD 26.21 per barrel before the markets started to rebalance and prices began to recover. Energy-related high yield bonds were heavily affected.

2.2%

16 March 2016

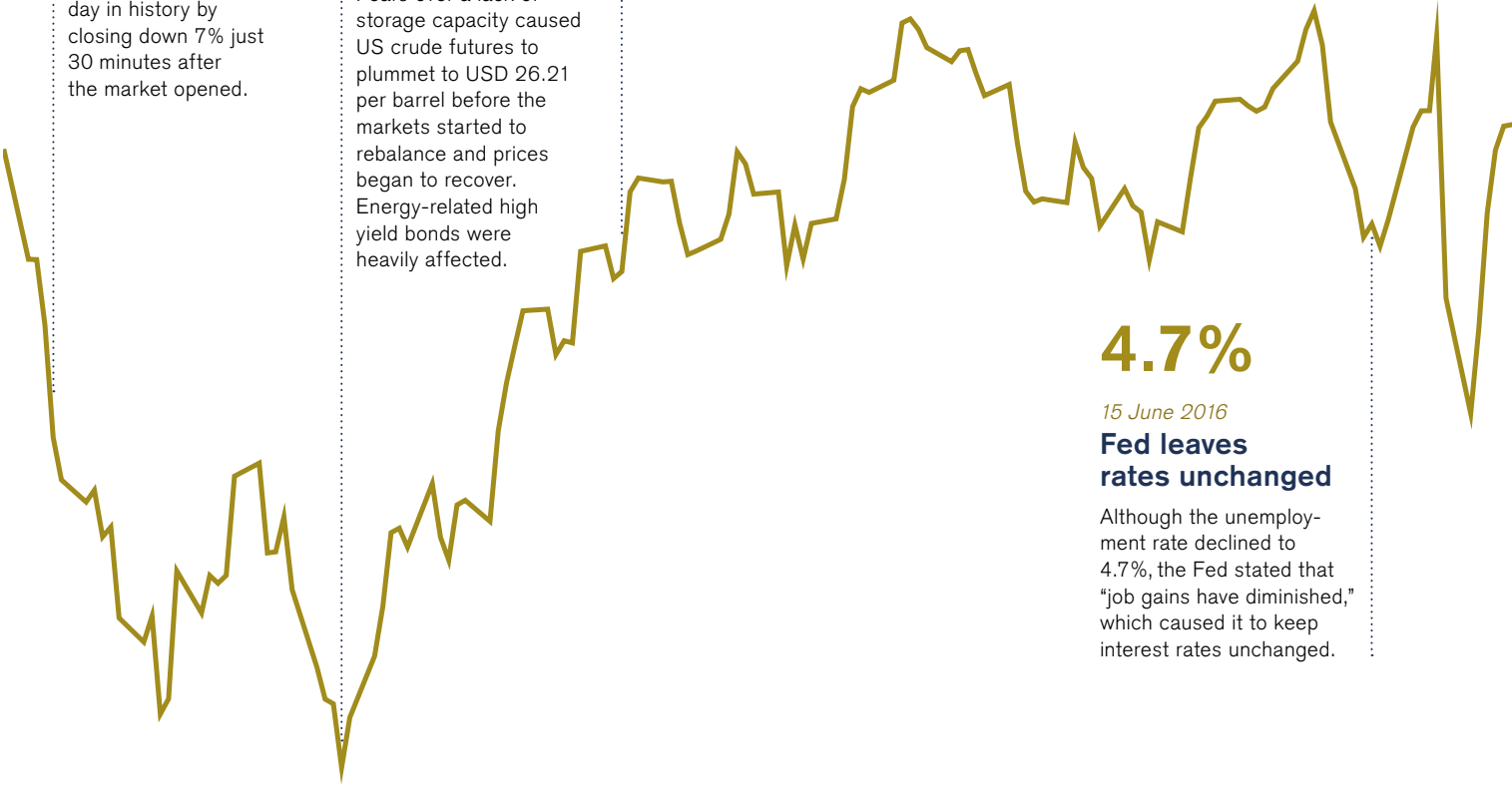
Fed leaves rates unchanged

The US Federal Reserve (Fed) cut its GDP growth outlook for 2016 from 2.4% to 2.2% due to risks related to global and financial developments.

23 June 2016

Brexit

The UK voted to leave the EU by a 51.9% vote on a turnout of 72.2% (33.6 million votes). GBP/USD dropped 8% on the day of the referendum and lost over 13% since the start of the year.



4.7%

15 June 2016

Fed leaves rates unchanged

Although the unemployment rate declined to 4.7%, the Fed stated that "job gains have diminished," which caused it to keep interest rates unchanged.

6 July 2016

Release of Nintendo Pokémon Go

From 6 July to 19 July, Nintendo's share price increased by almost 121%. Tweets averaged 200K per day since the launch of Pokémon Go, and the game had 11 million paying users.

14 July 2016

Terror attack in Nice

On France's National Day, a cargo truck killed 84 people at the Promenade des Anglais while driving through the crowds during a fireworks display.

15 July 2016

Attempted coup in Turkey

A military faction in Turkey tried to stage a coup to overthrow President Recep Tayyip Erdoğan's government. The MSCI Turkey Total Return Index dropped almost 7% when the markets opened the following Monday, 18 July.

31 August 2016

Presidential change in Brazil

Michel Temer took office after the impeachment of the first female president of Brazil, Dilma Rousseff. The MSCI Brazil Total Return Local Index increased 32.5% from January to 31 August.

18 September 2016

"Alternative für Deutschland" (AfD) gains record support

After stoking voters' fears about 1 million migrants who entered Germany in 2015, AfD gained support in 10 of 16 German state parliaments.

2%

21 September 2016

Fed leaves rates unchanged

Although the Fed expressed confidence in the growth of the economy, business fixed investment remained soft and inflation had still not risen to the Fed's 2% target.

7 October 2016

Pound falls 6% in 2 minutes

An automated algorithm malfunction was among the possible causes of a sudden fall.

8 November 2016

US elections

Donald Trump is elected 45th president of the USA. Global stock futures slide 4%, but reverse most losses later in the day. The MXN plunges over 10% before stabilizing.

MSCI AC World (index)

“While inflation is likely to pick up, not least due to commodity price stabilization, the weak evolution of demand suggests it is very unlikely to reach threatening levels.”

Oliver Adler

Oliver Adler, Head of Economic Research

Growth still low, but fairly resilient

Global growth should improve somewhat in 2017 but remain well below pre-crisis levels. The differentials between countries are likely to stay pronounced, not least as high debt limits the leeway for fiscal expansion in the weaker economies. Commodity price stabilization in 2016 suggests that inflation should edge up. With the inflation upturn more advanced, the US Federal Reserve is likely to raise rates further, albeit cautiously. Other central banks should maintain a more accommodative stance, but shift away from mechanical balance sheet expansion.

As in recent years, economic growth forecasts were too optimistic at the start of 2016 and had to be lowered. While the recovery in the Eurozone surprised to the upside, a weak start to the year in the USA and a persistent downturn in some emerging markets (EMs) kept growth well below pre-crisis levels. Our base case for 2017 calls for a slight acceleration of growth.

From headwinds to virtuous cycle in some EMs

On the positive side, we expect the downturn to give way to subdued growth in some EMs, e.g. Brazil, as recent headwinds partly abate. Commodity prices are expected to continue their recovery as excess supply is reduced. With EM current accounts generally improved and currencies no longer overvalued, vulnerability to a rise in US interest rates has also been reduced. As stable currencies lead to further declines in inflation, monetary policy in some hard-hit EMs should loosen, which should support a gradual domestic recovery. Moreover, with reform-minded governments having been elected in some Latin American countries, structural reforms should boost confidence and growth. Still, a return to the pre-crisis EM boom seems unlikely given slower growth in China, a significant private sector debt overhang and pressures to rein in fiscal deficits.

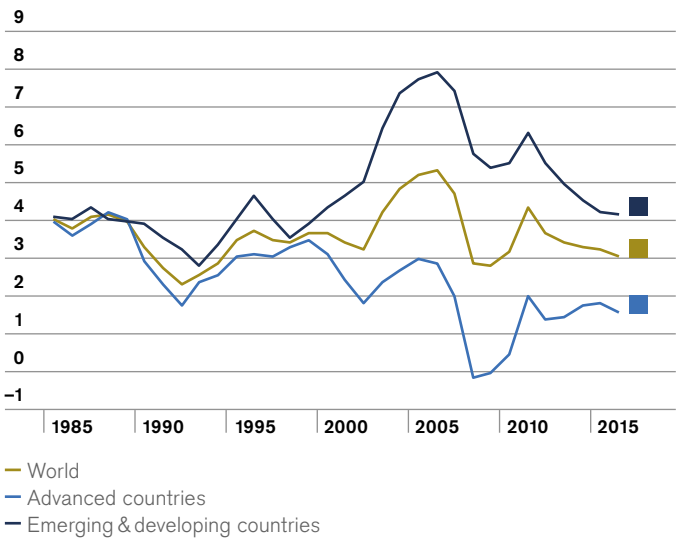
More balanced US growth

Meanwhile, we believe that US economic growth will remain reasonably robust in 2017 – we foresee real GDP growth of about 2%, after 1.5% in 2016. Steady gains in employment and wages in recent years and low interest rates should continue to support consumer spending and housing, in particular. Positive consumer demand and higher commodity prices should also boost corporate investment. Finally, mild fiscal stimulus is likely in the course of the year, in the form of infrastructure spending. That said, employment growth may well abate as companies' labor requirements are satisfied and slack in the labor markets is reduced. Real wage gains are likely to slow as inflation creeps up.

Continued expansion in the Eurozone

We are fairly confident that economic expansion in Europe will continue in 2017, absent a further severe political shock. The monetary expansion of the past few years has produced continued declines in interest rates and moderate credit growth, which has boosted consumer spending and real estate markets. Exports have also recovered on the back of a fairly weak euro. Finally, fiscal austerity gave way to a modest fiscal boost, in part to provide support for refugees. As a result of >

Fig. 1 **Global growth to be marginally higher in 2017**
Real GDP growth (in %, PPP-weighted)
Source: International Monetary Fund, Credit Suisse. Last data point: 2017 (forecast)



Populist
The term "populist" was first used in the USA in the 1890s. Present-day populism is characterized by shifts both to the political left (e.g., Occupy Wall Street) and to the right, for example in the response to immigration.

Fig. 2 **Credit growth seems unsustainable in China**
Growth of total bank lending (in % YoY)
Source: Datastream, Credit Suisse. Last data point: September 2016

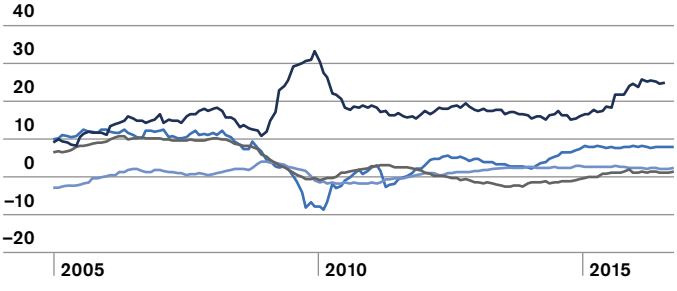
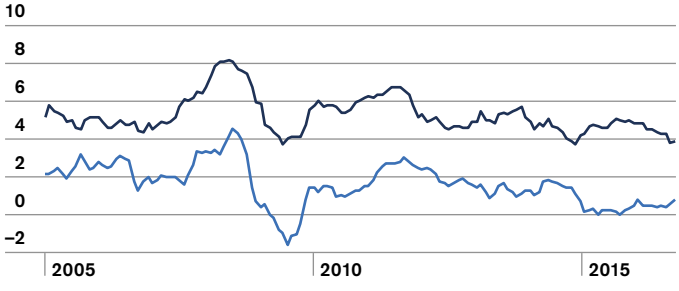


Fig. 4 **Inflation retreating in emerging markets**
Consumer prices excluding food and energy (in % YoY)
Source: Datastream, Credit Suisse. Last data point: September 2016



China, India, Indonesia, Korea, Brazil, Mexico, South Africa, Turkey, Russia

Fig. 3 **Fiscal impulse likely weak in 2017**
Change in cyclically adjusted primary balance (in % of potential GDP)
Source: IMF, Credit Suisse. Last data point: 2017 (forecast)

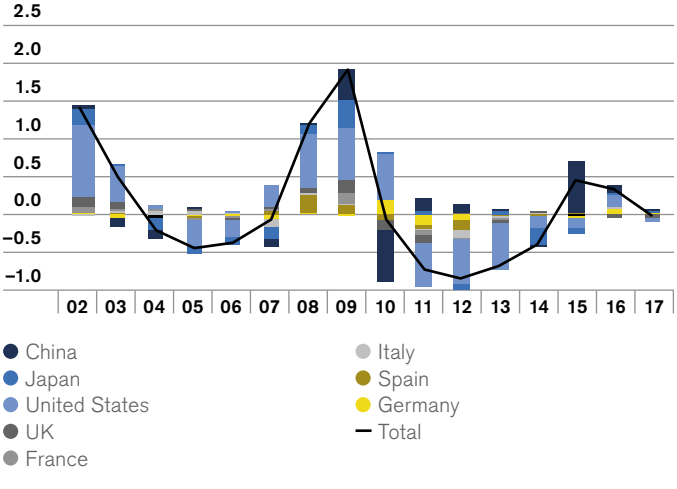
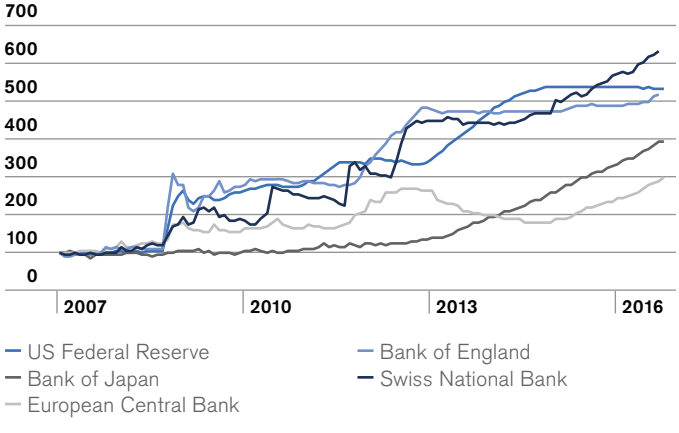


Fig. 5 **Central banks likely to dial back expansion**
Balance sheet size of selected central banks (Jan 2007 = 100)
Source: Datastream, Credit Suisse. Last data point: October 2016



Demographics
"Demographics are the single most important factor that nobody pays attention to, and when they do pay attention, they miss the point."
Peter Drucker

these impulses, employment has been rising steadily. Our base case calls for these trends to continue in 2017. With unemployment still high and governments facing populist pressures, fiscal policy will hardly tighten much even where deficit targets continue to be missed. Also, corporate investment is likely to remain subdued given the economic and political uncertainties, but a slight improvement seems likelier than a further retrenchment.

Renewed euro crisis fairly unlikely
The Brexit decision will, in our view, negatively affect longer-term investment and growth prospects in the UK. However, the sharp devaluation of sterling in the second half of 2016 partly protects UK growth while negatively affecting the Eurozone. The latter impact should be limited given that exports of goods and services to the UK constitute only about 3% of EU-27 GDP. Still, renewed jitters over Eurozone cohesion and bank stability cannot be ruled out, especially given looming elections. But a full-fledged banking-cum-sovereign crisis seems unlikely to us given better capitalized banks and the backstop provided by the European Central Bank.

China stimulus to stretch into 2017
Our forecast of continued global growth relies on stability in China and broader Asia – China together with Emerging Asia has recently contributed up to 40% to global growth. In this region, momentum also began to improve in the second half of 2016, and we expect it to continue into 2017. The key reason is that the Chinese government has significantly boosted infrastructure spending while relaxing monetary and credit conditions. Consequently, credit growth and real estate investment have accelerated sharply. Both trends look unsustainable to us in the longer term, but are likely to remain in place well into 2017. In India, growth should continue to be bolstered by reforms implemented in 2016, while imbalances in most other Asian economies are limited, suggesting that fairly high growth can be maintained.

Monetary policy in search of greater flexibility
With private sector momentum subdued in most advanced economies, in part due to structural factors, and government debt high, political support for fiscal expansion is likely to remain limited barring a more severe downturn. Hence, we believe that monetary policy will need to continue to provide significant support in 2017 and beyond. While inflation is likely to pick up, not least due to commodity price stabilization, the weak evolution of demand suggests it is very unlikely to reach threatening levels. A slight overshooting of inflation is quite possible in the USA, but we believe the Federal Reserve will remain fairly tolerant of this development. In most other advanced countries, policy should remain accommodative. Even so, central banks will increasingly move away from a mechanistic expansion of their balance sheets to limit balance sheet risks and political pressure. While greater flexibility in principle makes monetary policy more sustainable, the new regimes are quite likely to add to greater interest rate and overall financial market volatility. ■

Investor takeaways

- We expect global growth to improve in 2017, though any acceleration is likely to be limited. Due to stabilizing commodity prices and the advanced US business cycle, inflation should edge higher but not pose a threat.
- The Eurozone, the USA and Japan should see continued moderate economic growth. The longer-term growth outlook for the UK is clouded, as the looming Brexit is likely to depress investment.
- Improved current accounts should help stabilize currencies and reduce inflation in fragile emerging markets. China's credit surge is stabilizing growth but poses longer-term risks.

Message from Thomas Gottstein, CEO Credit Suisse (Switzerland) Ltd.

It is encouraging to see that the Swiss economy has recovered rather well from the Swiss franc shock of 15 January 2015 and managed to restore its leading competitive position. However, from my numerous conversations with entrepreneurs, I have learned that the developments of the past two years have left their mark on profit margins. Moreover, I notice that many firms are again discussing the attractiveness of Switzerland as a business location.

In my view, we must ensure that Switzerland continues to offer an attractive environment for companies and investors alike, and that we retain our locational advantages. I frequently travel around the various regions of Switzerland and am continually impressed by the capacity to innovate – particularly of the small and medium-sized enterprises, which provide two thirds of all the jobs in our country. We at Credit Suisse play our part in promoting innovation, not just in our capacity as a lender but also by supporting exciting start-up firms with initiatives such as the Kickstart Accelerator.

The situation remains challenging for investors as well. Interest rates remain very low and continue to pose problems for investors. We must assume that the Swiss National Bank will maintain its policy of negative interest rates in 2017. Consequently, it is not easy to strike the right balance between risk and return. I hope the information from our experts provides a comprehensive picture of our market expectations and therefore a solid basis for you to take your investment decisions. Moreover, our special report on the "conflicts of generations" will hopefully provide some food for thought about important issues of our time.

Credit Suisse (Switzerland) Ltd. recently began operating, with around 1.4 million Swiss clients having been transferred to the new legal entity. This independent bank within our Group was not created merely out of regulatory necessity. Rather, it is of vital importance for us to implement our strategic priorities. It also epitomizes our commitment to Switzerland as our home market. More than 160 years ago, visionary statesman and entrepreneur Alfred Escher established the then Schweizerische Kreditanstalt to finance Switzerland's rail network. This entrepreneurial spirit is deeply ingrained in our DNA – this is evident not just in conversations with clients who are themselves entrepreneurs, but also in our firm belief that each individual investor is an entrepreneur at heart. We intend to be equal partners to our clients and foster the trust they place in us. Our aim is to deliver global expertise at a local level.

Despite the challenges that the financial industry faces, our clients will remain our top priority. I firmly believe that technological advances will significantly change the way banks interact with clients. We are committed to making the necessary investments, paying particular attention to creating a more attractive client experience. I am equally convinced that personal contact between client and advisor will remain of fundamental importance going forward. Financial matters are personal and require a relationship that is built on trust. I strongly believe that the human touch will not go out of fashion any time soon. ■

Anja Hochberg, Chief Investment Officer Switzerland

A strong competitive position

The Swiss economy is set to continue its moderate growth path in 2017, despite a strong Swiss franc. The strong competitiveness of Swiss industry and the continued, albeit slow, global economic expansion should be supportive. Very low interest rates will remain the key challenge for domestic investors.

Despite the strong appreciation of the Swiss franc, Switzerland's economy avoided a recession in 2015 and growth accelerated in 2016. Robust domestic demand, including private consumption and the real estate sector, contributed to this benign development. Looking ahead, we continue to see domestic demand supporting growth. Yet its contribution is likely to be lower than in previous years, given that the labor market is peaking and much consumption-related demand has been met.

Swiss competitiveness provides basis for success

Alongside domestic demand and continued intervention by the Swiss National Bank (SNB) to minimize Swiss franc appreciation, the strong competitiveness of Swiss companies is a key success factor. In fact, Switzerland exported more in the first half of 2016 than ever before. While the greatest share came from the pharmaceutical industry, other, more price-sensitive sectors such as machinery and metals regained traction as well. However, some challenges remain.

Political decisions key to stabilizing business expectations

The expansion of Swiss industry cannot proceed smoothly unless global growth, and especially in the Eurozone, remains on track (as we expect) and currency fluctuations remain within reasonable bounds. Swiss industry must also retain access to high-quality labor. We believe that a "soft" implementation of the mass immigration initiative should ensure that this remains the case. Finally, we expect voters to vote in favor of the corporate tax reforms demanded by the Organisation for Economic Co-operation and Development, according to which Switzerland's corporate tax rate will remain among the most competitive internationally.

Swiss franc perspectives

As a result of the SNB's negative interest rates and currency market interventions, the Swiss franc could depreciate versus both the EUR and the USD. It is, however, still stronger than before the exchange-rate floor was eliminated. Our base case calls for a gradual depreciation of the Swiss franc in 2017, as global growth gains traction and demand for safe-haven assets diminishes. Swiss franc appreciation pressures could re-emerge if renewed stresses arise in the Eurozone or globally, or if the SNB and the markets conclude that the Swiss economy is strong enough to weather such appreciation.

The likelihood of continued Swiss franc strength suggests that the negative interest rate regime will persist throughout 2017 and probably beyond. Fixed income investors will thus need to seek higher-yielding alternatives such as bank and emerging market debt. Additional returns can be generated even if the currency risk is hedged. The Swiss equity market should remain supported by competitive strength and high dividends. ■

Investor takeaways

- Low (or even negative) interest rates are likely to remain in place for a prolonged period of time. Swiss fixed income investors will therefore need to continue to seek higher-yielding foreign currency alternatives.
- Thanks to their competitiveness and attractive dividends, Swiss large and small-cap companies offer good opportunities for equity investors. The defensive nature of the market is a plus in case of turbulence.
- A considerable portion of Swiss franc portfolios should, in our view, be diversified globally. However, in fixed income, currency risk should largely be hedged.

Message from Iqbal Khan, CEO International Wealth Management

International Wealth Management (IWM) is a key pillar of Credit Suisse's business portfolio and growth strategy. Our diversified business mix across Europe and the key emerging markets allows us to steadily grow alongside our clients, applying a focused use of capital and risk capacity. Yet the environment continues to present many challenges: As this publication outlines, global economic growth is likely to remain subdued, which suggests that investment returns will be limited, while political and other risks could generate instability in financial markets. In the face of these uncertainties, clients are, understandably, cautious in their investment activities. Despite these exogenous factors, we have demonstrated our ability to partner sustainably with our clients and deliver the added value that they have come to expect from us. Developing and maintaining deep and trusted relationships with our clients remains the key success factor for a leading wealth manager.

The quality of our interactions with our clients is at the very center of everything we do. It is our aspiration to deliver value to clients by covering the needs of individual investors and corporate clients, from both an investment management and a lending perspective. Our research and investment strategy, implemented in our mandates and advisory process, as well as our product analysis and design are key components of our ability to deliver Client Value. To ensure this delivery and enhance our proximity to clients, we have also added experienced relationship managers in a number of our target markets. We have opened new offices in the Netherlands and are looking to broaden our presence in Mexico and Saudi Arabia.

"The quality of our interactions with our clients is at the very center of everything we do."
Iqbal Khan

We are well on course to achieve our ambitious objectives. The strong inflow of net new assets in both Private Banking and Asset Management is a testimony to our clients' trust and satisfaction with our service. We have significantly outperformed key private banking peers in terms of revenue, profit and net new asset growth in the first half of 2016. We are pleased to see that we rank first in the Middle East in the Euromoney Magazine Survey 2016 for "Best Private Banking Service Overall" and are in the top three in our other core regions, i.e. Western Europe, Emerging Europe and Latin America.

I am proud of our achievements and enthusiastically look forward to the opportunities to build on these successes across our regions. I thank you for the trust you place in us and hope you will find the thought leadership in this publication of interest. ■

Michael O'Sullivan, Chief Investment Officer International Wealth Management

Will Brexit break Europe?

Europe is up against numerous challenges in 2017. First and foremost, the path to Brexit is likely both to dominate the headlines and take up a great deal of political energy. Furthermore, there are elections coming up in the key member states of France and Germany. An important consideration for the markets, meanwhile, is how and when the European Central Bank chooses to normalize its monetary policy. It promises to be an eventful year, also in the broader (EMEA) region.

The UK's vote for Brexit sent shockwaves through Europe and the world. Concerns about the ramifications of Britain's departure from the European Union (EU) and speculation about the terms of the exit have been rife ever since. What is certain even at this stage is that Brexit will visit economic and political uncertainty not just upon the UK itself but also its European neighbors.

After the political chaos that followed the "no" vote in June, the speedy government formation in the UK helped to calm nerves, with the Bank of England also lending support. Economic data in Q3 and Q4 were surprisingly good as well.

Full impact of Brexit still to be felt

However, we believe that general optimism is premature. Our sense is that the initial calm belied the fact that Brexit simply has not happened yet, partly because Downing Street has still to fully marshal its strategy for this difficult process. As we move through 2017, the uncertainty for the British economy is likely to be expressed through ongoing deferment of business investment and perhaps less optimistic consumer behavior. While fiscal policy could become more supportive, doubts may increase about whether the sharp drop in sterling will act as such a useful automatic stabilizer; higher inflation and financial market volatility may offset some of the positive effects.

Brexit will also have significant implications for the rest of Europe, the immediate one being a sense of political distraction as time and energy are devoted to the Brexit process. Given that UK Prime Minister May has promised to trigger Article 50 before the end of March 2017, "exit" will become an unavoidable election talking point in the run-up to the French and German elections.

Other countries better off out?

There is a view abroad that Brexit may tempt other countries to follow the example of the UK and leave. However, we are not convinced. In a very populistic sense, other European countries may well feel that they, too, could be "better off out." For example, the Apple tax ruling may convince Ireland that the EU is anti-business, Portugal may feel that too many restrictions have been put on its economy, Eurosceptic Swedes – and there are many of them – may also feel that their patience with the EU has run out. Greece, which has been battered most by the strictures of Brussels and Berlin, might also want to finally throw in the EU towel, and EU-sceptics could be encouraged in Italy as well as Eastern Europe.

Team GB

Yet, it is more likely, in our view, that European states will want to temper their enthusiasm about leaving the EU behind. When Brexit actually starts, it will be a long, drawn-out, confusing spectacle. Britain will need more trade negotiators for Brexit than the entire Team GB contingent at the Rio Olympics. Negotiations will be difficult partly because the EU and its large members cannot afford for Brexit to become contagious. In addition, there is more cultural, political and diplomatic distance between Britain and the EU than perhaps any other country. Thus, while many of them might wish to leave, they would consider this unnatural.

However, there is a growing likelihood that while other EU states do not want to leave the EU outright, they may increasingly disregard it. There are plenty of event risks coming up in 2017 – the still unresolved troubles of Italy's banking system and the ongoing debate on migration, to name just two. In some respects, this may not be a bad thing. Europe may rethink its policy on migration. The alternative to a re-assessment of migration policy, especially in light of Brexit, is a more pronounced shift to the extreme right in European politics, which itself would represent an existential threat to Europe.

>

Brexit
The precise origin of the term "Brexit" is unclear. It was first used in 2012 and is believed to be modeled on "Grexit," coined by the economist Ebrahim Rahbari that same year, to denote the potential withdrawal of Greece from the Eurozone.

Tail risk
Tail risk is the risk of an asset or portfolio of assets moving more than 3 standard deviations from its current price.

Is Europe against globalization?
Economically, some states may feel less constrained to stimulate their economies and more resistant to reforms, given the cover of bond buying by the European Central Bank (ECB). More broadly, in the aftermath of opposition to the Transatlantic Trade and Investment Partnership (TTIP) framework by several European politicians and the apparent tit-for-tat fines by the USA and the EU on each other's companies, the EU needs to take a clear stance on trade and globalization and clarify whether it actually supports them. For the moment, we expect the Eurozone to record tepid growth of close to 1.5%, which will continue to be unevenly distributed among the various countries.

"What is certain even at this stage is that Brexit will visit economic and political uncertainty not just upon the UK itself but also its European neighbors."
Michael O'Sullivan

However, politically, the steadier growth that the EU is witnessing will be welcomed as France and Germany face elections at the highest levels. As for France, we see room for upside surprises economically if a center-right government takes power, especially if it is led by Alain Juppé, whose proposed economic program is more liberal than other candidates'. Germany presents a greater risk from a European point of view, as failure by Angela Merkel to regain the chancellorship would rob Europe of its uniting political force. At this stage, the markets are not at all pricing the possibility of electoral success for new parties and more extreme candidates in either France or in Germany. This kind of scenario represents a tail risk.

Fiscal space
Economically, the central question in Germany will be its willingness to deploy fiscal spending in areas such as infrastructure to create a second economic tailwind following monetary policy. This approach has economic logic, though politically remains more sensitive. Our sense is that through 2017, headline writers will focus a great deal of their time

Fig. 1 **European banks lag their US counterparts**
Performance of European versus US banks (in local currency terms, Jan 14 = 100)
Source: Datastream, Credit Suisse. Last data point: 30/09/2016

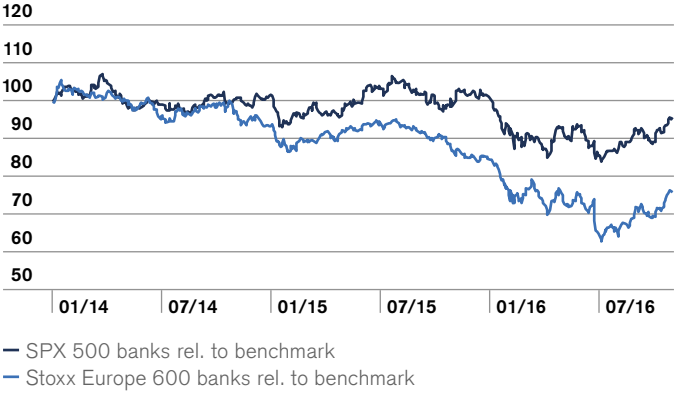
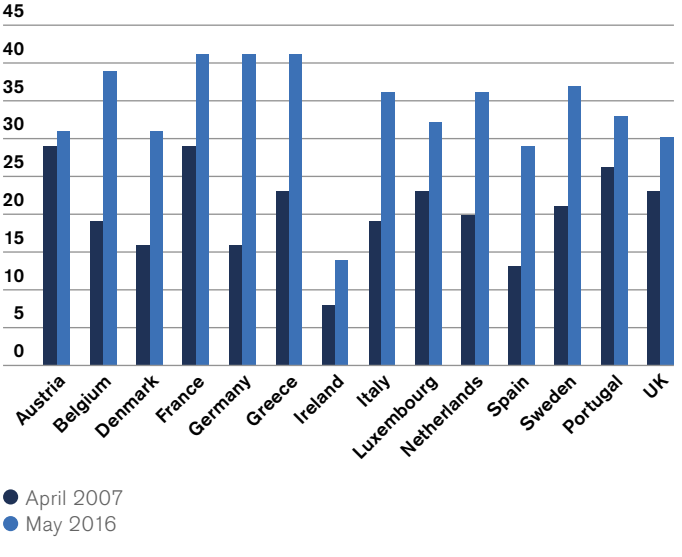


Fig. 2 **Sentiment towards the future of the EU**
People "fairly pessimistic" (in %).
Source: Eurobarometer (2016) European Commission/Credit Suisse.
Last data point: May 2016



Tapering
Tapering is the gradual winding down of central bank activities used to improve the conditions for economic growth.

LTROs
LTRO stands for the long-term refinancing operation, which was launched in 2011 by the European Central Bank (ECB) to provide unlimited credit to banks in the wake of the euro crisis.

"Traditionally, Europe has been an economy driven by bank lending (rather than markets), making the banking sector the critical transmission mechanism for growth."
Michael O'Sullivan

on politics, but from an investment point of view, returns will be driven by the interconnected triad of economic growth, banks and monetary policy.

Traditionally, Europe has been an economy driven by bank lending (rather than capital markets), making the banking sector the critical transmission mechanism for growth. Given this, many ECB policies are designed to run through the banks (i.e. long-term refinancing operations) but some, such as the current focus on bond buying and negative rates, undermine bank profitability, thus curbing lending and limiting growth. The fact that some banks are still in balance sheet repair mode does not help. This policy conundrum will continue to bedevil the Eurozone throughout 2017.

A taper for bond markets
With Eurozone bond markets now effectively "owned" by the ECB, 2017 will prove decisive in terms of how the central bank navigates the logistical limits of its own ambitious quantitative easing and, eventually, a taper to this program later in the year or into 2018. From the point of view of the banking sector, better growth, if it materializes, together with higher bond yields, if the ECB permits them, would prove an attractive combination.

At some point, we suspect it will be late summer, the markets may start to price in a taper and bond prices turn down. This will be an important turning point in the strategies of insurance companies, pension funds and investors with a low risk appetite. In the equity market, it may be associated with a shift toward a less defensive/more cyclical approach. Such tapering may, however, trigger a greater degree of market pricing of country risk among Eurozone member states. Spain, for example, may see a lower credit premium than Italy as a reward for its much better growth profile and the relative health of its banking sector, while Portugal may take the place of Greece as the new point of concern for bond investors given its fiscal woes. Finally, as the global business cycle edges its way through the recovery phase and the Fed continues to tighten policy, the EUR will likely remain close to and at times below the current levels, at least through the early part of 2017.

Political challenges in EMEA
Meanwhile, the EMEA "region" will likely continue to exhibit highly divergent economic trends: commodity exporters in the Middle East as well as Russia and South Africa (if politics allows so) should continue to find their footing as commodity prices stabilize. Political concerns leave us cautious on Turkey, while Central and Eastern European countries are likely to find themselves torn between the effects of more stable growth in the Eurozone and the potential for a geopolitical spillover from Russia. It remains to be seen whether the political willpower can be mustered to push through further tough reforms in Ukraine, and whether Poland retrenches further from its successful economic and political transformation of the past decades. ■

Investor takeaways

- Uncertainties over Brexit, political risks and intermittent worries over the health of European banks are likely to create bouts of volatility in European risk assets, making the risk-adjusted returns on equities less attractive.
- Given our sense that Brexit is unlikely to trigger exits by other EU members, peripheral sovereign and bank bonds should hold up well. Risks in Italy and Portugal must be monitored.
- The Eurozone should see modest growth. Yet due to the divergence between a slightly tighter Fed and a still very accommodative ECB, the EUR is unlikely to make gains against the USD. The GBP should stabilize given its drop below fair value in 2016.

Sylvio Castro, Head of Investment Advisory Brazil

Investor-friendly direction

Much of Latin America has been in a slump since the China and commodity-led super-cycle broke down in 2014/15. However, currency and current account adjustments have come a long way. With the election of reform-oriented governments in key countries, the chances for an economic recovery and further market gains have improved.

Much of Latin America has been in a long period of weak growth, or even recession, due to the recent decline in commodity prices triggered by a slowdown in China. Underlying structural issues stemming from income inequality, inadequate educational systems and overregulation exacerbated this weakness. More immediately, currencies that were significantly overvalued in the boom years came under severe pressure, forcing central banks to tighten monetary policy. This added to stress in economies where credit growth had been excessive. Meanwhile, fiscal deficits increased sharply and stoked fears of a renewed debt crisis.

Political reform in the face of severe financial constraints

Such a debt crisis has yet to materialize, and we do not think it is likely in the coming years, for the following reasons: Foreign debt is significantly lower relative to GDP than prior to previous crises; more of the debt is denominated in local currency, reducing vulnerability; and the share of debt owed by governments has generally declined. Moreover, foreign currency reserves are much higher and currency policy is more flexible, enabling more gradual adjustment to the worsening external environment. In fact, current accounts have improved significantly in the past year or so.

That said, governments have little leeway to ease fiscal policy or encourage credit expansion. Encouragingly, however, newly elected, reform-oriented governments have begun to implement structural reforms. While it is hard to implement reforms at a time of lower economic growth, we remain cautiously optimistic that all the major economies will take steps in the right direction, including Mexico, Argentina, Colombia, Peru and, eventually, Brazil.

More favorable backdrop should boost bonds and stocks

As of mid-2016, business and consumer confidence ticked up in the region although it remained weak in some countries, notably Brazil. This suggests that Latin American economies may be turning the corner. Moreover, with the exception of Mexico and Argentina, currencies began to strengthen in early 2016, reducing inflationary pressure. As inflation eases and fiscal policy turns tighter, a number of central banks should be able to gradually relax monetary policy.

With real interest rates significantly higher than in the developed world or other emerging markets, this backdrop suggests continued gains in Latin American fixed income investments. In contrast to the "taper tantrum" of 2013, increased expectations of a rate hike by the US Federal Reserve toward the end of 2016 only had a minor effect. Given our base case of very gradual US rate hikes, Latin American bonds should hold up well, in our view, even if some currencies temporarily come under pressure again.

The outlook for Latin American equities is mixed, however. At the time of writing, the region's equities traded at a 10% premium to global emerging market equities. They were also fairly expensive relative to their ten-year historical level, and earnings expectations also seemed high. Nevertheless, global portfolio managers appear to have been underweight in Latin American equities over the past few years. If central banks ease policy, there is thus some room for a further re-rating. ■

Investor takeaways

- After a prolonged period of weakness, there are signs of a moderate growth improvement in Latin America, while inflation is retreating. Central banks should be able to ease policy, albeit cautiously.
- Still fairly high real interest rates bode well for continued gains in Latin American fixed income. Hard currency bond returns will likely be only moderate. Potential gains are higher in local currency bonds, though at the risk of higher volatility. Currencies should generally hold up well.
- The outlook for Latin American equities is more muted than in other emerging markets given fairly high valuations.

Commodities
In 1977 the Economist magazine coined the term "Dutch disease" to describe the negative effects on the Dutch economy brought about by an over-reliance on commodity exports following the discovery of gas reserves. The term is now used more broadly to refer to the risks inherent in commodity booms.

Colombia

Economic activity in Colombia weakened in 2016, reflecting weak external conditions and low commodity prices. However, even though voters rejected the proposed peace agreement between the government and the FARC rebels, economic growth should improve slightly in 2017. Inflation is expected to come down to around 4% and thus re-enter the official target range.

Mexico

In Mexico, economic activity slowed in 2016 on the back of tighter monetary conditions, declining mining activity and announced fiscal spending cuts. With economic reforms stalled and higher inflation expectations requiring tighter monetary policy, we expect only subdued growth in 2017.

Venezuela

Extreme inflation, a severe economic slump with shortages in basic goods and economic management have further intensified social and political tensions in Venezuela. With oil prices still far below their highs and without any major reforms in sight, the economic outlook for 2017 continues to look difficult.

Peru

The economy of Peru, where a market-friendly president was elected in 2016, continues to stand out by exhibiting very high growth relative to the rest of the region, largely due to higher mining production. We expect these favorable developments to persist in 2017, partly due to fiscal reforms and a stabilizing inflation rate.

Brazil

Brazil, the largest economy in the region, is showing tentative signs of economic recovery. Confidence indicators are stabilizing, though at low levels. We expect GDP growth to pick up slowly in 2017. While inflation is likely to remain above the official target of 5%, its gradual decline should allow the central bank to gradually cut rates. A more positive scenario hinges on the approval of structural reforms by the Congress, most importantly the government spending cap and pension reform.

Chile

Falling commodity prices and declining investment caused significant economic weakness. However, inflation is back within the target range and budget consolidation is on track. For 2017, we expect improved, but still weak growth with lower inflation. A reformist candidate stands a good chance to win the presidential election in November.

Argentina

In Argentina, the government of the new president seems to be on the right track, putting a more coherent and credible macroeconomic policy framework into action. However, the adjustments have been costly in terms of economic activity and inflation. Inflation remains high, though to quite some extent as a result of price liberalization. Monetary and some fiscal easing should begin to boost economic growth in 2017.

Message from Francesco de Ferrari, Head of Private Banking Asia Pacific

The investment environment in 2016 was difficult, characterized by uneven global growth, significant uncertainty over monetary policies and major political events such as the Brexit vote and the US elections. This complex operating environment meant selecting the correct tactical investment decisions remained challenging. On a more positive note, I am encouraged to see a gradual repair of the global economy – the central Credit Suisse view for 2017 – and in the forthcoming months, greater political clarity for the United States. I firmly believe these factors will present our clients and investors with attractive opportunities in the year ahead.

The global shift in economic growth toward developing countries, which has been temporarily disrupted, is likely to resume, in our view. This should further increase the scale and volume of assets generated by entrepreneurs and other investors in regions such as Asia Pacific and Latin America. I am therefore convinced that this is a unique opportunity for banks such as Credit Suisse. That said, there is a need to adapt the traditional banking models to the ever-changing environment and to address the evolving needs of clients in the world's most dynamic regions.

With the formation of the new Credit Suisse Asia Pacific division, our vision is to be the Trusted Bank for Entrepreneurs. As wealth in Asia Pacific continues to grow and financial markets deepen, over the long term we see significant opportunities to help you, our clients, capture this growth.

With the outlook for global economic growth in 2017 moderate, we believe that lower risk assets will continue to command a premium. The trend toward a more balanced approach to investing will likely continue, with clients seeking to build a diversified portfolio which includes exposure to different asset classes that have historically exhibited limited correlation. Such a multi-asset approach focuses on different sources of risk while delivering an attractive yield. This remains an important criterion for most of our Asian clients. With our discretionary and advisory mandates, Credit Suisse Portfolio Solutions offers two approaches to help our clients achieve these investment goals. Alternative Investments (AI) such as hedge funds or private equity are also gaining significance as building blocks of diversified portfolios. Historically, Asian private clients have been underinvested in AI. However, many family offices and other investors with longer time horizons and a tolerance for illiquidity are increasingly including larger allocations to AI. Credit Suisse strongly believes in AI, as evidenced by the significant allocation to that asset class in our recommended strategic asset allocation (up to 20% of the portfolio).

Beyond investments, the information needs of our clients have been transformed by technological innovations. In 2015, we launched our award-winning digital private banking platform. This is designed to empower our Asian clients with real-time and simplified access to Credit Suisse knowledge and expertise. It is encouraging for me to see that clients' use of the platform has surged as new functionalities and devices have been added.

As 2017 unfolds, I can assure you that we will continue to support our clients in navigating the risks as well as realizing investment opportunities critical for our private investors. Alongside this, we will continue to identify new long-term business opportunities for our corporate investors. ■

John Woods, Chief Investment Officer Asia Pacific

Cautiously constructive

The enviable stability that has characterized Asian growth over the past five years appears set to continue into 2017, with the region likely to expand by 5.9%, similar to the rate recorded in 2016. Of the ten major economies we cover, seven are expected to post higher rates of growth. Only in three is growth likely to decelerate.

Absolute rates of growth in Asia Pacific remain at healthy levels, particularly by international standards. Indeed, Asia's growth rates have been remarkably stable, varying less than 1% over the past five years, which speaks volumes for the flexibility policy makers enjoy in managing the economy through fiscal or monetary stimulus. Nevertheless, stimulus is essentially cyclical and can support an economy only for so long. Investors can expect little change in the shallow downward drift in growth – a by-product of an apparently permanent downshift in global trade – which we believe is likely to continue until the region's economic superpower, China, begins to stabilize. Accordingly, the focus among policy makers in the region has been to promote alternative sources of growth.

Consumer rebalancing

Economic rebalancing – from manufactured exports to services-based consumption – represents Asia's critical growth risk. Fortunately, Asia's transition appears to be firmly under way. What is more, such is the scale and speed of change in the consumer and infrastructure segments that the two sectors will likely dominate client investment strategies for years, perhaps decades, to come. In 2016, for example, consumption and investment in Asia (ex-Japan) contributed 3.4% and 2.0%, respectively, to the region's growth of 5.9% (with net exports contributing 0.1%).

Inevitably, too great a reliance on consumption carries its own risks, particularly if financed by debt. Between 2008 and 2015, for example, according to the Institute of International Finance, booming property prices, auto purchases and goods purchased on household finance and credit cards, among other things, saw consumer credit as a proportion of GDP increase from approximately 38% to 55%. While such metrics are not particularly high by developed market standards, they mask significant differences across the region. For example, in 2015, India and Indonesia reported household debt/GDP ratios of just 10% and 15%, respectively. Conversely, for the same year, the household debt ratios for Korea (88%) and Taiwan (83%) were clearly high and, looking forward, pose risks to growth should interest rates rise and/or should households choose or be forced to delever. In particular, Malaysia (71%) and Thailand (70%) represent real risks, as their metrics essentially doubled between 2008 and 2015.

However, our base case for 2017 does not anticipate a forced deleveraging of household debt, or corporate and/or sovereign debt. It is highly likely that the worst of Asia's credit boom is over and accumulation of further debt will likely moderate over time. As such, we believe that capital inflows will remain resilient, reflecting ample USD liquidity and a stable real interest rate differential between Asia and the USA. We further think that currency depreciation expectations remain within prudent bounds.

Asia's "infra-spending"

The second leg of Asia's growth initiative, investment in infrastructure – or "infra-spending" – is regarded as complementary to consumer spending and an effective means of stimulating growth, creating jobs and raising productivity. In 2017, infraspending is expected to add around 1.5% to regional growth (vs. 0.5% in 2016), driven largely by China and its mega USD 160 bn One Belt, One Road (OBOR) initiative. Moreover, such spending is likely to continue for many years. For example, in its Q3 2016 development report, the Asian Development Bank states that countries in Asia will invest in infrastructure projects worth USD 8 trn by 2020.

Driving the spending, beyond the need to repair and upgrade existing infrastructure, is the relentless drift of people toward cities across the region. The pressure this exerts on existing and often creaky infrastructure requires often massive spending on transport, social welfare and public utilities. With global investors hunting for yields amid record-low interest rates and public-private partnerships fast becoming a more accepted type of business arrangement, spending and investing in infrastructure projects will likely mean more projects are successfully funded and implemented. Infrastructure >

Female entrepreneurs
200 million women starting or running businesses worldwide, according to the Global Entrepreneurship Monitor 2014 Women's Report.

SDR
An SDR – Special Drawing Right – is the International Monetary Fund's own currency unit that governments can borrow to pay their bills. The value of the SDR is based on a basket of five major currencies.

spending is not without risks or costs, however, as China's legendary appetite for building things shows. Subsidized money (from state-owned banks) can lead to misallocations in investment, resulting in excess capacity, colossal waste and (inevitably) impaired loans in the banking system. However, such is the region-wide demand for investment spending that its overall importance to growth is set to rise, with its strategic importance signified by the opening of the Asian Infrastructure Investment Bank in Beijing in 2016.

Improving view on China

Our cautiously constructive view toward Asia reflects our improving view toward China. After some six years of apparently relentless economic deceleration, the China economy is showing signs of stabilization, which has encouraged us to revise higher our GDP growth forecast to 6.6% YoY from 6.5% YoY for 2016 and to 6.3% YoY from 6% YoY for 2017. In particular, we see China's "new" services economy continuing to offset the drag from the "old" manufacturing-based economy.

For example, while China's external sector may experience challenges, strength in the domestic economy – particularly the services sector – should surprise to the upside. The ongoing recovery in global commodity prices should underpin industrial profits, which in turn should support the labor market and consumer spending. The property sector, too, will likely remain buoyant, leading to falling inventories and a pick-up in fixed asset investment. Against such a positive backdrop, marked volatility in the CNY is unlikely, although we continue to expect a modest, controlled depreciation to 7.00 against the USD by year-end 2017.

Asia strategy

A supportive confluence of firming economic growth, reasonable valuations and improving profitability suggests to us that emerging Asian equities will perform well in 2017, possibly outperforming their global counterparts. To the extent that global liquidity has long been the marginal price setter for Asian equities, performance may be even stronger should capital inflows increase.

Consensus expectations of 12.3% earnings per share growth for the MSCI Asia ex-Japan (vs. –5% in 2016)

Fig. 1 **Signs of growth stabilization**
China GDP (YoY %) vs Purchasing Managers' Index (PMI)
Source: Bloomberg, Credit Suisse. Last data point: 31/10/2016

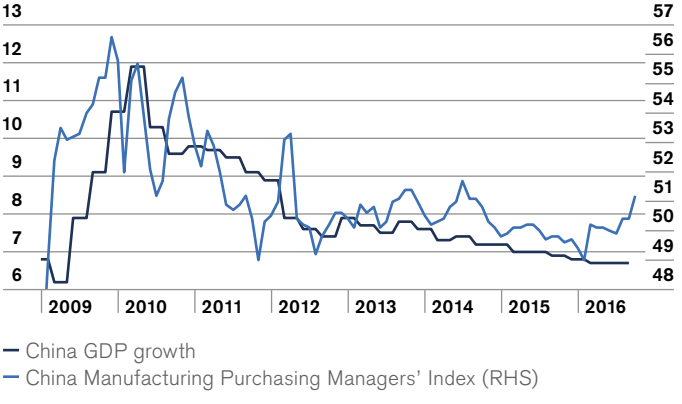
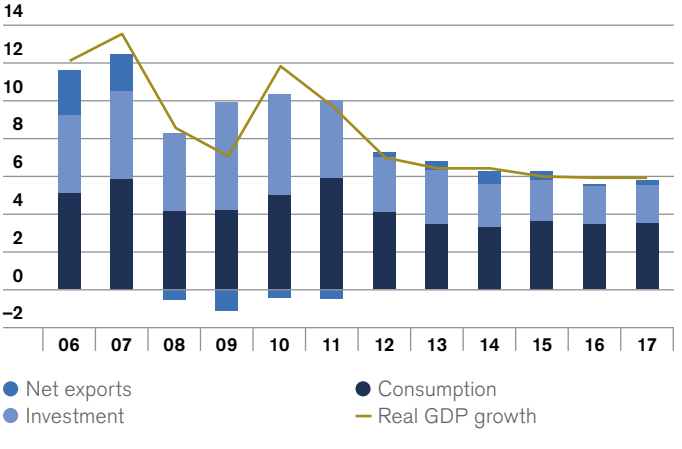
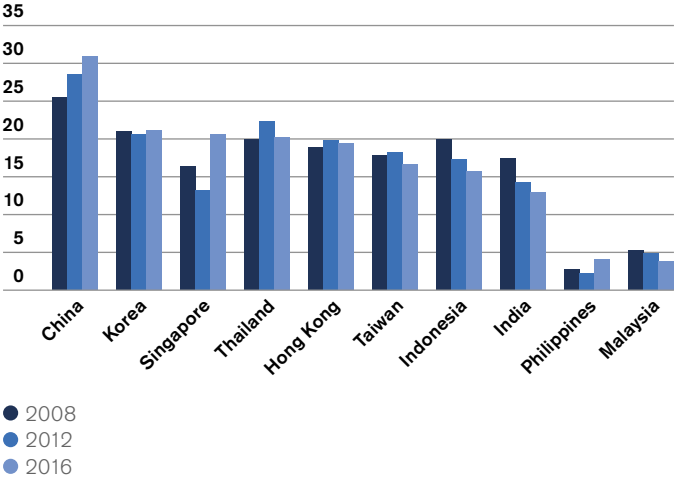


Fig. 2 **Rebalancing towards services-based consumption**
Asia real GDP contribution (YoY in %)
Source: Credit Suisse. Last data point: 2017 (forecast)



"One Belt, One Road initiative"
"One Belt, One Road" refers to a Chinese initiative to increase trade across central Asia by connecting the region to the rest of the world through a network of transport routes and energy installations.

Fig. 3 **Infrastructure is a significant growth driver for 2017**
Infrastructure spending by country (% of GDP)*
Source: IMF, Credit Suisse. Last data point: 30/09/2016
**Note: 2016 figures are IMF and government estimates.*



underscore analyst optimism, with cyclicals – financials, technology and commodities – outperforming. We expect the China and Hong Kong markets to lead regional equities in 2017, as the recovery in earnings, attractive valuations and buoyant liquidity accelerate south/north-bound flows. India's robust macro story remains intact, and a rebound in earnings growth should continue to steer the market higher. South Korea and Taiwan equities are likely to fare better than their Southeast Asian counterparts, which are grappling with either subdued earnings or expensive valuations.

In terms of fixed income, despite the likely rise in US interest rates and modestly stretched valuations, we expect Asian USD investment grade credit to post total returns of around 4% in 2017, well down from the 8% recorded in 2016. Using the JACI Investment Grade Index as a portfolio proxy, our total return expectations reflect a running yield of 3.8% and an expected spread tightening of 45 bp, compensating for a rise in underlying 5-year US Treasury yields of around 30 bp.

With yields at record lows, our return expectations are less about valuations than technical factors, in particular foreign capital seeking superior risk-adjusted yield opportunities. However, there are risks to our view, specifically the effect on spreads if sovereign and corporate creditworthiness erodes should debt levels increase and default rates tick higher. Our base case for Asia's growth – and credit – outlook suggests this will not be the case. Nonetheless, we continue to closely monitor developments to ensure that our recommended exposures remain prudent and appropriate. ■

Investor takeaways

- Asia can look forward to stable growth in 2017, underpinned by a structural transition from manufactured exports to services-based consumption.
- Our improving view on Asia reflects our improving view on China's economy, where we believe the domestic economy – particularly the services sector – should surprise to the upside.
- A supportive confluence of firming economic growth, reasonable valuations and improving profitability suggests to us that emerging Asian equities should perform well in 2017, possibly outperforming their global counterparts.

Joe Prendergast, Head of Financial Markets Analysis

Under new management

Despite some policy uncertainties, steady US growth and tentative Fed tightening are likely to underpin US yields in 2017, capping both stock and bond returns but setting the scene for the USD to turn higher.

US financial markets have not usually cared very much whether the president represents the Democratic or the Republican party, but the prospect of Donald Trump in the White House in 2017 is different. On the one hand, there is heightened policy uncertainty – with particular risks to trade and foreign relations more generally. On the other, there is a backdrop of steady growth in late 2016 and a good prospect that Congress is going to be more responsive to the Trump agenda of fiscal expansion and tax cuts in the year ahead, as well as a potential corporate tax break on the repatriation of foreign earnings. While we see only modest US stock market returns overall, equities are likely to outperform US Treasuries.

US bond yields to rise

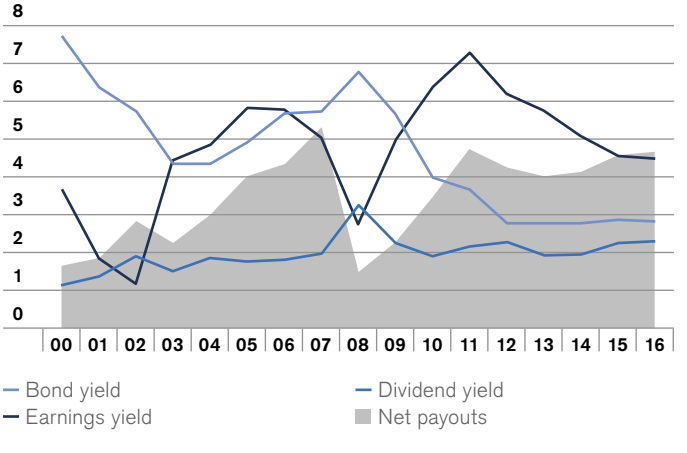
As the US economy is likely to grow by around 2% and the Federal Reserve (Fed) tentatively continues its policy tightening, we expect US Treasury bond yields to rise and the US yield curve to steepen. The perception that the US central bank is proceeding cautiously to ensure that deflation risk has evolved into inflation risk should be supported by rising wages and the recovering oil price. This, in turn, should underpin the recovery in inflation expectations and confidence that rates can normalize more meaningfully over the medium term. Apparent dissatisfaction with the effects of ongoing quantitative easing (QE) programs among other central banks may also influence the US market, as steps toward tapering QE should support yield rises more broadly. In 2017, we expect the US 10-year yield to trend higher, above 2%.

Earnings unlikely to deliver, capping equity potential

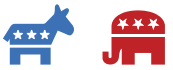
Given the moderate outlook for US economic growth, the current consensus expectation for a 13% rise in S&P 500 earnings in 2017 is likely to be disappointed. While it is not unrealistic to expect a rebound in energy earnings to lead to a recovery, the expectation of more than 9% growth ex-energy appears optimistic. The benefits to US firms of falling financing costs and tax optimization have no doubt peaked, both practically and politically. Moreover, labor costs are rising and threats to trade and growth remain. Even allowing for modest fiscal stimulus via infrastructure spending and possible corporate tax reform, including a foreign tax repatriation windfall, we expect US earnings ex-energy to grow within a 4%–7% range. At late-2016 valuations, with a price/earnings ratio above 17, this leaves modest upside potential for the S&P 500. Furthermore, corporate buyback activity is likely to fall as bond yields now rise, challenging equity valuations as payout yields decline. Figure 1 shows that the trend between earnings and dividend yields is now converging lower as earnings struggle to keep pace with payouts. In the absence of earnings growth, we hence see limited capital gains from US equities in 2017 and expect a total return of 3%–5%. Defensive equity sectors such as US telecoms and utilities are likely to come under pressure from

"Labor costs are rising and threats to trade and growth remain."
Joe Prendergast

Fig. 1 **US earnings yield converging with net payouts**
Bond yield is A-rated US corporate bond yield; net payouts equal dividends + share repurchases – share issuance (% per year)
Source: Bloomberg, Credit Suisse. Last data point: Q2 2016 (annualized)



Migration
Country with the largest migrant population in 2015: United States (14.5% of total population)
Country with the greatest migrant share in 2015: United Arab Emirates (88.4% of total population).



Donkey vs. elephant
The icons of the American political parties – the Democratic donkey and the Republican elephant – were created in the mid-19th century by Harper's Magazine cartoonist Thomas Nast.

"2017 is likely to be a challenging year for US corporate bonds."
Joe Prendergast

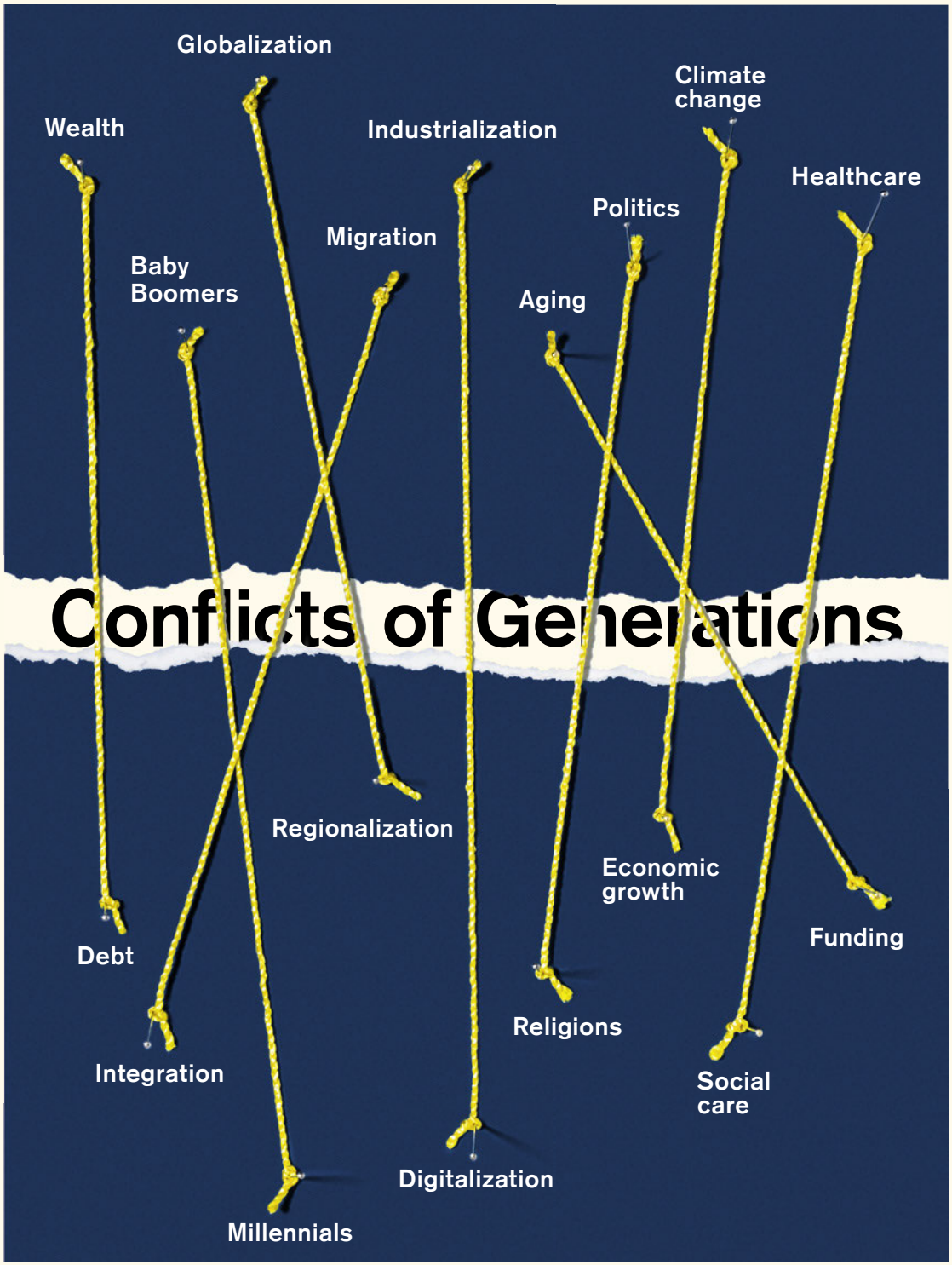
higher bond yields. Thanks to strong expected top-line growth, healthcare and IT are less likely to see earnings and payouts suffer. One sector that has underperformed in 2016 but could now benefit from a gradually higher yield environment is US financials. The potential outperformance of this sector offers some attractive protection against rising US Treasury yields.

Rising leverage a concern for US credit
2017 is likely to be a more challenging year for US corporate bonds. Commodity-related issuers may be an important exception, contributing to market stability and returns. The energy sector saw a major fall in leverage in 2015–16, as it adjusted to the oil price decline, so it may now see an extended recovery as oil prices hold at higher levels and the Trump agenda favors increased fossil fuel production. This should translate into lower default rates and some improvement in recovery rates, which have been low in this cycle. But many other sectors are now increasing leverage. So after the sharp yield decline in 2016, no further spread compression in US high yield credit is likely unless the economy does better than expected. High yield debt should still outperform US non-financial investment grade credit in 2017, due mainly to its higher carry and lower duration. US financial sector bonds are also expected to outperform non-financials. In an international context, the build-up of significant US yield spreads vs. foreign bonds suggests that foreign inflows into core US investment grade markets are likely to resume in 2017, limiting yield increases. Similarly, for longer-duration investments, the US corporate sector is preferred relative to the other major markets.

The US dollar is close to turning
As the Fed slowly resumes tightening and US yields rise versus foreign yields, the US dollar will ultimately benefit. Having softened versus the euro, the Swiss franc and the Japanese yen since December 2015, the dollar should bottom out and trend upward against the other major currencies in 2017. Part of the reason for the dollar's softness in 2016 has been the deep revision of the pace of expected Fed tightening in 2017. Yet it is also due to a natural reaction to the early stages of tightening. Indeed, as the dollar softened in 2016, the monetary actions of the other central banks, including significantly negative interest rates, have seen interest rate spreads widen in the US's favor similar to a "normal" interest cycle. As such, we expect the dollar to rise more determinedly in 2017. Non-US investors should watch for further bouts of dollar weakness in early 2017 to offer an opportunity to accumulate the US currency and add asset exposure for yield and potential currency gains. ■

Investor takeaways

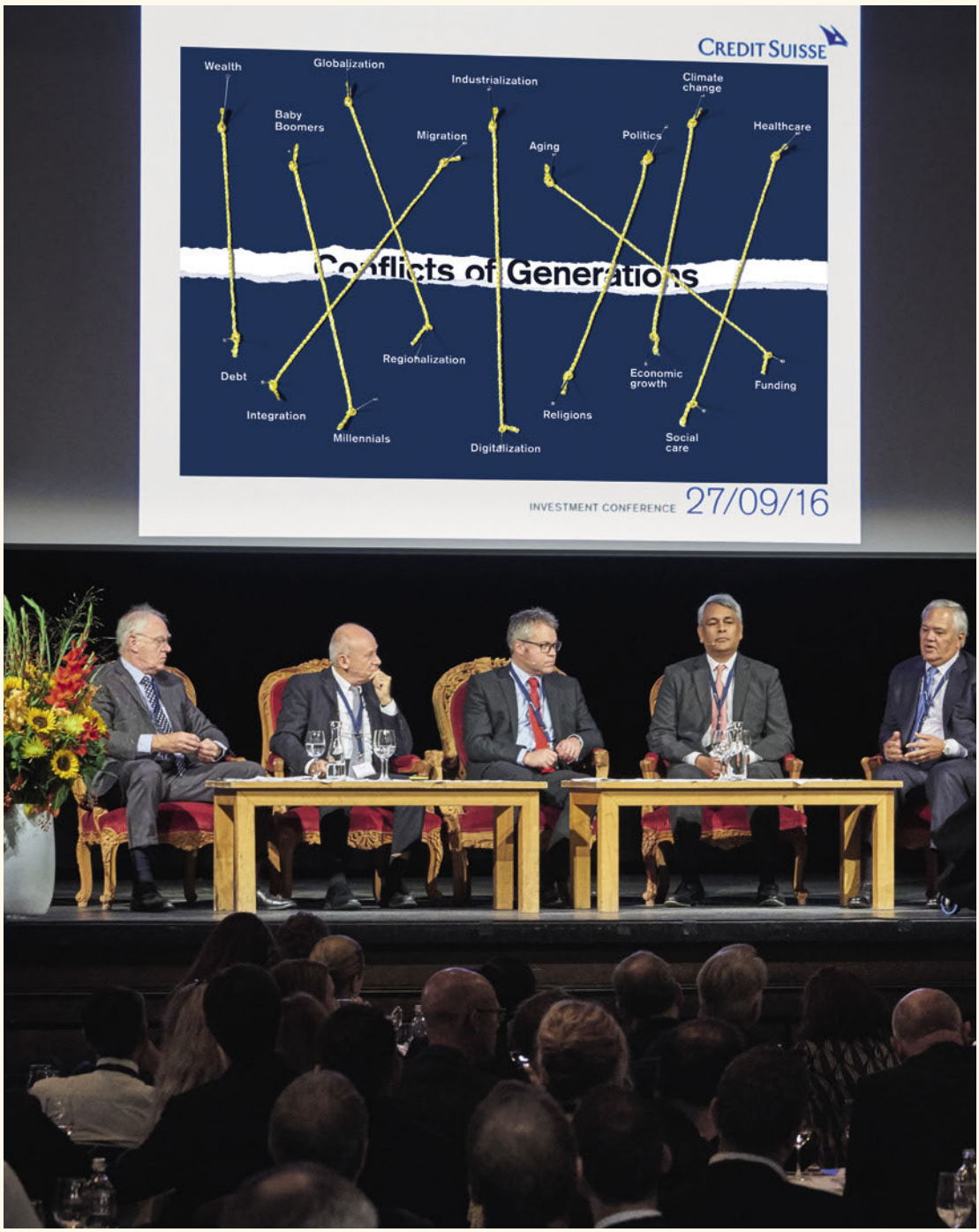
- Earnings growth is needed to sustain higher equity valuations. With fewer buybacks, rising yields and earnings expectations vulnerable to disappointment, we expect S&P 500 total returns in the region of just 3%–5% in 2017.
- US credit metrics are deteriorating, but a sustained energy rebound should lower defaults and raise recovery rates in the year ahead, underpinning US high yield credits in an environment of rising yields.
- Non-US investors should watch for further bouts of dollar weakness to offer opportunities to accumulate the US currency and add asset exposure for yield and potential currency gains through 2017.


Conflicts of Generations
Globalization
Wealth
Industrialization
Climate change
Healthcare
Politics
Migration
Baby Boomers
Aging
Regionalization
Economic growth
Funding
Debt
Religions
Integration
Social care
Digitalization
Millennials

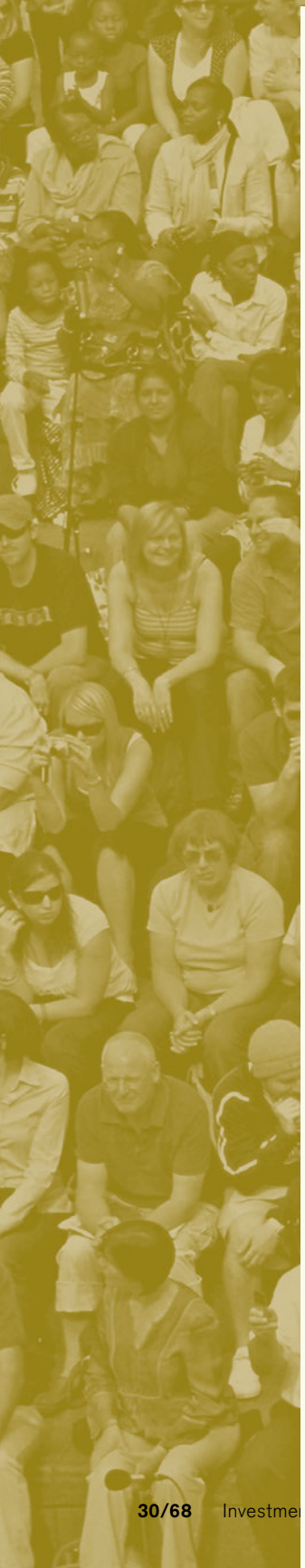
Conflicts of Generations
An increasingly polarized world

For some 50 years after the Second World War, most developed nations enjoyed a time of increasing prosperity and peace – economic, social, religious and political peace. But tensions have been rising at multiple levels recently, with partly worrying potential for escalation.

For many years, globalization and international trade were viewed as a source of growth for low-cost countries and of purchasing power for high-cost countries: a win-win situation. Technology held the promise of easier working conditions and higher productivity, good for workers and business owners alike. Migration was a welcome source of growth enablement and mutual enrichment. Conflicts were primarily something that affected distant, less developed countries, a fact that was reflected in the risk premiums on these countries' assets. More recently, however, there has been a noticeable turn in the zeitgeist. With unemployment persistently high among young and low-skilled developed market workers since the financial and the European debt crisis, globalization, international trade and technology are increasingly regarded as a threat to jobs. The simultaneous accumulation of tremendous wealth and staggering public debt combined with growing income inequalities in the USA and Europe have fueled frustration and discontent among substantial segments of these regions' population and whet the appetite for fiscal redistribution. Mass migration from countries at war and overwhelmed political establishments unable to respond adequately have added to the charged socioeconomic backdrop. Disgruntled citizens are mobilizing in political movements, with the potential to reset policies, sometimes radically. Populist forces which used to be more prevalent in the emerging markets – markets traditionally more affected by inequality and class conflict – are now on the rise in the developed world. That said, such movements often reflect legitimate and growing concerns of citizens around the world regarding social justice, security as well as health and the environment. What are the true issues at stake? What are their effects on the economy and financial markets? What can investors and banks do to work toward solutions? These were some of the questions we asked Credit Suisse investment specialists and thought-leaders on the occasion of an internal Investment Conference held in Zurich on 27 September 2016 and moderated by Bob Parker, Strategic Advisor, Credit Suisse. In this report, we share the key takeaways of that day with our investors and clients. Our Investment Outlook publication draws intensively from this analysis and provides tangible takeaways based on the conclusions we reached.



From left to right: Bob Parker, Strategic Advisor, Investment Strategy, Credit Suisse; Oliver Adler, Head of Economic Research, Credit Suisse; Neville Hill, Global Economics & Strategy, Credit Suisse; John Woods, CIO Asia Pacific, Investment Strategy, Credit Suisse; Joseph G. Carson, Global Economic Research, AllianceBernstein



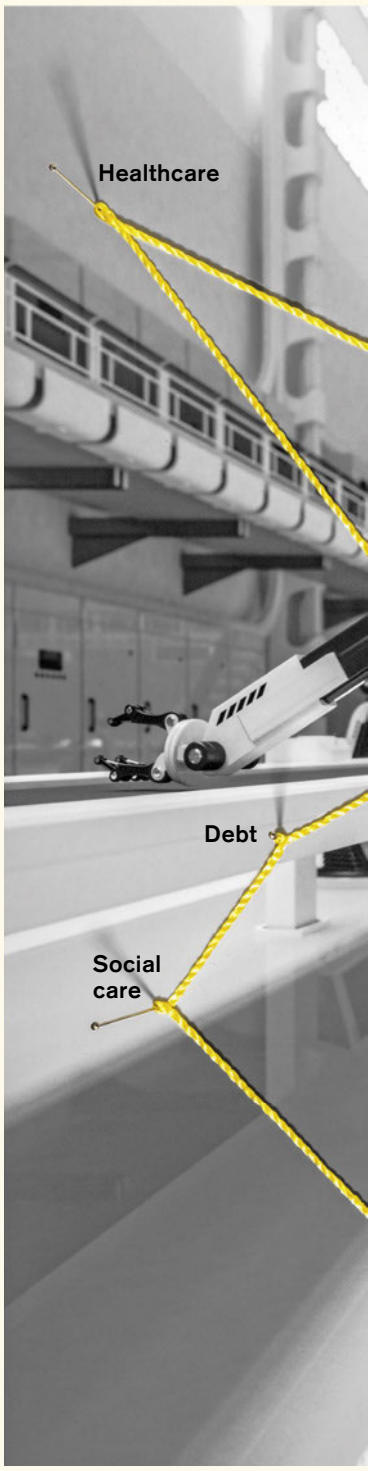
▸ What are the key tensions and polarizations to be most concerned about?

Michael Strobaek, Global CIO and Head of Investment Solutions & Products, Credit Suisse

Migration versus integration
The tension between migration and integration plays a central role as a driver of discontent and populism at the moment. Migration has picked up very sharply in the last decade. Between 2000 and 2015, the world population grew by 17%, but the number of migrants increased by 30%. Many of these migrants are of working age but have a low level of education, which poses tremendous integration problems for the host countries. Language barriers and cultural differences exacerbate the difficulty of integrating these individuals into the countries they end up in.

Aging versus funding
One of the greatest economic and financial achievements of the post-Second World War era was the implementation of retirement schemes that helped eradicate old-age poverty. Now, however, we have come to a point where retirement systems are quite simply no longer financially sustainable. While there were seven working people per pensioner in 2015, there are forecast to be only 3.5 in 2050. The aging of populations in itself is, of course, a sign of tremendous progress in public health and testimony to a peaceful world – the number of armed conflicts has declined significantly since the Second World War. But with some 30% of global government bonds offering a negative yield, public sector as well as corporate pension funds will increasingly have difficulties honoring their obligations. If interest rates stay as low as they are for another five years, companies with an unfavorable age structure of their staff (i.e., too few active employees relative to the number of pensioners) could even face bankruptcy, unless pension benefits are reduced or charges on active employees raised. In the latter case, the working population is likely to increasingly rebel against paying for what might be seen as wealthy pensioners.

Wealth versus health
As economies grow and prosper, their pollution footprint tends to grow as well. A case in point – global GDP grew by 13% between 2008 and 2013, with a concurrent increase in global >



Technology

Technological change can support sustainable economic growth worldwide, provided it leads to higher quality, more affordable goods and services and a more productive economy.

urban air pollution of 8%. This is particularly apparent in emerging economies such as China and Indonesia and carries a global cost: The World Health Organization estimates that in 2013 5.5 million lives were lost as a result of diseases associated

"The biggest problem in the world is the distribution/ redistribution of wealth."
Michael Strobaek

with outdoor and household air pollution. Such and other premature deaths come with a price tag for the economy – amounting to USD 5 trillion globally. Another global polarization is that rich countries are grappling with the problem of obesity and the related health problems of diabetes, arthritis and coronary heart disease, to name but a few, while poor countries still battle malnutrition. It is a sad truth that the wealthy nations waste 1.3 billion tons of food each year – enough to feed 868 million people. It goes without saying that these stark contrasts provide further fuel for discontent, frustration and conflict.

Man versus machine Technology has become an integral part of our private and working lives. It is hard to imagine work without

Michael Strobaek Global CIO and Head of Investment Solutions & Products, Credit Suisse

Magnus Lindkvist TED speaker, Author, Speakersnet

computers and associated software, and smartphones are ubiquitous. In 2003, there were 500 million devices connected to the internet versus a global population of 6.3 billion. By the year 2020, there will be 50 billion devices connected to the internet versus a global population of 7.6 billion. But for as much as technology makes our lives more convenient, increases our knowledge and helps us communicate more efficiently – just think of services like WhatsApp, Instagram and Twitter – it has not prevented overall labor productivity from declining. There is a genuine concern that the diffusion of technology is unequal.

"One of the existential crises in finance is that many of the services we see as invaluable can't effectively be monetized."
Magnus Lindkvist

▸ To what extent are these tensions reflected at a macroeconomic level?

Oliver Adler, Head of Economic Research, Credit Suisse
Global economic growth is likely to be only marginally higher in 2017 than in 2016. Apart from underlying demographic trends,

subdued corporate investment is likely to continue to restrain growth. The rapid technological transformations underway are not yet showing up in rising labor productivity at the macro level. However, with households deleveraging and banks having made significant progress in the most advanced economies, the risk of a recession induced by financial stress has been reduced. Yet, the leeway for governments to provide any significant impulse is very limited given high public sector debt. Monetary policy will thus continue to have to provide support, even if central banks need to move from mechanistic to more flexible tools.

"We observe that polarizations are increasing, and this requires elements of protection in an investment strategy."
Nannette Hechler-Fayd'herbe

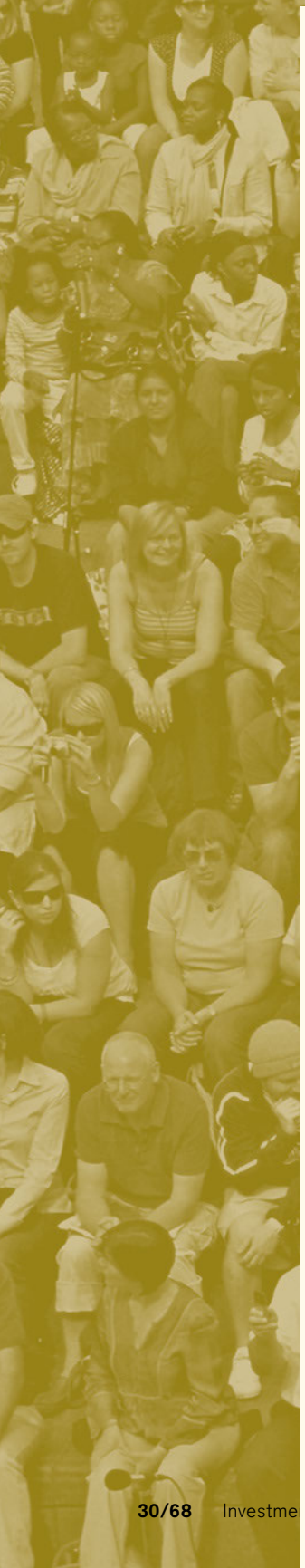
John Woods, CIO Asia Pacific Investment Strategy, Credit Suisse The perspective for Asia is solid. Demographics are supportive in many countries. India, which is benefiting the most from the demographic bonus of a young and increasingly well-educated population, is expected to be the strongest-

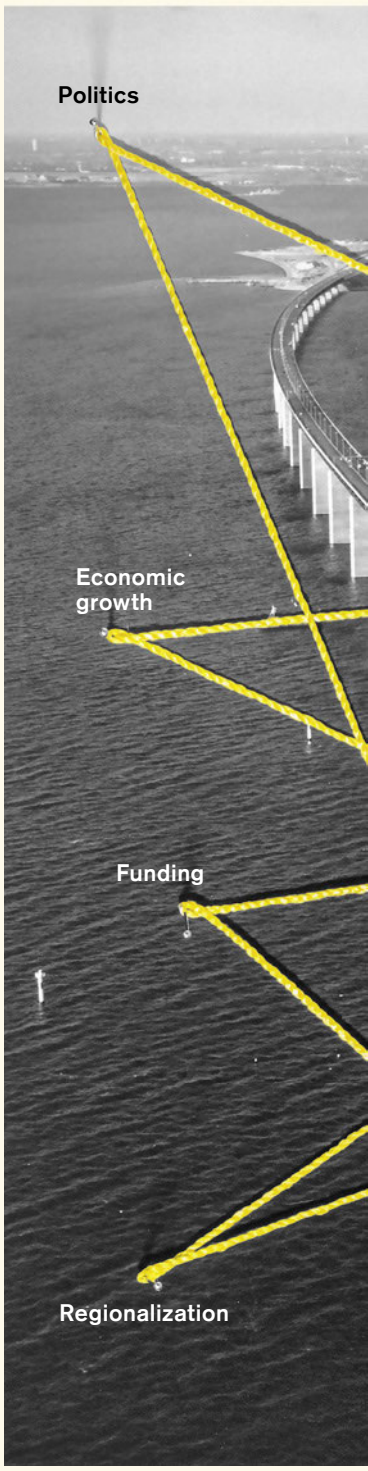
Oliver Adler Head of Economic Research, Credit Suisse

Nannette Hechler-Fayd'herbe Global Head of Investment Strategy, Credit Suisse

"The rapid technological transformations underway are not yet showing up in rising labor productivity at the macro level."
Oliver Adler

growth economy in 2017. Furthermore, the outlook for China appears encouraging as well, despite weak demographics. Speaking for the Asia-Pacific region overall, one commonality is the fact that it is generally difficult to make workers redundant, which is why unemployment is relatively low in many of these countries. This represents an opportunity for these markets and is, of course, good for consumption, which has also been supported by technology. On the downside, however, the level of consumer debt has increased strongly, particularly in Southeast Asia, and this classic development of credit-driven growth is one to keep an eye on. Having risen from some 55% of GDP prior to the 2008 financial crisis to 85% at present, consumer debt poses a risk should interest rates go up. >

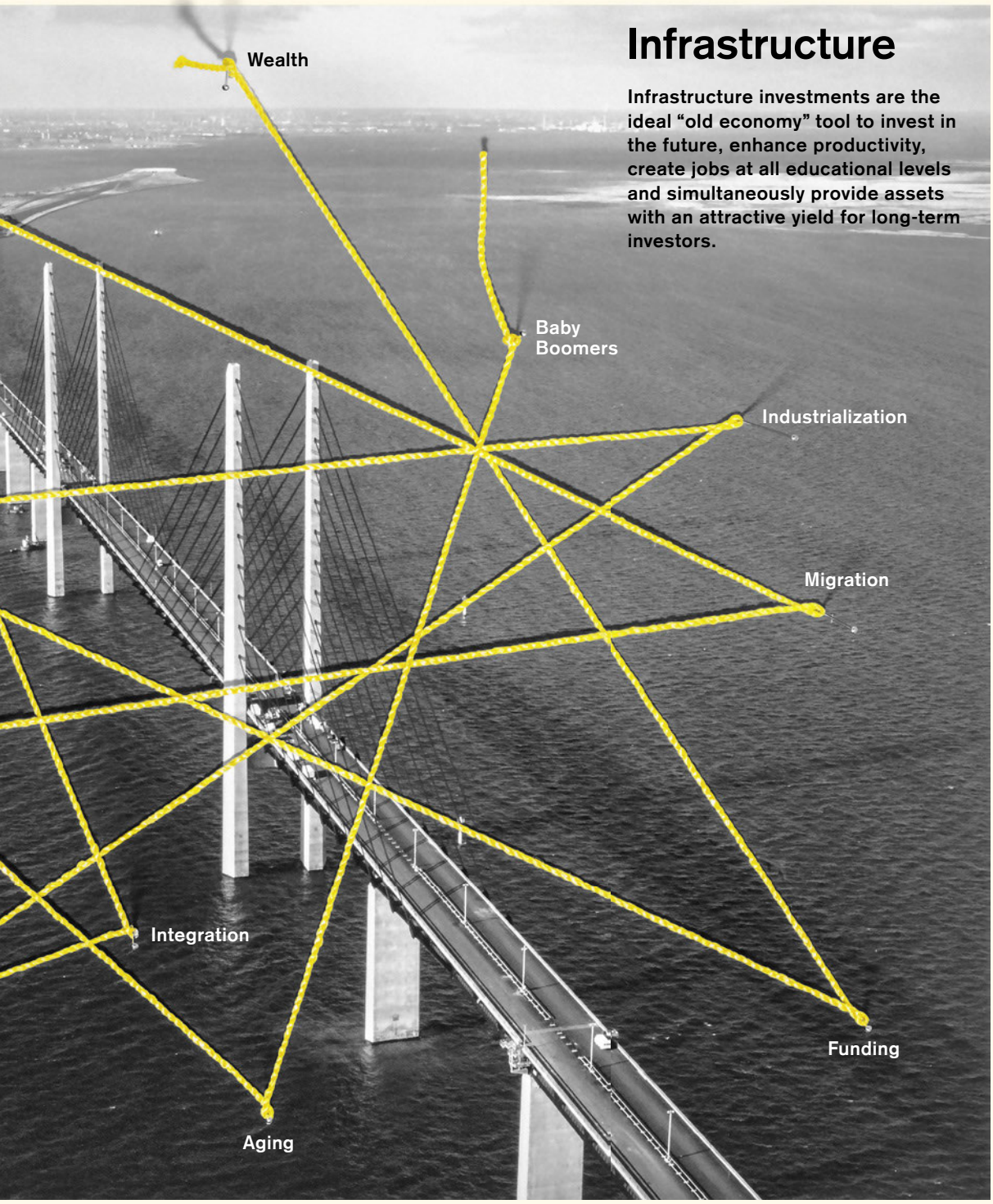




▸ Could political polarization derail growth in Europe and in the USA?

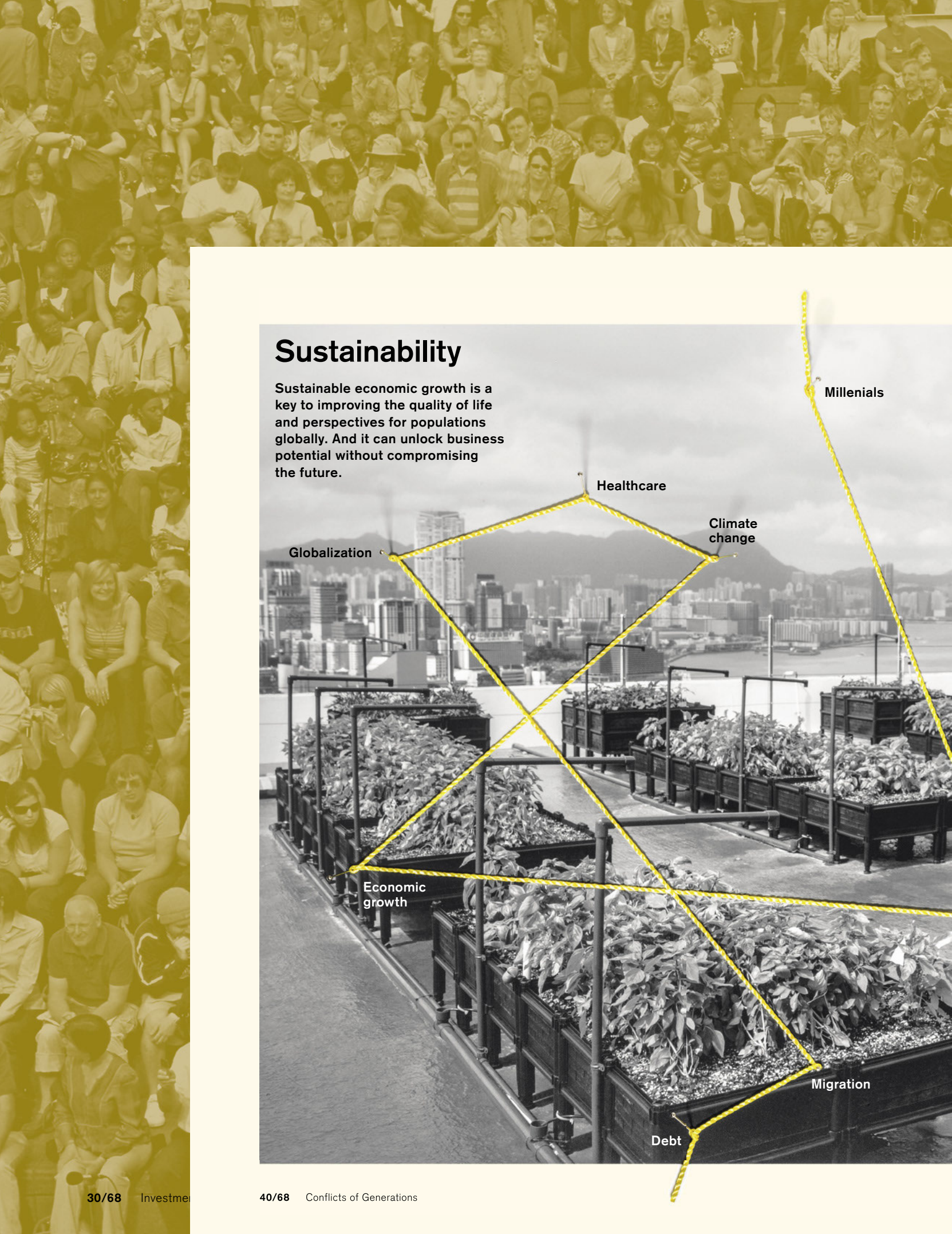
Neville Hill, Global Economics & Strategy, Credit Suisse Looking at 2017 from a specific European and UK angle, the upcoming elections in France, Germany and the Netherlands are potential risks, with right-wing parties and politicians attracting the attention of voters disenchanted above all by the migration crisis and also by prolonged austerity, growing inequalities as well as stubbornly high unemployment – in short, by the disappointing record of the European Union as an economic project. In France, Marine Le Pen is scoring points with anti-immigration arguments, while Germany's Angela Merkel is being challenged by the Eurosceptic, anti-migrant AfD (Alternative für Deutschland) party. Though these elections bear the potential of a similarly surprising outcome as the UK's Brexit vote on EU membership, the actual outcomes should be more benign than feared. In the UK, Brexit is going ahead, with Theresa May indicating that Article 50 of the Lisbon Treaty will be triggered by the end of March 2017 before the French elections take place. From a European perspective, the French will be an important negotiating partner in the Brexit discussions, but incumbent president François Hollande is widely expected to not win another mandate. The British could benefit from a change in leadership, barring a complete surprise outcome with Marine Le Pen winning the second round of elections. Such an outcome would throw into doubt France's commitment to the EU.

Oliver Adler The Swiss experience with the mass immigration vote looking to limit free labor mobility between the EU and Switzerland has also shown that "hard" votes are ultimately implemented in a much less drastic way than what many fear at first. The Swiss parliament is likely to opt for a light and indirect version of immigration control by giving limited preference to nationals in cases of high sectoral and regional unemployment. >



Infrastructure

Infrastructure investments are the ideal "old economy" tool to invest in the future, enhance productivity, create jobs at all educational levels and simultaneously provide assets with an attractive yield for long-term investors.



Sustainability

Sustainable economic growth is a key to improving the quality of life and perspectives for populations globally. And it can unlock business potential without compromising the future.

Millenials

Healthcare

Climate change

Globalization

Economic growth

Migration

Debt

Joseph G. Carson,
Global Economic Research,
AllianceBernstein
Looking at the USA, where the presidential election and – much like in Europe – popular frustrations and a polarized society are making daily headlines, the economy is actually in a healthy state. The strength of the consumer, which is benefiting from an increase in wages and a solid labor market, will prove a favorable combination with added government spending. Expectations for change under a new administration should drive growth. The presidential candidates' intentions to increase investment spending could also result in positive growth surprises.

▸ Are the financial markets discounting the risk of radical political change?

Nannette Hechler-Fayd'herbe,
Global Head of Investment Strategy, Credit Suisse
At present, European assets, whether it is credits of the European periphery or export-oriented European equity markets, are not pricing in the potential political risk related to mounting support for anti-EU politicians. Surprise outcomes at the upcoming elections could therefore lead to spikes in financial market volatility, which would put assets at risk temporarily. Correlations among risky assets, for example equities, credits and commodities, are currently higher than usual. So there are considerable spillover risks for large segments of the financial markets. This highlights the need to include uncorrelated assets such as hedge funds in portfolios and use periods of low volatility to buy portfolio protection (put options, for example).

Ulrich Keller, Alternative Funds Solutions, Credit Suisse
I agree that carefully selected hedge funds could prove a good place to be should the mentioned risks materialize. Hedge funds overall have disappointed in 2016, but the underperformance masks the fact that some strategies have done relatively well (e.g. relative value and tactical strategies). Therefore, it is important to differentiate the sources of (under)performance, since what has hurt recently may very well be a performance driver going forward, for instance rate expectations and equity >

"Politics in many developed countries has been shifting toward populism, while emerging markets have in fact appointed more reform-oriented governments."
Andrew Balls

market performance. In fact, such cyclical drivers present an investment opportunity. More generally, hedge funds should remain sources of uncorrelated returns. Interestingly, value-generating managers can increasingly be found in more nimble investment boutiques as well as outside the large financial centers, for instance in places like Australia or Scandinavia. Opportunities can also be found in illiquid assets such as private equity and infrastructure.

Nannette Hechler-Fayd'herbe
Any major political surprises would go hand in hand with central banks actively keeping monetary policy easy and helping to limit market instability. With low real yields, volatility spikes would probably remain temporary and setbacks of risky assets could well prove to be buying opportunities. However, the yield challenge would persist for a prolonged period of time.

Andrew Balls CIO Global Fixed Income, PIMCO

Andrew Garthwaite Global Equity Strategist, Credit Suisse

This places responsibility on investment advisors to guide investors to sources of yield in traditional assets where risk is acceptable but also on the industry to produce yield synthetically, for example with the help of structured products.

▸ Traditionally, the emerging markets were synonymous with political risk. How do these markets look in this new world characterized by political uncertainty in the developed markets?

Andrew Balls, CIO Global Fixed Income, PIMCO
Emerging markets have regained investor interest in 2016 and will likely do well also in 2017. Having cleaned up their past economic "sins," a number of emerging markets have undertaken significant governance reforms and have become more business-friendly. Moreover, while politics in many developed countries has been shifting toward populism and far-right

"Emerging market equities could be in a five-year phase of outperformance."
Andrew Garthwaite

movements have been gaining ground, emerging markets such as Argentina and Peru have in fact appointed more reform-oriented governments, which is supporting the investment environment. Furthermore, emerging markets benefit from

"Thematic investing is spotting trends before they happen – the sweet spot of investments."
Loris Centola

fundamentally positive underlying demographic trends (except in China), i.e. a young, better educated population that is laying the foundation for a continuation of the secular trend of emerging-market consumption. Interesting investment propositions can be found in emerging-market local and hard currency debt, which plays an all the more important role as global core bond yields remain unattractively low.

Richard Kersley, Global Thematic Research, Credit Suisse
The rapidly growing middle class in the emerging world and the associated changing consumption patterns remain one of the most powerful global equity themes. When it comes to looking for specific investment opportunities,

Loris Centola Global Head of Research, Credit Suisse

Richard Kersley Global Thematic Research, Credit Suisse

we focus on the spending patterns of the young, whose purchasing power is strongest, particularly in China. "Lifestyle" is a key dynamic of "millennial" spending trends – focused on travel, health and sports. Equally, it is important to understand how young consumers interact and what they spend their money on. E-commerce and connectivity continue to offer attractive investment opportunities.

"'Lifestyle' is a key dynamic of 'millennial' spending trends – focused on travel, health and sports."
Richard Kersley

Andrew Garthwaite, Global Equity Strategist, Credit Suisse Emerging market equities could be in a five-year phase of outperformance. Wage growth has now fallen below productivity growth, which is driving a recovery in margins and return on equity. Earnings momentum is positive and, importantly, emerging market currencies, excluding the RMB, look in aggregate about 30% cheap based on our models. Moreover, the emerging markets have much more monetary and fiscal policy flexibility than >

the developed markets. With sector adjusted price/earnings on a 15% discount to developed markets, valuations are no constraint. Selectivity is the key, however. We like Korea, China and India and favor the beneficiaries of a fall in emerging market sovereign yields, for instance financials.

▸ What powerful investment themes are emerging and what are the benefits of thematic investment?

Loris Centola, Global Head of Research, Credit Suisse
Themes are a good way to provide uncorrelated ideas or building blocks to a portfolio, in other words uncover ideas that work when nothing else does. The key is to discover these trends early and turn them into tangible investment propositions.

Magnus Lindkvist, TED speaker, Author, Speakersnet There really are two models of companies at the moment. Companies that compete with others and companies that create – this distinction needs to be made by investors. Real progress comes from the latter, but not always can creation be monetized. All attempts to monetize Twitter services, for example, have failed so far.

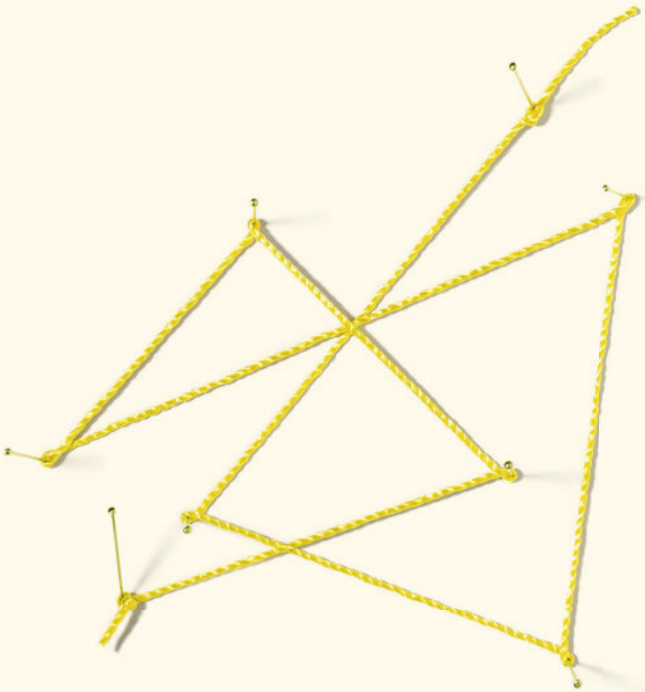
Stuart O'Gorman, Director and Head of Global Technology Equities, Henderson While technology creates exciting new markets, it is a process of creative destruction. The technology sector continues to steal share from the old economy at an accelerating rate, with an ever increasing list of old economy industries under attack. For example, the internet has already severely damaged the newspaper industry and is in the process of doing exactly the same thing to the TV industry.

Richard Kersley The theme of competition is also very present in other industries, where companies are threatened by Chinese competition, for example. While China offers a great end-market opportunity for many developed companies, a competitive threat is emerging as Chinese corporates ascend the value-added curve. Chinese companies have for some time proved a highly disruptive influence in commodity markets. However, the high level of research and development, government support for local producers and a degree of technology transfer have seen Chinese companies satisfy a greater part of their own domestic demand and now export their capabilities at a lower price point. The country's Made in China 2025 plan underlines that this trend is likely to continue.

Loris Centola Sustainability will appeal to an increasing number of investors over time, both as a theme and a way for investors to affirm their convictions. This includes not only environmental, social and governance-related aspects, but also increasingly sustainability with regard to the funding of retirement plans. We believe that companies with underfunded pension funds, for example, present a risk to investors. By avoiding companies with unresolved pension fund issues, investors can accelerate measures to restore sustainability and thereby stability.

Nannette Hechler-Fayd'herbe
As far as productivity-enhancing investments are concerned, we have made the case for infrastructure investments, as they are the ideal "Old Economy"

tool to invest in the future, enhance productivity, create jobs at all levels of education and simultaneously provide assets with a positive yield for long-term investors. Facilitating access and improving risk profiles of the asset class for private and institutional clients should be the number one priority of the industry in the coming years. ■



The time for affirmative investments

Investors, like citizens in everyday life, exert influence with their investment decisions. The trust – or lack thereof – which they express toward companies, sectors and sovereigns will determine returns on assets. We at Credit Suisse like to think that investors have an important role to play. Choosing to actively invest in assets and products can help alleviate some of the problems that have been discussed in our conference. Avoiding assets of companies or sectors that are at the source of these problems or worsen them should help move the economy and society in the right direction through bottom-up pressure. As a bank, we can contribute also, by providing analysis, facilitating access to investments and contributing concrete elements of a solution to the current significant challenges.

Investment Conference
Conflicts of Generations

The internal Investment Conference held in Zurich on 27 September 2016 explored how today's rising tensions and polarizations affect the economic and investment outlook, what investors should pay attention to and how they can exert influence with their decisions to invest in assets and products that can alleviate some of the problems.

Panelists

- *Michael Strobaek,* Global CIO and Head of Investment Solutions & Products, Credit Suisse
- *Oliver Adler,* Head of Economic Research, Credit Suisse
- *Neville Hill,* Global Economics & Strategy, Credit Suisse
- *Joseph G. Carson,* Global Economic Research, AllianceBernstein
- *John Woods,* CIO Asia Pacific Investment Strategy, Credit Suisse
- *Nannette Hechler-Fayd'herbe,* Global Head of Investment Strategy, Credit Suisse
- *Andrew Garthwaite,* Global Equity Strategist, Credit Suisse
- *Andrew Balls,* CIO Global Fixed Income, PIMCO
- *Ulrich Keller,* Alternative Funds Solutions, Credit Suisse
- *Loris Centola*, Global Head of Research, Credit Suisse
- *Richard Kersley,* Global Thematic Research, Credit Suisse
- *Stuart O'Gorman,* Director and Head of Global Technology Equities, Henderson
- *Magnus Lindkvist,* TED speaker, Author, Speakersnet
- *Bob Parker,* Strategic Advisor, Investment Strategy, Credit Suisse

Editor

Nannette Hechler-Fayd'herbe, Global Head of Investment Strategy, Credit Suisse

More information
For more information on the conference, please visit credit-suisse.com/investmentoutlook

Data sources: UN, Credit Suisse Global Wealth Report; McKinsey Global Institute Analysis, IBM; Forbes; Cisco IBSG, WHO, World Bank, Credit Suisse

Picture sources: Mathias Hofstetter (cover, p. 35, 39, 40, 45), Thomas Eugster (p. 33, 36, 37, 42, 43); 3alexd, gettyimages (p. 35), Øresundsbron, Pierre Mens (p. 39); Bloomberg, gettyimages (p. 40)

“Equities fulfill two roles in a portfolio: They provide a complementary source of yield with the dividends they pay and they offer the potential for capital gains.”

Nannette Hechler-Fayd’herbe

Volatility
The volatility index VIX – also known as the "fear index" – provides a measure of investor jitters as reflected in the stock market. Conceived in the early 1990s, the VIX is calculated using S&P 500 options prices.

Nannette Hechler-Fayd'herbe, Global Head of Investment Strategy

Continued financial repression

Investors are wary about whether the good performance of recent years can continue in 2017. Given the charged sociopolitical background in the Western world and a dense political calendar, potential abounds for market-moving events. Central banks will likely stick to monetary policy that suppresses market risk. Experience shows that in such an environment, temporary market corrections can be opportunities to deploy capital selectively.

The biggest challenge investors face in 2017 is to find yield at a reasonable risk. Investment grade credit spreads are tight relative to the leverage high credit-quality corporations have built up in recent years. We could see a mild credit spread widening in corporate bonds next year. We would thus focus any reinvestments of maturing investment grade bonds on financial bonds. We think European subordinated financial debt has the most to gain from banks' stronger capital positions and easy financial conditions.

Fixed income: Selective opportunities in EM debt
Emerging market (EM) hard currency bonds are also a good potential source of yield and diversification. Nevertheless, after the strong rally in 2016, country and sector selection is key in 2017. Argentina, Brazil and Indonesia as well as selected EM bank bonds are among our favorites. Investors who can tolerate currency risk can also consider EM bonds in local currencies, which provide yields of over 6%. Brazil is among our preferred local markets – we believe the currency is well supported and carry is very attractive. Colombia offers the best prospects of falling local yields as an additional source of price return. Fixed income asset managers have responded to the lack of yield with absolute return strategies. Given that longer maturity EM local currency bond valuations are mixed at present, our approach to managing interest rate risk will be selective and opportunistic.

Equities: Swiss stocks, healthcare and technology
Focusing on portfolio yield enhancement, telecoms and, to a lesser extent, utilities offer the most interesting prospects among the equity sectors. While their capital appreciation potential might be limited, steady cash flows make their 5% and 4% dividend yield, respectively, attractive. With respect to potential capital gains, the timing of investment is an important determinant of total returns. One way to mitigate the influence of good or bad timing is to focus on high conviction themes and regions at the start of the year and seize selected opportunities as they arise. Our strongest conviction with respect to sectors is healthcare and technology. Healthcare offers some of the strongest corporate fundamentals, and the high risk premium built in ahead of the US elections means it could recover ground in 2017. Technology, meanwhile, is still growing in areas such as cybersecurity, robotics and virtual reality. Across regions, we like Switzerland for its defensive qualities and sector exposure. Emerging market equities have catch-up potential versus their developed market counterparts, so they remain part of a diversified equity portfolio. However, we would not overweight them after the US elections. Europe could remain at risk of underperformance.

Resilient real estate markets globally
Commercial real estate markets continue to benefit from sound private household finances, low interest rates and low recession risks. We hold a relatively positive view on the asset class. Momentum is expected to remain robust in the US, across much of continental Europe and Japan. Leasing activities are holding up well in these regions, while they are falling in the UK and China. In UK real estate, returns are expected to suffer as a result of the Brexit vote. In Asia Pacific, slower growth in China is limiting rental growth and pushing up vacancy rates. However, we expect Japanese and service-oriented Australian cities like Sydney or Melbourne to escape this trend due to lower interest rates and solid labor markets. Furthermore, the residential markets in Asia Pacific benefit from relatively high absolute GDP growth rates. Even in Switzerland, where oversupply is increasingly weighing on operating income numbers, total returns are expected to be resilient, as low interest rates and high investor demand bolster capital values. We believe that real estate investment trusts focused on affordable housing will be one area of growth in the sector.

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Bull market
The terms "bulls" and "bears" to describe market speculators first appeared in the 18th century. Bears probably referred to bearskin traders, who profited when the market went down. How the bulls got their name is less clear.

Commodities in bumpy rebalancing

Commodities are continuing their rebalancing process, though progress is uneven and inventory overhangs remain large. However, this headwind should start to ease in the second half of 2017. We favor energy commodities, where cuts in capital expenditure have already led to a meaningful slow-down in production dynamics, while demand proves resilient. With inventories starting to normalize, oil prices could move toward USD 55. Industrial metals are slower to adjust, and any further resilience will depend on continued producer discipline and China's willingness to add more stimulus. Meanwhile, gold is seen as a good portfolio diversifier given its weak correlation with the major asset classes. Yet, we expect modestly higher real yields and a firming US dollar to be headwinds for gold in 2017.

Hedge fund returns modest; growth in private equity

Since the financial crisis, hedge funds have favored less risky and more liquid trades. Though this change has weighed on their performance potential, it has made them far less volatile. In 2017, we expect hedge funds to produce modest single-digit returns, supported by an environment of benign volatility and moderate but robust growth. Moreover, events such as a shift in monetary policy or the Brexit negotiations are likely to provide opportunities for managers. Unlike hedge funds, the private equity industry continues to grow rapidly. The asset class is related to the performance of listed equity, but it is inherently illiquid as funds are typically closed for ten years. As a result, investors are offered a sizeable illiquidity premium. The industry uses leverage to partly finance its transactions, so the current environment of low interest rates is an important return driver. Corporate restructurings and other activities are also picking up, meaning the industry backdrop is currently favorable. We thus believe that private equity can produce attractive returns for investors who can tolerate illiquidity and the risks related to leverage.

Currencies: Slow USD progression

The soft performance of the US dollar vs. other major currencies in 2016 is unlikely to repeat itself in 2017. Assuming the US Federal Reserve (Fed) continues its cautious monetary tightening, the currency can be expected to bottom out and

Tab. 1 **Can the good performance continue in 2017?**

Financial market volatility spikes could put assets at risk temporarily, but also spell opportunity.
Source: Bloomberg. Latest data point: 09/11/2016

Equities*

	Close on 9 November 2016	End-2017 forecast
S&P 500	2,163	2,230
EuroStoxx 50	3,056	3,175
SMI	7,898	8,320
FTSE 100	6,912	7,000
TOPIX	1,376	1,430
MSCI Emerging Markets	101,518	108,000

Bond Yields

	Close on 9 November 2016	End-2017 forecast
10-year US Treasury	2.04%	2.40%
10-year German Bund	0.22%	0.40%
10-year Swiss Eidgenossen	–0.35%	–0.10%

Credit Spreads

	Close on 9 November 2016	End-2017 forecast
Investment grade**	130	150
High yield**	470	550
Emerging market HC***	333	360

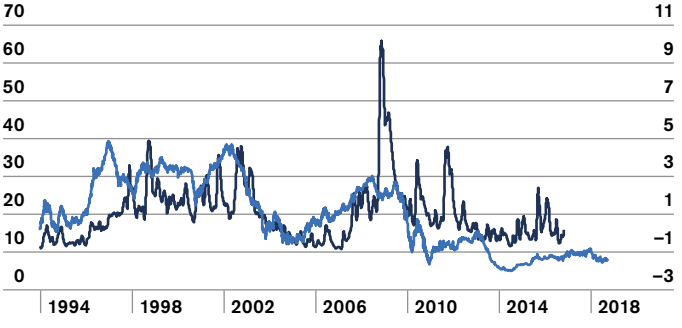
Currencies & Commodities

	Close on 9 November 2016	End-2017 forecast
EUR/USD	1.0910	1.05
USD/CHF	0.9844	1.04
USD/JPY	105.67	96.00
GBP/USD	1.2406	1.23
Gold (USD/oz)	1,276	1,250
WTI Oil (USD/bbl)	45.27	55.00

** All equity indices are price indices with the exception of MSCI Emerging Markets which also includes dividends. Closing price of TOPIX is as of 10 November*
*** Barclays Global Agg Corporate and Global High Yield index*
**** JP Morgan EMBIG Div. (sovereign index)*

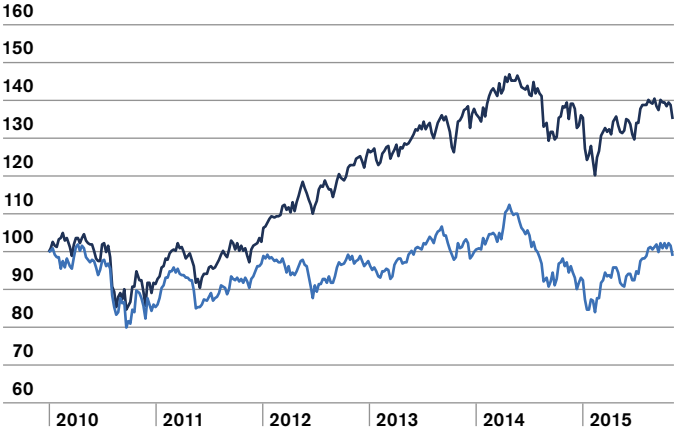
Safe havens
A "safe haven" currency is one that provides a hedge against global risk. Traditional safe haven currencies include the Japanese yen, the Swiss franc and the US dollar. The Swiss franc was created in 1850. Its status as a safe haven dates back to World War I.

Fig. 1 **Financial repression to keep real yields and volatility low**
VIX vs. 2Y US real rates lagged by 2 years (in %).
Source: Bloomberg. Last data point: 04/11/2016



— US 2Y real interest rates (2-year lead, RHS)
— VIX Index

Fig. 2 **Catch-up potential for emerging markets**
MSCI AC World and MSCI EM, index = 100 in 2010.
Source: Datastream, Credit Suisse. Last data point: 04/11/2016



— MSCI AC WORLD
— MSCI Emerging Markets

start an uptrend in 2017. With US yields at attractive levels, euro, yen and sterling-based investors could increase exposure to unhedged US dollar assets as this process unfolds and the dollar troughs. For Swiss franc investors, the relative success of the Swiss economy could lead to a less active Swiss National Bank and potentially more risk. In the developed market currencies, we favor the Norwegian krone. We expect a mixed performance from EM currencies: While any Fed tightening is likely to most affect the Asia Pacific region, it is less likely to hit currencies in Europe, the Middle East and Africa or Latin America, as they offer generally higher yields and still relatively attractive valuations. Our preferred currency for 2017 is the Russian ruble, and we least like the Turkish lira.

Structured investments can help plug asset gaps
While event risks could make volatility spike, such spikes are likely to fade relatively quickly. This creates opportunities for derivative instruments and structured investments. In this context, risk spikes can be used to sell volatility to generate a synthetic yield. During calmer periods, one possibility is to buy (call) options to gain exposure to markets, while limiting downside risks. We also continue to see value in derivative strategies that take advantage of the oil forward curve to extract synthetic yields of around 6% with structured investments. ■

Investor takeaways

- The year ahead promises more pockets of politically-driven volatility, but central banks will likely continue to suppress market risk and market corrections offer opportunity.
- We see financial and emerging market bonds as the most attractive sources of yield, but selectivity of issuer risk remains key.
- Healthcare and IT stocks offer the most convincing prospects in equities; private equity can provide attractive returns for investors who are able tolerate illiquidity.

Georg Stillhart, Asset Allocation Advisory/Investment Strategy

The foundation of a promising portfolio

Defining how a portfolio of assets should be composed is the critical first step toward achieving investment success. More than 80% of a portfolio's return and risk are determined by this investment policy, or Strategic Asset Allocation (SAA). Of course, shorter-term tactical decisions and the selection of specific investment instruments are important as well, but only once the fundamental structure of a portfolio has been defined.

In recent years, continued declines in interest rates have led to sizeable returns in most developed bond markets. This trend has resulted in today's market environment of historically low or even negative interest rates. Absent a severe economic downturn or deflation, both of which seem quite unlikely to us in the coming year, the returns in traditional high quality bonds are likely to be very low. This forces investors to look for alternative sources of return. But where to invest is a challenge, not least because interventions by central banks in recent years have affected not just the yields and prices of bonds but also those of other asset classes, as well as the relationship between the returns of various asset classes (higher correlation).

Prospects for the next five years

Our five-year forward-looking capital market assumptions (CMA) represent our best estimates of returns and risks for the major asset classes, providing the cornerstone on which to build a robust diversified multi-asset portfolio. One of the key forecasts contained in our most recent CMA update is that equity returns compare favorably to both bonds and cash. Emerging market stocks are expected to outperform their developed market counterparts on the back of better margins and more attractive valuations. Within fixed income, return prospects should remain better for lower rated credits, emerging market debt and convertibles. Hedge funds should offer precious diversification benefits, while private equity stands out as an attractive alternative source of risk-adjusted returns.

Based on expected risks and returns, we continue to believe that fixed income allocations should be invested mostly in corporate as well as emerging market and high yield bonds. We do not think that core government bonds should be completely eliminated from a strategic fixed income allocation due to their role in stabilizing portfolios in case of unforeseen risk events. They represent about 22% of our overall fixed income allocation. Investors that predominantly invest in fixed income assets due to limited risk tolerance or personal affinities should, in our view, diversify their portfolio by including a significant allocation of convertibles and a sizeable share of inflation-linked bonds.

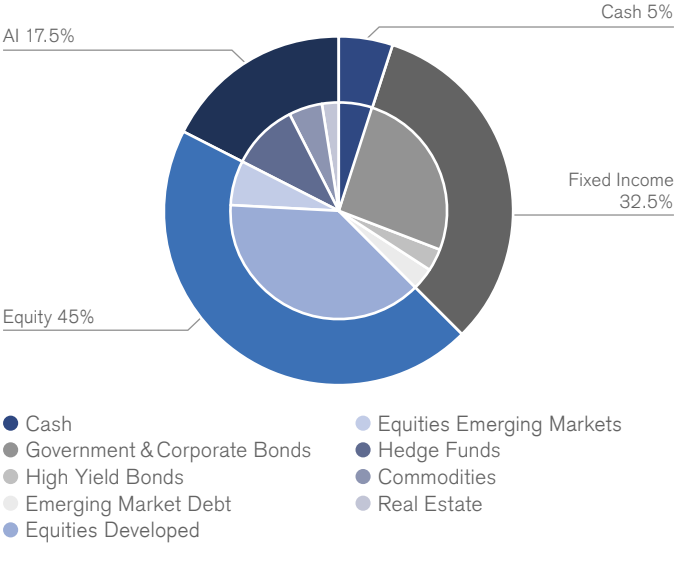
Invest globally in equities

Favoring the home market is a common and understandable behavior of investors. Home assets therefore represent an important building block in all our portfolios. But investing predominantly or exclusively in home assets may introduce an unwanted sector bias in a portfolio. Moreover, a portfolio may become too exposed to specific economic and monetary cycles. In contrast, investing globally reduces exposure

Fig. 1 **Strategic allocation for medium risk profile clients**

USD balanced profile without private equity

Source: Credit Suisse. Last data point: September 2016



Health check
The expression "health check" originally had a medical connotation. Today, it can refer to an examination of any machine or system to ensure that it is working properly. "Clean bill of health" is a similar idiom that enjoys wide use outside of medicine.

to individual country risks while providing a broader range of opportunities. This was again demonstrated in 2016, and our forecast of equity returns for the coming years continues to suggest that investing globally in equities offers useful diversification benefits. The inclusion of emerging market equities should be of particular interest in 2017 and beyond. EM equities represent about 15% of our global equity allocation.

Alternative investments, a key building block
Alternative Investments (AI) are increasingly gaining importance as a building block of diversified portfolios, particularly in today's world of low-for-longer interest rates and yields. At Credit Suisse, we have always had a broadly diversified exposure to alternative asset classes in all standard discretionary and advisory portfolios. AI typically represent a share of 17.5% in a balanced risk profile. While this allocation is larger than other wealth managers', it is broadly in line with that of pension funds around the world. At the same time, it is substantially lower than that of more specialized investors with particularly long investment horizons, such as endowments or family offices. AI encompass a broadly diversified universe including hedge funds, real estate, commodities and private equity. These investments typically respond to different drivers than traditional assets such as bonds and stocks. They also act as inflation protection in periods of rising inflation, while benefiting from falling yields in periods of declining inflation. They therefore play an attractive role in diversifying, stabilizing and indeed optimizing portfolios. We stick to our systematic inclusion of hedge funds (10% in a balanced profile), commodities (5%) and real estate (2.5%).

Private equity as an asset class has matured over the past decade, attracting greater attention and acceptance from investors. Private equity assets under management (AuM) more than tripled between 2005 and 2015, expanding from USD 1.2 trillion to USD 4.2 trillion. Though only accessible to qualified investors due to limited liquidity and large lots, our analysis suggests that private equity is often a sensible addition to a diversified AI exposure, offering differentiated long-term investment returns. To compensate for the significant illiquidity, private equity investors typically achieve genuine long-term investment outperformance. Credit Suisse's main discretionary portfolios do not include private equity, as the inherent illiquidity of the asset class makes it unsuitable for liquid portfolios. But in advisory portfolios of qualified long-term investors, a 5% private equity allocation is part of the recommended asset allocation for portfolios of above CHF (or USD) 5 million.

FX health check: The right scale of FX risk?
Investing globally typically entails currency risks if the international investments are not currency (FX) hedged. Some investors believe FX risk should be completely eliminated because there is no compensation for this risk in the long term. However, the issue with FX hedging is that it has become more costly for investors based in currencies whose central banks have introduced negative interest rates. If the US Federal Reserve gradually normalizes interest rates, the costs for these investors will likely increase further. Consequently, acceptable currency risks and acceptable returns after costs have to be kept in balance. At Credit Suisse, we therefore hedge FX exposure where currency risk significantly raises asset class risk. We think that fixed income investments need to be systematically FX hedged as FX exposure raises risks meaningfully in this asset class. The same holds true for real estate and hedge funds. In equities, we find that global diversification benefits outweigh currency risks and therefore do not systematically hedge currency exposure. We leave commodities unhedged in non-USD portfolios as FX hedges actually increase risk for many commodity investments. ■

Investor takeaways

- Fixed income portfolios should contain a good mix of corporate, emerging market and high yield bonds, with convertible bonds an interesting addition.
- Equities should be diversified globally with sufficient exposure in emerging market equities.
- Alternative investments are gaining importance to diversify, stabilize and optimize a multi-asset portfolio overall.

Christine Schmid, Global Equity and Credit Research

Focus on innovation power

Continued global economic healing, in other words low but resilient growth fueled by ongoing financial repression, is our base case for 2017. Temporary volatility spikes are possible and should be seen as buying opportunities in our preferred sectors. Within all sectors, the ability to achieve efficiency gains, size innovation power, as well as strong cash positions will be key success factors in the face of slow growth.

With global growth still subdued, companies exposed to or able to generate higher structural growth or that achieve cost efficiencies should be rewarded with a valuation premium. Thus, one of our sector focal points is the potential to reduce costs and re-leverage. Companies that are cash-rich and lightly leveraged are best positioned. As corporate cash levels are still high, further mergers and acquisitions are possible, supported by cheap financing. What will also matter in coming years is the innovative power of each sector.

Our view by sectors

• *Consumer goods need an emerging consumer revival:* The long-term earnings power of the consumer goods sector depends on a full recovery of middle-class consumers in the emerging markets (EMs) and real growth in the developed markets. European producers should find support in a weaker EUR relative to the USD. Most companies also face challenges from digital disruption or regulation that requires additional investment.

• *Energy sees lower cost structures and stabilizing oil prices:* Stabilizing oil prices and improved cost structures should drive modest earnings growth in the energy sector. Defaults and lower investment in the US shale gas segment have somewhat reduced overproduction and enabled better pricing. Yet cash flow deficits and rising debt levels could continue to weigh on companies' credit metrics and dividends. Also, any increase in taxes could affect earnings and cash flow prospects.

• *Financials focus on central banks and cost efficiency:* We expect the revenue headwinds in European banking to continue in 2017 along with the need for cost efficiencies. US banks should start to see a positive impact from the expected increase in US interest rates next year. In EMs, banks have recovered from recent lows, particularly in Brazil, as non-performing loans stabilize. Life insurance could remain under pressure by historically low rates. We thus continue to favor non-life insurance, particularly companies with sustainable dividend power. The risks to our views are further rate cuts by central banks or rates rising too rapidly, which could provoke a default cycle.

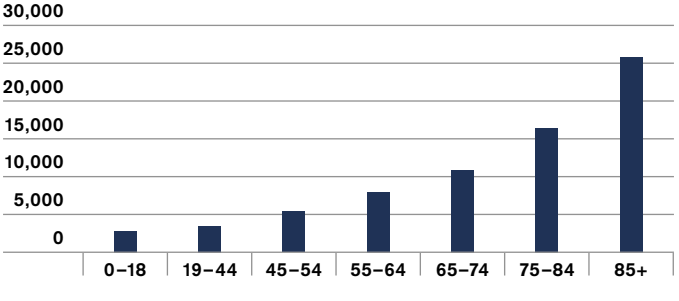
• *Healthcare on the cusp of a new innovation cycle:* Innovation drives the healthcare business model and underpins sustainable long-term growth. In the run-up to the US presidential election, drug pricing was a much-discussed topic. Yet we believe that innovation should sustain pricing power. Greater understanding of human biology, aided by low-cost genetic sequencing, is translating into product approvals. We see the industry as having embarked on a new innovation cycle that should produce many new products.

At the same time, the growing middle class in EMs is demanding state-of-the-art therapies. In the developed world, it is the elderly who consume most healthcare resources. Combined with innovation, both trends are leading to an increase in sector revenues. The key risks for the healthcare sector are non-approval of clinical studies and potential new regulatory constraints.

• *Industrials torn between the future and the past:* The biggest long-term driver for industrials is so-called Industry 4.0 – in particular robotics, 3D printing and big data. Beyond

Fig. 1 **Innovation and demographics underpin healthcare revenues**

Total healthcare spending per capita, by age group (in USD).
Source: Centers for Medicare and Medicaid Services.



Big Data
1.13 billion: The average number of daily active Facebook users worldwide in June 2016.

Cybersecurity
Protecting networks, computers and data from attack or unauthorized access is a growth industry. A 2015 study by Frost & Sullivan on the information security workforce predicted that 1.5 million information security professionals would be needed by 2020.

Industry 4.0, we expect the industrial sector to profit from an increase in fiscal spending and especially infrastructure investment. Underinvestment since 2009 has opened up infrastructure gaps in many markets in the areas of transport, communications, power and water/waste. Industrial companies that offer new products and services to improve the efficiency of power grids and broadband networks, for example, are set to benefit from such investment.

One of the major risks to well-established industrials is growing pension deficits. Slow growth and low rates are straining public and private pension systems. Pension funds today apply discount rates that are too high and thus end up materially underfunded. Combined with rapidly aging populations, pension deficits put special pressure on labor-intensive sectors, in particular in Europe, where we expect interest rates to remain low for longer. German companies are among the most affected, especially in the airline and industrial sectors.

• *IT at the heart of digitalization:* Innovation also drives areas such as virtual reality, the Internet of Things (IoT), and cybersecurity. These are the big themes driving growth in the technology sector, particularly in software. Amid mounting geopolitical uncertainties, demand for security has risen in recent years. Interestingly, greater connectivity (IoT, Industry 4.0, Cloud) has increased the vulnerability of the IT infrastructure. Thus, we expect the demand for cybersecurity to be even more important in 2017. The risks to the global technology sector are sharp currency moves and the resulting currency mismatch between revenues and costs. The sector is also vulnerable to short consumer product cycles, i.e. smartphones, tablets and PCs.

• *Materials limited by continued oversupply:* In 2016 so far, the materials sector has rallied off multi-year lows, supported by seasonal effects, low inventories, slower supply growth and improved macroeconomic fundamentals. Mining has done particularly well. The chemicals industry, which represents the bulk of the materials sector, is facing low organic volume growth and limited pricing power, which has led to mega-mergers. We expect this trend to continue.

• *Telecoms reflects strong free cash-flow generation:* Telecoms offer a defensive high-margin business with relatively strong cash-flow generation and dividend payments. Telecoms seem increasingly able to push through higher access prices based on higher quality ("more for more" strategy). Nevertheless, rising rates have made the sector vulnerable due to its capital-intense and high fixed-cost base.

• *Utilities are a problem child:* Lower energy and power prices (overcapacity and lower demand) are weighing on non-regulated businesses and gas suppliers. We expect no earnings recovery in the short term, and we see a further need for structural adjustments. In the longer term, renewable energy, smart grid and EMs provide growth potential for the sector. ■

Investor takeaways

- Ongoing innovation provides room for structural growth in healthcare and technology as well as in other sectors such as industrials. Technology is set to profit from rising demand for cybersecurity against the backdrop of elevated geopolitical risk.
- Stable cash flows and dividends can be found in telecom and healthcare.
- In the energy sector, efficiency and stabilizing oil prices provide leeway for earnings growth. Meanwhile, the financials sector remains under pressure to improve efficiency amid still low interest rates.

“Thematic investing is a more focused way of investing and helps narrow the search for good investments.”

Loris Centola

Theme or trend?
A theme is an idea that pervades a work of art – like nature or alienation – or some other human endeavor. A trend, in contrast, refers to a prevailing tendency. In finance, a trend might be technological or demographic change, while the respective themes are robotics or aging, for instance.

Loris Centola, Global Head of Research

Harnessing market drivers

Thematic investing goes beyond the traditional regional or sectoral investment approach. It seeks to identify the themes and trends that are going to drive market returns going forward. Looking through this lens, it is possible to identify a number of promising themes that should provide investors with exposure to the three overarching investment topics that, in our view, are likely to dominate 2017: finding growth opportunities, sources of yield and risk diversification.

In a world where traditional investments appear less and less attractive and economic growth is likely to be mediocre, a thematic approach can help investors identify attractive investment areas that may provide superior returns. Thematic investing combines the best of two worlds: starting from a top-down analysis of global and regional macroeconomic trends, we identify interesting asset classes, regions or sectors to invest in. However, within a region or sector, performance may be driven by specific trends that can only be identified with a thorough bottom-up analysis of the companies in this region or sector. Combining this bottom-up analysis with the top-down process, we are able to identify the trends and themes that are likely going to shape the markets going forward. Thematic investing thus is a more focused way of investing and helps narrow the search for good investments. Themes are also a good way to uncover ideas that work when nothing else does.

Growth opportunities

Take our outlook for economic growth, for example. Economic growth in Europe and the USA is likely going to remain subdued in the coming year. Nevertheless, there are thematic opportunities that allow investors to profit from substantial growth in certain areas of the global economy:

- Vital infrastructure has been neglected in the USA and in Europe over the last decade. As a result, the Western world is now facing a major shortfall in infrastructure spending. In the USA alone, the shortfall is estimated to be USD 1.7 tn until 2025. US president-elect Donald Trump, for example, has pledged to dedicate several hundreds of billions of dollars to infrastructure spending in the coming years, potentially making stocks with exposure to US and European infrastructure spending attractive investment targets.
- Economic growth in the emerging markets (EMs) remains significantly higher than in the developed economies. While the Chinese growth model adjusts toward lower growth rates than in the past, growth in the consumer sector not only remains high but is still accelerating. In China and other EMs, we thus prefer consumer stocks due to their exposure to this dynamic trend.

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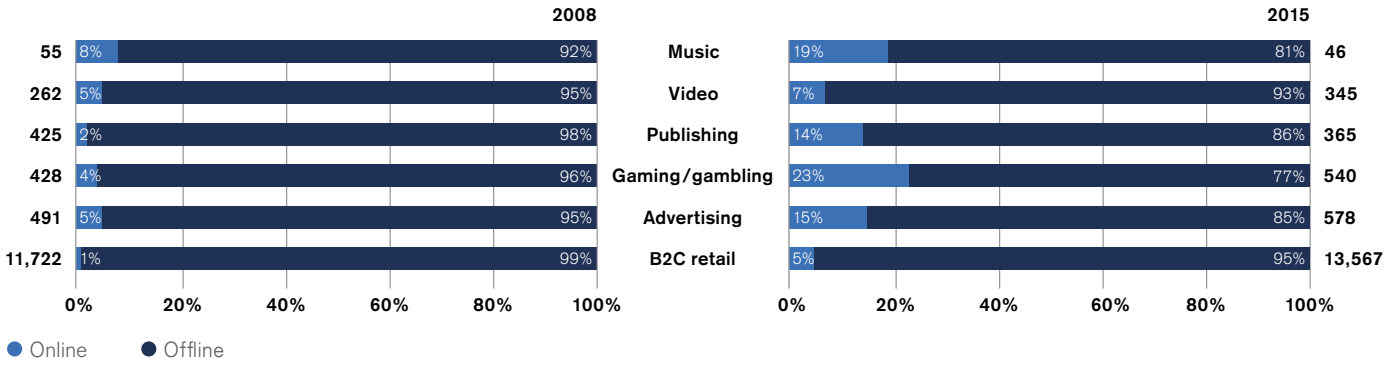
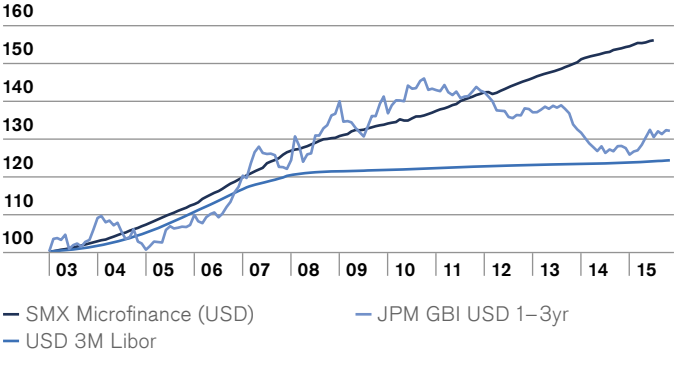
Fig. 1 **Online penetration increased significantly**
Consumer markets in the process of shifting towards online delivery (in USD bn). Source: A. T. Kearney, Credit Suisse.



Risk diversification
Harry Markowitz, the father of modern portfolio theory, showed in 1952 how risk can be reduced through diversification, or the wisdom of not putting all your eggs in the same basket. He shared the Nobel Prize for Economic Sciences in 1990.

• Meanwhile, consumption habits are changing globally. Digitalization, for example, is a long-term trend that is increasingly disrupting traditional consumption patterns and production processes, also thanks to the massive shift from "offline" to "online." Companies that are so-called "disruptive digitizers," i.e., companies that enter traditional markets with new digital forms of production and distribution, are likely to increasingly gain market share, which in turn should lead to above-average earnings growth and stock returns. Digitalization benefits not only producers, but also end users, providing more effective and efficient platforms. Therefore, technology pervades numerous sectors beyond IT, including healthcare (e.g., medical equipment makers), the media (e.g., digital advertisers), entertainment (e.g., gaming) and industrial companies (e.g., agricultural equipment manufacturers).

Fig. 2 **Microfinance performance**
Microfinance investments provide returns in excess of money markets (Performance Jan. = 100).
Source: Credit Suisse/IDC. Last data point: 01/10/2016



Sources of yield
Even if the US Federal Reserve tries to slowly normalize interest rates, they are likely to remain extremely low, or even negative, throughout much of the developed world. This means that the search for extra yield is likely going to remain intense. Investors can capture yield by purchasing longer maturity bonds and taking on duration risk, or they can take on credit risk. Our recommendation is clearly in favor of credit risk. Attractive risk-return opportunities can be found in two major areas:

• EM debt in hard currencies still provides a significant yield pick-up compared to developed market debt. Since growth is likely to continue to recover in important issuer countries, which experienced severe setbacks in the economy as well as in bond prices, their sovereign and quasi-sovereign bonds should offer the best opportunities, as flows are starting to indicate. In local currency EM debt, the expected returns are also quite attractive since yields tend to be higher, while many currencies are undervalued and offer additional upside potential against the majors.

• Other yield-enhancing investments can be found in the financial sector. Subordinated financial bonds still offer some of the most attractive yields in developed and emerging markets alike. Similarly, hybrid bonds that mix fixed income features with equity-like characteristics can be attractive yield enhancers. In all of these cases, however, the key to good performance is a thorough analysis of issuer quality and the features of the bond. Selectivity is key, as several shocks to financial institutions in 2016 have demonstrated once again.

Risk diversification
Given the increasingly demanding outlook for both equities and standard fixed income investments, risk diversification remains vital. Because we are trying to position our themes in a portfolio context, we are constantly looking for themes that provide risk diversification to investors, such as the following examples.

• Sustainability appeals to an increasing number of investors, both as a theme and a way for investors to affirm their convictions. We find that with the increased use of batteries in electric vehicles and electric storage systems, for instance, investing along the value chain of battery production is one of the most promising themes for the coming year. It taps into a fast growing market and offers some benefits of diversification for traditional stock portfolios.

• Microfinance is a thematic focus from an impact investment standpoint. In a portfolio, it also provides diversification benefits, as microfinance investments have a low correlation with other assets and are attractive low volatility, interest rate-enhancing assets in an environment of persistently low interest rates. Microfinance investments are short-term loans made in some of the poorest countries in the world to help local families build a business or make a living through farming.

Digitalization
Digitalization is a pervasive phenomenon in modern societies. Some innovations, such as online and mobile banking, were probably predictable. Others, like robotic advisors and blockchain transactional technologies, could take the sector into uncharted territory.

This non-exhaustive list of examples demonstrates that investors looking for good investment opportunities should not despair. While our overall outlook suggests that returns in the core asset classes are likely to be muted, thematic investments can provide added returns by capturing a number of growth and yield opportunities. Here, much like elsewhere, broadly diversifying a portfolio is the key to investment success.

Private equity: An interesting asset allocation building block
Finally, though not exactly a theme, we highlight private equity (PE) investments as an interesting asset allocation component. As discussed in our portfolio health check article, we believe that PE can provide added risk-adjusted returns for investors that can tolerate the illiquidity and the long investment horizon required by the long "lock-up" periods inherent to the asset class. If done right, PE investments can provide returns with a relatively low, but positive correlation to traditional equity markets. Selecting good managers is key, however – only the upper quartile of private equity funds generate returns that compensate adequately for low liquidity, in our view. ■

Investor takeaways

- Despite subdued economic growth around the world, investors can find opportunities to capture above-average growth through infrastructure investments, digital disruptors and EM consumer stocks.
- EM bonds and subordinated financial bonds provide a yield pick-up versus traditional bond and money market investments.
- Sustainability-related themes like stocks of companies in the fast-growing battery industry can provide diversification benefits to a portfolio, as can impact investments like microfinance.

Calendar 2017
Another busy year in politics

World Economic Forum annual meeting
Davos, Switzerland

ECB: monetary policy meeting
Frankfurt, Germany

Semi-annual Humphrey-Hawkins testimony
Washington, DC, United States

European Council meeting
Brussels, Belgium

Brexit: Article 50 trigger
UK

30th ASEAN summit
Cebu, Philippines

Spring meeting of the World Bank Group and the International Monetary Fund
Washington, DC, United States

Asian Development Bank 50th annual meeting
Yokohama, Japan

G7 Summit
Taormina, Sicily, Italy

OPEC meeting (Q2 2017)
Location to be defined

European Council meeting
Brussels, Belgium

January | February | March | April | May | June

US presidential inauguration
Washington, DC, United States

General election
Ecuador

Chief executive election
Hong Kong

General election
Netherlands

Presidential election
France

Presidential election
Iran

Legislative election
France

MiFID* II transposed into national law of EU member states
Europe

Semi-annual Humphrey-Hawkins testimony
Washington, DC, United States

G20 summit
Hamburg, Germany

Jackson Hole Economic Policy Symposium
Wyoming, United States

31st ASEAN summit
Philippines

19th National Congress of the Communist Party of China (Fall 2017)
Bejing, China

Annual meeting of the World Bank Group and the International Monetary Fund
Washington, DC, United States

European Council meeting
Brussels, Belgium

OPEC meeting (Q4 2017)
Location to be defined

APEC summit
Da Nang, Vietnam

European Council meeting
Brussels, Belgium

9th BRICS summit
China

July | August | September | October | November | December

Presidential election
India

Presidential election
Singapore

Federal election
Germany

Parliamentary election
Norway

Legislative election
Argentina

Legislative election
Czech Republic

Presidential election
South Korea

General election
Chile

General election
New Zealand

*Markets in Financial Instruments Directive

For more information on the Investment Outlook 2017, please visit
credit-suisse.com/investmentoutlook

Disclaimer

Risk warning

This report may include information on investments that involve special risks. You should seek the advice of your independent financial advisor prior to taking any investment decisions based on this report or for any necessary explanation of its contents. Further information is also available in the information brochure "Special Risks in Securities Trading" available from the Swiss Bankers Association
at http://www.swissbanking.org/en/home/publikationen-link/shop_popup.htm?ID=11308

For a discussion of the risks of investing in the securities mentioned in this report, please refer to the following Internet link:
https://research.credit-suisse.com/riskdisclosure

The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments is affected by changes in spot or forward interest and exchange rates, economic indicators, the financial standing of any issuer or reference issuer, etc., that may have a positive or adverse effect on the income from or price of such securities or financial instruments. By purchasing securities or financial instruments, you may incur a loss or a loss in excess of the principal as a result of fluctuations in market prices or other financial indices, etc. Investors in securities such as ADRs, the values of which are influenced by currency volatility, effectively assume this risk.

Investment principal on bonds can be eroded depending on sale price, market price or changes in redemption amounts. Care is required when investing in such instruments.

Commission rates for brokerage transactions will be as per the rates agreed between CS and the investor. For transactions conducted on a principal-to-principal basis between CS and the investor, the purchase or sale price will be the total consideration. Transactions conducted on a principal-to-principal basis, including over-the-counter derivative transactions, will be quoted as a purchase/bid price or sell/offer price, in which case a difference or spread may exist. Charges in relation to transactions will be agreed upon prior to transactions, in line with relevant laws and regulations. Please read the pre-contract documentation, etc., carefully for an explanation of risks and commissions, etc., of the relevant securities or financial instruments prior to purchase

Structured securities are complex instruments, typically involve a high degree of risk and are intended for sale only to sophisticated investors who are capable of understanding and assuming the risks involved. The market value of any structured security may be affected by changes in economic, financial and political factors (including, but not limited to, spot and forward interest and exchange rates), time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Any investor interested in purchasing a structured product should conduct their own investigation and analysis of the product and consult with their own professional advisers as to the risks involved in making such a purchase.

Some investments discussed in this report have a high level of volatility. High volatility investments may experience sudden and large falls in their value causing losses when that investment is realized. Those losses may equal your original investment. Indeed, in the case of some investments the potential losses may exceed the amount of initial investment, in such circumstances you may be required to pay more money to support those losses. Income yields from investments may fluctuate and, in consequence, initial capital paid to make the investment may be used as part of that income yield. Some investments may not be readily realizable and it may be difficult to sell or realize those investments, similarly it may prove difficult for you to obtain reliable information about the value, or risks, to which such an investment is exposed. Please contact your Relationship Manager if you have any questions.

Past performance is not an indicator of future performance. Performance can be affected by commissions, fees or other charges as well as exchange rate fluctuations.

Sensitivities
Sensitivity analysis is understood as the change in the market value (e.g. price) of a financial instrument for a given change in a risk factor and/or model assumption. Specifically, the market value of any financial instrument may be affected by changes in economic, financial and political factors (including, but not limited to, spot and forward interest and exchange rates), time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer.

Financial market risks
Historical returns and financial market scenarios are no guarantee of future performance. The price and value of investments mentioned and any income that might accrue could fall or rise or fluctuate. Past performance is not a guide to future performance. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income. You should consult with such advisor(s) as you consider necessary to assist you in making these determinations.

Investments may have no public market or only a restricted secondary market. Where a secondary market exists, it is not possible to predict the price at which investments will trade in the market or whether such market will be liquid or illiquid.

Emerging markets
Where this report relates to emerging markets, you should be aware that there are uncertainties and risks associated with investments and transactions in various types of investments of, or related or linked to, issuers and obligors incorporated, based or principally engaged in business in emerging markets countries. Investments related to emerging markets countries may be considered speculative, and their prices will be much more volatile than those in the more developed countries of the world. Investments in emerging markets investments should be made only by sophisticated investors or experienced professionals who have independent knowledge of the relevant markets, are able to consider and weigh the various risks presented by such investments, and have the financial resources necessary to bear the substantial risk of loss of investment in such investments. It is your responsibility to manage the risks which arise as a result of investing in emerging markets investments and the allocation of assets in your portfolio. You should seek advice from your own advisers with regard to the various risks and factors to be considered when investing in an emerging markets investment.

Alternative investments
Hedge funds are not subject to the numerous investor protection regulations that apply to regulated authorized collective investments and hedge fund managers are largely unregulated. Hedge funds are not limited to any particular investment discipline or trading strategy, and seek to profit in all kinds of markets by using leverage, derivatives, and complex speculative investment strategies that may increase the risk of investment loss.

Commodity transactions carry a high degree of risk and may not be suitable for many private investors. The extent of loss due to market movements can be substantial or even result in a total loss.

Investors in real estate are exposed to liquidity, foreign currency and other risks, including cyclical risk, rental and local market risk as well as environmental risk, and changes to the legal situation.

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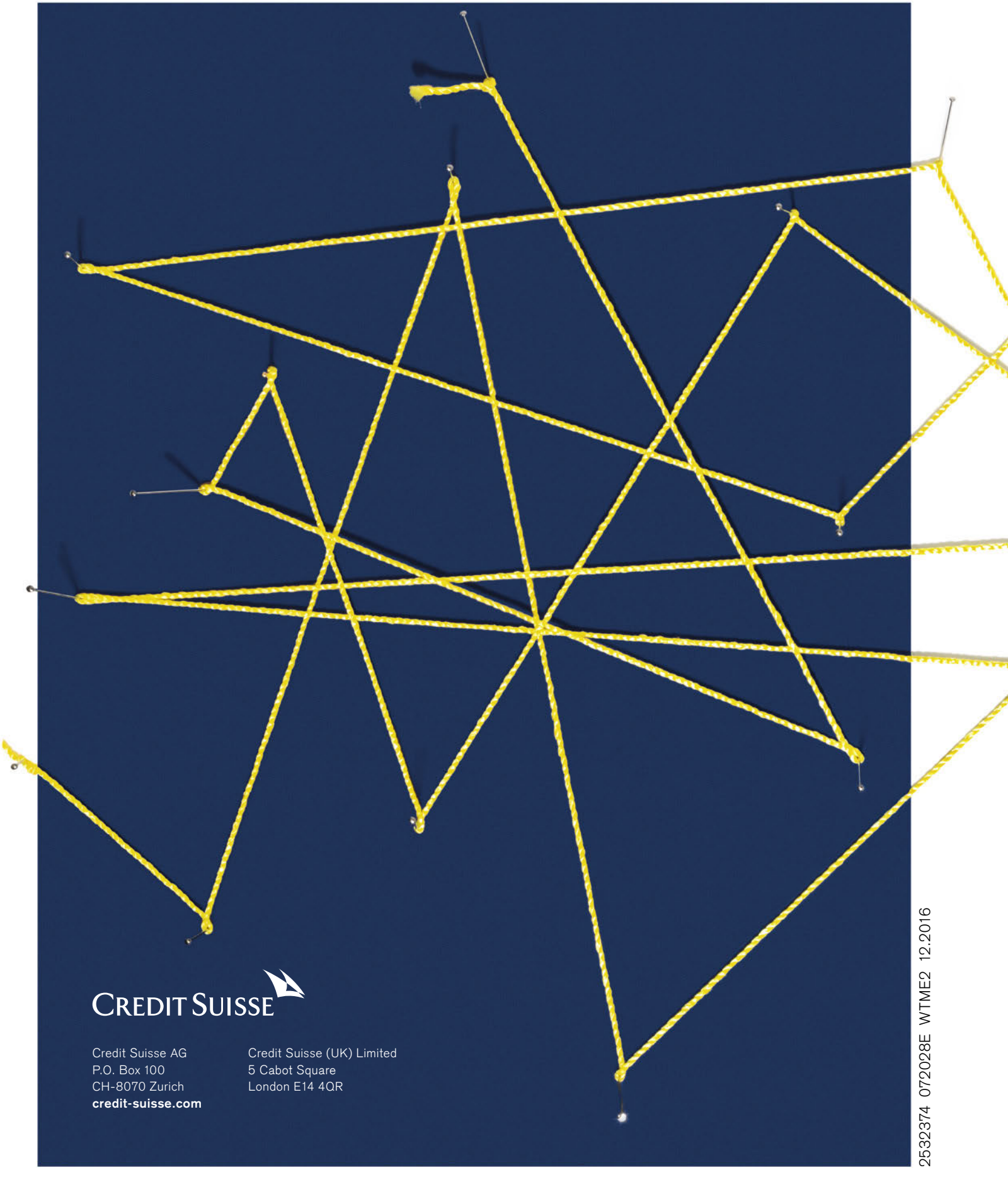

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