

# Investment Outlook 2020



Resilience after all.

# Resilience after all.



# From my perspective

**Tidjane Thiam**  
CEO Credit Suisse Group AG

It is my pleasure to present our Investment Outlook 2020. The past year has turned out better for most investors than might have been expected, considering the geopolitical uncertainty that prevailed during the period and weakening economic momentum.

So what is in store for 2020? It is unlikely that all the issues that have accompanied us since early 2018 will be resolved, be it the US-China trade conflict or political uncertainties in Europe. Investors will also continue to have to contend with extremely low (or negative) interest rates in bond markets. These are among the key themes that figure in my discussions with clients and other stakeholders.

Putting all of these issues into a broader context and differentiating between what is of greater or lesser relevance for businesses and investors alike is the paramount and arduous task of our bank's economists, financial analysts and strategists. The sum of these efforts is a central element of our holistic House View.

The main results of our analysis and our key views for the economy and markets are presented in the pages that follow. I trust you will find our analysis both interesting and relevant as you plan for the year ahead.

In this vein, I wish you a prosperous – and resilient – 2020.

Tidjane Thiam





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# Resilience after all

**Michael Strobaek** Global Chief Investment Officer  
**Nannette Hechler-Fayd’herbe** Global Head of Economics & Research and RCIO IWM

Unforeseen and surprising events have shaped 2019, and we have little doubt that they will impact the world in 2020 as well. In light of such uncertainty, it is of utmost importance for investors to build resilient portfolios.



Even if the US-China trade war eases and Brexit uncertainty diminishes, the year 2020 is unlikely to be entirely smooth sailing: a polarized US presidential campaign, margin pressure, high corporate debt, and fewer interest rate cuts by the major central banks – not to mention unexpected political developments – are likely to sporadically test investor nerves.

Overall, however, we believe that the global economy and risk assets will continue to show considerable resilience in the face of these challenges. This is the message that the title of this year’s publication, Resilience after all, is intended to capture.

While we expect rather subdued economic growth in 2020 and returns that are generally lower than in 2019, a serious market downturn or even financial crisis seems unlikely to us. We observe a number of imbalances in various economies and sectors, but none of them seems serious enough to trigger such a crisis. Conversely, technological progress remains in full force and, importantly, policy makers will continue to provide support.

The following pages lay out the key elements of the Credit Suisse House View for 2020. We have strived to provide a consistent and well-structured guide across the most important asset classes, markets and sub-segments. It suggests that investors who hold well-diversified portfolios, tilted toward areas of extra return, should continue to garner healthy returns. Furthermore, sustainability is increasingly relevant for investors, as it has already become a matter of great importance for voters and consumers around the world.

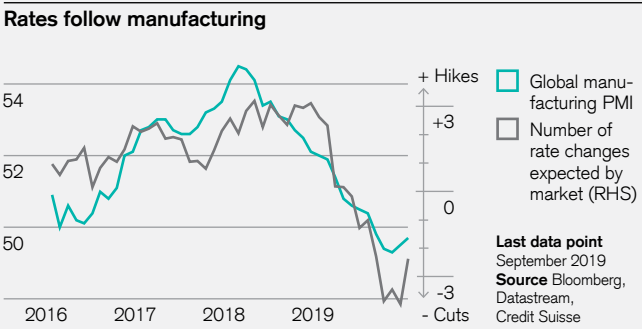
We hope you will find this publication helpful and wish you a successful year ahead.



# Markets defy weakening growth

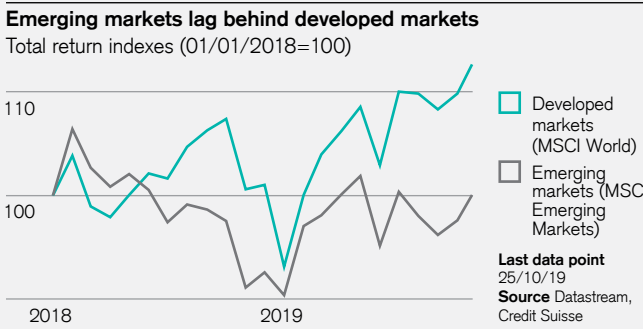
## Fed turns as global manufacturing weakens

Global growth and manufacturing sentiment have been weakening since the USA first imposed tariffs on China and other countries. Problems in the German auto sector only exacerbated the weakness. But because the US economy held up, in large part thanks to the 2018 tax cuts, the US Federal Reserve (Fed) projected continued rate hikes going into 2019. After equities corrected sharply in late 2018, the Fed changed course, moving to policy easing.



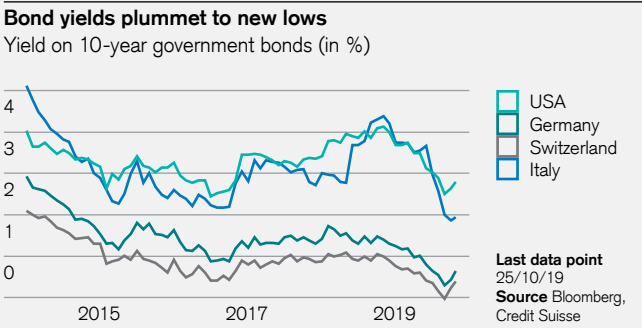
## Equities: Testing highs

At the start of 2019, the major equity markets rebounded strongly after their setback in late 2018, fueled by the Fed's shift to policy easing. The rally stalled temporarily mid-year on mounting worries over the global economy. Emerging market (EM) equities rebounded as well. But whether the underperformance vs. developed markets that began with the start of the US-China trade war in early 2018 has been broken remains to be seen.



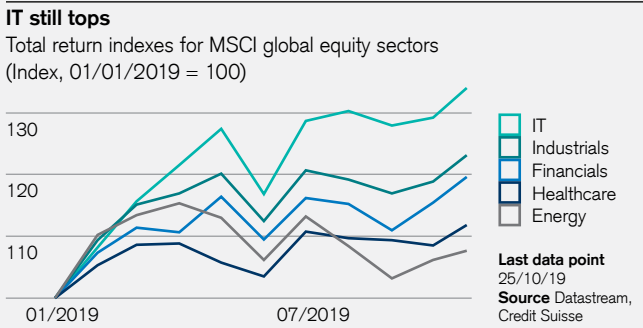
## Bonds rally across the board

US Treasury yields declined sharply, though not quite to post-financial crisis lows as fears of a global downturn took hold. In Germany and Switzerland, yields reached historic lows, with all now below Japanese levels. Despite far higher debt, the rally also took hold in Italy as the government moved away from its anti-euro and anti-Brussels stance. Emerging market bond yields also fell, though not quite as much.



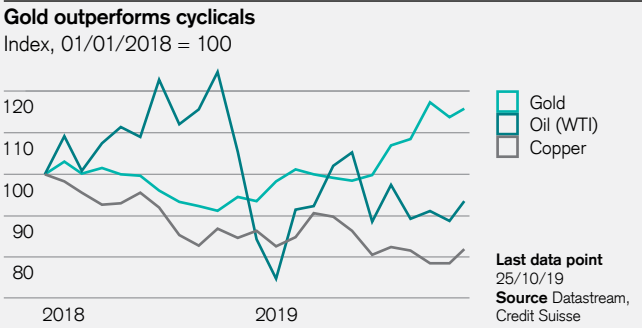
## Equity sectors: Gains across the board

All of the major equity sectors participated in the early 2019 rebound, but only IT managed to build decisively on its gains. In contrast, demand concerns and lower oil prices held back energy, while the drug pricing debate in the USA weighed on the healthcare sector's performance. In view of weakening manufacturing demand, it is surprising that the industrials sector held up so well. Financials slightly underperformed the MSCI World, as flat or inverted yield curves dented earnings.



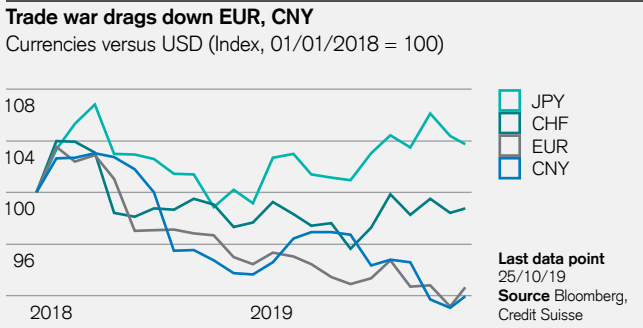
## Commodities: Diverging paths

US tariffs on China and the slowdown in global manufacturing weighed on industrial metals such as copper. As for oil, early 2019 saw prices recover as the Organization of the Petroleum Exporting Countries sought to restrain supply. But prices softened again as demand slowed. Meanwhile, gold prices rallied on the back of lower interest rates.



## USD still strong

After 2018 gains, the USD continued to appreciate against almost all major currencies, supported by better US growth and the (remaining) interest rate advantage. Only the JPY gained once again, as the Bank of Japan did not lower rates. China allowed the CNY to devalue to offset some of the tariff-related pressure. This weighed on other EM currencies, in addition to local rate cuts; only the MXN held up as the country reached a new trade agreement with the USA and Canada.



# Credit Suisse

## House View in short

“ A recession is unlikely in light of ongoing monetary policy support, ample credit, some fiscal easing and low oil prices.

### Geopolitics

Our base case is a de-escalation in the US-China conflict, but uncertainty remains high. The US presidential election campaign is likely to be highly polarized and may affect investor sentiment. European political risks should abate as uncertainty over Brexit subsides.

### Economic growth

Global economic growth is set to remain sluggish with only a minor recovery in industrial production, capital expenditure (capex) and trade. However, a recession is unlikely in light of ongoing monetary policy support, ample credit, some fiscal easing and low oil prices.

### Inflation

Inflation looks to remain well below central banks' 2% target in Europe and Japan, while it should decline in China and other emerging markets (EM). However, inflation is likely to exceed 2% in the USA, at least temporarily.

### Interest rates

We expect the US Federal Reserve (Fed) to remain on hold after the third rate cut in October 2019. The European Central Bank (ECB) will also stand pat on rates while pursuing quantitative easing (QE). The Swiss National Bank (SNB) should be able to avoid rate cuts, but may need to continue intervening in the foreign exchange market. Rate cuts should continue in a number of EM.

### Fixed income

Returns on most core government bonds are likely to be negative, except in the USA. Tight spreads imply anemic returns for investment grade bonds in developed markets (DM). Expect solid returns on most EM hard currency debt, with strong – albeit volatile – returns in some EM local currency debt, as well as frontier markets. Subordinated financial debt in DM remains attractive.

### Equities

Against the backdrop of limited earnings growth and flat to higher bond yields, returns in key equity markets are likely to be in the single-digit range. EM equities can recover if the trade war abates, and financial stocks should benefit if yield curves continue to steepen. In a low yield environment, stable-dividend stocks would do well.

### Real estate

Most real estate investments should continue to deliver moderately positive returns. We prefer direct real estate where lower interest rates do not yet appear to be fully reflected in the price.

### Commodities

Barring a major escalation involving Iran and Saudi Arabia, oil prices are likely to continue to stay subdued. Gold looks set to remain supported on the back of extremely low interest rates.

### Forex

The USD should hold up initially, but the EUR should gain in H2 as a Eurozone recovery takes hold. The CNY could depreciate slightly more vs. the USD on domestic weakness. The GBP would gain strongly on the back of a Brexit resolution. Our base case is for the CHF and JPY to trade sideways.



# Global economy



# Moderate growth, but no recession

We expect only sluggish global growth in 2020 of 2.5%, almost unchanged from 2019, but a recession continues to look unlikely given supportive macro policies. De-escalation on the trade war front will be key.

Over the past year, we have witnessed a significant slump in global manufacturing and trade, with global export volumes dropping by about 2% from the high of 2018, the biggest decline in recent decades except for periods of recession.

**More than trade**

The USA's imposition of tariffs on China and China's retaliation undoubtedly contributed to this slump, but the domestic slowdown in China – due to more cautious households and restrained credit growth – played a key role as well. Weakness in German auto sales exacerbated the manufacturing slump. As a result of heightened uncertainty, global corporate capital expenditure (capex) slowed significantly as well.

Meanwhile, the services sector lost some steam but continued to grow in most countries. With the services sector being the largest employer in developed countries as well as many emerging markets, demand for labor continued to grow and wages have been rising, albeit gradually. As a result, consumer sentiment and spending remained relatively robust.

**Path to recovery in 2020**

We expect the slump in manufacturing to bottom out in the first half of 2020, not least because of a natural inventory cycle. As the slowdown in manufacturing abates, the risk of it “infecting” the services sector should also diminish. The easing of policy by the US Federal Reserve (Fed) over the course of 2019 has helped boost credit, especially to US households. This support should remain in place in 2020 – although we do not expect further rate cuts – and should for instance bolster home purchases as well as other consumer spending.

Interest rate cuts by the Fed have also eased constraints on emerging markets dependent on USD funding. Central banks in a number of countries should be able to lower interest rates further, not least because inflation is declining. In Europe, we expect fiscal policy to ease gradually, which should support the growth rate in the region. However, a key to recovery will be at least a partial resolution to the trade war. A reduction in tariffs would improve profitability and sentiment in both the USA and China, which should help reignite capital spending.

**Main macro risks**

The key risk remains that the damage done by the trade war carries into 2020. Other geopolitical risks, especially the potential for a flare-up in the Middle East, remain in place but are less likely to materialize. In particular, we do not expect the global economy to be hit by an oil-price shock but rather expect oil prices to stay under pressure due to excess supply.

Even in the event of a trade deal, it seems likely that China's economy will continue to slow somewhat, at least in H1 2020. High mortgage debt combined with greater job uncertainty are likely to hold back consumer spending, while policy makers will remain cautious regarding stimulus measures. Slowing growth in China will continue to limit the recovery potential of its main trading partners in the region. An escalation of tensions in Hong Kong would pose downside risks.



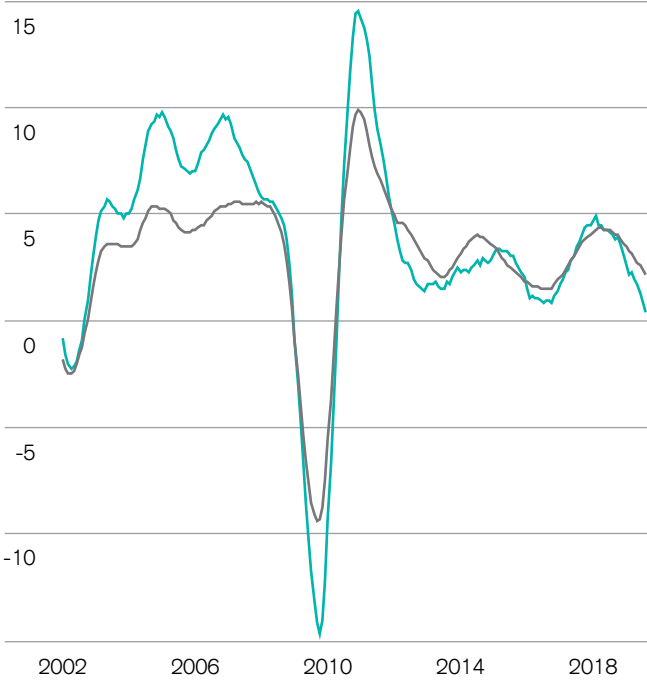
**From Quantitative Easing (QE) to Modern Monetary Theory (MMT)**

Find out more:  
[credit-suisse.com/mmt](https://credit-suisse.com/mmt)

Meanwhile, the USA is likely to face an unusually polarized election, which could negatively affect business and consumer sentiment. A further risk is that higher-than-expected inflation would raise fears of stagflation. In such a case, the Fed would be constrained in its actions. Bond yields might then rise substantially, triggering a general tightening of financial conditions.

On the following pages, we look at the outlook for 2020 on a country-by-country and regional basis, focusing on the base case as well as risks.

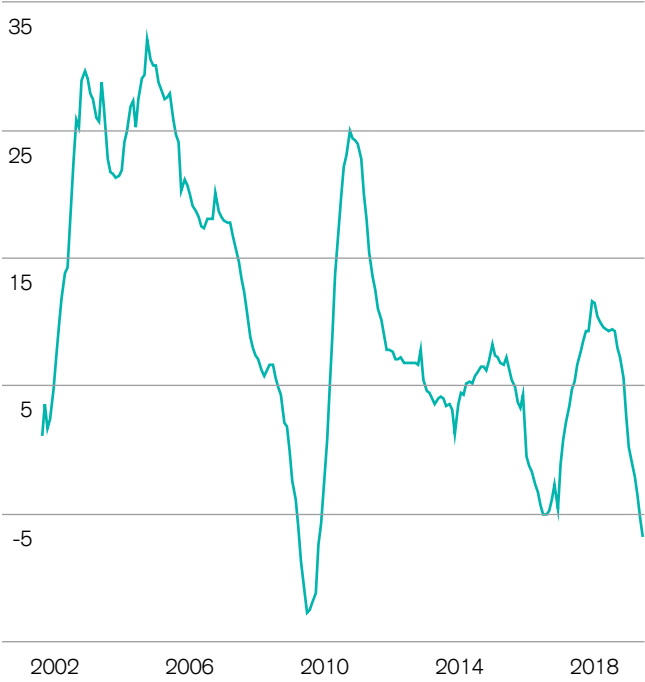
**Downturn in global manufacturing and trade**  
YoY changes (in %, 12-month moving average)



Trade volume  
Industrial production

Last data point August 2019  
Source Datastream, Credit Suisse

**US imports from China sharply lower**  
YoY change (in %, 12-month moving average)



Last data point August 2019  
Source Datastream, Credit Suisse

USA

# Dodging recession

**Growth:** We expect sluggish gross domestic product (GDP) growth for the US economy in 2020 (1.8%), accompanied by elevated recession risks (20%–30% probability in the next 12 months), and rising core inflation – at least at the beginning of the year. While job growth will moderate, rising labor costs will continue to weigh on corporate profits. Good news could come from a recovery in manufacturing activity if the USA and China reduced

tariffs. However, their full elimination appears unlikely and the trade war could potentially escalate in other areas. If the USA, for example, implemented tariffs on European automobiles and Europe retaliated, European producers and US consumers would be hurt.

**What to watch:** After cutting rates three times in 2019, our base case is for the Fed to remain on hold. Nevertheless, another cut is more

likely than a hike in 2020, and the Federal Reserve could increase asset purchases. While a potential rebound in manufacturing, as well as labor shortages that boost inflation would, in principle, argue for rate hikes, any rate move close to the election seems very unlikely.

China

# Cautious consumers

**Growth:** The government is likely to pare its growth target to 5.9%, and actual numbers could drop somewhat below that objective. Apart from the lingering impact of US tariffs, the burden of real estate debt, job insecurity, as well as weakness in local financial markets will likely restrain domestic consumer spending. The limited efficiency of credit allocation remains a key concern, and the manufacturing sector will remain under pressure due to continued overcapacity and competitive disadvantages in some sectors.

However, assuming a de-escalation of the trade dispute with the USA and moderate stimulus measures, the decline in economic growth will be limited.

**What to watch:** At the end of the first quarter, the Chinese government could announce added fiscal spending for 2020. With more fiscal room, authorities are likely to rely less on special purpose bonds and more on direct spending to support growth, at least until there is greater visibility with regard to the 2020 US election and future

US trade policy. Unless the trade war escalates, the Chinese authorities are likely to limit any depreciation of the CNY.

Eurozone

# Further fiscal support

**Growth:** We expect GDP growth of 1%. A de-escalation of the US-China trade dispute would reduce the drag on the Eurozone, and Germany in particular, helping to end the contraction of exports and industrial production. Given the resilience of domestic demand and the Eurozone labor market throughout 2019, the removal of that headwind should allow Eurozone GDP growth to gradually improve. Resilient credit growth

should also support the ongoing economic expansion. Monetary policy is unlikely to ease further within the Eurozone, but the European Central Bank (ECB) decisions taken in September 2019 (rate cut and renewed asset purchases) have already created a slight tailwind.

**What to watch:** New leadership of the European Union (EU) and ECB could bring new political

impetus. More concretely, 2020 might well mark the first year of Eurozone fiscal expansion in over a decade. Furthermore, we could well see a more generous interpretation of the Stability and Growth Pact by the European Commission, which would allow Italy and other countries to further ease fiscal policy. A continued trade war and its potential expansion to Europe poses the greatest risk, as well as a no-deal Brexit.

Japan

# Olympic boost

**Growth:** The Japanese economy is likely to slow somewhat in 2020 (GDP growth of 0.4%), but the expected turn in global manufacturing should limit the slowdown. The consumption tax hike of October 2019 may also continue to exert a drag. However, assuming there is no global recession, the Japanese economy will be able to overcome domestic headwinds.

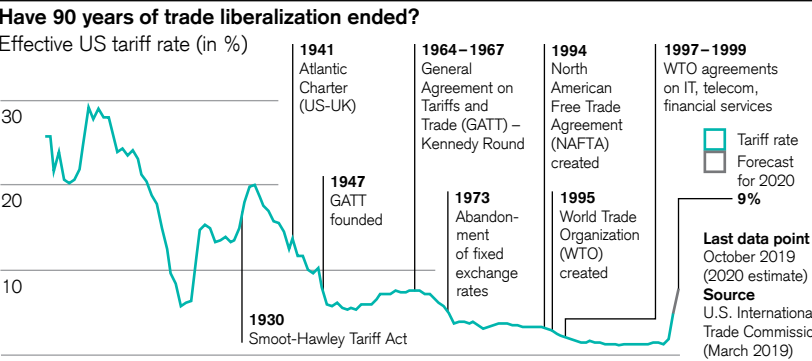
Meanwhile, the 2020 Summer Olympics will provide a tailwind by boosting inbound tourism. Public investment is also likely to remain strong in the first half of the year.

**What to watch:** Monetary policy will remain loose in 2020 and beyond. In fact, the Bank of Japan (BoJ) could potentially raise its inflation target. The consumption

tax hike will be offset to some extent by added government spending. Given its sensitivity to global trade and the Chinese economy, the outcome of the trade war and the evolution of demand in China are important as well. New trade agreements with the EU and the USA provide some long-term upside.

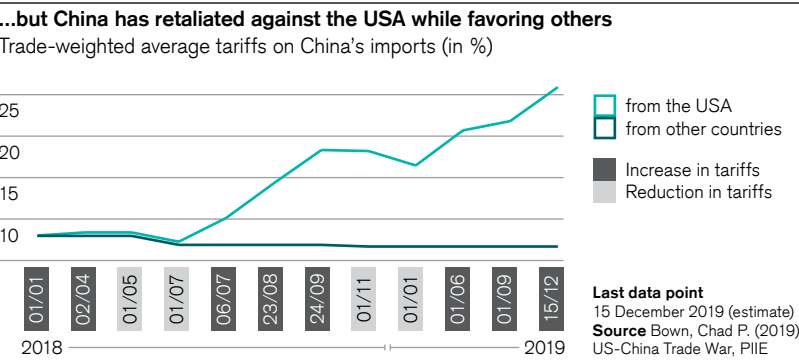
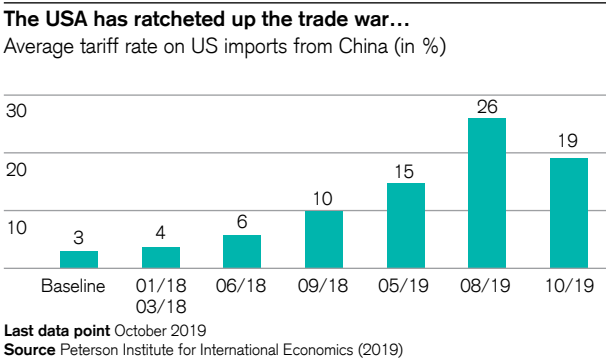
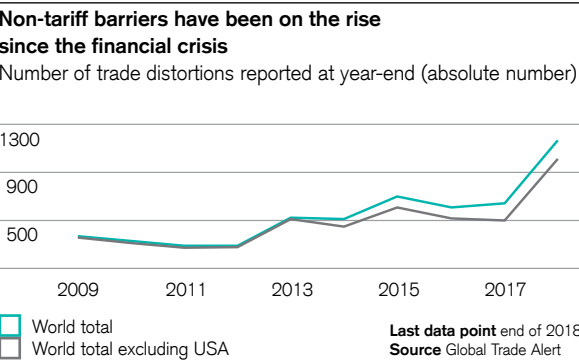
# Untangling the trade war

## From trade peace to trade war



“Trade wars are good and easy to win.”

**Donald Trump**  
US President,  
2 March 2018 on Twitter



“I don't believe any country in the world is going to retaliate [against us].”

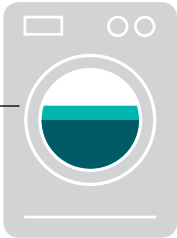
**Peter Navarro**  
White House trade adviser,  
2 March 2018 on Fox News

## Many losers...

Tariffs hurt consumers, either directly...

Increase in prices for washing machines after US tariffs imposed in February 2018

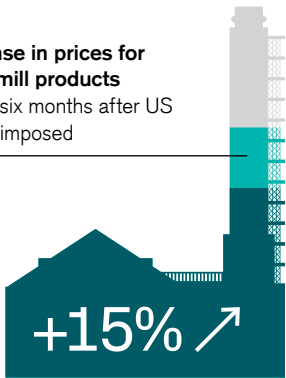
+9%



...or indirectly via higher input prices

Increase in prices for steel mill products within six months after US tariffs imposed

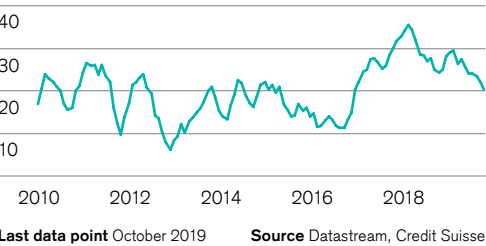
+15%



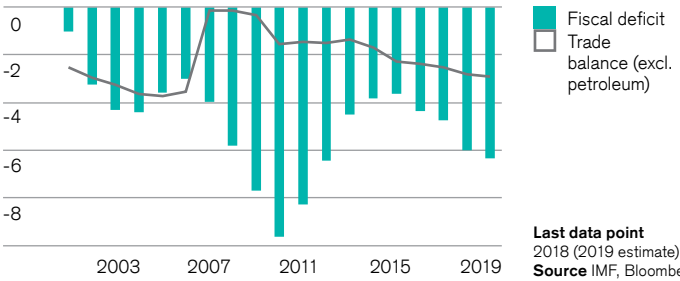
“...It's less business going on. It's less investment. It's more uncertainty. It weighs like a big, dark cloud on the global economy.”

**Christine Lagarde**  
Incoming European Central Bank President,  
23 September 2019 on CNBC

**Tariffs weigh on business plans...**  
Survey of capex intentions of US companies (Empire State and Philly Fed), indexed

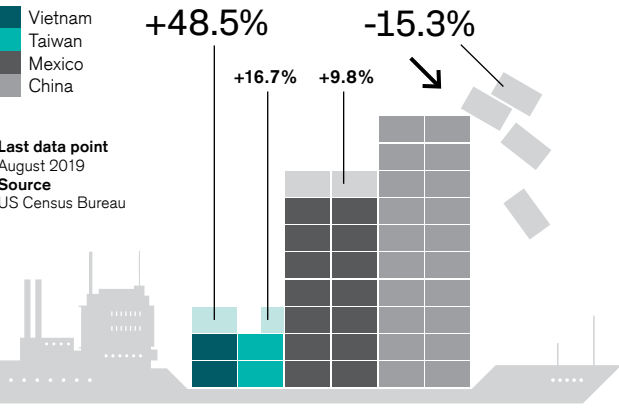


**...without solving structural issues**  
US general government structural balance and trade balance (in % of GDP)



## ...and a few lucky winners

**Countries gained from the trade war...**  
US import shares and changes, 2015 to 2019 from ...



**...as did Brazilian soybean farmers**  
Soybean imports by China since the start of the trade war

Brazil 78%\*  
United States 5%\*

-83% United States  
+30% Brazil

\* Share of soybean imports to China from October 2018 to February 2019

**Last data point** February 2019  
**Source** US Dept. of Agriculture, IHS



UK

# Still all about Brexit

**Growth:** Assuming a smooth Brexit process, our central expectation is that the UK grows somewhat more strongly in 2020 than in 2019. A Conservative majority would allow the UK to leave the European Union (EU) with a deal, while a Labour government (in a majority or coalition) would open the door to a second referendum. A hung parliament could produce deadlock and more uncertainty. While a no-deal Brexit is unlikely, in our view, such a scenario would cause a significant recession, with a decline in real GDP of 1% to 2% even if the Bank of England (BoE) eases monetary policy and the government loosens fiscal policy in response.

**What to watch:** The BoE's wait-and-watch approach is likely to continue while Brexit uncertainty remains high. If the UK leaves the EU with a deal or if Brexit is canceled, there would be considerable upside to corporate investment and overall growth. The BoE might then begin hiking interest rates in the course of 2020.

Switzerland

# Trade holds key to recovery

**Growth:** We expect moderate GDP growth in 2020 (of 1.4%) in light of the still subdued global backdrop. Domestic demand should remain supported by continued immigration, robust employment and slightly higher wages. Pharmaceuticals exports are likely to remain on a clear upward trend.

The mechanical and electrical engineering (MEM) sector will likely remain under pressure due to still weak demand from key export markets, including Germany and China.

**What to watch:** The Swiss National Bank (SNB) will do what it can to prevent CHF appreciation. While a rate cut is not our base

case, it could come to pass if the global economy remains weaker than expected and other central banks cut rates. US tariffs on pharma exports or the classification of Switzerland as a currency manipulator pose some risk. Increased geopolitical tensions would increase the risk of renewed safe haven flows into the CHF.

Asian EM (ex-China)

# Prospects hinge on trade war

**Growth:** The outlook for the more advanced countries of North Asia, i.e. South Korea and Taiwan, remains subdued due to weakness in Chinese trade, with growth of just over 2%. The outlook for Hong Kong will depend strongly on local political developments. Meanwhile, economic growth remains far stronger in much of Southeast Asia, which has more catch-up potential and is less integrated into China-based supply chains. Some countries, most prominently Vietnam, stand to benefit as production continues to shift in their direction. Singapore suffered a significant setback in 2019 in part due to the slowdown in global and China-oriented trade; a slight rebound to around 1.7% seems likely in 2020 if trade tensions abate. Growth in India is likely to remain high in absolute terms at around 6%, but well below potential due to the ongoing weakness in the banking and real estate sectors.

**What to watch:** A de-escalation of the US-China trade war would significantly benefit the countries closely tied into China-based supply chains. Even more important is the evolution of domestic demand in China and its impact on imports from the region. In India, which is much less dependent on global trade, domestic financial and monetary stability are key to a successful recovery.

Australia

# Eye on household debt

**Growth:** While low growth in household income, weaker housing market conditions and elevated household debt weighed on consumption in 2019, an increase in public spending supported economic growth. Infrastructure investment should continue to provide support in 2020. After a relatively subdued 2019, we expect Australia's economy to pick up with an estimated growth rate of 2.8%.

**What to watch:** Although house prices have already corrected to some extent, housing affordability is still low. Real estate thus remains high on the political agenda and further housing supply reforms are very likely.

The Reserve Bank of Australia (RBA) lowered its interest rate in several increments in 2019 to support the economy and could continue to do so in 2020. At the same time, financial supervision will remain in focus given the stability risks related to real estate.

EMEA

# Coping with setbacks

**Growth:** Turkey appears to have emerged from recession in Q2 2019 and is likely to achieve growth of 2%–3% in 2020. The headline inflation rate, projected at 12% for end-2019, could slow further after Q1 2020. Growth in Russia is likely to remain anemic at only around 1%–2% due to unfavorable demographics, bureaucratic burdens and low efficiency of public investment. Weak metals prices as well as structural issues such as labor market rigidities and a lack of public investment will continue to hold back South Africa. A number of Eastern European economies have suffered setbacks due to their close ties with the German auto industry, but growth is likely to remain reasonably robust given strong domestic demand and these countries' strong competitive position in other areas of trade.

**What to watch:** In Turkey, policy mismanagement remains the key risk against the backdrop of President Recep Tayyip Erdogan's target for single-digit interest rates and real GDP growth of 5% next year. The changing domestic political landscape and ongoing (albeit muted) geopolitical risks

also complicate the outlook, in our view. In Russia, low inflation (for the previously mentioned reasons) should pave the way for lower interest rates. A pick-up in Germany would benefit Eastern Europe. There are significant downside inflation risks building in South Africa. If they come to pass, South Africa will probably be one of a very few countries with large potential for policy easing in 2020. Investors will also be closely watching to see if Moody's downgrades its rating for South Africa after the 2020 budget.

Latin America

# Bottoming out

**Growth:** Brazil and Mexico, the region's two largest economies, showed only marginally positive growth in 2019. This was in part due to the global manufacturing slowdown, but domestic policy uncertainty played an even bigger role. The outlook for Brazil has improved, however, with the approval of pension reform, which will strengthen long-term fiscal stability and should be positive for privatizations and a continuation of the fiscal consolidation process. We expect GDP growth of 2.7% in 2020. In Mexico, growth should also improve somewhat (1.6% in 2020), partly in response to monetary policy easing. Meanwhile, some domestic risks have abated, including uncertainty over the 2020 budget and financing pressures on state-owned oil company Pemex. That said, it is questionable whether added government investment in the oil sector will produce adequate returns given declining global oil prices.

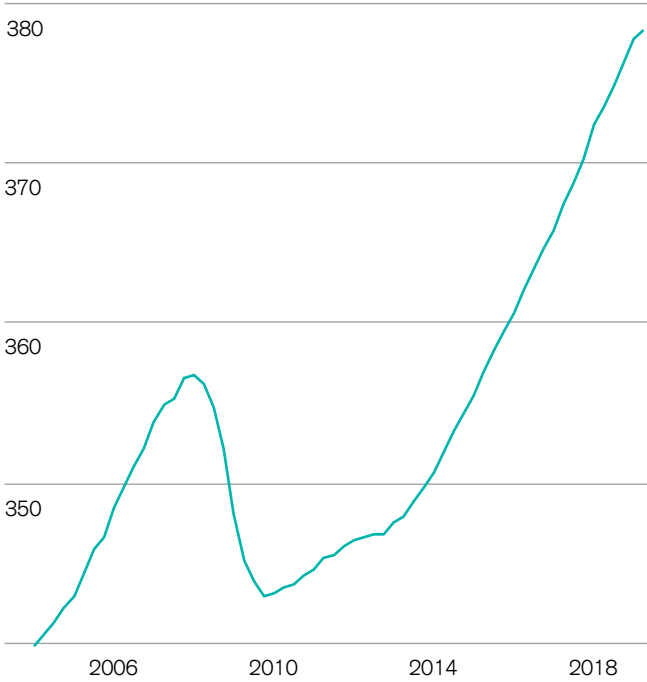
**What to watch:** In Mexico, other reforms such as tax reform look more likely despite political tensions. In addition, US congressional approval of the new free trade agreement known as the United States-Mexico-Canada Agreement (USMCA) would boost confidence, but this is not a given. Inflation in Mexico has declined to the central bank's 3% target, and should remain fairly stable at below 4% in Brazil.

Regions

# In summary

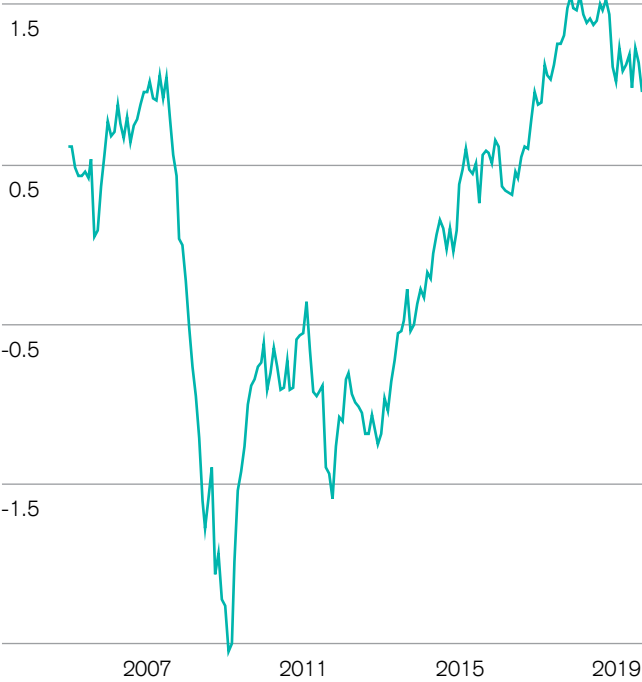
Our regional views amount to a mixed global growth picture. US as well as Chinese growth is likely to be somewhat lower than in 2019. At the same time, the expected recovery in the Eurozone and select EM should offset some of the softness. A major setback to global growth seems unlikely, in our view, given continued accommodative monetary policy, ample bank credit in most regions, as well as moderate oil prices. Apart from the global trade tensions, we see no obvious shocks that would trigger a recession. However, the global economy did come close to recession in 2019 – measured by the slowdown in global trade, for instance – which suggests that even limited shocks, whether geopolitical or economic in nature, could turn a downturn into something more serious.

**Employment high and still growing**  
Total employment in the USA, Eurozone and Japan (in millions)



Last data point Q2 2019  
Source Datastream, Credit Suisse

**Consumer confidence close to peak**  
Consumer confidence in the USA, Eurozone and Japan (GDP-weighted average, standardized)



Last data point September 2019  
Source Datastream, Credit Suisse





# Main asset classes



# More modest returns

Most asset classes showed a strong performance in 2019. Investors should not expect to see this feat repeated in 2020, although financial assets will likely continue to benefit from generally low yields.

While the trade war intensified and the global economy worsened, most asset classes showed a strong performance in 2019. This was largely due to the US Federal Reserve’s (Fed) sharp turn toward easing, which boosted investor confidence. Our forecast for 2020 is for most asset classes to deliver lower returns than in 2019. Even though we expect manufacturing to stabilize and trade tensions to abate, a number of factors will likely weigh on performance.

The drivers that played a key role in financial markets in 2019 – geopolitics, economic momentum and central bank policy – will undoubtedly remain influential in 2020, but we are likely to see some of them change direction. Other factors, including corporate fundamentals and investor sentiment, will also be important.

**Economic momentum set to stabilize**  
While we expect overall gross domestic product (GDP) growth to be somewhat softer relative to 2019, we forecast a slight acceleration of industrial production (IP). As our research has shown, there is a close link between IP momentum and financial markets. Better IP momentum tends to support risk assets while pressuring high-grade bonds.

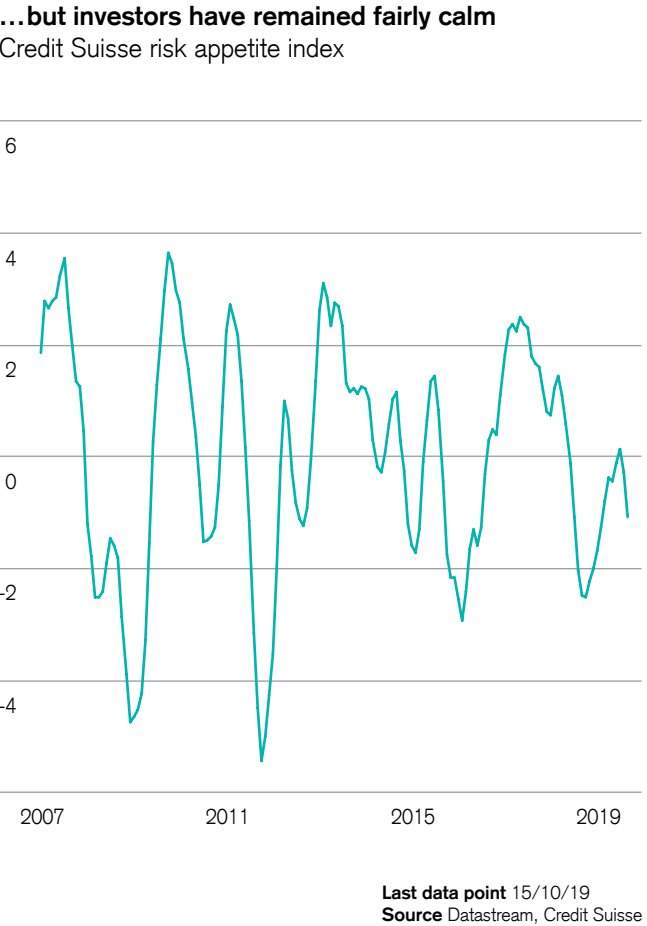
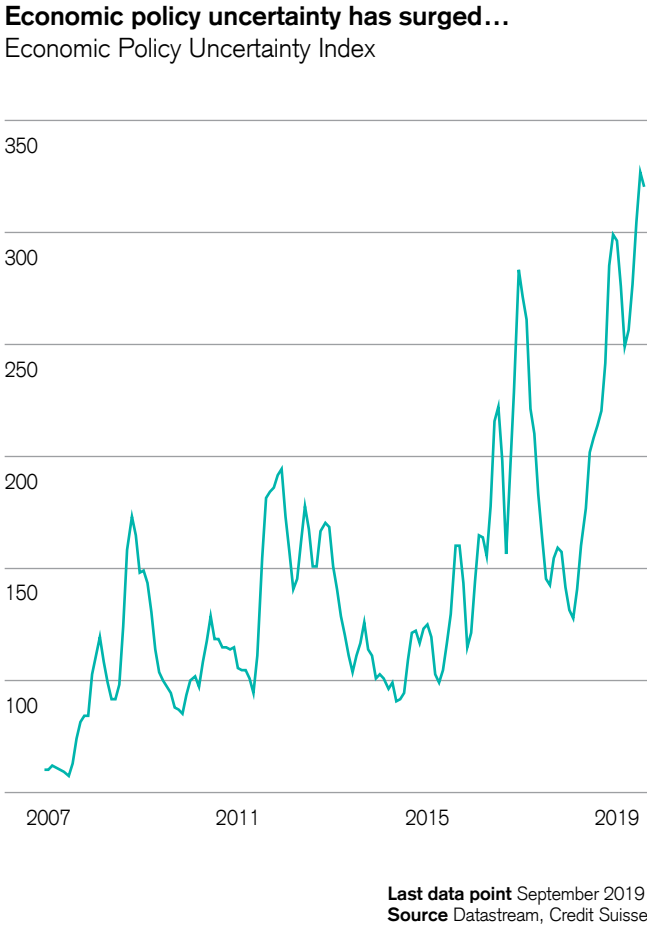
**More restrained central banks**  
Our base global economic scenario suggests that monetary policy support will be less pronounced than in 2019. Our economists expect the Fed and the European Central Bank (ECB) to keep interest rates on hold, although the ECB’s quantitative easing (QE) program will continue. Reduced monetary accommodation is likely to limit returns on most assets.

**(Geo)political wild cards**  
Forecasts regarding geopolitics are highly uncertain, but our base case is that the US administration will try to achieve some kind of trade deal with China. If successful, such an outcome would favor risk assets, especially Asian equities. However, the USA may face an unusually polarized presidential election campaign in 2020, which could harm investor sentiment. Conversely, a resolution of the Brexit uncertainty would support European risk assets and the GBP. Further flare-ups in the Middle East cannot be excluded, though a major military conflict remains unlikely.

**Margin pressure intensifying**  
US companies have achieved high profitability in recent years: subdued wages boosted profits as sales increased. Cuts in US corporate taxes also added to profits. Yet this “fairy tale” is coming to an end, and we expect margins to be subject to downside pressure going forward. While interest costs should remain subdued, labor costs are likely to continue to rise. Another factor likely to weigh on profitability is tariffs on imports from China, which have increased input costs for many companies.

**Valuations still favor equities**  
However, relative valuations still clearly favor equities. Although the price-to-earnings ratio (P/E) of global equities has moved up slightly over the past year, the valuation of high-grade bonds has increased more markedly as real yields have declined. That said, given the various headwinds, we expect absolute returns on major equity markets to be lower than in 2019.

**Corporate leverage a risk for low quality credit**  
Leverage of non-financial corporations has increased in recent years and, according to some measures, surpassed the levels we saw before the 2008 global financial crisis. However, debt today is far easier to finance given very low interest rates. Yet risks on lower quality credit have increased, in our view. We therefore favor intermediate credit risk, including various segments of emerging market debt.



# Sweet spots in credit

While returns on many of the highest quality bonds will likely be negative in 2020, there are still opportunities, including in the BB segment for high yield bonds.



With the global economy cooling amid ongoing US-China trade tensions, bond yields trended downward during much of 2019, generating substantial capital gains. At the time of writing, government and investment grade (IG) bonds were on track for a significantly stronger performance than in 2018 – this despite the fact that 35% of European IG corporate bonds were already trading at negative yields at the start of 2019.

**Yields headed back up**

According to our base case, the global economy should improve slightly in the coming year and IG and government bond yields are thus likely to rise. This would generate capital losses. As yield curves are still rather flat, the setback would be more severe for bonds with long maturities. Many high-quality bonds will therefore likely produce negative returns in 2020. If starting yields are very low or even negative, avoiding negative returns will be close to impossible.

We expect returns to be positive in only a few high-grade markets, such as US Treasuries or Australian government bonds. In contrast, returns are likely to be negative in much of the Eurozone and in Switzerland.

Positive returns are only likely in the case of a severe recession or geopolitical crisis. Then yields for the high-grade segment would further decline and the resulting capital gains could even outweigh negative starting yields.

**Tighter times for credit**

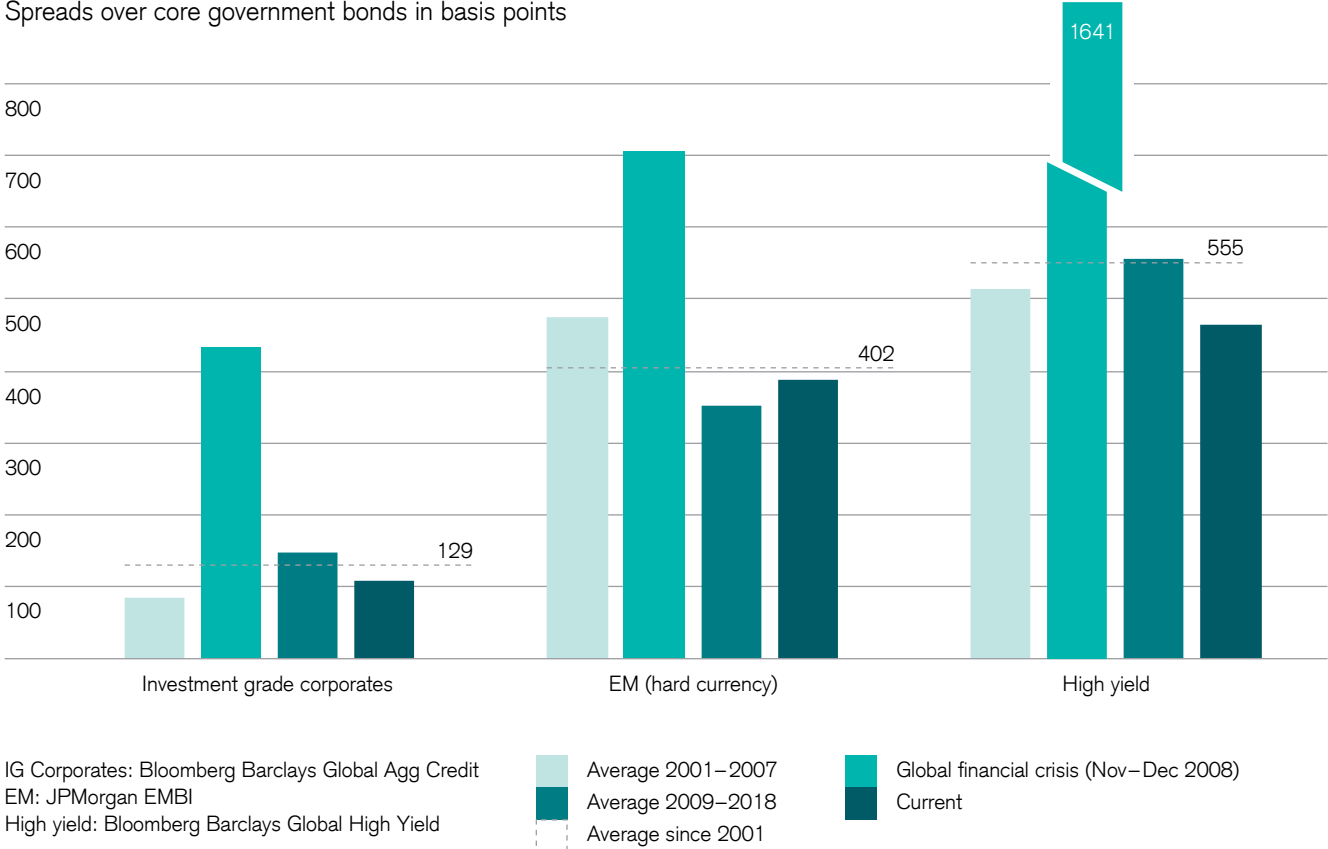
Spreads (the yield difference between riskier bonds and government bonds) in most credit segments also narrowed in 2019. Absolute yields thus dropped to very low levels in most segments. In some areas, yields now appear inadequate to compensate for the risk of worsening fundamentals and rising defaults.

This applies in particular to those debtors with a very low rating (e.g. single B) that are strongly exposed if the global economy further weakens. Moreover, leverage has increased in cyclically vulnerable areas such as steel and energy.

However, yields in some credit segments, both within IG and high yield (HY), look sufficient to compensate for such risks even if they are low. The following pages provide more detail on the opportunities and risks in 2020 for fixed income.

**Emerging market bonds offer good risk/return trade-off**

Spreads over core government bonds in basis points



Last data point 25/10/19  
Source Bloomberg, Credit Suisse

# Narrow focus in investment grade

**Backdrop:** Although yields in IG are very low in absolute terms, we continue to see attractive opportunities. Most of these bonds are unlikely to face downgrades even in an environment of subdued economic growth.

**Opportunities:** We see interesting opportunities in emerging market (EM) investment-grade dollar corporate bonds, not least in some Asian markets, where worries over the impact of the US-China trade war have triggered a rise in spreads even though corporate fundamentals

remain sound. Some European hybrids in non-cyclical sectors such as utilities and communication also offer interesting risk-adjusted returns.

# High yield: Focus on subordinated financials

**Backdrop:** HY spreads could continue to widen as long as recession fears have not been overcome, with B rated bonds most vulnerable to a sharper rise in yields. However, we continue to see opportunities in the slightly better BB segment.

**Opportunities:** This includes subordinated financial bonds. Ongoing regulatory pressure to strengthen bank balance sheets and the trend decline in non-performing loans, not least in the European periphery, should be supportive. HY bonds that

conform to environmental, social and governance (ESG) standards are of increasing interest and relevance as well.

# Emerging market bonds: Good risk/return

**Backdrop:** Spreads have declined less in the main EM bond indexes since the 2008 financial crisis than in a number of higher risk credit segments in developed markets, where leverage is often higher. The latter may have benefited more strongly, albeit indirectly, from central banks' asset purchase programs, which focused on advanced economy bonds. Conversely, EM bonds now offer a higher risk premium from which investors can benefit.

**Opportunities:** The US Federal Reserve's more accommodative stance should continue to benefit EM that are reliant on USD funding. Economic fundamentals in some of the large borrowing countries such as Brazil, Mexico and Turkey should continue to improve in 2020. Declining inflation rates should help bring down domestic interest rates in a number of countries, which would, in particular, support EM local currency bonds. However, as some currencies may come under pressure, a selective approach is required.



**Frontier markets:  
The new high yield**

Find out more:  
[credit-suisse.com/  
frontiermarkets](https://credit-suisse.com/frontiermarkets)

# Be conservative with asset-backed securities

**Backdrop:** Structured credit instruments, more generally known as asset-backed securities (ABS), are considered a primary catalyst for the 2008 financial crisis and have often been regarded with skepticism since then. However, we see various interesting opportunities in this area. But caution is advised in some areas including some of the traditional US and European ABS markets.

**Opportunities:** European covered bonds still offer moderate returns and a high credit rating. Collateralized loan obligations (CLO), especially senior and mezzanine tranches, also offer a good risk-return tradeoff. They are typically much less affected by rising defaults than HY bonds or leveraged loans. Moreover, their floating rate nature provides a buffer against rising longer-term

yields. In contrast, more than half of the US ABS issuers are from the automobile industry, which is undergoing structural change.



# Focus on growth sectors and dividends

Despite numerous headwinds, the MSCI World Index provided investors with a total return of just above 20% in the first ten months of 2019, well above an average year's return. We expect a more muted performance in 2020 as global central banks dial back interest rate cuts.



In 2019, the negative impact that diminishing growth momentum had on equities was more than offset by the significant boost that lower interest rates provided. In 2020, we expect economic growth to stabilize. We expect central banks will only provide limited additional support, though liquidity conditions should remain accommodative. The US Federal Reserve (Fed) in particular will not lower interest rates, in our view, or at most by very little, in contrast to what the market currently expects. In addition, margin pressures are likely to increase as labor costs rise. This suggests that equity returns will likely be more in line with an average year.

## **Positive base case for equities**

Nevertheless, our base case for equities is positive. As geopolitical tensions moderate and the trade war subsides, at least to some extent, business sentiment should improve and contribute to a recovery in industrial production (IP). Additional fiscal spending, especially in Europe, and the after-effects of monetary easing in 2019 should also support economic and sales growth. Finally, relative valuations still clearly favor equities. Growth-oriented sectors and stocks that benefit from sustained long-term societal changes should continue to outperform. Stocks that provide stable dividends are also favored.

## **Watch the margins**

Since the financial crisis, corporate profits have generally been boosted by subdued costs. While some cost drivers will remain at bay, others will not. Interest costs will remain very low for the foreseeable future and may even decline as maturing debt is refinanced at lower rates. Wages, however, have been growing faster in developed countries, particularly the USA.

The increase in the share of wages is a typical late-cycle phenomenon that should last for some years even if the economy entered into recession. Moreover, while productivity growth has increased, it is unlikely to fully offset these additional costs. Rising labor costs could lead to reduced cash flows. When combined with already extended financial leverage, this could limit stock buybacks, which have been an important driver in recent years.

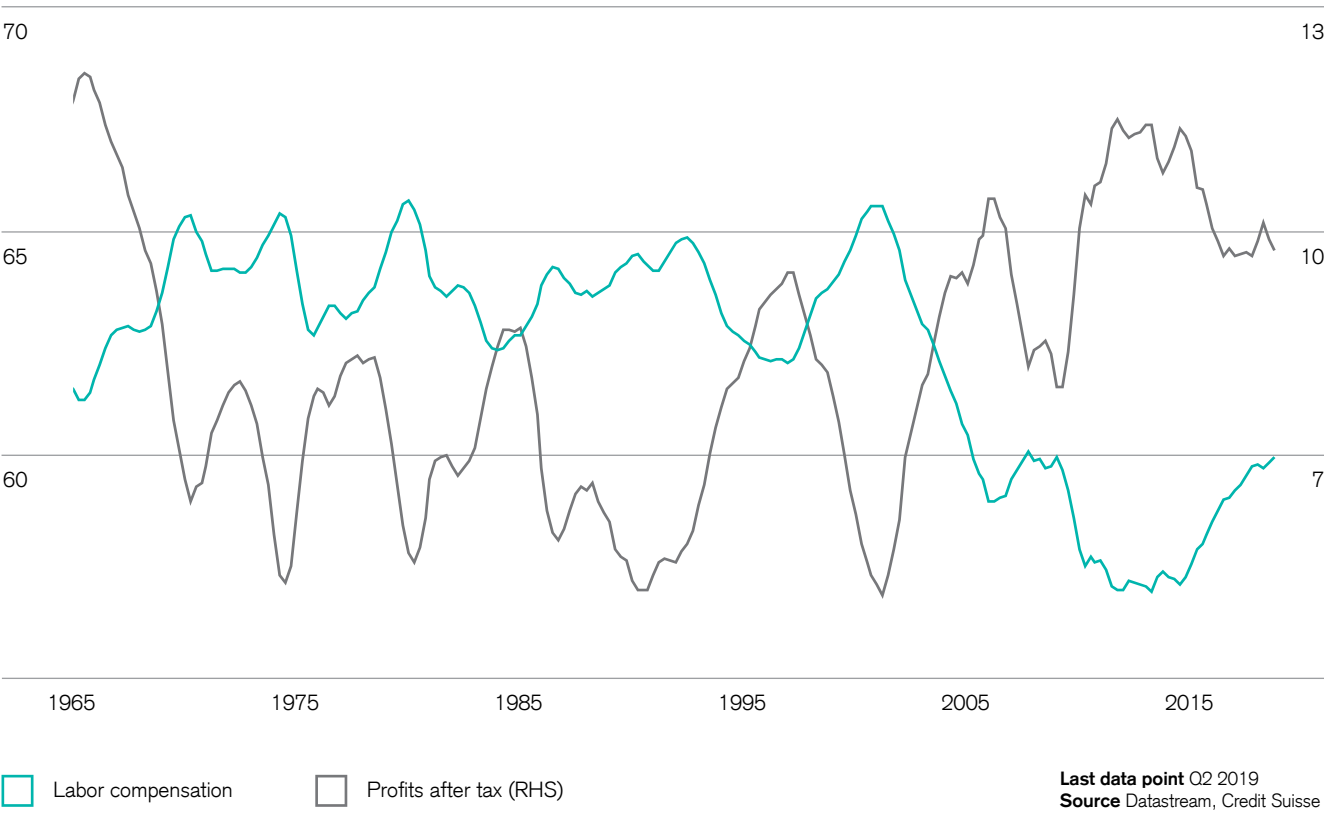
## **The X Factor: US presidential election**

The run-up to the 2020 US presidential and congressional elections in November 2020 could also have a meaningful impact on equity markets, though there is no hard and fast statistical evidence that equity performance in an election year differs from other years.

What may be different this time around is that the election year could be more turbulent than usual given the deep split in the US electorate. Moreover, if polls shifted clearly in favor of one of the left-leaning Democratic candidates, some sectors exposed to potential future intervention (e.g. healthcare, energy or financials) could come under pressure.

**Profit share likely to drop further as labor catches up**

Shares of profits after tax and labor compensation in US national income (in%, 4-quarter moving average)



**Finding returns in a low-yield sea**

Despite our expectation of mid-single-digit equity returns in the year ahead, returns are likely to be significantly higher than for investment grade bonds. Stocks of companies that offer sustainable dividend payouts should be well supported.

Based on today's equity prices, we expect a dividend yield for the MSCI World aggregate of roughly 2.5%. Some sectors such as financials, energy or utilities should continue to pay above-average dividends.

**Growth-getters**

More growth-oriented investors may consider high-conviction sectors or themes that are likely to experience strong earnings growth. One such area is education technology, which is on the cusp of high growth as education is becoming increasingly digital and therefore more cost-effective and impactful.

Separately, sustainability is becoming more important not only for consumers and companies, but also for investors. We believe that we are at the start of a transition to a more sustainable economy. While some companies and sectors may come under pressure, significant new opportunities should arise. Our five high-conviction Supertrends touch upon these and other highly relevant topics – please refer to page 40 for details about them.

# A bird's-eye view on major markets

**USA: Expect outperformance despite hurdles**

Since the start of the bull market in March 2009, the S&P 500 has outperformed other markets by large margins (around 210% vs. MSCI EMU and around 245% vs. MSCI Japan). Our base case presumes continued strong performance of the US market due to superior economic growth and the strong weighting of the IT sector. But its potential is limited by growing margin pressure as a result of rising wages, the waning effects of the 2018 corporate tax cuts, a less supportive Fed and, possibly, uncertainty surrounding the presidential election.

**Eurozone: ECB support versus trade war**

Considering the political worries and weakness in manufacturing, Eurozone equities held up surprisingly well in 2019. The move back to monetary easing and the associated weakening of the EUR no doubt provided support. However, measured in USD, the market underperformed the S&P 500 by 4.3%. Looking into 2020, we believe the market should be supported, among other factors, by the European Central Bank's accommodative monetary policy, a likely resolution of Brexit, and its undemanding valuation. The biggest risks are a potential escalation of the US trade war with China and potential US tariffs on European autos.

**UK: Look beyond Brexit**

The UK market underperformed global equities quite significantly in 2019. However, this was not primarily due to Brexit uncertainty but rather a result of weakness in the materials sector, which makes up a large share of the UK equity market. Looking into 2020, we believe the market will be among the weaker ones as continued sluggish growth in China continues to weigh on materials. A smooth Brexit would paradoxically add to pressure on export-oriented sectors as the GBP would likely appreciate significantly. However, it would support domestically oriented smaller companies. In the unlikely event of a hard Brexit, we would expect decisive easing by the Bank of England and a much weaker GBP.

**Switzerland: Steady as she goes**

Swiss equities continued to show a very strong performance in 2019, driven in part by the market's consumer staples giant. Our outlook for 2020 suggests a steady but not spectacular performance, as the defensive Swiss market would underperform more cyclical markets if global manufacturing improves. If successful, efforts by the Swiss National Bank to prevent CHF appreciation would be supportive. A weaker CHF in combination with a steeper yield curve would in particular support financials. A shift in US healthcare policy following the 2020 US presidential elections poses a certain risk to Swiss pharmaceuticals.

**China/EM equities: Trade war de-escalation is key**

Emerging market (EM) equities have underperformed developed markets substantially since early 2018. Initially, tightening Fed policy weakened a number of markets that are reliant on cheap USD funding. Matters worsened with the start of the US-China trade war – note that China and other northern Asian markets make up more than 55% of the MSCI EM index. A de-escalation of the trade war would thus likely support EM equities, even if other factors such as weaker growth in China may dampen the recovery. Lower inflation and easier monetary policy should continue to support EM such as Brazil.

**Japan: Hoping for an improvement in the IP cycle**

The past year was disappointing for investors in Japanese equities as the domestic as well as the global economy slowed amid the US-China trade dispute. For 2020, we think this market's fortunes should improve, as a pick-up in the global IP cycle and a recovery of capex spending in particular will benefit the cyclical Japanese market more than most others. Moreover, the market is attractively valued, with a forward P/E of just above 13 times. The Bank of Japan's commitment to maintaining an accommodative stance and limiting JPY appreciation is also a positive.

# Sector views

Tailwinds

- Innovation – e.g. 5G, Internet of Things, artificial intelligence (AI), digitalization – drives growth
- Software is key enabler of productivity enhancements



IT

Headwinds

- Saturation with smartphones limits hardware sales
- Slowing corporate investments due to uncertainty

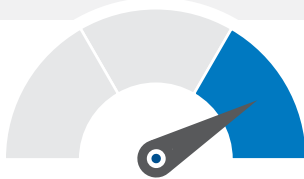
- Central bank “tiering” should boost profitability of European banks
- Valuations attractive, fundamentals improving (e.g. return on equity)



Financials

- Flat yield curve reducing net interest margins
- Margin pressures in retail and wealth management

- Significant growth rates of mobile entertainment (video gaming, video streaming)
- Shift of advertising from traditional to online offers meaningful revenue potential



Communication services

- Regulatory pressure, e.g. antitrust, privacy investigations, is challenging business models
- Content creation and compliance pressures require significant spending

- Attractive dividend yields
- Defensive sector, economic uncertainty or trade disputes have limited influence



Utilities

- Elevated valuations
- Somewhat higher bond yields would reduce appeal of this bond proxy

- Attractive dividend yields
- Outside retail, commercial real estate prices are expected to remain stable



Real estate

- Somewhat higher bond yields would reduce appeal of this bond proxy
- E-commerce reducing appeal of retail real estate

Tailwinds

- Aging population
- Better healthcare coverage and affordability in emerging markets



Healthcare

- Elevated political risks during 2020 US elections, healthcare costs and coverage a target of candidates
- Litigation risk related to opioid epidemic

- Even a partial resolution of the trade dispute would lift economic uncertainty
- Potential increase of infrastructure spending in various countries



Industrials

- Economic uncertainty reducing corporate investments, industrial production
- Earnings growth could disappoint

- Solid dividend yield
- Defensive sector, in favor if economic uncertainty persists



Consumer staples

- Valuations elevated
- Appeal of this bond proxy sector likely to fade as interest rates expected to back up

- Solid labor markets, wage growth and household balance sheets support consumer demand and spending
- Low interest rates support spending on home-related durables



Consumer discretionary

- If US-China trade dispute continues, slowdown in manufacturing could spread to labor markets and consumer demand
- Traditional retailing faces structural challenge from e-commerce

- Geopolitical tensions with potential to disrupt supply may boost risk premium in oil prices
- Attractive dividend yield



Energy

- Manufacturing weakness, a slower Chinese economy reduces demand growth, while US shale oil producers add to abundant supply
- Pressure to address environmental issues could accelerate move to sustainable energy solutions

- Low interest rates could lift construction-related demand
- Valuation attractive



Materials

- Low global economic growth and strong dollar are a drag
- Slowing growth in China a risk



# Supertrends

What do rising pet ownership, global climate school strikes, and the launch of next-generation 5G mobile networks have in common? They all are testimony to the sweeping societal changes that we picked up on when we first launched our five Supertrends in 2017.

Our Supertrends cover a broad variety of timely topics: our increasingly multipolar world; infrastructure; population aging; the influence of the next generation; and fast-paced technological innovation. They are focused on structural driving forces and aim to improve a portfolio's overall risk/return profile, outperforming the broader market in the long run. Our conviction in these trends remains strong.

**A new addition: Education technology**  
In June 2019, we introduced new angles to our Supertrends framework. In relation to the Silver Economy Supertrend, for example, there is a growing number of seniors living with pets. Animals have their own dietary and veterinary needs, which should fuel growth in the pet care market to over USD 200 billion globally by 2025. In terms of our Millennials' Values Supertrend, being online and using social media comes naturally to Generation Z. They drive demand for education technology, which is in the early stages of what we believe will be a major transformation. Marketers Media expects the digital education market in North America to grow to more than USD 400 billion by 2023. In our Technology Supertrend, we broaden our "digitalization" subtheme to focus on 5G and how it impacts big data.

In addition, environmental, social and governance (ESG) criteria remain a key topic and investment focus particularly for the Millennials, whose voices as responsible consumers are increasingly being heard.

**Long-term themes across sectors**  
Thanks to the Supertrends' modular concept, investors can invest in single stocks, more niche themes, or the broader Supertrends themes. Together the five Supertrends provide broad diversification in terms of Credit Suisse's single stock selection, with every sector in the MSCI World part of a portfolio. The largest exposures in a Supertrends portfolio context are in IT, healthcare and industrials. In terms of regions, the USA makes up almost 50% of our Supertrends stock selection – less than its weight in the MSCI World. Conversely, we have a higher exposure to emerging markets, which reflects long-term growth opportunities in many of these countries, as well as worldwide societal and demographic trends.

## Pushing for change

Millennial consumers in particular denounce inefficiencies in the consumer goods industry.



# USD set to crest

The USD should hold up initially, but the EUR is likely to gain in the second half as a Eurozone recovery takes hold. The CNY may depreciate slightly more vs. the USD on domestic weakness. The GBP should gain strongly on the back of a Brexit resolution.

**Major currencies: USD carry to lose its clout**  
In 2019, the USD continued to gain against most developed market (DM) currencies. If global growth and trade stabilize, as we expect, the cyclically sensitive EUR should gain ground. Yet if the geopolitical situation worsens or global growth disappoints, the USD would stay supported while the JPY and CHF would likely be the biggest winners.

**USD:** Going into 2020, the USD should remain supported as it retains a growth as well as interest rate advantage, or “carry,” over most other G10 currencies. But these advantages are likely to weaken in the course of the year. Moreover, the focus of market participants may begin to shift to the overvaluation of the USD, encouraging outflows from USD assets.

**EUR:** After disappointing in 2019, the Eurozone is expected to show moderate growth in 2020, in part supported by added fiscal stimulus and diminishing Brexit uncertainty. This should support the EUR. Longer-term factors, especially the region’s growing current account surplus, are also supportive. Renewed worries over Italy’s political and fiscal stability pose a (low probability) risk.

**JPY:** Although global risk aversion should abate and limit the upside potential of the JPY, we think the JPY’s undervaluation against the USD should support the currency. The fact that the Bank of Japan is constrained regarding interest rate cuts is also supportive.

**GBP:** In 2019, the GBP suffered bouts of weakness amid continued Brexit uncertainty. In 2020, we think the GBP has the greatest appreciation potential given its significant undervaluation and the increasing likelihood of a Brexit deal being voted through and implemented over the coming months. In that event, the Bank of England would also be more likely to tighten policy and further support the GBP.

**CHF:** The CHF is overvalued against the EUR. If the Eurozone economy picks up, the CHF could well lose some ground against the EUR. If the global political and economic outlook were to worsen, the Swiss National Bank would likely continue to intervene to limit CHF appreciation.

**Stabilizing growth**

Most emerging market (EM) currencies fared better in 2019 than the year before. With the US Federal Reserve easing policy, their carry provided support. Beyond this general factor, performance differed considerably between regions and countries. In Asia, China allowed the CNY to weaken in order to offset some of the US tariff burden, which put pressure on other currencies in the region. Low-yielding currencies in the Europe, Middle East and Africa region were the largest underperformers.

Looking ahead, EM currencies enter the year with a lower carry advantage; real interest rates dropped considerably in 2019 on the back of monetary policy easing. Conversely, valuations have generally become more attractive. Moreover, growth should pick up in many EM in response to looser financial conditions.

**CNY:** The currency underperformed most Asian peers in 2019. Any de-escalation in the trade war would alleviate pressure, in particular now that the currency is closer to fair value. However, with China’s growth likely to continue to slow and its current account surplus much reduced, we do not see any longer-lasting upside.

**KRW:** The KRW lost ground in the first months of 2019 due to the economy’s close integration into Chinese-based supply chains but it recovered thereafter. It should continue to recover if the trade war abates and sentiment on the tech sector continues to improve, not least because it is now clearly undervalued.

**INR:** Possible reforms in the areas of tax, labor and investment laws are likely to attract foreign investment inflows over time, supporting the currency. Valuation is fair but carry is eroding.

**MXN:** The MXN is a “trade war winner” with Mexico’s exports gaining on the back of China’s setbacks. Meanwhile, political pressure lifted after the USA, Canada and Mexico signed a new trade treaty. With growth expected to pick up moderately and the central bank taking a cautious stance, the MXN’s carry should erode only gradually. Valuation is supportive.

**BRL:** Valuation has improved and growth seems to be stabilizing, with economic surprise indices at the highest levels in over a year. With pension reform complete, attention is likely to shift to tax reform. We do not expect the central bank to cut the benchmark Selic rate more than the market currently anticipates. The currency should hold up.

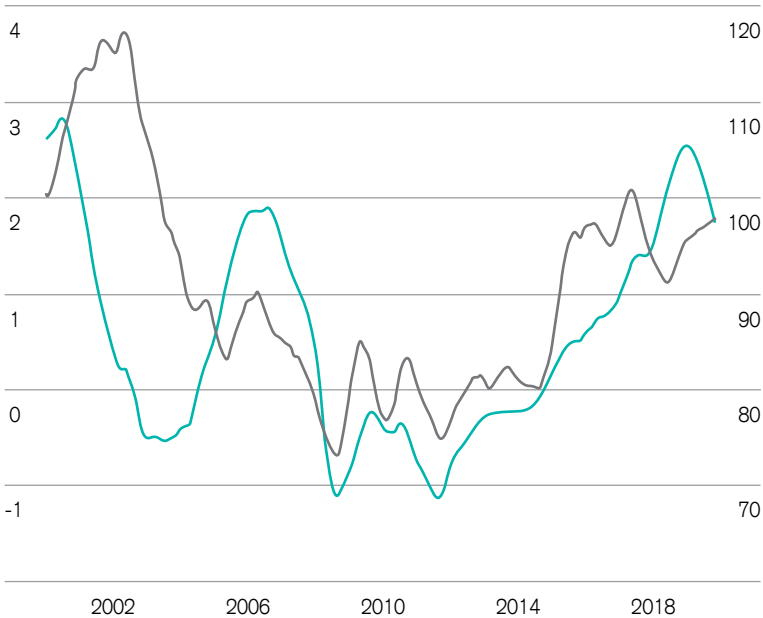
**RUB:** A strong current account surplus and low debt levels are still supportive. However, after appreciating strongly in 2019, the RUB is no longer attractive from a valuation perspective.

**TRY:** Fundamental valuation, a still high carry and an improving economy should offset political uncertainty. However, volatility is likely to remain high.

**ZAR:** South Africa continues to lag as economic imbalances keep building and the outlook for structural reforms remains bleak. The currency is likely to remain under pressure.

**Interest rate support for USD waning**

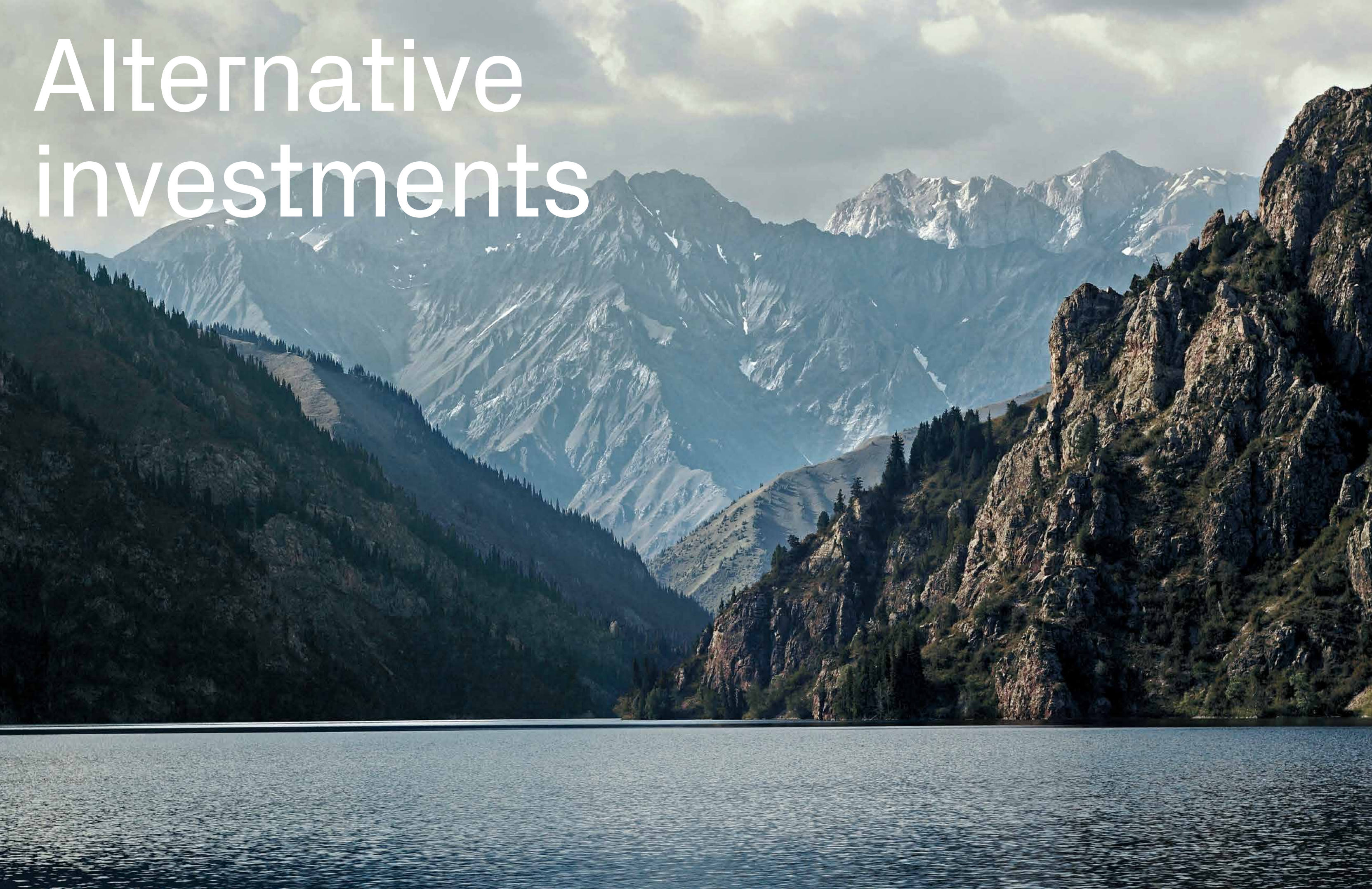
Spread in percentage points and dollar index (RHS)



2-year swap spread (US minus weighted G6 currencies)  
Dollar Index (DXY); 3-month moving average (RHS)

Last data point 24/10/19  
Source Datastream, Credit Suisse





# Alternative investments



# Yields remain compelling

Alternative investments have become increasingly established as a building block of portfolios, particularly in today’s world of low-for-longer interest rates and yields. They are appreciated not only for their diversification benefits, but also for providing stability to portfolios. We start by looking at real estate, which we expect to see a still positive environment in 2020.

Real estate investors have witnessed a number of structural shifts in recent years. As a result, they have had to adjust their strategy to capture the most promising opportunities.

**E-commerce benefits industrial assets**

In terms of real estate sectors, we believe that the structural trend away from bricks-and-mortar retail outlets to e-commerce will continue to put pressure on traditional retail locations (e.g. non-prime shopping centers and non-prime high-street stores). In contrast, industrial assets should benefit from this shift as the e-commerce supply chain requires considerably more ware-house and logistics space.

Another much-discussed structural change is the growth of flexible office space, which now accounts for a sizable percentage of total take-up: around 10% in major US markets, 15% in the UK, and 12% in the rest of Europe, according to Property Market Analysis. Investors may be able to increase occupancy levels and widen their tenant base by collaborating with

flexible office space providers. That said, the long-term impact on rental values is debatable and there is a risk that large amounts of office space are released into the market when short-term leases expire.

**Focus on income generation and uncorrelated investments**

The projected environment of moderate economic expansion and accommodative monetary policy is in general supportive for both listed and direct real estate worldwide. Against this backdrop, we prefer direct real estate where lower interest rates do not yet appear fully reflected in the price. While property yields in most real estate markets are at the lower end of their historical range, recent rate cuts are likely to attract further investor capital. Returns in direct real estate tend to be rather stable due to the rental income component, which is favorable in a potentially volatile late-cycle environment.

In terms of investment strategy, we look for high quality assets where the fall in yields is not yet fully reflected in valuations (e.g. core assets focusing on properties in good locations with long-term leases). So-called value-add strategies, which have a low correlation to the overall market, may also generate excess returns. Here, value is added by actively reconfiguring and refurbishing properties, for instance.

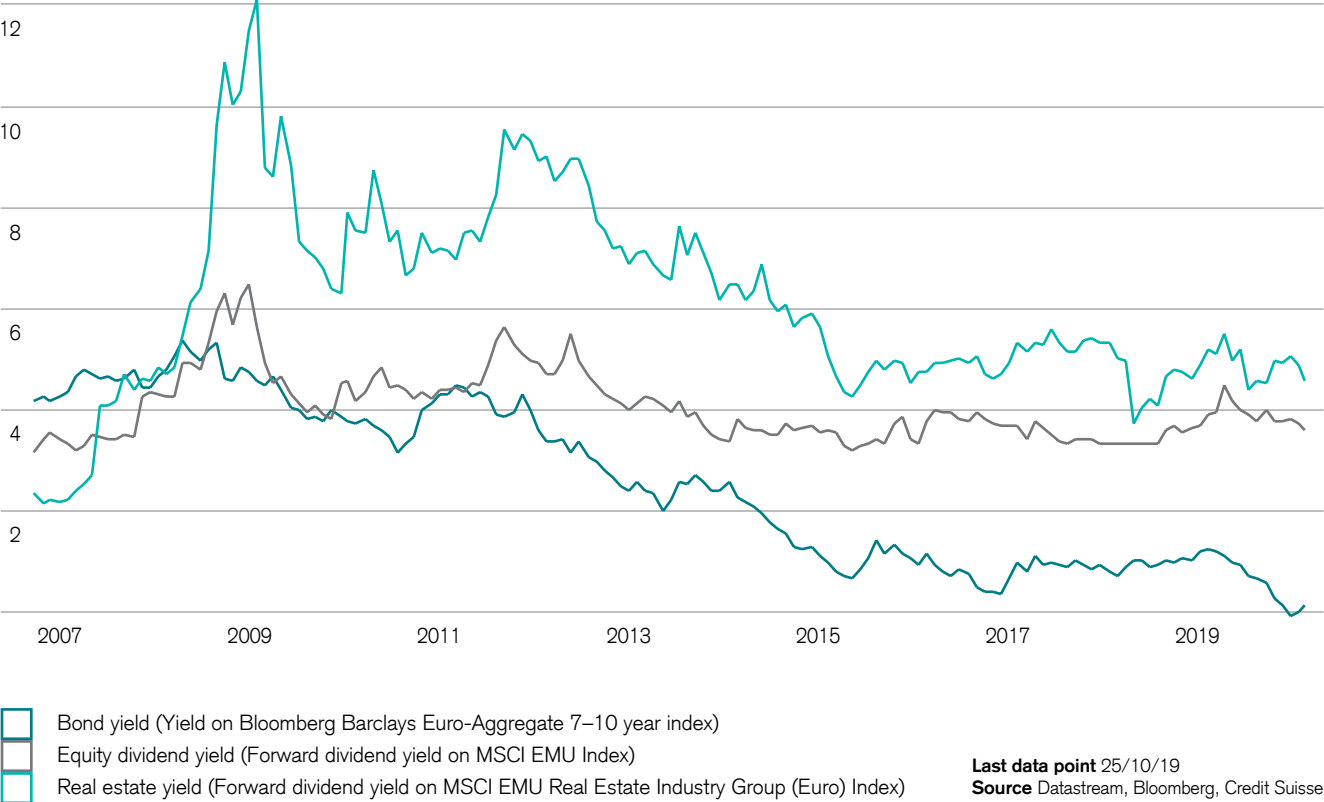
In contrast, global real estate equities already reflect lower rates with historically high valuations. Moreover, earnings upside is limited as growth slows in underlying markets. While multiple expansion and lower yields drove most of the strong 2019 performance, we expect this to be less the case in 2020.

**Seek regions with high dividends**

From a regional point of view, we focus on relatively high dividends rather than growth. As such, we favor the Eurozone with a yield spread over government bond yields of approximately 500 bps as of the editorial deadline, which is above the long-term average. In case of an orderly Brexit, we also believe that UK listed real estate offers potential given undemanding valuations, the conservative debt structure of real estate companies, and a potential rebound in underlying markets, especially London office space. Upside for US listed real estate, however, seems limited as lower interest rates and improving earnings expectations are already reflected in the pricing.

**Real estate yield advantage persists**

Yields on bonds, global equities and real estate equities (in %)



# Due diligence is key

Private markets have become increasingly more mainstream as smaller asset managers and family offices began to look for exposure and minimum investments declined. Given the illiquid nature of private markets, however, due diligence, fund and manager selection are paramount.

Private equity has become more and more popular in recent years, but this development has come at a cost. Asset valuations and competition for investments remain the key industry concerns, covenant-lite debt has returned and new entrants continue to challenge the industry's profits.

**Expanding private markets**

That said, private markets are almost twice as large as a decade ago, the rise of secondary funds offers depth and differentiated exposure, while the average deal is typically less levered. For investors, a larger universe brings with it better diversification potential. In 2020, we expect private equity (PE) to deliver a total return of approximately 8% per annum, somewhat below the historical average of 9.2%. Less supportive conditions for credit, high levels of undeployed capital but also lower overall risk limit expected returns. That said, PE still offers a fair illiquidity premium over public equities.

**Access to better pricing and longer-term potential**

PE funds can help improve portfolios' risk-adjusted returns as they target companies exposed to fundamental long-term growth in otherwise inaccessible private markets. PE entry deal prices depend on the state of capital markets, while exits normally reflect the significant evolution of a business which is less correlated to capital markets developments. Therefore, PE offers some diversification for investors. However, the higher than historical investment volumes and the lower risk profile of investments imply that expected returns are likely to diminish over time.

Against this backdrop, we favor seasoned PE managers sourcing proactively outside the core markets. Such investments should benefit from lower valuations compared with the stronger growth potential of businesses. Moreover, historical return analysis shows that the funds of the managers in the top quartile tend to stay in the same quartile about 30% of the time (sample period from 1980 to 2015 based on Preqin data). Thus, in the current environment of low growth and perceived late-cycle risks, some exposure to seasoned managers invested in otherwise inaccessible markets should help mitigate some of those late-cycle risks.

**Focus on top providers and defensive strategies**

We believe that PE can also generate excess returns over liquid markets in an increasingly challenging environment. But given lingering uncertainty and historically low interest rates, we favor strategies that offer PE-like upside with some downside protection, for instance real assets and growth capital. Key risks include illiquidity, long-term investment horizons, leverage and the complexity of transactions. These risks can be mitigated through diversified investing over the cycle and by selecting skillful and experienced managers. Due diligence, fund and manager selection are paramount given the illiquid nature of private markets.

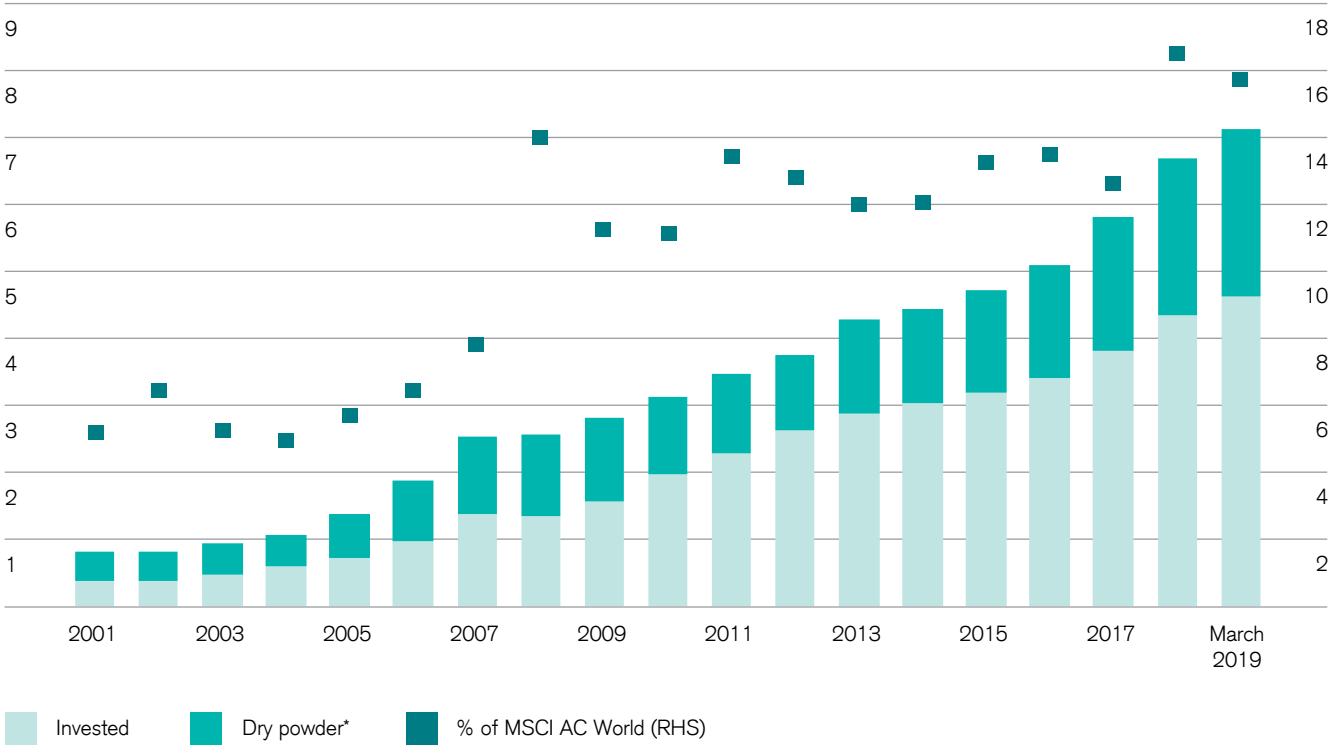


**What is private equity?**

Find out more:  
[credit-suisse.com/privateequity](https://credit-suisse.com/privateequity)

**Significant investment volumes targeting private equity**

Private equity assets under management (in USD trn) and in % (RHS)



\*Dry Powder – committed, but uninvested capital

# Portfolio stabilizers

In a world of extremely low bond yields and cyclical uncertainty ahead, holding a diversified portfolio of hedge funds (HF) continues to make a lot of sense. Performance of seasoned HF managers is likely to remain moderate, but still above investment grade bonds.

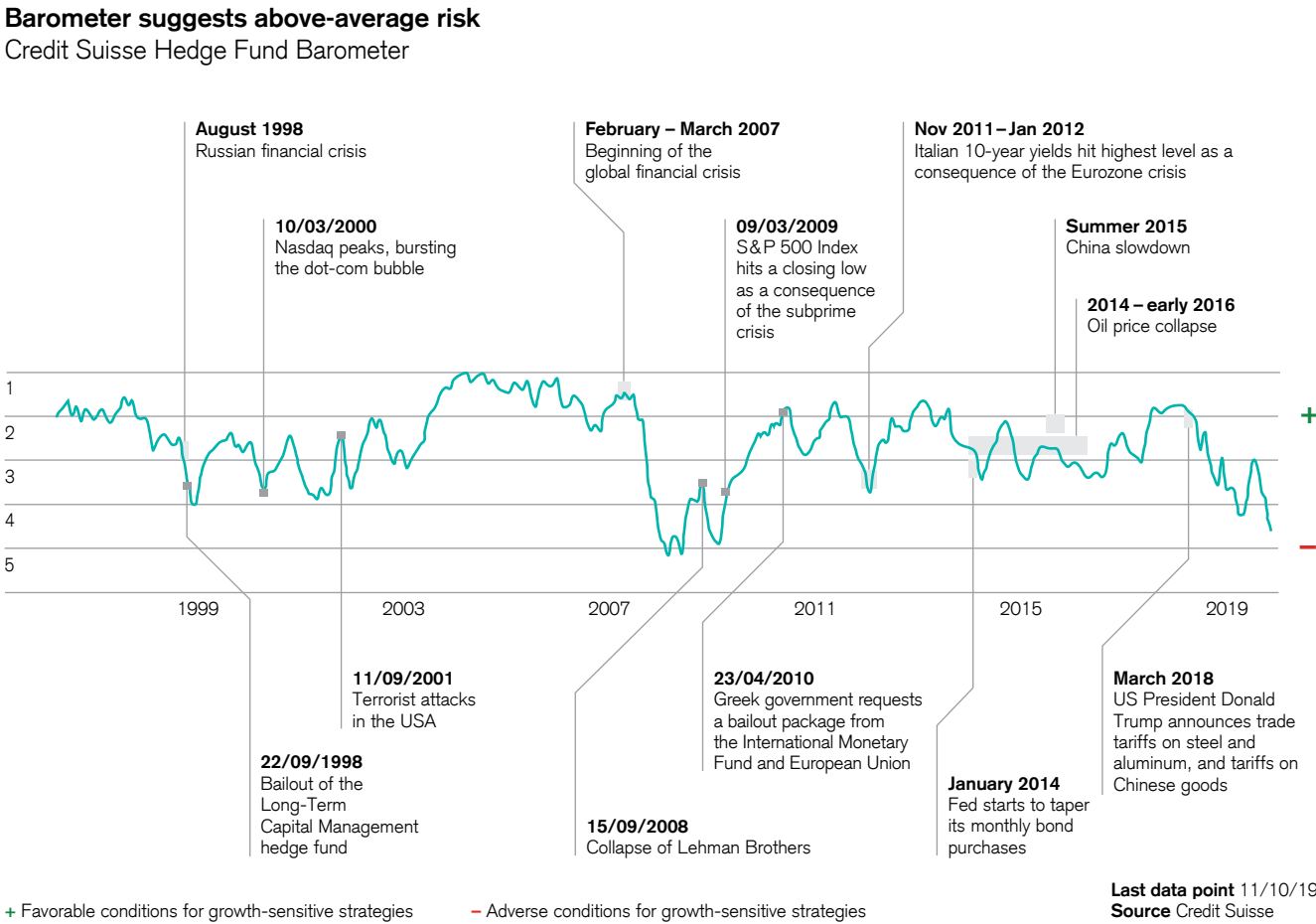
To the end of August 2019, the performance of the broad hedge fund index (HFRI index) was in the mid-single digits in USD terms. That was significantly better than in 2018 (-4.7%), but close to the ten-year average of 4.28%. Moreover, the dispersion of returns among the different HF managers was high, with a number of them generating negative returns.

**Specialized manager selection is paramount**  
While hedge funds have increased leverage over the past decade, we believe a more institutionalized approach to risk management as well as more prudent liquidity measures mitigate several of the risks. Thus, unlike the years preceding the 2008 global financial crisis, the industry rewards investors with lower risk, but also more modest returns.

That said, the industry's returns as a whole also remain somewhat exposed to traditional assets. In the environment we project, we believe that seasoned HF managers with a demonstrated ability to create value throughout the cycle can perform well. Thus, going into 2020, specialized fund manager selection is paramount in our investment process.

**Barometer favors low beta funds**  
The Credit Suisse Hedge Fund Barometer, which measures market volatility, liquidity, systemic risk and business cycle indicators, provides a guide to clients as to which types of HF exposures are appropriate given any particular market regime. The latest reading of the Barometer is in the negative range, which suggests that exposure to equity market risk (beta) within the HF universe should be avoided. This speaks in favor of diversified macro and opportunistic long/short equity strategies, as well as uncorrelated strategies that seek exposure to alternative risk premiums such as momentum or carry. This allows the HF allocation to act as a stabilizer in portfolios. Beyond specific strategies, it remains key to rely on experts who perform extensive and highly informed due diligence on the various HF managers.

“ An allocation to hedge funds acts as a stabilizer in portfolios.





# Waiting for the upswing

Commodities have been on diverging paths this past year, with cyclical segments trailing precious metals amid slowing industrial production. Going forward, we expect this divergence to diminish.

In 2019, gold rallied, while industrial metals were subdued. If our base case of stabilizing global growth and flat to somewhat higher bond yields materializes, industrial metals have modest upside potential, while gold prices are likely to consolidate. Oil prices may face a period of weakness to force supply adjustments before recovering at some point.

**Cyclical commodities await improved industrial production**

The prospects for cyclical commodities are muted as long as the slump in industrial production (IP) continues. An easing of trade disputes and improved confidence would be needed for a recovery. However, it remains to be seen whether this happens as early as H1. Industrial metals prices additionally discount a negative growth scenario in China. Should growth stabilize, we see potential for upside surprises. These are more likely in copper, while other metals look more subdued unless IP recovers strongly.

**Oil: Oversupply vs. Middle East tensions**

Modest demand growth coupled with robust supply from countries that are not members of the Organization of the Petroleum Exporting Countries (OPEC), particularly US shale producers, points to oversupplied oil markets in 2020. To prevent

surpluses, OPEC+ (including Russia) will have to extend or even deepen existing supply cuts and US shale production must slow. Our base case foresees temporary price weakness to force supply adjustments, which then paves the way for a recovery. Military conflict in the Gulf region would be an upside risk to prices. However, regional powers and the USA are seeking to de-escalate the situation for now.

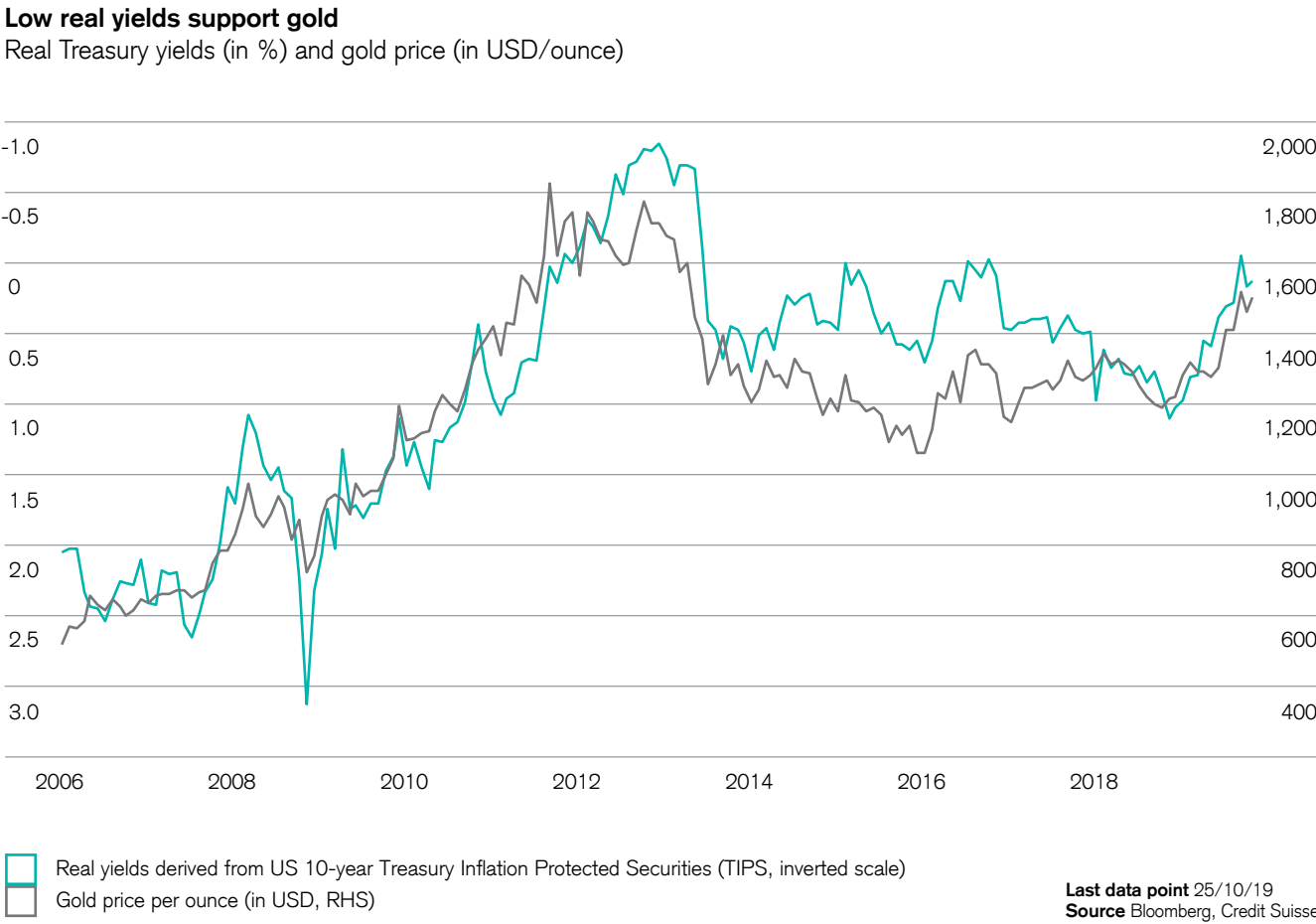
**Gold: Still supported by low yields**

Gold prices and other precious metals are likely to remain supported as long as (real) yields remain low or even negative and economic uncertainty persists. While speculative long positions in gold are high, we see no clear catalyst to trigger a major unwind of these positions.

**Two risk scenarios**

A stronger or earlier IP recovery would favor industrial metals the most, and hurt precious metals. Energy would also be supported, but less so given strong supply. In case of a full-fledged recession, precious metals would make further gains while energy prices would be particularly vulnerable.

Oil prices may face a period of weakness to force supply adjustments before recovering at some point.





# Investment strategy 2020



# Opportunities in a low-rate world

Now that interest rates around the world have reached record lows or slipped into negative territory, even risk-averse investors will need to buy higher-risk assets to generate positive returns. We see a number of opportunities to generate additional returns without taking on too much risk.

Several macroeconomic developments will drive the investment landscape in 2020. We expect monetary policy to remain accommodative, with the US Federal Reserve (Fed) expected to hold interest rates steady after frontloading several cuts in 2019. This should help sustain economic growth around current moderate levels. Lingering recession worries are likely to recede, as a manufacturing recovery will likely kick in during the first half of 2020, leading to some steepening of the yield curve.

**Do not neglect future inflation risks**

The rather moderate growth outlook in itself might not speak for taking much cyclical investment exposure. However, we think otherwise given the very weak or even negative return outlook when investing in cash and low-risk government and investment grade bonds.

One result of the recent annual update to our five-year return outlook for our asset universe is that investors are likely to face very meager returns in low-risk assets going forward. In fact, even traditional fixed income investors risk suffering losses in real wealth due to inflation.

**Measured diversification**

In our view, investors should take risks in a measured and diversified way by applying a multi-asset framework. Such a framework can take advantage of remaining pockets of value in low-risk markets, while increasing expected returns by investing in equities and seeking out less conventional investments in fixed income.

While high-grade bonds still have an important role to play in terms of diversifying risk, investors need to look for a broader set of return drivers to achieve positive returns. Within asset-backed credit, we favor the European covered bond segment, which has a high credit rating. For investors who seek a buffer against the negative impact of rising bond yields (duration risk), senior and mezzanine tranches of collateralized loan obligations should be an attractive portfolio addition to partly replace lower yielding short-term bonds.

**Adding EM bonds**

We also believe that investors should add emerging market (EM) hard currency bonds, which offer a similar expected return outlook as more traditional high yield bonds, but at a better rating level. EM local currency bonds could also be an option, though currency risk will require additional attention for calibrating portfolio shares. In general, we think that integrating EM, including frontier markets, into the fixed income part of portfolios also helps enhance diversification within a multi-asset framework.

**Equities offer return potential**

Equities and alternative investments offer more potential to drive returns. In our opinion, equities offer an attractive expected return advantage over low-yielding bonds. Investors who are more income oriented should favor companies with stable dividends. On a sector level, we prefer IT as one of the few high-growth sectors. We also like financials, as we expect that some improvement in the cyclical outlook will likely trigger further rotation into that sector in the first half of 2020.

**Alternative opportunities**

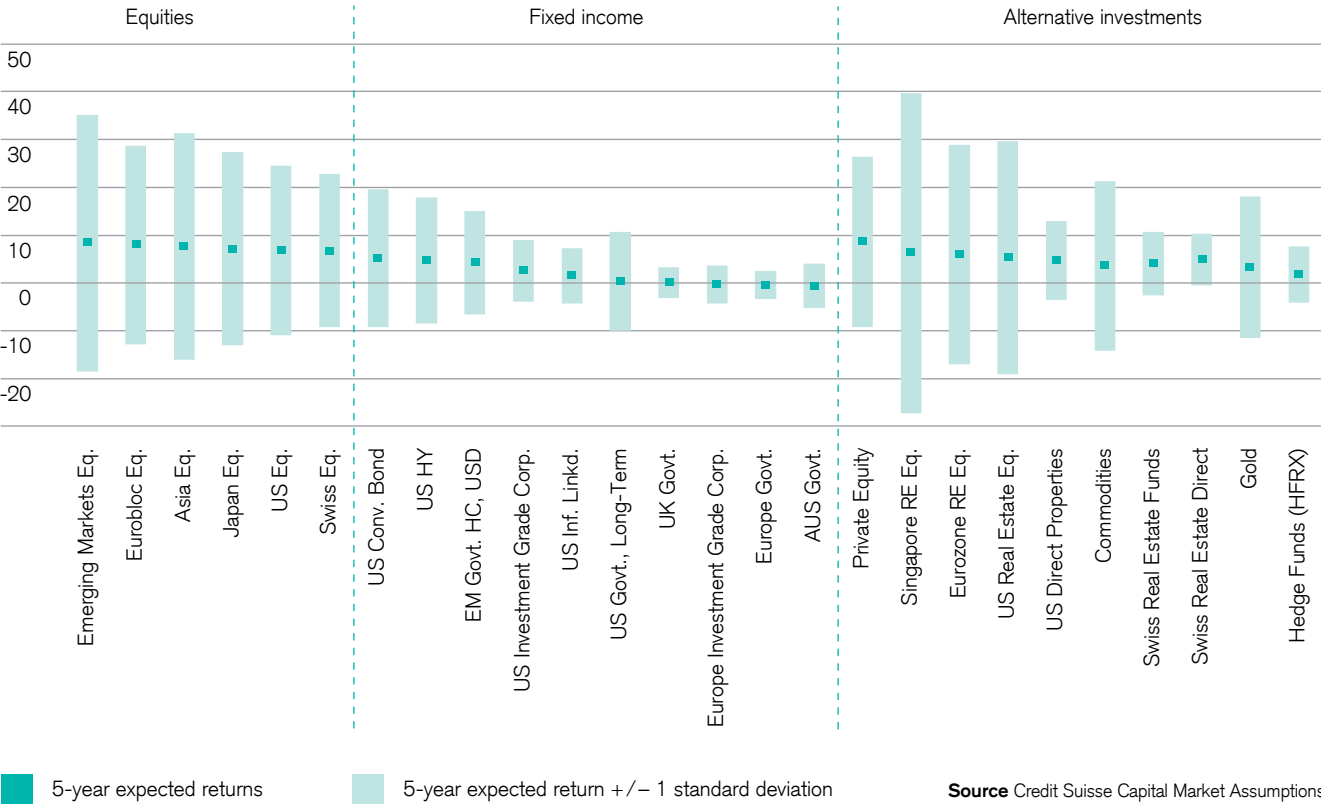
Within alternative investments, real estate enables further portfolio diversification and enhances return potential. In multi-asset portfolios, we generally add exposure to hedge funds for diversification purposes. For investors who are willing to commit money over a longer period of time to gain a liquidity premium, private equity offers an opportunity to enhance returns over the long term.



**Capital Market Assumptions (CMA)**

Find out more:  
[credit-suisse.com/cma](https://credit-suisse.com/cma)

Lackluster returns for high-quality bonds



Source Credit Suisse Capital Market Assumptions



# Forecasts

We expect only sluggish global growth in 2020 of 2.5%, almost unchanged from 2019. Against the backdrop of limited earnings growth and flat to higher bond yields, returns in key equity markets are likely to be in the single-digit range in 2020, while returns on most core government bonds are likely to be negative.

## Forecasts for growth and inflation

Real GDP (y/y %)				Inflation (annual avg. y/y %)			
	2018	2019E*	2020F**		2018	2019E*	2020F**
Global	3.2	2.6	2.5	Global	2.7	2.6	2.5
United States	2.9	2.3	1.8	United States	2.4	1.8	2.0
Canada	1.9	1.3	0.9	Canada	2.3	1.9	1.8
Eurozone	1.9	1.1	1.0	Eurozone	1.8	1.2	1.1
Germany	1.5	0.5	0.4	Germany	1.9	1.3	1.3
Italy	0.7	0.1	0.7	Italy	1.2	0.6	0.7
France	1.7	1.2	1.1	France	2.1	1.3	1.3
Spain	2.6	2.2	1.8	Spain	1.7	0.8	1.0
United Kingdom	1.4	1.2	1.3	United Kingdom	2.5	1.9	2.1
Switzerland	2.8	1.1	1.4	Switzerland	0.9	0.5	0.5
Japan	0.8	0.8	0.4	Japan	0.9	0.5	0.1
Australia	2.7	2.0	2.8	Australia	2.0	1.8	1.9
China	6.6	6.1	5.9	China	1.9	2.6	2.2
India (fiscal year)	7.2	6.8	6.0	India (fiscal year)	4.0	3.4	3.4
Brazil	1.1	1.2	2.7	Brazil	3.7	3.7	3.7
Russia	2.3	1.4	1.6	Russia	2.9	4.5	3.2

\* E: estimate  
\*\* F: forecast

Last data point 05/11/19  
Source Datastream, Haver Analytics, Credit Suisse

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

“ We believe that the global economy and markets will continue to show considerable resilience in the face of these challenges.

## Financial market performance / forecasts

Equities*	2019 YTD performance as of 5 November 2019	2020 expected total returns	Credit	2019 YTD performance as of 5 November 2019	2020 expected total returns
US equities	24.7%	6.50%	Global investment grade bonds**	11.30%	2.60%
EMU equities	24.4%	5.80%	Global high yield bonds**	12.02%	3.10%
Swiss equities	27.0%	4.10%	Emerging market HC bonds***	13.06%	3.60%
UK equities	13.6%	5.70%			
Japanese equities	17.1%	5.60%			
Emerging market equities	14.1%	5.40%			
			Currencies & commodities	Close on 5 November 2019	End-2020 forecast
			EUR/USD	1.11	1.15
			USD/CHF	0.99	1.00
			EUR/CHF	1.10	1.15
			USD/JPY	109.00	103.00
			GBP/USD	1.29	1.40
			USD/CNY	7.02	7.20
			Gold (USD/oz)	1505.00	1500.00
			WTI (USD/bbl)	57.00	55.00
Bond yields	Close on 5 November 2019	End-2020 forecast			
10-year US Treasury yield	1.80%	2.20%			
10-year German Bund yield	-0.31%	-0.10%			
10-year Swiss Eidgenossen yield	-0.45%	-0.30%			

\* Performance and expected returns are total return including dividends. Markets refer to MSCI country / regional indices in local currency. Performance of the periods 06/11/2014 – 05/11/2019 for those indices in chronological order are: MSCI USA: 5.5%, 1.3%, 26.6%, 7.2%, 14.9%; MSCI EMU: 17.8%, -8.7%, 29.5%, -8.1%, 13.4%; MSCI Switzerland: 4.8%, -10.5%, 30.0%, 0.0%, 18.2%; MSCI UK: 0.0%, 9.5%, 17.3%, -2.2%, 7.1%; MSCI Japan: 15.3%, -13.3%, 34.8%, -4.9%, 4.2%; MSCI EM: -0.1%, 4.6%, 30.1%, -6.9%, 11.3%  
\*\* Barclays Global Investment Grade Corporate and Global High Yield index  
\*\*\* JP Morgan EMBIG Div. (sovereign index)

Last data point 05/11/19  
Source Bloomberg, Datastream, Credit Suisse

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

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**Risk Warning**  
**Every investment involves risk, especially with regard to fluctuations in value and return. 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.**

For a discussion of the risks of investing in the securities mentioned in this document, please refer to the following Internet link:  
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**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.**

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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.

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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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