Asset Management
March 2023

CREDIT SUISSE

The interest-rate environment is set to remain volatile

Author:
Paul Hsiao,
Director, Product Advocacy

What investors should know

Central banks around the world are aggressively raising interest rates to curb the highest levels of inflation seen in decades, tightening financial conditions and increasing market volatility. Yet, for investors, the future may be even more uncertain because the economic trajectories of the world's largest countries are now diverging.

Takeaways:

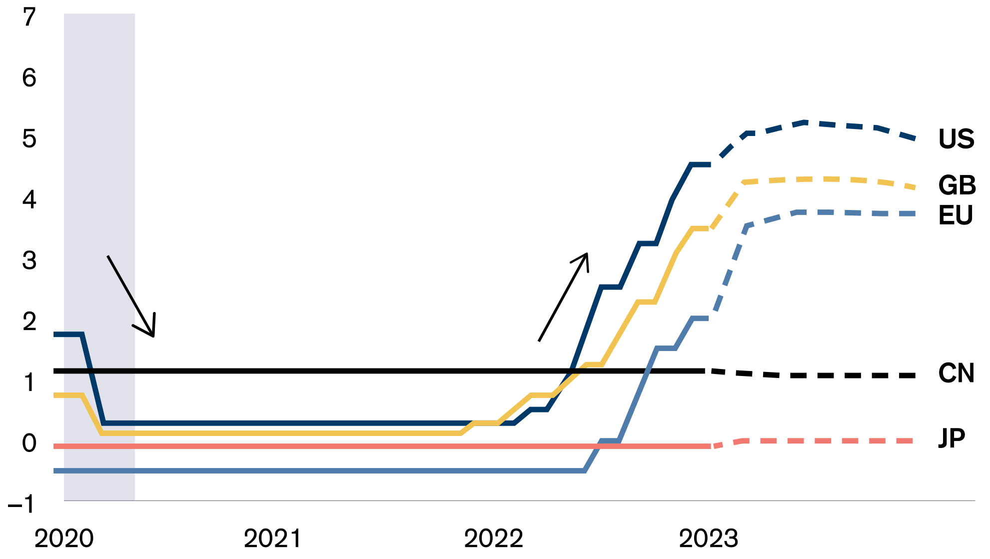
- The great experiment of sustained low interest rates is coming to an end.
- Aggressive policy rate hikes complicate the economic story for the world's largest economies – further adding to interest-rate volatility.
- In this volatile environment, favor actively managed fixed-income strategies. Investors should also consider defensive equity strategies that are less correlated with the broader market.

Rates, once coordinated, are now divergent

Policy rates set to reach highest levels in decades in 2023

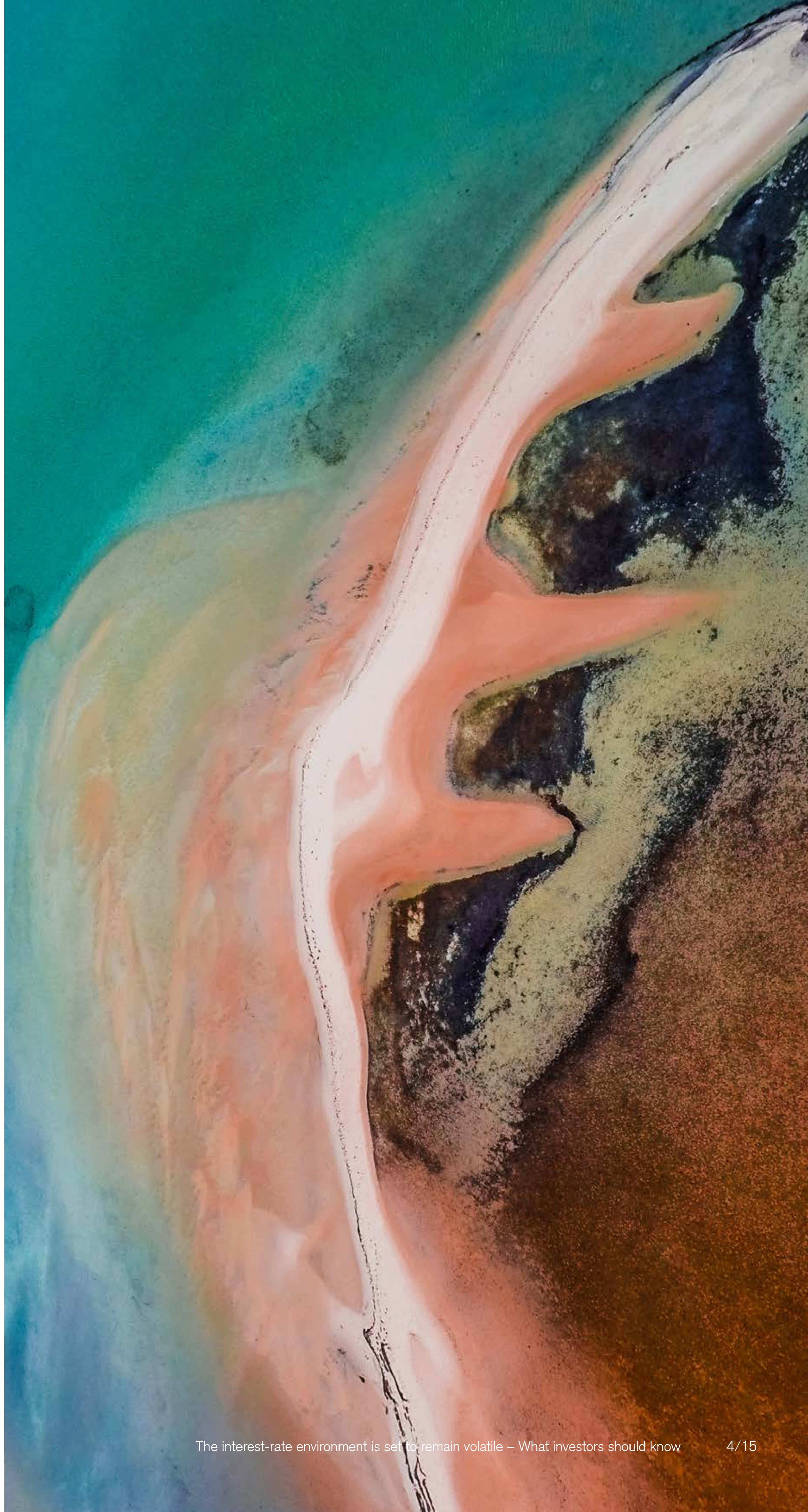
Central banks are aggressively raising rates while economic fundamentals are diverging

Central bank policy rate paths
(in %)



Note: Rate path taken from consensus economist forecasts on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

The great experiment of low interest rates looks like it is about to end. Amid higher inflation and quick economic recoveries, central banks in the world's largest economies – except China – have hiked rates for the first time in years, and many have raised them to the highest levels in recent memory. Many investors expected a repeat of the aftermath of the Great Financial Crisis (GFC), when inflation and policy rates remained at ultralow levels for the foreseeable future – after all, long-term economic drivers did not materially change from 2009 to 2021. And yet, supply-chain snarls, an accelerated recovery of the employment market, and a war in Europe brought global inflationary pressures to a boil; headline inflation rates in many economies shot past their central banks' targets and stayed stubbornly high throughout 2022. The inflation that was missing after the Great Financial Crisis came back with a vengeance.



These are uncharted waters for many investors. In the past, the US Federal Reserve used to blaze the trail of rate hikes globally, with a cadre of central banks following its lead. Today, the world's largest economies are experiencing idiosyncratic and divergent economic fundamentals, leading to different rate paths and varying degrees of confidence about the path forward.

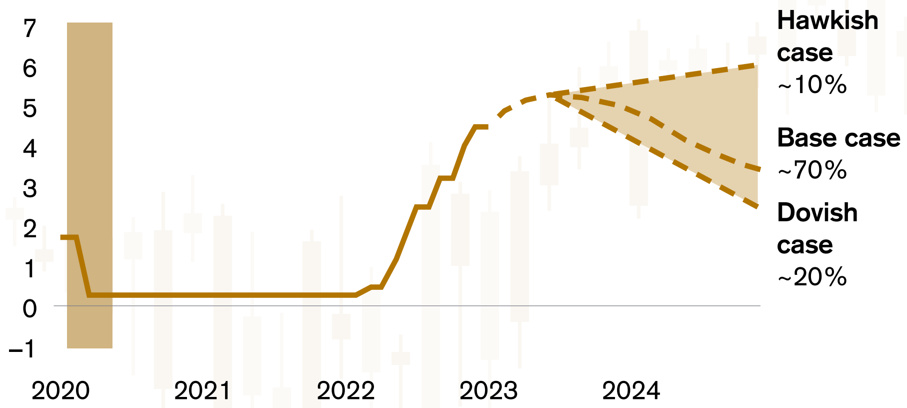
In the US, a surprisingly robust economy underpins the Fed's rate trajectory

US fundamentals heatmap

US (Fed)	Pressure to hike				Pressure to cut
Growth	Above trend and picking up	Above trend and stable	**Growing and slowing**	Mid recession	Sharp recession
Inflation	High above target	**Above target** →	Around target	Below target	Deflation
Labor market	**Full employment** →	Close to full employment	Neither too loose nor too tight	Far from full employment	High unemp.
Financial conditions	Very loose	Loose	**Tight**	Very tight	

→ Likely shift in 12 months

Fed's possible policy-rate trajectories
(in %)



Note: Base case derived from consensus of economists polled on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

The road is not straight but is clear for Federal Reserve

Confounding pessimists, economic momentum in the United States has remained surprisingly resilient. The latest GDP report showed growth beating expectations and averaging out to around a 3% annualized rate in the second half of 2022, far higher than the 2.3% average seen during the post-GFC recovery. Growth expectations have also improved, with the International Monetary Fund (IMF) upgrading its growth forecast for 2023 in its latest World Economic Outlook. Economists polled by Bloomberg have lowered their expectations of a recession regardless of the yield curve.

The employment market in particular has remained a remarkable pillar of strength. Despite headlines about several stressed sectors announcing layoffs, the US unemployment rate remains the lowest in decades, and the economy is the closest to "full employment" that the Federal Reserve has seen in recent memory. Perhaps even more impressively, job growth is still vibrant, fueling the continued surge in retail spending and inflationary pressures.

The flip side of better-than-expected growth and a hot labor market is their impact on inflation and interest rates. Inflation has moderated in the United States, and the peak yearly rates are likely behind us. But underneath the headline picture is a worrying picture for the Federal Reserve. Although the pressures from inflation components like energy costs and other commodities have sharply declined in recent months, services inflation excluding energy, a so-called "sticky" form of inflation since its effects tend to linger, is running at a pace more than twice as fast compared to its pre-COVID trend.

Given these underlying fundamentals, we assign a high probability to the Fed's base case and assign a slight overweight to the dovish (scenario for lower than expected interest rates) case compared to the hawkish (scenario for higher than expected interest rates) case in the event that inflation eases faster than expected. As a result, the rate path for the Federal Reserve is very clear: higher before pulling back closer to the Fed's terminal rate of 2.75%. Though the path is narrow, the Fed looks like it can deliver a "soft landing" after all.

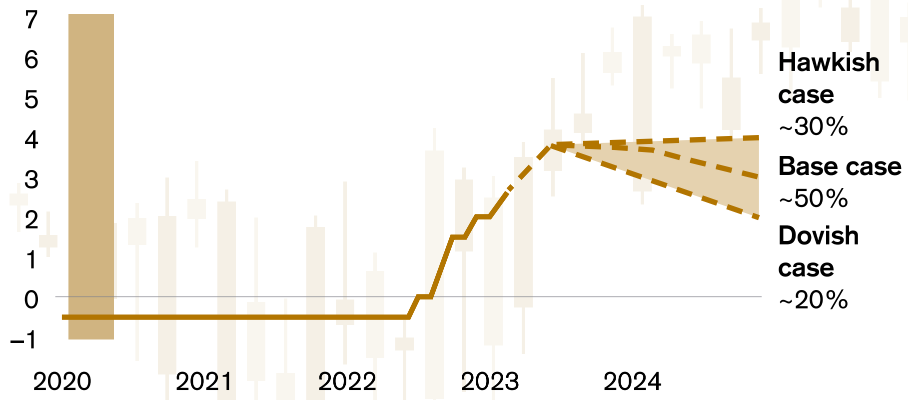
The ECB is in a more difficult and uncertain situation

Europe fundamentals heatmap

Euro Area (ECB)	Pressure to hike				Pressure to cut
Growth	Above trend and picking up	Above trend and stable	Growing and slowing	Mid recession	Sharp recession
Inflation	High above target	Above target	Around target	Below target	Deflation
Labor market	Full employment	Close to full employment	Neither too loose nor too tight	Far from full employment	High unemp.
Financial conditions	Very loose	Loose	Tight	Very tight	

→ Likely shift in 12 months

ECB's possible policy rate trajectories
(in %)



Note: Base case derived from consensus of economists polled on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

Most policymakers would say that stagflation – an environment of sluggish growth and high inflation – is the most undesirable and difficult economic environment to emerge from. And that's precisely what policymakers in Europe are facing. In contrast to the underlying strength seen in the United States, growth in Europe is expected to dip into contraction territory during the first half of 2023. Even with a milder-than-expected winter, Germany, the Eurozone's largest economy and growth engine, reported that its GDP fell short of expectations in Q4 2022 and is on track for two quarters of consecutive contraction by the end of Q1 2023 thanks to combined pressure of high interest rates and high energy prices.

Labor markets also aren't showing the same type of strength compared to that of the United States. Germany's unemployment rate – one of the lowest in the Eurozone – rose in the second half of 2022 and, at 5.5%, remains much higher than the 3.4% seen in the US. Other economies in the euro area, like Greece, are still showing an unemployment rate above 10%, which makes any rate-hike decisions by the European Central Bank difficult because the cure for high inflation may come at a dear cost for Eurozone economies that are already in weak shape.

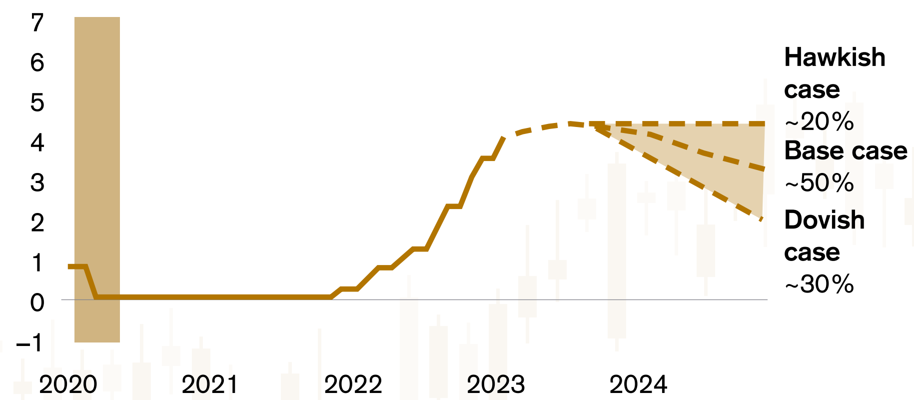
Adding to Europe's woes is a more severe inflation problem. Although the yearly pace of inflation has declined over the past few months, inflation is running faster than in the United States and is much closer to 10% than to the ECB's 2% target. As a result, the probability of higher-for-longer interest-rate levels in the euro area is relatively high, which is a marked difference after years of a zero-to-negative interest-rate policy after the Great Financial Crisis.

Likely recession puts ceiling on rate hikes by Bank of England

UK fundamentals heatmap

UK (Bank of England)	Pressure to hike				Pressure to cut
Growth	Above trend and picking up	Above trend and stable	Growing and slowing	Mid recession	Sharp recession
Inflation	High above target	Above target	Around target	Below target	Deflation
Labor market	Full employment	Close to full employment	Neither too loose nor too tight	Far from full employment	High unemp.
Financial conditions	Very loose	Loose	Tight	Very tight	

BOE's possible policy rate trajectories
(in %)



Note: Base case derived from consensus of economists polled on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

Growth in the United Kingdom is even more problematic. The UK reported its quarterly real GDP growth rate at or below zero for the second half of 2022, and growth expectations have also dimmed. Despite many upgrades for other developed nations in its most recent forecast, the IMF downgraded its 2023 growth forecast for the UK. Forecasters now expect a recession to occur in the face of historic labor disputes, high interest rates, and very painfully high inflation.

The one bright spot in the UK's economy may be its low unemployment rate. But other labor market indicators show a mixed picture. Unemployment claims are stuck at a far higher level than their pre-COVID trend, which surely is not a sign of a tight labor market, and the labor force participation rate remains well below the average of the past two decades. Brexit has also made it more difficult for UK firms to source labor from other parts of Europe, adding to the challenges the economy faces.

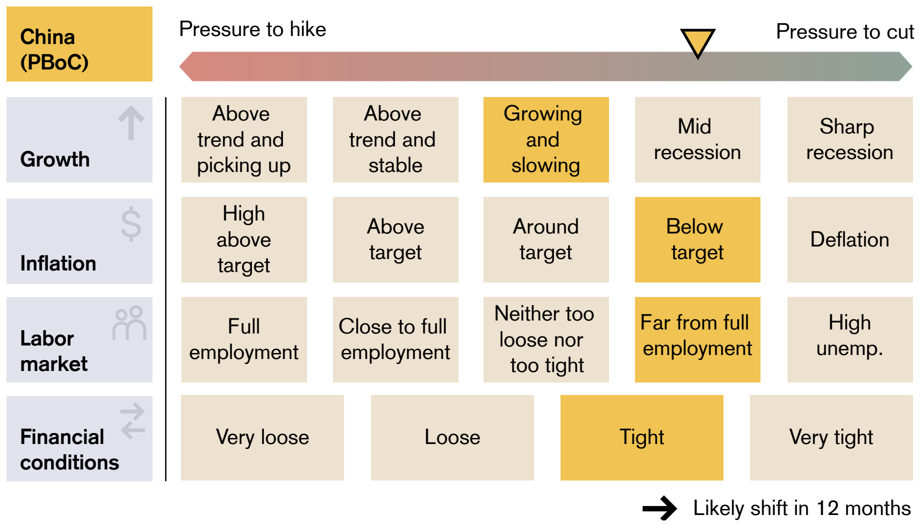
In this stagflationary environment, we assign 50% odds that the Bank of England will follow the path expected by forecasters and investors, with rates peaking between 4% and 5% in 2023 before falling in 2024 with a dovish tilt if inflation or growth slow more than expected.

China's policy and fundamentals unlikely to change in next year

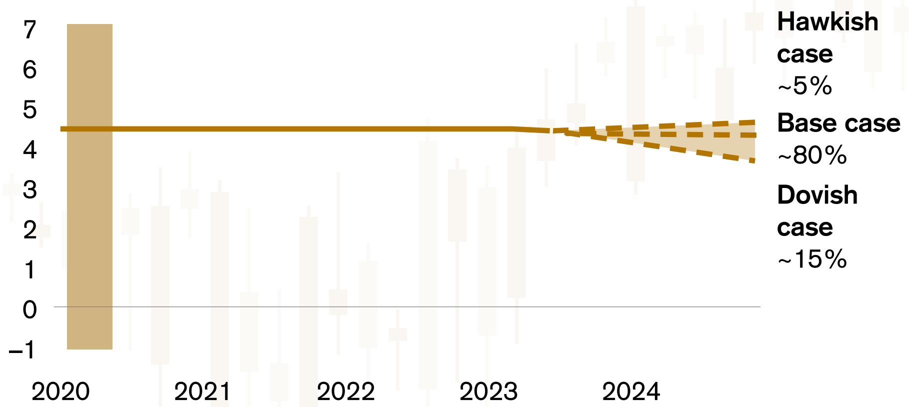
In China, growth and inflation are more supportive of a lasting accommodative monetary policy in sharp contrast to the central banks in the West. While a recession in China is far more unlikely, the growth rate there is expected to stay at a moderate pace. Inflation remains below target, and various labor market indicators are not showing an environment of full employment.

We therefore have a strong conviction that policy rates will not change significantly in China in the medium term.

China fundamentals heatmap



PBoC's possible policy rate trajectories
(in %)

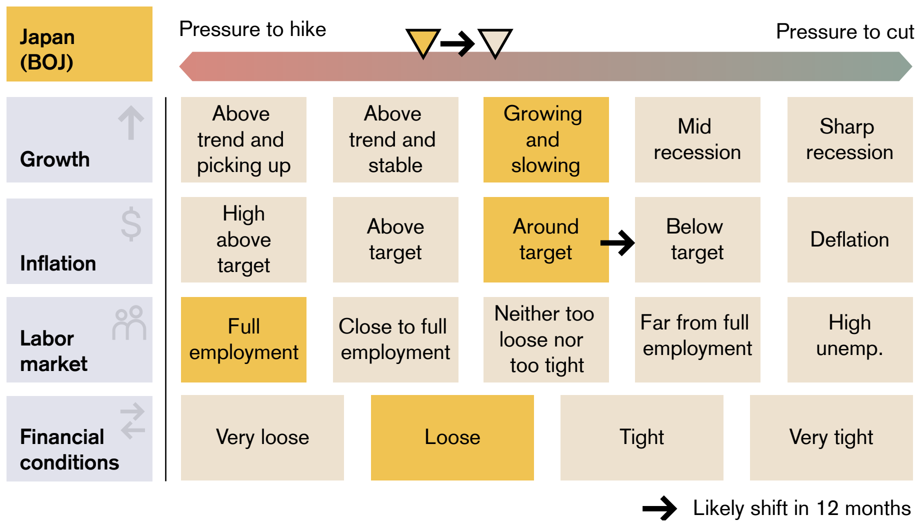


Note: Base case derived from consensus of economists polled on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

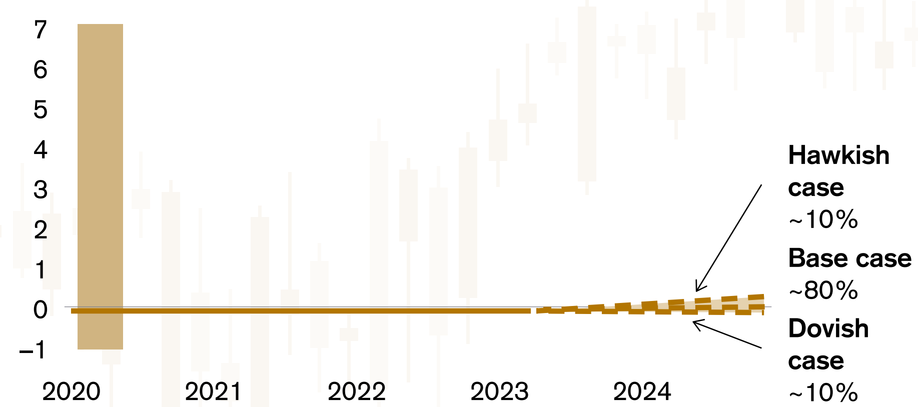
Inflation likely to slow in Japan, keeping policy in place

Like our forecast for the People's Bank of China, we do not expect to see significant changes to the Bank of Japan's interest-rate policy either. Japan's current growth momentum and current inflation reading both can act as ammunition for hawks on the BoJ's governing board. But the durability of those dynamics is questionable, especially because Japan's headline inflation rate is much more influenced by energy and fresh food prices compared to other economies. We believe that the policymakers at the Bank of Japan agree, so we do not expect to see significant changes to the Bank of Japan's policy rate in the medium term.

Japan fundamentals heatmap



BOJ's possible policy rate trajectories
(in %)



Note: Base case derived from consensus of economists polled on Bloomberg
Source Bloomberg, Credit Suisse Asset Management as of March 1, 2023

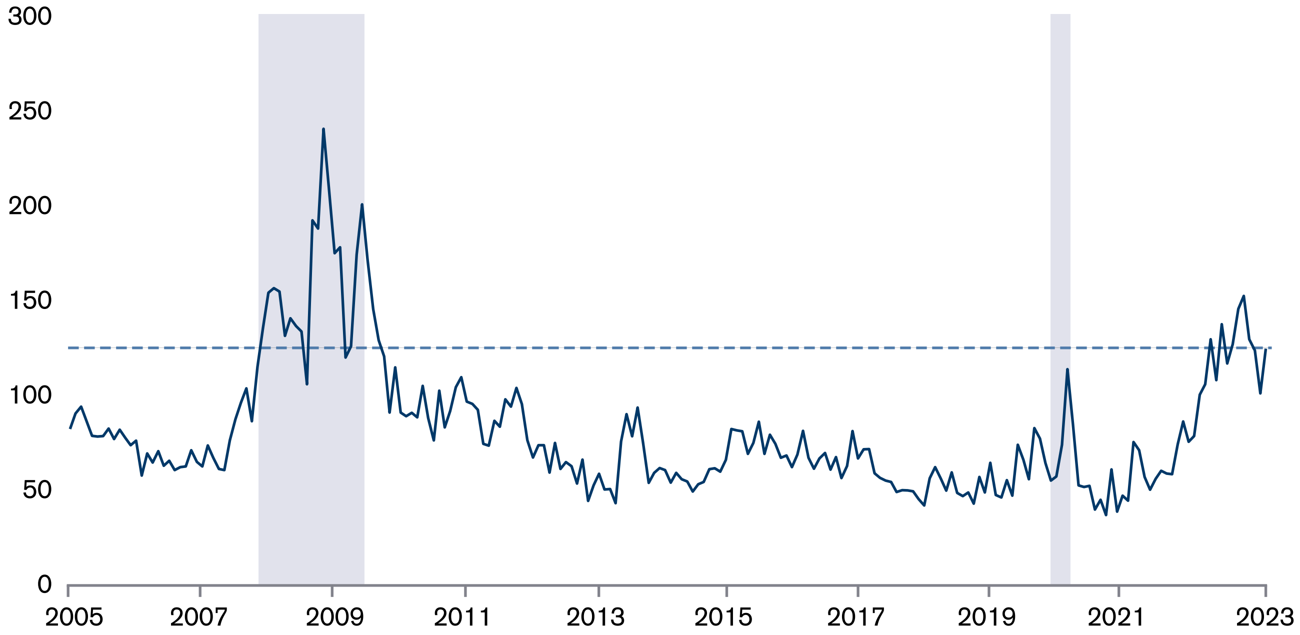
Diverging economic fundamentals underscore how unusual and volatile this environment is

For investors, such an analysis surely complicates an already unusual post-COVID environment. Each of the major economies discussed has its idiosyncrasies personified in wildly different conviction levels for the medium-term policy-rate path. Given the moderate growth and high inflation readings in the West, we expect yield curves to stay inverted for some time, which can distort the plumbing of financial markets. For major Asian economies, the rate path is clearer, but the durability of China's and Japan's economic recovery is more of a question mark than that of the United States. In this environment, we expect bond markets to be highly data-dependent and likely more volatile than they were during the post-GFC business cycle.

Such an environment breeds uncertainty and volatility. For example, the Credit Suisse interest-rate volatility index is trending at an unusually high level outside a recession and may stay elevated for some time. Investors should consider pursuing active fixed-income strategies that invest in high-quality companies or defensive equity strategies that are less correlated with the broader market.

Interest-rate volatility now the highest in recent memory outside of a recession

Credit Suisse Interest Rate Volatility index



Note: Latest point is February 2023
Source Credit Suisse Asset Management as of March 1, 2023

Historical performance indications and financial market scenarios are not reliable indicators of future performance. It is not possible to invest in an index. The index returns shown do not represent the results of actual trading of investable assets/securities. Investors pursuing a strategy similar to an index may experience higher or lower returns and will bear the cost of fees and expenses that will reduce returns.

Discover more on the Credit Suisse Asset Management solutions to benefit from this market environment.

1 **CSIP (Lux) Global Investment Grade Convertible Bond Fund**
A hybrid investment that shares characteristics of bonds and stocks that can aid investors in a defensive environment while being capable of capturing equity-like upside if growth accelerates.
Learn more →

2 **Credit Suisse (Lux) China Advantage Equity Fund**
An actively managed equity fund that takes advantage of China's continued growth outperformance and its more growth-centric central-bank policy.
Learn more →

3 **Credit Suisse (Lux) Emerging Market Corporate Investment Grade Bond Fund**
An actively managed bond fund that can help mitigate bond-market volatility by investing in investment-grade emerging-market companies.
Learn more →

4 **Credit Suisse (CH) 130/30 Swiss Equity Fund**[1]
A five-star Morningstar-rated[2] strategy that aims to invest in high-quality Swiss companies and tends to have a lower correlation with broader global equities.
Learn more →

5 **Credit Suisse (CH) Corporate CHF Bond Fund**
A Swiss-domiciled fixed-income strategy and a winner of a 2023 Refinitiv Lipper Fund Award for Switzerland that aims to achieve an appropriate long-term return on investment by investing in CHF-denominated corporate bonds from issuers worldwide.
Learn more →

6 **Credit Suisse (Lux) SQ US Corporate Bond Fund**
A highly-rated Smart Quant (SQ) fund and a winner of a 2023 Refinitiv Lipper Fund Award for Switzerland that provides investors with an efficient way to gain exposure to USD corporate bond markets with an average credit rating of BBB+.
Learn more →

[1] The Fund's use of leverage may lead to an amplified reaction to market movements, i.e. increase the volatility of the Fund and may amount to a more substantial loss than in unleveraged products.
[2] For more information about the rating methodology, time frame, and the number of funds included in the analysis, please visit www.morningstar.com.

For more information about the award methodology, time frame, and the number of funds included in the analysis, please visit lipperfundawards.com

The product's investment objectives, risks, charges and expenses, as well as more complete information about the product, are provided in the prospectus (or relevant offering document), which should be read carefully before investing.
The investment promoted in this marketing material concerns the acquisition of units or shares in a fund and not of any underlying assets. The underlying assets are owned by the fund only.

Risks:
Bond markets carry risks of issuer default and are subject to economic and market fluctuations. The fund may make investments in emerging market country and high yield bonds, which can entail greater risk than comparable investments in industrialized countries. The Fund's risk and reward profile does not reflect the risk inherent in future circumstances that differ from what the Fund has experienced in the recent past. This includes credit risk, liquidity risk, counterparty risk, operational risk, political and legal risk, and sustainability risks.

The full offering documentation including complete information on risks may be obtained free of charge from a Credit Suisse client advisor, representative, or, where applicable, via Fundsearch (credit-suisse.com/fundsearch).

CREDIT SUISSE

Follow us on Twitter

Follow us on LinkedIn

The Refinitiv Lipper Fund Awards, granted annually, highlight funds and fund companies that have excelled in delivering consistently strong risk-adjusted performance relative to their peers. The Refinitiv Lipper Fund Awards are based on the Lipper Leader for Consistent Return rating, which is a risk-adjusted performance measure calculated over 36, 60 and 120 months. The fund with the highest Lipper Leader for Consistent Return (Effective Return) value in each eligible classification wins the Refinitiv Lipper Fund Award. For more information, see lipperfundawards.com Although Refinitiv Lipper makes reasonable efforts to ensure the accuracy and reliability of the data contained herein, the accuracy is not guaranteed by Refinitiv Lipper.

Source: Credit Suisse, unless otherwise specified.
Unless noted otherwise, all illustrations in this document were produced by Credit Suisse Group AG and/or its affiliates with the greatest of care and to the best of its knowledge and belief.

This material constitutes marketing material of Credit Suisse Group AG and/or its affiliates (hereafter CS). This material does not constitute or form part of an offer or invitation to issue or sell, or of a solicitation of an offer to subscribe or buy, any securities or other financial instruments, or enter into any other financial transaction, nor does it constitute an inducement or incitement to participate in any product, offering or investment. This marketing material is not a contractually binding document or an information document required by any legislative provision. Nothing in this material constitutes investment research or investment advice and may not be relied upon. It is not tailored to your individual circumstances, or otherwise constitutes a personal recommendation, and is not sufficient to take an investment decision. The information and views expressed herein are those of CS at the time of writing and are subject to change at any time without notice. They are derived from sources believed to be reliable. CS provides no guarantee with regard to the content and completeness of the information and where legally possible does not accept any liability for losses that might arise from making use of the information. If nothing is indicated to the contrary, all figures are unaudited. The information provided herein is for the exclusive use of the recipient. The information provided in this material may change after the date of this material without notice and CS has no obligation to update the information. This material may contain information that is licensed and/or protected under intellectual property rights of the licensors and property right holders. Nothing in this material shall be construed to impose any liability on the licensors or property right holders. Unauthorised copying of the information of the licensors or property right holders is strictly prohibited. The full offering documentation including, the prospectus or offering memorandum, the Key Investor Information Document (KIID), the Key Information Document (KID), the fund rules, as well as the annual and bi-annual reports (''Full offering documentation''), as the case may be, may be obtained free of charge in one of the languages listed below from the legal entity/entities indicated below and where available via Fundsearch (credit-suisse.com/fundsearch). Information on your local distributors, representatives, information agent, paying agent, if any, and your local contacts in respect of the investment product(s) can be found below. The only legally binding terms of any investment product described in this material, including risk considerations, objectives, charges and expenses are set forth in the prospectus, offering memorandum, subscription documents, fund contract and/or any other fund governing documents. For a full description of the features of the products mentioned in this material as well as a full description of the opportunities, risks, and costs associated with the respective products, please refer to the relevant underlying securities prospectuses, sales prospectuses, or other additional product documents, which we will be pleased to provide to you at any time upon request. The investment promoted in this marketing material concerns the acquisition of units or shares in a fund and not of any underlying assets. The underlying assets are owned by the fund only. Some of the product(s) included in this material may not be registered and/or available for purchase in your country of domicile.
If in doubt whether the product(s) is/are registered for distribution in your country, please consult your relationship manager or locally registered distributor. If investment products have not been registered with, or authorized by a supervisory authority, certain investor protections provided under supervisory laws and regulations may not be provided. This material may not be forwarded or distributed to any other person and may not be reproduced. Any forwarding, distribution or reproduction is unauthorized and may result in a violation of the U.S. Securities Act of 1933, as amended (the ''Securities Act''). The securities referred to herein have not been, and will not be, registered under the Securities Act, or the securities laws of any states of the United States and, subject to certain exceptions, the securities may not be offered, pledged, sold or otherwise transferred within the United States or to, or for the benefit or account of, U.S. persons. In addition, there may be conflicts of interest with regards to the investment. In connection with the provision of services, Credit Suisse AG and/or its affiliates may pay third parties or receive from third parties, as part of their fee or otherwise, a one-time or recurring fee (e.g., issuing commissions, placement commissions or trailer fees). Prospective investors should independently and carefully assess (with their tax, legal and financial advisers) the specific risks described in available materials, and applicable legal, regulatory, credit, tax and accounting consequences prior to making any investment decision. The alternative investment fund manager or the (UCITS) management company, as applicable, may decide to terminate local arrangements for the marketing of the shares/units of a fund, including terminating registrations or notifications with the local supervisory authority. A summary of investor rights for investing into European Economic Area domiciled investment funds managed or sponsored by Credit Suisse Asset Management can be obtained in English via www.credit-suisse.com/am/regulatory-information, local laws relating to investor rights may apply.

Representative, Management Company (Fondsleitung): Credit Suisse Funds AG[3], Uetlibergstrasse 231, CH-8070 Zurich I Custodian, Paying Agent, Distributor: Credit Suisse (Switzerland) Ltd., Paradeplatz 8, CH-8001 Zurich I Distributor: Credit Suisse AG, Paradeplatz 8, CH-8001 Zurich I Distributor: Credit Suisse Asset Management (Switzerland) Ltd., Kalandergasse 4, CH-8045 Zurich I Language versions available: German, English, French, and/or Italian I Supervisor (Entity of Registration): Swiss Financial Market Supervisory Authority (FINMA)

[3] Legal entity, from which the full offering documentation, the key investor information document (KIID), the fund rules, as well as the annual and bi-annual reports, if any, may be obtained free of charge.