

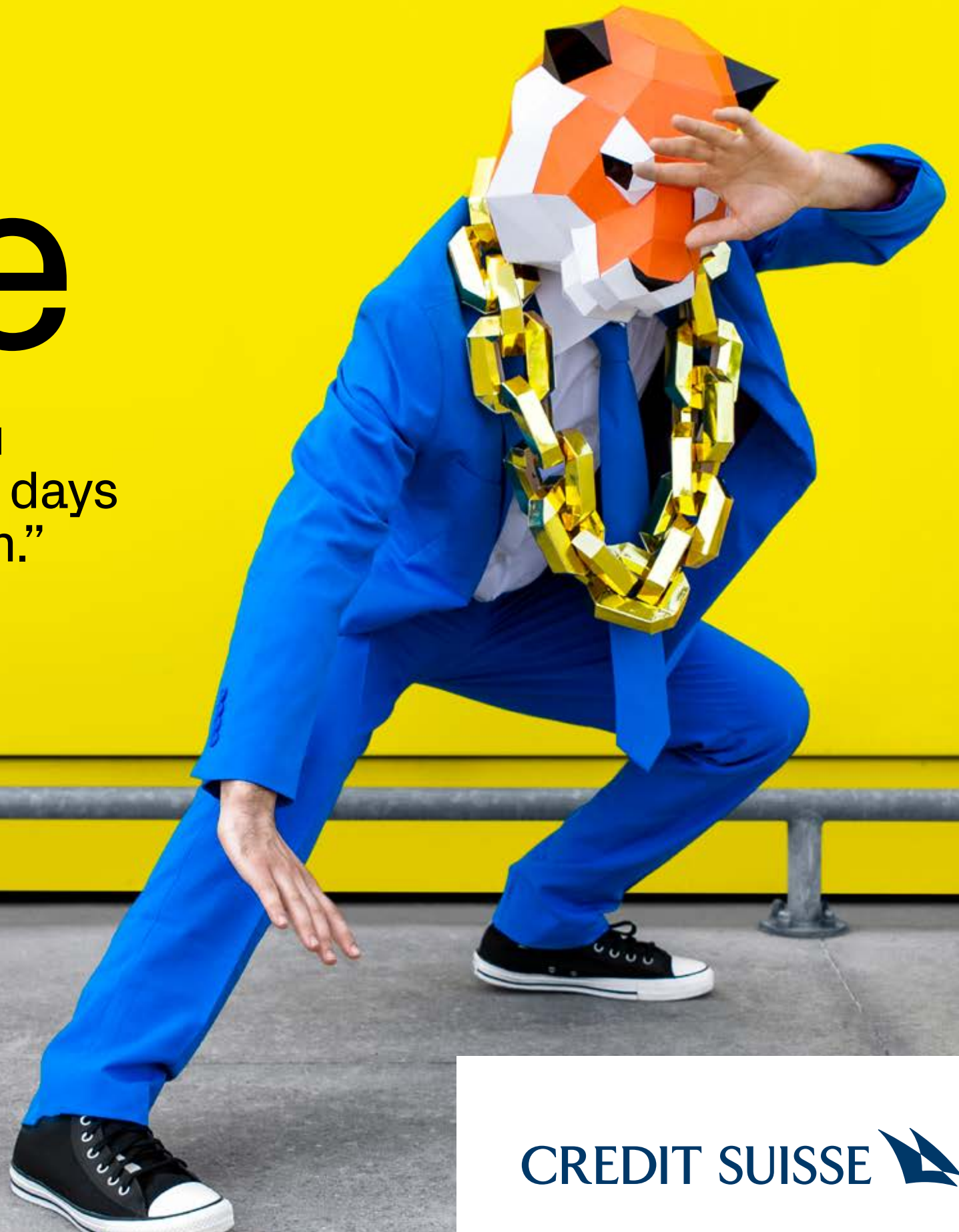
No. 01/2022

Scope

Inflation: “Some days you tame the tiger. And some days the tiger has you for lunch.”

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Asset Management



CREDIT SUISSE 

The sixty-four thousand dollar question

To what extent and for how long will inflation rise? The uncertainty surrounding the effects of inflation has increased massively. The current situation is calling for existing investment strategies to be reviewed and new opportunities to be evaluated.

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The Scope interview

Angus Muirhead, Head of Equities in Credit Suisse Asset Management, about the new focus in equity investments.

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Asia

Most investors fail to appreciate the potential of Asia, even though the region has the best markets for active stock-pickers.

[Read article →](#)



Senior loans

A notable bond segment that thrives even in inflationary environments.

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Inflation? Inflation!

Filippo Rima

Asset Management
Head of Investment

We have dealt intensively with ETFs, ESG, and climate neutrality in recent years. These topics remain topical, which is why we are also addressing them in this issue of Scope. Maintaining continuity here is important.

The situation is quite different when it comes to the framework conditions for investors. These conditions have changed substantially over the past few weeks and months – in the wake of both the rapid rise in inflation in major currency regions as well as the brutal war right in the center of Europe.

While the course of the war in Ukraine and its impact remain highly unpredictable, there are several well-known strategies for dealing with inflation. We explain these strategies and their various sensitivities in an illuminating report.

Some days, you tame the tiger. And some days, the tiger has you for lunch. This poignant quotation from Tug McGraw impressively dramatizes Friedrich Hayek's historical warning at the conference of the Mont Pelerin Society in the year 1969. At that time, inflation – the tiger – still went on the prowl regularly, fueling fear and uncertainty in the financial markets, in political circles, in society, and at central banks across the globe. Hayek said then that when the tiger is on the loose at first, it eats us; but if it runs faster and faster while we stay still, we are done for too. The markets and central banks will very soon show whether this is still true today. At any rate, the tiger nowadays still seems far from being tamed again ...

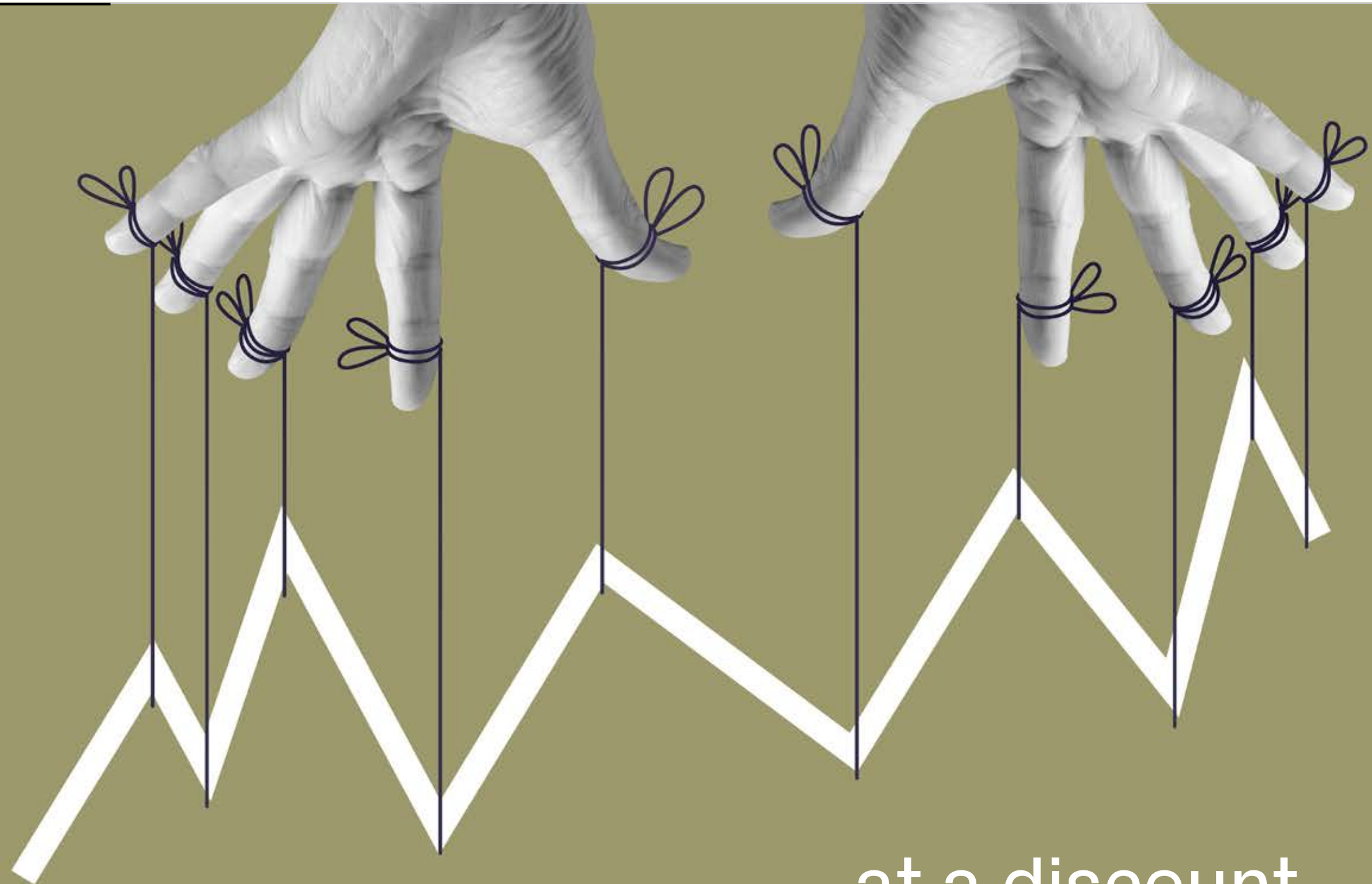


It is already clear that investors will be facing difficult decisions if governments and central banks decide to take aggressive action to combat inflation. Bond investors especially need an inflation-fighting strategy ([see our analysis for further information](#)). Equity investors are wondering to what extent the market has already priced in the negative influences and what they should do now. Angus Muirhead, Head of Equities, presents his view in the [Scope interview](#).

I would also like to particularly recommend the articles on the potential that Asia offers active stock-pickers and on senior loans. The latter is an investment segment that may still be unfamiliar to many investors. Especially in times of turbulent markets and rising inflation, senior loans can have a positive effect on portfolio quality.

I hope you enjoy this issue.

Filippo Rima



at a discount

Innovation

Interview with Angus Muirhead

Head of Equities at Credit Suisse Asset Management

Following a sharp drop in equity markets, it seems that many investors are tempted to cut their losses. What are your thoughts?

Angus Muirhead: I think it's a very natural reaction. Nobody enjoys losing money, and it's human nature to cut our losses when we experience pain. Risk aversion can, of course, be very useful in certain situations and is linked to our fight or flight survival instinct. However, in other situations, it can limit our ability to make rational decisions.

The current market backdrop provides the perfect storm of myriad fears and uncertainty. With negative sentiment all around, the perceived fear of loss is so great that it becomes difficult to see any potential opportunities.

But, given the uncertainty, isn't "flight" the right course of action?

The market often goes through these periods of extreme sentiment, both positive and negative. The negative periods often stand out more, because the movements tend to be sharper. You could say that the market goes up on an escalator and comes down in an elevator. Predicting the short term is notoriously difficult and this is why our thematic strategies focus on long-term secular trends.

It's difficult to imagine exactly how the current situation will be resolved, but we should remember that most of the things we're concerned about are already in motion: inflation, rising interest rates, war in Ukraine, COVID lockdowns in China, supply chain delays, and a fear of recession. They're also related. End the war and beat COVID and the other issues should dissipate.

If we cut our losses at this point, it feels to me that we are late and reacting to issues that the market has already largely discounted. Equity markets started to price in many of these issues from October 2021 and other risks have started to be priced in over the last few weeks and months.

Are you suggesting that the equity markets have hit bottom?

Unfortunately, we can't say that with any real certainty. Nonetheless, we can say that the price of most securities has fallen sharply and that valuations are generally more attractive now than a few months ago. Of course, the caveat is that the economic outlook is likely to be weaker than was expected six months ago due to higher interest rates, higher input and labor costs, and supply chain challenges. Therefore, we should assume lower revenue growth and earnings power for some companies in the valuation model.

So in a simple price/earnings multiple, the P has fallen, but the E has fallen too?

In many cases, yes. But remember, the stock market is vast and no company is exactly the same as any other company, so the extent to which the growth and earnings power of a company are affected by these issues is highly heterogeneous. Currently, in spite of the market sell-off and the challenges in the world, many of our portfolio companies are reporting very strong end demand from clients.

Therefore, we believe it is critical to perform deep-dive fundamental analyses and to be highly selective in stock selection.

Should investors shift from growth to value stocks?

I think that shift has already happened. However, we should also be careful about the definition of value stocks. Does “value” simply refer to low valuation multiples? Our view is that “cheap” is often not a good indicator of value. It’s more important to identify exceptional companies and to buy them at a price below your estimate of intrinsic value. Growth, in revenues and earnings, is of course a key component of the calculation of intrinsic value, and therefore the terms growth and value cannot be unbundled.

What measures are you taking in portfolios in this environment?

Everything has sold off to some extent, in particular, innovative, small to mid-size companies with great long-term growth potential, but which are not yet operating at scale or have yet to break even.

As markets have pulled back, most stocks in our pure-play Thematic Equity universes are now more accessible in terms of valuation. So we are using this opportunity to “high grade” our portfolios.

Buying the stocks of companies in which we have the greatest conviction and where we find excellent management teams, strong business models, ESG credentials, IP (intellectual property), and well-differentiated solutions. In most cases, we are looking for the ability to consistently stay ahead of the competition through innovation.



What is your expectation for the rest of the year?

With so many significant macroeconomic and geopolitical issues in play, equity markets are likely to remain volatile. Nevertheless, periods of extreme volatility often create opportunities for the long-term patient investor. An age-old adage is that time in the markets is worth much more than timing the markets. The challenge is to try to imagine the most logical scenarios. Not to predict, but to plan for a number of different outcomes.

It is likely that some signs of resolution around the key issues will be necessary before we see a genuine recovery in the market, but sentiment often recovers on the expectation of a brighter future, long before it becomes reality. As a result, we prefer to stay invested, but be highly selective in our exposure.

Angus Muirhead has 25 years of professional investment experience in equities, on the buy-side and on the sell-side. Angus Muirhead was appointed Head of Equities at Credit Suisse Asset Management on September 1, 2021. He remains Head of Thematic Equities and lead portfolio manager for the Credit Suisse Robotics strategy.

Angus Muirhead joined Credit Suisse Asset Management in 2016, as a Senior Portfolio Manager in the Thematic Equities team. He started his investment career in 1997 as a buy-side equity analyst at Phillips & Drew Fund Management in London, before moving to Tokyo in 2000 to focus on the Japanese technology and healthcare sectors. In 2007, he moved to Zurich as a Portfolio Manager specializing in global technology and healthcare-related thematic equity funds.



Asia is more
interesting than
most investors
realize

While Asia dominates economically, investors remain largely under-allocated. This gap can be expected to close over the coming years and decades through fundamentals that support this region. Asia is one of the best regions for active stock pickers.

Some of the best opportunities for investing in companies with capital appreciation and growing dividends are likely to be found in Asia over the next decade or two. The beauty of it: Investors do not need to make the traditional trade-off of growth for income. They can own some of the best structural growth stocks that are also growing their dividend payouts.

Asia is on track to account for more than 50% of global GDP at some point in the next 15–20 years.¹ One of every two US dollars of global consumption is likely to be spent in Asia.²

Beyond Asia's soaring consumption and the rise of its middle class, the region's extension of infrastructure, the surging urbanization, industrialization, and expenditure on R&D has meant its corporate sector is innovating faster than ever. We are seeing rapid strides in human development, health care, and life expectancy, as well as higher literacy levels.

Capturing the Asian opportunity set

A common question and perhaps one that is most misunderstood is how this explosive and transformative growth can be captured in a portfolio? Investors often like to know if their portfolios need to focus on a particular sector, country, style, or be diversified across a range of thematic opportunities. It is tempting for them to seek out the highest “growth” companies in order to benefit from the structural growth trends in the region.

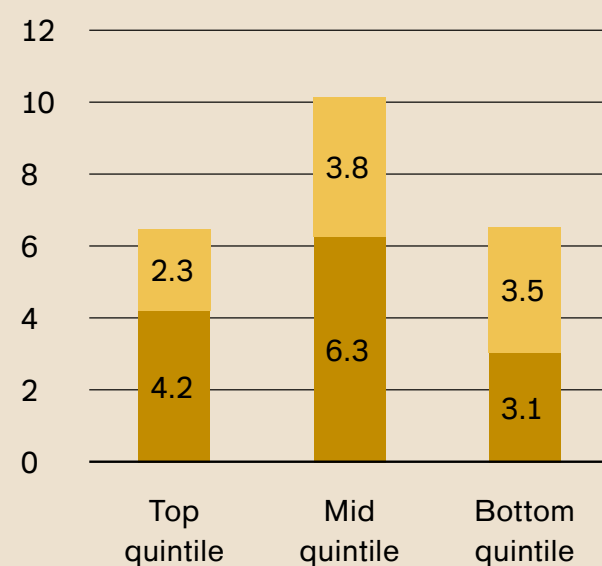
However, evidence over the last 20 years suggests that, actually, the highest growth stocks have underperformed, while it is the middle ground, perhaps best thought of as “sustainable” growth, that have generated the highest investment returns. Note from the chart below that not only have this middle tier generated the highest capital gains, but they have also paid attractive dividend yields.

¹ Business Standard (2019, July 15). Asia on track to top 50% of world GDP by 2040, says McKinsey report. [www.Business-Standard.Com. https://www.business-standard.com/article/international/asia-on-track-to-top-50-of-world-gdp-by-2040-says-mckinsey-report-119071500858_1.html](https://www.business-standard.com/article/international/asia-on-track-to-top-50-of-world-gdp-by-2040-says-mckinsey-report-119071500858_1.html).

² World Economic Forum (2021, October 22). What percentage of the world's consumer class live in Asia? <https://www.weforum.org/agenda/2021/10/growth-consumers-asia-indonesia-bangladesh-pakistan-philippines>.

APxJ (Asia Pacific ex Japan): Annualized total return by growth type 2000–2021

in percent



■ Price return
■ Dividend return

Sources Credit Suisse Asset Management, CS HOLT
Data as of December 31, 2021

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

Immense diversity and pricing inefficiencies

As is well known, Asia is extremely diverse, with differences in governance methods, economic systems, demographics, wealth, and growth trajectories. Asia is also much more than just an early-stage growth story, which is not always appreciated by investors. There are also many high-quality companies that can be found in this region.

Often, these groups adhere to the same level of corporate governance and compliance as their developed market rivals. Many of these companies have dual listings in developed markets, which require them to follow more rigorous regulations. Meanwhile, their international investor base, which may include large institutional investors, means that it is in their interest to adhere to the highest levels of corporate governance.

The key difference, however, is that these markets are a lot less efficient informationally. This can create excellent opportunities for active investors that actively exploit these pricing inefficiencies.

Ripe for stock pickers

The region is probably one of the best areas of opportunity for active stock pickers in the world. Firstly, this is due to the sheer size of Asia's equity market, which makes it an attractive market to hunt for stocks. Secondly, as mentioned, these markets are not as efficient as those in the developed world, which creates additional opportunities.

To really take advantage of these opportunities, however, you need to be an active investor. You also need to have access to the right resources. Often the best opportunities can only be found by having boots on the ground – analysts that are native to the region and have experience investing in that local market.

For instance, when you look at a country like South Korea, on a price-multiple basis it often looks cheap. However, there is a reason why South Korean stocks trade at a discount. This is a highly traditional market. Often there is a conglomerate discount priced into stock valuations due to companies having many crossover owners.

By contrast, if you look at India, stocks in this market look quite expensive. Often you will see stocks trading at more than 50 times price-to-earnings. However, this makes sense when you consider that these companies have earnings growth in the region of 20–30%.³ They actually provide a very good proxy for tapping into India's economic growth potential.

High priority for climate protection

Asia Pacific's vast population, economies, and communities are extremely vulnerable to climate change, making it a significant sustainability risk factor for the region. It impacts the region in many different ways. For example, in many parts of South Asia the most pressing issue is heat waves and chronic heat resulting in extreme weather conditions.⁴

China is the world's most important manufacturing base, which is reflected in its correspondingly high CO₂ emissions. The country is also a signatory of the Paris Climate Agreement and it has set itself an ambitious goal of reaching net zero by 2060.⁵

Furthermore, it has one of the world's largest electric car markets, with its own domestic electric vehicle companies, such as BYD and NIO. The country also has extremely ambitious plans to build renewable infrastructure and electrify its huge road network in the coming decades.⁶

In fact, a huge amount of green growth opportunities can also be found in Asia. Asia could have the greatest abundance of ESG investment opportunities anywhere in the world.

³ TTan, W. (2021, January 7). Earnings growth in Asia could jump by more than 20% this year, say UBS and Goldman Sachs. CNBC. <https://www.cnbc.com/2021/01/07/asia-earnings-growth-could-jump-over-20percent-in-2021-ubs-and-goldman-sachs-.html>.

⁴ VOA Learning English (2022, May 27). Report: South Asia's Heat Waves 30 Times Likelier with Climate Change. VOA. <https://learningenglish.voanews.com/a/report-south-asia-s-heat-waves-30-times-likelier-with-climate-change/6590454.html>.

⁵ Bloomberg News (2021, August 10). How China Plans to Become Carbon-Neutral by 2060. Bloomberg. <https://www.bloomberg.com/news/articles/2021-08-10/how-china-plans-to-become-carbon-neutral-by-2060-quicktake>.

⁶ World Economic Forum (2022, May 20). Which countries have the largest electric vehicle markets? <https://www.weforum.org/agenda/2021/02/electric-vehicle-market-global/>.



Consumption –

a long-term growth driver

Fueled by the rise of the Asian middle class and their increasing purchasing power, consumer spending is a long-term growth driver for the region. China's middle class is expected to reach over 1.2 billion people by 2030, while India's is expected to double from 400 million in 2021 to 800 million by 2030.⁷ Asian consumers are expected to account for half of global consumption growth in the next decade, equivalent to a USD 10 trillion opportunity. This has significant revenue implications for the ecommerce, financial services, automotive, consumer durables, travel and leisure, education, and health care industries as consumers look to upgrade their lifestyles.⁸

⁷ World Data Lab (2021, April 16). China vs. India — Where is the momentum in consumer spending? <https://worlddata.io/blog/china-vs-india-where-is-the-momentum-in-consumer-spending>.

⁸ World Economic Forum (2020, July 13). The rise of Asia's middle class. <https://www.weforum.org/agenda/2020/07/the-rise-of-the-asian-middle-class>.

Infrastructure

needs spending of USD 1.7 trillion per year

As a result of population and economic growth, Asia is reaching the limits of its infrastructure capacity. According to the Asian Development Bank, emerging Asia will need to spend USD 1.7 trillion per year in infrastructure until 2030 to maintain its growth momentum, tackle poverty, and respond to climate change. The USD 1.7 trillion annual estimate is more than double the USD 750 billion Asian Development Bank (ADB) estimated in 2009.⁹ The inclusion of climate-related investments is also a major contributing factor. Companies within the energy, materials, and industrials sectors are expected to be large beneficiaries.

⁹ Asia Development Bank (2019, May 1). Asian Development Bank: Meeting Asia's Infrastructure Needs. Asia House. <https://asiahouse.org/event/asian-development-bank-meeting-asias-infrastructure-needs/>.





Innovation

driven by innovation and technology

There is no question that Asia is successfully transforming itself from a purely low-cost production center or “made in Asia” to “born in Asia,” one driven by innovation and Asia’s highly adaptable digital consumers. Over the past decade, the region has developed and deepened its technological capabilities rapidly, accounting for a large share of global growth in technology company revenue start-up funding, spending on R&D, and patents filed. Most of Asia’s technological edge has centered around China, Japan, Taiwan, and South Korea, with China alone accounting for 45% of the world’s patents filed.¹⁰ However, India is also making good progress particularly as R&D centers expand beyond the public sector to those led by multinationals.

¹⁰ Woetzel, J., & Seong, J. (2021, January 5). What is driving Asia’s technological rise? McKinsey & Company. <https://www.mckinsey.com/mgi/overview/in-the-news/what-is-driving-asias-technological-rise>.

Climate change

accelerates renewable energy

Renewable energy is expected to account for an estimated 40% of average annual global energy investments through 2025 and Asia is a leading player. Its share of installed renewable capacity is 45%, compared with 25% in Europe and 16% for North America. At the same time, the International Energy Agency expects Asia to account for 64% of new renewable energy additions to 2040.¹¹ The clean energy industry is expected to be a major growth sector for Asia in the coming years.

¹¹ IEA (2021, December 31). Renewables – Global Energy Review 2021 – Analysis. <https://www.iea.org/reports/global-energy-review-2021/renewables>.

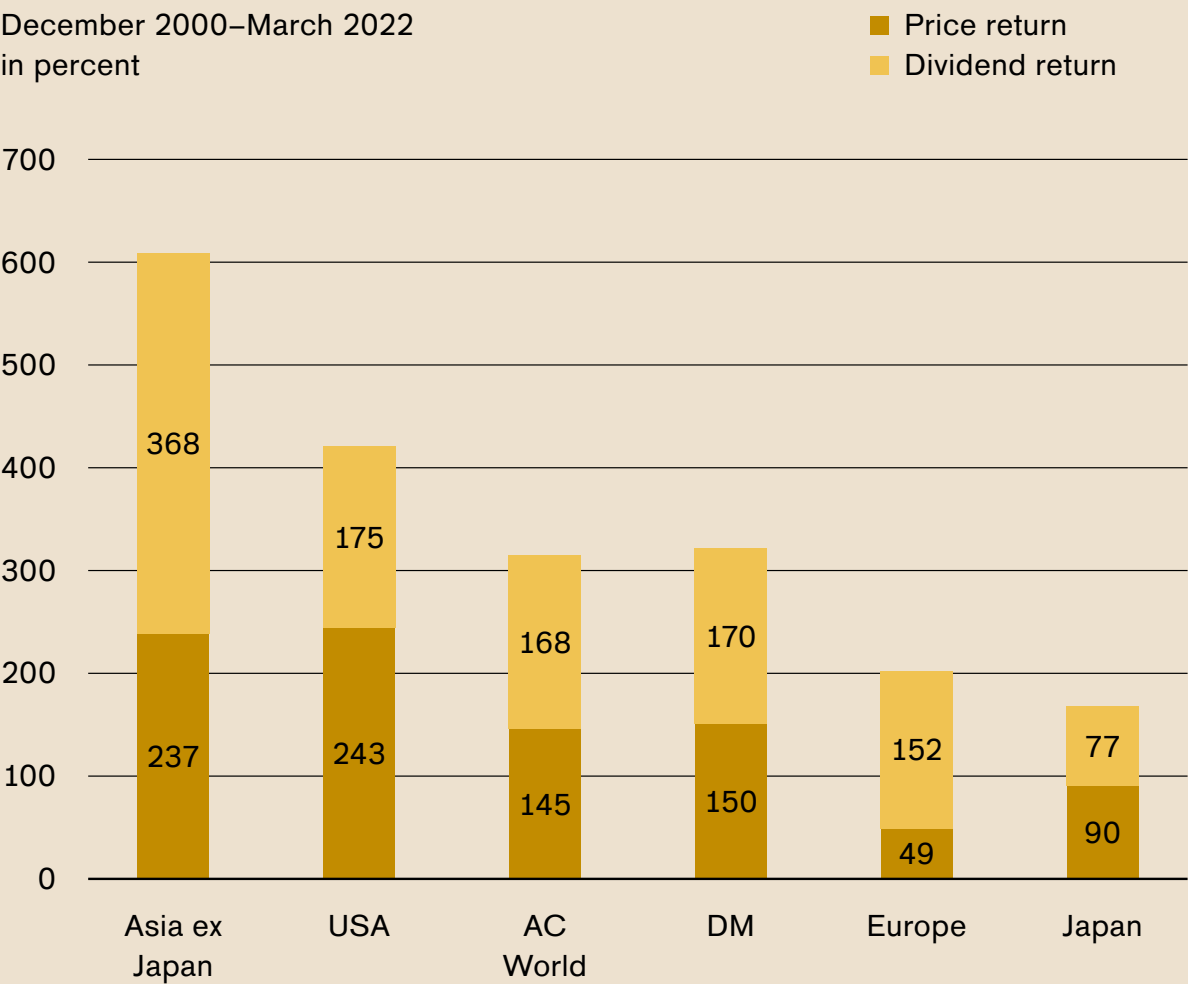


High appreciation for dividends

Asia offers some of the best dividend-paying stocks that are also exposed to some of the best structural growth opportunities in the region.

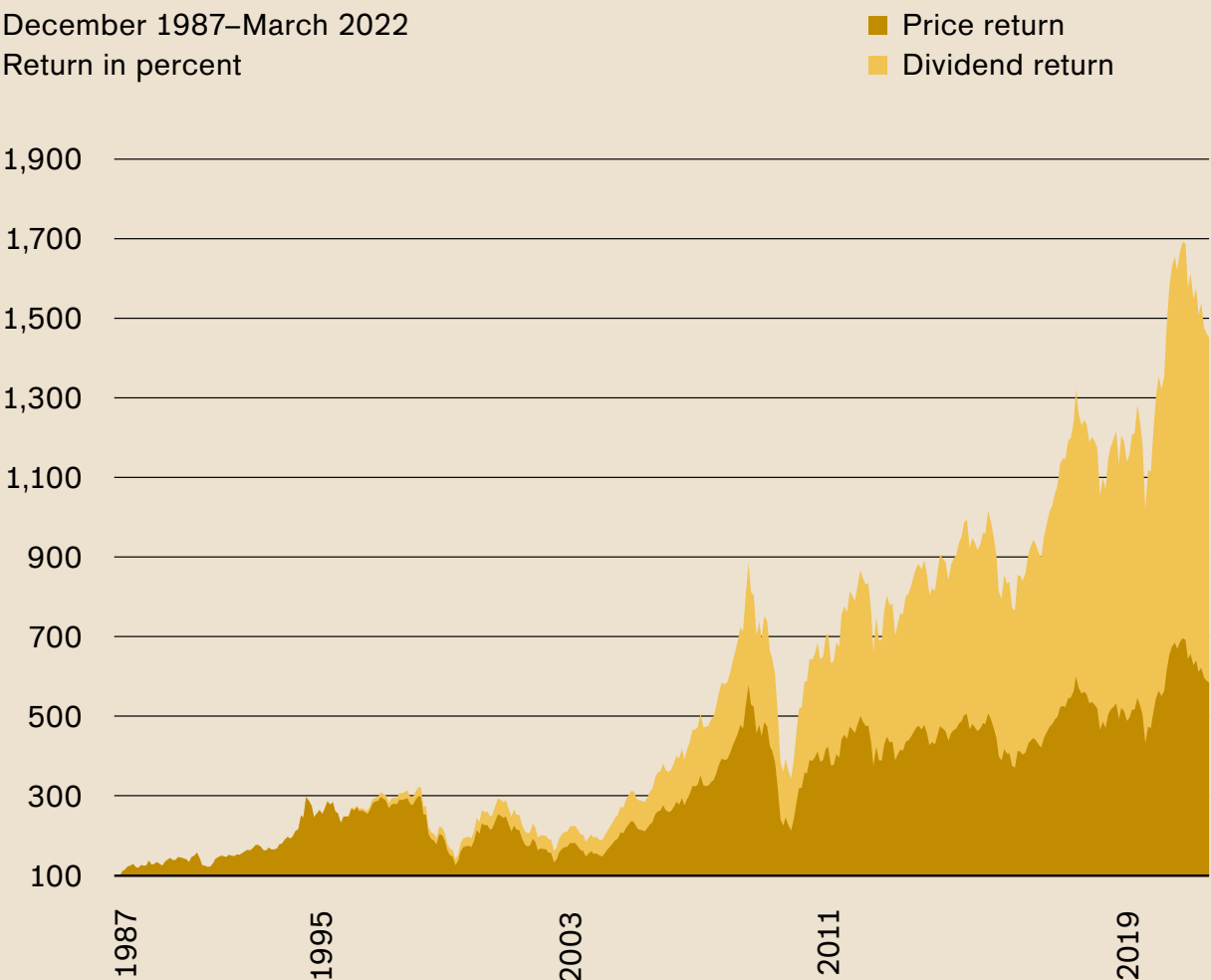
Total returns with dividends reinvested

Dividends have been a significant contributor to equity returns in APxJ.¹



Asia Pacific ex Japan

Dividends have accounted for 60% of total returns in APxJ.



Source Bloomberg. Data as of March 2022

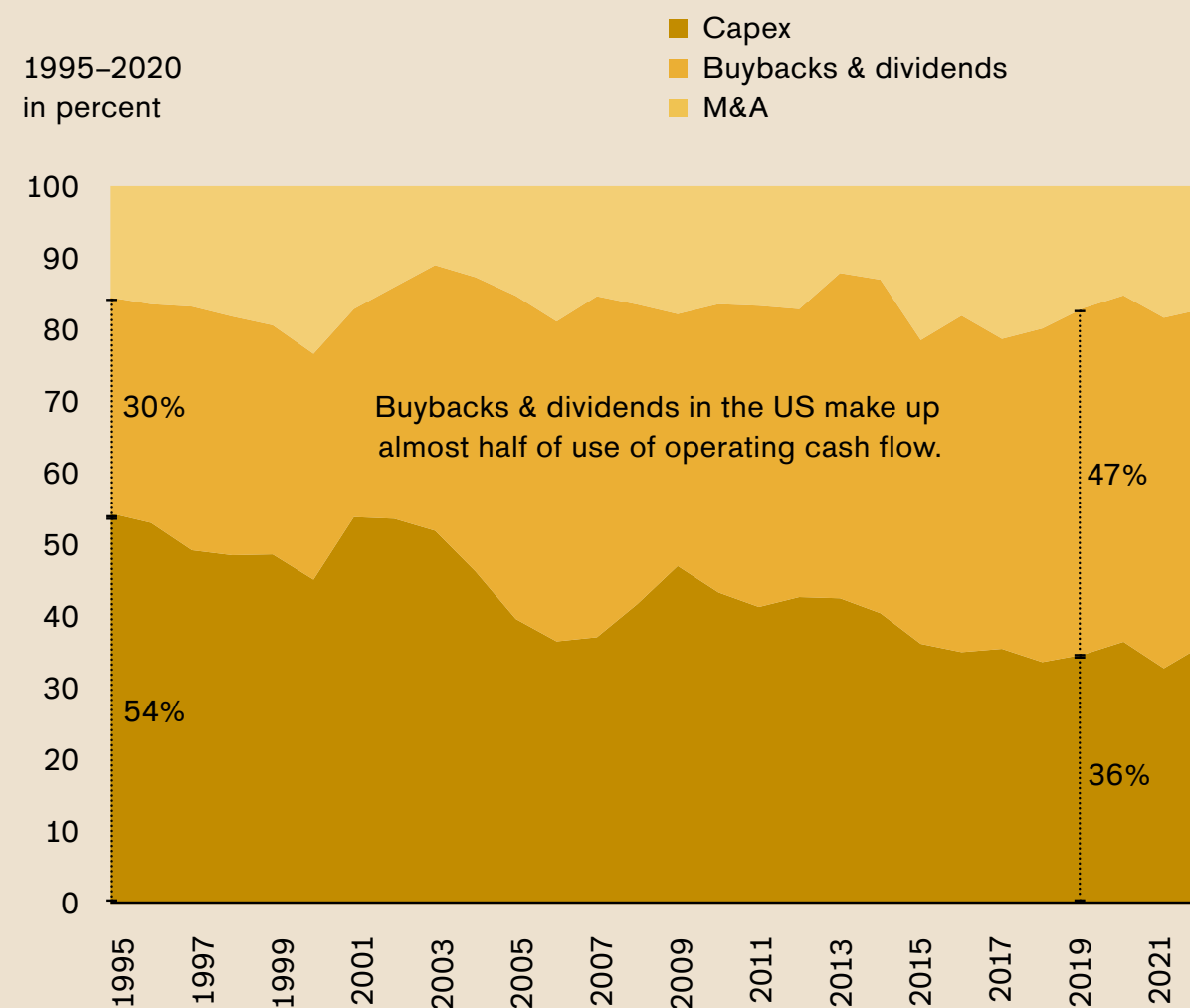
¹ Asia-Pacific excluding Japan.

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

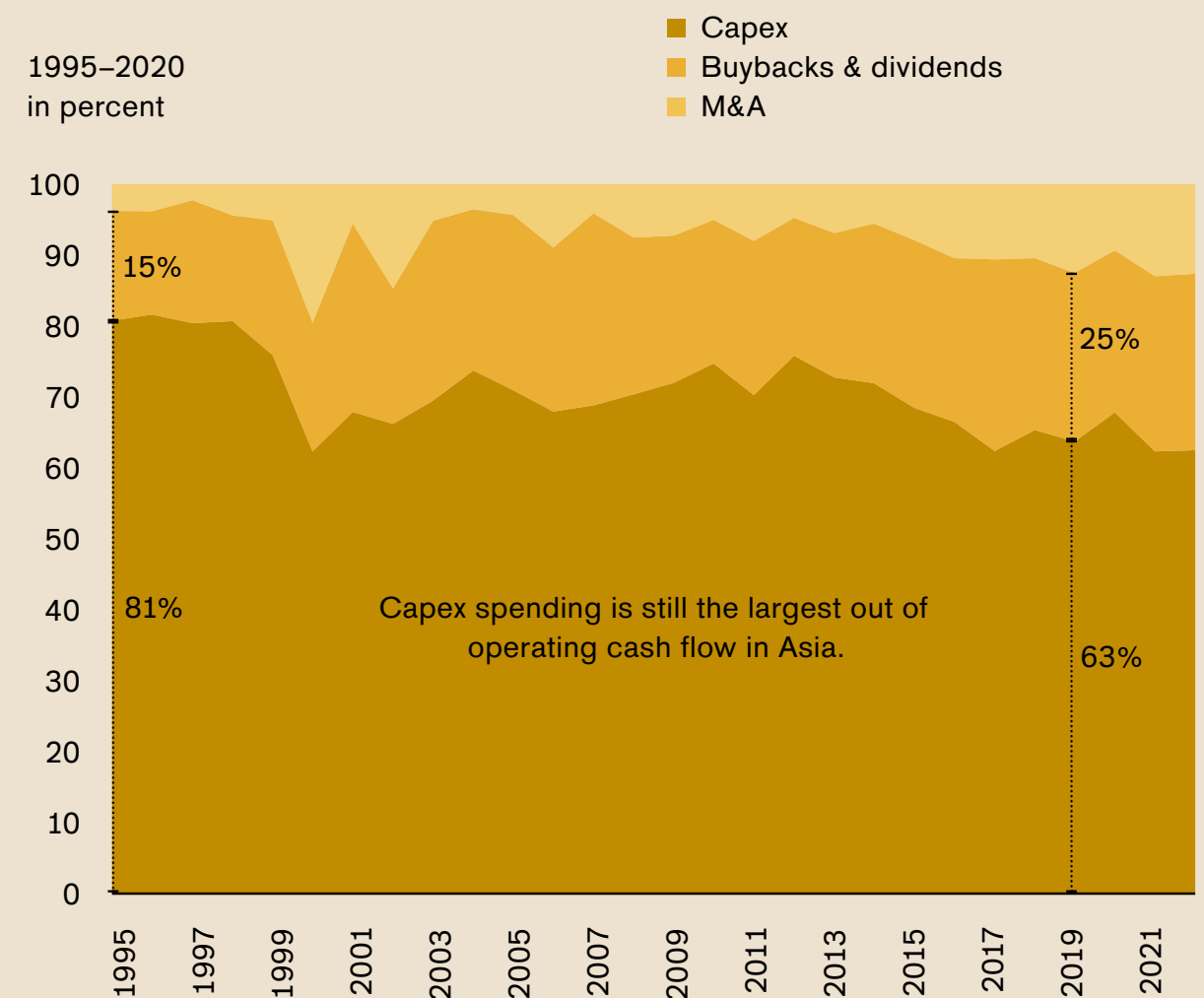
Cash flow mainly used for capex

Compared with their US peers, Asian corporates spend almost twice as much of their cash on capital expenditures.

MSCI USA (ex-financials) Capital allocation



MSCI Asia ex Japan (ex-financials) Capital allocation



Sources CLSA, Bloomberg, MSCI. Data as of March 2022

For illustrative purposes only. Historical performance indications and financial market scenarios are not reliable indicators of current or future performance. It is not possible to invest in an index. The index returns shown are not the results of actual trading of investable assets/securities. Investors pursuing a strategy analogous to an index can achieve lower or higher returns, and have to take into account the associated costs.

Why senior
secured loans
are

loved
by

bond
investors

This is not an asset class that all bond investors are familiar with. But it is an important one because it could become crucial in the fight against inflation.

For more than a decade, the investment environment for bonds has been nothing short of weird. We have lived through 14 years of insanely low interest rates and the longest credit cycle in financial history. The risk landscape has been transformed and distorted, forcing bond investors to completely rethink how they look at bond risk.

Now there is another seismic shift underway, brought about by the end of the pandemic. We are experiencing the highest levels of headline inflation in 40 years. Central banks are consequently planning to start a cycle of interest rate increases – an event that has not taken place since before the Great Financial Crisis in 2008.

For bond investors, this headache could turn into a migraine. Hopefully, senior secured loans could be part of the cure.

But first:

What are senior secured loans?

Senior loans are investments rated below investment grade. These investments are speculative in nature and are considered to have a high degree of investment risk. Such assets have greater default risks, greater exposure to market volatility and greater liquidity risks when compared to investment grade debt obligations.

We all know that traditionally banks make loans to businesses. In return, businesses secure those loans using inventory, property, equipment, and real estate. During the 1990s, banks started to increase their lending capabilities by syndicating these loans.

What this meant was that the bank was not the lender. The bank's role was to arrange the structuring process and then find investors for these loans. These instruments became known as senior secured loans.

They trade like bonds in the secondary market, but there are some differences. While senior secured bonds pay fixed coupons, senior secured loans pay floating rate coupons, which are made up of a fixed spread over a moving reference interest rate. In the past this was LIBOR, which is rapidly being replaced by the Secured Overnight Financing Rate (SOFR).

The fixed spread on a senior secured loan is set by the syndicating bank based on feedback it receives from investors on what is a suitable rate. For investors, a suitable rate represents the credit risk they are willing to take, or the risk premium that they want to be rewarded for holding the senior secured loan. Typically, this is assessed by a seasoned credit analyst who will look at the health of the company's earnings and its corporate outlook to assess how easily that business can service these loans without defaulting.

These are often the same analysts that study high yield bonds. This is because senior secured loans are usually issued by the same companies that issue high yield bonds.

Senior secured loans are not the same as high yield bonds

You need to remember that these are still loans, which makes them very different from bonds. Senior secured loans are secured by the assets of the borrower. Consequently, they have a more senior position in a company's capital structure.

This means that as loan holders, investors in senior secured bonds are paid first if a company goes bankrupt. This has a huge positive impact on the credit risk, which is one of the attractions for investing in them. Furthermore, investors also benefit from higher recovery rates in the case of default because these bonds are secured by assets.

However,

because senior secured loans are so different from other types of bonds in terms of their structure and covenants, their returns are less correlated to the rest of the bond universe, which is great for portfolio construction.

How senior secured loans are used in portfolio construction

What senior secured loans offer is an alternative source of risk premium for bond investors. This can be particularly useful for portfolio construction. When added to a portfolio, they can help increase diversification and enhance the portfolio's risk-return profile.

However, their most useful attribute is their ability to reduce duration risk. This is the risk associated with rising inflation and interest rates, which is the environment we are now entering. It means that bond investors can strategically use senior secured loans to fight the risk of inflation. These are instruments that will offer attractive income on a real basis, regardless of the inflation environment.

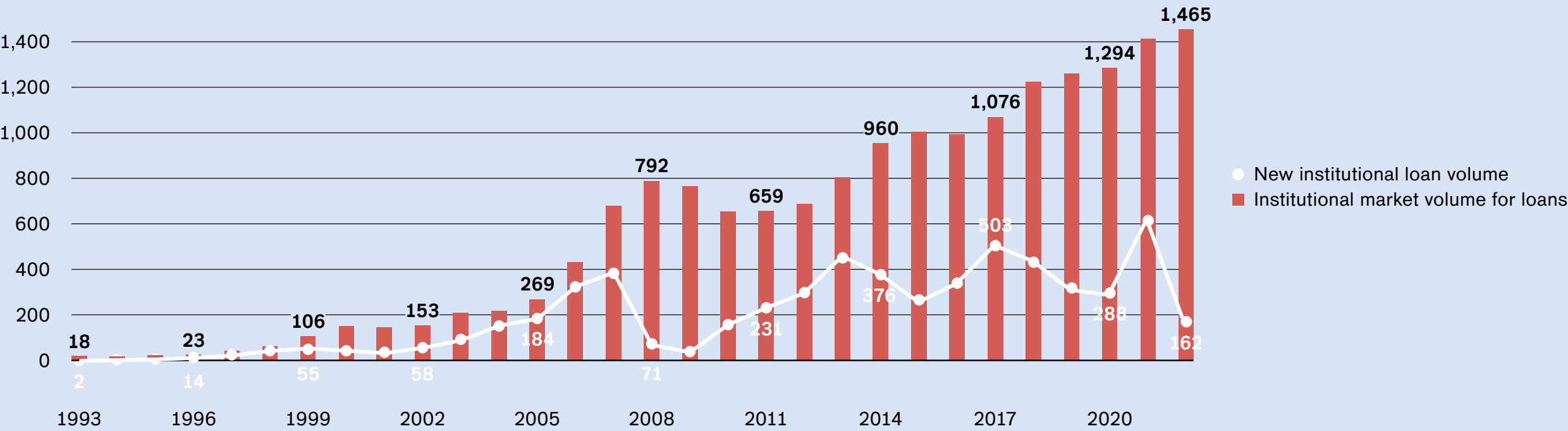
History of the senior loan market

Senior loans date back to the late 1980s, when the market for high-yield bonds expanded in the US and institutional investors began to participate in the purchase of loans. Insurance companies and investment funds were among the first non-banks to become involved in the business.

This development continued with the increasing consolidation of the US banking sector in the 1990s. Indeed, in the aftermath of the global financial crisis, structured vehicles – primarily collateralized loan obligations – became an increasingly important component of demand. The growth of this asset class was primarily down to the increasing involvement of non-banks, investment funds, and above all pension funds.

Demand for the asset class among institutional investors has increased substantially with the ongoing development of research, trading, and pricing. The market for non-investment grade loans is currently estimated at USD 1.4 trillion, thus outstripping the market for high-yield bonds.

Growth of institutional market for senior loans
in USD bn



Sources Credit Suisse, S&P LCD. Data as of May 31, 2022

The types of investors that buy senior secured loans

Broadly speaking, there are two sets of investors that buy senior secured loans. The first set are the issuers of collateralized loan obligations (CLOs), which make up about 60% of the market. These are special purpose vehicles that are set up to hold and manage pools of leveraged loans, to create a marketable security. This process is known as securitization. These CLOs can then be bought by other investors.

These investors are an important stabilizing force for the senior secured loan market. CLOs are lock-up structures, which means that they are less likely to sell during a correction, helping to lower market volatility.

The second set of investors, which are now growing in importance, are institutional investors such as high yield bond funds, hedge funds, pension funds, and insurance companies. These investors tend to be more strategic and hold senior secured loans as part of a long-term strategic asset allocation strategy. They too do not tend to move in and out of the market rapidly, which also helps lower market volatility.

These investors also hold secured loans because, as mentioned, they are very useful in fighting inflation. They help by lowering the overall duration risk of a portfolio and by providing a healthy yield that moves with interest rates.

Why senior secured loans are loved by bond investors

It is true that senior secured loans are rated below investment grade by major credit agencies. However, this is often because the companies that issue them are highly leveraged on a relative basis. This can happen when the loan is being issued to finance an acquisition. However, investors are compensated with a relatively attractive return versus other asset classes. This is also a fairly unique asset class, offering bond investors a very powerful strategic asset allocation tool during periods of market turbulence and inflation. That is why senior secured loans are loved by bond investors.

“Let’s get
all portfolios to

net
zero

by 2050.



This might be bold, but it's necessary."

Jeroen Bos

Global Head of Sustainable Investing at
Credit Suisse Asset Management

Of course, statements like these are meaningless without context. First, let me explain what we mean by net zero. This means investing in companies that emit zero carbon dioxide on a net basis by 2050 at the latest.

Here is some more context. In 2015, the Paris Agreement was signed by 192 countries, which was unprecedented.¹ The goal was to limit the rise in temperature well below 2°C above pre-industrial levels, plus pursue efforts to limit a temperature increase to 1.5°C. These measures aimed to significantly reduce the risks and impacts of climate change.

Limiting the rise in temperature is essential for our society's future and the generations to come. At the same time, limiting global warming is not only important for society but also for long-term returns on investment portfolios.

This is about protecting investors against climate change

If you are a millennial or younger, having a 2050 target date to reach net zero makes a lot of sense. Many people in this age cohort expect to retire after this date. The risk these investors face is that they might not be able to retire – climate change could jeopardize the performance of their pension portfolios in the coming decades. On top of this there is a risk that they would retire in a world where the quality of life has rapidly declined due to the negative effects of climate change.

Markets often do not fully price in climate risk so far ahead. This is because the timing of the potential impact is difficult to pinpoint exactly. The complexity of the topic, meanwhile, makes it challenging for the average investor to act upon it today.

Progress has been made, however, through improved reporting on the impact of climate change on investments. For instance, the Task Force on Climate-related Financial Disclosures (TCFD) has set standards for companies to provide clear, comprehensive, high-quality information on the impact of climate change. This mandatory disclosure is currently being discussed by regulatory authorities.

In my view as an asset manager, beyond regulations and reporting frameworks, we also need to help investors achieve their goals through our guidance. We should do this no matter how long the time horizon and how complex the topic.

¹ United Nations. (n.d.). The Paris Agreement. Retrieved May 25, 2022, from <https://www.un.org/en/climatechange/paris-agreement>.

By building portfolios that manage climate risks properly and by investing in solutions for the energy transition, we can help serve investors well. This approach can help deliver returns that are attractive, sustainable and long-term, and support the transition to a more sustainable and net-zero society.



Jeroen Bos has served as Global Head of Sustainable Investing at Credit Suisse Asset Management since January 2022. He also sits on the Sustainability Leadership Committee of Credit Suisse Group. Before joining Credit Suisse, Jeroen spent 14 years with NN Investment Partners (NNIP). Prior to that, he held senior positions at UBS in New York and JP Morgan in London. In addition, Jeroen is a member of the investment committee of the Rail & Public Transport Pension Fund in the Netherlands.

Jeroen holds a master's degree in economics from the Vrije Universiteit Amsterdam (VU). Moreover, he is also a Chartered Financial Analyst (CFA) and holds multiple certifications.

Take an active ownership approach to climate risk

It is also important to realize that as an investor you are the (partial) owner of a company. This ownership should also be used to support and influence companies that we invest in. This includes actively engaging with the management teams of these companies to ensure they commit to the transition to a net-zero society and incorporate climate risk seriously in their business and strategy.

Engaging as an active owner can therefore have a positive impact on society as well as on the companies we invest in, which in turn should support longer-term financial returns as well.

It is about making attractive financial returns while having a positive impact on society

Ultimately, taking into account risks and opportunities stemming from climate change makes a lot of sense for investors, both from a financial and societal perspective. Integrating climate aspects in portfolios will make these portfolios more resilient, better able to deal with climate risk, and allow them to benefit from potential opportunities stemming from the transition. This should not only benefit society but also support long-term investment returns. Therefore, this investment approach will become even more important in the future as a greater number of investors around the world are likely to adopt it. This is not about trying to be groundbreaking. This is about being ready for the future when it comes and reducing the exposure our investors have to climate risk.

Ultimately, this is a story about managing long-term risk. Climate risk is one of the key risks of our lifetime. The transition to a net-zero society will be one of the most important trends of the next few decades.

Making sure investment portfolios are ready is critical. The transition to net zero can be a win-win for both investors and society and that's why we commit to it!

How a plan to get to

net zero by 2050 might work



Climate risks and opportunities can be integrated into portfolios in different ways.

First, it is important to assess how prepared companies are in dealing with the impact of climate change. For instance, how exposed is a company to the impact that climate change could bring through floods, droughts, or extreme weather events?

Second, it is important to assess how well a company can cope with the disruptive nature of the energy transition. You also need to assess how resilient its business model is and its products are, and whether its products are at risk of being displaced. Furthermore, you need to look at what the impact on the long-term sustainability of its business model will be and its future profitability.

The level of preparedness can also be assessed by the company's commitment to a net zero transition. Observing whether they are intensively working on this transition with a clear strategy or committed to reaching net zero is a good sign. Evidence that they are using science-based targets to see how quickly they need to reduce emissions to meet their goals is even better.

The other aspect is that climate transition also brings opportunities for investors. Therefore, it is important to assess which companies can actually benefit from the transition to a net-zero society, where the greatest potential could exist.

Those companies that are ill prepared for climate risk should be approached with caution when building portfolios for clients. If there is a climate shock event, these are the companies that are likely to suffer the most. Their revenues and profits could take a big hit, which will likely hurt portfolio performance. This is exactly what investors should avoid, while focusing much more on investing in the winners of the transition to a net-zero society.

How to develop an inflation- fighting strategy for bond investors

Important points to consider when developing an investment strategy

Memories are short. We are still recovering from the aftermath of the pandemic. As the global economy returns from its slumber, supply chain shocks and now geopolitical events have seen energy and food prices soar. Meanwhile, pent-up demand from long periods of lockdown were unleashed from the buildup in savings, pushing up prices.

To put this into perspective, we have not experienced this level of inflation in 40 years. Inflation psychology has shifted significantly, and while longer-term inflation expectations have not yet become unanchored, they are increasingly at risk of becoming so. In fact, this four decade-long break saw a slow decline in macroeconomic volatility – a period known as the great moderation. Interest rates also fell gradually and finally hit record lows during the pandemic ([see figure](#)).

Today, bond investors will need to adapt, as bond prices have tumbled this year (yields have risen) after many major central banks began to end large-scale asset purchases and raise interest rates in their battle with soaring inflation. This subsequently pushed yields upwards across many of the largest economies, reaching their highest levels in years.

Below are a number of fixed-income considerations bond investors might find useful for establishing a fixed income strategy.

Reduce interest rate sensitivity (duration risk)

One possibility that investors can make use of, if interest rates and inflation expectations are rising, is to reduce the duration – the sensitivity of a portfolio to a change in interest rates. Short-duration bonds can help mitigate downside risks thanks to their lower sensitivity to both rate and credit spread movements.

Thanks to lower interest rate risk than traditional core bond strategies, short-duration bonds can limit capital losses from such developments. Since last November, hawkish central bank action has meaningfully flattened the yield curve, creating ample risk/reward potential in shorter-duration bonds versus medium- or long-term instruments.

A second possibility are floating rate strategies where investors could benefit from higher interest rates. Here, the rate on the floater adjusts periodically to the current market rates. Floating-rate credit offers significant yield pick-up versus money market and short-term instruments due to high-carry investments. Furthermore, floating-rate strategies with steady income streams from diversified credit exposures and limited interest rate risk do not just limit downside – they could actually deliver positive returns in such an environment.

Senior secured loans could be a third possibility. These are debt obligations generally issued by non-investment grade businesses. These loans are usually “secured” by a company’s assets and are typically used to fund a company’s growth or cover general operating expenses. They pay floating rate coupons, which can help reduce duration risk even more. Quite often, investors will invest in them alongside high yield bonds.

**The great
moderation
has seen
interest rates
fall over
40 years**



US 10-year Treasury Yield

in percent



Source Bloomberg

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

Invest in inflation-linked bonds

Inflation-linked bonds are a well-established asset class – the first “linker” was issued in the US, back in 1780. Globally, this is a USD 4.4 trillion market, which consists of a variety of bonds issued by governments, as well as several corporates.¹

Conventional bonds are issued with a fixed nominal coupon and a redemption payment amount agreed in advance. These conditions take into account inflation expectations at the time of issuance, but are not subsequently adjusted. Inflation-linked bonds by contrast guarantee a fixed real return, irrespective of inflation. Inflation-linked bonds adjust coupon payments in line with realized inflation, unlike conventional bonds.

While inflation-linked bonds have considerable upside potential, they also possess certain risks. As with other investments, the price or the value of an inflation-linked bond can fluctuate over time. While the value of nominal bonds is determined by changes in real interest rates and inflation expectations, the value of inflation-linked bonds only changes when real interest rates fluctuate.

If inflation expectations remain constant, the returns generated by nominal and inflation-linked bonds are therefore identical and depend on real interest rates. This means that any differences in the returns of the two bond classes are caused solely by changes in inflation expectations. If inflation expectations rise, inflation-linked bonds outperform nominal bonds. Conversely, they perform less.

The mixture makes the difference: Combining all four of the approaches described above could provide a fixed income investor with a great deal of protection in a rising inflation environment. Each approach is unique and offers diversification benefits. A skilled investor can strategically invest across these four areas and protect their bond portfolio from rising interest rates or rising inflation.

¹ Ranasinghe, D., Chatterjee, S., & Barbuscia, D. (2022, February 9). Surging inflation spurs demand for once rare linker bonds. Reuters. <https://www.reuters.com/markets/europe/surging-inflation-spurs-demand-once-rare-linker-bonds-2022-02-08/>

ESG risk –

the opportunities of active management



There are some ESG risks (environmental, social, governance) that can be removed automatically. For instance, stocks that may have high exposure to carbon taxes in the future, such as conventional energy businesses, could be filtered out early in the investment process. Likewise, sensitive sector stocks like tobacco, or companies manufacturing controversial weapons, such as cluster munitions, can be avoided to protect investors from being exposed to what could be considered unsustainable investment practices.

However, an avoidance strategy alone is not enough. A more comprehensive and active approach to ESG is needed. ESG risks are best mitigated through active management, using a firmly integrated process that combines quantitative analysis with robust bottom-up research.

How quantitative analysis is used to manage ESG risk

Using quantitative analysis to manage ESG risks may one day be automatically integrated into every investment strategy in the asset management industry. As technology improves, we are likely to see widespread adoption, and this could prove critical in this increasingly data-rich world.

Certain metrics can capture how effective companies are in having a positive impact on ESG. Integrating data into the investment process can be done in a variety of ways by helping automatically filter the investment universe. Data can also be used to provide ratings or scores for companies, or even to provide valuable information to portfolio managers when they make active portfolio decisions.

ESG risks can also be assessed during comparable company analysis, when portfolio managers build a comparable universe of similar companies to determine whether a stock is valued correctly. Here, quantitative measures of ESG risks could be used to derive a discount rate that a portfolio manager can apply to their valuation model.

Taking a qualitative approach to ESG risk is also important

Beyond quantitative analysis, ESG risks can also be assessed qualitatively, which is one of the most common techniques used in asset management. Portfolio managers can try to get a better understanding of ESG risks through their own fundamental research. This can often occur when they are conducting financial statement analysis with their analyst teams. For instance, this could involve searching through the notes of financial statements to gain greater insights into the operational issues that a company might face.

Portfolio managers may also analyze the supply chain of a company and the ESG risks that may threaten the sustainability of that supply chain. Additionally, portfolio managers often have personal relationships with the management teams of the companies they invest in, which gives them a unique perspective on the ESG risks that these companies face. They can even take on an active ownership role during this process to ensure that their ESG concerns are being addressed.

Actively managing ESG risks can have a positive impact

ESG investing is also about creating a positive impact. Here, the notion of “additionality” comes into play, which is when you take an action that adds value. Investments therefore need to pass the “but for” test, i.e. a positive impact could not have occurred “but for” our investment.

Impact investors are, therefore, naturally active. The logic here is that if you can add value you are more likely to have an impact and ultimately create a sustainability premium. Consequently, additionality with ESG can be easier to achieve in private markets, where investors are often actively engaged, carry out their own measurements and make use of the proxy voting process. Thematic investment also lends itself well to additionality, as themes can be associated with having a positive impact, such as edutainment, foodtech and agritech.

More than honey The world's production of honey in 2020 amounted to 1.77 million tons and in 2021 the number of beehives totaled upwards of 20 million. Aside from just producing honey, bee colonies also contribute to the reproduction of plants and the preservation of biodiversity through pollination.

Source European Commission, Honey Market Presentation, Expert Group, April 21, 2022



Using private asset due diligence techniques to manage ESG risk

Many investment teams are also adopting a due diligence approach to ESG, similar to what we see in the private equity industry. This is likely to be achieved if you focus on thematic investments and small cap stocks.

Here, an extremely robust process and structured approach can be used to assess the ESG risk for each stock that a portfolio manager holds. The benefit of taking this approach is that it can remove the human bias that can sometimes creep in with a portfolio management team. It also ensures that no stone is left unturned during the stock selection process.

Furthermore, it offers a better outside view of the company being studied. Although it is important to understand the outlook that a management team provides for a business, this type of due diligence approach can also challenge and verify the claims made by a management team on how they manage ESG risk.

Using this approach to tap new opportunities

These techniques are all valuable. The more active investors are when it comes to tackling ESG risks, the greater the sustainability premium they can earn. It can also make new opportunities which may benefit from a future sustainable economy more visible.

A good example is EdTech. EdTech, or educational technology, combines computer hardware, software and education to facilitate learning. The cost of education right now is soaring in both developed and developing countries. If education is allowed to become unaffordable then the less well off in society will suffer and this will create future disparity in wealth.

Technology, however, could level the playing field by making education cheaper to access. EdTech could dramatically lower the cost of accessing education and create more social equality in the future.

ESG will become the norm

Everything that we have described is set to become standard in the asset management industry. ESG considerations will increasingly be integrated into more and more investment processes. The difference, however, will be in the approach we take. Tackling ESG should not just be viewed as a criterion and a necessity. It can also be used to find new sources of returns and opportunities in addition to having a positive impact.



T-shirts/underwear

Annual CO₂ emission:

13 kg

Annual buying assumptions:

5 pieces

Lifestyle drives emission levels

Whether it's the car we drive, the flight we take, the products we buy, or the house we heat – all emissions globally are ultimately generated to accommodating consumer behavior and spending. The graphic shows the carbon footprint of fashion buying.





Jackets

Annual CO₂ emission:

29 kg

Annual buying assumptions:

2 pieces



Running shoes

Annual CO₂ emission:

42 kg

Annual buying assumptions:

3 pairs



Shirts

Annual CO₂ emission:

43 kg

Annual buying assumptions:

4 pieces



Dresses

Annual CO₂ emission:

46 kg

Annual buying assumptions:

3 pieces



Jeans

Annual CO₂ emission:

61 kg

Annual buying assumptions:

3 pairs





The evolution of 5G and its benefits for businesses

Stefan Koetz

Acting Head of Market Area Europe & Latin America,
Telefonaktiebolaget LM Ericsson

The interconnection of markets, sectors, industries, and society will change radically in the years ahead with 5G. Previous generations of mobile communications technology up to and including 4G/LTE were developed primarily for cellphone and smartphone use. The fifth generation of mobile communications and network technology (5G) currently under development aspires to meet the demanding communication requirements in the course of the digitalization of entire industries and our society much more comprehensively than before. A lot has happened since the first generation of mobile communications technology. Now 5G is here, and it will revolutionize our professional and private lives. The fifth generation of mobile communications technology promises faster speeds, shorter latencies, and larger bandwidths, thus enabling new use cases such as networked smart vehicles, augmented and virtual reality, and improved gaming and streaming experiences. 5G makes it possible to roll out automated systems, mobile applications, and managed networks of digital devices and smart objects in the Internet of Things (IoT) faster, on a larger scale, and with greater flexibility than before. Yet 5G is not just a catalyst for business innovation, but also is more ecological than all previous mobile communications generations.

What does the future look like with 5G?

5G lays the groundwork for doing business flexibly, efficiently, and responsibly. It opens cutting-edge possibilities for improving security and sustainability. Ericsson understands that end-to-end 5G network infrastructure vendors are rated on the basis of how well they enable IT provider performance to be competitive, efficient, and effective.

A rapid transformation driven by mobile communications technology is underway in every industry, and it is bringing about change in practically every sector through the advent of countless innovative solutions. Any enterprise that harnesses this new degree of connectivity will discover that the possibilities are limitless. The bedrock of this transformation is mobile communications technology, a tool that facilitates a complete digital transformation by enabling fast and scalable connectivity.

Ericsson is driving the buildout of 5G infrastructure in Europe and around the globe as the technological leader. The company currently has 172 commercial 5G agreements with unique communications service providers (CSPs) and powers 121 live 5G networks around the world. Ericsson Digital Services supplies cloud-native dual-mode 5G Core solutions for smarter networks to drive smarter business so that CSPs can offer a multitude of new business opportunities for mobile device users and industries.

Use cases from the automotive industry and gaming sector

New 5G use cases will create new sources of revenue for CSPs and new connectivity possibilities for subscribers. Examples come from an array of different sectors.

Stefan Koetz Stefan Koetz (59), graduate engineer, is the “Head of Customer Unit Western Europe, within Market Area Europe & Latin America”. In this function he is responsible for business in Germany, the Netherlands, Switzerland, and the Global Customer Unit Deutsche Telekom. In addition, he is the Chairman of the Management Board of Ericsson GmbH in Germany.

Mr. Koetz has worked in the information and communications industry for more than 20 years. He has held various management positions, including at Robert Bosch GmbH and Marconi Communications GmbH. From 2007 to 2010 he was Managing Director of Ericsson AG in Switzerland.



Cloud gaming

Augmented and virtual reality

Ericsson, Deutsche Telekom, and Samsung have successfully completed the world's first 5G end-to-end (E2E) network slicing trial, which was carried out at Deutsche Telekom's Bonn lab on a Samsung S21 commercial device tethered to a virtual reality (VR) headset. This customer-focused innovation shows the benefits of network slicing optimized for cloud VR game streaming. The trial used a commercial-grade 5G standalone (SA) infrastructure provided by Ericsson, including radio access network (RAN), 5G Cloud Core, slice orchestration, and ordering automation.

The test was carried out for a cloud VR streaming game use case with two independent E2E network slices consisting of a default mobile broadband slice and a cloud VR gaming-optimized slice. The gaming slice was designed and configured to enable higher throughput and stable low latency while also providing resource isolation between the two slices. The trial case demonstrated a superior experience on the gaming slice even under congested network conditions.

The above-mentioned companies are intended for illustrative purposes only and do not constitute an invitation or offer to buy or sell shares or investments.





Autonomous driving

Technology that keeps moving

Cars are no longer static objects that decline with advancing age. Driven by the transformation toward a software-centered solution, connected cars can be updated throughout their entire life cycle. This enables them to improve and evolve with each new update. But as vehicles become software-driven, the ability to solve software-related issues becomes critical. Cellular connection will ensure that the vehicle will always be the best version of itself.

Use case: Over-the-air updates (OTAs)

Software OTAs offer clear cost benefits to car manufacturers, one example being a reduction in the need for mass vehicle recalls. According to Thales, 19% of all recalls are software-related. Vehicle manufacturers deploying OTA to avoid physical recalls can reap cost savings of 87% or USD 54 per vehicle.

Investing in 5G-based technologies thus pays off for CSPs and the manufacturing industry. Ericsson helps to build and operate the right infrastructure for each new use case so that new applications do not remain merely a vision of the future, but become a reality.

ETFs have

changed

the way we invest

There are a lot of misconceptions about the ETF industry and what it represents. It is true that exchange traded funds (ETFs) have completely revolutionized the asset management industry. But exactly how they have done so is not always clearly understood. What is clear, though, is that ETFs have already changed the way we invest.

First, we need to look at the index tracking industry, a precursor to ETFs. The industry grew quickly as investors were reluctant to accept the high fees charged by active managers. Even if active managers outperformed, the fees they charged could significantly erode returns over time due to the effects of compounding. Index trackers allowed them to gain quick exposure to the market at a fraction of the fees charged by active managers.

The next innovation to come on the scene was the ETF. Unlike index funds, which are open-ended traditional mutual funds, ETFs are securities listed on a stock exchange. There are many benefits to this approach. While an index fund is traded just once a day, ETFs can be traded throughout the day, allowing price limits, stop losses, and other trading techniques.

ETFs offer so much more than just low fees. There is an incredible amount of innovation emerging from this industry. It is evolving rapidly. For instance, ETFs proved their resilience during the dramatic COVID-19 market crash in 2020, when liquidity in corporate investment grade bonds and high yield bonds dried up quickly. ETFs proved their worth, demonstrating that they could be a reliable instrument when other instruments became illiquid. They even served to support price discovery in the bond market, helping to match buyers and sellers at a price that was acceptable to both.

The ETF industry has emerged from the pandemic stronger than ever. Both listed (ETFs) and unlisted index funds saw record net inflows in 2021.

ETFs have proved to be a robust financial instrument

Many different types of investors use ETFs for a variety of purposes. The reasons are no longer limited to seeking passive exposure to an index or reducing fees. Many of those who buy ETFs are actually active investors and come from a variety of backgrounds.

There are investors who want to trade an index frequently. There are also those who want to buy and hold. Then there are institutional investors, such as portfolio managers who want to tactically tilt their asset allocation or build up exposure quickly and cheaply in a certain area of the market. ETFs can also be used by multi-asset teams as building blocks for asset allocation or risk allocation strategies.

The amount of innovation in the ETF industry in recent years has been breathtaking. Some ETFs have been designed specifically to target certain risk factors. Various different construction techniques have also been applied to help move away from some of the drawbacks of traditional cap-weighted indices.

ETFs support sustainable investing
The industry is now well established.

**Europe's UCITS
ETF market* has
already swelled
to an eye-watering
USD 1.5 trillion.**

And this figure is expected to grow, given the incredible amount of innovation that has seen the industry continuously expand and evolve.

One of the most interesting trends to emerge has been the use of ETFs in sustainable investing. ETFs can be used to efficiently follow robust ESG scores. Quantitative portfolio construction is also easy to implement with ETFs. Consequently, we have seen a dramatic rise in ESG-themed and ESG-integration products over the last few years.

The chart shows just how important Europe's ETF industry has become for sustainable investing. Just under a quarter of all assets under management invested in ETFs are in strategies that support sustainable investing (as of the end of 2021).

**However, 60%
of new inflows into
ETFs have been
received by ETFs
tied to sustainable
investing, which
shows just how
fast sustainable
investing is growing
in the ETF
industry.**

* Undertakings for collective investments in transferable securities (UCITS) means that the ETF complies with the EU's UCITS rules.

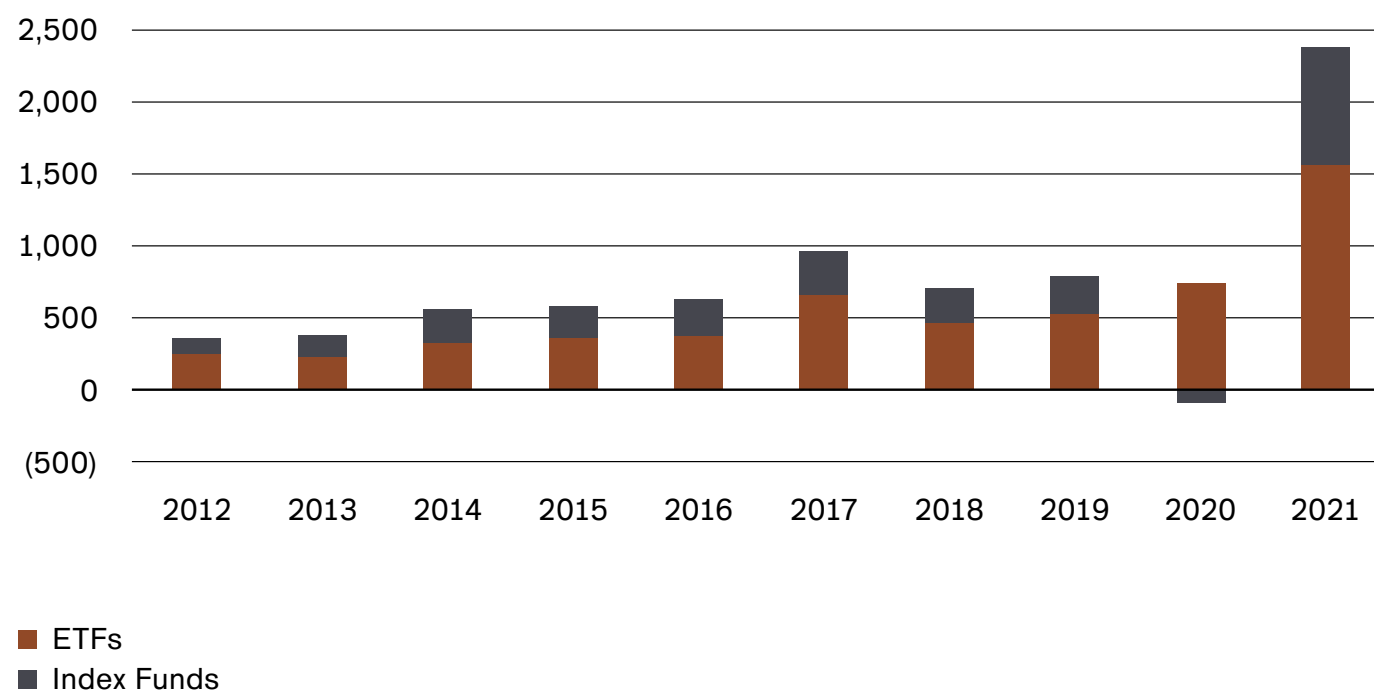
Who the future ETF winners might be

There will probably be a lot of consolidation within the industry as it matures. The ETF providers likely to succeed are the ones that are able to build up significant economies of scale and deliver the highest quality products to investors. Average industry fees continue to fall within the ETF industry, and they are expected to fall even further, so scale and efficiency are important.

There are also opportunities for ETF providers that focus on underserved markets where they can launch new and innovative ETFs. This can be incredibly useful for institutional investors and portfolio managers who need quick and liquid exposure in an area of the market they would otherwise have difficulty accessing.

Net inflows into passive strategies by instrument type – Global

in USD bn



Sources Morningstar, Bloomberg. Data in USD billions as of the end of December 2021

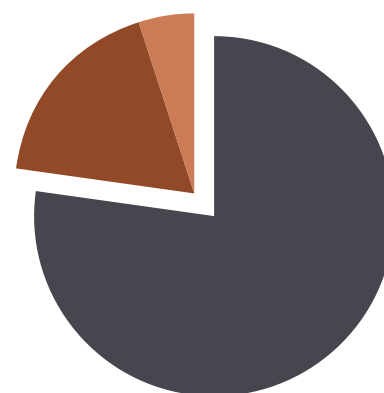
This is just the beginning for the ETF industry

The rise of the ETF industry represents a revolution in the way we invest. Over the next decade, one of the biggest areas of growth for the ETF industry could come from digital distribution channels. This includes the rise of robo-adviser apps, which could attract significant inflows into ETFs. It could also spark competition between ETF providers, which could lead to even more innovation and choice for investors.

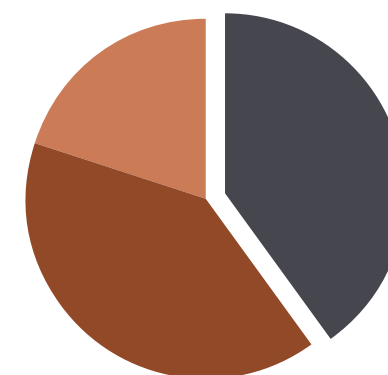
ETFs have come a long way over the years. A powerful combination of technology, low costs, transparency, and liquidity are behind the success of this industry. Investor preferences, regulatory guidelines, and an increasingly global investment landscape have so far fueled a record level of inflows. However, this is an industry that has by no means reached maturity. There is still a long way to go.

What we are witnessing is just the beginning. There is so much more to come.

UCITS ETFs



AuM share of SFDR-classified products



Share of net inflows for SFDR-classified products (2020–2021)

- Non-ESG focused financial products
- Financial products which promote environmental or social characteristics
- Financial products which have sustainable investment as their objective

Inflation marks the systematic strategies landscape

Yung Shin Kung

Head and Chief Investment Officer

Chin Te Liu

Head of Research & Technology

Macroeconomic measures implemented in response to the COVID-19 pandemic, supply chain disruptions, sociopolitical events, and changing Fed policy have heightened uncertainty around the path of future inflation. Depending upon the particular features of the systematic investment strategies approach, these strategies may experience changes in inflation expectations either as a threat or an opportunity.

After a multi-decade period of globalization-driven disinflation, COVID-19 has ushered in four main sources of inflationary pressure: (1) an increase in the money supply to support deficit spending and sustain unemployed workers, (2) a shift in the composition of the consumer expenditure basket towards goods rather than services, (3) rigidities in the labor market exerting upward pressure on wages, and (4) supply chain fragility. Russia's war with Ukraine has further exacerbated the situation.

Investors react to meaningful changes in inflation through security selection and asset allocation shifts. We focus on understanding the risks embedded in factor strategies through the prism of specific economic and market conditions, also known as regimes, which coincide with variations in the performance characteristics of the strategies we invest in. Changing inflation expectations naturally coincide with shifting regimes, and unsurprisingly 2021 witnessed meaningful factor rotations.

Potential inflation scenarios

Transitory

Recent inflation data proves temporary. Monetary and fiscal policy are effective in moving the economy back in line with long-term trend growth as interest rates remain stable.

Deflation

Lower labor force participation and supply shocks impact economic growth. Logistical bottlenecks limit the effectiveness of fiscal policy and there is limited scope to stimulate through monetary policy.

Accelerating

Inflation psychology takes hold, reflected in higher longer-term inflation breakeven levels. Investors continue to reposition away from nominal, duration-sensitive assets and a cycle of hoarding takes grip. Central banks seek to reassert price stability through more aggressive monetary policy. Depending upon the policy mix and the extent to which finished goods price increases pass through to wages, this could result in stagflation.

We are keenly interested in the question of how changes in inflation expectations impact various systematic investment strategies, and we see a good degree of variability in the magnitude and directionality of systematic strategies' inflation sensitivity.

Over the past several decades, both consumers and investors have grown accustomed to limited volatility in the prices of goods and services in developed market economies. COVID-19 has brought forth multiple potential sources of inflationary pressure. This has coincided with an increasingly bipartisan dismantling of US economic ties to China and conflict in Ukraine, which together introduce upward price pressures on a variety of goods and heighten the complexity of reinvigorating the world's strained supply chains. An investment landscape with significant inflation risk is an interesting one for systematic strategies.

Depending upon the particular features of their underlying economics, these trading strategies may see changes in inflation expectations as a potential headwind or a tailwind. We seek to understand and account for the ways in which shifts in economic and market regimes impact both our expectations for systematic strategy performance and the ways in which various systematic strategies relate to one another.

Sensitivity of systematic strategies to inflation

Strategy type	Description	Inflation sensitivity	Example
Fundamental – Valuation	Fundamental strategies express a view that market pricing is inefficient on the basis of an alternative appraisal methodology and seek to profit from that inefficiency, implicitly taking appraisal risk.	Many valuation strategies favor near-term cash flows over long-term cash flows, and are implicitly short duration/synthetic steepeners. The performance of these strategies often correlates positively with inflation changes and levels.	Equity Buyback seeks to capture the tendency of stocks of companies in developed markets buying back their shares to outperform their counterparts. The strategy seeks to exploit inefficiencies in the valuation of equities by observing corporate buyback activity.
Fundamental – Carry	Carry strategies assume market pricing is efficient and accept absolute or relative price risk for a return if pricing remains consistent.	Changes in inflation expectations are directly at odds with pricing efficiency, and carry strategies can be susceptible to loss as inflation expectations increase both outright and via substitution effects, particularly fixed income and commodity carry strategies.	Merger Arbitrage seeks to capture the return associated with the risk that announced merger transactions fail to consummate by providing liquidity to a group of investors unwilling or uninterested in holding deal risk. The spread between the share price of the company being acquired in advance of merger consummation and the price being offered at consummation offers a well-defined carry to investors willing to assume that the deal will not break.

If this material contains statements concerning the future, such statements are forward looking and therefore involve various risks and uncertainties. They are no guarantee of future results or future performance.

Strategy type	Description	Inflation sensitivity	Example
Tactical – Intermediation	Intermediation strategies take inventory risk and extract economic rent for supplying balance to the market and bridging temporary gaps in supply and demand.	Intermediation strategies can benefit from an expansion in trading activity catalyzed by changing inflation expectations. The flipside is that inflation can present a greater degree of inventory price risk, which these strategies tend to accept.	Duration Extension seeks to capture returns from the periodic rebalancing activity of duration-benchmarked investors in the US interest rate markets. The strategy takes short-term inventory risk in exploiting liquidity/congestion dynamics associated with the rolling of securities in fixed income benchmarks.
Tactical – Flow	Flow strategies take price discovery process risk and seek to exploit lead-lag effects attributable to the heterogeneity of physical and informational resource constraints among market participants.	Flow strategies benefit meaningfully from lead-lags in investor rebalancing activity both as inflationary pressures grow and as they recede.	Managed Futures seeks to capture autocorrelation dynamics in benchmark instruments across asset classes through a range of price-trend signals. The strategy is predicated on the notion that the absorption of and reaction to market-sensitive information differs across investors, creating lead-lag effects and price trends.
Tactical – Positioning	Positioning strategies take price elasticity risk and express a view that market positioning imbalances engender skews in the probability distributions of assets price returns.	Positioning strategies generally benefit from the unwinding of consensus/crowded positions as what were formerly considered lower probability outcomes are recast as higher probability outcomes.	Intraday Breakout in Energy seeks to exploit agency constraints and risk aversion inherent in the structure of energy markets which result in time-varying market liquidity depth. The strategy is designed to capture the tendency of markets to gap over the course of a trading day in the face of short-term supply-demand imbalances and takes a position consistent with the direction of large intraday market moves.

If this material contains statements concerning the future, such statements are forward looking and therefore involve various risks and uncertainties. They are no guarantee of future results or future performance.



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