Global Rates Outlook 2015

Thematic trades for the year ahead

US & EU Rates Strategy Teams

December 2014

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS.

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US Rates

Thematic trade ideas:

- Whites/Reds ED steepener
- 2y2y risk/reversal
- Long 2-year Treasuries versus OIS
- Long 5y5y TIPS Breakeven
- UST 5s30s flattener

Theme: Fed hikes and market liquidity

- Shifting Fed hike expectations and debate about the pace of tightening should dominate market discussion in the first half of the year as the economy continues to expand with a fresh tailwind from the "oil tax cut"
- As the lift-off date is established (we expect June 2015), focus will shift to the pace of tightening; terminal rate assumptions are eventually challenged
- Foreign flows, retail redemption fears and reduced market liquidity will be key themes
- Periodic fixed income outflows with less elastic dealer balance sheets will likely yield periods of high volatility for bond markets

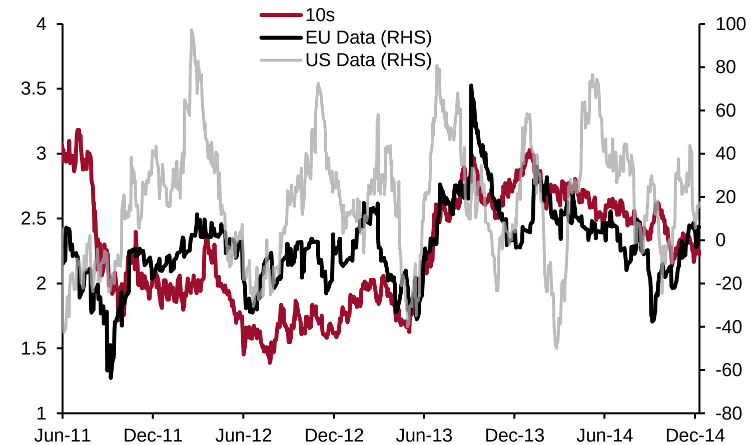
Market Impact

- Curve flattening will likely dominate market moves, with 3s and 5s leading sell offs initially, giving way to 2s as the leader when we enter the tightening cycle
- Oil should eventually find a new equilibrium; this suggests value is being created in TIPS. With forward breakevens already cheap, we think investors should start to build longs
- Volatility should finally begin to climb, with gamma's structural decline finally ending
- Wider swap spreads seen in the long end but short tenors remain at the whim of repo

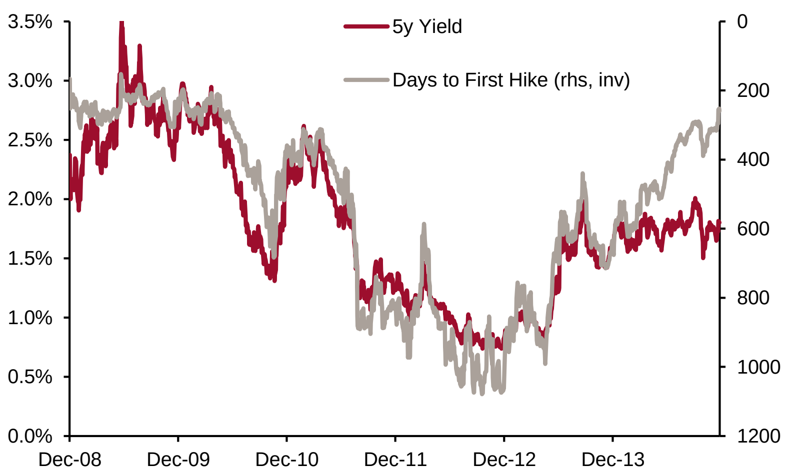
Theme: Global economic and policy divergence

- We expect further policy and growth divergence in 2015 with the Fed hawkish and the ECB dovish
- The global economic environment should give the Fed room to hike starting in June, even as the ECB continues to ease

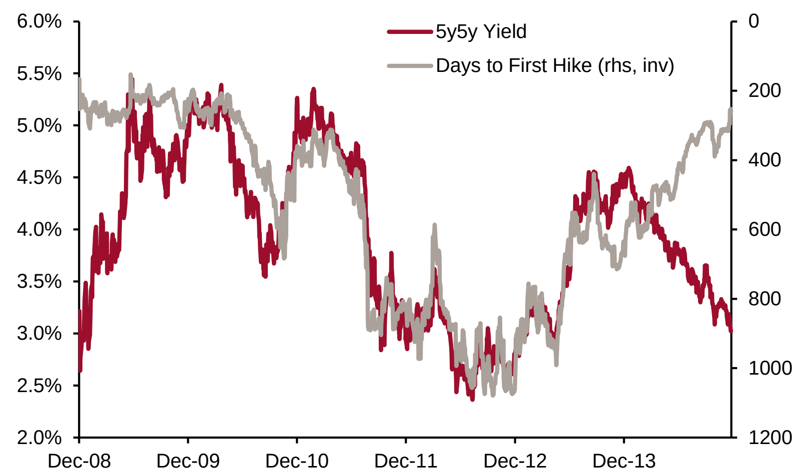
10yr UST more sensitive to EUR data than US data



5yr UST vs. Market Implied Days to first hike



5y5y vs. Market Implied Days to first hike



Source: Credit Suisse Locus, the BLOOMBERG PROFESSIONAL™ service

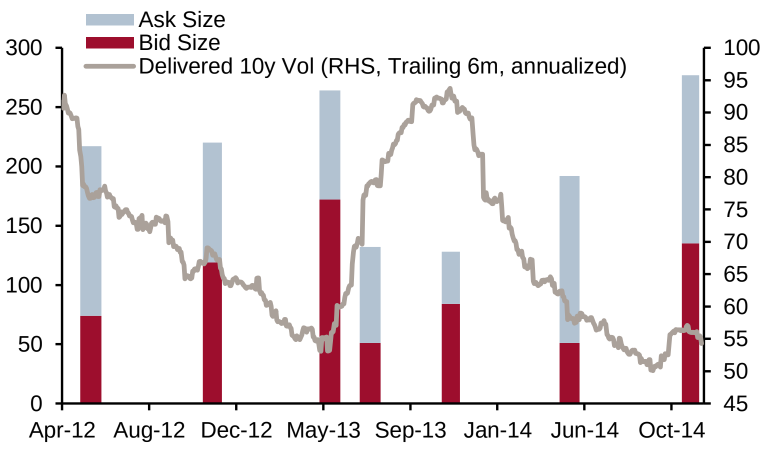
Theme: Fickle market liquidity could increase volatility

- Regulations continue to encourage trading book/balance sheet and VaR contraction for many securities products, nowhere is this more **noticeable than FICC**
- Smaller trading books mean occasionally suspect Treasury market depth, with the possibility of significant spikes in vol

Market Impact

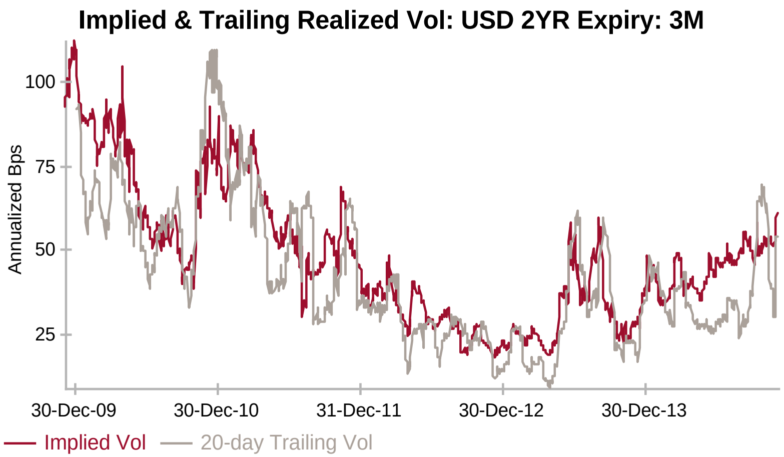
- Although the timing of intermittent vol spikes is unknown, we think implied vols can start to build in more risk premium
- When the hiking cycle is at hand we look for upper-left vols to firm up more sustainably

Depth of TSY market declines as vol increases



Source: Credit Suisse, eSpeed

Gamma remains too low given liquidity risks



Source: Credit Suisse Locus

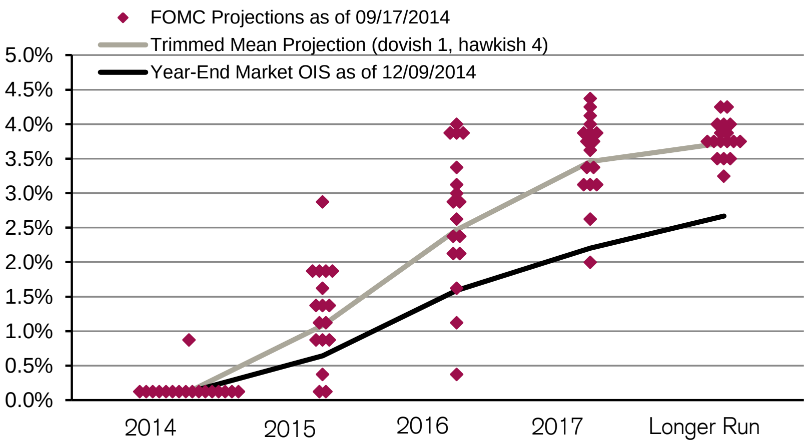
Theme: Market to price for more aggressive Fed

- Hike expectations may converge to the dots, which should drive additional flattening (5s30s and similar points) as the long-end remains structurally well-bid
- As debate switches to the pace of mid-2015 to mid 2016 hikes, 2s should begin to lead

Market Impact

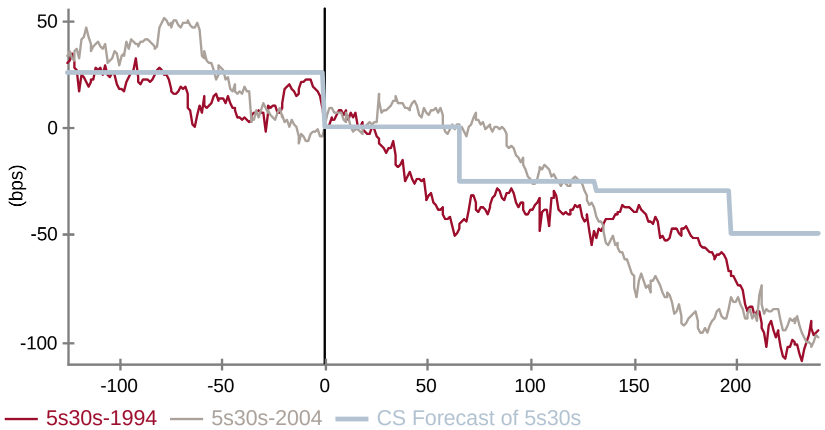
- 3s and 5s should underperform in sell offs over the first few months of the year, with 2s taking the lead soon before the first hike
- Curves have flattened significantly already, but the growth versus low inflation backdrop should allow a further move

Market remains priced below Fed expectations



Source: Credit Suisse, Federal Reserve

5s30s CS Forecast vs. prior hiking cycles (0=1st hike)



Source: Credit Suisse Locus

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Trade Idea: EDM5-M6 steepener

Current level: 92bp

Target/Stop-Out: 112bp/80bp

Rationale

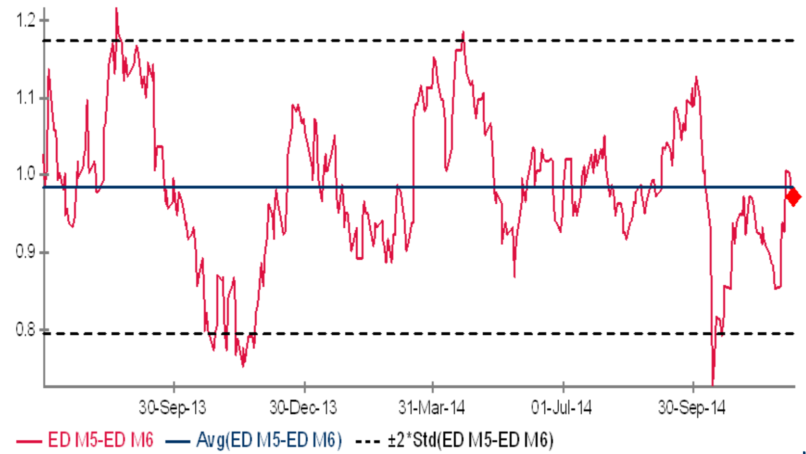
- Once the timing of the first hike becomes apparent, the market will focus on speed, but that may take time
- The market is currently priced for a peak hike speed of once at every other meeting
- We expect the Fed will have hiked rates four times by the end of 2015, starting in June

Risks

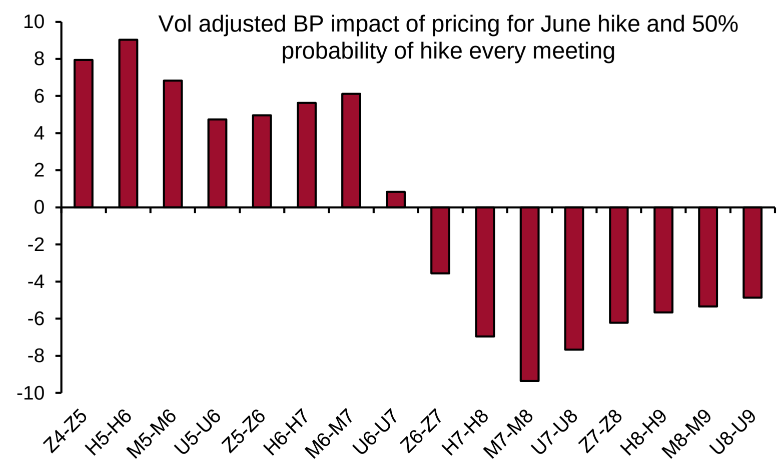
- The data rolls over and market prices for later and/or slower hikes

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

The EDM5-M6 curve is in the middle of its post talk range



We see M5-M6 steepener as offering the best risk/reward while allowing time to materialize



Trade Idea: 2y2y risk/reversal – sell -25bp OTM receiver to buy +35bp OTM payer

Current level: 0bp (Net Premium)

Target/Stop-Out: 14bp / -10bp

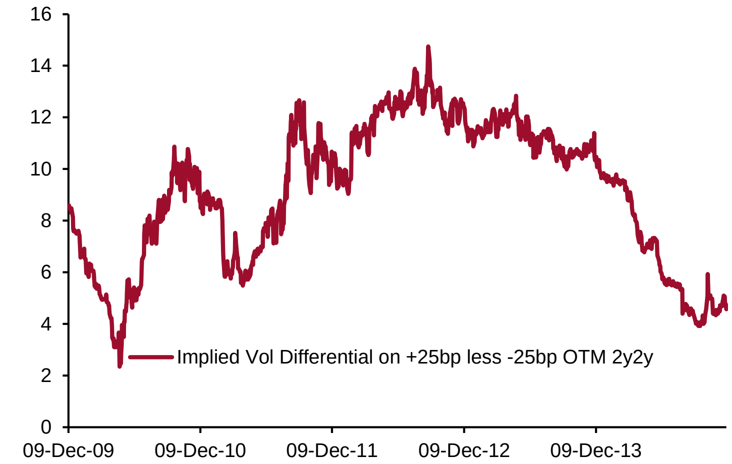
Rationale

- Shorter-maturity rates should remain a function of domestic economic and policy developments which we expect to be supportive of higher yields
- The 2y2y yield is some 65-70 bp rich to our 2-year yield forecast for year-end 2016
- Receiver skew is towards the rich end of its five-year range versus payer skew, allowing for relatively attractive entry levels

Risks

- Domestic economic slowdown that pushes hikes further out or causes the expected pace of hikes to decline further

Implied vol on OTM 2y2y payers appears relatively cheap compared to that on 2y2y receivers



2y2y yield versus the risk/reversal strikes

Source: Credit Suisse Locus

Trade Idea: Long 2y TSY vs. 2y OIS

Current level: 4.8bp

Target/Stop-Out: 20bps/-5bp

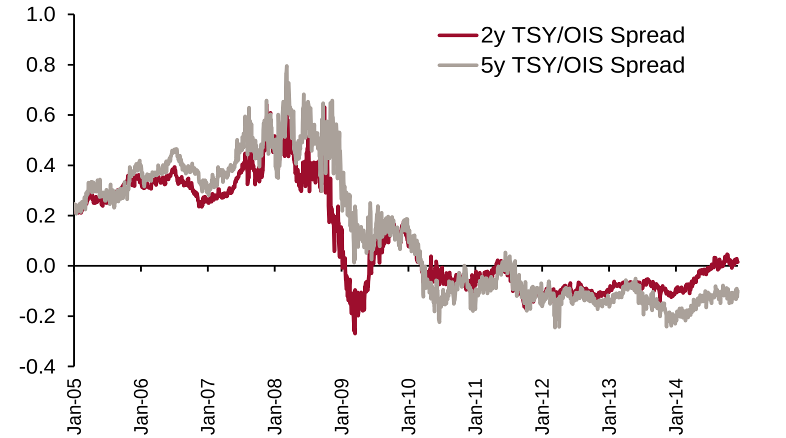
Rationale

- As fed funds effective moves up, we expect OIS to underperform Treasuries given less TSY supply, SOMA's lack of OTR TSYs to lend out, and a likely short-rates base to form that will increase demand to borrow collateral
- The Fed's expansion of RRP counterparties would give liquidity pools that are currently placed at the fed funds effective rate (e.g. GSEs) more options to lend out
- Effective FFs would better reflect credit risk relative to TSYs, while a decline in liquidity in that market would imply higher risk premium in OIS

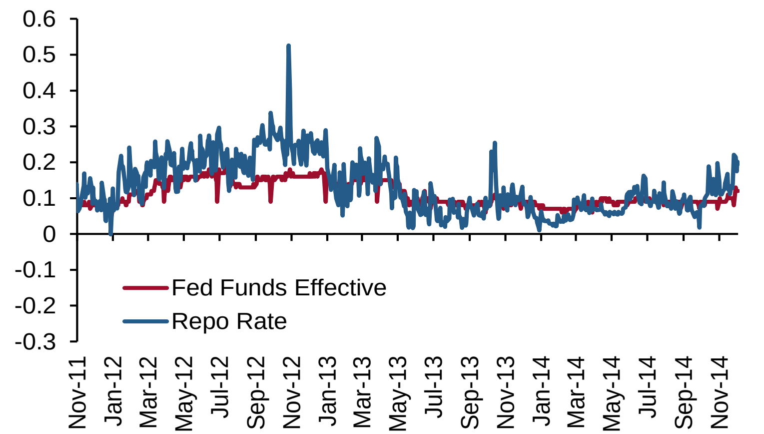
Risks

- TSY underperformance should large pools of money continue to lend below RRP in FFs

2y and 5y TSY/OIS Spread



GC TSY Repo vs. Effective Fed Funds



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

Trade Idea: Long 5y5y TIPS BEI

Current level: 213bp

Target/Stop-Out: 230bp/205bp

Rationale

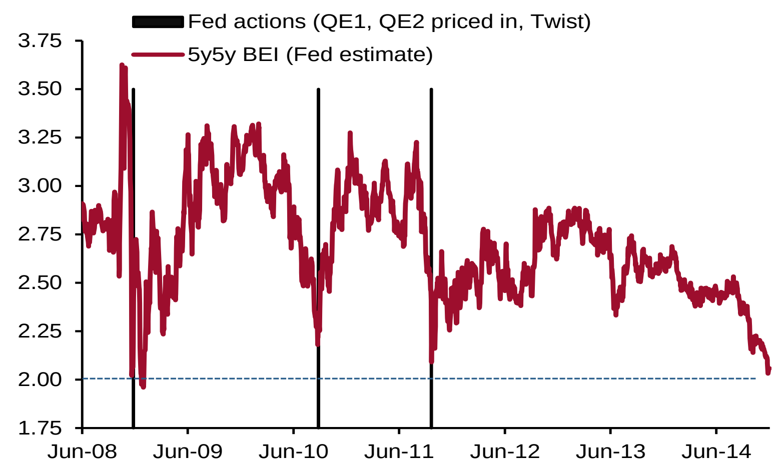
- Forward TIPS breakevens should again allow investors to express views on core inflation
- We expect core inflation in the US to remain firm as labor market slack continues to be absorbed
- 5y5y BEIs trade at multi-year lows, a level we deem attractive to begin building long positions
- Cross-market: Long US vs. short 5y5y RPI (UK)

Risks

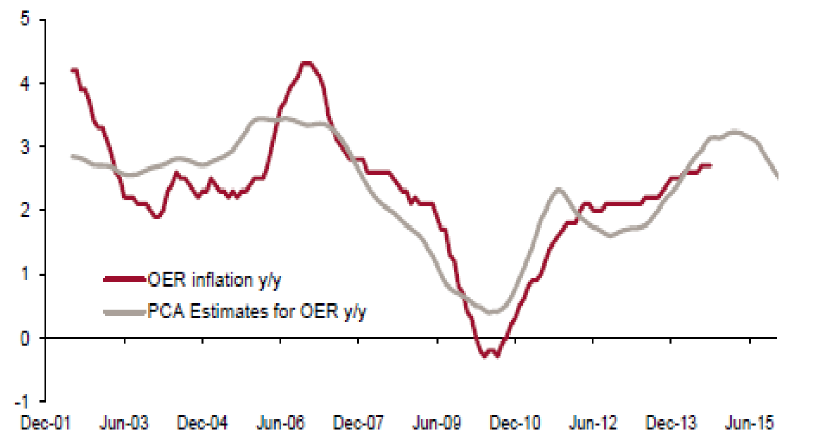
- Downside surprises in core inflation in the US
- Heightened liquidity risks could put a premium on TIPS yields, depressing forward BEIs

Link to full report: https://plus.credit-suisse.com/r/6SRfmT

5y5y TIPS BEIs



Actual vs. projected OER inflation



Source: Credit Suisse, Federal Reserve, Haver Analytics ®

Trade Idea: UST 5s30s flattener

Current level: 125bp

Target/ Stop-Out: 90bp/ 135bp

Rationale

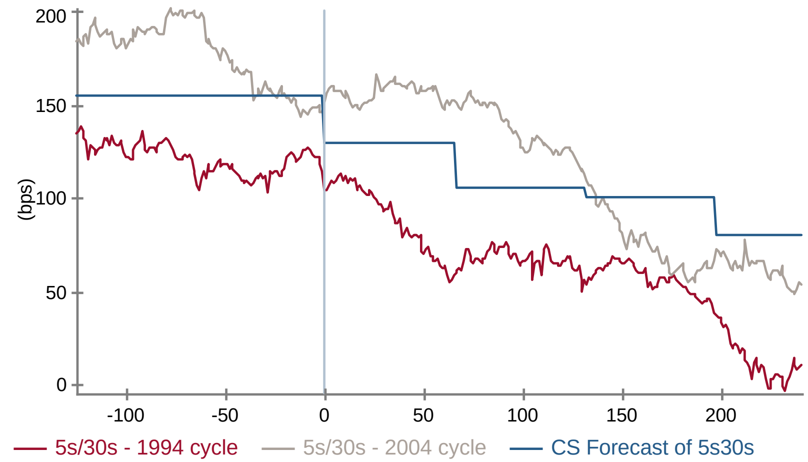
- Structural demand and global dynamics should remain significant drivers of long-end rates, keeping yields somewhat more constrained
- 5s and in are more likely to be a function of domestic innovations, particularly as the Fed initiates its hiking cycle

Risks

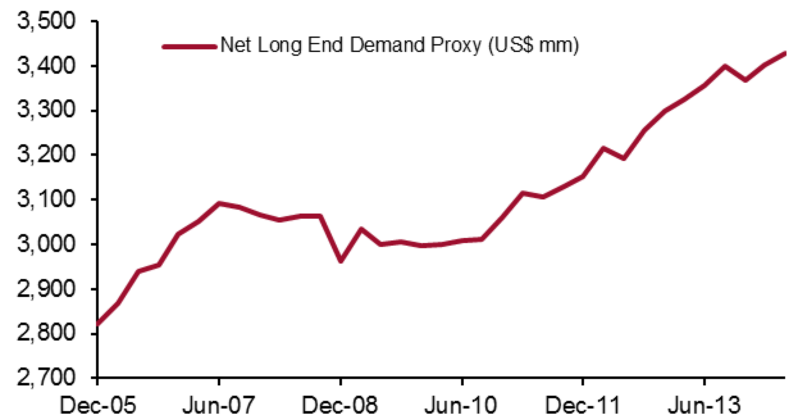
- The large flattening that has already taken place leaves the curve somewhat vulnerable to a steepening, potentially if the domestic backdrop takes a turn for the worse

Link to full report: https://plus.credit-suisse.com/r/2jteF3

5s30s in 2004 relative to our forecasts



Structural long-end demand keeps 30s well bid



Source: Credit Suisse, Federal Reserve

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European Rates

Thematic trade ideas:

- Long front-end swaps, core and periphery
- BTPs 7s30s steepener
- EUR and CHF long-end flattener
- EURUSD and CHFUSD cross-currency basis wideners
- Bearish France vs. core and periphery

European fixed income views

Market	View	Expression
Outright	• Receive rates out to 3y • Near-term neutral 10-15y; longer-term bearish • EUR becoming new funding currency	• Receive EUR 2y1y • 3y2y EURUSD XCCY widener • Receive SEK 2y1y
Curve	• 10s30s looks steep given global risk factors	• EUR 10s30s flattener • CHF 15s30s flattener
Curvature	• Curvature in 5s10s30s is too low	
ASW	• Long Bund vs. Eonia	• Buy RXH5 vs. Eonia
Bonds	• Overweight peripheral front-end • Overweight Italian front-end vs. 5s • Steeper curves in the periphery • Underweight France	• Long 2y Spain outright and vs. 2y France • Long 3y BTP vs. 5y France • Long 3y Portugal • SPGB 5s30s steepener • BTP 7s30s steepener
Money Markets	• Risk of liquidity squeeze in Q1 2015 but more liquidity likely to come later	• Receive Jun-16 IMM Eonia • Whites-reds Eonia flattener
Inflation	• Inflation can fall further in the near team • Expect 10s30s HICP to flatten if QE	• Short HICP 5y5y

Source: Credit Suisse

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Theme: Europe continues to muddle through

- **Tactical trades likely to dominate**
- **Path for data key for yield trajectory**
- **Hard to call whether QE happens, but critically, whether it benefits real-economy if it does**
- **Political risk increases significantly in 2015 increasing volatility and providing opportunities**

Scenarios	Central	Downside - no policy response	Downside - with ECB response	Upside
Core yields	No sharp repricing of yields Yields react to US outlook with low beta	Lower yields and flatter curve	Yields rally on announcement but questionable longer-term impact	Higher yields and core curves led by 10y
Periphery	Spreads grind tighter	Spreads widen led by 2-5y	Spreads tighten near term, but risks increase if data don't improve	Spreads tighten led by 10y
US-EUR 10y spreads	Divergence	No divergence	Divergence on announcement	Convergence in time led by Europe
Probability	45%	10%	30%	15%

Source: Credit Suisse

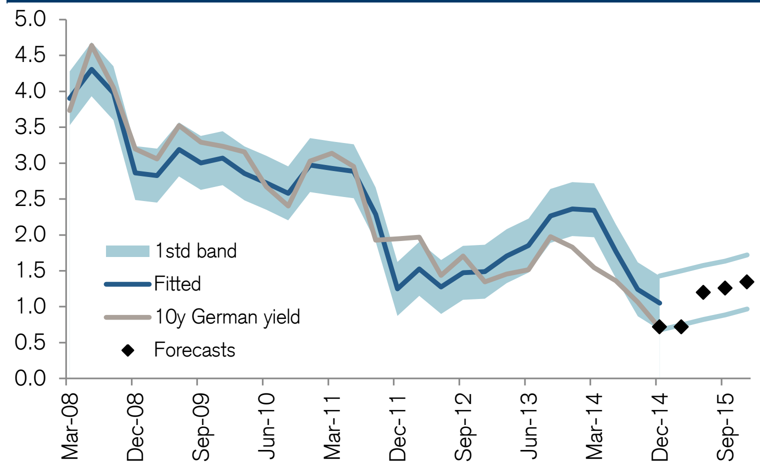
Theme: Duration near-term balanced then bearish

- Opposing forces keep the duration view balanced in Q1
  - Higher yields: higher US rates and slowly-improving European data
  - Lower yields: further declines in inflation near term, increased political risk and the possibility of QE
- Yields should ultimately rise – we expect 1.35% year-end for 10y Germany
- Yield impact of QE depends on economic data trajectory, strength of implementation and rhetoric into event:
  - Well flagged and stronger data: yields can rise
  - Weak data and/or uncertainty about impact: yields likely to remain subdued

Market Impact

- We expect an elbow-shaped profile for core yields: sideways for the first few months, then higher
- US - German yield divergence can continue
- Q1 trading range: 0.6% - 0.9%

10y Germany to reach 1.35% by year-end 2015



Source: Credit Suisse Locus

Theme: The hurdle to sovereign QE remains high

- Sovereign QE is not a foregone conclusion in Q1 2015
- Significant Governing Council divisions regarding appropriateness of sovereign bond purchases, what to buy, the right timing and whether they would work
- Interpretation of oil price decline should be important: how lasting the impact on inflation vs. positive growth stimulus
- If the ECB does do sovereign QE and economic data don't improve, market risk likely to increase significantly

Market Impact

- Since the ECB will remain very dovish, keeping the possibility of QE alive, it is hard to position against
- Increased risk of external event-driven volatility suggests reduced risk positions
- Market is pricing financial market impact but not real-economy impact

Inflation expectations not reacting to possible QE

Source: Credit Suisse Locus

Trade Idea: Short 5y5y HICP

Current level: 1.75%; Entry : 1.82%

Target/Stop-Out: 1.60%/1.95%

Rationale

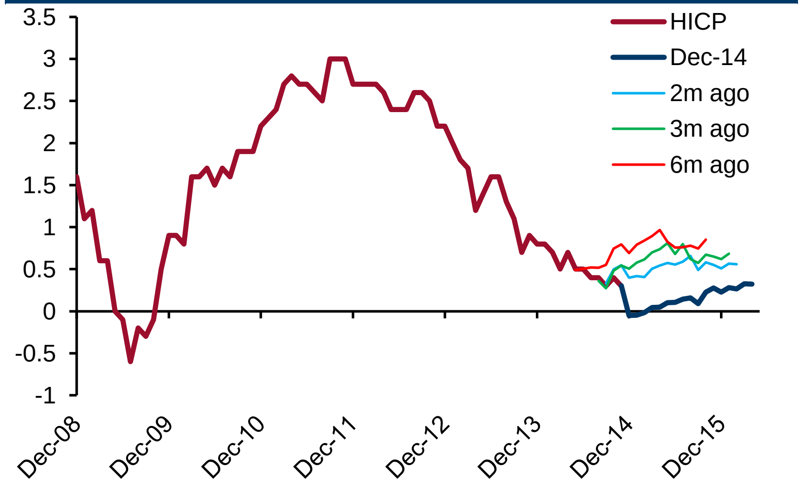
- The market is positioned for a sustained period of low inflation, with the breakeven term structure consistently shifting lower and currently expecting Q1-15 prints below 0%
- We think it will take time for the market to price for the higher medium-term impact of oil on growth and longer-dated inflation. The ECB's stance on the oil price impact is also not yet clear. Hence, we expect HICP 5y5y to weaken further

Risks

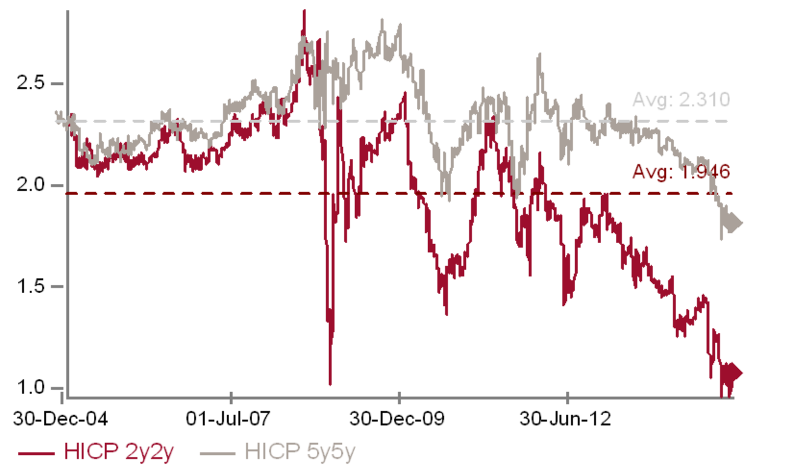
- The risk is an effective sovereign QE; we like EUR 5s10s real steepeners and 10s30s breakevens as potential hedges

Source: Credit Suisse Locus

Inflation prints in Q1-15 are priced to be negative



5y5y HICP : the ECB has moved the floor lower



Hedge Trade Idea: EUR 1y5y (or RXH5) payer spread

Current level: 5.5bp

Rationale

- Our key duration view is for yields to rise towards the end of 2015
- We are cautious on outright short-duration plays due to uncertainty on timing and effectiveness of QE, weak growth and declining inflation prints
- We recommend a 1x1 EUR 1y5y 0.75%/1% payer spread (spot: 0.4%, fwd: 0.55%) as a hedge to our view that rates remain range bound in the near term

Alternative

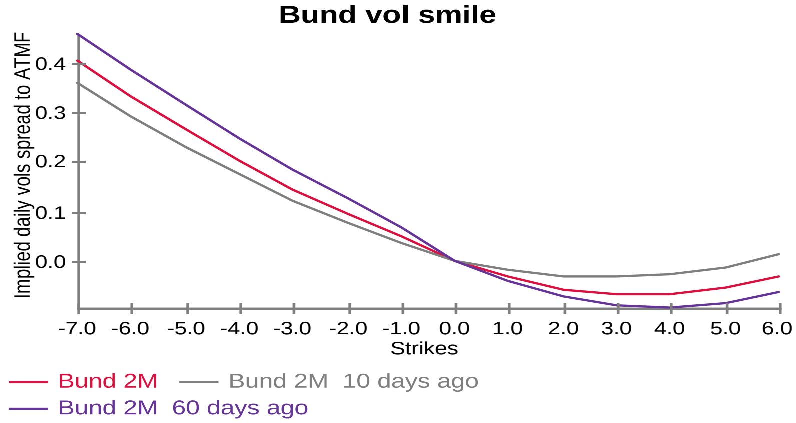
- RXH5 153/152 put spread (ref: 154) @ 30c

Risks

- Losses are limited to the premium paid

Source: Credit Suisse Locus

Payer skew has cheapened



Protected way to fade low level of yields

Theme: Front-end longs & cross-currency basis wideners

- Threat of QE to keep yields low in the front end
- Zero or possibly negative inflation prints in Q1 to keep the front-end anchored
- Divergence to the US to be most pronounced in front-end spreads
- Divergence to the US can also be expressed in peripheral spreads and through FX basis swap wideners
- Risks to this view emerge from low TLTRO uptake and a low liquidity environment persisting longer than the market is pricing

Market Impact

- The EUR front-end to diverge from the US
- Volatility in the front-end may be driven by heavy positioning and liquidity tightness
- But this will be contained by the threat of QE

Main trade recommendations

- Receive EUR 2y1y
- Receive EUR 2y1y versus USD
- Long front-end periphery
- Long BTPS 2y versus UST
- Long 1y1y Eonia
- EURUSD 3y2y cross-currency basis swap wideners
- CHFUSD 1y1y FX basis swap wideners

Trade Idea: Receive EUR 2y1y (outright and versus USD)

Current level: 0.37%; Entry/Add : 0.5%

Target/Stop: 0.1%/0.8%

Rationale

- A sell-off induced by tight liquidity would provide good entry since it increases the probability of ECB QE
- Vol-adjusted carry on 2y1y is still attractive
- PCA on real rates across the US, UK, EUR shows high correlation for 5y5y but low for 2y2y. Hence this is the best location to express monetary policy divergence view

Alternatives

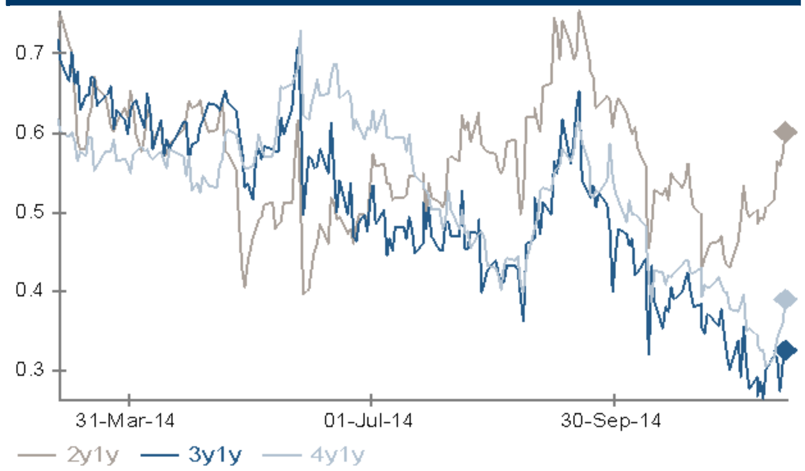
- Receive EUR 2y1y versus USD

Risks

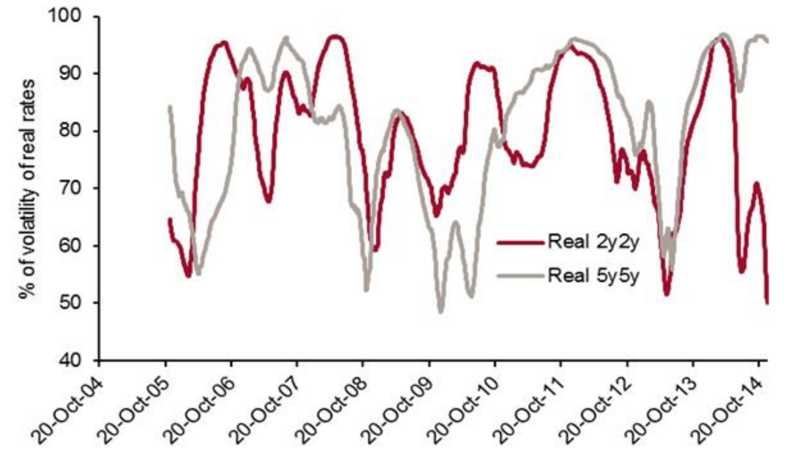
- No QE and liquidity conditions remain tight or growth picks up much faster than forecast

Link to full report: click here and here

EUR 2y1y attractive on vol-adjusted basis



EUR-USD front-end best place for divergence



Source: Credit Suisse Locus, Credit Suisse

Trade: Receive Jun-16 IMM Eonia

Current level: -2bp

Target/Stop-Out: -7bp/0bp

Rationale

- Risk of tighter liquidity in H1-15. This should prompt an ECB response which means liquidity should be sufficient from 3Q 2015
- With excess cash well above the €200bn threshold, overnight fixings should drop back at 10bps-12bps above the deposit rate
- Further deposit rate cut more likely than a hike

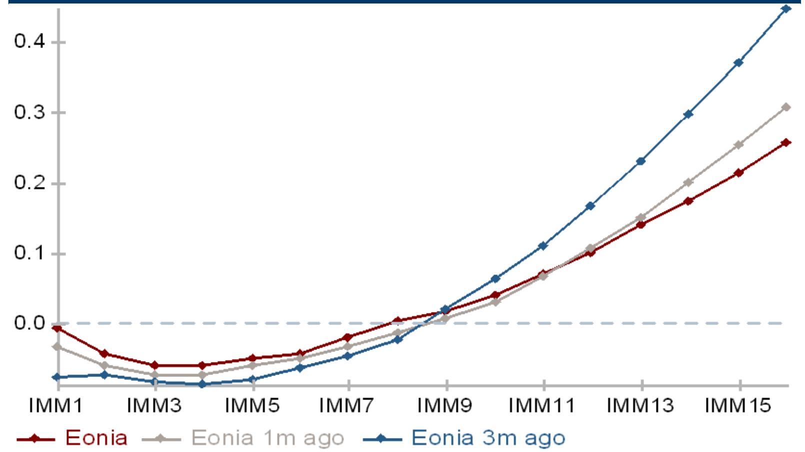
Alternative

- White- reds Eonia flattener
- ER M5-H6-Z6 fly

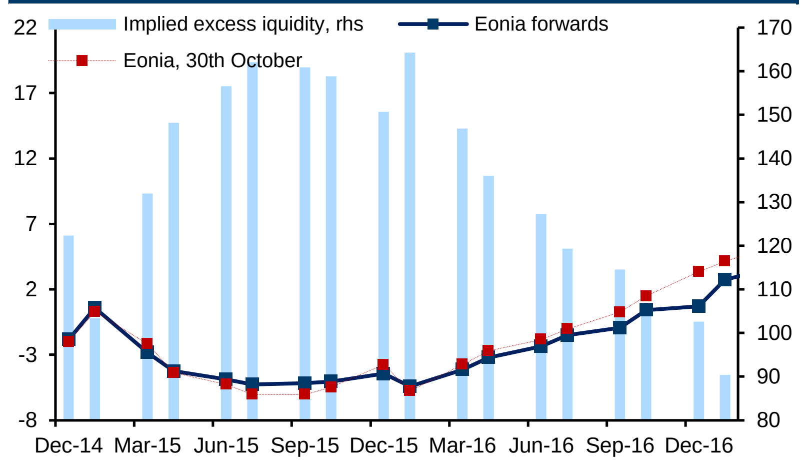
Risks

- No QE and liquidity conditions remain tight

Eonia IMM term structure has room to flatten more



More excess liquidity should be priced from 2016



Source: Credit Suisse, Credit Suisse Locus

Trade Idea: Receive SEK 2y1y

Current level: 0.56%

Target/ Stop-Out: 0.40% / 0.65%

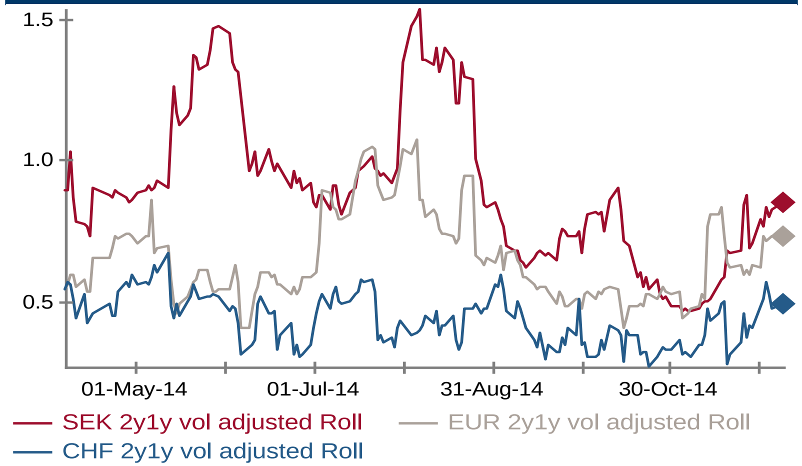
Rationale

- Receiving 2y1y has attractive vol-adjusted carry
- We expect the Riksbank to strengthen its forward guidance by further flattening the rates path
- SEK 2y1y still trades 25bp above EUR 2y1y
- Our PCA indicates that the SEK front-end is trading cheap

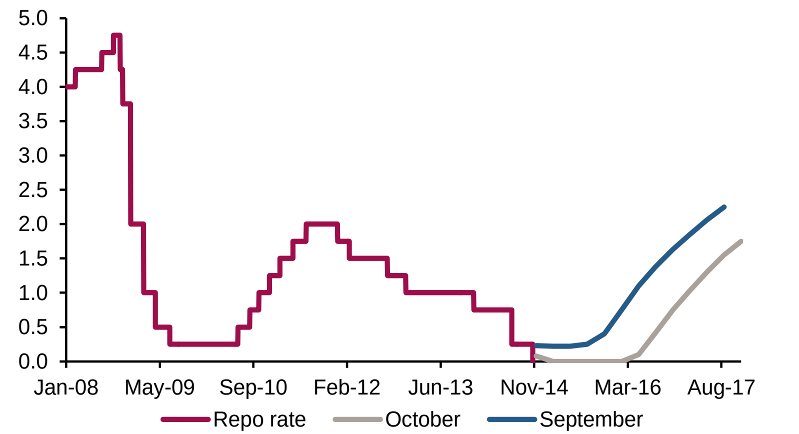
Risks

- Stronger economic data could lead to a less accommodative stance by the Riksbank

SEK offers better vol-adjusted carry than EUR/CHF



Riksbank repo path projections



Source: Credit Suisse Locus

Trade Idea: EURUSD 3y2y cross-currency basis widener

Current level: -20bp

Target/Stop: -30bp/-15bp

Rationale

- Play EUR-US market divergence through basis spreads as an alternative to FX
- EUR to become funding currency of choice for global issuers
- January normally has a negative seasonal (i.e., basis tightens). But we think next year will be different as more global issuers come to the EUR market

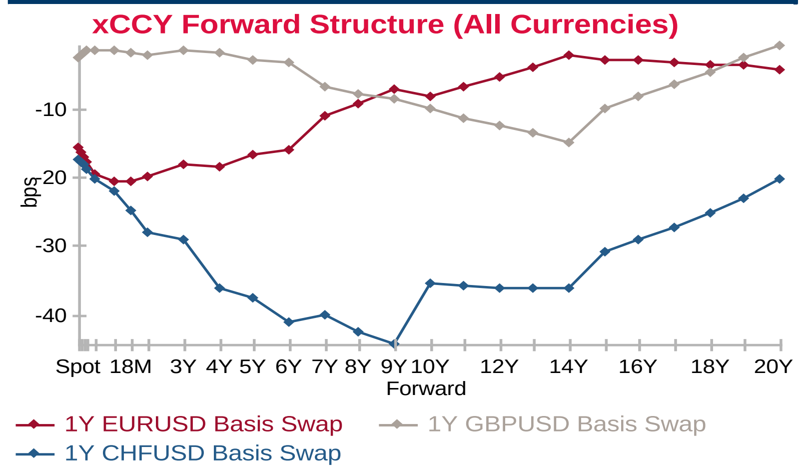
Risks

- EURUSD appreciates from current levels

Link to full report: click here

EURUSD FX basis versus FX

EURUSD basis can fall



Source: Credit Suisse Locus

Trade Idea: CHFUSD 1y1y cross-currency basis widener

Current level: -22bp

Target/Stop: -30bp/-18bp

Rationale

- Basis should react to January issuance
- The basis remains very flow driven but offers an alternative way to play for the USD strength theme
- The cross-currency basis does not have enough risk premium for SNB action. It is therefore a protected way to play for surprise SNB action

Alternative

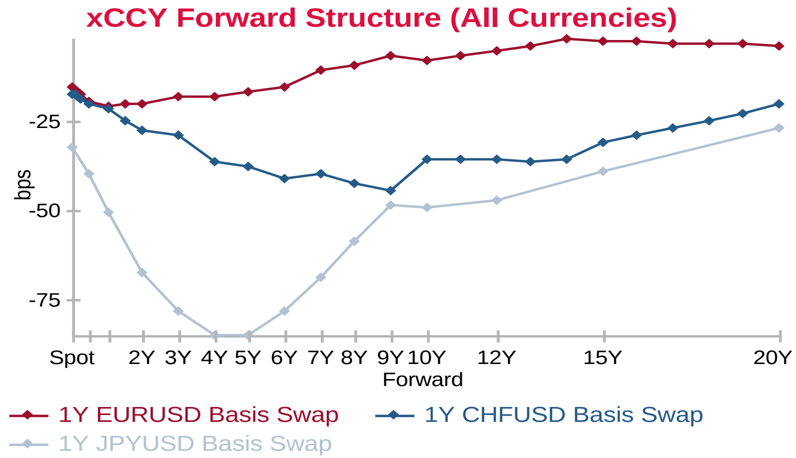
- EURUSD FX basis wideners

Risks

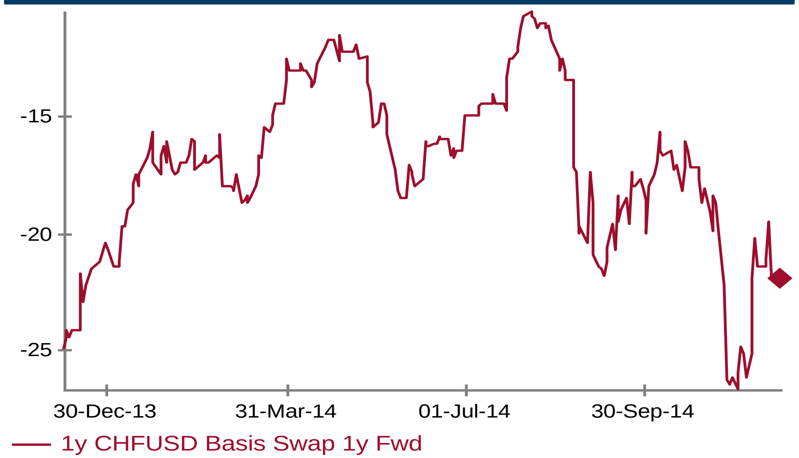
- No new policy response from the SNB

Source: Credit Suisse Locus

CHF short end basis cheap



CHF basis has room to widen



Theme: Long-end flattening

- Curve is steep as duration grab has spilled over into the 10y point
- Market pricing QE as reflationary for the back end of the curve but we question this (even in the US breakevens have not widened despite large balance sheet expansion)
- The curve could steepen if the ECB does QE only out to the 10y sector
- But we expect yield grab to continue pushing long-end yields lower
- QE exacerbates the economic versus financial market divergence

Source: Credit Suisse Locus

Market Impact

- The long-end will be driven by judgement on QE success
- EUR long-end cannot decouple from the US and UK

Trade recommendations

- EUR 10s30s flattener
- Receive EUR long-dated forwards
- EUR Forward flatteners
- CHF 15s30s flatteners
- HICP 10s30s flattener

Trade Idea: EUR 10s30s flattener

Current level: 66bp; Entry level: 75bp

Target/Stop: 60bp/85bp

Rationale

- 10s30s has lagged the flattening in the front end of the curve. Re-steepening in January should provide an entry opportunity
- With 5s10s30s so low, we expect the curve can flatten if there is either a sharp rally or sell-off in yields
- The EUR 10s30s curve looks steep versus the US and UK

Alternatives

- EUR 5y5y-10y10y flatteners
- CHF 15s30s flatteners

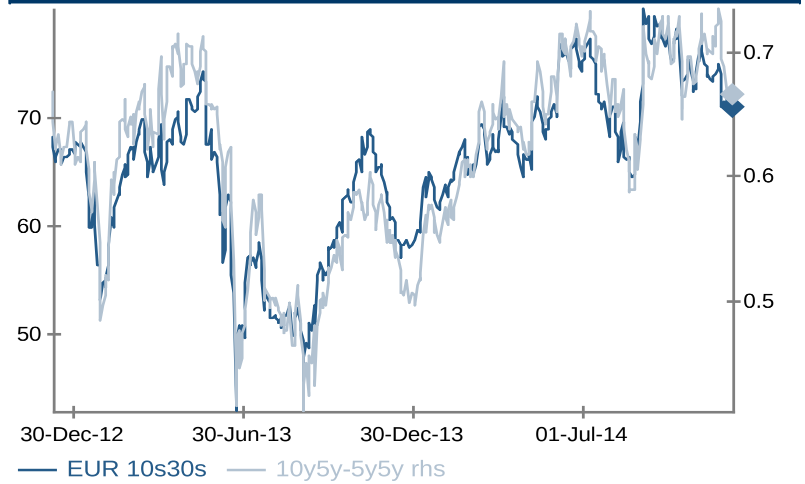
Risks

- The ECB does QE out to the 10y point

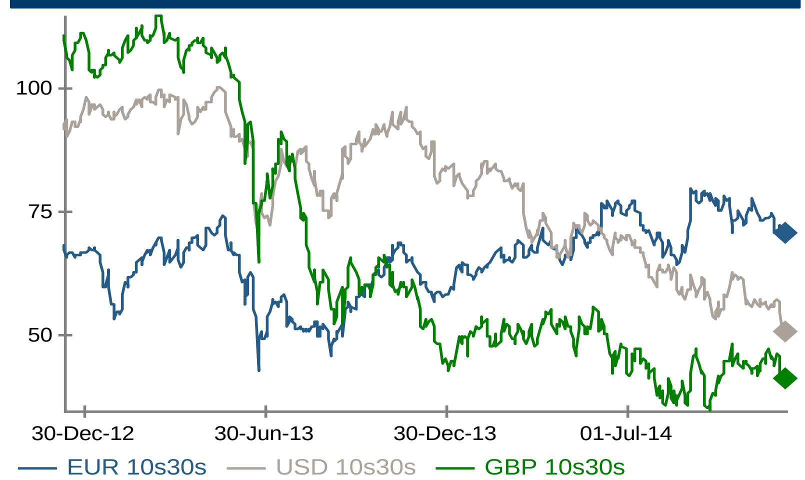
Link to full report: click here

Source: Credit Suisse, Credit Suisse Locus

EUR 10s30s is steep



Global curves are flatter



Trade Idea: CHF 15s30s flattener

Current level: 34bp

Target/Stop: 25bp/40bp

Rationale

- The CHF curve is normally correlated with EUR but is now steep versus Europe
- We like flattening in the EUR long end which should also filter into the CHF curve

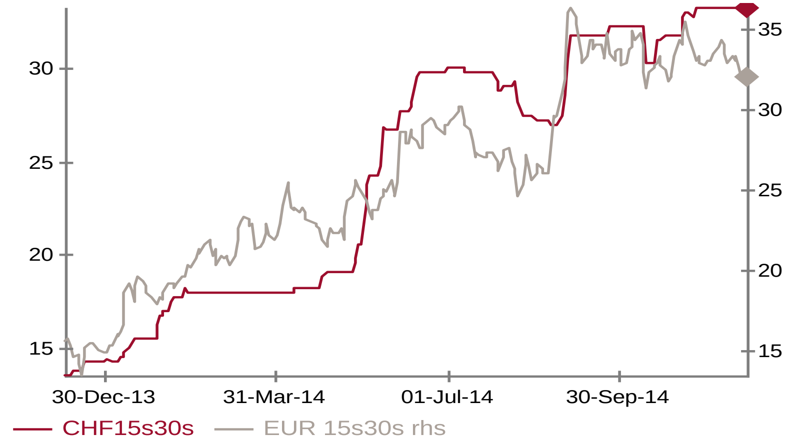
Alternatives

- EUR 5y5y-10y10y flatteners
- EUR 10s30s flatteners

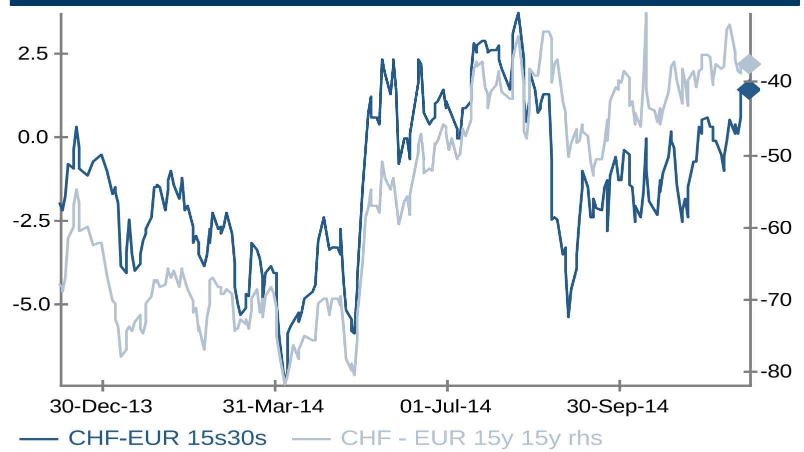
Risks

- The ECB decides to do QE out to the 10y point or the EUR 10s30s curve steepens
- Flow drivers keep the long end cheap

CHF 15s30s vs EUR steep



The CHF-EUR box is at the high end of the range



Source: Credit Suisse Locus

Theme: Trade ranges in German ASW

- Opposing forces are likely to balance each other out and prevent spreads from widening much more beyond 2012 levels
- If long-end spreads richen too much, we expect investors to come in to tactically receive swaps

Market Impact

- 10y and 30y ASW should range trade

Trade recommendations

- Bund-Eonia ASW widening
- Bund-Eonia wideners vs. Gilts
- 30y DBR ASW tightener

On the widening side	On the tightening side
Global risk off (geopolitics or stretched valuations)	Yield grab
Regulatory pressure	Year-end balance sheet constraints
German budget surplus growing	Credit easing
Quantitative easing	Increasing corporate issuance

30y ASW look rich; we prefer trading 10y from the long side

		Current	Pre crisis average	Post crisis average	2014 Low	2014 High
ASW	Schatz	24.3	16	64	22	34
	Bobl	31.4	17	53	30	40
	Bund	23.8	18	35	18	28
	30Y	6.9	15	-3	-4	8
OIS	Schatz	0	8	16	-3	5
	Bobl	0.4	10	16	-5	6
	Bund	-8.3	10	5	-16	-5
	30Y	-12.3	8	-22	-24	-12

Source: Credit Suisse, Note: Interesting trades highlighted in red

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Trade Idea: Bund-Eonia ASW widener

Current: -9.0bp Entry: -12bp

Target/Stop: -5bp/-15bp

Rationale

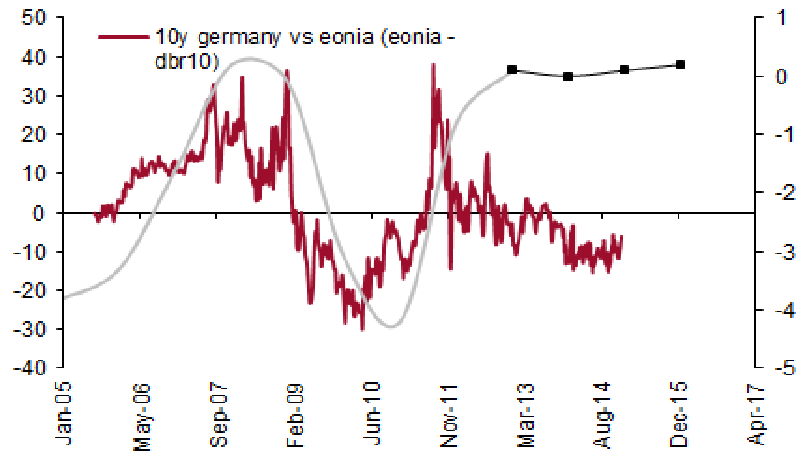
- The ECB is expected to take out 2.5x net issuance if it buys €500bn sovereign bonds in 2015. This should initially widen Bund ASW
- QE would also take out part of the stock of German paper – as there is zero net issuance in Germany next year
- We would enter ASW wideners at -12bp
- We see ASW wideners as a good hedge to our portfolio

Risks

- Yield grab forcing receiving in swaps
- QE creating common Eurobond transferring credit risk to Germany

German 10y ASW: Bunds are cheap to Eonia

German 10y ASW vs. German budget balance



Source: Credit Suisse, Credit Suisse Locus

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Summary of European Government themes and views

Thematic trade ideas:

- Periphery front-end attractive and curve steepeners
- Bearish semi-core, in particular France
- Trade ranges in core spreads

Market Impact

Country group	Country	Position vs. benchmark	Curve	Spread to Germany	Expression
Germany		Overweight	Neutral		Long Bund vs. Eonia
Non-German core	Austria	Underweight	Neutral	Neutral	10y RAGB vs. Nether
	Finland	Underweight	Neutral	Neutral	10y RFGB vs. Nether
	The Netherlands	Overweight	Neutral	Neutral	
Semi core	France	Underweight	Neutral	Wider	Short 10y France vs Germany Long 2y Italy vs. 5y France Short 2y France vs. Spain
	Belgium	Underweight	Neutral	Neutral	
Periphery	Italy	Overweight	Steeper	Tighter	BTP 7s30s steepener
	Spain	Overweight	Steeper	Tighter	Long 2y Spain 5s30s steepener
	Ireland	Benchmark	Neutral	Neutral	
	Portugal	Overweight	Neutral	Tighter	Long 3y Portugal

Source: Credit Suisse

Theme: Periphery front end cheap and curve steepeners

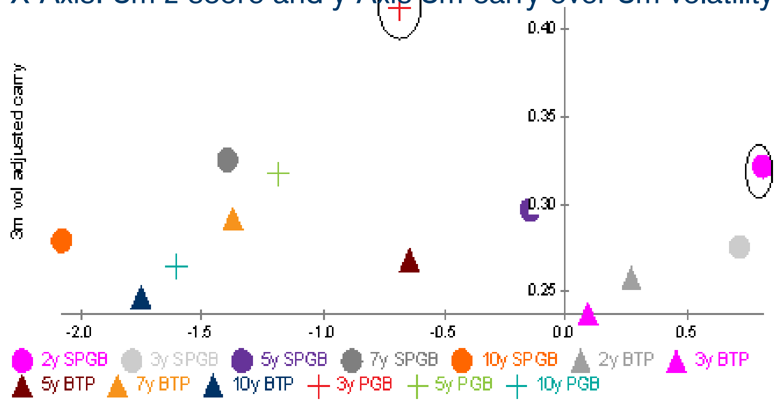
- Front-end should be more protected from political uncertainty
- Front-end offers decent volatility-adjusted carry and has relatively good entry levels
- Steepeners in the periphery have good entry levels and tend to carry positively
- Peripheral debt sustainability uncertainty should be priced into the long-end
- ECB more likely to buy up to 10y

Market Impact

- Long 3y Portugal
- Long 2y Spain outright or vs. France
- Long 2y Italy vs. France or vs. UST
- SPGB 5s30s steepener
- BTP 5s30s and 7s30s steepeners

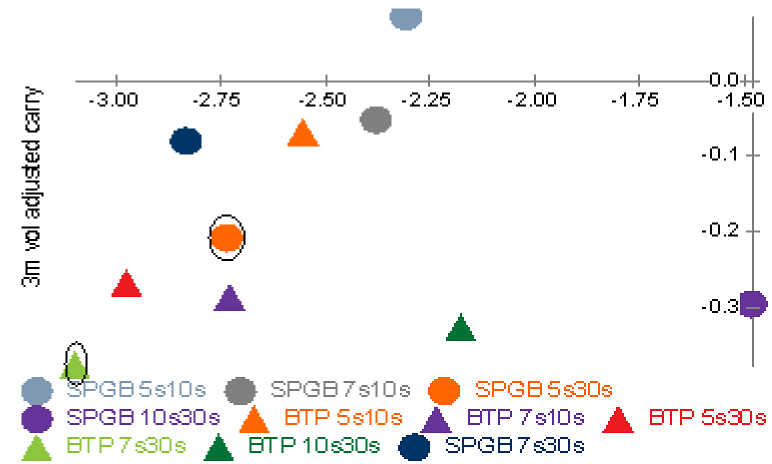
2y Spain and 3y Portugal attractive longs

X-Axis: 3m z-score and y-Axis 3m carry over 3m volatility



Source: Credit Suisse Locus

SPGB 5s30s and BTP 7s30s attractive steepeners



Trade Idea: Long 3y Portugal

Current level: 1.16%

Target/Stop-Out: 0.6%/1.25%

Rationale

- Portugal would likely benefit substantially from sovereign QE
- 3y Portugal has the highest volatility-adjusted carry and still offers a relatively good entry point for long position
- 3y Portugal has positive carry of 20bp for three months, almost double the highest carry in Italy or Spain for the same period

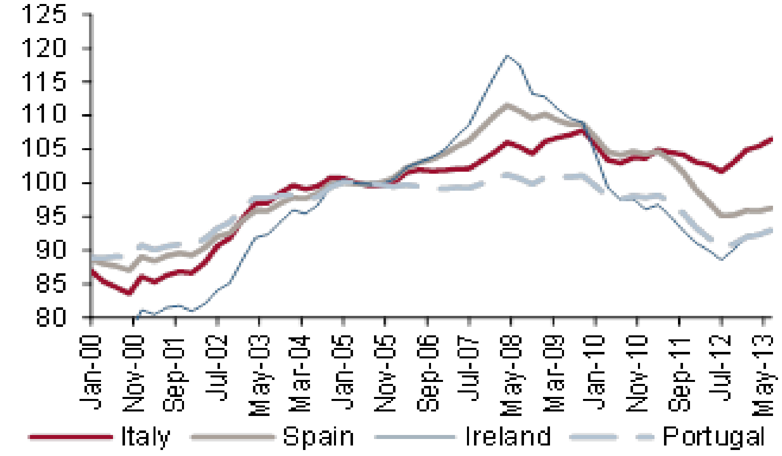
Risks

- ECB stepping away from its balance sheet target
- Portuguese elections in 2015
- Greek presidential election creating spill over

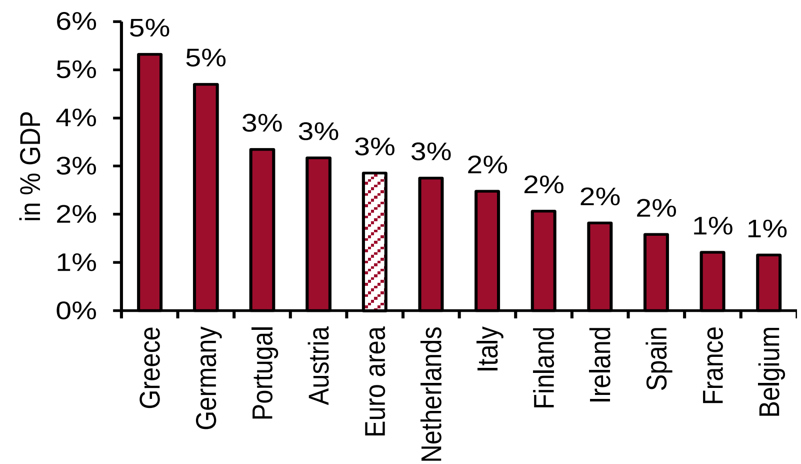
Link to full report

Source: Credit Suisse

Portuguese competitiveness better than Italy/Spain



ECB purchases ex-net funding



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Trade Idea: Long 2y Spain

Current level: 0.59%

Target/Stop-Out: 0.15%/0.68%

Rationale

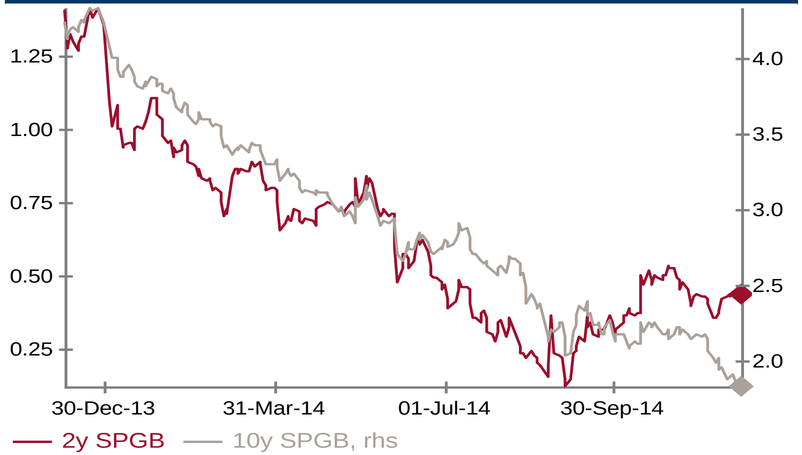
- We expect Spanish growth to be among the highest in the euro area due to the reform efforts of the Spanish government
- Spanish front-end has underperformed recently relative to the belly of the curve
- 2y or 3y Spain is attractive on a volatility adjusted carry basis and the position carries positively over the next three months
- Issuance favours expressions in the front-end

Risks

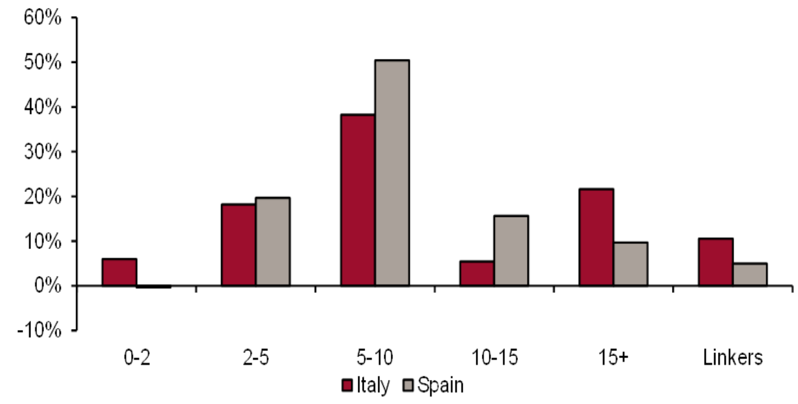
- Political uncertainty due to the elections in 2015

Link to full report

2y SPGB appears cheap relative to 10y SPGB



Spain has had negative issuance in the front-end



Source: Credit Suisse Locus, National Treasuries

Trade Idea: SPGB 5s30s steepener

Current level: 219bp

Target/Stop-Out: 250bp/200bp

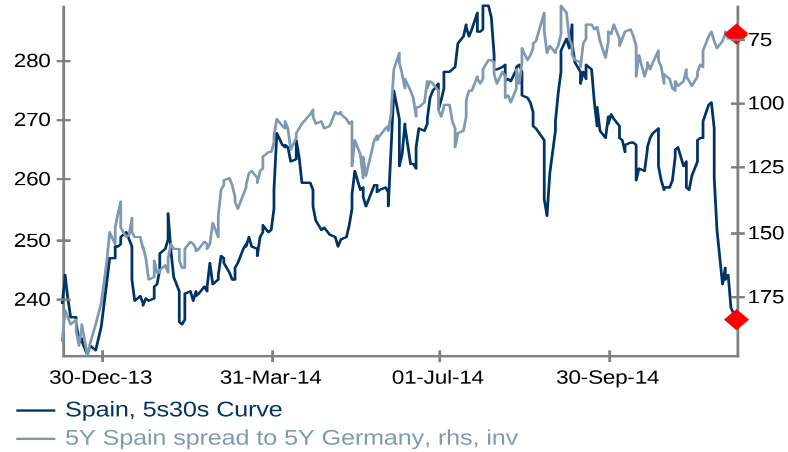
Rationale

- The Spanish 5s30s curve appears to be too flat relative to 5y SPGB-DBR spread
- The Spanish 5s30s curve appears to be too flat relative to the BTP 5s30s curve
- Spanish 5s30s steepeners have attractive vol-adjusted carry and carry positively 5bp over the next three months

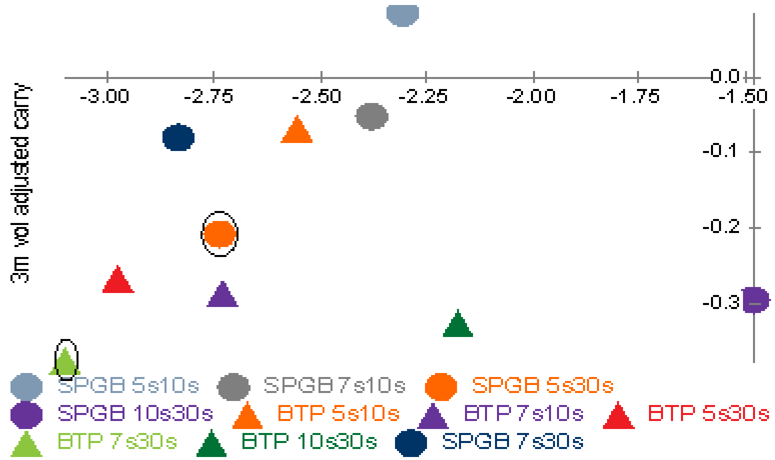
Risks

- Extension trades due to the low absolute yield would support the long end
- ECB buying 30y bonds could flatten the curve

SPGB 5s30s too flat given the level of spread



5s30s most attractive steepener in Spain



Source: Credit Suisse Locus

Trade Idea: BTP 7s30s steepener

Current level: 193bp

Target/ Stop-Out: 220bp/ 185bp

Rationale

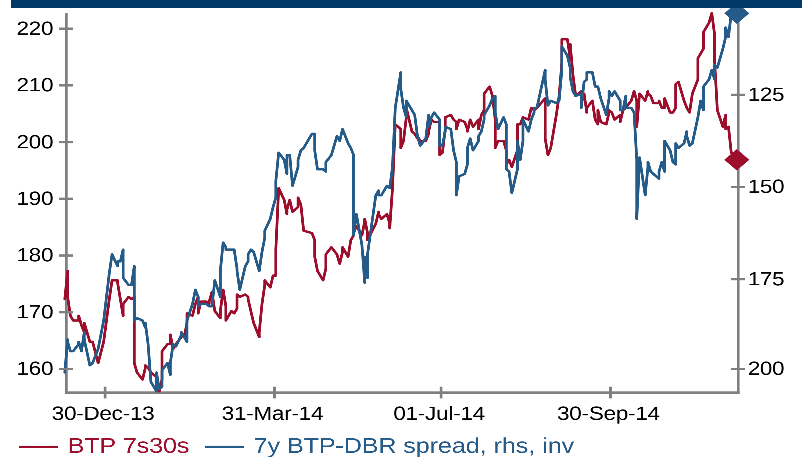
- BTP 7s30s steepeners have the highest vol-adjusted entry carry in Italy. The steepener carries positively 6bp for three months.
- The 7s30s curve appears to be too flat relative to the 10s30s curve
- ECB QE focused on the sub 10y sector would support steepening of the curve
- Sub-investment downgrade risk and long-term debt sustainability in Italy should be priced into the long end

Risks

- Extension trades due to the low absolute yield would support the long end
- ECB buying 30y bonds could flatten the curve

BTP 7s30s is too flat relative to BTP 10s30s

7s30s appears too flat relative to the 7y spread



Source: Credit Suisse Locus

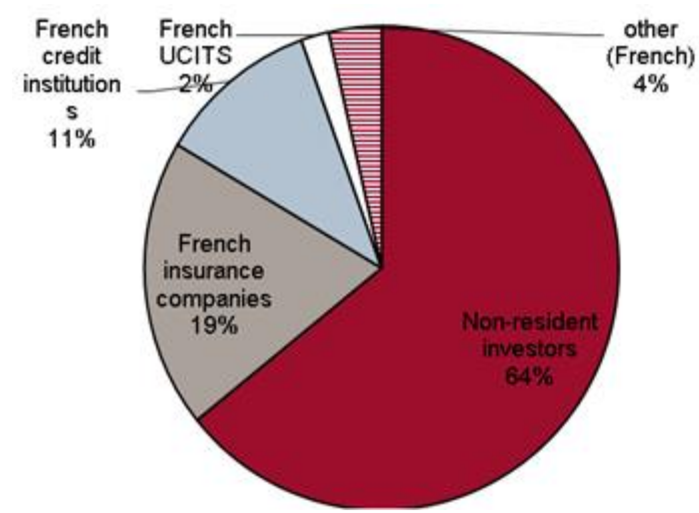
Theme: French economic performance remains weak

- France is the only country in the euro area with increased net funding requirements in 2015; it will have the highest net funding requirements in the euro area
- French sovereign bonds have been a preferred investment by international investors. Unwinding of these flows is a risk to France
- France lacks the economic reform effort of other euro area countries
- Our economists expect only weak growth in France

Market Impact

- France already at very tight levels in 0-10y and we see potential for widening here
- We express this via shorts in France versus Germany
- We favour periphery versus France

64% of French debt is held by foreigners



Source: Credit Suisse, Japanese Ministry of Finance

Trade Idea: Short 10y France vs. 10y Germany

Current level: 28bp

Target/Stop-Out: 35bp/15bp

Rationale

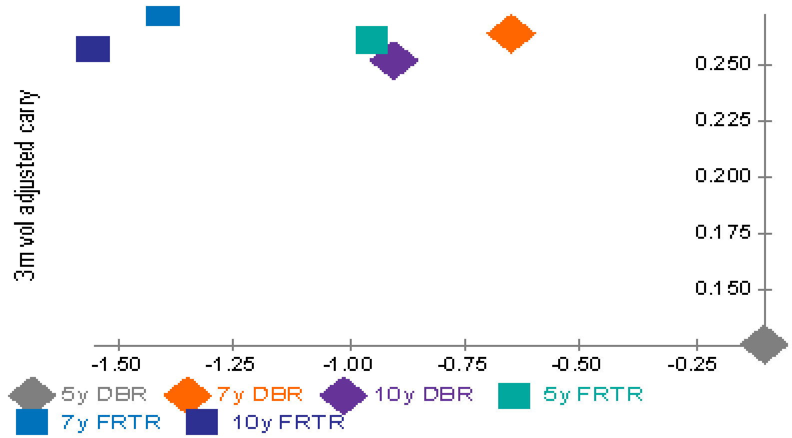
- Short 10y France versus Germany is a good hedge to bullish periphery positions
- 10y DBR offers similar vol-adjusted carry to 10y France
- Germany has zero net funding in 2015 while France has the highest net funding requirements.

Risks

- ECB QE not based on the ECB’s capital key

10y FRTR-DBR spread relative 10y BTP-DBR spread

France no longer offers better carry than Germany



Source: Credit Suisse Locus

X-Axis: 3m z-score and y-Axis 3m carry over 3m volatility

Trade Idea: Long 2y BTP vs. 5y France

Current level: -28bp

Target/Stop-Out: -5bp/-45bp

Rationale

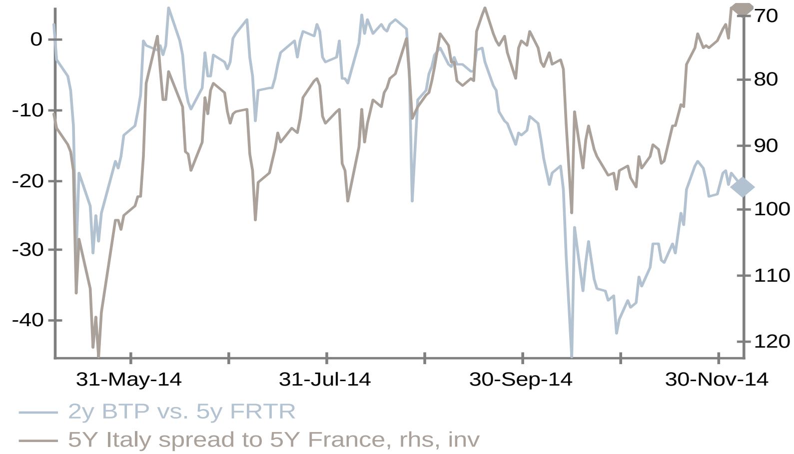
- Italy should benefit more from purchases by the ECB than France or Belgium given the lower deficit in Italy
- France has the highest net funding requirement in Europe while Italian net funding mainly covers coupon payments
- BTP 2y to FRTR 5y spread is too wide relative to FRTR-BTP 5y spread
- 2y BTP offers same vol-adjusted carry as 5y France but has a better entry level. 2y BTPs have higher absolute carry than 5y France

Risks

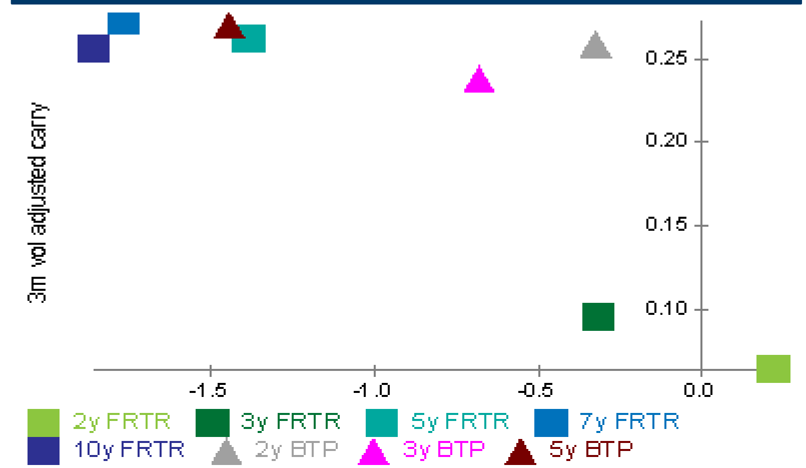
- Low growth and inflation in Italy leading to increasing debt stock

Source: Credit Suisse Locus

2y BTP vs. 5y FRTR relative to 5y spread



BTP vs. FRTR vol adjusted carry



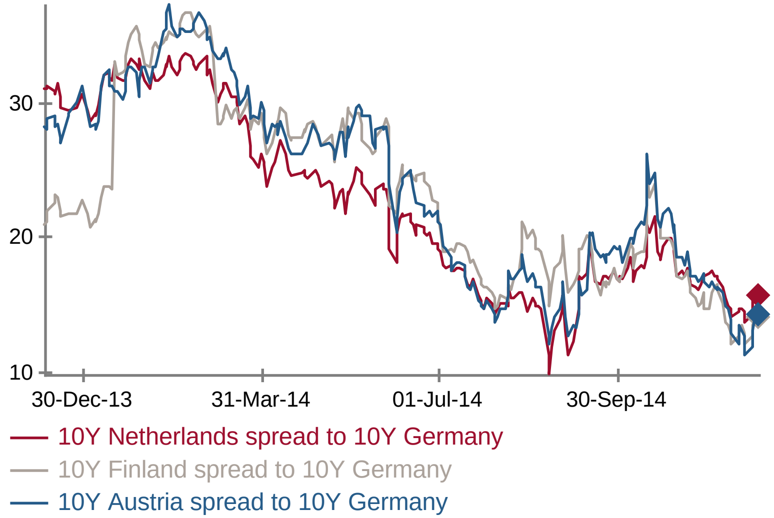
Theme: Trade ranges in core spreads

- We expect range trading to be dominant theme within core countries
- The ranges are likely to remain relatively tight in absence of severe market stress
- We see lower end of the range of each country's spread to Germany at 10bp and the upper end at 25bp
- We expect the Netherlands to have the tightest spread to Germany followed by Finland and then Austria

Market Impact

- Given current valuations, we recommend overweight positions in Germany and the Netherlands and underweight positions in Austria and Finland

Core country spreads to Germany



Source: Credit Suisse Locus

Trade Idea: Sell 10y Austria vs. 10y Netherlands

Current level: 2bp

Target/ Stop-Out: 7bp / -2bp

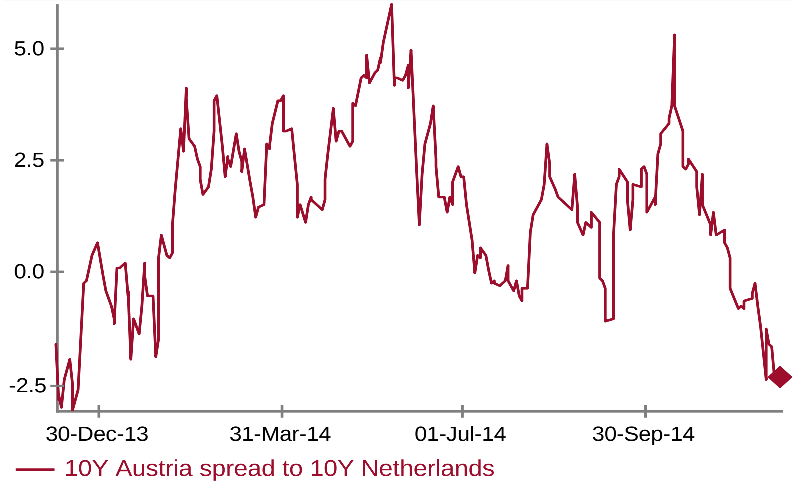
Rationale

- Dutch 2015 growth likely to be stronger than Austrian 2015 growth
- Dutch pension system is fully funded
- Austria's banking sector has substantial exposure to Russia. Including exposure that is either Austrian or Italian increases Austrian exposure to approximately €28 billion or 9% of GDP.

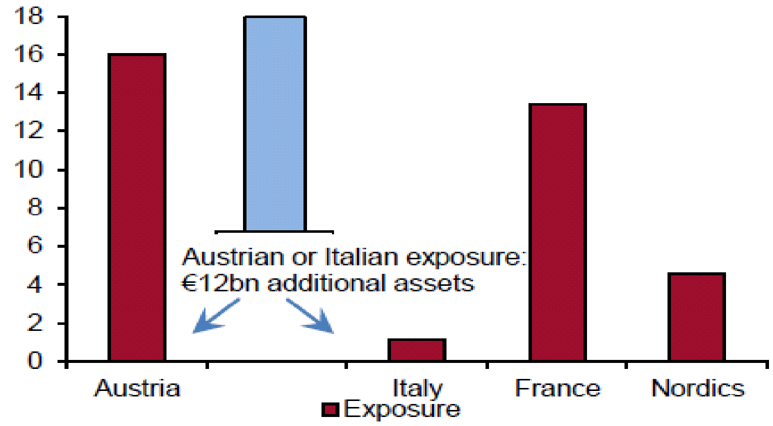
Risks

- ECB QE would be 3.8x net funding in Austria versus 2.4x net funding in the Netherlands

Austria is trading very tight versus the Netherlands



Austrian banks exposed to Russia



Source: Credit Suisse, Company reports

Trade Idea: Sell 10y Finland vs. 10y Netherlands

Current level: -4bp

Target/Stop-Out: 1bp/-8bp

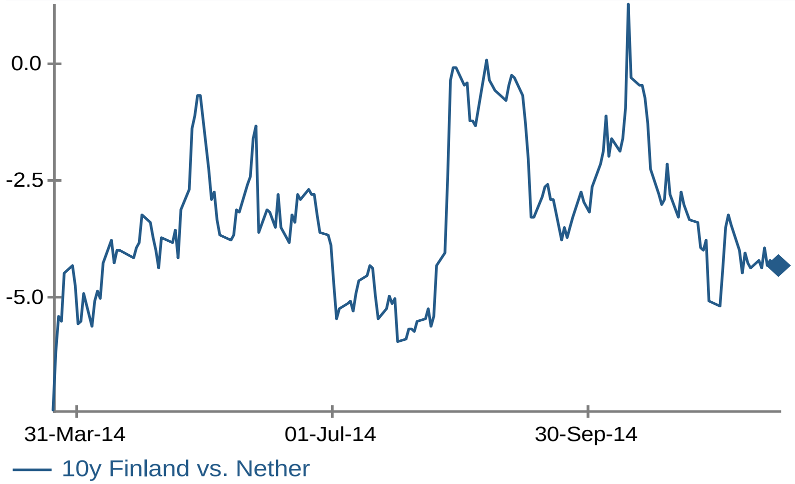
Rationale

- Our economists think that Finland will be among the worst economic performers in the euro area
- Finnish competitiveness worse than its peers and Italy or France
- Finland has the highest export exposure to Russia and the second highest imports from Russia. A deterioration in trade with Russia would be another downside risk for the Finnish economy

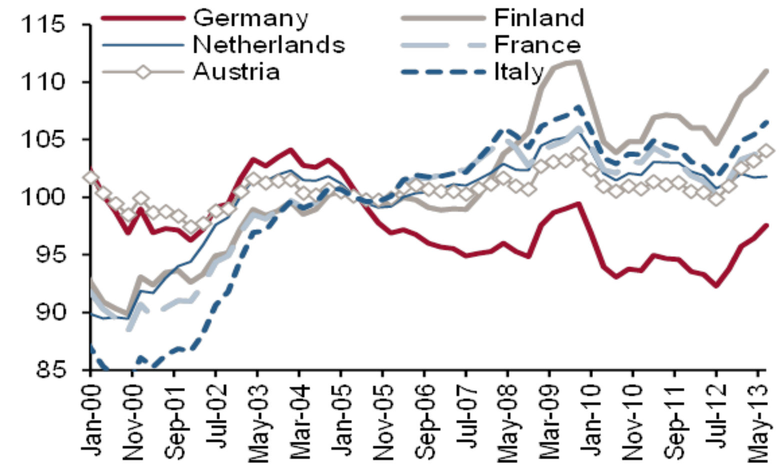
Risks

- Renewed weakness of the Dutch housing market

Finland trading very tight versus the Netherlands



Finnish competitiveness worse than Italian one



Source: Credit Suisse, European Commission

UK Rates

Thematic trade Ideas:

- GBP 1y1y vs. 2y1y steepeners
- UKT 10s30s curve flatteners
- Short 5y5y RPI
- Short 10y UKT ASW spreads

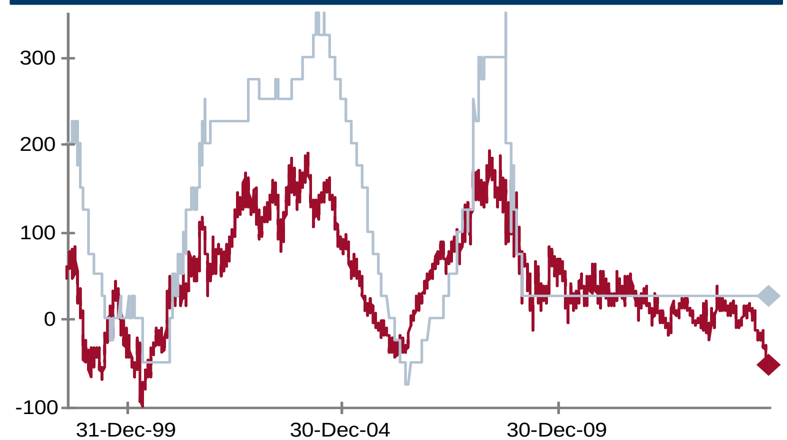
Theme: The US – UK – Euro “tug-of-war”

- Policy divergence between the Fed and ECB is a key theme for 2015, but…
- …which route will the UK follow?
- The market is increasingly pricing for the UK to “become more European” and for its monetary policy cycle to diverge from that of the US
- We think the MPC will begin to tighten policy in 2015. However, given (i) the UK’s close ties to the euro area and (ii) uncertainty around the election, we expect the Fed to move first

Market Impact

- We think GBP-EUR spreads should remain fairly range-bound and we look to trade around this
- Our favoured UK vs. US expression is via inflation: short 5y5y RPI vs. US
- We discuss these two trades in our cross-market section

Market pricing Fed to diverge away from MPC



Source: Credit Suisse Locus

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Theme: Conflicting forces facing gilts

- The US vs. euro "tug-of-war" is at the heart of the conflicting forces facing gilts in 2015
- We think yields should stay low in the near-term, before moving gradually higher
- Hence we avoid outright short positions but favour trades with a bearish bias
- Trading will be tactical, and timing is key

Market Impact

- We recommend front-end steepeners and long-end flatteners
- For the risk that we remain in a low yield, low inflation environment, we favour being short 5y5y RPI
- Given rising fiscal and political uncertainty, we are short 10y ASW spreads

Reasons for HIGHER yields

- Above-trend domestic growth
- Strong US data
- ECB QE if substantial enough to be deemed likely to be effective
- Fiscal slippage/rising domestic political risk

Reasons for LOWER yields

- Low inflation outlook
- Search for yield
- Threat of rising political risk in the euro periphery
- Increased fiscal consolidation

Trade Idea: GBP 1y1y vs. 2y1y steepeners

Current level: 47bp

Target/ Stop-Out: 65bp/ 37bp

Rationale

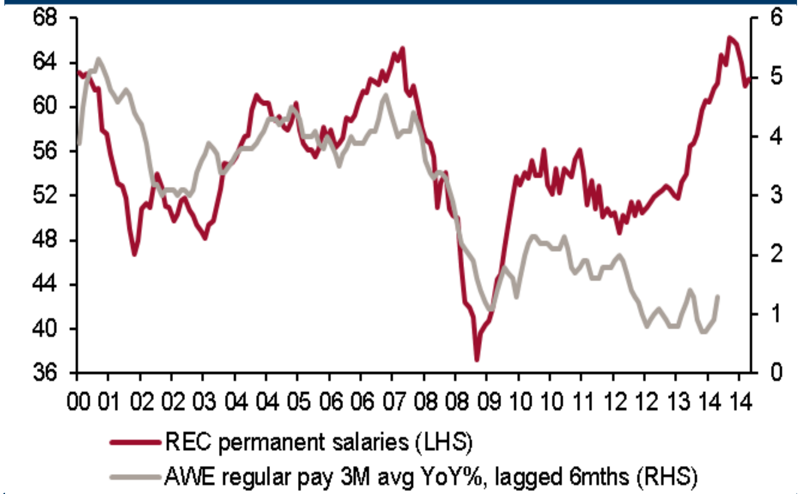
- Market is already pricing the MPC to continue to provide a large amount of monetary accommodation in the coming years
- The rising risk that the MPC delays tightening until higher inflation/wage growth comes through – and then has to hike more aggressively – is underpriced by the market

Risks

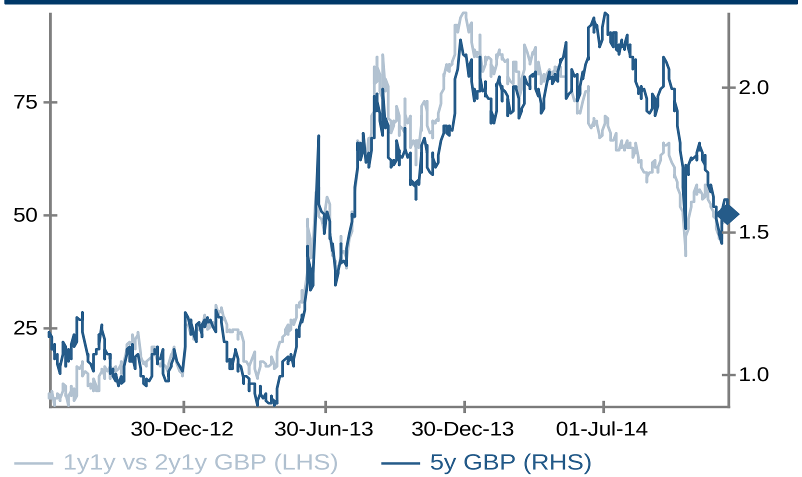
- Wage growth remains weak or low inflation shows signs of feeding negatively into inflation expectations which cause rate hikes to be pushed even further out

Link to full report

The pay puzzle in the UK



Bearish via front-end steepeners



Source: Credit Suisse Locus, the BLOOMBERG PROFESSIONAL™ service

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Trade Idea: UKT 10s30s curve flatteners

Current level: 75bp

Target/Stop-Out: 50bp/90bp

Rationale

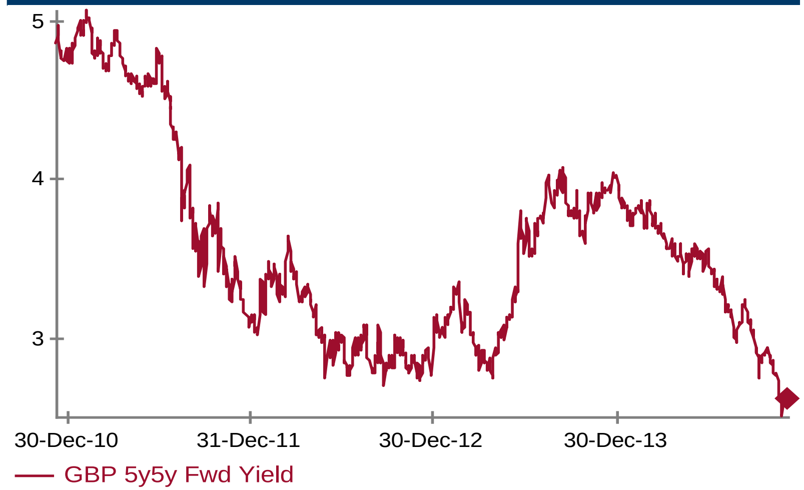
- We struggle to see the curve steepening regardless of whether yields rise or fall; the typical directionality between the curve and level of rates has broken down in 2014
- 30y gilts should remain well supported due to (i) structural demand (ii) unsynchronised global recovery (iii) global disinflationary pressure (iv) grab for yield (v) lower risk premia
- 10y sector should bear the brunt of any sell-off

Risks

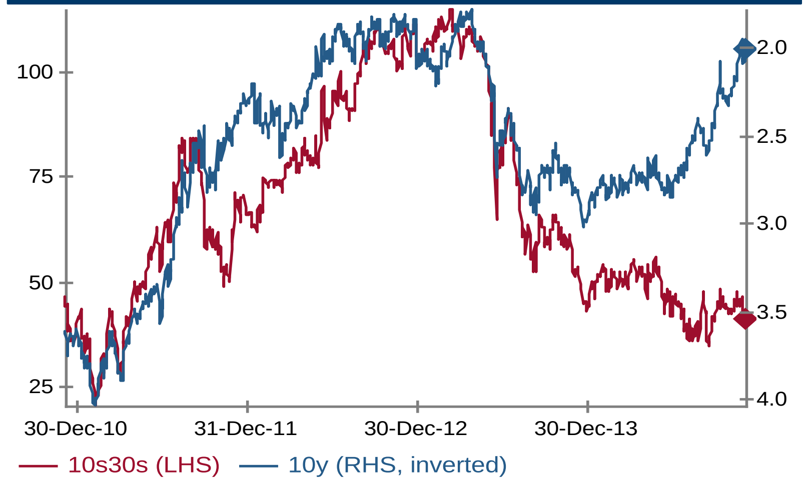
- Renewed flight-to-quality bid for gilts, perhaps due to renewed debt sustainability/political risks in the euro area

Link to full report

5y5y back to QE2 levels



Typical directionality has broken down in 2014



Source: Credit Suisse Locus

Trade Idea: Short 5y5y RPI

Current level: 3.37%; Target entry level: 3.43%

Target/Stop-Out: 3.30%/3.50%

Rationale

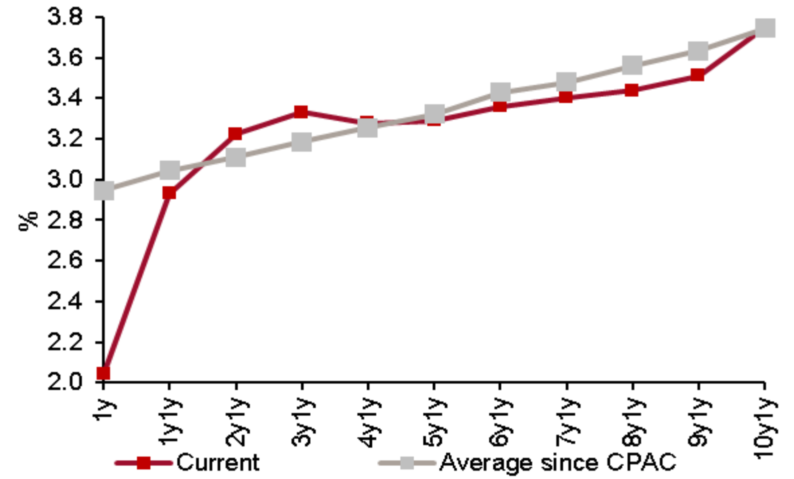
- The market is pricing low inflation to be a very temporary phenomenon in the UK
- We think the risks to this lie firmly on the downside
- 5y5y breakevens are inconsistent with the level of nominal rates: if nominals are being supported by rate expectations being pushed out due to growing disinflation concerns, then 5y5y inflation should be lower
- Positive carry

Risks

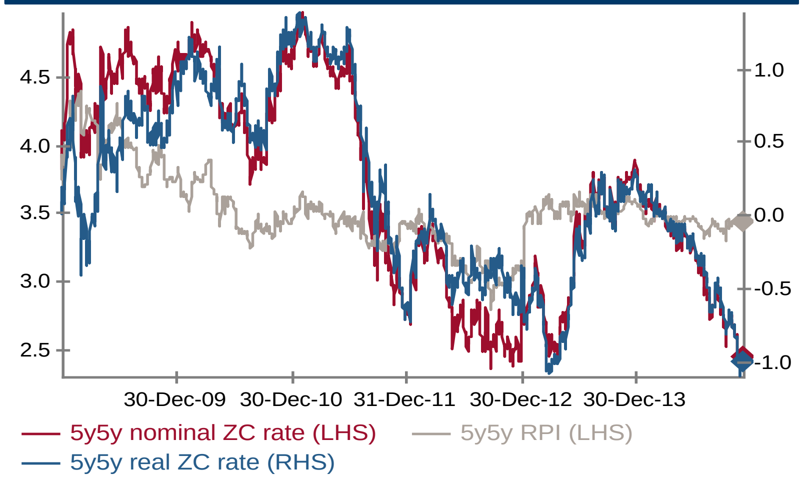
- Signs of rising domestically generated inflation pressure in the UK

Link to full report

1y forward BE curve: spot and average since CPAC



5y5y BEs inconsistent with level of nominal rates



Source: Credit Suisse Locus

Trade Idea: Short 10y UKT ASW

Current level: -8.8bp

Target/Stop-Out: 0bp/-13bp

Rationale

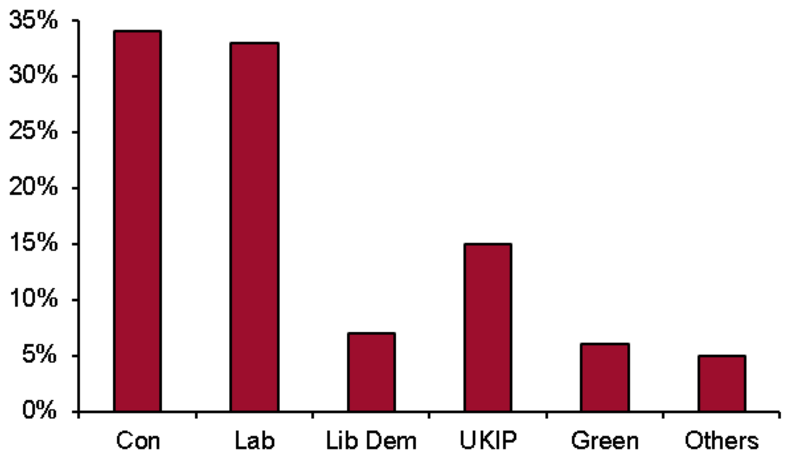
- Rising fiscal and political risks should weigh on asset swap spreads
- Position for uncertainty over the outcome of the election, commitment to fiscal consolidation and the future of the UK as part of the EU
- We favour shorts via 10y spreads as: (i) overseas investors are most sensitive to these risks (ii) current valuations are supportive (10s30s box and 5s10s30s fly)
- Alternatively, we recommend being short 10y UKT on the 10s30s ASW box

Risks

- ‘Safe-haven’ flows support gilt outperformance

Link to full report

Current election polls are very tight



10y spreads rich on the 5s10s30s ASW fly

Source: YouGov (poll from 7/8 Dec), Credit Suisse Locus, OBR

Cross Market Trade Ideas

Thematic trade Ideas:

- Receive EUR 2y1y versus USD
- Long US CPI 5y5y versus RPI
- Long Bund-Eonia against Gilt-Sonia ASW

Theme: Cross market trade ideas

Monetary policy divergence

- Receive EUR 2y1y versus USD
- Long BTP 2y versus 2y1y USD
- Play the range in 10y GBP-EUR

Inflation divergence

- Long US CPI 5y5y versus RPI
- Long US CPI 5y5y versus HICPxT

ASW – political risks in the UK and the periphery

- Long Bund-Eonia against Gilt-Sonia ASW

CHF-EUR spreads

- Play range in CHF-EUR 5y5y (receive CHF vs. EUR @ -30bp)

Source: Credit Suisse

Trade Idea: Pay USD 2y1y versus EUR 2y1y or BTP 2y

Current level: 171bp

Target/Stop-Out: 220bp / 140bp

Rationale

- US front-end should be a function of the domestic backdrop and of the Fed beginning hikes
- In Europe, we expect the front end to remain anchored on low growth and low inflation
- The threat of QE should lead to further front-end spread compression

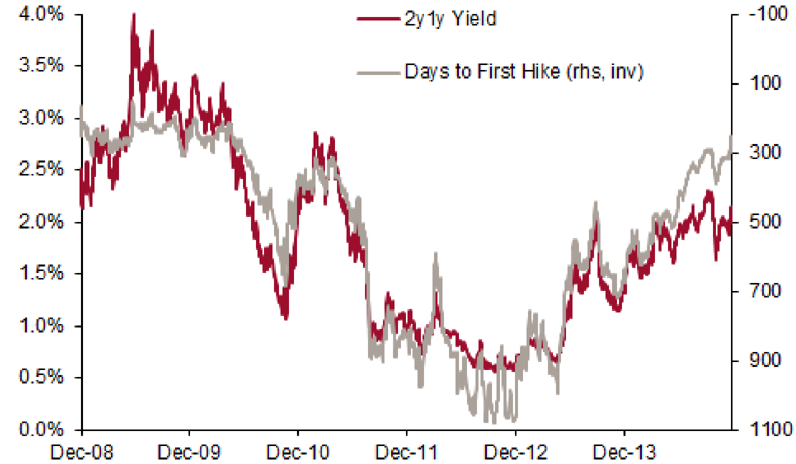
Alternative

- Buy 2y Italy versus paying US 2y1y (current -150bp, target: -220bp, stop: -100bp)

Risks

- Fed remaining dovish
- Liquidity tightness in Europe persists for longer than expected

2y1y US has generally tracked market hike pricing



BTP-US Spread an alternative to EUR-US

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

Trade Idea: Long 5y5y TIPS Breakevens vs. RPI

Target entry level: 128bps (Current: 121bps)

Target/Stop-Out: 100bps/145bps

Rationale

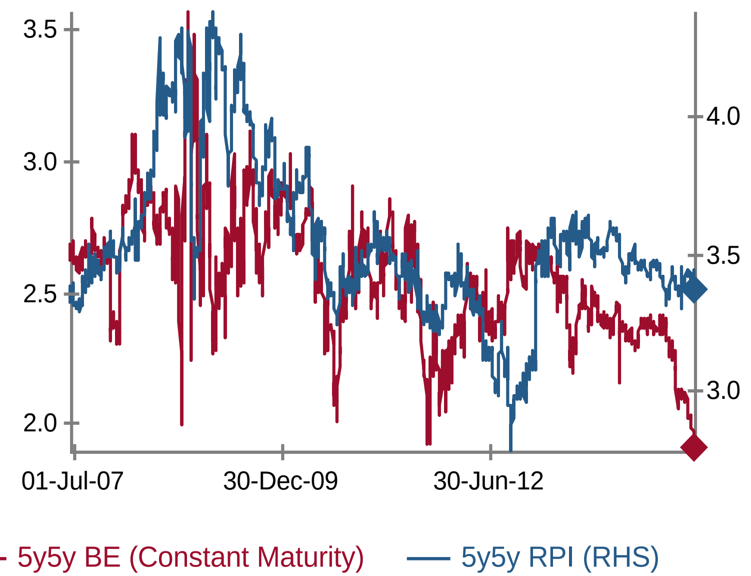
- We expect core inflation in the US to remain firm, which should allow 5y5y BEIs to bounce back from currently depressed levels
- In the UK we disagree with the optimistic pricing of the path of inflation over the coming years, and find the elevated level of 5y5y BEs inconsistent with 5y5y nominal rates
- Alternatively, we also like long 5y5y TIPS BEI vs. HICPxT positions

Risks

- Signs of rising domestically generated inflation pressure in the UK
- Downside surprises in US core inflation

Link to full report

5y5y TIPS BE versus 5y5y RPI



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

CREDIT SUISSE

Trade Idea: Long Bund-Eonia vs. Gilt-Sonia ASW

Current level: 15bp

Target/Stop-Out: 30bp / 10bp

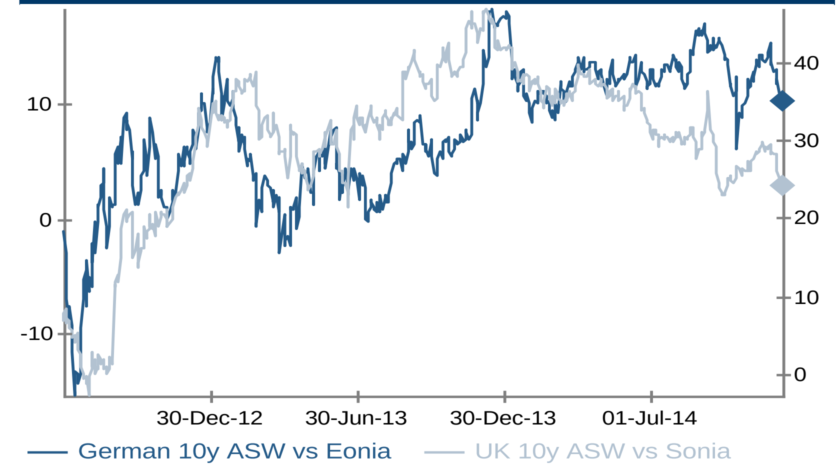
Rationale

- In Europe, QE should support ASW spread widening. Rising political risks in the periphery should support core ASW spreads
- In contrast, rising political risks in the UK should weigh on UK ASW spreads in 2015
- We prefer trading the ASW view versus OIS rates to reduce the exposure to corporate supply in January

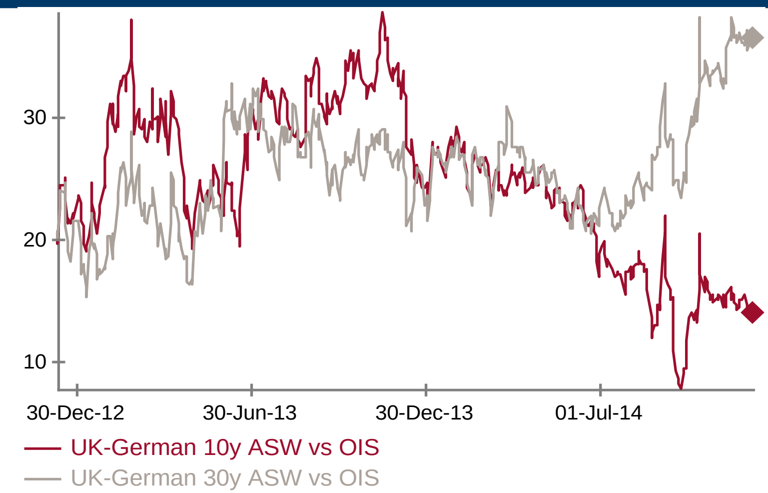
Risks

- Political risks do not emerge in the UK
- Data improves sharply in Europe

Correlation between Bund ASW & UK ASW too high



10y Gilt-Bund ASW should move closer to 30y spreads



Source: Credit Suisse Locus

CREDIT SUISSE

Trade Idea: Play the range in 10y GBP – EUR

Current level: 107bp

Target/ Stop-Out: Trade the 100-125bp range

Rationale

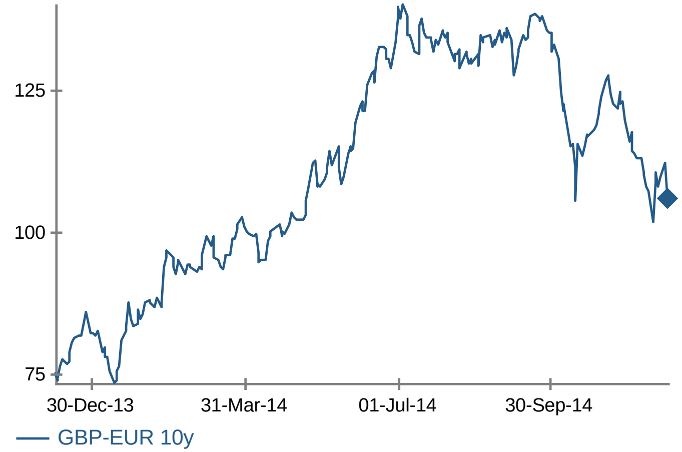
- We recommend playing the range in 10y GBP-EUR
- We struggle to see how the UK can completely decouple from the euro area
- In particular, the threat of a prolonged period of low inflation in the region, coupled with the close trading ties, should limit how far the GBP-EUR spread can widen
- We look to enter spread tighteners at 125bp and wideners at 100bp

Risks

- Growth in the UK accelerates strongly generating high inflation, causing tighter policy

UK and Euro real rates are highly correlated

Trade the 10y GBP – EUR range (100-125bp)



Source: Credit Suisse Locus

Trade Idea: Trade range in CHF-EUR 5y5y

Current: -40bp; Entry: -30bp

Target / Stop: -50bp / -15bp

Rationale

- CHF lagged the rally in EUR as the market was reluctant to price any policy action from the SNB
- Over 2015, we would expect questioning of this assumption
- We expect CHF-EUR spreads to range trade – our bias is to receive CHF on a back up

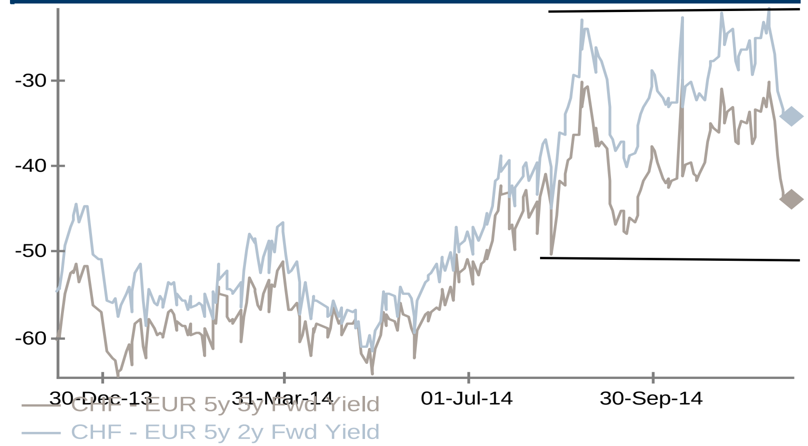
Alternative

- 5y2y CHF-EUR tighteners
- CHF 5s10s flattener vs. EUR

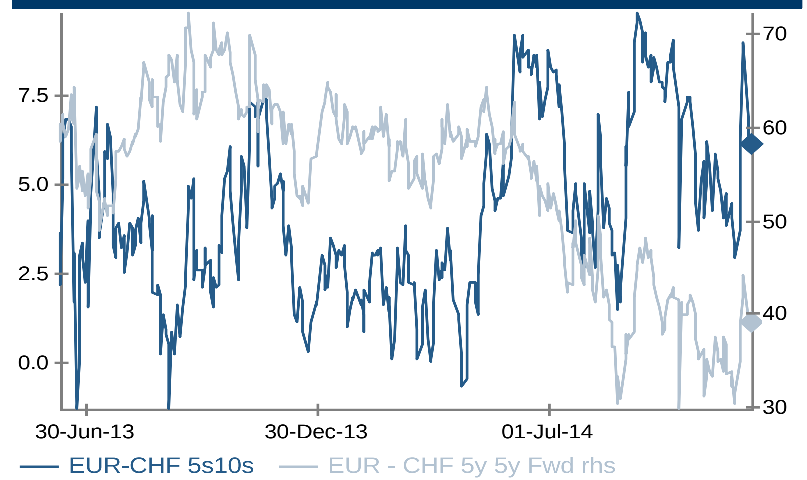
Risks

- No new policy response from the SNB
- Deflation in Europe

CHF versus EUR rates



An alternative is CHF-EUR 5s10s flatteners



Source: Credit Suisse Locus

CREDIT SUISSE

Credit Suisse 2015 Interest Rate Forecasts

US- Treasuries	2015 Q1	2015 Q2	2015 Q3	2015 Q4
Fed Funds	0 – 0.25	0.25 – 0.50	0.50 – 0.75	1.00-1.25
2-Yr Yield	0.65	1.25	1.75	2.00
5-Yr Yield	1.90	2.25	2.65	2.90
10-Yr Yield	2.65	2.85	3.10	3.35
30-Yr Yield	3.45	3.55	3.70	3.90
UK- Gilts	**2015 Q1**	**2015 Q2**	**2015 Q3**	**2015 Q4**
Base Rate	0.75	1.00	1.25	1.50
2-Yr Yield	0.70	0.80	0.95	1.25
5-Yr Yield	1.60	1.80	1.95	2.15
10-Yr Yield	2.00	2.35	2.50	2.75
30-Yr Yield	2.70	2.95	3.05	3.20
Euro – Germany	**2015 Q1**	**2015 Q2**	**2015 Q3**	**2015 Q4**
ECB Repo	0.05	0.05	0.05	0.05
2-Yr Yield	-0.05	-0.05	-0.05	-0.05
5-Yr Yield	0.10	0.20	0.30	0.40
10-Yr Yield	0.70	1.10	1.25	1.35
30-Yr Yield	1.80	1.95	2.05	2.15

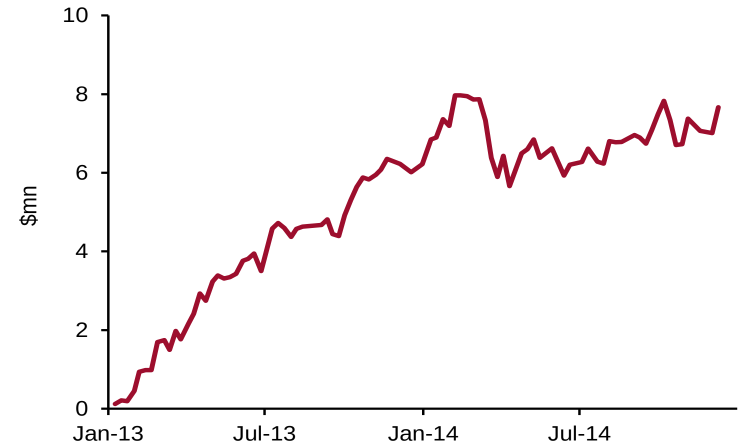
Source: Credit Suisse

Trade Performance

US 2013 & 2014 Trade Statistics

	2014	2013	Past 2 years
The PnL/volatility("Sharpe") ratio:	0.52	3.15	2.22
Profit making trades	35	77	112
Total non-zero trades	72	129	201
Win:loss ratio	0.95	1.48	1.26
PnL of profitable trades	8,623,830	15,023,737	23,647,567
PnL of loss making trades	(7,177,447)	(8,802,183)	(15,979,630)
Net Pnl	1,446,384	6,221,554	7,667,938
PnL ratio of profitable to loss-making trades	1.20	1.71	1.48

US 2013 & 2014 Cumulative P&L



European 2013 & 2014 Trade Statistics

	2014	2013	Past 2 years
The PnL/volatility("Sharpe") ratio:	2.44	1.93	1.96
Profit making trades	67	162	229
Total non-zero trades	111	240	351
Win:loss ratio	1.52	2.08	1.88
PnL of profitable trades	29,908,804	69,482,481	101,841,899
PnL of loss making trades	(11,073,170)	(31,689,372)	(45,213,156)
Net Pnl	18,835,634	37,793,109	56,628,743
PnL ratio of profitable to loss-making trades	2.70	2.19	2.25

European 2013 & 2014 cumulative P&L

Please note all trades are available and marked daily in Credit Suisse PLUS Analytics.
Link to latest P&L: https://plus.credit-suisse.com/r/tD5a3N
Source: Credit Suisse

Disclosure Appendix

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Buy: Indicates a recommended buy on our expectation that the issue will deliver a return higher than the risk-free rate.
Sell: Indicates a recommended sell on our expectation that the issue will deliver a return lower than the risk-free rate.

Corporate Bond Fundamental Recommendation Definitions
Buy: Indicates a recommended buy on our expectation that the issue will be a top performer in its sector.
Outperform: Indicates an above-average total return performer within its sector. Bonds in this category have stable or improving credit profiles and are undervalued, or they may be weaker credits that, we believe, are cheap relative to the sector and are expected to outperform on a total-return basis. These bonds may possess price risk in a volatile environment.
Market Perform: Indicates a bond that is expected to return average performance in its sector.
Underperform: Indicates a below-average total-return performer within its sector. Bonds in this category have weak or worsening credit trends, or they may be stable credits that, we believe, are overvalued or rich relative to the sector.
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Disclosure Appendix cont'd

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	Global Recommendation Distribution**	
Buy	11%	(of which 86% are banking clients)
Outperform	20%	(of which 60% are banking clients)
Market Perform	42%	(of which 61% are banking clients)
Underperform	25%	(of which 73% are banking clients)
Sell	2%	(of which 100% are banking clients)

*Data are as at the end of the previous calendar quarter.

**Percentages do not include securities on the firm's Restricted List and might not total 100% as a result of rounding.

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