BELVÉDÈRE
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STRONGER THAN EVER

MARKET INSIGHTS

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Have you had or are you planning a holiday abroad? Then you might have been pleased with the latest exchange rate movements. It matters hardly at all where you are travelling, your holidays are costing significantly less. The Swiss franc is currently stronger than ever before. The Swiss Franc Index, which is based on a basket of currencies, is at an all-time high. The euro, by far the major currency in the index, has given way – almost 5% since mid-January, around 2% in July alone. But above all, the US dollar has recently dropped significantly within a very short time and is trading as low as it last did shortly before the minimum euro exchange rate was introduced in 2011 and when it was abandoned in 2015.

Why is the dollar weak? Bluntly, one of the reasons is that it has a general propensity to weakness, anyway in the long term. The enormous US current account deficit constantly pulls the greenback down, just as Switzerland's huge current account surplus perpetually boosts the franc. This does not mean that the dollar cannot be strong and the franc weak over an extended period. However, the underlying trend favours the franc and weighs on the dollar. The USD/CHF rate is more likely to end up at 0.70 than at 1.00 in 10 or 15 years, although it may of course exceed parity again temporarily in the meantime.

Another reason: in 2021 and 2022, the US dollar had one of its strong phases. It gained 15% against the franc and 28% against the euro. All common calculation methods pointed to an overvaluation. It is always difficult to anticipate the point in time. But the correction that began at the end of 2022 could not have come as a surprise, even if the actual extent and speed – as so often – could not be expected. The fall of the dollar was also enabled by the looming US banking crisis in March. It is true that in times of major distress, the US dollar is usually a safe haven currency and benefits from any turbulence. That is unless, as in this case, the crisis originates in the US itself. The recent slide in the dollar was triggered by lower inflation figures and the prospect of an end to the rising interest rates cycle in the US, while interest rate hikes were still being expected elsewhere.

Where will the dollar go from here? When the pendulum has swung strongly in one direction, an intermediate stop or a countermovement becomes likely. Since the end of interest rate hikes came within sight in this country too, the dollar has stabilised. In addition, the current strength of the franc may galvanise the Swiss National Bank (SNB) back into action. While it had staged interventions to weaken the franc time and again for years, the SNB has recently let the currency appreciate in the fight against inflation. The SNB cannot be ruled out to become a currency buyer on the market again now. However, the US dollar is unlikely to experience a sustained rally, as it is still not undervalued. And the euro also has only limited appreciation potential at present.

So, the franc will remain strong for the time being. Is that a good thing for Switzerland? Or, to phrase it more generally, what is better for a country – a strong currency or a weak one? We will address this question here one month from now.

Th. Heller

Thomas Heller
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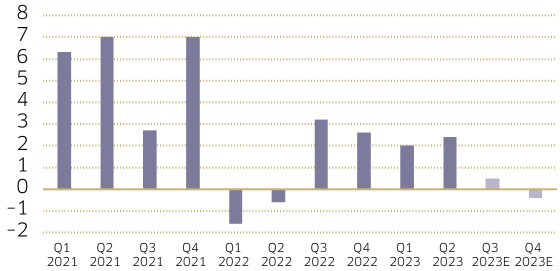
ECONOMY

The US economy grew surprisingly strongly by 2.4% (annualised) quarter on quarter. The decisive factor was not so much private consumption, but rather investments, which are also benefiting from the Inflation Reduction Act programme. Many construction projects are currently underway, including chip and battery factories. We believe this growth could continue. However, risks will increase towards the end of the year once the savings from the pandemic are used up and the effects of higher interest rates kick in.

The outlook for the euro zone has turned somewhat bleak. In July, the manufacturing purchasing managers' index fell to a low of 42.7, which means that the sector is likely to contract in the second half of the year. But the services sector has also cooled. Activity is slowing down and there is also a decline in hiring. The most likely scenario is stagnation.

The latest data from China were disappointing, so investors were eagerly awaiting the decisions of the Politburo at the end of July. It showed that the state is willing to take more action, specifically in the real estate market. In addition, it intends to promote the digital sector, among other things. The growth rates of the past are unlikely to be achieved again, but at least an improvement over the first half of the year is within the realm of possibility.

GDP growth in the US (in % vs. prior quarter, annualised; as of Q3 consensus estimates)



Source: Bloomberg

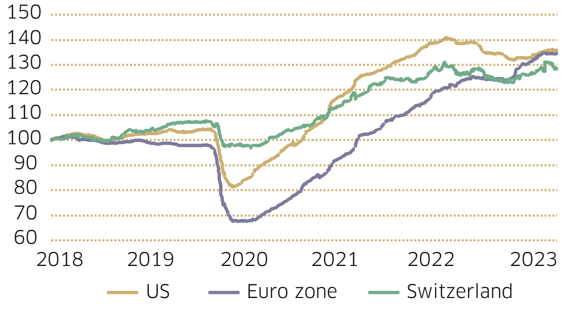
EQUITIES

Equity markets defied the burgeoning economic fears and for the most part performed well in July. This is particularly true for the US market (S&P 500 +3.2%), where the market also gained in breadth. However, the rally was accompanied by a weaker dollar (see editorial). The SPI and the Euro Stoxx gained 0.4% and 2.1%, respectively, in July. Most of the corporate results published so far have been positive or less bad than feared. Swiss companies were clearly affected by the strong franc. Nevertheless, most of them achieved positive growth rates. Holcim (+0.7%) is an example worth pointing out, as it is benefitting from the aforementioned investment trends in the US.

What is the outlook for equities? Basically, we expect the environment to remain favourable. This is mostly due to earnings estimates, which have seen an upswing after a weak 2022 (see chart). At the same time, interest rates are probably close to a peak, which should eliminate fears of even higher interest rates. Our optimism is also fed by the sound condition of many companies that are braving the difficult environment with innovation and new products.

Nevertheless, there are risks. The biggest ones include an unexpectedly sharp economic downturn, scarce stimuli in China and persistent inflation.

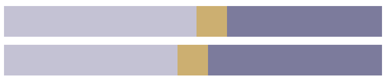
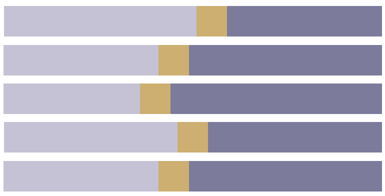
Earnings estimates (indexed, on a rolling 12-month basis)



Source: Bloomberg, BAM

INTEREST RATES

In July, encouraging news came about inflation in the US. Annual inflation surprisingly fell from 4% to 3% and is thus about 2/3 below last year's high. The core rate fell less sharply and at 4.8% is still well above the Federal Reserve’s target. Against this backdrop, the Fed raised rates another, probably final time, by 25 basis points to 5.25%. The European Central Bank followed suit and raised rates to 4.25%. The Bank of Japan is willing to soften its interest rate curve control, which might lead to higher interest rates and a stronger yen. For this, inflation would have to remain above 2%. At the long end, 10-year yields in the US crossed the 4% mark again in July. We see this as a last gasp and expect interest rates to fall in the medium term, mainly as a result of a decline in inflation. We expect a similar development for the euro zone. However, the scope for a decline in interest rates in Switzerland is smaller.

Asset class	Appraisal	Commentary
Bonds Government bonds Corporate bonds		The interest rate peak is imminent, but cuts by the end of the year are unrealistic. Long-term interest rates have probably peaked and are slowly going down.
Equities Switzerland Euro zone United Kingdom US Emerging markets		H1 figures show that most companies are holding up well in a challenging business climate. The market environment should remain favourable. However, risks from China or persistent inflation could lead to setbacks.
Real Estate Switzerland		Real estate investments are stuck between the imminent – and final – rate hikes and an interest rate turnaround.
Commodities Oil Gold		Saudi Arabia's production cuts have sent the oil price up. Investor demand for gold continues to shrink.

unattractive – attractive ■ Current asset class assessment

Imprint
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