BELVÉDÈRE
Asset Management

February 2024

STRONG SWISS FRANC – BOON OR BANE?

MARKET INSIGHTS

STRONG SWISS FRANC – BOON OR BANE?

In the current reporting season, Swiss companies are showing clear signs of a slowdown as a result of the strong Swiss franc. For instance, Belimo posted an appealing growth of 7.2% in local currencies in 2023, but only 1.4% in Swiss francs. At the goods testing group SGS, the strong Swiss franc wiped out the entire growth of 8.1%.

So, what is causing the Swiss franc strength, and will the trend continue? One of the main reasons for the robust Swiss franc is low inflation compared to other countries. Inflation in Switzerland has averaged at a mere 1.9% over the last three years, compared with 5.6% in the US and 5.5% in the euro zone. Moreover, at around 38% of GDP, government debt is not an issue in Switzerland – a stark contrast to the US, for example, where debt is threatening to get out of hand due to enormous fiscal programmes. Last but not least, the Swiss National Bank (SNB) strengthened the Swiss franc additionally by starting to reduce its substantial foreign currency positions.

Where will the Swiss franc go from here? The purchasing power parities of the key currency pairs stand at 0.93 for EUR/CHF and 0.80 for USD/CHF. In other words, the euro is currently fairly valued, and the US dollar is still slightly overvalued. Considering the fact that the US is running budget deficits of a high 6% again this year, there is a high probability for the Swiss franc to remain strong. Swiss companies may thus hardly hope for an imminent improvement of the situation.

What options do Swiss companies have to cushion the impact of the strong Swiss franc? A distinction needs to be made here between the translation effect and the transaction effect. The former takes effect when sales and costs are incurred in the same currency, which means that sales and profits move in tandem when the currency changes, but not so the margin. The downside effect is therefore manageable. The transaction effect is more serious when goods are produced in Switzerland to be sold abroad. In this case, a company must take action. The options are to relocate production abroad, make purchases from foreign suppliers, increase productivity, or work longer hours. Price increases would be even better, but they can only be implemented for highly specialised products – such as medical technology or pharmaceuticals. The tourism sector is certainly hit hardest, followed by very small exporting companies.

How does this affect the stock market? Listed medium-sized companies are generally less impacted by the dangerous transaction effect than unlisted small companies. They are able to react more nimbly and usually have local production facilities close to their customers. They show an impressive track record and the effect of the strong currency was rather like a fitness programme. This is reflected in their stock prices: the index of small and medium-sized companies (SMIM) has yielded gains of 8.2% p.a. over the last 20 years, outperforming the S&P 500, for example, which yielded 7.7% (in Swiss francs).

This is a good reason to stay invested, even or precisely because of the strength of the Swiss franc.

Giorgio Saraco
CEO, Belvédère Asset Management

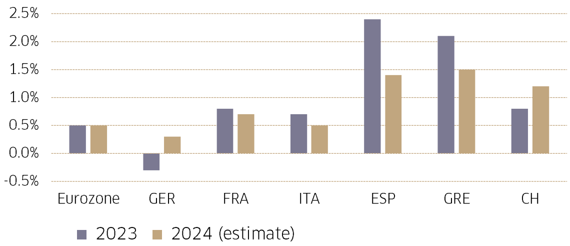
ECONOMY

The US economy ended the last quarter of 2023 with a strong GDP growth of 3.3%, driven primarily by private consumption. The upward trend for corporate investments is continuing; only manufacturing has barely got off the ground for months. In the euro zone, Germany remains the problem child. Its economy shrank in 2023 by 0.3%. In comparison, Greece, which was once derided, grew by more than 2%.

The Chinese economy recorded a year-on-year growth of 5.2% in the fourth quarter. Data reveal a persistently weak property market and a declining momentum in consumption. By contrast, investments and exports have picked up. To stimulate growth, the central bank has cut the reserve ratio for banks and made more loans available to real estate developers.

As for our outlook – the US has the best prospects, as we expect a successful soft landing there. The euro zone will probably continue to suffer from weak foreign trade for the time being. Private consumption, on the other hand, should prop things up, as inflation has receded significantly. According to consensus forecasts, growth in China will slow down from 5.2% to 4.6%. Higher figures are possible provided that the property market stabilises and consumer confidence rises as a result.

GDP growth (versus previous year)



Quelle: Bloomberg

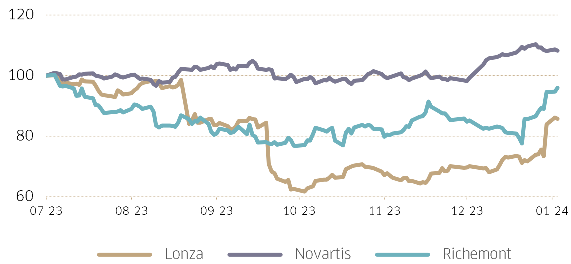
EQUITIES

Equity markets continued in January where they had left off in 2023 – with technology stocks dominating. The Nasdaq has risen by another 4% in the new year and ASML stock was in high demand in the euro zone after the manufacturer of lithography machines shone with a very strong order intake. With a performance of 2.2%, Swiss equities also got off to a good start in 2024, with Lonza (+22.3%), Richemont (+12.7%) and Novartis (+9.1%) making significant contributions. Second-tier stocks, which we consider favourable, such as Temenos (+13.1%) and Swissquote (+6.6%) also performed well.

What's next for the markets? The months of November to March are generally a profitable season for stock markets, so we expect the environment to remain favourable over the next two months. From a regional perspective, the Swiss market has further catch-up potential, as do the previously neglected second-tier stocks, whose valuations are in many cases still below average.

We are likely to see a consolidation in the medium term. The main concern is that more than five interest rate cuts have been priced in by the end of the year in the US, which is way too optimistic in our view. Furthermore, the potential for lower rates is limited at the long end, which eliminates the tailwind for equities from this side.

Comparison of Swiss stocks
(Total return, indexed)



Source: Bloomberg, BAM

INTEREST RATES

Interest rates at the long end experienced a backlash at the beginning of the year and rose again slightly. Towards the end of the month, some reassurance was derived from reports of the US Treasury's lower-than-expected new debt. However, this should not obscure the fact that the financing of the high budget deficits is secured, which means that some bond market turbulence cannot be ruled out later in the year.

The European Central Bank (ECB) left interest rates unchanged at its last meeting, but did not explicitly rule out a first cut as early as April. Seeing as how high interest rates are weighing heavily on the EU economy – more so than in the US, for example – it is quite conceivable that the ECB will cut interest rates already in April. A fall in inflation below 3% would not stand in the way of this. In such a scenario, the SNB would come under pressure, particularly if the Swiss franc were to remain so strong. The consensus expects to see the SNB cut interest rates for the first time in the third quarter. The consensus may indeed have to move forward.

Asset class	Assessment	Comment
Bonds		Interest rate declines at the long end have been exhausted for the time being. Issuing activity for corporate bonds is on the rise, including the speculative segment.
Government bonds		
Corporate bonds		
Equities		In the short term, equity markets have not yet used up their potential. However, in the medium term, the upward path is likely to become rockier, as interest rate fancies could be disappointed, notably in the US.
Switzerland		
Eurozone		
Great Britain		
US		
Emerging markets		
Real Estate		Residential property is benefiting from higher rents and lower financing costs. The environment for commercial property remains challenging.
Switzerland		
Commodities		The oil price is currently trading without a geo-political risk premium. Investors are continuing to sell gold.
Oil		
Gold		

unattractive attractive Current assessment

Matthias Wullschleger
Senior Investment Analyst

Imprint

Publisher: Belvédère Asset Management AG
Authors: Giorgio Saraco, Matthias Wullschleger
Stop press: 30.1.2024

Belvédère Asset Management AG | Part of Fundamenta Group
info@belvedere-am.com | www.belvedere-am.com