



MONTHLY ISSUE #112 | 1st May 2024

Magnificent Swiss Milking Time

EDITORIAL VIEW

- Notwithstanding recent headwinds, Swiss equities boast a remarkable long-term track record
- Their structural attractiveness rests on an enviable – and reliable – fundamental backdrop
- Tactically, stars are now realigning for Swiss equities, arguing for increased exposure again

GLOBAL STRATEGY

- Sticky US inflation, geopolitical risks and policy divergence are temporary challenges
- A healthy equity consolidation is on the cards, allowing for further upside in due course
- Bottom-line: “Don’t fight the Fed”, by reducing your risk stance somewhat

ASSET ALLOCATION

- Allocation – Some caution warranted, given near-term challenges to the Goldilocks backdrop
- Equity – Downgraded to neutral, still favouring an all-terrain & diversified approach
- Forex – Turning more bullish on the USD, on the back of higher rates and as a risk-off hedge

EDITORIAL VIEW

Magnificent Swiss Milking Time

The US market may well have its *Magnificent Seven* stocks, but we have our own *Magnificent Swiss* on this side of the pond, with little to envy to the former over the long run. Indeed, putting aside our *Mighty Federer*, *Speedy Odi* or *Super Lara* just for a moment, the Swiss equity market has also consistently stood out over the years, serving as a home to many global high-quality growth leaders. Hence, despite being sidelined by many investors in recent quarters, we do not believe that Swiss equities have lost their mojo. Rather, we view headwinds as transitory, with improving market breadth now likely to help restore the lustre of yesteryear.

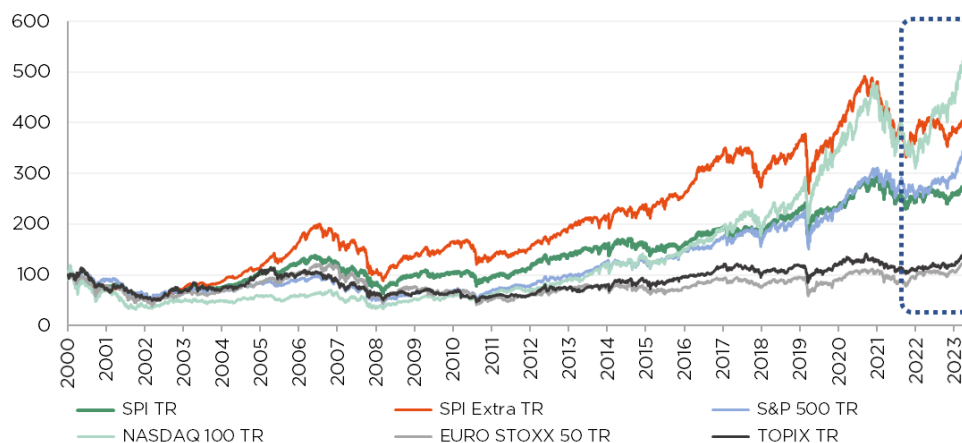
Structurally, we would argue that all investors, be they domestic or foreign, should always own at least some Swiss equities. Not just because Swiss indices rank among the best-performing equity assets over the long term, but also, and foremost, for the market's proven value-enhancing high-quality diversification benefits, combining attractive defensive large-caps leaders and nimbler fast-growing small- & mid-caps. The stable domestic political and economic environment supported by resilient growth, low debt, contained inflation, healthy demographics and a structurally strong currency, makes for an enviable *safe haven* backdrop. Often dubbed the new "Silicon Valley", Switzerland's entrepreneurial DNA and innovation hub also offer a business-friendly home to a set of diverse, often family-led, companies attracting a highly skilled flexible workforce. Finally, considering the export-oriented nature of its industry, with over 90% of domestically-listed company revenues generated abroad, the Swiss equity market provides investors with a truly *global* diversified asset. Needless to say, many Swiss names eventually end up qualifying as global innovative niche industry leaders with established brand values boasting higher productivity, better pricing power and solid balance sheets, all supporting superior earnings growth, high capital returns, and above-average cash generation.

Tactically, we now see a strong case for investors to increase or add back Swiss equities – especially small- & mid-caps. Indeed, the underperformance of recent years is largely explained by an unfavourable sector breakdown (e.g. lack of Technology & direct AI plays), a surge in bond yields that disproportionately hurt richly-valued high-quality stocks, and a stronger Swiss franc, all of which we now expect to reverse as global market breadth widens, interest rates gradually recede, and the home currency undergoes further near-term weakness after the recent surprise SNB cut. Moreover, backed by strong fundamentals, both the market's better visibility and superior short-term earnings outlook point to an unsustainably low historical relative valuation vs. the US and Europe. Not to mention that Switzerland is one of the very few developed equity markets to still offer an attractive dividend yield premium over domestic corporate and government 10-year yields, which should sustain positive flows too. Finally, given revived geopolitical uncertainties, both on the military and electoral fronts, we also expect the Swiss equity market to stand out as an oasis of stability for foreign investors.

Considering its structural particularities, in terms of stock and sector concentration, and predominantly high-quality constituents, the Swiss equity market remains an unmatched paradise for stock pickers, praising the importance of a diversified conviction-driven active portfolio management approach. On the latter, we believe that flexible all-cap strategies, spanning both attractive defensive mega-caps and fast-growing cyclical small- & mid-caps, are paramount to unlock the Swiss market's true potential and fully participate in its long-term outperformance. Hence, notwithstanding mixed recent relative returns, the structural appeal of Swiss equities is clearly intact, and we believe the time has come for investors to start milking our *Magnificent Swiss* again.

*Written by Damien Weyermann, CFA
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GRAPH OF THE MONTH



GLOBAL STRATEGY

Noise & smoke on the Goldilocks highway

- Sticky US inflation, geopolitical risks and policy divergence are temporary challenges
- A healthy equity consolidation is on the cards, allowing for further upside in due course
- Bottom-line: “Don’t fight the Fed”, by reducing your risk stance somewhat

While sticky US inflation is delaying Fed rate cuts and driving global bond yields higher, global economic growth is also proving more resilient with manufacturing activity, employment and consumption all posting upside surprises – notwithstanding revived geopolitical tensions in the Middle East.

Our base case macro scenario remains unchanged, but risks of a temporary reacceleration of growth and/or inflation are now challenging this favourable backdrop as they may require tighter (for longer) monetary policy. Further, the tensions in the Middle East potentially stand to add upward pressure on inflation and rates, while restraining global growth. Although we do not expect a major escalation in the region at this stage, we have nonetheless increased the odds of our downside macro scenario.

In the wake of rising rates and revived geopolitical concerns, equity indexes have edged off recent all-time highs but remain well supported by improving earnings trends, consistent fund flows, and especially wider breadth. In terms of valuation, looking beyond elevated global equity multiples still reveals attractively valued, though “less-magnificent”, market segments such as Europe and small-caps. And sentiment indicators are no longer in overbought territory after the recent pullback, while portfolio equity allocation is only back to long-term average levels following investor re-risking in the past months. Overall, we view the latest market setback as healthy, leaving room for further upside in due course.

In the meantime, the backup in rates has not (yet?) brought about a sufficient valuation opportunity on duration in our view. Sticky inflation, higher for longer (neutral) rates as well as sovereign debt sustainability concerns requiring a higher term premium cannot be dismissed. Similarly, a “no landing” scenario where the US economy continues to grow and rate cuts are not needed remains an option too. As a result, even though we consider rates to be “fairly valued”, it is still hard to get excited about credit at current spread levels.

Speaking of rates, the divergence between the US and

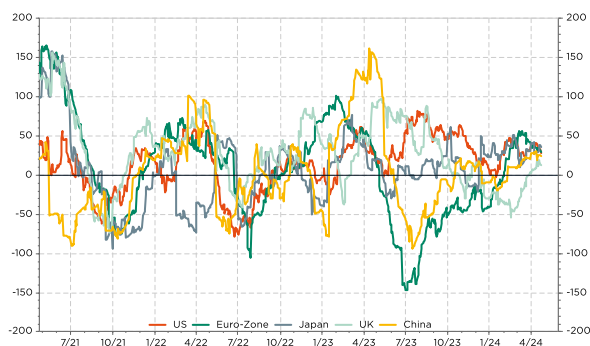
most other DM economies are supporting the greenback. In this context, the potential for a break in major currency crosses against the USD is thus also growing.

Commodities have lost some of their hedging/decorrelation power, but the high dispersion among sub-segments is noticeable (industrial and precious metals are strong, while energy has consolidated). They may offer some value in specific out-of-consensus macro scenarios such as stubbornly high inflation combined with more resilient than expected global growth, but we continue to favour gold over other commodities, as it is enjoying some well-flagged structural tailwinds (US fiscal trajectory, constrained supply, geopolitical fragmentation, higher average inflation, de-dollarisation and FX reserves diversification), and could also be supported by lower US real rates at some point.

To sum up, we remain constructive on equities but have elected to lock in some profits after the recent rally. The aforementioned noisier macro backdrop is fuelling higher market volatility, making for to a potential (healthy) consolidation in the near term. As far as sovereign bond duration is concerned, it may help to mitigate equity losses in the unlikely event of a major earnings downturn, but we still question its buffer benefits in a scenario of sticky inflation, hawkish hold monetary policy and not so severe recession. Given revived geopolitical risks and worrisome fiscal trajectories, other hedges or diversifiers such as gold may actually be more efficient. On this matter, we have also become more bullish on the US dollar. Beyond supportive resilient US growth, higher policy, neutral, real and long-term rates, and a form of US exceptionalism (*AI & Magnificent 7*), the greenback may also act as a risk-off hedge should things turn sour – akin to the Swiss franc.

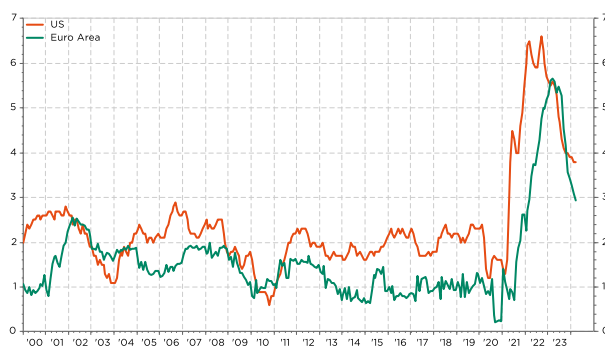
Written by Fabrizio Quirighetti, CIO, Head of multi-asset and fixed income strategies

Activity surprising on the upside globally Citi Economic Surprise Index by region



Source: FactSet

Falling later, but faster and lower Euro Area vs. US core inflation



Source: FactSet

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External sources include: Refinitiv Datastream, Bloomberg, FactSet, BofAML Survey, Statista

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