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## Is the current euphoria in the Swiss equity market sustainable?

**Sharp upturn in GDP growth. Solid outlook for 2019. Interest rate trends still atypical. Caution with regard to euphoria in the equity market.**

### Key points

- Sharp increase in GDP in Q1 (+0.6%, +1.7% yoy)
- We maintain a growth outlook of +1.5% for 2019
- Domestic and foreign demand together are boosting economic momentum in Switzerland
- Outlook still solid for Q2 2019
- Leading indicators no more optimistic in May than in April
- Low likelihood of Swiss franc appreciating significantly
- Long-term interest rate trends still atypical
- Euphoria in the Swiss equity market
- Temporary correction in securitised real estate

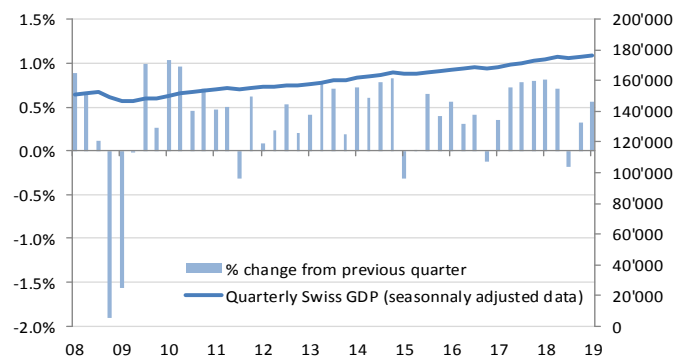
### Sharp increase in GDP in Q1 (+0.6%)

Despite an unpleasant surprise in Q3 2018 and following an upward revision of GDP growth from +0.2% to +0.3% in Q4, Q1 2019 growth figures published by the State Secretariat for Economic Affairs (SECO) provided further reassurance with an upturn at the beginning of the year that surprised many analysts. Indeed, the Swiss economy posted an excellent performance in Q1 with real growth of +0.6%, twice as high as the figure for Q4 2018. The consensus forecast had been for only +0.3% GDP growth. Q1 growth thus far exceeded economists' forecasts. Recall in this regard that the quasi panic in the stock market in December was caused in particular by the clearly unfounded fears of a potential recession in the US in 2019 and of an ensuing global slowdown from which Switzerland would not have been spared. It is now once again obvious that these excessive fears, which had caused equity markets to fall sharply and interest rates to slide, were clearly unsubstantiated given current economic conditions, which are almost startlingly robust.

Nominal GDP thus grew from 173.4 to 174.5 billion Swiss francs in Q1, reaching approximately CHF 698 billion on an annualised basis. Non-seasonally adjusted yoy GDP growth was +1.7%.

The Swiss economy is thus faring much better than expected so far this year and is also benefitting from improved economic conditions in Europe and in Germany in particular, whose real GDP was up +0.4% in Q1, for nominal yoy growth of +2.7%

### Swiss economic performance (GDP in CHF millions)



Sources: SECO, BearBull

The Federal Government Expert Group's economic forecast had been revised downward given a context deemed more uncertain at the beginning of 2019. The GDP growth forecast had been reduced from +1.5% to +1.1% due to concerns regarding a global economic downturn and its ensuing impact on Swiss exports. Thus, the slowdown in global and Swiss economic momentum that experts were expecting did not occur. Therefore, the economic health of our country is likely more robust in Q1, which enables us to reconfirm our own GDP growth estimate at +1.5% for 2019.

## Domestic and foreign demand together are boosting economic momentum in Switzerland

Swiss economic momentum has accelerated somewhat thanks to stronger growth in Q1 (+0.6% over three months and +1.7% yoy). Domestic demand was once again one of the main drivers of this acceleration, although exports also contributed positively. We are pleased to note that most industries and sectors saw some growth in their value added.

Momentum remained strong in the manufacturing sector, which grew another +1.5%. This positive trend was established over the past two quarters, bolstered by stronger foreign demand. The pharmaceutical sector, precision tools and watch-making performed well, benefitting from the increase in global demand for products 'made in Switzerland'. Exports of goods and services grew by +2.2% and +2%, respectively, over the quarter.

The consumption climate improved somewhat, contributing to the solid performance of private consumption, which finally experienced a slight upturn, posting slightly above average growth of +0.4% for the first time in eighteen months. Almost all consumption segments improved, with sharper upswings in healthcare and mobility.

Growth in the service sector was uneven in Q4. While value added grew in the healthcare (+0.9%) and business services (+0.4%) sectors, it decreased for the third quarter in a row in commerce (-0.6%), where the slight upturn in retail trade was unable to offset the downturn in wholesale trade. The financial sector continued to decline as well (-0.8%). Hampered by falling service exports (-2.6%) and still lacklustre final domestic demand (0.0%), growth in the service sector overall fell well short of its historical average.

Investment in the construction sector finally rebounded (+0.5%) after slowing down at the end of the year (-0.4%). Value added in the sector grew by +1.9%, its sharpest upswing since the end of 2017.

As for capital goods investment, it experienced a trend reversal with growth of +1.5% vs. -1.1% in the previous quarter.

Service sector segments all progressed, including service exports, up +1.7%. As for the commerce segment, growth resumed for the first time in five quarters.

Switzerland's economic performance in Q1 was not affected by uncertainty tied to the difficult trade negotiations between the US and China. Consumer sentiment is not showing any particular sign of concern, and indicators remain relatively stable.

## Outlook still solid for Q2 2019

Our baseline scenario for the Swiss economy remains reasonably optimistic, following the sharp economic upturn in Q1 2019. Global economic conditions surprised on the upside in Q1. The Eurozone and Germany rallied in the wake of GDP growth exceeding +3% in the US, and while many experts may prefer to remain cautious, lowering their global growth outlook for 2019 in light of the wrestling match that is dragging on between Donald Trump and the Chinese president, we are maintaining our economic forecast for the next few months. Over the past several months, our economy was able to rely on more sustained demand from other economic regions and on resilient domestic activity. The economic upturn in the euro area must nevertheless take firmer hold if the uncertainty stemming from the sudden drop in the German economy at the end of the year is to be dispelled.

We believe that the outlook for Q2 2019 will improve, boosting demand for Swiss products and services. Nevertheless, uncertainty remains high in the absence of a trade agreement between China and the US. This issue now seems more problematic. Indeed, while it remains in everyone's interest not to let the current situation degenerate into a total, open trade war, we think it may be difficult to reach an agreement in the near future given recent mounting tensions.

The current context is not particularly favourable to the Swiss franc, which is fairly unlikely to appreciate against the US dollar. A relatively stable exchange rate should benefit Swiss foreign trade. In addition to exports, domestic demand will also likely continue to trend upward, and consumption will likely strengthen somewhat in 2019 and grow a little more dynamically.

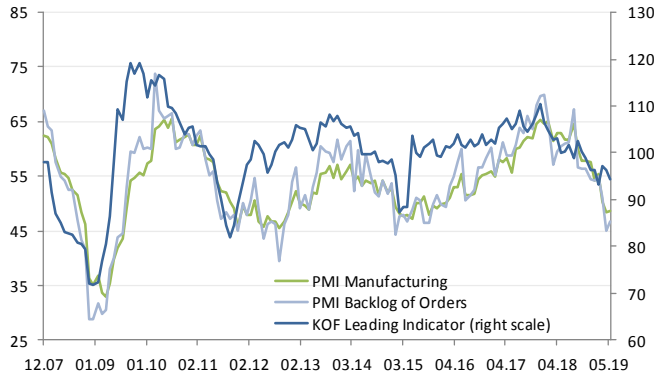
**In this context, we maintain a GDP growth outlook for Switzerland of +1.5% for 2019.**

## Leading indicators no more optimistic in May than in April

The KOF leading indicators continued to fall in April and May 2019, despite a promising upswing in March. The KOF economic indicator slid further in May from 96.2 to 94.4, dragged down by negative overall trends in most sub-indices, with the notable exception of the construction sector. This downturn has now lasted for over eighteen months, although the performance of the KOF indicator has not entirely correlated with that of Swiss GDP over the same period. The manufacturing PMI slid under its growth threshold in April, dropping to 48.5 points. It remained basically unchanged in May (48.6), which is well below the 64.6 level reached in August 2018, and now constitutes a significant source of

concern in terms of Swiss manufacturing. Leading indicators, which have been trending downwards for the past few months, are for now running counter to actual economic results. Indeed, for several months they have been pointing to an economic slowdown, which has not been substantiated by recent activity.

**PMI – KOF**



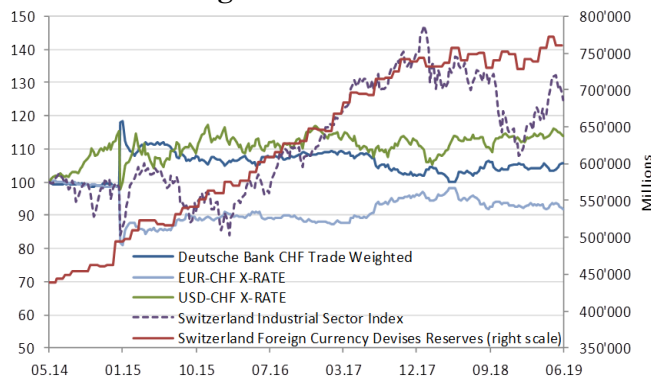
Sources: Bloomberg, BearBull

Indeed, industrial output has resumed, posting growth of +3.7% in March.

**Low likelihood of Swiss franc appreciating significantly**

The Swiss economy once again grew faster than the Eurozone’s in Q1, expanding by +0.6% vs. the +0.4% progression posted by its close economic partners. This small difference in growth rates has not yet become an adjustment factor with regard to the exchange rate, even if it would tend to favour a stronger franc. Nevertheless, the economic upturn in the euro area is reassuring, although it remains particularly fragile in the absence of a clearer reversal in industrial output, down a further -0.6% in March. The yield spread on 10-year German Bund and Swiss government rates narrowed abruptly between March and April, from 0.4% to 0.2% today, due to the sharper decrease in yields in the Eurozone. Nevertheless, this contraction did not affect the euro/franc exchange rate, which fluctuated around 1.13, in a narrow range between 1.116 and 1.145.

**Exchange rate and SNB reserves**



Sources: Bloomberg, BearBull

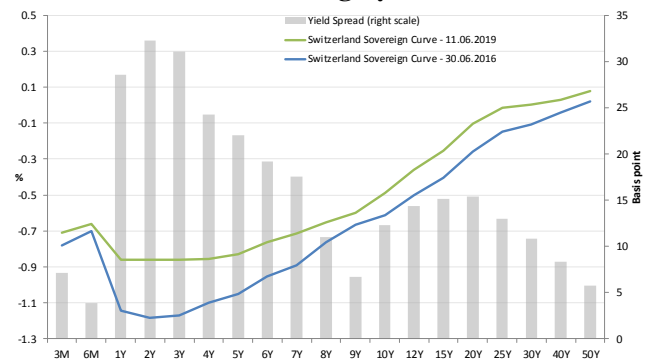
We continue to expect that any further weakening of the franc will depend on the relative economic performance and interest rate spread between the franc and the euro. We continue to think that the SNB will not raise rates as quickly as the ECB, which does not seem likely to happen in 2019. In the meantime, the exchange rate will likely stabilise between 1.12 and 1.17 against the euro. As for the US dollar, the rate spread and growth differential remain positive factors for the dollar. While this state of affairs is not new, it could be sufficient to further bolster trends favourable to the dollar.

**Long-term interest rate trends still atypical**

The rate markets manifestly do not want to be convinced that the global economy is not headed for a major slowdown. The generalised fall in yields, which continued in Q2 2019, is also affecting Switzerland, whose 10-year government yields fell from 0.1% in October 2018 to -0.5% in May.

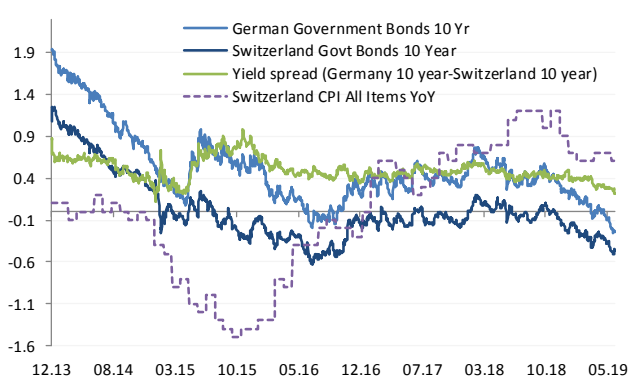
This situation seems to be calling into question the normalisation of long-term rates in Switzerland, which had started in the summer of 2016, even as growth is accelerating in our country. While the decline in inflation certainly drove the recent decrease in yields, we think the latter is not consistent with current favourable economic conditions.

**Swiss sovereign yield curve**



Sources: Bloomberg, BearBull

**10-yr EUR-CHF yields**



Sources: Bloomberg, BearBull

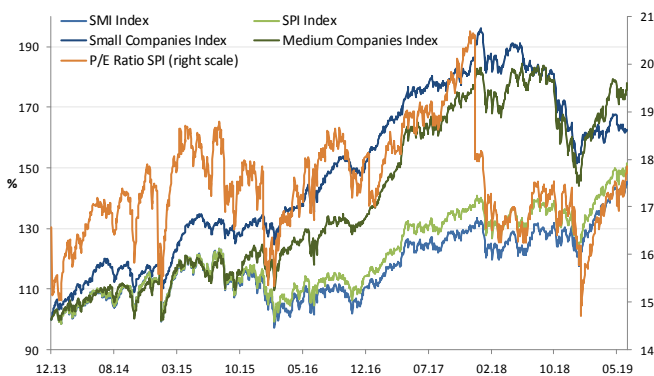
## Euphoria in the Swiss equity market

At the end of the year, following the sharp correction in the Swiss equity market, we noted that, barring a marked slowdown in global growth in 2019, the outlook for Swiss equities was favourable, in particular with regard to SPI stocks and to small and mid caps, which had been particularly impacted by the recent increase in volatility. The beginning of 2019 will have been as extraordinary as the end of 2018 for equity markets overall and for the Swiss market in particular. The correction of close to -10% of the SPI rapidly gave way to a spectacular rally of +22% in four months. Panic thus gave way to euphoria. The fall in international equities in May (-5.8%) did not impact the Swiss market (-1.7%), which reached new heights in June given the economic upturn as well as rather generous equity valuations. Negative yields in Swiss franc rate markets also contributed to this enthusiasm for equities, but we recommend adopting a more defensive strategy following the uninterrupted increase in share prices since the beginning of the year.

## Temporary correction of securitised real estate

Securitized real estate remains an attractive alternative to Swiss franc fixed income investments, but recent momentum is likely to stall in the short term. As expected, prices are consolidating temporarily following the increase in premiums (approximately 25%) as the supply of new investment vehicles arriving in the market over the next few months will momentarily rise. We continue to recommend a temporary reduction in the allocation to Swiss real estate investment funds.

### Swiss equities



Sources: Bloomberg, BearBull

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