

ECONOMIC RESEARCH – February 2025

INVESTMENT INSIGHT

SWITZERLAND



- ✓ Franc now expected to weaken against the euro
- ✓ Reappearance of limited opportunities for Swiss Bonds
- ✓ More attractive outlook for small caps

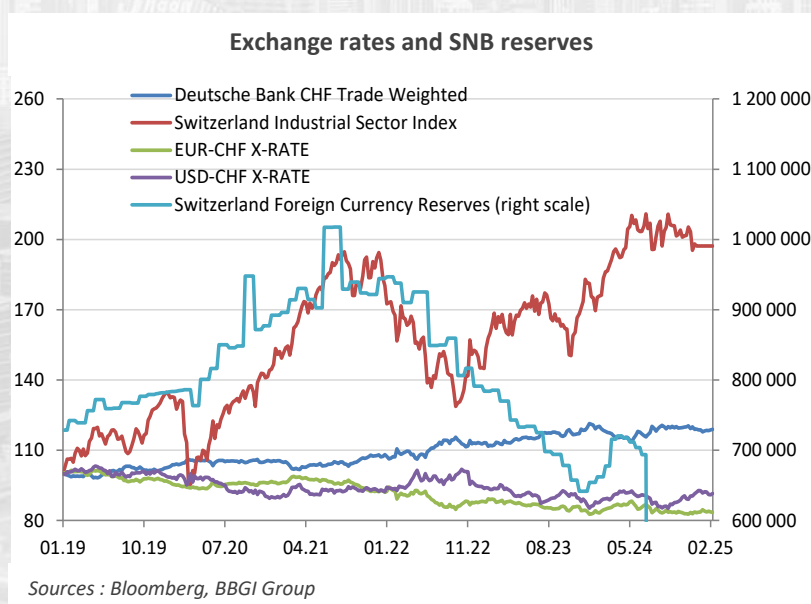
ATTRACTIVE OUTLOOK FOR SWISS SMALL CAPS

A shifting exchange rate landscape

The Swiss franc is poised for a new phase of weakness, particularly against the euro. Despite its traditional role as a safe-haven currency, the SNB's accommodative monetary policy is a powerful counterbalance. The franc has already met our target of 0.92 against the US dollar, but the more significant movement is expected against the euro. We anticipate the euro will appreciate by around +5% against the franc, potentially reaching parity later this year, breaking the long-standing consolidation around 0.94.

A new phase for bond yields

Following two years of declining inflation and key rate cuts, Swiss long-term government bond yields dropped to as low as 0.22% in December. This created an environment where capital gains were minimal, offering little incentive for new investments. However, recent profit-taking has pushed ten-year yields back up to around 0.6%. This new level, while still low, marginally improves the attractiveness of holding Swiss bonds. While we advise a cautious approach with rigorous duration management to mitigate the risk of rising interest rates, a further rate cut by the SNB to 0% or even below could once again encourage investors to move into longer-term positions in search of higher yields.



Attractive valuations and growth

After a strong performance in 2024, Swiss equities are attracting renewed investor interest, particularly due to their more attractive valuations compared to their US counterparts. The SNB's recent policy decisions and the franc's weakness have provided significant tailwinds for the stock market. However, the SMI, having already risen by +12% since the start of the year, may see its strong momentum weakened. Conversely, Swiss small and mid-caps, which have not yet had such a strong run, present a more compelling opportunity.

Small caps poised for outperformance

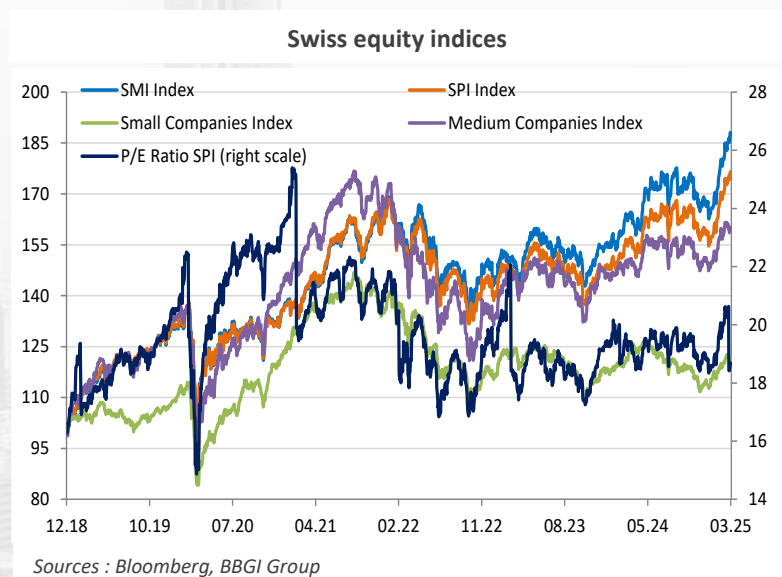
The disparity in performance between large and small caps is notable. The SPI small-cap index is still 5% below its May 2024 peak and has only gained +5.2% since the start of the year, lagging behind the large caps. The divergence in earnings prospects is a key factor. Small-cap earnings are estimated to grow by an average of +20% for the year, which is double the expected growth for SMI stocks. This strong growth potential is likely to drive a rotation of capital from large-cap "blue chips" toward smaller companies, offering better returns for investors.

Favoring small and mid-caps

In the current environment, we find the valuation levels of Swiss equities to be attractive on an international scale. However, within a Swiss equity portfolio, we recommend a strategic overweighting of small and mid-caps. Their more favorable earnings growth prospects make them a superior investment opportunity compared to the large-cap stocks that have already seen a substantial run-up. Investors should consider shifting their focus to these smaller, more dynamic companies to capitalize on this expected rotation.

SNB's influence on bonds and equities

The SNB's monetary policy is a pivotal factor shaping investment decisions. While the rate cuts have already driven down bond yields, the possibility of a further cut to zero or below could trigger a new wave of demand for bonds, flattening the yield curve. Simultaneously, the SNB's actions have made Swiss equities more attractive, particularly the small caps, which stand to gain from improving domestic conditions and more favorable valuations. The interplay between these policy decisions and market reactions underscores the importance of a nuanced, agile investment strategy that can adapt to both monetary policy shifts and evolving geopolitical dynamics.



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