Investments - Flash

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USD YIELDS OFFER A 3 TO 5% PREMIUM

Free lunch for a Swiss investor?

The upward acceleration in US long rates provides an interesting opportunity in the likely context of an emerging recession and diminishing inflationary risks. Indeed, 10-year US Treasury yields offer a 4% return and investment grade corporate bonds have almost reached a 6% yield on similar maturities. The expected recession should certainly weigh on yield curves suggesting a significant additional potential capital gain of around +5-7% for a 100 basis point drop in yields.

If this prospect seems interesting for a USD-based investor, is it also interesting for a Swiss investor who does not want to bear a currency risk?

A decline in US interest rates would certainly be synonymous with a fall in the dollar and therefore exchange rate losses for a Swiss investor.

In order to capture the yield differential of around 300 bp (4% USD-1.1% CHF), it would then have to hedge this currency risk, the cost of which is estimated (without bank charges) at 4.3%, due in particular to the relatively flat yield curves.

At the current rate of CHF 0.9925 to USD 1, the 12-month forward exchange rate is 0.9515. It therefore seems clear that this is not a free lunch for the Swiss investor, who would lose the 3-4% yield premium he was hoping to capture.

The investor can still "bet" on an additional capital gain, which in this case will constitute the bulk of his or her net expected return in Swiss francs.

He may also choose not to hedge his position if he does not fear a significant decline in the dollar that would wipe out the yield premium and capital gain.