WEEKLY ANALYSIS

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SWISS FINANCIAL ASSETS ONCE AGAIN ATTRACTIVE

The economy stagnated in the fourth quarter. Recession risks remain low. The rebound in inflation does not appear to be sustainable. Monetary policy reversal delayed. Attractive bond yields. Positive outlook for equities.

Key points

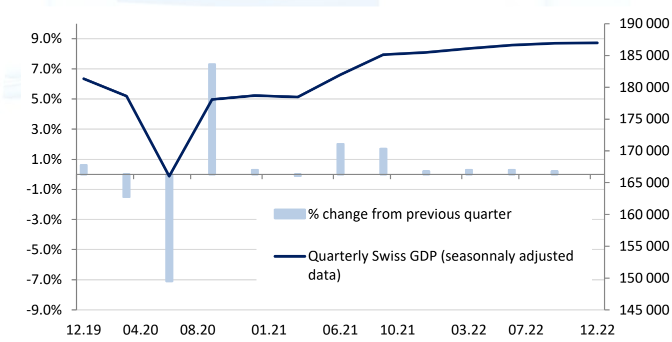
- Swiss economy stalls in Q4
- Outlook reduced to +0.7% growth in 2023
- Domestic demand supports GDP
- Leading indicators slightly more positive
- Inflation doubts reappear
- The SNB is expected to raise its key interest rates by 0.5%
- Spreads unfavorable to the Swiss franc
- Bond yields are once again attractive
- Positive outlook for Swiss equities

Swiss economy stalls in Q4

After a very slight increase of +0.2% in the third quarter, Swiss GDP stagnated in the fourth quarter (+0.0%). The Swiss economy thus slowed down at the end of the year under the pressure of a uncertain international environment. The manufacturing industry and exports are suffering from a more hesitant global economy. It is still domestic demand that is supporting GDP and enabling it to avoid a contraction. In 2022, the preliminary figures for Swiss growth suggest a slowdown in the solid growth recorded in 2021 from +3.9% to +2.1%. Taking into account the evolution of global inflation parameters, the evolution of restrictive monetary policies and the increase in financing costs in Switzerland and abroad, this 2022 GDP growth is still more positive than might have been feared. In the particularly difficult context marked in Switzerland by the negative impacts of the war in Ukraine and the rise of the Swiss franc, the Swiss economy may surprise by its relative stability. In our country, the economy seems to be much more resilient to the turbulence of all kinds that is appearing and threatening global growth. Since September 2020, the Swiss GDP will only have experienced a negative quarterly period of barely -0.1% in March 2021. The appreciation of the Swiss franc against the European currency in 2022 has been a significant brake on the development of Swiss exports to the euro zone. Switzerland is resisting the difficult international economic situation, but is unable to escape the effects of declining external demand. The result for the last quarter is part of a series of quarterly GDP developments close to zero that are still insufficient to maintain annual growth close to the historical average. This performance was below the expectations of economists' expectations who were hoping for a slightly better economy in the fourth quarter.

As far as we are concerned, we were expecting this economic slowdown at the end of the year, and the slowdown announced several quarters ago continues to materialize quite logically in our country. However, the domestic components remained relatively solid and were little affected by the rise in inflation. We will see below what the main components that have influenced the evolution of GDP in recent months have been, and what the detailed outlook is for the coming quarters in 2023. In 2022, the Swiss economy has nevertheless suffered indirectly from the tense situation in Europe, particularly in the energy sector. Some catching-up effects were seen in the service sector and in private consumption, despite the rise in inflation. The outlook for 2023 will be affected by a still uncertain international economic environment, leaving little chance for Swiss GDP to grow significantly beyond +0.7%.

Performance of the Swiss economy (GDP) in million CHF



Sources: Bloomberg, BBGI Group SA

Domestic demand supports GDP

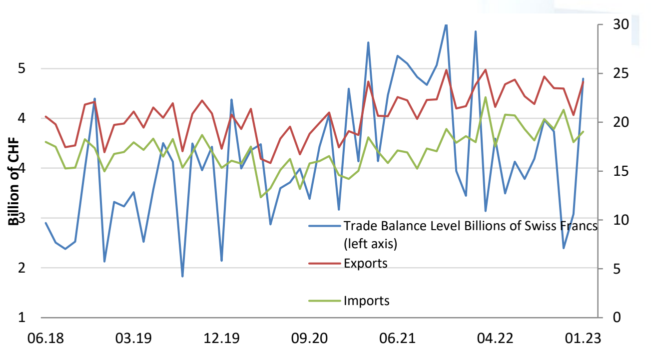
Despite an inflation level still above the SNB's target, domestic demand has actually resisted the negative effects of rising prices rather well. Final domestic demand grew by +0.5% in the fourth quarter, continuing the solid trend of the previous quarter. Growth was above average in capital goods investment (+1.7%), with vehicle sales in particular surprisingly strong thanks to improved supply chain conditions. Rising interest rates appear to have dampened the growth of construction investment (-0.5%). In particular, there was a sharper decline in the commercial segment, while residential construction held up well, resuming an upward trend after more than eighteen months of contraction.

Household consumption was still in decline compared to the previous two rather strong quarters (+1.4%, +0.7%), but it still remains positive with an increase of +0.3%, slightly below its average. Growth in the services sector was positive, while the retail sector grew modestly, resulting in overall trade growth of +0.4%. Public consumption also contributed positively with a similar increase of +0.3%. Retail trade benefited from increased spending on housing, energy, travel and food. The trade sector thus recorded a further significant increase of +2.3% and is emerging from a sequence of four consecutive negative quarters. The hotel and restaurant sector is continuing its post-covid recovery and has seen its value added advance by +1.5%, thanks in particular to the return of foreign tourists during the period under review, but is still well below (-5%) its 2019 level.

On the services side, the financial sector, unlike the other sectors, suffered a contraction of -2.5% after a fall of -4.4% in the previous quarter. In manufacturing, the tighter international situation had a negative impact in Q4, with the sector contracting slightly by -0.3%. The chemical-pharmaceutical industry, which was more stable, continued its growth of the previous quarter and was still ahead by +1.7%. In the other sectors, there was a fairly generalized decline, which led to a further fall in exports of around -0.9% (-5.9% in Q3), while imports contracted by -1-1%.

In January (+2.5%) the trend was positive, although down from the strong increase in December (+5.7%). Imports remained fairly stable during the same period, with increases limited to around +0.2%. The Swiss trade balance thus recorded one of its best results with a surplus of 5.08 billion francs in January 2023.

Trade balance, Swiss imports and exports

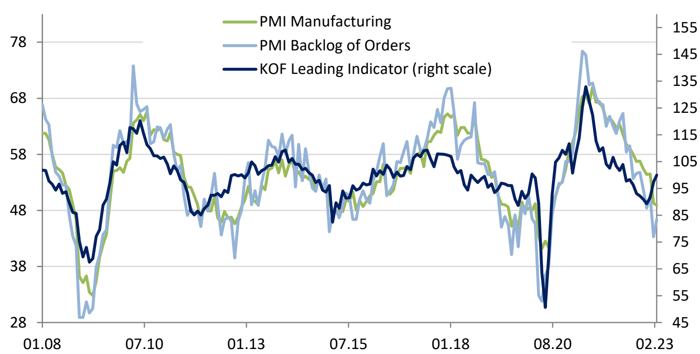


Sources: Bloomberg, BBGI Group SA

Leading indicators slightly more positive

At the beginning of 2023 the leading indicators offer some more positive signs. The KOF economic barometer has recovered somewhat and in February returned to its historical average of 100 after three consecutive months of increases. It reversed the downward trend that began in the spring of 2021 and rebounded significantly from its lowest level since 2015, excluding the pandemic in the second quarter of 2020. The rebound in the KOF leading indicator contrasts positively with the perceived risks and suggests a welcome improvement in the outlook for Switzerland. Activity in the manufacturing sector finally seems to be improving and is making a significant contribution to this result, but data in the consumer, export and financial segments are also developing favorably.

PMI and KOF indicators

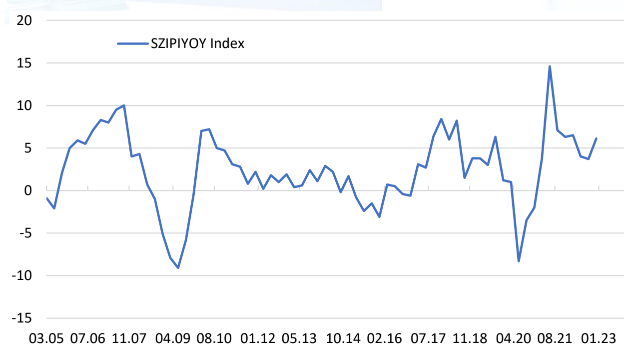


Sources: Bloomberg, BBGI Group SA

In the manufacturing industry, the situation is considered positive, particularly with regard to the evolution of order books and the competitive situation. But the manufacturing PMI indicators are not yet improving, as suggested by the latest drop to 48.9 in February. Consumer confidence published by SECO, however, suggests an improvement in sentiment, which has also rebounded from its extreme lows in December (46.5) to -30.2. The picture is also positive in the CS survey, which shows a very strong improvement in the perception of economic prospects in the rebound of its indicator from -40 to -12.3 in February.

Overall, the leading indicators remain uncertain and do not yet point to a clear economic recovery in our country, although retail sales were slightly less negative in January (-2.2%) than expected and industrial production in December was up +6.0% in Q4 2022.

Industrial production



Sources: Bloomberg, BBGI Group SA

Inflation doubts reappear

The recent evolution of inflation in Switzerland surprised observers in January and February. The monthly increase of +0.7% in February largely surprised economists (+0.5%), who were expecting a further decline in the CPI index to +3.1% (+3.3%). The increase to +3.4% thus turned out to be stronger than expected. The surprise came from rising airfares, travel prices, gasoline and rents. Inflation excluding food and energy came in at +2.4%, significantly exceeding the SNB's target for the first time.

However, the benchmark rent rate for lease contracts has remained unchanged at 1.25%, which should limit the contribution of rents to a future rise in inflation. The evolution of the Swiss franc against the euro and the dollar has not had a significant specific impact over the last two rather stable months, with the franc depreciating by -1.95% against the US dollar and by -0.6% against the euro. The currency factor has thus not contributed to containing price developments in our country over the past few months. The monthly inflation rate, which was around +0.7% until June 2022, had dropped to 0% per month by the end of December, giving rise to expectations of a significant improvement in price indices for the first half of 2023. The last two statistics published in January and February will logically rekindle uncertainty and the perception of the risks of a resumption of inflation.

In terms of producer prices, the situation has remained more favorable, as since the June peak of +6.9%, they have in fact slipped further in recent months on a year-on-year basis, falling to +3.3% at the end of February, and thus no longer represent the same threat to companies. We believe that this development should help companies to control their costs and margins. The stabilization of producer prices allows us to project a more positive outlook for consumer prices.

In national comparisons, Swiss inflation remains well below that of the UK, the eurozone and the US, which are also following a similar trend to Switzerland in terms of inflation regime. We expect the expected economic slowdown to ease price pressures as the effects of lower agricultural commodity prices in particular begin to work their way through the value chain and into consumer prices, contributing to a further decline in inflation. On the other hand, a warmer winter has averted the scenario of a gas supply crisis, which should also allow energy prices to fall.

The SNB is expected to raise its key interest rates by 0.5%

Since the SNB's change in monetary policy on June 15, 2022, the Swiss central bank has been more focused on its historical primary objective of ensuring price stability in Switzerland than on steering the Swiss franc. An appreciation of the franc is now even considered favorable to the implementation of its inflation control policy. It has been acting with some firmness since June 2022, raising its key rates from 175 bps to 1% in December. It is likely to raise its key rates by a further 0.5% on 23 March at its next meeting, to 1.5%. It is also likely that it will decide on another similar increase in June to reach the 2% level that corresponds to its inflation objective.

However, the latest inflation figures for February could raise fears of a higher resilience of inflation and push the SNB to act more significantly in March by raising the rate by 0.75%. However, we believe that the trend remains sufficiently uncertain for the SNB not to take an immediate risk of tightening too severely, which could prove to be excessive when economic growth is now at a standstill in Switzerland. In our opinion, the SNB should stick to its policy of a 0.5% increase and postpone the moment of the next inflexion.

Spreads unfavorable to the Swiss franc

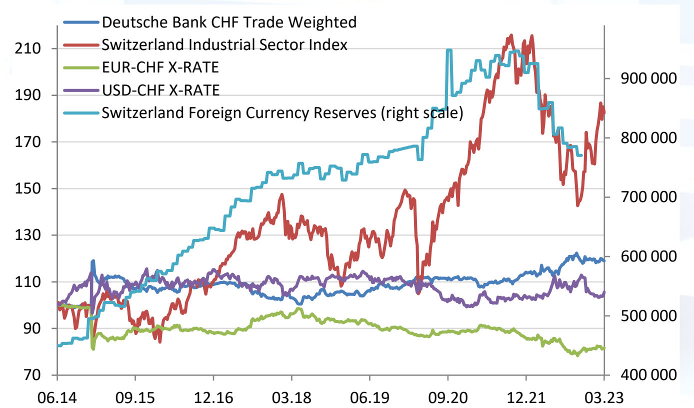
In most countries, monetary policies remain on the rise. The next rate hike by the SNB, but more likely the next two sequences of rate hikes, will not be superior to those implemented in the coming months by the FED, the ECB or the BoE. In particular, we believe that the SNB will not follow the same path of rate hikes as the ECB, which is facing a more dramatic inflation situation than Switzerland. The interest rate differential between the two currencies is therefore likely to increase permanently in favor of the euro.

At present, the yield spread between the two-year federal government bond and the German Bund is still around 110 basis points, whereas it was close to zero at the beginning of the year. This observation is similar at the various points of the relative yield curve. It should also be noted that, compared to the situation in 2015, the current level is even higher than the one that allowed the euro to rise from 0.97 to 1.20 in three years. The franc should therefore weaken again against the euro.

CPI & PPI -Switzerland

Sources: Bloomberg, BBGI Group SA

Exchange rates and SNB reserves



Sources: Bloomberg, BBGI Group SA

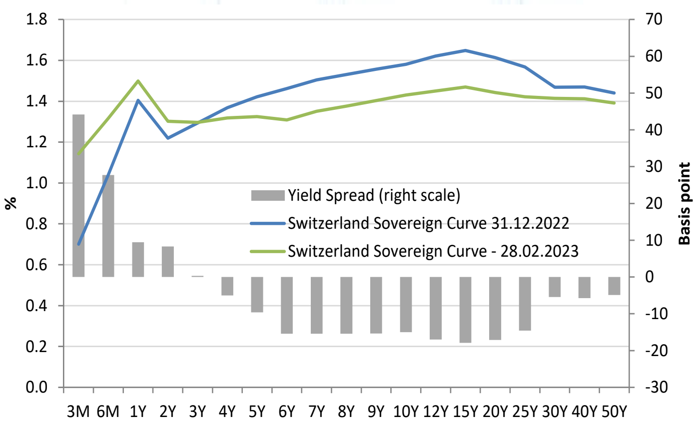
Bond yields are one again attractive

The correlation remains high between the capital markets, which still fluctuate to a large extent in tune with US economic statistics and the Federal Reserve's monetary policy expectations. The Swiss market is no exception to this correlation, as are other markets. Despite different economic cycles and different monetary policies, the less favorable than expected evolution of inflation in most countries has rekindled uncertainties regarding monetary policies.

In Switzerland, too, the January and February inflation figures have rekindled speculation that the SNB will tighten its policy. While expectations were previously more moderate and supported by monthly inflation close to zero, the adjustment since then has caused a 50 bp adjustment in yields on most maturities. While the SNB's policy rate expectations are now at 1.5%, both the two-year federal government yields and the 10-year bond yields have also reached 1.5%.

We had already announced that the sharp rise in the Swiss yield curve at the end of the year seemed to us premature given the Swiss economic context and the prospect of a reduction in inflationary pressures in 2023. At the time, we saw these yield levels as opportunities for Swiss investors who had been deprived of them since 2014 if inflation remained on a downward trend. Today, the projected increase in key rates for the first half of the year from around 1.5% to 2% is already close to the observed level of the entire government yield curve. We believe that rates have therefore reached a likely level of stabilization in the context of the current economic slowdown and an upcoming decline in inflationary pressures. In this context, Swiss bonds offer attractive new prospects.

Confederation's rate curve



Sources: Bloomberg, BBGI Group SA

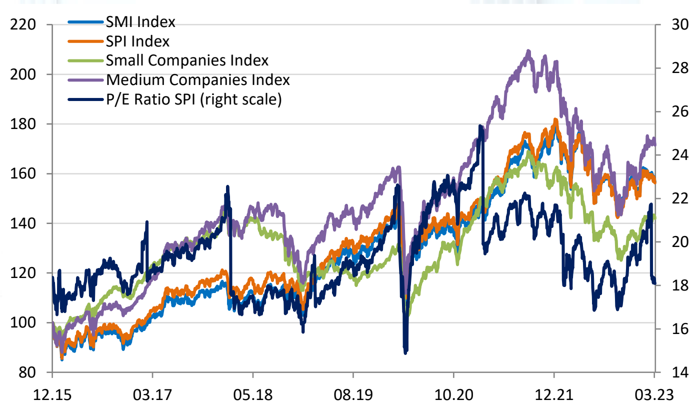
Positive outlook for Swiss equities

Equity markets have been particularly sensitive and even highly correlated to the evolution of monetary policies and interest rates in 2022. Recent fears of an upward revival of inflation in our country and its effects on yield curves have had relatively limited impacts on equity markets to date. The rise in 10-year rates by more than 100 bps in seven months has not caused any further correction in Swiss equity indices.

The recent rebound in rates in February did not sufficiently affect investors, who took this factor into consideration in relative calm. After a very substantial price recovery in the fourth quarter and a further rise in January, the February correction is therefore rather limited. It would seem that the rate hike is not a decisive factor, but rather a reason to take profits after a +13% uptrend for the SMI. Technical factors could soon revive the uptrend as the SMI tests its 100-day average. On the fundamental side, the prospect of a rising euro/CHF exchange rate should support the financial results of Swiss companies in 2023 and support their share prices.

However, the latest rally has put the Swiss market back in the group of relatively expensive markets in terms of PE for the year 2023. With a PE of 16.2x, the SMI is just below the S&P500 (18.3x) and significantly above the CAC40 (12.5x), the Dax (11.9x) or the FTSE (10.5x). If the international stock market climate were to improve after an only temporary upturn in inflation and interest rates, Swiss stocks, often considered as more defensive stocks, could well be abandoned in favor of others, in particular growth stocks, once again supported by the expected easing in bond yields. However, the Swiss market still has a positive expected return for the coming months.

Swiss Equity Indices



Sources: Bloomberg, BBGI Group SA

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