

Weekly Analysis

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OUTLOOK FOR SWISS EQUITIES REMAINS POSITIVE

No recession in Switzerland. Worrying leading indicators. Falling exports. Inflation stumbles over the 1% threshold. Rate cuts in line with our expectations. Limited weakness of the franc. Long-term rate target achieved. Positive outlook for the SMI.

Key points



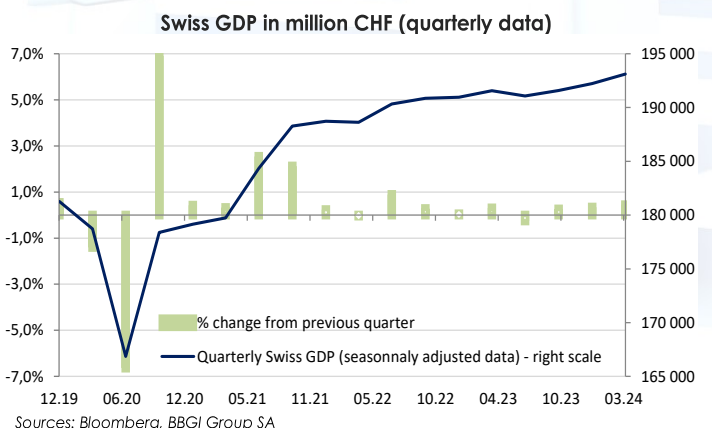
- The Swiss economy is moving at a slow pace
- Swiss exports plunge again
- Leading indicators more worrying
- Inflation currently stalling at +1%
- SNB cuts rates according to our schedule
- One should probably not bet on a too weak franc
- Target rate achieved for Confederation long rates
- Outlook for Swiss equities remains positive

The Swiss economy is moving at a slow pace

The Swiss GDP growth figures for the 1st quarter have just been published, showing once again the resilience of our national economy in a still very hesitant international environment. At the start of the year, the Swiss economy once again grew by around +0.6%/year, demonstrating the astonishing regularity of the country's dynamic. At the end of the year, three-month growth had already reached +0.3%, so the slowdown in the USA and virtual stagnation in Europe did not really penalize our economy's performance at the start of the year. It's true that the GDP growth announced by SECO is in line with a below-average growth trend, but it has been on the order of +0.3%/quarter for the past two years, with the exception of the temporary halt in June 2023, when it fell by -0.3%. The Swiss economy has thus been able to maintain its pace of growth, even though the manufacturing sector seemed to be suffering logically from the strength of the franc. The restrictive monetary policy pursued by the SNB had largely benefited the franc at the end of 2023, certainly making it more difficult for certain sectors to adapt to this factor, even though domestic and international demand seemed to be slowing down. Swiss GDP had grown by +1.3% in 2023, but the Q1

result suggests that 2024 will undoubtedly be more difficult. Since Q2 2020, at the height of the Covid crisis, Switzerland has remained on an upward trend, recording only one quarterly decline in June 2023. That said, Swiss momentum remains penalized by declining global demand and an excessively strong Swiss franc until early 2024. The manufacturing sector is still very much affected, but recently seems to be recovering a little and benefiting from Q1 developments on the exchange rate and interest rate fronts. The service sector still seems to be doing relatively better, as is household consumption.

In the manufacturing segment, value creation fell slightly in the 1st quarter (-0.2%), mainly under pressure from the chemicals and pharmaceuticals sector (-0.9%), which continued the slight downturn already seen in recent quarters. In the other industrial sectors, value added remained broadly stable. The construction sector recorded a slight improvement (+0.3%), thanks to higher sales in the building and civil engineering sector; the trend in construction investment was slightly less favorable (-0.2%). The energy sector (+2.1%) was the only industrial branch to record solid growth; energy exports also increased. Overall, value creation stagnated in the industrial sector, and the outlook for the 2nd quarter does not appear to show any reversal of this trend. For its part, the service sector fared better and strongly supported GDP growth in Q1, albeit with some heterogeneity between branches.

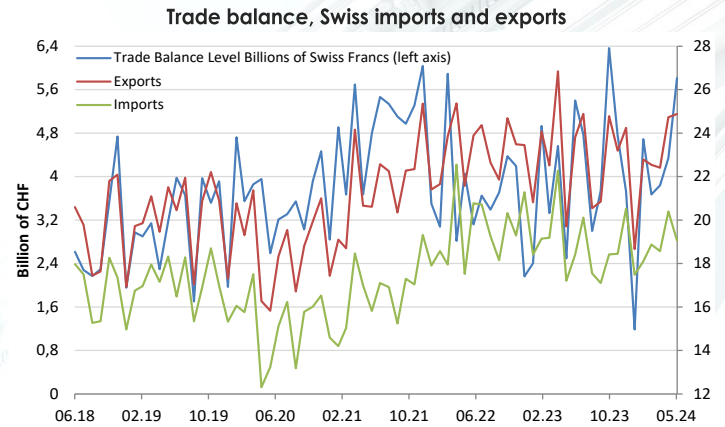


Financial services (-0.2%) posted a slight decline, which was also observed in business services (-0.3%). The transport and communications sector remained unchanged, while freight transport, in particular, grew moderately due to sluggish industrial activity. On the other hand, value creation was close to its historical average in the hotel and catering (+1.3%), health and social (+0.8%) and public administration (+0.2%) sectors. On the other hand, above-average growth was recorded in retail (+1.4%), contributing to the positive trend in trade as a whole (+1.3%). Echoing the growth in retail trade, private consumption showed robust growth (+0.4%), driven in particular by spending on food and non-food products, as well as on housing and health. Government consumer spending also rose slightly (+0.2%). Finally, final domestic demand (+0.4%) benefited from the positive impetus provided by capital goods investment (+0.8%), which returned to growth after three negative quarters. Investment was particularly strong in vehicles, information technology and research and development. Growth in domestic demand also led to a significant rise in imports (+2.0%) of goods and services in Q1. Exports of goods (-3.3%), on the other hand, declined, mainly due to the negative trend in transit trade. Exports of services (+1.0%) rose slightly. Overall, foreign trade made a negative contribution to GDP growth. Unsurprisingly, the franc was particularly strong in Q4, rising +8.07% against the US dollar and +4% against the euro. Against this particularly difficult backdrop for Swiss exporters, the economy performed well.

At the start of the year, we were of the opinion that the Swiss economy was extremely weakened by the strength of the Swiss franc and the growing risk of a downturn in exports. Now, with the weakening seen in the 1st quarter, this variable should become more neutral. While the consensus forecast is for GDP growth of +1.2% in 2024, our forecasts are scarcely more optimistic (+1.3%), and depend in part on a continuation of the franc's weakness and on an international economic recovery in the second half of the year. However, recent weeks have failed to confirm these two factors, which for the time being point to a recovery in the Swiss franc and weakness in the global economy.

Swiss exports plunge again

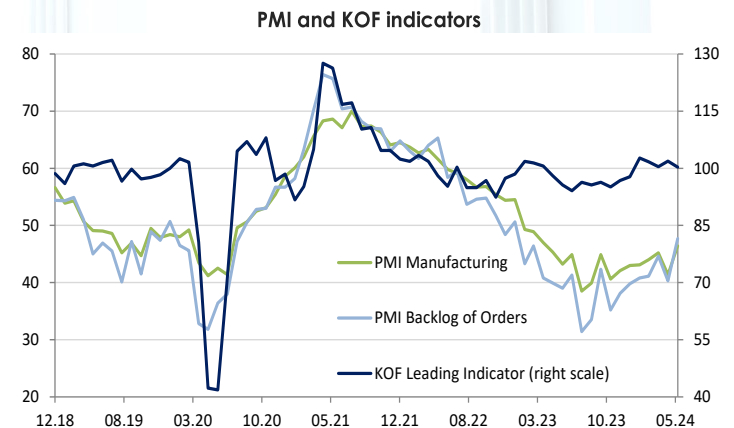
The franc had, fortunately, weakened in Q1 2024 after a particularly strong end to the year for the Swiss currency. In 2023, the trade-weighted Swiss franc had appreciated by +7.2% for the sixth year running, with the correction of around +8% against the dollar and +4% against the euro in Q1 restoring some balance. In recent weeks, despite the SNB's 1st rate cut, the franc has recovered slightly and will end Q2 with a modest rise. For the time being, these developments are insufficient to improve the competitiveness of Swiss industry. The foreign trade situation is feeling the pinch, with Swiss exports falling back in May by -3.5%, after having risen by +7% in April as a result of the franc's fall. The export sector is therefore struggling, as shown by international watch sales, which again fell by -2.2% in May. At the same time, imports recorded their sharpest contraction (-4.3%) since December 2020. The sharper fall in imports augurs well for the trade balance at the start of the year.



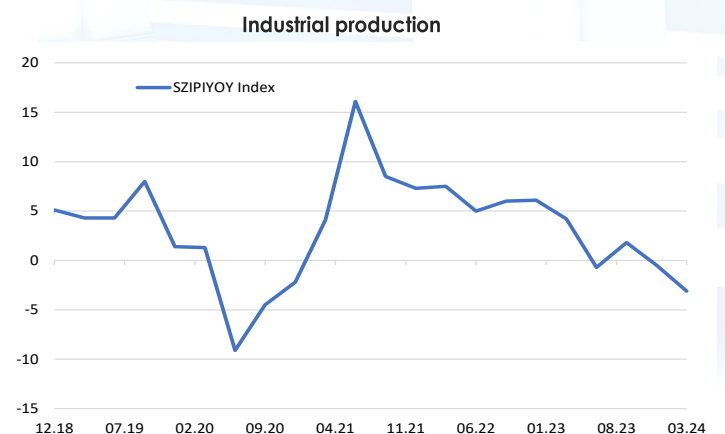
Sources: Bloomberg, BBGI Group SA

Leading indicators more worrying

The leading indicators published for the month of June show a further worrying deterioration in the services sector, while the manufacturing sector, which has already been struggling for some time, appears to be stabilizing slightly. Although this indicator is still not in a position to rise above the growth threshold of 50. The situation in industry remains problematic, but the deterioration in conditions in services is worrying and partly confirmed by a very low consumer confidence indicator. Finally, industrial production slipped back into negative territory at the start of the year, posting its worst quarterly performance (-3.5%) since Q3 2020. And yet, against this rather gloomy backdrop, retail sales advanced by +2.7%, posting their best increase since February 2022.



Sources: Bloomberg, BBGI Group SA

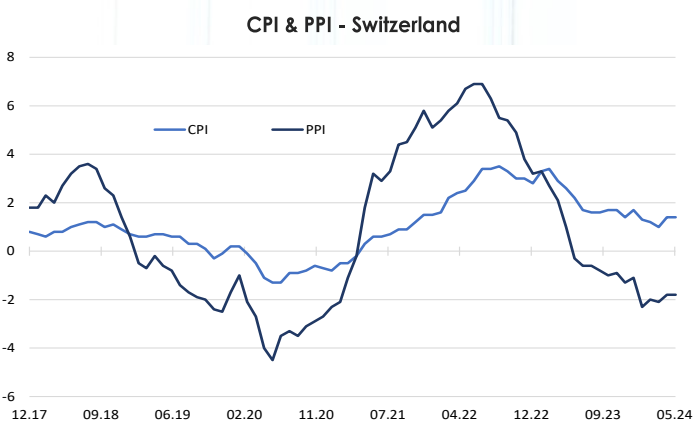


Sources: Bloomberg, BBGI Group SA

Inflation currently stalling at +1%

Swiss inflation rebounded slightly in April (+1.4%) from its lowest annual rise in March (+1%). In our opinion, the trend remains unchanged, having stagnated at this level for the past two months, with another small monthly rise of +0.3% in April, while core inflation remains well under control at +1.2%/year. These latest developments do not call into question the trend announced as early as July 2022 for a new, much more moderate inflation regime, which should rapidly bring inflation down to a reasonable level in our country. At the time, we suggested that a new regime would be in place by the 2nd half of 2022, which would be significantly lower than the one that prevailed during the first six months. We also suggested that price rises could be limited to +2.2%/year by June 2023, if our expectations of an average decline of around +0.2%/month were maintained for long enough. Since June 2023, and thus for almost four quarters, inflation has been below the SNB's 2% target. Inflation in Switzerland is following a favorable path, thanks in particular to the franc's resilience. Indeed, there is a correlation between a stronger franc and lower imported inflation.

The SNB lowered its key interest rates for the 2nd time in June, and remains the most active of the major central banks in managing inflation and growth risks. The SNB is no longer seeking to control prices through a strong franc, so it accepts a weak franc at the start of 2024, but does not want our currency to depreciate too quickly either. We expect Swiss inflation to remain on this trend for a few months yet, which could quickly translate into a year-on-year fall in inflation to just below +1%. The fall in the euro and dollar against the Swiss franc has undoubtedly helped to reduce the risk of imported inflation. Import and producer prices are also now under control.



Sources: Bloomberg, BBGI Group SA

The stabilization of producer prices allows us to project a more positive outlook for consumer prices. The expected global economic slowdown will ease pressure on consumer prices, allowing inflation to fall below the 1% threshold.

SNB cuts rates according to our schedule

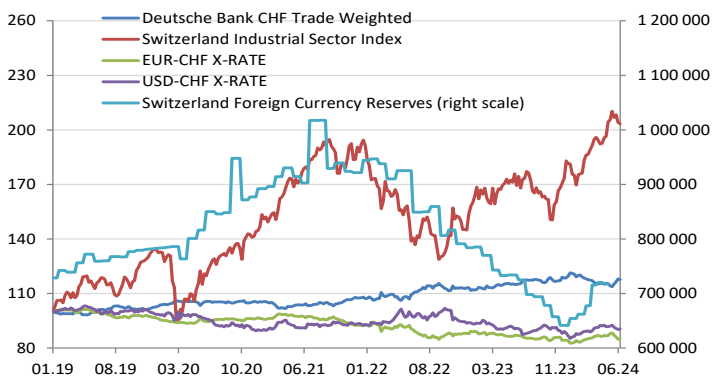
We expected the SNB to be the first central bank to change monetary policy in 2024, cutting its key rates for the first time in March. This is indeed what it decided to do, at a time when CPI

was hitting its lowest point of the year at 1%. After observing the sharpest fall in inflation among industrialized countries, the SNB finally took action and began a phase of normalizing its monetary policy. Up until now, the Swiss economy had weathered the SNB's interest-rate hike and the strength of the Swiss franc rather well, although the latter was increasingly threatening the industrial sector. Leading indicators in the manufacturing sector had already been pointing to the risk of a slump in activity for many months, but more recently it was the weakness seen in other sectors of the economy and services that was a growing source of concern. The SNB has not remained indifferent to the evolution of these risks for the economy in our country. It has therefore lowered its key rates twice now, by 0.25% each time, while at the same time relaxing its policy of supporting the franc. The policy of reducing the size of its balance sheet by cutting foreign exchange reserves, which had reached CHF 946 billion in January 2022 and had been drastically reduced by -32% in twenty-two months to CHF 641 billion, through sales of CHF 10 to 20 billion, had largely contributed to limiting inflation in our country. However, the level of foreign exchange reserves has now risen by +12.2% in just six months, reflecting further partial sales of Swiss francs, particularly at the end of the 1st quarter. In June, the SNB acted by cutting its key rates for the second time to 1.25%. In so doing, it is keeping pace with the adjustments we had planned and our timetable. We will now have to wait until September 26 to find out whether the SNB intends to lower rates again. Over the next three months, we believe that the evolution of inflation in our country should enable the Bank to confirm its opinion on the merits of the change in policy implemented over the last few months. In our view, however, a revival of the downward trend in inflation is a prerequisite for action by the SNB in September. However, a fall in the core CPI index, like the overall index, seems more difficult to achieve during the summer period, which should not easily allow the SNB to base its action on this prospect. The fact remains that the Swiss economic dynamic is not very solid, and that the risks of a slowdown in growth could become the next determining factor in the SNB's decision-making process. We believe that a further 0.25% cut remains likely at the September 26, 2024 meeting.

One should probably not bet on a too weak franc

The franc's strength certainly peaked at the end of December 2023, and the expected phase of weakness materialized as the SNB announced its change of policy. However, it is also likely that the Swiss rate cut will now follow a slower pace in international comparison, and in particular with the expected trend in key ECB and Fed rates. While Swiss rates could still be cut by 50 bps in the second half of the year, we believe that US rates could easily be cut by 100 bps by the Fed. Against this backdrop, it seems likely that the franc will remain weak, but we no longer anticipate a decline as significant as that envisaged at the start of the year. Nevertheless, the franc should weaken by 5 to 7% against the dollar and the euro.

Exchange rates and SNB reserves

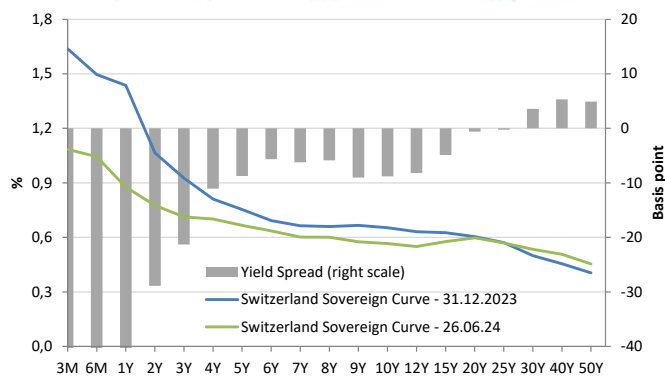


Sources: Bloomberg, BBGI Group SA

Target rate achieved for Confederation long rates

For two years now, inflation in our country has deflated to just under 1.15%/year for the month of May 2024. The downward trend predicted by BBGI for Swiss long-term interest rates has thus largely materialized over the last fifteen months, from 1.6% to just 0.6% today. Our forecasts for a decline in inflation and a change in monetary policy have also materialized, with the same expected time lag for SNB action. Our current expectations for ten-year rates are still 0.4% for the next low point in the current cycle, provided that Swiss inflation declines again and also approaches 0.5%/year in the coming months. That said, the recent movement has been very close to our forecast, probably already incorporating the 0.5%/year inflation outlook to a greater extent. The prospects of capital gains on Swiss franc bonds are therefore increasingly limited. Recent yield trends in Switzerland no longer offer much of interest.

Confederation rate curve



Sources: Bloomberg, BBGI Group SA

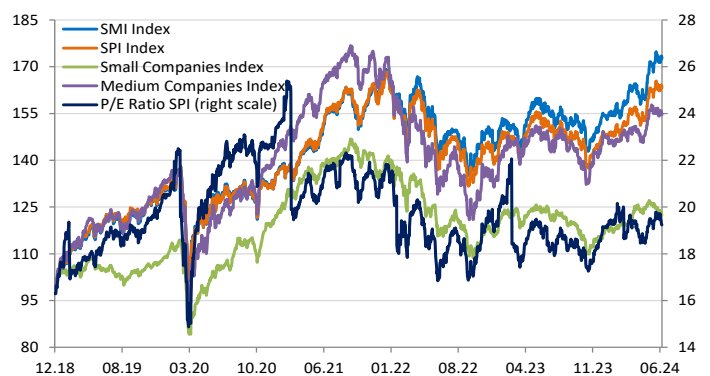
Outlook for Swiss equities remains positive

Swiss equities rose sharply in 2024, but despite an increase of +10%, they still lagged behind the performance of US stocks (\$S&P500 +14.5% in local currency), but were on a par with European companies (also +9% in local currency). The weakness of the Swiss franc in the 1st half of the year supported the Swiss stock market, but the Swiss franc-denominated results of other stock markets benefited from the currency effect. As a result, the Swiss market is still underperforming international equities in 2024, but to a lesser extent.

In the second half of the year, the Swiss equity market should gradually be supported by the impact of the franc's decline on Swiss companies' earnings, as well as by lower financing costs.

The decline in Swiss exports still reflects the difficulties posed by the relative strength of the franc for Swiss companies in the chemical-pharmaceutical and industrial sectors in particular, but this may finally change in the second half of 2024. The strength of the franc had weighed heavily on profit estimates expressed in Swiss francs, but the situation now looks less negative thanks to the expected evolution of SNB policy. Further key rate cuts and the end of SNB purchases of Swiss francs will help to weaken the franc. The latter should encourage a reassessment of earnings prospects and support the continuation of the current uptrend. The outlook for the Swiss market remains positive for 2024, especially for secondary stocks (mid caps and smaller), whose performance should outperform that of the blue chips.

Swiss equity indices



Sources: Bloomberg, BBGI Group SA

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