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Swiss equities have appeal

Market Comment, June 2020

The global economy may be having a tough year, but equity markets have calmed and are trending upwards. The dramatic further opening of the monetary floodgates by central banks and governments is creating a wave of liquidity that can flow into the real economy and/or the financial markets. Both of these things are likely to happen. Swiss equities and the Swiss franc have always been a byword for stability and historically attractive growth. In an international comparison, a stable political situation, well-positioned companies with healthy balance sheets and relatively stable profitability, and (in many cases) defensive characteristics make Swiss equities an appealing investment. What's more, Swiss equities currently find themselves in the unusual situation of being clearly more attractive on a price/earnings basis than the MSCI World Index.

We are all familiar with Switzerland's reputation as a haven of stability. This also extends to its economy, which has traditionally developed more smoothly than those of many other countries. This year, the coronavirus crisis is obviously weighing on the Swiss economy too, but the value creation of key sectors such as pharma and food can be expected to continue to benefit from robust global demand. Indeed, it could even be said that the coronavirus crisis has provided an extra tailwind for pharmaceuticals, as in many countries this industry is receiving a much greater inflow of funds than normal to develop the therapies and vaccines capable of combating the COVID-19 virus. What's more, growth here is not only robust but enjoying a structural rise – not least due to demographic developments. An increase in the number of elderly people as a proportion of the population also means more stable demand for the pharma sector, compared to the more cyclical sectors that are more dependent on the development of the economy in the short to medium term.

Switzerland is also a model of stability when it comes to currency development. For decades now, the Swiss franc has either remained stable or appreciated in value. The bandwidth of fluctuation – i.e. the volatility – of our currency is lower than that of other countries, such as the euro, for example, or numerous currencies of the emerging markets. One reason for this is an unusually high degree of political stability by international standards. This is all too clear when one compares the Swiss situation with the political tensions elsewhere in Europe, where the Brexit problem remains unresolved, or with the situation in the US, where domestic unrest and uncertainty tends to impact the US dollar – not to mention the political tensions between the US and China over Hong Kong and trade matters. In summary, Switzerland is politically much more stable than other countries, hence the franc is highly sought-after.

This raises the question of whether the franc's strength has historically resulted in unsatisfactory performance by Swiss equities. In fact, that is not the case. Even though the Swiss franc has appreciated against other major currencies by some 15% on a trade-weighted basis over the last 10 years, the Swiss stock market has risen by around 50% over the same period – even without factoring in the additional return generated by dividends.

> "Swiss equities are currently in the rare position of being more cheaply valued on a P/E basis than the MSCI World – for the first time in a decade."
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> Gérard Piasko, Chief Investment Officer

Generally speaking, Swiss equities have performed outstandingly in an international comparison. Since the end of 1989, i.e. over the last 30 years, Swiss equities (as measured by the MSCI Index Switzerland) have delivered a return some 330% greater than the MSCI World Index. Moreover, Swiss equities have clearly outperformed the German stock market (DAX), the Eurostoxx 50 (Eurozone) and emerging market equities. Only the US stock market has performed better – and we have long adopted an overweight stance in respect of US equities.

So what about this difficult 2020 stockmarket year? Once again, Swiss equities have (as at the start of June) outperformed the DAX, Eurozone equities, and emerging market equities. But why is that? "Swiss made" can and should stand for quality. And this quality is clearly reflected in the long-term growth of Swiss equities, as attested to above. But where does this quality come from? In an international comparison, the Swiss stock market contains a number of companies that boast stable income streams, attractive profitability and robust balance sheets. Many of these companies are among the market leaders in their sectors, which gives them promising long-term growth prospects.

The high proportion of companies from historically defensive sectors is also often an advantage. By defensive we mean sectors/companies that are less cyclical, i.e. less dependent on whether the economy is performing well or badly at any particular time. Companies of this kind therefore typically exhibit a beta of below 1 (or below 100%), i.e. they are less sensitive to market movements and the general development of global equities. This in turn means that their stock prices are typically subject to less fluctuation, i.e. lower volatility – no bad thing in an era of uncertainty.

Finally, it is worth looking at the current valuations of Swiss equities relative to other equity markets and indeed bonds. Compared to Swiss government bonds, which are historically expensive, the long-term valuation is attractive. Compared to other equity markets, the current relative valuation is very interesting right now. The price/earnings (P/E) ratio of Swiss equities (MSCI Switzerland) has historically tended to be high when measured against the P/E ratio of the MSCI World Index – after all, quality generally has its price. At the moment, however, the Swiss stock market is in the rare situation of trading at a relative discount to this global index containing shares from all countries. In other words, Swiss equities are more cheaply valued than those of the MSCI World, which has not been the case for a decade.

Gérard Piasko

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