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Swiss stocks follow global declines – what to do next?

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Swiss stock markets had a difficult return from Swiss National Day, falling 2.7% at publication. What to do now?

Swiss stock markets followed global markets lower after a day's closure for Swiss National Day. The SMI (Swiss Market Index) declined 2.7% at the time of writing on 2 August. The move follows a 1.4% drop in the US S&P 500 Index, a leading barometer of US shares, on 1 August, and declines in US 10-year government yields below 4% for the first time since February.

These "risk-off" moves of falling stocks and Treasury yields arose after weak US economic data that raised some investor fears of a US recession. Weekly initial jobless claims, a measure of US unemployment, rose to its highest level in nearly a year. And a well-watched sentiment survey for the US manufacturing sector, the ISM, fell to 46.8 in July (versus 48.8 expected and well below the 50 level separating expansion and contraction). That's the lowest it's been since November 2023, while the employment gauge in the release hit a low last seen during the height of the pandemic in June 2020.

What's the context?

The market downturn followed a 1.6% rise in the S&P 500 on Wednesday, driven by excitement about AI and increased capital expenditure by top technology firms. The Federal Reserve also hinted that it might cut interest rates as soon as September thanks to falling inflation and greater risks to the jobs market. However, Thursday's market moves showed that investors are worried the US economy might be slowing down too quickly. Now, markets are expecting three US interest rate cuts in 2024, up from two last week.

The consequences of AI spending and falling US inflation may seem limited for Swiss stocks at first glance. But as the largest economy in the world, US developments have a significant bearing on global markets, including Switzerland.

Today's financial markets are highly interconnected. When the US market experiences choppy moves up or down, it often leads to similar reactions in other markets, including Switzerland. Investors around the world react to US economic data, which can lead to global market movements.

US economic data also influence overall market sentiment. If investors are concerned about the US economy slowing down, they may become more risk-averse, leading to sell-offs in various markets, including the SMI.
Given its strong trade relationships with Switzerland, fears of a US recession may weigh on investor appetite for Swiss exporting companies, particularly in sectors like pharmaceuticals, machinery, and watches.

If fears of a US recession lead to falls in US interest rates and US Treasury yields, that can influence the borrowing costs of other countries and the companies and consumers working in them. Switzerland, as a small and open economy, is sensitive to such changes.

US data releases can also affect currency exchange rates. For example, if the US economy shows signs of weakness, the US dollar may weaken against the Swiss franc. The Swiss franc, or CHF, may gain against other, more growth-sensitive currencies given the perception that the CHF is a so-called "safe haven." These movements can impact Swiss companies that export goods to the US, as a stronger franc makes Swiss exports more expensive.

What does this mean for Swiss investors?

Weaker US economic data have made investors jittery and more fearful that the US could enter a recession. We believe these fears are premature.

While all eyes will fall on today's US jobs report and data on nonfarm payrolls, wages, and unemployment, we argue that the softer labor releases reflect cooling rather than recession. Weekly jobless claims were also affected by a hurricane in Texas, potentially making the data appear worse than it seems. Recent prints show the US economy is still growing, with the Atlanta Fed GDP tracker indicating a 2.5% rate of expansion. The Federal Reserve has also indicated that it has the flexibility to support the economy if needed.

We think the US is headed for a soft landing, not a contraction. This justifies two interest rate cuts this year, rather than the three that the market is now expecting. We would need to see more signs of weakness before changing our view.

What can Swiss investors do in their portfolios?

After a smooth rally until mid-July, US stock markets are now becoming choppier as we forecast in our second half outlook.

The approaching Fed rate-cutting cycle, ongoing scrutiny of AI developments, and rising political uncertainty ahead of the US presidential election in November mean Swiss investors should prepare for renewed volatility, but avoid overreacting to short-term market changes, in our view.

Against this backdrop, we advise Swiss investors to consider these strategies:

Seek quality growth: Focus on investing in companies with strong competitive advantages and consistent growth. Many Swiss companies offer such attributes in fields where Switzerland is especially competitive. These companies are likely to continue performing well, in our view. We also see merit in looking at quality Swiss companies that pay high, sustainable dividends with the potential to grow such shareholder returns over time.

Position for lower rates: With interest rates expected to fall, we see good opportunities in high-quality corporate and government bonds. These bonds are likely to appreciate in value as markets anticipate more rate cuts. Quality bonds can also help cushion portfolios in case of a recession. While investors may not find Swiss government bond yields so appealing in terms of outright yield, we do see opportunity in highly rated Swiss corporate bonds, diversified fixed income strategies, and select structured strategies that offer capital-preservation features.

Diversify with alternatives: Long-term investors can consider investing in hedge funds and private equity as a way to find fresh sources of return and potentially reduce swings in portfolio values. Some hedge fund strategies, like multi-strategy and macro funds, invest across different types of manager, strategy, and asset class to find investment ideas even in choppier markets. However, it's important to remember that investing in alternatives comes with risks, including illiquidity and less transparency.

By following these strategies, Swiss investors can navigate current market volatility and position their portfolios for potential opportunities ahead.