Source: UBS

Investing in a negative interest rate environment

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Even though the Swiss National Bank (SNB) has not yet pushed its policy rate into negative territory, investors should start considering how to position themselves for a prolonged period of extremely low interest rates.

Do you remember when it was said that the negative interest rates introduced by the SNB in January 2015 were merely a temporary emergency measure to combat the overvaluation of the Swiss franc? In reality, this “emergency” lasted almost eight years and was only lifted in 2022, when global inflation rates surged due to supply chain disruptions and the outbreak of the war in Ukraine.

Now, just three years later, Switzerland could soon slip back into a period of negative rates. At its most recent monetary policy assessment, the SNB lowered its policy rate by only 25 basis points—to 0%—rather than the 50 basis points some had expected. However, the SNB highlighted the exceptionally high uncertainty regarding the economic outlook and left the door open to pushing rates into negative territory if needed.

Much will now depend on the external value of the Swiss franc. For the SNB, the EURCHF exchange rate is likely more important than USDCHF, as most Swiss SMEs are more exposed to the euro than to the US dollar. As recently as April, the SNB intervened in the FX market—by our estimate, to the tune of around CHF 5 billion—to keep EURCHF above 0.9250.

Should the pair fall significantly below this level, or even below 0.90, the SNB would likely return policy rates to deeply negative levels, as it did from 2015 onward. If, on the other hand, the US dollar continues to weaken while the euro remains relatively stable, the SNB may be more willing to tolerate a weaker dollar, especially since the “fair value” of the dollar versus the franc is probably below 0.80, and the greenback remains slightly overvalued at current levels.

Regardless of how the currency and interest rate landscape evolves in the coming months, Swiss investors should brace for a prolonged period of extremely low yields in fixed income. First and foremost, it is important to review whether excessive liquidity—i.e., cash balances in transaction or savings accounts, or short-term deposits—is being held. This should be done as part of careful liquidity planning.

If there are surplus cash holdings that are unlikely to generate a positive real return for the foreseeable future, the question arises of how best to invest them. One option is to top up an existing, broadly diversified core portfolio. Given the considerable uncertainty about the market outlook, a phased investment approach over a set period may be advisable. In addition, targeted investments in income-oriented assets could be considered. These might include portfolios of high-quality dividend stocks, potentially supplemented by systematic covered call writing to generate additional, tax-advantaged income. Alternative assets, such as building a private equity roadmap or investing in hedge funds, are also worth considering. In fixed income, portfolios with slightly longer duration and comprising solid corporate bonds may offer opportunities.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, “junk bonds,” derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer’s “home” currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.