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Viktor, who has over 13 years' experience in research, joined WisdomTree from Renaissance Asset Managers where he was Head of Research. Viktor provides macro research on various equities and commodities, such as FTSE and gold. He also provides trading ideas for short and leveraged ETFs/ETPs. Viktor has previously worked as a Research Analyst at BlackRock and Thomson Financial. He started his career as an Equity Strategist at Commerzbank, after he completed a Masters in Economic from Maastricht University, in the Netherlands.

CHF: A Safe Haven Exposed By Euro Weakness Implications for Swiss investors seeking Eurozone exposure

On 15 Jan 2015 the Swiss National Bank (SNB) removed the capping of the CHF/EUR rate – a recognition by the SNB that the Eurozone crisis had past. As the Eurozone recovers, downward pressure on the euro has waned. Having appreciated 21% on the announcement of the currency cap removal the previous day, the Swiss franc's overshoot relative to the euro gradually reversed.

Trading 8% higher to the euro since the SNB removed the currency cap, the Swiss franc remains strong. Underpinning it is a dovish sounding European Central Bank (ECB) bent on "talking down" the euro in an effort to buy time: until domestic demand led growth becomes self-sustained, the Eurozone needs the support of exporters. Starting 2016 at a still early inflection point for broader based growth, the economy remains vulnerable. The ECB will choose to use rhetoric – more so than policy action – to keep a lid on the appreciation of the euro.

And herein lies the major uncertainty for foreign investors seeking exposure to the Eurozone in 2016. Following the bare minimum of additional easing of December 2015 that hugely disappointed the markets– a 10 bps deposit rate cut and 6 month extension of QE – the ECB has not exhausted its monetary easing potential to the fullest extent, leaving ample room for several salvos of similar minimal additional easing this year.

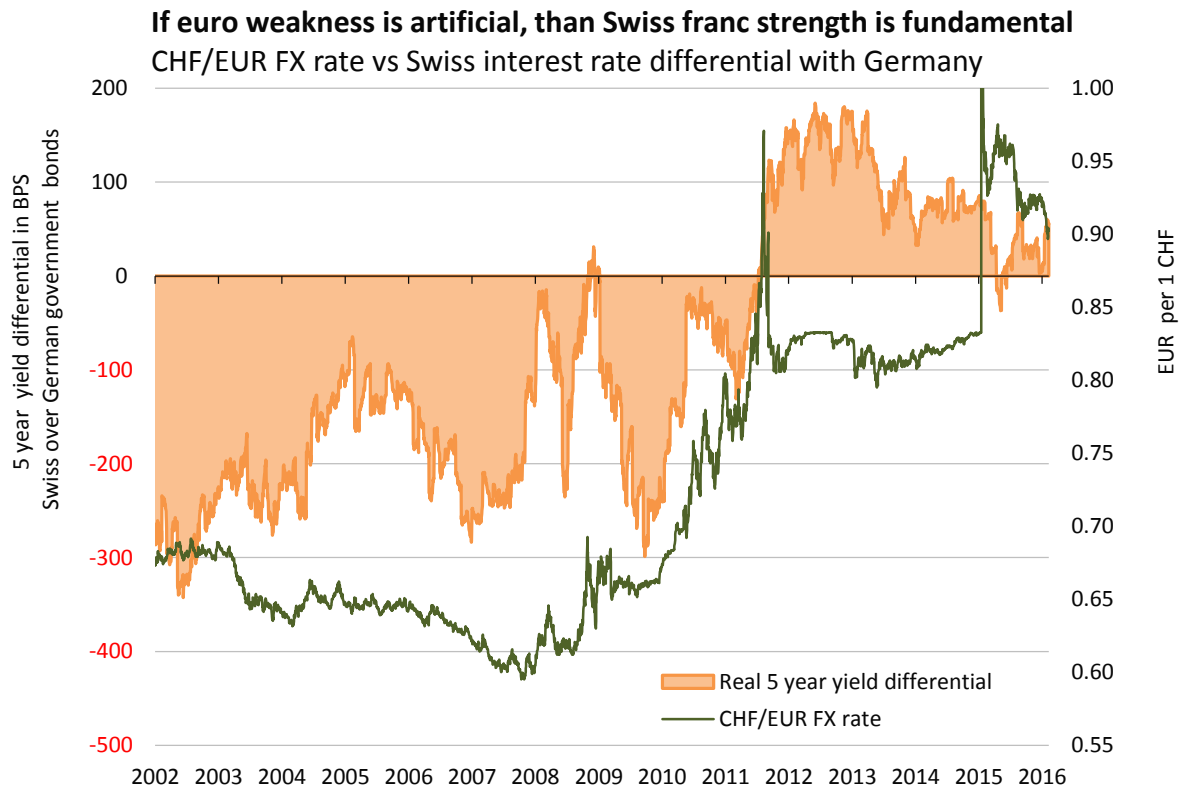
With investors left guessing as to how much easing power the ECB can potentially still unleash in 2016, the artificially suppressed euro becomes more volatile as speculators are enticed to the fore. This is why hovering at 10% and higher, the implied volatility of the euro remains elevated and on par with levels last seen in 2012, the very year when Draghi announced the ECB would "do whatever it takes to save the euro".

But it's the actions of the SNB, more so than the ECB, that underscore the strength of the Swiss franc. Once the artificial downward pressure from FX intervention by the SNB was removed, the strong fundamentals of the Swiss economy were laid bare. And with it, the safe haven status of Swiss franc.

Besides its democratic political system and transparent and independent institutions, the underpinning reason why investors consider the Swiss franc a safe haven, is a robust economy and low public sector indebtedness. For instance, since 2010, the economy of Switzerland expanded by 10% in real terms, only 1% short of Germany's but double the growth rate of the Eurozone. Little to no deficit spending was needed to propel Swiss growth as over the same period the government accumulated only 0.6% of GDP in new debt, barely lifting the total level of public sector indebtedness which, at 35%, is significantly less than Germany's (74%) let alone Eurozone's (92%).

Financial markets too, continue to judge the Swiss economy as robust and as safe as Germany's. A good gauge are the long term interest rates in both countries. Government bond yields for short to medium maturities are negative in both countries, but negative inflation in Switzerland forces these

below Germany's. Hence, when adjusted for inflation, real interests of government bonds in both countries are positive and for maturities up to 5 years (see chart) are actually higher in Switzerland than in Germany. The positive high real return potential means Switzerland should continue to attract capital flows and in so doing, put pressure on the Swiss franc to appreciate. In fact, the Swiss real interest rate premium over German Bunds in recent years is a marked reversal from almost a decade since the launch of the euro when Swiss real interest rates were lower than Germany's.



Source: WisdomTree Europe, Bloomberg

From an asset allocation point of view, this real yield premium matters. Swiss Investors seeking fixed income exposure will have a strong incentive to allocate into Swiss bonds, hold it to maturity and without exposure to currency risk, realise higher real income yields at home than were they to allocate into German Bunds.

For Swiss investors seeking dividends as an alternative or complementary to coupons, Eurozone equities will offer similar dividend yields to Swiss equities. However, where Eurozone can differentiate and add value is the exposure to a much broader equity market and where relative low correlations to Swiss equities improve the risk-return profile of a more diversified equity portfolio. Eurozone equities can also help Swiss equity investors absorb shocks from monetary policy decisions, such as when Eurozone equities remained unaffected by the sudden decision of the SNB to remove the currency cap, even as the 21% appreciation of the Swiss franc relative to the euro that day triggered a nearly 9% fall of the SMI index. Against such volatility, Swiss equity investors,



have been notably hit hard. An exposure to Eurozone equities can absorb such shocks and when currency hedged, offer additional protection against the downside risk of the euro. This not least when the artificial suppression of the euro by the ECB set to last for at least until March 2017 contrasts the otherwise solid fundamentals of the Swiss economy that justifiably earns the Swiss franc its safe haven status.



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