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Investment Policy

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Key points

Wakey-wakey!

At last **Europe** seems to have heard and heeded the wake-up call. In September 2024, Mario Draghi warned in his report on EU competitiveness that failure to act would condemn Europe to certain decline, possibly even calling into question the very existence of the Union. But we had to wait for Donald Trump to take the helm again in the US, and pull back from supporting Ukraine, for the EU to start getting its act together.

Europe is redefining its stance so that it can strengthen its **defences** and more besides. Admittedly, the challenge is daunting. But Member States uniting around a common goal – however ordinary it may seem – could breathe new life and purpose into the entire European project. Moreover, the European Commission has seemingly grasped the need for more pragmatism in implementing its green transition strategy would also help improve business competitiveness.

In addition, Germany's new chancellor, Friedrich Merz, wants to launch a comprehensive **package of measures** to stimulate the domestic economy by relaxing the sacrosanct debt brake. If all this extra spending is taken into account, it could boost the growth potential of the Eurozone's largest economy by just under half a percentage point and, to a lesser extent, that of the EU as a whole. That is not trivial!

Yet for now, all we have heard is 'fighting talk'. That in itself is positive, but the road ahead is long. Whatever the outcome, markets will now have to factor in the potential upside, as evidenced by the positive reaction by equities and the euro. This is also understandably reflected in higher long-term sovereign yields, which are palatable for Germany but less so for other Eurozone countries. Italy and France, for example, can ill afford higher debt costs as this would be a major **obstacle** to implementing the new economic policy. The institutions will need to engage in some creative accounting if there is going to be any chance of success.

Scenario and conclusions

- **Economy:** soft patch in US and expansionary fiscal policies in Europe and China
- **Trade war** could skew economic prospects for growth and inflation
- **Central banks** soldier on with monetary easing regardless
- **China:** GDP growth target set at 5%

→ **Equities**: neutral; preference for European equities

→ **Bonds**: overweight (IG corporate bonds)

→ **Currencies**: preference for CHF, cancellation of other currency bets

→ **Cash**: underweight

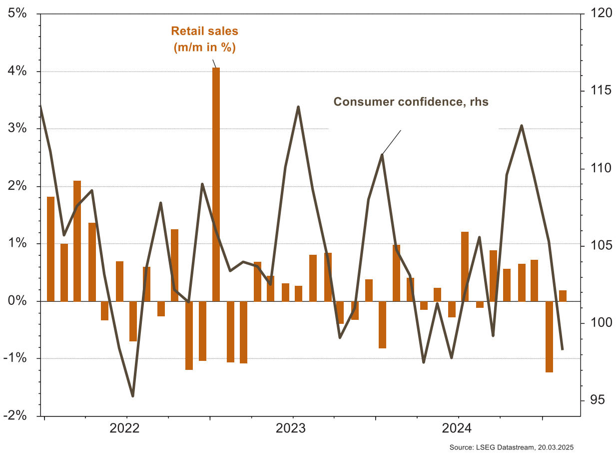
	UW (-)		N (=)		OW (+)
Asset allocation					
Equities			■		
Sovereign bonds			■		
Credit					■
Alternative investments			■		
Cash		■			
Equities					
US			■		
Europe				■	
Switzerland				■	
Japan			■		
Emerging markets		■			
Bonds					
Sovereign			■		
Corporate investment grade				■	
High-yield corporate	■				
Emerging market sovereign (USD)	■				
Emerging market sovereign (local)	■				

Economy: *days of American exceptionalism may be numbered*

The US economy could be heading for a **soft patch**. In contrast, we expect renewed confidence in Europe and China, leading to upward revisions in growth forecasts for them.

The Trump administration's approach to **US** economic policy has been disruptive. Sentiment among economic agents had been expected to recover in February. But consumer confidence fell to 98.3 versus a recent high of 112.8 in November 2024, while confidence among purchasing managers in the manufacturing sector also failed to gain traction, dipping to 50.3.

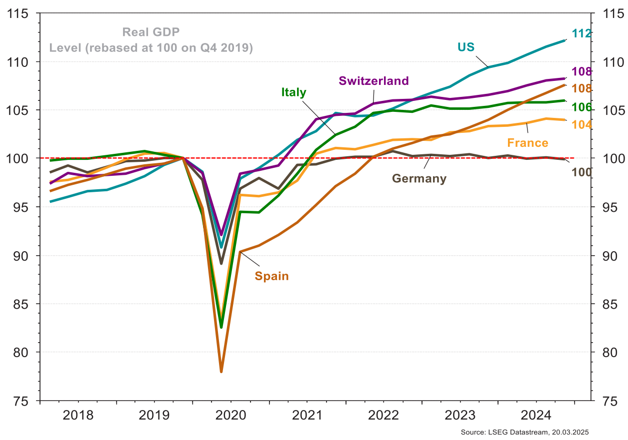
Chart 1 | US: consumer confidence waning and retail sales receding



Business investment and consumer spending decisions are being postponed because of the current hazy outlook. Tellingly, retail sales declined by 1.2% m/m in January **(Chart 1)**. Efforts to reverse illegal immigration and eradicate waste from the federal government will hurt the jobs market, representing a possible downside risk in the short term. Over the past two years, around 30% of all jobs created have been in the public sector. With Elon Musk and his DOGE (Department of Government Efficiency) wielding their chainsaws, cuts are inevitable.

In the **Eurozone**, courage is emerging to take decisive action, despite or even because of the challenging international environment it faces. Surprisingly, it is Germany that has come up with a **'whatever it takes'** plan, as the linchpin of future chancellor Friedrich Merz's political programme. This represents a fiscal shot-in-the-arm that Keynes himself would have been proud of, whereby EUR 500 billion (equating to just over 10% of GDP) will be injected into the economy in the coming twelve years. With public debt just above 60% of GDP, Germany certainly has room to manoeuvre, and this is the kind of shock treatment that its economy needs. The level of wealth (as measured by GDP) of its neighbours has risen well above pre-pandemic levels (France: 104; Italy: 106; Spain: 107.5) but has stagnated in Germany, where industrial production is 10% lower than it was a decade ago **(Chart 2)**.

Chart 2 | World: real GDP vs. 2019 (pre-COVID)



The stimulus put forward by the European Commission is focused on defence, which under the "ReArm Europe" moniker aims to boost such spending by EUR 800 billion. Besides implementation problems, funding is a major obstacle for several countries. According to the initial proposal, the Commission will allocate EUR 150 billion, but the Member States will have to stump up the remain-

Financial markets

*) To 19.03.2025	Performance			Valuation			Earnings growth			
Equity markets	Price (local currency)	Quarter Q1*)	Since 31 Dec 2024	12-month P/EPS	Dividend yield	Price/ net assets	12-month EPS	2025 EPS	2026 EPS	2027 EPS
United States	5 411.82	-3.66%	-3.66%	20.48	1.6%	4.7	13%	12%	15%	13%
Europe	555.37	9.40%	9.40%	13.95	3.2%	2.1	8%	7%	11%	10%
Japan	2 795.96	0.40%	0.40%	13.19	2.3%	1.4	8%	10%	9%	10%
Switzerland	13 040.92	12.00%	12.00%	16.75	3.0%	3.9	10%	9%	11%	10%
United Kingdom	4 700.78	5.20%	5.20%	11.68	3.7%	1.9	7%	6%	11%	9%
Emerging Markets (USD)	1 143.29	6.31%	6.31%	12.10	2.8%	1.8	13%	13%	13%	11%
World (USD)	3 701.87	-0.16%	-0.16%	18.21	2.1%	3.3	11%	10%	13%	11%

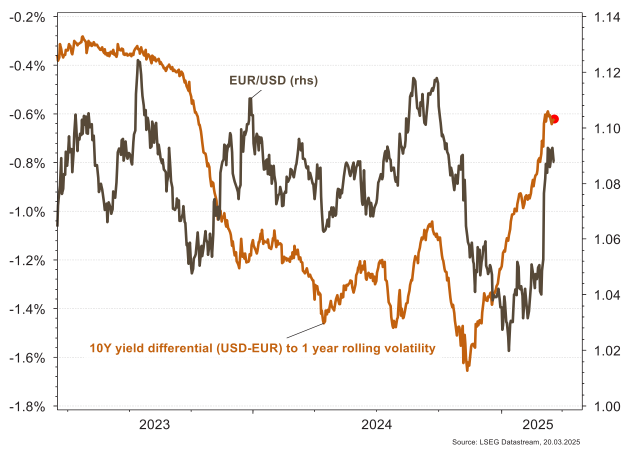
Source: Datastream, IBES consensus

ing EUR 650 billion. This is too much for Italy and France, even if the additional spending will not swell deficits or debt under Maastricht rules. This accounting leger de main has not fooled investors, who will not bother to draw the same distinction. Other solutions must be found to make these plans more credible.

The benefits of this investment drive on economic activity will not be visible immediately but work themselves out over several years, justifying the **increase in growth potential** for the Eurozone as a whole. Sadly, the growth multiplier for defence spending is around 0.4, far short of the 1 mark. So for every EUR 1 spent, the additional growth is only 40 cts. This is because over 60% of defence gear is purchased abroad (chiefly in the US).

Lastly, high street banks are relaxing lending conditions in response to the ECB's monetary easing. Its latest rate cut was 25 basis points in March and more are expected after inflation slowed to 2.4% y/y in February, not far from the official 2% target.

Chart 3 | EUR/USD: 10-year yield spread adjusted for volatility and exchange rate



Switzerland stands to benefit from the momentum that seems to be gaining traction among its neighbours. GDP growth was 0.5% q/q in Q4, driven by a strong recovery in business investment (+1% q/q) and solid consumer spending (+0.5%). Added to that, the SNB reported a profit of CHF 80.7 billion for 2024, enabling it to hand out CHF 3 billion to the federal government and cantons. Most important, inflation's retracement to deep levels (+0.3% y/y in February) gives the SNB room to continue cutting policy rates.

The **Chinese authorities** set a target for 5% GDP growth this year during the National People's Congress in March. To achieve this, the public deficit will be allowed to rise to 4% of GDP – a sign that the target is on the ambitious side. Quite rightly, the priority will be consumer spending. The gradual nationalisation of the property industry is aimed at providing public reassurance after households were spooked by a spate of private sector bankruptcies. The public will also benefit from other targeted measures, particularly amongst the lowest incomes. The authorities are also keen to accelerate adoption of AI. The success of DeepSeek, the generative AI app that is currently giving America's ChatGPT a run for its money, shows not only that China is on the right track in terms of innovation but also that the private sector is actively contributing to growth. The emphasis on setting an inflation target (at 2% vs. 3% previously) signals that the PBoC will maintain an accommodative monetary policy for some time to come, to avoid the risk of a deflationary spiral (inflation -0.7% y/y in February).

10-year sovereign bonds	Level at 19.03.2025	Change Q1*) (bps)	Change since 31 Dec 2024 (bps)
USD yields – United States	4.25%	-32	-32
EUR yields – Germany	2.77%	41	41
JPY yields – Japan	1.50%	42	42
CHF yields – Switzerland	0.75%	52	52
GBP yields – United Kingdom	4.63%	6	6
Emerging markets (USD)	6.75%	-20	-20
Emerging markets (local currency)	3.81%	22	22
Commodities	Price	Quarter Q1*)	Since 31 Dec 2024
Gold (USD/oz)	3 034.63	16.0%	16.0%
Brent (USD/bl)	71.75	-4.5%	-4.5%

FX	Level at 19.03.2025	Change Q1*)	Change since 31 Dec 2024
EUR vs. CHF	0.9572	2.00%	2.00%
EUR vs. USD	1.0927	5.52%	5.52%
EUR vs. JPY	163.1931	0.28%	0.28%
EUR vs. NOK	11.5190	-2.05%	-2.05%
GBP vs. EUR	1.1884	-1.78%	-1.78%
GBP vs. USD	1.2967	3.54%	3.54%
USD vs. CHF	0.8800	-2.90%	-2.90%
USD vs. CAD	1.4331	-0.35%	-0.35%
AUD vs. USD	0.6331	2.25%	2.25%

Source: Datastream

Monetary preferences

Rank 1	Rank 2	Rank 3
Appreciation expected	Stabilisation	Depreciation expected
CHF	↑ EUR | GBP | JPY | GOLD | ↓ USD	-
▪ **CHF**: haven and hedging currency, which compensates for lower yield; no longer overvalued	▪ ↑ **EUR**: better growth outlook and affordable ▪ **GBP**: attractive valuation and returns ▪ **JPY:** very attractively valued and contrarian monetary policy (rate hikes) ▪ **GOLD**: geopolitical hedge ▪ ↓ **USD**: richly valued and lower relative interest rates	

Investment conclusions

US equities are trading on all-time highs, pricing in quickening economic activity and leaving hardly any space for upsets. The problem is that the effects of fast-changing tariff policies are clouding short-term visibility on the US economy. At the other end of the spectrum, growth forecasts for Europe had previously been on the low side, as reflected in valuations. But the outlook is improving amid Germany's planned expansionary fiscal policies, alongside ReArm Europe. **Our equity exposure is unchanged**. But this new paradigm has prompted us to **reduce** the allocation to **US** equities and rotate into European and Swiss equities.

These adjustments have neutralised our FX preferences **(↓ USD and ↑ EUR)**, except for CHF, which remains our top-pick currency **(Chart 3)**. Despite its paltry yield, CHF has other advantages.

The low coupons paid on Swiss bonds have prompted us to further reduce the fixed-income weighting in our portfolios for which **CHF** is the reference currency. This has been followed by increased allocations to hedge funds and decorrelated structured products, to accompany our previously established position in real estate.

Slower economic growth and normal inflation both support our position in longer-dated, USD-denominated, high-quality sovereigns and credit. In the Eurozone, we were hit by the rise in yields connected with Germany's surprise announcements of fiscal stimulus. This new level largely prices in the new outlook and justifies maintaining our EUR fixed-income strategy (similar to our USD-specific strategy).

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