QUALITY SWISS STOCKS UNDER PRESSURE

Albin Kistler AG opinion piece
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Shares in high-quality Swiss companies have suffered substantial price losses this year. What lies behind this?

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A sharp correction
Looking at price trends on the Swiss equity market reveals a far from confident picture right now. The broad SPI shed around 20% of its value over the first three quarters of the year. Small and medium-sized firms have undergone even sharper corrections (the SPI Extra is around 30% lower). It is striking that companies with proven, highly profitable business models and decent growth rates are among the big losers. They include the likes of Belimo, Bucher, EMS-Chemie, Inficon, Interroll and Straumann.

Fig. 1: Quality Swiss stocks under pressure

Company	Price fall versus peak
Belimo	-37%
Bucher Industries	-35%
EMS-Chemie	-39%
Inficon	-51%
Interroll	-61%
Straumann	-56%

Source: Bloomberg, own calculations, as at 30 September 2022

What has gone wrong for these gems of the Swiss equity market? Surely it is in uncertain times like these that quality stocks should deliver a degree of protection against exaggerated price moves?

Pressure from three sides
In highly simplistic terms and abstracting from company-specific factors (acknowledgements to Credit Suisse), there appears to be three basic main causes behind these strong price signals and unsettled sentiment among market participants.

a) The end to the era of low interest rates
Inflation is back – and on a larger and faster scale than market participants had expected.
After dragging their heels initially, central banks are now slamming on the brakes and tightening short-term rates. Rates at the long end have also, albeit moderately, climbed back up from their lows. After a good many years, fixed-income instruments of all maturities are now offering yields well into positive territory again. This means that the era when investors seemingly had no alternative appears to be over: equities are competing with bonds again.
Higher interest rates have the biggest effect on growth stocks, as their future earnings are discounted at higher rates, significantly driving down their net present value.

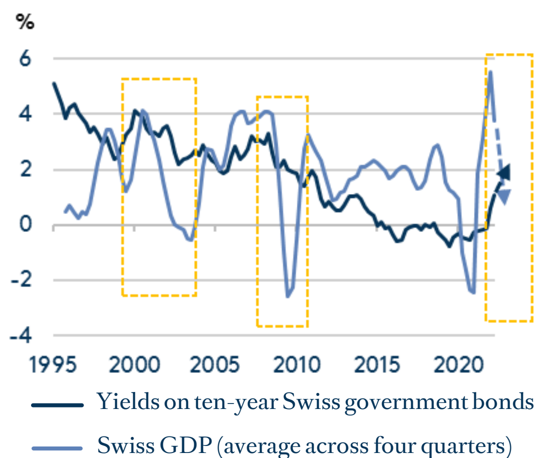
B) Gloomier economic outlook
The period of recovery that followed the Covid crisis has come to an end and global economic activity is cooling noticeably. The war in Ukraine and resulting turmoil in Europe's energy markets is another challenge for Swiss firms that should not be underestimated. Switzerland's corporate world is still closely interconnected with the economies of its EU neighbours. The expectation is therefore that corporate earnings will come under pressure in the near future. In short, we are finding ourselves in an economic downturn.

C) Strong Swiss franc
In the current situation, the public perceive the strong Swiss franc as more of a blessing than a curse. This was not the case in the past, thinking back to the days of the floor against the euro. The strong franc is currently helping us to keep a lid on inflation, via lower import prices. The other, less helpful, mechanism is still in play, however: for Swiss companies operating internationally, CHF appreciation means that profits earned in other countries are worth less when converted back into francs. That feeds through to their annual results.

Unavoidable adjustment

The reversal of the interest rate situation is certainly the biggest culprit behind the sharp fall in the price of quality stocks. Previously, when growth was weak and interest rates low, shares in solid companies with stable growth were extremely attractive and therefore expensive.
With higher interest rates there now comes a logical adjustment – in the shape of a broad-based price correction. But it has been a long time since we have seen this process coincide with a deterioration in the state of the economy: recent equity market corrections have taken place at times of falling or stagnant long-term interest rates.

Fig. 2: A weak economy and rising interest rates are a rare combination



Source: Bloomberg, own calculations

Looking to the future

Periods of corrections like these are painful for investors. In reality, such apparently inauspicious phases do though also harbour opportunities. To identify and seize these opportunities, we need to gain a picture of the long-term outlook:

1. Inflation and interest rates

Inflation will remain elevated for some quarters to come, above central banks' targets. But in the medium term, it will settle back to more manageable levels, partly as a result of central bank action and the economic slowdown. However, the expectation must be that inflation and therefore long-term yields will remain well above the zero mark. There is scant prospect of a return to the deflationary world of negative yields.

2. Growth

Developed economies are incredibly robust constructs. Growth is the rule; downturns are the exception. After all, it is human nature to strive to do better. Switzerland is a prime case in point: over the last quarter of a century, it has recorded just two years of negative growth. Businesses are the driving force behind this trend towards greater knowledge and prosperity. As the global economy becomes ever more open, transparent and competitive, it has continued to open up plenty of growth opportunities for well-run companies with strong market positions. The challenges facing us at present (supply chains, energy prices and labour shortages) are nothing new and will be resolved with time.

3. Strong franc

The Swiss franc will remain one of the world's strongest currencies. The differences between inflation here and in other currency areas are considerable and will drive the nominal appreciation of the franc over the short to medium term. The widening gulf in debt policy worldwide in general and the crucial acid test within the European single currency area in particular will ensure that the franc retains its safe-haven status in the long run too.

So what does that all mean for quality Swiss stocks?

Seasoned investors know that a company's stock market price very rarely reflects its true value. Phases of undervaluations and overvaluations are much more frequent. It becomes easier to navigate this when we keep in mind one thing: a share price will ultimately follow the company's earnings. This rule is the basis for successful long-term investing.
The macroeconomic prospects outlined above provide outstanding foundations for excellent Swiss companies. The pressure of the strong Swiss franc is forcing them to defend and build their market positions through steady efficiency gains, a rigorous focus and sustained investment in research and development.
However, they can only succeed at this if they have unquestionably robust finances (equity ratio and gearing) and a proven business model that has delivered strong growth over many cycles. The quality

Swiss companies listed above that have been heavily penalised by the market all undoubtedly have these attributes.

Fig. 3: Compelling quality

Company	Equity ratio 2021	Net cash (CHF m)	Earnings growth p.a. 2005–2021
Belimo	80%	160	8.6%
Bucher	55%	470	7.1%
EMS-Chemie	77%	630	7.6%
Inficon	69%	37	10.5%
Interroll	64%	45	10.1%
Straumann	50%	240	7.2%

Source: annual reports, own calculations

Outlook for investors

Share prices are trending upwards again after bottoming out. However, only those companies that are able to grow their earnings long-term will succeed in regaining their previous highs. The rest will be long-term victims of the correction in valuations.

Even though markets may be sending out a different message right now, quality Swiss names will remain the core of a secure portfolio delivering, sound long-term success in the future. The low prices mean there are attractive buying opportunities.

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