THE AUSTRALIAN

Swiss franc frames key questions for international investor

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1. These investors hold numerous fixed income and cash-product exposures domiciled in Switzerland; and

2. What happens to the Swiss franc directly affects the value and stability of our Australian dollar.

The dollar sits within an accepted but informally defined basket of six “hot currencies” that lubricate global trade, investment and serves to stabilise international purchasing power parities. They include the British pound, euro, yen, US dollar, Australian dollar and Swiss franc.

With the rise in significance of China’s offshore renminbi currency and the increased recent volatility in second-order currencies such as South Korea’s won and Mexico’s peso, the balance within these “hot currencies” matters even more so than ever before. Accepting that there is no single conclusive explanation as to why the Swiss franc has begun shifting specifically in February of every year, the most practical assumption to make is that it has become a start of year risk barometer for global investors.

No better was this exampled than during the 2015 “Swiss franc shock”, which was triggered on January 15, 2015, when in a surprise move, the Swiss National Bank abandoned its nearly 40-month long exchange rate floor versus the euro.

Throughout February, Swiss products and services became more expensive and in its place the Swiss National Bank (SNB) escalated a policy of negative interest rates in an effort to deter hot money inflows.

Even with the franc trending weaker again in the months that followed, it remained significantly overvalued causing many to call for the reintroduction of a Swiss franc exchange rate floor with the euro.

Gun-shy from the 2015 experience, which cost Australian UHNW investors in terms of capital loss and also additional banking, financial administration, legal and accounting fees, talk or even the rumour of any such reintroduction has spread concern within affluent Australian wealth communities.

Indeed, the export-weighted real external value of the Swiss franc has changed little over the last 12 months. However, it remains well above its long-term average and, importantly, depreciated significantly against the Japanese yen and dollars of Australia and Canada. This shift again has raised concern for conservative Australian UHNW investors because in addition to all known global market risk factors, the traditionally dependable Swiss franc is presenting additional risks that only became hazardous beginning in 2012.

For active traders, the CurrencyShares Swiss Franc (FXF: US) and Swiss Franc Daily Hedged Brent Crude (CBRT: EB) ETFs have provided versatile trading proxies primarily because these products allow traders to pair geopolitical events — such as Russian hostilities, ISIS or European refugee crises or eurozone political uncertainties such as the upcoming French elections — with a European exposure that is not priced in euros or British pounds, both of which have their own distinct complications in 2017.

Nevertheless, trading options provide little relief to conservative long-term investors who are seeking price and currency stability above all else.

Paradoxically, it is the skill of the Swiss National Bank who showed their willingness to intervene in the foreign exchange market to cushion the effect of the additional pressures placed on the Swiss franc that meant that neither the US elections in November nor the Italian constitutional referendum in December caused any significant overall changes in the value of the franc.

This has provided little reprieve to Australian UHNW investors who fret about the franc boiling over and in so doing, pushing our Australian dollar to US80c and our very important trading partner, Japan's yen, to new higher unwanted levels.

But this February has seen an intense concentration by private banks and institutional investors — reinsurance companies, multinationals and transnational hedge funds — on the franc-euro pairing, or what is technically known as the "CHFEUR" spot exchange rate.

The key concerns are that without an exchange rate ceiling:

• The franc-euro could blow out once again as seen in 2015;

• There will be heightened uncertainty in eurozone bond markets due in large part to 2017 European geopolitics, long-term yields on Swiss Confederation bonds — public bonds issued by the Swiss government — have also risen, but yield increases were less than in the US; and

• Swiss Confederation interest rate differential with the US rates has also widened even though the Swiss yield curve has not steepened as a result.

For Australians with investments in institutional superannuation funds, this has caused a slight benefit in that Australian government bonds (AGBs), have appeared more stable and reliable during the month of February and with this stability has come a slight capital appreciation from offshore investment inflows.

But little comfort should be taken from seeing Switzerland become the new battleground for international risk capital as it may be Australia's turn next given our mutual hot currency status.

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