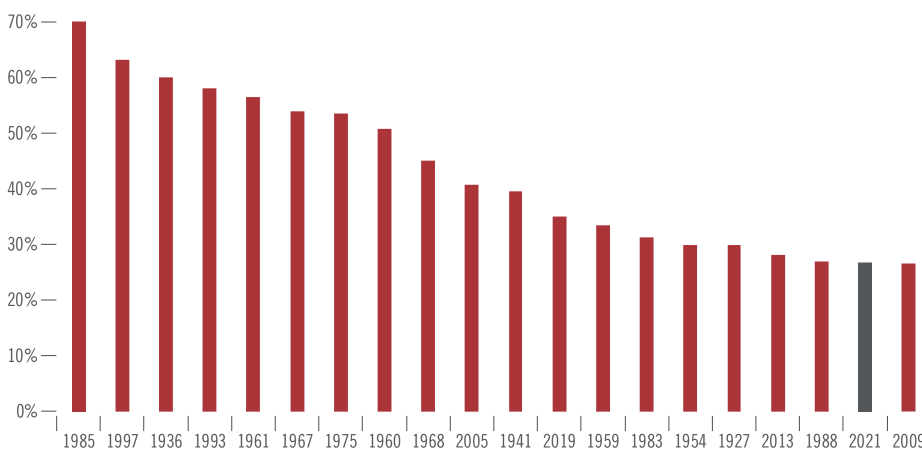
# 2021, AN OUTSTANDING YEAR

## COMMENTARY ON THE LONG-TERM PERFORMANCE OF SWISS EQUITIES AND BONDS

Jacques Henry, Nadia Gharbi | Pictet Wealth Management | February 2022

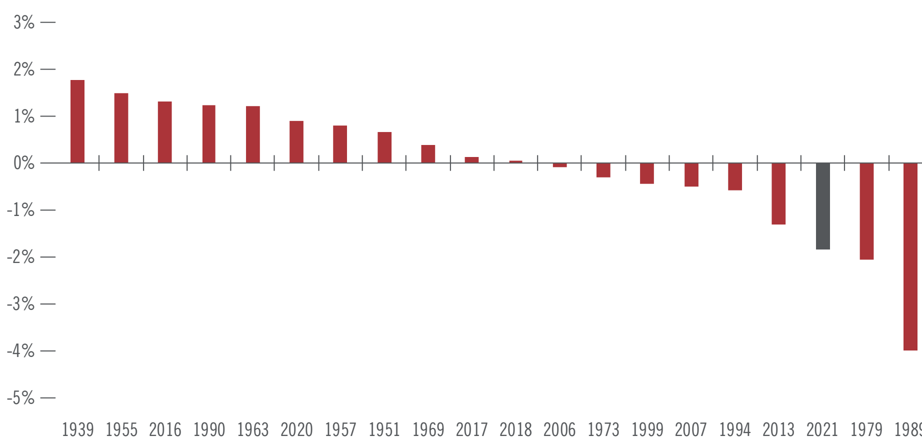
The average annualised return (geometric mean) for Swiss equities and bonds in Swiss francs over the long run now stands at 8.0% and 4.1% in nominal terms, respectively. These figures are somewhat lower than in July 1998 (the first update after our initial publication of long-term returns in 1988), when they stood at 8.6% and 4.6%, respectively. Nonetheless, the figures are resilient in real terms (after erosion of the value of money is taken into account). Swiss equities still show an average 5.9% annualised real return over the very long run—only slightly down from 6.0% in 1998—, while Swiss bonds now show an average annualised real return of 2.2% compared with 2.1% in 1998. In short, despite major macroeconomic and market changes over the past quarter of a century, there has been no regime shift in terms of real returns on Swiss equities and bonds.

### CHART 1: BEST ANNUAL RETURNS FOR SWISS EQUITIES SINCE 1926




Source: Pictet WM-AAMR, FactSet, December 2021

### CHART 2: WORST ANNUAL RETURNS FOR SWISS BONDS SINCE 1926




Source: Pictet WM-AAMR, FactSet, December 2021

### 2021 WAS OUTSTANDING FOR BOTH EQUITIES AND BONDS

2021 was a far-from average year for equities and bonds. After a paltry 3.8% return in pandemic-struck 2020, Swiss equities made a vigorous recovery last year, rising 23.4% in Swiss franc terms. This was the 19th-best annual equity return since 1926 *(see chart 1)*. In recent history, only 2013 and 2019 were better—the latter also being a year of recovery after Fed rate hikes in Q4 2018 had triggered a massive global equity sell-off.

Total returns from Swiss bonds were more noteworthy in historic returns, since they were the third worst since 1926. The resurgence in global inflation due to post-pandemic supply bottlenecks put upward pressure on rates, thus leading to a capital loss for Swiss bond investors in 2021. Taking into account the jump in annual inflation in Switzerland to 1.53% in 2021, a level not seen since 2007, the real return on bonds was even worse.

### HOW TO BECOME A MILLIONAIRE?

With figures going back to 1926, we now have almost a century's worth of data on annual returns. A good way to illustrate the "magic" of compounding is to track the total returns from CHF1,000 invested at the end of 1925 in our equity index



PICTET
1805

## 2021, AN OUTSTANDING YEAR
## COMMENTARY ON THE LONG-TERM PERFORMANCE OF SWISS EQUITIES AND BONDS

using a pure 'buy and hold' strategy (in other words, reinvesting dividends year after year and never selling). On this basis, our analysis shows that the initial CHF1,000 would have grown to CHF1.57 million 96 years later. Of course, this figure is too good to be true: we need to take into account the costs (brokerage fees, stamp duties, cost of portfolio rebalancing...) linked to equity investing. Even though these costs were probably higher in 1926 than in 2021, we decided to deduct 50 bps annually from equity returns across the board. This gives us a figure of CHF999,925—in other words, almost CHF1 million after costs for an initial investment of CHF1,000. This simple calculation illustrates that patience is a virtue; as returns compound over time, investors' time horizon can make all the difference.

### CHART 3: SWISS EQUITIES' ANNUALISED RETURNS GROUPED BY 10-YEAR PERIODS (Y-AXIS) AND RETURN RANGE (X-AXIS)

Source: Pictet WM-AAMR, FactSet, December 2021

Things are different for bonds. On the one hand, risk indicators look less forbiding: Swiss bonds show a 3.6% volatility (standard deviation of annual returns) compared with 20% for Swiss equities, while the maximum drawdown (maximum potential loss from investing at the market top and selling at the market trough) has been 4% for Swiss bonds vs. 34% for Swiss equities. Similarly, no loss has been incurred on Swiss bond investments of five years or longer since 1926. On the other hand, bond returns have been far much lower—about half the return of equities over the long run (an average annual total return of 4.1% for Swiss bonds since 1926 vs. 8.0% for Swiss equities). Therefore, over the long term, equities remain the investment of choice. Put another way, a decent long-term investment horizon together with sufficient risk tolerance justify a significant allocation to equities.

### EQUITIES: TO TIME OR NOT TO TIME

An equity drawdown is always scary and stressful. But one needs to take into account the ability of equities to recover after a sell-off. Smoothed over a long time period, the impact of drawdowns tends to dissipate. An unlucky investor with a five-year time horizon would have faced a negative total return on Swiss equities 14 times in the 96 years between 1926 and 2021, linked to three major markets events: the Wall Street crash in 1929, the bursting of the 'dot com' bubble in 2000-2001 and the global financial crisis in 2008. Investors with a 10-year horizon would have suffered a negative return if their initial investment had been made in only three periods of time since 1926, all linked to the 1929 crisis *(see chart 3)*. Nobody who invested in Swiss equities for 13 years would have experienced a loss on their initial investment since 1926. Discipline in equity is the best response to the old adage that "you can't time



PICTET 1805

## 2021, AN OUTSTANDING YEAR
## COMMENTARY ON THE LONG-TERM PERFORMANCE OF SWISS EQUITIES AND BONDS

the market". Even if investors cannot time the market, they can build up their portfolio's resilience.

Chart 4 is an extract from a more complete return triangle that can be downloaded at *http://group.pictet/longtermstudy*. The triangle shows the annualised return for each investment period from the beginning of 2006 to the end of 2021.

It indicates that investors who had the misfortune to invest in the Swiss stock market at the beginning of 2008 saw an average annual performance of -1.9% in the five-year period to the end of 2012. Assuming these investors did not withdraw their money, the average annual return between 2008 and 2021 would have subsequently rebounded to 6.4% by the end of 2021 – not bad taking into account the 34% loss in 2008.

The last row of chart 4 shows the annual return for investments initiated in each one of the past 15 years. Except for investments initiated in 2007 or 2008, all investments in Swiss equities initiated since 2006 and held until the end of 2021 would have posted average annualised returns above the long-term average of 8%, with double-digit annualised returns for investments initiated in most years. This should not come as a surprise as we have been in a bull equity market since the end of the global financial crisis.

### THE END OF THE DOWNWARD TREND ERA IN INTEREST RATES?

Long-term interest rates have trended downward over the last 30 years. A key factor behind this trend has been disinflation. But over the past year, supply bottlenecks and a spike in energy prices have been causing inflation to rise. Over the long term, the question is whether inflationary factors will dominate disinflationary ones, with factors such as the cost of the green transition and some retreat in globalisation possibly pushing inflation up in the coming years. But whether the pandemic has triggered a regime shift in inflation dynamics or not remains to be seen.

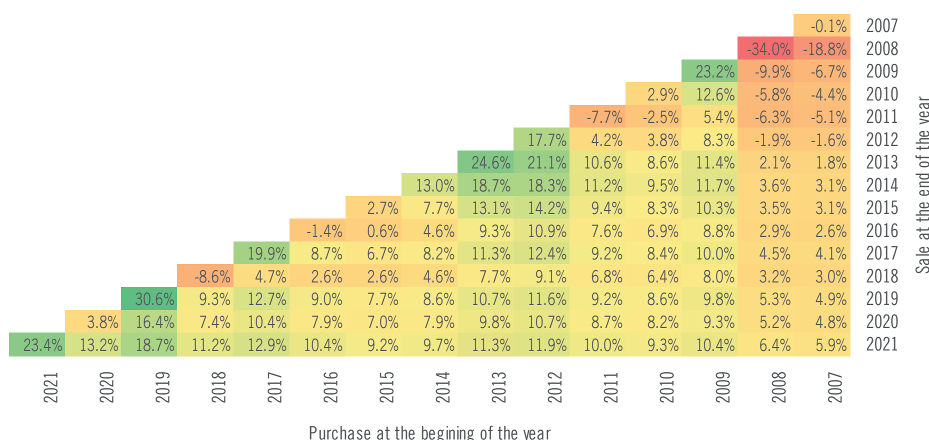
As a small open economy, Switzerland cannot decouple from rate developments in other countries. In the past, Switzerland has had lower interest rates than its main trading partner, Germany *(see chart 5)*. However, since the global financial crisis, this advantage has come under mounting pressure. Particularly since the pandemic, the difference between Swiss and German long-term interest rates has fallen and is now close to zero, although the Swiss National Bank's policy rate (the short-term deposit rate) is still 25 bps lower than the European Central Bank's (ECB).

At a time when other central banks are tightening monetary policy, triggering upward pressure on interest rates, the question is whether the SNB will jump on the bandwagon. The SNB has many times pointed out the importance of the interest-rate differential for its policy making. Indeed, the SNB has long argued the need to maintain a negative interest rate spread between the Swiss franc and other currencies to avoid excessive appreciation of the Swiss currency.

We expect the ECB to start hiking its deposit rate in H2 2022 or early 2023. Will the SNB follow the ECB's lead or will it be happy to see the interest rate spread widen further, thus reducing pressure on the franc?

How the SNB reacts to future ECB rate hikes will primarily depend on the inflation outlook. The SNB's sole mandate is price stability, defined by the bank as "a rise in the Swiss consumer price index (CPI) of less than 2% per annum". The SNB's current long-range forecast is for CPI of 0.8% by Q3 2024, well within its inflation target of below 2% and close to the long-term average of 1%. It's important to emphasize that inflation is less of an issue in Switzerland than elsewhere and therefore the SNB

**CHART 4: ANNUALISED RETURNS ON SWISS EQUITIES OVER THE PAST 15 YEARS (EXTRACT FROM LONG-TERM ANNUAL RETURN TABLE COMPILED BY PICTET WEALTH MANAGEMENT)**



| Sale at the end of the year \ Purchase at the begining of the year | 2021 | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2007 | | | | | | | | | | | | | | | -0.1% |
| 2008 | | | | | | | | | | | | | | -34.0% | -18.8% |
| 2009 | | | | | | | | | | | | | 23.2% | -9.9% | -6.7% |
| 2010 | | | | | | | | | | | | 2.9% | 12.6% | -5.8% | -4.4% |
| 2011 | | | | | | | | | | | -7.7% | -2.5% | 5.4% | -6.3% | -5.1% |
| 2012 | | | | | | | | | | 17.7% | 4.2% | 3.8% | 8.3% | -1.9% | -1.6% |
| 2013 | | | | | | | | | 24.6% | 21.1% | 10.6% | 8.6% | 11.4% | 2.1% | 1.8% |
| 2014 | | | | | | | | 13.0% | 18.7% | 18.3% | 11.2% | 9.5% | 11.7% | 3.6% | 3.1% |
| 2015 | | | | | | | 2.7% | 7.7% | 13.1% | 14.2% | 9.4% | 8.3% | 10.3% | 3.5% | 3.1% |
| 2016 | | | | | | -1.4% | 0.6% | 4.6% | 9.3% | 10.9% | 7.6% | 6.9% | 8.8% | 2.9% | 2.6% |
| 2017 | | | | | 19.9% | 8.7% | 6.7% | 8.2% | 11.3% | 12.4% | 9.2% | 8.4% | 10.0% | 4.5% | 4.1% |
| 2018 | | | | -8.6% | 4.7% | 2.6% | 2.6% | 4.6% | 7.7% | 9.1% | 6.8% | 6.4% | 8.0% | 3.2% | 3.0% |
| 2019 | | | 30.6% | 9.3% | 12.7% | 9.0% | 7.7% | 8.6% | 10.7% | 11.6% | 9.2% | 8.6% | 9.8% | 5.3% | 4.9% |
| 2020 | | 3.8% | 16.4% | 7.4% | 10.4% | 7.9% | 7.0% | 7.9% | 9.8% | 10.7% | 8.7% | 8.2% | 9.3% | 5.2% | 4.8% |
| 2021 | 23.4% | 13.2% | 18.7% | 11.2% | 12.9% | 10.4% | 9.2% | 9.7% | 11.3% | 11.9% | 10.0% | 9.3% | 10.4% | 6.4% | 5.9% |

Past performance and forecasts are not per se a reliable indicator of future performance.

Source: Pictet WM-AAMR, FactSet, December 2021

faces less pressure to tighten its policy. Nonetheless, we would expect the SNB's medium-term inflation forecast to increase somewhat over the coming quarters as a result energy prices and a tight labour market.

Because of its role in inflation, the direction of the exchange rate will remain a key determinant for SNB action. At the same time, the longer negative rates persist, the higher the potential challenges for financial stability. This is because negative deposit rates weigh on banks' profitability, creating an incentive to take on more risk. In addition, by exacerbating imbalances in the Swiss property market, negative base rates increase the vulnerability of the Swiss banking system and the overall economy. The SNB faces difficult choices, but we believe it will follow the ECB's lead by raising rates—although possibly allowing a quarter to pass before doing so in order to rebuild the rate-differential cushion.

## CONCLUSION: MORE OF THE SAME

Our long experience of looking after private investors and family offices suggests that investors' biggest risk of losing out lies in drastically reducing (supposed) portfolio risk because the near-term performance of capital markets is not in line with their risk tolerance and then missing out on the subsequent market upturn. The covid-19 pandemic is a case in point: selling equities in March 2020 would have resulted in missing the outstanding recovery since then.

With this in mind, we re-iterate the advice we have been offering for several years: investors should make an effort to map out a long-term, robust and sustainable investment strategy and think carefully about how it is implemented. Only too often, this vitally important question takes second place to other considerations thought to be more important (cost of asset management and advice, cost of analysis etc.).

Equities remain the investment of choice and given the difficult of 'timing the market', a long-term time horizon can be your best friend. Good advice and a long-term perspective can make a big difference to your wealth.

*Appendix: where do our data come from?*

*Our study of Swiss equities and bonds takes into account data going back to 1926 and was originally published in January 1988. It has been updated annually since 1998. Data on returns for a diversified portfolio of Swiss equities and another of Swiss franc-denominated bonds come from a variety of sources. We have used the Swiss Performance Index (SPI) as a base for calculating equity returns since 1992. Regarding Swiss bonds, the Pictet Bond index was used until the end of 2003. In 2022, for reasons of simplicity and consistency, it was decided to switch to the Swiss Bond Index Total Return AAA-BBB Index for annual returns stretching back to 2004. This necessitated slight adjustments to historical data on bonds from 2004 to 2021. Such a change does not impact our past comments but will make future updates easier.*

CHART 5: SWITZERLAND VERSUS GERMANY - 10Y GOVERNMENT BOND YIELDS

Sources: Pictet WM-AAMR, Refinitiv, 07 February 2022

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