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Investment Guide

The Art of Adaptability

CIO House View
JUNE 2025

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The Art of Adaptability

In the realm of financial markets, adaptability is no longer a competitive advantage — it is a prerequisite for sustained success. This reality brings to mind Donald Trump's much-cited book «The Art of the Deal», which portrays negotiation as a calculated contest of power: characterised by inflated opening demands, strategic ambiguity, and the deliberate use of uncertainty as leverage. While such tactics may yield results in high-stakes business negotiations, they can prove highly disadvantageous for long-term investors navigating the aftershocks of erratic policy decisions.

Following the tariff shock on 2 April, analysts and economists have been forced to adjust their forecasts and recommendations, often mirroring the erratic nature of Trump's tariff announcements. This situation highlights the importance of adaptability but also raises questions about the balance between responsive adjustments and maintaining a strategic focus.

«The Art of Adaptability» is not about constant repositioning in response to every headline. It is about strategic assessment — the ability to separate relevant matters from emotions. While it is essential to stay informed and adjust to new circumstances, it is equally important to avoid making erratic decisions based on incomplete or uncertain information. The lesson from the recent market disruption is clear: adaptability is essential, but it must be applied judiciously. Over the course of the year, we have consistently advocated for a calm and measured approach — maintaining diversified portfolios and adhering to long-term plans despite short-term uncertainty. This strategy has proven effective. Those who stayed the course were better positioned to navigate the volatility than those who reacted impulsively.

While the future is inherently uncertain, market volatility and temporary drawdowns are integral to the risk-return profile of any sound investment strategy. This fundamental principle should not be forgotten. Financial markets will always be subject to unforeseen events and policy shifts. The key lies in remaining focused, relying on rigorous analysis, and making decisions grounded in strategy rather than sentiment. In doing so, investors not only mitigate risk but also position themselves to seize opportunities — where others may be distracted by emotions.

Enjoy the reading.

Best regards,

Gzim Hasani

CEO

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Chief Investment Officer

Global Economy

- Trade-related uncertainties dampen prospects for 2025, but global growth is expected to stay positive.
- Central banks face challenges in making substantial interest rate cuts to support the economy.
- The Swiss National Bank (SNB) is expected to lower its key interest rate by 0.25% to zero in June.

From unprecedented tariff-related volatility to US deficit uncertainties

Forecasting the actions of the Trump administration is impossible. But if the current pause on tariffs becomes permanent, the global economy should remain resilient. Of course, wherever US import tariffs eventually settle, they will be much higher than they were before President Trumps second presidency, and probably still the highest in almost a century. But relative to expectations, the ongoing negotiations and the 90-day pause are positive. Therefore, while global growth is expected to slow given heightened unpredictability, it should remain positive. In the US, the disinflationary trend may be interrupted as tariffs are implemented, but inflation is expected to gradually moderate. Hence, a US recession looks unlikely given the prospect of lower oil prices, tax cut extensions and a mild regulatory environment.

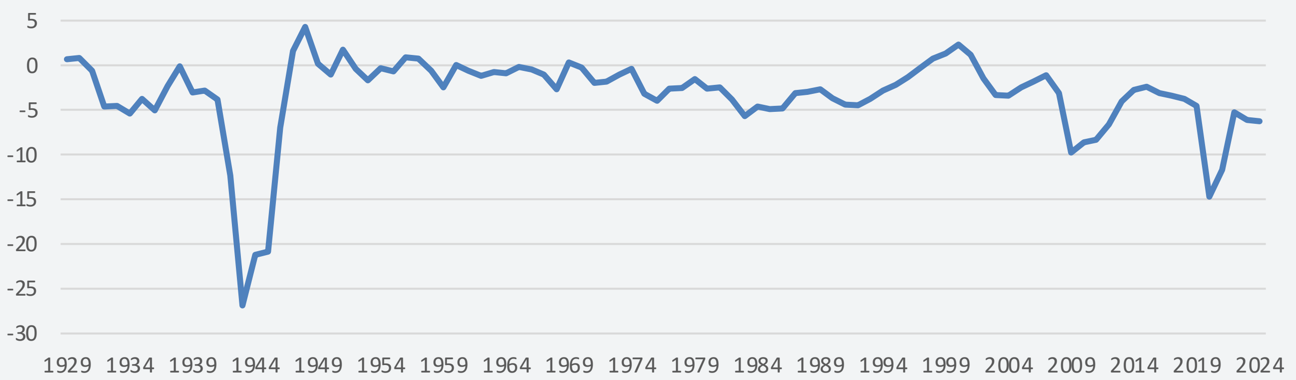
Speaking about tax cuts, despite already significant budget deficits, the US government is expected to further expand both its overall debt and the cost of servicing it. While the US total debt pile has grown from approximately USD 10 trillion in 2009 to around USD 36 trillion today, the new tax-and-spending package in consideration could add another 3-4 trillion to the national debt over the next decade. While the US is currently running a fiscal deficit of around 6.5% of GDP – which equals to USD 2 trillion per year, even after a period of strong economic growth, and net interest costs now absorb 18% of tax revenues - the deficit could exceed 9% by 2034, according to rating agencies.

While there are significant upside and downside risks associated with tariff assumptions, a less pessimistic growth outlook complicates the ability of central banks to make substantial interest rate cuts. Specifically, the current market expectations of two rate cuts by the US Federal Reserve by the end of the year, with the first anticipated in September, may look at risk even though markets expected at the depths of the tariff tantrum in early April four rates cuts. In Europe, the ECB is expected to continue cutting rates as inflation further declines while the German infrastructure spending and increased EU defense spending are seen as beneficial for confidence and future growth despite near-term headwinds.

Swiss Q1 flash GDP surprises positively

The Swiss economy experienced above-average growth in the first quarter of 2025. According to the SECO's early estimate of the quarterly real GDP, economic output increased by 0.7% compared to the previous quarter. While this data needs to be contextualized, as it represents figures before the uncertainties related to the trade war, it is positive. While this could affect the policy actions of the Swiss National Bank, the SNB is expected to maintain an accommodative monetary policy stance amid low inflation trends. According to latest consensus expectations, the SNB is expected to lower its key interest rate by 0.25% to zero on 19 June.

FIG. 1
US Budget Deficit as % of Gross Domestic Product



Sources: Federal Reserve Bank of St. Louis; U.S. Office of Management and Budget via FRED

Fixed Income

- The fundamentals for investment-grade bonds remain solid, and no significant deterioration in credit quality is expected.
- Quality high-yield bonds offer reasonable total return opportunities despite low credit spreads.
- Private debt and real estate investments are attractive alternatives to bonds.

US Treasuries navigating the loss of the last AAA rating and President Trump's stimulus package

US Treasury markets have seen heightened volatility in May following Moody's downgrade of the United States' sovereign credit rating from Aaa to Aa1. While the action was not a surprise, it has turned the market focus to the nation's fiscal trajectory. Compounding these worries, President Trump's fiscal package, known as the "One Big Beautiful Bill," is further adding to investors' concerns. The legislation proposes extending the 2017 tax cuts, introducing new tax exemptions, and significantly increasing defense and border security spending. The Congressional Budget Office estimates that this bill could add almost USD 4 trillion to the national debt over the next decade. In response, Treasury yields have risen, reflecting investor concerns over increased debt issuance and potential inflationary pressures. Yields on longer-dated bonds, from 10- to 30-years, have seen upward pressure as markets adjust to the anticipated surge in government borrowing. This is also affecting international bond markets, with long-term bond yields rising globally.

Ongoing challenges for Swiss investors

While there is a risk that bond yields could rise further in anticipation of higher US fiscal deficits, higher yield levels do also offer an opportunity for investors to lock in durable portfolio income without taking too much duration risks. For low-interest regions such as Switzerland, government bonds do not look appealing though given persistent low yields even if the SNB is expected to further cut the policy rate.

For Swiss investors, a combination of investment-grade bonds, high-quality high-yield bonds, and selective emerging market bonds remains attractive, despite hedging currency costs back into CHF. Current annualized hedging costs for USD/CHF and EUR/CHF are around 4.5% and 2.1%, respectively.

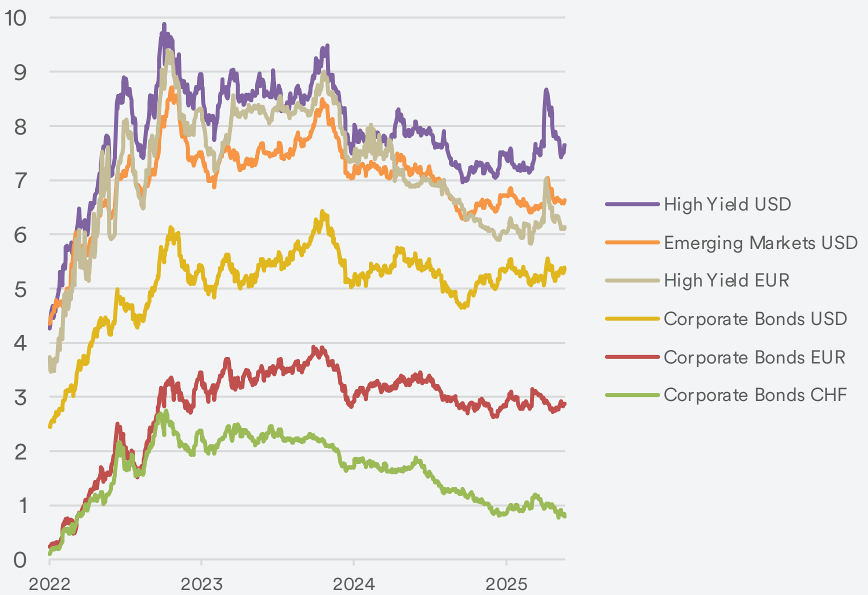
For investors who can tolerate illiquidity risks, alternative opportunities in private credit, private equity, or real estate continue to score attractive.

Is the US Exceptionalism ending?

The US relies on capital inflows to finance its budget and trade deficits. Nevertheless, even if the US government explicitly seeks radical changes at all levels, the US is still too large to fall too quickly. According to Bloomberg, foreigners hold over USD 19 trillion in US equities, USD 7 trillion in government bonds, and USD 5 trillion in US corporate bonds, accounting for about 20% to 30% of the entire market. While European and/or Chinese assets suddenly appear more attractive, they cannot replace the depth and liquidity of the almost USD 29 trillion US bond market.

FIG. 2

Evolution of yields in selected Bond Markets



Source: Bloomberg, smzh ag. 26/05/2025
Past performance is no indication for future results

Equities

- Despite heightened uncertainties, opportunities also arise for long-term investors.
- Tailwinds for European equities remain intact despite ongoing challenges from US trade policies. A resolution to the war in Ukraine could further improve sentiment.
- Swiss equities provide a blend of growth potential and stability, with income strategies like defensive dividends looking particularly attractive.
- Spikes in volatility offer interesting opportunities to explore derivative strategies.

US equities complete a round trip

Since reaching a low on April 8, global equity markets and in particular US indices have staged a steady recovery to recoup all the losses of the year, supported by improving investor sentiment, resilient corporate earnings, and expectations of policy support. While volatility has persisted, the broader tone has shifted from risk aversion to cautious optimism amid a sudden improvement in the economic outlook. Especially, the trade truce between the US and China substantially reduced the tail risks investors had priced into world markets.

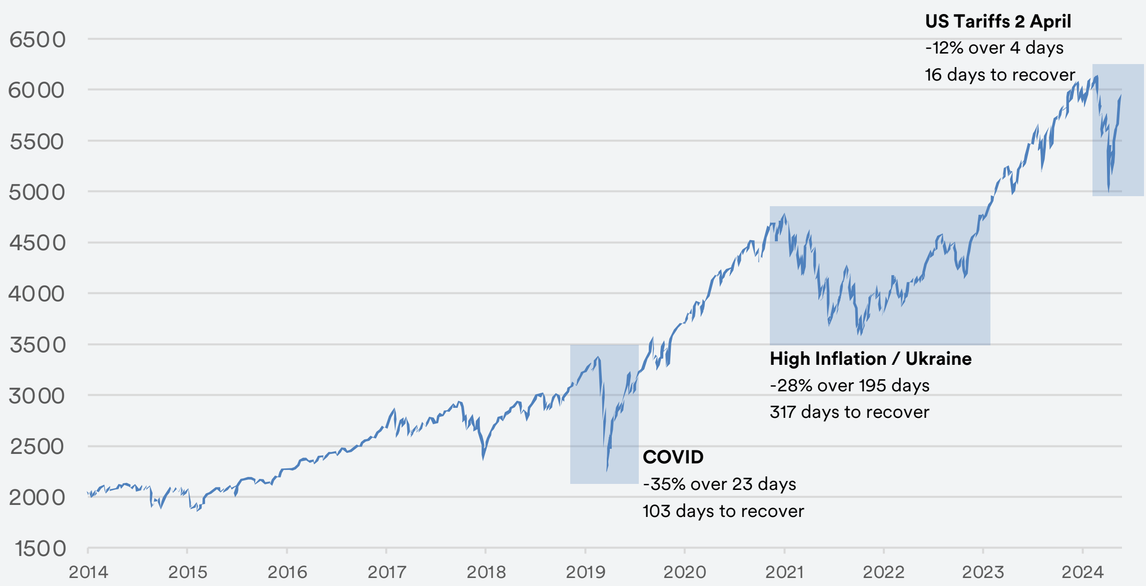
It is crucial to acknowledge that predicting the bottom of markets is an impossible task. The rapid recovery following the sell-off has once again demonstrated that remaining invested was indeed the correct strategy. Throughout the turmoil, we have consistently advocated for staying invested, and the recent market performance has validated this approach.

European markets continue to outperform

With the era of "US exceptionalism" maybe being over – and with it the US-led world economic and financial order of the last 50 years, the question for investors is now on how this might reshape capital flows. One of the most obvious destinations seems Europe, which is the home to the world's second-largest economy and second-biggest reserve currency and where the rule of law reigns supreme. Indeed, the equity markets in Europe and Switzerland continue outperforming this year. European earnings so far show that corporate health has been better than initially feared and equity prices have been riding the tide of the temporary US tariff pause and signs that China, a top customer for European firms, is striving to revive consumption. This strengthening of positive factors suggests that European and Swiss equities have the potential to continue outperforming other markets even in a challenging macroeconomic environment.

FIG. 3

S&P 500 Index shows a remarkable quick recovery after the tariff-related shock



Source: Bloomberg, smzh ag. 26/05/2025
Past performance is no indication for future results

Currencies and Gold

- Ongoing trend of international diversification likely to lead to further dollar weakness.
- The Swiss franc is caught between expensive valuations and its safe-haven status.
- Supporting factors of Gold remain intact, even though a healthy consolidation may be due.

How severe is the damage to the US Dollar?

The dollar has lost around 5% against a basket of major currencies since President Donald Trump's tariff 'Liberation Day' on April 2 and has fallen even 10% since mid-January. Although the currency has consolidated in recent weeks; it is far away from recovering like other risk assets did. Question marks about what the recent volatility means for the US Dollar remain. While a less clouded growth outlook and reduced expectations for US Fed rate cuts might lend some support to the dollar in the near-term, there is a clear risk that some damage has been done to foreign investors risk appetite for US assets. While the ongoing talk of the dollars demise as the worlds reserve currency looks overdone, this does not mean that the currency can depreciate further, especially given the concerns around the US current account and budget deficits. Over the longer-term, the trend of international diversification could lead to further dollar weakness. Therefore, investors with excess USD exposure may want to reduce their allocation in the US dollar.

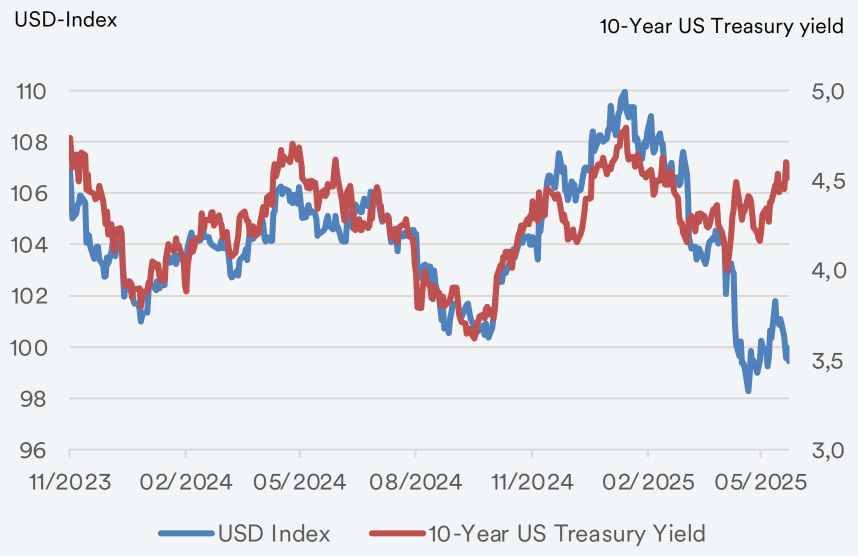
There is also evidence that the dollar's tight and well-established correlation with US Treasury yields has broken down in recent weeks. But history suggests that correlations could re-establish themself quickly again. While the dollar's longer-term direction may be lower, in the near term though, a pause or even a further recovery may be warranted, offering investors better levels to diversify away from it.

Gold benefits from investors' concerns around US debt dynamics

Amid growing concerns over the US government's weakening debt metrics, investors have gravitated towards gold as a safe-haven asset. Additionally, the weak US dollar makes gold more affordable for holders of other currencies. This currency dynamic has provided additional support to gold prices. Lingering stagflation risks within the US economy have further reinforced gold's positive trend. Overall, gold's performance reflects its role as a safe haven investment amid economic and geopolitical risks, and its outlook remains positive, where continued upward momentum looks likely.

FIG. 4

US Dollar and 10-Year US Treasury Yield moving in opposite direction since the tariff-shock



Source: Bloomberg, smzh ag. 23/05/205
Past performance is no indication for future results

Swiss Real Estate

- Mortgage lending practices are under the scrutiny of FINMA.
- Alternative financing instruments like mezzanine capital are gaining relevance, but their use is increasingly restricted by contractual limitations.

Mortgage lending practices under scrutiny

In its supervisory notice on 22 May 2025, FINMA once again expressed concern about the lending practices in the mortgage market. It criticizes that many banks insufficiently account for credit risks and frequently deviate from their own internal guidelines, for example through so-called ETP transactions (Exception-to-Policy) – i.e., financings outside of internal standards. According to FINMA, around 25% of new loans for residential investment properties is issued under an ETP. If uniform FINMA criteria were applied, this figure would rise to nearly 50%.

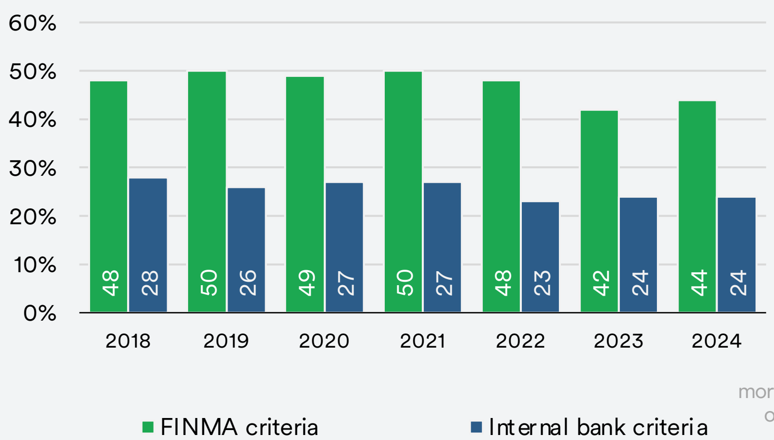
FINMA also highlights the varying ways in which banks utilize the existing regulatory leeway – for instance, in assessing affordability, loan-to-value ratios, or additional collateral. With the revised Capital Adequacy Ordinance implemented in 2025, this leeway has already noticeably narrowed. The latest FINMA data indicate that the ETP quota has generally been declining in recent years. In the short term, there appears to be no urgent need for action; however, in the medium term, regulatory pressure could further restrict banks' flexibility in lending.

Alternative forms of financing, which were meant to provide relief amid tightening credit conditions, are themselves increasingly constrained. While the number of providers and products – particularly in the mezzanine segment – is growing, banks are actively limiting their use. More and more often, loan agreements include clauses prohibiting subordinated financing – precisely the flexibility that would be most needed under increasing regulatory pressure.

Buyers with strong equity – particularly institutional investors with ongoing capital inflows – are clearly at an advantage in the current environment. Those heavily dependent on debt financing are increasingly facing constraints. For private investors, a stable and flexible capital structure is now essential to remain capable of acting under tighter conditions and to seize attractive acquisition or project opportunities.

FIG. 5

Comparison of ETP shares in new mortgage business: FINMA criteria vs. internal bank practices for residential investment properties



Note: The displayed ETP shares are based on the new mortgage business of 29 banks, each with a mortgage portfolio of at least CHF 6 billion. The evaluation is volume-weighted.
Source: FINMA, smzh ag

Bitcoin

- After surpassing the mark of 110'000 USD, Bitcoin is now among the five largest assets globally.
- ETF inflows have increased significantly and are concentrated in Bitcoin, supporting the current price trend.
- Market sentiment remains moderately optimistic – no signs of excess speculation like in 2021.

Bitcoin's New All-Time Highs: Sustainable Growth or Speculative Wave?

Bitcoin recently marked a new all-time high above 110'000 USD, making it currently the fifth-largest asset in the world by market capitalization. Notable is the timing relative to other asset classes: while gold had already begun its upward trend earlier, Bitcoin followed with a delay. The recent momentum coincided with the recovery in equity markets, supported by easing tensions in the US-China trade conflict. Bitcoin thus remains positioned between a tech investment and monetary store of value. The key question now is whether the rally is underpinned by structural strength or, as in 2021, merely represents an overstretched second wave.

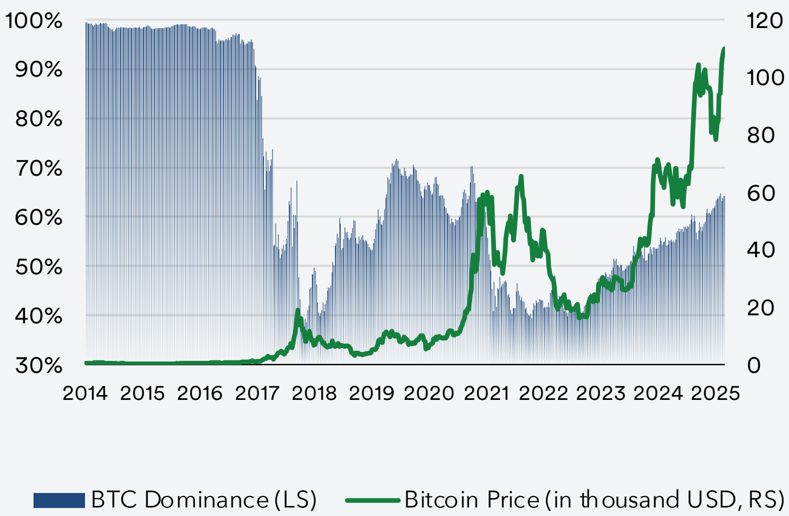
Sentiment indicators also remain contained: the Fear & Greed Index points to moderate risk appetite, with no signs of excessive euphoria. Compared to the second phase of the 2021 rally, which was driven by broad speculative participation, the current trend appears more disciplined.

Bitcoin is currently supported by relative strength and solid capital inflows. For investors, it remains attractive to maintain a buy-and-hold strategy and continue using temporary price corrections for selective accumulation.

A strong argument in favor of the sustainability of the current move comes from capital flows. Inflows into US spot Bitcoin ETFs have increased significantly. At the same time, the preceding rally in gold appears to have made Bitcoin more attractive as a macro hedge. A rotation of capital from gold into the digital alternative seems plausible. Within the crypto market, a clear concentration is evident: Bitcoin dominance, Bitcoin's share of the total market capitalization, has risen to over 64%. Capital flows remain selective and are focused almost exclusively on Bitcoin. Altcoins have shown little follow-through, with many trading below local highs and short-term rallies fading quickly.

FIG. 6

New all-time high in Bitcoin supported by capital inflow



Source: Bloomberg, TradingView, smzh ag. 26.05/2025

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