

Economico Flash ⚡ #21

Investment strategy: Allocation of the fixed-income quota


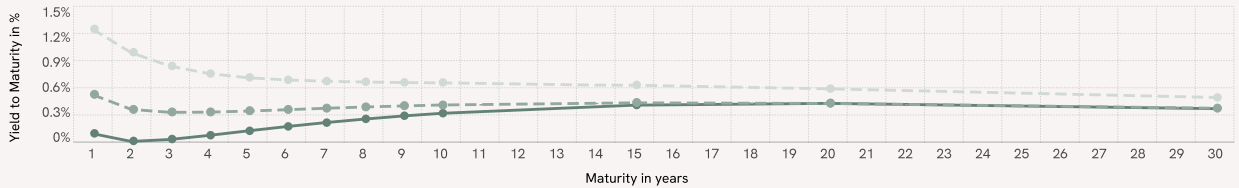
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Chart of the week: Current expiry yields and interest rate structure development in the Swiss franc

Asset Class	Benchmark	Yield to Maturity	Duration	Weighting in the Economico standard portfolios				
				Security	Interest Focus	Balanced	Growth	Share Focus
Money Market CHF	SARON CHF Overnight	0.45%	0.0	20%	5%	0%	0%	0%
Bonds CHF	Swiss Bond Index, AAA-BBB	0.65%	7.2	65%	65%	55%	40%	25%

Swiss Confederation bond yield curve



Source: SNB and Refinitiv market data as at 31.12.2024

This flash is about the allocation of the fixed-income ratio to the two asset classes included in the Economico standard portfolios: money market CHF and bonds CHF.

The return on the two asset classes is calculated from the **average interest rate** of the fixed-income securities combined in the asset classes, plus or minus the **changes in value** resulting from shifts in the yield curve.

The average interest rate is measured using the so-called **yield to maturity**. The average yield to maturity for the CHF bonds asset class was **0.65%** as at 31.12.2024. The changes in value due to interest rate changes are directly proportional to the average **duration** of the securities, and the potential change in value or risk of change in value of a fixed-interest security can be approximated using the formula *interest rate change * duration*. At the current duration of 7.2, a parallel upward shift of 1% in the yield curve would result in an immediate loss in value of 7.2%. CHF bonds - even those of high debtor quality such as Swiss Confederation bonds - are therefore subject to a substantial risk of change in value: if interest rates rise, the value of the bonds falls and vice versa. However, a negative (positive) change in value is always accompanied by a positive (negative) interest rate effect. Over the average remaining term, these two effects neutralize each other.

When comparing **money market CHF versus bonds CHF**, the first point of interest is the comparison of the average interest rate or yield to maturity: As longer maturities are generally compensated with a higher interest rate (<=> rising interest rate

structure), bonds CHF are preferable to money market CHF for reasons of profitability. According to the chart of the week, this is also currently the case: 10-year Swiss Confederation bonds yield 0.32%, which is 0.23% higher than 1-year Swiss Confederation bonds with an interest rate of 0.09%. Meagre, but more than nothing. However, if the yield curve is flat or even falling (<=> inverse yield curve) over a longer period of time, as it has been recently, then it is legitimate to replace CHF bonds with money market investments. When using money market investments, however, care must be taken to ensure that money market interest rates are actually generated in line with the market, which is often not the case with current account balances parked with the house bank.

When allocating the fixed-income value ratio of the Economico standard portfolios, we give preference to the CHF bond asset class over the CHF money market with reference to the generally rising interest rate structure. However, in the case of (persistently) flat or inverse interest rate structures, it makes perfect sense to deviate from this principle.

Takeaways

- CHF bonds (in contrast to CHF cash) are subject to value change risks.
- With a normally rising yield curve, CHF bonds yield better.