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Economico

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# Economico Flash #23

## Investment strategy: (No) Foreign currency bonds

**Chart of the week: Profitability comparison of CHF bonds and FW bonds, currency-hedged**

| Asset Class | Benchmark | Retrospective (annualized returns) | | | | |
|---|---|---|---|---|---|---|
| | | 1yr | 3yr | 5yr | 10yr | 20yr |
| Bonds CHF | Swiss Bond Index, AAA-BBB Segment | 5.35% | -0.19% | -0.30% | 0.47% | 1.80% |
| Government Bonds FC, hedged | FTSE World Government Bond Index (hdgd) | -1.39% | -4.38% | -2.57% | -0.86% | 1.15% |
| Corporate Bonds FC, hedged | FTSE WorldBIG Corporate Index (hdgd) | -0.76% | -4.85% | -2.11% | -0.14% | 1.71% |

| Asset Class | Benchmark | Forecast (per 31.12.2024) | | | | |
|---|---|---|---|---|---|---|
| | | Yield-to-Maturity | FX-Hedge | Coupon-Yield | Tax-Deduction | Net return |
| Bonds CHF | Swiss Bond Index, AAA-BBB Segment | 0.67% | 0% | 1.18% | 0.41% | 0.26% |
| Government Bonds FC, hedged | FTSE World Government Bond Index (hdgd) | 3.48% | 3.02% | 2.41% | 0.84% | -0.38% |
| Corporate Bonds FC, hedged | FTSE WorldBIG Corporate Index (hdgd) | 5.05% | 3.51% | 3.68% | 1.29% | 0.25% |

*Net return = yield to maturity - FX hedging - tax deduction*

Source: Historical yields according to AUGUR as of 31.12.2024; coupon yield: average 2024 according to SIX and FTSE

According to the last Flash on the subject of currency hedging, it is advisable to hedge the currency risk of foreign currency bonds (FC). If this is not done, the FW bond asset class should primarily be seen as a currency bet, which can also be established more easily and cheaply with a money market fund in the desired foreign currency.

Consequently, the question arises as to whether the FW bond asset class, currency-hedged, is a sensible addition to the CHF bond asset class. The historical yield comparison illustrated in the table above tends to suggest no, as CHF bonds have outperformed both issuer segments, FW government bonds and FW corporate bonds, over all time frames. The diversification argument can also be questioned in the case of high-grade CHF bonds (Swiss Confederation bonds, mortgage bonds, etc.).

If one looks ahead and compares the yield potential on the basis of yield to maturity, these are significantly higher for the FC segments in local currency due to the higher interest rates. However, if the interest rate difference resulting from currency hedging is deducted, the hedge-adjusted yield to maturity of the FC government bonds is lower than the yield to maturity of the CHF bonds, while that of the FC corporate bonds remains above the level of the CHF bonds even after currency hedging.

Credit risk-related deductions due to expected credit defaults have not yet been taken into account, but are low for the high-ranking investment-grade segments under review (AAA-BBB).

Private investors who are subject to income tax must also bear in mind that the coupon yields (which are significantly higher in the foreign currency segments) are subject to income tax as interest income and are therefore subject to withholding tax. This is the decisive argument for us not to include the asset class bonds FW, currency-hedged, in the composition of the Economico standard portfolios.

### Takeaways

CHF bonds or FC bonds, hedged?

- For tax-exempt investors: Red zero for FW government bonds, (perhaps) black zero for FW corporate bonds
- For taxable investors: Stay away from currency-hedged FW bonds