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Jean-Pierre Danthine, Samuel Danthine

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**On the Rewards to International Investing:
A Safe Haven Currency Perspective**

**Jean-Pierre Danthine
Samuel Danthine**

JEL Codes: F30, F31, G11

Keywords: Uncovered Interest Parity; Safe haven currency; currency hedging



PARIS-JOURDAN SCIENCES ÉCONOMIQUES

48, Bd JOURDAN – E.N.S. – 75014 PARIS
TÉL. : 33(0) 1 43 13 63 00 – FAX : 33 (0) 1 43 13 63 10
www.pse.ens.fr

On the Rewards to International Investing: A Safe Haven Currency Perspective *

Jean-Pierre Danthine (PSE and CEPR)

Samuel Danthine (ENSAI)

May 21, 2017

Abstract

The safe haven property of the Swiss franc presents a specific challenge for Swiss-based investors in their international investments. The central issue is whether the traditional underperformance of Swiss assets is compensated by the currency risk associated with the safe haven and the secular appreciation tendency of the franc. In this paper we review the evidence on the terms of this challenge. We conclude that long-run Swiss-based investors are well compensated for the currency risks they take on, that a Swiss-bias in asset allocation can lead to considerable return shortfalls over the long run, and that systematic currency hedging would not have been historically justified and is unlikely to be in the future.

Keywords: Uncovered Interest Parity; Safe haven currency; currency hedging
JEL Class.: F30, F31, G11

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Emails: jean-pierre.danthine@psemail.eu; danthine.samuel@gmail.com.

1 Introduction

Although the benefits of international portfolio diversification are particularly apparent to residents of a small country such as Switzerland, Swiss-franc based investors face a very specific challenge when they set foot abroad. On the one hand, the secular tendency of the franc to appreciate in nominal, but also possibly in real, terms against the major alternative currencies presents a significant hurdle when the proceeds of their international investments are converted back into the home currency. On the other hand, the persistent negative differential that has characterized the returns on CHF-denominated assets (relative to those observed in other major markets) acts as a countervailing force. Moreover, the negative interest differential is the corollary of the safe-haven property of the franc, which entails the risk of a sudden, rapid appreciation of the currency thus representing a third highly relevant factor in the analysis.

Using data from 1980 to 2003, that is before the Great Financial Crisis, Kugler & Weder (2004) came to the conclusion that the negative interest differential outweighed the tendency of the franc to appreciate so that an unhedged rolled over 3-month position in dollars, UK sterling and euros converted in Swiss francs delivered superior returns to a pure Swiss franc investment. They concluded that uncovered interest parity (UIP) had not been validated over their period of observation. They further observed the over-performance of an unhedged investment in foreign currency ten-year bond portfolios while a Swiss franc equity investment had delivered a superior return compared to equity portfolios in each of the three foreign currencies after conversion into francs.

In this paper, we return to this issue with the benefit of a severe crisis being part of our period of observation. The Swiss negative interest rate differential has been a puzzle for a long time (and it is the focus of Kugler and Weder's inquiry). We believe the additional period of observation permits reaching a coherent logical explanation for this phenomenon. A safe haven asset is one which provides insurance against rare but severe shocks. This insurance must have a price in the form of offering lower returns in normal times or else the asset in question would be a dominating asset. It is not surprising therefore that, in the case of the CHF, uncovered interest parity does not hold, possibly for long, crisis-free time periods. But this normal return deficit may be made up in crisis times where the safe haven characteristics of the currency manifest itself with a vengeance. We will see that this view is consistent with the observations over the last 36 years and highlight the ensuing challenges facing Swiss-based investors.

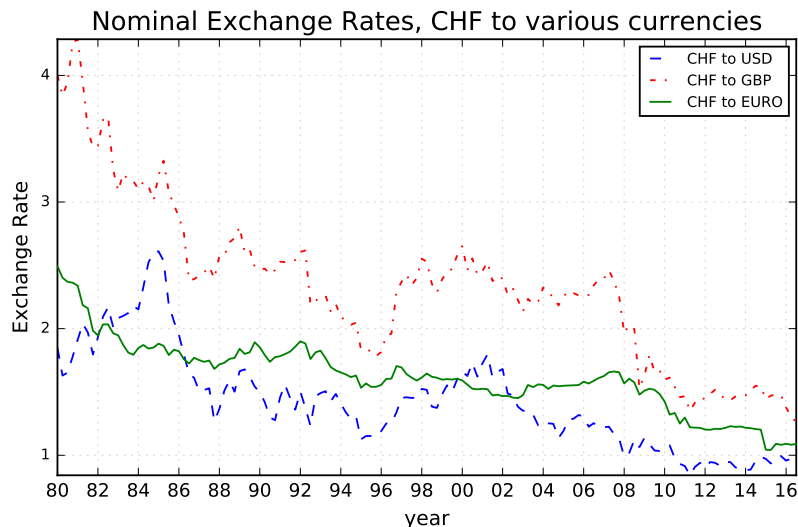
We push the inquiry one step further by adding a comparison between hedged and unhedged returns, taking the cost of hedging into account, with the goal of assessing the performance of a systematic currency hedging strategy. We observe that the question of whether it pays to hedge or not is directly related to the observation of significant and long lasting deviations from UIP. We suggest that a selective hedging strategy based on the strength of the franc has good chances of being successful and that it would have dominated a systematic hedge over the last 36 years.

2 Uncovered Interest Parity

As a starter, Figure 1 depicts the evolution of the bilateral exchange rates between the CHF and the DM/Euro, US dollar and the Pound Sterling since the beginning of our sample in 1980 until the end of 2016. It powerfully feeds the fear that unhedged investments in foreign assets by Swiss-

based investors are prohibitive: the trend-like appreciation of the CHF gives the appearance of a formidable obstacle for earning a positive return after conversion of one's investment into francs.

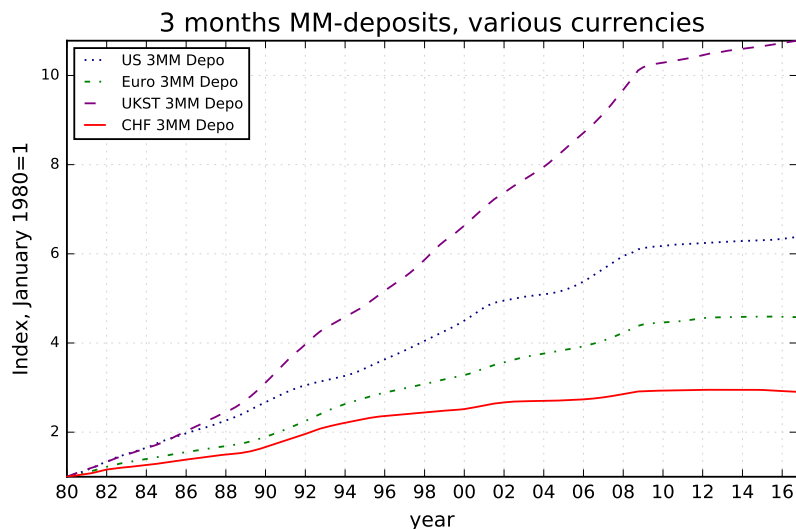
Fig. 1: Exchange rates to the CHF since 1980



Source: Bank of England

Figure 2 provides a radically different perspective. It displays the cumulative return obtained over the period by rolling over 3-month money market (MM) portfolios in dollars, euros/DM and UK Sterling as opposed to a similar portfolio in CHF. It illustrates the dilemma presented Swiss franc investors: the returns in the three alternative currencies are significantly more attractive than those that can be expected from a direct investment in franc. With the power of compounding, the difference over a period as long as the one adopted here can be huge.

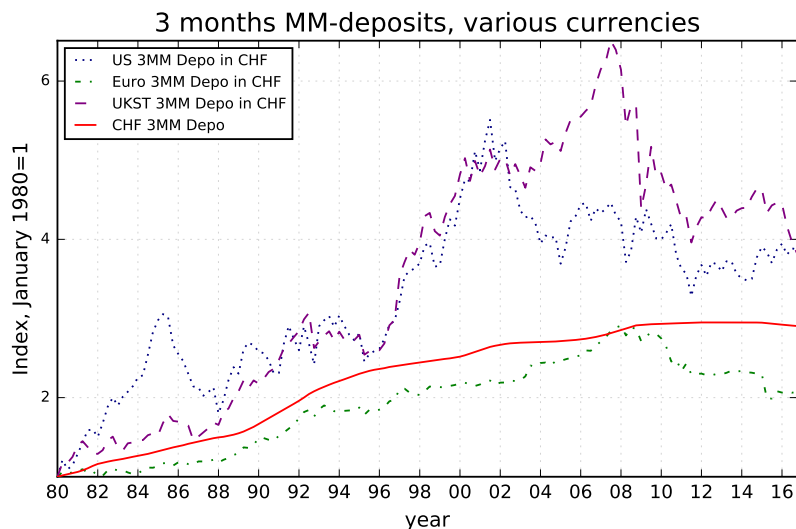
Fig. 2: Cumulative return on 3-month MM deposits



Source: Datastream

Naturally, a good deal of the nominal return differences shown in Figure 2 must be accounted for by inflation differences between the corresponding countries, with Switzerland exhibiting lower average rates of inflation. Simultaneously, these inflation differentials have much to do with the evolution of the exchange rates observed in Figure 1. But real exchange rates (i.e., exchange rates corrected for the inflation differentials) are not constant, deviations from purchasing power parity can be long lasting and the possibility of a secular *real* appreciation of the franc cannot be excluded. The critical issue for a Swiss-based investor is therefore whether, over the investment horizon, the positive return differentials on investments in foreign currencies more than compensate for the nominal appreciation of the CHF. Figure 3 shows that this has largely been the case for the dollar and the sterling, less clearly so for the euro. One sees that the dollar and sterling 3-month portfolios would have obtained a cumulative return significantly in excess of the similar investment in CHF, even after conversion into the Swiss currency. Moreover one observes that the cumulative excess returns (over the CHF-portfolio) can take temporarily extremely large values. On the other hand, the difference between the Euro-DM and the CHF portfolios is much smaller, with the two portfolios displaying a very similar performance approximately until the prelude to the crisis in 2007 (which corresponds to the beginning of the strong CHF appreciation that has marked the Great Financial Crisis), and the euro 3-month portfolio severely under-performing the CHF investment thereafter.

Fig. 3: Cumulative return on 3-month MM - deposits after conversion into CHF



Source: Datastream

Table 1 summarizes the average return differences with the CHF- portfolio for various sub-periods. Line 2 show the underperformance of the CHF portfolio before the crisis relative to the dollar and the sterling portfolios while parity is achieved at the eve of the crisis between the franc and the euro portfolios. Line 4 displays the strong reversal observed during the crisis especially for the euro and pound portfolios. Line 1 shows that, over the entire period, the return difference averages approx. 1.5 percent per year for the dollar and the pound portfolios while in the case of the euro the superior performance of the franc portfolio over the crisis has been the dominant factor.¹

Table 1: Return Differences on 3m Deposits

Period	EURO	USD	UKST
1980-2016	-0.79	1.65	1.34
1980-2007	0.01	2.70	3.60
1980-2003	-0.32	2.71	3.22
2008-2016	-3.78	-0.70	-4.80

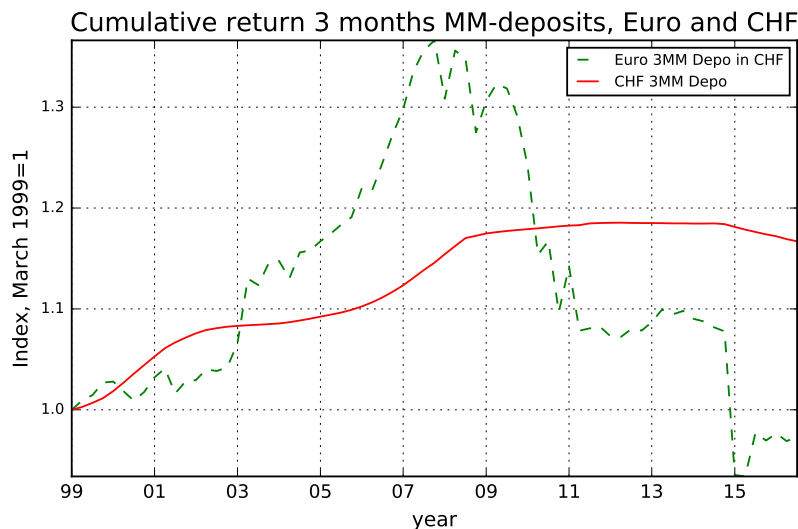
Note: Annualized returns on 3-month deposits after conversion in CHF in excess of the return on a 3-month CHF portfolio.

The comparison with the euro portfolio is somewhat questionable, however, because before the advent of the euro we are effectively looking at the performance of a 3-month DM investment while using a reconstituted synthetic euro which does not reflect the behavior of the DM itself,

¹We compute an average for the 1980-2003 period to enable a comparison with Kugler and Weder (2004). While our results are qualitatively similar to theirs, they are not quantitatively identical, most likely because of data issues and possible differences in the computations. Our tables and diagrams suggest the data volatility makes it perilous to focus on a single length sample.

but of a basket composed of the currencies of the then members of the euro (Germany being given a weight of 33 percent). To get a cleaner message it makes sense to look at the euro portfolio since the advent of the common currency. We do this in Figure 4 which delivers a clear message: the euro portfolio strongly over-performed in “peacetime” but this was followed, with the advent of the financial crisis, by a reversal in favor of the CHF-portfolio, leading to almost exactly 8 years of superiority of the euro portfolio followed by 8 years of under-performance.

Fig. 4: Cumulative performance of the Euro and CHF portfolios since the advent of the euro



Source: Datastream

These observations confirm that deviations from uncovered interest parity can be long lasting. They also show that in normal times, the return differential pays off in the sense that, over the years, it more than compensates for the nominal appreciation of the franc. In the case of the dollar and the sterling, and for the euro itself from its inception to 2007, the cumulative return advantage over long periods has been substantial. In crisis times, however, the appreciation of the safe haven currency combined with the compressed interest differentials at the Zero-Lower-Bound leads to reversals where investments in the safe haven currency delivers superior returns, as should be expected. Note that in the case of the dollar, the weakness of the early 2000’s has been as significant as the financial crisis itself. This is no doubt a reflection of the fact that the dollar also possesses a safe haven characteristic. Figure 4 shows that the reversal has been dramatic in the case of the euro, plausibly because the euro area has been at the center of the crisis, so that it has wiped out the return advantage cumulated until the advent of the crisis. Viewed from this angle the hypothesis of uncovered interest parity appears validated. This validation, however, comes with the modulo that, in the case at hand, one may have to wait for a very severe crisis before observing the equalization of returns (and, as for all low frequency events, such an event may not materialize in the course of a sample of finite length). The reversal has been in full force for the UK Sterling as well but the return advantage cumulated until 2007 was too large to have been wiped out by the advent of the crisis. The situation is similar in the case of the dollar. Here again the return advantage cumulated until approximately 2000 was so substantial that it was

not annihilated by the subsequent under-performance of the dollar portfolio.

For completeness and later use, a few comments on the data and the computation. Our data are the annualized 3 month - deposit rates and the 10-year benchmark government bond indices from Datastream, on the one hand, the relevant MSCI Equity indices, on the other. In addition, we use the nominal exchange rates between Switzerland and each of the other three countries published by the Bank of England (BOE).

If we denote \hat{r}_t the interest rate on 3-month deposit in CHF, and \hat{r}_t^* the corresponding rate for a 3-month deposit in one of our 3 alternative currencies, the return difference in Table 1 can be written

$$\hat{r}_t^{*CH} - \hat{r}_t = \left[(1 + \hat{r}_t^*) \frac{E_{t+1}}{E_t} - 1 \right] - \hat{r}_t = (1 + \hat{r}_t^*) \left[\frac{E_{t+1}}{E_t} - \frac{1 + \hat{r}_t}{1 + \hat{r}_t^*} \right] \quad (1)$$

where \hat{r}_t^{*CH} stands for the foreign return after conversion into CHF and E_t is the spot exchange rate between the CHF and the relevant currency.

3 Bond Portfolios

We now take a look at the relative performance of 10-year bond portfolios in the four currencies under consideration. The long-lived deviations from uncovered interest parity displayed in the last section are sure to have a significant influence on the longer maturity assets but differences in the dynamics of term-premia and inflation-risk premia across currencies are also plausible. This is notably the case because of the well-known link between inflation levels and volatility suggesting that inflation risk premia and their dynamics could differ between currencies.

Table 2: Excess Return on 10-year bond portfolios in local currency

Period	EURO	USD	UKST
1980-2016	2.10	3.06	4.74
1980-2007	2.16	3.88	5.61
1980-2003	2.25	4.45	6.30
2008-2016	1.93	0.58	2.15

Note: One year holding period return on 10 year benchmark government bond portfolios in various currencies net of the return on a comparable CHF portfolio.

Table 2 shows that until the advent of the crisis, differences in return between 10-year bond portfolios in dollar, UK and euro/ (bund), on the one hand, and a 10-year CHF portfolio, on the other, were substantial with an order of magnitude of 3, 5 and 2 percent per annum, respectively. Worth noting is how these return differences were compressed during the crisis (but not annihilated), in particular in the case of the dollar and the sterling. Since this was precisely the time where the safe haven currency appreciated, one can expect that the nominal return differences in that sub-period were no longer sufficient to compensate investors for the change in the value of the Swiss franc.

Table 3 confirms this intuition by displaying average return differences after conversion into Swiss francs. The crisis time was indeed a period where the CHF portfolio offered superior

return but the superiority of the CHF portfolio over the last 8 years has not been sufficient to compensate for the return deficit over the preceding period 27 years, except in the case of the euro. The euro and the CHF portfolios display an almost equal average return over the whole period. Note that even after taking the crisis period and the strong appreciation of the CHF into account, substantially higher returns for the US and UK bond portfolios are recorded over the entire period with average excess returns of 1.6 percent and 1.8 percent per annum, respectively.

Table 3: Excess Return on 10 year bond portfolios after conversion in CHF

Period	EURO	USD	UKST
1980-2016	-0.03	1.58	1.77
1980-2007	0.97	2.56	3.77
1980-2003	0.49	3.32	3.77
2008-2016	-3.00	-1.34	-4.23

Note: One year holding period return on 10 year benchmark government bond portfolios in various currencies after conversion in CHF net of the return on a comparable CHF portfolio.

Here again it is worth inquiring whether the difference in behavior between the euro, on the one hand, and the two other international currencies, on the other, could be due to the hybrid status of the euro comparison before 1999. The same answer is obtained as in the case of the 3-month money market portfolios: the euro-portfolio clearly dominates the CHF-portfolio for the first eight years of existence of the euro (with an average yearly over-performance of 2.19 percent) while the reverse is true (under-performance of 3 percent yearly) for the next 8 years as shown in Table 3.

4 Equity Portfolios

Let us now have a look at equity portfolios. Tables 4 and 5 compare equity returns in foreign currencies and in Swiss franc. Table 5 confirms the observation of Kugler and Weder (2004) that the positive return differences observed in the fixed income portfolios are not uniformly duplicated when it comes to equity, at least not in euro and in sterling. While the foreign currency equity portfolios uniformly dominate the CHF- equity portfolio in local currencies, the Swiss equity portfolio has over-performed the euro and sterling equity portfolios after conversion into Swiss francs. There is substantial volatility across period, however, and the performance of the franc during the crisis appears to be the dominating factor for these two currencies. By contrast the strong performance of the dollar equity portfolio since the trough of the crisis is the critical factor explaining the superiority of the dollar equity portfolio over the entire period.

5 A Costly Swiss- Home Bias

The main message of the three preceding sections may be that while a Swiss bias in international asset allocation can be understood as the product of fear (notably following a severe crisis) such a bias may prove very costly over the long run. It is true that over a horizon of a few years the evolution of the exchange rate can be dominant and have devastating consequences on unhedged

Table 4: Excess returns on equity portfolios in local currency

Period	EURO	USD	UKST
1980-2016	1.19	1.40	0.97
1980-2007	1.50	0.40	0.91
1980-2003	1.65	1.55	1.62
2008-2016	0.20	4.51	1.18

Note: One year holding period return on MSCI equity indices in various currencies net of the return on a comparable CHF portfolio.

Table 5: Excess returns on equity portfolios after conversion in CHF

Period	EURO	USD	UKST
1980-2016	-0.98	0.56	-1.39
1980-2007	0.11	0.04	-0.49
1980-2003	-0.38	1.60	-0.43
2008-2016	-4.37	2.20	-4.20

Note: One year holding period return on MSCI equity indices in various currencies after conversion in CHF net of the return on a comparable CHF portfolio.

portfolio returns. While the dollar weakness of the early 2000's has been significant, the exchange rate impact is felt most critically during a crisis period when international diversification from a safe haven currency base appears very disadvantageous. This no doubt explains the current proclivity of Swiss investors to "remain at home".

But the data also show that the cumulative return differences in normal times can be very large, i.e., the price paid for indulging a Swiss investment bias, measured in terms of the return shortfall over long horizons, can be extremely high. And the general positive return difference in favor of international assets means that despite the tendency of the franc to appreciate over time the benefits of international diversification can be obtained at little or no cost for a Swiss investor with a long view. Admittedly, in the long run we are all dead but, much before, we turn pensioners and this renders this observation highly relevant!

The temptation to believe that one could have the cake and eat it too may be present, however. After all, a Swiss-based investor could hope to take advantage of the positive return differences highlighted in Tables 3 and 5 while at the same time systematically hedging currency risks. We address this issue in the next section.

6 Should Swiss-investors hedge currency risks?

Assuming a Swiss-based investor is convinced by the message of the previous sections and wishes a significant fraction of her portfolio to be invested in international bond and equity portfolios, should she be advised to hedge the corresponding currency risks taking hedging costs into

account?²

To answer this question, we will approximate the hedging cost with the yearly equivalent of the difference between the 3- month return in alternative currency and the 3-month return in CHF. That is, we postulate, un-controversially until recently, that covered interest parity (CIP) holds but more controversially that there are no other transaction costs in covering a bond or an equity portfolio over the long run.³ By doing so, we certainly underestimate the hedging cost and our results should be viewed in this light.

Together with the observed negative return differential over short horizons, CIP implies that hedging currency risk entails a significant cost for a Swiss investor. The cost of hedging long bond or equity portfolios could nevertheless be justified by large exchange rate moves. To investigate this issue we adopt once again a long run perspective, i.e., we do not focus on the reduction of short run volatility offered by currency hedging. We are more concerned with the impact of hedging on returns, that is, on the question whether over time the protection against large exchange rate movements justifies the hedging costs.

Before looking at the results it is illuminating to have an analytical examination of the returns under consideration. Assuming covered interest parity, we can measure the ratio of the Forward (F) to the Spot exchange (E) as:

$$\frac{F_{t,t+1}}{E_t} = \frac{1 + \hat{r}_t}{1 + \hat{r}_t^*}. \quad (2)$$

Defining I_t recursively as $I_{t+1} = (1 + r_t^*)I_t$, $I_1 = 1$, we compute the return on the hedged portfolios as

$$r_t^{*h} = \frac{I_t F_{t,t+1} + (I_{t+1} - I_t) E_{t+1} - I_t E_t}{I_t E_t} = \quad (3)$$

$$\frac{F_{t,t+1}}{E_t} + \frac{I_{t+1} E_{t+1}}{I_t E_t} - \frac{I_t E_{t+1}}{I_t E_t} - \frac{I_t E_t}{I_t E_t} = \quad (4)$$

$$r_t^* \frac{E_{t+1}}{E_t} + \frac{F_{t,t+1}}{E_t} - 1, \text{ or alternatively} \quad (5)$$

$$r_t^{*CH} + \frac{F_{t,t+1}}{E_t} - \frac{E_{t+1}}{E_t}. \quad (6)$$

where $r_t^{*CH} = \frac{I_{t+1} E_{t+1} - I_t E_t}{I_t E_t}$ is the foreign return after conversion into CHF.

These return differences are not dependent on the nature of the underlying asset. They apply equally for the bond as for the equity portfolios.

Note as well that using equation (2) into Equation (6) one obtains

$$r_t^{*CH} - r_t^{*h} = \frac{E_{t+1}}{E_t} - \frac{1 + \hat{r}_t}{1 + \hat{r}_t^*}. \quad (7)$$

²Of course in a portfolio context the covariance between the hedged vs. unhedged return series should play a major role. It is beyond the scope of the present paper to perform a full portfolio optimization doing justice to these considerations.

³CIP was viewed as something close to a physical law until the crisis but it has been consistently violated since. This entails a supplementary element in the cost of hedging. See Borio et al. (2016) and references therein.

Comparing this last equation with equation (1) one sees that the issue of whether it pays to hedge is in fact another version of the question of whether UIP is validated. The long run deviations from UIP discussed in Section 2 therefore imply that there are long time periods where hedging does not pay but also other periods where the exchange rate moves swamp the interest differential and thus justify incurring the cost of hedging.

The differences in returns between unhedged and hedged portfolios are recorded in Table 6 where we have added to the 3 main sub-periods considered so far a computation of the average return differences for all the 5-year sub-periods in our sample. These results confirm the observations made in Section 2 showing not surprisingly that hedging foreign currency portfolios has paid in crisis times (line 4). But this has not been true if one considers the entire period of observation except in the case of the euro. In other words, focusing on the dollar and the sterling and adopting a long run perspective, the cost of hedging has not been covered by the average appreciation of the franc. Limiting ourselves to the period of existence of the euro, one would have been well advised to leave the euro-portfolio unhedged for the first 8 years of the existence of the euro (superior performance of 2.12 percent for the unhedged portfolio from 1999 to 2007) while of course the reverse has been true since the crisis as already noted.

Table 6: Average yearly Return differences - Unhedged vs Hedged portfolios

Period	Euro	US	UK
1980-2016	-0.77	1.53	1.27
1980-2007	0.18	2.24	3.21
1980-2003	-0.30	2.50	3.04
2008-2016	-3.76	-0.71	-4.77
1980-1985	-3.25	8.68	1.51
1985-1990	-0.30	-8.19	3.22
1990-1995	-2.09	-4.37	-2.43
1995-2000	0.48	7.92	7.78
2000-2005	1.14	-1.09	1.21
2005-2010	-2.06	-1.06	-3.39
2010-2016	-3.71	0.01	-3.06

Note: Differences of the mean quarterly returns on unhedged and hedged portfolios, annualized.

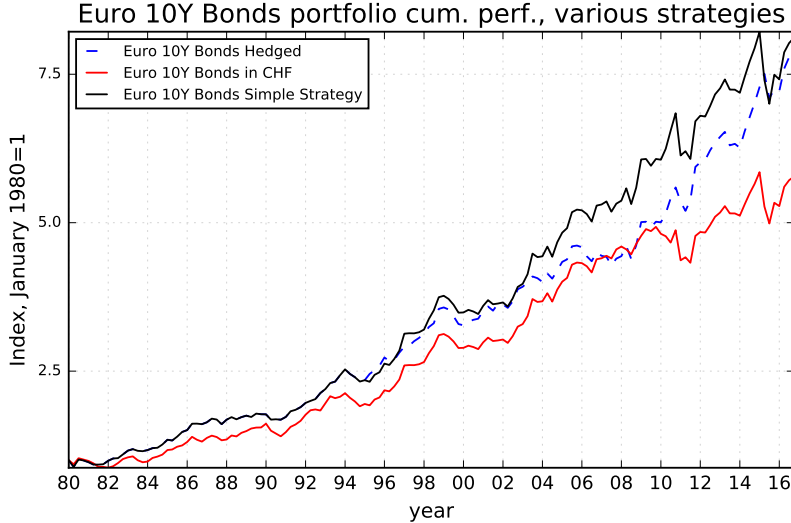
Figures 5 to 10 record the cumulative performance of hedged and unhedged 10-year bond and equity portfolios in the three alternative currencies under consideration. These figures, whose content does not deviate from the message of Figure 3, show that the cumulative performance of Unhedged vs. Hedged portfolios over the 36-year period has been positive in dollar and in sterling but negative in euro. More importantly the graphs make clear that systematic hedging of the foreign currency portfolios promise long sub-periods of very significant under-performance, the most dramatic ones being the period 1980-85 and 1994-2000 in the case of the dollar (these were two periods of dollar appreciation) and 1994- 2007 for the sterling (similarly one long period of strong sterling). The offsetting factor is of course the impact of a few prolonged up-moves in the Swiss franc, during the crisis of course but also associated with the dollar weakness of the early 2000's.

This configuration presents a significant challenge for Swiss-franc based investors. The long periods of very significant under-performance disqualify in our view a policy of systematic hedging of currency risks. Taking into account the additional intermediation transaction costs associated with portfolio hedging would make a policy of systematic currency hedging prohibitive. Yet it is also a fact that the periods of sharp CHF appreciation loom large over the overall portfolio performance and they should be avoided if at all possible. All in all, these observations strongly support a policy of selective currency hedging by a long-run Swiss-based investor. This in turn requires a careful analysis of FX relationships so as to be in position to make informed decisions on the timing of the hedging decisions. Here is not the place to develop an exchange rate forecasting model but such a model would have to take account of two facts: the random walk characteristic of exchange rates over the short run, suggesting that it is illusory to attempt timing the high frequency FX movements, and the return-towards-the mean property of real exchange rates over the medium to long run.

To illustrate, a very first step might be for a long run investor to refrain from hedging when the real value of its base currency is high on a historical basis - say x percent above its long run trend - and conversely to make sure a hedge is locked in when it is abnormally low, say y percent below trend. While one can go much further in terms of sophistication (notably by focusing on bilateral exchange rate relationships), Figure 11 suggests that the application of this simple rule based on the Real Effective Exchange Rate of the Swiss franc would likely have been very successful since it would have led to leaving the portfolios unhedged starting about in mid-1994 thus permitting to benefit from the long period of superior returns of the unhedged portfolios while being partly protected when the strong appreciation of the CHF started in 2007.⁴ The result of a version of this simple strategy - where the default is a fully hedged portfolio, the hedged is unlocked for $x = 10$ and is reintroduced when $y = -5$ - is also displayed in Figures 5 to 10. The simple strategy delivers clearly superior returns in the case of the British pound, is slightly dominant in the case of the euro (but is handicapped by the hedge being unlocked in January 2015 when the floor with the euro is abandoned by the SNB) and it beats the hedged strategies but not the unhedged portfolios in the case of the dollar.

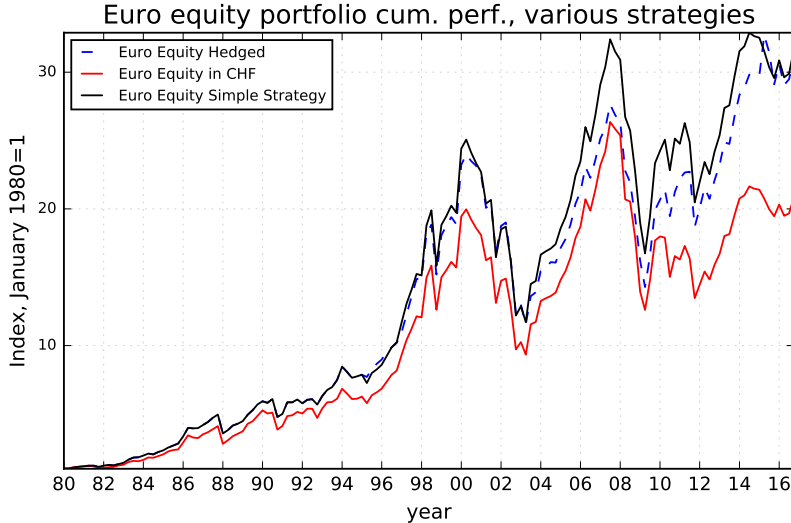
⁴The central horizontal line in Figure 11 is the average REER of the CHF from 1990 to 2008. Under the hypothesis of a stationary REER it is a number that could have been approximated *ex ante* during most of the 1990's and the 2000's.

Fig. 5: Euro 10Y bonds cumulative performance: Unhedged, Hedged and simple strategy



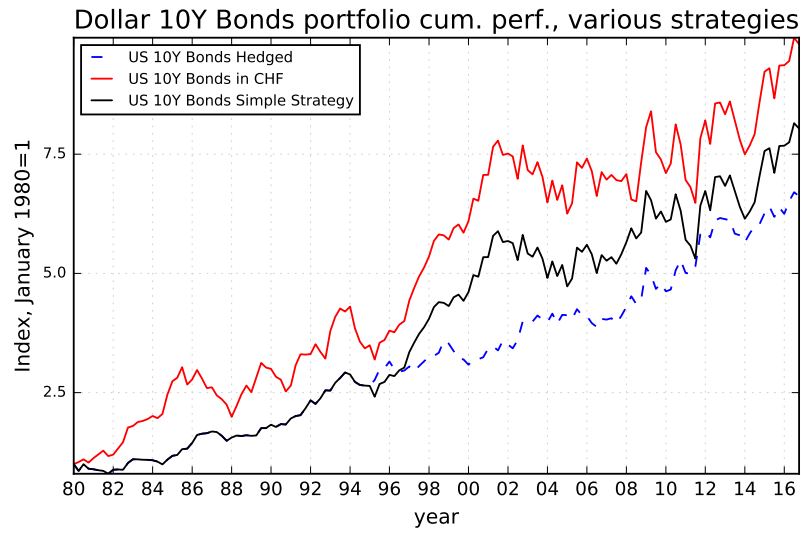
Source: Datastream

Fig. 6: Euro Equity cumulative performance: Unhedged, Hedged and simple strategy



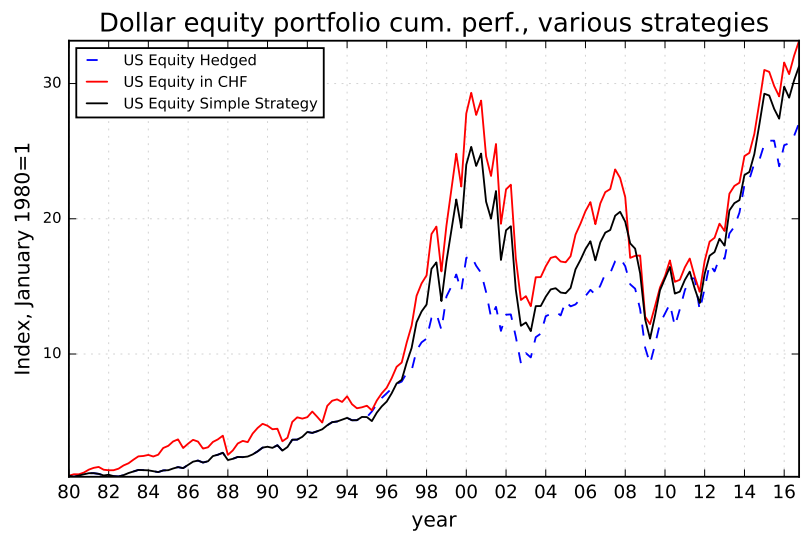
Source: Datastream

Fig. 7: Dollar 10Y bond cumulative performance: Unhedged, Hedged and Simple strategy



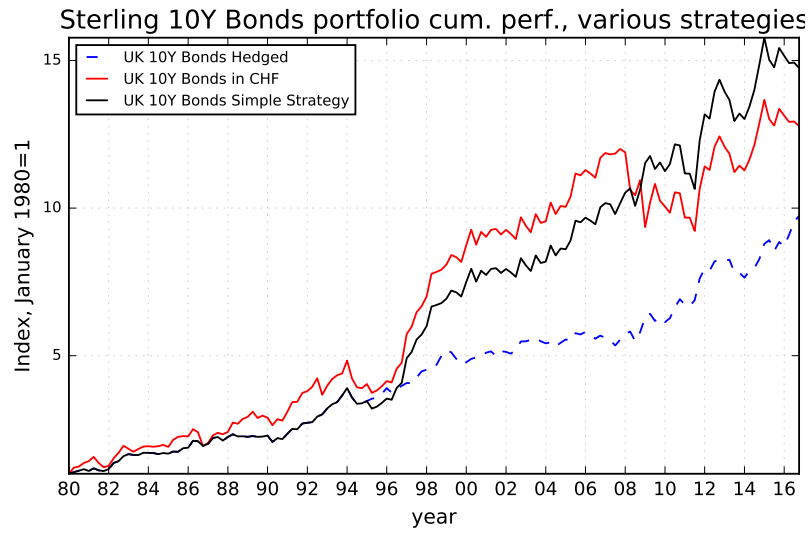
Source: Datastream

Fig. 8: Dollar Equity cumulative performance: Unhedged, Hedged and simple strategy



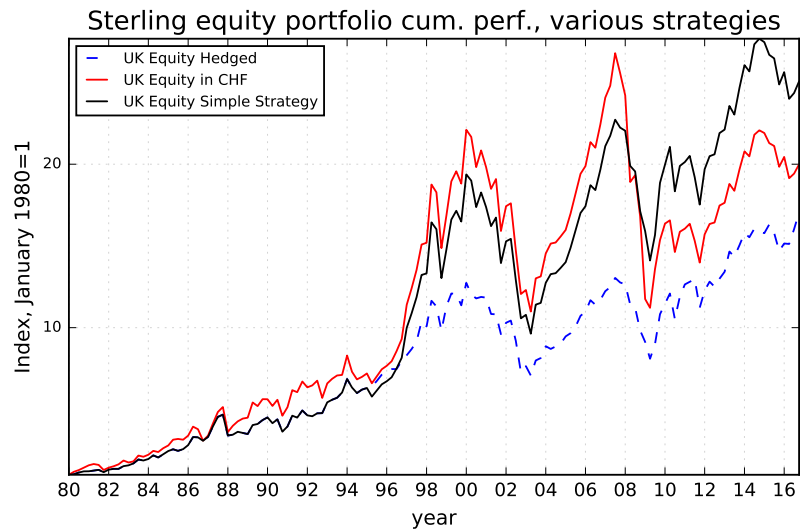
Source: Datastream

Fig. 9: Sterling 10Y bonds cumulative performance: Unhedged, Hedged and simple strategy



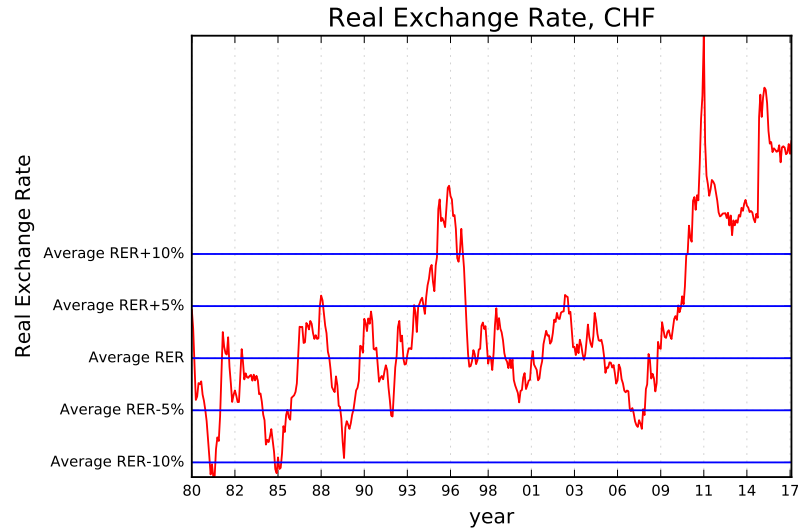
Source: Datastream

Fig. 10: Sterling Equity cumulative performance: Unhedged, Hedged and simple strategy



Source: Datastream

Fig. 11: CHF Real Exchange Rate



Source: BIS

7 Conclusions

Switzerland's external equilibrium is predicated on a steady stream of private (net) capital exports balancing the structural current account surplus of the country. This equilibrium has been disrupted since the Fall of 2008. In the current situation of disequilibrium, very significant public capital exports (in the form of FX interventions by the Swiss National Bank - SNB) are the only protection against an even stronger CHF. The question of whether a return to the pre-crisis equilibrium is likely is of prime importance for the country. A negative answer combined with the observation that permanent interventions by the SNB must be ruled out implies a structurally much stronger CHF eroding the competitiveness of large portions of the Swiss industry until the current account surplus is eliminated.

This study has reviewed the plausibility of a return to the pre-crisis equilibrium. It has shown that the positive return differentials obtained on foreign currency investments over Swiss assets has historically provided an appropriate compensation for the currency risk attached to the CHF and has permitted generating large cumulative excess returns on unhedged investments in non-Swiss assets. Selective currency hedging limited to episodes where the Swiss franc was extraordinarily weak would have generated an appreciable return boost.

While the usual word of caution: "past performance is no guarantee for future returns" is appropriate, the qualitative properties of a safe haven currency highlighted in this paper should prevail in the future as they have in the past 36 years. We are led to the conclusion that the current situation with a very strong franc is ideal for undertaking the currency risks associated with international investments. The conditions for a return to the pre-crisis external equilibrium are thus fulfilled, were Swiss investors ready to put behind them the trauma of the crisis-induced extraordinary appreciation of the franc and ready to hear the French dicton: "La peur est mauvaise conseillère".

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