

FX Watch

Focus on CHF Month-End Flows

Key takeaways

- CHF has become increasingly sensitive to month-end flows in recent years. Analysis shows "buy CHF" is dominant flow.
- EUR/CHF has been focus but USD/CHF flows have been more consistent. SNB US equity exposure explains the link.
- CHF buying into month-end (t-3) offers attractive levels to reinstate CHF shorts. Global bond agg perf also important

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G10 FX Strategy
Global

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Strong interest in month-end CHF flows

There has been increased focus in month-end flows in CHF in recent months against the backdrop of sizeable EUR/CHF and USD/CHF selling through a small window into that period. A variety of economic agents use the month-end fixing for a number of reasons – be it the corporate community; real money or central banks and over the years many have attempted to analytically quantify a) direction of month-end flows; and b) quantum. The track record on these models is modest: daily FX market turnover is \$5.5trn whilst there is also anticipatory behaviour to trade the other side of the model signal. Given the drawbacks of modelling month-end flows, this note is not intended to make a prediction on the quantum of flows but to look at historical behaviour of CHF through month-end and the statistical occurrence by matching equity performance to FX performance.

An important point of reference to note here is that whilst EUR/CHF has been the primary focus for markets, we believe that the main channel for flows is USD/CHF. December 2023 was perhaps the clearest example of significant CHF buying through month-end. However, FX returns through the window show that USD/CHF has been a more significant mover than EUR/CHF. Our analysis therefore focuses on USD/CHF.

Our Framework

We use T-3 as our starting date for month-end flows and T+1 (in case of residual flows post month-end). The critical factor in these flows has been the performance of US equity markets. Recall, the SNB holds 25% of its total FX reserve portfolio in equities, of which the vast majority is in the US. The simple rule of thumb to gauge month-end flows is as follows: rising US equity markets = need for non-US economic agents to sell USD to unwind hedges; falling equity prices = need to buy USD to keep hedges unchanged. We are not implying that for every monthly gain/loss, this will necessarily translate into corresponding FX flows. However, since January 2010 (164 month-end observations) the above rule has worked more than 100 times. This is an impressive hit rate. And as Exhibit 1 highlights, USD/CHF selling has increasingly dominated month-end flows when the S&P rallied through the corresponding month. It is interesting to note that these flows accelerated post 2016, a period through which the SNB balance sheet continued to rise strongly via interventions.

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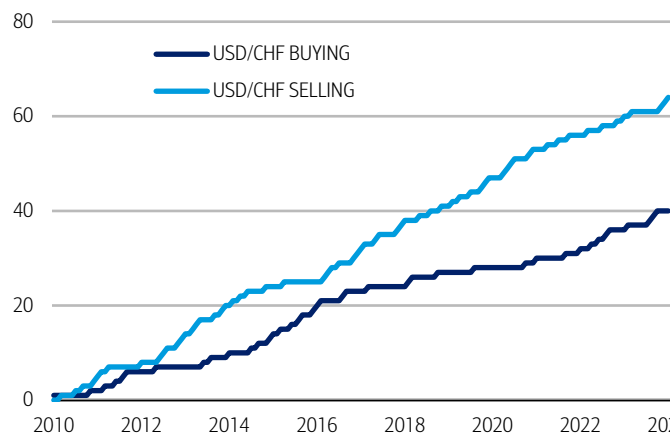
This also coincides with the increase weighting of USD holdings vs EUR holdings on the SNB balance sheet. This would support our strategy to focus on USD/CHF rather than EUR/CHF.

February Month-End Flows

Exhibit 3 plots February USD/CHF performance which conforms to our rule – higher USD/CHF when equities fall and lower USD/CHF when equities rise. The evidence for February is disappointing. Since 2010, USD/CHF has only fallen 4 times when the S&P has risen in February. More often than not, USD/CHF has risen against the backdrop of falling equities. At the time of writing, the S&P has rallied by nearly 4%. This would suggest some CHF buying on rebalancing flows alone. However, the other large component of month-end flows is the performance of fixed income. December 2023 perhaps provides the best case of the perfect storm of rising equities and rising bond returns. Month to date, the USD global agg index has fallen 1.4% whilst the EUR global agg index has fallen 1.3%. Aggregating bond and equity returns and using z-scores in Exhibit 4 shows the rise in volatility since 2019 and perhaps indicates why month-end flows vs USD have been more significant across G10.

Exhibit 1: USD/CHF trading at month-end when SPX < 0 or > 0

USD/CHF selling has dominated since 2010 as US equities rallied

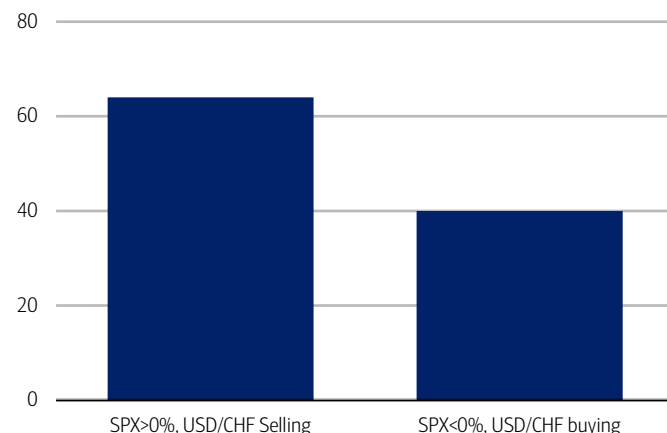


Source: BofA Global Research, Bloomberg

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Exhibit 2: # occurrences where USD/CHF reacts to SPX @ month-end.

Since 2010, month-end flows have been dominated by USDCHF selling

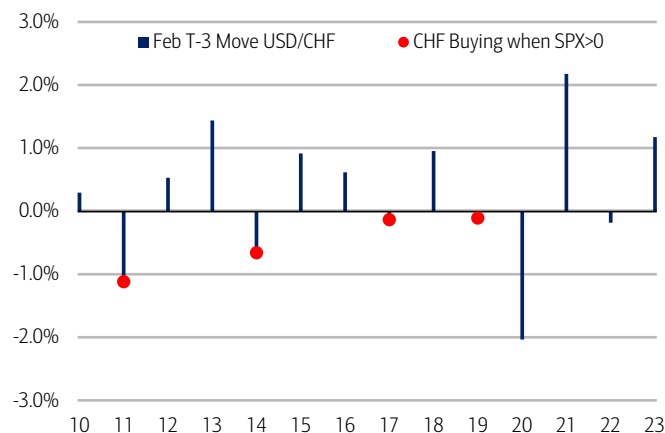


Source: BofA Global Research, Bloomberg

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Exhibit 3: USD/CHF T-3 performance February Month-end

February not particularly strong for CHF month-end buying.

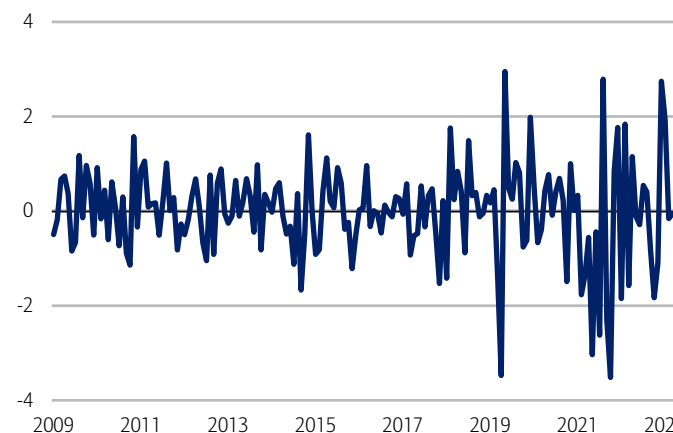


Source: BofA Global Research, Bloomberg

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Exhibit 4: All-sample z-score for USD, EUR global agg returns + SPX

Global bond performance and SPX increasingly volatile in recent years



Source: BofA Global Research, Bloomberg

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However, the aggregate Z-score is statistically insignificant. Any CHF buying is likely to be via the equity part of the portfolio.

Trading Implications

Heading into month-end, there are early signs that EUR/CHF and USD/CHF are succumbing to the kind of pressures that we have seen in the past. Whilst February has not historically been significant for CHF buying, the performance of US equities suggests that there will be some rebalancing flows. We cannot quantify the % move in CHF from here but advise clients looking to establish medium term shorts to stay on the sidelines for now and await better levels. We continue to see CHF as the consummate funding currency in a low vol positive carry environment.

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