



S.P. HINDUJA

BANQUE PRIVÉE

House View

JUNE 2022

Thoughts of the CEO

«Infrastructure: a new context for investors.»

In the May edition of our House View, I shared with you how we assess our society's increasing digitisation from an investment opportunity perspective. In this month's dispatch, I would like to focus on investment trends in infrastructure.

We are seeing more and more investors looking to fund projects to support the energy transition, close the widening investment gap in social infrastructure (mainly healthcare and educational assets), expand the digital infrastructure and solve the world's water scarcity problems.

As I have mentioned in previous letters, there will have to be a lot more investment in sustainable projects that support the energy transition. This goes far beyond wind and solar energy - think green fuels, clean transport, carbon capture and storage, energy efficiency and much more. This entire value chain presents opportunities for portfolio allocation into quality infrastructure assets in primary and secondary markets. According to BloombergNEF, global spend in energy infrastructure rose from USD 247bn 10 years ago to USD 755bn in 2021. The same source estimates that USD 4.5trn new capital is needed annually if global net-zero is to be achieved by 2050.

However, the current energy situation has led to a growing disagreement between those who argue for continuing growth in allocating funds to sustainable energy projects and those who think that investments in nuclear and fossil fuels should be resumed. To illustrate this trend, there is some 175GW of new coal plants capacity being built worldwide and formerly mothballed nuclear projects are being revisited. I believe that non-conventional energy will eventually be able to meet a large part of global energy demand at affordable unit prices.

The world's three biggest economies have ambitious plans to modernize their infrastructure network. Last year President

Biden signed off the USD 1.2trn US Bipartisan Infrastructure Bill, the European Union contemplates a EUR 300bn infrastructure plan, and China will prioritise big new infrastructure to boost its economy. These plans will be shaped by four growing trends:

- The race to net-zero which is expected to positively impact the demand for wind and solar, green fuels, clean transport, carbon capture and storage as well as energy efficiency.
- Artificial intelligence enables infrastructure managers to enhance data collection and asset operation and discover additional pockets of value creation.
- Investments in digital and social infrastructure that focus on issues like an aging population, financial inclusion and affordable access to healthcare and education.
- Lastly, and by no means least, as the climate crisis evolves, water scarcity (see our Figure of the Month below) becomes a growing global challenge that needs to be tackled by more efficient use of drinking water and recycling of polluted water. As many of you know, water treatment is an area we are very excited about and are actively participating in.

Yours sincerely,

Karam Hinduja

Our macro view

Persistently high inflation and economic slowdown are topics feeding investors' pessimism. Moreover, the resolve of the majority of central banks to curb inflation is building recessionary fears in the global economy. We need to be aware that this negative sentiment represents the current backdrop and it could become more accentuated in the months to come.

However, I want to add a positive tone too, as we believe the current disappointing macro data in US and China are so far consistent with slower growth, but not necessarily, with recessionary growth. With world GDP growth expected to be in positive territory this year and next, a tight labour market in the US and corporate earnings on the rise by 9.2% and 9.5% in 2022 and 2023 respectively (Refinitiv), this suggests we are still far away from a classical recession, notwithstanding the likelihood of volatile quarterly data.

- By Anil Chaturvedi

Positioning for inflation, lower growth and higher rates

The past month has witnessed an accentuation of investors' risk aversion on continuing negative news flow in both the macroeconomic and corporate domains. Rates, inflation and economic growth continue to be the focus for investors. While U.S. investors are hopeful that inflation might be decelerating and equity markets possibly hitting bottom, the reality is that the prices of goods and services remain high and the root causes of inflation, and the rising risk of slowing growth remains elevated. Despite rising prices, demand for services is keeping spending levels high.

In Europe, we have finally had the long-awaited announcement that the European Central Bank (ECB) now expects to begin the hiking cycle from July. The ECB wants to continue to hike gradually, it says, but we are now in a tightening cycle in Europe too.

While we have seen some early indicators suggesting that consumer and business spending still remain strong enough to keep the economy from going into stagflation (a period of high inflation and no economic growth) or a severe recession, uncertainty and rapid changes suggest that continuing to be focused on building resilient portfolios is the appropriate strategy. Moreover, in a scenario of continued uncer-

tainty, a temporary allocation to cash is positioned to deliver protection against volatility and to provide the ability to take advantage of better entry points. For those of you who wish to increase short-term allocation to cash, we would be glad to discuss options such as short-term secured notes offering competitive coupons.

Overall, we continue to see pockets of opportunity in certain segments of the fixed income market, namely nominals and investment grade credit (with credit spreads widening). At the same time, we avoid high yield and convertible securities as a slowing global growth and heightened volatility in equity markets would affect these two segments the most. I would also like to highlight the value of a diversified basket of infrastructure assets in the current high inflation/lower growth environment.

Against this backdrop, we continue to be focused on portfolio resilience and therefore maintain the defensive position we introduced in our tactical asset allocation (TAA) last month.



Fig.1: Current Asset Allocation

Global Asset Allocation Preferences						June 2022
Asset Class	Opinion	Constituents	We favour	We avoid	Commentary	
Cash	+				Temporarily increase cash for defensive profiles in times of heightened uncertainty.	
Fixed Income	+	Segments	Nominals over Inflation linkers.	Convertibles, Emerging Markets, lower end of the credit spectrum.	Central Banks accelerated normalisation effort heightens risk of economic slowdown. Nominal rates likely to top out in the near-term, making fixed income investments look attractive relative to risk assets.	
		Duration	Medium term.		Government bonds benefit from safe-haven flows - longer duration warranted.	
Equities	-	Markets	U.S.	China, Emerging Markets.	Persistent uncertainty owing to Russia-Ukraine conflict and risk of monetary policy mistakes, raising spectre of economic downturn. Zero-Covid policy in China reducing potential for reaching growth targets. Heightened uncertainty warrants reduction in exposure to risk assets.	
		Themes	Value, Quality stocks with high pricing power.		Focus on companies with robust pricing power. Value stocks generating real cash flow.	
Alternatives	+		Carbon, REITS, listed infrastructure.	Illiquid alternatives.	Potential for easing of supply/demand imbalances makes industrial metals temporarily less attractive.	
Opinion	++	very attractive				
	+	attractive				
	=	neutral				
	-	unattractive				
	--	very unattractive				

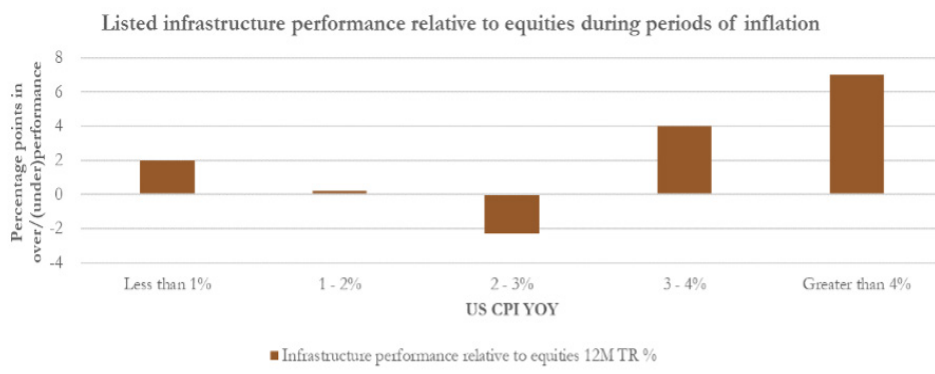
The attractiveness of investing in infrastructure in the current high inflation context

In the current context of slowing economic activity, persistently high inflation and low, albeit rising, real yields, investing in infrastructure offers a potentially attractive enhancement to traditional asset classes.

Infrastructure plays a crucial role in shaping long-term economic growth. History demonstrates that public expenditure in infrastructure has a multiplying effect on economic growth. According to the World Bank, one dollar of public infrastructure spend usually translates to 1.5 dollar of economic activity. This impact is substantially higher when the economy shifts into a recession.

Infrastructure as an asset class offers a number of attractive and distinctive financial features:

- Attractive returns through above average and often growing dividend yields.
- Long-term, stable and predictable cash flows.
- Low correlation with other classes.
- Lower sensitivity to economic cycles.
- Low default rates.
- Good inflation hedge.
- Socially responsible investments.



Infrastructure FTSE Global Core Infra 50/50 Net TR Index (USD) from Dec-05, prev Macquarie
Equities MSCI Daily TR Gross World USD
CPI US CPI Urban Consumers SA

Source: Bloomberg and First Sentier Investors, via First Sentier Investors. Quarterly time series from 2006-2021.



Infrastructure: less affected by inflation risk

Infrastructure assets customarily operate in low competition settings, close to natural monopolies, and often benefit from long-life concession frameworks. Their capital-intensive activities provide high barriers to entry, economies of scale in the form of high fixed cost bases and low variable cost and substantial pricing power thanks to inelastic demand for the services rendered.

Owing to a scarcity of inflation-linked products, infrastructure has emerged as an asset class yielding returns less affected by inflationary risks. The long-term nature of the contracts (often concessions) lead to future revenues being indexed to inflation and/or the concessions holder's flexibility to freely adjust prices, as is the case for certain toll roads for instance.

Revenue model	Subsectors	Inflation impact
Regulated	Electric Gas distribution Water	Government agreements in place dictate inflation is a pass-through.
Concession-based	Airports Toll roads	CPI+ toll or fee increases permitted via concession agreements.
Contracted	Midstream Freight rails Marine ports Communications	Price escalators linked to inflation. If inflation is lower than the escalator, the asset owner benefits from the price increase. Conversely, an inflation rate higher than this will disadvantage the owner.

Risk Factors

The infrastructure universe is not free of challenges and risks, of course. Changes in the prevailing regulatory framework is one of the most important risks. Financing presents another challenge. The current underfunding of infrastructure, particularly in developing economies, is hampering economic progress. Physical and digital infrastructure are under strain from population growth, rising cyberattacks and extreme weather patterns. In addition, new infrastructure development is increasingly intertwined with geo-political tensions and, in times of rising recession fears, infrastructure funding is likely to come under pressure.

We would be happy to discuss further with you the many ways one can invest in this asset class and the role it can play in your portfolio.

Our bank has developed expertise in certain segments of the infrastructure space over the past years in both the public and private domains. It mainly concerns renewable energy sources such as geothermal, wind and solar as well as water treatment and purification. To this effect, we remain at your disposal to discuss any of your requests and are happy to arrange a meeting to share our views.

Figure of the Month

3%

Only 3% of the world's water is freshwater and two thirds of it is not available for human consumption as it is stored away in frozen glaciers. With rising global temperatures, glaciers are melting and freshwater is getting wasted into the sea, further aggravating the freshwater scarcity. Despite this, we seem to act as if it will always be abundant. Quite the contrary, freshwater (the one we consume for drinking, cooking, bathing in and irrigating our fields with) is surprisingly rare.

As a consequence, some 1.1 billion people worldwide lack access to freshwater and a total 2.7 billion face freshwater scarcity at least one month in a year according to the World Wildlife Fund and the United Nations.

Agriculture consumes more water than any other source and wastes much of it through inefficiencies. Agriculture uses up 70% of the world's accessible fresh water and it is estimated that 60% of this is wasted due essentially to leaky, old irrigation systems, inefficient application methods and wrong location of cultivation fields. Besides, agriculture also pollutes freshwater in a significant way through the use of fertilizers and pesticides.

Population growth and climate change pose the biggest threat as it is estimated that agricultural production would need to expand by around 70% by 2050. Therefore, the reallocation of freshwater from lower to higher productivity activities is much needed and should be accompanied by careful selection of crops, developing water delivery systems, on-farms revitalisation of soil yields and use of advanced technologies to improve water use efficiency in agriculture.

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Founded in Geneva in 1994 by Srichand Parmanand Hinduja with a vision to provide clients with a bridge between East and West, our institution remains the only Indian-owned Swiss bank in history. With an active presence in Switzerland, India, UAE and the UK, S.P. Hinduja Banque Privée offers its clients the reliability of Swiss regulatory oversight, while providing specialized access to high-growth markets.

We are a private bank with an entrepreneurial spirit, embracing collective action and building creative solutions that advance the world, economically and socially.

The future of banking is emerging at the intersection of profit and purpose.

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